People's Choice
Banking for life

Market Watch

Monthly Commentary May 2021

Market Watch

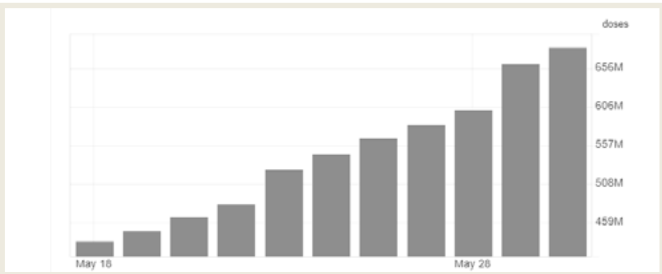
Over the course of May markets saw global inflation fears catalyse volatility. While the high vaccination rates across Europe and the US led to increased consumer sentiment, a rapidly deteriorating outbreak of COVID-19 throughout India sent shockwaves around the world. The US experienced a key piece of infrastructure temporarily cease operations after a Russian based criminal group conducted a ransomware attack on the Colonial Oil pipeline. Meanwhile, President Biden released an ambitious $6 trillion dollar budget. Back home, May saw the release of the much anticipated federal budget, with all eyes on how exactly the Government plans on recovering from the COVID-19 pandemic.

Developments in the global economy

COVID-19 Update

Globally, COVID-19 infections continue to rise with over 170 million cases in total reported since the start of the pandemic to the end of May. Notwithstanding these rising case numbers, vaccine efforts in many countries have been very successful. The US has now fully vaccinated more than 135 million people and President Biden's ambitious target of 70% of adults fully vaccinated by July 4 holiday should see this number rise even further. Moreover, China has vaccinated over 240 million people with their locally developed vaccines and the COVID-19 Vaccines Global Access initiative (COVAX) is currently contemplating using these Chinese manufactured vaccines for emergency use.

Chart 1: Total COVID-19 Vaccines in China



Source: Trading Economics

As for Europe, the World Health Organisation (WHO) estimates that 7% of the European population have been vaccinated, while another 5.5% have already contracted COVID-19.

Accordingly, Europe has experienced lower daily case numbers with a subsequent improvement in consumer sentiment.

However, at the other end of the spectrum, a catastrophic outbreak in India has resulted in over 28 million cases in May. With several states being forced into lockdown, Prime Minister Modi continues to push for citizens to get vaccinated.

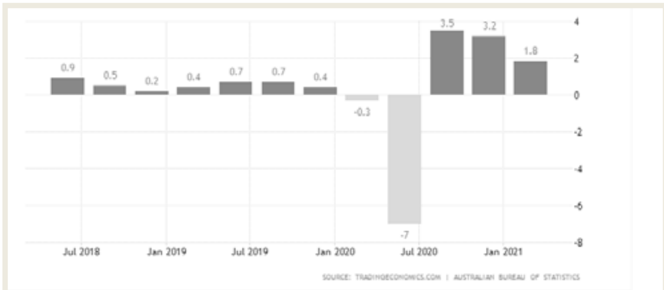
Interestingly, most emerging market countries have vaccinated fewer than 20% of their populations which will hinder the economic recovery for these countries, further exacerbating the gap between developed and emerging economies.

In Australia, there have been over 3.9 million vaccines administered thus far, with New South Wales and Victoria leading the way. During mid-May there was a small outbreak in Sydney which saw minor restrictions imposed temporarily. Additionally, Victoria entered its fourth lockdown after a cluster of cases emerged that have once again, entered the aged care sector. As a result of these new cases, the Trans-Tasman travel bubble with New Zealand was put on hold as Victoria gets ahead of the rise in infections.

Australia

During the month, the Reserve Bank of Australia (RBA) increased their 2021 GDP forecast to 4.75% from 3.50%, with a predicted growth of 3.50% in 2022. As anticipated, in the May month meeting the cash rate was held at 0.1%. The RBA have suggested that 3% or higher annual wage growth is required to sustainably push inflation back into their target parameters. However, we are currently far from achieving this.

Chart 2: GDP Growth Rate in Australia



Source: Trading Economics

The third budget from treasurer, Josh Frydenberg was delivered this month that demonstrated the resilience of the Australian economy. The economy experienced a mere 0.2% contraction last year, a better performance than all other developed economies. A significant theme in this year's budget is to continue preserving the economic recovery through further reducing the unemployment rate to below 5%.

However, this economic resilience has come at a cost – the totality of the government's COVID-19 support package is close to $300 billion, with a cash balance deficit of $161 billion estimated for 2020-21. Additionally, on May 30, following the release of the budget the Victorian Government announced its $250.7 million 'Circuit Breaker' package which aims to support small and medium sized businesses in the wake of Victoria's fourth lockdown.

Market Watch

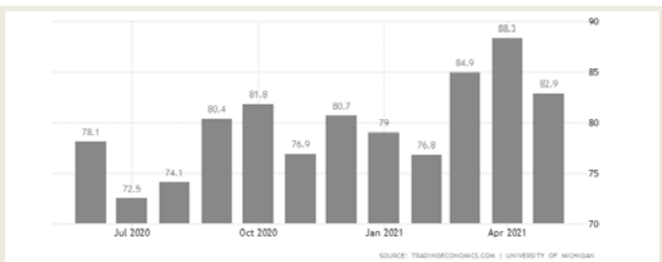
Businesses with loss carry-back provisions were beneficiaries of this year's budget with expensing of assets being extended at a cost of $20.7 billion. Other beneficiaries include aged care who are receiving $17.7 billion in funding over the next four years as well as low/middle income earners, with up to 10 million people receiving another tax offset in their refunds until 2023. On the other hand, the biggest losers were working mums who did not see any provisions for superannuation payments whilst on parental leave, overseas travel as borders are not anticipated to be reopened until mid-2022 and artificial intelligence as researchers do not believe the allocated $124 million over the next six years is adequate.

According to the Melbourne Institute, Consumer sentiment fell 4.8% between April and May, with the budget being released mid-way through the surveyed period. Although, the Roy Morgan survey indicated increased consumer confidence in the week ending May 23, lifting 2.3 up to 114.2. This is the highest level since September 2018 and indicates an improved economic outlook for Australia. Promisingly, unemployment expectations experienced a large decline of 15.3%. The May index reading of 100.2 is the lowest it has been in 10 years, quashing concerns surrounding the conclusion of JobKeeper.

United States

Projections for US GDP have been revised by the International Monetary Fund (IMF) with annual growth expected to be 6.4% in 2021. Pleasingly, unemployment claims in the US are declining. For the week ending May 15, claims fell by 34,000 from the previous month to 444,000, the lowest since Mid-March 2020, demonstrating key steps towards economic normalisation. President Biden has proposed his first full budget since being in office, which comprises of over US$6 trillion in spending for the next financial year. This includes US$1.8 trillion for an American Families plan and a further US$2.3 trillion towards an American Jobs Plan. To counter the high-level spending, Biden also plans to increase taxes for high income earners and corporations, but this will be challenging which Republicans staunchly opposing these changes. The University of Michigan consumer confidence survey saw a reduction from 88.3 to 82.9 in May. This dip may indicate a change in expectations for the months ahead, particularly around slowed economic growth and softening labour market.

Chart 3: US Consumer Confidence



Source: Trading Economics

As for the outlook of the US housing sector, the National Association of Home Buildings (NAHB) index was 83 in May, consistent with expectations from April. Surprisingly, builder sentiment remains positive attributing to the rising costs and diminishing availability of resources. This is supported by the Empire State Manufacturing Index which fell to 24.3 in May from 26.3 in April. This index displayed the increase in prices paid for materials, surged to 85.3, a historic high for this measure. The same sentiment was displayed by the Philadelphia Fed Index, which had its highest index of prices received in 40 years, attributed again to the lack of supply, and increasing cost of materials.

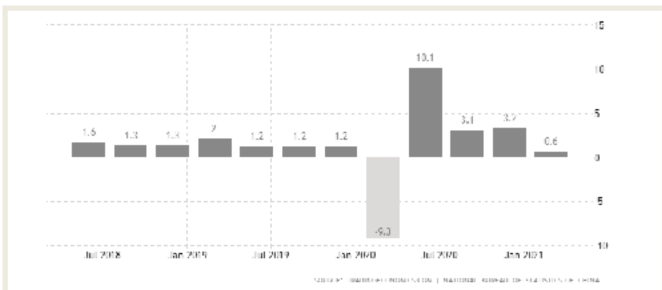
On May 7, Colonial's pipeline network experienced a ransomware attack when it was infiltrated by Russian cyber-crime gang DarkSide, who placed locks on the pipeline's data, demanding ransom in return for the release of their systems. Colonial's pipeline carries 45% of the East Coast's diesel, petrol, and jet fuel supply across an 8850km pipeline stretching between the Gulf Coast, eastern and southern US. In total, DarkSide stole 100 gigabytes of data and Colonial paid the criminals $4.4 million worth of Bitcoin with the primary goal of avoiding any prolonged impacts. However, Colonial will continue to incur tens of millions of dollars in trying to completely restore their systems. The impact of this attack on the market was an increase in the price of fuel, with the price for a gallon of petrol reaching over US$3, a first since 2014. Additionally, there was a shortage of fuel supply, however, this can be attributed to panic buying rather than a supply shortage.

Asia

China's GDP projections by the IMF is predicting continued upward growth with expectations of 8.4% expansion in 2021. It has been an eventful month for steel in China with regulators across multiple regions warning steel manufacturers against engaging in illegal pricing activities. In Tangshan (Hebei Province in North China), regulators threatened to revoke business licenses from anyone participating in these practices. In 2020, Tangshan produced 14% of raw steel in China and is the world's biggest steel producer. The warning followed a surge in steel prices, overtaking the rise of iron ore. Additionally, steel manufacturers in Shanghai received a similar message from the government, urging them to operate in a socially responsible manner to equilibrise steel prices.

In other news, the Chinese government is trying to mitigate the decreasing birth-rate by allowing couples to have a third child, after the initial reforms to the one child policy in 2016 which allowed couples to have two children, have not been effective in achieving sufficient natural population growth. Despite the plus 1 billion person population and emerging wealthy middle class, China is facing an increasing swelling older population.

Chart 4: China GDP Growth



Source: Trading Economics

Market Watch

Japan has been cut from the OECD's upgraded forecast for global economic growth due to its slow vaccine rollout and increase in COVID-19 cases. The University of Oxford's global vaccine distribution record showed Japan's vaccination rate of 6.4% was considerably less than the world average of 10.6%.

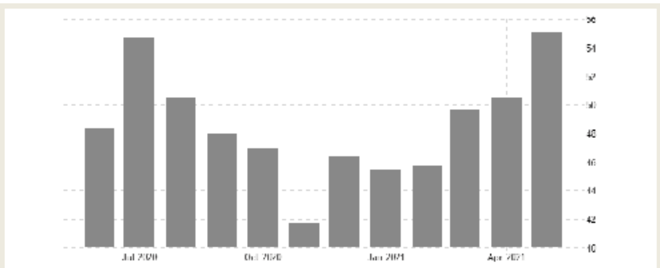
Japan's third emergency declaration was implemented from the 25 April and was initially going to be lifted on the 11 May but due to new infection numbers it was subsequently extended to the 31 May. This extension is estimated to cost the Japanese economy US$9.2 billion.

In Olympic news, 60% of respondents to a Kyodo News survey in mid-May contended the Olympics should be cancelled. It is estimated that cancelling the games would be at a cost of around US$17 billion. However, executive economist at the NRI, Takahide Kiuchi maintained the cost of cancelling the games would be less than the economic impact of having to implement another state of emergency due to hosting the games.

Europe

In the Eurozone, PMIs indicated acceleration in the pace of expansion across countries. The services PMI hit 55.1 in May – the highest it has been in 35 months. The manufacturing PMI decreased slightly by 0.01 but remained strong. It was also noted that supply constraints caused prices to increase to a historical high which consequently resulted in reduced production activity. In Germany, the IFO business climate index increased from 96.8 in April to 99.2 in May, exceeding market predictions and the expectations index improved to 102.9 in May which together suggest German economic prospects are looking positive.

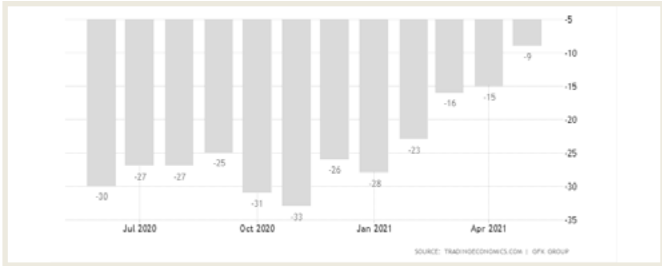
Chart 5 – Eurozone Services PMI



Source: Trading Economics

In the UK, the outlook is also optimistic with the UK being on track for an economic recovery in 2021. The easing of restrictions, fiscal support and successful vaccine distribution is equivalent to 10% of GDP and we could see GDP increase by more than 6% by the end of this year. Additionally, as the UK emerges from its third lockdown, the GfK Consumer Confidence Index improved to -9 in May from -15 in April – this was on par with pre-COVID levels in March 2020. Additionally, the month of May saw representatives from the Bank of England (BoE) meet with a parliamentary committee where they confirmed it was unlikely the BoE would use negative interest rates.

Chart 6 – UK Consumer Confidence



Source: Trading Economics

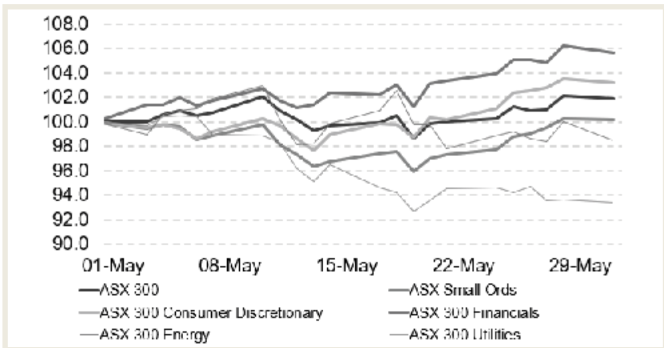
In the UK housing market, there was a surge in prices as the Office for National Statistics this week showed house prices increased 10.2%, the largest annual increase since the lead up to the 2007 financial crisis. The total value of homes sold this year in the UK is predicted to reach approx. $564 billion (USD), a 46% increase from 2020. This housing boom is likely the result of a combination of the stamp duty holiday, government mortgage guarantees and the influx of home buyers competing for bigger properties as they continue working from home.

Developments in financial markets

Australian shares

May saw another month of strong returns for the Australian Share market, continuing the strong rally of CY 2021. The ASX300 Accumulation returned +2.31%, while the ASX Small Ordinaries Accumulation gained +0.27% over the month. The one year returns on these respective indices is +28.72% and +26.73%. The market was led by strong performance in the financials and consumer discretionary sectors, ending up (+4.95%) and (+2.94%) respectively. Information Technology and Utilities struggled over the month, ending the month down (-10.34%) and (-6.29%) respectively.

Chart 7: Australian Shares (rebased to 100)



Source: BTIS/Bloomberg

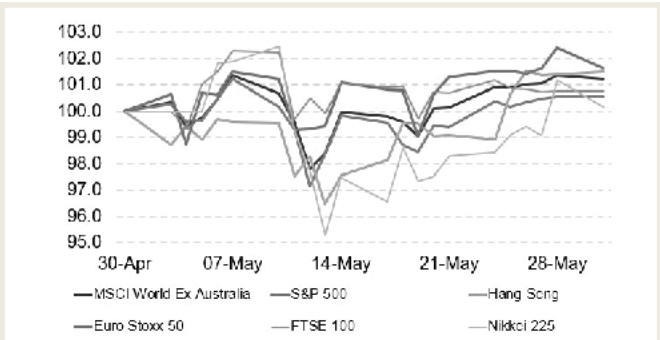
Market Watch

International shares

Over May volatility returned to International share markets, driven by headwinds of global inflation fears, and possible tapering by the US Federal Reserve. This nervousness created intra-month sell-offs across most major equity markets, however this was offset by positive news around unemployment, housing starts, consumer and business confidence, as economies around the world began to open from winter lockdowns. The MSCI World ex Australia Unhedged index ended the month up +1.19%. The S&P ended the month up +0.70%, the NASDAQ finished down -1.44%, as did Dow Jones -2.21%. The respective 1 year returns on the three US markets are +40.32%, +45.95% and +38.79%. European shares were similar, the Euro STOXX up +2.14%. France's CAC 40 and Germany's DAX Index ended up +2.83% and +1.88% respectively. With the 1 year returns on these respective markets being +27.51%, +37.31% and +33.09%.

Asian Share markets strengthened from last month. Japan's Nikkei seeing improvements, ending +0.16% return over the month, sustaining 1 year returns of +34.00%. China's Shanghai Composite finished the month up +4.89% and the Hang Seng up +1.49%. The Korean KOSPI fell slightly from April, ending up +1.78%, bringing its one-year return to +57.86%.

Chart 8: Major Market Indices (rebased to 100)



Source: BTIS/Bloomberg

Fixed interest

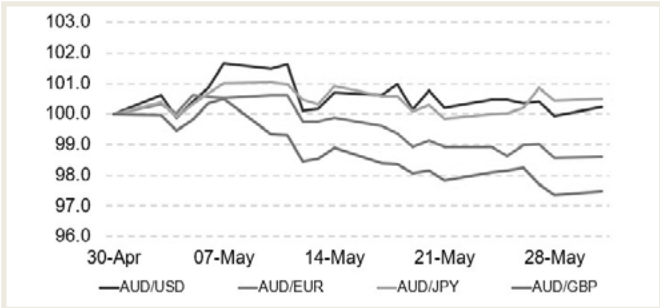
With central bank cash rates continuing to remain at or below zero around the developed world, the short end of the yield curve remains firmly anchored. The real focus remains on the longer end of the curve which is heavily influenced by two key economic indicators GDP and Inflation, both key topics mentioned above. Over the month of May, the US Federal Reserve stated that it will soon assess the need for tapering its bond purchases. The main concern for international markets is how central banks will respond to increased inflation and if the inflation is transitory or permanent.

The Bloomberg AusBond Composite (0+Y) index ending up +0.27% down from +0.56% in April. For international fixed interest markets, the Barclays Global Aggregate TR Hedged index lost ground as its one-month number closed at +0.21%. The 10-year Treasury bond yields in Australia finishing the month at +1.64%, while the US ended at +1.58%.

Currencies

In line with our commentary last month, the Australian dollar continues to appear range bound against most developed market countries. The AUD slightly down to +0.23% from April against the USD, ending the month at 0.7734. Additionally, the Euro also down from April at +1.72% against the USD, ending May at 1.2227. Moreover, the GBP ended up +2.82% to 1.4212.

Chart 9: Major Currencies (rebased to 100)

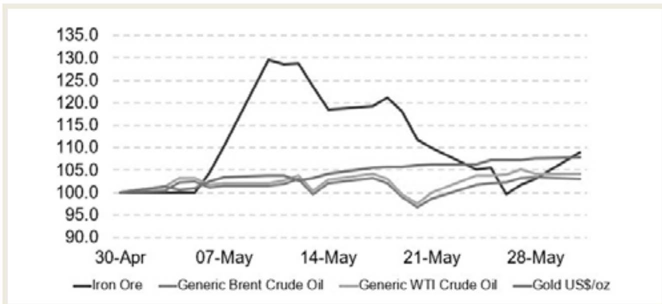


Source: BTIS/Bloomberg

Commodities

Crops, oil and metal prices cooled compared to previous months as countries grappled with the potential of rising inflation. However major commodities are anticipated to rebound with lockdowns easing and fiscal policy continuing globally. Oil fell in May with Brent Crude oil finishing the month at +3.08% to US$69.32 while WTI Oil was +4.31% to US$66.32. Iron Ore, again, performed best of all +9.08% to US$200.91. Gold continued upwards, ending the month up +7.79% to US $1906.87. The Bloomberg Commodity Index reported a gain of +2.73% up to 92.8252.

Chart 10: Major Commodities (rebased to 100)



Source: BTIS/Bloomberg