WEEKLY ECONOMIC COMMENTARY

Week beginning 26th May 2014

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

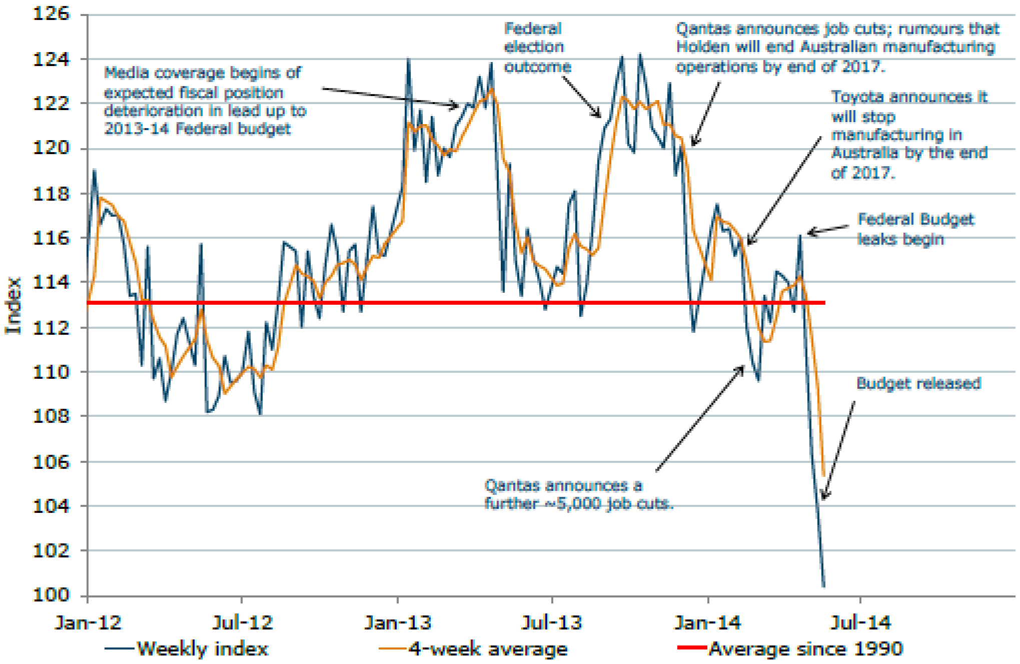
Economic Data	Period	Actual	Previous
Wage Price Index	March/Q	+0.7%	+0.7%
Westpac/MI Consumer Sentiment	May	-6.8%	+0.3%

The **wage price index** was up 0.7% in the March quarter, delivering an annual growth rate of 2.6%. The annual pace of wage inflation has been unchanged at 2.6% for the past three quarters, representing the weakest pace since the series commenced in 1999. Both private and public sector wage growth ticked up slightly in annual terms to 2.6% and 2.9% respectively, but remain very low by historical standards (education and arts wages rose, whilst IT and telecommunications sank).

The Westpac-MI Index of **Consumer Sentiment** fell 6.8% in May to 92.9, its lowest level since August 2011 (just prior to the most recent interest rate easing cycle by the Reserve Bank of Australia). The survey was conducted in the week of 12th to 17th May. Three of the five component indices fell in the month, with the largest decline registered in the "family finances for the next twelve months" category.

Interestingly, the "economic conditions in the next 5 years" and "good or bad time to buy major household items" rose. Westpac's Chief Economist, Bill Evans wrote, "the sharp fall in the index is clearly indicating an unfavourable response to the recent federal budget. Respondents were particularly concerned about the impact of the budget on their own finances."

Consumer Sentiment



Source: ANZ-Roy Morgan

The **Minutes of the May Reserve Bank Board meeting** were released last week. The key points were:

- The RBA is expecting below trend growth in next few quarters due to weaker export growth, weaker mining investment and fiscal restraint;
- Economic growth (GDP) is not expected to be back above trend until 2015/16 and then only gradually;
- Any improvement in the labour market is likely to be protracted – with no reduction in unemployment for some time;
- Inflation has slowed to around 3%, lower than the average of around 4% over the past decade; and
- A number of housing indicators seem to be easing back over recent months;

Therefore, the Board considers that "the current accommodative stance of monetary policy is likely to be appropriate for some time yet".

The Department of Employment's Internet Vacancies Index rose 0.4% in April to be down 0.6% over the year. The pick-up in the month halts falls seen over the preceding two months, which in turn followed a sharp rise in January.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Construction Work Done	28 May	March/Q	-0.8%	-1.0%
Private Capital Expenditure (CAPEX)	29 May	March/Q	-1.7%	-5.2%
Private Sector Credit	30 May	April	+0.3%	+0.4%

ECONOMIC COMMENTARY

LAST WEEK

In addition to further media attention around the Federal Budget, weak economic data releases and a fall in the iron ore price were the focuses for financial markets last week. Consumer sentiment plummeted and quarterly wages growth was again unchanged and the worst on record. Ongoing worries about growth in China have pushed the price of iron ore under $US100 per tonne for the first time in nearly two years, adding to the negative sentiment.

By the close of trading on Friday, the 90-day bank bill was trading at 2.69% compared to 2.70% a week earlier. At the long end, 3 and 10 year bond yields closed at 2.79% and 3.79% from 2.80% and 3.72% a week earlier.

CURRENCY

The Australian Dollar fell to a two-month low last week, coming under pressure from a stronger US Dollar, weaker iron ore prices, dovish statements from the Reserve Bank of Australia and concerns about the Chinese economy. There was also a warning from credit rating agency Standard & Poors that "unless substantial cuts are made to the deficit, it could be forced to reconsider Australia's AAA credit rating." The basis of S&P's concern is the risk that the Senate could vote against much of the planned savings from the Federal Budget.

By the close on Friday, the Australian Dollar was trading at USD0.9242 compared to USD0.9347 a week earlier.

EQUITIES

Our local share market took a weak lead form offshore after major markets in the United States and Europe finished lower early last week. Weak sentiment and a fall in the iron ore price also added to the sell off. Iron ore, measured out of the Port of Tianjin in China, lost over 3% last week, sliding to $US97.50 per tonne, its lowest point since September 2012. The bulk metal has slumped almost 7% in May, and is now down 28% for the year with the record high of above $190 a tonne reached in early 2011 a distant memory. The market recovered late in the week to post a small overall gain, assisted by a rally in Telstra (to a fresh 9 year high of $5.38), a strong lead from Wall Street, a bounce in the iron ore price and a better than expected reading of Chinese manufacturing activity.

By the close on Friday the S&P/ASX200 Index was trading at 5,492.8 compared to 5,479.0 a week earlier.

THIS WEEK

Data out this week includes the first quarterly partial indicators that feed into the upcoming March quarter GDP release (on 4th June). 'Construction work done' is expected to post another decline, with the fall in engineering work more than offsetting an improvement in residential construction. CAPEX data out on Thursday is also expected to post a small decline, adding to the large fall in the previous quarter, and a small upward revision to the CAPEX estimate for spending in 2014-15 (but still 15% lower than the same time last year). With mining investment expected to decline sharply going forward, the key uncertainty is the pace and magnitude of the pick-up in non-mining investment.

INTEREST RATE VIEW

In its Board Minutes last week, the Reserve Bank of Australia reaffirmed its view that expansionary monetary policy was working and made it abundantly clear that it intends to leave rates unchanged for some time. Naturally it remains unclear how long that might be, but with house prices easing and consumer sentiment plummeting, it appears as though the case for an immediate rate rise has disappeared. The next major event for the RBA remains the mining investment collapse and until it has a good feeling for the size and scope of that collapse, a conservative approach will be the best approach to policy.

There is no suggestion that the Reserve Bank of Australia will reduce the cash rate further but equally very little expectation that their economic outlook will see rates rising any time soon either. The RBA Minutes can be interpreted as suggesting that there will be a delay in any move (up) in rates over 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	2.80	2.59	2.63	2.69	2.69
180 day Bank Bill	2.78	2.61	2.66	2.72	2.72
1 year swap	2.88	2.81	2.86	2.90	2.89
3 year swap	3.15	3.44	3.36	3.30	3.19
5 year swap	3.52	4.03	3.92	3.79	3.64
10 year swap	4.12	4.82	4.70	4.50	4.33
AUD/USD	0.9687	0.9130	0.9023	0.9291	0.9242
S&P/ASX200 Index	4,983.5	5,352.8	5,433.8	5,531.0	5,492.8

CHART OF THE WEEK

Australia: The worst five years since the early 1990s recession

Balancing the mood with the data

To an outside observer of Australia, the 'mood' across the country might appear at odds with the data. After all, the unemployment rate is a little below 6%, the economy avoided recession during the GFC, household wealth has grown strongly over the past year, and the Q4 national accounts showed around 'trend' growth in real GDP in the quarter.

Despite a 'not bad' economy, consumer sentiment is only around its long-run average; with a material drop likely to be reported tomorrow in the wake of the Federal Budget if public opinion polls are any guide. Indeed the response by the electorate to what we didn't think was a particularly 'tough' budget has been stark.

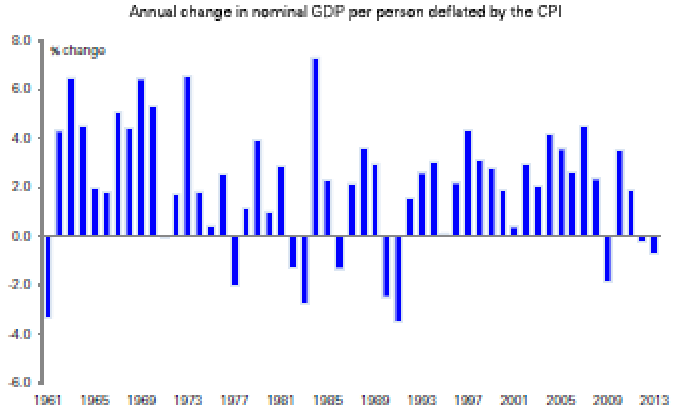
But are we looking at the wrong data?

However, we suspect that most of the data markets focus on is giving a misleading picture of exactly how the economy looks and feels to Australians.

In Figure 1 we have tried to capture this by plotting the annual change in nominal GDP per person, deflated using the consumer price index. (In other words, we have taken the entire value of the economy's production and then turned that into an estimate of how much each resident can buy using that production.

We then calculate the growth rate from year to year.) This gives us a guide to whether the economy is able to produce higher living standards (positive growth in our measure) or not (negative growth).

Figure 1: A living standards measure shows Australians have gone backward over the past two years …



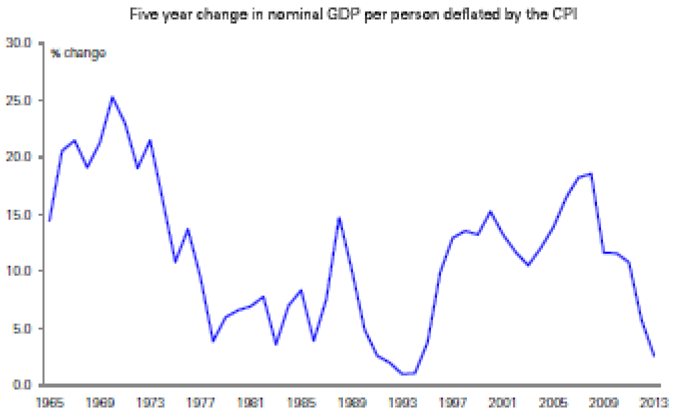
Source: Deutsche Bank, ABS

Australians have gone backwards for the past two years

As Figure 1 shows, the economy has been unable to produce higher living standards for the past two years. This is quite an unusual state of affairs. Indeed over the 50+ years covered in the chart it is only during the recessions of the early 1980s and 1990s that we see back to back declines in our living standards measure.

In Figure 2 we look at the five year change in our measure. Here we find that the increase has been just 2.6% over the past five years – marginally 'better' than that seen over the early 1990s recession, but a slower pace of growth than that seen through the stagflation of the 1970s or the period covering the early 1980s recession.

Figure 2: … with the past five years almost as bad as the early 1990s (and worse than the 70s)



Source: Deutsche Bank, ABS

Source: Deutsche Bank Research
Australian Economics Data Flash
Author: Adam Boyton, Chief Economist
20 May 2014

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, selected Ray White Rural agencies and our own metropolitan branches in Adelaide and Perth.

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