Morning report

Bank of Melbourne

Friday, 18 August 2023

Equities (close & % change)		
S&P/ASX 200	7,146	-0.7%
US Dow Jones	34,475	-0.8%
Japan Nikkei	31,626	-0.4%
China Shanghai	3,317	0.4%
German DAX	15,677	-0.7%
UK FTSE100	7,310	-0.6%
Commodities (close & change)*		
CRB Index	274.4	0.9
Gold	1,889.43	-2.4
Copper	8,153.25	-30.3
Oil (WTI futures)	80.39	1.0
Coal (thermal)	156.00	0.9
Coal (coking)	253.00	0.3
Iron Ore	105.35	-0.3

Sydney Futures Exchange (last & change)				
	Last		**Overnight Chg**	
10 yr bond	4.27		-0.05	
3 yr bond	3.90		-0.07	
3 mth bill rate	4.19		0.00	
SPI 200	7,067.0		-28	
FX Last 24 hrs	Open	High	Low	Current
TWI	60.4	-	-	60.4
AUD/USD	0.6424	0.6451	0.6365	0.6402
AUD/JPY	93.97	94.01	93.22	93.39
AUD/GBP	0.5046	0.5048	0.5007	0.5023
AUD/NZD	1.0819	1.0834	1.0780	1.0808
AUD/EUR	0.5904	0.5911	0.5864	0.5891
AUD/CNH	4.7115	4.7143	4.6753	4.6762
USD Index	103.47	103.60	103.06	103.43

Interest rates (close & change)		
Australia		
90 day BBSW	4.16	0.01
2 year bond	4.00	0.05
3 year bond	3.97	0.06
3 year swap	4.15	-0.04
10 year bond	4.32	0.11
United States		
3-month T Bill	5.25	-0.04
2 year bond	4.93	-0.04
10 year bond	4.27	0.02
Other (10 year yields)		
Germany	2.71	0.06
Japan	0.65	0.02
UK	4.75	0.10

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: The risk off sentiment continued overnight. US equities fell for the third consecutive day, amid continued concerns that interest rates could remain higher for longer. Yields were mixed, with longer term yields higher, while shorter term yields lower. The 10-year US Treasury yield increased toward its highest level since 2007. The US dollar was broadly unchanged at an elevated level. The Aussie remained under selling pressure, with yesterday's weaker than expected employment report reducing the likelihood that the Reserve Bank (RBA) will need to hike again this cycle.

Share Markets: US stocks posted a third consecutive day of losses as investors weighed the potential for the Fed to tighten policy further given the continued economic resilience. The S&P 500 and the Dow Jones both closed 0.8% lower, while the NASDAQ lost 1.2% over the day.

The ASX 200 fell for the second consecutive day, closing 0.7% lower. The index dropped to the lowest closing level since 12 July. Eight of eleven sectors were lower, led by financials. Futures are pointing to further softness on the open this morning.

Interest Rates: US yields were mixed, with longer term yields higher, while shorter term yields lower. The 2-year yield finished 4 basis points lower at 4.93%. The 10-year yield climbed to an intra-day high of 4.34%, increasing toward its highest level since 2007 (outside the COVID period).

Interest rate markets continue to price around a 40% chance of another hike from the Fed at some stage this cycle. Rate cuts are not fully priced until the middle of next year.

Aussie bond futures were lower. The 3-year bond (futures) yield fell by 7 basis points to 3.90%, while the 10-year (futures) yield declined by 5 basis points to 4.27%.

Interest rate markets are pricing around a 70% chance of another RBA hike between now and March next year. There is very little chance attached to a hike in September.

Foreign Exchange: The Aussie remains under heavy selling pressure amid falling yield support. The AUD/USD pair declined to a low of 0.6365 – the lowest since October 2022, before receiving support at the 0.6400 level. The pair is currently trading at around 0.6402.

The US dollar finished slightly stronger. The DXY index rose from a low of 103.02 to a high of 103.60 and is currently trading at 103.43.

Commodities: Prices were mostly higher. The West Texas Intermediate (WTI) oil future also increased, closing at US$80.39 per barrel.

Australia: Employment declined by 14.6k in July, the largest fall since the Delta lockdowns of 2021 but only the third fall in the past 21 months. The unemployment rate rose to 3.7%, from 3.5%.

While we are hesitant to call a distinct turn in the labour market, the July outcome suggests that we might be starting to see some chinks appear in the armour and that the market's ability to absorb the rapid increase in the working age population is beginning to wane.

Growth in the working age-population accelerated marginally to a record annual pace of 2.8% in July. However, the increase in labour supply was partially offset by a fall in the participation rate to 66.7%, from 66.8%. Without the cushion from a falling participation rate, the unemployment rate would have increased even further to 3.8%.

Despite the soft monthly read there remains considerable residual strength. On average over the past three months employment expanded 31.1k, comfortably above the 10-year average. Additionally, school holidays during the survey period mean there is good cause for caution.

Today's data is the first sign that labour demand may be starting to struggle in keeping up with record growth in supply. This mismatch is likely to deepen over time and lead to a further softening in labour market conditions. However, the turn in the labour market could be a slow burn rather than a sharp tilt.

The Reserve Bank (RBA) has made clear it will require evidence that upside inflation risks are materialising to prompt further tightening in monetary policy. Today's data suggests that these risks, at least from the perspective of the labour market, are remaining at bay.

Eurozone: The trade surplus increased to EUR12.5bn in June, compared to an upwardly revised EUR0.2bn surplus in May. This was better than the EUR4.0bn surplus the market was expecting.

Imports slipped by 17.7% in annual terms, mainly due to lower acquisitions of raw materials; crude materials; mineral fuels, lubricants; manufactured goods and miscellaneous manufactured products. Among major trade partners, imports declined mainly from Russia, China, the UK and the US. Exports rose 0.3% in annual terms, mainly driven by shipments of machinery & transport equipment; food, beverages & tobacco; and manufactured goods. Overseas sales rose mostly to China, the UK, Japan, and Turkey.

Japan: Core machinery orders, which exclude orders for those for ships and electric power companies, increased by 2.7% over the month of June, partly reversing the fall of 7.6% recorded over May. The outcome was lower than the 3.6% gain the market was expecting. On an annual basis, private-sector machinery orders declined by 5.8% in June, following an 8.7% decrease in May. Machinery orders are a leading indicator of investment spending in the coming six to twelve months.

New Zealand: The Producer Price Index (which measures wholesale prices) increased by 0.2% over the June quarter, slightly down from the 0.3% recorded over the March quarter. It was the smallest quarterly gain since the March quarter 2020. Quarterly producer price declines were recorded in the electricity and gas supply (-2.8%), manufacturing (-0.6%), and Agriculture, forestry, and fishing (-1.8%) industries.

United States: Initial jobless claims rose by 239k (broadly in line with market expectations), with continuing claims running at 1,716k. Both metrics continue to point to a tight labour market.

The Conference Board leading index fell by 0.4% over July, following a decline of 0.7% in June. The outcome was in line with market expectations. The leading index has now declined for 16 consecutive months, signalling the outlook remains highly uncertain.

The Philadelphia Fed Manufacturing Index rose to 12.0 index points in August, up sharply from the -13.5 points recorded in July. This was much better than the -10 points the market was expecting and was the first positive reading in a year. The new orders and shipments sub-indices were positive for the first time since May 2022. Expectations for growth over the next six months softened over the month.

Today's key data and events:

EZ CPI Jul Final y/y prev 5.5% (7pm)
JN CPI Jul y/y prev 3.3% (9:30am)
UK GfK Cons. Sentiment Aug prev -30 (9:01am)
UK Retail Sales Jul prev 0.7% (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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