TCorp Local Government Services

Economic Commentary – June 2015

New South Wales Treasury Corporation

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The Month in Review

Economic and Market Trends

The US experienced a very weak start to 2015. Understandably, this intensified concerns that growth had peaked and that it might be difficult for the US central bank to justify tightening monetary policy later in the year. US policymakers, however, have continued to argue that this was mostly due to temporary factors, such as inclement weather and a port shutdown.

Supporting those arguments was a very strong employment report for May. Jobs grew by 280,000 in May – well above expectations of a 220,000 increase. Moreover, average hourly earnings also increased by 0.3% in the month. US retail sales also grew by a robust 1.2% in May while homebuilder sentiment also exceeded expectations and is at the highest level it has been since 2005. Together, this suggests that growth in the US remains healthy, and that the US central bank could lift interest rates as early as September.

In China, there was further evidence that economic activity has stabilised after slowing substantially over the past year. While retail sales came in line with expectations and business investment remained weak, industrial production managed to eclipse expectations. Nonetheless, there was a sharp fall in the Shanghai Composite amid concerns of further restrictions on margin lending for retail investors. Policymakers responded by cutting its key policy rate and lowering the amount of deposits banks are required to hold relative to credit growth. We anticipate that Chinese growth will pick up over the remainder of 2015.

In Europe, Greece continued to dominate attention, as it struggled to obtain a deal with its creditors to renegotiate its debt, while missing a repayment to the IMF which was due on the 30th of June. The creditors had provided reform proposals to Greece which, if accepted, would have unlocked an extension of the bailout programme. Instead, Greek Prime Minister Alexis Tsipras announced a referendum (for the 5th of July) to decide whether or not to accept the reforms. Financial markets reacted abruptly to these events as a 'No' vote in the referendum may lead to Greek exit from the European Union. In any case, a near-term solution to the Greek Crisis seems unlikely, and market volatility should continue.

Back home, the Australian economy grew by a respectable 0.9% in the March quarter and by 2.3% over the past year. But behind the healthy headline, there were some factors which suggest this exaggerates the true strength of the economy. In particular, growth remains highly dependent on exports and housing construction - with business investment, government spending and household consumption growth all lacklustre.

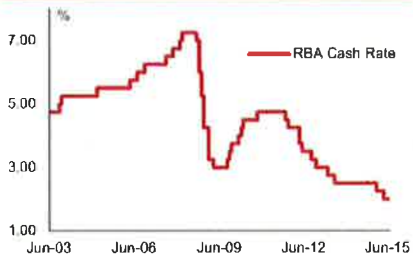
It also appears that growth has remained mixed in June quarter. The international trade data pointed to a sharp fall in exports in April. While this appears to be mainly temporary – as a major port was closed because of bad weather – it still suggests that exports will cease to support growth in the June quarter. At the same time, retail spending stalled in April, job advertisements were flat in May and consumer confidence dropped by 6.9% in June.

Providing a partial offset, however, was a strong labour market report for May. Jobs increased by a healthy 42,000 in the month, with both full-time and part-time employment improving. At the same time, the unemployment rate was reported to have fallen from 6.2% to 6%. The NAB business survey also provides some reassurance that the pace of growth is not deteriorating significantly, with its measure of business conditions rising from +4 to +7 in May.

Financial/Economic Data

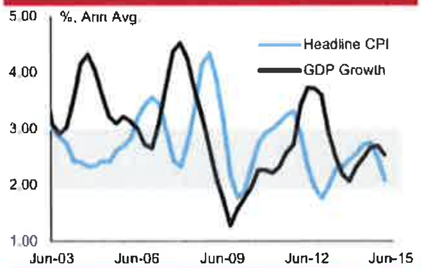
June 2015

RBA Cash Rate

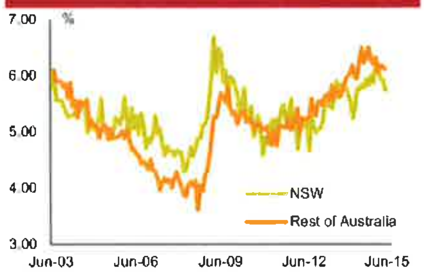


Australia Dollar

Australian Economy



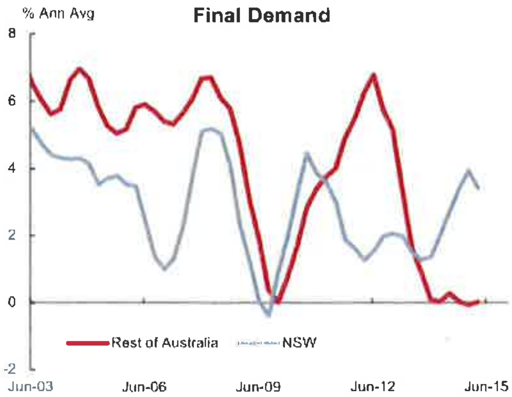
Unemployment Rate

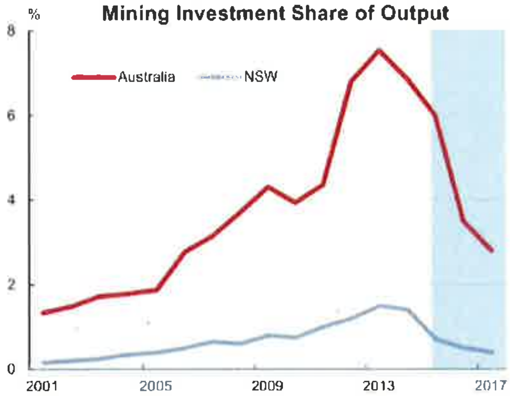


The State of NSW

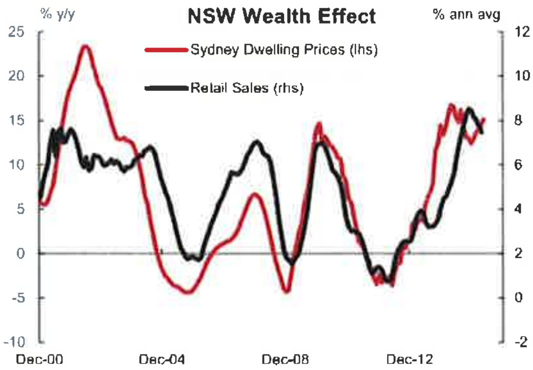
The 2015/16 NSW Budget – An upgraded outlook

Over the past year we have commented on the exceptional performance of the NSW economy. The economic update provided in the 2015/16 NSW Budget echoed our previous praises, highlighting the strong momentum in the household sector which has supported both the NSW economy and the NSW Government's finances. The Budget is also projecting that growth will remain above-trend (above 3%) over the next two years thanks to record low interest rates, robust population growth and a lower A$.





The key behind the outperformance of the NSW economy (chart top left) is its bias towards the services sector. These sectors, such as retail, finance and property, are more receptive to changes in interest rates. Meanwhile NSW is less reliant on the resources sector which is currently in rapid decline (chart top right). In fact, the fall in commodity prices - which is weighing on activity in other States – will push the A$ even lower, and extend further benefits to NSW's education, tourism and manufacturing sectors. The NSW Government is hoping for stronger momentum in non-mining investment, which up until now has been dampened by the subdued conditions both domestically and abroad. Fortunately, confidence among NSW businesses are now rising. And a sustained improvement in trading conditions are likely to translate to increases in hiring and investment.



Market Movements and Economic Data

Financial Data	30 Jun	Monthly change	
Cash Rate	2.00%	0.00	–
Corporate Bond Yield*	3.74%	0.29	▲
Term Deposit**	2.20%	-0.10	▼
ASX200	5459	-5.5%	▼
S&P500	2063	-2.1%	▼
AUD/USD	0.771	0.006	▲
Economic Data***	**30 Jun**	**Quarterly change**	
Headline CPI	1.3%	-0.4%	▼
Trimmed Mean CPI	2.3%	0.1%	▲
GDP Growth	2.3%	-0.1%	▼
House Prices	7.5%	0.5%	▲
Unemployment Rate	6.0%	-0.1%	▼

*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

In addition to the cyclical upswing of the NSW economy, the 2015/16 NSW Budget outlined the Government's ambitious infrastructure spending program which will total $68 billion over the next four years. Some infrastructure projects are already underway, such as the widening of the M4 Motorway in Parramatta (Stage 1 of the $16 billion WestConnex project), while the pipeline of other sizeable projects – NorthConnex, the Sydney Metro Northwest, and general upgrades to health facilities and transport infrastructure – will ensure a solid stream of economic activity in the coming years. Overall, the NSW public sector is poised to contribute meaningfully to growth over the coming years.