TCorp Local Government Services

Economic Commentary - June 2014

New South Wales Treasury Corporation

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The Month in Review

Economic and Market Trends

In May, we were pleased to report that the Australian economy recorded healthy growth in the March quarter. Since then, however, momentum appears to have eased, with retail sales, housing finance, building approvals, job advertisements and employment all weaker than expected in April and May.

Although it is clear that momentum has slowed, the extent of the deterioration appears modest at this stage, and will not unduly alarm policymakers. That said, they are likely to keep a close watch on consumer sentiment over the next few months, following its sharp fall in May. Consistent with weaker sentiment, there has been a recent flurry of retailers downgrading earnings guidance over the last month. Fortunately, confidence stabilised in June which suggests the weakness could prove temporary.

While the domestic economic data have softened, bond yields initially moved higher over the first half of June before declining substantially in the second half of the month, in line with global trends. The Australian dollar has also risen modestly above US$0.94, 5% higher than its level at the start of 2014. Meanwhile, the stronger A$ and still weak iron ore prices have exerted further pressure on the profitability of mining companies. However, the much stronger export volumes – as new mine production come on-stream – will ensure that overall profitability levels remain strong.

Elsewhere, global data have tended to have a firmer tone. US activity remains healthy with non-farm payrolls growing by a further 217,000 in May. In contrast to the healthy US labour market, GDP growth was surprisingly weak in Q1 with production declining at a 2.9% annualised pace. Analysts are, however, looking for growth to bounce back to +3% in Q2, and this expectation is justified by recent strong housing and manufacturing data.

For financial markets, the key focus for markets in June was the June European Central Bank (ECB) policy meeting. Following a prolonged period of falling inflation and declining credit in the Euro area, the ECB announced a package of policy measures which are intended to reverse this trend. In anticipation of the ECB policy meeting, global bond yields declined and equity markets rallied.

Market Movements

Month ending 30 June

Financial Data	30 Jun	Monthly change	
Cash Rate	2.50%	0.00	–
Corporate Bond Yield*	4.06%	-0.07	▼
Term Deposit**	2.80%	-0.15	▼
ASX200	5396	-1.7%	▼
S&P500	1960	1.9%	▲
AUD/USD	0.943	0.012	▲
Economic Data* **	**30 Jun**	**Quarterly change**	
Headline CPI	2.90%	0.20%	▲
Underlying CPI	2.65%	0.10%	▲
GDP Growth	3.50%	0.80%	▲
House Prices	10.90%	1.10%	▲
Unemployment Rate	5.80%	-0.20%	▼

*A 5-year rate, source: RBA **Average 90-day rate of the five largest banks for $10,000, source: RBA ***National data, y/y, source: ABS, RBA

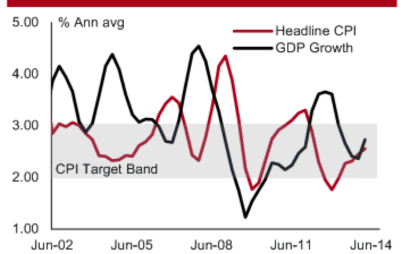
Financial/Economic Data

June 2014

RBA Cash Rate

Australia Dollar

Australian Economy



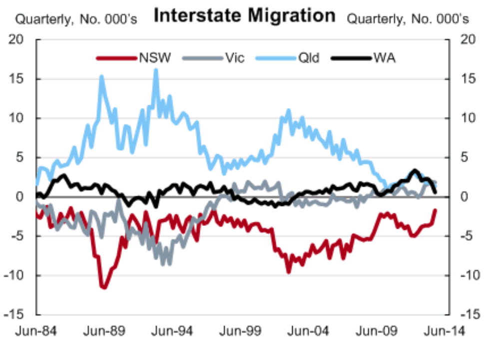
Unemployment Rate

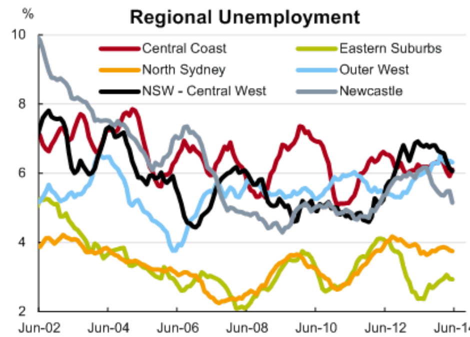
The State of NSW

Looking back over the 2013/14 financial year

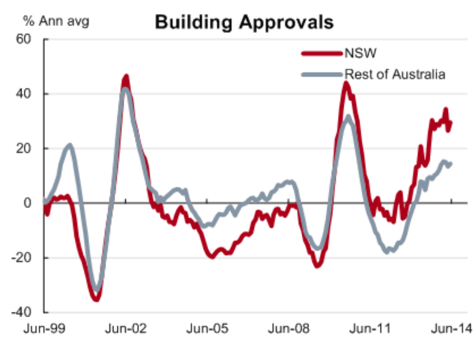
After several benign years of activity, the New South Wales economy finished the 2013/14 financial year on a clear path to recovery. NSW has proven to be a leading example of how the broader Australian economy will need to transition its production base away from the resource sector to towards services, such as household consumption, housing construction and non-mining business investment. The broad base of the upswing in activity in the State economy also inspires confidence that the recovery will be sustained.

While the Reserve Bank of Australia only lowered the cash rate on one occasion over the 2013/14 financial year, its previous rate cuts have proven sufficient in stimulating activity in those interest rate sensitive sectors crucial to the NSW economy. In addition, the State's population dynamics have swung from weighing on overall activity to providing one of the key driving forces behind the improvement in a broad range of economic indicators.





Against this backdrop, NSW has enjoyed a 7.3% pickup in retail spending over the year to May, more than double the pace than the rest of Australia. Given this represents 60% of overall State demand, this is certainly a noteworthy development. Likewise, building approvals have accelerated by 22.6% over the same period, also around twice the speed for the remainder of the nation. Further gains in new dwelling construction will also result in new infrastructure work, such as the building of new roads and utility facilities, while demand for a broad range of council services should also continue to rise.



As intended by policymakers, the NSW economy has been opportunistic in its activities given the low interest environment. And while the continued strength in the A$ may be a burden for many sectors of the economy, the resilience of underlying domestic demand will ensure the healthy gains in activity measures will continue. Put simply, NSW continues to be favourably placed given the economy's alignment to the services sector. And with the State Government's announcement of its hefty infrastructure spending plans over the next several years, further gains in prosperity should be forthcoming.