

Market Watch

Economic Commentary

November was not a good month for economic news. A range of groups released their 2009 forecasts for Australian and global economic growth. It was fairly sobering reading. Among groups to release forecasts were the Reserve Bank of Australia (RBA), the Commonwealth Treasury, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD).

The good news is that all groups expect economic growth to continue in Australia in 2009. The bad news was that forecasts for global growth were particularly weak. The US, Europe and Japan face recessions while emerging markets such as China and India face slower – but still fairly robust growth.

The latest IMF forecasts can be found at www.imf.org. Forecasts from the RBA and the Commonwealth Treasury can be found at www.rba.gov.au and www.treasury.gov.au respectively while the OECD forecasts are at www.oecd.org.

In the face of ongoing financial market turmoil, the United States made adjustments to its US\$700 billion banking and credit market rescue package. It also announced a further US\$800 billion package to get credit flowing through the US financial system.

The UK announced cuts to its Value Added Tax (VAT) while at the same time cutting interest official rates from 4.5% to 3.0%. Official interest rates were also cut in the Euro zone, China and in Australia.

The global economy has now seen a raft of rescue packages that aim to support the global financial system and stimulate economic growth in 2009. Australia's most recent contribution was the \$300 million to be given by the Federal Government to local governments for the purpose of constructing public amenities. Such measures will help sustain employment and spending in the economy.

The AUD fell in November. It was down 1.3% from US 66.45 cents at the start of the month to US 65.58 cents by month end. Lower interest rates and the continued offshore selling of Australian equities dampened demand for Australian dollars.

The AUD bought 0.4264 UK pounds at the end of November and 1.193 NZ dollars.

Australian shares

Despite a late rally, Australian share prices fell over the month. October's 14.0% decline was followed by a 7.8% fall in November. The S&P/ASX All Ordinaries index reached a new low of 3332 points in the month to be down 51.3% from its peak in early November 2007. Such levels were last seen in early 2004.

The market was buffeted by domestic and offshore news. The ongoing credit crisis is placing pressure on companies with debts and those in need of capital. During the month, companies to announce capital raisings included National Australia Bank, AMP, Sonic Healthcare, CSR and QBE Insurance.

The market also saw companies beginning to give guidance on future earnings. Harvey Norman spoke of a 30% decline in earnings while Qantas was indicating the possibility of a 64% decline. Such news does little to buoy the market.

The various financial system rescue announcements improved investor attitudes towards financial institutions in Australia towards the end of the month. Citigroup was given a further US\$20 billion in backing while the US government assumed some of its bad debts.

The effective rescue of Citigroup sent the message that a repeat of the Lehman Brothers failure - which sparked a massive sell-off in global equity and credit markets - would not be repeated. The UK also pumped capital into the Royal Bank of Scotland Group, taking effective control and now owning 60% of its equity.

The parlous state of banking around the globe saw financials fall heavily early in November and then pick up in the last week. Commonwealth Bank ended the month down 15.4% while National Australia Bank was down 12.6%. Babcock & Brown fell 80.5% but Macquarie Group posted a 6.0% rise.

Trading in resource companies was exceedingly volatile. Late in the month, BHP Billiton pulled out of its takeover bid for Rio Tinto. BHP Billiton ended the month up 10.8% while Rio Tinto was down 40.0%. Newcrest Mining was up 18.0% for the month while Alumina fell 40.1%.

Amid market weakness the strongest sectors were the cash generating utilities and telecommunications companies. Telstra fell only 1.5%, Telecom New Zealand rose 4.2% and AGL Energy rose 9.5%.

With a weakening economy, the consumer discretionary sector (-14.6%) was hard hit. Harvey Norman was down 16.7%, Fairfax Media fell 29.7% while Flight Centre fell 37.6%.

The factors pushing the market down have not disappeared but policy actions, such as reducing interest rates, government spending programs and global action to support the financial system will have a positive impact over time. In the meantime, the domestic economy is slowing and parts of the Western world are slipping into recession.

The S&P/ASX 200 Accumulation index (which includes re-invested dividends) fell 6.2% in November to be down 40.0% over 12 months.

November 2008

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Global shares

All major equity markets fell in November. With several large nations slipping into recession and large offshore banks continuing to report losses, global equity markets found little support. There was a rally towards the end of the month but the damage was already done. The MSCI World index, a broad measure of global shares, fell 6.7% in USD and was down 5.5% when measured in AUD. Over 12 months, global shares were down 44.6% in USD terms and have fallen 25.3% in AUD terms

A 16.9% rally in the last week of November was insufficient to stave off an overall 5.3% decline in the US Dow Jones Industrial average over the month. The S&P 500 fell 7.5% to be down 39.5% over 12 months. Further banking and credit market rescue packages were announced but the US auto industry giants were denied access to emergency funding.

The election of Senator Barack Obama as US President, the outline of his spending plans and his selection of economic advisors were generally well received by the market, however, the President-elect has a lot of work to do as the US economy slips into recession.

Asian markets generally followed global markets lower. With Japan now officially in recession, its market fell a further 0.8% to be down 45.7% over 12 months. Hong Kong was down 0.6% for the month and Singapore fell 3.4%. Bucking the trend was China whose Shanghai B market rose 20.0% following the announcement of rate cuts and an economic stimulus package. Its market is down 69.1% over 12 months.

The declines in European markets were not as severe as those seen during October. The UK was down 2.0%, the German market fell 6.4% as did the French market. Official interest rates fell across Europe and the European Union announced a modest stimulus package. Despite this, Europe faces a recession during 2009. The European Central Bank cut official interest rates by 0.5% to 3.25%.

Emerging markets were not spared from the global weakness. The MSCI Emerging Markets price index fell 7.6% in USD and was down 6.4% in AUD. The market in Russia was down 17.5%, Saudi Arabia was down 18.3% but Brazil only fell 1.8%. A 19.7% decline the price of oil to US\$54 per barrel did little to help oil producing nations.

Fixed interest

Policy makers continue to work overtime endeavoring to support their credit markets. Improved capitalization of banks, improved flows of credit and lower commercial lending rates go hand in hand.

In the US, the Troubled Assets Relief Program (TARP) has assisted bank capitalisation while a new US\$800 billion Term Asset-Backed Securities Loan Facility (TALF) aims to get credit flowing in the consumer finance, student loan and mortgage markets. These actions are also aimed at reducing interest rates for global inter-bank borrowing. The benchmark for such borrowing in USD is known as LIBOR or the London Inter-bank Offer Rate.

At the end of November LIBOR was 120 basis points or 1.2% above the US Fed Funds rate. This compares 200 basis points at the end of October, an average differential of 40 basis points or 0.4% over the past few years and a peak of 330 basis points or 3.3% in late September.

The turmoil in global financial markets continues to see strong demand for government bonds. US 10 year government bond yields are at levels last seen in the early 1950s with yields at 2.92% at the end of November.

At the beginning of the month, 10 year Australian government bond yields stood at 5.17% while domestic corporate bonds with credit ratings in the range BBB- to BBB+ had an average yield of 10.29%. By the end of November, the yields were 4.60% and 8.64% respectively. The higher corporate bond yields reflect the current illiquidity in corporate bond markets and the relative risk of default in that market.

The UBSA Composite Bond index returned 3.0% in November for a return of 13.4% over the past 12 months.

The Reserve Bank of Australia (RBA) reduced its official cash rate from 6.00% to 5.25% in November. The UBSA Bank Bill index returned 0.54% in the month and 7.79% over 12 months.

Listed property

The listed property sector actually rose 0.3% in November but is down 52.1% over 12 months.

The sector faces a significant debt refinancing task over the next few years and a slowing economy. In this environment, future distribution yields and future capital growth are uncertain.

Global property markets fell heavily again November. The S&P/Citigroup BMI World Property index fell 13.2% in AUD terms and is down 41.7% over 12 months.