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Overnight Markets Update

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US Treasuries sold off across the curve for a fourth consecutive day overnight, led by the stronger US factory orders reading and a retracement from last week's rally. The curve steepened with the 2 year yield finishing the session 1bp higher at 0.40% and the 10-year yield up a solid 8bps to 2.60%.

Australian bond futures also sold off across the curve in last night's session, underperforming US Treasuries at the short end of the curve, and outperforming at the long end. The implied 3-year yield finished the session 3bps higher at 2.82% while the implied 10-year yield rose 6bps to 3.78%.

US equities finished last night's session largely unchanged from the record highs reached in the previous day. The Dow Jones and Nasdaq both closed 0.1% lower at 16,722 and 4,234 respectively, while the S&P 500 remained unchanged at 1,924.

European equities traded in tight ranges for much of last night's session, before closing modestly lower. The Euro Stoxx 50 slipped 0.2% to 3,241, the FTSE dropped 0.4% to 6,836 and the German DAX finished the session 0.3% lower at 9,920.

Australian SPI futures finished the session 0.2% higher at 5,491.

In currency markets the USD weakened a touch as the EUR strengthened on profit taking ahead of ECB meeting this week. This occurred despite a weaker than expected inflation outcome for the continent, and highlights that the hurdle for the ECB President to surprise the market is high. In New Zealand, another unexpectedly weak dairy auction drove the NZD lower, and AUDNZD higher, as the AUD remained disappointingly resilient despite more weak data. The GDP numbers in Australia may provide a further boost to the AUDNZD cross, however we remain wary about being long AUD, and think that the ECB meeting and the US payrolls report will have more impact.

Indicative trading levels: AUD 0.9264, AUD/EUR 0.6798, AUD/GBP 0.55312, AUD/NZD 1.0988, AUD/JPY 94.982, AUD/CNY 5.7944, EUR/USD 1.3628, GBP/USD 1.675, USD/JPY 102.53.

Oil prices were mixed overnight. WTI futures rose 0.2% to USD102.81 per barrel on growth in US factory orders, while Brent futures dipped 0.1% to USD108.85 per barrel.

The spot gold price gained 0.1% overnight to USD1,245.3 per ounce.

Base metals prices were mixed. Copper (-0.9%) had its largest monthly fall on signals of easing Chinese demand. Nickel (-2.2%) and aluminium (-0.4%) also declined while lead (+0.5%) and zinc (+0.2%) rose. Spot iron ore edged 0.4% higher to USD92.5 per tonne and thermal coal futures gained 0.3% to USD72.8 per tonne.

Agricultural commodities prices were also mixed overnight. Corn (-1.5%) dropped to a 13-week low on expectations of record high US output along with a fall in wheat (-1.6%), palm oil (-1.2%), soybeans

(-1.1%) and canola (-0.3%). Meanwhile, cotton (+1.0) and sugar (+0.1%) gained and cocoa remained unchanged.

`Key drivers

Price action was generally limited overnight ahead of some key events later in the week, with global equities edging modestly lower from record highs. However, long US Treasuries sold off relatively sharply for the fourth consecutive session, going some way to retracing the strong rally seen in bonds earlier in the month. The USD weakened modestly and the EUR strengthened on profit taking ahead of Thursday's ECB meeting. Meanwhile, the spot iron ore price rose 0.4% to USD92.5 per tonne.

Euro area inflation rose 0.5% y/y in May, which was a touch below market expectations (+0.6 y/y). Within the breakdown, services inflation eased to 1.1% y/y in May from 1.6% y/y in April, energy prices were unchanged over the year to May, and food, alcohol and tobacco inflation eased to 0.1% y/y. These data provide further evidence of imminent policy support from the ECB. There was little reaction in financial markets (in fact, profit taking saw the euro rise throughout much of last night's session), suggesting much is already priced in. The factor that the market is now watching is what additional credit easing measures the ECB may introduce.

US factory orders for April were a touch better than expected at 0.7% m/m (mkt: +0.5% m/m) and March's growth was revised 0.4ppts higher to 1.5% m/m. Orders have now risen for three consecutive months. The data are consistent with a gradual recovery in output after the harsh winter and contain little new information to alter current expectations around the Federal Reserve. The ISM New York rose to 55.3 in May, from 50.6, consistent with other regional manufacturing indices.

There was an unexpected sharp fall in whole milk powder prices (WMP) at Fonterra's Global Dairy Trade auction overnight. In aggregate WMP prices declined 8.5% to $US3,590/t, with weakness evident across all contract periods, except July (+6.5%). The Global Dairy Trade index declined 4.2%.

In Australia yesterday, the RBA left the cash rate unchanged at 2.5% and continues to envisage an extended period of unchanged interest rates. RBA retained moderate language around the domestic outlook, with only mild acknowledgement of the recent decline in high frequency indicators. We retain our long-held view that the RBA cash rate will remain on hold until Q1 2015, although the recent loss of momentum in activity indicators suggests the risk is tilted towards a slightly later start or a more drawn out tightening cycle.

In terms of yesterday's data, retail sales growth was a touch weaker than market expectations in April, increasing a modest 0.2% m/m (ANZ: +0.2% m/m, mkt: +0.3% m/m). In our view, the weakness in the month was likely in part due to the close proximity of ANZAC day and Easter, which appears to have weighed on spending in some categories. Even still, after a strong pick-up since August last year, retail spending growth has noticeably weakened over the past three months. Meanwhile, the current account deficit (CAD) narrowed sharply to 1.4% of GDP, which is the smallest CAD since March 1980. We expect the CAD to narrow further going forward as iron ore and LNG exports ramp up. Net exports rose sharply in Q1 and look set to have contributed 1.4ppts to Q1 GDP growth.

Yesterday, the Queensland 2014-15 budget showed write downs in revenue in 2014-15 and outlined a plan to reduce Queensland's hefty debt by privatising around AUD34bn of government assets if it wins the 2015 election. The net operating deficit is expected to be AUD2.30bn in 2013-14 (from a previously projected AUD3.77bn at the last fiscal update in December).

In 2014-15, the surplus is projected to be AUD188m, down from a projected AUD1.91bn. The operating surpluses projected for 2015-16 and 2016-17 were revised higher to AUD3.19bn and AUD3.53bn. As expected, the fiscal deficit for 2014-15 was revised to AUD2.27bn from a previous estimate of -AUD664m. None of the estimates from these proposed privatisations have been included in the budget estimates. The final plan for asset sales will be announced in September.

The ACT also released its 2014-15 Budget yesterday, which showed slower growth in revenue, higher capital spending and increased indebtedness.

Today in Australia, we have shaved our preliminary forecast slightly and now expect Q1 GDP to have risen 1.0% q/q (mkt: +0.9% q/q). The main new pieces of information for Q1 since our preliminary forecast are: a much larger-than-expected subtraction from inventories, slightly weaker public demand, wages and profits, and a stronger contribution from net exports.

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