Zenith Monthly Economic Report

October 2010

ECONOMIC STATISTICS SUMMARY

	Cash Rate		Inflation Rate (%)		Unemployment Rate (%)		GDP Annual Growth (%)	
Country	Latest	Last Change	Latest	Month	Latest	Month	Past Year	Last Update
Australia	4.50	+0.25 (Apr-2010)	3.10	Aug-10	5.10	Sep-10	3.30	Aug-10
USA	0.25	-0.75 (Nov-2008)	1.30	Aug-10	9.60	Sep-10	3.00	Aug-10
Japan	0.10	-0.20 (Nov-2008)	-0.90	Aug-10	5.30	Aug-10	2.40	Aug-10
UK	0.50	-0.50 (Feb-2009)	4.70	Aug-10	7.80	Jun-10	1.70	Jun-10
China	5.31	-0.27 (Nov-2008)	3.50	Aug-10	NA	NA	10.3	Jun-10

AUSTRALIAN ECONOMIC COMMENTARY

On October 5, the RBA elected to leave the cash rate hold at 4.50% for the fifth consecutive month. This decision went against expectations of a 25 basis point rise. Commentary from the RBA suggests that we may see future interest rate decisions weighted more on global economic news rather than domestic data. The uncertainty in global financial markets, modest growth prospects in Europe and the US, and expectation of slower growth in 2011 were all cited as contributing factors in the decision. Essentially, the domestic data is not compelling enough to raise rates...yet.

All indicators suggest that we are heading into a rising rate environment, with inflation remaining at the top of the long term range, and employment remaining near capacity. However, continued rate rises will have their greatest effect on consumer confidence and retail spending. Given Australia's two speed economy, the RBA will need to carefully manage future decisions. Whilst cooling the overheated mining sector may keep inflation in line, it could inadvertently weaken the outlook for retailers regardless of the upcoming Christmas season. Retail has shown improving sales data for the last two months, but despite low unemployment rates and improving wages, consumers are still opting to save their money in anticipation of rate rises. Furthermore, our main trading partner China continues to expand, fuelling the mining boom which will further add to inflationary pressures, as the Chinese struggle with their own inflation problems.

The Australian dollar hit a 28 year high last week, almost reaching parity with the USD. This presents a mixed pattern for the economy. Typically, it means lower profits for exporters, particularly the global miners, leading to lower terms of trade. If the rise in AUD is sustained, this can reduce the budget surplus, as well as lower growth rates and inflation. It will be interesting to see how this impacts the proposed resources rent tax.

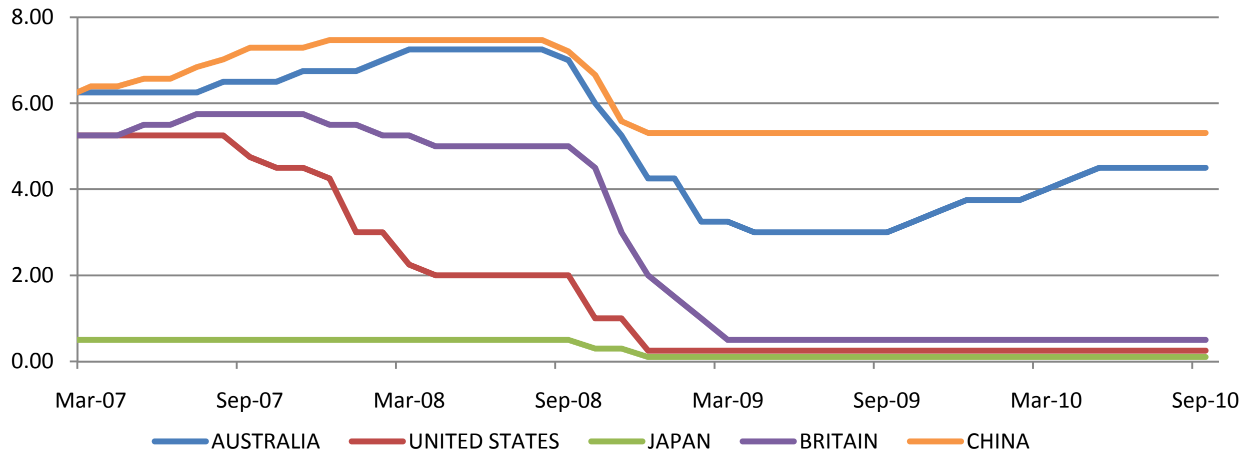
GLOBAL ECONOMIC COMMENTARY

Just like Australia, the rest of the world intently watched China for signs of a slowdown. Instead, August data revealed the fastest inflation rise in two years and the CPI rose for the tenth consecutive month. Strong manufacturing data shows that China's demand for commodities is as insatiable as ever. Overall, the GDP is set to rise to 9.5% for the year, up 0.4% from 2009. The IMF believes that growth will be 10.5% this year, and 9.6% the next. This can only bode well for the Australian economy. It is has become more than apparent that the Australian economy is much more linked to China and Asia. The old adage 'the US economy sneezes and the rest of the world catches a cold' is no longer true for Australia. Given the state of the US economy, this is very good news!

Whilst most of the US data remains mixed, it is clear that the risk of a double dip recession is abating. Instead, most economists predict long periods of stagnant growth. The upcoming news is that the Fed may introduce quantitative easing (QE) measures in early November. QE is a monetary policy employed by central banks to increase the supply of money by increasing the excess reserves held in the banking system. It is sometimes referred to as 'printing more money' although it actually involves asset purchases. This policy is typically invoked when the usual methods to control the supply of money have failed; usually the cash rate is at, or close to zero. The primary goal is to lower the chance of deflation and raise asset prices. This anticipated move has attracted widespread criticism. From the data that follows in this report, we can see health of the US consumer is paramount to the recovery. US retail sales figures remain weak as the average consumer continues to deleverage, and unemployment rates remain close to 10%. Another 95,000 jobs were lost this month according to the non-farm payrolls data. At the most simple level, people cannot spend money if they are not earning money. Compounding the problem is the aftermath of the housing bubble. With their assets devalued and illiquid, people are unable to sell their houses and relocate to find work. What the US economy really needs is measures that will generate jobs.

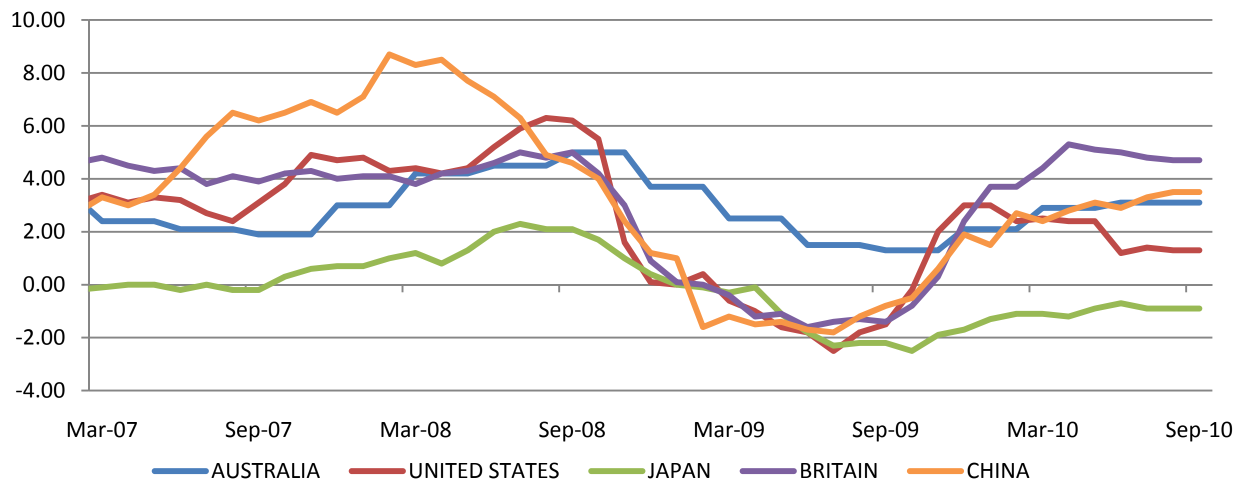
Last but certainly not the least, Europe remains the strongest threat to the global economy. Whilst growth is slowly improving, unemployment remains high. Furthermore, the sovereign debt crisis dramatically raised debt to GDP ratios. The effect of this is that governments will curtail spending for a number of years in order to repay the debt. The central banks have loosened monetary policy so greatly that they are left with no further options to stimulate the economy. The European reality will be one of slow growth over a number of years. However larger economies such as France and Germany are showing improved numbers. Interestingly, the Europeans are now adopting the 'two-speed' economy as a collective descriptive term. Overall, European growth is predicted to reach a mere 1.5% for 2010.

CASH RATES



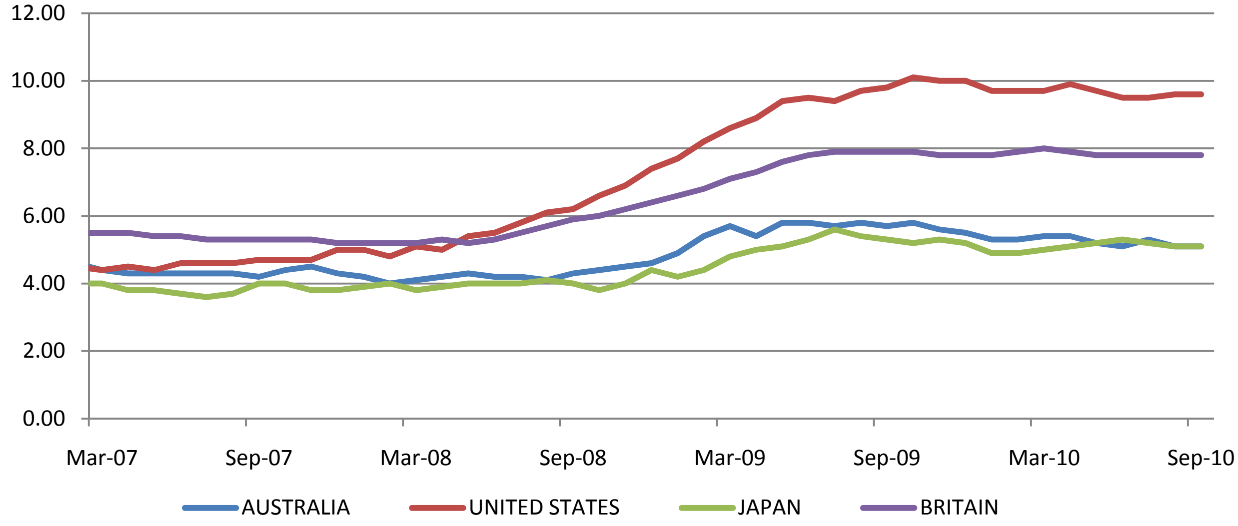
Most central banks kept cash rates on hold, reflecting uncertain global growth projections. The Bank of Japan cut rates to between zero and 0.1, whilst pledging to buy USD $60 billion in assets in an attempt to stimulate the economy. We do not expect to see a move in US rates until the second half of 2011 as deflation remains a risk; Britain will likely follow suit. Australian rates are almost guaranteed to rise soon, with predictions for the first rate rise next month. Australia remains attractive for international investors offering strong yields on cash and bonds and this foreign interest helps keep the dollar elevated. In stark contrast, anticipation of planned US quantitative easing measures saw 10 year treasury bonds yields drop below 2.3%, a new record low. The higher domestic interest rates will support the Australian Dollar's rise against the US dollar, now tipped to reach parity very soon after almost achieving this milestone recently.

INFLATION RATES (ANNUALISED)



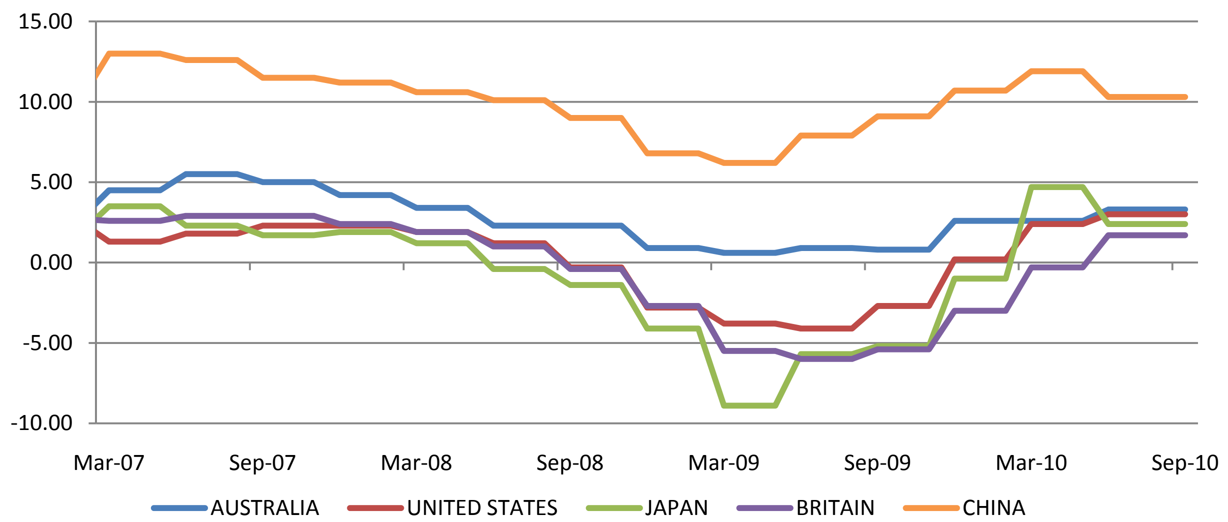
Australian inflation rates remain at the top of the long term target range. New inflation figures are due for release next month, and a further rise will almost certainly propel the RBA to increase the cash rate. The US rate has dropped again, down to 1.30%. Japan remains in a deflationary environment. UK rates remain comparatively high at 4.8%, well above their long term target of 2.0%. China's inflation rate remains stable at around 3.3%, above their long term target range. China has not raised interest rates post the GFC, so this may be first government measure to curb inflation.

UNEMPLOYMENT RATES



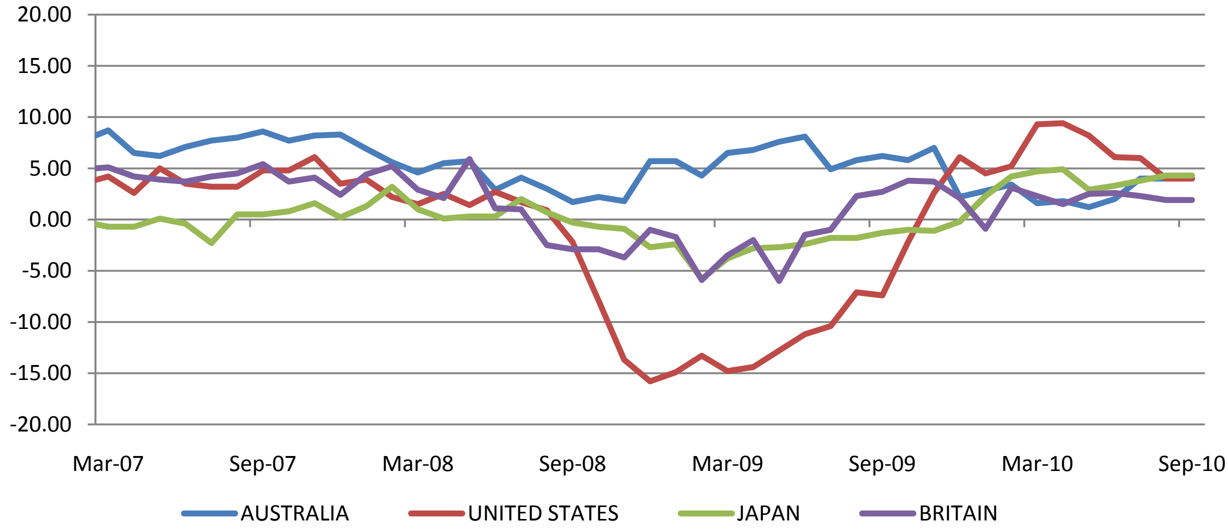
Australia's unemployment rate stayed steady at 5.1% although actual job numbers increased. This reflects continued strength in the labour force and it will be a key factor in future RBA decisions. US non-farm payroll data confirmed fears of significant job losses as 95,000 jobs were shed. Private employers increased employment, but the data was weaker than last month. Whilst the unemployment level remained the same, the data will reinforce expectations that the Federal Reserve will embark on a second round of quantitative easing next month. The UK's unemployment rate remains static at 7.8%, whilst Japan hovers around historically high levels.

GDP GROWTH (ANNUAL)



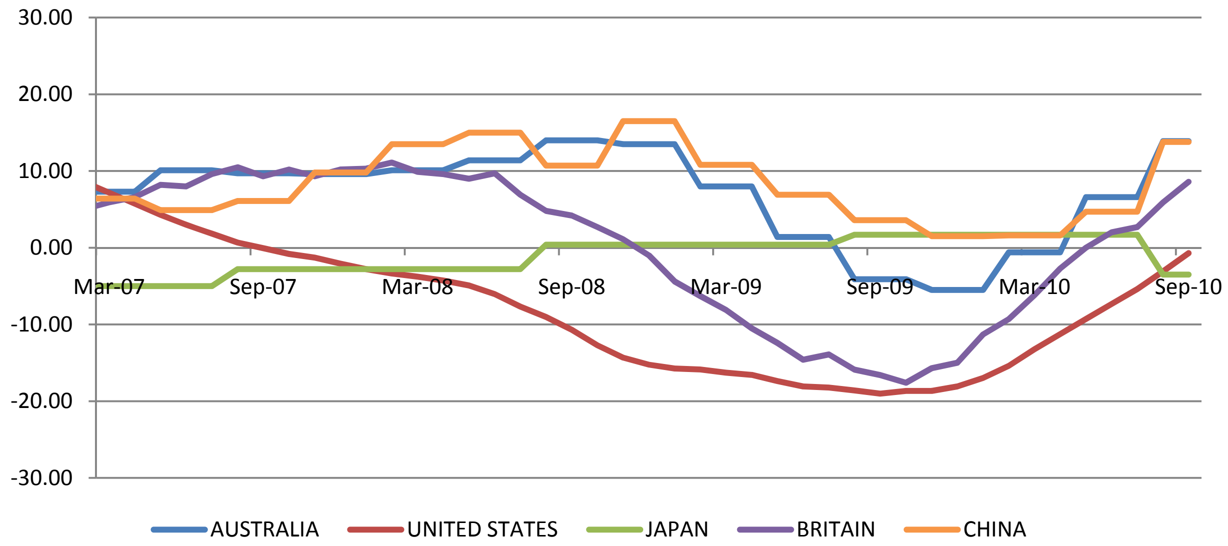
Annual GDP figures should be updated soon after Q3. The prospects for our ongoing growth going forward received a boost with the announcement that China is expecting its 2010 GDP to increase to 9.5%, despite fiscal contraction policies. Even with increased infrastructure spending, US growth is tipped to slow further. US growth predictions have been revised downwards to 1.6% from 2.4% continuing the lacklustre and painfully slow recovery. Whilst fears of a double dip recession have abated, it is becoming clear that future growth will be slow and incremental. In Q2, the British economy grew 1.1% - sadly, its fastest growth rate in four years. The prospects for growth going forward highlight the contrast between the developed world and the developing world, each of which exhibit very different characteristics. Exposure to emerging market investments may be the best way to achieve good growth in the medium to longer term.

CHANGE IN RETAIL SALES – ROLLING 12 MONTH CHANGE



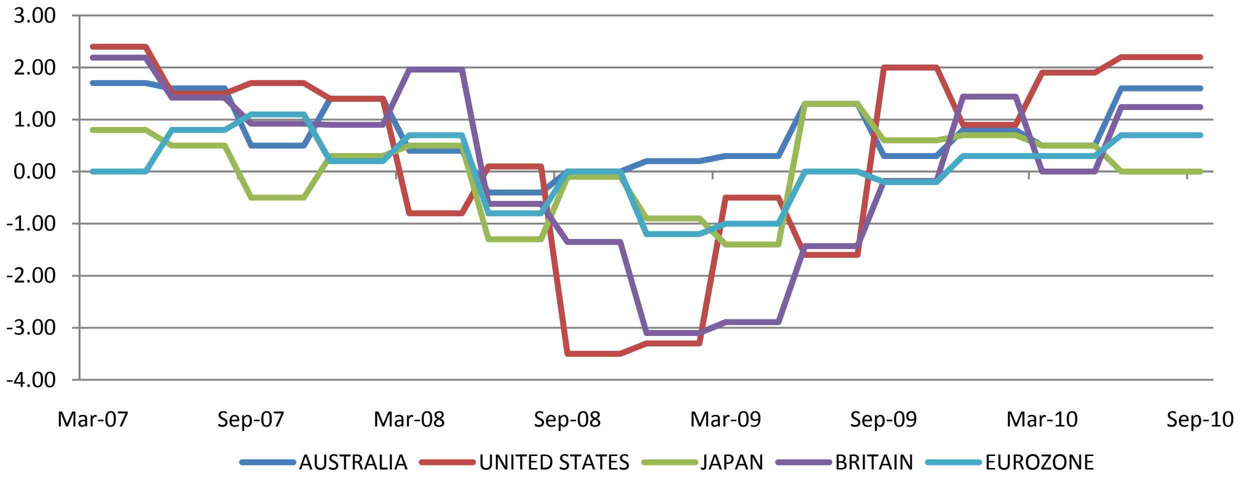
Another round of data showing improvement in retail sales added strength to the domestic economy, and may spur the RBA to increase rates. This continues to reverse the trend of previous months. On a year on year basis, Australia's sales remain the lowest of the countries displayed in the graph. US retail sales remain flat – the world's largest consumers have stopped buying, affecting most economies. Combining this data with the unemployment rate tells the story; the unemployment rate is probably the key metric to follow in the recovery. Consumer strength and retail spending will not return until employment improves. Add in house prices, and you have a vicious circle – people cannot move to states with jobs because they cannot sell their houses.

HOUSING PRICES – ROLLING 12 MONTH PRICE CHANGE



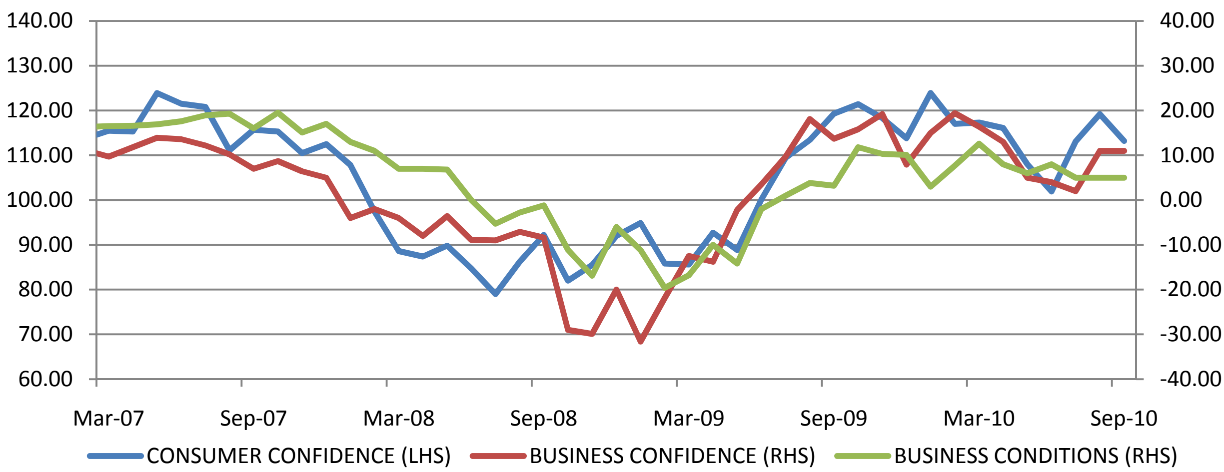
Australia and China's housing prices remain consistently high, reflecting higher levels of growth, unemployment and consumer confidence. The chart illustrates a very close correlation between Australian and Chinese property prices, highlighting the relative strength of both economies. US house prices remain in negative territory. Will the likely second round of quantitative easing raise asset prices and encourage Americans to refinance their homes? Currently, a massive 25% of housing loans are in negative equity. UK prices have pulled back after significant rises, correlating with their high inflation rates.

HOUSEHOLD CONSUMPTION – QTR ON QTR CHANGE IN HOUSEHOLD EXPENDITURE



Household consumption remains flat globally as consumers continue to deleverage. Sovereign debt concerns will keep European consumers quiet for some time to come. Again, consumption data will only increase when employment conditions improve and consumer confidence rises. If Australia's reserve bank lifts the cash rate In November, this may adversely affect both consumption and retail spending.

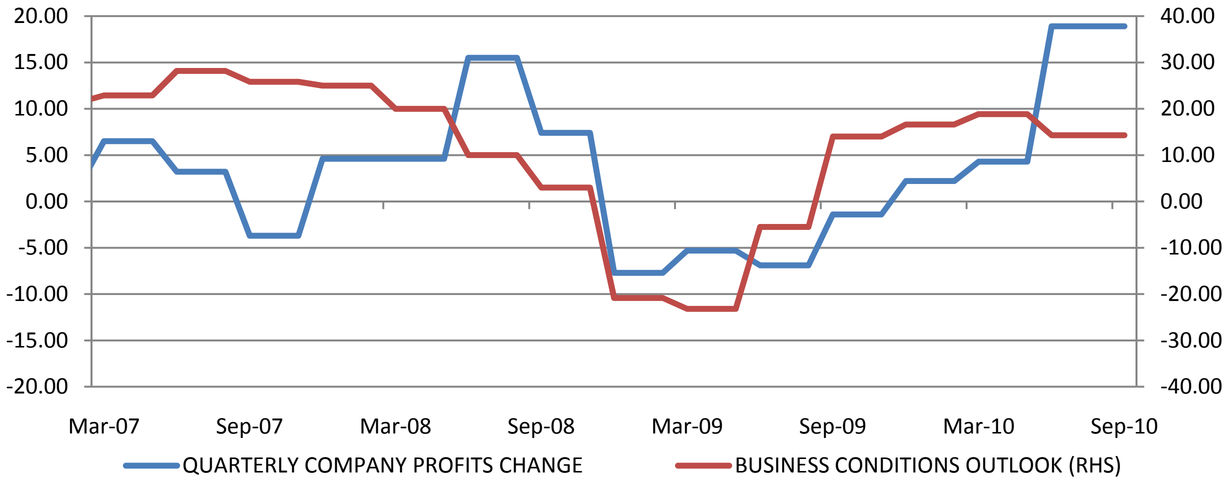
CONSUMER & BUSINESS CONFIDENCE / CONDITIONS



Consumer confidence fell in September by 5.0%, reversing most of the 5.4% gain from August. Behind this fall may be the realisation that interest rates must begin rising soon. Adding to the woe is the uncertainty surrounding the minority government, and its ability to pass legislation – at least in the original format. All components of the index fell, including an above trend drop of 7.2% in expectations of economic conditions, despite the strong data. Clearly Australians believe in gravity – what goes up must eventually come down. When the index sits above 100, it indicates that there are more optimists than pessimists so at 113.2, this is still positive news.

Business confidence increased in August, reaching the highest level in four months. On the other hand, business conditions remained subdued. Interestingly, the weaker sectors of the economy including manufacturing and construction showed a turnaround in confidence, whilst mining and finance deteriorated. Retail remains the least confident sector of the economy.

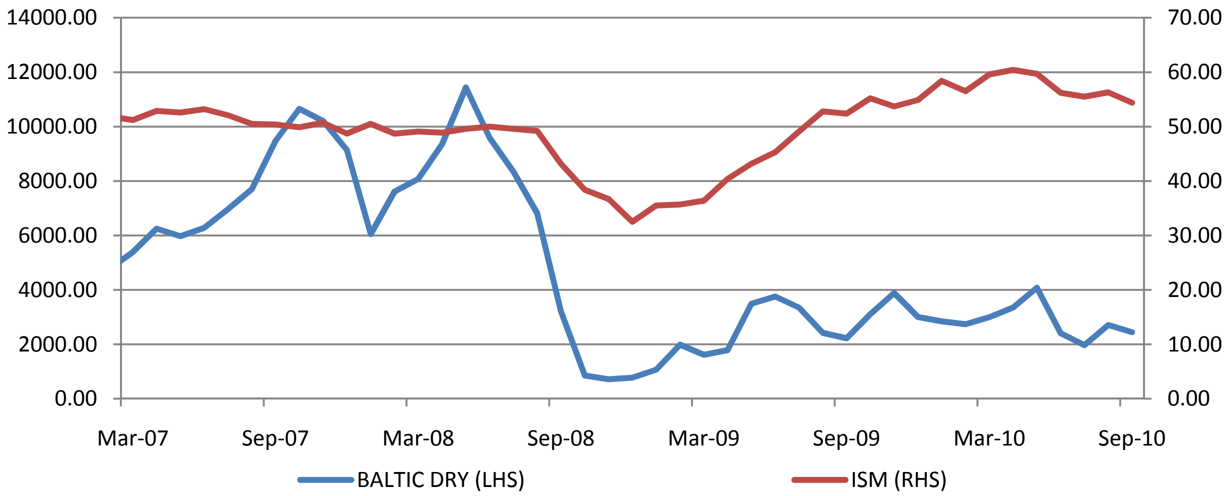
COMPANY PROFITS – QUARTER ON QUARTERLY PROFIT CHANGE & BUSINESS CONFIDENCE OUTLOOK



The business confidence outlook declined in the June quarter, although it remains positive overall. Q3 figures are expected soon. Overall confidence is still strongest in mining, manufacturing and finance, and weakest in construction, recreation and the retail sectors. The Q3 data will incorporate business sentiment after the federal election and could prove to be an interesting result.

Company operating profits lifted 18.9% in Q2. Impressively, profits rose in 9 out of the 15 industry sectors, with mining a clear leader, up 62.7%. The Q3 data should be released soon to offer an insight into corporate health.

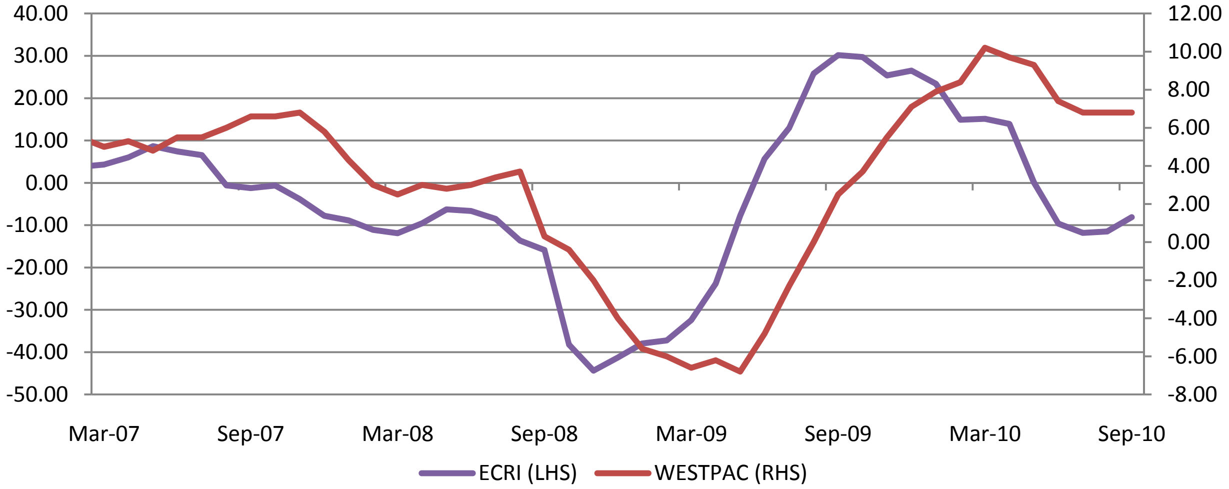
LEADING INDICATORS – BALTIC DRY INDEX & ISM MANUFACTURING SURVEY



Unfortunately, this month we see the downward trends continue in the leading indicators. The Baltic Dry Index (BDI) tracks international shipping prices for various dry bulk cargoes. As the supply of ships is relatively inelastic, the BDI indirectly measures global supply and demand for shipped bulk commodities such as coal, iron ore and building materials. Since it measures demand for raw materials, it is regarded as a leading economic indicator for growth. After a short lived rise due to the completion of new ships commissioned during the boom, it continues to fall, reflecting reduced demand for commodities, and by implication reduced global growth.

ISM Manufacturing surveys its member companies to rate US manufacturing activity levels. Typically, fluctuations in manufacturing greatly impact the GDP, so this survey is a leading indicator of economic turnarounds. It is highly valued as the earliest data figure released each month. Values over 50 indicate expansion; values below 50 indicate economic contraction. The ISM data graphically highlights the manufacturing-led US recovery. Unfortunately, it is also beginning to highlight that the manufacturing recovery has run its course. At 54.4, the indicator still suggests an expansionary economic environment. Yet as inventory re-stocking, the key driver of the above trend expansion, concludes, it is quite possible that the only way forward is down.

LEADING INDICATORS - WESTPAC LEADING INDICATOR (AUST) & ECRI WEEKLY LEADING GROWTH RATE (US)



The Westpac Leading Index indicates the likely pace of economic growth 3 to 9 months into the future. Whilst this data has remained static over the last few months, the chart illustrates the likelihood of strong economic growth. Whilst it has peaked this year, in absolute terms it remains high at 6.80, well above the long term predicted growth rate of 3.0-3.5%.

The ECRI Weekly Leading Growth Rate is a predictor of economic growth in the US. It is the earliest economic figure released each week and is therefore closely monitored. As illustrated, in recent months the downward trend has reversed. Values under 10 are a strong predictor of recession; it currently sits at -8.14 after rising from its recent low of -11.84. No more double dip recession! Whilst this is definitely a positive trend, it certainly goes against the grain of the other US data.

Author:

Angela Burmeister
Investment Analyst

Zenith Investment Partners Pty Ltd

(03) 9642 3320
angela.burmeister@zenithpartners.com.au

DATA SOURCE: BLOOMBERG

BLOOMBERG DATA SERIES

CHART	BLOOMBERG DATA SERIES
CASH RATES	Australia RBA Cash Rate Target
	Federal Funds Target Rate US
	Bank Of Japan Target Rate of Unsecured Overnight Call Rate Expected
	UK Bank of England Official Bank Rate
	China 1 Year Best Lending Rates
	ECB Main Refinancing Rate
CPI	Australia CPI All Groups Goods Component YoY
	US CPI Urban Consumers YoY NSA
	Japan CPI Nationwide YoY
	China CPI YoY
	UK RPI YoY NSA
GDP	Australia GDP SA YoY
	GDP US Chained 2005 Dollars YoY SA
	Japan GDP Real Chained NSA YoY%
	UK GDP Chained GDP at Market Prices YoY
	China GDP Constant Price YoY
UNEMPLOYMENT	US Unemployment Rate Total in Labor Force Seasonally Adjusted
	Australia Labor Force Unemployment Rate SA
	Japan Unemployment Rate SA
	UK Unemployment ILO Unemployment Rate SA
RETAIL SALES	Australia Retail Sales YoY SA
	US Adjusted Retail & Food Services Sales Total Yearly % Change SA
	Japan Retail Trade YoY NSA
	UK Retail Sales All Retailing Sales Per Week Chained Volume YoY SA
HOUSE/LAND PRICES	Australia House Price Index Established Homes YoY 2003-2004=100
	S&P/Case-Shiller Composite-20 City Home Price Index YoY (US)
	Japan Land Prices Nationwide All YoY%
	UK Nationwide House Prices All Houses YoY NSA
	China Land Transaction Price YoY
HOUSING APPROVALS	Australia Building Approvals Dwellings YoY
	US New Privately Owned Housing Units Started by Structure Total SAAR YOY
	Japan Housing Starts YoY NSA
HOUSEHOLD CONSUMPTION	Australia GDP Final Consumption Expenditure Households QoQ SA
	Eurostat GDP Constant 2000 Prices Eurozone Household Consumption Expenditure QoQ
	Japan GDP Chained Real Private Consumption QoQ% SA
	UK GDP Final Consumption Expenditure Chained Prices Household Expenditure QoQ
	GDP US Personal Consumption Chained 2005 Dollars % Change SAAR
COMPANY PROFITS & BUSINESS OUTLOOK	Australia Comp Gross Operating Profit QoQ Chg Seasonally Adjusted
	National Quarterly Business Survey Business Confidence Outlook SA
CONSUMER & BUSINESS CONFIDENCE	Westpac-Melbourne Institute Consumer Confidence Consumer Sentiment
	National Australia Bank Business Indicators Business Confidence SA
LEADING INDICATORS	Baltic Dry Index
	ISM Manufacturing PMI SA
	Australia Westpac Leading Index Annualised Growth YoY%
	ECRI Weekly Leading Index Growth Rate