

Weekly Bulletin – 14th March 2011

Economic concerns seem very irrelevant at the start of this week having watched the human tragedy of horrific proportions that has hit Japan following the earthquake and resultant tsunami. The extraordinary images that were broadcast across our television screens over the weekend have now been compounded by the sight of exploding nuclear power stations and the fears of radiation spreading out from the immediate area. The Japanese economy is hardly in the best position to deal with the disaster although it is assumed that the problems that the government were having in passing the budget will now not just be overcome, but that a supplementary budget will be put into place to fund the regeneration of the devastated areas.

In trying to assess the likely outcome of the current disaster, most commentators have assumed that the markets will follow a similar pattern to that following the Kobe earthquake in 1995. On that occasion the JPY appreciated by about 20% against the USD as overseas assets were sold and the funds repatriated to fund the regeneration of the areas. Insurance claims will also boost the currency with some early predictions showing that insurers are at risk for anything up to USD35 billion.

Even with a major inflow of currency from overseas, it would seem unlikely that an appreciation of this order is likely on this occasion. The JPY was already regarded as being considerably over valued against the USD, thus putting pressure on Japanese manufacturers, and the Bank of Japan is likely to intervene heavily if it felt that the overvaluation was likely to increase yet further. Similarly, the Japanese equity market fell by about 25% following the Kobe earthquake and while the Japanese equity market shed some 7% of its value this morning, there seems reasonable confidence that the fall may be contained at around these levels given that the key high technology companies are not based in the worst affected areas.

The 1995 disaster also generated a reduction in interest rates, a result that will not be repeated on this occasion as official Japanese rates are already at 0%. Indeed, the Japanese authorities are in the middle of a QE asset purchasing programme of some Y5,000 billion and this is expected to almost double in order to support the rebuilding programme. The Kobe disaster resulted in a Y3,000 billion reconstruction cost.

The Japanese, however, are not in as strong a position as they were in 1995 with the budget deficit totalling nearly 200% of GDP. The government has been able to sustain this incredibly large deficit through selling its debt almost entirely to domestic savers and, therefore, is not reliant on overseas investors to fund itself. This situation is unlikely to change even with the greatly increased funding requirement.

The major concern for the markets prior to the Japanese earthquake had been another fallout in the debt of the eurozone periphery countries. Yields on Greek, Irish and Portuguese bonds all registered new highs. Spain's bonds also suffered despite the Bank of Spain announcing that the capital requirement for its banking system was considerably lower than most forecasters had been projecting although a further downgrade in its rating, announced on Friday, will hardly help. Italy also came into the firing line with the yield on its bonds rising above the 5.00% mark for the first time since EUR rates dropped to current levels.

With the MPC announcing an unchanged monetary stance at their meeting last week, UK medium term rates are trading some 0.12% lower than a week ago. However, this would seem part of a more global move with USD and EUR rates also trending downwards. This is mainly in consequence of concerns over a slowdown in the growth of the Chinese economy. This has resulted in some fairly major falls in some commodity prices, especially copper, as it appears that inventories levels are at high levels. However, this only puts the copper price back to where it was at the beginning of the year.

This week is fairly barren on the economic release front. The latest labour market figures will be released on Wednesday with the unemployed claimant count figure to be close to unchanged, but with the average earnings figure rising from 1.8% to 2.3%. However, the rise in the latter is largely caused by the timing of bonus payments. Thursday sees the release of the Bank of England inflation attitudes survey. Given the increase in the CPI inflation measure to 4% and the current constant concern over energy prices, it would be very surprising if the expectation for longer term inflation levels had not increased. With the panic of late January and early February over, the subsequent rally has probably pushed UK rates down to a level from which they will find it difficult to make much further progress.

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Market Expectations

Date	Location	Title	Forecast	Previous Actual
14.03.11				
	EA	January industrial production m/m	+0.3%	+0.2%
		January industrial production y/y	+6.4%	+8.8%
15.03.11				
	US	March empire manufacturing	+16.0	+15.4
		February import price index m/m	+0.9%	+1.5%
		January total net TIC rows	+\$37.5bn	+\$48.2bn
		March NAHB housing market index	+17.0	+16.0
		March FOMC meeting		
16.03.11				
	UK	January ILO unemployment	+7.9%	+7.9%
		February claimant count (change)	+1.3k	+2.4k
		February claimant count	+4.5%	+4.5%
	EA	February core HICP y/y	+1.1%	+1.1%
		February HICP m/m	+0.4%	-0.7%
		February HICP y/y	+2.4%	+2.3%
	US	February housing starts	+575k	+596k
		February producer price index m/m	+0.6%	+0.8%
		February PPI ex food & energy m/m	+0.2%	+0.5%
		Q4 current account balance	-\$110.0bn	-\$127.2bn
17.03.11				
	US	February consumer price index m/m	+0.4%	+0.4%
		February CPI ex food & energy m/m	+0.1%	+0.2%
		March initial jobless claims	+385.0k	+397.0k
		February industrial production	+0.6%	-0.1%
		February capacity utilization	+76.5%	+76.1%
		February leading indicators	+0.9%	+0.1%
		Philadelphia Fed.	+30.0	+35.9

STERLING INTEREST RATES

	31.12.10	07.03.11	14.03.11
1mth LIBOR	0.59	0.61	0.61
2mth LIBOR	0.65	0.68	0.68
3mth LIBOR	0.76	0.81	0.81
6mth LIBOR	1.05	1.11	1.11
12mth LIBOR	1.51	1.59	1.58

Interest Rates Swaps Quarterly ACT/365

2 years	1.27	1.73	1.56
3 years	1.72	2.18	1.98
5 years	2.42	2.82	2.63
7 years	2.91	3.26	3.09
10 years	3.37	3.68	3.55
15 years	3.74	4.02	3.93
20 years	3.84	4.12	4.06
30 years	3.83	4.09	4.08

EURO INTEREST RATES

	31.12.10	07.03.11	14.03.11
1mth EURO	0.78	0.90	0.89
2mth EURO	0.89	1.03	1.02
3mth EURO	1.01	1.17	1.17
6mth EURO	1.23	1.49	1.49
12mth EURO	1.51	1.94	1.94

Interest Rates Swaps Quarterly ACT/360

2 years	1.37	2.17	2.04
3 years	1.71	2.45	2.33
5 years	2.32	2.85	2.75
7 years	2.74	3.12	3.03
10 years	3.16	3.38	3.30
15 years	3.54	3.67	3.60
20 years	3.62	3.76	3.69
30 years	3.43	3.63	3.56

DOLLAR INTEREST RATES

	31.12.10	07.03.11	14.03.11
1mth	0.26	0.26	0.25
2mth	0.28	0.29	0.28
3mth	0.30	0.31	0.31
6mth	0.46	0.46	0.46
12mth	0.78	0.79	0.78

Interest Rates Swaps Quarterly ACT/360

2 years	0.78	0.92	0.78
3 years	1.27	1.47	1.27
5 years	2.16	2.41	2.15
7 years	2.81	3.05	2.81
10 years	3.37	3.60	3.40
15 years	3.83	4.05	3.89
20 years	3.99	4.22	4.08
30 years	4.10	4.34	4.22

PROPERTY DERIVATIVES

INDEX	TERM (years)	BID	OFFER
		FIXED RATES	
TOTAL RETURN	Dec 11	5.00%	5.50%
	Dec 12	4.51%	5.01%
	Dec 13	4.75%	5.25%
	Dec 14	4.87%	5.37%
	Dec 15	4.94%	5.44%

STERLING RPI

	31.12.10	07.03.11	14.03.11
UK ZERO COUPON SWAPS			
5 year	3.05	3.39	3.33
10 years	3.23	3.46	3.43
15 years	3.45	3.58	3.56
20 years	3.60	3.63	3.63
25 years	3.69	3.64	3.64
30 years	3.74	3.66	3.66
Base Index	225.80	229.0	229.0

EURO HI CPXT

	31.12.10	07.03.11	14.03.11
EURO ZERO COUPON SWAPS			
5 year	1.80	2.26	2.18
10 years	2.03	2.32	2.25
15 years	2.16	2.39	2.31
20 years	2.13	2.43	2.36
25 years	2.13	2.47	2.40
30 years	2.24	2.49	2.46
Base Index	109.77	110.93	110.93

FOREIGN EXCHANGE RATES

	31.12.10	07.03.11	14.03.11
£/US\$	1.5591	1.6263	1.6129
£/€	1.1665	1.1614	1.1555
€/£	0.85735	0.86108	0.86547
€/US\$	1.3366	1.4003	1.3958
US\$/YEN	81.19	82.17	81.80

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

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