Morning Report

Tuesday, 4 July 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,246	0.6%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,418	0.0%	10 yr bond	3.99		0.03		90 day BBSW	4.35	0.00
Japan Nikkei	33,753	1.7%	3 yr bond	3.96		0.03		2 year bond	4.04	-0.18
China Shanghai	3,401	1.3%	3 mth bill rate	4.51		0.01		3 year bond	3.96	-0.09
German DAX	16,081	-0.4%	SPI 200	7,216.0		-1		3 year swap	4.29	-0.01
UK FTSE100	7,527	-0.1%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.97	-0.06
Commodities (close & change)*			TWI	61.7	-	-	61.7	**United States**		
CRB Index	260.9	-1.1	AUD/USD	0.6663	0.6692	0.6637	0.6672	3-month T Bill	5.13	-0.02
Gold	1,921.64	2.3	AUD/JPY	96.14	96.62	96.00	96.51	2 year bond	4.94	0.04
Copper	8,323.75	141.8	AUD/GBP	0.5248	0.5269	0.5229	0.5257	10 year bond	3.85	0.02
Oil (WTI futures)	69.79	-0.8	AUD/NZD	1.0860	1.0862	1.0816	1.0844	**Other (10 year yields)**		
Coal (thermal)	157.50	-1.8	AUD/EUR	0.6109	0.6129	0.6085	0.6113	Germany	2.44	0.04
Coal (coking)	231.00	0.3	AUD/CNH	4.8446	4.8484	4.8160	4.8390	Japan	0.41	0.00
Iron Ore	108.90	0.5	USD Index	102.91	103.27	102.75	102.98	UK	4.44	0.05

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: Risk sentiment remained resilient in the half day session ahead of the Fourth of July Holiday. US equities finished higher, following on from the solid performance on Friday. US bond yields and the US dollar declined on the back of the weaker than expected US manufacturing data released overnight. Yields recovered to finish higher, while the US dollar recovered to end broadly unchanged.

Share Markets: US equities finished higher in the half day session ahead of the Fourth of July Holiday. The tech-heavy Nasdaq closed 0.2% higher, the S&P 500 rose 0.1% while the Dow Jones was broadly unchanged (up 0.03% to 2 decimal places).

The ASX 200 rose for the second day, closing 0.6% higher yesterday. There were nine out of eleven sectors that ended higher, led by materials stocks.

Interest Rates: US Treasury yields increased across the yield curve. The 2-year treasury yield increased by 4 basis points to 4.94%. The 10-year yield increased by 2 basis points to 3.85%. These movements led to a further inversion of the US yield curve, with the spread between the 2- and 10-year US government bonds reaching its highest level since March this year, when Silicon Valley Bank collapse triggering a period of financial instability.

Interest rate markets are pricing an 85% chance of a 25-basis point hike from the Fed in late July. Markets are now pricing one more hike with a slight chance of another before the end of the year.

Consistent with the movements in the US, the Australian 3-year bond (futures) yield increased by 3 basis points to 3.96%. The 10-year (futures) yield also increased by 3 basis points to 3.97%.

Interest rate markets are pricing a 20% chance of a 25-basis point hike when the Reserve Bank meets later today. Markets are pricing a peak rate of around 4.5% by December 2023.

While markets are placing a relatively low probability on a rate hike at today's meeting, around half of the market economists recently surveyed by Bloomberg expect the Reserve Bank to hike by 25-basis points at today's meeting. Emerging pressures that are building on the back of recent wage outcomes, the tight labour market and ongoing government support point to ongoing persistence in inflation which in our view, is likely to sway the Reserve Bank to hike by 25-basis points.

Foreign Exchange: The Aussie dollar outperformed. The AUD/USD pair reached a high of 0.6692 during the London session, after bouncing off the low of 0.6637 recorded during the Tokyo session. The pair eased to settle at 0.6672.

The US dollar was broadly unchanged against its G10 peers. The DXY index declined from the intraday high of 103.27 to a low of 102.75, following the release of the weaker than expected US manufacturing data. The US dollar re-traced some of this fall to settle at 102.98, broadly unchanged from the previous day.

Commodities: Commodities were broadly firmer. Gold, Copper, Coking coal, and Iron ore were higher. Thermal coal and oil declined.

The West Texas Intermediate (WTI) future declined to be below US$70 per barrel (US$69.79).

Australia: Dwelling prices rose for a fourth consecutive month in June, though the pace of growth has moderated. Prices were up 1.1% nationally, led by a 1.2% gain in the capital cities and a 0.5% increase across regional areas.

Since finding a floor in February, prices are up 3.4% nationally. This has trimmed the peak-to trough fall in this cycle to only 6.0%. Growth remained strongest in Sydney (1.7%) and Brisbane (1.3%), though all capital cities except for Hobart reported growth in June.

Exceptionally tight advertised supply remains the bedrock of the price recovery. Advertised supply is more than 25% below the average for this time of year, while sales volumes (a proxy for demand) are around average levels.

The value of new housing finance, ex refinancing, increased by 4.8% over May, following an upwardly revised fall of 1.0% in April (initial reading was a fall of 2.9% in April). This was the strongest monthly growth rate since November 2021. It was driven by a 6.2% increase in investor finance (highest since May 2021) and a 4.0% in finance for owner occupiers.

The number of new housing finance commitments, ex refinancing and investors, increased for a third consecutive month (5.1%). Since reaching a trough in February, the number of new commitments has increased by a significant 11.8%.

Interestingly, the average value of loans used to finance the purchase of existing housing (by far the largest component of housing financing) has declined by 4.5% since February (or by around $30k).

Dwellings prices have increased since finding a floor in February, yet the average value of loans for established houses has fallen. This suggests that households are responding to higher interest rates and the fall in borrowing capacity by compromising and buying houses at a lower price point.

Given the current imbalances in the housing market, a sense of urgency may be emerging, with households more willing to compromise to purchase a property. This has some implications for future house price performance – an increase in advertised supply, particularly at higher price points, may test the depth of demand.

Building approvals rose 20.6% in May, following a 6.8% decrease in April. The rise in total dwellings was driven by the more volatile dwellings excluding houses series, which rose 59.4%. Approvals for private sector houses remain more subdued, rising 0.9%, following a 3.0% fall in April.

Despite the monthly pick up, approvals continue to be weak. Approvals for dwellings excluding houses are 22% below the recent peak recorded in March 2021, while approvals for detached houses are 43% below their peak also recorded in March 2021.

The Melbourne Institute's Monthly Inflation Gauge showed prices eased to a ten-month low of 0.1% in June following a 0.9% rise in May. In annual terms, the inflation gauge stood at 5.7%, a deceleration from the 5.9% recorded in May. These headline figures are consistent with the ABS' monthly inflation gauge released last week.

Job advertisements decreased by 2.5% over June, compared to flat reading in May. a month earlier. On an annual basis, job ads fell 10% but remained 47.5% above pre-pandemic levels, pointing to continued strength in the labour market.

China: The Caixin China General Manufacturing Purchasing Managers' Index fell to 50.5 points in June, from 50.9 points in May. The outcome was above the 50.0 index points expected by the market. Firms signalled little pressure on current production schedules, with backlogs of work rising slightly. On prices, input cost fell the most since January 2016, due to lower costs for raw materials. Selling prices also declined on the back of increased market competition and efforts to boost sales. These outcomes point to China exporting disinflation to other countries.

Bloomberg is reporting that China has imposed restrictions on exporting two metals crucial to the semiconductor and EV industries. Gallium and germanium will be subject to controls starting 1 August this year. These restrictions are likely to escalate the tech trade war with the US and Europe.

Eurozone: The Manufacturing PMI was revised downwards to 43.4 points in June, from a preliminary estimate of 43.6. this outcome signals the sharpest deterioration in the health of the sector since May 2020. Total new order intakes fell at the strongest pace for eight months, while factory staffing levels were reduced for the first time since January 2021.

New Zealand: There were 45,159 new homes approved over the year to May 2023, down 11% compared to the same period a year ago. Over the year to May 2023, there were 18,734 stand-alone houses approved, down 24% compared to the same period a year ago. Further, there were 26,425 multi-unit homes approved, down 0.2% compared to a year ago. These outcomes show that higher interest rates continue to slow activity in the housing market.

United Kingdom: The Manufacturing PMI fell to a six-month low of 46.5 index points in June, down from the 47.1 points recorded in May. The PMI has signalled contraction in each of the past 11 months. All five of the subcomponent indices (output, new orders, stocks of purchases, employment, and suppliers' delivery times) were at levels consistent with weaker operating conditions. Average input costs declined for the second month running. There were reports of reduced fuel costs, commodity price decreases and improved supply chains all leading to lower costs.

United States: The Institute for Supply Management (ISM) Manufacturing PMI declined to 46 index points in June, from 46.9 in May. This was weaker than the 47.1 index points the market was expecting. The outcome pointed to the fastest rate of contraction in the manufacturing sector since May 2020, when parts of the US were in lockdown. The PMI showed that demand remains weak, production is slowing due to lack of work, and suppliers have capacity. There were also signs of more falls in employment in the near term. Price pressures eased and the supplier deliveries index increased, a sign manufacturing lead times improved.

The S&P Global Manufacturing PMI was confirmed at a six-month low of 46.3 in June, pointing to a second successive monthly decline in the health of the manufacturing sector. There was a marked contraction in new orders, which was the steepest of this calendar year so far. Firms attributed the decline to suppressed demand due to inflationary pressure and higher interest rates.

Construction spending rose by 0.9% in May, following a downwardly revised 0.4% rise in April (from the initial estimate of 1.2%). The outcome was better than the 0.6% the market was expecting. Private spending rose by 1.1%, boosted by spending on residential construction, with spending on single-family dwellings increasing by 1.7%. Spending on non-residential construction declined by 0.3%.

Today's key data and events:

AU RBA Policy Meeting (2:30pm)

Cash Rate Target exp 4.35% prev 4.10%

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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