Morning Report

Monday, 8 May 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,220	0.4%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,674	1.7%	10 yr bond	3.40		0.08		90 day BBSW	3.87	0.00
Japan Nikkei	29,158	0.1%	3 yr bond	3.06		0.12		2 year bond	3.08	-0.01
China Shanghai	3,495	-0.5%	3 mth bill rate	3.89		0.03		3 year bond	2.96	-0.01
German DAX	15,961	1.4%	SPI 200	7,284.0		64		3 year swap	3.48	0.21
UK FTSE100	7,778	1.0%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.32	0.02
Commodities (close & change)*			TWI	60.3	-	-	60.3	**United States**		
CRB Index	261.6	4.8	AUD/USD	0.6693	0.6757	0.6693	0.6751	3-month T Bill	5.07	-0.01
Gold	2,016.79	-33.5	AUD/JPY	89.86	91.10	89.81	91.05	2 year bond	3.91	0.12
Copper	8,566.75	85.4	AUD/GBP	0.5324	0.5348	0.5321	0.5344	10 year bond	3.44	0.06
Oil (WTI futures)	71.34	2.8	AUD/NZD	1.0660	1.0731	1.0635	1.0725	**Other (10 year yields)**		
Coal (thermal)	168.50	-1.5	AUD/EUR	0.6078	0.6133	0.6075	0.6125	Germany	2.29	0.10
Coal (coking)	244.67	1.2	AUD/CNH	4.6304	4.6764	4.6297	4.6719	Japan	0.42	0.00
Iron Ore	99.35	0.6	USD Index	101.34	101.78	101.12	101.28	UK	3.78	0.13

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: Risk sentiment improved on the back of the stronger than expected US labour market data, which suggested the economy remained resilient despite the banking uncertainty.

US equities increased, bond yields rose, and the defensive US dollar declined.

Share Markets: US equities surged on Friday, breaking four consecutive days of declines. Investors welcomed the stronger than expected labour market data and were buoyed by solid earnings news. Apple was the main headliner, jumping almost 5% after the company's quarterly results were stronger than expected. Apple also announced a $90 billion stock repurchase plan.

The S&P 500 ended 1.9% higher, the Nasdaq was 2.3% higher and the Dow Jones was 1.7% higher.

The ASX 200 finished 0.4% higher on Friday. Eight of the eleven sectors recorded gains. Real estate (2.0%) and mining (+0.6%) were the best performing sector. Futures are pointing to a positive open today.

Interest Rates: Strong US labour market outcome encouraged selling in the fixed-income market, as investors moved money from bonds into stocks. This sent yields higher across the curve. The 2-year treasury yield increased by 12 basis points to 3.91%. The 10-year yield increased by 6 basis points to 3.44%.

Interest-rate markets expect that the Fed has now reached its terminal rate for the cycle. The market in pricing in around 90 basis points of cuts by the end of January 2024. This suggest that are pricing in over 100 basis points of cuts by the end of 2023. This suggest that the market is expecting rates to remain "higher-for-longer" given the resilience in the labour market.

The Australian 3-year government bond (futures) yield increased by 12 basis points to 3.06%, while the 10-year (futures) yield also increased by 8 basis points to 3.40%.

Cash rate futures suggests that the Reserve Bank (RBA) has now reached its terminal rate for the cycle and have prices in one 25 basis point cuts by the end of 2023.

Foreign Exchange: The AUD/USD pair climbed sharply. The pair was supported by the risk one tone and the RBA's hawkish May Statement of Monetary Policy released on Friday.

The AUD/USD pair increased from a low of 0.6693 in early trade to a high of 0.6757. It is currently trading around this level at 0.6751.

The US dollar index edged lower, ranging between a low of 101.12 and a high of 101.78 - it is currently trading around 101.28.

Commodities: Commodity prices were generally, led by copper, iron ore and coking coal. The West

Texas Intermediate (WTI) futures price of oil increased by 2.8%, to close at US$71.34 per barrel.

Australia: The growth outlook in the May 2023 Statement on Monetary Policy (SoMP) remained broadly unchanged.

However, there is a change in the composition. Some of the near-term softness we are seeing in partial economic indicators (such as retail trade) is expected to be partly offset by stronger expected growth in population.

As a result, the Reserve Bank (RBA) is implicitly forecasting per capita consumption and per capita GDP to go backwards, implying a per capita recession. In fact, per capita consumption and per capita GDP are both expected to be lower through 2023 and 2024, compared to the December quarter of 2022. In other words, the RBA expects individuals to spend less per period over the next two years, compared to the December quarter 2022.

This is significant. It highlights the tension in the RBA's deliberation. The economy is slowing and slowing quickly. This is because households faced with mounting cost of living pressures, elevated rents and higher interest rates are cutting back. However, the record influx of migrants has offset this drag and is adding to short run inflationary pressures.

At some point the drag from households cutting back on spending will to a large extent offset the boost to demand coming from migrants. Based on the RBA's forecasts, this is likely to occur in the second half of 2023, where activity is expected to slow significantly.

Further, inflation has been downgraded in 2023, but is unchanged in later years. The CPI is expected to return to the top of the 2-3% band by mid 2025. The composition of inflation is expected to shift as rent inflation strengthens, while non-housing inflation is expected to be weaker.

The value of new housing finance excluding refinancing rose 4.9% in March, ending a 13-month run of declines. The spike in lending activity coincided with the recent stabilisation in dwelling prices across the country.

This suggests that while supply is playing a key role in dwelling price action, demand certainly can't be ignored and appears to be showing early signs of stabilisation. The monthly bounce in credit demand was broad based for both investors (3.7%) and owner occupiers (5.5%), including all owner-occupier sub-categories. Even new lending for the construction of new dwellings (1.7%), which has underperformed, increased in the month.

The broad-based nature of the rise was also apparent across the states and territories. Queensland (9.3%) registered the largest increase in lending activity across the major states. NSW (1.4%) was somewhat of a laggard but that followed strong 6.0% growth in February. The turnaround in NSW coincides with the pickup in Sydney dwelling price growth.

Refinancing activity rose 6.5% to a new record high of $21.2 billion – well above the previous high of $19.9 billion. Competition in the mortgage market remains hot, fixed-rate mortgages are expiring at an increasing rate and households are shopping around for the best deal.

China: The Caixin General Services Purchasing Managers Index (PMI) declined to 56.4 index points in April, from 57.8 in March. It was the fourth straight month of expansion in services activity as the post-COVID recovery continued. Both new orders and foreign sales increased. On the price front, input cost inflation accelerated due to elevated staffing costs and higher prices for raw materials. Meanwhile, output cost inflation rose slightly as firms sought to boost competitiveness and attract sales.

Eurozone: Retail sales declined 1.2% over the month of March, following an upwardly revised 0.2% fall in February (from an initial estimate of a 0.8% fall). This outcome was worse than the fall of 0.1% the market was expecting. Purchases of food, drinks and tobacco declined by 1.4%. The sales of non-food products also decreased by 1.1%. Among the bloc's biggest economies, sales were down in Germany (-2.4%), France (-1.4%) and Italy (-0.3%).

Factory orders in Germany fell by 10.7% in March. This was much worse than fall of 2.2% the market was expecting. It marks the biggest drop in industrial orders since the height of the coronavirus pandemic in mid-2020. The decline was led by a large fall in orders for miscellaneous vehicle construction, which includes the construction of ships, railed vehicles, aircraft, spacecraft, and army vehicles.

United States: The unemployment rate edged down to 3.4% in April, from 3.5% in March. This was better than the 3.6% the market was expecting. The number of unemployed people decreased by 182,000.

Nonfarm payrolls increased 253,000 over April, following a 165,000 gain over March. This was better than 180,000 gain the market was expecting.

Employment continued to trend up in professional and business services, health care, leisure and hospitality, and social assistance. The March reading was revised sharply lower to 165,000 from an initial estimate of 236,000.

Average hourly earnings rose 0.5% over the month April to be 4.4% higher over the year to April. This follows a 0.3% increase in March. This outcome was the strongest in nine months, beating the 0.3% increase the market was expecting. The annual outcome of 4.4% was well above the 3% pace consistent with a 2% inflation rate.

The labour market remains extremely strong. The faster pay growth will keep the Fed uneasy about inflationary pressures. Most economists are of the view that this outcome makes the prospect of rate cuts in coming months less likely and strengthens the “higher-for-longer” scenario.

Total consumer credit rose $26.5 billion in March, after an upwardly revised $15 billion increase in April. The outcome was well above the increase of $16.5 billion the market was expecting. Revolving credit, like credit cards, was up 17.3% over March, compared to a 5.7% rise in April.

Following the US jobs report Fed official Jim Bullard, President of the St. Louis Fed, said a soft landing can still be achieved, calling the May hike to 5.125% rate a good step, but adding there is still a lot of inflation in the economy.

Austan Goolsbee, President of Chicago Fed, said it was too soon to judge what officials should do when they meet next month, although on the recent banking strains “It has to give you some pause…that’s likely to slow the economy and for sure you should take that into account.”

Today’s key data and events:

AU NAB Business Survey Apr (11:30am)
  Confidence prev -1
  Conditions prev 16
AU Building Approvals Mar exp 1.0% prev 4.0% (11:30am)
EZ Sentix Investor Confidence Index May prev -8.7 (6:30pm)
EZ Ger. Industrial Production Mar prev 2.0% (4pm)
JN Nikkei Serv. PMI Apr Final prev 54.9 (10:30am)

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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