Morning Report

Tuesday, 21 March 2023

Equities (close & % change)		
S&P/ASX 200	6,899	-1.4%
US Dow Jones	32,245	1.2%
Japan Nikkei	26,946	-1.4%
China Shanghai	3,391	-0.5%
German DAX	14,933	1.1%
UK FTSE100	7,404	0.9%
Commodities (close & change)*		
CRB Index	255.2	0.5
Gold	1,978.85	0.0
Copper	8,701.25	121.0
Oil (WTI futures)	67.61	0.9
Coal (thermal)	194.80	-2.6
Coal (coking)	352.67	-0.3
Iron Ore	124.80	-0.7

Sydney Futures Exchange (last & change)				
	Last		**Overnight Chg**	
10 yr bond	3.30		0.06	
3 yr bond	2.81		0.01	
3 mth bill rate	3.42		0.04	
SPI 200	6,969.0		45	
FX Last 24 hrs	**Open**	**High**	**Low**	**Current**
TWI	60.7	-	-	60.7
AUD/USD	0.6714	0.6730	0.6666	0.6719
AUD/JPY	88.50	89.24	87.14	88.23
AUD/GBP	0.5494	0.5518	0.5467	0.5472
AUD/NZD	1.0681	1.0758	1.0674	1.0756
AUD/EUR	0.6281	0.6300	0.6249	0.6265
AUD/CNH	4.6217	4.6299	4.5932	4.6178
USD Index	103.74	103.96	103.28	103.29

Interest rates (close & change)		
Australia		
90 day BBSW	3.69	0.00
2 year bond	2.85	-0.18
3 year bond	2.84	-0.17
3 year swap	3.34	0.00
10 year bond	3.24	-0.15
United States		
3-month T Bill	4.42	0.13
2 year bond	3.98	0.14
10 year bond	3.48	0.06
Other (10 year yields)		
Germany	2.13	0.02
Japan	0.25	-0.04
UK	3.31	0.03

Data as at 8:00 am AEST. Change is from the previous trading day (excluding the SFE, which is the change during the night session). Source: Bloomberg.

Main Themes: Developments in banking continued to dominate market sentiment and keep markets on a knife's edge. Confidence remains fragile. The key issues overnight centred around the implications of the UBS-Credit Suisse tie up and the risks surrounding Additional Tier 1 Debt (i.e. AT1 bonds). Fresh developments with First Republic Bank in the US also affected sentiment.

Global Banking Developments: Yesterday, some of the world's largest central banks announced co-ordinated action to expand pre-existing currency swaps. The central banks were the Bank of England, Bank of Canada, Bank of Japan, the European Central Bank, the US Federal Reserve and the Swiss National Bank. This is likely an effort to prevent dollar funding strains from appearing. Currency swap arrangements are already standing and have been for some time. In October 2013, following the 2008-09 GFC and, later, concerns about debt sustainability in Europe, the currency swap lines were made into permanent standing arrangements. The main change in the announcement was that central banks will increase the frequency of 7-day maturity operations from weekly to daily. Daily operations will begin on March 20 and extend through to the end of April.

There has been a sharp repricing of Banking AT1 and Cocos (Contingent Convertible Bonds) Capital after the wiping out of CHF17 billion of Credit Suisse's AT1 Capital. Authorities that brokered Credit Suisse's rescue merger with UBS have said CHF 16 billion of its AT1 debt will be written down to zero. That is the largest loss in the $275 billion AT1 debt market to date. AT1 bond holders rank below those holding equity stakes in Credit Suisse who can expect to receive CHF 0.76 per share. That shock rippled through financial markets yesterday, causing bank credit default swaps to widen. AT1 bond prices from other European banks also tumbled, as investors dumped AT1s and traders re-priced the risk and cost of banks' capital.

A UBS AT1 bond that is callable in January 2024 was trading at a yield of nearly 30% higher, up from 12% on Friday, demonstrating how much more costly such debt has become.

Created in the wake of the GFC, AT1 bonds are a form of junior or hybrid debt that counts towards banks' regulatory capital. They were designed as a part of total loss-absorbing capacity (TLAC) bonds to provide a 'bail-in' or a way for banks to transfer risks to investors and away from taxpayers if they got into trouble. The AT1 bonds, which also carry a higher coupon, can be converted into equity or written down when a lender's capital buffers are eroded beyond a certain threshold.

In the case of Credit Suisse, the AT1 prospectus made it clear that hybrid (AT1) holders would not recover any value. The Swiss regulator FINMA also said it "may not be required to follow any order of priority" meaning that the AT1 could be cancelled before the equity.

Pimco and Invesco are among the largest holders of Credit Suisse's AT1 bonds, which were wiped out by the UBS takeover. Pimco had about US$807 million of the securities and Invesco US$370 million. Dealers, including JPMorgan and Morgan Stanley, were reportedly willing to buy Credit Suisse AT1 debt for somewhere around 2 cents on the dollar and sell somewhere around 5 cents.

European authorities sought to restore confidence in the debt, saying that holders should only face losses after shareholders are fully written down.

In other developments, UBS's outlook was cut to negative by the credit rating agency S&P.

JPMorgan's and several other banks are discussing fresh stabilisation efforts for First Republic. First Republic Bank slumped to an all-time low on the news and on its second ratings downgrade by S&P in just a week.

New York Community Bancorp surged after agreeing to take over Signature's deposits and some of its loans.

Share Markets: US share markets climbed as regulators rushed to shore up investor optimism. Initially, share markets were sold off after the sharp repricing of AT1 and Cocos. The S&P 500 rose 0.9%, with all major groups gaining. The Dow lifted 1.2% and the Nasdaq 0.4%. The Euro Stoxx 50 gained 1.3%.

Interest Rates: The US 2-year treasury yield had another wild day. It rose to 4.02% during Asia trade, fell to a low of 3.62% in Europe's trading session overnight and then closed at 3.98% in New York. The close of 3.88% was 14 basis points higher than the close in the previous trading session.

The US 10-year yield dropped overnight to test a low of 3.29% but rebounded to close 6 basis points higher at 3.48%.

Markets are attaching a probability of around 70% to a rate hike of 25 basis points from the Fed this week when they meet, but are also continuing to price in a rate-cutting cycle to begin very soon after. Rate cuts are fully priced in by July.

The Australian 3-year government bond yield (futures) remained at 2.80%, while the 10-year yield was trading at 3.28% (basis futures).

Markets are attaching a low chance of a Reserve Bank (RBA) rate hike next month and they do not expect the RBA to raise the cash rate further.

Foreign Exchange: The US dollar index depreciated in overnight trade from around 104.00 to around 103.30. The AUD/USD was volatile, falling from 0.6740 in Asia trade yesterday to 0.6665 before rising overnight to around 67.20. The AUD/USD remains hostage to sentiment and US dollar developments in the near term.

Commodities: Gold, oil and the widely-watched commodities research bureau (CRB) index were higher in overnight trade.

Australia: Reserve Bank Assistant Governor Kent spoke yesterday. Kent said that banking considerations are just one of many considerations for monetary policy and that the global banking system is a lot stronger than it was a decade ago. He added that the impact on the Australian market has been modest so far and that the Board will take account of financial conditions in deciding on rates.

Eurozone: A trade deficit of €30.6 billion was recorded in January, slightly larger than the €30.2 billion gap posted in December 2022. Exports were up 11.0% on a year ago and imports rose 9.7% compared with last January.

United States: Amazon has announced it is dismissing 9,000 employees on top of the 18,000 announced in January, which was its largest layoff ever.

Today's key data and events:

NZ Trade Balance Feb prev -$1.95bn (8:45am(

AU RBA Board Meeting Minutes (11:30am)

EZ ZEW Survey Mar prev 29.7 (9pm)

US Philly Fed Non Mfg Index Mar prev 3.2 (11:30pm)

US Existing Home Sales Feb prev 4.20mn (1am)

Times are AEST. 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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