Morning Report

Thursday, 9 March 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,308	-0.8%		Last		Overnight Chg		**Australia**		
US Dow Jones	32,805	-0.2%	10 yr bond	3.68		-0.07		90 day BBSW	3.63	0.00
Japan Nikkei	28,444	0.5%	3 yr bond	3.42		-0.05		2 year bond	3.47	0.09
China Shanghai	3,442	-0.1%	3 mth bill rate	3.64		0.00		3 year bond	3.47	0.09
German DAX	15,632	0.5%	SPI 200	7,305.0		27		3 year swap	3.85	0.02
UK FTSE100	7,930	0.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.74	0.06
Commodities (close & change)*			TWI	61.1	-	-	61.1	**United States**		
CRB Index	267.0	-2.6	AUD/USD	0.6592	0.6629	0.6568	0.6593	3-month T Bill	4.86	0.04
Gold	1,814.22	0.8	AUD/JPY	90.41	90.92	90.23	90.49	2 year bond	5.06	0.05
Copper	8,892.00	148.5	AUD/GBP	0.5573	0.5596	0.5560	0.5565	10 year bond	3.98	0.01
Oil (WTI futures)	76.57	-1.0	AUD/NZD	1.0781	1.0811	1.0755	1.0788	**Other (10 year yields)**		
Coal (thermal)	192.80	0.2	AUD/EUR	0.6248	0.6274	0.6239	0.6251	Germany	2.65	-0.05
Coal (coking)	367.00	0.0	AUD/CNH	4.6105	4.6109	4.5870	4.5932	Japan	0.51	0.00
Iron Ore	125.95	-0.9	USD Index	105.61	105.88	105.37	105.67	UK	3.77	-0.06

Data as at 7:45 am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Changing interest rate expectations spurred choppy conditions in markets overnight. Investors continue to mull the prospect of a re-acceleration in the pace of Fed rate hikes. Remarks from Jerome Powell provided little certainty, noting that “no decision has been made” on the size of this month’s rate increase. Instead, Powell pointed markets in the direction of the incoming data, which also provided some mixed signals. US treasuries rose across the curve, the US dollar was slightly higher, while US equity markets were mixed.

Share Markets: US equities were mixed after swinging through gains and losses. The S&P 500 staged a late rally to finish 0.1% higher, while the Dow Jones closed down 0.2%. The NASDAQ rose 0.4%.

The ASX 200 dipped heavily yesterday as investors digested the implications of higher interest rates in the US. The ASX 200 fell 0.8%, led by energy, materials and consumer staples stocks.

Interest Rates: Treasury yields rose across the curve, unwinding an earlier slide, as traders up the probability of a higher peak in interest rates. The 2-year treasury yield jumped 5 basis points to 5.06%, after dipping as low as 4.97%. The 2-year yield is at its highest level since December 2007. The 10-year treasury yield rose 1 basis point to 3.98% after reaching a low of 3.90% earlier in the session. The 2-10-year portion of the US yield curve inverted further to -108 basis points, the largest inversion since the early 80’s.

Interest rate markets are now pricing an 85.6% probability of a larger 50-basis point hike from the Fed this month. This is up from 61.5% at the start of the week.

In contrast, Australian futures yields moved lower ignoring the lead from international markets. The Australian 3-year government bond (futures) yield fell 5 basis points to 3.42%, while the 10-year futures yield declined 7 basis points to 3.68%. The negative spread between the Australian and the US 2-year bond yield is at its largest on record, putting downward pressure on the Aussie dollar.

Interest rate markets only see a 45% probability of a rate hike from the RBA in April, as Governor Lowe reaffirmed the softer guidance from the March meeting. The market is still pricing a peak in the cash rate of just over 4% but this has pulled back from around 4.2% before the March meeting.

Foreign Exchange: The US dollar firmed against a basket of major currencies. The DXY index fell from a high of 105.88 to a low of 105.37 before retracing to finish the session higher at around 105.67.

The Aussie dollar remains under pressure as the expected interest rates paths of the US and Australia diverge. The AUD/USD pair plumbed a near 4-month low of 0.6568 at the end of the Asian session before finding its feet in overnight trade. The pair climbed to a high of 0.6629 but has since retraced to finish the day broadly flat around 0.6593. The Aussie is likely to remain under selling pressure in the near term.

Commodities: Gold and copper firmed, while oil and iron ore softened. The West Texas Intermediate (WTI) price of oil is trading around US$76.57 per barrel, down from over US$80 per barrel earlier in the week.

Australia: The Reserve Bank (RBA) Governor, Phillip Lowe, addressed the public in a speech yesterday, reinforcing the softer guidance from this week's policy statement. Lowe reiterated the high costs of inflation becoming entrenched and the Board's assessment that not doing enough to fight inflation remains a larger risk than overtightening.

However, the speech did acknowledge that the risk of overtightening has increased, noting that "we could be knocked off that narrow path". This helps explain the RBA's change in tone, which opened up the possibility of an imminent pause in rate hikes. Lowe weighed in on this possibility directly, stating that "we are closer to the point where it will be appropriate to pause interest rate increases to allow more time to assess the state of the economy".

It is important to note that a pause in the cycle is not necessarily the same as the end. This means we could see a pause before more tightening down the track in response to incoming data. Supporting this possibility, Lowe remarked "that further tightening of monetary policy is likely to be required to bring inflation back to target within a reasonable timeframe". The proviso "is likely" being a new addition.

On the timeframe for restoring price stability, it was noted that the Board considers a return to the inflation target by mid-2025 as "reasonable". This is consistent with the RBA's current forecasts and the Boards' objective of keeping the economy on an even keel. Indeed, the Governor opined that the benefits of bringing inflation down faster would not outweigh the likely costs of higher unemployment.

Canada: The Bank of Canada (BoC) held interest rates steady for the first time since March 2022, ending a run of eight consecutive rate hikes. The BoC is the first major central bank to suspend its tightening campaign in the face of an anticipated easing of higher inflation. This follows a cumulative 425 basis points of interest rate tightening. Inflation in Canada has slowed from a peak of 8.1% last year to 5.9% in January.

Eurozone: December quarter GDP was revised lower at final figures. The European economy was flat in the December quarter, down from an earlier reading of a small 0.1% expansion. A fall in household consumption and business investment was offset by higher government expenditure.

German industrial production jumped 3.5% in January, exceeding expectations for a 1.4% gain. This trimmed the annual fall in production to -1.6% from a revised -3.3% in December. The rebound is a positive development for the German economy for the start of 2023.

Japan: The current account swung from a narrow ¥33.4 billion surplus in December to a record ¥2.0 trillion deficit in January. This was compared to expectations for a ¥0.79 trillion deficit. The result was largely driven by a sharp widening in the trade deficit.

United States: Fed Chair, Jerome Powell, resumed his testimony before congress overnight. Powell stressed that no decision has been made on the size of this month's rate increase after opening the door to a possible 50-basis point hike in earlier remarks. Instead, Powell reiterated that the decision will hinge on the incoming jobs and inflation reports. Several local economists including Goldman Sachs and Citi have increased their forecasts to expect a 50-basis point hike this month.

The ADP employment report showed that companies added 242k jobs in February, accelerating from an upwardly revised 119k in January. This was comfortably above market expectations and presents some possible upside to the key non-farm payrolls data due out tomorrow.

A welcome moderation in job openings was slower than expected in January. JOLTS job openings fell to 10.8m in January, from 11.2m in December. The market had expected a larger softening in labour demand to 10.5m openings.

Combined, these data keep the pressure on the Fed as it considers whether to accelerate the pace of interest rate hikes at its next meeting.

The trade deficit widened to $68.3 billion in January from $67.2 billion in December. This was the widest deficit in three months and reflecting a pickup in imports as domestic demand remains resilient.

The Fed's Beige Book was released this morning, providing an update on the state of economy across each Federal Reserve district. The report echoed the results of recent data, pointing to a pickup in activity in the start of 2023. Although, there were some positive developments on the inflation outlook. The report noted that "looking ahead contacts expected price increases to continue to moderate over the year" and that there were some signs of consumer resistance to higher prices and businesses accepting tighter profit margins.

Today's key data and events:

JN GDP Q4 Final exp 0.2% prev 0.2% (10:50am)

CH CPI Feb y/y exp 1.9% prev 2.1% (12:30pm)

CH PPI Feb y/y exp -1.3% prev -0.8% (12:30pm)

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.

Jameson Coombs, Economist
Ph: +61 401 102 789

Contact Listing

Chief Economist
Besa Deda
dedab@stgeorge.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@stgeorge.com.au
+ 61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@stgeorge.com.au
+61 468 571 786

Economist
Jameson Coombs
jameson.coombs@stgeorge.com.au
+61 401 102 789