WEEKLY ECONOMIC COMMENTARY

Week beginning 18th August 2014

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Westpac/MI Consumer Sentiment	Aug	+3.8%	+1.9%
ABS Established House Price Index	June/quarter	+1.8%	+1.7%
Wage Price Index	June/quarter	+0.6%	+0.7%
NAB Business Confidence/Conditions	July	+11/+8	+8/+2

Business and Consumer Sentiment

The **Westpac-Melbourne Institute Consumer Sentiment Index** increased by 3.8% in August to a level of 98.5, with sentiment now at its highest level since April, retracing most of the post Federal Budget decline.

Four of the five component indices increased, including family finances 1-year ahead (up from 93.1 to 95.3) and economic conditions 1-year ahead (up from 87.1 to 94.4), with only the "economic conditions in the next five years" category registering a small decline.

Consumer inflation expectations were down 0.7% to 3.1% in August.

The **ABS established house price index** was up 1.8% in the June quarter, exceeding market expectations, to be up 10.1% over the year. Over the year, Sydney prices recorded he largest rise (+15.6%) followed by Melbourne (+9.3%), while Canberra and Darwin had the smallest rises (+2.2% and 3.4% respectively).

Wage Price Index

The **Wage Price Index** was up just 0.6% in the June quarter to be 2.6% higher over the year (the lowest level in the history of the index, which goes back to September 1997). Of the 18 measured industry categories, 14 reported slower growth and, compared to one year ago, yearly growth was weaker in all but one sector. Both private and public sector wage price indices rose by 0.6% in the quarter. Private sector wages are up 2.4% annually while public sector wages were a little stronger at 2.8%.

The **NAB Business Survey** was more upbeat than expected in July with **business confidence** rising to +11 (from +8) and **business conditions** rising to a four year high of +8 (from +2), building on the strength seen in June. Conditions are now at their highest level since March 2010 while confidence is the highest since September 2010. While all the component indices, trading conditions, profitability and employment saw solid rises, the strong showing was driven by the construction industry.

Lending finance has soared by 7.6% in June, reaching levels not seen since before the Global Financial Crisis. Total new lending in June was $72.9bn, the highest since January 2008. Commercial finance lending was the main driver of the growth rising 12.1% in June, but follows a fall of 5.9% in May. Housing finance for owner/occupiers was up 1.8%, lease finance up 0.9% and personal finance down 1.8%.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Motor Vehicle Sales	18 Aug	July	+0.3%	+1.7%
Skilled Internet Vacancies	20 Aug	July	n/a	+1.6%

ECONOMIC COMMENTARY

LAST WEEK

Economic data released in Australia over the course of last week was better than expected and suggests that "underlying" conditions in the economy are healthier than what was suggested by July's spike in the unemployment rate. Both business and consumer sentiment improved last month but still remain below the levels seen at the end of last year and the start of this year.

Offshore, risk sentiment improved mildly over the week on the back of easing tensions in Ukraine and geopolitical events remaining contained. This resulted in calming of nerves, sending equities and risk currencies higher. Bond markets however were unaffected by the change in sentiment. Instead, some soft US economic retail sales data, a 30-year US Treasuries bond auction and some disappointing GDP numbers in Europe (German and Italian June quarter GDP data fell 0.2% while France's GDP was flat) resulted in a sell off in offshore bond markets. This in turn pushed local bond yields higher last week.

By the close of trading on Friday, the 90-day bank bill was trading at 2.64% compared to 2.63% a week earlier. In the long term maturities, 3 and 10 year bond yields closed higher at 2.62% and 3.39% from 2.52% and 3.28% a week earlier.

CURRENCY

Having started the week on a soft note and trading down to a low of USD0.9200, the Australian Dollar managed to find support and rallied. This was assisted by some mild weakness in the US Dollar and comments by the Bank of England that they were in no hurry to hike rates, which sent the pound-sterling to a two month high of 55.78 pence against the Australian Dollar. The Australian Dollar remains stuck in a tight trading range between USD0.92 and USD0.95 since March, the weak iron ore price weighing on the currency and limiting the upside again last week.

By the close on Friday, the Australian Dollar was trading at USD0.9326 compared to USD0.9257 a week earlier.

EQUITIES

Last week was the fist week of the reporting season, with several high profile companies already having released some impressive numbers. As a result, our share market posted gains every day last week to close the week 131 points (+2.4%) higher. Commodities however are lower on over supply, falling economic growth in Europe and as investors fret about the strength of the Chinese economy. In particular, crude oil prices were lower with Brent hitting year lows, while iron ore was trading at a two month low of $93.20.

By the close on Friday the S&P/ASX200 Index was trading at 5,566.5 compared to 5,435.3 a week earlier.

THIS WEEK

It is another quiet week ahead for economic data with only second-tier releases due in the form of July Motor Vehicle Sales (Tuesday), and the Department of Employment Skilled Internet Vacancies Index (Wednesday).

Events this week also include the release of the Minutes of the August RBA Board meeting as well as the RBA Governor's semi-annual testimony to the House of Representatives' Standing Committee on Economics. The latter may provide financial markets with some information on the RBA's thinking around the possibility of another rate cut following the recent poor employment data and their recent downgrade of economic growth and inflation forecasts.

INTEREST RATE VIEW

There is a small (20%) probability of a rate cut factored into financial futures market pricing at the moment, mainly as a result of the Reserve Bank's recent Statement on Monetary Policy and their lowering of forecasts for growth and inflation. Most economists however are still of the view that the current period of stability for interest rates is going to continue for some time. The consensus is that the next move in rates will be up but not until the back end of 2015.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.50	2.50	2.50	2.50	2.50
90 day Bank Bill	2.60	2.63	2.70	2.65	2.64
180 day Bank Bill	2.58	2.65	2.73	2.66	2.66
1 year swap	2.76	2.87	2.89	2.76	2.79
3 year swap	3.30	3.38	3.20	2.97	3.01
5 year swap	3.85	3.93	3.62	3.37	3.41
10 year swap	4.64	4.70	4.25	3.99	3.97
AUD/USD	0.9178	0.9055	0.9347	0.9370	0.9326
S&P/ASX200 Index	5,113.9	5,382.9	5,479.0	5,522.4	5,566.5

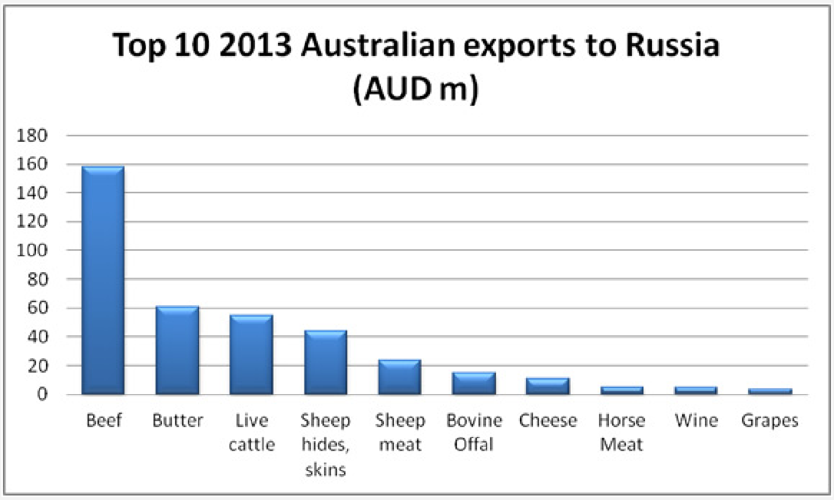
CHART OF THE WEEK

Tough talk but little to lose on Russian trade sanctions

Poke a Russian bear with a stick and he will retaliate. That's the lesson facing Australian exporters today.

When Australia announced it would join the United States and Europe in placing trade sanctions on Russia in response to Malaysia Airlines MH17 being shot down in Ukraine, it could do so realising there wasn't much trade to talk about.

The top 10 Australian exports to Russia in 2013 are shown in the chart (below), the recent Russian export sanctions will likely impact beef and butter the most.



Our trade relationship

Australian-Russia trade is only worth A$1.8 billion - Russia is our 28th largest export destination and 30th largest import source. In fact Russia's main export destinations are – wait for it – the Netherlands, Turkey and the Ukraine. It imports mostly from China (like everyone else), Germany and the USA. Australia only accounts for 0.3% of Russian imports as Russia's 44th largest import source and we are Russia's 99th largest export destination (barely registering on the trade accounts).

But now Russia's counter sanctions could hurt agricultural exports particularly in wheat, dairy, beef and kangaroo meat (Russia is our main export market for kangaroo meat). In most cases Australian exporters will be able to sell items like beef to Japan, Korea (thanks to the new FTAs) or Indonesia. In any case, Russia had already reduced beef imports from Australia (due to alleged concern over growth hormones). These would be the only sectors adversely affected assuming no further Russian retaliation over energy or financial sector sanctions placed on them by the west.

So how will the trade sanctions play out? Russia's actions could hurt Russia most of all. A government putting on tariffs or other forms of trade protection is a like a government shooting its own people during peace time. Or as the legendary Cambridge economist Joan Robinson used to say, trade bans are like "putting rocks in your own harbour".

Putin might well be bringing food shortages back to Russia like the bad old days of the Soviet Union and Tsarist regimes – something the poor Russian populace has been used to historically. For a democracy it would be unbearable, but at an 87% approval rating, Putin won't worry about that. As he told me at the APEC meeting in Sydney in 2007 meeting when John Howard allowed then Opposition leader Kevin Rudd to speak: "How nice to allow your leader of the opposition to speak, I would do so also, except I don't have one."

Russia trade facts (Source: DFAT Trade Statistics):

Australian exports to Russia:	$736 million
Australian imports from Russia:	$1.05 billion
Australian investment in Russia:	$2.35 billion
Russian investment in Australia:	$4.84 billion
Main Australian exports:	wheat, beef, butter, kangaroo meat
Main Australian imports:	crude petroleum, fertiliser, vodka
Number of Australian companies exporting to Russia:	377

Source: ***The Conversation****, academic rigour, journalistic flair*
by *Tim Harcourt, JW Neville Fellow in Economics at the Australian School of Business*
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