

## Morning Call

Wednesday, 8 September 2010

### Latest Market Headlines

#### Ireland extends bank guarantee

Ireland on Tuesday extended its guarantee for short-term bank liabilities, including corporate and interbank deposits, as expected, as the government sought to reassure investors. Irish bond yield spreads hit fresh peaks on Tuesday on renewed jitters about the health of the European banking sector exerting more pressure on the country. With Ireland once again at the centre of European debt fears amid concerns over the escalating cost of bailing out Anglo Irish, there were fears corporate depositors would pull funds out of Irish banks if the guarantee were allowed to expire at the end of this month.

***While the guarantee keeps Ireland on the hook for its struggling banks, it at least gives it breathing space ahead of a crucial month in which the banks need to refinance around €26bn of funding. Now that the uncertainty over short-term corporate deposits and inter-bank funding is cleared up, it allows the Irish banks to proceed with the needed terming out of their wholesale funding.***

#### German exports post first drop in 3 months

German exports fell unexpectedly month-on-month in July after two months of strong gains, though the country's trade surplus widened due to a larger decline in imports, new official data showed on Wednesday. Adjusted for seasonal swings, exports fell by 1.5% from June, while imports decreased by 2.2%. The market had expected exports to be unchanged on the month in July and imports to be up 0.5%. The adjusted trade surplus rose to €12.7bn from €12.4bn in June, the figures showed. A surplus of €12.9bn had been projected.

***The worry is that these latest figures are the start of a weakening trend for German exports and slower Eurozone growth, which would be more bad news for Irish bonds.***

### The Fundamentals: The Economist's View

#### US Treasuries

US Treasuries rose for the second straight day in Asian trade on Wednesday on renewed concerns about the underlying health of the European banking system, and as markets pondered about further easing moves by the Federal Reserve. Following on a Wall Street Journal report on Tuesday highlighting the weakness of July's bank stress tests, Ireland's extension of guarantees for short-term banking liabilities added to jitters about the European banking sector. Sovereign risk is a euro-centric issue and that is driving Treasuries. ***Markets are undecided whether the Fed will embark on additional policy easing. If the economy weakens further and the cost to additional policy action is lower, then the Fed will be more inclined to expand its balance sheet, pushing bond yields down more.***

#### Eurozone Bonds

Bund futures opened higher on Wednesday, extending the previous session's rally on worries about the European banking sector and after Ireland extended its guarantee for short-term bank liabilities. Portugal's sale of up to €1.25bn of 2013 and 2021 bonds will take centre stage today following the sell-off in 'peripheral' Eurozone government bonds on Tuesday. The Portuguese/German 10-year yield spread hit 362bps yesterday, the highest since early May, while the equivalent Irish spread rose to a euro lifetime high at around 391bps. ***Risk aversion is back, dollar/yen is at a 15-year low, US Treasuries are up, so we should see a decent start for Bunds today.***

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## UK Gilts

The UK manufacturing sector comes into domestic focus this morning with the release of the official July output figures. Manufacturing production was up 0.3% in the month in June and the market is looking for a similar increase this time round. However, we think the monthly rise in output will be slightly higher at 0.5%. Meanwhile, total industrial production is forecast to rebound back into positive territory after a fall of 0.5% in the previous month. ***If the figures come in as projected then Gilt yields should rise and sterling should gain versus the euro.***

## Other Bonds

Central bank focus turns to Canada today and it will be interesting to see if the Bank of Canada in raising rates by a further 25bps to 1.00% is as upbeat as the Reserve Bank of Australia (RBA) was yesterday. Australia's central bank left its key cash rate unchanged at 4.50% for a fourth month running on Tuesday, but sounded more upbeat on domestic demand and investment and less concerned about the global outlook. The RBA reiterated that policy was "*appropriate for the time being*", in a brief statement after its latest monthly policy meeting. The Australian central bank led the developed world in hiking 150bps between October and May. It noted that the global background was "*somewhat uncertain*" but underlined that booming export earnings were lifting household consumption and driving strong business investment. The bottom line is that you've got a big boost from incomes and the terms of trade, demand is quite strong, and capacity will be waning so inflation will head higher. ***The RBA will probably be on hold for another few months, but the next rate move is still up in our view, probably December or early 2011, and as such we expect to see a further flattening of the yield curve and a stronger Aussie dollar on a 3-month outlook.***

## Key Economic Indicators / Events of the Day

Time (BST)	Country	Release	Period	Bloxham	Median	Last
8.45	Eurozone	ECB Governing Council member Axel Weber holds a speech at the 15th Handelsblatt Jahresatagung, in Frankfurt				
9.30	UK	Industrial Output	July	<b>+0.2%</b>	+0.3%	-0.5%
9.30	US	Manufacturing Production	July	<b>+0.5%</b>	+0.3%	+0.3%
11.00	Germany	Industrial Production	July	<b>+0.8%</b>	+1.0%	-0.6%
14.00	Canada	BoC Rate Decision	September	<b>1.00%</b>	1.00%	0.75%
17.00	Eurozone	ECB Governing Council member Yves Mersch chairs discussion between Luxembourg Prime Minister Jean Claude Juncker and President of the EIB, Philippe Maystadt, at Bridge Forum event, in Luxembourg				
19.00	US	Fed 'Beige Book'				
19.30	US	Federal Reserve Bank of Minneapolis President Narayana Kocherlakota speaks on "Inside the FOMC" before a business leaders' meeting in Missoula, Montana				
20.00	US	Consumer Credit	July	<b>-\$4.5bn</b>	-\$3.8bn	-\$1.3bn

## Today's Debt Auctions /Buybacks/ Announcements

Germany sells €6bn of September 2012 Schatz.

Portugal sells up to €1.25bn of 2013 and 2021 government bonds.

Poland sells fixed-rate government bonds.

Czech Republic sells 7bn crowns of 2.80%, September 2013 government bonds.

US Treasury sells 4-week T-bills.

US Treasury sells \$21bn of re-opened 10-year notes.

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