Markets Summary – September 2019

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

Highlights in September

- The Reserve Bank of Australia (RBA) was on hold in September at 1.00% but cut the cash rate on 1 October 2019 by 25 basis points (bps) to 0.75%.
- September saw interest rate markets stage a solid sell-off, with higher yields and 10 year yields up by 30-50 bp.
- The Australian dollar (AUD) and the United States dollar (USD) briefly hit a 10-year low in early September.
- Dwelling prices rose by 1.1% across the eight capital cities in September.
- AUD credit delivered negative returns as yields rose.
- Equities markets were positive, although volatile.
- Agricultural commodities were generally stronger over the month as the drought continues.

Cash

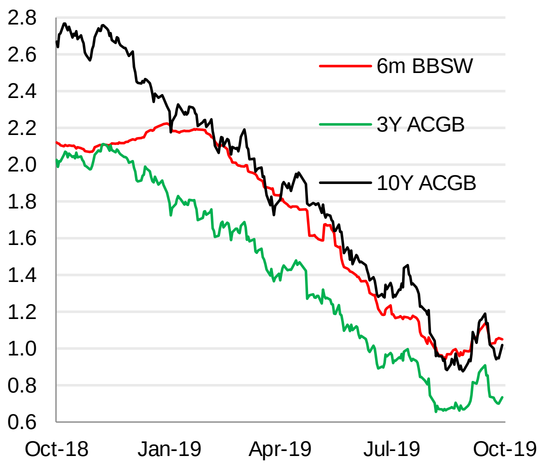
As expected, the US Federal Open Markets Committee (FOMC) cut the Fund target rate by 25 bps to 1.75% to 2.00% and the interest rate on excess reserves by 30 bps to 1.80%, in light of 'global developments' and 'muted inflation pressures.' The European Central Bank cut its policy rate by 10bps to -0.50% and confirmed it would be restarting bond purchases of 20bn euros a month from November. The People's Bank of China announced a broad-based 50bps cut to the Reserve Requirement Ratio (RRR) to help bank lending as the latest round of Chinese economic data disappointed across the board. Locally, the RBA also cut the cash rate on October 1 by another 25bps to 0.75% in response to the recent lift in the unemployment rate.

Australian and Global Fixed Interest

Interest rate markets showed a remarkably different month in September, from the scramble for yield in August (yields fell in August). 10 Year government bond yields rose by around 50bps for most major markets. The rise in yields (sell-off) was sparked by the largest fortnight of corporate issuance recorded in the US market. Over USD100bn was raised as yields touched new lows and spreads remained tight. While central banks remained more pessimistic on global risks, there was some pushback in the FOMC on the September rate cut.

Action in global fixed income markets during September was a good reminder of how low bond yields had fallen in previous months. For Australian government bond yields, having reached a low of 0.89% at the end of August and into early September, yields rose over the first few weeks of the month to 1.2%.

Chart 1 – Main Australian Yields



Source: Bloomberg, CBA

Global Credit

The market remains nervous as the geopolitical climate got more tumultuous in September. In the US, the Democrats stepped up efforts to impeach President Donald Trump with a formal impeachment enquiry being launched into the President's phone call with Ukraine. In the UK, Brexit remains a mess. UK Prime Minister Boris Johnson was ruled by the UK Supreme Court as 'unlawful' for suspending Parliament. The US-China trade dispute is unlikely to be resolved any time soon, and there's now fear the trade war could escalate into a capital war between the two countries after Bloomberg reported the White House has been considering measures to limit portfolio capital flows into China – later to be refuted. Oil suffered a supply shock earlier in the month after an attack on Saudi Arabia's oil production infrastructure, with 5% of global supply temporarily impacted.

Overall credit markets remained relatively calm as reactions to political headlines were confined to markets directly affected. Low government bond yields have led investors to search for higher yielding investments. This has been the main driver of credit spreads as more investors look at holding corporate bonds. Investors are being forced down the credit risk curve (taking on more credit through lower credit rated companies) as central banks continued to cut rates.

Credit delivered negative total returns in September mainly due to the increase in government bond yields. Looking at Australian corporate bonds and these remained range bound as geological risks were confined to markets that were directly affected. Lower rated companies outperformed as investors were forced down the credit risk curve as central banks continued to cut interest rates.

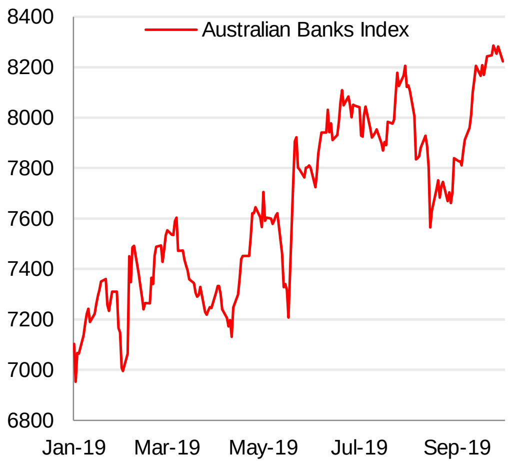
Global Equities

In September, key influences on sharemarkets included a drone strike on Saudi Arabian oil facilities; developments in the US-China trade war; Brexit; and central bank rate decisions.

Global sharemarkets rebounded after losses in August. The US Dow Jones rose by 1.9%, the S&P 500 lifted by 1.7%; and the Nasdaq rose by 0.5%. In Europe, the German Dax rose by 4.1% and the UK FTSE gained 2.8%. In Asia, Japan's Nikkei rose by 5.1% and the ASX 200 was up by 1.3%.

Over September, 13 of Australia's 22 sub-industry sectors posted gains. Household and personal products rose the most (up 18.8%), followed by Autos and components (up by 5.1%). Telecom fell the most, down by 4.3%. Banks rose 4.9% and Materials rose 1.6%. Of the size categories, Small Ordinaries led the gains, up by 2.0%, ahead of the large-cap ASX 50 index (up 1.4%), ASX 100 (up 1.3%) and ASX MidCap 50 (up 0.2%).

Chart 2 – Banks in favour



Source: iress, CommSec

Australian Dollar

The AUD trade-weighted index rose by 0.5% in September. AUD outperformed against all major currencies we monitor except GBP and CAD.

AUD traded in a relatively narrow 2 cent range in September. After reaching a fresh 10-year low of 0.6888 in early September because of a weaker than expected Australian July retail sales report and a firm USD, the RBA's decision to leave the cash rate unchanged at 1.00% proved the catalyst for a stronger AUD early in the month. Strong Australian trade balance data and a perceived easing in US-China trade tensions also supported the commodity currency over the first half of the month.

AUD pared gains over the final two weeks of September. The dovish RBA meeting minutes which suggested a near term rate cut (which was delivered on 1 October) contributed to the fall in AUD. The

RBA minutes highlighted that the RBA is becoming more concerned about the global backdrop. Rising US and UK political uncertainty late in the month also weighed on AUD.

Table 1 – Australian dollar September performance

AUSTRALIAN DOLLAR			
	End Aug 30-Aug-19	End Sep 30-Sep-19	M/M % Change
AUD-USD	0.6733	0.6750	0.3
AUD-JPY	71.59	72.95	1.9
AUD-EUR	0.6132	0.6193	1.0
AUD-GBP	0.5539	0.5492	-0.8
AUD-CHF	0.6667	0.6734	1.0
AUD-CAD	0.8963	0.8937	-0.3
AUD-NZD	1.0646	1.0777	1.2
TWI	58.9	59.2	0.5
Month High		0.6895	12-Sep-19
Month Low		0.6688	3-Sep-19

Source: Bloomberg, CBA

Commodities

Agri-commodity prices mostly rose during September. Cattle prices were the exception, falling by a modest 3% over the month. Pastoralists in drought regions continue to reduce their herds, weighing on prices. The rest of the agri-commodities made larger gains. Dairy, sugar and wheat fundamentals all evolved to somewhat tighter prospective supply.

Australian Residential Property Market

The Australian property market appears to be back on a two-speed track. Prices have risen sharply in Sydney and Melbourne over the past couple of months while price action in the other capital cities has been far more sedate.

The 1.1% lift in dwelling prices in the eight capital cities over September built on the 1.0% gain in August. Prices rose by 1.7% in Sydney over the month which means that prices have risen by 3.3% over the past two months. Price rises for houses have been a little stronger than for units. It's a similar story in Melbourne. Dwelling prices lifted by 1.7% in September taking the price gains to 3.2% over two months.

These type of rises would normally fall under the category of "house price boom". And that may well turn out to be the case. But context of course here is key. Prices fell by 15% in Sydney from their July 2017 peak to their May 2019 trough. And prices declined by 11% in Melbourne from their November 2017 peak to May trough. So there's still a long way to go if prices in Australia's two largest capital cities are to return to their peaks. That said, there is a lot of momentum in the market at the moment. All of the forward looking indicators are pointing to further price rises. More specifically, auction clearance rates are firm, house price expectations continue to lift.

Across the other capital cities there were mixed outcomes for dwelling prices in September. Prices were up in Canberra (+1.0%), inched higher in Brisbane (+0.1%), were flat in Adelaide (0.0%), but fell in Perth (-0.8%), Hobart (-0.4%) and Darwin (-0.2%). So at this stage the home buyer responses to rate cuts, the re-election of the Coalition Government and extra borrowing capacity from the APRA induced changes to loan serviceability assessment has not been uniform across the country.

Rising home prices at a national level will support household expenditure via the wealth effect. And in time rising dwelling prices should also boost residential construction (there is always a lag between rate cuts, rising dwelling prices, building approvals and then construction).

If dwelling prices and new lending lift too briskly financial stability concerns may come back into the fray. But at this stage the RBA does not appear too perturbed about recent developments. Last week RBA Governor Lowe was asked in a Q&A if it was a problem if house prices were rising too quickly, to which he responded, *"it's true that prices have risen for a few months in a row now. But we have got to remember that for 18 months prices fell in Sydney and Melbourne. And they came down 15% and have just come up a couple of % so I'm not particularly concerned about that"*. He further added, *"from a monetary policy perspective, it is not an issue at the moment"*. So it seems that current developments in the housing market are no impediment to further monetary policy easing.

Chart 3 – Dwelling price moves

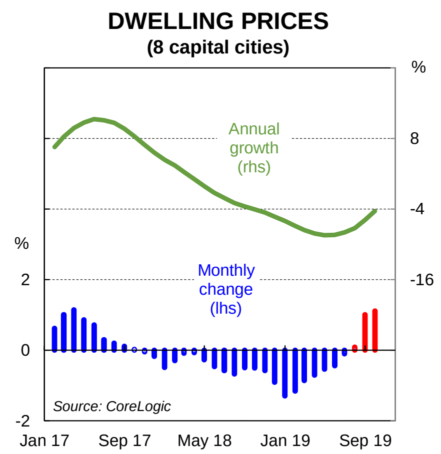


Chart 4 – Dwelling prices moves in 2019