October 2020
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Economic Commentary

Investors brace for another wave of economic disruption

The global economic data released during October was reasonable and mostly showed a recovery in activity as economies bounced back from the sharp contraction in Q2. The US economy grew by 7.4% in Q3 while European activity jumped by 12.7%. But while more up-to-date data suggest that the US recovery remained on track as it headed into Q4, there were some signs that the European recovery was beginning to falter as rising COVID-19 case numbers resulted in a steady rise in restrictions being re-imposed in some European nations.

In the US, for example, the Purchasing Managers' Index (PMI) for the service sectors increased from 54.6 in September to 56 in October. In contrast, Europe's services PMI fell from 48 in September to 46.2 in October. Recall that if the PMI is below 50 it suggests that activity is declining.

While governments faced with rising COVID-19 case numbers initially attempted to introduce targeted restrictions that would minimise the impact on the economy, the relentless rise in cases compelled the French and German governments to announce widespread lockdowns that will persist for November. Investors are also wary that some US states may be forced to consider similar options. The US Presidential election also weighed on investors' minds during October. In particular, investors are concerned that a contested result could undermine confidence.

The Reserve Bank of Australia prepares to embrace full-blown quantitative easing

The Commonwealth Budget was released in October and pointed to a budget deficit of 11% of GDP – the largest deficit in peace time. This, however, mainly reflected policy measures that had already been announced. New measures introduced in the budget were modest in size and were mainly directed towards the business sector. The bring-forward of personal income tax cuts, however, should provide some support to consumer spending.

With downside risks still weighing on the Australian economy, the Reserve Bank of Australia (RBA) has indicated a willingness to ease policy further at its November policy meeting. This will involve reducing their target rates for cash and the 3-year government bond yield from 0.25% to 0.10%, as well as indicating as willingness to purchase more longer-dated bonds.

Economic data pointed to fairly steady activity as the economy approaches the end of the year. While there was a disappointing fall in payrolls in early October, consumer spending remains reasonable and sentiment is improving. House prices also appear to have stabilised. Consumer prices rose by 1.6% in the September quarter as childcare fees were reintroduced and petrol prices recovered. While inflation appears stuck below the bottom of the RBA's 2-3% target band, there is no sign that overall inflation will decline much further.

In contrast to the rising COVID-19 case numbers in the northern hemisphere, case numbers in Australia dropped back to very low levels as Victoria's lockdown enabled authorities to contain the spread of the virus. This enabled the Victorian Premier to remove many of the restrictions that were crimping economic activity at the end of October. Some restrictions on interstate movements were also relaxed during the month.

Financial Market Commentary

Equity Markets (Performance is in local currency and excludes dividends)

The MSCI World (ex Australia) Equity index fell by 3.2% over October. This was driven by sharp stock market falls in most of the advanced economies. The US S&P500 fell 2.8% despite a decent earnings reporting season, as investors warily watched the rapid spread of COVID-19 case numbers, the Presidential election and the threat of more regulation for technology companies.

European equities fell by 5.2% during October, although German stocks were particularly weak, dropping by 9.4%. This reflected disappointing earnings news as well as Chancellor Angela Merkel's announcement that economic restrictions were being re-introduced during November.

The Australian equity market was one of the few developed country markets to perform well over October, managing to record a rise of 1.9%. This reflected the successful containment of COVID-19 in Victoria as well as speculation that the RBA was poised to ease policy further.

Emerging market equities also performed well during October, rising by 2% overall. This was driven by strong gains in Indian and Hong Kong stocks.

Interest Rates

The sharp decline in many equities markets over October would usually be associated with lower bond yields as investors sought the safe haven of government bond markets. During October, however, US 10-year bond yields rose by a strong 19bps to 0.87%. This surprising move in bond yields could reflect market positioning ahead of the US Presidential election. It may also reflect the anticipation of further significant fiscal stimulus which would boost both growth and inflation as well as result in a much larger funding requirement for the US Treasury.

The rise in US bond yields pulled longer-dated Australian bond yields higher with the 10-year yield rising by 4bps to 0.83%. Growing expectations that the RBA would reduce its target for the 3-year bond to 0.10%, however, ensured that shorter-term yields declined with the 3-year yield falling by 4bps to 0.12%. The yield on TCorp's 2030 bond fell by 11bps to 1.01%, however, on the expectation that the RBA could include longer-dated State-government bonds in an expanded bond buying program.

Currency and Commodity Markets

The Australian dollar fell by 1.2% against the US currency over October and by 0.7% against the Euro. Part of the RBA's strategy of reducing longer-dated bond yields is the belief that it will reduce demand for the A$. Of course, the A$ also generally declines during 'risk-off' periods when equity markets decline.

Commodity prices were generally weaker over October, with oil prices again falling sharply. The price of Brent crude oil fell by 8% over the month to $37 per barrel. This likely reflects the reimposition of economic restrictions in Europe that will particularly affect travel and hence the demand for oil. Iron ore prices also fell by 3% during the month, although at $120 per tonne, the price remains very high and is consistent with strong Chinese activity.

Financial Market Performance

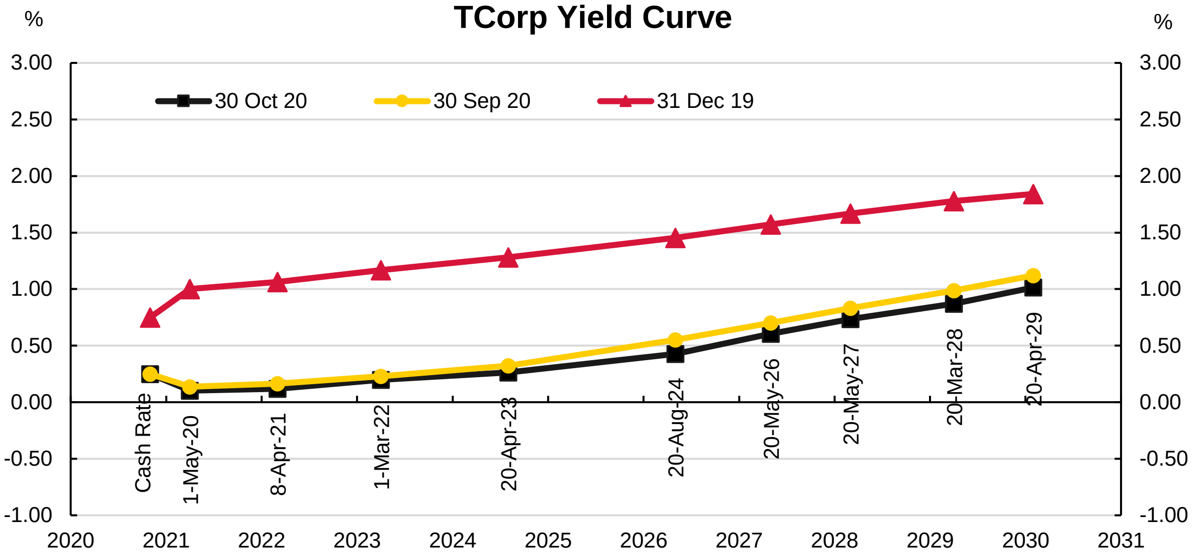
Currency Markets October 2020	Previous Month Close	Month High	Month Low	Month Close	Month Change
AUD/USD	0.712	0.724	0.703	**0.703**	-1.26% ▼
AUD/EUR	0.608	0.612	0.596	**0.603**	-0.73% ▼
AUD/JPY	75.237	76.469	73.349	**73.555**	-2.24% ▼
AUD/GBP	0.555	0.560	0.542	**0.542**	-2.21% ▼
AUD/BRL	3.993	4.074	3.947	**4.038**	1.12% ▲
AUD/RUB	55.26	56.14	54.35	**55.89**	1.15% ▲
AUD/INR	52.51	52.95	51.73	**52.08**	-0.81% ▼
AUD/CNY	4.834	4.880	4.701	**4.703**	-2.71% ▼

Equity Markets* October 2020	Previous Month Close	Month High	Month Low	Month Close	Month Change
MSCI World ex Australia	2423	2536	2345	**2345**	-3.2% ▼
MSCI Emerging Markets	1082	1138	1082	**1103**	2.0% ▲
S&P/ASX 200	5816	6229	5792	**5928**	1.9% ▲
S&P/ASX Small Ordinaries	2727	2913	2705	**2736**	0.3% ▲
S&P 500 (US)	3363	3534	3270	**3270**	-2.8% ▼
FTSE 100 (UK)	5866	6017	5577	**5577**	-4.9% ▼
Stoxx 600 (Europe)	361	373	342	**342**	-5.2% ▼
DAX (Germany)	12761	13138	11556	**11556**	-9.4% ▼
CAC 40 (France)	4803	4979	4570	**4594**	-4.4% ▼
Nikkei 225 (Japan)	23185	23671	22977	**22977**	-0.9% ▼
Hang Seng (HK)	23459	24919	23459	**24107**	2.8% ▲
Shanghai Composite (China)	3218	3360	3218	**3225**	0.2% ▲
Bovespa (Brazil)	94603	101918	93952	**93952**	-0.7% ▼
IPC (Mexico)	37459	38708	36626	**36988**	-1.3% ▼
S&P/BSE Sensex (India)	38068	40795	38697	**39614**	4.1% ▲

*Returns are in local currency, and exclude dividend payments

Bond Markets (%) October 2020	Previous Month Close	Month High	Month Low	Month Close	Month Change
RBA Official Cash Rate	0.25	0.25	0.25	**0.25**	0.00 –
90-day Bank Bill	0.09	0.09	0.06	**0.06**	-0.03 ▼
180-day Bank Bill	0.12	0.12	0.07	**0.07**	-0.06 ▼
1-year Term Deposit Rate	0.75	0.75	0.75	**0.75**	0.00 –
3-year Australian Bond	0.16	0.18	0.12	**0.12**	-0.04 ▼
10-year Australian Bond	0.79	0.90	0.72	**0.83**	0.04 ▲
10-year US Bond	0.68	0.87	0.68	**0.87**	0.19 ▲
10-year German Bond	-0.52	-0.49	-0.64	**-0.63**	-0.11 ▼
10-year Japanese Bond	0.02	0.04	0.02	**0.04**	0.03 ▲

TCorp Bonds (%) October 2020	Previous Month Close	Month High	Month Low	Month Close	Month Change
08-Apr-21	0.14	0.14	0.09	**0.10**	-0.03 ▼
01-Mar-22	0.16	0.17	0.12	**0.12**	-0.05 ▼
20-Apr-23	0.23	0.24	0.19	**0.20**	-0.03 ▼
20-Aug-24	0.32	0.34	0.25	**0.26**	-0.06 ▼
20-May-26	0.55	0.58	0.41	**0.43**	-0.12 ▼
20-May-27	0.70	0.75	0.57	**0.60**	-0.10 ▼
20-Mar-28	0.83	0.89	0.68	**0.74**	-0.10 ▼
20-Apr-29	0.99	1.04	0.82	**0.87**	-0.12 ▼
20-Feb-30	1.12	1.19	0.96	**1.01**	-0.11 ▼
CIB 3.75% 20 Nov 20	1.87	2.10	1.84	**2.08**	0.21 ▲
CIB 2.75% 20 Nov 25	-0.31	-0.31	-0.59	**-0.59**	-0.27 ▼
CIB 2.50% 20 Nov 35	0.34	0.27	0.04	**0.18**	-0.15 ▼



Commodity Markets (US$) October 2020	Previous Month Close	Month High	Month Low	Month Close	Month Change
Brent Oil (per barrel)	41.0	43.3	37.5	**37.5**	-8.5% ▼
Iron Ore (per tonne)	124.0	124.8	119.7	**120.2**	-3.1% ▼

TCorp Forecasts	Dec-20	Jun-21	Dec-21	June-22
RBA Official Cash Rate	0.10	0.10	0.10	0.10
90-day Bank Bill	0.10	0.10	0.10	0.10
10-year Australian Bond	0.75	0.75	1.00	1.00

About New South Wales Treasury Corporation (TCorp)

TCorp provides best-in-class investment management, financial management, solutions and advice to the New South Wales (NSW) public sector. With A$103 billion of assets under management, TCorp is a top five Australian investment manager and is the central borrowing authority of the state of NSW, with a balance sheet of A$99 billion. It is rated AAA by S&P and Aaa by Moody's.

TCorp

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