Report to General Manager

Attachment:
1. Monthly Investment Report as at 31 October 2019

SUBJECT: Investments and Loan Borrowings Held as at 31 October 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 31 October 2019.

Investment Portfolio:
The Investment portfolio provided an annualised return of 2.79% for the year to date as at 31 October 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 and principal payments on 31 July 2018. The principal outstanding as at 31 October 2019 is $8,510,235.19.

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 31 October 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 (excluding cash deposits) against the benchmark for the month of October 2019 and annualized for the year to date as at 31 October 2019 (including investments which have matured prior to 31 October 2019).

	October 2019	Annualised YTD as at 31 October 2019
Actual Return	0.18%	2.79%
Benchmark	0.08%	1.65%
Variance	0.10%	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 31 October 2019 have been reviewed and are $68,597 greater than the revised budget.

Summary of Returns from Investments:

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (October)	YTD/Annual Actual (October)	YTD Budget to Actual Variance (October)
2019/20	**$1,500,000**	**$1,529,055**	**$621,285**	**$689,882**	**$68,597**
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 31 October
AA Category	100.00%	62.97%
A Category	60.00%	4.18%
BBB Category	35.00%	31.87%
Unrated ADIs (NR)	10.00%	0.98%

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**

The next loan instalment is due on 31 January 2020.

Loan Funded Capital Projects as at 31 October 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

October 2019

IMPERIUM MARKETS

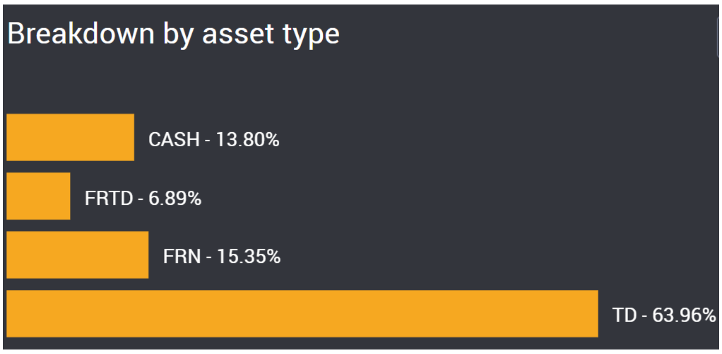
Level 14, 5 Martin Place
Sydney, NSW 2000
Website: https://imperium.markets
Email: michael.chandra@imperium.markets
Phone: +61 2 9053 2987
ABN: 87 616 579 527
ACN: 616 579 527
AFSL No. 429718 (Authorised Representative)
Holder of an Australian Market Licence

Council's Portfolio & Compliance

Asset Allocation

As at the end of October 2019, the portfolio was mainly directed to fixed and floating rate term deposits (70.85%). The remaining portfolio is directed to FRNs (15.35%) and overnight cash accounts (13.80%).

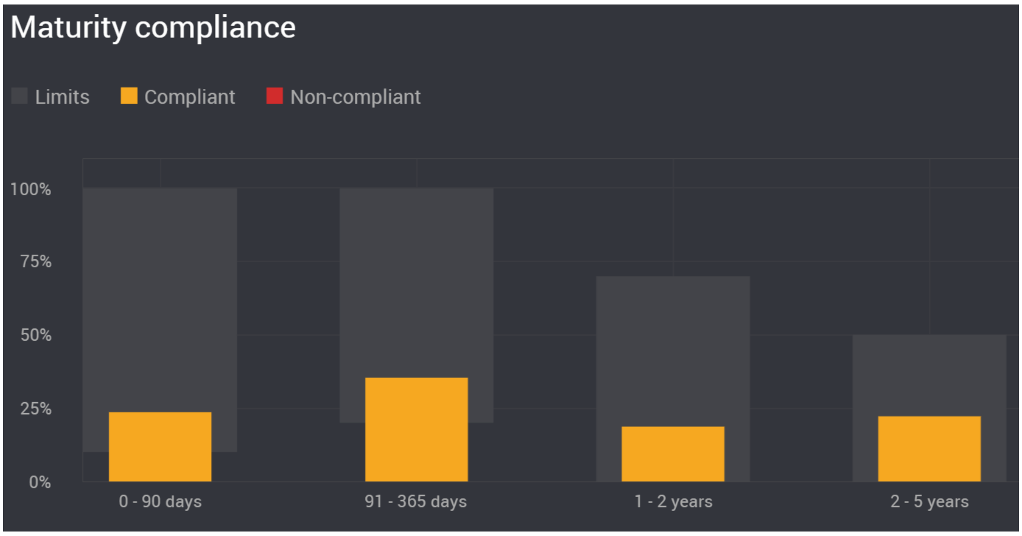
Should credit securities become more attractive relative to deposits, Council may increase its allocation to liquid senior floating rate notes (FRNs). This will not only offer potential upside with regards to the portfolio's investment returns, but also provide additional liquidity (FRNs are saleable – 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 22% of assets directed to medium-term (2-5 years). There is still high capacity to invest in the medium-term horizon, with approximately $28m at month-end.

All minimum and maximum limits comply with the Policy:



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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	$24,027,963	23.64	10	100	$77,603,887
✓	91 – 365 days	$36,006,500	35.43	20	100	$65,625,350
✓	1 – 2 years	$19,003,920	18.70	0	70	$52,138,375
✓	2 – 5 years	$22,593,467	22.23	0	50	$28,222,458
✓	5 – 10 years	$0	0.00	0	25	$25,407,962
		$101,631,850	**100.00%**			

Counterparty

As at the end of October, all counterparties were within Policy limits, although BoQ (BBB+) remains close to capacity limits (around $163k remaining). Limits are also dependent on movements in the overall portfolio's balances.

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.

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-	$2,024,358	1.99%	30.00%	$28,465,197
✓	CBA (BankWest)	AA-	$12,937,069	12.73%	30.00%	$17,552,486
✓	NAB	AA-	$23,039,450	22.67%	30.00%	$7,450,105
✓	Westpac	AA-	$26,000,000	25.58%	30.00%	$4,489,555
✓	Suncorp	A+	$4,244,126	4.18%	15.00%	$11,000,651
✓	AMP Bank	BBB+	$8,126,972	8.00%	10.00%	$2,036,213
✓	BOQ	BBB+	$10,000,000	9.84%	10.00%	$163,185
✓	Auswide Bank	BBB	$9,000,000	8.86%	10.00%	$1,163,185
✓	Newcastle PBS	BBB	$2,006,500	1.97%	10.00%	$8,156,685
✓	ME Bank	BBB	$3,253,375	3.20%	10.00%	$6,909,810
✓	WAW CU	Unrated	$1,000,000	0.98%	5.00%	$4,081,592
			$101,631,850	**100.00%**		

IMPERIUM MARKETS

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.

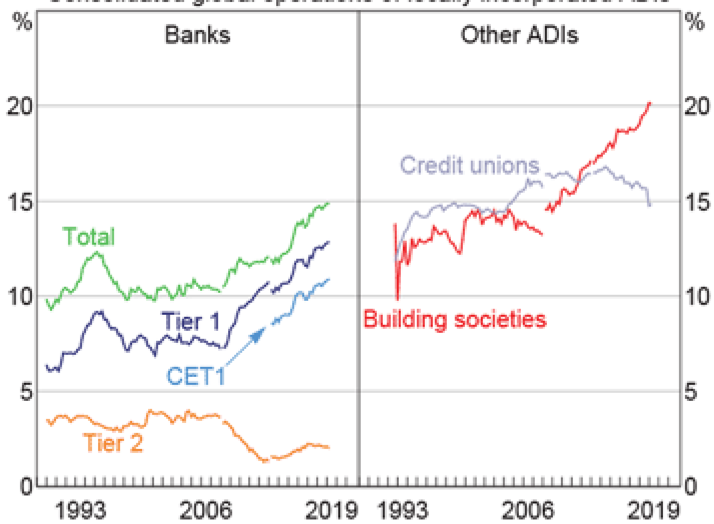
APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned that was previously the case years ago. APRA's stress test which hypothetically increased the unemployment 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.

Capital Ratios*

Consolidated global operations of locally incorporated ADIs



* 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

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 October 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	$64,000,877	62.97%	100%	$37,630,973
✓	A Category	$4,244,126	4.18%	60%	$56,734,984
✓	BBB Category	$32,386,847	31.87%	35%	$3,184,301
✓	Unrated ADIs	$1,000,000	0.98%	10%	$9,163,185
		$101,631,850	**100.00%**		

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Performance

Council's performance for the month ending 31 October 2019 is summarised as follows:

Performance	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.06%	0.23%	0.54%	0.31%	1.29%
AusBond Bank Bill Index	0.08%	0.25%	0.65%	0.37%	1.65%
Council's T/D Portfolio	0.19%	0.59%	1.27%	0.81%	2.78%
Council's FRN Portfolio	0.17%	0.53%	1.20%	0.73%	2.82%
Council's Portfolio^	**0.18%**	**0.58%**	**1.25%**	**0.79%**	**2.79%**
Outperformance	**0.10%**	**0.33%**	**0.60%**	**0.43%**	**1.14%**

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

For the month of October, the total investment portfolio (excluding cash) provided a strong return of +0.18% (actual), outperforming the benchmark AusBond Bank Bill Index return of +0.10% (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 +2.79% 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.

<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 August 2019 Council Rankings), earning on average, more than $120,000 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, 7 are still yielding higher than 2½% p.a. That is, around 27% of outstanding deposits held are earning more than 2⅔ times the prevailing cash rate of 0.75%.

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 October 2019, Council's deposit portfolio was yielding an **attractive 2.12% p.a.**, with an average duration of around 449 days (~1.23 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 0.75% (and potentially lower next year).

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 is still largely priced into the market by mid-2020**.

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

ADI	LT Credit Rating	Term	T/D Rate
BoQ	BBB+	5 years	2.00% p.a.
P&N Bank	BBB	5 years	1.95% p.a.
BoQ	BBB+	4 years	1.90% p.a.
P&N Bank	BBB	4 years	1.80% p.a.
BoQ	BBB+	3 years	1.75% p.a.
BoQ	BBB+	2 years	1.65% p.a.
Auswide Bank	BBB	2-3 years	1.65% p.a.
AMP Bank	BBB+	2-3 years	^1.60% 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 years	~1.70% p.a.
Westpac	AA-	2 years	~1.61% 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+	9, 12 months	^1.85% p.a.
AMP Bank	BBB+	10, 11 months	^1.80% p.a.
MyState Bank	BBB	3 months	1.70% p.a.
MyState Bank	BBB	4 months	1.65% p.a.
BoQ	BBB+	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	1.65% p.a.
ICBC, Sydney Branch	A	12 months	~1.60% p.a.
Westpac	AA-	12 months	~1.60% p.a.
Westpac	AA-	6 months	~1.59% p.a.
Suncorp	A+	6-7 months	~1.58% p.a.
NAB	AA-	3 months	1.58% p.a.

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Senior FRNs Review

Over October, amongst the senior major bank FRNs, physical credit securities were marked marginally 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**.

Collectively over the month, the "A" rated cohort was also marked marginally wider across 3 and 5 year tenors. During the month, Bank of Communications (A-) issued a new 3 year deal at +89bp, printing $350m, which we thought was at fair value.

There were a few issuances in the "BBB" rated sector during the month including:

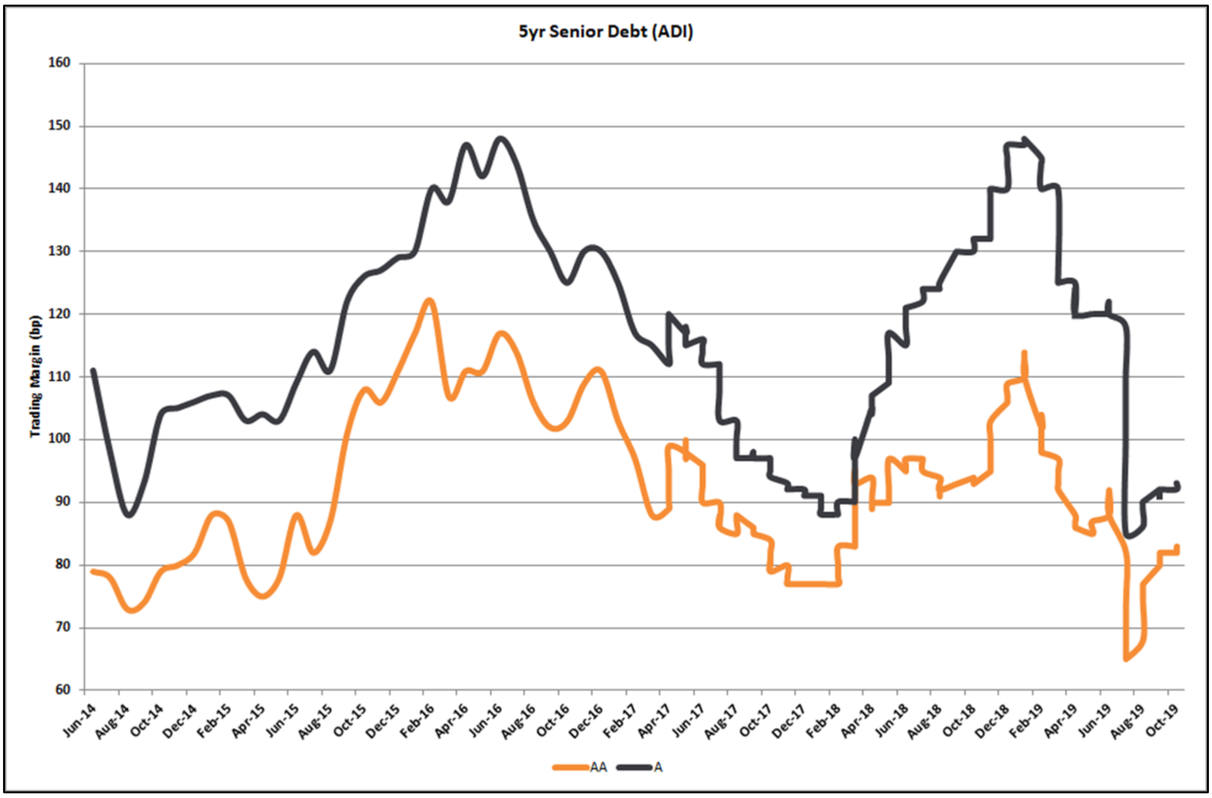
- BoQ (BBB+) 5 years at +110bp, printing $600m
- CUA (BBB) 5 years at +112bp, printing $100m
- Teachers Mutual (BBB) 3 years at +90bp, printing $100m

We saw all three issuances as being offered at fair value. There remains little turnover in the secondary market amongst the lower rated ADI 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)	31/10/2019	30/09/2019
"AA" rated – 5yrs	+83bp	+82bp
"AA" rated – 3yrs	+61bp	+59bp
"A" rated – 5yrs	+93bp	+92bp
"A" rated – 3yrs	+75bp	+73bp
"BBB" rated – 3yrs	+90bp	+98bp

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 **+51.5bp** or capital price ~$100.324 (capital gain ~**$6,480**).

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.

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Economic Commentary

International Market

Financial markets were boosted by prospects of further stimulus by global central banks, although the ongoing trade wars and geopolitics saw further volatility throughout October. In the US, **the S&P 500 Index again surpassed its cyclical highs, gaining another +2.04%** for the month, while the NASDAQ gained +3.66%. Across Europe, the main economies were mixed, with gains in Germany's DAX (+3.53%) and France's CAC (+0.92%), while UK's FTSE Index fell on the back of ongoing Brexit dramas (-2.16%).

The US Fed delivered its third rate cut of the year, lowering its benchmark funds rate to 1.50%-1.75%. The tempered language used by US Fed Chair Powell in providing the Fed's forward guidance was of key interest. The FOMC removed a clause that had appeared in post-meeting statements since June saying it was committed to "*act as appropriate to sustain the expansion*." Instead, officials now "*see the current stance of monetary policy as likely to remain appropriate*".

US jobs report for September revealed that nonfarm payrolls rose +136k and wage growth at +2.9%. **The unemployment rate fell to a 50 year low of 3.5%** (from 3.7%).

US core CPI rose +0.1% m/m in September after a run of three monthly increases of +0.3%, taking the annual rate to +2.4%.

President Trump said he expected to sign the so-called Phase One part of the trade deal with China ahead of schedule but did not elaborate on the timing.

PM Boris Johnson was forced to write to the EU seeking a delay to Brexit, he did but he did not sign the letter. He also attached a second signed letter making it clear that he did not support Parliament's request for an extension.

China's GDP grew by +6.0% over the year for the September quarter, down from +6.2% over the June quarter, marginally below the 6.1% level expected.

Canadian prime minister Trudeau won a second term but fell 15 seats short of a majority and will need support of the minor parties to pass legislation.

The MSCI World ex-AUS rose +2.47% for the month of October.

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+2.04%	+1.92%	+12.02%	+12.63%	+8.52%	+11.35%
MSCI World ex-AUS	+2.47%	+2.19%	+10.45%	+9.86%	+5.71%	+7.50%
S&P ASX 200 Accum. Index	-0.35%	-0.91%	+19.28%	+12.56%	+8.47%	+8.34%

Source: S&P, MSCI

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Domestic Market

The RBA cut the official cash rate by 25bp on 1st October to a record low of 0.75%. The Board justified the move as needed to "*support employment and income growth*" and to provide confidence that it will meet its inflation target, while also noting that it took into account "*lower interest rates globally*".

While the Board continues to note it expects "*an extended period of low interest rates*", it now refers to **the goal of reaching "*full employment*", rather than simply reducing the unemployment rate**, which in turn, suggests they are open to cutting rates if required.

RBA Governor Lowe again highlighted the usefulness of clear communication and structural policies in reducing "*risk premia*", while **suggesting that negative rates would be "*extraordinarily unlikely*" in Australia**.

The unemployment rate ticked down to 5.2% in September, beating market expectations of 5.3%. Underemployment also fell to 8.3% from 8.5%. The participation rate pulled back slightly to 66.1% from its all-time high of 66.2%.

Headline and core inflation printed in line with market forecasts in Q3, with the CPI up +0.5% q/q and +1.7% y/y, with the trimmed mean coming in at +0.4% q/q and +1.6% y/y. The figures were also in line with the RBA's outlook.

The trade balance fell in August to a surplus of $5.9bn from $7.3bn in July, broadly in line with expectations. Exports fell -3% m/m in August, down $1.5bn driven almost entirely by the 10% fall in iron ore on the back of lower iron ore prices.

Capital-city prices rose +1.1% in the month of September, its third consecutive monthly rise after having fallen over 2018/early-2019. The gain was driven by Sydney (+1.7% m/m), Melbourne (+1.7% m/m), and Canberra (+1.0% m/m).

Residential building approvals bounced in September by 7.6% against market expectations of a flat outcome.

The Australian dollar gained +2.6% this month, finishing at US69.26 cents (from US67.49 cents the previous month).

Credit Market

The main global credit indices tightened over October despite the ongoing volatility in financial markets. Credit spreads remain very tight on a historical basis (trading around early 2018 levels):

Index	October 2019	September 2019
CDX North American 5yr CDS	55bp	60bp
iTraxx Europe 5yr CDS	51bp	55bp
iTraxx Australia 5yr CDS	59bp	67bp

Source: Markit

IMPERIUM MARKETS

Fixed Interest Review

Benchmark Index Returns

Index	October 2019	September 2019
Bloomberg AusBond Bank Bill Index (0+YR)	+0.08%	+0.08%
Bloomberg AusBond Composite Bond Index (0+YR)	-0.49%	-0.49%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.14%	+0.12%
Bloomberg AusBond Credit Index (0+YR)	-0.24%	-0.13%
Bloomberg AusBond Treasury Index (0+YR)	-0.66%	-0.67%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.43%	+0.08%

Source: Bloomberg

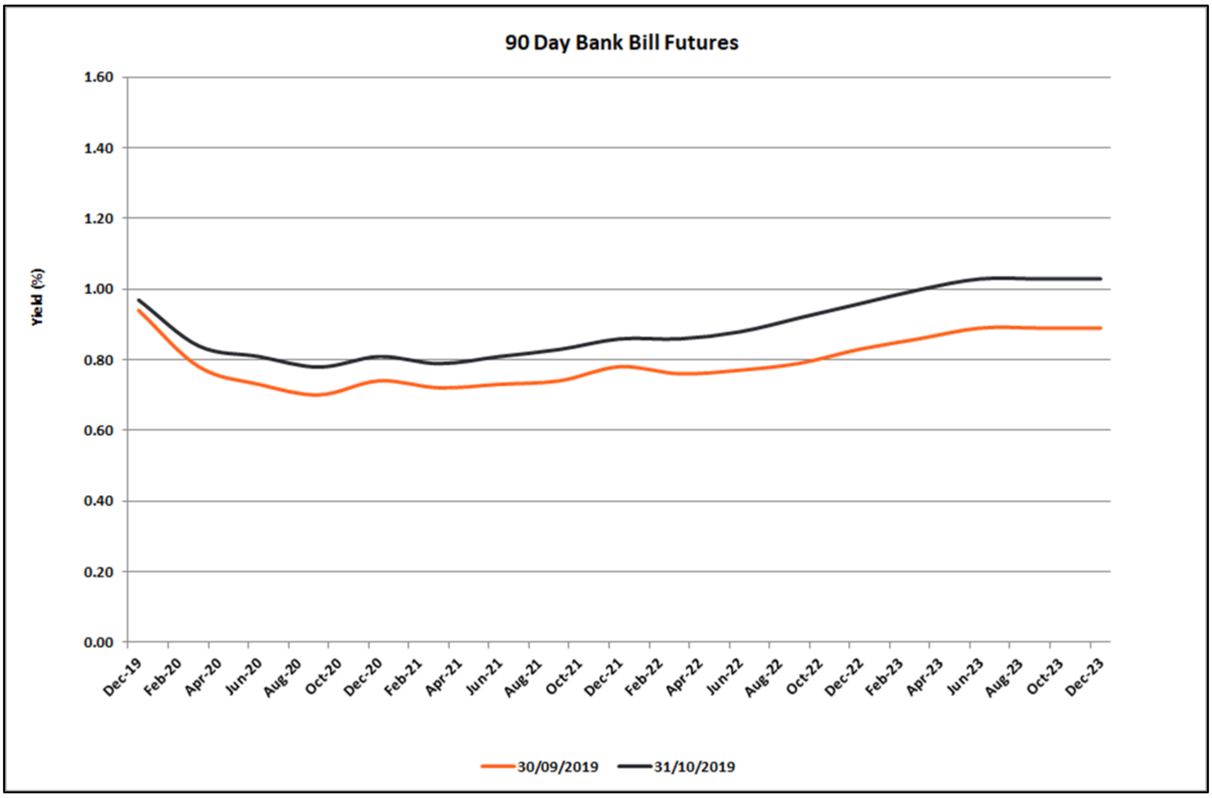
Other Key Rates

Index	October 2019	September 2019
RBA Official Cash Rate	0.75%	1.00%
90 Day (3 month) BBSW Rate	0.93%	0.95%
3yr Australian Government Bonds	0.81%	0.73%
10yr Australian Government Bonds	1.14%	1.01%
US Fed Funds Rate	1.50%-1.75%	1.75%-2.00%
10yr US Treasury Bonds	1.69%	1.68%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over October, bill futures rose across the longer-end of the curve following the movement in the bond market. **At month-end, the futures market was largely pricing in the next 25bp rate cut by mid-2020, which would take the official cash rate down to 0.50%.**



Source: ASX

Fixed Interest Outlook

The ongoing trade wars and geopolitics has resulted in most global central banks recommencing their easing cycle. The pessimistic outlook for global growth has resulted in an increase in negatively yielding bonds globally. Although global central banks have provided further monetary stimulus, and long-term interest rates have now reached unprecedented lows, business investment globally has been weak as organisations remain wary on the prospects for growth.

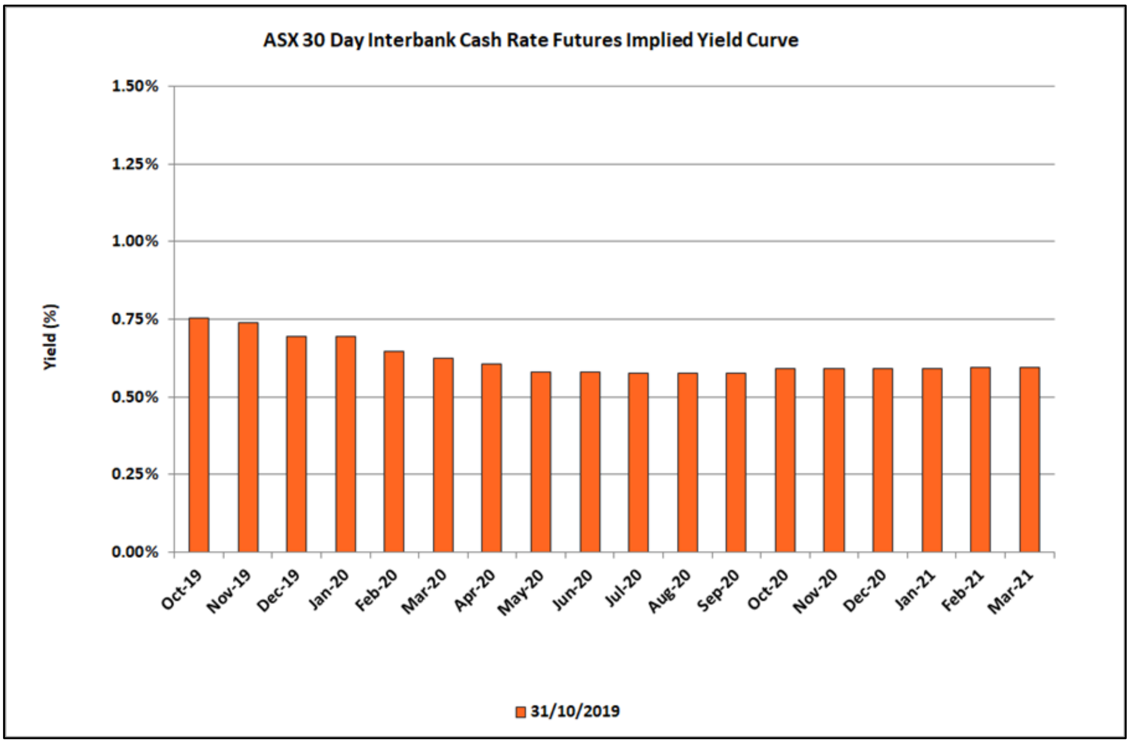
After cutting rates for a third time this year in late October, the US Fed has signalled it may pause from cutting further, providing a more tempered language in its forward guidance, noting "t*he Committee will continue to monitor the implications of incoming information for the economic outlook as it assesses the appropriate path of the target range for the federal funds rate*" and that bank officials "*see the current stance of monetary policy as likely to remain appropriate*".

Domestically, the RBA remains on an easing bias and is now targeting 'full employment', as oppose to merely 'reducing' unemployment. 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**.

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, although this scenario is seen as highly unlikely. Governor Lowe also commented that the potential for negative rates in Australia was "*extraordinarily unlikely*".

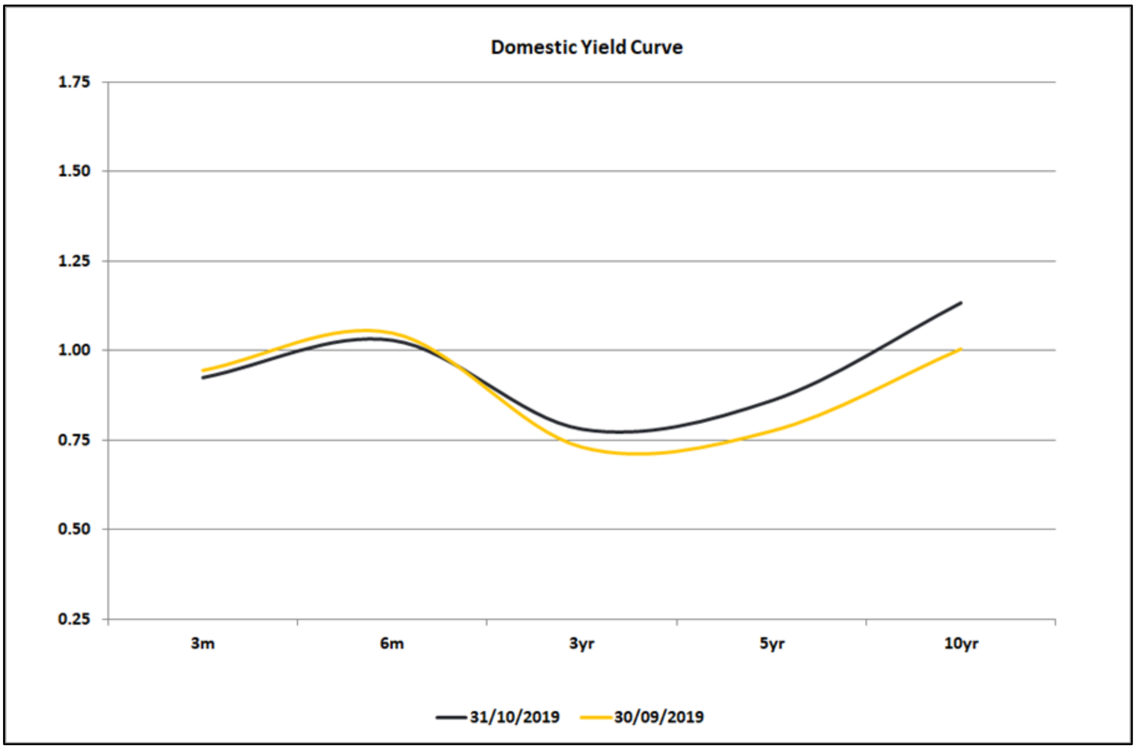
The global key risks for the RBA stem from the impact of ongoing trade and technology disputes, softening inflation, political uncertainty (e.g. US, Brexit, Hong Kong) and a broader slowdown in the global economy. In Australia, they are closely monitoring employment, inflation, wage growth, housing and 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 largely factors in the next 25bp rate cut by mid-2020, potentially taking the official cash rate 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 13bp at the longer end of the curve, with 10-year government bond yields trading just below the 1.2% level:



Source: AFMA, ASX, RBA

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