

Morning Report

Friday, 2 June 2023



Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,111	0.3%			Last	Overnight Chg		Australia		
US Dow Jones	33,062	0.5%	10 yr bond	3.59				90 day BBSW	4.01	0.03
Japan Nikkei	31,148	0.8%	3 yr bond	3.37				2 year bond	3.58	0.03
China Shanghai	3,359	0.0%	3 mth bill rate	4.06				3 year bond	3.38	0.01
German DAX	15,854	1.2%	SPI 200	7,172.0				3 year swap	3.73	0.00
UK FTSE100	7,490	0.6%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.62	0.01
Commodities (close & change)*			TWI	59.8	-	-	59.8	United States		
CRB Index	257.4	3.5	AUD/USD	0.6502	0.6582	0.6485	0.6572	3-month T Bill	5.19	-0.06
Gold	1,977.61	14.9	AUD/JPY	90.60	91.35	90.30	91.24	2 year bond	4.34	-0.06
Copper	8,080.00	-31.9	AUD/GBP	0.5228	0.5251	0.5217	0.5247	10 year bond	3.60	-0.05
Oil (WTI futures)	70.10	2.0	AUD/NZD	1.0806	1.0847	1.0798	1.0828	Other (10 year yields)		
Coal (thermal)	130.85	-4.4	AUD/EUR	0.6085	0.6122	0.6072	0.6109	Germany	2.25	-0.03
Coal (coking)	225.50	2.0	AUD/CNH	4.6280	4.6780	4.6205	4.6695	Japan	0.42	-0.01
Iron Ore	101.75	-0.3	USD Index	104.13	104.50	103.50	103.56	UK	4.12	-0.07

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: There was a risk on tone overnight as Fed officials continued to make dovish comments and investors digested US economic data which came in softer than expected, supporting a rate pause. Sentiment was also supported as the House of Representatives passed the US debt ceiling Bill. The Bill will now go to the Senate where it is also expected to pass, before becoming law.

US equities made strong gains. Bond yields were lower. The US dollar declined, with risk sensitive currencies, including the Aussie dollar, increasing.

Share Markets: The risk on tone supported strong gains in US equity markets, led by tech stocks. The S&P 500 jumped by 1.0%, the Nasdaq increased by 1.3%, while the Dow Jones increased by 0.5%.

The ASX 200 closed 0.3% higher. Eight of the eleven sectors were higher, led by health and consumer staples stocks. Futures are pointing to positive open today.

Interest Rates: US government bond yields declined across the curve, on the back of the dovish Fed speak. The US 2-year yield declined by 6 basis points to 4.34%. The US 10-year yield declined by 5 basis points to 3.60%.

Markets are currently attaching a probability of 23% to another rate hike from the Federal Reserve when they next meet in June. Markets are pricing in around one and a half rate cuts by early 2024.

The 3-year Australian government bond yield (futures) declined by 1 basis point, to 3.37%. The 10-year government bond yield (futures) declined by 3 basis points, to 3.59%.

Markets are currently attaching a 24% chance that the Reserve Bank (RBA) will hike in June. However, markets are not pricing in another rate hike in August, following the release of the June quarter inflation data.

Foreign Exchange: Risk sensitive currencies, including the Aussie dollar, made solid gains overnight. The AUD/USD pair reached a high of 0.6582, before settling at around 0.6572.

The US dollar declined against a basket of major currencies. It ranged between a low of 103.50 to a high of 104.50, before closing around 103.56.

Commodities: Commodities were mixed. Gold, oil and coking coal were higher. Copper, thermal coal and iron ore were lower.

The West Texas Intermediate (WTI) crude future rose to US\$70.10 per barrel. Saudi Arabia's exports slumped in May as output cuts came into effect.

Australia: Dwelling prices rose 1.2% in May despite a cash rate hike in the month. This was the third consecutive monthly rise and followed gains of 0.5% in April and 0.6% in March. After a 9.1% drawdown from the April 2021 peak, prices have rebounded 2.3% since February 2023.

The pace of growth broadened and accelerated. Monthly growth was the strongest since November 2021 and all capitals and regions (except regional Victoria) recorded robust growth.

An imbalance between supply and demand continues to be a major driver. New and total listings are well below average. Total listings are almost 25% below their five-year average, while new listings are 13% down on the five-year average and 26% below 2022 levels.

Against this backdrop, demand has accelerated. Record migration, an incredibly tight rental market, and expectations that interest rates are nearing a peak have supported demand. Sales volumes are picking up, and over the past three months have been 16% above volumes over the three months to February 2023.

Sydney led the growth, with the more expensive quartile leading the way. Sydney dwelling prices rose 1.8%, marking the fourth consecutive month of gains and third consecutive month of growth above 1%. Brisbane and Perth also recorded monthly gains above 1%.

Dwelling prices appear to have found a firm bottom and an uptrend is in place. The balance of competing factors is important. Our house view is for prices to be broadly unchanged in 2023, before rising 5% in 2024. However, with the current momentum, risks are skewed to the upside.

New private capital expenditure (capex) jumped 2.4% in the March quarter. The December quarter was revised up to 3.0% from the initial estimate of 2.2%. Investment in machinery and equipment jumped 3.7% over the quarter, while new buildings increased by 1.3%.

While the volume of investment grew strongly, the actual value invested slowed. The prices of these investment goods are showing clear signs of decelerating. In fact, prices of investment goods increased by 0.5% over the quarter – the slowest rate since March quarter of 2021 and much lower than the average rate of 2.2% recorded over the past six quarters.

This suggests that the disinflationary impulse from the resolution of supply-chain disruptions has arrived. It will take time for this to flow through to domestic prices, but the scene is set for inflation to continue to ease over 2023.

Capex spending could increase by 13.1% to \$161.1bn in 2022-23, and by 1.7% to \$163.8bn in 2023-24, if we adjust survey outcomes in line with

historical norms.

However, if we adjust using the realisation ratio from the most recent RBA tightening cycle (2010-11), capex would increase by 10% to \$156.6bn in 2022-23, and would fall by 1.9% to \$153.7bn in 2023-24. Using either method, capex is expected to be weak in 2023-24.

The price of investment goods eased significantly over the quarter which is encouraging businesses to invest and source investment goods that have been unavailable. Looking ahead, capex is expected to be weak in 2023-24, with the outlook softening since last quarter's capex survey.

China: The Caixin General Manufacturing Purchasing Managers' Index (PMI) increased to 50.9 in May 2023, from 49.5 in April. The PMI showed that output rose the most in 11 months, new order growth was at 2 year-high, and foreign sales increased. On the cost side, input prices fell on the back of better supply chains and lower prices of metals, food, and fuel.

United Kingdom: The S&P Global Manufacturing PMI declined to a four-month low of 47.1 in May, down from 47.8 in April. All the PMI components, which includes output, new orders, employment, stocks of purchases and supplier lead times, declined over the month. Manufacturing production scaled back for the third consecutive month. New export orders fell for the sixteenth consecutive month in May. Average output charges rose over May, as manufacturers acted to repair margins from the damage caused by recent steep cost increases. However, the rate of increase in selling prices was the weakest for two-and-a-half years.

Eurozone: The consumer price index (CPI) increased by 6.1% over the year to May, down from the 7.0% recorded in April. The outcome was better than the 6.3% the market was expecting. The slowdown in inflation was driven by a 1.7% annual decline in energy prices, following the 2.4% annual decline recorded in April. The core inflation rate, which excludes energy, food, alcohol, and tobacco, also eased to 5.3% from the 5.6% recorded in April. The outcome was also better than the 5.5% the market was expecting.

Notwithstanding this better-than-expected outcome, ECB President, Christine Lagarde, said there's "no clear evidence" that inflation has peaked and "we have made clear that we still have ground to cover to bring interest rates to sufficiently restrictive levels."

The unemployment rate edged down to 6.5% in April, from the upwardly revised 6.6% rate (from the initial estimate of 6.5%) recorded in March. The outcome was in line with market expectations. The number of unemployed persons declined by 33k to 11.088 million. The youth unemployment rate declined to 13.9% in April, from 14% in March. Amongst the largest economies, the lowest unemployment rate was recorded in Germany (2.9%), while the highest rates were recorded in Spain (12.7%) and Italy (7.8%). The outcome shows that the Area's labour market remains tight.

United States: Private businesses created 278k jobs in May, following the revised 291k jobs created in April (initial estimate was 296k). This was well above the 170k jobs the market was expecting. The services sector added 168k, led by leisure and hospitality and trade/transportation/utilities. The goods producing sector added 110k jobs. On the wage front, pay increases slowed for both job changers (12.1% increase compared with 13.1% last month) and job stayers (6.5% increase compared with 6.7% last month).

The S&P Global Manufacturing PMI was revised lower to 48.4 in May, from the preliminary read of 48.5. This was down from the read of 50.2 recorded in April. The fall was driven by a contraction in new orders. Employment continued to increase, as firms expanded their capacity to fulfill existing backlogs of work amid improved supply conditions. On the price front, input costs fell for the first time since May 2020.

The ISM Manufacturing PMI fell to 46.9 in May, from 47.1 in April. The reading indicated a seventh consecutive month of contraction in the manufacturing sector, as companies manage outputs to better align with demand. In May, new orders, inventories, and backlogs of orders contracted. On the other hand, employment rose at a faster pace, with companies indicating near equal levels of activity toward expanding and contracting head counts.

Construction spending increased by 1.2% over April after rising 0.3% in March. The outcome was much stronger than the 0.2% the market was expecting and was driven by investment in non-residential structure. Private investment in non-residential structures increased by 2.4% over the month. On the other hand, investment in residential construction rose 0.5% over the month.

Philadelphia Fed President, Patrick Harker, said the Fed is close to the point where it can stop

raising interest rates. "I do believe that we are close to the point where we can hold rates in place and let monetary policy do its work to bring inflation back to the target in a timely manner... I think we should pause, because pause says we're going to hold for a while — and we might," he said.

Today's key data and events:

AU Housing Finance Apr (11:30am)

Investor exp 2.0% prev 3.7%

Owner Occupier exp 3.5% prev 5.5%

Total exp 2.0% prev 4.9%

NZ Terms of Trade Q1 prev 1.8% (8:45am)

US Non-farm Payrolls Chg. May exp 180k prev 253k (10:30pm)

US Unemploy. Rate May exp 3.5% prev 3.4% (10:30pm)

US Avg. Hourly Earnings May exp 0.3% prev 0.5% (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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