HD (ED) ANZ Global: Aust bond futures sold off with US markets

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Sydney - Monnday - September 15: (RWE Aust Business News) - The latest global business information compiled by ANZ research analysts. ` Weekend markets update

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US Treasuries continued to sell off on Friday night and are around 25bps higher since the start of September. The curve steepened with the 2-year yield unchanged at 0.56% and the 10-year yield increasing 5bps to 2.61%.

Australian bond futures also sold off, underperforming US Treasuries across the curve. The implied 3-year yield increased 3bps to 2.88% and the implied 10-year yield increased 6bps to 3.67%.

US equities drifted lower on Friday night ahead of the FOMC meeting this week. The market has now broken its run of five straight weeks of rises. The S&P 500 fell 0.6% to 1,986, the Dow Jones fell 0.4% to 16,988 and the Nasdaq finished 0.5% lower at 4,568.

European equities were broadly unchanged but the German DAX underperformed, declining 0.4% to 9,651. The Euro Stoxx 50 declined a marginal 0.1% to 3,235 but the FTSE 100 rose 0.1% to 6,807.

Australian SPI futures fell 0.3% to 5,519.

In currency markets, the AUD has begun this week where it left off last, under pressure. The proximate driver on this occasion were the weekend China data, which reinforced the signal from bulk commodity prices over recent months, that China's economy is continuing to slow as its deleveraging cycle continues.

This week the key events are global, with the FOMC likely to support the USD in response to a shift in language towards tightening, as well as some volatility in GBP around the Scottish referendum on Thursday. We expect the AUD to continue to push lower.

Indicative trading levels: AUD 0.9006, AUD/EUR 0.6942, AUD/GBP 0.5533, AUD/NZD 1.1053, AUD/JPY 96.53, AUD/CNY 5.53, EUR/USD 1.2974, GBP/USD 1.6276, USD/JPY 107.19.

Oil prices declined on Friday as signs continue to mount that global demand is softening at the same time global supply is set to rise. WTI futures fell 0.7% to USD92.27 per barrel and Brent futures lost 0.8% to USD97.11 per barrel.

The spot gold price (-0.9%) continued its slide on waning inflation expectations but lifting interest rate forecasts. Gold fell to a seven-month low of USD1,229.7 per ounce.

Base metals prices prices were flat to lower on Friday but may take a hit on the open due to the weaker China data released over the weekend. Copper, nickel, lead and zinc were broadly unchanged, while aluminium (-0.5%) fell modestly.

· Agricultural commodities prices were mixed on Friday. Corn (-1.2%) and wheat (-0.9%) weakened further following the US Government forecast of record global wheat output and rising inventories. Sugar also declined a solid 1.9%. In contrast, soybeans (+0.3%), canola (+0.6%), palm oil (+0.8%) and cocoa (+1.1%) all rose.

Key Drivers

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The global bond market sell-off continued on Friday night. In the US, most of the pain was at the long end and both the US 10- and 30-year bond yields are 27bps above the recent troughs in late August. US equities also declined modestly.

Economic data were supportive of these moves with solid US retail sales and consumer confidence further building the case for the Federal Reserve to raise interest rates. Meanwhile, the AUD remains under pressure, opening just above USD0.90 this morning following weaker-than-expected **China** activity data on the weekend. Oil prices fell further, with Brent down almost 15% from year highs.

US retail sales in August were largely in line with expectations but revisions were positive. Headline sales rose 0.6% m/m in August, in line with market expectations, but growth in July was revised up to 0.3% m/m (originally reported as unchanged). 'Control' retail sales (which feed into GDP calculations) rose 0.4% m/m in August while July sales were revised 0.3ppts higher to 0.4% m/m. This is consistent with goods consumption rising at a solid pace in Q3.

**China** activity data (released Saturday) was soft to weak. Industrial production was the largest miss, rising 6.9% y/y (mkt: 8.8%) in August, the slowest pace since the global financial crisis, and much slower than the 9% y/y pace in July. Electricity production declined 2.2% y/y in August. The significant divergence between industrial production and electricity production points to a weak heavy industry, led by sluggish demand in **China**'s private **residential property** market. Retail sales (+11.9% y/y) and fixed asset investment (+16.5% y/y) growth also slowed and came in below expectations.

Short of outright policy easing, ANZ expects that **China** will likely miss the 7.5% GDP growth target this year, and a sharp economic slowdown will also make ongoing structural reforms more difficult.

Also in **China**, August monetary data (released Friday) suggest that **China**'s credit extension improved somewhat after the sharp decline in July, although it remains soft. **China**'s new yuan loans bounced back to RMB703bn in August from the extremely low RMB385bn in July.

Aggregate financing also picked up (RMB957.4bn) but was significantly lower than in the same period last year. M2 money supply growth slowed further to 12.8% y/y in August, the first time since March that M2 growth came in below the central bank's target of 13% y/y.

Euro area industrial production picked up in July, rising 1.0% m/m, and June growth was also revised higher to flat from -0.3% m/m previously. The composition was also encouraging, with solid capital goods production growth. This should help ease fears of a continuation of weak growth in Q3.

This week in Australia, the minutes of the RBA September **Board** meeting will be released tomorrow.

We expect the Minutes to reiterate the slightly more upbeat tone on the domestic economy purveyed in the post-meeting statement. Chris Kent (RBA Assistant Governor, Economic) will also speak tomorrow at the Bloomberg Economic Summit and the Banks' quarterly Bulletin will be released on Thursday. The key focus offshore will be the Federal Reserve policy meeting where markets are looking for a more upbeat tone.

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