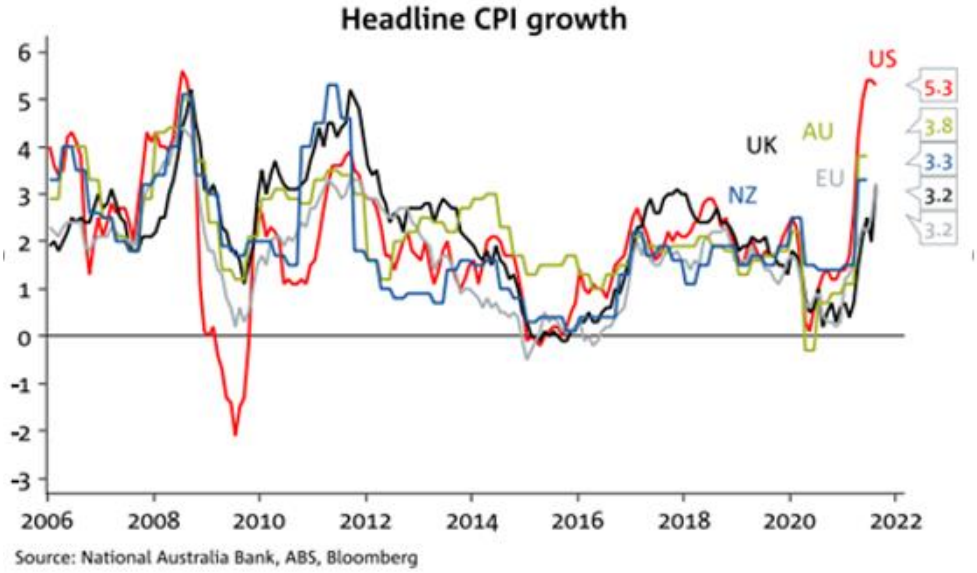
Local Government Finance Authority

Financial Market Conditions – October 2021

In Australia, there has been a clear shift in focus over recent months from the number of COVID cases, to the level of vaccination rates, and the easing of restrictions and borders opening both nationally and internationally. For financial markets, the predominant focus globally has been elevated inflation persisting for longer than expected and intensified supply chain disruptions. There is an increasing divided view from central banks with regards to monetary policy and appropriate responses with regards to the quantitative easing that has been delivered throughout the pandemic and the timing of the tightening of monetary policy.

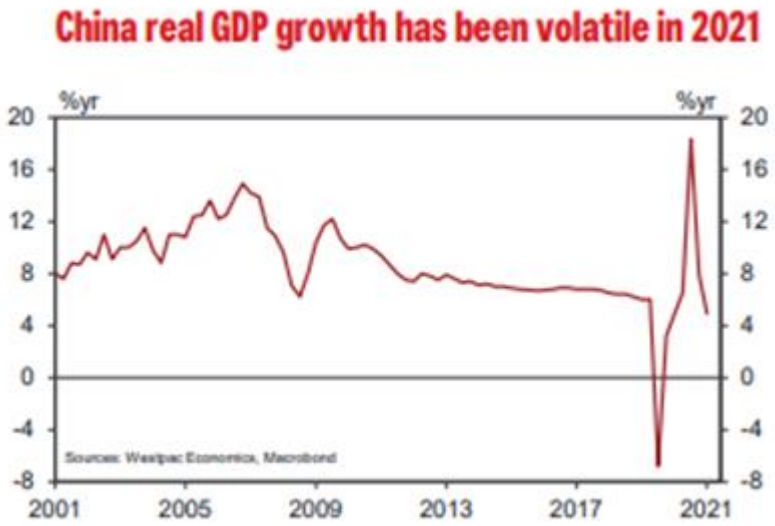
Equity markets rebounded from its contraction in September, and stocks globally closed at record highs once again. For the year, the S&P 500 is up more than 22%. Global markets gains were supported by encouraging corporate earnings and an easing of fears around China's property sector. In the first week of November, the Australian share market printed its best week since May, and US equity indices recorded its best month of the year.

In terms of economic data, the US continues to post high inflation figures, with September printing its highest level in 13 years, and October prices rose by 6.2% year on year, the highest result in 31 years. The Federal Reserve still expects that inflation will prove transitory, however there is increasing evidence that both underlying inflation and wage growth have increased sharply. US jobs data through the month was stronger than expected, with the jobless rate falling from 4.8% to 4.6%. Whilst the US Federal Reserve continues to 'talk down' the prospect of higher rates in the short term, they have reduced the pace of quantitative easing, commenting that the pace of tapering will become more data dependant from January. Markets expect that rates will start to rise in 2022. There is a divide among central banks globally about inflation concerns and associated monetary policy decisions, for some countries, such as the UK, Canada and New Zealand, they have highlighted the potential need to tighten monetary policy sooner rather than later – with New Zealand hiking rates in October for the first time in seven years.



In Europe, the economic recovery has continued to accelerate. Although headline inflation is twice the ECB's target, the October Monetary Policy Statement reinforced their views that these pressures as transitory and that they will continue to maintain the pace of asset purchases to support the economy. While the market has priced a small rate hike in for late-2022, the ECB's forecasts and rhetoric point to no change until at least 2024. Energy prices continue to surge, printing at 23% higher for the year, due to strong global demand and regional supply shortages. Employment is seeing evidence of green shoots, with unemployment falling from 8.6% to 7.5%, however, wage growth is not evident.

Concerns regarding the Chinese economy and potential defaults with two large property developers in China were abated with the avoidance of defaults with the assistance from the Chinese government. Their continued focus on the zero-COVID goal has weighed on the GDP growth expectations, and as such forecasts for GDP growth in China have been downgraded from 9% to 7% with the potential of further shut-downs. China's economy is struggling with several headwinds including lockdown restrictions, a weaker property sector and the energy crunch seeing widespread factory closures. However, despite some headwinds, consumers are still spending with retail sales continuing to post growth. Even despite global supply-chain disruptions, China posted a record monthly trade surplus in October with exports rising by 27%.



Improved sentiment in Australia following increased vaccination rates and the prospect of borders opening in addition to positive economic data has resulted in a considerable move in higher interest rate expectations. The most significant data focus was higher than expected Q3 inflation data, 2.1% over the year, posting its highest annual rate since 2015. This was the catalyst driving yields sharply higher, as much as 0.50% over 10 years – despite the RBA's view that rates will be maintained until 2024. Retail sales came well above expectations in September, despite lockdowns and Australia's housing markets are again outperforming expectations, continuing to post strong gains despite recent extended lockdowns, with prices already up 18% over the year. The RBA at its November meeting recognised the faster-than-expected progress towards its goals and the revised outlook for inflation, however the Board noted that if wage growth and inflation is higher than expected, it could warrant a 2023 move in the cash rate, they do not believe this will occur in 2022.