Daily Alert
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Powell's comments on inflation spooks markets

Swings in market sentiment have continued, with concerns over the efficacy of current vaccinations to the (rapidly-spreading) Omicron variant and hawkish comments by FOMC Chair Powell instilling a risk-off tone in markets overnight. There were sizeable swings in currencies (towards safe havens), pronounced volatility in equities (the CBOE VIX rose to just shy of 28), sharp falls in most commodity prices, and with yield curves flattening as longer-term interest rates fell.

In his Senate Testimony FOMC chair Powell noted the Omicron variant posed downside risks to employment/economic activity and increased uncertainty for inflation. What spooked markets were Powell's comments that despite Omicron risks, the strong US economy and elevated inflation could prompt the FOMC ending its QE programme and then rising interest rates sooner than planned. **Powell noted it was time to drop "transitory" to describe US high inflation that could linger well into 2022.** Treasury Secretary Yellen remained confident on the US recovery but urged Congress to raise the debt limit (due to be breached after December 15) and the Senate to pass the USD1.75 tr Build Back Better spending bill despite the risk of cost overruns.

Global equities sank after the Powell comments. Major US equity indices were down 1.5%-2% overnight, with widespread falls across the S&P500. European equity indices were also lower, with falls in the Asian session. **Commodity prices were generally lower.** Near-term contract prices for WTI (USD65 per barrel) and Brent (USD68) were down sharply, with the former down a whopping USD17 since the start of November. Here's hoping for lower fuel prices for Christmas. Metals prices (excluding gold) rose.

US Treasury yields responded to the Powell comments with market pricing for FOMC hikes firming (up 5bps or so, with 50bps of FOMC hikes by 2022 priced in), short-term Treasury yields rising (2Y 0.52%) and longer-term yields down (10Y 1.44%). Yield curves were also flatter in Europe. NZ swap yields were generally higher yesterday, with NZ government bonds weighed by lower Australian bond yields.

Data wrap: Eurozone CPI was stronger than expected, jumping to 4.9% yoy (core CPI 2.6% yoy), the highest on record. German CPI surged to 5.2% yoy, the highest since the early 1990s. The US Conference Board measure of consumer sentiment dipped slightly in November (109.5), with respondents remaining considerably more upbeat about the present situation (142.5) than the future (87.6). S&P house prices continued to make gains in September (1.0% mom, 19.1% yoy). Chinese manufacturing (50.1) and non-manufacturing PMI's (52.3) were both stronger than expected.

The final November ANZBO survey did not show signs of a pending Traffic Light System boost, with the activity metrics pointing to a further moderation in subpar growth, but with costs and pricing intentions soaring. A less than ideal mix, but reflective of the challenges facing businesses and households alike. Conditions for the retail sector remain tough. The RBNZ October credit aggregates showed still-strong housing credit growth (0.8% mom, 11.4% yoy), despite tightening credit conditions, higher mortgage interest rates and lower loan demand.

Across the ditch the Q3 current account surplus (AUD23.9bn, 4.8% of GDP) hit a new record high, whereas lower multi-unit approvals saw dwelling approvals slide (-12.9% mom), with housing credit running at a solid 0.6% mom clip. With fixed mortgage interest rates also on the rise across the ditch, our CBA colleagues expect dwelling price growth will moderate (+7% over 2022 before falling 10% over 2023).

FX Update: Increased risk aversion drove currency market action, with the yen, euro and Swiss franc at the top of the G10 leader board, with commodity currencies and sterling the major laggards. Outside of the G10, the Turkish lira plummeted after President Erdogan ruled out interest rate hikes to combat inflation. The NZD dropped below 68 US cents last night and has been volatile, trading in a 0.6770 to 0.6860 USD range. The NZD has been edging up against the AUD and currently lies around 0.9590 AUD. Equity market direction will be an important barometer for the NZD.

Day Ahead: NZ Building consents are expected to have remained elevated close to record levels in October, although the outlook for 2022 is for cooling activity. Interim NZ Crown Financial Statements for the 4 months to October (10am) will be perused for signs of a COVID-19 hit (mild thus far). Lockdowns across the Tasman should drive a sizeable Q3 contraction in Australian GDP (mkt: -2.5% qoq, CBA: -3.0% qoq). The Caixin manufacturing PMI for China is out (mkt: 50.6) with the OECD economic outlook, German October retail sales (mkt: +0.9% mom), manufacturing PMIs for the Eurozone. The US manufacturing ISM (mkt: 61.2) should show strong momentum in November, with a solid 525k print expected from the November ADP employment survey. The House Testimony by Powell and Yellen tomorrow morning and a raft of speeches by the FOMC, ECB and BOE are also out. **Author:** mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.6814	0.2%	NZD/SEK	6.155	-0.4%	NZX WMP	4225.0	0.0%	Dow	34604	-1.5%
NZD/AUD	0.9586	0.5%	NZD/DKK	4.479	-0.2%	Gold $/o	1774.6	-0.6%	S&P 500	4582	-1.7%
NZD/EUR	0.6023	-0.3%	NZD/THB	23.0	0.2%	WTI Oil $/b	66.0	-5.6%	NASDAQ	15545	-1.5%
NZD/JPY	77.06	0.4%	AUD/USD	0.7108	-0.3%	**Money Market (%)**			FTSE	7059	-0.7%
NZD/GBP	0.5137	0.4%	EUR/USD	1.131	0.4%	90 Day BB	0.80	0.00	CAC-40	6721	-0.8%
NZD/CAD	0.8731	-0.8%	USD/JPY	113.1	-0.6%	OCR	0.75	0.00	DAX	15100	-1.2%
NZD/CHF	0.6266	-0.3%	**10 Yr Bond Yields (%)**			**ASB Swap Rates (%)**			H.Seng	23475	-1.6%
NZD/HKD	5.313	0.2%	NZ	2.49	-0.02	1yr	1.53	-0.04	Nikkei	27822	-1.6%
NZD/SGD	0.9311	-0.1%	US	1.45	-0.05	2yr	2.10	-0.04	ASX200	7256	0.2%
NZD/CNH	4.338	-0.2%	Aust	1.70	-0.05	5yr	2.54	-0.06	NZX50	12719	0.0%

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