Morning report

Bank of Melbourne

Wednesday, 18 August 2021

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,511	-0.9%		Last		Overnight Chg		**Australia**		
US Dow Jones	35,343	-0.8%	10 yr bond	98.88		0.00		90 day BBSW	0.01	0.00
Japan Nikkei	27,424	-0.4%	3 yr bond	99.74		0.00		2 year bond	0.03	-0.01
China Shanghai	3,613	-2.0%	3 mth bill rate	99.99		0.00		3 year bond	0.23	-0.03
German DAX	15,922	0.0%	SPI 200	7,411.0		-34		3 year swap	0.39	0.00
UK FTSE100	7,181	0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	1.14	-0.02
Commodities (close & change)*			TWI	61.4	-	-	61.3	**United States**		
CRB Index	214.1	-1.8	AUD/USD	0.7336	0.7341	0.7243	0.7255	3-month T Bill	0.06	0.00
Gold	1,786.19	-1.3	AUD/JPY	80.18	80.25	79.34	79.50	2 year bond	0.21	0.00
Copper	9,233.50	-191.0	AUD/GBP	0.5300	0.5303	0.5276	0.5280	10 year bond	1.26	0.00
Oil (WTI)	66.59	-0.7	AUD/NZD	1.0447	1.0541	1.0420	1.0488	**Other (10 year yields)**		
Coal (thermal)	160.20	-3.2	AUD/EUR	0.6230	0.6232	0.6185	0.6195	Germany	-0.47	0.00
Coal (coking)	222.00	0.0	AUD/CNH	4.7512	4.7539	4.7051	4.7103	Japan	0.02	-0.01
Iron Ore	157.00	-1.3	USD Index	92.6	93.2	92.6	93.1	UK	0.56	-0.01

Data as at 8:00am. Change from previous trading day (excluding the SFE which is the change during the night session). Source: Bloomberg.

Main Themes: Widening worries about the US economic recovery dominated sentiment in financial markets overnight. These worries were driven by a sharper-than-expected fall in US retail sales. They contributed to falls in global share markets and commodity prices. The US S&P 500 index posted its biggest daily drop in a month. Against this backdrop, the AUD/USD fell to an 8-month low of 0.7243.

Share Markets: The major US share market index, the S&P 500 index, ended its 5-day rally and fell from a record high. It fell 32 points (or -0.7%), which is its biggest point decline in a month. Worries about the economic recovery and rising infections due to the delta variant of COVID-19 finally took a toll. In terms of the other widely-watched indexes, the Dow fell 282 points (or -0.8%) and the Nasdaq declined 138 points (or -0.9%).

The falls in Wall Street are likely to influence the Australian share market today.

Interest Rates: US bond yields ended the session overnight unchanged. The 2-year yield closed at 0.21% and the 10-year yield closed at 1.26%. The 10-year yield was lower during intraday trade, but managed to recover ground by the close.

Foreign Exchange: The USD index appreciated overnight and the AUD was sold off heavily, as the appetite for risk fell away, leading to declines in commodity prices. The AUD/USD fell from an overnight high of 0.7341 to an 8-month low of 0.7243 – lowest since 13 November 2020.

On 19 June in this report (and several subsequent reports), we warned the AUD would likely return towards US 70 cents in the coming months before strengthening over the medium term. We remain comfortable with this view. The break last night under support of 0.7280 leaves the AUD/USD vulnerable to further selling.

Commodities: Most commodity prices fell overnight, underpinned by concerns about the world economic outlook.

COVID-19: NSW recorded 452 new cases yesterday. Elsewhere, the ACT recorded 17 new cases, Victoria 24 and Queensland 1.

New Zealand has entered a snap nationwide 3-day lockdown after recording 1 case yesterday. The Auckland and the Coromandel regions be in lockdown for 7 days. This is the first NZ case in the community for 6 months.

Australia: The minutes of the Reserve Bank's board meeting earlier this month were published yesterday. The Reserve Bank (RBA) surprised the market, and us, at this meeting. Despite the drastic deterioration in the near-term outlook on the back of the lengthy lockdown in NSW, the central bank opted to stick to its plan of tapering bond purchases from September.

The minutes provided more colour on the RBA's decision. Effectively, the RBA is looking through the near-term disruption. Their forecasts are suggesting the NSW lockdown will have little lasting impact on the economy.

However, it is a rapidly evolving situation. There is a fairly big caveat over the near-term forecasts. It is noted the delta variant has introduced a "high degree of uncertainty to the outlook for the second half of 2021" and that activity is expected to decline in the September quarter.

The RBA said its surprise decision to push ahead with tapering in September reflects the lags of monetary policy, noting fiscal policy is best placed to respond to lockdowns.

Members judged that additional bond purchases would have their maximum effect in 2022 when the economy would be rebounding strongly, and only a marginal effect at present when the support is most required.

But the Board left the door open to adjust policy "in response to further bad news on the health front" that would lead to a "more significant setback to the economic recovery".

Separately, the RBA stuck to its view that its "central scenario" is that the cash rate won't increase until 2024. We still expect the RBA will lift the cash rate in 2023, despite the near-term setbacks.

In other data, the Roy Morgan weekly consumer index rose 2.5% to 101.1 in the week ending August 15. Consumer confidence bounced back as the lockdown in South-east Queensland came to an end. Sentiment also rose in Sydney, despite increasing COVID-19 case numbers.

Eurozone: The preliminary GDP report for the euro area showed growth of 2.0% in Q2, from 2.0% growth in Q1. Annual growth was little changed at 13.6% in Q2 from 13.7% in Q1. GDP growth was in line with consensus expectations.

Employment in Q2 rose 0.5%, rebounding from a fall of 0.2% in Q1, taking annual growth to 1.8%.

New Zealand: We now expect the Reserve Bank of New Zealand to leave the OCR on hold at today's Monetary Policy Statement. Regardless of the economic case for higher interest rates, there is nothing to be gained from pushing the Official Cash Rate (OCR) higher now, rather than waiting for more clarity on the COVID-19 situation.

Yesterday a case of COVID-19 in the community was announced. A link to the border has not yet been established. In response, the Government has announced that Z will move to Level 4 (the strictest COVID-19 alert level) from midnight last night. This lockdown will initially be for seven days in the Auckland and Coromandel regions, and three days in the rest of the country. The key here is that the NZ Government cannot be confident about the scope of the problem. Further testing and tracing will be needed in the coming days to establish this.

Experience shows that economic activity tends to bounce back readily once restrictions are lifted. And when that happens, the RBNZ will be left facing many of the same issues as before. These issues include an economy that is running up against cost pressures and capacity constraints, with risks that inflation could become more persistent. Ultimately, we expect OCR hikes will still be needed, but we will review the likely timing of this as we get more clarity.

United Kingdom: The unemployment rate in the three months to June fell to 4.7%, from 4.8% in the previous period.

United States: Retail sales fell sharper-than-expected in July amid cooling purchases of goods and some signs of a pullback in consumer demand as COVID-19 cases tied to the Delta variant rise. Retail sales fell 1.1% in the month against consensus expectations for a smaller drop of 0.3%. Excluding autos, sales fell 0.4%.

However, industrial production beat consensus expectations. This measure rose by 0.9% in July against expectations for a rise of 0.5%. It follows growth of 0.2% in June and was driven by a sharp gain of 11.2% in the production of motor vehicles and parts.

The NAHB housing market index fell to 75 in August, from 80 in July. This fall suggests some cooling of sentiment in the housing market.

US Federal Reserve Chairman Jerome Powell warned there will be major changes to the economy that the Fed will need to monitor as the US is still in the midst of the pandemic, adding that it's not yet clear how big of an impact the delta variant will have. He didn't address the outlook or monetary policy ahead of Jackson Hole next week and FOMC minutes tonight.

Elsewhere, Minneapolis Fed President Neel Kashkari said there will be "broader economic implications" from the virus resurgence, adding that the US is likely a "few years away" from a rate hike.

Today's key data and events:

NZ PPI Output Q2 prev 1.2% (8:45am)
JN Machinery Orders Jun exp -2.8% prev 7.8% (9:50am)
AU WBC Leading Index Jul prev -0.07% (10:30am)
AU Wage Price Index Q2 (11:30am)
  q/q exp 0.7% prev 0.6%
  y/y exp 2.0% prev 1.5%
NZ RBNZ Policy Setting (12pm)
  Official Cash Rate exp 0.50% prev 0.25%
UK CPI Jul exp 0.2% prev 0.5% (4pm)
EZ CPI Jul y/y Final exp 2.2% prev 1.9% (7pm)
EZ Construction Output Jun exp 0.9% (7pm)
US Housing Starts Jul exp -2.6% prev 6.3% (10:30pm)
US Building Permits Jul exp 1.0% prev -5.3% (10:30pm)
US FOMC Meeting Minutes for July 27-28 (4am)

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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