Morning report

Thursday, 19 October 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,078	0.3%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,665	-1.0%	10 yr bond	4.74		0.07		90 day BBSW	4.20	0.05
Japan Nikkei	32,042	0.0%	3 yr bond	4.22		0.03		2 year bond	4.26	0.09
China Shanghai	3,207	-0.8%	3 mth bill rate	4.31		0.01		3 year bond	4.17	0.08
German DAX	15,095	-1.0%	SPI 200	7,018.0		-83		3 year swap	4.41	0.04
UK FTSE100	7,588	-1.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.65	0.10
Commodities (close & change)			TWI	60.2	-	-	60.2	**United States**		
CRB Index	285.8	2.7	AUD/USD	0.6365	0.6393	0.6328	0.6336	3-month T Bill	5.33	-0.01
Gold	1,948.65	25.5	AUD/JPY	95.37	95.67	94.84	95.00	2 year bond	5.22	0.01
Copper	7,937.50	-8.0	AUD/GBP	0.5225	0.5241	0.5212	0.5220	10 year bond	4.91	0.08
Oil (WTI futures)	88.25	1.6	AUD/NZD	1.0795	1.0826	1.0788	1.0822	**Other (10 year yields)**		
Coal (thermal)	150.35	0.1	AUD/EUR	0.6016	0.6041	0.6011	0.6014	Germany	2.92	0.04
Coal (coking)	324.33	-13.2	AUD/CNH	4.6611	4.6754	4.6383	4.6434	Japan	0.81	0.03
Iron Ore	115.55	-0.3	USD Index	106.19	106.64	106.01	106.58	UK	4.66	0.15

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 risk off tone prevailed as the instability in the Middle East intensified overnight. Reports suggest Iran is threatening further action and has stated that 'time running out' for a diplomatic solution following an explosion in a hospital located in Gaza City.

The price of oil jumped. A higher oil price and robust economic data in the US prompted a further sell-off in treasuries. The US 10-year government bond yield reached a 16 year high of 4.93%. Global government bond yields were generally higher.

The higher yields and oil price weighed on stocks, which closed in the red. The US dollar was higher. Fed Chair Jerome Powell is set to speak tonight which may lead to further moves in yields.

Share Markets: Greater uncertainty, higher yields and a higher oil price weighed on stocks. The S&P 500 declined 1.3%, the tech-heavy Nasdaq dropped 1.6%, while the Dow Jones finished 1.0% lower.

The ASX 200 gained 0.3% yesterday led by energy stocks. Five of eleven sectors finished higher. Futures are pointing to a negative open this morning.

Interest Rates: Yields were higher across the curve. The 2-year yield increased by 1 basis point to 5.22%. The 10-year yield rose 8 basis points to 4.91%, after reaching a high of 4.93% - the highest level since 2007. This move contributed to a steepening in the yield curve.

Swaps markets are pricing a near 50% chance of another Fed rate hike by January 2024. This is up from just over 30% at the end of last week.

Aussie bond futures followed the lead from US markets. The 3-year (futures) yield increased by 3 basis points to 4.22%, while the 10-year (futures) yield increased by 7 basis points to 4.74%.

Interbank cash rate futures have now fully priced in one more hike by the Reserve Bank (RBA) by March 2024. This is on the back of hawkish comments by Reserve Bank Governor yesterday. This is up from around 40% at the end of last week.

Foreign Exchange: The US dollar finished higher given the higher bond yields and flight to quality. The DXY ranged between a low of 106.01 and ahigh of 106.64 and is currently trading around 106.58.

The Aussie dollar was lower trading from a low of 0.6328 to a high of 0.6393. The AUD/USD pair was trading at around 0.6336 at the time of writing. The pair remains vulnerable to shifts in sentiment. Stronger than expected activity data out of China did little to support the pair.

Commodities: Commodity markets, particularly energy commodities, remain a key barometer for how the market perceives risks around the Israel-Hamas conflict. The price of oil jumped higher overnight. The West Texas Intermediate (WTI) oil future approached US$90 a barrel, before trimming gains and settling at around US$88.25.

Australia: The Westpac-Melbourne Institute Leading Index continues to point to a period of weak conditions. The six-month annualised growth rate in the Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, rose to -0.34% in September from -0.48% in August. It was the fourteenth consecutive negative read, implying that sub-trend growth momentum will carry well into 2024.

Reserve Bank (RBA) Governor, Michelle Bullock, said during a fireside chat in Sydney, the longer inflation remains elevated, even if it's a supply shock cause by conflict overseas, "the more people adjust their thinking, the more entrenched inflation is likely to become, so that's the challenge." This is consistent with the recently released RBA Board September minutes, which suggest the Board will not tolerate a longer timeframe for inflation to return to target than is currently being forecast. Governor Bullock did say that tighter monetary policy is starting to bite, and a key uncertainty remains how households and businesses respond to higher rates and whether they will be inclined to reduce savings buffers to fund current spending. The RBA will release update activity and inflation forecast next month.

Eurozone: The inflation rate was confirmed at 4.3% over the year to September 2023. This was a step down from the 5.2% recorded in August and the lowest since October 2021. Prices increased at a slower pace for services, non-energy industrial goods, and food, alcohol & tobacco. The core inflation rate, which excludes volatile food and energy prices, was also confirmed at 4.5% over the year to September 2023.

United Kingdom: The consumer price index (CPI) grew by 6.7% over the year to September 2023, in line with the August read. This was slightly higher than the 6.6% the market was expecting. Softer price increases in food and non-alcoholic beverages and furniture and household goods were offset by a smaller decline in energy costs. The core inflation rate, which excludes volatile items such as energy and food, dropped to 6.1%, reaching its lowest point since January 2023. On a monthly basis, the CPI rose by 0.5% in September, in line with market expectations.

Israel-Hamas: The bombing of a hospital in Gaza City inflamed hostilities between Israel and Arab countries. The leaders of Jordan, Egypt, and the Palestinian Authority cancelled a summit with US President Joe Biden. Iran also intensified its rhetoric against Israel.

China: Economic activity and consumer spending gained momentum over the September quarter, with outcomes exceeding what the market was expecting.

The economy expanded by 4.9% over the year to the September quarter. This was higher than the 4.5% the market was expecting. Annual growth in industrial production was unchanged at 4.5% in September 2023. This was the equal highest reading since April and slightly above the 4.4% the market weas expecting. In terms of specific industries, production continued to grow for most sectors, particularly electrical machinery and equipment, chemical raw materials and products, ferrous metals, and automobiles.

Retail sales grew by 5.5% over the year to September 2023. This was stronger than the 4.9% the market was expecting and an acceleration on the annual growth of 4.6% recorded in August. Consumers ramped up spending on everything from restaurants, alcohol, and cars.

United States: The Fed's Beige Book of regional economic conditions indicated the outlook for the US economy is stable or may show softer expansion, with most districts indicating little to no change in economic prospects since September. The Beige Book noted that "Labor-market tightness continued to ease across the nation. Consumer spending was mixed, especially among general retailers and auto dealers, due to differences in prices and product offerings".

Housing starts rose by 7% to an annualized rate of 1.36 million in September. This was slightly weaker than the 1.38 million starts the market was expecting. Single-family housing starts rose by 3.2% to an annualized rate of 96k.

Building permits decreased by 4.4% to an annual rate of 1.473 million in September 2023. This was stronger than the 1.45 million permits the market was expecting. Single-family authorizations increased by 1.8% to a 16-month high of 965k in September.

Federal Reserve Governor, Chris Waller, said the Fed "can wait, watch, and see how the economy evolves before making definitive moves on the path of the policy rate. I will be looking carefully at the data to see whether the real side of the economy begins to cool off or whether prices, the nominal side of the economy, heat up."

Fed Bank of New York President, John Williams, advocated keeping rates at restrictive levels for some time" and that "We're going to stick at it to make sure that we really achieve that goal of 2% on a sustained basis."

Today's key data and events:

AU Labour Force Sep (11:30am)
 Employment Change 20k prev 64.9k
 Unemployment Rate exp 3.7% prev 3.7%
 Participation Rate exp 66.9% prev 67.0%
US Philadelphia Fed Index Oct prev -13.5 (11:30pm)
US Existing Home Sales Sep prev -0.7% (1am)
US Leading Index Sep prev -0.4% (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.

Pat Bustamante, Senior Economist
Ph: +61 468 571 786

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+ 61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 571 786

Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789