Morning Report

Wednesday, 1 February 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,477	-0.1%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,086	1.1%	10 yr bond	3.55		0.00		90 day BBSW	3.37	-0.01
Japan Nikkei	27,327	-0.4%	3 yr bond	3.19		0.00		2 year bond	3.12	-0.01
China Shanghai	3,413	-0.4%	3 mth bill rate	3.57		-0.01		3 year bond	3.18	-0.01
German DAX	15,128	0.0%	SPI 200	7,469.0		44		3 year swap	3.61	-0.05
UK FTSE100	7,772	-0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.55	0.02
Commodities (close & change)*			TWI	62.7	-	-	62.7	**United States**		
CRB Index	278.1	3.7	AUD/USD	0.7059	0.7066	0.6984	0.7059	3-month T Bill	4.52	-0.04
Gold	1,928.31	5.1	AUD/JPY	92.10	92.21	91.09	91.86	2 year bond	4.20	-0.03
Copper	9,210.80	10.4	AUD/GBP	0.5716	0.5731	0.5673	0.5726	10 year bond	3.51	-0.03
Oil (WTI futures)	79.03	1.1	AUD/NZD	1.0913	1.0927	1.0881	1.0920	**Other (10 year yields)**		
Coal (thermal)	240.35	-12.7	AUD/EUR	0.6508	0.6512	0.6452	0.6493	Germany	2.29	-0.03
Coal (coking)	332.00	-0.5	AUD/CNH	4.7708	4.7728	4.7235	4.7678	Japan	0.50	0.01
Iron Ore	127.80	0.7	USD Index	102.27	102.61	102.01	102.06	UK	3.33	0.00

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: Economic data suggesting inflation risks are subsiding in the US helped boost investor sentiment, lifting share markets. The US data helped cement expectations the US Federal Reserve would pivot tonight and raise its federal funds rate by only 25 basis points.

Share Markets: US share markets lifted after US wages data (employment cost index) added to evidence that inflation risks may be cooling and the Fed is likely to pivot and lift the fed funds rate by 25 basis points tonight. The Dow jumped 1.1%, the S&P 500 index rose 1.1% also and the Nasdaq surged 1.7%.**Interest Rates**: US bond yields fell across the curve. The 2-year and 10-year yield in the US each closing 3 basis points lower. Yields fell as economic data in the US pointed to a cooling in economic activity and inflation risks.

The US Fed meets tonight. Markets widely anticipate the Fed will raise rates by 25 basis points. Attention will also be on Fed Chair Powell and whether he suggests a pause is imminent. Markets expect Powell will not sway from his message that the inflation fight is far from over.

Australian bond and swap yields fell yesterday in reaction to weak retailing and credit growth data. However, yields recovered some of the decline to finish only modestly lower from yesterday's open.

The market probability attached to a rate hike next week from the Reserve Bank (RBA) moved a tad lower yesterday to 71% after the weaker domestic data. The peak in the cash rate is priced as 3.76% iN September by the market.

Currencies: Yesterday we warned the risks were the AUD/USD would move lower in Asia trade. The weaker-than-expected retail sales data and slowing credit growth data spurred the AUD/USD pair lower. Overnight, the AUD moved to a near 1-week low of 0.6984 before recovering to be back above the 0.7000 handle. In the near term, the direction of the AUD/USD will come from the Fed's decision and accompanying statement.

Commodities: The lift in risk sentiment overnight and revision higher in world growth by the International Monetary Fund (IMF) helped commodity prices post gains.

Australia: Retail trade fell by 3.9% over the month of December 2022 – the sharpest fall since August 2020. Last month we suggested that the strong outcome for November was largely due to a bring forward of Christmas spending, as households looked to take advantage of sales.

This latest outcome vindicates this view. In fact, on average over the last three months of 2022, retail trade has fallen by around 0.5% per month. As a basis of comparison, on average over the last three months of 2021 and 2020, retail trade grew by 1.8% and 1.1%, respectively.

Over the quarter, retail trade grew by 0.9% over the

December quarter. However, this includes both higher prices and transactions. We saw last week that the consumer price index increased by 1.8% over the quarter. So, this suggests that retail trade over the quarter could be negative after adjusting for prices.

What does all this mean? The spending impulse from pent-up demand has likely come to an end. There are now clearer signs spending is slowing and the Reserve Bank's rate hikes are reducing demand.

Private-sector credit growth eased to 0.3% over December, the slowest monthly gain since February 2021. The outcome was a clear step down from the average monthly growth of 0.6% recorded since the start of the RBA's hiking cycle in May 2022.

In annual terms, credit remains 8.3% higher than a year ago. This outcome also represents an easing from the peak annual growth of 9.5% recorded in September 2022.

Business credit growth is now showing some clear signs of decelerating. Business credit grew by 0.3% in December, the lowest monthly expansion since April 2021. In annual terms, business credit was 12.9% higher, after recording a peak of 15.1% in October 2022. These trends are consistent with businesses reporting a softening in conditions, an increase in capacity utilisation and a pause in their intentions to expand and/or invest in capital goods.

Housing credit grew by 0.3% in December, the softest monthly read since October 2020. Credit to owner occupiers rose 0.4% in the month whilst credit to investors grew 0.3%. Higher mortgage rates and the possibility of more rate hikes are clearly impacting housing credit.

China: China's economic activity swung back to growth in January, after a wave of COVID-19 infections passed through the country faster than expected.

The official purchasing managers' index (PMI), which measures manufacturing activity, rose to 50.1 in January from 47.0 in December. Consensus forecasts had predicted the PMI to come in at 48.0.

There was also a decisive rebound in non-manufacturing activity. The services PMI leapt to 54.4, from 41.6 in December.

Both indexes had previously shown the economy to be contracting since September.

Meanwhile, the official composite PMI, which combines manufacturing and services, rose to 52.9 from 42.6 in December.

Europe: GDP data showed the euro zone economy grew 0.1% in the last quarter of 2022. This result was better than consensus estimates of a 0.1% contraction. However, it still represented a slowdown from the 0.3% growth rate in the third quarter.

Separate data showed an unexpected and large fall of 5.3% in German retail sales for December. Germany's unemployment rate remained at 5.5%.

The European Central Bank meets (ECB) tomorrow. Interest rate markets have priced in a 50 basis-point hike at this meeting.

United States: The Fed's preferred measure of wages growth, the employment cost index (ECI), rose 1.0% in Q4, down from 1.1% in Q3 and 1.2% in Q2 and 1.4% in Q1. Whilst Q4's outcome is not significantly lower than the previous quarter's, it is notable that the growth in the ECI continues to trend lower. The ECI data suggests inflation risks are moderating.

The Conference Board's consumer confidence index fell to 107.1 in January, down from December's revised reading of 109.0. Consensus estimates were looking for a reading of 109.1.

The drop in confidence was due to a drop in consumers' expected outlook. The expectations index fell to a reading of 77.8, down from the previous level at 83.4. A reading below 80 for the expectations index can often signal a recession within the next 12 months. The present situation index rose to 15.9, up from December's reading of 147.4.

The Chicago PMI fell to 44.3 in January, from 45.1 in December. It disappointed consensus forecasts.

In house prices data, the FHFA house price index fell 0.1% for November, after a flat outcome in October. And the S&P CoreLogic CS 20-city index fell 0.5% in November with the annual growth rate slowing from 8.6% in October to 6.8% in November.

World: The IMF raised its 2023 global growth outlook slightly due to "surprisingly resilient" demand in the US and Europe, an easing of energy costs and the reopening of China's economy.

The IMF said global growth would still fall to 2.9% in 2023 from 3.4% in 2022, but its latest World Economic Outlook forecasts mark an improvement over an October prediction of 2.7% growth this year with warnings that the world could easily tip into recession.

For 2024, the IMF said global growth would accelerate slightly to 3.1%, but this is a tenth of a percentage point below the October forecast as the full impact of steeper central bank interest rate hikes slows demand.

In its 2023 GDP forecasts, the IMF said it now expected US GDP growth of 1.4%, up from 1.0% predicted in October and following 2.0% growth in 2022. It cited stronger-than-expected consumption and investment in the third quarter of 2022, a robust labour market and strong consumer balance sheets.

It said the euro zone had made similar gains, with 2023 growth for the bloc now forecast at 0.7%, versus 0.5% in the October outlook, following 3.5% growth in 2022. The IMF said Europe had adapted to higher energy costs more quickly than expected, and an easing of energy prices had helped the region.

The UK was the only major advanced economy the IMF predicted to be in recession this year, with a 0.6% fall in GDP as households struggle with rising living costs, including for energy and mortgages.

For China, the IMF revised up its outlook for 2023 expansion in GDP to 5.3%, from the 4.4% it estimated in October, but warned growth would likely fall again to 4.5% in 2024.

The IMF anticipates the boost from renewed mobility for Chinese people to be short-lived. It acknowledged that China's reopening would put some upward pressure on commodity prices. However, the IMF expects the reopening of China as a benefit to the global economy. Reopening is expected to help ease production bottlenecks that have worsened inflation.

Today's key data and events:

AU CoreLogic Home Value Index Jan (5am)
NZ Unemployment Rate Q4 exp 3.3% prev 3.3% (8:45am)
NZ Priv. Wages Ex. O/T Q4 exp 1.2% prev 1.1% (8:45am)
NZ Employment Q4 exp 0.3% prev 1.3% (8:45am)
CH Caixin Mfg PMI Jan exp 49.8 prev 49.0 (12:45pm)
UK Nationwide House Px Jan exp -0.4% prev -0.1% (6pm)
UK Markit Mfg PMI Jan Final exp 46.7 prev 46.7 (8:30pm)
EZ CPI Jan y/y exp 8.9% prev 9.2% (9pm)
EZ Unemployment Rate Dec exp 6.5% prev 6.5% (9pm)
US ADP Employ. Chg. Jan exp 180k prev 235k (12:15am)
US Construction Spending Dec exp 0.0% prev 0.2% (2am)
US ISM Mfg Jan exp 48.0 prev 48.4 (2am)
US FOMC Policy Decision (6am)
Fed Funds Rate exp 4.50%-4.75% prev 4.25%-4.50%

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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