

InterestRateInsights

with Australian Unity Personal Financial Services

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Central banks take centre stage

By Macquarie Economic Team

The global economy is set for a rocky few months, characterised by risk aversion in financial markets resulting in weaker economic growth. What started with US and European sovereign debt concerns is now escalating to envelop European banks, interbank funding markets and ongoing repercussions across asset markets, including equities, bonds, commodities and foreign exchange.

It is Europe, rather than the US, that is now firmly at the centre of attention, with disorderly default or restructuring the central scenario for Greece, likely followed by Ireland and Portugal. Moreover, the current financial turmoil is no longer just a sovereign debt crisis, but a liquidity crisis bordering on a banking crisis.

Although less severe than 2008 – by a large margin – indicators of financial stress and fear have nonetheless risen sharply and there are increasing concerns about counterparty risk with European banks. Moreover, European policymakers remain obstreperous in dealing with the challenges facing the region, from sovereign debt to bank capital requirements.

In many regions this environment of fear and risk aversion will have a flow-on impact on business sentiment and investment intentions, consumer confidence and consumption, while currency gyrations may exacerbate an already slowing global trade cycle.

Despite this, the majority of global central banks are likely to be proactive and respond with strong action to ease financial fears, increase liquidity and support growth. Indeed, with the 2008/09 financial crisis still a recent memory, the majority of central banks will do everything possible to prevent a repeat and are poised to support growth, even at the risk to inflation.

Europe and the US

There is certainly a concern that European policymakers remain uncompromising, but we remain of the view that they will come to an eventual resolution, albeit potentially not for a couple of months and not before severe market gyrations.

In late September the Federal Reserve announced its 'Twist' strategy, extending the average maturity of its holdings by purchasing \$400b of long-dated Treasury securities, with up to a 30yr maturity, while selling short-dated Treasuries until mid 2012. This was a significant action and markets were largely disappointed by the announcement. But the real impact of the decision is more likely over the longer term.

The likelihood that the US has embarked on an extended period of ultra-low real interest rates, measured in years and not months, is potentially the most important implication of the Federal Reserve's decision. If this is correct then there will have to be some serious rethinking by a wide range of institutions.

Changing corporate behaviour is one of the most important issues. If managements start to believe that long-term interest rates are going to be suppressed for years then there should come a point when the hurdle rate applied to business investment decisions is also lowered. And if the Federal Reserve can convince corporate America that long-term yields are going to remain near current levels for years then this would be the first step towards stronger business investment.

Another group that should be vitally interested in the Federal Reserve's decision are those institutions with long-term financial liabilities and assets. One of the most important sectors is defined benefit pension

plans. Put simply, plunging bond yields may mean that investment managers are unable to meet pre-defined rates of return, and some may eventually have to look at higher yielding and riskier assets.

Changing behaviour in this manner is not an easy decision. But if the Federal Reserve can convince these institutions that they mean to suppress long-term yields for years then there must come a point when investment behaviour starts to change.

Central banks in other parts of the world are also showing concern over the development of events. Despite elevated inflation the Central Bank of Brazil has cut rates on contagion fears. The Swiss National Bank has announced the pegging of the Swiss Franc to the Euro as a means of stemming risk aversion based currency inflows that threatened the Swiss economy. Closer to home, the New Zealand central bank has also signalled caution over international events. Asian central banks will also be looking to keep rates on hold.

Implications for Australia

Against the background of ongoing turbulence in global markets Australian policymakers remain confident that the economy is well-placed to ride out the latest instability gripping financial markets.

This confidence was recently articulated in the Reserve Bank of Australia (RBA) Financial Stability Review released on 23 September with the RBA noting “the Australian banking system is considerably better placed to cope with periods of market strain than it was before the crisis, having substantially strengthened its liquidity, funding and capital positions in recent years”.

The importance and effectiveness of the so-called ‘circuit breakers’ should also not be underestimated, particularly for Australia. The A\$ has fallen significantly against the US\$, providing a welcome boost to monetary conditions, which we estimate is the equivalent of a 25bps cut in the official cash rate. And at the same time, the Australian 10 year bond yield has also fallen.

The activation of the ‘circuit breakers’ in response to a surge in global risk aversion can be expected to sharpen the RBA’s focus on the downside risks to Australian growth and inflation. That said, we doubt that the events to date will be a catalyst for an imminent cut in the official cash rate with the RBA likely to wait for more tangible evidence of weaker demand growth and cost and price pressures.

Interest rates we are currently negotiating for clients

As at 6 October 2011	Standard bank rate p.a.	Lowest rates we have recently found for clients p.a.	Saving p.a.
Variable home loan	7.86%	6.80%	1.06%
Fixed rate home loan			
- 1 year	6.74%	5.99%	0.75%
- 3 years	6.74%	6.29%	0.45%
- 5 years	7.19%	6.69%	0.50%
Vehicle and equipment loans	9.7%	7.99%	1.71%

*Please note these rates do not include any fees and charges payable by the borrower. Comparison rates for individual products are available on request. Whilst these rates are the lowest rates in each category, the quoted product and lender may not necessarily be available for your client or suitable for their needs. A full analysis of each client is required before suggesting a suitable loan product.

We search for the most suitable loan for your clients

We have access to all types of loans from the major banks and other leading lenders. So when you ask us to find a better loan for your clients, we put our specialist loan computer software and our research team to work to find your clients the most suitable loan we can.

All your clients need to do is give us the usual documentation. Then leave it to us to find the loan which could save your clients a lot of money every year. Then we'll do the paperwork for your clients.

Your clients do not pay us for our service. We are paid by the lender. In other words, the banks and other lenders pay us to help your clients save money on their interest repayments.

Who is Australian Unity Personal Financial Services?

We specialise in providing professional strategic advice to help you improve your current financial position and ultimately achieve your long term lifestyle goals.

Importantly, our initial advice isn't a 'set and forget' service. Instead we offer you regular financial mentoring and ongoing guidance – in all aspects of your personal finances – to set you, and keep you, on the path to financial wellbeing.

Our team of experienced financial professionals can provide you with a detailed and totally tailored blueprint for financial success in any or all of the following areas:

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- Wealth creation
- Retirement planning
- Investments
- Superannuation
- Home loans
- Commercial loans
- Investment loans
- Equipment finance
- Car finance
- Personal estate planning
- Business estate planning
- Personal risk insurance
- Business risk insurance

Australian Unity has a proud 170 year heritage of helping Australians create secure financial futures. This pedigree and experience, combined with our corporate strength and leading edge strategic advice capability, means we are uniquely placed to offer you high quality personal financial services... each finely tuned to your particular needs to ensure you achieve your vision of a secure financial future.

After all, your financial wellbeing is at the heart of everything we do.

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Because knowledge is the first step to creating a secure financial future.

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