Morning Report

Tuesday, 4 April 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,223	0.6%			Last	Overnight Chg		Australia		
US Dow Jones	33,601	1.0%	10 yr bond		3.24	-0.08		90 day BBSW	3.70	-0.02
Japan Nikkei	28,188	0.5%	3 yr bond		2.87	-0.08		2 year bond	2.99	0.04
China Shanghai	3,455	0.7%	3 mth bill rate		3.64	0.00		3 year bond	2.98	0.04
German DAX	15,581	-0.3%	SPI 200		7,251.0	4		3 year swap	3.35	-0.02
UK FTSE100	7,673	0.5%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.32	0.02
Commodities (close & change)*			TWI	60.3	-	-	60.3	United States		
CRB Index	271.3	3.6	AUD/USD	0.6683	0.6790	0.6651	0.6784	3-month T Bill	4.60	-0.03
Gold	1,984.64	0.0	AUD/JPY	89.08	90.06	88.56	89.83	2 year bond	3.96	-0.06
Copper	8,994.50	-5.8	AUD/GBP	0.5420	0.5480	0.5415	0.5463	10 year bond	3.41	-0.06
Oil (WTI futures)	80.42	4.8	AUD/NZD	1.0692	1.0792	1.0689	1.0779	Other (10 year yields)		
Coal (thermal)	234.25	26.1	AUD/EUR	0.6165	0.6236	0.6159	0.6223	Germany	2.26	-0.04
Coal (coking)	302.00	-0.3	AUD/CNH	4.5936	4.6712	4.5795	4.6644	Japan	0.39	0.04
Iron Ore	120.25	-0.5	USD Index	102.69	103.06	101.98	102.06	UK	3.43	-0.06

Data as at 8:00 am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Weaker-than-expected data for the US manufacturing sector led to a fall in bond yields, as investors adjusted their expectations of future interest rate hikes. Lower interest rates helped equities, which gained on the day. The Australian dollar jumped as the US dollar weakened against a basket of major currencies. Oil prices spiked as markets reacted to OPEC+ unexpected decision to sharply cut oil production and digested the potential implications for inflation and the trajectory of central bank policy settings.

Share Markets: A fall in bond yields helped equity markets, which rose and closed higher on the day. The moves were driven by large gains in energy shares, as oil prices spiked. The S&P 500 closed 0.4% higher and the Dow Jones jumped 1.0%. The tech-heavy Nasdaq underperformed and slipped 0.3% as Tesla sank amid disappointing data suggesting that price cuts were only able to slightly increase deliveries.

The ASX 200 rose 0.6% yesterday. Futures are slightly higher, pointing to positive open today.

Interest Rates: Bond yields dropped sharply after US ISM manufacturing data showed that the sector slowed and fell further into contractionary territory in March. This suggested that the Fed may have less work to do to control inflation.

The US 2-year bond yield dropped 6 basis points, to 3.96%. This followed bond yields initially rising and hitting a high of 4.14% during the Asian session, when markets were digesting the potential inflationary implications of the surprise oil production cuts announced by OPEC+.

The 10-year bond yield followed suit, falling 6 basis points, to 3.41%, after hitting a session high of 3.54% during the Asian session.

Interest-rate markets are pricing in a 63% chance of a 25-basis-point hike at the May Fed meeting before starting to price cuts for the rest of the year. A little over 50 basis points of cuts are currently priced to the end of 2023 from the current level.

Australian markets followed the lead from the US overnight. The Australian 10-year and 3-year government bond yield (futures) both dropped 8 basis points, to 3.24% and 2.87%, respectively.

Interest-rate markets are pricing a pause at today's Reserve Bank (RBA) meeting, with only a 2% chance of a hike priced by markets. Looking further ahead, markets are attaching a 24% probability of another 25-basis-point hike in May, before they begin to price cuts later in the year. However, a full 25-basis-point cut isn't priced until 2024, with only 15 basis points of cuts (from the current 3.60% rate) priced to the end of 2023.

Foreign Exchange: The AUD/USD pair jumped as the US dollar declined in line with lower interest rate expectations. The pair traded at a low of 0.6651 during the Asian session, before jumping higher to

0.6790 during the New York session after the weaker-than-expected US manufacturing data was released. The pair then traded sideways, to close at 0.6784.

The USD Index declined against a basket of major currencies. The index dropped from a high of 103.06 during the Asian session to a low of 101.98 during the New York session, before closing at 102.06.

Commodities: Oil prices jumped sharply as markets reacted to the decision by OPEC+ to cut supply by 1.15 million barrels per day. The move led to the West Texas Intermediate (WTI) futures contracting moving higher to over USD80 per barrel for the first time since early March.

Gold was flat on the day, copper fell, and iron ore was also down.

Australia: Dwelling prices rose 0.6% in March, the first monthly increase since the start of the hiking cycle. Price increases were concentrated in Sydney (+1.4%), Melbourne (+0.6%) and Brisbane (+0.1%).

Limited advertised supply has underpinned the orderly fall in dwelling values since April and is a major driver behind the tick-up in prices recorded in March. But supply is only part of the story.

We are beginning to see signs that demand is firming. Estimates of purchasing activity rose in March, while auction clearance rates are back to average levels and the median number of days on the market looks to be plateauing.

The highest quartile of the market, particularly in Sydney, is leading the uptick in prices. The Sydney upper quartile declined the most during the downturn. Additionally, buyers in this segment are typically less constrained by interest rates and borrowing capacity.

Surging rents and low vacancy rates may be driving some spill over from renting to purchasing and long-term migrants may be skipping the rental phase simply because they are unable to find any rental accommodation. Speculation that we are nearing the end of the RBA's rate hike cycle may also be at play, giving some prospective purchasers confidence to re-enter the market.

New housing finance (ex. refinancing) slid 0.9% in February, taking the run of consecutive monthly declines to thirteen. Investor lending fell 0.5% whilst owner-occupier lending dropped 1.2%. The value of new housing credit fell to its lowest since September 2020.

However, the data shows signs of a possible turning point emerging. Indeed, the monthly fall for housing finance was smaller for the third straight month and is well off the biggest monthly fall in this cycle of nearly 7% in mid 2022.

Strong net overseas migration, rapid rises in rents and the likelihood that the Reserve Bank is near the top of its cycle or done hiking could be contributing to this shift. A recovery in lending could be in store before 2023 is out.

Refinancing activity remained robust again, rising by 3.5% for owner occupiers in the month to hit a record high. Compared with a year ago, refi is up 26.4%. The sharp lift in mortgage rates has spurred households to shop around for the best deals, including cashbacks. This trend should continue with around 880,000 loans due to expire off a fixed rate this year.

Against a backdrop of sharply higher mortgage rates, it's no surprise that more first-home buyers joined the sidelines. The share of lending to first-home buyers fell to a seven-month low of 26.3% in February, from 26.7% in January.

Building approvals increased in February following significant volatility over the holiday period. The number of approvals rose 4.0%, following a 27.1% plunge in January and a 14.3% surge in December. Looking through some of the volatility, approvals were 4.5% lower over the three months to February compared to the three months to January.

Underlying weakness is still evident, and approvals are expected to remain subdued for some time. The number of approvals in February was at its lowest level in almost 11 years (excluding January) and down over 45% from the cycle peak in March 2021.

Private sector house approvals (+11.3%) drove the monthly gain and rose for the first time in six months. This partly retraced the 13.5% drop in January. House approvals were higher across all states. However, despite the gain, the trend points to weakness. The three-month moving average remained deeply negative, falling by 10.2% over the three months to February.

Private multi-density approvals (e.g. apartments and townhouses) dropped 9.5% in the month to their lowest level in almost 11 years. Approvals for multi-density dwellings have been highly volatile, falling by 45.7% over the year to February 2023.

The monthly Melbourne Institute inflation gauge rose by 0.3% in March, down from the 0.4% pace in February. In annual terms, the measure was 5.7% in March, down from 6.3% in February. This measure provides another indication that inflation likely peaked in the December quarter of 2022.

China: Manufacturing activity slowed in March but remained at a neutral level according to the Caixin manufacturing purchasing managers' (PMI) index. The PMI slowed to 50.0 in March, signalling neither expansion nor contraction. This was down from 51.6 in February and below consensus expectations of 51.4.

The outcome was weaker than the official manufacturing PMI, released on 31 March, which slowed to 51.9 in March, from 52.6 in February. The Caixin PMI tracks smaller businesses and exporters compared to the official PMI and indicates that smaller businesses are not doing as well as their larger competitors.

The weaker-than-expected result also suggests that the China's recovery after its exit from COVID-zero policies is somewhat bumpy for the manufacturing sector, as weaker growth among key trading partners, such as the US, Europe, and Japan, impacts demand for exports.

Eurozone: The final reading of the March manufacturing PMI was finalised at 47.3, slightly higher than the flash reading of 47.1. The manufacturing sector has been in contractionary territory for nine consecutive months.

Japan: Manufacturing activity accelerated in March but remained in contractionary territory. The Jibun bank manufacturing PMI increased to 49.2 in March, from 48.6 in February. The outcome was the highest since October 2022. However, despite the increase, manufacturing activity has remained in contractionary territory for five consecutive months. Higher levels of output and new orders contributed to the rise.

United Kingdom: The March manufacturing PMI was finalised at 47.9, slightly below the preliminary reading of 48.0. The outcome confirms that the sector has remained in contraction for the eighth consecutive month as higher interest rates and a slowing economy weigh on activity.

United States: Manufacturing activity dropped further into contractionary territory as higher interest rates and slowing global growth weigh on the sector. The ISM manufacturing PMI dipped to a cycle low of 46.3 in March – its lowest level since March 2020.

The outcome extended the contraction seen in the sector to five consecutive months. It follows a reading of 47.7 in February and was well below consensus expectations of 47.5.

Weakness was broad-based as all subindices were in contractionary territory and several fell to a cycle low. Notably, prices paid (49.2 in March vs 51.3 in February) and inventories (47.5 in March vs 50.1 in February) both shifted from expansion into contraction in the month. New orders were also weaker, falling to 44.3 from 47.0.

Importantly for the Fed, the employment sub-index also slipped further, in a sign that the labour market may be slowing ahead of key payrolls data on Friday. The employment sub-index slipped to 46.9 – its lowest level since July 2020. This followed a 49.1 reading in February.

In the wake of the ISM update, the Atlanta Fed's GDPNow forecast for GDP in Q1 declined to 1.7%, from 2.5%.

Separately, the S&P manufacturing PMI was finalised at 49.2 in March, broadly in line with the preliminary reading of 49.3.

Construction spending declined 0.1% in February. This was below expectations of a flat result and followed a revised 0.4% gain in January (revised higher from an initial reading of -0.1%).

Today's key data and events:

AU RBA Board Meeting (2:30pm)

Cash Rate Target exp 3.60% prev 3.60%

EZ PPI Feb y/y exp 13.2% prev 15.0% (7pm)

US Factory Orders Feb exp -0.5% prev -1.6% (12am)

US Durable Goods Orders Feb Final exp -1.0% prev -1.0% (12am)

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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