

Investment update

Signs of improvement in the Australian economy

After many months of uncertainty, there appears to be clear signs that the worst of the global financial crisis (GFC), and the economic and financial volatility that came with it, has abated. Since August, we have seen a number of measures and indicators showing encouraging signs of improvement.

In our September *Investment Update* we looked at the global investment cycle and its four main stages, these being slow down, recession, recovery and boom.

In this *Update*, we consider whether Australia is entering the recovery stage by looking at some key aspects of our economy that are more consistently showing positive signs.



What is...?

Unemployment rate refers to the portion of the labour force not currently employed and seeking employment. This rate is used as one of a number of indicators of the health of an economy.

Cash rate refers to the interest rate banks use to lend and borrow money to other banks and is set by the Reserve Bank of Australia.

Liquidity refers to the capacity for an investment to be converted quickly into cash in order to meet short term obligations.

Gross domestic product (GDP) refers to the total value of the goods and services a country produces per year and is based on a formula that includes factors such as consumer and government spending and the value of exports and imports.

1. Overall, the Australian economy is looking stronger than expected

Compared to many overseas economies, the Australian economy experienced a much milder downturn. This should ultimately lead to a quicker recovery for our economy.

Strong intervention by the Australian Government and the Reserve Bank of Australia (RBA) has meant that our economy was relatively shielded from some of the harsher effects of the GFC. Intervention included the Government's economic stimulus package and a drastic lowering of rates by the RBA, amongst other things.

A number of economic indicators showed generally positive movement in August and September, pointing to a potentially positive trend for the rest of 2009 and into 2010.

Business confidence, a measure of where the economy is heading and whether there are positive or negative expectations for the future, rose to its highest level for six years before falling slightly in September.

Other domestic economic data for September was positive, with retail sales and gross domestic product (GDP) increasing slightly. Unemployment decreased slightly, with the rate of 5.8% being slightly lower than the expected rate of 5.9%. And with continued demand from China and India, commodity prices have remained strong, further supporting Australia's potential economic recovery.

2. The RBA increased the cash rate

On 6 October 2009, the RBA increased the cash rate for the first time in many months, in response to positive news across economic indicators including improving global market sentiment, stronger than expected economic conditions in Australia, a lower-than-expected unemployment rate and improving liquidity in debt markets.

At an individual investor and consumer level, increasing interest rates can be positive (e.g. better returns on deposit accounts and term deposits) as well as negative (e.g. the cost of borrowing is higher).

From an economic point of view and particularly in the context of the GFC, a rise in interest rates can be considered a good sign. The RBA dropped rates very quickly in 2008 as an emergency measure to cushion the blow of any potential recession. As a result of this swift response (in conjunction with other initiatives such as the Government's stimulus package), the downturn experienced in Australia was milder in comparison to that of other countries. The recent raising of the cash rate is indication of further progress for the Australian economy, particularly as Australia is one of the first countries to raise interest rates following the GFC.

3. The unemployment rate is low

A feature of a downturn or recession is higher unemployment. As previously mentioned, in Australia the unemployment rate to date has not risen to be as high as expected.

However, the unemployment rate is expected to rise into 2010. And whilst more people remain employed, many are working reduced hours as part of their

employers' efforts to reduce costs in the face of the GFC.

Despite this, for now, in the context of other positive signs, the comparatively low unemployment rate can be taken to be a good indicator of Australia's sound economic health.

4. The Australian dollar is rising

The Australian dollar is currently experiencing its highest levels against major currencies such as the US dollar and the UK Pound since the lows of the GFC. This strength is buoyed by a weak US dollar and higher commodity prices, which are currently a significant positive force on the Australian economy. This is due to the continued growth of the Chinese and Indian economies (amongst others) and their need for commodities that Australia offers, such as iron and coal.

The relative strength of the Australian economy is also a factor in the strengthening of the Australian dollar against other currencies. As mentioned earlier, Australia was one of the first countries to raise interest rates in the wake of the global downturn.

5. The global economy is showing signs of growth

Whilst overseas economies are still suffering from some effects of the global recession, such as high and increasing unemployment, signs of recovery are evident. Major economies, such as the US, UK and Europe have shown signs of rebounding from the 2008 lows, as have developing economies such as China and India.

The rapid global economic growth is supported, at least partly, by strong intervention by governments and central banks that provided much-needed

stimulus capital to keep the global economy liquid and moving.

Assisting this was strong upward movement in share markets, both locally and overseas. This share market growth is expected to continue for the rest of 2009 and into 2010. Other world economic indicators such as mining, commodity prices and manufacturing increased over the last quarter, however construction and wholesale measures were not as positive.

6. The property market is heating up again

Australia's property market has experienced similar movement to our economy, showing some falls in property prices and auction clearance rates. Despite this, the property sector has improved considerably during 2009, based on a number of factors including a general housing shortage, the availability of the first home owners' grant and lower interest rates making entry to mortgages easier. Supporting these factors is the traditional Australian focus, particularly amongst baby boomers, on property as a safe investment as well as favourable tax treatment for property investments.

The recent interest rate rise coupled with expectations that the RBA will continue to raise rates until 2011 means that borrowing will become more expensive. In turn, that will increase potential negative pressures on the property market.

Even in the face of predicted rate rises in the short term, the property sector has maintained significant positive growth and is providing further evidence of the strength of the Australian economy.

