People's Choice
Banking for life

Market Watch

Monthly Commentary October 2021

Climate change concerns and energy woes dominated the global economy this month as nations prepared for the UN's Climate Change Conference (COP26) and continued to respond to a tightening energy market. Focus on China continues as investors keep their eyes on the property sector, looking for any further indications of instability after September's Evergrande "almost-crisis". Financial markets, spurred on by strong September quarter earnings, sparked the bulls across Australia, the US and Europe.

Developments in the global economy

COVID-19 Update

Australia was able to celebrate a meaningful milestone this month as the country's vaccination rate surpassed Israel, the poster child for the COVID-19 vaccine rollout. States began to launch and fulfil re-opening plans as vaccine milestones were hit. Prime Minister Scott Morrison announced plans to reopen the international border following the completion of home quarantine trials in NSW and SA. On the 1st of November, Australian residents will have the freedom to move beyond international borders without permission from the federal government, an anticipated move coming after more than 600 days of restricted borders. Further, from this date, fully vaccinated residents will also be able to return to Australia however, entry requirements will differ state to state.

In NSW, the resignation of Gladys Berejiklian in the face of an ICAC investigation and subsequent appointment of Dominic Perrottet as premier at the beginning of the month has seen an acceleration of the states re-opening. Re-opening rules saw fully vaccinated citizens able to return to NSW and not be required to quarantine, however will need a negative PCR COVID test within 72 hours of entering. Victorians will follow a similar returning procedure, where the state's hotel quarantine program will only be needed for international arrivals who have not had an approved vaccine or refused to be vaccinated.

Following Perrottet's speeding up of NSW restriction rollbacks, fully vaccinated people were allowed back at NSW pubs and beauty salons as well as able to play community sport and gather in large groups. Victoria saw a similar end to stay at home orders as the state reached its 80% vaccination rate a week ahead of schedule.

Queensland announced a re-opening plan this month and will be opening their borders to all states from December 17 or when 80% vaccination rate is reached. Tasmania had a slightly turbulent month after the southern region of the state was plunged into a snap lockdown, however re-emerged as planned three days later.

Internationally, COVID began to take more of a backseat in policy agendas. Japanese case numbers plummeted to the lowest in nearly a year this month however health experts remain vigilant as the threat of a winter rebound still exists. COVID cases in eastern Europe surpassed 20 million this month as more than 40% of those cases were reported in Russia where only 36% of the population has had at least one vaccine shot. The region continues to grapple with the worst outbreak since the pandemic started, as their inoculation efforts lag and morgues begin to reach full capacity. Ukraine extended their state of emergency until the end of the year to aid in reining in infection rates.

Australia

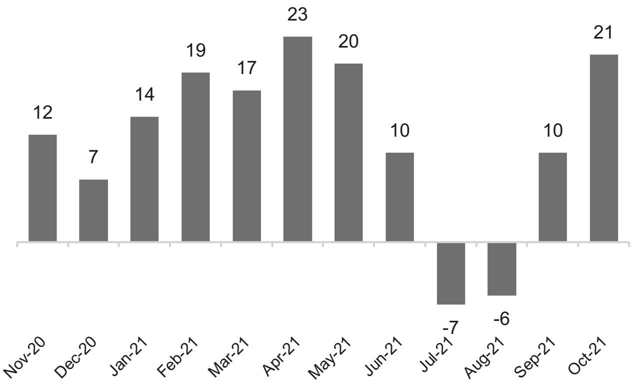
Housing became the hot topic this month for Australian regulators as October dwelling prices grew 1.5% - hitting a cumulative 21.6% growth over the year. Being the strongest annual growth since 1989, it seems some early signs of geographical divergence are beginning to appear as Perth prices fell -0.1% for the first time since June 2020. Growth across the two largest markets of Sydney and Melbourne has also slowed from the pace seen earlier in the year reporting 1.5% and 1% respectively.

As concerns increase over the level of sustainability for housing growth, multiple regulators have begun putting eyes on the market. The Australian Prudential Regulation Authority (APRA), Australia's banking regulator, announced an increase in the serviceability buffer from 2.5% to 3%. This measure, that increases the buffer that lenders must use to assess the borrowing capacity of prospective borrowers, will formally come into place on 1 November.

Since this announcement there has been mixed discourse, with Federal Treasurer Josh Frydenberg supporting APRA's move, stating that Australia needed to recalibrate its balance between credit and income growth. However, critics have pointed out that it might contribute in further eroding the small component of housing demand that is still first home buyers.

Business confidence for September was reported this month alongside vaccine rollouts and reopening roadmaps leading to a jump in the metric. Rising 19 points to a high of +13, this makes it the largest monthly gain since mid-2020 and well-above the long-run average. By industry, the jump in confidence was led by recreation & personal services and wholesale trade. Confidence remains strongest in mining and construction while it is still low, or in negative territory across other industries.

Chart 1: Australia' Business Confidence



Source: Trading Economics

Climate change was a large topic of discussion this month ahead of Prime Minister Scott Morrison's attendance at the 26th UN Climate Change Conference (COP26) in Glasgow. Prior to the conference, the Liberal party was engaged in negotiations with the Nationals hoping to reach a decision on committing to a net zero emission by 2050. The coalition finished the month agreeing to that target with a near term commitment to cut emissions by 26% below 2005 levels by 2030. Many have been underwhelmed at these commitments and are watching closely if COP26 will cause a possible improvement of this goal.

The Reserve Bank of Australia (RBA)'s Deputy Governor came forward warning of the potential implications for this weak target – warning that foreign investors were increasingly bringing up the topic of climate change with the RBA, Australian corporates and government debt buyers.

Core inflation for the September quarter was released this month – surprising markets as it reached its highest levels in the last 6 years. Data from the Australian Bureau of Statistics (ABS) showed the headline consumer price index (CPI) rose 0.8% in the third quarter and 3.0% for the year, much as expected. However, the trimmed mean measure of core inflation favoured by the RBA rose 0.7% in the quarter, above forecasts of 0.5%. This gave capital to the RBA critics, as supposedly evidencing the stance that the RBA is behind the curve on inflation and monetary policy tightening should happen earlier than planned.

Unemployment was also a theme for the month as Australian media outlets reacted to PWC and Deloitte's report coining a post-COVID easing era as 'The Great Resignation'. The consultants published that almost 40% of workers in Australia are planning to change jobs within the next 12 months, following the phenomenon seen already in the US. The September unemployment rate was reported this month, citing a 10-basis point increase reaching 4.6%. As employment declined across the country, economists have attributed this predominantly to Victoria where the state absorbed nearly 90% of the fall in national jobs. The jury is still out on if this Great Resignation era is a short-lived phenomena or a true threat to Australian employment stability as economists, politicians, media outlets and influencers continue to put their 5 cents into the debate.

United States

Government spend was the primary theme of US events this month following the tensions in September over the debt ceiling. In the middle of the month, the House of Representatives gave final approval on the Senate passed bill to temporarily raise the government's borrowing limit to US$28.9trillion. This temporary rise has quelled concerns – at least for now as it will delay the risk of default until early December. Lawmakers will have until 3rd of December to pass spending legislation to prevent a government shutdown.

Climate change was also on the agenda for the US this month, as the US Department of Housing and Urban Development (HUD) announced that it would allocate more than US$2billion in recovery and mitigation funds to nine states and Puerto Rico. This spend comes after 15 separate major disasters, including Hurricane Ida that was estimated to have caused US$20billion to US$30billion in damages.

However, not all government entities were prepared to embrace the conditions attached to the new raised debt ceiling. Despite the US Treasury making a US$350 billion Coronavirus State and Local Fiscal Recovery Fund available to state and local governments, some US states who are struggling with Delta's resurgence have been found not taking advantage of these funds. Idaho, where the highest infection rate in the US has been reported, was found to have rejected some federal funding support despite reports that the state is struggling with not having enough tests nor sufficient medical help.

The US has not been immune to energy woes as natural gas prices surged this month. The country's manufacturing purchasing managers' index (PMI) sunk 2.3 points this month to 58.4 as material shortages coupled with higher electricity prices saw a seven-month low of this metric. Energy prices contributed to an uplift of inflation in September as it edged up to 5.4% - a 13 year high.

September's unemployment rate dropped 40 basis points to 4.8%, the lowest rate since March 2020. However, economists have warned that this drop should be predominantly attributed to people leaving the labour force as the negative effects of Hurricane Ida and COVID's summer spike continue to be felt.

The Federal Reserve's (the Fed) Chair, Jerome Powell, announced that there is still ground to cover to reach maximum employment and therefore satisfy one for the two major hurdles for the central bank to raise rates. However, some action was seen from the Fed on the monetary policy front as it announced a decision to taper asset purchases. Criticism continues of the Fed's inflation stance (the second hurdle to raise rates) as commentators continue to analyse the "transitory" branding.

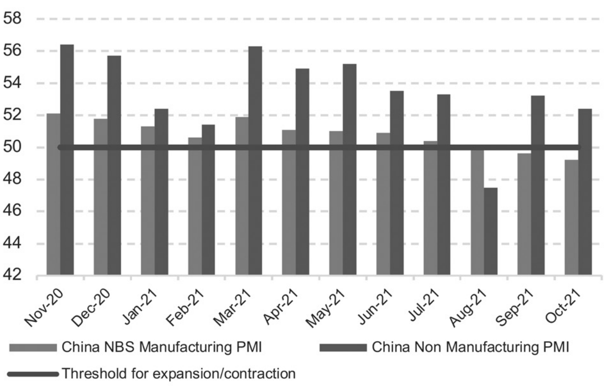
In news further south of the US, Venezuela opened their borders to Columbia for the first time in nearly three years. Venezuela closed the border in February 2019 as the Venezuelan opposition, backed by Bogota and Washington, attempted to bring humanitarian aid into the country through its land border with Colombia against the wishes of President Nicolas Maduro. Columbia prepared for this opening by deploying 14,000 troops to the border to monitor this activity. Venezuela will be hoping that this border opening will help boost cooperation and trade between the two countries as it continues to battle with a multi-year, hyperinflationary economic collapse.

Asia

China's reported its September quarter GDP numbers this month which disappointed market expectations and led to further uncertainty on the road ahead. The National Bureau of Statistics reported an annual growth of 4.9%, underperforming expectations for a 5.2% expansion. This puts China's GDP growth rate back on its bearish run that it held pre-pandemic. Underpinning this, was an additional disappointing quarter for industrial production underpinned by the tightening energy market.

This was mirrored in China's manufacturing PMI as a decrease was recorded in October to 49.2, deepening the contraction below the 50-point threshold first breached in September 49.2. Power shortages and higher costs in materials dragged this metric down, as underlying metrics of factory output, new orders and export sales all declined this month. For non-manufacturing PMI, though declining in October, showed robust recovery from August's sharp contraction. The country's consumer confidence for August was released this month reporting a 10 month low, as the government urged citizens to keeps stores of daily needs ahead of what is predicted to be a tough Winter.

Chart 2: China's Purchasing Managers' Index Data



Source: Trading Economics

A struggling property sector also created a catalyst for disappointing GDP reporting, as growing uncertainty still pervades this month. Following September's headlines centred around Chinese real estate developer Evergrande, this sector continued to be a hot area in Asian markets. Despite missing another payment to debtors this month, China's central bank has assured that Evergrande's situation is controllable.

However, with half of the world's distressed dollar denominated debt tied up in China's real estate sector, investors are watching closely for further signs of instability. This month, analysis was released from multiple research houses that benchmarked the top 30 property firms in China against the country's three redlines – a policy rolled out in January encouraging deleveraging in this sector. With more than two thirds of this sample found to have breached at least one of these "lines", China's central bank announced their continuing view that the industry is stable and Evergrande was a unique case. Investors continue to monitor for signs of validation for this view despite the evidence of red line breaches of major property firms.

In Japan, the newly elected Prime Minister Fumio Kishida got to work, announcing multiple new policy objectives. These included voicing a need for an economic stimulus package worth at least US$282 billion to cushion impact of COVID pandemic. As well as this, Japan announced that will begin to use its foreign reserves to buy ESG securities to combat climate change, as the country was not immune to the tightening energy market, recording power prices hitting a 10-month high for October.

India's headlines followed a similar flavour of responding to energy pressures as the world's biggest coal miner, Coal India, temporarily stopped auctioning coal to non-power customers. Customers such as aluminium smelters, cement manufacturers and steel plants had to look internationally for coal which translated into the country's second largest trade gap being recorded in October. Through sourcing this resource internationally, Indian manufacturers showed robustness this month as the manufacturing PMI increased by 2.2 points continuing the metric into its 4th month of expansion.

Europe

Energy and inflation remained the central themes for European activities this month, as Russian President Vladimir Putin attributed the tightening energy market to green energy transitions. The country, who provides Europe a third of its gas, is seemingly capitalising on energy concerns as it wagers additional gas shipping capacity to Europe for the approval of use of a pipeline crossing the Baltic Sea to Germany. Strong opposition of this approval being granted to Russia is the Ukraine who answered call to arms and announced that they will offer an additional 55 billion cubic meters of gas to Europe. As demand continues to surge for energy in Europe as nations continue to re-open and Winter approaches, economists remained concerned that price hikes will be passed onto consumers and ultimately boost inflation.

The IMF's European department voiced their view that the tightening energy market is a simple supply demand mismatch and should fade out during 2022 and therefore should have short lived effects on long term inflation. As the consumer price increases without underlying wages increasing too due to slack labour markets, the IMF expect there to be some impact on short term inflation.

However, the monetary policy story and inflation views seems to be diverging within Europe as emerging economies (predominantly in Eastern Europe) have seen stronger surges in price growth and higher levels of inflation. Czech Republican, Polish and Hungarian central banks all raised their rates within the past year to tackle inflation making it clear that they do not believe high inflation in this European block is transitory. Hungary is planning more drastic measures, including a nearly 20% increase of their minimum wage next year.

Annual inflation in the UK shrunk marginally by 0.1% for September as base effects saw a slowdown in restaurant pricing from last year's Eat Out to Help Out government scheme rolled out to encourage dining out. Consumer credit increased in September to -1.8% from -2.4% in August, however still remaining weak as increased credit card debt failed to balance repayments made on auto finance and personal loans.

Challenging supply chain headwinds continued this month in the UK impacted by rising energy prices and shortages of workers (notably tanker drivers). However, business metrics steered through robustly as the country's manufacturing PMI rose for the first time in five months in October, reaching 57.8 points – a fair recovery from September's seven month low of 57.1. Strength was also seen in the services sector as that PMI jumped to 58 in October, up from 55.4 the previous month showing that the effects of re-opening efforts are still being felt today.

Germany had a mixed bag of events, ranging from migrant influxes from Belarus to an outbreak of bird flu from a goose farm. Meanwhile ministers from the Bundestag responded to the energy issues assuring that Germany does not have a gas supply shortage but instead an organic withdrawal of reserves triggered by moving into winter.

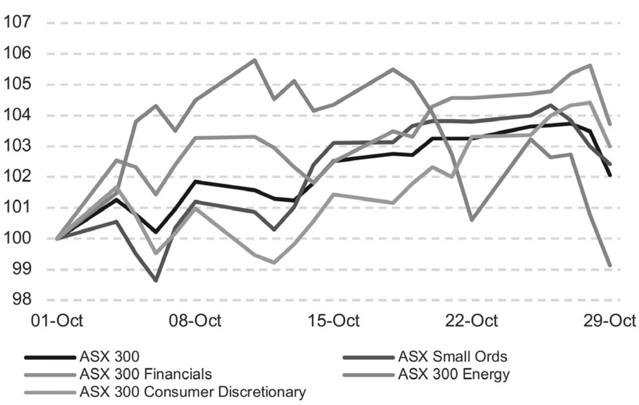
Following last month's election, a coalition has still not yet been formed with talks of early December being when a new chancellor will be finalised. These continued negotiations have opened up discussions of "what ifs" as researchers try to piece together possible policy outcomes based on the possible combination of parties in the coalition.

Developments in financial markets

Australian Equity

Australian markets were mixed this month as the ASX300 Accumulation returned 0.10%. Earnings announcements defined the tides of sectors, as Healthcare returned a strong (+3.05%) spurred on by companies such as CSL and ResMed beating their quarterly estimates. Financials, Consumer Discretionary and Materials all had solid months, returning (+2.78%), (+2.15%) and (+2.49%) respectively. Energy saw a downturn (-0.36%) as markets reacted to Australia's Energy Security Board announcing their forecasting that coal powered energy to be off the grid by 2030.

Chart 3: Australian Equity October Performance, rebased to 100



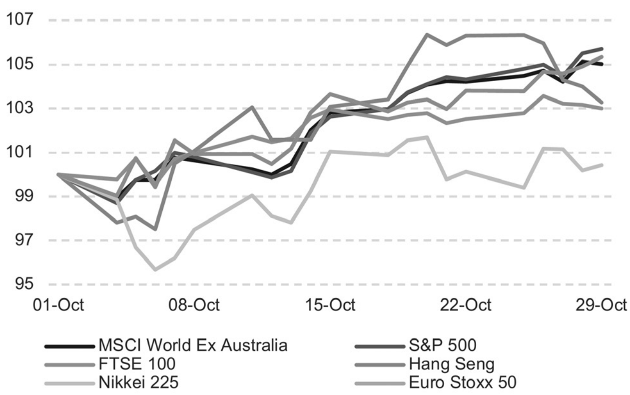
Source: BTIS / Bloomberg

International Equity

Overall, global markets finished in a mixed position this month. US markets showed fully recovery from September spookiness, booming as the S&P returned 7.01%, the NASDAQ 7.29% and the Dow Jones 5.93%. These bullish runs were spurred on by earnings seasons where much like the Australian market, many companies exceeded expectations. According to market analysts, earnings by S&P500 companies have beaten estimates by 10% in the September quarter.

Europe had a weaker bull run than the US but still showed overall strength, as the Europe 600 STOXX reported 4.55%, the French CAC 40 4.76%, the German DAX -2.81% and the UK's FTSE100 2.13%. Asian markets reported mixed returns as while the Hang Seng showed strength in its 3.26% October return, the Japanese Nikkei 225, Shanghai Composite and Korean KOSPI all finished negative, reporting -1.89%, -3.20% and -0.58% respectively.

Chart 4: International Equity October Performance, rebased to 100



Source: BTIS / Bloomberg

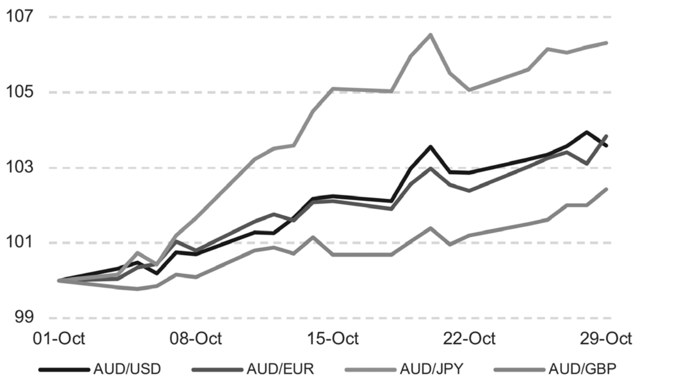
Fixed interest

With continued concerns in the global economy over energy prices uplifting inflation, markets are paying close attention central banks' sentiments and policies. The Bloomberg AusBond Composite (0+Y) index declined during the month to return -3.55% – This was one of the worst monthly performances in history for the Australian market. Higher and more persistent than expected inflation, the abrupt end to the RBA's bond purchasing targeting short term yields and the economy emerging from lockdown sooner than expected led to a significant bear steepening of the yield curve. In international fixed income markets, the Barclays Global Aggregate TR Hedged index's returned -0.26% over the month.

Foreign Exchange

The Australian dollar showed considerable strength this month across most currencies. Markets responded to Australia' core inflation announcement as it sped to its fastest annual pace since 2015 for the September quarter. This prompted a mid-month sharp jump in the Aussie that soon re stabilised for the remainder of October. Against the USD, Aussie returned 4.0% over the month as well as 4.2% against Euro. Strongest momentum was seen in the AUD/JPY as returns topped to 6.6% over the month.

Chart 5: Foreign Exchange October Performance, rebased to 100



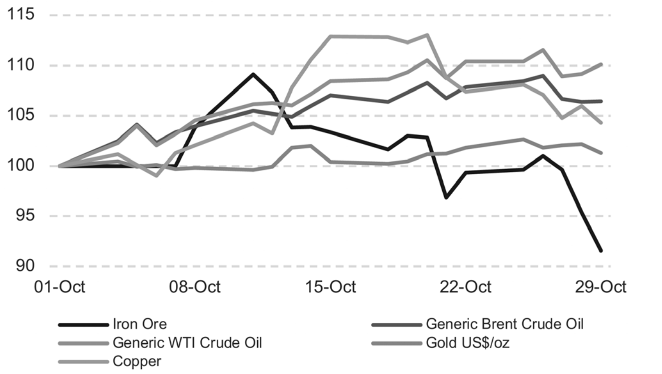
Source: BTIS / Bloomberg

Commodities

Iron ore was a big loser this month as it returned -8.4%. Though this softens September's downward momentum (where the commodity returned -23.72% for that month), many economists believe this is not a depreciation of the metal but instead a mean reversion given the strong growth over the past 18-24 months. Yet, persistent Chinese steel production continues to be a headwind for iron.

Oil showed strength in October as Brent Crude returned 7.5% and WTI Crude 11.4%. Gold remained relatively flat in the face of the US Fed announcing tapering to pandemic stimulus measures as it finished the month returning 1.5%.

Chart 6: Commodity Markets October Performance, rebased to 100



Source: BTIS / Bloomberg

Cryptocurrency

Crypto had a strong run this month as the major coins all finished higher than they started. The historic appreciation followed a similar cadence to listed US markets as Bitcoin and Ethereum both hit all-time highs. Notably, the new social media driven coin Shiba Inu (the rival to Dogecoin, dubbed the "Dogecoin killer") reported a more than 750% gain this month. Chatter within markets have pegged Bitcoin as a hedge against inflation and attributes this bull run as an indication that the US is facing real inflation.

This document has been created by Westpac Financial Services Limited (ABN 20 000 241 127, AFSL 233716). It provides an overview or summary only and it should not be considered a comprehensive statement on any matter or relied upon as such. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation and needs. Projections given above are predicative in character. Whilst every effort has been taken to ensure that the assumptions on which the projections are based are reasonable, the projections may be based on incorrect assumptions or may not consider known or unknown risks and uncertainties. The results ultimately achieved may differ materially from these projections. This document may contain material provided by third parties derived from sources believed to be accurate at its issue date. While such material is published with necessary permission, Westpac Financial Services Limited does not accept any responsibility for the accuracy or completeness of or endorses any such material. Except where contrary to law, Westpac Financial Services Limited intends by this notice to exclude liability for this material.

Information current as at 11 November 2021. © Westpac Financial Services Limited 2021.