Markets Summary – January 2020

Taken from the CBA Global Markets Research report, 'January Month in Review', 'FX Month In Review' and 'CoreLogic Dwelling prices – January 2020), all first published on 3 February 2020.

Highlights in January

- Late in January concerns around the coronavirus negatively impacted bond yields, currencies, equity markets and credit markets.
- The year started with a sharp fall in yields, with the Australian 10-year government bond yield down almost 30 basis points (bps).
- Australian credit delivered strong returns.
- The Australian Dollar (AUD) and United States Dollar (USD) fell by 4.7% because of the perceived economic toll of the bushfires and coronavirus on global and domestic growth.
- Iron ore and oil prices fell, while there were gains in coking and thermal coal prices.
- Equity markets started the year strongly, before the negative impact of the coronavirus
- In Australia, dwelling prices rose by a strong 0.9% across the eight capital cities.

Cash

January is typically a quiet period for the cash market, with no Reserve Bank of Australia (RBA) speeches or meetings scheduled. This year, while better labour force and inflation data largely extinguished the case for a February rate cut, the financial markets continued to price in expectations of further interest rate cuts.

On the data front, the unemployment rate fell to 5.1%, continuing a decent run while the Consumer Price Index (CPI) was mixed. However fears of lower activity from bushfires and the coronavirus have kept the market in check. Ultimately, economists have concluded that a February rate cut is unlikely and forecasts have been taken to April/May.

Australian and Global Fixed Interest

During January, Australian government bond yields plunged as fears over bushfires and the coronavirus hit the market. The 10-year yield started the month around 1.25%, falling to 0.97%.

Shorter term government bond yields also fell with the 3 year yield moving 17bps, which was less than the move in the 10-year government bond yield.

Impacting financial markets early in the month were escalating tensions between the US and Iran. However, these tensions subsequently eased and the US and China signed Phase One of their trade agreement. This reduced global uncertainty somewhat before the coronavirus became a clear emerging risk. Chinese President Xi publicly acknowledged the seriousness of the virus on 20 January; this largely saw government bond yields fall, like in Australia. In the US, the 10-year government bond yield fell from 1.91% at the end of December to 1.51% at the end of January.

Global Credit

Australian credit markets got off to a strong start as government bond yields fell and credit spreads remained resilient to falls in offshore markets post the coronavirus outbreak. It feels like a distant memory, but risk assets did manage to rally to fresh new highs earlier in the month after the US and China agreed to sign the Phase One trade deal. US credit spreads suffered a painful blow towards the latter part of the month as the market panicked, fearing that the coronavirus outbreak could have a significant impact on global growth. In Australia credit spreads did tighten, helping a positive performance for Australian credit markets. In contrast we did see US credit spreads widen.

Global Equities

The Australian equity market performed strongly, up 4.98% and easily outperforming the US market at -0.04%.

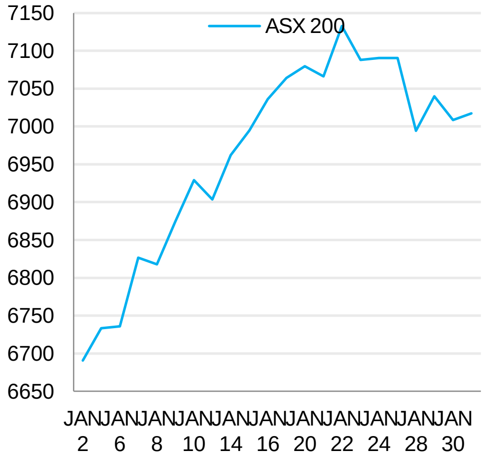
Global sharemarkets began the year and new decade in a positive fashion with hopes that a US-China Phase One trade deal could lead to stronger growth for major economies. But that optimism was dented from 20 January as investors monitored the spread of the coronavirus.

Overall in January, the US Dow Jones fell by 1.0% but the S&P 500 lost only 0.2% and the Nasdaq actually rose by 2.0%. In Europe, the German Dax index fell by 2.0%, and the UK FTSE lost 3.4%. In Asia, Japan's Nikkei lost 1.9%, but the ASX 200 out-performed, up by 5.0% in the month – the best January gain in eight years.

Twenty of Australia's 22 sub-industry sectors posted gains over the month, with the only declines coming from Food, beverages and tobacco (-3.3 per %) and Insurance (down 0.8%). The strongest gains were recorded by Food and staples retailing (up 14.2%); Pharmaceuticals and biotech (up 12.9%); and Software and services (up 11.1%)

Of the indices, the ASX50 index and ASX100 rose by the most (both up by 5.1%), followed by the ASX200 index (up by 5.0%); ASX MidCap50 index (up by 4.7%); and Small Ordinaries up by 3.4%.

Chart 1 – ASX 200 over January



Source: iress, CommSec

Australian Dollar

In January, financial markets used the AUD to express fears on China regarding the coronavirus.

AUD/USD depreciated, but most of the falls were concentrated at the start and end of the month. AUD/USD declined by over 2% in the first week of January because escalating tensions between the US and Iran supported USD. The Australian bushfires also weighed on the AUD at the start of January although some offsets included the easing of US-Iranian tensions and the signing of the US and China phase one trade agreement. Reduced global uncertainty saw AUD pare early losses around the middle of the month.

The downtrend in AUD/USD was quick to resume after news of the Wuhan coronavirus broke. The fast spread of the virus and the perceived negative economic implications of attempts to contain the virus pushed AUD to its January low of 0.6683 at the end of the month. Not even reduced expectations for a February RBA rate cut following the December labour market report could offset the dampening effect on AUD/USD of fears about the coronavirus.

Table 1 – Australian dollar January performance

AUSTRALIAN DOLLAR			
	End Dec 31-Dec-19	End Jan 31-Jan-20	M/M % Change
AUD-USD	0.7021	0.6692	-4.7
AUD-JPY	76.24	72.51	-4.9
AUD-EUR	0.6258	0.6030	-3.6
AUD-GBP	0.5292	0.5068	-4.2
AUD-CHF	0.6777	0.6447	-4.9
AUD-CAD	0.9115	0.8856	-2.8
AUD-NZD	1.0421	1.0348	-0.7
TWI	60.3	58.1	-3.6
Month High		0.7024	1-Jan-20
Month Low		0.6683	31-Jan-20

Source: Bloomberg, CBA

Commodities

Commodity prices finished mostly lower in January. Demand hopes arising from the signing of the US-China Phase One trade deal on 15 January, quickly gave way to global growth fears linked to the spread of the coronavirus. Thermal and coking coal were notable exceptions to the down-trend. As the virus spread, gold gained demand as a safe haven.

China's commitment to buy energy products from the US, as outlined in the PhaseOne trade deal, looks exceptionally challenging to meet.

Premium coking coal prices lifted in early January on restocking demand in China before the Lunar New Year holiday period. Restocking demand was strong due to expectations by Chinese buyers that coking coal prices would rise after the Lunar New Year holiday period.

Iron ore prices fell, alongside most other commodities, on demand fears linked to rapid spread of the coronavirus. A number of provinces in China have already announced that they have extended the Lunar New Year holiday period to 8 February or 9 February to contain the spread of the virus. Originally the holiday period was meant to end on 30 January, but was officially extended nationwide to 2 February as the virus initially spread. For markets like iron ore, which are driven by physical trade, the delay to industrial activity is keeping buyers away from the spot market and weighing on prices.

Liquefied Natural Gas (LNG) spot prices (as measured through swap futures) fell sharply in January. Prices have fallen through the northern winter months, which is unusual given the typical boost that spot LNG prices see during this peak demand period. Milder than usual weather in Asia helps explain the subdued demand from Japan, China and South Korea and the decline in LNG prices. However, more structural factors have been at play too. Global LNG trade is expected to surge 60-70% by 2030 from a level of ~320million tonnes in 2019. Just under half of those additional LNG exports are expected to come from the US.

Australian Property Prices

Dwelling prices rose by a strong 0.9% across the eight capital cities in January. This was the seventh consecutive month of positive price growth. The annual rate of growth now sits at 5.2%, up from 2.9% last month.

Dwelling prices rose the most in Sydney and Melbourne this month (see Table 2). Although prices were higher across all of the capital cities. Sydney and Melbourne prices are now both up 11.2% from their trough in May 2019.

In Melbourne, the recovery from the most recent downturn is almost complete with prices just 1% lower than the high reached in November 2017. Sydney has a little further to go with a 5% lift needed to bring prices back to their July 2017 levels.

Dwelling prices are now trending higher in all capital cities except for Perth and Darwin. Prices in Perth look to have stabilised and are broadly moving sideways. Dwelling prices in Darwin are still falling as the unemployment rate rises and the population falls post the construction of the LNG major projects.

Sales volumes have lifted in Sydney and Melbourne, although continue to remain below their long run averages. Nonetheless, the lift in sales volumes are a positive for consumer spending with people typically purchasing new furniture and other furnishings when they move into a new dwelling.

The leading indicators of the housing market remain strong. The home buying intentions component of CBA's household spending intentions survey is rising strongly and is close to record highs. New lending for housing has also picked up solidly. Residential building activity is declining at a time where supply is quite low and population growth remains solid. By mid-2020, there could be an undersupply of housing, which could add upward pressure on prices.

Table 2: CoreLogic Dwelling prices

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	Capital cities
%chg mth	1.1	1.2	0.5	0.2	0.1	0.9	0.1	0.3	0.9
% ann chg	7.9	8.2	1.1	0.4	-5.7	5.0	-8.1	3.1	5.2
% chg from trough	11.2	11.2	3.4	1.7	NA	4.9	NA	4.4	8.0
% 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)

Chart 2 – Dwelling prices