Report to General Manager

Attachment:
1. Monthly Investment Report as at 31 January 2020

SUBJECT: Investments and Loan Borrowings Held as at 31 January 2020

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 January 2020.

Investment Portfolio:
The Investment portfolio provided an annualised return of 2.52% for the year to date as at 31 January 2020, 1.12% 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 January 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 31 January 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 January 2020 and annualised for the year to date as at 31 January 2020 (including investments which have matured prior to 31 January 2020).

	January 2020	Annualised YTD as at 31 January 2020
Actual Return	0.17%	2.52%
Benchmark	0.08%	1.40%
Variance	0.09%	1.12%

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 January 2020 have been reviewed and are $204,341 greater than the revised budget.

Summary of Returns from Investments:

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (January)	YTD/Annual Actual (January)	YTD Budget to Actual Variance (January)
2019/20	**$1,500,000**	**$1,529,055**	**$978,055**	**$1,182,396**	**$204,341**
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 January 2020
AA Category	100.00%	58.60%
A Category	60.00%	8.01%
BBB Category	35.00%	29.51%
Unrated ADIs (NR)	10.00%	3.88%

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**
01/07/2019	**$ 8,910,951.91**			
31/07/2019	**$ 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 31 January 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

January 2020

IMPERIUM MARKETS

Imperium Markets Pty Ltd ABN: 87 616 579 527
Authorised Representative of Libertas Financial Planning Pty Ltd AFSL 429 718
Phone: +61 2 9053 2987
Email: michael.chandra@imperium.markets
Level 13, 333 George Street, Sydney NSW 2000

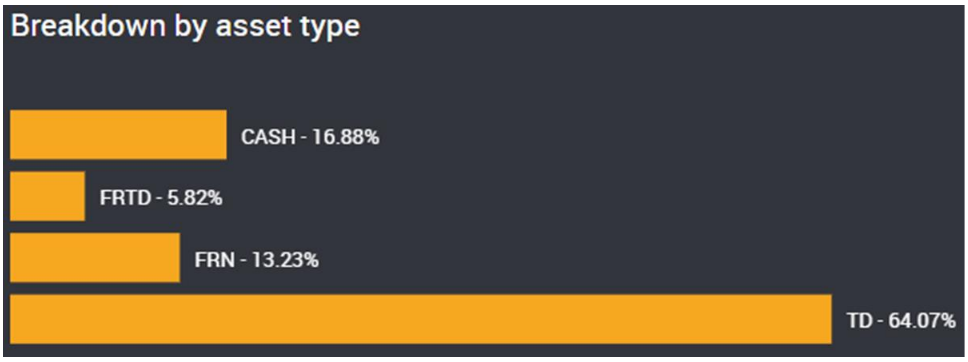
IMPERIUM MARKETS

Council's Portfolio & Compliance

Asset Allocation

As at the end of January 2020, the portfolio was mainly directed to fixed and floating rate term deposits (68.56%). The remaining portfolio is directed to FRNs (14.88%) and overnight cash accounts (16.56%).

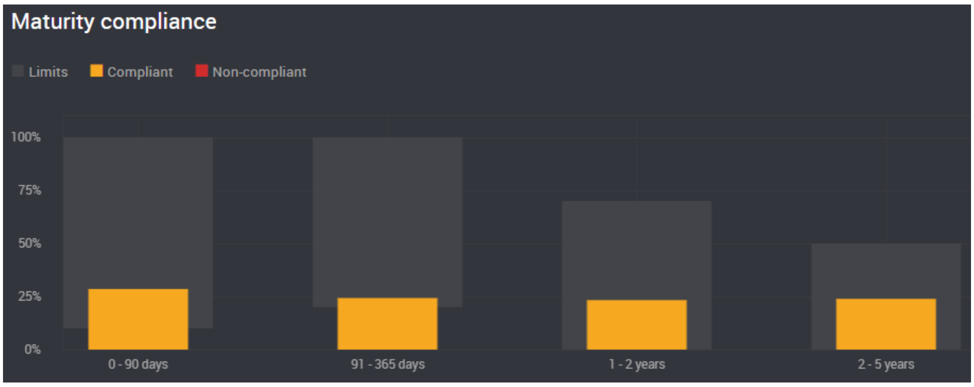
Should credit securities become more attractive relative to deposits, Council may increase its allocation to liquid senior floating rate notes (FRNs). This will not only offer potential upside with regards to the portfolio's investment returns, but also provide additional liquidity (FRNs are saleable – 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 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	$29,385,891	28.53%	10%	100%	$73,625,710
✓	91 - 365 days	$25,000,000	24.27%	20%	100%	$78,011,600
✓	1 - 2 years	$24,004,656	23.30%	0%	70%	$48,103,464
✓	2 - 5 years	$24,621,054	23.90%	0%	50%	$26,884,747
✓	5 - 10 years	$0	0.00%	0%	25%	$25,752,900
		$103,011,600	**100.00%**			

Counterparty

As at the end of January, all counterparties were within Policy limits, although Auswide (BBB) remains close to maximium limits.

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-	$2,028,734	1.97%	30.00%	$28,874,746
✓	CBA (BankWest)	AA-	$16,286,655	15.81%	30.00%	$14,616,825
✓	NAB	AA-	$16,052,975	15.58%	30.00%	$14,850,505
✓	Westpac	AA-	$26,000,000	25.24%	30.00%	$4,903,480
✓	Suncorp	A+	$4,248,548	4.12%	15.00%	$11,203,193
✓	ING Bank	A	$4,000,000	3.88%	15.00%	$11,451,740
✓	AMP Bank	BBB+	$8,140,204	7.90%	10.00%	$2,160,956
✓	BOQ	BBB+	$9,000,000	8.74%	10.00%	$1,301,160
✓	Auswide Bank	BBB	$10,000,000	9.71%	10.00%	$301,160
✓	ME Bank	BBB	$3,254,485	3.16%	10.00%	$7,046,675
✓	Nexus Mutual	Unrated	$3,000,000	2.91%	5.00%	$2,150,580
✓	WAW CU	Unrated	$1,000,000	0.97%	5.00%	$4,150,580
			$103,011,600	**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.

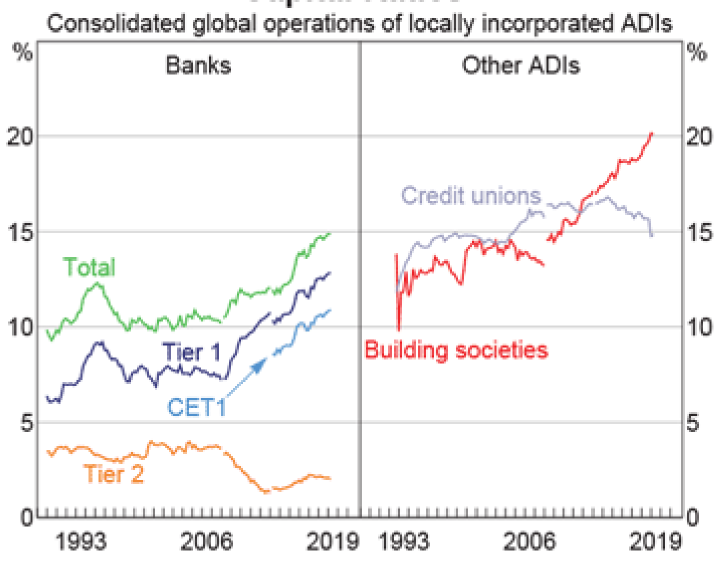
APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned that was previously the case years ago. APRA's stress test which hypothetically increased the unemployment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

Capital Ratios*



* 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

Credit Quality

The portfolio remains well diversified from a credit ratings perspective. As at the end of January 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	$60,368,364	58.60%	100%	$42,643,236
✓	A Category	$8,248,548	8.01%	60%	$53,558,413
✓	BBB Category	$30,394,689	29.51%	35%	$5,659,371
✓	Unrated ADIs	$4,000,000	3.88%	10%	$6,301,160
		$103,011,600	**100.00%**		

Performance

Council's performance for the month ending 31 January 2020 is summarised as follows:

Performance	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.06%	0.19%	0.42%	0.50%	1.10%
AusBond Bank Bill Index	0.08%	0.24%	0.49%	0.61%	1.40%
Council's T/D Portfolio	0.18%	0.53%	1.12%	1.34%	2.52%
Council's FRN Portfolio	0.17%	0.49%	1.03%	1.23%	2.49%
Council's Portfolio^	**0.17%**	**0.52%**	**1.10%**	**1.32%**	**2.52%**
Outperformance	**0.09%**	**0.28%**	**0.61%**	**0.71%**	**1.12%**

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

For the month of January, the total investment portfolio (excluding cash) provided a strong return of +0.17% (actual), outperforming the benchmark AusBond Bank Bill Index return of +0.09% (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.

Over the past 12 months, the total portfolio (excluding cash) returned an outstanding +2.52% p.a., outperforming bank bills by 1.12% 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 October 2019 Council Rankings), earning on average, around $75,000 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 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%.

IMPERIUM MARKETS

Council's Term Deposit Portfolio & Recommendation

As at the end of January 2020, Council's deposit portfolio was yielding an **attractive 2.05% p.a.** (unchanged from the previous month), with an average duration of around 478 days (~1.3 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 potentially 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 is still largely priced in by mid-2020**.

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

ADI	LT Credit Rating	Term	T/D Rate
Judo Bank	Unrated ADI	2 years	2.10% p.a.
BoQ	BBB+	5 years	1.95% p.a.
BoQ	BBB+	4 years	1.85% p.a.
AMP Bank	BBB+	18 months	^1.80% p.a.
Auswide Bank	BBB	2-3 years	1.70% p.a.
BoQ	BBB+	3 years	1.65% p.a.
BoQ	BBB+	2 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
ING Bank Australia	A	2 years	~1.65% 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 a possibility 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	^2.00% p.a.
Bank of Sydney	Unrated ADI	6 months	2.00% p.a.
Judo Bank	Unrated ADI	12 months	2.00% p.a.
AMP Bank	BBB+	3 months	^1.95% p.a.
Judo Bank	Unrated ADI	9 months	1.95% p.a.
AMP Bank	BBB+	9, 12months	1.90% p.a.
Judo Bank	Unrated ADI	6 months	^1.90% p.a.
Bank of Us	Unrated ADI	3-6 months	1.75%-1.80% p.a.
ME Bank	BBB	4-7 months	1.60% p.a.
Bank of Queensland	BBB+	6 months	1.55% p.a.
Australian Military Bank	BBB+	3-6 months	1.55% p.a.
Bendigo-Adelaide	BBB+	5-9 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
ING Bank Australia	A	12 months	1.65% p.a.
Macquarie Bank	A	3, 4 months	1.65% p.a.
ING Bank Australia	A	6-11 months	1.60% p.a.
NAB	AA-	3 months	1.60% p.a.
NAB	AA-	5-6 months	1.55% p.a.
NAB	AA-	12 months	1.48% p.a.

Senior FRNs & Recommendations

Over January, amongst the senior major bank FRNs, physical credit securities were marked around -2bp tighter (at +75bp) at the longer end of the curve (5 years). There were new 5 year benchmark issuances by NAB and ANZ, pricing at +77bp and +76bp respectively. ANZ also issued a 3 year benchmark issue at +62bp.

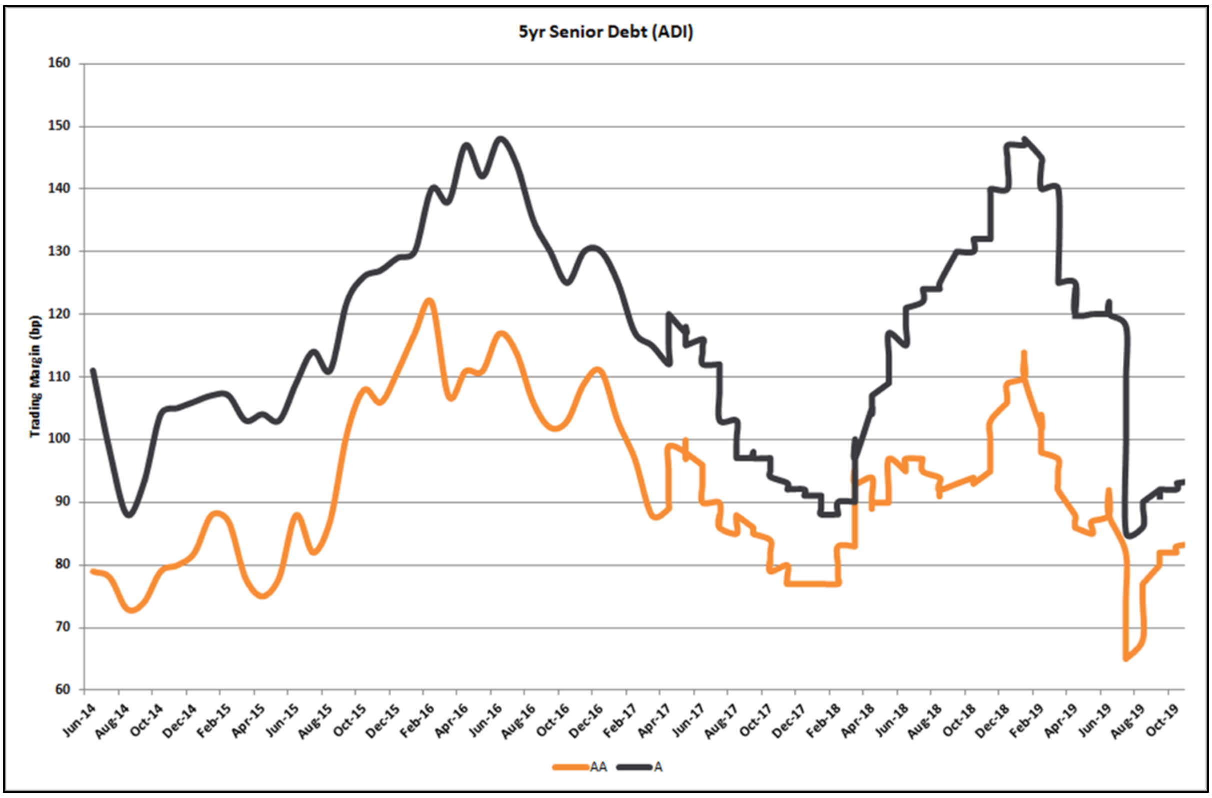
Those investors that require liquidity with a domestic major bank (highly rated) and can roll down the curve should invest in 5 year terms over 3 year terms (or shorter), given the ability to lock in capital gains as early as two years after being launched. **The grossed up return would be closer to around +95-100bp over a 2 year holding period in a relatively stable credit environment**.

Collectively over the month, the "A" rated sector was marked around 3-5bp tighter at the longer-end of the curve. In contrast, the "BBB" rated sector was marked marginally wider after Newcastle PBS (BBB) issued a new 5 year benchmark issue at +112bp, which we thought was priced at a fair level. We expect further issuances with the holiday season now having passed. 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 2020, 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)	31/01/2020	31/12/2019
"AA" rated – 5yrs	+75bp	+77bp
"AA" rated – 3yrs	+58bp	+61bp
"A" rated – 5yrs	+85bp	+90bp
"A" rated – 3yrs	+70bp	+73bp
"BBB" rated – 3yrs	+94bp	+90bp

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.

Council FRNs – Sale/Switch Recommendations

During the month, Council sold out of the following FRN:

- $2.00m Newcastle PBS (BBB) FRN maturing 07/04/2020 (ISIN: AU3FN0026969). Trading margin at **+37bp** or capital price $100.217

Council realised capital gains of $4,340 with the above sale. It then switched proceeds into the newly issued 5 year Newcastle PBS (BBB) FRN at +112bp, resulting in an overall pick-up in yield of around +75bp. *We recommend that Council retains its remaining FRNs at this stage.*

Economic Commentary

International Market

There were fresh geopolitical tensions earlier in the month following the assassination by US forces of Qassem Soleimani, Iran's top military commander. **Global equity markets were also dampened on escalating concerns over the deadly Wuhan coronavirus**, in which the World Health Organisation (WHO) eventually declared a global state of emergency.

In the US, the S&P 500 Index finally ended its rally, finishing the month -0.16% lower. In contrast, the NASDAQ continued its rally gaining +1.99% for the month. Across Europe, the major economies fell across the board led by UK's FTSE (-3.40%), France's CAC (-2.87%) and Germany's DAX (-2.02%).

Phase one of the China-US trade deal was confirmed. The agreement required the US to reduce tariffs from 15% to 7.5% on $120 billion of Chinese imports and refrain from further tariff escalations. In return, the agreement required China to reform its intellectual-property practices and financial markets and to purchase an additional $200 billion of American goods and services.

The US unemployment rate remained steady at 3.5% in December. US core CPI was +0.1% m/m against +0.2% expected, with the annual rate coming in at +2.3% y/y.

The US FOMC statement had minimal changes. The most significant comment was **US Chair Powell indicating that running at inflation below 2% wasn't adequately meeting economic requirements and furthermore that "*2% should never be viewed as the ceiling*"**.

UK CPI came through as its weakest level in three years with core CPI at +1.4% y/y against +1.7% expected.

After a 46 year relationship firmly aligned within the EU, and after more than three years of Brexit talks, deals and political wrangling, **the United Kingdom officially left the European Union on January 31**.

The Eurozone unemployment rate was steady at 7.5% in November, remaining at the lowest level since July 2008.

The IMF trimmed its global growth forecasts for 2020 to 3.3% from 3.4% and 2021 by two-tenths to 3.4% from 3.6%.

China's economy grew by 6.1% in 2019, the lowest growth rate since 1990.

The MSCI World ex-Aus Index fell -0.70% for the month of January:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-0.16%	+6.19%	+19.28%	+12.28%	+10.09%	+11.63%
MSCI World ex-AUS	-0.70%	+4.95%	+15.62%	+9.50%	+7.06%	+7.87%
S&P ASX 200 Accum. Index	+4.98%	+6.08%	+24.72%	+12.36%	+9.33%	+9.08%

Source: S&P, MSCI

IMPERIUM MARKETS

Domestic Market

The RBA is expected to keep the cash rate at 0.75% for its first meeting in 2020 (on 4th February). This comes on the back of a better than expected unemployment rate for December.

The unemployment rate for December ticked down to 5.1% (from 5.2%), with the participation rate remaining flat. The unemployment rate remains well above what the RBA considers to be the full employment rate of 4.5%. The underemployment rate stayed at 8.3%, which has remained relatively flat over the year, ranging from 8.2%-8.5%.

Capital-city prices rose by +1.2% in December, marking the sixth consecutive monthly rise and taking annual growth to +3.0% y/y. Building approvals were up a strong +11.8% in November, easily above the expectations of a modest +2% rise.

The trade surplus rose to $5.8b in November from $4.1b the previous month (revised down from $4.5b), easily beating market expectations of a $4.1b surplus.

Retail sales rose by a strong +0.9% in November, beating market consensus of +0.4%.

PM Scott Morrison announced a $100m stimulus package of grants for farmers, graziers and primary producers affected by the bushfires.

The headline Q4 CPI came in at +0.7% q/q, to be up +1.8% y/y. The trimmed mean CPI came in at +0.4% q/q and +1.6% y/y, which was in line with the RBA's forecast.

The domestic share market continued its rally, with the S&P ASX 200 Accumulation Index gaining close to +5.0% for the month.

The Australian dollar fell over 4% in January, finishing at US67.24 cents, down from US70.06 cents the previous month.

Credit Market

The main global credit indices widened over January in the "*risk-off*" environment. Credit spreads remain very tight on a historical basis (trading around early 2018 levels):

Index	January 2020	December 2019
CDX North American 5yr CDS	51bp	45bp
iTraxx Europe 5yr CDS	46bp	44bp
iTraxx Australia 5yr CDS	52bp	47bp

Source: Markit

IMPERIUM MARKETS

Fixed Interest Review

Benchmark Index Returns

Index	January 2020	December 2019
Bloomberg AusBond Bank Bill Index (0+YR)	+0.08%	+0.07%
Bloomberg AusBond Composite Bond Index (0+YR)	+2.33%	-1.64%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.20%	+0.15%
Bloomberg AusBond Credit Index (0+YR)	+1.65%	-0.85%
Bloomberg AusBond Treasury Index (0+YR)	+2.78%	-2.07%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+3.61%	-2.28%

Source: Bloomberg

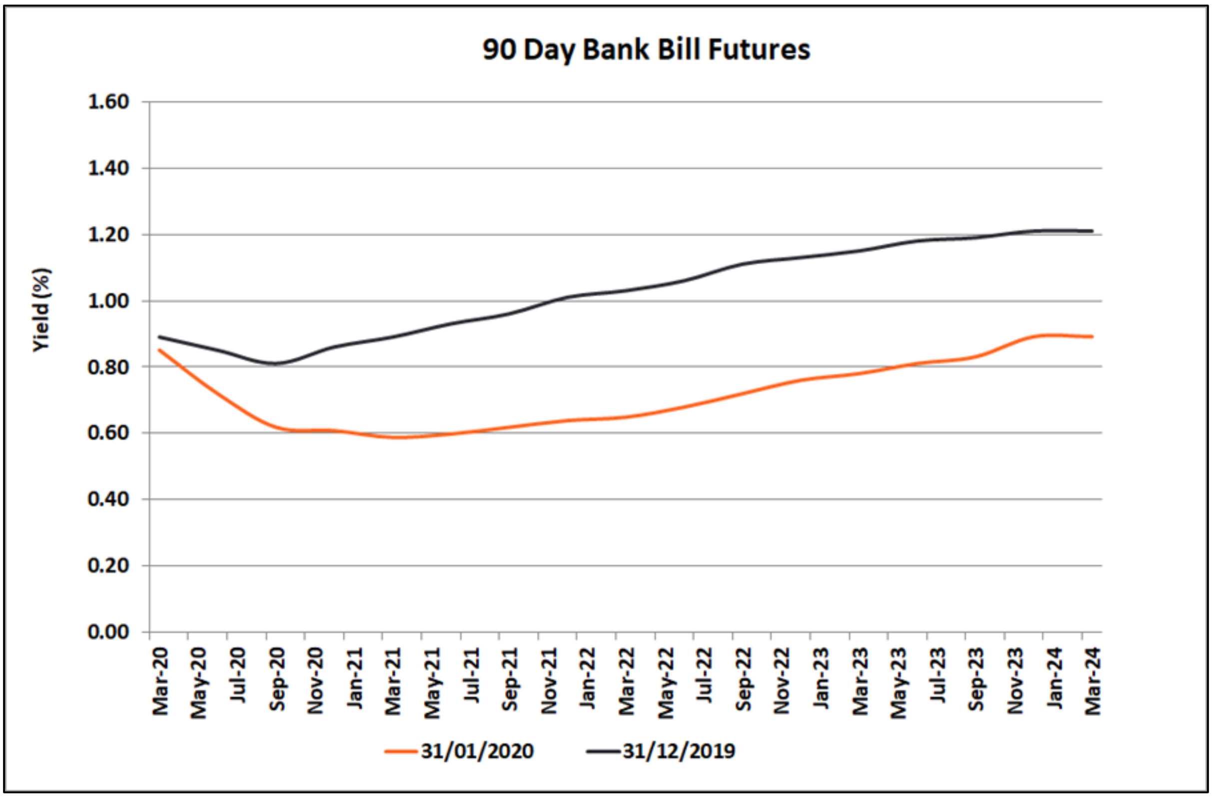
Other Key Rates

Index	January 2020	December 2019
RBA Official Cash Rate	0.75%	0.75%
90 Day (3 month) BBSW Rate	0.88%	0.92%
3yr Australian Government Bonds	0.62%	0.92%
10yr Australian Government Bonds	0.96%	1.37%
US Fed Funds Rate	1.50%-1.75%	1.50%-1.75%
10yr US Treasury Bonds	1.51%	1.92%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over January, bill futures fell significantly across the longer-end of the curve, with yields following the movement in the bond market. **At month-end, the futures market was still largely pricing in another 25bp rate cut by mid-2020, which would take the official cash rate down to 0.50%.**



Source: ASX

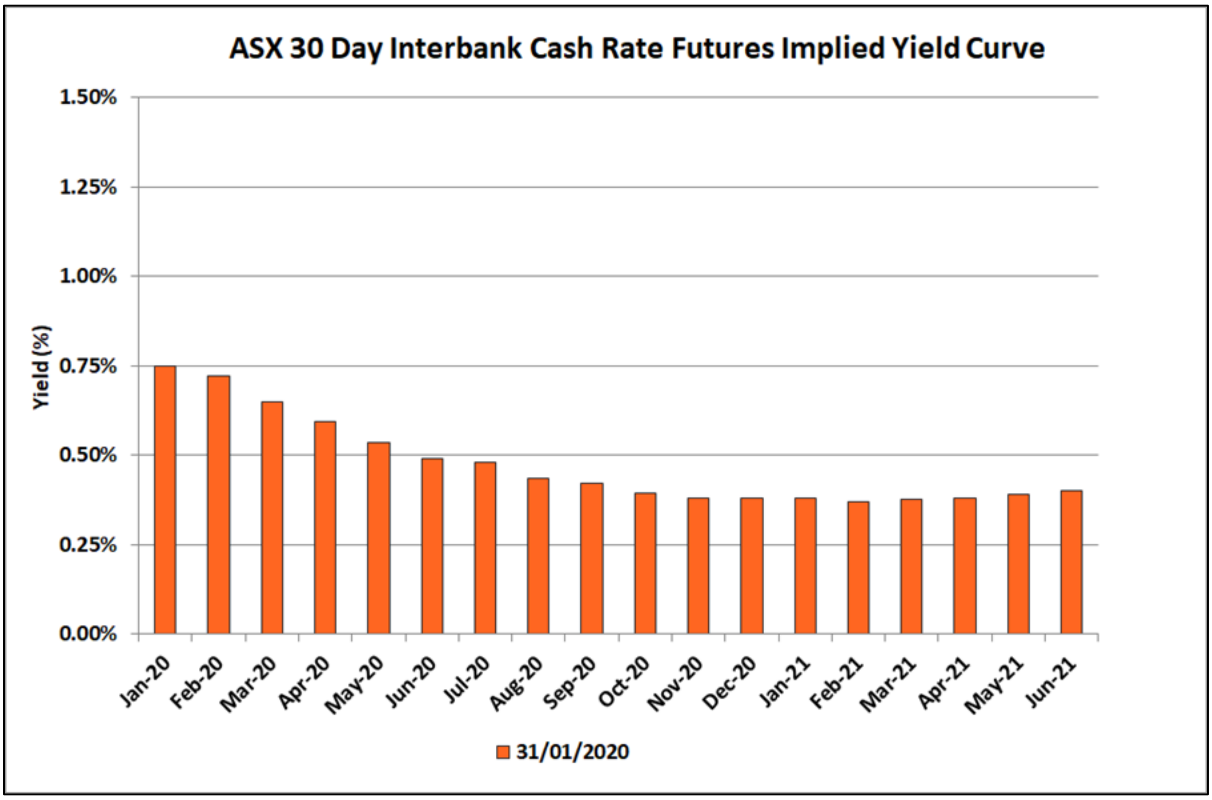
Fixed Interest Outlook

US Fed Chair indicated that the "*Fed is not satisfied with inflation running below 2% and it is not a ceiling*". However, he also remarked there are grounds for "*cautious optimism*", noting supporting financial conditions, easing trade tensions and lower odds of a hard Brexit. There are slightly larger expectations that further rate cuts may be delivered by the Fed to warrant their desire for higher inflation. The market is now pricing in around 1.6 cuts by the end of 2020, rather than the 1.2 prior to their official meeting in January.

Domestically, the RBA remains on an easing bias and is targeting '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**.

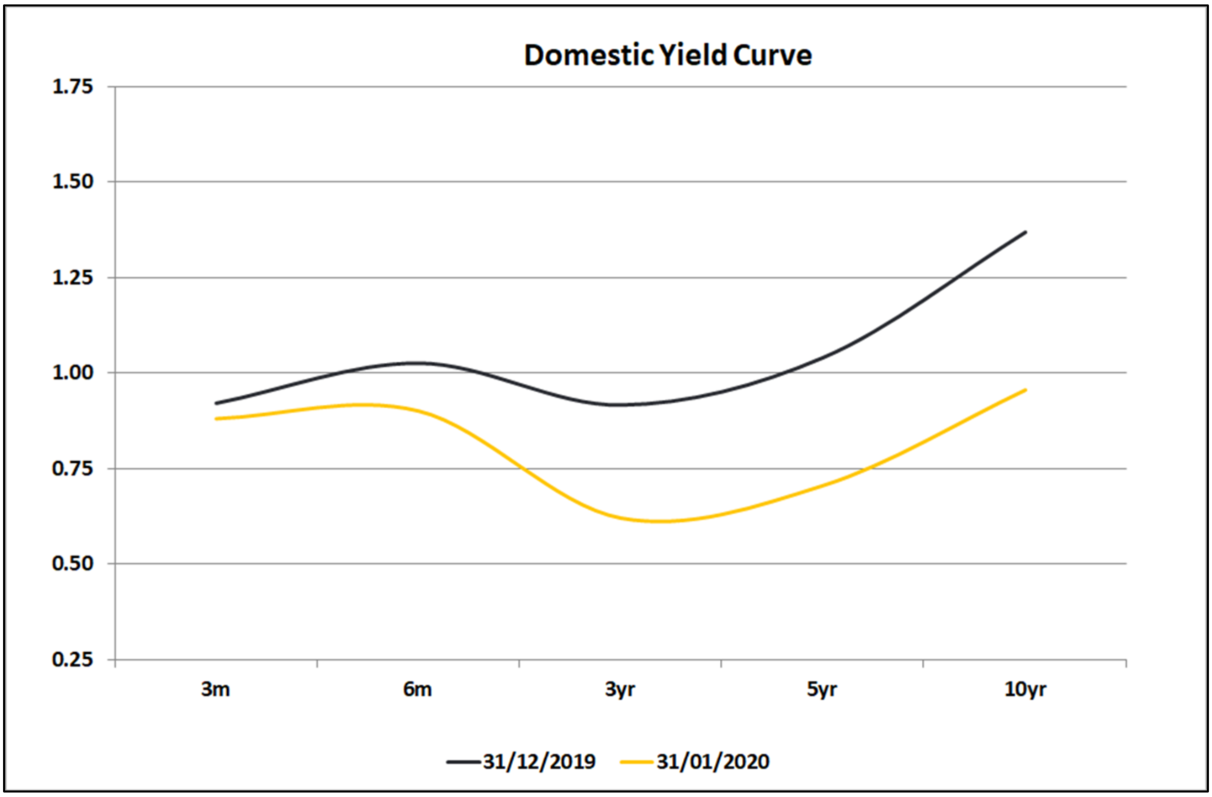
The global key risks for the RBA stem from the impact of ongoing trade and technology disputes, persistently low inflation, geo-political uncertainty and a broader slowdown in the global economy. In Australia, they are closely monitoring employment, inflation, wage growth, housing and consumption. Should these areas continue to show signs of softening, **the RBA remains on hand to adjust the official cash rate lower if required**.

<u>The futures market continues to factor in the possibility of another 25bp rate cut by mid-2020, which would take the official cash rate down to 0.50%, with potential for a further rate cut later in the year</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 fell up to 41bp at the longer end of the curve, with 10-year government bond yields trading below the 1% level again:



Source: AFMA, ASX, RBA

Disclaimer

Imperium Markets provides fixed income investment advisory services and a financial market platform through which clients and fixed income product providers may transact with each other.

The information in this document is intended solely for your use. The information and recommendations constitute judgements as of the date of this report and do not consider your individual investment objectives and adopted policy mandate.

Imperium Markets monitors the entire fixed income investible universe and recommends the best rate available to us, regardless of whether a product provider uses our market platform. You are responsible for deciding whether our recommendations are appropriate for your particular investment needs, objectives and financial situation and for implementing your decisions. You may use our platform to transact with your chosen product providers.

Imperium Markets charges a flat fee for our investment advice. Any commissions received are rebated to clients in full. If you choose a product provider who uses our market platform, the product provider pays us 1bp p.a. funding fee of the value of the investments transacted.