Morning Report

Wednesday, 22 February 2023

Equities (close & % change)		
S&P/ASX 200	7,336	-0.2%
US Dow Jones	33,130	-2.1%
Japan Nikkei	27,473	-0.2%
China Shanghai	3,466	0.5%
German DAX	15,398	-0.5%
UK FTSE100	7,978	-0.5%
Commodities (close & change)*		
CRB Index	268.5	0.9
Gold	1,835.27	-6.1
Copper	9,133.75	159.5
Oil (WTI futures)	76.16	-0.2
Coal (thermal)	196.00	16.5
Coal (coking)	377.00	-0.5
Iron Ore	129.85	-1.2

Sydney Futures Exchange (last & change)				
	Last		Overnight Chg	
10 yr bond	3.93		0.11	
3 yr bond	3.65		0.08	
3 mth bill rate	3.71		0.03	
SPI 200	7,216.0		-43	
FX Last 24 hrs	Open	High	Low	Current
TWI	62.3	-	-	62.3
AUD/USD	0.6913	0.6920	0.6848	0.6855
AUD/JPY	92.81	93.01	92.37	92.50
AUD/GBP	0.5744	0.5748	0.5658	0.5662
AUD/NZD	1.1055	1.1082	1.1013	1.1039
AUD/EUR	0.6470	0.6476	0.6432	0.6439
AUD/CNH	4.7417	4.7461	4.7196	4.7265
USD Index	103.89	104.26	103.77	104.18

Interest rates (close & change)		
Australia		
90 day BBSW	3.50	0.02
2 year bond	3.56	0.02
3 year bond	3.56	0.02
3 year swap	4.08	0.08
10 year bond	3.81	0.00
United States		
3-month T Bill	4.68	-0.01
2 year bond	4.73	0.11
10 year bond	3.95	0.14
Other (10 year yields)		
Germany	2.53	0.06
Japan	0.51	0.00
UK	3.61	0.14

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

Main Themes: Bond yields surged higher and equity markets dropped sharply as stronger-than-expected activity indicators across the US, UK and Europe, particularly in the services sector, supported the view that interest rates would need to rise higher and remain elevated for longer in order to reduce inflationary pressures. Geopolitical tensions and a cautious outlook from bellwethers Walmart and Home Depot added to the sour mood. The US dollar also jumped against a basket of major currencies.

Share Markets: Share markets dropped sharply as the stronger-than-expected activity data supported a need for higher rates, weighing on equity markets. Cautious forecasts from Walmart and Home Depot also negatively impacted risk sentiment.

The S&P 500 plunged 2.0% – its worst selloff since mid-December. The Nasdaq dropped an even larger 2.5%, while the Dow Jones followed suit, and dropped 2.1%.

The ASX 200 fell 0.2% yesterday. Futures are pointing to a weak open on the back of the sharp moves in US markets.

Interest Rates: Bond yields surged higher and expectations for the terminal Fed funds rate increased. The 2-year treasury yield surged 11 basis points higher on the day, to 4.73%. The 10-year yield jumped by an even larger 14 basis points, to 3.95% – its highest level since November 2022.

Higher interest rate expectations were also reflected in an increase in the terminal Fed funds rate priced by interest-rate markets, which rose to 5.37% in mid-2023, from 5.28% on Friday last week. Interest-rate markets are now also pricing in 28 basis points of hikes at the Fed's March meeting, indicating some probability of a more aggressive 50-basis-point move.

Australian interest-rate markets mimicked the moves in the US. The 3-year Australian government bond yield (futures) jumped 8 basis points, to 3.65%, while the 10-year government bond yield (futures) surged 11 basis points, to 3.93%.

Interest-rate markets are pricing in 20 basis points of hikes at the RBA's March meeting and expect the cash rate to peak at 4.27% in late 2023.

Currencies: The US dollar strengthened against a basket of major currencies in line with expectations that interest rates will need to move higher than previously expected. The USD Index rose from a low of 103.77 to a high of 104.26. It pulled back slightly and was trading at 104.18 at the time of writing.

The AUD/USD declined on the back of US dollar strength. The pair fell from a high of 0.6920 to a low of 0.6848, before recovering slightly to trade at 0.6855.

Commodities: Copper and thermal coal were stronger on the day. Gold, iron ore, coking coal and oil all slipped.

Australia: In February, the Reserve Bank (RBA) hiked the cash rate by 25 basis points, to 3.35% – it's highest since September 2012.

It wasn't the decision which captured the attention of markets and economists, it was the policy statement. The statement provided clear guidance that at least two more rate hikes are on the horizon amid subtle changes to the RBA's rhetoric.

Yesterday, the minutes revealed that the RBA is more concerned about the upside risks to inflation and has elevated its focus on controlling inflation. The objective of 'keeping the economy on an even keel' now appears to be secondary.

An improvement in the global outlook and "a pattern of incoming prices and wages data exceeding expectations" largely explain the RBA's renewed aggression to tackle inflation.

The RBA Board considered a 25 or 50 basis point hike in February, quashing some expectations for a pause. Ultimately, the Board concluded that the case to hike by 25 basis points was more compelling as interest rates had already increased substantially and the monthly frequency of meetings provided scope to react to future uncertainties.

In the December meeting, the RBA considered a pause, flagging the long and variable lags in monetary policy as a key argument in favour of this option. However, the February minutes make little effort to highlight this argument.

The February meeting marked an important change in the RBA's characterisation of where the inflation risks lie and their resolve to prevent any upside risks from being realised.

Europe: Activity in the services sector was stronger than expected and in expansionary territory (i.e. above 50) for the second consecutive month. The services purchasing managers' index (PMI) rose to 53.0 in February, up from 50.8 in January. This was above consensus expectations of 51.0. The outcome was the strongest since June 2022, which also recorded the same reading. The strength in the services sector shows that the economy is holding up well under the weight of higher rates.

Conversely, activity in the manufacturing sector remained in contractionary territory for the eighth consecutive month and was weaker than expected. The manufacturing PMI came in at 48.5 for February, below expectations of 49.3. This was also slightly lower than the January outcome of 48.8.

Investor sentiment in Germany, Europe's largest economy, improved for a fifth consecutive month as inflationary pressures gradually ease and concerns around a deep recession decline. The ZEW survey of expectations rose to 28.1 in February, above expectations of 23.0 and the highest since before Russia invaded Ukraine. This was up from the 16.9 reading in January and was the second month of readings above 0, after the measure was in deep negative territory throughout most of 2022. The measure of the current situation also improved but remained in deep negative territory at -45.1.

Japan: Services activity accelerated in February, as the services PMI rose to 53.6 in the month, up from 52.3 in January. This was the sixth consecutive month of expansion and was the highest reading since June 2022. On the other side of the ledger, manufacturing activity fell deeper into contractionary territory. The manufacturing PMI fell to 47.4 in February, from 48.9 in January. This was the fourth consecutive month of contraction and was the weakest outcome since August 2020. New orders declined while output recorded its eight consecutive month of contraction – dropping to its lowest level since July 2020.

New Zealand: Producer price pressures are showing continued signs of easing, despite remaining elevated. Producer input prices, as measured by the producer price index (PPI) rose by 0.5% in Q4 2022. This was down from 0.8% in Q3. PPI output prices were 0.9% higher in Q4, down from 1.6% in Q3.

The quarterly growth in both PPI input and output prices has decelerated over 2022, after quarterly growth rates for both measures peaked in Q1 2022.

In annual terms, input and output price pressures remain elevated, at 8.0% and 7.7%, respectively.

United Kingdom: Services activity surprised to the upside and moved into expansionary territory in February. The services PMI jumped to 53.3 in the month, following a 48.7 outcome in January and above consensus expectations of 49.2. This was the first move into expansionary territory since the 50.0 reading in September 2022 and was the strongest outcome since June 2022. New business rose to 53.8, from 49.9 in January, the highest reading since May 2022.

Activity in the manufacturing sector also surprised to the upside but remained in contractionary territory. The manufacturing PMI rose to 49.2 in February, up from 47.0 in January and above expectations of 47.5. The increase was underpinned by stronger results in employment and output.

The government recorded a budget surplus in January as borrowing by the public sector reduced by £6.2 billion in the month, following a revised

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budget deficit of £24.8 billion in January. This was below expectations, which centred on a further increase in borrowing of £1.3 billion.

United States: Services activity was stronger than expected and moved into expansionary territory for the first time since June 2022. The S&P services PMI jumped to 50.5 in February, up from 46.8 in January and above expectations of 47.3. The gain reflected a stronger outcome in employment, which rose to 51.5 in February from 50.8 in January. In what will likely be a consideration for the Federal Reserve, prices charged rose in February to their highest level since October. The higher-than-expected February outcome narrows the previous gap between the S&P services PMI and the ISM services PMI measure, which surprised to the upside in January at 55.2.

Manufacturing activity remained in contractionary territory, despite surprising to the upside. The manufacturing PMI was 47.8 in February, up from the prior 46.9 reading and above consensus expectations of 47.2. Employment was higher, at 52.6 in February versus 50.3 in January. Output also rose versus the prior month and increased to the highest level since October.

Existing home sales fell 0.7% in January as higher interest rates continue to weigh on the property sector. This was below consensus expectations of a 2.0% gain but was above the December outcome of -2.2%.

Today's key data and events:

NZ Trade Balance Jan (8:45am)

AU WBC Leading Index Jan prev –0.13% (10:30am)

AU Wage Price Index Q4 (11:30am)
  q/q exp 1.1% prev 1.0%
  y/y exp 3.6% prev 3.1%

AU Construction Work Done Q4 exp 1.6% prev 2.2% (11:30am)

NZ RBNZ Policy Decision exp 4.75% prev 4.25% (12pm)

NZ Credit Card Spending Jan prev 12.4% (1pm)

EZ CPI Jan Final exp -0.2% prev -0.4% (6pm)

EZ GER IFO Business Climate Survey Feb exp 91.2 prev 90.2 (8pm)

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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