WEEKLY ECONOMIC COMMENTARY

Week beginning 6th April 2015

ECONOMIC DATA ROUNDUP

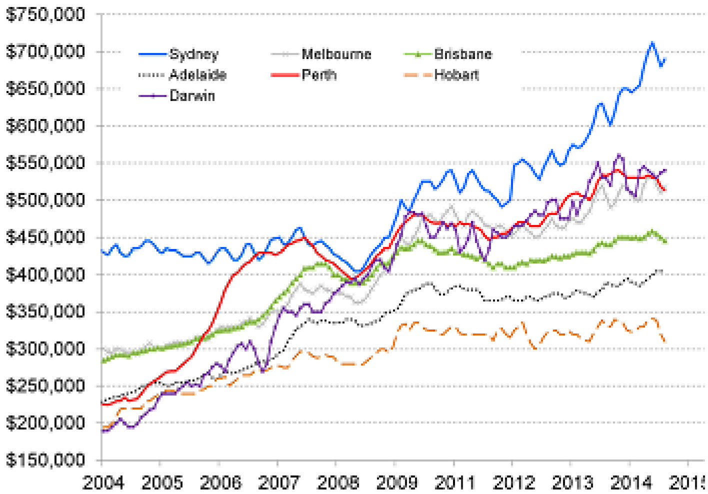
DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Private Sector Credit	February	+0.5%	+0.7%
Building Approvals	February	-3.2%	+7.9%
ABS Job Vacancies	February	+1.1%	+2.6%
Trade Balance	February	-$1.256bn	-$980m

Private Sector Credit increased by 0.5% in February to be up 6.2% over the year, the fastest annual growth since January 2009. Housing credit slowed a little in February but was still up 0.5% overall (+7.1% annually), with investor credit up 0.7% and owner-occupied up 0.5%. Business credit increased by 0.6% (+5.6% annually) while personal credit fell 0.3% (+1.0% annually).

Residential **Building Approvals** retraced part of the large rise recorded in January, falling by 3.2% in February but remaining up 14.3% over the previous year. The decline was centred in Queensland, with the volatile high-density “other dwellings” segment falling significantly, more than the rise recorded in this segment in New South Wales and Victoria. Approvals for houses rose 0.2% in the month (to be flat for the year) while private “other dwelling” approvals fell 6.6% (but were still up 34.5% annually).
Capital city house prices rose 1.4% in March to be up 7.4% annually. The Sydney housing market continues to be boosted by strong investor demand, with prices rising 3.0% and up 14% annually. As a result, prices in Sydney have increased at around double the Australian capital city average over the last year, while house prices in regional Australia continue to lag behind, rising only 1.9% annually.

House Prices



The **ABS job vacancies** index rose 1.1% over the three months to February, to be 6.3% higher over the year. Private sector job vacancies rose 1.0% over the quarter (+4.9% annually), while public sector vacancies were up 2.4% (and +22.7% annually).

Australia’s **trade deficit** widened in February to $1.256bn. The trade balance has been in deficit for eleven consecutive months, primarily reflecting weaker commodity prices. Imports posted an increase of 1.9% this month, mainly driven by a sharp 11% rise in rural exports, which was partially offset by a 1% increase in exports. Lower commodity prices are likely to keep the trade balance in deficit until the end of 2015.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
ANZ Job Ads	07 Apr	March	n/a	+0.9%
Retail Sales	07 Apr	February	+0.3%	+0.4%
RBA Board Meeting – Rates Decision	07 Apr	April	2.25%	2.25%
Housing Finance	10 Apr	February	+3.0%	+2.5%

ECONOMIC COMMENTARY

LAST WEEK

Financial markets were up around the world early last week on rumours of upcoming Chinese stimulus, with the People's Bank of China Governor saying that China's growth rate had tumbled "a bit" too much and that the government could do more to support growth in the economy.

Investors were also focused on portfolio positioning at the end of month (and first quarter), which resulted in some profit-taking (selling) on the last day of the month. Market activity moderated as the week progressed, with traders remaining on the sidelines or positions were squared up (closed) ahead of the four-day Easter break as well as the upcoming RBA meeting.

By the close of trading on Thursday, the 90-day bank bill was trading at 2.18% compared to 2.23% a week earlier. In the long term maturities, 3 and 10 year bond yields closed at 1.68% and 2.31% respectively, from 1.78% and 2.41% a week earlier.

CURRENCY

After starting the week at USD0.7760, weakness in some commodity prices coupled with a stronger US Dollar saw the Australian Dollar fall almost two cents, extending recent losses and again moving below USD0.76 and just above the six-year low of USD0.7560 recorded last month. Increased speculation of a rate cut by the RBA this week also helped push the currency lower.

By the close on Friday the Australian dollar was trading at USD0.7592 compared to USD0.7800 a week earlier.

EQUITIES

Equity markets posted solid gains early last week following news of some large merger and acquisition activity offshore, as well as speculation of further economic stimulus in China.

The price of iron ore has set another post-financial crisis low last week, trading below $50 a tonne and falling 11% in a week. This was assisted by a stronger US Dollar as investors continue to fret about an oversupply that shows no sign of disappearing and a potential "flat-line" demand for iron ore from China. Oil also settled lower last week as negotiations on a nuclear program in Iran threatens to end oil sanctions and allow OPEC to ship more oil into an already over-supplied market.

By the close on Friday the S&P/ASX200 Index was trading at 5,898.6 compared to 5,919.9 a week earlier.

THIS WEEK

INTEREST RATE VIEW

All eyes will be on this Tuesday's RBA Board meeting for any announcement on the official cash rate. Sophie Rodrigues, a bureau chief reporter at Market News International and an early correct caller of both the February RBA rate cut and also the steady cash rate in March, last week wrote that "in net terms there had been net negatives in the eyes of the RBA, pointing to a RBA cut this week", citing further falls in the price of iron ore, some retracement in coal prices and a stubbornly high currency.

There are also some compelling reasons to hold off until May. By then, the RBA will have seen another month of data on employment plus the latest CPI data for the March quarter. Holding off till May also allows more time to see whether there are further signs that the outlook for non-mining investment is improving. The scheduled publication of the Statement on Monetary Policy in May also enables a more thorough analysis of current conditions and clearer communication of any policy change.

Another rate cut by the RBA this Tuesday is currently priced as a 75% chance. That's significantly more than after the March RBA Board meeting. The catalyst for the shift in expectations has been the renewed drop in the price of iron ore, which is now 20% below the level it was on the day on the RBA's March board meeting. The expected cash rate in May hasn't shifted much and still has almost a 100% probability of being 2.00%.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.50	2.50	2.50	2.25	2.25
90 day Bank Bill	2.68	2.71	2.75	2.35	2.18
180 day Bank Bill	2.73	2.75	2.82	2.38	2.20
1 year swap	2.71	2.70	2.52	2.13	1.95
3 year swap	3.21	2.91	2.43	2.20	2.02
5 year swap	3.73	3.32	2.68	2.50	2.31
10 year swap	4.45	3.83	3.11	2.93	2.73
AUD/USD	0.9238	0.8794	0.8045	0.7808	0.7592
S&P/ASX200 Index	5,422.8	5,318.2	5,450.3	5,904.2	5,898.6

CHARTS OF THE WEEK

High dividend yields support equity returns

Over the past seven decades in Australia the level of 'real' dividend yields across the market has provided a pointer to broad stock market rallies ahead.

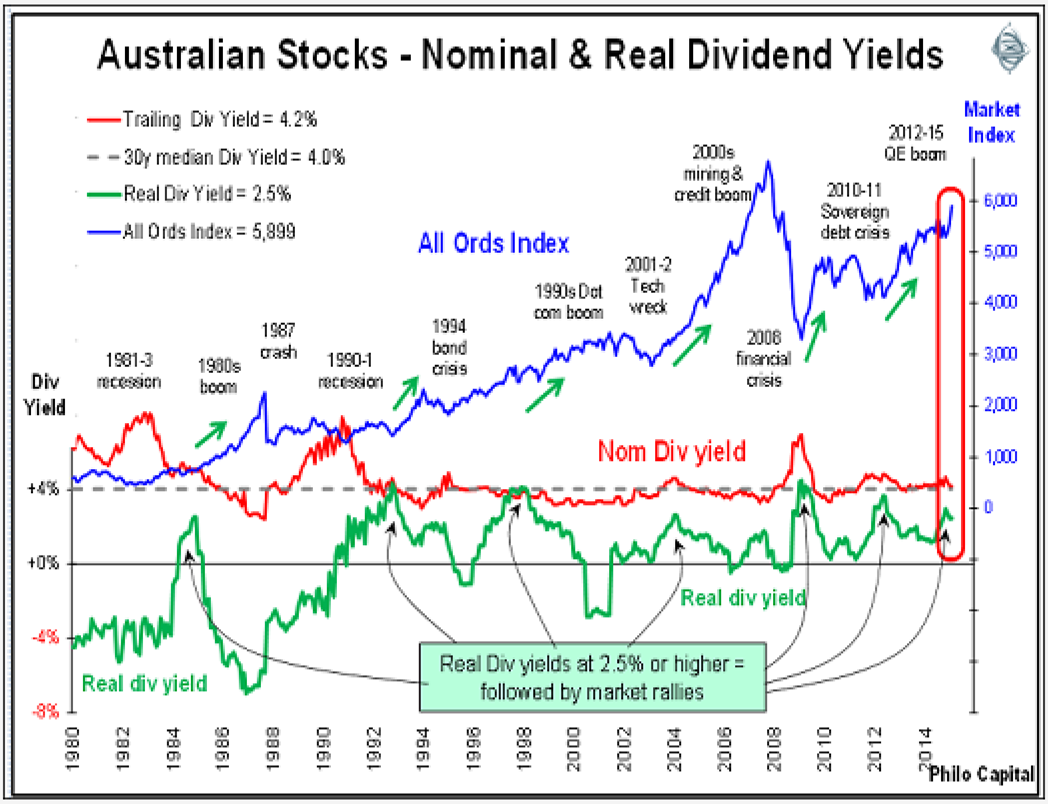
The 'nominal' dividend yield is the aggregate level of dividends for the market over the most recent 12 month period divided by the current market index level. The 'real' dividend yield is the 'nominal' dividend yield less the current or most recent annual inflation rate. A similar measure also works for the US market. The chart shows the Australian market since 1980 noting the booms and busts.

When the real dividend yield reaches 2.5%, the market has rallied for the next several quarters. This measure considers all of the rallies through the 2000s credit/mining boom, the GFC, the sovereign debt crisis and QE boom, and it has also worked in all prior cycles since World War 2, except in the high-inflation 1970s.

In 2014 the Australian market was flat but at the end of 2014 the real dividend yield once again reached 2.5% indicating the market was likely to rally, and it has indeed risen strongly. At the end of February 2015, the real dividend was still 2.5% (4.2% nominal yield less 1.7% inflation), and this has provided further support to our bullish stance on shares.

Local investment markets are being driven by three main factors – monetary, fiscal and political. On the monetary front the Reserve Bank has had to keep cutting interest rates to try to bring down the dollar and to stimulate business investment. The plan is not working as intended. The dollar is still too high and business investment has stalled. Banks are not lending to businesses and businesses are not borrowing or investing. Lending growth is showing signs of growth but it is mainly housing lending, and investment property lending in particular.

Investment has collapsed in the resources sector (thanks to falling commodities prices, over-supply and weak demand), and it has also stalled in other sectors due largely to political uncertainty and the budget crisis.



Instead the rate cuts have fuelled asset price booms driven by foreign and local investors. Foreign investors have so far not been deterred by currency losses. They continue to chase our relatively high interest rates and yields on bonds, commercial property and shares, which are still high compared to the rest of the world. Local investors are shifting money out of bank deposits and chasing higher yields in 'risky' assets at high prices.

The government has been canvassing various measures to cut back spending – eg charging for previously 'free' doctors' visits, counting the family home in assets tests for welfare, and means testing childcare subsidies. The Federal Treasurer has also signalled that a whole range of taxes and tax breaks are on the table for the upcoming May budget – including capital gains tax, negative gearing, franking credits, GST and superannuation tax breaks. These may sound logical and sensible but they will cost votes the government cannot afford to lose. The labour market is weakening, the unemployment rate is rising, wage growth rate is slowing, and inflation is declining.

But for investors, the extraordinarily loose monetary policy (low interest rates) and fiscal policy (budget deficit blowout) are supporting asset prices (shares, bonds and property).

Source: www.cuffelinks.com.au
Article by Ashley Owen, April 1, 2015
Ashley Owen is Joint CEO of Philo Capital Advisers and a director and adviser to the Third Link Growth Fund. This article is educational only and is not personal financial advice, and does not consider the circumstances of any individual.

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 and our Investment Centre in Adelaide.

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