

Daily Market Strategy

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Market Strategy

Kenneth Broux

Senior Market Economist

0207 158 1750

kenneth.broux@lloydsbanking.com

- Double whammy for GBP?
- Gilts extend gains on Cons/LD deal, curve flatter

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.4879

€/\$: 1.2628

\$/Y: 92.61

UK 5y sw: 2.91%

US 5y sw: 2.49%

EU 5y sw: 2.22%

Overnight

- George Osborne named Chancellor
- emergency Budget within 50 days, to include £6bln deficit reduction this year
- German Q1 GDP up 0.2% q/q, tops 0.0% consensus
- strong US 3y auction b/c 3.27, indirects take 50.7%, direct take 15.6%

The instalment of a Conservative/Lib Dem government helped GBP and gilts to rally late yesterday, but sentiment remains on a knife-edge as overnight price action demonstrates. Selling pressure in stocks is not dissipating despite a return to stability in the Shanghai comp (S&P futures currently down 5.60) and this is helping gilts to consolidate safe haven gains, with 10y yields settling below 3.90% and the 2y/10y curve retaining most of its flattening gains (277bp). As for GBP, enthusiasm of a Cons/LD government is tested by the overriding theme of risk aversion. Beyond a possible, albeit temporary prop from employment data and the BoE QIR at 10:30 (2010 inflation forecast revised upwards?), the outlook for GBP/USD is highly dependent on the performance of stocks and whether fears of debt contagion and bailouts calm down. With respect to rates, gilts and the short sterling strip are pretty well positioned to digest a higher inflation projections for this year (still on target over 2years?), considering the much stakes in the sovereign credit markets.

Ahead today

- UK: the BoE Inflation report at 10:30 commands most attention, though stronger employment data may underpin confidence that the economy is making good progress; to what extent does the Bank revise its forecasts for inflation and GDP growth, and does the governor stay tight-lipped with regard to future policy as he awaits the emergency Budget of the new government?
- EU: an official press conference is scheduled by the EC on the EFS
- US Treasury sells \$24bln 10y notes, a \$40.5bln foreign trade deficit is forecast for March

FX: The outperformance of the CAD is striking in the context of broader selling pressure of risk and commodity and high yield currencies. The CAD is up across the G10, including a 0.6% gain so far this week vs the AUD. This in itself may be no surprise considering the slowly diverging path for implied rate differentials (RBA tightening nearly done; BoC to start). CAD/AUD pierced 1.09 resistance yesterday and remains bid this morning, hitting a 1.0991 high. This puts the cross on target for 1.11 (1.1128 the Aug-08 high). For GBP/CAD, key trendline support runs in the 1.5175 area. For GBP/USD, a hesitant start to the morning session has seen the pair bid up to 1.4950 from a 1.4861 low. We look for the BoE to support bullish momentum, and target a rally over 1.50 towards 1.5150, though equities may have the last word. For EUR/GBP, we target a test of last week's 0.8428 low and a break through 0.84 support.

Rates: UK 5 swaps drift below 2.90%, making progress to the lower end of the 2.80%-3% range. For gilts, a well received 2027 auction and the new government are inspiring new buyers, albeit helped by still nervous equity markets. For 10y gilts, a move through 3.90% to 3.86% brings 3.80% within range, a level that could draw buying if the BoE reassures on its 2y inflation projection. The 2y/10y curve bull flattens to 276bp (gilts) and 212bp (swaps). EU spreads initially widened at the open but have reversed course and are now tighter ahead of the Spanish Budget and EU comments.

	Close	Daily Change %
FX		
EUR/GBP	0.8466	-1.69%
GBP/USD	1.4956	0.73%
EUR/USD	1.2662	-0.98%
USD/JPY	92.650	-0.69%
AUD/USD	0.8952	-0.84%
Bonds %		
US 10Yr	3.524	-1.7
EUR 10Yr	2.937	-1.8
UK10 Yr	3.886	-3.6
UK 5yr Swap	2.910	2.0
Equities		
S&P500	1155.79	-0.34%
FTSE100	5334.21	0.00%
Eurostoxx50	2730.48	0.00%
Shanghai Composite	2655.71	0.31%
Commodities		
Crude Oil \$/bl	76.37	-0.56%
Gold \$/oz	1232.9	2.47%
Copper	320.7	-0.67%
Baltic Dry	3822	3.10%
Other		
VIX	28.32	-1.80%
iTraxx XOVER	481.35	-4.6

Today's Data	Time	Consensus	Previous	Events
UK Claimant Count Total, Apr	09:30	-20k	-32.9k	BoE Inflation Report (10:30)
UK ILO Unemployment Rate, Mar	09:30	8.0%	8.0%	ECB speaker: President Trichet (09:00)
UK Average Earnings, Mar, y/y	09:30	2.1%	2.3%	Fed speakers: Lockhart (13:20), Rosengren (15:15), Bullard (18:15)
German GDP, Q1, q/q	07:00	0.2%A	0.2%R	
French GDP, Q1, q/q	07:45	0.1%A	0.5%R	
EU-16 GDP, Q1, q/q	10:00	0.1%	0.0%	US Treasury sells \$24bln, 10y notes
US Foreign Trade, Mar	13:30	-40.5bln	-39.7bln	
US Monthly Budget Statement, Apr	19:00	-56.0bln	-20.9bln	

*All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg, DataStream & CQG

Lloyds TSB Corporate Markets Economic Research, 10 Gresham Street, London, EC2V 7AE, Switchboard: 0207 626 1500.

Bloomberg page: LLOY<GO>

GBP/USD: ST rally to 1.5150 possible



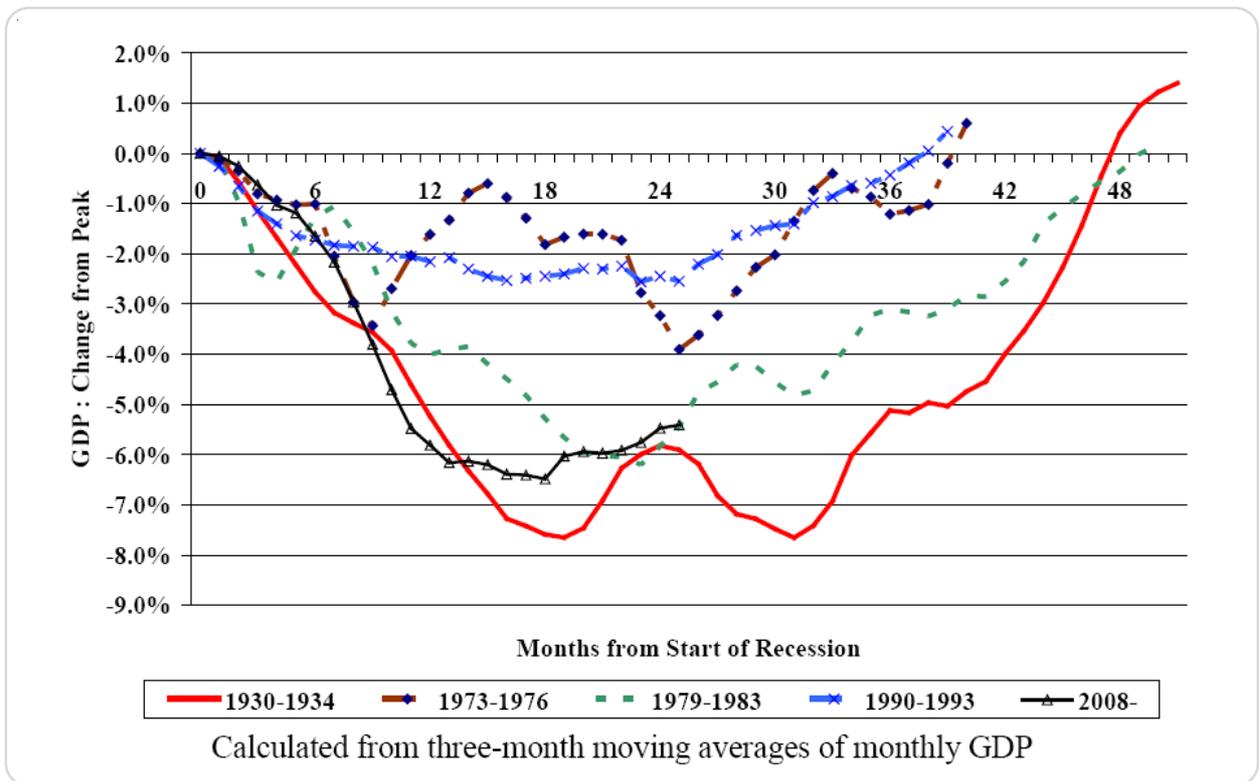
EUR/GBP: support at 0.8397



UK 2y/10y swap spread: support at 207bp



Shape of current UK recovery still closer to 1930-34 depression than 1990-1993 recession (NIESR)



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EUR/USD	1.2662	-0.98%	Equities	S&P500	1155.79 -0.34%
USD/JPY	92.65	-0.69%		DJIA	10748.26 -0.34%
AUD/USD	0.8952	-0.84%		FTSE100	5334.21 0.00%
EUR/GBP	0.8466	-1.69%		Eurostoxx50	2730.48 0.00%
GBP/EUR	1.1812	1.71%		Shanghai Composite*	2655.71 0.31%
GBP/USD	1.4956	0.73%		*latest price	
GBP/JPY	138.56	0.04%		Commodities	%
GBP/CHF	1.6627	0.90%		Crude Oil \$/bl	76.37 -0.56%
GBP/AUD	1.6707	1.59%		Gold \$/oz	1232.9 2.47%
GBP/CAD	1.5285	0.62%		Copper c/lb	320.7 -0.67%
GBP/NZD	2.0877	1.62%		Silver \$/oz	19.31 4.24%
GBP/NOK	9.2590	1.56%		Baltic Dry	3822 3.10%
GBP/ZAR	11.2397	1.09%			
GBP/CNY	10.2106	0.74%			
				Swaps %	bp
Bonds %		bp		US 5yr	2.512 -0.1
US 10Yr	3.524	-1.7		EUR 5yr	2.242 -1.5
EUR 10Yr	2.937	-1.8		UK 5yr	2.910 2.0
UK10 Yr	3.886	-3.6			
				Official Rates %	
Other				UK	0.50
VIX	28.32	-1.80%		US	0.25
iTraxx XOVER	481.35	-4.6		EU	1.00
DJ Agriculture Index	57.40	0.53%		Japan	0.10

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