Monthly Commentary - February 2020

Over the month of February, we saw the Coronavirus (COVID-19) threaten to derail the revival in global economic growth which began in the latter part of 2019. Domestically, the current account recorded its 3rd consecutive surplus. Unemployment rates moved further away from the RBA's goal. Equities were under pressure as the month closed, with the largest weekly declines since the GFC.

Developments in the global economy

Australia

The Coronavirus is spreading across the world, with four epicentres other than China; Iran, Italy, South Korea and Japan. Australian Prime Minister Scott Morrison has labelled the COVID-19 outbreak a 'global health crisis', warning that economic impacts are stretched across further than just the education and tourism sectors – disrupting supply chains and manufacturing. Treasurer, Josh Frydenberg, upon his return from a G20 finance ministers' meeting in Saudi Arabia, has acknowledged the economic hit from the virus outbreak could be worse than the bushfires amid fears that the "shutters could come down on the global economy".

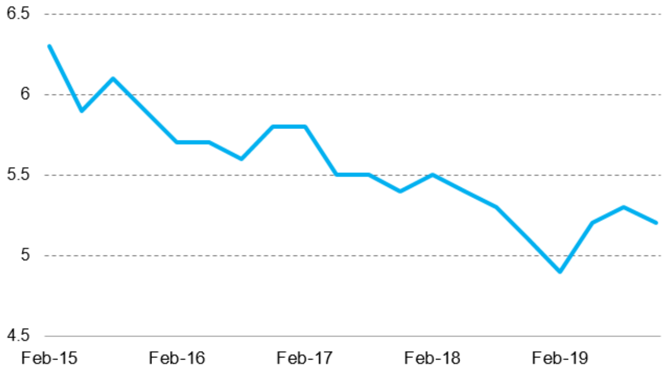
For the first meeting of the year, the Reserve Bank (RBA) left the cash rate on hold at a record low of 0.75%. Following on the decision, the RBA hinted its key forecasts would remain broadly unchanged. The accompanying statement showed a renewed sense of positivity regarding the economic environment. The Quarterly Statements on Monetary Policy by the RBA was released, hinting an optimistic forecast for economic growth this year; expecting growth to return to trend in 2020 after a sub-par 2019. GDP is expected to be 2¾% over 2020 and 3% over 2021. Clearly, with recent events as markets moved into March has abated much of this optimism.

The Westpac-Melbourne Institute Index of Consumer Sentiment rose 2.3% to 95.5 in February from 93.4 in January. Despite improvements this month, the index remains below the long run average of 101.4 and firmly in pessimists territory (readings below 100 indicate that pessimists outnumber optimists). February's lift most likely reflects the easing concern regarding the bushfires, despite negative developments - particularly the coronavirus epidemic abroad.

The unemployment rate has jumped to 5.3% - from 5.1% December – further distancing from the RBA's goal of a 4.5% unemployment rate. This is after two consecutive improvements during the end of last year. Despite 13,500 new jobs created in January. The increase in unemployment was due to a rising participation rate, being up 66.1% in January, from 66.0% in December. Wages growth remained sluggish in the December quarter despite the spare capacity in the labour market.

The Australian economy posted a modest 0.5% increase in Q4. Annual growth increased to 2.2%, although up from 1.8% in Q3, it remains below trend which is around 2.75%. Furthermore, the current account registered its third consecutive surplus in Q4 – the first time since 1973. The surplus printed $0.96b - representing 0.2% of GDP - narrowing down from AU$6.5bn in Q3. Falling prices of commodities and deterioration of terms of trade have put sinking pressures on the surplus. The terms of trade index fell 5.3%, led by a 6.5% fall in the goods index over the quarter. On annual basis, the terms of trade ended 2019 slightly lower by 0.6%. The Australian economy may suffer a bigger dip due to the overwhelming importance of China in Australia's trade in goods and services as restriction in global supply chains drag.

Chart 1: Australian Unemployment Rate



Source: BTIS/Bloomberg

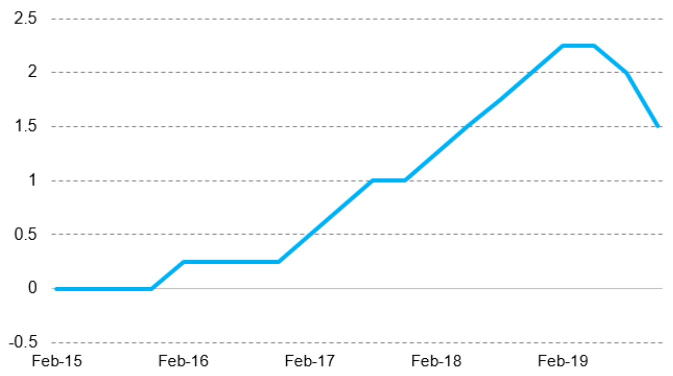
United States

The US Centre for Disease Control and Prevention (CDC) issued a statement warning Americans to prepare for the spread of the coronavirus on US soil. It advised that there would be a significant disruption to daily life if the virus spread, and said that the US is taking an emergency plan that closely resemble actions taken from other countries. US Federal Reserve's Charles Evans said central bank officials are observing the situation. Furthermore, Fed Chairman Jerome Powell said the virus "poses evolving risks" to US economic activity. Apple warned of the potential for a global iPhone supply shortage resulting from its Chinese factories being shut due to the outbreak. The tech giant claimed it will potentially fail to meet its quarterly revenue target of $63-67 billion due to the supply shortage for willing buyers.

The US GDP remained unrevised at an annualised rate of 2.1% in Q4 of 2019, compared to 3.1% in Q1. However, the underlying US demand in the economy was slower than reported. The trade deficit in goods narrowed to US$65.5 billion in January from US$68.7b in December. Import levels sank faster than exports.

The University of Michigan's headline consumer confidence index rose from 99.8 in January to 101.0 in February – the last highest rate was in March 2018. From the statistics, consumers seem to be disregarding COVID-19 threats, however this may be temporary as number of US cases and fatalities reported is rising. Consumer spending had a 0.2% rise in January, compared to 0.4% in December. The Core Personal Expenditure (CPE) deflator rose 0.1% in January, while year-end growth rose 1.6% up from 1.5% in December 2019. The US Federal Reserve target is 2% per annum. Pending home sales rose 5.2% in January, reversing course from December's decline. Housing supply and mortgage rates are low, aiding demand.

Chart 2: US Interest Rate



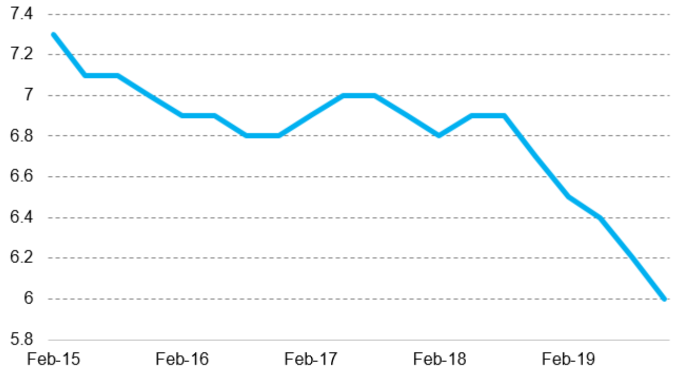
Source: BTIS/Bloomberg

Asia

Extreme quarantine restrictions have begun the shut down of factories and public gatherings across Asian regions. Containment efforts, has affected demand and supply chains on manufacturing as companies are running below capacity with higher shutdown periods. Asian countries such as Japan and South Korea have outlined fiscal measures to aid affected sectors.

The People's Bank of China (PBoC) is putting emphasis on keeping monetary policy flexible as its steps to supports the real economy. It will continue to implement financial policies designed to support epidemic prevention and control efforts, including strengthening countercyclical adjustments of monetary policy and ensuring stable functioning of the financial markets. Short-term, the authorities have made corporate loan conditions easier by reducing rates. China is on track for its worst first-quarter performance on record, with the latest figures set to inject fear into already volatile share markets. The Caixin measure for the manufacturing purchasing managers' index (PMI) fell to 40.3 in February – the lowest level since the survey began in April 2004 - from 51.1 in January. Non-Manufacturing PMI tumbled to a record low of 29.6, while the Services PMI plunged to 26.5 in February from a 51.8 in January.

Chart 3: China GDP (Annualised)



Source: BTIS/Bloomberg

The Japanese economy shrank -1.8% in the December quarter, following a downwardly revised 0.1% growth in Q3. It was the steepest falls in GDP since Q2, 2014. Department stores fell 2% over the year to December. Japan's trade deficit narrowed to JPY 1.31 trillion in January 2020 from JPY 1.42 trillion in the same month, last year. It marked the third consecutive month of trade deficits. The low value is due to decreased shipments of car and machines to the US and car part sales to China.

Europe

British Prime Minister Boris Johnson has threatened to walk away from Brexit talks in June if significant process has not been made. The UK's negotiating mandate has been published. Johnson has rejected European demands to submit to independent oversight of Britain's laws. Britain's chancellor, Sajid Javid, has quit weeks before the scheduled annual budget statement, in a shock move provoked by Prime Minister Boris Johnson's attempt to shake up his cabinet after Brexit. Javid was replaced by 39-year old deputy, Rishi Sunak. Former Brexit Minister Steve Barclay took over Sunak's position as chief secretary to the Treasury.

The UK received an update to its annual GDP growth for 2020 to 1.1% - from 1.2% in Q3 and 2% in Q1 of 2019. Companies have reduced stock levels more aggressively than anticipated at the end of 2019, removing this year's potential drag. The Office for National Statistics (ONS) reported that UK retail sale volumes increased by 0.9% in January, reversing a 0.6% decline in December. Drawing a line under the worst recorded year for retail sales in 2019, the value of goods bought also increased after the amount spent rose by 1.2%.

In response to the Coronavirus, European Central Bank's Christine Lagarde said that the outbreak is not at the stage where it requires a monetary policy response and that they are still monitoring the situation. The Italian economic minister announced a €3.6 billion stimulus package to mitigate the impact of the coronavirus outbreak to affected areas. The Eurozone economy grew 0.1% in Q4 of 2019, compared to 0.3% in Q3. There was zero German growth due to the challenges given its close trading ties with China. Eurozone consumer confidence rose from 102.6 in January to 103.5 in February. The February manufacturing sector PMI rose to 49.1 from 47.9 in January, Eurozone's January's unemployment rate showed a reduction to a decade low of 7.4%.

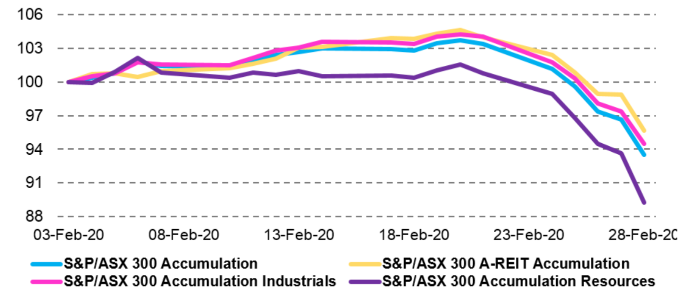
Developments in financial markets

Australian shares

Following strong performances in 2019 and early 2020, the Australian share market finished the month of February with sharp falls. The S&P/ASX 300 Accumulation returned -7.76% in February, compared to a positive 4.89% in January.

On a sector basis, there were no positive returns over the month. The Healthcare sector saw the least decline with -3.28%. Energy (-20.58%), Info Tech (-15.72%), Materials (-14.36%) and Consumer Discretionary (-10.22%) were the hardest hit over February – not surprising given the current heightened fears in the market.

Chart 4: Australian shares (rebased to 100)



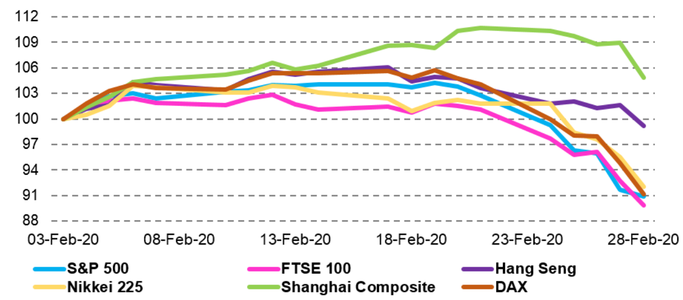
Source: BTIS/Bloomberg

International shares

US equities commenced the month moderately strong. The S&P Index set a new high record on healthy economic job data, and President Trump's acquittal in the final impeachment vote. However, the rising level of COVID-19 cases, concerns over supply-chain disruption and economic growth prompted one of the sharpest US stock market sell offs since the GFC over the month. Financial and Energy sectors were hit the hardest, while utilities – traditionally more defensive – also struggled. The final week of February were particularly painful for shares; for some it was at their weakest levels since the GFC in 2008. The Japanese market fell 10.2%, with almost all declines in the last week.

In February overall, COVID-19 weighed heavily on global shares. Eurozone equities experienced sharp falls as STOXX Europe 600 and CAC 40 returned -8.54% and -8.55% respectively. In Asian, the Nikkei 225 Total Return was -8.82%, Korean KOSPI was -6.23% and the Shanghai Composite was -3.23%. Over in the States, the Dow Jones returned -9.75% while the S&P 500 was down 8.23% over February.

Chart 5: Major Market Indices (rebased to 100)



Source: BTIS/Bloomberg

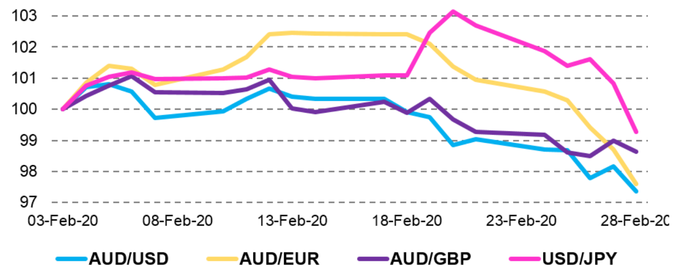
Fixed interest

The spread of COVID-19 gave rise to large declines in riskier assets such as shares, while governments bonds performed well over February. Investors sought safe haven assets perceived to be lower risk. Bonds yields declined markedly due to prices. The US 10-year treasury yield dropped to 1.13% from 1.54% at the beginning of the month, while at the longer end of the curve, the US 30-year treasury yield decreased to 1.65% from 2%. The German 10-year bonds fell to -0.61%, while UK 10- year's decreased to 0.44%.

Currencies

Currencies around the world have been under pressure amid the coronavirus outbreak. During the final days of the month, the coronavirus accelerates the further decline of the AUD, touching an 11-year low. With the developed world providing the safe haven for currencies, large movements out of emerging market and into historically developed nations such as Japan and Switzerland has resulted – all of which were strong over the month. The big fallers were emerging market economies. The AUD/USD declined -2.64%, compared to -4.69% last month. EUR/USD and USD/JPY were in the negatives again, -0.60% and -0.42% respectively. The GBP/USD end price of February was 1.2823.

Chart 6: Major currencies (rebased to 100)

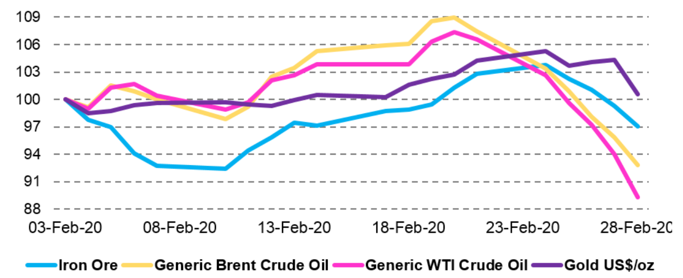


Source: BTIS/Bloomberg

Commodities:

Commodities were lower as fears over global economic growth continues to mount. Brent and WTI Crude Oil posted double digit declines with -13.14% and -13.19% respectively. At the end of the month, OPEC announced that they were determined to stabilise prices with "renewed commitment", which has stemmed some of the selloff in oil. Oil producers are nervous since the break-even price for many wells in US shale fields is approximately $45. Gold, the traditional safe haven commodity had a decline of -0.22%, finishing at $1585.69 per oz. On the last trading day, gold had a 3.6% fall – the largest in 7 years.

Chart 7: Major commodities (rebased to 100)



February Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 300 Accumulation	-7.76%	-5.22%	8.75%	8.62%	6.23%
S&P/ASX 300 Industrials Accumulation	-6.43%	-3.75%	12.57%	8.00%	6.11%
S&P/ASX 300 Resources Accumulation	-13.24%	-11.21%	-5.55%	11.67%	6.69%
S&P/ASX 300 Accumulation A-REIT	-4.69%	-2.98%	12.31%	10.30%	9.12%
S&P/ASX Small Ords Accumulation	-8.68%	-5.87%	1.64%	8.31%	7.43%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	-4.88%	-1.60%	15.61%	13.86%	10.18%
EPRA/NAREIT Developed Index Hedged A$	-8.08%	-7.12%	2.24%	4.49%	4.08%
STOXX Europe 600 Total Return	-8.54%	-7.80%	0.76%	0.48%	-0.86%
S&P 500 Total Return	-8.23%	-5.50%	8.19%	9.87%	9.23%
Nikkei 225 Total Return	-8.82%	-9.01%	0.98%	5.50%	4.38%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.08%	0.23%	1.30%	1.68%	1.85%
Bloomberg AusBond Composite (0+Y)	0.86%	1.51%	8.98%	5.98%	4.45%
Barclays Global Aggregate TR Hedged A$	1.21%	2.75%	9.33%	4.97%	4.47%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	70.9799	-5.15%	-7.95%	-12.79%	-6.82%	-7.25%
Generic Brent Crude Oil	50.52	-13.14%	-19.08%	-23.49%	-3.14%	-4.19%
Generic WTI Crude Oil	44.76	-13.19%	-18.87%	-21.78%	-6.07%	-2.10%
Gold US$/oz	1585.69	-0.22%	8.31%	20.74%	8.30%	5.50%
Iron Ore	80.1	-10.30%	-4.42%	-1.85%	-4.67%	4.52%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.6515	-2.64%	-3.67%	-8.16%	-5.24%	-3.56%
EUR/USD	1.1026	-0.60%	0.07%	-3.03%	1.40%	-0.31%
USD/JPY	107.89	-0.42%	-1.46%	-3.14%	-1.46%	-2.04%
GBP/USD	1.2823	-2.90%	-0.79%	-3.32%	1.18%	-3.64%

Source: BTIS/Bloomberg

For more information

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