bank SA

# Morning Report

Wednesday, 6 April 2022

| Equities (close & % change) | | | Sydney Futures Exchange (close & change) | | | | | Interest rates (close & change) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| S&P/ASX 200 | 7,528 | 0.2% | | **Last** | | **Overnight Chg** | | **Australia** | | |
| US Dow Jones | 34,641 | -0.8% | 10 yr bond | 97.02 | | -0.07 | | 90 day BBSW | 0.24 | -0.01 |
| Japan Nikkei | 27,788 | 0.2% | 3 yr bond | 97.26 | | -0.06 | | 2 year bond | 1.96 | 0.11 |
| China Shanghai | 3,441 | 0.9% | 3 mth bill rate | 99.25 | | -0.02 | | 3 year bond | 2.48 | 0.10 |
| German DAX | 14,424 | -0.6% | SPI 200 | 7,449.0 | | -48 | | 3 year swap | 2.77 | 0.21 |
| UK FTSE100 | 7,614 | 0.7% | FX Last 24 hrs | Open | High | Low | Current | 10 year bond | 2.86 | 0.02 |
| Commodities (close & change)* | | | TWI | 63.7 | - | - | 64.9 | **United States** | | |
| CRB Index | 298.2 | 0.5 | AUD/USD | 0.7490 | 0.7661 | 0.7536 | 0.7581 | 3-month T Bill | 0.61 | -0.02 |
| Gold | 1,923.60 | -9.1 | AUD/JPY | 91.87 | 94.17 | 92.28 | 93.68 | 2 year bond | 2.51 | 0.09 |
| Copper | 10,437.00 | -18.3 | AUD/GBP | 0.5716 | 0.5823 | 0.5746 | 0.5795 | 10 year bond | 2.55 | 0.15 |
| Oil (WTI futures) | 101.96 | -1.3 | AUD/NZD | 1.0835 | 1.0925 | 1.0849 | 1.0911 | **Other (10 year yields)** | | |
| Coal (thermal) | 271.35 | 25.8 | AUD/EUR | 0.6783 | 0.6981 | 0.6869 | 0.6951 | Germany | 0.61 | 0.11 |
| Coal (coking) | 424.00 | -26.0 | AUD/CNH | 4.7720 | 4.8779 | 4.8008 | 4.8360 | Japan | 0.22 | 0.01 |
| Iron Ore | 162.40 | -1.1 | USD Index | 98.63 | 99.52 | 98.84 | 99.48 | UK | 1.65 | 0.11 |

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

**Main Themes:** US Federal Reserve Governor set markets alight overnight when she suggested balance sheet reductions could start as soon as May and rate hikes might need to be more aggressive. The possibility of more sanctions against Russia was also a feature of market action overnight.

US share markets sold off and US bond yields jumped with both the US 2-year and 10-year yields at their highest since March 2019.

Locally, markets overnight continued to digest the more hawkish language contained in the Reserve Bank's board statement yesterday. Cash-rate futures now have a cash rate of around 2% priced in by the end of the year and the Aussie dollar jumped more than 1 US cent.

**Share Markets:** US share markets were sold off in the wake of Federal Reserve Governor Brainard's comments suggesting balance sheet reductions could start as soon as May and rate hikes might need to be more aggressive. The S&P 500 lost 0.8%, the Dow lost 1.3% and the tech-heavy Nasdaq was harder hit, closing down 2.3%.

**Interest Rates:** US Treasuries retreated on the hawkish tone from the Federal Reserve Governor Brainard. The sell-off in Treasuries sent the US 2-year yield up 9 basis points to 2.51%. The US 10-year yield jumped the most in one month – of 15 basis points - to 2.55%. Both yields are at their highest since March 2019. The US 2-10-year yield curve steepened slightly to +4 basis points at the close. Interest-rate markets continue to almost filly price in a 50 basis point rate hike from the Fed when they meet next month.

The Australian 3-year government bond futures yield rose from 2.54% ahead of the Reserve Bank statement to a high of 2.75%. Meanwhile, the US10-year bond yield rose from 2.86% to 3.00%. Interest-rate markets fully price a rate hike to 0.25% by the June meeting and have a cash rate now of around 2% by end year.

**Foreign Exchange:** The AUD jumped more than 1 US cent in the wake of the Reserve Bank's hawkish statement yesterday. AUD/USD rose from around 0.7535 just before the statement to an overnight high of 0.7661. The sharp gains in the AUD/USD in a short space of time led to a modest pullback to 0.7580 in the New York trading session.

In this report yesterday, we flagged we expected the AUD/USD to rise above 0.7600 in the very short term after the AUD/USD had just cleared a key resistance level of 0.7550. The speed in which the AUD/USD pierced the next resistance level at 0.7610 (representing the 61.8% Fibonacci retracement of the AUD's fall from its February 2021 peak of 0.8007 to its 2022 low of 0.6968 in January) gives us a more convincing signs that the AUD/USD rally has resumed.

We expect 0.7750 in the short term, although there is a risk of a period of consolidation before the AUD/USD stretches towards 0.7750. In the space of just three weeks, the AUD has appreciated by over 4 US cents – the last time the AUD rose this fast over a three week period was in June 2020.

The NZD followed the AUD higher, moving to an overnight high of 0.7034 against the USD - the highest since 19 November 2021. However, the AUD had a sharper rally against the USD, sending AUD/NZD to a 1-year high of 1.0925.

**Commodities:** Commodity prices retreated, including oil and gold, after solid gains in the previous trading session.

**Australia:** The cash rate was left on hold at 0.10% as widely expected. However, the Reserve Bank (RBA) made several critical changes to the statement which point to a rate hike in the coming months.

The changes in tone suggest the RBA is sowing the seeds for a rate hike in coming months, and possibly as soon as June. Our house view remains August, but the odds of a rate hike as soon as June have shortened significantly, making June a close call.

The last paragraph is always the most important of the statement and in the last paragraph there were four key changes. It is the last paragraph where the most critical changes were made.

First, the word “patient” was dropped. Previously, the RBA repeatedly pledged patience around raising rates. It especially wanted further evidence of a pick-up in wages growth to be assured inflation would be sustained in its 2-3% per annum target band. Additionally, the RBA no longer stated that it is “too early to conclude” that inflation is sustainably within the band. Instead, it said that inflation has picked up and that a further increase is expected.

Second, the RBA dropped the sentence “there are uncertainties about how persistent the pick-up in inflation will be”, suggesting perhaps it’s more convinced about the upward trajectory of inflation.

Third, the three new words “over coming months” sends an important signal around the possible timing of the first rate hike in this cycle. The RBA underscored that “over coming months, important additional evidence will be available to the Board on both inflation and the evolution of labour costs… the Board will assess this and other incoming information as it sets policy…” These new sentences are a nod to the fact that a rate hike is coming soon – it will only be a matter of months – but the RBA still wants to see more data. We anticipate the RBA wants to see another consumer prices report (April 27) and wage price index (WPI) report (May 18).

Finally, the RBA dropped the reference to being “committed to maintaining highly supportive monetary conditions”, further indicating that a change in these highly accommodative settings is on the horizon.

**Europe:** The final services purchasing managers’ index (PMI) for the eurozone firmed to 55.6 in March, from the flash estimate of 54.8 and the previous month’s result of 55.5.

**Ukraine and Russia**: The US, European Union (EU) and Group of 7 nations are speculated to announce a new round of penalties later today, including a ban on all new investments in the country. The EU has also proposed prohibiting imports of Russian coal and the US may tighten sanctions on Russia's largest banks by freezing their assets abroad.

**United Kingdom:** The final result for the services PMI was stronger at 62.6 in March compared with 61.0 for the flash estimate and 60.5 in the previous month. Price concerns continued to dominate.

**United States:** Federal Reserve Governor Lael Brainard said the central bank could start reducing its balance sheet as soon as May and would be doing so at “a rapid pace.” She also indicated that interest rate hikes could come at a more aggressive pace than the typical increments of 0.25 percentage points. And called reducing inflation pressures “paramount”.

Kansas’s Federal Reserve President Esther George said a hike of 50 basis points "is going to be an option that we'll have to consider."

The US trade deficit held close to a record in February, as the merchandise shortfall shrank and the surplus in services declined, partly reflecting the impact of broadcast rights for the Olympics. The February gap in goods and services trade was little changed at $89.2 billion after a record shortfall in January. The value of imports of goods and services rose 1.3% in February to a record high of $317.8 billion. Exports climbed 1.8% to $228.6 billion.

The US services sector expansion broadened in March, a sign the domestic economy remained on a solid footing. The ISM services index increased 1.8 points to 58.3 in March. The consensus estimate was 58.5. Demand-side indicators improved, with growth broadening for new orders (up 4.0 points) and business activity (up 0.4 points). The breadth of gains was also wide, with 17 of 18 services industries reporting growth.

However, businesses continue to experience capacity constraints, although some reported labour shortages easing. The employment component rose 5.5 points to 54.0 (from a contraction of 48.5 prior).

Commentary pointed to fresh disruptions due to geopolitical events, with grain and fertiliser prices near all-time highs.

**Today's key data and events:**

CH Caixin Services PMI Mar exp 49.7 prev 50.2 (11:45am)

EZ Ger. Factory Orders Feb exp -0.2% prev 1.8% (4pm)

EZ PPI Feb y/y exp 31.7% prev 30.6% (7pm)

US FOMC Meeting Minutes Mar 16 (4am)

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.

**Besa Deda, Chief Economist**

Ph: 0404 844 817

## Contact Listing

**Chief Economist**
Besa Deda
dedab@banksa.com.au
(02) 8254 3251

**Economist**
Matthew Bunny
matthew.bunny@banksa.com.au
(02) 8254 0023

**Senior Economist**
Jarek Kowcza
jarek.kowcza@banksa.com.au
0481 476 436

**Associate Economist**
Jameson Coombs
jameson.coombs@banksa.com.au
0401 102 789