Lloyds TSB | Corporate Markets

Financial Markets Review

22 January 2010

Fall in equities boosts government bonds

After a strong start to the week, sterling gave up much of last week's gains versus the dollar. Against other G-10 currencies, however, sterling outperformed registering gains of 2.5% versus the New Zealand dollar and 1.66% versus the Canadian dollar.

Downside surprises to money supply and retail sales data in the second half of the week combined with the broad based US dollar rally led to GBP/USD selling off to a low of 1.6078 on Friday before closing at 1.6144.

Concerns over the state of Greek public finances continued to weigh on the euro which fell through key technical levels versus sterling and the US dollar, accelerating the fall. Profit-taking on Friday saw the euro recover some ground with GBP/EUR falling back to 1.1407.

Commodity currencies were hit hardest this week following concerns over the durability of the global recovery despite China posting strong economic data this week.

Financial market review - foreign exchange

After a strong start to the week, sterling gave up much of last week's gains versus the dollar. Against the other G-10 currencies, however, sterling outperformed, registering gains of 2.5% versus the New Zealand dollar and 1.66% versus the Canadian dollar. EUR/GBP continued its descent, hitting a five-month low of 0.8651 following continued concerns over public finances in Greece and strong UK CPI data early in the week. The USD took another leg higher as equities moved lower during the course of the week on concern over the impact of Chinese tightening measures on global growth, banking sector reform proposals by the US government and weaker Q4 US corporate earnings. The Brazilian real dropped a further 2.4% versus the dollar and 1.7% versus sterling.

GBP/USD started the week positively, continuing on from last week's rally and spiking to a five-week high of 1.6458 following the shock UK CPI numbers which posted the largest rise in the annual rate on record, just as last year saw the largest drop. Downside surprises, however, to economic data during the rest of the week combined with the broad based US dollar rally led to GBP/USD selling off over the course of the week to a low of 1.6078 on Friday, before closing at 1.6144. Weaker than expected money supply data and retail sales weighed on the currency as markets began to entertain more seriously the notion that the Bank of England may well opt for an extension of quantitative easing at the next MPC meeting.

GBP/EUR rallied at the start of the week until its seven day winning streak came to an end on Thursday after breaking above 1.15. Concerns over the state of Greek public finances continued to weigh on the euro which fell through key technical levels versus sterling and the US dollar, accelerating the fall. Profit-taking on Friday, however, saw the euro recover some ground with GBP/EUR falling back to 1.1407. After a test of 1.44, EUR/USD sold off to key support at 1.4293 (the 200 day MA). Once this level gave way, a flood of sell orders pushed the currency pair down to an intra-week low of 1.4029 before profit-taking on Friday to close at 1.4153.

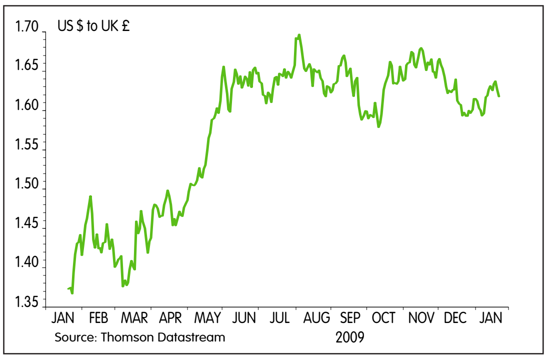
Commodity currencies were hit hardest this week following concerns over the durability of the global recovery. Despite China posting a robust set of economic data this week, namely GDP up 10.7% in Q4 2009, measures to restrict bank lending combined with an increase in the three-month bill rate has fuelled speculation that full monetary policy tightening will occur in the near-term in an attempt to rein in speculative excesses, leading to concerns that the global recovery may be stifled. USD/CNY 12-month forwards rose further during the week to 6.68. AUD/USD fell 1.07% on the week while the New Zealand dollar underperformed, falling 2.49% versus the US dollar. In the emerging market space, the Brazilian real continued to underperform on foreign portfolio outflows

Financial market rates, ending Fri. 22 Jan 10

At 4.30pm, 22 Jan 10		Change from 15 Jan 10
FTSE 100	5302.99	-2.79%
Exchange rates		
US$/UK£	1.6144	-0.57%
Euro €/UK£	1.1407	+1.00%
Euro €/US$	1.4153	-1.55%
Swaps - 5 year (mid)		**basis points**
UK pound	3.18	-2.0
US dollar	2.68	-3.0
Euro	2.62	-2.0
Bond yields - 10 year		
UK	3.92	-2.0
US	3.62	-5.0
Euro	3.22	-4.0

€/$ fell below 1.40 on Greece debt worries

£/$ fell below 1.62 on weak UK retail sales



Government bonds extended their excellent performance since the start of the year, buoyed by a retreat in equity markets and weaker than expected economic data from the G3 economies. UK 5y swaps hit a 3.33% high but closed the week below 3.20% nea a 4-week low. Roughly £4bn in sterling issuance was raised in the capital markets.

2010 calendar of central bank meetings

European ECB (1.00%)
4 February, 4 March, 8 April, 6 May, 10 June
US FOMC (0-0.25%)
27 January, 16 March, 28 April
UK MPC (0.50%)
4 February, 4 March, 8 April, 6 May, 10 June

Rolling calendar of UK data releases and events

Q4 GDP (26/01)
GfK consumer conf. (29/1)
Mortgage approvals (01/02)
PMI Manufacturing (01/02)
PMI Services (03/02)
Producer Prices (05/02)
Industrial Production (10/02)

Rolling calendar of US data releases and events

Existing home sales (25/01)
Consumer confidence (26/01)
New home sales (27/01)
Durable goods orders (28/01)
Q4 GDP (29/01)
Chicago PMI (29/01)
ISM Manufacturing (01/02)

Interest rate market review - bonds, cash and swaps

Government bonds extended their excellent performance since the start of the year, buoyed by a retreat in equity markets and weaker than expected economic data from the G3 economies. UK 5y swaps hit a 3.33% high but closed the week below 3.20% near a 4-week low. Roughly £4bn in sterling issuance was raised in the capital markets, with mostly foreign financial names raising finance. The 2y/10y swaps curve steepened back up to 221bps. 10y yields for Greece and Portugal spiralled higher as budget concerns intensified.

The report on Tuesday of a steep rise in UK inflation in December unsettled UK debt markets on Tuesday, causing a surge in gilt yields. 10y yields rose 12bps to a 4.05% and 2y yields rose 15bps to 1.36%, causing the yield curve to flatten. 5y swaps hit a high of 3.33%. Annual CPI soared to 2.9% in December vs 1.9% in November. RPI jumped to 2.4% from 0.3%. Stronger than expected labour market data. The question for the BoE is whether the data will influence inflation projections over a 2y horizon, and whether it believes there is a risk that inflation expectations could rise. This would put pressure on the BoE to decide to halt asset purchases at the MPC meeting next month.

Gilt yields reversed and fell sharply later in the week, however, as equities posted heavy falls and UK M4 money supply showed a surprise 1.1% m/m drop in December. Markets looked though the stronger UK labour market figures on Wednesday - the claimant count total fell for a 2nd successive month in December - causing 10y yields to fall back below 3.90% and 5y swaps to fall through 3.20% to the lowest level since December 21. Retail sales disappointed in December, showing only a 0.3% m/m gain vs median expectations of a 1.1% rise.

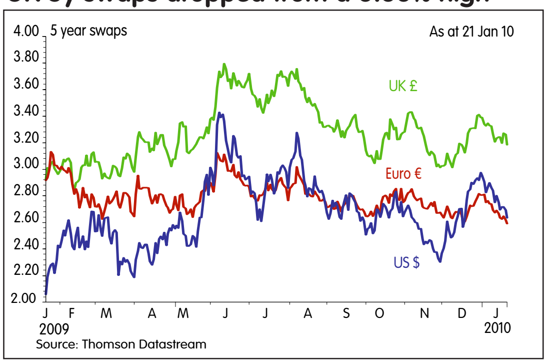
In a speech to business leaders in Exeter, BoE governor King steered clear of commenting on whether he favours extending QE, and instead sounded confident that inflation would fall back to target by year-end provided that monetary growth stays under control. Markets have been at pains to try and infer clues from recent MPC commentary with regard to the BoE's plan on QE. With no one quite prepared to rule out more QE if UK Q4 GDP disappoints next week, gilts and swaps may target a return to the November lows, supported by fading equity market optimism. The FTSE-100 experienced a bad week, falling below 5,300 to a one-month low as markets reacted to US plans to reform the US financial industry. A retreat in commodity prices also weighed on the FTSE after the Australian press reports of government plans to levy a 40% tax on mining companies. The concentration of commodity listed companies in London gives the FTSE greater exposure to profit taking in commodity stocks if prices fall. Corporate sterling issuance was heavy and dominated by overseas financial institutions including the EIB (£1.3bn) and Intesa SanPaolo (£350mn). London and Quadrant Housing raised £300mn.

US Treasuries outperformed gilts and bunds as the S&P and Dow registered heavy falls on President Obama's statement and failed to convert solid Q4 results from a number of US blue chips. Weaker than expected Philly Fed survey and a stronger USD also bolstered demand for US paper. 10y yields sank to a 1-month low of 3.58%. 2y yields dropped to a 0.81% low and 5y swaps closed below 2.70%. The UK/US 10y swap spread widened to 25bps. KfW raised $4bn in USD funds, and was followed in size by Italy ($2.5bn) and Bank of Nova Scotia ($2.5bn).

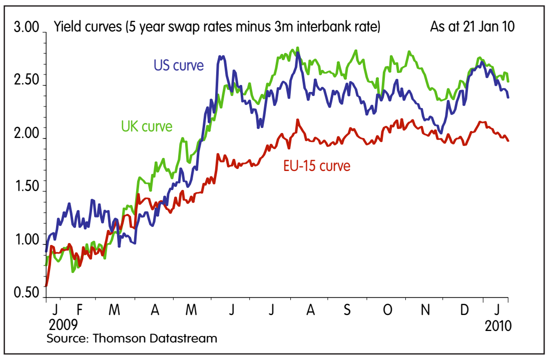
Euro zone bunds equally drew support from lower stocks (Dax closed the week below 5,700), but more importantly for economy watchers was the surprise drop in the January composite PMI survey to 53.6 vs 54.2 in December. This marked the first decline since last February. 5y swaps finished 2bps lower at 2.62%, having touched an intra-week low of 2.58%. Greek 2y yields surged 80bps intra-day on Wednesday to 4.66%.

£/€ hit a 5-month high above 1.15

UK 5y swaps dropped from a 3.33% high



Yield curves flattened



Kenneth Broux, Senior Market Economist
Altaz Dagha, Strategist

Foreign exchange - graphical analysis of recent trends

Chart 1: £/$ fell back on weak UK retail sales

Chart 2: €/$ slides on Greece debt concerns

Chart 3: £/€ climbs over 1.15

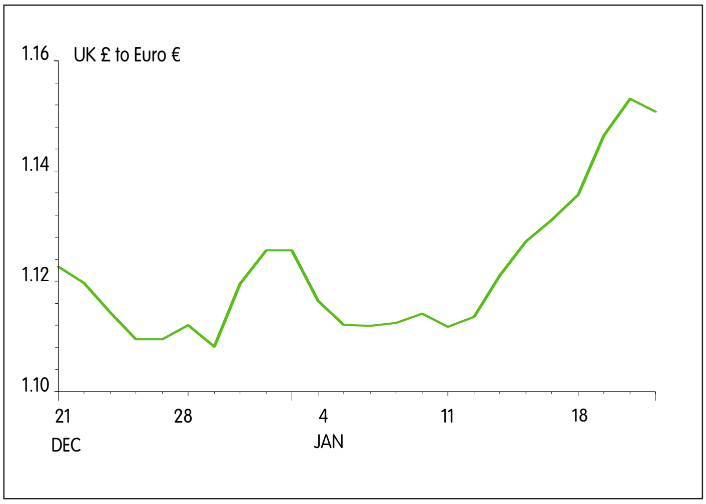


Chart 4: $/¥ capped at 91.0

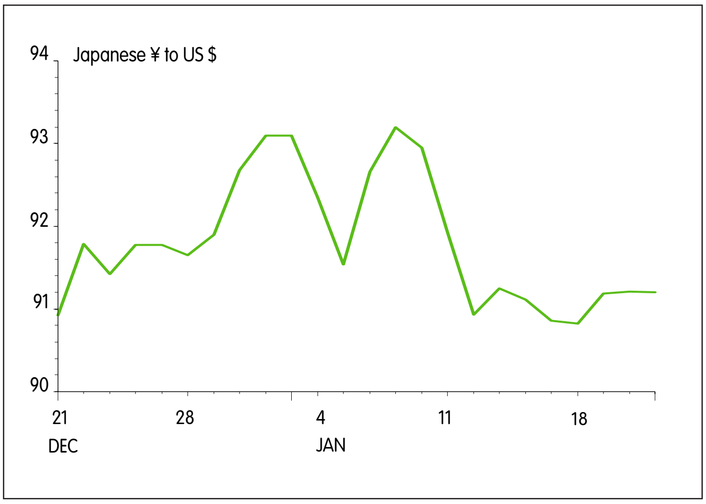


Chart 5: $/C$ rebounds on lower oil prices

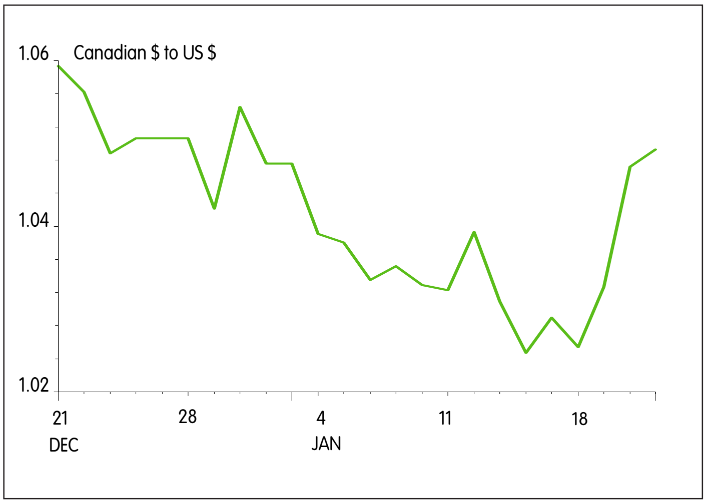
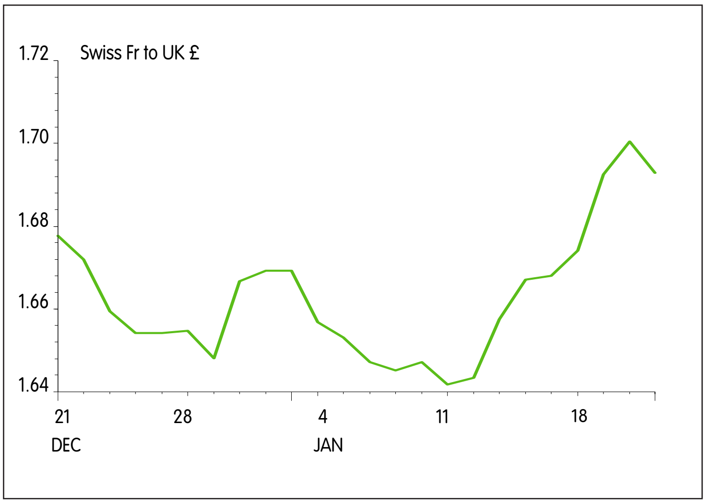


Chart 6: £/CHF tops out at 1.70



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Fixed income - graphical analysis of recent trends

Chart 1: UK 2yr yields near 1.20%

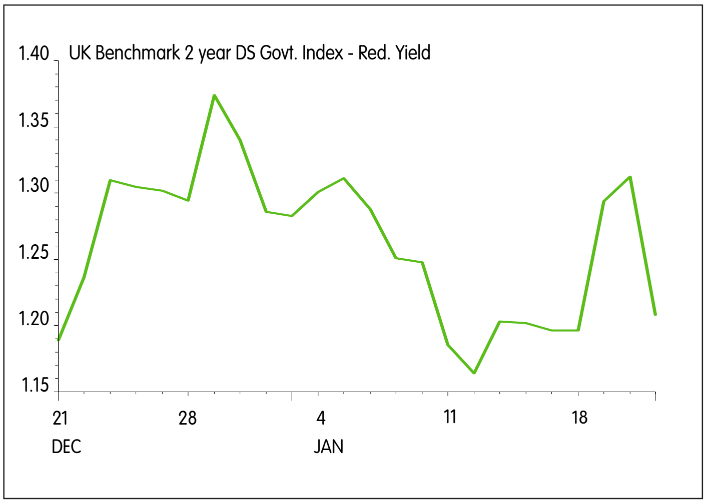


Chart 2: UK 10yr yield falls from 4.10% high

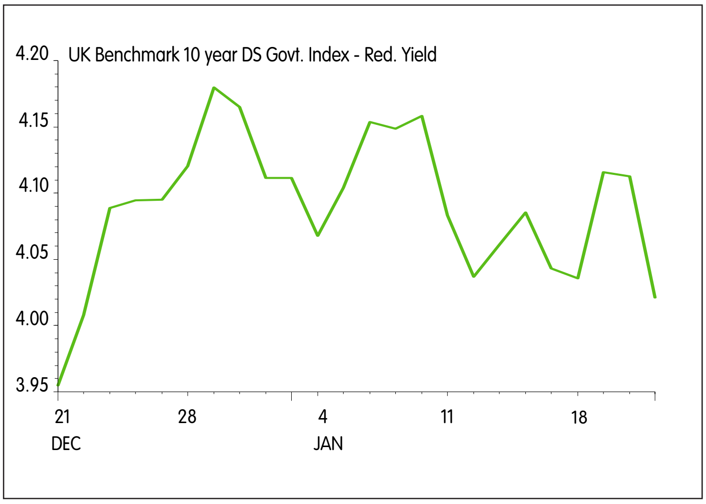


Chart 3: US 2yr yields extend towards 0.80%

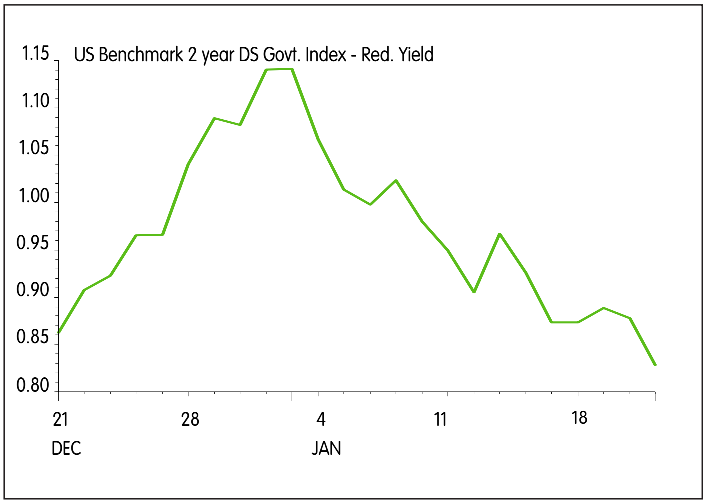


Chart 4: US 10yr yield touches 3.60%

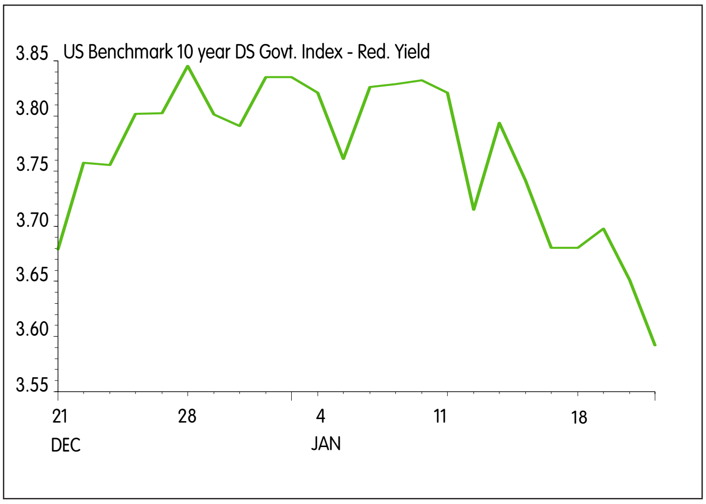


Chart 5: EU-16 2y yield back near 1.10%

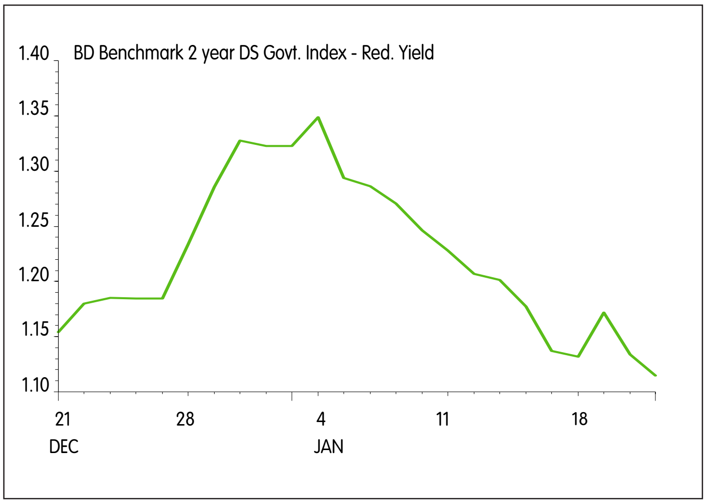
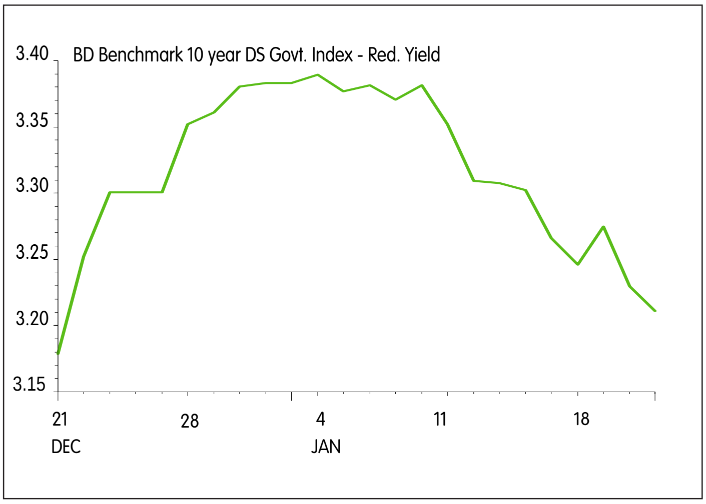


Chart 6: EU-16 10yr yields hit 3.20%



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Interest rate markets - graphical analysis of recent trends

Chart 1: US 5yr swap back near December low

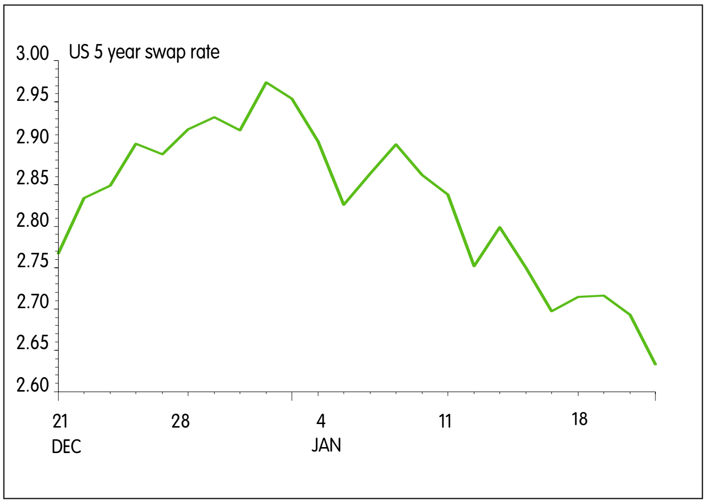


Chart 2: Euro 5yr swap 20bp lower vs early January

Chart 3: UK 5yr swap near 3.15%

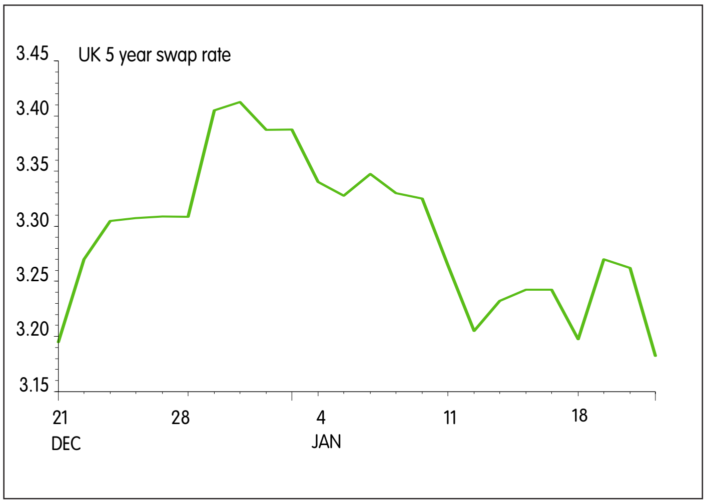


Chart 4: US curve flatter, spread tests 240bps

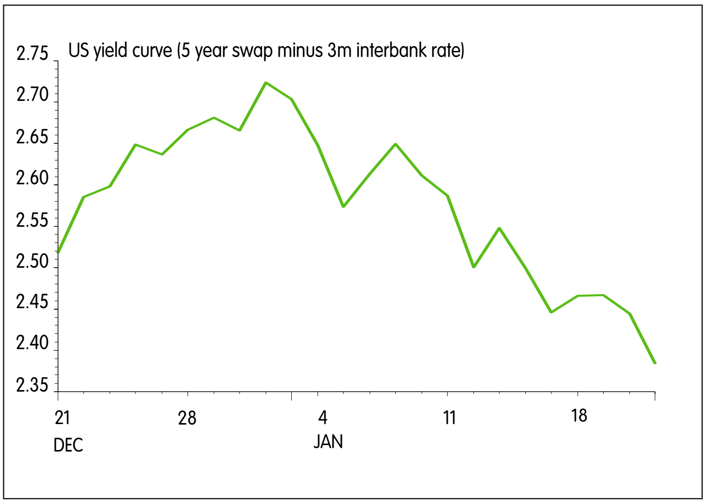


Chart 5: Eurozone curve spread tightens below 200bps

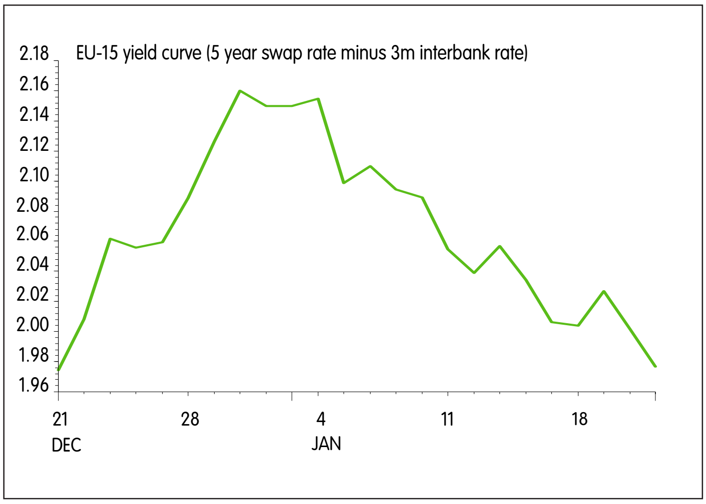
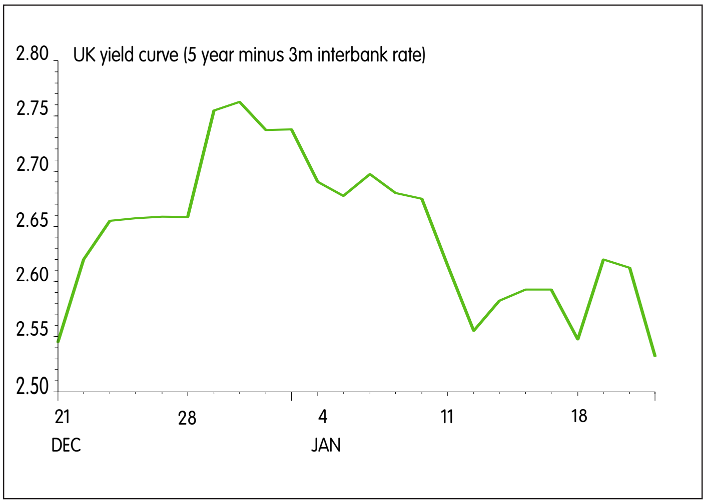


Chart 6: UK curve eyes 250bps support



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Key commodity and equity markets - Graphical analysis of recent trends

Chart 1: Gold fells below $1,100

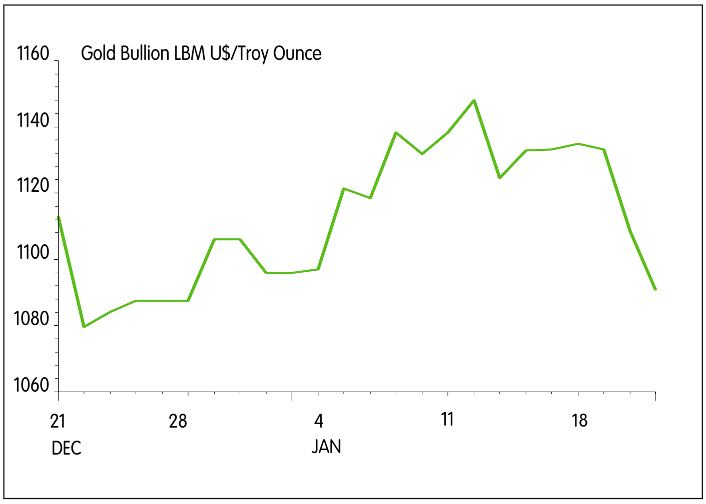


Chart 2: Brent crude slides to $75

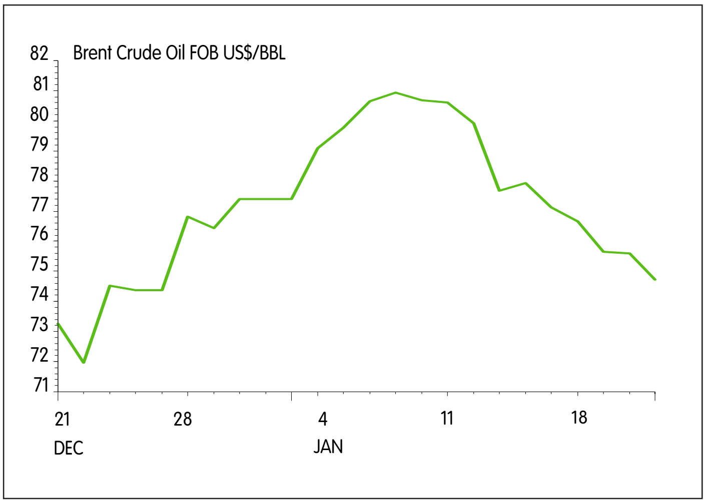


Chart 3: FTSE-100 through 5,300 support

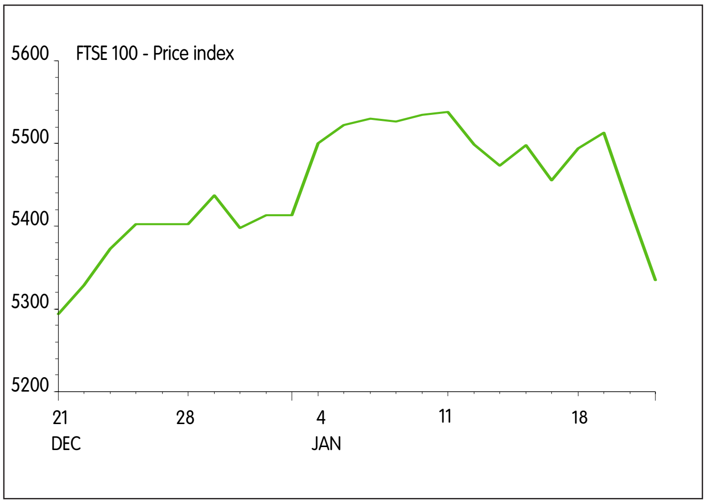


Chart 4: Dow Jones erases gains, tumbles below 10,400

Chart 5: Nikkei finds support at 10,600

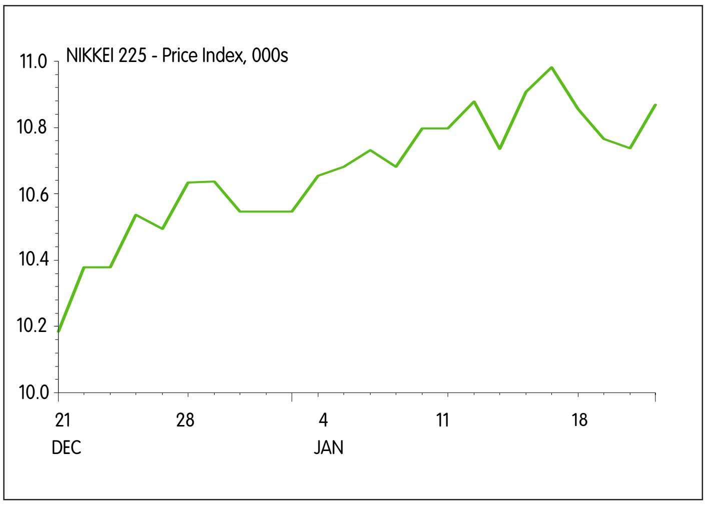
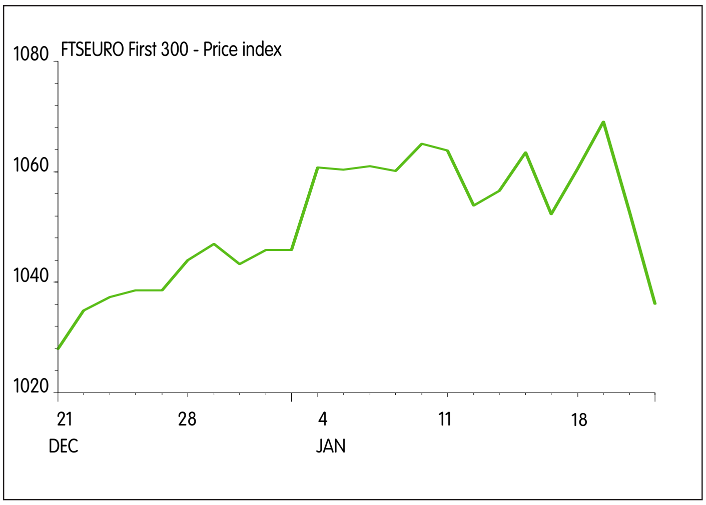


Chart 6: EuroFirst 300 erases January gains



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Client support – Contact Details

Research Team

Trevor Williams	+44 (0)20 7158 1748	trevor.williams@lloydstsb.co.uk
Adam Chester, UK Macro	+44 (0)20 7158 1740	adam.chester@lloydstsb.co.uk
Jeavon Lolay, Global Macro	+44 (0)20 7158 1742	jeavon.lolay@lloydstsb.co.uk
Hann-Ju Ho, Sector Research	+44 (0)20 7158 1745	hann-ju.ho@lloydstsb.co.uk
Mark Miller, Global Macro	+44 (0)20 7158 1742	mark.miller2@lloydstsb.co.uk
George Johns, UK Macro	+44 (0)20 7158 1751	george.johns@lloydstsb.co.uk
Kenneth Broux, Market Strategy	+44 (0)20 7158 1750	kenneth.broux@lloydstsb.co.uk
Altaz Dagha, Market Strategy	+44 (0)20 7158 1747	altaz.dagha@lloydstsb.co.uk
Support/Administration		
Sarah Pedder, Distribution	+44 (0)20 7158 1746	
Mandy Wright, Distribution	+44 (0)20 7158 1746	
Nikesh Sawjani, Information Manager	+44 (0)20 7158 1749	
Caroline McDonagh, Graphic Designer	+44 (0)20 7158 1743	
Institutional Equity Sales		
Terry Murray	+44 (0)20 7158 1725	terry.murray@lloydstsb.co.uk
Andrew Gipp	+44 (0)20 7158 2056	andrew.gipp@lloydstsb.co.uk
Sam Weitzman	+44 (0)20 7158 1726	sam.weitzman@lloydstsb.co.uk
Corporate Customer Sales		
Andrew Willett	+44 (0)20 7158 1616	andrew.willett@lloydstsb.co.uk
Kathryn Ball	+44 (0)20 7158 1672	kathryn.ball@lloydstsb.co.uk
Capital Markets Distribution		
Martin Bates	+44 (0)20 7158 1983	martin.bates@lloydstsb.co.uk
Commercial Sales		
Matt Lawrence	+44 (0)20 7158 1661	matthew.lawrence@lloydsbanking.com
Wealth Product Sales		
Andrew Evans	+44 (0)20 7158 1691	andrew.evans@lloydstsb.co.uk

Disclaimer