Morning Report

Tuesday, 8 August 2023

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Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,309	-0.2%		Last		Overnight Chg		**Australia**		
US Dow Jones	35,473	1.2%	10 yr bond	4.10		0.03		90 day BBSW	4.19	0.01
Japan Nikkei	32,255	0.2%	3 yr bond	3.78		0.01		2 year bond	3.92	0.00
China Shanghai	3,427	-0.6%	3 mth bill rate	4.24		0.00		3 year bond	3.87	0.00
German DAX	15,951	0.0%	SPI 200	7,275.0		29		3 year swap	4.04	0.00
UK FTSE100	7,554	-0.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.19	0.00
Commodities (close & change)*			TWI	60.7	-	-	60.7	**United States**		
CRB Index	279.2	-0.3	AUD/USD	0.6572	0.6593	0.6555	0.6573	3-month T Bill	5.26	0.00
Gold	1,942.91	8.9	AUD/JPY	93.16	93.70	93.12	93.67	2 year bond	4.76	0.00
Copper	8,537.00	-49.0	AUD/GBP	0.5154	0.5173	0.5137	0.5142	10 year bond	4.09	0.05
Oil (WTI futures)	81.94	-0.9	AUD/NZD	1.0778	1.0788	1.0755	1.0770	**Other (10 year yields)**		
Coal (thermal)	144.25	3.8	AUD/EUR	0.5968	0.5993	0.5964	0.5973	Germany	2.60	0.04
Coal (coking)	246.75	-0.3	AUD/CNH	4.7233	4.7451	4.7207	4.7336	Japan	0.63	-0.02
Iron Ore	102.45	1.4	USD Index	102.01	102.38	101.97	102.07	UK	4.46	0.08

Data as at 8:00am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: With limited top tier economic data released overnight, markets were in a holding pattern ahead of this week's US inflation read.

US equities finished higher, partly reversing some of the losses recorded last week. Bond yields were mixed, and the US dollar was broadly unchanged against against a basket of major currencies.

Share Markets: US equities finished higher as investors positioned ahead of this week's inflation read. The S&P 500 increased by 0.9%, the Dow Jones was 1.2% higher and the Nasdaq increased by 0.6%. This follows losses recorded last week which were triggered by Fitch's US credit downgrade and some mixed economic and earnings reports.

The ASX 200 fell 0.2% yesterday. Six of the eleven sectors were lower, led by financials stocks. Futures are pointing to a positive open today, following the lead from overseas markets.

Interest Rates: US bond yields were mixed. The 2-year yield was unchanged at 4.76%. The 10-year yield rose 5 basis points, to 4.09%. The increase in longer term yields is consistent with hawkish comments from Fed speakers overnight.

Interest-rate markets are pricing around a 12% chance of a hike at the Fed's September meeting. Markets are attaching only around a 35% chance of one more hike in this cycle, before they begin pricing cuts from mid-2024 onwards.

Looking at domestic yields, the 3-year government bond yield (futures) rose 1 basis point, to 3.78%. The 10-year government bond yield (futures) rose 3 basis points, to 4.10%.

Interest rate markets are split on whether the RBA is done in this cycle. Markets are attaching next to no chance of a hike in September but have around a 40% probability of one more hike by the end of the year. A full cut from the 4.10% rate is not currently fully priced until 2025.

Foreign Exchange: The US dollar was unchanged. The USD Index traded between a low of 101.97 and a high of 102.38, before settling around 102.07.

The AUD/USD pair was broadly unchanged, trading between a low of 0.6555 and a high of 0.6593, before settling around 0.6573.

Commodities: Commodity prices were broadly lower. The West Texas Intermediate (WTI) oil future also declined, closing at US$81.94 per barrel.

Australia: Job advertisements rose 0.4% over the month of July. However, compared with a year ago, job advertisements are 8.9% lower – pointing to a loosening in labour market conditions.

The Reserve Bank (RBA) is forecasting inflation to be back within the 2-3% target by the end of 2025. To achieve this, the unemployment rate is forecast to increase from its current rate of 3.5%, to 4.5% by the end of 2024 and remain at this level through

2025 - or from an extremely low to a very low rate.

This would be a truly remarkable achievement. It would mean successfully navigating the narrow path of returning inflation to target while preserving the gains in the labour market.

But the historical experience suggests that the RBA may be a little too optimistic. In previous disinflationary cycles the unemployment rate has increased by significantly more to get inflation back to target – indeed using the average over the past three cycles, the unemployment rate would need to increase to around 6% to get inflation back down.

Why the optimism? A key assumption is that the global supply curve will revert to where it was before the pandemic. We are seeing evidence that this is happening – shipping costs are back to 2019 levels and headline inflation is falling globally as the prices of energy commodities and food items come off their peaks.

Additionally, the RBA expects that the cumulative 400 basis points of cash rate hikes (and potentially one more) will be enough to prevent a wage price spiral but not enough to slow demand to the extent that will induce mass job shedding.

Is the Goldilocks finish possible? It hasn't happened before, but this doesn't mean it's impossible. We believe the RBA can achieve its soft landing. But given the tightening that has occurred, we think the unemployment rate will increase by slightly more.

Eurozone: The Sentix investor confidence index improved to -18.9 index points in August, from -22.5 in July. This was better than the -24.5 points the market was expecting. Despite the improvement the index shows that the zone remains in recession mode.

Germany's industrial production declined by 1.5% over the month of June. This was much worse than the decline of 0.5% the market was expecting. This outcome shows that high energy prices, tighter financing conditions and weaker global demand continue to weigh heavily on the German economy.

United States: Consumer credit increased by $17.85 billion in June, following an increase of $9.45 billion in May. The outcome was much better than the $13 billion increase the market was expecting. Non revolving credit, which includes auto and student loans, underpinned the large increase over the month.

Federal Reserve Board of Governors member, Michelle Bowman, reiterated her view that the Fed may need to raise rates further to fully restore price stability. "I supported raising the federal funds rate at our July meeting, and I expect that additional increases will likely be needed to lower inflation to the FOMC's goal," Bowman said. She also noted "We have made progress in lowering inflation over the past year, but inflation is still significantly above the FOMC's 2% target, and the labor market continues to be tight, with job openings still far exceeding the number of available workers."

Federal Reserve Bank of New York President, John Williams, said US monetary policy needs to be restrictive for some time, adding that interest-rate cuts may be warranted next year if inflation slows. "Monetary policy is in a good place — we've got the policy where we need to be… Whether we need to adjust it in terms of that peak rate — but also how long we need to keep a restrictive stance — is going to depend on the data" Williams said in an interview conducted last week but published overnight.

Today's key data and events:

AU WBC-MI Cons. Conf. Aug prev 81.3 (10:30am)
AU NAB Business Survey Jul (11:30am)
Confidence prev 0
Conditions prev 9
CH Exports Jul y/y prev -12.4% (TBC)
CH Imports Jul y/y prev -6.8% (TBC)
CH Trade Balance Jul prev US$70.62bn (TBC)
EZ Ger. CPI Jul Final prev 0.3%(4pm)
JN Current Account Jun prev ¥1.9tr (9:50am)
US Trade Balance Jun exp -$66.6bn prev -$69.0bn (10:30pm)

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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