Morning Report

Wednesday, 6 September 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,314	-0.1%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,642	-0.6%	10 yr bond	4.16		0.03		90 day BBSW	4.13	0.00
Japan Nikkei	33,037	0.3%	3 yr bond	3.82		0.02		2 year bond	3.84	0.00
China Shanghai	3,307	-0.7%	3 mth bill rate	4.13		0.00		3 year bond	3.81	0.01
German DAX	15,772	-0.3%	SPI 200	7,266.0		-18		3 year swap	4.06	0.00
UK FTSE100	7,438	-0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.14	0.04
Commodities (close & change)*			TWI	60.5	-	-	60.5	**United States**		
CRB Index	284.9	0.6	AUD/USD	0.6462	0.6465	0.6358	0.6377	3-month T Bill	5.27	-0.01
Gold	1,926.12	-16.6	AUD/JPY	94.65	94.71	93.59	94.19	2 year bond	4.96	0.08
Copper	8,453.25	-44.0	AUD/GBP	0.5117	0.5119	0.5064	0.5077	10 year bond	4.26	0.08
Oil (WTI futures)	86.69	1.1	AUD/NZD	1.0878	1.0881	1.0835	1.0839	**Other (10 year yields)**		
Coal (thermal)	166.35	6.8	AUD/EUR	0.5987	0.5988	0.5919	0.5949	Germany	2.61	0.03
Coal (coking)	272.67	1.0	AUD/CNH	4.7016	4.7038	4.6485	4.6589	Japan	0.66	0.01
Iron Ore	116.50	1.5	USD Index	104.13	104.91	104.11	104.78	UK	4.53	0.06

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 rose amid significant increases in investment grade bond sales. The US dollar also increased on the back of the higher yields. Equities were down amid growing evidence of an economic slowdown in China and the euro area, and concerns about higher oil prices fuelling inflation. Saudi Arabia and Russia announced extended supply cuts which saw the price of oil jump overnight.

Share Markets: US equities closed lower as traders return from a long holiday weekend. Concerns over the global economy and higher oil prices weighed on stocks. The S&P 500 fell 0.4%, the Dow Jones lost 0.6% and the Nasdaq made up ground in late trade to finish 0.1% lower.

The ASX 200 closed 0.1% lower yesterday. Gains in health shares were more than offset by falls in materials and financials. Six of eleven sectors finished lower. Futures are pointing to a weak open today.

Interest Rates: US treasury yields were higher across the curve. The 2-year yield finished 8 basis points higher at 4.96%. The 10-year yield also increased by 8 basis points to 4.26%.

Interest rate markets are pricing in around a 45% chance of another hike from the Fed in this cycle. Rate cuts are fully priced for the middle of 2024.

Aussie bond futures were also higher. The 3-year futures yield increased by 2 basis points to 3.82%. The 10-year futures yield gained 3 basis point to be at 4.16%.

Following yesterday's decision, cash rate futures imply around a 50% chance of another rate hike from the Reserve Bank (RBA) this cycle. A rate cut is almost fully priced for December 2024.

Foreign Exchange: The US dollar continues to outperform. Higher yields supported the dollar as well as its relative economic performance, with the US economy showing resilience amid growing headwinds in China and the euro area. The USD Index reached a high of 104.91 (highest since February), before settling at 104.78.

The AUD/USD pair broke a key support level at 0.6400 and reached a low of 0.6385 (lowest level since November), before settling below the 0.6400 level, at around 0.6377. The decline in the pair reflects the strength in the US dollar, which advanced against every G-10 currency. The pair has underperformed in part due to headwinds from China and interest rate differentials continuing to favour the US.

Commodities: Oil prices rose as Saudi Arabia and Russia extended their supply cuts to year-end. Saudi Arabia will extend its cutback of 1 million barrels a day until December, maintaining output at about 9 million barrels a day. Russia announced that its export reduction of 300k barrels a day will be extended to year end. The West Texas Intermediate (WTI) futures price is currently at USD86.69, its highest level since November.

Other commodity prices were mixed, with coal and iron ore higher, and copper and gold lower.

Australia: The Reserve Bank (RBA) Board left the cash rate unchanged at an 11-year high of 4.10% today for the third straight month.

Philip Lowe goes out in his last Board meeting as Governor with the rate-hiking job done. The RBA has now paused in 4 of its last 6 meetings, including today's meeting, providing more evidence that the cash rate may now be at its peak.

Whilst we are of the core view that the cash rate has peaked and rate cuts will start in the second half of next year, the RBA is unlikely to drop its warning around the possibility of further tightening. It cannot afford to drop the tough talk whilst inflation remains high.

The RBA's accompanying statement and its changes from the previous statement were mostly unremarkable in nature with a few key exceptions. These exceptions centred on inflation, the labour market and China.

On inflation, the tweaks to the language suggest the RBA is more convinced inflation has peaked and is declining, although it flags inflation will stay high for some time yet. The RBA still appears on alert for sticky services inflation.

On the labour market, the RBA watered down the description of the labour market from "very tight" to "tight", perhaps also an implicit suggestion that wages growth is nearing its peak.

Finally, there was the insertion of the uncertainty clouding the outlook globally coming from China and the ongoing stresses in its property market. This presents a downside risk to Australia's growth outlook and, ultimately, inflation outlook, as growth and inflation are irrevocably tied.

The value of Australia's trade balance declined to $31.4 billion in the June quarter, down from $39.4 billion in the March quarter. This was driven by a massive 7.9% fall in our terms of trade (ratio of export to import prices) – the largest since the June quarter 2009. The volume of net exports (trade adjusted for price changes) increased, which matters most for economic activity.

The volume of Australia's net exports increased by $4.5 billion in the June quarter. This was driven by a 4.3% increase in export volumes which was partly offset by a 0.7% increase in import volumes. Services exports and imports have rebounded to around 94% and 79% of pre-COVID levels, respectively.

Based on this, net exports are expected to contribute 0.8 percentage points to economic growth in the June quarter. In addition, new public demand grew by 1.3% and is expected to contribute 0.5 percentage points to GDP growth in the June quarter, once accounting for public inventories.

Putting these together, our central forecast is that the economy grew by 0.4% over the June quarter to be 1.8% higher in annual terms. Following the weaker than expected inventory outcome yesterday, there was a real risk Australia could have recorded the first negative quarter of activity since the March quarter of 2011 (excluding the COVID period). Today's trade and public spending data more than offset this risk.

While the aggregate number is likely to hold up when the ABS publishes the national accounts tomorrow, the makeup is likely to show that the household sector is doing it tough and per capita measures are likely to show considerable weakness.

China: The Caixin Service Purchasing Managers' Index (PMI) ticked fell to 51.8 index points in August, from 54.1 points in July. This was much lower than the 53.5 points the market was expecting. Growth in new orders pulled back while export sales fell for the first time since last December. On the price front, input cost inflation eased to a six-month low while cost inflation slowed to the lowest level since April.

Eurozone: The Composite PMI was revised lower to 46.7 index points in August, from a preliminary 47.0 points. This points to the biggest contraction in private sector activity since November 2020. The contraction in activity was broad-based across the manufacturing and services sectors. Notwithstanding the weakness in activity, input price inflation accelerated for the first time since September 2022.

The Services PMI was revised lower to 47.9 index points in August, from a preliminary of 48.3 points. August recorded the first decline in services activity this year. The volume of new business fell for the second consecutive month while new export business fell for the third consecutive month.

Producer (or wholesale) prices fell by 0.5% over the month of July, following a 0.4% decline over June. The outcome was in line with the fall of 0.6% the market was expecting. It was driven by lower prices for energy and other intermediate goods.

United Kingdom: The Services PMI was revised higher to 49.5 index points in August, from a preliminary of 48.7 points. Notwithstanding the revision, this outcome pointed to the first downturn in services activity since January. Lower output reflected falling sales volumes. Input price inflation was the lowest since May 2021, while prices charged rose at the slowest pace in two years.

United States: New orders for manufactured goods declined by 2.1% in July, following a 2.3% increase in June. This was better than the 2.5% fall the market was expecting. The fall was driven by a 5.2% fall in the orders for durable goods, which was mainly driven by a large fall in orders for transportation equipment.

US Fed Committee member, Christopher Waller, signalled support for a pause this month, stating “there is nothing that is saying we need to do anything imminent anytime soon… The data last week clearly showed the job market is starting to soften… If we can keep inflation coming down for the next few months, on trend at like two tenths a month, we are in pretty good condition.”

Loretta Mester, President of the Cleveland Fed, was more hawkish telling a German newspaper that more hikes may be needed, but "there's still a lot of time before our next decision."

Today’s key data and events:

AU GDP Q2 (11:30am)
q/q exp 0.4% prev 0.2%
y/y exp 1.8% prev 2.3%
EZ Ger. Factory Orders Jul prev 7.0% (4pm)
EZ Retail Sales Jul prev -0.3% (7pm)
US Trade Balance Jul exp -$67.5bn prev -$65.5bn (10:30pm)
US Markit Serv. PMI Aug Final prev 51.0 (11:45pm)
US ISM Non-Mfg Aug exp 52.3 prev 52.7 (12am)
US Fed's Beige Book (4am)

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.

Pat Bustamante, Senior Economist
Ph: +61 468 571 786

Contact Listing

Chief Economist
Besa Deda
dedab@banksa.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@banksa.com.au
+ 61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@banksa.com.au
+61 468 571 786

Economist
Jameson Coombs
jameson.coombs@banksa.com.au
+61 401 102 789