Morning report

Bank of Melbourne

Tuesday, 2 May 2023

Equities (close & % change)		
S&P/ASX 200	7,335	0.3%
US Dow Jones	34,052	-0.1%
Japan Nikkei	29,123	0.9%
China Shanghai	3,484	1.1%
German DAX	15,922	0.8%
UK FTSE100	7,871	closed
Commodities (close & change)*		
CRB Index	266.3	-1.8
Gold	1,982.60	0.0
Copper	8,590.00	6.5
Oil (WTI futures)	75.66	-1.1
Coal (thermal)	202.05	0.0
Coal (coking)	234.67	-1.6
Iron Ore	101.85	-0.1

Sydney Futures Exchange (last & change)	Last	Overnight Chg
10 yr bond	3.44	0.08
3 yr bond	3.05	0.06
3 mth bill rate	3.72	0.02
SPI 200	7,336.0	-5

FX Last 24 hrs	Open	High	Low	Current
TWI	59.8	-	-	59.8
AUD/USD	0.6614	0.6668	0.6608	0.6629
AUD/JPY	90.12	91.33	90.04	91.15
AUD/GBP	0.5262	0.5316	0.5260	0.5305
AUD/NZD	1.0693	1.0766	1.0691	1.0747
AUD/EUR	0.6001	0.6058	0.5999	0.6039
AUD/CNH	4.5823	4.6286	4.5790	4.6117
USD Index	101.68	102.19	101.62	102.12

Interest rates (close & change)		
Australia		
90 day BBSW	3.67	-0.01
2 year bond	3.05	0.01
3 year bond	3.01	0.01
3 year swap	3.49	0.00
10 year bond	3.35	0.02
United States		
3-month T Bill	4.89	-0.04
2 year bond	4.14	0.13
10 year bond	3.57	0.15
Other (10 year yields)		
Germany	2.31	0.00
Japan	0.41	0.01
UK	3.72	closed

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: First Republic Bank became the second largest banking collapse in US history after regulators announced a takeover by JPMorgan Chase Bank. Market reactions to the announcement were somewhat muted as a takeover was expected following the Federal Deposit Insurance Corporation (FDIC) taking control of the bank and seeking bids over the weekend.

Markets looked to other developments for direction during the day. Bond yields rose sharply as data suggested that the US manufacturing sector was not as weak as expected and that price pressures remained elevated. This contributed to expectations that interest rates may need to be higher for longer to contain inflation. Large bond sales from investment-grade issuers also added upward pressure to bond yields, as new debt led to increased competition for investor funds.

The US dollar strengthened in line with higher interest rate expectations, while equity markets ended broadly flat on the day.

Global Banking Developments: First Republic Bank became the second largest banking collapse in US history after Washington Mutual in 2008 as regulators announced that JPMorgan Chase Bank would acquire the bank. This follows the bank being taken over by the FDIC after it faced a rapid deposit outflow of over 40% in Q1 2023.

Prior to the FDIC takeover, the share price had plummeted from near $123 in early March to $3.51. This reflected a more than 97% plunge from levels prior to the beginning of the banking issues, which were sparked by the collapse of Silicon Valley Bank.

As of 13 April, First Republic Bank had around $229.1 billion of total asset. JPMorgan agreed to acquire most of the bank's assets and all deposits. According to reports, it acquired around $173 billion of loans, $30 billion of securities, and $92 billion of deposits. The FDIC and JPMorgan will enter a loss-share transaction to cover losses on single family, residential, and commercial loans as part of the takeover. The FDIC estimates that the cost to the Deposit Insurance Fund will be about $13 billion. However, the final cost will need to be determined.

JPMorgan CEO Jamie Dimon said that the takeover means that the US banking turmoil is near its end. He also noted that the financial system remained "extraordinarily sound", while acknowledging that lending will be impacted for some time. JPMorgan will not continue the First Republic Bank brand.

Share Markets: Equity markets closed flat to slightly in the red after trading in the green for much of the session. The S&P 500 was broadly unchanged on the day (0.0%), while the Nasdaq and Dow Jones both fell 0.1%. First Republic Bank shares were halted following the announcement of the takeover. JPMorgan shares rose 3.0% on the day as markets reacted positively to the news. The S&P 500 banks index closed flat. However, looking further at the components of the index, the result reflected a 3.4% drop for regional banks, while diversified banks rose 0.4%.

The ASX 200 rose 0.3% yesterday. The utilities sector (1.3%) was the strongest performer, followed by energy (1.0%) and health care (0.9%). Information technology (-1.4%) and materials (-0.4%) were the worst performing sectors on the day. Futures are pointing to a weaker open today.

Interest Rates: Bond yields rose as stronger-than-expected manufacturing data suggested that inflationary pressures may remain elevated for longer. Large volumes of investment-grade corporate bond issuances, including from Meta, Comcast, and Hershey Co. impacted demand for other fixed income investments, contributing to lower prices and higher yields.

The US 2-year yield jumped 13 basis points, to 4.14%. The 10-year yield was up 15 basis points, to 3.57%.

Interest-rate markets are pricing a 95% probability of a 25-basis-point hike at this week's Federal Reserve meeting. Markets expect the fed funds rate to peak at around 5.15% in June, before they begin pricing cuts in the second half of 2023. Markets are now pricing slightly less than two full 25-basis-point cuts by January 2024. This compares with more than two full cuts being priced on Friday.

The 3-year Australian government bond yield (futures) rose 6 basis points, to 3.05%. The 10-year government bond yield (futures) was 8 basis points higher, at 3.44%. Interest-rate markets are pricing in next to no chance of a hike at today's RBA meeting. Looking further ahead, markets are pricing in almost 10 basis points of hikes by August this year, before cuts begin to be priced. However, a full 25-basis-point cut is not priced until 2024.

Foreign Exchange: The US dollar rose against a basket of major currencies in line with higher interest rate expectations. The USD Index rose from a low of 101.62 to a high of 102.19, before pulling back slightly to 102.12.

The AUD/USD pair bucked the trend and closed higher. The pair initially rose from a low of 0.6608 during the Asian session to a high of 0.6668 in New York trade. However, it then retracted some of these gains after the publication of stronger-than-expected US economic data, falling to 0.6629.

Commodities: Oil, iron ore, and coking coal were lower on the day. Thermal coal was flat, while copper was higher.

Australia: Dwelling prices increased by 0.5% in April, following an increase of 0.6% in March. Price increases were concentrated in Sydney (+1.3%), Perth (+0.6%) and Brisbane (+0.1%). Melbourne also recorded an increase (+0.1%) – the capital cities across the east coast of Australia have experienced the largest influx of net overseas arrivals.

Today's data provides further evidence that the housing market has stabilised and passed the trough for this cycle. Unlike most previous hiking cycles, house prices have started to stabilise while the RBA was hiking rates.

Reporting suggests that demand for dwellings has been supported by the record surge in net overseas arrivals, with some migrants looking to skip the rental queue and purchase instead. Census data suggest that in the past it would typically take a migrant 4-7 years to buy a dwelling. There could also be cashed up investors getting into the market, speculating that prices have bottomed out from here. At the same time, persistently low levels of advertised supply remain a key factor supporting housing values.

The Melbourne Institute inflation gauge rose by 0.2% in April, to be 6.1% higher in annual terms. The monthly pace slowed from a 0.3% outcome in March, while the annual pace accelerated from a 5.7% prior reading. The indicator provides an alternative monthly measure of inflation in addition to the newer monthly indicator from the ABS.

Job ads fell 0.3% in April according to the ANZ-Indeed measure. The measure has now declined for three consecutive months. In annual terms, jobs ads were down 5.4% in April. However, despite the falls, job ads are coming off very elevated levels as the labour market has remained tight though this cycle.

Japan: The manufacturing PMI was finalised at 49.5 in April. This was unchanged from the preliminary reading. The outcome suggests the manufacturing sector has remained in contractionary territory for six consecutive months. The result reflected falls in output, which were in contraction for the 10th consecutive month. On the other hand, new orders were higher than the previous month and rose to their highest reading since July 2022.

United States: The ISM manufacturing PMI showed that the manufacturing sector remained in contractionary territory for the sixth consecutive month. However, the outcome was better than what the market was expecting, with all major components rising. The ISM manufacturing PMI came in at 47.1 in April. This followed a 46.3 outcome in March and was above the 46.8 outcome expected by consensus. All major components of the index rose in the month, including employment and new orders. Importantly for the Fed, the prices paid component jumped into expansionary territory in the month, suggesting that prices were rising again. It increased from 49.2 in March to 53.2 in April. This outcome suggests that the Fed likely has more work to do to contain inflationary pressures and adds weight to another 25-basis-point at this week's meeting.

While the ISM manufacturing PMI remained in contractionary territory, the S&P manufacturing PMI was finalised at 50.2 in April. This was down slightly from the preliminary reading of 50.4.

Construction spending was up 0.3% in March. This followed a -0.3% outcome in February and was above consensus expectations of 0.1%. Private construction rose 0.3%, with a 1.0% gain in private non-residential construction partly offset by a 0.2% fall in residential construction. Public construction, representing almost 22% of the total, was up 0.2%.

Today's key data and events:

RBA Monetary Policy Meeting (2:30pm)

Cash Rate Target exp 3.60% prev 3.60%

RBA's Gov. Lowe Speech (9:20pm)

EZ M3 Money Supply Mar exp 2.4% prev 2.9% (6pm)

EZ CPI Apr Prel. y/y exp 7.0% prev 6.9% (7pm)

UK Nationwide House Prices Apr exp -0.5% prev 0.8% (4pm)

UK Markit Mfg PMI Apr Final exp 46.6 prev 46.6 (6:30pm)

US Factory Orders Mar exp 1.3% prev -0.7% (12am)

US Durable Goods Orders Mar Final prev 3.2% (12am)

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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