

Stimulating the sharemarket

Since October 2008 the Rudd Government has announced numerous fiscal stimulus measures totalling more than \$50 billion. These measures coincide with historically low interest rates with the Reserve Bank of Australia lowering interest rates by 4.25 per cent in the last eight months to 3 per cent.

The Government's strategies have been put in place to extend credit to struggling industries, safeguard jobs, encourage consumer spending and foster long-term economic growth. Major initiatives to date include:

- The National Building – Economic Stimulus Plan will inject \$42 billion into the Australian economy over the next four years. The package includes cash handouts, community infrastructure and social housing.
- In October 2008 the Government introduced the bank deposit and wholesale term funding guarantee to restore confidence in the financial system.
- In December 2008 the Government gave handouts worth \$10b to 'mums and dads' to stimulate retail spending.
- In an effort to keep construction projects afloat and safeguard jobs, the Government has proposed an Australian Business Investment Partnership (or RuddBank as it is affectionately known) be set up to provide debt funding for commercial property with financially viable underlying assets and income streams.

The fiscal injections will push the budget into deficit for the first time since 2001-02. Treasury is forecasting a budget deficit of \$35.5 billion next financial year with large deficits projected until 2011-12. While at face value next year's deficit figure appears large, at 2.9 per cent of GDP, it is much smaller than previous deficits and those of other advanced economies.

Australia versus the world - budget deficit as proportion of GDP



The Government says the temporary deficit is necessary to provide for future jobs and economic growth. The latest stimulus package aims to add 0.5 per cent to GDP in the current financial year and 0.75 per cent to one per cent in 2009-10. The consensus economic view is that the economy will grow by 0.75 per cent in 2009-10 after shrinking by 0.5 per cent in 2009.

The International Monetary Fund (IMF) says that while the global downturn could be long and severe, strong policy action, particularly expansionary fiscal policy could help accelerate and strengthen the recovery. In fact, the synchronised fiscal and monetary stimulus policies from around the world are the key differentiating factors between the current economic downturn and the Great Depression, which the current global financial crisis is often compared to.

The pain before the gain

The IMF is expecting a contraction of negative 1.3 per cent this year in the world economy and a negative 3.8 per cent for the developed economies.

Economists are eagerly awaiting release of March quarter GDP data to confirm whether Australia has joined the US, Japan, UK, Germany, France, Italy and a number of other economies in recession. While not in recession, economic growth in Australia's largest trading partner, China, has halved in just over 12 months to 6.1 per cent.

Despite the contraction in Australian economic growth, the local economy is fairing better than its major trading partners. RBA Governor Glenn Stevens said the combination of stimulatory fiscal initiatives, lower interest rates, weaker Australian dollar and a more robust financial system puts Australia in a better position to ride out the international difficulties than many countries.

While the local economy isn't out of the woods yet and there is likely to be more pain to come particularly on the employment front, it's important to remember that historically the sharemarket recovers well before the economy.

History shows that "sharp falls in the sharemarket are often followed by extreme rebounds", states Morningstar. As we commented in our November 2008 edition of FUNDamentals 'When patience is a virtue', it takes on average 41 months to make a new high after a low, with the percentage gain in the first 12 months after the low (on average) 32 per cent. Source: AMP Capital Investors

Has the sharemarket reached a bottom?

In March the Australian sharemarket delivered its first positive monthly return since August last year (with the S&P/ASX 300 Index rising 8.1 per cent) posting its strongest rally since November 2007 and largest monthly rise in nine years.

The US Government's decision to inject capital into a number of financial institutions to assist with their toxic loans and the G20's agreement to inject US \$1.5 trillion into the world economy were viewed as positives by the market, sparking a rally in both US and local stocks. Other positive signs include rising US consumer spending, local business investment, global manufacturing and Australian housing finance approvals.

With more positive sentiment returning to the sharemarket, many pundits are asking whether we've reached the bottom. Unfortunately, the only way you will know the answer to this question is when you've missed it.

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