



Financial Markets Review

27 November 2009

Bond yields drop on Dubai debt default fears

The Swiss franc and the Japanese yen were among the top performing currencies this week after equity and credit markets worldwide plummeted on fears over a possible debt default in Dubai and a sharp decline in Chinese equities. USD/CHF fell to parity and USD/JPY fell below 85.0. GBP ended the week lower against the USD and the EUR as participants turned away from pro-risk currencies. The AUD and NZD were also hit alongside the CAD and NOK as commodity prices slumped.

Financial market review - foreign exchange

The Swiss franc and the Japanese yen were among the top performing currencies this week after equity and credit markets worldwide plummeted on fears over a possible debt default in Dubai and a sharp decline in Chinese equities. USD/CHF fell to parity and USD/JPY fell below 85.0. GBP ended the week lower against the USD and the EUR as participants turned away from pro-risk currencies. The AUD and NZD were also hit alongside the CAD and NOK as commodity prices slumped.

UK data had only a peripheral influence on sterling this week. Q3 GDP was revised to -0.3% q/q from -0.4%, in line with expectations. A smaller drop in EUR/USD vs GBP/USD lifted EUR/GBP back over 0.91 to a one-month high of 0.9135.

A sharp fall in the Shanghai composite on Tuesday set the wheels in motion for a round of profit taking in global equities and high yield and commodity currencies following an almost uninterrupted rally since early November. The flight-to-quality lifted the USD index off its 2009 low of 74.17, though sellers of the USD slowly re-emerged on Friday and suggest that the reprieve for the USD of further weakness could be short-lived. Price swings were exacerbated by thin liquidity as US markets were closed for Thanksgiving.

The JPY was the best performer among G10 currencies, logging gains ranging between 1.3% vs the Swiss franc to 3.8% vs the NZD. The Japanese Ministry of Finance expressed its increased frustration at the strength of the JPY overnight on Friday and this whisked USD/JPY off the lows back towards 87.0. The Nikkei has underperformed the FTSE-100 by more than 11% in November on profitability concerns for Japanese exporters, causing foreign investors to move out aggressively of JPY stocks in the latest week. GBP/JPY dropped 4.7% over the space of two days but a late spurt of buying on Friday and a bounce in the FTSE-100 prompted GBP/JPY to close the week over 143.0.

UK data had only a peripheral influence on sterling this week. Q3 GDP was revised to -0.3% q/q from -0.4%, in line with expectations. Q3 business investment showed a much smaller drop of 3.0% vs 10.2% in Q2. A stronger than forecast CBI distributive trades survey for November bolstered optimism for strong holiday sales. The index measuring expected sales was unchanged at +19 in De-

A drop in oil prices below \$75pb and a pullback in gold prices pulled the rug from under the CAD and AUD, while the Swiss franc, first strengthening to parity vs the USD, promptly reversed on alleged SNB intervention. The RBA is expected to raise the cash rate target to 3.75% next week.

Financial market rates, ending Fri. 27 Nov 09

	At 4.30pm, 27 Nov 09	Change from 20 Nov 09
FTSE 100	5245.73	-0.11%
Exchange rates		
US\$/UK£	1.6500	-0.12%
Euro €/UK£	1.1029	-0.82%
Euro €/US\$	1.4960	+0.70%
Swaps - 5 year (mid)		
		basis points
UK pound	3.04	-7.0
US dollar	2.37	-8.0
Euro	2.68	-5.0
Bond yields - 10 year		
UK	3.54	-10.0
US	3.22	-12.0
Euro	3.17	-9.50

ember, a 28-month high. GBP posted modest gains this week vs the NOK, SEK, AUD and NZD, but lost ground vs the EUR. A smaller drop in EUR/USD vs GBP/USD lifted EUR/GBP back over 0.91 to a one-month high of 0.9135. We expect EUR crosses to remain volatile over the coming week ahead of the ECB council meeting on Thursday where GDP and CPI projections for 2010 may be revised and steps may be announced to reduce excess liquidity.

A plunge in oil prices below \$75pb and a pullback in gold prices from the highs pulled the rug from under the CAD and AUD, while the Swiss franc, first strengthening to parity vs the USD, promptly reversed on alleged SNB intervention. The RBA is expected to raise the cash rate target to 3.75% next week. EUR/CHF bounced off 1.5012 support to 1.5133, but resumed its decline back below 1.51 on a 22-month high in the Swiss KOF business index and a late return of risk appetite on Friday.

In emerging markets, the Turkish Lira and South Korean won were the worst performers along with the Rouble. USD/Lira dropped 1.9% and USD/Won fell 1.4%. EUR/Yuan reached a new high at 10.3395 ahead of the ECB/EU visit to China over the weekend.

In emerging markets, the Turkish Lira and South Korean won were the worst performers along with the Rouble. USD/Lira dropped 1.9% and USD/Won fell 1.4%. EUR/Yuan reached a new high at 10.3395 ahead of the ECB/EU visit to China over the weekend.

€/£ extends rise above 1.51



£/\$ gives back gains on flight-to-quality



Interest rate market review - bonds, cash and swaps

Government bonds were supported last week, driven by concerns about Dubai World's agreement to delay its debt repayments, and exacerbated by low liquidity surrounding US Thanksgiving. The event sparked broader concerns about the high levels of public and private sector debt in both emerging and developed economies. Swap rates in the US and UK fell significantly, while inter-bank rates were little changed. Sterling 5yr swaps fell below 3% for the first time since May, while the dollar equivalent declined to a 7-month low of 2.27%. UK 3m libor rose marginally to 0.61375%.

Government bonds were supported last week, driven by concerns about Dubai World's agreement to delay its debt repayments, and exacerbated by low liquidity surrounding US Thanksgiving. The event sparked broader concerns about the high levels of public and private sector debt in both emerging and developed economies. Swap rates in the US and UK fell significantly, while inter-bank rates were little changed. Sterling 5yr swaps fell below 3% for the first time since May, while the dollar equivalent declined to a 7-month low of 2.27%. UK 3m libor rose marginally to 0.61375%.

2009/10 calendar of central bank meetings

European ECB (1.00%)

3 December, 14 February, 4 March, 8 April

US FOMC (0-0.25%)

16 December, 27 January, 16 March, 28 April

UK MPC (0.50%)

10 December, 7 January, 4 February, 4 March, 8 April

Rolling calendar of UK data releases and events

Net consumer credit (30/11)
Mortgage approvals (30/11)
PMI manufacturing (01/12)
PMI Services (03/12)
BRC retail sales (8/12)
RICS house prices (8/12)
Industrial production (8/12)
NIESR GDP est (8/12)

Rolling calendar of US data releases and events

ISM manufacturing (1/12)
ADP employment (2/12)
ISM non-manu (3/12)
Non-farm payrolls (4/12)
Factory orders (4/12)
Trade balance (10/12)
Import prices (11/12)
Retail sales (11/12)

The UK Office for National Statistics (ONS) revised up its estimate for Q3 GDP to a quarterly decline of 0.3% versus the original estimate of -0.4%. This means the UK still remains technically in recession, in contrast to most other major economies that have reported third-quarter growth figures. The economy is widely expected to return to growth in Q4, a view supported by a positive report on retail activity from the CBI distributive trades survey, but the big picture remains that the pace of recovery is likely to be gradual and uneven. The expenditure breakdown of the Q3 GDP figures, revealed for the first time last week, also raised concerns about whether the necessary rebalancing of the economy away from consumption towards exports is taking place, as net exports actually subtracted from quarterly growth. Bank of Governor Mervyn King this week left the door open for further asset purchases if the medium-term outlook for inflation turns out to be weaker than expected, but MPC members reiterated that inflation will spike higher in the next few months, due to temporary factors such as the expected VAT rise in January. Over the week, 5yr and 10yr swap rates fell 7bps, but 2yr swaps were little changed. Corporate sterling issuance this week includes Telefonica (£650m 2022 paper at 145bps over gilts) and Marks and Spencer (£400m 10yr paper at 245bps over gilts).

In the US, \$118bn of government bond issuance was successfully digested. Third-quarter GDP was revised down in line with expectations to 2.8% (annualised) from 3.5%. Durable goods orders for October were weaker than expected, but other data generally surprised on the upside for economic activity. These included existing and new home sales, personal consumption and initial jobless claims, with the latter an indication of a

UK 5y swap fell below 3%



Kenneth Broux, Market Economist
Hann-ju Ho, Senior Economist

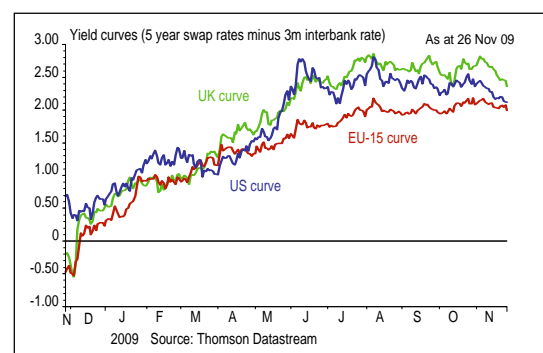
£/€ fell below 1.10, hits one-month low



potential further improvement non-farm payrolls next week. However, the minutes of the last FOMC meeting remained dovish overall, reiterating that interest rates are likely to remain low for an 'extended period'. With the US economy in the early stages of recovery, we do not expect the Fed to countenance raising rates until around the middle of 2010. US 10yr treasury yields fell 12bps to 3.22%, while 2yr yields fell 3bps to 0.69%. In terms of swaps, 5yr and 10yr rates fell 12-14bps, while 2yr rates were little changed. Corporate issuance over the week included below investment grade companies Psalm (\$1.179bn 2024 at 401bps over USTs and \$1.021bn 2019 at 412.3bps over USTs) and Clearwire Communication/Finance (\$920m 2015 at 1007bps over USTs), as well as NIBC Bank NV (\$2bn 2024 at 68.8bps over USTs).

In the euro area, some positive business surveys in the form of the PMI and German IFO did not prevent a decline in bond yields and swap rates. The euro area composite PMI rose to 53.7 in November, a 2-year high, and indicated that economic growth recorded in Q3 will continue into the final quarter. The IFO survey also rose by more than expected. Moreover, German annual CPI inflation, on the EU-harmonised measure, rose to 0.4% in November from -0.1% and this is expected to be reflected in the euro area flash CPI release next week. A Bundesbank report suggesting that German banks could face up to €90bn of further writedowns, mainly from bad loans, received some attention and may lead to a more cautious scaling-back of unlimited liquidity by the ECB next week. There was significant corporate euro issuance last week including from HSBC, UBS, Intesa, Unedic, KfW and Ontario Province. Volkswagen issued €1.25bn 2015 at 112.6bps over DBR.

Yield curves flattened



Foreign exchange - graphical analysis of recent trends

Chart 1: £/\$ fell back as risk aversion set in

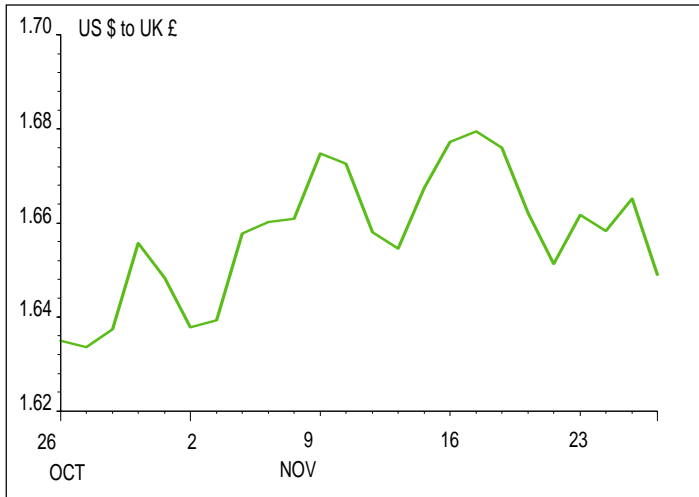


Chart 2: €/€ hit an intra-week high over 1.51

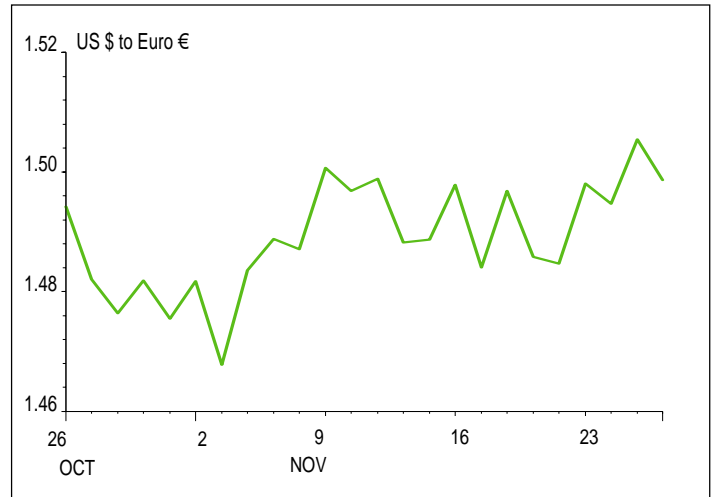


Chart 3: £/€ fell below 1.10

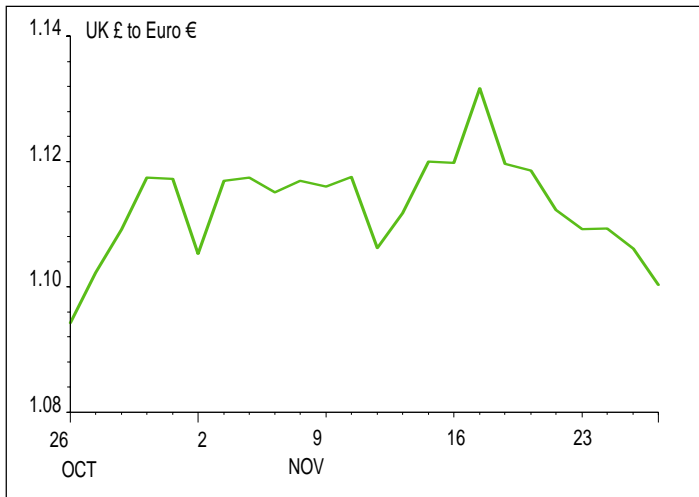


Chart 4: \$/¥ plunged below 85.0

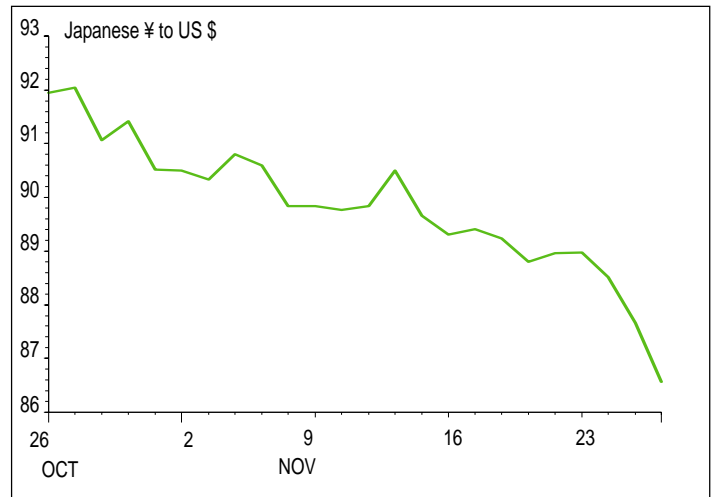


Chart 5: \$/C\$ rebounded over 1.07 on lower oil prices

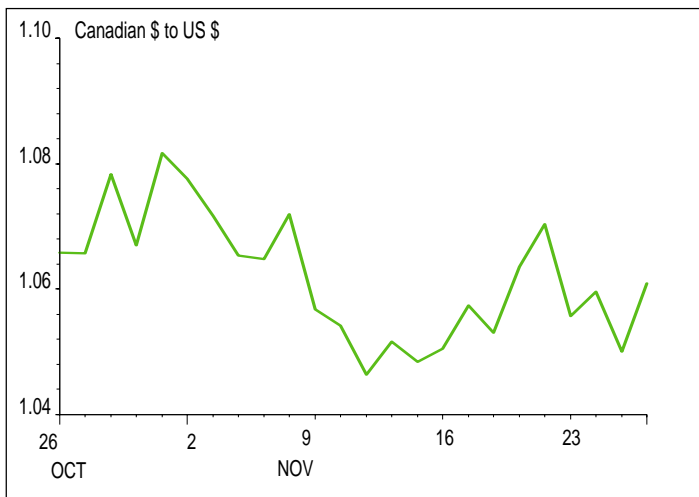
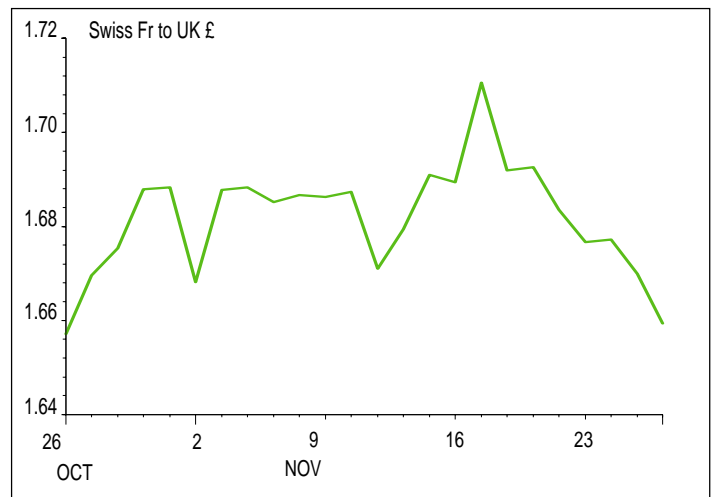


Chart 6: £/CHF dropped below 1.66



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Fixed income - graphical analysis of recent trends

Chart 1: UK 2yr yield continued to decline

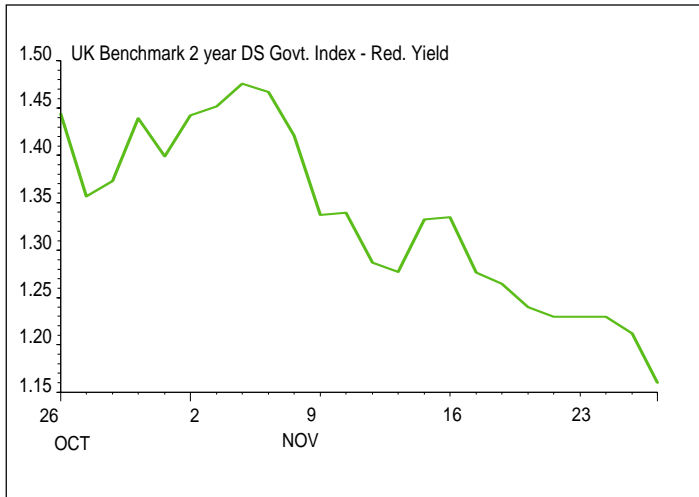


Chart 2: UK 10yr yields fell temporarily below 3.50%

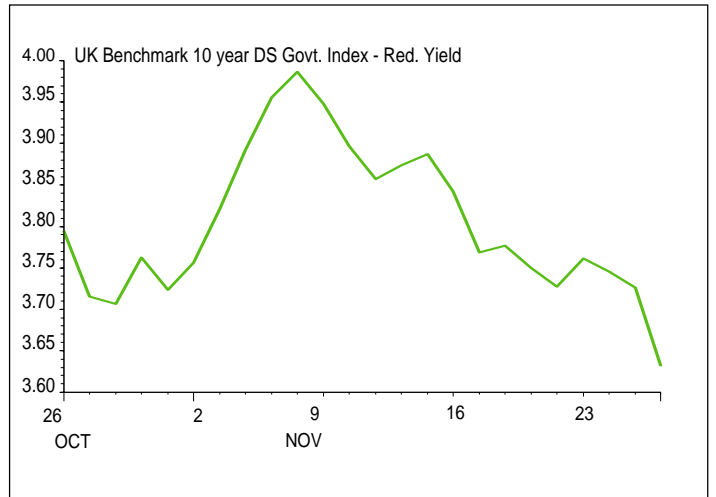


Chart 3: US 2yr yield fell to 2009 lows

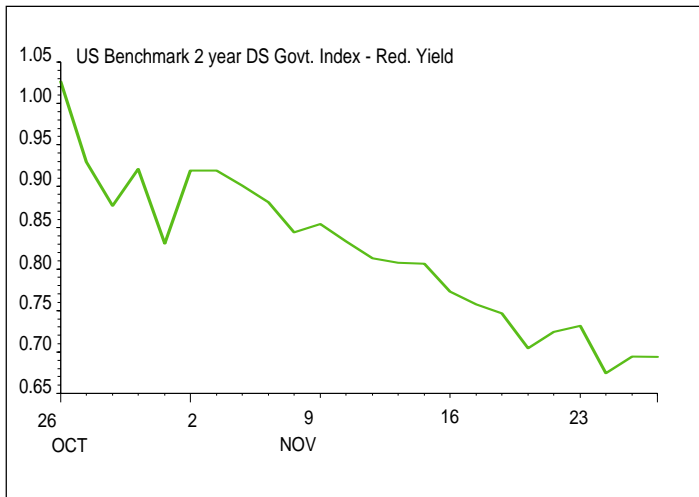


Chart 4: US 10yr yield weighed by increased risk aversion

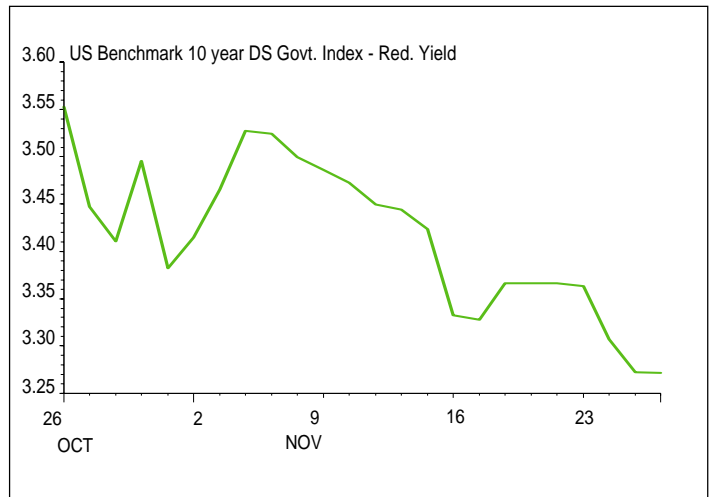


Chart 5: EU-16 2y yield fell despite strong survey data

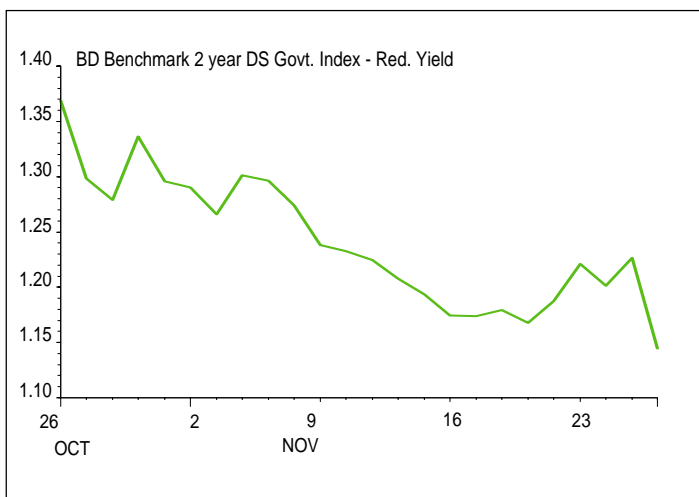
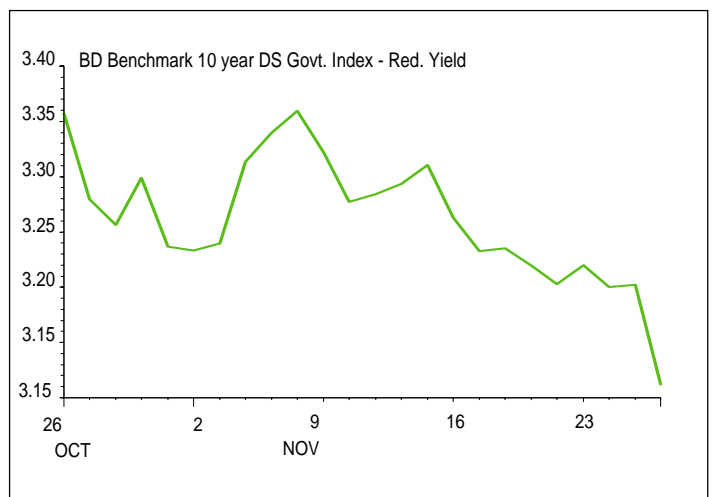


Chart 6: EU-16 10yr yield fell below 3.2%



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

Interest rate markets - graphical analysis of recent trends

Chart 1: US 5yr swap fell to a 7-month low

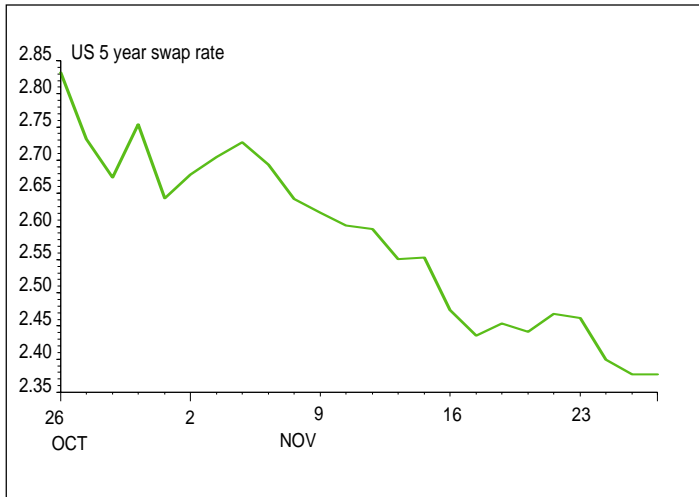


Chart 2: Euro 5yr swap declined less than dollar swap

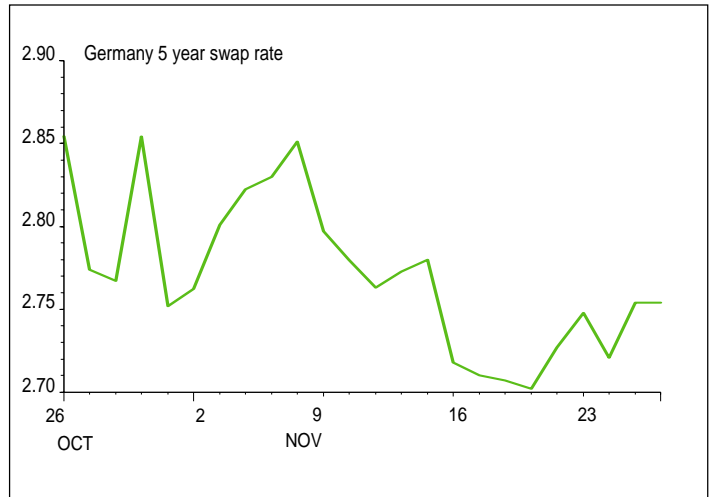


Chart 3: UK 5yr swap fell below 3%



Chart 4: US curve continued to flatten

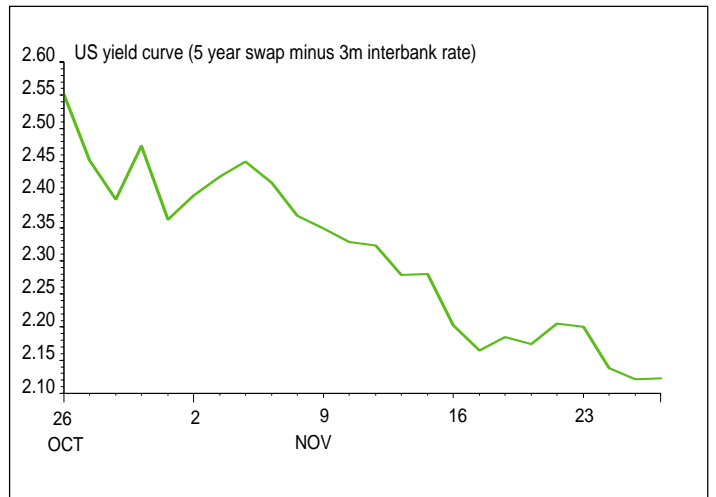


Chart 5: Eurozone spread flattened for a second week

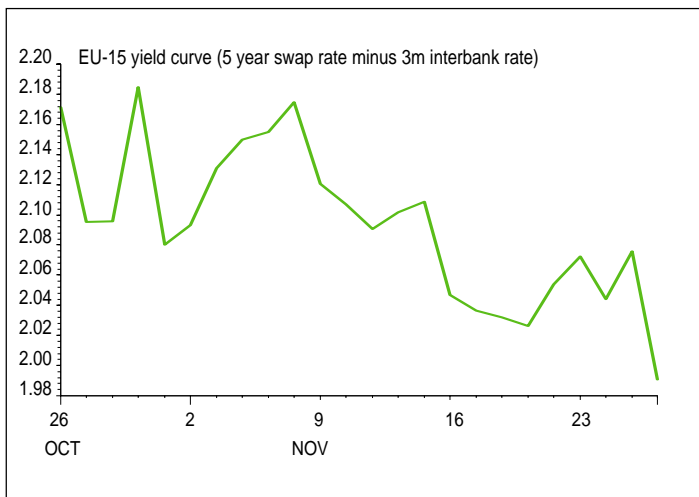
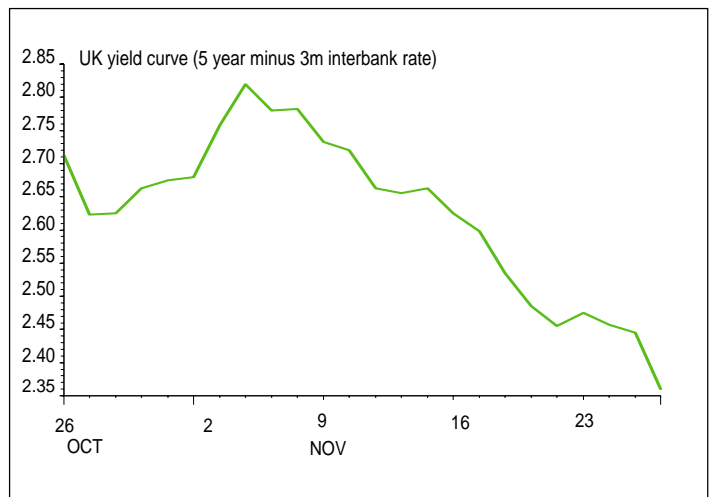


Chart 6: UK curve flattened, as swap rates fell



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Key commodity and equity markets - Graphical analysis of recent trends

Chart 1: Gold hit a new high close to \$1,200

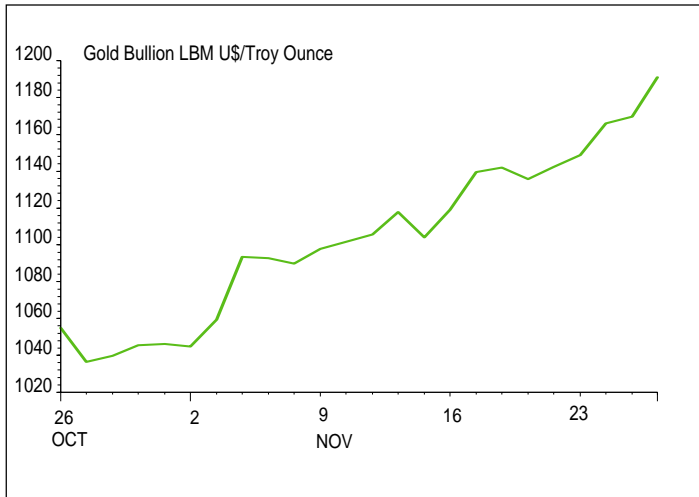


Chart 2: Brent crude oil dropped below \$76pb

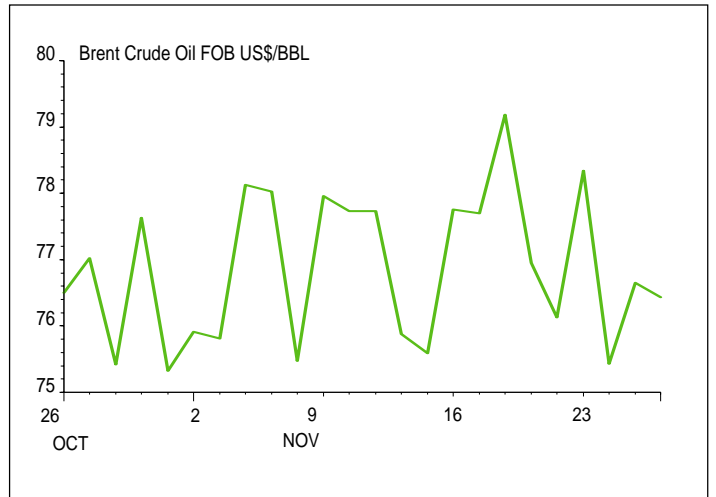


Chart 3: Relief bounce led FTSE-100 to close over 5,200



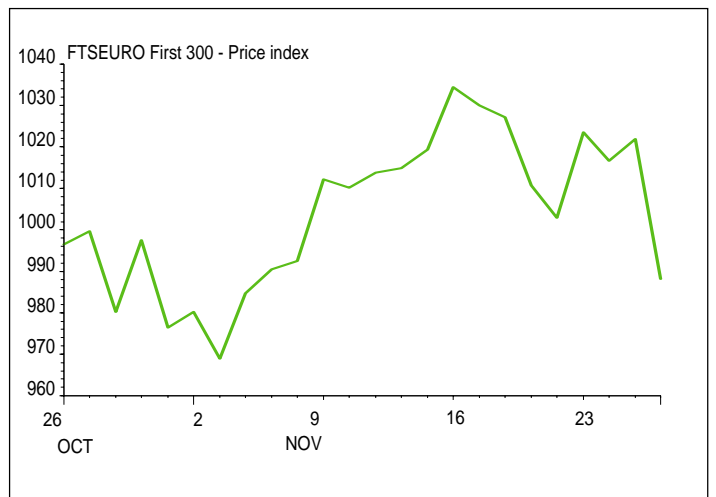
Chart 4: The Dow Jones fell on Dubai debt jitters



Chart 5: Nikkei extends slide on strong JPY



Chart 6: EuroFirst 300 rebounds over 1,000 on Friday



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Client support – Contact Details

Research Team

Trevor Williams	+44 (0)20 7158 1748
Adam Chester, UK Macro	+44 (0)20 7158 1740
Jeavon Lolay, Global Macro	+44 (0)20 7158 1742
Hann-Ju Ho, Sector Research	+44 (0)20 7158 1745
Mark Miller, Global Macro	+44 (0)20 7158 1742
George Johns, UK Macro	+44 (0)20 7158 1751
Paul Rodriguez, Market Strategy	+44 (0)20 7158 1744
Kenneth Broux, Market Strategy	+44 (0)20 7158 1750
Naeem Wahid, Market Strategy	+44 (0)20 7158 1741
Altaz Dagha, Market Strategy	+44 (0)20 7158 1747

Disclaimer

Any documentation, reports, correspondence or other material or information in whatever form be it electronic, textual or otherwise is based on sources believed to be reliable, however neither the Bank nor its directors, officers or employees warrant accuracy, completeness or otherwise, or accept responsibility for any error, omission or other inaccuracy, or for any consequences arising from any reliance upon such information. The facts and data contained are not, and should under no circumstances be treated as an offer or solicitation to offer to buy or sell any product, nor are they intended to be a substitute for commercial judgement or professional or legal advice, and you should not act in reliance upon any of the facts and data contained, without first obtaining professional advice relevant to your circumstances. Expressions of opinion may be subject to change without notice. Although warrants and/or derivative instruments can be utilised for the management of investment risk, some of these products are unsuitable for many investors. The facts and data contained are therefore not intended for the use of private customers (as defined by the FSA Handbook) of Lloyds TSB Bank plc. Lloyds TSB Bank plc is authorised and regulated by the Financial Services Authority and a signatory to the Banking Code, and represents only the Scottish Widows and Lloyds TSB Marketing Group for life assurance, pension and investment business.

Support/Administration

Terry Murray	+44 (0)20 7158 1725
Andrew Gipp	+44 (0)20 7158 2056
Sam Weitzman	+44 (0)20 7158 1726