

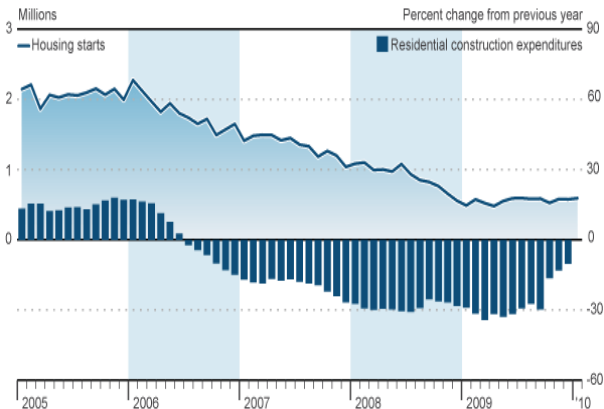
INSIDE DEBT

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Wednesday, February 17, 2010

CHART OF THE DAY

U.S. housing starts



Housing starts rebound in January, as the housing sector crawls out of its three-year slump.

TODAY'S TOP NEWS

- Fed officials pondering debt sales, minutes show
- U.S. housing starts hit 6-month high, output rises
- Plosser: Fed should sell MBS sooner instead of later
- U.S. govt posts \$42.63 bln budget deficit in Jan
- Euro zone periphery gets a breather in Greek lull
- BoE MPC vote 9-0 for no more QE, rates at 0.5 pct
- Euro zone Dec trade in surplus, recovery still weak
- China seen allowing stronger yuan in 2010

ECON WATCH

FOR THURSDAY FEBRUARY 18

ET	Indicators	Unit	Reuters	Prior
04:30 GB	PSNCR mm	bln	-20.00	24.853
04:30 GB	PSNB, mm GBP	bln	-2.80	-5.366
06:00 GB	CBI trends - orders	ind	-36	-39
07:00 CA	CPI all items mm	%	0.3	-0.3
07:00 CA	CPI all items yy	%	1.8	1.3
07:00 CA	CPI BoC Core mm	%	0.0	-0.3
07:00 CA	CPI BoC Core yy	%	1.9	1.5
08:30 US	Initial Claims	k	430	440
08:30 US	Continuing claims	mln	4.50	4.538
08:30 US	Producer prices mm	%	0.8	0.4
08:30 US	Producer prices yy	%	4.4	4.4
08:30 US	Ex-Food / Energy mm	%	0.1	0.0
08:30 US	Ex-Food / Energy yy	%	0.8	0.9
10:00 US	Lead indicators	%	0.5	1.1
10:00 US	Philly Fed index	ind	17.0	15.2
-	JP BOJ rate decision	%	0.10	0.10

MARKETS TODAY

TODAY'S TOP STORY: Several Federal Reserve policymakers want to begin selling securities relatively soon as a way to cut back their massive supply of cash to the financial system, the central bank said.

For more please [click here](#)

TREASURIES: U.S. Treasury prices fell further after Federal Reserve minutes suggested the U.S. central bank will soon begin withdrawing its monetary stimulus.

- 30-yr bond prices fell more than a point to yield 4.71 pct, up from 4.64 pct on Tuesday.
- 10-yr Treasury prices shed 20/32 yielding 3.74 pct.
- 5-yr Treasury prices were down 12/32 to yield 2.39 pct.
- 2-yr notes fell 3/32 to yield 0.86 pct.
- 2-10's part of the yield curve widened by about 3 bps to 288 bps.

FOREX: The dollar extended gains against the euro and yen after minutes from the Federal Reserve's January meeting showed members saw a need to begin a program of assets sales in the near future and the economic recovery to continue.

- Dollar jumped 1.16 pct to 91.19 yen, compared with 90.95 yen earlier.
- The euro fell 1.13 pct at \$1.3608, from a high of \$1.3779 on Tuesday, while it rose against the yen by 0.2 pct to 124.09 yen.
- Sterling was down 0.68 pct to \$1.5678.
- Dollar index was up 0.92 pct to 80.437.

CORPORATES: U.S. corporate bond spreads narrowed as data added to evidence of the economic recovery and as sovereign debt jitters eased. Yet corporate bonds could soon come under pressure again, as they have been for much of the past month, if concerns about European government debt grow or if the U.S. economic rebound runs out of momentum, analysts said.

- The CDX.IG-13 index tightened by about 2 bps to 96 bps.
- Yield spreads of corporate bonds over Treasuries were between 5 and 10 bps tighter, but on light volume.

STOCKS: U.S. stocks edged higher as stronger-than-expected earnings from companies including Deere & Co and upbeat economic data more than offset a decline in commodity-related shares.

- Dow rose 0.40 pct to 10,310.23, S&P gained 0.43 pct to 1,099.58 and Nasdaq rose 0.55 pct to 2,226.29.
- Deere stock rose 5.06 pct to \$56.5.
- Shares of Whole Foods Market Inc shot up 12.55 pct to \$34.35 and boosted the S&P consumer staples sector by 0.76 pct.
- United Technologies Corp shares gained 2.2 pct to \$67.35.
- S&P financial index rose 0.38 pct, S&P energy index fell 0.35 pct.

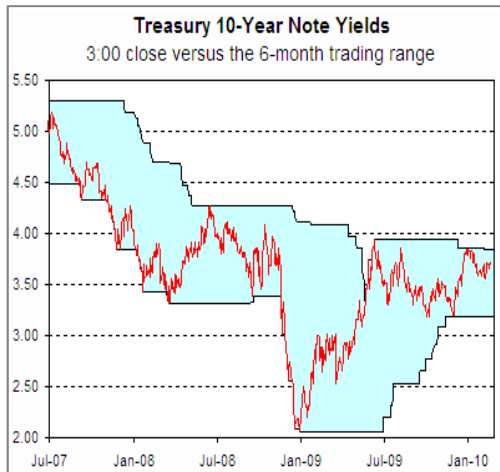
C & E: Oil rose slightly, holding above \$77 a barrel in choppy, light-volume trading as the market weighed positive U.S. housing and industrial output data against pressure from a stronger U.S. dollar.

- U.S. crude prices was up 0.65 pct to \$77.51.
- Gold was down 0.38 pct to \$1,114.75 an ounce.
- Reuters-Jefferies index shed 0.34 pct at 273.84.

- 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	0.050	0.015	0.051	0.005
3-Mo Bill	0.100	0.085	0.101	0.009
6-Mo Bill	0.180	0.170	0.183	0.001
1-Year	0.340	0.330	0.346	0.013
2-Year	100.023	100.055	0.864	-0.102
3-Year	99.836	99.867	1.432	-0.207
5-Year	99.344	99.383	2.392	-0.387
7-Year	99.766	99.813	3.163	-0.547
10-Year	99.016	99.078	3.744	-0.656
30-Year	98.594	98.672	4.713	-1.242

EQUITIES

	INDEX	CHANGE
DJIA	10305.24	36.35
NASDAQ	2222.11	7.92
S&P 500	1098.96	4.09

OIL

	PRICE	CHANGE
NYMEX	77.4	0.4
BRENT	76.2	0.7

EURODOLLAR FUTURES

	CLOSE	CHANGE
Mar-10	99.725	0.005
Jun-10	99.605	0.000
Sep-10	99.385	-0.010
Dec-10	99.055	-0.025

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.190	O/N	0.200
2-Week	0.200	2-Week	0.210
1-Month	0.220	1-Month	0.210
3-Month	0.220	3-Month	0.240

AGENCY REPOS		i-REPO SM INDEX	
O/N	0.190	10:00 AM	0.130
2-Week	0.190	3:00 PM	0.128
1-Month	0.200		
3-Month	0.220		

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	26.25	30.25	1.12	1.14
3-Year	31.50	35.50	1.74	1.76
5-Year	30.50	34.50	2.69	2.69
7-Year	14.00	18.00	3.30	3.29
10-Year	7.75	11.75	3.82	3.81
30-Year	-15.00	-11.00	4.56	4.54

FUTURES

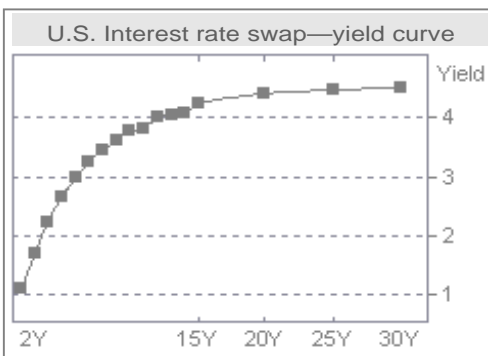
	PRICE	CHANGE
CBOT 5 yr	116.36	-0.43
CBOT 10 yr	118.03	-0.28
CBOT 30 yr	117.41	-0.41

CURRENCIES

	BID	ASK
Euro	1.3613	1.3616
Sterling	1.5683	1.5688
JP Yen	91.12	91.16
Swiss Franc	1.0776	1.0778
Can Dollar	1.0449	1.0454
Mexico	12.8712	12.8806

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.140	0.150	-	-
1-Month	0.180	0.280	0.127	0.137
3-Month	0.220	0.400	0.144	0.154
6-Month	0.250	0.450	0.180	0.190
12-Month	0.600	1.000	0.332	0.342



FED FUNDS NYFRSM - 10AM

Open	0.1400	1m	0.2188
High	0.1500	3m	0.2531
Low	0.0800		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.875	12/01/2012	10 0	0.94
3-Year	1.375	09/01/2013	15 0	1.58
5-Year	2.875	09/02/2015	31 30.5	2.71
7-Year	5.125	18/10/2016	24.75 24.25	3.41
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	34.5 34	5.06

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	15/12/2011	6 0	0.89
3-Year	1.75	22/02/2013	21 20.5	1.65
5-Year	2.625	20/11/2014	17.5 0	2.57
7-Year	5.25	15/09/2016	24 23.5	3.4
10-Year	3.75	27/03/2019	24.5 0	3.99
30-Year	6.25	15/07/2032	39.75 39.25	5.11

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.0910	105.1110	2.664
FHLMC	5.0	105.1010	105.1210	2.652

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.1110	105.1310	3.022
FHLMC	5.5	105.1910	105.2110	2.870
GNMA	5.5	105.2130	105.2330	3.541

Wrightson ICAPSM Chart of the Day
Capacity Utilization Rate



TODAY'S TOP NEWS

Fed officials pondering debt sales, minutes show

Several Federal Reserve policymakers want to begin selling securities relatively soon as a way to cut back their massive supply of cash to the financial system, the central bank said.

Minutes to the Fed's January meeting suggested officials still have a relatively positive outlook for the economy even as they worry about the impact of persistently high unemployment.

The minutes indicate that while there is increasing confidence within the central bank about the efficacy of its tools to withdraw monetary stimulus, there is also nagging disagreement on the timing and sequencing of exit steps.

Other officials, however, appeared worried that dumping mortgage debt into a fragile market might drive up home loan rates, compromising what tentative stabilization has been achieved in housing.

Kansas City Federal Reserve Bank President Thomas Hoenig dissented at meeting because he was uncomfortable with the low-rate pledge. The minutes showed that he did not want to drop the vow altogether, but simply tone it down.

Plosser: Fed should sell MBS sooner instead of later

The U.S. Federal Reserve should sell its mortgage-backed securities holdings sooner rather than later as the economic recovery gathers steam in order to extricate itself from fiscal policy, a senior central bank official said.

The Fed put in place a raft of emergency programs at the height of the financial crisis, including one to buy \$1.25 trillion worth of securities backed by mortgages held by Fannie Mae and Freddie Mac. Its balance sheet more than doubled to over \$2 trillion in the process.

The Fed pledge to keep benchmark U.S. interest rates low for an extended period "is a concern" as it confines the U.S. central bank in its policy flexibility, Philadelphia Fed's President Charles Plosser said.

Separately, the federal regulator of Fannie Mae and Freddie Mac proposed an overhaul of rules governing how the mortgage funding giants serve low-income homeowners while limiting their risks. The FHFA for 2010 and 2011 said it is planning goals for single-family home purchases for low income families, very low-income families and families in low-income, high minority and disaster areas.

Euro zone periphery gets a breather in Greek lull

Debt markets gave stressed governments on the euro zone's southern rim a break in a lull in the crisis over debt-stricken Greece.

Spain drew a stampede of demand for a government bond issue and Portugal's borrowing cost fell in signs that market fears of sovereign risk in the euro zone may be easing, at least for now.

Analysts said a successful Spanish sale could open the door for Greece to launch a planned 10-year bond after European Union leaders pledged support last week for Athens' plans to shrink its huge budget deficit but stopped short of financial aid.

Spain booked 12 billion euros of orders for a 5-billion-euro syndicated 15-year bond, according to IFR, a Thomson Reuters service. The pricing was at the low end of the initial guidance.

Debt-ridden Portugal, seen by markets as the next domino to fall if Greece were to have payments problems, sold 1 billion euros of 12-month treasury bills at a lower average yield of 1.173 percent in a well bid auction.

In another boost, Greek budget revenues in January exceeded the country's target, helped by a one-off tax on big corporations, preliminary finance ministry data showed.

U.S. housing starts hit 6-month high, output rises

U.S. housing starts rose to a six-month high in January and industrial output increased solidly, pointing to an economic recovery that was taking a firm hold and respectable first-quarter growth. Groundbreaking activity for new homes increased 2.8 percent to an annual rate of 591,000 units, reversing the prior month's weather-induced drop, a report from the Commerce Department showed. That was above market expectations for a 580,000-unit pace.

In a separate report, the Fed said industrial production rose 0.9 percent, with manufacturing, mining and utilities all posting gains. Economists had expected a 0.7 percent increase.

Over the past 12 months, housing starts have surged 21.1 percent, the largest increase since April 2004.

Capacity utilization rose to 72.6 percent from 71.9 percent a month earlier, but was still 8 percentage points below the average from 1972 to 2009, suggesting little inflationary pressure.

Permits for new building projects fell 4.9 percent to 621,000 units last month after rising to a 14-month high of 653,000 in December, the Commerce Department said.

U.S. govt posts \$42.63 bln budget deficit in Jan

The United States posted a smaller-than-expected \$42.63 billion budget deficit in January, Treasury Department data showed, due in part to a drop in spending caused by a shift in the calendar. The January deficit fell short of analysts' consensus forecast in a Reuters poll for a \$47 billion budget gap and compares with a \$91.41 billion deficit posted in December and a \$63.46 billion gap for the same period a year ago.

In January, outlays fell to \$247.88 billion from \$310.33 billion in December and compared with \$289.55 billion in January 2009, the department said. Receipts totaled \$205.24 billion from \$218.92 billion in December and were the lowest for a January since 2005, the department said. Receipts in January 2009 stood at \$226.09 billion.

The deficit over the four months of the fiscal year to date now stands at a record \$430.69 billion compared with a deficit of \$395.94 billion for the same four-month period a year ago.

Earlier this month, the White House forecast a \$1.56 trillion budget deficit in 2010, or 10.6 percent of GDP.

But for 2011 the White House expects the budget deficit to shrink to \$1.27 trillion, or 8.3 percent of GDP.

BoE MPC vote 9-0 for no more QE, rates at 0.5 pct

All nine members of the BoE's MPC voted this month not to expand the central bank's quantitative easing policy -- dashing expectations that at least one might have called for more asset purchases.

Minutes of the MPC's Feb. 3-4 meeting also showed a unanimous vote in favor of leaving interest rates at a record low 0.5 percent, though the decision on whether to increase the 200 billion pounds (\$313.7 billion) program to pump money into the economy was "very finely balanced" for some MPC members.

Economists had expected that at least one MPC member -- probably David Miles -- would have voted for more QE given that the BoE's economic forecasts published last week show inflation undershooting its 2 percent target over the medium term. The main arguments put forward for increasing QE were getting inflation back to target quicker and attenuating the long-term damage to the supply capacity.

Official data released at the same time as the minutes showed unemployment benefit claims rose by 23,500 in January, compared to economists' expectations of a 10,000 fall.



TODAY'S TOP NEWS

Euro zone Dec trade in surplus, recovery still weak

The euro zone posted a trade surplus in December, reversing a deficit a year earlier but only because exports contracted less than imports and weak monthly growth in imports indicates a still fragile economic recovery, data showed.

Eurostat said the unadjusted external trade surplus of the 16 countries that use the euro was 4.4 billion euros in December, up from a 1.8 billion deficit a year earlier and up from a revised 4 billion surplus in November. Adjusted for seasonal swings, the euro zone trade surplus was even higher at 7 billion euros in December, against 5.3 billion in November, with exports climbed 3.1 percent month-on-month and imports rising only 1.7 percent. Unadjusted exports fell 1 percent year-on-year to 111.8 billion euros, while imports slid 6 percent to 107.4 billion.

Separately, Spain shrank by 0.1 percent in the fourth quarter from a quarter earlier, in line with a flash estimate made last week and better than the 0.3 percent decline in the quarter before, the National Statistics Institute said.

China seen allowing stronger yuan in 2010

Beijing is likely to let its currency begin rising in value again this year in response to growing pressures at home and abroad, two U.S. private sector specialists on China said.

"I think China has been waiting for its exports to resume growth, which they started to do in December. That, I think, gives them the domestic cover they need to resume gradual appreciation," John Frisbie, president of the U.S.-China Business Council, said during a panel discussion. Many Western economists maintain that China's currency is undervalued by 25 to 40 percent, giving Chinese companies an unfair advantage in international trade. Obama's recent comments have raised speculation his administration might label China a "currency manipulator" in an semi-annual Treasury Department report due on April 15.

Wednesday's panel discussion focused mostly on a Chinese proposal to promote its high-technology sector by excluding foreign companies from its vast government procurement market unless they establish Chinese brands and transfer research and development of new products to China.

S&P survey sees U.S. mortgage defaults up, UK down

Expectations for defaults and losses in residential mortgage-backed securities continue to rise sharply in the United States, while tailing off in Britain, even as its economy has been slower to recover, a survey found.

The forecast for the 12-month default rate on U.S. prime fixed-rate mortgages in RMBS rose to 5.75 percent from 4 percent forecast in the previous quarter, according to a S&P's global survey of more than 60 buy-side and sell-side financial institutions released.

In the United States, mortgage default risk has risen in the face of emergency government and lender efforts, including a \$75 billion plan to refinance or modify loans to troubled borrowers.

The survey forecast default rates on underlying U.S. sub-prime mortgages would rise to 34.4 percent from a previous forecast of 23 percent. The forecast also rose for U.S. prime adjustable-rate RMBS to 10.5 percent from 6.25 percent.

Japan manuf mood least bleak in 1-½yrs -poll

Japanese manufacturers are becoming steadily less pessimistic about economic conditions showing them at their least gloomy since July 2008 as the economy recovers on the back of exports, particularly to emerging economies.

The monthly survey likely points to an improvement in the BoJ's influential quarterly tankan business sentiment survey, which next comes out on April 1.

Service-sector companies remained more pessimistic than manufacturers, reflecting tame domestic demand in an economy mired in deflation. But their sentiment also hit its highest level since June last year.

The Reuters Tankan survey of 400 large firms appeared to support that cautiously optimistic view. Asked what they would prioritize if profits recover, 31 percent of companies said they would seek to boost internal reserves and only 11 percent said they would prioritize capital spending. And while twenty-nine percent said they would seek to lift wages, 76 percent said that government moves to tighten regulations on hiring temporary workers would not lead to an increase in full-time workers.

NEXT UP

BOJ seen holding off on new steps on recovery hopes

The Bank of Japan is likely to keep interest rates at 0.1 percent and hold off on any new initiatives as its board members expect the economy to avoid slipping back into recession despite a likely slowdown early this year.

The central bank remains ready to ease policy again in the future, with possible triggers being a sudden spike in the yen, a heavy tumble in Tokyo stocks or renewed pressure from the government to do more to ease deflation.

But the BOJ is expected to hold fire now and stick to the view that Japan's export-driven recovery will continue on the back of robust growth in Asia and other developing countries.

Growth is likely to slow early this year due to cuts in public works and the waning impact of government stimulus.

BOJ officials think the Japanese economy will stay on a recovery path as the bank projected last month and will not need additional support from further monetary easing. Most BOJ officials say its current annual purchases of 21.6 trillion yen of government bonds strikes an appropriate balance between the need to provide long-term funds to markets and the need to dispel concerns the BOJ is aiming to monetize government debt.

January receipts key for UK budget deficit outlook

PSNB surplus forecast at 2.8 bln stg vs 15.7 bln in Jan '09. Surplus on cash measure, PSNCR, 20 bln stg, vs 23.6 bln Jan '09. Government borrowing has risen faster in Britain than almost any other big economy in the past two years, but recent releases have raised a glimmer of hope that the pace of deterioration is now slowing.

January is traditionally a surplus month for the public finances due to the timing of income tax receipts and other factors may provide a boost, even if the pain of an 18-month recession is still taking a heavy toll on the public coffers.

Britain's VAT rate returned to 17.5 percent on Jan 1 after a 13-month reduction. The government's new bank payroll tax is not payable until August 31 it is possible banks may have raised salaries to compensate for less attractive bonuses, boosting income tax. The government has penciled in borrowing of 178 billion pounds for the 2009/2010 financial year, an unprecedented 12.6 percent of GDP.

Better-than-expected figures for November and December have raised expectations the government may undershoot this target, but January's figures will be key.



DEEP DIVE Commentary and Analysis

Dollar/yen vol curve to flatten, offers spread play

By Marco Garavello

The dollar/yen volatility curve is the steepest among the majors, and some flattening may be on the cards as fears over U.S. fiscal health erodes the dollar's safe haven status in the coming months.

Investors looking for a flattening in the curve -- driven by a pick up in volatility in the front end or selling in the back end or both -- may play this view via calendar spreads or volswap spreads.

The spread between the one-year and three-month at the money contracts in dollar/yen has widened since the beginning of 2010 to just above 1.5 vols, levels last seen in mid-November 2009 and close to multi-year highs.

The short end has sold off aggressively, as realized vols have significantly declined with dollar/yen spot confined to a relatively tight range.

As both the low-yielding dollar and yen have become favorite funding currencies for carry trades, their performance has tended to be highly correlated in periods of both risk aversion and risk appetite. Both have been seen as safe havens.

The downside in the cross has been limited by the spectre of Bank of Japan intervention, while the topside has been capped by Japanese exporters' hedging activity.

The back end, by contrast, has held up relatively well.

Demand from corporates and funds for longer-term protection has remained strong due to uncertainty over the global economic recovery, while supply of volatility, which typically comes from buyers of structured products, has been very limited.

However, this steepening trend may end in coming weeks.

Some analysts expect the dollar to come under scrutiny as the market focuses on the widening U.S. fiscal deficit and the greenback may in the short term lose the safe haven status it shares with the yen.

As a result dollar/yen spot could become more volatile and this would be supportive for the short end of the curve.

Some option traders may eventually decide the back end is overpriced compared with actual volatilities and the historical average of the same implieds.

In the one-year tenor, at the moneys are marked at 13.85 percent, versus realized volatility of only 11.7 percent and a two-year average of implieds at 13.6 percent.

As the longer term prospects for dollar/yen remains a slow grind higher, relative value players, who try to exploit the difference between short dated and long dated vols, may eventually be induced to sell the back end.

CALENDAR SPREAD

One way to profit from a potential flattening in the dollar/yen vol curve is to buy calendar spreads via vanilla options.

In this case, the investor could buy three-month at the money or downside strikes, and sell one-year at the money or topside strikes.

By entering this strategy, the holder would go long volatility in the short end and short volatility in the back end, thus profiting from a potential flattening in the curve.

Since the exposure to volatility for a shorter dated option is lower than for a longer dated one, in order to achieve an initial neutral exposure to the vol market the notional on the three-month contract will have to be a multiple of that on the one-year contract.

Another way to play the flattening trade is to enter a volswap spread.

A volswap is a zero-cost product, whose payout at maturity is determined by the difference between realized volatility over a certain horizon and a specified vol level set upfront, typically just

above the level of implieds for that tenor.

This product allows the holder to express a more direct view on volatility compared to a standard vanilla option, because there is no strike.

In this case, the investor could go long a three-month volswap and simultaneously go short a one-year volswap, both on the same dollar notional.

-- Marco Garavello is an FX market analyst for Reuters. The opinions expressed are his own --

German domestic worries cloud Greek bailout hopes

By Dave Graham

Should Germany ride to Greece's rescue if it can't even provide for its own?

Behind a facade of principled opposition to bailing out debt-stricken Greeks, the question increasingly haunts the corridors of power in Berlin.

Chancellor Angela Merkel's government has so far resolutely deflected appeals to promise aid despite fears that failure to help Athens could threaten the euro -- the stability of which has long been held sacrosanct by Germany's political elite.

Merkel's stance has been vindicated by opinion polls showing that a vast majority of the public oppose a bailout. The Greek crisis could become an issue when her centre-right coalition faces a key regional election in Germany's biggest state in May. Of almost 31,000 votes cast in an online survey by mass-selling German daily Bild, 82 percent of respondents said the European Union should not rescue Greece.

"The proud, cheating, profligate Greeks" ought to be "thrown out of the euro on their ear" because of their finances, the influential newspaper said in a recent editorial.

In public, Germany argues that leniency would take pressure off Athens and other euro zone debtors to cut their deficits. Behind the scenes, lawmakers acknowledge that Berlin has prepared measures if a rescue becomes inevitable.

For now though, it has become almost impossible for Merkel to hold out any prospect of aid for Greece because of a storm over the future of Germany's welfare system, said Dietmar Herz, a political scientist at the University of Erfurt.

The highest German court last week ruled that minimum jobless payments -- known as Hartz IV -- were unconstitutional, fuelling expectations that they will be raised, a step that surveys suggest a large majority of the public would support.

Guido Westerwelle, head of Merkel's coalition partners, the pro-business Free Democrats (FDP), sparked uproar last week when he compared the existing benefits to "late Roman decadence".

"Things like the welfare state decide elections in Germany," said Herz. "It's very hard to sell the idea of aid to Greece just now. Germany will allow time for the Greek cuts to work, and if they pay off, the government will soften its stance."

GREEK JOKE

Scepticism about Greece has spread to Germany's neighbors, notably in other countries deemed by the European Commission to have run tighter finances such as the Netherlands and Austria.

A poll for Dutch daily De Telegraaf on Wednesday showed some 92 percent of Dutch wanted Greece out of the euro, while over 90 percent favored the Netherlands and Germany exiting the euro area and getting their own currency back.

Austrian business daily WirtschaftsBlatt this week told readers a new wisecrack was making the rounds in Brussels: "What's the shortest joke in the eurozone? Greek statistics."



DEEP DIVE Commentary and Analysis

The German government has repeatedly stressed it means to be an anchor of stability in the euro area, but criticism of the lax budgetary policy of other member states is creeping more and more into the domestic political discourse.

"If we start (to help Greece) now, where does it stop?" Michael Fuchs, a senior lawmaker in Merkel's Christian Democrats told Welt am Sonntag. "I can't tell a Hartz IV claimant he's not getting another cent but that Greeks can retire at 63."

Germans retire at 65, but the age is being raised to 67.

The tone of media attacks on Greece has taken on a harder edge in recent weeks, encouraging those who want Germany to pursue its own national interests to speak out.

A reader's editorial in the Rheinischer Post daily entitled "Hartz IV and Greece" urged Germany to pull out of the EU to escape the clutches of "lying and cheating" partners.

HISTORICAL FEAR

Policymakers who played a key role in the introduction of the euro such as former Finance Minister Theo Waigel and the European Central Bank's first chief economist, Otmar Issing,

have scolded Greece and urged the government to hold firm.

Wolfgang Gerke, president of the Bavarian Financial Centre, said Greece should get ready to return to its old drachma currency, at least temporarily.

Herz of Erfurt University said the views reflected fears rooted in Germany's troubled past that "the euro had to be vaccinated against the Greek disease".

After two world wars, partition and re-unification in the 20th century, Germans crave nothing more than stability.

"It goes back a long way: from the hyperinflation of the early 1920s to the postwar currency reform, right up to when Germany gave up the deutschemark," said Herz. "Now they are worried Greece could spark a new financial crisis."

Merkel's ruling coalition faces a key test of its popularity in May when a state election is held in North Rhine-Westphalia, home to more than one in five of the population.

"If a big Greek aid package is suddenly announced a lot of voters will ask 'What's all this?'" said Herz. "The government is simply trying to keep this under wraps for now."

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