

Morning Call

Tuesday, 7 September 2010

Latest Market Headlines

Bank of Japan says to take timely action, rates on hold

The Bank of Japan held off on loosening monetary policy further on Tuesday but said it will take timely action when necessary, setting the stage for possible easing next month when there is clearer evidence of the strong yen's impact on the slowing economy. After easing policy just last week, the nine-member board kept interest rates on hold at 0.10% as widely expected. But government pressure on the Bank for more aggressive steps will likely grow in the coming months with the economy expected to slow and the political outlook clouded by a possible change in the ruling party's leadership, and hence premier. Financial markets are bracing for a possible shift away from Prime Minister Naoto Kan's efforts to rein in Japan's massive public debt if he loses a September 14 leadership battle to powerbroker Ichiro Ozawa, as media surveys suggest is possible.

Japanese government bonds have tumbled in the last two weeks, hit in part by worries that Ozawa could win and be forced to issue more bonds to keep spending promises made when the party swept to power last year, although he maintains the funds can be found by cutting waste and shifting spending priorities.

UK retail sales growth picks up in August

British retail sales growth accelerated last month, helped by clothes sales, a new survey showed on Tuesday, but discounting played a part in the improvement and consumers remain reluctant to splash out on expensive items. The British Retail Consortium (BRC) said retail sales values were 1.0% higher than a year ago in August on a like-for-like basis. Total sales, which include new floor-space, were 2.8% higher.

The good news is sales are still growing but anxiety about job cuts and tax rises is putting people off making major spending commitments.

The Fundamentals: The Economist's View

US Treasuries

US Treasury debt prices firmed in Asia on Tuesday and futures were steady, taking a breather from a recent sell-off as traders wait to see if US players returning from a long weekend will continue to push yields higher. The Treasury sells \$33bn in 3-year notes today, \$21bn in re-opened 10-year notes on Wednesday and \$13bn in re-opened 30-year bonds on Thursday. ***In our view the market is still highly cautious about the economic outlook and whether the Fed will ease again, and a move back to 3.00% for the 10-year note is unlikely near-term.***

Eurozone Bonds

Eurozone government bonds edged up at Tuesday's open, supported by losses in equities overnight, and having stabilised the previous day after three sessions of steep losses. Bunds were also supported by a *Wall Street Journal* report, which stoked fears about the viability of European banks by highlighting the weakness of Euroland stress tests earlier in the year. 'Peripheral' issues were pressured on Monday, particularly Belgian bonds on the back of heightened political uncertainty. In supply, Austria will auction €1.9bn of 2019 and 2026 government bonds. Going into this week's substantial supply, it remains to be seen just what appetite for bonds investors have, once they no longer believe in economic or credit meltdown. ***Supply this week totals around €11bn with Germany and Portugal also coming to the market, but redemption and coupon payments of about €19bn should support the sales.***

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UK Gilts

The Bank of England is expected to hold interest rates at a record low on Thursday, and probably well into next year to keep the economic recovery on track in the face of a painful fiscal squeeze and weakening global backdrop. Not all the Bank's policymakers are comfortable with policy remaining so loose. Worries about above-target inflation have prompted Andrew Sentance to vote for a quarter-point rate rise in each of the last three months. But there is little sign that other MPC members are warming to this view and most economists reckon UK rates will stay at 0.50% until the second quarter of 2011 at the earliest. Britain's economy grew a faster than expected 1.2% in the second quarter, but this looks set to be the peak of growth, with a slowdown predicted in the second half of 2010. However, **with last week's increased risk taking, investors may see unchanged monetary policy on Thursday as a further negative for Gilts at this juncture.**

Other Bonds

Twenty-five of 41 Canadian forecasters polled by Reuters last week expect the Bank of Canada to raise its overnight target rate to 1.00% tomorrow from 0.75% at present. The poll included Canada's 12 primary securities dealers. Investors will watch for the Bank's reaction to weaker than expected second-quarter growth of 2.00%, a full percentage point below the central bank's projection. The market will also be watching for a possible shift towards more neutral language that would indicate no further hikes are planned, at least until December or possibly into 2011. **Our own view is that the Bank will tighten policy again tomorrow but hint at pausing for the remainder of the year. Such an outcome should boost short-dated Canadian bonds and see the 'loonie' temporarily weaken on the forex markets.**

Key Economic Indicators / Events of the Day

Time (BST)	Country	Release	Period	Bloxham	Median	Last
	US	SEC Chair Mary Schapiro speaks to the Economic Club of New York, in New York				
8.00	EU	Ecofin meeting, in Brussels				
11.00	Germany	Industrial Orders	July	+0.8%	+0.5%	+3.2%
15.00	US	Employment Trends	August	96.0	96.0	97.0
18.30	Eurozone	ECB Executive Board member Juergen Stark participates in an event on the euro, in Wiesbaden, Germany				
22.00	US	ABC News Consumer Comfort Index	w/e Sept 5	-43	-44	-45

Today's Debt Auctions /Buybacks/ Announcements

Austria sells €1.925bn of 4.35%, 2019 and 4.85, 2026 RAGBs.

Denmark sells government bonds.

UK's DMO sells £800m of 0.75%, index-linked Treasury 2047 Gilt.

Switzerland sells 3-month T-bills.

Hungary sells 2-week and 3-month T-bills.

Turkey sells 2012 zero coupon government bonds.

Federal Reserve purchases notes/bonds.

Canada to repurchase C\$500m of cash management bills.

US Treasury sells 3-month and 6-month T-bills.

US Treasury sells \$33bn of 3-year notes.

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