TCorp Local Government Services

Economic Commentary – March 2016

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The Month in Review

Economic and Market Trends

Following the Bank of Japan's decision to push interest rates into negative territory in February, the European Central Bank (ECB) also announced a larger-than-expected policy stimulus in March. The ECB cut the deposit rate a further 10bps to -0.4%. The ECB also expanded the size of its monthly asset purchase program from €60b to €80b and for the first time included corporate bonds as eligible securities it can purchase. The real surprise, however, was an extension of its Targeted Long-Term Repurchase Operations which provides unlimited financing to banks at zero percent interest rates, a rate which falls to -0.4% if the banks then lend the funds on to clients.

Chinese policymakers also appeared more determined to support economic growth following the National People's Congress. Policymakers announced looser monetary policy, more fiscal stimulus as well as the provision of Special Construction Bonds which are designed to stimulate infrastructure spending in the economy. China's February economic data again showed disappointing outcomes for industrial production, but fixed asset investment – which would capture any improvement in infrastructure spending – marginally beat expectations.

The US Federal Reserve also signalled more willingness to support the growth outlook, despite some preliminary signs of rising inflation and continued strength in employment growth (230,000 jobs were added in February). At its March meeting, Fed officials kept interest rates unchanged, but now expect to increase interest rates only twice over the remainder of 2016 (50bps) whereas previously they expected to increase interest rates 4 times (100bps).

Australian economic data tended to have a softer tone over the last month, but remains well within its recent ranges, and was not sufficiently soft to shift people's views of the underlying momentum of the economy. The National Accounts data confirmed that the Australian economy grew by 0.6% in the December quarter, which is close to the economy's potential growth rate. Since then, retail sales grew by a tepid 0.3% in January, following a flat outcome in December, building approvals fell by 7.5% in January reversing a sharp gain in the previous month, and employment was flat (300 jobs were added) in February following a 7,900 jobs decline in January. Despite that, the unemployment rate fell from 6.0% to 5.8% in February and while consumer sentiment has been volatile, recent weekly readings have tended to be firmer. Moreover, the NAB business survey suggests that overall business activity remains solid.

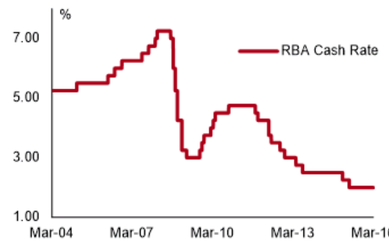
Policymakers are likely to be frustrated with the renewed strength of the A$. Over the past 18 months, the weaker A$ has provided a tailwind to the tourism and education sectors, which has boosted domestic spending and employment. Policymakers were hoping that the next step would be for firms in those sectors to begin boosting investment. But should the recent strength in the A$ prove to be more sustained – or even if it strengthens further – then a key support to the Australian economy could become a headwind again.

Global bond yields moved higher in the first-half of March as the perceived downside risks to global inflation receded. The US 10-year bond yield increased from 1.70% to just under 2.00% by mid-March. However, the Fed's downward revision to its policy rate forecasts for 2016 saw 10-year yields fall back to 1.76%. Australian government bond yields followed a similar pattern, ending the month at 2.48%. The A$ rallied 7% in March to an 8-month high of 76.6 US cents. Further monetary easing measures by the major central banks and the increase in commodity prices supported the currency in March.

Financial/Economic Data

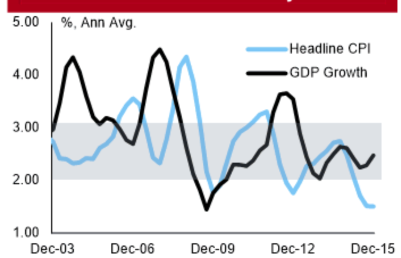
March 2016

RBA Cash Rate



Australia Dollar

Australian Economy



Unemployment Rate

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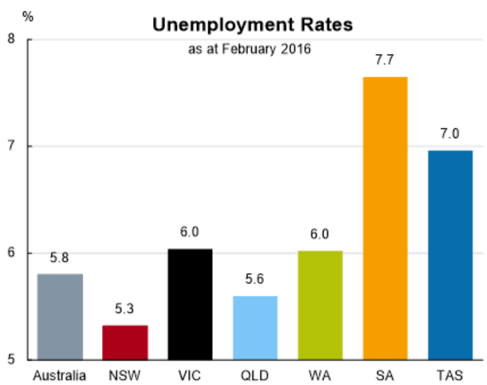
The State of NSW

The NSW economy maintains its lead against the other States and Territories

NSW remains the powerhouse for growth in the national economy. The low setting of interest rates and the weaker A$ (despite its more recent rally) continues to boost activity in NSW's services-oriented economy. Lower mortgage rates have resulted in a protracted pick-up in the number of owner-occupier home loans approved in NSW (+12.3% y/y in February). Not surprisingly, the increase in housing demand has resulted in a surge in new residential construction (+12.5% y/y in Q4), with the annual average pace of building permits in NSW still running at almost 20%. And while auction clearance rates in Sydney fell towards 50% in the final weeks of 2015, they have since recovered back to levels consistent with a strong housing market (above 70%).

Fortunately for retailers, as the supply of housing increases, so too does the demand for household items, such as furniture and whitegoods. Stronger household expenditure has been reflected in the acceleration in retail trade in NSW (+4.6% y/y in February), although it has slowed from the cycle high of almost 10% y/y (April 2014). The depreciation in the A$ (roughly 30% since 2011/12) has also worked wonders for NSW export sector. In the year to January, NSW hosted over 2.8 million international visitors, with Chinese tourists representing the largest share of visitors to NSW (15.6% of total). The lower A$ has also enhanced Australia's international competitiveness more broadly. The value of Australia's services exports increased by 11% over the year to February – double the pace of the past decade's average.



Market Movements and Economic Data

Financial Data	31 Mar	Monthly change
Cash Rate	2.00%	0.00 –
Corporate Bond Yield*	3.87%	-0.28 ▼
Term Deposit**	2.20%	0.00 –
ASX200	5083	4.1% ▲
S&P500	2060	6.6% ▲
AUD/USD	0.766	7.2% ▲
Economic Data***	**31 Mar**	**Quarterly change**
Headline CPI	1.7%	0.2% ▲
Trimmed Mean CPI	2.1%	0.0% –
GDP Growth	3.0%	0.3% ▲
House Prices	6.6%	-1.4% ▼
Unemployment Rate	5.8%	0.0% –

*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

And finally, the combination of stronger housing construction, household spending and exports has resulted in a much needed boost to NSW's labour market. Unemployment in NSW has continued to trend lower. In February, unemployment in NSW fell to 5.3%, 1.0% lower than a year ago, and lower than any other State. Meanwhile, the number of people employed in NSW is 4% higher than a year ago. To sum up, the benefits of lower interest rates and A$ for the NSW economy are clear. And while there has been a moderate easing in momentum in recent months, the NSW economy has performed admirably in the wake of increased risks to the global growth outlooks and the bout of financial market volatility experienced in the opening weeks of this year. More importantly, it has provided support to the overall Australian economy at a time where mining investment has been declining rapidly.