

APRIL 2011 – JUNE 2011

Cash & fixed interest are generally considered relatively low risk investments when compared to shares and property. Consequently the expected returns are lower, and modest returns are generally made over long time periods. One thing to bear in mind is inflation. For example, if the interest rate earned on a cash investment is 5% p.a. and the annual inflation rate is 3% p.a., the real return is 2% p.a.

Quarter Review

Market concerns that the Greek government would fail to pass critical austerity packages which would open the door to the possibility of an immediate default peaked in mid-June, sending yields on 2 year Greek government bond yields above 30% p.a. at one point.

Credit rating agencies S&P and Moody's both downgraded the country's credit rating by multiple notches, leaving it only marginally above a default classification.

Domestically, hawkish commentary from the RBA early in the quarter was reflected in consensus forecasts factoring in monetary tightening at some stage within Q3. However, persistent softening in economic data, suggesting a lack of momentum in domestic demand, weighed on economists, and as a result, consensus expectations for growth in the Australian economy have been revised sharply down. This, coupled with heightened concerns around key developments, caused the market to price in the chance of a monetary policy easing in Australia, with a full 0.25% rate cut priced in before the end of the year in the days leading up to the passing of the Greek austerity package. Despite this, policymakers have maintained an upbeat assessment of medium term economic growth prospects, holding their conviction that the benefits of the mining boom will filter through to households and the broader economy, suggesting that the RBA retain a slight tightening bias.

Outlook

At the early July 2011 board meeting the Reserve Bank of Australia left the cash rate target on hold at 4.75% as expected. The Consumer Price Index is due for release towards the end of July 2011 and is likely to drive pricing for future Reserve Bank moves.

A note from our legal team

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Australian Bank Bill Yields

