Report to General Manager

Attachment:
1. Monthly Investment Report as at 29 February 2020

SUBJECT: Investments and Loan Borrowings Held as at 29 February 2020

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ENDORSED BY: Margaret Palmer, Director Corporate Services

EXECUTIVE SUMMARY:

This report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 29 February 2020.

Investment Portfolio:

The Investment portfolio provided an annualised return of 2.52% for the year to date as at 29 February 2020, 1.22% above the reportable BBSW Bank Bill Index.

Borrowings:
Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at 29 February 2020 is $8,306,826.48

FINANCIAL IMPLICATIONS:

The 2019/20 budgeted returns on investments is estimated to be $1,529,055.00. This is significantly less than previous returns due to the declining cash reserve balances and continued low interest rates. Any surplus funds generated in excess of adopted estimates will be transferred to Council's internally restricted reserves.

Comment by Responsible Accounting Officer:
Investments and Loan borrowings funding comply with Council's Financial Management Policy.

RECOMMENDATION:
1. THAT the report on Investments and Loan Borrowings held as at 29 February 2020 be received.

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

Direction: 5. Our Civic Leadership

Outcome: 5.1 Council leads the strategic direction of North Sydney

BACKGROUND

The Responsible Accounting Officer must provide Council with a monthly report detailing all funds:

a. Invested under Section 625 of the Local Government Act 1993. This report must include certification that the investments have been made in accordance with the Act and the Regulations made thereunder, the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.
b. Borrowed under Section 624 of the Local Government Act. This report must comply with the borrowings Order issued by the Minister for Local Government and Council's Debt Management Policy.

CONSULTATION REQUIREMENTS

Community engagement is not required.

SUSTAINABILITY STATEMENT

The following table provides a summary of the key sustainability implications:

QBL Pillar	Implications
Environment	• There are no perceived short or long-term environmental implications.
Social	• There are no perceived short or long-term social implications.
Economic	• Provides Council with a significant source of income.
Governance	• Compliance with all legislative requirements and statutory obligations.

DETAIL

Investment Portfolio

The following table provides details of the performance of Council's investment portfolio (excluding cash deposits) against the benchmark for the month of February 2020 and annualised for the year to date as at 29 February 2020 (including investments which have matured prior to 29 February 2020).

	February 2020	Annualised YTD as at 29 February 2020
Actual Return	0.17%	2.52%
Benchmark	0.08%	1.30%
Variance	0.09%	1.22%

Investment Performance

Investment returns continue to exceed the indicative benchmark (BBSW Bank Bill Index). All funds have been invested in accordance with the Act and the Regulations made thereunder and with Council's Financial Investment Policy. Further, Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted. These restrictions have placed greater emphasis on obtaining competitive investment options and the need for sound investment advice from Council's independent advisor.

Council continues to seek independent advice for all investments and is actively managing the portfolio to ensure that returns are maximised taking into account diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report prepared by Council's Investment advisor. (refer attachment 1.)

The actual investment returns for the year to date as at 29 February 2020 have been reviewed and are $241,818 greater than the revised budget.

Summary of Returns from Investments:

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (February)	YTD/Annual Actual (February)	YTD Budget to Actual Variance (February)
2019/20	**$1,500,000**	**$1,529,055**	**$1,089,055**	**$1,330,873**	**$241,818**
2018/19	$1,590,000	$1,730,000		$2,253,497	$523,497
2017/18	$2,300,000	$2,490,000		$2,589,813	$99,813
2016/17	$2,000,000	$3,000,000		$3,276,518	$276,518
2015/16	$2,320,000	$3,640,000		$4,105,146	$465,146
2014/15	$3,400,000	$4,150,000		$4,414,692	$264,692
2013/14	$2,700,000	$3,400,000		$3,983,515	$583,515
2012/13	$2,000,000	$2,887,751		$4,238,785	$1,353,069
2011/12	$2,000,000	$3,400,000		$3,728,080	$328,080

Financial Investment Policy

The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio shall be:

Long Term Rating Range	Maximum Policy Holding	Distribution as at 29 February 2020
AA Category	100.00%	53.87%
A Category	60.00%	11.52%
BBB Category	35.00%	30.85%
Unrated ADIs (NR)	10.00%	3.76%

Loan Borrowings

Council's Debt Management Policy provides the framework for Council's borrowing activities and defines key responsibilities and the operating parameters within which borrowing and related risk management activities are to be carried out.

The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating or a combination of both in order to maintain its risk averse strategy.

Loan borrowing will be undertaken in line with the following principles:

a) That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.

b) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and fund the creation of new infrastructure.

c) That loan funds will be limited to:

- acquisition or enhancement of income producing assets;
- construction and/or upgrading of buildings; and
- infrastructure assets that have a life expectancy of greater than 10 years.

The current Debt Facility is as follows:

The current facility is a fixed loan financing option, fully amortising the drawn down amount of $9,500,000.00 over 10 years, fixed interest rate with quarterly repayments of interest and principal.

The current loan details are as follows:

Loan amount:	**$ 9,500,000.00**			
Loan term:	**10 years**			
From:	**31/07/2018**			
To:	**31/07/2028**			
Interest rate:	**4.02%p.a.(fixed)**			
Repayment:	**Quarterly**			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
1/07/2019	**$ 8,910,951.91**			
31/7/2019	**$ 8,711,603.51**	**$ 90,291.14**	**$ 199,348.40**	**$ 289,639.54**
31/10/2019	**$8,510,235.19**	**$88,271.22**	**$201,368.32**	**$ 289,639.54**
31/01/2020	**$8,306,826.48**	**$86,230.83**	**$203,408.71**	**$289,639.54**

The next loan instalment is due on 30 April 2020.

Loan Funded Capital Projects as at 29 February 2020:

Project 1: Upgrading the Car Park in Alexander Street, Crows Nest

A **$5 million** loan has been sourced to fund this project.
Current length of Loan as per LTFP: 10 years to 2028

Project 2: Upgrading of On-Street Parking Management System

A **$4.5 million** loan has been sourced to fund this project.
Current length of Loan as per LTFP: 10 years to 2028

Monthly Investment Report

February 2020

IMPERIUM MARKETS

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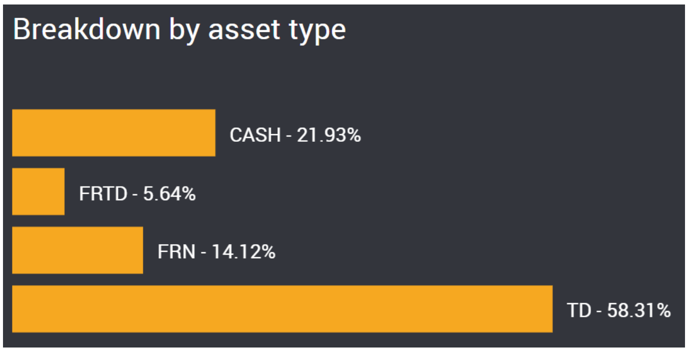
Council's Portfolio & Compliance

Asset Allocation

As at the end of February 2020, the portfolio was mainly directed to fixed and floating rate term deposits (63.95%). The remaining portfolio is directed to FRNs (14.12%) and overnight cash accounts (21.93%).

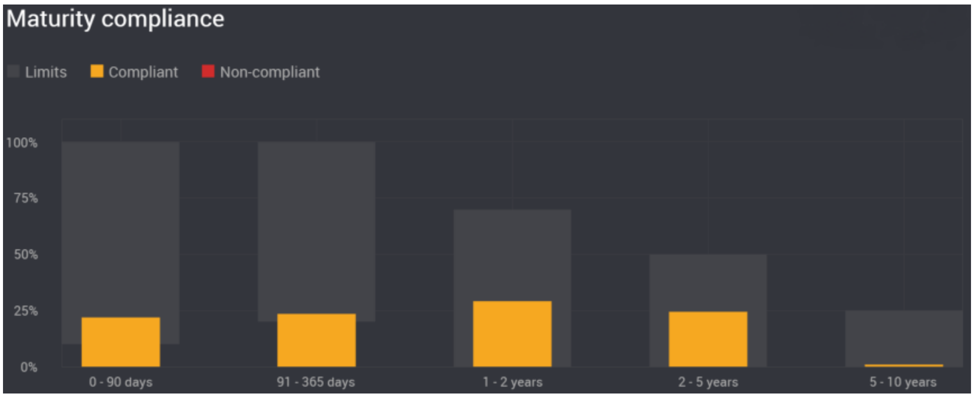
Should credit securities become more attractive relative to deposits, Council may increase its allocation to liquid senior floating rate notes (FRNs). This will not only offer potential upside with regards to the portfolio's investment returns, but also provide additional liquidity (FRNs are saleable – generally accessible within 2 business days). With further rate cuts imminent, the priority is now to lock in any remaining attractive medium-longer dated fixed deposits that may be available in the market.



Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective with around 24% of assets directed to medium-term assets (2-5 years). There is still high capacity to invest in the medium-term horizon, with approximately $26.9m at month-end.

All minimum and maximum limits comply with the Policy:



Where liquidity permits, we recommend new surplus funds be directed to 2-5 year horizons given this is where the most attractive value can be found. We suggest this be allocated to fixed term deposits ahead of further rate cuts (refer to respective sections below).

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$23,316,981	21.93%	10	100	$83,013,348
✓	91 - 365 days	$25,000,000	23.51%	20	100	$81,330,329
✓	1 - 2 years	$31,004,936	29.16%	0	70	$43,426,294
✓	2 - 5 years	$26,008,412	24.46%	0	50	$27,156,752
✓	5 - 10 years	$1,000,000	0.94%	0	25	$25,582,582
		$106,330,329	**100.00%**			

Counterparty

As at the end of February, all counterparties were within Policy limits, although Auswide (BBB) and BoQ (BBB+) remains close to maximum limits.

On 27th August 2019, AMP Bank was downgraded by ratings agency S&P to BBB+ (negative watch), from A- (negative watch). Their short-term rating was unchanged at A-2. This was a result of AMP Group selling its life insurance arm at a revised deal earlier in the month. S&P believed that the group's profits will be less diversified going forward due to this sale. We have no issues with Council's exposure to AMP Bank given they continue to have a robust balance sheet with their level of capital remaining above the minimum regulatory requirement set by APRA.

Effective 1st March 2020, Nexus Mutual (unrated ADI) merged with Beyond Bank Australia (BBB/A-2). As a result, all investors holding Nexus Mutual deposits will receive a ratings upgrade effective 1st March 2020.

Overall, the portfolio is well diversified across the entire credit spectrum, including some exposure to the unrated ADIs.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	ANZ	AA-	$2,026,274	1.91%	30.00%	$29,872,825
✓	CBA (BankWest)	AA-	$22,210,457	20.89%	30.00%	$9,688,642
✓	NAB	AA-	$7,044,105	6.62%	30.00%	$24,854,994
✓	Westpac	AA-	$26,000,000	24.45%	30.00%	$5,899,099
✓	Suncorp	A+	$1,249,248	1.17%	15.00%	$14,700,302
✓	ING Bank	A	$11,000,000	10.35%	15.00%	$4,949,549
✓	AMP Bank	BBB+	$8,144,612	7.66%	10.00%	$2,488,421
✓	BOQ	BBB+	$10,000,000	9.40%	10.00%	$633,033
✓	Auswide Bank	BBB	$10,000,000	9.40%	10.00%	$633,033
✓	ME Bank	BBB	$3,254,335	3.06%	10.00%	$7,378,698
✓	Newcastle PBS	BBB	$1,401,299	1.32%	10.00%	$9,231,734
✓	Nexus Mutual	Unrated	$3,000,000	2.82%	5.00%	$2,316,516
✓	WAW CU	Unrated	$1,000,000	0.94%	5.00%	$4,316,516
			$106,330,329	**100.00%**		

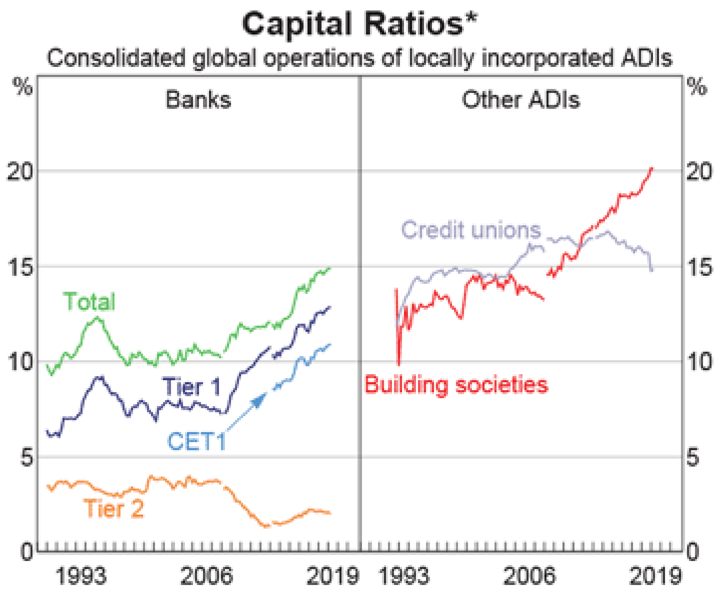
We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned that was previously the case years ago. APRA's stress test which hypothetically increased the unemployment rate to 11% (more than double the current rate) and for house prices to fall 35% showed the banks remained above the minimum capital levels. We note that APRA's latest discussion paper also highlighted that the domestic major banks were required to raise more capital while the lower rated ADIs were already deemed to be at a satisfactory level.

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). We believe that deposit investments with the lower rated ADIs should be continued going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns.

In the current environment of high regulation and scrutiny, all domestic ADIs continue to carry high levels of capital, particularly amongst the lower ("BBB") and unrated ADIs. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**

The biggest single risk that depositors face in the current low interest rate environment is not credit risk, but reinvestment risk.



* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs

Source: APRA

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Credit Quality

The portfolio remains well diversified from a credit ratings perspective. As at the end of February 2020, all categories were compliant within the Policy limits.

From a ratings perspective, the BBB rated entities now generally dominate the number of ADIs issuing deposits within the investment grade space. We anticipate more investors will naturally allocate a higher proportion of their assets into this sector (on a historical basis), considering the most attractive assets from senior debt securities are generally offered by these ADIs.

Council may consider lifting the aggregate limit with the BBB and unrated ADI category at its next policy review.

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$57,280,836	53.87%	100%	$49,049,493
✓	A Category	$12,249,248	11.52%	60%	$51,548,950
✓	BBB Category	$32,800,245	30.85%	35%	$4,415,370
✓	Unrated ADIs	$4,000,000	3.76%	10%	$6,633,033
		$106,330,329	**100.00%**		

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Performance

Council's performance for the month ending 29 February 2020 is summarised as follows:

Performance	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.06%	0.19%	0.39%	0.56%	1.04%
AusBond Bank Bill Index	0.08%	0.23%	0.48%	0.68%	1.30%
Council's T/D Portfolio	0.17%	0.52%	1.08%	1.50%	2.45%
Council's FRN Portfolio	0.16%	0.49%	1.00%	1.38%	2.38%
Council's Portfolio^	**0.17%**	**0.52%**	**1.10%**	**1.32%**	**2.52%**
Outperformance	**0.09%**	**0.29%**	**0.62%**	**0.64%**	**1.22%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

For the month of February, the total investment portfolio (excluding cash) provided a strong return of +0.17% (actual), outperforming the benchmark AusBond Bank Bill Index return of +0.08% (actual). The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins.

However, the majority of the high-yielding deposits are fast maturing and will be reinvested at lower prevailing rates. With deposit margins tightening over the past few years, the FRN portfolio's performance has narrowed the gap compared to term deposits as shown in the past 12 months returns, although this is likely to reverse following the multiple interest rate cuts in June, July and October 2019. Further rate cuts are expected over coming months in 2020.

Over the past 12 months, the total portfolio (excluding cash) returned an outstanding +2.52% p.a., outperforming bank bills by 1.22% p.a. This has been very strong given deposit rates reached their all-time lows and credit margins have generally contracted over the past 3 years.

<u>We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned (as per our December 2019 Council Rankings), earning on average, around $40,000 in additional interest income compared to its peers</u>. We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio. Of the 26 individual deposits North Sydney Council held, 6 are still yielding higher than 2½% p.a. That is, around 23% of outstanding deposits held are earning more than 2⅔ times the prevailing cash rate of 0.75%.

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Council's Term Deposit Portfolio & Recommendation

As at the end of February 2020, Council's deposit portfolio was yielding an **attractive 2.02% p.a.** (unchanged from the previous month), with an average duration of around 578 days (~1.58 years).

Where possible, we recommend Council extends or at least maintains this average duration. In the low interest rate environment, the biggest collective risk that the local government sector has faced over the post-GFC era has been the dramatic fall in interest rates - from 7¼% to the current historical low levels of 0.75% (and likely lower in 2020).

As the past decade has highlighted (post-GFC era), we have seen too many portfolios' roll a high proportion of their deposits between 3-6 months, resulting in their deposits being reinvested at lower prevailing rates. That is, depositors have generally not insured themselves against the low interest rate environment by diversify their funding across various tenors (out to 5 years) but rather placed all their 'eggs in one basket' and kept all their deposits short. **Reinvestment risk has collectively been and continues to be the biggest detriment to depositors' interest income over the post-GFC period**. **Another interest rate cut appears to be imminent over coming months**.

At the time of writing (early March), we see value in:

ADI	LT Credit Rating	Term	T/D Rate
Judo Bank	Unrated ADI	2 years	2.05% p.a.
AMP Bank	BBB+	18 months	^1.80% p.a.
BoQ	BBB+	5 years	1.80% p.a.
BoQ	BBB+	4 years	1.70% p.a.
Auswide Bank	BBB	2-4 years	1.75% p.a.
Police CU SA	Unrated ADI	3 years	1.64% p.a.
Police CU SA	Unrated ADI	2 years	1.59% p.a.
BoQ	BBB+	3 years	1.50% p.a.
BoQ	BBB+	2 years	1.45% p.a.

^ AMP T/Ds – these are grossed up rates which includes a 0.20% p.a. rebated commission from Imperium Markets

For those investors that have capacity issues with the "BBB" and unrated ADI sector, we see value in:

ADI	LT Credit Rating	Term	T/D Rate
ING Bank Australia	A	2 years	~1.50% p.a.

The above deposits are suitable for investors looking to provide some income protection and mitigate reinvestment/rollover risk in the low interest rate environment, and particularly with a further interest rate cut expected over coming months.

For terms under 12 months, we believe the strongest value is currently being offered by a number of lower and unrated ADIs offering above-market specials (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
AMP Bank	BBB+	6 months	^2.05% p.a.
Judo Bank	Unrated ADI	6, 9 and 12 months	2.00% p.a.
AMP Bank	BBB+	3 months	^1.95% p.a.
Bank of Sydney	Unrated ADI	3 months	1.90% p.a.
AMP Bank	BBB+	12 months	^1.90% p.a.
Warwick CU	Unrated ADI	6-12 months	1.90% p.a.
Bank of Sydney	Unrated ADI	10-12 months	1.70% p.a.
BNK Bank	Unrated ADI	6-12 months	1.65% p.a.
Auswide Bank	BBB	6, 12 months	1.60% p.a.
Auswide Bank	BBB	3 months	1.55% p.a.

^ AMP T/Ds – these are grossed up rates which includes a 0.20% p.a. rebated commission from Imperium Markets

Amongst the higher rated ADIs ("A" rated or higher), the following deposits remain attractive for terms under 12 months:

ADI	LT Credit Rating	Term	T/D Rate
Macquarie Bank	A+	3, 4 months	1.70% p.a.
Macquarie Bank	A+	6 months	1.65% p.a.
Macquarie Bank	A	9 months	1.60% p.a.
ING Bank Australia	A	12 months	1.50% p.a.
ING Bank Australia	A	6-11 months	1.40% p.a.
NAB	AA-	3-4 months	1.40% p.a.
NAB	AA-	6-8 months	1.35% p.a.

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Senior FRNs & Recommendations

Over February, amongst the senior major bank FRNs, physical credit securities were marked around 5bp at the longer end of the curve (3-5 years) in the "risk-off" environment. Those investors that require liquidity with a domestic major bank (highly rated) and can roll down the curve should invest in 5 year terms over 3 year terms (or shorter), given the ability to lock in capital gains as early as two years after being launched. **The grossed up return would be closer to around +100-105bp over a 2 year holding period in a relatively stable credit environment**. Spreads have since widened by another 5bp heading into March.

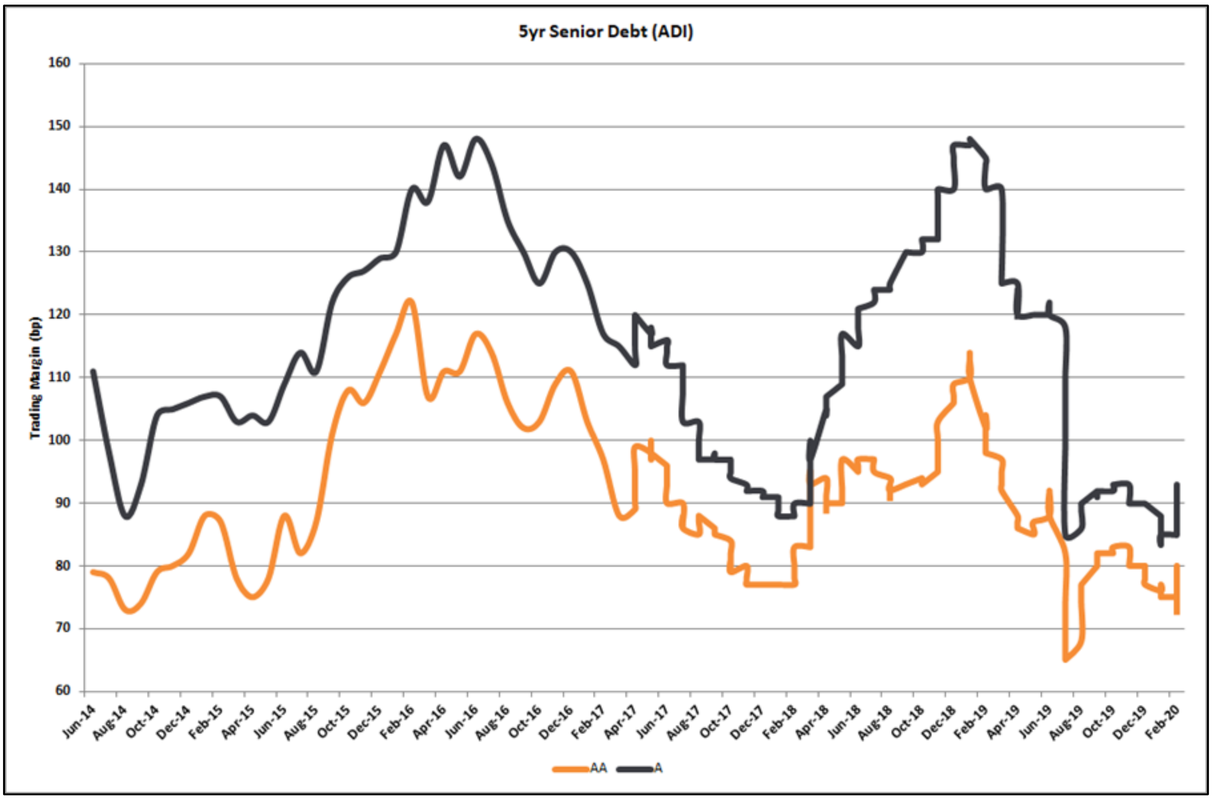
Collectively over the month, the "A" rated sector was marked around 8bp wider at the longer-end of the curve (3-5 years). During the month, there were new issuances from Macquarie Bank (A+) for 5 years at +84bp and ICBC (A) for 3 years at +77bp.

Amongst the "BBB" rated sector, there were new 3 year senior issuances from CUA (BBB) at +90bp and RACQ Bank (BBB+) at +93bp. At month-end, the 3 year part of the curve was marked around +100bp, widening around 6bp for the month. There remains little turnover in the secondary market amongst the lower rated ADI sectors.

Despite the widening over the month, credit remains tight on a historical basis. With a further rate cut priced in over coming months, any medium-longer-dated fixed deposits offered above +100-110bp should be considered. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	28/02/2020	31/01/2020
"AA" rated – 5yrs	+80bp	+75bp
"AA" rated – 3yrs	+63bp	+58bp
"A" rated – 5yrs	+93bp	+85bp
"A" rated – 3yrs	+78bp	+70bp
"BBB" rated – 3yrs	+100bp	+94bp

Source: IBS Capital



Source: IBS Capital

We now generally **recommend switches** ('benchmark' issues only) into new primary issues, out of the following senior FRNs that are maturing:

- **On or before early 2023 for the "AA" rated ADIs (domestic major banks)**;
- On or before early 2021 for the "A" rated ADIs; and
- Within 12 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last 1-2 years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current low interest rate environment, any boost in overall returns should be locked in when it is advantageous to do so.

Economic Commentary

International Market

COVID-19 was at the forefront of investors' minds with a jump in news cases reported outside China, from South Korea, the Middle-East and Italy. Confirmed cases of COVID-19 have extended to over 30 countries, with the total surpassing 80,000 and the worldwide death toll over 2,600.

As a result, financial markets suffered a rout in February as the severity and duration of disruption from the CoVID-19 escalated. In US equity markets, **the Dow Jones plummeted -10.07%** while the NASDAQ fell -6.38%. Across the main European markets, UK's FTSE fell -9.68%, France's CAC by -8.55% and Germany's DAX by -8.41%. Bond yields fell significantly, hitting all new-time lows on a flight to safety.

Chinese officials were evaluating whether the target for economic growth this year should be softened. The target is normally revealed in March and economists had already expected a softening to "*around 6%*" from 6-6½% in 2019. China has also stated it will halve the tariffs on $75bn of US imports to support growth.

The PBoC provided additional support to its local market by injecting 700bn yuan into the banking system using 7-day reverse repurchase agreements.

In the US, the unemployment rate rose by one-tenth to 3.6% in January, although this came from a rise in the participation rate which rose two-tenths to 63.4%. Wages growth was also stronger than expected at +3.1% y/y against the +3.0% consensus.

US data saw January CPI come in 0.1% below expectations, keeping the annual rate steady at +2.3%.

Germany's Q4 GDP printed at +0.0% quarter-on-quarter, against expectation of a +0.1%.

Japanese Q4 GDP surprised sharply to the downside, coming in at -1.6% q/q against -1.0% expected. The sharper than expected fall came mainly from October's consumption tax increase and Typhoon Hagibis: consumption was -2.9% q/q, though business investment was also weaker than expected at -3.7% q/q.

A shaky budget outlook for Britain after UK chancellor Sajid Javid resigned during a confrontation with prime minister Boris Johnson over whom should control the country's economy. The replacement Rishi Sunak comes with expectations of a loosening in Britain's fiscal regime.

The MSCI World ex-Aus Index fell -8.53% for the month of February:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-8.41%	-5.95%	+6.10%	+7.72%	+7.02%	+10.34%
MSCI World ex-AUS	-8.53%	-6.51%	+2.84%	+5.40%	+4.02%	+6.79%
S&P ASX 200 Accum. Index	-7.69%	-5.18%	+8.64%	+8.59%	+6.17%	+7.98%

Source: S&P, MSCI

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Domestic Market

The RBA kept the cash rate unchanged at 0.75% for its first meeting in 2020. The Board said it decided to hold rates steady given they were already at a very low level and reiterated the long and variable lags of the transmission of monetary policy. **The Board retained an easing bias**, adding that it would "*continue to monitor developments carefully, including in the labour market*".

The RBA's subsequent Minutes reaffirmed their view that further cuts remained on the table to "*speed progress towards the Bank's goals and make it more assured in the face of the current uncertainties*."

Retail sales rose by +0.5% in Q4, beating market expectations, and marking the largest quarterly increase since Q2 2018. Meanwhile, the trade surplus fell to $5.2b in December, from a downwardly-revised $5.5b in November. Exports rose by 1.4%, while imports rose by 2.4%.

Home loan approvals recorded a strong rise of +4.4% in December, with strength in both owner-occupiers (+5%) and investors (+3%). Owner-occupier approvals are now just 3% below their August 2017 peak, having risen 23% from the trough in May 2019.

Governor Lowe has emphasised the economic headwinds faced in Australia, reiterating the prolonged low interest rate environment over the long term.

The wage price index printed another quarter of +0.5% growth for the third quarter in a row, meeting the market and RBA expectations, keeping **annual wages growth at +2.2%**.

The unemployment rate ticked up to 5.3% in January (from 5.1% in December). The participation rate rose 0.1% to 66.1%, while the underemployment rate rose by 0.3% to 8.6%. The Australian dollar subsequently fell to an 11-year low – its lowest level since the GFC.

Total construction fell by -3% in Q4, much weaker than market forecasts. For Q4 GDP private construction fell by -4.2% in Q4, the weakest outcome since Q3 2018.

The AUD fell to an 11-year low of US65.24 cents, down 3% for the month (from US67.24 cents).

Credit Market

The main global credit indices widened significantly over February in the "*risk-off*" environment. Spreads were marked between 30-40% wider across the board and now trade at levels last experienced around mid-2019:

Index	February 2020	January 2020
CDX North American 5yr CDS	68bp	51bp
iTraxx Europe 5yr CDS	64bp	46bp
iTraxx Australia 5yr CDS	67bp	52bp

Source: Markit

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Fixed Interest Review

Benchmark Index Returns

Index	February 2020	January 2020
Bloomberg AusBond Bank Bill Index (0+YR)	+0.08%	+0.08%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.86%	+2.33%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.08%	+0.20%
Bloomberg AusBond Credit Index (0+YR)	+0.58%	+1.65%
Bloomberg AusBond Treasury Index (0+YR)	+1.03%	+2.78%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.03%	+3.61%

Source: Bloomberg

Other Key Rates

Index	February 2020	January 2020
RBA Official Cash Rate	0.75%	0.75%
90 Day (3 month) BBSW Rate	0.81%	0.88%
3yr Australian Government Bonds	0.51%	0.62%
10yr Australian Government Bonds	0.81%	0.96%
US Fed Funds Rate	1.50%-1.75%	1.50%-1.75%
10yr US Treasury Bonds	1.13%	1.51%

Source: RBA, AFMA, US Department of Treasury

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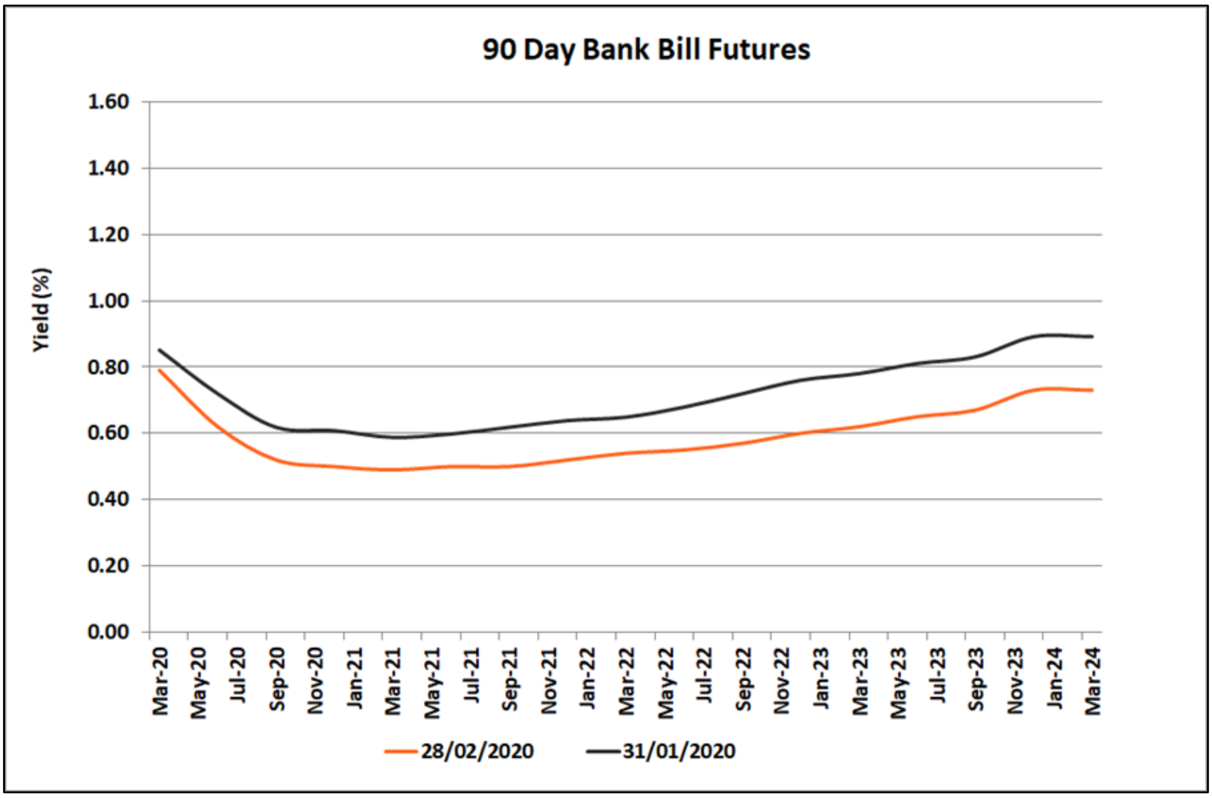
90 Day Bill Futures

Over February, bill futures fell significantly across the board, with bond yields setting new lows. **At month-end, a further 25bp rate cut was all but priced in within 3 months, with some calling for an earlier cut as the repercussions of the CoVID-19 continue to escalate.**



Source: ASX

Fixed Interest Outlook

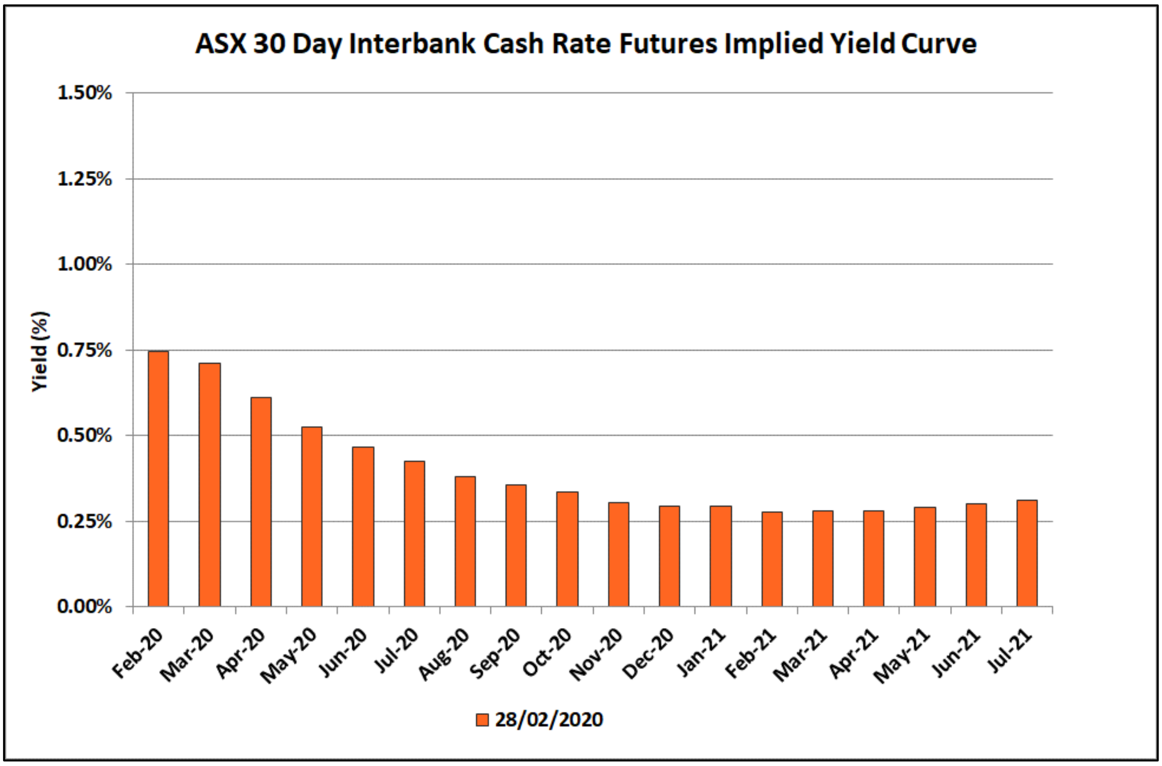
In early February, US Fed Chair Powell repeated his mantra of a need for a material change in the outlook in order for the Fed to deviate from a neutral policy stance in 2020. It was in stark contrast to his comments at the end of the month pledging to "*use our tools*" to backstop the US economy as the coronavirus fears "*poses evolving risks to economic activity*".

The market was quick to react on the Fed's rhetoric, with the futures market pricing in around a 95% chance that the US Fed will cut rates by 50bp on 18th March (5% chance it will cut rates by 25bp).

Domestically, the RBA remains on an easing bias to target 'full employment' (an unemployment rate of around 4½%). They have repeatedly indicated to expect an **"*extended period*" of low interest rates in order to achieve full employment and progress towards their inflation target**. With the higher unemployment reading in January's figures, should the level of unemployment remain or increase even further, this may force the Board's hand to ease further.

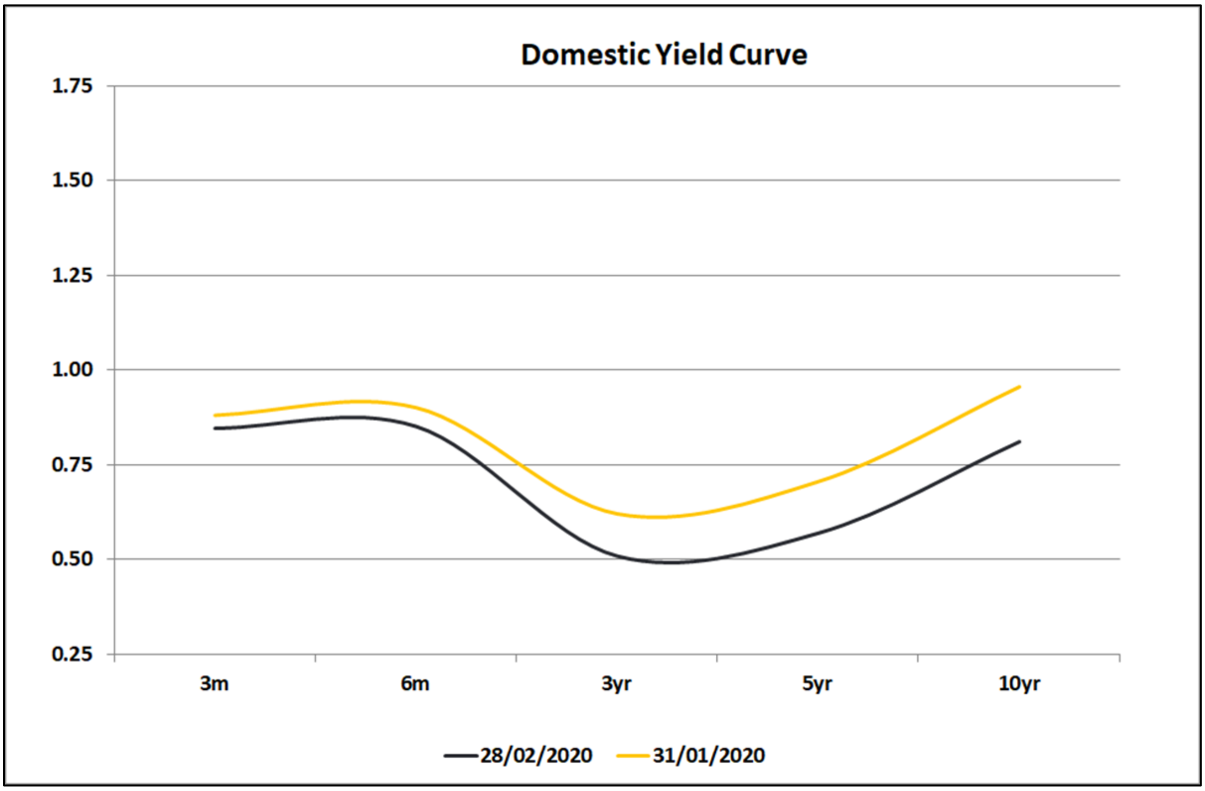
The global key risks for the RBA stem from the impact of ongoing trade and technology disputes, geo-political uncertainty and other negative externalities (e.g. pandemics such as the coronavirus). In Australia, they are closely monitoring employment, inflation, wage growth, housing and consumption, and the impact of the recent bushfires and floods. Should these areas continue to show signs of softening, **the RBA remains on hand to adjust the official cash rate lower if required**.

<u>The futures market continues to fully factor in the next 25bp rate cut over coming months, with some anticipating it may be delivered as early as 3rd March, as the effects of the CoVID-19 disrupts global growth</u>:



Source: ASX

Over the longer-term, the domestic bond market continues to suggest a 'lower-for-longer' period of interest rates. Over the month, yields fell significantly, up to 15bp at the longer end of the curve, with 10-year government bond yields trading at all-time lows (around 0.8%):



Source: AFMA, ASX, RBA

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