Morning report

Wednesday, 2 March 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,097	0.7%		Last		Overnight Chg		Australia		
US Dow Jones	33,295	-1.8%	10 yr bond	97.92		0.11		90 day BBSW	0.09	0.01
Japan Nikkei	26,845	1.2%	3 yr bond	98.52		0.09		2 year bond	1.10	0.00
China Shanghai	3,657	0.8%	3 mth bill rate	99.90		0.00		3 year bond	1.55	0.00
German DAX	13,905	-3.8%	SPI 200	6,997.0		-49		3 year swap	1.66	-0.08
UK FTSE100	7,330	-1.7%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	2.19	0.05
Commodities (close & change)*			TWI	60.6	-	-	61.1	United States		
CRB Index	280.9	11.8	AUD/USD	0.7262	0.7290	0.7239	0.7258	3-month T Bill	0.30	-0.03
Gold	1,946.77	37.8	AUD/JPY	83.48	83.86	83.10	83.36	2 year bond	1.34	-0.09
Copper	10,095.50	176.5	AUD/GBP	0.5413	0.5449	0.5405	0.5448	10 year bond	1.73	-0.10
Oil (WTI futures)	104.69	9.0	AUD/NZD	1.0733	1.0751	1.0717	1.0734	Other (10 year yields)		
Coal (thermal)	305.45	54.0	AUD/EUR	0.6479	0.6533	0.6471	0.6522	Germany	-0.07	-0.21
Coal (coking)	463.33	14.8	AUD/CNH	4.5869	4.6033	4.5757	4.5857	Japan	0.18	-0.02
Iron Ore	149.40	1.3	USD Index	96.75	97.58	96.63	97.35	UK	1.13	-0.28

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: Financial markets jitters jumped overnight. Markets became more unsettled by the conflict in Ukraine and the prospect that it could be prolonged. News reports suggest Belarus may be about to enter the conflict with tanks amassed at the border.

Uncertainty remains very elevated, reflected in a spike in the VIX volatility index. It jumped 11.9 points overnight to a 13-month high of 33.7.

Oil surged overnight by almost 10%, as fears grew of ongoing disruptions to oil supply. Russia is the world's third largest exporter of crude oil and crude products.

The spike in oil and nervousness around the conflict spurred a further move of investment funds to safe-haven asset classes. Major share market indices sold off, global bond yields plunged, gold shot up and demand for the US dollar grew. The EUR and GBP were sold off heavily.

Fears about stagflation are also rising as the price pressures in energy markets add to growing inflation pressures. A prolonged and broadened conflict could also depress confidence, consumer spending and business investment, hurting growth in Europe and globally. This combination raises the spectre of stagflation.

Share Markets: US share markets dropped sharply overnight, as a spike in crude oil prices sent shudders through markets. The S&P 500 index fell 85 points (or -2.0%) and the Dow plunged nearly 600 points (or -1.8%).

European share markets again experienced a much sharper sell off, led by strong selling of companies exposed to Russia. The Euro Stoxx 50 fell 4.0% and the German DAX dropped 3.9%.

Yesterday, the ASX 200 share market index rose 47 points (or +0.7%) but we expect the market to turn lower today, as the red spreads to the Asian Pacific equity markets.

Interest Rates: The conflict continues to push investors towards safe-haven assets, especially government bonds. The global bond rally has extended as a result.

The US 10-year bond yield fell 10 basis points to 1.72%. It has now dropped almost 30 basis points since Russia invaded the Ukraine last Thursday. It is at its lowest rate since 13 January 2022. Meanwhile, the US 2-year bond yield fell 9 basis points to 1.34% - which is the lowest rate since early February 2022.

Across to Europe overnight, German 10-year yields dropped 21 basis points and UK 10-year bond yields plunged 28 basis points. Prior to the conflict, markets were expecting the European Central Bank to start raising rates later this year. This pricing has now been wound back.

Australian 3-year government bond yields (futures) fell from 1.58% to 1.45%, while the 10-year bond yield fell from 2.20% to 2.03%.

The first Reserve Bank rate hike is fully priced for July 2022. However, the probability attached to a 15 basis point rate hike in July is now at 103%, well down from almost 300% in the middle of February. By the end of this year, a cash rate of over 1% is still priced in by Australian interest-rate markets.

Foreign Exchange: The shift to safe-haven assets led to increased demand for the USD. The USD index jumped from an overnight low of 96.63 to an overnight high of 97.58.

The EUR and GBP were heavily sold off against the USD with the European region the most exposed to the Ukraine-Russia conflict. EUR/USD dropped from an overnight high of around 1.1240 to an overnight low near 1.1090. GBP/USD moved from an overnight high of about 1.3440 to a low near 1.3300.

The AUD/USD remained in an incredibly tight range of 0.7239-0.7290, despite the sharp moves in other major currencies. Elevated commodity prices are providing support for the AUD amid growing concerns about global growth. The AUD tends to be a barometer for global growth and its associated risks.

The relative steadiness in AUD/USD combined with the sharp sell offs in the EUR and GBP meant the AUD appreciated significantly on the crosses with EUR and GBP. The AUD/EUR shot up to an overnight high of 0.6533 – the highest since 18 March 2021. And the AUD/GBP spiked to an overnight peak of 0.5450 – the highest since 16 November 2021.

Commodities: Oil continued to soar. The West Texas Intermediate (WTI) price of oil surged almost 10% overnight to above US$105 a barrel for the first time since 2014. The spike occurred despite the US and other major economies agreeing on a coordinated release of crude stockpiles. There is speculation the International Energy Agency (IEA) will deploy 60 million barrels from reserves around the world.

We would not rule out oil scaling to above US$120 a barrel in the near term. Since the invasion, oil has jumped around 14% due to concerns around oil supply disruptions. Russia is the world's third largest exporter of crude oil and crude products.

The price of gold jumped sharply, benefitting from safe-haven flows and the prospect of ongoing elevated inflationary pressures from the Ukraine-Russia conflict.

Australia: Australia reported its 11th consecutive quarterly current account surplus, the longest on record, in the December quarter of 2021. However, the surplus narrowed by $9.3 billion to $12.7 billion.

The decrease largely reflected a drop in the trade surplus. The trade gap fell $6.4 billion over the quarter, as import values increased (+4.9%) and export values fell (-1.1%).

In volume terms (i.e. stripping out price effects) exports declined by 1.5% over the quarter. Import volumes were also down, by 0.9%.

The terms of trade declined by 5.1% from a record high in the September quarter.

Net exports are also expected to detract 0.2 percentage points from growth.

Demand from the government sector fell 0.4% in the December quarter, as government spending pulled back after very strong growth associated with the COVID-19 response. New public final demand is expected to detract 0.1 percentage points from growth in the quarter.

The housing market continued to lose momentum in February; dwelling prices lifted 0.6% – the slowest monthly growth rate since March 2020. Annual growth is continuing at a fast clip, but it is softening. It slowed to 20.6% in February and the peak is likely now behind us.

Notably, dwelling prices declined slightly in Sydney in January for the first time since September 2020, while prices were effectively flat in Melbourne. Momentum has slowed considerably at the top end of the town, which typically sees larger fluctuations in growth than other segments of the market.

Housing finance, excluding refinancing, rose 2.6% in January, and hit a new high of $33.7 billion. Disruptions from Omicron clearly didn't dissuade buyers. The increase in lending in January was led by investors, up 6.1% in the month. Lending to owner-occupiers rose 1.0% in the same period.

The Reserve Bank (RBA) kept the cash rate on hold yesterday at 0.10%, where it has been since November 2020. The RBA has underscored the need for patience because of two key factors. Uncertainty over how long global supply-chain disruptions will persist, and wages growth. Indeed, wages growth seems the sticking point, as the RBA holds concerns that wages growth will build up only very gradually.

In the space of just a few weeks, a new source of uncertainty has emerged. The RBA early in its statement highlights that "a major new source of uncertainty" is the war in Ukraine. Related to this uncertainty are developments in energy markets because Russia is a large exporter of energy.

The RBA remains concerned over possible inertia in wages growth in Australia. However, recent speeches have indicated a focus on a broader range of wage measures beyond just the wage price index. Yesterday's statement contained references to these broader measures. Indeed, most references were to "labour costs", in contrast to "wages growth" in earlier statements. These broader measures of wages should show a stronger build-up of pressures.

The move to a broader measure of wages growth also distances the RBA from RBA commentary in 2021 that the cash rate would not rise until the wage cost index lifts by 3%.

However, the RBA stuck to the same mantra as its statement last month in the last paragraph stating that "while inflation has picked up, it is too early to conclude that it is sustainably within the target range".

We remain comfortable with our view that the rate-hike cycle will kick off in August. However, an earlier move can't be ruled out.

China: Activity picked up in February, indicating that recent policy support may be starting to kick in. Manufacturing activity continued to expand – the official manufacturing purchasing mangers' index (PMI) edged up to 50.2, from 50.1 in January; Compared to market expectations of a tilt into contractionary territory. The Caixin manufacturing PMI also increased, jumping to 50.4 in February, from 49.1 in January. Services activity also surprised to the upside. The official non-manufacturing PMI lifted to 51.6 in February, from 51.1 previously.

Eurozone: German headline and harmonised inflation pushed above consensus estimates. The harmonised consumer price index (CPI) rose to 5.5% in the year to February, up from 5.1% in the previous reading. And the headline annual rate rose to 5.1% in the same period, up from 4.9% previously.

The final reading of the manufacturing purchasing managers' index (PMI) for the Eurozone region for February was shaved to 58.2, from the flash reading of 58.4.

Russia & Ukraine: Russia's invasion of Ukraine entered a more brutal phase overnight. Ukrainian military intelligence tweeted that some 300 Belarusian tanks are amassed at the border. Belarus may be close to entering the war.

The European Union (EU) may exclude seven Russian banks from SWIFT, but the proposed list spares Sberbank and Gazprombank.

The Russian central bank banned coupon payments to foreign owners of ruble bonds known as OFZs in what it called a temporary step to shore up markets.

Euroclear stopped accepting bond payments in Russian rubles.

Talks between the Moscow and Kyiv are set to resume later today.

United Kingdom: The final manufacturing PMI print came in at 58.0 for February, up from the flash reading of 57.3.

United States: The manufacturing ISM index rose to 58.6 in February, up from 57.6 in January. The result was stronger than consensus expectations, which centred on an outcome of 58.0. The result was driven by a lift in new orders, suggesting manufacturing activity will be robust in coming months. Employment pulled back slightly, though remained positive. Prices moderated, but remain at very elevated levels.

Today's key data and events:

NZ Building Permits Jan prev 0.6% (8:45am)

NZ Terms of Trade Q4 prev 0.7% (8:45am)

AU GDP Q4 (11:30am)
  q/q exp 3.3% prev -1.9%
  y/y exp 3.9% prev 3.9%

EZ CPI Feb y/y Prel. exp 5.6% prev 5.1% (9pm)

UK N'wide House Prices Feb exp 0.6% prev 0.8% (6pm)

US ADP Employment Change Feb exp 375k prev -301k (12:15am)

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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