



# Weekly Commentary

10 September 2010

Economic Research Unit: (01) 609 4613

## Themes from the week

– Euro weakens, Ireland in eye of bond storm

## Headlines for the week ahead

– Inflation in US, UK and Euro area, Retail Sales in US and UK

## Irish yields rally from new highs

The market's concern about the cost to the State of supporting the Irish banking sector, particularly in relation to Anglo Irish bank, ignited again early in the week, resulting in a substantial rise in Irish bond yields, both in absolute terms and relative to Germany; 10 year yields, as measured by the 4.5% 2020, rose from 5.75% to 6% at one stage, with the spread over the 2.25% 2020 bund moving out to a new wide for the year of 372bp. The spread narrowed later in the week, ending at just under 350bps.

A number of factors prompted the rebound. Risk aversion in general fell in response to better US data but a number of specific Irish factors were at work. The Government announced a plan to split Anglo into two, with deposits sitting in a Funding bank, and the remaining Non-Nama assets and debt securities in an Asset Recovery Bank, which will be wound down over time. The capital required by these banks will be determined by the Central Bank over the next month, so some issues are still unresolved, but the market response was positive. In addition, the high cover for the NTMA's Treasury bill auction also prompted some spread tightening and the ECB was also reported as being in the market purchasing bonds. Irish inflation, as measured by the CPI, also turned positive for the first time since late 2008 and industrial production data showed strong gains over the past few months.

The other peripheral bond markets in the euro area also suffered, notably Greece, as did the euro, which fell against most of the major currencies. The euro/ dollar rate had traded above \$1.2900 on Monday but fell below \$1.2700 at one stage. Similarly the single currency made early gains against sterling, trading at 83.90 pence, but also slid to finish just above 82 pence.

The major equity indices also made gains, boosted by a sharp fall in the weekly jobless claims in the US, and this prompted a further unwind of the recent flight to bonds, with 10-year Treasury yields rising to 2.80%. The flow of significant US data increases in the coming week, with the main focus on inflation and retail sales.

Dan McLaughlin

## Data section contents (changes on the week)

<a href="#">Spot and forward rates</a>	<a href="#">Equity indices</a>
<a href="#">World forex rates</a>	<a href="#">Bond yields</a>
<a href="#">Money market rates</a>	<a href="#">Commodities</a>
<a href="#">Long term rates</a>	

## Highlights for the week ahead

		Prev	Fcst	Cons
<b>Mon</b>	Euro Industrial Production	-0.1%		0.2%
<b>Tues</b>	UK CPI	3.1%		2.9%
	UK Pics	-8		-11
	Ger ZEW	14.0		10.1
	US Retail Sales	0.4%		0.3%
<b>Wed</b>	UK Unemployment rate	7.8%		7.8%
	Euro CPI	1.7%		1.6%
	US Industrial Production	1.0%		0.3%
<b>Thurs</b>	UK Retail Sales	0.9%		0.4%
	US Philly Fed	-7.7		0.5
<b>Fri</b>	US CPI	1.2%		1.1%
	US Michigan Confidence	68.9		70.0

## Spot rates

[More details in data section](#)

EUR/GBP	↓	0.8234	EUR/CHF	↓	1.3029
EUR/USD	↓	1.2725	EUR/JPY	↓	106.88
GBP/USD	↑	1.5450	EUR/CAD	↓	1.3140
EUR/SEK	↓	9.2083	EUR/PLN	↓	3.9295
EUR/NOK	↓	7.8635	EUR/ZAR	↓	9.1330
EUR/HUF			EUR/CZK	↑	24.688

## Long term rates

[More details in data section](#)

	2 year	3 year	5 year	7 year	10 year	15 year	20 year
EUR	1.43	1.61	1.99	2.31	2.66	2.95	3.04
GBP	1.40	1.69	2.26	2.72	3.22	3.66	3.77
USD	0.79	1.13	1.79	2.29	2.77	3.19	3.36

## Official rates

[More details in data section](#)

	Current	Q3'10		Q4'10		Q1'11
		Fcst	Cons	Fcst	Cons	
EUR	1.00	1.00	1.00	1.00	1.00	1.00
GBP	0.50	0.50	0.50	0.50	0.50	0.50
USD	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25

## Recent research

[See all recent research \(www.boi.ie/eru\)](#)

See most recent versions of:

[The Bulletin](#) (monthly analysis of international and Irish markets)

[UK View](#) (quarterly analysis of trends in the UK economy)

[The Outlook](#) (quarterly analysis of trends in the Irish economy)

[Irish Property Review](#) (quarterly analysis of Irish property trends)

[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****Sovereign debt concerns re-surface**

Sovereign debt concerns re-surfaced this week, with Greek, Portuguese and Irish 10-year yields rising quite sharply relative to equivalent German yields over the first few days of trading. The euro weakened too, falling from over \$1.29 to the dollar to trade below \$1.27 for a time, while equity markets lost ground. However, there was some improvement in the latter part of the week and sovereign spreads tightened in again to varying degrees. Ireland performed best in this regard, with the 10-year spread over Germany reversing more than half of the 25bps widening that occurred in the early part of the week. The Irish government's announcement to split Anglo Irish Bank into two separate entities, a funding bank and an asset recovery bank, while leaving some important questions unanswered, seemed to help sentiment towards Ireland. The Portuguese government managed to get away a number of bonds at its mid-week debt auction, which probably was the trigger for the renewed tightening of spreads generally. Equity markets also recovered ground to finish up on the week, though the euro finished well below last Friday's closing level albeit ending off its intra-week lows. Meanwhile, economic data were thin enough this week, with industrial output for the large economies of Germany, France and Italy the main releases. The message from them is that the pace of growth of manufacturing output is beginning to moderate, albeit from quite a robust rate. This is turn is consistent with the expected moderation in overall euro area economic growth over the second half of this year, from the 1% quarter-on-quarter increase in GDP recorded in the second quarter.

**Ireland****Ireland appears to be exiting deflationary period**

Irish consumer prices, as measured by the CPI, have been on a rising monthly trend since February, and this implied that the annual inflation rate would turn positive again in the fourth quarter. In the event this occurred a month earlier than we expected; August's 0.7% increase in the index brought the annual inflation rate to 0.2% from -0.1% in July. As such this represents the first move into positive territory for the annual inflation rate since December 2007. The surprisingly large rise in the August index was driven by higher mortgage interest costs, as banks here seek to pass on some of their higher costs of funding. Interest payments rose by 10% on the month, so contributing 0.56 percentage points to the overall rise in the index, and taking the annual change in mortgage costs to over 24%. Eight of the twelve component groups in the CPI have recorded price rises over the past three months, although half are still recording price falls on an annual basis.

Currency movements tend have a significant impact on Irish prices, given the small and open nature of the economy. Consequently, the fall in Irish prices from late 2007 may have had as much to do with the rise in the euro, particularly against sterling, as the size of the output gap. Similarly, the fall in the euro against the UK currency over the past eighteen months (some 15%) has no doubt been a factor behind the price trend evident since the turn of the year.

**United Kingdom****Bank of England on hold and likely to stand pat for some time**

The Bank of England met this week and kept rates on hold and did not extend QE. We have seen from the minutes of previous meetings that there is some debate ongoing within the Committee regarding the policy stance. These views range from Andrew Sentence who wants to increase interest rates to other committee members who argue in favour of further easing. The latest evidence suggest the economy has slowed from its relatively rapid pace in Q2, when real GDP rose by 1.2% from the first quarter, with the National Institute in the UK estimating growth moderated to 0.7% in the three months to August. The latter is still reasonably robust, and is broadly in line with the UK economy's longer-run trend rate of growth. However, the MPC is still likely to be concerned about the possibility of growth slowing further over the coming months but has to balance that against a situation where inflation remains elevated (although the Bank predicts it will ease to below the target of 2% in the medium term). For right now, we think the MPC will follow a policy of hold the line and continue to do nothing. We don't think that interest rate increases are likely until the second half of next year at the earliest. Given the

---

**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\*](#)

---

downside risks to growth in 2011 there is a small chance of further QE measures but this is also fairly unlikely unless the economic situation deteriorates substantially.

---

**United States****Government bond yields back up further**

Government bond yields backed up further this week. The yield on the benchmark 10-year bond rose by about 10bps to 2.8%, some 30bps off its recent low of just a couple of weeks ago. This rise in yields has occurred against the backdrop of some better than expected economic data which suggest that the recent slowdown in the pace of economic growth is just that and does not presage the much feared 'double-dip'. This in turn has forced markets to re-assess the likelihood of Fed 'action' to support the economy. Increasing speculation that the Fed might have to embark on a further round of asset purchases ('quantitative easing, or QE) certainly contributed to the further leg lower in yields in August, when they fell by almost 60bps over the course of the month. However the recent data have lessened the likelihood that the Fed will have to conduct further QE, hence the back up in yields over the past couple of weeks. Following last Friday's better than forecast employment report, the run of good data continued this week, with the latest labour market data showing another fall in the number of new jobless claimants in the w/e September 3rd, and the latest trade data for July suggesting that *net* exports might make a small positive contribution to GDP growth in Q3, having had a substantial negative impact in Q2 (subtracting 3.4% points off growth in that quarter). The coming week brings another string of important data, including retail sales, consumer confidence and industrial output. If the recent pattern of the data beating expectations continues, then bond yields will almost certainly rise further, which in turn should support the dollar on the foreign exchange market.

---

**Japan****Bank of Japan on hold but may yet intervene to halt Yen appreciation**

The Bank of Japan met this week and kept rates on hold at 0.1%. The Bank announced further QE measures a few days before the meeting by expanding a corporate loan program. The markets gave this action a fairly muted response last week as the size of the QE program is widely thought to be too little too late to tackle the problems in the Japanese economy. The Bank is under pressure from the Government and commentators to do more to stop the appreciation of the Yen, tackle deflation and revive the feeble domestic economy. Governor Shirakawa, in his press conference after the meeting, said that the Bank did not rule out any policy option if the situation required them. The moves last week did little to help the Yen's position where it remains close to a 15 year high against the dollar. Shirakawa said that the bank is thoroughly aware of the fact that the stronger yen is affecting exporters. There have been rumours all week that the Bank is preparing to intervene directly in the market to force some depreciation of the Yen but no action has been taken yet.

## Data section – changes on the week

## Spot and forward rates

Change on the week

EUR/GBP				EUR/USD				GBP/USD			
			Change				Change				Change
Spot	↓	0.8234	-1.37%	Spot	↓	1.2725	-1.30%	Spot	↑	1.5450	0.03%
1M		1		1M		-1		1M		-4	
3M		3		3M		-4		3M		-10	
6M		4		6M		-9		6M		-20	
12M		8		12M		-19		12M		-41	

## World forex rates

Change on the week

EUR currency pairs				USD currency pairs				GBP currency pairs			
			Change				Change				Change
EUR/CAD	↓	1.3140	-1.87%	USD/CAD	↓	1.0322	-0.63%	GBP/CAD	↓	1.5950	-0.59%
EUR/AUD	↓	1.3747	-2.24%	USD/AUD	↓	1.0804	-0.98%	GBP/AUD	↓	1.6681	-0.89%
EUR/NZD	↓	1.7475	-2.27%	USD/NZD	↓	1.3744	-0.96%	GBP/NZD	↓	2.1216	-1.01%
EUR/CHF	↓	1.3029	-0.60%	USD/CHF	↑	1.0239	0.75%	GBP/CHF	↑	1.5817	0.72%
EUR/JPY	↓	106.88	-1.66%	USD/JPY	↓	83.98	-0.37%	GBP/JPY	↓	129.73	-0.38%
EUR/SEK	↓	9.2083	-1.16%	USD/CNY	↓	6.7690	-0.48%	GBP/SGD	↓	2.0698	-0.20%
EUR/NOK	↓	7.8635	-0.14%	USD/MXN	↑	12.9557	0.17%	GBP/MYR	↓	4.7985	-0.22%
EUR/HUF	↓	283.50	-0.19%	USD/SGD	↓	1.3397	-0.23%	GBP/NOK	↑	9.5414	1.41%
EUR/PLN	↓	3.9295	-0.14%	USD/BRL	↓	1.7229	-0.54%	GBP/HKD	—	12.0003	—
EUR/ZAR	↓	9.1330	-1.42%	USD/THB	↓	30.76	-1.28%	GBP/SEK	↑	11.1770	0.09%
EUR/CZK	↑	24.688	0.26%	USD/ZAR	↓	7.1754	-0.13%	GBP/DKK	↑	9.0377	1.39%
								GBP/ZAR	↓	11.0860	-0.10%

## 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	1.00	↑ 0.34	↑ 0.39	↑ 0.47	↑ 0.51	↑ 0.61	↑ 0.75	↑ 0.95	↑ 1.06	↑ 1.23
GBP	0.50	↓ 0.41	↓ 0.40	↓ 0.41	↓ 0.45	↓ 0.53	— 0.64	↓ 0.85	— 1.07	↑ 1.23
USD	0-0.25	↑ 0.26	↓ 0.27	↓ 0.27	↓ 0.29	↓ 0.32	↓ 0.36	↓ 0.51	↑ 0.75	↓ 0.90

## Long term rates

Change on the Week

	2 year	Chng	5 year	Chng	7 year	Chng	10 year	Chng
EUR	↑ 1.43	0.04	↑ 1.99	0.02	— 2.31	0.00	↓ 2.66	-0.03
GBP	↑ 1.40	0.08	↑ 2.26	0.08	↑ 2.72	0.08	↑ 3.22	0.08
USD	↑ 0.79	0.04	↑ 1.79	0.07	↑ 2.29	0.06	↑ 2.77	0.05

## Government bond yields (YTM)

Change on the Week

	2 year	Chng	5 year	Chng	10 year	Chng	30 year	Chng
Ireland	↑ 2.04	-0.10	↑ 4.88	0.21	↑ 5.84	0.10		
Germany	↑ 0.70	0.08	— 1.33	0.00	— 2.34	0.00	↓ 2.90	-0.05
US	↑ 0.55	0.03	↑ 1.55	0.06	↑ 2.75	0.05	↑ 3.83	0.04
UK	↓ 0.72	0.02	↓ 1.78	0.04	↑ 3.05	0.05	↑ 4.04	0.02

## Prime Rate

Bank of Ireland prime rate	1.03
----------------------------	------

## Equity indices

Change on the Week

	Change
ISEQ	↓ 2773 -0.97%
DOW Jones	↓ 10415 -0.31%
S&P 500	↓ 1104 -0.03%
SMI	↑ 6425 0.38%
Nasdaq	↑ 2236 0.11%
FTSE 100	↑ 5491 1.15%
Eurostoxx 50	↑ 2774 1.01%
Nikkei	↑ 9239 1.37%

## Commodities

Change on the Week

	Change
Brent	↑ 77.67 1.30%
WTI Cushing	↑ 75.81 1.62%
Gold	↑ 1249.45 0.29%
Wheat	↓ 704.00 -0.60%

## Emissions Allowance

## Contacts

### Bank of Ireland Global Markets

[www.boi.ie/globalmarkets](http://www.boi.ie/globalmarkets)

Chief Executive: Austin Jennings  
 Head of Global Customer Business: Kevin Twomey

Colvill House, Talbot Street, Dublin 1, Ireland  
 Fax: +353 1 799 3035 Tel: +353 1 799 3000  
 e-mail: [info@boigm.com](mailto:info@boigm.com)

### Economic Research Unit (ERU)

Chief Economist, Bank of Ireland: Dr. Dan McLaughlin  
 Senior Economist: Michael Crowley  
 Economist: Patrick Mullane

Tel: +353 1 609 3341  
 e-mail: [eru@boigm.com](mailto:eru@boigm.com)  
 Listen to Daily Commentary on Freephone: 1800 60 70 60

### Corporate & Institutional Sales

**Freephone 1800 30 30 03**

### Retail Sales

**Freephone 1800 790 153**

Deputy Head of Customer Group: John Moclair  
 Head of Corporate Sales: Liam Connolly +353 1 790 0000  
 Head of Customer Group Funding: Paul Shanley +353 1 609 3212  
 Institutions: Gavin Rylands 1800 60 70 40  
 Property & Specialised Finance: Ed Preston +353 1 609 3277  
 Corporate Relationship Manager: Eamon McManamy +353 1 609 3215

Head of Retail Sales & Customer Group Operations: Aine McCleary  
 Business Development & Sales Management: Adrienne McNally  
 Business Banking Sales: Leslie Cosgrave 1800 790 153  
 Branch Sales: Michelle O'Meara +353 1 609 4330

### Global Markets United Kingdom (UK)

Head of UK: Liam Whelan  
 Head of Business Development: Duncan Wilson  
 Head of London Treasury Sales: Sandra Perry

P.O. Box 62929, Bow Bells House, 1 Bread Street., London EC4P 4BF  
 Tel: +44 (0) 20 7429 9111  
 GB Treasury Sales Team Freephone: 0800 039 0038  
 Tel: +44 (0) 7429 9121; Treasury Sales Team: 0800 776 616

### Global Markets United States (US)

Head of US: Darsh Mariyappa  
 Head of US Business Development: Joe Connolly  
 Head of US Sales: Garreth Boyle

300 First Stamford Place, Stamford, CT 06902, US  
 Tel: +1 203 391 5555  
 Fax: +1 203 391 5901

### Global Products Team

Global Head of Structured Business: Brian Vaughan  
 Head of Structured Products Distribution: Barry McLoughlin

Tel: +353 1 790 0040  
 Tel: +353 1 790 0400

### Marketing

Head of Marketing: Andrew Hearnden

Tel: +353 1 609 3302

Market data supplied by Thomson Reuters

#### Disclaimer

Produced by the Economic Research Unit at Bank of Ireland Global Markets ("GM"). Bank of Ireland incorporated in Ireland with limited liability. Bank of Ireland is regulated by the Financial Regulator. In the UK, Bank of Ireland is authorised by the Irish Financial Regulator and authorised and subject to limited regulation by the Financial Services Authority. Details about the extent of our authorisation and regulation by the Financial Services Authority are available from us on request. This document is for information purposes only and GM is not soliciting any action based upon it. GM believes any information contained herein to be materially accurate but GM does not warrant its accuracy or completeness and this information should not be relied upon for any purpose. No prices or rates mentioned are bids or offers by GM to purchase or sell any currencies, securities or financial instruments. Except as otherwise may be specifically agreed, GM has not acted nor will act as a fiduciary, financial or investment adviser with respect to any derivative transaction that it has executed or will execute. Any investment, trading and hedging decision of a party will be based on its own judgement and not upon any view expressed by GM. This document does not address all risks related to the transactions described. You should obtain independent professional advice before making any investment decision. Any expressions of opinion reflect current opinions as at 10 September 2010. This publication is based on information available before this date. For private circulation only. This document is property of GM. The content may not be reproduced, either in whole or in part, without the express written consent of a suitably authorised member of GM staff.