

Daily Market Strategy

Monday, 21st June 2010

Market Strategy

Kenneth Broux

Senior Market Economist

0207 158 1750

kenneth.broux@lloydsbanking.com

- China relaxes yuan stance
- Gilt issuance projected to drop 28%

Market Outlook

Opening levels (7.15am)

£/\$: 1.4909 €/\$: 1.2455 \$/Y: 90.66
 UK 5y sw: 2.62% US 5y sw: 2.32% EU 5y sw: 2.17%

Overnight

- China announcement comes before the G20 summit; flexibility is not the same as revaluation; max daily move limited to 0.5%; USD/CNY forwards price in 1.8% appreciation over 12 months
- PBoC to put emphasis to reflect market supply and demand with reference to a basket of currencies; peg with USD abandoned
- USD and government bonds drop; commodities and equities rally
- Rightmove house prices up 0.3% m/m in May, 6th successive gain

China's decision to review its currency exchange regime hasn't given market participants much time to settle in to their routine this morning, catching more than a few dealers cold. Fairly light liquidity and short covering explain the disproportionate response in the high yield and commodity crosses and the bear flattening in G3 government bonds. Introducing currency flexibility is one thing, letting the yuan actually appreciate is another. USD/CNY 12 month forwards are pricing in only an 1.8% appreciation over 12 months. We find details of the PBoC announcement still very sketchy to be honest and cannot help but think that the decision is tactical in nature ahead of the G20 to appease the US and should therefore not make a great deal of difference of how the market trades beyond the next 24 hours. The outperformance of long-dated gilts vs Treasuries and bunds comes ahead of tomorrow's Budget, where gilt issuance is forecast to be slashed by about 28% (consensus £165bn vs £185.2bn in April projection).

Ahead today

- UK, EU, US: no data
- ECB president Trichet testifies to the EP at 3pm

Weekly IMM positions

	08-Jun		15-Jun				
	rep	non rep	rep	non rep		change	
CAD	23	21	44	27	20	48	4
CHF	-11	-9	-20	-16	-7	-23	-3
GBP	-75	-23	-97	-48	-18	-67	31
JPY	-13	-9	-21	-4	-13	-17	5
EUR	-112	1	-111	-62	-13	-75	36
AUD	8	4	12	12	1	13	1

FX: we write in a special note (ask for copy) that GBP/USD finds itself at a crossroads. The bullish ST trend gained momentum overnight as a function of broad USD weakness but does not exclude GBP/USD from reversing sub 1.45- if 1.4950-1.50 cannot be overcome. The cross rallied to a 1.4936 high overnight and now awaits reaction of the US to China's announcement. For EUR/USD, with markets still short EUR, a squeeze pushed the cross through 1.2450 to a 1.2487 high. Resistance is situated at 1.25. We are keeping close eye on EUR/JPY and other JPY crosses to determine whether the overnight moves are sustained. EUR/CHF hit our 1.37 target overnight by sliding to a 1.3667 low, adding support to our strategy of buying CHF dips.

Rates: 5y swaps are attempting to break out of the 4-week range as yields climb to 2.65% on what could turn out to be an outside day. We are reserving judgement however until the Budget tomorrow and are inclined to buy weakness in LT gilts, backed by reduced issuance targets and the CPI outlook. 10y UK/Germany tightens to 78bp. The 2y/10y swap spread is flat at 203bp, but cash narrows to 266bp.

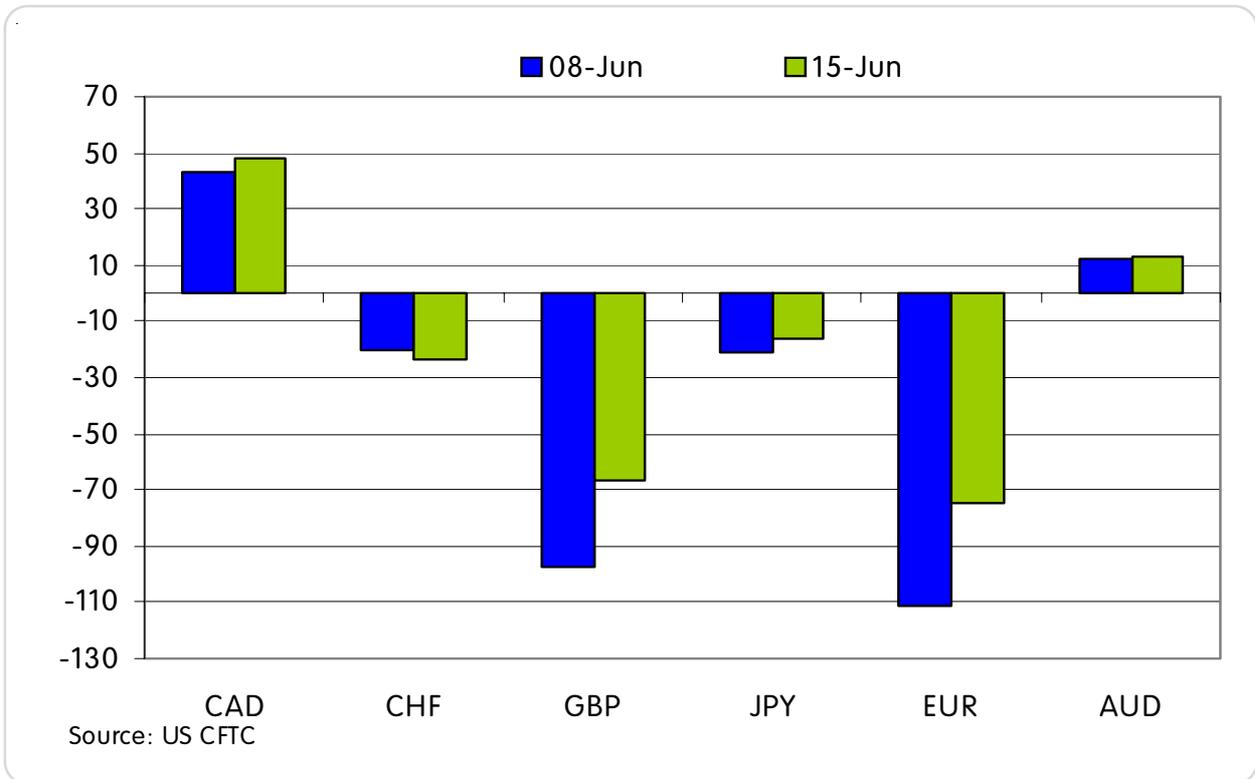
	Close	Daily Change %
FX		
EUR/GBP	0.8359	0.03%
GBP/USD	1.4824	0.00%
EUR/USD	1.2388	-0.01%
USD/JPY	90.710	-0.33%
AUD/USD	0.8720	0.39%
Bonds %		bp
US 10Yr	3.220	3.1
EUR 10Yr	2.729	6.6
UK10 Yr	3.544	6.1
UK 5yr Swap	2.615	5.5
Equities		%
S&P500	1117.51	0.13%
FTSE100	5250.84	0.00%
Eurostoxx50	2737.02	0.00%
Shanghai Composite	2586.21	2.90%
Commodities		%
Crude Oil \$/bl	77.18	0.51%
Gold \$/oz	1256.8	0.94%
Copper	290.2	-0.77%
Baltic Dry	2694	-3.23%
Other		%
VIX	23.95	-4.39%
iTraxx XOVER	520.44	-21.0

Today's Data

	Time	Consensus	Previous	Events
UK Rightmove House Prices, Jun	00:01	0.3%A	0.7%	ECB speakers: Stark (11:45), Paramo (15:00) ECB president Trichet testifies to the EP (15:30)

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

IMM positions: EUR and GBP shorts reduced, increased CHF shorts an anomaly?



AUD/USD: through 50d MA (0.8786), targeting 0.90



Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.2388	-0.01%	S&P500	1117.51	0.13%
USD/JPY	90.71	-0.33%	DJIA	10450.64	0.16%
AUD/USD	0.8720	0.39%	FTSE100	5250.84	0.00%
EUR/GBP	0.8359	0.03%	Eurostoxx50	2737.02	0.00%
GBP/EUR	1.1964	-0.03%	Shanghai Composite*	2586.21	2.90%
GBP/USD	1.4824	0.00%	*latest price		
GBP/JPY	134.47	-0.33%	Commodities		
GBP/CHF	1.6432	-0.32%			
GBP/AUD	1.7001	-0.38%	Crude Oil \$/bl	77.18	0.51%
GBP/CAD	1.5150	-0.62%	Gold \$/oz	1256.8	0.94%
GBP/NZD	2.0975	-0.32%	Copper c/lb	290.2	-0.77%
GBP/NOK	9.4319	0.06%	Silver \$/oz	19.18	2.46%
GBP/ZAR	11.1254	-0.96%	Baltic Dry	2694	-3.23%
GBP/CNY	10.1255	0.02%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.220	3.1	US 5yr	2.262	0.6
EUR 10Yr	2.729	6.6	EUR 5yr	2.149	5.0
UK10 Yr	3.544	6.1	UK 5yr	2.615	5.5
Other			Official Rates %		
VIX	23.95	-4.39%	UK	0.50	
iTraxx XOVER	520.44	-21.0	US	0.25	
DJ Agriculture Index	57.51	0.44%	EU	1.00	
			Japan	0.10	

IMPORTANT NOTICE

This document, its contents and any related communication (altogether, the "Communication") does not constitute or form part of any offer to sell or an invitation to subscribe for, hold or purchase any securities or any other investment. This Communication shall not form the basis of or be relied on in connection with any contract or commitment whatsoever. This Communication is not intended to form, and should not form, the basis of any investment decision. This Communication is not and should not be treated as investment research, a research recommendation, an opinion or advice. Recipients should conduct their own independent enquiries and obtain their own professional legal, regulatory, tax or accounting advice as appropriate. Any transaction which a recipient of this Communication may subsequently enter into may only be on the basis of such enquiries and advice, and that recipient's own knowledge and experience. This Communication has been prepared by, and is subject to the copyright of, Lloyds. This Communication may not, in whole or in part, be reproduced, transmitted, stored in a retrieval system or translated in any other language in any form, by any means without the prior written consent of Lloyds. This Communication is provided for information purposes only, and is confidential and may not be referred to, disclosed, reproduced or redistributed, in whole or in part, to any other person. This Communication is based on current public information. Whilst Lloyds has exercised reasonable care in preparing this Communication, no representation or warranty, express or implied, is made as to the accuracy, reliability or completeness of the facts and data contained herein by Lloyds, its group companies and its or their directors, officers, employees, associates and agents (altogether, "Lloyds Persons"). The information contained in this Communication has not been independently verified by Lloyds. The information and any opinions in this Communication are subject to change at any time and Lloyds is under no obligation to inform any person of any such change. This Communication may refer to future events which may or may not be within the control of Lloyds Persons, and no representation or warranty, express or implied, is made as to whether or not such an event will occur. To the fullest extent permitted by applicable law, regulation and rule of regulatory body, Lloyds Persons accept no responsibility for and shall have no liability for any loss in relation to this Communication, however arising (including in relation to any projections, analyses, assumptions and/or opinions contained herein nor for any loss of profit or damages or any liability to a third party). Lloyds TSB Corporate Markets is a trading name of Lloyds. Lloyds TSB Bank plc's registered office is at 25 Gresham Street, London EC2V 7HN and it is registered in England and Wales under no. 2065. Lloyds is Authorised and regulated by the Financial Services Authority and is a member of the London Stock Exchange.