Markets Summary – August 2019

Taken from the CBA Global Markets Research report, 'August Month in Review'; first published on 2 September 2019

Highlights in August

- The Reserve Bank of Australia (RBA) was on hold in August at 1.00% after back to back rate cuts.
- More than 20 developed markets saw a fall in their bond yields over the course of August.
- The Australian dollar (AUD) decreased against most currencies amidst slowing global growth and Reserve Bank of New Zealand (RBNZ) rate cut.
- AUD credit spreads widened in August with cash underperforming synthetics.
- Aussie sharemarket breaks its longest monthly winning streak since September 2009.
- The iron ore price fell in August.
- Dwelling prices rose by 1.0% across the eight capital cities in August.

Cash

The RBA took a break from cutting rates in August, having delivered two successive cuts for the first time in over six years. The RBA tweaked its rhetoric to adding further cuts 'if needed', a view the markets continue to believe will be warranted over time. Domestic data started to show some tentative signs of life, with house prices in Sydney and Melbourne turning up. Nonetheless, the financial markets are pricing for the RBA to cut the cash rate to below 0.50%.

Australian and Global Fixed Interest

Markets went on a wild ride in August as the US and China scaled up the tit-for-tat war on tariffs. It all started with the US putting an additional tariff of 10% on the remaining US$300bn of goods from China starting from 1 Sept 1 (in addition to the US$250bn already tariffed at 25%). In retaliation, China announced that they had ceased buying agriculture products from the US. Rising geo-political risks in Argentina, Italy and Hong Kong also impacted both the bond and stock market

Markets sold off in panic but consolidated after the US announced it would delay tariffs on around US$150bn of Chinese goods to mid-December to minimise impact on Christmas sales.

However the trade war saga went to another level later in the month, as the US announced plans for an additional 5% tariff on US$550bn of Chinese imports after China said it would impose an additional 5% duty on US$75bn of US goods from 1 September 1. With the new increases, what used to look like a tariff ceiling – 25% tariffs on everything from China – now looks more like a floor.

The fear and loathing in markets continued in August, with bond yields across the globe being crushed by both softer data and the escalation in rhetoric. The latter was not just a result of the trade wars, but also due to strong calls from President Trump for the Federal Reserve Open Markets Committee (FOMC) to cut rates by as much as 100bp.

The Australian bond market followed the world lower in August in yet another significant move. Having seen 10 years break decisively through 1%, the 30 year bond yield fell below 2% and then below 1.5% in August. The 10 year Australian government bond yield ended August at 0.88%.

Chart 1 Aus/US spread makes new lows

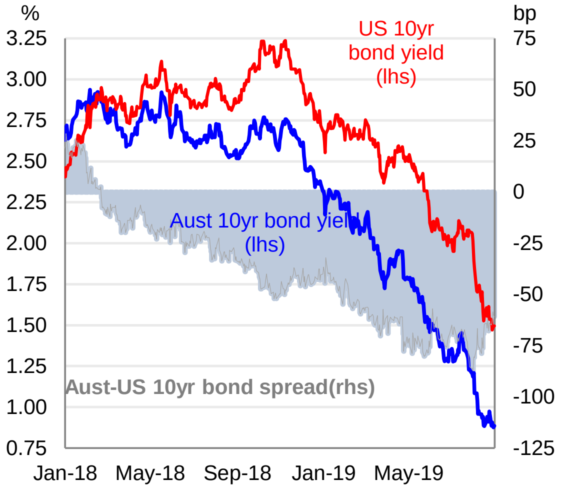
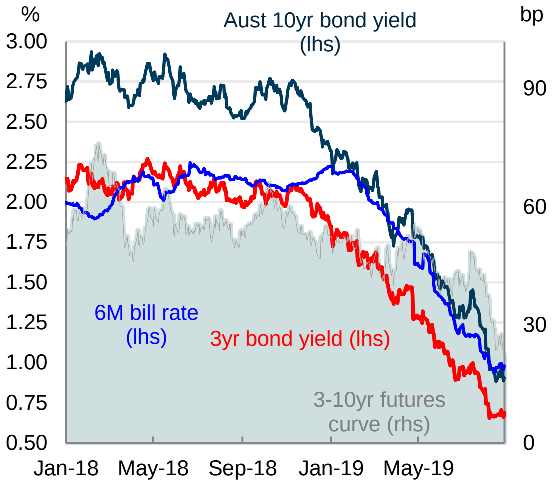


Chart 2 – Main Australian Yields



Global Credit

The Australian reporting season has largely come to an end. Overall, spreads were little impacted as balance sheets generally remained in good shape. However, in slow economic growth environment, growth capex will remain subdued, if not negative, and a few corporates could start to face financial constraints in the next 12 to 18 months if growth continues to deteriorate and asset recycling becomes increasingly difficult.

A$ credit spreads widened in August as trade-war concerns continued to weigh on investor sentiments. The reporting season was more of a sideshow and had little impact on spreads. However, stock selection remains relevant in a low growth environment as corporate balance sheets could deteriorate quickly as asset recycling becomes increasingly difficult.

Global Equities

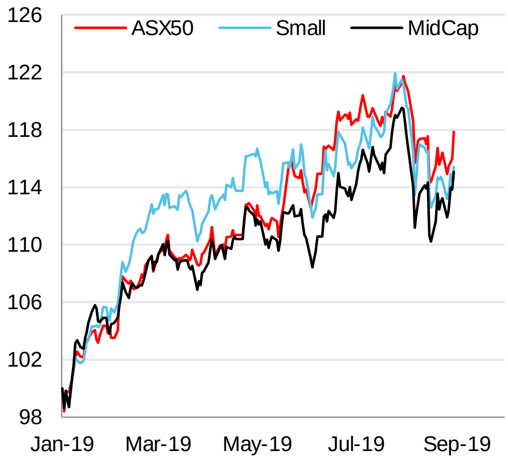
Global sharemarkets were volatile in August. US-China trade hostilities, rising geo-political tensions and concerns about a potential global recession weighed on risk sentiment. US shares posted their biggest monthly decline since May. And Australia's S&P/ASX 200 index broke its longest monthly winning streak since September 2009, as shares retreated by the most since November 2018.

The Australian corporate reporting season continued to produce mixed results. Retailer JB-HiFi and materials company James Hardie, both surprised on the upside, but packager Orora and Blackmores disappointed.

In August, the US Dow Jones fell by 1.7%, the S&P 500 declined by 1.8% and the Nasdaq fell 2.6%. In Europe, the German Dax fell by 2.0%and the UK FTSE declined by 5.0%. In Asia, Japan's Nikkei fell by 3.8% and the ASX 200 was down 3.1%.

Over August, 16 of Australia's 22 sub-industry sectors posted losses. Household and personal products (down by 19.6%) fell by the most, followed by Consumer durable and apparel (down by 15.4 %) and Materials (down by 7.9%) as the iron ore price fell sharply. Pharmaceutical & Biotech shares lifted by the most, up by 4.5 per cent. Of the size categories, Small Ordinaries led declines, down by 4.2%, below the ASX mid-cap 50 index (down 2.9%), large cap ASX50 and ASX100 indexes (both down 2.8%).

Chart 3 – Big caps outperforming



Australian Dollar

The AUD trade weighted index decreased by 1.0% in August.

AUD/USD traded in a narrow range of about two US cents in August. AUD/USD fell in the first week of August for two reasons. First, AUD/USD declined 0.9% to around 0.6835 following Fed Chair Jay Powell's confirmation that the cut to the Funds rate *"it's not the beginning of a long series of rate cuts"*. Second, AUD/USD decreased by almost one US cent following the RBNZ's surprise decision to cut its cash rate by 50 basis points (bp). A 25bp cut by the RBNZ was widely expected by market participants.

AUD struggled to regain its early August losses over the rest of the month. However, AUD was briefly supported by a surprise 41,000 increase in Australian employment in July (consensus: 14,000).

Table 1 – Australian dollar July performance

	AUSTRALIAN DOLLAR		
	End July 31-Jul-19	**End August 30-Aug-19**	**M/M % Change**
AUD-USD	0.6845	0.6733	-1.6
AUD-JPY	74.45	71.59	-3.8
AUD-EUR	0.6180	0.6132	-0.8
AUD-GBP	0.5628	0.5539	-1.6
AUD-CHF	0.6804	0.6667	-2.0
AUD-CAD	0.9028	0.8963	-0.7
AUD-NZD	1.0435	1.0646	2.0
TWI	59.5	58.9	-1.0
Month High		0.6868	1-Aug-19
Month Low		0.6677	7-Aug-19

Source: Bloomberg, CBA

Commodities

Commodity prices were mostly lower in August, led by iron ore. Nickel and to a lesser extent, gold, were the exceptions. The main negative drivers across the commodity space were growing demand fears, particularly as the US-China trade war escalated. Nickel prices surged in August on speculation, and later confirmation, that Indonesia would bring forward their ban on nickel ore exports.

Iron ore prices dropped sharply in August as an improving supply outlook met growing demand concerns. Demand worries were driven by the escalating US-China trade war last month. Iron ore was particularly sensitive to the yuan devaluation, which effectively made iron ore more expensive for Chinese buyers. That is important because China accounts for ~70% of the world's iron ore imports. Negative steel mill margins in China also weighed heavily on iron ore prices. While the supply outlook didn't change materially from July, markets remained hopeful that Vale will follow through on plans to add supply. Of the ~4% of global seaborne supply currently sidelined by Vale, the company expects to restore half of that by the end of this year. The remaining ~2% of seaborne supply currently sidelined by large Brazilian iron ore miner Vale, is expected to take two to three years to fully restore.

Gold futures rose in August as US 10 year real yields (bond yields less inflation) moved sharply lower to negative territory. US-China trade tensions, increasing global growth concerns and the prospect of US interest rate cuts were the main drivers of falling US real yields. Lower real yields increase the appeal of gold relative to US interest bearing securities. It is worth noting that the slight strengthening of the US dollar has had a muted impact on gold prices.

Premium coking coal spot prices continued to decline in August. Demand concerns appear to be the main driver, particularly with the weakness in China's manufacturing activity. Coal import restrictions in northern China has also negatively impacted seaborne coking coal prices.

Australian Residential Property Market

The property market is showing signs of more than just a stabilisation. In fact, just looking at the prices increases, it could be said that boom type conditions are returning.

Across the eight capital cities dwelling prices posted a strong 1.0% rise in August led by large rises in both Sydney (1.6%) and Melbourne (1.4%). Prices also rose in Canberra, Hobart and Brisbane but fell in Adelaide, Perth and Darwin (see table).

Nationally dwelling prices reached their trough in June. There are a number of factors behind the turnaround in housing. Looking at the daily data shows that prices began to lift in Sydney and Melbourne just after the Coalition was returned to government in late May. The Labor governments proposed taxation policies around housing had been weighing on the property market. Since then the RBA have cut the cash rate twice in June and July. The lower cash rate was largely passed through to mortgage interest rates by the major lenders. There have also been changes to serviceability metrics which means that many borrowers can borrow more than before.

In the three months since May, Sydney and Melbourne dwelling prices have lifted by 1.9% and 1.8% respectively. Other indicators of the housing market, such as auction clearance rates have turned higher.

CoreLogic have noted that monthly sales activity has begun to increase over recent months, although sales are still well below 'normal' levels. Total new inventory is 23% lower than a year ago in Sydney and 20% lower in Melbourne.

Lower housing turnover has been one factor behind the slowdown in consumer spending, with households spending less on furniture, furnishings and equipment. A lift in turnover should result in a lift in spending growth in these categories. But a lift in the supply of housing on the market could also take some of the heat out of recent price gains. This could be a test for the market coming into Spring.

Rising house prices may also provide a boost to household spending through the wealth channel. Falling dwelling prices over recent years saw a sharp slowing in spending growth in categories that are typically more sensitive to changes in household wealth.

Chart 4 –Dwelling price moves

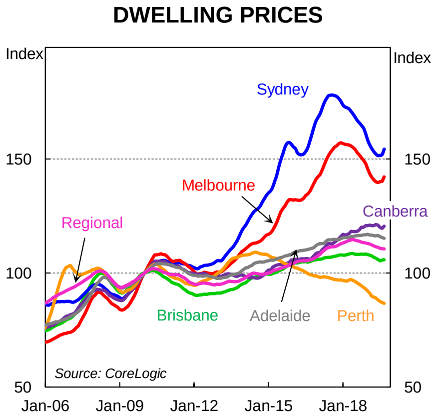


Chart 5 – Dwelling prices and auction clearance rates

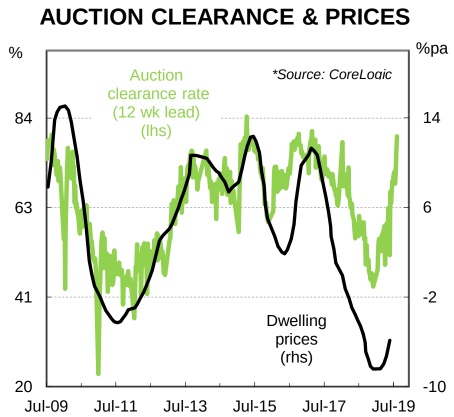


Table 2: CoreLogic Median Dwelling (Houses and Apartments) Prices – August 2019

	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)