

MARCH 2010

- **Global economic recovery stalled by weakness in US and Europe.**
- **Chinese, Australian economies continue to grow.**
- **Equity markets improve but hampered by sovereign debt concerns.**

Global economies

Hopes of a concrete global recovery were hampered in February, with the central banks of the seven richest nations showing little indication of shifting their defensive positions on monetary policy.

It's not known exactly how long this holding pattern will continue, as Governments consider how to depart from the current climate of loose monetary policy, high liquidity and the sale of assets acquired through the global financial crisis.

The Bank of England and the European Central Bank, together with the Bank of Japan and the Bank of Canada, all kept rates steady in February. However, interest rates in these countries may soon be lifted, with less talk of downside inflation risks.

Greece unveiled a third package of budget cuts to meet its commitment to reduce the budget deficit from 12.7% of Gross Domestic Product (GDP) in 2009 to 8.7% of GDP in 2010.

In China, monetary authorities had employed a strategy of improving liquidity in the banking system and stimulating appreciation of the Yuan. More recently however, China has opted to keep the Yuan steady. This decision should continue to support growth but the question of how long China can maintain this policy will continue to be a topical point.

And while the Chinese economy continues to accelerate at an impressive pace, the world's other emerging superpower, India, recorded an easing in economic growth, down from 7.9% to 6.0% in the December quarter (Q4). This drop was largely attributed to heavy monsoonal rains affecting agricultural output.

European growth in the December quarter was weak at just 0.1%, with the German economy particularly flat.

Among the major European economies, only France recorded growth while Spain, Italy and Greece all went backwards. Meanwhile, the UK economy barely escaped being pulled back into recession, recording growth of just 0.3%.

News out of developed Asia has been more positive, with the Japanese economy managing a better outcome last quarter. Recording growth of 1.1% for December, Japan is likely to continue to benefit from growth out of China/Asia as well as the strengthening US economy.

While overall global economic growth has been patchy, some positive data emerged in the news of an almost universal rebound in global manufacturing activity. While it's still early days, it's hoped this is a good indication the tentative global recovery can be sustained.

Equity markets

February was a good month for equity markets, following a weak January performance. While concerns over sovereign debt in Europe remained, Greece's government went some way to restoring market confidence by announcing European Commission-backed measures designed to reduce debt.

Across the Atlantic, equity markets were boosted by suggestions from US Federal Reserve Chairman Ben Bernanke that the US Federal Fund Rate will remain low for an extended period of time.

On the domestic front, the Australian sharemarket appears to be on a firm footing, with a large number of companies' profits remaining solid and economic conditions continuing to improve. However the global outlook will continue to drive market sentiment and continued gains locally will depend on sustained improvement in the US and global economies.

FEBRUARY MARKET PERFORMANCE (table)

Key Indicators Summary

Equity Markets - Price Indices		At Close	% Change	% Change
Index		28/02/2010	1 Month	12 Months
Australia	All Ordinaries	4651.11	1.2%	41.1%
Japan	Nikkei	10126.03	-0.7%	33.8%
Hong Kong	Hang Seng	20608.70	2.4%	60.9%
UK	FTSE 100	5354.52	3.2%	39.8%
Germany	DAX	5598.46	-0.2%	45.7%
US	Dow Jones	10325.26	2.6%	46.2%
EMU*	Euro 100	2146.66	-0.2%	38.8%
World**	MSCI - Ex Aus	814.32	1.8%	43.0%

Property - Price Index		At Close	% Change	% Change
Index		28/02/2010	1 Month	12 Months
Listed Trusts	ASX A-REITS	869.51	-0.2%	30.4%

Interest Rates		At Close	% Change	% Change
		28/02/2010	1 Month	12 Months
Aust 90 day Bank Bills		4.13%	-0.3%	1.0%
Australian 10 year Bonds		5.50%	0.1%	1.1%
US 90 day T Bill		0.01%	-0.1%	-0.2%
US 10 year Bonds		3.62%	0.0%	0.6%

Currency		At Close	% Change	% Change
		28/02/2010	1 Month	12 Months
US dollar	A\$/US\$	0.8957	1.3%	40.2%
British pound	A\$/STG	0.5875	6.3%	31.7%
Euro	A\$/euro	0.6573	3.1%	30.4%
Japanese yen	A\$/yen	79.70	-0.1%	27.8%
Trade-weighted Index		69.50	0.4%	26.8%

* Top 100 European stocks trading on the FTSE

** Source : www.msci.com

Source : Iress Market Technology

Past performance is not a reliable indicator of future performance.

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Australian economy and markets

Economy at a glance

On 3 March, the release of Australian GDP figures confirmed a strengthening local economy. A strong second half of 2009 saw the economy grow by 0.9% in the December quarter, following growth of 0.3% in the September quarter.

While growth was spread broadly across market sectors, it's important to note the impact of fiscal stimulus on results.

For example, December's rapid growth in domestic demand was heavily influenced by the growth in public spending, brought on by various fiscal stimulus measures.

In fact, growth in the public sector was up a sturdy 3.8%, comprised of a 1.8% growth in government consumption (eg public servants' salaries and ongoing running costs) and a 10.2% increase in public investment.

Private demand also accelerated; growing by a strong 1.5%, led by an 11% growth in business plant and equipment investment. Private consumption also grew, and the housing construction cycle got underway with a 1.1% growth in private dwelling investment.

So what does this all mean? In simple terms, of the 2.1% contribution to quarterly GDP growth from domestic demand, public spending contributed less than 1%, while private spending contributed around 1.25%.

In essence, fiscal stimulus was a major direct and indirect support to domestic growth.

The latest Private Capital Expenditure survey points to prospective large rises in business investment.

This survey implies 2009-10 capital expenditure (CAPEX) will be around 1.5% higher than 2008-09. In contrast, the previous survey had suggested a fall of around 3% for this financial year.

For the coming 2010-11 financial year, CAPEX is expected to be 15.3% higher than first estimated for 2009-10; a promising sign.

Looking ahead, the nature of growth is set to change from here on in. Public investment in schools will likely peak by December 2010, while private investment in housing construction and resource-based investment is expected to rise. Improving conditions in the labour market are also likely to support growth in household disposable income and consumption.

At its March Board meeting, the Reserve Bank of Australia (RBA) resumed its tightening cycle. Following a pause in rate movements in February and no scheduled meeting in

January, the Board voted to raise the cash rate by another 25 basis points to 4%.

The decision to raise the official rate was based squarely on the strength of the domestic economy. Particular mention was made of the falling unemployment rate, down to 5.3% and now within sight of the target unemployment rate of less than 5%.

Several business surveys confirm the RBA's rationale and "suggest growth in the economy may have already been at or close to trend for a few months".

Other positive factors cited by the RBA included strong resource investment, solid housing credit growth and rising house prices.

The release of December quarter national accounts validated the RBA's decision, with quarterly growth right on market expectations.

Importantly, the RBA also noted improved conditions in business credit. This welcome sign was a more positive view than a month ago, where an entire paragraph was devoted to the subject in the Statement on Monetary Policy as justification for its 'on hold' decision.

Australian dollar (AUD)

February was another strong month for the Aussie dollar, which reached a high of 90.71 US cents. This was largely influenced by RBA Deputy Governor Ric Battellino's speech on 23 February which provided an upbeat assessment of Australia's growth prospects courtesy of the mining boom.

Global economies and markets

US

Economic data out of the US has been somewhat patchy over the past month, following very strong growth in Q4 2009.

On the upside, the manufacturing index which historically, has been a good leading indicator of overall GDP growth, increased in January.

This improvement is consistent with above-trend levels of economic growth. On the downside, some key indicators have moved backwards in recent months.

Consumer confidence fell by over 10% in February to its lowest level since April 2009, less than half normal levels. Meanwhile, the recovery in the housing market looks to be stalling, with both new and existing home sales falling sharply in January.

Fuelling more concern is the perception of continuing weakness in the labour market despite strengthening GDP growth. Payroll employment fell by a further 20,000 jobs in January, and while the unemployment rate fell modestly to 9.7%, it's still far too early to tell if the employment situation is improving. In fact, claims for unemployment insurance have increased since early February, signalling another month of net job losses.

All up, this data seems consistent with NAB Wholesale Banking (NAB's) long-held view that while a recovery is in motion, it'll be subdued compared to historical standards. GDP is expected to grow by 2.5% in 2010, and accelerate to around 3% in 2011.

Another note of concern is the possibility the Fed may be looking at a rate rise while the US economy is still considerably fragile despite past indications that the funds rate will remain low for an extended period of time. This speculation is fuelled by suggestions the Fed has been canvassing options for its exit strategy from the extraordinary policies instituted through the financial crisis, as well as its decision to tighten the terms of its discount window lending programs.

China

Given the difficulty in obtaining meaningful business activity data during Chinese New Year, there will be a focus on the policy stance within China throughout March. Overall, macroeconomic policy has been tightened, which seems appropriate given the rapid pace of activity, emerging inflation and fears of unsustainable growth in the housing market.

However, NAB's view is that the reaction to recent policy tightening by markets has been overly negative. Monetary policy remains highly supportive of growth, and there's scope for continued expansionary fiscal policy. Further, the many ad-hoc administrative adjustments have been largely aimed at the housing market, which in itself, is unlikely to result in a broader economic slowdown. The obvious risk is that authorities tighten too soon, or too aggressively. Monetary policy is expected to tighten through 2010, with economic growth sitting at 9.25%.

While there is room to further stimulate growth, monetary policy remains expansionary despite some tightening in the reserve requirement ratio.

Fiscal policy appears to have been less expansionary than expected in 2009. The general government deficit was around 2.25% of nominal GDP (GDP which does not factor in inflation), compared with the official projection at March 2009 for a deficit of around 3%. Expenditure growth was broadly in line with expectations, while revenue growth was stronger than projected. This probably reflects the impact of a more rapid economic recovery than anticipated, resulting in higher tax revenue. More importantly, it suggests a healthier fiscal position, enabling further stimulus to be delivered this year if required.

Japan

Economic activity in Japan has continued to improve, supported by stimulus measures and better conditions in trading partner economies. This is in contrast however to the underlying weakness in domestic demand.. NAB forecasts growth of 2.25% in 2010 and 2.5% in 2011.

GDP increased by 1.1% in the December quarter, following negligible growth in the prior quarter. While caution is required in interpreting quarterly GDP data, the recovery to date has been small relative to what's required to make up for the previous declines.

The Japanese economy has expanded by around 2.5% since March 2009 following a peak to trough decline of more than 8%. Deflationary pressures persist with the Consumer Price Index (CPI) falling by 0.2% in January and by 1.2% over the year.

Stronger external demand has been an important source of stimulus for the economic recovery, contributing 2.5% to GDP growth over the past three quarters. Export volumes have risen since March 2009, led by higher demand from regional trading partners. Imports, on the other hand, have increased only marginally.

Europe

Sovereign debt concerns continue to cloud the economic scene in Europe. Greece remains the key source of trouble, in addition to concerns of problems spreading to Spain, Portugal and Ireland. Despite reports of a financial rescue plan the region is likely to remain unstable for some time yet, given the scale of the structural adjustments required.

Problems in Greece have been compounded by a generally weak round of data in the broader region. Euro-area GDP increased by just 0.1% in Q4 2009, down from growth of 0.4% in Q3. Of the major economies, France was the only one to record reasonable growth of 0.6% for the quarter. Germany recorded a particularly flat outcome, while GDP in Spain and Italy declined.

Partial data for some of the larger economies in the region suggest moderate economic conditions continued from December until now. In Germany, the business survey recorded a drop in business conditions. Meanwhile, the investor sentiment index fell for the fifth successive month.

More broadly, the area-wide manufacturing index was stable in February, consistent with positive but modest GDP growth.