



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, down over -20% in Australian and around -13% globally for the month of March. April saw shares rebound strongly, offsetting some of the losses in March, with equities returning around +9% in Australia and +10% abroad.

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 (note, we are unlikely to see the unemployment rate down to 4.5% and inflation within their 2-3% target band any time soon);
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;
3. The RBA Board expects rates would be low "for a very long period of time".

The biggest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits (fixed and floating), which accounts for around ~53% of Council's total portfolio. **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 an attractive 2.55% p.a. at month-end, with a weighted average duration of around 566 days or ~1.6 years. This average duration will provide some income protection for the next 1-2 years. As existing deposits mature however, they will inevitably be reinvested at much lower prevailing rates.

Given official rates have fallen to all-time 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 of 1%-1½% p.a. may potentially be the "norm" and potentially at the upper end of the range over the next few financial years.