TCorp – Local Government Services

Economic Commentary – February 2014

For further details please contact: Kevin Hill, Client Relationship Manager
T: 02 9325 9210 E: kevin.hill@tcorp.nsw.gov.au

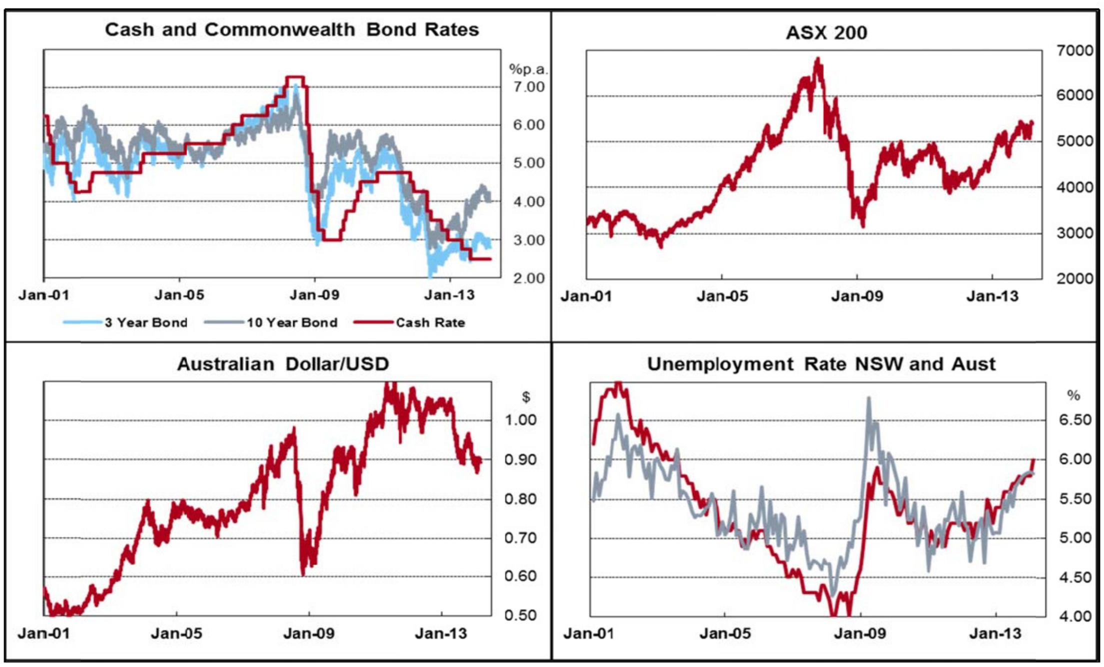
Financial Data	28 Feb	Monthly Change		Economic Data***	28 Feb	Quarterly Change	
Cash Rate	2.50	↔	0.00	Headline CPI	2.70%	▲	0.50
Corporate Bond Yield*	4.48%	▼	-0.04	Underlying CPI	2.60%	▲	0.25
Term Deposit**	3.10%	▲	0.10	GDP Growth	2.30%	↔	0.00
ASX200	5404.82	▲	214.82	House Prices	7.60%	↔	2.20
Australian Dollar	0.8924	▲	0.0168	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

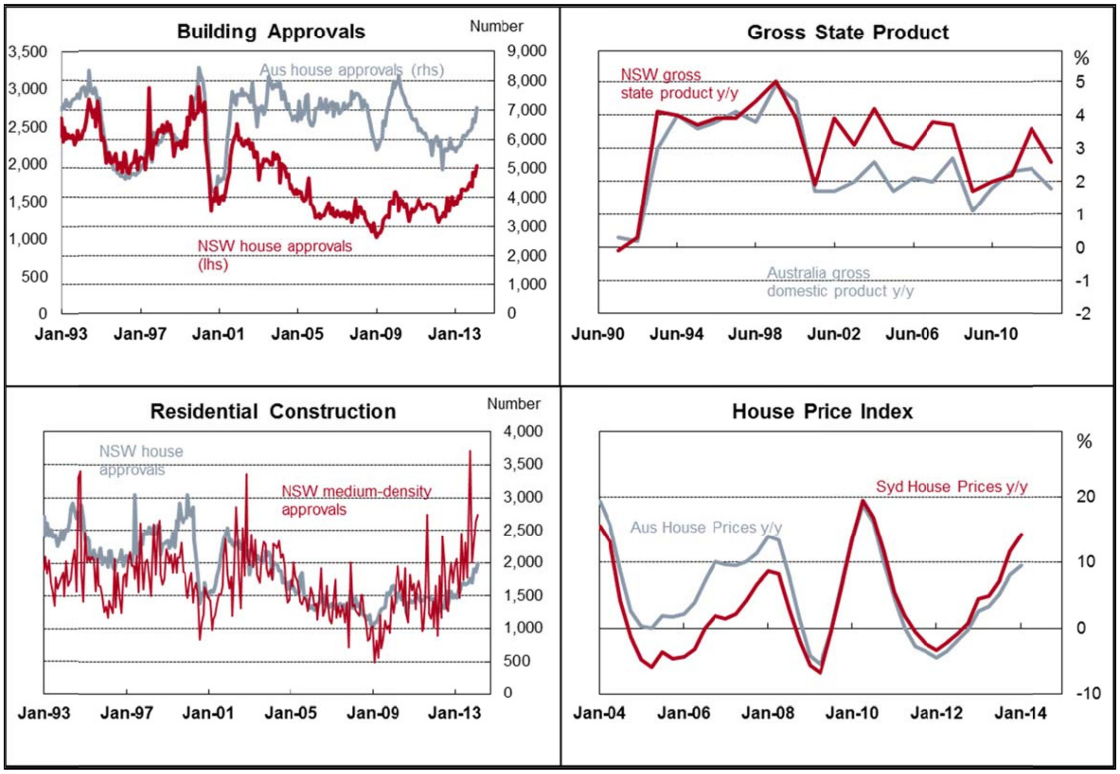
Market Trends

At its February Board meeting, the Reserve Bank of Australia (RBA) removed its easing bias due to some signs of stronger household spending and the fall in the A$ over recent months. After this, however, the A$ tended to move higher over the remainder of the month, while a survey of planned business investment confirmed that mining investment was set to fall sharply which suggests that interest rates will need to remain low for an extended period. At the same time, benign wage data suggest that the recent increase in inflation will be temporary.

In February, equity markets recovered the ground they lost in January due to fears that slower emerging market growth would undermine corporate profits. This also occurred despite a run of weaker US economic data. US policymakers blamed this on poor weather rather than a deterioration in the underlying pace of activity, and while this appears largely correct, it did work to limit the rise in bond yields. Later in the month, concerns about the political situation in Ukraine intensified which also supported safe haven assets, such as bonds.



Local Government – Key Themes



The challenge of keeping consumers spending

With mining investment poised to begin falling sharply, and the Federal Government keeping a tight rein on spending, the RBA has been keen to stimulate household spending in order to sustain economic growth at a decent pace. But while lower interest rates have been designed to encourage more housing activity and spending, working in the opposite direction has been the desire of companies to cut costs.

Firms' focus on cost cutting can be seen in the rise in the unemployment rate which hit 6% in January (but remained at 5.8% in NSW). At the same time, wage growth rates over 2013 fell to their slowest pace in the 16-year history of the wage cost survey. Obviously, this combination of factors means that household income growth is weak, which obviously makes it harder for consumer spending growth to accelerate sharply.

This is why it's so crucial that the RBA's efforts to stimulate the housing market prove to be very effective. Higher house prices improve household wealth which may encourage them to spend more freely. At the same time, an increase in housing construction boosts employment and incomes. And, of course, as the newly-built homes are completed, consumption will rise as the new home owners purchase whitegoods and furniture. The charts above highlight that the housing recovery in NSW appears to be progressing well. Although it is also noticeable that the composition of housing demand appears to have switched decisively in favour of medium-density developments, which may alter both the timing and strength of the flow-on effects through the rest of the economy.