TCorp – Local Government Services

Economic Commentary – January 2014

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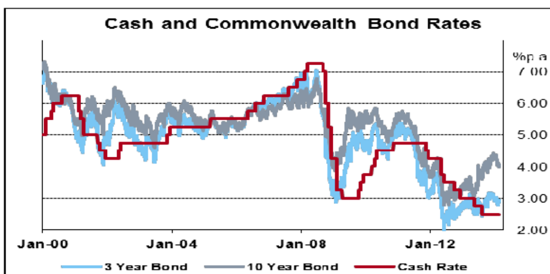
Financial Data	31 Jan	Monthly Change		Economic Data***	31 Jan	Monthly Change	
Cash Rate	**2.50**	↔	0.00	Headline CPI	2.70%	▲	0.50
Corporate Bond Yield*	4.52%	▼	-0.26	Underlying CPI	2.60%	▲	0.25
Term Deposit**	3.00%	▼	-0.05	GDP Growth	2.30%	↔	0.00
ASX200	**5320.05**	▼	-162.00	House Prices	7.60%	↔	2.20
Australian Dollar	**US$0.8756**	▼	-0.0161	Unemployment	5.80%	▲	0.10

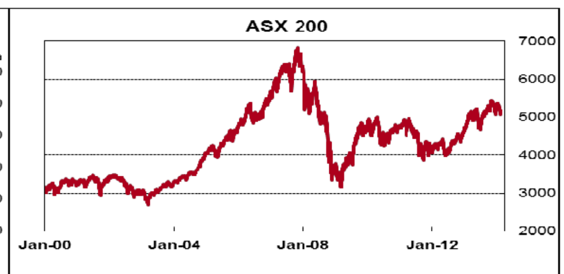
* A 5-year rate, source: RBA (new data series)
** Average 90-day rate of the five largest banks for $10,000, source: RBA
***National data, y/y, source: ABS, RBA

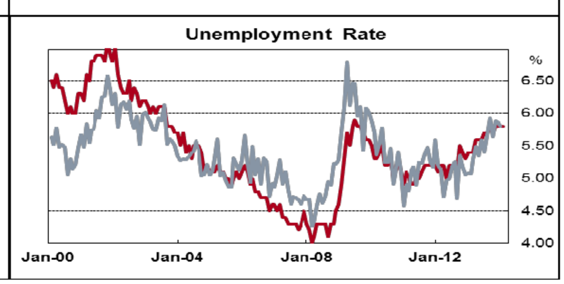
Market Trends

The Reserve Bank of Australia (RBA) did not have a monetary policy meeting in January; however, financial markets became more convinced that interest rates will remain on hold over 2014 following some encouraging signs of stronger retail spending, the pick-up in the housing market and the sharp fall in the AUD. This more than offset renewed fragility in emerging markets which unnerved equity markets in January and resulted in some sharp falls in share prices.

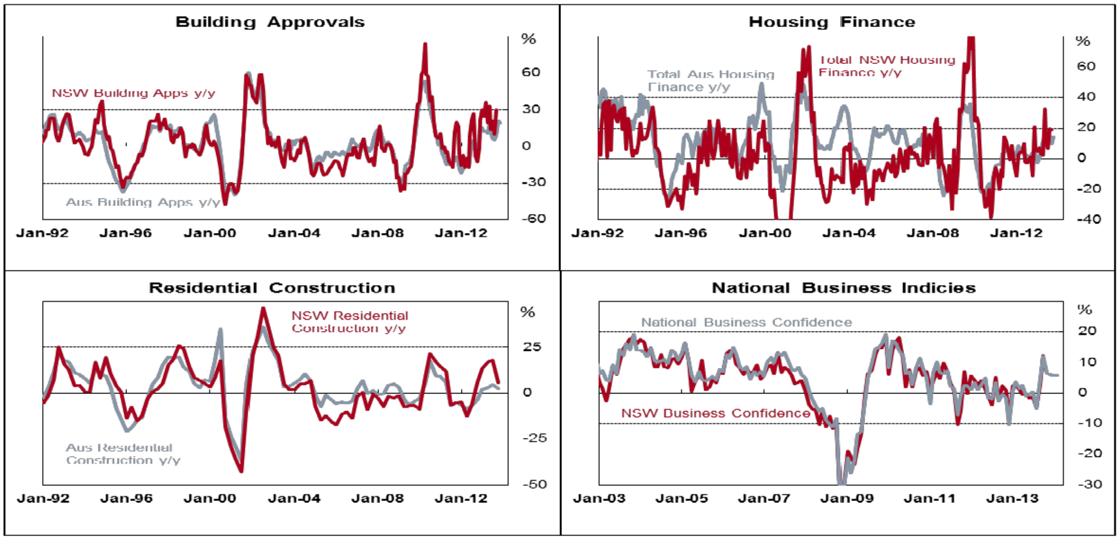
The main development internationally has been the US Federal Reserve's (Fed) decision to begin reducing the size of its monthly asset purchase programme. This decision has been justified by a continuation of solid US economic data, even though a severe cold spell did affect some sectors over December/January. The Fed's decision to commence tapering did, however, unsettle emerging markets. They were major beneficiaries of US quantitative easing as global investors searched for higher yields outside of the US markets. Now that these flows are being reversed, some emerging markets experienced sharp depreciations in their currency, which prompted their central banks to raise interest rates in an attempt to stabilise FX rates. Investors are now worried that this will crimp developed economy exports and profits, which explains why equity markets performed poorly and also why bond yields eased over January.







Local Government – Key Themes



Housing

The housing market tends to quieten down over the Christmas/New Year period, but even though activity has been lighter, it appears that the recovery that occurred in 2013 has continued into 2014, with NSW exhibiting the strongest improvement. What has been noticeable, however, is that investors have been particularly prevalent in driving the improvement in prices, while first-home buyer activity remains muted.

Similarly, the recovery in housing construction has been led by stronger multi-unit dwelling approvals (i.e. apartments) rather than single detached houses. Over 2013, only 44% of residential building approvals were for single detached houses. Even so, there were more houses approved for construction in 2013Q4 than at any time since mid 2004.

2014 National growth outlook – a reversal of the two-speed economy?

Over recent years, Australia has experienced a two-speed economy, with very strong growth in Western Australia and the Northern Territory, and sluggish growth along the east coast of Australia. For example, over the last 5 years, WA growth averaged 5%, while in NSW it averaged 1.9%. The strength of growth in WA was obviously driven by the mining investment boom. But it should also be remembered that sluggish growth in NSW resulted from the relatively high level of interest rates – and the A$ -- as the RBA calibrated policy to accommodate that mining investment boom.

Now, with mining investment peaking – and soon set to begin falling – WA growth is likely to weaken substantially. As a result, the RBA will likely keep interest rates low for a sustained period and the A$ is also likely to weaken. But that could also mean that NSW growth strengthens over the period. In other words, Australia might still have a two-speed economy, but it could well be characterised by solid growth amongst the eastern States, and weaker activity in the resource-based States. Indeed, the previous occasion in which there was a large fall in mining investment – which followed the Asian Crisis in 1997-98 – this is exactly what occurred.