



The Hudson Report

QUARTERLY ECONOMIC UPDATE

Thursday
12th November
2009

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Quarterly Economic Update for 1 July - 30 September 2009

Cautious Optimism Emerges - It was just over one year ago that the collapse of financial services firm Lehman Brothers sparked the start of a global recession. At the time, it was anticipated that if a recovery was to happen, it would be months, if not years away. A year on, it appears the 2009 downturn is clearing with signs of optimism and growth forecast into the new calendar year. On the home front, Australia has definitely performed better than expected, outshining other developed economies.

We certainly had some good news in the June quarter – with the share market leading the way with the beginnings of a “V” shaped recovery. It appears the positive signs are creeping into other indicators and measures of our economic activity as well, as continued growth in the world share markets. Property investors are coming back to the market to carry on the impetus initiated via the first home stimulus package, and the economic statistics such as, GDP growth and unemployment, are showing slightly positive on the Australian front with declaration of the recession being over (though statistically speaking, it didn't arrive – but oh so close... it was only a technicality).

Globally the signs provide continued optimism, but are still small in the wake of Australia's economic statistics.

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The Australian Economy

Inflation - The Consumer Price Index (CPI) increased by 1.0% in the September quarter 2009, up from the 0.5% rise in the June quarter. This took the annual rate of inflation down to **1.3%**, from 1.5% in the year to the June quarter 2009. This inflation rate is obviously well below the RBA's 2%-3% target band and is the lowest annual inflation rate since June 1999.

The news for underlying inflation, which excludes volatile price movements, was not as positive with the annual growth rate remaining at elevated levels. The underlying measure of inflation rose 0.8% over the September quarter with the annual inflation rate declining to 3.5% from 3.9%. This remains above the RBA's 2%-3% target range and the RBA will watch this measure closely.

Consumer Price Index	1.3% change (year to 30th September 2009)
Unemployment Rate	5.7% (as at 30 September 2009)
GDP Growth	0.6% (June Qtr 09) * 0.6% (Jun 08 to Jun 09)
Exchange Rate (in US\$)	88.4 US Cents (as at September 30th)

Source: Reserve Bank of Australia * September GDP released on 16/12/09

The above economic table becomes very encouraging when you stand it next to other developed nations on the planet.

Unemployment - Employment surprised on the upside with 40,600 jobs created in September 2009, versus market forecasts of 10,000 job losses. This lowered the unemployment rate to **5.7%**, from 5.8%. Annual employment growth turned positive, recording +0.10%. Prior to September's employment data, employment growth was -0.33% which was the weakest level since February 1993. These positive results are tempered with the knowledge that working hours have dropped significantly with ABS reporting a fall of 4 million hours (0.27%).

GDP – The latest figures available are for the June quarter (September not released until 16 December). The June quarter revealed an increase in GDP of 0.6% for the 3 months to June 2009. The 12 month result of June to June also yielded the same result an annual increase of 0.6%. It is the annual result that breathes confidence of turning the corner by reflecting positive activity for 12 months.

What was behind the good GDP result?

- 0.8% increase in consumption thanks to the government fiscal stimulus measures.
- Capital expenditure now also on the rise with 1.9% increase in private business investment - attributable mainly to the investment allowance and the resultant 5.6% increase in spending on machinery and equipment.
- Negative influences on GDP came from new building construction and imports.

In summary, whilst Australia has not had 2 successive negative quarters for GDP growth, we have had a 2% rise in unemployment which is not finished with yet. This is definitely recessionary behaviour, however the dual prong attack by the government fiscal stimulus packages (at both the personal and business level) and the RBA discount interest rates have set the agenda for the RECOVERY in economic terms to be under way (or the very least just around the corner).

Source – Colonial First State

Monetary Policy - Interest Rates

NO interest rate rises were received by 30 September, however we all know the RBA has raised rates by 0.25% in both their October and November meetings. It is important to put this into perspective. This should not be seen as a tightening of monetary policy but simply an unwinding of emergency (stimulatory) settings back to more 'normal' levels. In simple terms the heavily discounted interest rates are no longer.

Whilst the SALE on bank loans is over, it is worth noting that this is a reflection of a more optimistic RBA about the direction of the Australian economy.



From the Top Brass – G20

Most of the recent economic data has signalled that advanced economies are starting to recover, and emerging markets continue to expand. Recent commentary from the G20 leaders summit, as well as the US Federal Open Market Committee, has been a mixed message. On one hand - it's reassuring regarding signs that the global economy is on the mend from one of the steepest recessions for many years, but highlighting on the other hand, also issuing a strong message that it is too early to wind back support measures just yet, and to wait until growth takes hold.

US Chairman of the Federal Reserve, Ben Bernanke noted. ***“Even though from a technical perspective the recession is very likely over at this point, it's still going to feel like a very weak economy for some time”.***

Other central banks of the UK, Canada and Korea all profess confidence in the economic outlook, but have all left their country's interest rates on hold as have most central banks (**Australia** one of the very few to be an exception to the rule in this regard). The key concerns on a global scale include the rising unemployment on household finances, and rising bad debts on financial institutions.

In summary – the top brass have signalled a return to buoyant economic conditions is clearly some way off yet, but the current stabilisation of most indicators is encouraging.

GDP Results for June 09 quarter

As the table below demonstrates, the GDP results for the last 3 months echo somewhat of a turning point on a global basis with the June quarterly results looking much better than the 12 month results, indicating the larger annual

figures are really a result of earlier quarter GDP results as opposed to the more recent quarters. Forecasts for global GDP growth in 2009 have stabilised since falling sharply in September 2008, while forecasts for 2010 have now started to be revised up.

Real GDP - Global Index Snapshot					
	Australia	US	Japan	Euro	UK
GDP Growth – 3 months to June 2009	0.6%	-0.2%	0.5%	-0.1%	-0.5%
GDP Growth – 1 year to June 2009	0.6%	-3.8%	-7.3%	-4.7%	-5.5%

Source: RBA - results based on June 2009 * note USA has since produce positive results for Sept quarter.

Global GDP Forecast						
GDP Growth	Aus	US	UK	China	Emerging Economies	Developed Economies
2008 actual	2.4	0.4	0.6	9.0	4.9	0.4
2009 forecast	1.0	-2.4	-4.4	8.4	0.5	-3.3
2010 forecast	2.9	3.3	2.0	9.5	5.7	2.8

Source/s: Ord Minnett

REGIONAL REVIEW

The **US economy** has returned to growth in the third-quarter of 2009, after a contraction (0.2%) recorded in the second-quarter (see above), and follows four quarters of negative growth. Driving economic growth was household consumption, in particular auto sales, residential investment and government spending. The positive GDP result is likely to boost consumer confidence over coming months, and could further stimulate consumption and growth going forward.

While the GDP data was positive signaling the worst appears to be over, other US economic data was mixed, in particular the lagging indicator of unemployment, which is still rising. In early October, job losses were worse than expected with a further 263,000 jobs lost (more than expected), and the unemployment rate rose to 9.8%. Expectations are for the rate to move through 10% over the next few months (did so early this week).

However, more regulation will be required to rebuild confidence in their economy. Data out of the US over the month confirmed this with weaker than expected existing and new home sales, and durable goods orders.

USA Property - Most U.S. cities saw gains in the median price of single-family homes sold last quarter, according to reports from the National Association of Realtors. The national median home price was up 4% from the previous quarter (2nd positive quarter in a row). The reports indicates a shrinking supply of unsold homes suggests the housing market is getting closer to price stabilisation.

EUROPE – Remained stagnant for the June quarter, with only France and Germany showing small positive GDP growth. Eastern Europe continued to lag behind the rest of the world. In the UK, GDP fell further in the 2nd quarter, but consumer confidence and industrial production increased.

ASIA - Australia's relationship with the Asian region has proved to be quite advantageous with China becoming progressively more important to us. **After 43 years of selling more exports to Japan, this year, we have sold more to China.** China delivered very solid September quarter growth and the momentum appears to be sustaining into the 4th quarter. This was supported by strong results in other Asian countries such as Singapore and Korea.

China – Economic data remained strong with continued growth in fixed asset investments and retail sales, continued rebounds in industrial production and property related indicators. GDP figures in China have increased from 7.9% in the June quarter, expanding by more than **9% over the 12 months to the September quarter.**

The Rise of Emerging Markets - in World GDP

Emerging markets consumption levels exceeded US consumption in 2008. Emerging market gross domestic product

accounted for 35% of global gross domestic product in 2008, compared with 23% for the US.

THE BIG QUESTIONS

Is the crisis over?

Whilst the financial crisis is largely over, the economic crisis still lingers. The recession is behind us but the recovery has only just commenced. After contracting for four consecutive quarters through to the first quarter of this year, the global economy expanded in the June quarter. From here we expect it will continue to expand through 2010, but realise the recovery will take place over a number of years.

What will Drive the Recovery ?

The thrust of the global recovery is coming from the industrial sector, as output is ramping up quickly in response to collapsing inventories. The industrial production boom that got underway in Asia in the June quarter in 2009 is spreading to the US and Western Europe.

What are the main risk factors we should monitor?

For the recovery in the world economy and risky assets (ie shares) to last, the private sector will need to take over the baton from the public sector." Corporates are in the driving seat here, and we need to see them move from a precautionary mode into an expansionary one, which implies capital spending, jobs and income creation. Watch for these factors.

What is the Outlook ?

In a nutshell, much is getting back to normal in large part due to unprecedented global policy action directed at an unprecedented crisis. An enormous amount of work remains to be done and good fortune is needed, but the forces required to get the world economy and markets back to normal are in place.

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Australian Currency

The Aussie Dollar is arguably the strongest of the worlds well-traded currencies. It is in a primary uptrend against not only the US dollar but also the GB pound, the Euro and the Yen. The dramatic fall from grace during the worst of the global financial crisis has now been fully reversed with parity (\$1 for \$1) with the Greenback the subject of widespread discussion.

Index	30 September 2009	12 Mth % move
\$AUD / \$US	0.884	+8.9%
\$AUD / UK£	0.553	+13.5%
\$AUD / Euro €	0.604	+5.0%
\$AUD / ¥Yen	79.3	+2.0%

Source: [Reserve Bank Australia](#)

The Australian dollar has had a tumultuous 12 months falling by 40% then rising by 35% in 6 months earlier this year. The strengthening of the dollar has been a direct result of recent movements in commodity prices as well as a weakening of the US dollar.

IN the 6 months from March to September, the rising currency has impacted global share investments. From March lows, USA shares were up 55% (similar to Australia) however the \$AUD was up 35% creating a negative impact to

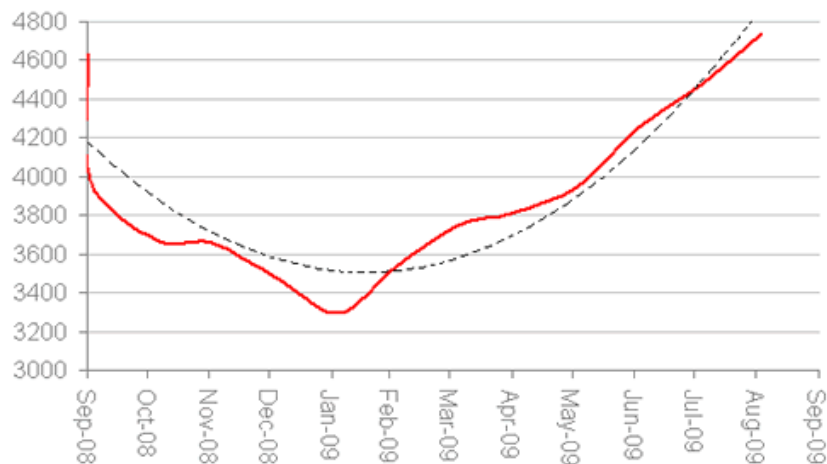
Australians investing overseas.

The A\$ rose in September quarter, closing at US0.884 cents compared to 0.8114 in June an upward rise of 8.9% (-8.9% to the Australian investor) for the September quarter. The majority of this rise 11.9% was over the month of September, on the justified expectation that interest rates in Australia will be lifted before the end of the year. This was of course delivered with rate rises of 0.25% in both October and November. Compared to 12 months ago the A\$ was at 0.791 resulting in a 11.8% shift higher.

The Australian Sharemarket

In the month prior to the horrific demise of Lehman Bros, the All Ords index was trading in the range between 4800 and 5200. Since then the market was within a whisker of the 3000 level before commencing a **V shaped reversal** (see graph below), and been on the mend ever since with only one temporary setback in June.

All Ords Price History 30 Sep 08 - 30 Sep 09 (monthly)



The All Ordinaries Index rose a further 5.7% in September, the 7 consecutive monthly gain. Over the 12 months to September 2009, the index has risen 2.3%. Since reaching its low on 6 March 2009, the Index has risen **52.3%** to 30 September closing at **4739**.

The Australian share market has rallied sharply over past six months. This was driven by realisation that the worst case scenario for the global and Australian economies did not eventuate. This has been driven by better than expected economic data in Australia, further signs of recovery in the global economy and supportive initiatives out of the G20 meeting in the US. As a result, company profit expectations have risen.

While this is positive, share price gains are now starting to factor in substantial earnings growth over the next few years. For this to happen, private demand must return within the economy, allowing companies to grow revenues and expand operating margins to provide earnings growth. The big test will be when governments around the world begin to withdraw the large amounts of monetary and fiscal stimulus.

Capital Raisings - Over the past 12 months, Australian listed companies have raised around A\$100bn in new equity. Over September, Primary Health Care, Paladin Energy and AWB were just some of the companies to raise additional equity, with a number of small companies also accessing the market. With investor appetite for equities returning, the initial public offering market has re-emerged.

Listed property - This sector also continued to rise, gaining 9.8%, following a sharp 16% rise in August. The sector has now risen **56.8% off its lows in May**. Confidence has returned to the sector, following large capital raisings and debt reductions. Global property markets also moved higher in September. With the exception of Italy, China and Japan, all major markets recorded positive returns. The strongest performance was in Germany. The UBS Global Investors Index (Net TR) A\$ rose 5.8% in the month to be 25.3% lower over 12 months.

The Paradigm moving forward for Australian Shares

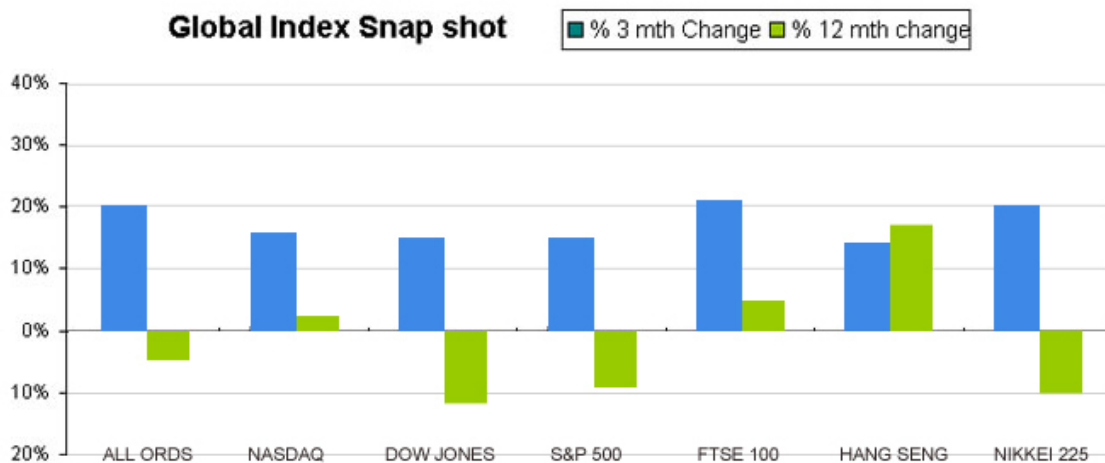
The influence of Asia and its demand on our resources will continue to become more important to Australia, however, we always react to Wall Street. **WHY ?** - The US economy may only be 20-25% of world GDP, but it is still more than 50% of the market capitalisation of the global share market.

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The GLOBAL SHAREMARKET

Global Index Snapshot as at September 30, 2009					
Index	30 June 2009	30 Sept 2009	3 Mth Move	30 Sept 2008	12 Mth Move
All Ordinaries	3948	4739	20.0%	4631	2.3%
NASDAQ (US)	1835	2,122	15.6%	2,092	1.4%
Dow Jones Industrial (US)	8447	9,712	15.0%	10,851	-10.5%
S&P 500 (US)	919	1,057	15.0%	1,165	-9.3%
FTSE 100 (UK)	4249	5,134	20.8%	4,903	4.7%
Hang Seng (HK)	18379	20,955	14.0%	18,016	16.3%
Nikkei 225 (Japan)	8109	10,133	25.0%	11,260	-10.0%

Source: Ord Minnett



The above table of figures tells its own story, bringing strong gains across all markets for the September quarter making the bulk of the 6 month recovery broadly labeled, as 50% returns since the bottom of most markets.

For the majority of markets, this now makes for a 12 month positive result from September to September (yeah!), with the notable exception is USA indexes of Dow Jones and the S&P 500. Whilst on the surface this suggests Australian markets have performed significantly better in recent times, it is really only a reflection of timing differences.

Putting things into perspective, the Dow Jones in USA has risen **48.3%** from its bottom on 9 March (6547) to 30 September compared to the All Ords rising **52.3%** over the same period.

The encouraging signs of stabilisation from world economies has been enough for equity markets to stage one of the

strongest market rallies, in percentage terms, for quite some time. The question now being asked,

“Is the market too expensive and has it been overbought?”

There are two factors behind the last 6 months of recovery in the share market. **Firstly** there is the buyers returning to the market to soak up the value that was left on the trading floor after the ‘bears’ had over-reacted and brought stock prices well below their true value. The **2nd stage** of a recovery is usually driven by corporate earnings. Put simply as earnings results improve, so to does the stock price. The last quarter earnings announcement from the US have only just finished, and was a good test for the share market. In order for markets to move higher from here, earnings estimates will have to rise. The stage has now been set for the commencement of the **earnings upgrade cycle**.

Asian markets were mixed over the month with Japan the main area of weakness after recent gains. Showing slightly more volatility than most markets, the Chinese share market rose 3.8% in September, following a 15.4% fall in August. An official from the Chinese National Bureau of Statistics suggested the Chinese economy will have no issues recording an 8% economic growth rate by end of 2009.

Looking Forward

There is still continued concerns by some that share markets rose too quickly. The global economy is growing, but the recovery is fragile and still supported by government stimulus measures. The test will be once stimulus is withdrawn and whether demand from the private sector can take over as the driver of global growth.

Concerns remain over the global banking system and the cost and availability of credit. Credit conditions remain tight, especially for small businesses, and this has the potential to hold back the pace of economic recovery.

SOURCE | Ord Minnett & Colonial First state



A trifecta of good results have come from the September preliminary figures for “Established house prices” of Australia’s eight capital cities.

1. As evidenced by the Established House Prices bar chart below, the weighted average price index for Australia’s capital cities has had its 2nd consecutive quarter of growth with a rise of 4.2% for the quarter. This follows four consecutive quarters of negative movement between June 2008 and June 2009.

2. This was enough to move the National (weighted) average to a positive 12 month result of 6.2% from September to September. This is a significant shift when you consider the National (weighted) average for June to June was – 1.4%.

3. The trifecta of good news is that the result was wide spread with every capital city (including Perth) recording positive results for both the last quarter and also the last 12 months to September 2009.

Overall the result of the last 3 months was fairly even across all cities which may be a reflection that the first home owners grants shows no location bias.

Index	Established House Price Index June Qtr 2009 to September Qtr 2009	Established House Prices Index September Qtr 2008 to September Qtr 2009
Sydney	4.3%	5.9%
Melbourne	4.7%	8.4%
Brisbane	4.4%	5.6%
Adelaide	1.7%	3.7%
Perth	4.5%	4.4%

Hobart	1.8%	5.4%
Darwin	3.4%	12.3%
Canberra	4.3%	7.8%
National Avg.	4.2%	6.2%

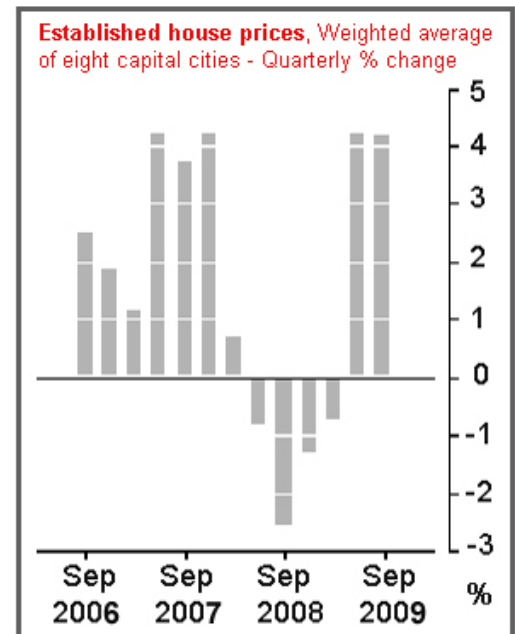
Source: Australian Bureau of Statistics - *preliminary estimates only*

It will be interesting to review this same graph in six to twelve months time to see if the number of first home buyers drops off sharply between September and December and also whether investors enter the market in sufficient numbers to prevent a drop off in property prices.

The change in trend from four negative quarters to 2 positive quarters in my opinion is a reflection of two underlying factors :

1. The First Home owners Grants have fuelled an increase in first home purchases.
2. The state of the economy as a whole is showing more positive signs and confidence the worst is behind us.

Both of these factors have resulted in an increase in participants (both buyers and sellers). As we head into the new calendar year the baton is passed from the first home buyers to the property investors to keep up the activity rate in the property market to fuel continued price growth in property. The fact that the RBA sees fit to unwind the excessive interest rate discounts of the previous year should be seen as a positive sign that the country's economic watchdog themselves are feeling more optimistic about our economy. We expect this confidence to continue to spread through the investor market.



Overall View

The Governor of the Reserve Bank Glen Stevens in his speech on 5th November 2009 summarised things best with his closing comments :

"As we look forward to a new expansion, Australia has many advantages.

- The financial sector remains in pretty good shape.
- The Government does not own, and has not had to give direct support to, any financial institution (therefore, will be relatively free of the difficult governance and exit strategy challenges that such support is raising in some countries).
- Public finances remain in good shape, with a medium-term path for the budget back towards balance, and without the large debt burdens that will inevitably narrow the both macroeconomic and microeconomic – remain in place, and they have worked.
- We remain open for trade and investment, with an exposure to Asia, which still has the most dynamic growth potential in the world over the next several decades.

These advantages are already paying dividends. Properly exploited, they will pay many more.

But there is no such thing as effortless, or riskless, prosperity. There is still a business cycle, and we do well to remember that even if we have been spared the worst of the recent downturn, we will need to continue investing in all the things that helped us get through the recent episode. And, we will need to accept and manage various changes that will probably confront us over the years ahead.

The road to prosperity will have some bumps, twists and turns. But it is the road to the right destination."

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