

## ECONOMICS & MARKETS

### Market Update 05 February 2021

05 Feb, 2021



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Data/Event	Movement	
	LATEST	PREVIOUS
US – ISM Manufacturing PMI (Jan)	58.7	60.5
Australia – Cash Rate Decision	0.1%	0.1%
US – Nonfarm Payrolls (Jan)	+49,000	-227,000

#### Financial markets

Indicator	Friday 5 February 2021	Friday 29 January 2021	Weekly Change %	5 February 2020	12-month Change %
S&P/ASX 200 Index	6,840.5	6,607.4	+3.5	6,976.1	-1.9
S&P/ASX 200 A-REIT	1,411.8	1,383.7	+2.0	1,675.3	-15.7
US S&P 500	3,886.8	3,714.2	+4.6	3,334.7	+16.6
Dow Jones EURO STOXX	409.9	391.8	+4.6	410.8	-0.2
UK FTSE 100	6,489.3	6,407.5	+1.3	7,482.5	-13.3
Japan Nikkei 225	28,779.2	27,663.4	+4.0	23,319.6	+23.4
CHINA – CSI 300	5,483.4	5,352.0	+2.5	3,828.5	+43.2
MSCI (ex-Aust/in LC)	2,114.6	2,024.7	+4.4	1,870.9	+13.0
Australian 90-day bank bill yield	0.01	0.01	-3.00 bps	0.92	-99 bps
Australian 10-year bond yield	1.20	1.09	+9.72 bps	1.03	+16 bps
US 10-year bond yield	1.17	1.09	+7.36 bps	1.65	-29 bps
Oil – West Texas Crude	51.87	47.63	+8.9	75.48	-31.3
A\$ trade-weighted index (TWI)	62.8	63.0	-0.3	58.5	+7.4
A\$ in US dollars	0.77	0.77	-0.2	0.67	+13.6

#### Major upcoming global economic releases and events

Date	Data/Event	FORECAST	PREVIOUS
9 February	Australia – NAB Business Confidence (Jan)	8	4
10 February	US – Consumer Price Index (YoY) (Jan)	+1.5%	+1.4%
10 February	US - Consumer Price Index ex Food & Energy (YoY) (Jan)	+1.5%	+1.6%

Source: Bloomberg, FXStreet, AMP Capital

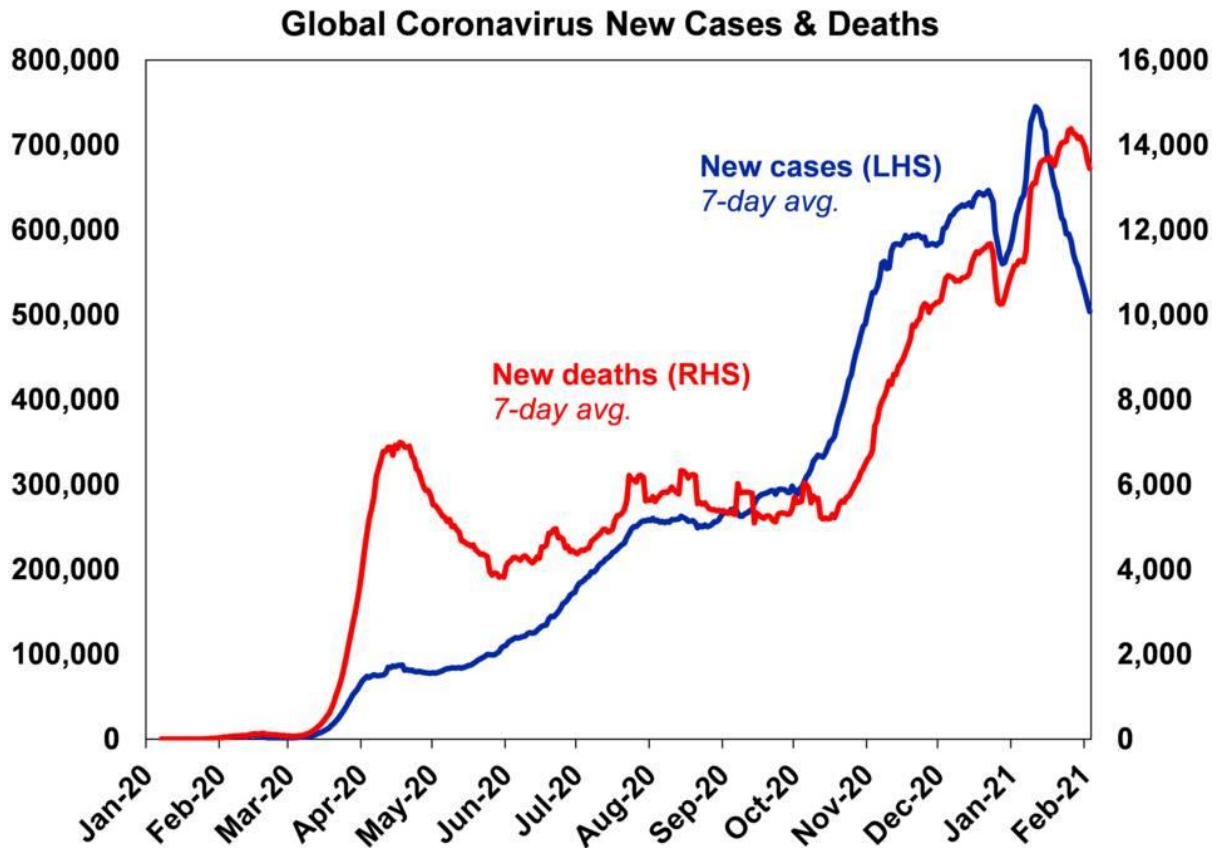
Investment markets and key developments over the past week

**Global share markets rebounded over the last week helped by good economic data and earnings news, reduced concerns around vaccines and as worries about the Reddit/day trader crowd adding to volatility fizzled.** Softer than expected US payroll jobs also added to expectations for more stimulus in the US. This all saw the US share market rise 4.6% for the week to a record high, Eurozone shares gain 4.6% to their highest since February last year, Japanese shares rise 4% and Chinese shares gain 2.5%. Reflecting the positive global lead along with strong Australian data and a very dovish message from the RBA on interest rates and more QE, Australian shares rose 3.5% with the gains led by a surge in financials, IT, Telco and retail stocks. Reflecting the “risk on” tone bond yields resumed their upswing and oil and metal prices rose. The iron ore price fell though (albeit it remains high) & the US\$ continued to see a bounce, but the A\$ rose slightly.

**So much for the correction!** After a 3% to 4% pull back a week ago share markets have yet again been buoyed by more good news – around economic data, earnings, declining covid cases, vaccines and stimulus. The vulnerability to a renewed short-term pullback remains with investor sentiment remaining upbeat but the broader trend likely remains up as it's too early to expect a cyclical bull market top with a more sustained global recovery in sight thanks to vaccines, earnings still being revised up, inflation low and central banks remaining dovish. Against this backdrop it will likely remain hard to time corrections.

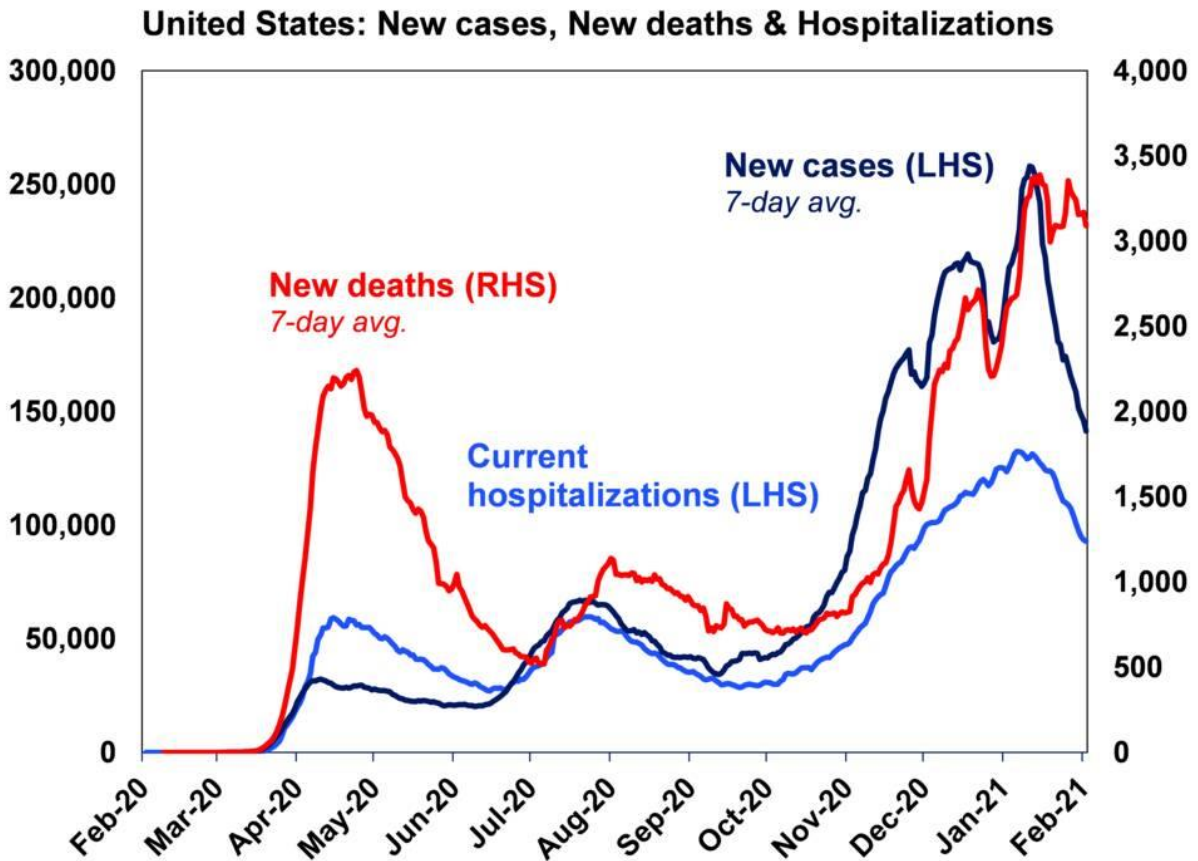
**Concerns about the Reddit/GameStop/Robinhood frenzy driving broader volatility in share markets have faded.** And for good reason. After surging 600% or so GameStop has plunged to be back near where it started. The Reddit crowd will work out just like everyone else has over the decades that there is no free lunch when it comes to investing and excitement does not necessarily equal investing success. As always it may take a bit of pain to learn that lesson. But meanwhile share markets will continue to see the normal pattern of booms and busts and euphoria and despair against a long-term rising trend driven by the fundamentals of earnings and interest rates.

**New coronavirus cases continue to decline globally in most regions,** with new deaths starting to follow.



Source: ourworldindata.org, AMP Capital

**The US is also seeing a clear downtrend in hospitalisations, like that in Europe.** If the downtrend in new cases continues then we are likely to see relaxation of severe restrictions – although it may be slower this time given new mutations and as authorities wait for greater vaccine coverage.

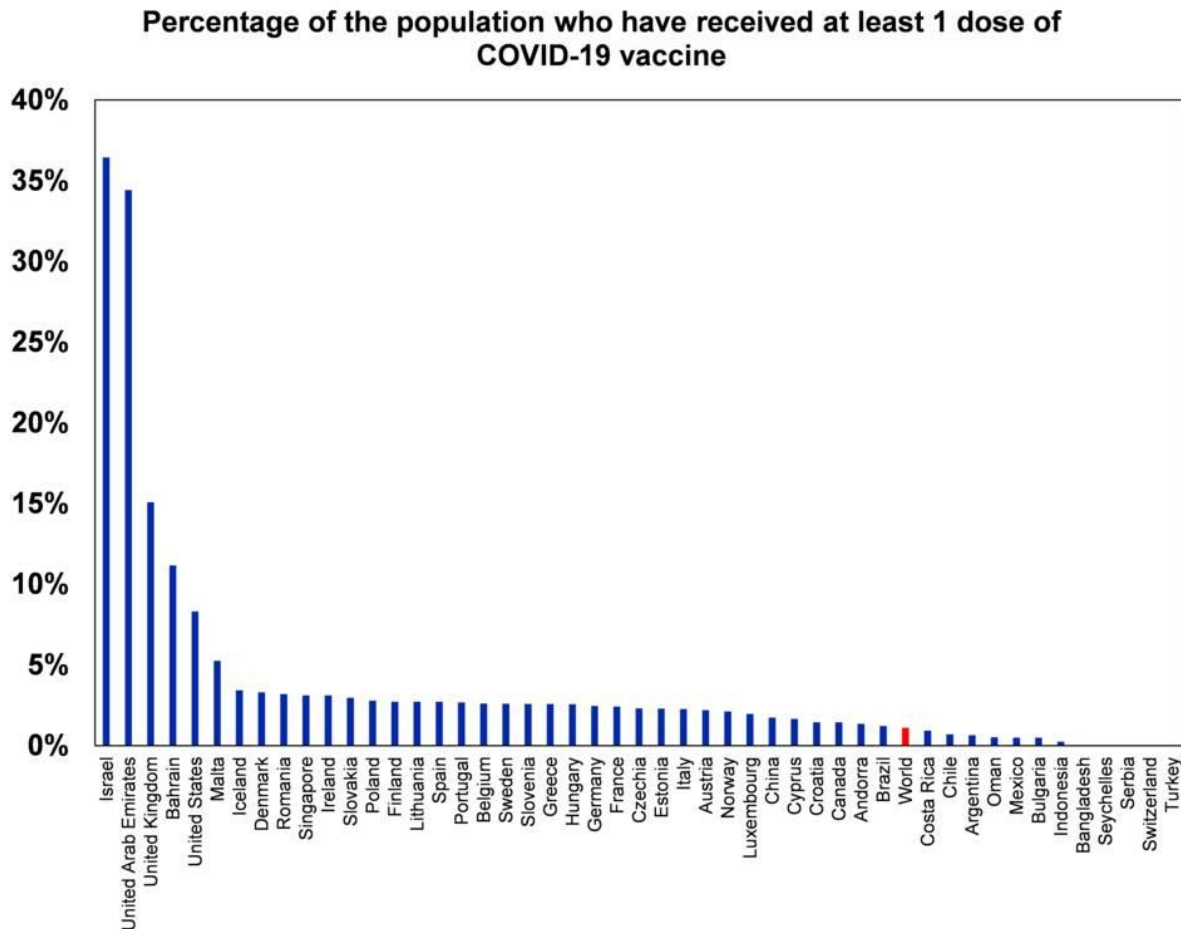


Source: ourworldindata.org, AMP Capital

**On the vaccine front the news is a lot more positive than commonly portrayed.** First, following the Novavax and Johnson and Johnson results we now have five western vaccines with good results in preventing coronavirus infection and we can't ignore the Russian and Chinese vaccines that look to have high levels of efficacy. So, while there is much angst about supply delays right now, the world is likely to have plenty by mid-year. Second, vaccine efficacy should not be measured just in terms of heading off infection but also in preventing serious infection, hospitalisation, and death. And on this front, none of those who participated in the trials of the western vaccines but who still got infected were admitted to hospital or died from coronavirus. This included those who were in the latter Novavax and Johnson and Johnson trials which covered the period of the new mutations. Third, there is evidence at least in relation to the AstraZeneca vaccine that it helps prevent people spreading coronavirus. Finally, a study from Israel where nearly 40% of the population have been vaccinated showed that of 240,000 people who had been vaccinated only 66 became infected and none were hospitalised or died. The key is that while the current vaccines may be less effective in preventing infections with the new mutations, they are highly effective in preventing hospitalisations and

deaths...so once a sufficient proportion of the population is vaccinated to reach “herd immunity” the vaccines should still allow a sustained reopening.

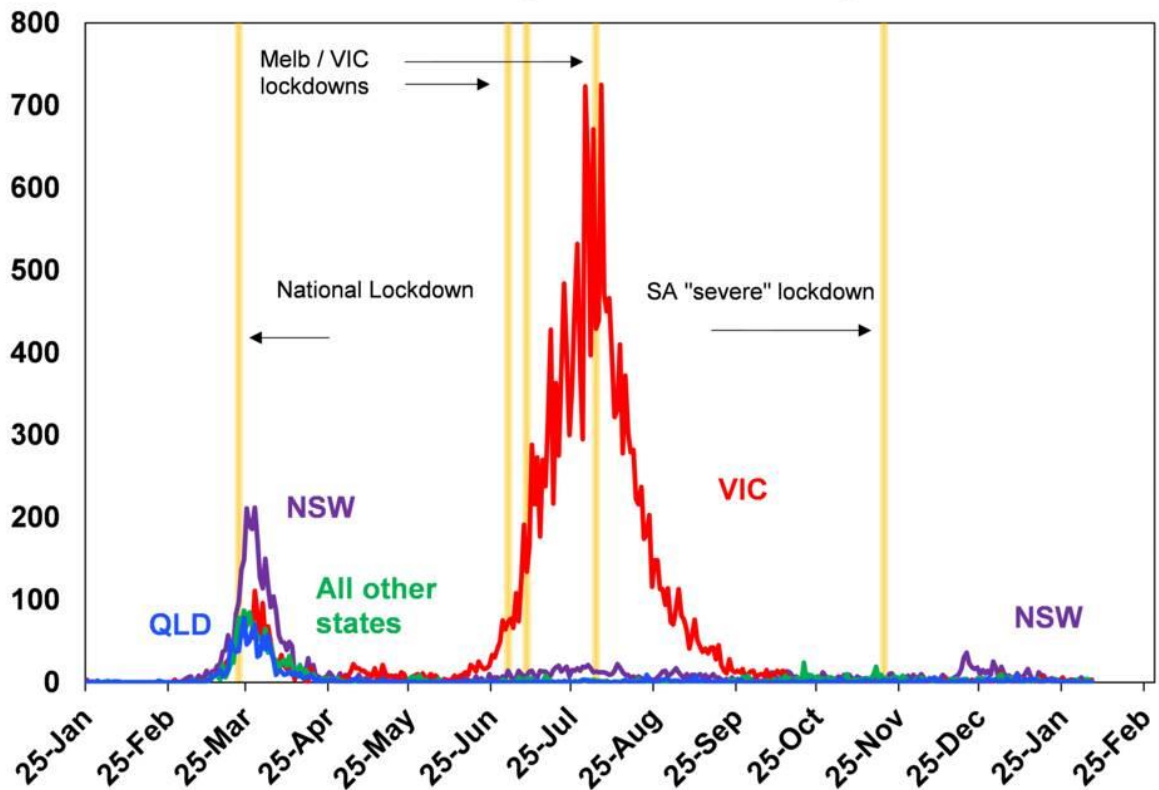
**In terms of the latter, we are continuing to see a steady lift in vaccinations in several countries with 15% of those in the UK and 8% of those in the US having at least one dose.** Rough estimates suggest that herd immunity in the US can be reached around mid-year with Australia maybe around October.



Source: ourworldindata.org, AMP Capital

**In Australia, while the returned traveller quarantine program continues to create problems the number of new coronavirus cases remains very low – and largely confined to returned travellers.**

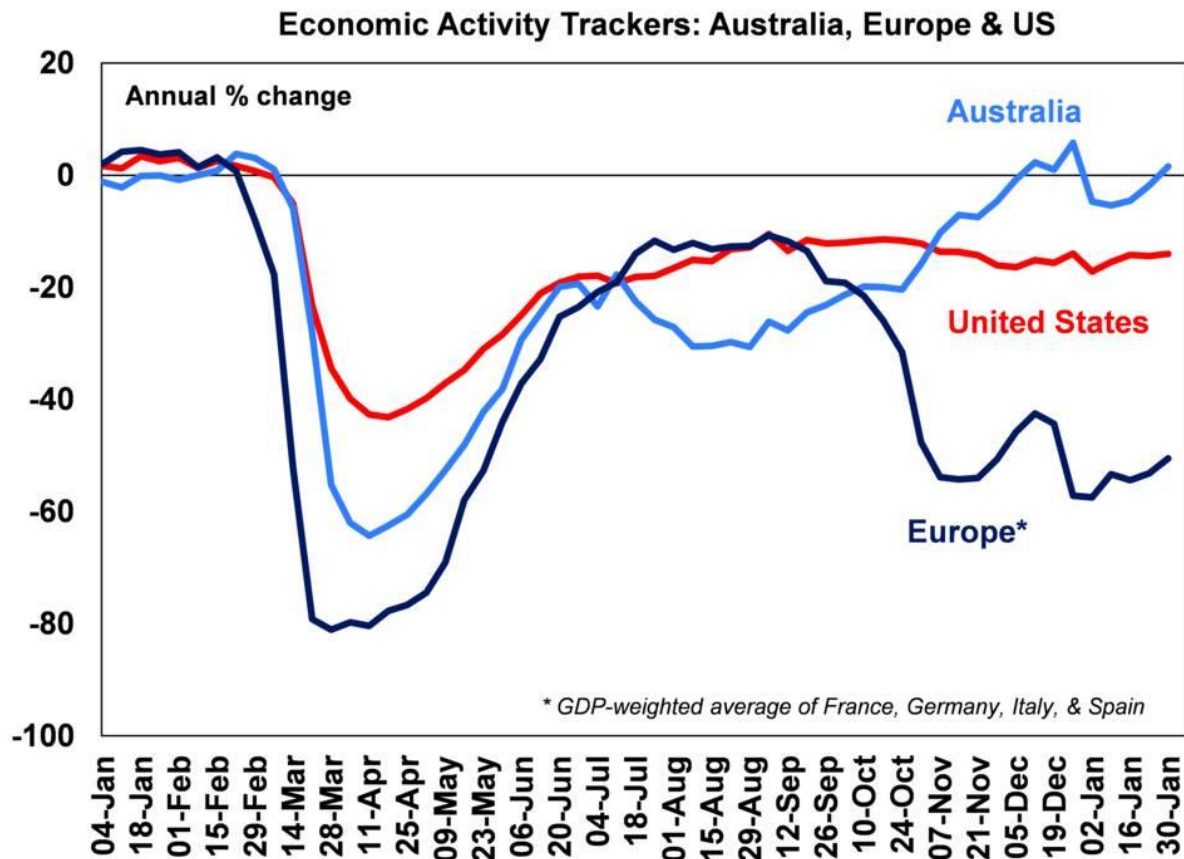
### Australia: New Daily Coronavirus Cases by State



Source: covid19data.com.au, AMP Capital

With new coronavirus cases remaining under control in Australia despite a few scares, our weekly Economic Activity Tracker for Australia has now moved back to be above where it was a year ago. Our US Economic Activity Tracker moved sideways again and remains soft and down from its September high. And our European Economic Activity Tracker rose slightly again over the last week but remains very soft.





Based on weekly data for eg job ads, restaurant bookings, confidence, mobility, credit & debt card transactions, retail foot traffic, hotel bookings. Source: AMP Capital

**There is nothing really new on the stimulus front in the US** with Biden trying to win over moderate Senate Republicans to support a regular stimulus bill but some combination of a regular bill (which needs 60 Senate votes) and reconciliation (which only needs 50 Senate votes plus the Vice President but needs to be budget neutral over time and which is already starting to be debated in the Senate) with the total being downsized a bit to get votes and moderate tax cuts also coming into focus under the reconciliation approach.

**In Australia, the RBA remains ultra-dovish and focussed on getting inflation sustainably up.** As widely expected, the RBA left interest rates on hold at its February meeting, but it surprised by announcing an extension to its bond buying program and indicated that it does not expect to raise rates before 2024 at the earliest. A QE extension was expected but most economists saw the announcement coming closer to the expiry of the current program in April and most also saw the first rate hike as being in 2023. The RBA's latest dovish moves came despite revisions to its economic forecasts in its February Statement on Monetary Policy to show slightly stronger growth and inflation in the near term and a faster decline in unemployment and reflects concern that if it doesn't match

bond buying by other central banks there would be an “unwelcome” rise in the \$A and that despite the improved economic outlook the RBA will still be short of its inflation and jobs goals for the next two years. Of course this does not mean that there won't be any fine tuning to monetary policy – the provision of cheap 3 year funding to banks looks unlikely to be extended beyond June unless there is a renewed deterioration in funding markets; the three year bond yield target of 0.1% may need to be adjusted if the RBA gets more confident that it will want to raise rates in three years; and if the economy does continue to surprise on the upside there is a good chance that the first rate hike may come in 2023 or late 2022. **But the clear message from the RBA is that it won't rush into a rate hike or broader monetary tightening until it sees actual inflation sustainably back in the target range.** So a spike in headline inflation to say 3.5% due to the return of child care fees and higher petrol prices as last June quarter's -1.9% deflation drops out won't cut it! All of which points to continuing low rates and the risk that bond buying may even be extended again beyond September.

**But what will the RBA do if house prices continue to hot up?** Right now, the RBA is celebrating the support to household balance sheets and a recovery in spending via wealth effects from higher house prices and is not too concerned about financial stability because there are few signs of a deterioration in lending standards. Most of the rise in housing finance is being driven by owner occupiers and first home buyers focussed on new housing as opposed to investors and speculation. In the first instance though, we are likely to see a wind back in government home buyer incentives this year, followed by a renewed tightening in lending standards if judged necessary rather than higher interest rates if low rates are still needed for the broader economy. This may become an issue later this year or in 2022.

**Mario to the rescue in Italy!** Italian assets were given a bit of a boost as their President asked former ECB President Mario Draghi to try and form a new government following the demise of the previous government. There is a good chance that he could and if so, it would head of an early election and hopefully see sensible use of Italy's share of EU Recovery Fund. Of course, the last technical government in Italy of Mario Monti cautions against getting too upbeat about Draghi. Monti helped stabilise things in the Eurozone debt crisis but failed to get much fundamental reform done



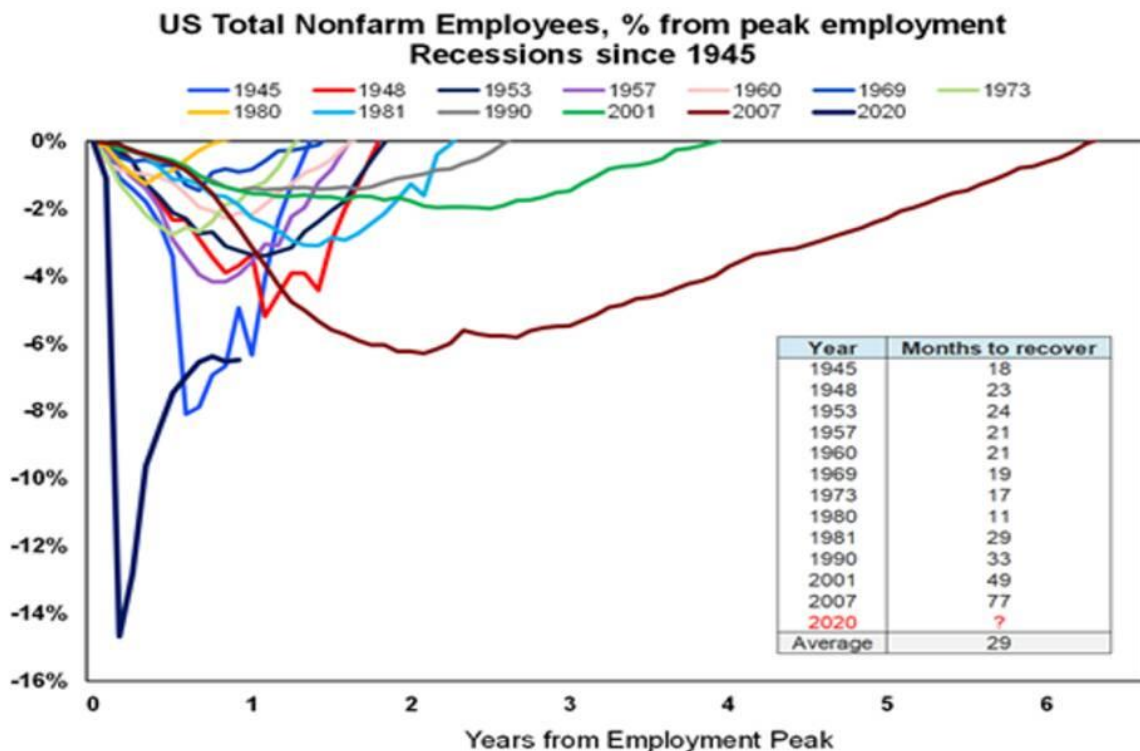
and only lasted 18 months. That said Draghi has greater authority than Monti did and for now it will be a good thing.

**There was a time in the 1970s when middle of the road singers recorded each other's**

**songs.** So, The Carpenters classic [For All We Know](#) – which seemed to get a run at every second wedding I went to and brings tears to my eyes every time I hear it – was recorded by Andy Williams. I used to think Andy was uncool but he had a great velvet voice and did really cool stuff in the late 1960s/early 1970s. In fact his version of [For All We Know](#) was probably just an album filler at the time but it sure is a great reinterpretation with a reworked intro to the point where he makes it like one of his own songs...and it brings tears to my eyes too!. Here they all are on [Andy's TV show](#). (I am not so sure about Richard Carpenter's hairstyle though!)

Major global economic events and implications

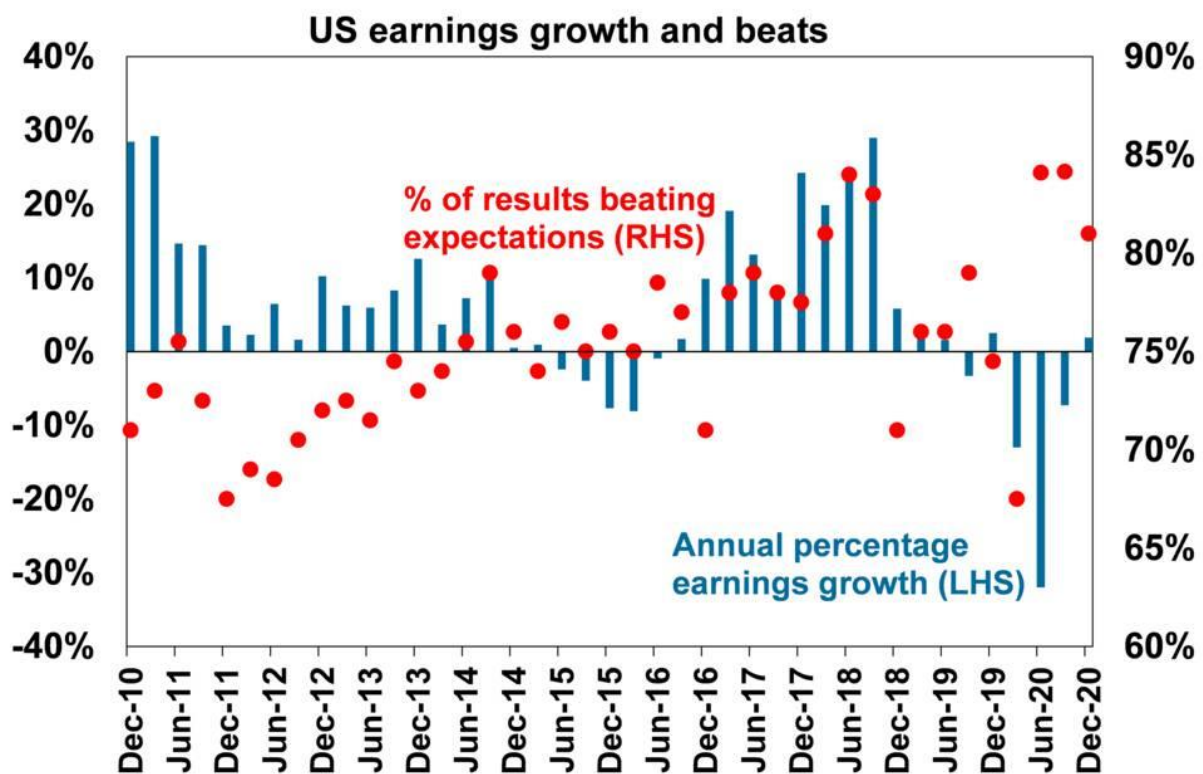
**US data releases were mixed with payrolls weaker than expected but strong readings for ISM business conditions indexes and PMIs** and a solid rise in construction. US payrolls disappointed with just a 49,000 gain in January, December's fall revised to a worse -227,000 loss and only 56% of jobs lost due to the pandemic now recovered, in contrast to 89% in Australia.



Source: Bureau of Labor Studies, AMP Capital

However, the soft payroll report will add to impetus for more stimulus and it's not quite as bad as it looks: household employment was strong; unemployment fell to 6.3% (albeit participation remains low); retail and leisure payrolls fell by 100,000 but will benefit from the decline in coronavirus cases and some reopening since mid-January; temporary services employment rose and it's a bit of a leading indicator; average hours worked rose strongly; and the strength in the ISM indicators point to stronger employment ahead.

US earnings are back to around pre coronavirus levels. The US December earnings reporting season is now about 58% complete, with results remaining strong. 81% of companies have so far surprised on the upside (compared to a norm of 75%) by an average 19% and 75% have beaten on revenue. As a result, consensus earnings expectations have been revised up to +2% year on year which is up from -9%yoy two weeks ago. In other words, earnings are likely now above pre coronavirus levels.



Source: Bloomberg, AMP Capital

Eurozone December quarter GDP fell a less than expected -0.7% in the December quarter as lockdowns intensified again after the reopening driven 12.4% rebound in the September quarter. It's worth noting that despite more severe lockdowns GDP held up far better than in the June quarter but it's still down 5.1% from the pre coronavirus level. Inflation jumped in January with core inflation rebounding to 1.4% year on year from 1.2%, but this reflected a bunch of one of factors including the

reversal of a sales tax holiday in Germany, a delay in French winter clothing sales and an adjustment to CPI weights so it didn't reflect a real rise in underlying inflation pressures and is unlikely to see the ECB become any less dovish.

The Bank of England left monetary policy on hold as expected, revised down near GDP term forecasts but was more upbeat on the outlook & indicated negative rates are not warranted.

Japanese household spending was stronger than expected in December.

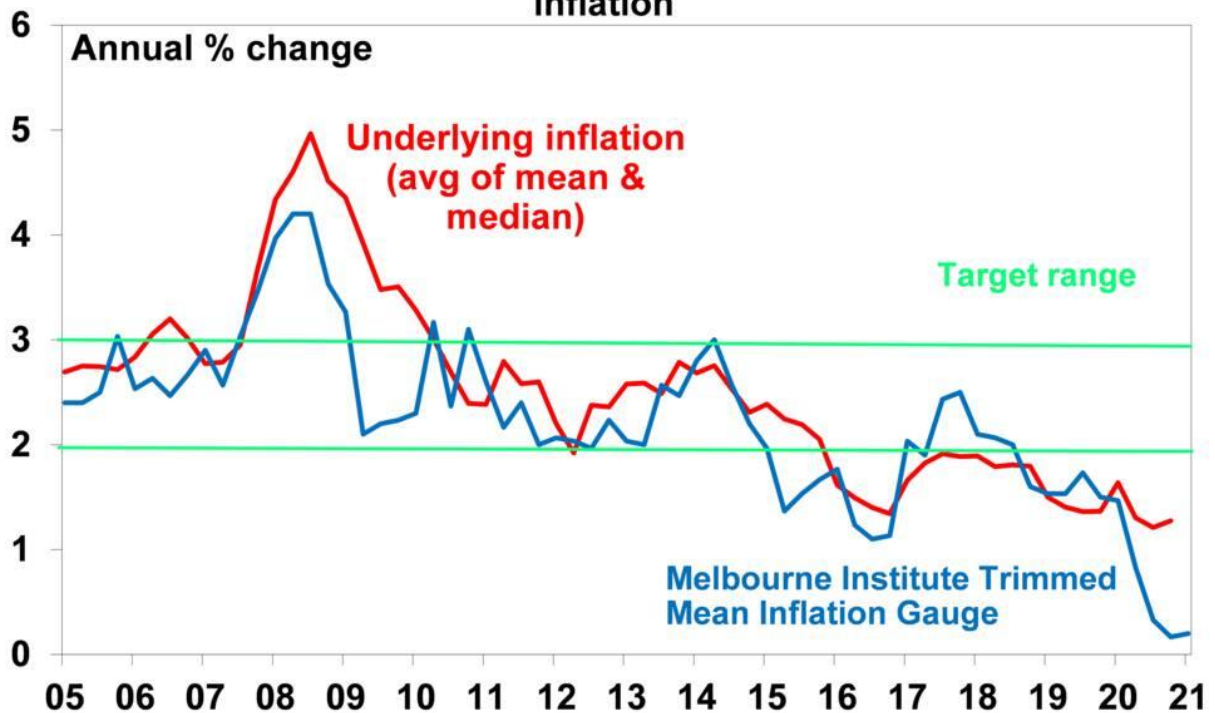
**Chinese business conditions PMIs fell in January** probably reflecting the bout of coronavirus cases and partial lockdowns in northern China. They remain in expansion mode though but along with a sharp reduction in Lunar New Year holiday travel point to some slowing in growth in the current quarter.

Australian economic events and implications

**The run of strong Australian economic data releases largely continued over the last week**, with strong business conditions PMIs, record levels for housing finance driven by owner occupiers and first home buyers and finance for new construction, another surge in building approvals driven by approvals for houses, continuing solid gains in house prices albeit with Sydney and Melbourne lagging, a further rise in ANZ job ads and a continuing strong recovery in payroll jobs after adjusting for seasonality. ABS final retail sales data confirmed a -4.1% decline in December retail sales as strong Black Friday sales brought spending forward and the covid scare in late December impacted. But this followed several exceptionally strong months, they are up a whopping 9.6% year on year and they rose a stronger than expected 2.5% in real terms in the December quarter. And the trade surplus rebounded in December, albeit by less than expected.

**Meanwhile, the Melbourne Institute's January Inflation Gauge continues to point to very low underlying inflation pressures.**

## MI Inflation Gauge points to ongoing low underlying inflation



Source: ABS, AMP Capital

While the rebound in house prices – on the back of record low rates, government incentives, “escape from the city”, FOMO and reopening - is a concern from an affordability perspective at least it’s being accompanied by a surge in housing construction which combined with a hit to underlying housing demand from the slump in immigration of around 100,000 dwelling per annum could ultimately lead to improved affordability – particularly in inner city Sydney and Melbourne.

Finally, APRA data indicates that the proportion of loans on payment holidays fell to just 1.9% of the total by value in December which is down from 10% in May, and the proportion of mortgages on payment holidays fell to just 2.4% which is down from 11% in May. So a huge surge in distressed property sales once payment holidays end is not going to happen!

What to watch over the next week?

In the US, headline CPI inflation for January (Wednesday) is likely to have increased further to 1.5% year on year reflecting the rise in energy prices but core CPI inflation is likely to edge down to 1.5%yoy from 1.6%. Data for small business optimism and job openings (Tuesday) will also be released and the December quarter earnings reporting season will continue.

Chinese inflation data for January (Wednesday) is expected to show a -0.2%yoy decline in CPI inflation but a rise in producer price inflation to +0.3%yoy. Credit data may also be released.

**In Australia, the NAB business survey for January (Tuesday) is likely to show continuing strength in business conditions** and a rebound in confidence as the late December early January covid scare subsided. Consumer confidence (Wednesday) is likely to have remained strong.

**The December half earnings reporting season will hot up with 23 major companies reporting including: Suncorp, Boral, Challenger and Dexu (Tuesday); CBA, CSL and IAG (Wednesday); AGL, AMP, ASX, Newcrest, Transurban and Telstra (Thursday); and Mirvac and Computershare (Friday).** Earnings are now expected to rebound in 2020-21 by 25% after the pandemic driven -24% plunge last financial year. In terms of sectors, earnings for resources are expected to rise by 47%, banks by 31% and IT stocks by 109%. Healthcare, media and gaming stocks are likely to see around 17% earnings growth and retailers are likely to surprise on the upside. Key themes are likely to be a rebound in dividends, stocks benefiting from a surge in housing activity and a likely outperformance of value and cyclical over growth stocks, and small caps outperforming large caps.

Outlook for investment markets

Shares remain at risk of a short-term correction after having run up so hard recently and 2021 is likely to see a few rough patches along the way. But timing such moves will be hard and looking through the inevitable short-term noise, the combination of improving global growth helped by more stimulus, vaccines and low interest rates augurs well for growth assets generally in 2021.

We are likely to see a continuing shift in performance away from investments that benefitted from the pandemic and lockdowns - like US shares, technology and health care stocks and bonds - to investments that will benefit from recovery - like resources, industrials, tourism stocks and financials. Global shares are expected to return around 8% but expect a rotation away from growth heavy US shares to more cyclical markets in Europe, Japan and emerging countries.

Australian shares are likely to be relative outperformers helped by: better virus control enabling a stronger recovery in the near term; stronger stimulus; sectors like resources, industrials and financials benefitting from the rebound in growth; and as investors continue to drive a search for yield benefitting the share market as dividends are increased resulting in a 4.5% grossed up dividend yield. Expect the ASX 200 to end 2021 at a record high of around 7200.

Ultra-low yields and a capital loss from a 0.5-0.75% or so rise in yields are likely to result in negative returns from bonds.

Unlisted commercial property and infrastructure are ultimately likely to benefit from a resumption of the search for yield but the hit to space demand and hence rents from the virus will continue to weigh on near term returns.

Australian home prices are likely to rise another 5% or so this year being boosted by record low mortgage rates, government home buyer incentives, income support measures and bank payment holidays but the stop to immigration and weak rental markets will likely weigh on inner city areas and units in Melbourne and Sydney. Outer suburbs, houses, smaller cities and regional areas will see relatively stronger gains in 2021.

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

Although the \$A is vulnerable to bouts of uncertainty about coronavirus and China tensions and RBA bond buying will keep it lower than otherwise, a rising trend is still likely to around \$US0.80 over the next 12 months helped by rising commodity prices and a cyclical decline in the US dollar.

### **Important notes**

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