Morning report

Wednesday, 15 March 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,009	-1.4%		Last		Overnight Chg		**Australia**		
US Dow Jones	32,155	1.1%	10 yr bond	3.48		0.03		90 day BBSW	3.64	-0.01
Japan Nikkei	27,222	-2.2%	3 yr bond	3.05		-0.01		2 year bond	3.10	-0.16
China Shanghai	3,402	-0.7%	3 mth bill rate	3.64		0.03		3 year bond	3.05	-0.16
German DAX	15,233	1.8%	SPI 200	7,052.0		67		3 year swap	3.62	0.15
UK FTSE100	7,637	1.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.45	-0.07
Commodities (close & change)*			TWI	60.3	-	-	60.3	**United States**		
CRB Index	261.1	-3.6	AUD/USD	0.6667	0.6696	0.6632	0.6680	3-month T Bill	4.64	-0.01
Gold	1,903.80	-9.9	AUD/JPY	88.82	90.10	88.55	89.64	2 year bond	4.24	0.26
Copper	8,827.00	-103.3	AUD/GBP	0.5473	0.5498	0.5458	0.5495	10 year bond	3.68	0.11
Oil (WTI futures)	71.48	-3.3	AUD/NZD	1.0721	1.0731	1.0691	1.0711	**Other (10 year yields)**		
Coal (thermal)	180.00	-2.9	AUD/EUR	0.6214	0.6242	0.6197	0.6224	Germany	2.42	0.16
Coal (coking)	361.50	-1.8	AUD/CNH	4.5669	4.6014	4.5566	4.5986	Japan	0.27	-0.07
Iron Ore	132.70	1.0	USD Index	103.62	104.05	103.50	103.67	UK	3.49	0.12

Data as at 7:45 am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: The collapse of Silicon Valley Bank (SVB) already had markets on a knifes edge, add to that stubbornly high US inflation and a spike in geopolitical concerns and it makes for very volatile trading. Confidence in the US banking system looks to have stabilised somewhat, as the joint policy response helped prevent any contagion through the broader banking sector. However, hotter-than-expected core inflation in the US suggested there's little scope for the Fed to employ a lighter touch in its inflation fight. This means the Fed likely has more to do to break the stickiness of inflation, but it will have to tread lightly to avoid further instability in the financial system.

Share Markets: US equities staged an initial rally as traders wagered that the worst of the banking turmoil was over. However, gains were quickly unwound after a Russian fighter jet collided with a US drone over the Black Sea. Geopolitical concerns have since subsided and the preceding market rally resumed. The S&P 500 finished the day up 1.7%, while the NASDAQ and the Dow Jones finished up 2.1% and 1.1%, respectively. Regional bank stocks rallied, clawing back some recent losses while the wider sector also gained.

The ASX 200 sank 1.4% yesterday as jitters from SVB continued to reverberate through global markets. A sharp fall in risk appetite saw the ASX tumble 2.2% on open before regaining some ground later in the day to close at 7,008.9 – the lowest level in more than three months.

Interest Rates: Trading in fixed interest markets remained choppy as investors weighed financial stability risks against the February inflation report and tried to digest the implications for monetary policy. The MOVE index, which measures volatility in bond markets, remained around its highest level since the GFC.

The two-year treasury yield jumped 26 basis points to 4.24%. This was the largest one-day gain since June 2022 but only partly retraced the 109 basis point slump over the previous three sessions – the largest three-day swoon since 1982. The 10-year yield gained 11 basis points to 3.68%.

Market pricing is implying around a 70% probability of a 25-basis point hike from the Fed this month, up from 57% yesterday. Markets currently see just one more hike from the Fed before rate cuts later in the year.

The Australian 3-year government bond (futures) yield fell 1 basis point to 3.05%, while the 10-year (futures) yield gained 3 basis points to 3.48%.

Market pricing currently implies just a 2% probability of a rate hike from the Reserve Bank (RBA) in April, suggesting an imminent pause in tightening. The market also thinks we have reached the end of the RBA's hiking cycle.

Foreign Exchange: The Aussie dollar firmed despite fragile market sentiment, consolidating its recent hop back above the 0.66 handle. The AUD/USD pair ranged between a low of 0.6632 and a high of 0.6696 and is currently trading around 0.6680.

The US dollar finished broadly flat after gyrating through gains and losses. The DXY index traded from a high of 104.05 to a low of 103.50 before consolidating around 103.67.

Commodities: Commodity prices were broadly weaker. Gold, copper and oil softened, while iron ore bucked the trend, rising to US$132.70 per metric tonne - its highest level since June last year.

Australia: After a brief reprieve over the holiday period, the mood among businesses has slipped back into pessimistic territory. Business confidence dropped 10 index points to -4 in February – the weakest reading since December 2021. It's also the biggest monthly drop in 14 months.

Conditions also eased 1 index point, to +17, but remain elevated and well above the long-run average. This suggests that economic momentum, while slowing from its 2022 pace, remained buoyant in the early part of 2023. A decline in forward orders suggests conditions are likely to weaken further.

Cost pressures remain in focus ahead of the RBA's April meeting. Quarterly growth in purchase costs and final prices was unchanged at 3.1% and 1.6%, respectively, while growth in labour costs rose to 2.8%, from 2.4%. Growth in retail prices has declined over recent months, while price pressures in services have yet to demonstrate a similar material slowing.

The RBA will also be watching the monthly inflation indicator, due 29 March, for signs of continued easing of price pressures. Amid the SVB-related ructions and a signal from the RBA that a pause could be on the table, risks have increased notably that the RBA will refrain from hiking next month.

Consumer sentiment remained at recessionary levels in March, unchanged from February at 78.5. There have now been three readings below 80 over the past five months. The last time we saw a cluster of readings below 80 was during the 1990s recession.

In March, the Reserve Bank (RBA) hiked by 25 basis points. However, the RBA opened the door to a pause in April as recent economic data was weaker than expected. This dovish shift wasn't enough to lift sentiment, and the weaker data likely limited any optimism.

The sub-indices were mixed. Near-term views (i.e. family finances and economic conditions over the next 12 months) declined, while the 'time to buy a major household item' index dropped to its lowest level since the GFC. Views on family finances over the last 12 months improved and consumers were more optimistic about the longer-term economic outlook.

The housing market landscape remains complicated as affordability is stretched. The 'time to buy a dwelling' sub-index dropped to 65.7 – its lowest since 1989, when interest rates were at 17%. Despite this, house price expectations rose by 8.6% (to 111.7), following a moderation in the pace of price falls and a slight lift in Sydney prices in February.

Sentiment remains incredibly weak as inflation, cash rate hikes, and a slowing economy weigh on households. The disconnect between sentiment and spending is likely to continue to narrow, albeit through a slowdown in spending, rather than a material lift in sentiment.

New Zealand: Net migration climbed by 5,170 people in January. This followed a 8,064 person gain in December, which was revised up from 4,581. This prompted a 33,158 annual increase in net migration, the largest rise since December 2020.

United Kingdom: The unemployment rate remained unchanged in January at 3.7% - near a record low. This beat consensus expectations which centred on a slight pick up to 3.8%.

Wage growth slowed over the three months to January despite the tightness of the labour market as an uncertain economic backdrop tempered business appetites to extend pay increases. Average weekly earnings growth slowed to 5.7%, from 6.0% previously but remains well above the levels recorded before the pandemic.

United States: Authorities swift response to the collapse of SVB appears to have prevented broader contagion in the sector and staved off a potential 'crisis of confidence', at least for now. Despite some stabilisation in confidence, Moody's downgraded its outlook for the US banking system to "negative" from "stable". The Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) are commencing a probe into the SVB collapse for potential misconduct.

The headline inflation result suggests price pressures are retreating and the Fed is making progress on inflation. However, core measures paint a much more sinister picture as services inflation proves sticky and a possible reacceleration in core inflation emerges.

The consumer price index (CPI) rose 0.4% in February, down from 0.5% in January and in-line with consensus expectations. Annual inflation slowed to 6.0%, from 6.4% in January – the slowest annual inflation rate since October 2021.

Core inflation, which strips out volatile food and energy items, accelerated to 0.5% in February, from 0.4% in January. This was the fastest monthly increase in the core measure in five months and beat expectations for a 0.4% gain. In annual terms, core inflation edged down to 5.5% from 5.6% in January. Despite some improvement since a peak of 6.6% in September, core inflation is showing no signs of budging.

This will raise some eyebrows at the Fed and support the prevailing mantra of interest rates being 'higher for longer'. However, this approach has been complicated by financial stability risks in the wake of the SVB collapse. On balance, the Fed likely still has more to do to break the stickiness of inflation, but it will have to tread lightly in the near term to strike the right balance between supporting financial stability and making timely progress towards the inflation target.

Today's key data and events:

NZ Current Acc. Q4 exp -$7.7bn prev -$10.2bn (8:45am)

CH Retail Sales Feb YTD y/y exp 3.5% prev -0.2% (1pm)

CH Indust. Production Feb YTD y/y exp 2.6% prev 3.6% (1pm)

EZ Industrial Production Jan exp 0.3% prev -1.1% (9pm)

US PPI Final Feb y/y dexp 5.4% prev 6.0% (11:30pm)

US NY Empire Mfg Mar exp -7.8 prev -5.8 (11:30pm)

US Retail Sales Feb exp -0.4% prev 3.0% (11:30pm)

US Business Inventories Jan exp 0.0% prev 0.3% (1am)

US NAHB Housing Market Index Mar exp 40 prev 42 (1am)

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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