

Economic and market developments, April 2010

Below is an edited transcript of a video recorded on 7 April, 2010 by MLC Investment Strategist Brian Parker.

In the last month world sharemarkets have moved higher, corporate debt spreads have narrowed, and oil and key industrial commodity prices have also risen. Broadly speaking, market sentiment on prospects for the global economy has improved over the month, despite the ongoing woes in Greece and other countries on the European periphery. On the economic front, the data released over the month appears to have justified the markets' view. In the US we've seen signs that the labour market is stabilising, incomes are rising, and private spending is starting to recover without the large scale assistance of the Government.

Despite this, the outlook for the US and global economies remains subject to much greater uncertainty than usual. Not all the woes of the financial sector have been resolved, and household balance sheets remain stretched. Consequently, the major central banks, in particular the US Federal Reserve, seem in no particular hurry to start removing the extraordinary monetary stimulus measures that have supported the recovery thus far.

Here in Australia, the economic data has been a little mixed. Retail sales and some housing indicators have been softer, while labour market indicators continue to improve. Business and consumer confidence levels have risen, and house prices have posted solid gains over the year. On the external side of our economy, demand for our key commodity exports has improved, as have the prices we're receiving for those exports. While last year, it was economic policy, both fiscal policy and the impact of sharply lower interest rates that did the heavy lifting in terms of promoting economic growth, this year, investment spending, exports, and a resurgent housing sector are likely to be the key drivers of growth.

This improving outlook for the Australian economy has prompted the Reserve Bank to continue the process of normalising interest rates. In early April, they raised the cash rate by 25 basis points to 4.25% - the fifth rise since October last year. Moreover, they've made it clear there are more moves ahead, although they've also made it clear they're taking into account the levels of key household and business borrowing rates, and not just the cash rate in calibrating monetary policy.

So what does this mean for financial markets?

Barring new shocks, the global economic recovery is sustainable, and we remain in the camp that says the recovery is going to be more modest than usual. Households in a number of economies, as well as financial institutions still have more work to do to restore health to balance sheets, which will tend to restrain spending as well as the demand for and supply of credit. Governments in many economies will be forced to raise taxes, cut spending, or both in order to rein in budget deficits. That an economic recovery is underway makes these adjustments easier, but doesn't eliminate the need for them.

Our medium term estimates of return prospects look reasonable, but prospective equity market returns – both here in Australia and globally - are a little lower than longer term norms. This speaks volumes about how far and fast markets rose during 2009, and how much of the recovery story is already priced into markets.

In previous months I argued the best way to describe the market environment going forward is to say that the easy gains have been made. The huge sigh of relief that investors around the world breathed last year is over. There are still gains ahead, but from here they're likely to be somewhat harder, and markets are likely to be a good deal more volatile than they were for much of 2009.

I'd still characterise the prospective market environment the same way today.

Thanks for listening.

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