Morning report

Bank of Melbourne

Tuesday, 7 February 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,539	-0.3%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,890	-0.1%	10 yr bond	3.53		0.06		90 day BBSW	3.36	0.03
Japan Nikkei	27,694	0.7%	3 yr bond	3.15		0.05		2 year bond	3.07	0.08
China Shanghai	3,395	-0.8%	3 mth bill rate	3.57		0.03		3 year bond	3.10	0.09
German DAX	15,346	-0.8%	SPI 200	7,471.0		0		3 year swap	3.57	0.04
UK FTSE100	7,837	-0.8%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.46	0.08
Commodities (close & change)*			TWI	62.4	-	-	62.4	**United States**		
CRB Index	266.2	0.0	AUD/USD	0.6898	0.6949	0.6856	0.6885	3-month T Bill	4.53	-0.01
Gold	1,869.12	4.1	AUD/JPY	91.32	91.61	90.96	91.31	2 year bond	4.48	0.19
Copper	8,962.25	-77.0	AUD/GBP	0.5732	0.5761	0.5699	0.5726	10 year bond	3.64	0.11
Oil (WTI futures)	74.42	1.0	AUD/NZD	1.0927	1.0976	1.0909	1.0924	**Other (10 year yields)**		
Coal (thermal)	243.00	20.5	AUD/EUR	0.6394	0.6436	0.6385	0.6416	Germany	2.30	0.10
Coal (coking)	345.67	-2.3	AUD/CNH	4.6969	4.7322	4.6662	4.6840	Japan	0.51	0.01
Iron Ore	122.10	-1.2	USD Index	103.04	103.77	103.01	103.61	UK	3.24	0.19

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: Investors continued to digest the implications of the much stronger-than-expected US jobs numbers from Friday and what it might mean for the path of monetary policy. Risk sentiment weakened as higher interest rates were priced in. Equity markets declined, bond yields surged higher, and the US dollar rose to its highest level in a month.

Share Markets: Equity markets weakened as expectations around the expected path of interest rates moved higher, impacting equity valuations. The S&P 500 was down 0.6%, the Nasdaq dropped 1.0%, and the Dow Jones softened 0.1%.

The ASX 200 was 0.3% weaker yesterday. Futures markets are pointing to a flat open today.

Interest Rates: Bond yields surged higher as investor expectations around the path of US monetary policy moved higher. The stronger-than-expected jobs data from Friday increased expectations that interest rates would need to move higher and stay there for longer to contain inflationary pressures.

The 2-year yield surged by 19 basis points, to 4.48%. The 2-year yield has now shot 45 basis points higher after hitting a low of 4.03% in the wake of the Fed's February meeting only a few days ago.

The 10-year yield similarly surged by 11 basis points, to 3.64%. The yield on the 10-year bond has surged by 31 basis point from a low of 3.33% following the Fed's meeting.

Expectations around the path of interest rates have also shifted following the stronger-than-expected data. Interest-rate markets are now pricing a peak in US rates of 5.14% in July. This compares with a peak of 4.89% following the Fed's February meeting. Additionally, while interest-rate markets are still expecting rate cuts to begin in 2023 after a peak in July, they are no longer expecting rates to be cut to below their current levels in 2023.

The RBA Board meets today for its first meeting in 2023. It is widely expected to hike rates by 25-basis-points. Ahead of the meeting, markets are pricing in an 81% chance of a 25-basis-point hike.

Overnight, Australian interest rates mimicked some of the moves in US rates, although the moves were more muted in Australia. The 10-year government bond yield (futures) rose 6 basis points, to 3.53%. The 3-year government bond yield (futures) was 5 basis points higher, at 3.15%.

Interest-rate markets are currently pricing in a peak of 3.72% in the cash rate. This is up from a peak of 3.64% on Friday.

Currencies: Expectations of higher interest rates for longer in the US contributed to strength in the US dollar, which rose to a one-month high overnight against a basket of major currencies. The US dollar index rose from a low of 103.01 to a high of 103.77, before consolidating around 103.61 at the time of writing.

The AUD/USD pair weakened in line with a stronger US dollar. The pair dropped from a high of 0.6949 in Asian trade to a low of 0.6856 during the cross over of the London and New York sessions. This was the lowest level since early January. The pair has since recovered slightly to trade at 0.6885 at the time of writing.

Commodities: Oil prices rose as the chief of OPEC pointed to a more upbeat outlook following China's reopening. Coal and gold were also higher, while copper and iron ore slipped.

Australia: The value of retail spending rose 0.9% in the December quarter, the weakest quarterly outcome in over a year. However, the picture sours more when we strip out the impact of higher prices. Retailing volumes (which adjust for prices), declined 0.2% in the December quarter. While down in the quarter, the outcome was better than the 0.5% drop expected by consensus.

Excluding periods impacted by lockdowns, this was the first quarterly decline in retail spending volumes since the December quarter 2018. The result is a sign that the post-lockdown surge in household spending has run its course as the Reserve Bank's (RBA) rate hikes take effect and the rising cost-of-living bites.

Volumes were lower in all categories of retail spending apart from food (+2.1%) and hospitality (+0.2%). Department stores (-2.9%), clothing & footwear (-2.3%) and household goods (-2.0%) were among the weakest performers in the quarter.

The price of retail items rose 1.1% in the December quarter, the softest rise in 12 months. This is a positive sign for the RBA. However, it is no cause for celebration. Price pressures remain elevated and November discounting had a part to play.

While retail spending appears to have turned a corner, partial indicators suggest that services demand is still running hot, especially for travel services. This will likely support household consumption as goods spending tails off. Despite this, we expect a material fall in consumption over the course of 2023 as tailwinds ease and budgets are stretched.

The Melbourne Institute's inflation gauge rose to a record high 6.4% over the year to January. This is an acceleration from the 5.9% annual pace in December. The increase was driven by gains across private motoring and rents. On a monthly basis, inflation accelerated to 0.9% in January, up from 0.2% in December. The trimmed mean measure rose by 5.3% in annual terms, up from 4.2% in December.

This measure is released ahead of the monthly consumer price index (CPI) indicator, which is published by the Australian Bureau of Statistics. The January CPI indicator is due on 1 March.

Europe: High inflation and rising interest rates are impacting households as retail sales declined by more than expected in December. Sales were 2.7% lower on the month, against an expected 2.5% fall. This was the largest monthly decline since April 2021. However, the fall followed a 1.2% gain in the prior month, which was revised up from a 0.8% increase. In annual terms, sales were down 2.8% over the year to December. Sales across all sub-categories were down by over 2% in the month, including food, non-food, online sales, and automotive.

Investor confidence improved in February but remained in pessimistic territory. Confidence rose from -17.5 in January to -8.0 in February. This was above consensus expectations of -13.5. Confidence has improved for four consecutive months since hitting a recent low of -38.3 in October. However, it has remained in pessimistic territory for 12 consecutive months.

Germany factory orders rose 3.2% in December, above consensus expectations for a 2.0% gain. This followed a fall of 4.4% in November, which was revised higher from an initial drop of 5.3%.

Today's key data and events:

AU Trade Balance Dec exp $13.5bn prev $13.2bn (11:30am)

AU RBA Board Meeting (2:30pm)

Cash Rate Target exp 3.35%% prev 3.10%

EZ GER Industrial Production Dec exp -0.8% prev 0.2% (6pm)

US Trade Balance Dec exp -$68.5bn prev -$61.5bn (12:30am)

CH Current Acc. Q4 prev US$144.3bn (6 Feb – 17 Feb)

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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