

SOUTHSHORE *News*

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By Michael Coombes

Interest rates look likely to have peaked

Finally there's some good news on interest rates.

Many economists are now predicting that the Reserve Bank (RBA) will leave rates on hold for the remainder of the year.

ANZ Chief Economist Saul Eslake is predicting that the RBA's next interest rate move will be a cut. He believes there are now strong signs of faltering consumer demand.

In fact he thinks the RBA will probably keep the cash rate at 7.25% until the June quarter of 2009, then cut it in the second half of 2009 and into 2010.

However the global credit crunch may see banks increasing their interest rates about 0.50% - above the RBA's rate rises. We are experiencing a very unusual series of events at the moment.

The RBA is using monetary policy to try and keep a lid on inflation and at the same time, the world financial markets are in turmoil, struggling to cope with the massive losses stemming from the so called US Sub Prime Mortgage Collapse.

This has resulted in a massive shortage of investment funds leading to an increase in the cost of funds.

Supply and demand

A simple matter of supply and demand. Unfortunately, even though the Australian banks are very well managed, have strong balance sheets and very low bad debt levels, they have to raise funds like every other bank in the world and are being forced to pay a higher price.

The banks have been forced to push the higher costs onto the borrowers. Therefore

we have had a double whammy - the RBA lifting rates to stem inflation and then the banks increasing rates further because of the increase in costs of raising those funds.

The current market sentiment is that the world markets will start returning to some type of normality in 3 to 6 months.

This is around the time that many banks will have had to report their financial results, including losses from the sub prime fallout.

The worst is behind us

When the markets are confident that the worst is behind us, investment funds will start to flow back into the market and the cost of raising finance will reduce.

While the RBA says it's seeing definite signs that inflation is slowing, one influential economist thinks it's slowing even faster than the RBA thinks.

The Commonwealth Bank's chief economist, Michael Blythe recently told a Committee for Economic Development of Australia Forum in Brisbane that we were too pessimistic about inflation in Australia.



He thinks the investment boom means Australia's capital stock is growing at its fastest rate since the 1960s.

Blythe told the forum that with inflation being reined in it was important not to talk down the economy.

There's certainly good cause for optimism about the West Australian economy, as you can see from this edition of the newsletter.

I hope you find it useful and interesting.

Business is strong despite rising interest rates

The US economy may or may not be sliding into recession, but in WA business is ticking along very nicely indeed, driven by an insatiable demand for our resources.

In fact it's an excellent time to invest in commercial property or business. Business is extremely profitable, confidence is high and the long term outlook is extremely promising.

However there's no doubt the US sub prime mortgage crisis is starting to bite, pushing banking interest rates higher as banks (and non bank lenders) cover the increased cost of their overseas borrowings.

The recent increase in interest rates might be slowing the housing market but we are yet to see any drop in demand for business finance.

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WA is now a world leader in resource research

Western Australia's booming economy is becoming increasingly diverse and sophisticated. Our state is now so much more than just an exporter of raw materials.

Perth is rapidly establishing itself as the services hub for the resources sector in the Indian Ocean and Asian regions. There are now more than 50 institutions doing basic and applied research for the resources sector.

Curtin University's Technology Park is the base for the CSIRO's new \$37 million research facility where 200 staff now carry out most of the organisation's resource related research.

Curtin is also the base for one of BHP Billiton's three Global Innovation Centres. When completed its 100 researchers will provide services for the company's operations throughout the world. BHP Billiton is also committed to building a new resources and chemistry precinct with more than 300 scientists, engineers and other staff.

And the rumours persist that BHP Billiton will move its entire headquarters from Melbourne to Perth and into its new building in Westralia Square when it's completed in 2011. The company has already shifted its petroleum, nickel and iron ore offices here.

Should you require further information on any topic relating to business or commercial property finance, residential property finance or equipment financing we'll be more than pleased to assist.

The information contained within this newsletter is of an advisory nature only and due to constant changes we advise you to contact us before making any formal financing decisions.

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Chevron's Global Technology Centre for the Asia Pacific region will also be operating by the end of the year. As many as 80 research staff will develop sub-sea platforms to support the company's regional operations.

Aluminium giant Alcoa has also made a big investment in research in Perth. With 80 staff and an annual budget of \$30 million, Alcoa's alumina research centre is one of the nation's largest corporate industrial research centres.

Perth is rapidly establishing itself as the place to be for the region's resources sector.

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Business is strong despite rising interest rates

The strong WA economy, with the promise of good growth, excellent margins and strong profits, is giving confidence to business owners to keep expanding.

WA businesses are looking at high interest rates as simply a cost of doing business, rather than a major impediment.

We're certainly not seeing a squeeze on credit - the banks are willing to lend, reflecting their confidence in the economy and the fact that they need to lend to make a profit!

In terms of credit policy, the main change that we are seeing is the banks factoring in even higher rates when assessing the applicants capacity to service.

This is not necessarily because the banks believe the rates will continue to increase, but rather because even they have been surprised by just how quickly the rates have risen and in typical bank fashion, they always look at the worst case scenario.

And there are signs that those high interest rates will start heading down in the 12 months. There's little doubt that inflation is slowing and that the Reserve Bank will eventually drop its interest rates.

Whilst the RBA might drop rates, this does not necessarily mean the banks will pass on those cuts immediately.

They may hang onto the higher margins in an effort to recoup lost profits. We will have to rely on competition between the banks for the rate drops to be passed on quickly.

While the state's skills shortage is a concern, there's also a lot of skilled migration to WA.

Another cause for optimism is that the US sub prime crisis is probably now as bad as it's going to get.

The US Federal Reserve has slashed its federal funds rate to 2.25% and pumped liquidity into the economy. It's now looking forward to a slow recovery.

There's no evidence that America's problems are anything else but the downswing of a normal business cycle. In three years time the US economy should be heading up again.

WA would then be in the enviable position of both the Asian economies and G7 economies all demanding our exports!

So if you're considering buying a business it makes sense not to let short term uncertainties cloud the vision of the medium and long term future, which is looking extremely promising.

There's never been a better time to buy a business, with economists predicting that the WA economy in 2010 will be 10-15% larger than it is today.

There's good reason for genuine optimism among business builders and business buyers.

So if you're thinking of buying a business make an appointment to come in and see us today to see how we can help you with finance.

