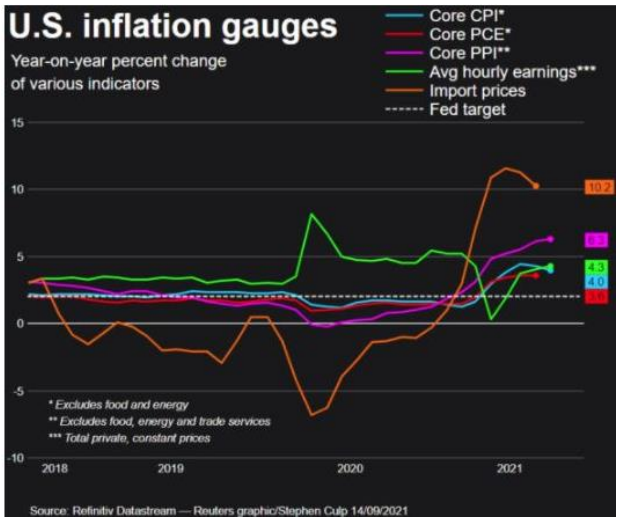
Local Government Finance Authority

Financial Market Conditions – September 2021

Over September, the predominate COVID news in Australia was in relation to vaccination rates and increasing confidence that economic activity will resume as restrictions ease. It is expected restrictions in lockdown states will ease mid-October, and that nationally the vaccination rate will hit 80% by mid-November. Whilst the Delta variant continues to present major challenges, even for countries with high vaccination rates, countries are trying to strike a balance between easing restrictions and avoiding undue pressure on health systems. The positive news is that despite the Delta variant, cases are not accelerating, and fatality rates remain low.

Following eleven months of consecutive gains throughout the year, global sharemarkets fell heavily in September. Concerns from investors were related to a developing energy crisis in Europe and China, potential financial crisis surrounding Chinese property developer Evergrande, and concerns over slowing of the global economy coupled with rising inflation pressures due to bottlenecks in supply, posing a threat of stagflation. Impacting the local share market, the iron ore price saw significant pressure and fell over 22% in one week. However, despite the 4% fall in global equities, markets are still up over 15% over 2021.

In the US, data continues to be varied, with US inflation data coming in weaker than expected, supporting the Fed's view that inflation pressures are transitory. However, wages surprised to the upside, illustrating pressures to the labour market. During the month the US Federal Reserve's Federal Open Market Committee (FOMC) signalled that bond-buying tapering is coming, especially if the economy continues to progress in line with expectations. Many members feel the 'substantial further progress' test on employment has been met, and Powell's own view is, it has 'all but met'. Markets are continuing to price in Fed raising rates by late 2022 and appear set for an announcement of tapering of QE at their October meeting. The soft CPI number however does give the Fed more flexibility and time.

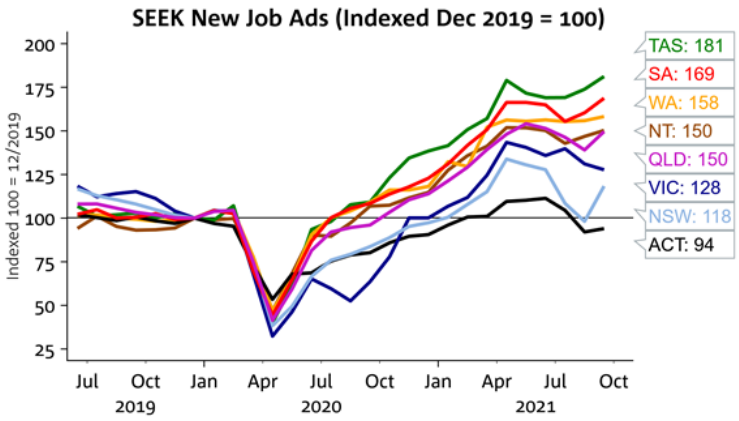


In Europe, economies are witnessing a continued recovery. Inflation was stronger than expected, however the ECB President, Christine Lagarde has made it clear that these transitory supply shocks don't have a bearing over the medium terms – illustrating the dovish attitude of the ECB to continue supporting the European economy as required. A major concern currently plaguing global markets is the ongoing energy crisis centred on Europe, with gas prices twice as high as they were a month ago as the region enters the start of winter. In the UK, data continued to be strong, with unemployment improving to be back at pre-pandemic levels. Inflation was higher than expected, and the Bank of England also are focused on supply constraints and potential persistence of high inflation into 2022. Canada has similarly witnessed historically high inflation figures, at 18-year highs with expected tapering next month and potentially the first-rate hike in Q3 2022.

China stepped back into the limelight throughout September with real concerns regarding the Chinese economy and the focus on the troubled Chinese property developer, Evergrande. In addition, the Delta strain and travel restrictions over the month continued concerns for ongoing supply shocks, with retail sales and industrial production lower than expected over the month. China's official manufacturing data highlighted that the situation is a real threat, with a contractionary reading in September for the first time since 2019. Further government clampdowns and restrictions in steel production (down by 13%) has also contributed to concern across markets. If the situation continues to persist, GDP growth could suffer a material hit in Q4.

In Australia, despite two major cities being in lockdown, availability and growth in vaccination rates has helped sentiment. Retail sales were weaker in August, however, were better than expected. There has also been a sharp rise in job advertising, suggesting labour demand remains strong. RBA Governor Lowe gave a speech on 'Delta, the Economy and Monetary Policy', commenting that the Delta outbreak has delayed but not derailed the recovery of the economy. He also addressed the issue of house prices, given they are 19% higher than before the pandemic. Lowe confirmed that the RBA will not raise the cash rate to cool the property market, outlining that 'higher interest rates would, all else equal, see lower housing prices, they would also mean fewer jobs and lower wages growth, a poor trade off in current circumstances.' Coincidentally on the 6th of October, APRA announced increase of 0.50% to assess new borrowers' ability for ADI's to meet loan repayments, at an interest at least 3% above the loan product rate.

Chart 1: SEEK job ads lift strongly in September, driven by a surge in NSW ahead of re-opening on October 11



Source: National Australia Bank, SEEK

In terms of GDP expectations, Lowe outlined that there is the expectation of a contraction of at least -2% over the September quarter, however, anticipates that the economy will be growing again in the December quarter. He reiterated that the cash rate would not be increased until inflation is sustainably within 2-3% target range and that wages need to be growing by at least 3%, and we are currently well short of this.