WEEKLY ECONOMIC COMMENTARY

Week beginning 7th January 2019

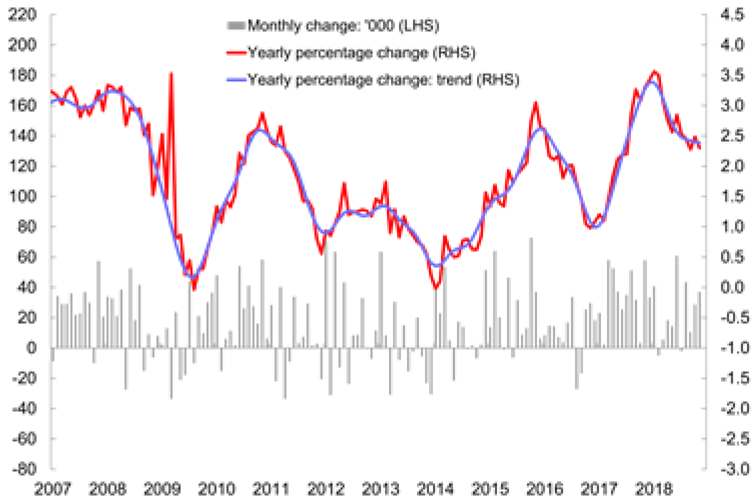
ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Employment	November	+37,000	+32,800
Unemployment	November	5.1%	5.0%
Private Sector Credit	November	+0.3%	+0.4%

Employment increased by 37,000 in November with part-time employment up a strong 43,400 which was partially offset by a reduction in full-time employment of 6,400. Normally an increase in employment of this size would be enough to push the unemployment rate lower but an increase in the participation rate to 62.3% (the highest in seven and a half years) saw the **unemployment rate** increase from 5.0% to 5.1% this month.

Employment Trends



Source: ABS, Citi Research

Private sector credit was up 0.3% in November to be up 4.4% annually (down from +4.6% in October). Housing credit was up 0.3% and 4.9% annually, while personal credit fell 0.3% in the month and is up 1.7% annually and business credit gained 0.5% to be up 4.4% annually. (Private Sector Credit measures the change in the total value of new credit issued to consumers and businesses).

In other data, the CoreLogic House Price index fell 1.3% in the eight capital cities in December, the largest monthly fall since the current downturn started and are down 6.1% over the year. Sydney prices were the main driver for the fall, down 1.3% (now down 8.9% annually) while Melbourne house prices were down 0.9% (down 7.0% annually).
House prices have now fallen by 6.9% from their peak in July 2017, which makes the current slump the third-deepest on record.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Trade Balance	8 January	November	$2.45bn	$2.316bn
Building Approvals	9 January	November	-0.3%	-1.5%
ABS Job Vacancies	9 January	November	n/a	+0.6%
Retail Trade	11 January	November	+0.5%	+0.3%

ECONOMIC COMMENTARY

LAST WEEK

Despite a lack of domestic data releases and holiday-thinned trading, financial markets maintained a significant risk-off tone over the last few weeks. The most significant was a collapse in US equity markets and a subsequent rally in US treasuries. The rally in US bonds also pushed our long term interest rates lower while the “seasonality” impact and end-of-year credit squeeze pushed short term bank bill yields (BBSW) 10 to 15 basis points higher over December. This is despite some economists (albeit a minority) starting to price in a small risk of an RBA rate cut.

Finally, the geopolitical risks didn’t go away with Brexit and trade negotiations still a hot topic as well as rumours of US Federal Reserve chair Jerome Powell potentially being fired. Adding to this was Trump’s threat to close down the US government if he didn’t get the finance for his great wall of Mexico – and this has persisted with certain US government departments and services closing in late December.

Most of this trend continued into the first week of the New Year, as traders started to return from holidays and digest the moves in markets.

By the close on Friday, the 90-day bank bill was trading at 2.07% compared to 2.02% in mid-December. In the long-term maturities, three and 10 year bond yields closed at 1.80% and 2.24% respectively, from 1.99% and 2.47% in mid-December.

CURRENCY

The risk-off moved resulted in a rally in the US dollar and a corresponding 3.5% fall in the Australian dollar over the last two weeks. While commodities held up fairly well, supporting the AUD, the oil price has collapsed over 10% during the month and weighed on the AUD (oil is now down 40% from its peak in October). Concerns over slowing global economic growth, the continuing US/China trade wars and a widening interest rate differential with the US also weighed on the AUD.

The AUD fell through the critical 70 cent level for the first time in three years last week and spiked to a 10-year low of USD0.6730 in wild Asian trading last Thursday before bouncing two cents higher and consolidating around USD0.6950.

By the close last Friday, the Australian dollar was trading at USD0.7010 compared to USD0.7192 in mid-December.

EQUITIES

Global equity markets closed the year down significantly with December recording another loss and this was despite a solid recovery late in the month. While US equities fell 9% in December (recovering from being down over 11% on Christmas Eve) our share market outperformed by only falling 0.2%. However, the S&P/ASX200 index had its worst annual loss in seven years, falling 6.9% (the Dow and Nasdaq were down 5.6% and 3.9% respectively as a comparison). Financial stocks, which account for one third of the index, dropped 15% over 2018 in their worst performance since the GFC due to falling house prices, tighter credit conditions and fears of more stringent regulations following the banking inquiry.

As for last week, equity markets continued their fall thanks in particular to Apple’s revised sharply lower first quarter revenue guidance (its first in almost two decades) which was blamed largely on “economic deceleration in greater China” - Apple shares fell 10% and the nervousness spilled over to the wider equity market.

By the close last Friday, the S&P/ASX200 Index was trading at 5,619.4 compared to 5,602.0 in mid-December.

THIS WEEK

A steady stream of economic data is due out this week with building approvals and retail sales the main focus. While monthly building approvals data can be volatile, analysts will be looking to see if the recent fall in house prices is reflected in this forward indicator. Retail sales are expected to receive a boost from the “black Friday” sales in November.

INTEREST RATE VIEW

Markets last week shifted sentiment after the AUD fell to a 10-year low and futures began to price in an RBA rate cut. In fact there was one RBA rate cur full priced in by the end of 2020 and the odds of one late this year was rising towards 50%. The shift was due to a combination of expected slowing global growth, lingering trade war negotiations and concerns a Chinese slowdown would negatively impact the Australian economy – raising fears of a recession.

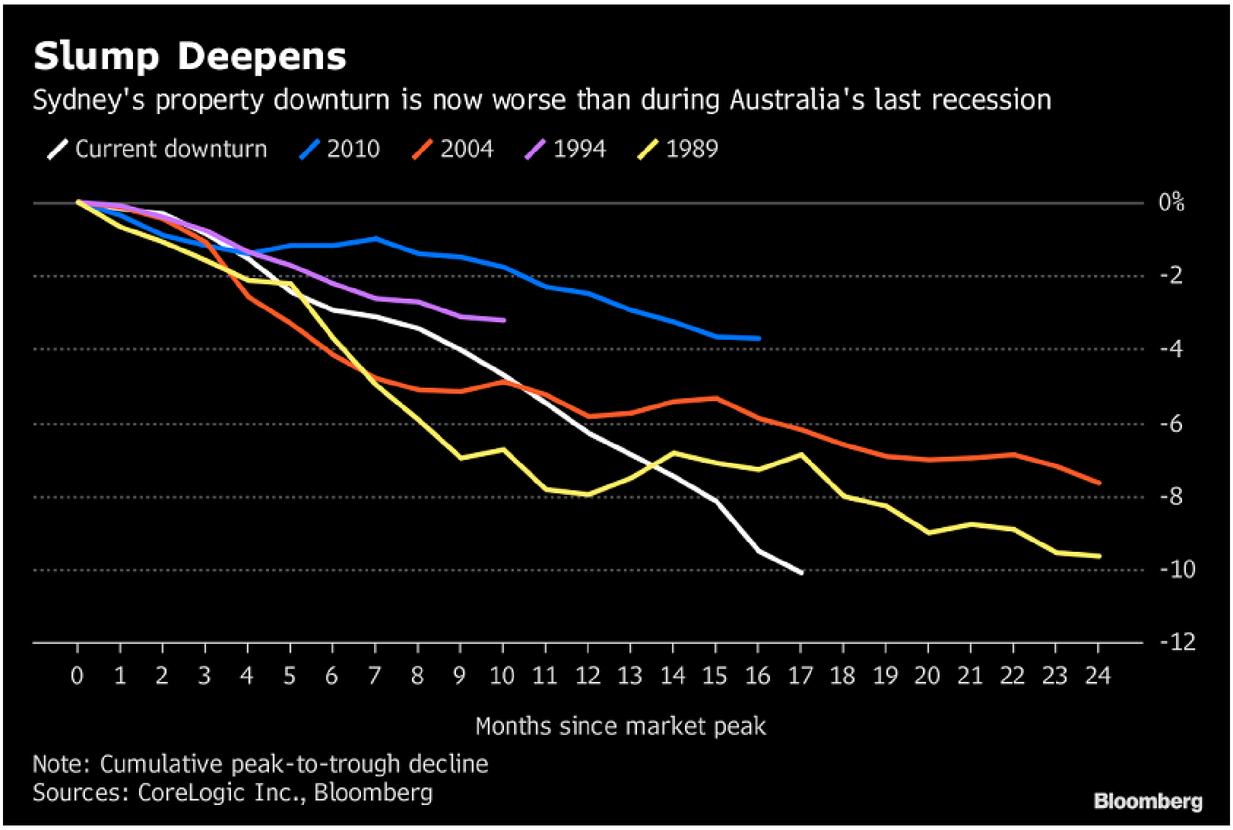
Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	1.50	1.50	1.50	1.50	1.50
90 day Bank Bill	1.81	2.06	1.92	1.99	2.07
180 day Bank Bill	1.99	2.18	2.11	2.14	2.18
1 year swap	1.84	2.02	1.92	1.92	1.93
3 year swap	2.12	2.16	2.11	2.00	1.88
5 year swap	2.47	2.50	2.49	2.32	2.15
10 year swap	2.79	2.82	2.89	2.65	2.48
AUD/USD	0.7839	0.7408	0.7059	0.7227	0.7010
S&P/ASX200 Index	6,122.3	6,272.3	6,185.5	5,681.5	5,619.4

CHARTS OF THE WEEK

Sydney house slump builds as prices drop the most in 30 years

Sydney's property market slump has reached a new milestone, with values falling further than the late 1980's when Australia was on the cusp of entering its last recession. Average Sydney home values have fallen 11.1% since their 2017 peak, according to CoreLogic's head of research Tim Lawless. That surpasses the top-to-bottom decline of 9.6% recorded between 1989 and 1991. Nationwide, house prices fell 4.8% last year, the weakest housing market conditions since 2008.

Sydney was the epicentre of a five-year boom and prices are still more than 60% higher than they were in 2012. That means few existing homeowners are underwater, and the big four banks, which dominate about 80% of the home loan market, have plenty of buffer before losses would bite.



The declines in Australia's most populous city are accelerating as tighter mortgage lending standards crimp the amount people can borrow and as nervous buyers sit on the sidelines.

The biggest driver of the falls has been a gradual tightening of credit standards over the past four years. Concerned that standards had become too lax and the market was overheating, regulators limited the number of interest-only mortgages and pressed banks to tighten scrutiny of income and expense verification.

Analysts estimate the maximum amount households can borrow has been reduced by about 20%.

In its latest survey of Australia, the OECD however warned that soft landings in housing markets are rare internationally and the country should be ready to respond to the risk of a significant price decline. Additionally, the RBA's deputy Governor, Guy Debelle, said banks risked exacerbating the slump if they all pulled back from lending simultaneously.

Australian authorities have repeatedly emphasized the declines are desirable as the boom was unsustainable, and have suggested the market is now returning more normal conditions.

Source: *CoreLogic,*
The Sydney Morning Herald and Bloomberg by Emily Cadman at ecadman2@bloomberg.net

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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