Morning Report

Wednesday, 14 June 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,139	0.2%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,212	0.4%	10 yr bond	3.98		0.03		90 day BBSW	4.22	0.01
Japan Nikkei	33,019	1.8%	3 yr bond	3.92		0.08		2 year bond	4.02	0.02
China Shanghai	3,390	0.1%	3 mth bill rate	4.54		0.03		3 year bond	3.84	0.01
German DAX	16,231	0.8%	SPI 200	7,191.0		44		3 year swap	4.18	0.01
UK FTSE100	7,595	0.3%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.93	-0.02
Commodities (close & change)*			TWI	62.2	-	-	62.2	**United States**		
CRB Index	260.8	3.9	AUD/USD	0.6752	0.6807	0.6738	0.6765	3-month T Bill	5.05	-0.06
Gold	1,943.74	-17.5	AUD/JPY	94.26	95.06	93.98	94.86	2 year bond	4.67	0.09
Copper	8,292.00	-65.8	AUD/GBP	0.5396	0.5403	0.5363	0.5364	10 year bond	3.81	0.08
Oil (WTI futures)	69.30	-0.1	AUD/NZD	1.1027	1.1049	1.1000	1.1001	**Other (10 year yields)**		
Coal (thermal)	137.25	-2.8	AUD/EUR	0.6277	0.6297	0.6257	0.6271	Germany	2.42	0.04
Coal (coking)	220.50	0.8	AUD/CNH	4.8317	4.8665	4.8277	4.8528	Japan	0.43	-0.01
Iron Ore	111.90	0.2	USD Index	103.57	103.62	103.05	103.30	UK	4.43	0.10

Data as at 7:40am 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 improved on the back of the US inflation data which showed inflationary pressures were easing, opening the door for the Fed to “skip” a rate hike in June. The outcome of the Fed policy meeting will be released overnight.

US equities closed higher, while the US dollar declined slightly. Bond yields were higher. This suggests that investors are positioning for a hawkish policy outlook, with the Fed signalling that rate cuts may take longer to materialise.

Share Markets: US equities ended the day higher, with the S&P 500 and the NASDAQ closing at their highest levels since April 2022. US inflation data showed that inflationary pressures are easing. Investors concluded that the data was consistent with the Fed “skipping” a rate hike in June, providing equities with a boost.

The tech-heavy NASDAQ outperformed, up 0.8% while the S&P 500 and the Dow Jones closed up 0.7% and 0.4%, respectively.

The ASX 200 finished 0.2% higher. Financials stocks led the market higher, with 8 of 11 sectors recording gains. Futures are pointing to a positive opening today.

Interest Rates: The softening of US inflation pressures evident in the May report led to lower bond yields, but only briefly and modestly. At the close, the US 2-year yield was up 9 basis points and the 10-year yield lifted 8 basis points.

The inflation report prompted swap traders to cut the probability of another rate hike at the Fed’s meeting tonight. The probability is currently 13%, down from 25% in the previous trading session. However, traders are still attaching a high probability to a rate hike by July at a probability of 73%. Further, the policy outlook released tomorrow night is expected to be hawkish, including the so-called dot plot, suggesting rate cuts may take longer to materialise. This has impacted sentiment in bond markets.

Foreign Exchange: The AUD/USD pair pushed to a fresh 5-week high of 0.6807 in the wake of the slightly weaker-than-expected US inflation data (4.0% vs 4.1% in annual headline terms). But the AUD/USD failed to make a genuine test of key resistance at around 0.6815-0.6820. The AUD’s approach near this resistance level spurred a sell off with the AUD/USD falling back towards 0.6750. A sustained break above 0.6815-0.6820 is needed to be confident the AUD/USD is on a new leg higher.

Commodities: Commodities were generally higher, with base metal prices firming, as the longer odds of another Fed rate hike boosted prospects for growth.

Australia: Business conditions fell for a fourth consecutive month in May, declining 7 points to a slightly below-average reading of +8. This was the softest reading since January 2022 and suggests that strong conditions enjoyed through much of 2022 and into 2023 are coming to an end.

All three sub-indices - trading, profitability and employment - pulled back in the month to also hit their lowest levels since January last year. A sharp fall in forward orders to -5 was particularly concerning for the outlook. This was the lowest level in 10 years (outside COVID).

Business confidence slipped 4 points to -4 but have oscillated between -5 and +10 over the past 12-months, highlighting the elevated uncertainty facing many businesses. The weight of evidence is beginning to suggest a weaker outlook, and this is showing up in confidence.

Despite a weakening in conditions, capacity utilisation remains elevated (84.7%) and well above average levels. This suggests businesses are still struggling to meet the needs of consumers notwithstanding an emerging pull-back in demand.

A similar message can be gleaned from the survey's cost measures which show a reacceleration in inflationary pressures across both input (labour and purchase costs) and output (final product prices and retail prices) costs in May.

The persistence of inflationary pressures in the face of weakening demand will alarm the Reserve Bank (RBA), who have recently re-ignited their inflation fight to tame growing risks of a slower return to target inflation and a possible de-anchoring of inflation expectations.

Consumer Sentiment remains entrenched at 'recessionary lows.' The consumer sentiment index was 79.2 index in June, broadly unchanged from the 79.0 points recorded in May.

Consumers have signalled that labour market conditions have started to turn. The Unemployment Expectations Index deteriorated (or increased) by 6.6% over June. For the first time this hiking cycle (since May 2022), the fall was larger than the deterioration that would be explained by seasonality. Managers and service workers, and those without jobs (unemployed and not in the labour force) were most pessimistic about the jobs outlook.

In a worrying sign, consumers expect conditions to deteriorate further before improving. Family Finances and the Economic Outlook over the next year remained very weak at 84.0 and 77.2, respectively. This is to be expected given four in five consumers surveyed after the Reserve Bank's (RBA) June meeting expect further rate hikes this year.

In a feature unique to this cycle, consumers continue to expect house prices to increase, while also expecting further rate hikes. The House Price Index increased by 1.7% over June, to be at 146.7 points - well above the long run average of 125.8 points. Price gains are expected to be particularly strong in WA and NSW.

Consumer sentiment has been at recessionary lows for much of the last year. However, only more recently have we seen this pessimism translate into weaker spending. This is likely to continue and may very well intensify if consumers become worried about job security.

New Zealand: Monthly provisional migration levels returned to near pre-pandemic levels, with the annual net migration figures showing a gain of 72,300 people over the year to April. Monthly net migration gain fell back to 5,800, less than half of the gains seen in the previous two months.

Eurozone: The ZEW Indicator of Economic Sentiment declined to -10 in June 2023 from -9.4 in May. It was the lowest reading since December last year, amid ongoing concerns about the economic outlook and the prospect of additional rate hikes by the European Central Bank. In June, around one third of the surveyed analysts expected a deterioration in activity while only 20% expected an improvement.

Germany's annual inflation was confirmed at 6.1% in May, down from 7.2% in April. Energy inflation eased sharply to 2.6% from 6.8% in April due mainly to a high base effect last year. Services inflation slowed to 4.5% from 4.7%. On a monthly basis, inflation declined by 0.1% in May, the first monthly decline in five months.

United Kingdom: The unemployment rate increased to 3.8% over the February to April period, up 0.1 percentage points from the quarter to March. The outcome was better than the 4.0% the market was expecting.

In a worrying sing for the Bank of England (BOE), wages growth excluding bonuses was 7.2% over the year to April. This was above the 6.9% the market was expecting, and the largest increase seen outside of the pandemic. Wages growth of this magnitude are not consistent with the BOE's inflation target of 2%.

United States: The Consumer Price Index (CPI) increased by 0.1% over the month of May, to be 4.0% higher through the year. This was the smallest annual increase since March 2021. The outcome represents a deceleration from the 0.4% monthly, and 4.9% annual, increase recorded in April. The monthly outcome was in line with market expectations while the annual outcome was slightly below the 4.1% the market was expecting.

In terms of drivers, gasoline prices dropped 5.6% over May, while electricity declined for a third straight month. On the other hand, the cost of shelter was the largest contributor to the monthly increase (up 0.6%) followed by the cost of used cars and trucks (up 4.4%).

However, core measures of inflation remain sticky. Core Inflation, which excludes food and energy, increased by 0.4% for a third straight month, to be 5.3% higher through the year. This was the smallest annual rise since November 2021 and followed a 5.5% annual increase in April. The monthly outcome was in line with what the market was expecting, while the annual outcome was slightly above the 5.2% the market was expecting.

Fed Officials, including Chair Jerome Powell, have signalled they prefer to “skip” a rate hike at the June meeting, while leaving the door open to future tightening. Today’s numbers are consistent with this approach.

Today’s key data and events:

EZ Industrial Production Apr prev -4.1% (7pm)

NZ Current Account Q1 (8:45am)

US PPI Final May y/y prev 0.2% (10:30pm)

US FOMC Policy Decision (4am)

Federal Funds Rate exp 5.00%-5.25% prev 5.00%-5.25

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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