Morning Report

bankSA

Wednesday, 7 February 2024

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,582	-0.6%		Last		Overnight Chg		**Australia**		
US Dow Jones	38,521	0.4%	10 yr bond	4.11		-0.03		90 day BBSW	4.35	0.00
Japan Nikkei	36,161	-0.5%	3 yr bond	3.64		-0.03		2 year bond	3.80	0.02
China Shanghai	2,924	3.2%	3 mth bill rate	4.31		-0.01		3 year bond	3.70	0.02
German DAX	17,033	0.8%	SPI 200	7,588.0		55		3 year swap	3.84	-0.07
UK FTSE100	7,681	0.9%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.13	0.03
Commodities (close & change)			TWI	60.9	-	-	60.9	**United States**		
CRB Index	269.1	0.9	AUD/USD	0.6483	0.6525	0.6478	0.6524	3-month T Bill	5.21	0.00
Gold	2,035.78	10.7	AUD/JPY	96.37	96.80	96.28	96.46	2 year bond	4.40	-0.07
Copper	8,267.25	-130.6	AUD/GBP	0.5171	0.5194	0.5167	0.5178	10 year bond	4.09	-0.07
Oil (WTI futures)	73.49	0.7	AUD/NZD	1.0708	1.0738	1.0701	1.0727	**Other (10 year yields)**		
Coal (thermal)	123.30	-1.4	AUD/EUR	0.6035	0.6068	0.6031	0.6066	Germany	2.29	-0.02
Coal (coking)	312.00	-4.0	AUD/CNH	4.6805	4.6994	4.6698	4.6985	Japan	0.72	0.00
Iron Ore	125.00	0.0	USD Index	104.45	104.59	104.15	104.15	UK	3.95	-0.06

Data as at 7:55am AEDT. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Markets were in a holding pattern overnight ahead of comments from several Fed officials. Mester's (Fed official) comments overnight were slightly more dovish than expected, which saw US bond yields decline. US equities edged higher, the US dollar advanced and the price of oil increased.

Share Markets: US equities ended slightly higher after swinging between gains and losses throughout the day. Some stronger than expected earnings reports, from the likes of Spotify and Palantir technologies, helped to drive the market higher.

The S&P 500 was 0.2% higher, the Dow Jones ended the day 0.4% higher, while the NADAQ closed 0.1% higher.

The ASX 200 slipped 0.6% in yesterday's trade, as markets took yesterday's Reserve Bank (RBA) policy statement and press conference as more hawkish than expected. Ten of eleven sectors were lower. Futures are pointing to a positive open this morning.

Interest Rates: US bond yields were lower across the curve on the back of some dovish remarks from Fed officials. More Fed officials are due to talk overnight which could see yields move further.

The 2-year yield declined 7 basis points to 4.40%, while the 10-year yield declined 7 basis points to 4.08%.

Interest-rate markets are attaching a 20% chance to a March cut. To the end of 2024, markets are pricing around 120 basis points of cuts, with the first cut fully priced in for June this year.

Aussie bond futures followed the lead from US markets. The 3-and-10-year (futures) yields each declined 2 basis points to be at 3.64% and 4.11%, respectively.

Following yesterday's RBA decision and communication, interest-rate markets are now expecting 50 basis points of rate cuts in the second half of the year (lower than the 67 basis points of cuts expected late last week), with the first full rate cut still pencilled in for August.

Foreign Exchange: The US dollar ended the session lower after swinging between gains and losses. The USD Index ranged between a low of 104.15 and a high of 104.59, before moving to 104.15 at the time of writing.

The AUD/USD pair tried to rally following the RBA's decision and communication but was unable to break through the 0.65 level. The pair increased from a low of 0.6478 to a high of 0.6525. It remains around this high at the time of writing (0.6524).

Commodities: The West Texas Intermediate (WTI) oil price increased overnight, with the WTI future edging higher to US$73.49 per barrel.

More broadly, gold advanced while copper and coal all softened. Iron ore was unchanged.

Australia: Yesterday marked a new era and look for the Reserve Bank (RBA) policy meeting and communication.

As widely expected, the RBA sat on the sidelines and left the cash rate unchanged at 4.35% – its highest level in 12 years. The Board is in the calibration phase of the hiking cycle, leaving the cash rate unchanged on six of the past seven meetings.

Since the last RBA meeting in December, the flow of economic data has surprised to the downside and the inflation outcome for the December quarter came in materially lower than what the market and, more importantly, the RBA had been expecting.

The real uncertainty today was not whether the RBA would hike, but whether it would pivot away from its tightening bias. The answer was no – while the wording in the statement about future policy changes was diluted, it still noted that "a further increase in interest rates cannot be ruled out".

The statement struck a cautious tone and suggested that any pivot would require the Board to be "confident that inflation is moving sustainably towards the target range".

In the press conference, RBA Governor Bullock said they "haven't ruled anything out" and they "haven't ruled anything in" and characterised the risks to the economy as broadly balanced. This suggests that the RBA will likely remain on hold in the near-term and decisions dependant on the data.

We're more confident that the next move in the cash rate will be down, later in 2024. The slowdown in spending growth has reduced the capacity of businesses to pass on higher costs. At the same time, we see labour costs continuing to ease as labour productivity improves. This should be conducive toward a fall in services inflation as we work through 2024 and beyond.

The policy statement was accompanied by the February Statement of Monetary policy (SoMP) and the RBA's fresh forecasts. The notable changes to the forecasts were that near-term economic growth forecasts were cut; June 2024 was cut from 1.8% to 1.3% and there were more downgrades to June 2025. The unemployment rate was revised higher across the profile with unemployment now expected to be at 4.3% at the end of this year (up from 4.2%) and 4.4% at the end of next year (up from 4.3%).

The attention was overwhelmingly on the inflation forecasts. For headline inflation, there were material downgrades to the forecasts. Headline was cut from 3.9% in June 2024 to 3.3% and in December 2024 it was cut from 3.5% to 3.2%. There were smaller cuts across the remaining profile.

Underlying inflation (as measured by the trimmed mean) returns to the target band, just, in June 2025 at 3.0%. The forecasts were also extended to June 2026. By this point, headline and underlying inflation are both expected to fall to 2.6% – around the mid-point of the 2-3% band.

The volume of retail spending rose 0.3% in the December quarter. This followed a 0.1% fall in the September quarter, which was revised down from an initially reported 0.2% gain.

The gain was stronger than expected, as the pace of price increases slowed to their weakest since the September quarter of 2021. This reflected some retailers resorting to offering discounts to get consumers in the door. Households remain price conscious in an environment still characterised by high inflation.

Retail spending represents around a third of household consumption. Spending continues to be under pressure. We expect consumption in the December quarter to be weak when the national accounts are printed. Today's stronger-than-expected result will not turn the tide, but it may help to temper some of the downside risks in the quarter.

Eurozone: Retail sale volumes (sales adjusted for inflation) dropped by 1.1% in December, following an increase of 0.3% in November. This was slightly softer than the fall of 1.0% the market was expecting. Sales of food items declined for a third consecutive time, while sales ok non-food times fell after two months of increases. On a yearly basis, retail sales fell by 0.8%, the 15th consecutive month of contraction.

United States: Loretta Mester, president of the Cleveland Fed branch, said the Fed will probably gain confidence to lower rates "later this year" if the economy performs as expected. Mester emphasised that they need more information to ensure that they are on track towards their inflation target. She added that she still anticipates three cuts in 2024.

Neel Kashkari, president of the Minneapolis Fed branch, said the Fed hasn't yet reached its 2% inflation target, but remains on track: "A remarkable thing has happened over the last six to nine months: Inflation has come down very quickly.

We're not all the way there yet, but we've made a lot of progress on inflation. If we just think we're going to continue what we've been experiencing, we're on track to get back to our 2% target. I don't want to say we're done yet."

Today's key data and events:

EZ Industrial Production Dec prev -0.7% (6pm)

NZ Unemployment Rate Q4 prev 3.9% (8:45am)

NZ Employment Q4 prev -0.2% (8:45am)

NZ Private Wages Ex. Overtime Q4 prev 0.8% (8:45am)

US Trade Balance Dec prev -$63.2bn (12:30am)

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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