Morning Report

Wednesday, 2 August 2023

Equities (close & % change)		
S&P/ASX 200	7,451	0.5%
US Dow Jones	35,631	0.2%
Japan Nikkei	33,477	0.9%
China Shanghai	3,450	0.0%
German DAX	16,240	-1.3%
UK FTSE100	7,666	-0.4%
Commodities (close & change)*		
CRB Index	280.8	-1.3
Gold	1,944.29	-20.8
Copper	8,819.50	171.3
Oil (WTI futures)	81.37	-0.4
Coal (thermal)	142.85	-1.8
Coal (coking)	240.50	3.3
Iron Ore	106.00	0.0

Sydney Futures Exchange (last & change)				
	Last		Overnight Chg	
10 yr bond	4.03		0.06	
3 yr bond	3.77		0.03	
3 mth bill rate	4.26		0.01	
SPI 200	7,360.0		-39	
FX Last 24 hrs	Open	High	Low	Current
TWI	61.3	-	-	61.3
AUD/USD	0.6718	0.6724	0.6602	0.6621
AUD/JPY	95.59	95.81	94.52	94.54
AUD/GBP	0.5232	0.5239	0.5169	0.5177
AUD/NZD	1.0821	1.0829	1.0733	1.0754
AUD/EUR	0.6108	0.6113	0.6010	0.6011
AUD/CNH	4.8010	4.8106	4.7413	4.7576
USD Index	101.89	102.43	101.85	102.18

Interest rates (close & change)		
Australia		
90 day BBSW	4.26	0.01
2 year bond	3.82	-0.12
3 year bond	3.75	-0.12
3 year swap	4.11	-0.02
10 year bond	3.97	-0.09
United States		
3-month T Bill	5.24	-0.02
2 year bond	4.90	0.03
10 year bond	4.02	0.06
Other (10 year yields)		
Germany	2.56	0.06
Japan	0.61	-0.01
UK	4.40	0.09

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: US bond yields rose across the curve despite softer data suggesting that the economy continues to slow and the labour market is still easing. The 30-year yield rose to its highest since November reflecting increased upcoming borrowing needs from the US government. Credit ratings agency Fitch downgraded the US government from AAA to AA+. Equity markets pulled back after recording strong gains over recent sessions. The US dollar rose against a basket of major currencies.

Share Markets: Equity markets pulled back after consistent strong gains over recent sessions. The S&P 500 fell 0.3% and the Nasdaq dropped 0.4%. The Dow Jones bucked the trend, rising 0.2%.

The ASX 200 rose 0.5% yesterday. All 11 sectors were higher on the day, with IT leading way, up 1.1%. The market initially rose following the lead from the US, before jumping further after the Reserve Bank (RBA) Board left the cash rate unchanged at 4.10%. Futures are pointing to a negative open today, following the lead from overseas markets.

Interest Rates: Bond yields were higher overnight despite US data suggesting the economy continues to slow. Increased borrowing needs from the US government may have had an impact on bond prices, as the supply of longer-dated bonds is expected to increase. The 10-year yield rose 6 basis points, to 4.02%. The 2-year yield was 3 basis points higher, at 4.90%. Interest-rate markets are pricing around a 16% chance of a hike at the Fed's September meeting. Looking further, markets are attaching only around a 35% chance of one more hike in this cycle, before they begin pricing cuts from mid-2024 onwards.

Australian government bond yields mimicked moves in the US, partly reversing large falls from yesterday following the RBA decision to leave the cash rate at 4.10%. The 10-year government bond yield (futures) rose 6 basis points, to 4.03%. This partly reversed a 9-basis-point fall in yesterday's session. The 3-year government bond yield (futures) rose 3 basis points, to 3.77%, partly reversing a larger 12 basis point drop yesterday.

Interest rate markets are split on whether the RBA is done in this cycle. Markets are attaching next to no chance of a hike in September (only 4%) but have around a 50/50 probability of one more hike by the end of the year. A full cut from the 4.10% rate is not currently fully priced until 2025.

Foreign Exchange: The US dollar strengthened against a basket of major currencies. The USD Index ranged between a low of 101.85 and a high of 102.43, before settling at 102.18.

The AUD/USD pair dropped following the RBA announcement and hit its lowest level in around a month during the session. The pair traded lower over the day from a high of 0.6724 in the morning of the Asian session. Immediately after the RBA announcement, the currency dropped from 0.6703 to 0.6664. It continued to trade lower through the session, eventually finding support around the psychological level of 0.6600 (0.6602 specifically) during the New York session. It was trading at 0.6621 at the time of writing.

Commodities: Oil slipped overnight despite reports showing that OPEC+ production had fallen by the most since 2020 following previously announced cuts from Saudi Arabia of 900k barrels per day coming into place. Gold and thermal coal were also weaker. Coking coal rose while iron ore ended unchanged.

Australia: The Reserve Bank (RBA) Board left the cash rate unchanged at 4.10% yesterday for the second straight month. The RBA has now paused in 3 of its last 5 meetings, demonstrating that we are at or near the peak in the cash rate.

The on-hold decision gives the RBA more time to better assess the full impact of the rate rises to date – 400 basis points or 4 percentage points since May of last year. Monetary policy does have long and variable lags.

The decision begs the question is this it for the RBA? We favour no further rate rises from the RBA and 4.10% being the peak in the cash rate. However, we are cautious and cannot fully rule out further tightening. One of the key reasons is inflation remains elevated and we are still a long time from inflation returning to the target band.

The RBA itself flags that "some further tightening may be needed". But decisions for the central bank have become acutely data dependant and we suspect the threshold for further tightening may be higher than where it has been.

The pause gives the RBA the best chance of ensuring it doesn't overtighten and jeopardise a potential soft landing. Residential construction is going backwards. There is also strong evidence of consumption growth slowing significantly and in per capita terms, the consumer sector is already experiencing recessionary conditions.

Dwelling values rose 0.7% in July, extending a run of 5 consecutive months of price gains. The monthly increase was a step down on the 1.1% increase through June but still represents a very strong pace. The run of price increases means dwelling values nationally are just 5.3% below their peak from April last year. Price growth in July was concentrated in Brisbane (1.4%), Adelaide (1.4%), Perth (1.0%) and Sydney (0.9%). Apart from Sydney, growth accelerated in each of these cities.

Since bottoming out in February, dwelling prices have risen by 4.1% nationally. This is even larger in Sydney where dwelling prices have surged by 7.6% since bottoming out in January. What many first thought was a 'dead cat bounce' has since materialised into a more sustained uptick in dwelling prices.

Housing finance fell 1.0% in June, partly unwinding a 5.4% gain in May (revised higher from an initial 4.8% reading). The result reflected a 2.8% drop in new loan commitments to owner-occupiers, partly offset by a 2.6% gain in new lending to investors. Despite the upward revision to past data, the outcome was weaker-than-expected by consensus.

Building approvals fell 7.7% in June, partly unwinding a 20.5% spike in May. The surge in May reflected approvals for multi-density dwellings, which can be volatile on a month-to-month basis. As a result, it was expected that some of this strength would be reversed in June. Indeed, approvals for multi-density dwellings plunged 21.0% in the month. Private sector house approvals also declined in June, down 1.3%. This followed a 0.8% gain in May. While there is significant volatility on a monthly basis, the underlying picture is still one of weakness in approvals, as a range of factors impact the contraction sector and buyer demand. Some early signs of stabilisation may be emerging, but approvals are expected to continue to be under pressure and we will need to wait for additional data to confirm whether a bottom has been found.

China: The manufacturing sector slipped back into contractionary territory in July, as reflected by the Caixin manufacturing Purchasing Managers' Index (PMI). Activity slipped to 49.2, down from 50.5 in June. This was below expectations of 50.1.

The result comes after the publication of official manufacturing PMI figures a day earlier, which showed that manufacturing activity remained in contractionary territory for the fourth consecutive month. The private sector Caixin index has a greater emphasis on smaller exporting businesses versus the official PMI.

The data confirms that exporters are finding conditions more challenging as goods demand from overseas is soft under the weight of elevated interest rates. The data also adds to further calls for economic stimulus measures from authorities.

Japan: The jobless rate fell to 2.5% in June, from 2.6% in May. This was below consensus expectations for an unchanged result. Employment rose by 190k people in the month and the job-to-applicant ratio was 1.30 – slightly down from the 1.31 result in May. Labour force participation rose in the month, from 62.9% in May to 63.1% in June.

New Zealand: Building permits rose 3.5% in June, with a 6.4% gain in house approvals. This reversed a 2.3% fall in May. While higher in the month, approvals over the quarter were weak relative to a year ago, as interest rate increases from the Reserve Bank of New Zealand weigh on the housing sector. Specifically, approvals in the June quarter of 2023 were 20% lower than a year earlier. The result was the second consecutive quarter where the number of building permits for houses and multi-density dwellings declined.

Eurozone: The unemployment rate remained unchanged at a record low of 6.4% in June, signalling a continued tight labour market. The outcome follows a downwardly revised result for May and was below expectations, both 6.5%. Youth unemployment (i.e. those under 25) also declined, falling to 13.8%, from 14.0% in May. While the labour market remains tight, falling job vacancies in Germany and France suggest that the pace of job creation is likely to slow in coming months, under the weight of monetary policy tightening from the European Central Bank.

The Markit manufacturing PMI was finalised at 42.7, unchanged from its preliminary reading. The manufacturing sector has been in contractionary territory for 13 consecutive months.

United Kingdom: The Markit manufacturing PMI was finalised at 45.3 in July. This was slightly higher than the flash reading of 45.0. The outcome confirms the manufacturing sector has been in contractionary territory for 12 consecutive months.

United States: The manufacturing sector extended its run of contractionary readings to eight consecutive months, according to the ISM manufacturing index. However, the index rebounded in the month. In July, the index rose to 46.4, from 46.0 in June. The outcome was slightly below expectations of 46.9. The outcome still points to weak conditions but has been stabilising around the 46 level in recent months. Looking at the components, all sub-indices remained in contractionary territory. Prices paid rose but remained in contraction, increasing from 41.8 to 42.6. This signals that prices are still contracting but at a slower pace and suggests the manufacturing sector and goods prices are likely to continue to contribute to the disinflationary pulse over coming quarters. Employment fell from 48.1 to 44.4 in a sign that a cooling in labour market conditions may be evident. New orders continued to contract but at a slower pace. The new orders sub-index rose from 45.6 to 47.3.

The S&P manufacturing PMI also signalled contraction in the sector and was finalised at 49.0 in July, unchanged from the preliminary reading.

Construction spending rose 0.5% in June, following a 1.1% gain in May. The outcome was slightly lower than expectations of a 0.6% gain. The results reflected a 0.9% gain in private residential construction, while private non-residential construction was flat in the month.

Ratings agency Fitch downgraded the credit rating of the US government from AAA (the highest rating) to AA+ overnight. The agency noted the repeated challenges over the debt limit as one reason for the downgrade. Additionally, an expected challenging fiscal position for the next three years and limited progress on tackling the largest areas of expenditure also played into the decision.

Today's key data and events:

NZ Unemployment Rate Q2 exp 3.5% prev 3.4% (8:45am)

NZ Private Wages Ex. Overtime Q2 exp 1.2% prev 0.9% (8:45am)

NZ Employment Q2 exp 0.6% prev 0.8% (8:45am)

US ADP Employment Chg. Jul exp 190k prev 497k (10:15pm)

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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