Morning report

Wednesday, 18 October 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,056	0.4%			Last		Overnight Chg	**Australia**		
US Dow Jones	33,998	0.0%	10 yr bond		4.65		0.08	90 day BBSW	4.15	0.00
Japan Nikkei	32,040	1.2%	3 yr bond		4.18		0.08	2 year bond	4.17	0.13
China Shanghai	3,233	0.3%	3 mth bill rate		4.29		0.02	3 year bond	4.09	0.14
German DAX	15,252	0.1%	SPI 200		7,100.0		20	3 year swap	4.37	0.18
UK FTSE100	7,675	0.6%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.55	0.09
Commodities (close & change)			TWI	59.9	-	-	59.9	**United States**		
CRB Index	283.1	0.7	AUD/USD	0.6343	0.6380	0.6333	0.6365	3-month T Bill	5.32	0.01
Gold	1,923.18	3.0	AUD/JPY	94.83	95.51	94.60	95.37	2 year bond	5.21	0.11
Copper	7,937.50	-8.0	AUD/GBP	0.5192	0.5229	0.5186	0.5225	10 year bond	4.83	0.13
Oil (WTI futures)	87.65	1.0	AUD/NZD	1.0702	1.0800	1.0690	1.0794	**Other (10 year yields)**		
Coal (thermal)	150.25	-4.8	AUD/EUR	0.6002	0.6033	0.5999	0.6018	Germany	2.88	0.10
Coal (coking)	337.50	12.0	AUD/CNH	4.6341	4.6705	4.6300	4.6636	Japan	0.78	0.02
Iron Ore	118.10	0.6	USD Index	106.20	106.53	106.02	106.19	UK	4.51	0.03

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: Markets remain cautious of the risk that the Israel-Hamas conflict could broaden. However, the announcement that Joe Biden will travel to the Middle East to bolster diplomatic efforts appears to be soothing concerns for now and keeping a larger market reaction at bay.

US equities finished broadly flat as risk tolerance remains light. However, robust economic data in the US prompted a further sell-off in treasuries, despite the recent spike in haven demand. The 2-year yield touched its highest level since 2006, while the 10-year yield is trading back around the levels seen ahead of the conflict.

Share Markets: US equities gyrated through gains and losses to finish broadly flat. The S&P 500 and the Dow Jones finished the session unchanged. NVIDIA slumped 4.7% followed an announcement that the US will restrict exports of particular chips to China. This prompted a broader sell-off in tech stocks, pushing the NASDAQ down 0.3%.

The ASX 200 gained 0.4% yesterday led by materials and financials. Futures are pointing to a steady open this morning.

Interest Rates: Robust economic data prompted a sell-off in US treasuries across the curve. The 2-year yield jumped 11 basis points to 5.21% after touching 5.24% - its highest level since September 2006. The 10-year yield rose 13 basis points to 4.83%, contributing to a steepening in the yield curve. The 10-year yield is now back around the level traded before the eruption of conflict between Israel and Hamas, which contributed strongly to safe haven demand.

Swaps markets are pricing a near 60% chance of another Fed rate hike by January 2024. This is up from just over 30% at the end of last week.

Aussie bond futures followed the lead from US markets. Both the 3-and-10-year (futures) yield rose 8 basis points to 4.18% and 4.65%, respectively.

Interbank cash rate futures imply just over an 80% chance of another hike by the Reserve Bank (RBA) by March 2024. This is up from around 40% at the end of last week.

Foreign Exchange: The US dollar churned during trade but finished broadly flat against its G10 peers. The DXY ranged between a low of 106.02 and ahigh of 106.53 and is currently trading around 106.19.

The Aussie dollar outperformed trading from a low of 0.6333 to a high of 0.6380. The AUD/USD pair was trading at around 0.6365 at the time of writing. The pair remains vulnerable despite a solid rebound over the past two sessions. Geopolitical developments and shifts in the US yield curve are likely to drive near-term price action. A swathe of Chinese economic data today could also provide the catalyst for a sizeable swing.

The Aussie made sizeable gains against the Kiwi dollar as a friendly inflation report tempered interest rate expectations. The AUD/NZD cross jumped from a low of 1.0690 to a 3-week high of 1.0800.

Commodities: Commodity markets, particularly energy commodities, remain a key barometer for how the market perceives risks around the Israel-Hamas conflict. The price of oil edged higher overnight but has pulled back from recent highs alongside growing diplomatic efforts to prevent a broader conflict. European natural gas has followed a similar trajectory pulling back from its recent peak, but notably higher than where it traded ahead of the conflict.

Australia: The RBA left the cash rate unchanged at 4.10% at its October meeting – the first meeting for new RBA Governor, Michele Bullock. The minutes from the meeting were released yesterday.

The Board concluded that "there had not been sufficient new information over the preceding month from economic data or financial markets to necessitate an adjustment in the stance of monetary policy".

Despite the pause, the RBA maintained a hiking bias and added that "the Board has a low tolerance for a slower return of inflation to target than currently expected". This suggests that an additional hike may be forthcoming if the RBA's goal of getting inflation back to the 2-3% target by the end of 2025 is placed in jeopardy.

A range of data will be available ahead of the November meeting, including on "economic activity, inflation and the labour market, as well as a set of revised staff forecasts". The September quarter inflation report and the updated set of RBA staff forecasts are the main acts when it comes to next meeting's decision.

While risks remain and additional monetary policy tightening cannot be ruled out, we continue to expect the RBA to remain on hold from here.

Eurozone: The ZEW expectations index rose to 2.3 in October, from -8.9 in September marking the strongest reading since April. The improvement was helped a by a stronger than expected reading in Germany, Europe's largest economy. The improvement in expectations points to a more optimistic outlook, supported by a resilient labour market and signs that interest rates may have peaked. However, expectations remain decidedly weak, reflecting the complex array of economic headwinds facing the eurozone economy.

Israel-Hamas: Joe Biden will travel to the Middle East to bolster diplomatic efforts to prevent a broadening of conflict in the region. This follows reports that Iran and other Hamas allies may be drawn in.

New Zealand: The consumer price index (CPI) rose 1.8% in the September quarter, trimming annual growth in inflation to 5.6%, from 6.0% previously. The result came in below expectations which centred on a 1.9% quarterly increase and an annual inflation rate of 5.9%. The report points to a faster easing in aggregate inflation pressures than previously expected, however, core inflation remains strong. This reflects that much of the improvement in headline inflation in the September quarter came from imported prices, underpinned by the continued improvement of global supply disruptions.

United States: Richmond Fed President, Thomas Barking, echoed the comments of other members noting that the Fed has more time to decide if it needs to raise rates further. Barkin poured water over some comments that the Fed could rely on higher long-term rates to do some of the heavy lifting, noting that "the challenge with depending on rates is they can move".

Retail sales surprised to the upside in September, further highlighting the persistence of household demand. Retail spending rose 0.7% in the month, compared to expectations for a 0.3% gain. August's reading was also revised higher to 0.8% from 0.6% previously. Retail turnover was particularly strong when excluding auto and fuel spending (0.6%), underscoring that the breadth of spending extends beyond transport costs. The control group, which feeds into the personal consumption expenditure (PCE) GDP measure, also rose a very solid 0.6% in the month.

Industrial production also beat expectations in September. Production expanded 0.3% in the month, compared to expectations for a flat reading. However, the August print was revised down to 0.0% from 0.4% previously. Industrial production appears to be stabilising following weak activity through the middle of the year.

Business inventories expanded 0.4% in August following a 0.1% gain in July. This was the largest monthly increase in inventories since December 2022. The build-up in inventories was particularly strong for vehicles, reflecting the ongoing resolution of global supply disruptions.

The NAHB housing market index slipped to 40 in

October, from 44 in September marking the third consecutive monthly drop. Homebuilder sentiment is now sitting at its lowest level since January, as higher interest rates and declining affordability take a toll on dwelling construction demand.

Today's key data and events:

AU RBA's Gov. Bullock Fireside Chat (9:30am)
AU WBC Leading Index Sep prev 0.0% (10:30am)
AU RBA's Smith Speech (10:40am)
CH GDP Q3 y/y exp 4.5% prev 6.3% (1pm)
CH Indust. Production Sep y/y exp 4.4% prev 4.5% (1pm)
CH Retail Sales Sep y/y exp 4.9% prev 4.6% (1pm)
UK CPI Sep exp 0.5% prev 0.3% (5pm)
EZ CPI Sep Final exp 0.3% prev 0.3% (8pm)
US Housing Starts Sep exp 8.0% prev -11.3% (11:30pm)
US Building Permits Sep exp -5.9% prev 6.8% (11:30pm)
US Federal Reserve Beige Book (5am)

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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