



Weekly Commentary

23 July 2010

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Themes from the week

– Upside surprises in Euro and UK data

Headlines for the week ahead

– US GDP, Euro inflation, Economic Confidence and M3

Euro market turbulence not evident in macro data

The market turbulence surrounding euro sovereign debt has had a significant impact on foreign central banks, with both the Fed and the BOE citing it as a reason to be more cautious on the global outlook. The most recent data from the euro area does not indicate that it has had a significant impact, at least as yet. Indeed, the past week has seen a series of significant upside surprises.

The IFO survey of German business confidence, for example, was expected to fall in July but instead recorded the biggest monthly increase since reunification, jumping from 101.8 to 106.2, a new cycle high. Similarly, the flash estimate of the euro PMI was also expected to slip but also rose, to 56.7 from 56.0. This helped steady the euro which had slipped earlier in the week against the US dollar, trading below \$1.28 at one stage. The market now awaits the stress tests on the major European banks.

Sterling rose against the dollar and the euro, supported by another set of upside surprises on the data front. This had started with June's retail sales, which jumped 1.1% excluding car fuel on the month and 1.3% in Q2. A bigger surprise emerged with the second quarter GDP data, revealing a 1.1% surge in Q2, against an 0.6% expectation. The consensus growth figure for 2010 may now be revised higher.

European equities rose in response to the better data and US stocks picked up momentum on Thursday after falling following a downbeat assessment of the economic situation from Fed Chairman Bernanke. The FOMC still expects moderate growth but sees downside risks and feels that the economic outlook remains 'unusually uncertain'.

In Ireland, the NTMA issued another €1.8bn bonds at its regular monthly auction, which brought total debt funding year to date to just over €18bn and as such to 90% of the 2010 target. This occurred despite a Moody's downgrade, reducing Ireland's rating to AA2 from AA1. The second tranche of NAMA loans was also passed over, excluding Anglo, totalling €5.5bn at an average discount of 48% against 42% ex Anglo in the first tranche.

Dan McLaughlin

Data section contents (changes on the week)

Spot and forward rates	Equity indices
World forex rates	Bond yields
Money market rates	Commodities
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Highlights for the week ahead

		Prev	Fcst	Cons
Mon	US New Home Sales	300k		320k
Tues	Euro M3	-0.2%		-0.1%
	US Case Schiller	3.81%		3.75%
	US Consumer Confidence	52.9		51.8
Wed	US Beige Book			
	US Durable Goods	-0.6%		0.8%
Thurs	UK Mortgage Approvals	49k		48k
	Euro Economic Confidence	98.7		99.0
Fri	Euro CPI	1.4%		1.8%
	US GDP	2.7%		2.5%
	US Chicago PMI	59.1		56.0

Spot rates

[More details in data section](#)

EUR/GBP	↓	0.8387	EUR/CHF	↓	1.3493
EUR/USD	↑	1.2946	EUR/JPY	↑	112.81
GBP/USD	↑	1.5432	EUR/CAD	↓	1.3461
EUR/SEK	↓	9.4440	EUR/PLN	↓	4.0640
EUR/NOK	↓	7.9700	EUR/ZAR	↓	9.6217
EUR/HUF			EUR/CZK	↓	25.170

Long term rates

[More details in data section](#)

	2 year	3 year	5 year	7 year	10 year	15 year	20 year
EUR	1.45	1.70	2.21	2.61	3.01	3.40	3.54
GBP	1.52	1.89	2.57	3.05	3.52	3.89	3.99
USD	0.86	1.22	1.95	2.52	3.02	3.46	3.63

Official rates

[More details in data section](#)

	Current		Q2'10		Q3'10		Q4'10
	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	0.75	0.25

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[The Bulletin](#) (monthly analysis of international and Irish markets)

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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**Data indicates Euro area recovery strengthening**

We had plenty of data from the Euro area this week, which, for the main part, came in ahead of expectations and indicates the recovery should strengthen in the short term. PMI readings for July for the EA were healthier than expected; Services rose to 56.0 while Manufacturing was up to 56.5. Both of those readings were slightly higher than the consensus forecast and having been showing expansions for 10 consecutive months. Industrial new orders in the EA in May were also much higher than expected. Orders rose by 3.8% following a 0.6% gain in April - a marginal fall in orders in May had been expected. The German IFO index also surged in July, up to 106.2 from 101.8. That's just a few points off the 2006 high for the index. The ECB expects that the pace of growth in the EA will pick up in the short term but will be held back later on in the year and next year by substantial fiscal consolidation in Euro area members.

The Euro held on to the substantial gains it made last week and looks to finish the week at over \$1.29. It touched off over \$1.30 at times but fell to under \$1.28, after some comments by Bernanke on the "uncertainty" of the US outlook, on Thursday before the Euro recovered to \$1.29 overnight. European equities also did well this week with the Eurostoxx gaining 2.8% on that better macroeconomic data as well as strong company earnings which are indicating that the global recovery is continuing. The Euro and the Euro area as a whole could get a boost if there is a positive reception to the Bank Stress test results which are released after the markets close on Friday. While a number of banks will possibly fail, the vast majority are expected to pass and if the market interprets the test as being rigorous enough, it could give a welcome fillip to the Euro area banks and indeed, sovereigns.

Ireland**Ireland bond issues overcome rating downgrade**

On Monday, Moody's downgraded Ireland's sovereign rating to AA2, outlook stable. This is broadly in line with other agencies ratings of Ireland. The agency said that is believed that Ireland had "turned the corner" and that they have a "constructive" view on the outlook for the country. The downgrade reflected "a gradual significant deterioration" in the Government's financial strength. The Moody's analyst saw average growth of up to 3% for up to 5 years for Ireland and that the current deficit cutting plan was credible. Default or help from European Stability Fund are "not issues" for Ireland. In context, this is as positive as a downgrade can be. The reason for the downgrade – the public finances – is an issue already well known and well flagged but the Government has up until now taken hard decisions to correct the situation and appear committed to continuing those actions. With a stable outlook, Moody's anticipates no further rating change for the "foreseeable future". Irish 10 year yields rose by 10bps following the announcement by Moody's but by the end of the day the increase was down to 5bps. 10 year yields look set to finish the week more or less on unchanged from last Friday. The NTMA held one of their regular auctions of approx. €1.8bn of Irish debt on Tuesday and they had no problems in getting that away.

United Kingdom**UK economy grows at fastest pace in 4 years**

The UK economy grew by 1.1% in real GDP terms in Q2, much faster than the consensus forecast. This is the fastest expansion in a quarter in four years and comes after a 0.3% expansion in Q1. The annual rate of growth stood at 1.6% in Q2. The services sector, which makes up about ¾ of the UK economy grew by 0.9% in the quarter, manufacturing expanded by 1.6%. There was a huge upside surprise in construction which increased by 6.6%, which is only the 2nd quarter since 2008 that the sector has not contracted. The strength of the UK recovery at the moment may fuel further debate at the MPC where one member believes that growth at the moment justifies a base rate increase while others see some arguments that inflation may not come back to target soon. Sentance was again the lone dissenter in July voting for a 25bps hike in a 7-1 split. The latest set of minutes pointed to some debate already going on within the MPC. According to the minutes "The Committee considered arguments in favour of a modest easing in the stance of monetary policy. The softening in the medium-term outlook for GDP growth over recent months would put further downwards pressure on inflation, once the impact of temporary factors had waned. Pay growth had remained subdued and there was little sign of a material pickup in medium-term inflation expectations" while on the other hand there were also arguments in favour of a modest tightening in the stance of monetary policy. Inflation was likely to remain above target for some months and there was a risk that medium-term inflation expectations would rise. The resilience of inflation over recent months had suggested that the downward impact

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of spare capacity could be weaker than expected and this created uncertainty around the extent to which inflation would fall back in the future. Demand growth had bounced back internationally, although the geographical distribution remained uneven. The average growth rate of the main measures of UK nominal demand in recent quarters had been around or above historical rates". The word 'uncertain' is prominent throughout the July MPC minutes. The Committee thought that growth may be slightly weaker than previously thought but that inflation was also likely to be higher in 2010 than envisaged in the May inflation Report. Spencer Dale may also be starting to lean towards the view that inflation will remain elevated but it would have been very surprising if he had voted for a rate hike this month. He said after the minutes were released that huge monetary stimulus remains and he saw inflation above target at year end, however he added that the growth outlook had deteriorated recently. Sentance said before the July meeting that events such as the budget had not changed his overall view so his vote for a hike was expected, and he could be a lone voice for a while yet. A new inflation report is due out next month.

United States**Bernanke downbeat on US outlook**

The Federal Reserve recently revised down its forecast for US growth this year and next, reflecting the softer tone of the latest data, and Bernanke articulated the central bank's current thinking in his semi-annual report to Congress.

The FOMC still expects moderate growth, a gradual decline in the unemployment rate and subdued inflation but most members of the committee view the risks to growth as being on the downside. One factor is this more downbeat assessment is financial conditions, both in the US and abroad, which are seen as being less supportive of economic growth in recent months, with bank credit still contracting. In addition, the housing market remains weak in the Fed's view and the slow pace of employment growth is also a drag on household spending. As a consequence Bernanke reiterated that 'economic conditions are likely to warrant exceptionally low levels of the Federal funds rate for an extended period'.

The Fed Chairman went on to discuss the need to tighten policy when the time comes and set out options for this exit strategy, which will be more complex than usual given the scale of the emergency policy actions taken over the last few years. These options have been well aired but what struck a new note was the recognition that the 'economic outlook remains unusually uncertain' and that the Fed was prepared to take further policy actions as needed to foster growth. The Fed's central case appears to be that such actions will not be necessary but the acknowledgement that there is a chance further easing will be required confirms that the Bank is less confident about the US recovery than it was a few months ago. The private sector too has revised down its forecast for US growth this year (although it is still around 3%) and the estimates for Q2 GDP, released this coming Friday, have also been pared back, to 2.5%.

Japan**Japan concerned over the Yen's gains**

Japanese officials are becoming more vocal over their concerns about the Yen's appreciation against the dollar. The currency got down to close to its December '09 high of 86.3Y against the Greenback this week before depreciating modestly to just over 87 by the end of week. That December high was a 14 year record for the Yen. Vice Finance Minister Ikeda said during the week that the government "wants to avoid excessive gains in the yen". Trade Minister Naoshima also said that the currency's gains pose a risk to the expansion. The Government continues to press the Bank of Japan to initiate more extraordinary monetary easing measures and has not ruled out more fiscal expansion even though they have pledged to cut the deficit. The Yen has climbed about 8% against the dollar in the past three months as uncertainly over the global recovery sent investors into the Yen as a refuge. BoJ Governor Shirakawa has also remarked on the currency's strength saying it may hurt the economy. However BoJ Deputy Governor Yamaguchi said the Bank was in no hurry to interfere in the markets saying the bank won't be compelled to act based on a specific exchange-rate level. "It takes a certain period of time for us to judge the effect of the yen's advance on corporate activities and sentiment". The Bank of Japan hasn't stepped into the currency market since it sold 14.8 trillion yen in the first three months of 2004.

Data section – changes on the week

Spot and forward rates

Change on the week

EUR/GBP			
			<i>Change</i>
Spot	↓	0.8387	-1.52%
1M		1	
3M		1	
6M		1	
12M		6	

EUR/USD			
			<i>Change</i>
Spot	↑	1.2946	0.12%
1M		-1	
3M		-3	
6M		-9	
12M		-19	

GBP/USD			
			<i>Change</i>
Spot	↑	1.5432	0.94%
1M		-2	
3M		-7	
6M		-15	
12M		-36	

World forex rates

Change on the week

EUR currency pairs			
			<i>Change</i>
EUR/CAD	↓	1.3461	-1.52%
EUR/AUD	↓	1.4489	-2.58%
EUR/NZD	↓	1.7828	-1.96%
EUR/CHF	↓	1.3493	-0.65%
EUR/JPY	↑	112.81	0.80%
EUR/SEK	↓	9.4440	-0.37%
EUR/NOK	↓	7.9700	-1.59%
EUR/HUF	↑	285.80	1.41%
EUR/PLN	↓	4.0640	-0.94%
EUR/ZAR	↓	9.6217	-1.79%
EUR/CZK	↓	25.170	-0.77%

USD currency pairs			
			<i>Change</i>
USD/CAD	↓	1.0399	-1.67%
USD/AUD	↓	1.1196	-2.73%
USD/NZD	↓	1.3785	-2.07%
USD/CHF	↓	1.0424	-0.75%
USD/JPY	↑	87.11	0.60%
USD/CNY	↑	6.7800	0.07%
USD/MXN	↓	12.7225	-1.63%
USD/SGD	↓	1.3706	-0.39%
USD/BRL	↓	1.7576	-1.39%
USD/THB	—	32.22	—
USD/ZAR	↓	7.4143	-1.94%

GBP currency pairs			
			<i>Change</i>
GBP/CAD	↓	1.6046	-0.80%
GBP/AUD	↓	1.7271	-1.76%
GBP/NZD	↓	2.1261	-1.19%
GBP/CHF	↑	1.6077	0.06%
GBP/JPY	↑	134.47	1.54%
GBP/SGD	↑	2.1150	0.54%
GBP/MYR	↑	4.9305	0.64%
GBP/NOK	↓	9.4933	-0.72%
GBP/HKD	↑	11.9891	0.87%
GBP/SEK	↑	11.2503	0.31%
GBP/DKK	↑	8.8802	0.75%
GBP/ZAR	↓	11.4702	-0.77%

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	↑ 0.45	↑ 0.46	↑ 0.52	↑ 0.55	↑ 0.60	↑ 0.74	— 0.93	↑ 1.11	↑ 1.25
GBP	0.50	↓ 0.34	↑ 0.41	↑ 0.50	↑ 0.47	↓ 0.55	— 0.64	↑ 0.89	↑ 1.07	↑ 1.24
USD	0-0.25	↑ 0.25	↑ 0.35	— 0.36	↓ 0.39	↓ 0.47	↓ 0.53	↓ 0.74	↓ 0.93	↓ 1.03

Long term rates

Change on the Week

	2 year	Chng	5 year	Chng	7 year	Chng	10 year	Chng
EUR	↓ 1.45	-0.02	↑ 2.21	0.07	↑ 2.61	0.09	↑ 3.01	0.10
GBP	↑ 1.52	0.09	↑ 2.57	0.09	↑ 3.05	0.10	↑ 3.52	0.10
USD	↓ 0.86	-0.02	↑ 1.95	0.01	↑ 2.52	0.03	↑ 3.02	0.04

Government bond yields (YTM)

Change on the Week

	2 year	Chng	5 year	Chng	10 year	Chng	30 year	Chng
Ireland	↑ 2.33	-0.03	↑ 4.47	-0.03	↑ 5.42	-0.01		
Germany	↓ 0.73	-0.04	↑ 1.67	0.07	↑ 2.70	0.09	↑ 3.37	0.07
US	↓ 0.58	-0.01	↑ 1.71	0.04	↑ 2.97	0.05	↑ 3.97	0.03
UK	↓ 0.83	0.07	↓ 2.14	0.11	↑ 3.44	0.11	↑ 4.30	0.15

Prime Rate

Bank of Ireland prime rate	1.03
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Equity indices

Change on the Week

	Change
ISEQ	↑ 2939 2.91%
DOW Jones	↑ 10322 2.22%
S&P 500	↑ 1094 2.70%
SMI	↑ 6194 0.16%
Nasdaq	↑ 2246 3.07%
FTSE 100	↑ 5302 2.78%
Eurostoxx 50	↑ 2720 2.82%
Nikkei	— 9431 —

Commodities

Change on the Week

	Change
Brent	↑ 77.48 2.79%
WTI Cushing	↑ 78.95 3.84%
Gold	↑ 1198.05 0.37%
Wheat	↑ 595.50 1.36%

Emissions Allowance

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Market data supplied by Thomson Reuters

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