

# ***The Wealth Generation***

**Colonial**  
First State

## **Market volatility: What now for Australia?**



### **Market update – 8 August 2011**

**Recent market volatility has begun to raise concerns of another global financial crisis. We look at what has caused recent market**

# **movements, and what this may mean for Australian financial markets in the future.**

## **Quick fix for the long term**

After weeks of uncertainty surrounding whether the US government would find a way to raise the debt ceiling and reduce the budget deficit in future years, a deal was negotiated. The debt limit was raised by \$US2.1 trillion and agreement was made to reduce debt by \$2.4 trillion over 10 years.

It was expected (as they had little other choice) that this action would be taken, however there are likely to be some longer term impacts as we have seen with last week's downgrade of their long standing AAA credit rating to AA+ by Standard & Poors (S&P) as well as a slowing of their economic growth. This is only one ratings agency however with both Moody's and Fitch affirming the AAA rating post the increase in the debt ceiling.

## **How much trouble is the US economy in?**

The agreed budget cuts are a step in the right direction, and the raising of the debt ceiling has removed the immediate risk of default, however the US economy still faces a number of headwinds.

Recent economic data confirmed that the US economy is struggling to recover further, with the pace of economic growth coming in at a modest 1.3 per cent in the second quarter of this year. Weak consumer spending, slower manufacturing activity and a general lack of confidence have seen growth prospects weaken.

Since the announcement of the debt ceiling increase, there has been concern that the US economy will grow at a pace slower than that assumed in the budget forecasts and that the spending cuts in the budget could further slow the pace of economic growth in the years ahead.

## **How will this affect Australia?**

The US economy and sharemarket continues to be the key barometer for global confidence and a winding back of growth expectations has already had an impact on markets around the world.

Although the Australian economy is still in a better position than most other developed economies, financial markets in Australia and around the world are likely to remain volatile in the near term. It appears that investors are beginning to reassess expectations for global growth in the current environment and as emotions run high, volatility is an inherent result.

Falls in recent weeks have been severe with investors becoming concerned we could be entering another global financial crisis. Markets have begun to react by moving out of risk assets. Importantly to date there has not been a freezing up in credit and bank funding markets as was the case during the global financial crisis – this will be important to watch going forward, especially given financial markets are now operating in unprecedented times post the downgrade by S&P to the US AAA credit rating.

## Is this another global financial crisis?

One important factor to remember is that financial market participants (including central banks and bank regulators) are much more prepared for financial market dislocation compared to the depths of the GFC. Lessons have been learnt although it is impossible to say another crisis won't happen.

It is clear from market volatility seen in the last few weeks that financial markets are lowering their growth expectations for the global economy. For the US, challenges still lie ahead. But if the political will increases, there is hope the US could change its ways, refocus on lowering government debt and build confidence back into the US economy (and financial markets).

If you have any concerns about this recent market volatility and the impact it may have on your investment, please speak to your financial adviser. Alternatively give us a call on 13 13 36.

**Don't forget to watch regular market updates on Sky News featuring Belinda Allen and Stephen Halmarick from our Investment Research team. The latest update can be found [here](#).**

### Disclaimer

The information contained in this document is based on the understanding Colonial First State Investments Limited ABN 98 002 348 352 AFS Licence 232468 has of the relevant Australian laws as at 27 April 2011. This is not advice and is intended to provide general information only. It does not take into account your individual needs, objectives or personal circumstances. You should assess whether the information is appropriate for you and consider talking to a financial adviser before making an investment decision. Product Disclosure Statements (PDS) for products offered by Colonial First State are available from [colonialfirststate.com.au](http://colonialfirststate.com.au) or by contacting us on 13 13 36. You should read the relevant PDS and consider whether the product is right for you. **Past performance and awards are no indication of future performance.**