bankSA

Morning Report

Friday, 17 December 2021

Equities (close & % change)			Sydney Futures Exchange (close & change)					Interest rates (close & change)		
S&P/ASX 200	7,296	-0.4%		Last		Overnight Chg		**Australia**		
US Dow Jones	35,898	-0.1%	10 yr bond	98.37		-0.01		90 day BBSW	0.07	0.00
Japan Nikkei	29,066	2.1%	3 yr bond	98.76		0.02		2 year bond	0.67	0.04
China Shanghai	3,852	0.8%	3 mth bill rate	99.80		0.00		3 year bond	0.97	0.06
German DAX	15,636	1.0%	SPI 200	7,206.0		10		3 year swap	1.31	0.01
UK FTSE100	7,261	1.3%	FX Last 24 hrs	Open	High	Low	Current	10 year bond	1.57	0.01
Commodities (close & change)*			TWI	60.1	-	-	60.5	**United States**		
CRB Index	227.2	3.4	AUD/USD	0.7173	0.7224	0.7146	0.7181	3-month T Bill	0.03	-0.01
Gold	1,798.60	21.7	AUD/JPY	81.81	82.44	81.42	81.66	2 year bond	0.62	-0.05
Copper	9,537.50	310.0	AUD/GBP	0.5409	0.5429	0.5387	0.5391	10 year bond	1.43	-0.03
Oil (WTI futures)	71.93	1.1	AUD/NZD	1.0575	1.0597	1.0550	1.0565	**Other (10 year yields)**		
Coal (thermal)	179.10	9.8	AUD/EUR	0.6352	0.6386	0.6330	0.6339	Germany	-0.35	0.01
Coal (coking)	335.50	-3.8	AUD/CNH	4.5732	4.6045	4.5549	4.5817	Japan	0.05	-0.01
Iron Ore	120.05	3.1	USD Index	96.38	96.45	95.85	95.98	UK	0.76	0.02

Data as at 8:30am AEDT. Change from previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Central bank decisions in the UK, Eurozone and Norway dominated market sentiment overnight. The Bank of England (BoE) surprised markets and became the first major central bank to hike rates. The Norges Bank also raised rates and the European Central Bank (ECB) modestly tightened policy.

Share Markets: Share markets ended in the red in the US. The Dow Jones sold off 30 points (or -0.1%), the S&P 500 index fell 41 points (or -0.9%) and the Nasdaq dropped 29 points (or -0.1%).

Rate hikes in the UK and Norway failed to dent investor enthusiasm for shares in Europe. Investors are hoping policy tightening will tame inflation without hurting growth. The Euro Stoxx 50 index lifted 42 points (or +1.0%) and the UK's FTSE 100 rose 90 points (or +1.3%).

Yesterday, the ASX 200 index shed 31 points (or -0.4%) after the release of stronger than expected employment data locally. Markets viewed this data as lifting the risk of a rate hike from the RBA sooner.

Interest Rates: US bond yields fell across the yield curve. The US 2-year yield eased 5 basis points and the US 10-year yield dropped 3 basis points.

Interest-rate markets are fully pricing the first Fed funds rate hike to be in May 2022.

The UK 10-year bond yield lifted 2 basis points to close at 0.76%, but had reached a high of 0.83% during the trading session, after the Bank of England (BoE) surprised markets and hiked rates.

German 10-year yields closed 1 basis point higher at -0.35% but were higher during intraday trade, after policy tightening from the European Central Bank (ECB).

The Australian 3-year government bond yields (futures) ranged between 1.24% and 1.28%, while the 10-year yield ranged between 1.62% and 1.70%.

Interest-rate markets are fully pricing the first RBA rate hike to be in July 2022. The probability of a rate hike in July jumped to 129% yesterday after the jobs data, from 92% the day before.

Foreign Exchange: The AUD/USD lifted modestly after the employment data yesterday, from a low of 0.7156 to a high of 0.7181, but then unwound these gains and fell to 0.7146. However, European trading took the AUD/USD up to a 3-week high of 0.7224, before these gains were partially shed. The AUD/USD is sitting at around the 0.7180 handle at the time of writing.

Currency markets start to head into thinner conditions and the month of January. January is an interesting month for the AUD/USD; it's a month where it has not been unusual over the past decade for the AUD/USD to install a yearly or multi-month high or low in this month.

In other key moves overnight, the EUR/USD rose from 1.1285 to 1.1360 and the GBP/USD jumped

from 1.3250 to 1.3374.

Commodities: Iron ore, gold, oil, and thermal coal were higher on the day. Copper surged as one of Peru's biggest mines started to wind down operations, while coking coal was lower.

Australia: A blockbuster labour force release yesterday showed that 366.1k new jobs were added in November. This is the largest increase in employment in a single month on record, going back to the late 1970s. The jobs spike also fully recovers the jobs lost over July to October due to the lockdowns.

The unemployment rate fell 0.6 percentage points to 4.6%, near its lowest level in more than a decade. The participation rate leapt to 66.1% from 64.6% in October, just shy of the record high of 66.3%.

Hours worked, a better indicator of the state of the labour market through lockdowns, jumped 4.5% in November and is now less than 1% below of its level before the Delta lockdowns.

Easing restrictions in NSW and Victoria drove the strong result. Employment was up a record 179.8k and 141.0k in each state, respectively.

Jobs growth is set to continue as economic activity picks up. We expect the unemployment rate to march lower to sub 4% by the end of next year.

Separately, yesterday the Federal Government released its Mid-Year Economic and Fiscal Outlook (MYEFO), giving an update on the Budget released in May and a fresh set of economic forecasts.

The Budget bottom-line improved by $2.3 billion over the forward estimates compared with the May estimates. A stronger-than-expected recovery in the labour market and higher-than-expected iron ore prices led the upgrade.

However, the Government has also increased spending to combat the impacts of the Delta lockdowns. Government spending to manage the health impacts of the outbreak and to support the economy amounted to $25 billion since May.

The Government has upgraded its economic forecasts, reflecting a faster-than-expected economic recovery. However, we are more optimistic, particularly on commodity prices. Their conservative assumptions may lead to another upgrade to the forecasts ahead of the election next year.

New policy announcements, aside from the Delta support measures, were relatively minor. However, a possible $16 billion of future election spending promises, allocated over four years, have been budgeted as 'decisions taken but not yet announced'. These may see the light of day ahead of the election.

Reserve Bank (RBA) Governor Lowe laid out the options for the bond purchase program which will be reviewed at the February meeting. In a speech yesterday, Lowe said three options were on the table: (1) tapering purchases further and concluding the program in May, (2) tapering purchases further and reviewing the program again in May or (3) ceasing purchases altogether in February.

Lowe said the option they choose to take will much "depend upon the news" they receive between now and when they meet in February.

He highlighted the importance of further readings on inflation and the strength of the labour market., as well as learning more about Omicron effects and the actions of other central banks.

Lowe said that if "better-than-expected progress" towards the Board's goals of employment and inflation were made, then the case to cease purchases in February "would be stronger".

Yesterday's very strong jobs data raises the risk that the program could be dropped altogether in February.

The final piece of data yesterday was consumer inflation expectations. They rose to 4.8% in December, from 4.6% in October. Inflation expectations are at their highest level since August 2012.

Eurozone: The ECB left the key policy rates unchanged – the main refi rate stayed at zero per cent and the deposit rate at -0.5%. But the ECB tightened policy announcing it will boost the pace of regular bond purchases for half a year as it phases out emergency debt buying.

It was another small step in rolling back crisis-era stimulus. The ECB promised to hold down borrowing costs next year and even kept the door open to restarting emergency support.

In a decision that leaves policymakers with plenty of escape clauses to change direction, the ECB will end emergency bond buys next March but temporarily double the pace of its longer-running Asset Purchase Programme (APP) to ease the transition.

It will also invest cash from maturing bonds for longer and promised to keep the PEPP emergency scheme mothballed, ready to be deployed at short notice in the event of turbulence.

The ECB raised its inflation projections across the board and now sees it at 3.2% next year, well above

target, before a drop to 1.8% in both 2023 and 2024. ECB Chair Christine Lagarde acknowledged that there are some upside risks to the price increase outlook.

The Markit PMIs for manufacturing, services and the composite eased in December from the previous month. Manufacturing from 58.4 to 58.0, services from 55.9 to 53.3 and the composite from 55.4 to 53.4. Critically, all three indexes remained above 50.0, suggesting an expansion of activity ahead remains likely.

In other data, the trade surplus shrunk in the eurozone and by a lot more than expected by consensus. The trade surplus fell from €6.1 billion in September to €2.4 billion in October, as imports of energy from Russia and Norway surged.

New Zealand: GDP fell by 3.7% in the September quarter, following a revised 2.4% increase in the June quarter. In the year to Q3, GDP shrank 0.3%. Lockdowns during the period drove the fall, as restrictions on activity clipped household consumption.

Norway: The Norges Bank raised rates by 25 basis points last night. It is the second time in this cycle. The statement highlighted that unemployment had fallen further and capacity utilisation is estimated to be above normal. Virus measures are expected to dampen activity in the near term, but Norges is confident the recovery will continue.

United Kingdom: The BoE surprised markets with its first rate hike since the pandemic struck. The BoE also became the world's first major central bank to raise interest rates since the pandemic hammered the global economy, and warned inflation was likely to hit 6% in April - three times its target level.

Surprising investors, the BoE said it had to act now, even as the Omicron coronavirus variant sweeps the UK, because it saw warning signs in underlying inflation pressures.

The nine-member Monetary Policy Committee voted 8-1 to raise Bank Rate to 0.25% from 0.1%.

Governor Andrew Bailey said Omicron was already hurting retailers and restaurants but the BoE had felt compelled to stop the recent jump in prices from becoming a longer-term problem.

The BoE pointed to the likelihood of more "modest tightening of monetary policy" over its three-year forecast period.

The Markit purchasing managers' indexes (PMIs) for manufacturing, services and the composite eased in December from the previous month. Manufacturing from 58.1 to 57.6, services from 58.5 to 53.2 and the composite from 57.6 to 53.2. Critically, all three indexes remained above 50.0, suggesting an expansion of activity ahead remains likely.

United States: Industrial production rose 0.5% in November, a little below consensus expectations for a 0.6% rise. But the result is up for a second consecutive month following a hurricane in September. Easing capacity constraints also provided support. The index is now back above its pre-pandemic level.

Building permits rose 3.6% in November and housing starts jumped 11.8% in the month, both well above consensus estimates. Housing starts are now at their highest level since March this year, although raw materials and labour shortages remain a headwind.

The Philadelphia Fed index fell in December to 15.4, from 39.0 in November, hitting its lowest level in a year. As conditions have recovered, the six-month-ahead outlook index has moderated, but businesses generally remain optimistic. The underlying components point to easing pressures on supply chains and lower inflationary pressures.

The Kansas City Fed manufacturing index was unchanged at 24 in December, signalling expansion. Echoing industrial production and the Philadelphia Fed index data, the survey showed signs that supply bottlenecks are easing. Supplier-delivery times fell and inventories grew at a faster pace.

Today's key data and events:

NZ ANZ Business Confidence Dec prev -16.4 (11am)
UK GfK Cons. Sentiment Dec exp -17 prev -14 (11:01am)
UK Retail Sales Nov exp 0.8% prev 0.8% (6pm)
EZ IFO Bus. Climate Survey Dec exp 95.3 prev 96.5 (8pm)
EZ CPI Nov y/y Final exp 4.9% prev 4.9% (9pm)

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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We wish you a very happy and safe festive season.
Thank you for your readership this year.
This is the last daily Morning Report for 2021.
We will be returning on Monday, 17 January, 2021.

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