

Morning Call

Thursday, 2 September 2010

Latest Market Headlines

Fed officials say more easing won't help on jobs

Two top Federal Reserve officials said on Wednesday the US central bank should not rush into more monetary easing, which would do little to lower the high US unemployment rate. The Fed should only embark on additional monetary stimulus if deflation forces its hand, Philadelphia Federal Reserve Bank President Charles Plosser told Reuters in an interview. Lowering long-term interest rates further *"is not going to solve the unemployment problems and it is dangerous to think that it will,"* Plosser said. If the Fed were to send a signal that it is trying to control the jobless rate, now at 9.5%, and then fails to do so, it could hurt its ability to ensure price stability should it face a real threat of deflation, he said. Separately, Dallas Fed President Richard Fisher said uncertainty over the potential cost of healthcare reform and future taxes was keeping businesses from adding to their staffs, and clarity on fiscal and regulatory policies was needed to reduce that uncertainty. *"I believe that monetary accommodation alone cannot buy happiness,"* Fisher told business leaders at a lunch in Houston.

We are in full agreement with both Plosser and Fisher.

ECB to extend liquidity as uneven recovery weighs

The European Central Bank is expected to extend its liquidity safety-net on Thursday, delaying its exit from crisis support as policymakers confront a lopsided Eurozone recovery and vulnerable banks in *'peripheral'* countries. The ECB is widely expected to leave interest rates at a record low of 1.00% for the 16th month in a row in September and the median expectation of market analysts is for no change until the fourth quarter of 2011. The ECB's 22-member Governing Council is likely to decide to keep lending banks unlimited funds until early next year, maintaining the lifeline relied on by banks in countries like Spain, Ireland and Greece.

The fragile situation in markets and the uneven economic recovery mean the ECB, like other central banks, will have to tread carefully in pulling back support measures.

The Fundamentals: The Economist's View

US Treasuries

US Treasuries were a tad firmer in Asia on Thursday after falling sharply in the previous session, with some investors looking for bargains in the wake of the surprisingly strong ISM manufacturing data for August yesterday. The market is now focusing on tomorrow's non-farm payrolls report for last month. Lack of improvement in the US jobs market has fanned expectations of a slowdown in the economy and of more easing steps by the Federal Reserve. ***While some market players think the Fed could take more easing steps at its next policy meeting, on September 21, others believe the strong ISM data have cut the chances of a fresh move later this month. The situation will be re-assessed after Friday's jobs figures.***

Eurozone Bonds

German Bund futures opened higher on Thursday but are expected to remain subdued ahead of a slew of supply from France and Spain and as investors await the outcome of the ECB's latest policy meeting. The French and Spanish auctions kick off the month's Eurozone bond calendar after a relative drought of supply in August. Spain will issue up to €4bn of 5-year Bonos and France up to €9bn of paper maturing in 2016 to 2041. ***Clearly the new supply will weigh on the market ahead of the ECB meeting, but Bunds are likely to be re-assured by an extension of liquidity operations by the central bank.***

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UK Gilts

The latest PMI data provided further evidence that the expected slowdown in the UK manufacturing recovery from its highs earlier in 2010 is underway. Growth of output slipped to an 11-month low, as the expansion in total order books slowed substantially since July. The headline index fell to 54.3 in August from 56.9 in July, with the new orders component dropping to 52.0 from 58.5 in the previous month. **These figures suggest that GDP growth is likely to slow in the third and fourth quarters after its strong performance in the second quarter, which would be negative for sterling but positive for Gilts.**

Other Bonds

Sweden's Riksbank announces its latest interest-rate decision this morning, with the majority of local analysts looking for a second consecutive 25bps rise, to 0.75%. Although inflation remains subdued now, there are plenty of factors that might lead the central bank to head off price rises in the future. The economy grew 3.7% year-on-year in the second quarter, the fastest pace in over three years, and the labour market has begun to strengthen. Consumer confidence has also reached 10-year highs, though there have been some signs recently from business confidence indicators that the pace of growth is beginning to slow. **Still, the Swedish economy is in a stronger position than most, and we expect the Riksbank to continue with its interest-rate 'normalisation' process this morning with a quarter-point hike to 0.75%, which should be negative for short-dated SGBs but positive for the krona versus the euro.**

Key Economic Indicators / Events of the Day

Time (BST)	Country	Release	Period	Bloxham	Median	Last
8.30	Sweden	Riksbank Rate Decision	September	0.75%	0.75%	0.50%
9.30	UK	Construction PMI	August	53.0	53.2	54.1
10.00	Eurozone	GDP (quarter-on-quarter)	Q2 Revised	+1.0%	+1.0%	+1.0%
12.45	Eurozone	ECB Policy Decision	September	1.00%	1.00%	1.00%
13.30	Eurozone	ECB Press Conference	September			
13.30	US	Jobless Claims	w/e Aug 28	468,000	475,000	473,000
13.30	US	Productivity	Q2 Revised	-1.8%	-1.9%	-0.9%
13.30	US	Labour Costs	Q2 Revised	+1.1%	+1.2%	+0.2%
14.00	US	Federal Reserve Chairman Ben Bernanke testifies on "Causes of the Recent Financial and Economic Crisis" before the Financial Crisis Inquiry Commission, in Washington				
14.00	US	Federal Reserve Bank of Boston President Eric Rosengren and Federal Reserve Bank of Cleveland President Sandra Pianalto participate in "Reserve Bank President Perspective" discussion before the Federal Reserve REO and Vacant Properties Summit, in Washington				
15.00	US	Durable Goods	July Rev.	+0.4%	+0.5%	+0.3%
15.00	US	Factory Orders	July	+0.1%	+0.3%	-1.2%

Today's Debt Auctions /Buybacks/ Announcements

French Treasury sells up to €9bn of 2016 to 2041OATs.

Spanish Treasury sells up to €4bn of 3.00%, April 2015 Bonos.

UK's DMO sells £3,750m of 5.00%, 2014 Gilts.

US Treasury announces details of forthcoming 3-year, 10-year and 30-year bond sales.

US Treasury sells 10-year TIPS.

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