

# Market and Economics Report



by Dr Shane Oliver, Head of Investment Strategy & Chief Economist

## Global economy

**Review:** During April, the International Monetary Fund (IMF) released its World Economic Outlook and revised up its growth forecasts, noting that the global economy is recovering but at “different speeds in different parts of the world.” The US economy continues to perform solidly. US real gross domestic product (GDP) expanded by 0.8% quarter-on-quarter in the March quarter, the Institute for Supply Management manufacturing survey rose to its highest level in nearly six years and employment rose further in April. However, the survey showed broad gains across the production, employment and export indices, suggesting a sustainable industrial upturn. The National Association of Home Builders index data was only mildly promising, indicating that the recovery is yet to become reality for US home builders. US Federal Reserve Chairman Ben Bernanke was cautious about the outlook for the US economy, stating that “we are far from being out of the woods”, with the implication that interest rates will remain low. Japan continued along a slow and steady recovery path during April. The Bank of Japan’s quarterly corporate survey (the Tankan survey) registered improving prospects for manufacturers, rising to its highest level in 18 months in the March quarter. Japanese consumer confidence also rose in March, reaching a two-year high. The Japanese Cabinet Office leading index points to a steady recovery proceeding over 2010. Chinese economic data remained strong with real GDP expanding by 11.9% year-on-year in the March quarter, which was higher than expected. Retail sales were up strongly and industrial production and fixed asset investment remained robust. The Chinese central bank raised the reserve requirement ratio for the third time this year and announced tough measures to slow property price appreciation. However, with inflation still low, there is no need for aggressive policy tightening. News from Europe continued to be dominated by Greece’s fiscal problems. During the month, ratings agency Standard & Poor’s downgraded the credit ratings of Greece, Portugal and Spain, taking Greece’s rating to junk bond status. The European Union and the IMF doubled the size of the bailout package in an attempt to mitigate further damage and have since announced a bigger support package to prevent contagion to other countries. Despite the ongoing debt issues, European economic data was generally positive. Europe’s purchasing manager index rose to its highest level since October 2006 and other surveys showed rises in consumer confidence and industrial sentiment.

**Outlook:** Despite obvious risks, the global recovery is continuing and still easy monetary and fiscal conditions point to solid global growth this year, particularly in the emerging world.

## Australian economy

**Review:** Australian economic data generally remained strong.

The IMF released its World Economic Outlook and included a strong upgrade for Australia’s growth forecast. Australia’s labour market showed continued strength during the month with a further 19,600 new jobs created, and the unemployment rate remained steady at 5.3%. Private sector credit for February improved, led by housing credit which continued its recent strong pace of growth. The National Australian Bank business survey showed continued strong business confidence and consumer sentiment remained at high levels. The headline consumer price index rose by 0.9% for the March quarter, taking the annual rate (+2.9%) to the top of the Reserve Bank of Australia’s (RBA) preferred range, making further policy tightening more likely reflecting the strength of the economy. The central bank continued the process of raising interest rates back to longer-term average levels.

**Outlook:** We expect solid growth through 2010, driven by the global recovery, a housing upturn and stronger investment. We expect the cash rate to rise to 4.75% or 5% by year-end.

## International shares

**April review:** The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned +0.3% in local currencies (or -1.4% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +1.6% in local currency terms. In the European region, the Eurostoxx Accumulation Index returned -2.4% in local currencies and the UK FTSE 100 Accumulation Index returned -2.0% in local currency terms. Shares in Asia were also mixed with Japan’s Topix Accumulation Index returning +0.8% and China’s S&P/CITIC 300 Total Return Index returning -8.0%.

**Short-term outlook [six to 12 months]:** Global shares are likely to provide good returns on a 12-month plus view, given the likelihood of reasonable growth in profits and still low interest rates. However, we expect a rougher ride than over the last 12 months.

**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 7.5% per annum on average.

## Australian shares

**April review:** Australian shares experienced a correction towards the end of April. The S&P/ASX 200 Accumulation Index fell 1.4% during the month. The Australian market followed the global lead and fell following the announcement of the US Securities & Exchange Commission’s (SEC) lawsuit against Goldman Sachs and on the back of worries about sovereign debt in Europe and Chinese monetary tightening.

**Short-term outlook:** Australian shares are likely to provide solid returns on a 12-month view. Valuations are reasonable, interest rates are low and shares are likely to be buoyed by better economic conditions and rising profits in 2010.

**Medium-term outlook:** Reflecting reasonable growth prospects, medium-term returns of around 9.5% per annum are likely.

## Real estate investment trusts

**April review:** The S&P/ASX Property 200 Accumulation Index returned +3.7% during April, substantially outperforming the broader Australian equity market.

**Short-term outlook:** Most property stocks have recapitalised and are good value from a long-term perspective, and the credit crunch is fading. As such, they should provide solid returns over the next 12 months.

**Medium-term outlook:** Solid yields and moderate growth prospects suggest medium-term returns of around 9% per annum are likely.

## International bonds

**April review:** International bond yields fell across the board in April. The US ten-year bond yield fell by 17 basis points (bps) to 3.66% and Japan's ten-year bond yield fell by 11 bps to close at 1.29%. In Europe, the UK ten-year bond yield fell by 9 bps to close the month at 3.85% and Germany's ten-year bond yield fell by 7 bps to 3.02%. Despite generally strong global economic data, the sovereign debt concerns about Greece continued to weigh on markets, preventing any meaningful sell off in bond yields.

**Short-term outlook:** Sovereign bond yields are likely to drift higher on expectations for eventually rising short-term interest rates and high public borrowing levels.

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

## Australian bonds and cash

**April review:** The RBA once again decided to raise the cash rate at its April meeting, taking the cash rate to 4.25%. The three-year Australian bond yield closed the month 3 bps higher at 5.31%. The curve continued its flattening trend over the month as the ten-year bond ended the month 7 bps lower at 5.72%. During the month, bank bills rose to their highest levels since December 2008. The three-month bank bill rate opened at 4.49% and closed 14 basis points (bps) higher at 4.63%. Six-month bank bill yields also rose, opening at 4.76% and closing 11 bps higher at 4.87%.

**Short-term outlook:** Bond yields are likely to drift higher on the back of gradually rising global bond yields and the increasing cash rate in Australia.

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

## Australian dollar

**April review:** The Australian dollar (A\$) once again pushed higher over April, rising against the US dollar (US\$), the Japanese yen (JPY) and the currencies of Australia's major trading partners (as per the Trade Weighted Index [TWI]). The A\$ closed the month at 92.44 US cents (up 0.8% from 91.67 US cents) and JPY86.92 (up 1.4% from JPY85.69). The TWI closed the month at 72.5 (up 1.1% from 71.7). The A\$ was strong early in the month before faltering in response to global issues including the SEC's actions against Goldman Sachs and the Greek debt crisis.

**Short-term outlook:** Further gains in the A\$ are likely on the back of the improving global growth outlook, strong demand for resources, the positive outlook for commodities and the prospect for rising local interest rates.

**Medium-term outlook:** AMP Capital expects the A\$ to be strong over the medium term, helped by strong commodity prices.

## Key financial markets

	30 April 2010	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	33,973	-1.4%	+32.4%
MSCI World (ex-Aust Accumulation/ unhedged in A\$)	3,453	-1.4%	+7.4%
US S&P 500 Accumulation Index	1,967	+1.6%	+38.8%
Dow Jones Eurostoxx Accumulation	420	-2.4%	+25.8%
UK FTSE 100 Accumulation Index	3,554	-2.0%	+35.9%
Japan Topix Accumulation Index	1,225	+0.8%	+19.6%
S&P/CITIC 300 Total Return Index	2,864	-8.0%	+19.2%
S&P/ASX 200 Property Accum. Index	19,852	+3.7%	+37.4%
UBS Global Real Estate Investors Index (hedged in A\$)	1,093	+5.5%	+58.9%
Aust 90-day bank bill yield	4.63%	+14 bps	+155 bps
Aust 10-year bond yield	5.71%	-7 bps	+114 bps
US 10-year bond yield	3.66%	-17 bps	+54 bps
A\$ in US cents	92.44	+0.8%	+27.5%
Trade-weighted index	72.5	+1.1%	+21.4%

**Important note:** While every care has been taken in the preparation of this document, AMP Capital Investors Limited [ABN 59 001 777 591] [AFSL 232497] makes no representation or warranty as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided and may not be reproduced without express permission from AMP Capital.