

# INSIDE DEBT

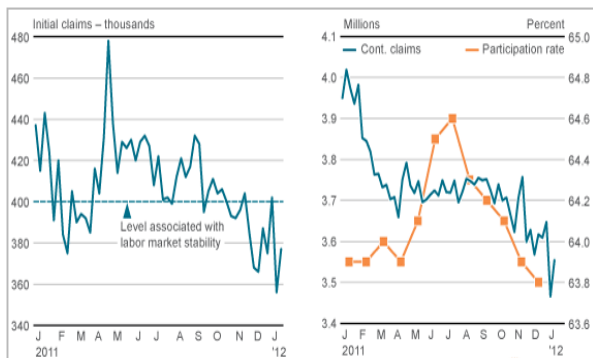
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Thursday, January 26, 2012

## CHART OF THE DAY

### U.S. Jobless Claims

Click on the chart for full-size image



New claims for unemployment insurance rose to 377,000 last week. For the week ended January 14, continuing claims fell to 3.55 million.

## TODAY'S TOP NEWS

- ECB role under scrutiny as Greek debt talks resume
- U.S. durable goods data points to economic momentum
- Senate clears way for \$1.2 trillion debt limit hike
- German consumer morale hits 10-month high going into Feb
- U.S. prime money funds cut euro zone exposure-Fitch
- U.S. state pension assets, earnings grew in 2010
- Euribor rates at lowest since March 2011

## ECON WATCH

FOR FRIDAY JANUARY 27

ET	Indicators	Unit	Reuters	Prior
02:00	DE Import Prices	mm	% 0.2	0.4
04:00	EZ Money-M3 ann growth	%	2.2	2
04:00	EZ Money-Private Loans	%	1.9	1.7
08:30	US Real GDP qq SAAR	%	3	1.8
08:30	US Implicit Deflator	%	1.8	2.6
08:30	US Final Sales	%	2.5	3.2
08:30	US PCE Price Index	%	0.6	2.3
08:30	US Core PCE Prices	%	0.9	2.1
09:55	US Reuters/UMich Sent	--	74.1	74
09:55	US Current Conditions	--	83	82.6
09:55	US Expectations	--	69	68.4
--	US Building Permits	mln	--	0.679

- For EYE ON ASIA click here
- For MARKET SNAPSHOT on Asia click here
- For EYE ON LATAM click here

## U.S. MARKETS TODAY

**TODAY'S TOP STORY:** Greece's tortuous negotiations over a debt swap with private creditors honed in on demands that the European Central Bank contribute to a deal to bring Athens' messy finances back on track. **For more please click here**

**TREASURIES:** Treasury debt prices rose, and five-year note yields dipped to the lowest level since at least the 1960s, a day after the Federal Reserve said it will likely hold interest rates near zero at least through late 2014.

- Treasury sold \$29 bln in 7-yr notes with high yield of 1.359 pct and bid-to-cover ratio 2.73.
- 5-yr notes yield was last at 0.78 pct from 0.80 pct.
- 10-yr notes added 19/32 to yield 1.94 pct from 2 pct.
- 30-yr notes surged more than a point to yield 3.09 pct from 3.15 pct.

**FOREX:** The euro traded roughly unchanged against the dollar, after earlier hitting a five-week high, as the recent rally in the single currency petered out even after the U.S. Federal Reserve's pledge to keep rates near zero for several more years.

- The euro was last at \$1.3103, up 0.1 pct, sharply below a session high of \$1.3184 hit earlier. The failure of EURUSD to breach the 61.8 percent retracement of the \$1.3550 high in December to the \$1.2624 low on Jan. 13 is behind the euro's drop, according Brian Dolan, chief currency analyst at Forex.com in Bedminster, New Jersey.
- The dollar gave back some of its recent gains against the yen, slipping to 77.44, down 0.44 pct. Strong technical resistance was cited around the 200-day moving average now at 78.33 yen.

**CORPORATES:** Corporate bond spreads tighten to unchanged as investors remain cautious on economic reports that differed from the trend of an improving recovery.

- The CDX.IG-17 index was unchanged at 102 bps.
- New issuers included Targa Resources Partners, Nara Cable and Lamar Advertising.

**STOCKS:** A month-long rally on Wall Street appears to be sputtering, as stocks slipped in what investors called a possible warning of weakness ahead.

- Dow was down 20.97 points or 0.16 pct at 12,735.99, S&P fell 7.53 points or 0.57 pct to 1,318.52 and Nasdaq lost 12.50 points or 0.44 pct to 2,805.81.
- Toll Brothers lost 4.9 pct and SunTrust Banks shed 5.18 pct, while Caterpillar shares gained 2.01 pct.

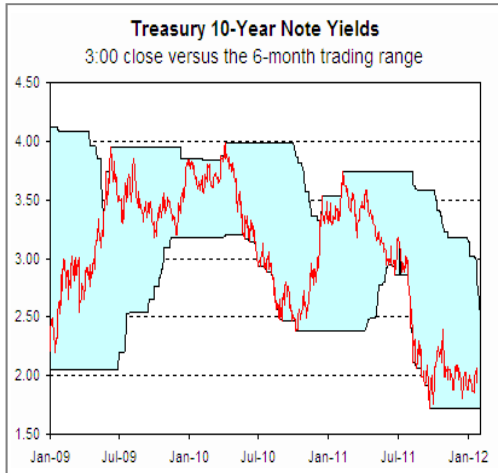
**C & E:** Crude futures ended only slightly higher after paring gains late as the euro turning negative against the dollar and weak equities, pulling oil prices back from an advance sparked by the Federal Reserve's commitment to keep interest rates low.

- March crude rose 0.51 pct to settle at \$99.91 a barrel having traded from \$99.23 to \$101.39.
- Gold rose 0.59 pct to \$1,719.54 an ounce.
- Reuters Jefferies index edged up 0.33 pct to 317.42.

- 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	0.055	0.02	0.056	0.012
3-Mo Bill	0.050	0.040	0.051	0.007
6-Mo Bill	0.075	0.070	0.076	0.012
1-Year	0.105	0.095	0.107	0.007
2-Year	100.055	100.086	0.223	0.016
3-Year	99.828	99.859	0.309	0.059
5-Year	100.477	100.523	0.778	0.207
7-Year	100.297	100.344	1.330	0.414
10-Year	100.531	100.578	1.940	0.523
30-Year	100.484	100.563	3.100	0.992

**EQUITIES**

	INDEX	CHANGE
DJIA	12728.42	-27.82
NASDAQ	2801.62	-16.58
S&P 500	1317.13	-8.87

**COMMODITIES**

	PRICE	CHANGE
NYMEX	99.8	0.4
BRENT	111.0	1.2
SPOT GOLD	1722.7	13.3
PALLADIUM	689.2	-1.8
SILVER	33.4	0.2

**REPURCHASE AGREEMENTS**

G/C		MORTGAGE REPOS	
O/N	0.160	O/N	0.200
2-Week	0.170	2-Week	0.220
1-Month	0.180	1-Month	0.250
3-Month	0.180	3-Month	0.250
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.180	10:00 AM	0.120
2-Week	0.200	3:00 PM	0.119
1-Month	0.200		
3-Month	0.210		

**IR SWAPS <19901>**

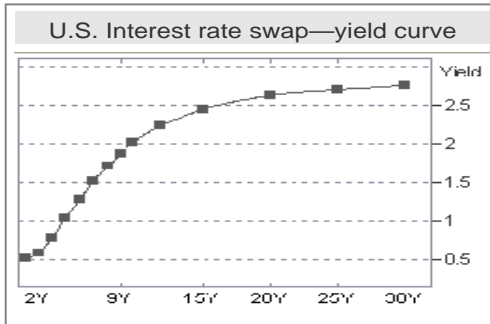
	SPREAD		RATE	
2-Year	29.75	33.75	0.51	0.54
3-Year	29.00	33.00	0.59	0.62
5-Year	26.75	30.75	1.04	1.06
7-Year	20.75	24.75	1.53	1.55
10-Year	8.75	12.75	2.03	2.04
30-Year	-33.00	-29.00	2.77	2.77

**EURODOLLAR FUTURES**

	CLOSE	CHANGE
Feb-12	99.48	0.01
Mar-12	99.53	0.03
Jun-12	99.52	0.02
Sep-12	99.50	0.03

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

	BID	ASK	BID	ASK
O/N	0.080	0.110		
1-Month	0.240	0.350	0.078	0.088
3-Month	0.350	0.500	0.082	0.092
6-Month	0.550	0.700	0.091	0.101
12-Month	0.820	1.030	0.096	0.106



**FUTURES**

	PRICE	CHANGE
CBOT 5 yr	123.84	0.23
CBOT 10 yr	131.44	0.67
CBOT 30 yr	142.84	1.06

**CURRENCIES**

	BID	ASK
Euro	1.3104	1.3106
Sterling	1.5690	1.5694
JP Yen	77.46	77.48
Swiss Franc	0.9204	0.9206
Can Dollar	1.0013	1.0018
Mexico	12.9855	12.9916

**ACTIVE FANNIE MAE AGENCIES**

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.5	8/9/2013	1 -2	0.225
3-Year	0.75	12/19/2014	14 11	0.444
5-Year	1.25	1/30/2017	30.25 27.25	1.075
7-Year		-		
10-Year				
30-Year	6.625	11/15/2030	24.5 21.5	3.343

**ACTIVE FREDDIE MAC AGENCIES**

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.375	11/27/2013	8 5	0.295
3-Year	0.625	12/29/2014	14 11	0.444
5-Year	2	8/25/2016	19 16	0.963
7-Year		-		
10-Year	2.375	1/13/2022	46 43	2.397
30-Year	6.25	7/15/2032	29 26	3.386

**Active MBS 15YR**

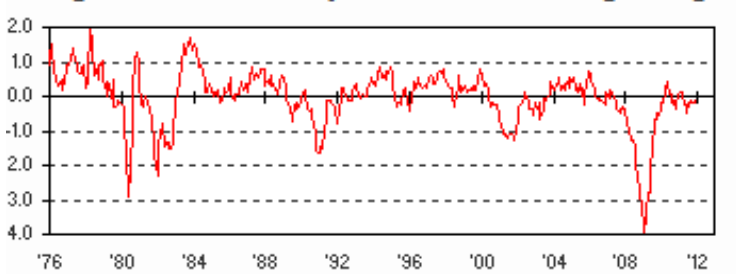
	CPN	BID	ASK	YIELD
FNMA	3.5	104.3110	104.3150	2.425
FHLMC	3.5	104.3130	104.3170	2.276

**Active MBS 30YR**

	CPN	BID	ASK	YIELD
FNMA	4.0	105.0970	105.1030	2.181
FHLMC	4.0	105.0260	105.0320	2.167
GNMA	4.0	107.1520	107.1560	2.218

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

**Chicago Fed National Activity Index: 3-Month Moving Average**



## TODAY'S TOP NEWS

**ECB role under scrutiny as Greek debt talks resume**

Greece's tortuous negotiations over a debt swap with private creditors honed in on demands that the European Central Bank contribute to a deal to bring Athens' messy finances back on track.

EU Economic and Monetary Affairs Commissioner Olli Rehn told Reuters "there is likely to be some increased need of official sector funding, but not anything dramatic." It was the first time a top EU official had confirmed more public money than a 130 billion euro package would be required to rescue Greece.

The ECB had ruled out taking voluntary losses on its Greek bond holdings but is now debating how it would handle any forced losses and whether to explore legal options to avoid such a hit, central bank sources told Reuters on Wednesday.

Greek bankers and government officials said they had not heard of any new proposal from creditors, after local media reported they were willing to improve their "final offer" of a 4 percent interest rate on the new bonds to about 3.75 percent.

Charles Dallara, chief of the Institute of International Finance that leads negotiations on behalf of private creditors, is due to meet Prime Minister Lucas Papademos.

The IIF has said Thursday's discussions will be "informal" and aim to sort out legal and technical issues quickly. German Chancellor Angela Merkel said the debt swap talks were on a "good path".

**U.S. Senate clears way for \$1.2 trillion debt limit hike**

The U.S. Senate voted to support President Barack Obama's move to increase the nation's borrowing authority by \$1.2 trillion, ending Republican attempts to block the debt limit hike.

By a mostly partisan vote of 52-44, the Democratic-controlled Senate killed legislation passed by the Republican-led House of Representatives last week to deny the additional borrowing authority.

Both the House and Senate would have had to vote for the resolution of disapproval in order to stop the debt ceiling increase.

Republicans pushed the legislation during this election year knowing that without a debt limit increase the U.S. government would default, sending shock waves through global economies.

But confident that Senate Democrats would back Obama's move to raise borrowing authority to \$16.394 trillion, Republicans took advantage of an opportunity ahead of November elections to restate their opposition to mounting government debt.

**U.S. prime money funds cut euro zone exposure-Fitch**

U.S. prime money market funds further reduced their exposure to securities issued by euro zone banks in December because of nagging worries about the region's sovereign debt crisis, Fitch Ratings said.

The 10 biggest money market funds tracked by Fitch that can invest outside of U.S. government securities cut their holdings of euro zone bank debt by 16 percent on a dollar basis at the end of December versus the end of November, the rating agency said in a research report.

Since the end of May, the funds reduced their euro zone debt holdings by 72 percent.

U.S. money funds had been a major source of short-term financing for euro zone banks, which accounted for 9.9 percent of their assets. These funds' assets stood at \$644 billion at the end of December, equivalent to 45 percent of the \$1.44 trillion of all U.S. prime fund assets. Since the end of May 2011 when the euro zone debt crisis flared up again, the funds' French exposure has fallen 94 percent, Fitch said.

**U.S. durable goods data points to economic momentum**

New orders for U.S. manufactured goods rose in December and a gauge of future business investment rebounded, showing the economy ended the year with more momentum than previously thought.

The Commerce Department said orders for durable goods climbed 3.0 percent last month, boosted by a surge in aircraft orders. Economists had forecast orders rising 2.0 percent.

Orders for capital goods outside defense and excluding aircraft climbed a steeper-than-expected 2.9 percent. They had declined the previous two months.

In a separate report, the Conference Board said its index of future U.S. economic activity rose to a five-month high in December as labor market conditions improved.

The Labor Department data showed initial claims for state unemployment aid increased 21,000 to 377,000. The four-week moving average for initial claims, which provides a better view of trends, fell 2,500 to 377,500. The Commerce Department also released a report showing new U.S. single-family home sales unexpectedly fell in December for the first time in four months, while the median home price dropped.

Separately, annual revisions from the Institute for Supply Management-Chicago showed the business barometer was revised to 62.2 last month, just shy of the initial reading of 62.5.

**German consumer morale hits 10-month high going into Feb**

German consumer morale rose unexpectedly to a 10-month high going into February, a survey showed, in the latest sign that consumption may support Europe's biggest economy through uncertain times.

Confidence improved for the fifth month in a row, the report by GfK market research institute showed, highlighting a consistently upbeat mood among consumers despite the headwinds of Europe's unresolved debt crisis.

The consumer sentiment indicator, based on a survey of 2,000 Germans, rose to 5.9 - the same point where it stood last April - compared with economists' forecast for a reading of 5.6.

"Private consumption can do what it's supposed to -- provide an important support for the economy this year," GfK said in a statement accompanying survey data.

"It is above all important that trust lost during the crisis is restored," it added.

**U.S. state pension assets, earnings grew in 2010**

Bucking criticism about their financial performance, state retirement systems' assets grew in 2010, with investment earnings rising for the first time since 2007, the U.S. Census reported.

The pension funds' cash and investments totaled \$2.2 trillion in 2010, up 10.7 percent, or \$213.9 billion, from 2009, when their cash and investment holdings fell by \$610.8 billion.

The funds' investment earnings were \$289.6 billion in 2010, compared with 2009, when the investments lost \$511.5 billion.

According to the Census, contributions from employees and employing governments totaled \$97.7 billion in 2010.

Government contributions accounted for two-thirds of the pension fund receipts and increased 1.8 percent, while employee contributions decreased 1 percent.

Separately, tax revenue of the U.S. states grew 6.1 percent in the third quarter of 2011, but slow economic growth could cause improvements to slacken, the Rockefeller Institute of Government reported.



## TODAY'S TOP NEWS

**Euribor rates at lowest since March 2011**

Euro zone bank-to-bank lending rates fell to their lowest in nearly 11 months with the European Central Bank poised to offer more 3-year loans in February.

The cost of borrowing dollars for three months in the unsecured interbank market eased after U.S. Federal Reserve Chairman Ben Bernanke said on Wednesday the central bank was ready to offer the economy additional stimulus after announcing it would likely keep rates near zero until at least late 2014.

Euro zone bank-to-bank lending rates fell to their lowest since March 2011 to 1.142 percent, and down from 1.149 percent in the previous session. The spread between the 3-month Euribor rate and Eonia overnight rates was 77 basis points, down from 79 basis points the day prior. The three-month dollar Libor rate fell to 0.5531 percent from 0.5566 percent.

Banks borrowed 3.47 billion euros from the ECB overnight, down from 3.62 billion the day prior. They deposited 484.13 billion euros at the deposit facility overnight, down from 485.79 billion euros the day prior.

**Italy sells top amount at bond sale, yields fall**

Italy's borrowing costs dropped sharply as it sold the maximum amount of 5 billion euros at an auction of short-term debt, helping drive down yields on its longer-dated bonds ahead of a crucial sale of five- and 10-year paper on Monday.

At the first auction since credit rating agency Standard & Poor's downgraded Italy by two notches, yields on its two-year zero-coupon bonds fell to 3.76 percent - the lowest since August and more than a percentage point less than it paid a month ago.

Italian government bond yields and the cost of insuring its debt against default fell after the auction, with the yield on its benchmark 10-year bond 15 basis points lower on the day at 6.09 percent.

Separately, Portuguese five- and 10-year government bond yields were marked at euro-era highs as yields for five-year rose 82 bps to 20.25 percent, while ten-year yields were 23 bps higher at 15.23 percent.

**UK Jan retail sales suffer biggest drop in nearly 3 yrs- CBI**

British retail sales suffered their biggest annual fall in nearly three years in January, as shoppers reined in spending after picking up pre-Christmas bargains, an industry survey showed.

The Confederation of British Industry distributive trades survey's balance for reported sales volumes plunged to -22 in January from +9 in December, its lowest level since March 2009, when Britain was last in recession.

Analysts had forecast a fall to -6.

Retail sales grew well in the three months to December, but many firms were concerned about the prospects for early 2012. Annual retail sales growth was flattered in December 2011 because of heavy snow a year earlier, but the CBI said January 2012 annual performance suffered because of relatively strong sales in the year-ago month.

The CBI's expected sales balance for February rose to -10 from -18, but firms expected to scale back the volume of orders they place with suppliers by the biggest amount since September 2009.

**NZ central bank holds rates, softens outlook**

New Zealand's central bank held its cash rate steady and added a dovish tone by signalling that policy rates will be on hold for longer than indicated earlier.

The Reserve Bank of New Zealand kept the official cash rate at a record low of 2.5 percent where it has been since March, as expected, to cushion the economy from global risks such as the ongoing European debt crisis.

The central bank cut its policy rate shortly after a devastating earthquake in February and has maintained its easy stance even when some peers in the region were raising rates to counter high inflation.

It is widely expected to begin tightening rates this year.

"Given ongoing uncertainty around global conditions and the moderate pace of domestic demand, it remains prudent to keep OCR on hold," RBNZ Governor Alan Bollard said in a one page comment.

## NEXT UP

**POLL-Bernanke keeps Wall St stimulus expectations intact**

Federal Reserve Chairman Ben Bernanke lent support to expectations at most leading Wall Street firms that the U.S. central bank will provide new stimulus for the economy in the first half of this year, a Reuters poll showed.

Economists at 12 of 18 primary dealers said the central bank would do further quantitative easing. The poll was conducted after Bernanke's news conference. Eight of the dealers forecast the Fed would undertake a new stimulus program in the first half of 2012, while the remainder of those looking for more stimulus said it would happen later in 2012.

The median forecast from 10 dealers pointed to a program of \$600 billion of purchases of Treasuries or mortgage-backed securities. Credit Suisse expects the Fed to announce a securities purchase program of about \$600 billion in the first half of 2012. Most economists at primary dealers had already been calling for further Fed stimulus, with 12 of 17 dealers saying the central bank will undertake further quantitative easing in a poll conducted late last week. The median of forecasts for the size of the program was also \$600 billion in the earlier poll, and eight dealers also forecast such a program would be announced in the first half of this year.

**POLL-More pain awaits euro zone periphery**

Greece, Portugal, Spain, and to a lesser extent, Ireland, still face a year or two of economic strife as severe austerity measures rip into growth prospects for the euro zone's weakest members, a Reuters poll showed.

A Reuters poll of over 20 economists taken this week said Portugal's economy will contract 3.2 percent this year and stagnate in 2013.

All of the four countries in the poll will suffer double-digit rates of unemployment for the next couple of years, well above the latest euro zone average of 10.3 percent.

Greece will suffer an economic contraction of around 3.7 percent this year - marking its fifth year in recession - before stagnating in 2013. A separate poll of 50 economists suggested there is a 70 percent chance that Portugal will require a second EU/IMF bailout at some point.

The poll suggested there is a great deal of doubt among economists over whether S&P was right to cut the ratings of nine euro zone countries. Only 21 out of 46 economists thought S&P's euro zone ratings reflected the situation better than rivals Moody's and Fitch, which have so far refrained from wholesale downgrades of euro zone sovereign credit ratings.



## EYE ON ASIA

## POLL &amp; PREVIEW

## Thai Dec factory output seen down 28 pct y/y due to floods

Factory output probably fell 28 percent in December from a year earlier after a 48.6 percent slump in November, reflecting the impact of severe flooding late last year.

Some factories are back in business but many plants remain closed after the flooding shut seven big industrial estates in October, with the auto and electronics sectors the worst hit.

The central bank said production might not return to normal until the third quarter.

Thailand is Southeast Asia's biggest auto maker and the world's second-biggest maker of hard disk drives. Many of the flood-hit firms are big exporters in those sectors.

The Bank of Thailand said the impact of flooding had been greater than expected and the recovery was likely to be drawn out, while faltering global demand was a drag on exports.

The BOT said 2011 GDP growth would be lower than the 1.8 percent forecast and it would review its 2012 growth forecast of 4.8 percent. It is due to release new forecasts next week.

Exports probably dropped 2.4 percent in December. The central bank trade data is based on financial settlements and usually mirrors earlier customs-based data, which showed annual exports fell just 2 percent in December.

Industrial goods account for about 65 percent of total exports and agricultural products 17-19 percent.

Imports, however, were expected to grow nearly 19 percent from a year earlier, after falling 1.9 percent in November.

## EVENTS

For Jan 27

## INDIA

- Bank loan growth for two-weeks: Prior 15.90 pct
- FX reserves, USD w/e: Prior 292.52 bln

## SINGAPORE

- Final URA property index for Q4: Prior 0.2 pct

## THAILAND

- Manufacturing production for December: Expected -28.00 pct  
Prior -48.60 pct
- Forex reserves w/e: Prior 174.9 bln
- Currency swaps: Prior 30.9 bln

## MARKET SNAPSHOT as of 3:00 pm EST

GOVERNMENT BOND BENCHMARKS					EQUITIES			FORWARDS 3 months <FORWARDS>		
	5-Year		10-Year			Close	Change		Bid	Ask
	Bid	Yield	Bid	Yield						
Australia	111.488	3.493	114.755	4.008	S&P/ASX200	-	-	JPY	-6.85	-6.35
Japan	99.798	0.342	100.108	0.988	NIKKEI 225	8849.47	-34.22	AUD	-105.41	-104.91
China	102.340	3.010	101.339	3.400	HKSE	20439.14	328.77	NZD	-49.8	-48.8
Hong Kong	100.600	0.697	98.000	1.414	SHANGHAI	2319.12	23.04	HKD	-18	-13
Singapore	102.550	0.507	105.650	1.597	STRAITS TIMES	2894.43	2.79	SGD	-5.6	-5.5
					SENSEX	17077.18	81.41	THB	18.25	18.75
INTEREST RATE SWAPS <SWAPS>					DEPOSITS 3 months <DEPOS>			NDF's 3 months <NDFS>		
	5-Year		10-Year			Bid			Bid	Ask
	Bid	Ask	Bid	Ask						
AUD	4.41	4.47	4.79	4.845	JPY	0.18		CNY	-0.022	-0.017
JPY	0.435	0.495	0.9525	1.0125	CNY	5.2		TWD	-0.215	-0.195
CNY	3.67	3.77	3.69	3.89	AUD	4.6		KRW	1128.5	1129.4
HKD	0.99	1.07	1.75	1.83	NZD	2.95		INR	51.025	51.125
TWD	1.05	1.06	1.29	1.33	HKD	0.3		MYR	3.056	3.06
INR	5.85	6.05	5.85	6.25	SGD	0.25		PHP	42.95	43.06
KRW	3.43	3.47	3.5775	3.6175				IDR	8965	9065
SGD	1.13	1.16	2.025	2.06						

## EYE ON LATAM

## LATAM TOP STORIES

**Brazil eyes low interest rates, unemployment falls**

Brazil's central bank gave the strongest signal yet that it will keep slashing interest rates into single-digit territory, even as record-low unemployment reinforced concerns that the tight labor market could pressure inflation.

The bank struck a dovish tone in the minutes of its latest monetary policy meeting in which it cut interest rates for the fourth straight time, saying that a weak global economy would continue to help ease inflation pressures at home.

The minutes were released just two days after official data showed consumer prices rose more than expected in the month-long period through mid-January, rekindling worries about naggingly high inflation in Latin America's largest economy.

Still, the central bank stressed that the 12-month inflation rate in Brazil will continue to decline, increasing the likelihood that benchmark lending rate - now at 10.5 percent - will fall into single digits.

The central bank said structural changes to the Brazilian economy are helping to pave the way for lower interest rates, a sea change for a country that has long had some of the highest borrowing costs in the world.

Brazil's IPCA consumer price index rose a higher-than-expected 0.65 percent in the month through mid-January, highlighting the inflation challenge going forward.

The government barely hit the official target ceiling of 6.5 percent last year.

**Mexican retail sales jump in Nov from Oct**

Mexican retail sales rose in November at their fastest pace in over a year, fueled by a long weekend of sales, but the boost may be temporary amid signs of slowing domestic growth.

Mexican retail sales rose 2.2 percent in November from an upwardly revised 0.1 percent in October, the national statistics agency said. A Reuters poll forecast a 2.1 percent jump.

November saw the fastest monthly pace of growth since May 2010.

A private retail association has already reported sales in November surged by a record of nearly 15 percent, fueled by a long weekend of discounts and early government bonuses.

The sharp gain in November may have weighed on December's demand, analysts noted.

Mexican consumer confidence slipped to a three-month low in December and last week Mexico's central bank noted the domestic economy was losing steam under the weight of a global slowdown.

Retail sales increased 7.5 percent in November compared to the same month a year earlier, above the 5.20 percent rate expected by analysts. That was the fastest year-over-year increase since April 2005.

**Argentina unemployment below 7 pct - President**

Argentina's unemployment rate was 6.7 percent in the fourth quarter of 2011, President Cristina Fernandez said, sinking below the 7 percent barrier for the first time in her government.

Unemployment was 7.2 percent in the third quarter of last year and 7.3 percent in the fourth quarter of 2010.

Joblessness is at its lowest in two decades but analysts say keeping people in jobs will be a leading challenge for Fernandez

## LATAM MARKETS TODAY

**TREASURIES:**

- Mexican 10-yr notes were up, yielding 5.95 pct and 30-yr bonds rose yielding 7.31 pct.
- Brazilian 10-yr notes surged, yielding 11.52 pct and 2-yr notes gained, yielding 10.31 pct.

**FOREX:**

- Brazilian real was down 0.57 pct to 1.75 per dollar.
- Mexico's peso lost 0.09 pct to 13.0065.
- Chile peso slumped 1.07 pct to 486.95 per dollar.
- Colombia's peso slipped 0.05 pct to 1,810.8 to the dollar and Peru sol was unchanged at 2.691 to the dollar.

**STOCKS:**

- MSCI Latin American stock index gained 0.84 pct to 4,046.45. The index's relative strength index crossed into so-called overbought territory.
- Homebuilders and oil companies drove gains in Brazil's Bovespa index. The index rose 0.75 pct to 62,953.06. Brazil's exchange was closed on Wednesday for a local holiday.
- Vale lost 0.84 pct.
- PDG Realty drove gains in the index as it rose 5.22 pct and OGX added 1.07 pct.
- Wal-Mart Mexico led Mexico's IPC benchmark index higher. The IPC index edged up 0.08 pct to 37,240.78. Wal-Mart de Mexico gained 2.36 pct and America Movil rose 0.07 pct.
- Chile's IPSA index edged down 0.02 pct, its fourth straight session of losses.
- Falabella was up 0.52 pct and Cencosud fell 1.15 pct.

## LATAM TOP STORIES

*(continued)*

as the global economic outlook worsens.

The combative 58-year-old leader addressed a crowd assembled in the presidential palace, chiding her political enemies and speaking for nearly an hour about the economy.

This year looks to be a challenging one as Argentina faces fallout from Europe's financial meltdown and slowing demand from No. 1 trade partner Brazil and key commodities client China.

Argentine workers are demanding pay raises in line with inflation estimated by private economists at more than 20 percent, fueling the risk of labor unrest.

**Uruguay outlook now positive, was stable -Moody's**

Moody's Investors Service revised upward its credit rating outlook for Uruguay to positive from stable, citing fiscal discipline that has led to moderate deficits and declining debt metrics.

"Along with an enhanced ability to manage adverse economic and financial conditions, the government's credit profile has been improving gradually - but steadily - moving closer in line with that present in higher-rated sovereigns," Moody's said in a statement.

Moody's rates Uruguay's long-term sovereign foreign currency credit at Ba1, one notch below investment grade. Both Standard & Poor's and Fitch Ratings have Uruguay at the similar rating level of BB-plus, but with stable outlooks.



## DEEP DIVE Commentary and Analysis

## FED FOCUS

## Bernanke has 'finger on trigger' for new bond buys

By Ann Saphir and Jonathan Spicer

The Federal Reserve has moved closer to embarking on a new round of its controversial money-pumping after the central bank and its chairman Ben Bernanke highlighted a grim outlook for the U.S. economy.

Bernanke on Wednesday opened the door a bit wider for the Fed to return to buying securities in the months ahead to buttress a weak recovery and keep inflation from slipping too far below its newly adopted 2-percent target.

"It sounds like the finger is on the trigger," said Thomas Simons, a money market economist at Jefferies & Co.

The Fed's announcement that it was unlikely to raise interest rates until at least late 2014, more than a year beyond its previous guidance, immediately pushed down Treasury bond yields and Bernanke's comments to the media raised expectations of a further round of so-called quantitative easing, or QE3.

It remains to be seen if the potential political backlash proves too daunting.

The prospect of the Fed pumping yet more money into the U.S. economy was seized upon by Republican hopeful Newt Gingrich to slam President Barack Obama's record. That highlighted the political pitfalls for the Fed in an election year.

Barring an unexpected pick-up in inflation or the U.S. economy suddenly kicking into a higher gear, Bernanke said it was logical that the Fed should look at ways to do more to help.

"The framework makes very clear that we need to be thinking about ways to provide further stimulus if we don't get improvement in the pace of recovery and a normalization of inflation," he told a quarterly news conference.

"Probably the main take-away from the press conference is the sense conveyed by Bernanke that it would not take much of a disappointment in growth or inflation to get the Fed to start another round of QE," said Michael Feroli, chief U.S. economist at J.P. Morgan.

"In fact, from his answers it's not even clear any disappointment would be necessary to see more QE," Feroli wrote in a note, adding he was not forecasting another round of asset purchases even if the bar for action was low.

The Fed in late 2008 slashed interest rates to near zero and has since bought \$2.3 trillion in long-term securities in an unprecedented drive to spur growth and revive the economy after the worst recession in decades.

Yet the recovery has been slow and the outlook issued by the Fed on Wednesday was bleak.

With core inflation now at 1.7 percent and Fed officials forecasting unemployment to stay above 8 percent this year, many analysts took Bernanke's comments to mean QE3 is all but inevitable.

## MORTGAGES

The Fed has trained its sights on the stalled housing market in recent months, so any move to QE3 is most widely expected to involve buying mortgage securities to help bring down further already record-low mortgage interest rates.

Some economists said Bernanke may wait until the end in June of the Fed's "Operation Twist", which involves selling short-term bonds and buying longer-term ones in its \$2.9 trillion portfolio to push down long-term interest rates further.

Bernanke may also want to wait until the market has absorbed his sweeping changes in communications policy which included the Fed adopting an explicit inflation target and releasing the interest rate projections of its policymakers for the first time on Wednesday.

Buying more mortgage-backed securities would drive down longer-term rates on mortgages with a view to countering what remains a drag on a U.S. economy still struggling to emerge from the worst recession in generations.

"I think it could happen any time now, based on the language that we saw today," said Eric Stein, a portfolio manager at Eaton Vance in Boston.

"I would think the first thing would be squarely focused on purchasing mortgage-backed securities, partially because Treasury yields are already so low, and housing is one of the major issues."

## POLITICAL PITFALLS

The blowback from a heavy round of MBS purchases could be just as fierce as that provoked by the Fed's second round of quantitative easing which was announced in November 2010.

QE2, which targeted Treasuries, attracted sharp criticism from Republicans who warned it could fuel inflation and crimp the Fed's ability to tighten policy eventually, and who accused Bernanke of going beyond the central bank's mandate.

"People are now expecting more QE, and that would be in mortgages," said John Canally, investment strategist and economist at LPL Financial in Boston. "I think economically they (the Fed) would want to do that, but I don't know if politically they can withstand the forces against it."

Republican presidential candidates have repeatedly criticized the Fed and Bernanke on the campaign trail. Asked about the Fed's latest statement, Gingrich said it was "a sign of the failure of the entire Obama program" that Bernanke is bracing for such weak economic growth that he will have to keep rates low for so much longer.

At the same time the Fed is "putting in future inflation expectations," Gingrich told reporters in Florida on Wednesday. "It's more of Bernanke laying down a very bad future."

Foreign countries slammed the Fed's previous bond-buying programs, saying they artificially weakened the U.S. dollar and hurt their exporters. Brazil's finance minister talked of a "currency war."

Some economists say the political pressure on the Fed may prove too heavy.

"A third round of QE is still beyond them - or maybe the chairman simply doesn't have the stomach for the congressional mauling that further asset purchases would have precipitated....," said Ian Shepherdson, chief U.S. economist at High Frequency Economics.

Nonetheless, many others expect that the Fed will act again.

Economists at 12 of 18 primary dealers, the large financial institutions that do business directly with the Fed, believe the central bank will undertake further quantitative easing, according to a Reuters poll after Bernanke's news conference.

Some top investors have placed their bets, too.

Bill Gross, who runs the world's largest bond fund, has ramped up purchases of mortgage-backed securities which at the end of November accounted for 43 percent of his holdings. The self-styled "bond king" said last month that any QE3 would likely be focused on the housing sector.

Keith Wirtz, chief investment officer at Fifth Third Asset Management, with \$18 billion in assets, said the Fed had gone "all in" with its promise to keep rates low through late 2014, and predicted that any rise in long-term borrowing costs would push the Fed to buy more bonds.

"Brace for QE3 if rates start to move higher on the long end," he said.



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