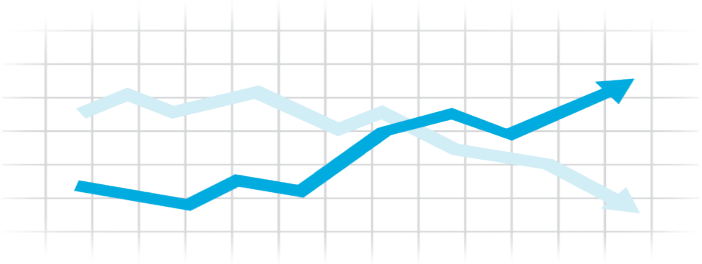
WEEKLY ECONOMIC COMMENTARY



Week beginning 16th July 2018

ECONOMIC DATA ROUNDUP

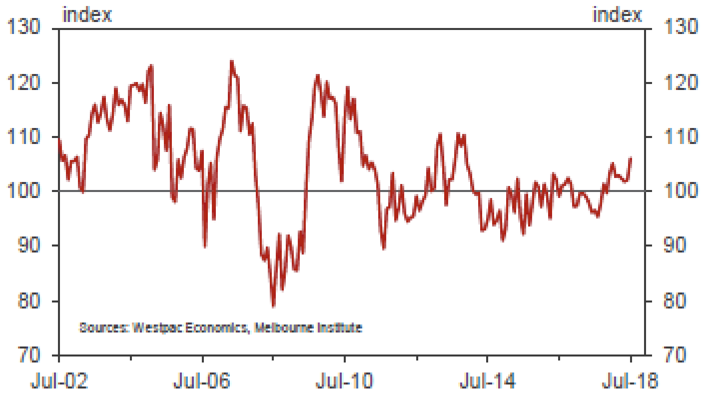
DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
NAB Business Survey - Conditions	June	+15	+14
NAB Business Survey - Confidence	June	+6	+7
Westpac/MI Consumer Confidence	July	+3.9%	+0.3%
Housing Finance	May	-0.4%	-1.9%

There was little movement in the NAB's business survey measurements this month and although it has moderated in recent months, it remains above the long term average. The **business conditions index** ticked up by 1 point to +15 in June, after a downwardly revised +14 in May and remains well above the average. Both profitability (+17) and trading (+23) rebounded, with the latter remaining around the highest levels since the GFC. While the employment component fell for the second month, it remains at +5 and suggests there will be a continuation of employment growth and ongoing reduction in unemployment. The **business confidence index** was down 1 point in June to +6 and remains in line with average levels. Confidence remains the highest in the mining and construction industries and the lowest in recreation and personal services while the other industries remain at or around the national average.

The **Westpac Melbourne Institute Consumer Sentiment index** rose 3.9% in July to 106.1 from 102.1 in June and the eighth month where the index is above 100 (indicating optimists outnumber pessimists). This percentage change was the strongest since May 2016, when households boosted sentiment by 8.5% in response to the RBA lowering the cash rate to 1.75%. This month's rise is being driven by growing optimism about the economy with a more balance growth profile across all states and stabling conditions in the mining sector. The component measuring family finances versus one year ago was up 2.4%. The "economic outlook, over next five years" component rose 9.8% in July and is now up almost 20% annually while the "economic outlook, over next 12 months" component was up 3.9% and 13.5% annually. These measures were affected by the recent tax cuts as well as the announcement of proposed changes to the GST revenue.

Westpac/MI Consumer Sentiment Index



The total value of **housing finance** increased by 0.4% in May and now down 5.3% over the year. Investor finance was down 0.1% in May (down 13.4% annually) while owner-occupier housing finance was up 0.8% in May and up 1.6% annually. The total number of housing finance was up 1.1% in May to be down 2.5% over the year. Owner occupier finance was up 0.7% (+2.2% annually while investor finance was down 0.1% (-13.1% annually).

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Employment	19 July	June	+10,000	+12,000
Unemployment	19 July	June	5.4%	5.4%

ECONOMIC COMMENTARY

LAST WEEK

Trade tensions have again gathered steam last week after the previous week's imposition of 25% tariffs on $34bn of imports by both the US and China. Reaction to US plans to impose a 10% tariff on an additional $200bn of Chinese goods, fuelling fears of a full-blown trade war, triggered a sell off across risk assets, pushing equities and bond yields lower and the US dollar higher. Markets had calmed down late in the week as US and Chinese officials signalled they were open to resume trade talks which somewhat allayed fears of a trade war emerging.

On the data front, last week's NAB business survey for June showed little changed from May but conditions and confidence still at robust levels. Consumer sentiment however was up a solid 3.9%, the most positive monthly result since November 2013, sentiment boosted by the recent tax cuts and GST revenue distribution.

The Bank of Canada surprised no one last week with its decision to lift their overnight rate by a further 25 basis points to 1.5%, noting that future moves will be gradual. In the accompanying commentary the Bank stated that it continues to expect the global economy to grow by about 3¾% in 2018 and 3½% in 2019, while also acknowledging that "the possibility of more trade protectionism is the most important threat to global prospects".

By the close on Friday, the 90-day bank bill was trading at 2.02% from 2.06% a week earlier. In the long term maturities, three and 10 year bond yields closed at 2.06% and 2.64% respectively, from 2.07% and 2.63% a week earlier.

CURRENCY

The Australian dollar was hit last week by a stronger US dollar which was benefitting from risk-off trading following the news that the US was to implement a further $200bn of tariffs and then by a fall in commodity prices, especially oil which fell 6% last week following news that Libya would resume export activities.

The British pound fell against the euro last week following the resignation of UK Foreign Secretary Boris Johnson. Johnson, who was the face of the campaign to exit the European Union, followed Cabinet Secretary David Davis in stepping down last week over disagreements about Prime Minister Theresa May's Brexit strategy.

By the close last Friday, the Australian dollar was trading at USD0.7415 from USD0.7408 a week earlier.

EQUITIES

Investors took some comfort from the initial lack of aggressive response by China to the US tariffs imposed last week with global equity markets starting the week with a positive tone. This helped investors focus back on fundamentals including an expected strong US quarterly earnings season which was about to start.

Trade concerns however resurfaced mid-week when the US announced that it was poised to release a list for a further $200bn of Chinese goods that may be subject to a 10% tariff penalty and this caused a sell off in global equity markets. Risk assets did rebound last Friday as China and the US both signalled a slightly conciliatory tone on trade tensions and the share markets closed the week on a positive note.

By the close last Friday, the S&P/ASX200 Index was trading at 6,268.4 compared to 6,273.3 a week earlier, the highest close since December 2007.

THIS WEEK

The only data out this week will be the latest monthly labour force data for June. Economists are expecting a slight slowdown in employment growth this month (+10,000) - but still moderate net employment growth and confirming there is still solid momentum in the labour market. The unemployment number, at 5.40% is expected to remain unchanged.

INTEREST RATE VIEW

The RBA Board minutes from the early July meeting will be released this week. The minutes may give some further clarity on the RBA's views about the direction of global trade policy as well as the spike in short-term interest rates and the impact for monetary policy. Financial markets for now continue to expect no change to the official cash rate till mid-2019.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	1.50	1.50	1.50	1.50	1.50
90 day Bank Bill	1.70	1.80	2.07	2.06	2.02
180 day Bank Bill	1.83	1.98	2.16	2.16	2.18
1 year swap	1.78	1.87	2.02	1.99	2.03
3 year swap	2.08	2.19	2.27	2.20	2.17
5 year swap	2.47	2.56	2.63	2.56	2.49
10 year swap	2.90	2.91	2.93	2.89	2.83
AUD/USD	0.7755	0.7951	0.7795	0.7456	0.7415
S&P/ASX200 Index	5,765.1	6,077.1	5,829.1	6,094.0	6,268.4

CHART OF THE WEEK

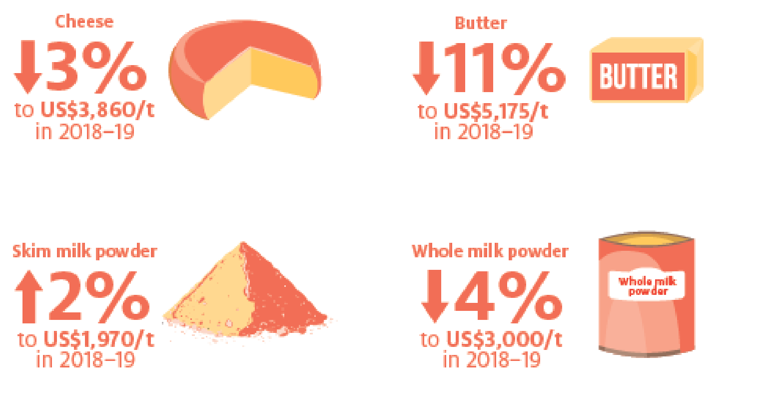
World dairy prices forecast to fall

World prices for most dairy commodities are forecast to fall in 2018–19 in response to increased supplies from major exporters. The butter price is forecast to fall the most in percentage terms (11%) but is still expected to remain well above the 10-year average to 2016–17.

An expected sell-off of EU intervention stockpiles is likely to limit potential increases in dairy prices. As a result, skim milk powder prices are expected to increase only slightly, in nominal terms, and remain below US$2,000 per tonne. World cheese prices are expected to fall as a result of higher US milk production creating greater exportable supplies of cheese.

- Cheese, butter and whole milk powder prices are forecast to fall in 2018–19.
- Processor competition for Australian milk is expected to increase.
- The 2018–19 farmgate milk price is forecast to be 48 cents per litre.

World dairy product price forecasts, 2018–19



Note: Price movements shown in US dollars in nominal terms.

An assumed fall in the Australian dollar in 2018–19 is expected to support the competitiveness of Australian exporters.

Supplier competition expected to increase in 2018–19

Saputo Australia completed their acquisition of Murray Goulburn in late April 2018, after the Australian Competition and Consumer Commission accepted a court-enforceable undertaking from the company to divest the Koroit manufacturing plant in southern Victoria. In early May, Saputo Australia announced a retrospective increase for the 2017–18 season to $5.68 per kilogram of milk solids for all suppliers. The company is expected to announce an opening price for the 2018–19 season in June, but had not done so as of 15 June.

Several processors have publicly stated their intention to increase their supplier base in 2018–19. This is expected to provide some support for farmgate prices and incomes. Over winter and spring, farm incomes may come under pressure from rising supplementary feed and water costs. Fodder supplies are already limited in some regions. Water prices in southern regions have increased from historically low levels to near five-year averages. According to the Bureau of Meteorology's three-month rainfall outlook for June to August, median rainfall is unlikely for south-eastern Australia. This follows one of the warmest and driest Aprils on record.

In 2018–19, farmgate prices are expected to remain relatively unchanged year-on-year, supported by export price premiums for dairy commodities. Australian farmgate prices are strongly correlated with export prices. The competitiveness of Australian exports is expected to be supported by an assumed fall in the Australian dollar.

Shifts in Australian production streams

In the first half of 2017–18 production of skim milk powder fell by 23% and butter fell by 30%. Processors are responding to price incentives to shift manufacturing to whole milk powders and cheese. Low skim milk powder prices have reduced returns to the skim milk powder/butter manufacturing stream.

Australian processors have made significant investments in cheese production capacity. Australian cheese production is estimated to increase by 6% in 2017–18 and a further 2% in 2018–19 to reach 365,000 tonnes. If realised, this would be the highest level of cheese production since 2005–06.

Source: *Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES)*
ABARES 2018, Agricultural commodities: June quarter 2018. CC BY 4.0.
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