Friday, July 2, 2010

Brief summary of key market developments

HIGHLIGHTS

- The **USD** remained under pressure in early trade on Friday following a bulk of disappointing macro data y-day. Market anxiety ahead of the key **US employment report** for the month of June, also weighed. Expectations are for a 110k drop in non-farm payrolls following a 431k increase in the prior month while the unemployment rate is seen rising to 9.8% from May's 9.7%.
- **US Treasuries** remained supported earlier today on mounting worries over the pace of the country's economic recovery. Long-dated Treasuries outperformed with the **2/10-year UST yield spread** narrowing to its lowest intraday level since mid-May 2009.
- **Greece:** The **European Investment Bank** announced that it lend €2bn to Greece, its biggest-ever loan, to fund nearly half its €4bn share required for the launch of projects in transport, waste management, renewable energy and other areas with the overall projects worth €21.5bn. The rest of the money will come from the European Union and other sources. The loan is for a period of 25 years with 7 years grace period. The interest rate will be fixed or variable between 2% to 4% and the funds will be drawn in three tranches.
- **Turkey's** Finance Minister Mehmet Simsek said on Thursday that the government's 3.5% GDP growth forecast for 2010 will likely be revised upward. Perhaps mirroring the impact of the sovereign debt crisis in the country's major trade partners, June's PMI manufacturing slid to 53.2 from 56.5 a month earlier.
- At its June inflation report **Poland's** central bank revised its GDP growth projections for 2010, 2011 and 2012 higher, to 3.2%, 4.6% and 3.7% respectively, from 3.1%, 2.9% and 3.1% forecasted in the previous in February. In tandem with a higher pace of recovery in the domestic economy, the NBP also revised upwards its inflation projections to 2.5%, 2.7% and 2.9%, respectively, from 1.8%, 2.4% and 3.5% previously.
- Poland's PMI manufacturing rose to a 34-month high of 53.31 in June from 52.23 in May amid accelerating growth in new order. But, **Hungary's** PMI manufacturing index inched down to 49.5 in June from 49.6 a month earlier, driven primarily lower by declines in output volume and product stocks.
- **CEE stock markets and currencies broadly firmed** in morning trade on Friday. Focus this weekend is on Sunday's Presidential elections.

Equity markets

US equity markets fell overnight for the fourth session in a row as a bulk of weak macro data reinforced concerns that the country's economic recovery is stalling. The **Dow Jones industrial average index** dropped by 0.42% to 9,732.53, the **Standard & Poor's 500 Index** shed 0.32% to 1,027.38 and the **Nasdaq Composite Index** lost 0.37% to 2,101.36. Elsewhere, **Asian bourses** were barely changed today with the market sentiment remaining fragile ahead of today's key US employment report for the month of June. Expectations are for a 110k drop in non-farm payrolls, the first contraction this year, following a 431k increase in the prior month as thousands of temporary jobs for census workers ended. The unemployment rate is seen rising to 9.8% from May's 9.7%. The **MSCI index of Asia-Pacific shares outside Japan** ended flat after rising by as much as 1.0% in early trade while **Japan's Nikkei 225 average index** gained just 0.13%. Meanwhile, **European stock markets** were recording modest gains in early trade with miners being in focus following news that the Australian government ended a dispute with global miners by a watering-down version of its "super profits" tax. The **FTSEurofirst 300 index** was standing 0.54% higher at the time of writing after hitting a five-week closing low of 969.21 on Thursday on intensified worries over the momentum of the global economic recovery.

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FX markets

EUR short-covering ahead of the key US employment report, helped the common currency retained a firm tone against the **USD** early today. The pair was hovering around 1.2521/25 at the time of writing, within distance from a five-week high of 1.2540 touched y-day. Spain's well received €3.5bn auction of a 5-yr notes y-day after Moody's put the country's Aaa sovereign credit rating under review earlier this week, also favored the EUR. To add to EUR-positives, a Reuters report quoted unnamed sources as saying that all the German banks had fared well under the stress tests being carried out. Meanwhile, the ECB lent a higher-than-expected €111.2bn in its 6-day operation y-day, adding to the €131.9bn in the 3-month operation conducted a day earlier. A weaker-than-expected US employment report could weigh further on the USD with the technical picture suggesting that near-term resistance for the EUR/USD stands at its 55-day moving average around 1.2550 ahead of 1.2570, a 38.2% retracement of its decline from 1.3692 in April to 1.1876 in early June**.** Elsewhere, the **USD/JPY** was trading close to the 88.00 level in early European trade, having recovered some ground from a seven-month low 86.95 touched on Thursday ahead of the long Independence Day weekend in the US. Against this background, **the dollar index DXY** was hovering around 84.649 in early European trade, not far from y-day's two-month lows of 84.423 while the technical picture suggests that a sustainable break below 84.65 could open the way for further weakness ahead.

Government bond markets

U.S. Treasuries retained a firm tone today supported by mounting concerns about the country's growth outlook following a string of disappointing macro data y-day. Long-dated US Treasuries outperformed with the 10-yr benchmark yielding levels around 2.93% at the time of writing, not far from a fresh 14-month intraday low of 2.88% touched at a point on Thursday. The **2/10-year UST yield spread** was standing close to 230.5bps at the time of writing, its narrowest level since mid-May 2009 and some 2bps lower relative to y-day's close. Taking their cue from US Treasuries, **German government bonds** remained supported in early European trade on market anxiety ahead of today's US employment report. Short-dated notes outperformed with the **2/10-year Bund yield spread** widening to levels near 191bps at the time of writing after closing at 188.9bps on Thursday, its lowest level since early December 2009. In other news, the **European Investment Bank** announced that it lend €2bn to Greece, its biggest-ever loan, to fund nearly half its €4bn share required for the launch of projects in transport, waste management, renewable energy and other areas with the overall projects worth €21.5bn. The rest of the money will come from the European Union and other sources. The loan is for a period of 25 years with 7 years grace period. The interest rate will be fixed or variable between 2% to 4% and the funds will be drawn in three tranches. On the macro front, **Greece's PMI-manufacturing index** rose to 42.2 in June from a 13-mmonth low of 41.8 in the prior month. However, the breakdown of the report showed that incoming new business fell for the 10th straight month, output dropped at the sharpest pace in 14 months and employment fell at the fastest rate in 15 months, adding to worries over the country's growth outlook. Meanwhile, the **10-yr Greek/German bond yield spread** was hovering around 770bps at the time of writing, barely changed from Thursday's settlement.

News & Macro data releases

ISM-manufacturing index dropped in June for the second consecutive month to a lower-than-expected 56.2, the lowest level in seven months, vs. May's 59.7 and 59.0 expected remaining though above the 50.0 boom-or-bust level for the 11th month in a row. The breakdown of the report was as gloomy as the headline showing that **new orders** slipped at 58.5, the lowest level since October 2009, from 65.7 in May while **employment** eased to 57.8 vs. May's 59.8.

US jobless claims unexpectedly rose by 13k in the week ended June 26 to 472k from an upwardly revised 457k against market consensus for a drop to 452k. The **4-wk moving average** rose to 466,500, the highest level since early March, from 463,250 while **continued claims** rose to 4.616mn vs. 4.573mn in the prior week confounding expectations for a drop to 4.540mn. The **insured unemployment rate**, the percentage of U.S. workers that gets jobless benefits, was unchanged for the third week in a row at 3.6%.

The National Association of Realtors monthly index of pending home sales, which leads existing home sales by one to two months, halted a three-month rising streak to drop by a record 30.0%mom in May, vs. -12.5%mom expected to 77.6, the lowest-ever, from 110.9 in April mainly due to the expiry at the end of the prior month of the popular government tax credit for home buyers.

US construction spending fell by 0.2%mom in May, less than -0.8%mom expected following an upwardly revised gain of 2.7%mom in the prior month.

G10 Event Risk Calendar this week

Monday, June 28: German June's CPI (first state results), Eurozone May's CPI (final), Eurozone May's retail sales, Eurozone May's M3 money supply, US May's personal income & personal spending, Japan's retail sales for May, Fed's Warsh (voter) speaks

Tuesday, June 28: Japan's industrial production for May, France's INSEE business survey for June, Eurozone June's economic sentiment indicator, UK mortgage applications & net consumer credit for May, UK Gfk consumer confidence for June, US Case-Shiller April's house price index, CB consumer confidence for June, Japan's household spending & unemployment rate & industrial production for May

Wednesday, June 30: German June's unemployment, Switzerland's KoF leading indicator for June, Eurozone June's CPI (preliminary), UK Q1 GDP (final), US ADP employment report or June, US June's Chicago PMI, Japan's PMI-manufacturing for June, ECB's 3-m unlimited tender, German Presidential elections, Fed's Evans (non-voter) speaks

Thursday, July 1: Japan's Q2 Tankan survey, China's PMI-manufacturing for June, Eurozone PMI-manufacturing for June (final), UK BoE credit conditions survey for Q2, UK PMI-manufacturing, US initial jobless claims, US ISM-manufacturing for June, US May's pending home sales, US May's construction spending

Friday, July 2: Eurozone's PPI & unemployment rate for May, US non-farm payrolls & unemployment rate for June, US May's factory orders

Emerging Markets

Turkey's Finance Minister Mehmet Simsek said on Thursday that the government's 3.5% GDP growth forecast for 2010 will likely be revised upward. However, Simsek noted that concerns remain over the impact of the sovereign debt crisis in the euro area on the Turkish economy. His comments follow upbeat GDP data for Q1 released earlier in the week, which revealed that the domestic economy expanded by 11.7%yoy, adding to the view that Turkey will lead the recovery in the CEE region. The OECD and the IMF currently predict GDP growth in the excess of 6%yoy for this year. Separately, perhaps mirroring the impact of the sovereign debt crisis in the country's major trade partners, June's PMI manufacturing slid to 53.2 from 56.5 a month earlier. Albeit still pointing to a solid expansion of the sector, with May's data standing at a record peak and marking the 13th consecutive month of expansion, June's figures showed that the rise in new orders and output growth were weaker compared to a month earlier.

At its June inflation report **Poland's** central bank revised its GDP growth projections for 2010, 2011 and 2012 higher, to 3.2%, 4.6% and 3.7% respectively, from 3.1%, 2.9% and 3.1% forecasted in the previous report in February. In 2009 the domestic economy registered growth of 1.8%, being the only in Europe to have avoided recession. Although the bank expects consumption to remain at relatively low levels in the forecasting period, it anticipates that the rebound will be primarily led by strong growth in investment, particularly next year, ahead of the 2012 European football championships which Poland co-hosts with Ukraine. In tandem with a higher pace of recovery in the domestic economy, the NBP also revised upwards its inflation projections to 2.5%, 2.7% and 2.9%, respectively, from 1.8%, 2.4% and 3.5% previously. In other news, Poland's PMI manufacturing rose to a 34-month high of 53.31 in June from 52.23 in May, confounding expectations for a slide to 52.0 and showing ongoing expansion in the sector. The index was driven higher by accelerating growth in new orders which registered the fastest rate since December 2005. On the other hand, **Hungary's** PMI manufacturing inched down to 49.5 in June from 49.6 a month earlier, driven primarily lower by declines in output volume and product stocks.

CEE equity markets broadly reversed course in early trade on Friday to swing back into positive territory trailing major European bourses higher. Romania's main stock index **BETI** led the winners' pack posting gains to the tune of nearly 2% in morning trade. Meanwhile, **CEE currencies** also firmed in early trade today with Romania's leu extending its rebound from record lows touched against the euro earlier this week amid growing concerns about the country's fiscal outlook and progress of the IMF-led financial aid package. In detail, the **EUR/RON** slid to 4.3000 multi-session lows earlier today recoiling from a lifetime high of 4.4023 touched on Tuesday in the wake of a Constitutional Court decision to rule against some of the government's fiscal austerity measures. Elsewhere, the Serbian dinar slightly firmed but remained close to record lows hit recently against the common currency earlier this week. The **EUR/RSD** eased as far as 103.65 lows today but stood not far off an all time high of 104.81 achieved on Wednesday.

Focus this weekend is on Sunday's presidential election run off in **Poland**. In the first round of the polls, speaker of parliament and acting President, Bronislaw Komorowski, won 41.5% of the vote, while former Prime Minister and twin brother of the deceased President, Jaroslaw Kaczynski, followed with a share of 36.5%. The most recent opinion survey indicates that the two candidates will be running neck and neck on Sunday's elections. According to a survey on Thursday conducted by GFK Polonia's pollster, both candidates are seen collecting 45% each, while 10% of the individuals participating in the survey were undecided and GFK said that the odds point towards a Kaczynski win. Nevertheless, according to other opinion polls Komorowski leads the race. His win is broadly perceived as positive for financial markets. He a member of the ruling PO party and is expected to cooperate efficiently with the government on the adoption of the euro and on fiscal policies aimed at curbing the country's budget deficit at the EU ceiling over the coming years, in contrast with his predecessor who had in the past blocked reforms backed by the government.

CEE Event Risk Calendar this week

Monday, June 28: Constitution day – markets closed (Ukraine), government bond auction with due in 2020 planned for BGN 45mn (Bulgaria)

Tuesday, June 29: May unemployment rate, Parliament expected to elect government candidate Pal Schmitt as President to replace incumbent Laszlo Solyom (Hungary)

Wednesday, June 30: MPC rate announcement (Poland), Q1 current account, May PPI (Hungary), Q1 GDP, May trade balance (Turkey), May PPI, May budget balance (Bulgaria), Q1 GDP (Ukraine), MPC rate announcement, potential resumption of IMF discussions over EUR 20bn Stand –By Arrangement (Romania), government to decide on economic plans announced earlier this month (Hungary), Q1 GDP, Jun CPI , May industrial output , May trade balance (Serbia)

Thursday, July 1: Jun PMI (Hungary, Poland, Turkey), Jun FX reserves (Romania), Chamber of Commerce inflation data for Istanbul (Turkey), government bond auction worth HUF 50bn (Hungary)

Friday, July 2: Apr trade balance final (Hungary), May PPI (Romania)

Sunday, July 4: 2nd round of Presidential elections (Poland)

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