

Week Beginning 30th January 2012

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

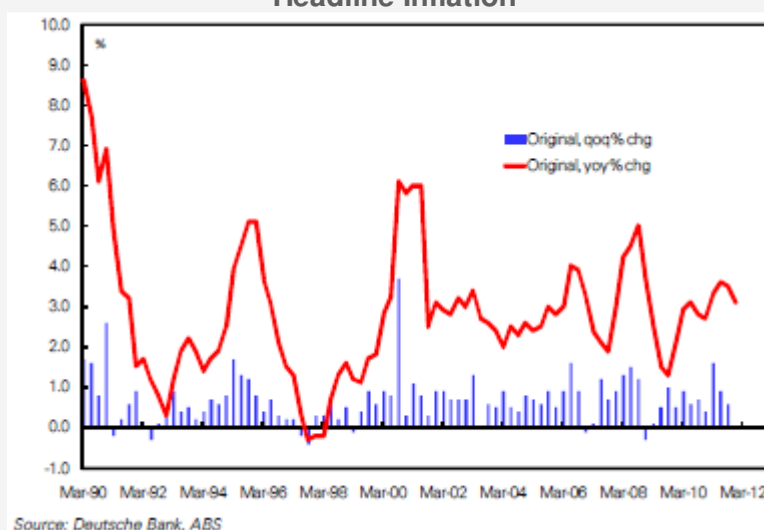
| Economic Data | Period | Actual | Previous |
|----------------------------|--------|--------|----------|
| Producer Price Index | Dec/Q | +0.3% | +0.6% |
| Headline CPI (quarterly) | Dec/Q | +0.0% | +0.6% |
| Headline CPI (annual) | Dec/Q | +3.1% | +3.5% |
| Underlying CPI (quarterly) | Dec/Q | +0.6% | +0.3% |
| Underlying CPI (annual) | Dec/Q | +2.6% | +2.5% |

The final stage **Producer Price Index** rose 0.3% in the December quarter for an annual rise of 2.9% (from 2.7% previously). The rise was mainly due to rises in the prices of industrial machinery & equipment manufacturing (+3.2%), other manufacturing (+3.1%) and motor vehicle & part manufacturing (+1.4%); partly offset by falls in prices of other agriculture (-21.8%) and flour mill and cereal food manufacturing (-6.1%).”

Headline CPI was unchanged in the December quarter to be up 3.1% over the year (from +0.6%/+3.5% in the Sept/Q). The RBA’s preferred measure of **underlying inflation** (the average of the weighted median and the trimmed mean) printed at an average rise of 0.6% in the quarter and 2.6% annually.

The weak CPI result was driven largely by sharp falls in fruit and vegetable prices, reflecting the unwinding of the earlier impact of floods and the cyclone in early 2011. There was also evidence that retailers are finding it difficult to increase prices in the current environment, with falls in clothing & footwear and motor vehicles, while the impact of earlier AUD appreciation likely played a role here, too. The key surprise on the upside was the strength in communication prices.

Headline Inflation



In other data releases, the DEWR index of **job vacancies** on the Internet fell 3.0% in December with vacancies down in all eight occupational groups, the strongest falls in machine operators, drivers & laborers. Annual vacancies, down 8.1%, are now down in seven of the eight groups with the strongest fall recorded in clerical & administrative workers and sales workers. The Westpac-Melbourne Institute **Leading Economic Index**, which indicates the likely pace of economic activity three to nine months ahead, fell 0.2% in November to be up 1.6% annually, down from 2.3% in October. A coincident index, which is a broad measure of current economic activity, grew at an annualised rate of 3.0% in November, from +3.4% in October.

DATA OVER THE NEXT WEEK

| Economic Data | Date | Period | Forecast | Previous |
|-----------------------------|-------|--------|----------|----------|
| Private Sector Credit | 31/01 | Dec | +0.3% | +0.3% |
| House Price Index | 01/02 | Dec/Q | -0.3% | -1.2% |
| International Trade Balance | 02/02 | Dec | \$800m | \$1.38bn |
| Building Approvals | 03/02 | Dec | +3.0% | +8.4% |

ECONOMIC COMMENTARY

LAST WEEK

Focus for our local market last week was on the Dec/Q CPI release with the flat result for the quarter slightly lower than expected and supportive of an emerging lower inflation story in an uncertain domestic economy. In addition, there will be another drop in annual inflation in the March quarter as the large 1.6% rise for Mar/Q last year is replaced by considerably lower number, taking annual CPI below 2%.

Offshore markets were generally lower last week as investors reacted more to a lack of announcement on Greek debt talks as opposed to actual news. The Greek's were left pleading with euro zone finance ministers as they rejected the bond swap offer in its current form, with the coupon rate again proving the sticking point. The EU officials have said 'no deal' to the 4% coupon that the negotiators for private bond holders have said is their final offer for a voluntary deal. The EU is calling for a coupon rate of no more than 3.5%. It is interesting to note that there doesn't seem to be as much horror at the mention of a Greek default any longer with some now saying that they don't believe a Greek default would have a domino effect in the euro zone. The US FOMC made no change to monetary policy (as expected) but extended the period over which rates are expected to be kept "exceptionally low" to at least late 2014, from the previously stated mid-2013. The Fed announced that it expects modest growth of 2.5% in 2012, unemployment to fall only gradually, and inflation to remain contained.

By the close of trading last Friday the 90 day bank bill was trading at 4.36% compared to 4.38% a week earlier. At the long end 3 and 10 year bond yields closed on Friday at 3.29% and 3.82% from 3.27% and 3.83% a week earlier.

CURRENCY

Our currency rallied to its highest level in 3 months last week (USD1.0688), firstly assisted by the lower than expected CPI data and then following comments by the US Federal Reserve that US interest rates would be kept low until at least 2014 which caused the USD to weaken against the cross rates.

By the close on Friday the AUD was up another 2 cents, trading at USD1.0625 compared to USD1.0416 a week earlier.

EQUITIES

Offshore, the Dow rallied to its highest level since May, as the US Fed signalled low rates till at least late 2014 and didn't rule out bond purchases to bolster the economy. The announcement was a sign that the Fed expects the US economy, which is improving, to need significant help for three more years but it also reinforced investors' confidence that the Fed was committed to restoring growth. Locally, favourable CPI data last week and growing confidence that the RBA will cut interest rates have sparked a rise in our share market, the 4th weekly rise in a row, with investors piling into bank stocks.

By the close on Friday our S&P/ASX 200 index was trading at 4,288.4 compared to 4,239.6 a week earlier.

THIS WEEK

Economic data releases this week includes December private sector credit (Tuesday, f/c +0.3%), Dec/Q house prices (Wednesday, f/c -0.3%), December international trade (Thursday, f/c \$0.8bn) and building approvals (Thursday, f/c +3.0%). In addition we get the NAB Business Survey for December and the RBA commodity price index for January.

INTEREST RATE VIEW

The favourable inflation outlook gives the RBA scope to deliver a further modest reduction in the official cash rate to 4%, most likely at the upcoming February 7 meeting. While we continue to have mixed news on the domestic economy and no further large downshift in global economic data recently, the RBA Board discussion will likely hinge around the downside risks to their inflation forecast which is now starting from a lower base. The RBA's focus may also turn to the employment prospects (outside mining) where recent news of impending lay-offs and downsizing of workforces has ignited speculation of an impending rise in unemployment.

The big question is whether the RBA Board considers that the two rate cuts delivered so far is enough insurance or do they need to some more. The Board may prefer to wait and keep their powder dry given better news and further policy measures in Europe and the US, but in my view it is better to take out more insurance now rather than later.

Financial markets currently have a 75% probability of a 25bps rate cut factored in for next week.

| Economic Data | 12 months ago | 6 months ago | 3 months ago | 1 month ago | Now |
|--------------------|---------------|--------------|--------------|-------------|---------|
| Official Cash Rate | 4.75 | 4.75 | 4.75 | 4.25 | 4.25 |
| 90 Day Bank Bill | 4.94 | 5.07 | 4.75 | 4.47 | 4.36 |
| 180 day Bank Bill | 5.09 | 5.11 | 4.70 | 4.42 | 4.40 |
| 1 year swap | 5.06 | 4.87 | 4.34 | 3.90 | 4.19 |
| 3 year swap | 5.34 | 4.83 | 4.43 | 4.00 | 4.17 |
| 5 year swap | 5.70 | 5.18 | 4.81 | 4.37 | 4.54 |
| 10 year swap | 6.00 | 5.54 | 5.22 | 4.65 | 4.89 |
| AUD/USD | 0.9911 | 1.0943 | 1.0669 | 1.0088 | 1.0615 |
| S&P/ASX200 Index | 4,774.9 | 4,424.6 | 4,353.3 | 4,071.1 | 4,288.4 |

CHART OF THE WEEK

Time to Retire?

Australian superannuation fund accumulation members who have the luxury of time in the market can turn a blind eye to the turmoil wreaking havoc on their portfolios, but for pre- and post-retirees, it's a different story.

Reading the latest *World Bank Global Prospects 2012* report, one could be forgiven for thinking that we are on the precipice of financial Armageddon, with GFC the sequel set for release in 2012! I may be a little over the top with "Armageddon" but recent downgrades in world growth by both the IMF and the World Bank, we may be in for some tough times again and the outlook could drop further should the situation in Europe worsen.

It makes one wish for the good old days in 2007, back when the world economy was strong and young financiers received huge bonuses, while those reaching retirement were thinking to themselves "if my super keeps growing at these rates, I'll buy a small island and retire there".

However, times have changed, and for many of those 60-65 year olds closing in on retirement the plans to buy an island are now just a distant memory (apart from some possible cheap Greek islands that may come on the market soon). Many are now wondering what a possible GFC Mark 2 could mean for the average battler reaching retirement.

While I don't confess to having a crystal ball what we can do is take a look back to the bad old days of GFC Mark 1 and now see how the biggest Australian super funds fared during the financial years of 2008, 2009 and 2010.

A report analysing the top 50 Australian funds in terms of total assets at the end of financial year 2010, the largest fund had assets at the time of approximately \$43 billion, while the 50th had assets of \$3 billion.

These funds represent \$538 billion in aggregate value, and have over 18 million members*. Crunching some back of the envelope calculations to see how the average Australian would have fared if they had their money invested in these funds in early 2008 we get some interesting results.

For the lucky members of the top performing fund in this group the good news is they only lost a relatively small amount of money. However for the unlucky ones who had a fund ranging near the bottom of our group, it was a different story as the below tables demonstrate.

Top 5 Super Funds

| | Assets 2010 (billion) | Compound return (2008 – 2010) | Net loss for average Australian nearing retirement age† |
|--------|--------------------------|----------------------------------|--|
| Fund 1 | \$6.4 | -1.1% | -\$2,086 |
| Fund 2 | \$3.3 | -2.8% | -\$5,544 |
| Fund 3 | \$18.2 | -3.4% | -\$6,792 |
| Fund 4 | \$3.4 | -5.2% | -\$10,225 |
| Fund 5 | \$8.4 | -5.5% | -\$10,938 |

Bottom 5 Super Funds

| | Assets 2010 (billion) | Compound return (2008 – 2010) | Net loss for average Australian nearing retirement age† |
|---------|--------------------------|----------------------------------|--|
| Fund 50 | \$5.9 | -22.4% | -\$44,336 |
| Fund 49 | \$3.3 | -21.3% | -\$42,180 |
| Fund 48 | \$9.3 | -20.4% | -\$40,396 |
| Fund 47 | \$8.6 | -17.4% | -\$34,468 |
| Fund 46 | \$3.7 | -16.5% | -\$32,707 |

These returns highlight a striking reality. Not only did all of the many millions of members of the top 50 Australian super funds lose money during GFC 1, the results show super fund size is not necessarily an indication of safety, with those who had money invested in funds with tens of billions of dollars losing money along with those with smaller funds.

Let's hope that GFC 2 doesn't become a reality.

Notes:

*This high number given Australia has a population of only 22 million is a reflection of the fact that Australians of working age are members of over two funds on average, with the actual number of individual members hard to estimate.

†Average male (60-64) who has a super balance of \$198,235.

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Postal Address: GPO Box 551
Adelaide, SA 5001

Telephone: 1300 660 115
Facsimile: 08 8121 0106

www.ruralbank.com.au
service@ruralbank.com.au

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"Only government can take perfectly good paper, cover it with perfectly good ink and make the combination worthless."

~ Milton Friedman