Morning report

Thursday, 16 June 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	6,601	-1.3%		Last		Overnight Chg		**Australia**		
US Dow Jones	30,669	1.0%	10 yr bond	95.92		0.20		90 day BBSW	1.71	0.08
Japan Nikkei	26,326	-1.1%	3 yr bond	96.22		0.23		2 year bond	3.31	0.23
China Shanghai	3,464	0.5%	3 mth bill rate	96.87		0.17		3 year bond	3.69	0.24
German DAX	13,485	1.4%	SPI 200	6,622.0		16		3 year swap	3.98	-0.17
UK FTSE100	7,273	1.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.20	0.25
Commodities (close & change)*			TWI	62.5	-	-	62.0	**United States**		
CRB Index	314.8	-0.9	AUD/USD	0.6876	0.7024	0.6873	0.7005	3-month T Bill	1.56	-0.18
Gold	1,833.82	25.3	AUD/JPY	93.12	93.94	92.95	93.86	2 year bond	3.19	-0.24
Copper	9,232.00	5.3	AUD/GBP	0.5732	0.5768	0.5729	0.5755	10 year bond	3.28	-0.19
Oil (WTI futures)	115.31	-3.6	AUD/NZD	1.1060	1.1148	1.1053	1.1146	**Other (10 year yields)**		
Coal (thermal)	345.00	14.3	AUD/EUR	0.6603	0.6720	0.6585	0.6705	Germany	1.64	-0.11
Coal (coking)	383.67	-2.7	AUD/CNH	4.6469	4.6919	4.6383	4.6756	Japan	0.26	0.01
Iron Ore	132.60	3.2	USD Index	105.47	105.79	104.66	104.86	UK	2.47	-0.12

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: The US Federal Reserve upped the ante in its efforts to fight inflation. It raised the federal funds rate by 75 basis points – the largest sized rate hike since 1994. US share markets bounced back and US bond yields unwound some of the sharp gains recorded over recent trading sessions. The US dollar index was also pushed off its overnight high after the decision.

The European Central Bank (ECB) also called an unscheduled meeting, causing sharp moves in the euro and European yields.

Locally, markets are eyeing the jobs market data out later today. The AUD-USD has moved back above 70 US cents and interest-rate markets are still fully priced for 50 basis points from the Reserve Bank next month.

Share Markets: US share markets jumped, despite the largest rate hike from the Fed since 1994. It reflects the fact that markets had priced in a large rate hike and had sold off aggressively since the middle of last week; the US S&P 500 index lost 425 points (or -10.2%) over the 5 trading sessions to June 14, before rising 55 points (or +1.5%) overnight. Equity traders were also encouraged by Fed Chair's comments that these larger-sized hikes will not be common. The Dow jumped 304 points last night (or +1.0%) and the Nasdaq spiked 271 points (or +2.5%). But with more tightening on the way and the Fed committed to bringing down inflation, share markets are likely to face ongoing selling pressures.

Interest Rates: US treasury yields tumbled overnight. The US 2-year yield dropped 24 basis points, but that follows an incredible increase of 70 basis points over the 5 trading sessions to 14 June. The US 10-year yield pulled back 19 basis points, but again it follows a sharp rise of 50 basis points in the previous 5 sessions. Interest-rate markets are almost fully priced for another 75 basis points from the Fed at its next meeting in July. They also expect the federal funds rate to be 255 basis points higher before the end of the year.

The Australian 3-year government bond yield (futures) fell from 4.00% to 3.77%, while the 10-year yield fell from 4.27% to 4.10%. Interest-rate markets are fully priced for another 50 basis points from the Reserve Bank at its next board meeting in early July (with a probability of 108% attached to a move of 50 basis points). Markets are also expecting the cash rate to be at 3.85% by year's end, up from the current official cash rate of 0.85%.

The large 75 basis points move from the Fed opens the possibility that other major central banks could follow suit in their attack to arrest inflationary pressures.

Foreign Exchange: The AUD/USD pair fell to a 4-week low of 0.6851 in the previous trading session and has gradually lifted from that low. Key support remains near the lows of 2022, which is the 0.6825-30 area. The AUD-USD lost one third of a US cent in the wake of the US Fed decision to hike the fed funds rate by 75 basis points, but these losses were very quickly erased. The AUD-USD is currently trading just above 0.7000. The labour market data out locally later this morning should determine how much further the AUD-USD can rise in the near term. We expect this appreciation in the AUD-USD will struggle to get past 0.7070 in the near term even with a very strong jobs report.

The USD index appreciated in the lead up to the Fed's decision but then sold off heavily, falling from an overnight high of 105.8 to a low of 104.7. A recovery in the EUR-USD pair contributed to dragging the USD index. The EUR-USD had risen to a high overnight of 1.0508 in early European trade, but it then sold off heavily to 1.0360 before recovering to be around the 1.0460 handle.

Commodities: The widely-watched basket of commodity prices, the CRB index, eased overnight, led by a decline in the price of oil.

Australia: The Fair Work Commission granted a 5.2% increase in the minimum wage yesterday, following its annual wage review. The Commission also awarded a minimum 4.6% increase in modern award minimum wages, including a flat-rate $40 per week wage increase for full-time low-income earners. The changes are due to come into effect from 1 July this year, except for workers in the aviation, tourism and hospitality sectors where the changes will be delayed until 1 October 2022.

Consumer confidence dropped 4.5% in June to 86.4, its lowest level in 22 months, following the Reserve Bank's (RBA) 50 basis point rate hike on 7 June. The index is approaching lows recorded during previous crises. Households are concerns about higher prices for goods and services, including fuel, and higher mortgage rates. Reflecting these concerns, the biggest drag on sentiment were measures of personal finances. Expectations for the economic outlook over the next year also deteriorated.

Rising rates are also weighing on the sentiment towards housing. The 'time to buy a dwelling' index fell 3.1% to 75.1, its lowest level since the global financial crisis (GFC). A growing share of households are expecting a sizeable increase in interest rates over the next year.

Spending has bounced back strongly from lockdowns. However, the significant hit to consumer confidence over recent months points to downside risks to the outlook for consumer spending growth.

China: Industrial production rose at an annual pace of 0.7% in May, beating consensus expectations of a 0.9% fall. The result follows a 2.9% annual decline in April, alongside harsh lockdown restrictions.

Retail sales declined for a third consecutive month, shedding 6.7% over the year to May. However, the fall was softer than anticipated by consensus, as some lockdown measures lifted across parts of the country.

Eurozone: The European Central Bank (ECB) held an unscheduled meeting "discuss the current market conditions" amid growing alarm at the sharp rise in European bond yields. After the meeting, it announced it will skew reinvestments of maturing debt to help more indebted members and will devise a new instrument to stop fragmentation, including preserving the functioning of the monetary policy transmission mechanism.

Industrial production rose 0.4% in April, after dropping sharply in March by 1.4%. In year-on-year terms, production is still contracting. It is down 2.0% in the year to April.

Japan: Growth in machinery orders smashed consensus expectations in April, surging 10.8% in the month, compared to the median forecast of a 1.3% fall. The monthly gain was the largest since October 2020 and takes machinery orders 19.0% higher in annual terms. It's the fastest annual growth rate in almost seven years.

New Zealand: The current account deficit narrowed to NZ$6.1 billion in the March quarter, from a revised NZ$7.3 billion deficit in the December quarter.

United States: The US Federal Reserve delivered a rate hike of 75 basis points this morning – the largest sized hike since 1994. The hike increases the Fed's benchmark federal funds rate to a range of 1.50% and 1.75%. It suggests there are real fears among policy makers that the inflation issue is escalating. The vote on the committee was 10-1 in favour of 75 basis points.

Until recently, markets had expected the Fed to deliver a smaller-sized rise of 50 basis points, but the stronger-than-expected consumer prices data last week set the stage for a 75 basis points hike today. Consumer prices rose at an annual rate of 8.6% in the year to May – a fresh 40-year high. The increase in prices was broad based.

In the press conference accompanying the decision, the Fed Chair, Jerome Powell made it clear that the

Fed will continue to tighten aggressively to restrain soaring inflation. Powel said a similar increase in July was possible, but he does “not expect moves of this size to be common”. The Federal Open Market Committee (FOMC) projections for the benchmark fed funds rate in its dot plot jumped to 3.38% by year’s end (from 2.75%), suggesting nearly 1.75 percentage points of tightening is still to come. Officials said they're "strongly committed" to getting prices back to their 2% target.

There was also a large batch of economic data released overnight in the US. The most important of these was retailing data.

US retail sales unexpectedly fell by 0.3% in May and data for April was revised lower to show sales rose 0.7% instead of 0.9% as previously reported. The fall in May was the first in five months. The consensus among economists was for growth of 0.2% in retail sales in May. In year-on-year terms, retailing rose 8.1% to be well above the pre-pandemic trends.

The decline in retail spending in the month was led by a drop in motor vehicle purchases amid rampant shortages and record high gasoline prices. China's zero COVID-19 policy has exacerbated a global semiconductor shortage. High inflation also hurt demand for spending on other goods and services. Large retailers such as Walmart and Target have recently cut their profit forecasts due to cost pressures.

The New York Fed’s Empire State business conditions index, a gauge of manufacturing activity in the state, rose 10.4 points in June, but remained in negative territory with a reading of minus 1.2 reading in June. Consensus had expected a reading of 2.3, according to a survey by Bloomberg. Any reading below zero indicates deteriorating conditions. Notably, the prices-paid and prices-received sub indexes remained elevated.

The National Association of Home Builders (NAHB) housing market index dropped 2 points to a 2-year low of 67 in June, reflecting a softening in homebuilder sentiment slid due to rising inflation and higher mortgage rates.

Finally, export prices continued to outpace import prices in May. Export prices rose 2.8% in the month and 18.9% in the year to May. Meanwhile, import prices lifted 0.6% and 11.7% over the respective periods.

Today’s key data and events:

NZ GDP Q1 exp 0.6% prev 3.0% (8:45am)
AU Consumer Inflation Expect’ns Jun prev 5.0% (11am)
AU Labour Force May (11:30am)
  Employment Change exp 5.0k prev 4.0k
  Participation Rate exp 66.3% prev 66.3%
  Unemployment Rate exp 3.8% prev 3.9%
UK BoE Policy Meeting (9pm)
  Bank Rate exp 1.25% prev 1.00%
US Philadelphia Fed Index Jun exp 5.0 prev 2.6 (10:30pm)
US Housing Starts May exp -1.8% prev -0.2% (10:30pm)
US Building Permits May exp -2.5% prev -3.0% (10:30pm)

Times are AEDT. 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: (02) 8254 3251

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Economist
Matthew Bunny
matthew.bunny@bankofmelbourne.com.au
(02) 8254 0023

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
0481 476 436

Associate Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
0401 102 789