Markets Summary – January 2021

Taken from the CBA Global Markets Research report, "January Month in Review", first published on 2 February 2021 and "Lending Indicators and Dwelling Prices – Dec 2020 and Jan 2021" first published on 1 February 2021.

Highlights in January

- Yields rose given the optimistic economic outlook, but the lack of likely Reserve Bank of Australia (RBA) action tempered moves.
- Australian credit spreads tightened.
- The Australian dollar (AUD) weakened slightly from recent highs.
- Equities had a volatile month.
- Commodity prices enjoyed another strong rise.
- Dwelling prices rose by 0.7% across the eight capital cities combined.

Summary

Australian government bond yields generally rose in January with longer term yields rising more than short term yields. The market is responding to the clear improvement in the economic (and health) outlooks while at the same time reticent to assume the RBA will act in the near term. Equities were showing increased volatility towards the end of the month, but still managed to close at 0.31% higher in Australia (though down 1.01% in the US).

The AUD lost ground on a Trade Weighted Index basis. Equities were roiled by Coronavirus cases, riots and retail speculation. Credit performed well and closed the month with spreads tighter once again.

Cash

There has been clear improvement in the economic position in recent months but the market is taking the RBA at its word that any change in rates is over three years away. There's been a slow, but continuous, tightening in the Bank Bill Swap rates too. This general fall in front-end yields appears to be coming from the continuous and relatively rapid increase in the cash balances at the RBA (called Exchange Settlement) balances. The extra cash is slowly moving all front-end yields lower.

Some very short term government bonds have been printing at negative yields semi-regularly across January, but only by very small amounts.

Australian and Global Fixed Interest

The ongoing economic improvement in Australia, tied in with the continuing strong control of the virus, has once again seen bond yields rise and long term yields rise more than short term yields. The 10 year bond yield rose by 12bp to 1.09% in January. The 3 year bond yield remain tied to 0.10% by the RBA.

In global markets, the US 10 year bond yield rose 14bp to 1.05%.

The RBA and the Australian Office of Financial Management (AOFM) which is the borrowing arm of the government are both the main players in the Australian market at present. The AOFM is having a smaller impact now with the ongoing RBA buying the dominant presence in January. The AOFM stayed out of markets until 20 January and sold only $A5bn in total. In contrast, the RBA bought $A12bn of Australian Commonwealth government bonds and $A3bn of Semi government bonds in January.

In January, the two main economic data points were the labour force (50k more jobs, unemployment down to 6.6%) and CPI (headline up 0.9% on the quarter and 0.9% on the year). Although the improvement in the economy is clear, January ends with market yields a little higher but generally resisting a significant repricing. The RBA is scheduled to meet tomorrow for the first time in two months which sets off a veritable blizzard of events. The market generally marked time a little across the second half of January, waiting to see what the RBA might say.

Global Credit

Australian credit outperformed most other markets in January. On average spreads tightened 4bps for non-financials and 6bps for financials. Credit did outperform equities. The S&P/ASX 200 index lost 1% this month, impacted by an increase in volatility in offshore markets.

New corporate bond issues remained quiet. It is expected issuance will pick up after result announcements. The upcoming reporting season will give clarity on the precise impact of COVID-19 on corporate balance sheets. Cyclical sectors outperformed defensives this month. Retail REITs, airports and autos were among some of the best performing sectors in January as restrictions on mobility were getting lifted.

Commodities

Commodity prices were mixed in January, despite a slight strengthening of the US dollar. Coking coal was a clear strand-out, while spot LNG, after initially outperforming, saw the largest decrease by the end of January. Oil also did well.

Spot coking coal prices from Australia surged as demand outside China picked up. While China's ban on buying Australian coal hurt coking coal prices last October, it is likely the cause of last month's price rally. The ban has helped coking coal prices in the Atlantic Basin soar as China had to look to more distant markets to meet its coking coal needs. Higher coking coal prices in the Atlantic Basin finally reached a point where Australian coking coal prices were attractive to buyers in Europe, South America and India.

Spot LNG prices initially surged last month as severe cold weather across northern Asia saw spot LNG demand pick-up.

Iron ore started January well on resilient Chinese demand, but finished the month lower as declining steel mill margins weighed on demand.

Global Equities

Global share markets were battered by a variety of factors in January. Key influences on sentiment and trading included: the vaccine rollout; a lift in global virus case numbers; worries about lofty share market valuations; US earnings season; US politics; a mob breaching the US Capitol building; a new US stimulus package; and a trading frenzy in the US affecting a small number of stocks, and ultimately global markets.

US President-elect Joe Biden announced a $US1.9 trillion economic stimulus package late on January 14, prior to his inauguration. US Federal Reserve chair Jerome Powell said that the accommodative monetary policy stance will remain in place *"until the job is well and truly done".*

Overall in January, the US Dow Jones index fell by 2%, the S&P 500 index lost 1.1% but the Nasdaq index rose by 1.4%. In Europe, the German Dax index fell by 2.1% and the UK FTSE fell by 0.8%. Asian bourses generally outperformed with Japan's Nikkei index up by 0.8%, while Australia's ASX 200 index gained 0.3%.

Six out of Australia's 11 industry sectors posted gains in January. Leading the gains was Consumer Discretionary (up 4.7%) from Telecom (up 2.7%). But Property Trusts fell (down 4.1%), with Industrials down 3.0%. Of the size categories, the ASX 20 rose 1.6% from the ASX50 (up 0.7%). But the MidCap50 fell 1.1% while the Small Ordinaries index lost 0.3%.

Australian Dollar

The Australian trade weighted index decreased by 0.6% in January. AUD was weakest against GBP and strongest against JPY.

AUD/USD continued to increase in the first week of January, an extension of its rapid increase in November and December. AUD peaked at 0.7820 on 6 January before trending lower. Iron ore prices trended lower as January progressed after a very large increase in December, weighing on AUD. Media reports suggest Chinese authorities want Chinese steel makers to reduce steel production this year.

The Australian economic data was not a large driver of AUD in the month. However, the Australian data generally provided a positive surprise. For example, retail trade surged by 7.1% in November 2020. The housing market is also rebounding much faster than expected.

Table 1 – Australian dollar January performance

	AUSTRALIAN DOLLAR		
	End Dec	**End Jan**	**M/M %**
	31-Dec-20	**29-Jan-21**	**Change**
AUD-USD	0.7694	0.7644	-0.6
AUD-JPY	79.47	80.03	0.7
AUD-EUR	0.6298	0.6298	0.0
AUD-GBP	0.5629	0.5576	-0.9
AUD-CHF	0.6809	0.6811	0.0
AUD-CAD	0.9796	0.9768	-0.3
AUD-NZD	1.0709	1.0638	-0.7
TWI	63.4	63.0	-0.6
Month High		0.7820	6-Jan-21
Month Low		0.7592	28-Jan-21

Source: Bloomberg, CBA

Australian Property Prices

January's CoreLogic data showed that dwelling prices were up by 0.7% across the eight capital cities combined in the month. Sydney and Melbourne recorded moderate 0.4% price rises in the month. While the smaller and medium sized jurisdictions recorded large increases ranging from 0.9% in Brisbane and Adelaide to 2.3% in Darwin. The combined regions also posted a large 1.6% rise in the month.

Since the Coronavirus came into play in earnest in March 2020 dwelling prices have lagged behind the combined capitals average in Sydney and Melbourne, but particularly in Melbourne where COVID-19 cases were the highest and restrictions the toughest. Dwelling prices have risen in all other capital cities and the combined regions since Mach 2020. Demand for dwellings in regional areas has been strong as work from home policies mean that living in the regions is now a viable choice for many people.

There have also been some different trends between detached houses and apartments in recent months. Since September 20 prices of detached houses have risen by 3.3% across the eight capital cities combined while units have risen just 0.1%. The slowdown in population growth because of border closures is having a larger impact on the apartment market relative to detached houses. A high share of people who come to live in Australia are students and students tend to live in apartments close to the universities. The government HomeBuilder grant is also supported the detached housing market.

Chart 1 – Dwelling Price moves – since March 2020

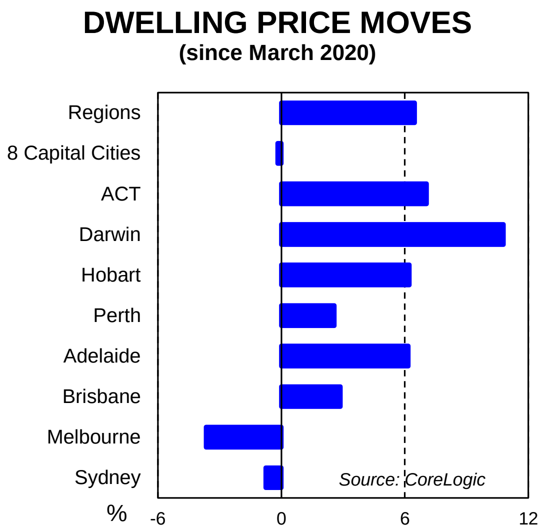

Chart 2 – Dwelling Price Index