

Weekly Market Commentary

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Overview FX and equity indices retreated from last week's peaks, hardest hit those of the Baltic States, Russia, Mexico and Australia which are down between 4% and 7% this week alone and around 10% this month. The US dollar recovered a little, commodity prices retreating in tandem, Yen crosses dropped from this year's highs, Eastern European currencies weakened, as did the previous darlings AUD, NZD, CAD and NOK, and yields eased a tad. All are symptoms of a little light de-leveraging, this time without the rush into quasi-dollars or the retreat from sterling (EUR/GBP £0.8912). A few exceptions, like 3-month LME Zinc at \$2,360 per tonne and its best since May last year, energy futures remaining close to this year's highs, but on the whole fairly orderly moves despite some sharp intra-day surprises. Fed Funds futures are priced at 20 basis points or less through to mid-January.

Political and Economic Developments First Israel and Australia, now Norway raises its key rate by 25 basis points to 1.50%. Some are suggesting these are leading next year's new trend but we are not so sure; at the moment we shall prefer to side with the Reserve Bank of New Zealand and the US Fed who foresee a prolonged period of ultra-low rates. A year since the world at large realised we had a financial crisis, and over two years since the interbank money market seized up, and still many do not get it. The problem is counterparty risk. Suspicion among bankers is rampant, as bad as it has ever been in Eurodollar circles, despite taxpayers' (via the government) largesse. As the saying goes: 'you can lead a horticulture but you can't make her think'.

US Q3 GDP grew at +3.5% Q/Q annualised, after contracting the previous four and the longest drag since the Great Depression, so that the US is officially out of recession. Somewhat worrying was that half that growth was due to the auto industry's 'cash for clunkers' scheme and the rest from a residential investment tax break and inventory re-building. New Home Sales dropped to 402K annualised as first time buyers, spurred by an \$8,000 incentive, opt for heavily discounted existing homes and foreclosures. And it has cost trillions to get to this point. Talk of removing stimulus packages (as mooted this week by the Bundesbank's Weber) is, in our opinion, hopelessly premature (which does not mean it will not happen). In the 1930's central bankers' mistakes were part of the problem.

Underlying Themes A string of secondary numbers this week showing a small drop in consumer confidence. Nothing dramatic in what some have taken to calling 'soft' data as opposed to 'hard' data (no doubt the same ignorant souls who divide commodities into 'soft' and 'hard' ones!) US consumers are now as gloomy as they were in July (though less so than February's record low 25.3 for a series that started in 1967). A similar situation among Italian retailers and Japanese small businesses as Tokyo October CPI set a new record low of -2.4% Y/Y, while UK individuals continue to pay down debt (Net Consumer Credit -£0.3B in October). Eurozone and British citizens a little less pessimistic this month, and German Unemployment dipped to 8.1% as government aid and short-time working stemmed layoffs. Slightly worryingly EZ16 M3 Money Supply dropped to a record low +1.8% Y/Y from a peak of +12.5% last year (the UK slightly less bad with M4 running at +11.6% from a record +18.7% in February). Japan's Unemployment also lower at 5.3% from a post-war peak at 5.7% in July caused by the hiring of temporary workers at exporting manufacturers.

What to watch for next week Sunday November 1st All Saints Day with presidential elections in Tunisia and Uruguay; All Souls holidays for some the day after, Culture Day in Japan Tuesday with mayoral elections in New York; Russia Unity Day Wednesday. Numbers-wise Monday UK October Hometrack Housing Survey, Manufacturing PMI's for various European countries, Japan Vehicle Sales and September Labour Cash Earnings, US Construction Spending, Pending Home Sales and October ISM. Tuesday US September Factory Orders, October Vehicle Sales and UK Construction PMI. Wednesday EZ16 September PPI, Japan October Money Supply, UK Nationwide Consumer Confidence, Services PMI, BRC Shop Price Index, US Challenger Job Cuts, ADP Employment Change, Non-Manufacturing ISM and the FOMC decides on rates (unanimously expected unchanged at 0.25%). Thursday UK September Industrial Production, Eurozone Retail Sales, the Bank of England and ECB decide on rates (both expected unchanged at 0.50% and 1.00% respectively), then US Q3 Unit Labour Costs. Friday Japan September Leading and Coincident Indices, German Factory Orders, US Consumer Credit, Wholesale Inventories, UK October PPI, US Non-Farm Payrolls and Unemployment. Saturday the second round of Afghan presidential elections.

Positioning and Technical Analysis November will mark the start in earnest of year-end preparations. We feel that many will have already covered cash requirements and that the authorities will ensure plentiful supply, whatever they might say in public. Therefore Treasuries should remain well-bid as banks play with a new version of the 'carry trade' while improving the quality and quantity of their reserves. FX will be dominated by correction and consolidation with a tendency for the Yen to strengthen against all the rest. Stocks subject to sudden slippage. Have a nice weekend!

