Markets Summary – March 2020

*Taken from the CBA Global Markets Research report, 'March Month in Review', and 'CoreLogic Dwelling prices – March 2020), all first published on 1 April 2020.*

## Highlights in March

- Coronavirus dominated the financial market landscape in March, returns across all asset classes were heavily impacted with extreme volatility.
- Central banks cut rates, turned liquidity on and started Quantitative Easing.
- Credit spreads have widened to levels unseen since the 2008 financial crisis.
- The bond index was positive, but the sectors were mixed.
- The AUD declined by 4% on a trade weighted basis in March, to hit its lowest level since 2002.
- Australian equities post the largest percentage decline since December 1987.
- In Australia, dwelling prices rose 0.7% across the eight capital cities in March.

## Summary

March felt like a month of 365 days, with incredible moves in bond yields, currency markets, commodity prices and equity markets. The risk off environment saw some steadying late in the month in the face of mammoth injections of liquidity and fiscal support, but the gyrations have left their scars.

Central banks across the world slashed policy rates to the effective lower bounds (which in most countries is close to zero), re-started Quantitative Easing or started it for the first time in Australia and NZ, added liquidity to markets and introduced a swathe of market support mechanisms and programs to stabilise the capital markets.

At the same time, governments moved swiftly to try to stave off the effects of Coronavirus in the human, social and financial sense, with large scale fiscal packages.

The Australian equity market performed poorly, posting the largest percentage decline since the December quarter of 1987.

The AUD/USD lost 4% on a trade weighted basis over the month and, on 19 March, hit the lowest level since October 2002. The AUD/USD traded a 17.5% range over the month, compared to a long run average of 4.5%.

**Cash**

The Reserve Bank of Australia (RBA) cut the cash rate twice in March. First a regular 25 basis points (bp) cut to 0.5%, followed by a mid-month extra-ordinary meeting where the RBA cut by a further 25bp to the effective lower bound (ELB) of 0.25%. The RBA also announced signifcant other operations. This saw short term cash rates fall over the month.

**Australian and Global Fixed Interest**

In March in the Australian government bond market, the 3 year bond yield fell 26bp to 0.24%, while the 10 year yield fell just 5bp to 0.76%.

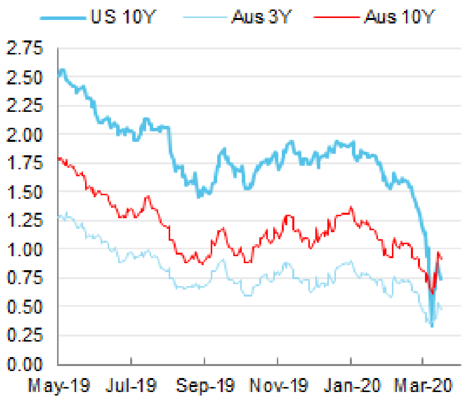
Those simple summary numbers obscure what has been an extraordinary month. As Coronavirus spread around the world, market after market went into disarray. The policy reactions differed slightly by jurisdiction, but the themes were fairly common. Official cash rates in a number of places were slashed to near zero including Australia, the US and New Zealand. This was mostly accompanied with large bond purchasing programs (Quantitative Easing), with Australia, the US and New Zealand included.

In particular, the RBA cut rates to 0.5% on 3 March, only to cut them again to 0.25% on 19 March, and begin Quantitative Easing. The RBA acknowledged that bond purchases and measures to assist short-term bank funding were likely to see the cash rate drift below that target, and by 31 March the effective cash rate had dropped to 0.2%.

The RBA announced its Quantitative Easing program would have a yield curve control (YCC) target. The RBA wants the 3 year government bond yield to be 0.25% and also wants to maintain the overall functionality of the government bond market. However, acknowledging the substitutability of bonds, the RBA is buying a range of bond maturities including both Commonwealth Government Bonds and state government bonds.

The market initially reacted poorly to the announcement, misreading the RBA as focusing on the 3 year yield only.

**Chart 1 – 3 year and 10 year government bonds**



*Source: Bloomberg, CBA*

Past performance is no indication of future performance.

**Global Credit**

What a month for credit markets! Credit spreads globally have experienced wild gyrations since the end of February when the COVID-19 virus first started to spread outside of China. Credit Default Swap indices in the US and Europe have shot up by more than 100bps and cash spreads for both Investment Grade and Non-investment grade corproate bonds all widened to levels unseen since the 2008 global financial crisis.

Central banks globally have stepped in with unprecedented measures to provide a back stop to the market sell-off. In mid March, the US Fed cut the Fed funds rate by a full percent, extended the discount window and cut the primary credit rate by 150bps to 0.25%. The primary credit rate or the Fed discount rate allows banks to borrow directly from the Federal Reserve. During the 2008 financial crisis, the Fed's discount window played a very signficant role in maintaining stability of the financial system. The Fed also reintroduced the Commercial Paper Funding Facility (CPFF) to allow it buy commerical paper directly from issuers. This helped to address illiquidity in the market, as before that, many companies were turning to the banks to draw on their lines of credit.

Towards the end of the month, the Fed announced it will get involved in the direct buying of US corporate bonds. A Primary Market Corporate Credit Facility (PMCCF) was set up to provide bridge financing of four years to investment grade companies headquartered in the United States. In addition, the Fed will also set up a Secondary Market Corproate Credit Facility (SMCCF) to purchase secondary corporate bonds issued by investment grade US companies and US listed exchange traded funds, whose purpose is to provide broad exposure to US investment grade corporates. Markets have responded very positively to the Fed's direct involvement in bond buying. The announcements have triggered some sizable improvements in the US credit markets and have driven offshore spreads tighter as well.

The primary market (where new corporate bonds are issued) in Australia has very much shut its door. We haven't seen a primary deal since mid February and it feels like investors are not yet ready to add risks, as most of them are still seeing redemptions.

**Global Equities**

Overall in March the US Dow Jones fell by 13.7%; the S&P 500 lost 12.5%; and the NASDAQ was down by 10.1%. In Europe, the German Dax index fell by 16.4% and the UK FTSE index lost 13.6%. In Asia, Japan's Nikkei index lost 10.5% and the Aussie ASX 200 index fell by 21.2%.

Over March, only one of Australia's 22 sub-industry sectors posted gains: Household & personal products (up 13.4%). Next best was Pharmaceuticals, Biotech and Life Sciences sector, down by 4.2%, and Food beverage and tobacco, down 4.4%. Leading the declines was Energy (down by 38.0%) from Real estate (down 35.8%) and Consumer services (down 34.6%). Of the size categories, the ASX MidCap50 index (down by 23.2%), was the worst performer from the Small Ordinaries index (down by 22.8%); from the ASX 200 and the ASX100 (both down 21.2%) and the ASX50 index (down by 20.9%).

**Chart 2 - ASX200 – from a record high**

## Table 1 – March timeline

Past performance is no indication of future performance.

| Date | Event & Impact on US Dow Jones & Australian ASX 200 | Daily % |
|---|---|---|
| Feb-28 | Chinese purchasing manager indexes hit record lows | Dow -1.4% |
| | | ASX -3.3% |
| Mar-02 | Hopes for fiscal/monetary stimulus from G7 nations | Dow +5.1% |
| | | ASX -0.8% |
| Mar-03 | US Federal Reserve cuts rates 50bp to 1.00-1.25% | Dow -2.9% |
| | Reserve Bank cuts cash rate 25bp to 0.50% | ASX +0.7% |
| Mar-04 | Victories in 'Super Tuesday' primaries by moderate Democrat Joe Biden | Dow +4.5% |
| | provides relief for investors | ASX -1.7% |
| Mar-05 | Swift spread of COVID-19 through the US | Dow -3.6% |
| | | ASX +1.1% |
| Mar-06 | Oil prices slump 10% as OPEC+ fails to cut output | Dow -1.0% |
| | | ASX -2.8% |
| Mar-09 | Oil falls another 25% on fear of a Russia-Saudi Arabia oil price war | Dow-7.8% |
| | S&P 500 index fell by 7%, triggering the level 1 circuit breaker | ASX -7.3% |
| Mar-10 | Investors await US White House response to COVID-19 | Dow +4.9% |
| | Oil rebounds by 10.4% | ASX +3.1% |
| Mar-11 | World Health Organisation declares COVID-19 a global pandemic. Dow | Dow -5.9% |
| | enters bear market. Bank of England cuts rates 50bp to 0.25% | ASX -3.6% |
| Mar-12 | US President restricts air travel with Europe. Disappointment at the | Dow -10% |
| | absence of US stimulus plan. First Australian stimulus package | ASX -7.4% |
| Mar-13 | US declares national emergency resulting in US$50 billion of | Dow +9.4% |
| | federal aid being advanced | ASX +4.4% |
| Mar-16 | RBNZ and US Federal Reserve both cut policy rates to 0.25%. | Dow -12.9% |
| | US S&P 500 index fell by 8%, triggering the level 1 circuit breaker | ASX -9.7% |
| Mar-17 | US White House works on stimulus plan estimated at US$1 trillion | Dow +5.2% |
| | US Federal Reserve buys debt directly from companies | ASX +5.8% |
| Mar-18 | New York Fed makes $1 trillion a day available for repo operations | Dow -6.3% |
| | Investors await US White House response to COVID-19 | ASX -6.4% |
| Mar-19 | Bank of England cuts rates to 0.1%. US opens swap lines. European Central | Dow +1.0% |
| | Bank buys $820bn in debt. RBA stimulus package, cash rate cut to 0.25% | ASX -3.4% |
| Mar-20 | New York & California issue "stay at home" orders | Dow -4.6% |
| | Nymex oil falls 10.7% | ASX +0.7% |
| Mar-23 | 2nd fiscal stimulus package in Australia (Mar 22). US Federal Reserve places | Dow -3.0% |
| | no limit on purchases of Treasury and agency mortgage-backed securities | ASX -5.6% |
| Mar-24 | US Congress moves closer to agreeing an economic relief package. Dow | Dow +11.4% |
| | Jones posts biggest daily percentage gain since 1933. | ASX +4.2% |
| Mar-25 | US Congress close to a vote on a US$2 trillion economic relief package | Dow +2.4% |
| | But US stocks lose ground into the close on 'snags' in the package progress. | ASX +5.5% |
| Mar-26 | US Senate approves relief package, awaits House of Representatives vote | Dow +6.4% |
| | European Central Bank will not cap bond purchases to any one country | ASX +2.3% |
| | US unemployment claims soar to record 3.28 million | |
| Mar-27 | US President approves a US$2.2 trillion relief package | Dow -4.1% |
| | US Dow Jones rises 12.8% over the week, the best gain since 1938 | ASX -5.3% |
| Mar-30 | Australian Government unveils $130 billion wage subsidy scheme | Dow +3.2% |
| | Record daily increase for ASX200 index. | ASX +7.0% |
| Mar-31 | Profit-taking and book-squaring at the end of the month and quarter | Dow -1.8% |
| | Biggest quarterly fall for the US Dow Jones since December quarter 1987 | ASX -2.0% |

**Australian Dollar**

The Australian trade-weighted index declined by 4% in March. AUD underperformed against all major currencies we monitor.

High volatility was the theme for March. AUD traded in a large 17.5% range in the month, compared to a monthly average of 4.5%.

AUD plunged in the first half of March and hit its lowest level of 0.5510 since 2002 on 19 March. On the same day, the RBA announced a comprehensive package, including Quantitative Easing, to help support Australia's financial system and the economy. The cash rate was cut to a historic low of 0.25%. Lower global equity prices, thin liquidity and continually strong demand for USD funding weighed on AUD. It remains to be seen, but it is likely foreign investors sold AUD assets over the month adding to this pressure.

AUD/USD pared some losses and lifted by 11% over the remainder of March because of a softer USD. AUD/USD was supported by the surging number of Coronavirus cases in the US and the deterioration in US economic data.

**Table 2 – Australian dollar March performance**

| | AUSTRALIAN DOLLAR | | |
|---|---|---|---|
| | **End Feb 28-Feb-20** | **End Mar 31-Mar-20** | **M/M % Change** |
| **AUD-USD** | 0.6515 | 0.6131 | -5.9 |
| **AUD-JPY** | 70.37 | 65.95 | -6.3 |
| **AUD-EUR** | 0.5905 | 0.5560 | -5.8 |
| **AUD-GBP** | 0.5080 | 0.4939 | -2.8 |
| **AUD-CHF** | 0.6284 | 0.5893 | -6.2 |
| **AUD-CAD** | 0.8733 | 0.8621 | -1.3 |
| **AUD-NZD** | 1.0416 | 1.0296 | -1.2 |
| **TWI** | 57.0 | 54.7 | -4.0 |
| **Month High** | | 0.6685 | 9-Mar-20 |
| **Month Low** | | 0.5510 | 19-Mar-20 |

*Source: Bloomberg, CBA*

**Australian Property Prices**

Like with all economic data at the moment, there was a clear delineation between before COVID-19 and post COVID-19. Dwelling price data across the eight capital cities lifted 0.7% in the month, but CoreLogic note that there was a slowing in the growth trend over the later stages in March. This is no surprise given the escalation of the Coronavirus crisis, as well as government policies to reduce the spread of the virus.

Looking at the monthly data and all capital cities apart from Hobart recorded positive gains in March. Sydney (1.1%), Melbourne (0.4%), Brisbane (0.6%), Adelaide (0.3%) and Perth (0.5%) recorded gains while Hobart recorded a 0.2% loss. Canberra (0.6%) and Darwin (2.0%) also recorded gains. Melbourne and Sydney had been recording similar monthly moves up until March, where there was a divergence. Melbourne prices are now back to the peak, while Sydney prices remain 2.8% below the peak in June 2017.

There is considerable uncertainty as to how well insulated dwelling prices may be over coming months. As of midnight Wednesday 25 March, the Federal government banned public open houses and auctions as social distancing requirements were expanded. Private property inspections can still be carried out and auctions can be moved online.

A survey conducted by CoreLogic between March 20 and 22 (before these new regulations were introduced) had already noted a fall in both buyer and sale inquiry levels. One clear result will be significantly reduced turnover. Turnover had been rising in Sydney, Melbourne and Perth but remained below the levels seen in early 2016. Lower turnover will also reduce other economic activity associated with moving houses including pest inspections, conveyancing, household furnishings purchases and removalists to name a few.

Bank policies to allow mortgage holders to defer mortgage payments during the crisis is expected to reduce the number of distressed sales on the market; this will help buffer falls in property prices. Lower sales volumes and buying volumes could see the property market effectively enter hibernation with limited impact on property prices. The labour market though will be an important driver. The recently announced JobKeeper package will help limit the rise in unemployment, but a large lift is still expected. Underemployment will also rise and hours worked will fall; this will impact on income and could see prospective buyers sit on the sidelines and wait this period of uncertainty out.

**Chart 3 – Dwelling prices**

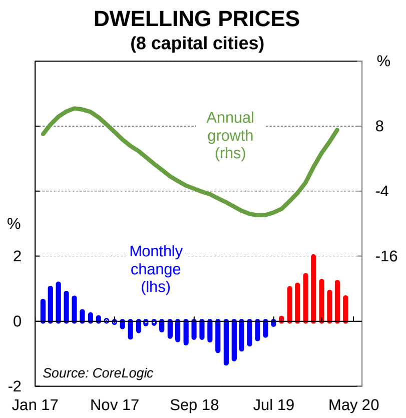



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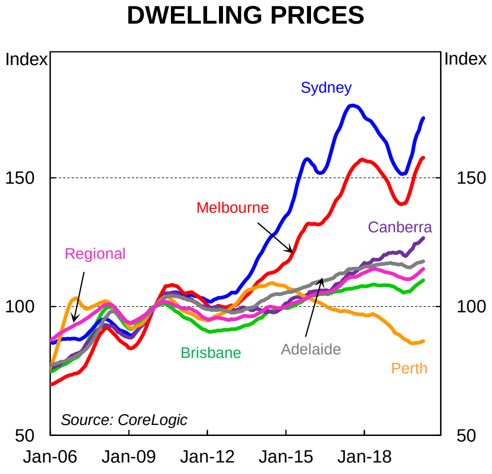
**Chart 4 – Dwelling prices by capital city**

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