

Monthly economic e-news

November 2011



‘Interest rate cuts will help to stimulate the economy and a stronger economy usually means higher share prices and greater returns for investors’

Craig Turnbull
Chief Investment Officer

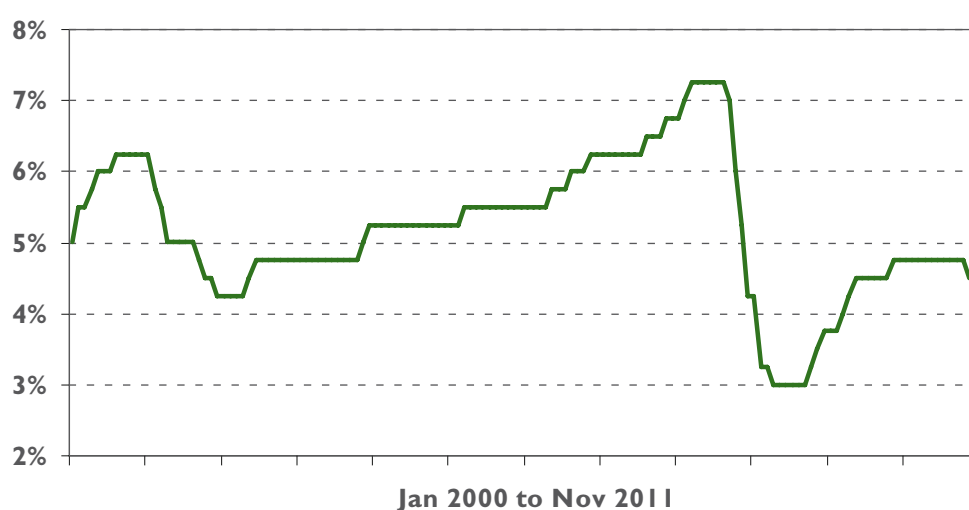


Are we likely to see more interest rate cuts

Just before the running of this year’s Melbourne Cup, the Reserve Bank of Australia (RBA) cut the official cash rate from 4.75% to 4.5%, the first change in interest rates for 12 months.

While many people still feel that interest rates are too high it’s important to note that in the context of the last decade, interest rates remain relatively low, particularly after the RBA sharply reduced rates in the wake of the global financial crisis.

RBA official cash rate



Source: RBA

RBA’s reasons for the recent interest rate cut

In the minutes of the RBA’s November meeting, the members of the Board cited a number of reasons for their decision to cut the official cash rate, including:

- Expectation that our inflation rate will decline over the next year as prices for some key food products, which were affected by the adverse weather earlier in the year, continue to fall.
- Forecast for only moderate economic growth in the US despite their economy showing some signs of improvement.
- Recent measures by Chinese authorities to keep inflation under control which may restrict their economic growth in the short term.
- Ongoing concerns about the European Union with expectations that economic conditions in Europe will continue to weaken further due to a continuing lack of confidence, the tightness of credit supply and the ongoing austerity measures.

So are there more interest rate cuts in the pipeline?

Historically, when the RBA adjusts interest rates up or down, it usually does so in incremental steps of 0.25% or 0.5% in order to gradually influence the cost of borrowing.

Cutting rates and reducing the cost of borrowing generally provides an economic stimulus by increasing the volume of money circulating in the economy.

And we may very well need some economic stimulus.

According to the Federal Government’s recent Mid-Year Economic and Fiscal Outlook, the deterioration in global economic conditions, particularly in Europe, is contributing to a weaker outlook for the Australian economy.

That’s why many analysts are predicting more interest rate cuts over the coming months to boost business and consumer confidence.

So how do interest rate cuts affect your super investment?

In the short term, the returns on cash will fall but bond prices are likely to rise as bond yields usually follow the cash rate down, and lower yields increase the price of bonds.

Fixed-term deposits will initially hold their value but returns on these deposits will fall when they are eventually rolled over for another term.

In the longer term, interest rate cuts will help to stimulate the economy and a stronger economy usually means higher share prices and greater returns for investors.

And on that note, I’d like to wish you a great Christmas and a happy new year.



Markets at a glance

for the month ending 30 November 2011

- ↓ Australian shares¹ down by **4.14%**
- ↓ Australian Government Bonds² down to **3.93%**
- ↓ Australian dollar down to **US\$1.0021**
- ↓ Cash rate³ down to **4.5%**
- ↓ International shares⁴ down by **2.49%**

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