TCorp Local Government Services

Economic Commentary - March 2017

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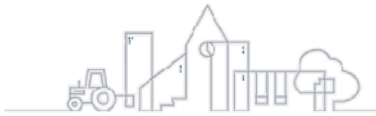


The Month in Review

Economic Commentary

In Australia, the ongoing strength of the Sydney and Melbourne housing market has been the main focus of policymakers. So far in 2017, auction clearance rates have remained at very high levels in Sydney and Melbourne, reported price growth has accelerated and investor lending has picked up once again.

In response to these developments, the Australian Prudential Regulation Authority (APRA) announced a further tightening of macro-prudential measures. This included limiting the proportion of new loans that can be 'interest-only' to 30% (currently 40% of all loans are interest only). And while APRA still wants banks to limit investor loan growth to less than 10%, they now expect banks to remain 'comfortably below' that threshold.

These actions are probably more timid than most analysts had expected and suggests that while these measures may have a modest effect on housing demand, they are unlikely to trigger a major shift in momentum.

GDP rose by 1.1% in the December quarter, as mining activity bounced back from its surprisingly sharp fall in Q3. More recently, the unemployment rate rose from 5.7% to 5.9% in February, suggesting that growth is running a little slower than trend. But survey data suggest that labour demand remains okay and there is nothing to indicate that overall growth has slowed suddenly.

'…there is nothing to indicate that growth has slowed suddenly'

The US Federal Reserve (Fed) raised the target range for the Fed Funds rate by 25bps in March, to 75-100bps. In late February, few analysts expected the Fed to hike rates at its March policy meeting. But successful jawboning by key Fed officials over the next couple of weeks meant that a rate hike was almost fully priced at the time of the meeting.

While the Fed hiked earlier than most analysts had expected a month ago, they still suggested that 3 rate hikes would be appropriate this year, and they also left their forecasts for growth and inflation relatively unchanged.

'The US labour market continues to tighten'

The US data flow remains relatively constructive overall, although there is a distinct contrast between survey-based data and those data which measure actual activity. This is perhaps best encapsulated in the Conference Board measure of consumer sentiment which surged to a 17-year high in March, and data on personal consumer spending, which has declined in real terms in January and February. Investors remain hopeful, however, that the survey data will eventually be reflected in stronger growth outcomes.

As in the US, surveys of European business activity continue to be strong, while Chinese data also remains favourable. As expected, the UK Government officially commenced its exit from the European Union by triggering the 'Article 50' clause of the Lisbon Treaty.

Market Commentary

Despite a continuation of strong global economic data and the decision of the US Federal Reserve (Fed) to raise interest rates in March, bond markets were generally becalmed over the last month. It appears that investors expected the Fed to unveil a more aggressive tightening path alongside its decision to hike rates in March.

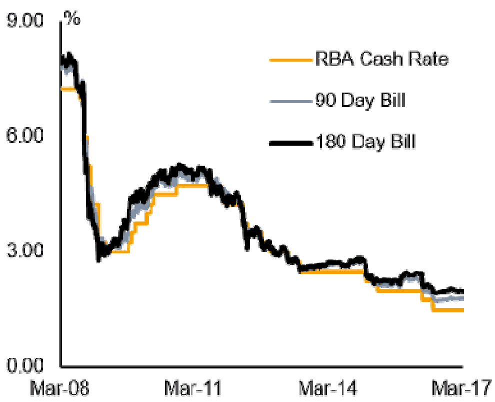
The Australian bond market modestly outperformed its US counterpart over March, with the 10-year CGS yield falling from 2.72% to 2.7%. TCorp yields came in a touch further, with yields on the 2026 and 2028 benchmark bonds falling 3bps over the month.

Financial Market and Economic Charts

March 2017

TCorp

Cash and Bank Bill Rates



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

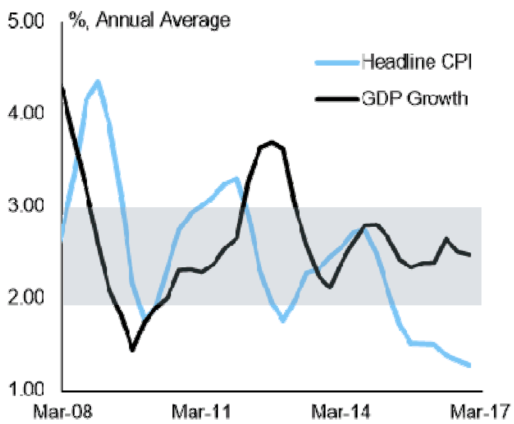
Australian Dollar

The A$ is still struggling to break above US 78 cents

Unemployment rate

There was a noticeable rise in unemployment outside of NSW in February

Australian Economy



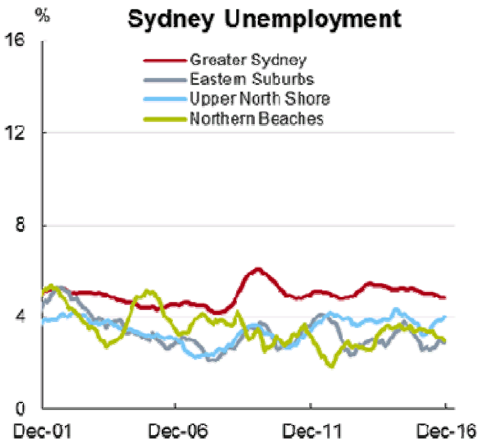
Inflation has been below the RBA's target band (2-3%) for 8 consecutive quarters

The State of New South Wales

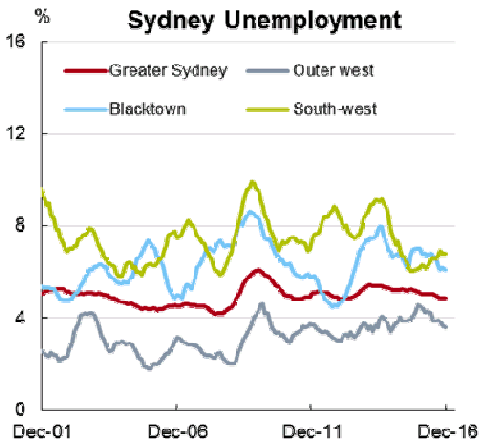
Regional labour markets

While NSW unemployment rate has remained relatively low over the last year it is also interesting to examine how regional labour markets have performed.

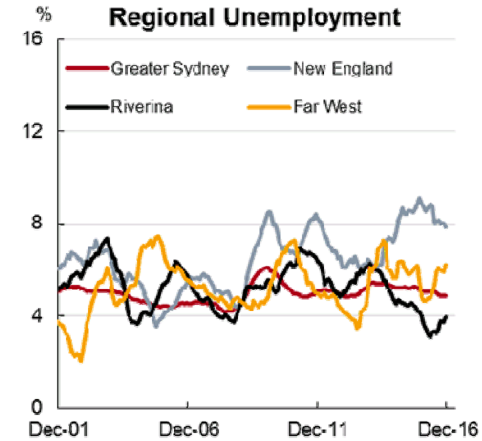
To do this, we focus on changes in unemployment rates, rather than the absolute level of a region's unemployment rate. This is because different regional demographic factors will affect the overall outcome. For example, young people tend to be less employed than older people so those regions with a younger demographic will inevitably have higher unemployment rates.



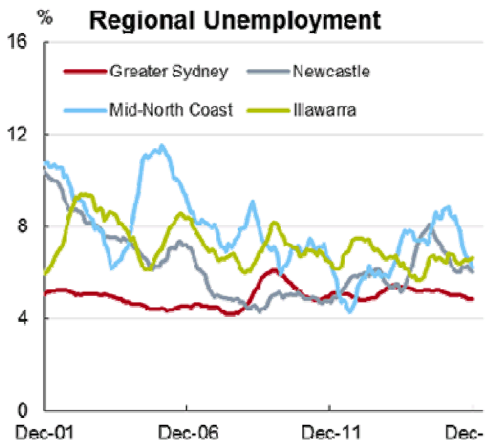
The chart above highlights that areas in the North and East of Sydney have remained areas of relatively low unemployment, as they have for the last decade.



In the South-West of Sydney, unemployment is about as low as it has been over the last 15 years, while unemployment in the Outer West remains low but has drifted higher. Meanwhile in Blacktown, the unemployment rate remains average and is line with Australia as a whole.



Looking outside of Sydney, we see areas such as New England where unemployment appears to have drifted higher, and areas such as the Riverina where unemployment looks very low (although given the small sample size for these areas we should be careful about drawing strong conclusions).



While for Newcastle, the Illawarra and Mid North Coast it is remarkable how, in all regions, the unemployment rate has converged towards 6%.

Our conclusion is that the good performance of the NSW labour market has not been overwhelmingly driven by the Sydney region. Rather, it appears that in most regions, unemployment is relatively low. And this compares favourably to the rest of Australia where we have seen quite a disparate performance over the last couple of years.

Financial Markets Data

March 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	1.80	1	▲	-2	▼
5-year A-Rated Corporate Bond Yield	3.38	-12	▼	-26	▼
3-year Australian Bond Yield	1.91	-5	▼	-5	▼
10-year Australian Bond Yield	2.70	-2	▼	-6	▼
10-year Australian Break-Even Inflation	1.89	-2	▼	-4	▼
10-year Australian Real Yield	0.81	0	▲	-2	▼
Fed Funds Rate (lower bound)	0.75	25	▲	25	▲
2-year US Treasury Yield	1.25	-1	▼	7	▲
10-year US Treasury Yield	2.39	0	▼	-6	▼
10-year German Bund Yield	0.33	12	▲	12	▲

NSW TCorp Bonds	Close (%)	1 Month (bps)		CYTD (bps)	
4.00% 20 February 2017	1.72	1	▲	-12	▼
6.00% 1 February 2018	1.92	-3	▼	-9	▼
3.50% 20 March 2019	2.09	-4	▼	-12	▼
6.00% 1 May 2020	2.25	-3	▼	-11	▼
4.00% 8 April 2021	2.37	-1	▼	-8	▼
6.00% 1 March 2022	2.55	-2	▼	-9	▼
4.00% 20 April 2023	2.67	-4	▼	-8	▼
5.00% 20 August 2024	2.89	-3	▼	-5	▼
4.00% 20 May 2026	3.12	-3	▼	-6	▼
3.00% 20 March 2028	3.33	-3	▼	-5	▼
3.00% 20 February 2030					
	0.56	-4	▼	-7	▼
3.75% 20 August 2020 CIB	0.95	-4	▼	-7	▼
2.75% 20 November 2025 CIB	1.44	-13	▼	-8	▼
2.50% 20 November 2035 CIB					
	3.01	0	–	-2	▼
10-year NSW TCorp Bond Yield	-0.03	0	–	-1	▼
10-year TCV (Victoria) Spread	0.16	0	–	-2	▼
10-year QTC (Queensland) Spread	1.72	1	▲	-12	▼

Equities	Close	1 Month		CYTD	
S&P/ASX 200 (Australia)	5,865	2.7%	▲	3.5%	▲
S&P 500 (US)	2,363	0.0%	▼	5.5%	▲
FTSE 100 (UK)	7,323	0.8%	▲	2.5%	▲
DJ Stoxx 600 (Europe)	381	2.9%	▲	5.5%	▲
Nikkei 225 (Japan)	18,909	-1.1%	▼	-1.1%	▼
Shanghai Composite (China)	3,223	-0.6%	▼	3.8%	▲

Currencies	Close	1 Month		CYTD	
AUD/USD	0.76	-0.5%	▼	5.8%	▲
EUR/USD	1.07	0.5%	▲	1.3%	▲
USD/JPY	111.39	-0.8%	▼	-4.8%	▼
GBP/USD	1.26	0.9%	▲	1.7%	▲
US$ Index	100.35	-0.8%	▼	-1.8%	▼

Commodities	Close	1 Month		CYTD	
Brent Oil (US$/bbl)	52.83	-5.0%	▼	-7.0%	▼
Iron Ore (US$/t)	80.39	-11.9%	▼	1.9%	▲
Newcastle Coking Coal (US$/t)	148.30	0.1%	▲	-19.3%	▼
Gold (US$/oz)	1,249.35	0.1%	▲	8.4%	▲