8.3. Investments and Loan Borrowings Held as at 31 August 2020

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ATTACHMENTS:
1. Monthly Investment Report - August 2020 [**8.3.1** - 18 pages]

PURPOSE:

This report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 31 August 2020.

EXECUTIVE SUMMARY:

Investment Portfolio:
The Investment portfolio provided an annualised return of 2.07% for the year to date as at 31 August 2020, 1.41% above the reportable BBSW Bank Bill Index. Investment 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 Floating-Rate Notes (FRNs) locked in at attractive margins.

Council's average duration of term deposits is approximately 483 days, thus reducing the exposure to declining interest rates experienced with investment renewals.

The COVID-19 pandemic has impacted Council's financial position and subsequently the funds available to invest. The collection of the first quarter rates instalment is now due by 30 September 2020 and not 31 August 2020, thus placing additional pressure on cashflows. The balance of the investment portfolio is managed to ensure liquidity to meet operational requirements.

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 August 2020 is $7,891,956.69.

FINANCIAL IMPLICATIONS:

The 2020/21 budgeted returns on investments is estimated to be $1,350,000.00. 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.

RECOMMENDATION:

1. THAT the report on Investments and Loan Borrowings held as at 31 August 2020 be received.

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
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.

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 August 2020 and annualised for the year to date as at 31 August 2020 (including investments which have matured prior to 31 August 2020).

	August 2020	**Annualised YTD as at 31 August 2020**
Actual Return	0.15%	2.07%
Benchmark	0.01%	0.66%
Variance	0.14%	1.41%

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.

During the month, 3 term deposits matured that were invested between 2-3 years ago at considerably higher interest rates. The re-investment of these funds at lower rates will have an impact on future interest earnings.

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 August 2020 have been reviewed and are $42,921.00 less than the revised budget.

Summary of Returns from Investments:

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (August)	YTD/Annual Actual (August)	YTD Budget to Actual Variance (August)
2020/21	**$1,350,000**	**$1,350,000**	**$292,073**	**$249,152**	**-$42,921**
2019/20	$1,500,000	$1,529,055		$1,896,660	$367,605
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

The negative YTD budget to actual variance is directly attributed to the extension provided for rates payments as the phased budget for investment returns was prepared based on the cashflow that typically would be available in August.

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 August 2020
AA Category	100.00%	48.22%
A Category	60.00%	17.%1
BBB Category	35.00%	33.20%
Unrated ADIs (NR)	10.00%	1.08%

As at the end of August, all categories were within the Policy limits.

Loan Borrowings

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

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

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

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

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

c) That loan funds will be limited to:
   - acquisition or enhancement of income producing assets.
   - construction and/or upgrading of buildings; and
   - infrastructure assets that have a life expectancy of greater than 10 years.

The current Debt Facility is as follows:

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

The current loan details are as follows:

Loan amount:	**$ 9,500,000.00**			
Loan term:	**10 years**			
From:	**31/07/2018**			
To:	**31/07/2028**			
Interest rate:	**4.02%p.a.(fixed)**			
Repayment:	**Quarterly**			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
1/07/2019	**$ 8,910,951.91**			
31/7/2019	**$ 8,711,603.51**	**$ 90,291.14**	**$ 199,348.40**	**$ 289,639.54**
31/10/2019	**$8,510,235.19**	**$88,271.22**	**$201,368.32**	**$ 289,639.54**
31/01/2020	**$8,306,826.48**	**$86,230.83**	**$203,408.71**	**$289,639.54**
30/04/2020	**$8,099,526.94**	**$82,340.00**	**$207,299.54**	**$289,639.54**
31/07/2020	**$7,891,956.69**	**$82,069.29**	**$207,570.25**	**$289,639.54**

The next loan instalment is due on 31 October 2020.

Loan Funded Capital Projects as at 31 August 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

August 2020

IMPERIUM MARKETS

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Impact of COVID-19 to Council's Portfolio

COVID-19 has adversely impacted financial markets, which in turn, has also affected Council's investment portfolio. We provide a quick summary in this section.

With regards to financial markets, of importance was the RBA cutting interest rates twice in March 2020, taking the official cash rate down to a record low of 0.25%. Shares (equities) experienced a significant correction in March but have since recovered most of their losses due to the unprecedented fiscal and monetary policy support from global central banks and governments.

With regards to the medium-longer term outlook for financial markets, of importance is the RBA's outlook and stance on the current situation:

1. The RBA's official cash rate will remain unchanged at its emergency level of 0.25% until its objectives of full employment and inflation are reached;
2. RBA Governor Lowe has commented that he has not seen any signs of stress in the financial system from this crisis because unlike the GFC, the banks have cash and are well capitalised. He also suggested that Australia had "*fantastic fundamentals*" and had so far been effective at containing the virus and providing policy stimulus;
3. The RBA Board expects rates would be low "*for a very long period of time*" and has recently suggested they **could cut official rates down to 0.10% (from 0.25%), if required**.

The biggest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits, which accounts for around ~75½% of Council's total investment. The biggest risk that Council faces over the medium-longer term in this environment is not the potential loss of capital (given all the banks are well capitalised and regulated by APRA), but the rapid loss of interest income as interest rates have plummeted.

Council's term deposit portfolio was yielding 1.68% p.a. at month-end, with a weighted average duration of around 483 days or ~1.3 years. **This average duration will provide some income protection against the low interest rate environment over the next 12 months**. As existing deposits mature however, they will inevitably be reinvested at much lower prevailing rates.

Given official rates have fallen to record lows, Council is likely to see a rapid decline in interest income over future financial years. Its budgeted income over the medium-longer term needs to be revised to reflect the low interest rate environment. Returns between 0.75%-1.00% p.a. may potentially be the "norm" over the next few financial years.

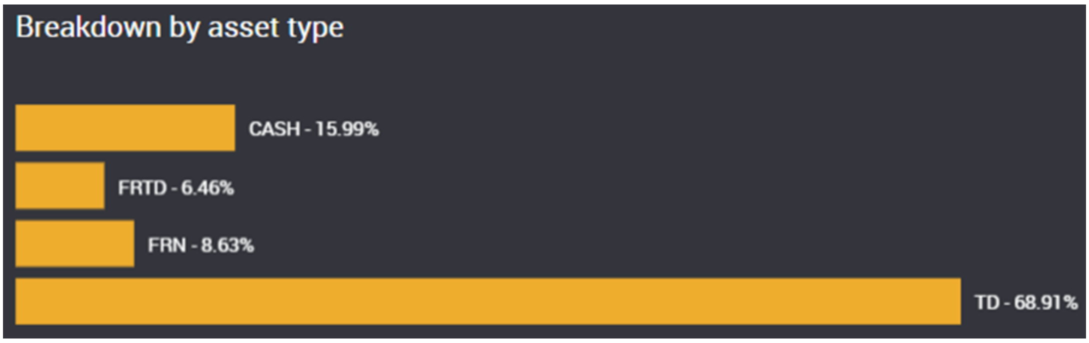
Council's Portfolio & Compliance

Asset Allocation

As at the end of August 2020, the portfolio was mainly directed to fixed and floating rate term deposits (75.37%). The remaining portfolio is directed to FRNs (8.63%) and overnight cash accounts (15.99%).

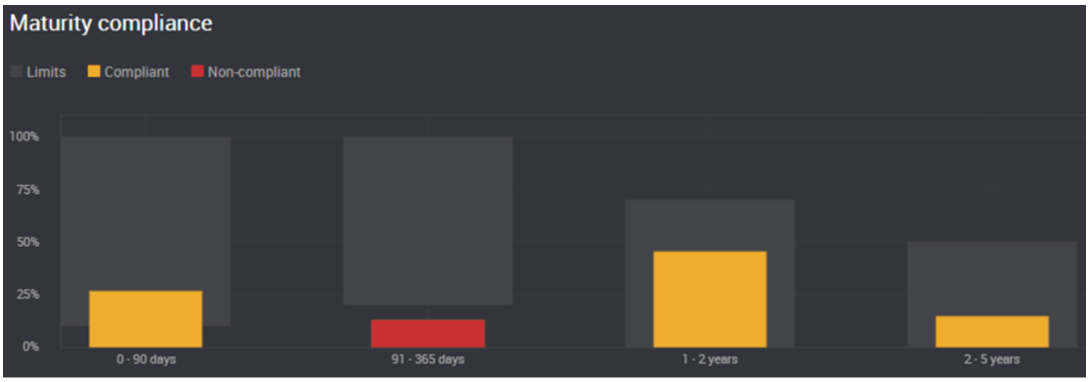
We would consider increasing the allocation to liquid senior floating rate notes (FRNs), if there are any remaining attractive securities in the primary or secondary market. This will not only offer additional upside with regards to the portfolio's investment returns, but also provide additional liquidity (FRNs are saleable – generally accessible within 2 business days). FRNs are also dominated by the higher rated ADIs which allows Council to maintain a bias towards the higher rated banks.

With official interest rates now at the RBA's effective lower bound, the priority should be to lock in any attractive medium-longer dated fixed deposits that may still be available to address reinvestment risk.



Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. The 3-12 month duration is slightly below minimum limit, but this is more than offset by the high allocation in the 0-3 month allocation. Around 25% of assets directed to medium-term assets (2-5 years). There is still high capacity to invest in the medium-term horizon, with approximately $23m at month-end.



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 to address reinvestment risk.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$24,854,083	26.76%	10%	100%	$68,016,454
x	91 - 365 days	$12,000,000	12.92%	20%	100%	$80,870,537
✓	1 - 2 years	$42,257,570	45.50%	0%	70%	$22,751,806
✓	2 - 5 years	$13,758,884	14.82%	0%	50%	$32,676,385
✓	5 - 10 years	$0	0.00%	0%	25%	$23,217,634
		$92,870,537	**100.00%**			

Counterparty

As at the end of August, the exposure to ING Bank (A), Auswide (BBB) and BoQ (BBB+) were marginally overweight to the Policy limits. There are no concerns with this temporary overweight position given this was purely due to the overall portfolio's balance shrinking over earlier months (capital expenditure).

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

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA (BankWest)	AA-	$16,746,009	18.03%	30.00%	$11,115,152
✓	NAB	AA-	$9,035,212	9.73%	30.00%	$18,825,949
✓	Westpac	AA-	$19,000,000	20.46%	30.00%	$8,861,161
✓	Suncorp	A+	$1,258,158	1.35%	15.00%	$12,672,423
x	ING Bank	A	$15,000,000	16.15%	15.00%	**-$1,069,419**
✓	AMP Bank	BBB+	$3,157,606	3.40%	10.00%	$6,129,448
x	BOQ	BBB+	$10,000,000	10.77%	10.00%	**-$712,946**
x	Auswide Bank	BBB	$10,000,000	10.77%	10.00%	**-$712,946**
✓	Beyond (Nexus)	BBB	$3,000,000	3.23%	10.00%	$6,287,054
✓	ME Bank	BBB	$3,257,570	3.51%	10.00%	$6,029,484
✓	Newcastle PBS	BBB	$1,415,982	1.52%	10.00%	$7,871,071
✓	WAW CU	Unrated	$1,000,000	1.08%	5.00%	$3,643,527
			$92,870,537	**100.00%**		

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

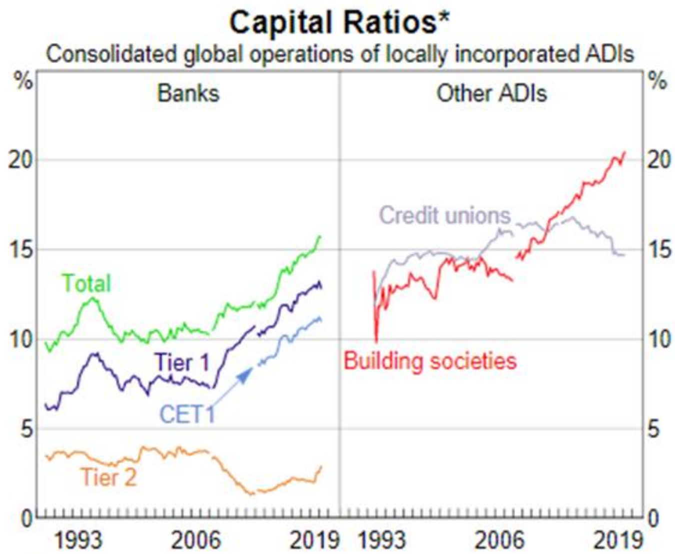
We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 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. ***RBA Governor Lowe has recently commented that they have not seen any signs of stress in the financial system and that unlike during the GFC, the banks now have cash, are well capitalised and are acting as "shock absorbers" in the current crisis***.

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 capital or credit risk, but reinvestment risk. Interest rates are now at their effective lower bound of 0.25% and could potentially drop to 0.10% if economic conditions deteriorate further.



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

Source: APRA

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Credit Quality

The portfolio remains well diversified from a credit ratings perspective. As at the end of August 2020, all categories were 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	$44,781,221	48.22%	100%	$48,089,316
✓	A Category	$16,258,158	17.51%	60%	$39,464,165
✓	BBB Category	$30,831,158	33.20%	35%	$1,673,530
✓	Unrated ADIs	$1,000,000	1.08%	10%	$8,287,054
		$92,870,537	**100.00%**		

Performance

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

Performance	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.02%	0.06%	0.13%	0.04%	0.52%
AusBond Bank Bill Index	0.01%	0.03%	0.18%	0.02%	0.66%
Council's T/D Portfolio	0.16%	0.48%	0.98%	0.32%	2.09%
Council's FRN Portfolio	0.09%	0.58%	1.00%	0.24%	2.02%
Council's Portfolio^	**0.15%**	**0.50%**	**0.99%**	**0.31%**	**2.07%**
Outperformance	**0.14%**	**0.48%**	**0.81%**	**0.29%**	**1.41%**

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

For the month of August, the total investment portfolio (excluding cash) provided a strong return of +0.15% (actual), outperforming the benchmark AusBond Bank Bill Index return of +0.14% (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.

We note most 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, although this is likely to reverse following the multiple interest rate cuts over the past year.

Over the past year, the total portfolio (excluding cash) returned an outstanding +2.07% p.a., outperforming bank bills by 1.41% 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 June 2020 Council Rankings). 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, 11 are still yielding higher than 1.75% p.a. That is, around 42% of the outstanding deposits held are currently earning more than the highest rate available in the market from any rated bank out to 5 years.

Council's Term Deposit Portfolio & Recommendation

As at the end of August 2020, Council's deposit portfolio was yielding an **attractive 1.68% p.a.** (down 24bp from the previous month), with an average duration of around 483 days (~1.32 years). We recommend Council 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 historical low levels of 0.25%.

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 overpaid for liquidity and 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**.

At the time of writing, we see value in:

ADI	LT Credit Rating	Term	T/D Rate
ICBC, Sydney	A	5 years	1.50% p.a.
ICBC, Sydney	A	4 years	1.30% p.a.
BoQ	BBB+	5 years	1.25% p.a.
BoQ	BBB+	4 years	1.15% p.a.
ICBC, Sydney	A	3 years	1.10% p.a.
BoQ	BBB+	3 years	1.05% p.a.
ICBC, Sydney	A	2 years	1.00% p.a.
AMP Bank	BBB+	18m - 2 years	^1.00% p.a.
BoQ	BBB+	2 years	0.95% p.a.

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

The above deposits are suitable for investors looking to provide some income protection and mitigate reinvestment/rollover risk in the low interest rate environment.

For terms under 12 months, we believe the strongest value is currently being offered by the regional ADIs (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
AMP	BBB+	6-12 months	^1.00% p.a.
BoQ	BBB+	12 months	0.80% p.a.
BoQ	BBB+	6-9 months	0.75% 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
ICBC, Sydney	A	12 months	~0.85% p.a.
ICBC, Sydney	A	6-9 months	~0.75% p.a.
NAB	AA-	9-12 months	0.75% p.a.
Westpac	AA-	12 months	~0.73% p.a.
NAB	AA-	3-8 months	0.70% p.a.

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Senior FRNs & Recommendations

Margins have tightened significantly over the past few months given the lack of volume and supply from primary issuances. Global credit assets have also tightened on the back of the US Fed's intervention in the secondary market, which included buying investment grade corporate securities.

Over August, amongst the senior major bank FRNs, physical credit securities remained relatively flat at the loner-end of the curve. Bid-ask spreads have normalised to pre-COVID levels on the back of excess liquidity and short supply. 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 in subsequent years.

A new 5 year senior major bank FRN would now be issued around +55bp, appearing relatively expensive. We expect minimal primary issuance from the domestic banks in the immediate future given the RBA's $150bn term funding facility (TFF) to the ADIs, offering a rate of 0.25% for 3 years. The lack of supply from new (primary) issuances has played a major role with the rally in credit markets over recent months.

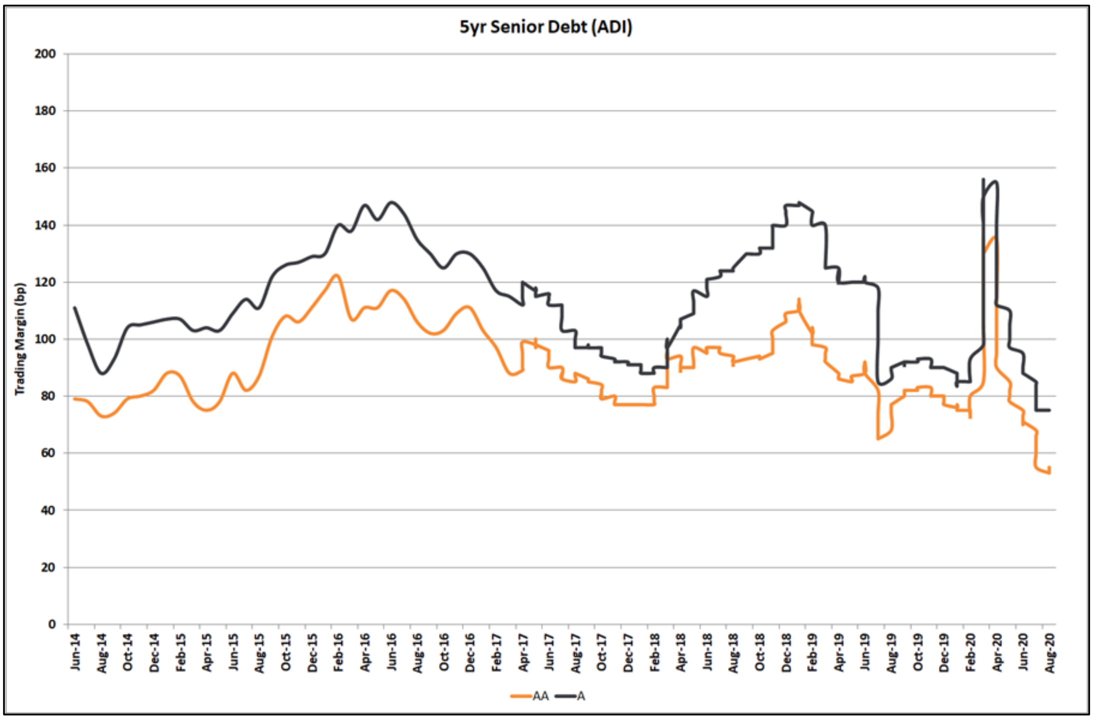
Amongst the "A" and "BBB" rated sector, the senior securities were also marked relatively flat over August. During the month, UBS AG (A) issued a 3 year deal at +80bp, tightening from initial guidance of +87bp, printing $600m.

While turnover in the secondary market is still predominately dominated by the major banks, given the lack of supply, we have started to observe that even a handful of regional bank senior paper has sometimes been trading inside "mid" levels.

Credit margins are now trading very tight on a historical level and look fairly expensive. 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)	31/08/2020	31/07/2020
"AA" rated – 5yrs	+55bp	+55bp
"AA" rated – 3yrs	+34bp	+35bp
"A" rated – 5yrs	+75bp	+75bp
"A" rated – 3yrs	+50bp	+50bp
"BBB" rated – 3yrs	+80bp	+75bp

Source: IBS Capital



Source: IBS Capital

We now generally **recommend switches** (‘benchmark’ issues only) into new attractive primary issues (or longer-dated alternatives), out of the following senior FRNs that are maturing:

- **On or before 2023 for the “AA” rated ADIs (domestic major banks)**;
- On or before mid-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's Senior FRNs Sale/Switch Recommendations

In early 2021, we recommend Council switches out of the following FRN:

- $2.00m CBA (AA-) FRN maturing 11/01/2024 (ISIN: AU3FN0046561) – trading margin marked around **+38.5bp** or capital price of $102.4766 (capital gain **~$49,500**).

The above sale would result in capital gains totalling ~**$49,500** and would most likely be switched into a higher yielding complying FRN or term deposit. At this stage, we prioritise switching into any remaining attractive medium-longer dated fixed deposit given the depressed state of interest rates.

Economic Commentary

International Market

Ongoing vaccine hopes continued to provide a safety net for risk markets. In the US, **the S&P 500 gained +7.01%, while the NASDAQ surged +7.57%, with both indices surpassing their previous all-time highs**. Across the main European markets, Germany's DAX gained +5.13%, while France's CAC rose +3.42% and UK's FTSE finished the month up +1.12%.

The US unemployment rate fell to 10.2% in July (from 11.1% in June), with nearly 1.8m jobs added.

Credit rating agency Fitch placed the US government's AAA rating on negative outlook due to the deterioration in the fiscal outlook.

US headline CPI came in at +1.0% in July from +0.6% in June, while core CPI came in at +1.6% from +1.2%.

Hopes that an interim US fiscal package could be agreed were re-ignited after House Speaker Pelosi indicated a willingness to cut their proposals in order to seal a deal with the US Administration and then provide more stimulus in January following the November elections.

US Fed Chair Powell revised the Fed's inflation mandate that "*will seek to achieve inflation that averages 2% over time*", noting that if inflation was running below 2%, "*appropriate monetary policy would likely aim to achieve inflation moderately above 2% for some time*".

Eurozone Q2 GDP fell more than -12%, led by an -18.5% fall in Spanish GDP.

The UK economy shrank by -20.4% in Q2, more than any other major economy and symptomatic of the UK's very high service sector concentration (around 80%). UK core CPI lifted to +1.8% from +1.4%, well above consensus.

Canada's average of its three core CPI measures came in softer than expected at +1.6%, down from +1.7%.

Auckland moved to Level 3 restrictions during the month for an initial three days, following a handful of positive COVID-19 community transmissions. New Zealand had previously reported more than 100 days without the virus.

The MSCI World ex-Aus Index gained +6.57% for the month of August:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+7.01%	+14.98%	+19.61%	+12.30%	+12.16%	+12.80%
MSCI World ex-AUS	+6.57%	+14.26%	+15.23%	+8.04%	+8.46%	+8.79%
S&P ASX 200 Accum. Index	+2.83%	+6.04%	-5.08%	+6.10%	+7.47%	+7.81%

Source: S&P, MSCI

Domestic Market

The Victorian government declared a state of disaster at the start of August, placing "stage 4" restrictions across Melbourne, including an 8pm-5am curfew, 5km travel limits, and remote learning for all students.

The RBA kept its policy unchanged at its August meeting as widely expected (cash rate and a 3 year government bond yield target of 0.25%). The Board revised its forecast for the unemployment rate to peak at 10% in December 2020, up from 9% in its May statement, largely driven by the stage 4 lockdown in Melbourne. The RBA August Minutes reaffirmed that the Board saw **no need to adjust their current policy settings but remains willing to do more if required**. This included **lowering the official cash rate down to 0.10%** (from 0.25%) and tweak existing measures of yield curve control and the term funding facility (TFF).

RBA Governor Philp Lowe said the states and territories need to inject another $40bn (~2% of GDP) into job creating infrastructure, warning that unemployment was forecast to stay above 7% for the next two years.

Real retail sales fell -3.4% over Q2, slightly weaker than the -3.0% expected by markets, with retail sales set to detract -0.6% from Q2 GDP.

June's trade balance revealed a surplus of $8.2bn, the 30th consecutive month of the trade account being in surplus. China's share of Australian exports rose despite political headwinds. Exports to China reached a record $14.6bn with goods exported to China comprising 48.8% of all goods exported, well up from 33% in February.

Annual wages growth is now +1.8% y/y, the lowest recorded annual rate in the 22-year history of the index.

The unemployment rate rose again in July, to 7.5% from 7.4%, a reflection that more people restarted their job search rather than people who gained work. The participation rate rose to 64.7% from 64.1%.

APRA released new figures showing a material increase in the volume of loans exiting deferrals (from $2bn in May to $18bn in June).

The AUD reached an 18 month high, finishing another +2% higher at US73.54 cents (from US72.13 cents the previous month).

Credit Market

The main global credit indices tightened again over August as risk markets continued their rally since the selloff earlier this year. The indices now trade back to their levels of mid-2019:

Index	August 2020	July 2020
CDX North American 5yr CDS	65bp	69bp
iTraxx Europe 5yr CDS	54bp	60bp
iTraxx Australia 5yr CDS	64bp	76bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	August 2020	July 2020
Bloomberg AusBond Bank Bill Index (0+YR)	+0.01%	+0.01%
Bloomberg AusBond Composite Bond Index (0+YR)	-0.42%	+0.37%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.10%	+0.42%
Bloomberg AusBond Credit Index (0+YR)	+0.12%	+0.91%
Bloomberg AusBond Treasury Index (0+YR)	-0.81%	+0.32%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-1.01%	+3.24%

Source: Bloomberg

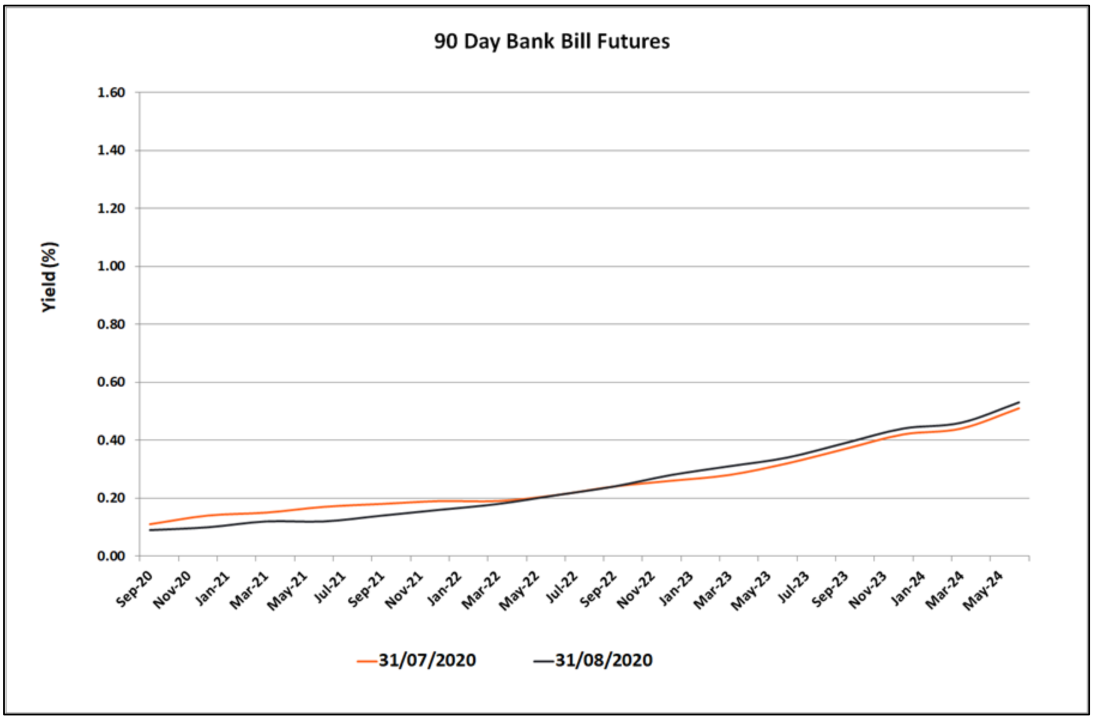
Other Key Rates

Index	August 2020	July 2020
RBA Official Cash Rate	0.25%	0.25%
90 Day (3 month) BBSW Rate	0.09%	0.10%
3yr Australian Government Bonds	0.28%	0.27%
10yr Australian Government Bonds	0.98%	0.82%
US Fed Funds Rate	0.00%-0.25%	0.00%-0.25%
10yr US Treasury Bonds	0.72%	0.55%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over August, bill futures rose at the long-end of the curve, consistent with the movement in the bond market. With the RBA suggesting they will keep rates unchanged for the foreseeable future, bill futures are likely to trade in a relatively narrow range, particularly for terms out to 3 years given the RBA's target to keep the 3 year bond rate at 0.25%.



Source: ASX

Fixed Interest Outlook

There is growing pressure for policymakers to provide additional support to revive the global economic recovery, particularly as further lockdowns are renewed or being considered. Ongoing hopes of an imminent vaccine have provided a safety net for risk markets.

The US Fed has reiterated it is committed to "*using its full range of tools to support the US economy*" and has signalled it is not considering raising interest rates at least until 2022.

The futures market is currently not pricing in a Fed rate rise until about four years after announcing the change to its inflation mandate to an "*average (rate of) 2% over time*". The futures market does however continue to price in the possibility that the US Fed may need to take rates into negative territory by the end of the calendar year (around 18%, although the Fed officially remains adamant this is not required).

Domestically, with official interest rates at the RBA's "effective lower bound" of 0.25%, their forward guidance is to keep committing the official cash rate unchanged until there is a sustainable recovery and its economic objectives of full employment (unemployment rate of 4.5%-5.0%) and target inflation (2-3%) are on track.

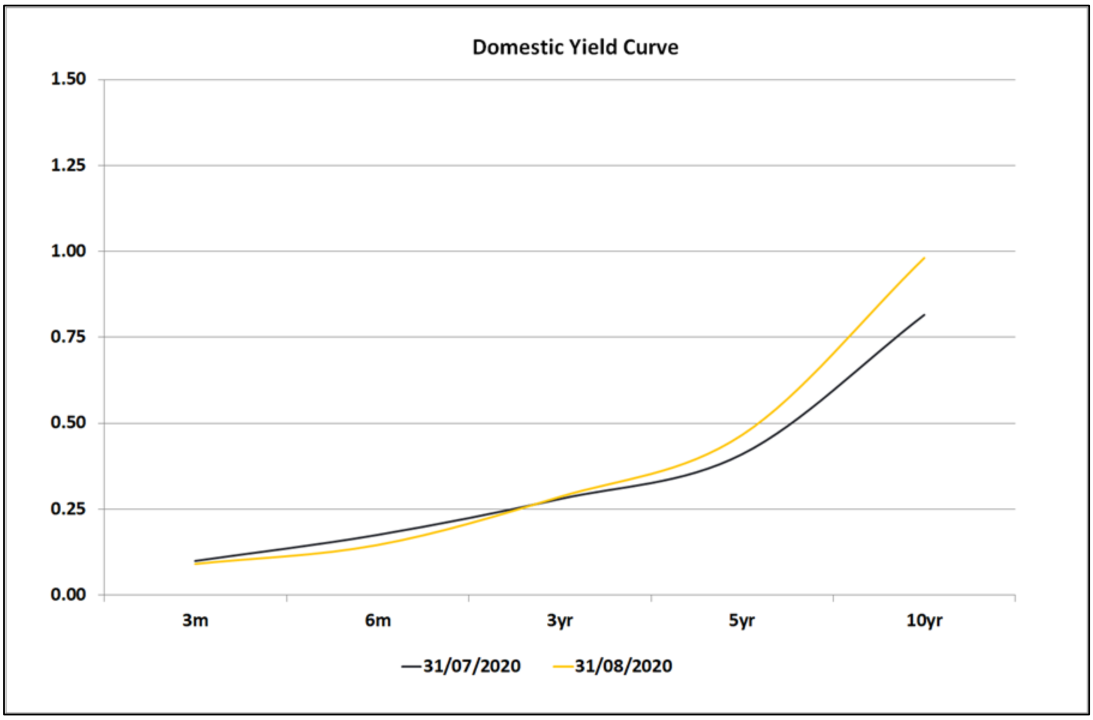
RBA Governor Lowe has commented that unlike during GFC, **the banks have cash and are well capitalised**, and that they are **not seeing any signs of stress in the financial system**. Although the pandemic was still a shock to the economy, Lowe has also commented that Australia had "*fantastic fundamentals*".

The outlook for wages growth remains weak with the RBA's latest forecasts seeing annual wages growth slowing to 1¼% in 2021, well below the post-inflation targeting average of 3.2% annual wages growth. Weak wages growth will weigh on inflation outcomes for some years.

Governor Lowe has repeatedly indicated that rates would be low "*for a very long period of time*" as the RBA needed to be confident inflation would be back in the 2 – 3% target range before considering lifting official rates. He has also indicated that **<u>if needed, the bank could lower the cash rate to a still-positive 0.10% (from 0.25%), buy more bonds and tweak the term funding facility (TFF)</u>**.

For now, the RBA is not contemplating adopting negative rates, indicating this would be "*extraordinarily unlikely*", citing the minimal benefits from those central banks that have undertaken such policies in recent years (e.g. Japan and Europe). With the Australian dollar appreciating significantly over recent months, they RBA also dismissed the idea of intervening in the foreign exchange market.

The domestic bond market continues to suggest a 'lower-for-longer' period of interest rates. Over the month, yields rose up to 17bp at the long-end, with 10-year government bond yields closing in on the 1% barrier:



Source: AFMA, ASX, RBA

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