



Weekly Commentary

14 November 2008

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Themes from the week

– Sterling falls sharply following bleak BOE forecast

Headlines for the week ahead

– BOE minutes of recent meeting published

Sterling adrift

Sterling had a bad week, falling against all the major currencies, with the largest declines against the Yen and the US dollar; the fall against the latter of around 7% took cable below \$1.46 at one stage, its lowest reading since mid 2002. The euro also appreciated by 6% against the UK currency, which took the pair out of the recent broad 78p-82p range and to a new high for the euro against sterling, around 86 pence.

Sterling had been trading above 81 pence over recent weeks but had withstood the shock 1.5% rate cut by the Bank of England on November 5th. The publication of the Bank's Inflation Report on Wednesday proved a catalyst for further selling however, as the economic forecast envisaged a far sharper downturn than the consensus view, including four consecutive quarters of negative GDP growth. That expectation, alongside falling commodity prices, persuaded the MPC that inflation would average 1% in 2010, even with the Bank rate at 3%, the lowest since 1954.

The implication, of course, is that rates will now fall much further and the market quickly moved to price in a Bank rate of 1.5% by the Spring, and as such below the expected level of ECB rates (around 2%). The latter may prove too high however, and in the coming weeks the market may revise this down particularly after the ECB's own economic forecasts are published in early December. Consequently, the euro too may suffer in response to a gloomy outlook from its central bank, although we will revise our sterling forecast lower in the near term, as a quick move back below 80 pence now looks unlikely.

Dan McLaughlin

Data section contents (changes on the week)

Spot and forward rates	Equity indices
World forex rates	Bond yields
Money market rates	Commodities
Long term rates	

Highlights for the week ahead

		Prev	Fcst	Cons
Mon	US Industrial production	-2.8%		0.0%
Tues	UK CPI	5.2%		4.8%
Wed	UK BOE minutes			
	US FOMC minutes			
	US CPI	4.9%		4.1%
	US Housing stats	817k		780k
Thurs	UK Retail Sales	-0.5%		-0.9%
	US Philly fed			
Fri	IRL Q3 Household Survey			
	E15 PMI			

Spot rates

[More details in data section](#)

EUR/GBP	↑	0.8606	EUR/CHF	↑	1.5100
EUR/USD	↓	1.2699	EUR/JPY	↓	123.20
GBP/USD	↓	1.4749	EUR/CAD	↑	1.5433
EUR/SEK	↓	9.9917	EUR/PLN	↑	3.6903
EUR/NOK	↓	8.7559	EUR/ZAR	↓	12.7170
EUR/HUF	↓	266.23	EUR/CZK	↑	25.155

Long term rates

[More details in data section](#)

	2 year	3 year	5 year	7 year	10 year	15 year	20 year
EUR	3.48	3.59	3.81	4.02	4.29	4.49	4.47
GBP	3.53	3.76	4.06	4.23	4.39	4.54	4.42
USD	2.44	2.85	3.49	3.87	4.12	4.19	4.17

Official rates

[More details in data section](#)

	Current	3 M		6 M		12 M	
		Fcst	Cons	Fcst	Cons	Fcst	Cons
EUR	3.25	2.25	2.50	2.00	2.00	2.00	2.00
GBP	3.00	1.50	2.00	1.50	1.50	1.50	1.50
USD	1.00	1.00	1.00	1.00	1.00	1.25	1.25

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[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**Euro Zone economy in recession**

The Euro Area economy is now in recession, at least on the basis of the commonly used measure of two consecutive quarters of negative GDP growth. According to data published by EUROSTAT this week, the economy contracted by 0.2% in the third quarter of this year, following a fall in real GDP of the same magnitude in the second quarter. Two of the largest economies, Germany and Italy, recorded falls in GDP of 0.5% in the three months to September, following declines of 0.4% in the previous three month period, though France has so far managed to avoid recession, with its economy expanding (albeit just about) by 0.1% in Q3 after contracting by 0.3% in Q2. The data confirm that the current downturn in activity is now more severe than in 2001-2002, when the economy slowed sharply but managed to avoid recession, with no quarter of negative GDP growth recorded at all over the period. The annual rate of inflation in the zone, meanwhile, was confirmed at 3.2% in October, well down from its peak of 4% last July. Moreover, a combination of the continuing fall in the oil price and positive base effects (arising from the fact that energy prices, and indeed food prices, were rising sharply at the end of 2007), means that inflation is likely to fall much further over the next few months.

The prospective fall in inflation, together with the greater than expected scale of the current downturn, means the ECB (as it has indicated) is going to lower rates further, with the next reduction – of at least 50bps we think - coming at its December meeting. The more interesting question is the level to which official rates in the zone will ultimately fall. The market currently appears to think the terminal rate will be 2%, which was also the trough for interest rates in the last easing cycle in 2001-2002. Given the current downturn is proving to be deeper than back then, the risk must be that interest rates are cut to below 2% this time around. If so, this will undermine the euro, which having fallen against the dollar since July is currently trading off its lows of just over 1.23 reached in late October. The single currency broke to a new all-time high – of over 86.5p – against sterling during the week, of course. That, however, owed more to the exceptional weakness of the UK currency than to the strength of the euro, which on the week lost some ground to both the dollar and the yen. The large reduction in UK rates at the last Bank of England meeting, and the certainty of more to come, has clearly undermined sterling of late. We are not convinced, though, that the euro will extend its gains against the UK unit, given the prospect of further (potentially sizeable) reduction in ECB rates from current levels, though the recent price action probably means we are now looking at a new short-term trading range for EUR/STG, of 80-85p

United States**Market interest rates continue to fall**

Government bond yields continued to trend lower over the course of the week, helped by a fall in equity markets and more weak economic data. Yields in the 2-year area fell by a little over 10bps, while 5-year yields were down even more, by over 20bps. Other longer-term rates also fell, with the 5-year fixed rate ending the week almost 20bps lower. Equity markets dropped sharply from Monday through to Wednesday before rallying quite impressively on Thursday; however the main indices still finished down on the week, with the S&P 500 shedding about 5% from the previous Friday to bring its losses in November to date to 9% following its 17% decline in the month of October. On the data front, the number of new jobless claimants rose sharply last week, which is consistent with an accelerating decline in employment (there was a step-up in the pace of decline over the September-October period according to the official payrolls report). Related to this, consumer spending looks to be weakening further, with retail sales falling in value terms by almost 3% last month. Some of this decline reflected the impact of falling gasoline prices on the value of gasoline sales, though excluding this effect spending was still weak, something that is likely to again act as a significant drag on overall economic growth again in the current quarter. The dollar had something of a mixed week, falling against the yen but gaining a little against the euro while strengthening sharply against sterling, the latter due largely to the extreme weakness of the UK unit on the exchanges this week.

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*](#)

United Kingdom**Euro appreciates to new highs versus Sterling**

The Euro rose to new highs against Sterling during the week. The single currency rose to trade above £0.86 after Sterling came under pressure following the publication of the Bank of England's Quarterly Inflation Report on Wednesday. The Bank of England's forecasts have been substantially revised downwards (for both growth and inflation) since the last report in August. The Bank's current central projection is that inflation will fall "well below" its target of 2% from the middle of 2009 and will remain below target for the forecast horizon out to 2011. The GDP growth forecast is also revised with the economy contracting through the rest of '08 and into '09 before a recovery in activity in the second half of '09 – with the contraction in growth peaking at around -2% annually in Q1 '09. Bank of England Governor Mervyn King said the MPC was "prepared to cut the bank rate if it proves to be necessary". The sharper than expected downturn in activity and the fall in commodity prices could drag inflation much lower than the Bank of England would tolerate. This risk of deflation will increase should the MPC not take further action. This report indicates that the MPC will continue to cut the base rate by large amounts and quickly - market has priced in a cut of over 75bps at the December meeting.

Ireland**Irish CPI inflation down to 4%**

The annual rate of CPI inflation in Ireland fell to 4.0% in October from 4.3% in September. Prices fell by 0.2% in the month mainly due to lower energy costs and unseasonable sales in consumer goods stores. We should see inflation fall further from this point and quickly. Over the past two years the CPI rate of inflation has been driven by increases in mortgage costs, energy costs and food prices. However, the collapse in oil and other commodities prices and the likelihood of ECB interest rate cuts will cause these items to have a disinflationary impact over the next year. We expect a substantial fall in inflation in November and onwards into 2009. The weakness in consumer spending will also push down prices. We are forecasting that CPI inflation in Ireland next year will average under 2%.

Retail sales in Ireland fell at an annual rate of 6.2% in September. This means that the annual decrease in 3Q was 5.6%, the biggest decline in 25 years. This is the third consecutive quarter of decline in retail sales. With taxation increases in the Budget reducing disposable income and the general weakness in the economy, things will get worse rather than better for the retail sector over the next year.

Japan**Japanese equities market suffers rollercoaster week**

The Nikkei had a volatile week. The index had a big jump on Monday following the announcement of a large stimulus package by China, a key Japanese export market. The index rose by close to 6% on the day. However, negative sentiment about the economy meant the gains were not sustained and the index lost over 9% between Monday and Thursday. Equities did recover somewhat on Friday but the index fell 1 ½% overall for the week as a whole.

This Japanese economy continues to slowdown and 3Q GDP figures are released next week. The data is expected to confirm that Japanese growth stagnated in the quarter due to weak demand for Japanese goods both at home and abroad. The Japanese economy contracted by 0.7% in 2Q.

Data section – changes on the week

Spot and forward rates

Change on the week

EUR/GBP			
			<i>Change</i>
Spot	↑	0.8606	5.85%
1M		-5	
3M		-17	
6M		-17	
12M		-10	

EUR/USD			
			<i>Change</i>
Spot	↓	1.2699	-0.29%
1M		-17	
3M		-26	
6M		-33	
12M		-25	

GBP/USD			
			<i>Change</i>
Spot	↓	1.4749	-5.90%
1M		-13	
3M		-9	
6M		-18	
12M		-29	

World forex rates

Change on the week

EUR currency pairs			
			<i>Change</i>
EUR/CAD	↑	1.5433	1.86%
EUR/AUD	↑	1.9175	1.65%
EUR/NZD	↑	2.2577	4.31%
EUR/CHF	↑	1.5100	0.57%
EUR/JPY	↓	123.20	-1.76%
EUR/SEK	↓	9.9917	-0.76%
EUR/NOK	↓	8.7559	-0.37%
EUR/HUF	↓	266.23	-0.55%
EUR/PLN	↑	3.6903	1.38%
EUR/ZAR	↓	12.7170	-1.59%
EUR/CZK	↑	25.155	0.35%

USD currency pairs			
			<i>Change</i>
USD/CAD	↑	1.2162	2.32%
USD/AUD	↑	1.5115	2.13%
USD/NZD	↑	1.7797	5.00%
USD/CHF	↑	1.1889	0.87%
USD/JPY	↓	97.04	-1.25%
USD/CNY	↓	6.8236	-0.03%
USD/MXN	↑	12.9800	1.20%
USD/SGD	↑	1.5179	1.54%
USD/BRL	↑	2.2740	5.92%
USD/THB	↑	34.94	0.06%
USD/ZAR	↓	10.0000	-1.16%

GBP currency pairs			
			<i>Change</i>
GBP/CAD	↓	1.7936	-3.74%
GBP/AUD	↓	2.2280	-3.83%
GBP/NZD	↓	2.6214	-1.23%
GBP/CHF	↓	1.7535	-4.96%
GBP/JPY	↓	143.10	-7.07%
GBP/SGD	↓	2.2388	-4.45%
GBP/MYR	↓	5.2993	-4.76%
GBP/NOK	↓	10.1652	-5.91%
GBP/HKD	↓	11.4303	-5.90%
GBP/SEK	↓	11.6041	-6.26%
GBP/DKK	↓	8.6494	-5.56%
GBP/ZAR	↓	14.7623	-6.90%

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		↓ 3.00	↑ 3.23	↓ 3.31	↓ 3.89	↓ 4.19	↓ 4.24	↓ 4.37	↓ 4.41	↓ 4.42
GBP		↓ 2.17	↓ 2.63	↓ 2.86	↓ 3.19	↓ 3.61	↓ 3.78	↓ 3.91	↓ 3.97	↓ 4.00
USD		↑ 0.41	↑ 0.93	↓ 1.13	↓ 1.77	↓ 2.48	↑ 2.76	↓ 3.01	↓ 3.00	↑ 3.27

Long term rates

Change on the Week

	2 year	Chng	5 year	Chng	7 year	Chng	10 year	Chng
EUR	↓ 3.48	-0.14	↓ 3.81	-0.08	↓ 4.02	-0.03	↑ 4.29	0.01
GBP	↓ 3.53	-0.15	↓ 4.06	-0.10	↓ 4.23	-0.08	↓ 4.39	-0.07
USD	↓ 2.44	-0.02	↓ 3.49	-0.14	↓ 3.87	-0.12	↓ 4.12	-0.13

Government bond yields (YTM)

Change on the Week

	2 year	Chng	5 year	Chng	10 year	Chng	30 year	Chng
Ireland	↓ 2.47	-0.41	↓ 3.58	-0.27	↓ 4.42	-0.13		
Germany	↓ 2.26	-0.14	↓ 2.82	-0.11	↑ 3.69	0.01	↑ 4.34	0.10
US	↓ 1.24	-0.10	↓ 2.37	-0.19	↓ 3.76	-0.03	↓ 4.24	-0.03
UK	↓ 2.19	-0.30	↓ 3.06	-0.35	↓ 4.08	-0.11	↑ 4.44	0.03

Prime Rate

Bank of Ireland prime rate	4.85
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Equity indices

Change on the Week

	Change
ISEQ	↓ 2708 -4.22%
DOW Jones	↓ 8749 -2.17%
S&P 500	↓ 899 -3.44%
SMI	↓ 5740 -4.46%
Nasdaq	↓ 1499 -9.00%
FTSE 100	↓ 4298 -1.54%
Eurostoxx 50	↓ 2493 -4.20%
Nikkei	↓ 8462 -1.41%

Commodities

Change on the Week

	Change
Brent	↓ 55.16 -3.82%
WTI Cushing	↓ 56.97 -6.67%
Gold	↑ 745.20 1.26%
Wheat	↑ 542.00 4.03%
Emissions Allowance	↓ 17.85 -4.29%

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Market data supplied by Reuters

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