WEEKLY ECONOMIC COMMENTARY

Week beginning 2nd March 2015

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

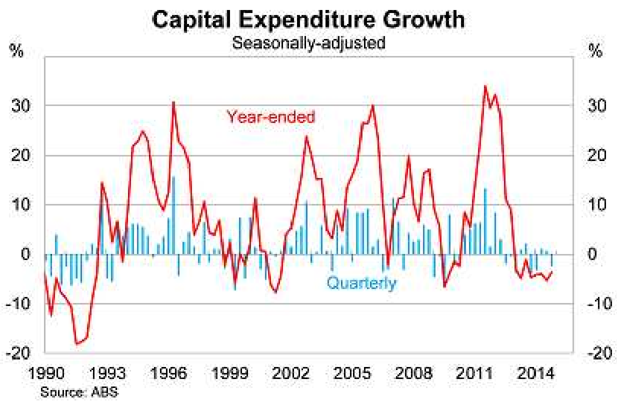
Economic Data	Period	Actual	Previous
DEER Internet Vacancies Index	January	+3.0%	-1.1%
Wage Price Index	December quarter	+0.6%	+0.6%
Construction Work done	December quarter	-0.2%	-2.2%
Private Capital Expenditure (CAPEX)	December quarter	-2.2%	+0.2%
Private Sector Credit	January	+0.6%	+0.5%

The Department of Employment's **Internet Vacancies Index** increased by 3.0% in January. The increase this month follows a flat outcome in December and a 0.8% decline in November, and leaves the series up 5.7% over the last year.

The **Wage Cost Index** rose by 0.6% in the December quarter, with yearly wage cost increases now at 2.47%, the lowest pace of yearly wage growth since this series began in 1997. Private sector wages were up 0.6% while public sector wages rose 0.7%. Annual wage cost growth of workers aligned with demographically driven industries such as health (+2.8%) and education (+3.4%) were above the average, while mining (+2.4%) underperformed the average for all of 2014 and construction (+2.5%) was in line with index growth.

Total **construction work done** fell 0.2% in the December quarter with both private and public spending similarly soft, declining 0.1% and 0.2% respectively. Solid gains in new house construction (+2.5%) was offset by falls in business construction (-2.9%), with falls recorded in both private engineering construction (-0.6%) and non-residential building work done (-1.5%).

Real capital expenditure (**CAPEX**) declined by 2.2% in the December quarter to be down 3.6% annually. The weakness was across the board with non-residential building falling 2.6% and machinery and equipment spending down 1.3%. Investment intentions for 2014-15 were little changed from their previous estimate, with total nominal CAPEX expected to fall by around 3% over this period, with non-mining set to rise 7% and mining set to fall 16%. The report provided the first estimates on capital expenditure intentions for 2015-16 which was lower than market expectations. While the outlook for mining investment remains weak (as widely expected), the outlook for non-mining investment is lower than we expected.



Private sector credit rose 0.6% in January to be up 6.2% annually – its fastest annual pace of growth since January 2009. Housing credit was up 0.8% (+10.1% annually) and business credit also increased 0.8% (+5.5% annually), while personal credit was flat for the month (+0.8% annually).

In the US Federal Reserve Chair's semi-annual testimony before the Senate banking committee last week, Janet Yellen sounded positive notes on the economy's performance over the past six months and tweaked the US Fed's forward guidance language, making it clear the Fed is in no hurry to raise rates. The language changes were designed to provide the FOMC with a little more flexibility regarding the timing of rate hikes. Yellen reiterated that any rate decision would be data dependent, but in an endeavour to break the relationship between forward guidance and the timing of "policy normalisation" (rate hikes), she noted that any modification in the forward guidance (i.e. removing "patient" from the Fed statement) should not be read as indicating "that the Committee will necessarily increase the target rate in a couple of meetings." Markets will therefore consider any meeting from June onwards as "live".

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Balance of Payments	03 Mar	December quarter	-$11.0bn	-$12.5bn
Building Approvals	03 Mar	January	-1.0%	-3.3%
RBA Board Meeting – rate decision	03 Mar	March	2.00%	2.25%
National Accounts (GDP)	04 Mar	December quarter	+0.6%	+0.3%
Retail Sales	05 Mar	January	+0.7%	+0.2%
Trade Balance	05 Mar	January	-$1.25bn	-$463m

ECONOMIC COMMENTARY

LAST WEEK

Interest rate markets were flat early last week amid little clear direction, with the focus turning to the US Federal Reserve Chair's testimony later in the week. Domestic economic data releases also gave markets no clear direction.

Sentiment turned positive later in the week following Greece successfully securing an extension to its bail-out program and the Federal Reserve Chair confirming that US rate hikes were still some way off. This, along with a weaker than expected CAPEX number, saw bond yields push lower into the close last week.

China's central bank announced a cut to both deposit and lending rates by 25bps over the weekend. After the rate cut, one year deposit and lending rate will be lowered to 2.50% and 5.35% respectively.

By the close of trading on Friday, the 90-day bank bill was trading unchanged from a week earlier at 2.33%. In the long term maturities, 3 and 10 year bond yields closed at 1.80% and 2.46% respectively, from 1.87% and 2.58% a week earlier.

CURRENCY

Our currency drifted higher last week as the US dollar continues to edge lower, reflecting the consensus that US Federal Reserve Chair Janet Yellen's testimony has pushed back the time at which the Fed will begin to raise US interest rates.

News that Chinese manufacturing data hit a four month high also helped push the Australian dollar higher. This came following the HSBC Purchasing Managers' Index posting a better-than-expected level of 50.1, just above the 50-point level that signifies that the Chinese economy has expanded.

By the close on Friday the Australian dollar was trading at USD0.7811 compared to USD0.7806 a week earlier.

EQUITIES

Our share market traded as high as 5,955.5 points last week, reaching a level not seen since January 2008. The market was held back by big ticket companies such as Telstra and Woodside trading ex-dividend, but still managed to post its highest level since May 2008. Overseas share markets also hit fresh seven-year highs mid last week as investors were comforted by US Fed chair Janet Yellen's comments and Eurozone creditors approved the list of reforms put forward by Greece to secure an extension of their bail-out funds. Weakness in financial and mining stocks, as well as a 9.5% fall in Woolworths late in the week, saw the market pull back from its highs and by the close on Friday the S&P/ASX200 Index was trading at 5,928.8 compared to 5,881.5 a week earlier.

THIS WEEK

The March Reserve Bank Board meeting on Tuesday will be the main focus for our market this week with the possibility of another follow-up rate cut an even-money call at the moment. On the economic data front we have Building Approvals and December quarter GDP on Wednesday and the latest monthly retail sales and trade balance data on Thursday.

INTEREST RATE VIEW

The Bank of Canada's (BOC) Governor commented last week that January's surprise rate cut was an "insurance" measure, and the BOC could now afford to see how the economy responds (to that cut), which saw the interest rate market reduce their expectation of a further 25 basis point cut at the next BOC meeting from 80% to 40%.

Could this be a precursor to what the RBA will do here this week?

The weaker than expected CAPEX numbers released last week has seen the Australian Dollar push below USD0.78 once again and served to push market pricing for a 25-point follow-up RBA rate cut this Tuesday to back just above the 50% probability.

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	2.25
90 day Bank Bill	2.63	2.62	2.74	2.56	2.33
180 day Bank Bill	2.65	2.64	2.81	2.57	2.33
1 year swap	2.61	2.60	2.63	2.31	2.07
3 year swap	3.06	2.84	2.65	2.23	2.09
5 year swap	3.60	3.20	2.94	2.43	2.37
10 year swap	4.37	3.70	3.45	2.76	2.79
AUD/USD	0.8956	0.9349	0.8439	0.7788	0.7811
S&P/ASX200 Index	5,404.8	5,629.8	5,207.7	5,588.3	5,928.8

CHARTS OF THE WEEK

US market embracing Aussie beef

THE United States is proving to be the land of opportunity for Australian beef producers, soaking up nearly 400,000 tonnes of Aussie beef in 2014 and showing no signs of coming off the pace in 2015.

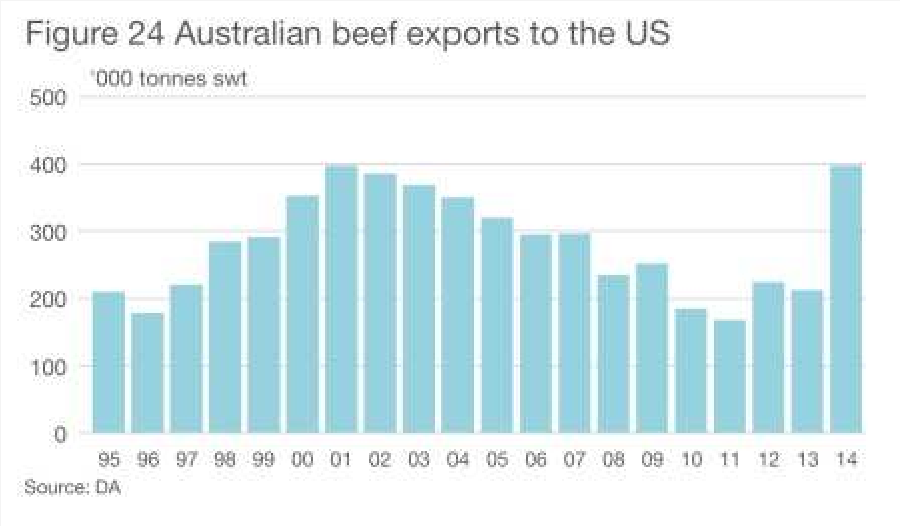
Along with sheer tonnage, Australia is driving a thin wedge into the US grass-fed beef market, a small but growing and important niche. Advice on “healthy eating” that includes beef now seldom to fails to mention grass-fed and/or organic in the same context. Australia is a prominent producer of both categories.

All the signs for continued demand from the US market are favourable, reports David Pietsch, Meat and Livestock Australia’s (MLA) International Business manager. The biggest cloud in the picture is Australia’s ability to supply that demand as the flow of local slaughter cattle shrinks.

US cattle prices slipped slightly in late 2014, but they still remain well above the long-term average. US Department of Agriculture forecasts that 2015 prices will be around the same levels as at the end of 2014.

The price of Australian beef is trending up, too, in line with the increased cost of cattle following widespread rain.

“We don’t want to oversell it,” Mr Pietsch said of the US grass-fed market. “It remains only a niche imported segment within a massive domestic grain-fed protein market, but I’m sure most Australian grass-fed beef producers would be quietly pleased that their product is gaining more recognition for its positive attributes, rather than being seen purely as a commodity.”



MLA’s grass-fed beef marketing efforts, in partnership with suppliers, have been “strongly directed” by the desire of AgForce Cattle and Cattle Council of Australia’s (CCA) marketing taskforce members to promote grass-fed beef’s positive attributes in the US market.

The timing seems about right. Chilled grass-fed beef exports to the US were up 89% year-on-year in 2014, amounting to more than $1 billion for the year. A “significant amount” is finding its way onto retail shelves and in foodservice outlets supplying consumers focused on healthy and natural foods. Rapidly expanding burger chain Chipotle is buying an unknown quantity of Australian grass-fed beef as part of its “responsible sourcing” program that focuses on grass-fed and hormone free product.

Mr Pietsch thinks Australian grass-fed beef sales in the US are falling into three main categories. The long-standing market for frozen, lean, grass-fed manufacturing beef still accounts for 65% to 70% of Australian exports to the US, and has grown off the back of lower cow slaughter in the US.

In the next tier is beef for further processing or value-adding into manufactured meat products, meal solutions, jerky, or food-service preparations like beef fajitas and deli meats. The “much smaller but growing” niche is in retail, Mr Pietsch said. Retail is absorbing a range of products, like the one-pound ground beef ‘brick’ (mince), chilled rib-eyes, tenderloins, striploins (sirloin), and top sirloin (rump). A growing number of restaurants are taking “considerable amounts of chilled beef”.

Future growth in these segments will somewhat be dictated by continued growth in US market demand, Mr Pietsch concluded, and by Australia’s capacity to supply. MLA’s marketing is concentrating on developing brand loyalty to Aussie beef, in the hope that US consumers will continue to seek out the product in the face of potentially higher prices.

Source: Stock Journal;
By Matthew Cawood, National beef writer for Fairfax Agricultural Media
7th February 2015

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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