



Financial Markets Review

4 December 09

Bond yields rise on surprise fall in US unemployment rate

The pound produced a mid-table performance, falling against commodity currencies and rallying against the low yielding currencies

The Japanese yen was the weakest of the G-10 currencies this week as the prime minister warned that yen strength cannot be "left as it is"

The move higher in equity and commodity prices, over the week, left the USD dipping lower against emerging market currencies

The ECB left eurozone interest rates unchanged. However in the following press conference President Trichet announced that the 12-month and 6-month tenders were coming to an end - this is another step in the ECB's exit strategy.

Financial market review - foreign exchange

In the G-10 currency space, the pound has produced a mid-table performance this week. It fell against the commodity currencies (Australian, New Zealand and Canadian dollars) whilst managing to rally against the defensive, low yielding, currencies (euro, Swiss franc and Japanese yen). GBP/USD and GBP/EUR both moved higher, closing the week at \$1.6531 and €1.1113 respectively.

The impact of economic data on sterling has been mixed. GfK consumer confidence and net consumer credit both deteriorated further, weighing on GBP/USD towards the start of the week. Housing data improved further – mortgage approvals rose to 57,300 in October and the Nationwide house price index increased (by 0.5%) for the 7th consecutive month in November. The most important data of the week were the PMI reports, where the manufacturing index fell to 51.8 (which importantly continue to signal expansion) and the services index remained at an elevated level (56.6).

The Japanese yen was the underperformer in the G-10 space, falling 3.7% against the USD and 3.9% against GBP. Japanese authorities remain concerned about the strength of the yen – USD/JPY traded down to a 14-year low (Y84.83) last week. The Japanese prime minister suggested that yen strength could not be "left as it is", suggesting that intervention may soon occur and prompting a rally in USD/JPY as a number of speculators closed their short positions.

US dollar performance has been mixed over the week. The USD index closes marginally higher at 75.6. US ISM data have disappointed. The manufacturing index slipped to 53.6 whilst the services report fell to 48.7 – this is important given that it is now back in contraction territory. The most important US data report this week was the US non-farm payroll report, which gave the USD a boost into the weekend. The report suggested that only 11,000 jobs had been lost in the US during November (the best outcome since December 2007) and that the unemployment rate dipped to 10%. The strong report led to a reappraisal

€/£ still grinding upwards



Financial market rates, ending Fri. 4 Dec 09

At 4.30pm, 4 Dec 09		Change from 27 Nov 09
FTSE 100	5322.36	+1.46%
Exchange rates		
US\$/UK£	1.6531	+0.19%
Euro €/UK£	1.1113	+0.76%
Euro €/US\$	1.4875	-0.57%
Swaps - 5 year (mid)		basis points
UK pound	3.12	+8.0
US dollar	2.63	+26.0
Euro	2.73	+5.0
Bond yields - 10 year		
UK	3.71	+17.0
US	3.48	+26.0
Euro	3.23	+6.0

of US interest rate expectations, helping to widen G-10 interest rate spreads in the US's favour – providing a bid tone to the US dollar in the process.

The European Central Bank left eurozone interest rates unchanged this week. However in the following press conference ECB President Trichet announced that the 12-month and 6-month tenders were coming to an end - this is another step in the ECB's exit strategy. The euro fell marginally throughout the press conference.

In the emerging market space, the USD ends broadly lower. The Indian rupee and the Brazilian real appreciated 0.75% and 0.86% respectively, against the USD. A move higher in equity and commodity prices increased inflows into emerging market nations, providing support to the currencies. Freely traded emerging market currencies have a good correlation with the global growth cycle. USD/BRL (which is trading around 1.7150) is very close to the 2009 low (1.6968). Interestingly, the USD has closed marginally higher (0.33%) against the Russian ruble – the USD has outperformed against only a handful of emerging market currencies this week. The USD/RUB move is partly explained by the oil price. NYMEX WTI crude oil was unable to rally higher over the week.

£/\$ stuck in 1.57-1.70 range since May



Interest rate market review - bonds, cash and swaps

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Much better than expected US employment data and the ECB announcement that it will start reducing excess liquidity took a heavy toll on government bonds this week, with yields rising in the major currencies and across the curve. Treasuries took an additional hit as the better employment data triggered selling ahead of the sizeable government auctions next week. UK 5y swaps dropped below 3% but in the end finished the week 8bps higher at 3.12%. UK 3-month libor ended the week flat at 0.61% resulting in a steeper yield curve.

Investors put worries about the debt situation in Dubai behind them this week and a strong equity rally in the Shanghai composite bolstered confidence and a return of risk appetite across G7 markets. This was translated into higher equity prices, tighter credit spreads, and rising bond yields, though UK 5y swaps touched a 2.94% low on Monday. The ECB and stronger than forecast US November employment data were the catalyst for a sell-off first in short dated paper on Thursday and subsequently in longer dated yields on Friday. The ONS on Friday reported a 2% q/q gain in Q3 construction output and this raises the possibility of an upward revision to UK Q3 GDP to -0.1% q/q/ vs -0.3% later this month. This contributed to the bearish backdrop for bonds and steered yields and swap rates higher.

UK economic data generally came in line with expectations this week with the exception perhaps of the manufacturing PMI for November. The survey showed a bigger than forecast drop to 51.8 vs revised 53.4 for October. The construction PMI rose to 47.0 vs 46.2 and the services PMI slipped to 56.6 vs 56.9. New car registrations rose 57.6% y/y in November, up from 31.6% in October. The DMO sold £2.5bn of 2039 gilts at a cover of 1.74, above the previous 1.62, so a good reception. The £5.5bn, 2015 auction drew strong demand and was covered 2.16 times. Corporate issuance in sterling was heavy but should start to tail off in the coming weeks. Deals came to market from Intercontinental Hotels (250mn at 290bps over), West Bromwich Building Society (500mn, 67bps over gilts), NAB (600mn at 143bps over) and KfW (900mn at 58bps over),

The announcement on Thursday of \$74bn in US Treasury sales next week provided early selling pressure

UK 5y swaps rise from 2.94% low



Kenneth Broux, Market Economist
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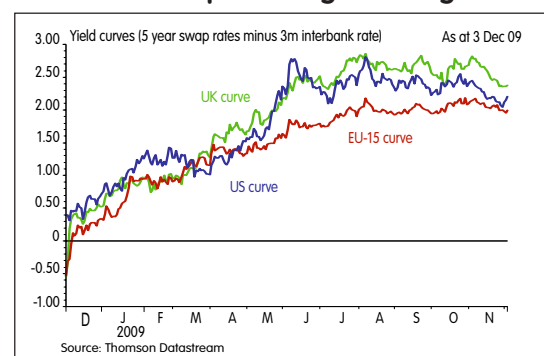
£/€ slide coming to an end



ahead of the November employment data. The report released on Friday showed a decline of only 11,000 jobs compared to the -125,000 consensus, marking the best result since the start of the recession. The unemployment rate fell to 10% from 10.2% and the number of weekly hours worked rose to 33.2, an 8-month high. The report topped the most optimistic forecasts and caused participants to scramble out of fixed income securities. Yields shot up across the curve but the selling was concentrated in the front end, with 2y yields rocketing to 0.83%. Separately, participants also fretted over reports that the Fed moved ahead this week with the testing of 'live' reverse repo auctions to prepare for an eventual withdrawing of liquidity. US 5y swaps finished the week 26bps higher at 2.63%. Corporate dollar issuance fell to \$10.7bn this week, below the weekly average of \$27bn for this year. MF Global pulled a \$250mn offering of 10y senior notes due to market conditions. Xerox issued \$2bn in 5y, 10y and 30y bonds.

An important week for euro zone bunds saw the ECB announce a final 12-month tender for unlimited liquidity but at a minimum bid rate. This could be higher than the refi rate depending on the demand for funds. This was interpreted as a sign that the ECB will raise interest rates in the second half of 2010 - though 3-month Eonia stayed flat at 0.40% - and set off a sharp rise in 2y yields above 1.35%. The ECB also revised up its 2010 GDP and CPI forecasts to 0.8% and 1.3% (mid-points). 5y swaps hit a 2.76% high on Friday following the US employment data. Corporate euro issuance was fairly light with Credit Suisse and KA Finance coming to market. 3-month euribor closed the week flat at 0.68%.

Yield curves steepen through the long end



2009/10 calendar of central bank meetings

European ECB (1.00%)
14 January, 4 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

BRC retail sales (8/12)
RICS house prices (8/12)
Industrial production (8/12)
NIESR GDP est (8/12)
Trade balance (9/12)
Pre-Budget Report (9/12)
Producer prices (11/12)
Consumer prices (15/12)

Rolling calendar of US data releases and events

Trade balance (10/12)
Import prices (11/12)
Retail sales (11/12)
Business inventories (11/12)
Producer prices (15/12)
Treasury capital flows (15/12)
Industrial production (15/12)
Consumer prices (16/12)

Foreign exchange - graphical analysis of recent trends

Chart 1: £/\$ firmly range-bound

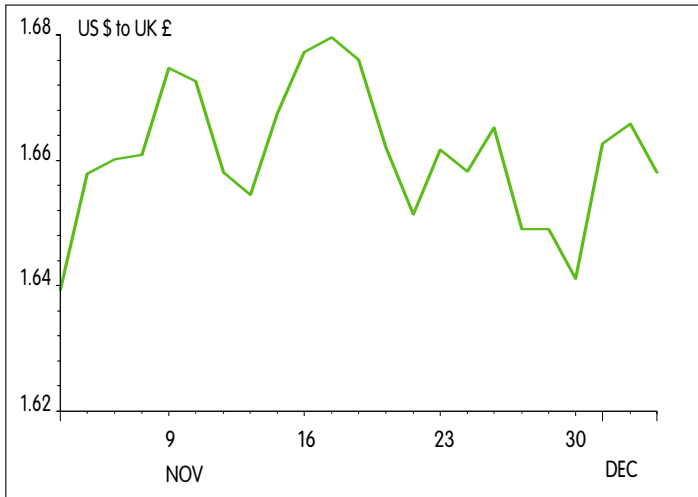


Chart 2: €/€ still pushing upwards

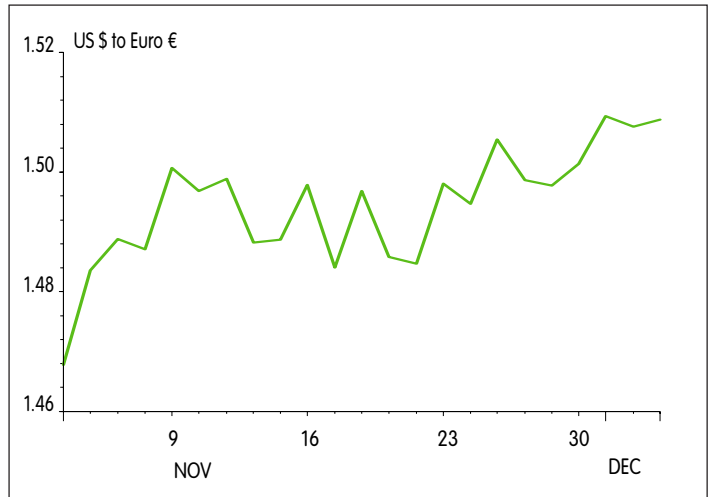


Chart 3: £/€ beginning to stabilise



Chart 4: \$/¥ recovery underway?

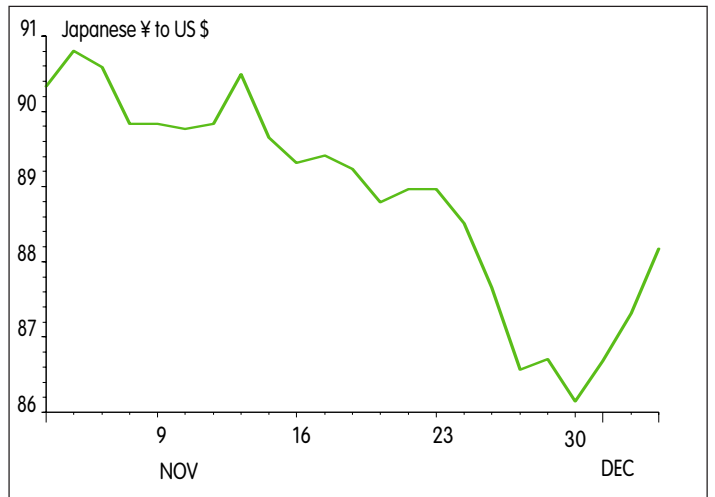


Chart 5: \$/C\$ stuck in a range

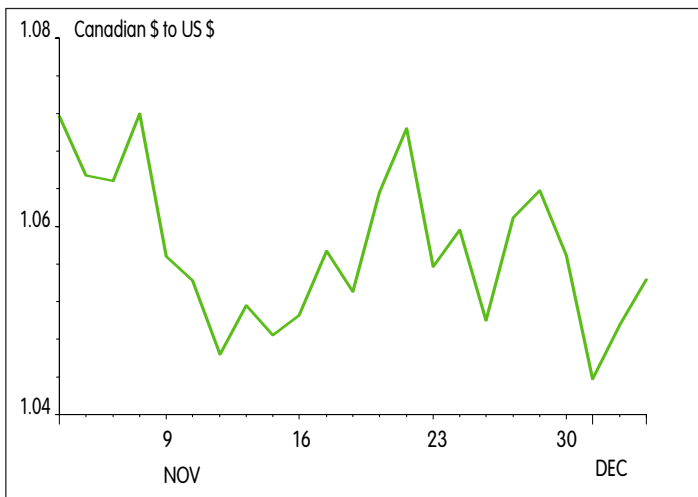
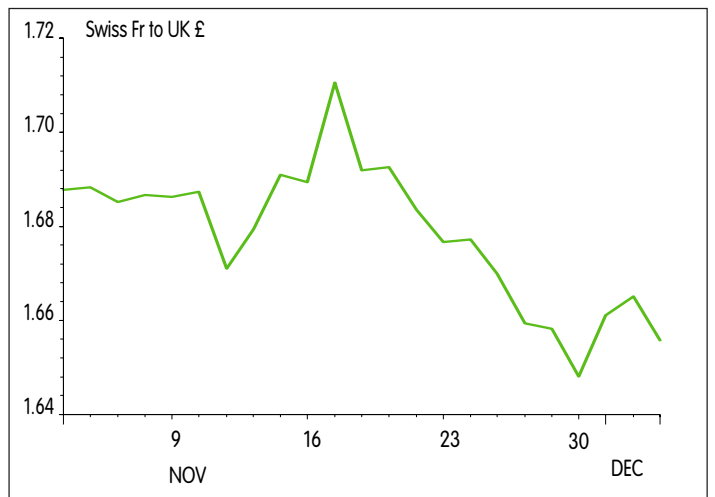


Chart 6: £/CHF grinding around 1.66



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Fixed income - graphical analysis of recent trends

Chart 1: UK 2yr yield finds support above 1.10%

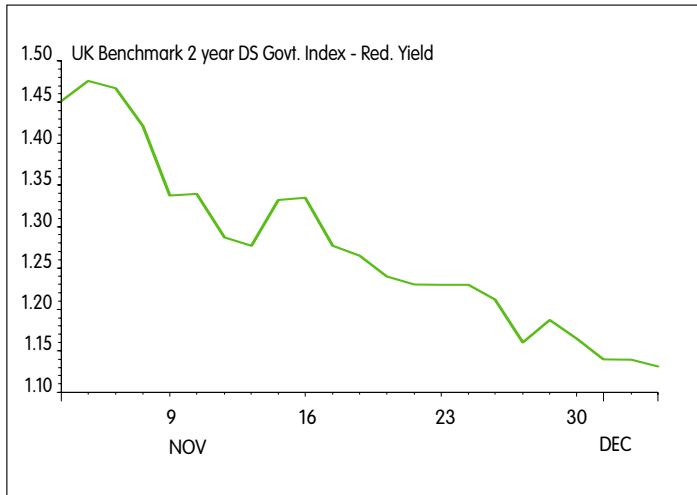


Chart 2: UK 10yr yields rise back over 3.70%



Chart 3: US 2yr yield bounce off 0.65% support

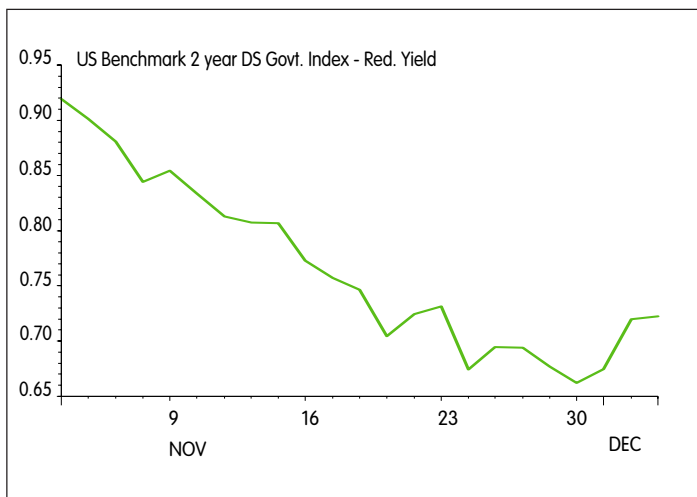


Chart 4: US 10yr yield shoot upwards on US jobs data

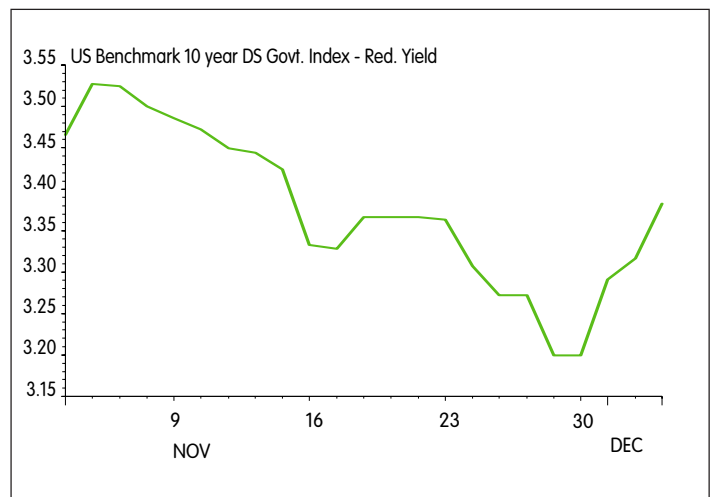


Chart 5: EU-16 2y yield jump on ECB liquidity announcement

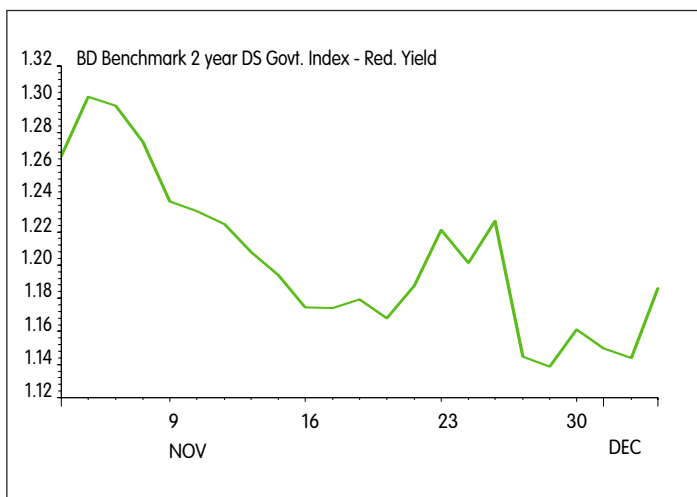
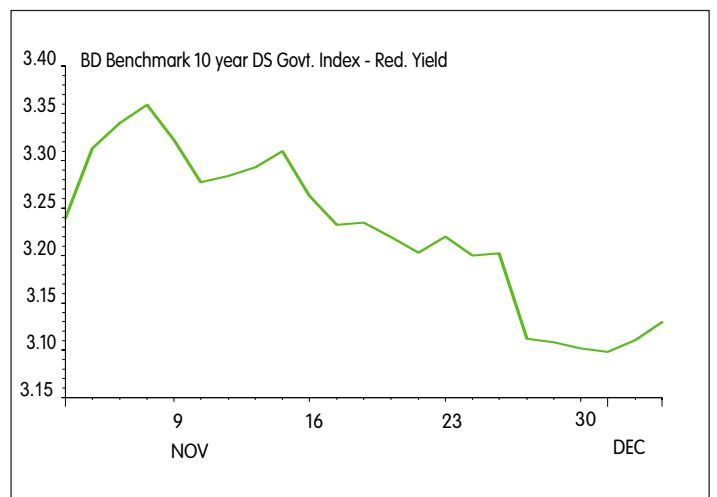


Chart 6: EU-16 10yr yield bounce off 3.10%



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Interest rate markets - graphical analysis of recent trends

Chart 1: US 5yr swap ends the week higher

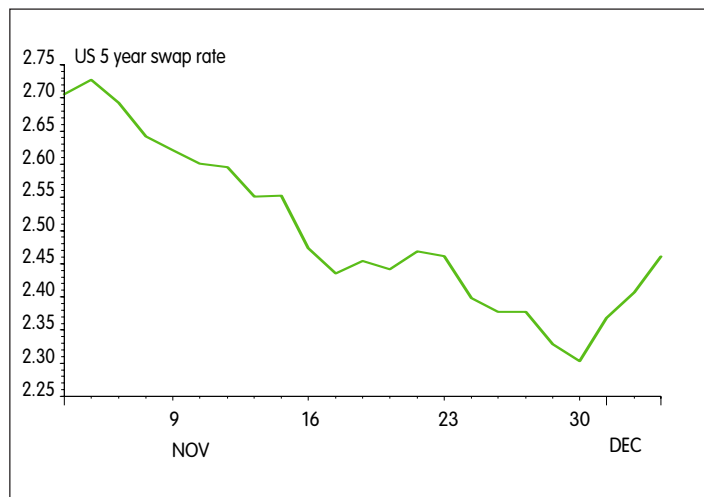


Chart 2: Euro 5yr swap rebounds over 2.65%

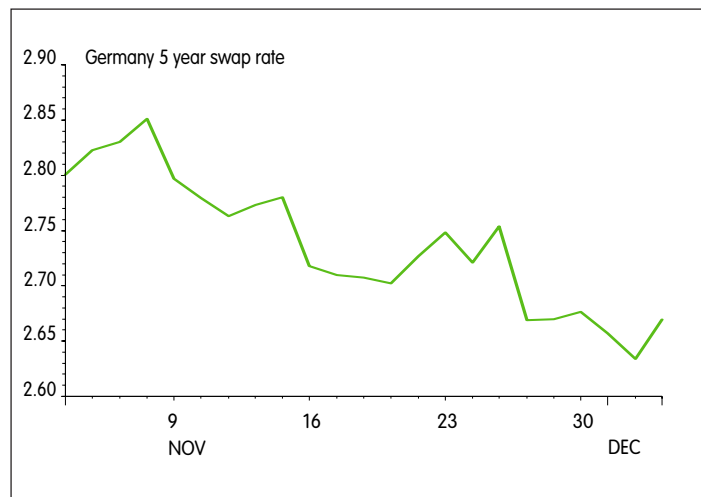


Chart 3: UK 5yr swap stable around 3.0%

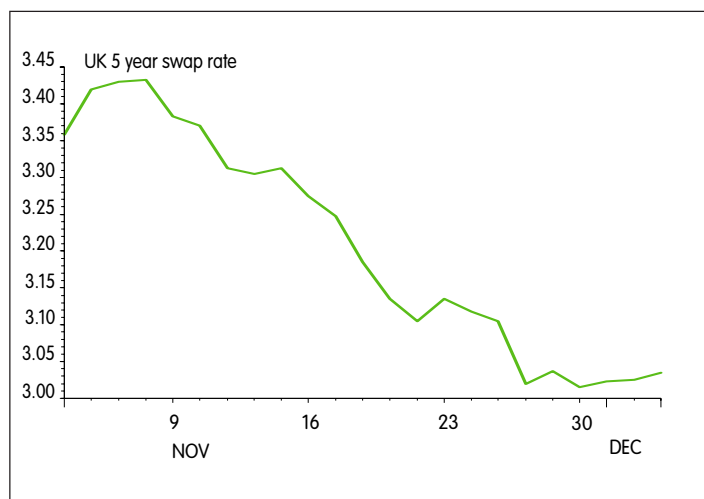


Chart 4: US curve steepens over 220bps

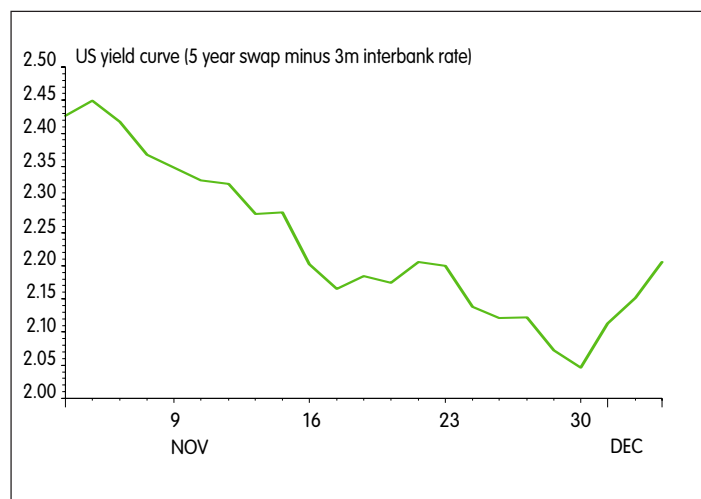


Chart 5: Eurozone curve steepened as swaps rise

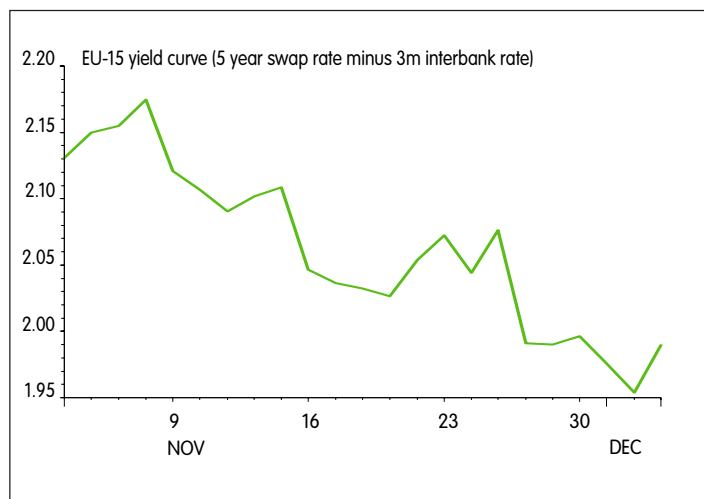
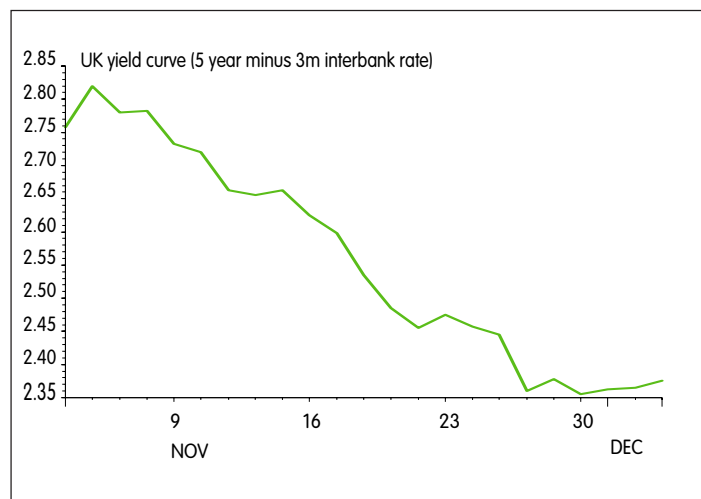


Chart 6: UK curve spread stays within range



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

Key commodity and equity markets - Graphical analysis of recent trends

Chart 1: Gold climbs over \$1,200

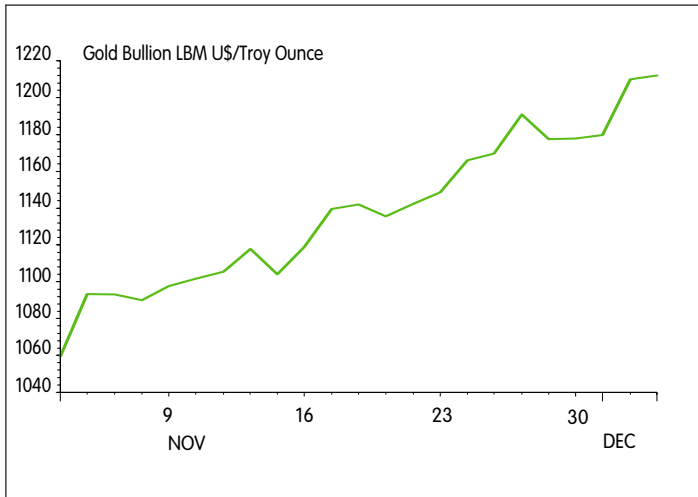


Chart 2: Brent crude oil oscillates around \$77pb

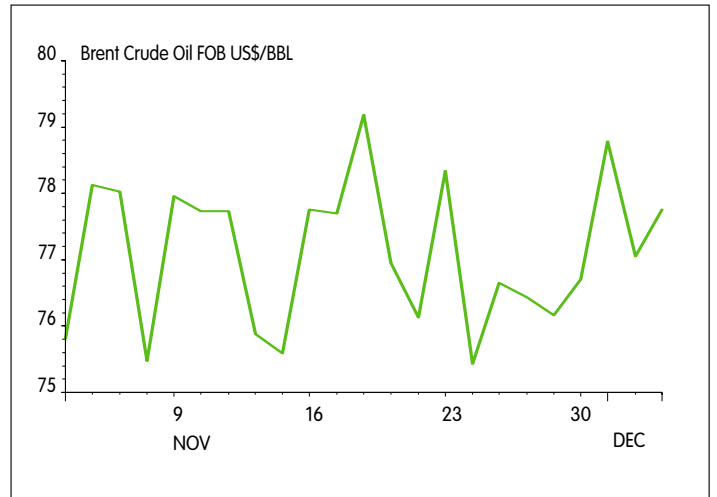


Chart 3: FTSE-100 closes the week above 5,300

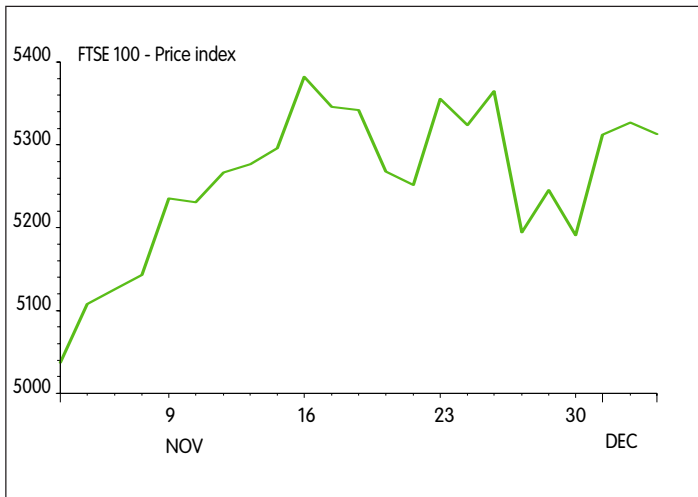


Chart 4: Dow Jones steady near upper ranges

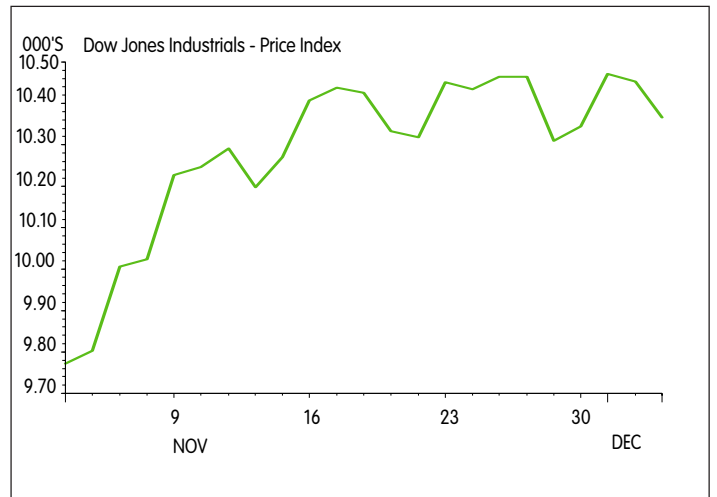


Chart 5: Nikkei soars back over 10,000 on weaker yen

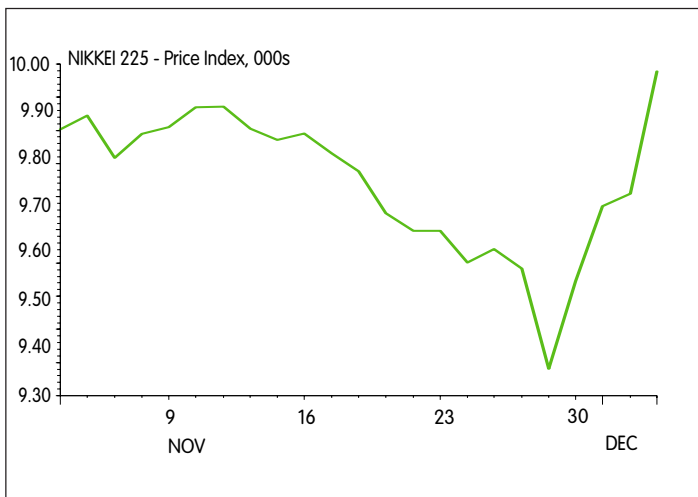
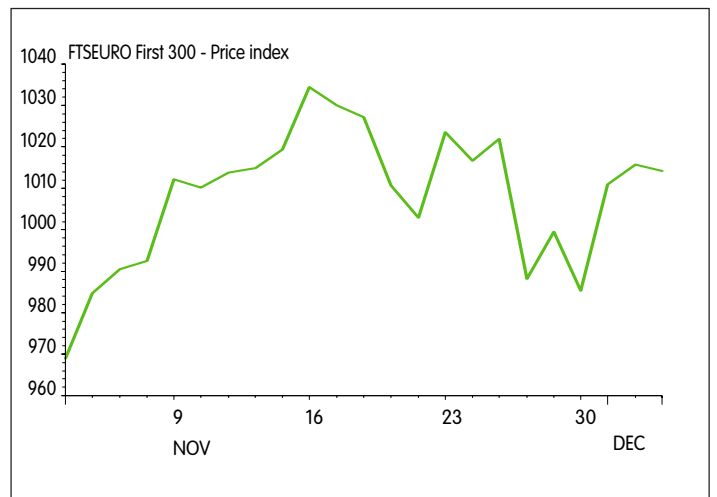


Chart 6: EuroFirst 300 finds support at 1,000



Source: Lloyds TSB Corporate Markets Economics and Thomson Datastream

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