

INSIDE DEBT

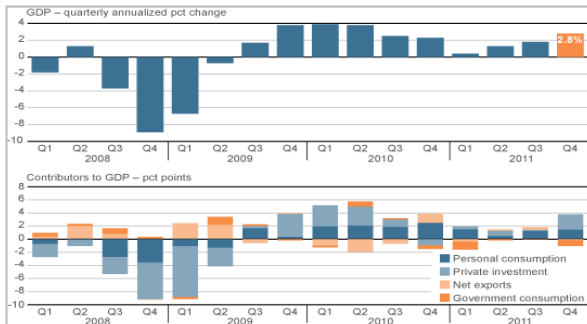
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Friday, January 27, 2012

CHART OF THE DAY

U.S. fourth-quarter GDP

Click on the chart for full-size image



The U.S. economy grew at a 2.8 percent annual rate in the fourth quarter, the fastest in one-and-a-half years and a sharp acceleration from the 1.8 percent growth in the third quarter.

TODAY'S TOP NEWS

- U.S. growth quickens, but speed bumps ahead
- EU, IMF press Greece on reforms, Rehn upbeat on debt deal
- Fitch cuts Italy, Spain, other euro zone ratings
- Fed will do its part to aid U.S. recovery, Dudley says
- Japan prices fall, mild deflation to persist
- China to grow at 8.5 pct in 2012 - central bank adviser
- Swiss economy faces recession in coming months - KOF

ECON WATCH

FOR MONDAY JANUARY 30

ET	Indicators	Unit	Reuters	Prior
05:00	EZ Business Climate	ind	-0.21	-0.31
05:00	EZ Economic Sentiment	ind	93.8	93.3
05:00	EZ Industrial Sentiment	ind	-6.8	-7.1
05:00	EZ Services Sentiment	ind	-1.0	-2.1
05:00	EZ Consumer Sentiment	ind	-20.6	-21.1
08:30	US Chicago Midwest	--	--	85.8
08:30	US Personal Income	%	0.4	0.1
08:30	US Personal Cons	%	0.1	0.1
08:30	US PCE Price Index	%	--	0
08:30	US Core PCE Price Ind	%	0.1	0.1
08:30	US Real Pers Spending	%	--	0.2
10:30	US Dallas Fed Mfg Ind	%	--	-3

- 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: The U.S. economy grew at its fastest pace in 1-1/2 years in the fourth quarter, but a rebuilding of stocks by businesses and slower business spending warned of weaker growth in early 2012.

For more please click here

TREASURIES: Treasury prices turned solidly positive, with yields dipping to session lows in worries over Europe's debt crisis and on the Federal Reserve's pledge this week to keep rates near zero through late 2014.

- 10-yr notes were up 13/32 to yield 1.90 pct from 1.94 pct.
- 30-yr notes jumped 21/32, yielding 3.06 pct from 3.09 pct.
- The 2-10's part of the yield curve flattened by 5 bps and 2-30's by 3 bps.

FOREX: The euro surged to its highest level against the dollar in 6-1/2 weeks as optimism that Greece and its creditors will soon come to an agreement and avoid a messy default had investors scrambling to cover short positions in the single currency.

- The euro hit its highest level since Dec. 13, rising to \$1.3220 before retreating a bit to last trade at \$1.3224, up 0.93 pct on the day.
- Against the Swiss franc, the greenback seesawed after the GDP data. The U.S. dollar was down 0.96 pct to 0.9117 francs.
- Against the yen, the euro fell 0.08 pct to 101.4 yen as the Japanese currency recovered broadly from lows struck this week.
- The dollar was last at 76.68 yen, 0.99 pct lower, leaving the yen on track for its biggest daily gain since late August.

CORPORATES: Corporate bond spreads tightened as economic data raised the possibility of another round of monetary stimulus by the Fed.

- The CDX.IG-17 index tightened by 1 bps to 100 bps.

STOCKS: Stocks trimmed earlier losses to end little changed, as investors saw dips in the market as an opportunity to buy into what's been a strong first month of 2012.

- Dow was down 74.17 points or 0.58 pct at 12,660.46, S&P fell 2.11 points or 0.16 pct to 1,316.32 and Nasdaq rose 11.27 points or 0.40 pct to 2,816.55.
- For the week, Dow ends down 0.45 Pct, S&P 500 was up 0.08 Pct and Nasdaq was up 1.07 pct.
- Chevron fell 2.5 pct and Ford Motor dropped 4.2 pct, While Eastman Chemical gained 6.9 pct.

C & E: Crude futures ended lower after erasing early gains as lower-than-expected U.S. GDP data for the fourth quarter of 2011 turned oil investors cautious, though losses were slim on supply disruption fears as Iran warned it may halt oil exports to Europe as early as next week in response to the EU's move to ban Iranian crude by July.

- Oil edged down 0.09 pct to \$99.61 per barrel.
- Gold added 1.04 pct to \$1,737.89 an ounce.
- Reuters-Jefferies index edged up 0.12 pct to 317.81.

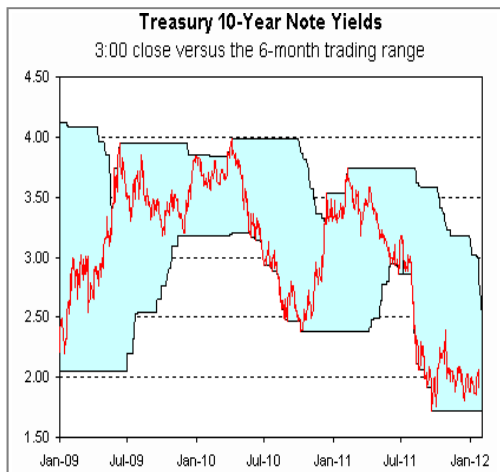
For a video preview of next week's economic events, [click here](#)

REUTERS INSIDER

- 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	0.060	0.025	0.061	0.005
3-Mo Bill	0.055	0.045	0.056	0.006
6-Mo Bill	0.080	0.075	0.081	0.006
1-Year	0.115	0.095	0.117	0.005
2-Year	100.063	100.094	0.219	0.008
3-Year	99.820	99.852	0.312	0.000
5-Year	100.578	100.617	0.757	0.094
7-Year	99.578	99.625	1.313	0.199
10-Year	100.859	100.922	1.903	0.305
30-Year	101.094	101.156	3.069	0.469

EQUITIES

	INDEX	CHANGE
DJIA	12680.89	-61.61
NASDAQ	2818.31	10.21
S&P 500	1318.22	-1.19

COMMODITIES

	PRICE	CHANGE
NYMEX	99.7	-0.1
BRENT	111.4	0.6
SPOT GOLD	1736.3	16.3
PALLADIUM	686.3	-1.4
SILVER	33.8	0.4

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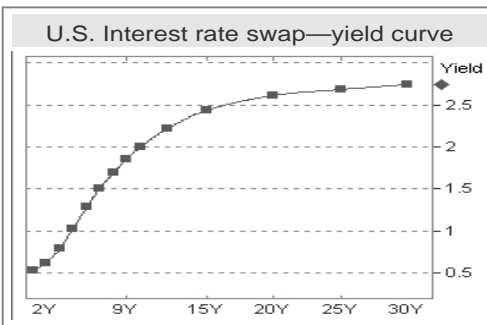
	SPREAD		RATE	
2-Year	30.50	34.50	0.52	0.55
3-Year	29.50	33.50	0.60	0.63
5-Year	27.50	31.50	1.03	1.05
7-Year	20.25	24.25	1.52	1.53
10-Year	9.75	13.75	2.00	2.01
30-Year	-32.00	-28.00	2.75	2.75

EURODOLLAR FUTURES

	CLOSE	CHANGE
Feb-12	99.48	0.00
Mar-12	99.53	-0.01
Jun-12	99.51	-0.01
Sep-12	99.50	-0.01

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.170	O/N	0.200
2-Week	0.190	2-Week	0.250
1-Month	0.200	1-Month	0.250
3-Month	0.200	3-Month	0.260
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.180	10:00 AM	0.130
2-Week	0.200	3:00 PM	0.122
1-Month	0.220		
3-Month	0.210		



FUTURES

	PRICE	CHANGE
CBOT 5 yr	123.88	0.04
CBOT 10 yr	131.73	0.30
CBOT 30 yr	143.47	0.63

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.080	0.110		
1-Month	0.240	0.350	0.086	0.096
3-Month	0.350	0.500	0.087	0.097
6-Month	0.630	0.780	0.091	0.101
12-Month	0.900	1.110	0.099	0.109

NYFRSM - 10AM

1m	0.2587
3m	0.5359

FED FUNDS

Open	0.0800
High	0.2100
Low	0.0700

CURRENCIES

	BID	ASK
Euro	1.3213	1.3216
Sterling	1.5723	1.5730
JP Yen	76.68	76.70
Swiss Franc	0.9124	0.9128
Can Dollar	1.0005	1.0010
Mexico	12.9356	12.9418

ACTIVE FANNIE MAE AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.5	8/9/2013	3.75 0.75	0.249
3-Year	0.75	12/19/2014	14.5 11.5	0.452
5-Year	1.25	1/30/2017	31.5 28.5	1.068
7-Year		-		
10-Year				
30-Year	6.625	11/15/2030	28 25	3.347

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.375	11/27/2013	8 5	0.291
3-Year	0.625	12/29/2014	14.75 11.75	0.454
5-Year	2	8/25/2016	19.75 16.75	0.951
7-Year		-		
10-Year	2.375	1/13/2022	47 44	2.369
30-Year	6.25	7/15/2032	29 26	3.357

Active MBS 15YR

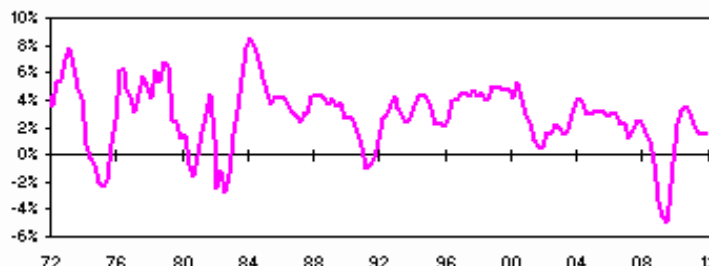
	CPN	BID	ASK	YIELD
FNMA	3.5	105.0760	105.0820	2.371
FHLMC	3.5	105.0700	105.0800	2.217

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.0	105.1800	105.1900	2.139
FHLMC	4.0	105.0700	105.0800	2.175
GNMA	4.0	107.2600	107.2600	2.063

Wrightson ICAPSM Chart of the Day

Real GDP: Year-over-Year Growth Rate



TODAY'S TOP NEWS

U.S. growth quickens, but speed bumps ahead

The U.S. economy grew at its fastest pace in 1-1/2 years in the fourth quarter, but a rebuilding of stocks by businesses and slower business spending warned of weaker growth in early 2012.

Gross domestic product expanded at a 2.8 percent annual rate, the Commerce Department said, a sharp acceleration from the 1.8 percent in the prior three months.

Excluding inventories, the economy grew at a tepid 0.8 percent rate, a sharp step-down from the prior period's 3.2 percent pace and a sign of weak domestic demand.

Consumer spending accelerated, stepping up to a 2 percent rate from the third-quarter's 1.7 percent.

A price index for personal spending rose at a 0.7 percent rate in the fourth-quarter, the slowest increase in 1-1/2 years. A core measure that strips out food and energy costs rose at a 1.1 percent pace, off sharply from the prior quarter and the slowest in a year.

Separately, the Thomson Reuters/University of Michigan's final reading on the overall index on consumer sentiment rose to 75.0 from 69.9 the month before. It was the highest level since February 2011.

Fitch cuts Italy, Spain, other euro zone ratings

Fitch Ratings downgraded the sovereign credit ratings for Italy, Spain, Slovenia, Belgium and Cyprus indicating there is a 1-in-2 chance of further downgrades in the next two years.

In its statement, Fitch said these countries have near-term vulnerability to monetary and financial shocks. "Consequently, these sovereigns do not, in Fitch's view, accrue the full benefits of the euro's reserve currency status," Fitch said.

Meanwhile, Italy's six-month funding costs fell sharply to levels last seen before the country came to the fore of the euro zone debt crisis last summer, helping power a rally in its bonds ahead of Monday's more challenging sale of longer-dated debt.

Meanwhile, Portuguese government bond yields punched new euro-era highs on Friday on growing investor belief the country may follow in Greece's footsteps and require a second bailout, keeping safe-haven German Bunds well bid.

Japan prices fall, mild deflation to persist

Japan's core consumer prices fell for the third consecutive month in the year to December, and mild deflation is expected to persist this year as energy prices stabilize and worries about Europe's debt crisis suppress wage growth and economic activity.

Core consumer prices declined an annual 0.1 percent, matching the median estimate also fell in a sign that Japan continues to grapple with a strong yen, which pushes down import prices and makes exporters reluctant to raise salaries.

Retail sales fell 1.2 pct in 2011, the first fall in two years, and auto and machinery equipment sales posted record falls in the series, which dates back to 1980. But sales rose an annual 2.5 percent in December, the biggest increase in 16 months.

The so-called core-core inflation index fell 1.1 percent in the year to December. Core consumer prices in Tokyo, available a month before the nationwide data, fell 0.4 percent in the year to January. That compares with the median estimate for a 0.3 percent annual decline.

Annual data showed the core CPI slipped 0.3 percent in 2011, the third straight yearly fall. Japan's consumer inflation has been around zero or minus for over a decade, except a 1.5 percent rise in 2008 on the back of an increase in energy prices.

EU, IMF press Greece on reforms, Rehn upbeat on debt deal

The European Union and IMF want Greece to push through more budget cuts and implement a series of long-agreed austerity reforms before they sign off on a new bailout the country needs to avert bankruptcy, a report obtained by Reuters shows. All eyes have been on Athens' tortuous debt exchange talks with its private creditors in recent weeks and a preliminary deal could be wrapped up by Sunday evening, a Greek government official said on condition of anonymity.

"We are one step away from completing the PSI (debt swap) deal," Finance Minister Evangelos Venizelos said, adding that the country would announce the public offer to its bondholders by Feb. 15.

EU economic and monetary affairs chief Olli Rehn also sounded optimistic on the odds of a deal soon, saying an agreement was "very close" and might be clinched as soon as this weekend. The head of a panel of German government economic advisers joined a growing chorus of voices calling for the European Central Bank to facilitate a bond swap to lower Athens' debts by forgoing profits on its Greek bonds.

Meanwhile, important understandings have been reached in talks about private sector involvement in a Greek debt restructuring, the Institute of International Finance said in a statement, adding that discussions would continue on Saturday.

Fed will do its part to aid U.S. recovery, Dudley says

Much work remains to maximize U.S. employment and stabilize prices in the face of a "sluggish" economic recovery, and the Federal Reserve will do its part, a Fed official said.

Unemployment is likely to remain "unacceptably high" for some time and inflation is likely to be below 2 percent, the Fed's new objective, for several years, New York Fed President William Dudley said.

"Clearly, much work remains to achieve the Fed's dual mandate of maximum sustainable employment in the context of price stability," Dudley told reporters after a speech at the New York Fed.

Separately, Richmond Federal Reserve Bank President Jeffrey Lacker said he voted against the central bank's decision this week to keep rates near zero until at least late 2014 because he believes rates will need to rise before then.

China to grow at 8.5 pct in 2012 - central bank adviser

China is likely to engineer a soft landing with economic growth slowing to about 8.5 percent this year from 9.2 percent in 2011, Li Daokui, an adviser to the country's central bank said. Inflation, which has nagged China for much of the past year, is also likely to ease to about 3 percent from 4.5 percent in 2011, said Li, who sits on a board that advises the People's Bank of China. "Anyone who has any understanding of China will agree that we will be able to achieve a soft landing," Li told Reuters on the sidelines of the World Economic Forum in Davos. "Real estate prices will also ease slowly, which will help cool the economy and bring down price pressures."

Li also said he expects China's economy to be hit by the problems in the euro zone, although he said he was opposed to China buying Italian or Spanish sovereign debt.

"How are we going to explain to the Chinese people that we are going into it alone and buying up Spanish or Italian debt? A multilateral solution is needed, and China should work together with countries like Brazil or India to help Europe," he said.



TODAY'S TOP NEWS

Swiss economy faces recession in coming months -KOF

Switzerland's leading growth indicator slid into negative territory in January for the first time since 2009, suggesting the strong Swiss franc will tip the economy into recession over the coming months. The KOF economic barometer, which points to the expected performance of the economy in about six months' time, fell to -0.17 points in January, its lowest level since August 2009.

Analysts in a poll had forecast an average drop to -0.05. A surge in the Swiss franc as investors have sought a safe haven from the escalating euro zone debt crisis has weighed on company profits, squeezed exporters' margins and piled pressure on the country's tourism sector. In an effort to stave off a recession, the SNB board members have stressed their commitment to defend the cap over the past week and interim central bank chief Thomas Jordan said the SNB would take further steps should the economic outlook and deflationary risks make them necessary. The KOF contrasts with other recent indicators, which had pointed to a brighter outlook for the economy.

U.S.'s Donovan: New mortgage aid plan near

U.S. Housing and Urban Development Secretary Shaun Donovan said the Obama administration is preparing to unveil an additional mortgage relief effort. Donovan did not elaborate on the new plan intended to help borrowers who have been hurt by declining home values and address the swelling number of foreclosures that have hit the real-estate markets four years after the collapse of the housing sector.

Donovan mentioned the new proposal while speaking at the U.S. Justice Department alongside Attorney General Eric Holder. The two were at a press conference to provide details about a new task force focused on cracking down on those whose misconduct contributed to the financial crisis.

The White House's latest idea would allow any borrower current on their mortgage to refinance, regardless of whether they owe much more than their home is worth or whether their income has fallen since the last time they refinanced.

Lending slump justifies ECB credit crunch fears

Loans to euro zone companies fell at the fastest pace on record in December, raising the question whether the half a trillion euros the ECB pumped into the financial system last month will be enough to prevent a full scale credit crunch.

Data showed the monthly flow of loans to euro zone firms - a key indicator of credit conditions - dropped by 37 billion euros in December, the biggest fall since records began in 2003. Lending had also contracted in November.

While economists agreed the data made worrying reading, they said it was too early to make a call on credit as it relates largely to the period before December's massive and unprecedented injection of longer-term cash by the ECB. Euro zone M3 money supply - a more general measure of cash in the economy - grew at an annual 1.6 percent in December, slowing from 2.0 percent in November and below expectations of 2.2 percent in a Reuters poll.

Decreasing to 2.1 percent, the three-month moving average of M3 growth remains well below the ECB's reference rate of 4.5 percent, above which the bank sees dangers to medium-term price stability.

UK Treasury to take charge in next bank crisis

Britain's finance ministry will have the power from next year to take charge in any future banking crisis, including being able to tell the Bank of England to pump money into the financial system. Finance minister George Osborne published a draft law on Friday reforming the way Britain's financial system is regulated and setting out who has ultimate authority in a crisis.

The legislation is an attempt to draw a line under the regulatory failings that forced taxpayers to stump up hundreds of billions of pounds to shore up the banking sector in 2008. It will scrap the Financial Services Authority from 2013 and hand power to supervise banks and insurers to the central bank.

"When taxpayers' money is at risk in a crisis this legislation gives the Chancellor (of the Exchequer) the power to direct the Bank of England to act," Osborne said in a speech to world political and financial leaders in Davos, Switzerland.

NEXT UP

POLL-Only modest rise seen for major govt bond yields

Major government bond yields will rise only modestly from their currently depressed levels, kept in check by a weak economy in Europe and further rounds of money printing in the U.S. and Britain, a Reuters poll showed.

Various government bonds yields in the United States, Britain and Germany have hit record lows in the first few weeks of the new year, and the survey of almost 50 analysts showed there will be no swift rebound in the coming 12 months. Fixed income strategists and economists polled over the last week showed 10-year government bond yields in the U.S., Germany, Britain, Canada and Australia each gaining around 50 basis from current levels over the course of the next year.

Still, that will represent only a partial resurgence in yields. U.S. and UK 10-year government bond yields each fell by around 140 basis points in 2011, while German Bund yields collapsed by 100 basis points. The 10-year U.S. Treasury, yielding around 1.95 percent on Friday, is expected to yield around 2.1 percent by the end of April, 2.3 percent in six months, and 2.6 percent in a year's time. The forecasts are roughly similar to the last poll in December. Muted inflation expectations will also keep yields in check.

PREVIEW-Europe's shrinking banks in for acute Q4 pain

European lenders, under pressure to shed assets and beef up their capital, will show the strains of volatile bond and stock markets and wilting investment banking income in fourth-quarter results in coming weeks.

As banks build up their defences to absorb euro zone crisis shocks, they have been shrinking riskier, capital-intensive businesses -- such as bond trading -- while trying to ward off funding struggles by competing for depositors. U.S. banks have already reported a sharp revenue fall at their investment banks and that pattern could be even clearer in Europe, where sovereign debt woes have sent investors running for cover and dried up deal-making.

European investment bank revenue will be down an average of 15 percent in the fourth quarter compared with the previous three months, compared to a 5 percent drop across the top five U.S. firms, analysts at Credit Suisse forecast. This could be a headache even for some of the biggest banks in these areas, like German group Deutsche Bank, one of the first big European banks to report, on Feb. 2.

EYE ON ASIA

POLL & PREVIEW

S.Korea Dec industrial output seen up, Jan exports seen weak

Industrial output in December probably rose a seasonally adjusted 0.7 percent from November, reversing two consecutive months of declines, but it may still fall short of offsetting a combined 1 percent loss for the preceding two months.

Investors' focus will also be directed to the inventory levels of produced goods after the central bank's advance estimates showed on Jan. 26 that fourth-quarter gross domestic product averted a decline mainly due to a rise in inventories.

Although it helped the country avert an outright decline in GDP for the October-December 2011 period, a build-up of stocks at a time when demand is shrinking could create an additional drag on the already slowing economy.

The ratio of inventories to shipments has trended generally upward since touching a low of 89.9 percent in January 2011 and hit a preliminary 114.4 percent in November, the highest since December 2008. Year-on-year export growth likely slowed to a mere 0.7 percent in January from a revised 10.8 percent in December.

It would mark the slowest growth since posting an 8.5 percent drop in October 2009. Year-on-year inflation is seen easing below the 4 percent cap of the central bank's target range after staying above the ceiling for the preceding two months in a row. The central bank, said inflation had passed its peak and would moderate further, although the pace of deceleration would only be gradual.

EVENTS

JANUARY 29

SOUTH KOREA

- Current account balance final for December: Prior 4.97 bln

JANUARY 30

CHINA

- People's Bank of China is expected to announce volume for Tuesday's auction of 1-year bills.

JAPAN

- Manufacturing PMI for January: Prior 50.2
- All household spending yy for December: Expected -0.2 pct Prior -3.2 pct
- All household spending mm: Expected 0.2 pct Prior -1.3 pct
- Unemployment rate: Expected 4.5 pct Prior 4.5 pct
- Jobs/applicants ratio: Expected 0.70 Prior 0.69
- Industrial output prelim: Expected 3.0 pct Prior -2.7 pct

NEW ZEALAND

- Building consents for December: Prior 1.70 pct

PHILIPPINES

- GDP quarterly yy for Q4: Expected 3.80 pct Prior 3.20 pct

TAIWAN

- Jobless rate for December: Prior 4.32 pct
- Money supply: Prior 5.07 pct

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	111.757	3.438	115.198	3.960	S&P/ASX200	4288.37	17.03	JPY	-6.85	-6.35
Japan	99.836	0.334	100.243	0.973	NIKKEI 225	8841.22	-8.25	AUD	-103.73	-103.23
China	102.340	3.010	101.339	3.400	HKSE	20501.67	62.53	NZD	-50.2	-49.2
Hong Kong	100.950	0.624	98.500	1.359	SHANGHAI	2319.12	23.04	HKD	-18	-13
Singapore	102.600	0.494	105.950	1.563	STRAITS TIMES	2916.26	21.83	SGD	-5.8	-5.6
					SENSEX	17233.98	156.80	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	4.3125	4.3725	4.6675	4.7225	JPY	0.18		CNY	-0.035	-0.03
JPY	0.4325	0.4925	0.9425	1.0025	CNY	5.2		TWD	-0.215	-0.195
CNY	3.67	3.77	3.69	3.89	AUD	4.6		KRW	1129.6	1130.7
HKD	0.92	1	1.72	1.8	NZD	2.95		INR	50.465	50.565
TWD	1.05	1.06	1.29	1.33	HKD	0.3		MYR	3.055	3.059
INR	5.9	6.1	5.85	6.25	SGD	0.25		PHP	42.92	43.02
KRW	3.425	3.465	3.57	3.61				IDR	8955	9055
SGD	1.065	1.085	1.955	2.005						

EYE ON LATAM

LATAM TOP STORIES

Brazil loan defaults ease, bank lending stronger

Loan delinquencies in Brazil eased off a two-year high in December, the central bank said, signaling that consumer and corporate defaults in Latin America's largest economy may have peaked.

Loans in arrears for 90 days or more, Brazil's most widely followed gauge of defaults, eased to 5.5 percent of outstanding loans in December from 5.6 percent in November. Brazilian banks ramped up loan disbursements in December, an upbeat sign in an economy that lost momentum in recent months. Outstanding loans in Brazil's banking system grew 2.3 percent in December from November, according to central bank data, picking up from 1.9 percent growth the month before.

The numbers underscore the uneven nature of Brazil's slowdown, in which weak manufacturing and retail numbers contrast with a strong job market, resilient credit and stubbornly high inflation. Private sector estimates showed that delinquencies peaked as the central bank slashed interest rates three times between August and November.

For the whole of 2011, lending expanded 19 percent, above the central bank's target of 17.5 percent. In 2010, a year in which Brazil's economy grew at its fastest pace in 24 years, overall lending expanded 20.6 percent.

Lending rose to the equivalent of 49.1 percent of gross domestic product, compared with 48.2 percent of GDP in November and 45.2 percent at the end of 2010.

State-owned banks are also expected to reduce the cost of credit to consumers as the government aims for at least 4 percent growth in 2012. Last year the economy likely grew around 3 percent.

The central bank expects 15 percent credit growth in 2012.

Chile's Pinera sees slower growth of 4.0 percent

Chile's economy should still grow by about 4.0 percent this year and add jobs even as a worsening global economic outlook takes its toll on the world's top copper producer, President Sebastian Pinera told Reuters in an interview.

Pinera's forecast for this year's expansion, which matches a target being sought in regional powerhouse Brazil, reflects Chilean officials' increasingly modest expectations for this year's economic activity.

Finance Minister Felipe Larraín had put 2012's growth target at 5.0 percent, but earlier this month said the country now hoped to expand above 4.0 percent this year. That compares to an estimated 6.2 percent last year.

Separately, Chile's central bank board said external economic risks allow for a more expansive monetary policy and said further changes to its benchmark interest rate will depend on macroeconomic conditions, minutes of the bank's January rate-setting meeting showed.

Colombia will seek to avoid capital controls-official

Colombia will seek to avoid imposing capital controls to ease gains in the peso currency and instead aim for long-term measures that will not cause "distortions" in the economy, a senior finance ministry official said.

Colombia will attract about \$15 billion in foreign direct investment this year, slightly above the record \$14.8 billion in 2011, Ana Fernanda Maiguashca, technical vice-minister of finance, told Reuters in an interview.

Colombia's economy is likely to grow more than expected this

LATAM MARKETS TODAY

TREASURIES:

- Mexican 10-yr notes were down, yielding 5.97 pct and 30-yr bonds fell yielding 7.35 pct.
- Brazilian 10-yr notes surged, yielding 11.47 pct and 2-yr notes gained, yielding 10.20 pct.

FOREX:

- Brazilian real was down 0.73 pct to 1.7372 per dollar.
- Mexico's peso lost 0.6 pct to 12.919.
- Chile peso fell 0.54 pct to 484.3 per dollar.
- Colombia's peso slipped 0.2 pct to 1,807.5 to the dollar and Peru sol edged down 0.07 to 2.689 to the dollar.

STOCKS:

- MSCI Latin American stock index fell for the first session in three, dropped 0.22 pct to 4063.37.
- Brazil's benchmark Bovespa stock index fell 0.08 pct to 62,904.20.
- Cyrela rose 1.51 pct OGX added 0.31 pct and Vale rose 0.22 pct.
- Mexico's IPC index fell 0.15 pct to 37,184.71.
- America Movil led the index lower as it fell 0.78 pct and Femsa lost 1.5 pct.
- Chile's IPSA index rose 0.17 pct to 4,226.08.
- Cencosud lost 1.24 pct and Banco Santander Chile dropped 0.91 pct.

LATAM TOP STORIES

(continued)

year and next, Maiguashca said. The government has previously said that growth last year could reach near 6 percent and 5.1 percent for this year.

POLL-Chile Dec industry output seen up 0.9 pct yr/yr

Chile's industrial output is expected to have grown 0.9 percent in December from last year, easing from the previous month as companies lower their inventories due to fears of sluggish global demand, the median forecast of 10 analysts polled by Reuters showed.

Estimated industrial output growth in the world's top copper exporter is far below the 3.8 percent increase that was registered in December 2010 and less than half the 2 percent increase in November 2011.

Production growth in the key mining, forestry and agricultural sectors has likely moderated ahead of expectations for softer demand from avid buyer China and global fallout from euro zone debt woes, the poll showed.

Weaker-than-expected industrial production could reinforce market bets that the central bank will cut rates again in February following its surprise reduction to 5 percent earlier this month, the first cut in over two years.

"We're seeing the effects of external turbulence. Within the industrial sector, we expect the lowest growth rates in areas linked to exports," said Mario Arend, chief economist with Celfin Capital.



DEEP DIVE Commentary and Analysis

Want to narrow the tax gap? Raise capital gains rate

By John Wasik

If the president and Congress are serious about income equality and cutting huge breaks for the wealthy, they should raise the capital gains rate.

While the president didn't mention it by name in his State of the Union speech on January 24, it's one of the many gorillas in the tax reform room.

There's no question that the 15 percent rate on capital gains and dividends largely favors super-wealthy taxpayers over wage earners. Just look at Mitt Romney's tax return. As former Labor Secretary and economist Robert Reich once noted: "It's a loophole large enough for the super-rich to drive their Ferraris through. About 80 percent of the income of America's richest 400 comes in the form of capital gains."

According to economist Jared Bernstein, who analyzed Congressional Research Service figures, capital gains and dividends were "the largest single contributor to the growth of inequality from 1996-2006."

Why should those who primarily make money from private equity, financial, business and real estate appreciation and dividends pay more than 50 percent less than wage workers who are subject to the top rate in federal, state, Medicare and Social Security taxes?

If you're from the supply-side camp, it's because the lower rate may encourage wealthy taxpayers to invest in capital, business and job formation while raising more tax revenues. More fundamentally, at least according to the conservative group Americans for Tax Reform, "when you tax something more, you get less of it."

When taxpayers know that the capital gains rate is going up, the "fire sale" effect comes into play: They sell assets to get taxed at the lower rate before the higher levy kicks in, hence the higher cash flow to the Treasury before the lower tax expires.

But there's no consistent evidence that shows that a lower capital gains rate does much for the economy long term. The rate of new business formations actually climbed from 1983-1987, when the maximum capital gains rate was 20 percent, according to the Kauffman Foundation, a think tank that specializes in entrepreneurship.

When the gains rate hit a maximum 29 percent from the middle of 1993 into 1997, there was another spurt of new business growth. Since 2006, though, small-business creation has generally fallen - even with the lower capital gains rate. The recession and housing meltdown are the likely malefactors.

Of course, recessions or periods of double-digit interest rates - which hurt small businesses the hardest - are the worst times for small-firm growth anyway, so the capital gains rate would not necessarily have been a primary hindrance during times like 1979 through 1983.

When do capital gains proceeds fill up the national Treasury the most? The data is inconclusive. In 1988, realized gains as a percentage of gross domestic product were more than 7 percent - the highest amount in almost a quarter century, and that was when gains rate was 20 percent.

Tax rates are often like porridge. Sometimes they may be too high; at other times just right. It could be that 20 percent is a sweet spot for gains. In contrast, the lowest capital gains/GDP percentage was 1.57 percent in 1977, when the maximum rate was nearly 40 percent.

What can barely be debated is that the capital gains rate is one of the multi-millionaire's best fiscal friends. Those who made \$10 million or more, according to IRS statistics from 2009, reaped a total of nearly \$70 billion in long-term capital gains. That's 10 times the amount of gains taken by those making from

\$75,000 to \$100,000.

While cutting the capital gains rate generates more revenue overall due to the fire-sale effect, it's not in the best interest of the country to keep it at 15 percent. Raising it would also reduce the burgeoning federal deficit. If it's not an efficient way of creating jobs or businesses, why keep it so low?

"Arguments that the capital gains rate affects economic growth are even more tenuous," says the non-partisan Tax Policy Center. The group saw no correlation between rates and GDP growth "during the last 50 years."

Of course, the gains rate is but one item among thousands of special breaks in the tax code. You have to put everything on the table, from mortgage deductions to offshore corporate income if you want to ferret out wasteful tax handouts, which is highly unlikely in this election year.

Yet if one believed that Congress was earnestly tackling deficit reform in the interest of fairness and fiscal sanity - or did nothing this year - I would tell my tax preparer to take every possible break in 2012. That's because the special rate on capital gains will expire after Dec. 31 - a deadline that will seem pretty urgent right around election time in November.

(The writer is a Reuters columnist. The opinions expressed are his own.)

Weaker euro helps Spain and Italy, not Germany

By Philip Blenkinsop

Germany is the champion of exporters, but it may not be getting as much of a boost from a newly weaker euro as advertised -- indeed, there is evidence that the bigger beneficiaries could be the troubled economies on the euro zone periphery.

Thomson Reuters data shows that German exports do not receive the boost of demand that do products from places such as Italy and Spain when the single currency is weaker.

It all comes down to what you are making - higher-end German products that cannot readily be substituted or more price-elastic lower value goods from the periphery nations.

Think precision tools versus olive oil.

The euro has fallen by 12 percent against the dollar in eight months since May 2011. Even with a modest recovery in recent weeks, it is still 7 percent lower than it was three months ago.

The broader trade-weighted exchange rate is down 4 percent in the past three months, according to ECB data.

So trade-driven Germany, which sells nearly 30 percent of the goods the European Union exports, would be the obvious winner.

Add to this the fact that Germany has a larger share of its customers outside the euro zone than many other bloc members.

It ships 60 percent of its exports to countries outside the currency zone, just behind Greece and Ireland on 61 percent, but ahead of Italy (57), Spain (45) and Portugal (36), according to Eurostat data from January 2010 to October 2011. The euro zone average is 51 percent.

Yet Germany's export performance appears to be far less dependent on the euro's fluctuations.

According to Thomson Reuters Datastream, there is a tight negative correlation between the balance of payments of periphery nations and the dollar/euro exchange rate.

In simple terms, this means a stronger euro tends to depress trade of these countries and a weaker currency boosts it.

The relationship is strongest for Spain and bailout recipient Ireland, followed by Greece, Portugal and Italy. France too has a strongly negative correlation and many other euro zone countries show similar, but weaker links between their trade balance and the exchange rate.

DEEP DIVE Commentary and Analysis

It is different in Germany, where the relationship is positive, meaning there is no trade boost from a weaker euro.

QUALITY CHECK

None of this detracts from the fact that German is far and away the most potent exporter in the bloc, putting all others in the shade. But it does suggest that getting a boost from a weaker currency is not as obvious as it might seem.

The difference appears to be due to how far a country's products are up the value chain.

Consumers or businesses may still buy a special German drill bit or a Mercedes, even if the price in their currency rises by 10 percent. But lower value products from the periphery, such as textiles, may be competing more on price globally, with far more elastic demand.

This would also explain why the Netherlands and Austria have positive correlations.

A country also does not need to be exporting its goods outside the euro zone to benefit from the single currency's weakness. It can simply be competing more effectively with imported products.

"For Italy, it has products more sensitive to exchange rates because they are more easily substituted - textiles, consumer goods, fashion items, clothing, shoes," said Unicredit economist Marco Valli.

The oil price, denominated in dollars, may also play a role. It has clung to around \$110 per barrel in recent months, so in euro terms has clearly risen.

France, which imports only about half of its energy needs, suffers less than its counterparts, which may explain in part why there is a close relationship between the euro's strength and its current account balance.

The weaker euro, meanwhile, is already working its magic on some peripheral economies.

Italy posted its first trade surplus with non-EU countries for two years in December, according to data released on January 24.

And Greece registered a 43 percent jump in overall exports in the period January-October from a year earlier, although less than 5 percent of the total was to countries outside the European Union and it remained in overall deficit.

"Greece and some other countries are also seeing some internal devaluation, which would increase the cost advantage," said ABN AMRO economist Nick Kounis.

Despite the potential gains, exports are still only a low share of the economies of peripheral euro zone members.

Exports as a percentage of gross domestic product in 2010 ranged from Greece's 22 percent to Portugal's 31 percent. Germany stood at 47 percent, according to World Bank data. Only Ireland, at 99 percent, bucked the peripheral trend.

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