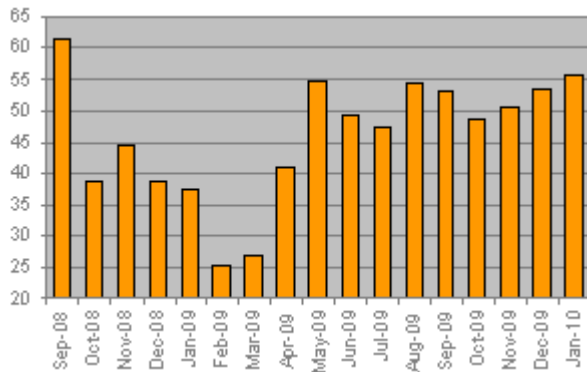


## CHART OF THE DAY

### U.S. consumer confidence



U.S. consumer confidence rose for the third straight month in January to the highest since September 2008, driven mostly by an improvement in present-day conditions.

## TODAY'S TOP NEWS

- U.S. confidence hits 16-mo high; home prices soft
- Senate may vote on Fed's Bernanke by Friday-Reid
- Spending freeze would slow Obama programs
- S&P warns may cut Japan's rating over soaring debt
- U.S. \$44 bln 2-year auction draws solid demand
- China tightening worries spook investors
- Cost-cutting repairs U.S. corp credit quality-report
- IMF sharply raises global economic growth forecast
- ECB's Stark warns of further euro zone downgrades
- Britain crawls out of recession but Q4 disappoints

## ECON WATCH

FOR WEDNESDAY JANUARY 27

ET	Indicators	Unit	Reuters	Prior
02:45 FR	Consumer confidence	ind	-31	-31
06:00 GB	CBI distributive trades	ind	8	13
07:00 US	Mortgage market index	ind	-	575.9
07:00 US	Mortgage refin index	ind	-	2663.8
10:00 US	New home sales-units	mIn	0.37	0.355
12:00 US	Midwest manufacturing	ind	-	84.2
14:15 US	FOMC rate decision	%	0.25	0.25
18:50 JP	Retail sales	%	0.2	-1.0
- DE	CPI pre mm	%	-0.3	0.8
- DE	CPI pre yy	%	1.0	0.9
- DE	HICP pre mm	%	-0.4	0.9
- DE	HICP pre yy	%	1.0	0.8

## MARKETS TODAY

**TODAY'S TOP STORY:** U.S. consumer confidence in January hit its highest level in nearly a year and a half, but a closely watched housing index showed an unexpected decline in November home prices, giving a mixed picture of the economic recovery. **For more please click here**

**TREASURIES:** U.S. Treasury prices pared gains as rising stocks prices whittled away an earlier safe-haven bid on concerns that China was moving closer to tightening its monetary policy.

- Bids for 30-year bonds hit a session low shortly after a \$44 billion auction of 2-yr government debt where solid demand was offset by a higher-than-expected yield on them.
- 30-yr and 5-yr bond prices rose 4/32, yielding 4.54 and 2.34 pct respectively.
- 10-yr Treasury notes was up 6/32 to yield 3.61 pct.
- 2-yr Treasury prices rose 1/32 to yield 0.81 pct.
- 2-10's part of the yield curve flattened by 1 bps to 280 bps.

**FOREX:** The dollar rose after China told certain banks to raise reserve requirements, dulling investor demand for high-yield assets and currencies on fears the lending restrictions may slow a global recovery.

- Dollar index was up 0.37 pct at 78.482.
- The euro fell 0.52 pct at \$1.4075 and fell 1.21 pct to 126.14 yen.
- Dollar fell 0.68 pct at 89.63 yen, close to a five-week low of 89.35 yen.
- Sterling fell 0.62 pct at \$1.6139.

**CORPORATES:** U.S. corporate bond spreads tightened as consumer confidence data bolstered views the economy's recovery is on track.

- The CDX.IG-13 index tightened by 1 bps to 94 bps.
- CIBC launched \$2 bln of three-yr covered bonds.

**STOCKS:** U.S. stocks slipped as solid earnings and consumer confidence data were tempered by trepidation before major political and regulatory developments expected later in the week.

- Dow fell 0.03 pct to 10,193.61, S&P was down 0.42 pct to 1,092.14 and Nasdaq shed 0.32 pct to 2,203.73.
- Travelers shares rose 2.74 pct to \$50.23, Apple Inc rose 1.41 pct to \$205.94.
- DuPont fell 0.06 pct at \$32.80, while Johnson & Johnson dipped 0.68 pct to \$62.79.
- The S&P Retail index advanced 0.56 pct.
- S&P financial index fell 1.69 pct, S&P energy index was down 0.50 pct and S&P auto index rose by 1.21 pct.
- KBW financial index fell 2.20 pct.

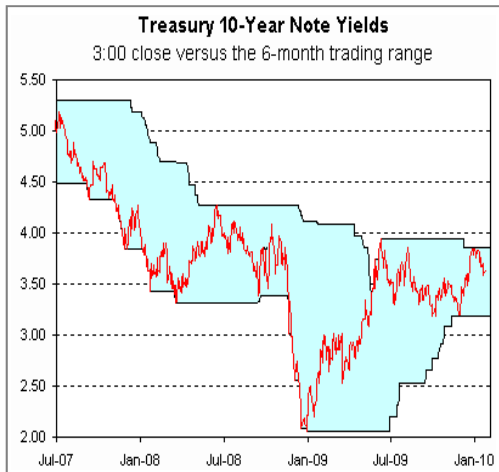
**C & E:** Oil hit a one-month low below \$74 a barrel and most other commodity prices dropped as well after giant consumer China moved to tighten monetary policy.

- U.S. crude prices shed 1.01 pct to \$74.5 per barrel. Earlier, it traded as low as \$73.82.
- Gold was down 0.09 pct to \$1,096.95 an ounce.
- Reuters-Jefferies index fell 1.03 pct to 273.88.

- 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	0.015	-0.015	0.015	0.002
3-Mo Bill	0.070	0.060	0.071	0.014
6-Mo Bill	0.145	0.135	0.147	0.008
1-Year	0.290	0.288	0.295	0.009
2-Year	100.328	100.359	0.829	-0.012
3-Year	99.938	99.969	1.397	-0.004
5-Year	101.234	101.281	2.358	0.051
7-Year	100.969	101.016	3.093	0.078
10-Year	97.906	97.969	3.630	0.023
30-Year	96.953	97.031	4.563	-0.180

EQUITIES

	INDEX	CHANGE
DJIA	10256.42	59.40
NASDAQ	2219.98	9.18
S&P 500	1100.49	3.71

OIL

	PRICE	CHANGE
NYMEX	74.7	-0.6
BRENT	72.8	-0.9

EURODOLLAR FUTURES

	CLOSE	CHANGE
Feb-10	99.735	0.000
Mar-10	99.710	0.000
Jun-10	99.590	-0.010
Sep-10	99.345	0.005

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.190	O/N	0.170
2-Week	0.190	2-Week	0.200
1-Month	0.190	1-Month	0.200
3-Month	0.210	3-Month	0.230
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.170	10:00 AM	0.110
2-Week	0.180	3:00 PM	0.108
1-Month	0.210		
3-Month	0.220		

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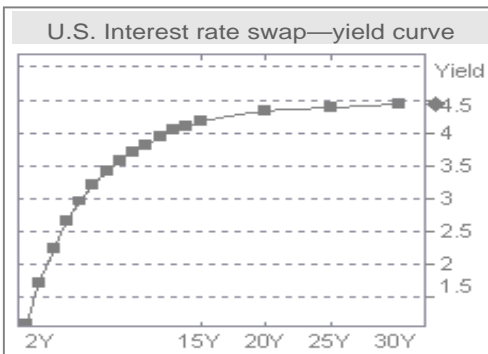
	SPREAD		RATE	
2-Year	27.75	31.75	1.10	1.13
3-Year	31.75	35.75	1.71	1.72
5-Year	29.75	33.75	2.65	2.66
7-Year	14.25	18.25	3.23	3.23
10-Year	9.75	13.75	3.72	3.71
30-Year	-12.75	-8.75	4.43	4.41

FUTURES

	PRICE	CHANGE
CBOT 5 yr	116.30	0.05
CBOT 10 yr	118.05	0.31
CBOT 30 yr	118.97	0.66

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.120	0.150	-	-
1-Month	0.180	0.280	0.126	0.136
3-Month	0.240	0.400	0.143	0.153
6-Month	0.280	0.480	0.171	0.181
12-Month	0.750	1.050	0.327	0.337



CURRENCIES

	BID	ASK
Euro	1.4083	1.4086
Sterling	1.6145	1.6150
JP Yen	89.69	89.72
Swiss Franc	1.0459	1.0462
Can Dollar	1.0603	1.0608
Mexico	12.8251	12.8312

FED FUNDS

	NYFR <sup>SM</sup> - 10AM
Open	0.1300 1m 0.2189
High	0.1300 3m 0.2472
Low	0.0700

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.875	12/01/2012	16 15	0.98
3-Year	1.375	09/01/2013	23 21	1.63
5-Year	2.875	09/02/2015	31.5 31	2.67
7-Year	5.125	18/10/2016	19.5 19	3.29
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	41 36	4.91

ACTIVE FREDDIE MAC AGENCIES

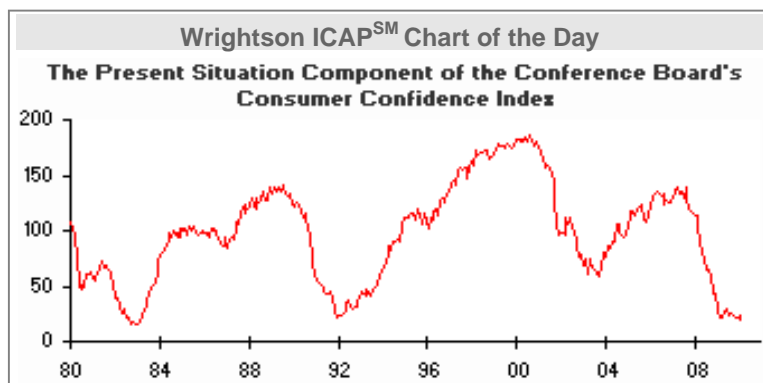
TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	15/12/2011	14 11	0.94
3-Year	1.75	22/02/2013	31 28	1.68
5-Year	2.625	20/11/2014	20 19.5	2.56
7-Year	5.25	15/09/2016	16.5 15.75	3.26
10-Year	3.75	27/03/2019	24 23	3.86
30-Year	6.25	15/07/2032	0 36	-

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.1410	105.1610	2.614
FHLMC	5.0	105.1410	105.1610	2.614

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.2200	105.2400	2.904
FHLMC	5.5	105.2500	105.2700	2.808
GNMA	5.5	105.2010	105.2210	3.575



## TODAY'S TOP NEWS

**U.S. confidence hits 16-mo high; home prices soft**

U.S. consumer confidence in January hit its highest level in nearly a year and a half, but a closely watched housing index showed an unexpected decline in November home prices, giving a mixed picture of the economic recovery.

The Conference Board reported that consumer confidence rose for the third straight month in January, driven by improved economic conditions.

Its index of consumer attitudes rose to 55.9 in January, the highest reading since September 2008 and up from an upwardly revised 53.6 in December. The index topped the median forecast for a reading of 53.5 from analysts polled by Reuters.

The IMF sharply raised its forecast for global growth to 3.9 percent from an October estimate of 3.1 percent.

The closely watched Standard & Poor's/Case-Shiller indexes released showed that home prices slipped in November.

The S&P composite index of home prices in 20 metropolitan areas edged down 0.2 percent in November and registered a 5.3 percent annual drop. A Reuters survey had forecast a 0.1 percent November rise. Yet a home price index from the U.S. Federal Housing Finance Agency showed that home prices rose 0.7 percent in November from October.

**Spending freeze would slow Obama programs-official**

U.S. President Barack Obama may take more time to deliver on some of his policy promises in light of a proposed spending freeze but is still committed to his core agenda, a top White House official said. Obama is seeking a three-year freeze on some domestic programs in his 2011 budget that would save \$250 billion by 2020, calling into question whether he can make good on expensive promises that range from healthcare reform - to revamping U.S. energy use. The nonpartisan Congressional Budget Office said the deficit for the current fiscal year will come in at \$1.35 trillion.

Separately, the U.S. Senate rejected the creation of a bipartisan task force to try to bring down the record U.S. budget deficits. The vote was 53-46, seven short of the needed 60 under an earlier agreement.

The U.S. government is working on new ways to boost modifications of second-lien mortgages in a move to enhance its foreclosure prevention program.

Changes are planned for the administration's program to modify second-lien loans after it failed to encourage holders to participate under current guidelines, William Apgar, senior adviser for mortgage finance at the U.S. Department of Housing and Urban Development.

**U.S. \$44 bln 2-year auction draws solid demand**

The U.S. government sold \$44 billion worth of two-year debt in a solid auction that bodes reasonably well for the remaining sales in this week's total of \$118 billion of new Treasury coupon supply.

The sale attracted brisk demand, with bids totaling 3.13 times the amount on offer versus the average of 2.94 in the 12 auctions of two-year debt that took place last year.

Yields were slightly above expectations, based on trade in the when-issued market at the bidding deadline.

Foreigners and large institutional investors showed near-average demand, based on the indirect bidding category, which accounted for about 43 percent of the sale.

That was only slightly below the average of 45.72 percent in the sales taking place since June 2009, a key benchmark for comparisons after changes in the way calculations are made.

**Senate may vote on Fed's Bernanke by Friday-Reid**

The U.S. Senate may be able to vote by Thursday or Friday on the nomination of Federal Reserve Chairman Ben Bernanke for a second term, Senate Majority Leader Harry Reid said.

Reid, speaking on the Senate floor, said the chamber had to first finish legislation on raising the statutory limit on the public debt. "It is our goal to finish the legislation on the debt limit quickly. Hopefully we can do that and maybe the Bernanke nomination by Thursday or Friday," Reid, a Democrat, said.

Senate Democratic leaders scrambled Tuesday to pull together the 60 votes needed to overcome procedural hurdles and then the 51 votes necessary to confirm Bernanke. Senate Republican Leader Mitch McConnell said he expects confirmation of Federal Reserve Chairman Ben Bernanke to a second term with support from both political parties. The Fed chairman's term expires on Sunday, and it is unclear whether he could continue to lead the U.S. central bank, at least temporarily, until confirmed by the Senate. Democrats said they expected Bernanke would win a second term. Bernanke's confirmation had seemed assured until an underdog Republican candidate rode a wave of populist sentiment to victory in a special election for the U.S. Senate seat from Massachusetts last week.

**S&P warns may cut Japan's rating over soaring debt**

S&P threatened to cut Japan's credit rating unless it produced a credible plan to rein in its soaring debt and lift growth in an economy plagued by persistent deflation.

The warning in the form of a downgrade in Japan's debt outlook coincided with the BoJ's policy meeting, in which the central bank forecast that price declines would be less pronounced than earlier thought.

Japanese policymakers are in a tight spot, with public debt heading towards 200 percent of gross domestic product -- the highest among developed economies -- interest rates near zero and the central bank's several emergency funding schemes still in place. S&P cut its outlook on Japan's long-term sovereign debt rating of AA to negative from stable, saying that the government's diminishing policy flexibility may lead to a downgrade "unless measures can be taken to stem fiscal and deflationary pressures."

Separately, the BoJ forecast prices would fall less than earlier thought but remained open to further policy easing in the face of renewed government calls for more support for a fragile economic recovery.

**China tightening worries spook investors, hit markets**

Fears of more Chinese policy tightening spooked global markets on Tuesday after Beijing ordered some banks to comply immediately with a planned increase in reserves and a report suggested earlier attempts at curbing lending had failed.

The developments prompted concern that the central bank would get more aggressive about reining in credit to fend off inflation and asset bubbles, potentially dragging on growth in the world's third-largest economy.

China implemented a planned increase in required reserves for some banks, sources said, sparking heavy selling of Asian stocks that underscored how sensitive global investors are becoming to Beijing's tightening of monetary policy.

The punitive increase in the amount of reserves some banks have to set aside, which was ordered last week, also came after a newspaper report said China's efforts to curb bank lending were meeting with mixed success, fueling fears that policymakers may take tougher action soon.



## TODAY'S TOP NEWS

**Cost-cutting repairs U.S. corp credit quality-report**

Widespread cost-cutting by U.S. companies caused a sharp improvement in companies' credit quality outlooks in 2009, limiting damage from the recession, independent research service Gimme Credit said.

Under the threat of a credit squeeze, companies reduced or put on hold such cash-consuming actions as mergers, acquisitions, share buybacks, dividend payouts and capital spending, Gimme Credit director of research Carol Levenson said in a report.

Such actions allowed even cyclical companies to limit the impacts of the recession and credit crunch, remaining profitable and retaining financial flexibility through the downturn, though it took time for such actions to kick in, Levenson said. Credit scores underwent a sea change in 2009, with upgrades accounting for about 70 percent of all changes and downgrades just 30 percent. In 2008, by contrast, 88 percent of all changes were downgrades and just 12 percent upgrades. Still, just 16 percent of last year's upgrades were to improving status, while 84 percent were from deteriorating to stable.

**IMF sharply raises global economic growth forecast**

The IMF sharply raised its global economic growth forecast, casting developing countries in a leading role while rich nations struggle with high unemployment and government debt.

In an update of its World Economic Outlook, the IMF said the world economy will expand by 3.9 percent in 2010, much higher than the 3.1 percent it projected in October, and the pace will pick up to 4.3 percent next year.

While an economic recovery appears to be gaining traction, the IMF warned the financial system remains fragile in the richer countries and banks will need a lot more capital.

As a group, advanced economies are expected to expand 2.1 percent this year and 2.4 percent in 2011, the IMF said.

In emerging and developing markets strong internal demand will provide "relatively vigorous" growth, the IMF said.

The IMF revised up its growth forecast for emerging and developing countries by almost 1 percentage point to 6 percent in 2010 and higher to 6.3 percent in 2011.

**ECB's Stark warns of further euro zone downgrades**

High public deficits could bring further ratings downgrades of euro zone countries, ECB Executive Board member Juergen Stark said.

His comments follow a string of rating agency downgrades of Greece, over worries about spiraling government debt.

But Stark added the total euro zone government deficits were significantly below that of the United States.

While public deficits helped stabilize the economy during the financial crisis, not reducing deficits would reduce confidence on sustainability of government finances. This could lead to rising long-term market interest rates and weaken the economy further. Stark also said he expected moderate economic growth in the euro zone this year, but warned uncertainty is high and the ride could be bumpy.

As the recovery progresses, inflation is expected to stay moderate over the monetary policy horizon -- typical seen as 18 months to 2 years.

**Britain crawls out of recession but Q4 disappoints**

Britain only just crept out of an 18-month recession at the end of 2009, suggesting any monetary tightening remains a long way off and raising fears about the prospects for recovery ahead of an election due by June.

The Office for National Statistics said GDP rose by 0.1 percent between October and December, well below analysts' forecasts for growth of 0.4 percent and lower than all the predictions in a Reuters poll.

For 2009 as a whole, the economy shrank by 4.8 percent -- the worst yearly performance since records began in 1949.

Separately, radical reform is needed to make the banking system safer, Britain's top central banker said, adding U.S. President Barack Obama's plan to curb some activities would not fully solve the "too big to fail" problem.

BoE Governor Mervyn King said there was no "silver bullet" to solve the banking sector's problems and tinkering with regulation alone, such as bumping up capital and liquidity requirements, would not be enough when "stuff happens".

## NEXT UP

**U.S. companies need to refinance \$513 bln this year**

U.S. companies will need to refinance some \$513 billion in corporate debt this year, increasing the potential for a corporate cash crunch, according to a study from restructuring firm AlixPartners.

The study suggests companies will keep the bond offering market busy to raise cash and control spending to deal with looming debt maturities and refinancing needs, said Peter Fitzsimmons, AlixPartners' president of North America.

Fitzsimmons said the credit markets did a "180-degree" turn last year, going from no activity to hyperactivity and that, while the credit market activity currently shows no signs of slowing, companies could easily face tighter conditions in the second half of the year. Fitzsimmons said struggling companies will have to look at what they can do to generate more cash internally, make working capital improvements and focus on cost reductions to boost cash to pay off debt and make themselves more attractive to lenders who could help them refinance.

AlixPartners said it found in another study that 600 major companies in the UK, France, Germany and Italy are facing \$569 billion of debt that will be up for refinancing this year as well.

**U.S. manufacturers upbeat on 2010 after a brutal 2009**

U.S. manufacturers face another tough year in 2010 after spending much of 2009 shrinking their businesses to cope with their worst slump in decades.

But most of these companies seem optimistic about their prospects this year, despite signs that the fragile economic recovery may be faltering.

They believe their collective cost-cutting efforts over the past year, when Caterpillar Inc alone eliminated nearly 25,000 jobs worldwide, have dramatically raised the industry's potential profitability if underlying demand rebounds even modestly.

When Harley-Davidson Inc reported a bigger-than-expected quarterly loss last week and warned of tough times in 2010, its executives said the motorcycle maker had focused its efforts on cutting back operations. Indeed, producers as diverse as Caterpillar, Deere & Co, Winnebago Industries Inc and Brunswick Corp believe a sharp drop in retail inventories over the past year could translate into a pickup in orders and profits in 2010 - even without an immediate rebound in end-customer demand -- if the independent dealers they rely on to sell their products begin to restock their products begin to restock their showrooms.



## DEEP DIVE Commentary and Analysis

**Bernanke tussle deals new blow to Fed autonomy**

By Pedro Nicolaci da Costa

For investors worried the Federal Reserve will lack the resolve to withdraw its unprecedented support to the financial system at just the right time, the world just got a little bit scarier.

The struggle to get enough Senate votes to back Ben Bernanke's nomination for a second term as Fed chairman puts an already corralled central bank under even greater pressure from lawmakers, raising fears that politics will sway Fed policy.

While few question the rate-setting Federal Open Market Committee's desire to keep inflation low and stable, some are concerned growing political encroachment into monetary affairs will weigh on policymakers' thinking.

"I believe the FOMC would try very hard, but it's almost impossible not to think about it," said Ann Owen, a former Fed economist who now teaches at Hamilton College in Clinton, New York. "What you don't want is the FOMC thinking about political repercussions of monetary policy."

The political jostling also strengthens the hand of lawmakers who would like to strip the Fed of its bank supervisory role.

Critics say the central bank opened itself up to just this sort of influence by supporting an excessively hands-off approach to regulating the nation's large banks.

Others argue that the Fed also was inviting congressional meddling when it resorted to highly unconventional policies to combat the worst financial crisis since the Great Depression. Some have construed programs such as the commitment to purchase \$1.4 trillion of mortgage debt as tip-toeing into the realm of fiscal policy, since it allocates resources to a specific sector of the economy.

"I feared from the beginning that the Fed's extensive lending operations, instituted without congressional authorization, would embroil it in political disputes, such as over disclosure and who did and did not get assistance," said William Poole, former president of the St. Louis Federal Reserve Bank.

Many investors share Poole's dismay, citing the close cooperation between the U.S. Treasury and Fed in propping failing financial firms such as insurer AIG.

"The federal government and the Fed have been in bed for the past year and a half. The AIG imbroglia is evidence of that. So, I do believe that the line has been crossed, if the line ever existed in the first place," said Haag Sherman, managing director at Salient Partners in Houston, Texas.

Most recently, the political quid-pro-quo seemed to be getting more blatant.

Senate Majority Leader Harry Reid, for instance, justified his rather lukewarm support of Bernanke on the basis of assurances made by Bernanke to "redouble his efforts to ensure families can access the credit they need."

**CONGRESS' POWER LOOMS**

Not that anyone really expected the Fed to begin pushing rates higher in the immediate future. Indeed, a report on Monday showing the deepest ever one-month drop in existing home sales suggested the economic recovery is still too tentative for the central bank to begin its much-debated pullback of extraordinary measures.

The looming shadow of Congress is sure to make Fed officials uncomfortable at this week's two-day meeting.

"Before the Bernanke-Senate blow-up, there was a minor chance Tom Hoenig would dissent," said Michael Feroli, referring to the Kansas City Federal Reserve Bank's hawkish president. "In the current circumstances, no committee member would break ranks with an embattled chairman. We expect no dissents."

The potential erosion of the Fed's regulatory powers, while less immediate, are equally salient.

One of the biggest criticisms of the central bank is that it was either unwilling or unable to rein in loose lending in the mortgage sector. Worse, it actively encouraged the housing bubble, some analysts say, by vocally denying its existence.

The Fed argues that its supervisory function informs monetary policy by giving it a bird's eye view of the banking sector's health. Stripping away that role, officials say, would thwart the adequate conduct of monetary policy.

Yet that may be something the Fed simply has to give up in order to prevent a measure it dreads even more -- a proposal to open up its momentary decisions to direct audits, which was already approved by the U.S. House of Representatives.

"The Fed has gotten a black eye that will take a long time to heal," said Dan Seiver, professor at San Diego State University.

**COLUMN-There's no way to hedge politics**

By Jim Saft

Ben Bernanke in peril and the Volcker crackdown on proprietary trading by banks show two truths of the current dispensation: there is no effective hedge against politics and the reflation trade rests on fragile foundations.

Neither of these realities is particularly good for financial markets and neither is going away any time soon.

Both, too, are utterly related not just to each other, but to the Senate election in Massachusetts which installed a Republican into what had been a Kennedy seat, in the process terrifying Democrats who fear they will be sunk by association with a set of policies perceived to be favoring Wall Street.

In the aftermath, President Obama unveiled a policy authored by former Fed chief Paul Volcker, which is intended to make financial firms get out of the business of using government insurance to underwrite speculative bets; well, not all speculative bets, but the bad kind.

At the same time the confirmation of Bernanke is under threat, and he and the institution he works for had to endure the humiliation of seeing Senator Harry Reid issue a statement endorsing him but implying that he'd extracted some sort of undertaking from the central banker to "redouble" his efforts to help those struggling in the recovery.

Whether all of this is good or bad, or even if it has much of an impact, the fact is that both are the result of a financially struggling electorate which is going to strive to control things that they've previously been convinced to more or less let alone.

That's quite a change from a few years ago, when most of us sat around stroking our chins and praising Alan Greenspan, banks and market forces as if they were one and the same. Everyone still agrees that you need banks, a market and a Federal Reserve Chairman, but there is a lot less agreement about how much freedom the three should be given.

This may be just a few politicians getting the vapors, and soon everyone may ignore finance and economics and get back to the Super Bowl and dancing competitions on television, but there is a real possibility that this popular upsurge has legs. Markets famously hate uncertainty, but this is worse: this is uncertainty mixed with hostility.

This does not have to play out one particular way, and this in some ways is the problem for investors. That stocks have been going their merry way higher in recent months while this issue lurked in the background is astounding. There is an extremely high level of uncertainty over how the world will work in coming years.



## DEEP DIVE Commentary and Analysis

## BRING ME THE HEAD OF, WELL, ANYONE

As for the Volcker Rule, if it works it is probably only fair, but you have to admit that it is also an arrow in the side of the whole reflation balloon which the administration has been pumping up since last year.

Wanting to avoid a Depression but being unwilling politically to take huge swaths of the banking system over temporarily, U.S. policy in essence underwrote the liabilities of the banking system without taking much of it over, leaving it to get on with arbitrating its new guarantee into profits with which to meet its losses and rebuild its capital. That worked, if by worked you mean prevented big banks from falling over and revived asset markets.

But seeing as how shareholders are impotent, the bankers are continuing to take a huge, and often growing, share of the loot, a fact that is also politically untenable. Fixing that without undermining the recovery of banking and the reflation of markets is not going to be easy.

Bernanke's plight, and the related effort to impose a new audit and other controls on the Federal Reserve are similarly both understandable and dangerous.

It's not as if Bernanke and crew didn't ask for it -- first by standing as godfather to the bubble and latterly by buying up mortgages in what amounts to poaching on the Congressional prerogative of doling out money to specific sectors of the economy. Even so two things stand out. A Fed chief who has been through a bruising political fight to retain office is an impaired Fed chief, both in terms of perceptions of independence and, potentially, real power and will to fight for that independence. Secondly, even if Bernanke was blameless, unemployment is high, former truths look pretty fragile and we can expect politicians to continue to meddle, or, if you like, to represent their electorates more actively.

It's possible that Bernanke can play scapegoat, resign, and in going protect the Fed. It's also possible that he is confirmed and stays with little long-term damage.

The underlying trend -- call it populism or call it democracy -- is not going away.

(At the time of publication James Saft did not own any direct investments in securities mentioned in this article. He may be an owner indirectly as an investor in a fund.)

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