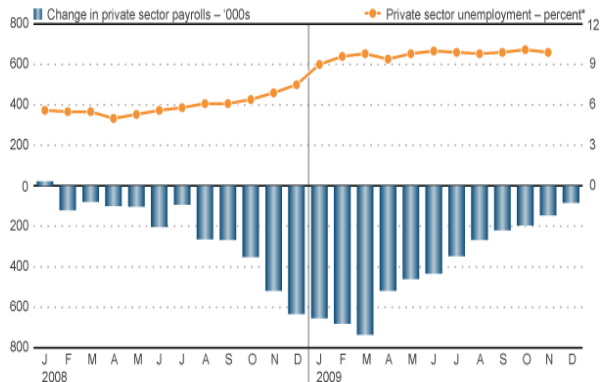


## CHART OF THE DAY

### U.S. private sector jobs



ADP Employment Services data showed that the private sector lost 84,000 jobs in December, underlined the tentative nature of the economic recovery.

## TODAY'S TOP NEWS

- Fed minutes: Ending MBS programs could hurt housing
- U.S. Senate panel nears agreement on role of Fed
- U.S. service sector grows, job losses slow in Dec
- Euro zone PPI, orders fall, show recovery fragile
- U.S. mortgage demand near 6-month low as rates jump
- U.S. crude oil stocks in surprise rise - EIA
- U.S. FDIC to weigh in on bank pay next week
- Cadbury shareholders bet on higher Kraft bid
- UK Dec services PMI rises, points to Q4 GDP growth

## ECON WATCH

FOR THURSDAY JANUARY 7

ET	Indicators	Unit	Reuters	Prior
02:00	DE Retail sales mm real	%	0.2	0.0
02:00	DE Retail sales yy real	%	-1.7	-1.6
05:00	EZ Retail sales mm	%	0.1	0.0
05:00	EZ Retail sales yy	%	-1.9	-1.9
05:00	EZ Business climate	ind	-	-1.56
05:00	EZ Economic sentiment	ind	90.0	88.8
05:00	EZ Industrial sentiment	ind	-17	-19
05:00	EZ Services sentiment	ind	-3	-4
05:00	EZ Consumer sentiment	ind	-16	-17
06:00	DE Industrial Orders m/m	%	1.5	-2.1
07:00	GB BoE rate decision	%	0.50	0.50
08:30	US Initial Claims	k	447	432
08:30	US jobless contin claims	mln	4.98	4.981
10:00	CA Ivey PMI	ind	52.0	55.9

## MARKETS TODAY

**TODAY'S TOP STORY:** Members of the U.S. Fed worried that the winding down of the central bank's massive purchases of mortgage securities, among other factors, could snuff a fragile housing market recovery, minutes of their December meeting showed. **For more please click here**

**TREASURIES:** U.S. Treasuries prices fell ending a two-day recovery as investors grew nervous ahead of a major employment report due at the end of the week.

- 30-yr bond prices fell more than a point yielding 4.7 pct against 4.61 pct on Tuesday.
- 10-yr treasury prices fell 17/32 yielding 3.82 pct from 3.77 pct.
- 2-yr notes rose 1/32 to yield 1.0 pct.
- 2-10's part of yield curve steepened by 8 bps to 283 bps.

**FOREX:** The dollar fell against the euro after minutes from the U.S. Fed's latest policy meeting suggested the possibility of more stimulus measures for the economy.

- Euro gained 0.33 pct at \$1.4411. Earlier, it rose to a session high of \$1.4434.
- The dollar rose 0.72 pct to 92.36 yen, off a high of 92.74 yen hit earlier in the day.
- Dollar index fell 0.2 pct to 77.465.
- Sterling rose 0.18 pct at \$1.6018.

**CORPORATES:** U.S. bond spreads tightened after ISM data showed the U.S. services sector grew in December, and a report said the rate of job losses slowed at U.S. private employers.

- The CDX.IG-13 index tightened by 4 bps to about 77 bps, lowest in more than two years as market analysts cite growing demand for corporate debt.
- Moody's remarked its Liquidity Stress Index delved to a 22-month low of 8.6% and saw its biggest monthly drop in December as speculative grade liquidity trends continued to improve.
- Motiva Enterprises LLC sold \$2 billion of debt in two parts.

**STOCKS:** Wall Street was little changed after Federal Reserve officials said they were still worried about labor market weakness and a report on the services sector showed only slight improvement in the economy.

- Dow rose 0.02 pct to 10,574.06, S&P was up 0.05 pct to 1,137.14 and Nasdaq dropped 0.33 pct to 2,301.09.
- Earlier, S&P climbed to an intraday 52-week high at 1,139.19, and the Nasdaq advanced to an intraday 52-week high at 2,314.07.
- S&P financials index rose 0.42 pct, S&P energy index gained 1.03 pct and S&P technology index dropped 0.88 pct.
- KBW banks index added 1.28 pct.

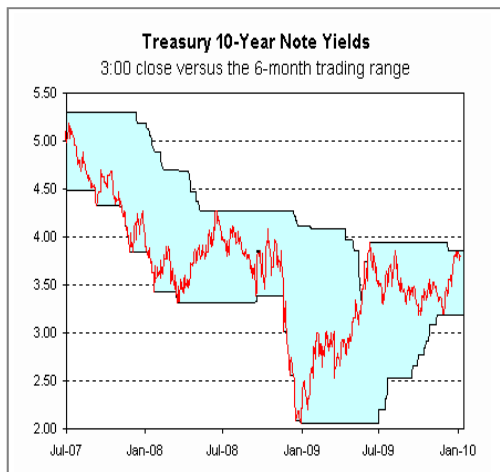
**C & E:** Oil prices rose, in a tenth straight day of gains, as expectations cold weather will boost heating fuel demand outweighed a U.S. inventory report showing a build in crude inventories.

- U.S. crude prices rose 1.54 pct to \$83.03 per barrel.
- Gold rose 1.78 pct to \$1,138.0 an ounce.
- Reuters-Jefferies index was up 1.51 pct to 293.75.

- For MARKET SNAPSHOT click here
- For NEXT UP click here
- For DEEP DIVE click here



MARKET SNAPSHOT as of 3:00 pm EST



TREASURIES <5> <500>

	BID	ASK	YIELD	CHANGE
1-Mo Bill	0.040	0.005	0.041	-0.01
3-Mo Bill	0.055	0.045	0.056	-0.014
6-Mo Bill	0.155	0.145	0.157	-0.003
1-Year	0.365	0.345	0.371	-0.010
2-Year	99.984	100.016	1.009	0.035
3-Year	98.766	98.797	1.557	0.008
5-Year	100.188	100.227	2.585	-0.074
7-Year	99.578	99.625	3.318	-0.164
10-Year	96.406	96.453	3.816	-0.391
30-Year	95.109	95.172	4.680	-1.039

EQUITIES

	INDEX	CHANGE
DJIA	10586.38	14.36
NASDAQ	2305.07	-3.64
S&P 500	1138.53	2.01

OIL

	PRICE	CHANGE
NYMEX	83.2	1.4
BRENT	80.0	-0.6

EURODOLLAR FUTURES

	CLOSE	CHANGE
Jan-10	99.745	0.005
Mar-10	99.690	0.025
Jun-10	99.460	0.040
Sep-10	99.105	0.050

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.130	O/N	0.130
2-Week	0.170	2-Week	0.180
1-Month	0.190	1-Month	0.180
3-Month	0.220	3-Month	0.220
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.140	10:00 AM	0.070
2-Week	0.170	3:00 PM	0.067
1-Month	0.170		
3-Month	0.220		

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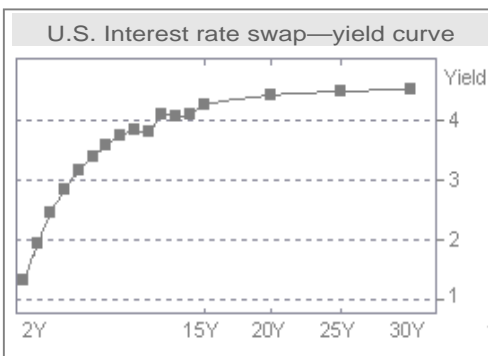
	SPREAD		RATE	
2-Year	25.75	29.75	1.26	1.28
3-Year	35.00	39.00	1.89	1.91
5-Year	26.50	30.50	2.85	2.85
7-Year	10.25	14.25	3.42	3.41
10-Year	7.75	11.75	3.89	3.87
30-Year	-17.50	-13.50	4.50	4.48

FUTURES

	PRICE	CHANGE
CBOT 5 yr	114.73	-0.05
CBOT 10 yr	115.80	-0.41
CBOT 30 yr	115.16	-0.88

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.120	0.150	-	-
1-Month	0.230	0.300	0.127	0.137
3-Month	0.250	0.450	0.144	0.154
6-Month	0.350	0.650	0.187	0.197
12-Month	0.950	1.350	0.410	0.420



CURRENCIES

	BID	ASK
Euro	1.4409	1.4412
Sterling	1.6003	1.6008
JP Yen	92.41	92.44
Swiss Franc	1.0279	1.0282
Can Dollar	1.0329	1.0334
Mexico	12.7209	12.7270

FED FUNDS NYFR<sup>SM</sup> - 10AM

Open	0.1400	1m	0.2237
High	0.1800	3m	0.2550
Low	0.0800		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.875	12/01/2012	12 11	1.17
3-Year	1.75	10/08/2012	3 2.5	1.59
5-Year	2.625	20/11/2014	17.5 17	2.76
7-Year	5.125	18/10/2016	13.5 0	3.45
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	37 0	5.05

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	15/12/2011	0 7	-
3-Year	1.375	09/01/2013	26 25	1.86
5-Year	3	28/07/2014	3 0	2.63
7-Year	5.25	15/09/2016	14 0	3.45
10-Year	3.75	27/03/2019	16 0	3.98
30-Year	6.25	15/07/2032	33 31	5

Active MBS 15YR

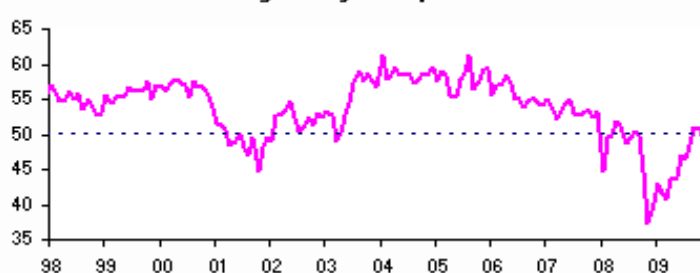
	CPN	BID	ASK	YIELD
FNMA	5.0	104.2930	104.3130	2.839
FHLMC	5.0	104.2930	104.3130	2.839

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	104.3020	105.0020	3.222
FHLMC	5.5	105.0220	105.0420	3.127
GNMA	5.5	105.0260	105.0460	3.755

Wrightson ICAP<sup>SM</sup> Chart of the Day

ISM Non-Manufacturing Survey: Composite Index vs Breakeven



## TODAY'S TOP NEWS

**Fed minutes: Ending MBS programs could hurt housing**

Members of the U.S. Federal Reserve worried that the winding down of the central bank's massive purchases of mortgage securities, among other factors, could snuff a fragile housing market recovery, minutes of their December meeting showed.

"Some participants ... noted the risk that improvements in the housing sector might be undercut next year as the Federal Reserve's purchases of MBS wind down, the homebuyer tax credits expire, and foreclosures and distress sales continue," the minutes said.

Labor market weakness remained an important concern for Fed officials, who said they expect unemployment to remain high for "quite some time."

Views about policy differed on the panel. Some officials said persistently high unemployment might make it desirable at some point to expand or extend large-scale purchases of assets.

However, one policy-maker said improvements in financial markets and in the economy may warrant scaling back the Fed's purchases and reducing holdings over time.

**U.S. service sector grows, job losses slow in Dec**

The rate of job losses at U.S. private employers slowed in December and the services sector showed marginal growth, according to reports which underlined the tentative nature of the economic recovery.

The Institute for Supply Management said its services index rose to 50.1 in December, reaching above the 50 mark for the third time in four months. The reading was above November's 48.7 but below economists' median forecast of 50.5.

Analysts also found only mild encouragement in ADP Employment Services data showing the the private sector lost 84,000 jobs in December. That was fewer than the 145,000 jobs lost in November, but did exceed the 73,000 expected by economists.

In a separate report, global outplacement consultancy Challenger, Gray & Christmas, Inc. said planned layoffs at companies fell to the lowest in two years last month,

Employers announced 45,094 planned job cuts last month, the fewest since December 2007, according to the Challenger report. That marked a 73 percent decline from 12 months ago, when 166,348 job cuts were reported, the report showed.

Last year marked the worst year of corporate job cuts since 2002, with employers announcing plans to cut 1,288,030 jobs. The pace of layoffs fell by 56 percent in the second half of the year however.

**U.S. mortgage demand near 6-month low as rates jump**

Demand for U.S. mortgages held last week near six-month lows as the highest long-term borrowing costs since August stifled refinancing, a Mortgage Bankers Association survey showed.

Average 30-year mortgage rates jumped 0.10 percentage point to 5.18 percent in the Jan. 1 week, up more than a half percentage point from the record low in March, driving down refinance requests to levels last seen in early August.

The rate was last higher in late August at 5.24 percent.

Total mortgage applications eked out a 0.5 percent rise in the Jan. 1 week after slumping nearly 23 percent in the Christmas week to the lowest level since late June.

The mortgage industry group's refinance index dropped 1.6 percent in the Jan. 1 week to 1,976.9 after tumbling more than 30 percent the prior week. At its 2009 peak, the refinance index topped 7,400 last January.

The purchase loan index rose 3.6 percent to 212.1 in the Jan. 1 week after a 4.0 percent drop the prior week.

**U.S. Senate panel nears agreement on role of Fed**

As Congress moves to reform U.S. financial regulation, key senators are nearing bipartisan agreement on stripping the Fed of its authority to supervise banks, two people familiar with the matter said.

Veteran Democratic Senator Christopher Dodd said he will not seek re-election in November in recognition that he faced an uphill battle and underscoring upheaval facing President Barack Obama's Democrats.

Wall Street was looking for clues as to how hard Dodd, in his remaining months in office, would push for a financial regulation revamp that banking lobbyists and Republicans are fighting.

So far, his bill has met opposition from Republicans on his panel. Lawmakers from both parties are tearing the measure apart to find consensus on how to regulate everything from banks to the \$450-trillion over-the-counter derivatives market.

Members agree the Fed should be confined to monetary policy and being lender of last resort. So it should not be directly supervising banks, the two people said.

Senate Banking Committee members agree there should be a mechanism in place to unwind troubled financial firms to avoid a repeat of 2008, when the government improvised and dealt with troubled firms like AIG and Lehman Brothers very differently.

The White House is pushing for so-called resolution authority, or giving the government the power to shut down a troubled firm and force creditors and shareholders to assume losses.

**Euro zone PPI, orders fall, show recovery fragile**

Euro zone industrial new orders were weaker than expected in October and producer prices grew less than anticipated in November, data showed, underlining the fragility of economic recovery and weak inflationary pressures.

Industrial new orders in eurozone fell 2.2 percent in October against September, Eurostat said.

Orders were dragged lower mainly by a slump in volatile demand for ships, planes and trains, without which the monthly decline was only 0.4 percent. October new orders were 14.5 percent lower than a year earlier, although that was only half the annual decline in May. Economists polled by Reuters had on average expected a 1.1 percent monthly fall.

Euro zone producer prices rose 0.1 percent against October but were still 4.4 percent down year-on-year, Eurostat said.

Economists polled by Reuters had on average expected a 0.2 percent monthly rise and a 4.5 percent year-on-year fall.

The monthly rise was fuelled mainly by energy prices which rose 0.8 percent on the month. Without them and construction costs, producer prices fell 0.1 percent on the month and were 3.1 percent down year-on-year.

**U.S. crude oil stocks in surprise rise - EIA**

U.S. crude oil stocks rose unexpectedly last week on higher imports and lower refinery runs, while distillates declined as cold weather gripped much of the nation, government data showed.

Commercial stockpiles of crude oil in the United States rose by 1.3 million barrels to 327.3 million in the week to Jan. 1, the EIA said, countering forecasts for a 500,000-barrel fall. Weekly crude imports rose by 328,000 barrels per day.

Stocks of distillates, which include heating oil and diesel, fell a modest 300,000 barrels to 159.0 million, missing a forecast 1.9-million-barrel drop, as refinery output of these fuels rose 99,000 bpd to 3.81 million bpd.

Separately, OPEC may be facing large rises in oil inventories in the next six months unless members step up their compliance



## TODAY'S TOP NEWS

with agreed output targets. A year of falling demand and ample supply have left oil inventories brimming. Stocks in industrialized consumer nations are equal to about 60 days of demand, or about 2.74 billion barrels, above the five-year average.

That could rise to almost 2.85 billion barrels by the second quarter of 2010 if OPEC maintains current production, according to a chart in the OPEC document.

**U.S. FDIC to weigh in on bank pay next week**

The board of the Federal Deposit Insurance Corp will meet on Jan. 12 to consider proposing rules on compensation for bank employees, the agency said.

The FDIC did not provide details on what it will propose, but it has been expected that the agency will weigh in on the issue of banker pay, which some officials have said encouraged excessive risk taking and contributed to the recent financial crisis.

The action by the FDIC board would follow pay guidelines issued by the Federal Reserve in October.

The Fed's bank pay guidelines, while somewhat vague, gave supervisors more explicit instructions to police pay for any employee able to take risks that could significantly and adversely affect the safety of a firm.

The Fed also is conducting a more thorough review of the practices of the 28 largest and most complex banking organizations.

**Cadbury shareholders bet on higher Kraft bid**

Kraft faced pressure to raise its bid for Cadbury with extra cash as the market digested Tuesday's warning from key investor Warren Buffett and an initial deadline passed with few of the UK confectioner's shares changing hands.

The U.S. food group said it had a 1.52 percent take-up from Cadbury shareholders for the 10.5 billion pound (\$16.8 billion) hostile bid by a first closing deadline of 1300 GMT on Jan. 5.

It said the cash and shares bid, currently worth 767 pence per share, remained open until Feb. 2, but analysts said Kraft would have to improve the terms to 800 pence or more to stand a chance of success.

**UK Dec services PMI rises, points to Q4 GDP growth**

British service sector activity accelerated slightly in December after the strongest growth in new orders since September 2007, boosting economists' belief that the economy exited recession in the last quarter of 2009.

The modest improvement in the services PMI index from the Chartered Institute of Purchasing and Supply and Markit follows a strong gain in the equivalent manufacturing survey, and an improvement in the Recruitment and Employment Confederation's job placement measure overnight.

CIPS/Markit said the business activity index rose to 56.8 from November's 56.6, slightly above economists' forecasts and just below October's 27-month high of 56.9.

Large firms' activity increased much faster than that of smaller businesses in December, with the business services sector growing fastest.

Markit said the data suggested that the service sector expanded by 1 percent in the last three months of 2009.

The services PMI new business index rose to 57.0 from 56.8, and while business expectations slipped, they remained close to the two-and-a-half year high set in September.

**Japan deputy PM to be finmin, raising fiscal questions**

Japan named fiery Deputy Prime Minister Naoto Kan as finance minister on Wednesday, turning to a politician with less hawkish fiscal views than his predecessor and leaving bond markets unsure the heavily indebted government would hold down spending.

Kan is a critic of the BOJ for being too rosy in its view of the economy and has pressured the central bank into easing its already hyper-loose monetary policy.

Kan may also be less tolerant of letting the yen strengthen and putting at risk a fragile export-led recovery from Japan's worst recession since World War Two.

Fujii's departure was another blow to the Democratic Party-led government as it struggles with falling ratings ahead of a crucial mid-year election.

Kan is unlikely to favor reckless spending given that public debt is nearly 200 percent of GDP.

## NEXT UP

**BoE seen holding policy in Jan, no QE move till Feb**

The Bank of England is likely to make no change to its monetary policy settings this week but growing signs of economic recovery have cemented expectations it will halt its quantitative easing programme next month.

The Bank's Monetary Policy Committee voted unanimously last month to leave interest rates at 0.5 percent and to keep its target for asset purchases -- almost 99 percent of which have been gilts -- at 200 billion pounds.

The BoE is on track to hit its QE target just before its February meeting, by which time it will also have fourth-quarter GDP data and new growth and inflation forecasts to hand.

A record government deficit which means public spending will need to be cut sharply, and the reversal of last year's cut in VAT has given Britons an added incentive to tighten their belts.

Such a backdrop means British interest rates are not expected to rise until the second half of 2010 at the earliest.

**POLL-US natgas stocks seen down 151 bcf in wkly EIAs**

U.S. natural gas storage levels are expected to fall by about 151 billion cubic feet when weekly data from the U.S. EIA is released early Thursday, according to a Reuters poll.

In the weekly survey of 24 industry traders and analysts, withdrawal estimates for the week ended Jan. 1 ranged from 129 bcf to 170 bcf.

Stocks fell an adjusted 60 bcf for the same week last year, while the five-year average drop for that week is about 78 bcf. The median draw in the survey was 154 bcf.

The U.S. NOAA said there were 222 heating degree days last week, 27 colder than the previous week, 19 colder than normal and 51 colder than the same week last year.

NOAA said it expected 250 heating degree days this week, 43 colder than normal and 69 colder than the same year-ago week. Early withdrawal estimates for next week's EIA report based on the colder outlook range from 185 bcf to 240 bcf versus an 88 bcf adjusted decline for the same week in 2009.



## DEEP DIVE Commentary and Analysis

**ANALYSIS-U.S. Senator Dodd's exit roils financial reform**

By Kevin Drawbaugh

How Senator Christopher Dodd handles his final months in office is suddenly the big question surrounding U.S. efforts to tighten financial regulation, with some analysts now expecting a more moderate reform.

The Democratic chairman of the Senate Banking Committee -- in trouble politically back home in Connecticut over his ties to the unpopular financial services industry -- announced on Wednesday that he will not seek reelection.

He is expected to complete his term and fulfill his commitment to win Senate passage of the Obama administration's financial reform agenda, or something close to it.

Without the imperative of winning votes for reelection, Dodd may be less motivated to press a populist reform agenda, making him more prone to compromise on controversial issues, said analysts and lobbyists.

Moreover, Dodd's status as a lame duck will reduce his influence as chairman, undercutting his ability to get his way, said Douglas Elliott, a former JPMorgan investment banker now with the Brookings Institution, a Washington think tank.

One reform proposal that could be in jeopardy is Dodd's idea to consolidate U.S. banking supervision into one agency, Elliott said.

Another potential soft spot on the agenda is the Obama administration's proposal to create a Consumer Financial Protection Agency (CFPA) to regulate mortgages, credit cards and other products, said Edward Yingling, head of the American Bankers Association, a lobbying group for banks.

Dodd strongly supports the CFPA, along with many Democrats. But Yingling, whose group opposes it, along with Republicans and other business interests, said: "The concept of an independent CFPA is unlikely to pass in the Senate."

**COMPROMISE STILL ON CARDS**

Jaret Seiberg, a policy analyst at investment firm Concept Capital, said Dodd's announcement is a neutral for banks and unlikely to impact financial reform legislation.

Dodd introduced a 1,139-page reform bill in November that was in some ways more ambitious than the 1,279-page bill pushed through the House of Representatives last month by Representative Barney Frank.

The Dodd bill was slammed immediately by Senator Richard Shelby, the top Republican on the banking committee. Dodd responded by setting up four bipartisan teams of two committee members each to work on controversial issues.

Some committee members have said they are making progress toward agreement, with key provisions of Dodd's original bill undergoing significant change.

"Dodd was already going to have to compromise ... if he wanted to enact the bill. His decision to retire after the election does not alter this equation," said Seiberg.

As Round Two of Congress' punishing fight over financial regulation gets under way this month, Dodd will have his legacy in mind as he ends a long career on Capitol Hill. He will also be watching the fragility of the Democrats' Senate majority.

Democratic Senator Byron Dorgan said on Tuesday he will not seek reelection.

Dug in deeply in opposition to reforms are Republicans and the "fat cat bankers on Wall Street," as President Barack Obama has labeled them. They suffered a defeat on Dec. 11, when the House approved a bill loaded with reforms the bankers opposed.

Now they are throwing everything they've got into blocking reforms in the Senate, knowing it is an arena where millionaire

lawmakers often look after their own.

The Senate will not fully reconvene until Jan. 20.

**DODD BEHIND IN POLLS**

It has been clear for months that Dodd was far behind in the polls in his home state where he has been hounded by questions about his ties to the unpopular financial industry.

In 2003, he took out two low-rate mortgages from Countrywide Financial Corp, once the largest U.S. home lender that was acquired by Bank of America in 2008. Countrywide was widely criticized for its subprime mortgage business.

Critics said the loans represented a conflict of interest since Dodd's committee oversees mortgage lenders. A Senate ethics investigation followed. Dodd later refinanced the two loans, said he regretted doing business with Countrywide and made public related documents. The investigation ended.

Dodd also has long-standing ties to Wall Street, having raised millions of dollars over the years from employees of firms such as Goldman Sachs and Citigroup, many of whom go home to Connecticut from New York City every night.

Dodd was further injured politically by his role in a controversy over bonuses for executives at bailed-out former mega-insurer American International Group.

He made a brief run for the 2008 Democratic presidential nomination, but withdrew after winning few votes.

**ANALYSIS-Emerging market debt issuance seen well bid in 2010**

By Daniel Bases

Emerging markets passed a severe stress test last year, carrying the global economy through the financial crisis while setting a record for debt issuance. The outlook for 2010 is nearly just as bright.

Investor demand for emerging market debt and syndicated loans could outstrip supply, putting upward pressure on secondary market prices, says one senior strategist.

"I've spoken to a number of high-yield investors in the U.S. and they claim that has been a problem for them, that they are actually getting more money than they are able to put back to work in the new issuance market," said David Spiegel, global head of emerging markets strategy at ING in New York.

"They are forced to buy secondary market issues, so prices go up a lot faster in the secondary market," he said.

Spiegel predicts that total issuance this year could top \$200 billion. JPMorgan forecasts a similar amount and both firms see corporate issuers once again overtaking sovereigns.

A combination of low global central bank interest rates, better fiscal performance in emerging markets, and government stimulus plans pumped cash into their economies helping pull markets back from the abyss.

In 2009, corporate and sovereign (agency, sovereign and supranational) issuance reached nearly \$245 billion, according to Thomson Reuters data.

Last year sovereigns out-issued corporates \$129.3 billion to \$115.2 billion, with most of the total coming in the second half of the year when credit markets started thawing.

The strength of emerging market government finances allowed governments to use counter-cyclical fiscal policy measures to issue more debt, outstripping corporate issuers.

But the credit crisis inhibited emerging market corporate borrowers starting in 2008, altering the traditional relationship between lender and borrower. Banks are no longer willing to hold their clients newly issued debt on their books and covenants are being written in much stricter fashion.



## DEEP DIVE Commentary and Analysis

## ISSUE NOW

Emerging market asset prices jumped higher at the start of 2010, backed by data from the U.S. and other countries showing an economic recovery is building steam, and with that comes the likelihood interest rates will have to start to rise.

"If people think the recovery is actually real and it is going to happen, then you have to figure rates are going higher and people probably want to get their issuance done before that happens," said one senior credit trader at a New York-based hedge fund.

JPMorgan estimates 16 emerging market central banks across the globe are poised to start raising interest rates this year, "well ahead of G-10 countries".

It sees Brazil, India and Korea raising rates in the first quarter alone.

That low interest rate environment helped the JP Morgan Emerging Markets Bond Index Plus, which tracks U.S. dollar denominated sovereign bonds, return nearly 26 percent last year.

The increased investor confidence from the depths of the March 2009 nadir for stocks contributed to a 416.475 basis point cut in the yield spread over benchmark U.S. Treasuries.

While emerging market economies were not the source of the crisis, they suffered the collateral damage of the freezing of global credit markets and their economies did weaken.

Spreads widened to as much as 865 bps on October 24, 2008, during the credit crisis crescendo. They are down to around 273 basis points but that is still nearly double their all-time narrowest point of 148.576 bps reached on June 1, 2007.

"We think it is an attractive asset class because the spreads at

which the debt is trading are still attractive from a fundamental risk perspective," said Ward Brown, portfolio manager of the MFS emerging markets debt fund in Boston.

"For 2010 we think a low growth environment in the U.S. and G7 is fine and supportive for emerging markets growth, and then from an investing perspective, that is a decent environment for fixed income to perform well," Brown said.

Turkey and the Philippines kicked off the year with a combined \$3.5 billion in debt issuance.

## CHANGING LANDSCAPE

Banks have become reluctant to extend credit on behalf of their clients by holding portions of the debt or syndicated loans they help to issue, says Mike Fitzgerald, partner and chair of the Latin America law practice at Milbank, Tweed, Hadley & McCloy LLP in New York.

"They will not take any credit risk and that's really a result of the economic crisis," he said.

Fitzgerald said banks are acting more like intermediaries and moving away from a lender/borrower business relationship.

Fees for borrowers may drop as a result, however it is not without drawbacks.

"It is better for you (the borrower) in the sense that fees are lower. But it is worse in that if you have to go back and get a waiver or an amendment to your (debt or loan) covenants, it is very hard to do," he said

"The banks are not so amenable to amending the covenants. Often times they would rather basically put the company in default and demand immediate payment."

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(Compiled by Anil Kumar and Rahul Karunakar in Bangalore)

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