Morning Report

Friday, 17 February 2023

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Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,410	0.8%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,697	-1.3%	10 yr bond	3.82		0.05		90 day BBSW	3.47	-0.01
Japan Nikkei	27,696	0.7%	3 yr bond	3.49		0.03		2 year bond	3.44	-0.01
China Shanghai	3,406	-1.0%	3 mth bill rate	3.66		0.02		3 year bond	3.45	-0.02
German DAX	15,534	0.2%	SPI 200	7,323.0		-16		3 year swap	3.92	-0.05
UK FTSE100	8,013	0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.76	0.02
Commodities (close & change)*			TWI	62.5	-	-	62.5	**United States**		
CRB Index	270.2	-0.1	AUD/USD	0.6907	0.6936	0.6841	0.6879	3-month T Bill	4.66	0.00
Gold	1,837.80	1.8	AUD/JPY	92.63	92.74	91.96	92.09	2 year bond	4.65	0.02
Copper	8,845.50	-90.0	AUD/GBP	0.5740	0.5751	0.5714	0.5736	10 year bond	3.86	0.06
Oil (WTI futures)	78.02	-0.6	AUD/NZD	1.0989	1.1019	1.0963	1.0996	**Other (10 year yields)**		
Coal (thermal)	186.30	-9.7	AUD/EUR	0.6462	0.6473	0.6423	0.6446	Germany	2.48	0.00
Coal (coking)	374.67	-0.3	AUD/CNH	4.7414	4.7587	4.7084	4.7259	Japan	0.51	0.00
Iron Ore	125.05	0.5	USD Index	103.84	104.23	103.53	104.02	UK	3.50	0.01

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: Risk sentiment waned as a hotter-than-expected US producer price index (PPI) inflation report and hawkish comments from Federal Reserve officials strengthened expectations that interest rates would need to be higher for longer. Both Fed officials stated that they saw a compelling case for a larger 50-basis-point hike at the previous Fed meeting at the beginning of February,

Bond yields were higher but retraced some of their movements by the end of the day. Equity markets declined and the US dollar moved higher, but also pared some of its gains.

Share Markets: Share markets dropped on the stronger-than-expected PPI inflation report and hawkish comments from Fed members. The S&P 500 fell 1.4%, the Nasdaq dropped 1.8% and the Dow Jones was down 1.3%.

The ASX 200 rose by 0.8% yesterday, driven by consumer discretionary, real estate, and materials stocks. Futures are pointing to a weak open today.

Interest Rates: Bond yields rose following the stronger PPI data and hawkish Fed comments. The 2-year treasury yield closed 2 basis points higher, at 4.65%. However, it traded as high as 4.68% during the session.

The 10-year yield jumped to a high of 3.87%, before closing near that high at 3.86% - 6 basis points above where it opened.

Interest-rate markets expect the Fed funds rate to rise to a peak of 5.26% in mid-2023, up from 5.24% a day earlier.

Australian government bond yield (futures) somewhat mimicked moves in the US. The 3-year government bond yield (future) was 3 basis points higher, at 3.49%. The 10-year government bond yield (future) was 5 basis point higher, at 3.82%.

Interest-rate markets expect the cash rate to peak at 4.10% in late 2023.

Currencies: The US dollar strengthened against a basket of major currencies. The USD Index rose from a low of 103.53 to a high of 104.23. It later retraced some of those gains and closed at 104.02.

The AUD/USD pair was weaker in line with a stronger US dollar. The pair dropped from a high of 0.6936 to a one-month low of 0.6841. It has since recovered some of its losses and was trading at 0.6879 at the time of writing.

Commodities: Gold and iron ore strengthened, while oil, copper and coal were all weaker on the day.

Australia: The unemployment rate increased to 3.7% in January 2023 - the highest rate since May 2022. The number of people employed declined by 12k over the month, following a revised decline of 20k in December. The number of people unemployed jumped 22k over January and by 30k over the past two months.

Other labour market indicators are also showing signs of slowing – the share of the working age population employed declined by 0.2 percentage points, the share of full-time employment and the participation rate both edged lower, and youth unemployment increased to 7.9% from 7.7%.

At the same time, we continue to see an acceleration of population growth on the back of higher migration levels. In fact, in January there was a 41k increase in the working age population. In a recent note, we pointed out that growing labour supply would act as a pressure relief valve for the tight labour market – we are seeing this play out.

The risk of a wage price spiral is also reduced if labour shortages become less acute.

While the labour market remains strong, data over the past few months suggests that we may have past the trough in the unemployment rate. This has happened more quickly than the Reserve Bank was expecting – their forecasts released last Friday had the unemployment rate increasing to 3.6% in June 2023 and 3.8% in December 2023 – its January and we're at 3.7%.

The current surge in net overseas migration will help bring demand and supply of labour into better balance over time. This will result in a tick up in the unemployment rate to a more sustainable level over time and could reduce the risk of a wage price spiral.

Consumer inflation expectations over the next 12 months declined in February, falling to 5.1% in the month, as reported by the Melbourne Institute. This was down from 5.6% in January. Despite the fall in the month, inflation expectations remain elevated and were above the 4.6% reading from the same time last year.

Japan: Core machinery orders grew by 1.6% in December. This was a turnaround from the sharp 8.3% plunge in November. The outcome was below consensus expectations of a gain of 2.8%. Over the year, core machinery orders were down by 6.6%. The annual outcome was weaker than the 6.1% drop expected by consensus.

New Zealand: A net migration gain of 4,581 people was recorded for December. This followed a revised gain of 7,354 people in November, revised up from the initial reading of 6,110. Net migration has now been positive for six consecutive months. Over 2022, there was a provisional net migration gain of 15,800 people. This was a turnaround of a net migration loss of 15,000 people in 2021, as border closures impacted migration patterns.

United States: Producer price pressures (i.e. factory gate prices) were stronger-than-expected in January. The producer price index (PPI) rose by 0.7% in the month, above expectations of a 0.4% gain. The prior month was also revised higher, to a drop of 0.2% from the initial reading of -0.5%.

On the positive side, annual PPI inflation decelerated for a seventh consecutive month. Producer prices rose by 6.0% over the year to January. This was below the December outcome of 6.5%, which was revised higher from an initial reading of 6.2%. However, the pace of deceleration was not as large as expected and the January outcome was above expectations of a 5.4% gain.

Underlying inflationary pressures strengthened in the month. The core measure, which strips out the volatile components of food and energy rose by 0.5% in January, above expectations of a 0.3% outcome. This was also above the revised December reading of 0.3%. In annual terms, core PPI inflation was 5.4%, above expectations of 4.9%, but down from the December outcome of 5.8%. Annual core PPI inflation has been consistently declining since hitting a peak of 9.7% in March 2022.

The data follows a stronger-than-expected consumer price inflation result earlier this week and provides further evidence that the disinflationary pulse is not moving as quickly as expected. This adds weight to the view that interest rates will need to continue to rise and be higher for longer.

The Philadelphia Fed business outlook index dropped sharply to a three-year low of -24.3 in February. This was well down on the -8.9 outcome from January and the -7.5 outcome expected by consensus.

Housing starts continued their weak performance as they declined by 4.5% in January. This was the fifth consecutive drop and was the longest streak of monthly falls since 2009. The outcome was weaker than the -1.9% drop expected by consensus. December was also revised down, from an initial reading of -1.4% to a larger drop of -3.4%.

Building permits were broadly flat in January, rising 0.1%. However, the outcome was below expectations of a 1.0% gain. The result follows a drop of 1.0% in December. Building permits have steadily declined from their peak of 1.896 million in December 2021 to 1.339 million in January 2023 as shortages of key materials and labour challenges have contributed to higher costs of building new homes. Higher interest rates have also continued to place challenges on the housing market and reduce demand for new home building and for sales of existing homes.

FOMC members Loretta Mester and James Bullard spoke overnight and added to commentary around the need for rates to go higher and remain there for longer.

Mester, who does not vote this year, said that she had seen a “compelling” case for a 50-basis-point hike back at the most recent Federal Reserve meeting at the beginning of February. She noted that risks to inflation are tilted to the upside and that inflation may not return to the Fed’s 2% target until 2025. She believes that the Fed will need to hike rates “a little bit” above 5% and stay there for a while.

Bullard, also non-voting this year, noted that he also advocated for a 50-basis-point hike at the previous meeting and wouldn’t rule out supporting a 50-basis-point hike at the upcoming meeting. Specifically, he stated “I have argued consistently for front-loading of monetary policy” and “I think we could have continued that at this past meeting”. He also added that his “overall judgment is it will be a long battle against inflation, and we’ll probably have to continue to show inflation-fighting resolve as we go through 2023”.

Today’s key data and events:

AU RBA Governor testimony to House of Reps (9:30am)

UK Retail Sales Jan exp -0.3% prev -1.0% (6pm)

US Import Price Index Jan exp -0.1% prev 0.4% (12:30am)

US Leading Index Jan exp -0.3% prev -0.8% (2am)

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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