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Australian Dollar Down, Bonds Rally As European Concerns Escalate

SYDNEY (Dow Jones)--The Australian dollar dropped in Asian trade Wednesday and bonds rallied broadly as economic concerns in Europe and the U.S. rippled across the globe.

For the higher-yielding, higher-risk Australian dollar, a renewed escalation of European debt concerns in the past few days has been particularly harrowing. On Tuesday, a downgraded economic outlook for China put Australian dollar traders on edge, with these European concerns pushing the Australian dollar back below US\$0.8500 at one point for the first time in more than two weeks.

Concerning Europe, market participants are particularly nervous about Thursday's expiration of a US\$542.53 billion European Central Bank bank-lending program.

"You've got a three-month (ECB) auction at the same time there is a question of how much is going to be rolled over from the 1-year loan to 3 months," said David Forrester, a currency strategist with Barclays Capital, referencing the ECB's 1-year bank lending program.

Still, the Australian dollar's declines didn't accelerate over the course of Wednesday's session, with the Reserve Bank of Australia reporting that credit to the Australian private sector rose a seasonally adjusted 0.5% in May from April and rose 2.7% from a year earlier. That data had some traders saying the central bank may need to hike again in the coming months after already pushing rates higher in six of its last eight meetings.

At 0605 GMT, the Australian dollar was quoted at US\$0.8522, down from US\$0.8636 late Tuesday. Against the Japanese yen, the Australian dollar was at Y75.46 from Y76.64.

For the Australian dollar against the U.S. dollar, the next step will likely be driven by a slate of U.S. data in the coming day, including reports on manufacturing and the labor sector, with Forrester echoing much of the Wall Street sentiment in adding "the data there hasn't looked that great lately."

While the European and U.S. concerns weighed heavy on the local currency, they gave a boost to bonds in Australia, especially on the short end. The three-year September contracts was recently up seven ticks to 95.43 and the 10-year bond rose four ticks to 94.885.

That move followed through on similar gains for U.S. Treasuries, with the short-term trend pointing to further bond price gains in the coming days, according to Stephen Nash, head of strategy for FIIG.

"I don't think there's really a question of if there's a European recession anymore, with the question just about how deep it will be. The market is still taking its time to assess that," said Nash.