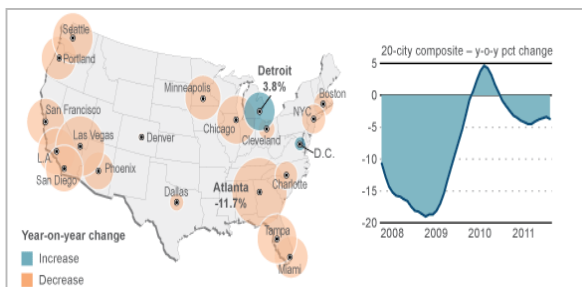


## CHART OF THE DAY

### U.S. home prices

Click on the chart for full-size image



In November, S&P/Case-Shiller 20-city composite home price index fell 3.7 pct year-on-year. Of the cities included in the composite, all but Detroit and Washington D.C. saw declines. Atlanta fared worst, with home prices down 11.7 percent from last year.

## TODAY'S TOP NEWS

- U.S. home prices drop, consumers turn gloomier
- Greece must pledge tough reforms for debt swap deal
- Euro jobs crisis puts Germany at core of growth debate
- U.S. set for 4th year of \$1 trillion-plus deficit-CBO
- Spain prices rise at slowest rate in 17 months
- Japan factory output rebounds as Thai flood impact fades
- Europe signs up to German-led fiscal pact

## ECON WATCH

FOR WEDNESDAY FEBRUARY 1

ET	Indicators	Unit	Reuters	Prior
03:58	EZ Markit Mfg PMI	ind	48.7	48.7
05:00	EZ Inflation flash yy	%	2.7	2.7
07:00	US Mortgage Ind	ind	--	775.6
07:00	US Refinancing Index	ind	--	4265
08:15	US ADP Nat Employment	k	185	325
09:30	CA RBC Mfg PMI SA	ind	--	54.02
10:00	US ISM Prices Paid	ind	49.5	47.5
10:00	US Construct Spending	%	0.6	1.2
10:00	US ISM	--	54.5	53.9
--	US Dom Car Sls	mln	4.5	4.49
--	US Dom Truck Sls	mln	6.05	6.01
--	US Total Vehicle Sls	mln	13.5	13.5

- 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:** U.S. home prices fell more steeply than expected in November, and consumers turned less optimistic in January, highlighting the hurdles still facing the bumpy economic recovery.

**For more please click here**

**TREASURIES:** Treasuries gained as the Federal Reserve made new purchases of longer-dated debt, and as hope faded that there would be an agreement for a stronger euro zone rescue fund.

- The Fed bought \$2.52 billion in bonds due between 2036 and 2041 from \$5.01 billion submitted by dealers.
- 30-yr bonds surged more than a point to yield 2.94 pct and 10-yr notes added 15/32, yielding 1.79 pct.

**FOREX:** The euro surrendered all gains and traded lower against the dollar as expectations evaporated that a Greek debt restructuring deal could be close, while a resurgent yen raised concern Japanese authorities could intervene to weaken it.

- The euro peaked at \$1.3213, not far from a six-week high hit last week of \$1.3228 and was down 0.43 pct at \$1.3079.
- Against the yen, the dollar hit a three-month low of 76.13, well off last week's peak of 78.28. The dollar was little changed on the day at 76.21 yen, with traders citing talk of dollar bids down towards 76.00 yen and stop-loss dollar offers below 75.80 yen.

**CORPORATES:** Corporate bond spreads tightened as the primary market witnessed some high-grade issuance.

- New issuers included, Toll Brothers, Ford Motor Credit, Tyco Electronics, Hutchison Whampoa, Southwestern Electric Power and Intermediate Holding.
- The CDX.IG-17 index tightened by 1 bps to 101 bps.

**STOCKS:** Wall Street closed its best month since October on a flat note as weaker-than-expected economic reports surprised investors after a stream of positive data in recent months.

- Dow ended the session down 19.83 points or 0.16 pct at 12,633.89, S&P was down 0.55 points or 0.04 pct at 1,312.46 and Nasdaq was up 1.46 points or 0.05 pct at 2,813.40.
- For the month, the Dow ended up 3.4 pct, the S&P 500 was up 4.4 pct and the Nasdaq rose 8 pct.
- Exxon Mobil fell 2.03 pct while McKesson gained 3.85 pct.
- The PHLX housing index dropped 1.43 pct and the Dow Jones home construction index declined 1.72 pct.

**C & E:** Crude oil futures fell for a third straight day as weaker-than-expected business activity in the Midwest, flagging consumer confidence and lower home prices erased more than \$2 of early gains that were spurred by hopes of a Greek debt-restructuring deal.

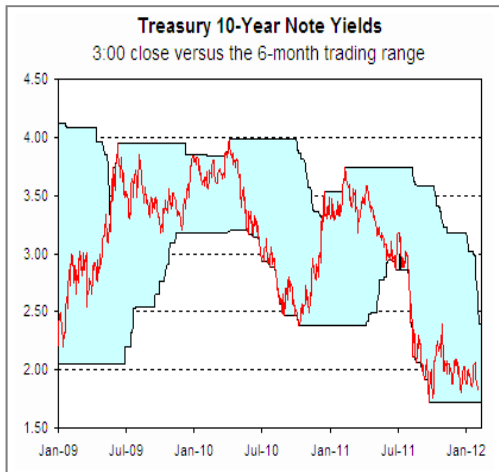
- Oil was down 0.37 pct at \$98.41 per barrel.
- Gold added 0.62 pct to \$1,739.39 an ounce.
- Reuters- Jefferies index lost 0.51 pct to 312.31.

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	0.055	0.02	0.056	-0.008
3-Mo Bill	0.060	0.050	0.061	0.005
6-Mo Bill	0.090	0.065	0.091	-0.002
1-Year	0.110	0.105	0.112	-0.003
2-Year	100.055	100.086	0.223	0.000
3-Year	99.844	99.875	0.304	0.016
5-Year	100.805	100.852	0.711	0.148
7-Year	100.047	100.094	1.243	0.258
10-Year	101.781	101.844	1.801	0.422
30-Year	103.641	103.703	2.941	1.211

EQUITIES

	INDEX	CHANGE
DJIA	12616.60	-35.61
NASDAQ	2811.83	0.01
S&P 500	1311.22	-1.67

COMMODITIES

	PRICE	CHANGE
NYMEX	98.3	-0.4
BRENT	111.0	0.2
SPOT GOLD	1736.1	7.5
PALLADIUM	682.5	-1.2
SILVER	33.2	-0.3

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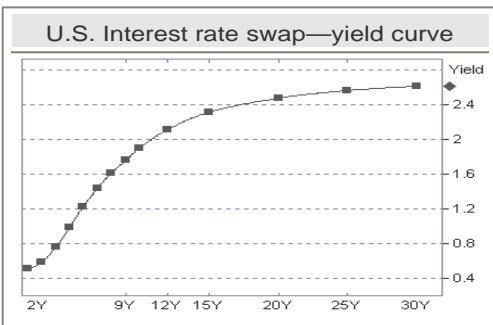
	SPREAD	RATE
2-Year	28.00	32.00
3-Year	28.25	32.25
5-Year	26.25	30.25
7-Year	19.00	23.00
10-Year	9.75	13.75
30-Year	-31.75	-27.75

EURODOLLAR FUTURES

	CLOSE	CHANGE
Feb-12	99.49	0.01
Mar-12	99.55	0.02
Jun-12	99.54	0.03
Sep-12	99.52	0.03

REPURCHASE AGREEMENTS

G/C	MORTGAGE REPOS
O/N	0.290
2-Week	0.230
1-Month	0.220
3-Month	0.210
AGENCY REPOS	i-REPO <sup>SM</sup> INDEX
O/N	0.290
2-Week	0.210
1-Month	0.200
3-Month	0.220
	10:00 AM
	3:00 PM



FUTURES

	PRICE	CHANGE
CBOT 5 yr	124.04	0.07
CBOT 10 yr	132.22	0.19
CBOT 30 yr	145.31	0.69

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.100	0.130		
1-Month	0.250	0.350	0.090	0.100
3-Month	0.350	0.500	0.090	0.100
6-Month	0.630	0.780	0.095	0.105
12-Month	0.900	1.110	0.098	0.108

NYFR<sup>SM</sup> - 10AM

1m	0.2313
3m	0.5307

FED FUNDS

Open	0.1000
High	0.1500
Low	0.1000

CURRENCIES

	BID	ASK
Euro	1.3092	1.3094
Sterling	1.5761	1.5766
JP Yen	76.17	76.18
Swiss Franc	0.9196	0.9200
Can Dollar	1.0021	1.0026
Mexico	13.0192	13.0254

ACTIVE FANNIE MAE AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.5	9/8/2013	1.25	-1.75
3-Year	0.75	12/19/2014	12.25	9.25
5-Year	1.25	01/30/2017	27.75	24.75
7-Year	-	-	-	-
10-Year	-	-	-	-
30-Year	6.625	11/15/2030	23.25	20.25

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.375	11/27/2013	6.5	3.5
3-Year	0.625	12/29/2014	12.25	9.25
5-Year	1	8/3/2017	31.25	28.25
7-Year	-	-	-	-
10-Year	2.375	01/13/2022	47.25	44.25
30-Year	6.25	07/15/2032	25.25	22.25

Active MBS 15YR

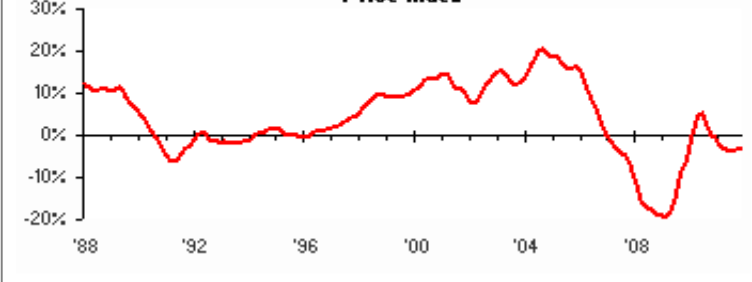
	CPN	BID	ASK	YIELD
FNMA	3.5	105.0660	105.0720	2.378
FHLMC	3.5	105.0460	105.0520	2.237

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.0	105.1970	105.2030	1.958
FHLMC	4.0	105.1260	105.1320	2.064
GNMA	4.0	107.2460	107.2520	2.020

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

Year-Over-Year Growth in the S&P/Case-Shiller 10-City Home Price Index



## TODAY'S TOP NEWS

**U.S. home prices drop, consumers turn gloomier**

U.S. home prices fell more steeply than expected in November, and consumers turned less optimistic in January, highlighting the hurdles still facing the bumpy economic recovery.

The S&P/Case-Shiller composite index of single-family home prices in 20 metropolitan areas, released, declined 0.7 percent on a seasonally adjusted basis, a bigger drop than the 0.5 percent economists expected. The decrease added on to the 0.7 percent decline in October from September.

Separately, an index of consumer attitudes fell to 61.1 in January from 64.8 the month before, as Americans turned gloomy about the job market and their income prospects, the Conference Board, representing private companies, said. Also weighing on the market was a report that showed business activity in the U.S. Midwest grew more slowly than expected in January - the index fell to 60.2 compared with a forecast of 63 - hurt by a weaker labor market.

On a seasonally adjusted basis, 17 of 20 cities racked up monthly home price declines, and average national prices were around levels seen in mid-2003, according to S&P/Case-Shiller. Prices in the 20 cities also steepened their year-over-year decline, falling 3.7 percent compared to a 3.4 percent decline in October.

**Euro jobs crisis puts Germany at core of growth debate**

The euro zone creaked under the weight of record unemployment at the end of 2011 while jobless rates in Germany fell to historic lows, putting the onus firmly on Europe's top economy to take the lead in steering the struggling region back to recovery.

Joblessness in Italy rose to its highest since current records began in 2004, underlining the divergent fortunes of nations at the region's core and its periphery. The data came a day after Europe's leaders met at a summit to try to shift the economic debate from fighting a deepening debt crisis to reviving growth.

Joblessness in Italy rose to 8.9 percent, its highest since current records began in 2004, the country's statistics institute said - a figure dwarfed by the 17-year high of 22.85 percent with which Spain ended the year. German unemployment, by contrast, fell a tenth of a percentage point in January from December to 6.7 percent.

Separately, German retail sales fell unexpectedly in December, the notoriously volatile indicator fell 1.4 percent in real terms on the month, and 0.9 percent on an annual basis, data from the Federal Statistics Office showed.

**Spain prices rise at slowest rate in 17 months**

Spanish inflation rose less than expected in January, data showed, in a sign of waning consumer spending power in an economy that is tumbling back into recession.

EU-harmonised consumer prices rose by 2 percent year-on-year, Tuesday's flash data from the National Statistics Institute showed, bringing the inflation measure back in line with European Central Bank's price stability target for the first time in 17 months. Spain's reading compared with a forecast of 2.2 percent in a Reuters poll of 11 economists and a previous reading of 2.4 percent. Spain's national consumer price index also rose 2 percent in January on an annual basis, down from 2.4 percent in December and marking the fourth straight month of easing inflation.

But the economic slowdown across the euro zone, and in Spain in particular, means any short-term easing in inflation would not have much of an influence on ECB policy, economist at Citi Guillaume Menuet said.

**Greece must pledge tough reforms for debt swap deal**

Near-bankrupt Greece struggled on with its foreign lenders to show them it can ram through spending cuts and labour reform in exchange for a crucial debt swap deal and a 130 billion euro bailout package needed to avoid an unruly default.

It is under pressure in talks to do more itself to help bridge a funding shortfall driven by a worsening economic climate and its previous reform plan having veered off track.

On top of biting austerity measures already taken that regularly bring droves of angry protesters onto the streets, Greece's lenders have demanded it make extra spending cuts worth 1 percent of GDP - or just above 2 billion euros - this year, including big cuts in defence and health spending.

A senior Greek banker said a deal with private bondholders to restructure 200 billion euros of Greek debt is largely in place after months of negotiating, but that a final accord is on hold until Athens can show it is serious about tackling reforms.

Papademos acknowledged that the main sticking points in talks with the so-called "troika" of foreign lenders - the European Central Bank, the EU and the International Monetary Fund -- revolved around spending cuts and labour reform.

**U.S. set for 4th year of \$1 trillion-plus deficit-CBO**

The United States is headed for a fourth straight year with a \$1 trillion-plus budget deficit, congressional forecasters said, giving Republicans ammunition to hammer President Barack Obama's spending record in November's elections.

The non-partisan Congressional Budget Office said the fiscal 2012 deficit would rise to \$1.079 trillion from its previous estimate of \$973 billion made last August. If Congress extends payroll tax cuts through year-end, as expected, deficits would likely rise by another \$100 billion through December.

In preparing its forecast, CBO had to speculate on how some big-ticket items will be handled in the future, including the 2001 and 2003 across-the-board tax rate reductions enacted by former President George W. Bush that are due to expire on Dec. 31.

The CBO forecast, which is based on current law and assumes that Bush-era tax cuts expire at the end of 2012, shows the deficit falling to about \$585 billion for fiscal 2013. That figure was also slightly above the August forecast.

**Japan factory output rebounds as Thai flood impact fades**

Japanese factory output rose more than expected in December as companies made up for disruptions caused by severe flooding in Thailand, but a sustained recovery is far from assured given renewed yen rises and slowing global growth. Finance Minister Jun Azumi issued a fresh warning to markets against pushing up the yen too much, stressing that Japan was ready to intervene in the market if yen moves became excessive.

Recovery of supply chains is seen helping factory output in the near-term but the outlook beyond that is murky as a slowing global economy, Europe's debt crisis and a strong yen threaten to crimp overseas demand.

Industrial output rose 4.0 percent in December, more than a median market forecast for a 3.0 percent gain and rebounding from a 2.7 percent drop in November, trade ministry data showed. Manufacturers surveyed by the ministry expect the rebound to continue, projecting output to rise 2.5 percent in January and 1.2 percent in February. But those modest gains were not enough to prompt the ministry to upgrade its assessment on output from the current view that it was moving sideways.

## TODAY'S TOP NEWS

**Europe signs up to German-led fiscal pact**

Chancellor Angela Merkel cemented her political ascendancy in Europe on Monday when 25 out of 27 EU states agreed to a German-inspired pact for stricter budget discipline, even as they struggled to rekindle growth from the ashes of austerity. Only Britain and the Czech Republic refused to sign a fiscal compact in March that will impose quasi-automatic sanctions on countries that breach European Union budget deficit limits and will enshrine balanced budget rules in national law.

The accord was eagerly greeted by the European Central Bank which has long pressed euro zone governments to put their houses in order. "It is the first step towards a fiscal union. It certainly will strengthen confidence in the euro area," ECB President Mario Draghi said.

French President Nicolas Sarkozy said he expected a deal on reducing Greece's debt to private bondholders within days and he believed independent European institutions - a clear reference to the ECB - would help meet a funding gap.

**EU set to overhaul regulation of derivatives**

The European Union is expected to announce an overhaul of regulations governing the \$700 trillion derivatives market, introducing rules to make one of the most opaque areas of finance easier to monitor and less risky.

Under the new rules, banks, hedge funds and other financial institutions that buy and sell derivatives will be encouraged to move away from the unregulated 'over-the-counter' market, which accounts for more than 90 percent of trades. Instead, trading will be standardised so that it happens on open exchanges, with settlement cleared centrally.

Separately, Britain said taxing ultra fast trading, as France pledged to do this week, would encourage business to move elsewhere and not make markets stabler. UK financial services minister Mark Hoban said the UK would still veto any European Union-wide tax on financial transactions, dubbed a Tobin tax, as it would hit London hardest as the bloc's top trading centre.

**Record drop in UK consumer credit, money supply**

Credit card and other unsecured lending to British consumers posted its sharpest drop in nearly two decades in December, supporting expectations that the Bank of England will soon inject more cash into the economy to prevent a deep recession.

A steep decline in money supply also added to views that 75 billion pounds in quantitative easing, or asset purchasing, launched in October are not enough to boost the economy, which may have already entered a mild recession at the end of last year. Consumer credit fell by 400 million pounds last month the biggest monthly drop since records began in 1993, the bank said, confounding forecasts for a 400 million pound rise.

Economists said the numbers confirmed their expectations that the Bank of England was set to inject more stimulus into the economy. Most reckon the bank will announce a 50 billion pound expansion to its quantitative easing programme next week.

**Data shows Canada set for subpar growth in Q4**

Canada's economy unexpectedly shrank in November for the first time since May, setting the stage for lacklustre fourth-quarter growth and a sluggish start to 2012.

Oil and gas production slid in the month, outweighing gains in manufacturing and most services industries to trigger a 0.1 percent contraction of gross domestic product, Statistics Canada said.

The economy grew 2 percent compared with a year earlier. Together with stalled GDP in October, the data suggests fourth quarter performance is set to fall well below the Bank of Canada's forecast of 2 percent annualized growth, down from 3.5 percent in the prior quarter.

The industrial product price index fell 0.7 percent in the month, the sharpest decline in 18 months. Raw materials prices fell 2.4 percent in the month. Oil and gas production fell 2.5 percent in November, partly due to maintenance shutdowns, and exports of both commodities slid.

## NEXT UP

**Poll-Investors kick off 2012 with defensive stance**

Investors have begun 2012 in a cautious mood, with U.S. and Japanese asset managers worried about the euro zone debt crisis cutting exposure to stocks and boosting bonds, while European accounts added risky assets, Reuters polls show.

The surveys of 55 leading investment houses in the United States, continental Europe, Britain and Japan released showed a typical balanced portfolio held 50.5 percent of its assets in equities this month, the lowest since October.

Allocation to bonds, which include government and corporate debt, rose to 36.2 percent of the portfolio, the highest in at least a year. Cash dropped to 6.0 percent from 6.6 percent, showing investors are willing to put their money to work.

Asset managers outside Europe are worried about the long-term effects on the economy of the sovereign debt crisis. In their fixed income portfolios, investors increased exposure to government debt to 53.6 percent while they cut allocation to high yield bonds to 10.8 percent.

Sixteen out of 25 respondents who answered an extra question said their confidence in growth prospects for the euro zone had increased since the start of the year.

U.S. asset managers cut equity allocation to 63.0 percent, pushing euro zone exposure to just 10.7 percent. With optimism on

the U.S. economy rising, allocation to North American stocks jumped to 65.2 percent.

Their bonds weighting rose to 30.6 percent, driven by higher investment grade debt holdings. Cash rose to 2.3 percent from 1.8 percent.

Continental European funds increased their equity holdings to the highest level since July, while cutting bonds and cash.

The survey of 17 funds showed a typical balanced portfolio held 45.8 percent of its assets in equities. Allocation to bonds fell for a fifth straight month to 38.7 percent, a level last seen in April. Cash fell to 9.0 percent from 10.5 percent last month.

Japanese fund managers raised their average bond allocation to a record high while cutting their stock weighting. The average bond weighting in the poll of 12 Japan-based institutional investors jumped to a record high of 50.2 percent from 47.0 percent in December. Their stock weighting dropped to 43.2 percent from 45.6 percent in December. Yield-seeking British investors began to return to riskier assets such as stocks, cutting cash, while worries about the impact of Europe's still-unresolved debt crisis encouraged them to increase their bond weighting. In a survey of 14 investment managers, the average exposure to cash in balanced portfolios dropped sharply to 8.9 percent. Bond allocations increased slightly to 25.2 percent from 24.6 percent a month earlier.



## EYE ON ASIA

## POLL &amp; PREVIEW

**China funds boost suggested equity exposure on econ view, policy**

Chinese fund managers boosted their suggested equity weightings in January on expectations that China has averted a hard-landing and the government will provide further policy support for the struggling stock market, a Reuters poll showed.

The average recommended stock weighting over the next three months rose to 83 percent from last month's 80.6 percent, with interest in financial and machinery stocks rising, according to the poll of eight China-based fund managers conducted this week. Fund managers also raised their suggested exposure to bonds to 10.1 percent from 8.1 percent a month earlier, but slashed recommended cash allocation to 6.9 percent from 11.3 percent.

Fund managers polled expected the benchmark Shanghai Composite Index to rise about 5 percent on average to 2,413 points over the next three months from the current level.

**Budget to buttress Hong Kong as economy slows; outlook grim**

As Hong Kong braces for a tough year ahead given global economic woes, the financial hub's new budget is likely to offer a range of short-term relief handouts while keeping property cooling measures intact.

The budget for fiscal year to begin on April 1 will be delivered on Wednesday. With Hong Kong's economy expected to slow markedly in 2012 and exports already falling on the back of weaker demand in the United States and Europe, the authorities are expected to offer a smattering of one-off economic sweeteners, including rent waivers on public housing, electricity subsidies and nominal tax allowances.

No new measures affecting the financial services sector are expected in the budget announcement.

## EVENTS

For Feb 1

**AUSTRALIA**

- House prices index final for Q4: Expected -0.7 pct Prior -1.2 pct

**CHINA**

- NBS manufacturing PMI for January: Expected 49.5 Prior 50.3
- HSBC manufacturing PMI: Prior 48.80

**INDIA**

- HSBC Markit mfg PMI for January: Prior 54.20
- Exports, USD for December: Prior 22.30 bln
- Imports, USD: Prior 35.90bln
- Trade deficit, USD: Prior 13.60 bln

**INDONESIA**

- Consumer confidence index for January: Prior 116.6
- Retail sales index for December: Prior 26.6 pct
- Inflation yy for January: Expected 3.64 pct Prior 3.79 pct
- Inflation mm: Expected 0.70 pct Prior 0.57 pct
- Core inflation yy: Expected 4.20 pct Prior 4.34 pct
- Trade balance in USD for December: Expected 1.70 bln Prior 1.52 bln
- Exports growth yy: Expected 4.10 pct Prior 8.25 pct
- Imports growth yy: Expected 18.30 pct Prior 18.37 pct

**SINGAPORE**

- PMI final for January: Prior 49.5

**THAILAND**

- CPI headline inflation for January: Expected 3.45 pct Prior 3.53 pct
- CPI core inflation: Expected 2.70 pct Prior 2.66 pct

## MARKET SNAPSHOT as of 3:00 pm EST

GOVERNMENT BOND BENCHMARKS					EQUITIES			FORWARDS 3 months <FORWARDS>		
5-Year		10-Year				Close	Change			
Bid	Yield	Bid	Yield	Bid				Ask		
Australia	112.490	3.283	116.719	3.795	S&P/ASX200	-	-	JPY	-6.85	-6.35
Japan	99.808	0.340	100.261	0.971	NIKKEI 225	8802.51	9.46	AUD	-103.26	-102.76
China	102.331	3.010	101.336	3.400	HKSE	20390.49	230.08	NZD	-49.5	-48.5
Hong Kong	101.200	0.572	99.000	1.304	SHANGHAI	2292.61	7.57	HKD	-16	-11
Singapore	102.600	0.493	106.200	1.534	STRAITS TIMES	2906.69	18.40	SGD	-4.5	-4
					SENSEX	17193.55	330.25	THB	18	18.4
INTEREST RATE SWAPS					DEPOSITS 3 months <DEPOS>			NDF's 3 months <NDFS>		
5-Year		10-Year								
Bid	Ask	Bid	Ask		Bid		Bid	Ask		
AUD	4.1875	4.2475	4.5675	4.6225	JPY	0.18	CNY	-0.0235	-0.0185	
JPY	0.4325	0.4925	0.94	1	CNY	5.2	TWD	-0.16	-0.14	
CNY	3.75	3.85	3.75	3.95	AUD	4.6	KRW	1129.9	1130.9	
HKD	0.89	0.97	1.63	1.71	NZD	2.95	INR	50.578	50.678	
TWD	1.03	1.04	1.27	1.31	HKD	0.3	MYR	3.067	3.071	
INR	5.85	6.1	5.85	6.25	SGD	0.25	PHP	43.03	43.13	
KRW	3.41	3.45	3.5575	3.5975						
SGD	1.06	1.085	1.94	1.97						

## EYE ON LATAM

## LATAM TOP STORIES

**Brazil meets 2011 budget target, fiscal worries ahead**

Brazil comfortably met its primary budget surplus target in 2011, official data showed, but government plans to revive a lackluster economy are stoking worries that fiscal discipline could take a backseat in 2012.

In President Dilma Rousseff's first year in office, Brazil posted a record primary budget surplus of 128.71 billion reais (\$73.36 billion) in 2011, equal to 3.11 percent of gross domestic product, the central bank said. That surpassed the government's target of a surplus equal to 3.1 percent of GDP, underscoring Rousseff's push to keep a lid on public spending.

**Brazil industry struggles in 2011, up 0.3 percent**

Industrial production in Brazil closed 2011 up a meager 0.3 percent, underperforming the broader economy, adding urgency to President Dilma Rousseff's efforts to revive the manufacturing sector.

There was a sliver of encouraging news as industrial output rose 0.9 percent in December from November, government statistics agency IBGE said. The data, which was broadly in line with expectations, reinforced perceptions that Brazil's economy has regained some strength after posting zero growth in the third quarter.

The monthly industrial data was in line with expectations. Production had been expected to rise 1 percent, according to the median estimate of 17 analysts in a Reuters survey. The forecasts ranged from 0.8 percent to 1.5 percent.

December's industrial production fell 1.2 percent compared with a year earlier, more than the 0.8 percent decline forecast in the Reuters survey.

**Mexico economy likely grew 3.7 pct in Q4-govt**

Mexico's economy likely grew 3.7 percent in the fourth quarter of last year compared to the same period a year earlier, the finance ministry said in a statement late on Monday.

The ministry estimated the economy grew 4 percent in the full year of 2011. Quarterly growth figures will be published on Feb. 16. Mexico's economy is struggling to recover from a deep recession in 2009 and the government forecasts economic growth this year of 3.5 percent.

**Chile ends 2011 with lowest jobless rate in nearly 5 years**

Chile's jobless rate fell to 6.6 percent in the fourth quarter, the lowest reading since a new index was introduced nearly two years ago and in almost 5 years going by a previous methodology, as job creation surged, the government said.

The October-to-December rate compared to 7.1 percent in the September-to-November period reported last month, the National Statistics Institute said.

Twelve economists polled by Reuters had forecast a median estimate of 7.0 percent for the three-month period.

The October-December rate was the lowest for a rolling three-month period since the December 2006-to-February 2007 period, when it touched 6.4 percent, according to a previous methodology replaced in early 2010.

**Chile key rate around normal levels -cen bank head**

Chile's benchmark interest rate is around "normal" levels, and the central bank has ample ability to act to address the impact

## LATAM MARKETS TODAY

**TREASURIES:**

- Mexican 10-yr notes were down, yielding 5.93 pct and 30-yr bonds rose yielding 7.33 pct.
- Brazilian 10-yr notes surged, yielding 11.23 pct and 2-yr notes gained, yielding 10.10 pct.

**FOREX:**

- Brazilian real edged down 0.07 pct to 1.7463 per dollar.
- Mexico's peso rose 0.39 pct to 13.0301. Chile peso added 0.16 pct to 491.4 per dollar. Colombia's peso slipped 0.43 pct to 1,809.2 to the dollar and Peru sol was down 0.04 pct to 2.688 to the dollar.

**STOCKS:**

- MSCI Latin American stock index gained 0.71 pct to 4,054.58.
- Commodities producers and builders drove Brazil's benchmark Bovespa index higher, while banks limited gains. The index rebounded from two days of losses, up 0.48 pct to 63,072.31. In the month, the index gained of more than 11 pct. Vale drove the index higher, rising 2.55 pct, Homebuilder Gafisa soared 6 pct. Bank stocks limited gains, Bradesco fell 3.15 pct, rival Itau Unibanco lost 1.07 pct and Banco Santander Brasil fell 1.4 pct.
- Mexico's IPC index added 0.49 pct to 37,422.68. Financial and retail firm Grupo Elektra led index as it rose 2.38 pct. America Movil fell 0.65 pct.
- Chile's IPSA index rose 0.91 pct to 4,260.75. Industrial conglomerate Empresas Copec drove gains in the index, adding 2.66 pct and Cencosud rose 1.6 pct.

## LATAM TOP STORIES

*(continued)*

of outside risks if the euro zone's crisis deepens, bank President Rodrigo Vergara said.

Vergara told Congress the tools included long-term repurchase agreements and swaps. He said the base scenario of the bank's December quarterly monetary policy report, which signals there is room for more expansive monetary policy, remained valid. Vergara said that while the country's banks are well capitalized, they should take measures to mitigate the impact of any steeper downturn abroad, and said the central bank was at the ready.

Meanwhile, Chile's banking sector profit rose 3.77 percent in 2011 to 1.712 trillion pesos (\$3.282 billion) after jumping 36.7 percent in December, as loans surged, the banking regulator said.

**POLL-Colombian inflation rate seen racing higher in January**

Colombia's consumer prices are seen rising 0.76 percent in January driven by increases in food, housing and transport costs, up from inflation of 0.42 percent in December, according to the median forecast in a Reuters poll of analysts.

Colombian policy makers pushed the benchmark interest rate up a quarter point to 5 percent on Monday to stave off inflationary pressures, anchor expectations and cool credit growth.

Inflation estimates in a Reuters poll of 26 economists ranged from 0.56 percent to 0.93 percent for January. The average of the estimates was 0.75 percent.

Colombia's consumer price index rose 0.91 percent in January of last year.



## DEEP DIVE Commentary and Analysis

## FED FOCUS

## Trying to read between the lines of the Fed rate message

By Jonathan Spicer

For a central bank that wants to make transparency its hallmark, the U.S. Federal Reserve's new forecast of nearly three more years of super-low rates has left room for a few doubts.

The Fed surprised markets last Wednesday when it extended its previous forecast for keeping its key interest rate "exceptionally low" until at least late 2014, more than a year longer than its previous guidance.

Ninety minutes later, the U.S. central bank published charts showing that more than a third of its policymakers expected a rate rise before 2014, whiplashing bond markets.

The difference in tone between the dovish statement of the Fed's policy-setting committee and the somewhat more hawkish-looking projections of its 17 individual members, has left some economists unsure as to when the Fed will start to reverse its historic, all-out support of the U.S. economy.

Some are re-examining the Fed's choice of language and questioning whether the term "exceptionally low" really means the current level of the Fed funds rate of zero to 0.25 percent.

Others are asking what the phrase "late 2014" means more precisely as they try to decipher the nuances of a central bank that is taking bold steps to support the economic recovery while at the same time stressing transparency into its inner workings.

"You can't possibly know with any degree of confidence what will unfold given this degree of uncertainty," said Michael Moran, chief economist at Daiwa Capital Markets, in New York, referring to the wide range of views on where rates are headed. "You just have to keep an open mind on monetary policy."

The Fed has kept short-term rates below 0.25 percent for more than three years already and purchased some \$2.3 trillion in long-term securities to help the U.S. economy claw its way back from a brutal recession.

With the recovery still fragile and at risk from fallout from Europe's crisis, the Fed is running out of tools and has turned to making statements about its intentions over the coming years in the hope of assuring skittish markets that it is committed to sticking with its super-loose monetary policy.

That could keep longer-term rates low in the open market. Low rates usually encourage economic activity and boost hiring.

This delicate management of expectations is playing out just as Fed Chairman Ben Bernanke is shining a light on what in the past were the central bank's opaque internal deliberations.

The first-ever release last week of projections by Fed policymakers of where they expect interest rates to be over the next few years revealed a remarkably wide range of views.

Three officials expected a rate rise as soon as this year. Two others did not see that happening until 2016.

## CONFUSION

In an early sign of confusion, yields on 10-year Treasuries dropped after the Fed's late-2014 comment on Wednesday and fell to as low as 1.92 percent. They bounced back to 2 percent after the rate projections were revealed.

Asked for clarity by reporters, Bernanke made it clear that the statement from the Federal Open Market Committee, which sets rates and currently has 10 voting members, prevailed over the 17 individual projections.

"The FOMC will always, in some sense, trump the projections of forward interest rates," he said.

But Charles Plosser, president of the Philadelphia Fed and among the most hawkish of the Fed's top officials, acknowledged on Monday that the FOMC's statement was "not as clear as it could have been."

Having low rates until late 2014 is "conditional on the evolution of the economy. I think that we don't make that clear enough," Plosser told CNBC television.

"A lot of people have been reading the statement as if it was a commitment and it is not a commitment."

## ALL EYES ON 2014

Plosser, who has focused more on keeping a lid on inflation than lowering the 8.5-percent U.S. unemployment rate, confirmed that he was one of the three officials forecasting a rate rise this year. He is among those skeptical of the Fed's ultra-easy policy and its talk of standing pat for some time to come.

Six of the FOMC's 17 policymakers saw rates rising to between 0.25 percent and 2 percent by the end of 2013. By the end of 2014 they were joined by a further five who expected increases in borrowing costs and as a group they saw rates between 0.25 and 2.75 percent, with a median of 0.75 percent.

The other six projected no change until after 2014.

Adding to intrigue over the path ahead for rates, Plosser, fellow hawk Richard Fisher of Dallas, and Minneapolis Fed President Narayana Kocherlakota, a moderate hawk, all regain positions on the FOMC in the critical year of 2014.

Bernanke, along with vice chair Janet Yellen and William Dudley, the influential head of the New York Fed, has steered the Fed's policy moves. But the chairman's current term expires in early 2014, adding to the uncertainty on the horizon.

Since August, when Bernanke clearly implied in a speech that "exceptionally low" rates meant zero to 0.25 percent, Wall Street has run with that assumption.

Now some economists are reading between the lines.

"There are different definitions of 'exceptionally low' levels of the federal funds rate. Perhaps one could think of any rate below 1 percent as exceptionally low," said Thomas Simons, money market economist at Jefferies & Co, who co-published a note to clients on the topic.

"What is your definition of late 2014? Maybe it's September," Simons said.

Accordingly, futures traders are hedging their bets over what the Fed will actually do.

According to rates contracts at exchange operator CME Group Inc, traders are pricing in a 48 percent chance that the first rate hike will occur in June, 2014. There is a 62 percent chance that it comes in July, 2014.

Economists at FTN Financial argued the Fed's statement was intended to reinforce the primacy of the FOMC over the broader group. "The unspoken message is that there are enough voting members at or near zero to keep rates unchanged even if others at the Fed disagree," they wrote last week in a note to clients.

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