Business Highlights

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FROM THE EDITOR – the state of the economy

Three months ago economists were predicting a faster return to good times for Australia (as I reported in my final edition of MBN Business News). The Australian dollar was expected to reach parity with the US dollar within ‘months’. Since then we have seen a savage dumping of Australian equities and the dollar in the past week. At the same time, consumer sentiment is falling as interest rates bite. The housing market, whilst having performed admirably in the year to March 2010, is expected to be a modest performer for the remainder of this year and retailers are deeply discounting in order to meet sales projections.

So, what went wrong?

Firstly, the rapid increases in interest rates has curtailed consumer expenditure and cooled the housing market. Mortgage interest rates are expected to further climb to approx 8.5% by the third quarter of 2011 with ongoing negative impacts on discretionary consumer spending and on property prices – especially in the mortgage belt areas.

Secondly, the Greek and Euro crisis (the bailout of Greece and the potential impacts on the Eurozone and support for the Euro currency) have led to the global rout of share prices and Australia was heavily impacted by investors withdrawing from the Australian equity market and dollar in favour of the US dollar (this is a result of investors shifting to the ‘low risk’ US dollar in times of uncertainty).

Thirdly, the introduction of a higher mining tax has significantly impacted local equities and the Australian dollar. Whilst Kevin Rudd has been reported as denying that the mining tax had any impact on this week’s events, some economists, such as Robert Gottliebsen, writing for *The Spectator* are of the opinion that the sell off of Australian equities by European and Japanese investors is due to the government’s ‘horrendous mining tax mistake’ affecting the ‘sovereign risk’ of Australia.

Sovereign risk? Last time I used those words was to assess investments in West Africa and the former satellite states of Russia – it's not a term one would associate with Australia. But economists are concerned. In my opinion, on its own, the mining tax would have had some impact on global investors who have the choice to invest in countries with a lower tax regime, but coming in tandem with the Greek crisis, it has spooked international investors more than it should have done.

With property forecast to be in the doldrums, this provides those of you who are gutsy with a perfect opportunity to buy into a stock market that has shed approximately 6.6% in value this last week alone. Whilst the short term outlook is uncertain, the market should rise once the dust settles.

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AUSTRALIAN ECONOMY

Retail outlook

Worried clothing retailers are bracing for heavy discounting in the next 2 months as shoppers hold back on spending, spooked by the sharpest monthly fall in consumer sentiment and an uncertain outlook for the economy. "You just have to walk through any shopping mall and you will see discount offers of 30-40% on most shop windows," Country Road chief executive Glenn Gilzean says.

"Retail conditions have been very tough since Christmas. Shoppers have started to wise up and are reluctant to buy unless items are on sale. It will be difficult to wean them off this mentality," Gilzean says.

Cue Clothing executive director Justin Lewis states: "The (interest) hikes are hitting our customers in the hip pocket. We have noticed that a number of our customers have started to hold back on spending since February.."

Teresa Ooi, *The Weekend Australian* – 22-23 May.

Myer chief executive Bernie Brookes has warned that high interest rates and share and debt market volatility had made consumers more cautious than they were a year ago and that conditions would remain tough until Christmas.

However it's not all gloom and doom per David Jones chief executive Mark McInnes who is anticipating a tough July quarter but is of the opinion that the worst is over for Australian retailers. He says that the emerging strong demand for men's suits, homeware and furniture – normally the first categories to suffer in a retail slump and the first to recover – suggests that recovery is imminent. (Sue Mitchell, *The Australian Financial Review* – 20 May.).

(Editor: Gerry Harvey is also sounding upbeat and has dismissed the collapse of Clive Peters as an event that was on the cards for a number of years.).

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Interest rates are biting

Home buyers and firms can expect an interest rate reprieve after the Reserve Bank of Australia acknowledged its rapid succession of rate rises had hit household spending and curbed borrowing. But any rate relief is likely to be short-lived as forecast soaring commodity prices are expected to fuel the biggest business investment boom in the nation's history, further fuelling inflation and as a result interest rates.

Economists are now predicting that the next interest rate hike will not occur until December.

Adrian Rollins, *The Australian Financial Review* - 19 May.

Interest rates have a tipping point at which borrower's resilience becomes sorely tested. This month's rise, which took the official cash rate to 4.5%, appears to be that point, judging from new data out this week.

The Westpac-Melbourne Institute Consumer Sentiment index fell by a sharp 7% in May, and a key measurement of sentiment towards buying property fell to levels not last seen since the depths of the global financial crisis.

Westpac chief economist Bill Evans noted that there are 'sensitivity points' for mortgage rates above which consumer sentiment can be damaged quite markedly. He noted that in the last interest rate hike cycle that point was reached when mortgage rates increased to 7.3%. Interest rates are currently 7.4% and Evans said future hike were going to hurt consumers.

Paul Syvret, *The Courier Mail* – 20 May.

(Editor: I have been critical in the past of the rapid increase in interest rates and the impact on households and small business. The interest rate cycle is predicted to continue later this year with the potential that mortgage rates will approximate 8.5% by late next year.).

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Safety in US Dollar

Over the past year or so, foreign exchange investors didn't want to have anything to do with the US dollar. Now it seems they can't buy the currency fast enough. Behind the switch is a common theme, and one not confined to financial markets: when times get tough everyone just wants to go home. And home is the US of A.

That's the driving force behind the Australian dollar falling almost US10c over the past month. The US itself might not be in such great shape but it's where everyone feels comfortable and, with concerns that Greece might leave the euro zone or talk the European Central Bank might announce plans to support the euro, investors are seeking the sanctuary of the greenback. And whenever the US dollar heads higher, risk assets fall. And vice versa

Phillip Baker, *The Australian Financial Review* – 21 May.

(Editor: The Australian dollar and equities are seen as risky assets as a result they have been dumped. Gold is also a safe heaven for investors during times of crises, Readers do not need to invest in gold itself but could purchase gold certificates or shares in gold based companies as a hedge).

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EMPLOYMENT

Job Market still recovering

(Editor: I have met with a number of leaders in the recruitment industry over the past week and all have the same view of the labour market: it's still sluggish. Blue collar mining jobs are on the increase whilst the white collar market is still recovering.).

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PROPERTY

20% increase in housing not a bubble

Australia's housing market is not facing a debt-fuelled bubble, despite a 20% rise in house prices during the year to March, according to Dr Ellis, senior official of the RBA. But lenders needed to remain stringent in their borrowing criteria to avoid one.

Dr Ellis advised borrowers (especially investors) to be conservative in their expectations of returns on residential property investment. "It [is] important for prospective borrowers to have realistic expectations, and not rely on hoped-for capital gain in order to service their debts," she said.

Ainslie Chandler, *The Australian Financial Review* – 19 May.

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Property Market Forecast

The Real Estate Institute of Australia president David Airey is bearish in his outlook for the property market suggesting that most capital city markets will be flat or record marginal growth for the year. Just 3 months ago he was forecasting robust growth, but he said he now felt that interest rates had moved too far, too fast, with the last two rises making a particularly strong impact on the market. This had resulted in more houses being put on the market, particularly in Western Australia.

"It's a pretty poor outlook at the moment," he said.

Not all share his sentiments. Some economists are predicting a 5% increase in property prices. Economists are predicting that Perth and Brisbane, which had been underperforming, will catch up to the other capital cities on performance by the end of the year.

Ainslie Chandler, *The Australian Financial Review* – 20 May.

(Editor: The mortgage belt areas are expected to record a negative growth in property in the next year as interest rates bite. The higher end of the property market is still expected to record price increases.).

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SHAREMARKET

Sharemarket savaged

The Australian sharemarket sank to a nine month low amid the global share meltdown this week and investors remain uncertain about the short term outlook despite a dramatic Friday afternoon rebound (following rumours that the RBA had stepped in to support the Australian dollar).

It was the worst week since the height of the financial crisis in 2008.

“It was like a perfect storm: there was Greece, the super-profits (mining) tax and a flight out of the euro and the dollar into the US currency,” UBS head of Australian sales George Canaan said.

Analysts are unsure about the future outlook for local equities as investor confidence remains fragile. “There’s clearly been a major reduction in risk appetite globally and it’s difficult to see the situation stabilising in the near term,” said Stephen Halmarick of Colonial First State Global Asset Management.

Richard Gluyas, *The Weekend Australian* – 22-23 May.

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Which shares to buy?

Having the guts to identify, and then buy stocks that will emerge from the current rubble and drag the sharemarket back into the black is always a challenge for investors, but one worth taking because of the potential pay-off.

Richard Schellbach, Citigroup analyst reckons that BHP Billiton, Rio Tinto, Qantas, Wesfarmers, CSL and News Corp have all been sold off heavily in the past month despite some good news on the earnings front, and he sees those stocks as leading the charge when the sharemarket recovers.

Phillip Baker, *The Australian Financial Review* – 21 May.

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