AMP CAPITAL

WEEKLY MARKET UPDATE

19 November 2021

SHANE OLIVER
Head of Investment Strategy and Chief Economist,
AMP Capital

Data/Event	Movement	
	LATEST	PREVIOUS
US – Retail Sales (MoM) (Oct)	+1.7%	+0.8%
US – Retail Sales (MoM) (Oct)	+1.7%	+0.8%
Australia – Wage Price Index (QoQ) (Q3)	+0.6%	+0.4%

Financial markets

Indicator	Friday 19 November 2021	Friday 12 November 2021	Weekly Change %	17 November 2020	12-month Change %
S&P/ASX 200 Index	7,396.5	7,443.0	-0.6	6,547.2	+13.0
S&P/ASX 200 A-REIT	1,686.3	1,656.0	+1.8	1,456.8	+15.8
US S&P 500	4,698.0	4,682.8	+0.3	3,581.9	+31.2
Dow Jones EURO STOXX	483.5	484.7	-0.3	384.4	+25.8
UK FTSE 100	7,223.6	7,347.9	-1.7	6,334.3	+14.0
Japan Nikkei 225	29,745.9	29,610.0	+0.5	25,634.3	+16.0
CHINA – CSI 300	4,890.1	4,888.4	+0.0	4,928.0	-0.8
MSCI (ex-Aust/in LC)	2,497.7	2,496.1	+0.1	1,949.5	+28.1
Australian 90-day bank bill yield	0.04	0.04	+0.00 bps	0.0	+100 bps
Australian 10-year bond yield	1.82	1.80	+0.95 bps	0.9	+104 bps
US 10-year bond yield	1.54	1.58	-2.90 bps	0.9	+81 bps
Oil – West Texas Crude	72.2	75.8	-4.7	38.5	+87.6
A$ trade-weighted index (TWI)	61.1	61.3	-0.3	60.8	+0.5
A$ in US dollars	0.73	0.73	-0.9	0.73	-0.2

Major upcoming global economic releases and events

Date	Data/Event	FORECAST	PREVIOUS
23 November	EU – Markit PMI Composite (Nov) PREL	+53.1	+54.2
23 November	UK – Markit Services PMI (Nov) PREL	+58.5	+59.1
24 November	US – Durable Goods Orders (Oct)	+0.2%	-0.3%

Source: Bloomberg, FXStreet, AMP Capital

Investment markets & key developments

Global share markets were mixed over the last week. US shares rose 0.3% for the week helped by strong data, but with gains pared slightly by concerns about rising coronavirus cases in Europe and hawkish US Federal Reserve (Fed) comments. Eurozone shares fell 0.3% on the back of coronavirus concerns after Austria announced a lockdown, but Japanese shares rose 0.5% and Chinese shares were flat. Australian shares fell -0.6% with sharp falls in financials on the back of bank margin concerns and in resources stocks reflecting lower oil and iron ore prices. Bond yields fell in the US and Europe but rose in Australia. Oil and metal prices fell, while iron prices rose slightly, but only after making new lows mid-week. The A$ fell as the US$ rose.

The drumbeat of higher inflation continues. The past week saw more faster-than-expected increases in inflation in the UK (4.2%year-on-year) (yoy) and Canada (4.5%yoy) and ongoing high readings for price pressures in US business surveys. All of which is maintaining pressure on central banks, with the Bank of England (BoE) on track to raise rates next month and Fed vice-chair Clarida saying the Fed might have to have a discussion about speeding up the taper, which would clear the way for an earlier rate hike next year. So far, the upwards pressure on long bond yields has been relatively minor, with yield curves tending to flatten reflecting longer-term inflation expectations remaining relatively contained and possibly concerns that central banks may make a policy mistake by tightening prematurely. Share markets meanwhile don't seem too fussed. Like the Fed and Reserve Bank of Australia (RBA), we are of the view that inflationary pressures should ease as workers return, production catches up and spending rotates back to services. However, this could take 6-12 months, with the risk that it feeds further into wage rises and inflation expectations, making the spike in inflation stickier.

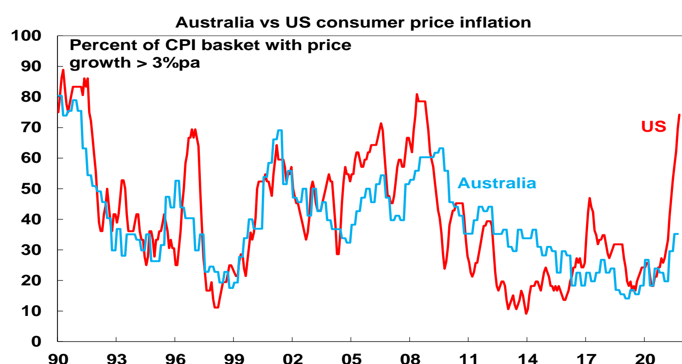
There were some more signs of easing bottleneck pressures over the last week, but it's a bit mixed: a surge in auto production in the US is consistent with an easing in the shortage of semi-conductors; the number of containers on LA docks is down by 29%; and now the oil price has fallen 10% from its highs. Against this, gas prices soared again due to a delay in the approval process for the Nord Stream 2 gas pipeline and geopolitical tensions with Russia and Belarus built, partly as Russia seeks to take advantage of Europe's energy shortfall.

President Biden's imminent decision on the next Fed Chair likely won't change things much at the central bank, but could boost short-term uncertainty. The reappointment of Powell just means more of the same. The other likely alternative, current Fed Governor Lael Brainard, would be seen as more dovish, but if the inflation scare persists she could be tested by bond vigilantes and possibly forced into an earlier tightening to demonstrate her inflation fighting credentials; and like Powell did a few years ago, she might have to 'find her way' in terms of how to communicate to markets without causing panic.

US Build Back Better bill passed through the House – now faces the Senate. While the Congressional Budget Office put the boost to spending at $US1.64trn over 10 years, which is less than Senator Joe Manchin's $US1.7trn target, it only sees $US1.27trn in new revenue. The gap is not a lot; and even narrower as it makes no allowance for tougher tax enforcement. The spending in the House bill however is actually estimated to be $2.4trn once tax benefits are allowed and it is front loaded relative to the revenue measures, adding about 0.6% of GDP to the budget deficit in the first four years from 2022, before turning contractionary. So Joe Manchin in the Senate is still likely to cut back the spending. That said, it's getting closer to being passed into law, as the Democrats need it to generate support going into the midterms. The key is that it's only a small stimulus spread over many years and big tax hikes have been averted, so its market impact will be minimal. Except that it should help clear the way to resolve the debt ceiling next month (either as part of the same bill or maybe as part of a separate deal with Republicans).

In Australia, we still see the first rate-hike in November 2022. The minutes from the last RBA meeting and a speech by Governor Lowe pretty much stuck to the dovish script, pushing back against market expectations for a 2022 high, conceding that a 2023 hike is possible, but that under its "central scenario" the conditions for a rate hike won't be in place until 2024. Governor Lowe makes many valid points about lower inflationary pressures in Australia - energy prices have been trending lower here, labour force participation is high, wages growth is weaker and underlying inflation is only just above the lower end of the target. However, forecasting is difficult, inflation has already been coming in ahead of the RBA's expectations, it's already had to soften its dovish view around no rate hike before 2024 and Governor Lowe's recent speech left some wiggle room in his comments that "wages growth is just one of the guideposts".

Our view remains that slightly stronger growth, and a slightly faster decline in unemployment resulting in slightly faster wages growth, will see the conditions fall into place for an RBA rate-hike by late next year. That said, money market expectations for three or four hikes over the next 12 months look way too hawkish, particularly compared to the US where only two hikes are factored in. The big difference in inflation pressures between the US and Australia is evident in the next chart – nearly 75% of the components in the US CPI are rising faster than 3%, compared to only 35% in Australia. This would suggest that even if rate hikes come earlier than the RBA is flagging, Australian 10-year bonds with a yield of 1.8% are a buy relative to US 10-year bonds on a yield of 1.59%.



Source: Bloomberg, ABS, AMP Capital.

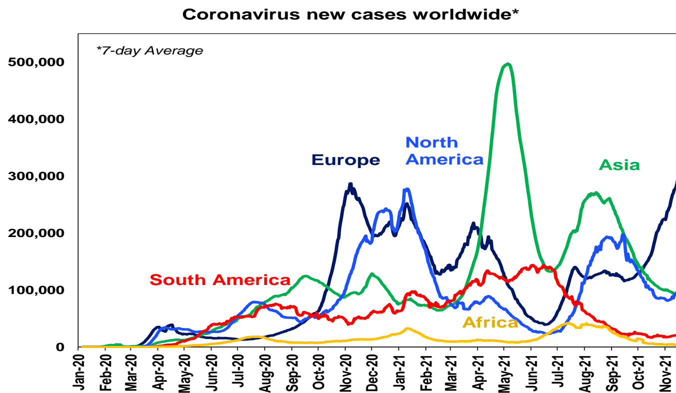
US/China tensions starting to defuse? The Xi/Biden summit reached no major resolutions, but at least it was a step in the right direction. The final part of both sides post summit statements meanwhile left the door open to future progress, which could include removing tariffs. There is a long way to go however (and US public opinion is sceptical), but at least we are a long way from the tit for tat lose/lose escalation of the Trump years.

The threat to the crypto craze from regulation and central bank digital currencies (CBDCs). As I see it, this is one of the biggest threats to the crypto craze. In the past week, the RBA's Head of Payments Policy Tony Richards warned "If there were to be global policy action to deal with some of the particular concerns about the use of crypto currencies, plus the arrival of new 'stable coins' and CBDCs…, existing cryptocurrencies might then have only niche uses at best." My own assessment is contained here.

Taylor's version. For some reason I missed the 12th November release of Taylor's version of Red. But I have caught up and love it. Great vocal performances from Taylor and new "from the Vault" tracks including I Bet You Think About Me (with video directed by Blake Lively) and a ten minute version of All Too Well. Well done Taylor, bad luck Scooter. Out of interest, back in December last year, Taylor had planned to release Evermore, and Paul McCartney planned to release McCartney III on 11 December. Apparently, Taylor then decided to postpone the release of her album by a week to respect the release of Paul's album, but then Paul upon learning this delayed his album one week so Evermore could be released on its original date. And for those who haven't seen it, here's The Paul McCartney Sandwich – but just swap vegemite for that yucky marmite stuff!

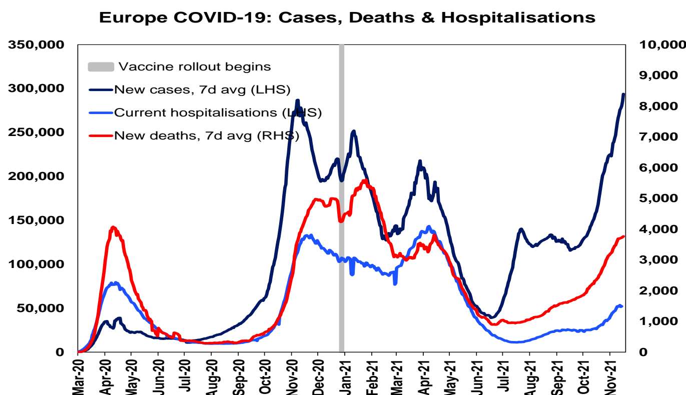
Coronavirus update

Global coronavirus cases on the way up again. As we noted last week, this is primarily being driven by Europe (notably Germany, Austria, the Netherlands, Denmark, Ireland and Finland), but the US is also starting to head higher as well. The drivers are a combination of the almost complete removal of restrictions, cold weather, stalling vaccination rates at or below 70% of the whole population, fading efficacy against new infection (just like Israel saw mid-year) and a slow start to boosters. The US and the UK are now hooking up again and both are at risk for similar reasons – although the booster rollout is more advanced, more so in the UK than in Europe.



Source: ourworldindata.org, AMP Capital

The surge in new cases is a significant threat to the economic outlook in Europe and the US – but the key to watch is whether vaccinations are successful in keeping hospitalisations down such that hospital systems can cope, so hard long lockdowns can be avoided. If so, it will then be part of a process of "learning to live with COVID", where it goes from being an epidemic to being endemic (like the flu). So far, hospitalisations in Europe remain subdued relative to the wave a year ago. Of course, having 70% of the population or less vaccinated with waning efficacy still leaves a high risk that cases could surge, overwhelming the hospital system. The key to avoiding that is to get vaccination rates to very high levels (with the help of vaccine mandates), quickly roll out booster shots to those whose last shot was five months or so ago and only remove restrictions gradually. In the meantime, some restrictions may be necessary if cases rise too quickly (as we are seeing in parts of Europe, with tougher vaccine requirements, the return of work at home and distancing requirements in some countries and as we saw earlier in Singapore). Some countries are already reverting to hard lockdowns – notably Austria (which is only 64% fully vaccinated) and Germany (68% vaccinated) which is also not ruling it out. But the experience of Singapore and Israel (and so far the UK) suggests it can be managed without reverting to hard lockdowns.



Source: ourworldindata.org, AMP Capital

54% of people globally have now had one dose of vaccine and 43% have had two doses. Key risks remain that poor countries are lowly vaccinated which increases the risk of mutations and that some advanced countries (notably the US and Europe) have seen vaccination programs stall at low levels.

Percentage of population that's been vaccinated & had a booster

	% 1 dose	% 2 doses	% Booster
Global	54	43	
Developed countries	76	69	
Emerging countries	65	49	
Poor countries	21	16	
Canada	81	78	2
Singapore	90	89	13
UK	76	69	20
US	70	59	9
Europe	70	67	5
Japan	79	76	0
Israel	69	64	45
Australia	77	71	1

Source: ourworldindata.org, AMP Capital

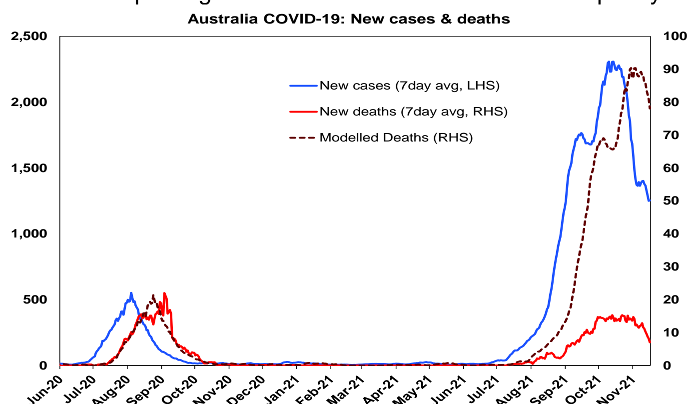
Australia's vaccination rate, at 71% of the whole population, is now above the developed country average and this is before the rest of Australia beyond the ACT, NSW and Victoria catch up. Allowing for current trends and the average gap between 1st and 2nd doses, the following table shows approximately when key vaccine targets will be met. All states and territories have now surpassed 70% of the adult population fully vaccinated. On current trends, Australia will average 90% of the adult population fully vaccinated by early December and 80% of the whole population in the first half of January. This could be sped up again through by new coronavirus scares, and the likely approval of vaccines for 5 to 11 year-olds (which looks likely from January) should take the percentage of the population fully vaccinated well beyond 80%.

Approximate dates to meet Australian fully vaccinated levels

	70% 16 +	80% 16 +	90% 16 +	80% pop
NSW	6 Oct	16 Oct	8 Nov	31 Dec
ACT	7 Oct	17 Oct	27 Oct	NA
Vic	20 Oct	30 Oct	22 Nov	13 Jan
Tas	19 Oct	8 Nov	NA	NA
SA	6 Nov	Late Nov	NA	NA
Qld	13 Nov	Early Dec	NA	NA
WA	14 Nov	Early Dec	NA	NA
NT	13 Nov	Late Nov	NA	NA
Aust	19 Oct	5 Nov	10 Dec	12 Jan

Source: covid19data.com.au, AMP Capital

The main risk in Australia remains a resurgence in new cases following the removal of restrictions – as seen in Israel, the UK, Europe, Singapore, etc - threatening to overwhelm the hospital system, necessitating some reversal in reopening. So far, however, so good. Vaccines clearly helped keep hospitalisations and deaths subdued relative to new cases through the September quarter wave (with deaths now running at around 10% of what last year's wave would have suggested). Australia's vaccination rate is pushing well above that seen in Europe and the US and a rapid deployment of booster shots to those vaccinated five or six months ago should help minimise the risk. Key to watch in the event of such a resurgence will be hospitalisations and deaths – if hospitals can cope, then a return to hard lockdowns can be avoided. The Israeli and Singaporean experience suggest reason for optimism. But vaccine rates need to keep rising and boosters need to be rolled out quickly.

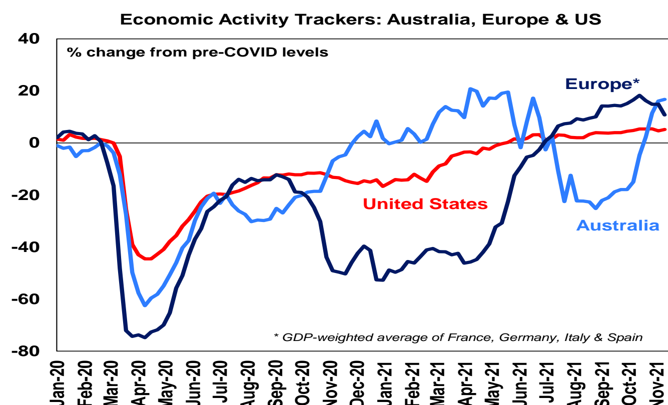


Source: ourworldindata.org, AMP Capital

Economic activity trackers

Our Australian Economic Activity Tracker edged up again over the last week, suggesting that economic conditions relative to 2019 are now stronger than is the case in Europe and the US. It's amazing that only just a few months ago all the talk was about how Australia is being left behind by the rest of the world…but COVID has a way of impacting different countries at different times.

Further gains are likely in the Australian Tracker, but it's naturally starting to slow again now that economic conditions have returned to around pre-Delta outbreak levels. It points to a strong rebound in the Australian December quarter GDP. By contrast, our European Economic Activity Trackers fell as the rise in coronavirus cases and supply constraints impacted, while our US Tracker remains stalled.



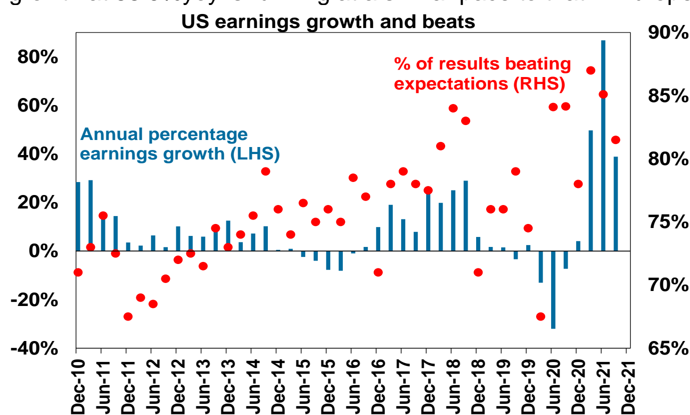
Based on weekly data for eg job ads, restaurant bookings, confidence, mobility, credit & debit card transactions, retail foot traffic, hotel bookings.

Source: AMP Capital

Major global economic events and implications

US economic activity data remains strong. Retail sales surged in October and, with more than $US2 trillion in excess savings providing an offset to soft confidence readings, it should be supported going forward. Industrial production also surged in October, driven in particular by an 11% lift in auto production (as semi-conductor constraints ease), with very strong readings for November manufacturing conditions in the New York and Philadelphia regional surveys. Housing starts surprisingly fell, but a strong gain in permits to build new homes along with a strong reading for home builder conditions suggest that housing construction will remain strong. Of course, the fly in the ointment remains the continuing high price readings in business surveys.

US September quarter earnings have come in up 38.9% on a year ago, which is nearly 10% greater than expected a month ago. 95% of S&P 500 companies have reported September quarter earnings and 81.7% have exceeded expectations. US earnings growth at 38.9%yoy is running at a similar pace to that in Europe, Australasia and the Far East, which is running at around 40%yoy.



Source: Bloomberg, AMP Capital

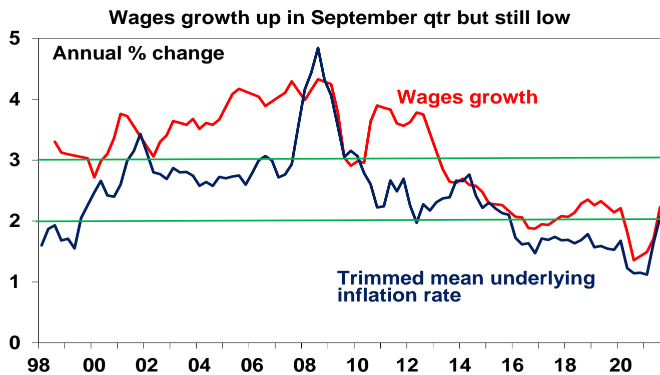
Bank of England on track to raise rates next month. A greater than expected acceleration in UK inflation in October to 4.2%yoy, strong gains in employment and easing concerns about the end of the furlough jobs support program, point to the BoE starting to raise rates next month. It's a similar story for Canadian inflation, which rose to 4.5%yoy.

Japanese September quarter GDP was down more than expected, but this was due to coronavirus restrictions that have since been lifted, so GDP should rebound this quarter. Japan continues to avoid higher inflation, with CPI inflation falling to 0.1%yoy and core inflation at -0.7%yoy. Meanwhile, Japan looks on track for more fiscal stimulus, but just beware that the headline number (reported to be around 15% of GDP) appears to include a lot of smoke and mirrors (adding in private spending that is assumed to be prompted by the spending, local government spending and the existing budget). Actual new borrowing is likely to be a lot less.

Chinese economic data for October was mixed, with stronger than expected industrial production and retail sales, but the property downturn weighing on investment and house prices falling. All up, it suggests growth remains subdued compared to early this year, but is not collapsing.

Australian economic events and implications

Australian wages growth still weak, but it has picked up. September quarter wages growth rose to a still weak 2.2%yoy and has a long way to go to get to the 3% or more level necessary to sustain inflation in the 2 to 3% target range. That said, the 0.6%qoq rise was reasonable, given the lockdowns with both NSW and Victoria actually seeing an acceleration in wages growth, private sector wages growth rose at its strongest pace since 2014 and the staggered increase in the minimum wage this year will serve to boost wages growth this quarter. With the strong jobs market and unemployment likely to push down to 4% next year and significant evidence of strong labour demand and labour shortages in several sectors, our assessment is that wages growth will rise more rapidly next year than the RBA is forecasting. As Governor Lowe points out "we have little experience as to how the Australian labour market works at an unemployment rate of 4%."



Source: ABS, AMP Capital

APRA flagging options for more macro prudential tightening but also noting that rate hikes could do their job in cooling property lending. Higher fixed rates may help, but the heavy lifting would still have to come from variable rates and the key driver there is the RBA's cash rate. A rate hike is still a year away in our view and more than two years away on the RBA's view. Meanwhile, the Australian Prudential Regulation Authority (APRA) has laid out various options, none of which are surprising, but it's clear that limiting lending to high debt to income borrowers and to high loan to valuation ratio borrowers are still on the table. A further lift to serviceability buffers probably remains the easiest option though. Our base case is that APRA will likely do more and that this will come early next year, contributing to the slowing in property price growth to 5% we anticipate through next year.

What to watch over the next week?

In the US, the focus is likely to be on business conditions PMIs for November (Tuesday), with the composite expected to remain strong at around 58, and core private final consumption inflation data for October (Wednesday), which is expected to show a further lift to 4%yoy. In other data releases, expect durable goods orders (Wednesday) to show further solid growth but existing home sales (Monday) to fall back after a strong rise in September. The minutes from the last Fed meeting at which it started to taper (Wednesday) will be watched for guidance around how dovish the Fed remains.

Eurozone business conditions PMIs (Tuesday) are likely to fall, reflecting the latest wave of coronavirus cases.

By contrast, Japanese business conditions PMIs (Tuesday) are likely to show a further improvement, reflecting the decline in COVID cases and easing in restrictions.

The Reserve Bank of New Zealand (RBNZ) is likely to raise rates by another 0.25% Wednesday, taking the cash rate to 0.75%.

Australian business conditions PMIs for November (Tuesday) are likely to show a further rise after reopening. Meanwhile, September quarter construction data (Wednesday) is expected to show a 3% contraction and business investment data (Thursday) is expected to fall 1.5%, reflecting the impact of the NSW and Victorian lockdowns and both will be inputs to September quarter GDP growth. Given the reopening, it will however all be a bit dated and the focus should really be business investment plans, which are likely to show a further lift, as businesses were surveyed around the time of reopening and given that business confidence held up reasonably well through the lockdowns. Retail sales data for October (Friday) will be more timely and will likely show a further solid gain of 2%, reflecting the start of reopening in NSW, the ACT and Victoria.

Outlook for investment markets

Shares remain vulnerable to short-term volatility, with possible triggers being the rebound in coronavirus cases globally, the inflation scare, less dovish central banks, the US debt ceiling and the slowing Chinese economy. We are now however coming into a stronger period seasonally for shares and the combination of solid global growth and earnings, vaccines allowing a more sustained reopening and still-low interest rates augurs well for shares over the next 12 months. However, continuing inflation and interest rate concerns will likely result in rougher and more constrained gains than what we've seen since March last year.

Expect the rising trend in bond yields to continue as it becomes clear the global recovery is continuing, resulting in capital losses and poor returns from bonds over the next 12 months.

Unlisted commercial property may still see some weakness in retail and office returns, but industrial is likely to be strong. Unlisted infrastructure is expected to see solid returns.

After rising by around 21% this year, Australian home price gains are likely to slow to around 5% next year as poor affordability, rising fixed rates, higher interest rate serviceability buffers, reduced home buyer incentives and rising listings impact, ultimately giving way to a 5-10% price fall in 2023.

Cash and bank deposits are likely to provide poor returns, given the ultra-low cash rate of 0.1%.

Although the A$ could pull back further in response to tightening US monetary policy and the weak iron ore price, a rising trend is likely over the next 12 months helped by still-strong commodity prices and a cyclical decline in the US$, probably taking the A$ up to around $US0.80.

Important note: While every care has been taken in the preparation of this document, AMP Capital Investors Limited (ABN 59 001 777 591, AFSL 232497) and AMP Capital Funds Management Limited (ABN 15 159 557 721, AFSL 426455) make no representations or warranties as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.