

Investment Strategy & Economics

Weekly market & economic update

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WEEK ENDING 13 JANUARY 2012



Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
Australia – Retail sales, November	mom	0.0%	0.2%	↔
Australia – Building approvals, November	mom	8.4%	-10.7%	↓
Europe – European Central Bank interest rate announcement, January	actual	1.0%	1.0%	↓
US – Retail sales, December	mom	0.1%	0.2%	↑
China – Consumer price index, December	yoy	-4.1%	+4.2%	↓

Financial markets

Indicator	Friday, 13 January 2012	Friday, 6 January 2012	Weekly change	13 January 2011	12-month change
S&P/ASX 200 Index	4,196	4,143	1.3%	4,795	-12.5%
S&P/ASX 200 Property Trusts	831	811	2.5%	857	-3.0%
US S&P 500	1,289	1,278	0.9%	1,284	0.4%
Dow Jones Eurostoxx	229	225	1.9%	284	-19.4%
UK FTSE 100	5,637	5,650	-0.2%	6,024	-6.4%
Japan TOPIX	735	730	0.6%	938	-21.7%
CITIC/S&P 300 China A	2,012	1,927	4.4%	2,654	-24.2%
MSCI World (ex-Aust/in LC)	851	844	0.9%	921	-7.5%
Aust 90-day bank bill yield	4.41%	4.45%	-4 bps	5.00%	-59 bps
Aust 10-year bond yield	3.84%	3.80%	4 bps	5.54%	-170 bps
US 10-year bond yield	1.86%	1.96%	-10 bps	3.30%	-144 bps
Oil – West Texas Crude	98.70	101.56	-2.8%	91.40	8.0%
A\$ in US cents	1.0322	1.0280	0.4%	0.9968	3.6%
TWI	76.7	76.2	0.7%	74.5	3.0%

Major upcoming global economic releases and events

Date	Data/Event	*Units	Previous	Forecast
17 January	China – Real GDP, December	yoy	+9.1	+8.7%
18 January	Australia – new motor vehicle sales, December	mom	-0.7%	-
19 January	US – CPI, December	mom	0.0%	+0.1%
19 January	Australia – Unemployment rate, December	actual	5.3%	5.3%
20 January	US – Existing home sales, December	actual	4.42 million	4.65 million

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

## Headline developments of the past week

- > **The European Central Bank's (ECB) first monetary policy meeting for 2012 saw no significant changes with interest rates staying on hold at 1.0%.** There were some notable comments on Europe's banking and debt crisis by the ECB President Mario Draghi who viewed that the European economy is showing "*tentative signs of stabilization*". The European Central Bank's support for European banks by providing three-year loans in December 2011 "*has been an effective policy measure*" that has served to support "*financing conditions and confidence*".
- > **Europe's government bond markets had an improving tone for the week** with moderately successful funding issuance by Italy and Spain. Both countries secured reasonable volume of funds at lower interest rates than were prevailing a month ago. This has had a positive impact on bond yields with Italian 10-year government yields declining by 0.44% to 6.58% and Spain's 10-year bond yield falling by 0.5% to 5.06 % over the week.
- > **Global shares have benefited from this stabilisation in European government bond markets.** American shares have risen by +1.4% for the week (US S&P 500) while the German DAX share index has risen by 2%. **Australian shares had a solid week with the S&P/ASX 200 Accumulation Index up +2%.**

## Major global economic releases and implications

- > **However, Europe's largest economy is now struggling** given the financial market turmoil and debt troubles of its European colleagues. Preliminary estimates from Germany's Federal Statistics Office indicate that Germany's economy expanded by 3% for 2011. This compares to the previous year's 2010 growth of +3.7%. However, given a robust first half of 2011, this 3% yearly average result implies that the **final quarter of 2011 Germany's economy contracted by approximately -0.3%.**
- > **American nominal retail sales disappointed in December** with a marginal rise of +0.1% month-on-month (mom) after a November monthly rise of +0.4% mom. While there was strength in US car sales in December (+1.5% mom), this was offset by weak electronic sales (-3.9% mom) and general merchandise spending (-0.8% mom). Yet US consumer spending has been solid over the past year despite weak asset prices and a sluggish labour market. For the past year, nominal US retail sales have risen by +6.5%. So December's US sales are a disappointment but not a turning point.
- > **China released economic activity this week which signalled that the economy's growth momentum is progressively cooling while inflation pressures are moderating.** China's annual export growth slowed further to +13.4%. China's CPI for December shows annual inflation at 4.1%, a continued improvement considering that China's inflation was running at 6.5% in mid 2011. Given these moderating export growth and price data, China now has considerable scope to lower interest rates in 2012 to mitigate any adverse developments from Europe's turmoil and weak export prospects.

## Australian economic releases and implications

- > **Australia's nominal retail spending recorded a flat result (0.0% mom) in November after October's subdued +0.2%.** Retail spending is also sluggish on an annual basis, having risen only +3.1% compared to an average of 6% p.a. from 2002 – 2007. There were no signs of any strength in November, with softness particularly evident in clothing sales and department stores while there was a surprisingly weak result recorded for Victoria on a state basis. **Australian consumers remain generally cautious about spending, casting a wary eye on Europe's debt crisis, global market turmoil and a more sedate Australian labour market.**
- > **While Australian home building approvals did rebound in November** (+8.4 % mom), the overall trend has been negative with approvals down -18.9% over the past year. Commercial construction outside of mining also remains weak, with "non-residential" building approvals down by -2.4% for November and -18.8% for the past year. Clearly lower mortgage and corporate borrowing rates with the Reserve Bank of Australia's recent interest rate cuts should be progressively beneficial for construction in 2012.

## Major market moves

- > Commodities have also benefitted from the improved risk appetites, with copper up +6% for the week while gold is +1.3% to US\$1639 per ounce.

## What to watch in the week ahead?

- > **Generally this should be a quiet week for economic data with the focus more on financial markets.**
- > The US sees the release of December data on housing starts, industrial production and inflation.
- > Europe will see a measure of German business confidence (ZEW) and the central bank's monthly bulletin.
- > **China is set to release critical economic activity data during the week** with real GDP for the December quarter as well as industrial production and retail sales for December. The key focus is whether China's economy continues to slow given tighter monetary policy in 2010-11 and recent weaker global demand for its exports (particularly in Europe).

- > **Australia will see the release of labour market data for December.** Employment growth should improve to +10,000 jobs compared to a disappointing November result of -6,300 and the unemployment rate is should hold steady at 5.3%.

## Outlook for markets

- > **Global shares are very cheap compared to corporate profits as well as government bond yields.** Yet Global shares have to battle the current prevailing headwinds of Europe's banking and debt crisis, doubts on the US recovery as well as concerns that Asia's growth is slowing sharply. While global shares are likely to tread water in the short term given the prevailing caution, 2012 should ultimately prove a better year than last year. Global shares have factored in a significant amount of stress as indicated by forward price to earnings (PE) multiples which are now 10.2 times for global shares compared to 12.4 times a year ago. For Australian shares, the forward PE is now 10.6 times compared to 13 times a year ago. The Australian S&P/ASX 200 is expected to rise towards 4800 by the end 2012
- > **Global bond yields are very low in the core countries of America, Germany, Britain and Japan.** This suggests low returns unless Europe's debt crisis intensifies further and a global recession transpires. Australian government bonds are relatively more appealing with higher yields than these global bonds. Yet Australian corporate debt is an even better investment proposition if one needs income or is worried about shares.
- > **Cash and term deposits should become less attractive in 2012 with the RBA likely to lower Australia's official cash rates by a further 0.25% to 4.0 % in February 2012.**
- > **Commercial property returns are likely to be solid in 2012 reflecting yields around 7%.** This suggests that only modest capital growth can generate a decent annual return.
- > **The A\$ is likely to have some large price swings in 2012 but generally remain solid.** Australia, as one of the very few countries with a stable AAA rating, is perceived as a "safe haven" with Europe's sovereign debt woes.

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