4 February 2025

MORNING REPORT

Today's economic developments and market movements.

Key themes

Focus in financial markets remained firmly on the implications of the new US import tariffs.

The risk-off sentiment hit major equity markets. USD rallied, and other major currencies took a beating as a result.

Overnight reports of the delay of the tariffs against Mexico brought some relief to financial markets helping to pare earlier loses.

While US short-term Treasuries sold-off on inflation concerns, other major government bonds rallied on the back of the risk-off sentiment.

Data snapshot

FX Last 24 hrs	Current	Change
TWI	58.9	-1.2%
AUD/USD	0.6185	-0.5%
AUD/JPY	95.69	-0.7%
AUD/GBP	0.4987	-0.5%
AUD/NZD	1.1055	0.3%
AUD/EUR	0.6007	0.2%
AUD/CNH	4.5243	-0.5%
AUD/SGD	0.8421	-0.1%
AUD/HKD	4.8195	-0.4%
AUD/CAD	0.9010	-0.2%
EUR/USD	1.0296	-0.6%
USD/JPY	154.72	-0.3%
USD Index	108.88	0.5%

AUS Interest Rate Swaps	Last	Change
30 day BBSY	4.29	-0.03
90 day BBSY	4.28	-0.01
180 day BBSY	4.37	0.01
1 year swap	3.88	-0.01
2 year swap	3.75	-0.01
3 year swap	3.72	-0.03
4 year swap	3.77	-0.03
5 year swap	3.84	-0.03
6 year swap	3.92	-0.02
7 year swap	4.00	-0.02
8 year swap	4.08	-0.02
9 year swap	4.16	-0.02
10 year swap	4.37	-0.01

Equities	Close	Change
S&P/ASX 200	8,379	-1.8%
S&P 500	6,003	-0.6%
Japan Nikkei	38,520	-2.7%
Hang Seng	20,217	0.0%
Euro Stoxx 50	5,218	-1.3%
UK FTSE100	8,584	-1.0%
VIX Index	18.32	11.5%

Government Bond Yields	Close	Change
Australia		
3 year bond	3.75	-0.07
10 year bond	4.38	-0.05
United States		
3-month T Bill	4.19	0.00
2 year bond	4.25	0.05
10 year bond	4.53	-0.01
Other (10 year yields)		
Germany	2.39	-0.08
Japan	1.25	0.01
UK	4.49	-0.05

Commodities	Current	Change
CRB Index	308.91	1.3%
Gold	2817.02	0.7%
Copper	8953.73	-0.9%
Oil (WTI futures)	72.86	0.5%
Coal (coking)	190.00	0.5%
Coal (thermal)	118.80	-2.5%
Iron Ore	104.20	-1.3%
ACCU	35.38	-4.4%

Sydney Futures Exchange	Current	Change
10 yr bond	4.43	0.02
3 yr bond	3.76	0.02
3 mth bill rate	4.19	0.03
SPI 200	8,402	0.7%

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

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Share markets:

In yesterday's trading session the focus in domestic and Asian equity markets was firmly on the negative implications from the US tariffs announced against Canada, Mexico and China. The ASX200 was down 1.8%, while Nikkei in Japan lost 2.7%. European markets opened with similar sentiment positing significant losses. But news headlines about the delay of the tariffs against Mexico brought some fresh optimism that the worst scenarios can be avoided. Having plummeted to the low of 5924 earlier in the day, the S&P500 index in the US rose 1.4% from the trough to finish the day only about 0.6% lower. Losses in European markets, which had less time to absorb the latest developments before closing, were more significant, with the Eurostoxx50 and FTSE100 closing respectively 1.3% and 1.0% in red.

Interest rates:

In the bond markets, the US Treasury yield at the short end of the curve rose reflecting concerns about the inflationary nature of the protectionist trade policies for the US economy. However, at the long end of the curve, yields were little changed as it remained unclear how long-lasting the tariffs might be and how they might affect growth longer term. The 10Y UST Treasury was down 1bp to 4.53%. Meanwhile, the Australian government bond market rallied, with yields 3-7bp lower across the curve. Bond futures a pointing to somewhat higher yields at the open today. European government bond yields were similarly lower yesterday, with the 10Y Gilt yield down 5 basis point to 4.49%.

Foreign exchange:

In FX markets, USD movements closely followed the US trade policy announcements, with the USD index rising sharply from last week's close of 108.5 almost reaching 110. But developments later on saw it reversing some of the gains to settle 0.5% higher on the day. Other major currencies followed a reverse pattern. AUD depreciated trading below 0.61 in the early afternoon yesterday. But since then, it bounced back up towards the 0.62 mark. Similarly, EUR traded close to 1.02 levels before recovering to around 1.03 to lose 0.6% in the day. With the European Union widely expected to be the next target in the US trade war, EUR might be more susceptible to the tariff news.

Commodities:

Crude oil markets whipsawed around recent levels. The March WTI contract had opened up 3.6% in Asian trade but by late trading in New York was briefly down on the day before a modest bounce into the close to be up 0.5%. In the midst of all this volatility, the OPEC held a virtual meeting where it kept plans to start increasing oil production from April through late 2026 and made no mention of President Trump's call to bring down prices.

Today's key data and events

Time	Event	Exp	Prev
8:45am	NZ Building Permits Dec	-	5.3%
2:00am	US Jolts Job Openings Dec	8000k	8098k
2:00am	US Factory Orders Dec	-0.70%	-0.40%
2:00am	US Durable Goods Orders Dec Final	-2.20%	-2.20%
8:45am	NZ Unemployment Rate Q4	5.1%	4.8%

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.

Metals bounced back from earlier losses as it became more obvious that US President Trump was willing to negotiate tariff increases with Mexico and Canada. Iron ore prices weakened again with the prospect of US tariffs on steel and a trade war with China hitting prices in thin holiday trade.

Australia:

Yesterday's retail sales figures reported a 0.1%mth decline in December, down from a robust 0.7%mth increase in the prior month. Shifting seasonal spending patterns between these two months and strong base effects from a year ago helped to lift annual growth from 3.1%yr to 4.6%yr. Looking at the breakdown, retail spending was weak across the board, with food and non-food categories reporting negative growth. Adjusted for prices increases (they rose 0.4%qtr), in December quarter retail sales were up 1% in real terms, which represented the steepest increase since Q1 2022. Population growth continued to provide a tailwind, but on the per capita basis real retail spending rose for the first time in over two years.

Meanwhile, dwelling approvals rose 0.7% in December partially offsetting November's 3.4% drop. The end of the year usually brings some monthly volatility to this series, and looking at the December quarter as a whole, approvals were up 4.5%, with private units driving growth, and private houses falling almost 5% over that period.

The CoreLogic home value index was down for a fourth consecutive month in January, reporting -0.2%mth growth, unchanged from December. This meant that the annual pace of growth extended the downward trend dropping below 4%yr. Preliminary estimates for market turnover suggested that market activity was down 9-10% in December quarter. The CoreLogic data was consistent with the trend seen late last year, and, going forward, reopening of the auction markets over the next three weeks alongside new estimates of consumer confidence should provide new insights into how conditions in the housing markets are likely to evolve this year.

China:

A week ago China's official manufacturing PMI surprised on the downside reporting that business sentiment worsened at the start of the year. Yesterday's release of Caixin manufacturing PMI survey carried a similar message, with the headline PMI index falling for a second consecutive month, to just 50.1. The surveys suggest that the Chinese manufacturing sector was struggling to gain more momentum, despite the various support measures announced by Chinese authorities last year. With the US having imposed news tariffs on key trading partners, including the 10% tariff increase on Chinese exports to the US, sentiment among Chinese export-focused manufacturers will probably sour further in the coming months.months.

Euro area:

The euro area HICP inflation surprised on the upside in January, with the headline rate rising to 2.5%yr. An increase in in energy price inflation from virtually zero to 1.8%yr was the principal driver, partly reflecting an increase in regulated energy prices in Italy. Meanwhile, core inflation did not show any progress remaining stuck at 2.7%yr for a fifth month in a row. Services inflation was stubbornly high – it eased only 0.1ppt to 3.9%yr recording fifteen month in a tight range around the 4% level. Looking ahead, weak consumer spending and favourable base effects should start pushing services inflation lower in the coming months, which should support moderation in the headline and core inflation rates.

Despite a 1.5pts increase in the headline sentiment index to 46.6 at the start of the year, the euro area manufacturing PMI remained consistent with ongoing contraction in the sector, the final survey release for January confirmed. Among key member states, German and French manufacturing PMI indices were reported at disappointing 45.0, while Italian PMI was only slightly more positive, at 46.3. Only Spain had its PMI index in the expansionary territory, but at 50.9, it represented the weakest sentiment in twelve months. Given that major European economies are likely to be the next target in the US trade war, European manufacturers have plenty to worry about. Against this backdrop, euro area manufacturing business sentiment and the actual output growth in this sector seem unlikely to show any meaningful improvement in the near-term.

United States:

US President Donald Trump agreed to delay the 25% import tariffs against Mexico. He announced this decision after a conversation with Mexico President Claudia Sheinbaum, where she reportedly agreed to send 10,000 officers to the US-Mexico border to help to stop the flows of illegal migration and fentanyl into the US. The two presidents also agreed to continue talks over the coming month. The situation illustrated that the US President is using tariffs as a negotiation tool, but it remains to be seen if actions at the border agreed so far will be sufficient to eliminate or at least reduce the tariffs against Mexico. In any case, the precedent will be followed closely by other countries on Trump's radar for import tariffs.

The US ISM Manufacturing PMI survey signalled a recovery in business sentiment at the start of the year. The headline index rose 1.7pts to 50.9 marking a return to the expansionary territory for the first time since October 2022. The improvement was seen across key subcomponents: the employment index jumped almost 5pts to 50.3, while new orders were up 3pts to 55.1. And the survey suggested that manufacturers' inventories fell again, implying that firms having to work hard to keep up with the firm demand.

Atlanta Fed President Raphael Bostic indicated that he would like to keep the monetary policy settings unchanged for some time to assess the impact of the 100 basis point cuts of policy easing the FOMC has already done. Comments from his colleague from the Boston Fed, Susan Collins, suggested that policy makers are likely to look through the tariff-driven increases in consumer prices, as long as inflation expectations remain stable.

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