Report to General Manager

Attachments:
1. Monthly Investment Report as at 30 September 2019

SUBJECT: Investments and Loan Borrowings Held as at 30 September 2019

AUTHOR: Garry Ross, Manager Financial Services

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 30 September 2019.

Investment Portfolio:
The Investment portfolio provided an annualised return of 2.88% for the year to date as at 30 September 2019, 1.14% above the reportable BBSW Bank Bill Index.

Borrowings:
Council entered into a fixed interest loan of $9.5 million with quarterly interest on principal payments on 3 July 2018. The principal outstanding as at 31 July 2019 is $8.7 million and the next quarterly instalment is due on 31 October 2019.

FINANCIAL IMPLICATIONS:

The 2019/20 budgeted returns on investments is estimated to be $1,500,000.00. 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 30 September 2019 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 against the BBSV bank bill index for the month of September 2019 and annualised for the year to date as at 30 September 2019 (including investments which have matured prior to 30 September 2019).

	September 2019	Annualised YTD as at 30 September 2019
Actual Return	0.19%	2.88%
Benchmark	0.08%	1.74%
Variance	0.11%	1.14%

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 30 September 2019 have been reviewed and are $124,445 greater than the revised budget.

Summary of Returns from Investments:

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (September)	YTD/Annual Actual (September)	YTD Budget to Actual Variance (September)
2019/20	**$1,500,000**	**$1,500,000**	**$394,000**	**$518,445**	**$124,445**
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

Distribution of Investments

The distribution of investments across each rating category as at 30 September 2019 is tabulated below:

Long Term Rating Range	Maximum Policy Holding	Distribution as at 30 September
AAA Category	100.00%	
AA Category	100.00%	56.19%
A Category	60.00%	7.27%
BBB Category	35.00%	32.52%
Unrated ADIs (NR)	10.00%	4.02%

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**

The next loan instalment is due on 31 October 2019.

Loan Funded Capital Projects as at 30 September 2019:

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

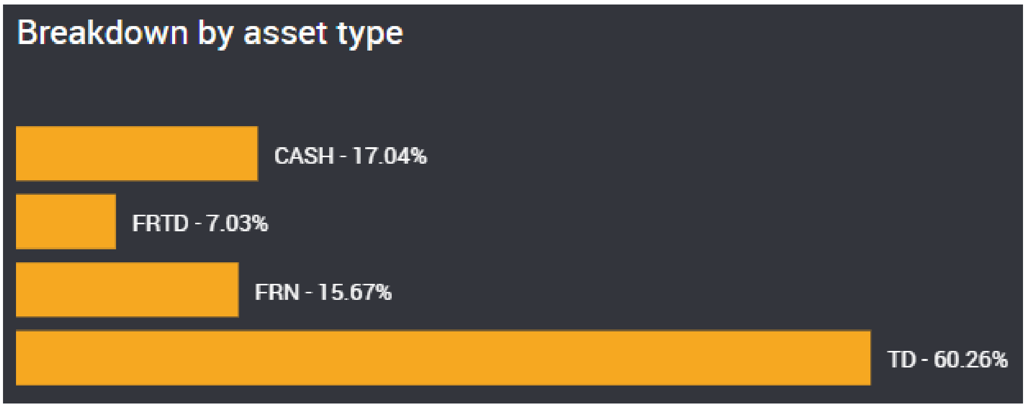
September 2019

Council's Portfolio & Compliance

Asset Allocation

As at the end of September 2019, the portfolio was mainly directed to fixed and floating rate term deposits (67%). The remaining portfolio is directed to FRNs (16%) and overnight cash accounts (17%).

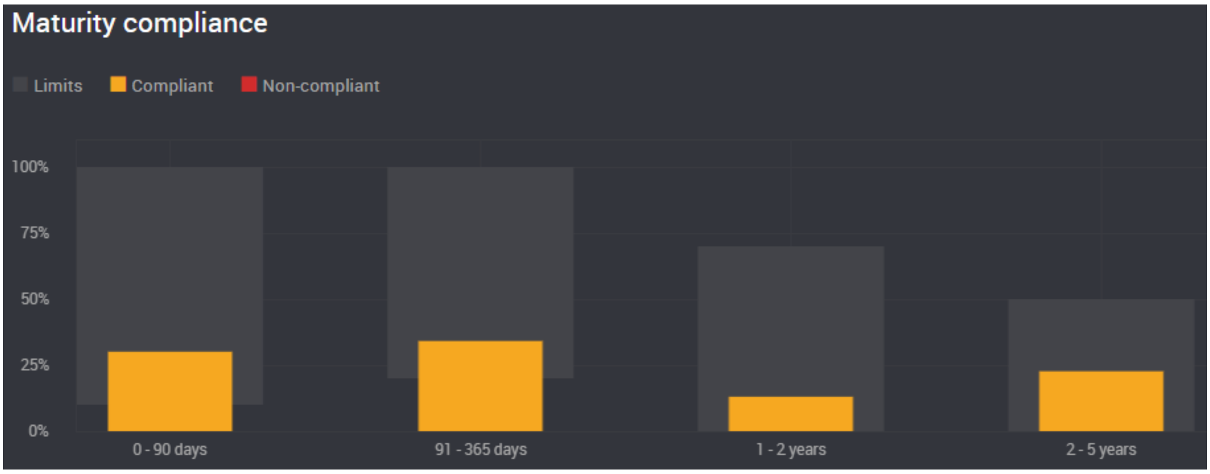
Should credit securities become more attractive relative to deposits, Council may increase its allocation to liquid senior floating rate notes (FRNs). This will not only offer potential upside with regards to the portfolio's investment returns, but also provide additional liquidity (FRNs are saleable – generally accessible within 2 business days). With further rate cuts on the horizon, 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 23% of assets directed to medium-term (2-5 years). There is now high capacity to invest in the medium-term horizon (2-5 years) following the capital outflows experienced over 2017-2018.

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	$29,969,038	30.10%	10%	100%	$69,607,043
✓	91 – 365 days	$34,008,290	34.15%	20%	100%	$65,567,791
✓	1 – 2 years	$13,003,490	13.06%	0%	70%	$56,699,767
✓	2 – 5 years	$22,595,263	22.69%	0%	50%	$27,192,778
✓	5 – 10 years	$0	0.00%	0%	25%	$24,894,020
		$99,576,081	**100.00%**			

Counterparty

As at the end of September, all counterparties were within Policy limits, expect for AMP Bank by ~$1.1m and BoQ (BBB+) by ~$42k. This can easily be rectified as approximately $3.1m is held in a 31-day Cash Notice Account.

On 27th August, 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. Council can also redeem $3m out of their 31-day Cash Notice Account to rebalance the portfolio accordingly.

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

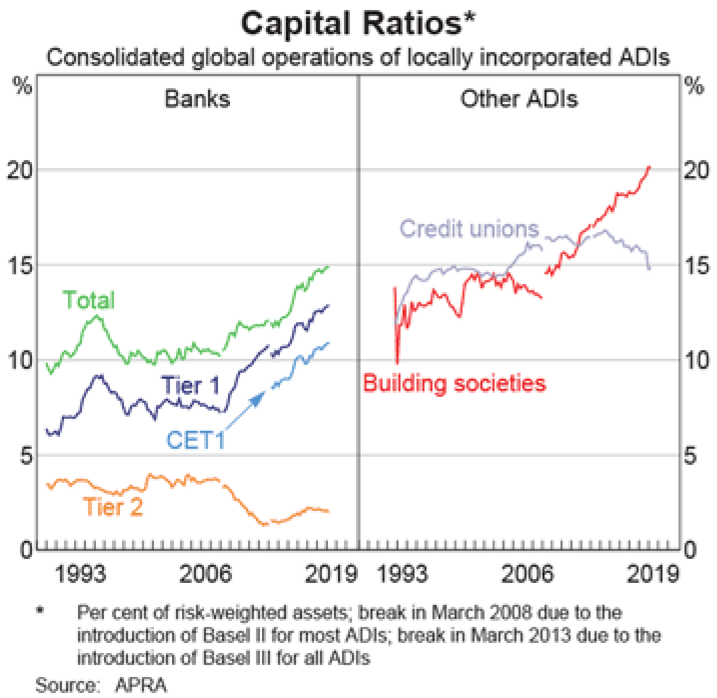
Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	ANZ	AA-	$2,024,230	2.03%	30.00%	$27,848,594
✓	CBA (BankWest)	AA-	$15,883,208	15.95%	30.00%	$13,989,616
✓	NAB	AA-	$23,040,725	23.14%	30.00%	$6,832,099
✓	Westpac	AA-	$15,000,000	15.06%	30.00%	$14,872,824
✓	Suncorp	A+	$7,244,144	7.27%	15.00%	$7,692,268
X	AMP Bank	BBB+	$11,121,928	11.17%	10.00%	**-$1,164,320**
X	BOQ	BBB+	$10,000,000	10.04%	10.00%	**-$42,392**
✓	Auswide Bank	BBB	$6,000,000	6.03%	10.00%	$3,957,608
✓	Newcastle PBS	BBB	$2,008,290	2.02%	10.00%	$7,949,318
✓	ME Bank	BBB	$3,253,556	3.27%	10.00%	$6,704,052
✓	The Mutual	Unrated	$3,000,000	3.01%	5.00%	$1,978,804
✓	WAW CU	Unrated	$1,000,000	1.00%	5.00%	$3,978,804
			$99,576,081	**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 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.



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

Credit Quality

The portfolio remains well diversified from a credit ratings perspective. As at the end of September 2019, 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	$55,948,163	56.19%	100%	$43,627,918
✓	A Category	$7,244,144	7.27%	60%	$52,501,505
✓	BBB Category	$32,383,774	32.52%	35%	$2,467,854
✓	Unrated ADIs	$4,000,000	4.02%	10%	$5,957,608
		$99,576,081	**100.00%**		

Performance

Council's performance for the month ending 30 September 2019 is summarised as follows:

Performance	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.08%	0.25%	0.60%	0.25%	1.35%
AusBond Bank Bill Index	0.08%	0.29%	0.74%	0.29%	1.74%
Council's T/D Portfolio	0.20%	0.62%	1.32%	0.62%	2.86%
Council's FRN Portfolio	0.18%	0.57%	1.28%	0.57%	2.93%
Council's Portfolio^	**0.19%**	**0.61%**	**1.31%**	**0.61%**	**2.88%**
Outperformance	**0.11%**	**0.32%**	**0.57%**	**0.32%**	**1.14%**

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

For the month of September, the total investment portfolio (excluding cash) provided a strong return of +0.19% (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 has now started to outperform deposits as shown in the past 12 months returns.

Over the past 12 months, the total portfolio (excluding cash) returned an outstanding +2.88% p.a., outperforming bank bills by 1.14% 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.

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 July 2019 Council Rankings), earning on average, more than $140,000 in additional interest income compared to its peers. 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 22 individual deposits North Sydney Council held, 10 are still yielding higher than 2.50% p.a. That is, around 45% of outstanding deposits held is earning more than 2½ times the prevailing cash rate of 1.00%.

Investors using the Imperium Markets platform have reduced the invisible costs associated with brokerage, and thereby lift client portfolio returns as investors are able to deal in deposits directly with the ADIs and execute at the best price possible. Council has experienced this first hand with its first trades executed since July 2019, earning between 4-6bp above direct rate sheets from the banks.

Council's Term Deposit Portfolio & Recommendation

As at the end of September 2019, Council's deposit portfolio was yielding an **attractive 2.31% p.a.**, with an average duration of around 418 days (~1.15 years).

Where possible, we recommend Council extends 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 1.00% (and likely lower).

As the past decade has highlighted (post-GFC), 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**. **Additional interest rate cuts remain a strong possibility over coming months, starting with one either on 1st October or 5th November**.

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

ADI	LT Credit Rating	Term	T/D Rate
BoQ	BBB+	5 years	2.00% p.a.
BoQ	BBB+	4 years	1.90% p.a.
BoQ	BBB+	3 years	1.80% p.a.
Auswide Bank	BBB	2-3 years	~1.75% p.a.
AMP Bank	BBB+	2-3 years	^1.70% p.a.
BoQ	BBB+	2 years	1.70% 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
ICBC, Sydney Branch	A	2-3 years	~1.65%-1.75% p.a.
Westpac	AA-	2 years	~1.55% 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 further interest rate cuts imminent on the horizon.

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	^1.95% p.a.
AMP Bank	BBB+	7-12 months	^1.90% p.a.
ME Bank	BBB	3-5 months	1.70% p.a.
BoQ	BBB+	6-12 months	1.65% p.a.
Bendigo-Adelaide Bank	BBB+	3-6 months	1.60% 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 and 6 months	1.70% p.a.
ICBC, Sydney Branch	A	12 months	~1.70% p.a.
NAB	AA-	3-4 months	1.68% p.a.
NAB	AA-	6 months	1.65% p.a.
NAB	AA-	12 months	~1.58% p.a.
Westpac	AA-	12 months	~1.56% p.a.

Senior FRNs Review

Over September, amongst the senior major bank FRNs, physical credit securities were marked wider at the longer end of the curve. 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 +115-120bp over a 2 year holding period in a relatively stable credit environment**.

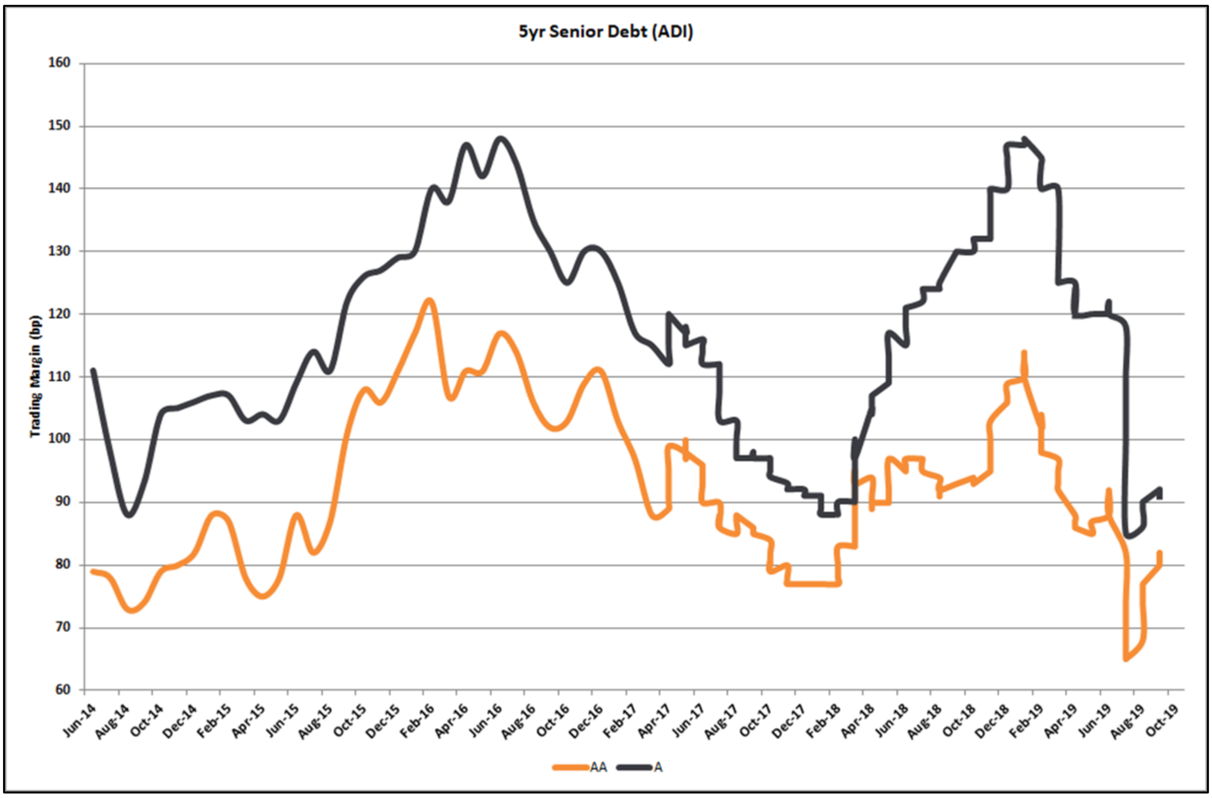
During the month, HSBC Sydney Branch (AA-) priced a dual 3 and 5 year benchmark issue at +63bp and +83bp respectively, which we believed was offered at fair value.

Collectively over the month, the “A” and “BBB” rated cohort were marked marginally wider across 3 and 5 year tenors. There remains little turnover in the secondary market amongst these sectors.

Overall, credit remains tight on a historical basis, reaching their levels experienced in early 2018. With a further rate cut priced in over coming months, any medium-longer-dated fixed deposits offered above +100bp 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)	30/09/2019	31/08/2019
“AA” rated – 5yrs	+82bp	+77bp
“AA” rated – 3yrs	+59bp	+57bp
“A” rated – 5yrs	+92bp	+90bp
“A” rated – 3yrs	+73bp	+72bp
“BBB” rated – 3yrs	+98bp	+97bp

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 2022 for the "AA" rated ADIs (domestic major banks)**;
- On or before 2020 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.

Council FRNs – Sale/Switch Recommendations

At the next best opportunity, we would recommend Council switching out of the following FRN given it is now yielding a low rate to maturity:

- $2.00m Newcastle PBS (BBB) FRN maturing 07/04/2020 (ISIN: AU3FN0026969). Trading margin around **+54bp** or capital price ~$100.41 (capital gain ~**$8,000**).

We can provide a switch recommendation into a new issue when it is advantageous to do so. Council also has the option to redeem this FRN and realise a profit should funds be required at short notice.

Economic Commentary

International Market

With global central banks moving towards an easing bias, this boosted sentiment during September, as most global equity markets returned back to positive territory. **In the US, the S&P 500 Index rose +1.72%**, while the NASDAQ gained **+0.46%**. Across Europe, the main economies also rose, led by Germany's DAX (+4.09%), France's CAC (+3.60%) and UK's FTSE Index (+2.79%).

The US Fed delivered a 25bp rate cut to 1.75%-2.00%, their second cut in over a decade, citing "*global developments for the economic outlook as well as muted inflation pressures*". The median dots do not show any further rate cuts in 2019, although 7 out of 17 officials are favouring one easing. Meanwhile, the US unemployment rate remained steady at 3.7% in August. Core CPI came in at +0.3% (expected +0.2%), to be up +2.4% over the past year (previous highs set in September 2018).

US House Speaker Nancy Pelosi announced a **formal impeachment enquiry for President Trump** which triggered a temporary 'risk off' mood in financial markets.

The US imposed a new round of tariffs on Chinese imports. A 15% duty now applies to $110bn of Chinese imports hitting consumer goods ranging from footwear to technology gadgets such as Apple watch. China responded with its own batch of tariffs expected to hit about $75bn of US goods.

The ECB moved with a 10bp cut to the deposit rate from -40bp to -50bp. They will also restart an open-ended QE bond buying programme at a rate of €20b per month commencing November 1st.

The Bank of England left their policy unchanged, taking the attitude a smooth Brexit would instigate rate hikes. UK inflation was much softer than expected, with annual core CPI down to +1.5%.

UK lawmakers passed a bill to delay Brexit by 327 to 299 votes, with debate moving the House of Lords. The UK's highest court ruled unanimously that the advice Boris Johnson gave the Queen on suspending parliament for five weeks was unlawful.

Recessionary fears in Germany escalated after the German Manufacturing PMI disappointed, coming in at 41.4, the weakest reading in 10 years.

Norway's Norges Bank raised rates to 1.50% from 1.25% in an adverse response to action being taken by other major central banks globally.

China announced a 0.5% cut to RRR for all banks effective 16th September, with a further 1% reduction in two stages for some city commercial banks (from 15th October and 15th November).

The MSCI World ex-AUS rose +1.94% for the month of September.

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+1.72%	+1.19%	+2.15%	+11.14%	+8.58%	+10.91%
MSCI World ex-AUS	+1.94%	+0.15%	-0.21%	+8.24%	+5.29%	+7.02%
S&P ASX 200 Accum. Index	+1.84%	+2.37%	+12.47%	+11.88%	+9.50%	+8.15%

Source: S&P, MSCI

Domestic Market

The RBA kept interest rates unchanged at 1.00% in its meeting in September. **The September Minutes provided a more dovish tone, after the Board dropped the reference (August Minutes) to waiting for an "*accumulation*" of evidence in deciding to cut rates again**. Instead, the Board would "*asses developments in both the international and domestic economies, including labour market conditions, and would ease monetary policy further if needed*".

Governor Lowe commented they are will be looking at the "*accumulation of evidence*" to justify a further rate cut, particularly surrounding the uncertainty around the global outlook.

The July unemployment rate increased from 5.2% to 5.3% and the underemployment rate also jumped from 8.4% to 8.6%. The rise was partly driven by a new all-time high participation rate of 66.2%.

Q2 GDP growth came in at +0.5% q/q, below the RBA's forecast of +0.8% q/q. On an annual basis, GDP came in +1.4%, matching the lowest point reached since the GFC. The industry's that were a drag to GDP came from the drought, weaker manufacturing, construction and retail.

Retail sales missed expectations, falling by -0.1% in July (market expecting +0.2%) after a +0.4% increase in June. This was the first fall since April, with weakness across most categories of sales and states.

The trade surplus fell from a record high of $8.0b in June to $7.3b in July, close to market expectations. Exports increased by a modest +0.6% in July after a +1.4% rise in June, while imports rose +2.9% in July.

The budget is broadly back in balance, the best result since 2007-08. The government announced the final budget outcome for 2018-19, with an underlying cash deficit of $0.7b (+0.0% of GDP), compared with a deficit of $10b in 2017-18 (-0.5% of GDP).

The Australian dollar rebounded +½% this month, finishing at US67.49 cents (from US67.18 cents the previous month).

Credit Market

The main global credit indices widened over September due the ongoing concerns surrounding the outlook for global growth. Credit spreads remain very tight on a historical basis (trading around early 2018 levels):

Index	September 2019	August 2019
CDX North American 5yr CDS	60bp	54bp
iTraxx Europe 5yr CDS	55bp	49bp
iTraxx Australia 5yr CDS	67bp	64bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	September 2019	August 2019
Bloomberg AusBond Bank Bill Index (0+YR)	+0.08%	+0.08%
Bloomberg AusBond Composite Bond Index (0+YR)	-0.49%	+1.51%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.12%	-0.04%
Bloomberg AusBond Credit Index (0+YR)	-0.13%	+0.87%
Bloomberg AusBond Treasury Index (0+YR)	-0.67%	+1.95%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+0.08%	+0.56%

Source: Bloomberg

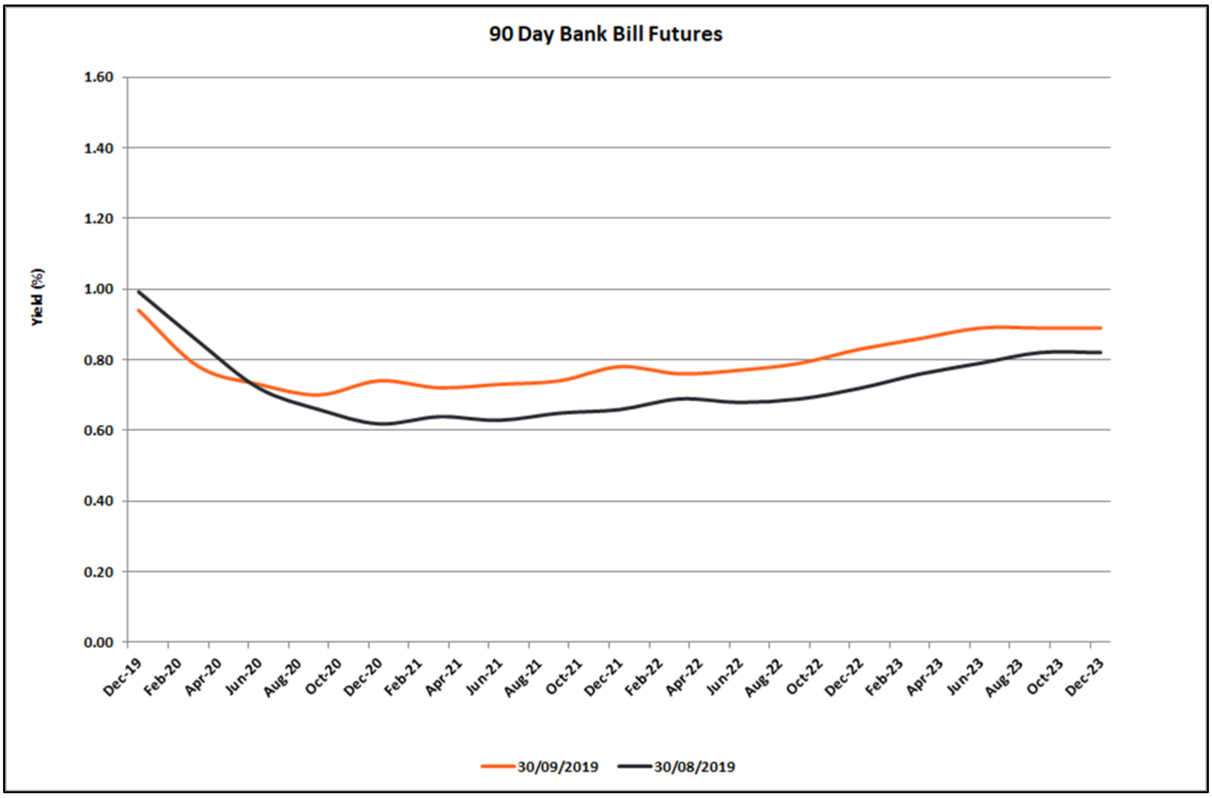
Other Key Rates

Index	September 2019	August 2019
RBA Official Cash Rate	1.00%	1.00%
90 Day (3 month) BBSW Rate	0.95%	0.97%
3yr Australian Government Bonds	0.73%	0.67%
10yr Australian Government Bonds	1.01%	0.89%
US Fed Funds Rate	1.75%-2.00%	2.00%-2.25%
10yr US Treasury Bonds	1.68%	1.50%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over September, bill futures marginally rose across the longer-end of the curve despite ongoing expectations of further rate cuts. **At month-end, the futures market was fully pricing in the next 25bp rate cut by November 2019 (potentially 1st October 2019), and a further 25bp cut by mid-2020, which would take the official cash rate down to 0.50%.**



Source: ASX

Fixed Interest Outlook

With global inflation remaining low and downside risks for global growth increasing (driven by the ongoing trade wars and geopolitics), most global central banks have reverted to an easing bias. After the US Fed cut rates again in mid-September, the market was factoring in around an 67% chance of another 25bp rate cut on 11th December 2019 at month-end.

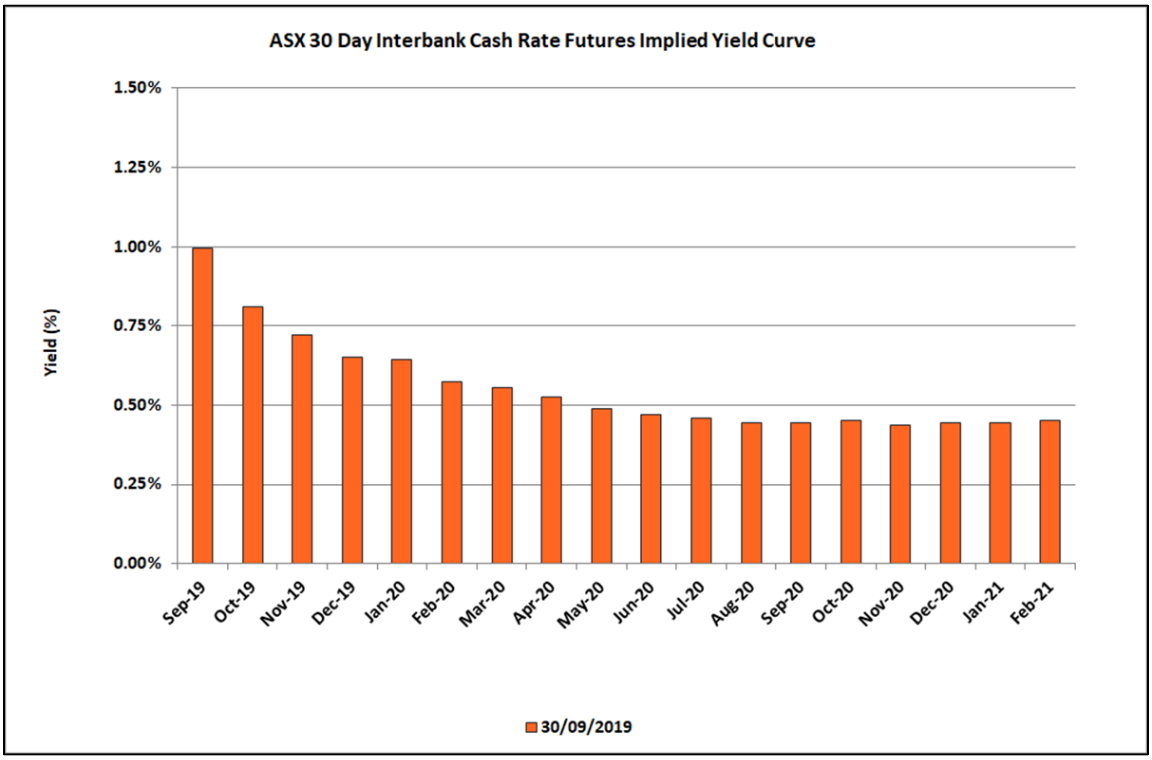
Domestically, the RBA remains on an easing bias looking to address the 'spare capacity' in the economy, particularly following the uptick in the unemployment rate. The RBA has suggested that additional stimulus through further rate cuts may be warranted in order to target full employment. Their forward guidance is now to expect an **"*extended period*" of low interest rates to achieve full employment and progress towards their inflation target**.

The global key risks for the RBA stem from the impact of ongoing trade and technology disputes, softening inflation, political uncertainty (e.g. US, Brexit, Hong Kong, Italy) and a broader slowdown in the global economy. The Board will continue to assess developments in the global and domestic market before considering further rate cuts.

The RBA has discussed unconventional policy measures if rates reached new lows. This includes purchasing of government securities by the RBA to lower the risk-free interest rate, particularly if the labour market continues to show signs of weakness.

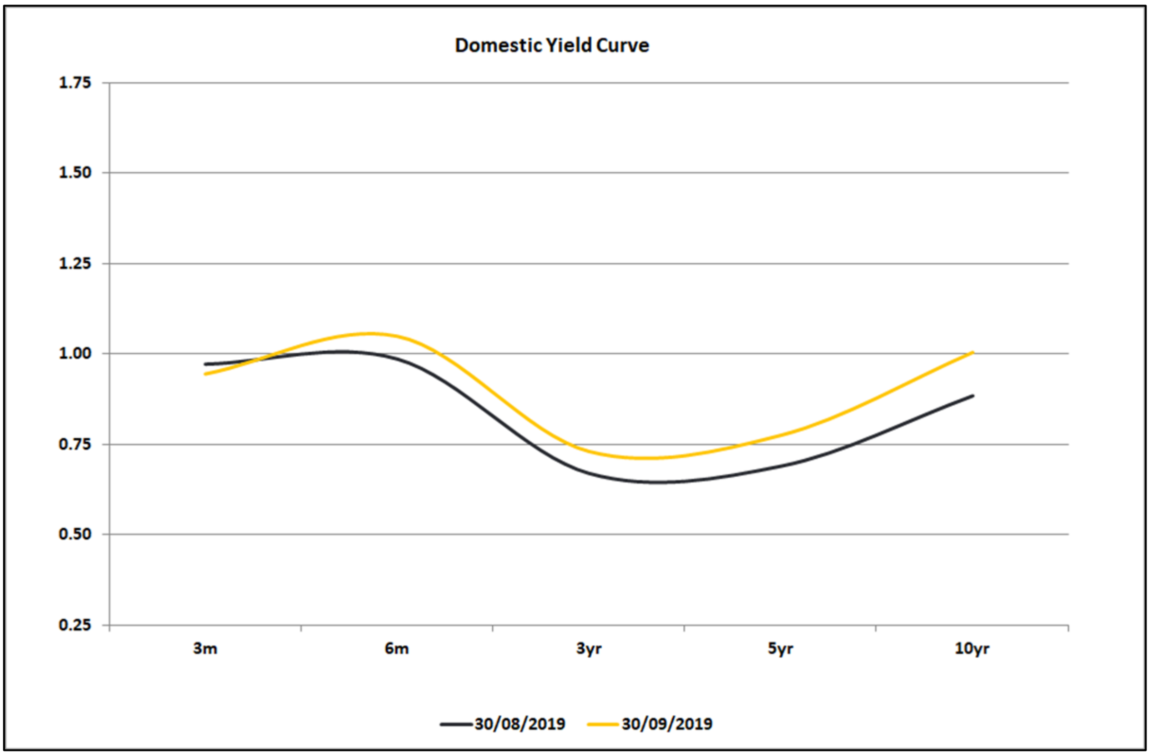
Domestically, they are closely monitoring employment, inflation, wage growth, housing and consumption. Should these areas continue to show signs of softening, **the RBA remains on hand to adjust the official cash rate lower if required**.

The futures market currently prices in around a 78% chance of 25bp rate cut on 1st October 2019, while fully pricing the next cut by 5th November 2019, taking the official cash rate down to 0.75%. An additional 25bp cut is also priced into the market by mid-2020 (down to 0.50%):



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 rose up to 12bp at the longer end of the curve, although 10-year government bond yields remain trading around the 1% level:



Source: AFMA, ASX, RBA

Disclaimer