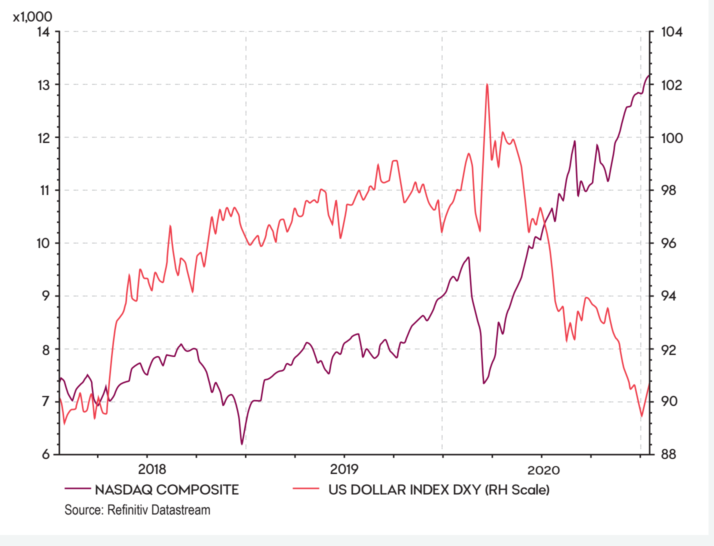
January 2021

Economic and market update

Economic Overview – as of 21st January 2021

Global markets

The new year began where 2020 left off with more extraordinary events including the storming of the US Capitol in Washington by rioters causing the evacuation of Congress. COVID-19 case numbers globally still continue to rise- however the markets maintained their focus on stimulus measures and the rollout of vaccines. The Democrats winning the US Senate run-offs added further impetus to stocks and risk appetite. The slim majority can now deliver the aggressive fiscal packages outlined by President Biden, but without deeper reforms that would require a larger majority. As the following chart shows, this has all seen a continuation of the bull market (especially for technology stocks) and further weakness in the US dollar, with a US$1.9 trillion package on its way.



The inauguration of Joe Biden as the 46th US President coincided with fresh record highs for US indices. The recent news of the Democrat Senate majority has also driven bond rates sharply higher, with the ten year yield up to 1.1 per cent from 0.8 per cent two months ago. US Treasury secretary nominee Janet Yellen commented in her Senate confirmation hearing that fiscal support was needed immediately and in volume, saying “There is consensus now: without further action, we risk a longer, more painful recession.” The US Federal Reserve has committed to keeping rates low until inflation ‘averages’ above target. Coupled with their statement last week that “now is not the time” to even discuss scaling back policy, the prospect of ‘reflation’ and a sharp steepening in the yield curve is growing.

The timing of economic recoveries by region versus the extent and duration of fiscal and monetary support may be one of the key themes of 2021 globally- depending on how effectively the vaccines are rolled out and their efficacy. At this stage many Asian countries may be quickest into recovery and tapering support measures, while parts of Europe and North America face a double dip recession as further lockdowns are required, even now as vaccines are rolled out. The reflation risks are being vigorously debated by economists: will limitless fiscal support and quantitative easing (QE) drive latent inflation, or is the lack of 'velocity of money' indicative that inflation will remain dormant? Central banks seem to be leaning to the latter- they will struggle to play catch up if they are mistaken.

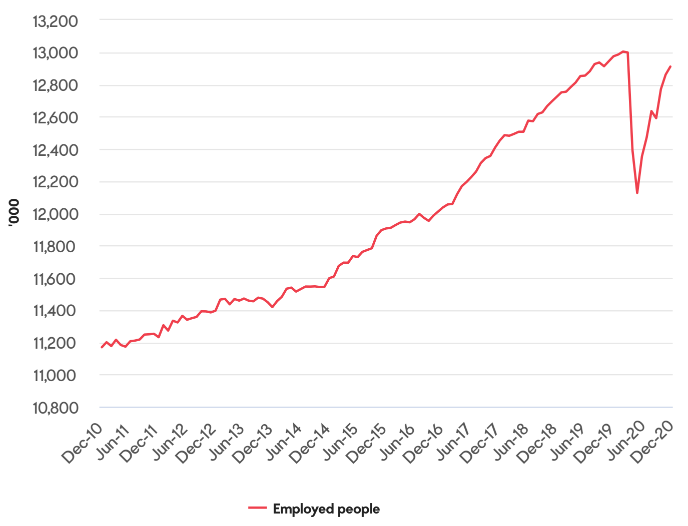
Economic data in China for December revealed a strong finish to last year with GDP growth at 6.5 per cent in Q4 year on year, its fastest pace in two years. Overall the Chinese economy grew by 2.3 per cent in 2020. The details showed that industrial production remains the key driver. Although retail sales and fixed asset investment were a little lower, a rebound in services activity which is now expanding year on year suggests growth in 2021 will be sustainable. The consensus forecast for Chinese GDP growth this year is over nine per cent. How Chinese relations with the US progress under the new administration will be a crucial geopolitical factor this year, and while the Biden administration is likely to maintain a tough line, including on technology and IP, the approach will surely be more multilateral and less haphazard.

Domestic economy

The V-shaped recovery in Australia became more evident through Q4. Almost every piece of economic data beat forecasts and demonstrated just how successful our health policies, fiscal support and monetary policy have collectively been. If you are still bearish on the Australian economy, it can't be based on economic data as evidence- but of course we remain dependent on the vaccine rollout, as is the case throughout the world. The Sydney northern beaches outbreak was briefly a concern and may have shaved around half a per cent off Q4 GDP (to around 2.5 per cent), but all hotspots seem under control at present. The concerns around a March fiscal cliff continue to recede, especially when considering the sharp fall in individuals dependent on the likes of JobKeeper. The tapering of fiscal support appears even more manageable given the latest analysis from Treasury which reveals around $200 billion in 'accrued stimulus,' i.e. savings that households and businesses have stockpiled, that presumably will start to be spent in the months ahead.

The latest employment data added to the positive outlook for 2021 with December's numbers showing a further increase of fifty thousand (mostly full-time) jobs, a rise in the participation rate to a new high of 66.2 per cent, and another welcome fall in underemployment and youth unemployment. Crucially, recent job vacancy data (refer appendix) shows vacancies are at a record high, up 12 per cent year on year. Other job advertisement data also points to businesses needing to employ in the months ahead, presumably helped by the JobMaker Hiring Credit scheme.

Employed people, Seasonally adjusted



Source: Australian Bureau of Statistics, Labour Force, Australia December 2020

Other data released over the last few weeks shows not just last year's losses reclaimed, but record or near-record levels, including:

- Housing finance (new housing loan approvals) surged to 24 per cent above pre-pandemic levels
- Retail trade rose seven per cent month on month in November, up 13.3 per cent year on year
- House prices rose one per cent in December, to be 2.3 per cent higher in Q4, and
- New house / renovation approvals rose to a 20-year high.

The Aussie dollar's ongoing strength is one of the few immediate concerns given its implications for exporters, coupled with the political tensions with China.

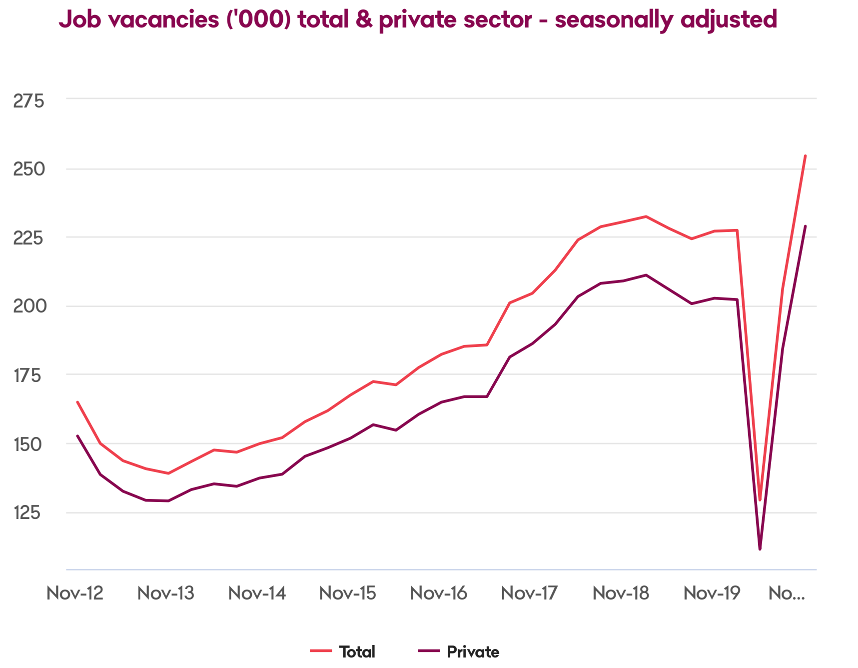
The RBA has little ability to encourage a lower currency other than extending QE. The above data however does not seem to make the case for further monetary stimulus, and the firm Australian dollar is reflective of genuine outperformance as well as a weak US dollar. It will be interesting to see the RBA's approach in May when the six months of $100 billion in QE bond purchases expires. The deteriorating trade relationship with China remains troubling, although it was noteworthy to see overall export volumes hold up in the latest trade data, even in the case of coal. No Australian coal is making its way into China at present, but this has pushed up the price as China sources its coal from elsewhere, with the gaps this has created from other coal importers apparently being happily accommodated by Australia.

Interest Rate Outlook

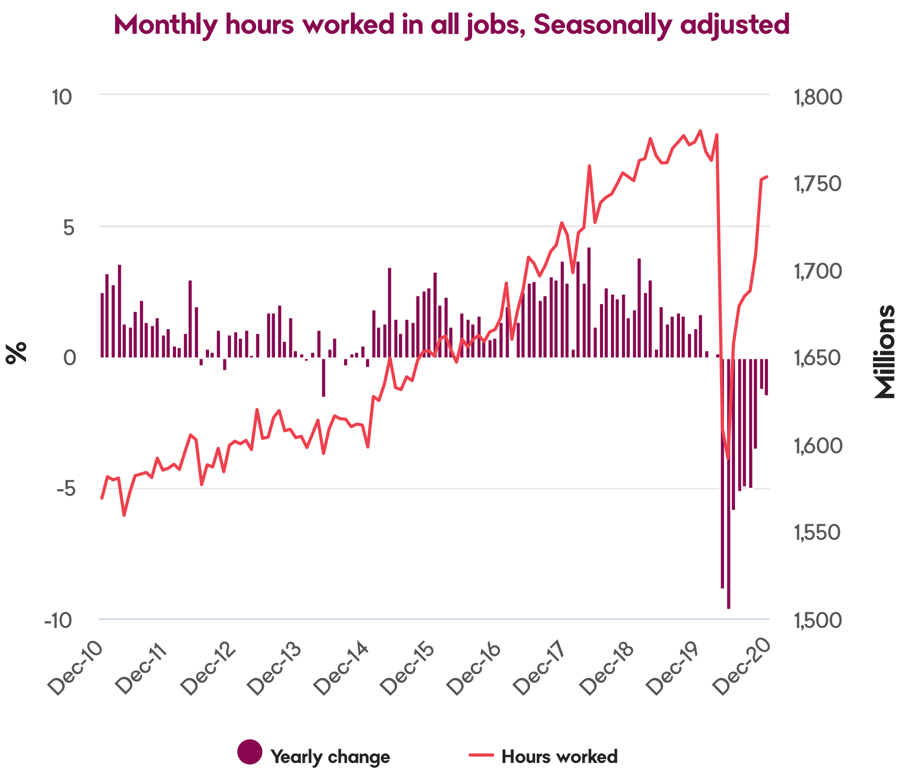
The RBA rate cut to 0.10 per cent for the cash rate, the targeted yield on three-year bonds and new drawings of the RBA's Term Funding Facility are likely to be the low point for these targets. Any further monetary stimulus if needed is likely to come in the form of increased QE rather than via negative interest rates. The RBA has stated that it expects the official cash rate to remain at its current level for at least three years, although faster progress in achieving full employment and inflation above two per cent is not out of the question at all.

	31 / 12 / 19	30 / 11 / 20	31 / 12 / 20	21 / 01 / 2021
90-day bills	0.89 %	0.02 %	0.02 %	0.01 %
3-year swap	0.95 %	0.13 %	0.14 %	0.15 %
5-year swap	1.18 %	0.36 %	0.39 %	0.43 %
AUD/USD	.7015	.7340	.7690	.7760
ASX 200	6 684	6 518	6 587	6 820
Credit Index (iTraxx- 5 yr)	46.7	59.4	57.3	60.4

Appendix - assorted charts: Australian labour markets

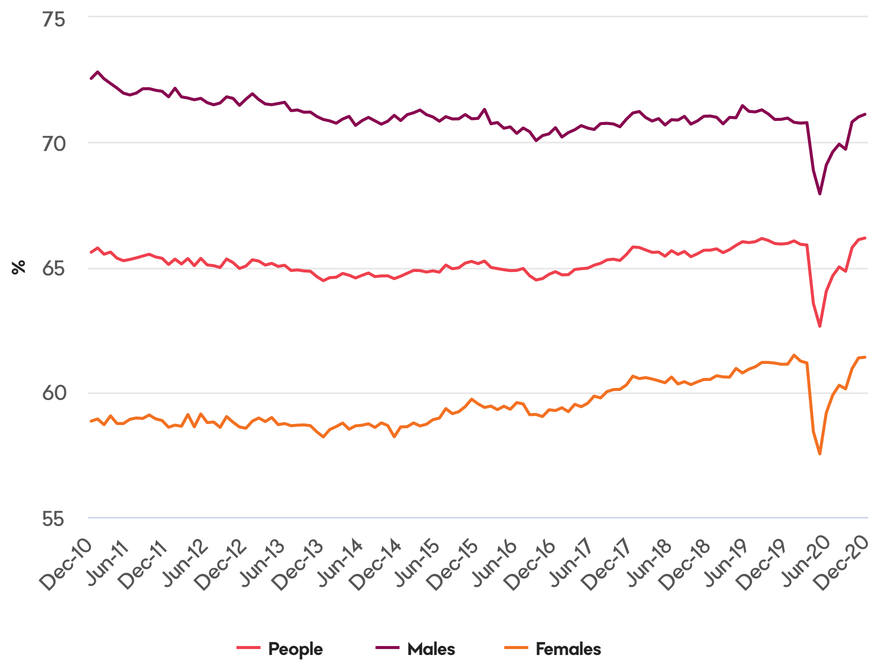


Source: Australian Bureau of Statistics, Job Vacancies, Australia November 2020



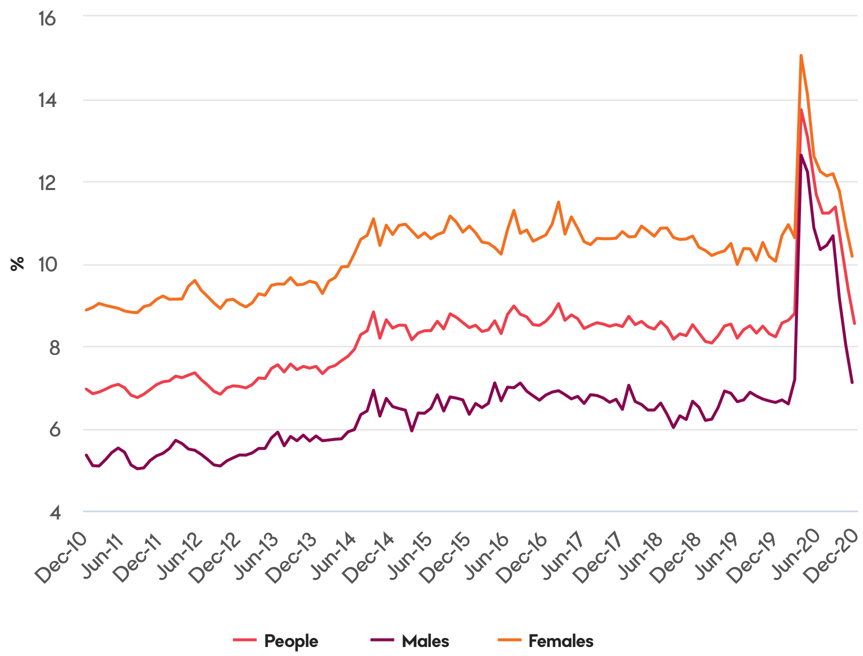
Source: Australian Bureau of Statistics, Labour Force, Australia December 2020

Participation rate, Seasonally adjusted



Source: Australian Bureau of Statistics, Labour Force, Australia December 2020

Underemployment rate, Seasonally adjusted



Source: Australian Bureau of Statistics, Labour Force, Australia December 2020