Morning report

Bank of Melbourne

Wednesday, 12 May 2021

Equities (close & % change)		
S&P/ASX 200	7,097	-1.1%
US Dow Jones	34,269	-1.4%
Japan Nikkei	28,609	-3.1%
China Shanghai	3,608	0.4%
German DAX	15,120	-1.8%
UK FTSE100	6,948	-2.5%
Commodities (close & change)*		
CRB Index	207.6	1.4
Gold	1,837.47	1.4
Copper	10,452.50	69.8
Oil (WTI)	65.41	0.1
Coal (thermal)	101.00	2.8
Coal (coking)	116.00	1.7
Iron Ore	220.95	-0.1

Sydney Futures Exchange (close & change)				
	Last		Overnight Chg	
10 yr bond	98.27		-0.06	
3 yr bond	99.75		-0.01	
3 mth bill rate	99.95		-0.01	
SPI 200	7,020.0		-45	
FX Last 24 hrs	**Open**	**High**	**Low**	**Current**
TWI	64.8	-	-	64.7
AUD/USD	0.7838	0.7856	0.7820	0.7838
AUD/JPY	85.27	85.45	84.82	85.17
AUD/GBP	0.5548	0.5556	0.5533	0.5544
AUD/NZD	1.0786	1.0796	1.0770	1.0792
AUD/EUR	0.6458	0.6460	0.6433	0.6454
AUD/CNH	5.0338	5.0461	5.0253	5.0388
USD Index	90.2	90.4	90.0	90.1

Interest rates (close & change)		
Australia		
90 day BBSW	0.04	0.00
2 year bond	0.08	0.00
3 year bond	0.29	0.01
3 year swap	0.32	0.00
10 year bond	1.78	0.06
United States		
3-month T Bill	0.01	-0.01
2 year bond	0.16	0.01
10 year bond	1.62	0.02
Other (10 year yields)		
Germany	-0.16	0.05
Japan	0.08	-0.01
UK	0.83	0.04

Data as at 9:00am. Change from previous trading day (excluding the SFE which is the change during the night session). Source: Bloomberg.

Main Themes: Investors became worried about a rise in inflation after a US small business report revealed the share of firms that raised prices was the highest since the 1980s. Data yesterday also showed that factory gate prices in China rose at the fastest clip in 3½ years.

Share markets came under selling pressures on these inflation fears, and global bond yields moved higher.

Share Markets: The US share market selloff broadened from tech, with energy and industrials leading shares lower. The S&P 500 dropped 36 points (or 0.9%) and the Dow lost 474 points (or 1.4%), while the Nasdaq finished 12 points (or 0.1%) in the red.

Interest Rates: The US 2-year treasury yield rose from 0.15% to 0.16% and the US 10-year yield rose from 1.60% to 1.62%. The US 10-year break-even inflation rate remained elevated at an eight-year closing high of 2.54%.

Australian 3-year government bond yields (futures) rose from 0.25% to 0.26%, while the 10-year yield rose from 1.66% to 1.74% - possibly and partially due to the Federal Budget's larger than expected projected deficits.

Foreign Exchange: The US dollar index is down 0.1% on the day, sitting at a two-month low. The Australian dollar stuck to a narrow trading range of 0.7820 and 0.7856. After the Federal Budget was handed down, the AUD/USD moved slightly lower to its overnight low before recovering some ground.

Commodities: OPEC raised forecasts for the amount of crude it will need to produce this year by 230,000 barrels a day. OPEC also said the current blow to Indian demand will be offset by a recovery in the US and elsewhere.

Australia: Australia's incredible economic rebound has helped the government project a smaller deficit for 2020-21 of $161.0 billion. This is substantially smaller than expected just a few months ago. For 2021-22, it is expected to be $106.7 billion.

The budget deficit is expected to gradually decline over the next few years. But large deficits will remain a feature, as the focus remains on rebuilding the economy. However, this is necessary. And we can afford it.

The uneven shape of the economic recovery and the uncertainty over the outlook means the government needs to ensure that the recovery is sustained. It is too early to consider budget repair.

The best way to keep the economy recovery alive and kicking is for the government to keep its foot on accelerator. In this way, more jobs are created, which helps lift consumer spending and the demand for goods and services that businesses produce. Economic activity is propelled forward through this virtuous cycle.

In this year's Budget, the main way the government aims to propel the recovery is by extending the temporary tax incentives to businesses it announced last year. These are the loss carry-back scheme and the full expensing measures.

Indeed, businesses were among the biggest winners from last night's Federal Budget. The extension of these measures helps businesses boost their cash flows and spur businesses to spend. Job growth should follow.

The tax initiatives do not stop there. The government is extending the low-to-middle income tax offset for another year, which delivers income tax cuts to households. This should help bolster consumer spending and economic activity, so too should the strong infrastructure spending program.

On economic activity, the government anticipates data will show that it returned to above pre-pandemic levels in early 2021.

For the coming financial year of 2021-22, the economy is forecast to grow at a solid pace of 4.25%, before slowing to a more moderate pace in 2022-23. Both growth forecasts are softer than our own predictions.

The government's forecasts for iron ore are also weaker than our own forecasts. Iron ore prices are expected by the government to fall to US$55 a tonne early next year, after recently piercing US$200 a tonne.

The government's conservative forecasts for both economic growth and iron ore means there is a good chance the government's bottom line will turn out better than forecast. It is a bit like a hollow log.

The unemployment rate might also beat the government's expectations. The government has outlined a fall in the unemployment rate to 4.5% in mid 2023, but the Reserve Bank expects that level to be reached sooner, as do we.

Rebuilding the economy and creating jobs were among the core themes in this year's Budget, as was protecting Australia from COVID-19.

There was another theme that was widely anticipated in the lead up to the Budget. It was spending on women's issues.

This Budget contained a package supporting the safety and economic security of women and it is a welcome step in the right direction.

However, we would have liked to have seen spending measures towards helping bolster access to capital for female start-ups and scale-ups. Our research shows that access to capital is one of the biggest obstacles facing women when starting or running a business.

Another obstacle often facing women is the lack of sufficient retirement savings due to the different work patterns of women that include career breaks. Lifting female participation in the workforce helps. The additional $1.7 billion in spending on childcare also assists.

But there is more work to be done, not just by the government.

Please refer to our Budget 2021-22 report published last night.

We have also produced a short video on our Federal Budget insights.

China: Factory gate prices or producer prices rose at the fastest rate in 3½ years in April. The PPI rose 6.8% from a year earlier, ahead of 6.5% tipped by economists and a 4.4% rise in March.

The consumer price index (CPI), however, rose a modest 0.9% in the year to April.

Eurozone: Germany's ZEW economic survey beat market expectations, rising to a 2-year high of 84.4 in May.

United States: The NFIB small business optimism index for April rose 0.6 points to a five-month high of 99.8. The improvement was driven by better sales expectations and improving earnings trends.

Of note, the report also revealed a significant increase (10 points) in the share of firms that raised prices to 36.0 – its highest since the 1980s. Planned price increases also jumped to its highest since 2008 in another sign that inflation is picking up.

The JOLTS job openings survey rose more than expected to a record high of 8.123mn, as the US economy re-opens. The survey adds to the suspicion that April's disappointing payrolls report was related to labour supply issues.

Two Federal Reserve speakers - Lael Brainard and Loretta Mester — used the same wording "the outlook is bright" to describe the economy. They also acknowledged last week's poor jobs report.

Another Fed speaker, Raphael Bostic, said the US is on the road to recovery, but "there is a long way to go."

All three Fed officials kept to the party line that any spike in inflation should be temporary and emphasised the need for policy to remain accommodative.

Today's key data and events:

EZ Industrial Production Mar exp 0.8% prev -1.0% (7pm)
UK GDP Q1 Preliminary exp -1.6% prev 1.3% (4pm)
UK Industrial Production exp 1.0% prev 1.0% (4pm)
UK Trade Balance exp £4.9bn prev £7.1bn (4pm)
US CPI Apr exp 0.2% prev 0.6% (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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