

# Forex Weekly

## Contents

View and Trade Summary	2
FX Editorial	3
FX Trends - Majors	5
FX Trends - Emerging	10
Technical Analysis	14
Short Rate Strategy	15
Weekly calendar	20

### ■ G10 FX Editorial

**Positioned wrong?** The past week's low US inflation and growth news contrasts with rising inflation and resilient growth elsewhere. On an interest rate spread basis, as well as a positioning basis, the USD looks vulnerable to a near-term correction (see graph). With the speculative community positioned for higher US inflation and growth recovery, we think the USD is skating on thin ice. Is the nascent USD rally the last hurrah before another fall? We think so, and recommend shorting the USD against the bulk of the G10.

### ■ G10 FX Trade Summary

**Currencies with a positive growth-inflation mix will be rewarded.** With some risk appetite coming back into the market last week, our anti-carry positions unsurprisingly did not perform well. Our relative value positioning fared much better in an FX market that is focused on relative growth and inflation trends. We stick with our conviction that currencies with a positive growth-inflation mix will continue to outperform. We hold our long position in the Scandinavian currencies and build up our short GBP and CAD stance.

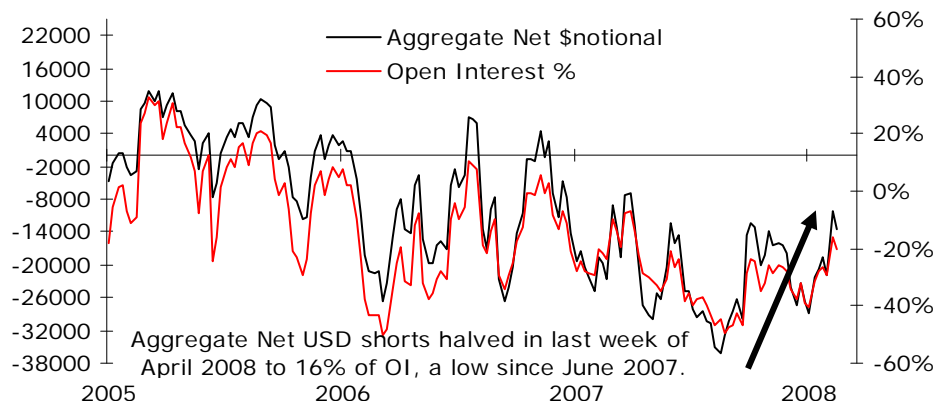
### ■ EM FX Trade Summary

**The macroeconomic backdrop remains unfavourable for EM.** High-yielding EMFX performed extremely well on the back of rising risk appetite. However, the macroeconomic mix remains rather unfavourable for EM, with a combination of slower growth and higher inflation suggesting increasing vulnerability. We keep our anti-carry trade bias. This week, we opened a short RUB vs its basket position with a target at 29.40.

### ■ FX Technical Analysis

In EUR/USD 1.5715/40 is the key resistance area to break to confirm the return to 1.6000/20. In EUR/JPY 164.95 and 166.65 should be the main resistance areas on the way back to last year's highs of 167.70/168.95.

### Aggregate USD shorts are less than half as big as they were a month ago



Source: SG Forex Research

## View & Trade summary

### Market Trends and SG Views

	09/05/2008	16/05/2008	Coming week	Coming month
EUR/USD	1.5433	1.5551	→	↗
EUR/JPY	159.31	161.84	→	↘
EUR/GBP	0.7929	0.7959	↗	↗
USD/JPY	103.23	104.07	↘	↘
USD/CAD	1.0064	0.9975	↘	↘
AUD/USD	0.9407	0.9501	→	→

Source: SG Forex Research

### G10 trade recommendation update

With some risk appetite coming back into the market last week, our anti-carry positions unsurprisingly did not perform well. With the FX market focused both on relative growth trends and inflation, our relative value trades performed well, with our short NZD/NOK position hitting its target. By contrast, our short EUR/JPY stance posted a loss and our short USD/CHF position hit its stop-loss. Looking ahead, we stick with our conviction that currencies with a positive growth inflation mix will continue to outperform. We hold our long positioning in the Scandinavian currencies and build up our short GBP and CAD stance.

**1- Enter long EUR/GBP.** With indications pertaining to growth on the weak side and the BoE unlikely to provide further monetary stimulus, given inflation concerns (our economists now expect the next cut to be in Q1 of next year), GBP is likely to remain under pressure. We see current levels against EUR as a good buying opportunity.

**2- Enter short AUD/JPY.** We shift our short EUR/JPY position to a short AUD/JPY trade. The fact that the global economy does not look as healthy as the markets seem to think (which is likely to make for a challenging risk backdrop) should bode well for JPY. The recent run-up in AUD looks overdone to us, given the dovish undertones from the RBA. So we feel comfortable being short ahead of the RBA minutes. The key risk to this trade is a continued rise in risk appetite.

**3- Enter short CAD/NOK.** The NOK looks to have value compared to CAD. For one, Norway's growth-inflation dynamic looks favourable, particularly compared to Canada's. And from a valuation perspective, the two currencies lie at opposite ends of the valuation spectrum. The potential for a correction from a drop in oil prices would also be limited with this cross, given that both currencies have a positive terms-of-trade link.

**4 Hold Long NOK & SEK vs. short EUR & GBP.** The Scandinavian currencies are poised to outperform, given the positive monetary policy and cyclical dynamics in Norway and Sweden. Being long looks particularly compelling against the likes of sterling, (in the UK, growth continues to sour), and the euro, which looks stretched against NOK and SEK. We feel comfortable holding the basket ahead of this week's Q1 GDP estimates and labour market report from Norway.

### Trade recommendations

Cross	Position	Date	Entry	Target	Stop	Current	P/L week **	P/L total
<b>New positions this week</b>								
CAD/NOK	Short	16-May	5.06	5.00	5.09			
AUD/JPY	Short	16-May	99.00	96.00	101.00			
EUR/GBP	Long	16-May	0.7950	0.8100	0.7850			
<b>Existing positions</b>								
Basket		09-May		3%	-1%		0.09%	0.09%
<b>Long NOK, SEK (50% each), Short EUR, GBP (50% each)</b>								
Risk reversal		28-Apr						
<b>Long 3M Call EUR/USD strike 1.62, Short 3M put strike 1.50</b>								
<b>Positions closed this week</b>								
EUR/JPY	Short	02-May	162.50	155.00	165.00	162.31	-1.63%	0.09%
NZD/NOK	Short	28-Apr	4.0020	3.8500	4.0700	3.8500	1.58%	3.94%
USD/CHF	Short	09-May	1.04	1.00	1.06	1.06	-1.89%	-1.89%
<b>Total</b>							<b>-1.85%</b>	<b>2.23%</b>

\*\* since last Friday

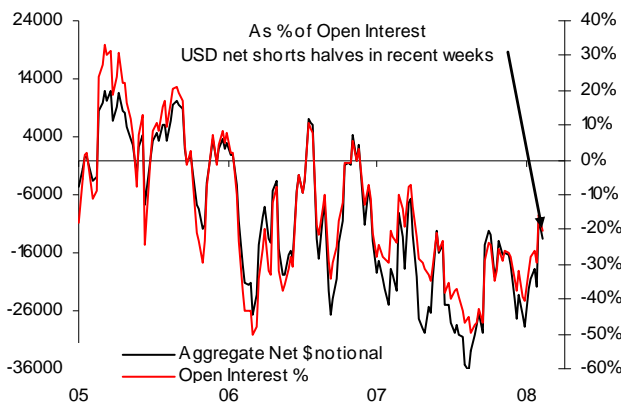
## Positioned wrong?

The past week's low US inflation and growth news contrasts with rising inflation and resilient growth elsewhere. On an interest rate spread basis, as well as a positioning basis, the USD looks vulnerable to a near term correction. With the speculative community positioned for higher US inflation and growth recovery, we think the USD is skating on thin ice. Is the nascent USD rally the last hurrah before another fall? We think so, and recommend shorting the USD against the bulk of the G10 and are looking at attractive entry levels for the week ahead.

### ■ The USD's last hurrah?

The USD has had an impressive mini-rally during the past few weeks, with EUR/USD sliding 7pts after breaching 1.60, USD/JPY hitting 105 instead of 95 and Cable reversing from above 2.00 towards year-to-date lows near the 1.9300 level. With the past week's low US inflation and growth news contrasting sharply with soaring inflation and solid growth data in Europe, Japan and the dollar bloc, we think that the nascent rally may be a last hurrah before the USD tumbles again to fresh cycle lows within the G10FX.

**Graph 1. Aggregate USD shorts are less than half as big as they were a month ago.**

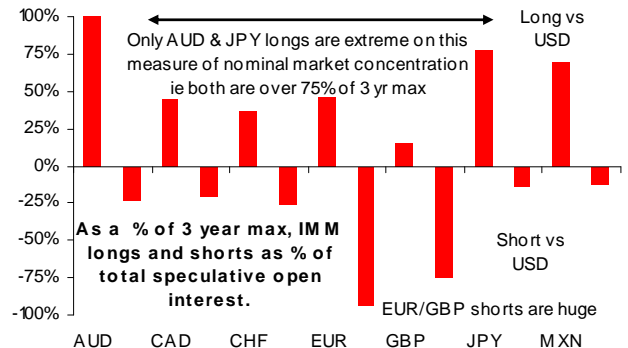


Source: SG Forex Research

### ■ Speculators are positioned for a US inflation/growth surge while Europe wilts. But is the opposite happening?

We think that the USD is skating on thin ice. First off, speculative positioning is extremely net short the EUR and GBP. Total speculative USD shorts have dropped by almost two-thirds in the past few weeks (see Graph 1). Further, almost the largest ever net and actual nominal short positions have been accrued in both EUR and GBP, at least since the EUR was established in 1999 (see Graph 2). The cost of carrying these positions is significant. This is aggravated by the fact that the largest offsetting USD net short is against the lowest yielding currency, the JPY. We believe that global speculators will only hold onto large loss making negative carry positions for a short while. Such an anti-carry bet is only viable if the market believes that the negative rate spreads are poised to narrow or flip back into positive territory over the medium term. Unfortunately for the FX speculators, the opposite is happening and USD negative spreads are widening.

**Graph 2. GBP & EUR shorts are extreme, AUD, & JPY longs also extreme. GBP/EUR risk quick reversal?**

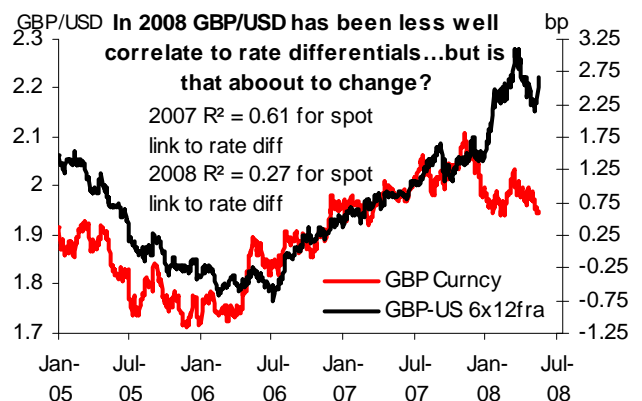


Source: SG Forex Research

### ■ Speculators' huge short GBP bet ignores rate spread

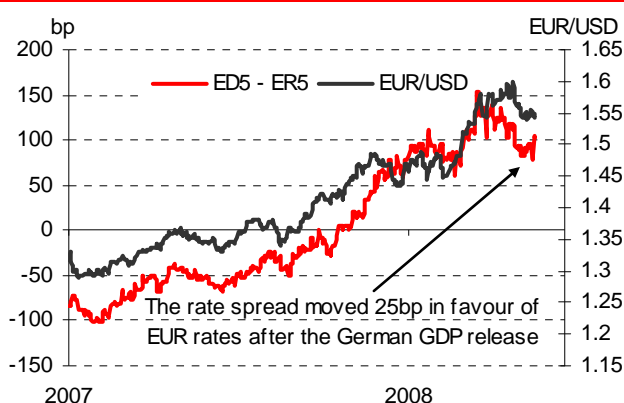
Both EU and UK economies are showing soaring inflation rates and increasingly hawkish central bank rhetoric. If the coming week's rash of data, including UK retail sales and GDP, German ZEW and EC PMIs, are as robust as the past week's flurry, then a cascade of short covering in GBP and EUR could hit the USD. We think last week could have been a turning point for the USD with respect to relative growth/ inflation rate assessments. In the UK, the BoE inflation report was shockingly hawkish. Governor King admitted that "a number of letters" would be sent to the UK Treasury in H2 2008 as inflation soars above 3%. Indeed, SG economists no longer expect a rate cut this year in the UK. Some GBP negativity came from King's view that growth may weaken sharply in 2008, but as an offset he said that activity beyond finance and commercial construction was impressively resilient, thus a UK recession was not a central scenario. This week's MPC minutes and retail trade/GDP data may entrench the "on hold" rate scenario. If so, GBP/USD could jump back towards 2.00. The past week's surge in interest rate differentials between UK and US forward rates has already started to make GBP/USD look too low and any further jump could open the flood gates.

**Graph 3. GBP/USD to get boost from rate spread surge?**



Source: SG Forex Research

**Graph 4. Will EUR/USD get a boost from rate spreads?**



Source: SG Forex Research

■ **Short EUR bet also ignores the ECB.**

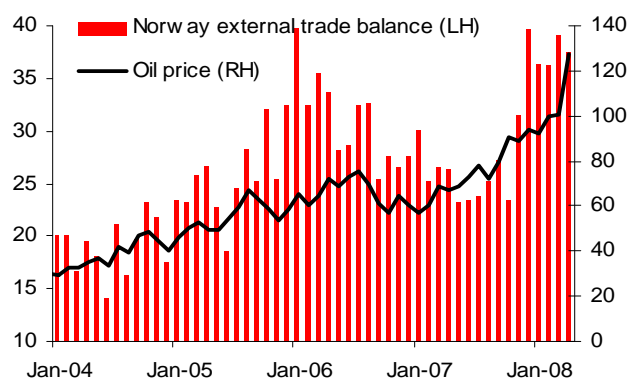
Similarly for the EUR, the huge short positioning of the speculative community is sharply at odds with both near term growth and interest rate dynamics. Notably, the past week's ECB bulletin was dominated by the "need" for increased vigilance on inflation. This factor, plus very robust German Q1 GDP, could push out chances of an ECB rate towards 2009 if upside surprises are repeated in Q2. The latest German GDP was so robust that even allowing for a sharp slowdown in Q2, eurozone GDP is on course to hit a number more like 1.9% this year compared with 1.7% in the ECB's prior forecasts. ECB president Trichet hinted last week that the central bank was prepared to look at the average rate of GDP growth in H1 as a whole in rate setting. The outlook for rates this year will thus depend on whether the slowdown expected in Q2 extends or deepens in H2. At the moment, much like the Bank of England's Inflation Report details, central banks believe that we face a real threat of stagflation with weak (not negative) growth rates and markedly higher inflation. This suggests rates are likely to be on hold for a considerable period of time in both the eurozone and UK. Clearly, this week's ZEW, EC PMI and full breakdown of the German GDP report will be closely watched for a backing of the central bank's views. And, given the huge short positioning in GBP and EUR, a string of upside surprises are all it may take for the flood gates to be open via a flip in speculative EUR and GBP net shorts back to longs and for the USD to slide again.

■ **US inflation risks appear surprisingly benign.**

In contrast to increased hawkishness in Europe, the US data shows surprisingly soft inflation rates and the Fed at least keeping rates of 2% on hold for the medium term. The latest weak inflation data in the US were to our view significant. The April core CPI rate rose by a modest 0.1% m/m, meaning that the core rate average growth in the past three months was also just 0.1%. Core inflation has not been weaker than this since summer 2005. This is no statistical quirk, it reflects the fact that US growth is quite possibly in recession and a wide negative output gap is already opening up. Last week's April CAPU was another deflationary shocker. Capacity usage sank by 0.7% in the month, the biggest fall since the Katrina hurricane. On a level basis, it crashed to 79.7%, again the weakest since

Katrina and barring that the weakest since the end of 2004. Sliding core CPI and widening spare capacity rates suggest that US inflation risks may well be less than expected. Certainly, we caution that the past week's inflation warnings from FOMC members such as Yellen and Fisher need to be balanced against such evidence. So far, this evidence is pointing to potentially far more moderate energy/commodity pass through to the final US consumer than in most of its G10 peers. Fed chairman Bernanke is an inflation targeting central banker. He will be aware that in addition to the negative wealth shock of higher commodity prices and tumbling property values, productive slack in both the US labour and goods markets is opening up so quickly that inflation expectations may remain subdued throughout the ongoing period of commodity price inflation. If weak core CPI persists in Q2, along with subdued GDP price deflators, the recent US money market's bet on a Q4 Fed Funds hike will appear premature. This could further undermine the USD.

**Graph 5. NOK to rally as Norway trade surplus booms on record energy prices?**



Source: SG Forex Research

■ **A new (higher) commodity price equilibrium.**

The USD is also at risk versus commodity FX. The news that the commodity price "super cycle" could be super revived again has started to become entrenched in the psyche of financial markets and central banks alike. Front oil contract prices leapt last week towards a fresh all-time high at \$128pb and natural gas also surged. Just the past week has seen Fed members and the BoE governor bemoan the likelihood that domestic growth rates will be severely reduced by the negative wealth impact of higher commodity prices in coming years, effectively signalling that soaring energy prices shall represent a new significantly higher equilibrium price than previously thought. We still think the NOK will be a front running beneficiary, with its trade surplus set to surge through soaring natural gas (as well as oil) prices through H2 2008 (see Graph 5). Trading wise we are looking at more attractive entry levels to short the USD against commodity currencies and possibly the EUR and GBP. Ahead of this we recommend a fresh long NOK trade versus the CAD (a relative value commodity FX trade) and hold our long NOK and SEK positions. We enter short AUD/JPY as a risk aversion strategy and again go long EUR/GBP.

peter.frank@sgcib.com

## FX Trends – Majors

### EUR/USD looking for inspiration: stay neutral in the short term and bull in the medium term

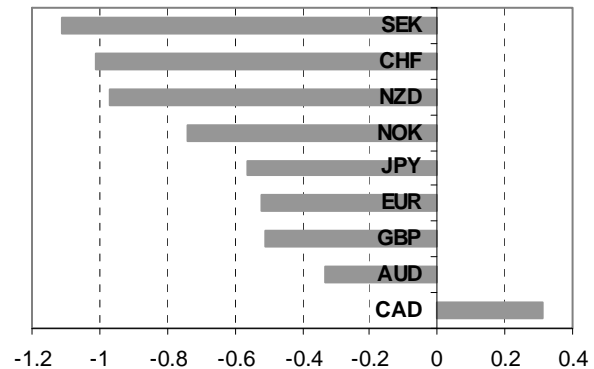
■ **EUR/USD looking for inspiration.** The cross traded inside a 1.5365/1.5570 range last week, in the wake of choppy Eurodollar and Euribor contracts. The combination of two major market themes (inflation/growth policy mix and economic recoupling) has left the cross uninspired. US inflation data have admittedly suggested that the domestic demand slowdown might start to cap price pressures. However, the successive all-time highs posted by oil prices suggest lastingly high global inflation rates. About the inflation/growth choice, central banks should continue to prefer fighting against the former. Despite its current resilience, this is a policy mix that definitely remains dollar-negative.

■ **US dollar consolidating.** The effective exchange rate of the US dollar has been trading inside a 72.80/73.30 range (0.6%) since early May. The dollar has not fully benefited from the recent adjustment on Fed expectations (15bp gain on the Fed Funds futures Dec. 2008 implicit rates over the same period). The greenback has stopped falling as Fed rate cut expectations disappeared. Yet the effective exchange rate of the US dollar has only gained 2.7% from the 22 April low and has even been consolidating since. The Fed Funds futures contracts price in that the next Fed gesture will be a rate hike, in early 2009. We still regard such expectations as excessive in the light of still weak economic indicators. It is, however, difficult to go against a trend. On the economic release front, only dovish FOMC Minutes seem likely to weigh on the US dollar this week. The release of PPI data (expected to print higher) and existing home sales should show no fresh news.

■ **Euro losing momentum?** Whilst Q1 GDP data in the eurozone surprised positively and brought some support to the euro, the Q2 outlook could be less rosy. This week's data releases should send key messages: the German ZEW index is likely to print higher but there needs to be solid Ifo and eurozone PMI's for a positive EUR reaction. As long as the ECB remains hawkish – which should be the case for the next few meetings – the euro should withstand partial data weakness. With positioning by specs short against the USD there is upside EUR/USD potential on any positive data surprises.

■ **Look for long EUR/USD entry levels on any upside EC data surprise.** This week's economic release calendar may provide no clear EUR/USD trend if the results are mixed, but there is strong upside potential if the data is positive. The cross however will have to break the 1.5365/1.5595 range either way to see some clear direction from the technical picture. We favour an upside breakout. Indeed, markets have priced in and speculators are positioned for the view that the US economy has troughed and that a slowdown has started in the eurozone. The main risk is now skewed towards disappointing US news and EUR/USD upside.

Graph 1. Performance vs. USD over the last five days (%)



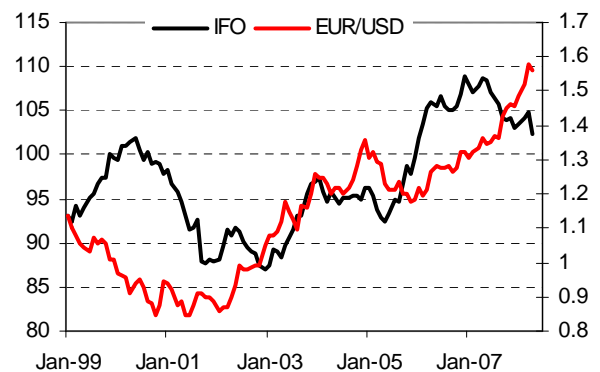
Source: SG Forex Research

Graph 2. Effective exchange rate of the US dollar



Source: SG Forex Research

Graph 3. Ifo and EUR/USD: an imperfect correlation



Source: SG Forex Research

carole.laulhere@sgcib.com

## JPY: Still looks to have value

### ■ The yen loses some ground once again

With risk aversion seemingly contained last week, the yen seemed to lose some ground (Graph 1). However, the lacklustre price action has not shaken our conviction that the currency generally has value and that the uptrend in most JPY crosses is likely to be temporary. For one, the Japanese economy is not as vulnerable to the financial turmoil as some of its G10 counterparts (estimates of first quarter GDP growth were significantly better than expected). If anything, the yen should benefit from a further drip feed of bad news pertaining to the global economy given what has been an inverse relationship between its performance and risk appetite. Trading-wise we swap our short EUR/JPY trade recommendation to a short AUD/JPY trade, as the strength in AUD looks to be overdone.

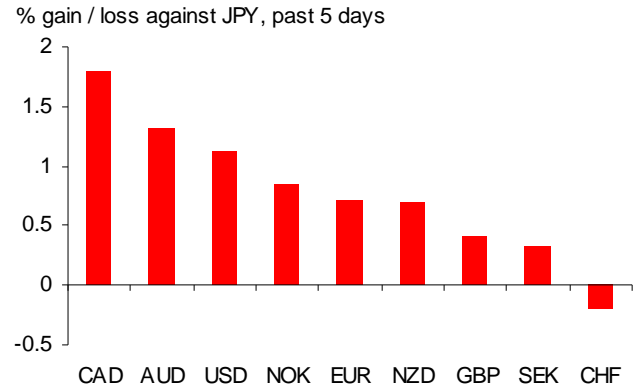
### ■ With volatility low – a respite in JPY outperformance?

A stock-take of Japan's macroeconomic indications suggests that the economy continues to motor along, though there have also been some downside surprises on the growth front (such as the recent drop in Machinery orders). Our growth surprise index for Japan continues to point to general resilience. All said, this week's BOJ policy meeting is unlikely to offer any significant surprises. FX-wise, what is likely to be of relatively more significance for the yen is that risk appetite – measured in part by equity market performance alongside a lower level of equity market volatility (as gauged by the VIX) – could mean that JPY crosses remain on an uptrend and the yen itself on the back foot. Although the relationship is not perfect, the VIX has had a good relationship with the yen (Graph 2) and we expect this to continue to be a factor in the near term despite our medium term constructive stance.

### ■ Valuation models continue to flag green

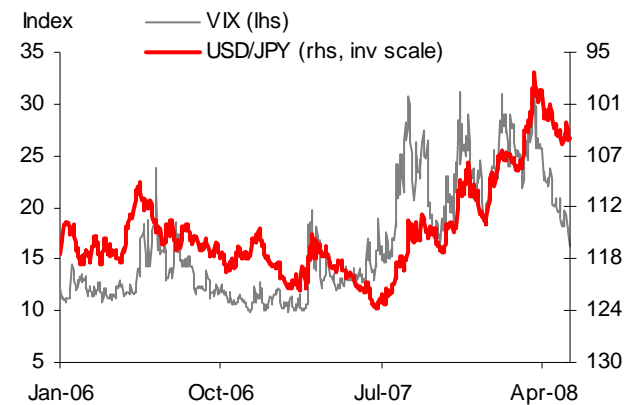
We feel comfortable in our positive directional JPY stance. For one, our medium term valuation models suggest that, if anything, the yen is due for further appreciation. This owes to its very favourable external position – its basic balance (the sum of its current account surplus and its capital account) continues to trend higher (Graph 3). However, the yen is faced with a second downside risk, namely ever increasing oil prices. As a net importer of oil, the Japanese economy is vulnerable to elevated prices. With the WTI oil price bouncing around all time highs, cracks may start to appear in the yen's performance given the adverse terms of trade dynamic. Though this is a risk, we think it likely that for the most part the yen will continue to outperform the rest of the G10 given what the bulk of our other valuation metrics are suggesting from our G10 FX valuation scorecard in the *SG FX Monthly*. According to SGEER, the yen is the only currency which is still undervalued on a trade weighted basis.

Graph 1. The yen lost ground last week.



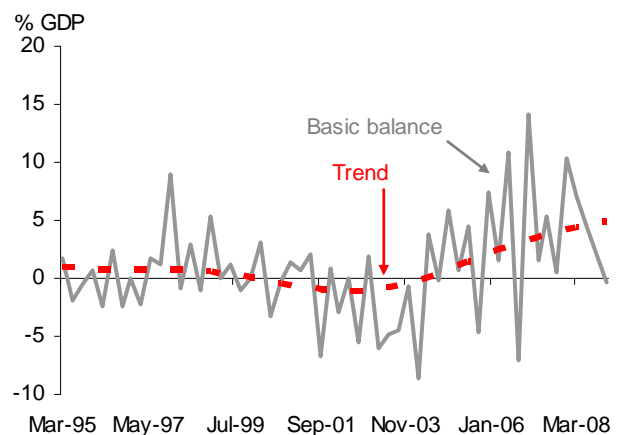
Source: SG Forex Research

Graph 2. More downside to JPY given lower VIX?



Source: SG Forex Research

Graph 3. Japan's external position a boon for JPY



Source: SG Forex Research

phyllis.papadavid@sgcib.com

## GBP: More downside in store?

### ■ Adverse growth/inflation mix will pressure GBP

This week seems to have been a roller coaster for sterling. GBP weathered a BOE press conference that erred towards the side of caution with Governor King's comments that the "nice decade" is over making the headlines and that not only had the growth outlook continued to deteriorate but that the prospect for higher inflation – and the UK consumer getting squeezed – were ever present. Our only question is why sterling did not weaken further than it did (Graph 1) following a particularly downbeat press conference and significant downside surprises in labour market data. Admittedly, GBP has already weakened significantly. What's more, with interest rates on hold (SG economics now forecasts the next hike will take place next year) and risk aversion being kept at bay it might garner some support in relation to its lower yielding counterparts. The UK's deteriorating growth/inflation mix does not bode well against the EUR and we hold our short exposure in our long Scandies basket. We also enter into a long EUR/GBP trade.

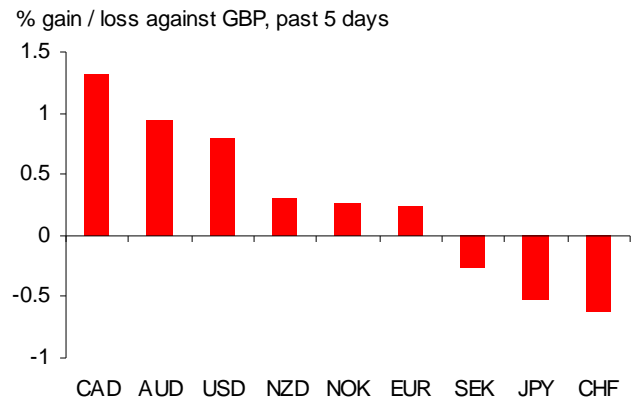
### ■ More downside surprises in store?

Looking ahead to the coming week, with the FX market likely to continue to punish currencies with weaker growth outturns GBP is likely to remain on the back foot. Downside surprises in this week's retail sales report will be important to watch out for, particularly at a time when our growth surprise index for the UK continues to edge lower (Graph 2). Equally, the CBI report as well as preliminary estimates of GDP will be market movers. We hold our short exposure in our long Scandies basket ahead of the reports. Upside surprises for GBP may lie on the monetary policy front with the release of the BOE minutes from the latest meeting. Further concerns about inflation may prompt some GBP buying with Cable offering upside potential. But patches of weakness on the growth front will sour GBP sentiment in our view against the bulk of G10 FX.

### ■ The UK's unfortunate external position

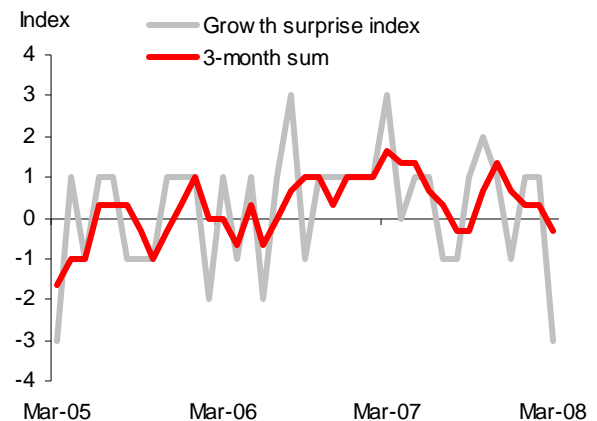
Although valuation models (given their long term orientation) usually take a back seat to growth and monetary policy considerations – the former continue to flash red for sterling, as we have highlighted in the past in the G10 valuation scorecard in our *FX Monthly*. Our caution on GBP hinges in large part on the UK's unsustainably large current account deficit. FX-wise, the size of the UK current account deficit is important. To the degree that the UK has US-like features – a large current account deficit amid a stretched housing market that is in the midst of a correction – GBP will likely remain under pressure against the UK's main trading partners which have favourable external positions (NOK, SEK, EUR, JPY). Of particular importance, from a capital flow perspective will be the degree to which M&A activity picks up in favour of UK assets. A recovery in UK equities, which may stimulate inflows into the UK will not only be conducive in restoring sentiment, but may help in improving the UK's basic balance (the sum of its current account surplus and its capital account) as well (Graph 3).

Graph 1. Sterling's mixed performance



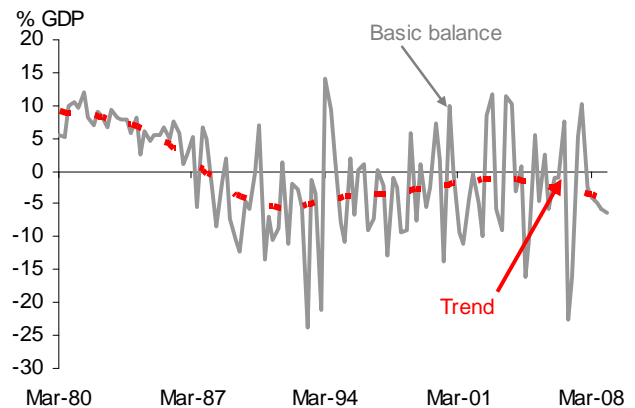
Source: SG Forex Research

Graph 2. UK growth surprise index takes a tumble



Source: SG Forex Research

Graph 3. The UK's basic balance has edged lower



Source: SG Forex Research

phyllis.papadavid@sgcib.com

## Other majors

<b>USD/CHF</b>	<b>1 week trend</b> →	<b>1 month trend</b> ↘
<b>EUR/CHF</b>	<b>1 week trend</b> →	<b>1 month trend</b> ↘
<b>Risk appetite leaves CHF on the defensive</b>	<p>CHF was the worst performer against USD last week as risk appetite was still weighting on low-yield currencies.</p> <p>Risk sentiment, and to a lesser extent Fed expectations, will continue to drive the CHF in the short and medium term. The currency will lose ground as long as risk appetite remains high and this should again be the case this week. Recoveries in risk aversion have been short-lived and will not last longer unless US indicators disappoint again.</p>	
<b>USD/CAD</b>	<b>1-week trend</b> →	<b>1-month trend</b> →
<b>USD/CAD mainly driven by USD moves</b>	<p>USD/CAD remains mostly driven by US dynamics, as the CAD is caught between two major contradictory drivers – namely rising oil prices and a deterioration in the growth outlook by contagion with the US.</p> <p>The weakening of the correlation with oil is noticeable as the highs reached by crude at USD 127pb have failed to trigger any real recovery of the CAD. With regards to data, we will mainly focus on CPI and retail sales this week, which should allow us to gauge the extent of the slowdown.</p> <p>We thus set up short CAD/NOK positions Ahead of the BoC meeting and as the NOK benefits more from oil prices than the CAD.</p>	
<b>AUD/USD</b>	<b>1 week trend</b> →	<b>1 month trend</b> ↘
<b>Vulnerability continue to increase, while the market is massively long AUD.</b>	<p>The AUD/USD continues to trade in a range of 0.93- 0.95. As we have already explained in the past few weeks, the main drivers of the Australian currency have evolved recently.</p> <p>Indeed, commodity trends – the main support factor for the AUD – are less clear now. For example, precious metals are trying to rebound while oil is still close to its highs but copper has started to consolidate. Historically, the AUD has been closely correlated with copper, so this trend could dominate.</p> <p>On the monetary front, it now seems clearer that the RBA will tolerate a temporary peak in inflation, given its expectations of slowing domestic demand. The fixed income market confirms this idea, as cumulated rate moves over the next 12 months are expected to be -6bp.</p> <p>Market positioning is another major vulnerability for the AUD. IMM data show +65.42k long net positions compared with a high of +88.82k in January 07.</p> <p>The past week's figures showed demand continuing to slow – the NAB index of business conditions in the industrial sector fell, as did housing loans – while fears of inflation dropped, with the wage index at +4.1%/y in Q1 vs. +4.3%/y expected.</p> <p>We continue to recommend avoiding the AUD, given its increasing vulnerabilities.</p>	
<b>NZD/USD</b>	<b>1 week trend</b> →	<b>1 month trend</b> ↘
<b>NZD has started to trend lower</b>	<p>The NZD has lost 2.90% against the USD over the past month. Back then we had underlined the sharp deterioration in New Zealand fundamentals and the change this implied in terms of monetary outlook: we explained that the NZD would suffer greatly. Today nothing has changed, so the NZD should continue its downtrend.</p> <p>Interestingly, although fixed-income market expectations are now quite aggressive in terms of rate cuts (-125bp total cut expected), markets are still relatively long NZD, with a net long IMM balance of +6.3K compared with a +27.8k high in July 07. This suggests good downside potential.</p> <p>Last week's domestic calendar confirmed the growth deterioration trend. Home prices (QV) slowed to +4.9%/y in April from +6.5%/y in March. REINZ home sales remained very weak at -45.5%/y. Retail sales also disappointed, at -1.2%/y from -0.6%/y previously. The only striking feature was the rebound in the PMI index to 51.4 from 48.7. This week's data will be of minor interest so not much attention will be paid to the release calendar.</p> <p>We keep a downside bias on NZD</p>	

**EUR/NOK**

**1 week trend** →

**1 month trend** →

**NOK still following oil**

In the past few weeks the NOK benefited from the sharp rise in oil prices. However, we continue to think consolidation is likely. This could trigger a squeeze of short EUR/NOK positions.

From a structural viewpoint – beyond the volatility caused by the variations in oil prices – the Norwegian monetary authorities still have good reasons to be more hawkish than the ECB, particularly since European growth is now showing signs of weakness. This justifies a baseline downward movement of EUR/NOK in the long term.

As far as figures are concerned, headline CPI registered a lower-than-expected rise of +3.1%/y against +3.5%/y expected, and core CPI printed +2.4%/y against +2.3%/y expected. The trade balance was weaker at 37.4bn vs. 39.1bn previously. This week will bring us Q1 GDP and the unemployment rate. These figures are widely expected to be robust and should not support the currency. In the short term, oil prices will therefore remain the currency's main driver - so beware consolidation risks.

**However, we recommend a short CAD/NOK position** as a relative value trade: the NOK has lagged relative to the recent rally in oil prices and Norway benefits from more positive economic fundamentals than the Canada.

**EUR/SEK**

**1 week trend** ↘

**1 month trend** ↘

**Stay long SEK on dips**

EUR/SEK rose from 9.28 to 9.3480 last week as Euribors underperformed Swedish contracts sharply.

However, we remain bullish SEK overall as the currency is supported by strong fundamentals and a good economic outlook. Two weeks ago, the Riksbank made it clear that it remained hawkish although does not plan to hike rates anytime soon.

The only Swedish data this week will be the unemployment rate (from the National Swedish Statistics) which is expected to fall in the wake of the AMV unemployment rate.

So, we still advise being long SEK.

**Trade recommendation; keep long SEK & NOK versus EUR & GBP**

carole.laulhere@sgcib.com, phyllis.papadavid@sgcib.com, david.deddouche@sgcib.com

## FX Trends - Emerging

### More volatility for the RUB from now on

■ **The Russian central bank announces a new FX policy:** The central bank of Russia yesterday announced that it was amending its forex policy and would intervene more often in the FX market. Until yesterday, the bank was intervening to smooth the fluctuations of the RUB versus its basket (0.55 USD/0.45 EUR) and keep the currency stable in a 30 kopeks range. It was intervening when upside or downside moves were close to 15 kopeks.

The new policy is aimed at widening the scope of FX interventions, meaning that the bank can enter the market even if the rouble fluctuations versus the basket are not threatening its corridor. The bank's statement said interventions would now be determined by the situation in the forex market, the country's trade balance and the federal budget. The bank will also use intervention to smooth liquidity in the money market during the monthly tax payment period, when the market can be very tight.

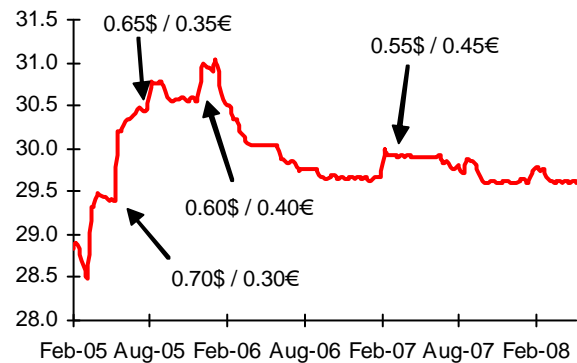
**What is the aim of the change in forex policy?** Obviously, the central bank wants the rouble's fluctuations to be less predictable and introduce a two-way risk to discourage speculative inflows. Since the end of 2005, the RUB has been gradually strengthening versus its basket and the inflationary outlook only reinforced the market's expectation for further appreciation. The central bank had mentioned several times since last year that it wanted to see more volatility in the rouble market. It will achieve this by making more unpredictable interventions. With this new policy, the central bank is preparing the RUB for a gradual move towards free float and a switch from exchange rate targeting to inflation targeting.

**What will be the impact on the rouble exchange rate?** Though the central bank's move weakened the RUB versus the basket to 29.78 on Wednesday from 29.66 the day before - due both to the CBR buying USD versus RUB and to unwinding of long RUB/basket positions - the developments on the trade and capital balances are still RUB supportive for the coming months at least. Indeed, after capital outflows of \$15bn in Q1, there were around \$20bn inflows in April according to the CBR. Prospects for May are good, notably following PM Putin's announcement on Wednesday that the government would grant tax breaks to firms developing fields in new regions (the stock market was up almost 3% on the news). Meanwhile, high oil prices are generating a large trade surplus and thus foreign currency receipts to be converted in RUB. Furthermore, the inflationary outlook is still deteriorating. In this context, after short term volatility, we expect the RUB to strengthen gradually in coming months, towards 29.40, once the CBR feels that the market is responding to the new two-way risk. In coming years though, the RUB will find less and less support as the trade and current account surpluses will shrink on the back of strong domestic demand that is boosting import growth.

#### Recommendation

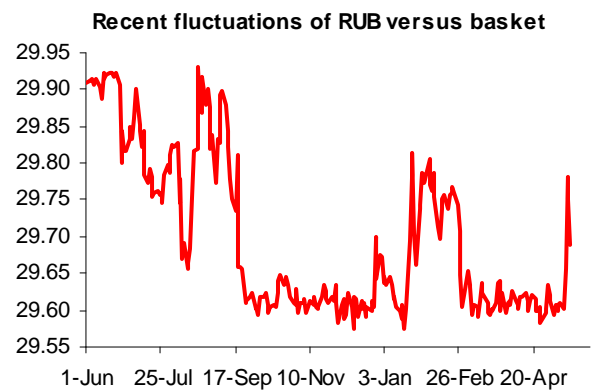
We opened a long RUB position versus the basket at 29.75 with a target of 29.40 and stop loss at 29.92.

Graph 1. RUB moves since the introduction of the basket



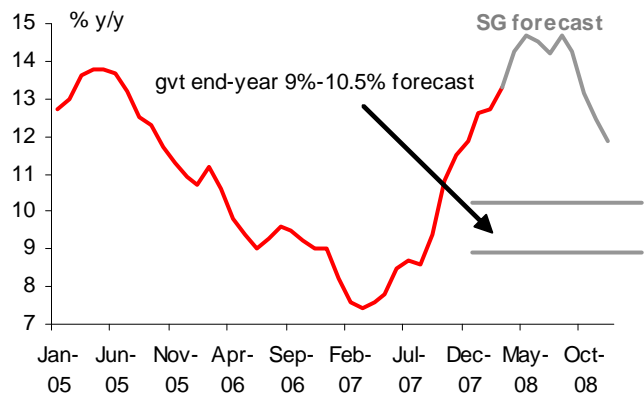
Source: SG Forex Research, Ecowin

Graph 2. Recent moves of the RUB versus the basket



Source: SG Forex Research, Ecowin

Graph 3. CPI growth has not reached its peak yet



Source: SG Forex Research, Ecowin

gaelle.blanchard@sgcib.com

## TRY's rise mainly a risk appetite phenomenon

■ **TRY performs on the back of stronger risk appetite.** USD/TRY has plunged by 10 figures below 1.23 since the beginning of April, and EUR/TRY by 20 figures. The main reason for these sharp movements is the return of risk appetite on the belief that the worst of the financial crisis is over. Domestic factors have played an extremely small role in investor appetite for Turkish currency. It could be argued that the central bank reversed the monetary cycle by raising rates, but market movements do not show a significant correlation between rate hike expectations and TRY performance. So the TRY seems vulnerable to a sudden change in market sentiment. It is obviously difficult of forecast such changes, but from a strictly macroeconomic standpoint there are several grounds for concern.

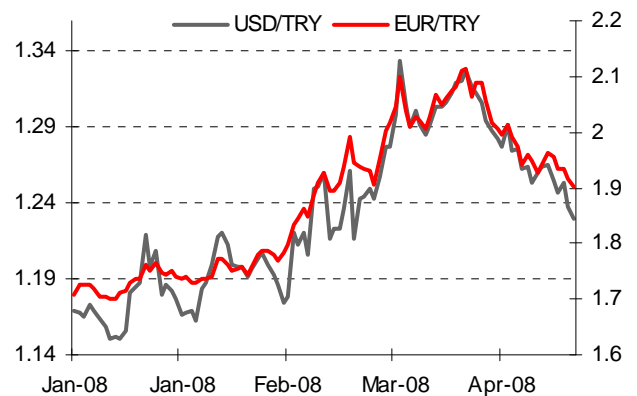
■ **Inflation trends remain negative.** Inflation has been on the rise since the beginning of the year and April data have once again surprised the market on the upside. The annual inflation rate has risen to 9.7%, its highest since May 2007. More importantly, core inflation is now increasing and inflation expectations are deteriorating. Year-end expectations have risen from 8.44% to 9.55% and 12-month expectations from 7.04% to 7.76%. Moreover, 24-month predictions are also now significantly above the tolerance range of 2-6%. These trends explain why the central bank decided to reverse its monetary policy tightening last week, raising the base rate by 50bp to 15.75%. The CBRT will no doubt continue to hike its rates and we will see another 50bp next month - but will this policy be able to maintain the TRY trend? We do not think so: as long as inflation keeps an upward trend, the peak in the inflation rate remains uncertain. A combination of higher inflation and lower risk appetite would prove negative for the TRY.

■ **The widening of the current account deficit increases TRY's vulnerability.** The latest balance of payments data confirmed that the current account deficit has entered a significant widening period. The deficit amounted to \$12.1bn in Q1 vs. \$9.3bn in Q1 2007 and could reach \$50bn by the end of the year. Moreover, capital flows to Turkish financial markets are drying up. FDI currently covers only 37% of the deficit compared to 80% a year ago, and foreign investors are tending to reduce their exposure to Turkish equities and bonds.

■ **All in all, the macro fundamentals suggest a weaker TRY going forward.** Those fundamentals will drive the currency lower if - as we expect - risk appetite decreases on the back of a deterioration in global economic prospects.

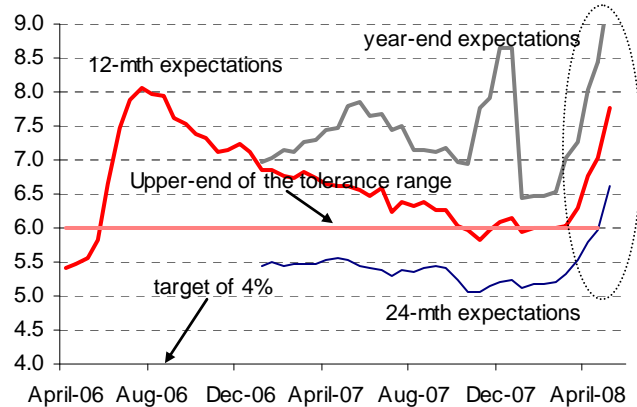
Our long USD/TRY was stopped out last Friday, but we keep our long EUR/TRY.

Graph 1 TRY on the rise again



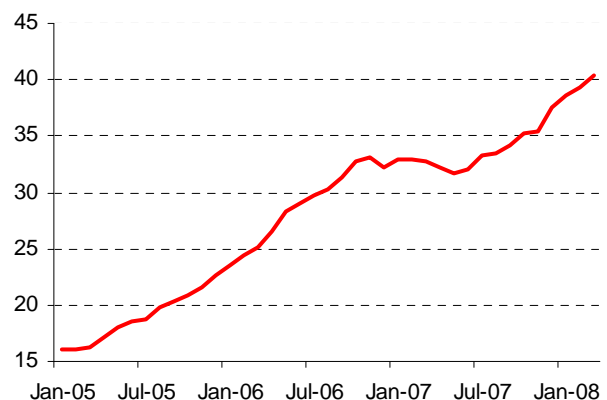
Source: SG Forex Research

Graph 2 Inflation expectations much higher than the CBRT's target



Source: SG Forex Research, CBRT

Graph 3 Current account deficit (1-year accumulated, USD bn)



Source: SG Forex Research, CBRT

[murat.toprak@sgcib.com](mailto:murat.toprak@sgcib.com)

## Other emerging currencies

EUR/PLN	1-week trend →	1-month trend ↘
<p><b>Wage data is a key determinant of monetary policy</b></p> <p><b>Next rate tightening move likely in June</b></p> <p><b>Some consolidation expected this week in EUR/PLN</b></p>	<p>EUR/PLN reached a new low last week at 3.3750, on the back of the improved regional environment, then settled back to around 3.3900. Though external factors and global market sentiment are currently more influential for emerging currencies than domestic factors, Polish data due this week are important. They will help assess the monetary policy outlook and the timing of the next rate hike. The latest economic data have been softer, unsurprisingly given the slowing global environment and the impact of the 175bp interest rate hikes since April 2007. Last week, the release of April CPI, up 4.0% y/y from 4.1% in March, reinforced the view that the central bank's MPC will keep rates on hold this month.</p> <p>April wage growth due on Monday is expected to be up 11.5% y/y from 10.2% in March. Wage growth is likely to be supported further in coming months, given labour market developments. Employment is rising steadily – growth for April is due on Monday and expected to be 5.8% y/y and the unemployment rate down to 10.5% from 15.1% at the start of 2007. Meanwhile, there are still skilled labour shortages and this problem will not be resolved any time soon. Though another tightening move in May appears unlikely, notably because of the PLN strength, wage growth above expectations would probably fuel hawkish comments from the MPC hard-line members, who remain on alert. We expect the next 25bp hike to occur in June, when the new Inflation Report will be released. Though this is expected to be the end of the tightening cycle, further rate hikes are not excluded if the inflationary outlook does not improve as fast as anticipated.</p> <p>FX-wise, we expect some consolidation in EUR/PLN after recent gains, though stronger than expected wage data and improved market sentiment could provide further support in the short term. Our longer term view remains bullish PLN due to strong fundamentals, especially relative to peer currencies. Hence, we keep our long PLN/HUF position with target of 76.00 and stop-loss at 71.27.</p>	
EUR/CZK	1-week trend ↗	1-month trend ↗
<p><b>Deteriorating economic outlook to weigh on the CZK</b></p>	<p>EUR/CZK reached a one-month low last week, pulled by SKK strength ahead of the setting of the EMU conversion rate for the Slovak currency. However, data released during the week confirmed our view that the economic outlook is deteriorating and will start to weigh on the CZK. GDP growth slowed to 5.4% y/y in Q1 from 6.6% in Q4 and March's current account recorded a deficit of CZK 0.57bn after a CZK 11.8bn surplus in February. The financial account data were also negative, as FDI inflows almost halved while portfolio outflows increased further.</p> <p>The strengthening of the CZK over recent months, and lower foreign demand, are hurting export growth and will reduce the trade balance. Coupled with the rate tightening cycle being close to ending, this will further weigh on the CZK in coming months. We keep our long EUR/CZK position with a target of 25.80, as well as our short CZK/SKK position with a target of 1.20.</p>	
EUR/HUF	1 week trend →	1 month trend ↗
<p><b>The next 25bp rate hike should be the last of the cycle</b></p>	<p>As we were expecting, EUR/HUF moved lower last week breaking the 250 level. However, the movement has not been isolated as EMEA high-yielding currencies have all performed well. The most recent economic data have not modified our view that another rate hike of 25bp is likely at the MPC meeting at the end of the month. Hence, the EUR/HUF will move higher in the coming weeks. However, contrary to market expectations, the NBH is unlikely to raise the key rate much beyond 8.50% given the persistent weakness of the economy. GDP grew only 1.6% y/y in Q1 despite the positive contribution from the agricultural sector, underlining that the economy remains under pressure from tight economic policy. In parallel, wage growth decelerated in April to 9.9% y/y from 13.1% in March, giving to the central bank more room for manoeuvre.</p> <p>As a result, we still see EUR/HUF reversing its downward trend in the coming weeks. The macroeconomic picture and correction in rate hike expectations will push the EUR/HUF lower in our view. The risk appetite seen in recent weeks looks excessive and any significant lessening of appetite will also contribute to a higher EUR/HUF. We keep our long position with a target at 267.</p>	

**USD/KRW**

1 week view 

1 month view 

Asian currencies are seeing their weakest monthly performance against the dollar since the beginning of the year. Losses have been driven by escalated inflation concerns and a related erosion of investor risk appetite which has prompted widespread covering of previously bullish positions.

**Underperformance of South Korean won to continue**

The South Korean won had already underperformed other regional currencies this year. This month so far it has lost another 3.5% against the USD, bringing losses since the beginning of the year to 10.4%. Investor risk aversion is showing in the huge portfolio outflow from the equity market, totalling \$17.2 billion since 1 January. The deterioration in the trade account due to high oil prices is another negative for the KRW. We see little relief for the trade account in the next few months, especially as slower global consumer demand starts to curb exports. The KRW will remain an underperformer until the trade account returns to a surplus.

**USD/CNY**

1 week view 

1 month view 

The past two weeks have seen a sharp backing-up of the pricing for CNY appreciation through the non-deliverable-forward market. The 12-month NDF was last indicated at 6.6115, from as low as 6.2755 in early April. Off the current spot of 6.9875, the current one-year quote prices an appreciation of around 5.3% over the next year, versus more than 10% in early April.

**USD/CNY forward pricing eases to more realistic pace**

Investors have seized on speculation that China is unlikely to maintain the recent pace of CNY appreciation due to increasing pressures on exporters from the currency gains. Our view is unchanged: we believe China is keen to promote its currency to a stronger level, where it will then be encouraged (through a combination of QDII and QFII programmes) to fluctuate in a potentially wider band. The recent period of accelerated appreciation neatly coincided with one where inflows of “hot money” were less likely to require large-scale USD buying intervention from the central bank, due to softened investor risk appetite during the subprime and liquidity crisis.

While we consider the correction in the NDF market is appropriate, we do not believe we have seen the end of USD/CNY downside. The best proxy for USD/CNY spot has been the dollar index. Assuming we have not yet seen the USD low, we do not think the downside move in USD/CNY has run its course either. We forecast USD/CNY at 6.90 at end-June and 6.80 at end-September. To reflect our view of a moderated pace of CNY appreciation in the second half of the year, we maintain a short 6-month against long 12-month NDF in our model portfolio. The trade was entered at 0.27 or 3.8% and we target a move to 2.0% with a stop loss at 4.5%.

**Short 6-month USD/CNY NDF at 6.8200, long 12-month NDF at 6.5500 (spread entered at -0.27, last -0.22)**

**TWD/PHP and JPY/MYR**

1 week view 

1 month view 

The biggest losers among Asian currencies month-to-date apart from the KRW have been the INR, PHP and MYR. India and Philippines’ trade accounts are deteriorating on the impact of high oil prices. and we see little relief for either in coming months, especially given the expectation of slower exports.

**TWD to outperform PHP, JPY to outperform MYR on divergent inflation and growth threats**

The MYR and the SGD have recently weakened significantly relative to previous positive trends. The MYR has dropped 2.5% and the SGD 0.9% since 1 May. Risk to external demand for Singapore and Malaysia, whose exports have high leverage to US consumption, had been overtaken by a focus on inflation threats. But with Malaysian exports showing deterioration we fear currency gains will ultimately face resistance from a slowing external sector.

In tune with a still fragile US outlook, we expect some further Asian currency underperformance. The Philippines, Malaysia, Singapore and India are at greatest risk due to a combination of oil prices, inflation and external demand threats. We have established long relative value trades of TWD against PHP and JPY against MYR.

**Long TWD/PHP at 1.3910, target 1.4300. stop-loss 1.3740**

**Long JPY/MYR at 3.0920, target 3.2500, stop-loss 3.0350**

gaelle.blanchard@sgcib.com, murat.toprak@sgcib.com, patrick.bennett@sgcib.com

## Technical analysis

► **EUR/USD - 1.5715/40 (\*)** is the key resistance area to break to confirm the return to 1.6000/20.

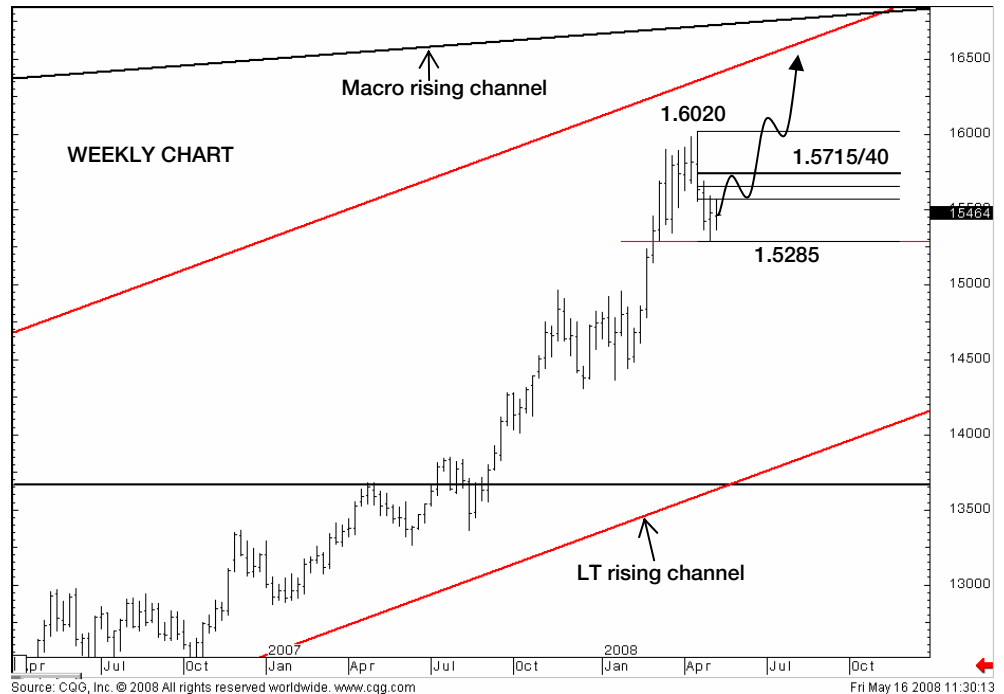
The 1.5285 support area has stopped the corrective down-move initiated at 1.6020.

This is the first step of an upward reversal, but it is not sufficient to rule out the ST downside risk. We therefore recommend caution until EUR/USD breaks above the 1.5715/40 resistance zone and confirms its reversal towards the 1.6000/20 region.

From a broader perspective, we expect EUR/USD to extend its major uptrend to the upper ends of the LT macro rising channels, coming at 1.6430 (+0.0067/month) and 1.6715 (+0.0014/month) in May.

(\*) ST Fibonacci retracement and daily pullback level.

### EUR/USD: Reversal towards 1.60 not yet confirmed



3 <sup>rd</sup> support	2 <sup>nd</sup> support	1 <sup>st</sup> support	Last	1 <sup>st</sup> resistance	2 <sup>nd</sup> resistance	3 <sup>rd</sup> resistance
1.4965	1.5145	1.5285	1.5465	1.5570	1.5715/40	1.6020

### EUR/JPY: Resumption of recovery towards the 168/169 zone

► **EUR/JPY - 164.95 and 166.65** should be the main resistance areas on the way back to last year's highs of 167.70/168.95.

Given the extent of the recovery initiated near the 158.25/35 support area (\*), the deeper than expected consolidation of the up-leg, which started at 151.75 in mid-March, is probably over.

So EUR/JPY should break above the 163.05/10 resistance area in the near future and return to the April high of 164.95.

It should then break above 164.95 and target last year's highs of 167.70/168.95 with a final step at 166.65.

(\*) Fibonacci retracement and mid-April low.



3 <sup>rd</sup> support	2 <sup>nd</sup> support	1 <sup>st</sup> support	Last	1 <sup>st</sup> resistance	2 <sup>nd</sup> resistance	3 <sup>rd</sup> resistance
156.80	158.25/65	160.60	162.15	163.05/10	164.95	166.65

## Short Rates

■ **Inflation fears back to the fore.** Last week saw futures prices continuing their slide in every major currency on the back of still deeper inflation concerns, as well as hawkish central bank talk (see Central Bank Watch).

The drop was particularly noticeable in EUR, with the publication of stunning GDP growth in Q1 in Germany, combined with hawkish ECB talk. Thursday Garganas warned that a rate hike could be decided if deemed necessary, and Weber and Liebscher quickly followed up saying that a cut was not an option this year. As a consequence rate-hike expectations made their comeback all along the Eonia curve, with September seen as the best timing for a move (30% probability; see Table 1). While the market is already quite aggressive regarding the ECB, we would wait for better entry levels to put on short Eonia positions (not before the odds for a hike in September/December reach 50%).

**Table 1. Implied market probabilities for the ECB refi rate based on forward starting Eonias on meeting dates**

ECB date	3.50%	3.75%	4.00%	4.25%
8-May	-	-	-	-
5-Jun	-	-	97.6%	2.4%
3-Jul	-	-	96.8%	3.2%
7-Aug	-	-	94.8%	5.2%
4-Sep	-	-	70.8%	29.2%
2-Oct	-	-	72.0%	28.0%
6-Nov	-	-	73.2%	26.8%
4-Dec	-	-	74.0%	26.0%
8-Jan	-	-	84.0%	16.0%
5-Feb	-	-	78.0%	22.0%
5-Mar	-	-	80.0%	20.0%

Source: SG Fixed Income Research

■ Fed officials heavily weighed in last week's hawkish tone, with numerous references to the inflation risk (see Fed Watch). In particular, the WSJ reported that Fed officials are openly discussing rate hike timing. Even the well-known dove Yellen acknowledged that *"it is important for the Fed to remove the stimulus we've put in place in a timely way."* Minneapolis Fed Gary Stern put it even more squarely, *"You can't wait until you're 100% confident that all the problems are behind us, the economy's now growing robustly and it's time to change policy [...] You've got to be prepared to say, yes, there are still some problems, the current environment isn't all that we might like it to be, but we really think the outlook is pretty good and it's time to act."* As a consequence, OIS now believe the Fed will have tightened policy by 25bp by the end of the year and by an additional 100bp next year. This remains much too aggressive a forecast in our view, but with oil prices reaching new highs almost every week, we would not fight the trend just yet.

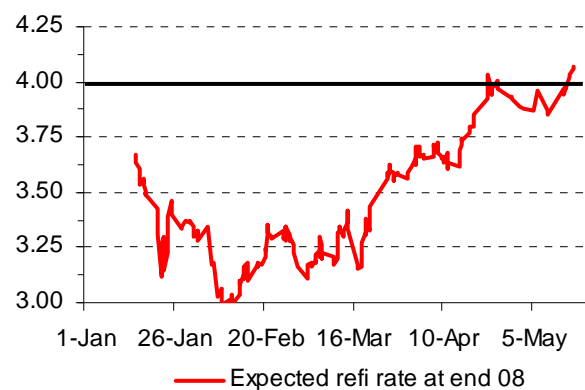
**Table 2. OIS-implied fed funds target rate on FOMC dates**

FOMC date	OIS pricing (%)	Exp. cuts(-)/hike(+)
25-Jun-08	1.978	-2.2
05-Aug-08	1.989	1.1
16-Sep-08	2.025	3.6
29-Oct-08	2.106	8.1
16-Dec-08	2.238	13.2
28-Jan-09	2.416	17.8
17-Mar-09	2.635	21.9
06-May-09	2.810	17.5
24-Jun-09	2.942	13.3
04-Aug-09	3.066	12.3
22-Sep-09	3.178	11.2
29-Oct-09	3.282	10.4
16-Dec-09	3.376	9.4

Source: SG Fixed Income Research

■ While risks are quite symmetrical at the moment in EUR and USD, the safest place to put on short OIS positions is probably in STG. Rate-cut expectations have been scaled back massively over the last few weeks, and notably after the release of the BoE Inflation Report last Wednesday. The projections in the Report show that the Bank expects inflation to remain above 3% until early next year. The Bank will thus have to write probably three letters to the chancellor (see BoE Watch). According to our UK economist, *"the inflation path postpones rate cuts as it is difficult to conceive that the MPC will cut rates whilst the Governor is writing these letters. That means that the first cut should, at the earliest, be late in Q1 2009."*

**Graph 1: Rate-hike expectations returned with a vengeance on the Eonia curve last week**



Source: SG Fixed Income Research

This view is now shared by the market, with Sonias broadly pricing the BoE to remain on hold until the end of the year (see Table 3). The STG OIS market offers the best opportunities to put on receiving positions as the risk still appears very much asymmetrical there. The economy remains weak and the housing market dynamics makes it very unlikely that we will see an upturn soon. So the market is very unlikely to start pricing hikes on the STG strip soon, even if the inflation picture is as ugly as everywhere else. Relative to the Fed and the ECB, the bank's base rate

Fixed Income & Forex Research

remains at a restrictive level, especially so considering the position of the UK economy in the business cycle. **Receiving the September, October or November MPC meetings through Sonias thus offers an attractive risk/reward (-5bp/+20bp) on the assumption the market will not price near-term hikes.**

In any case, it is pretty obvious that the inflation picture is going to tie the BoE's hands, at least to a certain extent, and hence delay a reaction from the Bank should the economy turn out to be much weaker than expected. That clearly favours – possibly conditional – flatteners as such a situation would lead the market to position an expected cut around the turn of the year rather than upfront. **Receive 6x12 Sonia @ 5% (4.985% mid). Target @ 4.80%. Stop @ 5.10%.**

Table 3. Sonia-implied BoE policy rate on MPC dates

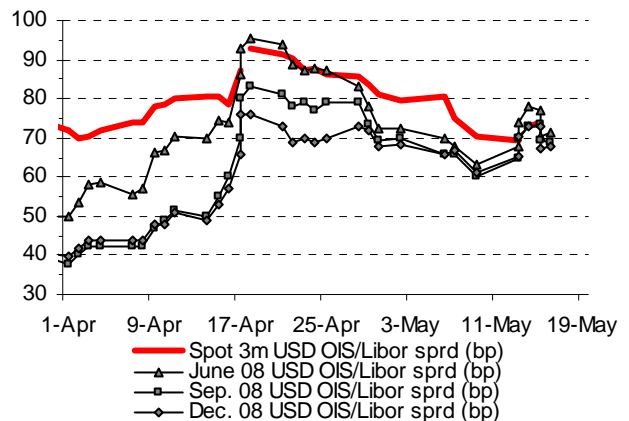
MPM date	Effective start date	Effective end date	Implied base rate	Expected cuts(-) / hikes(+)
5-Jun-08	6-Jun-08	10-Jul-08	4.98	-2.50
10-Jul-08	11-Jul-08	7-Aug-08	4.97	-1.00
7-Aug-08	8-Aug-08	4-Sep-08	4.96	-1.00
4-Sep-08	5-Sep-08	9-Oct-08	4.95	-1.00
9-Oct-08	10-Oct-08	6-Nov-08	4.95	0.00
6-Nov-08	7-Nov-08	4-Dec-08	4.95	0.00
4-Dec-08	5-Dec-08	8-Jan-09	4.94	-0.98
8-Jan-09	9-Jan-09	5-Feb-09	4.92	-1.74
5-Feb-09	6-Feb-09	5-Mar-09	4.90	-1.74
5-Mar-09	6-Mar-09	9-Apr-09	4.88	-1.74
9-Apr-09	10-Apr-09	7-May-09	4.88	0.12
7-May-09	8-May-09	4-Jun-09	4.89	0.12
4-Jun-09	5-Jun-09	9-Jul-09	4.89	0.12
9-Jul-09	10-Jul-09	6-Aug-09	4.89	0.12
6-Aug-09	7-Aug-09	3-Sep-09	4.88	-0.50
3-Sep-09	4-Sep-09	8-Oct-09	4.88	-0.50
8-Oct-09	9-Oct-09	5-Nov-09	4.87	-0.50
5-Nov-09	6-Nov-09	3-Dec-09	4.89	1.44
3-Dec-09	4-Dec-09	7-Jan-10	4.90	1.44

Source: SG Fixed Income Research

■ **USD OIS/Libor bases on a roller-coaster, while EUR bases continue to widen.** Given their strong tendency to behave in a directional way, bases widened dramatically on both sides of the Atlantic in the first part of the week on the back of a big sell-off in Eurodollar and Euribor Futures contracts. The latter was the consequence of heightened inflation fears leading to an upward revision in the Fed and ECB's policy rate projected paths, as well as speculation over changes to the calculation of Libor (the first results of the BBA review are due May 30). By Wednesday close, the June IMM USD OIS/Libor forward spread had widened back to 78bp, from just 63bp on May 9. Due to the flat structure of the USD forward bases curve (see last week's Weekly for more details), we saw the same kind of moves on the Sep. and Dec. maturities (+13.5bp to 73.5bp on Sep. 08, and +12bp to 73bp on Dec.). While the widening was less pronounced on the March 09 maturity, the forward spread still increased by 9bp to 50bp. Thursday saw a reversal of the previous moves on the back of weaker-

than-expected US industrial production – with Futures-implied rates dropping more than OIS rates – and hopes that the Fed would soon expand the size of its TAF operations. At the time of writing, June was down to 71.5bp, Sep. to 69bp, Dec. to 68bp and March 08 to 45bp.

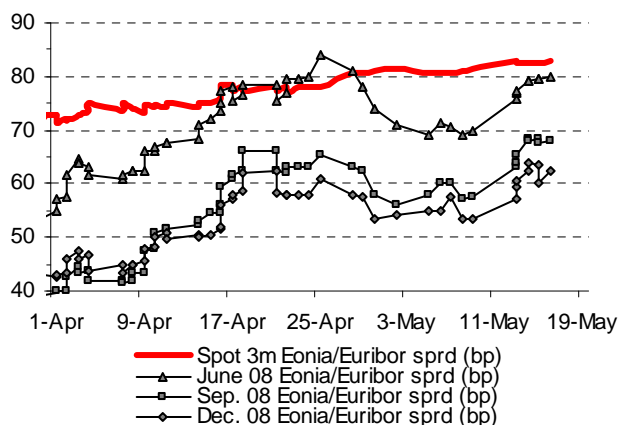
Graph 2: USD OIS/Libor bases on a roller-coaster...



Source: SG Fixed Income Research

In EUR, the second part of the week did not allow a narrowing of the spot and forward bases, as Euribors could not follow Eurodollar Futures on the way up. Indeed, hawkish comments from Garganas (see ECB Watch) combined with a much stronger-than-expected German GDP growth for Q1 (+1.5% Q/Q vs. +0.7% expected) maintained the downward pressure on Euribor prices. As a result, the spot Eonia/Euribor spread was left standing at a year-high of 83bp. The June forward spread was up 10bp on the week, to 80bp, while the Sep. and Dec. spread also widened some 10bp, to 68bp and 62.5bp, respectively.

Graph 3: ... while EUR bases continue to widen



Source: SG Fixed Income Research

■ We continue to be puzzled by the relative flatness of the USD forward basis curve relative to the EUR curve: the June-Dec. sector is inverted by a mere 3.5bp in USD, while it is inverted by 17.5bp in EUR. By the end of March, the

**Fixed Income & Forex Research**

EUR and USD spot and forward bases (up to Dec.) had essentially merged. One month later, the front USD bases are trading well below the EUR bases, yet the Sep. and Dec. USD bases are trading well above the EUR bases. We recommended a Jun.-Dec. USD basis flattener vs. EUR steepener two weeks ago and see no reason to unwind the position at this stage (the trade is more or less flat as we write).

Otherwise, **we do not think it makes sense for the Fed to increase the size of its TAF operations** (\$75bn) further at this stage. The next auction is scheduled on May 21, when a \$50bn operation will be rolled and expanded (the terms of the auction will be announced Monday). A \$75bn auction Monday would thus bring the outstanding amount borrowed at the TAF up from \$125bn to \$150bn. Given the size of the overbidding at the May 5 auction (\$21.6bn), a \$75bn auction this time around seems adequate. An increase could of course be warranted if Monday's auction was well oversubscribed, but that is not the most likely scenario in our view. On the other hand, it seems ever more obvious that the initial \$200bn worth of Fed's Treasury holdings dedicated to the TSLF was excessive, and so we should see the size of the forthcoming operations scaled back further. Thursday's Schedule 1-type auction was well undersubscribed (B/C: 0.29), which brings the amount outstanding under this program down to about \$130bn. Given the improvement we have seen in the conforming and private-label secondary MBS market, the demand from the part of Primary Dealers to swap ABS securities for Treasuries is set to drop further. Arguably, that leaves increased room for the Fed to increase the money it lends to depository institutions through the TAF program, but the current size may be sufficient for now.

While the Fed might be happy with \$150bn under the TAF program, there were rumours last week around a possible lengthening of the maturity of the program from 28 days currently to 3 months. Admittedly the psychological hurdle regarding the maturity of the Fed's loans to depository institutions has already been overcome in March, when the latter were given the possibility to tap the discount window for as long as 3 months, but it is equally unclear whether the Fed will decide to do so at auctions such as TAFs. In any case, that would certainly be a major step towards reducing the spread between the 3m OIS rate and the 3m Libor rate. Indeed, the stop-out rate at the May 5 auction came out 48bp lower than the 1m Libor, which helped the 1m OIS/Libor spot basis to narrow by some 19bp since then, to 50.7bp – in the meantime, the 3m basis only tightened by 5bp.

■ On the other side of the Atlantic, further ECB liquidity initiatives are more likely by the week. Indeed, the June EONIA-FRA basis is back at 80bp, as fixings stay stubbornly high (3m spot at a year-high of 83bp). Also, we keep in mind what Noyer said just three weeks ago: ***"I don't think we can tolerate the continuation of such tensions. We are first, by our close contacts with the banking sector, in the process of understanding precisely what triggered the latest developments and we will then find the appropriate way to help the market move in the right direction."*** Interestingly, the ECB noted in its May Monthly Bulletin that *"with respect to the Eurosystem's measures to enhance banks' access to liquidity and, more*

*generally, to improve the functioning of the money market at longer than overnight maturities, the most successful actions appear to have been the conduct of several supplementary LTROs and the variation of full allotment in the two-week MRO before the year-end."* As we have been arguing in the past, a switch to systematic full-allotment procedures at MROs combined with daily liquidity-absorbing fine-tuning operations so as to avoid a drop of the EONIA towards the deposit facility level (3%) would likely be quite effective in bringing down 3m fixings. It would indeed anchor the overnight rate slightly below 4%, which would quickly spill over to the 1-week and 1-month sectors. The induced steepening of the money market curve would then render the 3m sector much more attractive to investors (money market funds and foreign central banks). This reasoning seems shared at the ECB too, if the May Monthly Bulletin is to be believed: *"the general liquidity allotment policy aimed at steering the overnight rate is likely to have had a significant indirect positive effect on general money market conditions, because the success achieved in stabilising the overnight rate also spilled over to somewhat longer-term maturities – at least in the period to mid-January 2008 – for instance by enhancing the possibilities for arbitrage between different maturities."* So what is the ECB waiting for?

■ In outright terms, we now favour a cautious short OIS/BOR exposure given the risk of further central bank interventions, though we reckon that the room for narrowing is limited. While central banks' efforts may eventually curb the liquidity component of OIS/BOR spreads, the credit risk component, which has steadily increased since the start of the crisis, will be slow to narrow; especially so as large bank write-downs still lie ahead. We prefer to express this view on the June 08 Eonia/Euribor basis as the latter stands at a year-high of 80bp and is 11bp wider than the USD 3m June basis (Sep. 08 is 1bp tighter in EUR).

**The Sep. 08/March 09 sector of the forward Eonia/Euribor spread curve remains much inverted, so a steeper continues to make sense from a historical point of view.** Moreover, we could see a disinversion led by the front end of the curve if the ECB announces new liquidity initiatives/or the Fed lengthens the maturity of its TAF auctions to 3 months.

**Recommendations**

**STG.** Receive 6x12 Sonia @ 5% (4.985% mid). Target @ 4.80%. Stop @ 5.10%.

**EUR.** Sell the 3m June 08 IMM Eonia/Euribor spread @ 80bp. Target @ 70bp. Stop @ 90bp.

Hold steepeners on the Sep. 08/March 09 sector of the forward Eonia/Euribor spread curve.

**OIS/Libor EUR/USD box.** Hold USD BOR-OIS JUN-DEC flattener (short DEC basis, long JUN basis) vs. Eonia-Euribor JUN-DEC steepener.

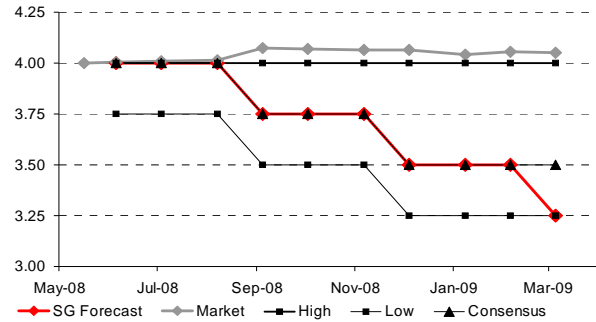
guillaume.baron@sgcib.com

## Central Banks' key rate monitor \*

\* Market rates extracted from OIS as of 16 May 2008, 2.00 pm GMT

### ECB refi rate: SG forecast vs market and consensus expectations

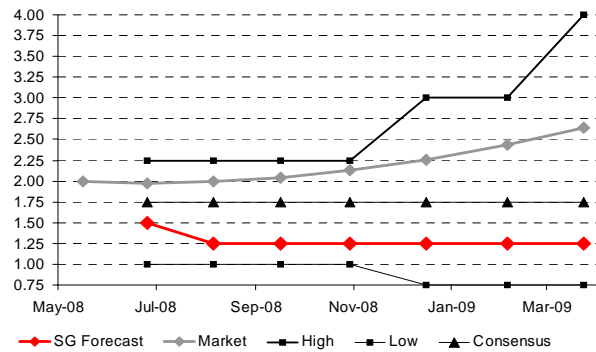
Gov Council date	SG Forecast	Market	High	Low	Consensus
-	-	4.000	-	-	-
5-Jun-08	4.000	4.006	4.00	3.75	4.00
3-Jul-08	4.000	4.008	4.00	3.75	4.00
7-Aug-08	4.000	4.013	4.00	3.75	4.00
4-Sep-08	3.750	4.073	4.00	3.50	3.75
2-Oct-08	3.750	4.070	4.00	3.50	3.75
6-Nov-08	3.750	4.067	4.00	3.50	3.75
4-Dec-08	3.500	4.065	4.00	3.25	3.50
8-Jan-09	3.500	4.040	4.00	3.25	3.50
5-Feb-09	3.500	4.055	4.00	3.25	3.50
5-Mar-09	3.250	4.050	4.00	3.25	3.50



Source: SG Fixed Income Research, Reuters survey on ECB refi rate forecasts

### Fed funds target rate: SG forecast vs market and consensus expectations

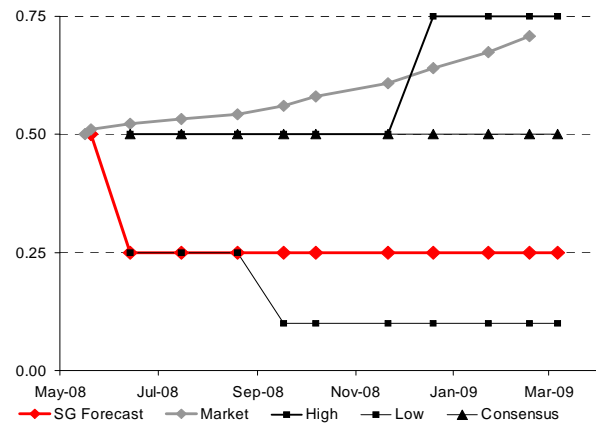
FOMC date	SG Forecast	Market	High	Low	Consensus
-	-	2.000	-	-	-
25-Jun-08	1.500	1.978	2.25	1.00	1.75
5-Aug-08	1.250	1.992	2.25	1.00	1.75
16-Sep-08	1.250	2.041	2.25	1.00	1.75
29-Oct-08	1.250	2.129	2.25	1.00	1.75
16-Dec-08	1.250	2.261	3.00	0.75	1.75
4-Feb-09	1.250	2.433	3.00	0.75	1.75
24-Mar-09	1.250	2.637	4.00	0.75	1.75



Source: SG Fixed Income Research, Reuters survey on fed funds target rate forecasts

### BoJ's OCR: SG forecast vs market and consensus expectations

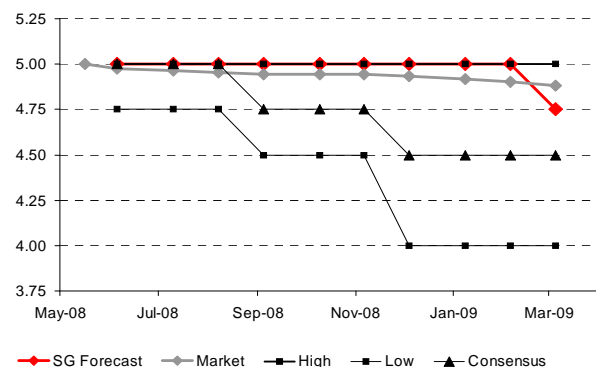
MPM date	SG Forecast	Market	High	Low	Consensus
-	-	0.500	-	-	-
20-May-08	0.500	0.510	-	-	-
13-Jun-08	0.250	0.523	0.50	0.25	0.50
15-Jul-08	0.250	0.533	0.50	0.25	0.50
19-Aug-08	0.250	0.543	0.50	0.25	0.50
17-Sep-08	0.250	0.560	0.50	0.10	0.50
7-Oct-08	0.250	0.580	0.50	0.10	0.50
21-Nov-08	0.250	0.608	0.50	0.10	0.50
19-Dec-08	0.250	0.640	0.75	0.10	0.50
22-Jan-09	0.250	0.674	0.75	0.10	0.50
17-Feb-09	0.250	0.709	0.75	0.10	0.50
6-Mar-09	0.250	-	0.75	0.10	0.50



Source: SG Fixed Income Research, Reuters survey on BoJ's OCR forecasts

### BoE's official rate: SG forecast vs market and consensus expectations

MPC date	SG Forecast	Market	High	Low	Consensus
-	-	5.000	-	-	-
5-Jun-08	5.00	4.975	5.00	4.75	5.00
10-Jul-08	5.00	4.965	5.00	4.75	5.00
7-Aug-08	5.00	4.955	5.00	4.75	5.00
4-Sep-08	5.00	4.945	5.00	4.50	4.75
9-Oct-08	5.00	4.945	5.00	4.50	4.75
6-Nov-08	5.00	4.945	5.00	4.50	4.75
4-Dec-08	5.00	4.935	5.00	4.00	4.50
8-Jan-09	5.00	4.918	5.00	4.00	4.50
5-Feb-09	5.00	4.900	5.00	4.00	4.50
5-Mar-09	4.75	4.883	5.00	4.00	4.50



Source: SG Fixed Income Research, Reuters survey on BoE's official rate forecasts

## SG Exchange Rate and Interest Rate Forecasts

### Exchange Rates (end quarter)

	16 May 08	Jun 08	Sep 08	Dec 08	Mar 09
EUR/USD	1.5551	1.65	1.58	1.60	1.55
USD/JPY	104.07	90	95	90	95
GBP/USD	1.9537	2.01	1.95	1.98	1.96
USD/CHF	1.0479	0.92	0.97	0.94	0.98
USD/NOK	5.0471	4.61	4.81	4.81	5.03
USD/SEK	5.9914	5.61	5.70	5.59	5.74
USD/CAD	0.9975	0.96	0.98	1.00	1.07
AUD/USD	0.9501	0.94	0.97	0.93	0.90
NZD/USD	0.7698	0.82	0.83	0.79	0.76
USD/CNY	6.9890	6.90	6.80	6.75	6.70
EUR/JPY	161.84	149	150	144	147
EUR/GBP	0.7959	0.82	0.81	0.81	0.79
EUR/CHF	1.6296	1.51	1.53	1.51	1.52
EUR/NOK	7.8487	7.60	7.60	7.70	7.80
EUR/SEK	9.3172	9.25	9.00	8.95	8.90
EUR/CAD	1.5512	1.58	1.55	1.60	1.66
EUR/AUD	1.6368	1.76	1.63	1.72	1.72
EUR/CNY	10.897	11.39	10.74	10.80	10.39

### Key central bank rates (end quarter)

	16 May 08	Jun 08	Sep 08	Dec 08	Mar 09
USA	2.00	1.50	1.25	1.25	1.25
Euro area	4.00	4.00	3.75	3.50	3.25
Japan	0.50	0.25	0.25	0.25	0.25
UK	5.00	5.00	5.00	5.00	4.75
Norway	5.50	5.50	5.50	5.75	5.75
Sweden	4.25	4.25	4.25	4.50	4.50
Switzerland	2.75	2.75	2.75	2.50	2.25
Canada	3.00	3.00	3.00	3.00	3.00
Australia	7.25	7.25	7.50	7.50	7.50
New Zealand	8.25	8.25	8.25	8.00	7.75

### 10-yr yield

	16 May 08	Jun 08	Sep 08	Dec 08	Mar 09
USA	3.775	3.20	3.50	3.75	3.75
Euro area	4.166	3.50	3.60	3.70	3.70
Japan	1.684	1.15	1.00	1.10	1.20
UK	4.766	4.00	4.10	4.20	4.15
Canada	3.563	3.60	4.00	4.50	4.50
Australia	6.307	6.10	6.05	6.00	5.95

Source: SG FX Research

## Weekly Calendar & Key FX Events

Economic indicators	GMT	Period	Last	SG Fcst	Cons
<b>During the week</b>					
<b>GE</b> Import Price Index (MoM)		APR	0.4%	na	0.6%
Import Price Index (YoY)		APR	5.7%	na	5.3%
<b>Monday 19-May-2008</b>					
<b>US</b> Leading Indicators	14:00	APR	0.1%	na	-0.1%
<b>JN</b> Tertiary Industry Index (MoM)	23:50	MAR	-1.7%	0.5%	0.5%
<b>Tuesday 20-May-2008</b>					
<b>AU</b> Reserve Bank's Board May Minutes	01:30				
<b>JN</b> BOJ Target Rate		May-20	0.5%	0.5%	0.5%
Coincident Index	05:00	MAR F	33.3%	33.3%	na
Leading Economic Index	05:00	MAR F	20%	20%	na
BOJ Monthly Report	06:00				
<b>GE</b> Producer Prices (MoM)	06:00	APR	0.7%	0.4%	0.6%
Producer Prices (YoY)	06:00	APR	4.2%	4.6%	4.8%
<b>SZ</b> SNB Releases Monthly Statistical Bulletin	07:00				
<b>IT</b> Industrial Orders s.a. (MoM)	08:00	MAR	2%	na	-2.5%
Industrial Orders n.s.a. (YoY)	08:00	MAR	14.3%	na	-0.4%
Current Account (mlns euro)	08:30	MAR	-4701	na	na
<b>GE</b> Zew Survey (Current Situation)	09:00	MAY	33.2	30	32
ZEW Survey (Econ. Sentiment)	09:00	MAY	-40.7	-37	-37
<b>US</b> PPI Ex Food & Energy (MoM)	12:30	APR	0.2%	0.2%	0.2%
PPI Ex Food & Energy (YoY)	12:30	APR	2.7%	na	2.9%
Producer Price Index (MoM)	12:30	APR	1.1%	0.1%	0.4%
Producer Price Index (YoY)	12:30	APR	6.9%	na	6.6%
ABC Consumer Confidence	21:00	May-18			
<b>Economic indicators</b>					
<b>Wednesday 21-May-2008</b>					
<b>SWE</b> Unemployment Rate	07:30	APR	6.3%	na	6.1%
<b>NO</b> GDP Mainland Norway s.a (QoQ)	08:00	1Q	0.9%	na	0.7%
GDP s.a. (QoQ)	08:00	1Q	1.3%	na	0.7%
<b>GE</b> IFO - Business Climate	08:00	MAY	102.4	101.9	102.0
IFO - Current Assessment	08:00	MAY	108.4	107.5	108.0
IFO - Expectations	08:00	MAY	96.8	97.5	96.2
<b>UK</b> Bank of England Minutes vote	08:30			8-1	
M4 Money Supply (MoM)	08:30	APR P	0.8%	na	na
M4 Money Supply (YoY)	08:30	APR P	11.9%	na	na
M4 Sterling Lending, BP bln	08:30	APR P	17.4	na	na
Public Finances (PSNCR), bln	08:30	APR	12.7	-5.0	na
Public Sector Net Borrowing, bln	08:30	APR	10.2	na	na
<b>CA</b> Bank Canada CPI Core MoM	11:00	APR	0.2%	na	0.2%
Bank Canada CPI Core YoY	11:00	APR	1.3%	na	1.4%
Consumer Price Index MoM	11:00	APR	0.4%	na	0.4%
Consumer Price Index YoY	11:00	APR	1.4%	na	1.4%
<b>US</b> MBA Mortgage Applications	11:00	May-16			
Minutes of April 29-30 FOMC Meeting	18:00				
<b>JN</b> Adjusted Merchnds Trade Bal., ¥ bln	23:50	APR	770.0	750	na
All Industry Activity Index (MoM)	23:50	MAR	-1.4%	-0.2%	-0.1%
Merchnds Trade Balance Total, ¥ bln	23:50	APR	1114.4 R	1000	729
<b>Thursday 22-May-2008</b>					
<b>IT</b> Consumer Confidence Ind. sa	07:30	MAY	99.8	98.5	99.2
Retail Sales s.a. (MoM)	08:00	MAR	0.3%	-0.2%	-0.2%
Retail Sales (YoY)	08:00	MAR	2.7%	na	0.5%
<b>NO</b> Unemployment rate(AKU)	08:00	MAR	2.4%	na	2.4%
<b>UK</b> Retail Sales s.a. (MoM)	08:30	APR	-0.4%	-0.2%	-0.4%
Retail Sales (YoY)	08:30	APR	4.6%	4.5%	4.2%
<b>EUR</b> Industrial New Orders SA MoM	09:00	MAR	0.6%	na	na
Industrial New Orders YoY	09:00	MAR	9.9%	na	na
<b>UK</b> CBI May Monthly Industrial Trends	10:00				
Retail Sales Less Autos MoM	12:30	MAR	-0.3%	na	0.4%
Retail Sales MoM	12:30	MAR	-0.7%	na	0.3%
<b>US</b> Initial Jobless Claims	12:30	May-17	na	370	370
Fed's Kroszner Speaks to State Banking Regulators in Florida	13:15				
House Price Index MoM	14:00	MAR	0.6%	na	na
House Price Index QoQ	14:00	1Q	0.1%	na	-1.0%
<b>JN</b> BoJ Monetary Policy Meeting Minutes for April	23:50				
<b>Friday 23-May-2008</b>					
<b>FR</b> Consumer Spending (MoM)	06:45	APR	-1.7%	0.2%	0.6%
Consumer Spending (YoY)	06:45	APR	1.2%	1.2%	2.2%
<b>IT</b> Trade Balance Non-Eu (Euros)	08:00	APR	-1212	na	na
<b>EUR</b> PMI Composite	08:00	MAY A	51.9	51.2	na
PMI Manufacturing	08:00	MAY A	50.7	50.3	50.3
PMI Services	08:00	MAY A	52	51.3	51.7
<b>UK</b> GDP 2nd estimate (QoQ)	08:30	1Q	0.6%	0.4%	0.4%
GDP 2nd estimate (YoY)	08:30	1Q	2.8%	2.5%	2.5%
<b>IT</b> GDP sa and wda (QoQ)	09:00	1Q P	na	0.2%	0.2%
GDP sa and wda (YoY)	09:00	1Q P	na	0.3%	0.4%
<b>US</b> Existing Home Sales, M	14:00	APR	4.93	4.91	4.85
Existing Home Sales MoM	14:00	APR	-2%	na	-1.4%
<b>CA</b> Canadian Money Supply	14:30	APR			

# Fixed Income, Forex & Credit Research

<b>Head of Research</b>	<b>Benoît Hubaud</b>	(33) 1 42 13 61 08 (44) 20 7676 7168	<b>Assistant</b>	<b>Valérie de Gladky</b>	(33) 1 42 13 92 89
-------------------------	----------------------	---	------------------	--------------------------	--------------------

<b>Fixed Income &amp; Forex Strategy</b>					
<b>Head</b>	<b>Vincent Chaigneau</b>	(44) 20 7676 7707			
<b>Fixed Income</b>	Adam Kurpiel	(33) 1 42 13 63 42			
	Ciaran O'Hagan	(33) 1 42 13 58 60			
	Aro Razafindrakola	(33) 1 42 13 64 93			
	Jose Sarafana	(33) 1 42 13 56 59			
	Guillaume Baron	(33) 1 42 13 57 07			
<b>Foreign Exchange</b>	Carole Lauhere	(33) 1 42 13 71 45			
	Peter Frank	(44) 20 7676 7458			
	Murat Toprak	(44) 20 7676 7491			
	Phyllis Papadavid	(44) 20 7676 7999			
	David Deddouche	(33) 1 42 13 56 22			
	Patrick Bennett (HK)	(852) 21 66 54 39			
<b>Technical Analysis</b>	Hughes Naka	(33) 1 42 13 51 10			
	Stéphane Billioud	(33) 1 42 13 35 55			
	Fabien Manac'h	(33) 1 42 13 88 35			
	<i>Commodities</i> Stéphanie Aymes	(33) 1 42 13 57 03			
<b>Economic Research</b>					
<b>Head</b>	<b>Brian Hilliard</b>	(44) 20 7676 7165			
<i>Europe</i>	Véronique Riches-Flores	(33) 1 42 13 84 04			
	Olivier Gasnier	(33) 1 42 13 34 21			
<i>Emerging</i>	Gaëlle Blanchard	(33) 1 42 13 44 96			
<i>ECB Watcher</i>	James Nixon	(44) 20 7676 7385			
<i>Great Britain</i>	Brian Hilliard	(44) 20 7676 7165			
<i>United States</i>	Stephen Gallagher	(1) 212 278 44 96			
	Aneta Markowska	(1) 212 278 66 53			
<i>Asia</i>	Glenn Maguire (HK)	(852) 21 66 54 38			

<b>Credit Research</b>					
<b>Head</b>	<b>Benoît Hubaud</b>	(33) 1 42 13 61 08 (44) 20 7676 7168			
<b>Deputy Head</b>	Denis Groven	(33) 1 42 13 78 21			
<b>Banks &amp; Insurance</b>	Nathalie Deliens	(44) 20 7676 7262			
	Rötger Franz	(44) 20 7676 7167			
<b>ABS</b>	Jean-David Cirotteau	(33) 1 42 13 72 52			
	Christopher Greener	(44) 20 7676 7055			
<b>Auto &amp; Transportation</b>	Pierre Bergeron	(33) 1 42 13 89 15			
	Stéphanie Herrault	(33) 1 42 13 63 11			
<b>Consumers &amp; Services</b>	Sonia van Dorp	(33) 1 42 13 64 57			
	Caroline Duron	(33) 1 58 98 30 32			
<b>Industrials</b>	Roberto Pozzi	(44) 20 7676 7152			
	David Wertenschlag	(44) 20 7676 7062			
<b>Telecom &amp; Media</b>	Juliano Hiroshi Torii	(44) 20 7676 7158			
<b>Utilities</b>	Hervé Gay	(33) 1 42 13 87 50			
	Florence Roche	(33) 1 42 13 63 99			
<b>High Yield</b>					
<i>Consumers &amp; Services</i>	Sonia van Dorp	(33) 1 42 13 64 57			
<i>Telecom &amp; Media</i>	Robert H Jaeger, CFA	(44) 20 7676 7136			
<i>General Industries</i>	Nadia Yoshiyama, CFA	(44) 20 7676 6985			

<b>Commodities</b>					
<b>Global Head</b>	<b>Frédéric Lasserre</b>	(33) 1 42 13 44 06			
<i>Oil &amp; Products</i>	Michaël Wittner	(44) 20 7762 5725			
<i>Oil &amp; Products / Strategy</i>	Remy Penin	(33) 1 42 13 55 74			
<i>Carbon &amp; Coal</i>	Emmanuel Fages	(33) 1 42 13 30 29			
<i>Base &amp; Precious</i>	Stephen Briggs	(44) 20 7762 5384			
<i>Plastics</i>	Sébastien Castelli	(44) 20 7762 5275			
<i>X Commodity Strategy</i>	Jesper Dannesboe	(44) 20 7762 5603			
<i>US Natural Gas - Strategy</i>	Michaël S. Haigh	(1) 212 278 57 45			

<b>Credit Strategy</b>	Suki Mann	(44) 20 7676 7063
	Guy Stear, CFA	(33) 1 42 13 40 26
	Juan Esteban Valencia	(44) 20 7676 7059

<b>Quantitative Research</b>					
<b>Head</b>	<b>Julien Turc</b>	(33) 1 42 13 40 90			
	Benjamin Herzog	(33) 1 42 13 67 49			
	Marc Teyssier	(33) 1 42 13 55 96			
	Sandrine Ungari	(33) 1 42 13 43 02			

**Paris**  
Tour Société Générale  
17 cours Valmy  
92987 Paris La Défense Cedex  
France

**London**  
SG House – 41, Tower Hill  
London EC3N 4SG  
United Kingdom

**Hong Kong**  
Level 38, Three Pacific Place  
1 Queen's Road East  
Hong Kong

**New York**  
1221, Avenue of Americas  
NY 10020 (USA)  
New York

The information herein is not intended to be an offer to buy or sell, or a solicitation of an offer to buy or sell, any securities and including any expression of opinion, has been obtained from or is based upon sources believed to be reliable but is not guaranteed as to accuracy or completeness although Société Générale ("SG") believe it to be fair and not misleading or deceptive. SG, and their affiliated companies in the SG Group, may from time to time deal in, profit from the trading of, hold or act as market-makers or act as advisers, brokers or bankers in relation to the securities, or derivatives thereof, of persons, firms or entities mentioned in this document or be represented on the board of such persons, firms or entities. Employees of SG, and their affiliated companies in the SG Group, or individuals connected to them may from time to time have a position in or be holding any of the investments or related investments mentioned in this document. SG and their affiliated companies in the SG Group are under no obligation to disclose or take account of this document when advising or dealing with or for their customers. The views of SG reflected in this document may change without notice. To the maximum extent possible at law, SG does not accept any liability whatsoever arising from the use of the material or information contained herein. **Dealing in warrants and/or derivative products such as futures, options, and contracts for differences has specific risks and other significant aspects. You should not deal in these products unless you understand their nature and the extent of your exposure to risk.** This research document is not intended for use by or targeted at private customers. Should a private customer obtain a copy of this report they should not base their investment decisions solely on the basis of this document but must seek independent financial advice.

**Important Notice:** The circumstances in which this publication has been produced are such (for example because of reporting or remuneration structures or the physical location of the author of the material), that it is not appropriate to characterise it as independent investment research as referred to in European MIF directive and that it should be treated as a marketing material even if it contains a research recommendation (« recommandation d'investissement à caractère promotionnel »). This publication is also not subject to any prohibition on dealing ahead of the dissemination of investment research. However, it must be made clear that all publications issued by SG will be clear, fair, and not misleading.

**Analyst Certification:** Each author of this research report hereby certifies that the views expressed in the research report accurately reflect his or her personal views about any and all of the subject securities or issuers.

**Notice to French Investors:** This publication is issued in France by or through Société Générale ("SG") which is regulated by the AMF (Autorité des Marchés Financiers).

**Notice to UK Investors:** This publication is issued in the United Kingdom by or through Société Générale ("SG") London Branch which is authorised and regulated by the Financial Services Authority ("FSA") for the conduct of its UK business.

**Notice to US Investors:** This report is issued solely to major US institutional investors pursuant to SEC Rule 15a-6. Any US person wishing to discuss this report or effect transactions in any security discussed herein should do so with or through SG Americas Securities, LLC to conform with the requirements of US securities law. SG Americas Securities, LLC, 1221 Avenue of the Americas, New York, NY, 10020. (212) 278-6000. Some of the securities mentioned herein may not be qualified for sale under the securities laws of certain states, except for unsolicited orders. Customer purchase orders made on the basis of this report cannot be considered to be unsolicited by SG Americas Securities, LLC and therefore may not be accepted by SG Americas Securities, LLC investment executives unless the security is qualified for sale in the state.

**Notice to Japanese Investors:** This report is distributed in Japan by Société Générale Securities (North Pacific) Ltd., Tokyo Branch, which is regulated by the Financial Services Agency of Japan. The products mentioned in this report may not be eligible for sale in Japan and they may not be suitable for all types of investors.

**Notice to Australian Investors:** Société Générale Australia Branch (ABN 71 092 516 286) (SG) takes responsibility for publishing this document. SG holds an AFSL no. 236651 issued under the Corporations Act 2001 (Cth) ("Act"). The information contained in this newsletter is only directed to recipients who are aware they are wholesale clients as defined under the Act.

http://www.sgcib.com. Copyright: The Société Générale Group 2008. All rights reserved.