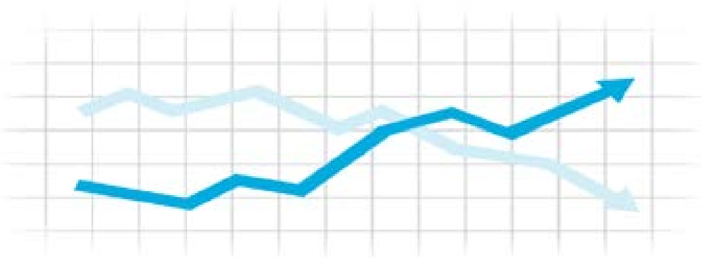
WEEKLY ECONOMIC COMMENTARY



Week beginning 5th September 2016

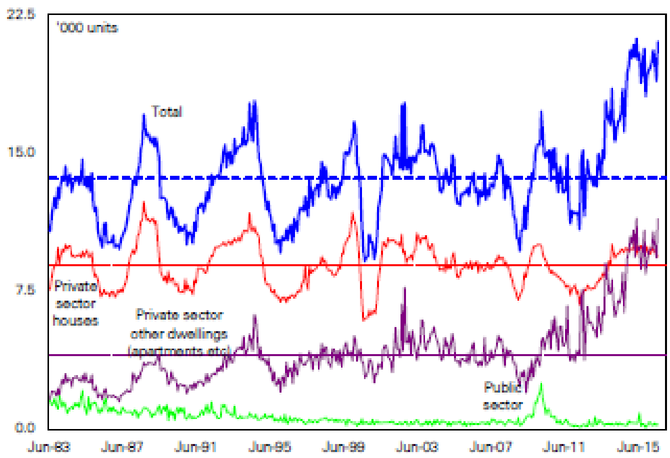
ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Building approvals	July	+11.3%	-2.9%
Private sector capital expenditure (CAPEX)	June quarter	-5.4%	-5.2%
Retail sales	July	+0.0%	+0.1%
Private sector credit	July	+0.2%	+0.2%

Building approvals jumped a solid 11.3% in July, the largest jump in monthly building approvals in two and a half years, to be up 3.1% over the year. While private house approvals fell 0.6%, the increase in total approvals this month was due to a 23% jump in private apartment approvals. This pushed both apartment and total approvals back toward recent record highs. At 21,000, monthly approvals are only marginally below the highest level on record, reached in May 2015.

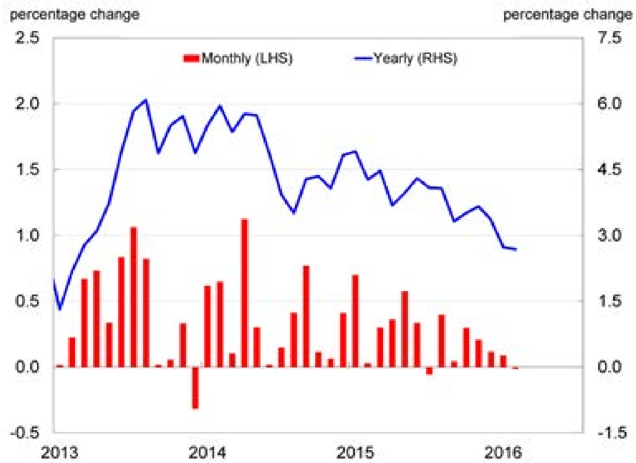
Number of dwelling approvals



Total **capital expenditure** (CAPEX) fell by 5.4% in the June quarter, with the volume of total capex spending down 17.4% over the year. The fall this quarter was mainly due to another very large fall in mining capex (down 16%), which was concentrated in building and structures investment (down 10.6%). Non-mining capex increased by 2.1% thanks to a large increase in manufacturing investment. Non-residential construction fell by 11% representing the largest fall since 2000. Equipment, plant and machinery investment, the only series that feeds directly into next week's GDP data, rose 2.8% (the strongest rise since 2014) – this should add 0.1% to GDP. The volume of non-mining investment is essentially flat over the year (-0.1%) while mining investment is down 36.6% over the year. Updated investment plans point to sharply lower mining capex and fairly flat non-mining investment in 2016/17.

Retail sales were flat in July – now up just 2.7% over the last year and continuing the weak momentum in this series seen this year. Retail sales are currently being weighed down by weak wages growth, ongoing competitive downward pressures on retail price inflation, and a structural shift in spending preference towards services. There were falls recorded this month in department store sales (-6.2%) and large store sales (-0.7%) which were partially offset by rises in furniture sales (+1.4% m/m) and café, restaurants, and takeaway food sales (+1.2%).

Retail Sales



Private sector credit was up 0.2% in July and is now 6.2% higher over the year. Housing credit was up 0.5% in the month (+6.6% annually) led by a 0.5% increase in owner occupied housing credit, while business credit increased by 0.3% (+6.2% annually). Personal credit however recorded a small 0.1% decline in July to be down 0.8% over the year.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
ANZ Job Ads	05 Sept	August	+2.0%	-0.8%
Business Indicators - Inventories	05 Sept	June quarter	+0.3%	+0.4%
Business Indicators - Company operating profits	05 Sept	June quarter	+3.0%	-4.7%
Balance of Payments	06 Sept	June quarter	-$19.5bn	-$20.8bn
RBA Board Meeting – rates decision	06 Sept	September	1.50%	1.50%
GDP	07 Sept	June quarter	+0.3%	+1.1%
Trade Balance	09 Sept	July	-$2.6bn	-$3.2bn
Housing Finance	09 Sept	July	-2.0%	+1.2%

ECONOMIC COMMENTARY

LAST WEEK

Economic data out last week was generally better than expected, the highlight being a rise of 11% in July building approvals with the exception being a flat retail sales number. Financial markets however failed to push either way, trading in a narrow range for most of last week.

Offshore, the UK's manufacturing index recorded the highest increase in 25 years last Thursday, while the US ISM manufacturing index showed the biggest single drop in two years. This latter number has once again eased expectations of a US rate hike, which sent the US dollar and interest rates lower, and this move flowed through to our market.

By the close of trading on Friday, the 90-day bank bill was trading unchanged at 1.73% while in the long term maturities, 3 and 10 year bond yields closed at 1.45% and 1.86% respectively, from 1.42% and 1.87% a week earlier.

CURRENCY

Comments from US Federal Reserve officials early last week indicating that a US rate hike was on the cards soon continued to help the US dollar strengthen against most G10 currencies. Some poor US data later in the week and a lower oil price saw the US dollar retrace, falling against most currencies. Our Australian dollar initially traded lower, touching a one month low of USD0.7497 before the US dollar weakness late in the week saw our currency rally once again.

By the close on Friday, the Australian dollar was trading at USD0.7544 compared to USD0.7632 a week earlier.

EQUITIES

US equities climbed higher early last week taking the Dow Jones Index to within 1% of its all-time high, after some better than expected US income and spending data. By mid-week, the rally had reversed after some poor US data and also weighed down by a fall in Apple after European Commission antitrust regulators ordered the company to pay $19bn in back taxes to the Irish government. A sharp fall in oil prices on concerns about over supply hurt mining and energy stocks last week (Santos and BHP both down almost 7% over the week) and our market closed 2.5% lower for the week and near a seven-week low. Shares in fertilizer companies jumped on news of a potential merger between Potash Corp of Saskatchewan and Agrium. A deal could be announced within a week amid talks of falling prices and lower farmer spending.

By the close on Friday the S&P/ASX200 Index was trading at 5,372.8 compared to 5,515.5 a week earlier.

THIS WEEK

Focus this week will be on the economic growth (GDP) data for the June quarter. Market estimates are for a quarterly rise of 0.3% but this comes on the back of a 1.1% rise in March and would bring annual GDP to 3.2%, broadly in line with the RBA's forecast for GDP of 3.25%. The RBA Board also meets this week and it will be the Governor Glenn Stevens' last meeting before retiring after 30+ years with the RBA. With economic data releases since the last meeting no better (or worse) than expected and the fact that the RBA already cut rates in August, another rate change this month is highly unlikely. The RBA should continue to indicate a mild, but not pressing, easing bias.

INTEREST RATE VIEW

Financial market pricing for the next move in rates will continue to be closely influenced by offshore factors in the near term, in particular the pricing for the next US Federal Reserve move. In response to the commentary from US Fed officials and the subsequent sell-off in US treasuries, the market has marginally reduced the probability of another RBA rate cut. While the RBA is seen to be on hold, possibly for the rest of this year, an easing bias clearly remains.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.00	2.00	1.75	1.50	1.50
90 day Bank Bill	2.15	2.32	2.00	1.79	1.73
180 day Bank Bill	2.21	2.43	2.14	1.98	1.93
1 year swap	1.97	2.16	1.89	1.70	1.66
3 year swap	2.05	2.14	1.83	1.69	1.63
5 year swap	2.45	2.38	2.09	1.92	1.87
10 year swap	3.03	2.68	2.38	2.16	2.07
AUD/USD	0.6980	0.7364	0.7253	0.7598	0.7544
S&P/ASX200 Index	5,040.6	5,090.0	5,318.9	5,475.8	5,372.8

CHART OF THE WEEK

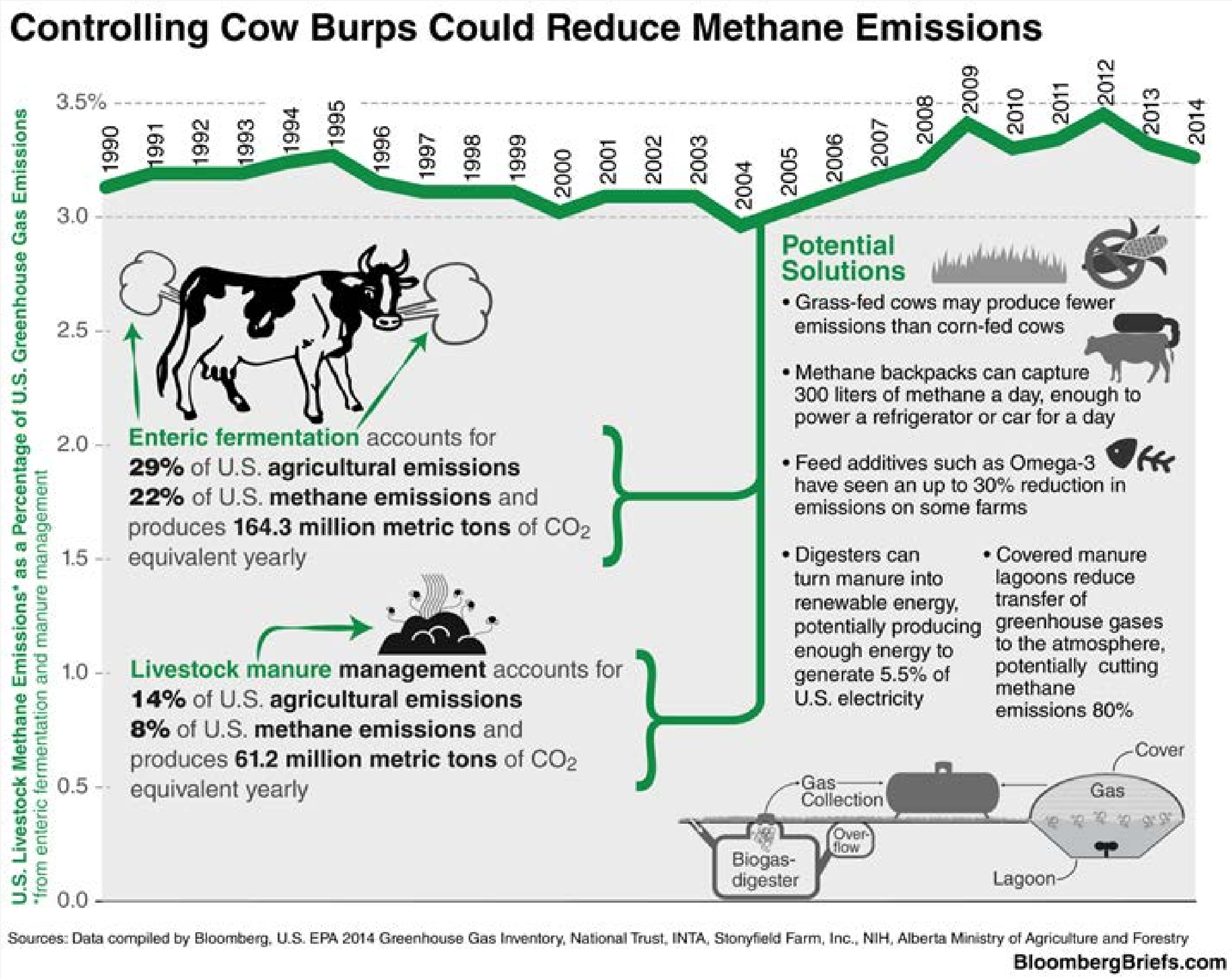
Could Less Gassy Livestock Be a Cash Cow?

It's time to have a conversation about flatulent cows.

The hamburgers and cheese that come from US cattle may be favourite fare at many summer cookouts, but the methane the same cows produce is significantly less appetizing.

That's especially the case for sustainable investors looking for a low-emission place to park their cash. "Enteric fermentation," or livestock's digestive process, accounts for 22% of all US methane emissions, and the manure they produce makes up 8% more, according to the US Environmental Protection Agency.

And although agriculture is a growing industry as the world looks to feed its swelling population, some investors are reluctant to support a sector with such a hefty methane footprint. "There are a lot of factors or buckets that go into agricultural emissions, but livestock tends to be one of the largest focuses," said David Nicola, portfolio manager of the Gratitude Railroad Farmland Fund, which launched this week and is targeting $40 million in capital commitments focused on regenerative agriculture.



It's also an issue for Michael Landymore, a senior portfolio manager at Impax Asset Management responsible for the firm's food and agriculture strategy. "We tend not to invest in companies that are solely focused on growing livestock," he said in an interview Wednesday.

Emissions Issues

Methane, like carbon, is a greenhouse gas, but methane’s global warming impact per molecule is 25 times greater than carbon’s, according to the EPA. In June, scientists from the Consultative Group for International Agricultural Research found that the agricultural sector must reduce non-CO2 emissions by 1 giga-tonne per year by 2030 if it's going to help meet the two degree limit on increases in global temperature required by last year's United Nations climate agreement in Paris. Almost 130 countries that arrived in Paris last year to agree on emissions reductions included agriculture in climate change mitigation targets, according to CGIAR.

CHART OF THE WEEK

But while many agree lower emissions are an important goal for the livestock industry, just how they get there is still up for debate. It doesn't help that there isn't even a uniform way to measure cow-produced emissions.

For meat producers, “monitoring greenhouse gas emissions from cattle is challenging as there are more than 700,000 cow-calf stocker ranches in the US” beef supply chain, Cargill Inc. spokesman Michael Martin said in an e-mail.

Isolating the impact of direct livestock emissions versus indirect emissions such as fertilizer, crop production, and transport for animal feed is also a challenge, companies and investors say. "The issue for agriculture is identifying the actors and creating levers for change,” Cynthia Simon, senior manager of investor initiatives at CDP, a not-for profit focused on corporate carbon and water measurement, said in an e-mail.

Stronger Together

Some big producers are banding together to try to tackle the issue. The US Roundtable for Sustainable Beef, which includes companies such as McDonald's Corp., Wal-Mart Stores Inc., Tyson Foods Inc., JBS USA Holdings Inc. and Cargill, launched in 2015 with the aim of finding better ways to measure the environmental impact of cattle. Greenhouse gas emissions is one of its six "high priority" indicators for sustainability, but “it is a challenge to align the entire value chain,” to get emissions measurements, said John Butler, chair of the roundtable, in an interview.

Some companies are also taking matters into their own hands, getting creative when it comes to cutting emissions from their herds. Cargill, for example, uses domed lagoons to capture some of the methane released from biodegrading cow manure. Yogurt maker Danone found through its research that adding Omega-3 fatty acids to a cow’s diet — largely through infused flax seed — can reduce methane emissions from cows by up to 30%. Further research, however, found that while the flax additive reduced methane, it also reduced milk production, pushing Danone to focus on other ways to cut farm emissions.

"We’re really actively engaged in supporting research in this area," said Britt Lundgren, Director of Organic and Sustainable Agriculture at Danone-owned Stonyfield Farm Inc. "Our understanding of this I think is still just at the tip of the iceberg and we’ve got a lot to learn before we feel like we have all the answers on how to reduce emissions from our farms."

Cow Backpacks

In Argentina, home to over 50 million cows, researchers from the Argentina National Institute of Agricultural Technology (INTA) are attempting to use "methane backpacks," plastic contraptions attached to cows, to capture methane from a cow’s digestive tract. The technology is in its early stages, but so far the backpacks have been able to extract 300 litres of methane a day, enough to power a car or refrigerator, according to INTA.

Creating tools that will help farms identify opportunities to reduce emissions, while maintaining or improving profitability is "the holy grail," Lundgren said.

Impax, whose food and agriculture strategy has about $178 million in assets under management globally according to its website, is investing in companies that breed livestock that produce less methane, develop emissions-reducing feeds and provide consumer alternatives to dairy, Landymore said. But it's going to be consumers, not investors, whose involvement results in real change, said Gratitude Railroad Farmland Fund's Nicola.

"Where the pressure to measure these emissions more thoroughly will come from are consumers. It’s not likely to come directly from investors," he said. "The opportunities that are created in sustainable agriculture nowadays, it’s generally based on the consumer waking up and realizing that they would like to have a higher quality product."

Source: Bloomberg by Jason L Strongin, 19th August 2016
This story originally ran in Bloomberg Brief's free Sustainable Finance newsletter.

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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