Morning report

Bank of Melbourne

Wednesday, 2 February 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,006	0.5%		Last		Overnight Chg		**Australia**		
US Dow Jones	35,405	0.8%	10 yr bond	98.04		-0.04		90 day BBSW	0.07	0.00
Japan Nikkei	27,078	0.3%	3 yr bond	98.58		-0.04		2 year bond	0.88	0.00
China Shanghai	3,522	-1.0%	3 mth bill rate	99.89		-0.01		3 year bond	1.33	0.01
German DAX	15,619	1.0%	SPI 200	6,965.0		56		3 year swap	1.54	0.01
UK FTSE100	7,536	1.0%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	1.90	0.01
Commodities (close & change)*			TWI	59.3	-	-	59.7	**United States**		
CRB Index	256.8	1.7	AUD/USD	0.7067	0.7128	0.7034	0.7127	3-month T Bill	0.19	-0.03
Gold	1,801.40	4.2	AUD/JPY	81.31	81.76	80.91	81.76	2 year bond	1.17	-0.01
Copper	9,554.00	-1.5	AUD/GBP	0.5255	0.5271	0.5235	0.5271	10 year bond	1.79	0.02
Oil (WTI futures)	88.36	0.2	AUD/NZD	1.0744	1.0758	1.0700	1.0729	**Other (10 year yields)**		
Coal (thermal)	192.50	-7.4	AUD/EUR	0.6291	0.6328	0.6263	0.6325	Germany	0.04	0.03
Coal (coking)	437.67	0.0	AUD/CNH	4.5030	4.5407	4.4822	4.5406	Japan	0.18	0.00
Iron Ore	138.90	1.8	USD Index	96.61	96.72	96.24	96.29	UK	1.30	0.00

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: Market sentiment fluctuated as investors digested robust US economic data and comments from Fed member Harker on rate hike expectations. US equities ended the day higher, bond yields were mixed and the US dollar fell against major currencies.

Share Markets: US share markets moved between gains and losses over the day before rallying higher towards the end of the session, adding to their best three-day rally since 2020. The S&P 500 and Nasdaq both rose 0.7% on the day, while the Dow Jones was 0.8% higher.

The ASX 200 rose 0.5% yesterday and futures are pointing to a positive open today.

Interest Rates: The US 2-year treasury yield fell 1 basis point to 1.17%, while the 10-year yield increased by 2 basis points to 1.79%.

The Australian 3-year government bond yield (futures) pulled back some of the dovish response to yesterday's RBA decision, which saw yields move lower from 1.41% to 1.32%, before settling around 1.40%. The 10-year government bond yield (futures) ranged between 1.91% and 1.96%.

Foreign Exchange: The US dollar fell against a basket of major currencies, with the AUD one of the outperformers. The USD Index fell from a high of 96.7 to a low of 96.2, before settling at 96.3.

The AUD/USD pair rose from a low of 0.7034 to a high of 0.7128 and continued to trade around that level at the time of writing.

Commodities: Iron ore, gold and oil rose overnight, while copper fell. Analysts suggested that the latest spike in oil prices may encourage OPEC+ to increase production by more than expected in an upcoming meeting.

Australia: The Reserve Bank (RBA) scrapped quantitative easing (QE) and left the cash rate unchanged at 0.10% yesterday, as widely expected.

The decision to drop the QE program reflected the progress towards employment and inflation goals, as well as other central banks bringing forward the conclusion of their bond-buying programs.

The RBA has sharply revised up its inflation forecast and moved its unemployment forecasts lower to sub 4 per cent, laying the groundwork for rate hikes later this year.

The RBA now expects underlying inflation it to hit 3¼ per cent "over the coming quarters" – notably above its target band.

On the RBA's fresh forecasts, unemployment will be pushing under full employment. It remains only a matter of time before wage pressures mount and a rate hike is sealed. We expect a rate-hike cycle to start in August with a rate rise of 15 basis points, taking the cash rate to 0.25 per cent. Subsequent hikes will return to 25 basis point intervals.

Dwelling prices recorded another month of solid growth in January, up 1.1%. However, momentum is continuing to slow. The three-month growth rate slipped to 3.4%, its lowest level since January 2021. Stretched affordability, a lift in supply and a rise in fixed interest rates are taking the steam out of the market.

Despite the moderation, demand is still solid underpinned by low interest rates. Indeed, housing finance data rose 4.4% excluding refinancing in December, and edged to a new high. The uptick is consistent with the lift in sales and dwelling prices after the Delta lockdowns.

Lending to owner-occupiers rose 5.3% in December. Lending to investors was up 2.4% and also hit a new record.

The Brisbane and Adelaide property markets continued to outperform their peers in January, as the divergence in house prices across capital cities persisted. Regional markets continued to outshine capital cities while house price growth outstripped units.

We expect dwelling price growth and housing lending will slow over 2022. There are already several headwinds in play, but the key driver will be when the Reserve Bank lifts the cash rate.

Retail sales dropped 4.4% in December after a 7.3% jump in November alongside ‘Black Friday’ sales. This was the largest monthly drop since April 2020. However, spending remains elevated, with monthly turnover at its second highest level on record.

The fall follows three consecutive monthly increases over September to November as spending bounced back following the Delta lockdowns.

The decrease also partly reflects surging COVID-19 cases, although this will be more clearly captured in January when cases peaked.

Victoria led the declines, down 8.4% followed by NSW with a fall of 4.2%. All other states and territories, expect the NT, recorded falls in the month.

Uncertainty remains and spending is likely to fall further in the near-term. However, the future is looking positive. Strong household balance sheets, low interest rates, a strong labour market, and pent-up demand should underpin robust growth in retail spending over 2022.

Eurozone: Unemployment fell to a record low of 7% in December as hiring continued despite increasing COVID-19 case numbers, elevated inflation, and continued supply-chain disruptions. This was down from a revised December outcome of 7.1% and below consensus expectations of 7.1%. Youth unemployment also fell to an all-time low of 14.9%. This measure has remained stubbornly high and hit peaks around 25% during the European sovereign debt crisis.

Unemployment in the broader European Union, which includes countries not in the single currency bloc, also dropped to a record low of 6.4%.

Manufacturing activity rose to a five-month high as the Markit manufacturing PMI rose to 58.7 in January. This was down on the preliminary estimate of 59.0 but was higher than the December outcome of 58.0.

New Zealand: The trade deficit narrowed to $477m in December. This is down from a revised $1.1bn deficit in November. Exports reached an all-time high of $6.1bn, while imports pulled-back slightly from their November high. In annual terms, the trade deficient widened to $6.8bn – the widest since May 2006.

United Kingdom: House prices rose by 0.8% in January to record an 11.2% growth rate over the year to January. This was the strongest start to a calendar year since 2005 and was above consensus expectations. The annual rate of growth increased from 10.4% over the year to December. The outcome was above consensus expectations of 0.6% for the month and 10.9% over the year to January.

Manufacturing PMI was finalised at 57.3 in January, up from the preliminary estimate of 56.9. Production rose at the fastest pace in six months, while new orders growth was weaker.

United States: The manufacturing sector remained in expansionary territory in January. However, the sector has lost momentum as rising COVID-19 case numbers, labour shortages, and supply-chain distortions continue to have an impact. The manufacturing ISM fell to 57.6 in January, broadly in line with expectations and down from the December outcome of 58.7. The Markit manufacturing PMI also fell from its December outcome. The index came in at 55.5 in January. While down on the December outcome of 57.7, the index was above its preliminary reading of 55.0.

Construction spending rose by 0.2% in December, below expectations of 0.6% growth and down from the revised November outcome of 0.6%. Total private spending expanded by 0.7%, however, this was partially offset by a decline of 1.6% in total public spending. Residential spending advanced by 1.1% in the month.

The labour market remained tight at the end of

2021 as job openings rose to 10.9 million in December. This followed a revised 10.8 million outcome in November and was above consensus expectations of 10.3 million openings. The quit rate remained high at 2.9%, despite falling from the record level of 3.0% in prior months.

Philadelphia Fed President Harker spoke overnight and noted that his base case is for four 25 basis point hikes in 2022. He stated that he would be supportive of the first hike coming in March. He was a “little less convinced” of a 50 basis point hike for now but could see the case for one if there was a spike in inflation.

Today’s key data and events:

NZ Private Wages Ex. Overtime Q4 exp 0.9% prev 0.7% (8:45am)

NZ Employment Q4 exp 0.4% prev 2.0% (8:45am)

NZ Unemployment Rate Q4 exp 3.3% prev 3.4% (8:45am)

AU RBA's Governor Lowe Speech (12:30pm)

EZ CPI Jan y/y Prel. exp 4.4% prev 5.0% (9pm)

US ADP Employment Change Jan exp 184k prev 807k (12:15am)

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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