

Investment Strategy & Economics

Weekly market & economic update

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WEEK ENDING 17 FEBRUARY 2012



Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
Australia - Housing finance, December	mom	+2.3%	+1.4%	↔
US – Retail sales, January	mom	+0.4%	+0.1%	↔
Eurozone – Gross domestic product, December quarter	qoq	-0.3%	-0.4%	↓
US – Industrial production, January	mom	+0.0%	+0.4%	↑
Australia – Unemployment rate, January	-	5.1%	5.2%	↔

Financial markets

Indicator	Friday, 17 February 2012	Friday, 10 February 2012	Weekly change	17 February 2011	12-month change
S&P/ASX 200 Index	4,196	4,252	-1.3%	4,938	-15.0%
S&P/ASX 200 Property Trusts	819	806	+1.6%	887	-7.7%
US S&P 500	1,361	1,343	+1.4%	1,340	+1.6%
Dow Jones Eurostoxx	249	245	+1.8%	297	-16.2%
UK FTSE 100	5,905	5,852	+0.9%	6,087	-3.0%
Japan TOPIX	811	779	+4.1%	974	-16.7%
CITIC/S&P 300 China A	2,131	2,129	+0.1%	2,744	-22.3%
MSCI World (ex-Aust/in LC)	905	890	+1.7%	951	-4.8%
Aust 90-day bank bill yield	4.36%	4.38%	-0.02 bps	4.90%	-0.54 bps
Aust 10-year bond yield	4.05%	4.00%	+0.05 bps	5.63%	-1.58 bps
US 10-year bond yield	2.00%	1.99%	+0.01 bps	3.57%	-1.57 bps
Oil – West Texas Crude	103.24	98.67	+4.6%	86.36	+19.5%
A\$ in US cents	1.0706	1.0673	+0.3%	1.0118	+5.8%
TWI	79.2	78.5	+0.9%	75.0	+5.6%

Major upcoming global economic releases and events

Date	Data/Event	*Units	Previous	Forecast
21 February	European - Consumer confidence, February	mom	+0.7%	+0.8%
21 February	Australia – Westpac leading index, December	mom	-0.2%	na
22 February	Australia – Wage cost index, December	qoq	+0.7%	+0.8%
22 February	US – Existing home sales, January	mom	4.61 m	4.65 m
24 February	US - University of Michigan Consumer Sentiment, February	index	72.5	72.9

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

Headline developments of the past week

- > **The ongoing confusion as to whether an agreement has been reached or not regarding Greece's latest bailout negotiations raged last week, resulting in a volatile ride for risk assets like shares.** Greece looks to have fulfilled the conditions required to receive another bailout, but European leaders' reluctance to grant the bailout ahead of elections in April is causing the process to be dragged out. Our assessment is that a deal is close by, as both sides have too much to lose, though the risks remain high. There is a good chance that Eurozone finance ministers will agree to a deal at their 20 February 2012 meeting.
- > **In a broader sense there was mostly good news regarding the European debt issue over the last week.** Moody's played catch up in downgrading various European countries. Against this, the European Central Bank (ECB) appears to be moving closer to forgoing profits on its Greek bond holdings in order to help ensure Greece's debt falls to 120% of gross domestic product by 2020, Spain is now a third of the way through its planned bond issuance for this year, China gave assurance that it would help support Europe in its debt struggles and German officials signalled a willingness to provide more assistance to Portugal. Most importantly bond yields in Spain, Italy, France and Portugal were little affected by the ongoing Greece debt debate of last week, suggesting investors are becoming less concerned about contagion.
- > **Meanwhile, global reflation remains an ongoing theme with the Bank of Japan announcing extra quantitative easing, a short-term inflation target of 1% and a medium-term target of 2%.** This is a very significant decision. If Japan is serious about meeting its inflation targets, it means more monetary easing in order to break the psychology of deflation and it could mean a fundamental downturn in the yen and the relative upswing in the performance of Japanese shares. Such a move adds to quantitative easing by the US, UK and ECB and is ultimately a positive move for financial assets generally.

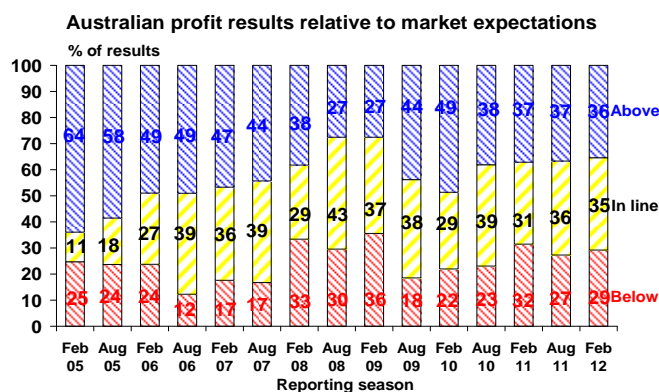
Major global economic releases and implications

- > **US data releases last week were mostly upbeat.** January retail sales and industrial production were a little softer than expected, but there was a slight rise in small business optimism, solid gains in manufacturing conditions in the New York and Philadelphia regions, a further fall in unemployment claims, another rise in an index of leading indicators, another fall in mortgage delinquency rates, further gains in housing starts and permits as well as a further recovery in home builders' conditions. The latter is very positive and adds to evidence the US housing sector is recovering. General Motors, the maker of my favourite cars, posted a record annual profit, adding to the renewal of US manufacturing underway. As Lee Iacocca reportedly said "as goes General Motors, so goes the nation" – perhaps. Congress has extended payroll tax relief and expanded unemployment benefits for the remainder of this year.
- > **The Eurozone contracted -0.3% in the December 2011 quarter, likely signalling the start of a recession.** Fortunately, the decline was less than feared and recent indicators suggest it will be a mild recession.
- > **Japan's economy also contracted in the December quarter.** Gains in industrial production, a tertiary activity index and a likely rebound in public demand point to a return to positive growth in the current quarter.
- > **Growth in Malaysia remained strong in the December 2011 quarter,** boosted by robust domestic demand. Slowing exports are likely to see growth slow to a still reasonable 4% this year, ahead of renewed strength next year.

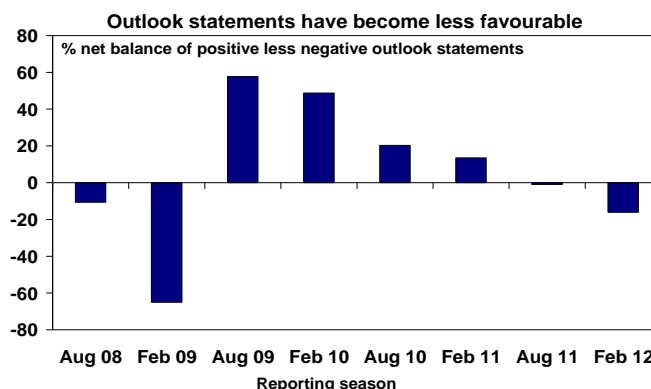
Australian economic releases and implications

- > **Australian data was refreshingly strong over the last week** with gains in housing finance, business confidence, consumer sentiment and employment. However, there are some grounds for caution. The strength in housing finance is likely to have been distorted by the pending expiration of home buyer support in New South Wales and Queensland. The business and consumer surveys were largely undertaken before recent bank rate hikes.
- > **And there are several reasons for caution regarding the January employment report.** First, the labour force report is volatile at the best of times but seasonal adjustment problems are at their worst in January. Secondly, hours worked actually fell significantly. Finally, the pace of job layoff announcements has picked up. So we continue to see unemployment rising in response to tough conditions outside the mining sector.
- > This, along with the de facto monetary tightening being delivered by the strong Australian dollar (A\$) and recent bank mortgage rate hikes, we still think there is a strong case to cut official interest rates further, though the strong January jobs data and the RBA's relatively relaxed stance suggest the next cut may be several months away.

- > **Roughly a third of companies have reported, so it's still early days in the December half-year profit reporting season. The results so far are soft.** To date, only 36% of companies have exceeded expectations (compared to a norm of 45%) and 29% have come in worse than expected (compared to a norm of 25%). 64% of companies have reported positive year-on-year profit growth but outlook statements are cautious and investors have greeted the results negatively with the majority of stocks seeing their share prices fall after results were released.



Source: AMP Capital Investors



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Major market moves

- > **Global share markets rose over the last week** thanks to strong US data and optimism Greece won't default next month. The stand out was the US share market which was flirting with last year's highs. By contrast, Australian shares fell and are struggling on the back of much tougher monetary conditions, as rate cut expectations have been dampened, mortgage rates have risen and the A\$ remains strong.
- > The A\$ rose on the back of stronger than expected jobs data and improved global confidence.

What to watch over the week ahead?

- > **In the US, expect modest further gains in existing home sales data** (due Wednesday) and new home sales (due Friday) and flat December house prices (due Thursday). Data for consumer sentiment will be released on Friday.
- > **In Europe, the focus will stay on Greece with finance ministers to consider the bailout package on Monday.** Purchasing managers index business conditions indicators (due Tuesday) and the German IFO index (due Thursday) will be watched closely.
- > **In Australia the focus is likely to remain firmly on interest rates** with the minutes from the RBA's last Board meeting to be released on Tuesday and a Parliamentary testimony by Governor Stevens on Friday, all likely to be watched closely in order to gain guidance as to the RBA's inclination on interest rates. Wages data will be released on Wednesday and is likely to show wages growth remaining pretty benign at around 3.4% per annum. Its also 'peak week' in the profit reporting season with over 100 major companies due to report.

Outlook for markets

- > **Shares are vulnerable to further consolidation or correction in the short-term given high levels of investor sentiment, strong gains this year-to-date and Greek worries. However, any pullback globally is likely to be mild and the broader trend is likely to remain up.** Valuations are attractive, particularly against very low bond yields, the risk of a Eurozone meltdown has receded, momentum in global economic indicators is positive, global monetary conditions are getting easier and easier and there is lots of cash on the sidelines. We continue to see the S&P/ASX200 pushing up to 4800 by year-end, but thanks to tougher monetary conditions in Australia and the strong A\$, the Australian share market is likely to remain a relative laggard.
- > Low global bond yields in major countries suggest low returns unless Europe's debt crisis intensifies. Australian corporate debt is a better investment proposition if one needs income or is worried about shares.
- > Beyond the current consolidation/correction, the broad trend in the A\$ is likely to remain up, helped by more global quantitative easing, solid commodity prices and improving global confidence. A retest of US\$1.10 is likely.

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