Markets Summary – October 2019

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

Highlights in October

- The Reserve Bank of Australia (RBA) cut the cash rate on 1 October 2019 by 25 basis points (bps) to 0.75%.
- October saw a second successive rise in bond yields.
- Equity markets enjoyed strong gains over the month.
- The Australian dollar (AUD) and the United States dollar (USD) lifted to a three month high because of optimism on a US-China trade deal.
- Iron ore prices fell while most other commodity prices rose.
- Dwelling prices rose by 1.4% across the eight capital cities in October.

Cash

A stabilisation in the US-China trade war and Brexit news provided the economic backdrop for better performance in risk assets and led to rising yields in Government bond markets.

Despite this better economic news, cuts to official cash rates continued in several economies including Australia and the US, with both delivering 25bp cuts.

The RBA was widely expected to cut rates at their October meeting. The RBA's policy rate now sits at a new record low of 0.75%. The RBA reiterated global risks "are tilted to the downside". Domestic concerns also remain noting that the economy has reached "a gentle turning point". Governor Lowe noted in a recent speech that the economy has hit a "soft patch" and "we did not expect this slowdown, so it has come as a bit of a surprise". The risks still lie with further interest rate cuts.

Australian and Global Fixed Interest

Government bond yields climbed in October, the second successive month this has happened. In Australia the rise of around 30 basis points at its peak came after the third RBA rate cut this year. Markets and forecasters are growing more confident the bulk of cuts have been delivered and further moves could be some time away.

The Australian 10-year government bond yield started the month at just under 0.9%, moving to a high of 1.18%, but fell late in the month to finish at 1.09%.

As expected, the US Federal Open Markets Committee (FOMC) cut the Federal Funds rate by another 25bps to a range of 1.50-1.75%. There is growing debate about the timing and extent of further rate cuts for the rest of the year. Further rate rate cuts seems to be less certain and most likely to be dependent on the incoming economic data. US 10-year government bond yields started the month at 1.67% and finished the month at 1.69% with some volatility inbetween.

Global Credit

The economic backdrop provided a relatively benign environment for global credit markets. Brexit developments effectively ruled out a volatile exit of the UK from the European Union with a new general election to be held on 12 December 2019. There was some small progress on the US-China trade war and the US Federal Reserve cut the Federal Funds rate as expected.

As a result, Australian credit markets traded in a tight 5 basis point trading range in absence of major macroeconomic or geopolitical breakthrough. September and October tend to be heavy issuance months following the reporting season with many companies issuing new corporate bonds. This did occur with issuance in the non-financial company space. Overall Australian credit markets underperformed global credit markets in October.

Global Equities

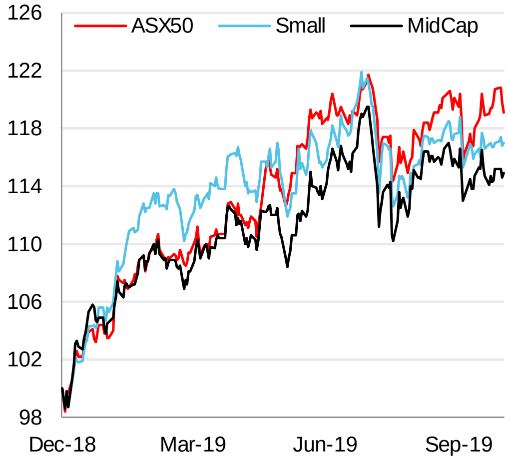
Global sharemarkets recorded mostly positive returns in October. US shares (S&P500 index) hit all-time record highs as investors became increasingly optimistic about the potential for a partial US-China trade deal and a resolution to the Brexit impasse. US President Trump announced a "phase one" trade agreement with China on 11 October, focusing on potential Chinese purchases of US agricultural products. Reports that China was prepared to buy at least US$20 billion of US agricultural products next year and the potential withdrawal of US tariffs on Chinese goods scheduled for December, boosted risk sentiment.

Encouraging US corporate earnings results and solid US jobs and economic growth (GDP) reports all boosted risk appetite. Global central banks continued to cut interest rates, but some signalled a potential pause in the rate cut cycle after delivering rate cuts over 2019.

US sharemarkets rose for a second consecutive month in October. To-date, of the S&P 500 companies that have reported, 75 per cent have posted better-than-expected earnings, according to FactSet data. The US Dow Jones rose by 0.5 per cent, the S&P 500 lifted by 2.0 per cent and the Nasdaq rose by 3.7 per cent. In Europe, the German DAX rose by 3.5 per cent, but the UK FTSE lost 2.2 per cent. Japan's Nikkei rose by 5.4 per cent and the ASX 200 was down by 0.4 per cent.

Over October, 11 of Australia's 22 sub-industry sectors posted gains. Pharmaceutical & Biotechnology products rose the most (up 9.6 per cent). Food, Beverage & Tobacco products fell the most, down by 5.0 per cent. Banks fell by 4.1 per cent and Materials were down 1.9 per cent. Of the size categories, Small Ordinaries led declines during the month, down by 0.7 per cent, followed by the large-cap ASX 50 and ASX 100 indexes (both down 0.4 per cent) and the ASX MidCap 50 (down 0.3 per cent).

Chart 1 – Big Caps outperform



Source: iress, CommSec

Australian Dollar

The AUD trade weighted index increased by 1.4% in October. The AUD was strongest against the USD and weakest against GBP.

AUD/USD trended higher in October, though there were periods of weakness. The RBA cut the cash rate to a record low of 0.75% on 1 October.

The weak USD supported AUD/USD throughout the month. In particular, the optimism of a US-China trade deal, as well as possible Brexit breakthrough weighed on the USD and lifted AUD. The Australian economic data supported AUD/USD too. AUD/USD jumped around 0.5% after the Australian unemployment rate declined to 5.2% in September from 5.3% in August.

Table 1 – Australian dollar October performance

AUSTRALIAN DOLLAR			
	End Sep 30-Sep-19	**End Oct 31-Oct-19**	**M/M % Change**
AUD-USD	0.6750	0.6894	2.1
AUD-JPY	72.95	74.48	2.1
AUD-EUR	0.6193	0.6182	-0.2
AUD-GBP	0.5492	0.5327	-3.0
AUD-CHF	0.6734	0.6800	1.0
AUD-CAD	0.8937	0.9075	1.5
AUD-NZD	1.0777	1.0749	-0.3
TWI	59.2	60.0	1.4
Month High		0.6930	31-Oct-19
Month Low		0.6671	2-Oct-19

Source: Bloomberg, CBA

Commodities

Commodity prices finished mostly higher in October, led by coking coal. Iron ore and to a lesser nickel, gold, were the exceptions. The main positive drivers across the commodity space were easing demand concerns, particularly with positive developments in the US-China trade war.

Iron ore prices dropped in October on mostly an improving supply outlook. Seaborne supply has improved from earlier this year as the disruptions that dogged the iron ore market have subsided. Vale, the large Brazilian iron ore miner, production appears to be recovering well. Weak demand conditions in China continue to weigh on iron ore prices too.

Nickel prices also fell in October as shortage concerns in nickel markets eased following Indonesia's announcement to ban nickel ore exports. A surge in China's nickel ore imports from Indonesia in September was key in quelling shortage concerns. But there was considerable uncertainty to that timing, with Indonesian policymakers announcing in late October that the ban would be effective immediately. Different policymakers later said the ban from 2020 was still in place. The latest announcements from policymakers suggest that the ban will take effect from 2020.

Australian Residential Property Market

Dwelling prices rose by a strong 1.4% across the eight capital cities in October. Prices rose in all capital cities with the exception of Perth (see table).

There were particularly large increases in Melbourne (2.3%) and Sydney (1.7%) dwelling prices in the month. This was the third consecutive strong monthly dwelling price increase in these capital cities. In Melbourne, dwelling prices are up 6.0% from their low in May, while in Sydney prices have risen 5.3%. Prices are rising the most for the most expensive properties. However these were the ones that experienced the largest declines during the downturn. Dwelling prices in Sydney and Melbourne are now back at late 2018 levels, but are still a fair way below the peaks of mid to late 2017.

A range of factors are contributing to prices increases, including lower mortgage interest rates and changes to serviceability metrics allowing people to borrow more money. Solid conditions in the labour market and Australia's strong rate of population growth are also supporting dwelling prices.

Building approvals data has shown approvals are now running at or below underlying demand. An undersupply of dwellings would also add to upward pressure on dwelling prices. Further rate cuts by the RBA could also push up prices. Sales volumes look to be stabilising in Sydney and Melbourne after several years of falls. Nonetheless turnover remains well below "normal" levels. Turnover also remains low in Brisbane and Perth. Lower housing turnover is a factor weighing on consumer spending growth. When turnover picks up, consumers tend to spend more on furniture, fittings and appliances.

Chart 2 – Dwelling price moves

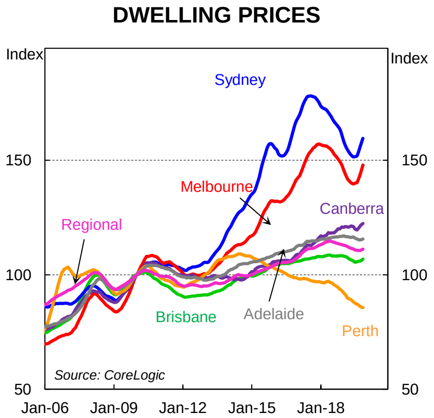


Table 2: CoreLogic Dwelling Prices

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	Capital cities
%chg mth	1.7	2.3	0.8	0.4	-0.4	0.9	0.3	0.6	1.4
% ann chg	-2.5	-1.0	-1.3	-0.9	-8.7	2.6	-9.2	2.0	-2.4
% chg from trough	5.3	6.0	0.8	NA	NA	NA	NA	NA	3.7
% chg peak to trough	-14.9 (July 17-May 19)	-11.1 (Nov 17-May 19)	-2.9 (Apr 18-June 19)	NA	-21.6 (June 14-)	NA	-30.7 (May 14-)	NA	-10.2 (Sept 17-June 19)