WEEKLY ECONOMIC COMMENTARY

Week beginning 4th February 2019

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

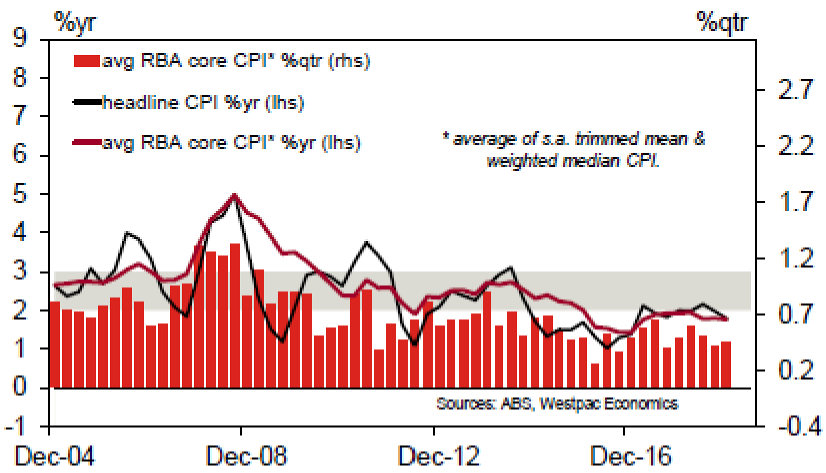
Economic Data	Period	Actual	Previous
NAB Business Survey - Conditions	December	+2	+11
NAB Business Survey - Confidence	December	+3	+3
Headline Inflation – Quarterly	Dec/quarter	+0.5%	+0.4%
Headline Inflation – Annual	Dec/quarter	+1.8%	+1.9%
Underlying Inflation – Quarterly	Dec/quarter	+0.4%	+0.4%
Underlying Inflation – Annual	Dec/quarter	+1.8%	+1.8%
Import & Export Prices	Dec/quarter	-1.0%/+4.4%	+1.9%/+3.7%
Private Sector Credit	December	+0.2%	+0.3%

The NAB business survey for December was a mixed result with business conditions down sharply while confidence was unchanged. The **Business conditions** index fell sharply, down 9 points to +2 in December – the largest monthly fall since the GFC with broad-based falls across all states and sub-indexes with mining and construction the only industries to record an improvement in the month. Employment fell 5 points to +4, profitability fell 8 points to 0 and trading conditions also fell 8 points to +7. The **business confidence** index was unchanged in December at +3 index points – an impressive result given the current tone of the market and the large fall in conditions this month.

Headline inflation was up 0.5% in the December quarter to be up 1.8% over the year. The result was below the RBA's forecast of 2.0%, but above the consensus of 1.7%. The broader price detail was in line with expectations. The main upward surprise was in the food category (+0.9%) where it appears the drought had a significant impact on some food items such as meat. In total, 6 of the 11 broad expenditure groups increased in in the quarter. The largest contributions came from the 9.4% increase in tobacco prices and a 6.2% lift in domestic airfares which were partially offset by a 2.5% fall in petrol prices.

The RBA's preferred inflation measure of **underlying (or core) inflation** which is seasonally adjusted and excluding extreme moves, increased by 0.4% in the quarter for an annual underlying CPI of 1.8%.

Inflation, Headline and Core



Export prices increased by 4.4% in the December quarter to be up 15.7% over the year. Stronger commodity prices lifted export prices in the quarter with iron ore (+9.0%), LNG (+8.6%), coal (+3.7%) and gold (+3.4%). The impact of the drought saw cereal prices up 4.4% and meat prices rising 2.4% in the quarter. **Import prices** rose by 0.5% in the quarter and were up 7.8% over the year. Prices of capital goods rose by 1.2% while intermediate goods rose by 0.2% and consumption goods by 0.5%.

Total **private sector credit** was up 0.2% in December to be up 4.3% over the year. Housing credit was up 0.3% (+4.7% annually) with owner-occupier housing credit up 0.4% and investor credit up 0.1%. Business credit was up 0.3% in the month and +4.7% annually while personal credit fell .04% in December to be down 2.0% annually.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
ANZ job advertisements	04 February	January	n/a	+0.0%
Building Approvals	04 February	December	+2.0%	-9.1%
Balance of Trade	05 February	December	+$2.25bn	+$1.925bn
Retail Trade	05 February	December	+0.1%	+0.4%
RBA Board Meeting – rate decision	05 February	February	1.5%	1.5%

ECONOMIC COMMENTARY

LAST WEEK

Last week opened with a broad risk-off tone, following disappointing earnings reports from high profile companies that pointed to a slowdown in Chinese demand for their downgrades. Risk sentiment was not helped by news that Trump said the chance of a bipartisan deal to avert the government shutting down again was “less than 50/50” and he again threatened to use his emergency powers if required to build the wall.

The US Federal Reserve held interest rates steady, as was widely expected, signalling a new phase in its monetary policy path, shifting its guidance language from a commitment to "some further gradual rate increases" to a more cautious tone emphasising flexibility and patience in its future policy settings. The markets liked this news and pushed equities higher and bond yields and the US dollar lower.

Locally, with the market having shifted from pricing in the probability of a rate hike to a rate cut in recent months, the weak inflation data and business conditions saw the markets continue to factor in the possibility of a rate cut, yields drifting lower over the week.

By the close on Friday, the 90-day bank bill was trading at 2.05% compared to 2.08% a week earlier. In the long-term maturities, three and 10 year bond yields closed at 1.73% and 2.21% respectively, from 1.71% and 2.22% a week earlier.

CURRENCY

The Australian dollar opened the week a little softer following the weak NAB business survey, trading to a low of USD0.7138. From there, a combination of low CPI data, higher commodity prices (especially oil and iron ore) and a weaker US dollar after the US Federal Reserve left rates unchanged pushed the AUD higher, rallying to a three year high of USD0.7295 and posting a 3% gain for the month of January.

By the close last Friday, the Australian dollar was trading at USD0.7238 compared to USD0.7097 a week earlier.

EQUITIES

After opening the week lower, equity markets rallied as risk sentiment improved after the US Federal Reserve watered down the prospects of future rate hikes and some better earning results from market heavyweights Boeing, McDonald’s, Facebook and Apple. The news of plans for a re-opening of Brexit negotiations provided European equities with some positive sentiment, however EU leaders have voiced their frustration with the process.

Our local share market posted a small loss for the week despite the offshore rally. The market was held back by the financial sector which was down 3% last week as bank shares fell in anticipation of some potential negative fallout from the Banking Royal Commission report due out this week.

By the close last Friday, the S&P/ASX200 Index was trading at 5,862.8 compared to 5,905.6 a week earlier.

THIS WEEK

The RBA comes into focus this week with their first board meeting for 2019. We also get a speech from the RBA Governor and the quarterly statement on monetary policy. While it is almost certain to leave rates unchanged analysts will be looking through the accompanying statement to see if the RBA acknowledges the growing offshore risks, reviews (down) their growth forecasts or deviates from their current neutral monetary policy stance.

Economic data releases this week include the latest monthly retail sales, job ads, trade numbers and building approvals.

INTEREST RATE VIEW

The RBA will probably reduce its economic growth forecasts at this week’s board meeting but should still signal that the next move in rates will be up. Some more pessimistic economic forecasts for economic activity, the labour market and inflation suggest that the RBA may have to cut interest rates before long. Futures markets have a 55% probability of a rate cut factored in before Christmas.

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	1.78	1.97	1.93	2.07	2.05
180 day Bank Bill	1.91	2.16	2.10	2.21	2.17
1 year swap	1.84	2.04	1.97	1.91	1.93
3 year swap	2.20	2.21	2.16	1.85	1.86
5 year swap	2.61	2.55	2.51	2.12	2.12
10 year swap	2.99	2.91	2.88	2.44	2.45
AUD/USD	0.8003	0.7361	0.7237	0.6935	0.7238
S&P/ASX200 Index	6,121.4	6,234.8	5,849.2	5,633.4	5,862.8

CHART OF THE WEEK

The inflation target

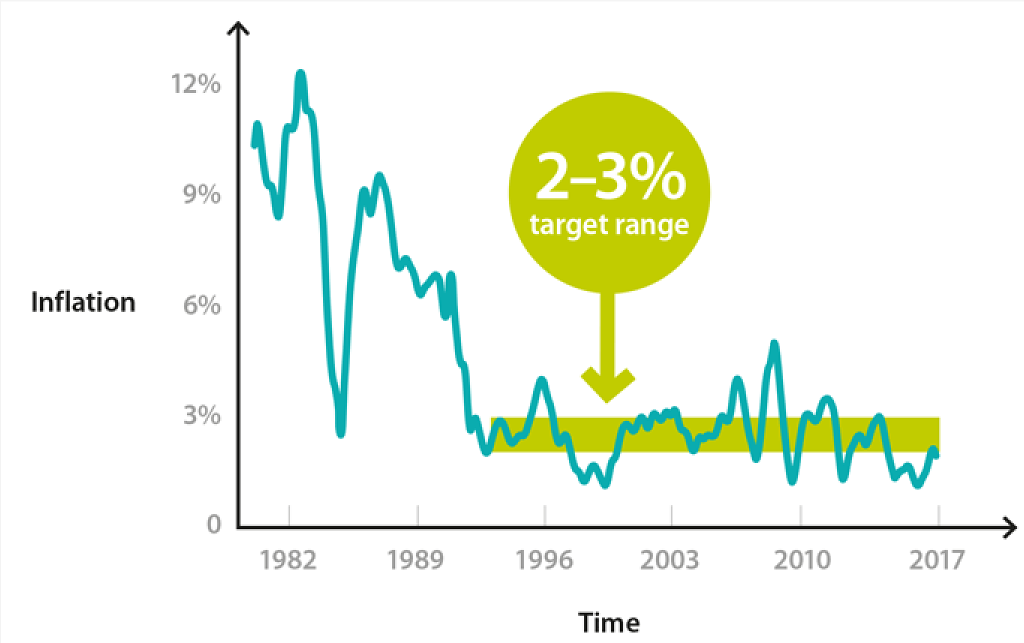
With the latest CPI data released last week and another set of numbers below the RBA's official target, I thought it would be appropriate to discuss this economic data release in a little more depth.

I can't believe it's been 25 years since the RBA adopted the current inflation target, which is 2% to 3%.

The RBA says it's pleased with how the key numbers compare on a before-and-after basis:

- From 1973 to 1993 – average annual inflation was 8.8%, unemployment was 6.9% and GDP was 2.8%
- From 1993 to 2017 - average annual inflation was 2.5%, unemployment 6.3% and GDP was 3.2%

"The inflation target has made a material contribution to the very satisfactory macroeconomic outcomes that the Australian economy has enjoyed over the past 25 years," according to the RBA. "Inflation has been consistent with target". "The unemployment rate, on average, has been lower and less variable than in earlier periods". "This has gone a long way to fulfilling the mandate of the RBA of contributing to the welfare and prosperity of the Australian people."



However, if CPI continues to remain below the 2% to 3% target, the RBA will need to eventually

- Review their target; or
- Cut interest rates to stimulate the economy and increase inflation.

About Rural Bank

Rural Bank has been a wholly-owned subsidiary of Bendigo and Adelaide Bank Limited since 2010. It is the only Australian-owned and operated dedicated agribusiness bank in the country, providing exceptional financial services, knowledge and leadership for Australian farmers to grow.

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Future driven.

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