



Daily Market Strategy

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Market Strategy

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

Market Outlook

Opening levels (7.15am)

£/\$: 1.4909

€/£: 1.2455

\$/¥: 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 £165bln vs £185.2bln 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

	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 %		
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

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.

Today's Data

UK Rightmove House Prices, Jun

Time

00:01

Consensus

0.3%A

Previous

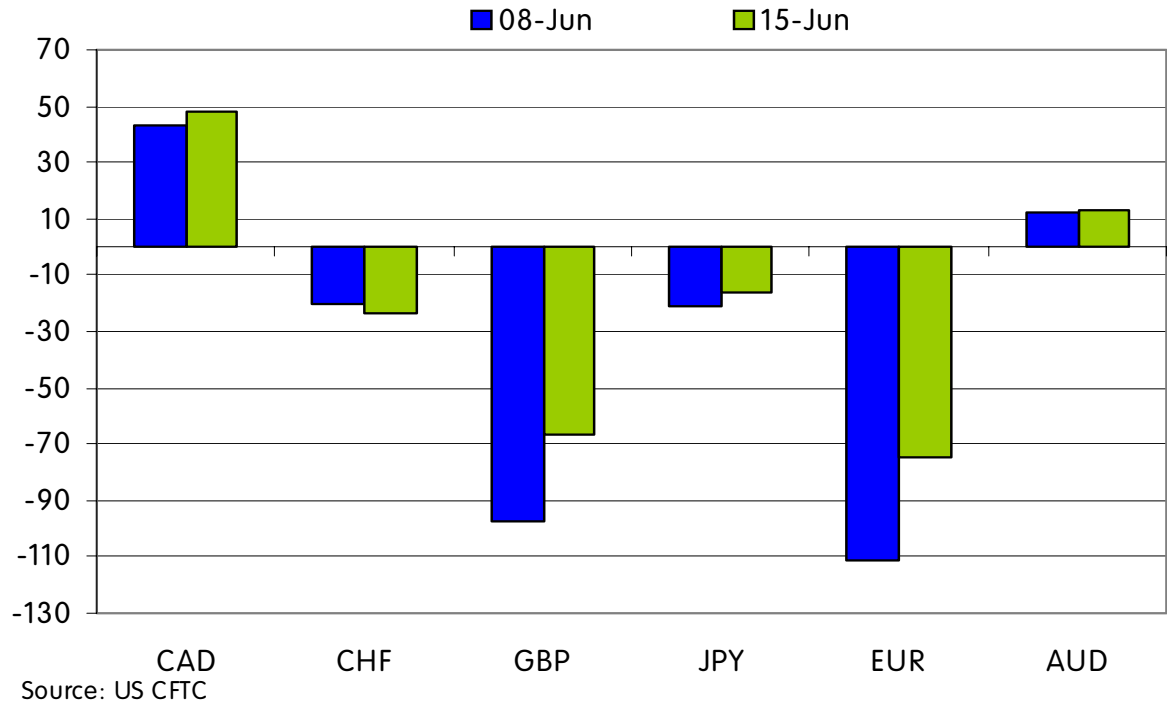
0.7%

Events

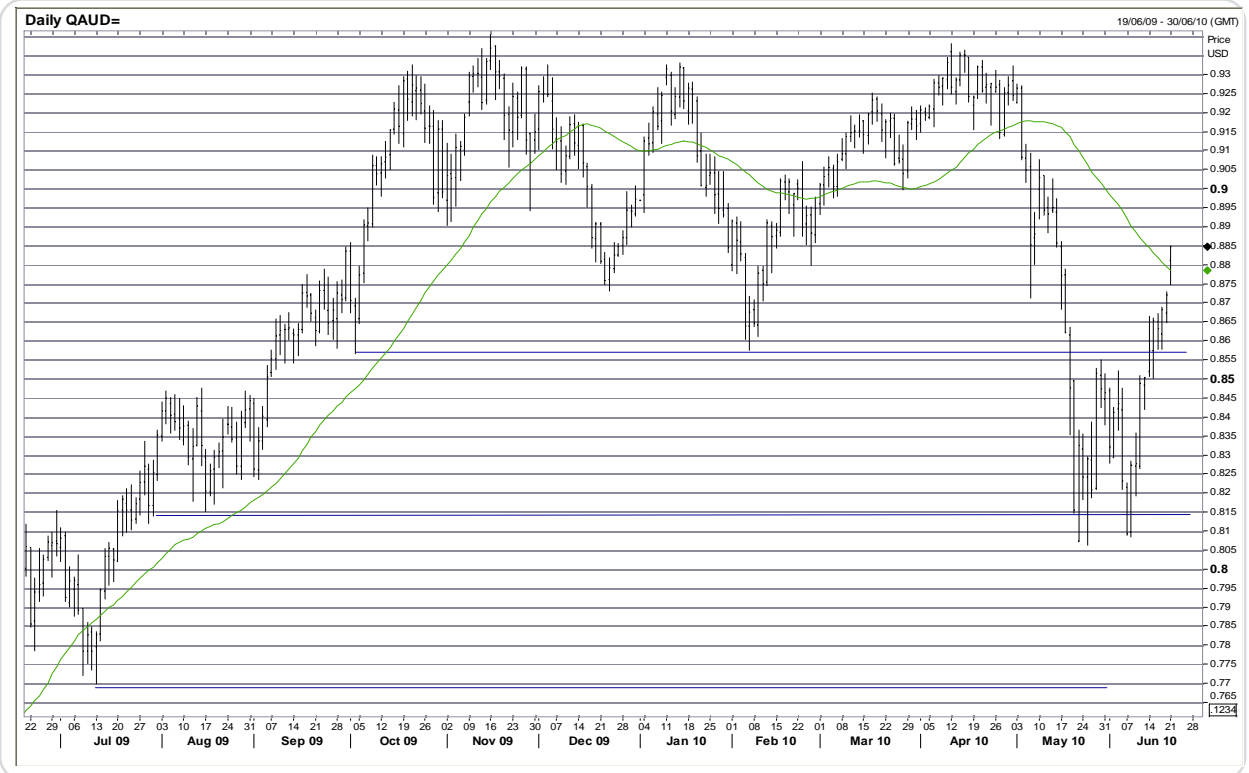
ECB speakers: Stark (11:45), Paramo (15:00)

ECB president Trichet testifies to the EP (15:30)

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%	Crude Oil \$/bl	77.18	0.51%
GBP/AUD	1.7001	-0.38%	Gold \$/oz	1256.8	0.94%
GBP/CAD	1.5150	-0.62%	Copper c/lb	290.2	-0.77%
GBP/NZD	2.0975	-0.32%	Silver \$/oz	19.18	2.46%
GBP/NOK	9.4319	0.06%	Baltic Dry	2694	-3.23%
GBP/ZAR	11.1254	-0.96%	Swaps %		
GBP/CNY	10.1255	0.02%	US 5yr	2.262	0.6
Bonds %			EUR 5yr	2.149	5.0
US 10Yr	3.220	3.1	UK 5yr	2.615	5.5
EUR 10Yr	2.729	6.6	Official Rates %		
UK10 Yr	3.544	6.1	UK	0.50	
Other			US	0.25	
VIX	23.95	-4.39%	EU	1.00	
iTraxx XOVER	520.44	-21.0	Japan	0.10	
DJ Agriculture Index	57.51	0.44%			

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