

Market and Economics Report



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Global economy

Review: Further indications of a deepening global recession emerged in January. The International Monetary Fund forecast that world growth will virtually stall at 0.5% in 2009. US economic data remained bleak. The labour market continued to deteriorate, reflecting the sharp downturn in US business conditions. The unemployment rate reached a 17-year high in January and non-farm payrolls fell by more than 500,000 for the third month in a row. The US housing market remains in a deep recession. Housing starts fell to a 50-year low after decreasing by 15.5% in December alone; home sales and prices also continued to decline. This weakness was a significant contributor to the sharpest US gross domestic product (GDP) contraction in 27 years, with GDP shrinking by 1.0% in the December quarter. Retail sales also fell. Consequently, 'deflation' concerns gained traction with another sharp fall in US consumer prices. Fortunately, there were some positive signs with various business surveys showing some improvement in January, albeit from a low base. Recessionary conditions continued to prevail in Japan, weighed down by deteriorating business confidence and sliding exports which translated into a softening labour market. Japan's unemployment rate edged higher to 3.9% in December and the 'jobs to applicants ratio' fell to its lowest level since 2004. Japan's core machinery orders registered an abrupt fall, indicating a deep downturn in the manufacturing sector. Industrial production fell 9.6% in December, illustrating the dramatic impact of the slide in global demand on Japan's corporate sector. Momentum in China's economy slowed as the country's export sector continued to be affected by the global recession. China's real GDP growth rate decelerated to 6.8% year-on-year (yoy), its slowest pace in seven years, and the annual inflation rate eased to a mere 1.2% yoy in December. In response, the People's Bank of China cut lending rates and reduced reserve ratio requirements. There have been some signs of bottoming in January data though with business conditions and lending growth improving. Economic activity in Europe and the UK continued to recede in January. Sharp falls in Europe's industrial confidence and consumer sentiment reflected a dismal profile for both the corporate and consumer sectors, and saw the European Central Bank announce a 0.5% interest rate cut. Conditions in the UK were similarly gloomy in January, with a 'pronounced contraction in spending and activity' impelling the Bank of England to cut interest rates to the lowest ever setting of 1.5%.

Outlook: Global growth is likely to be very weak out to mid-2009, with developed countries contracting. This should lead to falling inflation and further monetary easing in most major countries which, along with fiscal stimulus and lower energy prices, will aid recovery later this year and/or through 2010.

Australian economy

Review: Despite some encouraging signs, Australian data releases continued to reflect the downside risks to growth. Retail sales increased sharply in December helped by cash payments to households. Australia's trade balance remained in surplus, although this is likely to change as demand for commodities and exports subsides. In December, employment growth slowed, unemployment increased to 4.5% and job advertisements declined 9.7%. Business sentiment bounced and although consumer sentiment measures declined, aggressive rate cuts, falling oil prices, fiscal stimulus and lower mortgage rates appeared to mitigate these falls. Building approvals dropped sharply and private sector credit growth slowed significantly. Consumer price pressures moderated, with the consumer price index (CPI) coming in at 3.7% yoy in the December quarter. To help reduce the severity of the downturn, the Government announced a second fiscal stimulus package and the Reserve Bank of Australia (RBA) cut interest rates by a further 1.0%.

Outlook: Domestic economic conditions are likely to be very weak over the next six months, with a mild recession likely. Lower rates and fiscal stimulus should help prevent a deep slump and drive a recovery in 2009-2010.

International shares

Review: The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned -7.2% in local currencies (or -7.4% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -8.4%. In the Euro-zone, the Eurostoxx Accumulation Index returned -6.8%, while the UK FTSE 100 Accumulation Index returned -6.4%. Shares in Japan were also lower, with the Topix Accumulation Index returning -7.6%. However, Chinese shares defied the global trend, with the S&P/CITIC 300 Total Return Index returning 11.2% for January.

Short-term outlook [six to 12 months]: Turmoil may continue over the next few months on uncertainty regarding the depth and duration of the global recession. However, global shares are likely to provide reasonable returns on a 12-month plus view, given the likelihood of better economic conditions in 2010 and attractive valuations.

Medium-term outlook [five to ten years]: Improved dividend yields following the share slump and profit growth around nominal GDP growth will see medium-term returns from mainstream global shares of around 9% per annum on average.

Australian shares

Review: Volatility in the Australian share market persisted in January with the S&P/ASX 200 Accumulation Index returning -4.9% for the month. The profit outlook deteriorated with many companies announcing earnings warnings ahead of the February reporting season. Further capital raisings also put pressure on investor sentiment. Positively, shares were helped by attractive valuations and signs of imminent additional fiscal and monetary stimulus.

Short-term outlook: The Australian share market is likely to remain volatile over the next few months. Further falls are possible. However, shares should improve through 2009. Valuations are attractive and interest rates are low, and shares are likely to anticipate better economic conditions in 2010.

Medium-term outlook: Reflecting a much higher dividend yield and reasonable growth prospects, medium-term returns of around 12% per annum are now possible.

Listed property securities

Review: The S&P/ASX Property 200 Accumulation Index moved lower in January, returning -9.7% and underperforming the broader equity market. While well-capitalised stocks received the bulk of investor support and generally outperformed, a number of stocks which recapitalised in previous months struggled on profit taking during the month.

Short-term outlook: The next few months are likely to remain volatile due to worries about gearing levels, capital raisings and the underlying property outlook. However, listed property securities have probably seen the worst, are very good value and should benefit from lower interest rates.

Medium-term outlook: Now solid yields and moderate growth prospects mean medium-term returns of around 12% per annum are now possible.

International bonds

Review: International bond yields moved higher in January, buoyed by expectations that significant global monetary and fiscal policy action during the month would promote stability. The US ten-year bond yield rose 63 basis points (bps) to 2.84% and Japan's ten-year bond yield gained 13 bps to 1.30%. Germany's ten-year bond yield increased 35 bps to 3.30%, while the UK ten-year bond yield moved 68 bps higher to close at 3.70%.

Short-term outlook: Bond yields may fall further in the short term on the back of the global downturn and falling inflation.

Medium-term outlook: AMP Capital expects low returns from global bonds, reflecting low bond yields.

Australian bonds and cash

Review: The performance of the Australian bond market was mixed in January. The yield on ten-year bonds ended the month 3 bps

higher, rising from 4.07% to 4.10% over the month. Australia's three-year bond yield opened at 3.11% and closed 21 bps lower at 2.90%. The spread between Australian and US ten-year bond yields narrowed in January. Bank bill yields continued to decline. Expectations of another aggressive rate cut by the RBA put significant downward pressure on short-dated yields. The three-month bank bill rate opened at 4.15% and closed 74 bps lower at 3.41%. The six-month bank bill rate experienced a similar decline, opening at 3.70% and falling 59 bps to close at 3.11%.

Short-term outlook: Bond yields may fall further in the short term as growth and inflation fall.

Medium-term outlook: Returns from local bonds over the medium-term are likely to be modest, reflecting low yields.

Australian dollar

Review: The Australian dollar (A\$) was weaker in January, closing the month at 63.49 US cents (down 9.7% from 70.29 US cents) and JPY57.18 (down 10.3% from JPY63.76). The trade-weighted index (TWI) closed the month at 53.2 (down 4.3% from 55.6).

Short-term outlook: The next six months are likely to be weak with the A\$ buffeted by local and global growth worries, falling local interest rates and commodity price weakness.

Medium-term outlook: The A\$ should rebound over the medium term, helped by a rebound in commodity prices.

Key financial markets

	31 Jan 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	23,592	-4.9%	-34.3%
MSCI World (ex-Aust Accumulative/unhedged in A\$)	3,478	0.2%	-17.3%
US S&P 500 Accumulation Index	1,331	-8.4%	-38.6%
Dow Jones Eurostoxx Accumulation	311	-6.8%	-40.7%
UK FTSE 100 Accumulation Index	2,517	-6.4%	-26.3%
Japan Topix Accumulation Index	959	-7.6%	-39.9%
S&P/CITIC 300 Total Return Index	1,863	11.2%	-54.5%
S&P/ASX 200 Property Accum. Index	16,258	-9.7%	-51.7%
UBS Warburg Global Real Estate Investor Index	665	-13.0%	-51.1%
Aust 90-day bank bill yield	3.41%	-74 bps	-394 bps
Aust 10-year bond yield	4.10%	+3 bps	-197 bps
US 10-year bond yield	2.84%	+63 bps	-75 bps
A\$ in US cents	63.49	-8.8%	-28.7%
Trade-weighted index	53.2	-4.3%	-22.1%

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