Paradigm Group

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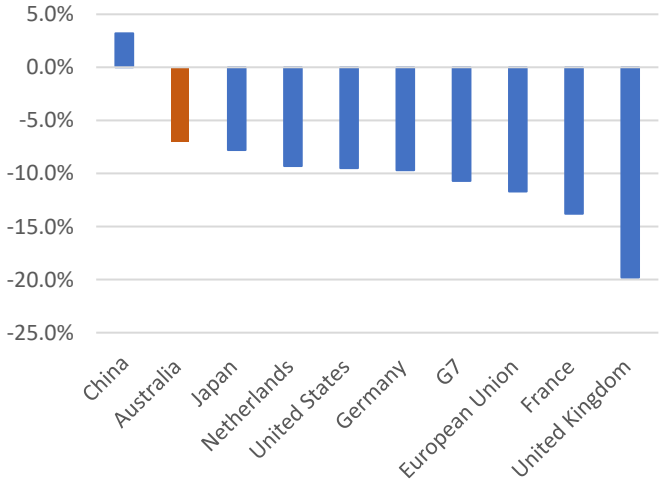
The global impact of COVID-19 continues to be felt across the world and Australia has not been immune from this. After an astonishing 28-year run, the Australian economy officially fell into a recession during the June quarter when the Gross Domestic Product (GDP) figures were reported in September. The Australian economy contracted by 7.0% in the June quarter, the largest decline since records began in 1959. However, as shown in Chart 1 Australia has faired well compared to other major countries. Notably, China reported a strong bounce back after contracting 6.8% in the first quarter of 2020.

Chart 1: June quarter GDP



Source: Australian Bureau of Statistics

Despite daily COVID-19 cases hitting new record highs, the global economy is showing signs of recovery. This has been driven by a record amount of fiscal (government spending) and monetary (interest rates) assistance including a record budget deficit announced by the Australian government in October. The federal budget has allayed fears that fiscal policy will do very little lifting in the face of the pandemic, with a singular focus on supporting incomes and employment. On the spending side, the government has put in place significant stimulatory measures, including $120 billion over 2019-20 and 2020-21, primarily for the JobKeeper payment. Other measures include $46 billion, mainly for the Coronavirus Supplement, economic support payments to households and an expansion in the JobSeeker payment. In addition $40 billion to provide further support for apprentices, trainees, hospitals, aviation and infrastructure. Treasury forecasts economic activity to pick up from late 2020 and into early 2021, driven by a further easing of restrictions and improvements in business and consumer confidence.

However, the recovery in Australia has been slowed with Victoria going into stage four lockdowns during the quarter.

The Reserve Bank of Australia (RBA) maintained the official cash rate at a record low of 0.25% during the quarter. The RBA has also hinted at further easing, with another rate cut or announcement of further quantitative easing widely expected at its November meeting. The Australian labour market saw further improvement in August, with the seasonally adjusted unemployment rate falling to 6.8%. The AIG Performance of Manufacturing Index (a measure of output where below 50 is contractionary) fell 2.6 points to 46.7 in September. Victoria reported the weakest result, down 6.4 points to 37.6 due to stage four restrictions.

The global recovery is taking hold as economies gradually emerge from lockdown, however significant uncertainty remains about the possible path the pandemic could take and the timeline for vaccines to be made available to the public.

Recent data suggests the US recovery lost some steam in September with key releases falling short of expectations. Nonfarm payrolls disappointed, with 661,000 jobs added, well short of expectations. Another concerning figure came from durable goods orders, which rose a meagre 0.4% in August, a significant reversal from the previous month's result. June quarter GDP contracted by 9.5%. The US Federal Reserve held the funds rate unchanged within the 0.00–0.25% range and is set to maintain rates at this current low level for the next few years, aiming to keep inflation moderately above 2% so that inflation averages the Fed's target over time.

Most EU member economies remain under pressure from COVID-19 containment measures as governments fear a new wave of infections could stall the recovery. Across the Euro area, GDP fell 11.8% in the June quarter. In the UK, June quarter GDP came in at an astonishing -19.8%. A recovery in GDP in July was underpinned by the reopening of schools, pubs and hairdressers. Whilst car sales saw a noticeable improvement, lifting above pre-crisis levels. However, the UK has recently re-introduced some restrictions which will cause some concern.

China has largely contained the COVID-19 virus with just over 91,000 confirmed cases and an official death toll of 4,700 at the time of writing. China's recovery is well under way, although consumers remain cautious that there may still be potential for further outbreaks. The Australian government forecasts China's growth to be 1.75% in 2020 and to reach 8.0% in 2021. Chinese industrial production and infrastructure spending are supporting the recovery, along with liquidity measures funded by a record bond issuance. However, the scale and speed of infrastructure spending has not been on par with previous years as the authorities struggle to find projects with an adequate return.

The spending on infrastructure projects from China in conjunction with supply issues from Brazil has seen the price of iron ore increase 24.2% over the quarter to US$121.25*m/t.* The higher iron ore price has contributed to the Australian dollar (AUD/USD) reaching a two year high of $0.737 in early September. The AUD appreciated 3.7% during the quarter to close at $0.716.

Market volatility continued during the quarter with the ASX 300 Accumulation Index (the ASX300 represents the top 300 Australian companies) giving back the gains made in July and August to finish flat for the September quarter (-0.06%). The ASX300 fell 3.6% in the month of September followed global markets down.

The Energy sector declined the most (-10.7%). Oil markets were under pressure with the Brent crude spot price falling 10.9% to US$40.95 per barrel amid concerns about the outlook for fuel demand as Europe and the US contend with a surge in new COVID-19 cases.

In the US, the tech heavy Nasdaq index declined 5.2% in September but returned +11.0% for the quarter and +24.5% for the calendar year to date (CYTD), thanks to stocks such as Amazon, Apple, Microsoft, Alibaba and eBay. Chart 2 shows the performance of the ASX300 vs the Nasdaq for the CYTD.

The Nasdaq index reached a new record high during the quarter of over 12,000 points before falling 10% in just six days. However, as shown in Chart 2 the Nasdaq index has recovered strongly from the March low while the ASX300 is still negative for the CYTD. This is similar for other global returns with Euro Stoxx50 -14.7%, FTSE100 -22.2% and Dow Jones -2.7%. The US S&P 500 price index has returned +4.1% CYTD, given Information Technology is the largest sector in this index. Such relative performance confirms the strength of the US market, relative to others, and the importance of exposure to that market.

The current quarter will continue to be dominated by the US election issues, which will determine the future for government spending and geopolitical issues. Markets will also be impacted by COVID-19 developments of potential vaccines and the re-opening of major economies.

Chart 2: CYTD comparison – ASX300, Nasdaq and S&P 500 Index