Morning report

Bank of Melbourne

Thursday, 27 January 2022

Equities (close & % change)		
S&P/ASX 200	6,962	-2.5%
US Dow Jones	34,168	-0.4%
Japan Nikkei	27,011	-0.4%
China Shanghai	3,621	0.7%
German DAX	15,459	2.2%
UK FTSE100	7,470	1.3%
Commodities (close & change)*		
CRB Index	251.9	3.1
Gold	1,848.02	5.0
Copper	9,832.75	69.8
Oil (WTI futures)	86.69	1.1
Coal (thermal)	234.60	10.6
Coal (coking)	409.50	-0.2
Iron Ore	138.50	0.8

Sydney Futures Exchange (close & change)				
	Last		Overnight Chg	
10 yr bond	97.95		-0.06	
3 yr bond	98.47		-0.06	
3 mth bill rate	99.79		-0.01	
SPI 200	6,894.0		-26	
FX Last 24 hrs	Open	High	Low	Current
TWI	60.3	-	-	59.9
AUD/USD	0.7140	0.7181	0.7097	0.7112
AUD/JPY	81.38	82.16	81.23	81.54
AUD/GBP	0.5294	0.5314	0.5276	0.5284
AUD/NZD	1.0662	1.0728	1.0681	1.0696
AUD/EUR	0.6307	0.6363	0.6311	0.6328
AUD/CNH	4.5221	4.5416	4.4967	4.5075
USD Index	95.90	96.47	95.91	96.48

Interest rates (close & change)		
Australia		
90 day BBSW	0.07	0.00
2 year bond	0.92	0.00
3 year bond	1.40	0.00
3 year swap	1.63	0.06
10 year bond	1.95	0.00
United States		
3-month T Bill	0.18	0.00
2 year bond	1.16	0.14
10 year bond	1.87	0.10
Other (10 year yields)		
Germany	-0.07	0.01
Japan	0.14	0.00
UK	1.20	0.03

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: US stocks fell and bond yields spiked after the Federal Reserve meeting, with Chair Powell backing rate liftoff in March.

Share Markets: US stocks slipped following the Federal Open Markets Committee (FOMC) meeting. The Dow declined 0.4% and the S&P 500 was down 0.2%. The ASX 200 fell 2.5%.

Interest Rates: US interest rates jumped higher after the FOMC. The 2-year US treasury yield increased 14 basis points to 1.16% while the 10-year yield rose 10 basis points to 1.87%. Markets remain fully priced for the first Fed rate hike in March.

Australian 3-year (futures) yields rose 9 basis points to 1.55% while 10-year future yields are up 9 basis points to 2.06%. The first RBA rate hike is fully priced for May.

Foreign Exchange: The AUD/USD pair fell to 0.7097 following the FOMC meeting, failing to break through the 0.7090 support level, before partly recovering to 0.7112.

The US dollar jumped higher, with the DXY rising from 95.90 to 96.48, reaching a one-month high.

Commodities: Oil prices rose as supply jitters grew alongside Russia-Ukraine tensions. Gold and copper firmed.

Australia: On Tuesday, inflation data revealed underlying inflation increased 1.0% in the December quarter to be 2.6% higher over the year. It is the highest annual rate in since 2014 and the second consecutive print within the RBA's target band. Headline inflation rose 1.4% in the quarter and 3.5% over the year.

The inflation results are well above the Reserve Bank's forecasts. The RBA expected annual underlying inflation to print at 2.25% and annual headline inflation to be at 3.25%.

Several other measures of inflation were at elevated levels. Tradables inflation grew by 4.9% over the year – its fastest pace in 20 years. And annual non-discretionary inflation hit 4.5%, the highest in 10 years and more than double the pace of discretionary inflation.

Rising fuel costs, global supply-chain disruptions and the housing boom remained key drivers of inflation in the quarter.

Mounting inflation pressures reinforce our expectation that the RBA will drop quantitative easing at next week's meeting. It also further shifts the dial in favour of a rate hike in 2022. Our forecasts remain for a rate-hike cycle to start in August with an initial 15 basis points.

Interest-rate markets shortened their odds of a rate hike. A rate hike of 15 basis points is now fully priced for May.

The business confidence index plunged 25 points to -12 in December. This marks the lowest reading since May 2020 and the sharpest monthly decline since March 2020. The fall in confidence was broad-based across the states. Businesses have faced fresh challenges following the surge in COVID-19 cases, as isolation requirements have exacerbated labour shortages and supply disruptions.

Encouragingly, the fall in business conditions in December was less pronounced. Conditions slid 3 points to +8, narrowly above the 10-year average of +6. The result showcases how business have found ways adapt to changing conditions throughout the pandemic.

Of note, all four price measures recorded in the survey increased to near-record highs and are well above pre-pandemic levels.

Canada: The Bank of Canada left its policy settings unchanged, as expected, but signalled rate hikes were imminent. The statement noted “interest rates will need to increase, with the timing and pace of those increases guided by the Bank's commitment to achieving the 2% inflation target”.

United States: As expected, the FOMC left its policy rates unchanged but Chair Powell signalled a rate hike at the next meeting in March. He also did not rule out hiking at every meeting. At the press conference, Chair Powell said “the committee is of a mind to raise the Fed funds rate at the March meeting” if conditions are there to do so. He noted that officials have not yet made any decisions about the path of policy because it needs to be “nimble”. He noted he is inclined to boost his inflation forecast by “a few tenths”.

The FOMC statement declared “it would soon be appropriate” to lift rates, citing inflation well above the 2% target and the robust labour market. It also stated asset purchases will conclude on schedule in “early March”. Balance sheet reduction will commence after rate liftoff. The vote was unanimous. Now, the focus is shifting to whether a 50-basis point hike is on the cards for the next meeting.

The Conference Board consumer confidence index slipped to 113.8 in January, from 115.8 in December. Confidence has been resilient in the face of the Omicron surge, although consumers felt less upbeat about their income prospects.

Manufacturing activity softened in January, according to the Richmond Fed manufacturing index, which fell to 8 from 16. A result above zero indicates expansion. The decline was underpinned by falls in the indicators for new orders and employment.

New home sales rose 11.9% to an 811k annualised pace in December, marking a nine-month high. The result points to firmer demand despite high prices and supply constraints.

The FHFA gauge of house prices rose 1.1% in November while the S&P CoreLogic indicator rose 1.2% in the same month. Dwelling prices were 18.3% higher over the year to November, according to S&P CoreLogic. High prices and the expectation of higher mortgage rates has not been enough to dissuade buyers. At the same time, supply has been held back by shipping bottlenecks, labour shortages and higher input prices.

Today’s key data and events:

NZ CPI Q4 q/q exp 1.3% prev 2.2% (8:45am)
AU WBC Leading Index Dec prev 0.12% (10:30am)
AU Trade Price Indices Q4 (11:30am)
  Import Prices exp 1.4% prev 5.4%
  Export Prices exp -2.2% prev 6.2%
US GDP Annualised Q4 q/q prev 2.3% (12:30am)
US Durable Goods Orders Dec Prel. (12:30am)
US Core PCE Dec q/q prev 4.6% (12:30am)
US Pending Home Sales Dec (2am)
US Kansas City Fed index Jan prev 24 (3am)

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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The Detail