Morning report

Bank of Melbourne

Wednesday, 25 January 2023

Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,490	0.4%		Last		Overnight Chg		**Australia**		
US Dow Jones	33,734	0.3%	10 yr bond	3.40		-0.07		90 day BBSW	3.28	0.00
Japan Nikkei	27,299	1.5%	3 yr bond	3.00		-0.06		2 year bond	2.98	0.01
China Shanghai	3,422	0.8%	3 mth bill rate	3.42		-0.02		3 year bond	3.05	0.00
German DAX	15,093	-0.1%	SPI 200	7,424.0		-11		3 year swap	3.41	-0.08
UK FTSE100	7,757	-0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.46	0.01
Commodities (close & change)*			TWI	61.9	-	-	62.4	**United States**		
CRB Index	278.0	-2.3	AUD/USD	0.7026	0.7058	0.6994	0.7042	3-month T Bill	4.54	0.00
Gold	1,937.30	6.3	AUD/JPY	91.83	91.93	91.26	91.65	2 year bond	4.21	-0.02
Copper	9,347.77	28.0	AUD/GBP	0.5679	0.5731	0.5666	0.5709	10 year bond	3.46	-0.05
Oil (WTI futures)	80.17	-1.5	AUD/NZD	1.0833	1.0848	1.0803	1.0832	**Other (10 year yields)**		
Coal (thermal)	276.40	-5.1	AUD/EUR	0.6465	0.6490	0.6452	0.6472	Germany	2.16	-0.05
Coal (coking)	334.33	-1.7	AUD/CNH	4.7629	4.7876	4.7528	4.7803	Japan	0.42	0.03
Iron Ore	123.95	-1.7	USD Index	102.06	102.43	101.72	101.96	UK	3.28	-0.08

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: Risk sentiment was subdued as investors digested a raft of global economic activity indicators and earnings reports from US corporates. Activity indicators were mixed across regions but continued to indicate a challenging economic environment and elevated risks of recessions across the US and other developed economies. Mixed earnings results added to uncertainty.

US equity markets ended the day slightly lower following a mixed lead from other global markets. Bond yields declined and the US dollar closed slightly weaker against major currencies.

Share Markets: The S&P 500 ended 0.1% down on the day as mixed earning results and economic data weighed on the equity market outlook. The Nasdaq was 0.3% weaker, while the Dow Jones bucked the trend and ended up 0.3%.

The ASX 200 ended yesterday up 0.4%. Futures are pointing to a soft open today.

Interest Rates: Bond yield declined across the curve. The US 2-year treasury yield fell 2 basis points, to 4.21%. The 10-year yield was 5 basis points lower, at 3.46%.

Interest-rate markets are pricing in 26 basis points of tightening at the upcoming Fed meeting and expect the fed funds rate to peak at 4.91% in mid-2023.

Australian government bond yields mimicked moves in the US. The Australian 3-year government bond yield (futures) dropped 6 basis points, to 3.00%, while the 10-year government bond yield (futures) was 7 basis points weaker, at 3.40%.

Interest-rate markets are pricing a 50% probability of a 25-basis-point hike at the February Reserve Bank Board meeting. This is down from 60% yesterday. Markets are pricing the cash rate to peak near 3.60% toward the latter part of 2023.

Foreign Exchange: The US dollar ended the day slightly weaker against a basket of major currencies, after swinging between gains and losses. The USD Index moved between a low of 101.72 and a high of 102.43, before settling at 101.96, slightly down from the 102.06 open.

The AUD/USD pair strengthened in line with a weaker US dollar. The pair swung from a low of 0.6994 to a high of 0.7058 as the London and New York sessions overlapped, before trading sideways for the remainder of the session to close at 0.7042.

Commodities: Oil was weaker but remained above USD80 per barrel. Coal and iron ore also fell, while gold and copper strengthened on the day.

Australia: Business conditions declined for the third consecutive month in December, falling by 8 index points, to +12. This was the largest monthly decline in 15 months.

Over the December quarter, conditions almost halved, declining by more than 11 index points. But encouragingly, they remain above average.

Declining conditions reflect a slowdown in growth momentum as rapid interest-rate hikes and elevated inflationary pressures impact households and flow through to businesses. However, this has come through with a lag, as spending has been supported by a tight labour market, elevated household savings and pent-up demand.

The trading, profitability, and employment sub-indices pulled back. Leading indicators also declined in the month. Forward orders, capacity utilisation and capital expenditure intentions were down. However, all measures remained above average and in positive territory.

On the other hand, business confidence rose. Confidence increased from -4 index points in November, to -1 index points in December. Despite the slight uptick, confidence remains in pessimistic territory and is likely to remain under pressure as the economy slows in 2023.

In a positive sign for inflation, cost pressures continue to ease from their 2022 peaks. Growth in final prices and inputs, such as labour and purchase costs, were weaker in the month.

Europe: Business activity surprised to the upside in January as services activity shifted back into positive territory. The services PMI moved from 49.8 in December to a 50.7 in January (a reading above 50 indicates expansion). This was slightly better than consensus expectations, which centred on a reading of 50.1. This was the highest reading since July 2022 and followed five consecutive months of readings in contractionary territory (below 50).

Manufacturing activity remained weak in the month, albeit slightly beating consensus expectations. The manufacturing PMI came in at 48.8 in January, the seventh consecutive month of contraction. This followed a reading of 47.8 in December and was slightly higher than consensus expectations of 48.5. New orders rose to their highest reading since May 2022, although remained below 50, at 45.3.

Japan: Manufacturing activity stayed in contractionary territory in January as exports remained weak amid a continued slowdown in the global economy. The manufacturing PMI remained at 48.9 in the month. This was unchanged from December and was the third consecutive month of readings below 50.

Services activity surprised to the upside as the services PMI came in at 52.4 in January. This was above the December reading of 51.1 and was the fifth consecutive month of expansion.

The outcomes resulted in the composite PMI moving from a contractionary 49.7 in December to an expansionary 50.8 in January.

United Kingdom: Activity indicators remained weak as recession risks continued to rise. This indicates a difficult economic environment in 2023 as the region faces higher interest rates, rising inflationary pressures, weaker exports, and labour market challenges amid rising industrial disputes and challenges sourcing labour.

Manufacturing and services activity both remained under pressure and in contractionary territory. Manufacturing contracted for the sixth consecutive month, with the manufacturing PMI at 46.7 in January. On the positive side, the outcome was better than consensus expectations and above the December outcome of 45.3. New orders remained weak, despite rising from 41.4 in December to 43.8 in January.

Services activity was also downbeat, sliding from 49.9 in December to 48.0 in January. This was below consensus expectations of 49.5 and was the lowest reading since January 2021. The weak outcome extended the run of contractionary readings to five consecutive months.

United States: The Richmond Fed's manufacturing index dropped sharply in January, falling from +1 in December to -11 in January. This was below consensus expectations of -5. New orders plunged from -4 to -24 in the month, as economic activity slows amid rising rates. Businesses are also finding it hard to meet the existing orders they have, as order backlogs fell deeper into negative territory and shipments also slipped.

Activity indicators surprised slightly to the upside. However, they remained weak and in contractionary territory, continuing to signal a slowdown in economic activity and elevated risks of a recession. The manufacturing PMI came in at 46.8 in January, it's third consecutive month of contraction. This was above consensus expectations of 46.0 and was up on the 46.2 outcome in December. New orders were higher while employment slipped into contractionary territory.

The services PMI also remained in negative territory for a seventh consecutive month, at 46.6 in January. Most notably, input prices rose sharply to their highest reading since November 2022, suggesting that price pressures remain a lingering issue. While still downbeat, the reading was above consensus expectations of 45.0 and was up on the 44.7 read from December. Employment was also weak and dropped to its lowest level since October 2022.

Today's key data and events:

NZ CPI Q4 q/q exp 1.3% prev 2.2% (8:45am)
AU CPI Q4 (11:30am)
  Headline q/q exp 1.5% prev 1.8%
  Headline y/y exp 7.4% prev 7.3%
  Underlying q/q exp 1.6% prev 1.8%
  Underlying y/y exp 6.6% prev 6.1%
NZ Credit Card Spending Dec prev -2.6%(1pm)
EU GER IFO Business Climate Survey Jan exp 90.3 prev 88.6 (8pm)

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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