Morning Report

Thursday, 4 May 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,197	-1.0%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,414	-0.8%	10 yr bond	3.33		-0.08		90 day BBSW	3.87	0.19
Japan Nikkei	29,158	0.1%	3 yr bond	3.02		-0.09		2 year bond	3.22	-0.03
China Shanghai	3,484	1.1%	3 mth bill rate	3.88		-0.03		3 year bond	3.13	-0.06
German DAX	15,815	0.6%	SPI 200	7,165.0		-35		3 year swap	3.48	-0.02
UK FTSE100	7,788	0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.41	-0.04
Commodities (close & change)*			TWI	60.8	-	-	60.8	**United States**		
CRB Index	256.6	-4.1	AUD/USD	0.6664	0.6703	0.6649	0.6672	3-month T Bill	5.05	0.03
Gold	2,038.92	0.0	AUD/JPY	91.00	91.07	89.77	89.84	2 year bond	3.80	-0.16
Copper	8,456.25	-48.0	AUD/GBP	0.5344	0.5348	0.5307	0.5311	10 year bond	3.34	-0.09
Oil (WTI futures)	68.60	-3.1	AUD/NZD	1.0734	1.0735	1.0679	1.0711	**Other (10 year yields)**		
Coal (thermal)	182.30	-7.7	AUD/EUR	0.6057	0.6060	0.6027	0.6030	Germany	2.25	-0.01
Coal (coking)	240.00	3.7	AUD/CNH	4.6208	4.6301	4.6011	4.6177	Japan	0.42	0.00
Iron Ore	100.50	-0.8	USD Index	101.87	101.92	101.07	101.26	UK	3.70	0.03

Data as at 7:45am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: A 25-basis point hike from the Fed met widely held expectations, so it was the statement's guidance and Jerome Powell's remarks which drove markets. The Fed's guidance opened the door to a potential pause in its tightening cycle, though Powell stressed that future decisions would remain data dependent. The flow-on impacts from banking sector developments were a likely catalyst for the revised guidance as Powell noted that the availability of credit was tightening for households and businesses. Despite softer guidance, Powell was quick to dismiss expectations for rate cuts this year.

A potential pause was not enough to support equities which closed broadly lower, led by regional banking stocks. Treasury yields dipped, especially at the short end of the curve, while the US dollar softened.

Share Markets: US equities wavered ahead of the Fed's policy decision but ended the day broadly lower. The S&P 500 was off 0.7% while the Dow Jones and the NASDAQ closed down 0.8% and 0.5%, respectively.

The regional lender PacWest Bancorp slid 44% in late trade, following a 28% slump on Tuesday. PacWest is the latest regional bank in the spotlight after JP Morgan subsumed the First Republic Bank. Reports suggest that PacWest has been considering a potential break-up or capital raise and is open to a sale, though a formal auction has not commenced.

The ASX 200 tumbled 1.0% yesterday, continuing its slide following the Reserve Bank's (RBA) surprise rate hike. Healthcare and energy names led the declines, while futures are pointing a further fall on open this morning.

Interest Rates: US treasury yields fell across the curve as the Fed opened the door for a potential rate pause. The slide in yields was concentrated at the short end of the yield curve; the 2-year yield fell 16 basis points to a one-month low of 3.80%. The 10-year yield fell 9 basis points to a near one-month low of 3.34%.

Interest rate markets think the Fed is finished hiking rates and see the next move as a rate cut. A 25-basis point hike is fully priced by September.

The Australian 3-year (futures) yield fell 9 basis points to 3.02%, while the 10-year (futures) yield dropped 8 basis points to 3.33%.

Interest rate markets see a 28% chance of another hike from the RBA between now and August. A full 25-basis point cut isn't priced until early 2024.

Foreign Exchange: The US dollar softened alongside the downward shift in the yield curve. The DXY index fell from a high of 101.92 to a low of 101.07 before retracing some its fall to trade around 101.26 at the time of writing.

The Aussie dollar was stronger on the back of the weaker greenback. The AUD/USD pair strengthened from a low of 0.6649 to a high of 0.6703 but struggled to hold onto gains. The AUD/USD is currently trading near 0.6672 around 10 pips North of where it opened.

Commodities: Commodity prices were broadly weaker overnight. Copper, oil and iron ore were all lower, while gold was flat.

The West Texas Intermediate (WTI) futures contract closed at US$68.60 per barrel – it's first close below US$70 per barrel since late March.

Australia: Retail trade increased by 0.4% over the month of March. Only two categories recorded an increase over the month – food and cafes & takeaway food services, both directly related to the population surge. Retail turnover also increased across all states.

A growing population will continue to support higher consumption, especially spending on food and essentials. Overseas migrants are also likely to dine out and undertake tourist activities, supporting spending on cafes, restaurants & takeaway.

Outside of this, consumers have pulled back on discretionary items – over the past three months, retail trade excluding food and cafes, restaurants & takeaway has fallen by a massive 1.6%.

Over the March quarter, spending growth was flat, clearly pointing to a slowdown in spending. At the same time, consumer prices increased by 1.3% over the quarter. This suggests that after adjusting for inflation, retail trade could have declined by more than 1% in volume terms (which is what matters for GDP growth). Retail trade accounts for around 20% of aggregate demand.

The picture softens further when adjusting for population growth. Spending per working-age person declined by 0.6% over the March quarter – this fall is in line with the fall observed during the GFC. Adjusting for population and consumer prices suggests that real spending per capita fell by around 2% - this is sizeable and raises concerns about a potentially more rapid slowdown.

The underlying weakness in household spending evident in the December quarter National Accounts looks to have continued into 2023, as cost-of-living pressures and rising interest rates weigh on household income.

Eurozone: The unemployment rate edged down to a fresh record low of 6.5% in March, beating consensus expectations for the jobless rate to remain steady at 6.6%. The additional tightening in labour market conditions means risks to wages and inflation pressures are likely to sit to the upside and will support additional policy tightening from the European Central Bank (ECB). The ECB meets tonight and is widely expected to hike by 25-basis points, stepping down from 50-basis point increments. Though, markets are still pricing some chance of a larger 50-basis point increase.

New Zealand: The unemployment rate remained unchanged at 3.4% in the March quarter, beating consensus expectations for the jobless rate to tick up to 3.5%. The result was underpinned by a surprise acceleration in employment growth which jumped to 0.8% in the quarter, from 0.5% in the March quarter.

The resilience of the labour market is a further sign of more persistent price pressures, though private wages growth came in below expectations of 0.9% for the quarter, the softest increase in 12-months. This suggests that while the labour market remains resilient, wages pressures may be starting to subside.

United States: The Fed's Federal Open Market Committee (FOMC) concluded its two-day meeting this morning and hiked the federal funds rate by 25-basis points as widely expected. The latest increase takes the target range for the policy rate to 5.00%-5.25%, its highest level since mid-2007.

As has been the case at most recent meetings, the guidance in the policy statement and Jerome Powell's remarks proved just as important as the decision itself. Crucially, the statement omitted a line that the FOMC "anticipates that some additional policy firming may be appropriate". Powell noted that this was a "meaningful change" and that instead the Committee will consider various factors "in determining the extent to which additional policy firming may be appropriate". When asked if this was a signal of an imminent pause, Powell remarked that the decision will continue to be driven by the incoming data on a meeting-by-meeting basis.

While the statement makes room for a potential pause if warranted by the data, Powell was quick to push back against expectations for rate cuts this year, adding that it was not yet clear whether rates are sufficiently restrictive to bring inflation back to the Fed's 2% target.

On the banking sector, Powell noted that conditions had "broadly improved" since March but suggested that the developments were translating into tighter credit conditions for households and businesses. The full extent of this tightening remains to be seen but was a likely factor in the FOMC's decision to soften its guidance for future rate hikes.

ADP employment data surprised meaningfully to the upside in April, recording the largest monthly increase in employment since July last year. Private payrolls jumped by 296k in April, smashing expectations for a 150k increase and up from a revised 142k gain in March. The outcome will test recent commentary that we are beginning to see early signs of a softening in labour market conditions.

The ISM services purchasing managers' index (PMI) edged up to 51.9 in April from 51.2 in March, broadly meeting consensus expectations. The result indicates mild expansion in services activity, though the rate of expansion has decelerated noticeably over the start of 2023. A strong increase in the new orders sub-index suggests that demand is holding up, while the prices paid sub-index points to further stickiness in inflation as a recent down-trend looks to have stalled.

Today's key data and events:

NZ Building Permits Mar prev -9.0% (8:45am)

AU Trade Bal. Mar exp $13.6bn prev $13.9bn (11:30am)

CH Caixin Mfg PMI Apr exp 50.0 prev 50.0 (11:45am)

EZ Markit Serv. PMI Apr Final exp 56.6 prev 56.6 (6pm)

EZ PPI Mar y/y exp 6.1% prev 13.2% (7pm)

EZ ECB Policy Decision (10:15pm)

Main Refinancing Rate exp 3.75% prev 3.50%

UK Markit Serv. PMI Apr Final exp 54.9 prev 54.9 (6:30pm)

US Trade Bal. Mar exp -$63.1n prev -$70.5bn (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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