WEEKLY ECONOMIC COMMENTARY

Week beginning 4th August 2014

ECONOMIC DATA ROUNDUP

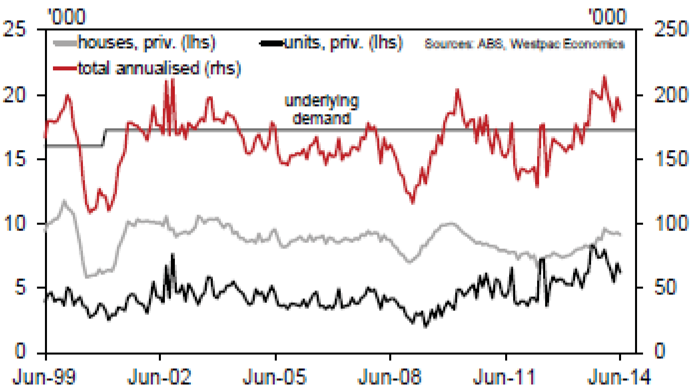
DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Building Approvals	June	-5.0%	+9.9%
HIA New Home Sales	June	+1.2%	-4.3%
Private Sector Credit	June	+0.7%	+0.4%
Producer Price Index	June/quarter	-0.1%	+0.5%

Building approvals fell by 5.0% in June, partially retracing the strong rise in May, to be 16.0% higher over the year and reflecting a continuation of the downward trend over the past six months. This is despite a pick-up in home prices and improved consumer and home buyer sentiment over the period. Approvals for private sector houses declined 2.2% in the month (+12.2% annually), while the volatile "other dwellings" sector fell 10.5% in the month (+22.0% annually).

New home sales rose 1.2% in June according to the Housing Industry Association, driven by a 15.9% spike in sales of multi-units (apartments), while detached house sales fell 1% in the month. In the three months to June, new home sales increased by 2%, with detached house sales up 2.6%.

Building Approvals



Private sector credit was stronger than expected, rising 0.7% in June to be up 5.1% annually. The increase was largely driven by an increase in business credit which rose 1.0% in the month (+3.5% annually) to record its largest monthly increase since October 2008. Housing and business credit also rose strongly, both up 0.6% in June to be up 6.4% and 0.7% respectively over the year.

The **Producer Price Index** (the measure of the change in the price of goods (output) as they leave their place of production) fell 0.1% in the June quarter to be up 2.3% over the year. It was the first quarterly fall in the index since the March quarter 2012. All sub-categories posted price falls this quarter, the largest in the imports of crude materials (-2.9%) and imports of intermediate materials (-2.7%).

The number of new businesses in the June quarter jumped 23% on the previous three months and was up 9% in the year to June, a Dun and Bradstreet study shows. The survey also found that 64% more respondents were positive about the economy than a year ago. Dun and Bradstreet chief executive Gareth Jones said low borrowing costs were helping improve business confidence. "Confidence is critical for entrepreneurship and these numbers on business startups indicate there is a building mood of positivity about opportunities in the economy," he said.

International trade prices were down in the June quarter on a rebound in the currency (up 4% over the quarter) and weaker commodity prices, particularly iron ore and coal. Import prices were down 3.0% in the quarter and export prices down 7.9%.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Retail Sales	04 Aug	June	+0.3%	-0.5%
ANZ Job Ads	04 Aug	July	n/a	+4.3%
Balance of Trade	05 Aug	June	-$2.1bn	-$1.9bn
RBA Board Meeting - Rates Decision	05 Aug	Aug	2.50%	2.50%
Employment	07 Aug	July	+10,000	+15,900
Unemployment	07 Aug	July	6.0%	6.0%
Housing Finance	08 Aug	June	+0.5%	+1.2%

ECONOMIC COMMENTARY

LAST WEEK

As expected, the US Federal Reserve continued its tapering program last week, announcing a further $10bn reduction to its bond buying program, to $25bn per month. The Fed remains on track to end its Quantitative Easing stimulus program in October. The US Fed also reiterated that any move in their federal funds rate (currently sitting at 0% to 0.25%) would arrive “a considerable time after the stimulus program ends”.

Ratings agency Standard and Poor’s reaffirmed Australia’s AAA rating last week. S&P commented that Australia’s rating benefitted from “the country's strong public policy settings, economic resilience, and significant fiscal and monetary policy flexibility…”, also adding that the outlook remains stable.

Bond yields began the week with a rally as further sanctions on Russia from the US and European Union led to safe haven flows into US treasuries. Poor market sentiment emerged last Friday – this followed a run of disappointing corporate earnings in Europe and the US overnight, concern about the Russia/Ukraine crisis, an interest payment default on $13bn of government debt by Argentina (the second in 13 years), and another plunge in Portuguese stocks after problems emerged with Portugal’s Banco Espirito Santo (earnings fell 42%).

By the close of trading on Friday, the 90-day bank bill was trading at 2.64% compared to 2.65% a week earlier. In the long term maturities, 3 and 10 year bond yields closed higher at 2.74% and 3.52% from 2.68% and 3.44% a week earlier.

CURRENCY

The US dollar was broadly stronger on optimism about the US economic outlook, the outcome of the US Fed meeting and flight to quality buying which hurt most currencies on the cross rates late last week. The Australian dollar fell almost 1 cent mid-week and then spiked to a low of USD0.9274 early last Friday before finding some support.

By the close on Friday, the Australian Dollar was trading at USD0.9282 compared to USD0.9409 a week earlier.

EQUITIES

The local share market had another positive week up until Thursday and closed the month with a gain of 4.4% (the best monthly performance in a year) as investors hoped for a strong upcoming earnings season. Sentiment offshore turned sour on Thursday night, the Dow Jones Index falling 317 points, which saw our market sell off heavily last Friday, giving up most of the gains made earlier in the week. Adding to the gloom were poor earnings numbers reported by Kraft and, in Asia by Samsung and very poor production numbers reported by Exxon-Mobil. In Europe, VW and Lufthansa disappointed and Adidas issued a profit warning which it said was partly attributable to the Ukrainian situation.

By the close on Friday the S&P/ASX200 Index was trading at 5,556.4 compared to 5,583.5 a week earlier.

THIS WEEK

This week is shaping up to be quite busy, with a number of scheduled key economic data releases and events. Along with the regular monthly Reserve Bank of Australia Board meeting (with no change to rates expected), the RBA releases its latest quarterly Statement on Monetary Policy (with updated growth and inflation forecasts) and gives the RBA a bit more scope to explain their thinking on monetary policy in more detail than the normal post-meeting statement.

On the economic data front we have the latest monthly employment numbers (unemployment to remain at 6.0%), as well as June Retail Sales which are expected to rebound from the last two month’s weak numbers and print a solid gain. The Trade Balance and Housing Finance data for June is also due for release.

INTEREST RATE VIEW

Markets have continued to wind back their expectations of a possible rate cut by early 2015, with the futures markets now only pricing in a 35% probability of a rate cut by April 2015, down from 42% last week and 70% previously.

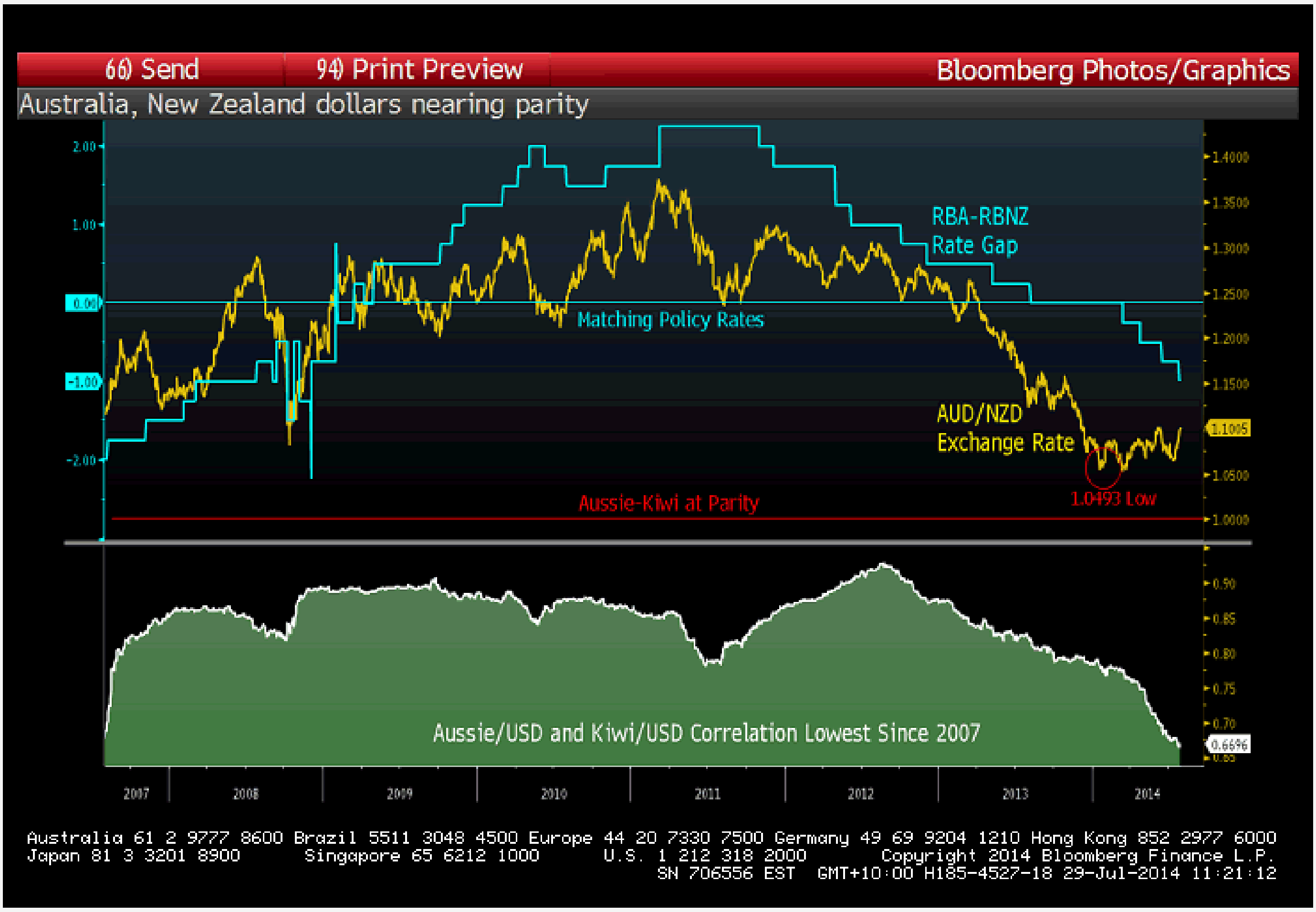
Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.75	2.50	2.50	2.50	2.50
90 day Bank Bill	2.63	2.61	2.68	2.68	2.64
180 day Bank Bill	2.59	2.65	2.71	2.71	2.67
1 year swap	2.66	2.82	2.90	2.84	2.83
3 year swap	3.10	3.30	3.27	3.08	3.11
5 year swap	3.63	3.84	3.74	3.50	3.51
10 year swap	4.44	4.59	4.42	4.14	4.08
AUD/USD	0.8904	0.8750	0.9271	0.9377	0.9282
S&P/ASX200 Index	5,116.8	5,187.9	5,458.1	5,491.2	5,556.4

CHART OF THE WEEK

Australia's dollar is set to weaken to parity with its New Zealand peer for the first time, HSBC Holdings Plc predicts, as contrasting economic fortunes force a widening of the gap in interest rates.

The top panel of the chart below shows the Aussie fell below NZ$1.05 in January this year in what was only the third time in the currencies' post-float histories as traders correctly bet the Reserve Bank of New Zealand's benchmark interest rate would exceed that of its Australian counterpart.

The bottom panel shows the 240-day correlation between the Aussie-US dollar rate and the kiwi-greenback pair falling last week to the lowest since 2007 as the currencies' moves reflected diverging central bank signals.



"The main thing that has been driving the change in nature of the two currencies is the respective paths of monetary policy," said Paul Mackel, HSBC's Hong Kong-based head of Asian currency research. "People will be looking for opportunities to sell the currency pair once it becomes clear that the RBNZ's rate hike story is very much intact," driving a "push to parity," he said.

RBNZ Governor Graeme Wheeler signaled on the 24th July a "period of assessment" after the developed world's first round of interest-rate increases since 2011. The benchmark rate stands at 3.5% following four straight 25 basis point rises since March, while the RBA continues to hold borrowing costs at a record-low 2.5% (a basis point is 0.01%).

Reserve Bank of Australia Governor Glenn Stevens reiterated last week that he could take borrowing costs lower if necessary, with the unemployment rate hovering near a decade high. Options traders expect 1 basis point of rate cuts by the RBA in the next 12 months, compared with 39 basis points of increases by its New Zealand counterpart, according to Credit Suisse Group AG indexes.

The 240-day correlation tumbled to 0.66 on 24th July from as high as 0.93 in August 2012. A correlation of 1 would mean the currencies were moving in lockstep, while a value of minus 1 would mean the opposite. The Aussie is currently buying NZ$1.1004.

Source: Bloomberg, 29 July 2014, by Kevin Buckland and Hiroko Komiya

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