TCorp Local Government Services

Economic Commentary - January 2017

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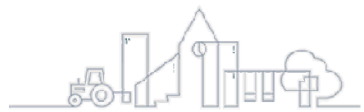


The Month in Review

Economic Commentary

Global economic data released in January was strong. In particular, measures of manufacturing activity are now at recent highs for several key economies. For some, the revival in global activity measures is confirmation that the new US President's proposed policies will boost global growth. Others, however, are curious as to whether the uptick in global activity merely represents business restocking, rather than a coordinated and sustainable acceleration in global growth.

In the US, the pickup in economic activity has been notable. The Institute of Supply Management manufacturing index increased to 54.7 in December – a level not seen since 2014. The increase in manufacturing output is impressive in light of the 10% appreciation in the US Dollar Index observed since mid-2016. Meanwhile, 144,000 jobs were added to the US economy in December. While this was below market expectations of 175,000, the report marked the sixth consecutive year that the US economy added over two million jobs.

'The sixth consecutive year the US economy added over two million jobs'

There are, however, some signs that US growth may moderate in 2017. New home sales, for example, fell by 10.4% in December. This might reflect the large increase in US bond yields – and hence US mortgage rates – that has occurred since mid-2016, and which is expected to weigh on interest-rate sensitive parts of the US economy – like housing.

The European economy also showed promising signs of strength in December. Bank lending to consumer and non-financial corporations continued to pick up (2.1% y/y). The Purchasing Managers' Index of manufacturing increased to its highest level since 2011 (55.1), while inflation jumped 0.5% (1.1% y/y) in December.

China also had its fair share of achievements in December. GDP growth in Q4 beat expectations at 6.8% y/y. Meanwhile, producer price inflation (PPI) hit 5.5% y/y in December - its highest level in six years. With PPI now positive, Chinese businesses should become more profitable.

'Chinese businesses should become more profitable'

The key macroeconomic data point released in January for local markets was the Statistician's Consumer Price Index (CPI) for the December quarter. Going into the release, inflation was running well below the bottom of the Reserve Bank of Australia's (RBA) 2-3% inflation target. Moreover, the RBA had made clear that it did not expect inflation to return to its target band until the end of 2018.

The RBA's prognosis of the inflation outlook was confirmed by the Q4 CPI. The CPI increased by only 0.5% q/q in Q4 - weaker than the market had expected. Over the last year, inflation was 1.5%, leaving headline inflation well below the bottom of the RBA's target band for the eighth consecutive quarter. With wages growth still decelerating, the risk to the inflation outlook will be a key consideration for monetary policy in 2017.

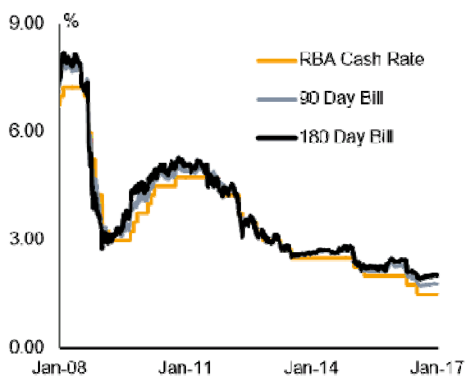
Market Commentary

Global bond markets were mixed in January. The 10-year US yield fell 8bps to 2.36% by mid-January, only to rise 9bps to 2.45% by month end. The 10 year Australian yield (which is heavily influenced by US equivalent) behaved in a similar fashion. Equity markets were mixed in January, with global bourses outperforming the local market. The US equity market finished 1.8% higher in January, while the ASX200 slid 0.8% in the month. While the 6% increase in iron ore prices would have supported the local bourse, the 14% fall in coking coal prices likely provided an offset. The A$ was particularly strong in January, rising over 5% to 0.76 US cents.

Financial Market and Economic Charts

January 2017

Cash and Bank Bill Rates



We expect the RBA will leave the cash rate at 1.50% in 2017

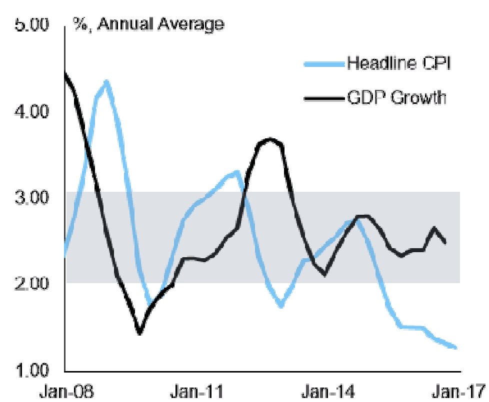
Australian Dollar

The A$ appreciated 5% against the US$ in January

Unemployment rate

Unemployment in NSW is around 0.8% lower than the rest of Australia

Australian Equities



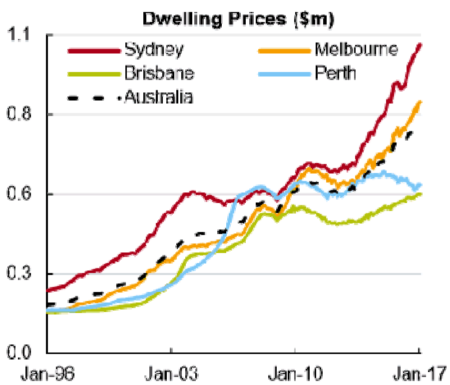
Inflation has been below the RBA's target band (2-3%) for 8 consecutive quarters

The State of New South Wales

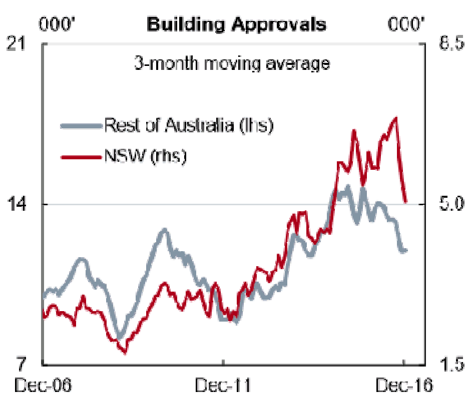
Housing Market Update

Australia's housing market has performed exceptionally well in recent years. Whether it be the record-high levels of construction, or the increase in house prices, the property market has been especially active in Australia.

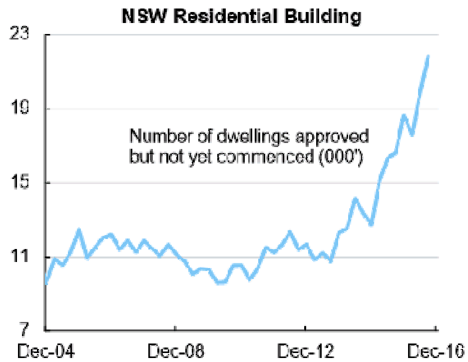
The strong performance, however, has not been uniform across the different States and Territories. Housing activity in the non-mining States have outperformed the mining-oriented States. This should not be a surprise - mining investment has fallen substantially while interest rates have declined to all-time lows. As a result, NSW has been a stand-out performer.



More recently, it seems that some housing market data have been more mixed. For example, building approvals – which remain above its long-term average – have formed a peak in both NSW and the rest of Australia.

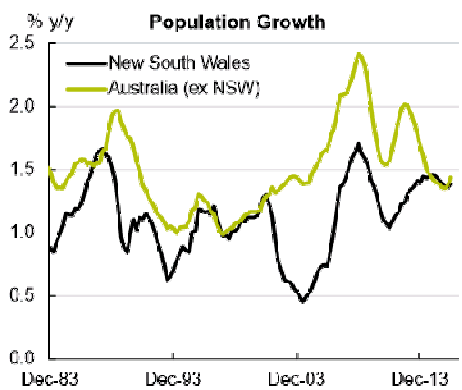


Building approvals are an indication of future construction activity. Fortunately, while the number of approvals has started to decline, there is still an incredibly large backlog of residential construction that has not yet commenced, especially in NSW.



The chart above – which excludes construction that has commenced – suggests that building activity in NSW should continue at a high level well into 2017. The impetus to growth, however, will not be as pronounced as before as the pace of construction activity starts to slow. It is the pace of activity rather than the level that is important for GDP growth.

Population growth in NSW remains strong, but it has stopped accelerating. Still, demand for housing should remain positive. And with lowest unemployment rate in Australia, housing demand is not likely to fall as sharply as it has in other parts.



Overall, the housing market in NSW should continue to perform well considering the historic rise in activity it achieved over the past couple of years. The bulky pipeline of work will keep the level of construction high, population growth will provide a reasonable support demand, while low interest rates will continue to allow for relatively low mortgage servicing costs.

Financial Markets Data
January 2017

Interest Rates	Close (%)	1 Month (bps)		CYTD (bps)	
RBA Cash Rate	1.50	0	–	0	–
Term Deposit (average 90-day rate for $10,000)	2.05	0	–	0	–
90-day BBSW	1.77	-4	▼	-4	▼
5-year A-Rated Corporate Bond Yield	3.50	-14	▼	-14	▼
3-year Australian Bond Yield	1.91	-5	▼	-5	▼
10-year Australian Bond Yield	2.71	-5	▼	-5	▼
10-year Australian Break-Even Inflation	1.91	-2	▼	-2	▼
10-year Australian Real Yield	0.80	-3	▼	-3	▼
Fed Funds Rate (lower bound)	0.50	0	–	0	–
2-year US Treasury Yield	1.20	2	▲	2	▲
10-year US Treasury Yield	2.45	1	▲	1	▲
10-year German Bund Yield	0.44	23	▲	23	▲

NSW TCorp Bonds	Close (%)	1 Week (bps)		YTD (bps)	
4.00% 20 February 2017	1.75	1	▲	1	▲
6.00% 1 February 2018	1.81	-3	▼	-3	▼
3.50% 20 March 2019	1.92	-9	▼	-9	▼
6.00% 1 May 2020	2.11	-10	▼	-10	▼
4.00% 8 April 2021	2.25	-11	▼	-11	▼
6.00% 1 March 2022	2.37	-9	▼	-9	▼
4.00% 20 April 2023	2.57	-6	▼	-6	▼
5.00% 20 August 2024	2.70	-5	▼	-5	▼
4.00% 20 May 2026	2.91	-3	▼	-3	▼
3.00% 20 March 2028	3.14	-3	▼	-3	▼
3.00% 20 February 2030	3.34	-4	▼	-4	▼
3.75% 20 August 2020 CIB	0.50	-13	▼	-13	▼
2.75% 20 November 2025 CIB	0.96	-6	▼	-6	▼
2.50% 20 November 2035 CIB	1.50	-1	▼	-1	▼
10-year NSW TCorp Bond Yield	3.00	-3	▼	-3	▼
10-year TCV (Victoria) Spread	-0.02	0	–	0	▼
10-year QTC (Queensland) Spread	0.19	0	–	2	▲

Equities	Close	1 Week		YTD	
S&P/ASX 200 (Australia)	5,621	-0.8%	▼	-0.8%	▼
S&P 500 (US)	2,279	1.8%	▲	1.8%	▲
FTSE 100 (UK)	7,099	-0.6%	▼	-0.6%	▼
DJ Stoxx 600 (Europe)	360	-0.4%	▼	-0.4%	▼
Nikkei 225 (Japan)	19,041	-0.4%	▼	-0.4%	▼
Shanghai Composite (China)	3,159	1.8%	▲	1.8%	▲

Currencies	Close	1 Week		YTD	
AUD/USD	0.76	5.2%	▲	5.2%	▲
EUR/USD	1.08	2.7%	▲	2.7%	▲
USD/JPY	112.80	-3.6%	▼	-3.6%	▼
GBP/USD	1.26	1.9%	▲	1.9%	▲
US$ Index	99.51	-2.6%	▼	-2.6%	▼

Commodities	Close	1 Week		YTD	
Brent Oil (US$/bbl)	55.70	-2.0%	▼	-2.0%	▼
Iron Ore (US$/t)	83.34	5.7%	▲	5.7%	▲
Newcastle Coking Coal (US$/t)	158.30	-13.9%	▼	-13.9%	▼
Gold (US$/oz)	1,210.65	5.1%	▲	5.1%	▲