

InScope

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Leader of the pack

Australia has cemented its economic strength by being one of the first developed countries to announce an interest rate increase since the global financial crisis took hold. One of the many reasons cited by the Reserve Bank of Australia (RBA) for this move is the apparent strength of Australia's export market and our trading links with Asia.

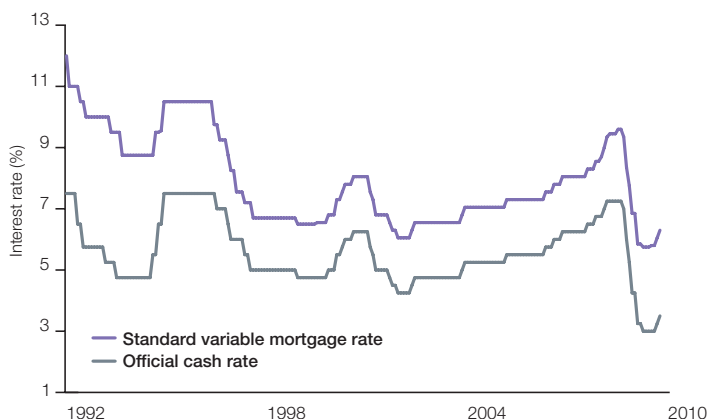
On the up

Despite some remaining risks to the Australian economic outlook, the RBA is determined to move interest rates back towards a more normal level after hitting the lowest level in more than half a century. Economists estimate a normal rate setting at between 5% – 5.5%.

After two consecutive rate increases, in October and November 2009, the prospect for further increases and the drivers for these increases is at the forefront of economic discussion.

The RBA has suggested that rate rises of 0.25% would occur relatively regularly over the coming period. This suggests the cash rate could reach 4% in early 2010. The official cash rate now stands at 3.5%.¹

Australian interest rates



Source: RBA. Data to 3 November 2009.

Inflation

The RBA aims to keep inflation between 2% and 3%. The inflation figures for September 2009 take the annual inflation rate down to just 1.3%. More importantly, the figures showed that underlying inflation (which removes volatile items to show the trend of price changes) sits at 3.5%, above the RBA's target band which supports the RBA's decision to increase rates.

The RBA has recognised the prospects for Australia's Asian trading partners appear to be noticeably improved. Growth in China has been very strong, which is having a significant impact on other economies in the region and on commodity markets. For Australia's Asian trading partner group, growth in 2010 is likely to be stronger than the global economy.

Strength of exports

Australia's economic strength has been bolstered by our international trade with Asian countries, particularly with regard to exports. Despite global trade falling by 20% in the past year, the volume of Australian exports stayed broadly flat over this period.²

Over the past six years, Australia has repositioned its export merchandise destinations to respond to the level of investment from Asia and the population growth in the region. The United States has fallen from the second largest to the fifth largest destination.

The recent trade data shows that Australia's four most important merchandise export destinations this year have been China, Japan, South Korea and India – all in Asia.³

¹ As at 3 November 2009.

² Reserve Bank of Australia, 'The Growth of Asia and some implications for Australia', October 2009, page 6.

³ Reserve Bank of Australia, 'The Growth of Asia and some implications for Australia', October 2009, page 6.

Focus on China

China has also displayed a strong recovery from the global financial crisis. In an October announcement the National Bureau of Statistics of China reported that the country – the world's third-largest economy – recorded economic growth of 8.9% over the 12 months to September 2009, the fastest pace in a year.⁴

These figures provide reasonable grounds for optimism about the prospects of the Australian economy. The recovery in China saw demand for raw materials rebound strongly and Australia's ability to respond to this demand has been a contributing factor in the strength of the Australian economy.

What this means for investors

The outlook for the Australian economy is positive, assisted by strength in our export partners, infrastructure spending, mining investment and population growth. This has implications for investment markets, in particular official cash rates, bond yields and sharemarkets.

Share investment

Over the past six months, as prospects for the recovery of the Australian economy grew, so too did the sharemarket. The Australian sharemarket has risen around 50% from its lows in March to October 2009, these movements have alleviated some investors' concerns about the worst case scenario eventuating.

Past performance is not a certain indication of the future. The growth prospects of the Australian economy highlights the potential rise in company profits over the next few years and this could support the sharemarket over the medium term.

Term deposits and bonds

For investors looking to commence a term deposit or similar investment in bonds, the increases in interest rates will mean higher rates of return on offer. Bond yields have risen in anticipation of lifts to official cash rates. New money invested will be at higher yields, although this does mean capital values of existing bonds fall.

Speak to us to understand how a continued change in interest rates may affect your circumstances.

⁴ National Bureau of Statistics of China, www.stats.gov.cn.

Important information

This general advice has been prepared without taking into account your particular financial needs, circumstances or objectives, and is based on Financial Wisdom Limited's understanding of the economic situation as at 3 November 2009. While every effort has been made to ensure the accuracy of the information, it is not guaranteed. All investments are subject to risk, including loss of income and capital invested. Past performance is no guarantee of future performance. You should obtain professional advice before acting on the information contained in this publication.

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