# TCorp Local Government Services

Economic Commentary – January 2016

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## The Month in Review

### Economic and Market Trends

Financial markets were very volatile in the opening weeks of 2016. Higher interest rates in the US have caused concerns around global economic growth. Further anecdotes that oil supply will continue to exceed demand pushed prices even lower. Brent oil fell to as low at US$26 a barrel in the middle of the month, dragging global equity markets and bond yields down with it. Towards the end of January risk assets regained some of their losses, but bond yields continued to fall.

The direction of China's economic data remains ambiguous, neither confirming the pessimists' fears of an imminent hard landing, nor sufficiently strong to suggest that the trough in growth has passed. GDP growth increased 6.8% y/y in Q4, a touch lower than market expectations. Retail sales in December were also slightly lower than expected, rising 11.1% y/y. On the positive side, exports grew by 2.3% y/y in 2015, which was stronger than the -4.1% y/y expected by markets, but the Caixin manufacturing index dropped to 48.2 which – as with the US – suggests that China's manufacturing output is contracting.

In contrast, European manufacturing expanded with the manufacturing PMI index rising to 53.2 in December. The lack of inflation remains a concern for the European Central Bank (ECB), however, with headline inflation dipping to 0.2% y/y in December. Even core inflation – which excludes petrol prices – was 0.9% y/y, which is about half the ECB's target of just under 2%. ECB President Mario Draghi reassured markets that members of the ECB *"have the power, determination and willingness to act"* if the outlook doesn't improve.

The Bank of Japan (BoJ) surprised markets by lowering the interest it charges on excess reserves (IOER) held at the central bank. The IOER was lowered from 0.1% to -0.1% to incentivise banks to increase lending to businesses and households. The BoJ remains committed to achieving its inflation target of 2%.

The Australian economy ended 2015 with the same steady pace of growth that prevailed for most of the year. Retail sales rose by a respectable 0.4% in November, while anecdotes about spending over the Christmas period were also generally positive. Job advertisements fell by 0.1% in December. Jobs dipped by 1,000, but as this followed a run of very strong outcomes, policymakers are likely to remain quite content with these results.

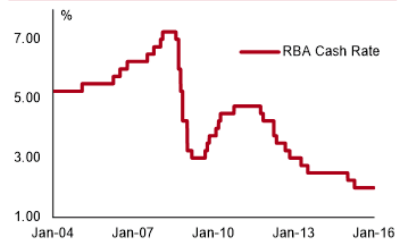
Building approvals were much weaker than expected in November, falling by 12.7% m/m and 8.4% y/y. That said, weakness was concentrated in the high-rise apartment component, which can be very volatile from month-to-month. Also consistent with a moderation of the housing market were house prices, which were flat in December after falling 1.5% in November.

The monthly TD Securities inflation gauge suggested that headline consumer prices increased by 0.3% in the December quarter, with underlying inflation coming in at 0.5%. While this suggests that inflation is currently right at the bottom of the Reserve Bank of Australia's (RBA) inflation target band, it is in line with the Bank's forecasts that were released in early December. The official inflation data will be published at the end of January.

## Financial/Economic Data

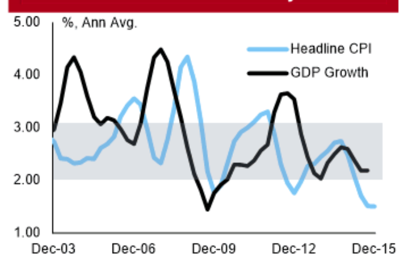
January 2016

### RBA Cash Rate




### Australia Dollar


### Australian Economy



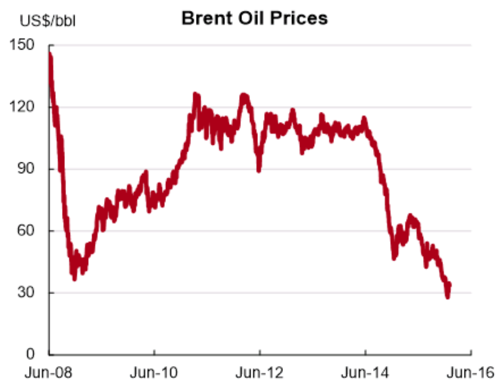

### Unemployment Rate

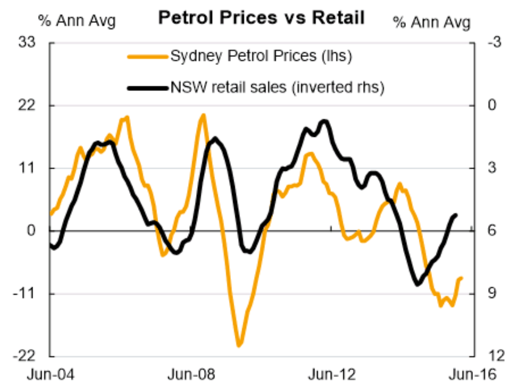
TCorp

# The State of NSW

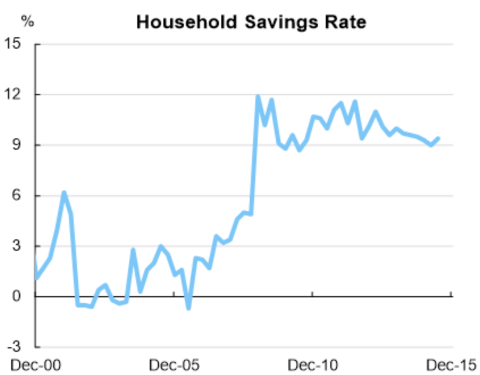
## Why is the price of oil falling and is it helping NSW?

The ongoing decline in oil prices has been a hot topic over the past 18 months. Since 2014, global oil prices have fallen around 80%. Just as interesting has been the reason for the decline. There is no doubt that slowing global growth has weighed on the demand for energy. The world has also become more efficient when it comes to using oil, while regulations are shifting towards using renewable energy sources. But it has been the increase in the oil supply that has been the key driver behind the decline in oil prices. New oil reserves are being discovered more quickly than existing reserves are being depleted. At the same time, the hydraulic fracking of natural gas in the US has increased the productivity of oil production in more recent times. Putting it all together, oil prices have fallen significantly to below US$30 a barrel in January.




For an energy producing economy or company, a sustained period of lower oil prices is problematic. For those countries who are a net importer of energy lower energy prices can be a boon for businesses and households. With the services sector representing a large part of the NSW economy, it has certainly been an outright beneficiary. For example, the top right chart suggests that when petrol prices fall, retail spending tends to rise as savings are redistributed. And when combined with lower interest rates and a falling A$, households feel more comfortable with increasing their discretionary spending.




**Market Movements and Economic Data**

| Financial Data | 29 Jan | Monthly change |
|---|---|---|
| Cash Rate | 2.00% | 0.00 – |
| Corporate Bond Yield* | 4.36% | 0.14 ▲ |
| Term Deposit** | 2.20% | 0.00 – |
| ASX200 | 5006 | -5.5% ▼ |
| S&P500 | 1940 | -5.1% ▼ |
| AUD/USD | 0.708 | -2.8% ▼ |
| **Economic Data***** | **29 Jan** | **Quarterly change** |
| Headline CPI | 1.7% | 0.2% ▲ |
| Trimmed Mean CPI | 2.1% | 0.0% – |
| GDP Growth | 2.5% | 0.6% ▲ |
| House Prices | 8.0% | -3.3% ▼ |
| 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

That said, lower petrol prices should be boosting activity in the household sectors around the world. However it is not as obvious in other countries. Some economists are even disappointed that spending hasn't accelerated at an even faster pace in Australia given how far petrol prices have fallen. One possible explanation has been the elevated household savings rate in Australia. Savings rates for households in the major economies have also remained relatively high. It seems that consumers may also be just as willing to bank some of the savings their getting from the pump.