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Investment markets and key developments over the past week

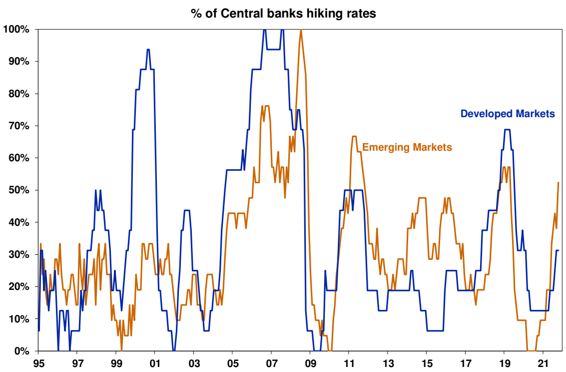
In the past few weeks, financial markets have been pricing in aggressive rate hikes from the major central banks over the next year because inflation data has been surprising on the upside. However, this week numerous central banks banded together and pushed back against market pricing which led to a fall in government bond yields, particularly at the front end of the yield curve. US 2-year yields are now at 0.42% from 0.49% a week ago, Germany yield are -0.71% now versus -0.59% last week and Australian yields are 0.67% from 0.77% last week. **Sharemarkets benefited from lower odds of near-term rate hikes** because this means that monetary settings will remain accommodative which is positive for earnings growth and economic activity. US shares reached a record high again, up by 1.6% this week, Euro shares are 2% higher, Australia is up by 1.4%, Japan is 3.1% higher (which also reflects Prime Minister Kishida preserving his Liberal Democratic Party majority in the election which removed uncertainty for the share market) while Chinese shares fell by 0.8%. **Commodity prices** took a breather this week with oil prices lower (Brent oil prices are around 6% below their recent peak) as US crude inventories have been rising, metals prices were also weaker with iron ore now just under $100/tonne (this is after reaching around $240/tonne in May). And coal and gas prices continue to be well below recent highs. The $US rose this week and the $A fell to 0.738 US dollars.

The RBA started the central bank calendar this week. The central bank decided to keep the cash rate on hold at 0.1% (this was expected), continue to buy bonds at the rate of $4bn/week to at "least mid-February 2022" (also expected) but drop its 0.1% yield target for the April 2024 bond. The removal of the yield target reflects expectations of a stronger economy post lockdowns, faster inflation and the RBA's own expectations of a rate hike occurring before 2024 which diminishes the effectiveness of the yield target. The guidance around a rate hike not expected "before 2024" was replaced with reference to conditions for a hike being bet with a tighter labour market and materially higher wages growth which are "likely to take some time" to be met. This changed guidance is still very far from market pricing of the cash rate which is now predicting three rate hikes over the next year, which is less than where it was before the RBA meeting. While the RBA is probably underestimating upside inflation risks to Australia in 2022, the market is getting carried away with concerns about inflation and being too aggressive in its pricing of hikes. We sit somewhere in the middle and see rate hikes starting in a year's time, with a lift in November 2022 taking the cash rate to 0.25%.

The US Federal Reserve announced a tapering of asset purchases at this week's meeting, as expected. Total monthly asset purchases will be reduced from $120bn/month to $105bn (made up of $70bn of Treasury securities and $35bn of mortgage-backed securities) from November, with asset purchases expected to run until mid-2022, although the Fed could adjust its purchases at any time depending on the outlook. The post-meeting statement was balanced and highlighted that the Fed wants to see inflation moderately above 2% "for some time" given the undershoot on inflation over recent years. The Fed still sees the factors lifting inflation to be "transitory" but did sound more uncertain about this. The market is pricing in two Fed rate hikes over the next year.

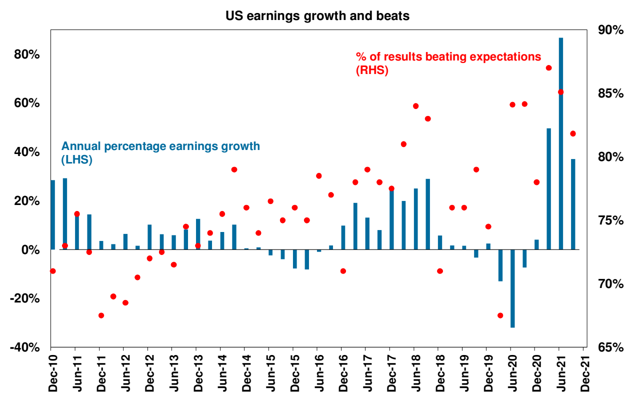
Markets were expecting the **Bank of England** to hike interest rates (but economist consensus was "no change") but the Committee voted 7-2 to keep the Bank Rate unchanged at 0.1% (a win for the economists!). While the Committee upgraded inflation forecasts over the next few years, there is uncertainty around how the labour market will shape up after the furlough scheme ends which argues for more patience in raising rates, meaning rate hikes are likely in early 2022. While the ECB had their meeting last week, **ECB President Lagarde pushed back against market pricing** for interest rate hikes in 2022 this week which makes sense given the low growth low inflation environment Europe has been in recent years.

Emerging market central banks have been hiking interest rates faster than across the developed world (see the chart below). On the BIS count, 52% of emerging market central banks hiked rates in October, compared to 31% of developed markets. In November, this count will increase for the emerging world with the Central Bank of Poland shocking the market this week with a 0.75% increase in interest rates and the Czech National Bank hiking by 1.25% to maintain control of inflation.



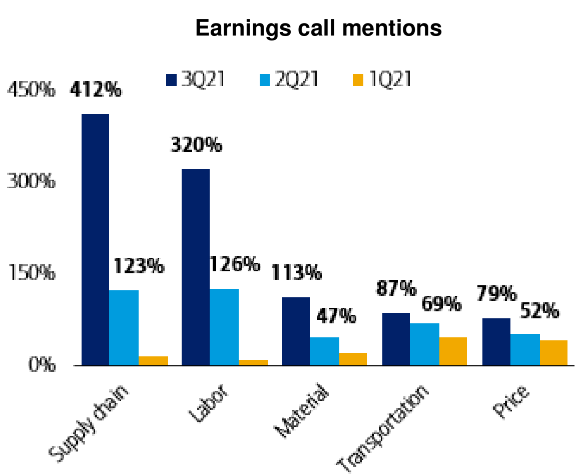
Source: BIS, AMP Capital

A positive US third quarter reporting season has been driving sharemarkets higher. Nearly 82% of companies have beaten expectations which is better than the average long-run beat of 76%. Annual earnings growth has slowed to around 37% but this comes off the back of very strong earnings growth in recent periods and is well above the usual growth in annual earnings (see the chart below).



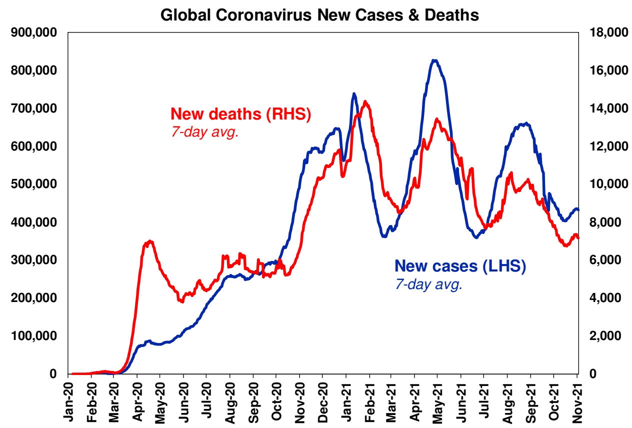
Source: Bloomberg, Credit Suisse, AMP Capital

Strong earnings and profit growth is occurring despite issues of higher inflation and supply chain problems which were mentioned **a lot** in the earnings results. The chart below shows the increase in mentions of things like "supply chain" and "labour" compared to the last quarter.



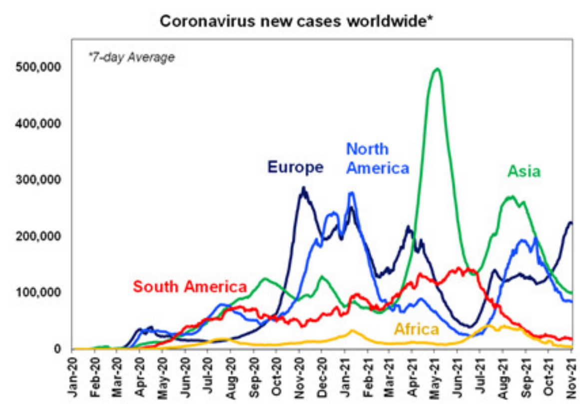
Source: AMP Capital

Global COVID-19 cases have been trending up slightly over recent weeks, but new cases are still running well below prior peaks (see chart below) and deaths are running well below prior waves. In Australia and the UK, deaths are running at less than 20% of the level suggested by the December/January wave, which are all signs that vaccines remain effective.



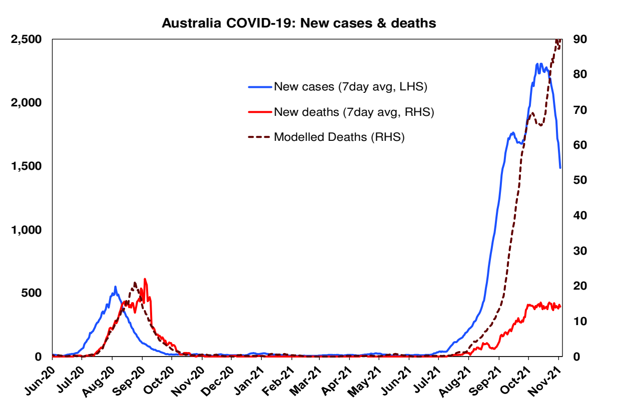
Source: ourworldindata.org, AMP Capital

Most of the recent upswing in new cases has been from Europe (see chart below) particularly in Germany and the UK which is a risk going into the European winter and shows the requirement for booster shots, as Europe started vaccinating its population in early-mid 2021. Europe has given around 2.6% of its population booster shots, while the UK is at 12.6%.



Source: ourworldindata.org, AMP Capital

In Australia, predicted deaths on current case numbers are around 90/day while they are averaging around 14/day.

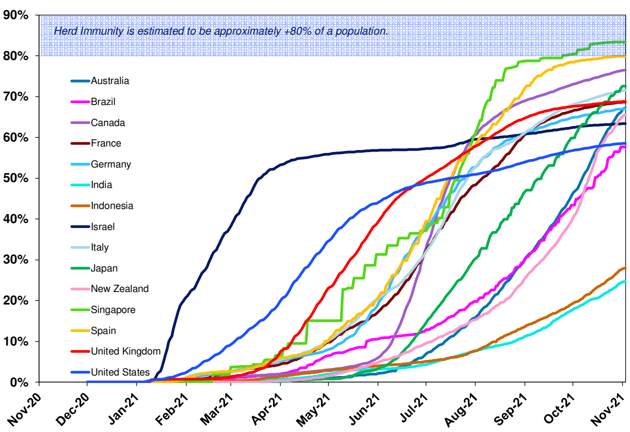


Source: ourworldindata.org, AMP Capital

Out of interest, The Economist estimates that the real death toll from COVID-19 is probably closer to 17mn (nearly four times its current level) based on "excess deaths" which is looking at the number of current deaths, compared to what is normal. This is still well below the approximately 50mn killed by the Spanish Flu.

A lot of countries seem to be reaching a ceiling for vaccinations at around 70% of the total population (see chart below).

Percent of the population who are fully vaccinated



Source: ourworldindata.org, AMP Capital

In this respect, Australia (despite being a late starter) should have at least 80% of its population vaccinated which is currently projected to occur on 13 December (see the second table below).

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

	% 1 dose	% 2 doses	% Booster
Global	52	40	
Developed countries	75	68	
Emerging countries	61	46	
Poor countries	20	15	
Canada	81	77	1
Singapore	84	83	14
UK	75	69	13
US	68	59	6
Europe	69	66	3
Japan	78	73	0
Israel	69	63	44
Australia	77	67	0

Source: ourworldindata.org, AMP Capital

Approximate dates to meet Australian fully vaccinated levels

	70% 16 +	80% 16 +	90% 16 +	80% pop
NSW	**7 Oct**	**16 Oct**	6 Nov	23 Nov
ACT	**7 Oct**	**17 Oct**	**27 Oct**	NA
Vic	**21 Oct**	**30 Oct**	16 Nov	26 Nov
Tas	**20 Oct**	13 Nov	NA	NA
SA	9 Nov	29 Nov	NA	NA
Qld	13 Nov	3 Dec	NA	NA
WA	15 Nov	5 Dec	NA	NA
NT	25 Nov	15 Dec	NA	NA
Aust	**19 Oct**	6 Nov	2 Dec	13 Dec

Source: covid19data.com.au, AMP Capital

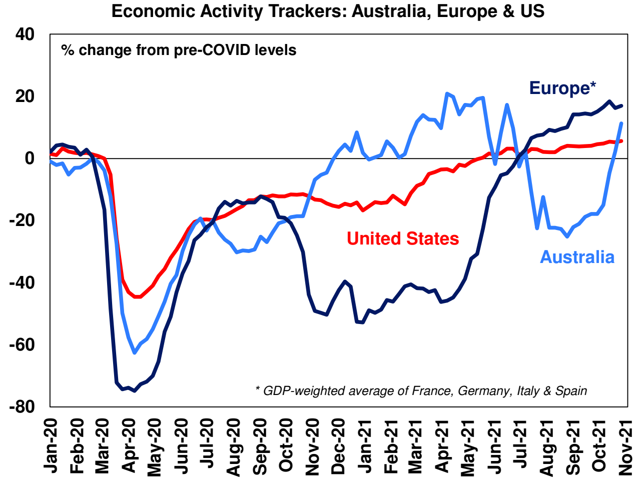
Once children aged between 5-12 start to be vaccinated (likely to start soon with the US approving a children's Pfizer vaccine), this will lift the share of global populations vaccinated.

The **NSW government** adjusted the reopening roadmap with some further easing of restrictions for those who are fully vaccinated from Monday 8 November, including no limit on the number of visitors to each household, venues allowing more patrons allowed in businesses with one person per two square metres (down from four) and an easing in capacity for outdoor recreation facilities. However, those who are unvaccinated will only be able to exit lockdown when the state reaches 95% vaccination rate for the total population (or December 15, whichever is earlier), which is two weeks later than the originally proposed 1 December (done to increase the vaccine take-up). **WA released its plan for living with COVID-19** and is still taking a very conservative approach to opening its borders to the rest of Australia and overseas, which will only happen once 90% of its population aged 12 and older is double vaccinated, this is likely in late January/early February.

There are still risks with COVID-19 disrupting economic activity including if new variants of the virus that are more immune to vaccines emerge in poor countries (which have lower vaccination rates) and if pockets of outbreaks cause a pause in economic activity (because of targeted lockdowns), especially in important trade regions which is the case recently in China.

Our **economic activity tracker** for Australia shot up this week, as re-openings in NSW and Vic continue to lift activity, with a pick up in restaurant bookings, credit card spending, mobility and foot traffic. The Australian tracker is now above the US (and above its pre-COVID levels) which shows the high level of pent-up demand from consumers and means that December quarter GDP is likely to be strong after the fall in the September quarter. The Europe tracker also continues to run above its pre-COVID rate, despite the recent uptick in cases.

Economic Activity Trackers: Australia, Europe & US

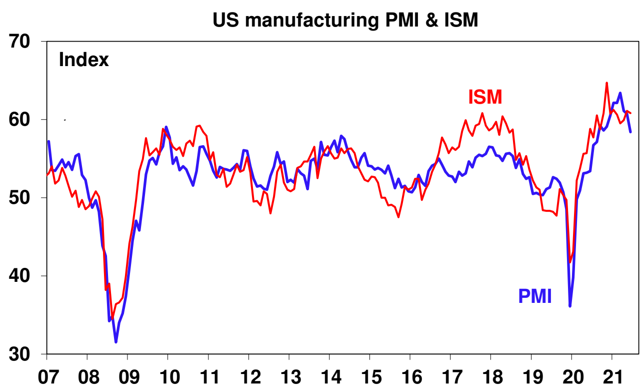


Source: ourworldindata.org, AMP Capital

Major global economic events and implications

Some more signs of slowing Chinese economic growth with the Chinese manufacturing and non-manufacturing PMIs both coming in below expectations. The services PMI fell to 52.4 (from 53.2 in the prior month) but shows that the sector is still expanding, while manufacturing PMI fell to 49.2 (from 49.6) which shows a contraction in the sector. There are some mixed signals across manufacturing indicators with the Caixin manufacturing PMI (which surveys smaller firms) stronger than the official reading, rising in October to 50.6 (from 50.0 in the prior month) which indicated rising manufacturing activity.

In the US, manufacturing activity is still running hot. The manufacturing ISM index for October was a little stronger than expectations at 60.8 but weakened slightly compared to last month (61.1 in September). The Markit PMI also remains solid (see the chart below), but down from its peak in early 2021. New orders fell (a sign of slowing demand but also pressures from supply chain issues), prices paid rose (but were lower than the peak in June) and supplier deliveries rose. US December GDP growth should be strong, after a disappointing third quarter. The services ISM shot up in October, to 66.7 (from 61.9 in the prior month) and well above expectations, with business activity and new orders up to record highs, which reflects the shift in consumer demand from goods to services.



Source: Bloomberg, AMP Capital

The Virginia governor election was won by Republican Youngkin which could be an early sign that the Democrats will lose seats and the House of Representatives in next year's mid-term (which is often common for the governing party).

In NZ, the September quarter unemployment rate fell to 3.4%, from 3.9% in the June quarter. The NZ labour market remains in good shape, despite the Delta outbreak.

In Europe, the September unemployment rate was unchanged at 7.4% from a month ago while the September producer price index rose by 2.7% (stronger than expected) with annual growth at a high 16%.

Australian economic events and implications

The RBA's quarterly ***Statement on Monetary Policy*** was mostly foreshadowed in Tuesday's post-meeting press conference. The RBA downgraded near-term GDP growth but upgraded growth forecasts in the second half of 2022 and early 2023. The unemployment rate looks slightly lower in early 2023 and trimmed mean (or core) inflation is higher across the forecast profile, getting to 2.5% in late 2023 (see the table below). Our own forecasts for GDP and inflation are slightly higher compared to the RBA's. We expect a strong rebound in economic activity in the first half of 2022 from the re-opening and pent-up savings and demand and this will flow through to prices. We also see supply chain and energy price inflation that is impacting global prices to be more pronounced in Australia than the central bank is assuming. The RBA are of the view that the factors pushing up non-oil energy prices are "less relevant here" and that Australia has had higher labour supply growth (than the US) which has put less upward pressure on wages growth. Low wages growth present some downside risks to our inflation forecasts. Wages growth is still subdued (running at around 2% per annum) and may not pick-up significantly when immigration returns as this will increase labour supply. In our view, there is a stronger feedback loop to wages from inflation than most assume, and higher inflation will be a driver of a pick-up in wages growth, despite the high participation rate and high labour supply growth. There was more push-back against market pricing for rate hikes in 2022 with the RBA commenting that a cash rate hikes in 2023 "could be warranted" but not in 2022 and that it was prepared to be "patient" in lifting interest rates.

Table 5.1: Output Growth and Inflation Forecasts[(a)]

Per cent

	Year-ended					
	June 2021	Dec 2021	June 2022	Dec 2022	June 2023	Dec 2023
GDP growth	9.6	3	4	5½	3¼	2½
(previous)	(9½)	(4)	(4½)	(4¼)	(2¾)	(2½)
Unemployment rate[(b)]	5.1	4¾	4½	4¼	4	4
(previous)		(5)	(4½)	(4¼)	(4¼)	(4)
CPI inflation	3.8	3¼	2¾	2¼	2¼	2½
(previous)		(2½)	(1½)	(1¾)	(2)	(2¼)
Trimmed mean inflation	1.6	2¼	2¼	2¼	2¼	2½
(previous)		(1¾)	(1½)	(1¾)	(2)	(2¼)
	Year-average					
	2020/21	2021	2021/22	2022	2022/23	2023
GDP growth	1.4	4¼	3¼	5	5	3
(previous)	(1¼)	(4¾)	(4½)	(5)	(4)	(2¾)

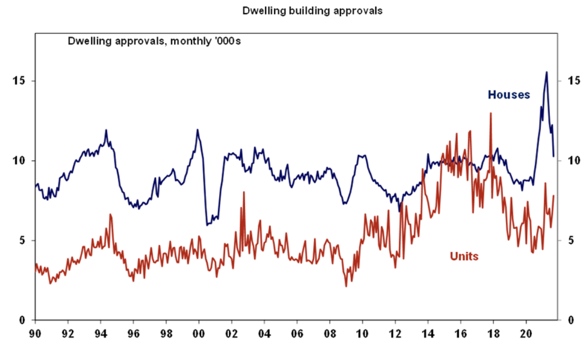
(a) Forecasts finalised on 3 November. The forecasts are conditioned on a path for the cash rate broadly in line with recent market pricing and assume other elements of the Bank's monetary stimulus are in line with the announcement made following the November 2021 Board meeting. Other forecast assumptions (August *Statement* in parenthesis): TWI at 62 (62), A$ at US$0.74 (US$0.74), and Brent crude oil price at US$80bbl (US$70bbl). The assumed rate of population growth is broadly in line with the profile set out in the Australian Government's 2021/22 Budget. Forecasts are rounded to the nearest quarter point. Shading indicates historical data, shown to the first decimal point.

(b) Average rate in the quarter

Sources: ABS; RBA

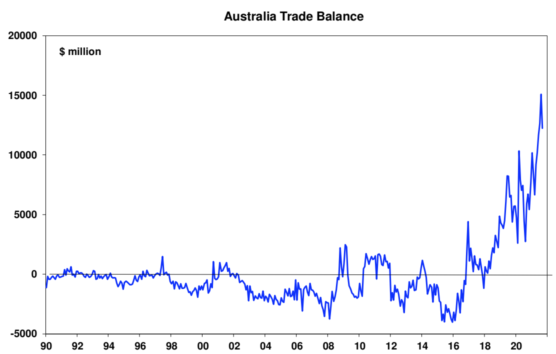
Source: RBA, AMP Capital

Home prices according to CoreLogic rose by 1.4% in October, which is a strong lift, but the monthly pace of home price growth has slowed from the peak in March which reflects a few factors: a bottoming in interest rates (with some fixed rates increasing), deteriorating affordability and waning stimulus from fiscal policy in 2020. Recent lockdowns in NSW and Vic also have not helped home price growth. However, home prices are likely to continue rising from now because of the resumption of the economic and jobs market recovery as lockdowns end, mortgage rates remain very low and the level of listings for homes is still low. Overall, we expect home price growth of 5% in 2022, with prices starting to fall from late next year. **Dwelling building approvals** fell by 4.3% in September, driven by a plunge in house approvals. House approvals have had a big upswing over the past year from various government housing programs (especially HomeBuilder) so a fall in approvals was expected, as the government stimulus brought forward demand. Because of the lag between approvals and actual construction, residential investment will make a positive contribution to GDP growth over the next 6-12 months. But, the outlook for housing construction after that time looks more challenging as mortgage rates are likely to start drifting up and it is uncertain when demographic demand will pick-up once immigration returns.



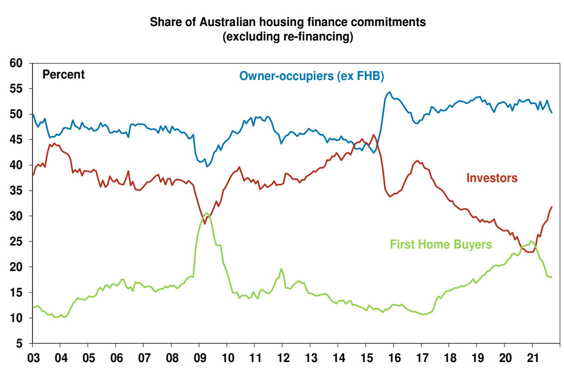
Source: ABS, AMP Capital

Retail sales volumes fell by 4.4% in the September quarter, which isn't as large as expected. Retail prices rose by 0.1% in the quarter, while we were expecting a larger rise which would have resulted in a larger fall in retail volumes. **The trade surplus** remains very large, despite the trade balance falling to $12.2bn in September from $15bn in the prior month. Total exports fell by 7.3% (driven by goods while services exports rose by 3.2%). Imports were 2.2% lower, with a decline in goods but lift in services. A larger trade surplus means more income flowing into Australia from the net export sector.



Source: ABS, AMP Capital

More signs of inflation pressure in Australia with the **Melbourne Institute inflation gauge** up by 3.1% higher in October. **ANZ job advertisements** for October surged by 6.2%, but this is after 3 months of falls and is in line with the easing of lockdowns. **Housing finance** data showed a 1.4% fall in total new housing lending (excluding re-financing) in September. Owner-occupied lending declined by 2.7% but investor lending rose by 1.4%. First home buyers fell by 1.9% in September and investors are now becoming a larger share of the lending market, as affordability pressures hit first home buyers.



Source: ABS, AMP Capital

What to watch over the next week?

In the US, October non-farm payrolls are expected to rise by 450K, a big lift on the disappointing number in the prior month, this should push the unemployment rate down to 4.7% from 4.8%. Average hourly earnings are expected to rise to 4.9% over the year to October**,** a noticeable lift on the ~3% annual growth rate prior to the outbreak of COVID-19. **October NFIB small business confidence** is also released, along with October producer prices. The October consumer price index should show a continuing strong rise in price growth (tracking at 4.2% per annum). **November consumer sentiment** (according to University of Michigan) is also released and is likely to remain relatively unchanged on the prior month, which is still well below its pre-COVID levels.

In the Euro area, limited data is out, with September retail sales growth likely to be low at 0.2% over the month. Other data releases include the ZEW survey of financial market analysts for November and September industrial production.

In Australia, the October NAB business survey is released, which gives an update on business confidence and conditions and should show an improvement in conditions, which have lagged the recovery in confidence. Westpac/Melbourne Institute consumer confidence for November is likely to rise, from the re-opening and easing of restrictions in NSW and Vic after lockdowns. **The October labour force data survey** should show a bounce back in jobs, by around 80K. The big rise in jobs is because of the re-opening of NSW after lockdown, with the timing of the jobs survey should capture one week of the NSW re-opening. The Vic re-opening occurred in late October so will be captured next month. We expect the participation rate to rise to 65% and the unemployment rate to rise slightly to 4.7% (from 4.5% in September) which is still lower than pre-pandemic.

In China, the October trade surplus is expected to weaken as import growth is likely to be stronger than exports. October consumer and producer price data is likely to show a lift in annual inflation with consumer prices running at 1.4% year on year and producer prices at a stronger 12.4% year on year.

Outlook for markets

Shares remain vulnerable to short-term volatility with possible triggers being coronavirus, global supply constraints & the inflation scare, less dovish central banks, US fiscal plans and the slowing Chinese economy. But we are now coming into a stronger period seasonally for shares and the combination of improving global growth and earnings, vaccines allowing a more sustained reopening and still low interest rates augurs well for shares over the next 12 months.

Expect the rising trend in longer-term 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.

Australian home prices look likely to rise by around 21% this year before slowing to around 5% next year, being boosted by ultra-low mortgage rates, economic recovery and FOMO, but expect a further slowing in the pace of gains as poor affordability impacts, home buyer incentives are cut back, listings return to more normal levels, fixed mortgage rates rise further, and macro prudential tightening slows lending.

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 the latest threats to the outlook and weak iron ore prices, a rising trend is likely over the next 12 months helped by strong commodity prices and a cyclical decline in the US dollar, probably taking the $A up to around $US0.80.