Morning Report

Wednesday, 17 May 2023

Equities (close & % change)		
S&P/ASX 200	7,235	-0.4%
US Dow Jones	33,012	-1.0%
Japan Nikkei	29,843	0.7%
China Shanghai	3,450	-0.6%
German DAX	15,898	-0.1%
UK FTSE100	7,751	-0.3%
Commodities (close & change)*		
CRB Index	259.9	-1.8
Gold	1,989.17	0.0
Copper	8,257.25	14.0
Oil (WTI futures)	70.86	-0.3
Coal (thermal)	161.70	-2.7
Coal (coking)	237.67	0.0
Iron Ore	104.80	-0.2

Sydney Futures Exchange (last & change)	Last	Overnight Chg
10 yr bond	3.47	0.06
3 yr bond	3.14	0.05
3 mth bill rate	3.98	0.03
SPI 200	7,217.0	-37

FX Last 24 hrs	Open	High	Low	Current
TWI	60.7	-	-	60.7
AUD/USD	0.6699	0.6710	0.6651	0.6657
AUD/JPY	91.17	91.26	90.57	90.79
AUD/GBP	0.5348	0.5356	0.5325	0.5332
AUD/NZD	1.0736	1.0740	1.0672	1.0685
AUD/EUR	0.6162	0.6167	0.6123	0.6129
AUD/CNH	4.6641	4.6742	4.6494	4.6579
USD Index	102.43	102.69	102.20	102.61

Interest rates (close & change)		
Australia		
90 day BBSW	3.91	0.02
2 year bond	3.26	0.01
3 year bond	3.11	-0.01
3 year swap	3.53	-0.01
10 year bond	3.41	-0.02
United States		
3-month T Bill	5.01	0.02
2 year bond	4.08	0.07
10 year bond	3.53	0.03
Other (10 year yields)		
Germany	2.35	0.04
Japan	0.40	-0.01
UK	3.82	0.00

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: A continued deadlock between Democrats and Republicans on the debt ceiling contributed to elevated investor concerns in late stages of trading on the day. House Speaker Kevin McCarthy noted that negotiators remain far apart after his meeting with President Biden. However, he added that a deal to is still possible within days and negotiations will continue. President Biden cancelled planned stops during his trip to Asia, including Australia.

Rising concerns led to a sharp fall in equity prices as the session came to a close, leading to stocks ending lower on the day. Earlier in the session, stronger-than-expected economic data from the US contributed to bond yields rising and to a stronger US dollar. The Australian dollar ended lower.

Share Markets: Stock markets recorded sharp falls towards the end of the session and ended lower on the day. Concerns around the debt ceiling are impacting market sentiment. The S&P 500 closed down 0.6%, the Nasdaq fell 0.2%, and the Dow Jones dropped 1.0%.

The ASX 200 fell 0.4% yesterday and futures are pointing to a weaker open today.

Interest Rates: Stronger-than-expected US economic data contributed to a rise in bond yields. The US 2-year treasury yield rose 7 basis points, to 4.08%. The 10-year yield was also higher, rising 3 basis points to 3.53%. Interest-rate markets are pricing in around a 13% chance of a hike at the Fed's June meeting and expect almost 60 basis points of cuts by the end of 2023.

The 3-year Australian government bond yield (futures) rose 5 basis points, to 3.14%. The 10-year government bond yield (futures) was 6 basis points higher, at 3.47%. Unlike in the US, the Australian yield curve remains positive. However, it is noteworthy that the 2-10-year bond yield spread closed at its lowest level since September 2008 yesterday. Interest-rate markets are pricing in little chance of another hike in June but have around a 43% chance of a hike by August. A full cut isn't priced until 2024.

Foreign Exchange: The US dollar strengthened against major currencies on the back of stronger bond yields. The USD Index rose from a low of 102.20 to a high of 102.69, before falling back slightly to 102.61.

The AUD/USD pair declined in line with a stronger USD. The pair fell from a high of 0.6710 to a low of 0.6651. It was trading at 0.6657 at the time of writing.

Commodities: Weaker-than-expected data from China contributed to oil prices falling and closing below US$71 overnight. Iron ore and thermal coal were also down, while copper rose.

Australia: In May, the Reserve Bank (RBA) Board surprised financial markets and most economists by hiking rates by 25 basis points. This followed a pause at the April meeting and took the cash rate to 3.85% – the highest since April 2012.

The meeting minutes were released yesterday. The minutes appear slightly more hawkish and demonstrate that the RBA remains concerned about the rapid pace of inflation. Potential risks leave the RBA's gradual path back to the inflation target with “little room for upside surprises”.

There were several arguments for a hike, including potential upside risks to inflation and inflation expectations amid an elongated return to target, the persistence of services inflation overseas and the risk we have the same experience, upward pressure on rents amid record population growth and low vacancy rates, and ongoing strength in the labour market which is putting pressure on services inflation.

Weak productivity growth was another risk. The RBA’s forecasts were “predicated on productivity growth returning to around the modest pace recorded prior to the pandemic”. However, if this didn’t happen, “growth in unit labour costs would be uncomfortably fast”.

Asset prices and their impacts on inflation, such as rising dwelling prices and a weak AUD, were discussed. The Board acknowledged that the April pause “was likely to have contributed” to this, while also noting that “several factors had contributed”. Recent data suggests dwelling prices have continued to rise, despite the May hike.

Arguments for a pause included inflation having peaked in the December quarter and being on the way down, risks inflation may slow faster than expected, weak consumption and expectations for further softness, and the long and variable lags in monetary policy which will see aggregate mortgage payments continue to rise even without further increases in the cash rate.

Consumer sentiment declined in May, falling by 7.9% in the month, to 79.0. Sentiment was dented by the unexpected cash rate hike in May. Cost-of-living support measures announced in the 2023-24 Budget were not enough to lift confidence. All sub-indices declined in the month. Family finances for a year ago and a year ahead both plunged by more than 10%. Views on the economy were down by over 9% and the expectations sub-index plunged 9.6%. View on current conditions were less negative, but still declined 4.8% in the month.

China: Industrial production expanded by less than expected over the year to April. Industrial production was 5.6% higher in annual terms in April. This followed a 3.9% annual increase in March. However, it was below the 10.9% gain expected by consensus. The annual gain reflected a 6.5% increase across manufacturing and a 4.8% increase for electricity, gas & water supply. Mining production was unchanged in the year.

Retail sales surged by almost 20% in annual terms in April as spending bounced back strongly from suppressed levels driven by lockdowns in Shanghai a year ago. In annual terms, retail sales surged by 18.4% in April. This followed a 10.6% annual jump in March. Despite the surge, the outcome was below consensus expectations of 21.9%.

While higher due to base effects a year earlier, the weaker-than-expected outcomes suggest the post-COVID recovery may be losing some steam. Some reports have suggested this increases the case for the People’s Bank of China to provide additional stimulus through rate cuts.

Europe: Investor expectations fell in May and dipped back into pessimistic territory after being above zero for the past four months. The ZEW expectations survey slipped to -9.4 in May, down from 6.4 in April. Readings from the survey have dropped sharply from a 2023 high of +29.7 in February but remain well above the September 2022 lows of -60.7.

Investor confidence in German slipped for a third consecutive month as the German ZEW expectations survey fell to -10.7 in May, from +4.1 in April. Current conditions dropped to -34.8, from -32.5. The reading adds to risks that the German economy may experience a mild recession in the period ahead.

The second estimate of eurozone GDP showed the economy expanded by 0.1% in the first quarter of 2023, to be 1.3% higher over the year. This outcome matched the reading from the first estimate.

A trade surplus of €17.0 billion was reported in March. This was the first trade surplus since September 2021 and reflects a turnaround from a €0.2 billion deficit in February.

United Kingdom: The labour market showed some signs of slowing after continued hikes from the Bank of England. The unemployment rate rose to 3.9% over the three months to March, up from 3.8% over the three months to February. This was above consensus expectations of 3.8%. Weekly earnings excluding bonuses were weaker than expected but remained elevated. Earnings rose to 6.7% over the three months to March. This was up from 6.6% to February but was weaker than the 6.8% expected by consensus.

Employment growth was stronger-than-expected in the three months to March, rising by 182k people. This was above expectations of 160k and followed a 169k outcome to February. However, April numbers showed employment growth fell by 136k in the month, down from a 42k gain in the prior month and well below expectations of a 25k gain.

United States: Industrial production rose 0.5% in April and was stronger than expected. The gain followed a revised flat outcome in March (revised down from an initial gain of 0.4%) and was above expectations of a flat outcome. Factory production rose 1.0%, utilities fell 3.1%, and mining rose 0.6%. Capacity utilisation rose to 79.7%, from 79.4% in March. While down from a peak of close to 81% in late 2022, this measure remains elevated and suggests the economy continues to come up against capacity constraints.

Retail sales rebounded in April following falls in March. The headline measure of retail sales rose 0.4% in April following a -0.7% fall in March. This was below consensus expectations of 0.8% for the month, however, the March figure was revised higher from an initial -1.0% reading. The control group measure came in stronger than expected, rising 0.7% in the month against expectations of a 0.4% gain. The outcome followed a 0.4% fall in March. The results suggest that while consumers are being impacted by tighter monetary policy, they still have some capacity to spend and outcomes are holding up in the face of higher rates.

Business inventories declined 0.1% in March, following a flat outcome in February. This was slightly below expectations of a flat outcome.

NAHB homebuilder confidence rose to 50 in May. This was up from the prior month and above expectations, both at 45. A lack of existing inventory has resulted in consumers shifting to newer builds and helped to boost construction.

A range of Fed members spoke overnight. Thomas Barkin maintained a hawkish stance, noting that he isn't convinced that inflation is defeated and that he would be willing to raise rates further if needed. He noted lessons from the 1970s and cautioned against stopping too soon, while also flagging that firms still having pricing power. Loretta Mester said that she didn't think rates were sufficiently restrictive yet. On the other hand, Lorie Logan noted that moving more slowly doesn't necessarily indicate that the Fed is less committed to meeting its target, and John Williams said that inflation is unacceptably high but moving in the right direct. He thinks the Fed must gather more economic data to assess the impact higher rates are having on the economy.

Today's key data and events:

JP GDP Q1 Prel. Exp 0.2% prev 0.0% (9:50am)
AU WBC Leading Index Apr prev 0.0% (10:30am)
AU Wage Price Index Q1 (11:30am)
q/q exp 0.8% prev 0.8%
y/y exp 3.5% prev 3.3%
JP Industrial Prod. Mar Final prev 0.8% (2:30pm)
EZ CPI Apr Final y/y exp 7.0% prev 6.9% (7pm)
US Housing Starts Apr exp -1.4% prev -0.8% (10:30pm)
US Building Permits Apr exp 0.2% prev -7.7% (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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