# Morning report

Bank of Melbourne

Friday, 2 July 2021

| Equities (close & % change) | | | Sydney Futures Exchange (close & change) | | | | | Interest rates (close & change) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| S&P/ASX 200 | 7,266 | -0.6% | | Last | | Overnight Chg | | **Australia** | | |
| US Dow Jones | 34,634 | 0.4% | 10 yr bond | 98.51 | | 0.04 | | 90 day BBSW | 0.03 | -0.01 |
| Japan Nikkei | 28,707 | -0.3% | 3 yr bond | 99.55 | | 0.00 | | 2 year bond | 0.10 | 0.03 |
| China Shanghai | 3,762 | -0.1% | 3 mth bill rate | 99.96 | | 0.00 | | 3 year bond | 0.41 | 0.00 |
| German DAX | 15,604 | 0.5% | SPI 200 | 7,205.0 | | 25 | | 3 year swap | 0.48 | 0.00 |
| UK FTSE100 | 7,125 | 1.2% | FX Last 24 hrs | Open | High | Low | Current | 10 year bond | 1.52 | -0.01 |
| Commodities (close & change)* | | | TWI | 62.7 | - | - | 62.5 | **United States** | | |
| CRB Index | 214.6 | 1.2 | AUD/USD | 0.7500 | 0.7508 | 0.7460 | 0.7468 | 3-month T Bill | 0.04 | 0.00 |
| Gold | 1,776.84 | 6.7 | AUD/JPY | 83.33 | 83.66 | 83.11 | 83.29 | 2 year bond | 0.25 | 0.00 |
| Copper | 9,303.75 | -59.8 | AUD/GBP | 0.5422 | 0.5437 | 0.5414 | 0.5425 | 10 year bond | 1.46 | -0.01 |
| Oil (WTI) | 75.23 | 1.8 | AUD/NZD | 1.0731 | 1.0730 | 1.0702 | 1.0714 | **Other (10 year yields)** | | |
| Coal (thermal) | 131.45 | 2.6 | AUD/EUR | 0.6324 | 0.6329 | 0.6298 | 0.6302 | Germany | -0.20 | 0.01 |
| Coal (coking) | 196.67 | 4.3 | AUD/CNH | 4.8507 | 4.8549 | 4.8300 | 4.8332 | Japan | 0.04 | -0.02 |
| Iron Ore | 204.95 | 0.0 | USD Index | 92.4 | 92.6 | 92.3 | 92.5 | UK | 0.73 | 0.01 |

Data as at 7:45am. Change from previous trading day (excluding the SFE which is the change during the night session). Source: Bloomberg.

**Main Themes:** Prices paid in a key US manufacturing survey rose to the highest level since 1979. And the US Federal Reserve's Harker fanned market expectations of a possible tapering of the US's quantitative easing program later this year. The US dollar climbed to a three-month high with the AUD/USD dropping to a 7-month low. Share markets pushed higher, despite inflation fears.

**Share Markets:** US share markets greeted the second half of the year with enthusiasm. Strong US economic data helped drive share markets higher. The S&P 500 index jumped 22 points (or +0.5%) to a new record high, the Dow rose 131 points (or +0.4%) and the Nasdaq increased 18 points (or +0.1%).

**Interest Rates:** US bond yields eased slightly at the long end of the curve. The US 10-year yield closed 1 basis point lower whilst the 2-year bond yield closed unchanged at 0.25%.

The Australian 3-year bond yield (futures) fell from 0.47% to 0.45% and the 10-year yield declined from 1.55% to 1.50%.

**Foreign Exchange:** The Australian dollar fell to a 7-month low of 0.7460, from an overnight high recorded in Europe trading of 0.7508. On June 18, we flagged in a separate note that we saw the risks as leaning towards the AUD falling towards US 70 cents in coming months before recovering. The selling in the AUD/USD exchange rate was again driven by a broad-based strengthening of the US dollar. The US dollar appreciation was supported by remarks made by the US Federal Reserve's Harker overnight. These remarks lifted market expectations of a possible tapering later this year in the US. The US dollar index rose to a fresh 3-month of 92.6.

The Aussie dollar looked heavy since June 16 when the US Federal Reserve met. The US Federal Reserve brought forward its rate hike forecast, predicting two rate increases by the end of 2023, according to the median of expectations in the dot plot. Markets are also bracing for tapering of the US quantitative easing program to possibly start as soon as later this year.

**Commodities:** OPEC talks broke down overnight. An agreement to boost output was thrown into doubt as the UAE blocked a preliminary deal Saudi Arabia forged with Russia, prompting the cartel to postpone its talks to Friday. The unexpected turn of events leaves consumers unsure of whether the 400,000 barrel a day monthly production increases proposed by the cartel from August to December will be agreed. Still, crude futures closed above US$75 a barrel for the first time since 2018.

**COVID-19:** NSW recorded 24 new COVID-19 cases yesterday. Premier Berejiklian announced that from mid July there will be pilot of 22 pharmacies across rural and regional NSW that will begin administering the COVID-19 vaccine.

Queensland recorded two new cases yesterday and the NT recorded one new case while SA, WA and Victoria all recorded zero cases. Victoria paused a planned easing of restrictions due to the outbreaks around the country, advising they will review the arrangements in a week.

**Australia:** The housing boom marched ahead in June. CoreLogic's national home value index increased by 1.9% in the month. Subsequently, annual growth in dwelling prices hit 13.5% in the month, marking the highest reading in 15 years!

Annual growth rates in the capital cities were no less impressive. Annual growth was the strongest on record in Darwin (21.0%), where data dates back to 1999. It was also the fastest in around 17 years in Hobart (19.6%) and Canberra (18.1%). Growth in Adelaide (13.9%) and Brisbane (13.2%) hit its strongest pace in 13 years while Sydney (15.0%) reached its fastest clip in 4 years.

The gap in the performance of regional areas and capital cities has narrowed, but house price growth continues to outstrip growth in apartment prices. The widening gap between house and unit prices, especially in Sydney where it is at a record high, and stretching affordability, suggests the outlook for unit price growth is improving.

The lockdowns implemented around the country will likely cause sales volumes to decline over the coming weeks. However, after previous circuit breaker lockdowns, activity recovered quickly as restrictions were eased. If the lockdowns remain relatively short, the impact on the housing market will likely be limited.

In the medium term, prices growth will continue to be supported by low rates, the ongoing recovery in the labour market and low supply. We continue to expect dwelling prices to lift by up to 20% this year, followed by more moderate growth in 2022.

Job vacancies surged to a new record high of 362k in the May quarter. The eye-watering number is consistent with reports of labour shortages from businesses, which we have been hearing for some time. Vacancies increased 23.4% in the quarter and are now 57.0% higher than pre-pandemic levels in February 2020. In May, there were 69k more vacancies than in February 2021 and 132k more than February 2020. The increase in vacancies has been broad-based across industries.

In other data, Australia's trade balance widened in May to around record highs, up from \$8.0 billion to \$9.7 billion. Imports rose 3.0% in the month while exports also continued to increase, up 6.0% in May. The gain in exports was led by metal ores, which hit a new high, reflecting higher iron ore prices and volumes. Rural goods and services also recorded increases in May.

**China:** The Caixin manufacturing purchasing managers' index (PMI) dropped slightly to 51.3 in June, from 52.0 in May, after new export orders fell. Surveyed businesses said that the resurgence of COVID-19 in China and abroad impacted both demand and supply. However, the reading over 50 continues to suggest that manufacturing continues to expand.

**Europe:** Markit's final PMI for manufacturing in the eurozone rose to a fresh record high of 63.4 in June, from the flash reading of 63.1. Production rose sharply and jobs growth marked a record high. Prices continued to rise at a record pace too, driven by ongoing supply constraints, although Markit said that some pressures appeared to be easing.

The unemployment rate in the eurozone fell to 7.9% in May, from an upwardly revised rate of 8.1% in April.

**New Zealand:** Residential building approvals dipped 2.8% in May, following a jump to a record high in April but remain 17.4% higher over the year. Over the year, there were over 43,466 building approvals, an all-time high. Much of the surge in approvals has been concentrated in Auckland, where approvals were up 28.0% in the year to May.

**United States:** The ISM manufacturing index fell 0.6 of a percentage point to 61.2% in May. The prices index jumped 4.1 percentage points to 92.1% - the highest reading since July 1979. The ISM survey cited rising demand and optimism, but increasing supply chain, hiring and cost pressures across almost all sectors.

Markit's final reading for the manufacturing PMI fell slightly to 62.1 in June, from the flash PMI of 62.6 in May. The June reading is unchanged from the final reading in May and suggests the expansion in manufacturing activity will continue.

Initial jobless claims fell to a new pandemic low last week and resumed a months long downward trend, adding to signs of a recovering labour market. Initial jobless claims fell by 51k to 364k in the week ended June 26 from the prior week's revised total of 415k. The drop brought the 4-week moving average, which smooths out volatility in the weekly figures, to 392,750, also a pandemic low.

The Federal Reserve President of Philadelphia, Patrick Harker, said he supported a start to tapering of quantitative easing late this year. Harker said "I am in the camp of starting the tapering process…I'd like to see it happen sooner rather than later. I'd like to see it being a slow, methodical process…we're doing $120 billion a month, if we cut back $10 billion each month, we'd be done in 12 months, right? I think that's a reasonable thing to do."

On the policy rate, Harker said that his forecast before was to not touch the Federal funds rate until 2023. He said that he is still there right now but flagged that if inflation were not to behave as hoped, then the Fed may have to act sooner.

The International Monetary Fund (IMF) predicted the US Federal Reserve will need hike rates in late 2022 or early 2023. The central bank will probably begin to taper asset purchases in the first half of next year, the fund said in its assessment.

**World:** A global tax overhaul is closer. Officials from 130 countries, including China and India, endorsed setting a minimum rate for international corporations like Facebook and Google in what US Treasury Secretary Janet Yellen labelled "a historic day for economic diplomacy." The OECD-brokered deal sets the stage for G-20 finance ministers to sign off on an agreement in principle next week in Venice. Implementation of rules to curtail tax avoidance by making multinationals pay an effective rate of "at least 15%" could come as soon as 2023, but hurdles remain.

**Today's key data and events:**

NZ ANZ Consumer Confidence Jun prev 114.0 (8am)

AU Housing Finance May (11:30am)

Total exp 5.0% prev 3.7%

Owner Occupier exp 4.5 % prev 4.3%

Investor exp 6.0 % prev 2.1%

EZ PPI May y/y exp 9.5% prev 7.6% (7pm)

US Nonfarm Payrolls exp 711k prev 559k (10:30pm)

US Unemploy. Rate Jun exp 5.7% prev 5.8% (10:30pm)

US Avg Hourly Earn. Jun exp 0.4% prev 0.5% (10:30pm)

US Trade Bal. May exp -$71.3bn prev -$68.9bn (10:30pm)

US Factory Orders May exp 1.6% prev -0.6% (12am)

US Durable Goods Orders May Final exp 2.3% prev 2.3% (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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