Morning report

Bank of Melbourne

Wednesday, 7 June 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,130	-1.2%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,573	0.0%	10 yr bond	3.80		-0.02		90 day BBSW	4.05	-0.02
Japan Nikkei	32,507	0.9%	3 yr bond	3.65		0.01		2 year bond	3.83	0.08
China Shanghai	3,350	-1.1%	3 mth bill rate	4.18		0.01		3 year bond	3.64	0.07
German DAX	15,992	0.2%	SPI 200	7,163.0		24		3 year swap	3.96	-0.01
UK FTSE100	7,628	0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.80	0.02
Commodities (close & change)*			TWI	60.8	-	-	60.8	**United States**		
CRB Index	260.7	0.2	AUD/USD	0.6617	0.6685	0.6610	0.6670	3-month T Bill	5.10	-0.02
Gold	1,963.52	1.7	AUD/JPY	92.34	93.26	92.14	93.13	2 year bond	4.48	0.01
Copper	8,337.00	2.0	AUD/GBP	0.5322	0.5376	0.5315	0.5370	10 year bond	3.66	-0.02
Oil (WTI futures)	71.74	-0.4	AUD/NZD	1.0897	1.0992	1.0884	1.0976	**Other (10 year yields)**		
Coal (thermal)	146.35	-2.8	AUD/EUR	0.6177	0.6246	0.6170	0.6237	Germany	2.37	-0.01
Coal (coking)	226.00	0.3	AUD/CNH	4.7103	4.7602	4.7061	4.7559	Japan	0.43	-0.01
Iron Ore	106.50	0.1	USD Index	104.01	104.37	103.82	104.12	UK	4.21	0.00

Data as at 7:55am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Global financial markets remain cautious, though there was a slight risk-on mood overnight. US and European equities treaded higher. Treasury yields were little-changed, and the US dollar edged higher.

Share Markets: US equities finished in the green alongside a rally in financial shares. The S&P 500 closed up 0.2%, the NASDAQ gained 0.4% and the Dow Jones was flat.

European equities were also firmer. The Euro Stoxx 50 rose 0.1%, while the German Dax and the British FTSE 100 rose 0.2% and 0.4%, respectively.

The ASX 200 fell 1.2% yesterday, in the wake of the Reserve Bank's (RBA) decision to hike the cash rate by 25 basis points to 4.10%.

Interest Rates: US treasuries were mixed as an auction announcement weighed on short-dated securities. The 2-year treasury yield finished 1 basis point higher at 4.48%, while the 10-year yield was down 2 basis point to 3.66%.

Interest rate markets expect the fed to pause rate hikes in June but see a 70% chance of a hike by July, before cuts in early 2024.

The Australian 3-year government bond (futures) yield gained 1 basis point to 3.65%, while the 10-year (futures) yield fell 2 basis points to 3.80%.

Interest rate markets favour one more hike from the RBA, pricing in a near 85% chance we see another lift in the cash rate by September.

Foreign Exchange: The Aussie dollar jumped on the RBA's rate hike decision and held onto gains overnight. The AUD/USD pair traded from a low of 0.6610 to a 3-week high of 0.6685 post the RBA decision and is currently trading around 0.6670.

Since striking a 6-month low of 0.6458 last Wednesday, the pair has now closed higher for four consecutive sessions and has comfortably returned to its consolidation range since early March.

The Aussie also outperformed on the crosses, notching up a 3-month high against the New Zealand dollar, an 11-week high against the pound and a near 6-month high on the Yen.

The US dollar was finished slightly higher against a basket of major currencies. The DXY index rose from a low of 103.82 to a high of 104.37 and is currently trading around 104.12.

Commodities: Gold, copper and iron ore firmed, while oil was slightly softer.

Australia: The Reserve Bank (RBA) increased the cash rate by 25 basis points at yesterday's Board meeting. This takes the cash rate up to an 11-year high of 4.10%. We flagged the strong risk of a rate hike last week in the wake of the Fair Work Commission's (FWC) minimum and award wage decision and the stronger-than-expected monthly inflation report.

The upside risk to inflation, the rapid rise in unit labour costs and the implicit omission this month around well-anchored inflation expectations suggests to us that the RBA has more tightening to do. We are now expecting at least one more rate hike in July.

With inflation outcomes surprising on the upside and wages growth expected to be stronger, the RBA has more to do to ensure inflation returns to the target band in a reasonable timeframe. Last week, the Governor explicitly said he would not accept a return to the target band later than mid-2025.

The Governor has spent a lot of time discussing the rapid rise in unit labour costs (ULCs). The RBA Board appears very concerned about the rise in ULCs given the strong relationship with inflation. Lifting productivity growth is complex and takes time. Productivity growth estimates can be volatile and in the short term it would be difficult to see a material pick up. Trying to restrain wages growth via rate rises would be the more obvious channel.

The statement maintained references to keeping the economy on an even keel and being on a narrow path. During his Senate Estimates appearance, the Governor said the RBA was still “hoping” they could tread the narrow path. However, he also added that “if it’s not possible to do that, we will do what’s necessary to make sure inflation comes back within the target range in the next few years.”

The higher cash rate and the high possibility of more tightening means economic activity should slow further.

The idea that the Board could bring down inflation while keeping the economy on an even keel seems less likely now. The risk of a recession has risen. The Australian 2-10-year bond yield curve notably inverted at the close of trade on Friday for the first time since 2008 – typically an inversion is a reliable indicator of recessions, although a sustained and extended inversion is usually required.

Australia’s current account surplus widened in the March quarter of 2023. The current account surplus printed at $12.3 billion, following a $11.7 billion surplus in the December quarter.

The surplus was driven by a $2.0 billion rise in the balance on goods and services (or trade surplus), to $41.1 billion – the second highest on record. An increase in the value of goods and services exports and decrease in imports drove the result.

In volume terms (i.e. stripping out price effects), both imports and exports rose. Services exports and imports have rebounded to around 82% and 73% of pre-COVID levels, respectively.

Net exports are expected to detract 0.2 percentage points from growth in the March quarter. The terms of trade (ratio of export to import prices), rose 2.8% in the March quarter.

New public sector demand grew 0.6% in the March quarter and is expected to contribute 0.2 percentage points to GDP growth in the March quarter.

We expect that GDP, due to be released later today, advanced 0.3% in the March quarter, to be 2.4% higher through the year.

Eurozone: European Central Bank (ECB) member, Klaas Knot, said that inflation is still way too high but acknowledged that the worst is behind us. Knot says the ECB will keep tightening policy until inflation is clearly returning to the 2% target, adding that we are starting to see the first signs that policy tightening is being transmitted to the real economy.

Retail sales were flat in April, falling short of expectations for a 0.2% gain. The result was an improvement on the 0.4% decline in retail spending in March and trims the annual fall in spending to 2.6%, from 3.3% in April.

German factory orders fell 0.4% in April, disappointing expectations for a 2.8% gain. This followed a massive 10.9% fall in orders in March. The decline was underpinned by a fall in engineering and metal production orders, partially offset by strong demand for electronics and vehicles.

Today’s key data and events:

AU RBA's Gov. Lowe Speech (9:20am)
AU RBA's Bullock Panel Participation (9:50am)
AU GDP Q1 (11:30am)
  q/q exp 0.3% prev 0.5%
  y/y exp 2.4% prev 2.7%
CH Trade Balance May prev US$90.2bn (TBC)
EZ Ger. Indust. Production Apr exp 0.6% prev -3.4% (4pm)
US Trade Bal. Apr exp -$75.8bn prev -$64.2bn (10:30pm)

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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