



Weekly Commentary

10 February 2012

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Themes from the week

– BOE extends QE by another £50bn, Greece remains the issue

Headlines for the week ahead

– Euro GDP, BOE Inflation report, US CPI and retail sales

No surprises from ECB or BOE

Having cut rates by 50bp over recent months the ECB was generally expected to leave the repo rate unchanged in February at 1%, although many analysts, including ourselves, still feel that further easing is possible. In the event the ECB statement revealed that the Bank is slightly less concerned than it was about the economic outlook, again noting 'tentative' signs of stabilisation and dropping the view that the downside risks to growth are 'substantial' although they still exist. The recent slowdown in credit growth is a worrisome development for the ECB, however, and close scrutiny of credit developments is 'essential' according to the Statement. The implication is that a near term rate cut is probably less likely now, albeit still data dependent, with bank lending a variable to watch.

The ECB also announced that seven national central banks are to broaden the collateral accepted in return for loans to the banking sector, and President Draghi again encouraged banks to avail of the second 3-year repo operation due later this month. The euro rallied on the week against most currencies, helped by news that political agreement had been reached in Greece on new fiscal measures, with the single currency trading above \$1.33. The euro eased somewhat late in the week as EU governments warned that further measures were required and that the proposals still left the forecast debt ratio well above the 120% target.

The Bank of England was generally expected to announce a £50bn extension to its asset purchase programme, taking it to £325bn, and it duly obliged, leaving sterling largely unchanged against the dollar on the week and a little weaker against the euro. The UK data has implied the economy regained some momentum of late, including a 0.5% rise in industrial production in December, but the Bank still feels that inflation would undershoot the 2% target in the absence of additional measures. The forthcoming Inflation Report will provide more details on the BOE's forecasts.

In a very quiet week for data the NASDAQ led US equity markets higher, and bonds continued to trade in the narrow range seen since last summer. The Irish bond market continued its advance, with yields falling in absolute terms and relative to Germany. The short end is particularly well supported, with the 14's now bid at 4.3% and the new 15's at 4.8%. On the data front, Irish car sales got off to a strong start in 2012, with registrations up 6.5% on an annual basis, and industrial production rose by 2.5% in December, although falling 1.7% in the fourth quarter. Production rose by 1% in 2011 following a 7.7% increase the previous year.

Dan McLaughlin

Data section contents (changes on the week)

Spot and forward rates	Equity indices
World forex rates	Bond yields
Money market rates	Commodities
Long term rates	

Highlights for the week ahead

		Prev	Fcst	Cons
Tues	UK CPI	4.2%		3.6%
	Ger ZEW	-21.6		-15
	US Retail sales	0.1%		0.7%
Wed	IRL External Trade			
	UK Unemployment rate	8.4%		8.4%
	UK Inflation report			
	Euro GDP	0.1%		-0.4%
	US Industrial Production	0.4%		0.6%
	FOMC Minutes			
Thurs	US housing Starts	657k		670k
Fri	UK Retail Sales	0.6%		-0.2%
	US CPI	3.0%		2.8%

Spot rates

[More details in data section](#)

EUR/GBP	0.8366	EUR/CHF	1.2090
EUR/USD	1.3231	EUR/JPY	102.84
GBP/USD	1.5813	EUR/CAD	1.3245
EUR/SEK	8.8194	EUR/PLN	4.2171
EUR/NOK	7.6209	EUR/ZAR	10.1939
EUR/HUF	294.28	EUR/CZK	25.319

Interest rate swap rates

[More details in data section](#)

	2 year	3 year	5 year	7 year	10 year	15 year	20 year
EUR	1.23	1.32	1.68	2.05	2.42	2.75	2.79
GBP	1.32	1.37	1.64	2.02	2.52	2.94	3.13
USD	0.59	0.70	1.14	1.64	2.11	2.55	2.73

Official rates

[More details in data section](#)

	Current	Q1'11		Q2'11		Q3'11	
		Fcst	Cons	Fcst	Cons	Fcst	Cons
EUR	1.00	0.75	1.00	0.75	1.00	0.75	0.75
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

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[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

Data section showing

% changes on the week

[*Spot and forward rates*](#)[*Long term fixed rates*](#)[*World forex rates*](#)[*Money market rates*](#)[*Equity indices*](#)[*Commodity prices*](#)[*Bond yields*](#)

Europe**ECB keeps rates at 1% - offer no clue about any future reduction**

The ECB kept interest rates unchanged at 1% at Thursday's meeting, in line with market expectations. Moreover, its President, Mario Draghi, said the Governing Council did not discuss 'current or prospective' interest rate changes, which on the face of it suggests the likelihood of the refinancing rate being cut any further from the current level of 1% has diminished. In its assessment of the euro area economy, the ECB said the available survey indicators "confirm some tentative signs of a stabilisation in economic activity at a low level" around the turn of the year. It expects the economy to recover very gradually in the course of 2012, supported by 'very low short-term interest rates' and all the measures taken to "foster the proper functioning of the euro area financial sector", although it believes that subdued global demand growth, the remaining tensions in euro area sovereign debt markets and their impact on credit conditions, as well as the process of balance sheet adjustment in the financial and non-financial sectors, will "continue to dampen the underlying growth momentum". Moreover, it believes the outlook is still subject to high uncertainty and downside risk, although the latter are not now as substantial as they seemed at the previous three or four meetings. In addition, the ECB has become more concerned about credit conditions in the zone given the recent sharp deceleration in the growth of lending to households and businesses, saying that close scrutiny of credit developments in the period ahead is essential. In relation to inflation, the ECB expects inflation to remain above 2% for several more months before declining to below 2%, with the risks to this outlook still view as 'broadly balanced'. The euro rose to a two-month high of over \$1.33 to the dollar following the meeting, The Euro, however, fell back on Friday to under \$1.32, after the Eurogroup of Finance ministers rejected Greece's latest austerity plan. The head of the Eurogroup, Juncker, said that 'they can't live with this system while promises are repeated and repeated and repeated and implementation measures are sometimes too weak' This is a surprisingly strong action from the Eurogroup, who are giving the impression they believe the problems in Greece can be limited to that country and are now playing hardball with the country's leaders. The Greeks have less than a week to come up with legally binding agreements from all political parties that the austerity deal will be implemented or else the Eurogroup will withhold further funding.

Ireland**Industrial production fell in Q4 but offer little clue about state of overall activity**

Irish industrial production rose by 2.5% in the month of December but that was not enough to offset the sharp 12.7% drop in November so production fell by 1.7% in the fourth quarter. For the year as a whole, production rose by 1.0% well down on the 7.7% advance in 2010. We would say that the fall in production in Q4 points to a poor quarter of growth (and indeed it is not a favourable indicator) but Irish production figures are volatile and there can be somewhat of a disconnect using industrial output as a reliable indicator of growth in the economy. In fact, up to this point in the year, industrial production has been a contrary indicator of growth as it fell in the first two quarters of the year when the economy recorded strong GDP growth figures. In Q3, production rose sharply, by 3.2%, and in that quarter GDP declined by 1.9%. The renewed decline in production in Q4 would be consistent with the weakening export environment but given its track record it doesn't give us much information about how Q4 will turn out.

United Kingdom**Bank of England extends QE scheme by another £50bn**

The Bank of England extended their asset purchase scheme by another £50bn taking the total to £325bn. This was widely expected with the Bank perhaps scaling the increase back from £75bn (which was the amount of the previous increase) in the face of signs of stabilisation in the economy. Their statement said they see a 'gradual' recovery later in the year with a 'gentle' recovery in real incomes but a 'significant margin' of slack in the economy is likely to persist. This decision means that the inflation report next week is likely to revise down, slightly, growth and inflation prospects for the UK. This may or may not be the end of the current QE program for the UK, the additional £50bn will take another 3 months to complete so the Bank are back on hold, at the very least, until then. There was little reaction to the Bank's announcement with the move already largely priced in. 10-year yields ended the week largely unchanged while Sterling fell a little on the week against the Euro to around 84p at times. This was more in context of Euro strengthening rather than Sterling weakness as Sterling was more or less unchanged on the week against the dollar at \$1.58.

Data section contents

Data section showing

% changes on the week

[*Spot and forward rates*](#)[*Long term fixed rates*](#)[*World forex rates*](#)[*Money market rates*](#)[*Equity indices*](#)[*Commodity prices*](#)[*Bond yields*](#)

United States**Government bond yields back up further**

Having risen sharply last Friday following the release of the much stronger than expected employment report for January, the benchmark government 10-year bond yield increased further this week, by around 5bps to almost 2%. Though the latter is, of course, still very low by historical standards, it is nevertheless almost 25bps higher than just a couple of weeks ago. While the Fed Chairman, Ben Bernanke, has played down the fall in the unemployment rate (of more than 0.5% points to 8.3% over the three months to January), saying that it *understates* the current weakness of the labour market, the recent improvement in the latter, and in economic conditions generally, has contributed to an increase in risk appetite in markets. This is reflected in a continuing rise in equity markets, and has put upward pressure on government bond yields, *despite* the Fed recently extending the period over which it expects the federal funds rates to remain exceptionally low by 18 months to 'at least late 2014'. Similarly, the dollar has also lost some ground as the appetite for risk has increased, with the US currency's trade-weighted value falling by over 2.5% from its best levels in 2012 to date, including a fall of almost 5% against the euro.

Japan**More intervention may be on the cards**

The Yen weakened against the dollar this week, to nearly 78Y from 76Y at the end of last week. The move comes after renewed speculation that the Japanese authorities were once again considering intervening in the currency markets. Finance Minister Azumi made some cryptic comments in parliament that he had previously ordered an intervention at 75.60 (with a stop at 78.20), a level which posed 'a threat to the Japanese economy'. He added that he 'won't hesitate to intervene' and 'won't be shy at all about unilateral intervention'. However he then denied that 75.60 was a level that would prompt a renewed intervention. The Yen rose to a three month high of just over 76Y to the dollar before the Minister's comments before declining to close to 78Y level that the minister suggested was a stop level for intervention.

Data section – changes on the week

Spot and forward rates

Change on the week

EUR/GBP		
		Change
Spot	0.8366	0.66%
1M	2	
3M	8	
6M	20	
12M	44	

EUR/USD		
		Change
Spot	1.3231	0.67%
1M	1	
3M	4	
6M	10	
12M	24	

GBP/USD		
		Change
Spot	1.5813	0.01%
1M	-4	
3M	-12	
6M	-27	
12M	-57	

World forex rates

Change on the week

EUR currency pairs		
		Change
EUR/CAD	1.3245	1.45%
EUR/AUD	1.2401	1.68%
EUR/NZD	1.5986	1.73%
EUR/CHF	1.2090	0.13%
EUR/JPY	102.84	2.22%
EUR/SEK	8.8194	0.38%
EUR/NOK	7.6209	-0.04%
EUR/HUF	294.28	1.20%
EUR/PLN	4.2171	1.05%
EUR/ZAR	10.1939	2.94%
EUR/CZK	25.319	1.59%

USD currency pairs		
		Change
USD/CAD	1.0006	0.78%
USD/AUD	0.9383	1.18%
USD/NZD	1.2089	1.03%
USD/CHF	0.9137	-0.53%
USD/JPY	77.72	1.52%
USD/CNY	6.2990	-0.06%
USD/MXN	12.7731	0.79%
USD/SGD	1.2592	1.39%
USD/BRL	1.7240	0.47%
USD/THB	30.86	—
USD/ZAR	7.7055	2.27%

GBP currency pairs		
		Change
GBP/CAD	1.5826	0.71%
GBP/AUD	1.4815	1.02%
GBP/NZD	1.9098	1.01%
GBP/CHF	1.4445	-0.44%
GBP/JPY	122.91	1.26%
GBP/SGD	1.9909	1.36%
GBP/MYR	4.7891	0.83%
GBP/NOK	9.1034	-0.80%
GBP/HKD	12.2674	-0.18%
GBP/SEK	10.5292	-0.37%
GBP/DKK	8.8799	-0.68%
GBP/ZAR	12.1939	2.32%

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	0.28	0.32	0.36	0.58	0.76	0.99	1.32	1.50	1.67
GBP	0.50	0.50	0.50	0.51	0.48	0.75	0.89	1.16	1.39	1.62
USD	0-0.25	0.15	0.23	0.26	0.32	0.41	0.52	0.66	0.82	1.04

Interest rate swap rates

Change on the Week

	2 year	Chng	5 year	Chng	7 year	Chng	10 year	Chng
EUR	1.23	0.02	1.68	0.02	2.05	0.02	2.42	0.01
GBP	1.32	0.01	1.64	-0.02	2.02	-0.04	2.52	0.00
USD	0.59	0.04	1.14	0.05	1.64	0.06	2.11	0.02

Government bond yields (YTM)

Change on the Week

	2 year	Chng	5 year	Chng	10 year	Chng	30 year	Chng
Ireland	4.08	-0.30	5.21	-0.24	6.84	-0.05		
Germany	0.24	0.04	0.90	0.03	1.95	0.02	2.59	0.05
US	0.25	0.02	0.81	0.04	1.98	0.06	3.14	0.02
UK	0.39	-0.02	1.00	-0.12	2.15	-0.03	3.34	0.11

Prime Rate

Bank of Ireland prime rate	1.25
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Equity indices

Change on the Week

		Change
ISEQ	3108	-0.87%
DOW Jones	12890	0.22%
S&P 500	1352	0.52%
SMI	6107	-0.75%
Nasdaq	2927	0.74%
FTSE 100	5853	-0.82%
Eurostoxx 50	2483	-1.30%
Nikkei	8947	1.31%

Commodities

Change on the Week

		Change
Brent	117.03	2.14%
WTI Cushing	98.59	0.77%
Gold	1716.90	-0.44%
Wheat	638.00	-3.44%
Emissions Allowance	7.54	-9.05%

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Market data supplied by Thomson Reuters

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