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Bank of Ireland
Global Markets

Weekly Commentary

27 August 2010

Economic Research Unit: (01) 609 4613

Themes from the week
– **US economic data continues to disappoint**

Headlines for the week ahead
– **US employment report and ECB meeting**

More poor US data

The past week brought another string of, for the most part, hugely disappointing US economic data. Most eye-catching perhaps were the dramatic declines in new and existing homes sales in July, of 12.4% and 27.2% respectively. Potentially more significant, though, was the 8% fall in capital goods orders – an indicator of future business investment – in the same month. While the orders data are very volatile from month to month, and the July fall did follow strong gains in both May and June, a drop of this magnitude is still unusual. If it is a signal that business is becoming cautious, then the economic recovery, which has already lost some momentum, would be at even greater risk given that business investment has been a notable bright spot over the past year, contributing about one third of the 3% or so increase in real GDP over the year to the second quarter (housebuilding, in contrast, has contributed little or nothing to economic growth over the twelve months).

Not surprisingly then, and notwithstanding some very positive German data, continuing concerns about the prospects for the US economy drove markets again this week. Stocks lost further ground, with the major indices shedding, for the most part, between 2% and 3%. On the currency markets, the Japanese yen and Swiss franc extended their recent gains, strengthening further against the US dollar, though the latter's recent rally against the single currency ran out of steam, with EUR/$ closing out the week largely unchanged from last Friday at around $1.27. Meanwhile, government bond yields fell yet further; by about 10bps to 2.5% in the case of the benchmark US 10-year bond, while German 10-year yields fell by 15bps to just 2.10%.

Within the Euro area, peripheral country bond yield spreads over Germany widened out on the week. In the case of Greece, 10-year yields rose by about 80bps relative to German yields, while Portugal saw spreads widen out by about 35bp. In the case of Ireland, the 10-year yield spread pushed out by about 40bps to almost 350bps. Ireland had also to contend with a downgrade from Standard & Poor's (S&P), which reduced its long-term sovereign credit rating on the Republic to AA- and maintained its negative outlook. The downgrade reflects S&P's view that the total cost to the Irish government of providing support to the banking sector, which it now estimates will total E90bn, has "increased significantly above our prior estimate", though the National Treasury Management Agency (NTMA) described this estimate as 'extreme'. Notwithstanding the downgrade, there was strong demand at the Irish T-bill auction on Wednesday, with the NTMA raising E600m and at a lower cost than at its previous T-Bill auction a couple of weeks ago.

Michael Crowley

Data section contents (changes on the week)

Highlights for the week ahead

		Prev	Fcst	Cons
Mon	EA Business Confidence	-4	-4	-4
	US Personal Spending	0.0%	+0.3%	+0.3%
	US Core PCE Inflation	1.4%	1.4%	1.4%
Tues	EA CPI Inflation	1.7%	1.6%	1.6%
	Fed Minutes (Aug 10 mtg)			
	Chicago PMI	62.3	57.5	57.5
Wed	UK PMI Manufacturing	57.3	57.0	57.0
	US ISM Manufacturing	55.5	53.0	53.0
Thurs	ECB Meeting			
	EA GDP (Q2)	+0.2%	+1.0%	+1.0%
fri	US Payrolls	-131k	-105k	-105k
	US Unemployment Rate	9.5%	9.6%	9.6%

Spot rates

More details in data section

EUR/GBP	↑	0.8198	EUR/CHF	↓	1.3034
EUR/USD	↑	1.2718	EUR/JPY	↓	107.74
GBP/USD	↓	1.5511	EUR/CAD	↑	1.3470
EUR/SEK	↓	9.3844	EUR/PLN	↑	3.9900
EUR/NOK	↓	7.9790	EUR/ZAR	↑	9.3852
EUR/HUF		285.10	EUR/CZK	↓	24.740

Long term rates

More details in data section

	2 year	3 year	5 year	7 year	10 year	15 year	20 year
EUR	1.33	1.48	1.80	2.08	2.38	2.67	2.76
GBP	1.31	1.58	2.11	2.56	3.03	3.46	3.59
USD	0.74	1.03	1.64	2.13	2.59	2.94	3.09

Official rates

More details in data section

	Current	3 M		6 M		12 M	
		Fcst	Cons	Fcst	Cons	Fcst	Cons
EUR	1.00	1.00	1.00	1.00	1.00	1.00	1.00
GBP	0.50	0.50	0.50	0.50	0.50	0.50	0.50
USD	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25

Recent research

See all recent research (www.boi.ie/eru)

See most recent versions of:
The Bulletin (monthly analysis of international and Irish markets)
UK View (quarterly analysis of trends in the UK economy)
The Outlook (quarterly analysis of trends in the Irish economy)
Irish Property Review (quarterly analysis of Irish property trends)
Irish Business Review (quarterly research, analysis and commentary)

All rates quoted are indicative market rates

Data section contents

Europe

Strong data suggests robust Euro recovery for the moment

In contrast to the flow of weak data from the US, recent data from the Euro area has continuously surprised to the upside. In particular, the German economy seems to be growing robustly at the moment even though a slowdown in the pace of growth is widely expected soon. The data we got this week continued this pattern. Euro area industrial new orders for June beat the consensus forecast, increasing by 2.5% after a 4.1% increase in May. The annual increase was just under 23% in June. New orders have recovered well after bottoming in early '09 and are up by about 28% since then - but that's still down about 17% from the peak in '07. The Euro area economy is showing signs of continued robust activity from the end of Q2 and into Q3 but this should be the peak for now. However, the German IFO surveys showed continued confidence in the recovery; the current assessment index increased to 108.2 in August from 106.8 in July while the expectations index decreased just marginally to 105.2 from 105.6 in the previous month. The business climate index rose to 106.7 from 106.2 in July, that's the third month of increase and the highest level it's been at since mid 2007. The consensus forecast is for the German economy to slow from this point on but nobody seems to have told that to German business executives who continue to believe that the economy will power ahead for the time being. If the German economy can manage to keep a reasonably robust recovery going, it would almost certainly have to be domestically driven, but it would have obvious major positive externalities for the rest of the Euro area. Strong data from the Euro area is, of course, welcome news however we think that the Euro area will follow the US down to a slower pace of growth with indicators starting to weaken in the next couple of months with the pace slowing by Q4 at the latest. This is when the austerity measures by EA government will start to affect the real economy while weakening demand from the US should also hit EA exporters. We should enjoy this current upward trend in data while it lasts because we fear that it will inevitably come to an end and in the near term.

Ireland

S&P downgrades Ireland

There was more bad news for Ireland this week with S&P cutting our long term rating one step to AA- with negative outlook. The agency said the negative outlook was reflective of their view that a further downgrade is possible if more fiscal support is needed for the banking sector or if other adverse developments weaken the government's ability to meet its medium term fiscal objectives. They also cited our growing debt burden and said it will be "well above" similarly rated countries in the EA by 2012. The S&P projections seem to imply that they have assigned no value to the assets in NAMA and that the State will bear the burden of the full cost of the agencies purchases. This would not be the consensus viewpoint as most commentators think that the underlying assets in NAMA may recoup substantial amounts of the outlay over the agency's approx. 10 year lifetime. The NTMA responded to the downgrade by saying that the S&P analysis was flawed and based on an extreme estimate of bank recapitalization needs. The downgrade placed Irish bonds under further pressure. 10 year yields rose by more than 20bps after the S&P announcement taking the yield to over 5.5%. German Bunds continued to rally this week and reached record lows of around 2.1%, meaning the yield premium for Irish 10 year bonds over equivalent German bunds reached an all time high of over 3.4%.

United Kingdom

Sterling's slow gain on Euro continues

It was a quiet week in the UK with no significant data released or speakers from the BoE. Sterling continued to gain on the Euro despite the recent run of relative strong data out of the Euro area. The Euro fell to under £0.82 during the week which is the highest Sterling has been against the single currency since last June and prior to that Sterling has not been at the level against the Euro since late 2008. Sterling has been in a long appreciating trend against the Euro since about late March when the cross was trading at above £0.90. It's likely that there will be some support at the £0.80 level so Sterling might have some difficultly breaking through that level in the near future. However, we think that Sterling will continue to gain on the Euro over the next 6 months and longer out and feel that Sterling/Euro will be trading at below £0.80 by the first quarter of next year. UK bonds rallied this week as equities declined and the flight to quality continued as concerns over the US and global recovery drove a risk adverse environment. 10 year gilt yields fell to 2.84% during the week, the lowest yield in at least 20 years. Similarly, 2 year gilts feel to under 0.6%, also a record low yield.

United States

More poor data

The past week brought another string of, for the most part, hugely disappointing economic data. Most eye-catching perhaps were the dramatic declines in new and existing homes sales in July, of 12.4% and 27.2% respectively. Potentially more significant, though, was the 8% fall in capital goods orders – an indicator of future business investment – in the same month. While the orders data are very volatile from month to month, and the July fall did follow strong gains in both May and June, a drop of this magnitude is still unusual. If it is a signal that business is becoming cautious, then the economic recovery, which has already lost some momentum, would be at even greater risk given that business investment has been a notable bright spot over the past year, contributing about one third of the 3% or so increase in real GDP over the year to the second quarter (housebuilding, in contrast, has contributed little or nothing to economic growth over the twelve months). Not surprisingly given the nature of the data, stocks lost further ground with the major indices shedding between 2% and 3%. The dollar lose further ground against the Japanese yen and Swiss franc, while its recent rally against the single currency ran out of steam, with EUR/$ closing out the week largely unchanged from last Friday at around $1.27. Government bond yields fell yet further, albeit mainly further out the curve, with the yield on the benchmark 10-year bond down around 10bps to 2.5%. As we write, the market awaits Fed chairman, Ben Bernanke's Jackson Hole speech on the outlook for the US economy, which almost certainly will set the tone for next week's trading.

Japan

Bank of Japan may expand QE at July

The dollar fell to under 84Y to the Yen this week, setting fresh 15 year highs for the Asian currency against the Greenback. This has prompted more rumours that the Japanese authorities may act to halt the Yen's appreciation. Finance Minister Noda said, after the dollar hit under 84Y, that the Japanese had to take "appropriate action when necessary" and he plans to " continue to watch currency movements very closely with great interest" as he understands that USDJPY rate movements have been "one sided". This is the strongest language yet from the Japanese Government that an intervention in the market may be warranted. A strong yen is hitting Japanese exports as the economic recovery slows and where domestic demand remains moribund. The Bank of Japan is rumoured to be considering further QE measures and Prime Minister Kan called Governor Shirakawa this week to discuss market volatility where the Prime Minister is thought to have argued for more QE measures. It is increasingly likely that the Bank of Japan will expand their QE measures at the next meeting in September. There was some speculation that the Bank would hold an emergency meeting this week but Governor Shirakawa left the country to attend the Federal Reserve symposium in Jackson Hole which dampened this speculation and added to concerns that the Governor may not be totally convinced that the situation requires immediate action. He may push to stay on hold at the September meeting as well despite the growing calls for further action by the Bank.

Data section – changes on the week

Spot and forward rates

Change on the week

EUR/GBP

			Change
Spot	↑	0.8198	*0.28%*
1M		1	
3M		3	
6M		6	
12M		10	

EUR/USD

			Change
Spot	↑	1.2718	*0.10%*
1M		-1	
3M		-2	
6M		-5	
12M		-11	

GBP/USD

			Change
Spot	↓	1.5511	*-0.13%*
1M		-3	
3M		-9	
6M		-18	
12M		-35	

World forex rates

Change on the week

EUR currency pairs

			Change
EUR/CAD	↑	1.3470	*1.19%*
EUR/AUD	↑	1.4316	*0.77%*
EUR/NZD	↑	1.8005	*0.18%*
EUR/CHF	↓	1.3034	*-0.80%*
EUR/JPY	↓	107.74	*-0.99%*
EUR/SEK	↓	9.3844	*-0.43%*
EUR/NOK	↑	7.9790	*0.69%*
EUR/HUF	↑	285.10	*2.45%*
EUR/PLN	↑	3.9900	*0.53%*
EUR/ZAR	↑	9.3852	*1.07%*
EUR/CZK	↓	24.740	*-0.35%*

USD currency pairs

			Change
USD/CAD	↑	1.0590	*1.09%*
USD/AUD	↑	1.1261	*0.66%*
USD/NZD	↑	1.4166	*0.08%*
USD/CHF	↓	1.0248	*-0.88%*
USD/JPY	↓	84.71	*-1.05%*
USD/CNY	↑	6.7977	*0.11%*
USD/MXN	↑	13.0901	*2.55%*
USD/SGD	↑	1.3574	*0.13%*
USD/BRL	↑	1.7621	*0.35%*
USD/THB	↓	31.31	*-0.67%*
USD/ZAR	↑	7.3570	*0.67%*

GBP currency pairs

			Change
GBP/CAD	↑	1.6430	*0.86%*
GBP/AUD	↑	1.7463	*0.66%*
GBP/NZD	—	2.1969	—
GBP/CHF	↓	1.5892	*-1.05%*
GBP/JPY	↓	131.39	*-1.19%*
GBP/SGD	↓	2.1046	*-0.04%*
GBP/MYR	↑	4.8791	*0.02%*
GBP/NOK	↑	9.7325	*0.58%*
GBP/HKD	↓	12.0654	*-0.07%*
GBP/SEK	↓	11.4417	*-0.61%*
GBP/DKK	↓	9.0811	*-0.24%*
GBP/ZAR	↑	11.3701	*0.18%*

Money market rates

Change on the Week

	Base		O'night		1 week		2 week		1 M		2 M		3 M		6 M		9 M		12 M
EUR	1.00	↓	0.32	↑	0.44	↑	0.48	↑	0.52	↑	0.62	↑	0.74	↑	0.95	↑	1.06	↑	1.23
GBP	0.50	—	0.40	—	0.44	↑	0.46	—	0.47	↓	0.54	↓	0.61	↓	0.84	↑	1.07	↑	1.22
USD	0-0.25	↓	0.22	↓	0.27	↓	0.30	↑	0.32	—	0.36	↓	0.43	↓	0.66	↑	0.77	↓	0.87

Long term rates

Change on the Week

		2 year	*Chng*		5 year	*Chng*		7 year	*Chng*		10 year	*Chng*
EUR	↑	1.33	*0.01*	↓	1.80	*-0.08*	↓	2.08	*-0.13*	↓	2.38	*-0.16*
GBP	↑	1.31	*0.02*	↓	2.11	*-0.01*	↓	2.56	*-0.03*	↓	3.03	*-0.05*
USD	—	0.74	*0.00*	↓	1.64	*-0.11*	↓	2.13	*-0.09*	↓	2.59	*-0.09*

Government bond yields (YTM)

Change on the Week

		2 year	*Chng*		5 year	*Chng*		10 year	*Chng*		30 year	*Chng*
Ireland	↑	2.94	*2.08*	↑	4.06	*1.24*	↑	5.61	*1.06*			
Germany	—	0.61	*0.00*	↓	1.23	*-0.07*	↓	2.12	*-0.16*	↓	2.60	*-0.31*
US	↑	0.52	*0.02*	↓	1.39	*-0.06*	↓	2.50	*-0.11*	↓	3.53	*-0.13*
UK	↓	0.48	*-0.16*	↓	1.42	*-0.26*	↓	2.86	*-0.10*	↓	3.84	*-0.17*

Prime Rate

Bank of Ireland prime rate	1.03

Equity indices

Change on the Week

			Change
ISEQ	↓	2657	*-3.60%*
DOW Jones	↓	9986	*-2.23%*
S&P 500	↓	1047	*-2.28%*
SMI	↓	6132	*-0.87%*
Nasdaq	↓	2119	*-2.80%*
FTSE 100	↓	5162	*-0.64%*
Eurostoxx 50	↓	2608	*-1.38%*
Nikkei	—	8991	—

Commodities

Change on the Week

			Change
Brent	↑	75.35	*1.47%*
WTI Cushing	↑	73.55	*0.12%*
Gold	↑	1236.80	*0.74%*
Wheat	↓	664.25	*-2.17%*
Emissions Allowance		15.16	*+1.20%*

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