TCorp Local Government Services

Economic Commentary – June 2016

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The Month in Review

Economic and Market Trends

The most important global event in the month was the UK's vote to leave the European Union (EU). While analysts and investors appreciated the risk of a successful 'Brexit' vote, it was certainly not their base case forecast. The same can be said for the polls and the betting odds leading up to the UK Referendum, which on average suggested a greater likelihood that the UK would vote to remain in the EU. However, the result of the referendum showed a robust 52-48 split in favour of leaving the EU, with over 70% of those eligible to vote participating - much higher than what analysts were predicting.

While this news alone was enough to send global financial markets into a frenzy, other events following the referendum only added to the drama. UK Prime Minister David Cameron announced that he will step down as leader in early September (when his party will meet to elect a new leader). There were renewed discussions of Scotland's withdrawal from the UK given its preference to remain in the EU. The Bank of England and European Central Bank announced emergency liquidity facilities for banks. And rating agency S&P downgraded the UK's sovereign credit rating 2 notches from AAA to AA.

The last week of the month was dominated by the uncertainty surrounding the 'Brexit' vote. While the UK voted in favour of leaving the EU, it is not legally effective until there is a formal request to the EU Parliament for official negotiations on trade and immigration policies to begin. The process can take more than 2 years.

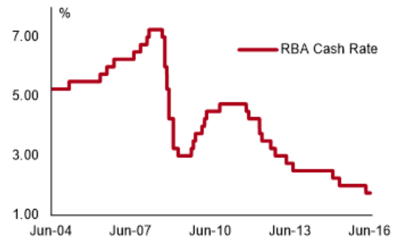
Elsewhere in the world, policymakers at the US Federal Reserve (Fed) have consistently warned financial markets participants that they were being complacent about the risks of tighter monetary policy and that they should expect higher interest rates in 'coming months'. The Fed's plans, however, were thrown into disarray by the 'Brexit vote', as well as the release of surprisingly weak employment data in May (only 38,000 jobs added) that raised questions about US economic momentum. The market is now pricing around a 30% probability that the Fed will hike rates over the next 12 months.

In local news, the Australian economy grew by 1.1% in the March quarter and by 3.1% over the past year. This exceeded analyst expectations with the main surprise being the strength of exports. Outside of exports, domestic spending remains subdued, growing by just 0.1% in Q1. Moreover, while the quantity of exports was very strong, lower commodity prices ensured that the value of exports fell. And this resulted in lower company profits overall. Nonetheless, financial markets welcomed the strong overall growth number and concluded that it removed some of the urgency for another rate cut from the Reserve Bank of Australia (RBA). Accordingly, the RBA left the cash rate unchanged at 1.75% at its June Board meeting.

Market movements in June were overwhelmingly dominated by the 'Brexit' referendum. As the 'Leave' vote was announced, the Australian stock market fell by 3.4%, the Japanese market fell by 7.3%, and the equity futures markets for the UK and US fell by 7.8% and 4.8% respectively. Global bond yields also went into free-fall. The 10-year Australian bond yield dropped by 20bps on the day, while the UK and US equivalents fell by over 30bps. The British pound suffered a 12% intraday decline – the largest since it has been freely floating - on Friday the 24th of June, and fell to its lowest level since 1985 (US $1.32). The A$ fell 3 US cents from US 76.5 cents to US 73.5 cents. The overall monthly performance of markets was not as dramatic as there was a relief rally in the closing days of June. That said, significant uncertainty on the outlook for the UK remains.

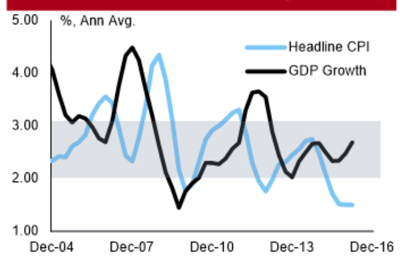
Financial/Economic Data
June 2016

RBA Cash Rate



Australia Dollar

Australian Economy

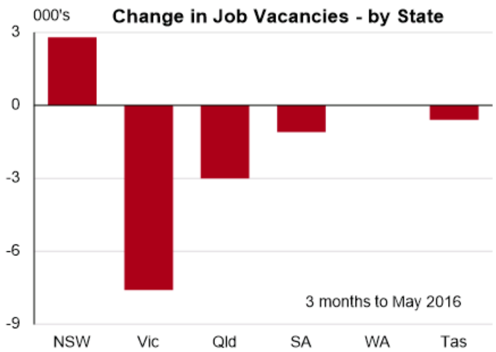


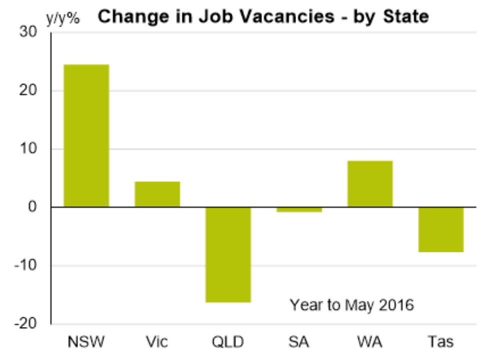
Unemployment Rate

The State of NSW

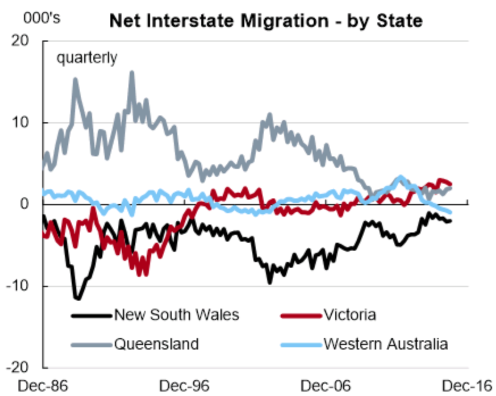
More signs of a solid labour market in NSW

The Statistician's quarterly measure of job vacancies highlighted once more the outperformance of the NSW labour market relative to the rest of Australia. In the three months to May, job vacancies in NSW increased by 2,800 to 68,100 (not seasonally adjusted). It was the only State in Australia where job vacancies increased over the three month period, and is consistent with other labour market indicators which suggest employment conditions in NSW are the most favourable in the country.





Over the year to May, job vacancies in NSW have increased by 24.5%. This compares to the next fastest increase in WA of 8%. While Victoria has seen some increase in economic activity, its jobs vacancies have only increased 4.4% over the year. These results suggest that even though lower interest rates and a weaker currency should broadly benefit those State's with economies closely tied to the services sector, NSW's economy has managed to capitalise on current financial and economic conditions much more quickly and sustainably.



Market Movements and Economic Data

Financial Data	30 June	Monthly change
Cash Rate	1.75%	0.00 –
Corporate Bond Yield*	3.26%	-0.23 ▼
Term Deposit**	2.15%	0.00 –
ASX200	5233	-2.7% ▼
S&P500	2099	0.1% ▲
AUD/USD	0.745	3.0% ▲
Economic Data***	**30 June**	**Quarterly change**
Headline CPI	1.3%	-0.4% ▼
Trimmed Mean CPI	1.7%	-0.4% ▼
GDP Growth	3.1%	0.2% ▲
House Prices	8.4%	1.8% ▲
Unemployment Rate	5.7%	-0.3% ▼

*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

A healthy labour market has multiple benefits for an economy. For some households, the prospect of acquiring a secure job is central to masking a decision of where to live. The outperformance of NSW's labour market has been reflected in the Statistician's recent interstate migration data as the number of people moving out of NSW has slowed to decade lows. Importantly, higher growth rates in population also supports the housing market – both through supply and house prices. Building approvals in NSW are at all-time high levels with over 70,000 permits issued over the past 12 months, while house prices in Sydney are up 13% over the year to May. A higher level of employment is also beneficial for State government revenues via higher payroll tax collections.