ECONOMICS & MARKETS

Market Update 24 September

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By Dr Shane Oliver
Head of Investment Strategy and Economics and Chief Economist, AMP Capital Sydney, Australia

Investment markets

Global shares fell sharply early in the week but then rebounded as fears around China Evergrande receded and the Fed meeting was out of the way. This saw US, European and Chinese shares rise for the week, but Japanese shares fell. Australian shares also fell despite a mid-week rally as the weak iron price weighed on miners which along with falls in financial and property shares more than offset big gains in energy and utility stocks. Bond yields rose again on the back hawkishness from the Bank of England, a rate hike from Norway's central bank and Fed signals for a faster reduction in bond buying. Oil prices rose and the iron ore price had a bounce, but the copper price fell. The $A rose slightly.

Shares stabilise but short-term correction risks remain. The US share market has seen a good rebound from technical support and fears about Evergrande causing a global Lehman moment have receded but we could still see more volatility over the next month or so: there could still be more bad news out of Evergrande before a restructuring occurs; the US debt ceiling is far from resolved; tax hikes are likely on the way in the US; supply constraints are continuing to weigh on growth and contribute to inflation; and seasonal weakness usually runs into mid-October. However, despite near term uncertainties we remain of the view that the likely continuation of strong global growth and tight monetary policy being a long way off augurs well for shares over the next 12 months.

Four reasons why a disorderly default and liquidation of Evergrande is unlikely. Global fears around contagion from Evergrande have receded a bit but it's too to sound the all clear. However, while Chinese authorities want to teach property developers and investors a lesson about the dangers of too much debt, they are most unlikely to allow Evergrande's failure to mushroom into a full-on credit squeeze dragging in other property developers and resulting in a property fire sale that collapses the property sector and the economy. There are basically four reasons why a restructure of Evergrande is likely:

• The Government can't allow a collapse in property prices as it would destroy much of the wealth of Chinese households.

• A collapse in the economy and property sector on the back of the pandemic could trigger a surge in social unrest.

• A collapse in property construction would be contrary to the Government's desire to make housing more affordable.

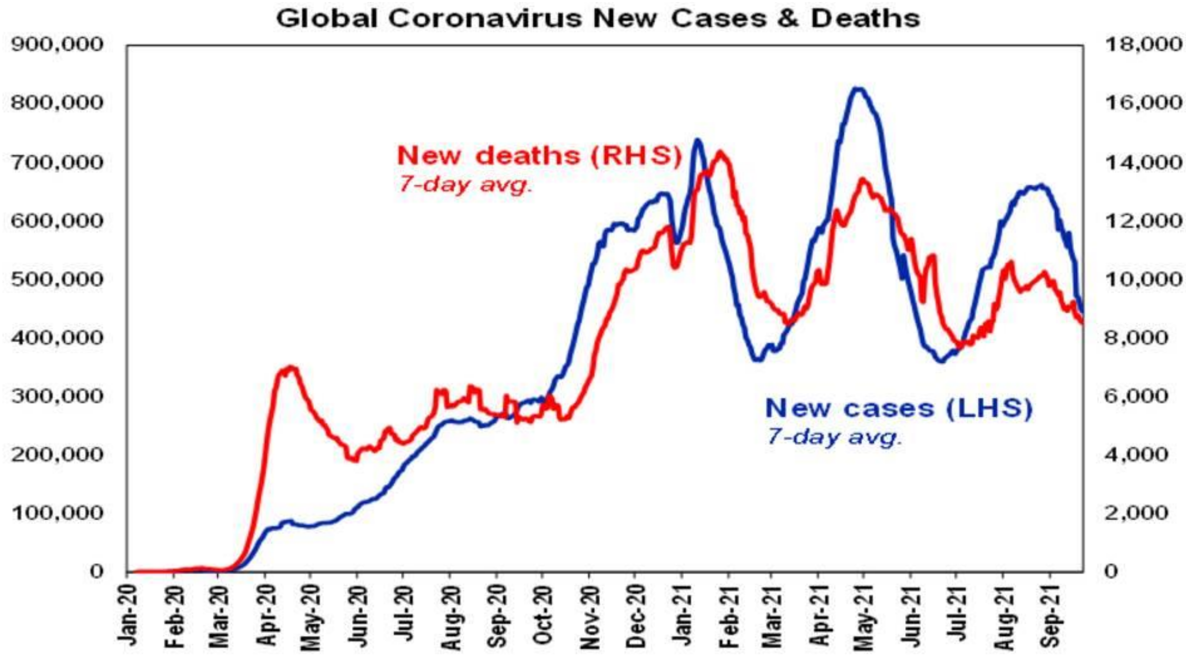
• And the Chinese Government saw the damage allowing Lehman to go bust caused and will have learnt from that.

The "resolution" of a Renminbi debt payment due on 23rd September and the relative calm in China's own debt markets are possibly signs that authorities are working towards a restructuring. While a default on its $20bn in US dollar debt would be big, its not out of line with corporate bond defaults in recent years and well below Lehman's $140bn default.

I wonder. In pre covid times when I used to go on planes there was a film called Sugar Man about this singer called Sixto Rodriguez. It looked kind of heavy so I didn't get far into it on the flight but a while later I was in a taxi and this guy was playing these really mind blowing songs and when I asked he told me it was Rodriguez and it turned out the taxi driver was South African so had a soft spot for Rodriguez. Anyway, I watched the film and realised he was fantastic. He had cut some songs years back – but didn't do so well in the US, but did in South Africa and Australia – but he sort of then disappeared. Anyway, here are two of his best: I Wonder and Forget It. "But thanks for your time. Then you can thank me for mine. And after that's said, Forget it." And Crucify Your Mind. These songs are really amazing. Its such a shame they sort of got lost for a while.

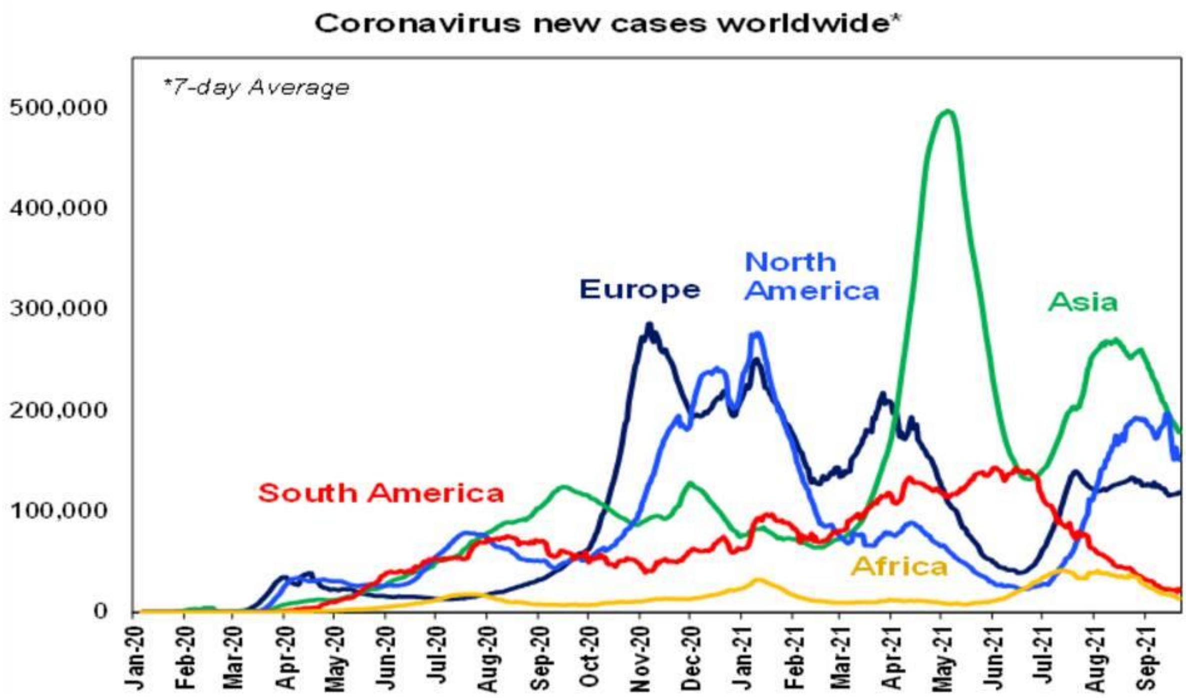
Coronavirus update

The better news flow continued on the coronavirus front. New global coronavirus cases are continuing to trend down.



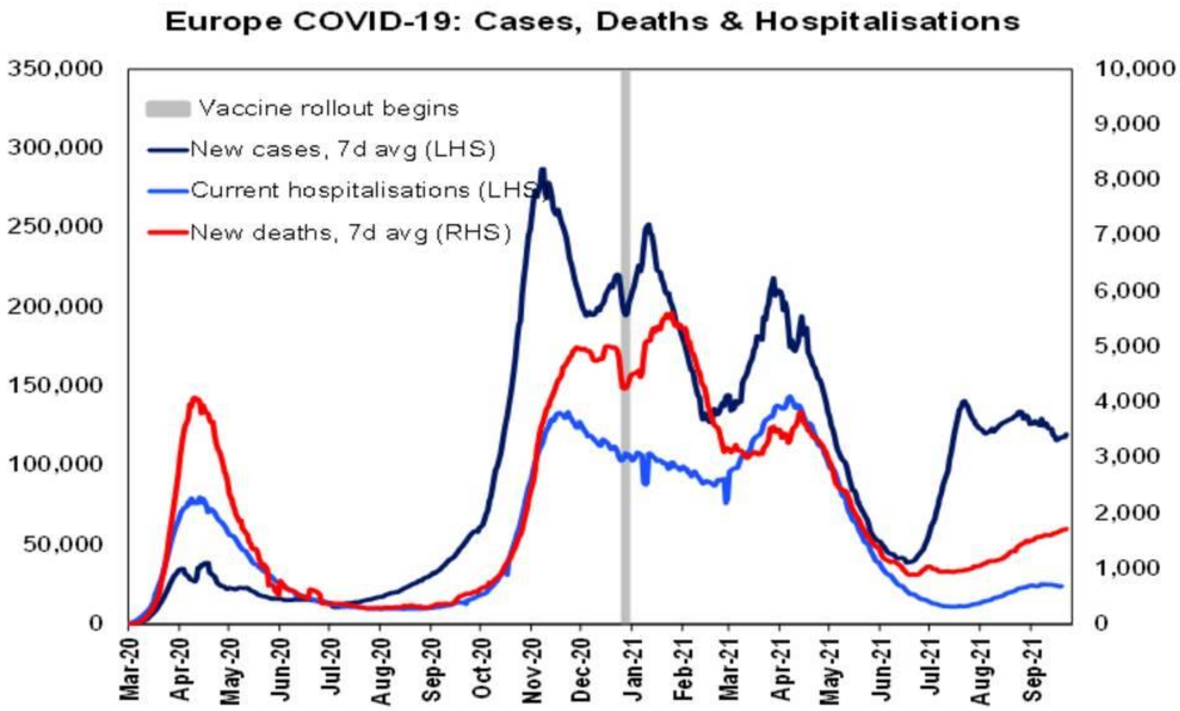
Source: ourworldindata.org, AMP Capital

Most regions are seeing a downtrend in new cases. Asia, South America and Africa are all trending down, the US looks to have rolled over as the lowly vaccinated South slows and Europe looks to have stabilised. China has seen some more clusters, but numbers are low.



Source: ourworldindata.org, AMP Capital

Vaccines are continuing to work in helping prevent serious illness. Hospitalisations and deaths remain relatively subdued compared to previous waves in Europe and the UK. And Israel is seeing a stabilisation or slowing in new cases, hospitalisations and deaths, likely helped by booster shots.



Source: ourworldindata.org, AMP Capital

46% of people globally and 70% in developed countries have now had at least one dose of vaccine.

Percentage of population that's been vaccinated & had a booster

	% 1 dose	% 2 doses	% Booster
Global	46	33	
Developed countries	70	60	
Emerging countries	54	38	
Poor countries	15	11	
Canada	78	72	0
Singapore	83	81	0
UK	73	67	0
US	65	56	0
Europe	67	62	0.4
Japan	67	55	0
Israel	67	62	35
Australia	60	39	0

Source: ourworldindata.org, AMP Capital

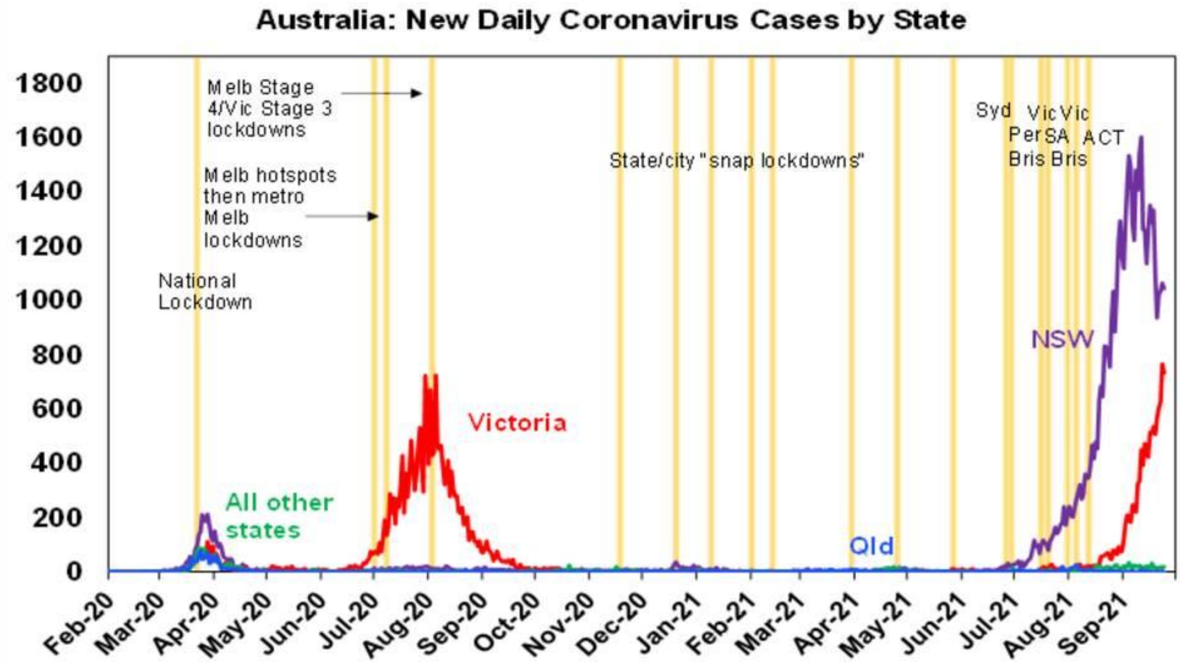
The key risks to watch out for are:

• a renewed spike in cases in developed countries into the northern winter (given 30% are unvaccinated and vaccines are only 60 to 80% effective in preventing infection) & as vaccine efficacy may start to wane without booster shots;

• the low coverage in poor countries – US moves to ramp up vaccine donations and support a goal of vaccinating 70% of the global population is a good move: and

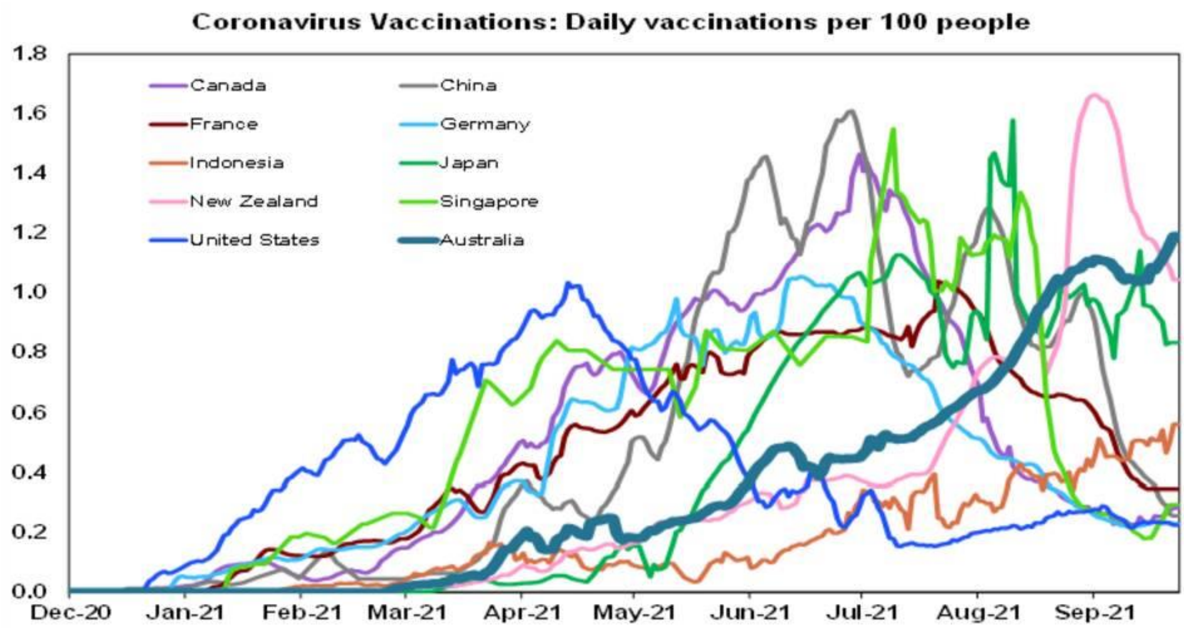
• the risk of more deadly/more transmissible mutations.

New Australian cases may have peaked (for now). Victorian cases are still surging, but NSW and the ACT are down from their highs and NSW's effective reproduction rate is below 1.



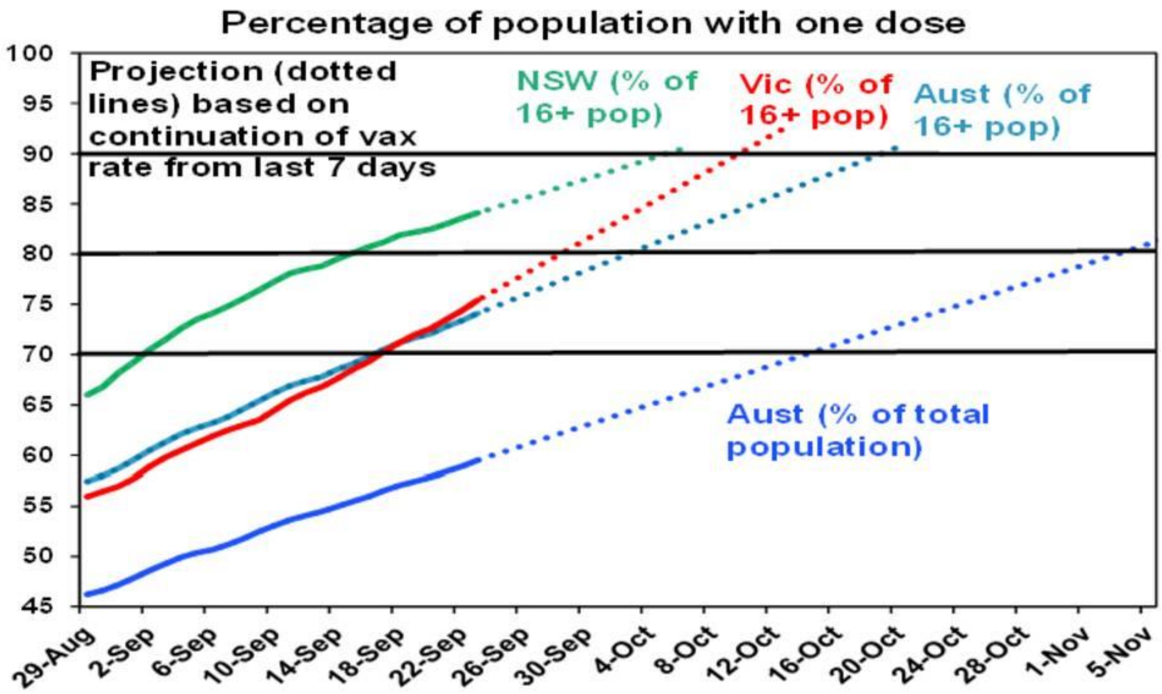
Source: covid19data.com.au, AMP Capital

60% of Australia's whole population has now had at least one vaccine dose and the daily vaccination rate is running at 1.2% of the population.



Source: ourworldindata.org, AMP Capital

Key vaccine targets are on track to be met in October and November, starting in NSW. The next chart shows a projection of when NSW, Victoria and Australia will meet adult vaccination targets for one dose based on an extrapolation of the average daily vaccination rates seen in the last 7 days. Note that for first doses, NSW is through 80%, Victoria through 70% and Australian through 70%.



Source: Covid19data.com.au, AMP Capital

On the basis of this projection the following table shows roughly when key double dose vaccination target dates will be met based on the current lag between 1st and 2nd doses. **NSW will hit the 70% of adults target around 5th October, Victoria around 31st October (although as seen in NSW it**

will likely speed up) and Australia on average around 25th October. At the current rate Australia could hit 80% of the whole population fully vaccinated by 11th December – which is what we should ideally be aiming for at least, given the risks around Delta!

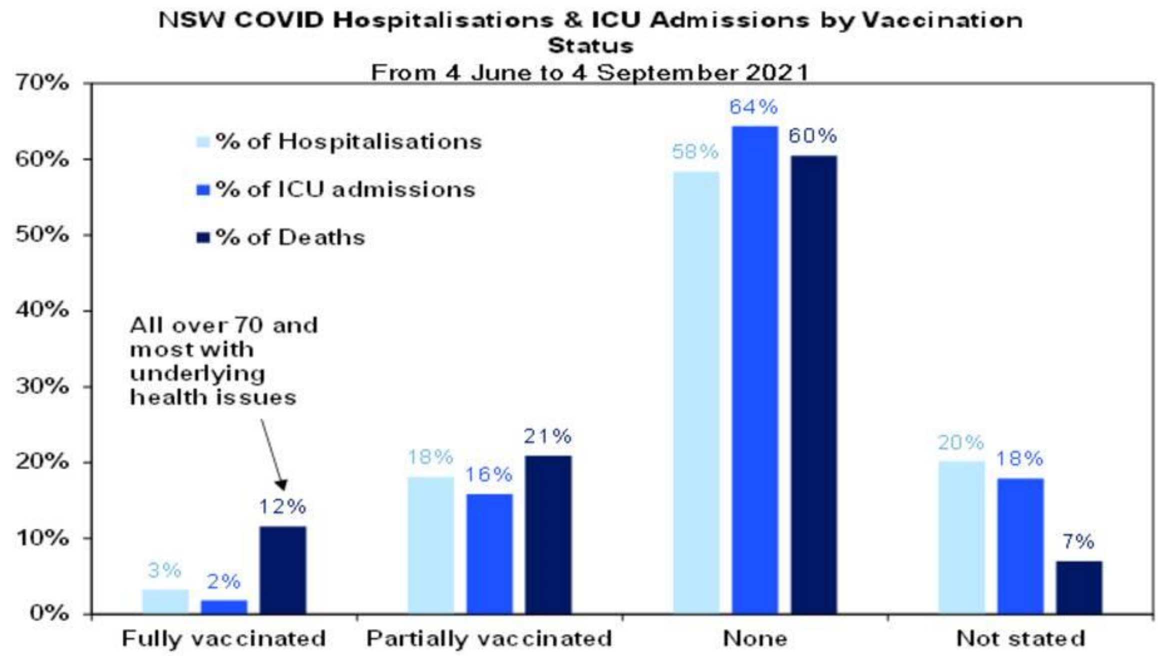
Projected dates to meet Australian vaccination targets

% of population	1 dose	Gap*	2 doses
NSW, 70% of 16 +	2 Sept	33	5 Oct
NSW, 80% of 16 +	15 Sept	33	18 Oct
Victoria, 70% of 16 +	17 Sept	44	31 Oct
Victoria, 80% of 16 +	29 Sept	44	12 Nov
Australia, 70% of 16 +	17 Sept	38	25 Oct
Australia, 80% of 16 +	3 Oct	38	10 Nov
Australia, 80% of total	3 Nov	38	11 Dec

* Current gap in days between 1st and 2nd doses. Source: AMP Capital

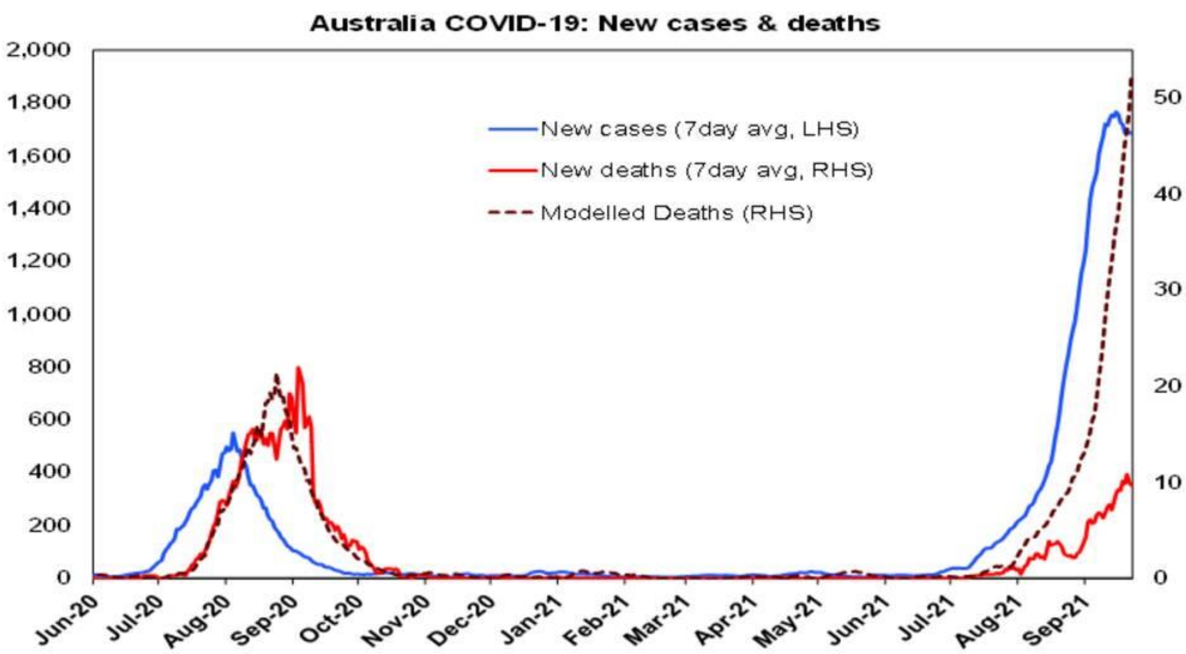
So, NSW is on track to start reopening by the second week of October, Victoria in late October/early November and the ACT (not shown) in mid-October. Ideally this should remain gradual initially until higher vaccination rates are met in order to avoid problems in the hospital system and hence setbacks. A surge in cases to record levels in Singapore (despite being 82% vaccinated) highlights that reopening probably won't be smooth sailing. So far Singapore's serious cases and deaths are remaining low (helped by vaccines) – although its early days.

Meanwhile, vaccination is continuing to help keep serious illness down. Coronavirus case data for NSW shows that the fully vaccinated make up a low proportion of hospitalisations.



Source: NSW Health, AMP Capital

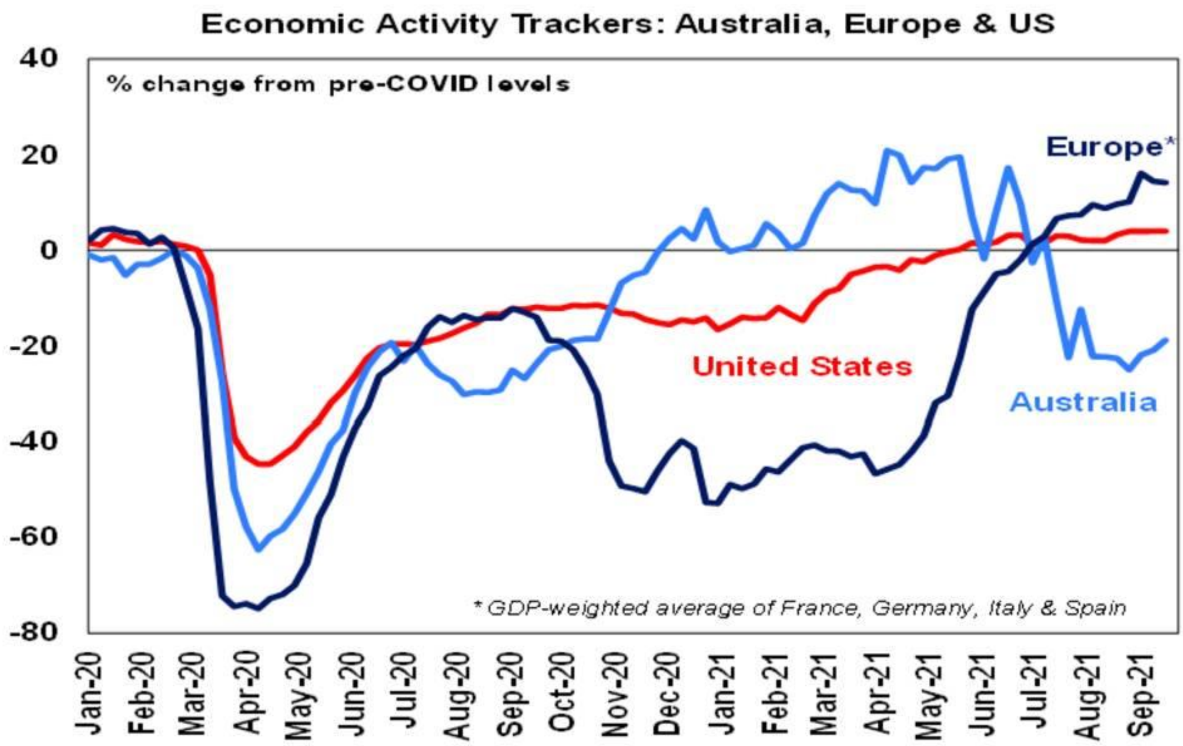
Consistent with this, the level of deaths (the red line in the next chart) are running at around 20% of the level predicted on the basis of the previous wave (dashed line).



Source: ourworldindata.org, covid19data.com.au, AMP Capital

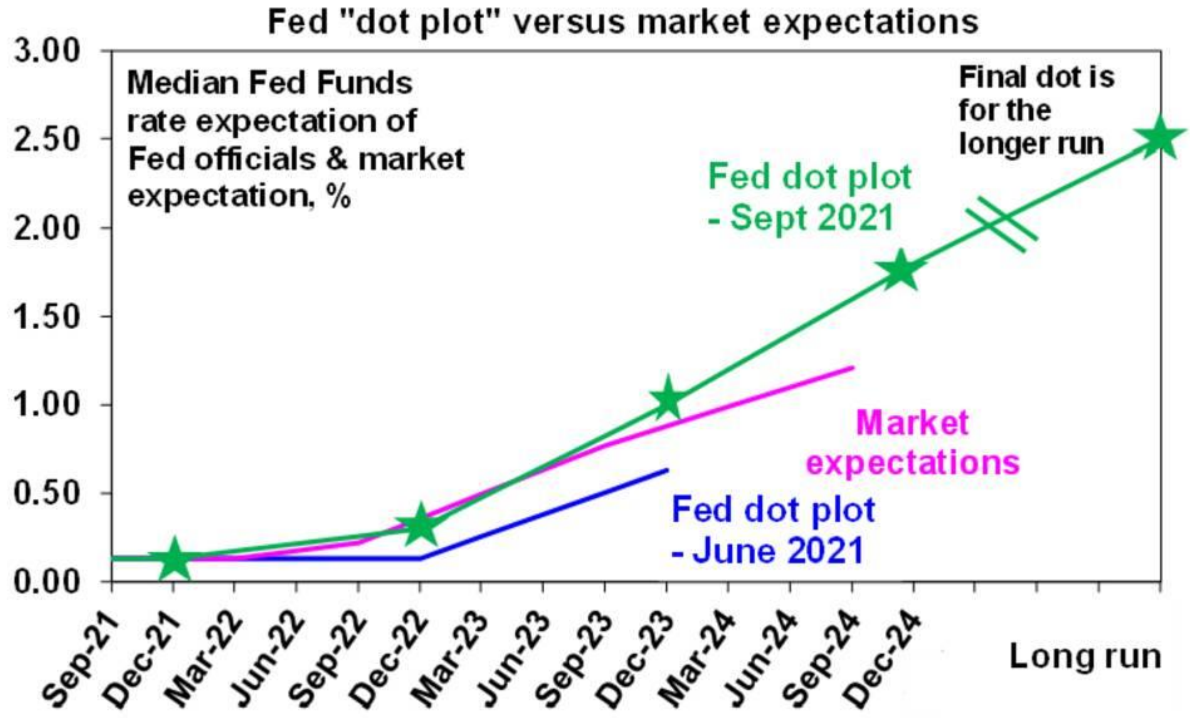
Other key developments

While our Australian Economic Activity Tracker remains well down from its June high, it continued to edge up over the last week, reflecting a modest increase in mobility as some regional lockdowns were eased. Assuming there are no further major state lockdowns, Australian economic activity has probably bottomed and will start to recover through next quarter with reopening. **Our US and European Economic Activity Trackers have held at reasonable levels although improvement has been stalled by Delta outbreaks.**



Based on weekly data for eg job ads, restaurant bookings, confidence, mobility, credit & debt card transactions, retail foot traffic, hotel bookings. Source: AMP Capital

Fed signals tapering likely to start in November – bullish but not aggressively hawkish. While there was a degree of market nervousness going into the Fed meeting it provided no real surprises. Yes the Fed indicated that tapering “may soon be warranted” with Fed Chair Powell saying it could start in November and end around mid-2022 (which implies about a $US15bn reduction in bond buying each month) and the “dot plot” of Fed officials’ interest rate expectations moved higher. However, the Fed’s optimism on growth, it’s still gradual move towards removing stimulus, the taper remaining conditional on further progress towards the Fed’s goals and the likelihood that the Fed’s key officials do not expect a rate hike until 2023 are all positive for markets.

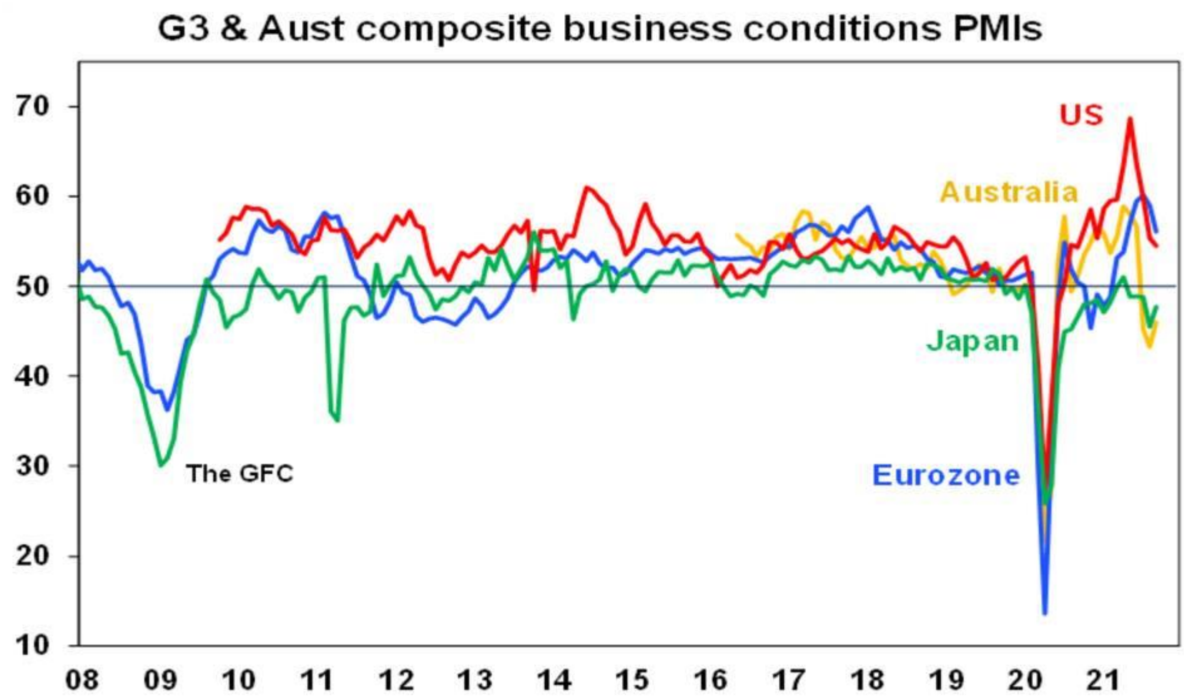


Source: Bloomberg, AMP Capital

Fed taper from November may make it easier for the RBA to taper again from February next year. The RBA's latest minutes added nothing really new – but they did note that other central banks starting to taper was another reason for it to continue with tapering this month. This is not surprising as RBA QE was partly aimed at matching QE by other central banks in order to offset upwards pressure on the $A. By February next year when the RBA's current bond buying will be up for review, the Fed will likely be well into tapering so it may make it easier for the RBA to take another step down in bond buying to say $3bn a week although the gradual initial recovery in Australia may work against this.

Major global economic events and implications

US business conditions PMIs and housing remain strong. US business conditions PMIs fell slightly in September as Delta concerns and supply constraints remain but remain strong. While home sales fell, home builder conditions along with housing starts remain strong.



Source: Bloomberg, AMP Capital

Eurozone PMIs fell in September but remain strong.

The Bank of England was more hawkish than expected opening up the possibility of an earlier end to QE and earlier rate hikes, and Norway's central bank became the first G10 central bank to raise rates.

The Bank of Japan made no changes to its ultra-easy monetary policy but provided details as to how its Green Financing operations will work (cheap funding to clean green financial institutions that meet certain conditions). Meanwhile, Japanese business conditions PMIs improved slightly in September and core inflation remained weak at just -0.5%yoy.

Australian economic events and implications

Australian payroll employment still falling. Payroll jobs fell -1.3% in the second half of August and are down -1.7% since July with lockdowns continuing to impact and the full impact of the Victorian and ACT lockdowns starting to show. Meanwhile quarterly jobs data confirmed that the biggest jobs losses have been in hospitality and leisure including the arts. We continue to expect employment to have fallen another 150,000 or so in September before starting to recovery with "reopening".

Fortunately, business conditions PMIs look to have bottomed. The composite PMI remained weak in September as lockdowns depress the services sector, but managed to rise 2 points as reopening roadmaps boosted optimism.

Household wealth surged by another 5.8% in the June quarter. No surprises here as both property prices and the share market were strong. This is providing a boost to consumer spending via a positive wealth effect.

What to watch over the next week?

In the US, Congress will need to pass a continuing funding resolution to avoid a Government shutdown from 1st October – and most likely will. On the data front the key focus is likely to be on the September manufacturing ISM which is expected to remain strong at around 60 with still solid price gains and core private final consumption deflator inflation which is likely to show a moderation to 0.2%mom but remaining high at 3.6%yoy, with both due Friday. In other data, expect gains in durable goods orders (Monday), consumer confidence and home prices (Tuesday) and pending home sales (Wednesday).

In Europe the initial focus will be on the outcome from Sunday's German election – but it's unlikely to be market negative. While coalition building could prolong the uncertainty the most likely outcome is a left leaning coalition with the Social Democrats, Greens and FDP or failing that a coalition between the Social Democrats and Christian Democrats. The latter likely means more of the same, but the former means easier than otherwise fiscal policy and both mean ongoing support for the Eurozone. On the data front, Eurozone economic sentiment data (Wednesday) is expected to have remained strong, unemployment (Thursday) is likely to fall further to 7.5% and core CPI inflation (Friday) is likely to remain around 1.6%yoy.

Japanese industrial production data (Thursday) is likely to show a further fall and jobs data and the Tankan business survey will be released Friday.

Chinese business conditions PMIs (Thursday) will be watched for some improvement after the relaxation of some coronavirus restrictions this month.

In Australia, expect August retail sales (Wednesday) to fall -2.5% as the lockdowns continue to impact, building approvals to fall -3% reflecting the ongoing unwinding of the HomeBuilder boost, a further acceleration in housing credit and August job vacancies to have held up reasonably well consistent with private job ad data (all due Thursday), and housing finance to show a -2% fall but CoreLogic home price data to show a solid 1.3% gain in capital city property prices led by Brisbane, Sydney and Adelaide (both due Friday).

Outlook for investment markets

Shares remain vulnerable to short-term volatility with possible triggers being coronavirus, global supply constraints & the inflation scare, less dovish central banks, likely US tax hikes and a debt ceiling standoff and the slowing Chinese economy. But looking through the short-term noise, the combination of improving global growth and earnings, vaccines ultimately allowing a more sustained reopening and still low interest rates augurs well for shares over the next 12 months.

Expect the rising trend in bond yields to resume as it becomes clear the global recovery is continuing resulting in capital losses and poor returns from bonds over the next 12 months.

Unlisted commercial property may still see some weakness in retail and office returns but industrial is likely to be strong. Unlisted infrastructure is expected to see solid returns.

Australian home prices look likely to rise by around 20% this year before slowing to around 7% next year, being boosted by ultra-low mortgage rates, economic recovery and FOMO, but expect a progressive slowing in the pace of gains as poor affordability impacts, government home buyer incentives are cut back, fixed mortgage rates rise, macro prudential tightening kicks in and immigration remains down relative to normal.

Cash and bank deposits are likely to provide poor returns, given the ultra-low cash rate of 0.1%. The setback from coronavirus lockdowns could push the first rate hike back into 2024.

Although the $A could pull back further in response to the latest coronavirus outbreaks, the threats posed to global and Australian growth and falling iron ore prices, a rising trend is likely over the next 12 months helped by strong commodity prices and a cyclical decline in the US dollar, probably taking the $A up to around $US0.80.