Morning report

Thursday, 2 March 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,252	-0.1%		Last		Overnight Chg		**Australia**		
US Dow Jones	32,663	0.0%	10 yr bond	3.83		0.04		90 day BBSW	3.59	0.03
Japan Nikkei	27,517	0.3%	3 yr bond	3.57		0.05		2 year bond	3.51	-0.08
China Shanghai	3,472	1.0%	3 mth bill rate	3.72		0.04		3 year bond	3.51	-0.09
German DAX	15,305	-0.4%	SPI 200	7,205.0		0		3 year swap	4.02	-0.09
UK FTSE100	7,915	0.5%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.79	-0.06
Commodities (close & change)*			TWI	61.4	-	-	61.4	**United States**		
CRB Index	272.8	3.0	AUD/USD	0.6726	0.6784	0.6695	0.6754	3-month T Bill	4.72	0.03
Gold	1,837.35	10.4	AUD/JPY	91.57	92.22	91.28	91.99	2 year bond	4.88	0.06
Copper	9,096.50	137.5	AUD/GBP	0.5592	0.5636	0.5571	0.5620	10 year bond	3.99	0.07
Oil (WTI futures)	77.73	0.7	AUD/NZD	1.0882	1.0891	1.0796	1.0806	**Other (10 year yields)**		
Coal (thermal)	193.50	0.7	AUD/EUR	0.6361	0.6381	0.6319	0.6334	Germany	2.71	0.06
Coal (coking)	359.50	14.0	AUD/CNH	4.6752	4.6838	4.6334	4.6457	Japan	0.51	0.00
Iron Ore	126.50	0.4	USD Index	104.97	105.09	104.09	104.45	UK	3.84	0.01

Data as at 8:00 am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Investors recalibrated their interest rate expectations as economic data in Europe continued to show inflation is sticky, while US Fed officials remained hawkish. The 10-year treasury yield briefly jumped above 4% for the first time since November, as markets priced higher for longer interest rates. US equities finished lower, while the Dollar slid.

Share Markets: US equities were broadly lower overnight but fluctuated considerably in intra-day trade. Equities have come under renewed pressure as bets ramp up for a higher peak in interest rates, raising questions about the resilience of earnings. The S&P 500 and the NASDAQ finished the day down 0.5% and 0.7%, respectively. This was the lowest close for the S&P 500 in almost 6-weeks. The Dow Jones bucked the trend, closing flat.

The ASX 200 closed down 0.1% yesterday, after gyrating through gains and losses. The index fell as much as 0.6% on open yesterday, before rallying almost 0.8% on the release of domestic data. Stocks were unable to hold onto gains into the afternoon, sliding sharply in late trade. Futures are pointing to a soft open this morning.

Interest Rates: US yields increased across the curve as traders ramped up bets on the peak in the federal funds rate and pushed back expectations for rate cuts. The 2-year treasury yield gained 6 basis points to 4.88%, its highest level since July 2007. The 10-year yield jumped 7 basis points to 3.99%, but briefly pierced above the 4% handle for the first time since November.

Interest rate markets are fully pricing a 25-basis point hike from the Fed in March and are attaching a small risk of a larger hike. The implied peak in the policy rate is up to almost 5.5%.

Australian futures yields followed treasuries higher. The Australian 3-year government bond (futures) yield rose 5 basis points to 3.57%, while the 10-year yield gained 4 basis points to 3.83%

Interest rate markets are attaching a 76% probability to a 25-basis point hike from the Reserve Bank (RBA) in March and are pricing a peak in the cash rate of just under 4.2%.

Currencies: The US dollar was marginally weaker against its G10 peers, despite a lift in yields. The DXY index fell from a high of 105.09 to a low of 104.09 before retracing some of its losses to trade around 104.45 at the time of writing.

The Aussie dollar closed higher after a choppy session. The AUD/USD pair fell to an 8-week low of 0.6695 immediately after the release of the National Accounts and inflation data. But found its feet in later in the day, staging a rally to 0.6784. The pair has since pulled back and is currently trading at 0.6754.

Commodities: Commodities were broadly higher overnight alongside signs of a more rapid than expected recovery in China. The West Texas

Intermediate (WTI) futures price rose to US$77.73 per barrel.

Australia: The Australian economy expanded 0.5% in the December quarter, a slowdown from the September quarter and missing expectations for a stronger gain. Annual growth slowed to 2.7%.

The economy has reached its turning point. The impact of higher interest rates, inflation, and rents showed in yesterday's National Accounts.

Household disposable income declined and recorded its weakest outcome since the September quarter 2012 (outside of COVID) as income growth has not kept up with higher costs of living.

Domestic demand from households, governments, and businesses came to a halt over the quarter. Outside of COVID this was the weakest outcome since the June quarter 2014.

The return of overseas arrivals at a record pace is holding up aggregate economic activity. GDP per capita was flat over the quarter. However, in aggregate terms GDP increased by 0.5% over the quarter on the back of a higher population.

Household consumption on a per person basis declined over the quarter. Without the increase in the population, aggregate consumption (which accounts for around 55% of the economy) would have gone backwards.

The Residential construction sector is under pressure. Shortages of materials, labour and the unwinding of HomeBuilder and other subsidies have more than offset the tailwind from the healthy pipeline of activity – forward indicators point to continued weakness.

The external sector continues to outperform. Services and mining exports are growing strongly, while imports have slowed on the back of weaker domestic demand.

The monthly consumer price index (CPI) indicator rose 7.4% over the year to January, slowing considerably from an 8.4% annual increase in December. In monthly terms, CPI declined 0.4% providing our first potential sign of the beginning of disinflation.

Note, however, that January's result is still exceptionally high and that the inflation pulse remains strong. The data, although promising, confirms that there is a long way to go in returning inflation to target.

There were some positive developments on goods inflation, which showed little sign of budging in the December quarter. Prices for household equipment and clothing & footwear fell sizeably in January, pointing to a more material softening in goods prices this year.

We have received our first piece of evidence that inflation is likely to have peaked in the December quarter. However, price pressures remain elevated and as we have seen overseas, inflation may prove sticky. Additionally, the Reserve Bank (RBA) will need concrete evidence that the inflationary pulse is softening before swaying from its current course.

Dwelling prices racked up their tenth consecutive fall in February, recording a national decline of 0.1%. A notable feature of February's data was that the decline of 0.1% was the smallest fall since May, when the RBA began hiking rates.

Sydney prices rose 0.3% – the first lift in 13 months. Unit prices nationally also ceased declining – recording a flat outcome in February.

Dwelling prices across other major cities continued to fall but the data suggests that the pace of declines is slowing.

The strong growth in rents (we predict record growth of 11.5% this year), a ramp up of net overseas migration (we expect 300k to be breached this financial year) and a shortage of stock (building approvals and construction activity contracting sharply and listings are lacklustre) could result in a mix where prices look to find a bottom beyond just Sydney and units.

However, further rate rises from the RBA may stall the process of prices finding a bottom until later this year and a resumption of declines in Sydney and the unit market can't be ruled out.

China: The February purchasing managers' indices (PMI) point to a significant strengthening in conditions alongside a robust reopening. The Manufacturing PMI rose to 52.6 in February from 50.1 in January, beating consensus expectations. This was the strongest reading since April 2012. The services PMI also surprised to the upside, jumping to 56.3 from 54.4 previously. Both PMI's are now comfortably in expansionary territory and the economic recovery gains momentum.

The Caixin manufacturing PMI, which surveys small businesses, also advanced rising to 51.6 from 49.2. This was the first read above 50 a year, pointing to a broad-based improvement in conditions.

New Zealand: Building approvals fell 1.5% in January, extending a sharp 7.1% slide in December. Month-to-month approvals continue to be volatile, however, an underlying slowdown in the pace of approvals is underway. Falling dwelling prices, higher interest rates and the elevated cost of construction remain material headwinds for new dwelling consents.

Europe: German inflation was unchanged at 8.7% in February, defying expectations for a mild softening. This adds to evidence that inflation in Europe is proving stickier than anticipated. In monthly terms, inflation jumped 0.8% beating expectations for a 0.5% gain. Although the monthly rate did slow from 1.0% in January. Three of the four largest European economies have printed stronger inflation results than expected in February, pointing to upside risk to tonight's bloc-wide inflation report.

United Kingdom: Bank of England Governor, Andrew Bailey, challenged market expectations that another rate hike in March is a sure-thing. Bailey said, "at this stage, I would caution against suggesting either that we are done with increasing the Bank Rate, or that we will inevitably need to do more", leaving all options on the table for the March meeting.

The February manufacturing PMI was finalised a tick higher at 49.3, remaining in contractionary territory for a seventh consecutive month.

The Nationwide house price index tumbled 1.1% over the year to February, the sharpest annual fall in over 10 years. The result was weaker than expected, though the monthly fall of 0.5% met expectations.

United States: Fed officials added to speculation that the federal funds rate will need to be higher for longer to contain inflation. Minneapolis Fed boss, Neel Kashkari (voting member), said he was inclined to "push up my policy path" after signs inflation is proving sticky and the labour market remains strong. Kashkari was careful to remain ambiguous, but suggested he is leaning towards a peak in the policy rate above his previous expectation of 5.4%.

Meanwhile, Atlanta Fed President, Raphael Bostic (non-voting member), preferred a peak rate in the range of 5.00%-5.25%, but added that rates would need to stay at that level "until well into 2024".

The February manufacturing PMI was revised down to 47.3 at final figures. This was down from a preliminary read of 47.8. The February reading was still an improvement on January's outcome despite the downward revision.

The ISM manufacturing PMI sent a similar message, rising to 47.7 in February from 47.4 in January. However, the index remains comfortably withing contractionary territory, where it has been since November.

Construction spending declined 0.1% in January, while December's 0.4% fall was revised lower to -0.7%. The fall comes alongside a pronounced fall in investment in single-family homebuilding, as interest rates and construction costs rise.

Today's key data and events:

NZ Terms of Trade Q4 prev -3.4% (8:45am)

AU Bld. Approvals Jan exp -7.0% prev 18.5% (11:30am)

EZ CPI Feb y/y exp 8.3% prev 8.6% (9pm)

EZ Unemployment Rate Jan exp 6.6% prev 6.6% (9pm)

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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