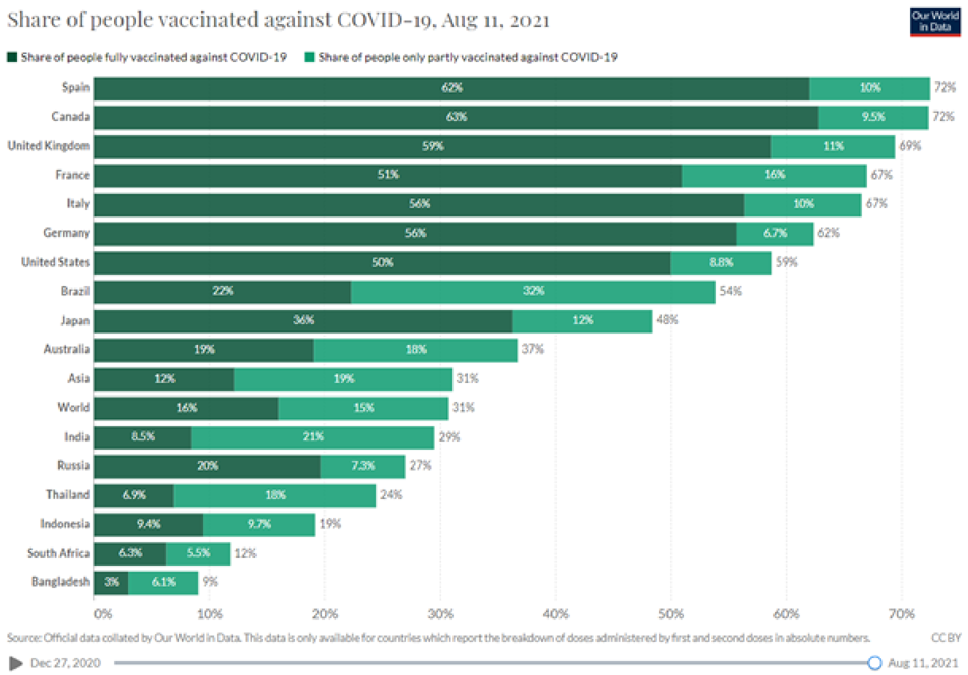
Financial Market Conditions – July 2021

COVID-19 continues to be a dominant force, with the delta variant representing a risk both locally and overseas. The emergence of the COVID-19 delta variant has proven to be a major challenge for Australia. Only Tasmania and the ACT have been spared from lockdowns over the last two months, with 80% of Australia population in lockdown at one point. Globally, longer term interest rates have fallen, unwinding the increases seen earlier in the year. There has been a dampening of expectations of economic recovery globally, with markets witnessing that the pace of the economic recovery will continue to be dependent on the success of vaccination programs, virus outbreaks, and the ability to control the spread of the virus.

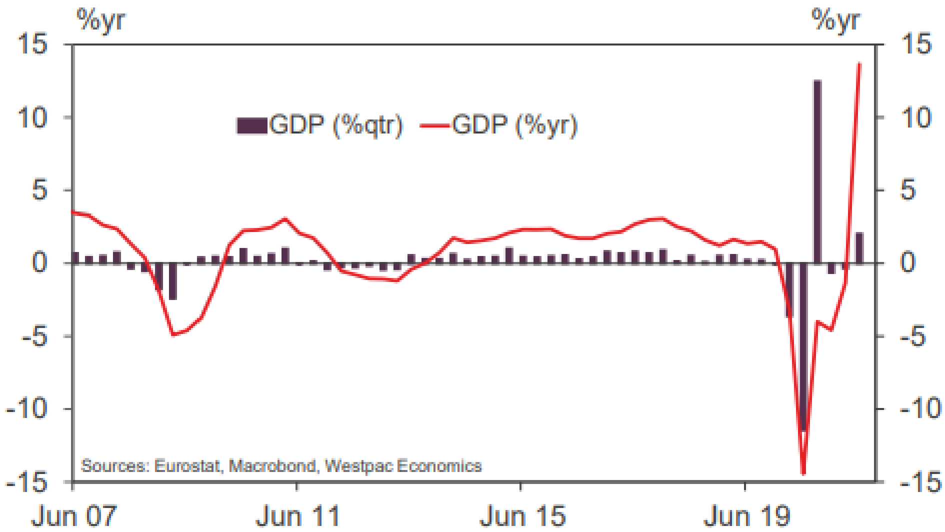


Throughout the month, equity markets showed intermittent volatility with fears over rising COVID cases globally and the Chinese government causing some uncertainty, announcing regulations in the technology and education sectors to 'prevent market abuse and improve oversight'. The regulatory action highlights the ability for the Chinese government to intervene into markets, making it more difficult for competitors to enter – which caused a sharp decline in Chinese and Asian equities. Whilst the turbulence throughout the month caused some volatility, positive economic news globally, continued accommodative monetary environment and fiscal support, underpinned by global vaccine rollouts has seen global equity markets continue to edge higher.

The most recent minutes of the Federal Open Market Committee (FOMC) meeting showed clear evidence of the growing confidence in the outlook for growth in the economy, however still outlined that there is further 'ground to cover' before the normalisation process can begin. Strong US payrolls supported this view, and the unemployment rate fell to 5.4% from 5.9%. However, after months of upward surprises; core inflation moderated slightly to be 0.5% higher in July. Used car prices, accommodation and travel dipped after consecutive months of rises, to an annual pace of 4.3% (from 4.5%). US GDP disappointed, however still expanded at 6.5% annualised in Q2, and consumer spending at its highest level in more than a century.

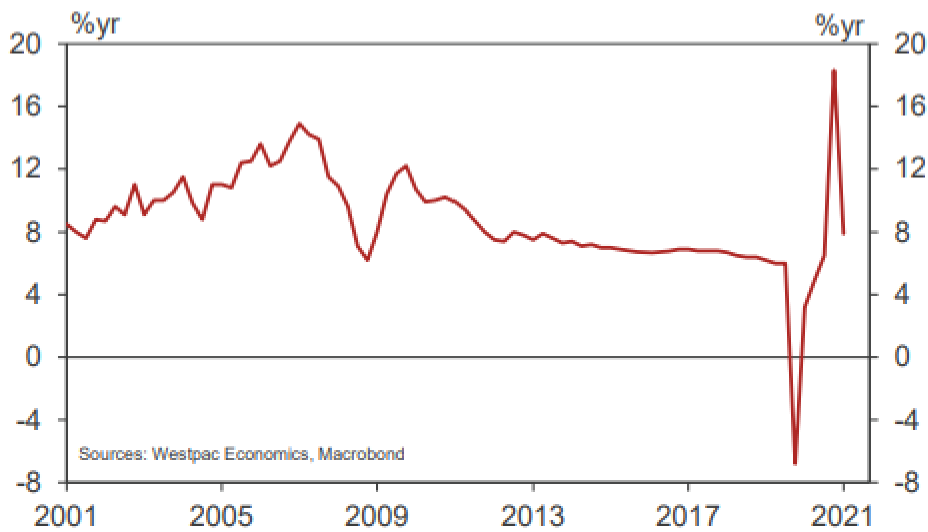
The Eurozone is continuing to play catch up, and data is promising. The Eurozone GDP for Q2 came in at 2%, significantly higher than expected (and in fact, faster than the US). Italy's Q2 performance was particularly astounding at 2.7%, given they endured the worse COVID experience of any major country, now growing almost twice as fast as Germany.

Euro Area snaps out of technical recession…



In China, the aggressive growth that was witnessed over the past 6-months appears to be slowing down but still continued to grow at a faster rate than most developed economies. Growth continues, albeit at a slower rate. GDP for Q2 printed below the market's expectation at 7.9%, and retail sales weakened from 12.4% to 12.1%. Finance figures were also weaker than expected with credit growth its slowest pace since pre-pandemic at 10.7% year on year. Small COVID outbreaks continued to occur throughout China, which affected household spending and services. Iron ore and China's steel production has been capturing headlines over the month, with Iron Ore prices down as much as 17% since the record high in May. The Chinese government have attempted to place caps on output and raising export tariffs on steel materials after China's steel production rose 12% in the first half of 2021. The AUD has continued to weaken, touching its lowest level since November 2020. Depending on the true impact of these controls, Australia may have witnessed the peak in demand for iron ore, for now.

China real GDP growth: an unparalleled rebound



In terms of other parts of the Australian economy, there is no doubt that lockdowns locally have affected the economic landscape. Compared to the start of 2021, consumption is now down almost 7%. Hospitality is down almost 25% since the start of the year (compared to down 2.4% in the same week in 2019), clearly reflecting the hard hit from lockdowns and border closures. Not surprisingly, GDP forecasts for Australia are being amended due to the COVID lockdowns. Retail results are even softer - now down over 10% since the start of the year. The RBA noted in its August statement that 'the near-term outlook is highly uncertain and dependent on health outcomes', and as a result it is expected that the unemployment rate will increase for a time, however banks and the RBA generally believe that this will bounce back and the unemployment rate is expected to resume its downward path to be back at below 5% by December. GDP growth is expected to be a little over 4% over 2022 and around 3% over 2023.The RBA continue to communicate that until inflation is consistent with a 2-3% target and wages growth is evident, rates will remain low.