**Markets Summary – March 2019**

*Taken from the CBA Global Markets Research report, 'March Month in Review'; first published on 1 April 2019*

**Highlights in March**

- Bonds yields fell globally.
- The ASX 200 rose 9.5% (the strongest gain in 9½ years) in March quarter after falling 9.0 % in the Dec quarter.
- The Australian Dollar weakened a little losing 0.56% against the US Dollar.
- The CoreLogic data showed that dwelling prices continued to fall in March, but the pace of falls moderated and spread beyond Sydney, Melbourne and Perth.

**Cash**

Australian short term money market rates moved to price an imminent Reserve Bank of Australia (RBA) easing cycle. Just prior to the labour force data, the market has a one-in-three chance of a rate cut by May. The stronger labour data saw the markets retreat a little from this view, but at month end the market was still pricing around two rate cuts from the RBA.

**Australian and Global Fixed Interest**

There was a fairly major fall in bond yields in March. The US 10 year yield dropped 27 basis points (bp) to 2.39%. The move was inspired by a market that is now fearing a full US economic slowdown. There were also concerns when the yields on a 3 month US Treasury Bill was higher than a 10 year US Treasury yield. In the past this has been foreshadowed by a recession and is referred to as a 'negative yield curve, or 'inversion'. As a result, the US 2 year bond yields fell 23.5bp to 2.48%.

The move lower in yields was concentrated in the second half of the month and set new year lows for 10 year yields on an almost daily basis. There was no clear economic driver for this and the US economic data remains quite reasonable. For example, US GDP was recorded at 2.6% on 1 March (though had been revised to 2.2% by the final reading) and a measure of inflation, the core Personal Consumption Expenditure deflator was 1.9% on 2 March. The employment report which was impacted by bad weather was recorded at just +20K, but the unemployment rate did drop to 3.8%. Average hourly earnings rose 0.4% in the month and 3.4% on the year.

In both Australia and New Zealand, the bond markets also moved lower. The Australian 3 year yield fell 25bp to 1.38% (well under the cash rate at 1.50%) while the 10 year fell 32.5bp to 2.10%.

In New Zealand, the change in the assessment from the Reserve Bank of New Zealand (RBNZ) to expect a lower cash rate triggered lower bond yields in both NZ and Australia. The RBNZ was concerned about global growth rates, specifically in Australia and China.

It seems remiss not to mention Brexit here – though the market impact is modest so far. Brexit remains the great unknown - with the potential for complete cancellation, a new referendum, a soft Brexit with close trade ties, or a hard Brexit as the new deadline of 12 April approaches. Markets seem unable to price the disparity of outcomes. The difference in the reaction to Brexit and the sharp movements of the US yields on the back of any hint of developments in the US/China trade discussions is sharp.

Chart 1 – Main Australian Bond Yields

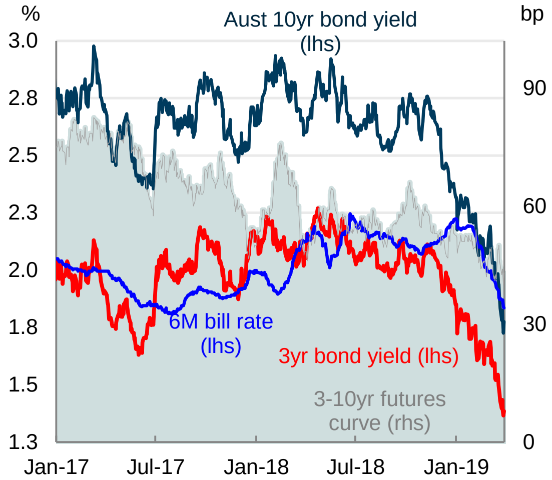
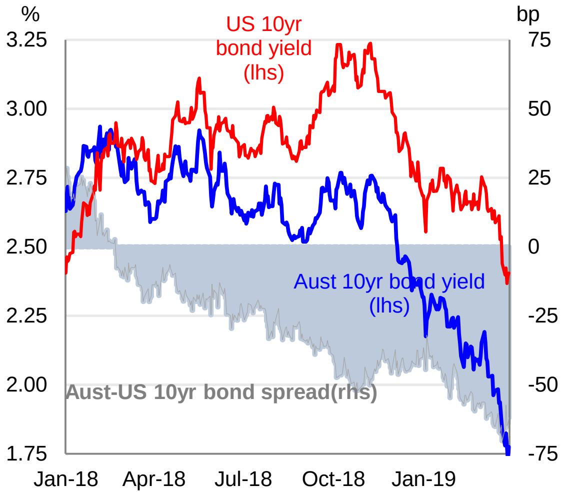



Chart 2 - Aus/US bond spread makes new lows



## Global Credit

March saw spreads (the difference between government bond yields and the yield on a corporate bond) in credit cash markets continue to tighten while spreads for synthetic credit securities moved wider driven by recession worries. Most of the volatility happened towards the end of the month after the Federal Reserve took a more patient stance and signalled that there would be no more rate hikes for the rest of the year. The Reserve Bank of New Zealand also surprised the market by saying that the next move is likely to be a cut. Talks of rate cuts by central banks triggered falls in government bond yields, with yield curves flattening, sometimes a precursor for slower economic growth and sometimes recessions.

## Global Equities

Global sharemarkets were focused on Brexit, US-China trade talks, the global economic slowdown and risks of a recession in March.

Sharemarkets commenced the month with a mixed start to trade. The US Dow Jones fell on five of the first six days of the month, losing 1.8 per cent. But the Australian ASX 200 actually rose in four of the six days, gaining 0.6 per cent. Weighing on US sharemarkets over March 5 and 6 were large declines in shares of General Electric (down 4.7 per cent and 7.6 per cent respectively) after warning about negative cash flow in its businesses. Negative reaction to the latest European Central Bank policy decision and weaker-than-expected US jobs data for February further weighed on global markets over March 7 and 8.

In the second week, the Dow Jones rose on four days, recouping 1.6 per cent of its early March losses. In contrast, the ASX 200 fell on four days, losing 0.5 per cent. Shares in Boeing lost over 11 per cent on March 11 and 12 after a raft of countries suspended operations of the plane maker's 727 Max-8 plane following a fatal crash in Ethiopia. Investors also monitored Brexit votes in the UK Parliament over March 12 and 13, but sharemarkets generally stayed in the black. Positive news on US-China trade talks drove global sharemarkets higher on March 15.

In the third week of March, global markets were generally firmer in the first four days before a sell-off of around 2 per cent on March 22. Brexit negotiations dominated over the week. On March 20 the US Federal Reserve left interest rates on hold and signalled that there would be no more rate hikes over 2019. And while President Trump noted progress on trade talks with China, he indicated that tariffs could be left on China for a lengthy period. The US Dow Jones fell 142 points on March 20 before rebounding 217 points the next day.

Global sharemarkets fell by 2 per cent on Friday March 22 on poor European economic news. The Australian sharemarket responded with a 1.1 per cent loss on March 25. An inverse yield curve in the US (3-month treasury bill yields above the yields for 10-year bonds) also sparked recession fears.

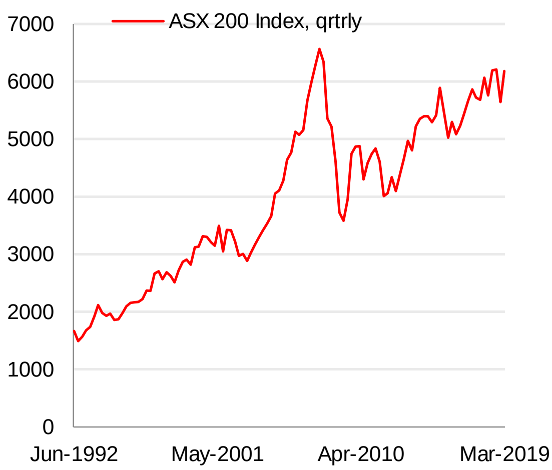
In the final week of March, uncertainty over Brexit was balanced against optimism on US-China trade talks. Fears of a recession continued to be debated. On March 28 US GDP growth for the December quarter was revised down from 2.6 per cent to 2.2 per cent. The Dow rose on four of five days, gaining 1.7 per cent.

Over March, major sharemarkets were generally higher. The US Dow Jones was flat with the S&P 500 up by 1.8 percent and Nasdaq up by 2.6 per cent. In Europe, the German Dax rose by 0.1 per cent and UK FTSE rose by 2.9 per cent. And in Asia, while Japan lost 0.8 per cent, the ASX 200 lifted by 0.2 per cent.

Over the March quarter, major sharemarkets rose between 6 per cent (Japan) and 16.5 per cent (Nasdaq). The ASX 200 rose 9.5 per cent (strongest gain in 9½ years) after falling 9.0 per cent in the December quarter.

In the March quarter, all but one of Australia's 22 industry sectors posted gains. Household & Personal Products lagged fell by 23.7 per cent. But Consumer Durables & Apparel rose 52.7 per cent with Software & Services up 20 per cent. Materials rose 15.7 per cent with Telecom up 15.6 per cent while Banks rose 2 per cent. The Small Ordinaries outperformed, up by 11.7 per cent, with big companies (ASX50) up by 9.4 per cent and mid-cap stocks up by 8.1 per cent.

Chart 3 - Australian Sharemarket – ASX 200




*Source: IRESS, CommSec*

**Australian Dollar**

The Australian trade weighted index eased by 0.3% in March.

AUD/USD slumped after Australian Quarter 4 (Q4) GDP growth was below expectations at just 0.2% (consensus: 0.3%/quarter). The growth weakness reflected softer household spending, the downturn in residential construction and the drought. Australian interest rate market pricing fell after the soft Q4 GDP result and 1 month futures contracts priced a RBA rate cut by November 2019. Australian 2 year government bond yields fell by nearly 6bp and the Australian US 2 year government bond spread moved towards the lower end of its 5 month trading range to 87bpts, further weighing on the AUD.

AUD/USD lifted late in March because of the US Federal Open Market Committee (FOMC) and Australian February labour market report. Australian employment growth missed expectations, rising by only 4,600 (15,000 expected), but the all-important unemployment rate dipped to 4.9% from 5.0%. This is the first time the unemployment rate has fallen below 5.0% since 2011. The unemployment rate was in focus more than usual in March. In a speech in late February, RBA Governor Lowe stated that "*if there were to be a sustained increase in the unemployment rate and a lack of further progress towards the inflation objective, lower interest rates might be appropriate at some point*".

**Table 1 – Australian dollar performance**

| | AUSTRALIAN DOLLAR | | |
|---|---|---|---|
| | **End Feb 28-Feb-19** | **End Mar 29-Mar-19** | **M/M % Change** |
| **AUD-USD** | 0.7094 | 0.7096 | 0.0 |
| **AUD-JPY** | 79.02 | 78.67 | -0.4 |
| **AUD-EUR** | 0.6239 | 0.6326 | 1.4 |
| **AUD-GBP** | 0.5349 | 0.5445 | 1.8 |
| **AUD-CHF** | 0.7081 | 0.7063 | -0.3 |
| **AUD-CAD** | 0.9343 | 0.9473 | 1.4 |
| **AUD-NZD** | 1.0422 | 1.0429 | 0.1 |
| **TWI** | 60.7 | 60.5 | -0.3 |
| **Month High** | | 0.7168 | 21-Mar-19 |
| **Month Low** | | 0.7003 | 8-Mar-19 |

*Source: Bloomberg, CBA*

## Commodities

Commodity prices finished mostly lower in March, led by thermal coal. Iron ore and oil bucked the trend, lifting slightly last month. Commodity specific supply factors were mostly at play. However, demand was broadly supportive of commodity prices. These demand factors were primarily US-China trade deal hopes and Chinese policy support. Chinese policymakers are looking at tax cuts and infrastructure projects to support economic growth in 2019.

Australian thermal coal prices fell notably in March, diverging from the slight increase in Chinese coal prices. There were fundamental factors that could have lowered coal prices, such as the restart of Chinese coal mines in the province of Shaanxi. But those factors don't explain the divergence in Australian and Chinese coal prices. We think China's coal policy, which has resulted in the increase in custom clearance times for Australian coal, better explains the price movements in coal markets. There were reports last month that Dalian customs had banned coal imports from Australia, but the claim has been officially denied. China's coal policy has at the very least left Chinese coal importers hesitant to learn from experience if there are increased restrictions on Australian coal.

Iron ore prices tracked mostly sideways in March, holding on to the gains following the Feijao dam disaster at the end of January. Vale, the large Brazilian iron ore miner has provided iron ore sales guidance of 307-322Mt in 2019, down from an earlier estimate of 382Mt. The new guidance implies output losses of 50-75Mt, equivalent to 3.1-4.7% of seaborne supply. Ultimately, markets may face a net disruption of 40-65Mt (2.5-4.1% of seaborne supply). Our estimate includes the latest impact of Tropical Cyclone Veronica on WA's iron ore production, as well as increasing Chinese supply and weaker demand by Chinese steel mills. We have accounted for Rio Tinto's latest report that the damage sustained at port facilities from Cyclone Veronica combined with a fire at Cape Lambert in January will result in iron ore production losses of ~14 Mt. We think prices are likely to rise above

US$90/t in the short term as physical markets are only now feeling the absence of Vale's iron ore exports.

Oil prices moved slightly higher last month, driven primarily by OPEC-led supply cuts, particularly from Saudi Arabia. The kingdom is cutting oil production more than it pledged under an OPEC-led supply deal in order to balance oil markets as quickly as possible. Russia is also moving closer to complying with its supply obligations under the same deal. At the end of March, Russia reduced supply by 153k barrels per day from October levels, still below the target of 228k barrels per day. Unplanned outages in Libya, Venezuela and Iran – countries exempt from the OPEC led supply accord – are also adding to the bullish sentiment in oil markets. Falling US oil rigs has also helped oil prices by raising doubts to the rapidly rising profile of US oil production.

Agriculture-commodity prices mostly gained during March. And several were by substantial amounts. Cattle prices jumped 14% because some major pastoral regions had received substantial rainfall by month-end. Pastoralists quickly went from being de-stockers to re-stockers as the rain accumulated. Dairy prices, in the form of Whole Milk Powder, gained 8% in March. The rise was in part a recovery from an extra-heavy seasonal peak in NZ production. Dry weather in Australia and NZ dairy regions added to the rise. Finally, Cotton prices also gained 8%. The prospect of China buying more cotton because of a US-China trade deal buoyed prices.

**Australian Residential Property Market**

The decline in national dwelling prices continues, with prices falling 0.7% in March. The falls have moderated but are spreading beyond Sydney, Melbourne and Perth. In March, six out of eight capital cities saw dwelling prices falls with Hobart and Canberra the exception.

In Sydney and Melbourne, the falls are still sizeable but are the smallest since October 2018, at 0.9% and 0.8% respectively. In Sydney auction clearance rates have been trending higher with the preliminary clearance rate over the weekend at over 60%. If this continues it could be a sign the worst falls are in the past. We would though have to see some stabilisation in the housing finance numbers to convince us of that. Numbers for February are due 9 April. In Sydney prices for units fell more than houses over March, which was a reversal of recent trends. Since the peak in July 2017 Sydney prices are now down 13.9%, with houses down 15.2% and units down 11%. The most expensive dwellings continue to lead the falls in both Sydney and Melbourne.

Perth prices are still falling as well but were the smallest since June 2018. In new developments, Brisbane prices were down 0.6% for March, the largest fall this cycle and were led by falls in both houses and apartments. Prices in Adelaide fell 0.2% in March, led by falls in house prices, apartment prices have remained resilient to date. In Melbourne prices were down 0.8% in March driven by houses while apartments were stable.

There remains a significant difference between the performances of dwellings by price quartile. The most expensive dwellings have experienced the largest price falls to date, driven by Sydney and Melbourne. Prices falls have been less severe at the lower end of values, particularly in Melbourne as more first home buyers are entering the market.

Further prices falls are expected. The amount of credit flowing to housing lending is still retreating at this stage. Sentiment is also negative as the last chart shows. While survey respondents believe it is a good time to buy a dwelling, they are unlikely to do so while expectations of dwelling prices are for further falls.

For the Australian economy overall the housing market is in sharp focus. Markets are pricing close to two cuts to the official cash rate by the RBA. However the RBA has also made it clear that the issues with the household sector and the tension between better labour market data and weaker GDP data is due to low income growth, particularly non-labour sources of income. Fiscal policy through tax cuts and cash handouts are announced in the Federal Budget should help and boost disposable income. While rate cuts could stabilise the housing market it is less clear that it would provide the solution to weak household income growth that is a broader issue for the economy.

**Chart 4 – Annual change in dwelling prices**

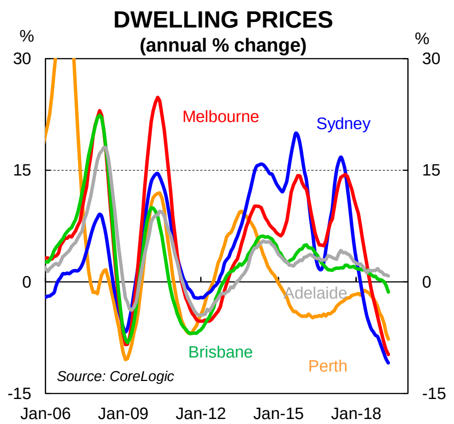



**Table 2: CoreLogic Median Dwelling (Houses and Apartments) Prices – March 2019**

| | Sydney | Melbourne | Brisbane | Adelaide | Perth | Hobart | Darwin | Canberra | Capital cities |
|---|---|---|---|---|---|---|---|---|---|
| **%chg mth** | -0.9 | -0.8 | -0.6 | -0.2 | -0.4 | 0.6 | -0.6 | 0.0 | -0.7 |
| **% ann chg** | -10.9 | -6.6 | -1.3 | 0.8 | -7.7 | 6.0 | -6.8 | 3.1 | -4.8 |
| **% chg from peak (peak)** | -13.9 (July 17) | -10.3 (Nov 17) | -1.6 (Apr 18) | -0.5 (Dec 18) | -18.1 (June 14) | na | -27.5 (May 14) | na | -9.3 (Sep 17) |

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