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Woodhall's Wrap

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The Big Picture

October was the month of wars - currency and trade. Since everyone wants a lower currency to help exports - and a race to the bottom means nobody wins - there have been some cunning ways to disguise true intents from all the major countries.

Quantitative easing (QE2) - the buying back of bonds - aids a devaluation. In possible retaliation, China has put quotas on rare earths - the life blood of modern technology (see FAQ question 5) and a lot of countries have been caught with their pants down. The US, as always, has a unique ability to distinguish between what others think of as a US breach of the WTO rules and what it thinks is simply managing its economy well. Russia has new quotas on wheat exports.

It took the RBA statement - and no rate rise - on October 5th to bring home the link between rates and currencies - thus spoiling the parity party revellers. Our dollar did climb above parity for 10-15 seconds - not enough for a celebratory drink - more a quick sip. A high dollar hurts most of Australia. Exporting and import-competing industries are hurting. But the RBA seems to have all under its control. Rates might go up on Melbourne Cup Day but that is no longer a foregone conclusion especially as inflation came in on the low side. Rates will still be higher next year but rises will come in an orderly fashion.

An analyst with a great name for finance, Ed Ponsi, said on CNBC, "What is there to not like about the Australian economy?" We had a massive jobs report early in the month. 49,500 new jobs when 20,000 were expected. More importantly there was a cut in part-time work (-6,000) and an increase of nearly 56,000 in full-time.

There have been some welcome signs of growth in the US. A good earnings season, consumer confidence up, 10% increase in existing home sales but it is not all beer and skittles. The embryonic strength is lowering the expectations of QE2 and keeping the greenback afloat.

The IMF has done a couple of things this month. It reaffirmed strong but not spectacular global growth expectations (4.2%) and it redistributed some its votes from Europe to Asia - funnily enough leaving the US where it was - so better representing views in the currency war.

All the action starts on November 2nd. The Melbourne Cup, the RBA board meeting, the US mid-term elections. Many expect the next day to start QE2 in the US and a bump-up in equities. At least there is a sense of humour creeping back to fill the black void that was the GFC. In October, an illiterate clown was elected to the Brazilian Congress with twice the votes of the others. It was a much closer thing in this country! And the Soc Gen rogue trader was sentenced at last. Three years in prison and a $A7,000,000,000 fine. Unless he can get a good job when he comes out, it looks like a quick case of bankruptcy.

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Asset Classes

Australian Equities

After a wobbly start to October, some good news helped the ASX 200 above 4,700. It is still a resources-led boom but broker expectations are getting quite solid. It looks like an above average 12 months ahead with industrials, consumer staples helping resources and the rest of the market along. Although the banks are coming in with nice profits, growth is less strong in this sector unless they can tackle the anti out-of-cycle-rate-rise mentality.

Of course there is no more reason to tie our mortgage rates to the RBA rate than a Big Mac price should be tied to beef prices. Most of the funding for our banks comes from overseas and they don't have much regard for what the RBA does - and there isn't much beef in a Big Mac.

Foreign Equities

The double dippers have left the arena (the sane ones anyway). The third quarter US earnings season went off quite strongly - again. At one point 80% of companies had beaten broker forecasts. If the Democrats do well in the November 2nd mid-term elections, the Dow is thought likely to fall. But that option seems about as likely as our Julia and Tony agreeing on how we should 'move forward'.

The 23rd anniversary of the1987 crash came and went with no alarm. Volatility in markets has largely returned to moderate levels. The VIX, measuring implied volatility in options markets, fell below 20% - the high end of the good ol' days. The ducks are in a row for markets to get a new leg up but it will need some strong positive news. QE2 - or the so-called 'Bernanke put' - is thought to be underpinning the downside. The is a sense that governments are starting to cope with co-operation but it is still a Germany (austerity package) against a US (ease the money supply) policy tussle. Perhaps there is room for both in the short term?

Bonds

Bond stories have been few and far between - other than the quantitative easing in the US and UK which is a buy-back scheme for treasuries in those countries. Talk of bonds being 'toppy' seem to have subsided.

Interest Rates

Before the October meeting of the RBA (5th) everyone was seemingly pricing in a rate rise on that day and almost certainly in November if that didn't eventuate. Amazingly, the pricing for a November rise, following the no-change in October, fell close to zero. As the month progressed, some confidence came back into the market but a Melbourne Cup Day increase was seen to be about fifty-fifty until the CPI came in low. It is hard to see a rate rise now before Christmas. Most of this wavering in expectations seems due to the fact that the RBA strongly acknowledges the impact of a rate rise on our dollar and its impact on the export sector.

Currency

They had a 'parity party' for the Aussie on 18th October which lasted only 15 seconds. The dollar reached $US1.0003 before retreating below 98c a couple of days later. The US quantitative easing is designed to devalue the greenback so it might be a while before our dollar gets back to its normal range 70c - 85c. Many commentators have switched to a range of 90c - $US1 but some are still thinking as high as $US1.10.

Oil

After some time in a range of $70 - $80 the price jumped above $80 at the start of October and seems to be range-trading $80-$85. Presumably US demand would have to come back strongly for the price to jump much higher. That seems a while off.

Gold

Gold reached $1,376 before taking a slight pull back. With embryonic signs of life in the USA, a more significant pull back could occur before too long.

Other ...

Copper, a good barometer of real demand - as opposed to speculative or comfort demand - has reached close to all-time record prices. While some of this gain in price is due to the weakness of the greenback, much is due to China and beyond.

Regional Analysis

Australia

Some sense of relief has come over the commentating community. Jobs growth is particularly strong, inflation came in at the low end of expectations, rates are less likely to rise because of the damage they do to our dollar and the export community, and property prices are in check without any serious risk of a non-existent bubble bursting. It is hard to think of what our next problem is likely to be. Steady as she goes.

The jobs data does deserve some special examination. Going into the GFC lots of part-time jobs replaced full-time and unemployment only rose slightly. Now, in this time of strength, we are losing part-time jobs and increasing full-time. Nearly three times the number of full-time jobs than expected were recorded this month. This growth cannot go on successfully without a policy response.

Of course we still have a minority government that is struggling to get runs on the board. Thankfully we are bowling at the moment so the economy can jog along at above-trend growth but the jobs situation is probably more important than carbon pricing and the NBN put together.

China

China - you have to admire them not least of all for their ability to manage the economy when all around was in disarray. Their growth came in at 9.6% - just the right side of double figures - with inflation only a tad high at 3.6%.

Of course the world markets got spooked when China raised interest rates by 25 bps - their first rise since 2007 - because no one was expecting it. They are in control. They even slapped a 3% premium on retail fuel to better control the economy. The big danger though is respect.

Obama can't control himself when it comes to berating others. Getting stuck into China over exchange rates produced a nice little retaliation on the export of rare earths to the US for its weapons of controlled destruction (see FAQ, question 5). It will probably be settled in a reasonable fashion but the warning bell was rung.

U.S.A.

Amazingly, some good news has been coming out of the US. Yes there is no jobs growth and the over-supply of housing is enormous. But there are signs of life, so much so that Consumer Confidence actually rose.

With Obama's rating at its lowest ever, and an election only a day away, his support base is evaporating. Could he even be a one term President like Jimmy Carter - and Jimmy was only brought in to deflect derision of the Office after the Nixon exit.

Europe

The European trade unions are still struggling to take their medicine over getting out of the GFC. Many countries are adding a couple of years to retirement ages. Since many of the new limits are below 65 and we just meekly accepted an increase from 65 to 67, it makes you wonder what people are really thinking. Hang on - we didn't even have a recession!

With Europe firmly fixed on austerity packages to reduce deficits in a reasonable fashion, it makes one think what the US will do when it counts its debt. If Europe can manage their peoples through the recovery while the US just prints money, how long will it take for the US to lose its status as the world leader?

Rest of World

The rare earth trade war has caused the likes of Japan, South Korea and Vietnam to start looking for solutions together. This squabble could give Australia a more significant role in Asia as we are the next cab-off-the-rank to supply these high tech elements.