TCorp Local Government Services

Economic Commentary – September 2016

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The Month in Review

Economic and Market Trends

In September, the market's attention was centred on the G3 central bank policy meetings. First, the US Federal Reserve (Fed) kept its policy rate unchanged at 0.25%-0.50% at its September meeting. In the lead up to the meeting, several Fed Presidents suggested that the economic performance of the US economy warranted higher interest rates. Even Fed Chair Janet Yellen said the case for a rate hike had 'strengthened' in recent months when she spoke at a central bank conference in August. These comments made some analysts expect a rate hike in September. But while the Fed decided to leave its policy rate unchanged "*for the time being*", policymakers conceded that the risks surrounding the US economy were no longer to the downside, and that the case for higher rates had strengthened in recent months. In fact, three of the ten Fed committee members voted for a rate hike in September.

Second, the European Central Bank (ECB) also left monetary policy unchanged in September. Recent rhetoric from the ECB has been a little more upbeat on the growth outlook. Indeed, ECB President Mario Draghi expressed some pride that the ECB's previous policy measures had succeeded in delivering healthy growth. In fact, ECB officials commented that they did not even feel the need to discuss further policy easing at the policy meeting. This has resulted in some investors questioning whether the era of extreme central bank support may be drawing to an end. For financial markets that have become highly dependent on the prospect of ever-larger quantitative easing programmes, this could pose a significant challenge.

And third, the Bank of Japan (BoJ) met to discuss policy in September. After conducting a comprehensive review of its monetary policy settings, the BoJ announced that it will pursue 'yield curve control". While analysts are a little unsure what this entails, it appears to mean that the BoJ will seek to set a short-term interest rate (as most central banks do), as well as the 10-year bond yield - and thereby the slope of the yield curve. This should be positive for Japanese banks as they benefit from a steeper yield curve although analysts disagree as to whether it will benefit the broader economy.

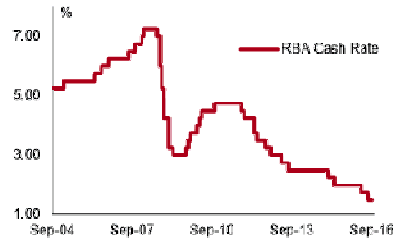
In Australia we received an update on economic growth. The Australian economy grew by 0.5% in the June quarter and by 3.3% over the past year. While rising exports have been the mainstay of Australian growth over the last year, in the June quarter it was government spending that underpinned growth. The strength of government spending in Q2 was surprising given that governments in most jurisdictions have committed themselves to fiscal consolidation. In our view, there is a good chance that the surge in spending in Q2 will be partly reversed in Q3. Even so, this unexpected boost was sufficient to ensure that the Australian economy has grown consistently for 25 years, which is a remarkable achievement. The Reserve Bank of Australia kept the cash rate unchanged at 1.50%.

Initially, equity markets had fallen dramatically during the month as the prospect of higher interest rates in the US looked more likely. However, the Fed's inaction helped reverse the mid-month losses in equity markets. After a bumpy ride, the S&P500 finished September slightly lower at -0.1%, while the ASX200 was up a modest 0.1%. Bond yields behaved similarly, rising in the lead-up to the Fed policy meeting but falling afterward. That said, bond yields finished higher in the month. The Australian 10-year yield finished 8bps higher at 1.91%, while the US 10-year yield was 1bp higher at 1.59%. The A$ increased 2% in September to almost 77 US cents as rising commodity prices supported the local currency.

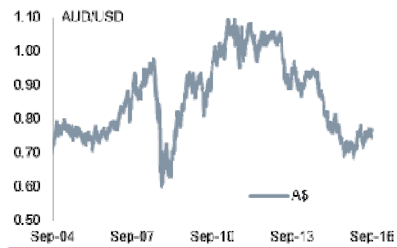
Financial/Economic Data

September 2016

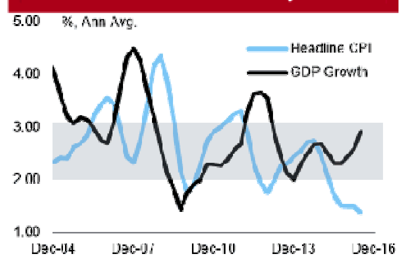
RBA Cash Rate



Australia Dollar



Australian Economy

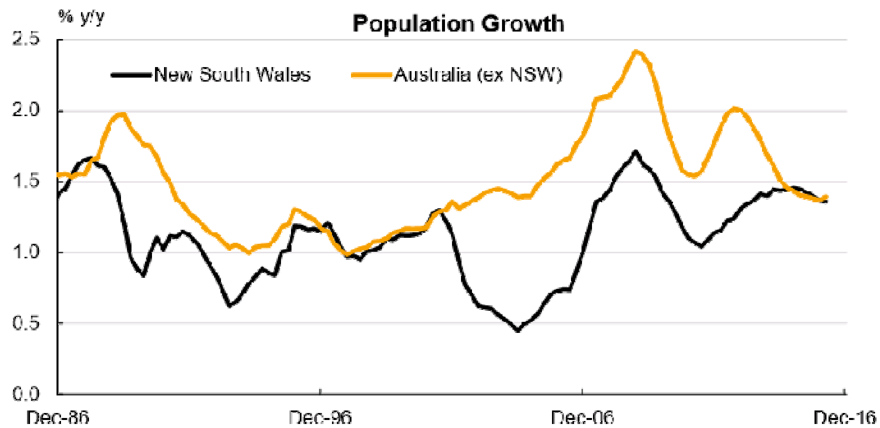


Unemployment Rate

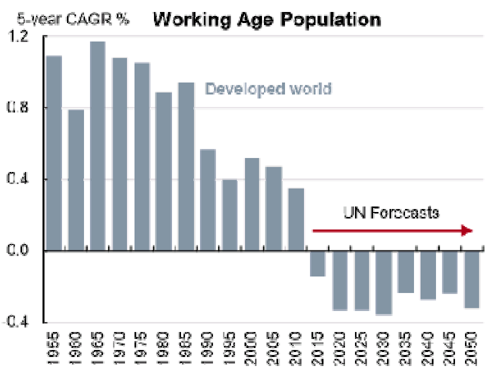
The State of NSW

Population growth in NSW matches Australia

Post the 2000 Sydney Olympics, NSW population growth slowed to 0.5% y/y, breaking away from the faster pace of growth observed in the rest of Australia (+1.4% y/y). Several years after, population growth in NSW lagged the rest of Australia resulting in less favourable outcomes in the labour market (rising unemployment) and in the property market (0% house price growth between 2004 and 2009).



Over the past year however, population growth in NSW has almost tripled from the lows a decade ago. Furthermore, population growth in NSW is now back in line with the rest of the nation for the first time since 2001. The relatively fast pace of population growth in NSW has both boosted and reinforced the healthy upswing in most indicators of economic activity, such as housing, household consumption, business investment, and State government spending.



Market Movements and Economic Data

Financial Data	30 Sep	Monthly change	
Cash Rate	1.50%	0.00	–
Corporate Bond Yield*	2.91%	0.05	▲
Term Deposit**	2.15%	0.00	–
ASX200	5436	0.1%	▲
S&P500	2168	-0.1%	▼
AUD/USD	0.766	2.0%	▲
Economic Data***	**30 Sep**	**Quarterly change**	
Headline CPI	1.0%	-0.3%	▼
Trimmed Mean CPI	1.7%	0.0%	–
GDP Growth	3.3%	0.3%	▲
House Prices	7.1%	0.8%	▲
Unemployment Rate	5.6%	-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

Population growth is becoming more difficult to achieve, especially growth in the working age population. While it isn't news that Japan's working age population is in decline, other major economies have since been added to the list, such as Germany and China. However population growth is an essential contributor to demand and overall growth. And this is why NSW (and even Australia as a whole), is well placed to navigate through these challenging global conditions, such as slowing global trade and low rates of return.