Morning Report

Wednesday, 21 June 2023

Equities (close & % change)		
S&P/ASX 200	7,358	0.9%
US Dow Jones	34,054	-0.7%
Japan Nikkei	33,389	0.1%
China Shanghai	3,397	-0.5%
German DAX	16,111	-0.6%
UK FTSE100	7,569	-0.3%
Commodities (close & change)*		
CRB Index	267.4	-3.5
Gold	1,936.42	-14.1
Copper	8,551.25	5.3
Oil (WTI futures)	71.19	-0.7
Coal (thermal)	134.55	1.8
Coal (coking)	234.00	2.5
Iron Ore	111.20	-1.8

Sydney Futures Exchange (last & change)	Last	Overnight Chg
10 yr bond	3.95	-0.08
3 yr bond	3.87	-0.06
3 mth bill rate	4.59	-0.01
SPI 200	7,307.0	-29

FX Last 24 hrs	Open	High	Low	Current
TWI	63.0	-	-	63.0
AUD/USD	0.6849	0.6855	0.6753	0.6787
AUD/JPY	97.22	97.42	95.57	95.97
AUD/GBP	0.5353	0.5357	0.5309	0.5317
AUD/NZD	1.1048	1.1053	1.0974	1.1007
AUD/EUR	0.6272	0.6276	0.6194	0.6215
AUD/CNH	4.9075	4.9142	4.8552	4.8753
USD Index	102.49	102.79	102.32	102.54

Interest rates (close & change)		
Australia		
90 day BBSW	4.32	0.00
2 year bond	4.15	-0.02
3 year bond	3.98	-0.02
3 year swap	4.21	0.00
10 year bond	4.03	0.05
United States		
3-month T Bill	5.07	-0.01
2 year bond	4.68	-0.03
10 year bond	3.72	-0.04
Other (10 year yields)		
Germany	2.41	-0.11
Japan	0.39	-0.01
UK	4.34	-0.16

Data as at 7:30am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Investors remain apprehensive in the lead up to Jerome Powell's two-day congressional testimony later this week. US equities finished in the red as investors raise doubts about the recent tech rally. Bond yields were lower across the curve, while the US dollar finished broadly flat.

Share Markets: US equities finished broadly lower, as questions begin to be raised about the longevity of the recent rally in tech names. The S&P 500 closed down 0.5%, while the Dow Jones and the NASDAQ declined 0.7% and 0.2%, respectively.

The ASX 200 jumped 0.9% yesterday, extending its rally to seven consecutive days. The ASX is now up 3.6%, from its intra-day low on 13 June. Futures suggest some weakness this morning on the back of the lead from the US.

Interest Rates: Treasury yields finished lower across the curve. The 2-year treasury yield eased 3 basis points to 4.68%, while the 10-year yield fell 4 basis points to 3.72%.

Interest rate markets are pricing a 75% chance of a 25-basis point hike from the Fed in July.

The Australian 3-year bond (futures) yield fell 6 basis points to 3.87%. The 10-year (futures) yield declined 8 basis points to 3.95%.

Markets pared their expectations for rate hikes from the Reserve Bank (RBA) following the release of the minutes yesterday. The minutes revealed that the decision to hike in June was more balanced than previously thought. Markets are pricing a 30% chance of an RBA rate hike in July, back from around 50% before the minutes. However, cash rate futures still imply an overwhelming chance of two more rate hikes, taking the cash rate to 4.60%. Though, the risk of a second hike has been trimmed and currently lies at around an 80% probability.

Foreign Exchange: The change in rate expectations dragged heavily on the Aussie dollar. The AUD/USD pair fell for a third straight session, tumbling a full cent from a high of 0.6855 to a low of 0.6753. The pair has since retraced some of its losses to trade at around 0.6787 at the time of writing. The recent up-swing from 0.6458 to 0.6900 may be running out of puff. However, the pull-back has not yet been sufficient to terminate the up-trend, suggesting the Aussie is taking a breather to consolidate. Downside support lies at 0.6730, a close below that level is a sign the rally has come to an end.

The US Dollar index traded between a low of 102.32 and a high of 102.79, before closing broadly unchanged at 102.54.

Commodities: Commodities were mixed overnight. Gold, iron ore and oil softened, while copper and coal firmed.

Australia: The Reserve Bank (RBA) hiked the cash rate by 25-basis points in June, taking the cash rate to 4.10%. After the RBA's April pause, we flagged potential risks of inflation expectations becoming unanchored, which, if realised, would require more hikes later in the cycle.

The June minutes suggest that this risk may be starting to materialise. Back-to-back rate hikes from the RBA in May and June plus guidance of more to come suggest the RBA Board is worried about inflation expectations.

Inflation expectations are important because they shape how households and businesses behave and it is this behaviour which ultimately determines economic outcomes, including wages growth and inflation.

The Board judged that inflation expectations risks, higher than expected growth in award wages, a slower-than-expected moderation in goods inflation and pressures in the energy and rental markets "had shifted the balance of risks on inflation to the upside".

Managing the upside risks to inflation will likely come at the cost of the RBA veering off the narrow path. This does not necessarily entail a recession (although the risks have certainly increased), but instead that a more significant slowdown in the labour market is now likely required to ensure expectations remain anchored and that inflation returns to target.

On balance, we think that more hikes will be required. We are expecting two more 25-basis point rate hikes taking the cash rate to 4.60%.

RBA Deputy Governor, Michelle Bullock, provided an address on the labour market yesterday. The statement provided a detailed account of recent labour market developments and reiterated the Board's objective of returning inflation to target while preserving as many of the employment gains as possible. Bullock welcomed the recent improvement in the balance between labour supply and demand but underscored that unemployment remains below the level which would be consistent with the inflation target.

China: The People's Bank of China (PBoC) reduced its benchmark loan prime rates (LPR) by 10 basis points yesterday, providing much needed stimulus as the economic reopening wanes. The 1-year LPR - which is used as a benchmark for corporate borrowing - was cut to 3.65%, while the 5-year LPR – a benchmark for mortgage borrowing – was eased to 4.20%.

Japan: Growth in industrial production was finalised at 0.7% in April, a solid improvement on the preliminary reading of -0.4% and an acceleration on the 0.3% gain in March. The rise in production extends the run of consecutive monthly increases to three. Annual growth remained negative in April, at -0.7%.

United States: Housing construction permits rose 5.2% in May, by far eclipsing expectations for a more tepid 0.6% rise. The strong rise unwinds consecutive monthly declines in the rate of approvals through March and April, taking the number of permits granted in May to the strongest since October.

Housing starts also surprised to the upside, surging 21.7% in May, compared to expectations for a 0.1% fall. The sharp rise takes the number of new starts in the month well back above pre-pandemic levels following a deep slowdown since April last year.

The improvement in dwelling construction corresponds with a broader stabilisation in housing market activity after an initial hit from aggressive interest rate increases.

Today's key data and events:

AU Westpac Leading Index May prev 0.0 (10:30am)

UK CPI May exp 0.5% prev 1.2% (4pm)

UK Public Sect. Borrowing May exp £20.0bn prev £24.7bn (4pm)

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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