# Lloyds TSB | Corporate Markets

# Financial Markets Review

**29 January 2010**

## US dollar strengthens to a 5-month high

### Financial market review - foreign exchange

The euro stayed under downward pressure all week, losing ground against all G10 currencies but the Norwegian krone as pessimism broadened following talk of a possible bailout of Greece by the EU. Risk aversion plays also favoured outflows from high yield and emerging market currencies and helped the US dollar index to strengthen to a 5-month high above 79.0. EUR/USD fell below 1.39 for the first time since July 14 last year. Sterling rose against the euro to 1.1625 before profit taking set in, with participants squaring up ahead of the BoE meeting next week.

Selling euro rallies remains the favourite strategy in global currency markets as Greece struggles to bring speculation to a halt that the EU will eventually have to intervene to restore confidence in the country's public finances. Worries also spread to Portugal and resulted in a sharp rise in CDS spreads and bond yields compared to the German 10y benchmark. Meanwhile, the focus on risk averse strategies is characterised by lower than usual attention for economic data, even though a stronger than expected German IFO confidence survey suggests the economy has started the new year in good shape. German business confidence rose in January to an 18 month high. EUR/CHF fell through 1.47 to a 10-month low in a move that will not go unnoticed at the SNB where the strength of the Swiss franc has triggered intervention in the past to slow franc appreciation and prevent dis-inflationary pressures from gathering momentum. EUR/GBP fell to a 0.8602 low on Thursday as Greek bond spreads rocketed, but the pair reversed back over 0.8650 as GBP/USD caught up with EUR/USD and dropped below 1.61.

Weak UK Q4 GDP data only caused a knee-jerk selling in GBP on Tuesday as heavy dividend related GBP/USD buying by oil major BP supported corporate demand. The UK economy limped out of recession in Q4, registering feeble 0.1% q/q growth, below the 0.4% consensus forecast. With corporate buying fading by the end of the week and S&P issuing a pessimistic report on the UK, most GBP crosses turned south led by GBP/USD. The USD also attracted inflows after it emerged that FOMC member Hoenig had voted against keeping expectations in Wednesday's statement that interest rates will stay low for an 'extended period'. In addition, the USD was supported by falling equity markets and associated safe haven flows, and the report of a 5.7% annualised increase in US Q4 GDP. This topped the 4% consensus.

Emerging market currencies were also subject to heavy selling as participants reduced equity and commodity holdings. Silver dropped 4.6% and copper plummeted 6.7%. The Chilean Peso and Brazil real led the table of top decliners, registering falls of 4.1% and 2.5% respectively. The South African rand stood out, logging a 0.5% gain. USD/yuan traded in a narrow range, ending the week at 6.8268. GBP/yuan fell below 11.0 to a 3-week low.

### Financial market rates, ending Fri. 29 Jan 2010

| At 4.30pm, 29 Jan 10 | | Change from 22 Jan 10 |
|---|---|---|
| **FTSE 100** | 5188.52 | -2.15% |
| **Exchange rates** | | |
| US$/UK£ | 1.6014 | -0.81% |
| Euro €/UK£ | 1.1542 | +1.18% |
| Euro €/US$ | 1.3875 | -1.96% |
| **Swaps - 5 year (mid)** | | basis points |
| UK pound | 3.10 | -8.0 |
| US dollar | 2.69 | +1.0 |
| Euro | 2.61 | -1.0 |
| **Bond yields - 10 year** | | |
| UK | 3.91 | -1.0 |
| US | 3.64 | +2.0 |
| Euro | 3.20 | -2.0 |

### €/$ fell below 1.39

Source: Thomson Datastream

### £/$ on the verge of falling below 1.60

Source: Thomson Datastream

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UK bond yields wound up modestly higher this week, despite a much weaker than expected outturn for the first estimate of Q4 GDP. Over the week, benchmark 10yr gilt yields fell 1bp to 3.91%, having at one point fallen to a low of 3.84%. Five-year swaps fell 6bps to 3.11% and 3m libor was marginally higher at 0.61625%.

### 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%)
16 March, 28 April, 23 June
**UK MPC** (0.50%)
4 February, 4 March, 8 April, 6 May, 10 June

### Rolling calendar of UK data releases and events

Mortgage approvals (01/02)
PMI manufacturing (01/02)
PMI services (03/02)
Producer prices (05/02)
Trade balance (09/02)
Industrial production (10/02)
BoE Inflation Report (10/02)
CPI inflation (16/02)
BoE MPC minutes (17/02)

### Rolling calendar of US data releases and events

Core PCE deflator (01/02)
ISM manufacturing (01/02)
ADP employment (03/02)
ISM services (03/02)
Factory orders (04/02)
Non-farm payrolls (05/02)
Unemployment (05/02)
Consumer credit (05/02)
Trade balance (10/02)

## Interest rate market review - bonds, cash and swaps

UK bond yields wound up modestly higher this week, despite a much weaker than expected outturn for the first estimate of Q4 GDP. The Office for National Statistics once again surprised the markets with a weak figure showing the economy merely limping out of recession. Quarter-on-quarter growth was estimated at 0.1%, well below consensus forecasts of 0.4%, though the preliminary figure factored in assumptions of weak December industrial and services activity, which may yet be revised. But the bigger picture is that the UK has exited recession later than other major advanced economies and even then has barely returned to positive growth.

Hawkish comments from the BoE MPC's Andrew Sentance, plus some stronger than expected numbers from the GfK consumer confidence survey and Nationwide house prices may partly explain why bond yields help up. GfK rose 2 points to -17, while Nationwide said house prices rose 1.2% in January, the ninth consecutive monthly increase. More likely, however, is that ongoing concerns about the UK's public sector debt levels (not helped by comments from Pimco) kept bond yields higher. Indeed, supporting this argument is that sterling swap rates fell over the week, leading to a narrowing of swap spreads. Over the week, benchmark 10yr gilt yields fell 1bp to 3.91%, having at one point fallen to a low of 3.84%. Five-year swaps fell 8bps to 3.10% and 3m libor was marginally higher at 0.61625%.

In the euro zone, ongoing concerns about the Greek economy provided safe-haven support for benchmark German bonds. This was in spite of significant demand for the Greece's syndicated bond offer. Bond yields were also weighed by weaker than expected inflation data from German, which resulted in a lower than expected euro zone flash CPI estimate of 1.0% in January, up from 0.9% in December, but weaker than expectations of 1.2%.Further, unemployment in Germany and the euro zone also continued to climb, with the jobless rate in the euro zone rising to double digits (10.0%) for the first time since the euro's inception.

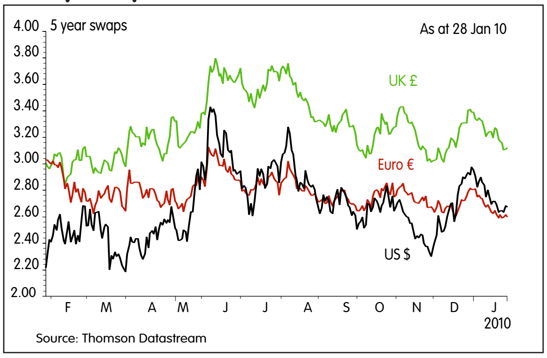
Economic confidence in the euro zone continued to improve, however, as evidenced by the German IFO and EU Commission surveys, while hawkish comments from the ECB's Weber pushed yields higher. Over the week, German 2-year bond yields rose 2bps to 1.13%, but yields further along the curve were lower, with 30-year yields down 8bps at 3.93%. Euro 5-year swaps and 3m libor were little changed at 2.61% and 0.61%, respectively.

The US Federal Reserve left interest rates at a 0-0.25% range, as widely anticipated. The accompanying statement reiterated the pledge to keep interest rates at 'exceptionally low levels' for an 'extended period'. FOMC member Hoenig, however, believed in a more hawkish stance and voted against the policy action. Treasury yields rose following the Fed rate decision and the release of the statement.

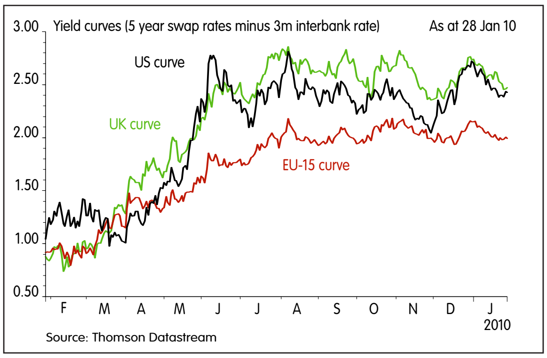
Weak housing and durable orders data provided some supported for bonds. A closer examination of the December orders data, however, revealed that shipments of non-defence capital goods excluding aircraft soared 8.5% (annualised) on the quarter and pointed to a strong rise in business investment. This was confirmed in the first estimate of Q4 GDP which was significantly stronger than expected, coming in at 5.7% (annualised) versus the consensus forecast of 4.8%, thus supporting bond yields. The $118bn supply of notes this week was well covered. Over the week, benchmark 10yr treasury yields rose 2bps to 3.64%, while 2yr yields yields rose 10bps to 0.89%. US 5yr swaps were up slightly at 2.69%, while dollar 3m libor were unchanged at 0.24906%.

### £/€ rose above 1.16


### UK 5y swaps fell below 3.10%




### Yield curves flattened





**Kenneth Broux, Senior Market Economist**
**Altaz Dagha, Strategist**

# Foreign exchange - graphical analysis of recent trends

**Chart 1: £/$ faces key BoE meeting next week**

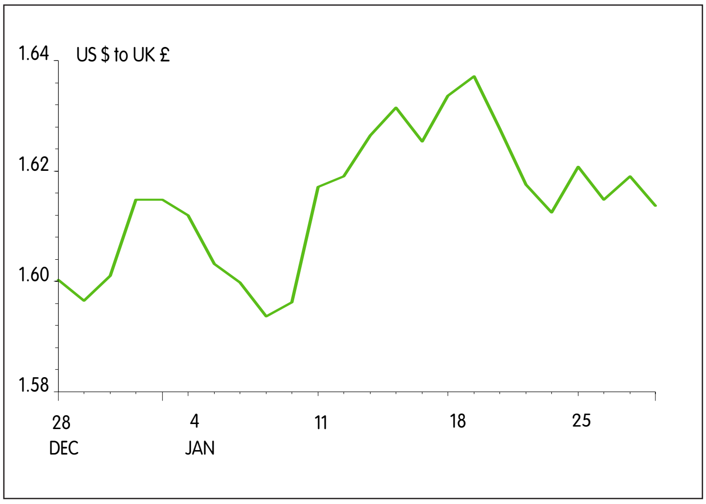



**Chart 2: €/$ extends slide**


**Chart 3: £/€ attracts demand above 1.15**


**Chart 4: $/¥ fell below 90.0**

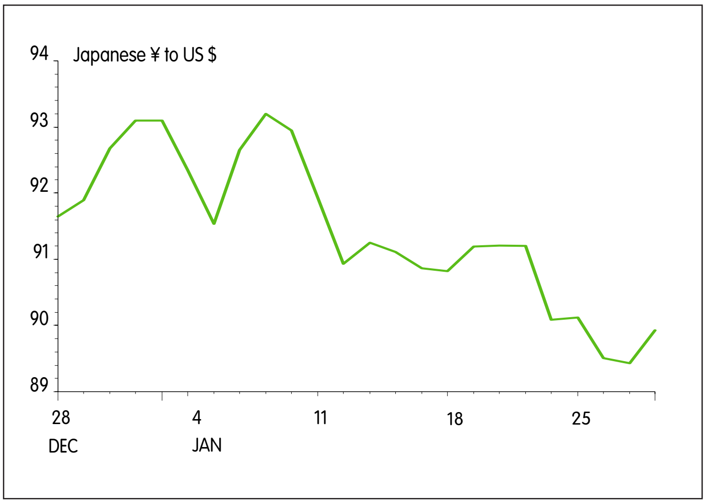



**Chart 5: $/C$ rose over 1.06**

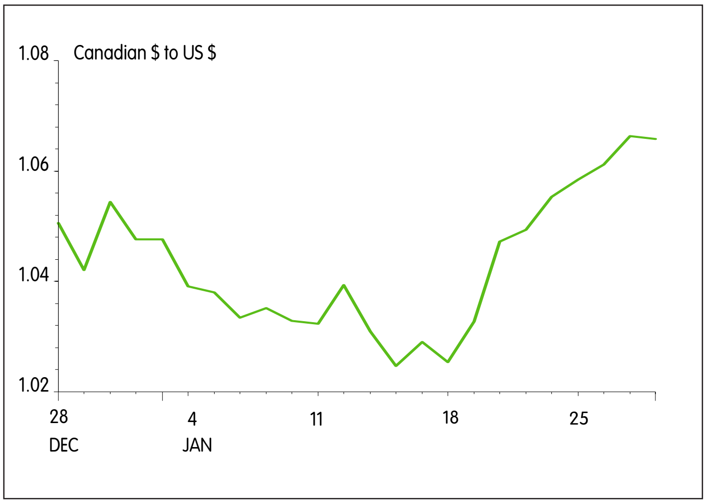
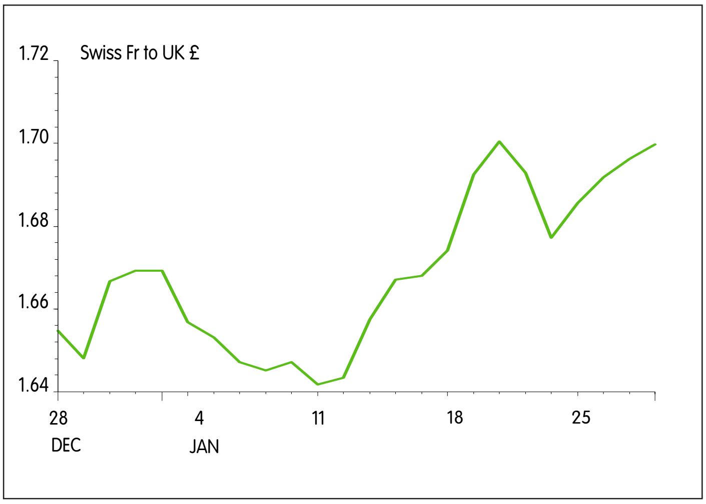


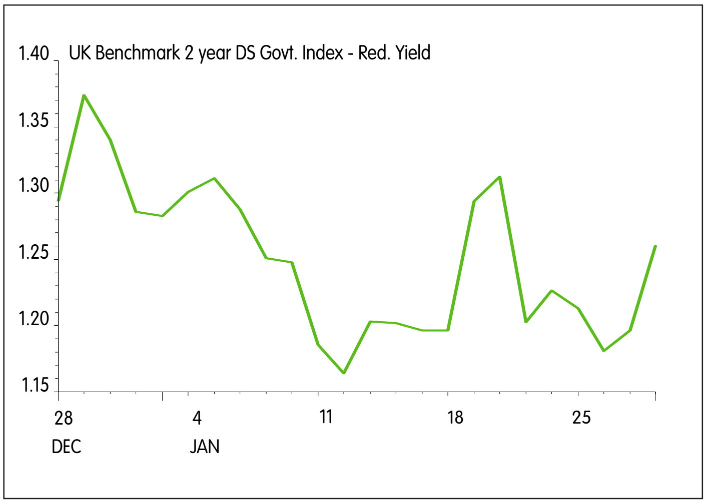

**Chart 6: £/CHF reached 1.70**



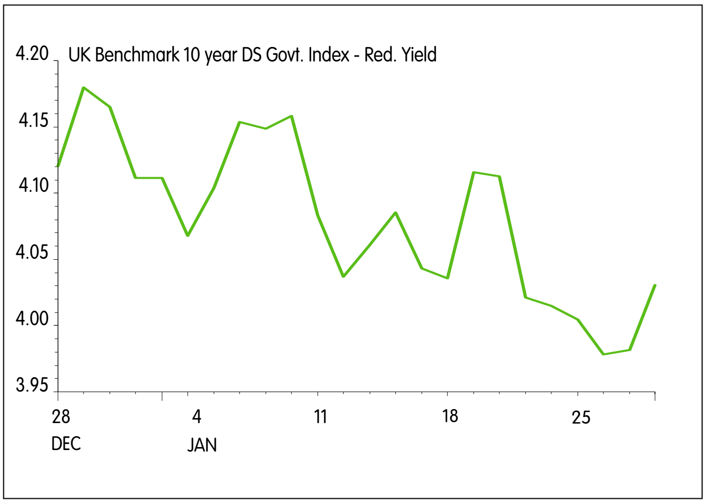

**Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream**

# Fixed income - graphical analysis of recent trends

### Chart 1: UK 2yr yields rebound over 1.20%

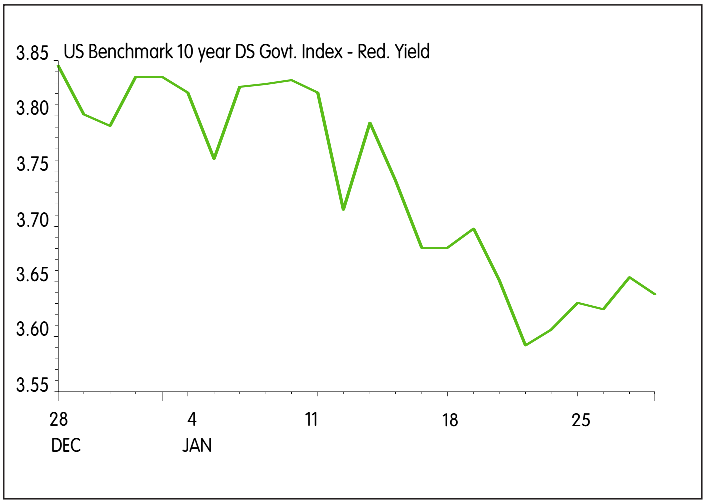



### Chart 2: UK 10yr yield finds support near 3.95%

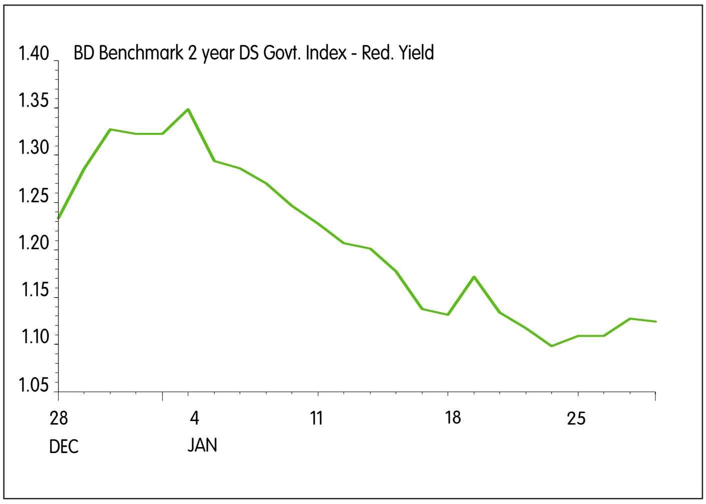



### Chart 3: US 2yr yields ease back below 0.90%

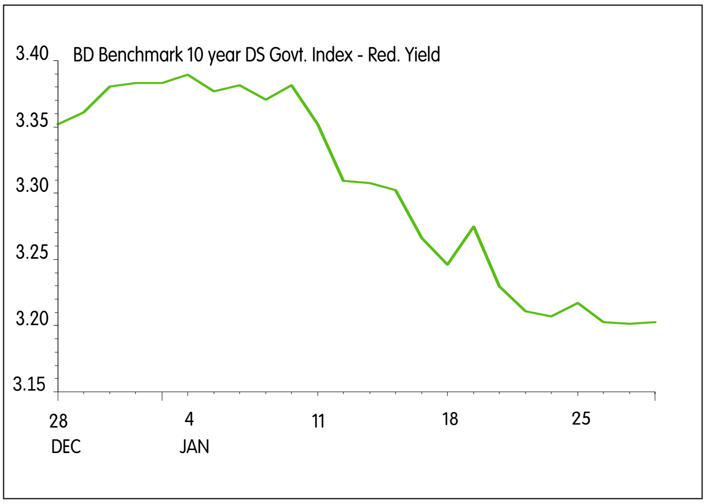

### Chart 4: US 10yr yield drop below 3.65%




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



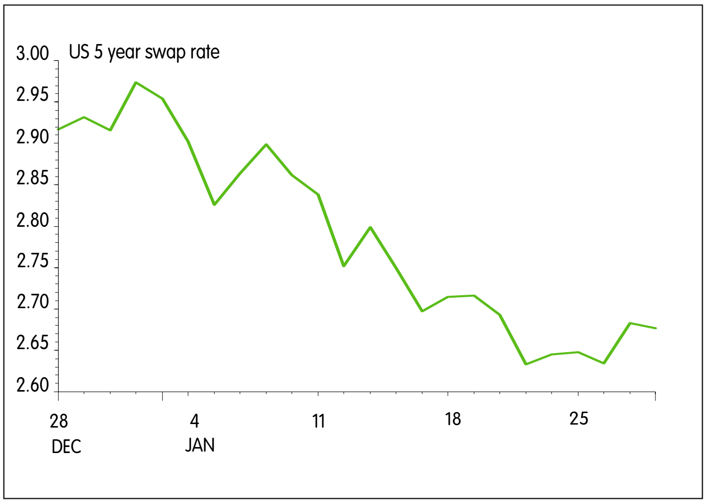

### Chart 6: EU-16 10yr yields fall to 3.20%



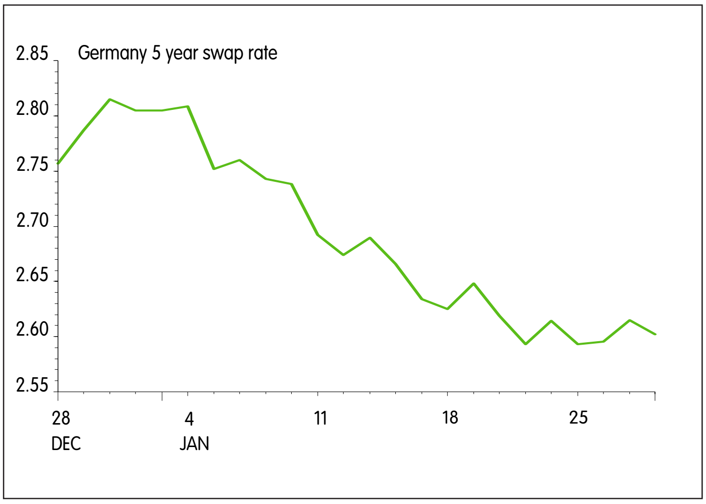

**Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream**

# Interest rate markets - graphical analysis of recent trends

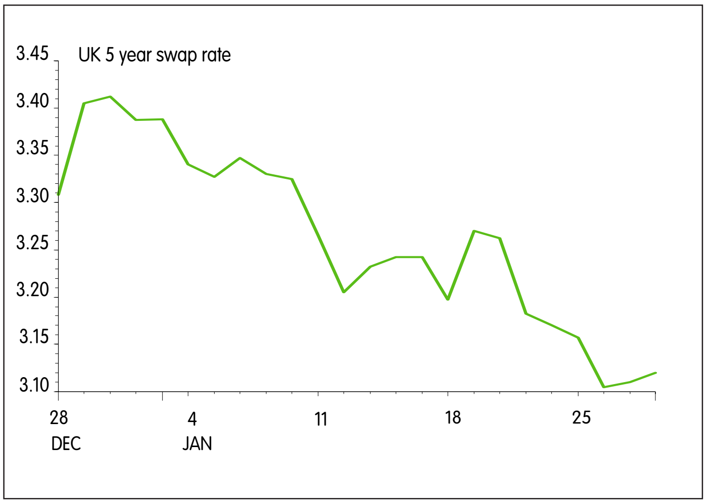
### Chart 1: US 5yr swap drop to 2.65%



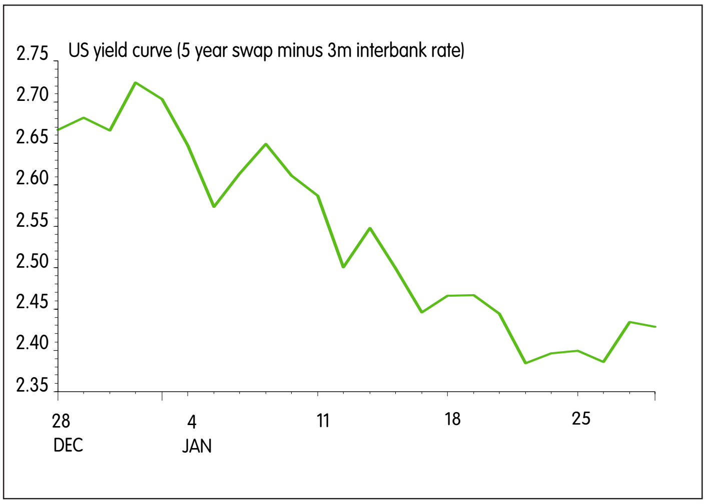

### Chart 2: Euro 5yr swap test 2.60%



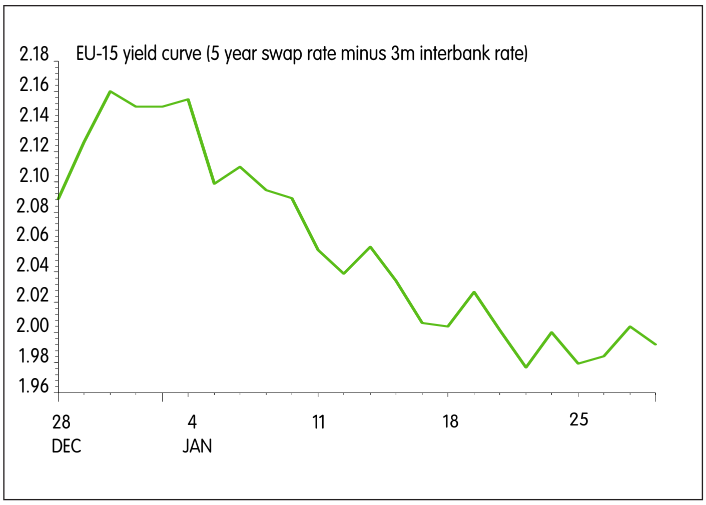

### Chart 3: UK 5yr swap bounces off 3.10%



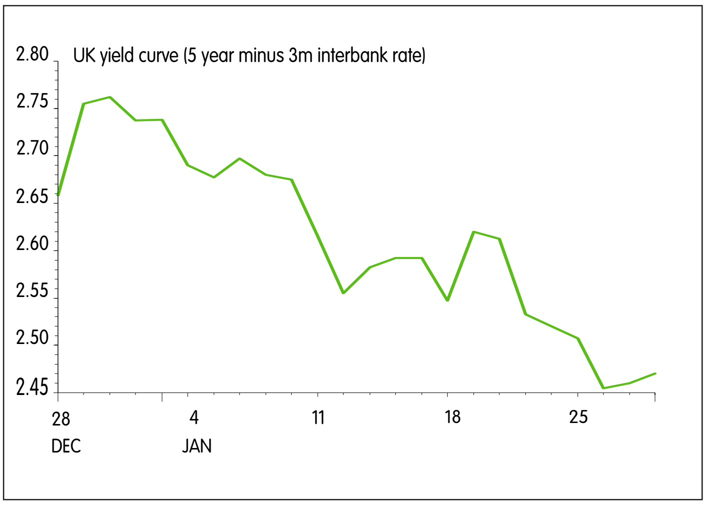

### Chart 4: US curve flattened below 240bps




### Chart 5: Eurozone curve spread steady around 200bps



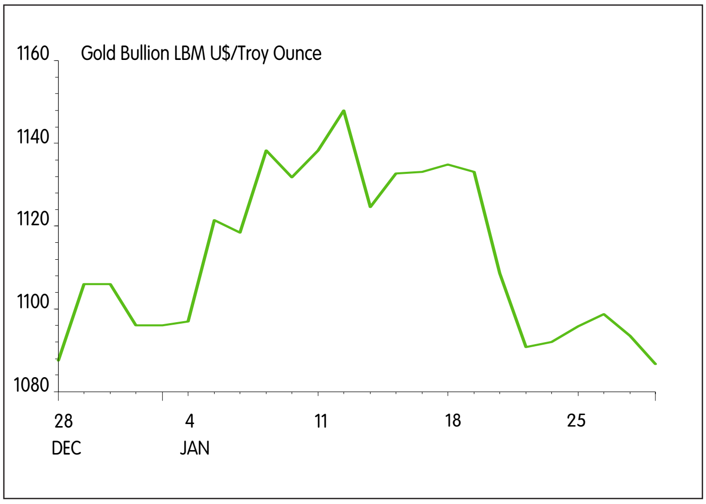

### Chart 6: UK curve finds support at 245bps



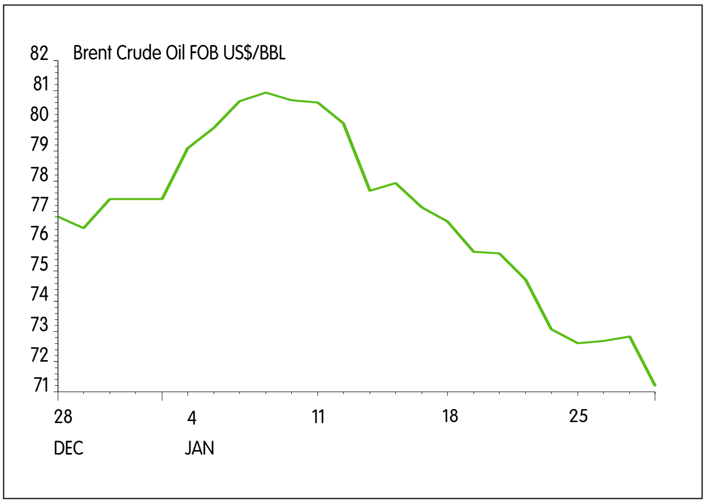

**Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream**

# Key commodity and equity markets - Graphical analysis of recent trends

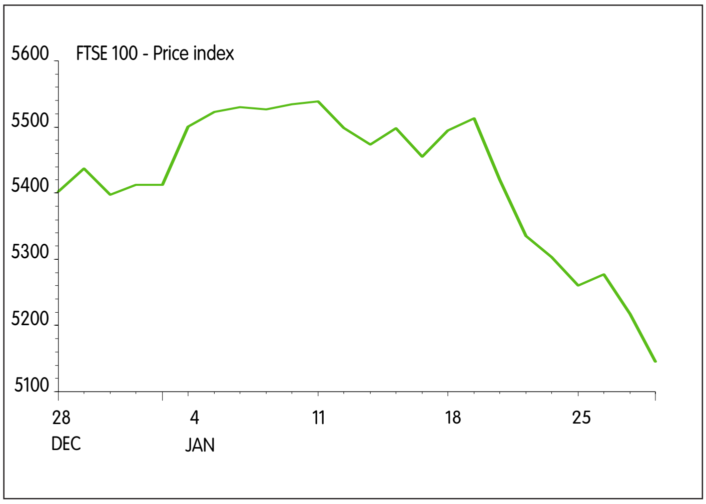
### Chart 1: Gold drops below $1,100



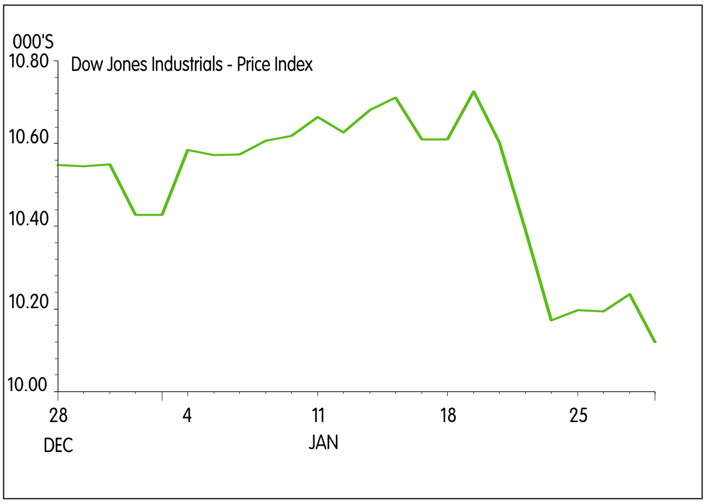

### Chart 2: Brent crude approaches $70



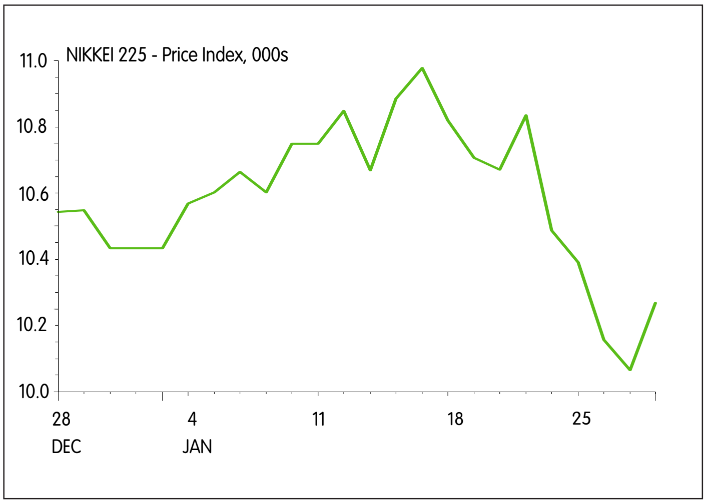

### Chart 3: FTSE-100 falls through 5,200




### Chart 4: Dow Jones down over 5% from January high




### Chart 5: Nikkei finds support at 10,000




### Chart 6: EuroFirst 300 faces test of 1,000


**Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream**

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