Markets Summary – May 2021

Taken from the CBA Global Markets Research report, "May Month in Review", first published on 1 June 2021 and "Dwelling Prices – May 2021" first published on 1 June 2021.

Highlights in May

- Bond yields finished the month little changed.
- Credit markets were quieter.
- Commodity prices lifted.
- Environmental, Social and Governance (ESG) deals continued to be a big part of the Australian debt landscape.
- Equities enjoyed another month of gains.
- The Australian dollar (AUD) fell against most currencies.
- Dwelling prices rose by 2.3% across the eight capital cities combined, with Hobart and Sydney rising strongly.

Summary

Bond yields finished the month a little higher in the short end, and lower in the long end. Short-term cash rates were stable. Credit markets were stable and saw a large drop in the volume of deals to $A500m, while spreads remained stable. Once again, commodity markets enjoyed buoyant moves, with a very strong rise is Australia's bulk commodity export prices. Equities performed well in May, led by gains offshore.

Cash

In its May policy meeting, the Reserve Bank of Australia (RBA) left monetary policy unchanged and announced it will make a decision on its yield curve control and Quantitative Easing (QE) program at its 6 July meeting. Given the improving Australian economic outlook, the RBA significantly upgraded its economic projections in its May Statement of Monetary Policy. In particular, the RBA's central scenario sees Gross Domestic Product (GDP) rise by a very strong 5.25% in 2021 and 4% in 2022. The unemployment rate is forecast to be 5.0% at end-2021 and 4.5% at end-2022. Nevertheless, the RBA noted that it expects the pickup in wages and inflation to be "only gradual and modest".

Australian money markets were impacted by US developments this month. There is a significant surplus of United States Dollar (USD) in the system, and this is also being swapped and invested in other currencies – meaning there was extra demand for AUD short-term investments.

Short-term interest rates, including the six-month Bank Bill Swap Rates (BBSW) drifted slowly lower in May, down 1.15bp to 0.0850% by month-end. The three-month BBSW rate fell 0.40bp to 0.0360%. The one-month BBSW rate fell 0.50bp to 0.0100%.

Assumed RBA pricing dropped marginally in May, though the anticipation of actual cash rates returning back towards the target of 0.10% by mid-2022 remains.

Australian and Global Fixed Interest

The main focus of May for markets was the Federal Budget. This saw an extra dollop of longer-term stimulus, but weaker economic data and another Coronavirus outbreak towards the end of May saw yields fall slightly in Australia. The overall stability of yields was noteworthy, with very little movement over May as a whole, or at any particular time during May.

The 3-year bond (Apr-24) remains under the RBA's Yield Curve Control (YCC) program, but still managed to fall 3.75bp to 0.0625%. The 10-year bond (Jun-31) fell 6bp to 1.635%. The 10-year yield traded in a tight range of 1.58% to 1.76%.

The United States (US) markets had a similar pattern, with yields relatively range-bound but drifting slightly lower. The US 2-year rallied 2bp to 0.15% over May. The US 10-year rallied 3bp to 1.61%. The mild Australian Commonwealth Government Bonds (ACGB) outperformance in May saw the 10-year spread move from 5bp to 4bp.

The May RBA meeting was relatively uneventful, but the RBA continued to highlight (both at the meeting and in subsequent communications) that the July meeting would see major decisions made about the future of the YCC program and the Bond Purchase Program (BPP).

The May Federal Budget was stimulatory and generally well received. There had been significant improvement in the underlying expectations for the years 20/21 and 21/22 with much smaller deficits and lower debt overall. However, extra spending in the earlier years actually increased the deficits in later years. The current Budget plan remains exceptionally stimulatory across the entire forward estimates. (See chart.)

The near-term improvement allowed the Australian Office of Financial Management (AOFM) to announce a reduced borrowing program of $A210bn in 2020/21 and only $A130bn in 2021/22. This was a mild surprise and caused some small outperformance by bonds.

The economic data has been reasonable in May, without being particularly good and without signs of the self-reinforcing lift-off some had hoped for. For example, wages grew 1.6% in the quarter while the unemployment rate fell to 5.5% - but this fall was driven by a fall in the participation rate to 66.0% and came with a 30.6k fall in total jobs. Retail sales grew 1.3% in the month, but the retail sales ex inflation fell 0.5%.

Global Credit

After a busy April, corporate issuance in May slowed down. Total non-financial issuance in May was only $A500m, below long-term average of $A910m. Yet given the heavy volumes we saw in March and April, Year To Date (YTD) non-financial issuance is strong at $A7.4bn, well above long-term Jan-May average volume of $A3.9bn.

A couple of Real Estate Investment Trusts (REITs) gave their quarterly updates this month. Vicinity and Scentre reported that customer visitations and cash collection rates have improved in recent months, but the outlook remains uncertain for Central Business District (CBD) centres. The concern is that the new Coronavirus outbreak in Melbourne could delay the recovery in shopping centre foot traffic in the coming weeks. Dexus reported a slight decline in office occupancy.

Commodities

Commodity prices finished mostly higher in May on the back of a weaker US dollar. Only a few commodities though saw notable gains like coking coal, thermal coal, spot Liquefied Natural Gas (LNG) and gold. China's crackdown on commodity speculators saw price gains pare back in mostly steel, iron ore and base metals. Oil was the only major commodity that saw prices finish the month a touch lower than where it began.

Coking coal prices surged through the back half of May as demand outside China picked up. Australian coking coal prices have found support from higher Atlantic basin coking coal prices as buyers outside China look to source the cheapest coking coal. Demand for Atlantic basin (US and Canadian) coking coal has broadly increased over the last six months due to stronger demand from China. China's demand for Atlantic Basin coking coal has lifted because of the country's unofficial ban on Australian coking coal. It's worth noting that Chinese domestic coking coal prices continued to rise despite the recent pullback in Chinese steel prices. That is likely to support Atlantic Basin coking coal prices and demand.

LNG spot prices drifted higher in May on concerns that warmer-than-usual summer temperatures will drive stronger gas demand in North Asia. Higher than average temperatures are already forecast for Beijing, Shanghai, Tokyo and Seoul in the beginning of June.

Iron ore prices surged in the first half of May – rising to record highs of $US233/t (62% Fe, CFR China) on May 12. Prices though pulled back by nearly ~20% in the following 12 days as Chinese policymakers looked to restrict commodity speculators and hoarders. The rapid fall in steel mill margins in China shows just how quickly market conditions have changed for iron ore. China's steel mill margins have declined ~80% since peaking on May 12 and are now back at levels last seen in late March. Lower steel mill margins in China usually leads to lower iron ore prices and vice versa.

Global Equities

Over May, global bourses were generally higher. In the US, value stocks were favoured over growth stocks. The US Dow Jones rose 1.9%; S&P 500 rose 0.6%; but the Nasdaq fell by 1.5%. In Asia, the Japanese Nikkei rose 0.2% as the Aussie ASX 200 rose 1.9% (eighth straight gain). And in Europe, the German Dax rose 1.9% with the UK FTSE rose by 0.8%.

In Australia, seven of the 11 industry sectors posted gains led by Financials (up 4.4%) and Heath Care (up 3.5%). Information Technology lost 9.9% with Utilities down 7.0%). Across size groupings, the blue chip ASX20 rose 3.1%, while the Small Ordinaries rose just 0.2%.

Chart 1: Monthly moves for ASX200

Australian Dollar

The Australian trade-weighted index decreased by 1.4% in May. The AUD fell against all major currencies except the USD and JPY.

Strong commodity prices helped AUD/USD reach its month high of 0.7891 at the beginning of the month. Notwithstanding, AUD/USD quickly pared those gains because of flare ups in Australia-China government relations. A weaker than expected Australian labour market report for April also briefly undermined AUD/USD. AUD/USD spent the second half of the month fluctuating around 0.7750.

Table 1 – Australian dollar May performance

AUSTRALIAN DOLLAR			
	End Apr 30-Apr-21	**End May 31-May-21**	**M/M % Change**
AUD-USD	0.7716	0.7734	0.2
AUD-JPY	84.34	84.75	0.5
AUD-EUR	0.6415	0.6325	-1.4
AUD-GBP	0.5582	0.5441	-2.5
AUD-CHF	0.7045	0.6951	-1.3
AUD-CAD	0.9483	0.9330	-1.6
AUD-NZD	1.0770	1.0638	-1.2
TWI	64.4	63.5	-1.4
Month High		0.7891	10-May-21
Month Low		0.7675	4-May-21

Source: Bloomberg, CBA

Australian Property Prices

The CoreLogic data shows that dwelling prices rose by a strong 2.3% across the eight capital cities combined in May 2021. This is stronger than the April lift of 1.8%, but below the record breaking rise of 2.8% in March.

Prices rose in all capital cities in the month, but the range of gains were wide. Sydney lifted by 3.0% and Hobart was up by 3.2%. At the lower end of the gains was Perth, with prices up by a still strong 1.1%. Over the past year prices have risen the most in Darwin (+20.3%) and Hobart (+16.5%). The smallest rises have been in Melbourne (+5.0%) and Perth (+8.5%).

Prices in the combined regions were up by 2.0% and have outperformed capital cities over the past year. There are some tentative signs this trend of outperformance may be softening. Prices in the combined regions are up by 15.2% over the year as the desire for more space and people being able to work from home has likely increased the relative attractiveness of regional areas.

Price rises for units have underperformed price rises for detached houses in the recovery. Detached house prices have risen by 14.4% since September 2020, while unit prices have risen by 6.8%. This has been driven by two main forces; owner-occupiers were the first to return to the housing market post the worst of COVID-19 and the desire for more space post lockdowns fuelled the recovery in detached houses. While the closure of international borders has reduced demand for units. Once borders are reopened and student numbers rise, we expect that there will be some catch up for units.

The top end of the housing market, defined as properties in the top 25% of prices, is outperforming the more affordable end of the market, the opposite to late 2020. Since September 2020, the upper quartile has risen by 14.3%, compared to the lower quartile of an 11.3% gain. This has particularly been the case in Sydney, less so in Melbourne.

Turnover for houses has also lifted sharply since mid-2020. Stronger turnover tends to lead to a lift in spending on things like household furnishing and equipment. New listings have also risen in recent months.

Chart 2 – Dwelling Price moves – by apartment and house

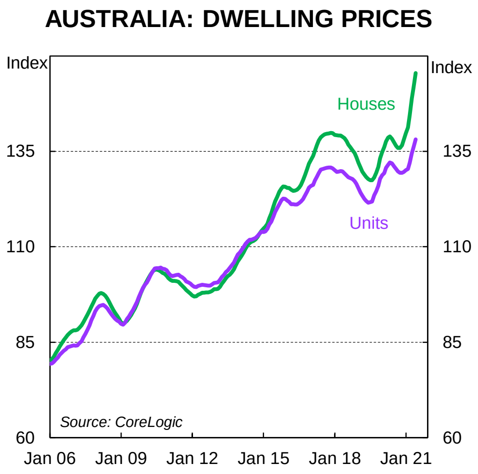

Chart 3 – Prices by capital cities