Weekly Economic and Financial Market Snapshot

8 June 2012

	Indicative Rates & Prices [a]			
	Year Ago	**Last Week**	**This Week**	**Today**
Interest Rates (% pa)				
cash	4.75	3.75	3.50	3.50
bank bills				
30-day	4.83	3.66	3.58	3.62
90-day	5.01	3.51	3.44	3.54
180-day	5.16	3.37	3.33	3.46
Swaps				
1-year	5.09	3.04	3.02	3.09
3-year	5.24	3.25	3.20	3.26
5-year	5.53	3.63	3.55	3.61
10-year	5.78	4.05	3.96	4.03
Exchange Rates units of FX per $A				
$US	1.0676	0.9806	0.9825	0.9866
renminbi	6.9179	6.2237	6.2543	6.2838
yen	85.9	78.0	77.5	78.4
euro	0.7336	0.7818	0.7858	0.7876
TWI [b]	77.4	73.9	74.1	74.3
Commodities				
gold ($/ounce)				
$US	1,542	1,566	1,603	1,571
$A	1,445	1,597	1,632	1,592
oil ($/barrel)				
$US	99.87	89.91	84.27	84.82
$A	93.41	91.84	86.06	85.14
base-metals [c]				
$US	181.6	152.3	149.8	150.1
$A	139.7	122.6	120.3	118.9
Equities				
All Ords	4,650	4,125	4,100	4,112
Dow	12,170	12,496	12,245	12,461

Notes: *(a)* Indicative wholesale prices/yields. With the exception of cash and all data in the "today' column, all observations are weekly averages ending Friday. Cash is snapshot on the Friday of the relevant week.

(b) Trade-weighted index value of AUD, based at May 1970 = 100.

(c) Composite index based on London Metal Exchange (LME) prices of aluminium, nickel, copper, zinc and lead; weighted by each metal's relative importance in the RBA's index of commodity prices. Base of index is 3 January 2005 = 100

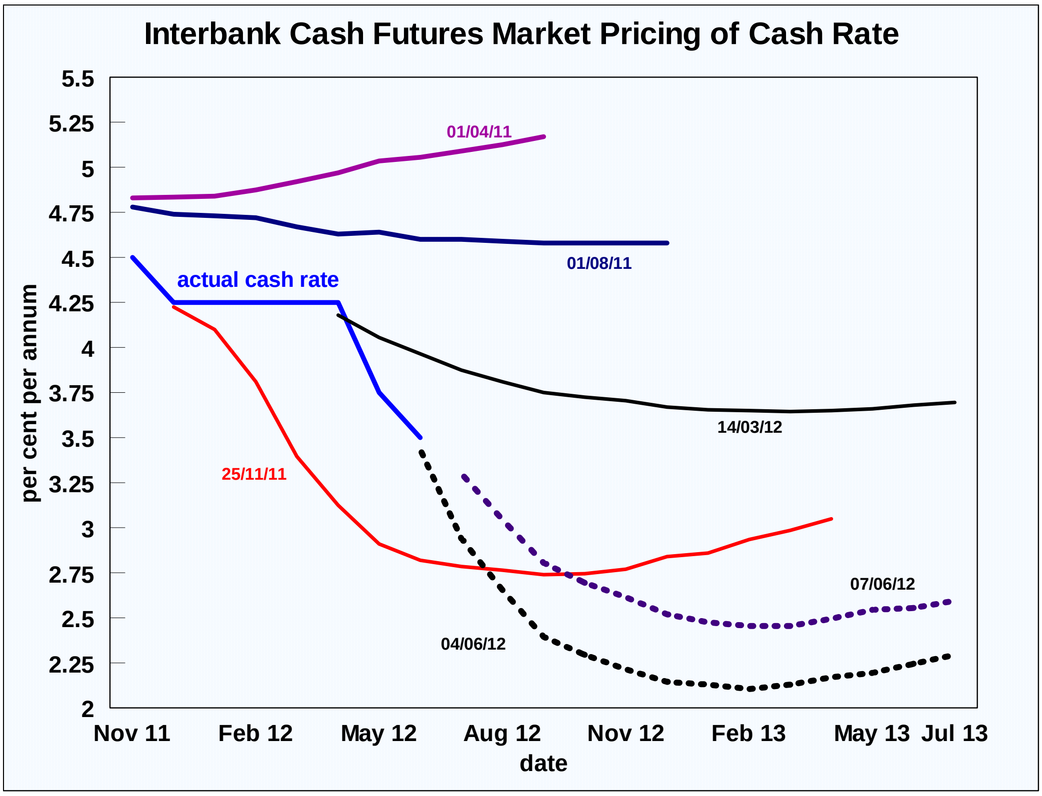
Actual and implied short-term interest rates plunged even lower in the lead-up to Tuesday's cash rate decision, as the interbank cash futures market at least was assuming a 50 basis point cut by the RBA. But when the central bank elected for a smaller rather than bigger cut, rates quickly tracked back up. And when stronger, rather than weaker economic data were published in each of the next two days, yields continued the retracement.

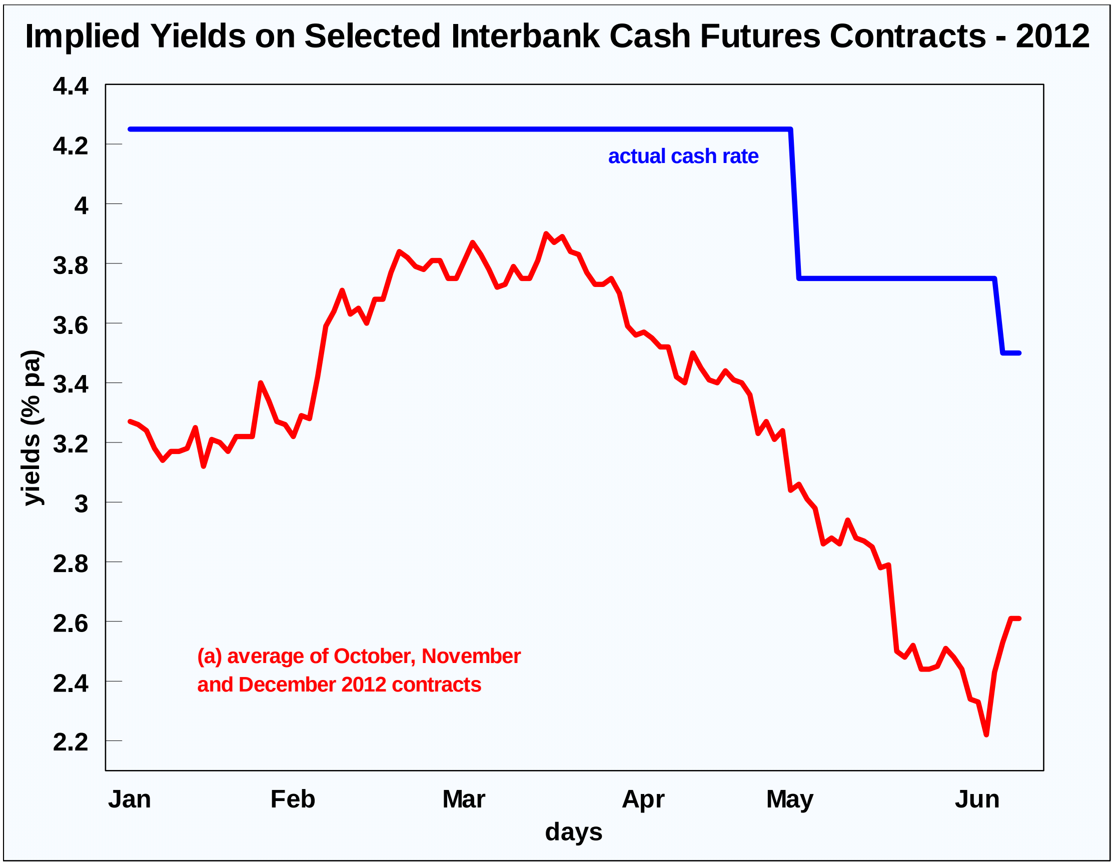
But the interbank market is still pricing for a total of up to 100 basis points of additional cash rate cuts by the end of this year.

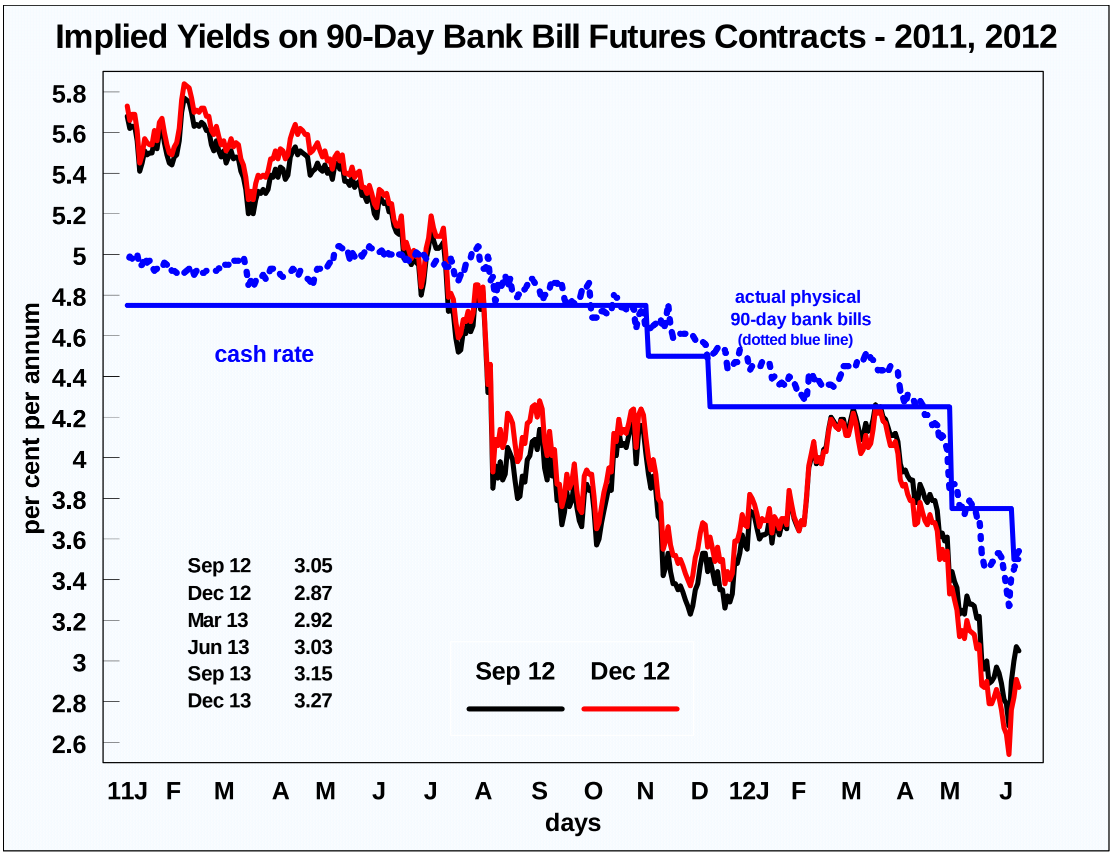
While the interbank cash futures market may be pricing in an insurance policy against GFC2 and/or deep recession, neither outcome forms the basis of the RBA's central scenario - although at least GFC-lite would have to be well in contention to be the next most likely scenario, you would think.

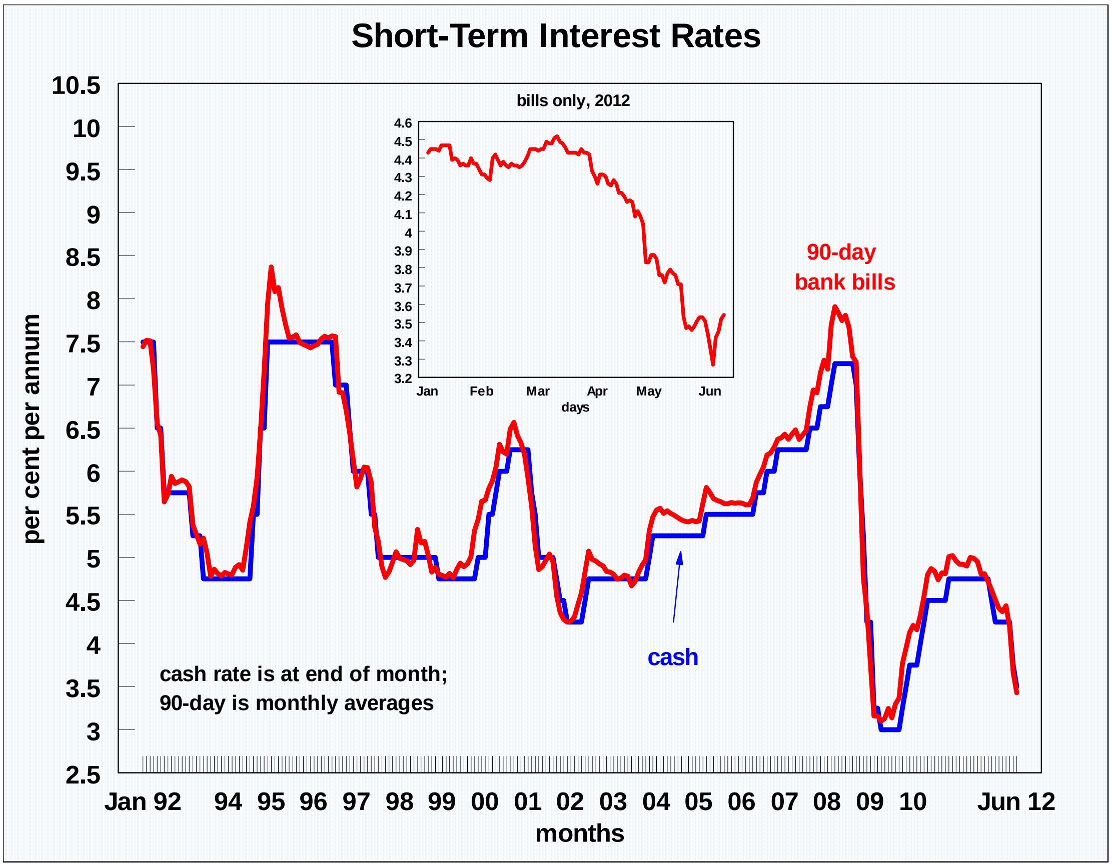
But at this stage, the RBA's moves are precautionary and based mainly on the deteriorating external backdrop, including in particular the ongoing euro sovereign debt crisis that is threatening to engulf Spain even though its government's net debt to GDP ratio is on a par with the German one from which bond risk premia are measured - although the Iberian nation's burden is forecast by the IMF to be 25 percentage points above Germany's by 2017.

Rather, the RBA is taking the opportunity provided by the benign outlook for inflation in the short term to take out an insurance policy with an excess - as opposed to the expensive one with a zero excess that the interbank cash futures market has purchased. But the RBA cautions that …"maintaining low inflation over the longer term will require growth in domestic costs to slow as the effects of the earlier high exchange rate wane".




Implied Yields on Selected Interbank Cash Futures Contracts - 2012
yields (% pa)
4.4
4.2
4
3.8
3.6
3.4
3.2
3
2.8
2.6
2.4
2.2
actual cash rate
(a) average of October, November
and December 2012 contracts
Jan
Feb
Mar
Apr
May
Jun
days


Implied Yields on 90-Day Bank Bill Futures Contracts - 2011, 2012
per cent per annum
5.8
5.6
5.4
5.2
5
4.8
4.6
4.4
4.2
4
3.8
3.6
3.4
3.2
3
2.8
2.6
cash rate
actual physical
90-day bank bills
(dotted blue line)
Sep 12 3.05
Dec 12 2.87
Mar 13 2.92
Jun 13 3.03
Sep 13 3.15
Dec 13 3.27
Sep 12
Dec 12
11J F M A M J J A S O N D 12J F M A M J
days



The day after the cash rate cut was announced, the national accounts for the March quarter were published by the ABS - more than two months after the end of the period to which they relate. But as they detail the economy's bottom line - growth in gross domestic product (GDP) - they nevertheless are the base from which the RBA sifts through some of 'noise' generated from partial indicators of the nation's economic pulse.

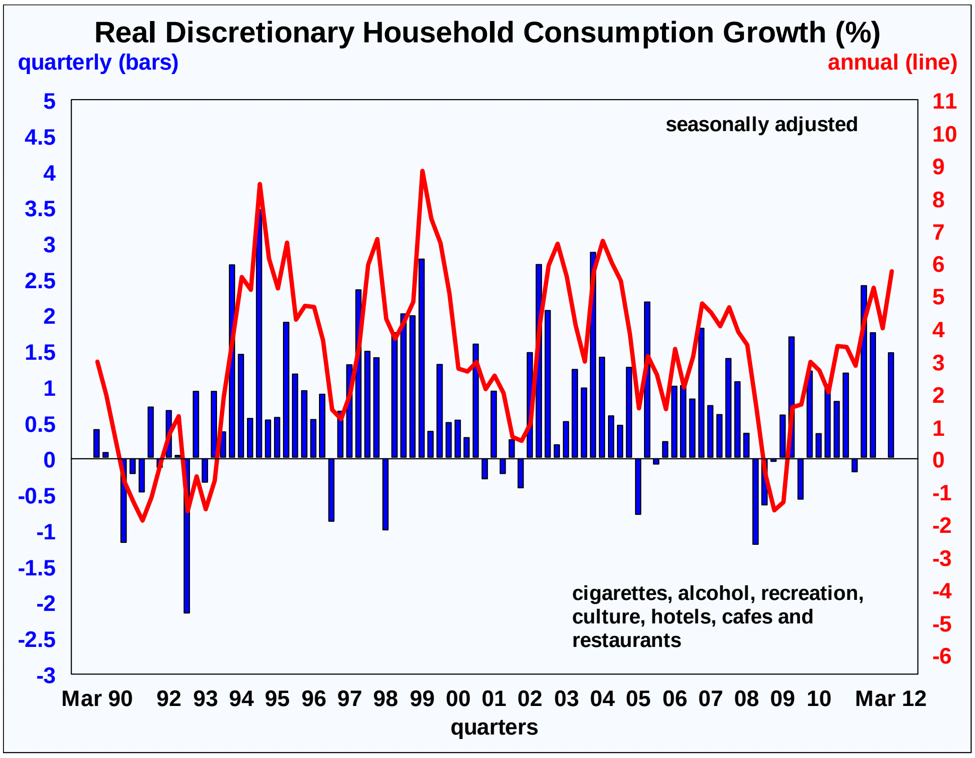
The composition of GDP growth is just as important as the rate of growth, which for the record was 1.3 per cent in the first quarter of 2012 (up from 0.6 per cent in the final quarter of last year) and 4.3 per cent in the year to March 2012, up from 2.5 per cent in the year to December 2011.

Household consumption is the bread and butter of the economy over time, accounting for 55 per cent of GDP in the five years to March 2012, little different to its 56 per cent share over the course of the entire period for which quarterly national accounts data are available - which dates back to 1959.

While traditional retailers of goods continue to struggle, the broader measure of household consumption nevertheless grew by a solid 1.6 per cent in the March quarter, and by a none too shabby 4.6 per cent in the year to March. Those rates are in real, inflation-adjusted terms, which is a proxy for the volume of sales. But the relationship between the nominal (ie before adjusting for inflation) and real turnover pretty much confirms price discounting is the reason retailers are maintaining what looks like solid growth in the volume of their sales turnover.

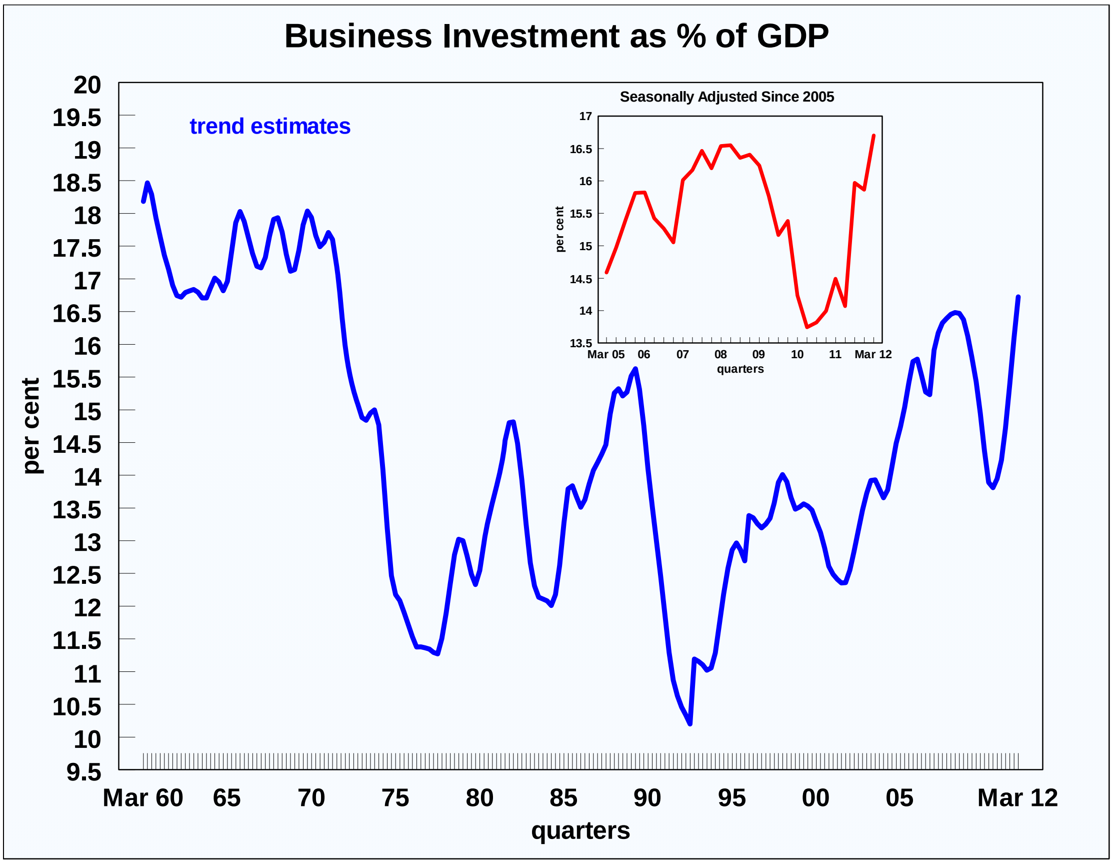
Real Household Consumption Expenditure Growth and Percentage Point Contribution (PPC) to Total Growth									
		growth (%)						PPC	
	% of	quarterly				annual		Dec-11	
	total (a)	Jun-11	Sep-11	Dec-11	Mar-12	Mar-11	Mar-12	qtly	annual
Food	10.3	0.2	0.8	1.8	3.7	2.7	6.6	0.4	0.7
Cigarettes and tobacco	1.7	-0.5	-1.5	-0.4	0.0	-1.1	-2.3	0.0	0.0
Alcoholic beverages	1.9	2.7	2.2	0.2	0.4	2.7	5.8	0.0	0.1
Clothing and footwear	3.5	2.1	-3.5	1.9	1.5	0.7	1.9	0.1	0.1
Rent and other dwelling services	19.4	0.7	0.6	0.7	0.7	2.6	2.7	0.1	0.5
Electricity, gas and other fuel	2.2	-0.1	-2.2	0.8	1.3	7.2	-0.2	0.0	0.0
Furnishings and household equipment	4.7	1.3	1.6	-0.3	0.8	2.5	3.4	0.0	0.2
Health	5.8	0.2	2.4	-1.7	2.6	4.4	3.5	0.1	0.2
Purchase of vehicles	3.0	-5.3	7.3	2.3	-0.4	4.1	3.5	0.0	0.1
Operation of vehicles	4.9	-0.2	0.1	0.9	0.6	3.6	1.5	0.0	0.1
Transport services	3.1	3.8	0.1	2.8	5.5	13.8	12.6	0.2	0.4
Communications	2.6	0.2	-0.2	0.4	0.8	2.6	1.2	0.0	0.0
Recreation and culture	10.7	2.3	2.0	-0.4	1.5	4.0	5.6	0.2	0.6
Education services	3.9	0.2	0.8	0.3	2.0	5.4	3.3	0.1	0.1
Hotels, cafes and restaurants	7.0	3.2	1.9	0.6	2.0	2.0	7.8	0.1	0.5
Insurance and other financial services	8.6	1.6	0.8	0.4	1.9	3.4	4.8	0.2	0.4
Other goods and services	6.8	1.0	1.1	0.7	0.9	3.1	3.7	0.1	0.2
Total	100.0	1.0	1.0	0.6	1.6	3.4	4.2	1.6	4.2

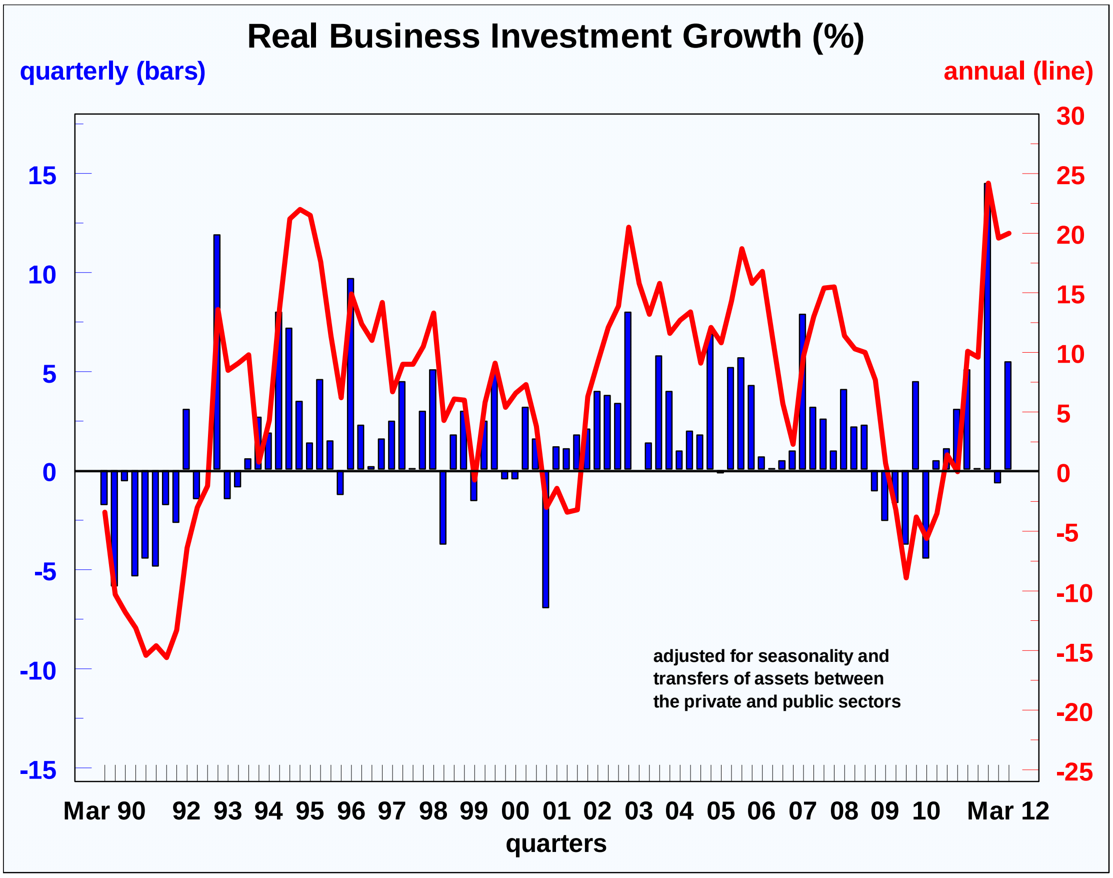
Growth in what could be classified as 'discretionary' expenditure - tobacco, alcohol, recreation, culture, cafes and restaurants - rebounded in the March quarter after stalling in the December quarter, to 1.5 per cent, and 5.7 per cent in the year to March 2012. And if the consumption of alcohol and tobacco are excluded, the recreation, culture, hotels cafes and restaurant categories - which collectively comprise just under 18 per cent of total household consumption - between them accounted for 1.1 percentage points of the total real growth of 4.2 per cent in household consumption in the year to March 2012.

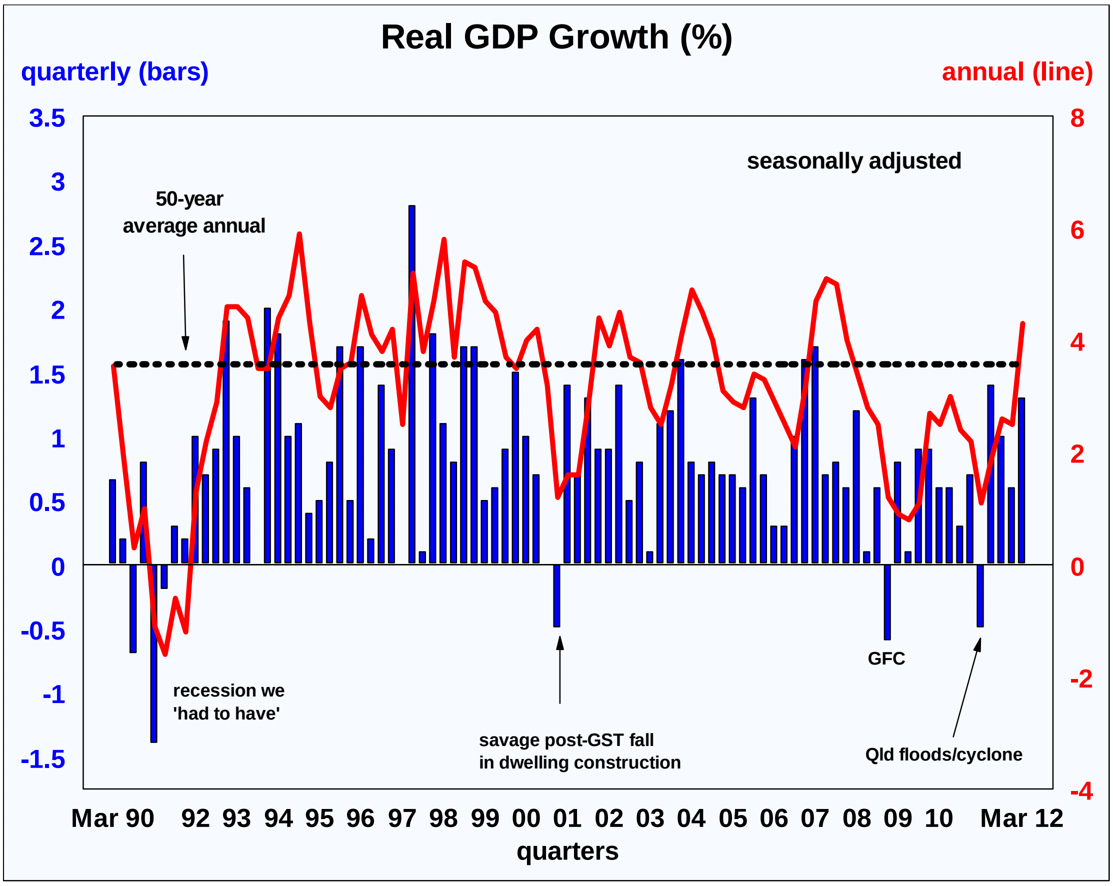


But while business investment is a much smaller part of GDP - around 16 per cent in the five years to March 2012 and less than 15 per cent since 1959 - its contribution to overall GDP growth often can be, and currently is, bigger than household consumption's when business investment is in a strong growth phase.

After stalling in the December quarter, real business investment grew by 5.5 per cent in the March quarter, and by 20 per cent in the year to December, and accounted for 3.2 percentage points of the 4.3 per cent growth in the economy's bottom line - GPD. By contrast, household consumption's contribution was 2.4 percentage points, even though its share of GDP (the 55 per cent referred to earlier) is more than three times business investment's share of a touch under 17 per cent - which, while small compared to household consumption, is at a 40 plus year high on the back of the resources boom.




Real Business Investment Growth (%)
quarterly (bars)
annual (line)
adjusted for seasonality and
transfers of assets between
the private and public sectors
Mar 90 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 Mar 12
quarters

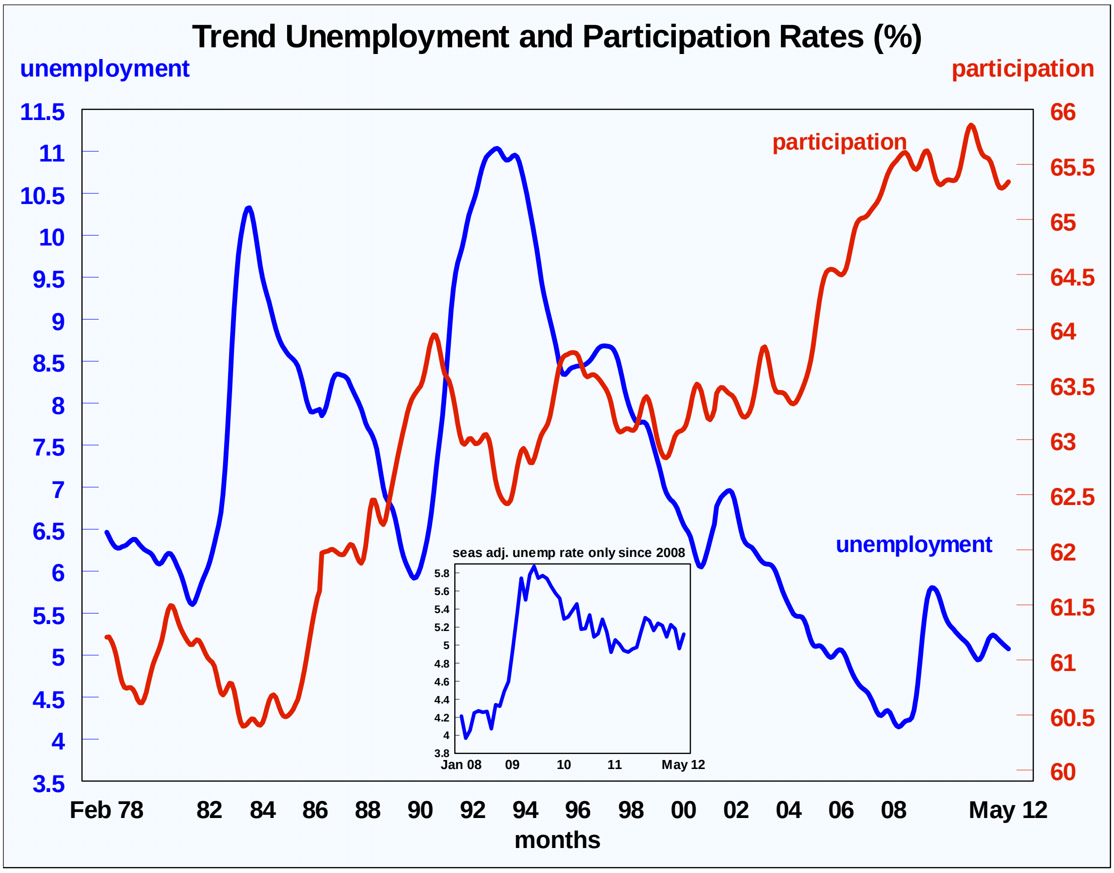

Real GDP Growth (%)
quarterly (bars)
annual (line)
seasonally adjusted
50-year
average annual
recession we
'had to have'
savage post-GST fall
in dwelling construction
GFC
Qld floods/cyclone
Mar 90 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 Mar 12
quarters

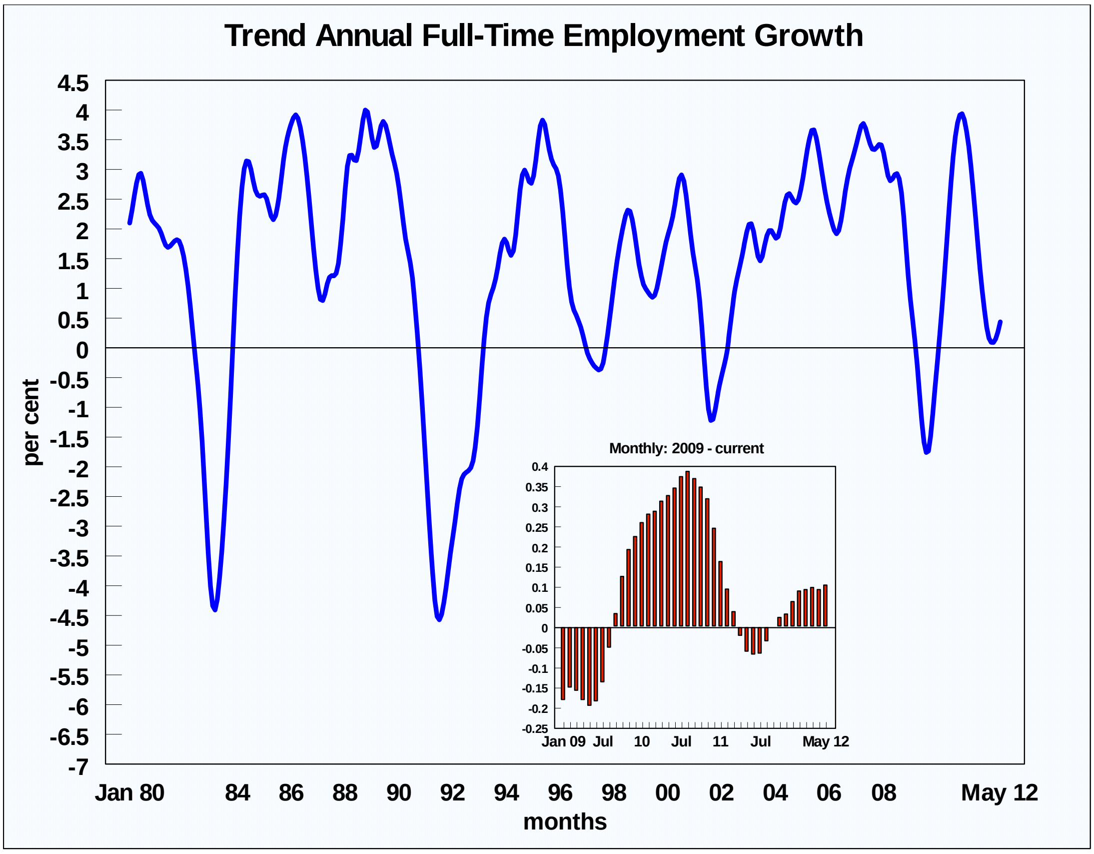
But just as providers of consumer services are doing better than traditional retailers of goods, the profile of business investment is heavily concentrated in the resources sector at the expense of manufacturing as the latter grapples with the high Australian dollar that in part is due to the strength in the former.

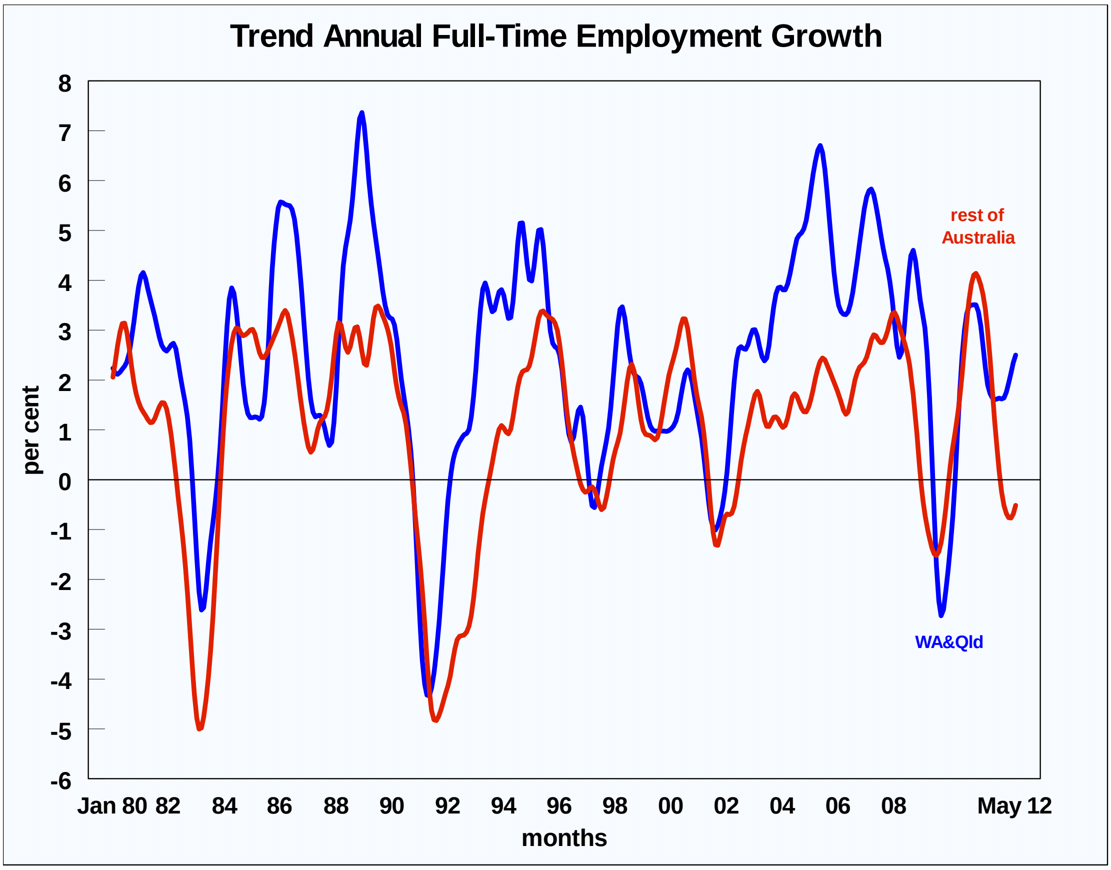
And if the multi-speed economy is not apparent enough in the national accounts and some of its key components, then it is in the labour force - trend full-time employment in WA and Queensland together grew by 2.5 per cent in the year to May, but fell by 0.5 per cent in the rest of Australia.

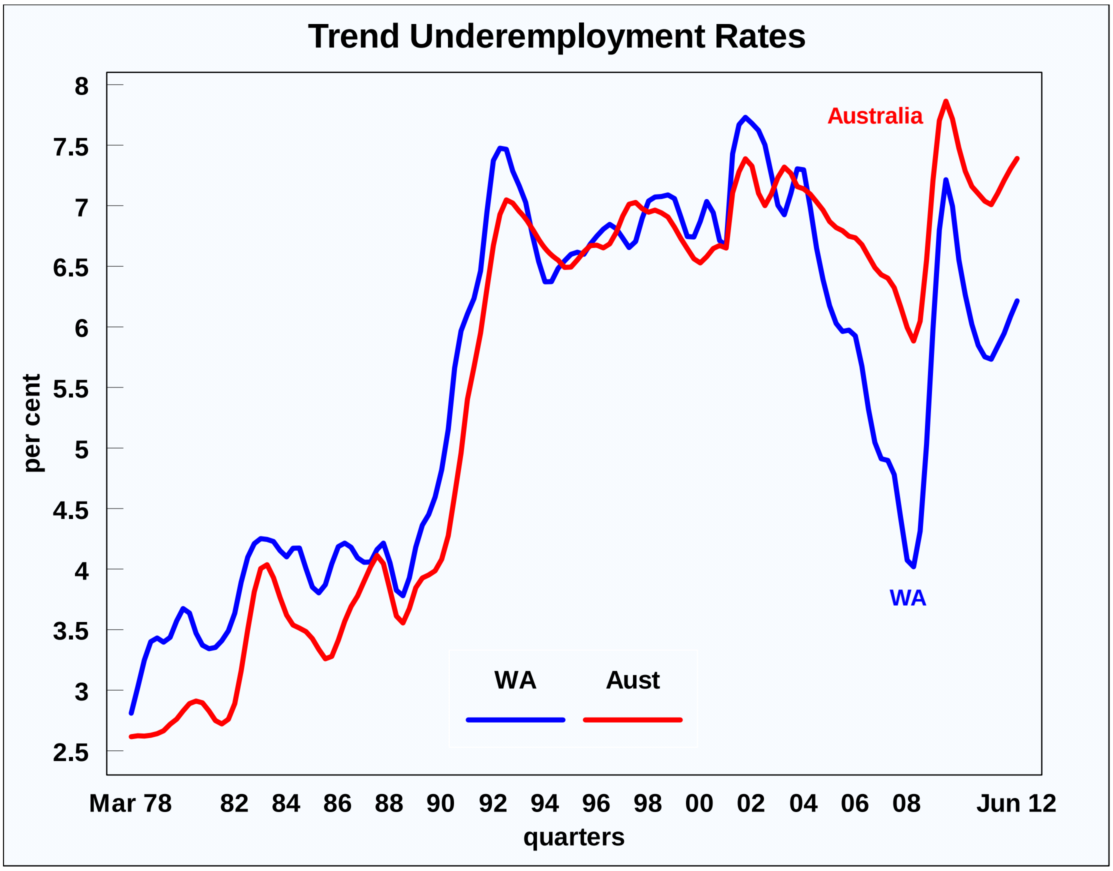
Details of employment by industry sector will not be published until next Thursday, but it is fair to assume that it will be dominated by the mining and related sectors, including engineering construction. The most recent data up to the March quarter revealed acceleration in the share of total employment accounted for by health and social assistance, so manufacturing and retail's losses are not entirely the mining sector's gains - at least not directly.

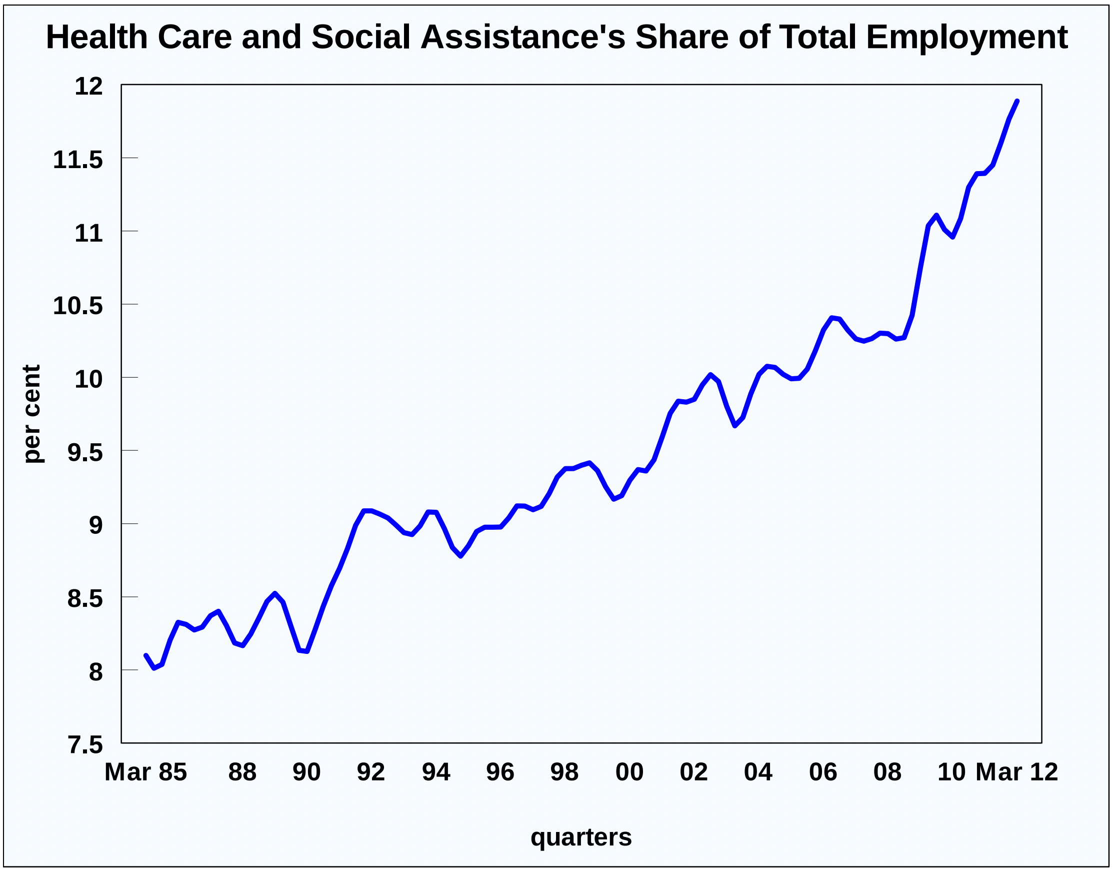
But neither is the two-speed economy exclusively a story of the mining states versus the rest. Underemployment is rising again across the country, including even in WA. Not at the same rate as during the GFC, but noticeably nevertheless.




Trend Annual Full-Time Employment Growth
per cent
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
-3
-3.5
-4
-4.5
-5
-5.5
-6
-6.5
-7
Jan 80 84 86 88 90 92 94 96 98 00 02 04 06 08 May 12
months
Monthly: 2009 - current
0.4
0.35
0.3
0.25
0.2
0.15
0.1
0.05
0
-0.05
-0.1
-0.15
-0.2
-0.25
Jan 09 Jul 10 Jul 11 Jul May 12


Trend Annual Full-Time Employment Growth
per cent
8
7
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
-6
rest of
Australia
WA&Qld
Jan 80 82 84 86 88 90 92 94 96 98 00 02 04 06 08 May 12
months

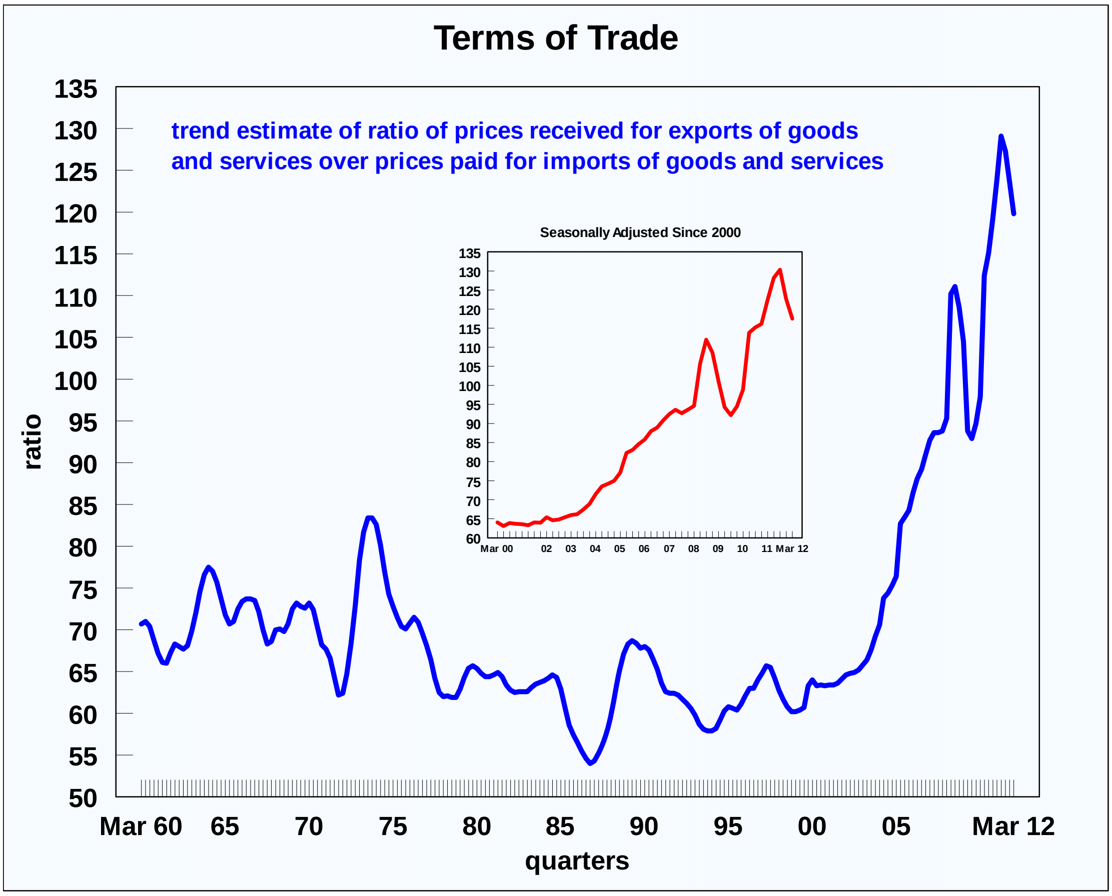

Trend Underemployment Rates
8
7.5
7
6.5
6
5.5
5
4.5
4
3.5
3
2.5
per cent
Australia
WA
WA
Aust
Mar 78
82
84
86
88
90
92
94
96
98
00
02
04
06
08
Jun 12
quarters


Health Care and Social Assistance's Share of Total Employment
12
11.5
11
10.5
10
9.5
9
8.5
8
7.5
per cent
Mar 85
88
90
92
94
96
98
00
02
04
06
08
10 Mar 12
quarters

The explanation by the RBA for its decision to lower the cash rate by 25, rather than 50 basis points this week included an assessment, prior to the May data, that … "Overall labour market conditions firmed a little, notwithstanding job shedding in some industries, and the rate of unemployment remains low".

And while the headline unemployment rate rose a touch in May, it was because so too did the participation rate, which more than offset net jobs growth of 39,000, more than all of which was full-time jobs growth (ie full time employment rose by 46,000 and part-time jobs fell by 7,000). Financial markets correctly focused on full-time employment growth rather than the uptick in the jobless rate, although a fuller reaction would have focussed more attention on the more modest growth in provisional trend full-time jobs growth of around 8½ thousand. But implied yields had fallen too far before the RBA decision anyway, so the futures market has sort of got it about right almost by default.

As was already apparent from export and import price indices published ahead of the national accounts, Australia's terms of trade retreated further in the March quarter, but to just very high, rather than stratospheric levels. And while the terms of trade is the ratio of export prices divided by import prices, it is the former, but the prices of commodities in particular, that drove the terms of trade off the scale in the first place, and also what has caused them to peak.

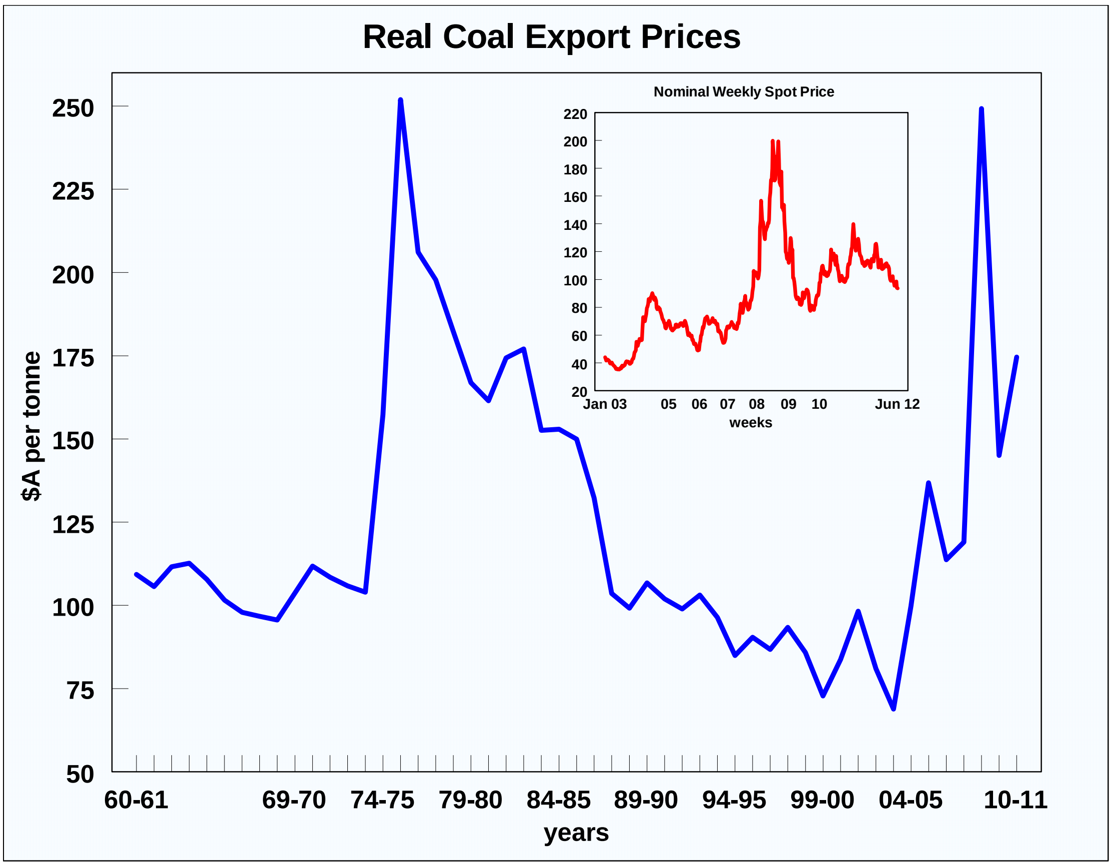


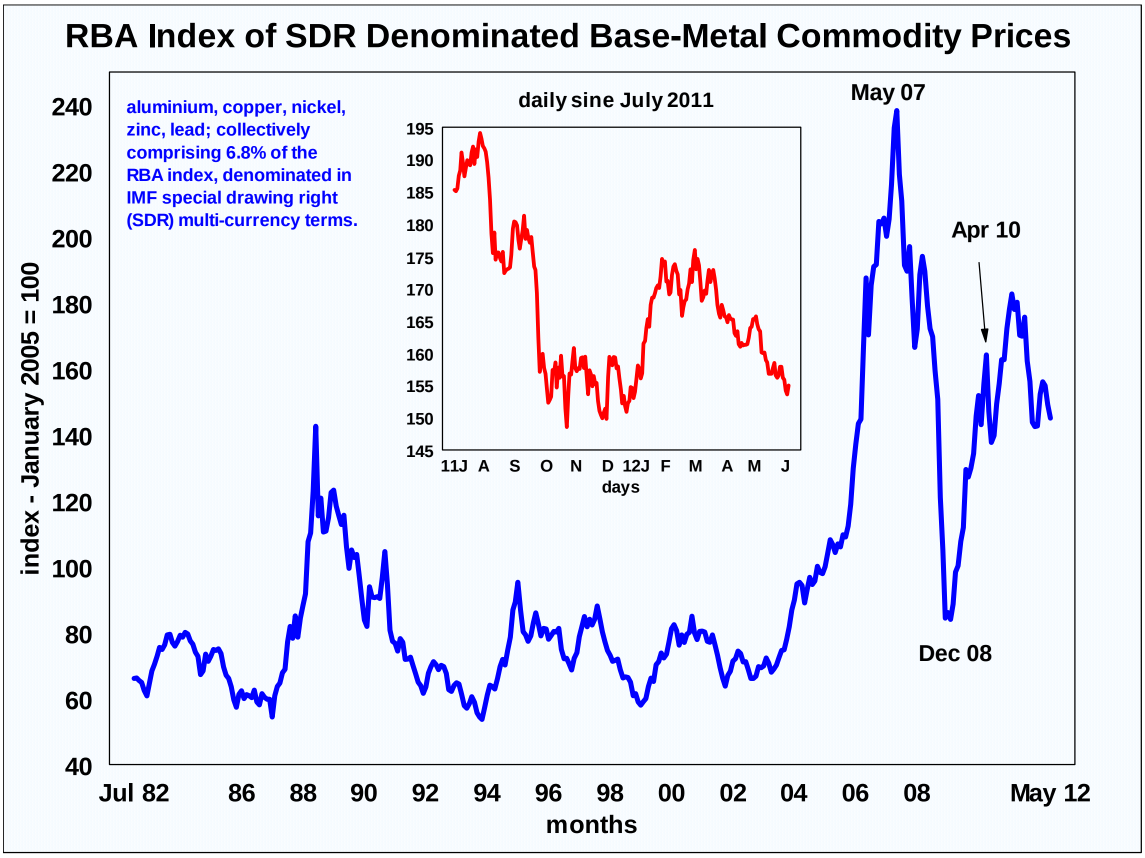
Commodity prices are certainly coming under some pressure, but at this stage the rate of decline is not in the GFC league by any means. The RBA's assessment this week was …"Commodity prices have declined lately, though they are mostly still high".

Given that coal and iron ore prices collectively account for 67 per cent of the RBA's index of commodity prices - and 36 per cent of the value of the nation's exports of goods and services - the outlook for the prices of those two commodities goes quite a way to assessing the outlook for the Australian economy as a whole. And in turn the outlook for China's economy is crucial to coal and iron ore prices.

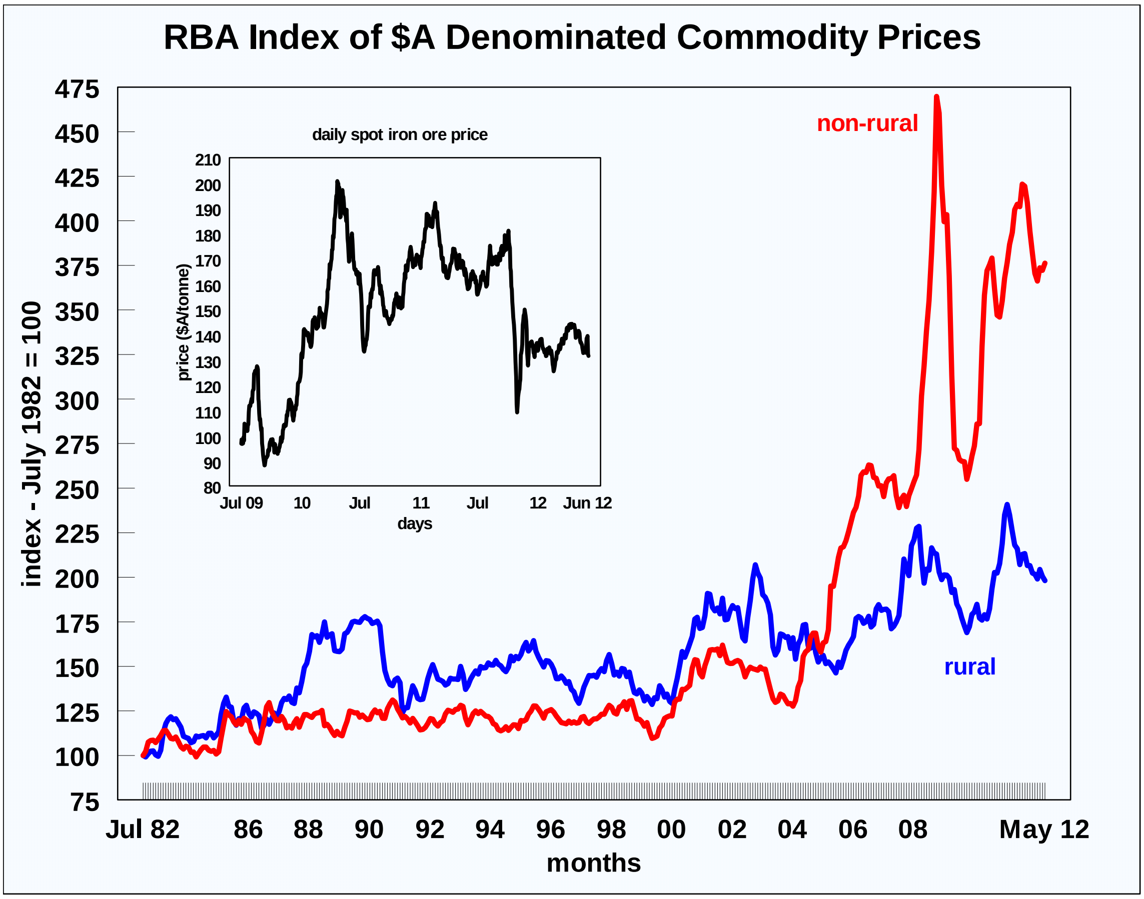
Without by any means validating the plethora of stories in the mainstream media and the blogosphere about what could go wrong in China and if it does what the consequences would be, the RBA is subtly upgrading its concerns about the middle kingdom. When it lowered the cash rate by 50 basis points last month it judged that …"Growth in China has moderated, as was intended, and is likely to remain at a more measured and sustainable pace in the future".

A month later (ie this week's 25 basis point cut), the RBA concludes that …"more recent indicators suggest further weakening in Europe and some further moderation in growth in China" … and …"Conditions in other parts of Asia have largely recovered from the effects of last year's natural disasters, but the ongoing trend is unclear and could be dampened by slower Chinese growth".





RBA Index of SDR Denominated Base-Metal Commodity Prices

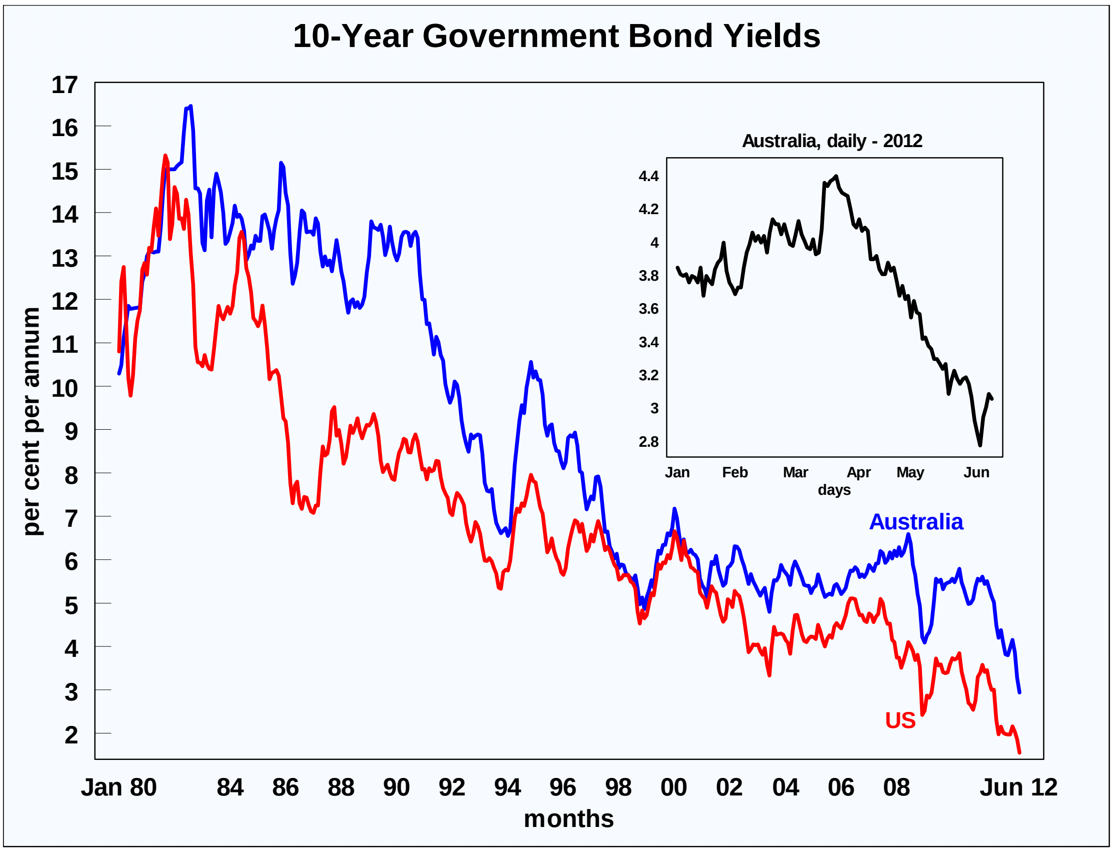


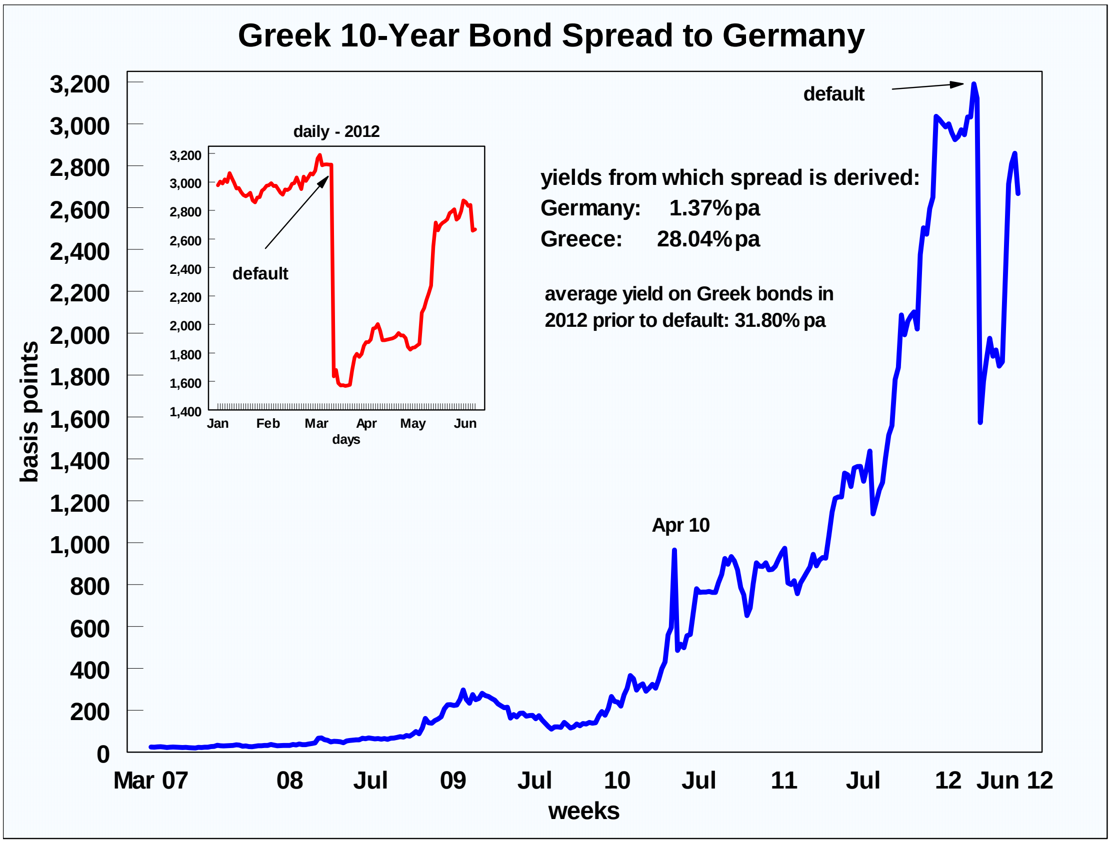
RBA Index of $A Denominated Commodity Prices

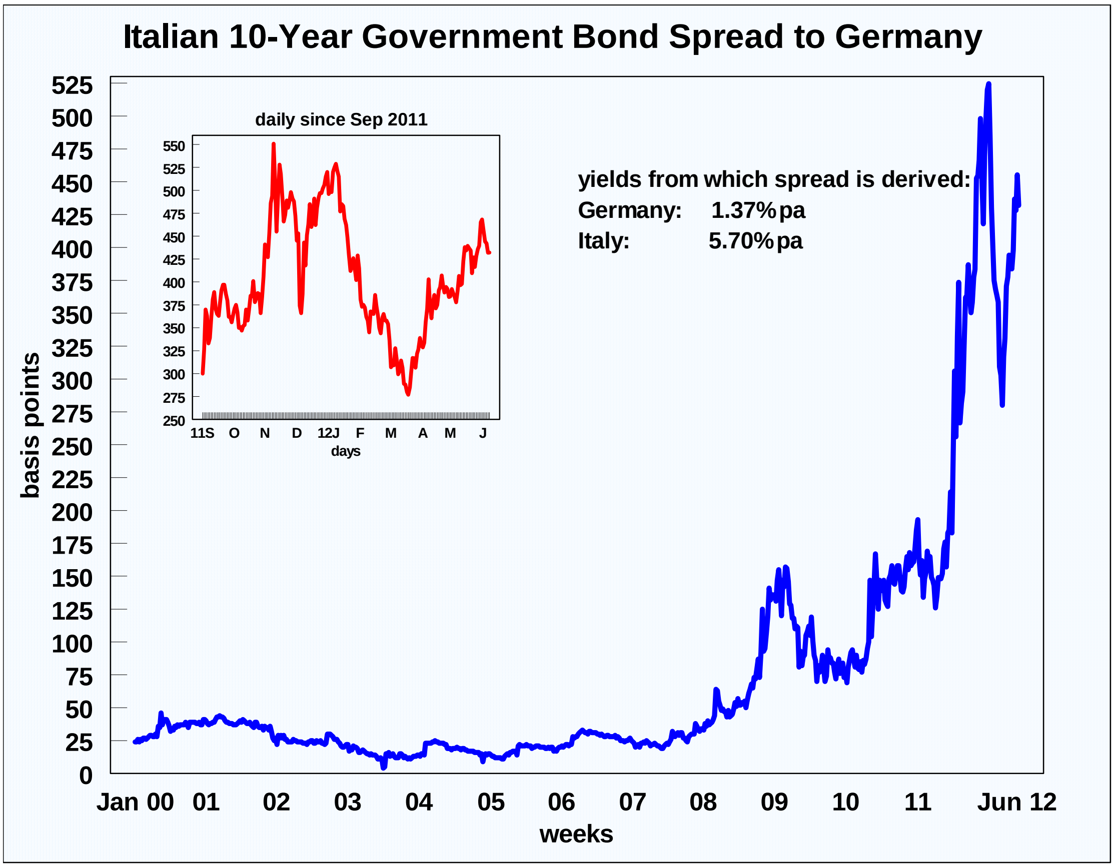
The decline in interest rates is by no means confined to the short end of the yield curve that is heavily influenced by actual and expected monetary policy. The US and Australian government bond markets continue to 'benefit' from the euro area's sovereign debt woes, as skittish investors still clearly reluctant to dip back too heavily into equities park funds in safe havens.

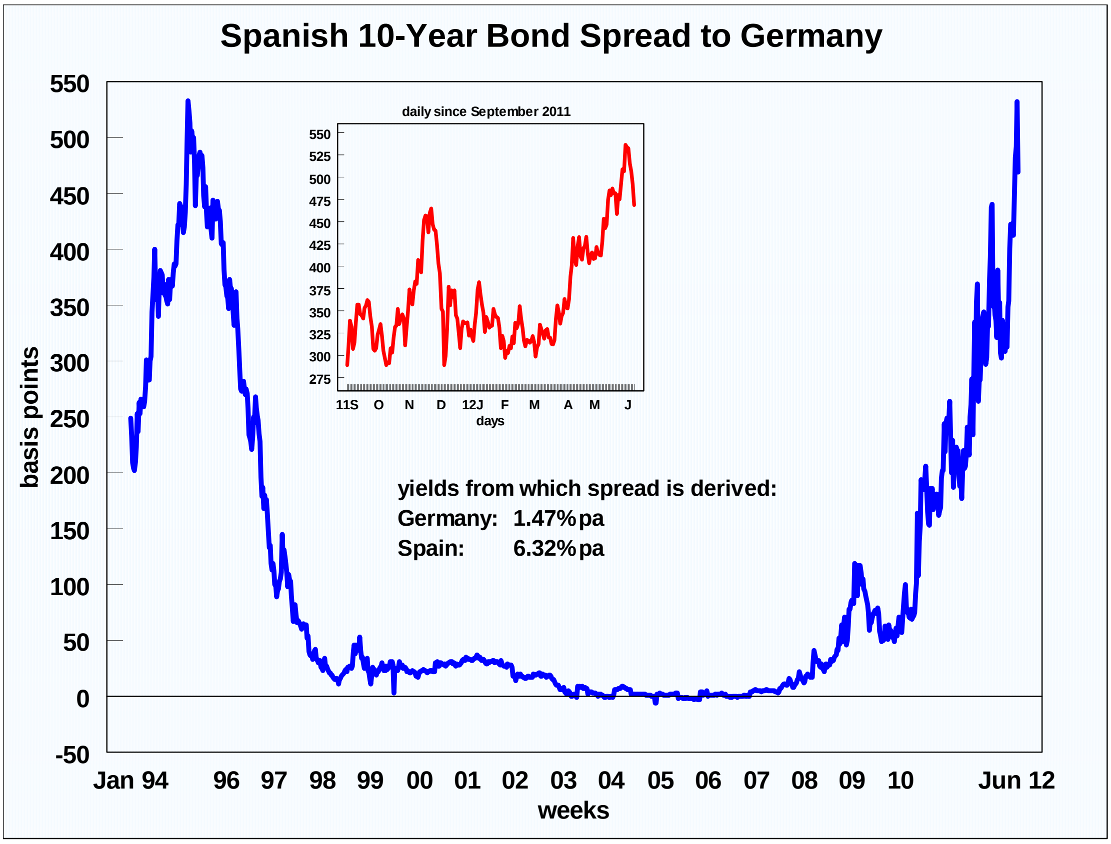
So benchmark 10-year government bond yields continue to test ever deeper historical lows. And while the US bond market has $2 trillion of support from the Fed behind it in the form of quantitative easing of monetary policy, the local market is on its own, although it is indirectly feeding off the strength of its US counterpart by virtue of the strong influence of American bond yields on their local cousins since the two economies' inflation rates converged in the early 1990s.

Although yields and risk premia over Germany in troubled euro bond markets have retreated so far this week, it has only partially reversed the steep rise in the previous couple of weeks. Moreover, optimism about a breakthrough in the impasse has been dashed so many times before, while until the Greek election is out of the way, it is difficult to envision a lasting and viable solution - and depending on the result in the re-run of the Greek poll, that might not be a circuit breaker either.




Greek 10-Year Bond Spread to Germany
basis points
weeks
Mar 07
08
Jul
09
Jul
10
Jul
11
Jul
12
Jun 12
daily - 2012
default
days
Apr 10
yields from which spread is derived:
Germany: 1.37% pa
Greece: 28.04% pa
average yield on Greek bonds in
2012 prior to default: 31.80% pa


Italian 10-Year Government Bond Spread to Germany
basis points
weeks
Jan 00
01
02
03
04
05
06
07
08
09
10
11
Jun 12
daily since Sep 2011
days
yields from which spread is derived:
Germany: 1.37% pa
Italy: 5.70% pa



National accounts and labour force data are sourced from ABS catalogues 5206.0 and 6202.0 respectively; cash rate, 90-day bank bill yields, 10-year government bond yields and monthly commodity prices are all sourced from the RBA; year average coal export prices from the Bureau of Resource and Energy Economics (BREE); all other data are sourced from Bloomberg.

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