Muslim Business Network

MBN Business News

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MBN brings you the latest business news on a monthly basis.

IN THIS WEEK'S ISSUE

FROM THE EDITOR – the state of the economy

The recovery appears to be gaining momentum despite rising interest rates and warnings that the Australian currency could reach parity with the US dollar early next year. Treasury and the Reserve Bank are predicting that GDP will grow by 2.7% next year and that unemployment will peak at 6.5%. Private economists are predicting that GDP will grow by at least 3.4% next year and by 2.4% this year (compared to official predictions of 1.5%). Westpac are predicting a 4% growth in the economy next year. And despite a surprise decrease in investments, the future investment outlook is very positive.

Underpinning the brighter outlook is strong Asian demand for commodities. The Reserve Bank is also sending positive signals into the market by predicting that the economy has entered a "new upswing", driven by commodities, which would underpin growth for years to come.

These positive recovery signposts have encouraged market speculation that the Reserve Bank will tighten monetary policy by increasing interest rates for an unprecedented third time by 0.25% on December 1. Businessmen are encouraging the RBA to exercise caution and defer any increase to January to avoid tanking Christmas sales.

Interest rate hikes are expected to accelerate next year and settle at 4.25 – 4.5% by mid 2010. These are fairly high increases within a short period of time and could have a major impact on affordability of mortgages by those who have bought homes in the last 5 years.

The RBA is actually in a quandary – if it does not increase interest rates, the low rates will fuel a property bubble and create major housing affordability issues.

Mortgage lending continues to grow and improving house prices are creating wealth for many. First-home owner activity is expected to decline significantly when the grant is withdrawn in December.

Premium retailers are predicting a bumper Christmas, although it is worth observing that a number have commenced discounting significantly and it's not yet December.

One major dark cloud that has emerged is the Dubai debt crisis. This has impacted equity markets across the globe and seriously impacted on global confidence. It has also significantly dented confidence in Islamic finance and specifically the sukuk instrument which certain Muslim economists have previously questioned its validity in Islamic law (as reported by MBN Business News earlier this year).

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AUSTRALIAN ECONOMY

Retail outlook

In editions published last year and earlier this year, MBN Business News noted that the government stimulus paid late last year benefited discount retailers at the expense of premium departmental/retail stores. With the impacts of the stimulus wearing off, analysts are predicting that the discount end of the market will struggle for overall market share this Christmas whilst the premium stores are shaping up to benefit from a bumper Christmas (notwithstanding the impact of any interest rate hikes). This is good news for David Jones, Myer, JB Hi-Fi and Harvey Norman, but bad news for The Reject Shop, Premium Investors, Fantastic Holdings, Speciality Fashion and, to a lesser extent, Woolworths.

In another worrying sign, about 40% of households polled for a consumer sentiment survey (Westpac-Melbourne Institute) said they expected to spend less this year compared with last (again, this is expected to impact discount stores).

Bailey & Baker, *The Australian Financial Review* - 17 November.

Gerry Harvey is very bullish about the Christmas period. "Our sales this year are going to be an absolute record, this is going to be the biggest Christmas we have ever had, we are going to break all records," he said.

Lema Samandar, *The Courier Mail* – 4 November.

(Editor: MBN Business News readers will contrast the statements Mr. Harvey has made this year to the very pessimistic outlook he had this time last year.).

Just Group CEO, Solomon Lew contrasted with Mr Harvey. He indicated that Harvey Norman will have a better second six months as their first six months was so weak. And while he agreed that consumers were buying from retailers that had product, many businesses were heavily discounting stock to boost sales. He said Just Group, which owns brands such as Just Jeans, Jacqui E, Peter Alexander and Dotti, was not prepared to chase sales at the expense of margins.

(Editor: Mr Lew has a point. Some of the discounting currently taking place pre Christmas is better than the post Christmas sales.).

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Fresh upswing points to third RBA rates rise

The chances of another interest rate rise were boosted this week when a senior Reserve Bank official declared Australia's economy had entered a "new upswing" that would underpin growth for years. Economists are of the opinion that better than expected increase in construction volumes coupled with higher predictions of GDP growth signal an unprecedented third consecutive interest rate rise on December 1.

Fleur Leyden, *The Courier Mail* – 26 November & *AAP* – 27 November

Leading Australian businessman Solomon Lew believes an interest rate rise in December could cruel Christmas spending for retailers and the Reserve Bank should hold its fire until the jobs and housing markets stabilise. "The concern is whether the Reserve Bank will be raising rates in December and if they do I think it'll be a dampener (for the retail sector).

Fleur Leyden, *The Courier Mail* – 25 November

The Reserve Bank has acknowledged that whilst it is untenable to leave interest rates very low, there was a risk that raising them too soon could undermine the rebound in activity. "Business and consumer confidence could prove fragile, and economic activity at home and abroad might slow more than expected as the effects of stimulus measures faded. Also, the rise in the exchange rate would constrain output and dampen inflationary pressure." The RBA states. "On the other hand, a lengthy period with interest rates at a very low level carries its own risks, particularly once the threat of serious weakness has passed."

Adrian Rollins, *The Australian Financial Review* - 18 November.

(Editor: A number of retailers have expressed concern about an interest rate hike just before Christmas. This is the time to translate growing consumer sentiment into hard dollar sales rather than potentially 'putting shoppers off'. There is a potential that the RBA may hold off if the Dubai crisis impacts world equity markets. This will be a tough call for the RBA. If they get it right then hey presto we curtail inflation. If they get it wrong we could tank the economy with recovery only likely after the first quarter of next year).

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BHP predicts strong demand for commodities

BHP Billiton's confidence in the resurgence in Chinese demand for commodities is increasing, though chief executive Marius Kloppers still worries that short-term commodity prices might be driven more by financial speculators than real underlying demand.

Mr Kloppers said Chinese demand "continues to surprise on the up-side." "We have no reason to change our long held view that Chinese growth will continue and will continue to be resource-intensive."

He predicted strong demand for coal and iron ore – both power drivers to Australian growth.

Tony Grant-Taylor, *The Courier Mail* - 27 November.

The head of a major Chinese steel group has predicted that iron ore prices will rise by 10% next year. This could fuel iron ore projects in Western Australia.

Stephen Wyatt, *The Australian Financial Review* - 27 November.

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Businesses keep tight hold on cash

Businesses, lead by manufacturers, have sharply reined in capital spending, increasing the economy's reliance on government investment and a recovery in home building for growth. But the surprise 3.9% fall in private expenditure is not expected to be enough to convince the Reserve Bank to leave interest rates on hold when it meets on December 1.

Despite the decrease, increasing confidence in the recovery has encouraged firms to upgrade their investment plans for 2009-10.

Adrian Rollins, *The Australian Financial Review* - 27 November & *The Sydney Morning Herald* – 26 November.

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SMALL BUSINESS

Tax Office targets mounting business losses

Small and medium businesses have been put on notice by the Australian Taxation Office that they will be closely scrutinised for any tax losses claimed.

John Kehoe, *The Australian Financial Review* – 26 November.

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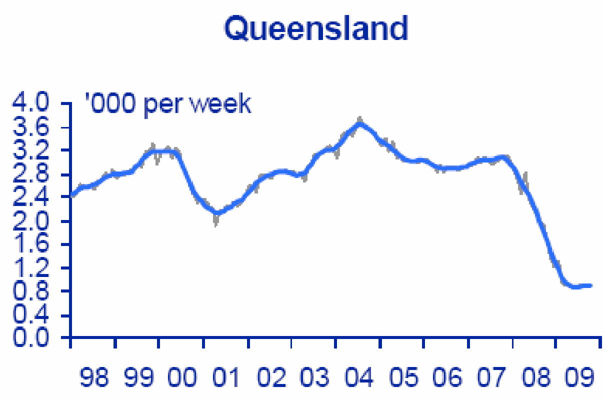
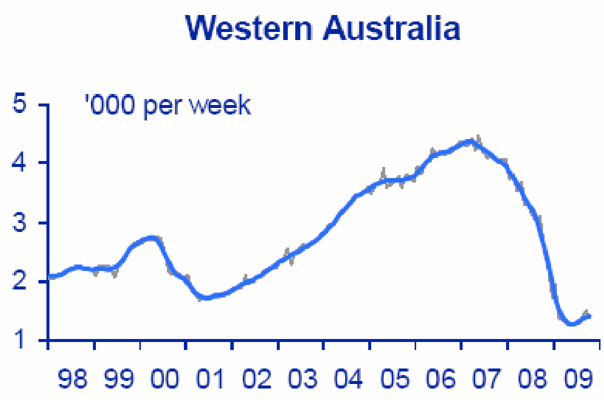
EMPLOYMENT

Job advertisements decline

The ANZ Job Advertisement series released this month showed the total number of jobs advertised in major metropolitan newspapers and on the internet fell by 1.7% in October. This follows a rise of 4.4% in September. Total job advertisements are 6.8% (8,501 advertisements) higher than their cyclical low point in July, **but 42.3% lower than 12 months earlier**.

Trends in job advertising tend to lead actual employment by around 6 to 9 months. As such, it is expected that employment will remain relatively flat during summer with a small increase in unemployment to just over 6.5%





ANZ Bank – Job Advertisements – 9 November.

(Editor: This downturn has been characterised by cuts to hours rather than jobs. I have been recruiting at various stages in the past year and have noted that whilst supply of candidates remains high, the quality of the pool has declined. Economists are of the opinion that it's still too soon to celebrate jobs recovery. But a turnaround is not far off. If commodities continue their growth we could be back to where we were in 2007 by late 2010/early 2011.).

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Working youth may face jobless winter

Youth unemployment has fallen sharply in the past four months thanks to a stronger global economy, federal government incentives to hire apprentices and employers preparing for skill shortages late next year. But economists and recruiters warn of dangers as the effects of government stimulus measures fade and young people hired for the busy Christmas period are dumped on the labour market.

Sam McKeith, *The Australian Financial Review* – 17 November.

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PROPERTY

House prices to rise further but they're worth it, says RBA

Worried about paying too much for a house? The Reserve Bank isn't and it expects prices to climb even further. In a speech that amounted to a defence of Australia's historically high house prices, the Reserve Bank deputy governor, Ric Battellino, told a housing conference this week to expect worse and to recognise home buyers are getting value for money.

He said house prices would be boosted by increased population growth and immigration, solid increases in household incomes and "substantial competition" for construction industry workers from the mining sector.

Peter Martin, *The Sydney Morning Herald* – 26 November.

(Editor: Interest rates are a double edged sword right now. If the RBA does not increase interest rates, there is a potential that continued low rates will create a property bubble with speculators chasing property for capital gains. Perth experienced aspects of this during the recent mining boom, when property prices increased sharply. The RBA has expressed its concerns about this development and will move rapidly. However, with higher property prices, increases in interest rates will have a major impact on affordability.).

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SHAREMARKET

Dubai leads to Black Friday

A fresh wave of fear swept through global financial markets yesterday as the Dubai debt crisis triggered a $35 billion sell-off of Australian shares and sent the dollar plunging more than US2 cents. The sentiment towards equities was expected to worsen overnight, as the early futures market estimated Wall Street would plunge by up to 245 points in one of the worst sessions for six months.

As world markets appeared to be over the worst of the global financial crisis, the revelation that Dubai World, the government investment conglomerate, had requested a standstill on its $US60 billion of debt until next year provided a stark reality check by raising fears of the emergence of a damaging new phase.

The concerns centre on the risk of Dubai, as a sovereign state, defaulting on its debt and triggering a second credit crunch two years after the first sub-prime saga emerged.

Murdoch & Condon, *The Weekend Australian* – 28-29 November

"This is a black Friday for investors," said Macquarie Private Wealth associate director Lucinda Chan. "It's been a blow to market sentiment and confidence has been shaken."

The Sydney Morning Herald – 27 November.

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Stock picking comes into its own

The more than 8 month-long rally in the Australian sharemarket has made it difficult to find undervalued stocks, but some analysts are confident that superior stock-picking skills will help keep portfolio returns in positive territory next year as the global economy recovery remains on track.

Up until the Dubai crisis stocks have barely paused for breath as they have galloped ahead by 50% since March of this year. But while the renewed appetite for equities has yielded double-digit returns, many people are concerned there is limited upside from here on. Instead, investors will have to rely on excellent stock-pickers for the best returns.

Leading analysts are of the opinion that the recent equity rally has returned the market to fair to full valuation levels.

Phillip Baker, *The Australian Financial Review* – 26 November.

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More earnings upgrades on the way

Hot on the heels of a flurry of better-than-expected profit announcements, analysts are expecting more Australian companies to upgrade earnings forecasts as the economy rebounds. Companies such as BHP Billiton, Toll Holdings, Westpac and Wesfarmers top a list of stocks that analysts believe could book large earnings increases, mounting the case (despite the impact of the Dubai crisis) that the rally in certain shares could extend further.

David Ciampa, *The Australian Financial Review* – 26 November.

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PERSONAL FINANCE

Tax cheats exposed

The federal government's guarantee on bank deposits has helped the Australian Taxation Office detect up to 1200 people who were hiding money in accounts in offshore tax havens. Statistics released by the ATO show transactions between Australia and tax havens doubled in October last year, the same month the government introduced the guarantee.

John Kehoe, *The Australian Financial Review* – 25 November.

(Editor: A number of people moved funds onshore (to Australia) when the government introduced the guarantee to protect bank deposits. The ATO picked up on a number of these transactions.).

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GLOBAL ECONOMY

Global economy still vulnerable, warns IMF

The head of the International Monetary Fund has warned that the global economy is still in a “highly fragile” state following the financial crisis, and could face further turmoil in the months ahead. The managing director of the IMF said “Financial conditions have improved but are far from normal. Signs show confidence is returning, but banking systems in many advanced countries remain undercapitalised, weighed down by laden legacy assets and, increasingly, underperforming loans.

Graeme Wearden, *The Australian Financial Review* – 25 November.

(Editor: His warning was made before the Dubai crisis.).

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$US flounders as Fed looks on

The US dollar sank to the weakest in 14 years against the Japanese yen and a 15-month low against other major currencies after the Federal Reserve signaled it would not step in to prop up the ailing greenback. Japan has called for the Chinese to relax its peg to the US dollar which has strengthened Chinese competitiveness to ire of other countries. Russia has began divesting US dollars.

Pip Freebairn, *The Australian Financial Review* – 27 November.

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SPECIAL FEATURE - DUBAI: TEST FOR ISLAMIC FINANCE

A default by Dubai will put the world of Islamic finance to the test at a time when hard questions are being asked by bankers and lawyers about the protection afforded by financial instruments based on sharia law.

The bond that is at the heart of the threat of default and financial ignominy for Dubai is the sukuk, an instrument invented by bankers and Islamic scholars to comply with the sharia prohibition against charging interest.

The concern is that a sukuk does not provide the same legal protection as a traditional interest bearing bond. It is not clear how creditors will rank in an insolvency. In some cases, investors have found themselves competing against other creditors for the underlying assets. To date, the legal structure of a sukuk has never been tested in a court.

There have beena number of high profile failures recently.

Carl Mortished, *The Times* – 27 November.

(Editor: A number of Islamic scholars have questioned the authenticity of sukuks under Islamic law. This is becoming a common investment tool for Muslims seeking an alternative to bonds which attract interest. You need to fully understand all aspects of this type of investment before purchasing these.).

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