PORT MACQUARIE-HASTINGS COUNCIL

Investment Report

February 2023

IMPERIUM MARKETS

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Executive Summary

Compliance

Compliance Measure	Within Policy Limits (Y/N)	Reason if Not Compliant
Term to Maturity	Yes – Compliant	n/a
Counterparty	Yes – Compliant	n/a
Credit Quality	Yes – Compliant	n/a

Performance

As at 28/02/2023	1m (actual)	1m (% p.a.)	FYTD (actual)	FYTD (% p.a.)
AusBond Bank Bill Index	0.24%	3.18%	1.68%	2.54%
Council's Portfolio^	**0.16%**	**2.16%**	**1.27%**	**1.92%**
Relative Performance	-0.08%	-1.02%	-0.41%	-0.62%

^Total portfolio performance excludes Council's cash account holdings.

Market Update Summary

Risk markets were generally sold off in February after several stronger-than-expected reports on the US economy (particularly employment) changed the outlook on the peak of the interest rate cycle.

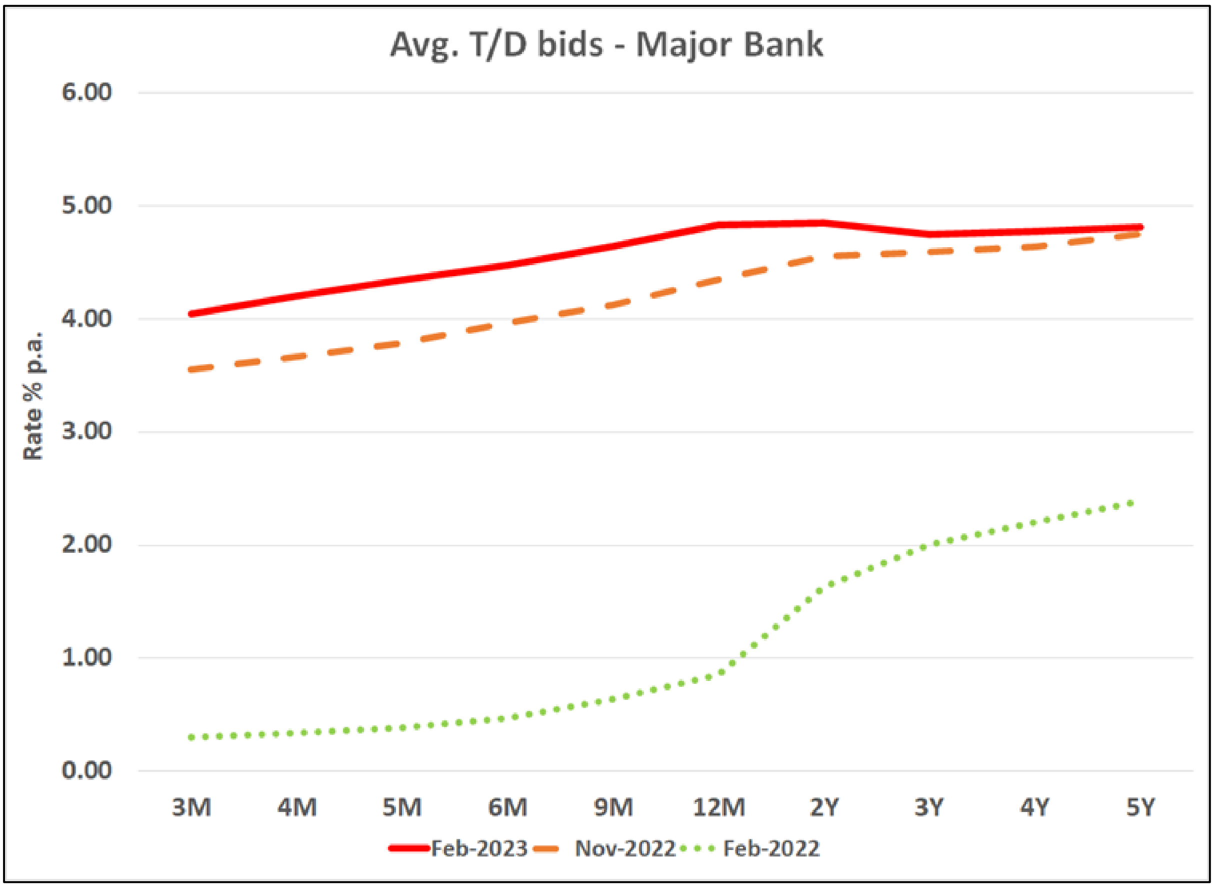
Domestically, the RBA continues to signal that it expects to increase interest rates, with at least two or three more 25bp hikes over the months ahead, likely locking in a March rate hike, and then possibly another in April and/or May. Thereafter, noting the lags in monetary policy, a pause around the end of Q2-Q3 is likely whilst the RBA monitors the economic data. Interestingly, RBA Governor Lowe commented that "*if inflation expectations stay well anchored, the supply-side problems get fixed up, wage growth and wage setting doesn't move up too fast and we can come back on that narrow path. So that is a plausible scenario: that rates rise and then start coming down next year. But a few things are going to have to go right for that to happen. It's possible, but there are other scenarios as well*".

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 ~88½% of Council's total investment, and cash (~6% of the total investment portfolio).

Council's term deposit portfolio was yielding 2.23% p.a. as at 28/02/2023, with a weighted average duration of around 586 days or ~1.60 years. We note the current interest rates in the term deposit market:

- The highest deposit rate from any rated ADI in the market is now ~5.15% p.a. for 5 years;
- The highest deposit rates amongst the "AA-" rated ADIs (major banks) is now yielding between 4.90%-5.00% p.a. (depending on terms between 12m – 5 years);
- The highest deposit rates amongst the "A" rated ADIs was yielding between 4.95%-5.15% p.a. (depending on terms between 12m – 5 years);
- The highest deposit rates amongst the "BBB" rated ADIs was yielding between 4.95%-5.15% p.a. (depending on terms between 12m – 5 years).

The deposit market has largely already factored in the current rate hike cycle, reflected by the flattening of the curve over the past few months, particularly at the long end of the curve (+2yrs). Interestingly, some 2-5 year deposit rates continue to be offered slightly below or close to the same level as the 12 month rate from a number of ADIs, as the market factors in the potential for a recession and official rates to subsequently fall in coming years:



Source: Imperium Markets

'New' investments above 4¾% p.a. is currently available if Council can continue to place the majority of its surplus funds for terms of 12 months to 2 years. *With recessionary fears being priced in coming years, investors may take an 'insurance policy' against future rate cuts by investing across 3-5 year fixed deposits and locking in rates above or close to 5% p.a. (small allocation only).*

Council's Portfolio

Asset Allocation

The portfolio is predominately directed to fixed term deposits (88.55%). The remainder of the portfolio is directed to fixed bonds with the Northern Territory Treasury Corporation (4.71%), the overnight cash account with Westpac (6.03%) and the single FRN with Bendigo-Adelaide (0.71%).

Senior FRNs remain relatively attractive as spreads have widened over the past year – new issuances should now be considered again on a case by case scenario. In the interim, fixed deposits for 12 months to 3 years appear quite appealing following the spike in medium-to longer-term yields during the rate hike cycle. With recessionary fears being priced in coming years, investors can choose to allocate some longer-term surplus funds and undertake an insurance policy against any potential future rate cuts by investing across 3-5 year fixed deposits, locking in and targeting yields close to or above 5% p.a.

Term to Maturity

All maturity limits (minimum and maximum) comply with the Investment Policy. Short-Medium Term (1-3 years) assets account for around 49% of the total investment portfolio, with capacity of around $87m remaining. Future investments should be directed to the 1-3 year horizon as this is where we currently see the best value.

Where there is (counterparty) capacity to invest in attractive 1-3 year investments, we recommend this be allocated to new any remaining attractive fixed term deposits (refer to respective sections below).

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 365 days	$159,133,650	37.48%	0%	100%	$265,507,381
✓	1 - 3 years	$209,507,381	49.34%	0%	70%	$87,741,341
✓	3 - 5.5 years	$56,000,000	13.19%	0%	40%	$113,856,412
✓	5.5 - 10 years	$0	0.00%	0%	10%	$42,464,103
		$424,641,031	**100.00%**			

Counterparty

As at February 2023, Council did not have an overweight position to any single ADI. Overall, the portfolio is diversified across the investment grade credit spectrum (rated BBB- or higher).

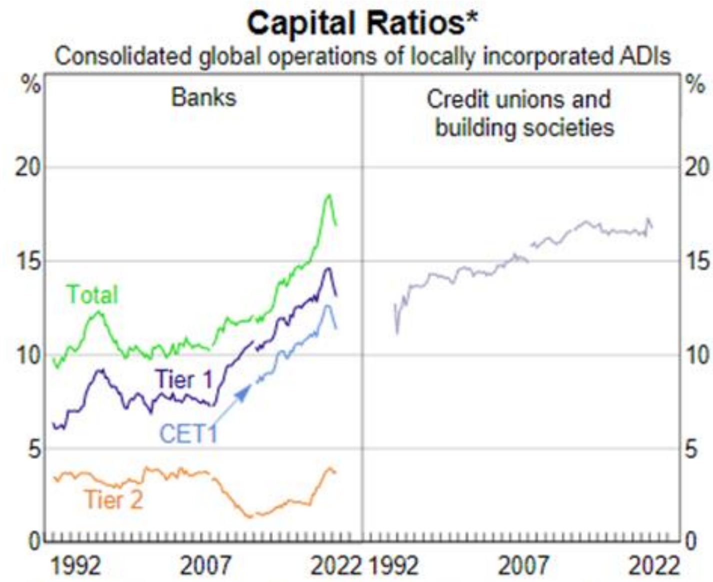
Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	NAB	AA-	$69,000,000	16.25%	30.00%	$58,392,309
✓	North. Territory	AA-	$20,000,000	4.71%	30.00%	$107,392,309
✓	Westpac	AA-	$103,633,650	24.41%	30.00%	$23,758,659
✓	ICBC Sydney	A	$72,000,000	16.96%	20.00%	$12,928,206
✓	ING Bank	A	$53,000,000	12.48%	20.00%	$31,928,206
✓	Aust. Military	BBB+	$3,000,000	0.71%	10.00%	$39,464,103
✓	Australian Unity	BBB+	$5,000,000	1.18%	10.00%	$37,464,103
✓	BOQ	BBB+	$28,000,000	6.59%	10.00%	$14,464,103
✓	Bendigo- Adelaide	BBB+	$3,007,381	0.71%	10.00%	$39,456,722
✓	AMP Bank	BBB	$8,000,000	1.88%	10.00%	$34,464,103
✓	Auswide Bank	BBB	$3,000,000	0.71%	10.00%	$39,464,103
✓	MyState Bank	BBB	$18,000,000	4.24%	10.00%	$24,464,103
✓	P&N Bank	BBB	$39,000,000	9.18%	10.00%	$3,464,103
			$424,641,031	**100.00%**		

We remain supportive of the regional and unrated ADI sector (and have been even throughout the post-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.

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). The financial regulator, APRA has recently noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by $110 billion, or more than 70%, over the past eight years. Over the same time, banks' assets have grown by 44%. Some of the extra capital is supporting growth in the banking system itself but clearly, there has been a strengthening in overall resilience and leverage in the system is lower.

We believe that deposit investments with the lower rated ADIs should be considered 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. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

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



* 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

Fossil Fuel Investments

What is Council's current exposure to institutions that fund fossil fuels?

Using the following link http://www.marketforces.org.au/banks/compare, based on the Council's investment portfolio balance as at 28/02/2023 ($424.64m), we can roughly estimate that ~83% of the investments have some form of exposure.

Transition to investments without major exposure to fossil fuels

Council has not made a decision to divest from the current portfolio of investments which have exposure to fossil fuels. To do so would have unfavourable implications to the credit quality, rating and interest income forecasts.

However, where possible, and within the ministerial and policy guidelines, Council will continue to favour newly issued fossil fuel free investment products, providing it does not compromise the risk and return profile.

In time it is Councils intention to move to a more balanced portfolio which has less exposure to fossil fuels, providing it is prudent to do so.

What would be implications on our portfolio credit rating?

By adopting a free fossil fuel policy or an active divestment strategy, this would eliminate the major banks rated "AA-" as well as some other "A" rated banks (e.g. Macquarie and ING). Council would be left with a smaller sub-sector of banks to choose to invest with.

What would be risks and implications on Council's portfolio performance?

Some implications include:

- High concentration risk – limiting Council to a selected number of banks;
- Increased credit/counterparty risk;
- May lead to a reduction in performance (e.g. most of the senior FRN issuances are with the higher rated ADIs);
- Underperformance compared to other Councils which could result in a significant loss of income generated – could be in excess of hundreds of thousands or millions of dollars per annum.

It may actually be contrary to Council's primary objective to preserve capital as the investment portfolio's risk would increase (all things being equal). Council may not be maximising its returns – this is one of the primary objectives written in the Investment Policy.

Council's exposure is summarised as follows:

Counterparty	Credit Rating	Funding Fossil Fuel
NAB	AA-	Yes
NTTC	AA-	Yes
WBC	AA-	Yes
ICBC, Sydney	A	Yes
ING Bank Australia	A	Yes
Australian Military	BBB+	No
Australian Unity	BBB+	No
BoQ	BBB+	Yes
Bendigo-Adelaide	BBB+	No
AMP	BBB	Yes
Auswide	BBB	No
MyState Bank	BBB	No
P&N Bank	BBB	No

Source: https://www.marketforces.org.au/info/compare-bank-table/

Funding Fossil Fuel	Amount	Invested %	Wgt. Avg. Yield % p.a.
Yes	$353,633,650	83%	2.14%
No	$71,007,381	17%	2.89%
Total / Wgt. Avg.	**$424,641,031**	**100%**	**2.27%**

T/D Rates Before & After COVID

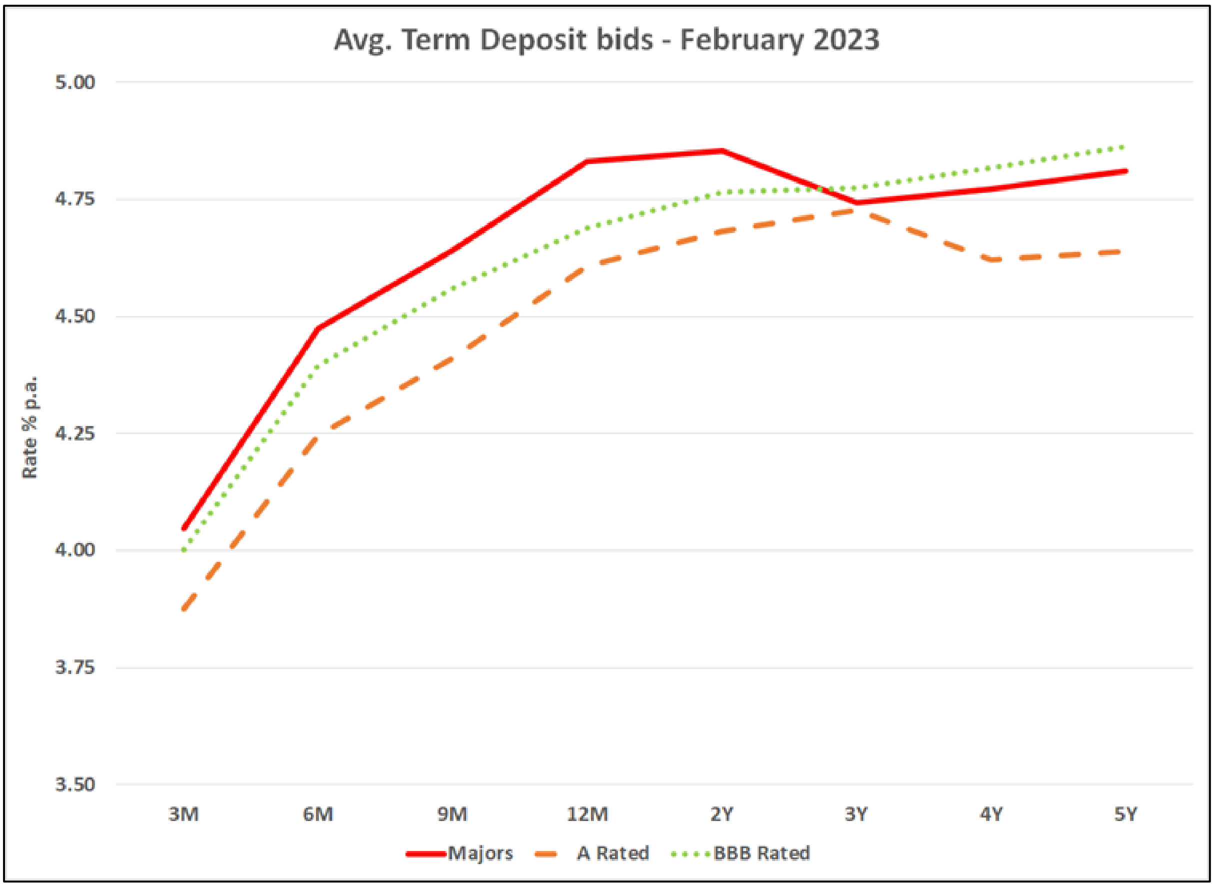
Pre-pandemic (March 2020), a 'normal' marketplace meant the lower rated ADIs (i.e. BBB category) were offering higher rates on term deposits compared to the higher rated ADIs (i.e. A or AA rated). But due to the cheap funding available provided by the RBA via their Term Funding Facility (TFF) since mid-2020[1], allowing the ADIs to borrow as low as 0.10% p.a. fixed for 3 years, those lower rated ADIs (BBB rated) did not require deposit funding from the wholesale deposit from the likes of PMHC. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering relatively attractive deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. This is why PMHC has invested a higher proportion of deposit investments with the higher rated (A or AA) banks over the past ~3 years.

Prior to the pandemic, PMHC locked in higher yields with the BBB rated banks given they were generally offering higher rates than the higher rated banks (a 'normal' market). This is also the reason why the BBB category's current yield is still higher than the higher rated banks - it is largely driven by the investments placed prior to the pandemic.

In the interim, the 'abnormal' marketplace still largely exists, with the higher rated banks (majors) often paying a higher rate of return over the lower rated institutions across various parts of the curve on any particular day.

Over the next few years, with the RBA now removing these cheap borrowing facilities, this should result in some of the lower rated banks (BBB rated) starting to become more competitive as the market starts to 'normalise'. PMHC should have a larger opportunity to invest a higher proportion of its surplus funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry. We are slowly seeing this trend emerge, as has been the case in recent months:

[1] The RBA's Term Funding Facility (TFF) allowed the ADI to borrow as low as 0.10% fixed for 3 years: https://www.rba.gov.au/mkt-operations/term-funding-facility/overview.html



Source: Imperium Markets

Credit Quality

The portfolio remains diversified from a credit ratings perspective. The portfolio is mainly directed to the investment grade ADIs (BBB- or higher). There is high capacity to invest in the higher rated ADIs (A or higher), particularly after the downgrades of BoQ and Bendigo-Adelaide Bank in May 2017.

There is currently sufficient capacity to invest with the "BBB" rated ADIs (~$42m remaining as at the reporting date). From a ratings perspective, the "BBB" rated banks now generally dominate the number of ADIs issuing deposits within the investment grade space. There has been further signs of appetite developing in the wholesale deposit market as additional lower rated ("BBB" and unrated) ADIs have come to market to raise 'new' money.

Over the coming year, we may start to see a more 'normalised' environment where the lower rated banks start to offer higher rates compared to the higher rated banks as the competition for deposits grow. As more of these banks become more competitive for funds, Council may look to allocate additional funds amongst this sector, particularly with those ADIs that are not lending to the Fossil Fuel industry i.e. the more 'ethical' banks.

If there are any attractive deposits being offered in the "BBB" rated sector (outside of BoQ, which Council is close to maximum limits), we will inform Council to take advantage and invest accordingly.

All ratings categories are within the current Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$192,633,650	45.36%	100%	$232,007,381
✓	A Category	$125,000,000	29.44%	60%	$129,784,619
✓	BBB Category	$107,007,381	25.20%	35%	$41,616,980
✓	Unrated ADIs	$0	0.00%	5%	$21,232,052
		$424,641,031	**100.00%**		

Performance

Council's performance for the period ending February 2023 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.25%	0.77%	1.42%	1.70%	1.81%	0.95%	0.70%
AusBond Bank Bill Index	0.24%	0.76%	1.40%	1.68%	1.76%	0.89%	0.66%
Council's T/D Portfolio	0.17%	0.52%	0.99%	1.29%	1.80%	1.74%	1.93%
Council's FRN Portfolio	0.32%	0.99%	1.99%	2.68%	4.04%	2.51%	2.07%
Council's Bond Portfolio	0.09%	0.30%	0.60%	0.80%	1.20%	-	-
Council's Portfolio^	**0.16%**	**0.51%**	**0.98%**	**1.27%**	**1.78%**	**1.73%**	**1.91%**
Outperformance	**-0.08%**	**-0.25%**	**-0.42%**	**-0.41%**	**0.03%**	**0.84%**	**1.25%**

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

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	3.35%	3.18%	2.89%	2.56%	1.81%	0.95%	0.70%
AusBond Bank Bill Index	3.18%	3.11%	2.85%	2.54%	1.76%	0.89%	0.66%
Council's T/D Portfolio	2.20%	2.11%	2.01%	1.94%	1.80%	1.74%	1.93%
Council's FRN Portfolio	4.19%	4.08%	4.06%	4.06%	4.04%	2.51%	2.07%
Council's Bond Portfolio	1.24%	1.21%	1.21%	1.20%	1.20%	-	-
Council's Portfolio^	**2.16%**	**2.08%**	**1.99%**	**1.92%**	**1.78%**	**1.73%**	**1.91%**
Outperformance	**-1.01%**	**-1.03%**	**-0.86%**	**-0.62%**	**0.03%**	**0.84%**	**1.25%**

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

For the month ending February 2023, the total portfolio (excluding cash) provided a solid return of +0.16% (actual) or +2.16% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.24% (actual) or +3.18% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be temporary. Council should also remind itself it has consistently 'outperformed' over longer-term time periods as demonstrated by the longer-term returns of the overall investment portfolio (+2yr tenors).

We are pleased that PMHC remains amongst the best performing Councils in the state of NSW where deposits are concerned. We have been pro-active in our advice about protecting interest income by strategically maintaining a slightly longer duration position. Council has reaped the benefits during the pandemic period and the portfolio should outperform by undertaking a similar strategy in the long-run.

Council's Term Deposit Portfolio & Recommendation

As at the end of February 2023, Council's deposit portfolio was yielding 2.23% p.a. (up 15bp from the end of the previous month), with a weighted average duration of ~1.61 years. Where possible, we recommend Council maintains this weighted average duration.

In the long-run, investors are rewarded if they can continue to maintain a slightly longer average duration. In a 'normal' marketplace, yields at the long-end are generally offered at a slight premium over shorter tenors.

At the time of writing, we see value in:

	LT Credit Rating	Term	T/D Rate
ING	A	5 years	5.13% p.a.
ING	A	4 years	5.12% p.a.
ING	A	3 years	5.11% p.a.
ING	A	2 years	5.10% p.a.
CBA	AA-	2 years	5.00% p.a.
BoQ	BBB+	2 years	5.00% p.a.
Westpac	AA-	2 years	4.95% p.a.
NAB	AA-	2 years	4.95% p.a.

The above deposits are suitable for investors looking to maintain diversification and lock-in a premium compared to purely investing short-term. For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (dependent on daily funding requirements):

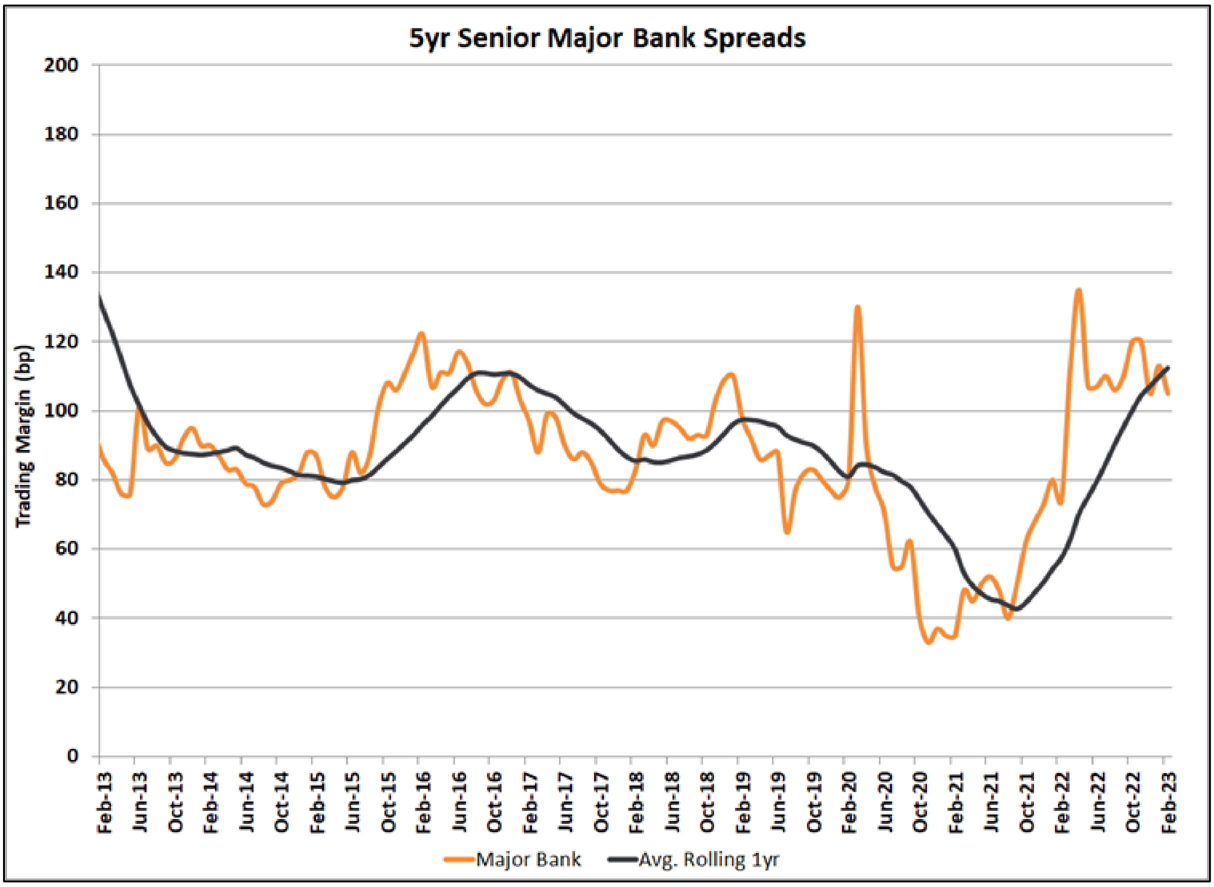
ADI	LT Credit Rating	Term	T/D Rate
CBA	AA-	12 months	5.02% p.a.
ING	A	12 months	4.98% p.a.
NAB	AA-	12 months	4.95% p.a.
Westpac	AA-	12 months	4.95% p.a.
Hume Bank	BBB+	12 months	4.95% p.a.
BoQ	BBB+	12 months	4.90% p.a.
CBA	AA-	6 months	4.64% p.a.
WBC	AA-	6 months	4.62% p.a.
NAB	AA-	6 months	4.60% p.a.
CBA	AA-	3 months	4.25% p.a.

If Council does not require high levels of liquidity and can stagger its investments across the longer term horizons (2-5 years), it will be rewarded over coming years if it can roll for an average min. term of 12 months to 2 years (this is where we current value), yielding, on average, up to ¼-½% p.a. higher compared to those investors that entirely invest in short-dated (under 6 months) deposits.

With recessionary fears being priced in coming years, Council can allocate some longer-term surplus funds and undertake an insurance policy by investing across 3-5 year fixed deposits and locking in rates close to or above 5% p.a. This will provide some income protection if central banks decide to cut rates in future years, assuming inflation is under control.

Senior FRNs Review

Over February, amongst the senior major bank FRNs, physical credit securities tightened by up to 10bp at the long-end of the curve. Nevertheless, major bank senior securities remain fairly attractive again in a rising rate environment (5 year margins above the +105bp level):



Source: IBS Capital

During February, there were other noticeable new primary issuance, mainly from the international banks:

- MUFG, Sydney Branch (A) 3 year senior FRN at +87bp
- Sumitomo, Sydney Branch (A+) 3 year senior FRN at +85bp
- RACQ (BBB+) 3 year senior FRN at +150bp
- DBS, Sydney Branch (AA-) 5 year dual senior security at +75bp
- Bank Australia (BBB) 4 year senior 'sustainable' FRN at +160bp
- Mizuho, Sydney Branch (A) 3 year FRN at +86bp
- HSBC, Sydney Branch (A+) 5 year dual senior security at +105bp

Amongst the "A" and "BBB" rated sector, the securities were marked between 5-10bp tighter at the 3-5 year part of the curve, with movements largely dictated by new issuances.

Credit securities are looking much more attractive given the widening of spreads in 2022. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	28/02/2023	31/01/2023
"AA" rated – 5yrs	+105bp	+113bp
"AA" rated – 3yrs	+75bp	+88bp
"A" rated – 5yrs	+125bp	+130bp
"A" rated – 3yrs	+90bp	+103bp
"BBB" rated – 3yrs	+145bp	+150bp

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 2025 for the "AA" rated ADIs (domestic major banks)**;
- On or before early 2024 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last few years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current challenging economic environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

Council's FRN & Recommendation

In late August 2019, Council placed a bid of $3m into the new Bendigo (BBB+) 5 year FRN at +97bp maturing 06/09/2024 (ISIN: AU3FN0050019). This FRN should be viewed as a 3½-4 year holding period, with the ability to 'roll down the curve', realise capital gains which would boost the overall return of the investment portfolio. As at 28/02/2023, the security was marked around +78.5bp (from +85.5bp at the end of the previous month) or a capital price ~$100.25 or unrealised capital gain of ~$7.0k. We recommend Council holds this FRN at this stage.

Council's Senior Fixed Bond

During September 2021, Council placed parcels in NTTC (AA-) fixed bonds as follows:

Investment Date	Maturity Date	Principal	Rate % p.a.^	Remaining Term (Yrs)	Interest Paid
7/09/2021	15/12/2024	$5,000,000	0.90%	1.80 yrs	Annually
14/09/2021	15/12/2025	$5,000,000	1.10%	2.80 yrs	Annually
2/09/2021	15/12/2026	$5,000,000	1.40%	3.80 yrs	Annually
7/09/2021	15/12/2026	$5,000,000	1.40%	3.80 yrs	Annually
	Totals / Wgt. Avg.	**$20,000,000**	**1.20%**	**3.05 yrs**	

^Council will receive the full rebated commission of 0.25% (plus GST) on the face value of investment on all these parcels (currently totalling $55,000).

We believe these investments were prudent at the time of investment, especially after the rate cut delivered in early November 2020 and the RBA's forward guidance on official interest rates (no rate rises '*until at least 2024*').

The NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

Senior Fixed Bonds – ADIs (Secondary Market)

As global inflationary pressures remain, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have reacted accordingly.

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0255776	ING	AAA	Covered	07/09/2023	0.53	3.00%	4.46%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	0.72	3.25%	4.39%
AU3CB0265403	Suncorp	A+	Senior	30/07/2024	1.42	1.85%	4.91%
AU3CB0263275	Westpac	AA-	Senior	16/08/2024	1.47	2.25%	4.69%
AU3CB0265718	ING	AAA	Covered	20/08/2024	1.48	1.45%	4.82%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	1.50	1.55%	4.68%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.53	1.70%	4.9%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.67	2.00%	5.07%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	1.89	1.65%	4.66%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	1.90	1.65%	4.68%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	1.96	1.70%	4.91%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	2.05	2.70%	4.67%
AU3CB0291508	Westpac	AA-	Senior	11/08/2025	2.45	3.90%	4.72%
AU3CB0291672	CBA	AA-	Senior	18/08/2025	2.47	4.20%	4.67%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	3.19	1.40%	5.24%
AU3CB0282358	ING	AAA	Covered	19/08/2026	3.48	1.10%	4.92%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.67	2.10%	5.23%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	3.91	2.40%	4.91%

Economic Commentary

International Market

Risk markets were generally sold off in February after several stronger-than-expected reports on the US economy (particularly employment) changed the outlook on the peak of the interest rate cycle.

Across equity markets, the S&P 500 Index fell -2.61%, while the NASDAQ lost -1.11%. Europe's main indices bucked the trend, with gains led by France's CAC (+2.62%), Germany's DAX (+1.57%) and UK's FTSE (+1.35%).

The US FOMC agreed (unanimously among the voters) to lift rates another 25bp to 4.50%-4.75% range, downshifting hikes further from the two 50bp moves and earlier more aggressive 75bp moves.

US headline payrolls came in at +517k vs. +188k expected, and the unemployment rate fell 0.10% to 3.4% (its lowest in 54 years), versus an expected rise to 3.6%. US Fed Chair Powell noted how the strength in the labour market underscores why the Fed thinks it could take time to bring inflation down. Powell then remarked that "*we think we're going to have to do further [rate] increases, and we think we'll have to hold policy at a restrictive level for some time*".

US CPI came in marginally above consensus. The core and headline came in-line with the median forecast at +0.4% m/m and +0.5% m/m, but they slowed less than expected on a year-ended basis. Headline CPI fell to +6.4% from +6.5%, while the core CPI fell to +5.6% y/y from +5.7%.

Canada's employment rose +150k, where consensus was for just +15k and the unemployment rate remained at 5.0%.

UK Q4 GDP was flat, as expected, following Q3's -0.2% q/q decline, with year-ended growth coming in at +0.4%. That sees the economy avoiding a recession for now. The Bank of England (BoE) hiked rates by 50bp, in line with the consensus forecast to 4%.

The RBNZ raised the OCR by 50bp to 4.75% as widely anticipated and there was only a minor tweak to the projected track, with the peak still assumed to be 5.5% but taking slightly longer to get there.

China's inflation data remained low by global standards and did nothing to warn authorities against keeping policy stimulatory. CPI rose to +2.1% y/y from +1.8%, in line with expectations.

The IMF raised its 2023 world GDP growth forecast to +2.9%, up from +2.7% forecast last October, supported by China's reopening. China is now expected to grow by +5.2% in 2023.

The MSCI World ex-Aus Index fell -2.42% for the month of February:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-2.61%	-2.70%	-9.23%	+10.35%	+7.91%	+10.12%
MSCI World ex-AUS	-2.42%	-0.25%	-8.98%	+8.29%	+5.19%	+7.04%
S&P ASX 200 Accum. Index	-2.45%	+0.30%	+7.16%	+7.93%	+7.90%	+8.10%

Source: S&P, MSCI

Domestic Market

The RBA raised rates by 25bp to 3.35%, the ninth consecutive increase. The Statement was hawkish with the RBA Board expecting "fu*rther increases in interest rates will be needed over the months ahead"*. Dr Lowe said "*inflation [was] way too high and it needs to come down*" and that the risks at the moment are "*two sided*" with the "*risk we haven't done enough on interest rates*". He added there was a risk the central bank's most rapid tightening cycle in a generation had not done enough to dampen household spending and tame inflation. "*How far we have to go up – I don't know. It's going to depend upon the inflation data, the resilience of spending, the strength of the global economy and what's happening with growth and wages"*.

The unemployment rate unexpectedly jumped to 3.7% in January (from 3.5% in December), with the participation rate decreasing to 66.5% (66.6%).

The wage price index (WPI) rose +0.8% for the December quarter and +3.3% y/y. This was 0.2% below the consensus of +1.0% q/q and +3.5%, which was also what the RBA had pencilled in. As for headline details, private sector wages rose +0.85% q/q and +3.6% y/y, a slower pace than the +1.2% q/q rise in Q3. Public sector wages rose +0.7% q/q and +2.5% y/y.

Retail sales fell a sharp -3.9% m/m in December (consensus -0.2%), following an upwardly revised November to +1.7% m/m (from +1.4%). The key implication is that we may be starting to see the first signs that monetary tightening is starting to weigh on consumption.

The December trade surplus was $12.2bn (consensus $12.5bn) from an upwardly revised November balance of $13.5bn. Exports fell 1.4% (-0.8bn) with key resource export categories all lower.

Private sector credit growth slowed to +0.3% m/m in December from +0.5% in November (consensus +0.5%). The annual rate slowed to +8.3% y/y, the second consecutive month of deceleration from its recent +9.5% peak in October.

Australian dwelling prices fell -1.0% m/m in January, the ninth consecutive month of decline. House prices nationally are now 8.9% below their peak, but remain 14.6% above pre-pandemic levels.

The Australian dollar lost -4.36%, finishing the month at US67.30 cents (from US70.37 cents the previous month).

Credit Market

The global credit indices widened over February in the 'risk-off' environment. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	February 2023	January 2023
CDX North American 5yr CDS	75bp	72bp
iTraxx Europe 5yr CDS	80bp	79bp
iTraxx Australia 5yr CDS	87bp	82bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	February 2023	January 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.24%	+0.27%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.32%	+2.76%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.43%	+0.42%
Bloomberg AusBond Credit Index (0+YR)	-0.62%	+2.19%
Bloomberg AusBond Treasury Index (0+YR)	-1.58%	+2.94%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-2.20%	+4.87%

Source: Bloomberg

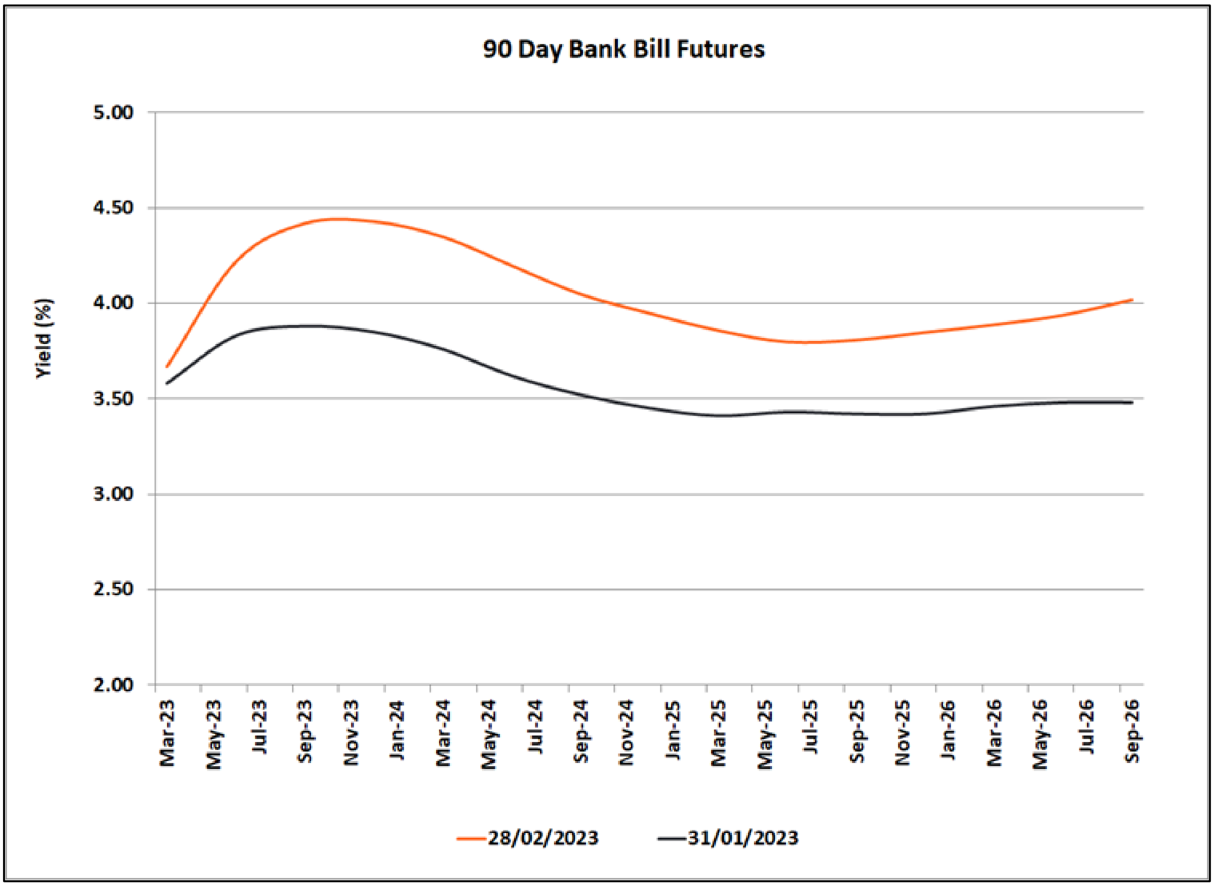
Other Key Rates

Index	February 2023	January 2023
RBA Official Cash Rate	3.35%	3.10%
90 Day (3 month) BBSW Rate	3.56%	3.37%
3yr Australian Government Bonds	3.60%	3.17%
10yr Australian Government Bonds	3.85%	3.55%
US Fed Funds Rate	4.50%-4.75%	4.25%-4.50%
3yr US Treasury Bonds	3.81%	3.90%
10yr US Treasury Bonds	3.92%	3.52%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over February, bill futures rose significantly across the board, with the market reacting to the US Fed Reserve's comments that they are still looking to raise rates over coming months. The markets continue to factor in the possibility of a global recession over the next few years, highlighted by the drop in the futures pricing in early 2024:



Source: ASX

Fixed Interest Outlook

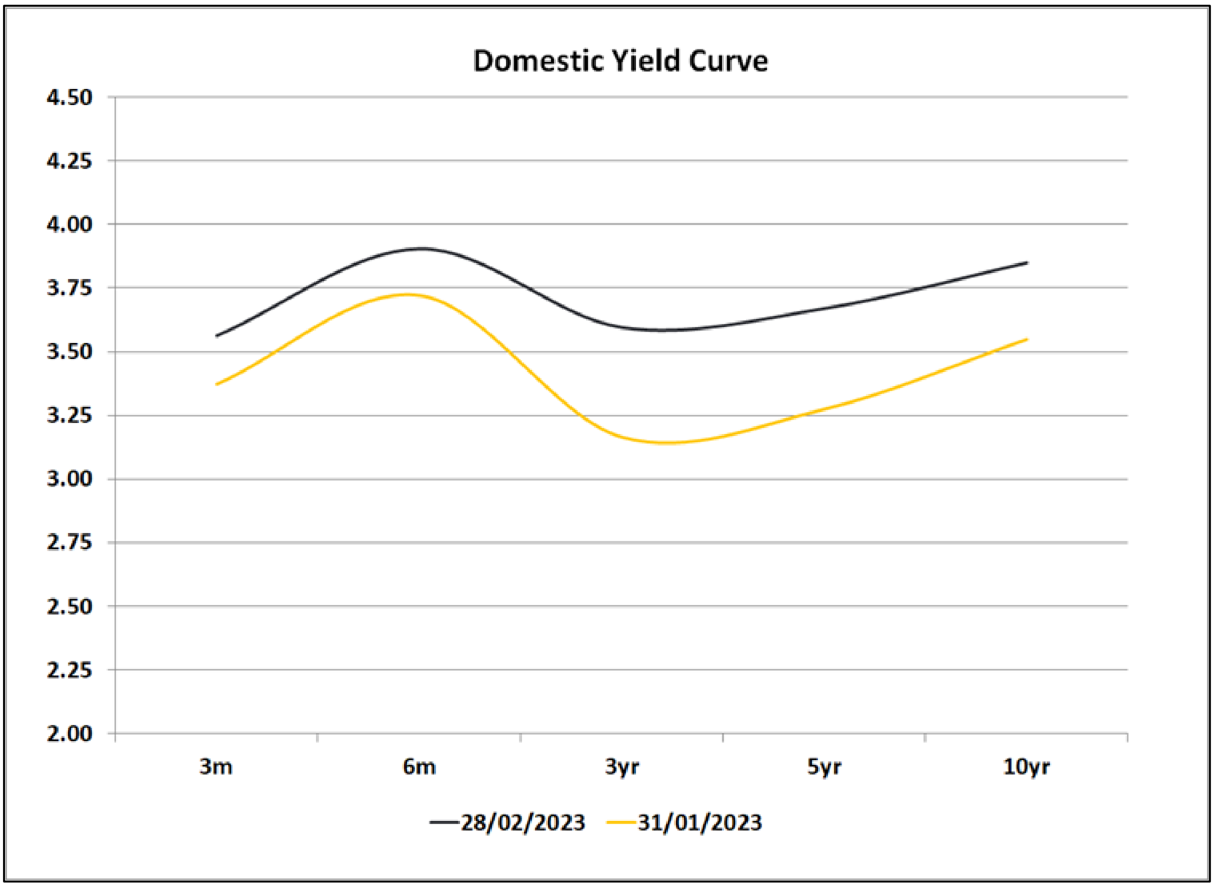
Money markets are now pricing for the US Fed to reach a mid-point of the 5.25%-5.50% target range. Futures markets nevertheless continue to factor in that rates will be coming down within 6 months of the peak being reached. US Fed Chair Powell sounded slightly less hawkish as he noted how the disinflationary process had already begun, however he still suggested that have a long way to go, particularly within the services sector. Powell also noted how the strength in the labour market underscores why the Fed thinks it could take time to bring inflation down to its 2% target.

Domestically, RBA Governor Lowe recently commented "*I don't think we're at the peak yet but how far they need to go, we're still unsure*". He sees monetary policy as restrictive and indicated the RBA Board is still "*trying to navigate a narrow path here*" and "*want to get inflation down*", "*but also preserve the gains*" seen in the labour market. However, that narrow path is highly uncertain with Dr Lowe noting that he doesn't "*know the answer*" to how far unemployment will need to rise.

The latest RBA Minutes revealed they considered moves for both 25bp or 50bp in February. The main arguments for moving by 25bp are that policy has already "*been adjusted substantially*" with considerable "*uncertainty around the outlook*", that there are substantial lags in policy and that "*monthly meetings provided the Board with frequent opportunities to assess how' uncertainties were being resolved*". For the RBA to step back to 50bp hikes, it is likely that the RBA would need to be convinced that wage and inflation expectations had shifted substantially.

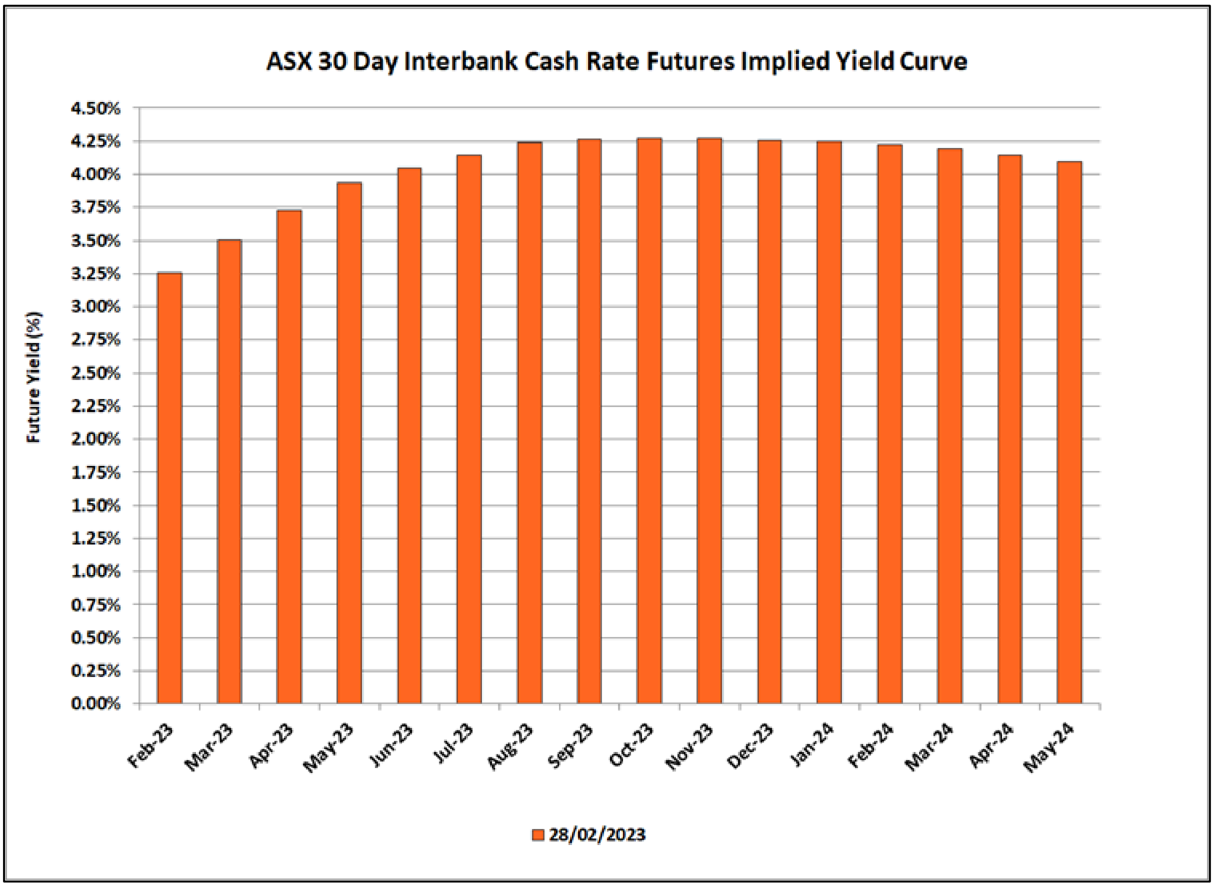
For now, the RBA continues to signal that it expects to increase interest rates, with at least two or three more 25bp hikes over the months ahead, likely locking in a March rate hike, and then possibly another in April and/or May. Thereafter, noting the lags in monetary policy, a pause around the end of Q2-Q3 is likely whilst the RBA monitors the economic data. Markets are currently pricing in up to 4 additional rate rises into mid-2023 (up to 4.25%). Fears of a looming global recession have actually seen rate cuts start to be priced in towards the start of 2024, although this seems unlikely for now.

Over the month, yields rose up to 40bp at the long-end of the curve:



Source: AFMA, ASX, RBA

RBA Governor Lowe commented that "*if inflation expectations stay well anchored, the supply-side problems get fixed up, wage growth and wage setting doesn't move up too fast and we can come back on that narrow path. So that is a plausible scenario: that rates rise and then start coming down next year. But a few things are going to have to go right for that to happen. It's possible, but there are other scenarios as well*".



Source: ASX

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