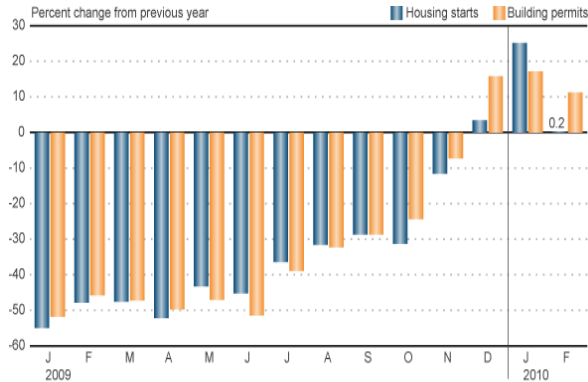


CHART OF THE DAY

U.S. housing starts & building permits



U.S. housing starts fell last month as winter storms disrupted construction and another drop in building permits suggested the weakness would linger.

TODAY'S TOP NEWS

- Fed renews "extended period" low-rate vow
- Bad weather depresses U.S. housing starts in Feb
- S&P affirms Greece's rating, ends downgrade review
- Top U.S. advisers say economic 'freefall' over
- Sen. Dodd urges quick action on financial reform
- U.S. bill would OK duties to fight China currency
- Lehman plans to end bankruptcy, create new company

ECON WATCH

FOR WEDNESDAY MARCH 17

ET	Indicators	Unit	Reuters	Prior
05:30	GB Claimant count chng	k	8.0	23.5
05:30	GB ILO unemployment rate	%	7.9	7.8
05:30	GB Avg wk Earn 3mth yy	%	1.7	0.8
07:00	US Mortgage market index	ind	-	633.1
07:00	US Mortgage refi index	ind	-	3007.2
08:30	US Producer prices mm	%	-0.2	1.4
08:30	US Producer prices yy	%	4.9	4.6
08:30	US Core PPI mm	%	0.1	0.3
08:30	US Core PPI yy	%	1.0	1.0
08:30	CA Wholesale trade mm	%	0.5	0.7
-	JP BOJ rate decision	%	0.10	0.10
-	GB BoE - Minutes of MPC Meet March 3-4			

FACTBOX

Winners and losers in Dodd's financial reform bill

U.S. Senate Banking Committee Chairman Christopher Dodd introduced his latest bill to overhaul the financial system on Monday.

For more please click here

MARKETS TODAY

TODAY'S TOP STORY: The U.S. Federal Reserve renewed its pledge to keep interest rates near zero for an "extended period" even as it sounded more upbeat about jobs.

For more please click here

TREASURIES: U.S. Treasury debt prices rose after the Federal Reserve, in its latest policy statement, reiterated plans to keep benchmark interest rates exceptionally low for an extended period.

- 10-yr Treasury notes were up 12/32 higher in price to yield 3.65 pct, down from 3.70 pct late Monday.
- 30-yr bonds rose more than half a point to yield 4.60 pct.
- 2-yr notes rose 2/32 higher to yield 0.91 pct from 0.94 pct.
- 2-10's part of the yield curve flattened by about 1 bps to 274 bps.

FOREX: The dollar fell against the euro and yen after the FOMC statement.

- The euro rose against the dollar to intraday peaks of \$1.3776, from \$1.3724 before the Fed statement. The euro was last traded at \$1.3774, still up 0.74 pct.
- Against the yen, the dollar slipped to 90.23 yen, down 0.25 pct.
- Dollar index was down 0.74 pct to 79.659
- Sterling jumped 1.36 pct to \$1.5254.

CORPORATES: U.S. corporate bonds spreads were little changed to tighter after the Fed left its rates on hold and the statement unchanged.

- The CDX.IG-13 index tightened to about 83 bps from 84 bps.
- Sitel LLC/Finance sold \$300 mln of senior notes in the 144a private placement market.
- Allied Irish Banks launched a \$4 bln bond exchange offer, which analysts said could contribute up to 400 mln euros (\$550 mln) towards its efforts to find fresh capital.
- Dubai World may offer creditors new debt tranches at zero or reduced interest in a plan to restructure \$26 bln in debt, a UAE newspaper said on its website, citing bankers close to the situation.

STOCKS: U.S. stocks rose after the U.S. Federal Reserve held benchmark rates near zero and renewed its pledge to keep them exceptionally low for an extended period.

- Dow rose 0.41 pct to 10,685.98, S&P gained 0.78 pct to 1,159.47 and Nasdaq was up 0.67 pct to 2,378.01.
- Intel shares rose 3.92 pct to \$22, after it released its newest server chips, in expectation of a rise in demand.
- The Philadelphia semiconductor index gained 2.69 pct.
- S&P financial index jumped 1.26 pct, S&P energy index gained 0.86 pct, S&P technology rose 0.71 pct. KBW bank index rose 1.68 pct.

C & E: Oil prices rose as the dollar weakened and the Federal Reserve kept its benchmark Federal Funds rate steady and reaffirmed its intent to keep rates low for an extended period.

- U.S. crude prices rose 2.52 pct to \$81.81 per barrel.
- Gold was up 1.67 pct at \$1,126.55 an ounce.
- Reuters-Jefferies index gained 1.02 pct to 273.54.

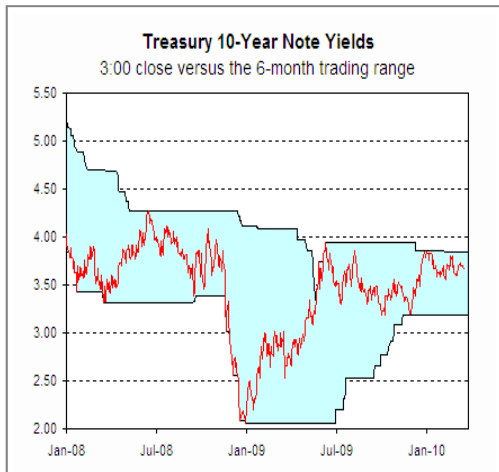
- For MARKET SNAPSHOT click here

- 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	0.125	0.09	0.127	0.009
3-Mo Bill	0.165	0.155	0.167	0.000
6-Mo Bill	0.235	0.230	0.239	-0.003
1-Year	0.380	0.370	0.386	-0.023
2-Year	99.914	99.945	0.920	0.055
3-Year	99.742	99.773	1.464	0.098
5-Year	100.094	100.133	2.355	0.234
7-Year	99.453	99.500	3.088	0.352
10-Year	99.750	99.813	3.655	0.375
30-Year	100.516	100.578	4.593	0.625

EQUITIES

	INDEX	CHANGE
DJIA	10666.26	24.11
NASDAQ	2371.13	8.93
S&P 500	1156.77	6.26

OIL

	PRICE	CHANGE
NYMEX	81.9	2.1
BRENT	79.2	1.1

EURODOLLAR FUTURES

	CLOSE	CHANGE
Apr-10	99.698	0.015
Jun-10	99.635	0.020
Sep-10	99.485	0.050
Dec-10	99.205	0.060

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.260	O/N	0.250
2-Week	0.250	2-Week	0.250
1-Month	0.250	1-Month	0.280
3-Month	0.260	3-Month	0.300
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.260	10:00 AM	0.190
2-Week	0.260	3:00 PM	0.189
1-Month	0.260		
3-Month	0.260		

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	17.25	21.25	1.08	1.11
3-Year	23.00	27.00	1.69	1.70
5-Year	23.50	27.50	2.59	2.59
7-Year	8.50	12.50	3.17	3.16
10-Year	2.25	6.25	3.67	3.66
30-Year	-16.25	-12.25	4.43	4.41

FUTURES

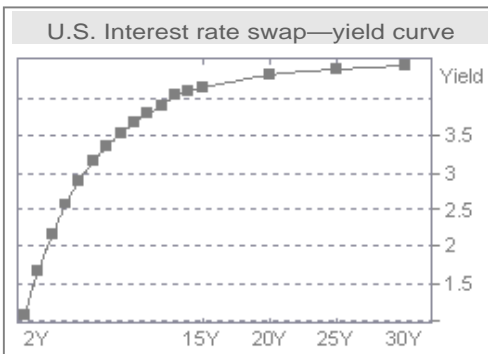
	PRICE	CHANGE
CBOT 5 yr	116.74	0.28
CBOT 10 yr	118.72	0.41
CBOT 30 yr	119.13	0.69

CURRENCIES

	BID	ASK
Euro	1.3749	1.3752
Sterling	1.5227	1.5232
JP Yen	90.35	90.38
Swiss Franc	1.0555	1.0558
Can Dollar	1.0147	1.0152
Mexico	12.5279	12.5312

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.200	0.250	-	-
1-Month	0.200	0.280	0.180	0.190
3-Month	0.230	0.400	0.192	0.202
6-Month	0.350	0.450	0.223	0.233
12-Month	0.650	1.000	0.358	0.368



FED FUNDS NYFRSM - 10AM

Open	0.2000	1m	0.2225
High	0.2500	3m	0.2625
Low	0.1800		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1	04/04/2012	13.5 13	1.03
3-Year	1.625	15/04/2013	0 22.5	-
5-Year	2.875	09/02/2015	26 25	2.61
7-Year	5.125	18/10/2016	16.75 16	3.26
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	35 34.5	4.94

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	15/12/2011	-2.25 -3	0.9
3-Year	1.75	07/05/2013	26 25	1.7
5-Year	2.625	20/11/2014	16 15	2.51
7-Year	5.25	15/09/2016	14.25 13.5	3.23
10-Year	3.75	27/03/2019	0 21	-
30-Year	6.25	15/07/2032	35.75 35.25	4.95

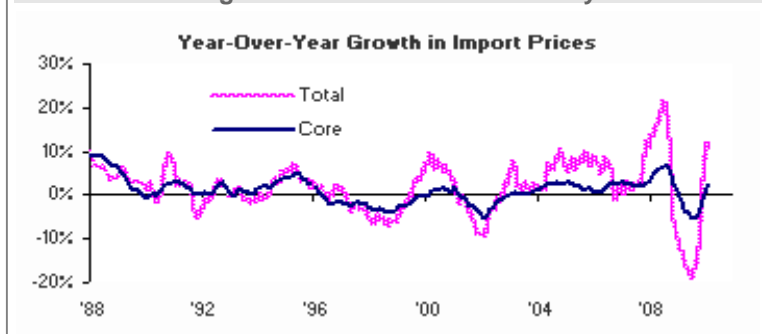
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.1860	105.1920	3.033
FHLMC	5.0	105.1960	105.2020	2.984

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.1560	105.1620	3.054
FHLMC	5.5	105.3000	105.3100	2.869
GNMA	5.5	106.1160	106.1220	3.318

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

Fed renews "extended period" low-rate vow

The U.S. Federal Reserve renewed its pledge to keep interest rates near zero for an "extended period" even as it sounded more upbeat about jobs.

The central bank's nod to a firmer job market after the deepest recession in decades offered a hint that it may be moving closer to dropping its promise to hold borrowing costs at rock bottom levels. It also had upbeat words on some business spending.

Still, it repeated its view that the economy's recovery would likely be moderate for a time and that inflation was likely to remain subdued as it held interbank overnight rates in a zero to 0.25 percent range. For a second consecutive meeting, Kansas City Federal Reserve Bank President Thomas Hoenig dissented, saying the commitment to keep rates exceptionally low for an extended period was no longer warranted.

The central bank also said business spending on equipment and software had risen "significantly," also a brighter assessment than the one it gave in January.

The central bank reiterated that it intends to wrap up purchases of mortgage-related assets by the end of March, but said it would monitor the economic outlook and financial developments to see if more support is necessary.

It called new homebuilding activity "flat at a depressed level."

S&P affirms Greece's rating, ends downgrade review

Standard & Poor's affirmed its ratings on Greece and ended its review for a downgrade, saying the government's recent deficit reduction measures are supportive of the ratings.

S&P said the outlook on the rating is negative, however, indicating a downgrade is still likely over the long term.

"Despite the new measures, we think it will be difficult for Greece to comply fully with its planned consolidation path, reducing its deficit to 5.6 percent of GDP in 2011 and 2.8 percent of GDP in 2012, if it does not implement additional measures in the coming years," S&P said in a statement, referring to GDP.

S&P affirmed Greece's long-term sovereign rating at BBB-plus, the eighth-highest investment-grade rating.

In explaining its affirmation, S&P cited the Greek parliament's March 5 approval of its third set of deficit reduction measures to bolster its consolidation strategy and meet a deficit target of 8.7 percent of GDP in 2010. An additional package which includes spending cuts and taxes will bring total budgetary efforts for 2010 to 16 billion euros, or 6.9 percent of 2010 GDP, S&P said, citing the government's estimates.

Sen. Dodd urges quick action on financial reform

U.S. Senate Banking Committee Chairman Christopher Dodd said Congress needs to fast track financial reform despite Republican pleas to slow down the process to rewrite sweeping new rules. A day after unveiling his long-awaited reform legislation, the Connecticut Democrat told MSNBC that Congress should not adjourn for its two-week Easter recess on March 26 without addressing financial reform.

The Senate Banking Committee will start meeting on March 22 to debate and amend the bill, a process Dodd hopes to have done within a week. It would then move to the Senate floor where Democrats would need 60 votes to overcome procedural roadblocks that are sure to be thrown up by Republicans. The Democrats control 59 of the 100 Senate seats.

A separate report showed, the derivatives market remains a "dark ocean" that needs more transparency but it was unclear if a ban on credit default swap trading would work in practice, a top U.S. regulator said.

Bad weather depresses U.S. housing starts in Feb

U.S. housing starts fell last month as winter storms disrupted construction and another drop in building permits suggested the weakness would linger.

Groundbreaking activity fell 5.9 percent to a seasonally adjusted annual rate of 575,000 units, reversing the prior month's gain, the Commerce Department said. Markets had expected housing starts to fall to 570,000 units.

New building permits fell 1.6 percent to a 612,000-unit pace last month, dropping for a second straight month. That compared to analysts' forecasts for 610,000 units.

The government revised January's housing starts upward to 611,000 units from the previously reported 591,000. Compared to February last year, starts were up 0.2 percent. Groundbreaking for single-family homes fell 0.6 percent last month to an annual rate of 499,000 units in January. Starts for the volatile multifamily segment fell 30.3 percent to a 76,000-unit annual pace. Separately, import prices fell 0.3 percent in February as the cost of crude oil and other petroleum products tumbled, the Labor Department said.

Top U.S. advisers say economic 'freefall' over

The U.S. economy has weathered the worst of the financial crisis but faces a lengthy period of high unemployment because of the severity of the recession, top Obama administration officials told Congress.

"Over the past year, its trajectory has changed from uncontrolled freefall to approximate stability," Treasury Secretary Timothy Geithner said in a joint statement with White House Budget Director Peter Orszag and Christina Romer, who heads the Council of Economic Advisers.

But they told the U.S. House of Representatives Appropriations Committee hearing that while job losses have "slowed to a trickle," it was likely to be some time before there is a real improvement in hiring. In the budget issued in February, the administration forecast a deficit of \$1.56 trillion for fiscal 2010 ending Sept. 30, falling to \$1.27 trillion in fiscal 2011.

In a separate statement, Geithner insisted there is "no way" major credit rating agencies will cut the gilt-edged rating they assign to U.S. debt offerings.

Geithner conceded that if the country's credit rating was lowered, it would cost more to borrow but insisted it won't happen.

U.S. bill would OK duties to fight China currency

China could face duties on some of its exports to the United States if it does not take steps to realign its currency, according to the draft text of a Senate bill to be unveiled. The legislation crafted by Senators Charles Schumer and Lindsey Graham would require the U.S. Treasury Department to identify countries with fundamentally misaligned currencies each September and March.

It would authorize the Commerce Department to take currency misalignment into its calculation of import injury duties for specific products if a targeted country has not begun steps within 90 days to realign its currency, the bill's text said.

Separately, China shunned mounting U.S. demands for a stronger yuan, saying again that its currency is not the cause of its big trade surplus and vowing to keep the currency stable to shore up exports. In a separate report, China's central bank held the yield on its one-year bills flat at auction again this week, fuelling expectations that the need for it to raise banks' reserve requirements might be easing because it is able to drain enough funds through its open market operations.



TODAY'S TOP NEWS

Lehman plans to end bankruptcy, create new company

Lehman Brothers Holdings Inc on Monday filed a plan with the U.S. bankruptcy court in Manhattan to wind down its remaining assets and operations -- and end the largest U.S. bankruptcy case in history. Under the proposed Chapter 11 plan, a newly created business called LAMCO would manage what is left of Lehman's commercial real estate, mortgages, principal investments, private equity, corporate debt and derivatives assets.

Lehman's ability to quickly sell its core assets and then propose an end to its bankruptcy about a year and a half after filing the most complicated case ever was seen as a triumph for the U.S. bankruptcy system. Lehman said the reorganization plan would provide a global and efficient resolution to the company's bankruptcy, by resolving creditor claims and even those claims that various Lehman entities have against each other.

Secured, administrative and priority creditors would be paid in full under the proposed plan, while general unsecured claims, direct intercompany claims and guarantee claims would in part be satisfied by some "pro rata" cash distributions.

EU hedge fund rules stalled, UK digs in heels

European Union plans to crack down on hedge funds hung in the balance when talks stalled after Britain dug in its heels to head off new rules that could damage its financial centre.

The draft law had been intended to curb pay and borrowing at hedge funds and usher in an era of transparency for a secretive industry that many politicians said exacerbated borrowing difficulties in Greece by betting on its debt. But the finance ministers were unable at talks to resolve a dispute between Britain -- which wants lighter regulation of an industry important for London's financial centre -- and Germany and France, which want a heavier clampdown. Germany voiced disappointment, saying it had been ready to agree to a draft law, while France's Michel Barnier, the EU's financial markets chief, signalled concern about further delays in introducing stricter rules. British finance minister Alistair Darling emerged upbeat from negotiations and warned against rules that would put Europe and "its only global financial centre, London ... at a competitive disadvantage".

Cheaper gas, food curb Feb euro zone inflation y/y

Lower prices of gas, food and clothes limited euro zone inflation in year-on-year terms in February despite more expensive fuel for cars and tobacco, Eurostat said.

Eurostat confirmed its earlier estimate that consumer prices in the euro zone rose 0.9 percent year-on-year last month, after a 1.0 percent increase in January, as expected by economists polled by Reuters.

Month-on-month prices grew by 0.3 percent, in line with expectations, driven mainly by more expensive package holidays and clothes, while fuel and food had the biggest downward impact. Core inflation slowed to 0.8 percent year-on-year from 0.9 percent in January after a 0.3 percent monthly rise. Separately, the German ZEW economic think tank said its monthly poll of economic sentiment came in at 44.5 in March, down from 45.1 in February. The consensus forecast in a Reuters poll of 43 economists last week was for a fall to 43.7.

In a separate report, the Swiss government raised its growth and inflation forecast for the Alpine state, in line with that of the central bank, but warned the economy's recent upswing could slow again later this year. Swiss GDP should grow by 1.4 percent in 2010 and 2.0 percent in 2011, the SECO said.

Australia's c.bank to raise interest rates further

Australia's central bank expects to raise interest rates further to keep pace with a buoyant economy and rising home prices, and played down the risk that the shoddy finances of some European countries could scupper global growth.

Minutes of the Reserve Bank of Australia's March policy meeting released showed it decided to raise interest rates to 4 percent as a run of strong data suggested the economy was already growing at a brisk pace of around 3.5 percent.

That meant it was appropriate for rates to rise gradually this year towards normal -- a level it has said could be around 4.75 percent. The minutes showed the RBA spent a lot of time mulling the impact of fiscal tensions in Greece and other euro zone countries. But it concluded that Europe's woes were unlikely to lead to a renewed bout of turmoil in markets.

NEXT UP

BOJ leaning towards easing policy but board split

The Bank of Japan is leaning towards easing monetary policy again this week under pressure from a government calling for action to beat deflation, sources said, but the board is split on how to justify the move.

Financial markets have largely factored in that the Bank of Japan will ease policy again but there are some doubts as to whether it will move this week or in April.

The BOJ is leaning towards expanding or extending a funding operation put in place at an emergency meeting in December. With a pool of 10 trillion yen (\$110.4 billion), it offers three-month loans to commercial banks at the policy rate of 0.1 percent. That pool of funds might be doubled to 20 trillion yen, or the loan period might be extended to six months.

It would also make sense to move this month rather than in April because it will help fill a hole of around 6 trillion yen left when an emergency lending facility expires in March.

For now, the BOJ policy-setting board is split on easing policy. If those disagreements can't be overcome in the next few days, a policy decision may wait until April 6-7, when the next policy meeting is scheduled.

BofA poll-One in five investors still sees Greek default

Fears of a Greek debt default have eased this month, but more than one in five fund managers still see it as a likelihood, a Bank of America Merrill Lynch poll showed.

The survey of 207 fund managers around the world showed more than three-quarters banking on either a European Union bailout (52 percent) or Greece sorting its debt crisis out itself (24 percent).

The latter was more than twice the percentage that believed Greece was capable of managing itself in February.

But scepticism has not disappeared. Some 19 percent of respondents said they expected an orderly default or restructuring with Greece remaining in the euro zone.

Two percent, among whom Britons featured noticeably, saw a disorderly default and an exit from the euro zone.

Three percent stated no opinion.

Overall, however, the mood was less anxious than a month earlier.

Some 27 percent were expecting an orderly or disorderly default in the February poll.



DEEP DIVE Commentary and Analysis

FACTBOX

Winners and losers in Dodd's financial reform bill

U.S. Senate Banking Committee Chairman Christopher Dodd introduced his latest bill to overhaul the financial system on Monday.

The committee is expected to work on the bill next week and it will likely change dramatically. Below are some of the winners and losers under the proposals Dodd made on Monday.

CREDIT RATING AGENCIES -LOSE

Credit rating agencies such as Moody's Corp, Standard & Poor's and Fitch Ratings would be subject to greater liability under Dodd's latest bill.

Securities and Exchange Commission gets authority to deregister rating agencies for providing bad ratings over time

Regulators required to remove unnecessary references to ratings in their regulations

LARGE BANKS - WIN AND LOSE

Fed continues to supervise banks such as Citigroup with assets over \$50 billion

Large financial firms such as Bank of America would have to pay into a \$50 billion fund that would be used to liquidate, resolve a large troubled firm

Banks such as Goldman Sachs could be prohibited from proprietary trading and investing in hedge funds and private equity funds

SMALL BANKS - WIN

Federal Deposit Insurance Corp and the Office of the Comptroller of the Currency would regulate banks and thrifts with assets below \$50 billion

INSURANCE COMPANIES - WIN AND LOSE

Although the U.S. government has had to use billions of dollars in taxpayer funds to prop up insurer AIG, insurers will not be subject to federal oversight unless they are deemed to be systemically important

An office within Treasury Department would be created to monitor the insurance industry and coordinate international insurance issues

Large financial firms, including insurers, would have to pay into a \$50 billion fund that would be used to liquidate, resolve a large troubled firm

CONSUMERS -LOSE

New rules to protect consumers from risky financial products could be overturned by banking regulators if banking regulators believe the rule could threaten the financial system.

Consumer Financial Protection Bureau will be housed in the Federal Reserve, which has been criticized for failing to rein in the risky lending that contributed to the financial crisis

SHAREHOLDERS/INVESTORS - WIN AND LOSE

Would get say on executive compensation through a non binding vote

SEC gets authority to give shareholders a cheaper and easier way to nominate corporate board directors

Publicly listed companies' compensation committees would be required to be independent from firms' boards of directors

Brokers who provide financial advice would not be held to same standard as investment advisers, who have fiduciary standards or rules that requires them to act in their clients' best interest. Instead, the bill requires a study on whether brokers who give investment advice should adhere to fiduciary rules

PRIVATE EQUITY, VENTURE CAPITAL FUNDS -WIN

Advisers to hedge funds would be required to register with the SEC

Advisers to other private pools of capital such as private equity and venture capital are exempt from registration

U.S. FEDERAL RESERVE - WIN

New powers to supervise systemically important financial firms and preserves Fed's authority to supervise banks with assets over \$50 billion

Part of a "risk council" that would have authority to monitor risk in the financial system and decide whether a large complex company needs to divest assets

Regulates systemically important clearing, payments and settlements systems

Houses Consumer Financial Protection Bureau. Would have power along with other regulators to appeal consumer protection bureau's rules if deemed to hurt safety and soundness of banking system and stability of financial system

Dodd originally wanted to confine the Fed to setting monetary policy and acting as the lender of last resort.

COLUMN-China-U.S. yuan spat should underpin euro

By Neal Kimberley

With China-U.S. relations far from harmonious and the euro down more than 5 percent against the yuan since Jan. 12, traders might be forgiven for thinking being long euros is safer than being long dollars.

Chinese Premier Wen Jiabao on Sunday put the blame for this disharmony on the United States, saying the recent visit to Washington of exiled Tibetan leader, the Dalai Lama, and U.S. arms sales to Taiwan, violated China's territorial integrity and sovereignty.

China has threatened sanctions on companies such as Boeing, Lockheed Martin and United Technologies Corp involved in a planned \$6.4 billion arms package for Taiwan.

At the core of the differences is the long drawn out spat over the value of the yuan. Washington wants Beijing to let the yuan strengthen to help wipe out an eye-watering Chinese trade surplus, which stood at \$226.8 billion in 2009.

President Barack Obama, following on from his pledge in January's State of the Union speech, laid out a plan last week to double U.S. exports.

Obama said not all countries were playing by the same rules on trade. Many U.S. lawmakers believe Beijing's pegging of the yuan at 6.83 to the dollar since July 2008 gives Chinese companies an unfair price advantage.

Beijing's response was clear.

"We oppose mutual accusations between countries, and even using coercion to force a country to raise its exchange rate, because that's of no help to reforming the yuan exchange rate. We don't believe the yuan is undervalued," Wen said on Sunday.

Hearing such rhetoric, a trader in Beijing may well favour euros over U.S. dollars.

The single currency is also the most likely investment destination because, with the depth of the euro market, it is the only viable alternative reserve currency to the U.S. dollar.

With such a gulf in China-U.S. views fostering potential for further tension, investors should see holding relatively more euros than dollars as the default position.

The next key date will be April 15 when the U.S. Treasury issues a semi-annual report in which China could be named as a "currency manipulator".

On Monday, 130 U.S. lawmakers urged Treasury Secretary

DEEP DIVE Commentary and Analysis

Timothy Geithner and Commerce Secretary Gary Locke to take immediate action to address growing problems with China's "currency manipulation".

With Democrats facing tricky Congressional mid-term elections in November, such a move would also play well with the Democratic Party's bedrock unionised support.

For its part, China, emerging as a global powerhouse, cannot appear to kowtow to the United States.

U.S. BONDS

Indeed senior Chinese military officers have already proposed Beijing sell some U.S. bonds following the announcement of Washington's recent arms deal with Taiwan.

Judging from the net capital flow data issued by the U.S. Treasury, China may already have been trimming back its holdings of

U.S. Treasuries. In November, China held \$929 billion. That had fallen to \$889 billion by January.

Of course, the China-U.S. relationship is so complex and so critical to both sides that a clear breach is unthinkable.

Washington values Chinese investment in U.S. Treasuries. China's export-model economy still relies on the buying power of U.S. consumers.

But China-US differences are evident and positions are arguably becoming more entrenched. As tensions worsen, traders have to make an evaluation of how best to position themselves. The logical bolthole should be the euro.

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

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(Compiled by Anil Kumar and Pronita Naidu in Bangalore)

For questions or comments about this report, email us at: inside.debt@thomsonreuters.com or contact Chandra Ramarathnam on +91 80 4135 5899

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