Weekly Update
18 May 2009

Market Intelligence Straight to your Business

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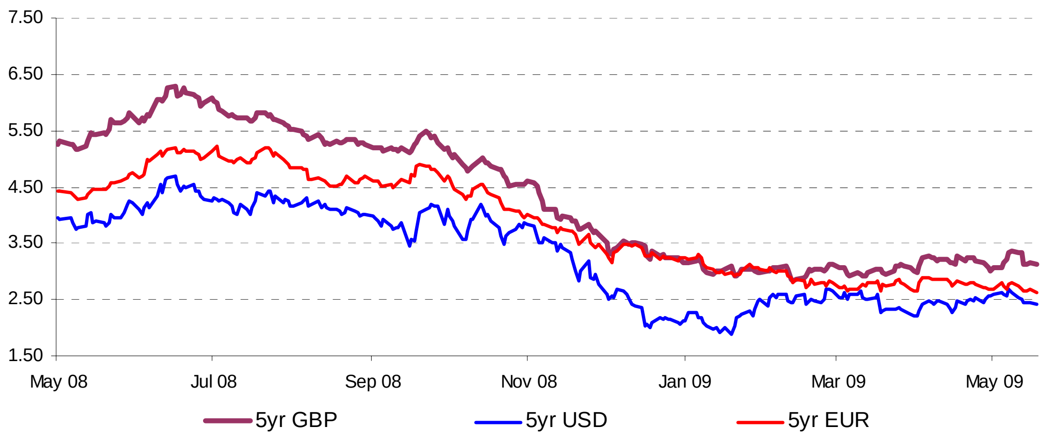
LOOK AT THINGS DIFFERENTLY

BANK OF SCOTLAND
TREASURY

Indicative Swap Rates

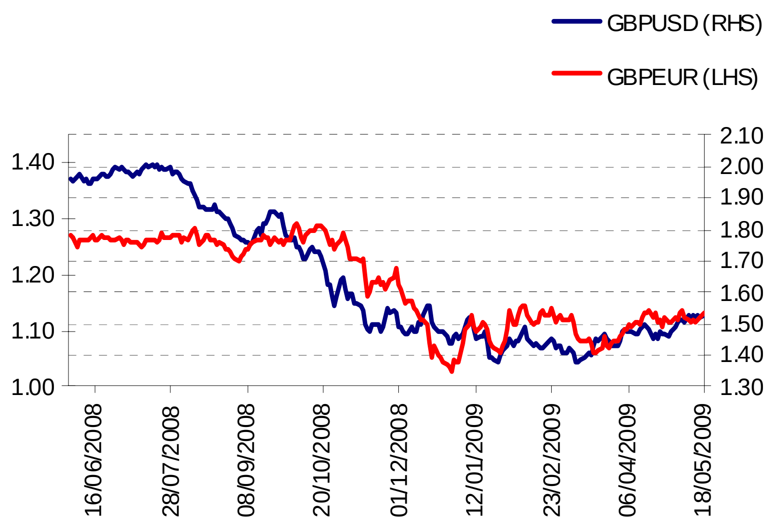
	£		€		$	
	Today	1 week ago	Today	1 week ago	Today	1 week ago
OFFICIAL RATE	0.50%	0.50%	1.00%	1.00%	0.25%	0.25%
3 MONTH LIBOR	1.36%	1.42%	1.25%	1.31%	0.83%	0.94%
6 MONTH LIBOR	1.57%	1.62%	1.45%	1.51%	1.36%	1.46%
12 MONTH LIBOR	1.84%	1.90%	1.62%	1.68%	1.66%	1.78%
2 YEAR	1.93%	2.14%	1.63%	1.74%	1.25%	1.37%
3 YEAR	2.46%	2.70%	2.02%	2.13%	1.73%	1.85%
5 YEAR	3.12%	3.33%	2.64%	2.73%	2.43%	2.54%
7 YEAR	3.47%	3.68%	3.09%	3.15%	2.84%	2.95%
10 YEAR	3.77%	3.99%	3.50%	3.53%	3.19%	3.30%
20 YEAR	4.10%	4.26%	4.00%	4.02%	3.60%	3.71%
30 YEAR	3.96%	4.06%	3.88%	3.88%	3.65%	3.76%

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	1.5249	1.5117
GBP/EUR	1.1326	1.1131
EUR/USD	1.3464	1.3583
GBP/JPY	146.03	147.38
FTSE 100	4359.6	4435.5
Euro Stoxx 50	2351.4	2433.6
*S&P 500	882.9	929.2
**Nikkei 225	9038.7	9452.0
Gold ($/oz)	930.1	913.3
Brent Crude ($/barrel)	55.9	56.6
Gilt Future	120.9	119.1
T-Bond	129.8	131.0
Bund	121.5	120.9



* Friday's closing rate
** Monday's closing rate

Commentary

Economics & Interest Rates:. Equity markets paused for breath last week after a series of disappointing economic data releases. The US S&P500 shed 5.1% over the past week (FTSE Eurofirst300: -2.5%, FTSE-100: -2.5% and Nikkei: -1.8%). Wednesday was a particularly poor day for stocks as market optimism subsided following weak US April retail sales (-0.4% m/m versus a consensus for a flat reading) and a relatively downbeat Bank of England Inflation Report.

The US sales data suggested a rather weak entry point into Q2 GDP, after the 6.1% annualised pace of contraction in Q1. Meanwhile, Bank of England Governor Mervyn King sounded a more cautious note on the prospects for economic recovery, with bank lending to households and firms potentially taking longer to normalise compared with the Bank's view back in February. This seems at odds with the tone of the Bank's own credit conditions survey, perhaps suggesting that Governor King is particularly sensitive at the moment about calling a bottom in the downturn.

Another key drag on risk assets last week came from softer-than-expected euro-zone preliminary Q1 GDP data, which registered a quarter-on-quarter contraction of 2.5% (consensus: -2.1%). Within this, Germany recorded its worst quarter-on-quarter performance since 1970 as activity declined by some 3.8%. In many ways, these releases serve as a reminder that the recent revival in risk appetite cannot yet be relied upon. Reflecting this, government bond and swap yields fell during the course of last week (broadly speaking, there was a narrowing in UK, US and euro-zone swap spreads in the 2-year to 10-year sector). Looking forward, we remain doubtful about the scope for significant and durable yield curve steepening over the short term.

This week sees a busy UK economic data calendar with April's CPI and retail sales figures taking centre stage. We look for a CPI outturn of 2.3% as household utility bill decreases start to impact with more force. The dominant trend in retail sales, meanwhile, remains difficult to pin down against a backdrop of better survey evidence (e.g. BRC and CBI Distributive Trades). We expect an outturn of +0.5% m/m, as weaker price pressures give (mild) support to households' purchasing power. However, risks to this forecast appear skewed to the downside. The second estimate of UK Q1 GDP is published on Friday, where last week's better-than-expected industrial production data tentatively hint at an upward revision from the "flash" estimate of -1.9% quarter-on-quarter. Elsewhere, this week sees May's German ZEW survey and preliminary euro area PMI reports, along with the US Philadelphia Fed survey, housing starts and the minutes from April's FOMC meeting.

Currencies: Risk sentiment remains the dominant driver of FX. A small rise in risk aversion last week led to USD and JPY outperformance. The worst performers were emerging market and commodity-linked currencies. For now EUR/USD appears to be finding support around its 200-day moving average ($1.3412). Across financial markets, the US S&P500 has been in a consolidation formation. The key support is 877, the break out level. A move below this would signal a significant rise in risk aversion.

Hence the data focus this week lies around leading indicators (German ZEW, euro PMI and Philadelphia Fed manufacturing surveys). A rise in these indicators (which we favour) is now needed to support the broader growth rally. A failure would leave currencies range-bound, leaving EUR/USD and GBP/USD targeting $1.3170 and $1.49 respectively.

EUR/GBP continues on its downward trend, despite the sharp rally in short-sterling (triggered by the Bank of England's Inflation Report). This indicates the scale of concerns over euro-zone growth, as highlighted by weak Q1 GDP data. Hence bouts of risk aversion are now negative for EUR/GBP - this is a reversal from last year when banking sector woes left GBP underperforming in periods of high risk aversion. As such, we expect further downside for the currency pair.

Key Economic Releases This Week

Date	Time	Cntry	Release/Event	Period	Forecast	Consensus	Previous
19-May	**09.30**	**UK**	**CPI**	**Apr**	**0.3 (2.3)**	**0.4 (2.4)**	**0.2 (2.9)**
19-May	**10.00**	**GER**	**ZEW Economic Sentiment**	**May**	**18.0**	**20.0**	**13.0**
19-May	**13.30**	**US**	**Housing Starts**	**Apr**	**515k**	**530k**	**510k**
20-May	**09.30**	**UK**	**Minutes 7 May MPC meeting**	**May**	**-**	**-**	**-**
20-May	**19.00**	**US**	**Minutes of 28-29 April FOMC mtg.**	**Apr**	**-**	**-**	**-**
21-May	**09.30**	**UK**	**Retail Sales**	**Apr**	**0.5 (2.5)**	**0.5 (2.5)**	**0.3 (1.5)**
21-May	**15.00**	**US**	**Philadelphia Fed Survey**	**May**	**-26.0**	**-18.0**	**-24.4**
22-May	**09.30**	**UK**	**GDP – 2nd Estimate**	**Q1**	**-1.9 (-4.1)**	**-1.9 (-4.1)**	**-1.9 (-4.1)**
22-May	**19.00**	**US**	**Fed Chairman Bernanke speaks**	**-**	**-**	**-**	**-**

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

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