

# PRESS DIGEST

19 July 2010 to 23 July 2010



[Note – the details contained in this press digest have been drawn from a review of the Financial Times and the Economist]

## Key prices at the beginning and end of the period

	End 23 July	Start 19 July	Wk's % Change	Wk's Change
FTSE 100	5,312.62	5,158.85	2.98%	153.77
Dow Jones Ind. Average	10,418.04	10,097.90	3.17%	320.14
Brent Crude \$ Sep	77.82	75.37	3.25%	2.45
Gold \$	1,195.85	1,208.75	-1.07%	-12.90
<b>Currencies</b>				
\$ per £	1.540	1.534	0.39%	0.01
\$ per €	1.282	1.295	-1.00%	-0.01
€ per £	1.202	1.185	1.43%	0.02
<b>Interest rates</b>				
UK Gov 10 year yield	3.44%	3.34%		0.10%
US Gov 10 year yield	2.99%	2.94%		0.05%
UK 3mths	0.65%	0.65%		0.00%
US Fed Funds Eff	0.18%	0.19%		-0.01%

## Economic Backdrop

**Global equity markets** reacted well this week to encouraging earnings reports and robust European data releases despite Friday's news that seven European banks had failed stress tests. The disclosure that seven out of the 91 institutions examined had failed the tests was roughly in line with expectations in the markets – although there appeared to be some scepticism about the methodology used.

Worries about the recovery in the **US** resurged when Ben Bernanke, chairman of the Federal Reserve, described the outlook as "unusually uncertain".

In the **UK**, figures released on Friday showed the economy grew at its fastest pace in four years in the second quarter. The UK's gross domestic product rose by 1.1%, far greater than the 0.6% rise forecast, thus taking the UK's annual growth rate up to 1.6%. The data supported sterling, prompting speculation in some quarters that the Bank of England could move to exit its ultra-loose monetary policy stance sooner than expected. Over the week, the **pound** rose 0.8 per cent to \$1.5416 against the dollar.

The euro touched a two-month high against the dollar above \$1.30, although it retreated slightly by the end of the week, as the

credibility of stress tests on European banks was called into question. Over the week, the euro eased 0.6 per cent to \$1.2820 against the dollar.

In **commodity markets**, US oil climbed to within a whisker of \$80 a barrel, helped by a storm threat to the Gulf of Mexico's energy infrastructure, but the general improvement in investor risk appetite, and the firmer tone of the dollar, pushed gold back below \$1,200 an ounce.

**Government bonds** also lost some of their haven appeal, with the yield on the 10-year US Treasury edging up 2 basis points to 2.96 per cent over the week. But the two-year US Treasury yield touched a record low of 0.56 per cent in the aftermath of Mr Bernanke's cautious comments.

## Mergers and Acquisitions

Consumer goods group **Reckitt Benckiser** yesterday agreed to buy Durex condoms and Scholl sandals maker **SSL International** for £2.5bn in cash to increase its presence in the health and personal care markets.

## Financial Institutions

The UK government has hired Jim O'Neil, Bank of America Merrill Lynch's corporate finance chief, to pilot its sales of the part-nationalised **Royal Bank of Scotland** and **Lloyds Banking Group**. Divestment of the £34bn of shareholdings now looks unlikely to start before 2012.

Spanish bank **Santander** is re-examining plans to list its UK operations to raise cash for the purchase of assets including 318 Royal Bank of Scotland branches, it is understood. The group could float 20 per cent of the division comprising Abbey, Alliance & Leicester and parts of Bradford & Bingley in the autumn.

**Goldman Sachs** reported an 83% collapse in second quarter net income, which was \$453m (£297m): revenues also slipped 36% to \$8.8bn, due to scarcer investment banking activity and weaker proprietary trading.

**Morgan Stanley** reported post-tax profit of \$1.4bn (£921m) for the three months to June, after posting a loss of \$138m in the second quarter of 2009. Net revenue was \$8bn, boosted by a positive contribution from the bank's debt-related credit spreads.

**Wells Fargo** reported Q2 earnings of \$3.06bn, or 55 cents a share, compared with \$3.17bn, or 57 cents a share, a year earlier.

**State Street** yesterday announced an operating profit increase of five% in the second quarter, fuelled by strong growth in its investment management and servicing business.

**US Bancorp** said profit soared as new lending boosted revenue, and quarterly revenue climbed almost nine per cent to \$4.5bn.

## Credit

Moody's, the ratings agency, on Monday downgraded **Ireland's** government bond ratings because of the country's deteriorating public finances. The downgrade of one notch to Aa2 puts Moody's rating on the same level as Standard & Poor's, which rates Irish debt at AA, and one notch higher than Fitch, which gives the country's bonds an AA minus rating.

The IMF and EU warned **Hungary** that its austerity measures look too short-term in a review of the country's €20bn loan programme, postponing the conclusion of a budgetary review in Budapest and insisting the government must rethink its plans.

## Other

In the **US** last Wednesday, President Obama signed into law the **Dodd-Frank Financial Reform Bill**: the most comprehensive overhaul of banking regulation since the 1930s. The legislation will create a **Consumer Financial Protection Bureau** to oversee mortgage and credit-related businesses, and set up a **Financial Services Oversight Council** giving regulators more power. It will cap banks' stakes in hedge funds and private equity at three per cent of their capital.

The Bill is 2,319 pages long, whereas the 2002 Sarbanes-Oxley Act was 66 pages, and the Glass-Steagall Act of 1933 only 37 pages.

America's government-sponsored enterprises (GSE), Fannie Mae and **Freddie Mac**, were again in the news. In 2008 the US government effectively nationalised Fannie and Freddie, under a

"conservatorship" scheme. It has now used about \$145bn of taxpayers' money to prop them up, more than was spent on direct injections into the US banks or car sector. The volume of outstanding mortgages backed by Fannie and Freddie now stands at \$5,500bn, around half the mortgage market. Estimates about the size of the future taxpayer bill now range from \$390bn to almost a trillion dollars.

Friday saw the publication of the **results of stress tests** on **Europe's** leading financial institutions, showing that only **seven of 91 banks failed** to meet its capital requirements. The **Committee of European Banking Supervisors**, which oversaw the tests, identified a capital shortfall of €3.5bn at the seven banks that failed to reach the pass mark of a 6 per cent tier one capital ratio. The test involved modelling macroeconomic and sovereign debt stresses over 2010 and 2011, applied to end-2009 capital levels. Five of the seven were cajas, Spanish savings banks: Germany's Hypo Real Estate and Greece's ATEbank were the only non-Spanish institutions to fail.

Among the near-fails, were Italy's Monte dei Paschi, Allied Irish Banks, and Germany's Postbank.

European regulators said the tests were three times as tough as last year's US ones. However, investors signalled their distrust of the assumptions underlying the tests and the surprisingly small number of banks to fail the tests. Their concerns rested on the fact that there was little evidence that the tests had been applied consistently and that they failed to address the sector's exposure to sovereign debt adequately. The tests on Greek banks envisaged what would be a 4% "haircut" or loss at current market prices, whereas S & P has warned that it is likely to be up to 70%

France and Germany issued a document calling for tougher penalties, including a temporary suspension of the Eurozone voting rights, on any country in persistent breach of the EU's budget deficit limits, whilst acknowledging that this may require a change in the EU treaty.

The UK chancellor launched the **Office for Tax Simplification (OTS)** this week, and said one of its first tasks would be to "cut through the thickets of reliefs that have grown up under years of ministerial meddling". It will also review small business taxation, including the IR35 rules that govern the self-employed.

**Britain's** big four **accountants** were criticised by an independent review this week for the "disappointing" quality of their audit work. One in ten audits produced by the major firms fell below the proper standards, the **Audit Inspection Unit (AIU)** said. Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers – along with smaller competitor PKF – were urged to adopt a more sceptical mentality when checking companies' accounts and use more rigour in testing managements' assumptions.

The four oil giants **Chevron, ConocoPhillips, ExxonMobil and Royal Dutch Shell** have pledged \$1bn (£659m) for a **rapid response unit** to battle future spills in the Gulf of Mexico, in a bid to regain America's trust following the BP disaster. BP will not immediately be involved. The independent joint venture will be able to react to a spill within 24 hours and capture up to 100,000 barrels of oil flowing 10,000 feet below the sea: it should be operational within 18 months.