TCorp Local Government Services

Economic Commentary – December 2015

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The Month in Review

Economic and Market Trends

After several months of intense speculation, the US Federal Reserve (Fed) raised its key policy rate by 25bps to 0.25% - 0.50% at its December policy meeting. The move was the first time the US policy rate had moved from the 'zero bound' that was set in 2008. It was also the first increase in the US policy rate in almost ten years.

Leading up to the December meeting, Fed members had become increasingly vocal about the prospect of a rate hike in 2015. But rather than focussing on the 25bp hike, Fed members emphasised the "gradual" pace at which they expect the policy rate will rise in subsequent policy meetings. In addition, Fed members stated that future policy rate adjustments will be strictly dependent on economic data, particularly the core PCE inflation rate (1.3% y/y in October) which remains well below the Fed's target of 2%.

The ongoing improvement in the US labour market added credence to the view that the US economy could cope with higher interest rates. The non-farm payrolls report for November – released a week before the Fed's December meeting – showed a 211,000 increase in jobs for the month. There were also upward revisions of 35,000 jobs in the previous months. Unemployment was unchanged at a very low level of 5.0%, while the increase in the participation rate to 62.5% suggested that the labour market was more active in November.

In China, economic activity stabilised after several months of slowing. Data released for November were generally more positive. Industrial production increased by 6.2% y/y, the fastest annual pace since June. Encouragingly, the pickup in industrial production was driven by the auto and high-tech sectors of the economy. Meanwhile retail sales increased 11.2% y/y and suggests the pickup in household expenditure is still gaining momentum.

China's key policymakers also met for the annual Central Economic World Conference in December. The conference was centred on the top economic tasks and policies which will be in focus for 2016, such as dealing with structural overcapacity and high levels of debt in the economy. Policymakers also hinted that further fiscal and monetary easing may be used in early 2016 to assist in the transition in the economy away from the heavy industries.

The Reserve Bank of Australia (RBA) left interest rates unchanged at 2.00% at its December Board meeting. GDP growth for Q3 – released the day after the RBA's meeting – showed that the economy expanded by 0.9% (2.5% y/y). Bulk commodity and services exports accounted for most of the growth in the quarter, whereas domestic demand continued to decline, driven by a large fall in business investment and weak public spending. Household spending as measured by the national accounts picked up, but only modestly so. More timely data on spending showed a 0.5% increase in retail trade in October. Retail trade has trended higher although slowing house price growth could weigh on spending in 2016.

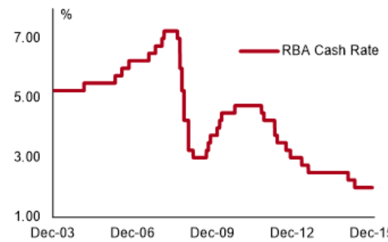
The November Labour Force Survey (LFS) recorded another questionably strong increase in employment (+71,400). Data in the LFS have been inconsistent with other employment indicators, although the latter still suggest that conditions are improving.

The Commonwealth Government also delivered its Mid-Year Economic and Fiscal Outlook (MYEFO) for 2015/16. As most economists were expecting, the MYEFO showed a deterioration in the underlying cash balance due to lower than forecast commodity prices and GDP growth.

Financial/Economic Data

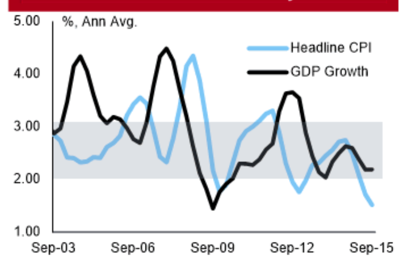
December 2015

RBA Cash Rate



Australia Dollar

Australian Economy



Unemployment Rate

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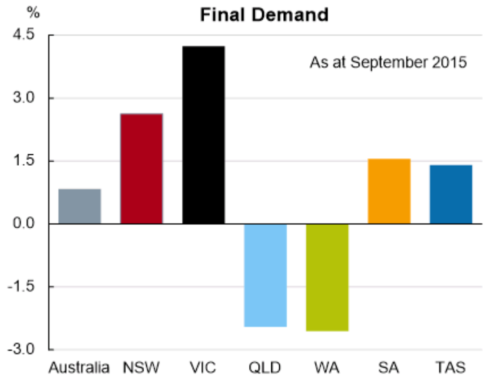
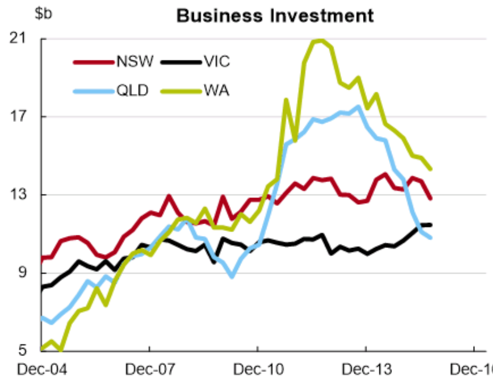
The State of NSW

NSW is still standing strong, but now faces some competition

The Statistician recently released its September quarter GDP report. The report confirmed that the NSW economy is still one of the better performing State economies in Australia. Data measuring business sentiment, housing consumption and the labour market tell a similar story, and suggest that domestic demand remains particularly robust in NSW. The only exception, however, has been the subdued growth in non-mining business investment more broadly. As a result, NSW's final demand (which includes household, business and public expenditure) slowed to 2.6% y/y from 3.5% y/y. In contrast, final demand in Victoria accelerated in Q3 to 4.2% y/y from 3.3% y/y.





Both the NSW and Victorian economies are very similar. They are predominantly driven by interest rate sensitive sectors such as business investment, retail spending and housing construction. NSW and Victoria have performed similarly with the latter two. But it is business investment where they have differed. Business investment in Victoria has experienced much stronger growth, while in NSW it has only continued to fall (-4.5% y/y). Luckily, business surveys suggest that investment will return to the State as trading conditions remain ideal for NSW. In addition, the NSW Government's infrastructure projects will ensure a significant amount of construction activity in the coming years. According to the Labour Force Survey, unemployment in NSW is at a 3-year low.

Market Movements and Economic Data

Financial Data	31 Dec	Monthly change
Cash Rate	2.00%	0.00 –
Corporate Bond Yield*	4.22%	0.42 ▲
Term Deposit**	2.20%	0.00 –
ASX200	5296	2.5% ▲
S&P500	2044	-1.8% ▼
AUD/USD	0.729	0.8% ▲
Economic Data* **	**31 Dec**	**Quarterly change**
Headline CPI	1.5%	0.0% –
Trimmed Mean CPI	2.1%	-0.1% ▼
GDP Growth	2.5%	0.6% ▲
House Prices	11.4%	0.9% ▲
Unemployment Rate	5.8%	-0.4% ▼

*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

Meanwhile, in the commodity powerhouses of Australia, Queensland (-2.5% y/y) and Western Australia (-2.6% y/y) continued to see their overall final demand contract. Both have experienced precipitous falls in mining investment, and have had to battle falling commodity prices. Government revenues in Queensland and Western Australia have, as a result, taken a hit. Lower revenues mean that the respective State Government have reduced capacity to implement public-backed spending initiatives to stimulate growth.