WEEKLY ECONOMIC COMMENTARY

Week beginning 26th October 2015

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

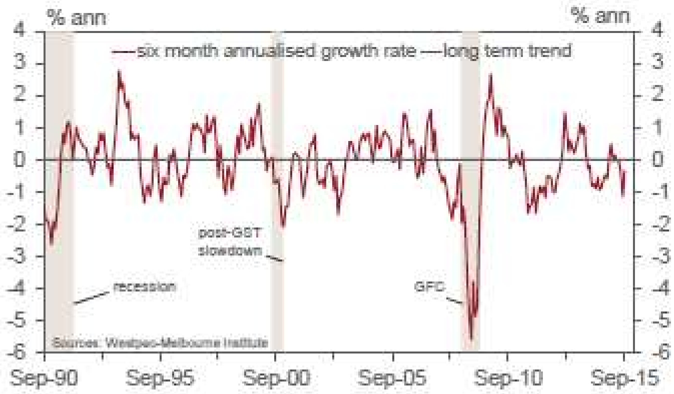
Economic Data	Period	Actual	Previous
DEER Internet Vacancies Index	September	+4.2%	+0.2%
NAB Business Conditions Index	Sept quarter	+11	+5
NAB Business Confidence Index	Sept quarter	0	+4

The **Department of Employment Internet Vacancy Index** was up 4.2% in September. Over the five months to August 2015, there was a reduction in the number of new job advertisements listed on the Australian Job Search (AJS) website. This may have been as a result of the transition of employment services from Job Services Australia to 'jobactive'. The number of job advertisements listed on AJS has begun to recover this month, however, the data in this report should be used with caution.

The **NAB Business Conditions Index** was up 6 points in the September quarter to +11, its highest level since 2008 and above the long-term average. All components of business conditions (trading, profitability, employment) were higher, although the improvement was the most apparent in trading and profitability. The rise is consistent with the growing evidence that non-mining sectors of the economy are staging a more pronounced recovery. **Business confidence** however fell 4 points to zero, likely a reflection of the timing of the survey which took place just prior to the change in Liberal leadership and at a time when global equity market volatility was at a peak. Confidence varied across industries with construction and retail apparently the most buoyant – likely to be related to residential property market performance.

The **Westpac-Melbourne Institute Leading Index,** which indicates the likely pace of economic activity three to nine months into the future, increased from negative 1.14% in August to negative 0.35% in September. Growth in the Index has now been below trend for the last five months and, over the last six months, the six-month annualised growth rate in the Leading Index has slowed from being 0.16% above trend to 0.35% below trend.

Westpac MI Leading Index



The minutes from the Reserve Bank of Australia's October Board meeting released last week suggested little change for the near-term path for monetary policy. While there are clearly concerns over growth prospects in China and East Asia, on the domestic front the tone was essentially "glass half full". The minutes emphasised that the RBA is comfortable with the outlook for the labour market and the apparent slowing in the housing market. However the Board did highlight the importance of the global outlook and seems to be more downbeat on China.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Headline CPI - quarterly	28 Oct	Sept Quarter	+0.6%	+0.7%
Headline CPI – annual	28 Oct	Sept Quarter	+1.7%	+1.5%
Underlying CPI - quarterly	28 Oct	Sept Quarter	+0.5%	+0.5%
Underlying CPI - annual	28 Oct	Sept Quarter	+2.4%	+2.3%
International Trade Prices - imports	29 Oct	Sept Quarter	n/a	+1.4%
International Trade Prices - exports	29 Oct	Sept Quarter	n/a	-4.4%
Private Sector Credit	30 Oct	September	+0.6%	+0.6%
PPI	30 Oct	Sept Quarter	+0.5%	+0.3%

ECONOMIC COMMENTARY

LAST WEEK

The main focus for markets came early last week. According to China's national statistical bureau, the economy grew by 6.9% annually in the September quarter, which was a little slower than the 7.0% growth seen in the June and March quarters but slightly better than the 6.8% market forecast. The improvers in the third quarter were the services sector and internal retail consumption. This was in sharp contrast to the industrial sector, which is on a weakening trajectory due to lower export demand and declining fixed asset investment (construction). Market reaction to China's GDP data was most obvious in the commodity markets, with price declines in the metals and energy sector – crude oil falling around 3%. The commodity-linked currencies were also weaker as a consequence.

The other event last week was the announcement by the CBA, NAB and ANZ to lift interest rates on their variable mortgage rates by 15, 17 and 18 basis points respectively. They said the rate hike was designed to offset some of the costs associated with meeting new capital reserve requirements instituted by the banking regulator in response to the Financial System Inquiry. The Australian Prudential Regulation Authority's new rules will require lenders to bolster their capital reserve risk ratios from 16% to 25% by mid-2016, necessitating the banks to raise billions of dollars from shareholders, institutions or customers.

By the close of trading on Friday, the 90-day bank bill was trading at 2.16% from 2.14% a week earlier while in the long term maturities, 3 and 10 year bond yields closed at 1.83% and 2.62% respectively, from 1.82% and 2.60% a week earlier.

CURRENCY

The Australian dollar lost ground last week in response to a combination of weaker commodity prices and a fall in the Chinese stock market. The Australian dollar logged a minor rally mid-week in the wake of news that the Labor Party would provide support to the China-Australia Free Trade Agreement, but the currency still closed the week lower.

By the close on Friday, the Australian dollar was trading at USD0.7276 compared to USD0.7290 a week earlier.

EQUITIES

Financial stocks continued their recent downward trend which weighed on the broader share market early last week as investors digested the government's response to the Murray financial services inquiry, which backed calls for tougher capital requirements on the banks. Equity markets however came to life last Friday as the European Central Bank gave a strong hint that more stimulus in the form of either further quantitative easing (QE) or loose monetary policy is on the way to boost the economy. ECB President Mario Draghi said the central bank's QE program would need to be "re-examined" at its December meeting, which spurred risk-on trading and pushed global equity markets higher on the day and closed the week with some minor gains.

By the close on Friday the S&P/ASX200 Index was trading at 5,351.6 compared to 5,268.2 a week earlier.

THIS WEEK

We get an update on Australia's inflationary pressures this week with September quarter CPI data, out this Thursday. While this will be the highlight for the week's data, with inflation expected to print in line with RBA forecasts (0.6% headline and 0.5% for underlying), it is not expected to have a material impact on financial market pricing.

INTEREST RATE VIEW

The market had started to unwind some rate cut expectations last week until the CBA, NAB and finally ANZ announced a rate hike which prompted markets to rekindle hopes of a move by the RBA especially given the delay by the US Federal Reserve and the easing signals by the ECB. While not quite as aggressive as previous, futures are still expecting more than one 25 basis point rate cut over the year ahead. The probability of a rate cut next week however has fallen to 30% from 50% a week ago, but remains over 50% for a move in December.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.50	2.25	2.00	2.00	2.00
90 day Bank Bill	2.74	2.26	2.14	2.18	2.16
180 day Bank Bill	2.76	2.30	2.25	2.26	2.22
1 year swap	2.67	2.14	2.05	2.02	1.94
3 year swap	2.82	2.23	2.17	2.08	2.01
5 year swap	3.17	2.51	2.58	2.44	2.38
10 year swap	3.67	2.87	3.17	2.97	2.90
AUD/USD	0.8765	0.7808	0.7291	0.7038	0.7276
S&P/ASX200 Index	5,412.2	5,933.3	5,566.1	5,042.1	5,351.6

CHART OF THE WEEK

Source: Bloomberg - by Narayanan Somasundaram, 13th October 2015. Lana Taylor quit a job at Unilever Pty Ltd to buy, renovate and sell homes in Sydney, where prices have increased in 13 of the past 15 years.

Taylor, a marketing manager at the consumer goods company until October 2013, and two friends started Three Birds Renovations in July last year. Since then, they have bought and sold three homes in Sydney's north-western suburbs and made a gross profit of about $600,000. They are working on the fourth, which will be ready for sale by Christmas. "We aim to flip the property in six weeks," said Taylor, 37. "We are kind of living the dream, where three friends, three mums are buying and renovating houses for a living."

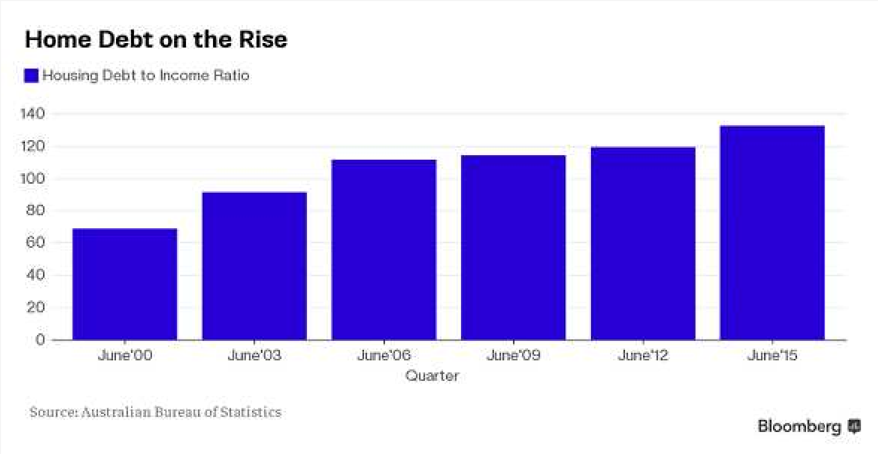
Sydney home prices soared 44% in the three years ended September, enticing speculators who've been partly inspired by home renovation shows on how to spruce up and sell homes for quick profits. The frenzy surrounding Sydney's property boom, reminiscent of the exuberance in US real estate before the 2008 financial crisis, has prompted regulators and Goldman Sachs Group Inc. to warn the market is overheated, while Bank of America Merrill Lynch and fund-manager AMP Capital expect prices to fall.

Since September 2013, more than 1,500 houses and 800 apartments have been resold in less than a year in Sydney, for about 20% more on average, according to online property listing firm Domain Group. That compares with about 530 houses and almost 400 apartments in the previous two years.

People need to be careful because "house prices aren't going to continue to rise much more quickly than income; debt levels can't keep rising faster than income," Reserve Bank of Australia Deputy Governor Philip Lowe said at a conference in Sydney last Tuesday. "Ideally, we'll now go through a period of quite modest house price growth. I think that would de-risk household balance sheets a little and would probably be good for the economy."

Mortgage Risks

Rushing to buy and sell homes is underscoring a build-up of mortgage risks as households take on record debt, lured by home-loan costs at the lowest in five decades. The housing debt to income ratio touched a record high of 132.8% in the three months ended 30 June up from 119.4% three years earlier, according to government data.



"More and more people are being drawn into flipping homes and when interest rates rise or a lot more properties hit the market, they may be caught out," said Martin North, principal at Digital Finance Analytics, which has partnered with JPMorgan Chase & Co. to produce mortgage reports for more than 10 years.

The profit from resales is too good to pass up when wages in the eastern states of New South Wales and Victoria, where most of Australia's population lives, have increased less than 3% since mid-2013. The average annual income is about $55,000 to $60,000. ''You've got people looking at short-term flipping of property as opposed to long-term investment," Stu Benson, a sales manager at Domain Group, said by phone.

Macquarie's View

This is something not lost on regulators, who have already tightened lending to investors. Treasury Secretary John Fraser in June declared a housing bubble in Sydney and pointed to home renovation shows such as The Block and House Rules as partly to blame for the frenzy.

Macquarie Group Ltd. on Monday said that prices are poised to fall because of weak population growth and increasing supply. Sydney and Melbourne home prices are expected to fall by as much as 10% by 2017 and investors need to be mindful of lower returns in the "medium term," AMP Capital said in an e-mailed note Tuesday. ANZ expects residential values to climb only 5% next year.

The housing juggernaut seems to be slowing down amid a regulatory clampdown. Auction clearance rates, used to gauge demand, have come down to 71.4% in Sydney from a peak of over 90% in April, while prices are showing some fatigue: home values in Sydney climbed just 0.1% in September from the previous month, the slowest pace since May, according to property researcher CoreLogic Inc.

That hasn't deterred Taylor and her friends, who spent $3.08mn on the three houses and $365,000 doing them up. They sold them for a combined $4.05m. The gross profit is before stamp duty, legal fees and interest paid, she said. If one sticks to budget, timeline and buys the right properties, and "as long as you buy and sell in the same market, you should be fine," she said. "We have a renovation budget of about 12% of the value of the house and we aim to do about three a year."

About Rural Bank and Rural Finance

Rural Bank has been a wholly-owned subsidiary of Bendigo and Adelaide Bank Limited since 2010 and is the only Australian-owned and operated dedicated agribusiness bank in the country.

From 1 July 2014, Victorian agribusiness lender, Rural Finance joined Rural Bank as a division of Bendigo and Adelaide Bank Limited. As a specialist rural lender, Rural Finance has been fostering the sustainable economic growth of rural and regional Victoria for more than 65 years.

Together, Rural Bank and Rural Finance are supporting farmers and farming communities by providing them with specialist financial tools, industry insights and investment into the future of the Australian agribusiness sector.

Rural Bank's specialist farm finance tools are available nationally via a network of banking partners, including Bendigo Bank and Community Bank® branches and Elders Rural Services. Additionally, Rural Finance has a network of offices across regional Victoria.

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