

# Quarterly Economic Update

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**PATRON**  
*Financial Advice*

- Financial market sentiment deteriorated significantly over the past quarter on developments in the Euro zone sovereign debt crisis, although it partly recovered in the past few weeks. The deterioration was reflected in heightened market volatility. The trigger for the marked deterioration in sentiment was a sovereign ratings downgrade of the US by Standard & Poor's in early August. Concerns about the global economic growth outlook also intensified -the IMF downgraded its global growth forecasts and cited heightened downside risks.
- As the Euro zone sovereign debt woes deepened, the risks of contagion to other troubled European economies and the banking sector escalated. A default by Greece is looking increasingly more likely – a major concern lies in managing the fall out. A plan in July to expand the European Financial Stability Fund (EFSF) is an important step, but more needs to be done. Markets are hopeful for a solution and await the EU summit on 23 October and a G20 leaders' summit on 3 November for details on a comprehensive strategy.
- The RBA kept rates on hold as expected in October, but is progressively becoming more dovish in tone. The RBA has now hinted at the possibility of cutting rates if needed. Our view for rates to be on hold for the rest of the year remains intact, however, we do not completely rule out a rate cut before the end of this year.
- The US Federal Reserve announced it would sell short-term bonds and use the proceeds to purchase longterm bonds ("Operation Twist"). Its effectiveness is, however, limited given demand for borrowing remains low while there is still reluctance to lend.
- Economic growth in Australia rebounded in Q2, recovering after the natural disasters earlier in the year. However, coal exports have not yet recovered fully from the disasters. The multi-speed nature of the economy continues to be reflected in the economic data. Business investment is booming but some other sectors are being weighed down by consumer caution and the strong Aussie dollar.
- The deterioration in financial sentiment saw bond yields, stock markets and commodity prices fall sharply on concerns about the Euro zone sovereign debt crisis and the outlook for global economic growth. Even gold's safe haven status diminished as investors sought cash. Markets were however extremely volatile given uncertainty about the response to European sovereign debt problems.
- The Aussie dollar came under pressure over the quarter, falling below US\$0.9400, the lowest in over a year, but has since bounced back to above parity as risk sentiment improved. The deteriorating outlook for global growth was a major factor in its decline, but it has been extremely volatile, moving with changing risk appetites. Adding to selling pressure was the fading prospect of rate hikes from RBA.

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