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EUR bounces assisted by solid Greek debt auction, strong US earnings results. Eurozone core government bonds weaken

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- **Eurozone core government bonds weaken on firmer global equity markets, well received Greek T-bills auction.** German government bonds gave back some of their recent robust gains over the last few sessions as the latest bounce in risk appetite curbed flight-to-safety flows. A well received Greek T-bills auction, also had an impact. Short-dated German government bonds underperformed in view of the cautiously optimistic tone on the Eurozone's growth outlook ECB President Trichet adopted at the post-meeting July's press conference last week. In this environment, the 2/10-year Bund yield curve undertook some bearish flattening.

- **EUR bounces assisted by solid Greek debt auction, strong earnings results.** With investors remaining concerned about the sustainability of the US' economic recovery, the EUR/USD is likely to remain supported in the coming sessions provided that upcoming US corporate earnings results do not deliver negative surprises. But with euro area fiscal problems persisting, any further potential EUR upside is likely to prove short-lived especially if the euro area debt crisis deepens or stress-tests results reinforce concerns about the state of the banking sector. Technically, a clear move above recent highs has the potential to open the way for more appreciation towards 1.2940 (100-day MA) or even higher. On the downside, strong support stands at 1.2480 (July 6 low) in the way to 1.2455 (55-day MA).

GLOBAL RISK MONITOR

Credit spreads narrow on earnings optimism, easing European banking concerns

Major credit risk indicators improved over the last few sessions, as increased optimism for a solid quarter of US corporate results shifted market attention away from lingering euro area fiscal jitters. Despite continued fears over a slowdown in the pace of the US economic recovery, market expectations are for a Q2 earnings increase of 27%yoy –the third consecutive quarter of earnings growth- for companies in the S&P 500 index on favourable basis effects.
Growing optimism that the publication of the EU-wide stress-test results (on July 23) will help restore confidence in the stability of the banking sector, also underpinned the latest improvement in market sentiment. The Committee of European Banking Supervisors (CEBS) named 91 banks accounting for 65% of the Eurozone's banking system, including large cross-border banks as well as many regional banks, that will be tested for resilience to sovereign risk at a level beyond the deterioration of market conditions experienced in early May 2010. The tests will be published on a bank-by-bank basis following a common set of criteria: double digit hair-cuts on sovereign debt of some peripheral Eurozone countries (i.e 16%-17% for Greek government credit), no hair-cut on German bonds and just 0.7% on French bonds, Tier 1 threshold –a key measure of financial straight- was set at a minimum benchmark of 6% while global GDP growth for 2010 and 2011 was assumed 3% below the EU Commission's official forecasts.
Separately, in its updated World Economic Outlook, the IMF revised upwards its global GDP growth forecast for 2010 to 4.2% from 4.6% in April, warning though that the euro area's debt crisis poses a risk to economic recovery. The cautiously optimistic tone ECB President Trichet adopted at the post-meeting press conference last week, was also behind the latest improvement in market sentiment. Mr. Trichet noted that the Eurozone's economy is expected to grow at a moderate pace in an environment of high uncertainty and confirmed that the ECB will continue to support banks with unlimited liquidity provision.
A well received Greek 26-week T-bills auction and somewhat easing double-dip global recession fears following a hefty drop in US initial jobless claims last week and stronger-than-expected May's industrial production for both Germany and French, also bolstered sentiment.

Reflecting the latest improvement in market sentiment, the iTraxx Crossover index (of 50 junk-related bonds) eased to levels around 530bps in European trade on Tuesday, some 40bps lower from a three-week high recorded earlier this month. In a similar vein, the iTraxx Europe index was hovering around a two-month low of 116.5bps at the time of writing while Sovereign Credit Spreads as reflected by the ITRAXX SovX index closed at 136bps on Monday, not far from a six-week low of 134bps recorded in the prior session. Similarly, the S&P 500 implied volatility index, VIX, ended at 24.43 on Monday, its lowest closing level in a month, after hitting a three-week high of 34.5bps just a few sessions earlier.

With market participants remaining particularly concerned about the global growth outlook, focus turns this week to a bulk of key data releases including China's CPI, IP, retail sales for the month of May as well as Q2 GDP on Thursday which is expected to show a moderate decline to 10.5%yoy from 11.9%yoy in the prior quarter. In the US, the Empire State survey and industrial production data on Thursday lure market attention with both running a risk of surprising on the negative side in view of the fading impact of the inventory adjustment. Thus, market doubts about the sustainability of the global economic recovery might continue to mount in the sessions ahead. Meanwhile, european bank stress tests results are looming while there is skepticism on whether the methodology applied, is too lenient. In this backdrop, there are questions regarding the sustainability of the latest bounce in risk appetite.

iTraxx Crossover (Junk-related)

iTraxx Europe Index (Investment grade credits)

Risk-Metrics

Credit	13-Jul-10	1Wk Net Chg	high (y-t-d)	01-Jan-10
iTraxx Europe	118	-10	209	76
iTraxx Crossover	534	-34	1150	432
Money (LIBOR - OIS in bps)				
	13-Jul-10	1Wk Ago	high (y-t-d)	01-Jan-10
USD	34	34	123	9
EUR	20	26	114	27
GBP	23	24	165	16
Swap spreads (gvnt bond yield - swap rate) in bps				
	13-Jul-10	1Wk Ago	high (y-t-d)	01-Jan-10
USD 10yr	-6	-8	9	-14
USD 2yr	-32	-37	-12	-28
EUR 10yr	-22	-30	-6	-21
EUR 2yr	-64	-75	-29	-55
Equity markets	13-Jul-10	1Wk Chg	high (y-t-d)	01-Jan-10
VIX	25	-8	57	19
FX	13-Jul-10	1Wk Chg	high (y-t-d)	01-Jan-10
EUR/CHF	1.34	0.01	1.54	1.48
USD/CHF	1.06	0.59	1.19	1.04
	13-Jul-10	1Wk Ago	high (y-t-d)	01-Jan-10
3-mth implied Vol. (EUR/USD)	13	14	23	12
3-mth implied Vol. (USD/JPY)	12	13	21	15
Emerging Markets	12-Jul-10	1Wk Net Chg	high (y-t-d)	01-Jan-10
EMBI+ (spread in bps)	320	-17	698	272

Selective 5-year Credit Default Swap Spreads

US & European financ	13-Jul-10	1Wk Ago	high (y-t-d)	low (y-t-d)
Citigroup (US$)	180	187	666	129
Merrill Lynch (US$)	184	192	562	97
Morgan Stanley (US$)	253	270	446	108
Credit Suisse (EUR)	124	138	263	52
Deutsche Bank (EUR)	130	140	187	67
UBS (EUR)	134	151	362	67

GOVERNMENT BONDS

Eurozone core government bonds weaken on firmer global equity markets, well received Greek T-bills auction

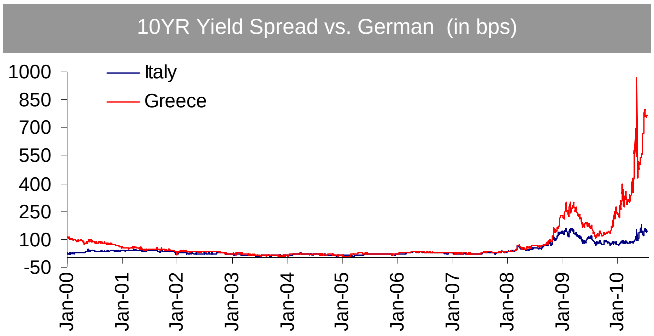
US Treasuries weakened over the last few sessions as firmer equity markets reduced the appeal of save-haven government paper. Appetite for profit taking in the wake of US Treasuries' hefty gains over the last few weeks, might also had an impact. Long-dated bonds underperformed with comments from Chinese authorities that US Treasuries would remain an important market for its foreign exchange reserve managers, failed to exert a positive impact. Supply concerns added to the recent bearish tone with the Treasury Department offering a total of $69bn in nominal UST auctions this week ($35bn in three-year debt on Monday, $21bn in 10-year notes on Tuesday and $13bn in 30-year bonds on Wednesday). The 10-yr benchmark was yielding levels around 3.05% at the time of writing after moving above 3.00% last Friday for the first time in nearly two-weeks. Meanwhile, a bigger-than-expected decline in the latest initial jobless claims data and news that US same-stores sales advanced in June for the 10th consecutive month pushed the 2-yr US bond yield up to 0.63%, its highest since May 25, compared with levels slightly below 0.61% a week earlier. Against this background, the 2/10-year UST yield curve undertook some bearish steepening with the corresponding spread widening to levels near 242bps on Tuesday in European trade after narrowing to one-year lows of 232bps early last week.

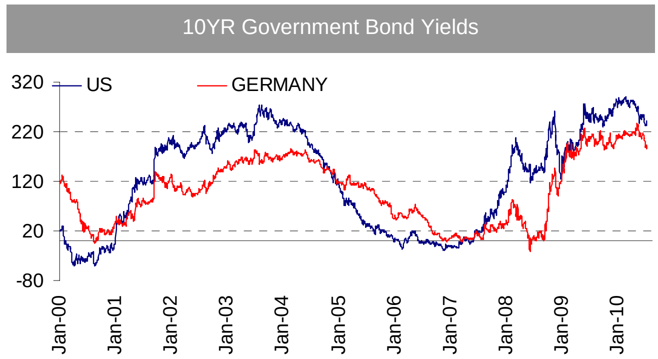
In a similar vein, German government bonds gave back some of their recent robust gains over the last few sessions as the latest bounce in risk appetite curbed flight-to-safety flows. A well received Greek T-bills auction, also had an impact. Greece's Public Debt Management Agency sold €1.625bn, including €375mn in non-competitive bids, of 6-month T-bills on Tuesday, its first sovereign debt sale since a €110bn EU/IMF rescue package was agreed in May. Short-dated German government bonds underperformed in view of the cautiously optimistic tone on the Eurozone's growth outlook ECB President Trichet adopted at the post-meeting July's press conference last week. The 2-yr Schatz yield was trading close to 0.71% in European trade on Tuesday, some 8.5bps higher relative to levels marked a few sessions earlier. The 10-yr benchmark was yielding levels near 2.62%, not far from a two-weeks high close to 2.64% recorded late last week. In this environment, the 2/10-year Bund yield curve undertook some bearish flattening over the last few sessions with the spread standing close to 186bps at the time of writing, its narrowest level since mid-October last year, after reaching levels slightly over 194bps a week earlier.

With the Greek auction now out of the way, focus is on additional non-German government bond issuance of nearly €20bn due later this week, with the main bulk coming from Portugal, Italy (Wednesday) and Spain (Thursday). If delivered successfully, euro area peripheral bond markets might see some tentative signs of relief with EMU peripheral government bonds spreads vs. Bunds undertaking some narrowing and German government bond yields moving higher. But with upcoming Eurozone & US macro data likely to keep intact market talk for a slowdown in the pace of the world economic recovery, any further upside potential in safe-haven German bond yields is likely to be limited. Technically, strong support for the 10-yr German Bund yields stands at 2.50% (June 8 low) ahead of 2.25%. On the upside, resistance comes at 2.80% (June 21 high) in the way to 3.00% (April 30 high) and 3.15% (April 13 high).

Meanwhile, US Treasuries underperformed Bunds over the last few sessions in the wake of a hefty increase in jobless claims which helped ease fears over a double-dip US recession. Renewed supply concerns, might also had an impact. The 10-yr US Treasury note/Bund yield spread widened to levels close to 44bps in European trade on Tuesday, some 10bps wider compared to levels witnessed a week earlier.

Elsewhere, UK gilts outperformed German Bunds over the last few sessions with the corresponding spread narrowing close to five-month lows early this week as the austere UK government's budget which is projected to lead to a GBP20.2bn reduction in gilt issuance this fiscal year, continues to have an impact on market sentiment.





Government Bond Yields and Swap Rates

Bund	**13-Jul-10**	**1Wk Ago**	**1-Jan-10**
2yr yield	0.77	0.67	1.33
5yr yield	1.59	1.49	2.42
10yr yield	2.63	2.58	3.39
Slope (2/10yr spread in bps	186	192	206
2yr swap spread (bps)	-64	-75	-55
5yr swap spread (bps)	-47	-59	-39
10yr swap spread (bps)	-22	-30	-21
US Treasuries			
2yr yield	0.63	0.63	1.14
5yr yield	1.84	1.82	2.68
10yr yield	3.05	2.98	3.84
Slope (2/10yr spread in bps	242	235	270
2yr swap spread (bps)	-32	-37	-30
5yr swap spread (bps)	-26	-28	-30
10yr swap spread (bps)	-6	-8	-14
GGB (Greece)			
2yr yield	11.01	10.78	4.06
5yr yield	10.99	10.58	4.96
10yr yield	10.30	10.21	5.77
Slope (2/10yr spread in bps	-72	-57	171
2yr swap spread (bps)	940	916	178
5yr swap spread (bps)	893	850	215
10yr swap spread (bps)	744	733	218

CURRENCIES

EUR bounces assisted by solid Greek debt auction, strong earnings results

Following solid demand in Spain's syndicated 10-yr bond sale late last week, **Greece's eagerly awaited 26-week T-bills auction on Tuesday**, the first sovereign debt auction since the country secured €110bn EU/IMF rescue package in May, was well-received. Meanwhile, european banking sector concerns have eased somewhat over the last few sessions after EU-wide bank stress tests preliminary criteria were considered less onerous than initially feared. To add to EUR-positives, ECB President Trichet adopted a cautiously optimistic tone at the post-meeting press conference last week, saying that the Eurozone's economy is expected to grow at a moderate pace in an environment of high uncertainty and confirmed that the central bank will continue to support banks with unlimited liquidity provision. In addition, Mr. Trichet appeared relaxed about the recent slight rise in monetary market rates noting that this development is largely a consequence of commercial banks' own decision to reduce their liquidity demand from the ECB after the expiry of the 1-yr tender in late June (€442bn). In the meantime, expectations for another solid quarter of US corporate results are on the rise. The earnings season officially started on Monday with Alcoa Inc, the largest US aluminum producer, which posted surprisingly strong results and lifted its outlook for global consumption for metal. According to Thomson Reuters data, expectations are for a 27% Q2 earnings increase compared to the same period a year earlier, up from a +22.4%yoy consensus at the beginning of the year. Against this environment, market focus gradually shifted over the last few weeks away from the EMU sovereign credit pressures to the US growth outlook where worries over the sustainability of the economic recovery are on the rise following the expiration of the federal home buyer tax credits and the fading effect from the inventory adjustment.

The above developments helped the common currency stage a short-covering rally over the last few sessions with the **EUR/USD** hitting a fresh two-month high near 1.2740 in early N.Y trade on Tuesday. The FX market reaction to the bigger-than-expected July decline in Germany's ZEW investor sentiment index and news that Moody's downgraded Portugal's sovereign credit rating by two notches to A1, was rather muted.

With investors remaining concerned about the sustainability of the US' economic recovery, the EUR/USD is likely to remain supported in the coming sessions provided that upcoming corporate earnings results do not deliver negative surprises. But with euro area fiscal problems persisting, any further potential EUR upside is likely to prove short-lived especially if the euro area debt crisis deepens or stress-tests results reinforce concerns about the state of the banking sector. Technically, a clear move above recent highs has the potential to open the way for more appreciation towards 1.2940 (100-day MA) or even higher. On the downside, strong support stands at 1.2480 (July 6 low) in the way to 1.2455 (55-day MA).

Switzerland's inflation data surprised to the downside in June with the headline CPI unexpectedly falling by 0.4%mom and taking the annual rate down to 0.5% from 1.1% in the prior month. Resurfaced deflation fears - one of the reasons the SNB had favored a weaker franc- coincided with comments from SNB Chairman Philip Hildebrand that the central bank is watching FX movements closely. The above developments revived intervention fears given the Swiss franc's sharp appreciation since the latest policy meeting on June 17 when the central bank admitted in the accompanying statement that deflation risks have "largely disappeared" and did not repeat that it would "act decisively to prevent an excessive appreciation of the franc". But with the Swiss economic recovery remaining on track, the risk of deflation is considered to be low provided that the euro area fiscal crisis does not intensify further. Swiss retail sales surprised to the upside rising by 3.8%yoy in May vs. +1.8%yoy expected from April's 1.3%yoy. Moreover, after peaking at 4.0% early this year, the unemployment rate remained in a downward trend in June for the fifth month in a row to slip to 3.7% as labor market conditions continue to improve. Against this environment, the risk for an imminent SNB intervention seems limited.

The EUR/CHF reacted to the SNB's June policy statement with a sharp downturn. The currency pair was trading close to 1.3334/40 in European trade on Tuesday, not very far from 1.3070 all-time lows recorded earlier this month after reaching levels near 1.4000 just a few weeks earlier. With investors awaiting european bank stress test results and more clues about Switzerland's inflation outlook, there seems scope for consolidation within 1.3250-1.3430 in the coming sessions But on a multi-week basis, the CHF is likely to continue strengthening slowly against the EUR as the Swiss economy is expected to keep on performing better than the Eurozone and the SNB is likely to embark on a tightening cycle well ahead of the ECB.

In spite of the UK coalition government's firm stance to address the country's fiscal problem following the publication of an emergency budget in mid-June that aims reducing the budget deficit from 12%-of-GDP in 2009 to 2.1%-of-GDP by 2014, sovereign credit rating concerns linger. S&P affirmed this week the UK's AAA long-term debt rating but kept a negative outlook saying that the country's economic outlook is more pessimistic than underlined in last month's emergency budget while the net general government debt may approach a level "incompatible" with the triple-A rating. Meanwhile, in an environment of persistingly high unemployment and subdued wage growth, concerns that fiscal tightening runs the risk of pushing the economy back into the recession, are on the rise. The chief economist of the UK's Chambers of Commerce warned recently that the economic recovery is unlikely to be sustained and the Q1 GDP report showed that the economy remains heavily reliant to government spending. Meanwhile, Q1 current account deficit widened to its highest level since Q3 2007 while, according to May's RICS survey, the housing market is deteriorating sharply.

Against this environment, the GBP's upward trend against the USD witnessed over the last few weeks stalled. Market optimism that the UK emergency budget is tough enough to address the country's fiscal problem faded while UK growth and sovereign credit concerns came to the fore. After falling to multi-session lows near 1.4950 early on Tuesday, the GBP/USD was standing close to 1.5080/85 at the time of writing gaining some support from an unexpected increase in June's core CPI. Despite its latest upside attempt, the pair remained below a two-month high of 1.5250 recorded late last week.

With investors remaining particularly concerned about the UK's growth prospects, upcoming macro data are likely to prove highly significant for the GBP's short-term FX direction. Technically, a sustainable move below 1.4950 recent lows could open the way for a retest/downward break of 1.4870 (July 1) while on the upside, strong resistance lies at 1.5250 in the way to 1.5390 (April 30 high).

	Spot as of June 15, 2010 GMT 14:00GMT	Consens 1-mth*	Consens. 6-mth*	Consens. 12-mth*
EUR / USD	1.2599	1.2400	1.1800	1.1800
USD / JPY	88.46	89.00	95.00	98.00
EUR / JPY	111.41	110.1	111.4	115.2
GBP / USD	1.5109	1.500	1.455	1.490
EUR / GBP	0.8338	0.827	0.822	0.800
AUD / USD	0.8779	0.850	0.870	0.880
NZD / USD	0.7138	0.690	0.700	0.710
USD / CAD	1.0304	1.050	1.030	1.020
EUR / CHF	1.3328	1.337	1.332	1.350

*** Reuters July 2010 FX Polls**

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