Morning report

Wednesday, 2 September 2020

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	5,953.4	-1.8%		Last		Overnight Chg		**Australia**		
US Dow Jones	28,645.7	0.8%	10 yr bond	99.06		0.05		90 day BBSW	0.09	0.00
Japan Nikkei	23,138.1	0.0%	3 yr bond	99.69		0.00		2 year bond	0.24	-0.01
China Shanghai	3,574.6	0.4%	3 mth bill rate	99.91		0.00		3 year bond	0.26	-0.01
German DAX	12,974.3	0.2%	SPI 200	5,950.0		23		3 year swap	0.21	0.02
UK FTSE100	5,862.1	-1.7%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	0.97	-0.01
Commodities (close & change)*			TWI	62.3	-	-	62.9	**United States**		
CRB Index	153.3	0.1	AUD/USD	0.7373	0.7414	0.7359	0.7375	3-month T Bill	0.10	0.00
Gold	1,970.2	2.4	AUD/JPY	78.08	78.36	78.01	78.14	2 year bond	0.13	0.00
Copper	6,700.5	19.0	AUD/GBP	0.5517	0.5529	0.5476	0.5511	10 year bond	0.67	-0.04
Oil (WTI)	43.0	0.2	AUD/NZD	1.0950	1.0960	1.0888	1.0909	**Other (10 year yields)**		
Coal (thermal)	51.4	-0.6	AUD/EUR	0.6180	0.6192	0.6155	0.6189	Germany	-0.42	-0.02
Coal (coking)	113.0	0.0	AUD/CNH	5.0501	5.0609	5.0315	5.0412	Japan	0.05	0.00
Iron Ore	119.6	1.3	USD Index	92.2	92.4	91.7	92.3	UK	0.30	-0.02

Copper, oil, coal & iron ore prices are based on futures pricing. Source: Bloomberg, Thomson Reuters Eikon.
Data as at 8:00am AEST. Change from previous trading day (excluding the SFE which is the change during the night session).

Main Themes: US share markets marched further to new highs. ISM manufacturing activity was stronger-than-expected. Yesterday, the RBA extended its term funding facility aimed at keeping borrowing rates low.

Share Markets: US share markets continued its winning streak, and again was supported by tech stocks. The S&P500 and the Nasdaq record to new record highs, rising 0.8% and 1.4%, respectively. The Dow gained, and is 3.1% down from its January peak.

Yesterday, the Australian ASX200 fell 1.8%, led by a sharp fall in QBE shares.

Interest Rates: Yields on US treasuries fell, lifting only temporarily after positive US manufacturing data overnight. Bond yields in Europe also fell, which were weighed down by weak inflation data. US 10-year yields fell 4 basis points to 0.67%.

Foreign Exchange: The US dollar index edged higher, but not before the euro spiked to above $1.20 for the first time since 2018. The Australian dollar lifted to breach 74 US cent, but then settled down to US$0.7375 this morning.

Commodities: Oil prices rose, supported by stronger-than-expected manufacturing data. Gold prices fell, moving inversely with the US dollar.

COVID-19: Globally, there were 208,215 new cases yesterday according to the World Health Organisation.

In Australia, there were 85 new cases, comprising of 70 cases from Victoria, 13 from NSW and 2 cases from Queensland.

Australia: Dwelling prices across the eight capital cities according to CoreLogic fell 0.4% in August, the fourth consecutive monthly fall. The weakness in incomes, elevated unemployment and uncertainty about the outlook are weighing on demand for housing.

The impact of COVID-19 cases on housing markets in the various capital cities was evident. In August, the largest fall across capital cities was in Melbourne, recording a decline of 1.2%. The lift in COVID-19 cases and the Stage 4 restrictions implemented in Melbourne from August 2 have affected housing activity significantly.

Sydney had the second largest fall across capital cities, dropping 0.5% in August, where a rising cluster of COVID-19 cases has likely impacted confidence. However, there was greater resilience in the housing markets of other capital cities, which are outperforming the more populous cities of Sydney and Melbourne.

Building approvals bounced strongly in July following four months of decline. Approvals rose 12.0% in July to be up 6.3% on a year earlier. The increase in approvals was driven by a 22.7%

increase in private sector 'other dwellings' which include multi-unit dwellings or apartments.

Activity across the states was varied. Tasmania saw a 50.0% increase in approvals while in NSW they were up 32.0%. Both Victoria (9.3%) and Queensland (7.7%) also saw solid gains in July. South Australia (-10.5%) and Western Australia (-8.3%) saw declines in dwelling approvals.

While the overall rebound is welcome, approvals remain well down on the heady levels seen during 2017 and 2018. It remains to be seen how rising levels of unemployment, weak wages growth, high levels of household debt and shrinking migration will impact upon the industry.

Australia's current account surged $8.7 billion to a record high of $1.7 billion in the June quarter (series dating back to 1959). The widening of the surplus was due to imports falling harder than exports. As a share of the economy, the current account surplus represents 3.7% of GDP. That eclipses the previous record high of 2.3% of GDP - recorded in December 1972 and in December 1961.

The trade surplus grew to $23.9 billion in the quarter, up by $4.7 billion, representing 5.0% of GDP - a record high.

Net exports are expected to add a sizeable 1.0 percentage points to activity in the June quarter, up from a 0.4 percentage point contribution in March. Today's GDP data for the June quarter is expected to show a 6.0% contraction, although there is significant uncertainty surrounding this forecast. If the result turns out close to expected, it would be the largest quarterly contraction since the Great Depression and would confirm that Australia has been in recession over the first half of this year. It would be the first recession since the early 90s.

The Reserve Bank (RBA) Board met yesterday. There were no changes to the cash rate and quantitative easing. However, the RBA's term-funding facility (TFF) available to authorised deposit-taking institutions (ADIs) was extended and expanded.

Under the expanded TFF, ADIs will have access to extra funding, equivalent to 2% of their outstanding credit, at a fixed rate of 25 basis points for 3 years. ADIs will be able to draw on this extra funding until the end of June 2021, encouraging low lending rates in the economy and helping boost confidence among ADIs around ongoing access to cheap funding.

The RBA repeated its now familiar mantra that it will not increase the cash rate target and the yield target will remain in place until progress is made towards its goals of full employment and inflation.

With both key variables – the unemployment and inflation rates – a long way from target and likely to stay that way for some time, further stimulus from the RBA and government cannot be ruled out.

The RBA's central forecast is for the unemployment to rise to around 10% later this year, before it gradually declines to be 7% in two years' time. Inflation is expected to average 1-1.5% over the next couple of years.

Further stimulus from the RBA could take the form of cutting the cash rate from 0.25% to 0.10% and/or cutting the 3-year bond yield target from 0.25% to 0.10%. Forward guidance could also take a more dovish tilt.

Encouragingly, the RBA added that "a recovery is now under way in most of Australia". The RBA predicts this recovery will be "both uneven and bumpy", which echoes rhetoric of recent speeches from RBA officials, including the Governor.

The RBA expects the outbreak in Victoria to have a major effect on the Victorian economy. Together with subdued economic activity, the RBA expects it to be some months before a meaningful recovery in the labour market is under way.

China: The Caixin purchasing managers' index (PMI) in August was solid, rising 0.3 points to 53.1.

Europe: The unemployment rate across the euro zone edged higher from 7.7% in June to 7.9% in July, highlighting that labour market conditions remain weak, despite a recovery in economic activity.

CPI fell 0.4% in August, more than the 0.1% expected by the median estimate. It brought the annual rate into negative territory and was down 0.2% in the year to August. It was the first deflation reading since mid-2016.

United States: The ISM manufacturing PMI improved for the fourth consecutive month, rising to 56.0 in August. It was the highest reading since late 2018 and confirms a further recovery in the manufacturing sector. Nonetheless, the level of activity is likely still below pre-pandemic levels. A worrying sign was that the employment sub-index has remained below 50, at 46.4 in August, although this was an improvement from 44.3 in July.

Federal Reserve Governor Lael Brainard hinted at further stimulus. Brainard said that "with the recovery likely to face COVID-19-related headwinds for some time, in coming months, it will be important for monetary policy to pivot from stabilization to accommodation". Recent rhetoric has indicated that further stimulus is required, but there has been little guidance in what that stimulus could entail. Yield curve control (ie. setting a target for US treasury yields) was discussed as a possibility at the FOMC's previous meeting but did not seem like a possible policy action.

Today's key data and events:

NZ Terms of Trade Q2 exp 0.6% prev -0.7% (8:45am)
AU GDP Q2 (11:30am)
Q/Q exp -6.0% prev -0.3%
Y/Y exp -5.2% prev 1.4%
UK N'wide House Prices Aug exp 0.5% prev 1.7% (4pm)
EZ PPI Jul exp 0.4% prev 0.7% (7pm)
US ADP Employment Aug exp 1mn prev 167k (10:15pm)
UK BOE's Bailey, Bowe, Brazier, Ramsden & Vlieghe Speeches (11pm)
US Fed's Williams Webinar (12am)
US Factory Orders Jul exp 6.0% prev 6.2% (12am)
US Dur Goods Orders Jul F exp 11.2% prev 11.2% (12am)
UK BOE's Broadbent and Haldane Speeches (12:30am)
US Fed's Mester Speech (2am)
EZ ECB's Weidmann Speech (3am)
US Federal Reserve Beige Book (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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