Morning report

Bank of Melbourne

Monday, 7 February 2022

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,120	0.6%		Last		Overnight Chg		**Australia**		
US Dow Jones	35,090	-0.1%	10 yr bond	97.96		-0.07		90 day BBSW	0.07	0.00
Japan Nikkei	27,440	0.7%	3 yr bond	98.46		-0.10		2 year bond	0.94	0.08
China Shanghai	3,522	-1.0%	3 mth bill rate	99.88		-0.01		3 year bond	1.39	0.08
German DAX	15,100	-1.7%	SPI 200	6,993.0		-41		3 year swap	1.71	0.14
UK FTSE100	7,516	-0.2%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	1.96	0.09
Commodities (close & change)*			TWI	60.0	-	-	60.1	**United States**		
CRB Index	261.3	1.3	AUD/USD	0.7138	0.7152	0.7052	0.7081	3-month T Bill	0.22	0.02
Gold	1,808.28	3.4	AUD/JPY	82.05	82.22	81.30	81.64	2 year bond	1.31	0.11
Copper	9,871.50	4.0	AUD/GBP	0.5248	0.5257	0.5214	0.5232	10 year bond	1.91	0.08
Oil (WTI futures)	92.31	2.0	AUD/NZD	1.0715	1.0727	1.0680	1.0709	**Other (10 year yields)**		
Coal (thermal)	189.60	7.6	AUD/EUR	0.6240	0.6250	0.6163	0.6180	Germany	0.21	0.06
Coal (coking)	434.67	-1.7	AUD/CNH	4.5344	4.5436	4.4906	4.5060	Japan	0.20	0.02
Iron Ore	144.95	-0.1	USD Index	95.37	95.70	95.14	95.49	UK	1.41	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: A surprisingly strong jobs report in the US dominated market sentiment on Friday. US non-farm payrolls printed much higher than consensus estimates and even the range of estimates, causing US bond yields and the US dollar to jump. US share markets mostly finished higher, despite aggressive tightening priced in by markets from the Fed. Gains in energy shares helped underpin equities after crude oil rose to its highest price in over 7 years.

Share Markets: The S&P 500 share market index ended 23 points higher on Friday (or +0.5%) and the Nasdaq shot up 219 points (or +0.6%). The strong finishes were underpinned by a positive earnings report from Amazon. Energy stocks also underpinned the gains after crude oil prices rose to a 7-year high. However, the Dow Jones erased its gains near the close to end down 21 points (or -0.1%).

On Friday, the ASX 200 closed up 42 points (or +0.6%) and for the week, the ASX 200 index rose 90 points (or +1.3%). It was the first positive weekly finish in four weeks.

Interest Rates: Interest-rate traders moved to price in more tightening from major central banks around the world. This pricing is reflected in higher short-term yields. Indeed, US short-dated bond yields bolted higher on Friday, after the US payrolls report was stronger than economists were anticipating. There are nearly 6 rate hikes priced in this year for the US starting in March. The US 2-year bond yield jumped 11 basis points to a near-2-year high of 1.31%. And the US 10-year bond yield rose 8 basis points to close at 26-month high of 1.91%.

In Europe, hawkish remarks from Dutch's central bank head shortened the odds of tightening from the European Central Bank (ECB) this year. His remarks followed Thursday's statements from Lagarde suggesting a rate hike later this year was now a possibility. The German 10-year yield rose 6 basis points to close at a 3-year high of 0.21%.

Foreign Exchange: The USD index appreciated after the stronger-than-expected payrolls report. The USD index rose from a Friday night low of around 95.15 to a high of 95.70, before a modest sell off from these highs took the USD back to the 95.50 handle.

The standout on Friday and for the week was undoubtedly the euro. The EUR/USD held on to its gains on Friday night after it jumped aggressively on Thursday night. The EUR/USD spiked from around 1.1265 to a high of 1.1484 on Thursday after the ECB President, Lagarde, pointedly refused to repeat 2021 reassurances that interest rates would not rise this year. The EUR spent Friday night consolidating these gains at around the 1.1445-1.1470 range. Support around these levels was also underpinned by hawkish remarks from the Dutch central bank head, Knot, on Friday night. He expects rate rises later this year. It left AUD/EUR languishing around 0.6170.

The AUD/USD was sold off heavily on Friday, causing it to fall from a high of 0.7168 to a low of 0.7034. Strong demand for the USD was the main culprit in the sell-off of the AUD/USD pair. The AUD has minor support around 0.7030 with major support sitting in the 0.6970-0.7000 region.

Commodities: The West Texas Intermediate futures price of crude oil closed at US$92.31 a barrel on Friday – that is the highest in more than seven years (since late September 2014).

Australia: The Reserve Bank (RBA) released its quarterly Statement on Monetary Policy (SoMP) on Friday, which included an updated set of economic forecasts. The statement was the bookend to a big week for the RBA, as it slowly turns the ship and prepares for earlier than previously indicated rate hikes.

GDP is expected to grow above trend this year, but has been sliced back to 4¼ per cent, from 5½ per cent. This change reflects the stronger growth outcome for 2021. It also accounts for the impact of Omicron. The RBA noted Omicron's impact on spending is relatively small.

The RBA expects the unemployment rate to fall below full employment to 3¾ per cent by the end of 2022 (previously 4¼ per cent), before remaining at this level.

The biggest shift was in the underlying inflation forecast, which is expected to break above the upper end of the 2-3% target range. It is expected to hit 3¼ per cent by the June quarter of 2022 and then remain in the top half of the band for the foreseeable forecast horizon.

The potent combination of above-trend growth, unemployment below full employment and underlying inflation above or in the top half of the target band reinforces our expectations that a rate-hike cycle will start in August.

China: China's National Development and Reform Commission (NDRC) said inflation risks will fall this year for China. The NDRC expects shifting monetary policies abroad to weaken the global commodities rally. It also expects lingering Covid and global-supply concerns to ease.

Eurozone: Klaas Knot of the European Central Bank (ECB) said he expects an interest-rate increase as early as the fourth quarter of this year. Knot was speaking to Buitenhof, a Dutch political TV program, after the ECB's hawkish pivot last week. Knot also said a second hike can then take place in spring 2023. Traders accelerated bets on tightening, sending government debt yields across Europe well above zero on Friday for the first time in years.

Retail sales in the eurozone was much weaker than expected, despite the Christmas shopping season, amid a record rise in consumer prices. Retail sales fell 3.0% month-on-month for a 2.0% year-on-year rise in December. Economists polled by Reuters had expected a 0.5% monthly fall and a 5.1% annual rise.

Factory orders increased 2.8% after rising a revised 3.6% in the previous month, a stronger reading than even the highest estimate in a Bloomberg survey of 27 economists. On a year ago, factory orders lifted 5.5% - the sharpest pace in three months.

Business surveys have recently pointed to an easing of the bottlenecks that have curtailed factory output and driven up costs for producers. If confirmed, an improved supply situation could help fuel a strong rebound expected to take hold later in the year.

New Zealand: Building consents grew by 0.6% in December, following an equivalent monthly rise in November. In annual terms, building consents jumped 24.0%. A record 48,899 new homes were approved in the 2021 calendar year.

United States: The employment report on Friday was unequivocally strong. Non-farm payrolls spiked 467,000 in January, well above consensus median estimates for a rise of only 125,000. Indeed, the result of 467,000 even beat the range of estimates, which ranged from a decrease of 400,000 to a gain of 385,000 jobs.

Employment is 2.9 million jobs below its pre-pandemic peak.

The government also reported that 374,000 more jobs were created in the 12 months through March 2021 than previously reported.

Strong employment gains were accompanied by the biggest annual increase in wages since May 2020; average hourly earnings rose 5.7% in the twelve months to May and by 0.7% in the month. The result was also above consensus median estimates.

But Omicron's surge cut the average workweek to 34.5 hours, the shortest since April 2020, from 34.7 hours in December.

The unemployment rate rose slightly to 4.0% in January, from 3.9% in December, due to a lift in the participation rate. The labour force participation rate, or the proportion of working-age Americans who have a job or are looking for one, increased 0.3 percentage points to 62.2%.

Other details of the household survey were strong. Employment increased by 1.199 million jobs. The survey counts people who have a job as employed regardless of whether they got paid during the survey week if they were temporarily absent from their jobs because of illness or other reasons.

A broader measure of unemployment, which includes people who want to work but have given up searching and those working part-time because they cannot find full-time employment, dropped to 7.1%, the lowest since February 2020, from 7.3% in December.

The strong payrolls report paves the way for the US Federal Reserve to start raising rates in March by at least 25 basis points to tame high inflation. It also will see the odds shorten for a rate hike of 50 basis points.

Today's key data and events:

AU ANZ Job Advertisements Jan prev -5.5% (11:30am)

AU Real Retail Sales Q4 exp 7.7% prev -4.4% (11:30am)

CH Caixin Services PMI Jan exp 50.5 prev 53.1 (12:45pm)

EZ Ger. Indust. Production Dec exp 0.4% prev -0.2% (6pm)

EZ Sentix Investor Conf. Feb exp 15.4 prev 14.9 (8:30pm)

NZ National Holiday

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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