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Recovery hopes trigger rebound in sentiment

By Dave Shellock
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The euro bounced off a two-month low against the dollar and global equities rallied sharply as geopolitical concerns faded and the latest data releases painted a more positive picture of the global economy.

But there was no let-up for peripheral eurozone debt after Standard & Poor’s cut Ireland’s sovereign ratings and Dublin’s four-year austerity plan failed to soothe market nerves.

The 10-year Irish government bond yield leapt to 8.91 per cent, widening its spread over the German Bund yield to 625bp, not far from a record 652bp reached this month.

Persistent fears about the risk of contagion from Ireland kept other peripheral eurozone bond prices under pressure. The Spanish-German yield spread reached 249bp, the widest since the launch of the euro, before easing back.

Dublin said it would slash spending by about a fifth and raise tax revenues over the next four years to help pay for the crisis in the country’s banking sector and meet the terms of a EU/IMF bail-out.

But analysts said it was hardly surprising that the new plan had provided no relief to the markets.

“There appears little hope of the crisis in Ireland calming until the political uncertainty has been overcome and the bank support measures are shown to be yielding results,” said Ben May, of Capital Economics.

“Even in the unlikely event that the government can quickly achieve both of these, we still think that it faces an almost insurmountable task of getting public debt down to a more sustainable level, which will eventually leave it with no choice but to default.”

Sonia Pangusion, senior economist at IHS Global Insight, warned that Ireland would be relying on an export-led recovery as the budgetary measures did little to help the domestic side.

“Such dependency on the external performance increases Ireland’s economic risk, should the recovery of core Europe, and the encouraging rebound in the UK, see some retreat,” she said.

Indeed, the UK’s third-quarter GDP growth was confirmed at 0.8 per cent – although analysts warned that the pace was likely to moderate.

“The VAT hike in January should lead to consumers bringing forward spending in the fourth quarter, before a sharp pullback in the first quarter of 2011,” said Joost Beaumont, economist at ABN Amro.

Meanwhile, German business confidence jumped to a record level in November, according to the Ifo institute – with both the current assessment indicator and the expectations component increasing.

But it was a welter of US economic releases ahead of the Thanksgiving Day holiday that offered market bulls most in the way of sustenance. Most notably, the number of new claims for jobless benefit fell 34,000 to a two-year low of 407,000 last week.

“The mosaic being drawn of the job market is getting much clearer – labour market conditions are solidly improving, though still not with enough speed to bring down the unemployment rate,” said **Bernard Baumohl**, chief global economist at The Economic Outlook Group. “But the trend is encouraging.”

Furthermore, consumer sentiment reached its highest level since June, according to a University of Michigan survey, while personal income and expenditure data were also positive, analysts said.