Morning Report

Monday, 21 June 2021

Equities (close & % change)		
S&P/ASX 200	7,369	0.1%
US Dow Jones	33,290	-1.6%
Japan Nikkei	28,964	-0.2%
China Shanghai	3,695	0.0%
German DAX	15,448	-1.8%
UK FTSE100	7,017	-1.9%
Commodities (close & change)*		
CRB Index	205.9	1.6
Gold	1,764.16	-9.3
Copper	9,133.25	-169.0
Oil (WTI)	71.71	0.1
Coal (thermal)	123.50	-0.8
Coal (coking)	171.25	0.5
Iron Ore	207.00	0.2

Sydney Futures Exchange (close & change)	Last		Overnight Chg	
10 yr bond	98.43		0.03	
3 yr bond	99.49		-0.02	
3 mth bill rate	99.96		-0.01	
SPI 200	7,168.0		-111	
FX Last 24 hrs	**Open**	**High**	**Low**	**Current**
TWI	63.3	-	-	62.7
AUD/USD	0.7555	0.7561	0.7476	0.7491
AUD/JPY	83.29	83.38	82.43	82.53
AUD/GBP	0.5425	0.5452	0.5405	0.5424
AUD/NZD	1.0785	1.0813	1.0767	1.0788
AUD/EUR	0.6344	0.6347	0.6304	0.6311
AUD/CNH	4.8786	4.8791	4.8319	4.8384
USD Index	91.9	92.4	91.8	92.3

Interest rates (close & change)		
Australia		
90 day BBSW	0.02	0.00
2 year bond	0.06	0.04
3 year bond	0.43	0.06
3 year swap	0.47	-0.01
10 year bond	1.60	-0.05
United States		
3-month T Bill	0.03	0.00
2 year bond	0.25	0.04
10 year bond	1.44	-0.07
Other (10 year yields)		
Germany	-0.20	-0.01
Japan	0.06	0.00
UK	0.75	-0.02

Data as at 8:00am. Change from previous trading day (excluding the SFE which is the change during the night session). Source: Bloomberg.

Main Themes: Markets continued to respond to the Federal Reserve's surprise hawkish tilt last week. US stocks fell and the yield curve flattened, with the short end higher and the long end lower. The US dollar rose.

Share Markets: US stocks continued to tumble on Friday following the Federal Reserve surprise hawkishness. The Dow declined 1.6% and the S&P 500 fell 1.3%.

Interest Rates: The US yield curve flattened with markets pricing in a 50% chance of a hike by September 2022. Longer-dated US bond yields fell, with the 10-year treasury yield dropping 7 basis points to 1.44%. The 2-year yield rose 4 basis points to 0.25%.

Australian 3-year yields (futures) rose from 0.50% to 0.52%, while the 10-year futures yield declined from 1.62% to 1.58%.

Foreign Exchange: The Australian dollar continued to decline, falling from 0.7555 to 0.7491 against the US dollar, the lowest level since December. The US dollar strengthened.

Commodities: Gold and copper retreated while oil held above $71.

COVID-19: The number of infections in Sydney grew to nine yesterday and masks have become mandatory indoors in parts of Sydney.

Australia: For some time, we have been flagging the growing risk of a cash rate hike before 2024. Last week's jobs data, which was nothing short of amazing, has led us to formally alter our forecast. On Friday, we published a report that outlined our change in views; we now expect the Reserve Bank (RBA) to move before 2024.

The unemployment rate is likely to have a '4' in front this year and hit full employment in the middle of next year, which will generate wage and inflation pressures. Reports of labour shortages by businesses are only likely to get louder.

We expect the RBA to deliver its first rate hike in early 2023, followed by two more rate hikes over 2023. We expect the first rate hike will be 15 basis points in size and the other two rate hikes will be 25 basis points each, taking the cash rate to 0.75% by the end of 2023. This is the same cash rate that prevailed before the pandemic.

Our views around the RBA's yield curve control (YCC) and quantitative easing (QE) programs remain unchanged. The RBA will decide the future of these programs at its July 6 board meeting. We expect the RBA will keep its YCC target of 0.10% pegged to the April 24 bond rather than move to the November 24 bond. We also anticipate QE will be extended in the form of an open and flexible program with $5 billion in purchases per week.

Australian bond and swap yields troughed last year, as investors reassessed the economic outlook. We anticipate the upward pressure on yields to continue, as markets reprice expectations around the RBA. The YCC and QE programs will cap some of these upward pressures but not enough to cease the move higher. The upwards pressure on swap yields has implications for fixed borrowing rates, including fixed home loan rates.

We anticipate the US Federal Reserve will begin tapering its QE program in January 2022, although acknowledge that it could start tapering as soon as the December quarter of this year.

The Fed should start raising the federal funds rate in December 2022 and follow with at least two rate hikes in 2023. This suggests the Fed will move earlier than the RBA and will be moving by slightly more than the RBA over 2023, which has implications for the AUD.

The AUD/USD struggled to regain its 2021 high of 0.8007 in May when iron ore prices pierced US$230 a tonne. Market expectations that the Fed could begin pulling back policy by early next year is contributing to a rise in the USD and selling in the AUD/USD.

The AUD/USD is likely to continue to face more downward pressure before demand returns. Our forecasts for AUD/USD have been pared back to 0.8000 for the end of 2021 and 0.8400 for the end of 2022. The risks attached to these forecasts lie to the downside.

Japan: The Bank of Japan maintained its policy settings, as widely expected. The short-term policy rate and 10-year government bond yield target remained unchanged at -0.1% and 0.0%, respectively.

The central bank has decided to extend its pandemic relief program by 6 months from September 2021 to March 2022. It also announced a new back-financing program for climate change, which it aims to start by the end of the year. This move came sooner than expected, signalling tight cooperation with the government which is targeting carbon neutrality by 2050.

In other data released on Friday, Japan's consumer price index (CPI), excluding fresh food, rose 0.1% in May from a year earlier. This was the first positive result since March 2020.

United Kingdom: Retail sales fell 1.4% in May, surprising economists. Consensus was centred on a rise of 1.6% in the month. The data suggests the recovery in consumer spending could be losing steam.

United States: Federal Open Market Committee member Bullard said that he sees rate rises as coming as early as 2022 and suggested that the Fed was tilting a "little bit more hawkish".

Today's key data and events:

AU Retail Sales May exp 0.5% prev 1.1% (11:30am)
UK Rightmove House Prices Jun prev 1.8% (9:01am)
US Chicago Fed Nat Act Index May exp 0.88 prev 0.24 (10:30pm)

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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