

MARKET OUTLOOK

31-Jul-2009

Economic Outlook

United States

In the US, recent economic data releases supported evidence that a turnaround in the economic contraction is in sight. Signs of stabilisation in key economic indicators, including household spending and the secondary housing market, were a welcome relief. However, the much anticipated recovery will be without job creation (better known as a "jobless recovery"). The elevated pace of job losses is expected to continue, at least in the near term, and unemployment to peak well above 10% next year. Importantly, however, this has also set the stage for a sizable decline in core inflation which in turn will see monetary policy likely to remain accommodative for some time. Economic growth is expected to be below trend in the medium term given that significant financial headwinds remain, and deleveraging is expected to continue in many sectors.

The Eurozone

In Europe there are still no convincing signs of improvement in activity despite notable rebounds in business surveys. Policy response has been also less impressive compared to most other regions. Earlier hopes for more aggressive policies or quantitative easing have diminished. Coordinated fiscal stimulus from a number of European countries has also been missing. While the ECB has provided ample liquidity into the financial market, many financial institutions remain vulnerable to further collateral damage from the ongoing credit crunch.

China

Chinese economic recovery looks to have broadened to domestic demand following surges in credit growth and fixed investment, benefiting from large government stimulus measures. While the positive momentum looks set to continue in the near term, the longer term sustainability of the recovery looks a bit patchy. Inventories in key industrial companies in China remained at high levels and profit margins look to remain under pressure given demand uncertainty. The surge in credit growth on the other hand has fuelled surging demand for equities and might explain the sudden turnaround in real estates woes. The risk of another asset bubble is rising.

Japan

In Japan the industrial sector is showing signs of life. Exports and outputs have rebounded, albeit from very depressed levels. While most of the outlook surveys have also rebounded, current conditions remain relatively weak. A strong and sustainable recovery remains a distance away. With continued restraint on capital investment and a labour market that looks set to deteriorate further, domestic demand remains vulnerable. The large spare capacity in the economy means deflationary pressures are likely to persist well into the next year, adding another layer of risk to the fragile recovery.

Australia

Meanwhile, recent economic data released in Australia continued to provide evidence that the timely monetary and fiscal policy responses have supported activity in the first half of the year. Despite some positive momentum being carried into the current quarter, the pace of negative results for leading indicators suggest that the economy could remain weak in the near term followed by a period of modest growth. Government infrastructure spending however will support the economy from the year end. Labour markets also remain a key indicator to a sustainable recovery. The minutes from the latest policy meeting indicated that the Reserve Bank has moved to a more neutral stance on monetary policy.

Australian Sharemarket Outlook

The outlook for the domestic economy remains cautiously positive as macro economic data being released continues to show signs that the recent recovery might be sustainable. After negative data on private credit growth early in the month, news on retail sales, consumer sentiment and employment data were all stronger than expected leading many market participants to conclude that the worst is behind us with focus now on the length of the recovery.

This view was backed somewhat by the RBA's decision to leave rates unchanged at their July meeting. Comments by the RBA Governor suggest that the easing cycle is probably over and fixed income markets are now anticipating the RBA to start lifting rates sometime in early 2010.

International Sharemarket Outlook

Despite the strong recent market performance in the US, economic signals have been mixed. Consumer sentiment remains subdued despite the pace of the recession slowing. The impact of recent stimulus packages are starting to be felt and tax cuts along with extended unemployment benefits have given yet another boost to household purchasing power.

In the Eurozone, there is growing consensus that the economy bottomed out in the first quarter of the year. The massive decline in industrial production witnessed over the past 12 months is showing signs of moderating bringing renewed hope which is being reflected in confidence surveys.

In Asia, the resolution of India's political situation will allow much needed fiscal stimulus to be released into the economy. China remains one of the fastest growing nations in world, with GDP growth estimated at 7%. Recent monetary easing has provided a fillip for the local sharemarket, which has rebounded strongly over the past few months.

Australian Fixed Income Outlook

The economic outlook is better than what it was three months ago, both on the global front and domestically. The domestic economy, whilst slowing sharply, has remained remarkably resilient when compared to other industrialised economies. Many commentators have put this down in part to our links with the Chinese economy which has also performed relatively well as aggressive fiscal and monetary policy responses also had a positive impact.

A challenge for the Australian economy in the coming months will be to see how it performs without further fiscal stimulus packages that have been working in its favour through the first half of 2009. Furthermore, the performance of the housing market with particular reference to housing prices will also be closely watched as further price rises may well see the RBA lift the official cash rate by year end.

For local bond yields, the nearer term outlook remains mixed. Bond yields have risen as the economic data has improved with the benchmark 3-year government bond now trading at circa 5%. A continuation of the recent economic trends is now required to bring forward expected rate hikes to validate current market pricing. Some consolidation around this level is expected during the coming month.

International Fixed Income Outlook

The economic outlook for the global economy is better than what it was three months ago as the so called "green shoots" appeared, signalling the worst of the recession has now past. The focus for fixed income market participants will be to see if these recent trends continue or at a minimum hold the improvement in the various key leading economic indicators when the next round of economic news is released.

Global bond yields have been moving higher and yield curves steepening in response to better economic data. There is also a lot of debate amongst market commentators and participants regarding the shape and the strength of the recovery, and it will be sentiment in this regard that will drive the nearer term performance of global bond markets.

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