Markets Summary – July 2019

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

Highlights in July

- The Reserve Bank of Australia delivered a back-to-back rate cut in July, following on from June's move.
- Financial markets are still pricing further rate cuts by the RBA.
- There was a sharp drop in bond yields in July, both locally and globally.
- The ASX 200 lifted by 2.9% hitting record highs during the month.
- The CoreLogic data showed that dwelling prices stopped falling in July. This was the first lift in prices since the downturn commenced in September 2017.

Cash

After the rate cut in June, the Reserve Bank of Australia (RBA) doubled up with its second 25bp cut at the July meeting, reducing the cash rate from 1.25% to 1%. This took yields across most maturities to new record lows. Market pricing eased back slightly after the second cut, but in the last few days of the month, terminal pricing came close to a further 50bp of rate cuts priced in for mid-2020. Central banks globally remained reasonably dovish, with expectations of policy easing led by the Federal Open Market Committee (FOMC) which was delivered in early August.

Australian economic data did not offer a particularly strong signal, with the RBA possibly suggesting a pause by adding that cuts could come 'if needed'.

Australian and Global Fixed Interest

Central banks took the centre stage in July. The month started with the RBA cutting the cash rate by another 25bps to 1.00%. The month ended with the US Federal Reserve delivering a 25bps cut to the Fed Funds target rate to 2.00% - 2.25%, its first rate cut in more than a decade. In addition, the FOMC also decided to stop shrinking the Fed's balance sheet as at 1 August at US$3.65trn.

Elsewhere, Bank of Korea also cut interest rate by 25bps to 1.75%, the first cut in three years. Bank of Japan trimmed its 2019 Japan Gross Domestic Profit (GDP) and inflation projections and is ready to take additional easing measures if inflation pressure don't pick up. The European Central Bank (ECB) also shifted to an explicit easing bias and is expected to cut the deposit facility interest rate in September.

The likelihood of a disorderly Brexit has increased following the election of Boris Johnson as the United Kingdom. prime minister. UK TLAC bonds struggled, widening more than 15bps in three days towards the end of the month in fear of a hard Brexit.

The US/China two-day meeting in Shanghai resulted in no breakthrough in key trade issues such as intellectual property rights and forced technology transfer. Instead, the two sides have agreed to meet again in Washington in early September.

The Australia bond market had a small sell-off (yields rose) in the first couple of weeks of July, but rallied back strong (yields fell) in the second half. The Australian government 10-year bond yield fell from 1.32% at end of June to 1.18% at end of July.

Chart 1 Aus/US spread makes new lows

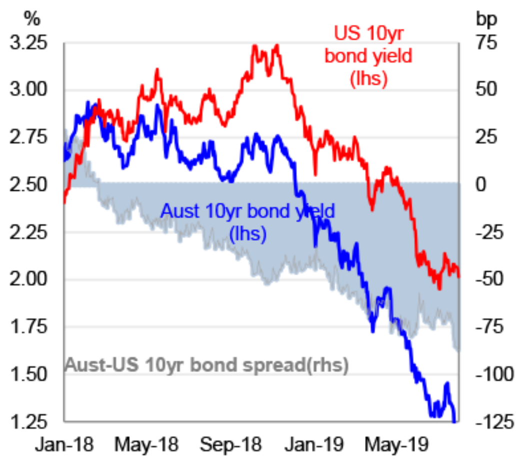
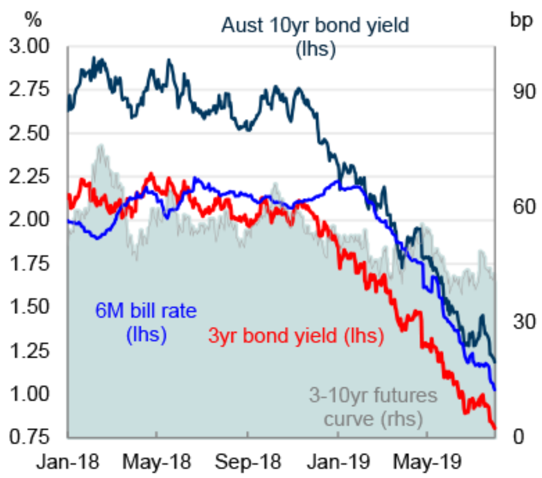


Chart 2 – Main Australian Yields



Global Credit

Australian dollar (AUD) credit spreads were marginally tighter on the month, and remain generally well supported despite global headwinds. July was a heavy issuance month for AUD financials after new funding requirements were finalised by the Australian Prudential Regulation Authority. There was strong demand for the bank bonds issued.

Global Equities

Global sharemarkets rose again over July. The potential for a US rate cut, encouraging US earnings data and continued hopes of a US-China trade deal all supported sentiment over the month.

In July, the US Dow Jones was up by 1.0%, the S&P 500 increased by 1.3% and the Nasdaq finished up by 2.1%. In Europe, the German Dax fell by 1.7%, but the UK FTSE rose by 2.2%. And in Asia, Japan's Nikkei rose by 1.2% and the ASX 200 lifted by 2.9%.

Over July, 19 of Australia's 22 sub-industry sectors posted gains. Leading the gains was Consumer durables & apparel (up by 17.5%) followed by Food, beverages & tobacco (up by 14.8%). But Capital goods fell by 2.3%, followed by Automobiles & components (down 0.9%). Of the size categories, the ASX mid-cap 50 outperformed (up 4.8%) from the Small Ordinaries (up 4.5%). The ASX 100 index rose by 2.8% and the ASX 50 index rose by 2.5%. And the ASX 200 lifted by 2.9% hitting record highs during the month.

Chart 3 – ASX 200 index

Australian Dollar

The AUD trade weighted index fell by 1.0% in July, with AUD/USD down 2.5% in the month.

The AUD started the month on the back foot ahead of the widely expected RBA cash rate cut on 2 July. However, a record high Australian June monthly trade surplus saw the AUD rally in the days following the RBA's rate cut. The rally was short-lived after stronger than expected US non-farm payrolls. AUD continued to drift lower until US Fed chair Powell's testimony to Congress. Powell strongly signalled that the FOMC was poised to cut interest rates in July. On 19 July markets were pricing a 64% chance of a 50bp cut following comments by NY Fed President Williams. This saw AUD/USD hit its highest level for the month at 0.7082.

However, the NY Fed quickly clarified Fed that Williams had not been hinting at a 50bp cut. As a result, market pricing for a 50bp cut unwound over the rest of the month, taking AUD/USD lower with it. AUD did pare losses on 31 July after Australian Q2 CPI beat expectations and reduced market expectations for a RBA rate cut in August. However, the firmer USD after Powell's comments following the FOMC meeting saw AUD/USD fall to close on its lows for the month, and to more than a three and a half year low (excluding levels traded in the 3 January flash crash).

Table 1 – Australian dollar July performance

	AUSTRALIAN DOLLAR		
	End June 28-Jun-19	**End July 31-Jul-19**	**M/M % Change**
AUD-USD	0.7020	0.6845	-2.5
AUD-JPY	75.71	74.45	-1.7
AUD-EUR	0.6172	0.6180	0.1
AUD-GBP	0.5530	0.5628	1.8
AUD-CHF	0.6854	0.6804	-0.7
AUD-CAD	0.9195	0.9028	-1.8
AUD-NZD	1.0450	1.0435	-0.1
TWI	60.1	59.5	-1.0
Month High		0.7082	19-Jul-19
Month Low		0.6832	31-Jul-19

Source: Bloomberg, CBA

Commodities

Commodity prices were mostly lower in July, led by coking coal. Nickel and to a lesser extent, gold, were the exceptions. The main negative drivers across the commodity space were growing demand fears and a stronger USD.

Nickel prices surged last month on the back of falling LME stockpiles. LME nickel stockpiles have been falling for some time and a ~20% increase in nickel prices can't fully be explained. Other factors likely helped nickel prices higher too. Nickel ore supply from Indonesia was impacted by heavy rains last month. The expected surge in electric vehicles has boosted the demand outlook for battery metals including nickel.

Iron ore prices remained steady in July, despite an improving supply outlook. Iron ore port stockpiles in China, which have been in freefall since early April finally ticked higher last month. Vale also maintained its 2019 iron ore sales guidance Gold futures rose in July on the prospect of US interest rate cuts.

Premium coking coal spot prices declined notably in July. Demand concerns appear to be the main driver, particularly with the weakness in China's manufacturing activity. Other developments are also adding downside pressure to seaborne coking coal prices. Customs officials at Jingtang and Caofeidian coal ports in Chinese province of Hebei said they would halt customs declaration services from July 16 until further notice.

Australian Residential Property Market

The fall in national dwelling prices came to an end in July. Prices lifted 0.1%, the first monthly gain since the downturn commenced in September 2017. The total peak to trough fall was 10.2%. This was slightly less than our expectation of a 12% total peak to trough fall.

The gains were led by dwelling price rises in Sydney, Melbourne and Brisbane. Prices all lifted by 0.2% over July. Five of the eight capital cities saw prices rise, while three fell: Adelaide (-0.3%), Perth (-0.5%) and Canberra (-0.3%).

In Sydney prices rose for apartments (0.3%) and houses (0.2%). Despite concerns over the supply of apartments, prices are still rising. Housing affordability reasons could be at play here. Prices are also rising at all value points with upper quartile value properties rising 0.2%, the medium quartile up 0.3% and the bottom quartile rising 0.2%.

The same thematic is occurring in Melbourne. Prices for units are lifting faster than houses despite the sheer volume of supply that has come onto the market. Dwelling prices for Brisbane rose for the first time since November 2017. Prices in Perth continue to fall despite falling rental vacancy rates.

Some stabilisation in dwelling prices could help the consumer over the second half of 2019, especially when combined with interest rate cuts and tax refunds. The RBA has stated they are looking at the data for signs of aggregate demand lifting. We still expect the RBA to cut rates a third time to support the economy and lower the unemployment rate. We expect the next rate cut in November.

Chart 4 –Dwelling price moves

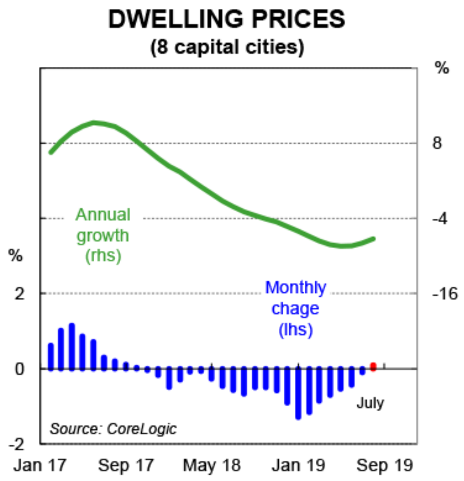


Chart 5 – Dwelling price

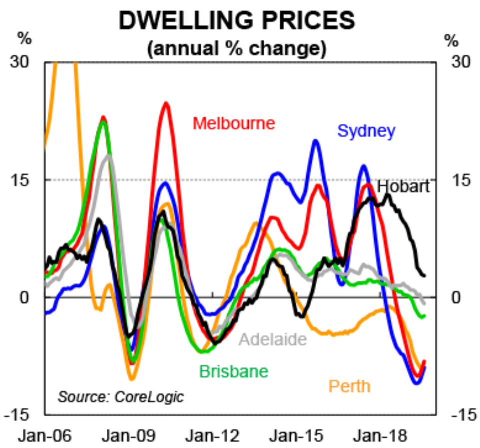


Table 2: CoreLogic Median Dwelling (Houses and Apartments) Prices – July 2019

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	Capital cities
%chg mth	0.2	0.2	-0.2	-0.3	-0.5	0.3	0.4	-0.3	0.1
% ann chg	-9.8	-8.2	-2.4	-0.8	-8.9	2.8	-8.7	1.1	-7.3
% chg from peak (peak)	-14.9 (July 17)	-11.1 (Nov 17)	-2.9 (Apr 18)	-1.3 (Feb 19)	-20.2 (June 14)	-1.3 (Mar 19)	-30.1 (May 14)	na	-10.2 (Sept 17)