Morning report

Wednesday, 8 March 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,365	0.5%		Last		Overnight Chg		**Australia**		
US Dow Jones	32,856	-1.7%	10 yr bond	3.70		0.02		90 day BBSW	3.63	0.00
Japan Nikkei	28,309	0.3%	3 yr bond	3.44		0.06		2 year bond	3.38	-0.13
China Shanghai	3,444	-1.1%	3 mth bill rate	3.64		0.02		3 year bond	3.37	-0.14
German DAX	15,560	-0.6%	SPI 200	7,270.0		-62		3 year swap	3.90	-0.09
UK FTSE100	7,919	-0.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.68	-0.08
Commodities (close & change)*			TWI	61.4	-	-	61.4	**United States**		
CRB Index	269.6	-4.0	AUD/USD	0.6727	0.6748	0.6581	0.6592	3-month T Bill	4.77	0.05
Gold	1,814.79	-32.1	AUD/JPY	91.49	91.74	90.21	90.41	2 year bond	5.01	0.13
Copper	8,902.75	-62.8	AUD/GBP	0.5598	0.5604	0.5548	0.5573	10 year bond	3.97	0.01
Oil (WTI futures)	77.41	-3.1	AUD/NZD	1.0870	1.0872	1.0742	1.0781	**Other (10 year yields)**		
Coal (thermal)	209.05	-1.4	AUD/EUR	0.6301	0.6312	0.6235	0.6248	Germany	2.69	-0.06
Coal (coking)	367.00	-1.3	AUD/CNH	4.6764	4.6844	4.6029	4.6109	Japan	0.50	0.00
Iron Ore	126.15	-0.8	USD Index	104.33	105.65	104.12	105.61	UK	3.82	-0.04

Data as at 8:00 am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Risk sentiment waned as Fed Chair Jerome Powell delivered hawkish testimony to the Senate in his regular semi-annual address. He spoke of the work that needs to be done to get inflation back to target and noted that the recent run of stronger-than-expected data "suggests that the ultimate level of interest rates is likely to be higher than previously anticipated".

The move led to a sharp repricing of short-term interest rates and a spike in the 2-year yield. The 2-10-yield spread inverted further to over 100 basis points (a full percentage point). Equity markets declined and the US dollar spiked higher against major currencies, driving the AUD/USD pair sharply lower.

Share Markets: Equity markets pulled back as investors digested comments from the Fed Chair and the implication of higher interest rates on equity valuations. The S&P 500 ended 1.5% lower, the Nasdaq lost 1.2%, and the Dow Jones dropped 1.7%.

The ASX 200 rose 0.5% yesterday on the back of less hawkish commentary from the Reserve Bank at the March Board meeting. However, taking the lead from overnight movements, futures are pointing to a lower open today.

Interest Rates: Comments from Fed Chair Powell led to changes in expectations around the path of interest rates and sharp movements in short-term bond yields. The 2-year yield spiked 13 basis points to 5.01% – the highest since July 2006. Movements in the 10-year yield were more muted and it closed 1 basis point higher, at 3.97%, after briefly trading above 4%.

The movements in short- and long-term yields drove the 2-10-year spread to invert further to 104 basis points (over a full percentage point). This was the first time the yield curve inversion breached a full percentage point since 1981.

Interest-rate markets are pricing in 40 basis points of hikes at the upcoming March Fed meeting. This is up from around 31 basis points yesterday. The Fed funds rate is expected to peak at around 5.63% in late 2023, up from 5.48% yesterday.

Australian bond yields somewhat mimicked moves in the US. The 3-year government bond yield (futures) rose 6 basis points, to 3.44%. The 10-year government bond yield (futures) was 2 basis points higher, at 3.70%.

Interest-rate markets are pricing in around a 55% chance of a 25-basis-point hike at the April meeting and expect the cash rate to peak at around 4% in late 2023. This is down from 4.16% prior to the RBA meeting.

Currencies: The large moves in short-term bond yields and comments from Fed Chair Powell contributed to a sharp jump in the US dollar against a basket of major currencies. The USD Index jumped from a low of 104.12 to a high of 105.65. It is currently trading near that level, at 105.61.

The AUD was the underperformer on the day and lost over 2% of value against the USD. The AUD/USD pair extended declines which began following the RBA meeting and dropped sharply from a high of 0.6748 in the Asian session to a low of 0.6581 in the New York session, breaking through the 0.6600 handle. It has since recovered some ground and was trading at 0.6592 at the time of writing.

Commodities: Oil dropped sharply, with the West Texas Intermediate (WTI) futures contract down over 3% on the day to US$77.41 per barrel. Other commodities, including gold, copper, coal and iron ore all dropped amid US dollar strength.

Australia: The Reserve Bank (RBA) Board delivered another 25-basis-point hike yesterday, taking the cash rate to 3.60% – the highest since May 2012.

It takes the number of consecutive rises to ten and the cumulative tightening since May to 350 basis points (or 3.5 percentage points) – the most aggressive tightening cycle since before the 1990s.

The hike was widely expected. But the tone of the statement was not. There was a noticeable shift, with the commitment to another hike next month toned down.

Importantly, the RBA dropped its explicit reference to "further increases in interest rates will be needed over the months ahead." They replaced it with the "Board expects that further tightening of monetary policy will be needed to ensure that inflation returns to target."

Last month's statement seemed like the Board was on a pre-determined course to hike the cash rate at least twice more, but yesterday's statement is indeterminate around timing and how much more tightening is needed.

It appears policy makers have recognised the risk of overtightening, as evidenced by the run of soft data. The language was centred on giving more options to respond to data in future meetings.

The RBA appears to view the balance of risks as lying to more tightening down the track, but it has opened up the idea that they may be closer to the peak and/or closer to a pause.

In assessing when and how much further to raise rates, the RBA will be paying close attention to developments in the global economy, spending, inflation, and jobs market.

The Group view remains that the cash rate will need to increase to 4.10% in this cycle, including with a rate hike next month. However, there's a risk that the peak falls shy of this level and/or takes longer to get to this level. We cannot rule out a pause next month.

The Governor gives a keynote address today where more clues around the cash-rate outlook may be deciphered.

The trade surplus came in at $11.7 billion in January. This was down from the upwardly revised $13.0 billion surplus recorded in December and was below consensus expectations of a $12.3 billion surplus. However, despite declining in the month, the surplus remains extremely sizable. The decline from the prior month reflected a 5% increase in imports, driven by gains across non-industrial transport equipment as supply disruptions eased. The gain in imports was partly offset by a 1% increase in exports, reflecting stronger exports across metal ores and services. The boost in services exports reflects the continued rebound in international tourism.

Eurozone: Factory orders in Germany rose by 1.0% in January. This was down from a revised 3.4% gain in December but was above consensus expectations for a fall of 0.7%. Over the year to January, factory orders were down 10.9%. The gain in the month reflected stronger orders of capital goods (+8.9%), particularly aircraft and spacecraft construction, and motor vehicle engines. Intermediate (-8.9%) and consumer goods (-5.5%) were both weaker.

United States: Federal Reserve Chair Jerome Powell gave his Semi-Annual Monetary Policy Report to the Congress, where he noted that "the latest economic data have come in stronger than expected", he also added that this "suggests that the ultimate level of interest rates is likely to be higher than previously anticipated".

Powell noted that there was "a long way to go" on getting inflation back down to the 2% target. He also suggested that the labour market would remain resilient and that there wouldn't be "a very significant downturn in the labour market."

Regarding further rate hikes, Powell said that if data warranted "faster tightening they would be prepared to increase the pace of rate hikes".

Today's key data and events:

AU RBA Governor Lowe Speech (8:55am)

JP Current Account Jan exp -¥785.0bn prev ¥33.4bn (10:50am)

EZ GER Industrial Production Jan exp 1.4% prev -3.1% (6pm)

EZ GDP Q4 Final exp 0.0% prev 0.1% (9pm)

US ADP Employment Change Feb exp 200k prev 106k (12:15am)

US Trade Balance Jan exp -$68.7bn prev -$67.4bn (12:30am)

US JOLTS Openings Jan exp 10.6m prev 11.0m (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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