Morning Report

Thursday, 7 September 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,257	-0.8%		**Last**		**Overnight Chg**		**Australia**		
US Dow Jones	34,443	-0.6%	10 yr bond	4.14		0.02		90 day BBSW	4.12	0.00
Japan Nikkei	33,241	0.6%	3 yr bond	3.80		0.01		2 year bond	3.83	-0.01
China Shanghai	3,311	0.1%	3 mth bill rate	4.12		0.00		3 year bond	3.80	-0.01
German DAX	15,741	-0.2%	SPI 200	7,196.0		-35		3 year swap	4.03	-0.01
UK FTSE100	7,426	-0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.13	-0.01
Commodities (close & change)*			TWI	60.0	-	-	60.0	**United States**		
CRB Index	284.7	-0.2	AUD/USD	0.6378	0.6405	0.6358	0.6383	3-month T Bill	5.29	0.02
Gold	1,916.56	-9.6	AUD/JPY	94.19	94.34	93.86	94.22	2 year bond	5.02	0.06
Copper	8,374.25	-123.3	AUD/GBP	0.5074	0.5109	0.5065	0.5105	10 year bond	4.28	0.02
Oil (WTI futures)	87.54	0.9	AUD/NZD	1.0839	1.0875	1.0833	1.0874	**Other (10 year yields)**		
Coal (thermal)	165.50	-4.0	AUD/EUR	0.5948	0.5965	0.5934	0.5951	Germany	2.65	0.04
Coal (coking)	273.33	0.7	AUD/CNH	4.6582	4.6785	4.6518	4.6728	Japan	0.66	0.00
Iron Ore	114.80	-1.5	USD Index	104.74	105.02	104.59	104.84	UK	4.53	0.01

Data as at 7:50am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Risk sentiment was pared overnight as stronger-than-expected US services activity prompted concerns of rates remaining elevated for longer. US equities were weaker, while treasury yields rose across the curve. The US dollar finished slightly higher, and oil continued to rally.

Share Markets: A rally at the short end of the US yield curve put pressure on equity valuations. The S&P 500 fell 0.7%, while the Dow Jones and the NASDAQ slipped 0.6% and 1.1%, respectively.

The ASX 200 fell 0.8% yesterday, futures are pointing to a weak open this morning.

Interest Rates: The US yield curve bear flattened as yields at the short-end rose faster than longer-dated treasuries. The 2-year yield rose 6 basis points to close above 5% for the first time in over a week. The 10-year yield rose 2 basis points to 4.28%.

Interest rate markets are pricing just under a 50/50 chance of another rate hike from the Fed, most likely in November.

The yield on Aussie bond futures also rose. The 3-year futures yield was up 1 basis point to 3.80%, while the 10-year yield rose 2 basis points to 4.14%.

Interest rate markets are pricing just a 25% chance of another hike from the RBA in this cycle and are almost fully pricing rate cuts for December 2024.

Foreign Exchange: The US dollar was firmer overnight, supported by higher yields. The DXY rose to a high of 105.02, it's highest level since March, but has since retraced to around 104.84 at the time of writing. Both the Pound and the euro bounced off their lowest levels against the US dollar since early June.

The Aussie dollar was sold off heavily yesterday, falling from a high of 0.6405 to a fresh 9-month low of 0.6358. Growth concerns in China and dwindling expectations for further rate hikes is putting the pair under pressure.

The Japanese Yen is also struggling against the stronger Greenback. The USD/JPY pair rose to a 9-month high of 147.82 in yesterday's trade, sparking expectations of potential market intervention from the Bank of Japan to defend the currency.

Commodities: Oil continued to rally as expectations of market conditions tighten on resilient global demand and softer production. The West Texas Intermediate (WTI) future rose to US$87.54 per barrel, its highest close since November last year. The WTI future has railed almost 11% in the past 10 sessions.

Gold, copper and iron ore softened, while coking coal was firmer.

Australia: Gross Domestic Product (GDP) rose 0.4% in the June quarter to be 2.1% higher through the year. The economy continues to show a level of resilience, which is arguably unexpected at this point in the economic cycle. To put the GDP numbers into perspective, the pace of growth in the quarter and over the year was higher than the RBA's forecasts. Whilst the economic slowdown is not as deep as expected yet, we do expect activity to continue to step down until after the first rate cut surfaces. Rate cuts before the middle of next year seem unlikely.

An explosion in population growth over the past year has been a big part of the 'resilience' story. Population growth will not continue at this remarkably fast pace of 2.4%, but it will stay solid. Extra people add to spending in the economy. If we strip away the impact of population, GDP per capita went south for the second straight quarter, which officially puts Australia in recession "in per capita terms".

Whilst the population is growing, productivity is not. It continues to weaken and has led to a surge in unit labour costs, which threatens to pose a challenge to policymakers in bringing down inflation. Productivity growth is not easily generated and is hard won following innovation and reform. There is no silver bullet and all economic agents have their part to play.

A feature of the growth outlook is the changing of the batons in growth drivers. Households are tightening their belts. This is not going away soon with the ongoing squeeze on budgets from higher mortgage rates, higher rents and elevated prices. Household consumption eked out growth this quarter, but it was the slowest rate in nearly two years. Households will continue to be more cautious and careful in spending their dollars and this will see a deeper shift away from discretionary spending, but businesses could continue to stay tenacious for a time yet. Business investment plans published last week point to a record 2023-24 financial year for non-mining businesses.

Among the big swing factors for the outlook are inventories and trade. The former was a big drag in the quarter. Inventories had been run up to record levels during covid as supply chains were severely disrupted. With a normalisation underway, inventories ran down a massive $3.4 billion in the June quarter – the biggest drain since late 2008 when the economy was gripped by the GFC (outside of the pandemic). The risk lies to a further rundown in inventories, as consumer spending growth slows further and the wholesale sector is forced to move stock off floors.

The trade sector helped offset the drag from inventories this quarter, but it may not be able to wave this wand next time, as global economic activity slows. Of most importance to Australia is China, our largest trading partner. China's growth story remains vulnerable.

Eurozone: German factory orders tumbled 11.7% in July, materially undershooting expectations for a milder 4.3% fall. This followed an upwardly revised 7.6% increase in orders in June but marked the steepest monthly fall in orders since April 2020, when the pandemic broke out. The German manufacturing sector is grappling with an unhealthy combination of weak Chinese demand and an energy crisis, with a near-term solution seeming unlikely on both fronts. This will continue to hamstring growth in Europe's largest economy.

Retail sales in the Eurozone region fell 0.2% in July following an upwardly revised 0.2% gain in June. The result marked the first contraction in retail spending in three months.

European Central Bank (ECB) member Klaas Knot warned that investors may be underestimating the chances of a rate hike from the ECB next week.

United Kingdom: Bank of England (BoE) Governor, Andrew Bailey, said UK monetary policy is probably "near the top of the cycle" suggesting rates may not have to rise further. This is despite very sticky core inflation, accelerating wages growth and little sign of a loosening of conditions in the labour market. Bailey added that he expect a "marked" drop in inflation by the end of the year.

United States: The ISM services purchasing managers' index (PMI) came in hotter than expected in August, increasing to 54.5 from 52.7. Economists had expected services activity to deteriorate marginally in the month. The surprise boost in activity pushed the index to its highest level since February with strength concentrated within the entertainment & recreation and accommodation & food services industries. The services prices paid sub-index firmed for a second consecutive month, pointing to further stickiness in services inflation.

The August S&P services PMI was finalised at 50.5, revised down slightly from the flash reading of 51.0. The measure points to stalling growth in services activity, contradicting the ISM measure.

The trade deficit widened marginally to $65.0bn in July, from $63.7bn in June. The value of exports rose 1.6%, while imports increased 1.7%. Resilient household demand is encouraging merchants to boost orders with foreign suppliers, supporting import volumes.

The Federal Reserve's Beige Book pointed to a slowing in economic activity and jobs growth in August. Discretionary spending continues to slow, while respondents reported that consumers were relying less on savings and more on credit to finance spending activity. Despite a slowing in hiring, labour market imbalances persisted with the availability of skilled workers and the number of applicants remaining constrained. Businesses expect wages growth ease more broadly over the remainder of the year as imbalances improve. On inflation, most contacts reported that price growth slowed overall. Cost pressures remained persistent, but businesses were increasingly struggling to pass on cost increases, putting pressure on profit margins.

Today's key data and events:

AU Trade Bal. Jul exp $9.1bn prev $11.3bn (11:30am)

AU RBA Gov. Lowe Speech (1:10pm)

CH Exports Aug y/y exp -9.0% prev -14.5% (TBC)

CH Imports Aug y/y exp -9.0% prev -12.4% (TBC)

CH Trade Bal. Aug exp US$73.9bn prev US$80.60bn (TBC)

EZ Ger. Indust. Production Julexp -0.4% prev -1.5% (4pm)

EZ GDP Q2 Final exp 0.3% prev 0.3% (7pm)

Times are AEST. All data forecasts are m/m or q/q and seasonally adjusted unless otherwise specified. Forecasts for Australian data are our forecasts and for other countries they are consensus forecasts.

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