Morning report

Bank of Melbourne

Thursday, 4 November 2021

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,393	0.9%		Last		Overnight Chg		Australia		
US Dow Jones	36,158	0.3%	10 yr bond	98.15		0.03		90 day BBSW	0.05	-0.01
Japan Nikkei	29,521	-0.4%	3 yr bond	98.91		0.00		2 year bond	0.65	-0.07
China Shanghai	3,667	-0.2%	3 mth bill rate	99.91		-0.01		3 year bond	0.92	-0.02
German DAX	15,960	0.0%	SPI 200	7,400.0		37		3 year swap	1.17	0.00
UK FTSE100	7,249	-0.4%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	1.85	-0.04
Commodities (close & change)*			TWI	62.8	-	-	62.3	United States		
CRB Index	235.8	-17.5	AUD/USD	0.7429	0.7459	0.7412	0.7449	3-month T Bill	0.04	-0.01
Gold	1,770.29	-17.5	AUD/JPY	84.67	84.99	84.50	84.94	2 year bond	0.47	0.02
Copper	9,646.50	-99.0	AUD/GBP	0.5458	0.5473	0.5427	0.5443	10 year bond	1.60	0.05
Oil (WTI)	80.86	-3.1	AUD/NZD	1.0448	1.0458	1.0391	1.0399	Other (10 year yields)		
Coal (thermal)	145.40	19.3	AUD/EUR	0.6416	0.6433	0.6401	0.6417	Germany	-0.17	0.00
Coal (coking)	371.67	0.2	AUD/CNH	4.7572	4.7678	4.7470	4.7640	Japan	0.08	0.00
Iron Ore	95.50	-1.9	USD Index	94.1	94.2	93.8	93.9	UK	1.08	0.04

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

Main Themes: The Federal Reserve announced that it would start tapering its bond-buying program this month by $15 billion. It was a widely expected decision. The accompanying statement and press conference remarks from the Fed Chair led equities higher, bond yields higher and a sell off in the US dollar. There was little guidance on when rate hikes would start but markets are betting on September 2022. US economic data published overnight printed above consensus expectations, including ADP jobs data.

Share Markets: US share markets rose to record highs after the Fed announced tapering of its bond-buying program. The decision was widely anticipated. The Fed did not suggest they were in a hurry to start raising rates, supporting investor demand for equities.

The Dow rose 105 points (+0.3%), the S&P 30 points (or +0.7%) and the Nasdaq 162 points (or +1.0%). All three indexes hit all-time highs for a second straight day.

Interest Rates: The US Treasury yield curve steepened, amid doubts over the Fed's ability to control rising inflationary pressures. After the Fed's announcement the Treasury yield curve steepened. The US 2-year bond yield rose 2 basis points whilst the 10-year yield lifted 5 basis points.

Euro-dollar futures, a closely tracked measure of interest rate expectations, show the market is still pricing in rate rises to start in September 2022.

In another announcement, separate to the Fed, the US Treasury said it would reduce the amount of debt it issues this quarter, as funding needs for fiscal projects have waned. It is the first cut to Treasury bond auction sizes in five years and provides a counterweight to the Fed's taper.

The Australian 3-year government bond yield (futures) rose from 1.07% to 1.14% ahead of the Fed. Markets are fully pricing the first rate hike from the Reserve Bank to be in June 2022.

Foreign Exchange: The US dollar index fell after the Fed statement announcing the start of tapering. The sell off in the USD pushed up AUD/USD from an overnight low of 0.7412 to an overnight high pf 0.7459. It remains under its recent peak of 0.7555 recorded ahead of the RBA meeting this week. The AUD pushed up ahead of this meeting but then lost ground as investors showed 'buy the fact, sell the rumour' behaviour.

Commodities: Oil fell ahead of the OPEC+ meeting schedule for later today. The US Energy Information Agency (EIA) report showed US crude inventories were at the highest since August. Nationwide stockpiles rose by 3.29 million barrels last week, with production back to where it was before Hurricane Ida hit at the end of August. The cartel is expected to stick with plans for a modest supply hike when it gathers, shunning calls from major consumers, including the US, to cool the price rally by turning the taps on.

COVID-19: NSW recorded 190 new cases and four deaths yesterday. Victoria recorded 941 new cases and eight deaths. Elsewhere, the ACT recorded 15 new cases.

Australia: Residential building approvals fell in September. The number of total residential building approvals fell by 4.3% in September. Approvals have declined for five out of the past six months.

The decline in the month was driven by a plunge in private sector house approvals (-16.0%). It is the largest monthly drop since June 2000, immediately prior to the introduction of the GST, and the second largest monthly decline on record.

Private sector house approvals were down 34.2% from their record highs in April 2021. The decline has been driven by the unwinding of the bring-forward effect from stimulus measures, such as HomeBuilder. Delta-related lockdowns likely also contributed to the fall in September.

Demand is strong and dwelling approvals remain elevated relative to pre-pandemic levels. The unwinding of policy effects may have further to run. However, the pipeline of construction activity remains robust. This will support jobs and economic growth as the economy recovers from the Delta downturn over the coming year.

China: Activity in China's services sector remained in expansionary territory through October. The services purchasing managers' index (PMI) largely unchanged at 53.8.

Eurozone: European Central Bank (ECB) President, Christine Lagarde, renewed her push back against market bets for a rate hike in 2022. Lagarde said overnight that "we have clearly articulated the three conditions that need to be satisfied before rates will start to rise." She added that the outlook for inflation over the medium term remains subdued and the conditions "are very unlikely to be satisfied next year."

The unemployment rate fell to 7.4% in September, from 7.5% in August, after a strong recovery over summer.

New Zealand: The unemployment rate fell to 3.4% in the September quarter, equalling the record low set in 2007, and down from 4.0% in the June quarter. Employment rose 2.0% for the quarter, up 4.2% on a year earlier. Private sector wages continued to rise at a solid pace, growing 0.7% through the September quarter, alongside the tightening in the labour market.

The data depicts a clear tightening of the labour market which is expected to translate into further inflationary pressures, and the Reserve Bank of New Zealand will need to take further action to cool things down. Our base case is for another 25 basis point hike at the meeting later this month, although given the strength of the data, there is also a reasonable case for a 50 basis point hike.

United Kingdom: The Bank of England (BoE) meets later today. Financial markets see a good chance that the BoE will start raising interest rates for the first time since 2018.

Separately, data showed house prices rose last month at a faster rate than expected. Robust demand and a lack of new homes coming to the market kept up momentum. Data from Nationwide showed house prices rose by 0.7% in October after a 0.2% rise in September. Consensus had pointed to another 0.2% increase. The increase left house prices 9.9% higher than a year previously, although this marked the weakest annual growth rate since April.

United States: The Federal Reserve said it would begin scaling back its massive $120bn monthly bond-buying programme this month by $15 billion. This decision was widely expected and clears the way for rate hikes to begin as soon as the second half of 2022. The central bank will cut Treasury purchases by $10 billion and MBS by $5 billion

The tapering process will begin in the middle of this month, which suggests the stimulus programme would cease in June 2022. The purchases would be reduced by the same amount in December and further reductions were deemed to "likely be appropriate" each month thereafter.

The Fed committee said it was "prepared to adjust the pace" of the tapering process "if warranted by changes in the economic outlook".

However, the Fed tweaked the language it used to describe the inflationary outlook in a subtle admission that higher prices could persist for longer than it had originally anticipated. It said that upward pressure on prices is "expected to be transitory" whereas previous statements had said inflation was being largely driven by "transitory factors".

No adjustment was made to the Fed's main policy rate, which is near zero, and the Fed's statement reiterated that the economic bar for raising rates was far higher than that for tapering. Indeed, Fed Chairman Jerome Powell did his best to de-link tapering from the outlook on hikes in his press conference. He said the timing for tightening "will depend on the path of the economy" and adding "we think we can be patient." There was little guidance provided in the statement or Powell around when rate hikes would start.

Other observations made by Powell were that maximum employment could be reached next year, there's no evidence of a wage-price spiral and inflation should wind down by the second or third quarter of 2022.

The ADP survey showed that privately run US businesses added 571,000 new jobs in October, in a sign that companies are still managing to find workers despite the biggest labour shortage in decades. The increase in jobs is larger than the 400k expected by consensus.

However, the pace of hiring is still too slow to fully meet the needs of businesses. More than 10 million open jobs are available and a lack of workers has prevented many companies from producing enough goods and services to meet demand.

The hope is that more people will be drawn back into the workforce due to a fading pandemic, the end of emergency unemployment benefits and rising wages. However, so far there's been little evidence of that; the share of people working or looking for a job is at the lowest level since the late 1970s.

The ISM services index rose from 61.9 in September to a record high of 66.7 in October. It was well above consensus expectations for a result of 62.0. Several components rose to multi-year, if not all-time highs. The biggest increase of any component was the business activity measure, which shot up 7.5 points to a record high 69.8. New orders surged to 69.7, a more than six-point jump from the 63.5 level in September. The highest reading of any sub-component is still the prices-paid measure. gains in prices paid (to 82.9 from 77.5),

Factory orders increased 0.2% in September. Data for August was revised down to show orders rising 1.0% instead of 1.2%, as previously reported. Median consensus had forecast factory orders to be unchanged. Factory orders gained 17.6% on a year-on-year basis. Manufacturing activity is being driven by still-strong demand for goods, despite spending shifting back to services. Businesses are rebuilding depleted inventories, but shortages of labour and raw materials stemming from the COVID-19 pandemic remain challenges.

Today's key data and events:

AU Trade Bal. Sep exp $12.4bn prev $15.1bn (11:30am)
AU Retail Sales Vol. Q3 exp -4.5% prev 0.8% (11:30am)
EZ Ger. Factory Orders Sep exp 1.8% prev -7.7% (6pm)
EZ Markit Services PMI Oct Final exp 54.7 prev 54.7 (8pm)
EZ PPI Sep y/y exp 15.4% prev 13.4% (9pm)
UK Bank of England Policy Meeting (11pm)
Bank Rate exp 0.10% prev 0.10%
US Trade Bal. Sep exp -$80.2bn prev -$73.3bn (11:30pm)
US Initial Jobless Claims w/e 30 Oct exp 275k prev 281k (11:30pm)

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.

Besa Deda, Chief Economist
Ph: (02) 8254 3251

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