Markets Summary – July 2020

Taken from the CBA Global Markets Research report, 'July Month in Review', first published on 3 August 2020.

Highlights in July

- There was no change to the RBA cash rate
- Credit spreads tightened
- The Australian dollar (AUD) rose 3.17% on a Trade Weighted Index basis
- Australian equities rose again, despite a late month fall
- In commodities, higher iron ore, gold and oil prices offset lower coking coal prices

Summary

Fixed income markets were once again confined to tight ranges during July. The Australian Government's 3-year bond yield stayed at the RBA's 0.25% target, while the 10-year yields fell in the month. Credit spreads and equity markets once again enjoyed gains. The AUD also rose strongly against the US dollar (USD) as risk appetites returned and the global environment was more positive. The AUD/USD rose more than 3% on a Trade Weighted Index basis, and 4.3% vs the USD as the latter sagged against all major currency pairs.

Cash

The RBA didn't change rates in July, but did at least canvas the possibility of a further reduction in rates (while still leaving them positive). The market pricing of the RBA implied financial markets is 0.13%, below the official cash rate of 0.25%. Cash rates remain low with the 3-month bank bill swap rate closing July at 0.10%, a fall of 0.15 basis points (bp). The 6-month bank bill swap rate trended a little higher over July, closing the month 1.5bp higher at 0.1752%.

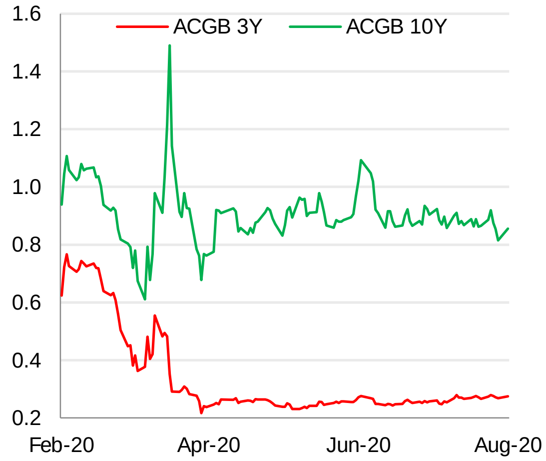
Australian and global fixed interest

Australian Government bond yields were very stable over July. The 3-year bond yield stayed at the RBA's target of 0.25%. The 10-year yields fell with most of the movement in the last couple of days of the month (see Chart 1).

The July Economic and Fiscal Update (JEFU) was presented on 23 July and confirmed exceptionally large deficits for both 2019-20 ($A85.8bn) and 2020-21 ($A184.5bn).

The RBA, once again, did not buy any bonds (but this changed in August).

Chart 1 – Australian bond yields



Source: Bloomberg, CBA

Global credit

Aussie credit delivered solid performance in July. There was new corporate bond issuance in the month from offshore banks and local corporates. There has been strong investor demand as there is not much liquidity in the secondary market, which makes it hard for investors to meaningfully boost allocation to credit. The success of recent new corporate bond issuance suggests that most credit funds are well positioned to absorb new issuances provided that the issuers are relatively unsusceptible to COVID-related risks.

The US reporting season kicked off in earnest with more than 60% of companies in the S&P 500 having reported results for the June quarter. By and large, companies have reported results exceeding expectations. In Australia sectors less exposed to COVID-19 risks have outperformed. New outbreaks in Victoria could pose further challenge to sectors including REITs, universities and infrastructure.

Global equities

Investors were watchful over July, fearful of the economic impact of a lift in COVID-19 cases in a number of countries including the US and the state of Victoria in Australia.

Investors continued to be cheered by reports of progress made on a COVID-19 vaccine, and also responded to new earnings results in the US. US policymakers debated the need to extend financial support for the unemployed. A deterioration in US-China relations (including tit-for-tat closures of consulates) weighed on sentiment as did data showing a lift in global COVID-19 cases. European shares rallied on news the European Union leaders secured a "historic" deal on a €750-billion ($856 billion) recovery fund and its related €1.1-trillion budget for 2017-2021.

The US earnings season started late in the month and was generally positive, especially in results from technology companies. The US Federal Reserve left the target range for the federal fund’s rate at 0-

0.25% and comments from the Federal Reserve's chair soothed investor nerves. US second quarter GDP showed the US economy contracting 32.9% annualised in the June quarter.

In July there were mixed results with technology out-performing. In the US, the Dow Jones was up by 2.4%, the S&P 500 increased by 5.5% and the Nasdaq finished up by 6.8%. In Asia, Japan's Nikkei lost 2.6%. In Europe, the German Dax was flat and the UK FTSE fell by 4.4%.

Australian equities

The ASX 200 lifted 0.5% in July despite losing 2% on the last day of the month. Across Australia's 22 sub-industry sectors, 11 posted gains in July. Leading the gains was Consumer durables and apparel (up by 13.9%), followed by Materials (up5.8 %). Household and personal products fell the most (down 9.6%).

Of the size categories, the MidCap50 out-performed (up 2.0%) from the Small Ordinaries (up 1.3%), the ASX100 (up 0.5%) and the ASX50 (up 0.2%).

Australian dollar

The AUD rose by 3.2% on a trade-weighted basis in July.

AUD appreciated over the majority of July because of a weakening in the USD. A second wave of virus infections in Victoria and the reimposition of strict lockdowns in the state did little to offset the AUD's strength. AUD broke above its 0.68-0.70 US cent trading range in the middle of July and remained above 0.70 for the rest of the month.

AUD lifted sharply after EU members agreed to the terms of its recovery fund. Fiscal solidarity is supportive for both the Eurozone economic recovery and the broader global economy. AUD then rose to its highest level since February 2019 on 31 July. Market participants revising lower their outlook for the US economy over the second half of the month was also the catalyst for the stronger AUD. Finally, AUD was also supported by a rally in gold prices in July (Australia is the third largest gold producer). Spot gold prices hit a record high at the end of the month.

Table 1 – Australian dollar July performance

AUSTRALIAN DOLLAR			
	End Jun 30-Jun-20	End Jul 31-Jul-20	M/M % Change
AUD-USD	0.6903	0.7143	3.5
AUD-JPY	74.51	75.59	1.5
AUD-EUR	0.6145	0.6065	-1.3
AUD-GBP	0.5567	0.5459	-1.9
AUD-CHF	0.6539	0.6521	-0.3
AUD-CAD	0.9372	0.9578	2.2
AUD-NZD	1.0695	1.0775	0.7
TWI	60.0	61.9	3.2
Month High		0.7227	31-Jul-20
Month Low		0.6877	1-Jul-20

Source: Bloomberg, CBA

Commodities

Commodity prices finished mostly higher in July as the US dollar weakened, although demand prospects were mixed. A surge in COVID-19 cases around the world weighed on the commodity demand outlook. However, demand prospects were bolstered by easing COVID-19 lockdowns. Liquefied natural gas (LNG), gold and iron ore saw the strongest gains, while coking coal fell.

Spot LNG prices lifted strongly in July. While the percentage gain was impressive, spot LNG prices only finished last month at ~$US2.5/mmbtu, well short of what it began this year ($US5.3/mmbtu). Supply cuts in the US help explain the boost in spot LNG prices, but oversupply risks still remain in play. In July European LNG storage levels were at 5-year highs for this time of year.

Gold prices rose last month to record highs on the back of falling US 10-year real yields, a weaker US dollar and stronger safe haven demand. The fall in US 10-year real yields was the most important driver given the strong inverse relationship between the gold price and US 10-year real yields over time. The decline in US 10-year real yields was mainly driven by an increase in US 10-year inflation expectations. Safe haven demand primarily reflected global growth concerns linked to rising COVID-19 cases around the world and escalating US-China tensions.

Iron ore was also another standout performer last month. The steel-making ingredient rose as steel mill margins in China stayed healthy. Seaborne coking coal prices fell last month on weaker buying from China.