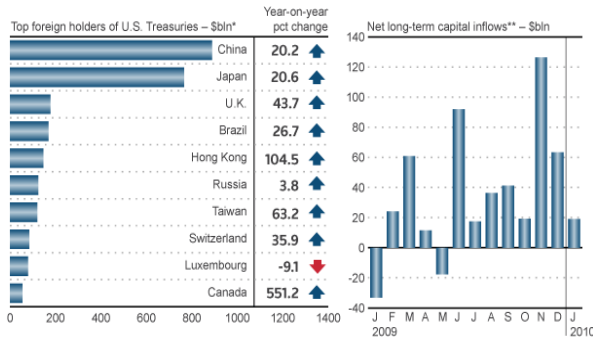


CHART OF THE DAY

Foreign holders of U.S. Treasuries



China remained the largest single holder of U.S. government debt, with \$889 billion in hand in January, down from \$894.8 billion in December. Japan was second with \$765.4 billion compared with \$765.7 billion the prior month.

TODAY'S TOP NEWS

- U.S. Sen Dodd boosts Fed in new financial reforms
- Snowstorms curb U.S. industrial output, rebound seen
- China yield curve steepens; eyes inflation risks
- U.S. lawmakers press for action on China currency
- U.S. suffers net capital outflow in January
- EU exec to put Greek plan to finmins, Germany doubtful
- Short-term rates attuned to Fed meeting Tuesday

ECON WATCH

FOR TUESDAY MARCH 16

ET	Indicators	Unit	Reuters	Prior
03:45	FR HICP final mm	%	0.3	-0.2
05:00	IT HICP final mm	%	0.0	-1.5
05:00	IT CPI final mm	%	0.1	0.1
06:00	EZ Inflation, final mm	%	0.3	-0.8
06:00	EZ Inflation, final yy	%	0.9	1.0
06:00	EZ Infl ex food & energy mm	%	0.4	-1.3
06:00	EZ Infl ex food & energy yy	%	0.8	0.9
06:00	DE ZEW econ sentiment	ind	43.7	45.1
06:00	DE ZEW current conditions	ind	-52.0	-54.8
08:30	US Housing starts	mln	0.57	0.591
08:30	US Building permits: number	mln	0.61	0.622
08:30	US Import prices mm	%	-0.2	1.4
08:30	US Export prices mm	%	0.3	0.8
08:30	CA Labor Productivity Rate	%	0.8	-0.2
08:30	CA Manufacturing sales mm	%	0.5	1.6
14:15	US FOMC rate decision	%	0.00	0.25
-	JP BOJ 2-day meet starts			

MARKETS TODAY

TODAY'S TOP STORY: The Federal Reserve would gain new powers over non-bank financial firms and keep much of its authority over banks under a new bill on financial regulatory reform unveiled by the chairman of the U.S. Senate Banking Committee, Christopher Dodd.
For more please click here

TREASURIES: U.S. Treasuries were little changed, as investors moved to the sidelines before a Federal Reserve policy meeting in uncertainty over what the central bank may signal about its exit strategy.

- 30-yr bonds fell 5/32 to yield 4.63 pct.
- 10-yr Treasury notes were down 1/32 to yield 3.71 pct.
- 5-yr notes were unchanged at 2.41 pct.
- 2-yr notes rose 1/32 to yield 0.94 pct.

FOREX: The euro fell against the dollar, weighed down by a lack of concrete progress on a financial aid package for debt-strapped Greece.

- Euro shed 0.75 pct at \$1.3672, retreating from a four-week high just shy of \$1.3800 hit on Friday.
- The euro was down 0.31 pct at 1.4524 francs, Earlier it hit a low of 1.4509 Swiss francs, its weakest level in more than 16 months.
- Dollar was down 0.17 pct to 90.5 yen while the euro fell 0.92 pct to 123.75 yen. The sterling fell 0.81 pct to \$1.505.

CORPORATES: U.S. corporate bond spreads were unchanged to slightly wider as slow trading ahead of a Federal Reserve interest rate decision brought last week's rally to a pause.

- The CDX.IG-13 index widened by about 1 bps to 84 bps.
- Spreads hit their tightest level in over two years on Friday after narrowing by 6 bps on the week to about 174 bps over Treasuries.
- With the market on hold ahead of the Fed decision, the pace of new issuance is expected to slow to about \$15 bln this week from last week's \$28 bln.

STOCKS: U.S. stocks were little changed as a late rebound in financial stocks offset nagging worries the Chinese government may tighten credit, a move that could slow growth in the global economy.

- Dow rose 0.16 pct to 10,641.85, S&P was up 0.05 pct to 1,150.51 and Nasdaq shed 0.23 pct to 2,362.21.
- The KBW Banks index rose 0.20 pct while JPMorgan Chase lost 0.19 pct to \$43.07.
- Consol Energy Inc tumbled 10.09 pct to \$48.85 after they agreed to buy the Appalachian natural gas properties of Dominion Resources Inc for \$3.48 bln in cash.
- S&P financial index fell 0.08 pct, S&P energy index was down 0.96 pct.

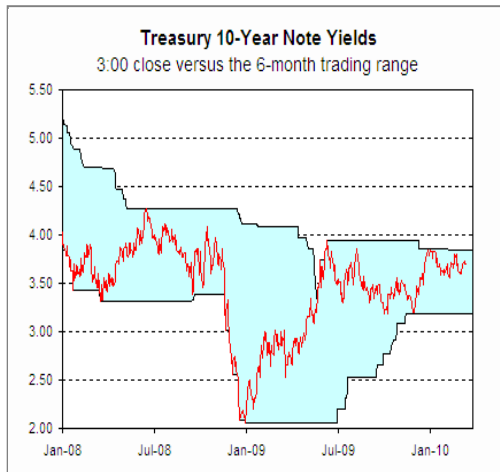
C & E: Oil prices fell nearly 2 pct to below \$80 a barrel, pressured by a stronger dollar and concerns that potential credit tightening in China might curb energy demand in the world's second-largest oil consumer.

- U.S. crude prices shed 1.64 pct to \$79.91 per barrel.
- Gold was up 0.62 pct at \$1,106.35 an ounce.
- Reuters-Jefferies index fell 0.92 pct to 270.79.

- 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	0.115	0.085	0.117	0.008
3-Mo Bill	0.150	0.140	0.152	0.008
6-Mo Bill	0.230	0.220	0.233	0.008
1-Year	0.398	0.393	0.404	-0.004
2-Year	99.852	99.883	0.952	0.039
3-Year	99.641	99.672	1.499	0.039
5-Year	99.836	99.883	2.411	0.008
7-Year	99.078	99.125	3.148	0.000
10-Year	99.328	99.391	3.706	0.000
30-Year	99.828	99.906	4.635	-0.078

EQUITIES

	INDEX	CHANGE
DJIA	10609.12	-15.57
NASDAQ	2353.53	-14.14
S&P 500	1146.33	-3.66

OIL

	PRICE	CHANGE
NYMEX	79.8	-1.4
BRENT	77.4	-2.0

EURODOLLAR FUTURES

	CLOSE	CHANGE
Mar-10	99.743	0.005
Jun-10	99.615	0.000
Sep-10	99.440	0.040
Dec-10	99.145	0.050

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.300	O/N	0.300
2-Week	0.250	2-Week	0.250
1-Month	0.250	1-Month	0.280
3-Month	0.250	3-Month	0.300
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.300	10:00 AM	0.220
2-Week	0.250	3:00 PM	0.210
1-Month	0.280		
3-Month	0.300		

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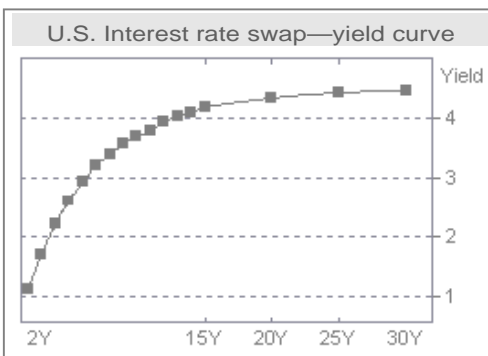
	SPREAD		RATE	
2-Year	18.00	22.00	1.12	1.15
3-Year	22.75	26.75	1.72	1.74
5-Year	22.75	26.75	2.63	2.64
7-Year	7.50	11.50	3.22	3.21
10-Year	1.75	5.75	3.72	3.71
30-Year	-16.50	-12.50	4.47	4.44

FUTURES

	PRICE	CHANGE
CBOT 5 yr	116.38	0.00
CBOT 10 yr	118.13	-0.13
CBOT 30 yr	118.22	-0.25

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.220	0.250	-	-
1-Month	0.200	0.280	0.191	0.201
3-Month	0.230	0.400	0.199	0.209
6-Month	0.330	0.450	0.227	0.237
12-Month	0.650	1.000	0.379	0.389



CURRENCIES

	BID	ASK
Euro	1.3669	1.3672
Sterling	1.5043	1.5048
JP Yen	90.46	90.48
Swiss Franc	1.0623	1.0626
Can Dollar	1.0205	1.0210
Mexico	12.5564	12.5652

FED FUNDS NYFRSM - 10AM

Open	0.2200	1m	0.2175
High	0.2500	3m	0.2612
Low	0.2000		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1	04/04/2012	13	11.5	1.1
3-Year	1.625	15/04/2013	24	21	1.75
5-Year	2.875	09/02/2015	24	23.5	2.66
7-Year	5.125	18/10/2016	18	0	3.35
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	38	0	5.02

ACTIVE FREDDIE MAC AGENCIES

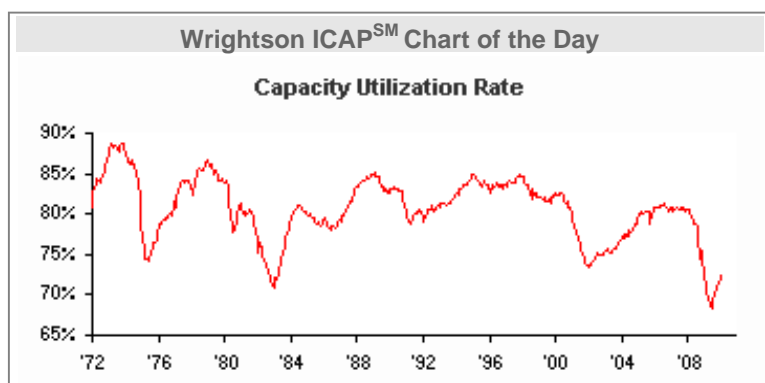
TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	-4	-7	0.92
3-Year	1.75	07/05/2013	27	26	1.78
5-Year	2.625	20/11/2014	14	13	2.55
7-Year	5.25	15/09/2016	16.75	16.25	3.32
10-Year	3.75	27/03/2019	20	19.5	3.93
30-Year	6.25	15/07/2032	36.5	34.5	5

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.2230	105.2270	2.997
FHLMC	5.0	105.2220	105.2260	2.958

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.1700	105.2000	3.038
FHLMC	5.5	105.2800	105.3000	2.894
GNMA	5.5	106.1300	106.1400	3.304



TODAY'S TOP NEWS

U.S. Sen Dodd boosts Fed in new financial reforms

The Federal Reserve would gain new powers over non-bank financial firms and keep much of its authority over banks under a new bill on financial regulatory reform unveiled by the chairman of the U.S. Senate Banking Committee, Christopher Dodd. Senator Richard Shelby, the top Republican on the Senate Banking Committee, said in an interview with CNBC before the bill was unveiled that Dodd will need "a lot of Republican help" to get financial reform approved in the Senate. Any bill that emerges from Dodd's committee would need 60 votes in the Senate to overcome procedural roadblocks that are sure to be thrown up by Republicans; the Democrats control only 59 seats. Dodd's new legislative proposal would create a new framework for dealing with big firms that could threaten the stability of the financial system if they became troubled.

Dodd's bill would create a systemic risk council and allow the Fed, with the council's approval, to order the break-up of large financial firms judged to pose a threat to the stability of the financial system. The bill also contains a version of what has been dubbed the "Volcker rule" that would require regulators to establish rules to prohibit proprietary trading at banks, and bank sponsorship of hedge funds and private equity funds.

China yield curve steepens; eyes inflation risks

China's bill and bond curves steepened in what traders viewed as a bottoming out of long-term yields as the market's attention turns to risks of inflation and concern over monetary policy tightening.

Speaking to reporters at a news conference to mark the end of China's annual parliament meeting, Premier Wen Jiabao reiterated on Sunday that China must balance growth and inflation targets. Traders said the comments suggested China was still on course to normalise its ultra-loose monetary policy, which would help longer-term bond yields to rise a few basis points in coming days after dropping in previous months.

The central bank may step up efforts to drain excess funds in its open market operations or raise banks' reserve ratios in coming weeks and the market is wary of the possibility that March economic data could confirm that an interest rate hike is drawing closer, traders said. The indicative five-year government bond yield fell to 2.7539 percent bid on Monday from 2.7573 percent on Friday but the 10-year yield rose to 3.4318 percent from 3.4145 percent, according to Reuters Reference Rates.

U.S. suffers net capital outflow in January

Foreign investors, led by central banks, were net sellers of all U.S. securities in January but continued to buy U.S. Treasuries, the Treasury Department said.

China remained the largest single holder of U.S. government debt, with \$889 billion in hand in January, down from \$894.8 billion in December. Japan was second with \$765.4 billion compared with \$765.7 billion the prior month.

Net outflows from all U.S. securities, including short-term instruments such as Treasury bills, totaled \$33.4 billion in January, reversing a \$53.6 billion inflow seen in December. Official investors -- primarily central banks worldwide -- were the biggest sellers, unloading a record net \$34.1 billion, the most since they sold \$26.3 billion in September 1998 following financial crises in Asia and Russia. Long-term securities saw a net inflow of \$19.1 billion, though that was below December's \$63.3 billion tally. Overseas investors were net buyers of Treasuries to the tune of \$61.4 billion, down from \$69.9 billion in December, but official investors sold a net \$4.2 billion.

Snowstorms curb U.S. industrial output, rebound seen

U.S. industrial production braked sharply in February, held back by severe winter storms that slammed parts of the country, while manufacturing activity in New York state stalled this month. While U.S. manufacturing output fell in February, it rose outside of the auto sector, and mining activity posted a strong gain. In addition, factory employment, shipments and unfilled orders in New York state all rose this month.

The Fed said industrial output edged up 0.1 percent last month after increasing 0.9 percent in January, in line with market expectations. They blamed the slowdown on inclement weather.

The report also showed the amount of the nation's industrial capacity in use hit the highest level in more than a year.

Separately, the NY Fed said its March manufacturing activity in New York state slipped to 22.86 from 24.91 in February. Markets had expected the measure to fall to 22.00. In addition to inclement weather, industrial production last month was curbed by a steep drop in motor vehicle output. Manufacturing dipped 0.2 percent after growing 0.9 percent in January. Mining increased 2.0 percent, adding to the 1.1 percent rise in January, while utilities gained 0.5 percent after a 0.6 percent rise.

Capacity utilization inched up to 72.7 percent, the highest since December 2008, from 72.5 percent in January.

U.S. lawmakers press for action on China currency

President Barack Obama faced growing congressional pressure to get tough with China over its currency practices, one day after Chinese Premier Wen Jiabao brushed off accusations that Beijing was undervaluing its currency for an unfair trade advantage.

The lawmakers' letter showed the pressure Obama faces to push China to revalue its currency, which many U.S. lawmakers believe is to blame for lost manufacturing jobs and the huge U.S. trade deficit with China.

The lawmakers urged the Commerce Department to make a major policy change and agree to impose "countervailing duties" on a case-by-case basis against countries that manipulate their currency for an unfair trade advantage.

Separately, Chinese Premier Wen Jiabao on Sunday spurned foreign calls for the yuan to rise and showed no let up in scolding the United States over recent bilateral tensions. Wen said calls from the United States and other big economies for China to lift the value of its yuan currency were unhelpful, even protectionist, and vowed that Beijing will steer its own way on currency reform through a risk-filled economic landscape.

EU exec to put Greek plan to finmins, Germany doubtful

The European Union's executive said it was ready to propose a framework that could be used to aid Greece, despite signs of continuing reluctance from France and Germany to make concrete commitments.

Ministers were expected to discuss the possibility of providing loan guarantees or bilateral loans to help Athens finance its debts if needed, but officials signaled no figure would be put on the amount of help that could be extended.

European Monetary Affairs Commissioner Olli Rehn confirmed the Commission had succeeded in drawing up proposals for a mechanism that could be put to a meeting of the euro zone's 16 finance ministers in Brussels.

Meanwhile, French Economy Minister Christine Lagarde urged Germany in an interview published to expand domestic demand because its large trade surplus threatened the competitiveness of other euro zone economies.



TODAY'S TOP NEWS

Short-term rates attuned to Fed meeting Tuesday

The U.S. Federal Reserve's policy meeting on Tuesday is the main event for short-term money markets this week. Investors are focused on whether the central bank still plans to keep interest rates exceptionally low for an extended period. Apprehension ahead of the meeting has seen three-month dollar Libor rise to a 3-1/2 month high. While no one expects the Federal Reserve to raise interest rates any time soon, it has been unwinding some extraordinary measures put in place during the financial crisis. Recent remarks by Fed officials appear to argue the central bank will renew its commitment to exceptionally low rates for a prolonged period. The frozen Greek repo market showed the first tentative signs of improvement, a leading broker said, as euro zone finance ministers met with potential aid for Greece topping their agenda. The Greek repo market stalled several weeks ago, as concerns over the indebted country saw its bond yields soar and counterparty credit lines to its banks disappear.

Euro zone Q4 employment falls, points to weak growth

The euro zone lost 347,000 jobs in the last quarter of 2009, data showed, as the 16-country area's economic recovery remained beset by fragility. The number of employed fell 0.2 percent in the final three months of the year against the previous quarter to 144.3 million, pulled down by job losses in the industrial sector, Eurostat said. Employment during the fourth quarter fell 2.0 percent year-on-year. The euro zone's GDP grew by 0.1 percent in last year's final three months against the third quarter and contracted by 2.1 percent from a year earlier. Eurostat said employment fell 1.1 percent quarter-on-quarter in manufacturing, 0.4 percent in construction, 0.5 percent in trade, transport and communications and 0.1 percent in the financial sector. Employment in the public sector, health care and administration increased 0.2 percent. The steepest drops were registered in Greece and Spain, both at 0.8 percent. The euro zone's unemployment stayed flat in January from the previous month at 9.9 percent.

Triple-A rated governments safe but risks grow-Moody's

The credit ratings of the world's four largest triple-A sovereign debt issuers as well as Spain are safe but risks to their blue-chip status have grown, a report from Moody's Investors Service said. For the United States, UK, France and Germany, as well as Spain and less fiscally-challenged Denmark, Finland, Norway and Sweden, the quarterly Aaa Sovereign Monitor report concluded that government ability to manage the debt was the deciding factor in keeping their Aaa status. Moody's said there are concerns about how governments will handle improved economic conditions and the unwinding of aggressive expansionary fiscal and monetary policies. A separate report showed, Britain's economy may contract again for one quarter, but is unlikely to return to recession, Bank of England policymaker Kate Barker was quoted as saying in an interview published over the weekend.

Japan gov prods BOJ for action, yen may be the target

Japan's government kept up pressure on the central bank to loosen monetary policy even as it upgraded its assessment of the economy for the first time in eight months. It reiterated in a monthly economic report that deflation posed a risk to Japan and repeated its call for the Bank of Japan to support the world's second-biggest economy, a modest upgrade from "picking up" or showing "signs of picking up" contained in reports back to July. Finance Minister Naoto Kan said the Bank of Japan understood the government's expectations. A strong currency also makes import prices cheaper, so can add to deflationary pressures. Kan seemed to underline that the currency was in the government's cross-hairs by saying on Monday that the euro's woes could affect it. Separately, Japan Post Bank bought about 300 billion yen (\$3.3 billion) in U.S. Treasuries in October-December, the first time it has purchased U.S. government debt since the start of its privatisation process in October 2007, the Nikkei business daily said.

NEXT UP

U.S. housing starts, building permits seen down in Feb

The median forecast for U.S. housing starts is for a drop of about 3.6 percent to a seasonally adjusted annual rate of 570,000 units in February from 591,000 units the previous month. Forecasts from 73 economists ranged from a drop to 500,000 units to a rise to 600,000 units. The median forecast for U.S. building permits is for a drop of about 1.9 percent to a seasonally adjusted annual rate of 610,000 units in February from 622,000 units the previous month. Forecasts from 51 economists ranged from a drop to 580,000 units to a rise to 640,000 units. U.S. housing starts likely decreased in February, largely due to harsh winter weather and lower demand. New building permits are also seen falling in response to slower new homes sales. Sales of newly built U.S. single-family homes plunged to a record low in January, according to the Commerce Department. The federal government's \$8,000 first-time home buyer tax credit and a \$6,500 credit for home owners buying a new residence will soon expire. Eligible borrowers must sign contracts by April 30 and close loans by June 30.

Funds of hedge funds see no big portfolio changes in Q2

Funds of hedge fund managers do not plan huge changes to their portfolios in the next quarter, a Reuters poll shows, but fewer funds are likely to deliver average returns than was expected three months ago as equity markets have cooled. Reuters' quarterly survey of 10 managers who invest in a basket of hedge funds with combined assets of over \$80 billion showed 11 of 15 major strategies covered were expected to deliver at least average returns in the first or second quarters. That compares to 14 of 15 in a December survey, but is a huge leap from the three of 15 seen in a poll taken in February last year when the global recession was causing mayhem in markets. Just two of 15 strategies are seen giving above average returns -- global macro and distressed debt - compared to four of 15 in last quarter's survey as the hefty gains made during the rebound peter out. The dominant investment strategy continues to be global macro funds -- which aim to profit from betting on the direction of markets, currencies and debt -- but riskier, and more profitable, strategies such as distressed debt are emerging.



DEEP DIVE Commentary and Analysis

ANALYSIS-Could Lehman be Ernst & Young's Enron?

By Emily Chasan

Ever since the fraud at U.S. energy trader Enron Corp brought down accounting firm Arthur Andersen eight years ago, global auditing firms have worried that a major misstep could be fatal.

Over the past few years, the firms have pushed for liability caps on litigation and settled dozens of cases, all amid concerns that each of the "Big Four" accounting firms faces potential litigation from undetected frauds at large public companies that could destroy them.

Ernst & Young became the latest auditor to come under fire this week after the court-appointed examiner in the Lehman Brothers Holdings Inc bankruptcy said the audit firm did not challenge accounting gimmicks that allowed Lehman to hide some \$50 billion in assets in 2008, while claiming it had reduced its overall leverage levels.

"As an auditor, you're always concerned when you're auditing a large company that ultimately fails," said Lynn Turner, a managing director in the forensic accounting practice at consulting firm LECG and former chief accountant of the Securities and Exchange Commission.

"But a lot of those do occur where the auditors come out OK and the auditors aren't at risk -- obviously in this case the examiner thinks differently," Turner added.

At issue is a repurchase and sale program called Repo 105, which Lehman used without telling investors or regulators, and the examiner concluded was used for the sole purpose of manipulating Lehman's books.

In the examiner's report Lehman executives described the Repo 105 as everything from "window dressing" and an "accounting gimmick" to a "drug."

According to the examiner's report, Ernst & Young's lead partner on the Lehman audit said the firm did not "approve" the Repo 105 accounting policies, but rather "became comfortable" with its use.

Lehman, which filed the largest U.S. bankruptcy case in history on Sept. 15, 2008, is likely to use some of the examiner's claims to pursue lawsuits against those it believes are responsible for the investment bank's collapse.

"This is like the horses getting out of the starting gate on the track -- the lawyers are going to sue the pants off anyone and everybody involved," said Anthony Sabino, a securities law professor at St. John's University's Tobin School of Business.

Bryan Marsal, chief executive of Lehman Brothers Holdings Inc and co-founder of restructuring firm Alvarez & Marsal, said through a representative that Lehman "will carefully evaluate it in the coming weeks to assess how it might help us in our ongoing efforts to advance creditor interests."

Lehman's examiner, Anton Valukas, found the repo transactions to be partly responsible for Lehman's demise, and said Lehman may have "colorable claims" against Ernst & Young for failing to notice that the repos lacked a business purpose.

Auditors are supposed to "look at the substance" of such transactions in addition to seeing whether they have actually complied with U.S. accounting rules, Turner said, noting that he has not seen anything that would prove to him that the Repo 105 transactions complied with U.S. Generally Accepted Accounting Principles.

Ernst & Young said in a statement: "Our last audit of the company was for the fiscal year ending November 30, 2007. Our opinion indicated that Lehman's financial statements for that year were fairly presented in accordance with Generally Accepted Accounting Principles (GAAP), and we remain of that view."

"After an exhaustive investigation the examiner made no find-

ings in his report that Lehman's assets or liabilities were improperly valued or accounted for incorrectly in Lehman's November 30, 2007, financial statements."

According to the examiner's report, Ernst & Young had just started planning for its year-end audit of Lehman, when the firm collapsed into bankruptcy.

"They are going to say, hey, we got hoodwinked like everybody else," Sabino said.

"They've got defenses. For the directors and the officers, they're in a much tougher spot."

But most troubling for the auditors could be allegations in the examiner's report that Ernst & Young did not inform the audit committee on Lehman's board about a whistleblower who had expressed concerns about the repos to them.

For Ernst & Young, the firm has previously faced similar allegations that it failed to notify a board of directors when it discovered potential problems in a tangle with U.S. securities regulators over its audits of health club operator Bally Total Fitness.

In December, the Big Four firm agreed to pay the U.S. Securities and Exchange Commission an \$8.5 million fine, one of the highest settlements ever paid by an accounting firm.

Fines are not the only cost the firm might face, however.

"If nothing else, it's perception -- this is going to cost them a whole lot in legal fees, and it's damaging to their reputation," Sabino said.

ANALYSIS-Greek crisis may wound southeast Europe

By Sam Cage and Radu Marinus

The Greek debt crisis is poised to undermine already dwindling investment flows into south-eastern Europe's emerging economies, adding to barriers to recovery in one of the continent's most fragile regions.

Greek lending in central and eastern Europe is concentrated mainly in Romania and Bulgaria, both struggling to recover from sharp economic contractions and most exposed to any scaling back in funding as Greece's banks shore up their own finances.

Greece has been a major investor in the region -- it is the second biggest in Serbia -- since the fall of communism in 1989. Its problems have so far had only a limited impact on nearby states and it is unclear how much of a drag it may create.

But the European Bank for Reconstruction and Development warned last week of potential hits to bank systems and economies and analysts have also raised concerns.

Greek firms are also not expected to invest heavily in their usual target areas as they digest severe government cost cuts at home, while simple proximity to a country that has become the latest trouble spot on investors' radar may also be an issue.

"I think there's a very real risk, actually," said Capital Economics analyst Neil Shearing. "You may not get wholesale retreats from Romania and Bulgaria but you're not going to get an increase in flows, certainly."

By comparison, Greek banks and firms have little major activity in the European Union's emerging states further north and West like Poland, Hungary and the Czech Republic.

LENDERS ACHING

A 50-plus-percent spike in bank loan growth helped Romania's economy double in size from 2004 to 2008 and a similar trend gave Bulgaria a big boost, but that rate of expansion has fallen to near zero in both states and is not expected to return soon.

Mired in recession, they need foreign investment to kick-start recovery. But, since a string of downgrades to Greece's credit rating by rating agencies, banks are not likely to expand their loan books abroad this year.

Greek banks make up four of Bulgaria's top 10 and three of



DEEP DIVE Commentary and Analysis

Serbia's. Two of Romania's top 10 are Greek and they account for 15 percent of banking assets. For Bulgaria, it is 30 percent, and its central bank governor has moved to quash government concerns about a possible liquidity drain.

In Serbia, Greek banks control more than 15 percent of assets, and even though the central bank says Athens' woes are not a problem, banking sources say officials are keeping a close eye on Greek lenders.

"We could see some more cautiousness when it comes to extending credit action, which already is at a very low level," said BNP Paribas FX strategist Bartosz Pawlowski.

"It will be something that will delay credit growth which in turn will delay economic recovery."

Greece's troubles are too recent to show up in actual data, analysts say, and some Austrian banks like Erste have suggested they could plug any gaps left by loan declines by Greek or other lenders that have been hit by the crisis.

But last year's data showed a push by Erste for more market share in Romania, where it is by far the biggest foreign-owned lender, raised its loan levels only marginally, to 11.2 billion euros, from 10.9 billion a year earlier.

The uncertainty is shown in analyst ratings on Greek banks -- Goldman Sachs has "sell" recommendations on Bank of Piraeus and National Bank of Greece. Other Greek operators in south-east Europe include Alpha Bank, EFG Eurobank and Emporiki.

FDI STIFLED

Another problem is foreign investment in general. In Romania, it almost halved to 4.9 billion euros in 2009, from 9.5 billion a year earlier. Greece ranked sixth in FDI at the end of 2008, with a share of 6.5 percent.

Investment from Greece to Bulgaria also plummeted last year to just 48.5 million euros in 2009, or around 2 percent of FDI, from around 7 percent, or 400 million a year earlier.

In Serbia, FDI fell 60-70 percent last year to 1.5 billion euros, and while Greece's part was roughly flat at 46 million euros, it was well below the pre-crisis 336 million euros seen in 2007, central bank data showed.

On top of the region's own troubles -- which forced Bucharest and Belgrade to grab International Monetary Fund-led rescue loans to avoid worst crises last year -- another thing that is not likely to boost confidence is their simple proximity to a country investors now treat with more caution.

"The Greek troubles and the Romanian situation send worrying signals. This all affects investor mood and the ability of the country to attract fresh capital," said Kiril Avramov, of the Political Capital think tank in Sofia.

Romania's economy is expected to grow by around 1.3 percent in 2010. Bulgaria's is still on shaky ground, with economists and the government seeing GDP growth at just 0.2-0.3 percent.

Capital Economics is more pessimistic, seeing Romania's GDP staying flat this year and Bulgaria's economy shrinking a further 1.5 percent.

That means investors looking to tap emerging Europe's recovery may shift money to more stable countries like Poland, the only European Union state to avoid recession last year, or those with limited Greek exposure including the Czech Republic.

"Obviously more central European countries are less exposed to the Greek problems, as the impact is only indirect," said Miroslav Plojhar, an analyst at JP Morgan.

"From this point of view, all other countries are much safer than Romania and Bulgaria."

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