WEEKLY ECONOMIC COMMENTARY

Week beginning 14th July 2014

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
ANZ Job Ads	June	+4.3%	-5.6%
Westpac/MI Consumer Sentiment	July	+1.9%	+0.2%
Employment	June	+15,900	-4,800
Unemployment	June	6.0%	5.8%
Housing Finance	May	-1.2%	+1.7%

ANZ Job Advertisements rose 4.3% in June, retracing part of May's large fall and returning to levels seen three months ago. The increase this month was driven by a bounce in Internet job ads (up 4.5%), while newspaper job ads fell 2.3%. ANZ said job ads are 6% higher than at the start of the year, suggesting labour demand has improved very gradually.

The **Westpac-Melbourne Institute Consumer Sentiment Index** rose 1.9% in July to 94.9 points, compared with 93.2 points in June (still below the neutral 100 level) and only recovering a small portion of the 6.8% decline in May. Despite the improvement, sentiment remains around 14% below the level reached in late 2013. According to Westpac, a record 74% of survey respondents recalled news on the Budget and taxation last month, and the recollections were "extremely unfavourable", offering the best explanation for the weak sentiment. While confidence in the labour market remained stubbornly weak, there was an improvement in views around family finances and the economic outlook for the next 12 months.

Consumer Sentiment

After the May **employment data** disappointed with a revised fall of 5,100 from an original -4,800, **employment** increased by 15,900 in June. A 19,700 increase in part-time employment was partially offset by a 3,800 fall in full-time employment. A rise in the participation rate pushed the **unemployment rate** from 5.87% to 6.02% this month (to two decimal places), matching the highest level since July 2003. Also, the rise in the unemployment rate was largely due to just two states, VIC and SA, which accounted for almost 68% of the total rise in unemployment.

Housing finance (excluding refinancing) fell 1.2% in May to be 15.1% higher over the year. Finance for owner-occupiers fell 1.4% in the month (+8.3% annually) while investor finance fell 0.9% (+23.8% annually).

In other data, the NAB measure of business conditions was surprisingly strong, rising to +2 in June from -1 in May, with strength in trading conditions and profitability offsetting a modest weakening in the employment component. Business confidence recorded a small increase in June to +8 from +7 previously, with firms apparently shrugging off the sharp deterioration in consumer confidence that followed May's Federal Budget.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
New Motor Vehicle Sales	15 July	June	+2.3%	+0.3%
NAB Business Survey	17 July	June/Q	n/a	0.3

ECONOMIC COMMENTARY

LAST WEEK

US Treasuries rallied last week after the Minutes from the US Federal Open Market Committee (FOMC) June meeting reduced concerns that interest rates could be raised sooner than expected. The market had hoped for a broader discussion on inflation, which did not materialise, while the Committee agreed to end the central bank's bond-buying program by October and also showed no urgency to raise US interest rates.

The rally was also supported late in the week by some flight to quality buying on the back of a “risk-off” tone in financial markets, with headlines of financial stress at a Portuguese bank prompting demand for safe-haven assets. European financial markets sold off, rocked by the news of a missed debt payment by Banco Espírito Santo – Portugal’s second largest lender, which raised fears of broader contagion across the Portuguese financial markets. It also followed the downgrade of another Portuguese bank by Moody’s last Wednesday, stating “concerns regarding its creditworthiness are heightened by the lack of transparency around the bank’s financial position….”

Our market followed US bond yields lower over the week, the rally in interest rates helped locally by the reported rise in the unemployment rate to 6%, which trumped the 15,900 rise in employment and fuelled more speculation of a rate cut.

By the close of trading on Friday, the 90-day bank bill was trading at 2.64% compared to 2.67% a week earlier. At the long end, 3 and 10 year bond yields closed at 2.50% and 3.42% from 2.61% and 3.59% a week earlier.

CURRENCY

The Australian Dollar opened stronger last week assisted by the persistent offshore bid for Australian Dollar denominated high-yield assets compared to the low yields on offer in other developed markets (exacerbated by recent ECB easing).

However, the “risk-off” sentiment also emerged in currency markets late in the week reversing the earlier rally in our currency as the US Dollar strengthened against most cross rates, pushing the Australian Dollar below USD0.94 into the close on Friday.

By the close on Friday, the Australian Dollar was trading at USD0.9387 compared to USD0.9354 a week earlier.

EQUITIES

After the US Dow Jones Index topped 17,000 for the first time last week, stocks have wobbled as investors re-evaluate the strength of overseas economies and the potential end to the US Fed's stimulus (bond-buying) program in October. Investors are also sizing up lofty stock valuations with the Dow sitting on an 11% gain over the past year. Some offshore selling also emerged in Europe late in the week following the emergence of some contagion risk (refer above) as investors fled equities for the safe haven of government bonds. The negative sentiment however did not persist and investors became more confident that the issues in Portugal would be contained and would not have a broader impact on other European banks. Equities partially recovered earlier losses but still closed the week lower.

By the close on Friday the S&P/ASX200 Index was trading at 5,486.8 compared to 5,525.0 a week earlier.

THIS WEEK

There is a relatively quiet week ahead for local data releases with the highlight likely to be the Minutes of the Reserve Bank’s July Board meeting, due out on Tuesday. The Minutes may throw some more light on the RBA Board’s views on the economy’s progress and its transition away from the mining boom.

On the data front, motor vehicle sales for June are due on Tuesday and the NAB business survey for the June quarter is due Thursday.

INTEREST RATE VIEW

The market in recent weeks has switched from expecting the Reserve Bank of Australia to commence a tightening cycle in late 2014 towards pricing in the prospect of a further rate cut. Financial markets are now attaching more than a 50% chance of a rate cut by the end of this year, with policy tightenings now not expected to occur until late 2015.

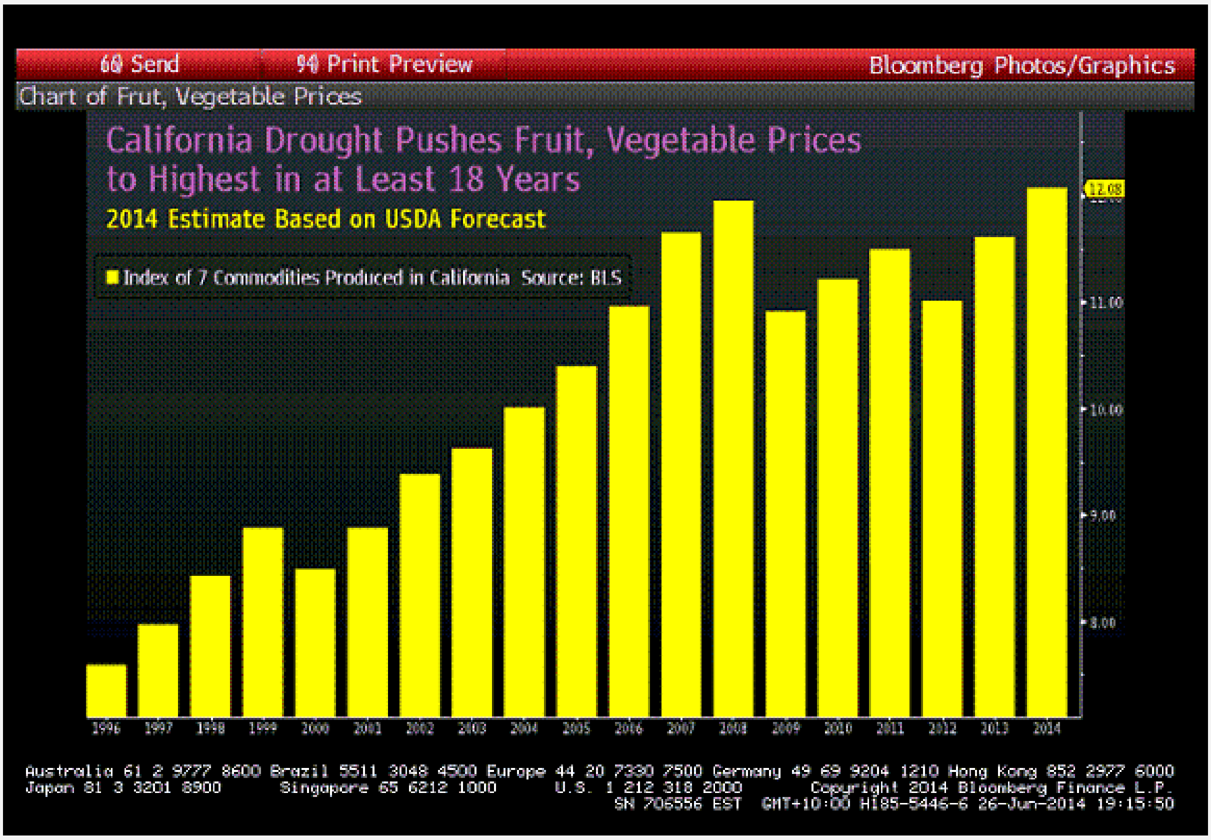
Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.75	2.50	2.50	2.50	2.50
90 day Bank Bill	2.76	2.64	2.71	2.71	2.64
180 day Bank Bill	2.74	2.66	2.74	2.72	2.66
1 year swap	2.80	2.85	2.92	2.91	2.75
3 year swap	3.25	3.38	3.36	3.23	2.98
5 year swap	3.78	3.96	3.85	3.66	3.39
10 year swap	4.51	4.77	4.56	4.30	4.01
AUD/USD	0.9153	0.9027	0.9377	0.9420	0.9387
S&P/ASX200 Index	4,973.9	5,292.1	5,428.6	5,405.1	5,486.8

CHARTS OF THE WEEK

Californian Drought means higher prices.

Eating a healthy dose of fruits and veggies will start putting a bigger dent in your wallet as severe drought conditions across California push up prices.

The chart below shows that an index tracking consumer costs of seven fruits and vegetables grown in California this year will reach the highest since at least 1996, when the data from the Bureau of Labor Statistics begins. The forecast is based on the US Department of Agriculture's outlook for produce prices to increase 4% this year.



"The drought will have a long and lasting impact," Annemarie Kuhns, an agricultural economist at the US Department of Agriculture, said in a telephone interview. "We have seen higher prices in farm-level prices which is an indicator that increases are here to stay."

California, the largest US agricultural producer with output of crops, dairy and meat valued at $44.7 billion in 2012, has been parched by dry weather for much of the past year. The entire state was rated in severe to exceptional drought as of June 17, according to the US Drought Monitor.

The index of produce prices tracks broccoli, tomatoes, strawberries, lettuce, lemons, navel oranges and grapes, and California is a leading U.S. producer of all the crops.

Source: Bloomberg 26th June (by Fareeha Ali and Megan Durisin)

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