

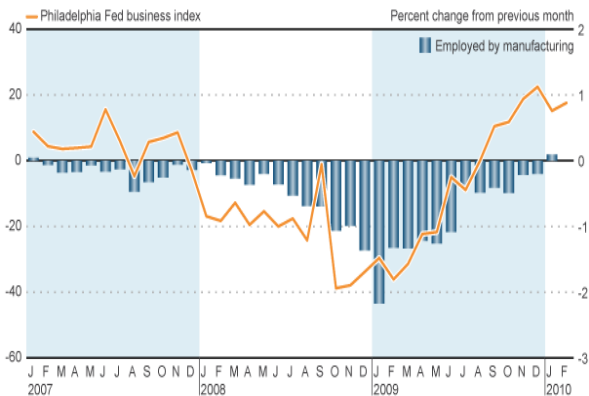
# INSIDE DEBT

PRODUCED BY REUTERS IN PARTNERSHIP WITH ICAP

Thursday, February 18, 2010

## CHART OF THE DAY

### U.S. Mid-Atlantic manufacturing



Mid-Atlantic manufacturing rose more than expected as new orders jumped to their highest in more than five years to 22.7 from 3.2 in January.

## TODAY'S TOP NEWS

- U.S. jobless, price data fan concerns on economy
- Obama names deficit panel, gives it wide leeway
- Obama team raises pressure on health insurers
- EU should be clearer on Greek support-minister
- UK govt. borrowing up in usual surplus month
- Regulator see private MBS market returning as Fed exits
- Implied euro rates at lows, ECB exit seen hard
- Euro zone consumer sentiment down in February

## ECON WATCH

FOR FRIDAY FEBRUARY 19

ET	Indicators	Unit	Reuters	Prior
02:00	DE Producer prices mm	%	0.3	-0.1
02:58	FR Mfg Flash PMI	ind	55.2	55.4
02:58	FR Ser Flash PMI	ind	56.0	56.3
03:28	DE Mfg Flash PMI	ind	53.9	53.7
03:28	DE Service Flash PMI	ind	52.4	52.2
03:58	EZ Mfg Flash PMI	ind	52.6	52.4
03:58	EZ Service Flash PMI	ind	52.5	52.5
03:58	EZ Composite Flash PMI	ind	53.5	53.7
04:30	GB Retail sales mm	%	-0.5	0.3
04:30	GB Retail sales yy	%	1.1	2.1
08:30	US CPI mm	%	0.3	0.2
08:30	US CPI yy	%	2.8	2.7
08:30	US Ex-food/Energy mm	%	0.1	0.1
08:30	US Ex-food/Energy yy	%	1.7	1.8
08:30	US Real earnings	%	0.2	0.0
08:30	CA Retail sales	%	0.5	-0.3
08:30	CA Retail ex-autos	%	0.4	0.0

## MARKETS TODAY

**TODAY'S TOP STORY:** The number of U.S. workers filing new applications for unemployment insurance unexpectedly surged last week, while producer prices increased sharply in January, raising potential hurdles for the economy's recovery. **For more please click here**

**TREASURIES:** U.S. Treasuries fell after the government announced a record amount of bonds for its auctions next week and data suggested the economy's tepid recovery from the worst recession in decades remained on track.

- The government said it would auction a record \$126 billion in coupon debt next week, including the first sale of 30-year TIPS.
- 30-yr bond prices fell half a point to yield 4.74 pct, up from 4.69 pct on Wednesday.
- 10-yr Treasury prices fell 16/32 to yield 3.79 pct.
- 5-yr Treasury prices were down 8/32 yielding 2.44 pct, up from 2.39 pct.
- 2-10's part of the yield curve widened by about 4 bps to 293 bps.

**FOREX:** The dollar was little changed against the euro in a volatile session, as mixed data highlighted the fragility of the U.S. economy.

- The euro rose 0.05 pct to \$1.3609. Earlier, it rose as \$1.3653. The session low was \$1.3540.
- Dollar was up 0.02 pct to 91.25 yen while the euro rose 0.08 pct to 124.2 yen.
- The Australian dollar was up 0.31 pct at \$0.9091 and the New Zealand dollar up 0.41 pct at \$0.7059.

**CORPORATES:** U.S. corporate bond spreads were little changed as investors awaited more news on the Greek debt crisis and for clues on how the country's next bond issue would fare.

- The CDX.IG-13 index tightened by about 4 bps to 92 bps.
- In the U.S., there has been a dearth of issuance so far this week, while traders say volumes have been light.
- The Federal Home Loan Bank System launched its new \$3 bln three-year global note sale.

**STOCKS:** U.S. stocks rose as investors viewed earnings and favorable brokerage comments on companies and some economic data as signs that an economic rebound will continue.

- Dow rose 0.81 pct to 10,392.90, S&P gained 0.66 pct to 1,106.75 and Nasdaq rose 0.69 pct to 2,241.71.
- Wal-Mart stock slid 1.09 pct to \$53.47.
- Boeing Co rose 1.73 pct and IBM Corp was up 1.17 pct to \$127.81.
- Hewlett-Packard jumped 1.38 pct to \$50.81.
- S&P material index rose 1.16 pct, S&P technology shares rose 0.83 pct.

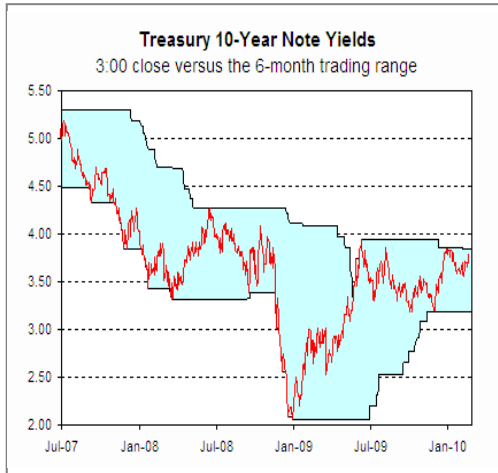
**C & E:** Oil rose more than 2 pct to hit a one-month high over \$79 a barrel, bolstered by a government report showing a drop in U.S. distillate supplies and concerns OPEC member Iran may be working to develop a nuclear-armed missile.

- U.S. crude prices jumped 2.28 pct to \$79.09.
- Gold rose 1.46 pct to \$1,122.15 an ounce.
- Reuters-Jefferies index rose 0.84 pct at 276.15.

- 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	0.075	0.040	0.076	-0.004
3-Mo Bill	0.095	0.085	0.096	-0.003
6-Mo Bill	0.180	0.170	0.183	0.001
1-Year	0.340	0.330	0.346	0.001
2-Year	99.992	100.023	0.880	-0.039
3-Year	99.742	99.773	1.464	-0.098
5-Year	99.086	99.133	2.447	-0.250
7-Year	99.344	99.391	3.231	-0.406
10-Year	98.516	98.578	3.805	-0.531
30-Year	97.984	98.047	4.752	-0.797

**EQUITIES**

	INDEX	CHANGE
DJIA	10391.70	82.23
NASDAQ	2241.47	15.18
S&P 500	1106.95	7.44

**OIL**

	PRICE	CHANGE
NYMEX	79.0	1.7
BRENT	75.6	-0.7

**EURODOLLAR FUTURES**

	CLOSE	CHANGE
Mar-10	99.720	-0.003
Jun-10	99.590	-0.010
Sep-10	99.375	-0.010
Dec-10	99.035	-0.020

**REPURCHASE AGREEMENTS**

G/C		MORTGAGE REPOS	
O/N	0.190	O/N	0.210
2-Week	0.200	2-Week	0.210
1-Month	0.200	1-Month	0.220
3-Month	0.200	3-Month	0.240
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.200	10:00 AM	0.130
2-Week	0.190	3:00 PM	0.132
1-Month	0.210		
3-Month	0.220		

**IR SWAPS <19901>**

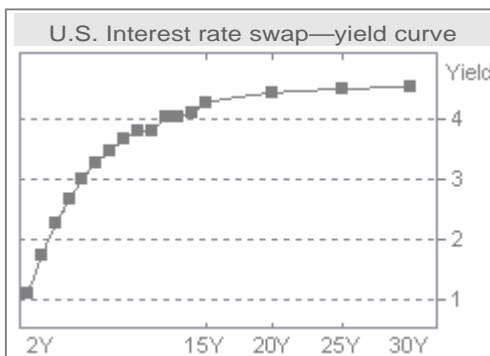
	SPREAD		RATE	
2-Year	26.50	30.50	1.14	1.16
3-Year	31.25	35.25	1.77	1.79
5-Year	30.00	34.00	2.74	2.74
7-Year	12.50	16.50	3.35	3.35
10-Year	7.25	11.25	3.87	3.86
30-Year	-15.50	-11.50	4.59	4.57

**FUTURES**

	PRICE	CHANGE
CBOT 5 yr	116.10	-0.25
CBOT 10 yr	117.83	0.16
CBOT 30 yr	117.19	0.38

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

	BID	ASK	BID	ASK
O/N	0.140	0.150	-	-
1-Month	0.180	0.280	0.130	0.140
3-Month	0.220	0.400	0.147	0.157
6-Month	0.250	0.450	0.181	0.191
12-Month	0.600	1.000	0.340	0.350



**CURRENCIES**

	BID	ASK
Euro	1.3614	1.3616
Sterling	1.5617	1.5622
JP Yen	91.30	91.32
Swiss Franc	1.0774	1.0778
Can Dollar	1.0405	1.0410
Mexico	12.8160	12.8216

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

Open	0.1300	1m	0.2188
High	0.1400	3m	0.2531
Low	0.0800		

**ACTIVE FANNIE MAE AGENCIES**

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.875	12/01/2012	9 0	0.97
3-Year	1.375	09/01/2013	13.5 0	1.59
5-Year	2.875	09/02/2015	29.5 28.5	2.74
7-Year	5.125	18/10/2016	19.25 18.75	3.42
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	34.75 34.25	5.1

**ACTIVE FREDDIE MAC AGENCIES**

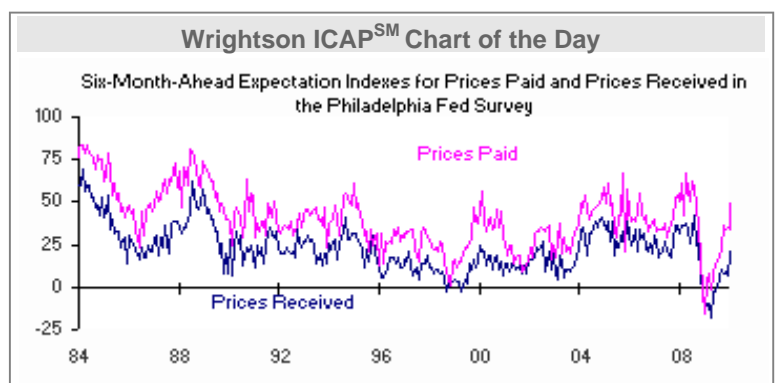
TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	15/12/2011	5 0	0.9
3-Year	1.75	22/02/2013	20 19.5	1.67
5-Year	2.625	20/11/2014	14 13.5	2.59
7-Year	5.25	15/09/2016	17.25 16.5	3.4
10-Year	3.75	27/03/2019	23 0	4.04
30-Year	6.25	15/07/2032	39.5 38.75	5.15

**Active MBS 15YR**

	CPN	BID	ASK	YIELD
FNMA	5.0	105.0400	105.0600	2.729
FHLMC	5.0	105.0500	105.0700	2.716

**Active MBS 30YR**

	CPN	BID	ASK	YIELD
FNMA	5.5	105.0400	105.0600	3.115
FHLMC	5.5	105.1400	105.1600	2.938
GNMA	5.5	105.1500	105.1700	3.603



## TODAY'S TOP NEWS

**U.S. jobless, price data fan concerns on economy**

The number of U.S. workers filing new applications for unemployment insurance unexpectedly surged last week, while producer prices increased sharply in January, raising potential hurdles for the economy's recovery.

Initial claims for state jobless benefits increased 31,000 to 473,000, the Labor Department said. Financial markets had expected them to fall slightly to 430,000.

Another report from the department showed prices paid at the farm and factory gate rose a faster-than-expected 1.4 percent from December.

Separately, the Philadelphia Fed's business activity index rose to 17.6 in February from 15.2 the prior month, while the Conference Board's index of leading economic indicators rose 0.3 percent last month after a 1.2 percent gain in December.

Stripping out the volatile food and energy costs, core producer prices rose 0.3 percent last month after being flat in December. The core index, which had been forecast to rise 0.1 percent, was lifted by a surge in light motor truck and pharmaceutical prices.

**Obama team raises pressure on health insurers**

The Obama administration ratcheted up pressure on health insurers, saying some firms planned double-digit rate increases while earning billions in profits and paying their bosses multimillion-dollar salaries.

The report came as President Barack Obama tries to revive his stalled healthcare reform plans and two weeks after Health Secretary Kathleen Sebelius sent a letter to Anthem Blue Shield of California demanding information about the firm's plan to boost premiums by up to 39 percent.

The report cited several firms as having planned big premium hikes in recent years. Anthem sought them in several different Northeastern states, the report said.

Blue Cross/Blue Shield of Michigan wanted a 56 percent hike for plans sold on the individual market, it said.

UnitedHealth, Tufts and Blue Cross asked for 13- to 16-percent increases in Rhode Island, and some plans in the individual market in Washington increased premiums by 40 percent until the state imposed stiffer regulations, the report said.

**UK government borrowing up in usual surplus month**

Britain posted its first ever budget deficit for the month of January this year, a worse than expected result for a Labor government struggling to pacify debt-wary markets ahead of an election it is tipped to lose.

Today's surprisingly bad figures weighed on the pound and British government bond prices fell, as concerns grow about the credibility of Labor's plans to curtail a record budget deficit forecast to top 12 percent of GDP this year.

Lending to businesses shrank at its fastest pace on record in December, according to the BoE.

The Office for National Statistics said British public sector net borrowing, the government's preferred measure, came in at 4.339 billion pounds (\$6.78 billion) last month compared with a five billion pounds repayment a year ago.

That marked the first PSNB borrowing for a January since records began in 1993.

A Treasury spokesman said the latest figures were in line with forecasts made in December's pre-budget report and were weak because they reflected just how bad conditions were for businesses and consumers at the height of the recession.

**Obama names deficit panel, gives it wide leeway**

President Barack Obama named a bipartisan panel to tackle exploding U.S. budget deficits and promised it broad leeway to put the country on a path to fiscal responsibility.

Obama's comment suggested that the panel would have latitude to consider any proposals to cut government spending -- which he warned had become extravagant -- and raise taxes.

The president promised during his campaign that families making less than \$250,000 would not face tax increases but recently said he was "agnostic" about whether the panel could consider middle-class tax hikes.

Facing political pressure and investor anxiety over mounting government debt, Obama assigned the commission to come up with a strategy to balance the budget, excluding interest payments, in five years. The administration estimates the panel's recommendations could bring annual budget deficits down to 3 percent of gross domestic product. The White House forecast a \$1.6 trillion budget deficit this year, or about 10.6 percent of GDP. Economists say 3 percent annual deficits could keep the debt from soaring further, but some fiscal hawks lament that Obama is not setting a more aggressive goal. The panel's recommendations must be reported to Congress by Dec. 1.

**EU should be clearer on Greek support-minister**

The European Union should be more specific about how it would support Greece in a crisis, to help lower the highly indebted country's borrowing costs now, Greek Finance Minister George Papaconstantinou said.

In an interview with Reuters, he also said that while Greece respected the euro zone's principle of dealing with fiscal problems by itself, it did not rule out seeking IMF assistance but was not actively pursuing it.

If the EU gave a clearer indication of the mechanism that might be used, in an emergency, to help Greece, bond spreads would fall and a rescue would not be needed, Papaconstantinou said.

Greece appointed prominent commercial banker Petros Christodoulou as new chief of its PDMA.

Separately, Greece's debt troubles will require "unprecedented adjustments" and act as a further drag on the euro zone's economic recovery, which will lag that of the United States, a senior fund manager at Franklin Templeton said.

**Regulator see private MBS mkt returning as Fed exits**

Private investors are likely to come back to the mortgage backed securities market as the Fed winds down its \$1.25 trillion mortgage purchase program, the regulator for Fannie Mae and Freddie Mac said.

The central bank has said it intends to stop purchasing MBS by the end of March. Many economists expect mortgage rates to rise somewhere between 25-75 basis points after the Fed ends its MBS purchases.

DeMarco said conservatorship cannot be a long-term solution, but did not offer any views on what he would like to see for two firms, commonly referred to as GSEs.

House Financial Services Committee Chairman Barney Frank has scheduled a hearing for March 2 to begin to consider how to restructure the way Americans finance their homes.

Separately, U.S. mortgage rates dropped for a second consecutive week, remaining below 5.0 percent, a closely watched mortgage survey showed. Interest rates on U.S. 30-year fixed-rate mortgages averaged 4.93 percent for the week ended Feb. 18, down from the previous week's 4.97 percent, according to a survey released by Freddie Mac.



## TODAY'S TOP NEWS

**Implied euro rates at lows, ECB exit seen hard**

Implied euro zone interest rates squeezed lower as markets took the view that some countries' fiscal problems will make it difficult for the ECB to scale back its stimulus measures. Two-year bond yields and interest rate swaps -- which were also driven down by receiving interest related to corporate bond issuance -- hit new lifetime lows.

Euribor interest rate futures also hit new highs, pushing their implied yields lower. The September Euribor contract rose as far as 98.99.

Market interest rate expectations for December, as measured by OIS forwards, have fallen to 0.85 percent from 1.35 percent at the start of the year, according to the bank.

Overnight borrowing from the ECB fell sharply after almost a week exceeding 3 billion euros, easing concerns about potential banking troubles.

**Euro zone consumer sentiment down in February**

Euro zone consumer confidence declined in February for the first time in 10 months, data showed, underlining just how fragile the region's economic recovery remains.

The indicator fell to -17.4 points from -15.8 in December in the 16-nation currency area, the European Commission said in a flash estimate. Full sentiment figures will be published at the end of the month.

The data confirmed that recovery depends on exports and government spending, rather than private demand, as consumers keep their spending tight due to increasing unemployment.

They may also be worrying about future tax hikes, given the large fiscal stimulus governments have given to their economies, economists said. Analysts expect growth to remain weak this year, putting pressure on the European Central Bank to refrain from any interest rate hikes and on governments to maintain fiscal stimulus program that bolster their economies.

Separately, bad loans held by Spanish financial institutions rose to a new 13-year high in December as banks reined in new credit and borrowers struggled to repay debts as recession maintained its grip on the economy.

**BOJ chief urges govt to respect its independence**

The BoJ chief fended off renewed political pressure to do more to fight deflation, saying the government should respect the central bank's independence if it wants to avoid unsettling financial markets.

Finance Minister Naoto Kan turned the heat up on the central bank this week, saying inflation of 1 percent was the minimum needed for price stability, a goal that has eluded Japan in nine of the past 10 years.

But BOJ Governor Masaaki Shirakawa ruled out adopting an inflation-targeting policy, saying focusing on short-term price pressures could prevent sustainable growth. He also shrugged off calls from some policymakers to step up its government bond buying operation aimed at lowering market rates. The central bank has said it is committed to fighting deflation, but its policy statement issued earlier in the day as well as Shirakawa's comments shed little light on what it could do in the future.

**Canada annual inflation jumps to near 2 pct**

Higher gasoline prices pushed Canada's annual inflation rate to just below the central bank's 2 percent target in January, but that is not expected to trigger interest rate hikes before the second half of this year.

The CPI climbed 0.3 percent in the month, Statistics Canada said. But 12-month inflation sped past expectations to 1.9 percent from 1.3 percent in December as prices in the transportation sector rose by the largest amount since September 2005.

Analysts had expected inflation at a slightly lower 1.8 percent but still approaching the Bank of Canada's target at the midpoint of a 1-3 percent range. Rising vehicle prices pressured the core rate of inflation to 2 percent annually after edging up 0.1 percent in the month. Separately, Foreigners invested heavily in Canadian bonds in November as credit markets recovered and the Canadian dollar rose, pushing total purchases of Canadian securities to C\$10.54 billion (\$10.23 billion) in the month, Statistics Canada said. Their net purchase of C\$97.82 billion in the first 11 months of 2009 is higher than any previous annual foreign investment on record.

## NEXT UP

**CPI, supply in Treasury traders' sights**

The U.S. Treasury debt market could see another down day following heavy selling ahead of new supply, analysts said.

The Treasury Department's announcement of the auctions of \$118 billion in new two-, five- and seven-year notes scheduled for next week helped drive a sell-off, that was also fueled by economic data showing higher-than-expected price increases for producers. Information on prices paid helps economists and traders predict future inflation trends.

A sharper-than-expected increase in prices heralds higher inflation, which, in turn, spurs Treasury selling as investors get rid of lower-yielding securities in anticipation of buying new ones after interest rates rise.

The government on Friday will release data on prices consumers paid for goods and services in January. Estimates in a Reuters poll put consumer price index headline inflation at 0.3 percent.

"If you get anything worse than 0.3 percent or 0.1 percent for core inflation, you'll probably have a little more downside," said John Spinello, U.S. Treasury strategist at Jefferies & Co in New York.

**U.S. home prices at bottom but no gain seen in 2010**

The meltdown in U.S. housing is over, but home prices are expected to mostly stagnate in 2010 as the sector slowly weans itself off government incentives, according to the latest Reuters poll. A survey of 38 economists and property market analysts taken Feb. 11-17 found they do not expect the average home price to move in 2010, based on the S&P's/Case-Shiller 20-city Composite Home Price Index.

That consensus forecast is less optimistic than a similar poll taken in November, when economists expected a near 3 percent rise in 2010, showing a deterioration in the outlook in the last few months despite signs of U.S. economic recovery.

But average home prices are probably at or near a bottom after plunging by a third from their peak in mid-2006. More than half of the economists polled -- 24 of 38 -- said prices have reached a trough. A majority of the rest said that would happen this year. Economists expect a modest 2 percent rise in 2011. However, while housing has stabilized, economists do not see prices resuming the kind of rises seen before the spectacular housing collapse late in the last decade, thanks to a still-weak U.S. labour market, where unemployment is just under 10 percent.



## DEEP DIVE Commentary and Analysis

**COLUMN-At least U.S. has Japan to fall back on**

By Jim Saft

The bad news for holders of U.S. debt, in case you missed it, is that China has sold so many Treasuries that it is no longer America's leading lender.

The worse news is that there is a new creditor-in-chief, and it is Japan, an aging country with its own government debt bubble to contend with.

China sold about \$34 billion of Treasuries in December, taking its holdings to \$755 billion, while Japan increased its purchases and now is in the top spot of the Treasury Department's scroll of merit, with \$768 billion. China's holdings peaked in April, since when the trend has been gently downward.

From a demographic point of view, though, the United States making a long term borrowing plan based on access to Japanese funding is a bit like my daughter making a retirement plan that has me continuing to work when she stops at its centre.

Japan is a wonderful country with many strengths, but one salient feature of Japan is that it is aging, or should that be aging, deeply in debt and dependent upon very low rates to continue to make those debts manageable.

Japan's government debt to GDP ratio is 190 percent, as against 84 percent for the U.S. That huge debt, which has nearly quadrupled in the past 15 years, is made tenable because the Japanese are great savers and own the vast majority of their government's stock of debts, unlike Americans, who own instead the vast majority of stuffed animals made in China. Japanese debt is also manageable because market interest rates are so low -- just a 1.32 percent yield on 10-year government bonds.

Japan is getting old quickly and by 2020 will have an old age dependency ratio, the proportion of its population too old to work, approaching 50 percent. That will eventually spook global capital markets, driving up Japan's borrowing costs. At the same time the overall call for capital in Japan will rise, both to fund consumption by retirees and, in one way or another, to service debt.

That makes Japan a real risk for the United States as a source of funding. They will have their own fish to fry and lending to the U.S. will be well down the priority list.

Japan's growing stock of U.S. debt has to be viewed as temporary. This, in combination with questions about China's strategy towards the United States and its debt, will throw a considerable shadow over the Treasury market for the foreseeable future.

**CHINA'S STRATEGY**

There are, to be fair, lots of reasons why China's sale of Treasuries might not turn out to be that big of a deal. China may simply be rebalancing after it plunged heavily into U.S. short-term debt during the crisis, or the data may be hiding offshore purchases by China of Treasuries. And, to judge by action in the bond market, whatever selling China has been doing has not hurt the U.S.'s ability to fund itself at very cheap rates much at all. To top it off, there was strong overall global demand for U.S. assets.

There is also the fact that China and the United States need one another. Not only does China still depend upon U.S. consumption for its industrial base, it also, as a huge owner of Treasuries, stands to be among the biggest loser in any uncontrolled sell-off.

Still, and even with good will on both sides, the vendor financing arrangements between the U.S. and China cannot persist. Even as public debt spirals in the U.S. there is recognition that the economy had become too reliant on consumption and debt. China's old and valued client will be a bit less valuable going

forward.

Worries about China's plans are not helped by calls by senior Chinese military officers last week to punish the U.S. for arms sales to Taiwan by selling some Treasuries in "retaliation."

And China itself has criticized the dollar's central role in the global economy and U.S. management of its own finances, raising suspicions that China, realizing that the good days are gone, is wondering how it can extricate itself from its central role in the Treasury market.

That extrication is likely to happen little by little rather than all of a sudden, but even so it will not take too much diversification by the Chinese to have a real impact on U.S. market interest rates. Substantial and reliable long-term funding isn't likely to come from Japan either, meaning that the best hope for Treasury investors lies not abroad but in the United States.

A bet on U.S. Treasuries then is a bet not just on the U.S. economy but on the U.S. political process.

(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.)

**ANALYSIS-U.S. deficit panel faces long odds for success**

By Andy Sullivan

President Barack Obama's deficit commission will have to pick from a menu of unpleasant options as it comes up with a plan to get the U.S. budget under control. That will be the easy part.

Getting Congress to act on its proposals could be much more difficult.

A toxic political atmosphere and heavy lobbying from outside interest groups will make lawmakers reluctant to sign off on a plan likely to include a mix of tax hikes and spending cuts that could cause them significant political pain, analysts say.

"Both sides need to probably slaughter some sacred cows, and right now I don't think that there's political will on either side -- the well is so poisoned," said Chris Krueger, an analyst with Concept Capital, which tracks Washington for institutional investors.

Financial markets, which could punish the United States with higher borrowing costs if Washington doesn't reduce its massive budget gaps, are also unlikely to be convinced that the country has changed course until they see results.

"The market pays more attention to concrete steps that are taken," said Suvrat Prakash, U.S. interest rate strategist at BNP Paribas in New York. "This is more symbolic than a concrete step to reducing the deficit."

The panel's co-chairs, Democrat Erskine Bowles and Republican Alan Simpson, helped forge a bipartisan budget deal in the 1990s and both are widely respected in Washington.

Their commission aims to bypass the usual legislative process to forge bipartisan consensus over the tough steps needed to rein in budget deficits that are bigger than any since World War Two, when measured against the economy.

But both Democrats and Republicans have already signaled they are not likely to support a wide-ranging commission.

The Senate voted 97 to 0 in January to declare the Social Security retirement program off limits to any deficit commission that Congress might set up.

Shortly after that, senators from both parties joined forces to defeat the establishment of a congressional commission as interest groups on the left and the right lobbied against it.

That dynamic is unlikely to change.

**LITTLE INCENTIVE TO COOPERATE**

Republicans, who have remained remarkably unified against



## DEEP DIVE Commentary and Analysis

Democratic proposals on a host of issues, will see little incentive to cooperate as they eye big gains in the November congressional elections that could hand them control of the House and the Senate.

They also will be reluctant to sign off on any proposal that includes tax increases as they face pressure from grassroots activists on the right.

"Democrats want Republicans on board so that they can say these tax increases are bipartisan, and that is why Republicans would be foolish to have anything to do with it," said Grover Norquist, head of the conservative Americans for Tax Reform.

Democrats, meanwhile, have been hammered for supporting Obama initiatives like stimulus spending and the healthcare overhaul. Without significant Republican support, they could be reluctant to back any plan that includes painful tax increases or cuts to popular programs.

And the cross-party friendships that make bipartisan deals possible are increasingly rare as lawmakers spend less time socializing in Washington and more time raising money and meeting voters in their home districts, observers say.

"We have never really seen a toxic environment quite like this," said former Republican Representative Jim Kolbe at a roundtable discussion on Tuesday.

Paradoxically, Obama might find a greater chance of a bipartisan deal if Republicans win control of Congress in November, as voters would hold them responsible as well for governing.

The budget deals of 1990 and 1997 that led to budget surpluses were forged when one party controlled the White House and the other controlled Congress.

During that period, several blue-ribbon presidential commissions came up with plans to rein in ballooning entitlement programs. They were ignored.

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(Compiled by Anil Kumar and Pronita Naidu in Bangalore)

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