Morning Report

Wednesday, 18 May 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,113	0.3%			Last	Overnight Chg		**Australia**		
US Dow Jones	32,655	1.3%	10 yr bond		96.51	-0.06		90 day BBSW	1.02	0.02
Japan Nikkei	26,660	0.4%	3 yr bond		96.94	-0.07		2 year bond	2.59	0.03
China Shanghai	3,242	0.6%	3 mth bill rate		98.60	-0.05		3 year bond	2.87	0.04
German DAX	14,186	1.6%	SPI 200		7,181.0	70		3 year swap	3.26	-0.01
UK FTSE100	7,518	0.7%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	3.41	0.02
Commodities (close & change)*			TWI	61.8	-	-	62.5	**United States**		
CRB Index	315.4	-0.2	AUD/USD	0.6969	0.7041	0.6968	0.7029	3-month T Bill	1.02	-0.01
Gold	1,815.16	-9.0	AUD/JPY	89.98	91.17	89.80	90.94	2 year bond	2.70	0.13
Copper	9,379.50	129.0	AUD/GBP	0.5657	0.5680	0.5611	0.5627	10 year bond	2.99	0.10
Oil (WTI futures)	112.40	-1.8	AUD/NZD	1.1047	1.1081	1.1033	1.1049	**Other (10 year yields)**		
Coal (thermal)	353.70	13.7	AUD/EUR	0.6679	0.6715	0.6642	0.6662	Germany	1.05	0.11
Coal (coking)	501.50	-0.5	AUD/CNH	4.7372	4.7579	4.7174	4.7415	Japan	0.25	0.00
Iron Ore	127.80	-0.3	USD Index	104.23	104.23	103.23	103.29	UK	1.88	0.15

Data as at 7:30am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Hawkish remarks from the US Federal Reserve Chair and other Fed Presidents together with strong retailing data helped underpin a lift in US bond yields. Economic data in the UK was also solid – the unemployment rate fell to its lowest level in nearly 50 years, spurring the British pound to post its strongest one-day rally against the US dollar since October 2020.

Today, Australian markets await the release of the wage price index data, which could heavily influence the size of next month's rate hike from the Reserve Bank.

Share Markets: US share markets rose overnight and ended the trading session near their intraday highs. The S&P 500 added 81 points (or +2.0%), the Dow rose 431 points (or +1.3%) and the Nasdaq shot up 322 points (or +2.8%).

Interest Rates: The US bond yield curve flattened further overnight. The US 2-year yield rose 13 basis points, underpinned by hawkish remarks from the US Federal Reserve's Chair. The 10-year bond yield lifted 10 basis points.

Interest-rate markets are currently pricing the Fed funds rate to be 53 basis points higher at the next meeting in June and 215 basis points higher by year's end.

The Australian 3-year government bond yield (futures) rose from 3.00% and 3.05%, while the 10-year yield rose from 3.44% to 3.50%. Cash-rate futures are currently pricing the cash rate to be 43 basis points higher at the Reserve Bank's June meeting and for the cash rate to end this year close to 2.75%.

China's main bond trading platform for foreign investors stopped providing data on transactions, triggering concerns about debt-market transparency after record outflows. There's no clear indication of whether the move is temporary or related to the lockdown of Shanghai.

Foreign Exchange: The US dollar index fell overnight with the US dollar depreciating against every G-10 peer except the Japanese yen. Against this backdrop, the AUD/USD rose to an overnight high of 0.7041. The appreciation of the AUD against the greenback was modest against a weakening of many key commodity prices overnight.

A notable outperformer among the major currencies overnight was the British pound; GBP/USD posted its biggest one-day rally since October 2020, after the unemployment rate fell to its lowest level in nearly 50 years. GBP rose almost 2 US cents, rising from an overnight low of 1.2317 to an overnight high of 1.2499. Against this backdrop, AUD/GBP fell from 0.5680 to 0.5611.

Commodities: Most key commodity prices were weaker overnight.

Australia: The Reserve Bank (RBA) hiked the cash rate for the first time in more than a decade on 3 May. The minutes from were released yesterday. They provided more colour on the decision, including on a few key considerations: wages, the size of changes in the cash rate and the RBA's balance sheet.

The size of future cash rate moves remains an open question. The RBA has avoided locking itself into any particular-sized moves on a backdrop of heightened uncertainty. The Board considered lifting the cash rate by 15, 25 or 40 basis points at the May meeting.

The RBA will allow the bonds it purchased under its quantitative easing program to mature instead of reinvesting the proceeds or selling the bonds. The minutes note that selling the bonds would have a "modest" effect compared to hiking the cash rate.

The minutes reiterate that the central bank is increasingly relying on its business-liaison program for information on wages, which is timelier than the lagged wage price index that the RBA has traditionally examined. A fresh update on the wage price index for the March quarter is published today by the Australian Bureau of Statistics.

The Governor has stressed the importance of getting "back to business as usual". These remarks suggest the RBA might favour another "standard" sized move of 25 basis points next month, but stronger employment and wages data might mean the RBA has to move the cash rate by more. Employment and wages data will be critical to June's decision.

Europe: Preliminary figures revealed GDP grew 0.3% in the euro area in Q1, after 0.2% growth in Q4 of 2021. Annual GDP growth lifted 0.1 percentage points to 5.1% in Q1.

Dutch Central Bank Head, Klaas Knot, the European Central Bank (ECB) should raise its key interest rate by 25 basis points in July but should not yet rule out a bigger increase.

United Kingdom: The unemployment rate in the three months to March fell to 3.7%, from the previous result of 3.8%. It is the lowest unemployment rate in nearly 50 years. The number of job vacancies rose to a new high of 1.3 million, suggesting solid jobs growth is set to continue.

The tightening labour market is adding to wage pressures. Other data overnight showed growth in regular weekly earnings rose to 7.0% in the three months to March, up from 5.6% in the three months to February.

United States: The US Federal Reserve Chair, Jerome Powell, told the Wall Street Journal that the Fed won't hesitate to raise rates above neutral if need be and warned that tightening could bring discomfort. He further said "we're going to keep pushing" until inflation falls "in a clear and convincing way." He added "there could be some pain involved in restoring price stability", but thinks a strong labour market can be sustained even if the jobless rate goes up a few ticks. He repeated guidance calling for 50-basis-point hikes in June and July.

The Minneapolis Federal Reserve President, Neel Kashkari, said it's an open question whether the central bank will have to induce a recession to reduce inflation.

And James Bullard, the Fed President of St. Louis, called said Fed plans to continue raising the target federal funds rate by half a percentage point in coming meetings remained "a good plan" to bring inflation down, and said the Fed hoped that could be accomplished with "the least amount of disruption we can get."

Bullard also said he anticipates the US economy will likely continue to grow at an above-trend pace for at least the next 18 months, and households are likely to continue spending as the influence of the pandemic fades. Bullard indicated growth in the range of 2.5% to 3% is likely and "fast compared to the long run potential rate of growth" for the US, which may be just below 2%. Bullard's remarks appeared to downplay possible recession risks from tighter Fed monetary policy.

Retail sales rose by a solid 0.9% in April, despite headwinds from high inflation, souring consumer sentiment and rising rates. Data for March was also revised higher to show sales advancing 1.4% in the month (instead of 0.5% as previously reported).

April's increase in retail sales reflected both strong demand and higher prices. Spending was notably stronger on motor vehicles and at restaurants.

Core retail sales (i.e. sales excluding auto and gas) jumped 1.0% in April, exceeding consensus forecasts for growth of 0.7%. On a year ago, retail sales were up 8.2%.

The economy's underlying strength was underscored by other data showing production at factories accelerated in April by 1.1%. The result was well above consensus forecasts for growth of only 0.5%. Capacity utilisation also improved, from 78.2% in March to 79.0% in April – the highest since late 2018.

The National Association of Home Builders (NAHB) housing market index turned lower for the fifth straight month in May. The index dropped 8 points to 69.0 – the lowest level since June 2020, as sentiment among builders soured further. However, the diffusion index remained above 50.0, suggesting more builders still view conditions as favourable.

Today's key data and events:

JN GDP Q1 Prel. exp -0.4% prev 1.1% (9:50am)
AU WBC Leading Index Apr prev 0.35% (10:30am)
AU Wage Price Index Q1 (11:30am)
  q/q exp 0.8% prev 0.7%
  y/y exp 2.5% prev 2.3%
JN Industrial Production Mar Final prev -0.5% (2:30pm)
EZ CPI Apr y/y Final exp 7.5% prev 7.4% (7pm)
UK CPI Apr exp 2.6% prev 1.1% (4pm)
US Housing Starts Apr exp -1.9% prev 0.3% (10:30pm)
US Building Permits Apr exp -2.7% prev 0.3% (10:30pm)

Times are AEDT. 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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