Bank of Melbourne

Morning report

Thursday, 4 June 2020

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	5,941.6	1.8%		**Last**		**Overnight Chg**		**Australia**		
US Dow Jones	26,269.9	2.0%	10 yr bond	99.01		-0.04		90 day BBSW	0.10	0.00
Japan Nikkei	22,613.8	1.3%	3 yr bond	99.72		0.00		2 year bond	0.27	0.01
China Shanghai	3,064.3	0.1%	3 mth bill rate	99.84		-0.03		3 year bond	0.26	0.01
German DAX	12,487.4	3.9%	SPI 200	5,999.0		73		3 year swap	0.28	0.00
UK FTSE100	6,382.4	2.6%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	0.97	0.06
Commodities (close & change)*			TWI	59.8	-	-	60.9	**United States**		
CRB Index	135.0	0.9	AUD/USD	0.6889	0.6983	0.6857	0.6922	3-month T Bill	0.15	0.00
Gold	1,699.7	-28.0	AUD/JPY	74.84	75.77	74.41	75.39	2 year bond	0.19	0.03
Copper	5,508.8	45.3	AUD/GBP	0.5490	0.5538	0.5459	0.5504	10 year bond	0.75	0.06
Oil (WTI)	36.7	-0.6	AUD/NZD	1.0817	1.0861	1.0757	1.0778	**Other (10 year yields)**		
Coal (thermal)	57.1	0.0	AUD/EUR	0.6168	0.6237	0.6129	0.6161	Germany	-0.35	0.06
Coal (coking)	108.2	2.6	AUD/CNH	4.8963	4.9523	4.8822	4.9285	Japan	0.02	0.00
Iron Ore	98.3	0.2	USD Index	97.6	97.6	97.2	97.3	UK	0.27	0.05

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

Main Themes: Market euphoria continued overnight as economic data from around the world beat expectations and investors shrugged off escalating US-China tensions.

Share Markets: Equity boards once again flashed green around the world overnight. In the US, the Dow Jones rose by 527 points (or 2.0%) and the S&P 500 rose 42 points (or 1.4%). The S&P 500 has gained for four straight sessions and in seven of the last eight sessions. The index remains 7.8% below its all-time high reached in February this year.

European stocks also rallied following better-than expected business survey readings suggesting that the economy is on the road to recovery. The Euro Stoxx 50 gained 3.5%.

Interest Rates: US treasury yields rose as investors sought riskier assets. The yield on the US 10-year treasury note rose 7 basis points to 0.75% and the 2-year yield increased 3 basis points to 0.19%.

Australian bond yields also rose yesterday, spurred by a general improvement in risk appetite and pushed up further following robust Chinese services business sentiment data. The 10-year bond yield rose 6 basis points to 0.97%. The 3-year bond remained within the RBA's target band at 0.26%.

Foreign Exchange: The US dollar index sank to 97.32 this morning as interest turned to riskier assets. It was mostly one-way traffic down for the US dollar, despite reports that the US will ban Chinese airlines in the latest spat between the world's two largest economies. The yen was one of the few currencies to fall against the US dollar.

The Australian dollar continues to strengthen, and was at US$0.6922 this morning. It reached a high of US$0.6983 yesterday, just before the release of the Australian national accounts and building approvals data. It subsequently declined throughout the afternoon but rebounded after European and then US economic data was less weak than expected.

Commodities: Oil prices rose in volatile trading. The WTI futures contract increased US$0.5 per barrel to US$37.3, its highest since early March. Investors are betting that OPEC+ will rebalance the market, however, there is uncertainty about the likelihood of a meeting scheduled for later today. Russia and Saudi Arabia want firm commitments from other nations that they will cut production (notably Iraq and Nigeria). Without a deal, cuts are set to taper off in July.

COVID-19: The number of new confirmed cases remains subdued. There were 8 new cases confirmed in the 24 hours to 3pm yesterday, according to the Department of Health.

Australia: The Australian economy contracted over the first quarter of the year - GDP fell 0.3% in the quarter, the first contraction in nine years. Annual growth slowed further in the March quarter to 1.4%, which is the slowest pace in 10½ years and well below potential growth or trend growth of around 2.6%. The impact of COVID-19 and bushfires earlier in the year has dragged down economic activity. Household consumption, dwelling investment and business investment all declined and was partially offset by strength in government spending. With the bulk of restrictions fully in place towards the end of March, a much sharper contraction in activity is expected to have occurred in the second quarter of the year. This would suggest that a recession in Australia is virtually a certainty and has been underway since early this year. It would be the first recession in Australia since 1991. The impact of COVID-19 was evident in the sharp decline in spending on services, especially services tied to the transport (including air travel), hotels, cafes & restaurants and recreational & culture sectors. Restrictions also bit these sectors hardest. The good news is the duration of this recession might be quite short and limited to just two quarters, although economic activity is likely to remain in a slow gear for some time.

The forecast collapse in building approvals due to the impact of COVID-19 failed to materialise. The falls so far in approvals are more akin to a slide. Building approvals dropped 1.8% in April, defying consensus expectations for a bigger fall of nearly 11%. Since the end of last year, building approvals are down 1.5%, - a fall, but nowhere near the double-digit decline feared. However, since the recent peak in the cycle in November 2017, building approvals are down 34.1%. We expect building approvals nationally to continue to fall, as higher unemployment and depressed household incomes cause housing demand to slow. Low immigration this year and possibly next year means that underlying demand for housing will also be soggy. Low interest rates will provide some support, especially in areas where available housing stock is low.

The Federal government announced details of its construction stimulus program, which it has dubbed “HomeBuilder”. Speaking yesterday, Prime Minister Scott Morrison said the scheme would provide $25k to eligible home owners who sign a contract to start building or substantially renovate an existing property starting from today. The scheme is expected to be means tested and will exclude individuals with an income higher than $125k per year or couples with a combined income of more than $200k per year. To be eligible, renovations must cost between $150k and $750k and for new builds the value of the build must be less than $750k. Investment properties and renovations on homes worth more than $1.5 million will be exempt.

The scheme will be administered by the States and is forecast to be worth around $688 million in total. If the level of take-up of the grants matches the costing estimates, the decline in approvals witnessed in the data is likely to be arrested in the months ahead.

China: The Caixin services PMI jumped from 44.4 in April to 55.0 in May, back into expansion territory (above 50) for the first time since January. The rebound points to a steady recovery after lockdown measures were imposed in February.

Europe: The final Eurozone Markit PMI readings for May improved, suggesting that the worst of the economic shock is passing. The final reading rose to 30.5 from the preliminary (or flash) estimate of 28.7. Although there are signs of improving optimism, the index remains deeply in contractionary territory, with concerns over longer term demand being cited.

Unemployment data also surprised to the upside, with the unemployment rate rising to 7.3% in April from 7.1% in March. Extensive job support schemes and possibly data distortions due to lockdowns appear to have had an impact.

United States: The ISM non-manufacturing index rose to 45.4 in May from 41.8 in April, boosted by business activity. The index remains below the 50 line which separates expansion from contraction, but adds to other data suggesting that the downturn in economic activity was less severe in May compared with April.

There was a tentative sign of good news to come for the labour market as well, with the ADP payrolls report (a private survey of the jobs market which is used as a guide for the official numbers) beating expectations. It showed that private sector employment fell 2.8 million in May, much better than the 9 million fall expected by consensus.

Factory orders for April fell 13.0% compared with an 11.0% decline in March, confirming the weak state of the economy following strict containment measures introduced to slow the spread of COVID-19.

Meanwhile, the US said it would be suspending passenger flights from China in retaliation against similar moves by Beijing to stop US flights. The order is due to take effect from June 16, but could be brought forward, according to a statement by the Department of Transport.

Today's key data and events:

AU Trade Balance Apr exp $7.5bn prev $10.6bn (11.30am)
AU Retail Sales Apr exp -18% prev 8.5% (11.30am)
EZ Retail Sales Apr prev -11.2% (7.00pm)
EZ ECB Monetary Policy Meeting prev 0.0% (9.45pm)
US Trade Apr exp –$49.2bn prev –$44.4bn (10.30pm)

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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