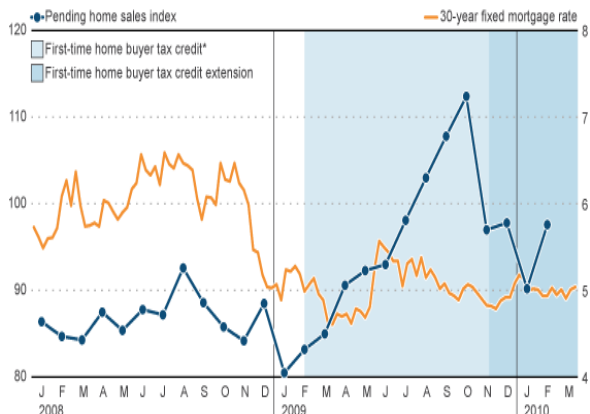


CHART OF THE DAY

U.S. pending home sales



Contracts for pending sales of previously owned homes unexpectedly rose 8.2 percent to 97.6 in February, a survey from the National Association of Realtors showed, a rise the group said may be attributed to home buyers taking advantage of a soon-to-expire tax credit.

TODAY'S TOP NEWS

- U.S. services sector grows at fastest clip since '06
- U.S. 10-year TIPS auction met with strong demand
- U.S. Treasury, OMB seek savings via paperwork trim
- Greece blames Germany for "racial approach" on aid
- IMF draft raises 2010 world growth forecast-reports
- U.S. says Obama seeks market-based Chinese currency
- U.S. bankruptcy filings rise to highest since 2005
- Conservatives signal no more tax hikes to cut UK debt
- U.S. gov't fetches 8.5 pct return from bailouts-SNL
- Japan MOF's Noda denies extra budget

ECON WATCH

FOR TUESDAY APRIL 6

ET	Indicators	Unit	Reuters	Prior
01:00	JP Coincident indicator	ind	-	2.5
01:00	JP Leading indicator	ind	-	2.4
04:30	EZ Sentix Index	ind	-6	-7.5
12:00	US Chicago midwest	ind	-	83.1
18:01	GB Nationwide Cons. Conf.	ind	-	80.0
19:50	JP Foreign reserves \$	bln	-	1051
-	US FOMC Minutes - March 16 meeting			
-	JP BOJ 2-day meet starts			

MARKETS TODAY

TODAY'S TOP STORY: The U.S. services sector grew in March at its fastest pace in nearly four years, data showed, while pending sales contracts for existing homes rose in February, suggesting steady economic improvement. **For more please click here**

TREASURIES: U.S. Treasury prices fell with benchmark yields touching 4 pct for the first time in 10 months, after encouraging data boosted bets on a faster pace of recovery and pared safe-haven demand for bonds.

- The market came off its session lows after strong demand for \$8 bln of TIPS, part of this week's \$82 billion in note supply.
- 10-yr Treasury notes fell 13/32 to yield 3.99 pct. Earlier, the yield rose as high as 4.007 pct -- a level not seen since June 2009.
- 30-yr bonds were down 22/32 yielding 4.85 pct.
- 2-10's part of the yield curve flattened more than 2 bps to 282 bps.

FOREX: The dollar retreated from a seven-month high against the yen as investors booked profits following four days of gains for the U.S. currency.

- Higher oil and metals prices helped propel the Canadian dollar to a 20-month high against its U.S. counterpart, leaving it within striking distance of parity, while the euro slipped.
- Dollar fell 0.49 pct to 94.29 yen, after earlier hitting 94.78 yen, a seven-month high. The euro fell 0.07 pct at \$1.3478.
- U.S. dollar fell 0.56 pct to 1.0028 Canadian dollars.

CORPORATES: U.S. corporate bond spreads tightened as improving economic data underpinned sentiment, helping the corporate market extend a seven-week narrowing trend.

- The CDX.IG-14 index tightened to about 84 bps from about 86 bps.
- Corporate bond yields remain close to their lowest levels since 2004, or about 4.58 pct.
- Corporate spreads are 161 bps, the lowest since November 2007 and down from 180 bps just a month ago.
- High-yield sales in March totaled \$34 bln, a record month, while the \$91 bln of IG sales made it the busiest month since May 2008.

STOCKS: U.S. stocks rose, pushing the Dow near 11,000, as signs of a turnaround in the U.S. labor market fueled hopes that the economic recovery is gaining strength, though higher bond yields and oil prices tempered some optimism.

- Dow rose 0.43 pct to 10,974.30, S&P gained 0.80 pct to 1,187.48 and Nasdaq was up 1.12 pct to 2,429.53.
- Apple shares rose 1.07 pct to \$238.49, Noble Energy jumped 2.19 pct to \$76.93, Halliburton gained 3.61 pct to \$31.85.
- S&P energy index rose 1.64 pct, S&P technology index gained 1.11 pct.

C & E: Oil prices rose to their highest since October 2008, after U.S. manufacturing, home sales and jobs data boosted optimism about a recovery in the world's top economy.

- U.S. crude oil gained 2.2 pct to \$86.74 per barrel.
- Gold was up 0.64 pct to \$1,131.65 an ounce.
- Reuters-Jefferies index rose 1.11 pct to 279.51.

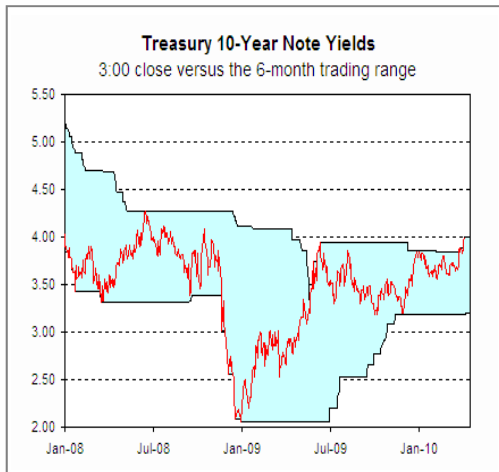
• For MARKET SNAPSHOT click here

• 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	0.170	0.135	0.172	0.005
3-Mo Bill	0.170	0.160	0.172	0.004
6-Mo Bill	0.255	0.250	0.259	0.014
1-Year	0.435	0.433	0.442	0.021
2-Year	99.641	99.672	1.185	-0.141
3-Year	98.914	98.945	1.756	-0.234
5-Year	98.867	98.914	2.745	-0.355
7-Year	98.734	98.781	3.455	-0.359
10-Year	97.000	97.063	3.996	-0.445
30-Year	96.578	96.641	4.843	-0.641

EQUITIES

	INDEX	CHANGE
DJIA	10963.80	36.73
NASDAQ	2425.62	23.04
S&P 500	1186.13	8.03

OIL

	PRICE	CHANGE
NYMEX	86.6	-0.1
BRENT	81.0	-0.2

EURODOLLAR FUTURES

	CLOSE	CHANGE
Apr-10	99.683	-0.008
Jun-10	99.615	-0.010
Sep-10	99.385	-0.050
Dec-10	99.045	-0.065

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.290	O/N	0.290
2-Week	0.250	2-Week	0.280
1-Month	0.260	1-Month	0.300
3-Month	0.300	3-Month	0.320
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.290	10:00 AM	0.210
2-Week	0.260	3:00 PM	0.202
1-Month	0.260		
3-Month	0.290		

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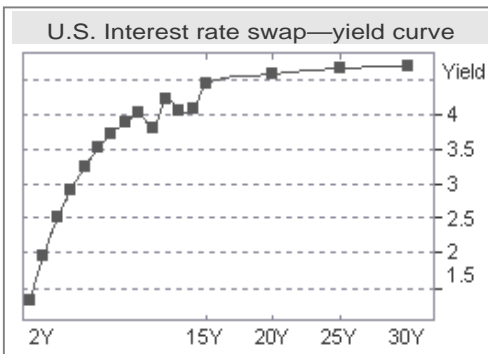
	SPREAD		RATE	
2-Year	14.00	18.00	1.31	1.34
3-Year	21.00	25.00	1.95	1.97
5-Year	18.25	22.25	2.92	2.92
7-Year	6.25	10.25	3.51	3.50
10-Year	1.25	5.25	4.00	3.98
30-Year	-17.25	-13.25	4.67	4.64

FUTURES

	PRICE	CHANGE
CBOT 5 yr	115.67	-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	0.180	0.250	-	-
1-Month	0.220	0.300	0.198	0.208
3-Month	0.240	0.400	0.210	0.220
6-Month	0.350	0.450	0.252	0.262
12-Month	0.700	1.050	0.464	0.474



CURRENCIES

	BID	ASK
Euro	1.3481	1.3484
Sterling	1.5279	1.5284
JP Yen	94.28	94.30
Swiss Franc	1.0622	1.0626
Can Dollar	1.0025	1.0030
Mexico	12.2530	12.2586

FED FUNDS

	NYFR SM - 10AM
Open	0.2000 1m 0.2344
High	0.2000 3m 0.2869
Low	0.2000

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1	12/04/2012	15 0	1.32
3-Year	1.625	15/04/2013	21 0	1.9
5-Year	2.875	09/02/2015	20 19.5	2.94
7-Year	5.125	18/10/2016	15 12	3.61
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	39 0	5.23

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	15/12/2011	-3.5 0	1.11
3-Year	1.75	07/05/2013	24 23.5	2
5-Year	2.625	20/11/2014	9.5 8.5	2.85
7-Year	5.25	15/09/2016	11.75 8.75	3.57
10-Year	3.75	27/03/2019	26 25	4.26
30-Year	6.25	15/07/2032	40 0	5.22

Active MBS 15YR

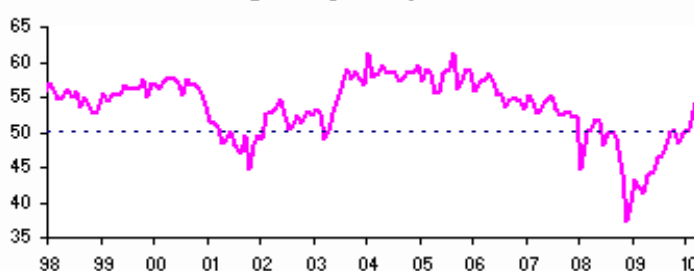
	CPN	BID	ASK	YIELD
FNMA	4.0	100.1710	100.1750	3.848
FHLMC	4.0	100.1870	100.1930	3.816

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.5	99.0360	99.0420	4.659
FHLMC	4.5	99.0560	99.0620	4.645
GNMA	4.5	100.0460	100.0520	4.448

Wrightson ICAPSM Chart of the Day

ISM Non-Manufacturing Survey: Composite Index vs Breakeven



TODAY'S TOP NEWS

U.S. services sector grows at fastest clip since '06

The U.S. services sector grew in March at its fastest pace in nearly four years, data showed, while pending sales contracts for existing homes rose in February, suggesting steady economic improvement.

ISM said its service index grew in March for a third straight month, jumping to 55.4, its strongest reading since May 2006. That was up from February's 53.0 reading and above economists' forecasts for 54.0 for March.

A separate report from the National Association of Realtors showed contracts for pending sales of previously owned homes unexpectedly rose in February.

The employment component of the ISM index rose slightly in March, while new orders jumped as well.

The Conference Board said the U.S. job market strengthened for a seventh straight month in March, with fewer Americans having trouble finding work. Employment Trends Index rose 0.7 percent to 94.4 in March from an upwardly revised 93.7 in February, originally reported as 93.5.

Meanwhile, The Obama administration expects U.S. job creation to quicken but economic recovery has a long way to go despite improved trends, White House officials said on Sunday.

U.S. Treasury, OMB seek savings via paperwork trim

The U.S. Treasury Department announced that it was joining forces with the government's budget agency to cut costs by exploring money-saving measures, including trimming paperwork. It said Treasury and the Office of Management and Budget will set up an Office of Financial Innovation and Transformation inside Treasury that is to try to improve the quality of financial management as the government struggles with huge budget deficits.

In a statement issued by Treasury, OMB Controller Danny Werfel said the intent was to find "common, simpler, and lower-cost solutions for basic financial management activities such as accounts payable and reporting."

Treasury noted that agencies annually spend \$750 million simply processing paper invoices for payments and that automating such processes in order to reduce unnecessary paperwork could save 20 percent of that total. The fiscal 2011 budget proposed an allocation of \$17 million to set up the new office.

IMF draft raises 2010 world growth forecast-reports

The world economy could grow 4.1 percent this year, 0.2 points more than previously forecast, IMF says in the latest draft of its World Economic Outlook, Italian news agency ANSA reported.

The U.S. economy is now expected to grow 3.0 percent this year, instead of the 2.7 percent forecast in the IMF's January report, according to ANSA and Italian newspapers which published the draft figures on Sunday.

The IMF is due to publish its next World Economic Outlook on April 21, business newspaper Il Sole 24 Ore said.

According to the draft, euro zone growth this year is now forecast to be 0.8 percent, down 0.1 points from January's estimate. In 2011, the figure is seen at 1.5 percent, also down 0.1 points, the reports said.

Europe "is coming out of recession more slowly than other regions," the draft said, because there are "various forces which are putting a brake on recovery," including Greece, Il Sole 24 Ore said in its report on Sunday. Germany is expected to report a 1.2 percent rise in GDP in 2010 and 1.7 percent in 2011, the draft says according to the reports. Those figures are down 0.3 points and 0.2 points respectively from the January forecast.

U.S. 10-year TIPS auction met with strong demand

An auction by the U.S. Treasury Department of \$8 billion in Treasury Inflation-Protected Securities was met with strong demand, as investors placed well over three times as many bids as there were securities available for purchase.

Analysts attributed the strength of today's TIPS auction, which saw a high yield of 1.71 percent -- below market expectations -- to a solid concession before the auction along with growing expectations of a stronger economic recovery, higher interest rates and more inflation.

"We continue to see structural buying in the TIPS market and investors often use TIPS auctions as a liquidity event," said Michael Pond, Treasury and inflation-linked strategist at Barclays Capital in New York. "We've been seeing increased foreign participation in TIPS auctions."

Today's auction was the first in a week of \$82 billion in new supply.

Greece blames Germany for "racial approach" on aid

Germany's hard line on aid for Greece has been based on a "moral, racial approach" and the prejudice that Greeks don't work enough, Greek Deputy Prime Minister Theodoros Pangalos told a Portuguese newspaper.

Pangalos told the paper that German leaders were too focused on catering to domestic voters at a time when the European Union required solidarity. Polls show Germans are overwhelmingly against a financial bailout for Greece and Chancellor Angela Merkel ensured at a summit in Brussels last month that tough conditions were attached to any such aid. Pangalos said this approach was "ridiculous" and failed to take into account strong productivity gains in Greek industry and agriculture.

Pangalos described the financial safety net deal for Greece agreed by EU leaders on March 25 as a "good step forward", but said it should have been more straightforward.

Meanwhile, The worst of Greece's financial crisis is over but the debt-stricken country must tackle cronyism and cut back on waste to emerge a stronger nation, Prime Minister George Papandreou said.

Separately, the sort of debt problems seen in Greece are likely to spread further in the euro zone and Portugal could be the next victim, Greek Deputy Prime Minister Theodoros Pangalos was quoted as saying.

U.S. says Obama seeks market-based Chinese currency

The United States reiterated its call for China's currency to be market-based, as lawmakers warned they would act if there was no movement from China on revaluing the yuan.

A Chinese government economist said that while the the U.S. decision to delay the contentious report was "a positive signal" that would permit more talks, it did not mean Beijing will change the value of the yuan any time soon.

"At least the U.S. side has created some room for further consultations and negotiations," said Huo Jianguo, head of the Commerce Ministry's think-tank, of the U.S. decision.

"But I don't think there will be a yuan adjustment in the near-term. We need to see whether China's export recovery will be sustained and need to see whether companies can cope with a stronger yuan."

Geithner said he would use meetings of the Group of 20 and a U.S.-China "strategic dialogue" in Beijing in May to urge China to budge on the yuan. President Barack Obama, many U.S. lawmakers and several economists say the currency is kept artificially low to boost Chinese exports.

TODAY'S TOP NEWS

U.S. bankruptcy filings rise to highest since 2005

More Americans filed for bankruptcy protection in March than at any time since federal bankruptcy laws were overhauled in 2005, reflecting the unevenness of the economy's stabilization after the deepest recession since the 1930s.

There were 158,141 U.S. bankruptcy petitions, covering consumers and businesses, filed in March, according to preliminary data compiled from court filings and released Thursday by Automated Access to Court Electronic Records.

The total increased 20 percent from 132,005 last March and jumped 35 percent from February's 117,240.

March's filings were 19 percent greater than the 133,393 recorded in October 2009. That total had been the highest since reforms to the U.S. Bankruptcy Code were implemented in October 2005. March's filings included 149,979 petitions by individuals and 8,162 filed by businesses, according to AACER.

Conservatives signal no more tax hikes to cut UK debt

Britain's opposition Conservatives said they do not intend to raise taxes beyond current Labor government plans to tackle a record budget deficit because spending cuts will do most of the work.

Conservative economics spokesman George Osborne has said he wants to cut the deficit faster than Labor's plans to halve it over four years.

The Conservatives have already pledged to reverse part of a planned increase in payroll tax next year but argue that because their deficit reduction plans place a greater emphasis on spending cuts, taxation plans beyond that should be sufficient.

Separately, British Prime Minister Gordon Brown said the world's large economies were close to agreeing a global tax on banks to help prevent another financial crisis, the Financial Times reported. Brown said the scene was set for a "global responsibility levy".

Meanwhile, 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 last week.

U.S. gov't fetches 8.5 pct return from bailouts-SNL

U.S. taxpayers earned an annualized 8.5 percent return from the government's bailout of 49 financial firms, underscoring efforts by the industry to speed up repayments and warrant repurchases, according to a report by SNL Financial.

Firms such as Citigroup and rivals that have made partial redemptions were excluded from the analysis, SNL Financial said in a statement.

Proceeds from TARP warrant repurchases and auctions led to a surge in returns through March 30, SNL said. So far, since the start of the program in late 2008, 64 institutions have fully repaid government aid.

The biggest banks, such as Goldman Sachs Group Inc, repaid the money they owed the Treasury last year and earlier this year. Still, more than 600 smaller banks are left in the program, and owe roughly \$130 billion to taxpayers.

Overall, firms that have exited the programs, plus those 18 that have fully redeemed their TARP preferred stock but still have their warrants held by the Treasury, returned 7.6 percent in the period, SNL Financial noted.

Japan MOF's Noda denies extra budget

Japan's government will use budget reserves to support the economy rather than compiling an extra budget, deputy finance minister Yoshihiko Noda said.

"The government is ready to respond flexibly if the economy shows some changes," Noda told a news conference.

He stressed that the government has budget reserves worth about 1 trillion yen (\$10.60 billion) available for fiscal 2010/11, which started on April 1, and further reserves of the same amount for use in case of emergency.

"The government will use the reserves first," he said, adding that there had been no discussion of a supplementary budget for fiscal year.

By tapping the reserves, the Democratic Party-led government would avoid the need to issue new bonds on top of a record 44.3 trillion yen (\$469.4 billion) in annual issuance already in the budget.

NEXT UP

PREVIEW-BOJ seen pausing in its battle against deflation

The Bank of Japan is expected to hold fire at its policy meeting next week, but is ready to ease its ultra-loose policy further in its drawn-out battle with deflation.

Having just expanded its cheap funds scheme, the central bank will likely save its limited remaining policy options in case a spike in the yen or bond yields triggers renewed government calls for more central bank action.

The government, saddled with the biggest debt in the developed world and struggling with sliding approval ratings ahead of a midyear upper house election, has been leaning on the central bank to help the economy.

Japan pulled out of its worst postwar recession nearly a year ago, but persistent declines in prices threaten to derail the recovery, hurting consumer spending and investment.

Discussions at the board will centre on whether strong factory output and improvement in business morale seen in the bank's March tankan survey warrant an upward revision in its economic assessment.

Such a revision could help defuse potential government pressure and buy the central bank more time.

POLL-U.S. crude oil stocks seen up for 10th week

U.S. crude oil inventories last week likely rose for the 10th straight week due to higher imports, according to a preliminary Reuters poll.

On average, the poll of seven analysts forecast a 1.7 million barrel increase in crude stocks and a 1.4 million barrel drawdown each in distillates and gasoline supplies.

Refinery utilization should show an 0.2 percentage point increase, to 82.8 percent of capacity, the poll showed.

In the corresponding week a year ago, refinery usage was up 0.1 percentage point at 81.8 percent of capacity.

Crude oil imports should show an increase as much as 500,000 barrels per day last week, said Beutel, after having dipped 337,000 bpd, to 9.1 million bpd, in the week to March 26 according to government data.

Gasoline supplies were expected to have dropped last week, after a surprise build the week before, analysts said.

The drawdown in distillates, which include heating oil and diesel fuel, was deemed seasonal by most analysts. In particular, they cited improving demand for diesel, amid signs of perceptible recovery in the manufacturing sector.



DEEP DIVE Commentary and Analysis

Former CDO, credit experts eye emerging markets

By Walden Siew and John Parry

Throng of U.S. credit experts displaced in the credit crisis have shifted their sights to emerging markets in South America and Asia, anticipating a corporate bond boom there will replace jobs lost in the securitization business.

Investors' realization that sliced and diced piles of debt with lofty-sounding acronyms such as CDOs could be treacherous was one catalyst for the global financial meltdown. As faith in that part of the bond market evaporated many experts who built, analyzed and sold such securities saw their jobs vanish.

More so than any other bond market sector, securitization desks were decimated in the market meltdown and ensuing wave of Wall Street layoffs, headhunters say.

"Back-to-basics" credit analysis is now particularly in demand, while Wall Street recruiters say many structured finance and securitization experts are still out in the cold.

"I think they have had a very difficult time trying to find a new home," said Gary Goldstein, president of Whitney Group, an executive search firm focusing on the financial services industry. "Many started out thinking that with all the TARP (the U.S. government's Troubled Asset Relief Program) money and the distressed investing that was going to be occurring, they would be a logical hire for some of these distressed opportunity funds," Goldstein said. "It didn't happen," he added.

Such distressed debt funds may need only a handful of credit experts, not the cohorts of staff who wove mortgage-backed securities into collateralized debt obligations at the height of the structured products boom before the crisis.

Yet there are signs that some of the alchemists who helped create these now infamous securities backed by pools of bonds and loans are reinventing themselves in more traditional roles in one of the fastest growing areas in 2010: emerging markets.

Reuters spoke to former analysts who covered CDOs for credit rating agencies S&P, Moody's and Fitch and who are now at hedge funds or fund of funds that specialize in emerging market opportunities and preferred to remain anonymous.

Some big buy-side institutions also have been selectively hiring some former securitization experts.

Mark Kiesel, who heads global credit research for Pacific Investment Management Co (PIMCO), the world's largest bond fund manager, says the global financial crisis has accelerated the growth of emerging markets and global credit analysis teams.

Kiesel has expanded his global team to 32 credit analysts from 18 five years ago. He sees parallels between the United States in the 1950s, as the country emerged from World War II, and emerging market nations such as China and India today, which will have huge infrastructure and financing needs that will stoke emerging credit markets, he said.

Experience in securitization is a key skill for analysts PIMCO has been hiring in emerging markets, where issuance will grow due to an increasing need to fund infrastructure projects.

Kiesel expects corporate bond issuance to pick up in the so-called BRIC nations, in Mexico, and in Asia in general. Emerging markets now make up more than 10 percent of some of Kiesel's portfolios, versus low single digits a few years ago, he said, noting good investing opportunities in some companies such as Gazprom, Petrobras and Electrobras.

Pimco hired Brigitte Posch, head of Latin America securitization and trading at Deutsche Bank in New York, in August 2008 to help Kiesel's team with fundamental credit analysis.

"Over time you'll need more people in emerging markets and more people evaluating the local opportunities in those countries including China, Brazil and India," Kiesel said. "These are growing countries that are increasing their influence in the markets.

They will have a lot more companies coming to market, and you're going to need people to do the bottom-up credit work for those countries."

That type of fundamental analysis was sorely lacking for complex Collateralized Debt Obligations and other mortgage-backed securities, the implosion of which helped trigger the 2007-2009 financial crisis.

A political and regulatory backlash against excessive risk-taking has deterred many financial institutions from plunging back wholesale into the business of highly leveraged and complex securities. Some of the people who engineered such debt instruments are looking farther afield for work.

"A lot of these people have not and will not (get jobs) because they were just excess fat," said Gustavo Dolfino, senior managing director at New York search consultancy Accretive Solutions. "Many are trying to reinvent themselves," shifting to government bond desks instead, "or are moving to Asia to find a new life," he said.

Some structured credit experts have found a new niche at big consulting firms to advise them on the valuations of CDOs on companies' and banks' balance sheets, said Goldstein. Others have been talking to credit rating agencies, where many started their careers, he added.

Investors rethink U.S./UK safety as debt surges

By Richard Leong and Emelia Sithole-Matarise

A surge in public borrowing in Britain and the United States has distorted historic market relationships and may have put to rest the long-held notion of risk-free U.S. and U.K. government debt.

For the first time on record, investors are demanding higher premiums on U.S. and U.K. government bonds than on debt issued between top-rated banks in the two countries.

This seismic shift along both sides of the Atlantic has turned the spotlight on the indebtedness of the world's No. 1 and No. 6 economies -- the legacy of expansionary policies adopted to combat recession.

What remains to be seen is whether this yield flip is an aberration, or a game-changer that permanently pumps up the relative U.S. and U.K. public debt cost versus G7 peers.

"Sovereign debt is not what it used to be," said Eric Green, chief U.S. economics and rates strategist at TD Securities in New York.

The latest warning sign for the United States and Britain is the yield inversion between so-called interest rate swap agreements and government debt.

Companies use these contracts to exchange fixed-rate obligations for floating-rate ones to manage changing cash flows and interest rates. They hedged \$342 trillion worth of various financial products at the end of June 2009.

The rate for the company to receive fixed-rate cash payments in a swap contract is expressed at a yield premium or spread over Treasuries.

At one point last week, a company could obtain fixed-rate dollar payments at a yield nearly 0.10 of a percentage point below the yield on a 10-year Treasury note. By Thursday, the rate on fixed rate payments briefly turned positive to Treasury yields.

CONTRASTING VIEWS

The yield inversion between swaps and government debt is seen by some analysts as a sign the United States and Britain could be following the same fiscal path as euro zone economies like Portugal, Italy, Ireland, Greece and Spain.

The euro zone market saw this inversion happen last year with Germany. Concerns about its soaring debt levels, and rising confidence among investors seeking higher yielding assets, saw

DEEP DIVE Commentary and Analysis

benchmark Bund yields slip below 10-year euro interest rate swap contracts last May for the first time in the euro's lifetime. That reversal was short-lived and the spread is now rangebound above zero.

The dominant view is that the United States and United Kingdom will also see only a short-lived yield inversion.

There are many analysts who attribute the reversal to a confluence of "technical" factors including unwinding of massive bad swap bets, the sheer amount of new supply and the increased use of swaps to hedge new corporate debt.

"This is not a credit issue. It's mainly a supply issue," said James Caron, head of global rates research with Morgan Stanley in New York.

Since the outbreak of the credit crisis in 2008, U.K. gilt supply has quadrupled, while the outstanding amount of U.S. Treasuries ballooned by 50 percent to \$7.6 trillion.

By comparison, the euro zone supply has risen by just over 50 percent to almost 1 trillion euros forecast for this year. That is largely why the 10-year Bund yield has been rangebound just below swaps since its brief inversion early last year.

INVERSION HERE TO STAY?

The yield inversion on the 10-year dollar swap and 10-year U.S. government note happened less than two months after the U.K. 10-year swap yield fell below that on 10-year gilts.

Part of the swap's yield premium reflected the perceived default risk of a counter-party, often a top-rated bank.

Thus, the inversion of these historical yield relationships bol-

stered the case for those who say investors are demanding more compensation to hold U.S. and U.K. government bonds.

"It's becoming an incredibly important barometer on sovereign risk going forward," said Joseph Brusuelas, President of Brusuelas Analytics in Stamford, Connecticut.

Still, most analysts argue that it is overblown to conclude U.S. and U.K. public finances have deteriorated so badly they are more likely to default than their countries' banks. The case of a government default has weakened since the two countries bailed out their banks just over a year ago.

"After all, if at the extreme, government default became a reality, what hope would there be for the banking system?" said Steven Major, a strategist at HSBC in London.

Morgan Stanley's Caron added if investors were fearful of a U.S. or U.K. default, the cost to insure their debt should have skyrocketed in the credit default swap (CDS) market.

The prices on U.S. and U.K. CDS, while edging higher in recent days, were far below the record highs seen during the global financial crisis.

Regardless of one's interpretations, the collapse in the yield gap between U.S. and U.K. swaps and public debt will likely remain in the near future as heavy government borrowing goes on.

"It is quite possible that the inverted swap spread...will persist for the next one to three months," HSBC's Major said.

On the other hand, technical factors could lead to a protracted inversion like the one seen in U.S. 30-year swaps. Hedging on exotic long-dated products has kept the 30-year swap spread from normalizing since early 2009.

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