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 1.25pm

SUMMARY

- Supportive comments from the US Federal Reserve (Fed) saw most markets enjoy a 'risk-on' rally last week. Equity markets rose, with the US S&P500 index posting a record close on Friday, credit spreads narrowed and bond yields fell.
- In contrast, domestic data remains subdued and expectations of a near-term rate cut have grown.

WEEK IN REVIEW



Domestic

- The unemployment rate rose to 5.73 per cent in June from 5.55 per cent; a 10,300 increase in employment was more than offset by a 23,700 increase in unemployment. The number of people recorded as being unemployed has risen to 709,300, a fifteen-year high. The unemployment rate in Queensland spiked higher, to 6.4 per cent from 5.9 per cent, though this data is quite volatile from month to month and the trend measure of unemployment in Queensland is a more moderate 6.0 per cent.
- ANZ job advertisements declined by 1.8 per cent in June and have now fallen for four consecutive months. Other job advertisement series also suggest subdued employment growth.
- The June NAB Business Survey showed a further deterioration in business conditions, with this index falling to a reading of -8 from -4, and capacity utilisation fell to a four-year low. NAB described the survey results as 'worrying' and now expect the Reserve Bank of Australia (RBA) to lower the cash rate in August.
- The housing sector remains a brighter spot for the local economy. The number of housing finance commitments for owner-occupiers rose by 1.8 per cent in May, a fifth consecutive gain. Investors are active in the housing market, though first-home buyers are not, a result of recent regulatory changes. The fixed-rate share of loans rose to 19.5 per cent, a five-year high, with more consumers moving to lock in low fixed rate funding.


Offshore

- Domestic and global markets continue to be heavily influenced by Fed policy. Federal Open Market Committee minutes released last week noted that 'many members' would like to see further improvement in the labour market before slowing the pace of asset purchases. Speaking after the release of the minutes, Fed Chairman Ben Bernanke also stated that 'highly accommodative monetary policy for the foreseeable future is what's needed'. The Chairman will address US Congress this week, providing an opportunity for a clearer enunciation of Fed strategy.
- In Europe, European Central Bank (ECB) President Mario Draghi repeated that interest rates would stay at or below present levels for an extended period. Political uncertainty in Portugal caused some concern and both Italy and France suffered credit rating downgrades over the course of the week.
- In China, the run of softer data continued. Trade data showed a slowing in both export and import growth, and total financing rose at its slowest pace since April last year. This had an immediate impact on the AUD and could lead to slower Chinese growth over the period ahead. Chinese officials have indicated they will use policy tools to support steady growth.
- The IMF lowered global growth forecasts last week, though their new projections are now broadly in line with the current consensus.

Outlook for short-term interest rates¹

TIME HORIZON	DIRECTIONAL VIEW	COMMENTS
1 - 3 months		The market is fully expecting a further official cut in cash rates in the next few months.
12 months+		An expected stronger global backdrop should lead to higher yields (out to three years) over time, though mixed domestic conditions should ensure that this transition to higher yields is not smooth.

Outlook for long-term interest rates²

TIME HORIZON	DIRECTIONAL VIEW	COMMENTS
1 - 3 months		Following a dramatic rise in bond yields since early May, some consolidation is possible in the near term as markets balance global risks against the probable 'tapering' of quantitative easing.
12 months+		A gradual pick-up in global economic activity, combined with the 'tapering' of quantitative easing, should result in further increases in yields over time.

1. Outlook for a range of short-dated instruments from bank bills to three year bond yields.

2. Outlook for a range of long-dated government bonds with maturities between seven and ten years.

Financial markets data table

		BASIS POINT CHANGE			
INTEREST RATES		CLOSE	1 WEEK	1 MONTH	1 YEAR
Generic QTC Bonds	3 year	3.12	-13	7	-24
	5 year	3.73	-10	22	-7
	7 year	4.27	-8	25	24
	10 year	4.81	-5	30	52
Aust Govt bonds	3 year	2.66	-16	6	43
	5 year	2.99	-8	29	86
	7 year	3.38	-9	22	89
	10 year	3.74	-8	29	86
Aust Corporate bonds	5 year (AA)	4.51	-18	20	-35
	5 year (A)	4.93	-13	26	-20
	5 year (BBB)	5.63	-17	19	-38
Aust Bank Bills	3 months	2.75	-8	-4	-79
	6 months	2.71	-10	-6	-76
	9 months	2.67	-11	-7	-68
	12 months	2.66	-12	-7	-61
US Govt bonds	2 year	0.34	-6	1	9
	10 year	2.58	-16	35	111
UK Govt bonds	2 year	0.36	-4	-8	14
	10 year	2.33	-16	18	80
German Govt bonds	2 year	0.10	-1	-7	14
	10 year	1.56	-16	-3	31
CREDIT					
Aust iTraxx IG	5 year	128	-6	4	-49
Asian (ex-JP) iTraxx IG	5 year	147	-11	16	-23
EU iTraxx IG	5 year	108	-2	0	-62
EU iTraxx financials	5 year	159	-2	5	-122
EU iTraxx SovX	5 year	96	2	7	-169
US CDX IG	5 year	78	-4	-4	-34

Source: Bloomberg

		% CHANGE			
EQUITIES		CLOSE	1 WEEK	1 MONTH	1 YEAR
ASX 200		4,974	2.7	3.8	21.8
S&P 500		1,680	3.0	3.3	23.8
Euro Stoxx 50		2,675	3.0	0.3	18.4
Nikkei		14,506	1.4	14.3	66.3
Shanghai		2,039	1.6	-5.7	-6.7
VIX Volatility Index		13.8	-7.1	-19.3	-17.3

		% CHANGE			
COMMODITIES		CLOSE	1 WEEK	1 MONTH	1 YEAR
Oil WTI (US\$/bbl)		106.0	2.9	8.4	21.8
Gasoil (diesel) (AU\$/t)		1,009	0.9	7.6	17.3
Sing fuel oil 180 (bitumen) (AU\$/t)		667	0.6	2.6	11.4
Henry Hub Nat Gas (US\$/mmbtu)		3.64	-2.4	-2.2	27.0
LME steel billet (US\$/t)		136	-4.6	-6.2	-70.2
LME Copper (US\$/t)		6,954	2.4	-2.3	-8.0
LME Aluminium (US\$/t)		1,845	4.4	-1.0	-2.0
LME Nickel (US\$/t)		13,775	3.5	-3.5	-12.7
LME Zinc (US\$/t)		1,903	3.4	2.0	3.3
Generic thermal coal (US\$/t)		77	-0.5	-8.7	-12.1
Generic coking coal (US\$/t)		133	0.3	-6.0	-39.1
Gold (US\$/oz)		1,286	4.2	-7.3	-18.9
Silver (US\$/oz)		19.9	4.6	-9.5	-26.8
Wheat (US\$/lb)		681	3.8	-0.3	-18.2
Sugar (US\$/lb)		16.1	-1.2	-0.9	-28.5
Cotton (US\$/lb)		85	1.7	-5.5	22.7
Cattle (US\$/lb)		122	-0.1	1.4	4.1
Europe (CO2) emissions (€/t)		4.03	-5.8	-9.6	-47.2
Reuters/Jefferies CRB Commodities Index		287	2.1	0.2	-2.5

		% CHANGE			
CURRENCY		CLOSE	1 WEEK	1 MONTH	1 YEAR
AUDUSD		0.9049	-0.6	-4.8	-11.4
AUDEUR		0.6924	-2.0	-2.6	-16.8
AUDGBP		0.5990	-1.6	-0.9	-8.3
AUDJPY		89.78	-2.3	-0.1	11.5
AUDCAD		0.9406	-2.1	-2.9	-9.3
AUDSEK		6.0322	-2.1	-1.7	-16.0

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FINANCIAL MARKET CHARTS

CHART 1: GENERIC QTC BOND YIELDS

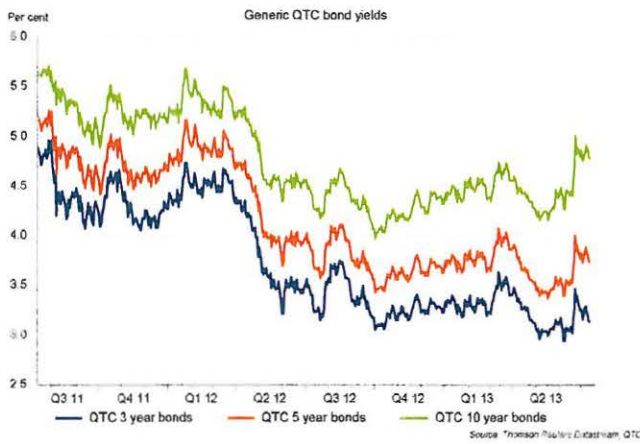


CHART 2: GLOBAL 10 YEAR GOVERNMENT BOND YIELDS

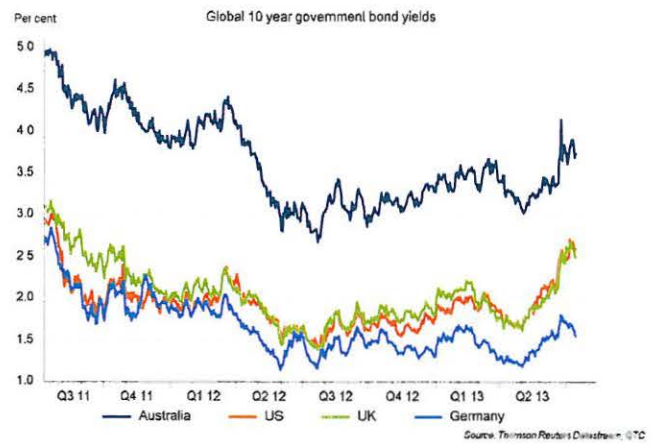


CHART 3: EQUITIES



CHART 4: EXCHANGE RATES

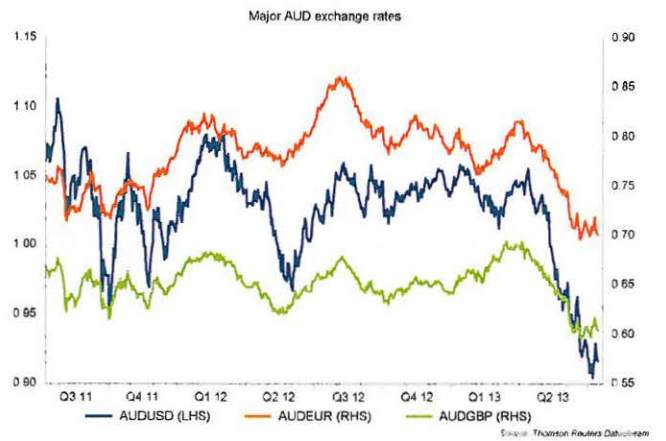


CHART 5: CREDIT SPREADS

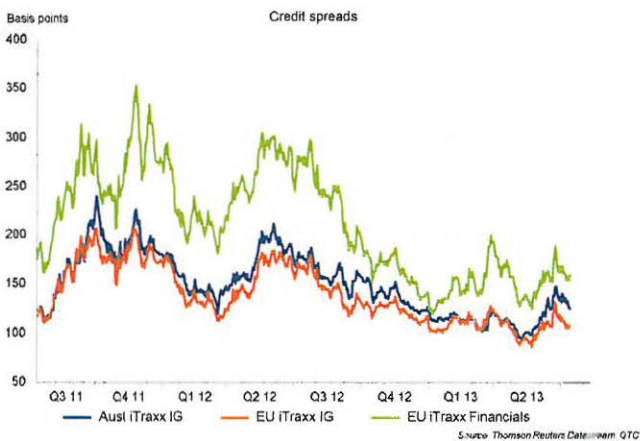


CHART 6: REUTERS/JEFFERIES CRB COMMODITIES INDEX

