Morning report

Thursday, 2 February 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,502	0.3%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,094	0.0%	10 yr bond	3.47		-0.10		90 day BBSW	3.34	-0.03
Japan Nikkei	27,347	0.1%	3 yr bond	3.13		-0.08		2 year bond	3.14	0.02
China Shanghai	3,443	0.9%	3 mth bill rate	3.56		-0.02		3 year bond	3.21	0.02
German DAX	15,181	0.3%	SPI 200	7,463.0		22		3 year swap	3.56	-0.04
UK FTSE100	7,761	-0.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.57	0.02
Commodities (close & change)*			TWI	62.4	-	-	62.4	**United States**		
CRB Index	271.8	-6.3	AUD/USD	0.7059	0.7145	0.7036	0.7133	3-month T Bill	4.52	-0.03
Gold	1,952.85	24.5	AUD/JPY	91.86	92.24	91.25	91.89	2 year bond	4.09	-0.11
Copper	9,210.80	10.4	AUD/GBP	0.5726	0.5768	0.5718	0.5764	10 year bond	3.40	-0.11
Oil (WTI futures)	76.87	-2.0	AUD/NZD	1.0920	1.0994	1.0915	1.0980	**Other (10 year yields)**		
Coal (thermal)	240.75	-3.4	AUD/EUR	0.6493	0.6510	0.6466	0.6491	Germany	2.28	0.00
Coal (coking)	347.00	15.0	AUD/CNH	4.7675	4.7997	4.7539	4.7951	Japan	0.49	0.00
Iron Ore	125.65	-0.3	USD Index	102.04	102.19	101.04	101.16	UK	3.31	-0.02

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: Equity and bond markets rallied and risk sentiment improved in the wake of the US Federal Reserve interest rate decision. The Fed hiked rates by 25 basis points, to a range of 4.50% - 4.75%.

The move was widely expected. However, comments from Fed Chair Powell in his press conference suggested that "a couple" of additional hikes were likely and that an end to the tightening cycle was in sight. Chair Powell also didn't push back as hard against the recent loosening in financial conditions as was expected.

These comments were interpreted as dovish and equity and bond markets rallied strongly as a result. The US dollar declined against a basket of major currencies.

Share Markets: Equity market rallied into the close following comments from Fed Chair Powell. The S&P 500 closed 1.0% higher on the day after treading water and being largely unchanged throughout most of the day. The Nasdaq surged by a larger 2.0%, while the Dow Jones ended flat.

The ASX 200 rose 0.3% yesterday. Futures have followed on from the strength in US markets and are pointing to positive open today.

Interest Rates: Interest rates were somewhat contained ahead of the Fed meeting but fell sharply afterwards. The 2-year yield ranged between a low of 4.17% and 4.25% ahead of the meeting. Following the meeting, the 2-year yield plunged to a low of 4.08% as investors adjusted their expectations of future interest rate hikes. Yields subsequently closed at 4.09%, 11 basis points down on the day.

The 10-year yield was similarly volatility and closed 11 basis points lower, at 3.40%. The 10-year yield ranged between 3.45% and 3.51% prior to the FOMC meeting, before dropping sharply to a low of 3.38% in the wake of the meeting. It subsequently rose slightly to close at 3.40%.

Interest-rate markets are now pricing in a peak of 4.89% in rates in mid-2023. This is down slightly from a peak of 4.92% prior to the Fed meeting.

The Australian government bond yield (futures) mimicked the moves in US interest rates. The 3-year (futures) yield closed 8 basis points lower, at 3.13%, after ranging between 3.18% and 3.22% ahead of the FOMC meeting. The 10-year (futures) yield was down 10 basis points, at 3.47%, after ranging between 3.54% and 3.58%.

Interest rate markets are pricing in a 76% chance of a 25 basis point hike at the Reserve Bank's upcoming Board meeting and expect the cash rate to peak at just under 3.80% in August.

Currencies: The US dollar declined against a basket of major currencies in the wake of the Fed's decision. The USD Index dropped from a high of 102.19 to a low of 101.04 following the meeting. It subsequently recovered some ground and closed at 101.16.

The AUD/USD pair strengthened in line with a weaker US dollar. The pair spiked from a low of 0.7036 earlier in the day to a high of 0.7145 after the meeting. The pair pulled back slightly and was trading at 0.7133 at the time of writing.

Commodities: Oil prices declined following a report that indicated that inventories in the US were at a 19-month high. Copper and coal were higher, while iron ore slipped.

Australia: Dwelling prices fell 1.0% in January, taking the run of declines to nine consecutive months. In annual terms, prices fell 7.2% over the year to January. This was an acceleration from the 5.3% annual drop over the 2022 calendar year.

However, momentum is shifting as the pace of falls across the largest markets moderated.

The downturn has been rapid and is the fastest and largest since the series began. Dwelling prices are 8.9% below their April 2022 peak. However, it is important to put this into context. The falls follow an incredible run up in prices across all capital cities and regional areas during the boom.

Prices are likely to continue to decline over coming months. While we are nearing the end of the Reserve Bank's rate hiking cycle, further increases are expected as inflationary pressures remain elevated. Mortgage holders rolling from fixed rates to variable rates will also pose a headwind.

A strong labour market, low stock levels, and demand from a rapid return of overseas migration will provide some support to the market.

China: The Caixin manufacturing purchasing managers' index (PMI) came in at 49.2 in January, signalling continued contraction across the manufacturing sector. The index has been in contractionary territory for six consecutive months. The result was up from the 49.0 reading in December. However, it was below consensus expectations for an outcome of 49.8.

Despite remaining in contractionary territory, the survey detail showed an easing in supply chain pressures and measures of confidence around the outlook rose to the highest level since April 2021. Output and new orders continued to shrink, but at a slower pace than in December.

The outcome follows a reading of 50.1 from the official manufacturing PMI, released yesterday. The Caixin PMI tracks smaller firms and manufacturers, while the official PMI looks at larger companies.

The varied outcome across the two measures suggests that smaller firms are finding conditions more challenging and are lagging larger firms in the recovery.

Europe: Inflation surprised to the downside in January as energy prices fell by more than expected. The consumer price index (CPI) rose by 8.5% over the year to January. This was lower than the 8.9% result expected by consensus and was down from the 9.2% reading in December. The annual pace of inflation has now decelerated for three consecutive months.

However, while headline inflation was down, core CPI, a better measure of underlying inflationary pressures, remained around a record high.

Core CPI was 5.2% higher over the year to January. This matched the record high December outcome and was above expectations of 5.1%. The core reading suggests that inflationary pressures remain elevated in the region.

The unemployment rate was 6.6% in December. This was unchanged from the November reading, which was revised higher from 6.5% to 6.6%. The outcome was slightly higher than consensus expectations, which centred on an outcome of 6.5%.

New Zealand: The unemployment rate rose to 3.4% in Q4 of 2022, from 3.3% in the previous quarter. The result was slightly higher than consensus expectations of 3.3%.

Employment rose by 0.2% in the quarter, down from the 1.3% growth in the previous period and slightly lower than the 0.3% expected by consensus. The rise in employment was driven by a 0.6% increase in full-time jobs, and a 0.2% increase in part-time jobs. Hours worked also rose by 1.4% in the quarter, boosted by a rebound following an elevated number of workers being away due to illness in Q3. The participation rate remained steady at a record high of 71.7%.

The tight labour market has continued to flow through into robust wages growth, albeit slightly weaker than expected by consensus. Private wages excluding overtime rose 1.1% in the quarter, matching the rise from the previous quarter. This was slightly lower than the 1.2% expected.

Overall, the data paint a picture of a labour market that remains tight and with strong wages growth, despite some deceleration in the quarter. Further slowing is expected over 2023 as higher interest rates impact the economy.

United Kingdom: House prices declined by 0.6% in January, following a -0.3% drop in December. House prices have now been declining for four consecutive months. The outcome was slightly weaker than the -0.4% drop expected by consensus. In annual terms, house prices were 1.1% higher over the year to January.

The manufacturing sector remained in contractionary territory for six consecutive months, as the Markit manufacturing PMI was finalised at 47.0 in January. However, this was slightly higher than the preliminary reading of 46.7.

United States: The Federal Reserve raised the Fed Funds Rate by 0.25%, to a range of 4.50% - 4.75%. The move was widely expected. However, markets were watching closely for any changes to the narrative and sentiment from the statement and importantly, the press conference that followed.

In his press conference, Fed Chair Powell noted that further tightening is required and that rates will need to remain restrictive for some time. He stated that the "disinflationary process had started" but that it was at an early stage and that the labour market remains strong. He indicated that there are likely to be a "couple more rate hikes to get to the level we think is appropriately restrictive".

He noted that further hikes were required "because inflation is running hot." He also added that "We are taking into account long and variable lags. We are thinking about that."

Comments from Chair Powell were interpreted as dovish, particularly as he didn't push back as hard as expected on the recent loosening in financial conditions. The comments imply that two more hikes are likely before the Fed pauses to assess the impact of the hiking cycle to date.

The economy added 106k new jobs in January, as measured by the private ADP employment. This was down from a revised 253k in December and below the 180k expected by consensus. The weaker-than-expected read comes ahead of official employment data due later this week, which is expected to show a gain of 190k jobs in January.

The ISM manufacturing survey fell to 47.4 in January, indicating continued contraction in the manufacturing sector. The outcome was worse that the 48.0 expected by consensus and below the 48.4 result from the prior month. The result extends the run of contractionary reads to three consecutive months. The detail of the survey showed a decline in new orders and a rise in prices paid.

Construction spending declined in December, falling 0.4% over the month. This was the first monthly decline since August and was weaker than consensus expectations of a flat result. The outcome follows an upwardly revised 0.5% gain in November.

Today's key data and events:

NZ Building Permits Dec prev 7.0% (8:45am)

AU Building Approvals Dec exp -4.0 prev -9.0% (11:30am)

UK BoE Policy Decision exp 4.00% prev 3.50% (11pm)

EZ ECB Policy Decision exp 3.00% prev 2.50% (12:15am)

US Factory Orders Dec exp 2.3% prev -1.8% (2am)

US Durable Goods Orders Dec Final exp 5.6% prev 5.6% (2am)

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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