



Daily Market Strategy

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Market Strategy

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- MPC comments support GBP, swaps
- CHF in demand ahead of SNB, USD soft

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.4652

€/£: 1.2200

\$/¥: 91.96

UK 5y sw: 2.49%

US 5y sw: 2.38%

EU 5y sw: 2.09%

Overnight

- 'We must force the inflation genie back into its bottle' says MPC member Sentence in The Sunday Times; warns that a 2nd significant inflation spike in recent years will make for 'interesting debates' on the MPC in the second half of the year
- BoE bulletin warns permanent reduction in spare capacity because of financial crisis may explain higher inflation; not Vat, high oil price, weak sterling
- UK independent OBR to publish first forecasts at 10am, to prepare for spending cuts and higher taxes in June 22 Budget

Our assertion in the Weekly Strategy notes that participants are still reluctant to add risk appears unjustified as early price action is characterised by a decent start for equities and weakness in government bonds and the USD. We admit that the overnight headlines are 'UK heavy' but they do provide the rationale for the opening trades as markets are reminded that fiscal policies of the Cons/LD coalition and the unfavourable inflation backdrop provide a still very uncertain outlook for BoE policy (GBP crosses bid, 5y swaps up 8bp). This puts the onus on CPI tomorrow but not until the scale of consolidation is announced on June 22 will we get a better understanding of the policy setup for H2-10 and whether our preference for curve flattening is justified. The UK headlines are fairly tame compared to the more explicit 'risk averse' leaning commentaries on Europe ('EU preparing rescue plan for Spain', 'Europe's banks face second funding squeeze on sovereign crisis'), and give us more reason to treat the opening trades with a degree of suspicion.

Ahead today

- UK: the OBR's first set of macro projections will reportedly include a substantial downward revision to GDP growth for 2011 from 3-3.25% to about 2%, paving the way for potentially deeper cuts in the Budget next week.
- EU: industrial output for April, not a market mover
- US: Fed member Bullard to talk about the global recovery.

IMM positioning

| | 01-Jun | | 08-Jun | | | | |
|-----|--------|---------|--------|---------|-----|------|--------|
| | rep | non rep | rep | non rep | | | change |
| CAD | 22 | 20 | 42 | 23 | 21 | 44 | 2 |
| CHF | -15 | -11 | -26 | -11 | -9 | -20 | 6 |
| GBP | -70 | -23 | -94 | -75 | -23 | -97 | -4 |
| JPY | -6 | -7 | -13 | -13 | -9 | -21 | -8 |
| EUR | -93 | -4 | -97 | -112 | 1 | -111 | -14 |
| AUD | 15 | -2 | 13 | 8 | 4 | 12 | -1 |

FX: dollar sentiment turned negative in the middle of last week and continues to deteriorate albeit at a modest pace as the DXY slips below the ascending trendline at 87.05. The move helps AUD/USD to progress through the May 28 high (0.8552), though conviction to push on aggressively appears light. USD/CHF is flirting with 1.14 support. We target a move to 1.13.

Rates: a lively start has seen UK 5y swaps shoot up to 2.56% in early trade, with the front-end of the curve underperforming in swaps and cash. Resistance comes in around 2.63% ahead of the OBR forecasts. Sentence's comments can be credited for the bear flattening which is keeping 2y/10y swaps within touching distance of 190bp. Higher equities may keep upward pressure intact on yields unless US and Asian markets reverse into tomorrow's CPI release.

| FX | Close | Daily Change |
|--------------------|---------|--------------|
| EUR/GBP | 0.8513 | -0.18% |
| GBP/USD | 1.6928 | 1.29% |
| EUR/USD | 1.4412 | 1.09% |
| USD/JPY | 95.26 | 0.62% |
| AUD/USD | 0.842 | 0.74% |
| Bonds | | |
| US 10Yr | 3.633 | 15.4bp |
| EUR 10Yr | 3.344 | 4.4bp |
| UK10 Yr | 3.879 | 7.8bp |
| UK 5yr Swap | 3.703 | 6.8bp |
| Equities | | |
| S&P500 | 1002.6 | 1.53% |
| FTSE100 | 4682.4 | 1.61% |
| Eurostoxx50 | 2674.07 | 1.36% |
| Shanghai | 3473.5 | 0.31% |
| Commodities | | |
| Crude Oil \$/bl | 71.58 | 3.07% |
| Gold \$/oz | 956.8 | 0.29% |
| Copper | 273.9 | 4.38% |
| Baltic Dry | 3251 | -2.96% |
| Other | | |
| VIX | 25.56 | -1.39% |
| iTraxx XOVER | 606.05 | -8.3bp |

Today's Data

Japan Industrial Output, Apr final
EU-16 Industrial Output, April

Time

05:30
10:00

Consensus

1.3%A
0.5%

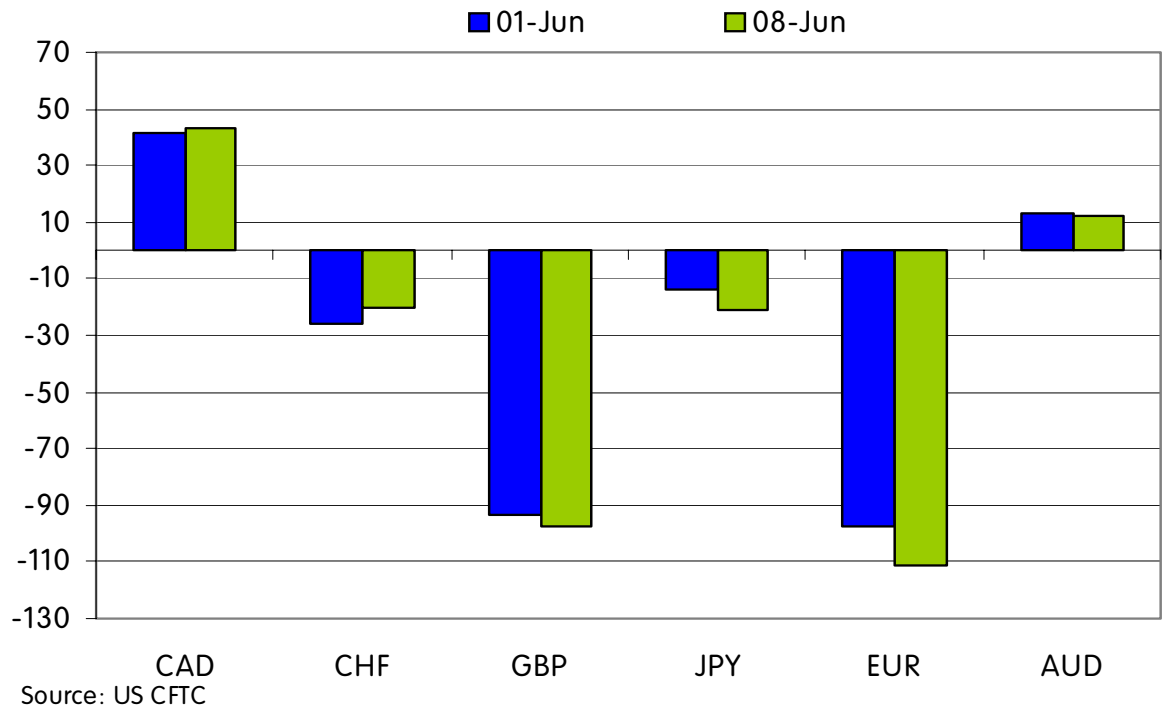
Previous

1.3%
1.3%

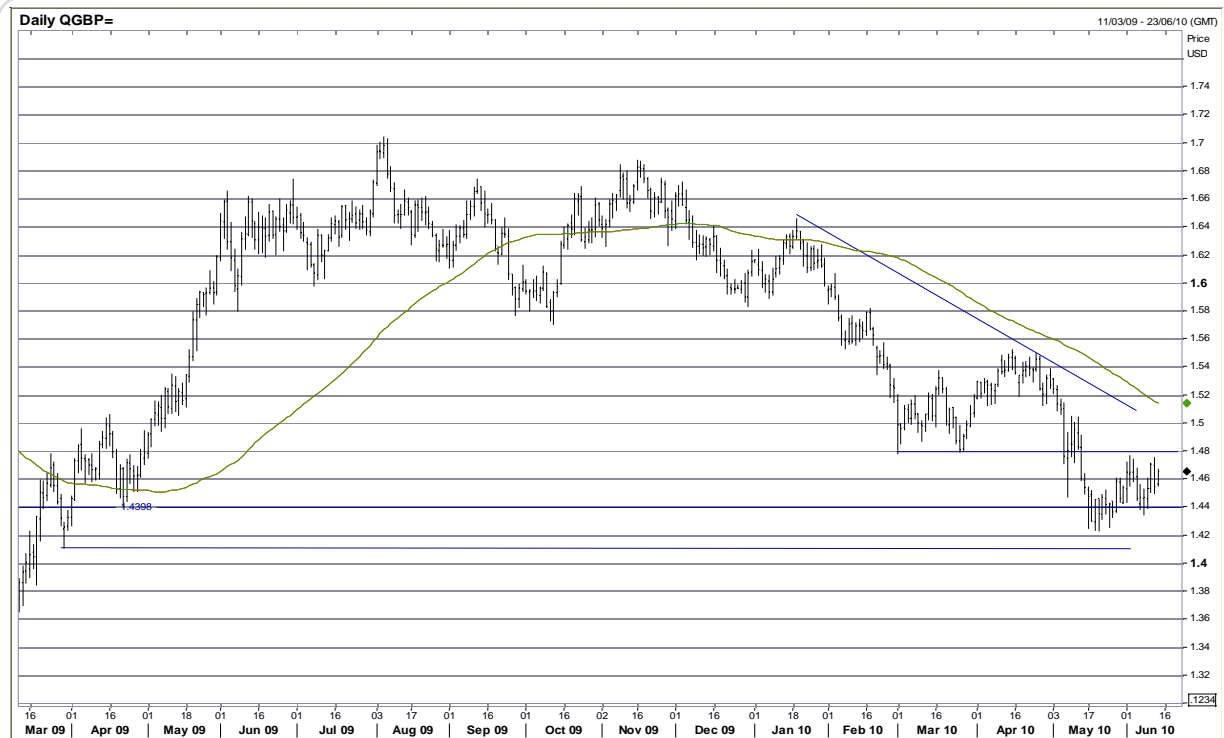
Events

Fed speakers: Bullard (10:15)

Weekly IMM positions: Increase in EUR and GBP shorts, CAD longs rebound



GBP/USD: in narrow range



Market Summary

| FX | Close | Daily Change % |
|----------------------|---------|----------------|
| EUR/USD | 1.2112 | -0.10% |
| USD/JPY | 91.65 | 0.34% |
| AUD/USD | 0.8503 | 0.01% |
| EUR/GBP | 0.8325 | 1.02% |
| GBP/EUR | 1.2015 | -1.01% |
| GBP/USD | 1.4552 | -1.11% |
| GBP/JPY | 133.36 | -0.77% |
| GBP/CHF | 1.6723 | -0.48% |
| GBP/AUD | 1.7111 | -1.13% |
| GBP/CAD | 1.5020 | -0.87% |
| GBP/NZD | 2.1088 | -1.59% |
| GBP/NOK | 9.4127 | -1.32% |
| GBP/ZAR | 11.1826 | -1.39% |
| GBP/CNY | 9.9397 | -1.10% |
| | | |
| Bonds % | | bp |
| US 10Yr | 3.235 | -8.5 |
| EUR 10Yr | 2.566 | -4.4 |
| UK10 Yr | 3.463 | -9.7 |
| | | |
| Other | | |
| VIX | 28.79 | -5.82% |
| iTraxx XOVER | 596.90 | -6.7 |
| DJ Agriculture Index | 55.72 | 1.77% |

| Equities | Close | Daily Change % |
|---------------------|----------|----------------|
| S&P500 | 1091.60 | 0.44% |
| DJIA | 10211.07 | 0.38% |
| FTSE100 | 5163.68 | 0.00% |
| Eurostoxx50 | 2638.31 | 0.00% |
| Shanghai Composite* | 2569.94 | 0.00% |
| *latest price | | |
| | | |
| Commodities | | % |
| Crude Oil \$/bl | 73.78 | -2.25% |
| Gold \$/oz | 1226.7 | 0.83% |
| Copper c/lb | 290.4 | 1.45% |
| Silver \$/oz | 18.25 | 0.00% |
| Baltic Dry | 3288 | -3.94% |
| | | |
| Swaps % | | bp |
| US 5yr | 2.348 | -6.9 |
| EUR 5yr | 2.069 | -7.1 |
| UK 5yr | 2.493 | -5.5 |
| | | |
| Official Rates % | | |
| UK | 0.50 | |
| US | 0.25 | |
| EU | 1.00 | |
| Japan | 0.10 | |

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