

HD (ED) ANZ Global: Aust bond futures rally across curve in US markets

WC 1,172 words

PD 21 May 2014

SN Ralph Wragg Australian Business News

SC AAPRAW

LA English

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Sydney - Wednesday - May 21: (RWE Aust **Business** News) - The latest global **business** information compiled by ANZ research analysts.

Overnight Markets Update

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US Treasuries rallied across the curve overnight as risk appetite declined ahead of Wednesday's release of the April FOMC minutes. The curve flattened with the 2-year yield declining 1bp to 0.34% and the 10-year yield dropping 3bps to 2.51%.

Australian bond futures also rallied across the curve overnight, outperforming US Treasuries at the short end while modestly underperforming at the long end. The implied 3-year yield fell 4bps to 2.79% and the implied 10-year yield slipped 2bps to 3.68%.

US equities declined overnight, ending a two-day gain after results from US retailers undershot earnings expectations. The Dow Jones finished the session 0.8% lower at 16,374, the S&P 500 fell 0.6% to reach 1,873, while the Nasdaq lost 0.7% to 4,097.

European equities traded in tight ranges for much of the session before closing with modest losses. The Euro Stoxx 50 slipped 0.2% to 3,164, the FTSE 100 fell 0.6% to 6,802 and the German DAX declined by 0.2% to 9,639.

Australian SPI futures finished the session 0.5% lower at 5,403.

In currency markets risk aversion took hold and carry **sold** off broadly amid weaker stocks and stronger **bonds**. Softer retailer results broadened the sell-off, however weakness did begin in Asia with the AUD. There, a steady accumulation of bad news, namely a warning on the sovereign AAA rating, continued weakness in **iron ore** prices, a soft consumer confidence number and slightly dovish set of RBA meeting minutes finally dented the AUD. As we have maintained for some time the recent rally in the AUD has not been fundamentally driven and it now looks vulnerable on all crosses. Later this week the **China** PMI will be the key risk to the AUD downtrend, with other activity indicators highlighting that production likely remained subdued.

Indicative trading levels: AUD 0.924, AUD/EUR 0.6745, AUD/GBP 0.54873, AUD/NZD 1.0782, AUD/JPY 93.604, AUD/CNY 5.7638, EUR/USD 1.37, GBP/USD 1.6839, USD/JPY 101.3.

Oil prices were mixed overnight, with WTI futures declining 0.3% from a four week high to close at USD102.44 per barrel with inventories expected to remain high. Meanwhile, Brent futures were up 0.4% to USD109.91 per barrel.

The spot **gold** price edged higher for a second day, rising 0.1% to reach USD1,294.3 per ounce as **equity** markets weakened.

Base metals prices declined overnight. Nickel (-1.8%) fell for the first time in three days on concerns that the high prices would limit demand for the metal. **Lead** (-0.9%), **copper** (-0.7%), zinc (-0.5%), and aluminium (-0.3%) also dropped. Thermal **coal** futures fell 0.6% to USD76.1 per tonne and spot **iron ore** closed 1.0% lower at USD97.5 per tonne.

Agricultural commodities largely declined overnight, with corn (-1.3%) falling on speculation that improved weather conditions will boost crops. Wheat (-1.9%), sugar (-1.1%), soybeans (-1.0%), palm **oil** (-0.5%) and cotton (-0.2%) also eased while cocoa (+1.3%) rose and canola remained unchanged.

Key drivers

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Global equities were weaker across the **board** amid a round of disappointing corporate earnings reports from both sides of the Atlantic, while US government **bonds** rallied.

The AUD fell close to 1c to USD0.924, on an accumulation of bad news, including Monday night's S&P warning on Australia's AAA credit rating (although they later clarified no cut is imminent). The spot **iron ore** price fell a further 1% to USD97.5, down 6% in a week and 18% off its most recent peak in mid April.

In the US, Federal Reserve Bank of New York President William Dudley reiterated the pace of eventual interest rate increases in the US "will probably be relatively slow," depending on the economy's recovery and how financial markets respond.

Last night's Global **Dairy** Auction saw **dairy** prices fall and the NZD weaken in response. The Global **Dairy** Trade price index fell 1.8% to an average price of USD3,873/MT, taking the cumulative fall to 25% since early February. This was despite the lowest volumes on offer at the auction since June 2013.

The pound was given a boost overnight following the release of a stronger-than-expected UK inflation report for April. Headline inflation came in at 0.4% **m/m** and 1.8% y/y (mkt: +0.3% **m/m**; +1.8% y/y), while core inflation was 2.0% y/y (mkt: +1.8% y/y). The detail of the report suggests the timing of Easter supported price rises in some areas such as transport, with air fares (+18% y/y) and sea fares (+22%y/y) up solidly. Upstream price pressures, as reported in the PPI data separately, remain subdued.

Bank of Finland Governor Erkki Liikanen reiterated some of the alternative stimulus measures the ECB could announce at its June policy meeting. Liikanen said that should money market rates rise, policy options include ending adjusting the rate corridor, cutting rates and/or conducting QE. Overall, though, there was nothing new relative to the options spelled out by ECB President Draghi in his speech on 24 April.

Yesterday in Australia, the ANZ-Roy Morgan consumer confidence fell a further 3.2% to 100.4 in the week ending 18 May, after the 2014-15 Commonwealth Budget was handed down.

Confidence began weakening noticeably four weeks ago when some significant policies were leaked ahead of the Budget's release and is down a sharp 14% since then; the steepest decline over a four-week period since the series became weekly in October 2008. This index will be an important indicator to watch for the consumer spending outlook.

Meanwhile, the RBA May **Board** Minutes were overall slightly more dovish than we had expected. The RBA is expecting below trend growth in next few quarters due to weaker export growth, weaker **mining** investment and fiscal restraint, while the improvement in the labour market is forecast to be protracted.

There was no suggestion of any likelihood that the RBA will reduce rates further but equally very little expectation that the economic outlook will see rates rising any time soon either.

At face value, the Minutes suggest the risk of a delayed start to tightening in 2015 and/or of more gradual rate rises than ANZ's forecast (currently 100bps of tightening through 2015). * Tonight, the Minutes of both the Fed's and the BoE's most recent policy meetings will be released, and the Bank of Japan will conclude a two-day meeting.

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