Morning report

Thursday, 19 January 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,393	0.1%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,297	-1.8%	10 yr bond	3.43		-0.13		90 day BBSW	3.32	0.00
Japan Nikkei	26,791	2.5%	3 yr bond	3.10		-0.09		2 year bond	3.10	-0.04
China Shanghai	3,380	0.0%	3 mth bill rate	3.50		-0.02		3 year bond	3.17	-0.04
German DAX	15,182	0.0%	SPI 200	7,314.0		-25		3 year swap	3.52	-0.13
UK FTSE100	7,831	-0.3%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.55	-0.06
Commodities (close & change)*			TWI	61.9	-	-	62.3	**United States**		
CRB Index	276.1	-1.1	AUD/USD	0.6986	0.7063	0.6936	0.6936	3-month T Bill	4.52	-0.02
Gold	1,903.89	-4.8	AUD/JPY	89.58	91.92	89.34	89.39	2 year bond	4.07	-0.13
Copper	9,329.00	43.0	AUD/GBP	0.5690	0.5706	0.5622	0.5622	10 year bond	3.37	-0.18
Oil (WTI futures)	79.24	-0.9	AUD/NZD	1.0867	1.0895	1.0787	1.0791	**Other (10 year yields)**		
Coal (thermal)	326.50	-3.5	AUD/EUR	0.6472	0.6502	0.6428	0.6429	Germany	2.02	-0.07
Coal (coking)	323.00	5.5	AUD/CNH	4.7294	4.7628	4.6960	4.6969	Japan	0.46	-0.07
Iron Ore	123.50	1.8	USD Index	102.37	102.90	101.53	102.42	UK	3.31	-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: Weak US data initially provided markets with optimism that the Fed would downshift tightening. However, this was soon overshadowed by growth and earnings concerns as comments from Fed officials supported further hikes. US equities finished lower, Treasury yields plunged across the curve and the US dollar finished broadly flat after a choppy session.

Share Markets: US share markets closed down after softer economic data raised earnings concerns and Fedspeak provided little scope for optimism on interest rates. The S&P 500 lost 1.56%, while the Dow Jones and NASDAQ fell 1.8% and 1.2%, respectively.

The Aussie share market swung between gains and losses yesterday but finished slightly higher. The ASX 200 gained 0.1%, led by healthcare and consumer staples stocks. Futures are pointing to a soft open this morning.

Interest Rates: US Treasury yields were sharply lower across the curve, as weaker economic data raised speculation that the Fed would scale back the pace of its tightening cycle. The 2-year treasury yield fell 13 basis points, the largest daily decline since mid-December, to 4.07%. The 10-year yield fell 18 basis points to 3.37%, marking the biggest one-day fall since early November. Both the 2-and-10-year yields closed at their lowest level since September.

Interest rate markets are fully pricing a 25-basis point hike from the Fed in February and are pencilling in a small risk of a larger 50-basis point move.

The Australian 3-year government bond (futures) yield fell 9 basis points to 3.10%, while the 10-year (futures) yield fell 13 basis points to 3.43%.

Interbank cash rate futures have the probability of another 25-basis point hike from the Reserve Bank (RBA) in February at around 60%.

Foreign Exchange: The Aussie dollar closed broadly lower, despite hitting a fresh 5-month high. The AUD/USD pair hit a high of 0.7063, its highest level since mid-August, before being sold off heavily in New York trade. The sell-off reflected some US dollar strength on the back of softer economic data which prompted a flight to safety and a rally in Treasuries. The Aussie dollar was trading around 0.6936 at the time of writing.

The US dollar was broadly flat after gyrating between a high of 102.90 and a low of 101.53. The DXY index is currently trading around 102.42.

The Japanese Yen swung wildly in the wake of the Bank of Japan's (BOJ) policy decision. The Yen tumbled following the decision, reaching as high as 131.58 against the Dollar. But later staged a rally to close only marginally weaker.

Commodities: Oil softened marginally to finish at US$79.24 per barrel, while gold also softened. Iron ore, copper and coking coal firmed.

The International Energy Agency (IEA) expects global oil demand to reach a record high this year on the back of a rebounding Chinese economy. However, the IEA noted that the market still faces headwinds. Supply is expected to exceed demand by around 1 million barrels per day this quarter, before tightening in the second half.

Australia: There were no major economic data releases yesterday.

Europe: December's inflation print was finalised lower at -0.4%, from -0.3% previously. Annual inflation was unchanged at 9.2%. This was the second consecutive decline in headline inflation following a peak of 10.6% in October. Core inflation was also unchanged at 5.2% over the year to December. However, core inflation is yet to roll over notching a fresh record high.

Japan: The BOJ left its monetary policy settings unchanged yesterday, prompting large swings in financial markets. The BOJ left its policy rate at -0.1% and did not alter its 0.0% yield target on the 10-year government bond. While markets were not expecting a change to these policies, there was some speculation that the BOJ would increase how far it would allow the 10-year yield to move beyond its target. Last month, the BOJ surprisingly increased this threshold from 0.25% to 0.50% and markets were positioned with caution yesterday in case of similar announcement. In the end, this did not eventuate, instead the BOJ doubled down on its yield target and suggested it would continue to purchase bonds to defend the target.

Core machinery orders tumbled 8.3% in November. This was weaker than consensus expectations for a more modest 1.0% decline and follows a 5.4% increase in orders in October. In annual terms, orders declined 3.7% compared to a 0.4% rise in October.

Industrial production in November was finalised at 0.2%, up from a preliminary reading of -0.1%. This followed consecutive monthly falls in production in September and October. Annual growth in production slowed to -0.9%, from 3.0% in October.

New Zealand: Retail card spending fell 2.5% in December, the first monthly decline since March. Retail spending remained 4.1% higher in annual terms, however, the monthly fall suggests that the rapid rise in interest rates may be starting to hit spending.

United Kingdom: The consumer price index (CPI) rose 0.4% in December, matching Novembers pace. This was marginally above consensus expectations for a 0.3% gain. In annual terms, inflation rose 10.5%, slowing from a 10.7% increase over the year to November. This was the second consecutive monthly decline in headline inflation following a peak of 11.1% in October. However, core inflation, which removes more volatile items such as food and energy, remains sticky and was unchanged at 6.3% over the year to December. Markets had expected a modest fall to 6.2%.

United States: St. Louis Fed boss, James Bullard, said that interest rates need to stay on the tighter side this year. This is at odds with market expectations for rate cuts late in 2023. Loretta Mester, head of the Cleveland Fed branch, echoed these comments and said that more hikes were needed.

Retail sales fell 1.1% in December, extending declines following a revised 1.0% fall in November. This was softer than consensus expectations which centred on a 0.9% fall. The monthly fall was the largest since December 2021, raising concerns that the economy is losing momentum.

Industrial production slipped 0.7% in December following a downwardly revised 0.6% fall in November. This was the largest monthly fall in production since September 2021 likely reflecting shrinking orders and companies preparing for lower output in the future. The result adds to an increasing flow of data flagging a softening outlook.

The producer price index (PPI), a measure of input price inflation for businesses, declined 0.5% in December. This was the largest monthly decline in the PPI since April 2020 and follows a 0.2% gain in November. Disinflation in food and energy prices play a major role. When removing these items, the PPI advanced 0.1% in the month, representing a marginal slowing on Novembers reading of 0.2%. In annual terms the PPI rose 6.2%, slowing from November's 7.3% annual pace. The read undershot expectations of a 6.8% gain. When excluding food and energy prices, the PPI gained 5.5% over the year to December, slowing from a 6.2% annual rise in November. The slow-down in producer prices has now extended for nine months and will continue to flow through to softer goods price inflation.

Business inventories gained 0.4% in November, meeting consensus expectations. This followed a revised 0.2% gain in October. The continued build-up in inventories likely reflects some early slowing in demand.

The National Association of Home Builders' (NAHB), housing market index rose to 35 in January, from 31 in December. This was the first monthly increase in 12 months. Despite the bounce, the index remains anaemic and well below its long-run average of around 50 as the Fed's aggressive tightening saps housing demand.

The Feds January Beige Book, which provides information on current economic conditions across the Fed districts, was released this morning. The survey included some encouraging signs that labour shortages were easing. But firms are still encountering difficulties in filling positions. Measures of economic growth were lukewarm. Five districts reported slight or modest increases in overall economic activity, while six noted no change or slight declines from the previous reporting period.

Today's key data and events:

AU MI Cons. Inflation Expectations Jan prev 5.2% (11am)

AU Labour Force Dec (11:30am)

Employment Change exp 30k prev 64.0k

Participation Rate exp 66.8% prev 66.8%

Unemployment Rate exp 3.4% prev 3.4%

US Total Net TIC flows Nov prev $179.9bn (8am)

US Building Permits Dec exp 1.0% orev -10.6% (12:30am)

US Housing Starts Dec exp -4.8% prev -0.5% (12:30am)

US Philad. Fed Index Jan exp -11.0 prev -13.8 (12:30am)

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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