

# Market and Economics Report



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## Global economy

**Review:** The global economic slowdown continued in September, driven by momentous events in the US financial system. The US financial crisis intensified dramatically with Lehman Brothers announcing bankruptcy, Bank of America agreeing to acquire Merrill Lynch, and AIG seeking a US\$85 billion rescue loan. Share markets experienced massive volatility and US economic data weakened further. US retail sales remained soft, industrial production and the leading index fell, and the ISM manufacturing and services surveys edged lower. The US Federal Reserve's (Fed) beige book of anecdotal evidence also indicated that activity remains slow. The US labour market continued to deteriorate with unemployment rising to 6.1%, suggesting that the US economy is either in or approaching a recession. The US housing market remained under pressure, with mortgage delinquencies continuing to rise, and mortgage applications and housing starts declining. During the month, the US Government took control of embattled mortgage providers and insurers Fannie Mae and Freddie Mac in order to shore up the struggling housing sector and protect investors. Positively, the US inflation rate fell 0.1% in August. Signs of slowdown were again evident in Japan, consistent with softening business investment and contraction of real gross domestic product (GDP) in the June quarter. In China, moderations in growth and inflation provided further scope for Chinese authorities to ease the tightening measures, with their central bank moving to cut rates to support the falling share market. European economic data weakened further in September. Euro-zone business conditions deteriorated, retail sales fell and German factory orders registered their eighth consecutive monthly fall. Despite the worrying economic growth and activity readings, both the European Central Bank and the Bank of England left interest rates on hold due to elevated inflation pressures. However, poor economic conditions are likely to lead both central banks to cut rates in the next six months.

**Outlook:** Growth is likely to slow further, but this will lead to falling inflation and interest rates in most major countries which will aid recovery in 2009.

## Australian economy

**Review:** Australia's economic data were largely mixed in September. Australia's real GDP growth in the June quarter was a modest 0.3%, representing the third successive quarter of slowing growth, driven by softer consumer spending. However, business indicators were robust with the strong terms of trade boosting company profits. The current account also benefited from mining exports, resulting in a narrowing of the deficit to A\$12.7 billion. The Reserve Bank of Australia (RBA) lowered interest rates by 0.25% to 7.0%, the first rate cut since 2001, in response to 'tight financial conditions',

'higher fuel costs' and 'lower asset values'. Lower petrol prices served to improve business and consumer sentiment and retail trade readings during the month. Labour market indicators were also stronger-than-expected although forward indicators point to a weaker market ahead. The RBA reiterated that Australia's financial system is weathering the current turmoil relatively well. However, while the RBA remains confident in the soundness of the Australian financial system, the central bank appears concerned about the consequences of the ongoing global financial turmoil.

**Outlook:** Domestic economic conditions are likely to remain weak over the next six to 12 months. However, while the risk of recession has increased it should be avoided due to a strong pipeline of investment projects and the latest increases in iron ore and coal prices.

## International shares

**Review:** The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned -10.8% in local currencies (or -3.6% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -8.9% for the month. In the Euro-zone, the Eurostoxx Accumulation Index returned -11.5%, while the UK FTSE 100 Accumulation Index returned -12.9%. Shares in Asia also suffered, with Japan's Topix Accumulation Index returning -12.6% and China's S&P/CITIC 300 Total Return Index returning -6.9% in September.

**Short-term outlook [six to 12 months]:** Turmoil may continue in the short term on US recession worries. However, global shares are likely to provide reasonable returns on a 12-month view, given the likelihood of further monetary easing and reasonable fundamental valuations.

**Medium-term outlook [five to ten years]:** Modest dividend yields and a slowdown in profit growth to around nominal GDP growth will constrain the returns from mainstream global shares to around 8% per annum on average.

## Australian shares

**Review:** September was a month of extreme volatility for the Australian share market, driven by the extraordinary events in the US financial market and the subsequent intensification of the credit crisis. The Australian share market moved broadly in line with the US and global share markets, losing ground as concerns about the US Government's bailout package mounted. A ban on short selling in response to major one-day declines and speculative trading added to the local uncertainty. These events heightened concerns about the economic growth outlook, which drove commodity prices down and served to exacerbate risk aversion. The S&P/ASX 200 Accumulation Index returned -9.8% in September.

**Short-term outlook:** The Australian share market is likely to remain volatile over the next few months. However, shares should improve into year-end or at least through 2009. Valuations remain attractive, interest rates are falling and profit growth is likely to remain positive, boosted by the resources sector.

**Medium-term outlook:** Reflecting a solid dividend yield and reasonable growth prospects, medium-term returns of around 10% per annum are expected.

## Listed property securities

**Review:** The S&P/ASX Property 200 Accumulation Index returned -5.8% in September. Events in global financial markets drove the volatility in the Australian equity market. A-REITs were no exception, given their inclusion in the Financial sector category. Stocks that continued to outperform were those that were well capitalised, with strong balance sheets, limited near-term debt refinancing commitments and exceptional, deep and diversified relationships with quality debt providers. Financial and credit market turmoil meant that debt refinancing was again a central theme in the sector as access to debt continued to tighten.

**Short-term outlook:** The next few months are likely to remain volatile due to worries about gearing levels. 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 10% or 11% per annum are expected.

## International bonds

**Review:** International bonds yields were mixed in September, affected by equity market volatility and persistent concerns about the global growth outlook. The US ten-year bond yield gained 1 basis point to 3.82% and Japan's ten-year bond yield rose 5 bps to 1.47%. In Europe, the UK ten-year bond yield dropped 3 bps to 4.45%, while Germany's ten-year bond yield registered a larger decline, losing 17 bps to close at 4.01%.

**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 Australian bond market surged in September, which saw yields fall. Historic events in the US financial sector and the initial failure of the US debt relief package to find legislative approval saw equity and credit markets slump and local bond markets rally strongly. The three-year bond yield opened at 5.66%,

before falling 57 basis points (bps) to close at 5.09%. The ten-year bond yield lost 36 bps, opening at 5.76% and closing at 5.40%. The three-month bank bill rate opened at 7.27% and closed at 7.32%, though traded as high as 7.49% later in the month. Six-month bank bill yields opened at 7.29% and closed at 7.04%.

**Short-term outlook:** AMP Capital's view is that Australian bonds will deliver modest returns over the next year.

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

## Australian dollar

**Review:** The Australian dollar (A\$) weakened significantly in September. The A\$ closed the month at 79.44 US cents (down 7.3% from 85.66 US cents) and JPY87.71 (down 5.7% from JPY92.97). The TWI closed the month at 63.4 (down 5.7% from 67.2).

**Short-term outlook:** The next six to 12 months are likely to be weak with the A\$ buffeted by worries about local and global growth, falling local interest rates and a correction in commodity prices.

**Medium-term outlook:** The A\$ should recover over the medium term, helped by Australia's resilient growth, stable financial system and a rebound in commodity prices.

## Key financial markets

	30 Sept 2008	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	30,339	-9.9%	-26.8%
MSCI World (ex-Aust Accumulative/ unhedged in A\$)	3,496	-3.6%	-16.7%
US S&P 500 Accumulation Index	1,861	-8.9%	-22.0%
Dow Jones Eurostoxx Accumulation	422	-11.5%	-30.7%
UK FTSE 100 Accumulation Index	2,943	-12.9%	-21.2%
Japan Topix Accumulation Index	1,312	-12.6%	-31.4%
S&P/CITIC 300 Total Return Index	1,865	-6.9%	-58.5%
S&P/ASX 200 Property Accum. Index	26,823	-5.8%	-40.4%
UBS Warburg Global Real Estate Investor Index	239	-4.7%	-21.8%
Aust 90-day bank bill yield	7.32%	-5 bps	+43 bps
Aust 10-year bond yield	5.40%	-35 bps	-77 bps
US 10-year bond yield	3.79%	-1 bps	-79 bps
A\$ in US cents	78.88	-8.41%	-10.9%
Trade-weighted index	63.4	-6.4%	-9.4%

## Contact us

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