Markets Summary – April 2019

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

Highlights in April

- Australian shares rose for four straight weeks in April – the longest winning streak since May 2018. The Australian ASX200 index rose to the highest level since 2007.
- Australian interest rate markets experienced new record lows in yield in April, after the first quarter Consumer Price Index (CPI) showed no change for the quarter. The rate of annual inflation is now just 1.3%.
- The Australian dollar weakened a little once again over the month, with the lower than expected inflation reading driving the fall.
- Commodity prices such as iron ore, thermal coal and oil moved higher.
- The CoreLogic data showed that dwelling prices continued to fall in April, but the pace of the falls moderated again.

Cash

Australian interest rate markets reached new record lows in yield in April, after the Q1 Consumer Price Index (CPI) showed inflation was flat for the quarter and 1.3% for the year. The lower than expected inflation reading, which had been somewhat expected, came at the low end of forecasts and bolstered the case for a near term rate cut for the Reserve Bank of Australia (RBA). After a run of better- than-expected economic data, markets shifted pricing for the next move by the RBA to expect as much as a 65% chance of a cut at the May meeting, but fully priced for 25 basis points (bp) at August and a further 25bp for February 2020.

Australian and Global Fixed Interest

Given the moves in market pricing for the RBA, the bond market followed suit during April, with the highlights being new lows in yield and further difference in Australia/US bond spreads moving further into negative territory. The AUS/US 2 year spread traded to -102bp, its largest differential. That did little to undermine the AUD, with the currency sitting between a more negative interest rate differential and high commodity prices. The 10-year Australian government bond yield fell.

Chart 1 – Australia and US 10-year bond yields

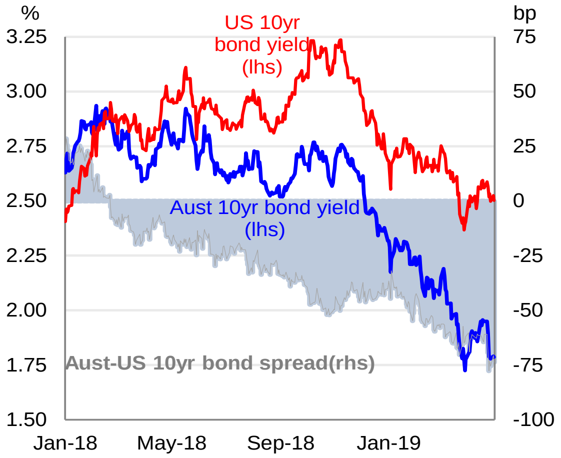
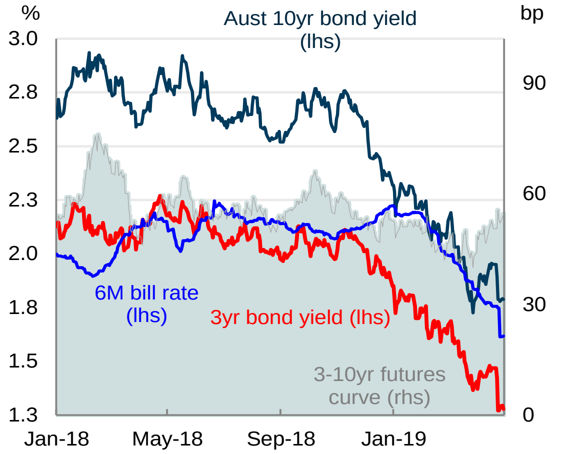


Chart 2 – Main Australian yields



Global Credit

April saw credit spreads (the difference between government bond yields and the yield on a corporate bond) continue to move lower as Australian government yields fell to record lows post weaker than expected Q1 CPI. Financial markets are no more than 50% priced in for a May cut, and fully priced for one cut in August and another one in Feb 2020.

The 2019/20 Federal Budget had little impact on credit spreads. The main focus of the budget was on consumer tax cuts. A few new infrastructure projects were added to the existing list, with the Government expected to invest AUD$100bn in transport over the next decade, however little was announced on energy policy, nor was there much on tax cuts for large corporates.

The US Q12019 reporting is 58% complete. Aggregate sales growth is running at +3.2% on the prior comparable period, while aggregate earnings is up +1.3%. Against market expectations, aggregate sales is at a modest miss compared to expectations of -0.03%, while aggregate earnings is a beat compared to expectations at +6.3%.

Global Equities

Global sharemarkets performed strongly in April. Improving economic data, US-China trade deal optimism, solid US earnings results and growing expectations for monetary and fiscal stimulus boosted investor sentiment. The US S&P500 and Nasdaq indexes hit fresh record highs and the Australian ASX200 index rose to the highest level since 2007.

US sharemarkets began April positively with the Dow Jones up 1.9 per cent in the first week with the S&P500 up 2.1 per cent and Nasdaq lifting 2.7 per cent. Shares of chemical company Dow rose by 10.9 per cent following its spinoff from DowDuPont. A stronger-than-expected March US jobs report, a rebound in China's manufacturing gauge, solid Eurozone retail spending data and renewed hopes for a US-China trade deal boosted sentiment. The German Dax led gains (up 4.2 per cent), followed by Japan's Nikkei (up 2.8 per cent) and the UK FTSE (up 2.3 per cent). But the 2019/20 Australian Federal Budget and better retail spending and building approvals data failed to lift the ASX 200 (flat).

Global sharemarkets were little changed in the second week of April. The International Monetary Fund (IMF) downgraded its global growth forecast for 2019 by 0.2 percentage points to a decade-low annual growth rate of 3.3 per cent, rattling investors. And a threat by US President Trump to levy tariffs on EU imports in retaliation for Airbus subsidies reignited concerns about trade wars. But commentary from central banks remained 'dovish', supporting risk sentiment. The Dow Jones ended the week flat as gains by Walt Disney (up 13.1 per cent) were largely offset by falls from UnitedHealth (down 10.3 per cent). In the UK, the 'Brexit' deadline was extended by six months, but the FTSE fell by just 0.1 per cent. Aussie shares played 'catch up' with the ASX200 leading gains, up 1.2 per cent.

Moving into the third week, investor attention turned to the commencement of the US corporate reporting season and a sharemarket debut for virtual pinboard company, Pinterest. Bank earnings results were mixed, but JPMorgan Chase (up 2 per cent) was amongst the strongest performers on the Dow Jones (up 0.6 per cent) over the week. But shares of health care and drug makers, such as Merck (down 7.9 per cent), Pfizer (down 5.6 per cent) and UnitedHealth (down 0.7 per cent), lagged on regulatory and policy concerns. Elsewhere, Chinese economic growth and March activity data beat market expectations, encouraging investors. Germany's export-orientated Dax index outperformed, up by 1.9 per cent, ahead of Japan's Nikkei (up by 1.5 per cent). Australia's ASX200 index was up by just 0.1 per cent, despite a solid March jobs report, due to election uncertainty.

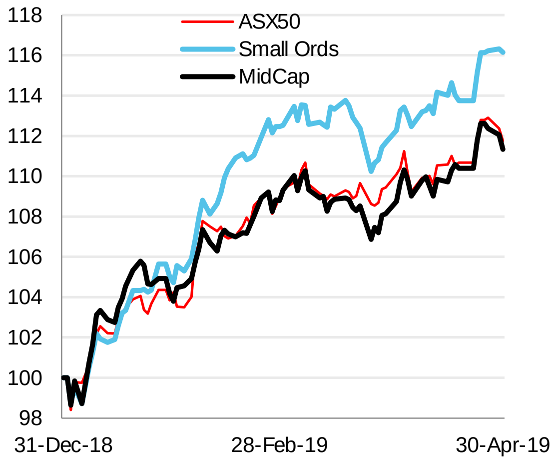
Shares were mixed in the final week of April. A better-than-expected March quarter US economic growth (GDP) report propelled the S&P500 (up 1.2 per cent) and Nasdaq (up 1.9 per cent) indexes to fresh record highs. But the Dow Jones fell by 0.1 per cent after shares in 3M fell by 12.4 per cent, after it cut its earnings outlook for 2019. Amazon (up 4.8 per cent) however, reported record earnings for the fourth consecutive quarter. To-date, over 50 per cent of S&P500 companies have reported results for the March quarter with 77 per cent of companies reporting actual Earnings Per Share (EPS) growth above analyst expectations.

Elsewhere, Japan's Nikkei rose 0.3 per cent over the week, the German Dax was up 0.8 per cent, but the UK FTSE fell by 0.4 per cent, despite straddling six-month highs in the week. The Aussie ASX200 outperformed (up 2.0 per cent) on growing interest rate cut expectations following a weak March quarter inflation number. Aussie shares rose for four straight weeks – the longest winning streak since May 2018.

Over April, major sharemarkets were higher. The US Dow Jones was up by 2.6 per cent, the S&P 500 rose by 3.9 per cent and Nasdaq was up by 4.7 per cent. In Europe, the German Dax rose by 7.1 per cent and UK FTSE rose by 1.9 per cent. And in Asia, Japan's Nikkei was up by 5.0 per cent, the ASX 200 lifted by 2.3 per cent.

In April, 18 of Australia's 22 sub-industry sectors posted gains. Consumer Durables & Apparel rose by 18.2 per cent, followed by Food, Beverage and Tobacco (up by 11 per cent). But Materials fell by 2.1 per cent. The Small Ordinaries outperformed, up by 4 per cent, with big companies (ASX50) up by 2.1 per cent and mid-cap stocks up by 3 per cent.

Chart 3 - Small caps outperform (Index January 1 2019=100



Source: IRESS, CommSec

Australian Dollar

The Australian trade weighted index was unchanged in April.

AUD/USD started April on the defensive. AUD/USD traded in a 0.5 cent range after the release of the RBA's policy statement. The volatility in AUD may reflect market participants' positioning for a dovish (less optimistic) statement that was not delivered. The RBA did however make a very subtle change to the final paragraph of its statement that could be interpreted as a dovish tilt: *"The Board will continue to monitor developments and set monetary policy to support sustainable growth in the economy"*.

AUD/USD moved higher by 1 US cent in the first half of April. AUD/USD was supported by stronger than expected Australian February retail sales, a record monthly Australian February trade surplus and a 19% surge in building approvals.

But AUD/USD fell in the lead-up to and particularly following the release of the Australian Q1. Headline CPI was flat while underlying CPI increased by only 0.2%/qtr (1.4%/yr), much weaker than expected. Pricing for a RBA rate cut for May surged from 10% before the CPI to 57% after the CPI. In the following days, AUD/USD finally, but only briefly, broke below its 0.7000-0.7200 range in late April.

Table 1 – Australian dollar April performance

	AUSTRALIAN DOLLAR		
	End Mar 29-Mar-19	End Apr 30-Apr-19	M/M % Change
AUD-USD	0.7096	0.7048	-0.7
AUD-JPY	78.67	78.55	-0.1
AUD-EUR	0.6326	0.6286	-0.6
AUD-GBP	0.5445	0.5409	-0.7
AUD-CHF	0.7063	0.7186	1.7
AUD-CAD	0.9473	0.9436	-0.4
AUD-NZD	1.0429	1.0560	1.3
TWI	60.5	60.5	0.0
Month High		0.7206	17-Apr-19
Month Low		0.6988	25-Apr-19

Source: Bloomberg, CBA

Commodities

Commodity prices were mostly lower in April, but there were some key exceptions. Iron ore, oil and thermal coal gained last month on mostly commodity specific factors. A stronger US dollar weighed on commodities last month. IMF's downgrade to global economic growth also weighed on demand hopes. Though not all was negative on the demand front. A US-China trade deal is back on the cards. Chinese data has also appeared to turn a corner, suggesting that China's commodity demand may have bottomed. But risks to that view remain even with the allure of increased infrastructure spending and tax cuts.

Iron ore prices tracked higher through the first half of April, before retreating slightly in the second half. The initial increase in iron prices last month mostly reflected reported disruptions to Australia's iron ore exports following Tropical Cyclone Veronica. Rio Tinto, BHP and Fortescue all flagged lower iron ore export guidance, equivalent to ~1.5% of the seaborne market. Those disruptions added to shortage concerns already exacerbated by the fallout from the dam collapse at Brazilian iron or miner Vale's Feijao mine. Iron ore prices retreated just after mid-April following court approval for Vale to restart its Brucutu mine. The allowance meant that markets were now seeing ~1.5% of iron ore traded on the seaborne market return back online. Despite the decreased shortage risk, iron ore prices continued to trend higher in the second half of April as falling Chinese iron ore port stockpiles, rising steel mill margins and elevated steel mill operating rates kept iron ore prices well bid. It is worth noting that April marked the first substantial fall in China's iron ore port stockpiles since Vale's dam disaster in late January.

Australian thermal coal prices recovered in April as oversupply concerns eased following the rapid fall in prices in March. Prices still remain lower than the beginning of the year as markets remain bearish on thermal coal. That view primarily reflects China's coal policy, which continues to restrict Australian coal exports. Domestic Chinese coal supply is also anticipated to rise this year, but safety and environmental checks could blunt the impact of increasing Chinese production. Rising seaborne supply (particularly from Australia) and weakening demand in the northern hemisphere as winter demand subsides are also keeping a lid on prices.

Oil prices rose sharply in late April after the US announced that it would not renew waivers for countries importing oil from Iran. With Iran exporting ~1.2million barrels per day of oil in the March quarter, ~1.2% of global supply is at risk of being wiped out as a result of the US sanctions. The reality though is likely less severe. China will likely continue to import some oil from Iran, limiting the impact on global supply to under ~1% of global production. The unexpected announcement signalled further shortage risks to a market that is already grappling with a zealous OPEC-policy to curtail production. While Saudi Arabia has flagged they are willing to lift oil production as Iran's oil exports decline, OPEC and allied producers are also looking to extend their deal to sideline ~1.2% of global supply. The deal currently expires in June, but the group are looking to extend it to the end of 2019. There are also increasing risks to US oil production growth forecasts this year despite easing pipeline takeaway constraints. US oil rigs have now fallen to the lowest level since March 2018. It is worth noting that oil prices retreated shortly after the US announcement on waivers. The price decline was driven by US President Trump's tweet that he "Spoke to Saudi Arabia and others about increasing oil flow. All are in agreement."

Australian Residential Property Market

The decline in national dwelling prices continues. This is now the longest and largest fall in dwelling prices since 1980. The cumulative fall is 9.7% form the September 2017 peak. This fall followed a total gain of 47.9% between January 2012 and September 2017. Falls have now put the net gain at 33.5%.

Prices fell by 0.5% in April in the eight capital cities. This is the smallest monthly fall since September 2018, continuing the recent trend of smaller declines. It suggests that the worst of the falls are behind us. Nevertheless, seven out of eight capital cities saw dwelling prices fall in the month. Canberra was the exception. It was the first month that prices fell in Hobart (down 0.9%), led by falls in house prices. Hobart had been the strongest capital city market boosted by favourable affordability and net interstate migration. Prices are also now moving lower in Brisbane and Adelaide, with falls larger for apartments than houses. Falls continue in Perth.

Sydney prices fell by 0.7% in April, led by falls in houses (-0.8%) compared to apartments (-0.5%). Falls in more expensive dwellings in Sydney continue to outpace cheaper properties. Melbourne prices fell by 0.6%.

The RBA flagged in the April *Financial Stability Review* for the Sydney apartment market that there is a "near term risk that delivery of a large volume of apartments into a weak market could amplify price declines". This outcome would exacerbate already rising rental vacancies and falling rents. To date we haven't seen an acceleration in price falls for apartments. The RBA is also concerned that lower valuations could lift the chance of settlement risk and cause issues for developer financing.

More immediately though there have been some signs of improvement in the Sydney market. Auction clearance rates have risen. We did see a bounce in housing finance numbers in February for lending to owner-occupiers and investors in NSW. Changes in lending tend to lead dwelling prices around six months out. Rental yields are also rising, increasing the attractiveness of real estate for investors.

Especially when compared to the level of alternative investments such as term deposits and government bonds.

There has also been a further lift in the time to buy a dwelling index. Overall though there is still the expectation in the survey of further falls in dwelling prices. Price falls should continue for a little while longer given the weakness in these survey readings and as the supply and demand of credit remains subdued.

Chart 4 –Dwelling price moves

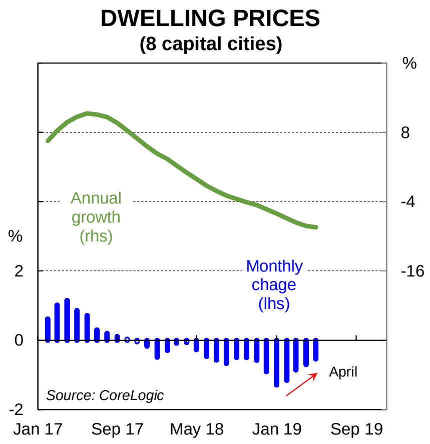


Chart 5 – Dwelling price annual moves by capital city

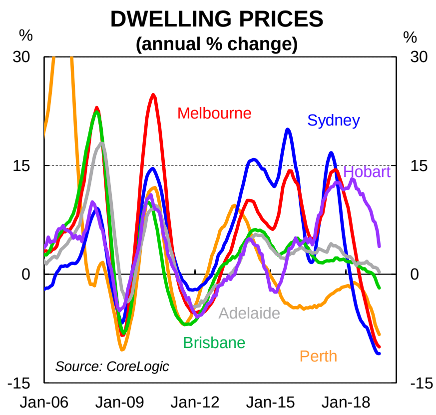


Table 2: CoreLogic Median Dwelling (Houses and Apartments) Prices – April 2019

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	Capital cities
%chg mth	-0.7	-0.6	-0.4	-0.1	-0.4	-0.9	-1.2	0.4	-0.5
% ann chg	-10.9	-10.0	-1.9	0.3	-8.3	3.8	-7.1	2.5	-8.4
% chg from peak (peak)	-14.5 (July 17)	-10.9 (Nov 17)	-1.9 (Apr 18)	-0.5 (Feb 19)	-18.4 (June 14)	-0.9 (Mar 19)	-27.5 (May 14)	na	-9.3 (Sept 17)