Australia – nothing like as bad as one would infer from the media and market performance

A lot of global investors are assuming that as an Anglo-Saxon economy, Australia cannot avoid the travails of its peers in the Northern Hemisphere. We disagree. Here are the reasons.

Although the embattled Aussie consumer is highly geared, his cash flows have been improving due to a dramatic reduction in mortgage rates (a function of rates coming down from a nominally high level in the first place and a plain vanilla variable mortgage structure) and a startling degree of fiscal largesse in the form of cash handouts to families and first-time home buyers, which has sparked a mini boom in parts of the Sydney house market.

The Australian banking system is solvent, liquid and functional. The banks are still making profits and pay (albeit reduced) dividends. Aside from an optional Government guarantee on large deposits, they remain fully private sector institutions with fairly normal levels of executive remuneration. Will bad loans increase? Of course. Will it threaten their viability? Absolutely not. From a valuation perspective we are neutral on the shares, but have no doubts as to their ability to survive.

In similar vein, the Federal fiscal position is extraordinarily healthy relative to virtually any other country on the planet. A stimulatory policy in response to a comparatively mild recession will result in a budget deficit of around 4%of GDP. The UK and the US are well into double digits already. Superannuation flows are a strong and rising support for domestic liquidity, and have enabled the majority of cash strapped Australian corporates to re-finance in the equity market.

So why has this paragon of Southern economic virtue not outperformed its peers?

One look at the Property Trust Index would lead one to believe that there is a disaster looming in commercial real estate. There has not been a massive overbuild of office space, unlike the early 1990s. There has been a rash of financial engineering, over-gearing and overseas expansion. The domestic property markets are off their peaks but in much better shape than (for example) the City of London.

There has also been a lot of hand-wringing over commodity prices. Fair enough, Australia has a lot of natural resources and in most cases those prices are down sharply, though gold and some of the softs are bucking that trend. This has clearly contributed, along with the demise of the carry trade, to the decline in the currency, which both offers some respite to the miners and gives an attractive entry point for investments in more domestically focussed stocks. The currency is cheap and the market is providing one of the better opportunities in our universe at present.