Morning report

Bank of Melbourne

Wednesday, 1 June 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,211	-1.0%		**Last**		**Overnight Chg**		**Australia**		
US Dow Jones	32,990	-0.7%	10 yr bond	96.63		-0.01		90 day BBSW	1.18	0.01
Japan Nikkei	27,280	-0.3%	3 yr bond	97.07		0.00		2 year bond	2.47	0.07
China Shanghai	3,339	1.2%	3 mth bill rate	98.71		0.01		3 year bond	2.84	0.08
German DAX	14,388	-1.3%	SPI 200	7,186.0		-26		3 year swap	3.20	0.00
UK FTSE100	7,608	0.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.35	0.10
Commodities (close & change)*			TWI	62.6	-	-	62.6	**United States**		
CRB Index	316.5	-4.0	AUD/USD	0.7196	0.7204	0.7150	0.7179	3-month T Bill	1.02	-0.02
Gold	1,837.35	-17.9	AUD/JPY	91.82	92.53	91.59	92.40	2 year bond	2.56	0.08
Copper	9,543.00	83.5	AUD/GBP	0.5687	0.5710	0.5684	0.5696	10 year bond	2.84	0.11
Oil (WTI futures)	115.32	0.7	AUD/NZD	1.0978	1.1037	1.0968	1.1016	**Other (10 year yields)**		
Coal (thermal)	427.00	26.0	AUD/EUR	0.6676	0.6721	0.6671	0.6687	Germany	1.12	0.07
Coal (coking)	413.33	-30.7	AUD/CNH	4.8011	4.8042	4.7775	4.7936	Japan	0.24	0.01
Iron Ore	130.30	-2.8	USD Index	101.36	102.17	101.41	101.75	UK	2.10	0.11

Data as at 8:30am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Risk sentiment weakened amid continued inflation concerns. Eurozone inflation was stronger than expected in May and accelerated to its highest level on record. Global equity markets declined, bond yields were higher, and the US dollar rose against most of its G-10 peers.

Share Markets: Equity markets failed to sustain a recent rebound as concerns continued to mount around inflationary pressures. The S&P 500 was 0.6% weaker, the Nasdaq declined by 0.4% and the Dow Jones was down 0.7%.

European stocks also declined as Eurozone inflation rose to an all-time high. The Euro Stoxx 50 fell 1.4%. The ASX fell by 1.0% yesterday. Futures are pointing to a week open today.

Interest Rates: Bond yields jumped as investors increased their expectations around interest rate hikes from the Federal Reserve.

The US 10-year Treasury yield spiked by 11 basis points, to 2.84%, while the 2-year yield was 8 basis points higher, at 2.56%. Interest rate markets are currently fully pricing 50-basis-point hikes at the June and July meetings.

The Australian 10-year (futures) yield rose by 2 basis points to 3.39%. The 3-year (futures) yield increased by 2 basis points, to 2.95%.

Foreign Exchange: The Aussie dollar finished lower after a choppy session. The AUD/USD hit a 3-week high of 0.7204, before dropping to an intraday low of 0.7150. The pair has since rebounded to close around 0.7179.

The US dollar strengthened against a basket of major currencies. The USD Index rose from a low of 101.41 to a high of 102.17, before consolidating to finish around 101.75.

Commodities: Commodity prices were mixed overnight. Copper was higher and oil edged up to hold above US$115 per barrel. Gold and iron ore softened.

Australia: Australia reported its 12th consecutive quarterly current account surplus in the March quarter of 2022. However, the surplus narrowed by $5.7 billion to $7.5 billion.

The narrowing reflected a $4.9 billion widening of the primary income deficit, to $20.0 billion, as mining companies distributed dividends to non-resident shareholders. Mining company profits were boosted by a 13.1% surge in commodity prices following the invasion of Ukraine. The terms of trade rose by 5.9% to hit a new record high.

The trade surplus narrowed by $0.9 billion to $28.2 billion, reflecting a dramatic jump in imports ($12.7 billion, or 11.9%). This marks the strongest quarterly import growth since 1985! It was partly offset by higher exports ($11.8 billion, or 8.7%).

Imports of consumption goods rose 17.5% in the quarter, the second largest increase on record, reflecting strong consumer spending as well as the acceleration in inflation.

Net exports are expected to detract 1.7 percentage points from growth in the March quarter, reflecting a significant rise in import volumes (i.e. stripping out price effects) of 8.1%, compounded by a decline in export volumes (-0.9%).

Public sector demand rose 2.5% in the March quarter. New public final demand is expected to add 0.7 percentage points to growth in the March quarter.

March quarter GDP is out today. We predict GDP expanded by 0.6% in the quarter, to be 2.9% higher over the year, alongside continued growth in household spending. Public demand and inventories are also expected to add to growth, while the external sector dragged.

Building approvals declined 2.4% in April. Approvals are now 36.8% below the peak from March 2021. Demand has been supercharged by low rates and government support. But demand is softening as government stimulus unwinds and the cash rate begins to move higher.

Private building approvals declined by 1.7% in April, driven by a 6.1% fall in multi-density approvals. Private house approvals edged up 0.5% but have declined in 8 of the past 12 months. Note private house approvals are coming off a high level and remain elevated relative to history.

Builders are facing significant supply headwinds – labour and material shortages are major impediments. Reserve Bank liaison indicates that construction delays are common. A detached home typically takes about 6 months to build but is currently averaging around 9 months.

Demand for private residential construction will inevitably soften further as interest rates rise. However, the strength of the labour market, growing wages pressures, and the gradual recovery in population growth will limit the fall in demand.

Credit growth took a leg up in April, ahead of the first hike in the cash rate in more than a decade in May. Credit extended to the private sector rose 0.8% in April, the fastest monthly pace since November 2021.

Credit has expanded by more than 0.5% in each of the last 12 months, as households and businesses responded to the stimulus unleashed by the Reserve Bank and government. In annual terms, credit growth accelerated to 8.6%, its fastest pace in 13½ years

Monthly growth in housing credit was unchanged at 0.6%. The monthly gain takes housing credit 7.9% higher in annual terms. Both owner-occupiers and investors contributed to housing credit growth, although momentum is shifting towards investors.

Business credit growth accelerated in April after moderating slightly over the start of 2022. Business credit expanded 1.4% in the month, to be 11.6% higher in annual terms. The result marks the fastest annual growth in business credit since October 2008.

The lift in borrowing costs as the Reserve Bank continues to hike the cash rate will take some of the steam out of credit growth. However, we expect credit growth will continue to be supported by the tightest labour market in almost 50-years and ongoing growth in business investment.

Business Inventories rose 3.2% in the March quarter, supported by a sizeable boost in import volumes. The result follows a revised 1.5% lift in inventories over the December quarter.

Company Profits surprised to the upside, surging 10.2% in the March quarter. This was the fastest quarterly jump in company profits since June 2020. The result was underpinned by a 25% rise in mining profits, as surging commodity prices boosted the bottom line for Australian miners.

China: The manufacturing purchasing managers' index (PMI) strengthened in May, lifting to 49.6, from 47.4 in April. The result beat market expectations, although the index remains narrowly in contractionary territory.

The services PMI also rebounded in May, jumping to 47.8, from 41.9 previously. The result was stronger than expected by consensus and provides an indication that activity may be quick to recovery as restrictions start to ease.

Eurozone: The headline consumer price index accelerated to an all-time high in May, rising 0.8% in the month to be 8.1% higher over the year. The result was stronger than expected, adding to pressure on the European Central Bank (ECB) to lift rates from their record lows. The increase was driven by food and energy after Russia's invasion of Ukraine pushed up commodity prices. ECB President Lagarde indicated last week that 25 basis point increases were likely at the meetings in July and September.

Japan: Industrial production contracted by 1.3% in April, following a 0.3% rise in March. The result was weaker than the 0.3% fall in production expected by the market.

New Zealand: Building permits slumped 8.5% in April, recording the first fall in approvals since January. The result follows a revised 6.2% gain in building permits in March.

Business confidence slipped further in May, falling to -55.6, from -42.0 in April. This was the lowest reading since April 2020 at the outset of the pandemic. Rising cost pressures and weakening demand, alongside tightening monetary policy, are weighing heavily on business sentiment.

United States: The FHFA house price index rose 1.5% in March, while the S&P CoreLogic 20-city index rose by 2.4% in the same month. The S&P CoreLogic index is now 21.2% higher over the year. Rising mortgage rates were not enough to slow the momentum in prices, even though the number of home sales is declining.

The MNI Chicago PMI rose to 60.3 in May from 56.4 in April. Demand was described as strong although the details flag a large increase in inventories and growing concerns over supply disruptions stemming from lockdowns in China.

The Conference Board consumer confidence index declined to 106.4, from a revised 108.6 in April, although the result was firmer than expected. The print is the weakest in three months, as persistently high inflation is straining household budgets.

The Dallas Fed manufacturing activity survey slipped to -7.3 in May from 1.1 in April. Declining new orders and a fall in expectations were partly offset by an increase in production.

Today's key data and events:

AU CL Dwelling Prices May exp -0.3% prev 0.3% (10am)

JN Nikkei PMI Mfg May Final prev 53.2 (10:30am)

AU GDP Q1 (11:30am)

q/q exp 0.6% prev 3.4%

y/y exp 2.9% prev 4.2%

CH Caixin Mfg PMI May exp 48.9 prev 46.0 (11:45am)

UK Nationwide House Prices May exp 0.6% prev 0.3% (4pm)

EZ Markit Mfg PMI May Final exp 54.4 prev 54.4 (6pm)

UK Markit Mfg PMI May Final exp 54.6 prev 54.6 (6:30pm)

EZ Unemploy. Rate Apr exp 6.8% prev 6.8% (7pm)

US Markit Mfg PMI May Final exp 57.5 prev 57.5 (11:45pm)

US Constr. Spending Apr exp 0.6% prev 0.1% (12am)

US ISM Mfg May exp 54.5 prev 55.4 (12am)

US Federal Reserve's Beige book (4am)

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.

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