Markets Summary – February 2020

Taken from the CBA Global Markets Research report, 'February Month in Review', 'FX Month In Review' and 'CoreLogic Dwelling prices – February 2020), all first published on 2 March 2020.

Highlights in February

- COVID-19 (Coronavirus) fears dominated financial markets, moving beyond concerns about the pace of Chinese economic growth to broader impacts later in the month.
- Government bond yields once again made record lows as global economic conditions and sentiment worsen.
- Credit spreads moved 5 basis points (bps) wider in the last couple of days on fear that the coronavirus outbreak would worsen and have deeper impacts on global growth.
- The Australian trade-weighted index declined by 1.9%. The Australian Dollar (AUD) declined against all major currencies.
- Equity markets dropped sharply over the month.
- In Australia, 1.2% increase in dwelling prices across the eight capital cities.

Summary

The spread of COVID-19 and its consequences dominated financial markets over February. This was particularly evident in falls in higher risk assets in the last week of the month.

While interest rate markets had already started to price in the risk of interest rate cuts, credit markets and equities were ambivalent until the final week of the month, when sharp falls were seen. For the AUD/United States Dollar (USD) and other currencies, multi-year lows were seen.

The Australian equity market performed poorly, losing 7.69% on an accumulation basis. The falls were widespread.

The AUD lost 2.64% against the USD and 1.9% on a trade-weighted basis. US equities lost 8.23%.

Cash

Australian short term cash markets started to price in the chance of the Reserve Bank of Australia (RBA) cutting the official cash rate. While much of the move was driven by the coronavirus and the impact on the global economy, the rise in the unemployment rate (to 5.3%) also reignited the idea of rate cuts. Early data, including CBA's own readings of household spending intentions, suggested that the sectors of the economy related to trade, tourism and education would be softer in the first quarter of 2020. The strength in the housing market did nothing to offset this view. The RBA did deliver a rate cut at its March meeting to help mitigate the impact of COVID-19 on the Australian economy.

Australian and Global Fixed Interest

In Australia, three year government bond yields were lower over the month, drifting towards 0.5% as the month finished, from above 0.6% at the start of the month. The 10 year government bond yield was also lower, falling from 0.95% to 0.82% over February.

On the data front, unemployment rose to 5.3%, adding to market expectations that the RBA was not at the end of its easing run. .

Global Credit

Credit spreads traded solidly for most of the month, but everything changed on 24 February when liquidity suddenly dropped as investors feared that the coronavirus could start to spread quickly outside of China and impact on global growth. US and European investment grade credit spreads widened 15-25bps in the last five trading days of February.

Australian credit spreads were negatively impacted three days later. The impact was greater in synthetic credit markets, the Aussie iTraxx, for example, widened by 22bps in the last week of the month. Actual corporate bonds were more resilient due to the illquid nature of the market.

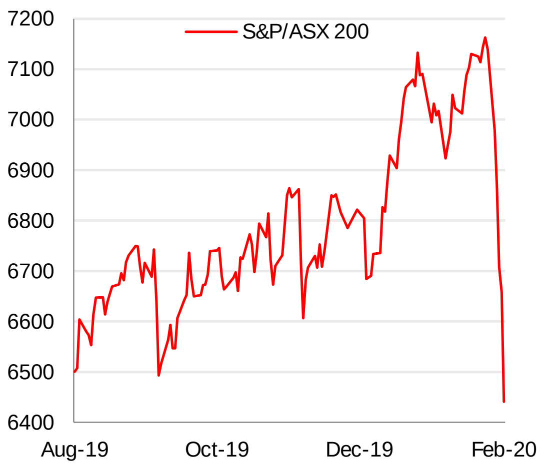
Global Equities

Global sharemarkets fell sharply in February as investors became increasingly concerned about the spread and increase in COVID-19 infection rates globally. In the final week of the month, major developed market indexes posted their worst weekly performances since 2008. Just a week earlier, however, US, European and Aussie shares hit record highs on optimism that the virus outbreak would be contained to China. Uncertainty about the US presidential election outcome, concerns over lofty sharemarket valuations and worries about the potential virus impact on corporate earnings and global growth also dampened risk sentiment and lifted volatility. Late in February, the International Monetary Fund downgraded economic growth forecasts for the world and Chinese economy sparking concerns. Late in the month, the US Federal Reserve noted it would "act as appropriate" to support the US economy. The Fed subsequently cut rates at an emergency meeting in early March.

Overall in February, the US Dow Jones fell by 10.1%; the S&P 500 lost 8.4% and the Nasdaq was down by 6.4%. In Europe, the German Dax index fell by 8.4% and the UK FTSE index lost 9.7%. In Asia, Japan's Nikkei index lost 8.9% and the Aussie ASX 200 index fell by 8.2%. December half year Aussie company results were mixed. Only around 51% of companies were able to lift profits (long-term average 60%), reflecting the difficult trading conditions in the Aussie retail, housing, travel and outdoor goods industries.

Over February, 21 of Australia's 22 sub-industry sectors posted losses. The worst performers were Household & personal products (down by 28%), followed by Capital goods (down 18.3%) and Energy (down by 18.2%). Only Consumer durables (up by 4.2%) posted gains. Of the size categories, the ASX MidCap50 index (down by 10.3%) was the worst performer, followed by the Small Ordinaries index (down by 8.9%); ASX100 and ASX200 indexes (both down by 8.2%) and the ASX50 index (down by 7.8%).

Chart 1 - ASX200 – from a record high



Australian Dollar

The Australian trade-weighted index declined by 1.9% in February. AUD declined against all major currencies apart from Great British Pound (GBP) and New Zealand Dollar (NZD).

AUD/USD declined in February because of fears China's coronavirus outbreak would reduce demand for Australian education and tourism exports. However, part of the weakness in AUD/USD reflected the outperformance of the US economy.

AUD/USD lifted mildly at the start of the month following the RBA's decision to keep the cash rate on hold in February. As widely expected, the RBA pointed out COVID-19 was a "source of uncertainty, which is having a significant effect on the Chinese economy at present". Indeed, AUD proved to be vulnerable to headlines around coronavirus and particularly its impacts on Chinese economic growth over the entire month. Concerns over lower Chinese demand placed downward pressures on crude oil prices and therefore Australia's LNG export prices, weighing on AUD/USD.

AUD/USD further fell below 0.6600 at the end of the month – a level not traded since March 2009. The catalyst was the lift in Australia's unemployment rate from 5.1% to 5.3% and underemployment rate from 8.3% to 8.6% in January. This led to financial markets pricing in a higher chance of rate cuts by the RBA, placing downward pressure on the AUD.

Table 1 – Australian dollar February performance

	AUSTRALIAN DOLLAR		
	End Jan 31-Jan-20	End Feb 28-Feb-20	M/M % Change
AUD-USD	0.6692	0.6515	-2.6
AUD-JPY	72.51	70.37	-3.0
AUD-EUR	0.6030	0.5905	-2.1
AUD-GBP	0.5068	0.5080	0.2
AUD-CHF	0.6447	0.6284	-2.5
AUD-CAD	0.8856	0.8733	-1.4
AUD-NZD	1.0348	1.0416	0.7
TWI	58.1	57.0	-1.9
Month High		0.6774	5-Feb-20
Month Low		0.6434	28-Feb-20

Source: Bloomberg, CBA

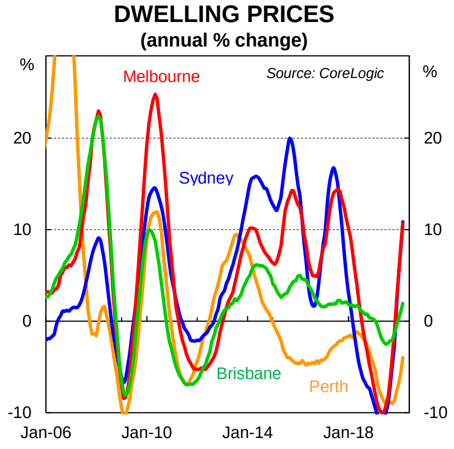
Australian Property Prices

The national benchmark eight capital city index continued to rise briskly due to strong price growth once again in Sydney and Melbourne. Price growth was also solid in Brisbane. The three RBA 25bp rates cuts in 2019, coupled with some regulatory changes and the coalition election victory, have had a profound impact on dwelling prices.

The 1.2% increase in dwelling prices in the eight capital cities over February marked seven straight months of very strong growth in prices. Annual growth has accelerated to 7.3%. By way of comparison, in June 2019 national dwelling prices were *down* by 8.0%/yr. Prices in Sydney rose by a very strong 1.7% in February and have lifted by 13.1% since May 2019 (the low point in the cycle). In Melbourne, dwelling prices marched 1.2% higher in February and have risen by 12.6% since May 2019. Dwelling prices in Melbourne are now back to their previous November 2017 peak (recall that prices fell by 12% in Melbourne from November 2017 to May 2019). Prices in Sydney are 4% shy of their July 2017 peak (recall that prices fell by 15% between July 2017 and May 2019). Price rises in the other capital cities have been less pronounced.

A strict reading of the leading indicators of the property market suggests that prices will continue to rise strongly over H1 2020. More specifically, auction clearance rates are firm, house price expectations continue to lift. But the risk is that momentum in the property market slows based on the significant impact that COVID-19 is having on both domestic and global economic activity and uncertainty. In addition, financial markets have been rocked over the past week or more and equity markets have fallen. This may weigh on sentiment in the property market. The high frequency data such as auction clearance rates will be an important gauge of any change in momentum.

Chart 2 – Dwelling prices



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