Morning Report

Wednesday, 15 February 2023

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Equities (close & % change)		
S&P/ASX 200	7,431	0.2%
US Dow Jones	34,090	-0.5%
Japan Nikkei	27,603	0.6%
China Shanghai	3,452	0.3%
German DAX	15,381	-0.1%
UK FTSE100	7,954	0.1%
Commodities (close & change)*		
CRB Index	273.6	0.8
Gold	1,855.45	2.0
Copper	8,926.00	81.5
Oil (WTI futures)	79.18	-1.0
Coal (thermal)	195.25	-5.0
Coal (coking)	375.00	1.0
Iron Ore	123.10	0.6

Sydney Futures Exchange (last & change)				
	Last		**Overnight Chg**	
10 yr bond	3.82		0.07	
3 yr bond	3.56		0.09	
3 mth bill rate	3.73		0.03	
SPI 200	7,359.0		1	
FX Last 24 hrs	**Open**	**High**	**Low**	**Current**
TWI	62.1	-	-	62.1
AUD/USD	0.6966	0.7029	0.6922	0.6992
AUD/JPY	92.16	93.04	91.81	93.02
AUD/GBP	0.5740	0.5743	0.5706	0.5742
AUD/NZD	1.0956	1.1029	1.0938	1.1029
AUD/EUR	0.6496	0.6512	0.6462	0.6512
AUD/CNH	4.7534	4.7834	4.7340	4.7790
USD Index	103.28	103.52	102.59	103.22

Interest rates (close & change)		
Australia		
90 day BBSW	3.49	-0.01
2 year bond	3.44	-0.01
3 year bond	3.46	-0.01
3 year swap	3.98	0.06
10 year bond	3.74	-0.02
United States		
3-month T Bill	4.63	-0.01
2 year bond	4.62	0.10
10 year bond	3.75	0.05
Other (10 year yields)		
Germany	2.44	0.07
Japan	0.51	0.00
UK	3.52	0.12

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: Bond yields were higher on the back of the still elevated US Consumer Price Index (CPI). The CPI showed a slowing momentum in goods disinflation and robust gains the prices of services. This outcome is consistent with Fed Chair Powell's view that rates must remain higher for longer to get inflation down.

With markets pricing in higher yields, US equities were volatile but ended higher while the US dollar was broadly unchanged.

Share Markets: US share markets declined following the release of the US CPI report. As investors digested the implications, equities retraced earlier losses to finish higher. The S&P 500 ended 0.2% higher and the Nasdaq was up 0.6%. The Dow declined by 0.5%, only partly retracting the falls seen earlier in the session.

Interest Rates: Bond yield increased across the US yield curve. The US 2-year treasury yield increased by 10 basis points to 4.62%. The 10-year yield increased by 5 basis points lower to 3.75%.

Interest-rate markets are pricing in 26 basis points of tightening at the upcoming Fed meeting in March and expect the fed funds rate to peak at around 5.3% in mid-2023 – up by around 25 basis points compared to before the release of the CPI data.

Australian government bond yields mirrored the moves recorded in the US. The Australian 3-year government bond yield (futures) increased by 9 basis points to 3.56%, while the 10-year government bond yield (futures) increased by 7 basis points to 3.85%.

Interest-rate markets are pricing 19 basis points of tightening when the Reserve Bank Board meets next month. Markets are pricing the cash rate to peak above 4.1% in mid-2023.

Currencies: The AUD/USD pair edged higher. The pair dropped from a high of 0.7029 in London trade to reach a low of 0.6922 during the New York session. The pair has since recovered and is trading at 0.6992 at the time of writing.

The US dollar was broadly unchanged against most of its G10 peers. The USD Index moved between a low of 102.59 and a high of 103.52, before settling at 103.22.

Commodities: Commodities were broadly stronger. The West Texas Intermediate (WTI) futures contract was broadly unchanged. It is sitting at USD79.18 per barrel. This comes after reports suggest that OPEC expects a slightly tighter global oil market, boosting its 2023 demand forecast by 100,000 barrels per day, and cutting non-OPEC supply outlook by 150,000 barrels per day.

Gold, coking coal, copper and iron ore were higher. Thermal coal was lower on the day.

Australia: Consumer sentiment tumbled 6.9% in February to 78.5. This was only marginally above the cyclical low of 78.0 struck in November. To find a lower reading, you would need to go back to the depths of the pandemic or all the way back to the 1990's recession.

The December quarter inflation report, which showed prices rising at their fastest pace in almost 33 years, and the Reserve Bank's (RBA) renewed resolve to tackle inflation likely prompted the sour mood as hopes of a potential pause in interest rate hikes were dashed.

The detail reflects this. Views on household finances relative to a year ago deteriorated sharply as pressure on household budgets builds. Adding to the sombre spirit, households do not expect a reprieve anytime soon. Future expectations for family finances also declined materially, while 53% of respondents expect a further 1% increase in the cash rate.

Business confidence spiked 6 points to +6 in January, the first reading above zero since September. Confidence is now back around long-run average levels as the reopening of China and resilience in the US and Europe provided cause for optimism in January.

Business conditions rose 5 points to +18. Conditions have moderated from the peak of +24 recorded in September but remain elevated. Strong summer trading conditions underpinned the strength. The profitability and employment measures also improved and remain elevated.

Capacity utilisation, which measures the extent to which businesses are exhausting their resources, rose to a near-record high of 85.7%. Forward orders also picked up.

Meanwhile, cost pressures reaccelerated after a marked slowdown over the second half of 2022. Purchase costs (3.2%), labour costs (2.7%) and final produce prices (1.7%) all rose in quarterly terms but remain below their peak from the middle of 2022.

United Kingdom: The unemployment rate was 3.7% in the three months to December 2022. This was unchanged from the November read and in line with market expectations. The number of people in work increased by 74k in the three months to December. However, over three-month period to January 2023, job vacancies fell by 76k.

Average weekly earnings increased by 5.9% year-on-year in the three months to December 2022. This represents a slowdown from the 6.5% year-on-year in the three months to November 2022. It was also lower than the 6.2% the market was expecting. This outcome suggest that wage pressures are easing.

Europe: Economic activity slowed in the December quarter 2022 but remained positive. Activity grew by 0.1% over the December quarter to be 1.9% higher in annual terms. This was stringer than the fall on 0.1% the market was expecting. Germany and Italy recorded negative growth rates for the quarter but France and Spain expanded

The number of employed increased by 0.4% over the December quarter 2022. This was higher than the 0.2% the market was expecting. The outcome represents an acceleration over the 0.3% recorded in the September quarter 2022. In annual terms, employment increased by 1.5%, following a 1.8% increase in the September quarter.

Japan: Economic activity expanded by 0.6% on an annualized basis during the December quarter 2022. The outcome was weaker than the 2.0% the market was expecting. The outcome shows that the economy partly retraced the annualised fall in economic activity of 1.0% in the September quarter. Strong private consumption and service exports supported activity. However, private capex and housing investment fell, reflecting higher costs for materials and workers.

United States: The Consumer Price Index (CPI) increased by 0.5% over January, in line with what the market was expecting. This represents an acceleration on the upwardly revised 0.1% increase recorded in December. CPI grew by 6.4% in annual terms, down from the 6.5% recorded in December. However, this was stronger than the 6.2% the market was expecting.

Stripping out energy and food prices, the "core" CPI was unchanged from December, increasing by 0.4% over the month of January. This was in line with market expectations. In annual terms core CPI increased by 5.6%, slightly higher than the 5.5% the market was expecting.

Looking at the detail, core goods prices rose 0.1% over January, an increase from the fall of 0.1% recorded in December. Core services prices increased by 0.5% over the month, slightly down on the 0.6% recorded in the previous month. Core services excluding housing rents showed a slower pace of price increases, up by 0.3% in January compared with 0.4% in December. Energy prices increased strongly by 2.0%, driven by rising gasoline prices and a sharp increase in natural gas prices.

The CPI read showed a slowing momentum in goods disinflation, robust gains service prices, and a strong increase in energy prices. That should support the

Fed Chair Powell's view that rates must remain higher for longer to get inflation down.

There was a mix of comments from Fed officials following the release of the CPI. Lorie Logan warned that the central bank may need to raise rates higher than previously envisioned to ensure that prices moderate – she said "We must remain prepared to continue rate increases for a longer period than previously anticipated, if such a path is necessary to respond to changes in the economic outlook or to offset any undesired easing in conditions". John Williams said "I am confident that the gears of monetary policy will continue to move in a way that will bring inflation down to 2%... We will we stay the course until our job is done." Thomas Barkin said the Fed may need to raise interest rates to a higher level than previously anticipated should inflation keep running too fast.

Patrick Harker was more dovish: "We are not done yet… but we are likely close. At some point this year, I expect that the policy rate will be restrictive enough that we will hold rates in place and let monetary policy do its work."

The NFIB Small Business Optimism Index increased to 90.3 points in January 2023. This was up from the six-month low of 89.9 points recorded in December 2022. Owners expecting better business conditions over the next six months improved 6 points. Around 42% of owners raised average selling prices, down a point from December. Further, around 29% plan to boost prices in the next three months – the first increase since October.

Today's key data and events:

EZ Industrial Production Dec prev 1.0% (9pm)

EZ Trade Balance Dec prev -15.2 (9pm)

UK CPI Jan prev 0.4% (6pm)

US Empire Mfg Feb prev -32.9 (12:30am)

US Retail Sales Jan prev -1.1% (12:30am)

US Industrial Production Jan prev -0.7% (1:15am) US Business Inventories Dec prev 0.4% (2am)

US NAHB Housing Market Index Feb prev 35 (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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