

Morning Report

Wednesday, 8 February 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,504	-0.5%			Last	Overnight Chg		Australia		
US Dow Jones	34,157	0.8%	10 yr bond	3.68		0.08		90 day BBSW	3.38	0.01
Japan Nikkei	27,685	0.0%	3 yr bond	3.32		0.06		2 year bond	3.23	0.15
China Shanghai	3,404	0.3%	3 mth bill rate	3.70		0.03		3 year bond	3.25	0.15
German DAX	15,321	-0.2%	SPI 200	7,463.0		32		3 year swap	3.75	0.16
UK FTSE100	7,865	0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.60	0.14
Commodities (close & change)*			TWI	61.9	-	-	61.9	United States		
CRB Index	270.8	4.6	AUD/USD	0.6885	0.6988	0.6880	0.6951	3-month T Bill	4.54	0.01
Gold	1,870.39	2.9	AUD/JPY	91.31	91.95	90.73	91.12	2 year bond	4.46	-0.01
Copper	8,902.50	54.3	AUD/GBP	0.5726	0.5784	0.5720	0.5773	10 year bond	3.67	0.03
Oil (WTI futures)	77.40	3.3	AUD/NZD	1.0924	1.1000	1.0906	1.0998	Other (10 year yields)		
Coal (thermal)	251.35	8.3	AUD/EUR	0.6417	0.6496	0.6415	0.6481	Germany	2.35	0.05
Coal (coking)	354.67	9.0	AUD/CNH	4.6844	4.7353	4.6795	4.7158	Japan	0.50	0.00
Iron Ore	118.60	-2.4	USD Index	103.60	103.96	103.00	103.37	UK	3.32	0.07

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 Reserve Bank's (RBA) policy meeting was the catalyst for large moves in domestic markets yesterday. While the decision to hike by 25 basis points was widely expected, the commentary was more hawkish than anticipated. The statement suggested at least two more hikes are on the agenda for the RBA, prompting a sharp re-pricing in market expectations for the peak in the cash rate. Across the pacific, Fed Chair Jerome Powell responded to last month's hotter-than-expected jobs report. Powell noted that further labour market resilience would shift the likely peak in interest rates higher, but reiterated that the disinflation process is underway. Markets ultimately interpreted the comments as consistent with those from the February meeting, unwinding initial sharp movements in markets.

Share Markets: US equities whipsawed on comments from Fed Chair Powell, before staging a broad rally once investors fully absorbed the remarks. The S&P 500 finished the day 1.3% higher, while the Dow Jones and the NASDAQ gained 0.8% and 1.9%, respectively.

The ASX 200 declined 0.5% yesterday after falling sharply following the RBA's policy meeting. The more aggressive tone struck by the RBA triggered a re-evaluation of the peak in interest rates, pressuring equity valuations. Futures are pointing to some strength on open this morning after gains in major US indices.

Interest Rates: US Treasury yields were mixed after gyrating on Powell's remarks. The 2-year treasury yield finished the session down 1 basis point at 4.46%, just shy of its intra-day high of 4.48% but solidly above its low of 4.38%. The 10-year yield gained 3 basis points to 3.67% as markets further considered Powell's undertaking to keep rates elevated for longer.

Interest rate markets are pricing a peak in the Fed funds rate of around 5.1% mid-way through this year.

Domestic yields spiked yesterday following the RBA's policy decision. The 3-year government bond yield jumped 15 basis points to 3.25%, while the 10-year yield climbed 14 basis points to 3.60%. Swap yields rose by a similar magnitude as investors updated expectations around the peak in the cash rate. Overnight futures yields continued to rally. The Australian 3-year futures yield climbed 6 basis points to 3.32%, while the 10-year futures yield was up 8 basis points to 3.68%.

Interest rate markets are now pricing a peak in the cash rate of above 3.9% later this year. This is up from around 3.7% before the RBA's meeting.

Currencies: A higher expected peak in the cash rate underpinned Aussie dollar strength. The AUD/USD pair spiked from around 0.6886 immediately before the RBA's decision to an intra-day high of 0.6988. The pair has since pulled back and is trading around

0.6951 at the time of writing.

The US dollar finished slightly lower against a basket of major currencies. The USD index treaded water before moving violently on Jerome Powell's remarks. The index fell from a high of 103.96 to a low of 103.00 immediately following Powell's comments, before retracing most of its losses to finish the day only marginally lower at 103.37.

Commodities: Commodity prices were broadly stronger overnight. Oil, copper and gold firmed, while iron ore bucked the trend to finish lower.

Australia: The RBA kicked off 2023 with another rate hike of 25 basis points, taking the cash rate to 3.35% – the highest since September 2012.

The tone of the statement was arguably more hawkish than December. The language was stronger around the RBA's resolve to bring inflation back to the target. In fact, the statement all but confirmed that more interest rate increases are on the horizon.

The key final paragraph included the statement: "The Board expects that further increases in interest rates will be needed over the months ahead to ensure that inflation returns to target and that this period of high inflation is only temporary".

Importantly, this referred to "further increases" and not "a further increase" or similar. This implies that there are likely to be two more hikes left in this cycle, if not more.

The RBA is getting closer to a cash rate peak, but there is still some way to go. The RBA has signalled that underlying inflationary pressures are likely to remain elevated. Further rate hikes will be required to ensure that inflation expectations remain well anchored, and that inflation is brought back towards the 2-3% target band over time.

Our view has been that the cash rate would peak at 3.85% in this cycle. Yesterday's move and accompanying changes to the statement provide further support to this view.

The trade surplus printed at \$12.2bn in December, narrowing from \$13.2bn in November. The result was in line with market expectations. Australia has now recorded five consecutive years of trade surpluses and is poised for further export strength as China's economy reopens and thaws from lengthy lockdowns.

Europe: German industrial production declined 3.1% in December after a revised 0.4% gain in November. This was considerably softer than consensus expectations which centred on a milder

decline of 0.8%. In annual terms, industrial production was 3.9% lower.

United States: In remarks overnight, Fed Chair Jerome Powell responded to last month's red-hot labour market report which was released shortly after the Fed's February policy meeting. Powell said the Fed may have to hike more than what is currently priced into markets if the labour market maintains its current strength. However, Powell reiterated that prices are expected to decline significantly this year, saying "these are the very early stages of disinflation".

The trade deficit widened to \$67.4bn in December, from a revised \$61.0bn in November. Despite growing political tensions, trade between China and the US reached a record high of \$690.6bn in 2022.

Consumer credit expanded by \$11.6bn in December, falling short of expectations for a \$25.0bn gain. This followed a revised \$33.1bn rise in consumer credit in November and was the softest monthly increase in consumer borrowing since January 2021. The softness is expected to be only temporary as a large cohort of the population turn to credit to support spending as inflationary pressures bite.

Today's key data and events:

JN Current Account Dec exp ¥112.0bn prev ¥1803.6bn
(10:50am)

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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