TCorp Local Government Services

Economic Commentary – March 2015

New South Wales Treasury Corporation

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The Month in Review

Economic and Market Trends

The European Central Bank (ECB) commenced their bond-buying program in March. Despite being very well flagged over recent months, the start of the program had a large impact on markets, pushing down global bond yields further, depressing the Euro and boosting equity markets.

The ECB's quantitative easing program is coinciding with some firmer data for the Euro area. Manufacturing, retail sales and confidence have all lifted in 2015, underpinned by the weaker currency and lower petrol prices. The recent movements in financial markets suggest that this momentum may build further heading towards the middle of the year.

While the ECB has now deployed its full stimulus policy arsenal, the US Federal Reserve is pondering if and when it should begin nudging rates higher. In February, the unemployment rate in the US fell to 5.5%, which is the level some economists think wages pressures will begin to appear. Given the current low level of inflation, this is not an immediate concern for policymakers. Even so, it does suggest that there is a case to lift the policy rate above zero.

In recent months, the Fed had vowed to remain 'patient' before tightening monetary policy, which markets interpreted as code for a commitment to keep rates at zero for at least the next two Fed meetings. With the Fed removing the 'patient' language at its March policy meeting, this opens the door to a possible June rate hike. That said, Fed Chair Yellen went out of her way to reassure markets that the Fed had not pre-committed to hiking rates as soon as June, and that any policy shift would be driven by the flow of data.

The recent flow of US data has, however, been disappointing. While the labour market data remain extremely strong, manufacturing, housing and retail spending growth have all moderated in early 2015. There are some extenuating circumstances – extremely cold weather and a port strike on the west coast temporarily disrupted activity – but it is disappointing that consumer spending has not yet improved even though confidence has picked up.

The Australian economy continues to stutter, with ebbing business and consumer confidence and sluggish employment growth. Lower commodity prices are also exerting further pressure on the mining sector, which is cutting costs and closing some mines in response to the weaker revenue outlook.

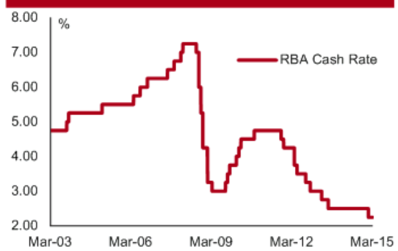
The one sector that continues to exhibit strong activity is the housing market, with auction clearance rates at very high levels in Sydney and Melbourne, strong house price growth and elevated building approvals. Some economists have suggested that the rapid pace of house price growth in Sydney should preclude further interest rate cuts. The Reserve Bank of Australia (RBA), however, is still hoping that APRA's macro-prudential guidelines, which are designed to restrain investor lending, will eventually moderate house price growth.

While Reserve Bank Board members chose to leave policy unchanged at their March policy meeting, they clearly left the door ajar for further easing in the next couple of months. Specifically, they stated that in order to foster sustainable growth 'further easing of policy may be appropriate over the period ahead'. When the RBA has previously used that language to describe the policy outlook, they have nearly always cut rates at one of the next couple of policy meetings.

Financial/Economic Data

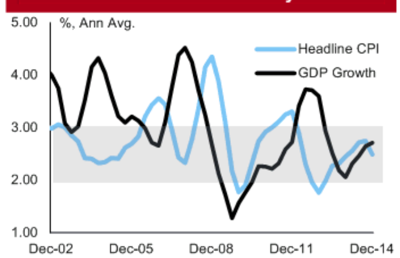
March 2015

RBA Cash Rate



Australia Dollar

Australian Economy

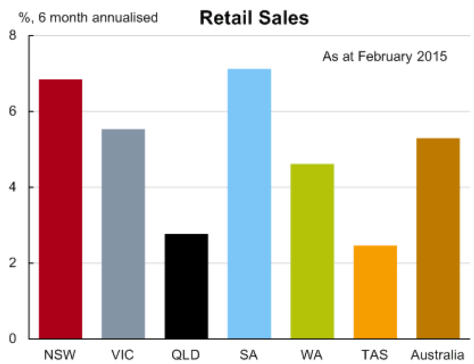


Unemployment Rate

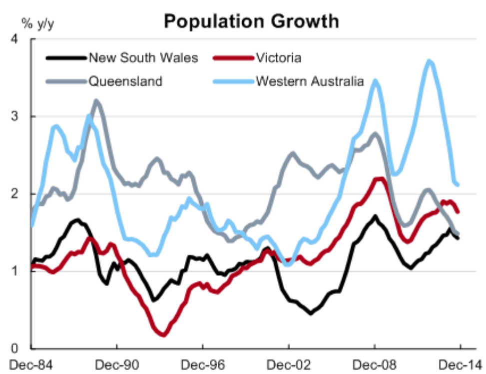
The State of NSW

NSW consumers pick up the pace

Lower interest rates and petrol prices are a boon for households. No doubt, there is something special about filling up a full tank of petrol at a 35% discount, while learning through your favourite radio station that the RBA cut interest rates at its February Board meeting. The boost to sentiment and disposable incomes normally results in some pickup in consumer spending. The Statistician's retail trade report for February provided evidence that this dynamic had played out perfectly in the opening months of 2015. It is also worth noting that analysts were starting to lose faith in the consumer's ability to increase their spending as petrol prices did not remain at the lows for long while negative anecdotes from some major retailers kept rolling in.



The boost to spending appears to have been broadly based across all States, although cyclical factors have also been at play. The sheer size of the NSW economy, coupled with acceleration in consumption, has made it the dominant force for national household expenditure. Overall retail trade in NSW continues to benefit from strong population growth and the hyper-housing cycle. South Australian consumers have also kept up, although the economy is only one fifth the size of NSW. Western Australian households have performed admirably in light of buckling resource investment in the region.



Market Movements and Economic Data

Financial Data	31 Mar	Monthly change	
Cash Rate	2.25%	0.00	–
Corporate Bond Yield*	3.18%	-0.02	▼
Term Deposit**	2.40%	0.00	–
ASX200	5892	-0.6%	▼
S&P500	2068	-1.7%	▼
AUD/USD	0.761	-0.020	▼

Economic Data***	31 Mar	Quarterly change	
Headline CPI	1.7%	-0.6%	▼
Trimmed Mean CPI	2.2%	-0.2%	▼
GDP Growth	2.5%	-0.2%	▼
House Prices	7.0%	-2.4%	▼

*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

The pickup in consumer spending is what policymakers have both expected and hoped for. With households now playing their role in this low interest rate environment, there is a greater chance that the Australian economy will be able to navigate through its rebalancing act relatively unscathed. However, there is still ample uncertainty around how disruptive falling private business investment will be for the economy, even outside of the resources sector. This is why the RBA appears willing to impart further monetary stimulus as soon as it deems necessary.