Morning Report

Wednesday, 16 August 2023

st.george

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,305	0.4%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,946	-1.0%	10 yr bond	4.25		0.00		90 day BBSW	4.17	0.00
Japan Nikkei	32,239	0.6%	3 yr bond	3.96		0.00		2 year bond	4.00	0.05
China Shanghai	3,330	-0.1%	3 mth bill rate	4.22		0.00		3 year bond	3.96	0.06
German DAX	15,767	-0.9%	SPI 200	7,168.0		-75		3 year swap	4.17	-0.01
UK FTSE100	7,390	-1.6%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.26	0.06
Commodities (close & change)*			TWI	60.4	-	-	60.4	**United States**		
CRB Index	274.3	-3.8	AUD/USD	0.6487	0.6522	0.6452	0.6456	3-month T Bill	5.25	-0.02
Gold	1,902.00	-5.1	AUD/JPY	94.42	94.87	93.93	93.98	2 year bond	4.95	-0.01
Copper	8,277.75	-7.0	AUD/GBP	0.5114	0.5130	0.5079	0.5083	10 year bond	4.21	0.02
Oil (WTI futures)	80.99	-1.5	AUD/NZD	1.0855	1.0879	1.0832	1.0844	**Other (10 year yields)**		
Coal (thermal)	160.40	0.4	AUD/EUR	0.5949	0.5971	0.5914	0.5921	Germany	2.67	0.04
Coal (coking)	252.50	-0.5	AUD/CNH	4.7220	4.7579	4.7179	4.7261	Japan	0.63	0.02
Iron Ore	100.80	-0.2	USD Index	103.15	103.27	102.82	103.20	UK	4.59	0.02

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: Markets were volatile overnight as investors reacted to a raft of mixed economic data from key regions. Stronger-than-expected US retail spending data added to signs of resilience in the world's largest economy, while downside surprises in China and a cut to a benchmark lending rate from authorities weighed on investors' minds following a run of weaker-than-expected data from the world's second largest economy.

Bond yields were volatile but ended little changed from where they opened, with longer term yields higher, while shorter term yields slipped. Equity markets dropped amid concerns that interest rates may need to remain higher for longer. Risk-sensitive currencies such as the Aussie fell, while the US dollar swung between gains and losses for little net change.

Share Markets: Equity markets were largely a sea of red amid investor concerns around interest rates remaining higher for longer following stronger-than-expected US retail spending data and comments from Minneapolis Fed President Neel Kashkari. The S&P 500 and Nasdaq both dropped 1.2%, while the Dow Jones lost 1.0%. The loss resulted in the S&P 500 falling below its 50-day moving average, a technical signal watched by many traders.

The ASX 200 rose 0.4% yesterday. However, the index is poised for a drop this morning, as futures are pointing to a weaker open following the falls in US markets overnight.

Interest Rates: Interest rates were volatile overnight and initially spiked following the release of stronger-than-expected retail spending data. The US 2-year treasury yield initially spiked to a high of 5.02%, before falling to a low of 4.90%. It later recovered some ground and closed at 4.95% – 1 basis point below where it opened. The 10-year yield was similarly volatile. It spiked to a high of 4.27% after the data release, before dropping rapidly to a low of 4.16%. It moved higher from that low, closing at 4.21% – 2 basis points higher from the open. Interest-rate markets continue to price only a small chance of a hike from the Fed at the September meeting (11%) and around a 38% chance of one more hike in this cycle. Aggressive cuts continue to be priced through 2024, with markets anticipating four cuts in the year.

Australian interest rates ended unchanged overnight. The 3-year Australian government bond yield (futures) was 3.96%, while the 10-year (futures) yield was 4.25%. Interest-rate markets continue to expect the RBA to extend its pause in September but have a slightly less than 60% chance of one more hike in this cycle by mid-2024.

Foreign Exchange: The AUD/USD pair lost ground overnight following weaker-than-expected data out of China, a softer-than-expected gain in Australian wages growth, and stronger US data. The pair dropped a low of 0.6452 – its lowest level since November 2022. It had hit a high of 0.6522 earlier in the Asian session but lost ground throughout the day. It was trading near this low, at 0.6456, at the time of writing.

The US dollar moved between gains and losses but ended the session broadly unchanged from where it opened. The USD Index ranged between a low of 102.82 and a high of 103.27. It was trading at 103.20 at the time of writing.

Commodities: Oil lost ground but remained above US$80 per barrel. Copper, gold, and iron ore also slipped. Coal prices were mixed, as coking coal fell while thermal coal was higher.

Australia: The Wage Price Index (WPI) increased 0.8% over the June quarter to be 3.6% higher in annual terms, a touch lower than the 3.7% recorded in March and forecast by the Reserve Bank (RBA). The WPI has now grown by 0.8% over the last three consecutive quarters.

While the quarterly growth rate has stalled, the composition is shifting in a way we anticipated. Wages growth in industries where prices are regulated by governments (e.g. health care) and have wages determined by collective agreements continue to catchup, while wages in the remaining sectors have moderated.

We expect this shift to continue and wages growth to pick up next quarter as the Fair Work Commission's (FWC) 2023-24 award wage decision and updated public sector enterprise bargaining agreements come into effect. The RBA will be looking for broader wage pressures that could emerge if the FWC decision were to become the new anchor point for negotiations.

Interestingly, wages in the services industries (e.g. professional services) continued to pick up even though we saw a moderation in the prices of certain market services (excluding housing). This suggests that businesses are finding it more difficult to pass on higher costs to customers.

Today's outcome also showed the share of workers receiving a pay rise declined compared to a year ago, but of those that received an increase, the average increase was larger. This suggest that while aggregate labour market conditions are softening, shortages in certain areas remain.

The wages read was slightly below the RBA's forecasts meaning it is unlikely to prompt a 'calibration' in interest rates.

The RBA released the minutes of its policy decision from earlier this month when it left the cash rate on hold for the second consecutive month at 4.10%. Indeed, it also marked three on-hold decisions out of five Board meetings.

The minutes follow in the wake of testimony by the RBA Governor to Parliament on Friday and the release of the quarterly Statement on Monetary Policy (SoMP) the Friday before.

The result being that the minutes contained little fresh insights or information.

We continue to be left with an impression of a central bank that is on hold and would like 4.10% to be the peak with the minutes noting there was a "credible path back to the target with the cash rate staying at its present level". The run of data will continue to be very important.

A tightening bias has remained, but conviction is watered-down from previous minutes. The tightening bias is sensible given inflation remains elevated and above target.

The minutes did note that the staff forecasts were conditioned on "a further increase in the cash rate". However, they also added that a credible path back to the target exists with the cash rate staying at its present level, which was one of the arguments supporting their decision to pause.

A consideration of the risks by the RBA were viewed as "broadly balanced" yet acknowledging the "costs associated with these risks might be asymmetric" with a prolonged period of elevated inflation viewed as "costly". Again, suggesting the tightening bias remains.

Policy is currently in restrictive territory and the RBA has delivered 400 basis points of tightening, the full weight of which has still to fully flow through to the economy.

The RBA notes that scheduled mortgage payments as a share of household disposable income increased to 9.4% in the June quarter, around its historical peak, and that scheduled mortgage payments are set to increase above this historical peak as a high share of fixed-rate loans roll onto higher rates through the rest of 2023.

Importantly, for the first time the RBA noted that the net flows of voluntary payments into borrowers' offset and redraw accounts declined to be noticeably lower than the pre-pandemic average. That is consistent with pressures on disposable incomes and the resulting slowdown in consumer spending.

The RBA is intent on staying on a narrow path that it believes it is still on. The slowdown in consumer spending growth would be giving them reason to pause.

We continue to see 4.10% as the peak, but cannot fully rule out one more tap on the brakes in coming months if the incoming data suggest that the RBA needs to "calibrate" rates to get inflation down.

The Hon Chris Bowen MP, Minister for Climate Change and Energy, announced that the Department of Climate Change, Energy, the Environment and Water will conduct a review to assess carbon leakage risks, develop policy options, and undertake a feasibility assessment of a carbon border adjustment mechanism (CBAM), particularly in relation to steel and cement, at an Australian Business Economists (ABE) event yesterday. The Minister viewed that it is the right time to examine how best to prevent international carbon leakage risks, while protecting Australia's reputation as a reliable and secure trading partner.

China: Industrial production rose 3.7% over the year to July. This was down from annual growth of 4.4% in June and was below consensus expectations of 4.3%. Retail sales were also weaker than expected. Retail spending grew 2.5% over the year to July. This followed 3.1% annual growth in June and disappointed expectations of 4.0%. The outcomes add to a raft of data indicating that the economic rebound following the country exiting its COVID-zero policies is losing pace. Other economic indicators also disappointed expectations. This included fixed asset investment, which grew 3.4% over the calendar year to July, missing expectations of 3.7% growth. The property sector also continues to remain under pressure, as property investment fell 8.5% in the first seven months of 2023.

Reflecting the weaker run of data of late, authorities unexpectedly lowered a key lending rate to stimulate economic activity. Authorities reduced the 1-year medium-term lending facility rate to 2.50%, from 2.65%. The move follows reductions in other key benchmark rates over recent months. The results will likely add to calls for additional economic support from authorities, including fiscal stimulus.

Eurozone: Investor expectations rose in August but remained in negative territory. The ZEW investor expectations rose to -5.5 in the month, up from -12.2 index points in July. In Germany, expectations also rose, but remained weak. The German result rose from -14.7 in July to -12.3 in August. This was above expectations of -14.9. However, despite the improvement, investor expectations remain entrenched in negative territory and recorded the fourth consecutive reading below zero. Views on the current situation surprised to the downside, as the region has been dealing with a recession. The current situation index slipped to -71.3, from -59.5. This was the lowest level since October and was below the -63.0 expected by consensus.

Japan: The economy grew by a faster-than-expected rate in the second quarter, as GDP expanded 1.5% in the quarter. This was up from 0.9% growth in the first quarter and was above consensus expectations for 0.8% growth. In annualised terms, GDP expanded 6.0% in the quarter, above expectations of 2.9%. The result was driven by strong gains in exports. Net exports contributed 1.8 percentage points to growth in the quarter, led by strong vehicle exports to the US and Europe. This more than offset a 0.5% fall in household spending (below expectations of 0.0%) and a flat outcome for business investment (below consensus estimates of 0.4%). Due to the result, the level of economic activity rose above its pre-pandemic levels, hitting its highest level on record.

Growth in industrial production was finalised at 2.4% in June, above the preliminary estimate of 2.0%. In annual terms, industrial production was flat, above the initially reported 0.4% contraction.

United Kingdom: The unemployment rate rose to 4.2% over the three months to June, a tentative sign that the tight labour market is showing signs of loosening as aggressive rate hikes from the Bank of England (BoE) impact the economy. This was up from the 4.0% rate over the three months to May and has trended higher since bottoming at 3.5% in this cycle in August 2022. However, while the unemployment rate rose, wages growth was stronger over the quarter and rose to its highest pace on record. This result paints a challenging picture for the BoE and strengthens expectations that additional hikes will be necessary to bring down inflation. Excluding bonuses, wage grew 7.8% over the June quarter – the fastest pace on record (since 2001). This beat expectations of 7.4% and followed growth of 7.5% over the three months to May. Including bonuses, average weekly earnings increased 8.2% over the three months to June. This was above expectations of 7.4% growth and was up from the 7.2% result in the prior period. The prior results for both measures were also revised higher, signalling strength.

Interest-rate markets are now pricing an additional three hikes from the BoE by the middle of next year, up from around 2.5 hikes prior to the release of the data.

United States: Retail spending surprised to the upside, suggesting that consumer spending remains resilient in the face of higher rates. Retail spending grew 0.7% in July, up from 0.3% in June and above expectations of 0.4%. The picture was even stronger once stripping out vehicle and fuel sales, which can be volatile. The ex auto and gas measure jumped 1.0% in the month, beating expectations and the June rise, which were both at 0.4%. The control group measure, which reflects total industry sales that are used to prepare the personal consumption expenditure (PCE) estimates for most goods, also jumped by a stronger-than-expected 1.0% in the month, signalling resilience in retail spending.

Import and export prices rose by more than expected in July, following falls in June. The import price index gained 0.4% in the month, following a 0.1% fall in June. This was stronger than the 0.2% expected by consensus. The result reflected a 3.5% rise in petroleum costs. Excluding this category, import prices were flat in the month. Export prices rose 0.7% in July, following a 0.7% fall in June. This was also stronger than an expected 0.2% gain.

Manufacturing activity in the New York region contracted at a faster-than-expected rate in August. The empire manufacturing index fell sharply to -19.0 in August, from 1.1 in July. This was below expectations of -1.0. New orders plunged and inflationary pressures remained elevated. Measures prices paid and received rose to their highest levels in three months, while the new orders and shipments sub-indices dropped into contractionary territory for the first time in three months.

Homebuilder sentiment declined but remained at the breakeven point between expansion and contraction. The NAHB housing market index slipped to 50 in August, down from 56 in July and below expectations, which were for an unchanged reading from July. The August pullback follows a strong recovery in sentiment over 2023, from 31 in December 2022. Higher mortgage rates are impacting buyer demand, which may be offsetting some of the other factors supporting builder sentiment.

Business inventories were flat in June, unchanged from the same outcome in May. This was slightly weaker than the 0.1% expected by consensus.

Neel Kashkari noted that inflation was “still too high”, despite the progress the Fed has made in bringing it down. He remained open on the potential need for additional hikes, stating that he was “not ready” to call and end to the cycle and wants to see “convincing evidence” that inflation is on its way down.

Today’s key data and events:

AU WBC Leading Index Jul prev 0.1% (10:30am)

EU GDP Q2 Prel. exp 0.3% prev 0.3% (7pm)

EU Industrial Production Jun exp 0.2% prev 0.2% (7pm)

NZ RBNZ Policy Decision (12pm)

Official Cash Rate exp 5.50% prev 5.50%

UK CPI Jul exp -0.5% prev 0.1% (4pm)

US Housing Starts Jul exp 1.1% prev -8.0% (10:30pm)

US Building Permits Jul exp 1.9% prev -3.7% (10:30pm)

US Industrial Production Jul exp 0.3% prev -0.5% (11:15pm)

US FOMC Meeting Minutes (4am)

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.

Jarek Kowcza, Senior Economist
Ph: +61 481 476 436

Contact Listing

Chief Economist
Besa Deda
dedab@stgeorge.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@stgeorge.com.au
+ 61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@stgeorge.com.au
+61 468 571 786

Economist
Jameson Coombs
jameson.coombs@stgeorge.com.au
+61 401 102 789