

T Corp Local Government Services

Economic Commentary - September 2014

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The Month in Review

Economic and Market Trends

August represented the “calm before the storm” as markets awaited key policy meetings from the European and US central banks which would take place in September. Speculation mounted that the European Central Bank (ECB) would ease policy further in response to disappointing growth data and some signs that German business activity – the one bright spot in Europe – was losing momentum. These hopes were fulfilled when the ECB pushed short-term rates further into negative territory in early September.

This easing of policy was also notable as it took place shortly ahead of the ECB’s initial Targeted Long-term Refinancing Operation (TLTRO). The TLTRO is designed to spur increased bank lending in exchange for an extended period of very cheap funding. This demonstrates the ECB’s new found determination to support activity.

In contrast to the ECB, which is seeking novel ways of stimulating growth, the main question for the US Federal Reserve (Fed) is how, and when, it should revert back to normal monetary policy without provoking a replay of the ‘taper tantrum’ that riled markets in mid-2013. The main focus for the September Federal Open Market Committee (FOMC) meeting was whether policymakers would amend the language which indicated that interest rates would remain low for a “considerable time” after the quantitative easing program was completed. In the end, the Fed opted for a minor tweak of the wording but was keen to emphasise that this didn’t represent a significant change of view.

Elsewhere, the US data flow remains encouraging. While employment in August rose by a disappointing 142,000, most other indicators remained strong with auto sales, consumer confidence and manufacturing all exceeding expectations. On the other hand, the data flow for China tended to underwhelm expectations. While retail spending in August was just a touch weaker than expected, industrial production growth slowed to 6.9% in August compared with forecasts of 8.8%. At the same time, the property market remains soft.

The Australian economic data have been very volatile of late, but arguably won’t have altered the view of policymakers as to how the economy is travelling. More significant, however, was the Reserve Bank of Australia’s (RBA) semi-annual Financial Stability Review (FSR) which highlighted the Bank’s concern around the high levels of investor lending in the property market. The RBA believes this activity has been responsible for the increase in house prices, and that if it continues, it could push up prices to unsustainable levels. And with the problem most prominent in Sydney and Melbourne, it suggests that a targeted approach to curb speculative activity could be required.

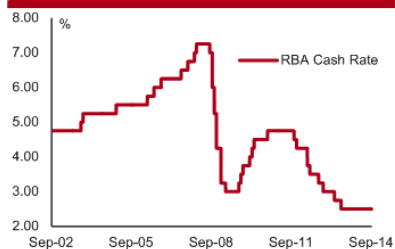
The prospective divergence between the US monetary policy stance and that in Europe and Japan has also had a marked impact on currency markets. The long awaited appreciation of the US\$ finally began to develop some momentum, with significant gains against the Euro (+3.8%) and Yen (+5.3%) in September. That said, it was the A\$ which led the fall, declining 6.3% to 87.50 US cents, while iron ore prices fell 11.8% to US\$77.50/t.

In response to the FOMC, global interest rates pushed higher with 10-year US Treasuries rising 30bps to 2.62% in the first half of September. Interestingly, global interest rates retraced half of this sell-off in the remainder of the month, with US 10-year yields finishing at 2.49%. Similarly, Australian 10-year bond yields finished 19bps higher at 3.48%.

Financial/Economic Data

September 2014

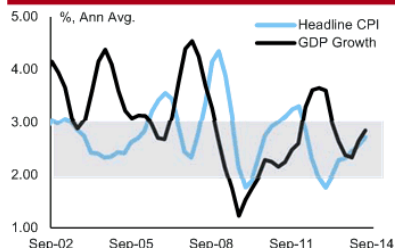
RBA Cash Rate



Australia Dollar



Australian Economy



Unemployment Rate

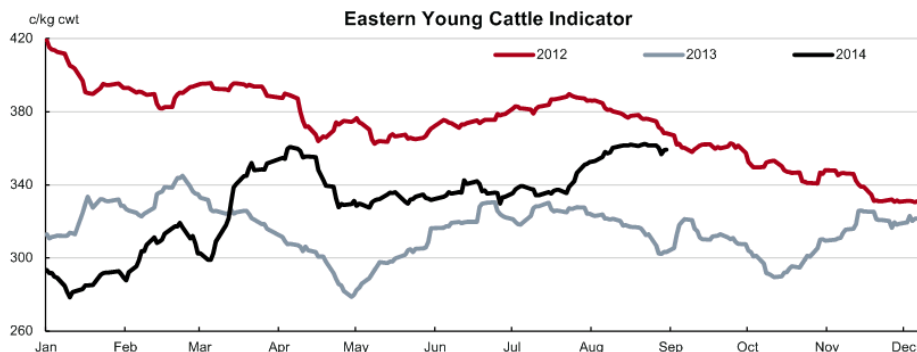




The State of NSW

Agriculture - an indispensable player of the export story

The extensive investment in mining projects observed over the past decade has certainly taken the spotlight from the agricultural sector. Nonetheless, agriculture still accounts for 15% of total goods exported, with products ranging from wheat to wine. And with the emergence of the developing world, the importance of the agriculture sector will undoubtedly intensify. Most notable will be the impact to Australian beef production. The beef industry is responsible for around 15% of Australia's total agricultural exports. And while in terms of total production Australia is one of the smaller players globally, its relatively small population base means it can export as much as two thirds of its beef production, making it the world's third largest beef and cattle exporter after Brazil and India. NSW plays a key role in the cattle industry, accounting for around 20% of Australia's total cattle production, with the main centres of operation located in the Upper Hunter, North West Slopes and Northern and Central Tablelands.



After the drought-induced weakness in cattle prices in 2013, Australian cattle producers have witnessed a favourable turn of events which has seen cattle prices recover to their highest level in over the past 2 years. To mention a few, South Korea and Japan have begun phasing out tariffs on beef imports which will improve the international competitiveness of Australian producers. Record low levels of cattle inventory in some of Australia's key customers, such as Canada and the US, will also provide a temporary boost to demand for local beef produce in the near-term. More importantly, the recent depreciation in the A\$ will increase the external demand and profitability of Australia's produce more broadly (and should reverberate throughout the other tradable sectors of the Australian economy). Overall, these factors will prove favourable for the regional areas NSW, as higher business profits flow through to increased investment and hiring, ultimately resulting in higher household incomes.



Market Movements and Economic Data		
Financial Data	30 Sep	Monthly change
Cash Rate	2.50%	0.00 —
Corporate Bond Yield*	4.12%	0.20 ▲
Term Deposit**	2.85%	0.10 ▲
ASX200	343	0.3% ▲
S&P500	1972	-1.6% ▼
AUD/USD	0.875	-0.059 ▼
Economic Data***	30 Sep	Quarterly change
Headline CPI	3.00%	0.10% ▲
Trimmed Mean CPI	2.90%	0.30% ▲
GDP Growth	3.10%	-0.30% ▼
House Prices	10.10%	-1.10% ▼
Unemployment Rate	6.10%	0.20% ▲

*A-rated 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

But while these events will certainly support the cattle industry over the next 6-12 months, the structural change in the global appetite for beef will provide underlying support to the industry in the longer-term. Specifically, the demand for higher quality protein is expected to accelerate as household incomes throughout the developed world increase. This dynamic has been most apparent in China, where it has been reported that domestic production of beef cannot keep pace with its demand. So as the Australia's mining boom begins to retrace, the agricultural sector will be on an expansionary path back into the spotlight.

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