Morning Report

Monday, 13 February 2023

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Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,434	-0.8%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,869	0.5%	10 yr bond	3.80		0.09		90 day BBSW	3.47	0.01
Japan Nikkei	27,671	0.3%	3 yr bond	3.52		0.09		2 year bond	3.40	0.08
China Shanghai	3,418	-0.3%	3 mth bill rate	3.76		0.03		3 year bond	3.42	0.08
German DAX	15,308	-1.4%	SPI 200	7,357.0		0		3 year swap	3.92	0.11
UK FTSE100	7,882	-0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.71	0.04
Commodities (close & change)*			TWI	62.2	-	-	62.2	**United States**		
CRB Index	272.7	2.2	AUD/USD	0.6932	0.6960	0.6907	0.6917	3-month T Bill	4.62	-0.01
Gold	1,865.57	3.8	AUD/JPY	91.25	91.48	90.23	90.89	2 year bond	4.52	0.04
Copper	8,830.26	-125.2	AUD/GBP	0.5722	0.5748	0.5716	0.5736	10 year bond	3.73	0.07
Oil (WTI futures)	79.72	1.7	AUD/NZD	1.0966	1.0988	1.0942	1.0970	**Other (10 year yields)**		
Coal (thermal)	206.00	14.5	AUD/EUR	0.6460	0.6502	0.6447	0.6479	Germany	2.36	0.06
Coal (coking)	372.67	13.3	AUD/CNH	4.7125	4.7386	4.7055	4.7210	Japan	0.50	0.00
Iron Ore	123.95	-0.8	USD Index	103.26	103.68	102.90	103.58	UK	3.40	0.11

Data as at 7:30am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Market sentiment remains subdued as investors contain optimism on Fed rate hikes ahead of key US inflation data early this week. US equities were higher on Friday but not enough to offset losses from earlier in the week. The US dollar firmed slightly, while Treasury yields strengthened.

Share Markets: US equities finished broadly higher on Friday, partly unwinding losses from earlier in the week. The S&P 500 gained 0.2% to finish the week down 1.1% - the worst week of 2023 so far. The Dow Jones gained 0.5% on Friday, while the NASDAQ bucked the trend, falling 0.6% to close the week 2.4% lower.

The ASX 200 sank 0.8% on Friday to finish the week 1.7% lower. Futures are pointing to a soft open this morning.

Interest Rates: US Treasury yields rose across the curve. The 2-year Treasury yield gained 4 basis points to 4.52%, while the 10-year yield rose 7 basis points to 3.73%.

Interest rate markets are fully pricing another 25-basis point hike from the Fed in March and see a peak in the federal funds rate of around 5.2% mid-way through 2023.

The Australian 3-year government bond (futures) yield gained 9 basis points to 3.52%, while the 10-year (futures) yield also jumped 9 basis points to 3.80%.

Interest rate markets are attaching around a 75% probability to another 25-basis point rate hike from the Reserve Bank (RBA) in March and expect a peak in the cash rate of around 4.1% mid-way through this year.

Currencies: The Aussie dollar softened slightly but remained comfortably within its recent trading range. The AUD/USD pair moved between a low of 0.6907 and a high of 0.6960 and is currently trading at the lower end of this range at around 0.6917.

The US dollar strengthened against a basket of major currencies. The DXY index ranged between a low of 102.90 and ahigh of 103.68 and is currently sitting around 103.58.

Commodities: The price of oil firmed but remained below US$80 per barrel. Gold was also stronger, while copper and iron ore softened.

The CEO of the world's largest oil producer, Saudi Aramco, joined the Secretary General of OPEC in stating that climate goals were undermining necessary investment in oil. The pair added that further investment is needed to meet the worlds future energy needs, suggesting a potential shortfall in oil supply.

Australia: The Reserve Bank (RBA) Governor's shift to a more hawkish tone last Tuesday came as a surprise to many. Friday's release of the February 2023 Statement on Monetary Policy (SoMP) confirmed that the RBA has become more concerned by stronger than expected wages growth and a shift in inflation psychology.

The SoMP includes updated forecasts for the economy. The outlook for economic activity remains broadly unchanged. The RBA is still expecting a soft landing and the unemployment rate is expected to increase but remain well below where it sat before the pandemic.

What did change was the outlook for underlying inflation (the inflation measure which dampens the impact of volatile items) and wages growth. The RBA is now expecting annual wages growth to be around ½ per cent higher in December quarter 2022 and June quarter 2023. This is feeding into higher underlying inflation, which is now around ¾ percentage points higher for June quarter 2023. By 2025, underlying inflation and wages growth are broadly in line with what was expected in November.

These forecasts are based on the cash rate reaching 3¾ per cent in mid-2023, up from the 3½ per cent expected in November 2022. In other words, the RBA believes the economy can withstand a cash rate of 3¾ per cent without slowing down too sharply.

We expect the RBA has more work to do to sustainably bring inflation back down. Our long-held view was that the cash rate would rise and peak at 3.85 per cent and we remain comfortable with this position.

China: The consumer price index (CPI) rose 2.1% over the year to January, accelerating from a 1.8% annual increase in December. The inflation outcome met consensus expectations as the economic recovery gathers momentum and demand heats up. Still, inflation in China remains well contained compared to other major economies.

Perhaps a sign that this will continue, the producer price index (PPI), which measures input price pressures for businesses, declined by more than expected. The PPI declined 0.8% in annual terms, following a 0.7% annual decline in December. January's reading marked the fourth consecutive decline in annual PPI inflation.

New Zealand: The BusinessNZ manufacturing PMI rose to 50.8 in January, from a revised 47.8 in December. This was the first reading above 50, the threshold between expansion and contraction, in four months. Four of the five sub-indices recorded expansion, while new orders contracted pointing to slowing demand as rate hikes take effect.

United Kingdom: December quarter GDP growth was flat, meaning the UK economy narrowly avoided a technical recession over the second half of 2022. Household and government spending helped keep activity above water, while public and private investment also contributed strongly to growth. In annual terms, growth slowed to 0.4%, from 1.9% in the September quarter.

United States: Philadelphia Fed Chief, Patrick Harker, said that the odds of achieving a soft landing are growing. However, Harker stressed that rates must move above 5% and stay there to ensure price pressures ease. The 2023 FOMC voting member favours "a couple more" 25-basis point hikes.

The University of Michigan consumer sentiment index rose to 66.4 in February from 64.9 in January, beating expectations for a reading of 65.0. The result highlights resilience despite a backdrop of slowing economic activity. One year ahead inflation expectations rose to 4.2% from 3.9% previously. However, 5-10 year ahead inflation expectations remained unchanged at 2.9%.

Today's key data and events:

NZ Performance Services Index Jan prev 52.1 (8:30am)

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