Morning report

Friday, 20 October 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	6,982	-1.4%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,414	-0.7%	10 yr bond	4.80		0.00		90 day BBSW	4.22	0.02
Japan Nikkei	31,431	-1.9%	3 yr bond	4.25		-0.01		2 year bond	4.31	0.05
China Shanghai	3,151	-1.7%	3 mth bill rate	4.31		0.01		3 year bond	4.24	0.07
German DAX	15,045	-0.3%	SPI 200	6,941.0		-45		3 year swap	4.42	0.01
UK FTSE100	7,500	-1.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	4.78	0.13
Commodities (close & change)			TWI	60.4	-	-	60.4	**United States**		
CRB Index	287.3	1.5	AUD/USD	0.6336	0.6357	0.6296	0.6328	3-month T Bill	5.31	-0.03
Gold	1,974.04	26.5	AUD/JPY	95.00	95.17	94.32	94.79	2 year bond	5.16	-0.06
Copper	7,940.00	2.5	AUD/GBP	0.5219	0.5221	0.5188	0.5212	10 year bond	4.99	0.07
Oil (WTI futures)	90.49	2.2	AUD/NZD	1.0822	1.0845	1.0794	1.0820	**Other (10 year yields)**		
Coal (thermal)	142.00	-4.3	AUD/EUR	0.6014	0.6017	0.5974	0.5980	Germany	2.93	0.01
Coal (coking)	302.00	-22.3	AUD/CNH	4.6425	4.6595	4.6114	4.6426	Japan	0.84	0.03
Iron Ore	115.50	-1.4	USD Index	106.57	106.67	105.98	106.24	UK	4.67	0.02

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: Comments from Federal Reserve Chair Jerome Powell drove risk sentiment overnight. Chair Powell walked a fine line between suggesting that a hike in November was unlikely and maintaining a hawkish stance by emphasising the resilience of the US economy and suggesting that additional hikes may be needed in future. The Fed is continuing to proceed carefully and is remaining data dependent as it assesses the potential need for further monetary policy tightening. Higher long-term rates are also helping do some of the Fed's heavy lifting. Investors interpreted the speech as an additional sign that near-term hikes were unlikely and reduced the odds of additional tightening. The 2-year bond yield fell as a result. However, the 10-year yield rose further, almost breaching the 5% level – its highest since July 2007.

Equity markets sold off after a volatile session as higher long-term yields and the continued conflict in the Middle East weighed on sentiment and valuations. The US dollar slipped in line with Powell's comments and a fall in short-term yields.

Share Markets: Equity markets ended lower after shifting between gains and losses during the session. The S&P 500 ended down 0.8%, recording its third consecutive fall. The Nasdaq dropped 1.0% and the Dow Jones lost 0.7%.

The ASX 200 dropped 1.4% yesterday. All eleven sectors were in the red, with 8 sectors recording falls of greater than 1%. IT, consumer staples, and real estate were the worst performers. Futures are pointing to a negative open this morning, taking the lead from US markets.

Interest Rates: Long-term bond yields extended their rise overnight as the US 10-year yield jumped to within a whisker of the 5% mark following comments from Fed Chair Powell. The 10-year yield rose 7 basis points, to 4.99% – the highest since July 2007.

The 2-year yield went the other way and fell 6 basis points, to 5.16%. The moves resulted in a sharp steepening of the yield curve. Specifically, the 2-10-year bond yield spread rose to -17 basis points, from -31 basis points a day prior. This was the highest level since September 2022.

Interest-rate markets pared back expectations for further hikes from the Fed this year. Markets are attaching around a 25% probability of one more hike in 2023 and a 42% chance by January 2024. This is down from a 40% and 54% chance, respectively, a day earlier. Markets have three cuts priced by January 2025. This reflects the addition of almost one full cut following Powell's speech, as markets were pricing a little over 2 cuts by the same period a day earlier.

Australian government bond yields didn't follow the direction of US bonds. The 10-year government bond yield (futures) ended the session unchanged, at 4.80%. The 3-year futures yield fell 1 basis points, to 4.25%. Interest-rate markets are attaching around a 25% chance of a hike at the RBA's November meeting and have one more hike fully priced by the middle of next year.

Foreign Exchange: The US dollar lost ground in line with lower short-term yields and reduced chances for additional hikes. The USD Index fell from a high of 106.67 to a low of 105.98. It was trading at 106.24 at the time of writing.

The AUD/USD pair ended slightly lower despite a weaker USD. The paid ranged between a low of 0.6296 and a high of 0.6357, before closing at 0.6328 – not far from its 0.6336 open.

Commodities: Oil rose back above US$90 per barrel as the conflict in the Middle East continues to develop. Gold also gained and extended its rally since hitting a recent low of 6 October as safe-haven flows continue to support demand for gold. Copper was higher, while iron ore and coal fell.

Australia: The unemployment rate ticked down to 3.6% in September from 3.7% in August. This was driven by a 19.8k fall in the number of unemployed people. Most of these individuals left the labour force as opposed to gaining employment.

The number of people employed increased by 6.7k in September – this was below the 20k the market was expecting. Over the past three months an average of 23k people were employed – marginally below the level required to keep the unemployment rate unchanged given the strong population growth and steady participation.

Forward indicators, such as the number of applicants per job ad, have pointed to a softening in demand for a while. It appears businesses have been adjusting hours worked as opposed to the number of people employed. This makes sense given recent struggles to attract suitable staff.

At the same time, potential labour supply (or the working age population), continues to grow strongly, consistent with the strong overseas arrival numbers. We expect this dynamic to continue going forward, which will lead to an orderly softening in labour market conditions.

The Reserve Bank (RBA) would not be concerned with these numbers. The labour market remains unquestionably strong. However, it's also not getting any tighter limiting the chances of an unsustainable break-out in wages. The softening in conditions at the margins would likely reassure the RBA that it's on the narrow path to achieving a soft landing.

Israel-Hamas: Credit ratings agency Moody's downgraded Israel's credit rating to watch negative from outlook stable, while the Israeli Government is planning to provide economic support for the country. Media reports suggest that the border cross with Gaza and Egypt will open on Friday, potentially allowing civilians to escape the region.

United States: Federal Reserve Chair Jerome Powell stated that the Fed is "proceeding carefully" with rate hikes, while also maintaining a hawkish stance by noting that policy wasn't "too tight right now" based on the evidence and that further hikes are still possible. The Fed is proceeding carefully given the rapid hikes to date. He said that geopolitical risks are "highly elevated" in the current environment.

He added to recent comments from other Fed speakers that tighter financial conditions reflected in higher long-term bond yields are helping to do some of the work for them. He noted that "persistent changes in financial conditions can have implications for the path of monetary policy".

On the other hand, he also flagged the resilience of the economy and the labour market as potential indications that rates may not be high enough and may need to be increased further. Specifically, he stated that the Fed is "attentive to recent data showing the resilience of economic growth and demand for labour. Additional evidence of persistently above-trend growth, or that tightness in the labour market is no longer easing, could put further progress on inflation at risk and could warrant further tightening of monetary policy".

Existing home sales fell 2.0% in September, following a 0.7% fall in August. As a result of the drop, the number of existing home sales fell below 4 million for the first time in 13 years. However, the outcome was better than the 3.7% drop expected by consensus. Weak supply continues to impact the market, demonstrated by low inventory levels. Higher mortgage rates are also impacting buyer demand.

The Philadelphia Fed Business Outlook survey fell to -9.0 in October, up from -13.5 in September. This was below consensus expectations of -7.0. Prices paid fell in the month but remained elevated, at 23.1 against 25.7 in September. Prices received were largely unchanged, at 14.6 compared to 14.8. Shipments, new order and employment all moved from contraction to expansion in the month.

The leading index printed at -0.7% in September, down from -0.5% in August. The index has remained in negative territory since February 2022. The outcome was below expectations of -0.4%. Weak consumer expectations were the biggest drag on the index, while jobless claims were the largest positive contributor.

Today's key data and events:

NZ Trade Balance Sep prev -$2.3bn (8:45am)

JN CPI Sep y/y exp 3.0% prev 3.2% (10:30am)

UK GfK Consumer Sentiment Oct exp -20 prev -21 (10:01am)

UK Retail Sales Sep exp -0.4% prev 0.4% (5pm)

UK Public Sector Borrowing Sep exp £17.5bn prev £10.8bn (5pm)

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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