

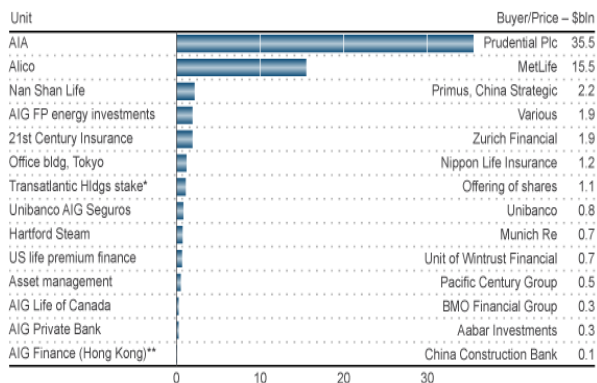
INSIDE DEBT

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Monday, March 8, 2010

CHART OF THE DAY

AIG sells its assets



AIG has struck deals for more than \$62 billion, needs to repay the U.S. about \$95 billion.

TODAY'S TOP NEWS

- MetLife seals Alico deal after two-year quest
- Greek PM urges G20 effort to rein in speculators
- NY Fed says to expand firms for reverse repos
- FDIC's Bair eyes low interest rates, more lending
- EU set to discuss CDS speculation Mar. 16-sources
- U.S. senators wrestle with Fed bank oversight
- Dubai World deal hope lifts markets, divides creditors
- Talk of China giving up on dlr is nonsense -banker
- Global growth robust, markets improving -Trichet
- UK won't tighten liquidity rules on banks for now

ECON WATCH

FOR TUESDAY MARCH 9

ET	Indicators	Unit	Reuters	Prior
02:45	FR Trade bal EUR	bln	-4.0	-4.27
04:30	GB Trade Balance GBP	bln	-7.00	-7.28
04:30	GB Trade Balance, Non-EU	bln	-3.40	-3.55
10:00	US IBD economic optimism	ind	-	46.8
17:00	US ABC CCI	ind	-	-49
18:50	JP Machinery orders	%	-4.1	20.1
18:50	JP Corp goods price m/m	%	0.1	0.3
18:50	JP Corp goods price y/y	%	-1.5	-2.1
19:01	GB RICS housing survey	Bal	30	32

MARKETS TODAY

TODAY'S TOP STORY: MetLife Inc pursued AIG's foreign life insurance business for two years before finally clinching a \$15.5 billion purchase that will give it beachheads in 47 nations from Peru to Bangladesh.

For more please [click here](#)

TREASURIES: Prices of U.S. government securities fell as investors prepared to absorb \$74 billion in debt scheduled to be auctioned this week, with Friday's better-than expected jobs report buoying hopes for an economic recovery and weighing on the market.

- 30-yr bond prices fell more than half a point to yield 4.68 pct.
- 10-yr notes were down 8/32 to yield 3.71 pct.
- 5-yr Treasury notes fell 2/32 yielding 2.36 pct while the 2-yr notes were unchanged to yield 0.9 pct.
- 2-10's part of the yield steepened by 3 bps to 282 bps.

FOREX: The euro was slightly up against the dollar as concerns about Greece's fiscal crisis eased after French President Nicolas Sarkozy said there are plans to support the debt-strapped country, if necessary.

- Euro remained unchanged at \$1.3629.
- The euro shed 0.2 pct at 123.04 yen, having hit a two-week high earlier. The dollar fell 0.18 pct to 90.28 yen.
- China re-pegged its exchange rate at 6.8266 yuan per dollar.
- Australian dollar rose 0.15 pct to \$0.9093, having earlier risen to its highest since Jan 21.

CORPORATES: U.S. corporate bonds spreads tightened as concerns about Greece's debt problems ease slightly on supportive comments from France and Germany.

- The CDX.IG-13 index tightened by about 3 bps to 83 bps.
- BofA launched \$2.5 bln of five-yr notes. The notes are expected to yield 215 bps over comparable Treasuries.
- DIRECTV Holdings launched \$3 bln of debt in a three part sale.
- Shinhan Bank, a unit of Shinhan Financial Group, sold \$700 mln senior unsecured notes.

STOCKS: Technology shares pushed the Nasdaq higher on an otherwise flat day for U.S. stocks, led by BlackBerry maker Research in Motion and Cisco Systems.

- Research in Motion shot up 5.6 pct to \$73.39 and Cisco systems rose 3.65 pct to \$26.13.
- Dow fell 0.13 pct to 10,552.59, S&P was down 0.02 pct to 1,138.48 and Nasdaq rose 0.25 pct to 2,332.21.
- Shares of AIG rose 3.38 pct to \$29.03 while Metlife rose 5.09 pct to \$40.90, McDonald's Corp advanced 2.28 pct to \$65.12.
- S&P financial index rose 0.15 pct, S&P technology index rose 0.33 pct.

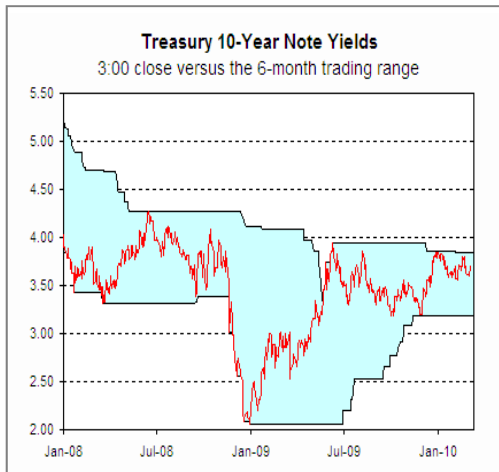
C & E: Oil rose toward \$82 a barrel in choppy trade as a firmer dollar and improved economic optimism tugged prices back and forth.

- U.S. crude prices rose 0.29 pct to \$81.74 per barrel, after hitting \$80.92, also the highest since Jan. 11.
- Gold fell 1.08 pct to \$1,121.55 an ounce.
- Reuters-Jefferies index shed 0.08 pct at 276.71.

- 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	0.110	0.075	0.112	0.004
3-Mo Bill	0.150	0.140	0.152	0.003
6-Mo Bill	0.200	0.195	0.203	0.002
1-Year	0.340	0.330	0.346	0.006
2-Year	99.953	99.984	0.900	0.008
3-Year	99.914	99.945	1.405	0.016
5-Year	100.094	100.133	2.355	-0.051
7-Year	99.203	99.250	3.128	-0.164
10-Year	99.281	99.344	3.712	-0.219
30-Year	99.203	99.281	4.675	-0.445

EQUITIES

	INDEX	CHANGE
DJIA	10560.00	-6.35
NASDAQ	2332.86	6.56
S&P 500	1139.10	0.39

OIL

	PRICE	CHANGE
NYMEX	81.8	0.3
BRENT	80.4	0.5

EURODOLLAR FUTURES

	CLOSE	CHANGE
Mar-10	99.738	0.003
Jun-10	99.635	0.010
Sep-10	99.430	0.005
Dec-10	99.130	0.005

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.220	O/N	0.230
2-Week	0.220	2-Week	0.240
1-Month	0.240	1-Month	0.260
3-Month	0.240	3-Month	0.270
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.230	10:00 AM	0.160
2-Week	0.240	3:00 PM	0.155
1-Month	0.250		
3-Month	0.250		

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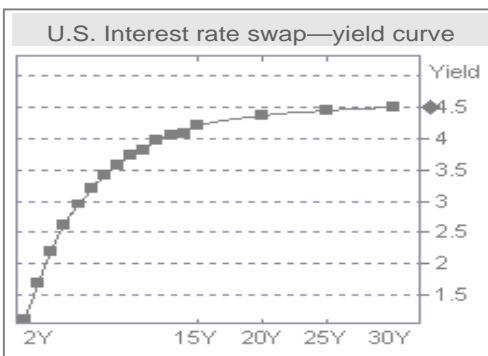
	SPREAD		RATE	
2-Year	21.00	25.00	1.10	1.12
3-Year	29.00	33.00	1.69	1.71
5-Year	25.75	29.75	2.61	2.61
7-Year	9.00	13.00	3.21	3.21
10-Year	2.75	6.75	3.74	3.72
30-Year	-17.25	-13.25	4.50	4.48

FUTURES

	PRICE	CHANGE
CBOT 5 yr	116.69	-0.05
CBOT 10 yr	118.36	-0.14
CBOT 30 yr	117.88	-0.31

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.170	0.200	-	-
1-Month	0.200	0.280	0.162	0.172
3-Month	0.220	0.400	0.175	0.185
6-Month	0.250	0.450	0.204	0.214
12-Month	0.600	1.000	0.357	0.367



CURRENCIES

	BID	ASK
Euro	1.3632	1.3634
Sterling	1.5072	1.5076
JP Yen	90.32	90.34
Swiss Franc	1.0730	1.0734
Can Dollar	1.0272	1.0278
Mexico	12.6716	12.6780

FED FUNDS NYFRSM - 10AM

Open	0.1700	1m	0.2156
High	0.2000	3m	0.2589
Low	0.1000		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1	04/04/2012	20	19	1.11
3-Year	1.75	22/02/2013	22	21	1.63
5-Year	2.875	09/02/2015	30	29	2.66
7-Year	5.125	18/10/2016	21	16	3.34
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	0	36.5	-

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	-2	-2.5	0.89
3-Year	1.625	15/04/2013	30.5	30	1.71
5-Year	2.625	20/11/2014	19	18	2.55
7-Year	5.25	15/09/2016	17.5	17	3.3
10-Year	3.75	27/03/2019	23	22	3.94
30-Year	6.25	15/07/2032	36.5	36	5.04

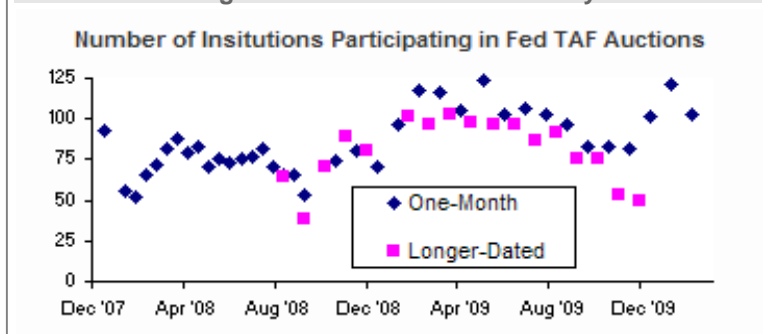
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.2200	105.2400	2.504
FHLMC	5.0	105.2200	105.2400	2.504

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.1600	105.1800	2.958
FHLMC	5.5	105.2800	105.3000	2.752
GNMA	5.5	106.0000	106.0200	3.436

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

MetLife seals Alico deal after two-year quest

MetLife Inc pursued AIG's foreign life insurance business for two years before finally clinching a \$15.5 billion purchase that will give it beachheads in 47 nations from Peru to Bangladesh.

The deal will help MetLife diversify revenue by product, distribution and geography.

MetLife said it would pay \$6.8 billion in cash and \$8.7 billion in equity for Alico, confirming an earlier Reuters report. For U.S. taxpayers, the deal will help them recover billions of their rescue funds, although they are probably still years away from untangling themselves totally from the once-mighty insurer.

With the AIA and Alico deals, AIG plans to repay the Federal Reserve Bank of New York about \$31.5 billion in cash, with more expected as it sells Prudential and MetLife securities over time. The proceeds should help the insurer pay down all of its New York Fed debt, but it will still leave the government holding roughly \$47 billion in equity investments, including the amount drawn under a \$30 billion equity line. The government also has a nearly 80 percent stake in AIG.

To exit from AIG completely, the government is likely to follow a strategy similar to what it has used with Citigroup Inc in a process that will probably take years.

New York Fed says to expand firms for reverse repos

The U.S. Federal Reserve is taking an additional measure to lay the groundwork to drain excess bank reserves, as it seeks to remove some of the \$1 trillion in cash it injected during the global credit crisis.

The New York Federal Reserve said it has begun a program to expand the number of firms for conducting reverse repurchase agreements, including domestic money market mutual funds.

It said the announcement should not be read as a signal for changes or timing in overall monetary policy.

The N.Y. Fed has not conducted reverse repos this year, though it did conduct small scale reverse repo tests late last year with primary dealers.

The New York Fed said its reverse repo program will be aimed at firms including domestic money market mutual funds that provide large amounts of short-term funding to financial markets.

EU set to discuss CDS speculation Mar. 16-sources

The European Union's executive and finance ministers are set to discuss possible ways to dampen speculation on sovereign CDS markets next week, two sources familiar with the situation said.

Greek debt has come under pressure as the country seeks to tackle a ballooning deficit and some politicians say CDS speculators are amplifying the country's problems.

A senior trading official expects the Commission to say it is studying CDS trading rather than bringing in an immediate ban on "naked" selling of CDS, where the buyer of a contract does not own any of the underlying asset it insures.

Greek Prime Minister George Papandreou said on Sunday that France, Germany and Eurogroup Chairman, Jean-Claude Juncker, were ready to announce measures to tackle market speculators abusing CDS in the next few days.

Britain is the EU's biggest CDS centre and a bloc-wide initiative from the Commission -- as opposed to one from euro zone countries -- would likely have a bigger impact.

Separately, the European Union's executive is considering a new rescue fund for euro zone countries to prevent future financial crises like that in Greece, a spokesman said.

Greek PM urges G20 effort to rein in speculators

Greek Prime Minister George Papandreou urged the Group of 20 nations to crack down on market speculators, warning that failing to do so could trigger another global financial crisis.

In a question-and-answer period after his speech, Papandreou blamed a lack of transparency about financial transactions for having aggravated Greece's financial woes.

Papandreou said Athens was not asking Europe to rush to the "aid of a reckless country" by helping Greece deal with its budget problems but warned the crisis could cause a domino effect, driving up borrowing costs for other countries with large deficits. Papandreou deplored the fact that the international community seemed "impotent" in dealing with complex, interrelated markets and urged the United States to join Europe in a coordinated bid to bring order to them.

Greek Prime Minister George Papandreou said that current borrowing by Greece at high rates of interest was unsustainable.

Meanwhile, Greece will not need foreign help to deal with its debt problems, central bank governor George Provopoulos said in a German newspaper interview released.

Separately, Portugal became the latest euro zone country to announce austerity measures to rein in a ballooning budget deficit as debt-stricken Greece urged global action to curb speculation in CDS.

FDIC's Bair eyes low interest rates, more lending

U.S. banking regulator Sheila Bair said that a low interest rate policy is "clearly appropriate" to get credit flowing, while also saying regulators should stop short of ordering banks to lend.

Bair has expressed frustration that creditworthy borrowers, including small businesses, cannot get loans.

Bair said there are plenty of instances of banks being too tight with credit, particularly large banks. She said a public spotlight needs to be shined on banks for having pulled back too far on credit.

U.S. bank regulators have repeatedly issued advisory notes to banks, urging them to extend prudent loans, but Bair said they should not mandate the activity.

Bair reiterated her priorities for financial reform, but said a regulatory overhaul will not be enough to rein in excesses.

She said the United States must examine policies that have skewed economic activities toward consumption and rapid growth in housing and the financial sector.

U.S. senators wrestle with Fed bank oversight issues

The Fed could retain oversight of large bank holding companies under a scaled-back regulatory reform plan being considered by key senators, but important questions remained unanswered, lobbyists said on Sunday.

It was still unclear, lobbyists said, if the Fed under the evolving plan would be an "umbrella supervisor," continuing to rely on other agencies for detailed bank exams, and how many companies might be put under the Fed. One option, they said, was to assign holding companies with assets of \$100 billion and up to the Fed, which would include nearly two dozen major firms.

Other, more expansive options were also being considered, with Senate Banking Committee Chairman Christopher Dodd expected to unveil legislation as soon as this week after months of negotiations with fellow Democrats and Republicans.

Separately, U.S. fiscal policy is on an unsustainable path of a huge budget gap that cannot be rectified by minor tinkering, a senior budget policy analyst said.



TODAY'S TOP NEWS

Dubai World deal hope lifts markets, divides creditors

Hopes of progress this week on Dubai World's \$26 billion debt restructuring lifted stocks and eased fears of default, but potential divisions emerged among creditors to the state-owned conglomerate.

Dubai World could put its plan to major creditors, which include HSBC and Standard Chartered, in London this week but was being delayed by efforts to value the assets of its Nakheel unit, builder of Dubai's palm-shaped islands, bankers said.

While some of the 97 creditors want to see the option of full repayment on the table, others are willing to take a "haircut" in order to get some money back fast, bankers said.

Dubai says the Dubai World plan will be fair, but Dow Jones has reported that creditors may get just 60 cents on the dollar.

Despite the potential divisions, hopes of progress in the talks cut the cost of insuring Dubai's debt against default and boosted Nakheel's 2011 bond.

Talk of China giving up on dlr is nonsense -banker

Any speculation that China might stop supporting the dollar in the next few years is absolute nonsense, a top state banker said.

Li Ruogu, chairman of Export-Import Bank of China, a lender tasked with supporting the country's foreign investments, said in a group interview that a collapse in the dollar's value would damage Chinese interests.

China should focus instead on trying to stabilize the dollar and on preserving its status as the leading global currency, said Li, a former deputy central bank governor.

China has \$2.4 trillion in official reserves and bankers believe about two-thirds of the total is invested in dollar assets.

Central bank governor Zhou Xiaochuan caused a stir a year ago by proposing that the SDR might eventually displace the dollar as the world's main reserve currency.

Separately, any rise in the yuan's exchange rate will be gradual, China's trade chief said in comments that underline the competing interests at the heart of Chinese policy-making.

Global growth robust, markets improving -Trichet

Global economic growth is robust and improving financial markets mean some policy stimulus can be withdrawn, top central bankers agreed.

But ECB President Jean-Claude Trichet said investors should not interpret the phasing out of non-standard measures as a signal for interest rate rises.

As economies recover from the crisis, major central banks have started to withdraw crisis measures introduced to support growth and Trichet said investors should not read into this any signal for rates, which remain at record lows in many regions.

Positives for growth included rebuilding of inventories although it was difficult to say whether this was permanent or not, Trichet said.

Separately, the financial crisis could evolve into a full-blown sovereign debt crisis if troubled countries do not get their public finances under control, ECB Executive Board member Juergen Stark said.

UK won't tighten liquidity rules on banks for now

Banks operating in Britain were given more breathing space when their regulator, the FSA, said it would not demand higher liquidity levels until the economy is recovering properly.

The FSA angered local banks last year by pushing ahead with a new liquidity regime requiring them to hold buffers of cash or highly-liquid assets like government bonds to withstand market shocks for a week or more without having to raise fresh capital.

It had been expected to ratchet up the requirements sometime this year, if economic recovery was assured but the bounce back has been anaemic. "The FSA believes that it would be premature to increase liquidity requirements across the industry at the current time. This position will be reviewed later on in the year with a further announcement in Q4, 2010," the FSA said in a statement. "Meanwhile, the FSA is continuing to work with firms that are most affected by the new regime focusing on the steps they are taking to mitigate liquidity risk and on the additional impact of our progressively tightening quantitative requirement," the FSA said.

NEXT UP

POLL-Most primary dealers see Fed rate hike this year

Most big banks that do business directly with the U.S. Federal Reserve said on Friday the U.S. central bank will raise benchmark interest rates this year and that the U.S. jobless rate has already peaked.

The poll was conducted after a government report showed U.S. employers cut fewer jobs than expected during snow-battered February and the unemployment rate held steady at 9.7 percent. The data did not prompt economists at the Fed's main dealing partners to change their outlook for Fed policy compared to a poll conducted on Feb. 19. The median forecast of dealers polled was still for a benchmark interest rate hike in the second half of 2010.

There were differing views as to how soon the Federal Reserve will raise rates after it removes from its policy statement its pledge to keep interest rates extraordinarily low for an extended period. The views ranged from shortly after to three quarters after.

Ten out of 16 dealers who responded to the question on when the Fed will remove its extended period pledge said the first half of 2010.

POLL-OPEC to keep oil production targets steady

OPEC will keep oil production targets on hold this month but could raise output later year as the world recovers from recession, pushing up demand for fuel, a Reuters poll showed.

Fourteen analysts were unanimous in saying the Organization of the Petroleum Exporting Countries would roll over its existing commitment to pump no more than 24.84 million bpd, equivalent to about 30 percent of global demand.

But most saw the chance of some increase in output this year, especially if oil prices rise from the \$70 to \$85 per barrel range seen for most of the last nine months.

Eight of 14 analysts said a change in OPEC output policy was possible this year, while six saw no change until 2011.

Benchmark U.S. light crude oil futures traded around \$82 per barrel on Monday, near the top of a price range that OPEC ministers have said is ideal for producers and consumers.

At this level, oil producers get a big enough margin to invest in new exploration and oilfield development but prices are not high enough to deter motorists and cut consumption.



DEEP DIVE Commentary and Analysis

ANALYSIS-Fed to linger in agency MBS market after exit

By Julie Haviv

Now that the U.S. Federal Reserve has nearly finished its massive mortgage bond buying spree, its huge portfolio could be used to tighten credit if and when the economy begins to show real signs of recovery.

After plowing billions per week into the \$5 trillion market for mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae since early 2009, the Fed ceases its \$1.25 trillion agency MBS purchase program at the end of March.

As overseer of the largest mortgage bond portfolio in the world, the central bank itself has indicated it wants to steer clear of selling agency MBS outright, at least for now.

"Selling agency MBS could be a useful tool, but it would also be outright reckless," said Christopher Sebald, chief investment officer at Advantus Capital Management in St. Paul, Minnesota.

Unloading its holdings would pressure the sector considerably and de-value the rest of its agency MBS holdings. By sending yields higher, it would negate the purpose of the purchase program, which was to bring down mortgage rates and to stimulate the battered housing sector and the overall economy.

Analysts say the Fed will likely initiate passive and active strategies to maneuver its balance sheet and may not sell MBS holdings until 2011, at the earliest.

The Fed is seen holding onto its agency MBS portfolio, letting the bonds mature and pay down over time. The bonds, meanwhile, could be exchanged with big U.S. banks for an interim period as a way to pull cash out of the economy.

REPOS AND ROLLS

Most experts believe the Fed will begin to drain liquidity from the financial system in the second half of the year.

Mukul Chhabra, vice president in the mortgage strategy group at Credit Suisse in New York, said the Fed could initially drain reserves through "reverse repos."

In this transaction, the Fed would take cash from the dealer community in exchange for its agency MBS holdings. The Fed later buys back the bonds at a specified time, typically one month later.

Dealer balance sheet constraints, however, may limit the total size of such a program to about \$100 billion, which is small compared to what it has in reserves, Chhabra said.

The Fed could also initiate a similar transaction in "dollar rolls." The Fed would deliver securities to a dealer and agree to repurchase similar securities on a future date at a predetermined price, but unlike a reverse repo, the dealer is not obligated to return the identical securities to the Fed.

Dollar rolls have a direct impact on agency MBS valuations. When rolls trade poorly, agency MBS tend to cheapen. In fact, one reason agency MBS have performed so well over the past year has been due to the strength in dollar rolls.

Chhabra said the Fed could sell dollar rolls to banks with the dealers as intermediaries. This would not use dealer balance sheets, and banks buying dollar rolls should not face significant accounting/regulatory constraints with respect to their own balance sheets.

The dealers could distribute the Fed dollar roll sales of \$200 to \$300 billion based on an estimated \$1 trillion market size currently, he said.

The dollar roll market is also not new to the Fed. In fact, the Fed has been involved in the dollar roll market throughout much of 2009 and 2010, not for monetary policy reasons, but more likely as an attempt to support the market.

To be sure, the dollar roll market is huge and would be a good tool for the Fed, Matthew Jozoff, managing director and head of

mortgage strategy at JPMorgan in New York, said in the firm's 2010 outlook.

The Fed has ample room in the dollar roll market to maneuver given the size of that market, he said.

FED RETURN UNLIKELY

The lowest mortgage rates in decades and high affordability helped the hard-hit housing market find some footing last year after a three-year slump, but the sector remains highly vulnerable to setbacks and heavily reliant on government intervention. Recent data on new and existing home sales point to a sector that is still struggling. If mortgage rates jump significantly after the agency MBS purchase program ends, the Fed could re-enter the market, but its imminent exit is probably permanent.

"While there are extreme cases in which the Fed could grow the program again, we find that scenario unlikely," Jozoff said.

Some Fed officials have said they want an eventual return to holding U.S. Treasuries as the primary asset.

Prior to 2009, the Federal Reserve had never purchased agency MBS, so its presence in this market has been significant. Commercial banks own about 21 percent of the market. Money managers, insurance companies and indexed pension funds own around 18 percent, while government-sponsored enterprises own about 15 percent.

Brett Rose, head of agency MBS strategy at Citigroup in New York, said the Fed could reinvest paydowns back into the agency MBS market, but does not believe that will happen.

"When it comes down to it, the agency MBS market does not need another trillion dollar buyer," he said.

While the Fed has been a substantial market player, it has cut weekly purchases down substantially in recent months. Other investors, particularly banks, will probably step in to fill the demand for mortgages.

Credit Suisse's Chhabra said the Fed will probably eventually seek to sell some of its holdings down the road.

"That is a possibility, but definitely not this year, perhaps next year, at the earliest," he said.

FX COLUMN-Stars may realign for yen selling intervention

By Neal Kimberley

While the Bank of Japan (BOJ) has not intervened in the currency markets since 2004, the need to be seen to combat deflation could trigger a re-think in the new Japanese financial year beginning in April.

Of course the idea is an absolute outlier and to date there has been no hint that any such course is being contemplated.

But in any battle against deflation, unsterilized foreign exchange intervention is an effective policy tool since it expands the supply of money. The Swiss National Bank (SNB) has justified its own currency intervention by explicitly presenting its efforts to curb Swiss franc gains as a complement to easy monetary policy.

The SNB's explanation of its policy has re-established a clear linkage between foreign exchange intervention and monetary policy objectives that could be conscripted to justify any future Japanese action.

On the issue of monetary policy, it is noticeable that the domestic political emphasis on combating Japan's deflation has been growing in recent weeks.

Finance Minister Naoto Kan said on Tuesday he hoped the BOJ would take appropriate steps to pull the country out of deflation and that he wants prices to rise above zero, if not more, in 2010.

By Friday, Kan was saying the Bank of Japan may be considering more easing measures after the government had requested



DEEP DIVE Commentary and Analysis

additional efforts. Sources familiar with the BOJ's thinking ventured that the central bank would indeed this month debate a further easing of its already ultra-loose monetary policy.

If such policy measures prove insufficient, it is possible that the option of foreign exchange intervention could be seen as the weapon of last resort.

While many would scoff at such an idea given the six-year gap since the BOJ was last active, the Japanese government itself has sent a signal that could at least be interpreted as a greater readiness for currency intervention.

Japan on Thursday raised its borrowing limit for foreign exchange intervention for the first time in six years. Under its fiscal 2010/11 draft budget, Japan will raise the borrowing ceiling for its foreign exchange special account, the war chest it uses for yen-selling currency intervention, by 5 trillion yen (\$55.5 billion) to 145 trillion yen.

If the Ministry of Finance were to authorize currency intervention via the Bank of Japan, the Japanese government would certainly give advance warning to the United States.

In the recent past the U.S. administration would likely have opposed a policy that would artificially support or inflate the value of the dollar against the yen.

But circumstances may be changing.

Recent purported Chinese disinvestment from U.S. assets meant that in the December U.S. Treasury Department international capital (TIC) data, Japan was the biggest holder of U.S. assets with \$768.8 billion.

Japan's position as a key ally of the U.S. is re-emphasized.

At the same time, there is a chance that a foreign policy issue

which has clouded Japan-U.S. relations might finally be being addressed.

During his successful 2009 election campaign Prime Minister Yukio Hatoyama raised the hopes of many in Okinawa that the U.S. Marines' Futenma airbase could be moved off the island.

Washington wants to stick to a 2006 deal to shift the facility to a less crowded spot on northern Okinawa.

On Friday a party elder of Hatoyama's ruling Democratic Party of Japan, Koza Watanabe, argued that the Prime Minister may have to resign if the Okinawa issue is not resolved before the end of May. Watanabe believes that with a self-imposed deadline the premier could solve the problem.

If a face-saving solution to this issue can be brokered, the United States might look more benignly on any future Tokyo request regarding currency intervention linked to the battle against Japanese deflation.

With EUR/JPY hovering just above 120 yen, a long way below the 170 yen highs of July 2008, European objections would probably be muted.

Seoul could scarcely interject given that the Bank of Korea is already said to be intervening to temper the appreciation of the won against the dollar.

As Japan struggles with resurgent deflation all policy tools need to be considered. In the new Japanese financial year this might ultimately include currency intervention. The idea should not be dismissed out of hand.

-- Neal Kimberley is an FX market analyst for Reuters. The opinions expressed are his own --

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