TCorp Local Government Services

Economic Commentary – April 2016

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The Month in Review

Economic and Market Trends

The tentative directional shift in Chinese economic momentum that we foreshadowed last month gained traction over March in response to the government's announcement that it will provide a large fiscal infrastructure stimulus package. Industrial production jumped from 5.9% y/y to 6.8% y/y in March, while growth in fixed asset investment – which is essentially business investment – rose from 10.2% y/y to 10.7% y/y. Not only did the data show a pick-up in economic activity in recent months, but the acceleration also exceeded market expectations. And this, in turn, has done much to reassure investors about the trajectory of the Chinese economy over 2016.

Data in the US were slightly more positive. The US manufacturing sector – which lost momentum in late 2015 – regained strength in March, with the ISM manufacturing index rebounding to 51.5 from 49.5 in February (a reading above 50 denotes rising activity). At the same time, employment grew by a strong 215,000 in March, exceeding estimates of a 205,000 rise and jobless claims fell to their lowest level since 1973. Inflation in the US remained higher than the last several years. Core consumer prices rose by 2.2% y/y in March.

At its April policy meeting, the US Federal Reserve (Fed) watered down its previous concerns surrounding the risks around global growth and financial stability. That said, Fed members were still monitoring those risk factors closely. And while data showed a slowdown in consumer spending in Q1, the Fed cited that the superb strength in the labour market should underpin household expenditure in 2016. Overall, the Fed kept open the possibility of a rate hike in June, although changes to the policy setting will be data dependent.

The Bank of Japan (BoJ) greatly disappointed market expectations at its April policy meeting as it decided not to ease policy further despite its failure to achieve its inflation and wages growth targets. The BoJ cited reduced tail risks - such as a hard landing in China or a recession in the US - as the reason behind its inaction, although the Bank maintains a heavy easing bias. Nonetheless, its decision resulted in a sharp decline in the Nikkei (-8%) and an appreciation in the Yen (+5%), both of which, if sustained, will hurt GDP growth.

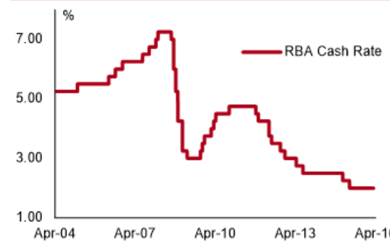
Australian inflation was stunningly low in the March quarter. Overall consumer prices fell by 0.2% q/q (1.3% y/y) in Q1, partly due to large declines in some volatile prices, such as petrol and fresh food. But the main surprise was that even after such items are excluded, the underlying pace of inflation was just 0.2% in Q1 and 1½% over the past year. Not only is this the weakest pace of inflation in 25 years, it also confirms that inflation is well below the bottom end of the 2-3% target band. Also, the broad-based decline in inflation is gathering momentum. Other local data were also weak. Retail sales were flat in February, following a tepid 0.3% gain in January. Private-sector house approvals fell by 1.2% (-5.1% y/y). Meanwhile, the RBA acknowledged at its April policy meeting that the stronger A$ - if sustained - would make the growth outlook "more complicated".

The surprise fall in inflation in Q1 forced markets to price in a higher chance that the RBA will cut interest rates in May. (At the time of writing, the RBA cut rates to 1.75% at its May meeting). In April, the 90-day bank bill fell 14bps to 2.15%. In the long-end, the Australian 10-year yield increased a meagre 3bps to 2.52%. The rebound in oil prices (+22%) in April supported inflationary expectations. The US 10-year yield increased 6bps to 1.83%, while the German 10-year yield almost doubled from 0.15% to 0.27%. Despite its strong rally earlier in the month, the A$ finished 0.7% lower at 76 US cents.

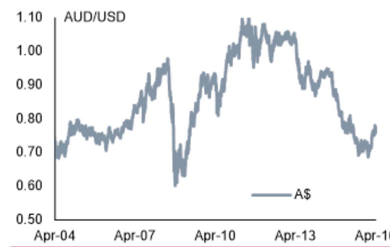
Financial/Economic Data

April 2016

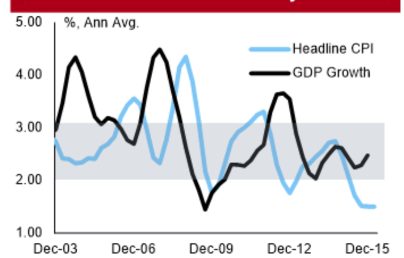
RBA Cash Rate



Australia Dollar



Australian Economy



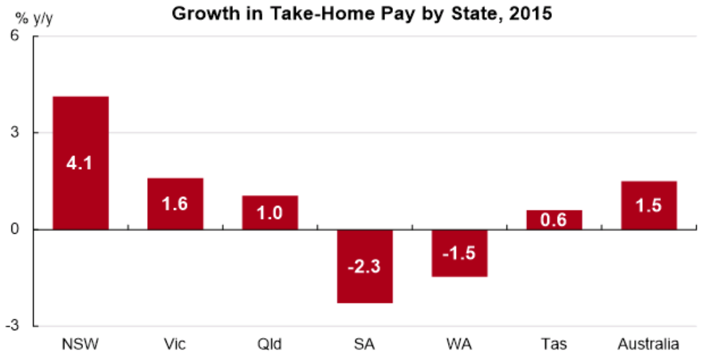
Unemployment Rate

TCorp

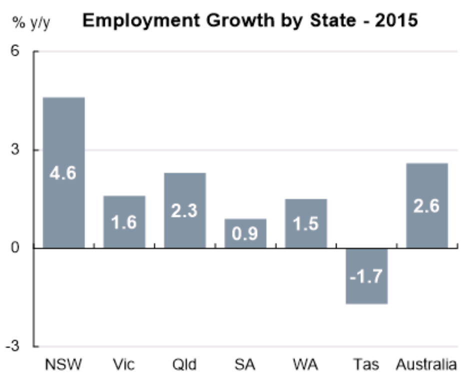
The State of NSW

Employee earnings grew the fastest in NSW in 2015

A particular problem for the Australian economy in recent years has been very weak income growth. Over 2015, however, the total earnings of NSW workers increased by 4.1% - more than double the pace of growth of the next fastest State. This is, of course, good news for the NSW economy, as it supports the retail sector and the housing industry as well as general confidence in the economy. There are three main factors that determine how strong employees' actual wages will grow.



First, there is the change in the wage rate itself. If this is supported by strong productivity growth, then this is a positive development. However, if it is simply at the expense of lower profits, then it is not sustainable. Second, workers could shift from low-paid jobs to higher-paid jobs. This doesn't usually have a great impact on overall earnings growth, although it may be a factor when there is a large boom (and subsequent bust) in a sector with very high pay, such as mining. Third, if the demand for labour is particularly strong, then workers will be able to shift from part-time to full-time work and obtain more overtime which also results in workers taking home more pay.



Market Movements and Economic Data

Financial Data	29 Apr	Monthly change
Cash Rate	2.00%	0.00 –
Corporate Bond Yield*	3.64%	-0.23 ▼
Term Deposit**	2.20%	0.00 –
ASX200	5252	3.3% ▲
S&P500	2065	0.3% ▲
AUD/USD	0.760	-0.7% ▼
Economic Data* **	**29 Apr**	**Quarterly change**
Headline CPI	1.3%	-0.4% ▼
Trimmed Mean CPI	1.7%	-0.4% ▼
GDP Growth	3.0%	0.3% ▲
House Prices	7.5%	0.9% ▲
Unemployment Rate	5.7%	-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

Looking more closely at NSW's strong outcome for 2015 reveals that an increase in the wage rate only explains part of the healthy result. That is, earnings growth for ordinary full-time workers increased by 2.3% over 2015. This is higher than the inflation rate of 1.7%, but is certainly consistent with a sustained increase in employment and investment. Rather, it appears that it is the strong hiring demand in NSW that has ensured employee earnings grew by more than 4% over 2015, as some workers shifted to full-time employment, overtime increased and extremely low levels of industrial action resulted in very few working days lost. In other words, the extremely healthy growth of employee incomes in 2015 that set NSW apart from all the other States appears to have been driven by the strength and confidence of NSW businesses which have very strong demand for labour, boosting take-home pay of workers which, in turn, underpins the future growth of the NSW economy.