

Weekly Bulletin – 6th February 2012

Last week saw UK rates firm slightly in the face of that rarest of things – a run of encouraging economic statistics. On the domestic front the GFK consumer confidence index improved from -33 to -29, which was a considerable improvement on the median forecast. However, it was the PMI surveys that really surprised the markets with the manufacturing index rising into positive territory for the first time since June last year with a reading of 52.1. The much more important service sector index also rose with a reading of 56.0, this is its highest level since March last year and was in contrast to the reduction to the 53.3 level that had been the median forecast.

It would have been too much to expect uninterrupted good news and the construction PMI duly obliged with an unexpectedly large fall to 51.4. However, this still remains in positive territory and the forecasters have been busy recalculating their forecasts for GDP growth for the 1st quarter. While it would be most unwise to get over excited at this stage, the current readings would point to a big rebound from the initial estimate of -0.2% for the last quarter of last year. The current figures, if maintained, would equate to a rise in GDP of about 0.7% in the 1st quarter. If the news in the UK was very positive, it was replicated in the US where the non-farm payroll figures, announced on Friday, showed a much larger increase in employment than had been expected with the rise of 243,000 being about 100,000 higher than the median forecast. Unemployment, which had been expected to remain unchanged, fell to 8.3% from 8.5%.

All of the above has made the MPC meeting on Thursday much more interesting. There had been a general expectancy that the MPC would ordain another round of QE, but some are questioning whether there will now be a sufficient majority of the committee that will be able to push this through. Those who had thought that another round of QE was likely are now paring down their expectation of the programme to be a maximum of £50 billion from £75 billion. There are those on the committee, like Spencer Dale, who are thought not to really approve of QE in principle and are hardly likely to be enthusiastic about another round in the light of these latest figures and especially if they fall into the camp that does not think that CPI inflation is likely to fall much below its 2% target and then not for very long. Other members, Adam Posen in particular, are avid supporters of QE and his comments over the past week have been strongly supportive of another round being approved at this week's meeting.

We suspect that the majority of the MPC stood ready to authorise another round of QE and would doubt if last week's better than expected news will do much to deter them. However, it would now be a surprise if the quantum was as much as £75 billion. Perhaps more interesting will

be the maturity profile of the future purchases as well as any hints on whether the QE process, if maintained further into the future, will continue to be restricted to just gilts.

As gilt yields at the shorter end of the market have fallen to negligible levels and are 0.50% or more lower than swap rates, we would expect the MPC to stay away from this maturity band. Even out at the 10 year maturity point, gilt yields are 0.30% higher than swaps and we would expect the MPC to look to make purchases for maturities in excess of 10 years at which point the gilt/swap spread narrows very considerably. Adam Posen, and many outside commentators, believe that the MPC should be rather more imaginative in its QE operations and, in particular, start purchasing assets other than gilts. This would help to push liquidity in to the market more directly and would avoid the necessity to purchase longer term maturities, which just goes to ensure that annuity rates are reduced from their already pitifully low levels in comparison with inflation. Adam Posen clearly does not believe that any change in policy is likely on this occasion, but it would be interesting to hear the objections of moving QE purchases on to other low risk assets such as bonds funding residential mortgages.

The ECB also meets on Thursday to decide on any change to monetary policy. Until recently, another cut in the EUR refi rate had been regarded as a near certainty, but reading ECB actions has rather been thrown out of kilter by their decision last month to lend 3 year money at 1.00%, a rather more generous form of QE than the MPC's. It is also one that has had a very beneficial impact on liquidity in the EUR market and a further dose of this exercise is expected in the near future. Given this change of policy, it has rather left the issue of the appropriate level for short term rates on hold and most commentators are now expecting the ECB to take no further interest rate action at their meeting. The thoughts expressed by Mario Draghi at the post meeting conference are, however, eagerly awaited.

Apart from the MPC meeting, the UK sees little in the way of other influential economic information being released this week although Thursday's manufacturing/industrial production figures should show a return to a growth position and the producer price indices, on Friday, should show that inflationary pressures are continuing to fall sharply.

JCD Rathbone

Market Expectations

Date	Location	Title	Forecast	Previous Actual
06.02.12				
	EA	February sentix investor confidence	-14.5	-21.1
09.02.12				
	UK	December trade balance goods and services	-£2700mn	-£2566mn
		December industrial production m/m	+0.2%	-0.7%
		December industrial production y/y	-3.1%	-3.1%
		December manufacturing production m/m	+0.2%	-0.2%
		December manufacturing production y/y	+0.3%	-0.6%
		December trade balance total	-£8600mn	-£8644mn
		December trade balance non-EU	-£5000mn	-£5021mn
		BoE Meeting		
	EA	ECB Meeting		
	US	February initial jobless claims	370k	367k
		December wholesale inventories	+0.5%	+0.10%
10.02.12				
	UK	January PPI input m/m	+0.2%	-0.6%
		January PPI output m/m	+0.1%	-0.2%
		January PPI input y/y	+6.8%	+8.7%
		January PPI output y/y	+3.7%	+4.8%
		January PPI core output m/m	0%	-0.1%
		January PPI core output y/y	+2.3%	+3.0%
	US	December trade balance	-\$48.5bn	-\$47.8bn
		February University of Michigan confidence	+74.0	+75.0

STERLING INTEREST RATES			
	31.12.11	30.01.12	06.02.12
1mth LIBOR	0.77	0.77	0.76
2mth LIBOR	0.88	0.88	0.88
3mth LIBOR	1.08	1.08	1.08
6mth LIBOR	1.38	1.39	1.39
12mth LIBOR	1.87	1.89	1.89
Interest Rates Swaps Quarterly ACT/365			
2 years	1.09	0.96	1.00
3 years	1.14	1.00	1.08
5 years	1.34	1.26	1.40
7 years	1.64	1.62	1.78
10 years	2.09	2.10	2.27
15 years	2.50	2.54	2.72
20 years	2.72	2.75	2.92
30 years	2.91	2.89	3.05

EURO INTEREST RATES			
	31.12.11	30.01.12	06.02.12
1mth EURO	1.08	0.72	0.67
2mth EURO	1.18	0.93	0.89
3mth EURO	1.39	1.13	1.09
6mth EURO	1.64	1.43	1.39
12mth EURO	1.95	1.76	1.73
Interest Rates Swaps Quarterly ACT/360			
2 years	1.06	0.90	0.85
3 years	1.17	1.00	0.96
5 years	1.56	1.40	1.36
7 years	1.92	1.77	1.76
10 years	2.25	2.14	2.16
15 years	2.54	2.48	2.51
20 years	2.58	2.53	2.56
30 years	2.46	2.44	2.47

DOLLAR INTEREST RATES			
	31.12.11	30.01.12	06.02.12
1mth	0.30	0.27	0.26
2mth	0.43	0.40	0.38
3mth	0.58	0.55	0.52
6mth	0.81	0.79	0.77
12mth	1.13	1.10	1.08
Interest Rates Swaps Quarterly ACT/360			
2 years	0.76	0.55	0.52
3 years	0.87	0.63	0.62
5 years	1.28	1.03	1.06
7 years	1.67	1.49	1.54
10 years	2.05	1.96	2.03
15 years	2.39	2.39	2.47
20 years	2.50	2.55	2.65
30 years	2.59	2.69	2.79

PROPERTY DERIVATIVES			
INDEX	TERM (years)	BID	OFFER
		FIXED RATES	
TOTAL RETURN	Dec 11	7.25%	8.25%
	Dec 12	3.40%	4.40%
	Dec 13	3.10%	4.10%
	Dec 14	2.96%	3.96%
	Dec 15	2.87%	3.87%

STERLING RPI	31.12.11	30.01.12	06.02.12
UK ZERO COUPON SWAPS			
5 year	2.96	2.95	2.96
10 years	3.22	3.16	3.19
15 years	3.38	3.28	3.31
20 years	3.50	3.36	3.39
25 years	3.53	3.38	3.42
30 years	3.59	3.43	3.48
Base Index	238.0	238.5	239.4

EURO HICPXT	31.12.11	30.01.12	06.02.12
EURO ZERO COUPON SWAPS			
5 year	2.05	2.06	1.97
10 years	2.25	2.33	2.30
15 years	2.36	2.48	2.47
20 years	2.43	2.54	2.52
25 years	2.49	2.55	2.53
30 years	2.56	2.61	2.59
Base Index	113.08	113.44	113.54

FOREIGN EXCHANGE RATES			
	31.12.11	30.01.12	06.02.12
£/US\$	1.5410	1.5675	1.5777
£/€	1.1927	1.1944	1.2077
€/£	0.8381	0.8373	0.82811
€/US\$	1.2915	1.3124	1.3065
US\$/YEN	77.56	76.68	76.64

All rates taken are based on offered side opening levels on the date of this bulletin.

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