WEEKLY ECONOMIC COMMENTARY

Week beginning 7th September 2015

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Private Sector Credit	July	+0.6%	+0.4%
Current Account Deficit	June quarter	-$19.0bn	-$10.7bn
Building Approvals	July	+4.2%	-8.2%
GDP	June quarter	+0.2%	+0.9%
Trade Balance	July	-$2.5bn	-$2.9%
Retail Sales	July	-0.1%	+0.7%

Private sector credit increased by a slightly better than expected 0.6% in July reflecting a monthly rise in business credit growth (+0.7%), flat personal credit and a rise in owner-occupier credit growth (+0.5%). Over the year, credit growth is up 6.1% with business credit growth up 4.8%, personal credit up 0.9% while housing credit is up 7.4%.

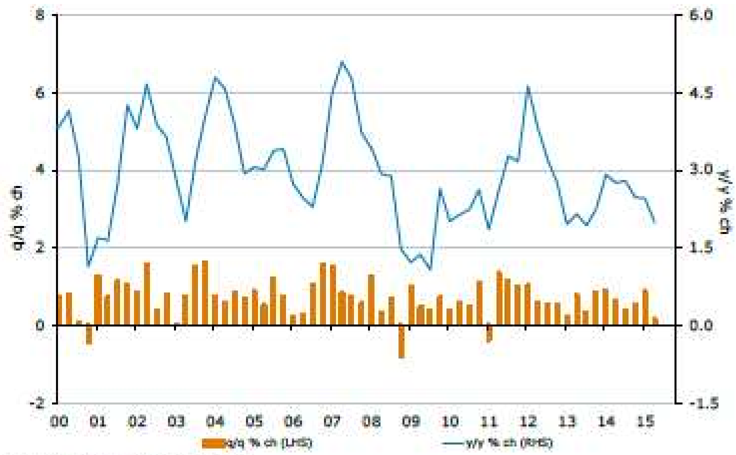
The **current account deficit** was a little wider than expected in the June quarter, printing at $19.0bn, the widest deficit since 2009. A further 3.4% decline in the terms of trade and a $2.3bn (28%) fall in net export volumes combined to produce the $5.5bn widening in the current account deficit to 4.7% of GDP. Export volumes fell 3.3% in the quarter while import volumes fell 0.7%.

Building approvals were up 4.2% in July to be up 13.4% over the year. The rebound this month was concentrated in ‘private other approvals’ (i.e. multi-dwelling approvals) which rose 6.1% to be up 25.2% annually while private house approvals fell 3.0% following a 3.7% gain in June, to be down 2.2% over the year.

Economic Growth or GDP for the June quarter was lower than expected, posting a rise of only 0.2% to have annual growth of only 2.0% (down from +2.5% last quarter). The weak result comes after a stronger than expected 0.9% rise in the March quarter. Some sectors were boosted by unseasonably good weather in the first quarter, with a degree of reversal in the second quarter (i.e. resources exports and residential construction).

On the expenditure side, GDP was flat in the quarter (+2.0% annually) driven by a significant subtraction from net exports and inventories, but boosted by a strong rise in public demand. The income measure of GDP rose 0.2% in the quarter (+1.8% annually), the ABS noting that this was the weakest growth in nominal GDP since 1961-62, while the production measure of GDP was a touch stronger at 0.3% (+2.1% annually).

Economic Growth, slowing



Source: ABS, ANZ Research

The **Trade balance** recorded a deficit of $2.5bn in July with last month’s deficit revised up to -$3.1bn. The narrowing in the deficit reflected higher exports +2.3% (mainly non-monetary gold) with core exports of coal and metal ores down by 2.5% and 4.7% respectively. Imports were virtually flat in the month, up only 0.1%.

Retail sales fell 0.1% in July to be up 4.4% annually. Household goods drove the swings in retail but food was also soft. The fall this month is likely to be a reversal of the 0.6% gain in June which was boosted by the small business package announcement in the Federal Budget. Household goods retailing fell 1.9% while “other retailing” fell 0.6%. Providing some offset were increases in clothing (+2.9%) and department stores sales (+1.3%).

Data over the next week

Economic Data	Date	Period	Forecast	Previous
ANZ Job Ads	07 Sept	August	n/a	-0.4%
Westpac/MI Consumer Sentiment	09 Sept	September	n/a	+7.8%
Housing Finance	09 Sept	July	+1.4%	+4.4%
Employment	10 Sept	August	+8,000	+38,500
Unemployment	10 Sept	August	6.2%	6.3%

ECONOMIC COMMENTARY

LAST WEEK

Following the Reserve Bank Board meeting, where the official cash rate was unchanged (as was widely expected), attention turned to the post-meeting statement for any hint of a change in the RBA's thinking. In the statement, the RBA acknowledged the equity market volatility, further commodity price weakness and a slowing of conditions in China, albeit perhaps partially balanced by "strong US growth". But in the end there was no material change from last month in that, *"The Board today judged that leaving the cash rate unchanged was appropriate at this meeting".*

Further poor economic data out of China last week saw negative sentiment return to global markets with equity and currency markets down and risk averse buying of bonds pushing yields lower.

Risk appetite evaporated in our market, firstly following the release of data showing that Australia's current account deficit had blown out to 4.7% of GDP, the widest deficit since 2009 at $19bn, and then 24 hours later by a weak June quarter GDP number.

By the close of trading on Friday, the 90-day bank bill was trading at 2.15% from 2.13% a week earlier. In the long term maturities, 3 and 10 year bond yields closed at 1.75% and 2.63% respectively, from 1.84% and 2.73% a week earlier.

CURRENCY

The Australian dollar lost ground last week, breaking through the psychological USD0.70 level at one stage on continued concerns about a slowdown in China. Traders were shying away from growth-orientated currencies like the Australian dollar in a risk-off play that saw the US dollar strengthen against most cross rates. After a mid-week bounce following a rebound in some key commodity prices (iron ore and oil), the Aussie traded to a new six year low of USD0.6959 late on Friday to close the week more than two cents lower. Upside in our currency seems to be limited, with increased sentiment in the US that rates will rise soon and continued negative sentiment out of China.

By the close on Friday the Australian dollar was trading at USD0.6980 compared to USD0.7170 a week earlier.

EQUITIES

A slowdown in Chinese manufacturing data to its lowest level in three years reignited concerns about the strength of the Chinese economy, which in turn pushed the Chinese equity market down once again. Traders and investors who were hoping that the volatility seen the previous week had passed were disappointed as global markets followed the Chinese sell off. Markets did however manage to recoup losses mid-week following some positive news from the US, but with Chinese equity markets closed on Thursday and Friday for World War II Victory Day holiday celebrations, market volatility was somewhat dampened late in the week.

By the close on Friday the S&P/ASX200 Index had, trading at 5,040.6 compared to 5,263.6 a week earlier.

THIS WEEK

The highlight this week will be another month of employment data with employment expected to post a small rise. There should be a reversal of the strong rise in the participation rate which saw the unemployment rate increase to 6.3% last month, with unemployment expected to fall slightly to 6.2%.

The consumer sentiment data will also gain some attention given the developments offshore over the last few weeks to see if sentiment has been adversely affected.

INTEREST RATE VIEW

The Reserve Bank maintains a mild easing bias after last week's monthly Board meeting and will be watching the evolution of the economic data and financial market developments (especially offshore) closely. The soft data releases over the last week have increased the chances of another RBA rate cut, albeit only slightly as the increased chance of a US rate hike this month has also increased, capping any possible downside in domestic interest rates.

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	2.63	2.34	2.15	2.15	2.15
180 day Bank Bill	2.66	2.39	2.25	2.26	2.21
1 year swap	2.64	2.13	2.10	2.10	1.97
3 year swap	2.92	2.20	2.34	2.24	2.05
5 year swap	3.31	2.51	2.76	2.64	2.45
10 year swap	3.83	2.96	3.34	3.19	3.03
AUD/USD	0.9350	0.7795	0.7692	0.7326	0.6980
S&P/ASX200 Index	5,598.7	5,898.9	5,498.5	5,610.1	5,040.6

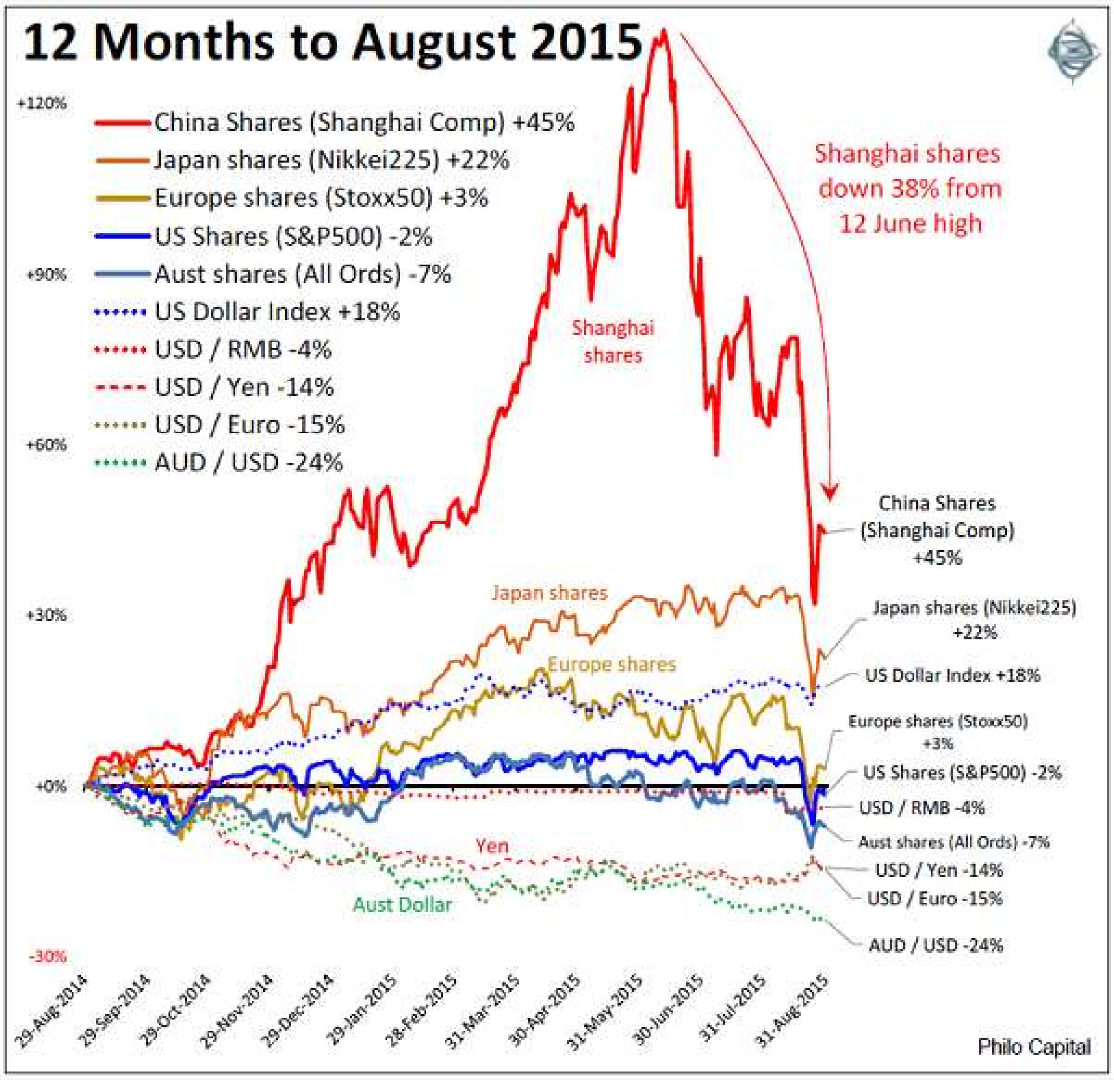
CHART OF THE WEEK

Chinese shares and currency red herrings

The main headline stories over the past month have been the sudden crash of the Chinese stock market bubble, the devaluation of the Chinese currency, and how they sparked a sell-off in global shares.

The bursting of the Chinese stock market bubble should not have been a surprise, as we wrote about it in May. The market is little more than a casino driven mainly by first time gamblers using borrowed money, and share prices have little to do with company fundamentals or the underlying economy.

The Chinese market fell by 26% mid-month but recovered partially to end down 12% for the month. To date the Chinese crash has wiped out just six months of gains, so the only people who lost money were those who panic bought in the frenzy earlier this year (many first-timers and many using borrowed money), and then panic sold in the crash.



Investors who had bought shares prior to March this year are still ahead. At the end of August the Shanghai Composite closed down 38% from its 12th June high. Fearing the crash would have wider implications for the Chinese economy the central bank cut interest rates and reduced bank reserve ratio requirements, increasing the amount banks can lend. It also suspended most listed shares from trading so shareholders were unable to sell shares. The main risk in emerging markets is the likely impact of a rising US dollar and US interest rates on US dollar borrowers.

Turning to recent currency moves, the real story of the past year has been the rise of the US dollar as the Fed prepares to raise interest rates with the improving US economy while other major markets are slowing, cutting rates and printing money. The Chinese have been remarkably patient watching the RMB being dragged upward by the US dollar peg. Over the past 12 months the RMB has fallen a tiny 4% against the US dollar, including the 3% “shock” devaluation on 11th and 12th August 2015. In contrast the Euro has fallen by 15% and the Yen has fallen by 14% over the same period.

Japanese and European company earnings and share prices have benefited from the falling Yen and Euro but US shares have struggled against the rising dollar and fears of higher US interest rates. Australian shares have also been flat, held back by the collapses in commodities prices and also by the big banks’ scramble to raise capital to reduce their leverage.

CHART OF THE WEEK

What else is happening in China?

The Chinese economy is probably growing at a rate much lower than the official 7%. Growth has been propped up since 2009 by debt-funded state-directed infrastructure spending. As the economy is slowing even further this year, the latest plan is to grow Beijing into a mega city of 300 million people that spills over into neighbouring Tianjin, Hebei and Shandong provinces. It has already started relocating government departments. The official unemployment rate is being kept low at around 4% by mega projects like these and also by keeping factories over-producing and then exporting the surpluses to the rest of the world, which has kept global inflation low.

Aside from the stock market fall the main market event in August was the sudden 3% devaluation of the RMB against the US dollar to help exporters. However by month end the central bank was having to intervene to prevent further declines, amid accusations from the US that China was enflaming a currency war.

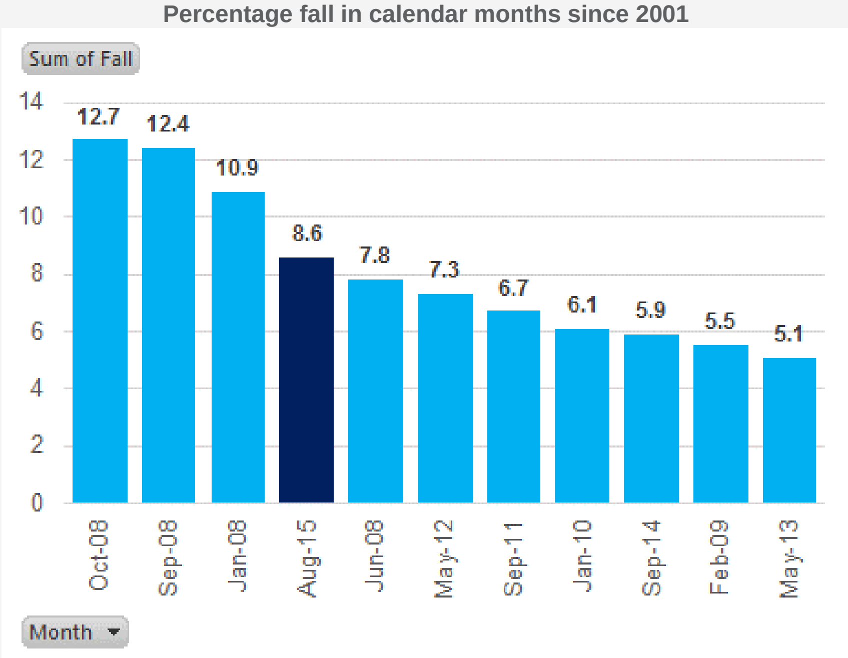
Military tension also rose between China and Japan in the lead-up to the 70th anniversary of the end of World War 2. Nationalist pride directed against China is Japan PM Shinzo Abe's 'fourth arrow' in his national revival plan. Also North Korea stepped up its war preparations against South Korea after a heated artillery exchange.

Article: Cuffelinks, Connecting Investors with Ideas
By Ashley Owen, 3rd September 2015
Ashley Owen is Joint CEO of Philo Capital Advisers and a director and adviser to the Third Link Growth Fund. This article is for general education only, not personal financial advice.

Global equity markets ended a turbulent month last week with their worst monthly losses in years, driven by concerns over China and the timing of a US interest rate rise. The Dow Jones Index settled for a monthly loss of 6.6%, its largest fall since May 2010 our local All Ords Index did even worse with a 8.6% fall – its fourth largest monthly fall since the height of the GFC (refer chart below).

China's unexpected devaluation of its currency earlier in August amplified worries about a slowdown in the world's second-largest economy, which pummelled global stocks, commodities and emerging-market currencies. Investors also grappled with the prospect of the US Federal Reserve pushing ahead with raising interest rates for the first time in almost a decade, from a level of virtually zero, which has been providing support for financial markets across the globe in recent years. These forces collided in August, along with existing concerns about elevated stock valuations in the US resulting in the world-wide correction.

Worst S&P ASX/200 Index Monthly percentage Falls
Percentage fall in calendar months since 2001



Rural Bank Limited is a wholly owned subsidiary of Bendigo and Adelaide Bank Limited and specialises in providing banking products and services to the Australian Agribusiness sector. Our customers are predominantly based in rural and regional Australia, although many of our deposit customers are from metropolitan areas.

Rural Bank's heartland is in rural Australia. We are fully committed to providing a leading, specialised banking service to primary producers, agribusiness participants and individuals or businesses seeking business loans. As part of the Bendigo and Adelaide Bank Group, we also offer customers the benefit of the broader capabilities offered by Bendigo and Adelaide Bank.

Our products and services are available at over 400 regional locations nationally including Bendigo Bank branches, Elders Rural Services branches and our Investment Centre in Adelaide.

Postal Address:
PO Box 3660,
Rundle Mall, SA 5000

Telephone: 1300 660 115
Facsimile: 08 8121 0106
service@ruralbank.com.au
www.ruralbank.com.au