Morning report

Wednesday, 1 December 2021

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,256	0.2%		Last		Overnight Chg		**Australia**		
US Dow Jones	34,484	-1.9%	10 yr bond	98.30		0.00		90 day BBSW	0.05	0.00
Japan Nikkei	27,822	-1.6%	3 yr bond	98.93		-0.03		2 year bond	0.64	-0.02
China Shanghai	3,735	0.0%	3 mth bill rate	99.95		-0.01		3 year bond	0.87	-0.04
German DAX	15,100	-1.2%	SPI 200	7,196.0		-35		3 year swap	1.30	-0.01
UK FTSE100	7,059	-0.7%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	1.69	-0.05
Commodities (close & change)*			TWI	60.3	-	-	60.2	**United States**		
CRB Index	219.2	-6.5	AUD/USD	0.7131	0.7171	0.7063	0.7130	3-month T Bill	0.05	0.00
Gold	1,772.47	-12.1	AUD/JPY	81.05	81.39	80.12	80.59	2 year bond	0.55	0.07
Copper	9,522.50	-148.0	AUD/GBP	0.5361	0.5369	0.5323	0.5360	10 year bond	1.44	-0.06
Oil (WTI futures)	66.74	-3.2	AUD/NZD	1.0475	1.0484	1.0423	1.0444	**Other (10 year yields)**		
Coal (thermal)	137.60	-13.4	AUD/EUR	0.6321	0.6334	0.6261	0.6287	Germany	-0.35	-0.03
Coal (coking)	305.33	5.2	AUD/CNH	4.5558	4.5656	4.5063	4.5386	Japan	0.06	-0.02
Iron Ore	102.00	-0.1	USD Index	69.29	96.64	95.52	95.84	UK	0.81	-0.05

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: Concerns about the Omicron variant of COVID-19 returned to markets overnight, leading to a further surge in volatility. Federal Reserve Chair, Jerome Powell added to the lift in risk aversion when he foreshadowed faster tapering of the Fed's bond purchase program. He also called an end to the use of 'transitory' in describing inflation.

The VIX volatility index rose to a level just below Friday's when the Omicron variant was announced.

The rise in risk aversion drove a fall in US and European share markets. And the US yield curve flattened. The USD index surged on Powell's remarks and the AUD/USD finally broke under a key support level to make a 13-month low.

Share Markets: Federal Reserve (Fed) Chair, Jerome Powell, sparked a rise in risk aversion overnight, foreshadowing faster tapering of the Fed's bond purchase program. Powell signalled the end of the term 'transitory' for describing inflation, while noting Omicron as a significant risk to the outlook.

Share markets reacted. All 3 major US indices fell overnight. The S&P 500 fell 1.9%, while the Dow Jones and the Nasdaq dropped 1.9% and 1.6%, respectively.

The European markets also struggled, as growing Omicron cases weighed on sentiment. The Euro Stoxx 50 closed 1.1% lower, while the FTSE 100 finished 0.7% lower. Germany's DAX also finished the session down, closing 1.2% lower.

The ASX 200 closed up 0.2% yesterday, retracing some of Monday's losses. Futures are pointing to a fall on the open this morning.

Interest Rates: Bonds were mixed across the yield curve. Yields on shorter-dated maturities jumped following a speech from Fed Chairmen Jerome Powell, as markets rushed to price faster tapering. The US 2-year yield jumped 7 basis points to 0.55%. Meanwhile, the US 10-year bond yield fell 6 basis points to 1.44%, leading to a flattening of the yield curve.

The market has moved forward expectations of a federal funds rate hike overnight. A hike is now fully priced for July 2022. The market was pricing the first hike in August yesterday.

The Australian 3-year government bond yield (futures) ranged between 0.99% and 1.09%, whilst the 10-year yield ranged between 1.66% and 1.74%.

Australian interest-rate markets have pushed back their expectations of a rate hike from the Reserve Bank (RBA). The first-rate hike in the tightening cycle is fully priced for September next year, although there remains a 91% probability attached to an August 2022 rate hike.

Foreign Exchange: The USD index was sold off in the European session, reaching a low of 95.52, before bouncing back sharply in New York trade to 96.65 following a more hawkish tone from the Fed Chair. The index has since fallen back, settling at around 95.9 currently. The British pound and Japanese yen fell against the USD, while the euro and the New Zealand dollar climbed.

In terms of the AUD, there were significant movements overnight. The crucial support level of 0.7106 finally gave way after the AUD/USD made several attempts in recent trading sessions.

The AUD/USD fell to an overnight low of 0.7063. It is the lowest level for the AUD in 13 months. This low is also within a whisker of 0.7053, a level that represents the 38.2% fibonacci retracement level of the AUD/USD's rally from 0.5510 to 0.8007 between February last year and March this year.

The break under 0.7106 sets up a more bearish outlook for the AUD/USD in the short term; indeed, we could not rule out the AUD/USD moving under 0.7000. The AUD/USD was last sub 0.7000 in early November last year. A close back above 0.7160 is needed to signal some strength re-emerging for the AUD against the USD in the near term.

Commodities: Commodities fell across the board overnight. The West Texas Intermediate futures price for crude dropped nearly 5%.

COVID-19: The National Cabinet met yesterday to discuss the implications of the new Omicron variant of COVID-19. While it was agreed Australia will continue heightened travel and quarantine restrictions for Southern Africa travellers, Prime Minister Scott Morrison ruled out the prospect of rolling lockdowns to curb the risk. NSW recorded its fifth case of Omicron yesterday, with at least one case of community transmission. Scott Morrison has called for a press conference this morning to provide an update from the National Cabinet.

Overseas, Omicron cases continue to spread across the globe. As of yesterday morning, there are 226 Omicron cases across 20 difference counties. Health experts are racing to determine the virulence of the new strain, as well as the effectiveness of current vaccines. Meanwhile, the European Union has reported that its Omicron cases have been asymptomatic or shown only mild symptoms. This was also reported from the South African Doctor who discovered the new variant.

Australia: There were a large number of data releases yesterday in Australia.

Australia reported a fresh record current account surplus of $23.9 billion in the September quarter. It is the fourth consecutive record posted and a $1.0 billion increase from the surplus registered in the June quarter. It is also the tenth consecutive current account surplus and the longest run of surpluses in the history of the series.

A widening in the trade surplus, underpinned by a lift in exports, led the expansion in the current account surplus. Export volumes rose by 1.2% in the quarter. There were firm gains in the exports of rural goods, especially wool & sheepskins and meat. Exports of non-rural goods were also firm.

Import volumes fell by 4.0%, as Delta lockdowns led to a drop in spending and demand for imported goods. This was the largest quarterly percentage fall in imports since the June quarter of 2020.

Net exports are set to make a solid contribution of 1.0 percentage points to GDP growth in the September quarter.

The terms of trade, a ratio of export to import prices, increased for the fifth consecutive quarter (up 0.5%) to be 23.1% higher over the year. The uplift reflects strong prices for commodity exports. Despite falls in iron ore prices, prices of coal and other mineral fuels remained strong.

New public final demand increased by 3.0% in the September quarter and is expected to contribute a robust 0.8 percentage points to GDP growth for the quarter.

GDP is out later this morning. We expect GDP to contract by 2.5% over the September quarter, led by a sharp contraction in economic activity in NSW and Victoria. Encouragingly, the contraction is not as deep as initially feared. Annual GDP growth is likely to slide to 3.2%.

The pace of credit growth stayed solid in October. It is consistent with a recovery underway nationally after NSW, Victoria and the ACT emerged from their lockdowns last month.

Credit to the private sector grew by 0.5% in October - a solid pace of growth. This pace is above the average monthly growth rate over the past 10 years of 0.4%. In the twelve months to October, the pace of credit growth quickened to 5.7% - the fastest recorded in 5 years.

Lending for housing grew 0.6% in October – the same, solid rate for three straight months, despite stretched affordability and macroprudential tightening. Lending growth remains firmest for owner occupiers where annual growth rose to 9.0% – the fastest in over 5 years.

Credit extended to businesses continued to recover, recording the sixth straight month of growth. Business credit rose 0.5% in October and the annual rate lifted to a 17-month high of 5.3%. Businesses are feeling optimistic, including about their spending plans.

Building approvals continued to decline in October, landing broadly in line with pre-pandemic levels. Approvals fell 12.9%, marking the largest monthly fall since May 2020. However, this is off a record high earlier in 2021, underpinned by government stimulus measures, such as HomeBuilder, and low interest rates.

The headline number masks early signs of stabilisation in building approvals. The fall in October was driven by a 37.5% fall in multi-density dwellings approvals (apartments and townhouses), a category which is volatile month to month.

In contrast, private sector house approvals increased 4.3% in October. This likely partly reflects a rebound from lockdown disruptions, but could also suggest that the HomeBuilder unwind has mostly run its course.

China: Manufacturing activity picked up in November for the first time in three months. The manufacturing purchasing managers' index (PMI) climbed to 50.1 in November, from 49.2 in the month prior, returning to expansionary territory. The rise in activity could be an early sign that pressures from surging raw materials prices, power rationing and supply chain bottleneck are beginning to ease.

The non-manufacturing PMI eased off slightly in November to 52.4, from 52.4 in October. However, the result beat consensus expectations of a larger fall and remains strongly in expansionary territory.

Eurozone: Consumer prices inflation jumped 0.5% in November according to preliminary figures. It follows a 0.8% surge in October and takes annual growth to a record high of 4.9%. The outcome was well above market expectations and mounts further pressure on the European Central Bank to deal with inflationary pressures ahead of their upcoming December policy meeting.

New Zealand: Business confidence for November was finalised at -16.4, up from a preliminary reading of -18.1. Inflation expectations remain high, despite the final figures revised lower. Inflation expectations were revised to 4.2%, a record for the series. Businesses' expectations for economic conditions remained firm at 15.0.

United States: House prices continued to rise at a solid clip, despite speculation about rate hikes next year. The FHFA house price index picked up 0.9% in September, but came in below consensus forecasts of a 1.2% increase. In a separate series, the S&P CoreLogic home price index jumped up 0.96% in September, also coming in short of consensus expectations of a 1.2% rise. Although the pace of prices growth has softened slightly, housing demand remains robust.

The Chicago PMI eased to 61.8 in November, down from 68.4 in October. Although business activity fell sharply over the month, it remains firmly in expansionary territory. Indeed, most sub-indices are signalling an expansion in business activity.

Consumer confidence backed off in November, as surging inflation continued to weigh on sentiment. The Conference Board's consumer confidence index fell from a revised 111.6 in October to 109.5 in November. The new Omicron variant of COVID-19 will introduce further uncertainty coming into next year and will likely weigh on confidence.

Today's key data and events:

NZ Building Permits Oct prev -1.9% (8:45am)

AU CoreLogic Dwelling Prices Nov prev 1.4% (10am)

AU GDP Q3 (11:30am)

q/q exp -2.5% prev 0.7%

y/y exp 3.2% prev 9.6%

CH Caixin Mfg PMI Nov exp 50.6 prev 50.6 (12:45pm)

UK Markit Mfg PMI Nov Final exp 58.2 prev 58.2 (8:30pm)

US ADP Emp. Change Nov exp 525k prev 571k (12:15am)

US Markit Mfg PMI Nov Final exp 59.1 prev 59.1 (1:45am)

US Constr. Spending Oct exp 0.4% prev -0.5% (2am)

US ISM Mfg Nov exp 61.2 prev 60.8 (2am)

US Federal Reserve's Beige Book (6am)

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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