Morning Report

Thursday, 1 June 2023

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Equities (close & % change)			Sydney Futures Exchange (last & change)					Interest rates (close & change)		
S&P/ASX 200	7,091	-1.6%		Last		Overnight Chg		**Australia**		
US Dow Jones	32,908	-0.4%	10 yr bond	3.61		0.00		90 day BBSW	3.98	0.02
Japan Nikkei	30,888	-1.4%	3 yr bond	3.38		0.01		2 year bond	3.55	-0.04
China Shanghai	3,359	-0.6%	3 mth bill rate	4.07		0.01		3 year bond	3.37	-0.06
German DAX	15,664	-1.5%	SPI 200	7,087.0		-13		3 year swap	3.75	0.01
UK FTSE100	7,446	-1.0%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.61	-0.08
Commodities (close & change)*			TWI	60.1	-	-	60.1	**United States**		
CRB Index	253.8	-1.6	AUD/USD	0.6518	0.6538	0.6458	0.6502	3-month T Bill	5.23	-0.01
Gold	1,962.73	3.4	AUD/JPY	91.11	91.42	90.26	90.59	2 year bond	4.40	-0.05
Copper	8,111.95	-12.6	AUD/GBP	0.5250	0.5265	0.5213	0.5227	10 year bond	3.64	-0.04
Oil (WTI futures)	68.09	-1.4	AUD/NZD	1.0783	1.0829	1.0777	1.0807	**Other (10 year yields)**		
Coal (thermal)	143.30	3.8	AUD/EUR	0.6072	0.6093	0.6056	0.6084	Germany	2.28	-0.06
Coal (coking)	223.50	1.0	AUD/CNH	4.6213	4.6308	4.6048	4.6275	Japan	0.44	0.00
Iron Ore	98.90	0.5	USD Index	104.06	104.70	104.01	104.24	UK	4.18	-0.06

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: Dovish comments from multiple Federal Reserve members contributed to a fall in bond yields and pullback in expectations of another hike at the upcoming June Fed meeting. This was despite some comments to the contrary from other Fed members. Equity markets weakened, leading to the key US benchmark almost wiping out gains for the month of May. The Aussie dollar dropped to its lowest level since November 2022 in overnight trade before recovering to close slightly below where it opened.

Progress is continuing on the US debt ceiling as the House moved towards voting on the bill. This was despite opposition from various members of both the Democrats and the Republicans.

Share Markets: Risk sentiment weakened as the recent tech rally pulled back slightly and concerns around growth prospects dominated. The S&P 500 dropped 0.6% and almost erased its gains for the month of May. The tech-heavy Nasdaq was also down 0.6%, while the Dow Jones slid 0.4%.

The ASX 200 fell 1.6% yesterday. Futures are pointing to weak open today.

Interest Rates: Fed members speaking about a potential pause at the upcoming June meeting contributed to bond yield movements and a pullback in pricing for hikes at the June meeting. The US 2-year treasury yield fell 5 basis points, to 4.40%. The 10-year yield was 4 basis points lower, at 3.64%. Interest-rate markets currently attach a 32% probability to a hike at the June meeting. This is down from almost 60% only two days ago. Looking further forward, markets are pricing around an 80% probability of one more hike by the Fed by July. Cuts continue to be expected in late 2023 and beyond, with a full 25-basis-point hike priced by January 2024.

Australian government bond yields didn't follow movements in US yields overnight. The Australian 3-year government bond yield (futures) rose 1 basis point, to 3.38%. The 10-year government bond yield (futures) was unchanged at 3.61%. Interest-rate markets are attaching around a 19% probability of a hike at the upcoming June RBA meeting and are almost fully pricing another 25-basis-point hike by September. This compares with a probability of around 4% only two days ago. Market pricing shifted yesterday after the publication of stronger-than-expected monthly inflation data for April.

Foreign Exchange: The Australian dollar sold off yesterday and fell to a low of 0.6458 – its lowest level since November 2022. It later recovered some ground and rose back above the 0.6500 handle, rising to 0.6502 at the time of writing. The downward move during most of the session followed a very brief spike to 0.6538 immediately after the publication of stronger-than-expected inflation data.

The US dollar strengthened against a basket of major currencies. It ranged between a low of 104.01 to a high of 104.70, before closing around 104.24.

Commodities: Oil and copper pulled back on the day, while gold, coal and iron ore were stronger.

Australia: RBA Governor Philip Lowe appeared before the Senate Economics Legislation Committee for the Budget Estimates. The Governor reiterated points made previously regarding the challenges of getting inflation back to target if unit labour costs (ULC) were to remain elevated. ULC provide a measure of nominal wages growth accounting for productivity. The Governor noted that productivity growth has been flat overall since the pandemic began. If productivity growth remained weak, the level of nominal wages growth that would be consistent with the inflation target would be lower than in the past. This would make the job of getting inflation back to target more difficult.

The Governor also stated that the RBA was in "very much a data dependent mode" regarding the potential for future interest rates hikes, but added that "given what we're seeing internationally, I think the risks on inflation are more to the upside and we need to be attentive to that".

The monthly consumer price index (CPI) indicator rose 6.8% over the year to April, from the 6.3% in March. The Australian Bureau of Statistics (ABS) notes that a "significant contributor to the increase" was the fuel excise cut, which reduced the price of fuel in April 2022.

When adjusting for volatile items and holiday travel, the seasonally adjusted indicator shows a 6.5% increase in annual terms, down from the 6.9% recorded in March, and down from the peak of 7.3% recorded in December. The seasonally adjusted indicator rose by 0.2% over the month of April, which was the slowest monthly growth rate since July 2021.

On the other hand, the annual trimmed measure, which dampens the impact of bigger price movements, increased to 6.7% in April, from 6.5% in March.

Housing (+8.9), food and non-alcoholic beverages (+7.9%) and transport (+7.1%) continue to be the largest contributors to inflation. Prices for holiday travel and accommodation increased over April following significant falls over the March quarter. A seasonal pick-up in demand due to Easter and school holidays supported prices.

While housing inflation continues to ease from the peak recorded late last year, the composition is shifting with rents accelerating to 6.1% in annual terms, the strongest pace going back to 2017 (start of the monthly indicator). The cost of new dwelling continues to moderate. As the double-digit growth in advertised rents are passed through to the stock of rental properties, we expect rents as measured by the CPI to accelerate further.

The result makes it particularly tricky to get an underlying read given the large impact of policy, seasonality in the data and many of the services prices that drove inflation over the March quarter (e.g. medical and hospital services, education, and financial services) were not updated for April – they are either updated quarterly or once a year. The June quarter inflation report will therefore provide a clearer underlying read.

Private sector credit growth rebounded in April from a slowdown that has been evident for some time. Credit expanded 0.6%, following 0.2% growth in March (revised lower from 0.3%). In annual terms, credit expanded 6.6%, down from 6.8% in March and continuing the gradual slowdown since hitting a near 14-year high of 8.9% in September.

Business credit was the standout. Credit to businesses grew 1.1% in April. It was the fastest monthly growth since September 2022 – a 7-month high. Monthly business credit growth had slowed to a crawl of 0.2% in March after hovering between 0.5% - 0.6% since September.

Elevated capacity utilisation is continuing to provide support to business credit. Additionally, generous tax incentives are due to expire on 30 June this year. Some of the strength in April may reflect businesses seeking to take advantage of these tax incentives prior to their expiration.

The Federal Budget provided clarity on future policy settings. The Instant Asset Write Off threshold will be $20k for businesses with turnover of less than $10 million from 1 July 2023 for one year only. This compares with the current temporary unlimited threshold. These changes will encourage some businesses to bring forward investment ahead of the end of June. However, beyond this point, business credit growth is likely to slow in line with weaker economic growth.

Housing credit expanded 0.3% for the fifth consecutive month. In annual terms, housing credit grew 5.2%, down from 5.5% in March. Looking at the components, monthly investor credit growth was steady at 0.3%, while owner-occupier credit picked up to 0.4%, from 0.3% in March.

Credit measures the change in the stock, so is slow moving relative to changes in the flow. Housing market activity and prices continue to pick up. New housing finance rose in March and is expected to have risen in April. This may provide some support to housing credit in future.

Construction work done rose 1.8% in the March quarter. This was above consensus expectations of 0.5% and followed a 1.0% rise in the December quarter (revised up from an initial fall of 0.4%). In annual terms, construction work done rose 5.1% over the year to the March quarter.

The outcome reflected a 4.9% jump in public sector construction work – reflecting the elevated infrastructure pipeline, in addition to a 0.6% increase in private sector construction work. Private sector infrastructure was also strong, rising 3.8% in the quarter.

The was partly offset by a fall in building work, which declined 1.1%, driven by a 1.8% decline in private residential building work. Despite a large pipeline of work in place, construction of residential dwellings has been hampered by spikes in input costs, challenges sourcing labour, and weather-related disruptions. The sector has also faced reduced profit margins as costs rose while revenue growth was limited due to the use of fixed price contracts. These developments have contributed to a rise in insolvencies across the sector. Weak residential construction is likely to continue to contribute to housing challenges, as demand remains strong amid record population growth, while the supply response is dampened.

China: The manufacturing sector was in contractionary territory for the second consecutive month, raising further questions as to whether the post-COVID rebound is losing steam. The manufacturing purchasing managers' index (PMI) declined to 48.8 in May. This was below consensus expectations of 49.5 and down from the 49.2 outcome in April.

Services activity also slowed in May from its April pace but remained in expansionary territory. The services PMI fell to 54.5 in May, from 56.4 in April. This was below consensus expectations of 55.2. Despite slowing in the month, services activity has been in expansionary territory for five consecutive months.

The outcome raises the potential that authorities will provide additional stimulus, potentially in the form of monetary policy easing from the People's Bank of China, to support the post-COVID recovery. This is supported by inflationary pressures not being a concern at present. However, additional policy easing has not been forthcoming as yet.

Japan: Industrial production disappointed to the downside as it fell 0.4% in April. This was well below consensus expectations of a 1.4% gain and followed a 1.1% rise in March. In annual terms, industrial production slid 0.3% over the year to April, below the 2.0% gain expected by consensus. The drop was the first negative outcome for three months and suggests that the Japanese economy may have got off to a weak start in Q2. Weaker global economic growth has likely weighed on industrial production across the economy.

Separately, retail sales also declined 1.2% in April, adding to further evidence of weakness in Q2 and to downside risks for growth.

New Zealand: Business confidence improved in May, rising to -31.1, from -43.8 in April. It has now risen meaningfully from the low of -70.2 in December 2022. However, while higher in the month, the deeply negative outcome represented the 23rd consecutive month of negative readings for this measure. Business confidence continues to the be impacted by rapid rate hikes and a slowing economy. Looking at the detail, the activity outlook improved but remained in negative territory (to -4.5 in May, from -7.6 in April). Exports rose to 2.0, from -1.5. Encouragingly for the Reserve Bank of New Zealand, inflation expectations pulled back to 5.47% in May, from 5.70% in April and pricing intentions also declined, from 53.7 to 52.4.

United States: Job openings unexpectedly surged in April, increasing for the first time in 2023. The April JOLTS job openings survey reported a rise in job openings to 10.10 million. This was above the 9.75 million openings from the prior month, revised higher from an initial 9.59 million reading. The result was above consensus expectations of 9.4 million. The quite rate declined from 2.5% to 2.4%. The result provides a somewhat mixed reading but suggests that the labour market remains tight.

The manufacturing sector in the Chicago region remained in contractionary territory for the ninth consecutive month, as the Chicago PMI dropped sharply to 40.4 in May. This was well below consensus expectations of 47.3 and down from the 48.6 prior reading. The outcome was the lowest reading since November 2022. Looking at the sub-components, the drop reflected material declines in new orders, production, prices paid, and employment.

Manufacturing conditions in the Texas region also slipped further into contractionary territory and dropped to their lowest level since the depths of the pandemic in early 2020. The Dallas Fed manufacturing index dropped to -29.1 in May, down from -23.4 in April. This was well below consensus expectations, which centred on an increase to -18.0.

The Fed's Beige Book was published, providing information on current economic conditions across the 12 Federal Reserve Districts. The report recorded that "economic activity was little changed overall in April and early May". Four of the 12 districts reported a small increase in activity, two reported moderate declines, and six reported no change in conditions. Regarding the outlook for the labour market, the report noted that "employment increased in most Districts, though at a slower pace than in previous reports". Regarding inflation, it was reported that "prices rose moderately over the reporting period, though the rate of increase slowed in many Districts". Looking forward, "contacts in most Districts expected a similar pace of price increases in the coming months".

Several Federal Reserve members spoke overnight and struck a more dovish tone regarding whether the Fed would hike or pause at its upcoming June meeting. Members referred to a potential pause in June as a "skip" to emphasise that pausing in June wouldn't imply the end of the rate hiking cycle.

Philip Jefferson noted that "skipping a rate hike" would enable the Fed to gather more data on economic conditions. However, he emphasised that this didn't mean the end of the hiking cycle, stating that it "should not be interpreted to mean that we have reached the peak rate."

Patrick Harker added to the comments and stated that he was "in the camp increasingly coming into this meeting thinking that we really should skip". However, he left his options open, flagging that strong labour market data could change his mind.

On the other hand, Loretta Mester noted that she didn't "really see a compelling reason to pause." Michelle Bowman was also more hawkish, noting that certain factor, such as the housing market, could provide less help to lower inflation given house prices were beginning to rebound.

Today's key data and events:

AU Private Capital Expenditure Q1 exp 0.3% prev 2.2% (11:30am)

CH Caixin Mfg PMI May exp 49.5 prev 49.5 (11:45am)

EU Unemployment Rate Apr exp 6.5% prev 6.5% (7pm)

EU CPI May y/y exp 6.3% prev 7.0% (7pm)

UK Markit Manufacturing PMI May Final exp 46.9 prev 46.9 (6:30pm)

US ADP Employment Change May exp 170k prev 296k (10:15pm)

US Markit Manufacturing PMI May Final exp 48.5 prev 48.5 (11:45pm)

US Construction Spending Apr exp 0.2% prev 0.3% (12am)

US ISM Mfg May exp 47.0 prev 47.1 (12am)

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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