



Debtor and creditor nations need to be drawn closer together

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You don't have to be a genius to conclude that household and business confidence has taken a hit and this will feed through into economic activity in the second half of the year.

There are some offsetting factors, in the unwinding of the Japanese supply side problems in manufacturing and the sharp fall in the oil price. Markets have adjusted to the new realities of a weaker global economy.

Equity markets are still not discounting a repeat of the Great Recession of 2008/9, however they have moved to discount a mild recession in US and sharp slowdown in global growth.

Central Banks are sending out a message that interest rates are going to remain at these extraordinarily low levels for some time to come. This will support a continued hunt for yield. The dividend yield on the FTSE 100 has risen to 4% following this year's dividend increases and the recent fall in equity prices.

In short, equities are yielding significantly more than bonds for the first time in 40 years, other than for a short period in 2008 when dividends were about to be cut. Compared with 2008, however, companies are in a much better position financially to withstand a slowdown in demand, as they have stronger balance sheets and have generally already lowered their cost bases.

We remain hopeful, if a little sceptical, that central banks and politicians can respond to recent in an appropriate manner. The emerging bloc accounts for half the global economy and any policy response to recent events must include these countries.

Dealing with government debt levels in the developed world remains at the heart of the problem, however realignment between creditor and debtor nations is also required and this will have to mean an adjustment in real exchange rates.

Source: rlam as at 10th August 2011 unless otherwise stated.

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