WEEKLY ECONOMIC COMMENTARY

Week beginning 7th October 2013

ECONOMIC DATA ROUNDUP

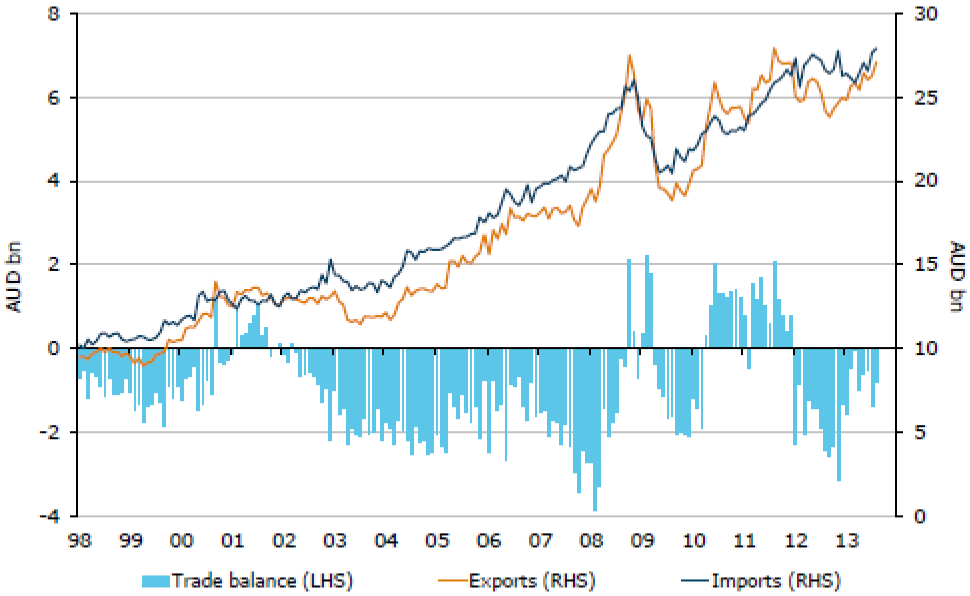
DATA RELEASED LAST WEEK

Economic Data	Period	Actual	Previous
Private Sector Credit	August	+0.3%	+0.4%
Retail Sales	August	+0.4%	+0.1%
Trade Balance	August	-$815m	-$765m
Building Approvals	August	-4.7%	+10.8%

Private sector credit increased by 0.3% in August, taking growth over the year to +3.4%. Housing credit rose 0.4% in August (+4.7% annually), business credit was up 0.2% (+1.4% annually) and personal credit rose 0.2% (+0.9% annually). The data revealed that financial intermediaries had $882.4bn in loans for owner-occupier housing, $424.4bn for investment properties and $135.8bn for 'other' personal credit in August. It showed total loans and advances to the private sector sitting on the balance sheets of banks and non-banks rose to $1.989 trillion in August from $1.981 trillion in July. The report revealed that term deposits sitting with banks climbed to $546.6bn in August, from $544.2bn previously.

Retail Sales rose 0.4% in August to be up 2.3% annually. A sharp rise in department store sales (+6.4%) drove a large portion of the increase in retail sales in the month but this followed weakness in this category in July (-7.9%). In other categories, food retailing rose 0.1% while "Clothing, footwear & personal accessories" and "Cafes, restaurants & takeaways" rose by 0.3% and 0.4% respectively. "Household goods" retailing fell 0.6%, and "other retailing" fell 0.2%.

Australia's **Trade Balance** widened to a deficit of $815m in August. There were significant upward revisions to imports data due to a change in ABS methodology. Nonetheless, imports were up 0.9% in August, thanks to a 4.6% gain in consumption goods. Pretty much all categories of consumer imports, ranging from food and beverages to clothing and footwear, cars, toys and books gained. Exports rose 3.1% thanks to a 3.2% gain in hard commodities, with metal ores and minerals up 7%. There were large increases in the price and quantity of iron-ore and hard-coking coal (the value of iron-ore exports climbed to an all-time high).



Residential Building Approvals fell 4.7% in August to be up 7.7% over the year. Within the details, much of the monthly weakness in dwelling approvals was in the volatile "units, apartments and townhouses" component (-8.9%), although detached house approvals were also lower (-1.7%).

In other data, according to RP Data Rismark, dwelling prices rose 1.6% in September to be up 5.5% annually. The strongest monthly gains were in Sydney and Melbourne where prices rose 2.5%. Prices fell in Brisbane, Perth, Canberra, Darwin and Hobart but rose in Adelaide. The most rapid annual price gains were in Sydney (+8.0%) and Perth (+7.6%).

Data over the next week

Economic Data	Date	Period	Forecast	Previous
ANZ Job Ads	08 Oct	September	n/a	-2.0%
NAB Business Confidence	08 Oct	September	n/a	+6
Westpac/MI Consumer Sentiment	09 Oct	October	n/a	+4.7%
Employment	10 Oct	September	+30,000	+10,800
Unemployment	10 Oct	September	5.8%	5.8%

ECONOMIC COMMENTARY

LAST WEEK

Risk sentiment was poor through most of last week with declines recorded in global equity markets, bond yields and the US Dollar almost every day as the concerns over the lack of progress in US Government budget negotiations continued to weigh on financial markets. After a bill linking the short-term extension of US Government funding with a delay to President Obama's health care policy ("ObamaCare") was rejected in the Senate over the weekend, the possibility of a US government shutdown weighed on risk sentiment early in the week. This was revealed on Tuesday night when the US Government began a partial shutdown for the first time in 17 years, after Congress failed to break a partisan deadlock. Reports suggest that about 818,000 workers were sent home without pay. Essential services workers would be kept on, with their pay deferred but guaranteed for a later date. The Federal Government employs about 2.9 million civilian workers (armed forces fall within this category). Financial markets took the view that this partial shutdown won't be especially damaging for the economy, but until the effects are known, the shutdown was a reason for the Fed not to reduce its $85bn bond buying program.

Locally, as expected, there was no change in the official cash rate for the second consecutive month after the monthly Reserve Bank of Australia (RBA) Board meeting last week. The accompanying statement was very similar to the previous version. The tone remained neutral and contained little new information for investors, with the RBA saying it will keep adjusting policy as needed to foster sustainable growth in demand.

By the close of trading on Friday, the 90-day bank bill was trading at 2.58% compared to 2.59% last week. At the long end, 3 and 10 year bond yields closed higher at 2.99% and 4.04% from 2.76% and 3.87% a week earlier.

CURRENCY

The US Dollar was weaker against most core currencies last week following little progress towards a resolution of the US Government shutdown which resulted in a rally of the Australian Dollar. Our currency also got a boost after the RBA decision to leave rates on hold last Tuesday and sustained those gains through the week. The RBA decision was widely expected, but markets may have been hoping for a clearer signal for another rate cut, due to the Dollar's recent strength.
By the close on Friday, the AUD was up just over a cent and trading at USD0.9436 compared to USD0.9327 previously.

EQUITIES

US equities fell heavily early last week; with Republicans and Democrats no closer to reaching agreement on a spending Bill that would avert a partial government shutdown. Our share market fell 1.7% over the week after posting seven consecutive weekly rises, as reports emerged of possible dire consequences from the US Budget impasse.
By the close on Friday, the S&P/ASX200 Index was trading at 5,208.0 compared to 5,301.7 a week earlier.

THIS WEEK

The key economic data release this week will be the latest employment report for September, although the impact of the Federal Election will blur the true state of the labour market. Despite an expected 30,000 rise in the number of people employed this month (mainly part-time), the unemployment rate is expected to remain unchanged at 5.8%. There is also a selection of private data due out, including an important business confidence survey. After a rise in both business and consumer confidence last month, the latest readings will be crucial to determine whether the improvement in confidence has been sustained, or if it was just a short-term bounce around the time of the Election.

Offshore, the US budget developments will remain in focus as the government of the world's largest economy is still in partial shutdown.

INTEREST RATE VIEW

Despite another month of stable cash rates from the RBA following their regularly monthly Board meeting last week, financial markets haven't ruled out another rate cut. The odds that the RBA will reduce its cash rate to 2.25% or less by April are about 60%, based on the current futures market. The bar for another RBA rate cut is pretty high although continuing gains in the Australian Dollar may force the RBA to make a rate reduction sooner rather than later.

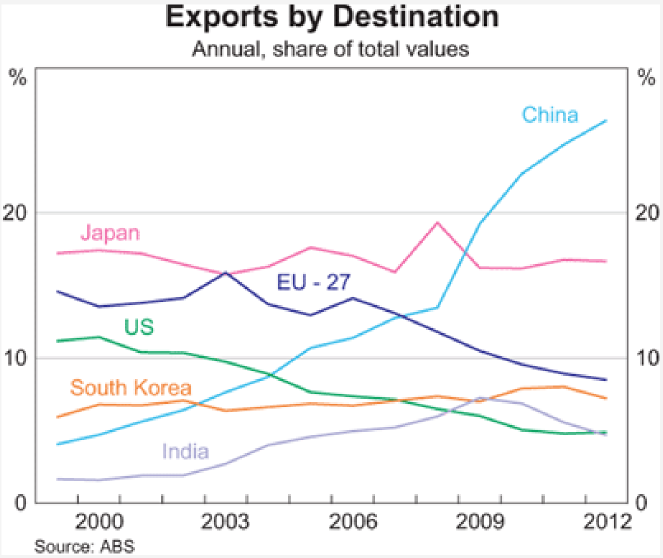
Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	3.25	3.00	2.75	2.50	2.50
90 day Bank Bill	3.19	3.07	2.83	2.59	2.58
180 day Bank Bill	3.17	3.12	2.81	2.61	2.59
1 year swap	2.99	3.16	2.81	2.75	2.70
3 year swap	2.98	3.34	3.28	3.45	3.31
5 year swap	3.27	3.67	3.78	4.04	3.85
10 year swap	3.74	4.16	4.47	4.79	4.56
AUD/USD	1.0247	1.0430	0.9142	0.9140	0.9436
S&P/ASX200 Index	4,494.4	4,891.4	4,841.7	5,145.0	5,208.0

CHART OF THE WEEK

The RBA's interest rate playbook

Being asked which is your favourite chart in the Reserve Bank of Australia's monthly chart pack is a bit like being asked which is your favourite child. Each month, the day after the meeting of the board, the Reserve Bank publishes the charts that would have been used as evidence to support the Bank's analysis of the economy and financial markets and would have been the centerpiece of discussion at the meeting. It is essential viewing.

There is one chart, nonetheless, that probably captures the essence of Australia's recent economic history and spells out where the future lies. It is Exports by Destination (right), which shows the change in the direction of exports over the past 15 year or so.



The striking feature is the emergence and then dominance of China. The 1990's ended with China taking just 5% of Australia's exports. In 2013, this had risen to over 25% and it has increased further through the course of 2013. Europe and the US combined, took over 25% of Australia's exports in the late 1990's and this has dropped to around 13%. India and South Korea are more important export markets than the US and it is all but certain that Europe will drop below these countries in the next couple of years.

There is an incredible range of other information in the central bank charts that are worth a look. While I have clearly cherry picked the following charts, these are the ones that would have been used to argue against a further interest rate cut or indeed, that the next move in interest rates should be up.

In terms of Australia's major trading partners, there clearly has been a consolidation in the growth at around a 4% pace. With stimulus being maintained, the Reserve Bank is a little more optimistic about the growth outlook for the world, even though risks remain.

While inflation is currently comfortably within the Reserve Bank's 2% to 3% target band, most of the underlying measures are no longer falling – they may even be ticking a little bit higher. The September quarter inflation data, coming out later this month, will be vital to confirm whether some of the inflation risks have been benign or not.

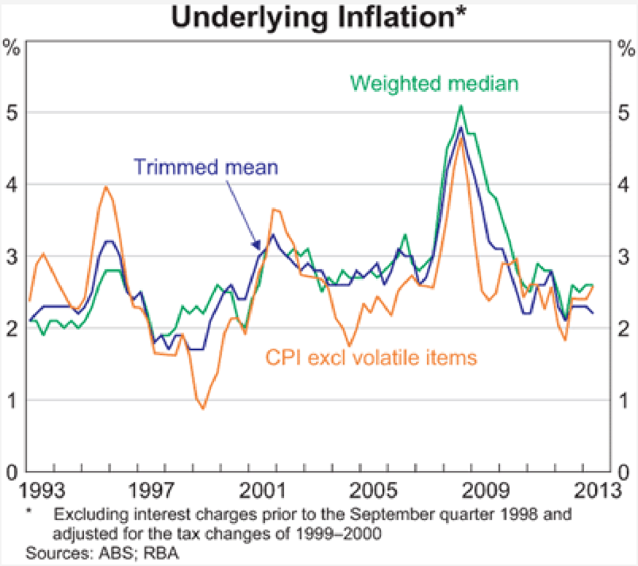
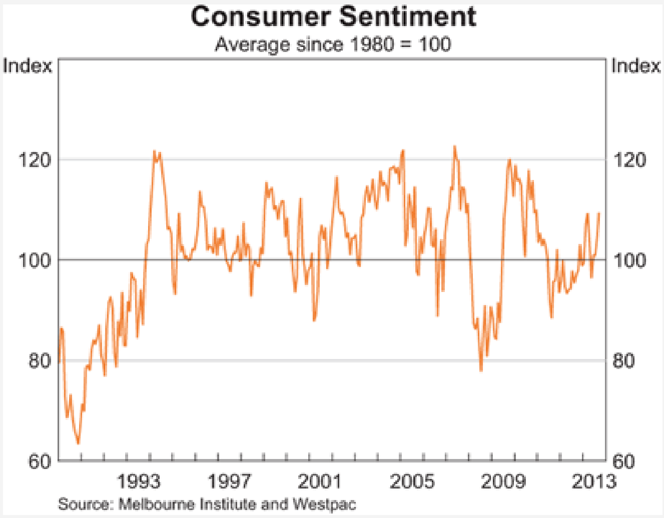
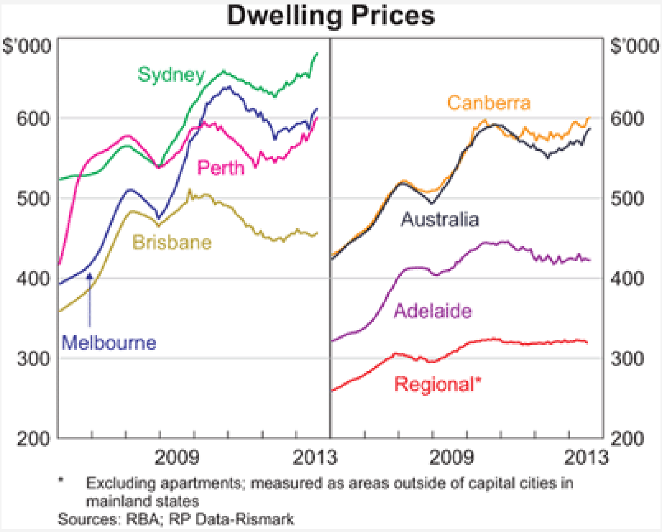


CHART OF THE WEEK

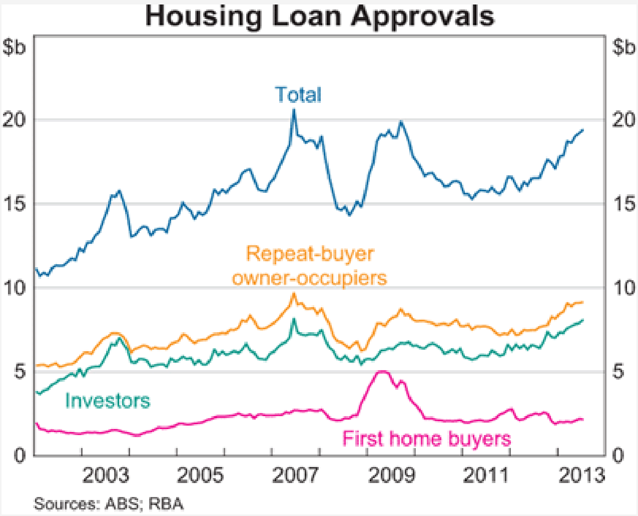
While not a massive influence on policy settings, consumer sentiment (right) does give some useful information of the prospects for spending and borrowing from the household sector. Sentiment has jumped by 10% in the last two months to be well above its long run average.

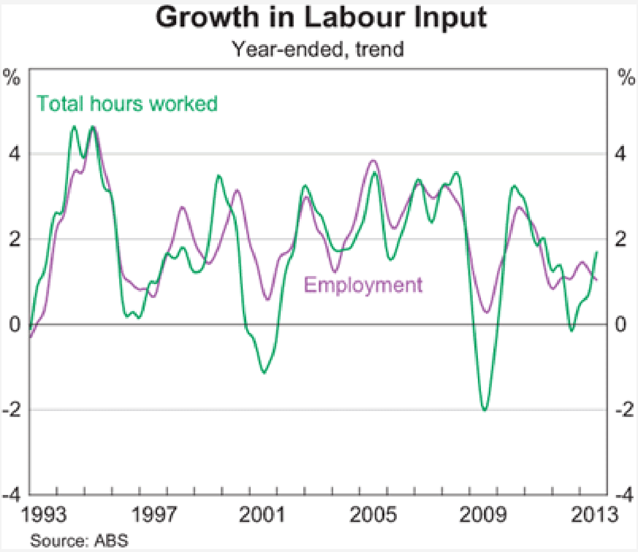




House prices (left) are clearly moving up, albeit from a lowish base. All of the losses between 2010 and early 2012 have been recovered at the national level and with interest rates currently at record lows, it seems certain more house price gains will occur. The Reserve Bank will not want this recent upside momentum to turn into a gallop.

The home loan approvals data are similarly showing an upswing (right).

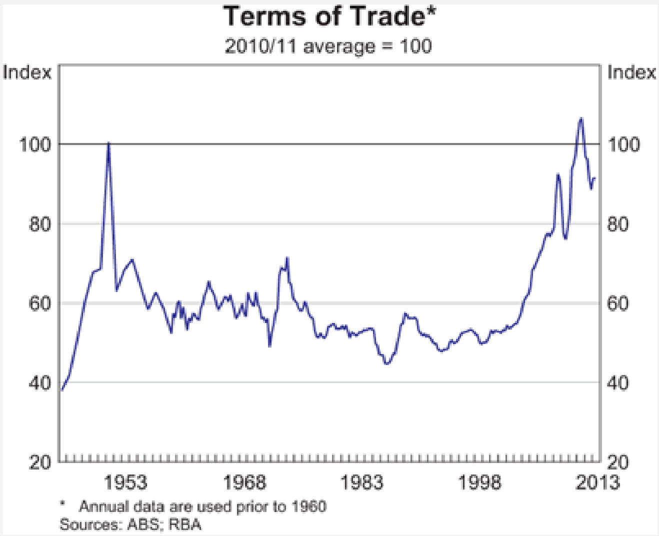


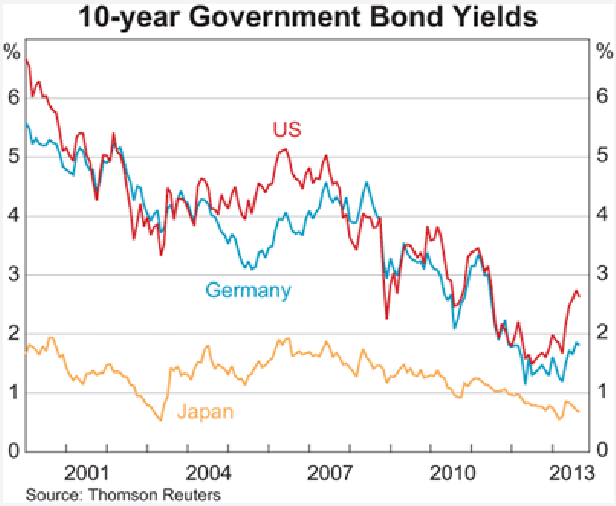


Despite some of the (legitimate) anxiety over the recent labour force data because of a weaker trend, annual employment growth remains reasonably solid at around 1% while total hours worked is strengthening. It suggests firms are working their existing workforce harder before deciding to add staff in a more formal way. There is also some prospect that employment will bounce-back in the few months after the election.

CHART OF THE WEEK

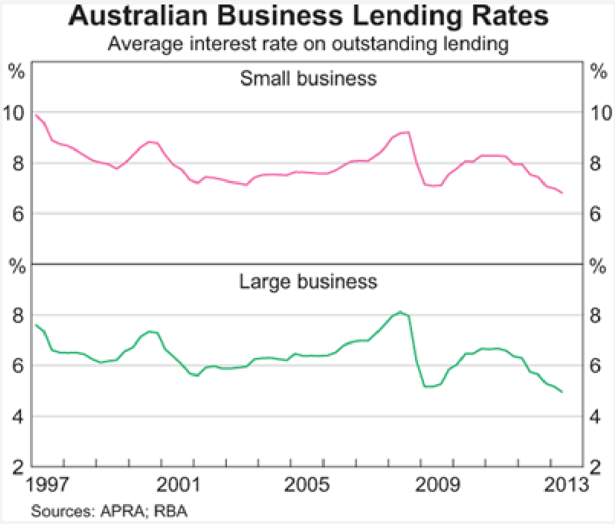
The fall in the terms of trade has been moderate and recent commodity price trends suggest further sharp falls are unlikely. Even a further 5 or 10 per cent drop in the terms of trade over the next year or so would leave them well above the long run average.

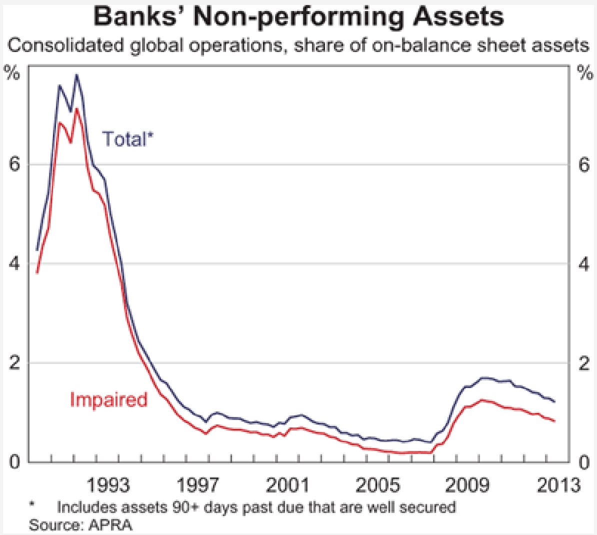




Global bond yields have been moving higher on the back of heightened inflation risks and a realisation that central banks will start to reduce the amount of monetary stimulus in the economy. At the moment, the back up in yields is not yet signaling strong economic growth with high inflation, but the bond market tends to be forward looking and alert to these risks.

Critically important, monetary policy in Australia is very easy. The average interest rate paid by the business sector has never been lower (right). With some leading indicators turning higher, more monetary stimulus is not needed.





And finally, the bank's non-performing loans (left) are low and falling, which suggests the current easy monetary policy settings are working. These low levels of non-performing assets are potentially a risk from the point of view of the banks allowing some relaxation in credit standards and borrowers wanting to take on more debt.

In all, the charts highlight some positive aspects about the economy, markets and just possibly some inflation risks, but for now, it is clear why the Reserve Bank left interest rates on hold at a record low level earlier this week. Watch out for the next chart pack to see whether these and other charts show turning points in the key indicators.

Source: Article by Stephen Koukoulas in Business Spectator, 4th October 2013.

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 two metropolitan branches in Adelaide and Perth.

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