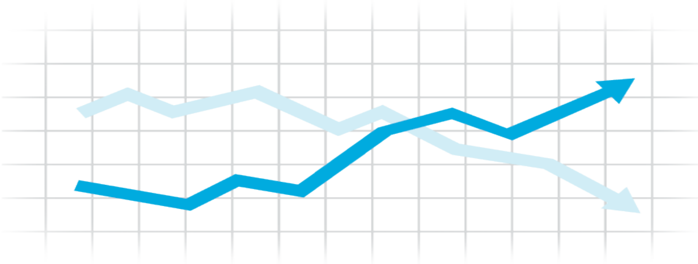
WEEKLY ECONOMIC COMMENTARY



Week beginning 7th March 2016

ECONOMIC DATA ROUNDUP

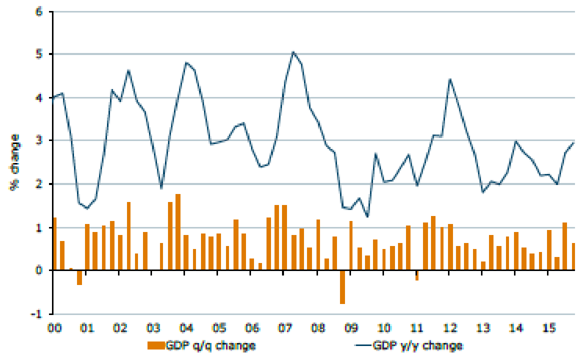
DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Company Profits	Dec quarter	-2.8%	+1.3%
Private Sector Credit	January	+0.5%	+0.5%
Balance of Payments	Dec quarter	-$21.1bn	-$18.1bn
GDP	Dec quarter	+0.6%	+0.9%
Building Approvals	January	-7.5%	+9.2%
Trade Balance	January	-$2.9bn	-$3.5bn
Retail Sales	January	+0.3%	+0.0%

Business indicators were weaker than expected in the December quarter. **Company profits** fell by 2.8%, the weakest areas were mining (-6.2%), wholesaling (-6.8%) and retailers (-6.4%), while construction and hospitality were the strongest. **Wages and salaries** were up 0.5% in the quarter and are now 2.8% higher over the year, while **inventories** were down 0.4% in the quarter. **Private sector credit** increased by 0.5% in January to be up 6.5% annually. The growth this month was attributed to a 0.5% rise in housing credit (owner occupier credit (+0.6%) grew faster than investor housing (+0.3%) for the month), while business credit also extended its recent solid run with a 0.6% gain, to be up 7.3% and 6.2% respectively over the year. Personal credit however fell 0.2% in January to be also down 0.2% on an annual basis.

The **Current Account** (balance of payments) for the December quarter was a little larger than forecast, posting a deficit of $21.1bn. Exports were up 0.6% in the quarter (+5.7% annually) while imports fell 0.6% (+1.2% annually). The result was driven by a widening in the trade deficit from $7.3bn in the September quarter to $9.9bn this quarter.

Real GDP Growth



Economic growth (GDP) increased by 0.6% in the December quarter and with a revised rise of 1.1% in the September quarter, the annual GDP is now 3.0%. Within the data, household consumption expenditure rose 0.8% (+2.9% annually) and dwelling investment rose 2.2% (+9.8% annually). These were partially offset by a fall in business investment of 3.3% (-11.3% annually) of which the new engineering component declined by 12.3% in the quarter and is down 26.8% annually.

Building approvals fell 7.5% in January and are now down 15.5% over the year. Private house approvals fell 6.0% (to be down 3.3% annually) while the volatile private "other approvals" (i.e. apartments) fell 10.8% in January (-6.7% annually).

Australia's **trade balance** narrowed in January to a deficit of $2.9bn. The value of exports increased by 1.1% this month after three months of resources-driven declines (resource exports were up 0.9% as the value of coal and other mineral fuel exports rebounded), while the value of imports fell by 1.1%.

Retail sales were up 0.3% in January to be 4.0% higher over the year. Sales were strong in hardware, building and garden supplies (+2.1%), cafés, restaurants, and catering (+1.9%) and "other" recreational goods (+1.7%) offset by weakness in department stores (-1.3%), liquor sales (-1.3%) and clothing (-0.2%).

The Reserve Bank left monetary policy unchanged once again last week after their monthly board meeting. The accompanying statement concluded by noting that there could be scope for easier policy should data and conditions (both domestic and offshore) allow it. There appears to be no concerns about the global financial market turbulence with regard to changing the RBA's thinking nor was there any mention of the recent increase in unemployment or the stubbornly high currency.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
ANZ Job Ads	07 Mar	February	n/a	+1.0%
NAB Business Survey (conditions/confidence)	08 Mar	February	n/a	+5/+2
Housing Finance	09 Mar	January	-3.0%	+2.6%
Westpac/MI Consumer Sentiment	02 Mar	March	+0.5%	+4.2%

ECONOMIC COMMENTARY

LAST WEEK

Not surprisingly, the RBA left the official cash rate unchanged at 2% at its board meeting last week with little change to the tone of the accompanying statement. As has been the case for some time now, the RBA remains ready to cut rates if necessary but it will be data-dependant. And to that extent, the GDP data last week showing 2015 economic growth at 3.0% was well above the RBA's forecast of 2.5% and reduces the prospect of the RBA cutting rates.

China eased monetary policy last week by reducing the reserve requirement ratio (the reserve banks have to hold with the central bank) by 50 basis points to 17% in an attempt to boost liquidity, reduce capital outflows and stimulate softening economic activity.

Some positive US data helped to calm fears of a recession and brought out the investors last week, pushing equities, commodities, interest rates and the US dollar higher last week. With some stability returning to markets, interest rates have become sensitive to the stronger than expected data last week and reacted by selling off (yields rising) by up to 20 basis points.

By the close of trading on Friday, the 90-day bank bill was trading at 2.32% compared to 2.28% the previous Friday while in the long term maturities, 3 and 10 year bond yields closed lower at 1.91% and 2.56% respectively, from 1.73% and 2.39% a week earlier.

CURRENCY

The Australian dollar was supported early in the week by firmer commodity prices which saw the currency drift higher. Following the better than expected GDP data mid-week and the corresponding unwinding of any early potential RBA rate cut, the Aussie spiked higher, touching a six month high of USD0.7384 last Friday.

By the close on Friday, the Australian dollar was trading at USD0.7365 compared to USD0.7227 a week earlier.

EQUITIES

Our share market posted a strong rally last week and closed above the key 5,000-point threshold as better-than-expected economic growth data added to the positive momentum from higher commodity prices and similar moves in offshore markets. Sentiment has clearly shifted for commodities in the last fortnight with both crude oil and iron ore prices touching a one-month high last week, assisting energy and resource stocks to post solid gains.

The Australian share market posted its best weekly rise in almost five months, gaining 210 points or 4.3%, but is still down 3.9% for the year.

By the close on Friday the S&P/ASX200 Index was trading at 5,090.0 compared to 4,880.0 a week earlier.

THIS WEEK

Compared to last week, the data flow this week is relatively light with only secondary economic indicators due for release. Nonetheless, the latest monthly consumer sentiment and business conditions data will gain some focus for the latest indications on how sentiment is tracking.

INTEREST RATE VIEW

The good news on the data front (GDP) last week sent all markets higher, with equities back above 5,000, the Australian dollar up to USD0.7360 and the cash futures market removing, or at least reducing expectations of future RBA rate cuts. While a full 25 basis point cut is still priced in by the futures market for August/September, the follow-up rate cut (previously fully factored in by the market) is now only a 50% chance.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.25	2.00	2.00	2.00	2.00
90 day Bank Bill	2.34	2.15	2.30	2.29	2.32
180 day Bank Bill	2.39	2.21	2.39	2.41	2.43
1 year swap	2.13	1.97	2.21	2.11	2.18
3 year swap	2.20	2.05	2.29	2.05	2.14
5 year swap	2.51	2.45	2.63	2.32	2.39
10 year swap	2.96	3.03	3.10	2.68	2.69
AUD/USD	0.7795	0.6980	0.7316	0.7182	0.7406
S&P/ASX200 Index	5,898.9	5,040.6	5,151.6	4,976.2	5,090.0

CHART OF THE WEEK

Sydney house prices cost 12 times the annual income

Sydney houses now cost 12 times the annual income, up from four times when Gough Whitlam was dismissed.

As many first time buyers turn to the bank of mum and dad to top up their deposits, a new report "Parental guidance not recommended" warns Australians are being caught up in a classic "Ponzi scheme".

The report by economic consultancy LF Economics – which has previously sensationally warned of a "bloodbath" when Sydney's property bubble bursts – estimates it will now take the average first time buyer in Sydney nine years to save a deposit, up from three years in 1975.

Baby boomers, who have benefited from skyrocketing prices, are increasingly able to fast track their children's path to property ownership by either stumping up part of the deposit or putting up their own homes as collateral.

LF Economics, founded by Lindsay David and Philip Soos, warns this may be helping a new generation to over-leverage into mortgages they can't afford, leaving their parents' homes exposed. "Unfortunately, this loan guarantee strategy in a rising housing market for securing ever-larger amounts of debt is essentially pyramid or Ponzi finance. This leaves many parents in a dangerous predicament should their children experience difficulties making loan payments, let alone defaulting and suffering foreclosure."

"In reality, many parents – the Baby Boomer cohort – are asset-rich but income-poor. The blunt fact is few parents have enough savings and other liquid assets on hand to meet their legal obligations without selling their home if their children default," the report warns.

Property experts disagree furiously about whether prices are in a bubble and about the best measure of housing affordability. Treasury secretary John Fraser has said that Sydney house prices are in a "bubble". But many economists remain wary of the term and point out that supply constraints and strong population growth will underpin prices, even if slower wages growth inhibits further price gains.

LF Economics argues that price gains have outstripped the fundamental worth of properties. "Financial regulators have ignored the Ponzi lending practices by lenders, believing the RBA will have the adequate ability to bail them out at taxpayers' expense the day this classic Ponzi lending scheme breaks down."

Economist Saul Eslake disagrees with the Ponzi term, however: "I would absolutely agree that Australian house prices in Melbourne and Sydney are very high both by historical and international standards and that they are very high in part because of the willingness of Australian households to borrow very large amounts of money relative to their incomes."

In 1975, the median Sydney house price was $33,960, compared to the median household Income of $8,273 – a multiple of 4.1, according to the LF Economics report. Prices remained fairly constant as a multiple of incomes until 1996 when lower interest rates sparked a phenomenal rise in home prices.

As of the middle of this year, the median Sydney house price was $1,004,767 according to data from the Real Estate Institute of Australia. The median household income was $85,067, according to an ABS survey of income and housing adjusted up for growth in average weekly earnings.

But thanks to record low interest rates, it still costs less today to service a mortgage out of the typical income than it did in 1989 when interest rates hit an eye-watering high of 17%. Back then, Sydney mortgage costs soaked up an entire year's household income. Today it's more like 70%, according to LF Economics, still way above the 30% of income that indicates mortgage stress.

CHARTS OF THE WEEK

Buying a unit is much more affordable. Unit prices in Sydney are almost eight times typical household incomes, taking an average of six years to save up a deposit. Once bought, the cost of servicing a mortgage on a unit still soaks up 50% of income.

The report warns that mortgages are likely to remain a shackle on young buyers for much of their lives, given that interest rates are already at record lows. At least mortgage holders who suffered under double digit interest rates in the late 1980's soon felt relief when mortgage rates were slashed during the recession "we had to have".

"As deposits and loan sizes are bigger today, first home buyers will have to commit an increasingly large proportion of their incomes to mortgage costs regardless of dwelling price trends. Purchasing property in the midst of a bubble carries significant risks via negative equity and unemployment."

Economist Saul Eslake does not expect a property price crash, but does warn that forces are shifting that will dampen demand and increase supply.

Slower population growth will limit new demand. Meanwhile, a growing proportion of Australia's housing stock is owned by investors, who may be more willing to sell if they think price gains will disappoint. "I'd still be surprised if there was a crash, but there may well be a sustained decline two to three years down the track."

“That would not be a bad thing”, Mr Eslake added, “as rising house prices served little economic benefit and contributed great social harm by deepening wealth inequality between property haves and have nots”.

Source: *The Sydney Morning Herald,*
Article by: *Jessica Irvine, senior writer*
26th November 2015

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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