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Market Watch

Monthly Commentary July 2021

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The Delta strain continues to run rampant across Sydney, with case numbers continuing to soar and some form of restrictions expected to last for months. Abroad, the Tokyo Olympics commenced despite a total crowd ban due to strict public health orders. Back at home, Brisbane celebrated being named the 2032 Olympic host. COVID-19 related restrictions eased in the UK, with Freedom Day occurring and all COVID related health orders removed. Throughout the rest of the world however, a dire situation is unfolding as Delta's unprecedented virulence is forcing countries to reimplement restrictions and reassess their reopening strategies.

Developments in the global economy

COVID-19 Update

In response to a Delta cluster stemming from NSW, the Victorian government announced a lockdown on July 16 which continued until July 27. Additional support for business was announced as part of a $400 million support package funded by the Federal and State governments.

South Australia entered a week-long lockdown on the 21st, emerging on schedule on the 28th. The State government announced a $100 million support package for businesses.

News was less positive in NSW, as the lockdown which begun on June 26, was extended twice during the month, now due to end at midnight on August 28. The government has made it clear that this end date will depend heavily on vaccination rates across the state, with initial goals set between 50-70% of the adult population. The Grattan Institute, an Australian public policy think tank, released a report at the end of July which warned that Australia cannot afford to abandon its zero COVID-19 strategy until 80% of the population is vaccinated. The Institute estimated that this could take until March 2022 if children are not included and if the vaccine supply issues persist until October this year.

During the month, the NSW Premier declared the current outbreak as a 'national emergency' after case numbers continued to increase along with the number of people infectious in the community. Premier Berejiklian called on national cabinet to reassess its vaccination strategy and increase the supply of Pfizer doses for Sydney. In response, the Prime Minister said the Federal Government would seek to increase future supply in NSW but denied redirecting current doses already allocated to other states.

In July, the NSW Premier also announced that the construction industry across Greater Sydney would be shut down for two weeks, with some exemptions for urgent safety work. Construction is the third largest industry in NSW, contributing $46.8 billion to the state's economy in 2019-2020 or 7.4% of gross state product. Resultingly, the closure was a huge blow to both the economy and jobs, as the industry employs approximately a quarter of a million workers in Greater Sydney. By the end of the month, construction in non-occupied settings outside of 8 Local Government Areas of concern reopened in Greater Sydney, subject to a one person per 4 sqm rule. However, with most of the construction workers residing in the 8 LGA's of concern, the industry is still suffering.

The federal and NSW governments announced further support for businesses, with JobSaver payments available between $1,500 and $100,000 per week based on payroll levels (this was previously capped at $10,000 earlier in the month), with eligibility based on a measured decline in turnover. In addition to existing fiscal support, the NSW government will offer businesses affected by the current lockdown free advice through the Business Connect advisory service.

Prime Minister Morrison announced a four-phase plan out of COVID-19 during July, with each phase dependent on reaching certain vaccination targets. The Federal Government also announced it would waive the liquid assets test for the one-off COVID-19 Disaster Payment for individuals. Throughout the month, the monies available under this scheme for the current NSW lockdown rose to between $450 and $750 per week, representing the same level of support as the first tranche of the original JobKeeper scheme. Additionally, from August, those who are receiving other welfare payments like Youth Allowance or the pension, who have lost more than 8 hours per week of work, will receive an additional $200 a week. In positive news, the Federal Government announced that Australia would acquire 85 million additional Pfizer booster shots in 2022 and 2023.

The end of July saw anti-lockdown protests break out in Sydney, Melbourne and Brisbane. In Sydney, protestors clashed with police with many people charged for breaching public health orders and other offences.

Meanwhile, in Tokyo, cases hit a six-month high as Japan braced to host the delayed '2020' Summer Olympics. In the UK, COVID-19 related restrictions were completely removed on 'Freedom Day', with masks no longer required, as nearly 70% of the adult population have had both doses of the vaccine. Despite this, new cases in the UK were still at their highest in six months during July. Notably, the UK has become one of the first nations in the world to plan a 'boost program' which will involve providing a third round of COVID-19 vaccinations for vulnerable Britons. Over in the US, the Center for Disease Control and Prevention rewrote its guidelines, advising both vaccinated and unvaccinated people to wear masks in public indoor settings. Meanwhile, health officials in Missouri asked the state to set up an emergency hospital to handle a surge in cases linked to the Delta strain.

Australia

In Australia, inflation overshot the Reserve Bank's inflation target band for the first time in a decade in the June quarter, but this was largely due to the unwinding of pandemic-related price reductions.

Minutes from the RBA's July meeting were released during the month, with the RBA announcing it will begin tapering bond purchases under its quantitative easing program from September. It also revealed that the RBA will keep the yield control curve pegged to the April 2024 bond. The cash rate was left unchanged. These July announcements should be read in the context of a near-term deterioration in the economic outlook as when the RBA's meeting was held, the NSW lockdown was expected to last just two weeks. At the time of writing, we know now that lockdown will protract beyond two months.

The economy is expected to contract in the September quarter; current estimates range around the 0.7% mark. Prior to the current outbreak GDP was expected to grow by almost 1.0%. As the lockdown mandate extends beyond 8 weeks, revised expectations for growth to return in the December quarter will likely be revised. Despite this, market consensus still expect the first cash rate hike to come in 2023, although acknowledge there is some risk this time frame could be pushed out if current lockdowns in NSW continue to be extended. This is consistent with expectations that activity will rebound rapidly once restrictions lift, and that the economy was in good shape heading into this period. Notwithstanding this prediction, the current outbreaks are a moving beast. Resultingly, the RBA response will ultimately hinge upon how the ongoing NSW lockdown impacts jobs and inflation.

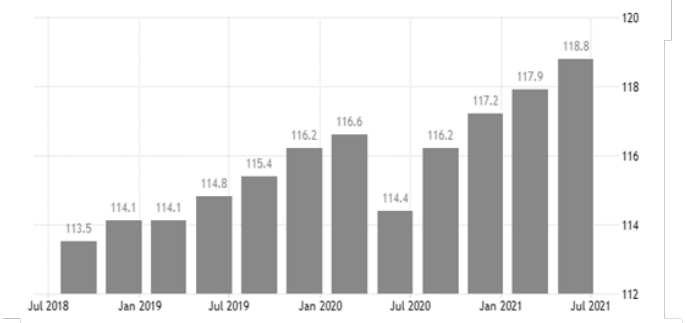
Jobs grew by 29.1k in June to take the unemployment rate down to 4.9%. This is the first time the unemployment rate has fallen below 5.0% since June 2011, making it the lowest rate in 10 years. Encouragingly, the fall occurred against a rise in the participation rate to a near record high. Last month's growth was in full-time employment, which rose 51.6k. Part-time employment declined 22.5k. Consensus expect full employment to be reached within the next 12 months and for the unemployment rate to have a '3' in front of it before the end of 2022.

Earlier in the month, Reserve Bank Governor Lowe gave a speech on 'The Labour Market and Monetary Policy" and discussed the labour supply factors that contributed to weak wages growth. These factors included high participation, greater access to overseas labour markets, and a rise in underemployment.

The headline Consumer Price Index rose by 0.8% in the June quarter, a touch stronger than consensus expectations that centred on a rise of 0.7%. The annual rate lifted from 1.1% in the March quarter to 3.8% in the June quarter - the highest annual rate in almost 13 years. Unlike the headline rate, the underlying inflation rate remains under the RBA's 2-3% inflation target band.

It has been underneath the band consistently since early 2016. The headline rate is expected to drop sharply in the second half of this year and the underlying inflation rate to move gradually higher and into the RBA's band next year.

Chart 1: Australia CPI



Source: Trading Economics

Quarterly surveyed business conditions rose to a record high in the June quarter. The index increased to 32, up 12 index points from the previous quarter. Business confidence eased slightly in the June quarter to 17 but remained well above the long-run average. However, the survey only captures part of the lockdown in Victoria which started in late May and predates the July restrictions faced in NSW, Victoria, and South Australia.

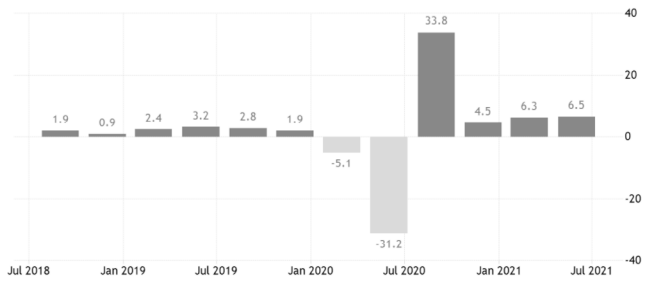
Consumer sentiment held up in July, despite the lockdowns across NSW with the monthly consumer sentiment index rising 1.5% to 108.8. The survey was conducted over the week of July 5-9, during the lockdown in NSW, but before tighter restrictions were announced on July 9.

The residential property boom continues to gather pace and while it has been largely driven by owner-occupiers, lending to investors has rapidly accelerated. The value of new loans excluding refinancing increased by 4.9% in May, hitting a new record high of $32.6 billion. The increase in May was driven by a 13.3% surge in investor lending – the third highest monthly growth rate on record.

United States

The US economy grew much less than expected in the second quarter, barely accelerating from the previous period, whilst GDP rose at an annualised rate of 6.5%, just up from a revised outcome of 6.3% in the first quarter of the year.

Chart 2: US GDP Growth Rate



Source: Trading Economics

On a quarter-on-quarter basis, GDP rose 1.6%, with the weakest components of the print being residential investments and inventories. This highlights the extent to which labour shortages and supply chain disruptions are slowing what is otherwise a solid economic expansion. Personal consumer spending was the strongest component of the GDP data. It rose at an annualised rate of 11.8% in the June quarter, after growth of 11.4% in the first quarter. Stimulus cheques to households between mid-March and early April have helped underpin spending.

Consumer confidence increased to 129.1 in July, from a revised 128.9 in June. This was above consensus expectations of 123.9. It is the sixth consecutive month of increases and takes the index to its highest level since February 2020. Confidence remains high despite the initial boost from reopening and vaccination progress having cooled off. Consumers continue to expect business conditions, jobs, and personal financial prospects to improve.

The Federal Housing Finance Agency house price index rose by 1.7% in May from 1.8% in April. This was above consensus expectations of 1.6%. House prices have risen by 18.0% over the year to May. The result takes the index to a record level.

The Richmond Fed manufacturing index rose to 27 in July, from a revised 26 in June. This was above consensus expectations of 20. The survey result showed optimism among manufacturers that business conditions would continue to improve. Employers reported difficulties with finding the right skilled labour, but also increased employment and wages over the period.

During July the Federal Open Market Committee (FOMC) indicated it was moving closer to tapering bond purchases, with Chair Powell acknowledging they had taken a “first deep dive” into discussing scaling back bond buying. There was also an acknowledgement that the economy “has made progress” toward the central bank’s inflation and employment goals. However, the FOMC also reiterated tapering would not commence until “substantial further progress” was made.

The National Association of Home Builders housing market index edged down to 80 in July, from 81 in June. Homebuilder sentiment nevertheless remains at historically high levels but has been steadily declining since late 2020.

The unemployment rate rose to 5.9% in June, from 5.8% in May, but the rate continued to be understated by people misclassifying themselves as being “employed but absent from work”. Without this misclassification, unemployment would have been 6.1% in June.

Asia

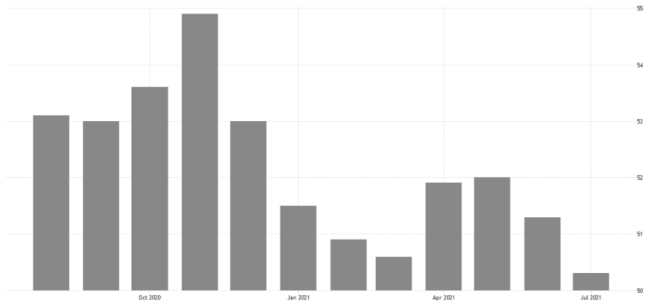
In reforms published by Chinese regulators during the month, firms that teach school curriculums will be banned from making profits, raising capital, or going public. Educational tech shares fell sharply in response. There is growing concern amongst investors that authorities will tighten regulation more broadly, which has weighed on Chinese equities more generally.

On a quarter-by-quarter basis, China’s GDP grew 1.3% in the June quarter, up from a revised 0.4% expansion in the previous quarter. This result was above consensus expectations for growth of 1.0%. China’s trade balance continued to widen in June to US$51.5bn, the highest trade surplus since January this year. Exports grew 32.2% over the year to June, above consensus expectations of 22.9%. Growth was supported by global demand for medical goods and work-from-home equipment. Imports grew 36.7% over the year to June, above consensus expectations of 29.3%. This was down from 51.1% in May. In other data, retail sales grew 12.1% and industrial production rose 8.3% over the year to June, both beating consensus expectations.

The People’s Bank of China cut the reserve requirement ratio (RRR) by 50 basis points to 12%, effective from 15 July. This reduces the amount of cash banks must hold in reserve to boost lending. The move came as a surprise to analysts. However, China’s economic recovery is slowing and the RRR cut is one way for authorities to ensure the recovery is sustained from here.

The producer price index rose 8.8% over the year to June, down from the near 13-year high of 9.0% in May. Meanwhile, the consumer price index rose 1.1% over the year to June, down from 1.3% in May. Food prices fell by 1.7% and non-food prices rose by 1.7%. The Caixin services purchasing managers’ index (PMI) fell to 50.3 in June, down from 55.1 in May. The Caixin composite output index also fell from 53.8 in May to 50.6 in June. Meanwhile, the Caixin manufacturing PMI dropped slightly to 51.3 in June, from 52.0 in May, after new export orders fell.

Chart 3: China Manufacturing PMI



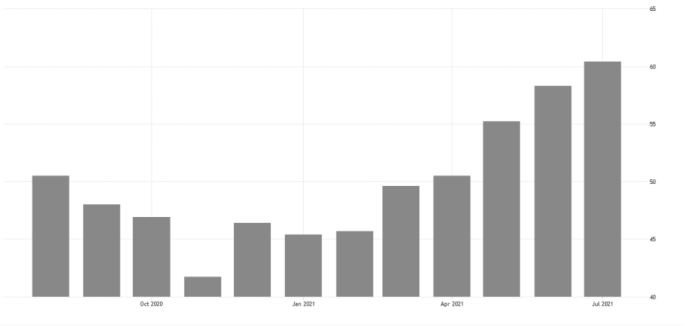
Source: Trading Economics

Across to Japan and July saw a third straight month of surging machine orders, with a gain of 7.8% in May, despite tighter virus-related restrictions. Machine orders are a leading indicator of capital investment. The produce price index rose 0.6% in June to be 5.0% over the year. The increase over the past 12 months partly reflects base effects but also higher commodity prices and the shortage of semiconductors

Europe

The European manufacturing PMI fell to 62.6 in July, from 63.4 in June. This was above consensus expectations of 62.5. While this is the lowest reading in four months, it indicates that the manufacturing sector activity remains in expansion. The sector is facing supply chain issues, which are translating into higher costs for firms. The services PMI also rose in July, to 60.4 from 5.3 in June. The sector is benefiting from easing restrictions in the region. Hospitality, travel and tourism are particularly benefitting.

Chart 4: Eurozone Services PMI



Source: Trading Economics

The European Central Bank (ECB) left its key policy settings unchanged following its July Monetary Policy meeting. This was widely expected by markets. The ECB revised its forward guidance to a more dovish stance. It stated that current accommodative monetary policy settings will remain in place until "it sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon". The guidance stated that this may lead to a period of transitory, above target inflation.

Consumer confidence fell to -4.4 in July, from -3.3 in June as COVID-19 cases increased across Europe, prompting new restrictions. This was below consensus expectations of -2.6.

Business activity in the eurozone region expanded at its fastest rate for 15 years in June, driven by strong performances by the manufacturing and services sectors. The latest and final Markit composite PMI for June rose to 59.5, from the preliminary reading of 59.2 and the May outcome of 57.1. The unemployment rate fell to 7.9% in May, from an upwardly revised rate of 8.1% in April.

Eurozone Industrial Production fell by 1.0% in May following a 0.8% rise in the prior month. This was below consensus expectations of a 0.3% fall. Growth was hampered by disruptions to global supply chains as economies begin to reopen.

In the UK, house prices declined 0.5% in July, but were still 10.5% higher over the year. This marks the first decline in four months, partly reflecting the tax break on purchases being phased out. British consumers were their most confident in July since before the pandemic began, despite the increase in COVID-19 cases. The GfK consumer confidence index rose to -7 in July, its highest level since February 2020. This is up from -9 in June. The UK's unemployment rate unexpectedly rose 0.1 percentage point to 4.8% in the three months to May. Employment rose just 25k in this period against consensus expectations for 91k. UK CPI rose 0.5% in June, above consensus expectations of a 0.2% increase.

World

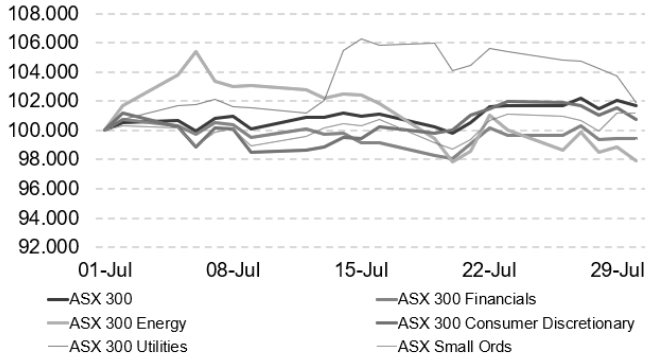
A global tax overhaul is closer after 130 countries, including China and India, endorsed setting a minimum rate for international corporations like Facebook and Google, in what US Treasury Secretary Janet Yellen labelled "a historic day for economic diplomacy". Implementation of rules to curtail tax avoidance by making multinationals pay an effective rate of "at least 15%" could come as soon as 2023, but some hurdles remain.

Developments in financial markets

Australian shares

The ASX300 Accumulation returned +1.11%, while the ASX Small Ordinaries Accumulation gained just +0.68% over the month. The one year returns on these respective indices is +29.14% and +32.30%. The market was led by strong performance in the Materials sector, which ended the month up (+7.94%). In a sharp comparison to June, the Information Technology and Utilities sectors fell, with figures ending down (-6.85%) and (-1.69%), respectively. The Energy and Financials sectors also struggled during July, down (-2.55%) and (-1.38%), respectively.

Chart 5: Australian Equities



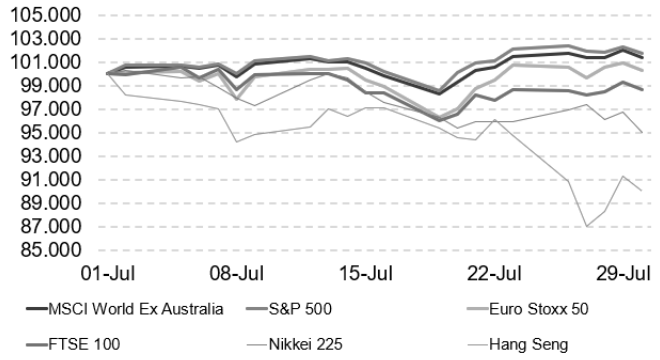
Source: BTIS/Bloomberg

International shares

The MSCI World ex Australia Unhedged index ended the month up +4.03%. The S&P ended the month up +2.38%, the NASDAQ finished up a conservative +1.19%, as did Dow Jones up +1.34%. The respective 1 year returns on the three US markets are +36.45%, +37.53% and +34.79%. European shares were similar, the Euro STOXX up +1.97%. France's CAC 40 and Germany's DAX Index ended up +1.61% and flat at +0.09%, respectively. With the 1 year returns on these respective markets being +29.58%, +38.24% and +26.24%.

Japan's Nikkei saw a substantial dip, ending -5.23% over the month, with 1-year returns decreasing to +27.71%. China's Shanghai Composite finished the month down -5.40% and the Hang Seng was down even further to -9.94%. The Korean KOSPI decreased from June, ending down -2.86%, bringing its one-year return to +42.37%.

Chart 6: International Equities



Source: BTIS/Bloomberg

Fixed interest

The Bloomberg AusBond Composite (0+Y) index saw no change at all from June. For international fixed interest markets, the Barclays Global Aggregate TR Hedged index's one-month number closed at 1.25%. The 10-year Treasury bond yields in Australia finished the month down 35 basis points of the back of fears of a potential slow down in the recovery ending the month at 1.19%.

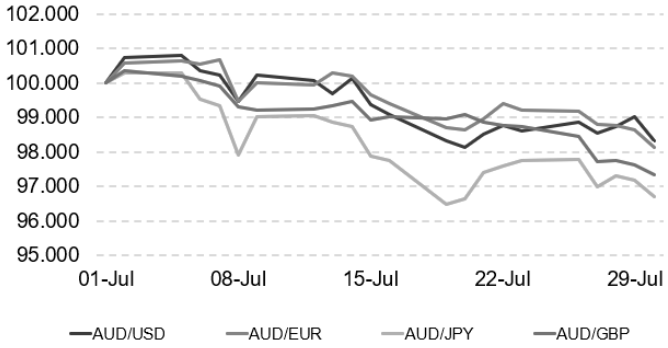
Concerns over the pace of economic growth and technical factors saw the US 10-year Treasury yields continue their recent decline, falling below 1.2% during the month, down 23 basis points, to then finish on 1.26% come month end.

Currencies

The beginning of financial year saw the AUD hold below US 75 cents, down a further -2.05% from June, ending the month at 0.7344. While the AUD may rise conservatively by year-end, expectations are that it will remain close to its current level against the greenback.

The Euro is very conservatively up from June at +0.10% against the USD, ending July at 1.187. The GBP ended up just +0.53%, buying 1.3904 USD.

Chart 7: Major Currencies



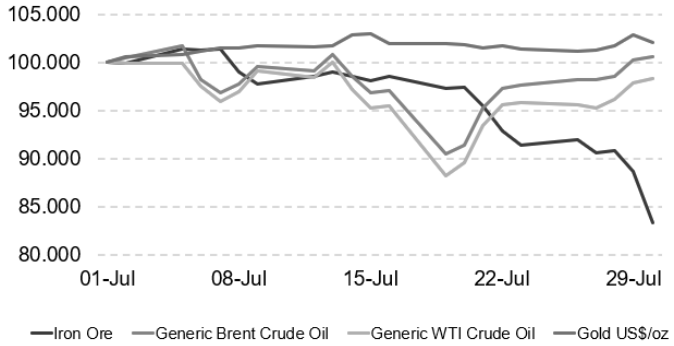
Source: BTIS/Bloomberg

Commodities

Oil prices were volatile in July, swinging between around USD$69 and USD$76, to inevitably finish up against June. Brent Crude oil finished the month at +1.60% to US$76.33, while WTI Oil finished up just +0.65% to US$73.95, both indicating much more conservative growth compared to June from May. Members of the Organization of the Petroleum Exporting Countries and its allies agreed to curb production limits, though demand appears to remain strong enough for the increase in supply.

Despite its upward trajectory over the past 12 months, Iron Ore saw a substantial dip in July, finishing down -15.43% to US$178.63. Therefore, Iron Ore's 12-month growth sits up +63.51%. Gold rose conservatively, ending the month up +2.49% to US$1814.19. The Bloomberg Commodity Index reported a gain of +1.83% up to 96.2754.

Chart 8: Major Commodities



Source: BTIS/Bloomberg