Morning report

Friday, 16 June 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,175	0.2%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,408	1.3%	10 yr bond	3.96		-0.05		90 day BBSW	4.24	0.02
Japan Nikkei	33,485	-0.1%	3 yr bond	3.91		-0.06		2 year bond	4.18	0.09
China Shanghai	3,410	0.7%	3 mth bill rate	4.67		0.00		3 year bond	4.01	0.09
German DAX	16,290	-0.1%	SPI 200	7,167.0		29		3 year swap	4.25	-0.01
UK FTSE100	7,628	0.3%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.00	0.03
Commodities (close & change)*			TWI	62.3	-	-	62.3	**United States**		
CRB Index	266.9	6.6	AUD/USD	0.6795	0.6893	0.6768	0.6881	3-month T Bill	5.05	-0.04
Gold	1,958.01	15.5	AUD/JPY	95.16	96.73	95.12	96.53	2 year bond	4.64	-0.05
Copper	8,515.25	56.8	AUD/GBP	0.5367	0.5395	0.5353	0.5383	10 year bond	3.72	-0.07
Oil (WTI futures)	70.62	2.4	AUD/NZD	1.0953	1.1049	1.0938	1.1035	**Other (10 year yields)**		
Coal (thermal)	156.35	5.7	AUD/EUR	0.6274	0.6310	0.6255	0.6288	Germany	2.50	0.05
Coal (coking)	226.67	-0.3	AUD/CNH	4.8756	4.9081	4.8621	4.9000	Japan	0.43	0.00
Iron Ore	111.90	-1.5	USD Index	102.96	103.38	102.09	102.16	UK	4.38	-0.01

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: The European Central Bank (ECB) raised rates by 25 basis points, as expected, and delivered hawkish commentary all but confirming that additional hikes were on the way. Additionally, a raft of US economic data showed that the impacts of the Fed's aggressive hiking cycle are filtering through more parts of the economy. These developments drove market sentiment overnight.

The outcomes contributed to falls in US bond yields and the US dollar against major currencies as expectations of future hikes were pared back in the US but increased in Europe. US equities jumped on the day on lower rate expectations and continued gains in AI-related stocks. The Aussie dollar surged and decisively broke through a key resistance level.

Share Markets: The recent stock rally gathered steam as the S&P 500 recorded its sixth consecutive day of gains. The index broke above 4,400 for the first time since April 2022 as all major groups rose. Gains in AI-themed stocks continued to drive returns, in addition to traders paring back their expectations of future hikes based on weaker-than-expected economic data. The S&P 500 rose 1.2%, the tech-heavy Nasdaq was 1.1% higher and the Dow Jones rose 1.3%.

The ASX 200 rose 0.2% yesterday, with seven of 11 sectors recording gains. Futures are pointing to a positive open today.

Interest Rates: US bond yields pulled back following weaker-than-expected economic data. On the other hand, European bond yields rose as traders priced in expectations of additional hikes from the ECB.

The US 2-year bond yield closed a 4.64%, down 5 basis points. The 10-year yield was 7 basis points lower, at 3.72%. Interest-rate markets are pricing around a 64% probability of a 25-basis-point hike at the Fed's July meeting – slightly down from the 67% expectation on the previous day. Markets expect rates to peak at 5.28%.

Yields in Europe responded to the ECB's decision and hawkish guidance. The German 2-year bond yield rose 3 basis points, to 3.13% and the 10-year yield closed at 2.50% – 5 basis points higher.

Interest-rate markets are more than fully priced for another hike from the ECB in July. Looking ahead, markets expect the deposit rate (currently 3.50%) to peak at 3.81%. This compares with an expected peak rate of 3.72% before the ECB meeting.

Australian bond yield mimicked moves in US bond yields overnight. The 3-year government bond yield (futures) fell 6 basis points, to 3.91%. The 10-year government bond yield (futures) slipped 5 basis points, to 3.96%. Interest rate markets have a 47% probability of a 25-basis-point hike at the July RBA meeting. This is up from around 24% a day ago. The much stronger-than-expected employment report yesterday raised the prospect of further cash rate hikes from the RBA to slow the economy to reduce inflationary pressures. Markets now expect rates to peak at 4.62% in November, up from 4.50% before the release of the labour market data.

Foreign Exchange: The US dollar fell against major currencies. The fall reflected changes in interest rate differentials as interest rates fell in the US but rose in Europe. The USD Index declined from a high of 103.38 to a low of 102.09, before settling at 102.16. The EUR/USD pair rose from 1.0804 to 1.0953 – to a one-month high, with most gains coming after the ECB decision.

The Aussie dollar surged during the session and decisively broke through the key resistance level of around 0.6815-0.6820 that we have noted in recent days. This continued its recent upward trend and suggests that it is likely to trade higher in the near term. The AUD/USD pair surged from a low of 0.6768 to a high of 0.6893 – its highest level in four months. It remains near that high at the time of writing, at 0.6881.

Commodities: Most commodities were higher in line with a weakening US dollar. Gold, copper, oil, and thermal coal all rose on the day.

Iron ore and coking coal bucked the trend and declined. These are key ingredients to producing steel and were impacted by weaker-than-expected data out of China.

Australia: Employment jumped an impressive 75.9k in May, the largest monthly increase since June last year. The increase in employment drove a slight fall in the unemployment rate to 3.6%, while the participation rate rose to a record high of 66.9%.

On face value, this may appear like a reignition in labour market strength. However, much of the increase in employment in May reflected pay-back from a seasonally impacted fall in April. Looking through recent fluctuations driven by the Easter holiday, today's data is a story of further labour market resilience and robustness, rather than a resurgence in strength.

The story of resilience is no less impressive. Since the end of 2022, the working age population has swelled by a massive 287k people, and the labour market has managed to soak up this supply with very little loosening in conditions.

This speaks to the backlog of demand which accrued while borders were closed. Until this excess demand is exhausted, we are likely to continue to see robust growth in employment. However, once this threshold is met, we expect to see a softening in labour market conditions.

In monitoring this shift, hours worked and the underemployment rate should be followed closely. After the experience of the pandemic, businesses may opt not to reduce headcount as demand slows to avoid the risk of needing to rehire later. Naturally, if this occurs the adjustment in labour needs will come through a change in hours of work.

There currently does not appear to be significant evidence that the easing in conditions required to bring inflation down is afoot, giving the RBA little reason to soften its stance on inflation.

Consumer inflation expectations were at 5.2% in June, according to the Melbourne Institute. This was unchanged from the May outcome. Consumer inflation expectations have reaccelerated over recent months after falling to 4.6% in April. Despite the recent increase, inflation expectations are still well down from the 6.7% peak in June 2022.

China: The 1-year medium term lending facility rate was reduced by 10 basis points, from 2.75% to 2.65%. The move represents the first cut in interest rates since August 2022 and follows the post-COVID reopening boost losing steam in recent months. Markets had been expecting Chinese authorities to provide some form of stimulus following recent weaker-than-expected outcomes across several economic markers. The move followed a reduction in short-term rates earlier this week.

Adding to the run of weaker-than-expected data, retail sales disappointed in May, rising by 12.7% over the year. The outcome was down from 18.4% in April and undershot expectations of 13.7%.

Industrial production expanded by 3.5% over the year to May. This represented a slowing from the 5.6% annual rate in April. However, the outcome was in line with consensus expectations.

The economy continues to face headwinds from weak consumer and business confidence, slowing demand for its exports, and continued challenges in the property sector. Further policy stimulus may be forthcoming.

New Zealand: The economy contracted in Q1 2023, marking the second consecutive quarter of contraction. GDP contracted 0.1% in Q1, following a 0.7% contraction in Q4 2022. In annual terms, the economy grew 2.2% over the year to the March quarter. The outcome means that the economy entered a technical recession. However, there are statistical challenges impacting the numbers as Stats NZ reintroduced seasonal adjustment factors to the numbers as the international border fully opened. This introduced volatility into the numbers and the results may be revised in the future. However, the underlying trend is that the economy is slowing rapidly following 525 basis points of hikes from the Reserve Bank of New Zealand as it tries to contain elevated inflation.

Falling inventories were a major drag on growth (-1.5 percentage points) as were net exports, led by a 1.5% drop in services exports. On the other hand, consumption (2.4%) and business investment (2.8%) increased in the quarter.

GDP per capita was weaker than aggregate GDP as rapid population growth supports aggregate outcomes. GDP per capita slipped 0.7% in the March quarter, following a 1.1% decline in the December quarter.

House sales were down 0.4% over the year to May. While still negative, the fall was much smaller than the -15.3% outcome in April and marks the first non-double digit drop in annual house sales since June 2021. In monthly terms, sales were up 2.5%, following a 7.5% gain in April. A stabilisation in the housing market is also evident in prices. The house price index rose 0.2% in May, following a 0.1% increase in April. Despite the stabilisation in recent months, prices were still 11.2% down on a year ago.

Eurozone: The European Central Bank (ECB) raised rates by 25 basis points, as expected. The decision lifted the rate on main refinancing operations to 4.00%, from 3.75% and the deposit rate to 3.50% – the highest level in more than two decades, from 3.25%. However, while the rate decision was expected, it was accompanied by hawkish guidance, raising the expectation that further hikes would be forthcoming. ECB President Christine Lagarde emphasised that there was “more work to do” and that another hike in July was “very likely”. Specifically, she said that “barring a material change to our baseline, it is very likely the case that we will continue to increase rates in July.”

Underlying inflationary pressures remain strong, despite some signs of softening. Lagarde noted that the outlook for growth and inflation remains highly uncertain and inflation forecasts were revised higher. Specifically, inflation was now expected to be 5.1% in 2023, from 4.6% previously. By 2025, inflation is expected to moderate to 2.2%, notably still above the ECB’s 2% target.

The trade balance shifted from a surplus in March to a deficit in April. The trade balance was reported as a €7.1 billion deficit in April. This followed a €14.0 billion surplus in the previous month. The outcome was well below the €17.5 billion surplus that was expected.

Japan: Core machinery orders, an indicator of future capital spending, rose 5.5% in April. This reflected a rebound from the 3.9% drop in March. The outcome was above consensus expectations of 3.0%. In annual terms, orders were still down 5.9% over the year to April.

United States: A raft of economic data was released on the day, showing that rate hikes are continuing to have an impact on the economy. This raised expectations that the Federal Reserve is getting closer to the terminal rate in this cycle. Initial jobless claims rose to 262k in the latest week, maintaining the same pace from the previous week. This was above expectations of 245k and suggests that the labour market is slowing under the weight of the aggressive rate hikes to date.

Industrial production slipped 0.2% in May, following a 0.5% gain in April. This was below expectations of a 0.1% rise. The result reflected a 1.8% decline in utilities due to lower electricity production and a 0.4% decline in mining. Manufacturing production partly offset the falls, rising 0.1% in the month.

The Philadelphia Fed business outlook survey declined to -13.7 in June, from -10.4 in the prior month. This was broadly in line with expectations of a -14.0 result. Conversely, the New York Fed Empire manufacturing survey was volatile and moved aggressively to +6.6 in June, from a -31.8 reading in May. Consensus expectations were for a -15.1 outcome.

On the other hand, retail sales surprised to the upside, painting a somewhat mixed picture. Retail sales were 0.3% higher in May, following a 0.4% gain in April. The result was above expectations, which centred on a 0.2% fall in the month. The control group, which represents the total industry sales that are used to prepare the estimates of PCE for most goods and is closely watched, was in line with consensus expectations. It rose 0.2% in May, following a 0.6% gain in April.

In a positive sign for the Fed, import and export prices declined in the month, implying a continued easing in inflationary pressures. Import prices fell 0.6% in May, following a 0.3% increase in April, while export prices were 1.9% lower, following a 0.1% decline in the previous month. Both outcomes came in weaker than expected by consensus.

Key data and events table over page.

Today's key data and events:

NZ BusinessNZ Mfg PMI May prev 49.1 (8:30am)

EZ CPI y/y May Final exp 6.1% prev 6.1% (7pm)

US UoM Consumer Sentiment Prel. Jun exp 60.0 prev 59.2 (12am)

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

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