

Weekly Market & Economic Update – week ending 3 September 2010



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Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
Japan – Retail trade, July	mom	+0.7%	+0.4%	↑
Australia – Building approvals, July	mom	+2.3%	-3.3%	↔
US – Institute for Supply Management (ISM) manufacturing survey, August	index	56.3	55.5	↔
Australia – Gross domestic product, June quarter	qoq	+1.2%	+0.5%	↑
China – Purchasing Managers Index (PMI) - manufacturing, August	index	51.7	51.2	↔

* revised

Financial markets

Indicator	Friday, 3 September 2010	Friday, 27 August 2010	Weekly change	3 September 2009	12-month change
S&P/ASX 200 Index	4,541	4,370	+3.9%	4,430	+2.5%
S&P/ASX 200 Property Trusts	901	866	+4.0%	846	+6.5%
US S&P 500	1,105	1,065	+3.7%	1,003	+10.1%
Dow Jones Eurostoxx	262	252	+4.1%	251	+4.4%
UK FTSE 100	5,428	5,202	+4.4%	4,797	+13.2%
Japan TOPIX	824	820	+0.5%	943	-12.6%
CITIC/S&P 300 China A	2,476	2,421	+2.3%	2,533	-2.3%
MSCI (ex-Aust/in LC)	812	785	+3.4%	758	+7.1%
Aust 90-day bank bill yield	4.72	4.75%	-3 bps	3.37	+135 bps
Aust 10-year bond yield	4.92	4.87%	+5 bps	5.41	-49 bps
US 10-year bond yield	2.70	2.64%	+6 bps	3.34	-64 bps
Oil – West Texas Crude	US\$74.60	US\$75.17	-0.8%	US\$67.96	+9.8%
A\$ in US cents	US\$0.9157	US\$0.9023	+1.5%	US\$0.8398	+9.0%
TWI	69.0	68.9	+0.1%	66.0	+4.5%

Major upcoming global economic releases and events

Date	Data/Event	Units*	Previous	Market Forecast
7 September	Australia – Reserve Bank of Australia cash rate decision, September	-	4.5%	4.5%
7 September	Japan – Leading Index, July	Index	99	98.2
9 September	Australia – Unemployment rate, August	-	5.3%	5.2%
9 September	US – Trade balance, July	US\$ billions	-49.9	-47.5
10 September	US – Wholesale inventories, July	mom	+0.1%	+0.4%

*Month-on-month (mom); quarter-on-quarter (qoq); year-on-year (yoy); seasonally adjusted annual rate (saar)

Headline developments of the past week

- The past week has seen the risk switch turned back on again with share markets and related investments surging higher in response to a string of better than expected economic data in the US, China and elsewhere leading to the view that maybe there won't be a double dip back into recession after all.

Major global economic releases and implications

- After a run of negative data, US economic data took a turn for the better. Private sector jobs growth came in better than expected in August and employment in the previous two months was revised up. The ISM manufacturing survey surprised on the upside and is at levels consistent with ongoing growth, albeit slower growth than earlier this year. Data for house prices and consumer confidence also came in better than feared, job layoffs fell sharply in August and unemployment claims fell slightly. On top of this, pending home sales in August and weekly mortgage applications rose again, suggesting that the housing sector may have bottomed following the ending of the home buyer tax credit. The past week's data supports our view that although the risk of renewed recession is significant, the more likely scenario is that the recovery will continue albeit with fairly slow and fragile growth over the next six months.
- European economic data was mildly positive, with modest increases in both consumer and business sentiment. However, unemployment in the Eurozone remained high at 10% in July.
- In Japan, data for industrial production, housing starts, retail sales and car sales all came in stronger than expected.
- Chinese manufacturing conditions indices rose slightly in August after several months of falls and are at levels consistent with economic growth stabilising around 9%.
- Elsewhere in Asia, India's growth rate rose to 8.8% year on year in the June quarter, confirming its ongoing acceleration. In South Korea annual growth in industrial production and exports has slowed but remains strong while inflation remains benign suggesting only modest monetary tightening going forward.

Australian economic releases and implications

- Australian economic data was surprisingly strong. Both retail sales and building approvals recorded solid gains in July, company profits surged 19% in the June quarter, the terms of trade surged and the current account balance had its best improvement relative to gross domestic product (GDP) since 1973. This all culminated in the news that GDP expanded by 1.2% in the June quarter or 3.3% over the last year on the back of strong gains in consumer spending, dwelling investment and exports.

Major market moves

- Economic data virtually everywhere, but notably in the US, China and Australia, has been better than expected

over the last week and this has resulted in strong gains in global share markets.

- The return to optimism in share markets also boosted commodity prices, with the copper price now just 4% below its April high, and the Australian dollar (A\$) rising back above US\$0.91.

What to watch in the week ahead?

- In Australia, the Reserve Bank of Australia (RBA) is expected to leave interest rates on hold. While a run of stronger than expected economic data culminating in above trend growth in the June quarter adds to the case for a rate hike this is likely to be balanced against uncertainty regarding the global outlook and expectations that inflation is likely to remain within the target range over the year ahead. However, the RBA is also likely to signal that its bias is still to raise rates and that above trend GDP growth in the June quarter along with a massive boost to national income from higher commodity prices have reinforced this.
- In the US, it will be a quiet week on the data front with the Federal Reserve's Beige book of anecdotal evidence likely to confirm that growth in the US has slowed and the trade balance likely to show an improvement in the deficit after the deterioration in July. Chinese trade data for July is likely to show a moderation in export growth due to slower global growth.

Outlook for markets

- Shares have been on a roller coaster ride over the last few months, following almost a one month up then one month down pattern, as the bulls and bears fight it out over whether there will be a double dip back into global recession. Right now the bulls seem to be back in charge thanks to indications that the US will avoid the much feared double dip, therefore we might see more upside in the weeks ahead as investors are forced to cover their short positions. But it's too early to say we are off the short-term roller coaster, and a return to double dip worries may drag markets back down later this month and into October, consistent with the seasonal pattern for weakness at this time of year. However, beyond the near-term uncertainties, we remain of the view that shares will see strong gains into year end and then through 2011. Shares are very cheap relative to government bonds, investors are extremely bearish and once it becomes clear that the US/global recovery is continuing (albeit slowly) there is likely to be a big reversal of investment flows - out of government bonds and back into equities.
- The A\$ is likely to remain volatile in the short term, but should rise on a six to 12 month horizon as it becomes clear that the global recovery is continuing, commodity prices are remaining strong and that Australian interest rates are remaining well above global rates.
- Double dip and deflation worries may keep bond yields low in the short term but medium-term returns are likely to be poor, reflecting low yields and excessive public debt levels in many developed countries.

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