November 2008

Market and Economics Report

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

Global economy

Review: The reality of a global recession became further entrenched in November. Financial market volatility persisted and some of the world's major economies reported successive quarters of negative growth. Consequently, the IMF revised its world growth estimates down. The US economy contracted in the September quarter with real gross domestic product (GDP) declining 0.1%. US housing construction activity continued to weaken. US consumers struggled with falling asset prices, tighter credit and rising unemployment, which continued to undermine spending. Business conditions, consumer confidence and manufacturing surveys also weakened. US inflationary pressures dissipated with the consumer price index (CPI) down 1% month-on-month (mom) due to falling commodity prices and weak economic activity. Japan's real GDP fell 0.1% quarter-on-quarter (qoq) in the third quarter with weak capital expenditure and declining net exports. Japan's labour market continued to soften, while industrial production, household spending and manufacturing and business conditions weakened. The Bank of Japan responded with a surprise 0.2% interest rate cut. China's economy also continued to moderate in November. Industrial production slowed sharply, reflecting weaker export demand. China's CPI dropped to 4.0% year-on-year (yoy) in October, the lowest in 17 months. In response, policymakers lowered interest rates, reduced reserve requirement ratios and announced a fiscal stimulus package in order to boost confidence and investment spending. China's consumer spending remained relatively robust with retail sales up 22% yoy in October. Europe also recorded its second consecutive quarter of activity contraction, which confirmed a recession in the region. Euro-zone real GDP fell 0.2% in the September quarter, following a 0.2% decline in the June quarter. Industrial production and various sentiment surveys indicated a dismal growth profile for both the industrial and consumer sectors in Europe. Conditions in the UK were equally bleak, with industrial production, house prices and transaction activity declining sharply. The resulting negative wealth effect continued to impact consumer spending, with UK retail sales down sharply. In response, the UK Government announced a £20 billion fiscal stimulus package to mitigate a deep recession. Both the Bank of England and the European Central Bank cut interest rates during the month.

Outlook: Global growth is likely to be very weak out to mid-2009, with developed countries contracting. This should lead to falling inflation and interest rates in most major countries which, along with fiscal stimulus and lower energy prices, will aid recovery in the second half of 2009 to 2010.

Australian economy

Review: Australian economic data softened further in November. Business confidence and conditions and consumer sentiment remained under significant pressure. New home sales rose in October, but house prices continued to decline. Wages growth moderated and the leading index fell sharply. The Reserve Bank of Australia (RBA) cut interest rates by another 0.75% in November and 1% in December. The central bank's downgrading of 2009 growth forecasts to below 2% and associated commentary cemented expectations of further monetary easing. Despite mid-year tax cuts and lower interest rates, real retail sales rose only 0.1% in the third quarter after two negative quarters. Private sector credit growth was at a notably slower pace while private capital expenditure was solid. Overall GDP growth virtually stalled in the September quarter at just 0.1%. The TD-Melbourne Institute's inflation gauge fell to 3.0% yoy from 3.9% yoy in October, suggesting the inflation risk is evaporating.

Outlook: Domestic economic conditions are likely to be very weak over the next six to 12 months, with a mild recession now likely. Lower rates and fiscal stimulus should help prevent a deep slump.

International shares

Review: The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned -6.1% in local currencies (or -5.2% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -7.2%. In Europe, the Eurostoxx Accumulation Index returned -6.1%, while the UK FTSE 100 Accumulation Index returned -1.4%. Shares in Japan were also down with the Topix Accumulation Index returning -3.7%. In contrast, Chinese shares proved a rare bright spot, with the S&P/CITIC 300 Total Return Index returning 10.5% in November.

Short-term outlook [six to 12 months]: Turmoil may continue over the next few months on uncertainty regarding the depth and duration of the global recession. However, global shares are likely to provide reasonable returns on a 12-month plus view, given the likelihood of better economic conditions in 2010 and attractive valuations.

Medium-term outlook [five to ten years]: Improved dividend yield following the share slump, and profit growth around nominal GDP growth will see medium-term returns from mainstream global shares of around 9% per annum on average.

Australian shares

Review: Australian shares were again under pressure in November. Elevated volatility in the local market corresponded with the US market, both of which made new lows during the month. Poor economic data, further signs of a slowdown in China and increasing evidence of global recession heightened concerns about Australia's economic and growth profit outlook, prompting further monetary and fiscal responses. Despite increasingly attractive equity valuations, risk aversion remained and investors continued to seek defensive positions. The S&P/ASX 200 Accumulation Index returned -6.2% in November. Property (0.2%) produced the only positive sector return for the month.

Short-term outlook: The Australian share market is likely to remain volatile over the next few months. Further falls are possible. However, shares should improve through 2009. Valuations are attractive and interest rates are falling rapidly.

Medium-term outlook: Reflecting a much higher dividend yield and reasonable growth prospects, medium-term returns of around 11% per annum are now possible.

Listed property securities

Review: The S&P/ASX Property 200 Accumulation Index gained in November, returning 0.2% and outperforming the broader equity market. Investors were again cautious given concerns about which A-REITs may be the next to raise equity and what discounts will be offered to ensure participation. The diversified sub-sector was the strongest performer in November, followed by industrial and commercial. Retail was the worst performing sub-sector over the month.

Short-term outlook: The next few months are likely to remain volatile due to worries about gearing levels, capital raisings and the underlying property outlook. 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 now possible.

International bonds

Review: International bond yields were significantly weaker in November as equity markets continued to struggle and safe haven flows dominated. The US ten-year bond yield fell 104 basis points (bps) to 2.92% and Japan's ten-year bond yield dropped 8 bps to 1.40%. In Europe, the UK ten-year bond yield declined 75 bps to 3.77%, while Germany's ten-year bond yield lost 64 bps to 3.26%.

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 again rallied in November. The three-year bond yield opened at 4.47% and closed 89 bps lower at 3.58%. The yield on ten-year bonds ended the month 60 bps lower, falling from 5.20% to 4.60% over November. The spread between Australian and US ten-year bond yields widened sharply over the month. Short-dated bank bill yields experienced significant declines in November. The RBA announced a larger-than-expected 0.75% interest rate cut which put further downward pressure on yields. The three-month bank bill rate opened at 5.81% and closed 109 bps lower at 4.72%. The six-month bank bill rate opened at 5.38% and fell 110 bps to close at 4.28%.

Short-term outlook: Bond yields may fall further in the short term as growth and inflation fall.

Medium-term outlook: Returns from local bonds over the medium-term should be modest, reflecting low yields.

Australian dollar

Review:The Australian dollar (A$) declined further in November. It closed the month at 65.33 US cents (down 2.4% from 66.94 US cents) and JPY62.42 (down 5.5% from JPY66.03). The TWI closed November at 54.6 (down 0.2% from 54.7).

Short-term outlook: The next six to 12 months are likely to be weak with the A$ buffeted by local and global growth worries, falling local interest rates and commodity price weakness.

Medium-term outlook: The A$ should rebound over the medium term, helped by a rebound in commodity prices.

Key financial markets

	30 Nov 2008	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	24,870	-6.2%	-40.0%
MSCI World (ex-Aust Accumulative/ unhedged in A$)	3,219	-5.2%	-22.4%
US S&P 500 Accumulation Index	1,438	-7.2%	-38.1%
Dow Jones Eurostoxx Accumulation	333	-6.1%	-45.0%
UK FTSE 100 Accumulation Index	2,596	-1.4%	-30.5%
Japan Topix Accumulation Index	1,007	-3.7%	-44.5%
S&P/CITIC 300 Total Return Index	1,531	10.5%	-60.0%
S&P/ASX 200 Property Accum. Index	20,123	0.25%	-52.1%
UBS Warburg Global Real Estate Investor Index	137	-16.0%	-51.1%
Aust 90-day bank bill yield	4.72%	-109 bps	-252 bps
Aust 10-year bond yield	4.58%	-60 bps	-132 bps
US 10-year bond yield	2.97%	-101 bps	-96 bps
A$ in US cents	65.12	-1.30%	-26.4%
Trade-weighted index	54.6	-0.2%	-20.8%

Contact us

If you would like to know more about how AMP Capital can help you, please visit ampcapital.com.au, or contact one of the following:

Financial Planners	AMP Capital's Investment Representative on 1300 139 267
Personal Investors	Your Adviser or Financial Planner
Wholesale Investors	AMP Capital's Client Service Team on 1800 658 404

p:\flyers\market&economic report\november 2008\market&economic_arrive_101208.ind