



Daily Market Strategy

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Market Strategy

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- **King: rate hike before asset sales**
- **CHF at intra-week high as SNB drops Franc commentary**

Market Outlook

Opening levels (7.15am)

£/\$: 1.4708

€/£: 1.2277

\$/¥: 91.31

UK 5y sw: 2.58%

US 5y sw: 2.32%

EU 5y sw: 2.07%

Overnight

- BoE governor King repeats spare capacity will press down on inflation, concerned about inflation expectations; monetary policy to be set in light of fiscal tightening in coming years
- Chancellor decides to abolish of FSA; BoE given powers to stop build-up of financial market risks, asset bubbles; responsibility to include monetary policy and financial stability
- EU spreads widest since start ECB bond purchase plan on May 9
- Will EU summit agree on publishing 'bank stress tests'?

GBP/USD is trading 150pips lower this morning from yesterday's highs, not drawing a great deal of confidence from the Mansion House speeches overnight and reacting to a mixed trading session for US and Asian equities. The proverbial elephant in the room is the ongoing widening in EU bond spreads vs bunds, and doubts over the liquidity position of countries like Spain. 2y/5y peripheral spreads over bunds have widened to the highs since the ECB started buying debt during the week of May 10 (see chart). It is against this backdrop and negotiations in Berlin by EU heads of State to publish EU wide bank stress tests that we will filter price action in major markets over the next 48 hours. BoE governor King didn't really touch on anything new in his address and his assertion that rates hikes will precede any asset sales supports the friendly outlook for longer-duration yields and a flatter curve. Yields have opened 2bp lower along the curve as we now await May retail sales and the 2014 gilt auction.

Ahead today

- UK: retail sales could surprise to the topside in May (consensus is for a mediocre 0.1% m/m gain), supported by lower inflation and higher house prices. Optimism is dampened by the sharp fall in consumer confidence and the acceleration in inflation expectations. The last 5%, 2014 gilt sale (Oct-09) was covered only 1.56x. Yields are currently trading some 70bp below the Oct level, a potential handicap for today's sale.
- EU: eyes on the heads of State summit in Berlin for decisions on financial and regulatory reform, as well as plans to harmonise economic and fiscal convergence and discussions on bank stress tests. Spain sells between 2.5bln and 3.5bln eur 2020 and 2041 bonds.
- US: monthly swings in core PPI and CPI don't correlate highly, but markets will be on alert for a hotter May headline CPI number after yesterday smaller than forecast PPI drop (-0.3%). Weekly claims are for NFP survey week.

FX: GBP/USD fell back overnight, slipping below support at 1.4784 and 1.47. The cross also took out 1.47 with an alleged reversal of BP related GBP buying for dividend payments adding negative momentum. Solid retail sales data are required to stop a descent towards 1.46. GBP/CHF pierced trendline support at 1.6597 and could accumulate losses towards 1.65 if the SNB deems it appropriate to drain liquidity and issue a less dovish inflation assessment. For EUR/USD, failure to extend above 1.2350 over the last two days caused momentum to evaporate and has seen the cross slip back below 1.23 overnight. Watch the EU summit headlines for direction.

Rates: A minor bid for gilts this morning is dragging yields lower by 2bp along the curve, despite the stronger start for the FTSE. UK retail sales and US CPI will bring some distraction later on, but worries over EU liquidity and bank stress tests may keep yields offered ahead of next week. 5y swaps and 2y/10y spreads are holding recent ranges. 10y Spain over bunds climbs to 229bp.

	Close	Daily Change %
FX		
EUR/GBP	0.8357	0.32%
GBP/USD	1.4731	-0.49%
EUR/USD	1.2311	-0.17%
USD/JPY	91.440	-0.02%
AUD/USD	0.8640	-0.18%
Bonds %		
		bp
US 10Yr	3.260	-4.2
EUR 10Yr	2.671	-0.3
UK10 Yr	3.536	-1.7
UK 5yr Swap	2.580	0.2
Equities		
		%
S&P500	1114.61	-0.06%
FTSE100	5237.92	0.00%
Eurostoxx50	2718.73	0.00%
Shanghai Composite	2560.25	-0.38%
Commodities		
		%
Crude Oil \$/bl	77.67	0.95%
Gold \$/oz	1229.0	-0.42%
Copper	301.4	-0.35%
Baltic Dry	2893	-4.21%
Other		
VIX	25.92	0.19%
iTraxx XOVER	558.61	-8.0

Today's Data

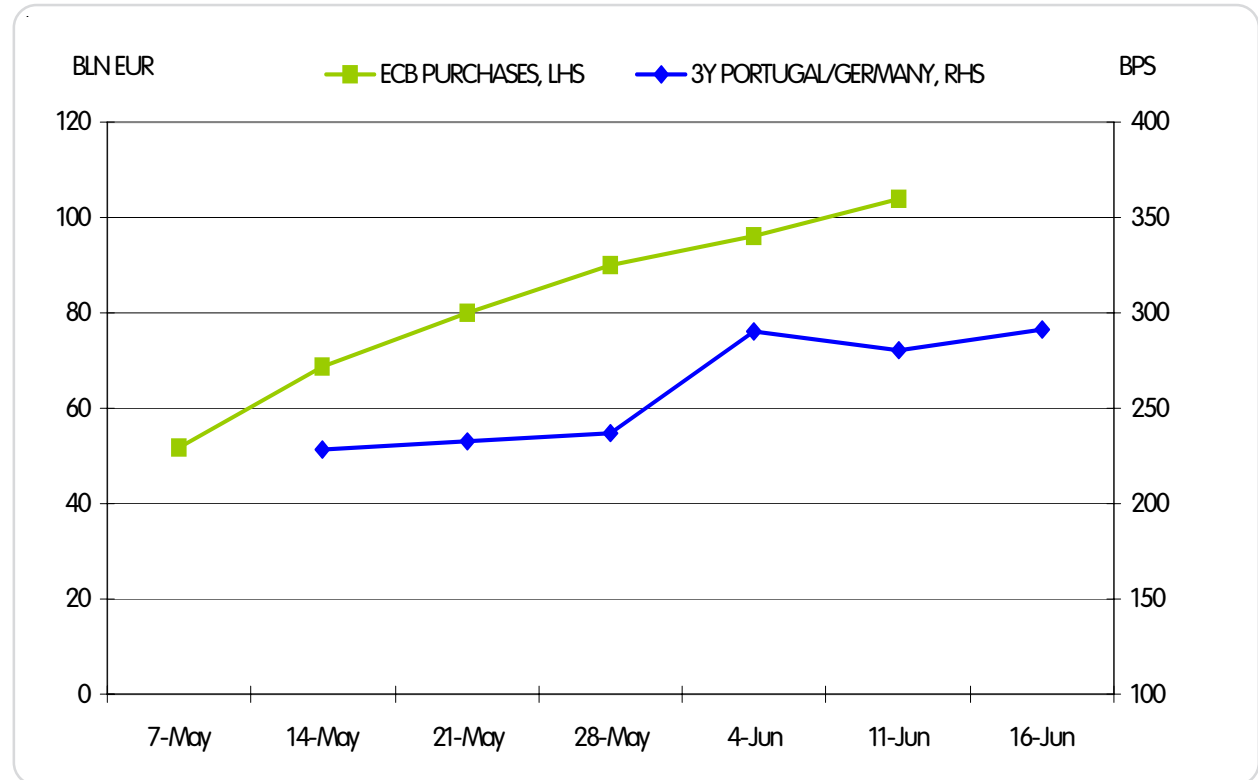
	Time	Consensus	Previous	Events
UK Retail Sales, May	09:30	0.1%	0.1%	EU Summit (Berlin)
UK CBI Industry Trends, Jun	11:00	-15	-18	ECB monthly bulletin (09:00)
US -- CPI, May	13:30	-0.2%	-0.1%	ECB speakers: Liikanen (09:00), Weber (13:00)
-- CPI Core, May	13:30	0.1%	0.1%	DMO sells £4bln, 2014 gilts
US Initial Claims, Jun 12	13:30	450k	456k	Spain sells 2020 (4%), 2041 (4.7%) bonds
US Current Account, Q1	13:30	-121.9bln	-115.6bln	SNB Rate Decision (08:30)
Philly Fed Survey, Jun	15:00	20.0	21.4	
US Leading Indicators	15:00	0.4%	-0.1%	

*All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg, DataStream & CQG

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Bloomberg page: LLOY<GO>

3y Portugal/bunds up over 50bp since start ECB govt bond purchase programme



UK 2y/10y swap spread: trendline resistance at 210bp





Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.2311	-0.17%	S&P500	1114.61	-0.06%
USD/JPY	91.44	-0.02%	DJIA	10409.46	0.05%
AUD/USD	0.8640	-0.18%	FTSE100	5237.92	0.00%
EUR/GBP	0.8357	0.32%	Eurostoxx50	2718.73	0.00%
GBP/EUR	1.1966	-0.32%	Shanghai Composite*	2560.25	-0.38%
GBP/USD	1.4731	-0.49%	*latest price		
GBP/JPY	134.70	-0.52%	Commodities		
GBP/CHF	1.6661	-0.68%	Crude Oil \$/bl	77.67	0.95%
GBP/AUD	1.7050	-0.32%	Gold \$/oz	1229.0	-0.42%
GBP/CAD	1.5089	-0.61%	Copper c/lb	301.4	-0.35%
GBP/NZD	2.1109	-0.36%	Silver \$/oz	18.47	-0.46%
GBP/NOK	9.4207	-0.07%	Baltic Dry	2893	-4.21%
GBP/ZAR	11.2025	-0.37%	Swaps %		
GBP/CNY	10.0605	-0.49%	US 5yr	2.330	-3.7
Bonds %			EUR 5yr	2.091	-2.2
US 10Yr	3.260	-4.2	UK 5yr	2.580	0.2
EUR 10Yr	2.671	-0.3	Official Rates %		
UK10 Yr	3.536	-1.7	UK	0.50	
Other			US	0.25	
VIX	25.92	0.19%	EU	1.00	
iTraxx XOVER	558.61	-8.0	Japan	0.10	
DJ Agriculture Index	57.37	0.84%			

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