

# INSIDE DEBT

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Thursday, April 1, 2010

## CHART OF THE DAY

### Dollar/Yen



The dollar climbed to a seven-month high against the yen, bolstered by upbeat U.S. data and moves by Japan's investors to invest funds into higher-yielding currencies overseas to mark the start of its new fiscal year.

## TODAY'S TOP NEWS

- U.S. data boosts self-sustaining recovery hopes
- Germany steps up, Greece to take a back seat
- U.S. mortgage rates top 5 percent-Freddie Mac
- U.S. business loan demand drops, defaults rise-PayNet
- Unemployment to stay 'unacceptably high' - Geithner
- Core emerging Europe PMIs rise to two-year highs
- UK March manuf. PMI rises to new 15-yr high

## ECON WATCH

FOR FRIDAY APRIL 2

ET	Indicators	Unit	Reuters	Prior
08:30	US Non-farm payrolls	k	190.0	-36.0
08:30	US Manufacturing Payroll	k	15.0	1.0
08:30	US Unemployment rate mm	%	9.7	9.7
08:30	US Avg earnings mm	%	0.2	0.1
08:30	US Avg workweek hrs mm	hrs	33.9	33.8
09:40	US ECRI inflation index	ind	-	101.4
-	US SIFMA recommends early close			

US, EZ, UK, CA, JP - Good Friday - Market Holiday

FOR MONDAY APRIL 5

ET	Indicators	Unit	Reuters	Prior
10:00	US ISM N-Mfg PMI	ind	54.0	53.0
10:00	US ISM N-Mfg Bus Act	ind	55.2	54.8
10:00	US Pending Home sales	%	-0.1	-7.6
10:00	US Employment Index	ind	-	93.5

EZ, UK - Market Holiday

## MARKETS TODAY

**TODAY'S TOP STORY:** The number of U.S. workers filing new claims for jobless aid fell last week and factory activity in March hit its highest level in more than 5-1/2 years, strengthening hopes for a self-sustaining recovery. **For more please click here**

**TREASURIES:** U.S. Treasury debt prices retreated after reports showed U.S. jobless claims dipped last week and U.S. manufacturing activity expanded last month at its fastest pace in more than five years.

- The 10-year dollar swap spread reached parity, touching positive territory after turning negative in the middle of last week.
- 30-yr bonds fell 9/32 to yield 4.73 pct from 4.71 pct on Wednesday.
- 10-yr Treasury notes were down 8/32 yielding 3.86 pct while the 2-yr notes fell 3/32 to yield 1.06 pct.
- 5-yr Treasury notes shed 5/32 yielding 2.59 pct from 2.56 pct.
- 2-10's part of the yield curve flattened by 1 bps to 280 bps.

**FOREX:** The euro rose against the dollar and the Swiss franc, while the greenback hit a seven-month high versus the yen a day before a key U.S. government jobs report.

- Euro was up 0.53 pct to \$1.3582.
- The euro rose 0.58 pct to 1.4320 Swiss francs. Earlier, the euro fell to record lows against the Swiss franc below 1.4150 francs, but then surged to session highs at 1.4410 francs.
- Euro rose 1.0 pct to 127.51 yen. Earlier, it fell as low as 125.96 yen.
- Dollar gained 0.47 pct to 93.87 yen, after hitting a high of 94.04 yen, its best level since late August 2009.
- Sterling rose 0.68 pct to \$1.5287.

**CORPORATES:** U.S. corporate bond spreads tightened after robust economic data bolstered sentiment, but the market's underlying tone remained cautious ahead of Friday's much-anticipated monthly jobs report.

- The CDX.IG-14 index tightened about 1 bps to 87 bps.
- Corporate spreads over Treasuries had narrowed to 161 bps as of Wednesday, according to BofA Merrill Lynch data.

**STOCKS:** U.S. stocks rose, lifted by upbeat manufacturing and job market data.

- Dow rose 0.65 pct to 10,927.14, S&P gained 0.73 pct to 1,178.01 and Nasdaq was up 0.19 pct to 2,402.58.
- Shares of RIM shed more than 7 pct to \$68.52.
- Exxon Mobil rose 0.94 pct to \$67.61, Chevron rose 1.15 pct to \$76.70, S&P energy index gained 1.63 pct.
- S&P financial index rose to 0.92 pct, S&P technology rose 0.09 pct.
- KBW bank index rose 0.85 pct.

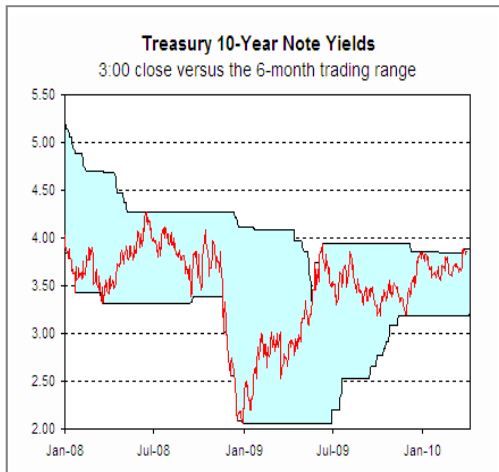
**C & E:** Oil rose for the fourth day in a row, closing at the highest level in 18 months, after upbeat U.S. economic data signaled better oil demand ahead, prompting fund buying as the new quarter began.

- U.S. crude oil gained 1.60 pct to \$85.1 per barrel.
- Gold was up 1.11 pct to \$1,125.2 an ounce.
- Reuters-Jefferies index rose 1.13 pct to 276.43.

- 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	0.165	0.13	0.167	0.001
3-Mo Bill	0.155	0.145	0.157	0.002
6-Mo Bill	0.235	0.230	0.239	-0.001
1-Year	0.378	0.370	0.384	-
2-Year	99.898	99.930	1.053	-0.055
3-Year	99.352	99.383	1.602	-0.059
5-Year	99.617	99.664	2.583	-0.113
7-Year	99.625	99.672	3.311	-0.164
10-Year	98.078	98.141	3.861	-0.219
30-Year	98.375	98.438	4.727	-0.172

**EQUITIES**

	INDEX	CHANGE
DJIA	10883.76	27.13
NASDAQ	2391.53	-6.43
S&P 500	1173.56	4.13

**OIL**

	PRICE	CHANGE
NYMEX	84.9	1.1
BRENT	83.7	1.0

**EURODOLLAR FUTURES**

	CLOSE	CHANGE
Apr-10	99.695	0.005
Jun-10	99.635	0.005
Sep-10	99.455	-0.010
Dec-10	99.155	-0.015

**REPURCHASE AGREEMENTS**

G/C		MORTGAGE REPOS	
O/N	0.240	O/N	0.250
2-Week	0.250	2-Week	0.250
1-Month	0.250	1-Month	0.260
3-Month	0.270	3-Month	0.290
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.250	10:00 AM	0.190
2-Week	0.250	3:00 PM	0.192
1-Month	0.260		
3-Month	0.310		

**IR SWAPS <19901>**

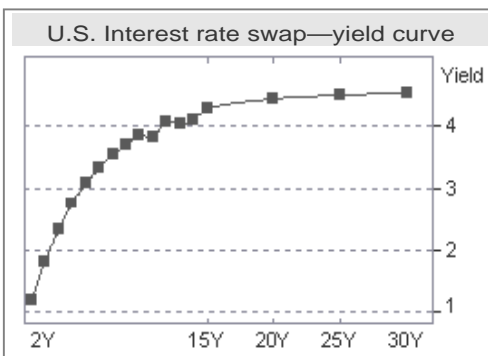
	SPREAD		RATE	
2-Year	14.50	18.50	1.19	1.21
3-Year	21.25	25.25	1.80	1.82
5-Year	16.75	20.75	2.74	2.75
7-Year	2.75	6.75	3.33	3.33
10-Year	-2.00	2.00	3.83	3.82
30-Year	-20.50	-16.50	4.52	4.50

**FUTURES**

	PRICE	CHANGE
CBOT 5 yr	114.75	-0.13
CBOT 10 yr	115.73	-0.20
CBOT 30 yr	115.28	-0.22

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

	BID	ASK	BID	ASK
O/N	0.160	0.200	-	-
1-Month	0.220	0.300	0.188	0.198
3-Month	0.240	0.400	0.198	0.208
6-Month	0.350	0.450	0.230	0.240
12-Month	0.700	1.050	0.405	0.415



**CURRENCIES**

	BID	ASK
Euro	1.3570	1.3572
Sterling	1.5271	1.5276
JP Yen	93.82	93.84
Swiss Franc	1.0552	1.0556
Can Dollar	1.0087	1.0092
Mexico	12.3338	12.3394

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

Open	0.1900	1m	0.2322
High	0.2100	3m	0.2844
Low	0.1600		

**ACTIVE FANNIE MAE AGENCIES**

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1	12/04/2012	15	14	1.18
3-Year	1.625	15/04/2013	20.5	19.5	1.79
5-Year	2.875	09/02/2015	21	20.5	2.8
7-Year	5.125	18/10/2016	20	0	3.51
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	40.75	37.75	5.13

**ACTIVE FREDDIE MAC AGENCIES**

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	-3.5	-4.5	1.02
3-Year	1.75	07/05/2013	24.5	24	1.84
5-Year	2.625	20/11/2014	0	9.5	2.7
7-Year	5.25	15/09/2016	11.75	8.75	3.43
10-Year	3.75	27/03/2019	26	25	4.13
30-Year	6.25	15/07/2032	43.75	40.75	5.16

**Active MBS 15YR**

	CPN	BID	ASK	YIELD
FNMA	4.0	101.0370	101.0430	3.669
FHLMC	4.0	101.0360	101.0420	3.669

**Active MBS 30YR**

	CPN	BID	ASK	YIELD
FNMA	4.5	99.2460	99.2520	4.527
FHLMC	4.5	99.2460	99.2520	4.527
GNMA	4.5	100.2360	100.2420	4.330

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



## TODAY'S TOP NEWS

**U.S. data boosts self-sustaining recovery hopes**

The number of U.S. workers filing new claims for jobless aid fell last week and factory activity in March hit its highest level in more than 5-1/2 years, strengthening hopes for a self-sustaining recovery.

Initial claims for state unemployment benefits slipped 6,000 to 439,000 in the week ended March 27, the Labor Department said.

The four-week moving average of new claims fell 6,750 to 447,250, the lowest level since September 2008.

Separately, the ISM said its index of U.S. factory activity rose to 59.6, the highest since July 2004, from 56.5 in February. Markets were expecting 57.0.

Construction spending fell for a fourth straight month in February to the slowest rate in nearly 7-1/2 years as activity softened in every major sector from homebuilding to public construction projects, a Commerce Department report showed.

Overall construction spending fell 1.3 percent to a seasonally adjusted annual rate of \$846.23 billion following a revised 1.4 percent decline in January that previously was reported as a 0.6 percent decrease.

**U.S. mortgage rates top 5 percent-Freddie Mac**

U.S. mortgage rates rose for a third straight week, moving above 5 percent and reaching their second highest level this year, a closely watched mortgage survey showed.

Interest rates on U.S. 30-year fixed-rate mortgages averaged 5.08 percent for the week ended April 1, up from the previous week's 4.99 percent, according to a survey released by Freddie Mac. That is above the year-ago level of 4.78 percent as well as the record low of 4.71 percent in early December. Freddie Mac started the survey in 1971.

Freddie Mac said the 15-year fixed-rate mortgage averaged 4.39 percent in the latest week, up from 4.34 percent the prior week.

Separately, Freddie Mac said it shrank its mortgage-related investment portfolio in February for the sixth straight month while the delinquencies on loans it guarantees kept rising. The company has been buying back tens of billions of dollars of seriously delinquent mortgage loans back from its securities pools. It has been dedicating cash toward those efforts more so than on accumulating mortgage investments. The unpaid principal balance of Freddie Mac's mortgage portfolio fell at an 18.5 percent annual rate in February to \$732.2 billion. That contrasts with \$822 billion a year earlier.

**Unemployment to stay 'unacceptably high' - Geithner**

The U.S. unemployment rate, currently at 9.7 percent, will remain "unacceptably high" for some time to come, U.S. Treasury Secretary Timothy Geithner said.

"The unemployment rate is still terribly high and it's going to stay unacceptably high for a long period of time," Geithner said on NBC's "Today" Show.

Economists polled by Reuters expect the report to show that the economy has added 200,000 jobs, which would mark only the second time jobs have increased since the recession started in December 2007.

"The economy's going to start creating jobs again," Geithner said. "The economy's growing now, that's the first step and with growth jobs will come."

Geithner said a regulatory overhaul working its way through Congress will ensure that the government will not have to rescue the financial-services industry again.

**Germany steps up, Greece to take a back seat**

Germany, Spain and Austria are scheduled to sell government bonds in the holiday-shortened week ahead but Greece is likely to take a back seat after recent sales saw cooler demand.

Analysts expect around 12 billion euros of supply, which will be easily met by roughly 18 billion in redemptions of maturing bonds and coupon payments.

Greece has to sell more bonds to meet its funding needs. So far, it has raised about 23 billion euros out of a 53.2 billion euro projected requirement for 2010.

Athens has said it aims to issue a global dollar-denominated bond in late April or early May in a move to widen its investor base and analysts expect another euro bond sale.

Separately, PIMCO sees Europe's action on Greece as ineffective in fixing the country's problems, while Britain's sovereign debt rating could be downgraded within a year, a top executive of the world's largest bond fund said.

Scott Mather, head of global portfolio management at PIMCO, told a briefing in Taipei that the company was underweighting UK, U.S. and pan-European 10-year sovereign bonds.

**U.S. business loan demand drops, defaults rise-PayNet**

Small and medium-sized business borrowers in the United States showed signs of continued stress in February as the percentage of loans in default stayed at a two-year high, PayNet Inc reported.

Accounts behind 180 days or more, and unlikely ever to be paid, remained at 0.90 percent of lenders' portfolios in February, unchanged from the 25-month high they reached in January, according to PayNet.

Accounts in moderate delinquency, or those behind by 30 days or more, rose in February to 4.41 percent from 4.37 percent in January, according to PayNet.

The only glimmer of hope in PayNet's monthly report was with accounts 90 days or more behind in payment, which improved modestly in February, slipping to 1.36 percent from 1.38 percent in January.

But the Thomson Reuters/PayNet Small Business Lending Index fell 6 percent year-over-year in February and was down 8 percent from the previous month.

Separately, Liquidity in U.S. CDS backed by loans may pick up after the contracts are relaunched this month to remove an option to cancel the contracts when the loans they insure are repaid.

**Core emerging Europe PMIs rise to two-year highs**

A surge in new orders pushed manufacturing in emerging Europe's two core economies to multi-year highs in March, but analysts said consumer demand remained weak and doubted the recovery had fully taken hold.

Galloping euro zone exports have helped lift badly battered manufacturing in EU members Poland and the Czech Republic and eased the effect of rising unemployment, low wage growth and tight credit conditions there.

The Polish PMI rose to 52.6 points last month, slightly below analysts' forecasts but still a 25-month high, Markit Economics data showed. The Czech PMI rose to 56.8 -- a two year peak. Hungarian PMI fell to 54.4 from revised 56 in February.

Separately, German retail sales fell by a bigger-than-expected 0.4 percent month-on-month in February.

In real terms, sales declined for a tenth straight month on an annual basis, falling 0.9 percent year-on-year, data from the Federal Statistics Office showed.

## TODAY'S TOP NEWS

**UK March manufacturing PMI rises to new 15-yr high**

A key British manufacturing survey rose to its highest level in over 15 years last month, and banks said they planned to step up corporate lending, in signs that the recovery is gaining strength.

The CIPS/Markit PMI purchasing managers' survey reported a small fall in factory employment, and a separate study showing less generous collective pay deals. The main news in support of recovery was a rise in the headline manufacturing PMI index to 57.2 from 56.5, a bigger jump than economists had forecast and the index's highest level since October 1994, when the economy was also emerging from recession. The PMI output component rose to 61.9 in March from 59.8, its highest since July 1994.

Separately, British banks expect to strongly increase corporate lending and unsecured lending to households over the next three months, while mortgage lending will grow more slowly, a BoE survey showed.

**China bond yields, rates slip as policy reaffirmed**

Most Chinese debt yields and money market rates fell slightly as a reaffirmation by the PBOC that the government would maintain an appropriately loose monetary stance offset tightening worries sparked by strong manufacturing data.

China's manufacturing sector gathered strength in March as orders climbed, two PMIs showed, pointing to brisk first-quarter GDP growth that could spur policy tightening.

The indicative yield for the most actively traded five-year government bonds edged down 0.06 basis point to 2.7254 percent bid from Wednesday's 2.7260 percent, while the 15-year bond yield dropped 0.14 bp to 3.8087 percent, according to Reuters Reference Rates. But in the central bank bill market, the indicative yield for benchmark one-year bills was flat at 1.95 percent.

In one sign of abundant liquidity, Chinese banks extended another heavy 600 billion to 700 billion yuan (\$88-103 billion) in new loans in March, the Shanghai Securities News reported.

The weighted average seven-day repo rate fell 3.33 bps to 1.5689 percent by midday from 1.6022 percent at Wednesday's close.

**Dubai property market needs more than Nakheel rescue**

Dubai's \$9.5 billion lifeline to developer Nakheel will do little to help its property market as a flood of new homes and offices come to market, with more in the pipes, fuelling oversupply concerns, analysts said.

That lifeline, with \$8 billion cash and a \$1.5 billion debt-for-equity swap, will see Nakheel, pay contractors and restart some of its viable projects.

It may also aid investor sentiment, said Nicolas Maclean, managing director of CB Richard Ellis Middle East.

Aberdeen Property Investors' chief investment officer and head of fund management, Andrew Smith, said Dubai's speculative development model meant it was unlikely to be on the mainstream buy list for many Western fund managers any time soon. Other measures are needed to lure investors back, including the recapitalization of the emirate's two Islamic mortgage firms Am-lak and Tamweel, and clear rules on visa rights for foreign owners.

**JGBs rally, futures post biggest gain in 4 months**

Japanese government bonds rallied, with futures posting their biggest-one day gain in four months as a burst of buying at the start of Japan's fiscal year prompted dealers to cover short positions.

The mid-term sector received support after Internal Affairs Minister Kazuhiro Haraguchi told Reuters that a sharp reduction in Japan Post's holdings of JGBs is not an option.

Investors hunted bargains with the benchmark 10-year yield having risen to a 4-½ month high of 1.400 percent, seen as an attractive level by players such as regional banks.

The 20-year yield fell 3.5 basis points to 2.130 percent.

Investors felt comfortable about buying government debt as the BoJ's quarterly tankan survey showed an improvement in corporate sentiment that was within market expectations. The headline index for big manufacturers' sentiment improved to minus 14 in March from minus 25 in December, its best reading since the failure of Lehman Brothers shocked financial markets in September 2008, from minus 25 in December.

## NEXT UP

**Census hiring to boost U.S. nonfarm payrolls in March**

The median forecast for nonfarm payrolls is for a rise of 190,000 in March after falling 36,000 in February. Forecasts range from a loss of 50,000 to an increase of 400,000, an indication of the uncertainty surrounding the impact of hiring for the 2010 census. The unemployment rate is forecast steady at 9.7 percent. Forecasts range from 9.5 percent to 9.9 percent.

The average work week for all employees is seen edging up to 33.9 hours from 33.8 hours in February.

Forecasts ranged from 33.8 hours to 34.0 hours. U.S. nonfarm payrolls probably increased in March, boosted by hiring for the decennial census and a snapback from February's weather-related losses.

Analysts reckon census hiring could have boosted employment by as much as 100,000 in March after adding 15,000 in February.

According to the Census Bureau, there are 1.17 million temporary census positions for fiscal 2010, which started in October.

A total of 17,000 temporary workers were hired in the first quarter, with an additional 181,000 hires planned for the three months from January to March.

**BoE rate hike seen in Q4 but vulnerable to delay**

The Bank of England will likely start hiking interest rates in this year's fourth quarter but may delay if economic growth disappoints or fiscal policy loses focus after an expected May election, a Reuters poll showed.

Median forecasts from the poll of 64 economists, who all expected the BoE to keep rates unchanged at its April meeting, showed the bank raising its base rate by 25 basis points from its current record low of 0.5 percent by the end of the year.

While expectations of when rates will rise were unchanged from the last Reuters poll published earlier this month, the spread of results in the latest survey showed a stronger inclination towards a hike of 25 basis points rather than 50.

The median probability given by economists of a hike by year-end was 60 percent, but several respondents who gave very low probabilities skewed the mean average to 49 percent.

Many respondents also offered views on the outcome of the next general election, widely expected on May 6.

The results from part of the poll showed a median 55 chance of a hung parliament -- the worst outcome for markets.



## DEEP DIVE Commentary and Analysis

## The Age of Frugality takes a holiday

By Jim Saft

That whole Age of Frugality thing didn't last long, did it? U.S. real personal consumption grew in February at a respectable 0.3 percent clip, the fifth straight such monthly rise, a fact widely greeted as news that the recovery is on course. The fly in this tasty soup, however, is income, which in real terms didn't increase at all, not even by one tenth of a percent.

American's did this neat trick -- spending more while earning the same -- the old fashioned way: they cut back on luxuries ... like saving.

Savings as a percentage of disposable personal income fell to 3.1 percent from 3.4 percent the month before and down from a recent peak of 6.4 percent in May 2009. In fact, the last time the savings rate was lower was October 2008 when a market maelstrom was convincing so many people, apparently falsely, that something rather dangerous and important was wrong with the economy. In real terms, consumption is only very slightly below where it peaked in 2007.

Astounding.

What happened? Well, from a certain point of view the medicine of reflation worked. Low rates punished savings and also drove the stock market and other risk assets higher. The fall in housing prices abated, leaving many personal balance sheets in better shape. Given the shape of the job market, I think we have an answer to the question of whether asset price inflation drives spending. It did during the boom and it is again now.

Government transfers helped too. They hit \$2 trillion for only the second time in history, as payments from the common coffers such as social security and unemployment insurance now comprise more than 18 percent of income.

This does not have to end terribly, but it most certainly does have to end.

As strategies to head off a depression, reflation and social insurance have real merit but in the absence of sustained jobs growth and the income gains it brings, they lack something critical: sustainability. At a certain point, and it needs to be relatively soon, the money that finances the easy rates and high transfers needs to be assured that this is in transition to something else. That is why the recent uptick in Treasury yields is troubling. Not because it denotes inflation -- that is not a threat -- but because it might just show a waning of faith in the United States as a borrower.

## WHAT WILL THOSE BOOMERS DO NEXT?

It is just about possible that Americans' stopping savings is some sort of a bellwether of a better economy. Perhaps the jobs picture looks better on the ground and people are willing to spend in anticipation of better income growth in the future. Certainly some of the consumer confidence data continues to show a bit of optimism about the future.

The data as it comes out, though, is less reassuring. Private U.S. employment dropped in March by 23,000, according to a report by payroll processing firm Automatic Data Processing Inc. While the ADP does not include government employment, which is getting a temporary boost from the census, the outlook for Friday's nonfarm payroll data, which does, is a lot less rosy than should be expected for a country in a recovery from an extremely sharp recession.

Another possibility is that the savings data shows the effect of another part of the huge baby boomer cohort moving into a somewhat premature and somewhat involuntary retirement. Many of them may have decided, encouraged by stock market valuations that may not be sustained, to partly fund themselves by running down their assets. Many boomers may well have

plenty of assets, but the effects on financial markets of them moving from the asset accumulation to the asset eating stage of life would be very large and not positive for stocks.

Even if consumers don't know it, the savings rate in the U.S. has to and will rise. There are two basic ways this could happen. The Federal Reserve and policymakers are hoping that it will gradually as employment revives and income recovers. That too would allow government transfers to fall, helping to reassure holders of Treasuries.

A less benign scenario starts with a crisis in the bond market. This drives interest rates up and also collapses the stock market, causing a panicked rise in savings that could make the blip we saw last year look tame.

In the end the information about how it plays out will come from one of two places; the job market or the bond market.

One way or another, frugality's holiday has to end.

(At the time of publication James Saft did not own any direct investments in securities mentioned in this article. He may be an owner indirectly as an investor in a fund.)

## Bunds to outperform as euro area growth lags U.S.

By Emelia Sithole-Matarise

Euro zone benchmark German Bunds have had a stellar performance so far this year against U.S. Treasuries and more gains look in store for the rest of 2010 with the world's biggest economy set to lead a global recovery.

A lacklustre growth environment, such as is forecast for the euro zone, tends to favour sovereign debt. Given persistent worries about fiscally weaker euro zone states, the more liquid and high-rated German Bunds look set to benefit.

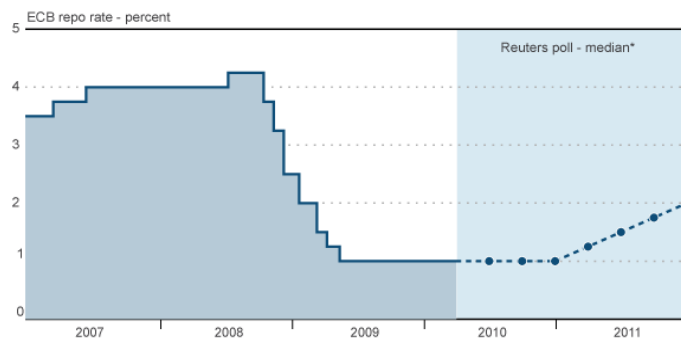
The gap between 10-year U.S. T-notes and Bund yields has ballooned by almost 40 basis points since the start of the year in favour of Bunds to its widest level in three years on increasing signs euro zone growth will lag the U.S. rebound.

Most analysts predict the spread will expand further in coming quarters to as much as a full percentage point by the end of the year.

Growing worries that a huge tide of U.S. government bond issuance this fiscal year are also behind expectations that Bunds will continue to outperform their U.S. counterparts.

"The fundamentals are much more bond bearish in the U.S. than in Europe," said Everett Brown, a strategist at IDEAglobal in London. "The U.S. usually leads in an economic cycle and the Fed will most certainly start raising interest rates well before the ECB (European Central Bank)."

Median forecasts in a recent Reuters poll of nearly 100 bond strategists showed 10-year U.S. T-note yields surging to 4.5 percent compared with 3.88 percent for the equivalent Bund in a year's time.



The latest Reuters polls also show a roughly 60 percent chance of interest rate hikes by end-2010 in the United States while

## DEEP DIVE Commentary and Analysis

economic worries as Greece's debt crisis simmers have seen ECB rate hike expectations pushed back to next year.

## WEIGHTY U.S. SUPPLY

A trio of tepid Treasury note sales last week also highlighted growing trepidation among investors that the heavy U.S. borrowing will hurt its ability to repay its debt in the not too distant future.

"You have more of a problem of Treasury supply in the U.S. than in Germany," said IDEAGlobal's Brown.

German government debt supply this year is expected to be more than 300 billion euros, including a record 86 billion euros of net new borrowing and its auctions have so far gone smoothly.

U.S. supply is estimated at \$1.5 trillion for the October-September fiscal year, 1-1/2 times more than total euro zone issuance expected this year.

"Bunds should outperform versus Treasuries over the next number of months and by Q4 2010 the spread should be at 100 ba-

sis points," said Padhraic Garvey, a strategist at ING in Amsterdam.

While the move wider appeared too much too fast for some in the market and might reverse somewhat in the second quarter as the Greek crisis that has supported Bunds at the margin waxes and wanes, the medium to long-term trend is for Bund outperformance.

"Though we expect a period of compression in Q2, the 10-year T-note/Bund spread will end the year above 50 basis points, probably not far away from current levels - keeping in mind that U.S./Euro bond spreads are and will remain very directional," said Cyril Beuzit, a strategist at BNP Paribas in London.

Bunds also fared better in terms of total returns in the first quarter than U.S. Treasuries, according to the latest Citigroup World Government Bond index data.

Bunds saw a return of 2.63 percent in local currency terms in the past three months versus 1.10 percent for U.S. Treasuries. In hedged dollar terms, Bund the return on German debt was 2.56 percent.

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(Compiled by Anil Kumar, Pronita Naidu and Mowna Ravikumar in Bangalore)

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