

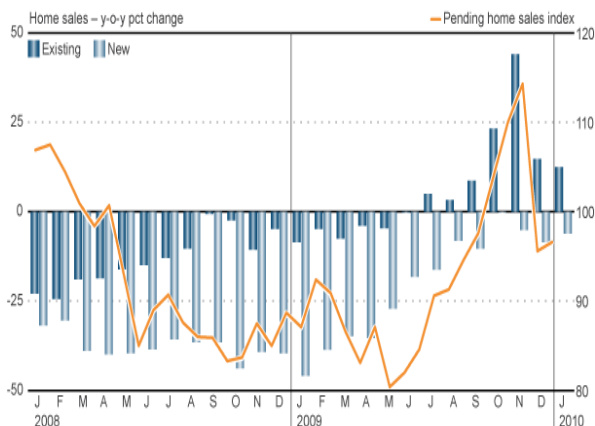
# INSIDE DEBT

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Friday, February 26, 2010

## CHART OF THE DAY

### U.S. existing home sales



Sales of existing homes plunge unexpectedly in January, but still up compared with last year.

## TODAY'S TOP NEWS

- Inventories buoy U.S. growth, but home sales slump
- U.S. Treasury loan fund to ease credit to small firms
- S&P still sees reasons to worry about U.S. recession
- Freddie ends buying of all interest-only mortgages
- Fed's Evans - rates low for extended period
- AIG alters payback plan to Fed - source
- **Fore more stories, please click here**

## ECON WATCH FOR MONDAY MARCH 1

ET	Indicators	Unit	Reuters	Prior
03:43	IT Markit/ADACI Mfg PMI	ind	52.1	51.7
03:48	FR Markit/CDAF Mfg PMI	ind	54.6	55.4
03:53	DE Markit/BME Mfg PMI	ind	57.1	53.7
03:58	EZ Markit Mfg PMI	ind	54.1	52.4
04:28	GB CIPS/Markit Mfg PMI	ind	56.1	56.7
04:30	GB BoE consumer Credit	bln	-0.10	0.052
04:30	GB Mortgage Lending	bln	0.80	1.165
04:30	GB Mortgage Approvals	k	50.00	59.023
05:00	EZ Unemployment rate	%	10.1	10.0
08:30	CA GDP mm	%	0.4	0.4
08:30	US Personal income mm	%	0.4	0.4
08:30	US Consumption, adj. mm	%	0.4	0.2
08:30	US PCE price index mm	%	-	0.1
08:30	US Core PCE price ind mm	%	0.0	0.1
08:30	US Personal consumption	%	-	0.1
10:00	US Construction spending	%	-0.7	-1.2
10:00	US ISM Manufacturing PMI	ind	57.5	58.4
10:00	US ISM Mfg Prices Paid	ind	68.5	70.0

## MARKETS TODAY

**TODAY'S TOP STORY:** The U.S. economy grew a touch more than initially thought in the fourth quarter, but a surprise big drop in sales of previously owned homes last month showed trouble spots still remain.

**For more please click here**

**TREASURIES:** U.S. Treasuries rose after news that home sales fell in January and consumer sentiment slipped in February reinforced expectations for subdued economic growth this year.

- 30-yr bond prices were up 9/32 to yield 4.56 pct, down from 4.58 pct on Thursday.
- 10-yr Treasury prices rose 3/32 yielding 3.62 pct.
- 5-yr Treasury notes gained 2/32 to yield 2.31 pct.
- 2-yr notes were up 1/32 yielding 0.82 pct.
- 2-10's part of the yield curve remained unchanged at 280 bps.

**FOREX:** The U.S. dollar fell against the euro as investors pared extreme short positions in the euro on the last business day of the month after its recent declines.

- Euro gained 0.5 pct at \$1.3615. Earlier, it went as high as \$1.3683.
- The euro was up 0.16 pct at 120.93 yen.
- The euro rose as high as 89.72 pence, its strongest since mid-January.
- Dollar shed 0.36 pct to 88.81 yen.

**CORPORATES:** U.S. corporate bond spreads tightened and the cost of protecting debt with credit default swaps fell as confidence that the Federal Reserve will keep interest rates low underpinned sentiment, strategists said.

- The CDX.IG-13 index tightened by about 2 bps to 92 bps.
- Fannie Mae launched \$4.0 bln of new two-year benchmark notes.
- Oshkosh Corp sold \$500 mln of high-yield bonds, ArvinMeritor Inc sold \$250 mln, and Equinix was expected to sell a \$750 mln issue after up-sizing it from \$500 mln.
- Reddy Ice Corp, however, downsized an initially planned \$300 mln offering to \$270 mln.

**STOCKS:** U.S. stocks looked set to make their best monthly advance since November in a seesaw session as a drop in the U.S. dollar offset economic reports that came in mostly weaker than expected.

- Dow gained 0.03 pct to 10,324.51, S&P was up 0.13 pct to 1,104.40 and Nasdaq rose 0.18 pct to 2,238.26.
- AIG Inc slid 10.03 pct to \$24.75 after it reported a quarterly loss of \$8.9 billion. Walgreen Co was down 2.17 pct at \$35.24.
- JP Morgan Chase rose 3.27 pct to \$41.97.
- S&P financial index jumped 0.71 pct, KBW bank index rose 0.89 pct.

**C & E:** Oil jumped nearly 2 pct toward \$80 a barrel, marking a more than 9 pct rise for the month, as an upward revision in U.S. GDP for the fourth quarter helped revive sentiment.

- U.S. crude prices rose 1.92 pct to \$79.67 per barrel.
- Gold was up 1.06 pct to \$1,116.4 an ounce.
- Reuters-Jefferies index gained 1.44 pct at 274.77.

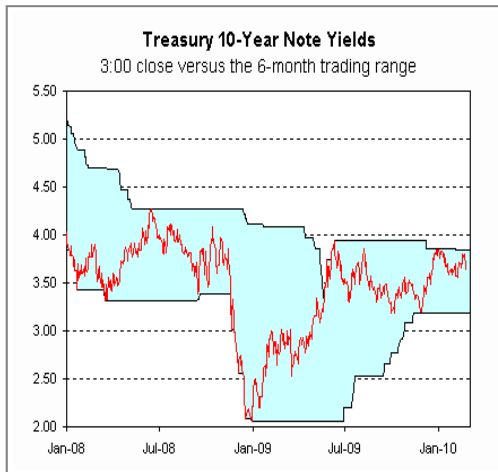
• For MARKET SNAPSHOT click here

• 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	0.095	0.06	0.096	0.001
3-Mo Bill	0.120	0.110	0.122	0.002
6-Mo Bill	0.190	0.165	0.193	0.005
1-Year	0.290	0.270	0.295	-0.004
2-Year	100.133	100.164	0.809	0.043
3-Year	100.148	100.180	1.324	0.109
5-Year	100.406	100.453	2.289	0.215
7-Year	99.766	99.813	3.037	0.211
10-Year	100.219	100.281	3.599	0.305
30-Year	101.406	101.484	4.539	0.664

EQUITIES

	INDEX	CHANGE
DJIA	10342.27	23.58
NASDAQ	2240.42	6.43
S&P 500	1105.85	3.12

OIL

	PRICE	CHANGE
NYMEX	79.5	1.4
BRENT	77.5	1.2

EURODOLLAR FUTURES

	CLOSE	CHANGE
Mar-10	99.738	0.003
Jun-10	99.650	0.005
Sep-10	99.485	0.000
Dec-10	99.200	0.010

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.180	O/N	0.200
2-Week	0.210	2-Week	0.220
1-Month	0.220	1-Month	0.220
3-Month	0.220	3-Month	0.240
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.180	10:00 AM	0.120
2-Week	0.210	3:00 PM	0.114
1-Month	0.220		
3-Month	0.230		

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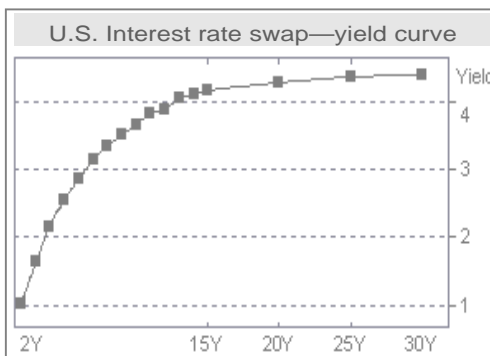
	SPREAD		RATE	
2-Year	22.50	26.50	1.02	1.05
3-Year	30.75	34.75	1.63	1.64
5-Year	26.75	30.75	2.55	2.56
7-Year	10.75	14.75	3.14	3.14
10-Year	6.00	10.00	3.66	3.64
30-Year	-16.00	-12.00	4.38	4.35

FUTURES

	PRICE	CHANGE
CBOT 5 yr	117.04	0.22
CBOT 10 yr	118.89	0.33
CBOT 30 yr	119.16	0.75

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.130	0.150	-	-
1-Month	0.200	0.280	0.138	0.148
3-Month	0.220	0.400	0.154	0.164
6-Month	0.250	0.450	0.178	0.188
12-Month	0.600	1.000	0.296	0.306



CURRENCIES

	BID	ASK
Euro	1.3616	1.3618
Sterling	1.5248	1.5252
JP Yen	88.87	88.90
Swiss Franc	1.0743	1.0746
Can Dollar	1.0517	1.0522
Mexico	12.7886	12.7936

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

Open	0.1400	1m	0.2181
High	0.1500	3m	0.2550
Low	0.0800		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	0.875	12/01/2012	0	2.5	<blank>
3-Year	1.375	09/01/2013	11.5	10.5	1.45
5-Year	2.875	09/02/2015	26	25	2.56
7-Year	5.125	18/10/2016	21.5	21	3.25
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	34.25	33.75	4.88

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	0	-3	-
3-Year	1.75	22/02/2013	20	18	1.57
5-Year	2.625	20/11/2014	14	13.5	2.46
7-Year	5.25	15/09/2016	17.75	17.25	3.21
10-Year	3.75	27/03/2019	19	17	3.79
30-Year	6.25	15/07/2032	33	32.5	4.87

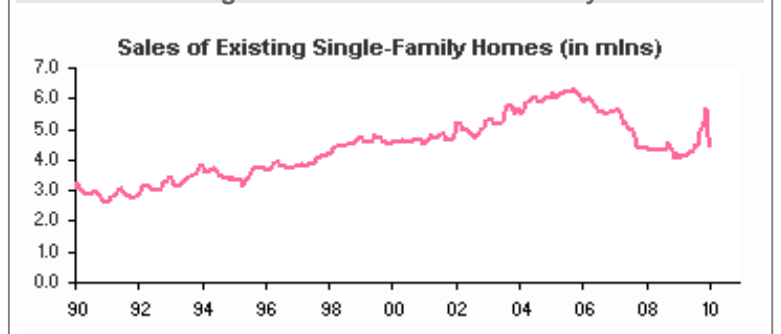
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.1300	105.1500	2.616
FHLMC	5.0	105.1300	105.1500	2.616

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.2300	105.2500	2.867
FHLMC	5.5	105.2300	105.2500	2.818
GNMA	5.5	105.2400	105.2600	3.514

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



## TODAY'S TOP NEWS

**Inventories buoy U.S. growth, but home sales slump**

The U.S. economy grew a touch more than initially thought in the fourth quarter, but a surprise drop in January home sales to a seven-month low and weaker consumer confidence underscored headwinds facing the recovery.

U.S. GDP expanded at a 5.9 percent annual rate, instead of the 5.7 percent pace estimated last month, the Commerce Department said.

Separate reports showed sales of existing homes dropped 7.2 percent to an annual rate of 5.05 million units last month, the lowest since June, the National Association of Realtors said.

Stripping out inventories, the economy expanded at an annual rate of 1.9 percent in the fourth quarter, rather than the 2.2 percent pace estimated last month, indicating growth was only being partially driven by demand.

Business inventories, which fell only \$16.9 billion in fourth quarter instead of \$33.5 billion estimated last month, added 3.9 percentage points to GDP, their biggest contribution since the fourth quarter of 1987.

Consumer spending increased at a modest 1.7 percent rate. With consumer confidence remaining subdued, spending is not expected to pick up much. The Thomson Reuters/University of Michigan's Surveys of Consumers' index of consumer sentiment dipped to 73.6 in February from 74.4 in January.

**S&P still sees reasons to worry about U.S. recession**

The U.S. would be at risk of a double-dip recession if things go awry in the global financial markets as a result of a major sovereign default, S&P's chief economist, David Wyss, said.

Wyss, however, on a conference call to investors, said the U.S. housing market is "stabilizing." He said he expects to see mortgage rates rise by about 1 percentage point over the next year, which should not cause a major disruption to housing.

Wyss said he does not expect the Fed to start raising its benchmark lending rate, the fed funds target rate, until early 2011.

Separately, John Chambers, head of S&P's sovereign rating committee, said that despite fiscal pressures, the U.S. sovereign rating is still "hanging in there" at an AAA level.

S&P maintains the United States' top AAA rating with a stable outlook, meaning there is not a significant chance of a change in the near future. However, S&P reiterated that reducing the U.S. budget deficit remains a tough longer-term challenge for the government.

**Fed's Evans - rates low for extended period**

A top U.S. Federal Reserve official said an erratic recovery dictates low rates for at least six months, while prominent economists said unsettled U.S. financial conditions are more of a drag on the economy than generally believed.

Evans spoke on the margins of a University of Chicago Booth School of Business forum where a blue ribbon panel of economists proposed an updated financial conditions index to guide central banker decision-making. If the U.S. Fed is stripped of its regulatory authorities, it could be under greater pressure to use interest rates to curb risky activities, Chicago Fed President Charles Evans said.

The Fed is depending on healing financial markets to help support recovery from a painful recession. Evidence of lingering financial malaise will make it harder for policy makers to budge from easy money policies any time soon. A financial conditions framework would likely be useful when evaluating the economic outlook and the conduct of monetary policy, NY Fed President William Dudley said, commenting on the proposal.

**U.S. Treasury loan fund to ease credit to small firms**

The U.S. Treasury Department argued that its plan for a \$30 billion lending fund could help end a drought for small-business loans because it will attract more small banks than the Treasury's previous bank bailout program.

Herb Allison, assistant Treasury secretary for financial stability, told a joint hearing of the House of Representatives Financial Services and Small Business committees there was concern small banks would avoid any program established under the TARP because of a perceived stigma.

Allison said that smaller institutions that accessed government capital through TARP have struggled with executive compensation restrictions under TARP that were the same for all institutions, regardless of size.

This has led to situations where small community banks with only a handful of employees could not make severance payments to a bank teller or secretary due to "golden parachute" prohibitions against senior executives and the next five highest-paid employees.

Even if Treasury removed some of those restrictions, many lenders would avoid TARP participation due to a belief in a "stigma" associated with the program and fear that they could be subjected to retroactive restrictions.

**Freddie ends buying of all interest-only mortgages**

Freddie Mac said that it would stop buying and securitizing all interest-only mortgages because of the poor performance of those loans.

Interest-only mortgages, including Freddie Mac's Initial Interest mortgages, provide only interest payments for a specified period starting with the first monthly payment, and then principal and interest for the rest of the loan term.

About 14 percent of the loans had credit enhancements, according to the company. The average unpaid principal balance per loan was \$254,601, Freddie Mac said.

Separately, Freddie Mac said its mortgage investment portfolio shrank in January, while delinquencies on loans it guarantees accelerated. The portfolio decreased at an annualized 18.4 percent rate to \$743.7 billion in January from \$755.3 billion the previous month, the McLean, Virginia-based company said in its monthly volume summary. Delinquencies, which increase stress on the company's capital, jumped to 4.03 percent of its book of business in January from 3.87 percent in December.

**AIG alters payback plan to Fed - source**

AIG has decided not to use securitized U.S. life insurance policies to repay the U.S. government after a \$182.3 billion rescue, a source familiar with the matter said.

AIG had planned to give the NY Fed securitization notes of up to \$8.5 billion representing embedded value of certain of its U.S. life insurance businesses to pay down its loan.

AIG now expects to repay the loan through other means, such as with cash generated by its insurance businesses and asset sales, according to The Wall Street Journal, which first reported the news.

AIG still has about \$25 billion outstanding under its Fed credit facility. The company reported an \$8.87 billion loss.

Chief Executive Robert Benmosche has said he envisions a smaller AIG in the future, with global property-casualty and U.S. life and annuity operations at its core.

It is also moving ahead with a massive initial public offering of American International Assurance, its Asian life insurance business.



## TODAY'S TOP NEWS

**Greek PM to visit Germany, seeks EU solidarity**

Greece's prime minister called for more solidarity from the European Union over the country's debt crisis and announced plans to visit Germany, whose backing would be vital for any EU financial aid.

George Papandreou said the worst fears about Greece's economy had been confirmed after an EU mission said Athens would miss its deficit-reduction targets unless it carried out more of the spending cuts that have sparked street protests.

Papandreou's office said the prime minister would visit Berlin on March 5 after an invitation from Chancellor Angela Merkel, but gave no other details. Merkel's government has resisted appeals to promise Greece aid. Opinion polls show a majority of Germans oppose a bailout but many economic analysts believe Europe's largest economy will step in if it believes the stability of the euro is threatened.

Investors who must decide whether to buy more Greek debt when it issues a new 10-year bond in the next few weeks are becoming increasingly anxious.

**Euro zone Jan inflation muted, ECB seen on hold**

Euro zone inflation remained subdued in January, final data showed, cementing expectations the ECB will keep interest rates on hold for months to come as economic recovery remains fragile. The European Union statistics office confirmed its earlier estimate that consumer prices in the 16-country currency bloc rose 1.0 percent year-on-year, up from 0.9 percent in December. Month-on-month inflation was -0.8 percent in January, the data showed, in line with the expectations of analysts polled by Reuters. Prices fell for clothing, household equipment, communications, culture, hotels and restaurants.

Energy prices rose in January by 2.1 percent month-on-month for a 4.0 percent annual gain. What the ECB calls core inflation fell to 0.9 percent year-on-year from 1.0 percent in December, which can only partly be explained by the sales season in January. Separately, German annual inflation slowed in February, official data showed, falling short of expectations and pointing to benign price pressures in the broader euro zone.

**UK emerged faster in Q4 from deeper recession**

The British economy grew faster than previously estimated in the last three months of 2009 but the 18-month recession from which it emerged turned out to be deeper, revised official figures showed.

Finance minister Alistair Darling welcomed the upward revision of fourth quarter GDP growth to 0.3 percent from an originally reported 0.1 percent but said there were still big risks and that support for the economy could not be withdrawn yet.

When to cut public spending has emerged as one of the biggest dividing lines ahead of an election expected on May 6, with the opposition Conservatives saying the record deficit needs to be brought down quicker than the Labour government plans.

The BoE is next week expected to hold interest rates steady at a record low of 0.5 percent and keep its asset-buying program to boost the economy on hold.

The service sector grew by 0.5 percent, five times faster than initially estimated. Growth in industrial output was also revised up to 0.4 percent from an initial 0.1 percent.

**Nomura to sell \$3 bln dollar bonds to grow in U.S.**

Nomura Holdings Inc said it would raise \$3 billion in its first ever sale of dollar-denominated bonds to help fuel its expansion in the United States.

The move follows new share issuance of about \$7 billion in 2009, and it recently raised another 1.25 billion euros in a bond sale. Nomura said it would sell \$1.5 billion in five-year bonds and another \$1.5 billion in 10-year notes.

The bonds are priced higher than what it would cost Nomura to raise money in Japan, underscoring the broker's ambitions to become a major player in the United States, home to the world's largest bond and equities markets.

Nomura's 5-year bonds will pay 5 percent interest, yielding 275 basis points more than comparable U.S. Treasuries. The 10-year notes offer 6.7 percent interest, for a 310 point spread.

In a separate report, core-core CPI fell 1.2 percent from a year earlier, matching a record drop the month before.

## NEXT UP

**February ISM indexes to show economic expansion**

The U.S. economy is expected to have expanded in February, although at a slower rate than in the previous month.

The median Reuters forecast for the manufacturing ISM is 57.5, while the median forecast for the non-manufacturing ISM, which forecasts activity in the services sector, is 51.

February would mark the seventh month of expansion for the manufacturing index, but at current estimates it would also be the first slowdown in two months.

The non-manufacturing index has been slow to take off, struggling around the break-even mark for the last six months, although rising for the last three of those.

The highest forecast for manufacturing ISM was 60.7 and the lowest was 55 in the 64-analyst poll. For the non-manufacturing ISM, the highest forecast was 52.9 and the lowest was 49, in a poll of 56 analysts.

Investors will likely focus on the employment component of the two indexes as they try to assess the strength of underlying employment trends ahead of February's payrolls report due out at the end of the week.

**Investors cut back on euro zone bonds-Reuters poll**

Investors shied away from European government debt in February, cutting bond allocations to the region in favour of UK and emerging market paper as angst over Greece and other euro zone peripheral economies grew.

Reuters polls of 45 leading investment houses, released on Thursday, also showed fund managers lifting their exposure to equities, although much of this was the result of bullishness among U.S. investors. Overall, the average exposure to equities was 55.4 percent, up from 55.1 percent in January. Bond allocations fell to 33.3 percent from 33.7 percent and cash rose to 4.8 percent from 4.1 percent. The picture that can be drawn from this is that investors are cautious about the global economic recovery but not overly worried about a large retrenchment.

One of those dangers is the increasing worry about sovereign debt, centred on Greece but also bringing in others such as Portugal, Spain, Italy and even France.

Allocations within bond portfolios to euro zone debt fell to 39.0 percent from 42.1 percent a month earlier. The main beneficiaries were Britain, up 9.7 from 7.3 percent, and emerging markets, up at around 7 percent from around 4 percent.



DEEP DIVE Commentary and Analysis

**COLUMN-Commodities and equities - a market of one?**

By John Kemp

Commodity prices are still being driven by general macroeconomic and financial factors rather than industry-specific supply and demand.

Most day-to-day variability in energy and metals prices seems to be linked to a "common factor" that is also driving equity markets. Commodity prices show increasing integration with other financial assets.

Prior to 2008, there was no evidence of a stable link between commodity markets or with other asset classes such as equities. Observed volatility in energy, metals and equity markets seems to have been largely independent. Correlations were too unstable to imply any degree of causality or co-movement.

In a paper entitled "Commodities and Equities: A 'Market of One'?", published in June 2008, economists for the U.S. Commodity Futures Trading Commission (CFTC) examined links between commodity markets and equity indices. They concluded there was no evidence inflows into commodity markets had led to their financialisation or an increase in co-movement:

"The lack of greater return co-movement across equities and commodities suggests that commodities have retained their role as a portfolio diversification tool. The import of this conclusion cannot be overstated, since many academics and practitioners have long called for substantial allocations to commodities as an asset class for the purpose of return generation and portfolio diversification."

"Our findings are consistent with the notion that commodities continue to provide benefits to equity investors in terms of portfolio diversification."

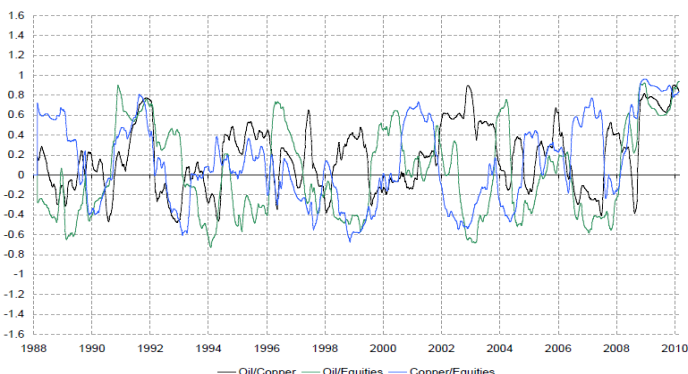
The volatility analysis above is not strictly comparable with the findings of the 2008 study, in which the authors were examining total returns (including dividends and roll returns) rather than simple changes in spot prices. But the comparison is close enough for present purposes.

Since 2008, price behavior has changed significantly, and commodity markets and other financial assets appear to have become increasingly integrated. Correlations between volatility in the oil, copper and equity markets have been remarkably stable, never falling below 80 percent, and at times approaching 100 percent.

In the most recent 12 months (Feb 2009-Feb 2010), the correlation between copper and equity markets has been 83 percent, rising to 84 percent between copper and oil, and 94 percent between oil and equities.

Strong integration during periods of extreme stress is not surprising. Observers have long noted that in a crisis all correlations go to one. But what is more interesting is that commodity markets have remained integrated with one another and with other financial assets long after the immediate crisis has passed. There is no sign the links are weakening even as confi-

CROSS-MARKET VOLATILITY CORRELATIONS

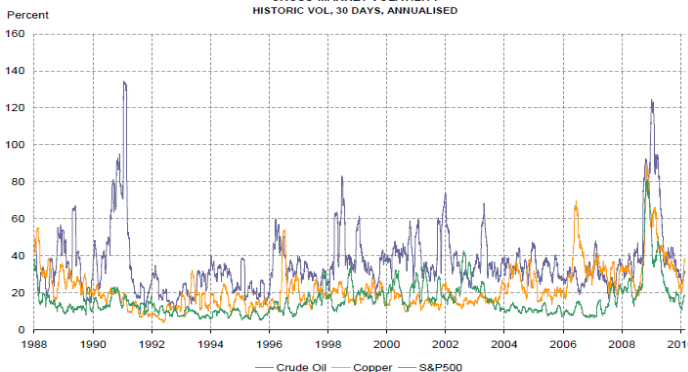


dence returns.

Recent co-movements in energy, metals and equity markets appear to reverse the conclusions of the 2008 CFTC study and suggest commodities and other financial assets have indeed become a "market of one", at least for the time being.

-- John Kemp is a Reuters columnist. The views expressed are his own --

CROSS-MARKET VOLATILITY HISTORIC VOL, 30 DAYS, ANNUALISED



**Common euro zone bond could bring widespread benefits**

By Natsuko Waki

Opposition to the issuance of bonds guaranteed by all 16 euro zone governments has gathered momentum with the escalating Greek debt crisis, but such bonds could prove beneficial to all members including Germany.

As concerns rise over the ability of Greece to finance its borrowing and the euro zone tackles its biggest debt crisis ever, policymakers are considering a number of options to solve the fiscal woes.

One idea on the table has been to issue common bonds backed by all 16 members that would cover the first 40 percent of the region's total government debt.

The idea for such a market has been floated in the past, but has always met with fierce opposition from Germany and other "core" countries. They say their disciplined fiscal stance will be diluted by weak members, while their funding cost -- lowest in the bloc -- will rise to accommodate indebted colleagues.

However, the scheme could bring benefits for all members. The sheer liquidity the unified market would bring has potential to lower yields for fiscally sound countries.

According to some estimates, the market could develop into a highly liquid bond class of some 4 trillion euros, four times the size of German bunds, the region's safest, and a true contender to the estimated \$6-7 trillion U.S. Treasury market.

"Politically we're not anywhere close to that... but it would be more attractive to have a larger, deeper and more liquid market. The common bond may facilitate the evolution of the market," said Jon Stopford, head of fixed income at Anglo-South African Investec Asset Management.

A common bond would also help develop wider futures contracts for the euro zone as opposed to the current German bund futures, making it more effective and attractive for investors to hedge their underlying debt.

Single euro zone bonds, which if established may surpass U.S. Treasuries as the world's biggest market, are likely to attract a wide range of investors, including banks, fund managers and even central bank reserve managers.

Goldman Sachs argues that a common bond would automatically increase liquidity by simply pooling the region's debt issuance -- a phenomenon seen in the euro zone corporate bond market where total issuance of non-financial paper nearly doubled in nine years since the euro birth at 2000.



## DEEP DIVE Commentary and Analysis

"A common bond with a joint guarantee could, in principle, benefit everybody," the bank said in a 2009 research paper.

"Pooling debt issuance through a common bond would eventually eliminate the liquidity-induced spread widening. Moreover, the effect would be reinforced by the fact that a common bond would, after some time, surpass the most liquid government bonds in the euro zone, implying also a lower liquidity premium for Germany."

The gross domestic product-weighted average of 10-year yields from all euro zone bonds stand at just below 4 percent, according to Julius Baer, compared with 3.12 percent for Germany and 6.58 percent for Greece.

## WINNING EXCESS RESERVES

Having a deep and liquid bond market also helps attract official institutions, who are keen to diversify their holdings away from the dollar and U.S. Treasuries.

According to the International Monetary Fund, the euro's share of the \$4.4 trillion of the world's currency reserves where detailed breakdowns were available stands at 28 percent, compared with the dollar's 61 percent.

China and Japan are the world's top reserve holders and also biggest buyers of U.S. Treasuries, each holding more than \$750 billion as of December 2009.

"With the common bond, the euro becomes more clearly a reserve currency," Stopford said.

"The world is looking for an alternative for having excess reserves held in dollars. The euro has long been touted as an alternative but it clearly has issues. The United States has a deeper liquid capital market because a unified Treasury market provided a liquid yield curve."

A unified bond would make the euro zone a viable contender to the United States in attracting these dollar-based reserves, especially from China and other emerging economies whose excess FX reserves are expanding rapidly -- a point highlighted by the Securities Industry and Financial Market Association in 2008.

"A commonly issued European government bond would better enable Europe to compete with the U.S. Treasury market globally," the SIFMA said in a paper.

"By creating a consolidated T-bill product, a common European debt instrument could aid the development of the euro as a reserve currency."

The SIFMA also said joint issuance would deliver steadier and more predictable supply, while the lower cost of liquidity management would solve an issue for some issuers who presently have to pay for the need to retain long term cash positions in order to fund short term gaps when their debt matures.

Global investors, according to Reuters polls released on Thursday, currently hold an average of 39.0 percent in euro zone bonds -- including government and corporate debt -- compared with 32.4 percent in the United States.

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(Compiled by Anil Kumar and Pronita Naidu in Bangalore)

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