Morning report

Bank of Melbourne

Thursday, 2 June 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,234	0.3%		Last		Overnight Chg		**Australia**		
US Dow Jones	32,813	-0.5%	10 yr bond	96.51		-0.06		90 day BBSW	1.19	0.01
Japan Nikkei	27,458	0.7%	3 yr bond	96.94		-0.08		2 year bond	2.53	0.06
China Shanghai	3,334	-0.1%	3 mth bill rate	98.69		-0.02		3 year bond	2.89	0.05
German DAX	14,340	-0.3%	SPI 200	7,181.0		-55		3 year swap	3.34	0.14
UK FTSE100	7,533	-1.0%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.42	0.07
Commodities (close & change)*			TWI	62.6	-	-	63.3	**United States**		
CRB Index	320.0	3.5	AUD/USD	0.7179	0.7230	0.7156	0.7177	3-month T Bill	1.10	0.00
Gold	1,846.60	9.3	AUD/JPY	92.40	93.62	92.33	93.40	2 year bond	2.64	0.09
Copper	9,504.50	53.0	AUD/GBP	0.5696	0.5759	0.5691	0.5747	10 year bond	2.91	0.06
Oil (WTI futures)	115.26	0.6	AUD/NZD	1.1016	1.1077	1.1012	1.1067	**Other (10 year yields)**		
Coal (thermal)	390.25	-19.9	AUD/EUR	0.6687	0.6750	0.6684	0.6736	Germany	1.19	0.07
Coal (coking)	410.00	-3.3	AUD/CNH	4.7936	4.8273	4.7910	4.8066	Japan	0.24	-0.01
Iron Ore	134.50	1.1	USD Index	101.75	102.73	101.74	102.55	UK	2.16	0.05

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: Stronger-than-expected data on US manufacturing activity pushed bond yields higher, supporting the US dollar. Share markets were weaker, while the price of oil climbed ahead of an OPEC+ meeting later today.

Share Markets: US share markets were broadly weaker overnight. The S&P 500 finished 0.8% lower, after being down as much as 1.6%. The NASDAQ and Dow Jones dropped 0.7% and 0.5%, respectively.

The ASX 200 gained 0.3% yesterday. Futures are pointing to weak open today.

Interest Rates: Treasury yields jumped alongside stronger-than-expected manufacturing data. The US 2-year treasury yield jumped 9 basis points to 2.64%, while the 10-year yield rose 6 basis points to 2.91%. Both 2 and 10-year yields hit a 2-week high.

Interest rate markets are fully pricing two consecutive 50 basis point rate hikes at the Fed's June and July meetings.

The Australian 3-year government bond (futures) yield rose 8 basis points to 3.06%. The 10-year (futures) yield gained 6 basis points to 3.49%.

Markets are currently pricing 31 basis points of hikes at the Reserve Bank's (RBA) June meeting.

Foreign Exchange: The Aussie dollar climbed to a 3-week high of 0.7230, before stronger-than-expected US data drove the pair to an intra-day low of 0.7156. The AUD/USD pair has since rebounded to finish broadly flat at 0.7177.

The US dollar found strength overnight alongside a spike in treasury yields. The greenback appreciated against a basket of its G-10 peers. The DXY index rose from a low of 101.74 to a high of 102.73, before settling around 102.55.

Commodities: The price of oil rose ahead of the OPEC+ meeting later today. The West Texas Intermediate price of oil climbed 0.5% to US$115.26 per barrel.

Gold, iron ore and copper also firmed.

Australia: The economy grew by 0.8% in the March quarter – a solid outcome amid the Omicron wave and weather disruptions in NSW and Queensland. Annual growth was 3.3% – above the long-run pace – and the economy was 4.5% bigger than before the pandemic.

A consumer spending slash underpinned growth in the quarter. Consumer spending jumped 1.5% in the March quarter, after a spike of 6.4% in the December quarter.

Spending growth was led by the industries that have been at the coalface of closed borders and mobility restrictions, notably transport services, hotels, cafes & restaurants and recreation & culture. Higher household incomes and households saving a lower share of their income facilitated the lift in spending.

Economic conditions are converging across industries and across states and territories. Consumer spending ramped up the most in NSW and Victoria, where restrictions were strictest. And state final demand was fastest in Victoria in the March quarter.

Government spending added considerably to growth in the quarter, reflecting support for flood affected regions and spending on the pandemic response (e.g. rapid antigen tests).

An uplift in business investment was also a feature. Business confidence remains buoyant and businesses are expanding and taking advantage of generous government incentives.

An economic expansion is firmly underway but there are growing headwinds – especially inflationary pressures, exacerbated by staff shortages and supply-chain disruptions. The GDP chain price index, a measure of inflation in the national accounts, jumped by a record-sized 4.9% in the March quarter, taking annual growth to an elevated rate of 8.2%.

Dwelling prices declined by 0.1% in May as the first increase in the cash rate in 11½ years and a range of other headwinds impacted the market. This was the first national drop in dwelling prices since September 2020.

Stretched affordability, higher fixed interest rates, an increase in listings across the two largest capital cities, and the prospect of interest rate hikes by the Reserve Bank (RBA) have all been weighing on housing market sentiment over recent months.

In May, the fall in the national index was driven by decreases in Sydney (-1.0%), Melbourne (0.7%) and Canberra (0.1%). For Sydney, this was the largest monthly fall since January 2019. Other capital cities and regional areas continued to report gains in the month.

Despite a decline in the national index, conditions across the country remain quite varied. The relatively more affordable capital cities of Brisbane and Adelaide have been performing strongly.

Regional areas continued to outperform capital cities. The combined regional index rose by 0.5% in May, compared to a 0.3% fall across the combined capitals index. House and unit prices both declined by 0.1% in May.

The housing market is facing a range of headwinds, including future expected increases in the cash rate. Momentum is projected to continue to slow further and price falls are expected to become more widespread through the rest of the year and into 2023.

Canada: The Bank of Canada (BoC) raised its policy rate by 50 basis points, as widely expected. The hike takes the key rate to 1.50%. Commentary released alongside the announcement stated that the BoC is prepared to act "more forcefully" to achieve its inflation target to prevent price pressures from becoming entrenched.

China: The Caixin manufacturing purchasing managers' index (PMI) climbed to 48.1 in May, from 46.0 in April. The result was slightly softer than the expected by consensus. However, the improvement may indicate that the manufacturing sector is starting to rebound from the impact of harsh lockdowns.

Eurozone: The unemployment rate was unchanged in April at 6.8%, as widely expected. The jobless rate has remained steady at a record low of 6.8% for three consecutive months.

The May manufacturing PMI was finalised at 54.6, up slightly from a preliminary reading of 54.4. The result is the softest reading since November 2020, although remains comfortably within expansionary territory.

United Kingdom: The Nationwide house price index rose 0.9% in May, up from a revised 0.4% gain in April. Annual growth slowed to 11.2% as strong monthly gains from the beginning of 2021 dropped out of the annual calculation.

The final manufacturing PMI for May was unchanged at 54.6. This is down from 55.8 in April and is the weakest reading since January 2021.

United States: The Markit manufacturing PMI was revised down to 57.0 at final figures. This follows a preliminary reading of 57.5. The result was below the April reading of 59.2, however, still indicates solid expansion in manufacturing activity.

In contrast, the ISM manufacturing PMI was upgraded in May, lifting to 56.1, from 55.4 previously. The result was stronger than expected by consensus. A solid rise in new orders, more than offset declines in the prices paid and employment sub-indices.

Construction spending advanced 0.2% in April, while the March reading was revised up to a 0.3% gain (0.1% previously).

The Fed's Beige Book reported continued economic growth across all Federal Reserve districts in May, although there are some signs that growth may be starting to slow. Most districts reported ongoing growth in manufacturing activity, while retail conditions appear to be softening as consumers are faced with higher prices. Businesses continue to report labour and materials shortages as a major challenge, alongside supply chain disruptions. Despite strong activity, businesses are less optimistic about future growth, as rising interest rates, high inflation, and ongoing supply issues cloud the outlook.

Fed member Mary Daly said she supports further 50 basis point rate hikes at the June and July meetings and is “comfortable to do what it takes to get inflation trending down to the level we need it to be”. Daly wants to see rates return to neutral by year-end, which she estimates to be around 2.50%.

Today’s key data and events:

NZ Terms of Trade Q1 exp 1.3% prev -1.0% (8:45am)

AU Trade Balance Apr exp $9.5bn prev $9.3bn (11:30am)

EZ PPI Apr y/y exp 38.4% prev 36.8% (7pm)

US ADP Employ. Chg. May exp 300k prev 247k (10:15pm)

US Factory Orders Apr exp 0.7% prev 1.8% (12am)

US Dur. Goods Orders Apr Final exp 0.4% prev 0.4% (12am)

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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