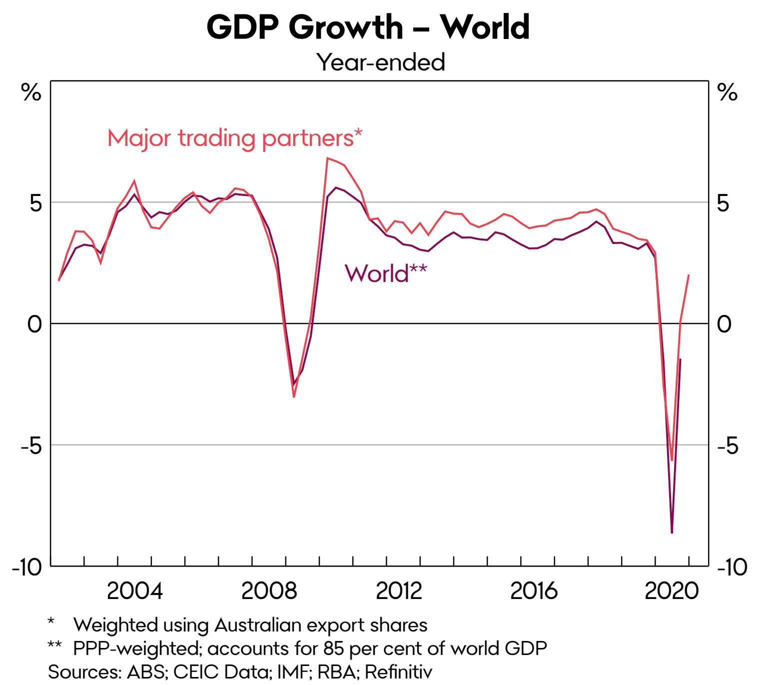
Economic and market update

April 2021

Economic Overview – as of 22nd April 2021

Global markets

The financial markets continue to take an optimistic view of the path out of the pandemic with vaccination programmes making steady progress, despite the occasional setback and some countries lagging. Developments in the US include roughly 64 vaccine doses administered per 100 people and very positive 'effectiveness' observed. This success, coupled with the US economy responding strongly to stimulus measures, has pushed stock markets to fresh record highs. Bond yields are also reflective of a tightening in monetary policy ahead of central bank guidance. The IMF upgraded its forecast for global growth to six per cent over 2021, which would extend the V-shaped recovery in the adjacent chart to it's highest level in decades.



The primary risk to this full recovery that the markets are pricing in is most likely via virus mutations, which have been evident in countries with higher infection rates. Therefore the challenge is ensuring that all regions have sufficient access to vaccines, and to fully reopen borders and international travel. Nevertheless the strong economic data in advanced economies is evidence of the success of fiscal and monetary policies. In the US this has driven a surge in business confidence including the highest level for manufacturing surveys since the 1980s . The stimulus cheques distributed, progress with vaccines and reopening the economy, have also driven a sharp rise in consumer activity. US retail sales are up close to 10 per cent in March. How this impacts US Federal Reserve policy settings will be clearer after the next Federal Open Market Committee meeting, however the Bank of Canada has announced a tapering of their Quantitative Easing (QE) weekly bond purchases by 25 per cent and indicated that rate rises may be needed next year.

Chinese economic data eased back a gear in the first quarter with GDP growth of only 0.6 per cent. However this was on top of an upwardly revised 3.2 per cent for Q4 2020, and a forecast for the Chinese economy of around eight to 10% growth over the year. It was already back to its pre-virus trajectory at the start of this year, and the focus is increasingly on ensuring sustainable growth and addressing economic reform, for example its shadow banking system.

The European economy continues to lag North America and Asia but has progressed in Q1 with a sharp rise in manufacturing Purchasing Managers Index surveys. German ten-year bond yields are up to minus 0.25 per cent from minus 0.6 at the start of the year. The euro-zone had been lagging on vaccine programmes but is now making meaningful progress, although still well behind the UK. The European Central Bank is expected to maintain its aggressive stimulus measures in the absence of inflationary pressures for now, but may start to taper QE later this year as it rides in the slipstream of the rest of the world.

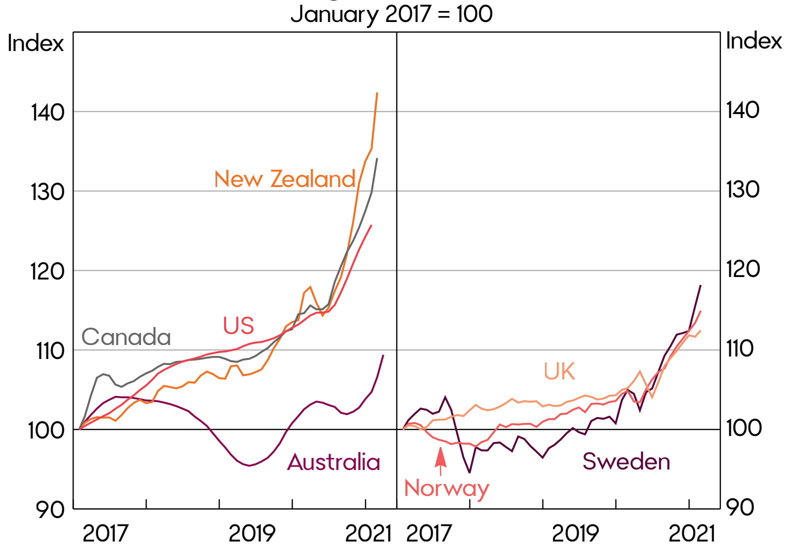
Domestic economy

The nine-month run of jobs data beating forecasts continued with March data showing another fall in the unemployment rate to 5.6 per cent. Underemployment is now below eight per cent for the first time since 2014 (refer charts in appendix). This is the last data prior to the end of JobKeeper, but this fall in underemployment, the rise in job vacancies and job advertisements, and recent business surveys all point to the tapering of fiscal support being a minor challenge for labour markets, and not a fiscal cliff.

The fact that RBA forecasts in the February Statement on Monetary Policy only saw unemployment down to six per cent this year and 5.5 per cent next year suggests that serious upgrades will be needed in the May Statement on Monetary Policy. However the language in the latest minutes from the April Monetary Policy Meeting was still as dovish as the start of the year. While noting the strong economic recovery had continued into 2021, there was still the conclusion that the cash rate need not increase, *"until actual inflation is sustainably within the two to three per cent target range. For this to occur, wages growth would need to be materially higher than it is currently. This would require significant gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest."* Like the global outlook, a setback in the vaccine rollout would support this scenario- but is the RBA really this pessimistic, or is their messaging motivated by their desire to limit the Aussie dollar's ascent?

Housing Price Indicies

January 2017 = 100



Sources: CoreLogic; Eiendom Norge; Nationwide; REINZ; S&P Global; Valueguard

The Reserve Bank's Financial Stability Review added colour to our central bank's views on the risks associated with the booming property market. The RBA stance appears as *"no impact on monetary policy, but a watching brief on lending standards."* The review noted that debt to disposable income ratios had actually improved over the last few years, and it also included the chart above showing Australia lagging the global trend of rising house prices.

The strength in the property market, together with only limited lockdowns and the full recovery of lost jobs, has added to the positive sentiment. This is despite the challenges in parts of the economy including hospitality. It was interesting to note the March retail sales data is up 1.4 per cent month on month. It showed that 'cafes, restaurants and takeaway food' led the industry rises, and are back above pre-pandemic levels. This is consistent with consumer sentiment now up to an eleven-year high, and business conditions printed at their highest level on record in the March survey. This combination of strong data appears to be a world away from an economy that requires a cash rate of 0.1 per cent, but the sustainability of the recovery does warrant further evidence. After all, we are only nine months past the deepest recession in living memory, although it was an induced recession, not one born from the economic cycle. Arguably a larger risk than a stalling recovery is how equity and property markets will cope once interest rates start to rise, even if that won't occur until 2023. The 6.7 per cent jump in Sydney dwelling values in the first quarter of 2021, and the national CoreLogic index rising at its fastest pace in 32 years is remarkable, but difficult to classify as good news or a concern.

Trade tensions with China have experienced a further setback with the Federal Government overturning the Victorian 'Belt and Road agreements' with China. Exports to China by value have remained firm thanks to the highest iron ore prices in a decade in US dollar terms, and record highs in Australian dollars. The arguments supporting a commodity 'super cycle' are compelling, including infrastructure investment post COVID-19 and decarbonisation investment. While China may continue to decouple from the US and Australia over time, global demand should more than compensate. This may drive a sharply higher exchange rate, but with the US economy looking more promising the greenback will also prove resilient.

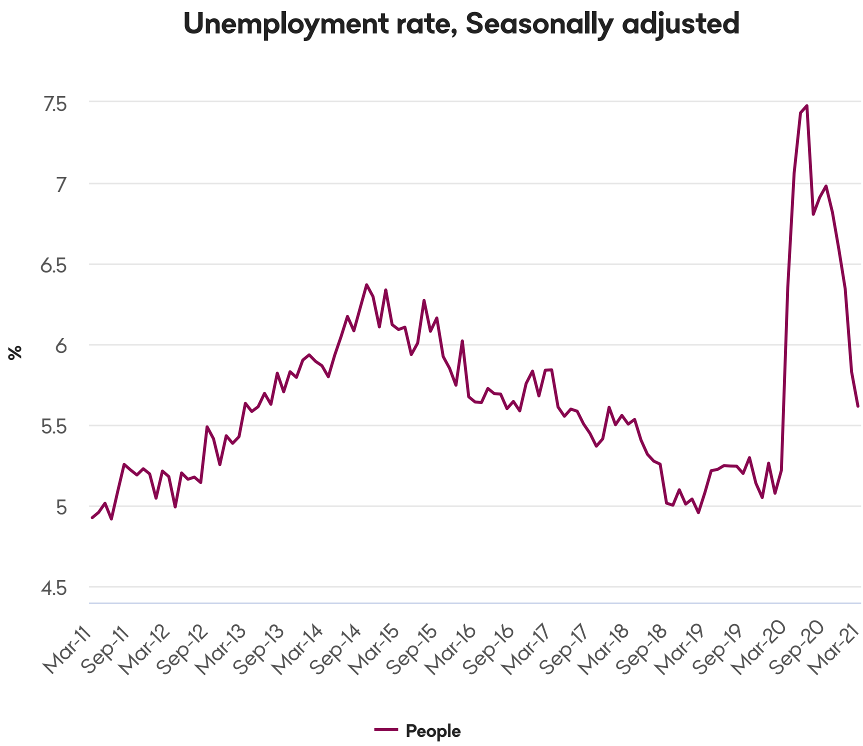
Interest Rate Outlook

The RBA rate cut in November to 0.10 per cent for the cash rate, and the targeted yield on three-year bonds, is very likely to be the low point for these targets. Any further monetary stimulus if needed would come in the form of ongoing Quantitative Easing. The steepening in yield curves here and around the world suggests global reflation is a material risk, but the pace and timing of this event is the subject of much debate. Despite consistently strong domestic economic data the RBA continues to insist that it doesn't expect inflation (via wages growth) to reach its target band until 2024 at the earliest, so it doesn't anticipate any need to increase the official cash rate until then.

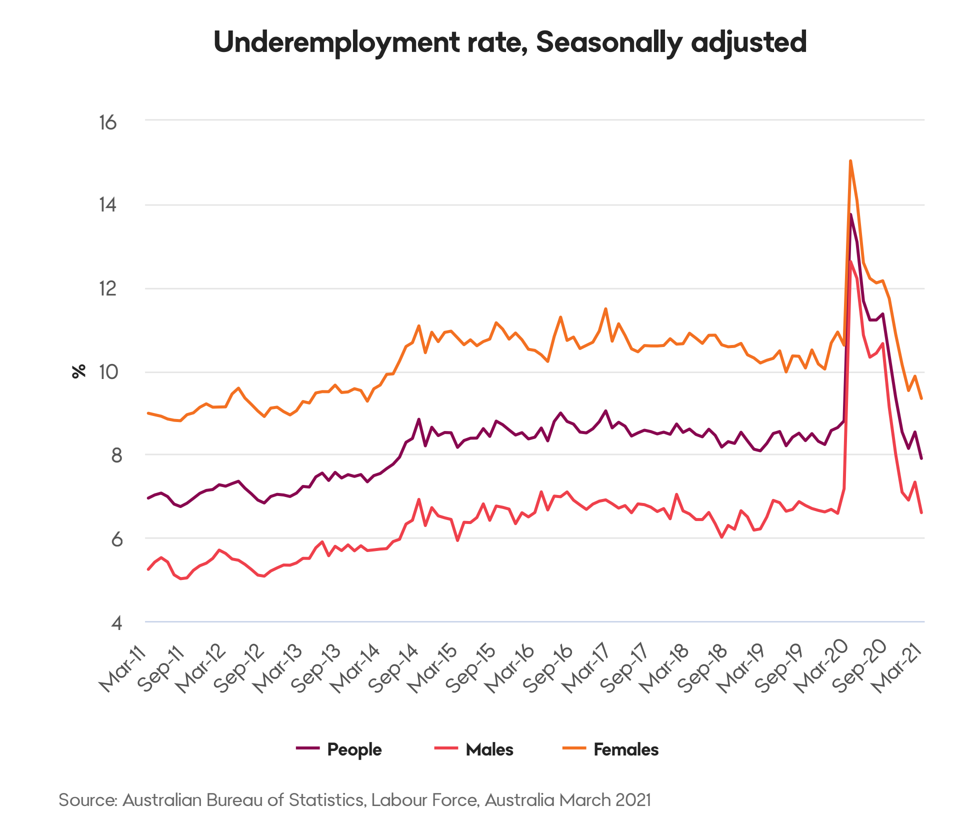
	28 / 02 / 20	28 / 02 / 21	31 / 03 / 21	22 / 04 / 21
90-day bills	0.81 %	0.03 %	0.035 %	0.04 %
3-year swap	0.57 %	0.39 %	0.36 %	0.32 %
5-year swap	0.71 %	0.95 %	0.91 %	0.82 %
AUD/USD	.6505	.7715	.7600	.7750
ASX 200	6 441	6 673	6 791	7 045
Credit Index (iTraxx- 5 yr)	57.4	61.2	64.2	63.0

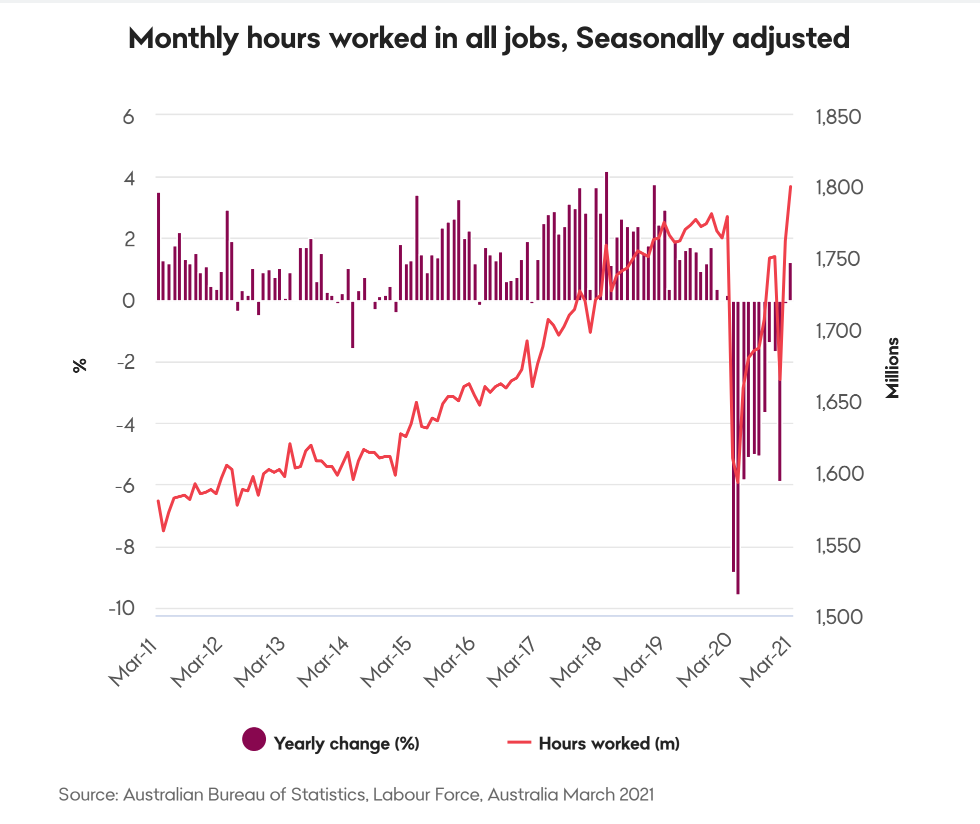
Appendix - Australian labour markets

Source: Australian Bureau of Statistics, Labour Force, Australia March 2021



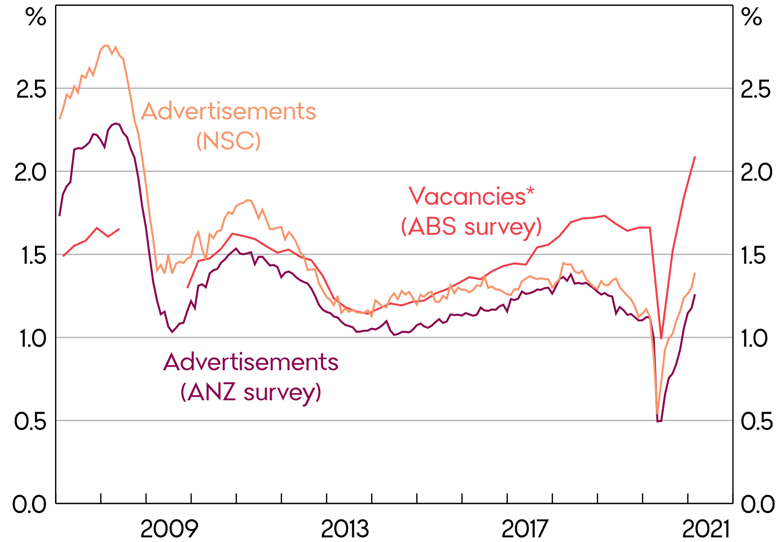
Source: Australian Bureau of Statistics, Labour Force, Australia March 2021


Underemployment rate, Seasonally adjusted
16
14
12
10
8
6
4
%
Mar-11 Sep-11 Mar-12 Sep-12 Mar-13 Sep-13 Mar-14 Sep-14 Mar-15 Sep-15 Mar-16 Sep-16 Mar-17 Sep-17 Mar-18 Sep-18 Mar-19 Sep-19 Mar-20 Sep-20 Mar-21
People
Males
Females
Source: Australian Bureau of Statistics, Labour Force, Australia March 2021


Monthly hours worked in all jobs, Seasonally adjusted
6
4
2
0
-2
-4
-6
-8
-10
%
1,850
1,800
1,750
1,700
1,650
1,600
1,550
1,500
Millions
Mar-11 Mar-12 Mar-13 Mar-14 Mar-15 Mar-16 Mar-17 Mar-18 Mar-19 Mar-20 Mar-21
Yearly change (%)
Hours worked (m)
Source: Australian Bureau of Statistics, Labour Force, Australia March 2021

Job Vacancies and Advertisements

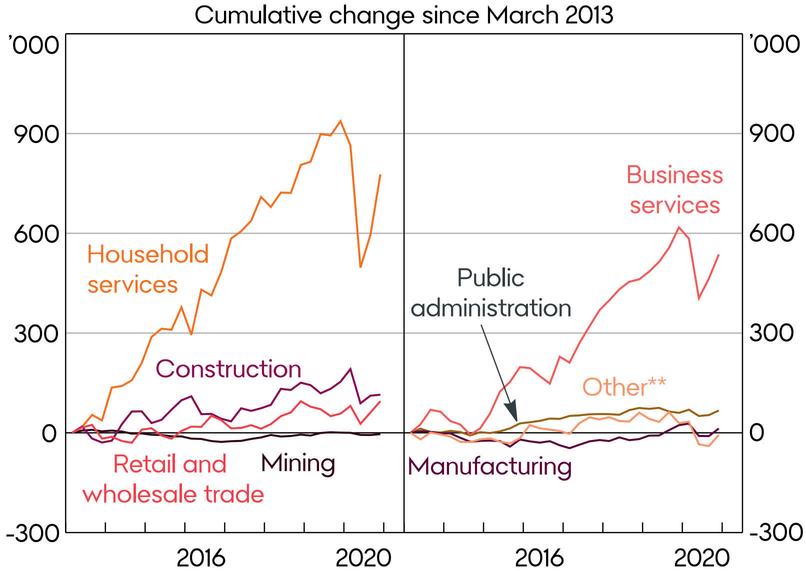
Per cent of labour force



* This survey was suspended between May 2008 and November 2009
Sources: ABS; ANZ; National Skills Commission (NSC); RBA

Employment Growth by Industry*

Cumulative change since March 2013



* The trend series have been suspended from June 2020 until more certainty emerges in the underlying trend in labour market activity over the COVID-19 period
** Includes agriculture, forestry & fishing; transport, postal & warehousing; and electricity, gas, water & waste services
Source: ABS