

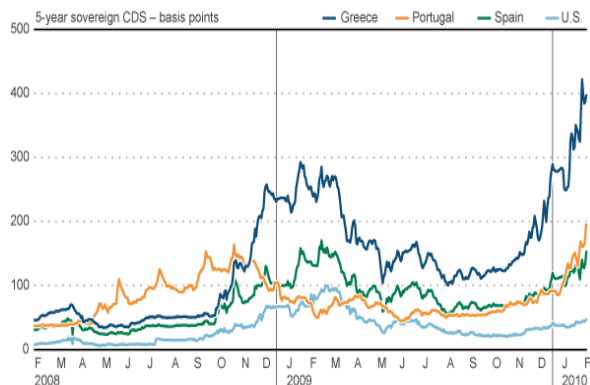
# INSIDE DEBT

PRODUCED BY REUTERS IN PARTNERSHIP WITH ICAP

Thursday, February 4, 2010

## CHART OF THE DAY

### Global sovereign credit default swaps



The cost of insuring sovereign debt is rising, particularly in Europe, reflecting growing concerns over high debt loads taken on by governments attempting to spend their way out of the financial crisis.

## TODAY'S TOP NEWS

- Markets hammer euro states as fiscal fears mount
- U.S. jobless claims rise, productivity stays high
- U.S. House backs debt limit hike, sends to Obama
- Cost to insure U.S. Treasuries highest since April
- Treasury's Geithner says China likely to move on yuan
- European sovereign debt deemed riskier than U.S. corps
- [For more stories, please click here](#)

## ECON WATCH

FOR FRIDAY FEBRUARY 5

ET	Indicators	Unit	Reuters	Prior
02:45	FR Trade bal EUR	bln	-4.6	-5.304
04:30	GB PPI Input mm	%	0.5	0.1
04:30	GB PPI Input yy	%	6.3	6.9
04:30	GB PPI output mm	%	0.3	0.5
04:30	GB PPI output yy	%	3.7	3.5
05:00	IT CPI prelim mm	%	0.2	0.2
05:00	IT HICP prelim mm	%	-1.1	0.2
06:00	DE Industrial output mm	%	0.5	0.7
07:00	CA Employment change	k	15.0	-28.3
07:00	CA Unemployment rate	%	8.5	8.4
08:30	US Non-farm payrolls	k	5	-85
08:30	US Manufacturing Payroll	k	-20	-27
08:30	US Unemployment rate	%	10.1	10.0
08:30	US Avg hrly earnings	%	0.2	0.2
08:30	US Avg work week	hrs	33.2	33.2
15:00	US Consumer credit	bln	-9.0	-17.5

## MARKETS TODAY

**TODAY'S TOP STORY:** Investors sold off stocks in Portugal, Spain and Greece and the euro plunged as market fears over the fiscal problems of debt-laden southern members of the euro zone widened.

[For more please click here](#)

**TREASURIES:** U.S. Treasury prices jumped amid a retreat in global stock markets, persistent fears over European sovereign risk and an unexpected increase in U.S. jobless claims.

- 30-yr bond prices rose more than a point to yield 4.54 pct.
- 10-yr Treasury prices jumped 28/32 to yield 3.6 pct.
- Yields of 2-yr Treasuries fell 0.8 pct, on track for their biggest drop since mid-December.
- 2-10's part of the yield curve tightened 3 bps to 280 bps from 283 bps.

**FOREX:** The dollar and yen soared as fears about the euro zone's worsening fiscal problems and a less-than-stellar U.S. jobless claims report drove investors to abandon risky assets for traditional safe havens.

- The dollar shed 2.21 pct to 88.96 yen. Earlier, it fell as low to 88.58 yen, the lowest since mid-December. The euro fell to a nearly one-year low to 122.23 yen.
- The euro fell 1.07 pct to \$1.374, after earlier hitting its lowest in more than eight months at \$1.3729.
- Sterling was hammered, falling to its lowest in nearly four months at \$1.5733 and was last down 0.78 pct at \$1.5758.

**CORPORATES:** U.S. corporate bonds sold off as growing concerns about sovereign debt problems in Europe broadly hurt riskier assets and after data hinted the labor market may be weaker than analysts had thought.

- The CDX.IG-13 index widened by about 8 bps to 100 bps.
- Kraft Foods re-launched its \$9.5 bln four-part debt sale at wider spreads than first launched earlier on Thursday morning.
- Berkshire Hathaway launched \$8 bln of notes in a six-part sale.

**STOCKS:** U.S. stocks ended sharply lower as mounting sovereign debt problems in Europe and an unexpected rise in jobless claims put investors on the defensive just ahead of the crucial payrolls report.

- Dow fell 2.61 pct to 10,002.18, S&P sank 3.11 pct to 1,063.11 and Nasdaq dipped 2.99 pct to 2,125.43.
- The CBOE Volatility Index spiked 20.93 pct, reflecting investor anxiety. S&P financial, energy, autos and retail index fell more than 3 pct.
- Alcoa fell 4.3 pct to \$12.91, with BofA down 5.02 pct at \$14.75. MasterCard tumbled 10.29 pct to \$222.11. Cisco Systems shares rose 0.39 pct to \$23.16.

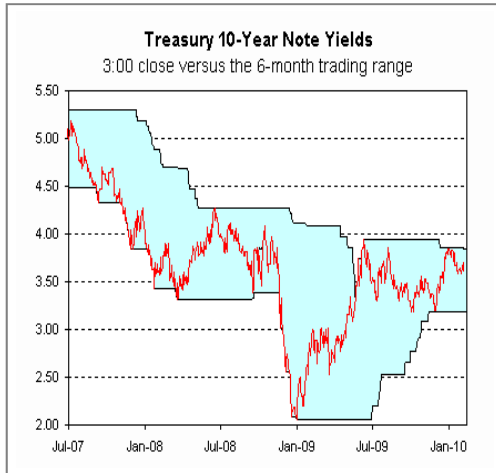
**C & E:** Oil prices plunged more than 5 pct in their steepest one-day drop since July, after a rise in U.S. jobless claims and spreading concern over Europe's economic health drove investors to sell commodities and seek less risky assets.

- U.S. crude prices fell 5.13 pct to \$73.03 per barrel.
- Gold was down 3.95 pct to \$1,065 an ounce.
- Reuters-Jefferies index fell 2.55 pct to 263.67.

- [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	0.045	0.01	0.046	-0.005
3-Mo Bill	0.090	0.080	0.091	-0.007
6-Mo Bill	0.155	0.145	0.157	-0.010
1-Year	0.285	0.275	0.290	-0.024
2-Year	100.117	100.148	0.816	0.141
3-Year	100.164	100.195	1.318	0.281
5-Year	99.750	99.797	2.304	0.508
7-Year	100.359	100.406	3.067	0.633
10-Year	98.109	98.172	3.606	0.852
30-Year	97.281	97.359	4.542	1.586

**EQUITIES**

	INDEX	CHANGE
DJIA	10063.70	-206.62
NASDAQ	2140.49	-50.34
S&P 500	1071.43	-26.12

**OIL**

	PRICE	CHANGE
NYMEX	73.1	-3.9
BRENT	72.1	-3.9

**EURODOLLAR FUTURES**

	CLOSE	CHANGE
Feb-10	99.743	0.005
Mar-10	99.710	0.000
Jun-10	99.605	0.025
Sep-10	99.365	0.055

**REPURCHASE AGREEMENTS**

G/C		MORTGAGE REPOS	
O/N	0.210	O/N	0.210
2-Week	0.220	2-Week	0.210
1-Month	0.210	1-Month	0.230
3-Month	0.240	3-Month	0.260
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.210	10:00 AM	0.140
2-Week	0.210	3:00 PM	0.135
1-Month	0.220		
3-Month	0.250		

**IR SWAPS <19901>**

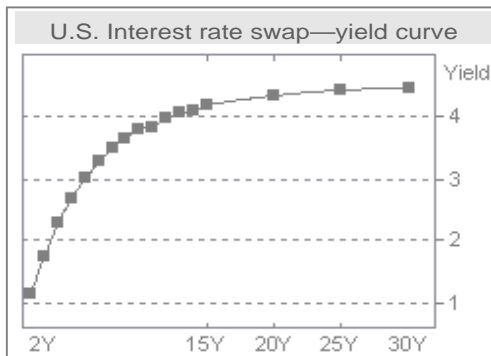
	SPREAD		RATE	
2-Year	27.75	31.75	1.09	1.11
3-Year	36.75	40.75	1.68	1.70
5-Year	30.75	34.75	2.61	2.61
7-Year	13.00	17.00	3.19	3.19
10-Year	9.00	13.00	3.69	3.68
30-Year	-15.25	-11.25	4.39	4.37

**FUTURES**

	PRICE	CHANGE
CBOT 5 yr	116.66	0.47
CBOT 10 yr	118.27	0.67
CBOT 30 yr	118.78	1.41

**EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)**

	BID	ASK	BID	ASK
O/N	0.140	0.160	-	-
1-Month	0.180	0.280	0.129	0.139
3-Month	0.240	0.400	0.143	0.153
6-Month	0.250	0.450	0.172	0.182
12-Month	0.650	1.000	0.318	0.328



**CURRENCIES**

	BID	ASK
Euro	1.3743	1.3746
Sterling	1.5763	1.5768
JP Yen	89.15	89.18
Swiss Franc	1.0655	1.0658
Can Dollar	1.0717	1.0722
Mexico	13.0894	13.0950

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

Open	0.1500	1m	0.2144
High	0.1500	3m	0.2472
Low	0.1300		

**ACTIVE FANNIE MAE AGENCIES**

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	0.875	12/01/2012	14	13	0.95
3-Year	1.375	09/01/2013	24.5	21.5	1.56
5-Year	2.875	09/02/2015	34	33.5	2.65
7-Year	5.125	18/10/2016	25	0	3.32
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	39	37.5	4.94

**ACTIVE FREDDIE MAC AGENCIES**

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	9.5	0	0.91
3-Year	1.75	22/02/2013	30	29.5	1.62
5-Year	2.625	20/11/2014	21.5	21	2.52
7-Year	5.25	15/09/2016	21.25	20.75	3.28
10-Year	3.75	27/03/2019	27.5	26	3.89
30-Year	6.25	15/07/2032	40.5	39.75	4.95

**Active MBS 15YR**

	CPN	BID	ASK	YIELD
FNMA	5.0	105.2600	105.2800	2.466
FHLMC	5.0	105.2600	105.2800	2.466

**Active MBS 30YR**

	CPN	BID	ASK	YIELD
FNMA	5.5	106.0500	106.0700	2.712
FHLMC	5.5	106.0700	106.0900	2.625
GNMA	5.5	105.3000	106.0000	3.478

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



## TODAY'S TOP NEWS

**Markets hammer euro states as fiscal fears mount**

Investors sold off stocks in Portugal, Spain and Greece and the euro plunged as market fears over the fiscal problems of debt-laden southern members of the euro zone widened.

The head of the IMF called for painful steps to cut huge fiscal deficits across Europe, saying no country should be under the illusion that it was possible to escape the financial crisis without paying the cost.

The Portuguese government's defeat over a regional finance bill, a climb-down by the Spanish government over pension reform, and protests by tax officials in Greece added to the woes of states struggling to cut budget shortfalls bloated by recession. IMF Managing Director Dominique Strauss-Kahn said his organization was ready to help Greece, which is under more pressure over its finances than any other bloc member, but expressed confidence the government would take the "very difficult measures" needed to deal with its fiscal crisis.

ECB President Jean-Claude Trichet said deficit-cutting measures announced by the Greek government were "steps in the right direction" and the ECB approved of the goals which Greece now has to meet.

**U.S. House backs debt limit hike, sends to Obama**

The U.S. House of Representatives voted to increase the government's borrowing authority to \$14.3 trillion and sent the measure to President Barack Obama to sign into law.

By a vote of 233 to 187, the House voted to raise the nation's \$12.4 trillion debt limit by \$1.9 trillion, which would probably allow them to avoid revisiting the politically toxic issue before November congressional elections.

Mindful of a growing voter backlash over government spending, Democrats crafted the legislation so it also requires new spending to be offset elsewhere in the budget.

**Treasury's Geithner says China likely to move on yuan**

Treasury Secretary Timothy Geithner said he shared U.S. lawmakers' concern about China's currency value, but was optimistic Beijing would begin letting the currency appreciate.

"I think it's actually quite likely (China) will move. I think they recognize it's important to them, in their interest as well," Geithner told the Senate Budget Committee.

It will also be "extremely difficult" for the United States to meet Obama's goal of doubling exports by 2014 if China does not allow its currency to appreciate, Senator Ben Cardin said.

Separately, China dismissed U.S. threats to get tough on trade and exchange rates to ensure American goods are not disadvantaged, saying that its currency was at a reasonable level.

**European sovereign debt deemed riskier than U.S. corps**

The perceived credit risk of Western European nations overtook that of high-grade U.S. companies for the first time, reflecting rising concerns over high debt loads taken on by governments attempting to spend their way out of the financial crisis.

The SovX credit default swap index, a measure of the credit risk of 15 Western European countries, rose to 94 basis points on Thursday, compared with 92 basis points for the benchmark U.S. index of investment grade companies.

Though many analysts discount comparisons between sovereign risk and corporations, the increase nonetheless reflects increasing focus on sovereign credit quality.

The SovX index has traded at higher levels than the European corporate credit index for most of this year.

**U.S. jobless claims rise, productivity stays high**

The number of U.S. workers filing for jobless benefits unexpectedly rose last week, but another big gain in productivity in the fourth quarter offered hope companies were getting close to adding to payrolls.

Initial claims for state unemployment insurance increased 8,000 to 480,000, the Labor Department said. Financial markets had expected claims to come in at 460,000.

Business productivity grew at a 6.2 percent rate in the fourth quarter as employers ramped up output at the fastest pace in six years and kept a tight lid on hiring.

Economists had expected productivity to rise at a 6.0 percent rate after gaining 7.2 percent in the third quarter. In the second quarter, productivity had risen 6.9 percent.

U.S. Treasury Secretary Timothy Geithner said new data showing "extraordinarily high" growth in productivity offers an encouraging sign for the economy and potential job growth.

Hours worked rose at a 1.0 percent rate, the first increase since the second quarter of 2007 and the fastest since the fourth quarter of 2006.

That recovery was underscored by a report on Thursday that showed an unexpected surge in orders received by U.S. factories and a drop in inventories in December.

**Cost to insure U.S. Treasuries highest since April**

The cost for investors to insure against a U.S. government default rose to its highest level in nearly 10 months, amid jitters over rising sovereign risks.

A surge in government borrowing due to the global recession and credit crisis has elevated anxiety over various nations' indebtedness, regardless of their size.

The U.S.'s soaring deficit has resurrected doubts over its long-term ability to repay its debt.

In the credit default swap market, the annual cost of insuring U.S. Treasuries debt against a potential default in a five-year period rose for a third straight session.

The price to insure against a potential U.S. Treasury default grew to 49.4 basis points, the highest since April 8, 2009 when it was 52 basis points, said CMA DataVision, a credit data firm.

In the meantime, the cost to insure Japanese government debt moved up to 83.0 basis points from a New York close of 78.7 basis points on Wednesday, CMA said.

**Hard to write Volcker rule as proposed-U.S. Sen Dodd**

Senate Banking Committee Chairman Christopher Dodd said it will be hard to write legislation to curb bank proprietary trading as specific as White House economic adviser Paul Volcker has proposed.

Dodd said it would be easier to write a bill requiring regulators to examine questions related to the so-called "Volcker rule" proposed last month by the Obama administration in a move that stunned financial markets.

"We'll see how it can be done," Dodd told reporters after chairing a hearing on the issue where he heard mixed reviews from Wall Street bankers on the rule, amid signs that its chances for adoption as proposed looked increasingly slim.

"It's going to be hard to write something as specific maybe as Paul Volcker recommended, but it's not as hard to write a requirement that the appropriate regulators examine this question," Dodd said.

He added that the banking committee would also look at related provisions of a financial reform bill approved in December by the House of Representatives.



## TODAY'S TOP NEWS

**Bank of England halts QE, leaves door open for more**

The Bank of England put a hold on its unprecedented 200 billion pound asset-buying program for the first time in 11 months, but left the door open for more so-called quantitative easing if the economy relapsed.

The pause in QE and the decision to hold interest rates at a record low of 0.5 percent had been widely expected but gilts fell and sterling rose after the announcement as some traders had positioned for an expansion of the asset-buying scheme.

Analysts said the overall tone of the BoE statement appeared dovish and it would be a long while yet before the central bank moved toward tightening monetary policy after the extraordinary measures taken over the last year.

BoE predicted the economic recovery would be gradual and the high degree of spare capacity in the economy would mean that inflation would fall below target for a period.

A British election is due by June and whichever party wins will, at some point, have to dramatically tighten fiscal policy to rein in a ballooning budget deficit.

**ECB holds rates, further exit steps pending in March**

The European Central Bank promised to lay out the next stage of its plans for a further pull-back of crisis measures when it meets next month, after it kept interest rates at a record low of 1.0 percent.

ECB President Jean-Claude Trichet also said Greece had taken positive steps to curb its deficits, and reaffirmed the view that the euro zone's economic recovery would be modest and uneven this year.

Asked about the ECB's plans for phasing out liquidity measures employed to boost the beleaguered banking sector and ensure credit supply, Trichet said the decisions would be made at its March meeting.

In a separate report, German manufacturing orders fell sharply in December from the previous month, official data showed, in a surprise blow to recovery led by a decline in foreign demand. Adjusted for seasonal swings, orders fell by 2.3 percent on the month, preliminary Economy Ministry figures showed.

**Senate will vote on job proposals next week -Reid**

U.S. Senate Democratic leaders unveiled a "jobs agenda" that includes tax breaks for small business and said they hoped to bring parts of it up for a vote next week.

Senate Majority Leader Harry Reid and other Democratic leaders said they wanted to get support from Republicans before determining what specific elements they will bring up for a vote. Democrats say their top legislative priority is to bring down the double-digit unemployment rate before the November congressional elections, but they face a growing backlash from voters over the aggressive measures they took last year to blunt the impact of the worst recession in 70 years.

Thus Democrats intend to advance their jobs proposals in a series of smaller bills, to avoid reactions like the sticker shock of the \$155 billion jobs package passed by the House of Representatives in December.

Separately, U.S. Treasury Secretary Timothy Geithner told a Senate panel he supports proposals to improve transparency for the Federal Reserve.

**BOJ Nakamura: fund supply not panacea for deflation**

Bank of Japan policy board member Seiji Nakamura said increases in the central bank's liquidity provision alone will not help Japan escape deflation.

"In order to solve demand shortages, it is important for the BOJ, the government and private sector firms each to play their own roles," Nakamura told business leaders in Fukuoka, southwestern Japan.

He said that to achieve sustained economic growth, the government needs to review the special fiscal steps it has taken in response to the global financial crisis and to consider long-term fiscal reconstruction.

Separately, Japan's finance ministry said it estimates that 51.3 trillion yen (\$564.8 billion) in new bond issuance will be needed to fund the national budget for the fiscal year starting on April 1, 2011. New bond sales could then rise to 52.2 trillion yen in fiscal 2012/13 and 55.3 trillion yen in fiscal 2013/14, the ministry said in a statement.

## NEXT UP

**U.S. Jan payrolls seen +5,000, jobless rate 10.1 pct**

Nonfarm payrolls are expected to have increased in January, only the second time since December 2007, when the worst economic downturn in 70 years started. Temporary hiring is picking up and labor market indicators during the month have pointed to an improving jobs situation.

The median forecast for nonfarm payrolls is for an increase of 5,000 after an unexpected 85,000 drop in December. Forecasts range from a decrease of 97,000 to an increase of 100,000.

The average work week is seen steady at 33.2 hours, with forecasts ranging from 33.2-33.3 hours.

The Department of Labor has estimated that the level of employment for the 12 months to March 2009 will be revised down by about 824,000. Monthly payrolls from March 2008 to March 2009 will likely be revised.

A gain in payrolls in January will be a confidence boost for households and may encourage consumers to spend more.

The unemployment rate is expected to edge up to 10.1 percent from 10 percent in December. The jobless rate is viewed as one of the factors that will determine the timing of the Fed's first interest rate increase since slashing overnight lending rates to near zero in December 2008.

**Canada seen adding 15,000 jobs in January**

The employment situation in Canada has stopped deteriorating over the past several months but has not necessarily shown signs of growth as monthly results have been unpredictable and choppy. There was a net job gain in the fourth quarter but only because hefty hiring in November outweighed job cuts in both October and December.

The median forecast of 22 analysts is for a net gain of 15,000 jobs in the month, following an unexpected loss in December of 28,300 jobs, according to revised data released last week. Forecasts range from -15,000 to +45,000.

The median forecast for the unemployment rate is 8.5 percent, up from 8.4 percent the previous month. Forecasts range from 8.3 percent to 8.7 percent.

The number of jobs in the economy is still almost 2 percent lower than the peak in October 2008 and economists say they need to see more consistent signs of employment growth to conclude the economy is fully on track to recovery.

Some of the other jobs being created, such as in construction, may be short-term ones resulting from fiscal stimulus projects. Services jobs were largely unscathed during the recession.



## DEEP DIVE Commentary and Analysis

**ANALYSIS-No respite from investor fear of policy error**

By Jeremy Gaunt

Even as surprisingly upbeat economic reports allow investors to reappraise January's global markets selloff, they have failed to dispel anxiety that 2010 may be a year of policy errors.

Soaring fourth-quarter U.S. and Chinese GDP, expanding global manufacturing activity, and even hopes of an improvement in U.S. employment data have helped buoy equities this week, shrunk volatility and generally lifted safe-haven bond yields.

It may be a sign that last month's risk retrenchment, which saw 4.4 percent stripped off the MSCI all-country world stock index was just a minor blip to remove froth in a bullish market.

But the data is tangential to what many investors consider their biggest risk, that of governments and central banks making a mistake while trying to bring their economic pump-priming policies back to normal.

The fear is that authorities will either move too quickly, stomping on fragile growth, or too slowly, firing up asset bubbles and inflation. And so while economic data pointing to a fresh slowdown clearly rankles, so too will signs of a sharp acceleration of activity.

The problem with policy errors is that they are likely to be history before their ultimate impact is clear -- and some economists believe mistakes are already being made.

Richard Batty, investment director at Standard Life Investments, asks why the U.S. Federal Reserve is ending its purchases of mortgage-backed securities at a time when the crucial U.S. housing market is only just recovering.

The move has the potential to drive up the cost to buyers of getting into the already hard-hit market. "We don't think higher mortgage rates are warranted," he said.

In Europe, meanwhile, the European Central Bank's scaling back of its program of offering banks cheap money via repurchases is seen in some quarters as having exacerbated the current stress in the euro zone's so-called peripheral economies, particularly Greece.

Since the ECB reduced its role in providing cheap money, Greek, Portuguese and other indebted peripherals' yields have blown out. Greek/German 10-year government bond yield spreads have hit a euro-era record 405 basis points, for example.

Stefan Angle, head of investment management at Swiss & Global Asset Management, said the one-size-fits-all monetary policy needed in the 16-nation currency bloc makes it inevitable that the ECB will make an error.

"It is a 100 percent certainty," he said. "The ECB cannot make the right policy for Greece, Spain, the Netherlands and Germany at the same time."

**ROCK AND HARD PLACE**

The policy error dilemma has shown itself perfectly in two quite different nations -- slow-growing Britain and red-hot China.

Britain's recovery from recession so far has been the weakest and most fragile of any major economy, with growth of just 0.1 percent in the fourth quarter. Near-term monetary or fiscal tightening risks cutting off the fuel that has engendered what growth there is.

The Bank of England has nonetheless paused in its program of buying gilts, potentially forcing borrowing costs higher.

Britain also faces a divisive general election fought in part over when to start cutting back on spending. The ruling Labor party favors holding off for now but the Conservatives, favorites to win, are arguing that some cuts need to be made as soon as possible.

A hung parliament, one in which there is no majority, is also

possible, raising the prospect of political stalemate.

Sarah Hewin, senior economist at Standard Chartered, said that while growth is fragile, it would also be dangerous to do nothing about Britain's deficit of 12.6 percent of GDP. "The risk of delaying is that markets take fright," she said.

Others have even warned of a sterling crisis.

**DEGREES OF HEAT**

China, a command economy with double-digit annual growth rates, has no such worries about whether or when to start pulling back the huge stimulus it launched to fight off the global economic downturn.

Rather, the dilemma is over how quickly to do it to avoid overheating, creating asset bubbles and firing up inflation.

"They have increased loans and lending by banks. Potentially, the error is that they have done too much," said Klaus Wiener, head of research at Generali Investments.

Some economists reckon China needs to unwind its stimulus programs fairly quickly -- but markets have been unnerved by the speed and extent of moves China has already made to limit credit growth.

It announced on Jan. 12 that it was raising domestic banks' reserve requirement ratios by 0.5 percent point, and its largest bank ICBC stopped rolling over some loans last week, triggering a bout of risk aversion among investors.

So policymakers around the world are struggling to balance the needs of growth against the need to avoid future problems, while keeping an eye on volatile investors who don't want the partial recovery of 2009 to come to nought.

"The potential for policy error is as large as it has ever been in history," Swiss & Global's Angele said.

**ANALYSIS-G7 under pressure to keep regulation on track**

By Huw Jones

The G7 faces pressure this weekend to show that the world's regulatory blueprint remains intact after U.S. President Barack Obama's surprise bank restructuring plan jeopardized a hard-won international consensus.

The G20 group of leading nations, rapidly replacing the G7 as the main forum for global governance, agreed at a meeting Obama hosted in September to focus on strengthening bank capital rules.

The U.S. leader stunned global markets and policymakers last month when he unilaterally proposed curbing the size and trading activities of banks to lessen the need for more massive taxpayer handouts in future crises.

The plan, which has cross-border implications, has raised concerns that a global deal on regulation is being hijacked by populist national interests.

"The G20 faces a real challenge in getting a global deal that includes America. The Obama plan was a bit of a bolt from the blue," said Stuart Fraser, policy chairman at the City of London which promotes the capital's financial services industry.

"It is regrettable that domestic political considerations appear to have been given precedence over the developing global consensus," Fraser said, referring to Obama's reaction to his Democratic Party's shock defeat in a Senate election in Massachusetts.

Four of the G7 countries that will meet on Friday and Saturday in the Arctic Canadian town of Iqaluit -- France, Germany, Britain and host Canada -- have signaled they do not believe such radical restructuring of banks is necessary.

European Union finance ministers are also under pressure to respond. They were due to discuss the issue in April but the Netherlands, which backs the plan, wants a debate when minis-



## DEEP DIVE Commentary and Analysis

ters next meet on Feb. 16.

## BANKS MAY EXPLOIT LOOPHOLES

The fear in Europe is that the U.S. plan -- even though there is no guarantee a fractious Congress will adopt it -- will encourage other countries to promote their own national interests, creating potential loopholes for banks to exploit.

"If we don't come up over the next 12 to 18 months with convergent types of approaches, then emmental cheese will be the likely outcome," said David Wright, deputy head of internal markets at the EU's executive European Commission.

Britain alarmed some countries by unilaterally introducing a new liquidity regime for domestic and foreign banks before a global deal had been reached.

It is also piloting "living wills" at a handful of banks as an alternative way of protecting the public purse in future financial crises.

British Financial Services Minister Paul Myners said this week that increasing capital charges on banks and imposing living wills was the best way to proceed.

The opposition Conservatives, tipped by polls to win the next election due by June, also backs unilateral regulatory action where needed.

"It is important where possible to reach international agreement on regulatory reform, but it might be the case that we have to act in advance of international agreements where it is right to do so, particularly given the size of the financial services sector in the UK," said Mark Hoban, the party's financial services spokesman.

## OTHER CRACKS

Obama's plan is not the only chink emerging in the G20 blueprint. Britain and France also slapped a windfall tax on bonuses, a step other G20 countries have yet to copy.

The Basel Committee of central bankers and supervisors is set to finalise a sweeping reform of its global Basel II accord on bank capital at the behest of the G20.

But France and Germany are quietly lobbying the European Union not to turn into law Basel's planned percentage cap on bank leverage, a bank official familiar with the lobbying said.

In accounting, the G20 set a mid-2011 deadline for agreeing one global set of rules to increase transparency for investors, but the EU and the United States are dragging their feet because of domestic interests.

"The politicisation of accounting standard setters is derailing the move to convergence," said Peter Chidgey, head of financial services at global accounting firm BDO.

There are differences over cutting risk in derivatives, with the United States wanting contracts traded on exchanges as much as possible while Britain is against mandatory change.

Some divergence may not matter as long as the outcomes are similar and no country or region ends up with an unfair advantage in attracting business, some commentators say, while some banks see differences as helping to slow down rulemaking.

"We have to get international cooperation onto an even keel and delivering results. Only by working together will we avoid regulatory arbitrage that could well sow the seeds for another potential crisis further down the line," Fraser said.

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(Compiled by Lokesh Jain and Pronita Naidu in Bangalore)

For questions or comments about this report, email us at:

[inside.debt@thomsonreuters.com](mailto:inside.debt@thomsonreuters.com)

or contact Chandra Ramarathnam on +91 80 4135 5899

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