MarketWatch

Market Watch

January Review 2020

The Coronavirus outbreak has sent ripples through global financial markets; disrupting world-wide trade and supply chains, pressuring asset prices and forcing multinational businesses to make decisions around trade and employee well-being. The Australian economy is currently suffering from bushfires and drought, below trend consumer confidence, all of which have harmed in particular the tourism and farming sectors. Britain has been hit by a case of Brexit blues as the UK formally left the European Union.

Developments in Global Economy

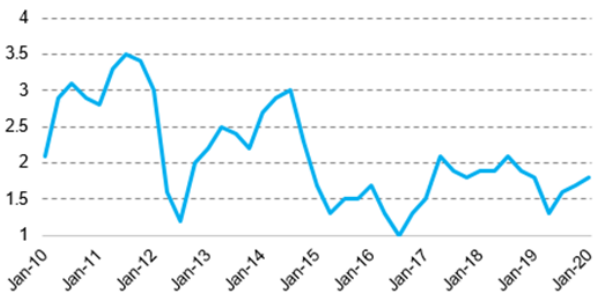
Australia

The economic damage from the bushfires along Australia's eastern seaboard is likely to exceed the $4.4bn record set by 2009's Black Saturday blazes, Moody's Analytics reported. Damage to fresh produce has put upward pressure on consumer prices. The coronavirus outbreak is further impacting the economy, with comparisons made to the 2003 Severe Acute Respiratory Syndrome (SARS) outbreak, which also impacted stock and currency markets. So far the coronavirus impact is similar, but whether it follows the same longer term pattern depends on how widespread the outbreak becomes. Sectors including education and tourism are likely to suffer the most, particularly whilst the Morrison government keeps travel restrictions in place. Simon Westaway, the executive director of the Australian Tourism industry Council said that the body is working on an estimate of the "significant" hit the sector will take from the ban on Chinese nationals entering Australia.

National housing finance data posted another robust gain in November, 1.8%, to be up by 5.9%. Investor credit grew more strongly over the month than owner-occupier loans, 2.2% and 1.6% respectively. Although, owner occupier credit remains the primary recovery driver for housing that began May 2019, gaining 20.5% to November, versus 10.9% for investors.

The Australian economy recorded another trade surplus in December, rounding out two straight years of monthly surpluses. Exports picked up 1.4% in December, higher by 8.3% than a year ago with export prices falling 5.2% in Q4. Import prices picked up 0.4% in Q4 amid moderate demand. Commodity exports such as iron ore and mineral fuels have slowly recovered in the last two months, after prices fell sharply over the September quarter. Despite ongoing drought and bushfires, rural-good exports rose in December.

Chart 1: Australian CPI



Source: BTIS/Bloomberg

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people's choice CREDIT UNION

According to the Westpac-Melbourne Institute Index of consumer sentiment, consumer sentiment fell 1.8% in January to 93.4. A fall in confidence was expected, given the impact of the devastating bushfires. Underlying detail in the survey showed an increase in housing sentiment, including an 8.1% increase in the house price expectations index. The overall low level of confidence is consistent with soft consumer spending and overall economic outlook uncertainty.

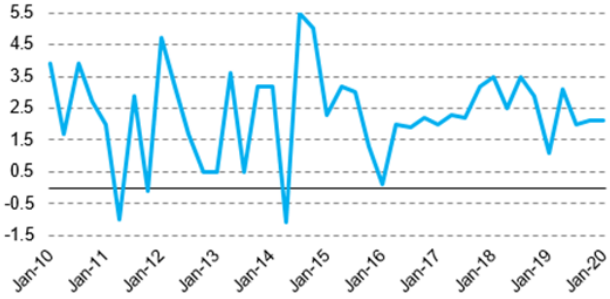
Retail sales picked up in November with a better-than-expected result at of 0.9%, taking annual growth to 3.3%. Indications are that Black Friday sales encouraged consumers in doing their Christmas shopping early. Retail conditions have improved slightly, but remain depressed due to the current economic conditions and lower than trend consumer confidence. High household debt and low wages growth continue to weigh on consumer spending. A 0.9% fall in restaurant and takeaway spending was attributed to disruption related to the bushfires.

December quarter headline inflation rose 0.7%, taking the seasonally-adjusted annual inflation rate up 1.8% from 1.7% in the previous quarter. It was the highest inflation rate since Q4 2018. Significant price rises were tobacco (+8.4%), domestic travel (+7.3%) and fruit (+6.8%). Price falls were international travel (-2.9%) and women garments (-2.5%). Core inflation prices increased 1.6% in Q4, consistent with previous quarters.

United States

US and China finalised the stage one trade agreement, signing the deal and releasing its full terms. In line with the announcement made before Christmas, the US will refrain from increasing further tariffs and will also halve the 15% rate introduced on circa US$120bn of imports in September 2019 to 7.5%. The 25% tariff on US$250bn of imports remain in place. President Trump also signed a trade agreement with Mexico (USMCA). Economic data showed the goods trade deficit widening in Q4. Furthermore, Trump's impeachment trial has been passed up the senate (Republican dominated), where the trial is taking place. Senators are convening to consider whether impeached President Donald Trump should be removed from office for committing 'high crimes and misdemeanors. Expectation is however that as the Republicans hold the balance of power in the Senate, acquittal is somewhat guaranteed.

Chart 2: US GDP (Annualised)



Source: BTIS/Bloomberg

The US economy expanded at 2.1% in Q4 - the same as in Q3 – closing out a year in which GDP decelerated to its slowest pace in three years amid a continuing drag in business investments. Personal consumption slowed more than anticipated, reading 1.8% in the final quarter compared to 3.2% in Q3. The 2.3% growth in US gross domestic product for the full year was below the 2.9% increase from 2018 and the 2.4% gain in 2017. The Federal Reserve's preferred inflation measure – the core personal consumption expenditure index – rose at an annualised pace of 1.3%.

The Federal Open Market Committee (FOMC) retained the Federal funds target rate unchanged at 1.50-1.75%. Chair Jerome Powell characterized economic growth as "moderate" and the labour market as "strong", and reiterated that the FED's see inflation to its objective of 2%.

Asia

The outbreak of the coronavirus has sent shockwaves through the global financial markets with increasing levels of uncertainty evident in China and other regions. The World Health Organisation has declared a public health emergency of international concern. The epidemic has resulted in quarantine and travel restrictions imposed across the Chinese Tier 2 city of Wuhan as authorities attempt to prevent the spread of the virus. The response to stem the spread will create a drag on economic activity in China and its surrounding neighbours as infrastructure networks are closed and residents are confined to their homes. The outbreak comes at a period when the Chinese economy was seeing signs of stability due to prior monetary and fiscal policy enactment.

The official manufacturing PMI for China came at 50.0 for January as reported by the National Bureau of Statistics. The survey was conducted before the coronavirus outbreak. Chinese officials have warned that the survey would not encapsulate the impact of the new coronavirus outbreak, as the survey was conducted before January 20th. Services PMI fell to 53.0 in January.

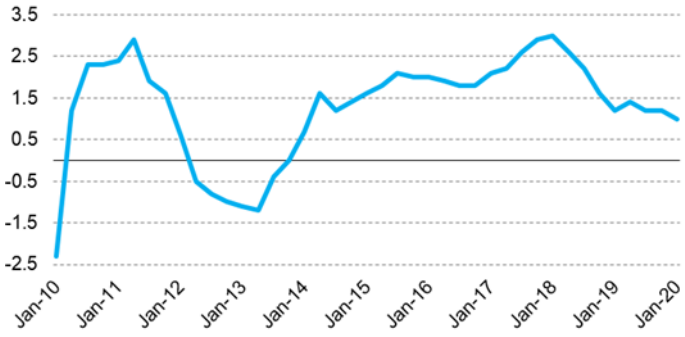
China and the US have signed the 'phase one' trade deal. Although existing tariffs remain, China has agreed to buy an additional US$200 billion in US agricultural, manufacturing, energy and services exports over the next two years. China will provide greater access to sectors and will strengthen intellectual protection. Furthermore, authorities have cut the bank reserve requirement ratio by 0.5% to 12.5% in January, down from 14.5% one year earlier. This has helped boost credit growth by 10.7% over the year. Inflation remains at 4.5% in December, driven by doubling pork prices as African swine fever swept through China's hog herds.

Japan's Jibun Bank Manufacturing PMI was revised to 48.8, compared to December's 48.4. The Services PMI read 51 for the month, pointing to the strongest expansion in the sector since September. New orders grew for the 42nd month and export sales increased. Japan's consumer price inflation rose to 0.8% year-on-year in December from 0.5% in November – marking the highest rate since April 2019.

Europe

The Bank of England (BOE) stood pat in BOE Governor Mark Carney's final meeting. Officials voted 7-2 to keep they key rate unchanged at 0.75%, belying investor expectations that the decision was on a knife-edge. BOE sets monetary policy to meet its 2% inflation target and to sustain growth and employment. According to Rightmove, UK house prices rose 2.3% over the month in December. Growth has been flat in previous months as Brexit uncertainty weighed on the property sector. On an annual basis, prices were 2.7% higher.

Chart 3: Eurozone GDP (Annualised)



Source: BTIS/Bloomberg

The UK has officially left the European Union after 47 years of membership with Brexit officially occurring on 31 January. The departure comes three years after the country voted by a margin of 52-48 per cent to walk away since it joined in 1973. Prime Minister Boris Johnson now faces 11 months of talks to agree on a trade deal before transition period ends on December 31. The UK will follow EU laws during the transition period.

The 50th Annual Meeting of the World Economic Forum (WEF) in Davos, Switzerland was held. Business, government and civil society were gathered to discuss the most pressing global issues with a view to improving the state of the world. The overarching theme of the event was climate change and the challenges of building more sustainable economies. The WEF annual risk report survey listed climate related environment threats as the top five global risks likely to have a major economic impact over the next ten years.

Christine Lagarde, President of the European Central Bank, has launched a review of its monetary policy strategy, which was adopted in 1998 with some elements clarified in 2003. The review - to be concluded by year end - will encompass quantitative formulation of price stability, economic and monetary analyses and communication practices with all stakeholders. The ECB may reset the inflation goal and study alternative measures of price growth. Furthermore, the ECB has left the key rate and their quantitative easing program unchanged.

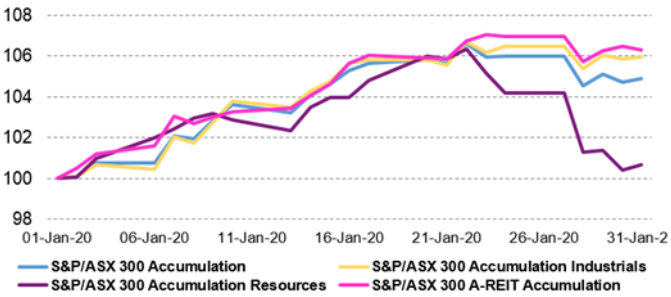
Development in Financial Markets

Australian shares

Disturbances continue to build up for the Australian share market, but it has remained resilient in the forefront of the bushfire crisis and China's worsening coronavirus outbreak. The S&P/ASX 300 Accumulation was up a healthy 4.89%. The S&P/ASX 300 Industrial Accumulation returned 5.97%, while A-REIT's were up a strong 6.30%.

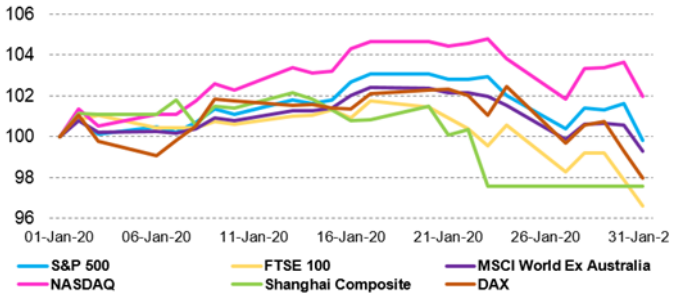
On a sector basis, the strongest contributors were Healthcare (+9.42%), Info Tech (+7.26%) and Consumer Staples (+4.76%). Utilities (-1.26%) and Energy (-0.97%) were lagged the greatest over the month.

Chart 4: Australian shares (rebased to 100)



Source: BTIS/Bloomberg

Chart 5: Major Market Indices (rebased to 100)



Source: BTIS/Bloomberg

International shares

Despite periods of volatility, 2019 was one of the best years for equity returns in decades with Wall Street closing at an all-time high, even with markets being preoccupied with the unexpected spread of the coronavirus.

MSCI World ex Australian Unhedged returned 4.35% for month, compared to -0.86% in December 2019. The Shanghai Composite fell -2.41% on Jan 23rd – its last day of trading before the Lunar New Year. The Hang Seng and Korean KOSPI were also in negative territory, returning -6.66% and -3.58% respectively. On the other side, the Nasdaq Total Return was a positive 2.03%, while the DAX receded coming in towards the end of January closing at -2.02%.

Fixed interest

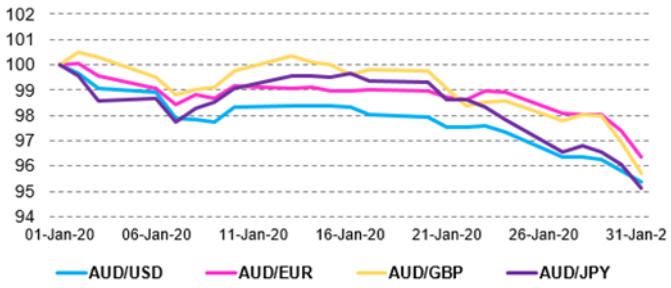
Coronavirus fears created a bid for safe havens that pushed the yield on 10-year Australian government bond below 1%, moving 42 bps since the beginning of the month. The Australian bond markets delivered a 2.33% return based on the Bloomberg AusBond Composite, while the Bloomberg AusBond Bank Bill Index returned at 0.08%.

The US bond market responded nervously to the US administrations assassination of Iran's top military general, reflecting a nine basis -point drop in the US 10-year Treasury yield. The US-10 year Yield finished the month of at 1.51%, compared to 1.92% in last month. At the shorter end of the curve, the US 2-year Treasury yield finished off at 1.35%

Currencies

With global currency markets interlinked and significant event in one economy filters through to others. The Australian dollar is connected closely to China's economic performance as it is their largest trading partner. China's isolation amid the coronavirus outbreak – a rare freeze for a vital economy – is rippling across the world's currencies. The flight to safety saw the Australian dollar against the US dollar fall -4.69%, a 3 cents drop compared to early January. The EUR/USD and the GBP/USD were also in negative territory, with -1.07% and -0.38% respectively.

Chart 6: Major Currencies (rebased to 100)



Source: BTIS/Bloomberg

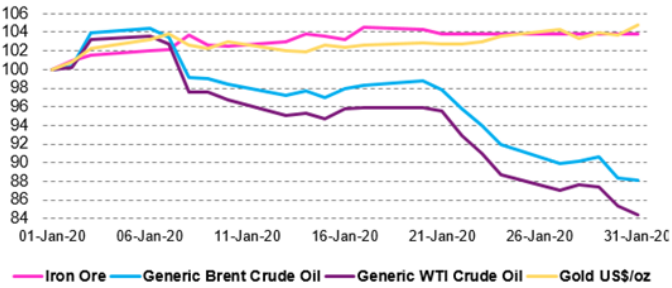
Commodities

Tensions between the US and Iran have been rising since 2018, when the US pulled out of a nuclear deal meant to curb Iran's nuclear program and prevent nuclear weapon production. The US also re-imposed sanctions on Iran. The US airstrike that killed Iran's top military leader early January set off new uncertainty around geopolitics and financial markets. Oil prices rose sharply afterthe event in early January.

The Bloomberg Commodity Index ended the month in negative territory, delivering a -7.48%. Oil prices fell and spiralled towards its worst monthly performance since May 2019 on growing alarm that the coronavirus outbreak is crimping fuel demand. OPEC is to consider moving its March meeting to next month. Prices of oil surged mid-month as two large production bases in Libya shut down amid a military blockade. Meanwhile, anti-government protests in Iraq disrupted production. Generic Brent Crude oil returned at -11.88%, finishing at $58.16. Generic WTI Crude oil delivered a -15.56%, closing at $51.56 per barrel after a monthly high of $63.27.

Furthermore, the price of Australia's most important export to China, iron ore, fell 11% in January due to the virus outbreak, according to ratings agency Moody's.

Chart 7: Major Commodities (rebased to 100)



Source: BTIS/Bloomberg