Economic Insights

CommSec

Economics | January 4, 2022

Year in Review. Year in Preview

FINANCIAL MARKETS: 2021 IN DETAIL

AUSSIE SHARES	Dec 31 2020	Dec 31 2021	% change
ASX 200	6587.1	7444.6	13.0
All Ordinaries	6850.6	7779.2	13.6
Returns on Aussie shares	74424.6	87626.1	17.7

GLOBAL SHARES	Dec 31 2020	Dec 31 2021	% change
US Dow Jones	30606.5	36338.3	18.7
US S&P 500	3756.1	4766.2	26.9
World index (MSCI)	2690.0	3231.7	20.1

CURRENCIES	Dec 31 2020	Dec 31 2021	% change
$US per $A, cents	77.02	72.56	-5.8
Yen per $A	79.45	83.52	5.1
Euro per $A, cents	62.69	64.11	2.3
$NZ per $A	1.0665	1.0628	-0.3
Trade weighted index	63.4	61.1	-3.6

INTEREST RATES	Dec 31 2020	Dec 31 2021	% change
Cash rate, %	0.10	0.10	nc
90 day bank bills, %	0.01	0.07	nc
3-year bond yields, %	0.11	0.92	nc
10-year bond yields, %	0.98	1.68	nc

COMMODITIES	Dec 31 2020	Dec 31 2021	% change
Iron ore, $US per tonne	159.20	119.00	-25.3
Thermal coal, $A per tonne	80.50	169.60	110.7
Oil, $US per barrel	48.52	75.21	55.0
Gold, $US per ounce	1895.10	1828.60	-3.5
Wool, Eastern market indicator	1157.00	1358.00	17.4
Beef, US cents per kg	485.02	640.44	32.0
Wheat, $US cents per bushel	640.50	770.75	20.3
CommSec commodity index	145.8	188.7	29.4

AUSSIE ASSETS	Dec 31 2020	Dec 31 2021	% change
Return on government bonds	10699.0	10391.5	-2.9
Return on residential property*	216.6	269.0	24.2
Price earnings Aussie shares*	17.28	15.1	nc
Dividend yield Aussie shares*	2.6	3.51	nc
Market size $bn, Aussie shares	2422.2	2798.5	15.5

GLOBAL PERSPECTIVES	Dec 31 2020	Dec 31 2021	% change
US dollar index	90.0	95.7	6.3
US 10-year bond yield, %	0.92	1.51	nc

Source: Reuters, iress, CommSec, Bloomberg, CoreLogic. * data to November

Year in Review 2021. Year in Preview 2022.

- Now that 2021 has been farewelled, it is an opportune time to reflect on the past year and look ahead to 2022.
- Last year we wrote: *"As we enter 2021, it is clear that COVID-19 still dominates the landscape. The bad news is that Europe and the US are experiencing second and third waves of the virus, driving case numbers to record highs and necessitating fresh lockdowns. The good news is that effective vaccines are starting to be distributed across the globe. The economic outlook will clearly be dictated by the virus and how quickly the vaccines can stem case numbers and allow economies to start repairing."*
- And that pretty well sums it up. It was another year dominated by the pandemic – the Delta strain and now Omicron. But the take-up of vaccines has indeed allowed economies to re-open. And Australians have led from the front in getting the vaccines, thus allowing us to enter the 'Living with Covid' stage of the process.
- Omicron is a new challenge and most likely there will be fresh challenges awaiting in 2022.
- With economies re-opening, central banks and governments are starting the process of winding back the extraordinary amount of financial and monetary stimulus. It is not just the fact that a process of 'normalisation' is underway. There is also the concern about inflation.
- Shutdowns and lockdowns hit manufacturing production, reducing the amount of available goods. But consumers are back in the malls and more businesses are back online, wanting the very raw materials and finished goods that are in relative short supply. As a result, prices are rising.
- Central banks initially thought that the spike in consumer prices would be temporary, owing to supply disruptions and pent-up demand in lockdowns. But policy chiefs, including US Federal Reserve Chair Jerome Powell, have since

backpedalled from labelling price rises as "transitory" with annual inflation rates hitting multi-decade highs - well in excess of central bank targets of around 2 per cent.

- Some central banks like New Zealand, Norway and the UK have already lifted interest rates. Other central banks like the US Federal Reserve are winding back bond purchases and talking about rate hikes in 2022. Still others like the Australian Reserve Bank are winding back some temporary stimulus measures but believe rate hikes are still some time away. Like all things affected by the pandemic, central banks can't be sure they have the 'right' approach.
- One thing that has tended to change relatively frequently is economic and financial forecasts. The need for flexibility in the pandemic has been well demonstrated over the past year.
- The cash rate remains at a record low of 0.1 per cent. The Reserve Bank doesn't see that changing until 2023 at the earliest. But Commonwealth Bank (CBA) Group economists believe the necessary pre-requisites for a rate hike – covering inflation, wages and unemployment – will be met in the December quarter of 2022.

The Economy

- The Australian economy is in good shape heading into 2022. The economy may have grown 4.4 per cent in 2021 and is expected to lift another 5.1 per cent in 2022. ('Normal' growth is around 2.5 per cent).
- The jobless rate stands at 4.6 per cent; annual underlying inflation is 2.1 per cent; and annual wage growth stands at 2.2 per cent. The Reserve Bank wants to see inflation sustainably between 2-3 per cent; unemployment near 4 per cent and wage growth near 3 per cent before lifting interest rates.

ECONOMIC FORECASTS

	Financial years			Calendar years		
	2021 (a)	*2022*	*2023*	*2020 (a)*	*2021*	*2022*
Economic Growth (GDP, %)	**1.5**	**3.7**	**4.9**	**-2.2**	**4.4**	**5.1**
Underlying inflation* (annual %)	1.3	2.5	2.6	1.3	1.8	2.6
Unemployment rate % (avg.)	6.2	4.6	4.1	6.5	5.1	4.4

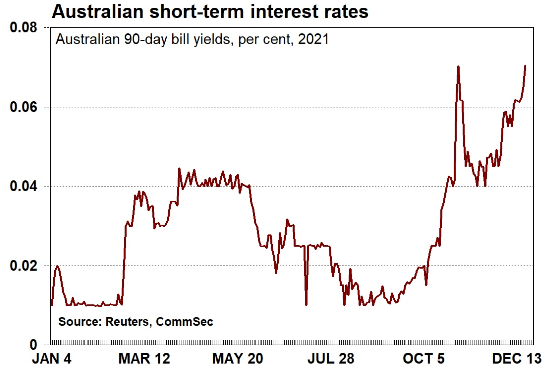
	Sep-21 (a)	*Dec-21 (a)*	*Mar-22*	*Jun-22*	*Sep-22*	*Dec-22*
Cash rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.50%
Sharemarket (ASX200)	7,332	7,445	7,500	7,550	7,600	7,650
Australian dollar	US72.1c	US72.5c	US74c	US76c	US78c	US80c

Source: CBA, CommSec
*Trimmed mean (a) Actual.

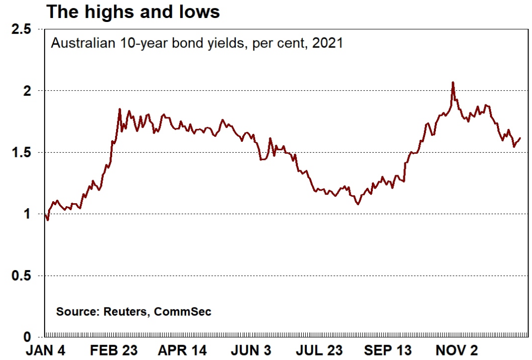
Interest rates

- In terms of Reserve Bank (RBA) monetary policy settings, final drawings for the Reserve Bank Term Funding Facility occurred on June 30.
- In August, the RBA said it would purchase government securities at the rate of $5 billion a week until early September and then $4 billion a week until at least mid November. In September the RBA said it would purchase government securities at the rate of $4 billion a week and to continue the purchases at this rate until at least mid-February 2022. In November the RBA discontinued the target of 10 basis points for the April 2024 Australian Government bond.
- The era of super-low interest rates continues. The cash rate is 0.1 per cent. Ninety-day bill yields lifted from 0.01 per cent to just 0.07 per cent over 2021. Extraordinary.
- Ten-year government bond yields have been the biggest mover over 2021, up from 0.98 per cent to 1.67 per cent (range 0.93-2.07 per cent). The lift in yields reflects global and domestic economic recoveries and the lift in global and domestic inflation. Inflation, the job market and the coronavirus will remain the key drivers of rates in 2022.

Australian short-term interest rates

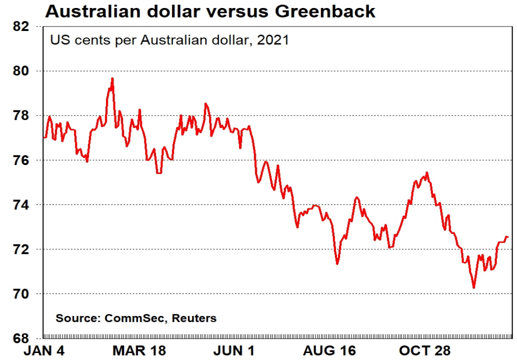


The highs and lows



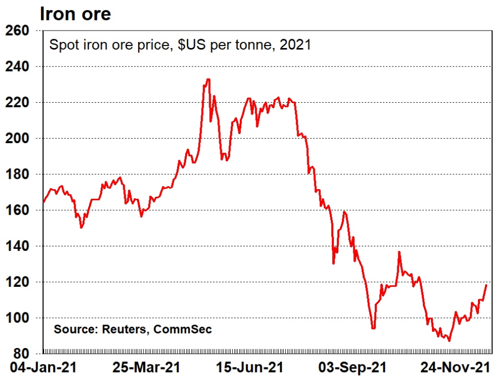
Exchange rates

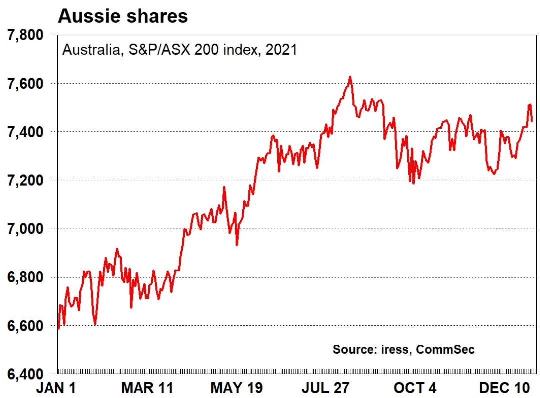
- The Aussie dollar is currently near US72.5 cents after starting the year near US77 cents (range US70-80 cents in 2021). While the Aussie lost around 6 per cent against the US dollar over the year, this reflects a stronger greenback rather than a weaker Aussie. The Aussie dollar rose 5.1 per cent against the yen and rose 2.3 per cent against the Euro but was flat against the New Zealand dollar.
- The weaker Aussie against the greenback has been despite strong Australian-side fundamentals – solid economy, higher commodity prices, consistent trade surpluses and record current account surplus. The lower dollar is providing valuable stimulus for Aussie businesses, especially exporters.



Commodities

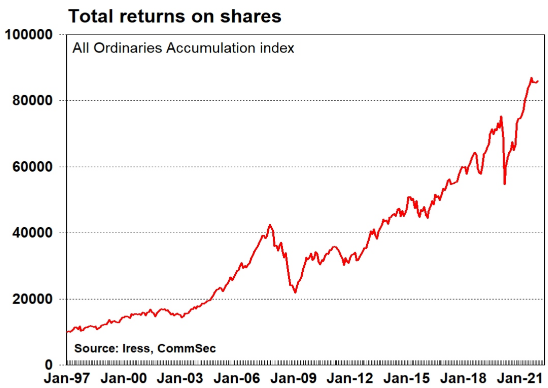
- Reflecting the re-opening of developed economies, demand for raw materials lifted over 2021, especially in the latter part of the year. As a result commodity prices have been healthy. That said, industrial metals prices have been volatile in back end of 2021 due to China's regulatory crackdown and property crisis along with US dollar strength.
- While the price of iron ore receded from the record high of US$233.10 a tonne recorded in mid-May, the current price near US$119 a tonne is still well above long-term average and the US$15-20 a tonne cost of production, although down 25.3 per cent in 2021.
- Gold fell 3.5 per cent in 2021; base metal prices rose 18.3-42.2 per cent; oil rose 55 per cent; natural gas rose 131.5 per cent; thermal coal rose 110.7 per cent; and coking coal rose 36.8 per cent.
- The CommSec daily commodity index lifted 29.4 per cent over 2021 with broad-based price gains across energy, metals and agricultural commodities. The CRB futures index rose by 38.5 per cent while the Aussie dollar fell 5.8 per cent against the greenback.
- Over the year to November the Reserve Bank commodity index increased by 36 per cent in SDR terms, led by higher liquefied natural gas (LNG), coking coal and thermal coal prices. The index increased by 34 per cent in Australian dollar terms.





Sharemarkets

- The world index (MSCI) excluding Australia in US dollar terms rose 20.7 per cent in 2021 after a 14 per cent lift the previous year. The MSCI Australia index in US dollar terms rose 5.9 per cent in 2021 after a 7 per cent rise the prior year.
- The Australian All Ordinaries index rose by 13.6 per cent in 2021 and S&P/ASX 200 rose by 13 per cent. The indexes are down 1-2 per cent from highs set on August 13.
- While gains for Australian shares exceeded those in Japan (+4.9 per cent), gains were below those recorded in Europe (STOXX 600 up 22.2 per cent) and the US. The US Dow Jones lifted 18.7 per cent over 2021 with the S&P 500 index up 26.9 per cent, and the Nasdaq added 21.4 per cent.



Australia sharemarket sectors & asset returns

- Australia's Telecommunications sector out-performed in 2021. The Telecom sector lifted by 28.5 per cent over 2021, ahead of Property Trusts (+21.6 per cent) and Consumer Discretionary (+21.3 per cent).
- At the other end of the scale, Information Technology fell by 2.8 per cent while Energy fell by 2.0 per cent.
- Of the size groupings, the MidCap50 (+18.5 per cent) out-performed the Small Ordinaries (+14.2 per cent). The S&P/ASX20 rose by 12.1 per cent and the S&P/ASX50 lifted by 12.4 per cent.
- Total returns on Australian shares (All Ords Accumulation index) lifted 17.7 per cent in 2021 after a near 4 per cent gain over 2020. The cash rate ended 2021 at 0.1 per cent while bond returns (Bloomberg AusBond Govt 0+ Yr index) fell by 2.9 pe r cent over 2021. And residential property (CoreLogic Home Value index) returned 24 per cent in the year to November.

SECTORS & SIZE GROUPINGS

percent change 2021

Telecom	28.5%
Property trusts	21.6%
Consumer Discretionary	21.3%
Financials	20.2%
Financials ex Prop Trust	20.2%
MidCap50	**18.5%**
Small Ords	**14.2%**
All Ords	**13.6%**
S&P/ASX100	**13.3%**
S&P/ASX200	**13.0%**
S&P/ASX50	**12.4%**
S&P/ASX20	**12.1%**
Industrials	11.2%
HealthCare	8.0%
Consumer Staples	7.1%
Materials	6.8%
Utilities	4.6%
Energy	-2.0%
Info Tech	-2.8%

Source: iress, CommSec

Outlook

- As noted earlier, the Australian economy may have grown by 4.4 per cent in 2021 and CBA Group economists expect another solid lift of 5.1 per cent in 2022, underpinned by household spending and business investment. Economic activity will also be well supported by infrastructure activity.
- The jobless rate is expected to ease from 4.6 per cent to around 4.1 per cent over 2022. Given strong demand for labour, the forecast could be realised earlier, but we expect labour supply to be boosted by skilled immigrants over 2022.
- Australian home prices could grow by a further 7 per cent in 2022, supported by still-low interest rates and a return of foreign migrants to Australia.
- We expect the Australian sharemarket to lift around 5 per cent over 2022. Economic activity (and profits) won't receive the same boost from fiscal and monetary stimulus as that delivered in 2021. Having said that the government will not be in a rush to remove support, and super-low interest rates will remain over the majority of 2022.
- A key uncertainty could be the outcome of the Federal election due in May. While the opposition Labor Party is currently well ahead in most opinion polls, a tight result or even a 'hung' parliament could potentially impact investor sentiment. But a centre-left government, as evidenced in the US, could see a big boost to government spending.
- Another key uncertainty is inflation. The Reserve Bank believes that Australia is not facing the same inflationary threat as other countries in part because labour force participation is higher, wage pressures are lower alongside falling energy prices. Both wages and underlying inflation are expected to grow at a 2.7 per cent annual rate by the September quarter of 2022.
- After lifting 6.4 per cent in 2021, the global economy is expected to grow by another solid 4.4 per cent in 2022, with likely Chinese fiscal stimulus underpinning demand for metals and ores and driving the Aussie dollar higher.
- The Aussie dollar is expected to rise over 2022 to reach US78-80 cents by the December quarter on the expectation that the Reserve Bank starts to 'normalise' interest rates.

GLOBAL FORECASTS

	2020	*2021*	*2022*	*2023*
World	**-4.9**	**6.4**	**4.4**	**3.4**
US (Dec qtr vs Dec qtr)	-2.6	5.2	3.2	2.3
Eurozone	-7.3	5.4	4.4	2.2
Japan (fiscal year)	-5.9	2.5	1.3	0.8
China	2.3	7.9	5.1	5.5

Source: CBA, CommSec

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