Markets Summary – February 2021

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

Highlights in February

- Government bond yields rose very sharply.
- Credit outperformed government bonds. Spreads continued to trend tighter although volatility picked up towards month end.
- The Australian dollar (AUD) rose 2.4% on a Trade-Weighted Index (TWI) basis.
- Equities had a choppy month, with interest rate sensitive sectors hurt.
- Iron ore and oil prices rose.
- Dwelling prices rose by 2.0% in February 2021. Prices of detached houses posted a particularly strong 3.0% lift in the month.

Summary

Once again this month, government bond yields were higher, with longer term yields rising more than short term bond yields leading to a steepening of the yield curve.

Equity markets were choppy as the rise in bond yields late in the month hurt the tech sector hard.

The AUD rose on a TWI basis and apart from a late month set back, took its cue from surging commodity prices. Credit outperformed government bond yields, delivering positive returns. Commodity prices enjoyed another strong month.

Cash

The Reserve Bank of Australia (RBA) had begun February by announcing they would buy a further $A100bn of bonds as part of the Bond Purchase Program, but also altered the wording of the forward guidance around rates. Instead of a commitment not to raise rates for three years, the RBA now communicates the necessary conditions for a rate rise (being wages growth and Consumer Price Index (CPI) sustainably in the 2% - 3% target band). Moreover, the RBA asserts that "The Board does not expect these conditions to be met until 2024 at the earliest".

At the same time, the market has begun pricing a risk that the RBA beings to raise rates in either late 2022 or early 2023. This is earlier than the RBA's guidance of 2024 at the earliest based on the current evolvement of economic conditions. Market pricing has meant short term money market rates have lifted. The effects are still relatively small, but 3M Bank Bill Swap Rates (BBSW) has risen 2 basis points (bp) to 0.03% and 6M BBSW has risen 4.91bp to 0.0641%.

Australian and Global Fixed Interest

In Australia the Commonwealth government bond market and the state government bond market saw very large rises in yields and a sharp steepening of the curve in February. (Note we are using Friday 26 February closing marks unless otherwise noted – though these are from a period of high volatility, and may not be truly representative. Yields have moved back significantly on 1 March.)

10-year government bonds rose by 76bp in February to close the month at 1.86%. Even discounting the last couple of mad days in February, the move was still significant, moving 48bp to 1.57% over the month to 24 February.

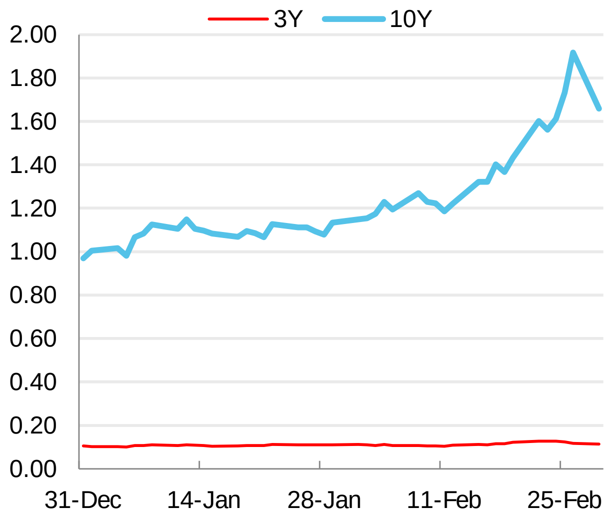
There were also significant moves in the three-year bond yield space as markets started questioning in the next rate rise by the RBA. The RBA currently has a three-year yield target of 0.1%. The three-year government bond maturing in April 2024, the target of the RBA's Yield Curve Control (YCC) buying program, sold-off 0.75bp to 0.1175%. This was despite significant RBA purchases to maintain the 0.1% target. The RBA bought $A7bn of bonds in the YCC program in February (and a further $A16bn of Commonwealth government bonds and $A4bn of state government bonds in the bond purchase program). However, the bonds around the 3Y point (that aren't the explicit target of the RBA) have risen in yields. For example a three-year bond maturing in November 2024 rose by 25.5bp to 0.4425% in February.

A significant part of the sell-off in bonds in recent months was a reassessment of the market's inflation outlook and a brightening economic outlook.

Australia was not the only country selling off sharply in February. The US yields also rose notably. The US 10Y rose 43bp to 1.48%. The Australian-US 10Y spread widened 29bp to 38bp over February.

Although the move higher in yields was driven by a change of the underlying economic assessment, there was no particular data point which triggered the move. The data is still mostly backward-looking while the move in yields is based around an optimism that the current re-opened economy will soon recover further. In Australia the economic data highlights were unemployment dropping to 6.4% and consumer confidence rising to 109.1 points. The wage print at +0.6% in the quarter also caused some comment.

Chart 1: 3Y and 10Y bond movements



Global Credit

Credit outperformed government bonds in February. However, this masked a volatile month, with spreads bouncing in a 10bps range for financials and 12bps for non-financials. Overseas banks, infrastructure, materials and REITs experienced the largest monthly range in spreads as bond market ructions flowed through to credit markets. Secondary bond spreads continued to trend tighter

Large Australian banks provided trading updates or profit results. Generally the majors reported better than expected profit results, with some evidence of worsening asset quality – though this was not as bad as expected. The reporting season showed that corporate credit metrics have deteriorated in the six months to June, but operating performance for most companies has started to recover from the fallout of COVID-19. Total leverage in the system increased as earnings continued to decline. Companies have continued to cut costs to offset the impact of COVID-19. Dividend payouts have increased. Mergers and acquisition activity have remained low and many companies will be looking for opportunities to sell more assets to reduce debt.

Commodities

Commodity prices were mixed last month. Industrial metals, oil and iron ore recorded gains on growth hopes in China and abroad. Meanwhile, coal, precious metals and spot LNG saw prices fall in February.

Gold prices fell in February as US 10 year real yields (US 10 year nominal yields less US 10 year inflation expectations) increased.

Oil prices also rose strongly in February on demand hopes linked to a recovering global economy. Oil demand is particularly sensitive to COVID-19 given that transportation accounts for two-thirds of global oil consumption. OPEC+ supply discipline also helped oil prices last month. OPEC+ meet later this week to decide oil supply plans for April.

Iron ore prices tracked higher in late February, on demand hopes after the Lunar New Year holiday period (11-17 February) in China. Demand is expected to pick up faster than usual after the Lunar New Year holiday period as a number of migrant workers stayed put during the Lunar New Year holiday period because of a COVID-19 outbreak in China in early February.

Global Equities

February was a turbulent month for global share markets. US shares hit record highs and both European and Aussie shares straddled 12-month highs, fuelled by government stimulus and aggressive monetary policy support. But rising government bond yields blunted momentum with the US 10-year Treasury yield up 0.369 percentage points over the month – the biggest increase since November 2016. Bond yields lifted on inflation concerns, prompting concerns that central banks may increase interest rates sooner-than-expected. But the big sell-off in shares in the final week wasn't enough to offset the solid gains made over the first two weeks of the month.

Overall in February, the US Dow Jones index rose by 3.2%, the S&P 500 index gained 2.6% and the Nasdaq index rose by 0.9%. In Europe, the German Dax index lifted 2.6% and the UK FTSE 100 rose by 1.2%. Japan's Nikkei 225 index outperformed to be up 4.7%, while Australia's S&P/ASX 200 index lagged, up 1.0%.

Eight out of Australia's 22 sub-industry sectors posted gains in February. Leading the gains was Household & personal products (up 10.3%) from Materials (up 7.2%). But Software & services and Retailing (both down 9.1%) fell most. Of the size categories, the ASX 50 index (up 1.5%) rose most from the Small Ordinaries index (up 1.4%), the ASX100 index (up 1.0%), but the ASX MidCap50 index fell 1.8%.

Australian Dollar

The trade weighted index increased by 2.4% in February. The Australian dollar increased against all currencies under our coverage except GBP in February.

AUD/USD dipped by only 30bp after the RBA announced it would buy an extra $A100bn of national and state government bonds when the current Quantitative Easing (QE) program ends in mid-April 2021. The aim of the RBA's QE program is to contribute "to a lower exchange rate than otherwise".

AUD/USD increased by more than 4 US cents from early February to 25 February. The continued rapid increase in commodity prices, and the increase in Australian bond yields compared to US bond yields, underwrote gains in AUD/USD. AUD/USD increased above 0.8000 for the first time since February 2018.

However, the increase in financial market volatility caused a sharp 3 US cent fall in AUD/USD towards the end of the month. Despite the increase in volatility, commodity prices generally held onto their gains

Table 1 – Australian dollar February performance

AUSTRALIAN DOLLAR			
	End Jan	**End Feb**	**M/M %**
	29-Jan-21	**26-Feb-21**	**Change**
AUD-USD	0.7644	0.7706	0.8
AUD-JPY	80.03	82.13	2.6
AUD-EUR	0.6298	0.6383	1.3
AUD-GBP	0.5576	0.5533	-0.8
AUD-CHF	0.6811	0.7006	2.9
AUD-CAD	0.9768	0.9819	0.5
AUD-NZD	1.0638	1.0653	0.1
TWI	63.0	64.5	2.4
Month High		0.8007	25-Feb-21
Month Low		0.7564	2-Feb-21

Source: Bloomberg, CBA

Australian Property Prices

The CoreLogic data showed that dwelling prices across the eight capital cities combined rose by 2.0% in February 2021. This is a strong lift and was driven by rising prices for both houses (3.0%) and units (1.2%). Over the year dwelling prices are up by 2.6%.

Momentum is clearly stronger in the market for detached houses relative to units at present. Since August 2020 house prices have risen by 5.5% while units are up by 0.8%. The lending data shows that owner-occupiers who are trading up and first buyers were the driver of the lift in lending over H2 20. But this year investors have joined in too (see our write up of the latest lending figures below). Investors have historically had a bigger presence in the apartment market. So stronger investor activity may help to support this part of the market.

There were lifts across all the capital cities ranging from 0.7% in Darwin to 2.5% for Hobart and Sydney. The combined regions rose by 2.1% to be up a strong 9.4% over the year. The combined regions have outperformed the eight capital cities over the COVID-19 pandemic. Our analysis shows that there have been less people leaving the regional areas for the city over the pandemic period increasing the demand for housing in regional areas (see here). The quick shift towards working from home that occurred during the pandemic has also increased the feasibility of living in a regional area for many people.

The leading indicators of dwelling prices are strong. In particular lending is growing at a strong pace and auction clearance rates are very high. We have forecast strong gains ahead of 14% over the next two years. We see the risks as skewed towards an even stronger outcome (see here).

Rising dwelling prices could support economic recovery in a couple of ways. Firstly, rising dwelling prices generate positive wealth effects and tend to go alongside stronger spending on certain goods like cars. Secondly, when people move dwelling we generally see stronger spending on household furnishings and appliances for the new home. The Government’s HomeBuilder grant scheme and ultra low mortgage rates have seen huge surge in approvals for new detached houses. And these homes will need filling and decorating.

Chart 2 – Dwelling Price moves – by apartment and house

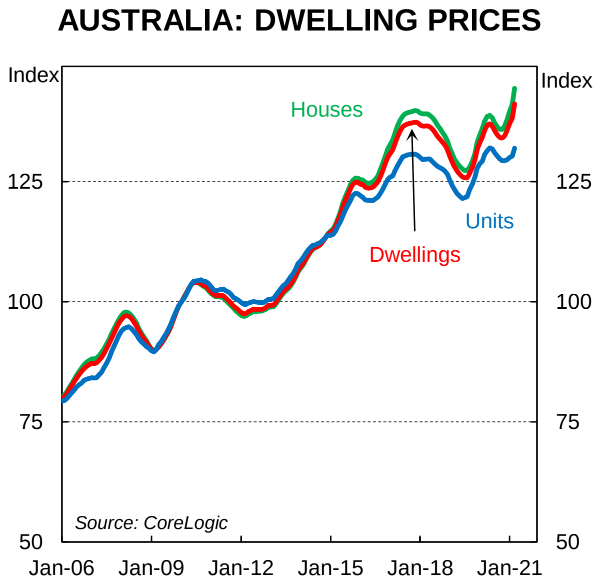


Chart 3 – Dwelling Price Index

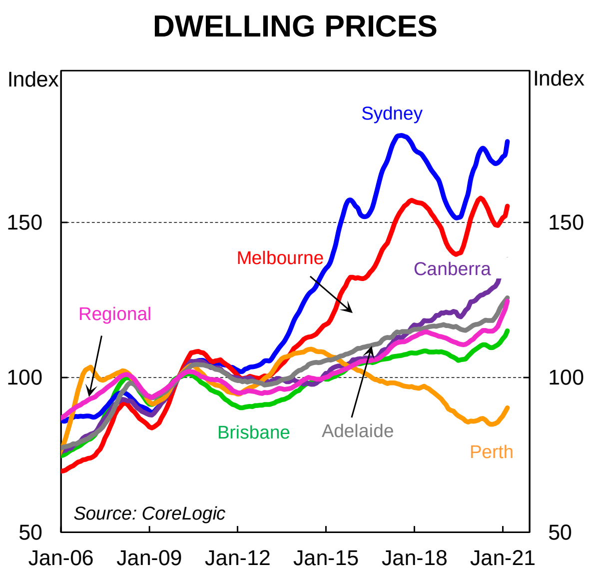
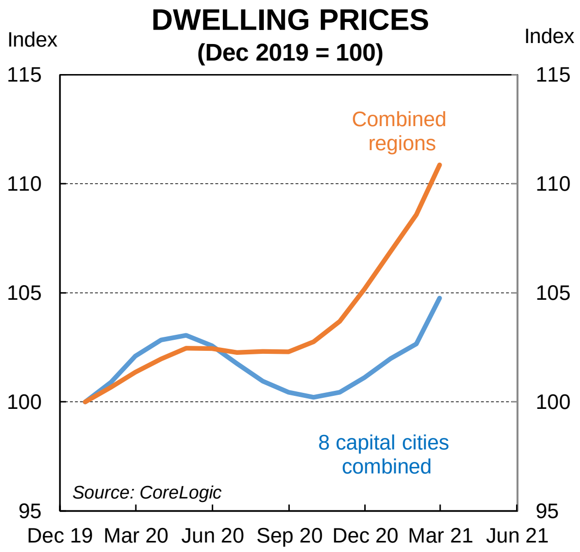


Chart 4 – Prices by capital cities and regions



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