

Weekly Update

11 May 2009



Market Intelligence Straight to your Business

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LOOK AT THINGS DIFFERENTLY

 **BANK OF SCOTLAND**
TREASURY

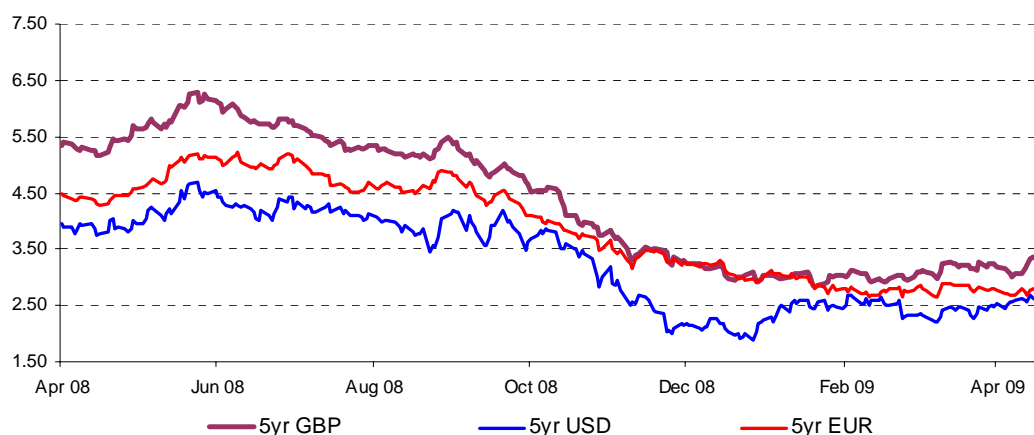
Indicative Swap Rates

	£		€		\$	
	Today	1 week ago	Today	1 week ago	Today	1 week ago
OFFICIAL RATE	0.50%	0.50%	1.00%	1.25%	0.25%	0.25%
3 MONTH LIBOR	1.42%*	1.45%	1.31%*	1.36%	0.94%*	1.02%
6 MONTH LIBOR	1.62%*	1.66%	1.51%*	1.57%	1.46%*	1.57%
12 MONTH LIBOR	1.90%*	1.92%	1.68%*	1.73%	1.78%*	1.88%
2 YEAR	2.12%	2.07%	1.73%	1.84%	1.39%	1.52%
3 YEAR	2.66%	2.50%	2.13%	2.20%	1.88%	1.98%
5 YEAR	3.30%	3.08%	2.75%	2.81%	2.59%	2.62%
7 YEAR	3.66%	3.43%	3.19%	3.17%	3.00%	3.00%
10 YEAR	3.97%	3.74%	3.60%	3.51%	3.34%	3.30%
20 YEAR	4.23%	4.02%	4.05%	3.96%	3.74%	3.66%
30 YEAR	4.02%	3.85%	3.91%	3.82%	3.78%	3.69%

Rate quotes taken from the inter-bank mid-market.

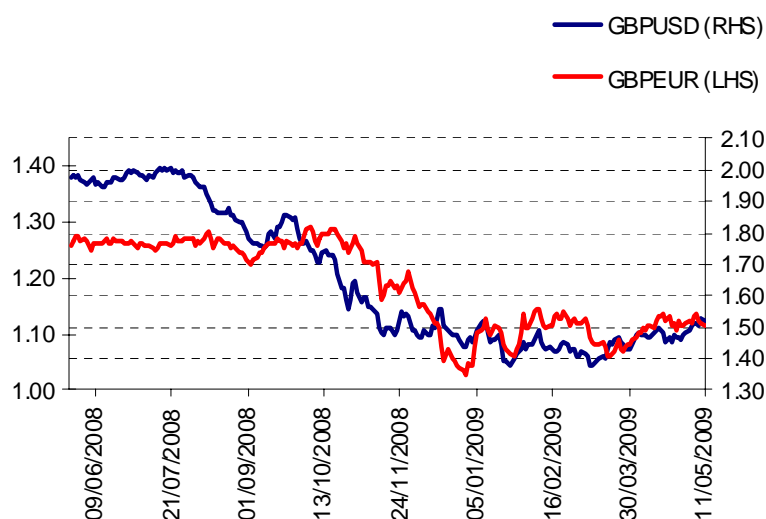
Swap rate quote conventions - UK: Semi, Actual/365 vs. 6M Libor Euro: Annually, 30/360 vs. 6M Libor US: Annually, Actual/360 vs. 3M Libor

*Friday's close



Market Levels

	Today	1 week ago
GBP/USD	1.5120	1.5018
GBP/EUR	1.1126	1.1202
EUR/USD	1.3591	1.3406
GBP/JPY	147.72	148.37
FTSE 100	4423.9	4243.2
Euro Stoxx 50	2436.9	2419.5
*S&P 500	929.2	877.5
**Nikkei 225	9452.0	8493.8
Gold (\$/oz)	913.6	902.1
Brent Crude (\$/barrel)	56.3	52.1
Gilt Future	119.0	120.4
T-Bond	129.8	131.0
Bund	120.6	122.0



* Friday's closing rate

** Monday's closing rate

Commentary

Economics & Interest Rates: Equities performed strongly last week, as a degree of risk appetite returned to financial markets. The US S&P500 rose by almost 6% during the week, while the FTSE Eurofirst300 gained 4.4% and the FTSE-100 rose 5.2%. The results of the US 'stress tests' – which recommended that 10 US banks boost capital by almost \$75bn – helped ease market concerns over credit provision into the real economy. Stock markets were also supported by more encouraging economic news (e.g. last week's US ISM non-manufacturing and UK PMI services surveys). Both the Bank of England and the ECB alluded to a slower pace of decline in activity in their policy statements last week. Finally, US non-farm payrolls fell by 593k in April – better than the -600k expected by the market.

It is still not clear whether the rally in equities since early March is the genuine article (it may be related purely to relief associated with short-term, market events). The outlook for UK corporate margins against a background of rising import prices and a weak demand environment is not particularly promising. And since central banks are still at an early stage in their quantitative easing (QE) strategies, there is no suggestion as yet that sellers of government bonds and private sector assets are putting their money to work in equities.

Nonetheless, last week's mood of optimism prompted a back-up in government bond and swap yields across much of the curve in the UK, US and Euro-zone. The Bank of England kept Bank Rate on hold at 0.5% at its latest policy meeting but felt the need to increase its QE programme by £50bn. This move, ahead of Wednesday's Inflation Report, aims to mitigate the downside risks to both economic activity and inflation. However, we also look for the Bank to highlight the potential risks to the CPI target from higher import prices, driven by a weak sterling exchange rate.

In the Eurozone, the ECB's decision to cut its main refinancing rate by 25bp, to 1%, was not unexpected. But Mr. Trichet's comment that 1% didn't necessarily mark a 'floor' may have raised the eyebrows of some observers. Together with the ECB's proposed €60bn purchases of covered bonds (and the prospect of other private sector asset purchases) we envisage rates on hold at 1% for the rest of this year. But since the Eurozone is the area where rate cuts stand the greatest

chance of being passed through into the real economy (note the narrow 3-month Euribor / ECB main policy rate spread), the ECB seems to be keeping options open.

This week sees an extremely busy US data calendar (see below). Meanwhile, UK highlights include May's Inflation Report and the latest labour market report. In the euro area, preliminary Q1 GDP data are published on Friday. The quarter-on-quarter consensus of -2.1% compares with a -1.6% outturn in 2008Q4 and primarily reflects a poor Q1 performance in Germany.

Currencies: The downward trend in the USD has intensified with the DXY index closing below its 200-day moving average (MA) and in danger of recording a head and shoulders reversal formation. USD weakness has been particular against high yielding growth sensitive currencies. EUR/USD has also broken through its 200-day MA as well as closing through the downward trend from the July 2008 high. The trend line currently provides support at \$1.3517. Daily RSI and stochastic indicators continue to provide upside risk for the pair.

The USD weakness has been driven by 3 key issues. Firstly, improvement in economic data has led to the perception that the worst is now past. Leading indicators continue to improve whilst the pace of job destruction in the US has fallen. Secondly the bank stress test results have shifted the focus away from the financial sector, removing the financial sector led risk aversion factor. Thirdly, US inflation expectations have continued to drift higher providing a mild USD negative factor.

On the data front this week, a further improvement in retail sales and the Empire survey is likely to weigh on the USD as risk positive sentiment rises. Additionally, we also see an upward risk to the inflation report, any increase here will also be USD negative.

GBP/USD continues to drift higher, supported by broad based USD weakness. The currency pair is now at a 4-month high with the next major level at \$1.5373. The spread between 2-year EZ/UK interest rate swaps continues to narrow (against the euro). Alongside an improvement in the financial sector (which is sterling positive) and upward data surprises we look for EUR/GBP to resume its downward move.

Key Economic Releases This Week

Date	Time	Cntry	Release/Event	Period	Forecast	Consensus	Previous
12-May	09.30	UK	Industrial Production	Mar	-0.8 (-12.8)	-0.7 (-12.7)	-1.0 (-12.5)
12-May	09.30	UK	Manufacturing Production	Mar	-0.9 (-14.0)	-1.0 (-14.1)	-0.9 (-13.8)
13-May	09.30	UK	Change in Unemployment	Apr	90.0k	82.5k	73.7k
13-May	09.30	UK	BoE Quarterly Inflation Report	-	-	-	-
13-May	13.30	US	Advance Retail Sales	Apr	-0.2	0.0	-1.2
13-May	13.30	US	Retail Sales ex-autos	Apr	-0.1	0.0	-1.0
15-May	10.00	EUR	GDP	aQ1	-2.3 (-4.3)	-2.1 (-4.1)	-1.6 (-1.5)
15-May	13.30	US	CPI	Apr	0.1 (-0.5)	0.0 (-0.6)	-0.1 (-0.4)
15-May	14.15	US	Industrial Production	Apr	-0.8	-0.5	-1.5

Annual rates shown in brackets. Consensus figures taken from Bloomberg poll

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