Morning report

Bank of Melbourne

Thursday, 17 August 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,195	-1.5%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,766	-0.5%	10 yr bond	4.24		0.03		90 day BBSW	4.15	-0.02
Japan Nikkei	31,767	-1.5%	3 yr bond	3.92		0.01		2 year bond	3.95	-0.05
China Shanghai	3,302	-0.8%	3 mth bill rate	4.21		0.01		3 year bond	3.91	-0.05
German DAX	15,789	0.1%	SPI 200	7,118.0		-23		3 year swap	4.17	0.00
UK FTSE100	7,357	-0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.21	-0.05
Commodities (close & change)*			TWI	60.8	-	-	60.8	**United States**		
CRB Index	273.5	-0.8	AUD/USD	0.6456	0.6480	0.6416	0.6424	3-month T Bill	5.28	0.01
Gold	1,891.81	-10.2	AUD/JPY	93.98	94.29	93.64	93.97	2 year bond	4.97	0.01
Copper	8,153.25	-30.3	AUD/GBP	0.5082	0.5086	0.5043	0.5046	10 year bond	4.25	0.04
Oil (WTI futures)	79.38	-1.6	AUD/NZD	1.0843	1.0851	1.0793	1.0819	**Other (10 year yields)**		
Coal (thermal)	164.50	3.1	AUD/EUR	0.5920	0.5930	0.5897	0.5903	Germany	2.65	-0.02
Coal (coking)	252.67	0.2	AUD/CNH	4.7257	4.7361	4.7089	4.7127	Japan	0.63	0.00
Iron Ore	101.10	0.3	USD Index	103.21	103.53	102.94	103.44	UK	4.65	0.06

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: Pressure on equities and treasuries ramped up towards the end of US trade as the minutes from the Fed's July meeting revealed hawkish comments from officials. Equities finished in the red for a second consecutive session, while the US yield curve steepened as the 10-year yield touched a fresh 10-month high and closed at its highest level since 2008.

Share Markets: Equities traded soft for most of the session but extended losses on the release of the Fed's July minutes which suggested that further tightening might be required. The S&P 500 fell 0.8%, while the Dow Jones and the NASDAQ lost 0.5% and 1.2%, respectively.

The Aussie bourse was sold off heavily yesterday led by materials, healthcare and financials. The ASX 200 finished down 1.5%, the largest daily slump in near 6 weeks. Futures are pointing to further softness on the open this morning.

Interest Rates: US yields were higher across the curve. The 2-year yield finished 1 basis point higher at 4.97% after hitting 4.99% towards the end of trade. The 10-year yield climbed to an intra-day high of 4.28%, its highest level since October 2020. Some late buying saw the 10-year close slightly lower at 4.25% its highest close since June 2008. The 10-year real yield (that is adjusted for expected inflation) also advanced strongly to its highest level since March 2009 (1.93%).

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 May next year.

Aussie bond futures mimicked the move in treasuries. The 3-year bond (futures) yield gained 1 basis points to 3.92%, while the 10-year (futures) yield was 3 basis points higher at 4.24%.

Interest rate markets are pricing around a 55% chance of another Reserve Bank (RBA) hike between now and February next year. There is very little chance attached to a hike in September.

Foreign Exchange: The Aussie dollar remains under heavy selling pressure alongside a weakening outlook for China and little yield support. The AUD/USD pair tumbled from a high of 0.6480 to a fresh 9-month low of 0.6416 and is currently trading around 0.6424 at the time of writing. The pair is yet poised to test key support at the 0.6400 level in the near-term but local jobs data today may provide some reprieve.

The US dollar finished slightly stronger after the release of the Fed minutes. The DXY index rose from a low of 102.94 to a high of 103.53 and is currently trading at 103.44.

The stronger Greenback saw the Yen struggle. The USD/JPY pair rose to a 9-month high of 146.41 and holding on to close above the 145 level for a third consecutive session.

Commodities: Oil was sold off to close below US$80 per barrel for the first time in two weeks. Gold and copper where also weaker, while iron ore bucked the trend.

Australia: The National Cabinet convened yesterday to consider possible solutions to address the housing crisis. It was announced that the Federal Government will contribute $3.0bn towards a new fund aimed at helping the states and territories fast-track housing construction. A new construction target of 1.2 million homes in the next five years (starting July 2024) was set, increasing the previous target pledged under the national housing accord by 200k homes. A $500m housing support program will also be established for local and state governments to boost new housing supply in well-located areas. Finally, leaders agreed on a suite of rental reforms, including limiting rent increases to once per year, a nationwide policy enforcing genuine reasonable grounds evictions and implementing minimum rental standards.

The six-month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, lifted to -0.60% in July from -0.67% in June.

Eurozone: The Eurozone economy advanced 0.3% in the June quarter following a flat result in the March quarter. The quarterly gain was as expected by economists and drove a slowdown in annual GDP growth to 0.6%, its slowest since the pandemic.

Industrial production unexpectedly grew in June, rising 0.5% compared to consensus expectations for a flat reading. However, May's initial outcome of 0.2% was revised down to flat. Despite the resilient result, the outlook for industrial production remains meagre as higher interest rates weigh on demand.

New Zealand: The Reserve Bank of New Zealand (RBNZ) left the official cash rate (OCR) on hold at 5.50%, as widely expected. This was the second consecutive meeting the RBNZ has left its key policy rate unchanged. However, changes to the Bank's published forecasts suggest a rising risk that additional tightening may be necessary to ensure inflation returns to the target range sufficiently quickly. Additionally, the expected timing of any rate cuts was pushed out from next year into 2025.

United Kingdom: Inflation surprised to the upside again in July reaffirming concerns about the persistence of price pressures. The consumer price index (CPI) declined 0.4% in July following a 0.1% rise in June. This compared to expectations for a larger 0.5% fall. In annual terms, inflation slowed markedly from 7.9% in June to 6.8% in July but this still overshot expectations of a 6.7% increase.

The all-important core CPI, which strips out volatile items, was unchanged in annual terms at 6.9%. The market was expecting a slight deceleration to 6.8%.

The result, coupled with recent white-hot wages data suggests there is still plenty of work left to do for the Bank of England to reign in domestic price pressures.

United States: The minutes from the Fed's July meeting showed that officials remained concerned that inflation would fail to recede, and that further hiking may be needed. The minutes noted that "most participants continued to see significant upside risks to inflation, which could require further tightening of monetary policy". However, it was also revealed that two officials favoured leaving rates unchanged instead of the rate hike which was ultimately delivered, although they did not officially dissent when voting. The minutes reveal a growing divergence between members in the assessment of policy, supporting to the dovish stance currently priced into markets.

Housing construction starts rose 3.9% in July after a downwardly revised 11.7% fall in July. Housing construction activity has ticked up in 6-month moving average terms, as new supply responds to a very tight established dwelling market prompting a lift in prices.

While starts were firmer, new permits for construction gained an anaemic 0.1% in July following a 3.7% fall in June. Despite the volatility the number of new approvals has stabilised in recent months after falling sharply through 2022.

Industrial production rose 1.0% in July, underpinned by a surge in vehicle production. The strong result followed a 0.8% fall in production in June and was the strongest monthly gain since January. Motor vehicle output increased by the fastest rate since the end of 2018. However, even when including this boost in vehicle production, factory output remains 0.7% lowers compared to a year ago as manufacturers continue to face challenges.

Please find today's key data and events overleaf.

Today's key data and events:

NZ PPI Q2 prev 0.3% (8:45am)

JN Machinery Orders Jun exp 3.5% prev -7.6% (9:50am)

AU Labour Force Jul (11:30am)

Employment Change exp 25k prev 32.6k

Unemployment Rate exp 3.5% prev 3.5%

Participation Rate exp 66.8% prev 66.8%

EZ Trade Balance Jun exp €4.0bn prev -€0.9bn (7pm)

US Philadelphia Fed Index Aug exp -10.0 prev -13.5 (10:30pm)

US Leading Index Jul exp -0.4% prev -0.7% (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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