

Weekly Update

8 June 2009



Market Intelligence Straight to your Business

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LOOK AT THINGS DIFFERENTLY

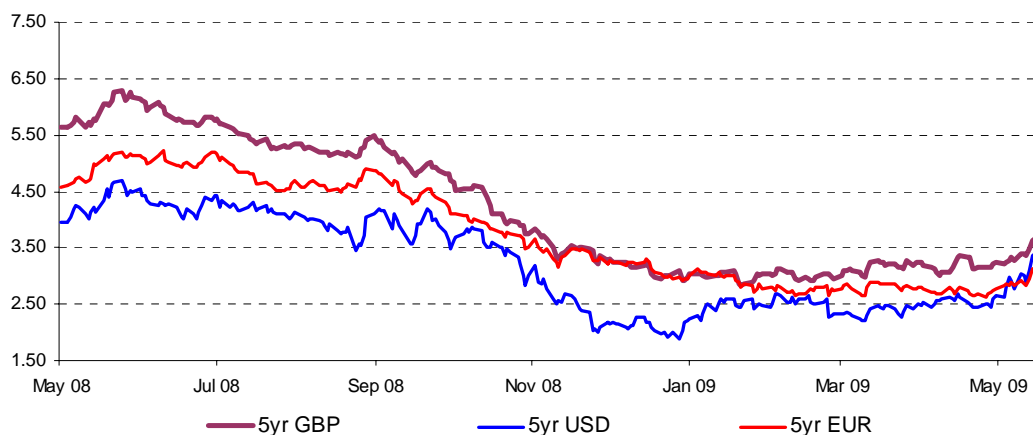
 **BANK OF SCOTLAND**
TREASURY

Indicative Swap Rates

	£		€		\$	
	Today	1 week ago	Today	1 week ago	Today	1 week ago
OFFICIAL RATE	0.50%	0.50%	1.00%	1.00%	0.25%	0.25%
3 MONTH LIBOR	1.26%	1.28%	1.27%	1.27%	0.63%	0.66%
6 MONTH LIBOR	1.47%	1.49%	1.48%	1.48%	1.20%	1.24%
12 MONTH LIBOR	1.74%	1.76%	1.65%	1.64%	1.60%	1.60%
2 YEAR	2.40%	2.02%	2.09%	1.78%	1.88%	1.43%
3 YEAR	3.06%	2.64%	2.54%	2.22%	2.53%	2.08%
5 YEAR	3.72%	3.39%	3.14%	2.92%	3.44%	3.04%
7 YEAR	4.01%	3.74%	3.52%	3.37%	3.92%	3.57%
10 YEAR	4.24%	4.05%	3.85%	3.78%	4.28%	4.00%
20 YEAR	4.44%	4.32%	4.22%	4.24%	4.56%	4.35%
30 YEAR	4.22%	4.16%	4.05%	4.08%	4.55%	4.38%

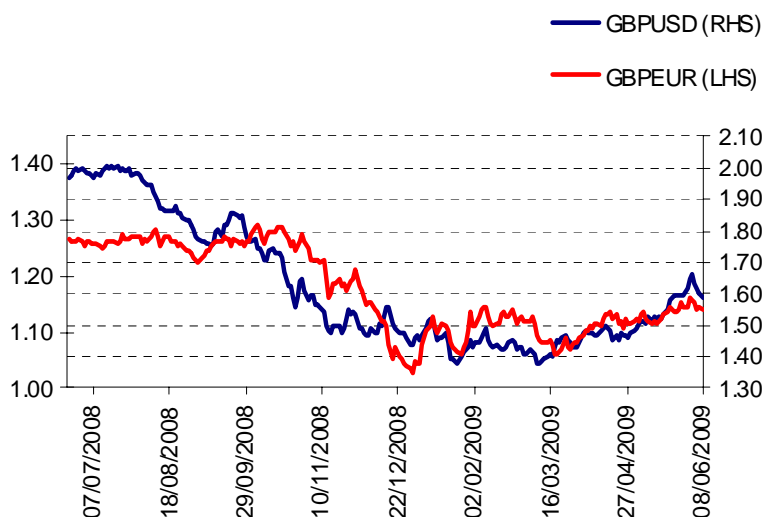
Rate quotes taken from the inter-bank mid-market.

Swap rate quote conventions - UK: Semi, Actual/365 vs. 6M Libor Euro: Annually, 30/360 vs. 6M Libor US: Annually, Actual/360 vs. 3M Libor



Market Levels

	Today	1 week ago
GBP/USD	1.5833	1.6443
GBP/EUR	1.1397	1.1615
EUR/USD	1.3893	1.4159
GBP/JPY	156.11	158.81
FTSE 100	4397.8	4506.2
Euro Stoxx 50	2471.4	2537.4
*S&P 500	940.1	919.1
**Nikkei 225	9865.6	9677.8
Gold (\$/oz)	950.4	975.3
Brent Crude (\$/barrel)	66.6	67.1
Gilt Future	117.3	118.0
T-Bond	129.8	131.0
Bund	117.8	118.3



* Friday's closing rate

** Monday's closing rate

Commentary

Economics & Interest Rates: The past week featured more upbeat economic data releases, at face value suggesting a gradual return of risk appetite. The US S&P500 rose by 2.4% during the week (FTSE Eurofirst 300: +1.2%, FTSE-100: +0.5% and Nikkei: +2.6%). The highlight was Friday's much smaller-than-expected drop in May US non-farm payrolls. Employment fell by 345k versus a consensus of -520k while the drop seen during March and April was revised lower - a net improvement of 82k over the two months combined. But various forward-looking business surveys also continued to improve. The UK services purchasing managers index was particularly notable in this regard, registering 51.7 in May - the first expansion in activity since April 2008.

Against this backdrop, there was significant sell-off in government bond and swap markets last week, especially in the 5- to 10-year area of the curve. US markets underperformed in the wake of the payrolls data, while swap spreads widened across the board. Taken alongside rising longer-term inflation expectations observed in break-even inflation rates, the sell-off in fixed income markets – for the moment at least - appears to be based on recovery hopes rather than concerns over the outlook for public finances / government debt. But as Fed Chairman Ben Bernanke noted last week, these two issues are hard to disentangle at the moment.

Meanwhile, sterling's exchange rate against the US dollar and euro has weakened following political tensions in the UK. Labour's poor showing in the recent local and European elections – along with perceptions of weakness by Gordon Brown in last week's Cabinet re-shuffle – has acted as a significant drag.

This week's economic data calendar is unlikely to resolve the issue of whether brighter economic data signal a *durable* recovery in the global economic conditions. For choice, we continue to feel that with credit supply and demand in the economy still fundamentally impaired and unemployment rising markedly, it remains premature to call a definitive economic recovery. An 'L'- (or even 'W'-shaped)

profile still looks on the cards. In the US, this week sees the release of retail sales data, where a positive month-on-month outturn is expected (total and ex-autos) following declines in April. Trade data are also published this week, with the deficit set to widen to around \$29bn from \$27.6bn previously. Elsewhere, we get UK April industrial production data on Wednesday with the Bank of England's latest Inflation Attitudes survey released on Thursday.

Currencies: Risk appetite continues to increase globally leaving equity and commodity markets close to highs for the year. The S&P500 briefly recorded a new cycle high on Friday, following the stronger-than-expected US non-farm payrolls report. The correlation between the FX carry trade and equities remains high, with AUD/JPY and NZD/JPY also close to their 2009 high. Stronger US data is now leading to a rise in interest rate expectations. The implied yield on the June 2010 euro-dollar futures contract rose by over 50bp on Friday and the 2yr-10yr yield curve has begun to flatten. The spread between 2-year euro and US interest rate swaps has fallen to an 18-month low, providing a broadly USD-positive environment.

US economic data are limited this week, with the focus largely on trade and retail sales. The trade report is a key risk for the USD, given the gradual rise in energy prices. A failure for trade to improve further would suggest a rise in the structural risk for the USD.

Whilst GBP/USD continues to drift lower (driven by broad USD strength – the GBP/USD 200-day moving average lies around \$1.54), EUR/GBP appears to have found strong resistance around £0.8870. The sharp failure at this level suggests that sterling weakness (due to UK political events) is now close to being fully discounted. Additionally, euro/UK interest rate spreads continue to drift lower, following the high recorded in late May 2009. This suggests that the risks for EUR/GBP now lie to the downside unless resistance up to £0.9040 is breached. In the UK, the key data risk for sterling is the latest BoE Inflation Attitudes survey.

Key Economic Releases This Week

Date	Time	Cntry	Release/Event	Period	Forecast	Consensus	Previous
9-June	00.01	UK	RICS House Price Balance	May	n/a	-52.0	-59.9
9-June	11.00	GER	Industrial Production	May	-0.3 (-20.6)	-0.3 (-20.6)	0.0 (-20.4)
10-June	09.30	UK	Industrial Production	Apr	-0.2 (-12.5)	-0.2 (-12.5)	-0.6 (-12.4)
10-June	13.30	US	Trade Balance	Apr	-\$29.0bn	-\$28.7bn	-\$27.6bn
11-June	09.30	UK	BoE Inflation Attitudes Survey	-	-	-	-
11-June	13.30	US	Retail Sales (Ex-Autos)	May	0.3	0.2	-0.5
12-June	10.00	EUR	Industrial Production	Apr	-0.7 (-20.0)	-0.5 (-19.8)	-2.0 (-20.2)
12-June	12.30	EUR	ECB's Trichet speaks	-	-	-	-
12-June	15.00	US	Univ. of Michigan Consumer Sent.	pJun	69.5	69.2	68.7

Annual rates shown in brackets. Consensus figures taken from Bloomberg poll

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