Morning Report

Thursday, 27 July 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,402	0.8%		Last		Overnight Chg		**Australia**		
US Dow Jones	35,520	0.2%	10 yr bond	3.99		-0.02		90 day BBSW	4.35	0.00
Japan Nikkei	32,668	0.0%	3 yr bond	3.85		-0.04		2 year bond	3.95	-0.07
China Shanghai	3,379	-0.3%	3 mth bill rate	4.36		0.01		3 year bond	3.90	-0.07
German DAX	16,131	-0.5%	SPI 200	7,358.0		-1		3 year swap	4.23	-0.11
UK FTSE100	7,677	-0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.01	-0.02
Commodities (close & change)*			TWI	62.0	-	-	62.0	**United States**		
CRB Index	280.9	-1.0	AUD/USD	0.6790	0.6793	0.6731	0.6760	3-month T Bill	5.24	-0.02
Gold	1,972.07	7.1	AUD/JPY	95.71	95.73	94.43	94.78	2 year bond	4.85	-0.02
Copper	8,664.50	155.5	AUD/GBP	0.5263	0.5266	0.5213	0.5223	10 year bond	3.87	-0.02
Oil (WTI futures)	78.78	-0.8	AUD/NZD	1.0911	1.0922	1.0850	1.0886	**Other (10 year yields)**		
Coal (thermal)	160.20	-1.4	AUD/EUR	0.6143	0.6145	0.6083	0.6097	Germany	2.49	0.06
Coal (coking)	239.00	1.5	AUD/CNH	4.8472	4.8499	4.8176	4.8346	Japan	0.46	-0.01
Iron Ore	113.00	-0.2	USD Index	101.32	101.44	100.86	101.02	UK	4.28	0.01

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 US Federal Reserve increased the fed funds rate by 25 basis points, as was widely expected. This increased the rate to a range of 5.25% - 5.50% – its highest since 2001. Markets were closely watching comments from Fed Chair Powell regarding the potential path of monetary policy going forward. Powell noted that the Fed would be taking a “data dependent” and “meeting by meeting” approach in the future. It would be looking for evidence that inflation is “durably down”. He left the door open for a pause or a hike at the September meeting.

Bond yields declined following Powell’s comments, equity markets wavered and were mixed, while the US dollar sold off against major currencies.

Share Markets: Equity markets were mixed following the Fed’s decision. Equities rebounded after initially trading lower during the day. But the rebound wasn’t enough to see the S&P 500 or Nasdaq close in the green. The S&P 500 closed flat while the Nasdaq was down 0.1%. The Dow Jones continued its winning streak, lifting 0.2%. It has now extended gains to 13 consecutive days – its longest winning streak since 1987.

The ASX 200 rose 0.8% yesterday. Eight of 11 sectors closed higher, with materials, IT, consumer discretionary, and financial all closing over 1% up on the day. On the other side of the ledger, real estate, health care, and utilities were down. The market jumped 44 points immediately following the release of weaker-than-expected inflation data and closed 62 points higher. The softer inflation result contributed to a higher probability of a pause at the August meeting, supporting risk sentiment and equity valuations. Futures are pointing to a broadly flat open today.

Interest Rates: Bond yields declined following comments from Powell noting that the fed would be data dependent and that the next meeting could be a pause or a hike. The US 2-year and 10-year treasury yields both fell 2 basis points, to 4.85% and 3.87%, respectively. Interest-rate markets are attaching around a 22% probability of another hike from the Fed in September and expect the fed funds rate to peak at 5.43%. This peak rate expectation is broadly unchanged from before the meeting.

Australian interest rates fell further overnight, taking the lead from the US and extending falls following the release of weaker-than-expected inflation results yesterday, which lowered the odds of a hike from the Reserve Bank (RBA) in August. The 3-year government bond yield (futures) fell 4 basis points, to 3.85%. The 10-year government bond yield (futures) was 2 basis points lower, at 3.99%. Interest rate markets are only attaching a 13% probability of a hike at the RBA’s August meeting. This is down from 44% before the release of the data. Looking forward, markets are expecting the cash rate to peak a little below 4.30% by the end of 2023 – implying that one more 25-basis-point hike is less than fully priced.

Foreign Exchange: The US dollar lost ground against it G10 peers following the decision and comments from Chair Powell. The USD Index fell from a high of 101.44 to a low of 100.86 in the wake of the decision. It later recovered some ground, to trade at 101.02 at the time of writing.

The AUD/USD pair lost ground yesterday following the weaker-than-expected CPI result, despite a weaker US dollar. However, it recovered some losses during the overnight session. The pair initially dropped sharply following yesterday's weaker-than-expected inflation release as the odds of a hike from the RBA were pared back. Specifically, it plunged from 0.6776 to a low of 0.6731 on the release of the data. It was volatile during the overnight session, testing that low again before gaining ground following the Fed's decision. It rebounded to 0.6783 in the wake of the Fed's decision and ultimately closed at 0.6760 for the day.

Commodities: Gold and copper gained ground yesterday. Oil was weaker as it was reported that US crude oil stockpiles fell 600k barrels last week – this was less than expected. Coal priced were mixed, with thermal coal lower while coking coal rose.

Australia: The June quarter inflation report showed that inflation is declining at a quicker pace than expected. The consumer price index (CPI) rose 0.8% over June quarter to be 6.0% higher in annual terms – the annual outcome represents a fall of 1 percentage point from the last read. This was the slowest quarterly growth rate since the September quarter 2021.

The RBA's preferred measure of inflation, the trimmed mean or 'core' inflation, moderated by almost 0.75 percentage points to be 5.9% higher in annual terms.

The prices of non-tradable items, which are determined by domestic factors, moderated to increase by 1.0% over the quarter, down from the 1.7% recorded last quarter.

Significantly, the prices of market services that are closely linked to aggregate demand and labour market conditions pulled back significantly, contributing less than 0.4 percentage points to non-tradable inflation, down from 0.8 percentage points recorded last quarter. This suggests that the inflationary impulse related to domestic demand could be moderating and moderating quickly.

With the prices of domestic items still increasing more quickly than tradables, demand could shift towards imports. There could also be supply side implications with lower global prices feeding into domestic items. Both impacts could do some of the heavy lifting for the RBA.

Yesterday's outcome was always going to be a key input into the RBA's next decision. Inflation is falling. The headline and underlying reads were both lower than the RBA's own forecasts. The pullback in the prices of market services would be very pleasing. Yesterday's result increases the risk that the RBA pauses next week to assess the long and treacherous policy lags.

Eurozone: The money supply expanded by 0.6% over the year to June. This was down from a revised 1.0% expansion over the year to May and was below expectations of a 0.9% gain.

United States: The US Federal Reserve increased the fed funds rate by 25 basis points, as was widely expected. This increased the rate to a range of 5.25% - 5.50% – its highest since 2001.

There were few changes to the post meeting statement. The Fed repeated guidance about considering "the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments" regarding future decisions.

During the press conference, Powell opened the door for an extended pause or another hike, if data suggested one would be necessary. He flagged the Fed would be taking a "data dependent" and "meeting by meeting" approach. After the decision and comments, many analysts now believe that the Fed will be on a 'hawkish hold' for the foreseeable future as the aggressive tightening of monetary policy put through so far works its was through the economy and places downward pressure on inflation.

New home sales slipped 2.5% in June, to 697k, better than an expected 5.0% decline. The result was down from a gain of 6.6% in the prior month. However, the May results were revised down heavily from an initial reading of 12.2%. The significant downward revision of previous data means that the result was still worse than expected, despite the growth rate not being as weak as predicted.

Today's key data and events:

AU Trade Price Indices Q2 (11:30am)
Import Prices exp -0.8% prev -4.2%
Export Prices exp -7.2% prev 1.6%
CN Indust. Profits Jun y/y prev -12.6% (11:30am)
JP BoJ Policy Balance Rate exp -0.10% prev -0.10% (TBC)
EZ ECB Policy Decision (10:15pm)
Main Refinancing Rate exp 4.25% prev 4.00%
US Durable Goods Orders Jun Prel. exp 1.2% prev 1.8% (10:30pm)
US GDP Annualised Q2 exp 1.8% prev 2.0% (10:30pm)
US Core PCE Q2 exp 4.0% prev 4.9% (10:30pm)
US Pending Home Sales Jun exp -0.5% prev -2.7% (12am)
US Kansas City Fed Index Jul exp -10 prev -12 (1am)

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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