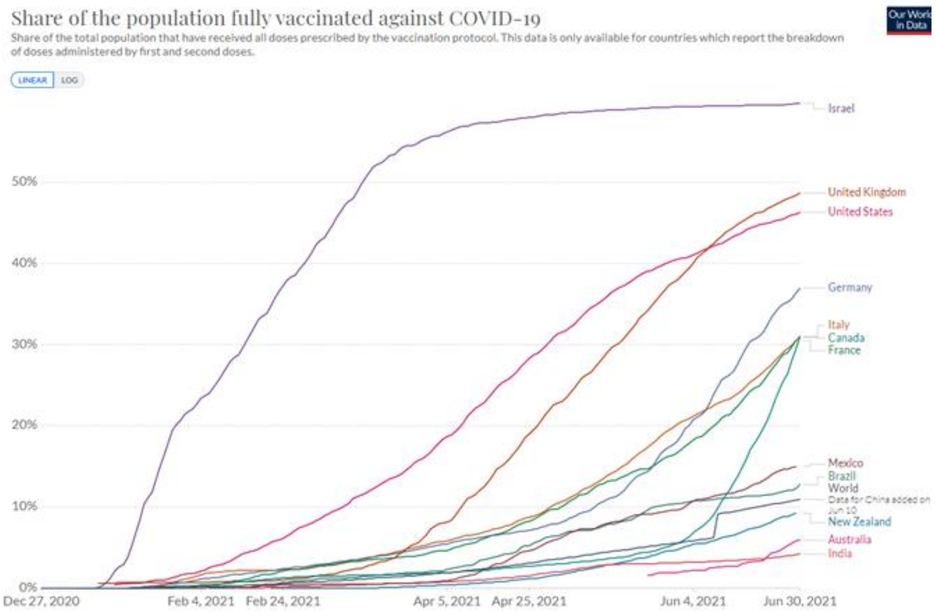
Financial Market Conditions – June 2021

Local Government
Finance Authority

As we enter the 2021-22 financial year, it is clear that the COVID pandemic still dominates the landscape. Countries are still experiencing virus outbreaks, however with increasing evidence that with effective vaccine programs, hospitalisations and fatalities are substantially reduced. Over time, this will mean fewer lockdowns and the opening of borders. However, the pace of vaccine rollouts continues to vary significantly. Currently, 23.5% of the world population has received at least one dose of a vaccine, Australia is behind the pack with less than 5% of its population vaccinated.



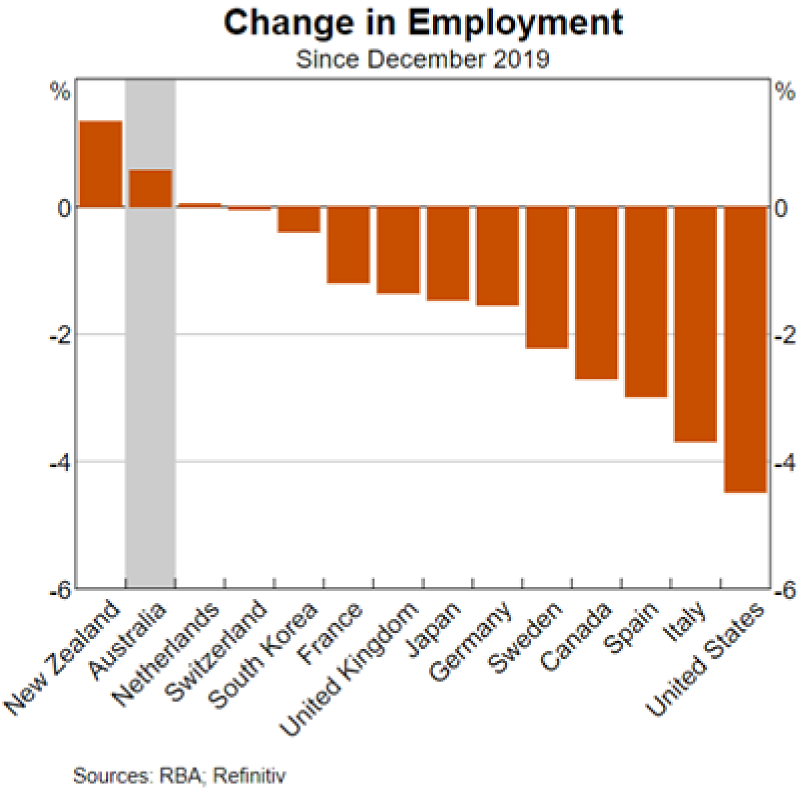
Throughout June, equity markets were generally higher, US markets touched a new record high at the start of July, and was 3% higher during June. Locally, equities were 4% higher. Over the last 12 months, local share markets have gained 24%, the biggest rise for a financial year in 34 years, narrowly beating the previous financial year record of 2006/07, when Australia was entering its mining boom. Equity markets globally also experienced large gains with the US up circa 35% over the year, Japan by 29% and UK and German markets up by 14% and 25% respectively.

Global economic data released throughout the month was mixed. US inflation data continued to surprise to the upside, with annual inflation at 5%, another record high since 2008. It's useful to note that half of the increase was made up of just three components being, fuel, utilities (energy up 29%) and used cars (up 30% in 12 months). The US Federal Open Market Committee (FOMC) will focus on the trimmed mean, which is at 1.8%. US payrolls disappointed over the month, printed at 559k, below the consensus, 675k, with US employment at 5.8%, remaining well above the pre-pandemic level of 3.5%. Over the month, market price movements and commentary were suggestive that investors are becoming comfortable with the Fed's view that inflationary pressures are transitory.

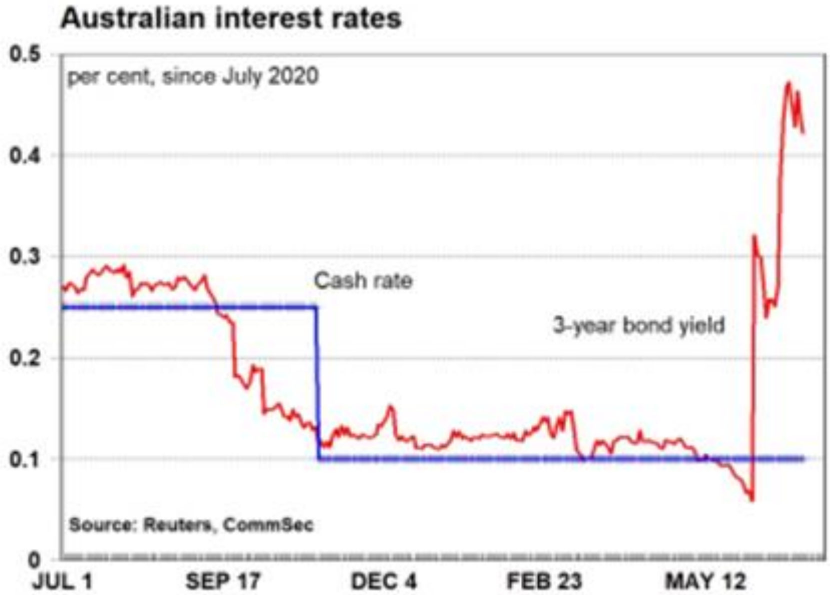
The Eurozone is witnessing a delayed recovery following lockdowns in early 2021. Manufacturing activity are now at new record highs. Employment has also improved, with the Eurozone unemployment falling to 7.9% from 8.0% in May.

Data out of China has also been varied. The manufacturing index was solid, coming in slightly above expectations, continuing to point to an expansionary environment despite global supply issues. However, there has been an easing in the non-manufacturing services sectors, which were impacted by regional lockdowns. Export and import data also disappointed over the month, however industrial profits were up 36% over the year.

In Australia, whilst consumer confidence data has continued to fall following the Melbourne lockdown, other data printed better than expected. Housing strength continued, with prices rising by 12% over the year nationally. Employment grew by 115k (vs forecast of +30k) and the unemployment rate fell to 5.1%. The level of employment in Australia is above its pre-pandemic level, and Australia and New Zealand are the only advanced economies where this is the case. Following this report, some domestic banks have begun altering their calls on the timing of a higher official cash rate, tapering of the Reserve Bank of Australia's (RBA) quantitative easing (QE) and timing of yield curve control measures. Some banks are expecting rate hikes as early as 2023, and the markets are already fully pricing in a rate hike of 0.25% by November 2022 and 0.75% by March 2024.



The market is anticipating the July board meeting whereby the RBA will make its decision on whether to extend the 3-year yield control target and how it will continue its QE program. They continue to communicate that it will not increase the cash rate until inflation is sustainably within the 2-3% target range. Whilst there have also been price increases for some items due to pandemic-related interruptions, they see inflation pressures subdued. The RBA believe that in order for inflation to be 2-3%, wage increases will need to be materially higher, currently not expected until at least 2024.



Notwithstanding this messaging, the last 12 months has seen the Australian economy flip substantially. In 2019-20 Australia experienced its first recession in 28 years – impacted by the coronavirus as well as drought, bushfires and storms. 2020-21 the Australian economy has experienced the sharpest recovery since the 1970s due to the speed and size of economic stimulus and support supplied by the government and the Reserve Bank.