bankSA

Morning Report

Thursday, 8 June 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,118	-0.2%		Last		Overnight Chg		Australia		
US Dow Jones	33,665	0.3%	10 yr bond	3.96		0.13		90 day BBSW	4.18	0.13
Japan Nikkei	31,914	-1.8%	3 yr bond	3.83		0.13		2 year bond	3.88	0.05
China Shanghai	3,352	0.1%	3 mth bill rate	4.20		0.02		3 year bond	3.70	0.06
German DAX	15,961	-0.2%	SPI 200	7,117.0		-13		3 year swap	4.14	-0.03
UK FTSE100	7,624	0.0%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.83	0.02
Commodities (close & change)*			TWI	61.3	-	-	61.3	United States		
CRB Index	261.4	0.8	AUD/USD	0.6670	0.6717	0.6642	0.6654	3-month T Bill	5.13	0.00
Gold	1,940.02	-23.5	AUD/JPY	93.14	93.53	92.78	93.23	2 year bond	4.56	0.08
Copper	8,293.10	-43.9	AUD/GBP	0.5370	0.5385	0.5344	0.5349	10 year bond	3.80	0.14
Oil (WTI futures)	72.46	-0.1	AUD/NZD	1.0977	1.1037	1.0969	1.1020	Other (10 year yields)		
Coal (thermal)	141.85	2.8	AUD/EUR	0.6238	0.6259	0.6213	0.6219	Germany	2.46	0.08
Coal (coking)	229.00	3.0	AUD/CNH	4.7564	4.7795	4.7489	4.7558	Japan	0.43	0.00
Iron Ore	109.40	1.5	USD Index	104.13	104.30	103.66	104.11	UK	4.25	0.04

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: The unexpected rate hike from the Bank of Canada dominated sentiment overnight.

Share Markets: US share markets fell, driven by a slide in tech shares including Alphabet and Microsoft. The Nasdaq dropped 1.2% and the S&P 500 declined 0.4%, although the Dow bucked the trend to rise by 0.3% at the close.

Interest Rates: US bond yields rose after the Bank of Canada (BoC) unexpectedly resumed hiking after being on pause since January. The US 2-year yield jumped 8 basis points and the 10-year yield lifted 14 basis points. Markets have a probability of around 35% attached to a rate hike from the Fed in June and are nearly fully priced for a move by July.

Foreign Exchange: The AUD/USD rose to a 1-month high of 0.6717 overnight after the BoC hiked the cash rate. Commodity currencies – the CAD, NZD and AUD – rose against the USD in the wake of that decision, but then quickly fell away. AUD/USD fell back down towards 0.6640.

Commodities: Oil rose only a tad at the close. Data from the Energy Information Administration (EIA) showed US refiners increased processing to the highest since August 2019 in anticipation of strong summer demand.

Australia: The Reserve Bank (RBA) Governor Lowe yesterday gave a speech, which indicated that several upside risks to inflation were concerning the RBA Board. Lowe said the longer inflation stays above the target band, the greater is the risk that inflation expectations rise and the harder it will be to bring inflation back to the target.

On the minimum wage decision, which we wrote about last Friday (and subsequently flagged the strong risk of a rate hike this week), Lowe said it depends on how widespread the larger increases are. He said the economy will get in trouble if we accept that all wages have to rise by 5.75%. So he described it as a "tricky balancing" act – where we have to ensure higher inflation does not translate in higher wages for everyone at that sort of pace.

The other upside risks - aside from inflation expectations and wages growth – he called out were the trend in services inflation overseas, the impact from the weaker Australian dollar and the rise in unit labour costs.

The Governor was "hopeful" that they were still on the narrow path that involved bringing down inflation whilst keeping the economy on an even keel. He said this narrow path will be "bumpy".

National accounts data for the March quarter was released yesterday. It revealed the economy is slowing quickly. Economic activity (i.e. GDP) expanded by 0.2% over the March quarter – the smallest increase in 1½ years. In annual growth terms, GDP slowed to 2.3% in the March quarter, from 2.7% previously.

The largest contributor to growth in the quarter was new business investment, including on machinery and equipment. In fact, new business investment rose at its fastest quarterly rate in two years. Household consumption growth slowed and added only modestly to growth. The government sector added to growth, whilst the trade sector and new dwelling investment dragged on quarterly growth.

Strong population growth has supported the aggregate outcome, growing by 0.5% over the March quarter. Consumption on a per capita basis has fallen over two consecutive quarters, as elevated cost of living pressures and higher interest rates bite.

Inflation measures in the national accounts have peaked but remain elevated. Goods prices are moderating but services prices accelerated. Wage pressures have continued to rise. Total compensation of employees grew at an annual pace of 10.8% - the fastest since the September quarter 2007.

The RBA Board is particularly concerned by the growth rate in wages against a backdrop of weak productivity, which means unit labour costs (ULCs) are rising rapidly. GDP per hour worked, a measure of productivity, fell 0.3% in the quarter while growth in ULCs accelerated to 2.0% in the quarter.

Global supply chain disruptions have dissipated. We are seeing the implications through an easing in the price of capital goods and imports. Combined with an elevated pipeline of engineering construction projects, this is helping to support business investment, which was strong over the quarter.

The housing imbalance is getting worse. Dwelling investment has fallen in six of the last eight quarters at a time when population is growing at a record pace.

The economic slowdown is likely to deepen as we move through the remainder of 2023. The recent rate rises with the prospect of further tightening should weaken activity, especially household spending. A per capita recession will come sooner than an outright recession. After a fall in per capita GDP in the March quarter, a per capita recession could materialise as early as next quarter.

Canada: The BoC on unexpectedly hiked its overnight rate to a 22-year high of 4.75% due to an overheating economy and stubbornly high inflation.

The BoC had been on hold since January to assess the impact of previous hikes after raising borrowing costs eight times since March 2022 to a 15-year high of 4.50% - the fastest tightening cycle in the bank's history.

The BoC in its statement said surprisingly strong consumer spending, a rebound in demand for services, a pick-up in housing activity and a tight labour market show excess demand is more persistent than anticipated. They also noted an uptick in inflation in April and the elevated nature of the three-month measures of core inflation remained high. The BoC stated that "concerns have increased that CPI inflation could get stuck materially above the 2% target."

China: Exports fell 7.5% from a year earlier in May and imports were down 4.5%, adding to signs an economic rebound following the end of covid controls is slowing as global demand weakens under pressure from higher interest rates. China's global trade surplus narrowed by 16.1% to US$65.8 billion.

Eurozone: German industrial production increased by 0.3% month-on-month in April, from an upwardly revised fall of 2.1% in March. For the year, industrial production was up by 1.6%. Industrial production is still some 5% below its pre-pandemic level. Without any significant pick up in activity, the German economy's recession could continue in the second quarter.

Several members of the European Central Bank (ECB), including Schnabel and Knot said overnight that they had “more work to do” to contain inflation. The ECB meet next week.

United States: The trade deficit widened in April to the largest in six months as exports declined by the most since the start of the pandemic and imports picked up. The shortfall in goods and services trade grew by $14 billion to $74.6 billion. The median estimate in a Bloomberg survey of economists called for a widening to $75.8 billion.

The value of goods and services exports fell 3.6%, the most since April 2020, while imports rose 1.5% in the month.

The wider deficit suggests trade will subtract from second quarter GDP.

Please refer to the table over the page for the key data and events today.

Today's key data and events:

NZ Mfg Activity Volumes Q1 prev -4.7% (8:45am)

AU Trade Balance Apr exp $1.2bn prev $1.5bn (11:30am)

EZ GDP Q1 F exp 0.0% prev 0.1% (7pm)

US Initial Jobless Claims Jun 3 exp 235k prev 232k (10:30pm)

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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