bankSA

Morning Report

Thursday, 14 December 2023

Equities (close & % change)		
S&P/ASX 200	7,258	0.3%
US Dow Jones	37,090	1.4%
Japan Nikkei	32,926	0.3%
China Shanghai	3,113	-1.2%
German DAX	16,766	-0.2%
UK FTSE100	7,548	0.1%

Commodities (close & change)		
CRB Index	258.1	0.0
Gold	2,024.49	45.0
Copper	8,270.50	9.0
Oil (WTI futures)	69.85	1.2
Coal (thermal)	144.75	1.0
Coal (coking)	334.00	0.0
Iron Ore	134.25	0.6

Sydney Futures Exchange (last & change)	Last	Overnight Chg
10 yr bond	4.17	-0.12
3 yr bond	3.80	-0.14
3 mth bill rate	4.30	-0.06
SPI 200	7,357.0	80

FX Last 24 hrs	Open	High	Low	Current
TWI	61.3	-	-	61.3
AUD/USD	0.6559	0.6673	0.6542	0.6670
AUD/JPY	95.44	95.67	95.18	95.37
AUD/GBP	0.5219	0.5283	0.5214	0.5282
AUD/NZD	1.0700	1.0767	1.0686	1.0750
AUD/EUR	0.6076	0.6131	0.6069	0.6130
AUD/CNH	4.7181	4.7693	4.7102	4.7616
USD Index	103.80	104.03	102.78	102.89

Interest rates (close & change)		
Australia		
90 day BBSW	4.36	0.00
2 year bond	4.03	0.00
3 year bond	3.94	-0.01
3 year swap	4.10	-0.01
10 year bond	4.29	-0.04
United States		
3-month T Bill	5.22	-0.01
2 year bond	4.42	-0.31
10 year bond	4.01	-0.19
Other (10 year yields)		
Germany	2.17	-0.05
Japan	0.69	-0.03
UK	3.83	-0.14

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: Bonds prices rocketed higher (i.e. yields plummeted) as the Federal Reserve delivered the 'on hold' decision that everyone was expecting and signalled that the rate hiking cycle was over. The Fed's updated dot plot projected no more hikes and 75 basis points of cuts next year, from the current level. Changes to the statement were also interpreted as dovish.

Share traders also rejoiced on the news and shares surged higher, nearing all-time highs. The US dollar sold off against major currencies, helping the Aussie jump higher and hold near its session highs.

Share Markets: Equity markets leapt higher on the Fed decision – nearing all-time highs, as lower interest rate expectations feed into equity valuations through a lower discount rate expectation. The S&P 500 surged 1.4%, extending its recent rally to five consecutive days. The Nasdaq and Dow Jones also surged 1.4% during the session.

The ASX 200 rose 0.3% yesterday, extending its recent run of gains to a fourth consecutive day. Six of 11 sectors were higher. Health care (1.1%) was the strongest performer, followed by real estate and financials – both up more than 0.6%. Energy (-0.8%) and consumer staples (-0.6%) were the worst performers. Futures are pointing to a positive open this morning, taking the lead from US markets.

Interest Rates: Bond prices rocketed higher (i.e. bond yields plummeted) as the Fed meeting convincingly signalled the end of any potential upside risks to rates in the eyes of traders and interest-rate expectations adjusted rapidly.

The 2-year treasury yield plummeted a massive 31 basis points – its largest daily plunge since March. This took the yield to 4.42% – its lowest since June. The 10-year yield plunged by 19 basis points, to 4.01% – the lowest since August.

Interest-rate expectations adjusted materially. Markets are now pricing in 5.9 cuts in 2024 and 6.5 cuts by January 2025. This is a very large move from the 4.4 and 5.0 cuts, respectively, priced in yesterday.

Australian government bond yields (futures) broadly mimicked moves in the US. The 3-year (futures) yield dropped 14 basis points, to 3.80%. The 10-year (futures) yield was 12 basis points lower, at 4.17%. Interest-rate markets are fully pricing a cut from the RBA in November next year and 1.3 cuts in 2024. This was broadly unchanged from yesterday.

Foreign Exchange: The US dollar lost ground against major currencies as yield support diminished in line with plummeting yields. The USD Index dropped sharply from a high of 104.03 to a low of 102.78. It was trading at 102.89 at the time of writing.

The AUD/USD jumped on the day in line with a weak USD. The pair rose from a low of 0.6542 to a high of 0.6673 – convincingly breaking through the 0.6600 handle. It consolidated around the daily high and was trading at 0.6670 at the time of writing.

Commodities: A lower US dollar added support to commodity prices, which were broadly higher across the board. Oil futures rose, but the West Texas Intermediate (WTI) futures contract remained below US$70 per barrel. The gain in oil followed the Energy Information Agency (EIA) signalling that US oil inventories fell for a second consecutive week. Gold, copper, coal, and iron ore all rose.

Australia: Yesterday's 2023-24 Mid-Year Economic and Fiscal Outlook (MYEFO) forecast the budget bottom line to be $40 billion better over the four years to 2026-27. This was driven by a sizable $66.1 billion upgrade in expected receipts, partly offset by higher expenses ($21.3 billion) and new spending measures ($5.2 billion). This has lowered the peak in both net and gross debt as a share of the economy.

As we expected, the 2023-24 budget deficit was revised lower to $1.1 billion (or 0.0% of GDP), from the $13.9 billion expected back in the May Budget. We continue to expect the 2023-24 Final Budget Outcome will show a surplus of at least $11 billion when unveiled next September.

Treasury continues to expect the economy will slow over the next few years to grow below trend with the unemployment rate drifting higher to 4.5% in 2025-26. The economic outlook was broadly unchanged with some near-term strength driven by investment and public spending, partly offset by lower household spending. Importantly, Treasury continues to expect inflation to drift lower and be at 2.75% by mid-2025.

Was the MYEFO update a showcase in "responsible budget management" as the Treasurer claimed? A large share of the windfall was banked, which we have argued is the prudent approach given we are amid a temporary budget sweet spot.

However, to assess the broader question – whether fiscal policy is reducing inflationary pressures, we must look at the totality of fiscal settings not just what happened in one update. Treasury's analysis of the structural budget position suggests that the budget in 2023-24 is neutral with respect to inflation – it is neither adding nor reducing inflationary pressures.

While neutral, policy settings are impacting cohorts differently – workers are being squeezed by bracket creep, but some of this drag is being offset by targeted temporary measures, such as cost of living relief measures, and spending on infrastructure.

Japan: The Tankan large manufacturing index rose to 12 in Q4. This was up from 9 in Q3 and was above expectations of 10. The index was at its highest point since Q1 2022.

Eurozone: Industrial production fell 0.7% in October. This was below consensus expectations for a 0.3% drop and followed a 1.0% fall in the prior month. In annual terms, industrial production was 6.6% lower in the year to October. This was below expectations of a 4.6% drop and followed a 6.8% fall over the year to September.

New Zealand: The current account deficit widened to $11.5 billion in Q3. This followed a deficit of $4.7 billion in Q2 and was above expectations of an $11.0 billion deficit. The outcome was driven by a $5.9 billion decline in the goods balance, as goods exports fell by $4.5 billion while goods imports rose $1.5 billion. Added to the this, the services trade balance also declined. A small $0.1 billion increase in services exports was more than offset by a $0.6 billion rise in services imports as New Zealanders travelled overseas, leading to a 50% surge in foreign travel spending.

United States: The Federal Reserve met for the final time in 2023 and delivered a widely expected 'on hold' decision. The focus for markets wasn't the decision itself, but the message from the statement, the press conference, predictions from Fed members on the future path of rates (the 'dot plots'), and updated forecasts.

The few changes to the statement were interpreted as dovish. A key qualifier was added around the risk of any potential future hiking (emphasis added): "In determining the extent of **any** additional policy firming that may be appropriate…". Economic growth was recognised as having slowed from its recent strong pace, and the Fed acknowledged that "inflation has eased over the past year" but still asserted that it "remains elevated".

The dot plots were where much of the action happened. The updated views showed that all members of the committee expected the current 5.25%-5.50% rate to be the peak. This compares to the previous forecasts, where the majority of members expected one more hike.

The number of expected cuts for 2024 also rose. The dot plots now imply 75 basis points of cuts in 2024 from the current rate (i.e. to a 4.625% mid-point). This compares to 50 basis points of cuts from a higher rate in the previous update. In other words, members expect rates to be 50 basis points

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lower at the end of the 2024 than they did in September.

For 2025, the dots predict that rate will fall another 100 basis points, to a 3.625% mid-point. This is 25 basis points lower than the September prediction. Estimates for 2026 and the longer term were unchanged, at 2.875% and 2.50%, mid, respectively.

In his press conference, Fed Chair Jerome Powell insisted that it was “far too early to declare victory” on inflation and that a potential further tightening remained an option if inflation was sticky. However, he conceded that Fed members had started to discuss when it would be appropriate to ease rates. This contrasts with previous appearances when he pushed back on that idea and emphasised that rate cuts weren’t even being discussed at that time.

The producer price index was unchanged in November – in line with consensus expectations. This followed a 0.4% fall in October. In annual terms, producer prices rose 0.9% in October, down from a 1.2% annual rise in September and slightly below expectations of a 1.0% annual gain. Annual growth in core producer prices, excluding food and energy, was 2.0% in October, below expectations of 2.2% and down from a 2.3% reading in September.

Today’s key data and events:

NZ GDP Q3 exp 0.2% prev 0.9% (8:45am)

JP Machinery Orders Oct exp -0.4% prev 1.4% (10:50am)

AU MI Consumer Inflation Expectations Dec prev 4.9% (11am)

AU Labour Force survey Nov (11:30am)

Employment Change exp 25k prev 55.0k

Unemployment Rate exp 3.7% prev 3.7%

Participation Rate Nov exp 66.9% prev 67.0%

AU RBA Assist. Governor Jones Speech (2pm)

JP Industrial Production Oct Final prev 1.0% (3:30pm)

UK BoE Policy Decision (11pm)

Bank Rate exp 5.25% prev 5.25%

EZ ECB Policy Decision (12:15am)

Main Refinancing Rate exp 4.5% prev 4.5%

US Retail Sales Nov exp -0.1% prev -0.1% (12:30am)

US Import Price Index Nov exp -0.8% prev -0.8% (12:30am)

US Business Inventories Oct exp -0.1% prev 0.4% (2am)

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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