WEEKLY ECONOMIC COMMENTARY

Week beginning 24th November 2014

ECONOMIC DATA ROUNDUP

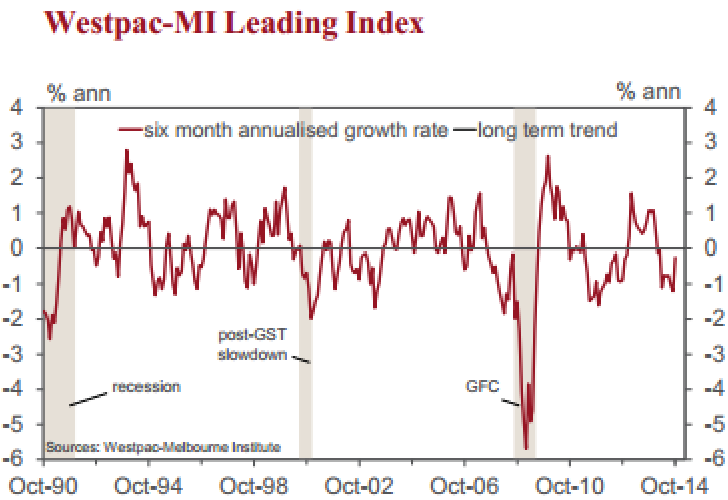
DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Motor Vehicle Sales	October	-1.6%	+2.8%
DEER Internet Vacancies Index	October	+0.0%	+0.5%
Westpac/MI Leading Index	October	-0.25%	-1.20%

New motor vehicle sales fell 1.6% in October, after rising 2.8% in September. Sales of passenger and other vehicles decreased by 0.4% and 0.2% respectively while sales of sports utility vehicles increased by 0.6%. For the year to October, new motor vehicle sales are down 0.5%.

Internet job vacancies data from the Department of Employment was flat in October but showed an increase of 11.9% over the year. There were decreases recorded in four of the eight sub-categories, the largest fall was in the “Technicians and Trade Workers” category (down 1.1% in the month) while the largest rise was recorded in the “Labourers” segment (up 2.4%). While the trend appears to have softened a little in recent months, the general lift in job advertising this year is notable.

The six month annualised deviation from trend growth rate of the **Westpac Melbourne Institute Leading Index** (which indicates the likely pace of economic growth over the coming three to nine months) increased to -0.25% in October, from -1.20% in September. The index continues to indicate that we can expect growth in the Australian economy to stay below trend in the final quarter of 2014 and into the first half of 2015. This is the ninth consecutive month where the growth rate in the index has been below trend and follows thirteen consecutive months when the growth rate was above trend.



Released last week, the minutes of the November **Reserve Bank Board Meeting** once again repeat that “the most prudent course was likely to be a period of stability in interest rates” which was no surprise to markets. There was little change in its assessment of the economy or its outlook for monetary policy. The RBA continues to expect that low interest rates will spur activity in the economy through the usual channels over time.

In a speech last week, Reserve Bank of Australia Governor Glenn Stevens indicated that interest rates are likely to stay low for years or until non-mining businesses have the courage to invest again. As mining investment and income growth falls and household debt and unemployment rises, he suggested there was little danger of the economy overheating to justify raising rates above the current 2.5% level.

He said a fall in the overvalued Australian dollar would help stimulate investment and market forces would eventually force it down. However, interest rates overseas were well below Australia's, making our currency attractive, and he expected overseas market turbulence in the near future.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Construction Work Done	26 Nov	Sept/Quarter	-0.5%	-1.2%
Private Sector Capital Expenditure (CAPEX)	27 Nov	Sept/Quarter	-0.5%	+1.1%
Private Sector Credit	28 Nov	October	n/a	+0.5%

ECONOMIC COMMENTARY

LAST WEEK

The data flow was very light last week so attracting the most attention for financial markets was the 7% slide in iron ore prices to just above $70 per tonne (the lowest level in five years), and the resulting fall in the Australian dollar.

The minutes of the Reserve Bank Board meeting were most noteworthy for the discussion suggesting that low rates continue to support housing investors.

Another surprising development over the last week was the news that Japan is once again back in recession. That's the fourth one in the past seven years for those who like to keep track and something the economists are focussing on given our trade with Japan.

By the close of trading on Friday, the 90-day bank bill was trading at 2.74% compared to 2.78% a week earlier. In the long term maturities, 3 and 10 year bond yields closed the week lower at 2.53% and 3.27% respectively, from 2.60% and 3.34% a week earlier.

CURRENCY

The Australian dollar moved lower last week as the market took on board the latest signs from the Reserve Bank of Australia that interest rates will stay low for a while yet, with a relatively downbeat assessment of the Australian economy by the RBA Governor Glenn Stevens. Mr Stevens said, "The level of interest rates, although very low, is well warranted on macro-economic grounds."

The Australian dollar has dropped below USD0.86 following disappointing Chinese manufacturing data and fresh lows for the iron ore price. The release of US Federal Reserve meeting minutes sounded upbeat, lending support to the greenback which also hurt the Australian dollar.

By the close on Friday, the Australian Dollar was still trading near its weekly low at USD0.8624 compared to USD0.8684 a week earlier.

EQUITIES

Our share market had another week of losses despite a positive lead from Europe and the United States where the Dow hit a new five-year high, our market overshadowed by worries about weakness in commodity markets.

The price of iron ore plunged 7% last week (and 50% in the year to date) placing intense pressure on a number of miners. The lack of optimism about the commodity stems from continued production expansion from the large players Rio Tinto, Vale and BHP Billiton as Chinese demand growth stalls. The latter factor, softening demand, was seen as the catalyst for last week's price fall. Gold was also down another 1.2% last week which also negatively affected our equity (as well as the currency) market.

By the close on Friday the S&P/ASX200 Index was trading at 5,304.3 compared to 5,543.3 a week earlier.

THIS WEEK

This week sees the release of the first of the partial indicators that will feed into the upcoming September quarter GDP data, with construction work done and CAPEX due out on Wednesday and Thursday respectively. Both numbers are expected to print a lower number than in the June quarter. The week concludes with October private sector credit data on Friday.

INTEREST RATE VIEW

In complete contrast to recent months when every analyst surveyed believed that the next move in rates would be up, heightened uncertainty surrounding the RBA's forecasts is beginning to weave its way into the outlook for some market economists. Mining investment in particular is difficult to read and could actually deteriorate more quickly than commonly believed due to the recent sharp fall in commodity prices. Financial markets have once again begun to talk about the possibility of another rate cut in this cycle.

However, while the combination of weakening mining investment, declining real wages and increasing unemployment makes it hard for me to believe that the RBA will raise rates any time soon, the possibility of lower rates further stimulating the investment housing market also argues for no further rate cut. Add in the sharp fall in the terms-of-trade and it is difficult to see our economy experiencing anything besides below-trend growth for some time. We may therefore see another year of stable (and low) interest rates.

As RBA Governor Glenn Stevens suggested in a speech last week, interest rates are likely to stay low for years.

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	2.59	2.69	2.64	2.74	2.74
180 day Bank Bill	2.63	2.72	2.65	2.76	2.82
1 year swap	2.63	2.69	2.62	2.67	2.71
3 year swap	3.25	2.99	2.90	2.80	2.81
5 year swap	3.84	3.44	3.29	3.15	3.15
10 year swap	4.65	4.13	3.83	3.65	3.67
AUD/USD	0.9183	0.9242	0.9317	0.8776	0.8624
S&P/ASX200 Index	5,335.9	5,492.8	5,645.6	5,383.1	5,304.3

CHARTS OF THE WEEK

CHINA DEAL A CRACKING WIN

The Australia-China Free Trade Agreement (FTA) represents a "cracking agreement" that surpasses expectations for tariff reductions on four key farm exports, says National Farmers' Federation (NFF) president Brent Finlay.

Prime Minister Tony Abbott this week confirmed the decade-long FTA process had been concluded following his meeting with Chinese President Xi Jinping in Canberra last Monday.

The FTA contains outcomes for other products and services to expand two-way trade currently valued at $150 billion between the two countries, with agriculture a critical component of future trade. Mr Finlay said the NFF rated the final details of the FTA according to outcomes for various commodities and awarded "top points" of five stars to dairy, beef, sheep, meat and horticulture.

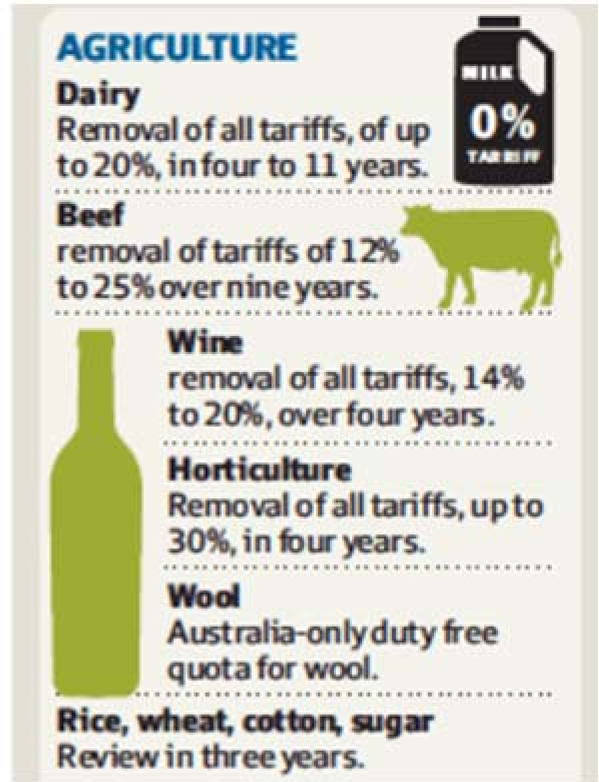
The chart right shows the specific tariff reductions. The FTA has significant benefits to most agriculture sectors. The dairy and beef sectors will generate savings of $630 million and $11 billion, respectively, from 2016 to 2025.

"In the negotiations we argued to get a New Zealand equivalent or better outcomes for red meat and dairy which would have made us very happy, but this has gone beyond that expectation and is a cracking agreement," Mr Finlay said. "We think this is another major milestone between Australia and China and this is a massive shot in the arm for Australian agriculture.

China is Australia's fastest growing dairy market, with total dairy exports to the region totalling 1.9 million tonnes in 2013 alone, an increase of 40% over the previous year.

The managing director of Australia's largest mainland dairy farmer ACE Farming Jeremy Bayard said the deal would increase farm gate milk prices. "Anything that improves access to global markets is a good thing. We are at a 15% disadvantage to New Zealand now so a reduction will give Australia greater weight.

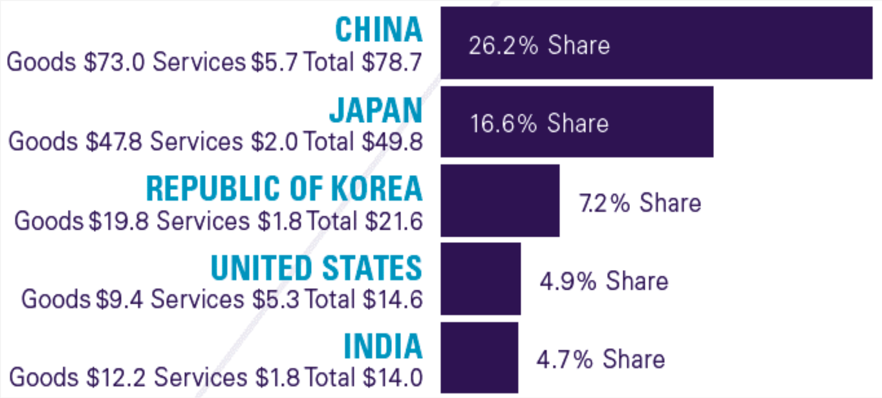
If our processing sector is healthier, then it should reflect a greater farm gate milk price and this should mean greater productivity and increased value of our farms."



Source: Australian Financial Review http://goo.gl/iqmKr5 and http://goo.gl/WTII2F

Australia has FTA's with Japan, South Korea and China (with efforts ramping-up for an agreement with India over the coming year). The significance of these agreements lies in the fact that China, Japan and South Korea represent our three largest export markets, with India fifth.

This gives credence to Prime Minister Abbott's claims that the China-Australia Free Trade Agreement "will add billions to the economy, create jobs and drive higher living standards for Australians".



The share of export is heavily skewed toward Asia, and predominantly goods based (Source DFATT)

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