July 2012

Financial Year 2011-2012
Swings & Roundabouts

Snapshot

Recent strong economic figures surprised Australian commentators and investors expecting gloomy news. There is no denying our economy is in good shape compared with other western industrialised nations, even if those figures aren't repeated in coming months.

However, this strength is not reflected in the share market where banking and sovereign debt issues in the Eurozone, hesitant growth in the US, and a slowing Chinese economy have meant volatility over the past year.

Snapshot: July 2011 to June 2012

Australian Key Indices as at June '12	
GDP annual growth rate	4.3%
RBA cash rate	3.5%
Inflation	1.6%
Unemployment	5.1%
Consumer confidence index	95.6

Share Market (% Change) July '11 to June '12	
Australia	-12.5%
US	0.4%
Euro area	-6.9%
China	-19.8%
Japan	-11.5%

This volatility has been significant in Australian share markets. The key ASX200 index started the 2011–12 year at 4608, tumbled 16.1 per cent to 3863.90 in September before recovering 14.8 per cent to 4435.90. From its peak on May 2, it fell more than 9 per cent by late June. Since the start of the 2011-12 financial year, it has lost more than 12.5 per cent.

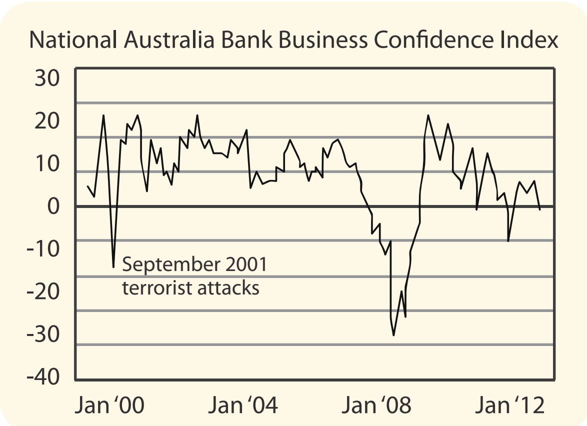
In contrast to Australia, US shares managed to stay in the black with the Dow Jones index up around half a per cent at the end of June. But over the same period Europe's FTSE Euro 300 was down around 6.9 per cent, Tokyo's Nikkei down 11.5 per cent, Hong Kong's Hang Seng down 12.9 per cent and China's Shanghai Composite down 19.8 per cent.

Confidence shaken

Australia's GDP jumped 4.3 per cent in the year to May; inflation is at a low 1.6 per cent; interest rates are down to 3.5 per cent and expected to fall further; and unemployment is still around the 5 per cent mark. All these statistics point to a solid economy, yet consumer and business confidence are at low levels.

Consumer confidence for instance, while up 0.3 per cent in June according to the Westpac–Melbourne Institute index, still shows more people are pessimistic rather than optimistic. Further, the figure is still 1.7 per cent below the rate prevailing last October.

And the National Australian Bank business confidence index was also at a nine-month low, down 2.2 per cent in May but remains above the lows of 2009.



Source: Nab, CommSec

Watchers would say this lack of confidence reflects the multi-speed economy with the resources sector still growing while other parts of the economy have slowed. Bad news continues to affect some sectors with retail, manufacturing and building suffering well-publicised staff losses and closures.

The cup's half full

To put the numbers in some perspective, economics commentator Ross Gittins points out there have been 17,000 jobs lost in a list of 25 recently reported layoffs. In a workforce of 11.5 million, he says that is "peanuts", though not for those who lose their jobs. Indeed it is comparable with the number of people leaving jobs voluntarily each and every month.

This more positive view is shared by Reserve Bank governor Glenn Stevens who believes Australians should be looking at a cup half full rather than one half empty.

Stevens also believes many of the issues in the Australian economy are based on structural rather than cyclical problems. As a result, he says more government intervention is not necessarily the solution. Stevens acknowledges structural change may be painful, but in the longer term it is better than burying your head in the sand.

He argues it is inevitable that an economy will run at multiple speeds; if one sector is doing well, another must inevitably do less well. Moreover, the resources sector may be dominant in Western Australia and Queensland but there are flow-on effects from its success to other parts of the economy, and the country.

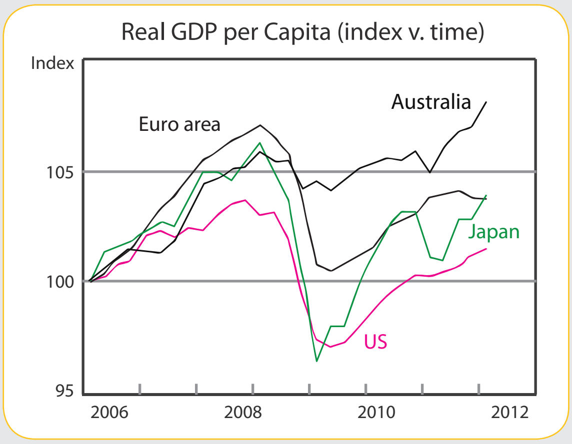
Switch to savings

One key area of structural change is the move to household savings after years of high spending, particularly up to 2007. Household savings moved from negative territory in the years 2002–05 to a current figure of about 9 per cent. As a result traditional retailers are feeling the pinch with consumers unlikely to return to the spending levels common in the early noughties. As people turn away from buying consumer durables in favour of services and experiences, this leads to more structural change.

Better shape

On almost all fronts, the economy is in much better shape than it was a year ago.

GDP growth, for instance, was only 1.2 per cent in June 2011, weighed down by the swathe of natural disasters including the tsunami in Japan and closer to home, the floods and Cyclone Yasi. A year later GDP growth is 4.3 per cent. Even if one concedes the current jump is an anomaly, the outlook according to many economists is for 3 per cent plus growth going forward. By comparison, major European economies are struggling to stay out of recession.

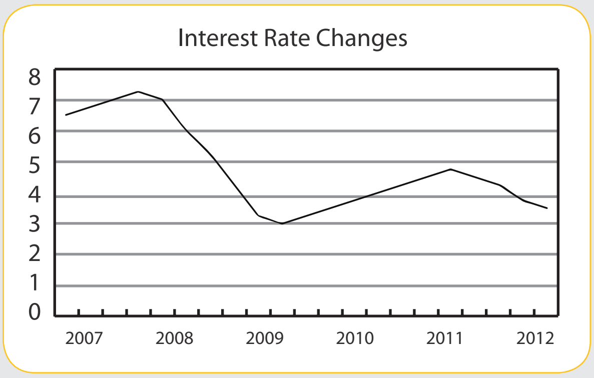


Source: 'The Glass Half Full', Glenn Stevens, Governor of the RBA, 8 Jun 2012

Inflation is now at a low of 1.6 per cent and well within the Reserve Bank of Australia's preferred range of 2–3 per cent. A year ago it was 3.3 per cent. Continued uncertainty in the market has helped to keep inflation down, aided by a decline in world oil prices, keeping a lid on domestic and business costs. And while the introduction of the carbon tax will see prices rise, for most households the injection of government compensation provides an offset.

Home sweet home

This time last year Australians were expecting rates might creep up. Yet interest rates are now 3.5 per cent and heading lower, with at least another cut possible by the end of the year. Of course this is good news for the one third of Australians with a mortgage but unlike earlier times, the low official interest rate has not led to a drop in deposit rates. Indeed, the banks are so keen to have your money to fund their lending that you can still earn up to 5.3 per cent in interest.



Source: http://www.rba.gov.au/statistics/cash-rate.html

For those with mortgages, the lower rates have resulted in greater housing affordability in terms of borrowing. House prices have also dropped, down more than 5 per cent in the year to May.

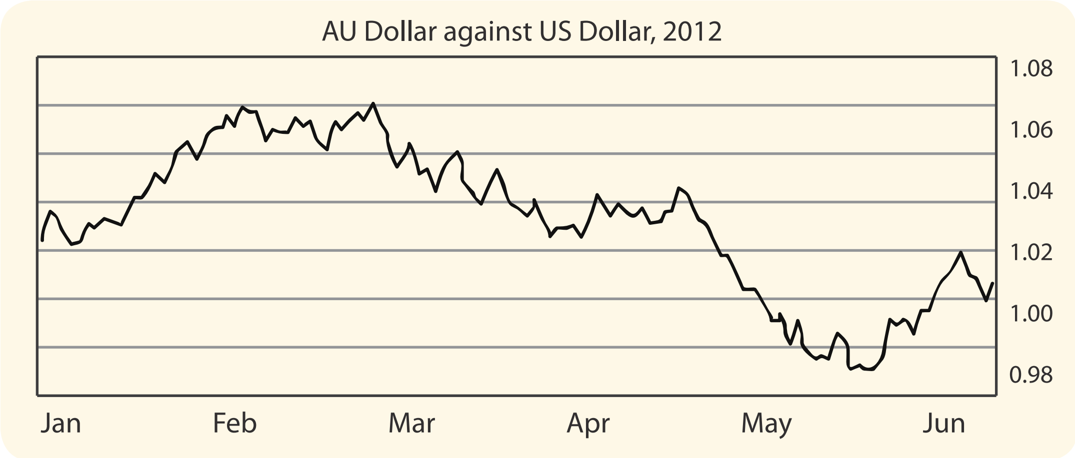
Disposable income

While Australians are somewhat pessimistic about the economy, in many ways it is in better shape than we think. Average weekly wages rose just over 4 per cent for both men and women. And while the unemployment rate edged up to 5.1 per cent in May, there were still 46,100 full-time jobs created during the month.

Snapshot

The dollar's dance with parity

The Australian dollar is currently trading close to parity, down from $1.05 at this time last year and from $1.10 reached last July.



Source: Yahoo!Finance

While some argue a strong dollar works against local tourism and manufacturers, the RBA's Stevens says Australians should be careful what they wish for, observing that a high dollar has positive impacts apart from making it cheaper to go overseas. The higher dollar means cheaper imports, which bring down the local cost of living, leaving more money in our pockets.

What happens next?

While Australia is enjoying solid growth, struggles and uncertainty continue in the Eurozone, even with Greece seeming to re-commit to the austerity path in its recent election. In many ways the turmoil in larger countries like Spain and Italy is even more important. All this uncertainty is causing wild swings on global share markets.

Volatility is not going to disappear until this uncertainty about Europe is resolved. However, some believe shares will be higher by year-end, particularly if there is further easing in interest rates.

If these uncertain times raise questions for you, please call us to discuss your concerns. To use Glenn Stevens' line, Australia's cup is half full, so now is the time to be looking at ways to add that extra bit of cream.

Phillip Thompson of Rise Financial
25 Michell Street
Monash, ACT 2904

P 02 6292 0015
F 02 6292 0071
E phil@risefinancial.com.au
W www.risefinancial.com.au