

Monthly economic e-news

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‘Once inflation starts to subside, some countries will be able to start reducing interest rates’

Craig Turnbull
Chief Investment Officer



Australian market regains some lost ground but global momentum is fading

We recently sent you a Market Update in response to the sharp downturn in the Australian and global share markets which occurred in early August.

The good news is that the Australian share market regained some of these losses in the second half of August to close the month down only 2.89%. But this was in contrast to European markets where the falls were much greater, for instance, the German share market was down by 18% by the end of August.

These sharp falls in international markets are a clear indication that global economic momentum is now fading.

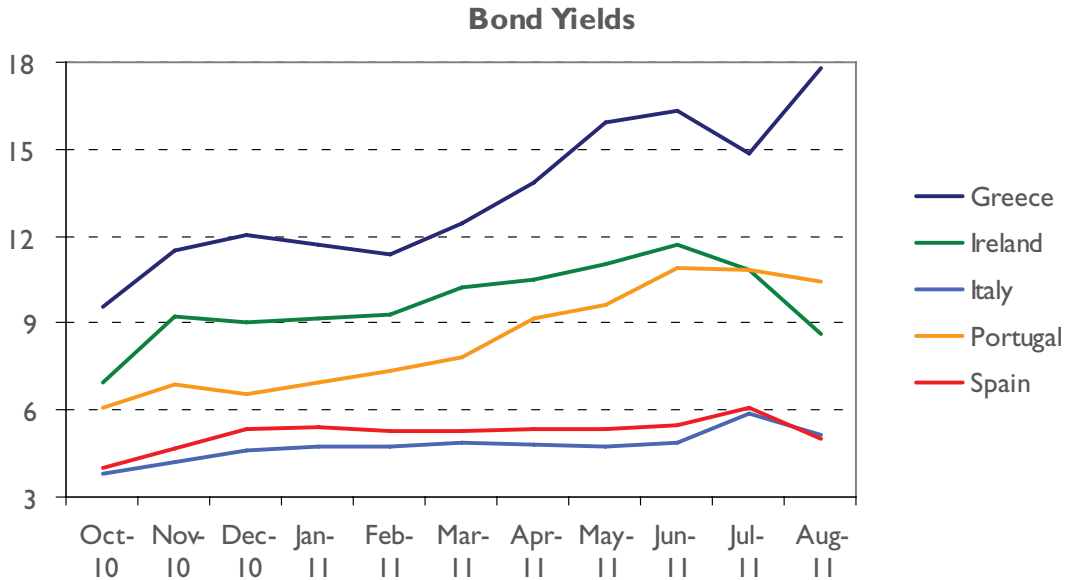
What are government authorities likely to do to stimulate the global economy?

There is a consensus that government debt levels are generally too high and larger fiscal deficits would cause interest rates to blow out, therefore we don't expect any significant government spending programs like we saw in 2009, in economies such as Australia, the USA, China and the UK.

The Chairman of the US central bank recently said they were prepared to take further monetary policy action if it becomes necessary. He is probably referring to another round of Quantitative Easing, a strategy used to stimulate the economy by printing more money to purchase billions of dollars worth of securities from the market.

In a similar move, the European Central Bank has already stepped up its purchases of European sovereign bonds. They purchased Italian and Spanish Government bonds in August, in an attempt to bring bond yields down to more manageable levels.

This is unlikely to be a long term solution though and European governments will have to find a way to reduce spending and curb debt levels.



Is there anything to be optimistic about?

Once inflation starts to subside, some countries such as Australia will be able to start reducing interest rates. While the Reserve Bank of Australia decided to maintain the Cash rate (official interest rates) at 4.75% at their meeting held in early September, there may be scope for reductions later in the year.

Lower interest rates make borrowing more affordable and will eventually help to stimulate the economy through increased consumer spending.

Another positive factor for most economies is the falling oil price. The price peaked at over US\$110 a barrel in April and has fallen back below US\$90 a barrel. This will provide consumers with more discretionary income for purchases on other items.

In the short term, the global economic outlook remains uncertain, but eventually there will be a recovery as buyers return to the market and from that point global share markets are likely to perform well, as they are currently quite cheap.



Markets at a glance

for the month ending 31 August 2011

- ↓ Australian shares¹ down by **2.89%**
- ↓ Australian Government Bonds² down to **4.37%**
- ↓ Australian dollar down to **US\$1.0691**
- Cash rate³ steady at **4.75%**
- ↓ International shares⁴ down by **7.34%**

1 ASX 200
 2 Yield on 10 year Australian Government bonds
 3 RBA cash rate
 4 MSCI – World ex Australia

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