

The big questions

By Stephen Halmarick, January 2010

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How did Australia make it through the global recession so unscathed?

I think there were actually three key reasons why the Australian economy did so well over 2009. The first was that the government and the Reserve Bank policy response was so aggressive; very rapid reduction in interest rates and very quick government stimulus. The second and related reason is the strength of the banking system.

So the Australian banking system really didn't suffer from the huge problems that you saw in other markets globally and that allowed the Reserve Bank and government stimulus to be passed through to the economy, to the consumer and to businesses really quite quickly and very effectively.

And the third factor really supporting Australia was our export profile, particularly up to China and the rest of Asia. So the demand for resources from China remained very-very strong as they stimulated their economy with infrastructure spending that enabled us to provide the resources to them i.e. iron ore, coal, gas etc.

So three key reason: strength of the policy response; strength of the banking system; and our export profile to Asia – really meant that the economy here did a lot better than most people were expecting and certainly a lot better than most other economies around the world.

What will drive the sharemarket in 2010?

Well I think, as always, the sharemarket continues to respond to the economy and company profit performance. And so as we go through 2010, you would expect that the continued recovery of the economy and the continued improvement of company profitability will flow through to the equity market.

And so there we have to look at which sectors of the economy have a strong competitive advantage and which sectors are going to do well. Clearly resources have been benefiting from the demand from Asia, particularly from China and you would expect over the medium term, that to remain the case.

There's going to be expectations of lots of private sector construction and public sector infrastructure spending this year; so looking at areas of the economy that would benefit from a big increase in private sector construction spending will be key.

As we mentioned before, the banking system is a key strength for Australia and that's likely to remain the case through 2010. A higher Australian dollar means that those that are importing products could continue to do quite well; so there's lots of parts in the economy where we have a strong competitive advantage that will provide investors with good opportunities through 2010.

What are your expectations for the year ahead?

Well I think we're going to see the economic recovery continue to move forward over the course of 2010. But in response to that of course, we're going to see the policy stimulus being withdrawn. So the Reserve Bank we know has already started putting interest rates up and you would expect to see more of that over calendar 2010. Markets are pricing for the official cash rate to get somewhere back to a more normal or neutral level – say 4.5% or 5%.

The other part of the stimulus is through the government stimulus package and we know that the peak period for government stimulus has passed and the direct stimulus for the consumer was really a 2009 story. We will see government stimulus continue in infrastructure spending over the course of 2010; but overall both the Reserve Bank and the government will be withdrawing its stimulus in the year ahead. But they're only doing that because they're confident that the private sector – particularly consumption and business investment – can really take up the slack.

So we do expect that business investment will be a big driver of growth this year in 2010 – particularly driven by the resources and the mining sector; so private sector investment into resources.

So as the economy keeps growing and driven by those private sector activities (both consumption and investment), that should be positive for the equity market and help investors continue to enjoy a period where the economy is growing; and the global economic outlook is also improving.

What are the key risks for 2010 and beyond?

Well domestically we know that we've got interest rates beginning to rise now. The Reserve Bank started putting interest rates up and over 2010 the expectation is that we'll see interest rates up to more normal levels – say around 4.5% to 5%. So that's a risk factor for those parts of the economy that will be exposed to higher interest rates i.e. the housing market and small businesses, in particular.

We're also going to have an Australian dollar much higher than we're used to. The average level for the Australian dollar in the last 20 years has been in the 70 cent range against the US dollar and now we're in the high 80's and early 90 cents. So the parts of the economy that are exposed to exporting will need to deal with a much higher Australian dollar and those parts of the economy that are importing will get the benefit of that higher Australian dollar. So there are some risk factors there on the currency as well.

Internationally, I think we've been reminded recently that the global economy, whilst recovering, is still relatively fragile; very high unemployment rates in a lot of other countries around the world and the global banking system – although certainly in much better shape than this time last year – is still relatively fragile.

We've seen a few sovereign countries such as Dubai and Greece, have their credit ratings downgraded – meaning that some other countries still are finding it very difficult in the recovery process.

So domestically we've got higher interest rates and stronger Aussie dollar as risks; and globally, just a reminder that the global financial system is still in a relatively fragile state.

How do global investors view Australia?

Well global investors have been viewing Australia in a very positive light. And you can see that as part of the reflection of the performance of the economy here. The Australian economy has done much better than most other countries around the world and certainly global investors are taking advantage of that by investing directly into our equity market and directly into our companies and helping fund the economy.

And that's really-really important for Australia that we continue to attract global capital inflow to help fund the economy to allow lending for housing and lending for what we know is going to be a very-very strong resources sector through the demand coming to us from China and rest of Asia; so global investors, really important to keep attracting those to fund the economy here.

And that opens up great opportunities for domestic investors to participate in those parts of the Australian economy where we have a strong competitive advantage i.e. resources, banking system and those sectors that are going to be exposed to the construction spending from the infrastructure boom; so really important to attract both local and global investors to those sectors of the economy that need the savings.

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