Markets Summary – October 2020

Taken from the CBA Global Markets Research report, "October Month in Review", first published on 3 November 2020 and "Dwelling Prices –Oct 2020, lending and approvals- Sept 2020" first published on 2 October 2020

Highlights in October

- Australian short-term bond yields fell as policy easing views ratcheted up.
- Credit traded in a tight range for most of October before Victoria's COVID-19 reopening triggered a strong rally.
- The Australian dollar (AUD) dropped again.
- Australian equities outperformed.
- Commodity prices were generally weaker with falls in iron ore, coking coal and oil prices.
- Dwelling prices rose by 0.2% across the eight capital cities combined – the first increase since April.

Summary

October saw government bond yields drop – in many cases to new lows – ahead of the November RBA meeting. The Australian bond curve traded lower than the US curve for the first time since March. Equity markets saw an outperformance in Australia. Expectations of rate cuts pushed the AUD across the major crosses.

Cash

Even though policy rates were unchanged in October, the weight of expectation of further rate cuts took short-term money market rates to new lows. This followed RBA Governor Dr Philip Lowe's speech in mid-October where he gave the clearest signal yet that the RBA would expand its balance sheet, buying bonds and lowering the various interest rate structures at the RBA's next meeting (3 November).

This took Bank Bill Swap Rates (BBSW) and other short dated instruments to new lows. One, three and six-month BBSW finished October at 0.05%, down from around 0.09% at the start of the month. Other marks such as Treasury Note yields dropped to new lows and of course the front end of the Australian Commonwealth Government Bond curve drifted towards the 0.1% level.

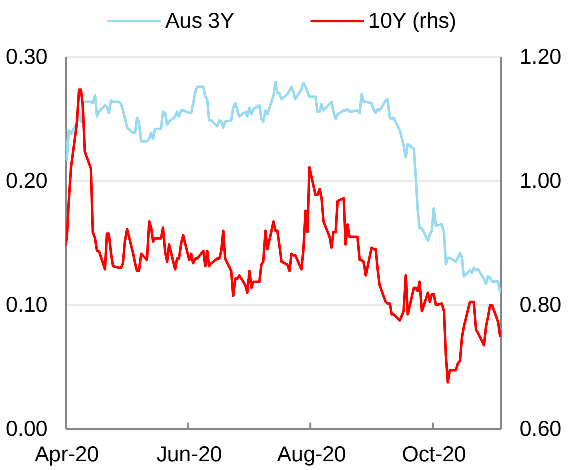
Australian and global fixed interest

As October closed, the market was widely anticipating that the RBA would lower interest rates and announce further buying of five-year to 10-year bonds at its November meeting. Set against that, the US bond market rose in yield fairly consistently through October.

The net effect for Australian bonds was a 10-year yield that was little changed. Front-end bond yields touched new lows in October on the expectation that quantitative easing was to start for the RBA QE. The yields on shorter-dated bonds fell towards the expected 0.1% rate that the market consensus had arrived on where interest rates and the three-year bond yield target will be lowered too.

At the same time, the influence of a shift higher in US government bond yields into the US presidential election pressured the longer-term bond yields and resulted in a volatile month. Over October the three-year Australian government bond yield fell from 0.18% to 0.14%, with a low of 0.135%. The 10-year bond was 1 basis point (bp) lower at 0.828%, notably higher than the 0.722% seen at its mid-month low.

Chart 1 – Australian bond yields



Source: Bloomberg, CBA

Global credit

Australian credit spent most of October trading in a tight range before markets responded positively to the reopening of Victoria and spreads enjoyed a strong rally in the last week of the month. Defensive sectors continued to perform better, but there was a pickup in demand for cyclical names after state governments announced more border openings. With the US presidential election looming and European countries having announced new lockdown measures to combat the resurgence of COVID-19, investors are likely to remain on the sidelines for some time.

A number of industries including REITs, airports, universities, airlines, infrastructure and autos continued to trade very wide relative to pre-COVID-19 levels. Some of these sectors should benefit from the next phase of economic recovery now Victoria is opening up. However, names with exposure to international tourism will continue to face uncertainties.

Global equities

In October, investors were spooked by threats to economic activity amid record high coronavirus infections in the US and Europe, following announcements of renewed lockdowns. Uncertainty ahead of the US presidential election and a lack of progress on US stimulus negotiations increased market volatility. A mixed bag of earnings reports from big tech companies also dampened sentiment, and US sharemarkets posted their biggest monthly declines since March, but US sharemarkets posted their second consecutive month of declines in October. The US Dow Jones index fell by 4.6%, the S&P 500 index fell by 2.8% and the Nasdaq index lost 2.3%. In Europe, the German Dax index plunged 9.4% and the UK FTSE fell by 4.9%. Late in the month record Coronavirus cases spurred leaders in Germany and France to announce new 'stay-at-home' orders. In Asia, Japan's Nikkei index slid 0.9%.

Australian equities

Aussie shares outperformed in October, supported by budget stimulus, rate cut hopes, takeover activity and an easing of Melbourne's lockdown, with Australia's ASX 200 index gaining 1.9%. Across Australia's 22 sub-industry sectors, 14 posted gains in October. Leading these gains was Household & personal products (+11.4%), but Commercial & professional services fell the most (-4.9%). Of the size categories, the MidCap50 index was up 6.1%, followed by the ASX100 Index (+2.1%), ASX50 Index (+1.3%) and the Small Ordinaries Index (+0.3%).

Australian dollar

The AUD trade-weighted index decreased by 2% and traded in a 3.3% range in October. The AUD fell against the US dollar (USD) after the RBA left monetary policy steady and maintained its easing bias. However, money markets priced in a high chance of cuts to policy interest rates in November, weighing on the AUD.

AUD/USD hit a peak in early October on evidence that Australia's housing market is going to come through the COVID-19 pandemic largely unscathed. However, the AUD remained heavy in the remainder of October after RBA Governor Philip Lowe's signal for possible near-term monetary easing. The uncontrolled COVID-19 infections in the US and Europe raised the prospect of slower global economic growth, weighing on AUD.

Table 1 – Australian dollar October performance

	AUSTRALIAN DOLLAR		
	End Sep	**End Oct**	**M/M %**
	30-Sep-20	**30-Oct-20**	**Change**
AUD-USD	0.7162	0.7028	-1.9
AUD-JPY	75.54	73.56	-2.6
AUD-EUR	0.6111	0.6035	-1.2
AUD-GBP	0.5544	0.5427	-2.1
AUD-CHF	0.6596	0.6445	-2.3
AUD-CAD	0.9539	0.9360	-1.9
AUD-NZD	1.0826	1.0625	-1.9
TWI	60.7	59.5	-2.0
Month High		0.7243	9-Oct-20
Month Low		0.7002	29-Oct-20

Source: Bloomberg, CBA

Commodities

Commodity prices were mixed in October. The USD finished the month only slightly higher than where it started, having rallied towards the end of the month on growing demand concerns as rising COVID-19 cases saw Europe announce new lockdowns.

Spot Liquefied Natural Gas (LNG) and coking coal were the key outliers in October, with spot LNG prices surging on easing oversupply concerns. Gas storage levels in Europe, which is the destination of last resort for LNG cargoes, were below 2019 levels in late October. While LNG demand has picked up from lows as COVID-19 lockdowns ease, particularly in China, India and Japan, the prospect of strong LNG demand during the winter months in North Asia is probably at the heart of the recent rally.

Coking coal prices fell sharply in October following reports that China is targeting imports of Australian coking coal. Oil prices also declined towards the end of the month on demand concerns. The new lockdowns in Europe to limit the spread of COVID-19 was the primary driver. Oil demand is particularly sensitive to lockdowns because transportation accounts for two-thirds of global oil consumption.

Australian property prices

Dwelling prices for the eight capital cities combined rose by 0.2% in October. This was the first increase since April when job losses and COVID-19 restrictions saw property prices begin to fall. Over the year dwelling prices are up by 3.7%.

All capital cities recorded an increase in dwelling prices in October with the exception of Melbourne (-0.2%). Prices in Melbourne have fallen by 5.6% since March when COVID-19 came into play, compared to a 2.5% fall for the eight capital cities combined. Restrictions and case numbers have been much higher in Melbourne compared to the rest of Australia and explain the bigger falls. However, open home inspections are now allowed in Melbourne and CoreLogic reports that listings have since soared and that buyer activity is recovering.

Across the other capital cities, there were solid dwelling price rises for Adelaide (1.2%), Darwin (1.2%), Hobart (1.0%), Canberra (1.0%). Prices also posted a decent increase in Perth (0.6%) and Brisbane (0.5%), but were essentially flat in Sydney (0.1%).

There are several headwinds facing the residential property market at present, with a weak labour market, falling rents and lower population growth acting as a drag. However, working the other way mortgage interest rates – a very important driver of dwelling prices – are now ultra-low.

Chart 2 – Dwelling price movements

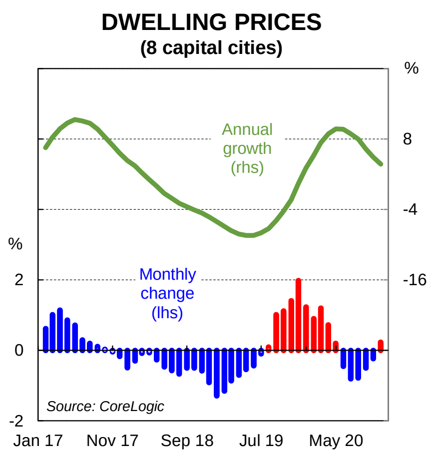


Chart 3 – Dwelling price Index