

## Weekly Market & Economic Update – week ending 27 August 2010



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Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
China – Leading index, July	mom	102.1	102.8	↔
US – Durable goods orders, July	mom	+0.3%	-1.0%	↔
Japan – Unemployment rate, July	mom	5.2%	5.3%	↔
US – Existing home sales, July	mom	3,830,000	5,370,000	↓
Australia – Capital expenditure, June quarter	qoq	-4.0%	-0.2%	↔

\* revised

### Financial markets

Indicator	Friday, 27 August 2010	Friday, 20 August 2010	Weekly change	27 August 2009	12-month change
S&P/ASX 200 Index	4,370	4,431	-1.4%	4,451	-1.8%
S&P/ASX 200 Property Trusts	866	866	flat	872	-0.6%
US S&P 500	1,065	1,072	-0.7%	1,031	+3.3%
Dow Jones Eurostoxx	252	253	-0.5%	258	-2.4%
UK FTSE 100	5,202	5,195	+0.1%	4,869	+6.8%
Japan TOPIX	820	830	-1.2%	964	-15.0%
CITIC/S&P 300 China A	2,421	2,448	-1.1%	2,619	-7.6%
MSCI (ex-Aust/in LC)	785	789	-0.5%	780	+0.7%
Aust 90-day bank bill yield	4.75%	4.70%	+5 bps	3.35%	+140 bps
Aust 10-year bond yield	4.87%	4.98%	-11 bps	5.36%	-49 bps
US 10-year bond yield	2.64%	2.61%	+3 bps	3.45%	-81 bps
Oil – West Texas Crude	US\$75.17	US\$73.46	+2.3%	US\$72.49	+3.7%
A\$ in US cents	US\$0.9023	US\$0.8879	+1.6%	US\$0.8389	+7.6%
TWI	68.9	68.8	+0.1%	65.5	+5.2%

### Major upcoming global economic releases and events

Date	Data/Event	Units*	Previous	Market Forecast
30 August	Japan – Retail trade, July	mom	+0.4%	+0.5%
31 August	Australia – Building approvals, July	mom	-3.3%	-0.7%
1 September	US – Institute for Supply Management manufacturing survey, August	mom	55.5	52
1 September	Australia – Gross domestic product, June quarter	qoq	+0.5%	+0.8%
2 September	US – Factory orders, July	mom	-1.2%	+0.5%

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

## Headline developments of the past week

- US Federal Reserve (Fed) Chairman, Ben Bernanke, indicated that the Fed stands ready to provide further monetary stimulus if the economic outlook deteriorates significantly further. However, there is nothing new in this and his insistence that the pre-conditions still appear to be in place for a pick up in growth in 2011 and that the Fed has not yet agreed on any criteria (or triggers) for more action suggests that the Fed is nowhere near ready to undertake more quantitative easing. US shares rose solidly on Bernanke's comment that the Fed will act if necessary, but given his failure to provide anything new this may be nothing more than a bounce from oversold levels.
- The Australian June half reporting season is largely over. Unfortunately, while there has been some improvement in the last week, the profit reporting season hasn't been particularly inspiring. The good news was that 72% of companies saw profits rise. However, only 39% of companies surprised on the upside, which is down from 49% in the February reporting season and down 57% at a similar stage in the last recovery cycle in August 2004. Company outlook statements were also cautious, with the ratio of positive to negative comments running around 2 to 1 compared to 6 to 1 during the last reporting season.

## Major global economic releases and implications

- US economic data seems to be going from bad to worse. June quarter gross domestic product (GDP) growth was revised down to 1.6% annualised, which some would say is stall speed from a previously reported 2.4% pace. Consumer sentiment slipped, both new and existing home sales fell sharply (pointing to renewed falls in US house prices), underlying capital goods orders fell sharply in July, weekly retail sales were lower and regional manufacturing surveys continue to point to a softening in business conditions. Our base case is still one of very weak growth in the US because corporate strength and a likely further bout of Fed quantitative easing should help the US avoid a return to recession for now. However, with the recent run of poor data out of the US, we think that the risk of a 'double dip' has increased from around 30% to around 35-40%. In any case, the US faces a tough six months ahead.
- European economic data was mixed. While industrial new orders rose 2.5% in June, European business conditions indicators for August fell slightly. They are still at high levels but it's quite likely that Europe is simply lagging the strength in the global economic cycle seen six months ago.
- Japanese economic data for July showed a slight fall in unemployment but weaker-than-expected household spending and continuing price deflation. Reflecting the deteriorating economic outlook, Japan's government is preparing further economic stimulus and has indicated that it will put pressure on the Bank of Japan to reduce the value of the yen. However, it is worth noting that we've heard that one before!

## Australian economic releases and implications

- Australian economic data was mixed. Construction activity rose strongly in the June quarter, with a very strong gain in housing activity. Meanwhile, business investment fell a surprising 4% in the June quarter. It is worth noting though that despite the mining tax debate, investment plans for the current financial year rose strongly and now imply a 30% or so rise in investment over the year ahead, led by the mining sector.

## Major market moves

- Despite a rally in US and European markets following Bernanke's comments late in the week, global share markets fell as a whole on the back of weak economic data and worries about a return to recession in the US.
- Despite growth fears, commodity prices rose and this helped to push the Australian dollar (A\$) higher.

## What to watch in the week ahead?

- In the US, the Institute for Supply Management's August manufacturing conditions index is expected to fall to around 52 from 55.5 in July, and private payrolls are likely to remain sluggish with a gain of just 40,000 in August. Neither outcome will do anything to allay worries about a return to recession in the US.
- In Australia, along with the election outcome, the focus is likely to be on June quarter GDP data. Growth is expected to be 0.8% for the quarter (or 2.7% for the year), reflecting solid contributions from consumer spending, dwelling construction and net exports.

## Outlook for markets

- With worries about a dip back into global recession now escalating and policy makers in the US and China unlikely to respond immediately, shares are at high risk of having another leg down, particularly as we head into the normally weak months of September and October. However, beyond the likelihood of another round of near-term share market weakness, we remain of the view that a double-dip recession globally will be avoided. And with shares offering very good value, the US Fed likely to embark on another round of quantitative easing, and China likely to start relaxing its tightening measures sometime in the next few months, shares are likely to stage a decent rally in the December quarter and then through 2011. It's likely to remain a volatile and constrained ride though.
- The A\$ is likely to remain under pressure in the short term but should rise on a six to 12 month horizon as it becomes clear that the global recovery is continuing, albeit very gradually in developed countries. In addition, commodity prices remain strong and Australian interest rates are still well above global rates.
- Double dip and deflation worries will 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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