

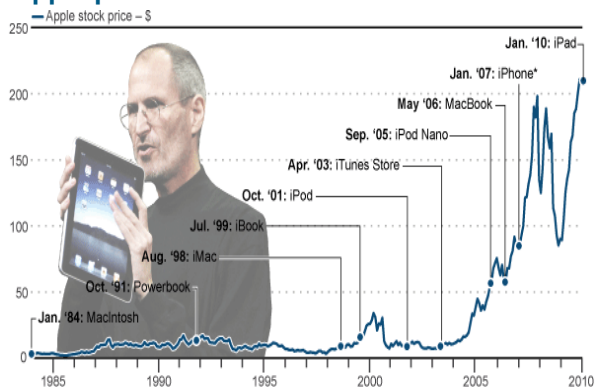
INSIDE DEBT

PRODUCED BY REUTERS IN PARTNERSHIP WITH ICAP

Wednesday, January 27, 2010

CHART OF THE DAY

Apple product launches



Apple Inc CEO Steve Jobs took the wraps off the "iPad" tablet, making a big bet on a new breed of gadgets that aim to bridge the gap between smartphones and laptops.

TODAY'S TOP NEWS

- U.S. Fed keeps rates steady, tone brighter
- Fall in U.S. new home sales fans fears on recovery
- U.S. lawmakers turn up heat on Geithner over AIG
- Obama to recast agenda to focus on jobs, deficit
- Apple unveils "iPad" tablet device
- U.S. \$42 bln 5-year auction draws good demand
- CFTC wants big players to trade on exchanges
- Greece denies China bond sale, markets dive

ECON WATCH

FOR THURSDAY JANUARY 28

ET	Indicators	Unit	Reuters	Prior
04:00	DE Unemployment chng sa	k	18	-3
04:00	DE Unemployment rate sa	%	8.2	8.1
05:00	EZ Business climate	ind	-1.1	-1.22
05:00	EZ Economic sentiment	ind	92.4	91.3
05:00	EZ Industrial sentiment	ind	-15	-16
05:00	EZ Services sentiment	ind	-2	-3
05:00	EZ Consumer sentiment	ind	-15	-16
08:30	US Durable gds orders mm	%	2.0	0.2
08:30	US Durable gds ex-trans mm	%	0.5	2.2
08:30	US Durable gds ex-def mm	%	0.4	0.1
08:30	US Non-def cap ex-aircrf mm	%	1.0	3.6
08:30	US Initial Claims	k	450	482
08:30	US jobless contin claims	mIn	4.60	4.599
18:30	JP CPI, core nationwide	%	-1.3	-1.7
18:30	JP CPI, core Tokyo	%	-1.8	-1.9
18:30	JP Unemployment rate	%	5.3	5.2
18:50	JP Industrial output prelim	%	2.5	2.2
-	JP BOJ - Minutes of monetary policy meet			

MARKETS TODAY

TODAY'S TOP STORY: The U.S. Federal Reserve left interest rates near zero and vowed to keep them there for a while to nurture an economic recovery held back by stubbornly high unemployment.

For more please click here

TREASURIES: U.S. government debt prices slipped after one Federal Reserve policymaker dissented from a decision to leave interest rates near zero.

- 10-yr Treasury prices shed 7/32, yielding 3.65 pct.
- 30-yr bond prices rose 1/32 to yield 4.56 pct.
- 5-yr notes fell 6/32 to yield 2.38 pct from 2.34 pct.
- 2-yr Treasury prices fell 2/32 yielding 0.91 pct.
- 2-10's part of the yield curve flattened by 7 bps to 274 bps.

FOREX: The euro extended losses and fell below \$1.40 for the first time since July after the U.S. Federal Reserve sounded more upbeat on the U.S. economy and said it will stick to its plan to end some emergency lending programs.

- Euro fell 0.36 pct at \$1.4023. Earlier it fell below \$1.40 for the first time since July at \$1.3994.
- Dollar rose 0.42 pct to 90.01 yen, wiping out earlier losses that took it as low as 89.15 yen.
- Dollar rose 0.31 pct at 1.0493 Swiss francs.
- The dollar index rose 0.36 pct at 78.714.

CORPORATES: U.S. corporate bond spreads were little changed ahead of President Barack Obama's State of the Union address.

- The CDX.IG-13 index widened to about 96 bps from 94 bps.
- Time Warner Cable Inc's 5 pct notes due in 2020 were the most actively traded, and spreads narrowed 1 bps to 169 bps.

STOCKS: U.S. stocks ended higher as investors were relieved that the Federal Reserve provided no further reason to sell stocks in its statement, while Apple boosted technology shares.

- Dow rose 0.41 pct to 10,236.16, S&P was up 0.49 pct to 1,097.50 and Nasdaq gained 0.80 pct to 2,221.41.
- Apple shares rose 0.94 pct to \$207.88 reversing course from a drop of more than 3 pct earlier in the session after it unveiled its iPad tablet computer.
- Caterpillar fell 4.32 pct to \$53.44, while United Tech fell 1.26 pct at \$67.61. Pulte Homes Inc fell 0.19 pct to \$10.33.
- S&P financial index rose 2.31 pct, S&P energy was down 0.58 pct, S&P technology rose 0.62 pct.
- KBW bank index rose 2.91 pct.

C & E: Oil prices dipped, pressured by rising U.S. product inventories builds due to ongoing weak demand in the world's top oil consumer.

- U.S. crude prices shed 1.35 pct to \$73.7 per barrel, moving below the 200-day moving average of \$73.66.
- Gold was down 0.90 pct to \$1,087.35 an ounce.
- Reuters-Jefferies index fell 1.87 pct to 268.76.

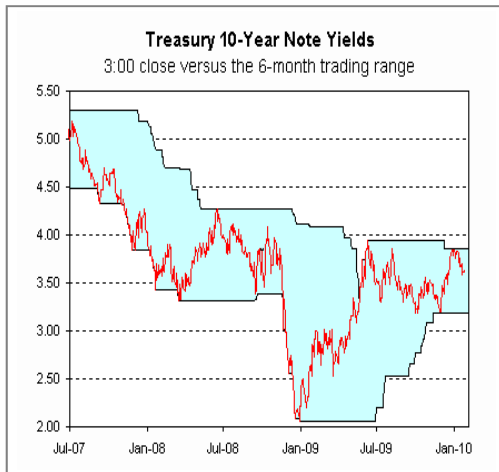
• For MARKET SNAPSHOT click here

• 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	-0.001
3-Mo Bill	0.080	0.070	0.081	0.009
6-Mo Bill	0.155	0.145	0.157	0.012
1-Year	0.310	0.305	0.315	0.024
2-Year	99.930	99.961	0.911	-0.086
3-Year	99.805	99.844	1.443	-0.152
5-Year	101.109	101.156	2.385	-0.172
7-Year	100.813	100.859	3.118	-0.188
10-Year	97.766	97.828	3.648	-0.180
30-Year	96.984	97.063	4.561	-0.039

EQUITIES

	INDEX	CHANGE
DJIA	10203.29	13.08
NASDAQ	2214.05	11.13
S&P 500	1094.28	2.56

OIL

	PRICE	CHANGE
NYMEX	73.7	-1.0
BRENT	72.3	-1.0

EURODOLLAR FUTURES

	CLOSE	CHANGE
Feb-10	99.735	0.000
Mar-10	99.715	0.005
Jun-10	99.580	-0.015
Sep-10	99.310	-0.035

FUTURES

	PRICE	CHANGE
CBOT 5 yr	116.05	-0.12
CBOT 10 yr	117.66	-0.17
CBOT 30 yr	118.34	0.06

CURRENCIES

	BID	ASK
Euro	1.4032	1.4034
Sterling	1.6172	1.6178
JP Yen	89.91	89.94
Swiss Franc	1.0492	1.0496
Can Dollar	1.0658	1.0664
Mexico	12.9593	12.9658

FED FUNDS

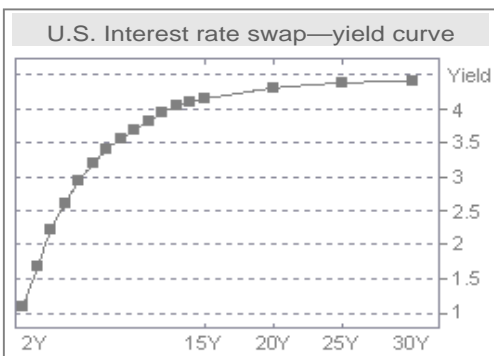
	NYFR SM - 10AM
Open	0.1300 1m 0.2163
High	0.1300 3m 0.2431
Low	0.0800

REPURCHASE AGREEMENTS

G/C	MORTGAGE REPOS
O/N	0.170 O/N 0.210
2-Week	0.190 2-Week 0.200
1-Month	0.190 1-Month 0.210
3-Month	0.210 3-Month 0.230
AGENCY REPOS	
O/N	0.180 10:00 AM 0.110
2-Week	0.190 3:00 PM 0.119
1-Month	0.210
3-Month	0.220

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	23.00	27.00	1.13	1.16
3-Year	31.75	35.75	1.75	1.77
5-Year	30.50	34.50	2.69	2.69
7-Year	15.00	19.00	3.27	3.26
10-Year	10.25	14.25	3.74	3.73
30-Year	-13.00	-9.00	4.43	4.41



EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.120	0.150	-	-
1-Month	0.180	0.280	0.121	0.131
3-Month	0.240	0.400	0.142	0.152
6-Month	0.250	0.450	0.174	0.184
12-Month	0.700	1.000	0.351	0.361

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	0.875	12/01/2012	13	11.5	1.05
3-Year	1.375	09/01/2013	23.5	22.75	1.68
5-Year	2.875	09/02/2015	0	32	-
7-Year	5.125	18/10/2016	0	21.5	-
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	39.5	38	4.94

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	10	9	0.96
3-Year	1.75	22/02/2013	30.5	30	1.75
5-Year	2.625	20/11/2014	20.5	20	2.59
7-Year	5.25	15/09/2016	18.25	17.75	3.3
10-Year	3.75	27/03/2019	0	24	-
30-Year	6.25	15/07/2032	39	38.25	4.95

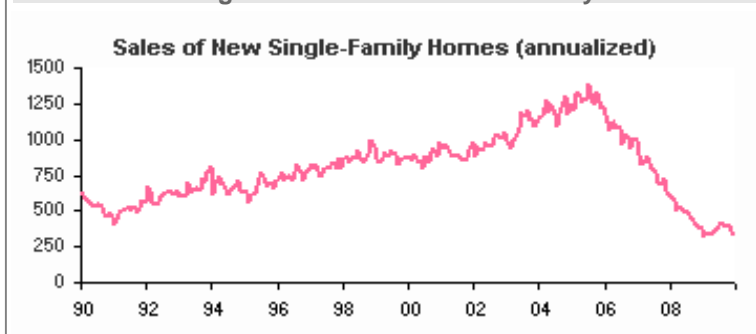
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.1720	105.1920	2.575
FHLMC	5.0	105.1620	105.1820	2.588

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.2530	105.2730	2.861
FHLMC	5.5	105.2820	105.3020	2.766
GNMA	5.5	105.2100	105.2300	3.566

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

U.S. Fed keeps rates steady, tone brighter

The U.S. Federal Reserve left interest rates near zero and vowed to keep them there for a while to nurture an economic recovery held back by stubbornly high unemployment.

The policy statement reflected a somewhat brighter tone than it had at the previous meeting in December, although the Fed removed a reference to improvement in the housing market.

"Information received since the FOMC met in December suggests that economic activity has continued to strengthen and that the deterioration in the labor market is abating," the Fed said.

In the December statement, the Fed had said economic activity "has continued to pick up."

The decision to hold rates steady was 9-1, with Kansas City Federal Reserve Bank President Thomas Hoenig dissenting because he wanted the central bank to eliminate a phrase vowing to keep rates exceptionally low for an extended period.

The Fed repeated its intention to allow the program to conclude as scheduled by the end of March, but added: "The Federal Reserve is prepared to modify these plans if necessary to support financial stability and economic growth."

U.S. lawmakers turn up heat on Geithner over AIG

U.S. lawmakers turned up the heat on U.S. Treasury Secretary Timothy Geithner over his role in the bailout of insurer AIG, challenging his claim he did not influence a decision to keep quiet AIG payments to big banks.

Both Democrats and Republicans questioned whether Geithner, who led the New York Federal Reserve Bank at the time, could have been in the dark over the decision not to disclose details of \$62 billion AIG paid to banks to settle swaps contracts.

One Republican said he should resign.

Geithner held firm to his defense that he had withdrawn from decisions by the New York Fed after he was nominated to the Treasury post in late 2008. He forcefully defended his role in helping rescue AIG.

Geithner said he served at the call of President Barack Obama and added: "I will do so as long as he asks me to do so."

Separately, U.S. Federal Reserve Chairman Ben Bernanke said he was not directly involved in negotiations with the counterparties of insurance giant AIG, having delegated the duties to the New York Fed.

Apple unveils "iPad" tablet device

Apple Inc Chief Executive Steve Jobs took the wraps off the "iPad" tablet, looking to define a new category of wireless device that will play video, games and all sorts of other media.

Jobs, who returned to the helm last year after a much-scrutinized liver transplant, is hoping to sell consumers on the value of tablet computing after numerous technology companies had failed to do so in recent years.

Called the "iPad," the device is Apple's biggest product launch since the iPhone three years ago, and arguably rivals the smartphone as the most anticipated in Apple's history.

The iPad has a near life-sized touch keyboard and supports Web browsing. It comes with a built-in calendar and address book, Jobs said. Despite the buzz surrounding the launch and Apple's storied golden touch on consumer electronics, the tablet is not necessarily an easy sell, analysts say.

In an online poll on reuters.com, 37 percent of more than 1,000 respondents said they would pay \$500-\$699 for the tablet. Nearly 30 percent weren't interested, while 20 percent said they would pay \$700-\$899.

Fall in U.S. new home sales fans fears on recovery

Sales of newly built U.S. single-family homes fell unexpectedly in December as the bounce from an initial tax credit fizzled, the latest sign that the government-led housing recovery might be losing some steam.

New home sales fell 7.6 percent to a 342,000 unit annual rate last month from an upwardly revised 370,000 units in November. It was the second straight month that new home sales declined. Markets had expected a 370,000 unit annual pace from November's previously reported 355,000 units.

New home sales for the whole of 2009 fell 22.9 percent to a record low 374,000 units, the Commerce Department said.

Separately, demand for loans to buy a home also fell, but on a smaller scale, the MBA said. Its index of mortgage applications fell 10.9 percent to 513.0 in the week ended Jan. 22.

Separately, ISM said its index of national factory activity came in at 54.9 versus the 55.9 it originally reported for December. The ISM revised its non-manufacturing index to 49.8 last month versus the 50.1 originally reported for December.

The Chicago Fed the index slipped 0.3 percent to a seasonally adjusted 84.1 from a upwardly revised 84.4 in November.

Obama to recast agenda to focus on jobs, deficit

President Barack Obama will recast his agenda in a high-stakes address to the American people, focusing on jobs and deficits as he seeks to weather his worst political storm since taking office.

Obama's annual State of the Union speech to Congress at 9 p.m. follows the loss by his Democratic party of a pivotal Senate seat, imperiling legislative priorities like healthcare reform and financial regulation.

Amid pomp and ceremony, Obama will try to show his prime-time television audience he understands their economic pain as he proposes new curbs on Wall Street and tax credits to middle-class families. Obama will highlight economic improvements and try to deflect criticism that the healthcare push shifted his focus. U.S. President Barack Obama will call in his State of the Union address on Wednesday for an extension of a tax break to businesses that allows them to write off investments in equipment more quickly. The tax break, a 50 percent "bonus depreciation" through 2010, is worth \$38 billion over the 2010-2011 period, a senior administration official said.

U.S. \$42 bln 5-year auction draws good demand

The U.S. government sold \$42 billion worth of five-year debt in a surprisingly well-bid auction that overcame expensive market conditions and uncertainty ahead of a Federal Reserve policy statement.

The sale, part of this week's \$118 billion worth of bond auctions, attracted solid overall demand, with bids totaling 2.80 times the amount on offer versus the average of 2.35 in the 12 auctions of five-year debt that took place last year.

Yields were below expectations, based on trade in the when-issued market at the bidding deadline, indicating that investors were willing to pay a slight premium in price to get the bonds.

Analysts graded this auction with a recent rally in mind, which meant the bonds were being offered at expensive prices, while the upcoming Fed statement added uncertainty to the market.

Foreigners and large institutional investors showed near-average demand, based on the indirect bidding category, which accounted for 52.8 percent of the sale.

That was slightly above the average of 51.49 percent in the sales taking place since June 2009.



TODAY'S TOP NEWS

CFTC wants big players to trade on exchanges

Congress should require banks and other big players to trade derivatives on regulated exchanges as an "absolutely essential" part of regulatory reform to prevent another market crisis, the chief U.S. futures regulator said.

Exchange trading of "standardized" swaps is an important element in the Obama administration proposal to bring over-the-counter derivatives under federal control.

Gary Gensler said referring to trading of swaps on regulated exchanges and electronic platforms. In prepared remarks, he said requiring banks and other Wall Street dealers to bring their standardized transactions to transparent trading venues would "shift the information advantage from a small group of derivative dealers on Wall Street to the broader market."

Gensler also backed establishing a so-called "Eddie Murphy" rule, named after the actor's role in the film "Trading Places," where traders sought to make a profit in orange juice futures after stealing an Agriculture Department report on the U.S. orange crop. The measure would ban insider trading using non-public information acquired from a government source.

Greece denies China bond sale, markets dive

Greece denied press reports it had chosen Goldman Sachs to sell up to 25 billion euros (\$35 billion) of bonds to China, sending Greek government debt prices sharply lower and hitting the euro.

Greece, facing a budget crisis, reiterated plans for an investor roadshow in Asia. Greece's problems put a cloud over the outlook for Europe and its impact on global growth. Euro periphery markets also took a beating, as Portugal received a warning on its rating from Fitch on deficit concerns. A downgrade for Portugal's credit rating is "more likely than not" after its 2009 budget deficit was worse than expected, Fitch Ratings said, prompting the government to ask ratings agencies not to rush to judgment on any downgrade decisions. A source familiar with the situation said that while Goldman was keen to do further business with Greece, there was no project under way to place debt specifically with Chinese investors.

ECB could withdraw more crisis support in H1-Weber

The ECB could remove more of its crisis support for the economy in coming months and will not set interest rates to suit the euro zone's few troubled members, Governing Council member Axel Weber said.

On the hot topic of the ECB's "exit strategy" for withdrawing the emergency steps taken to support banking and the economy since 2008, Weber said the bank would continue to slowly take away support measures this year having kicked-off what is expected to be a 1-2 year process in December.

ECB Board member Juergen Stark said this week that the bank would decide whether to take further steps to withdraw support in March when it was armed with new in-house economic forecasts.

Weber said that it would have to keep some support in place over the middle of the year when banks have to pay back the 442 billion euros they borrowed from the central bank last June.

Top China bank ICBC halts roll-over of some loans

China's largest bank, ICBC, said it has stopped rolling over some loans to slow credit growth after a surge at the start of the year, offering the latest evidence of a government-directed clampdown on lending.

In a statement issued after a week of reports and rumours of China's monetary tightening that have roiled global markets, the world's biggest lender by market value stressed that it would not halt new lending.

But given that Chinese companies typically borrow for short periods of as little as six months, and then roll the financing over, Industrial and Commercial Bank of China's move is tantamount to calling loans in.

Chinese officials have made clear that they do not want to freeze lending, only to see banks lend more evenly to avoid the kind of surge that now seems to be occurring.

To that end, regulators have ordered banks to call back some of the loans they extended in January, the official Securities Times reported. Officials are targeting about 7.5 trillion yuan in new loans this year, down from a record 9.6 trillion yuan in 2009.

NEXT UP

U.S. oil stocks post surprise fall on imports-EIA

U.S. crude oil stockpiles showed a surprise draw last week as imports fell, while distillate fuels chalked up an unexpected gain due to still-weak demand for refined products, data from the EIA showed.

Commercial stockpiles of crude oil in the world's biggest consumer sank 3.9 million barrels to 326.7 million barrels in the week to Jan. 22, EIA said, countering forecasts for a 1.4 million barrel rise.

Inventories of middle distillates unexpectedly rose by 400,000 barrels to 157.5 million barrels, compared with the 1.7 million barrel decline forecast by analysts in a Reuters poll.

Refinery utilization rates were up 0.1 percentage point at 78.5 percent of capacity last week, after dropping the week before to the lowest rate in about two decades, not counting shutdowns caused by hurricanes. Crude runs fell by 200,000 bpd last week. Analysts had forecast a dip of 0.1 percentage point. U.S. gasoline stocks rose 2.0 million barrels to 229.4 million barrels, topping a projected 1.1 million barrel gain forecast by analysts. U.S. total product demand declined 2 percent over the past four weeks from the same period a year ago, to 18.75 million bpd.

ECB seen holding rates until Q4, Greece still a worry

The ECB looks set to leave rates unchanged until late this year and analysts polled by Reuters still see a one in five chance that Greece will need to seek a financial bailout this year.

All 86 economists in a poll taken Jan. 25-26 said the central bank would keep rates at their record low of 1.0 percent next week, and only two saw any change before the middle of the year.

The bank has slashed interest rates, purchased covered bonds and offered unlimited funds for banks and these moves have paid off -- economists expect the economy to grow 1.2 percent this year and 1.6 percent next. It is expected to have shrunk by 3.9 percent in 2009. Median forecasts show interest rates on hold until the final quarter of the year when they will nudge up to 1.25 percent, and then climb to 1.75 percent by March next year. They were seen ending the year at 1.5 percent in a poll taken last week.

Greece fell into its first recession in 16 years in 2009 and is set to become the euro zone's most indebted member this year, with debt estimated at more than 120 percent of GDP, despite plans to cut expenditure and hike taxes.



DEEP DIVE Commentary and Analysis

Record U.S. deficit demands Obama start acting now

By Walden Siew

The United States' skyrocketing red ink is making investors increasingly anxious and they want President Barack Obama to take concrete steps on Wednesday toward reducing the nation's \$1.4 trillion budget deficit.

The record deficit for the world's largest economy now amounts to 10 percent of gross domestic product, the highest since World War Two and more than triple the 3 percent mark that economists generally see as a manageable maximum level.

That debt load has stirred investor fears of a weakening dollar, deterioration of the country's prized AAA credit rating and a huge supply of government debt that will drive yields higher, hurting both corporations and consumers.

Looking further out, many worry that if the federal government doesn't take control of its ballooning costs, the United States could face the same kind of stagnating economy that gripped Japan in the 1990s.

"If we can't get the deficit down to 3 percent GDP in about three years, you have ballooning interest payments that are unsustainable," said Ira Kalish, director of global economics for Deloitte Research in Los Angeles.

Kalish gives the Obama administration about three years to implement a plan and avoid such dire scenarios.

Obama is expected to emphasize a commitment to tackling those concerns and the budget shortfall when he delivers his State of the Union address on Wednesday at 9 p.m. (0200 GMT Thursday).

Administration officials said late on Monday that Obama is seeking a three-year freeze on many domestic programs in his new budget with a goal of saving \$250 billion by 2020.

"Obama certainly will address the budget and finance issues because it's paramount in investors' minds," said Margaret Patel, a senior portfolio manager at Evergreen Investments in Boston. "I would expect to hear some kind of plan that over time reduces the deficit."

While the justification for the huge deficit was that the economy was on the brink of financial collapse, "now he must address some kind of long-term policy," Patel said.

Many analysts characterized Monday's budget freeze announcement as symbolic because the savings are relatively small and come on the heels of recent setbacks.

Obama is seeking to push forward his budget and calm investor nerves in the wake of a shocking seven days for Democrats, who lost the Massachusetts Senate seat last week, after which Obama also made a surprise announcement of a proposal to curb risk-taking by banks.

Some investors still consider the possibility of another debt crisis only a few years away.

Signs of investor concerns are already priced into the market and higher bond yields and a resulting stagnation of economic growth could be on the horizon if the government doesn't tackle the deficit now.

"As you put it off, you've got a looming, bigger problem from all the entitlement programs as baby boomers start to retire," Standard & Poor's chief economist David Wyss told Reuters. "If we haven't done anything to reduce the deficit and the entitlement problems, the problem explodes."

The cost to insure U.S. government debt against default last week rose to 43.5 basis points, the highest level in seven months, partly on bond investors' concerns about U.S. public debt and global sovereign debt.

Those levels are still considered safe compared with riskier credits such as European Union member Greece, which trades at about 325 basis points, according to CMA DataVision.

While few analysts expect the U.S. government would ever default, credit markets hint that investors are increasingly worried about the potential for a spike in borrowing costs because of the record amount of U.S. public debt.

The White House has said that restoring jobs growth is Obama's top near-term priority, leaving him little room to cut spending or raises taxes any time soon, but he also believes it is crucial for the economy to reduce deficits in coming years.

The non-partisan Congressional Budget Office estimated on Tuesday that the U.S. budget deficit for the current 2010 fiscal year would shrink to \$1.35 trillion.

The White House, which updates its forecasts next week, has projected that the deficit would rise to \$1.5 trillion in the current fiscal year and fall back to \$1.1 trillion in 2011.

Although the United States is in little immediate danger of losing its sterling AAA rating, a long period of slow growth could be in store if the deficit is ignored.

Moody's Investors Service warned last year that the United States could lose its top rating in the next three years if the deficit is not addressed.

Moreover, S&P's Wyss said moves to cut the deficit must be made in coming years. Otherwise, the United States could suffer a lost decade of growth, akin to what happened in Japan in the 1990s, when economic expansion came to a halt after a massive stock market crash led to a debt and banking crisis, he said.

S&P on Tuesday threatened to cut Japan's AA credit rating, the third highest, due to its debt load.

"We could end up with stagnant economic growth, low private investment and no growth, essentially the Japan situation," said Wyss, who estimated the chances of that stark outlook at about 20 percent. "It's not trivial."

Commodity FX long-term bet after near-term dip

By Jessica Mortimer

Investors are becoming wary of commodity-linked currencies as risk aversion rears its head again, yet many of the reasons why they were the darlings of the foreign exchange market at the start of the year remain valid.

Commodity exporters' currencies, such as the Australian and New Zealand dollars, and the Norwegian crown, have slipped versus the U.S. dollar and yen recently on concern China's monetary tightening will dent its growth and hit demand for commodities.

But many analysts see these moves as short-term wobbles and say longer-term growth, fuelled by still buoyant Chinese demand, and rising interest rates, could lead the commodity currencies to outperform the likes of the dollar, euro and yen.

"The big picture suggests China should do well and I think the likes of Australian and Canadian dollars will go up, but there are enough warning signs for at least for the next few weeks, maybe longer," said Simon Derrick, currency strategist at Bank of New York Mellon.

Australia avoided technical recession during the financial crisis and its central bank was the first to hike interest rates, which are now at 3.75 percent and may rise next month.

Norway has also begun hiking rates, with New Zealand and Canada seen following suit in the second or third quarter.

"There is room for the Australia-U.S. interest rate spread to widen, and we still see upside in the Australian dollar on a 3-6 month horizon," said Marcus Hettinger, global FX strategist at Credit Suisse in Zurich. He has a three-month target on the Aussie of \$0.96, describing it as "a play on global growth".

Gains in commodity prices will also lift these currencies, with most analysts believing prices of base and precious metals will



DEEP DIVE Commentary and Analysis

rise this year, albeit at a slower pace to 2009. Oil prices are seen rising later in the year after a shaky first half.

SHORT-TERM WOBBLES

Reports last week that Chinese banks had been told to curb lending hit commodity currencies hard, causing the Australian and Canadian dollars to lose more than 1.5 percent against the dollar that day, while the kiwi fell around 2.5 percent.

"Things are not quite so clear cut as they were - a few weeks ago strong numbers out of China meant commodity currencies went up. Now it is muddied and people don't know if that means a tighter policy," said Derrick at BNYM.

When investors feel confident about taking on risk, higher-yielding, commodity currencies are popular, but they will be vulnerable if the current bout of risk aversion continues.

Technical analysts also warn that some of January's sharp gains may have been overdone, particularly in the Aussie dollar, which earlier this month hit a nine-year high against the euro and a 25-year high versus sterling. Mizuho's Nicole Elliot believes the Aussie will struggle in the "critical" \$0.94-\$0.95 area versus the U.S. dollar, making it tough to surpass November's 15-month high of \$0.9407.

"This is a super-long-term resistance and it (the Australian dollar) has very rarely held above that," she said.

RELATIVE VALUE

But some analysts caution against viewing commodity currencies as a group, looking instead at their relative merits.

If another period of risk aversion lies ahead, Mizuho technical analyst Elliot says, it may be wise to avoid the Australian dollar in favor of a more peripheral currency like the New Zealand dollar less subject to global influences.

Adam Cole at RBC Capital Markets sees "considerable upside" for the Canadian and New Zealand dollars, albeit probably not until the second quarter. However, he believes a lot of the good news is already priced in for the Australian dollar.

Morgan Stanley analysts are also bearish on the kiwi, arguing New Zealand data has been "consistently disappointing" and that the market may be pricing in too many rate hikes.

However, they say the Canadian dollar will benefit if the economy rebounds quicker than the Bank of Canada predicts, while oil-rich Norway's "strong balance sheet" will lift the crown as concern grows about fiscal sustainability.

INSIDE DEBT is produced by Reuters in partnership with ICAP.

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