Quarterly Economic Update

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Financial Advice

- Financial market sentiment deteriorated over the past quarter on developments in the Euro zone sovereign debt crisis. Concerns about the global economic growth outlook also intensified. In the US, the soft patch appeared to deepen with some disappointing jobs data and ongoing weakness in the housing market. In China, there were signs that growth was moderating while concerns about its banking system surfaced.

- Euro zone sovereign debt woes remained at the fore over the quarter. Greece overcame some hurdles in avoiding a near term default. But many more hurdles remain, not least of which is the political resistance to planned austerity measures. The decision on a second bailout for Greece will not be made until September, although Greece has secured the final tranche of its first EU-IMF bailout package. Greek credit default swap spreads, which gauge the cost of insuring against default, are at very high levels indicating default is likely. The risk of contagion was highlighted after Moody's downgraded Portugal to "junk" status earlier this week.

- The Reserve Bank kept rates on hold as expected in July. In its statement, the RBA remained upbeat about domestic economic growth and the mining boom, although the RBA noted this was conditional on the world economy growing as expected. While a further interest rate hike this year is still likely, it will come down to the strength of economic data. There is now a growing risk that no tightening will be needed this year.

- The US Federal Reserve ended its $600bn bond-buying program (QE2) last month, as scheduled. However, the Fed still owns the bonds bought over the program and will continue to reinvest maturing securities. Therefore current monetary policy will still be expansionary.

- Australia's economic data has been mixed over the past month. The impact of the Queensland floods continues to be felt in some economic indicators, making the underlying health of the economy more difficult to read. However, consumer spending continues to languish, with ongoing consumer caution and the strong Aussie dollar having a negative impact on the manufacturing sector and tourism.

- It was a volatile quarter for financial markets, with bond yields down sharply on concerns about the Euro zone sovereign debt crisis and the outlook for global economic growth. Stock markets were mixed around the world. But most global share markets recorded losses in the quarter, including the S&P 500 index. Commodity prices, including oil, slumped on nervousness about global economic growth. However, gold bucked the trend with demand for gold boosted on safe-haven flows.

- The Aussie dollar strengthened over the quarter, rising above US$1.07 and hitting a new post-float high in May. Speculation of further rate hikes from the RBA was supportive for the currency, although these expectations were wound back as worries over the global growth outlook grew. Risk aversion is weighing on the currency, but the Aussie dollar is still well supported from a range of positive underlying fundamentals. These include a high terms of trade, attractive interest rates and a relatively strong domestic economy.