

Wednesday, 5 April 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)			
S&P/ASX 200	7,236	0.2%			Last	Overnight Chg		Australia			
US Dow Jones	33,402	-0.6%	10 yr bond		3.22	-0.03		90 day BBSW	3.70	0.00	
Japan Nikkei	28,287	0.4%	3 yr bond		2.81	-0.05		2 year bond	2.91	-0.09	
China Shanghai	3,472	0.5%	3 mth bill rate		3.56	-0.05		3 year bond	2.90	-0.09	
German DAX	15,603	0.1%	SPI 200		7,251.0	-13		3 year swap	3.28	0.00	
UK FTSE100	7,635	-0.5%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.26	-0.06	
Commodities (close & change)*			TWI		60.2	-	-	60.2	United States		
CRB Index	271.1	-0.2	AUD/USD		0.6783	0.6793	0.6721	0.6753	3-month T Bill	4.63	-0.06
Gold	2,020.44	0.0	AUD/JPY		89.83	90.17	88.59	88.94	2 year bond	3.83	-0.14
Copper	8,743.75	-171.3	AUD/GBP		0.5463	0.5470	0.5387	0.5402	10 year bond	3.34	-0.07
Oil (WTI futures)	80.83	0.1	AUD/NZD		1.0779	1.0780	1.0688	1.0699	Other (10 year yields)		
Coal (thermal)	223.55	-10.7	AUD/EUR		0.6223	0.6230	0.6146	0.6163	Germany	2.25	-0.01
Coal (coking)	297.00	-5.0	AUD/CNH		4.6648	4.6740	4.6334	4.6453	Japan	0.43	0.03
Iron Ore	118.25	-0.5	USD Index		102.01	102.28	101.46	101.58	UK	3.43	0.00

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: Jobs data in the US led markets to reprice how much more tightening the US central bank has left to do. US bond yields and the US dollar fell, but equity markets failed to get a boost.

Share Markets: Banking stocks in the US were sold off, dragging the broader S&P share market index. The S&P 500 closed down 0.6% whilst the Dow and Nasdaq fell 0.6% and 0.5%, respectively.

Interest Rates: US bond yields fell across the curve, as markets repriced the probability of tightening from the Fed. The US 2-year yield fell 14 basis points and declined 7 basis points.

The Australian 3-year government bond yield (futures) fell from 2.91% to 2.80%, while the 10-year yield fell from 3.31% to 3.21%. Markets currently price the RBA cash rate to be only 6 basis points higher at the next meeting on 2 May, with a peak of 3.63% priced for that meeting. That is, markets are pricing that the RBA hiking cycle is over. Market pricing shows rate cuts are priced in from August 2023 with a full rate cut of 25 basis points almost completely priced in for December 2023.

Foreign Exchange: The US dollar index depreciated overnight. The AUD/USD fell from an overnight high of 0.6793 to a low of 0.6651.

Commodities: Commodities were mixed overnight.

Australia: The Reserve Bank (RBA) paused hiking rates yesterday – leaving the cash rate at 3.60%. It's

the first time it has paused in eleven meetings.

Easing inflationary pressures and increasing signs of slowing economic activity are the likely catalyst. The RBA noted it was appropriate to take time to pause and assess how households and businesses are responding to the cumulative 3.5 percentage points of rate hikes delivered since May.

It begs the question is the RBA done and dusted?

Interest-rate markets think so. They're pricing the next move to be a cut with a quarter of a per cent rate cut almost fully priced for the end of this year. We also see a real risk the tightening cycle is over.

The flavour of the statement suggests they could well be done – although the RBA has maintained that further tightening might be needed, keeping the door open, depending on the flow of data.

One of the biggest stand outs in the statement is that “there is further evidence that the combination of higher interest rates, cost-of-living pressures and a decline in housing prices is leading to a substantial slowing in household spending”. Household spending is the engine room of the economy and recent retailing numbers have been tepid. Retailing rose only a tad in February and when we looked over the past three months and adjusted the data in per capita terms, it was the sharpest contraction on record, outside of covid.

The RBA said some household have substantial savings buffers, but others are “experiencing a

painful squeeze of their finances". With 880,000 fixed-rate home loans due to expire this year, this painful squeeze risks turning into a crush.

In addition to the remarks on household spending, this statement also removed references to the outlook for business investment being positive, suggesting that the RBA's view on the economy has soured recently.

The RBA Assistant Governor, Kent, recently highlighted the long and variable lags with policy. As of December, only half of the full effect of the rate hikes to date – 350 basis points in total – were felt by borrowers. Kent noted that "45 per cent of the rise in the cash rate to date had passed through to total scheduled mortgage payments at the end of 2022, though slightly more will have passed through in the early months of this year."

Paving the way for a pause were also the monthly inflation results for January and February, which undoubtedly gave the RBA comfort that inflation, one, has peaked, and two, is coming down, possibly quicker than expected. Indeed, the monthly annual inflation rate has stepped down from 8.4% in December 2022 to 6.8% in February.

The monthly inflation data is a guide to the quarterly inflation report, but it doesn't provide a comprehensive pre-read on the quarterly result. However, we also know that a bunch of temporary factors pushed up the quarterly outcome for the December quarter. These temporary factors include the unwinding of the fuel excise, HomeBuilder and electricity-related subsidies from state governments. This adds to our expectations that inflation is headed in the right direction – down. And will continue to moderate through this year.

The RBA arguably appears more relaxed about the areas of inflation that could prove sticky, namely services inflation, which is heavily impacted by wages growth.

On wages growth, they repeated that they remain "alert to the risk of a prices-wages spiral". However, the labour market is showing signs of easing, albeit from a very tight level. They conceded there are some reports of an easing in labour shortages. The massive ramp up in net overseas migration is providing an injection of much needed labour supply. Forward-looking indicators of employment are also softening, for example, candidates per vacancy are rising and job ads are declining. Furthermore, there are increasing reports of redundancies and increased outsourcing offshore from our own customer liaison.

The reference to services inflation being high in the March statement was not carried across to the statement today; it was removed. Certainly, the monthly prices data has suggested that inflation for some services – such as in travel and accommodation – have dropped sharply in the first two months of this year.

The RBA is playing it safe and talking tough about possible further tightening whilst it awaits the March quarter inflation report and other important data, including jobs and business confidence and conditions. However, the forward guidance was still softened via the insertion of the words "some" to further tightening and "may well" to tightening being needed.

It is possible the March quarter inflation report published on April 26 leaves the RBA with one more rate hike to do (consistent with our Group view). However, the growing risk is that with the pace of inflation headed down, the RBA remains comfortable with keeping the cash rate at 3.60%. Adding to the economic developments have been the ructions across the banking sector in the US and Europe. The RBA expects these recent problems to lead to tighter financial conditions, suggesting that central banks will have less work to do than they would have otherwise.

Ultimately, much will depend on the data flow over coming months. But before then, the RBA Governor takes to the podium later today at the Press Club.

Eurozone: Producer prices fell 0.5% in February, taking the annual growth rate to 13.2%, from 15.1% in January.

United States: Pimco warned that recent bank failures and a rising cost of capital are increasing the risk of a "sooner and deeper recession," reinforcing the appeal of high-quality bonds.

Job openings (i.e. JOLTS) fell in February to 9.931 million, the lowest level since May 2021, and below market expectations. It suggests a cooling in labour demand, but the jobs market remains tight.

Factory orders fell 0.7% in February, after a decline of 2.1% in January. The ex transport measure, which is a closer proxy for business investment, pulled back 0.3% in the month.

For the calendar of events later today, please refer to the next page.

Today's key data and events:

AU RBA Governor Speech at Press Club (12:30pm)
NZ RBNZ Official Cash Rate exp 5% prev 4.75% (12pm)
EZ S&P Comp. PMI Mar Final exp 54.1 prev 54.1 (6pm)
EZ S&P Services PMI Mar Final exp 55.6 prev 55.6 (6pm)
UK S&P Comp. PMI Mar F exp 52.2 prev 52.2 (6:30pm)
UK S&P Serv. PMI Mar Final exp 52.8 prev 52.8 (6:30pm)
US ADP Employment Mar exp 210k prev 242k (10:15pm)
US Trade Bal. Feb exp -\$68.8bn prev -\$68.3bn (10:30pm)
US S&P Comp. PMI Mar F exp 53.3 prev 53.3 (11:45pm)
US S&P Services PMI Mar F exp 53.8 prev 53.8 (11:45pm)
US ISM Services Index Mar exp 54.4 prev 55.1 (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.

Besa Deda, Chief Economist

Ph: +61 404 844 817

Contact Listing

Chief Economist

Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist

Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+ 61 481 476 436

Senior Economist

Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 571 786

Economist

Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789

The Detail

The information contained in this report ("the Information") is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom Bank of Melbourne has a contract to supply Information, the supply of the Information is made under that contract and Bank of Melbourne's agreed terms of supply apply. Bank of Melbourne does not represent or guarantee that the Information is accurate or free from errors or omissions and Bank of Melbourne disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to Bank of Melbourne products and details are available. Bank of Melbourne or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. Bank of Melbourne owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of Bank of Melbourne.

Any unauthorised use or dissemination is prohibited. Neither Bank of Melbourne- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.
