Markets Summary – June 2019

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

**Highlights in June**

- The Reserve Bank of Australia (RBA) delivered its first rate cut since August 2016.
- The final month of the financial year saw the drop in government bond yields continue with speed, as once again new lows were reached
- The Australian ASX 200 lifted by 3.5 per cent.
- Commodity prices finished mostly higher last month. Coal bucked the trend.
- The CoreLogic data showed that dwelling prices continued to fall in June, but the pace of falls moderated again. Sydney and Melbourne recorded a lift in prices for the month.

**Cash**

On 4 June, the RBA cut the cash rate by 25 basis points (bps) to 1.25%. Governor Lowe also hinted he would contemplate further easing to below 1.0%, although he doesn't expect to cut the cash rate to the very low rate levels seen offshore, i.e. 0.25% - 0.50. The (RBA) also reduced its estimate of the non-accelerating inflation rate of unemployment (NAIRU) by 0.5% to 4.5%, which in turn puts downward pressure on the RBA's real neutral cash rate.

The delivery of a 25bp rate cut by the RBA confirmed the recent move lower in short term money market rates and embedded the view of the market that further interest rate cuts by the RBA would be forthcoming. Market pricing suggests a total of three rate cuts this cycle. This pricing is in line with the global shift in rates pricing, including that of New Zealand, Europe and the US.

**Australian and Global Fixed Interest**

The financial year finished on a positive note as China and the US reached a temporary trade truce at the G20 meeting in Osaka. US President Donald Trump announced he would hold off on tariffs planned on US$300bn of Chinese goods for the time being, and ease restrictions on US businesses supplying parts to Huawei. In return, China pledged to purchase an unknown large amount of US agricultural products.

Earlier in the month, the US also suspended tariffs on Mexico. US President Donald Trump tweeted that Mexico will soon make "large" agricultural purchases from the U.S. although Mexican Foreign Minister Marcelo Ebrard denied any agricultural side agreement being reached.

Dovish comments from the US Federal Reserve (Fed) and the European Central Bank (ECB) have kept hopes alive that central banks will act pre-emptively to keep interest rates low and monetary conditions accommodative. At the June 20 US Fed meeting, the Fed lowered their long-run median

Fed funds projection by 25bps to 2.375% while the FOMC chair Jerome Powell signalled he is open to cut the Fed Funds rate if necessary.

The rate cut and global move lower in bond yields took much of the short end of the Australian government bond curve below 1% for the first time. Government bonds with less than 1 year maturities remain under this mark. Government bonds with a longer maturity,the 30 year bond broke through 2% as well.

**Chart 1 – Aus/US spread makes new lows**

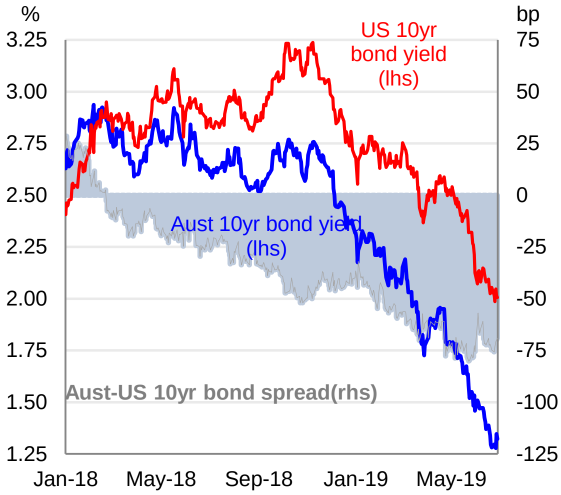
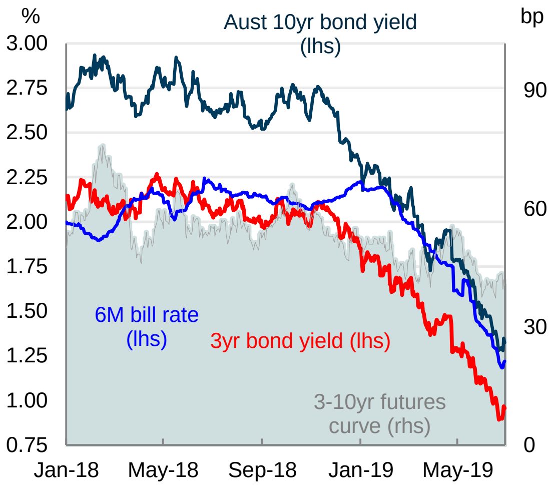



**Chart 2 – Main Australian Yields**



**Global Credit**

Australian dollar (A$) credit spreads were marginally wider on the month, but remain generally well supported despite global headwinds. June was a heavy issuance month for A$ financials but large volumes were well absorbed by the market with most deals printing tighter than initial guidance.

**Global Equities**

Global sharemarkets posted strong gains in June, with a number of indexes breaking records on growing expectations for coordinated interest rate cuts by global central banks. In the US, the Dow Jones recorded its biggest gain in June since 1938. And the broader S&P500 index posted its best June performance since 1955 and the strongest first half-year return (up 17.4 per cent) since 1997. Meanwhile, the Aussie ASX200 index lifted by the most since February, posting a strong 7.1 per cent quarterly gain.

US sharemarkets lifted over the first week of June. Investor expectations for a more supportive US central bank increased after the release of a disappointing May jobs report. US Federal Reserve Chair, Jerome Powell, said that policymakers will "act as appropriate to sustain the expansion", signalling an openness to cut US interest rates. The Dow Jones rose by 4.7 per cent on the back of gains from Dow Chemical (+9.7 per cent), Apple (+8.6 per cent) and Nike (+8.1 per cent).

The RBA cut its official cash rate on 4 June by 25 basis points to a record low 1.25 per cent in an attempt to reduce unemployment and ignite inflation. The first rate cut since August 2016 kicked-off a four day rally on the ASX200 index totalling 114.5 points with the index up 0.7 per cent over the week. But energy (-1.1 per cent) and materials (-0.4 per cent) shares lagged.

In the second week of June, the ASX200 index rose by 1.7 per cent, hitting 11-year highs. The materials sector rose by 5.2 per cent. The iron ore price lifted by 11.2 per cent to near 5-year highs, boosting shares of Fortescue Metals (+12.1 per cent). Global sentiment was also boosted by trade optimism after Mexican tariffs were avoided following an immigration deal with the US. But rising tensions in the Middle East and Hong Kong, and underwhelming Chinese economic data capped gains. US sharemarkets rose by 0.4-0.7 per cent, behind Japan’s Nikkei index (+1.1 per cent).

US sharemarkets pushed higher during the third week of June as investors were encouraged by more ‘dovish’ commentary from both the Fed and ECB. The ECB President Draghi noted that ”in the absence of improvement….additional stimulus will be required”. And US Federal Reserve Chair Jerome Powell said “The case for somewhat more accommodative policy has strengthened.” Both central banks could potentially cut interest rates as soon as July due to low inflation. The Nasdaq rose by 3 per cent and the German Dax rose by 2 per cent.

Over the final week of June, US shares fell around 0.3 per cent and the ASX200 was down 0.5 per cent. Investors were cautious ahead of the crucial Xi-Trump trade meeting at the G20 Summit in Osaka, Japan at the end of the month.

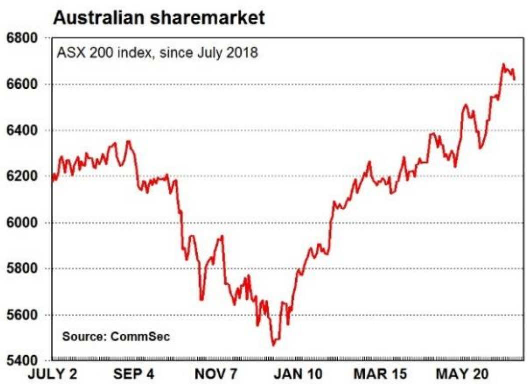
Over the June quarter, major sharemarkets performed strongly with the ASX200 up by 7.1 per cent. The German Dax was another outperformer, lifting by 7.6 per cent on hopes for ECB policy easing. But

Japan's Nikkei rose by just 0.3 per cent and the UK FTSE increased 2 per cent, despite Brexit turmoil. US sharemarkets rose by up to 3.8 per cent, but the Dow lagged, up by 2.6 per cent.

Over the financial year, the ASX200 index rose by 6.8 per cent and All Ordinaries index lifted by 6.5 per cent (total returns up 11 per cent). US sharemarkets outperformed with the Dow Jones up 9.6 per cent, the S&P500 rose by 8.2 per cent and the Nasdaq was up 6.6 per cent. Elsewhere, the Nikkei lagged (down 4.6 per cent), together with UK FTSE (down 2.8 per cent) and German Dax (up 0.8 per cent).

14 of Australia's 22 sub-industry sectors posted gains over the financial year. Leading the gains was Telecom (up 42.6 per cent) from Consumer durables & apparel (up by 40.8 per cent) But Household & personal products fell by 36.9 per cent, followed by Autos & components (down 24.2 per cent). Of the size categories, the ASX50 has outperformed (up 9 per cent) from the ASX100 (up 7.7 per cent). The MidCap50 was flat and the Small Ordinaries fell by 0.9 per cent).

**Chart 3 – ASX 200 index**




**Australian Dollar**

AUD/USD lifted modestly in early June. AUD/USD briefly spiked to 0.6993 after the RBA cut the cash rate by 25bp to 1.25% and delivered a neutral statement.

However, AUD/USD decreased by almost 2 US cents by the middle of June. Assistant Governor Luci Ellis indicated the RBA's estimate of the non-accelerating inflation rate of unemployment (NAIRU) had been revised lower to 4.50% from 5.25%. The RBA indicated that it wants the unemployment rate lower and is using the cash rate to help make that happen. The lift in Australia's unemployment rate in May to 5.2% (versus 5.1% expected) increased expectations of a follow-up rate cut in July and weighed on AUD/USD.

AUD/USD then recovered in the second half of June. Governor Lowe muddied the waters on rate cuts by suggesting it is "legitimate to ask how effective more [monetary policy] easing would be". Governor Lowe also reiterated the government could also support the economy by "use low rates to finance infrastructure". A weak USD contributed to a higher AUD/USD, particularly after the FOMC's June meeting.

**Table 1 – Australian dollar April performance**

| | AUSTRALIAN DOLLAR | | |
|---|---|---|---|
| | **End May** | **End June** | **M/M %** |
| | **31-May-19** | **28-Jun-19** | **Change** |
| **AUD-USD** | 0.6938 | 0.7020 | 1.2 |
| **AUD-JPY** | 75.12 | 75.71 | 0.8 |
| **AUD-EUR** | 0.6211 | 0.6172 | -0.6 |
| **AUD-GBP** | 0.5493 | 0.5530 | 0.7 |
| **AUD-CHF** | 0.6942 | 0.6854 | -1.3 |
| **AUD-CAD** | 0.9377 | 0.9195 | -1.9 |
| **AUD-NZD** | 1.0625 | 1.0450 | -1.6 |
| **TWI** | 60.0 | 60.1 | 0.2 |
| **Month High** | | 0.7023 | 10-Jun-19 |
| **Month Low** | | 0.6832 | 18-Jun-19 |

*Source: Bloomberg, CBA*

## Commodities

Commodity prices were mostly higher in June, led by iron ore and gold. Thermal coal and coking coal were the notable exceptions. The main positive driver across the commodity space was the prospect of interest rate cuts in the US and a weaker US dollar.

Iron ore prices tracked higher through most of June mostly due to supply concerns. China's iron ore port stockpiles fell sharply last month, continuing a trend that began in early April. Port stockpiles in China currently sit at 115Mt. Broadly speaking, ~120Mt is considered a "safe" level for port stockpiles, while ~100Mt (spell out) is considered a level that would lead to significant price volatility. The decline in China's iron ore port stockpiles primarily reflects the supply disruptions that have roiled iron ore markets this year. Headlining those disruptions was the fatal dam disaster at Vale's Feijao mine in Brazil in late January.

Two major events took place on the supply side last month. The first was the restart of Vale's Brucutu iron ore mine in late June following court approval. The other major supply event was Rio Tinto's downgrade to its 2019 iron ore shipments. While both events opposed each other, the net result was an increase in seaborne iron ore prices.

Gold futures rose in June on the prospect of US interest rate cuts following comments from the Federal Open Market Committee (FOMC). US 10 year real yields have fallen notably since the FOMC meeting and are encroaching negative territory. We have long held the view that the most important driver of gold prices over the long term is the outlook of US 10 year real yields. Lower real yields increase the appeal of gold relative to US interest bearing securities.

But that's not been the only support for gold prices. While the relationship between the USD and gold has weakened in the last few months, a softer USD is broadly positive for gold prices. And the decline in the USD following the FOMC announcement in June has provided support for gold. Safe haven demand also helped gold prices higher. Tensions have escalated between the US and Iran after Iran shot down a US military drone.

High energy (6000kcal/kg) Australian thermal coal fell in June. Weak coal demand in the European Basin appears the most likely driver, which has weighed heavily on Atlantic coal prices. Weak demand in China is particularly worth noting as coal stockpiles held by utilities remain elevated. China is predominantly a buyer of low energy (5500kcal/kg) coal, but Chinese buyers influence the marginal price for high energy seaborne thermal coal.

Agri-commodity prices had a mixed June. Prices for Australia's major exports were half up and half down among. Wool stood out with a significant 9% fall. Buyers have become more wary at what are still high price levels for wool. Dairy prices also fell. The 5% was though mostly a realignment to evolving seasonality. Wheat recorded the biggest gain (+4%). Weather issues, including here in Australia, have diminished the prospective supply of all grains.

**Australian Residential Property Market**

The fall in national dwelling prices continued in June. But the makeup of price movements has shifted. Prices were down a further 0.1% in the eight capital cities, taking the annual fall to 8.0% and the peak-to-trough fall to 10.2%. The June fall of 0.1% was the smallest decline since March 2018.

<u>Sydney and Melbourne both posted a rise in prices in June</u>. Sydney prices rose 0.1%, the first monthly gain since July 2017. The gains were driven by units, which were up 0.3% in the month. Houses recorded a flat outcome. Looking at the breakdown by value quartile, prices rose in both the upper quartile (0.2%) and the middle quartiles (0.1%). The upper quartile had been leading the falls so it is not surprising this quartile was the first to moderate. The total peak to trough fall in Sydney was 14.9%, right in line with our forecast of 15%.

Melbourne prices rose 0.2%, the first monthly gain since November 2017. There were gains in both apartments (0.5%) and houses (0.2%). Prices rose in the upper quartile of properties, were flat in the middle quartiles but also rose in the lower quartile. The Melbourne property market has been supported by very strong population growth. The total peak to trough fall is 10.9%, just under our forecast of a 13% fall.

Falls outside Sydney and Melbourne are continuing, particularly Brisbane and Adelaide. Prices were down 0.6% and 0.5% respectively. It could take a little while longer for prices to stabilise in these cities. Dwelling prices continue to fall in Perth and are now down 20% peak-to-trough. Falls continue despite very little increase in supply, falling vacancy rates and an improved outlook for the mining sector including a pickup in investment intentions and employment.

With the federal election now over, one of the potential negative headwinds for housing has been removed. We have also seen the RBA cut the cash rate in June and we expect further cuts in July and November. Changes by APRA to serviceability assessment metrics will increase the amount that people can borrow and provide some support at the margin to the housing market. Auction clearance rates have lifted in Sydney and Melbourne and other sentiment indicators have also improved. The key stabilisation indicator will be a pick-up in demand for credit. There are some signs home loan applications are rising.

Turnover though is still weak. This is one reason why consumer spending has been soft as lower housing turnover impacts demand for household goods and furnishings. Lower interest rates and tax cuts should help household spending but a lift in turnover in the housing market will also help.

**Chart 4 –Dwelling price moves**

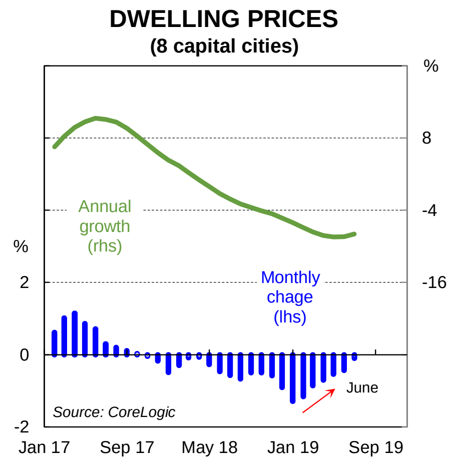



**Chart 5 – Dwelling price - the cycle**

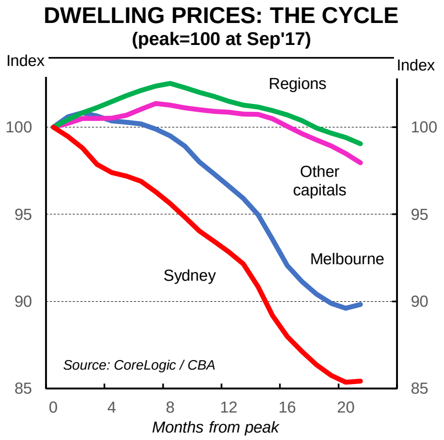



**Table 2: CoreLogic Median Dwelling (Houses and Apartments) Prices – June 2019**

| | Sydney | Melbourne | Brisbane | Adelaide | Perth | Hobart | Darwin | Canberra | Capital cities |
|---|---|---|---|---|---|---|---|---|---|
| **%chg mth** | 0.1 | 0.2 | -0.6 | -0.5 | -0.7 | 0.2 | -0.9 | -0.2 | -0.1 |
| **% ann chg** | -9.9 | -9.2 | -2.6 | 0.6 | -9.1 | 2.9 | -9.3 | 1.4 | -8.0 |
| **% chg from peak (peak)** | -14.9 (July 17) | -11.1 (Nov 17) | -2.9 (Apr 18) | -1.0 (Feb 19) | -19.8 (June 14) | -1.3 (Mar 19) | -30.1 (May 14) | na | -10.2 (Sept 17) |