

INSIDE DEBT

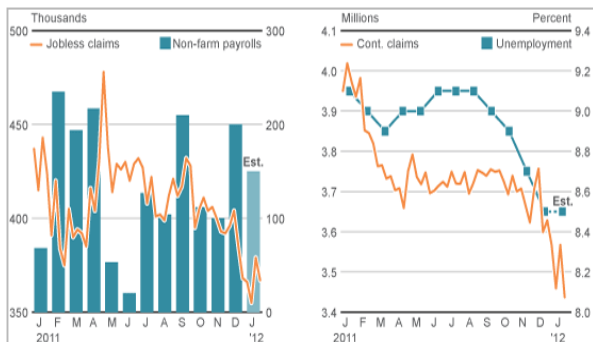
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Thursday, February 2, 2012

CHART OF THE DAY

U.S. jobless claims

Click on the chart for full-size image



Initial jobless claims fell last week to 367,000. For the week ended January 21, continuing claims fell to 3.4 million. The data falls outside the survey period for Friday's payrolls report, which analysts expect will show a gain of 150,000 jobs and an unemployment rate of 8.5 percent.

TODAY'S TOP NEWS

- U.S. jobless claims fall, jobs market slowly healing
- Bernanke defends low rate policy for weak economy
- EZ aims to agree on second Greek bailout Feb. 6
- China's Wen: May consider bigger role in EU rescue funds
- ECB must be "mobilised" for debt deal - Greek FM
- Republicans push to stop automatic spending cuts
- UK construction firms more upbeat despite slower growth in Jan-PMI

ECON WATCH

FOR FRIDAY FEBRUARY 3

ET	Indicators	Unit	Reuters	Prior
08:30 US	Non-farm Payrolls	k	150	200
08:30 US	Manufacturing Payrolls	k	15	23
08:30 US	Private Payrolls	k	170	212
08:30 US	Unemployment	%	8.5	8.5
10:00 US	ISM Non-mfg index	ind	53	53
10:00 US	ISM N-mfg Bus Act	ind	56.2	55.9
10:00 US	Factory Orders	%	1.5	1.8
10:00 US	Durable goods	%	--	3
10:00 US	Ex-Transportation	%	--	2.1
10:00 US	Ex-Defense	%	--	3.5
10:00 US	Nondefense ex-air	%	--	2.9

- 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: New claims for unemployment benefits in the U.S. fell more than expected last week, pointing to further healing in the nation's battered jobs market. **For more please click here**

TREASURIES: Prices of government bonds were little changed as investors held their breath before crucial U.S. jobs data on Friday and a highly anticipated outcome to Greece's debt swap talks.

- "People are staying quiet ahead of payrolls tomorrow," said Justin Lederer, interest rate strategist at Cantor Fitzgerald in New York.
- 10-yr notes rose 2/32 to yield 1.82 pct from 1.83 pct, while 30-yr bonds fell 9/32, yielding 3.01 pct.
- 5-yr notes gained 2/32, yielding 0.71 pct.

FOREX: The euro surrendered gains and was last little changed in a volatile session as bullish comments from Fed Chairman Ben Bernanke were overshadowed by ongoing concerns about the lack of resolution on the Greek sovereign debt crisis.

- The euro was last at \$1.3146, down 0.11 pct. Meanwhile, it was up 0.05 pct against the Swiss francs at 1.20 francs.
- Against the yen, the dollar slipped 0.04 pct to 76.19 yen, sticking near a three-month low touched on Wednesday and keeping alive concerns that Japanese authorities may intervene to curb yen strength.
- Australian dollar edged up 0.02 pct to \$1.0705, earlier it touched a five-month high against the U.S. dollar. The Australian dollar's almost 5 pct gain this year comes despite wide expectations that the Reserve Bank of Australia will cut benchmark interest rates again before they will raise them.
- The New Zealand dollar edged up 0.06 pct to \$0.8329.
- The dollar index was up 0.07 pct at 78.976.

CORPORATES: Corporate bond spreads tightened as jobless claims pointed towards an improving economic picture and investors prepared for a highly anticipated payroll report on Friday.

- The CDX.IG-17 index tightened by 1 bps to 100 bps.
- New issuers included, Schaeffler, CDW, CIT Group, INEOS Finance and Limited Brands.

STOCKS: Investors largely took a wait-and-see approach as stocks ended little changed ahead of Friday's key employment report, but tech shares rose on strong earnings from chipmaker Qualcomm.

- Dow was down 8.93 points or 0.07 pct at 12,707.53, S&P was up 1.52 points or 0.11 pct at 1,325.61 and Nasdaq rose 11.24 points or 0.39 pct at 2,859.51.
- Qualcomm gained 1.96 pct and MasterCard rose 6.7 pct
- Insurer Cigna went down 3.4 pct and Boston Scientific fell 4.1 pct

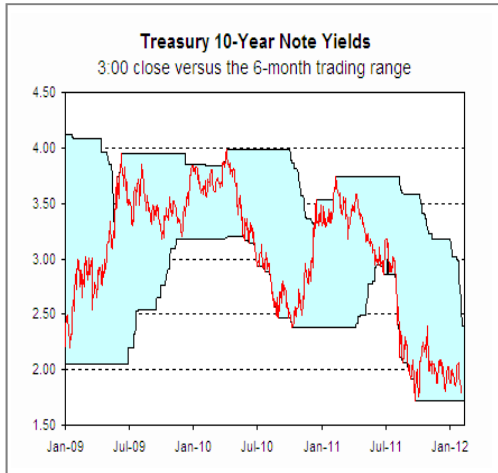
C & E: Crude futures fell as the previous day's data showing rising crude oil and gasoline stockpiles continued to generate bearish sentiment.

- March crude lost 1.02 pct to \$96.61 per barrel
- Gold added 0.86 pct to \$1,758.7 an ounce
- Reuters-Jefferies index slipped 0.20 pct to 310.90.

- 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	0.080	0.05	0.081	0.016
3-Mo Bill	0.080	0.070	0.081	0.021
6-Mo Bill	0.095	0.090	0.096	0.009
1-Year	0.135	0.110	0.137	0.010
2-Year	100.039	100.070	0.231	0.004
3-Year	99.836	99.867	0.306	0.000
5-Year	100.781	100.820	0.716	0.051
7-Year	99.969	100.016	1.255	0.117
10-Year	101.516	101.578	1.830	0.016
30-Year	102.141	102.219	3.015	-0.414

EQUITIES

	INDEX	CHANGE
DJIA	12708.71	-7.75
NASDAQ	2857.44	9.17
S&P 500	1325.50	1.41

COMMODITIES

	PRICE	CHANGE
NYMEX	96.5	-1.1
BRENT	112.2	0.7
SPOT GOLD	1756.2	12.5
PALLADIUM	702.5	8.3
SILVER	34.2	0.6

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.220	O/N	0.240
2-Week	0.200	2-Week	0.250
1-Month	0.210	1-Month	0.240
3-Month	0.200	3-Month	0.260
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.230	10:00 AM	0.180
2-Week	0.220	3:00 PM	0.181
1-Month	0.220		
3-Month	0.210		

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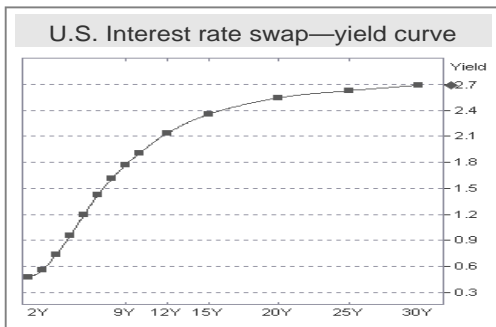
	SPREAD		RATE	
2-Year	24.25	28.25	0.47	0.50
3-Year	25.00	29.00	0.55	0.58
5-Year	24.00	28.00	0.95	0.98
7-Year	17.25	21.25	1.42	1.44
10-Year	8.75	12.75	1.91	1.93
30-Year	-32.25	-28.25	2.69	2.69

EURODOLLAR FUTURES

	CLOSE	CHANGE
Feb-12	99.52	0.01
Mar-12	99.58	0.01
Jun-12	99.58	0.02
Sep-12	99.56	0.02

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.090	0.120		
1-Month	0.250	0.350	0.099	0.109
3-Month	0.340	0.490	0.103	0.113
6-Month	0.540	0.690	0.107	0.117
12-Month	0.820	1.030	0.115	0.125



FUTURES

	PRICE	CHANGE
CBOT 5 yr	124.05	0.05
CBOT 10 yr	132.17	0.20
CBOT 30 yr	144.91	-0.25

CURRENCIES

	BID	ASK
Euro	1.3142	1.3144
Sterling	1.5802	1.5806
JP Yen	76.14	76.16
Swiss Franc	0.9167	0.9170
Can Dollar	0.9992	0.9994
Mexico	12.8104	12.8166

ACTIVE FANNIE MAE AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.5	8/9/2013	4	1
3-Year	0.75	12/19/2014	12.75	9.75
5-Year	1.25	1/30/2017	26.5	23.5
7-Year	-	-	-	-
10-Year	-	-	-	-
30-Year	6.625	11/15/2030	22	19

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.375	11/27/2013	7	4
3-Year	0.625	12/29/2014	13	10
5-Year	1	3/8/2017	30.25	27.25
7-Year	-	-	-	-
10-Year	2.375	1/13/2022	47	44
30-Year	6.25	7/15/2032	25	22

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	3.5	105.0520	105.0560	2.387
FHLMC	3.5	105.0520	105.0560	2.234

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.0	105.2330	105.2370	1.922
FHLMC	4.0	105.1330	105.1370	2.057
GNMA	4.0	107.2820	107.2860	1.994

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

U.S. jobless claims fall, jobs market slowly healing

New claims for unemployment benefits in the U.S. fell more than expected last week, pointing to further healing in the nation's battered jobs market.

Initial claims for state unemployment benefits slid 12,000 last week to 367,000, the Labor Department said.

A four-week moving average for initial filings fell 2,000 to 375,750, and claims have been lower than 400,000 for eight of the last 10 weeks. Economists see that level as a dividing line between an improving and deteriorating labor market. The number of people still receiving benefits under regular state programs after an initial week of aid fell 130,000 to 3.437 million in the week ended Jan. 21, the lowest since September 2008.

A separate Labor Department report showed growth in U.S. nonfarm productivity slowed in the fourth quarter. Some analysts said that suggested companies might be closer to squeezing all they can out of their current staff. The report on jobless claims showed the number of Americans on emergency unemployment benefits rose 100,392 to 3.022 million in the week ended Jan. 14, the latest week for which data is available. A total of 7.67 million people were claiming benefits during that period under all programs, little changed from the prior week.

Euro zone aims to agree on second Greek bailout Feb. 6

Euro zone finance ministers aim to agree a second financing package for Greece, a decision they hope will boost market confidence in euro zone public finances and help contain the two-year-old sovereign debt crisis.

A deal for Greece would include agreement on official new financing, the size of voluntary losses banks and other private bondholders are willing to accept and new reforms Athens must undertake. This would end months of uncertainty over private sector losses on Greek bonds and over the sustainability of the country's debt, now at 160 percent of GDP, which have increased costs of borrowing in many other euro zone countries. Senior euro zone officials are expected to meet on in Brussels to prepare the package, which would then likely be submitted for approval by euro zone finance ministers at an extraordinary meeting.

"We are very far in the negotiations and we should be able to close them in the coming days," EU Economic and Monetary Affairs Commissioner Olli Rehn told reporters in The Hague.

ECB must be "mobilised" for debt deal - Greek finmin

The European Central Bank must take part in Greece's debt swap, Finance Minister Evangelos Venizelos said, warning that a rescue package for Athens also hinges on other issues being resolved such as labor reforms and how Greek banks are to be recapitalized.

Prime Minister Lucas Papademos still hasn't secured broad political support for yet more austerity - another key condition to clinch a deal and avoid a chaotic default - with a meeting of political leaders yet to be pinned down. "In parallel with negotiations with private creditors, there must be negotiations for the official sector involvement. This means that the ECB must be mobilized, and we must resolve issues pertaining to national central banks," Venizelos told socialist party lawmakers, in the strongest appeal yet from Athens for the Frankfurt-based central bank to help reach a deal.

Separately, the ECB is considering how it can help bail out Greece, could send Athens profits from Greek bonds it holds via a roundabout route that would provide aid while respecting a ban on the ECB financing governments direct.

Bernanke defends low rate policy for weak economy

Europe's financial crisis still threatens the U.S. recovery, and the Federal Reserve will do everything it can to protect against damage to the economy, Fed Chairman Ben Bernanke said. Bernanke told Congress he was seeing signs that some of the uncertainty limiting U.S. business investment, including European banking woes, might be waning. But he said it was far too soon to say whether the United States could remain unscathed. He warned the debt troubles in Europe risked undermining the U.S. recovery. "We are in frequent contact with European authorities, and we will continue to monitor the situation closely and take every available step to protect the U.S. financial system and the economy," Bernanke said.

Separately, a top Federal Reserve official said, the U.S. central bank should be much more forceful in trying to bring down high unemployment, even if it means jumping into a potentially controversial new round of bond purchases. "If the committee were not able to refine our forward guidance in a way that I think would impart more monetary stimulus than what we currently have, I would favor more asset purchases," Chicago Fed President Charles Evans told reporters.

China's Wen: May consider bigger role in EU rescue funds

China is considering increasing its participation in the rescue funds aimed at resolving the European debt crisis, Chinese Premier Wen Jiabao told journalists.

But Wen did not make any explicit financial commitments for the European Financial Stability Facility or the upcoming European Stability Mechanism.

At a joint media briefing in Beijing with visiting German Chancellor Angela Merkel, Wen said China is still studying how it might lend further support, including possibly through the IMF. "China is also considering increasing its participation in the solution of the European debt crisis through the channels of the EFSF and ESM," Wen said.

Merkel told reporters that Chinese leaders again emphasized in their discussions that Europe must rely on itself to solve its own problem. "China is ready to work for a stable euro in its general responsibility for a stable global economy," Merkel said. She stressed that the stabilization of the euro was a matter for European nations. "We must do our homework," she said, adding the world expected Europe to present a united front.

Republicans push to stop automatic U.S. spending cuts

The U.S. military would be spared from automatic spending cuts set for next year under a proposal some top Senate Republicans offered that instead would save money by reducing the federal workforce.

Senator John McCain, senior Republican on the Armed Services Committee, assistant Senate Republican leader Jon Kyl and four others offered legislation that would eliminate the first installment of \$1.2 trillion in automatic spending cuts over a decade. The legislation faces an uphill battle in the Senate, led by Democrats likely to oppose the federal work force cuts. The White House also opposes efforts to circumvent the across-the-board spending cuts at the center of a budget brawl between Democratic President Barack Obama and Republicans in Congress during last year's fight to increase the U.S. debt limit.

The proposal by the half dozen Senate Republicans would let the military and most domestic programs avoid the automatic cuts that are to start taking effect in January 2013. Some \$127 billion would be saved instead by scaling back the federal workforce and freezing its pay.



TODAY'S TOP NEWS

UK construction firms more upbeat despite slower growth in Jan-PMI

Britain's construction companies have grown more optimistic about their business prospects for this year despite a slower expansion in activity in January, a survey showed, adding to hopes that the economy may avoid recession.

The headline Markit/CIPS construction Purchasing Managers' Index fell to 51.4 from 53.2 in December as growth in new orders slowed and some existing contracts were completed. That was below analysts' forecasts for a drop to 52.6 and the weakest rate of expansion in four months.

However, the component measuring firms' confidence about business over the next year rose to an eight-month high, helped by what they said were improving economic conditions.

Meanwhile, the Bank of England should consider buying more assets other than government bonds as part of a wide-ranging program to revamp Britain's banking infrastructure, BoE policy-maker Adam Posen said.

Europe gets bond market respite, real economy pain

Spain and France gained respite at bond auctions highlighting a rally in euro zone government debt markets since the European Central Bank flooded banks with cheap money in December.

The European Union's top economic official forecast a deal between Greece and its private creditors by the end of the week to cut Athens' debt, despite what another aide called "ultra-difficult" negotiations with bondholders.

Dismal corporate results showed Europe's "real economy" is suffering increasingly from the currency area's sovereign debt crisis after unemployment hit a new record this week.

Madrid and Paris drew healthy demand and saw their borrowing costs tumble despite having had their credit ratings downgraded -- Spain's by two notches -- by Standard & Poor's last month, following a similar strong showing by Italy.

Japan finmin asks BOJ to ease, yen in danger zone

Japan's finance and economic ministers piled pressure on the Bank of Japan to consider easing policy further, as the yen climbs back to levels that led to Tokyo to intervene heavily in currency markets last year to protect its export-reliant economy. BOJ Deputy Governor Hirohide Yamaguchi said he saw no need to ease policy right away, but the central bank could face growing calls to offer more monetary stimulus to help exporters through any prolonged slump, even though it has limited options remaining to support the faltering economy.

Economics Minister Motohisa Furukawa also called on the central bank to ensure that real interest rates remain low, as the Federal Reserve's commitment to keep its nominal benchmark rate near zero for nearly three more years pushes the dollar lower against the yen.

Swiss exports fall in Dec as strong franc weighs

Exports from Switzerland fell in December, hurt by turmoil in the euro zone which slashed demand for Swiss goods and drove the franc currency to unfavorably strong levels as investors looked for a safe place to park their money.

Economists have warned growth will slow considerably as exports suffer, with some even expecting the economy to fall into recession.

Swiss exports fell by a real 1.6 percent in December to 15.630 billion Swiss francs, the Federal Customs Office said. Exports to the European Union, Switzerland's biggest trading partner, dropped 4.2 percent, as the debt crisis curbed demand.

Overall last year, exports rose only 2 percent, the report showed, down from 7 percent in 2010 as companies cut prices to take account of the strong franc in a bid to preserve volumes. The Swiss National Bank expects growth of just 0.5 percent this year. Some economists even forecast a mild recession in the first half of 2012.

NEXT UP

POLL-Euro set to resume its slow fade vs the dollar

The euro's modest upturn against the dollar since the start of the year will soon run out of steam, according to a Reuters poll of over 60 analysts whose euro currency forecasts were the lowest since September 2010.

Some promising economic data and hopes Greece will yet avoid a damaging sovereign debt default helped push the euro around 3.5 percent higher since January 16 to around \$1.31.

But strategists were pessimistic about the quality of the rally, suggesting the euro will revert to its longer-term trend of modest depreciation against the dollar since hitting a peak around \$1.49 a year ago.

The poll showed the euro weakening a little to around \$1.29 in a month's time, \$1.27 in three months, and \$1.25 in six, before returning to \$1.28 in a year's time - roughly a cent or two lower in each case compared with forecasts from the January poll, and the lowest since September 2010.

Economists now expect the dollar index to end 2012 at 80.00. Economists did not expect the dollar index to breach the 79 mark in any poll since May last year.

That was a clear indication the dollar is expected to fare better as a safe haven currency in 2012, while the debt crisis rumbles on. Indeed, the euro looks set for its most volatile month since October, according to calculations from the survey.

The outlook against the British pound, by contrast, looks flat.

Sterling will cruise at current levels against the battered euro despite growing optimism about the British economy's ability to outperform a euro zone gripped by a sovereign debt crisis, a Reuters poll found.

POLL-C\$ seen hovering near parity with US\$ in 2012

The Canadian dollar, which recently cracked parity with its U.S. counterpart for the first since October, is expected to hover around the one-for-one level with the greenback for the rest of the year, a Reuters poll showed.

The survey of 50 global foreign exchange strategists was more bullish about the Canadian dollar's trajectory in the first half of 2012 than was a Reuters poll done a month earlier.

Median forecasts in the poll showed the currency at C\$1.01 to the U.S. dollar, or 99.01 U.S. cents, in one and six months from now.

Further on, the Canadian dollar is also seen trading at equal value to the greenback in January 2013.

By comparison, January's poll had Canada's dollar ranging between C\$1.02 and C\$1.03 in the first six months of the year.

Euro zone troubles have hurt Canadian growth, with a recent manufacturing report showing output and new order gains slowing sharply in January from December. Canadian gross domestic product contracted in November for the first time since May.



EYE ON ASIA

POLL & PREVIEW

Yen to stay firm as U.S., ECB ease policy

The blistering pace of monetary policy easing in the United States and the euro zone will keep the safe-haven Japanese yen strong throughout this year, a Reuters poll showed.

The yen surged by nearly a percentage point last week after the U.S. Federal Reserve said it was likely to refrain from raising interest rates until at least late 2014 and was ready to provide additional stimulus to the economy if needed.

The U.S. dollar is expected to buy you 77 yen in one month's time, 78 yen in six months and 80 yen in a year, according to the median consensus of over 60 strategists polled this week.

More bullish on Asia FX; biggest bets on won, rupee in 15 mth

Investors grew more optimistic about most emerging Asian currencies in the last two weeks, adding bets on the Indian rupee and the South Korean won to the largest in more than 15 months, a Reuters poll showed.

The survey of 11 currency analysts showed that currency players became the most bullish on the two Asian currencies, as well as the Malaysian ringgit and the Philippine peso, since mid-October 2010.

They also were the most optimistic on the Taiwan dollar since February last year, and the most bullish on the Singapore dollar since early August, according to the survey. Currency investors doubled positions in the Indonesian rupiah to the largest since late August, the poll showed.

Meanwhile, investors trimmed bets on the Chinese yuan during the last two weeks, the poll showed. The Reuters survey focused on what analysts believe are the current market positions in eight Asian emerging market currencies: Chinese yuan, South Korean won, Singapore dollar, Indonesian rupiah, Taiwan dollar, Indian rupee, Philippine peso and Malaysian ringgit.

EVENTS

For Feb 3

CHINA

- Angela Merkel is expected to travel Guangzhou's business forum to give her views on the Eurozone crisis - a perspective very welcomed by Chinese policymakers.
- HSBC services PMI for January: Prior 52.5

INDONESIA

- Indonesia and Pakistan will sign Preferential Trade Agreement (PTA).
- Consumer confidence index for January: Prior 116.6
- Retail sales index for December: Prior 26.6 pct
- Motorbike sales yy for January: Prior -10.3 pct

Japan

- IMF Deputy Managing Director Naoyuki Shinohara is expected to hold news conference along with Michael Keen, deputy director of IMF's Fiscal Affairs Department.

SRI LANKA

- Sri Lanka's central bank is expected to release its monetary policy review for February.
- IMF review on Sri Lanka's central bank policy.

THAILAND

- Forex reserves w/e: Prior 176.2 bln
- Currency swaps: Prior 31.1 bln

MARKET SNAPSHOT as of 3:00 pm EST

GOVERNMENT BOND BENCHMARKS					EQUITIES			FORWARDS 3 months <FORWARDS>					
5-Year		10-Year			S&P/ASX200	Close	Change	JPY	Bid	Ask			
Bid	Yield	Bid	Yield	Bid							Ask		
Australia	112.126	3.355	116.272	3.842	NIKKEI 225	8876.82	67.03	AUD	-104.67	-104.17			
Japan	99.856	0.330	100.451	0.950	HKSE	20739.45	406.08	NZD	-50.6	-49.6			
China	102.328	3.010	101.336	3.400	SHANGHAI	2312.56	44.48	HKD	-8	-5			
Hong Kong	101.100	0.592	98.800	1.326	STRAITS TIMES	2901.04	-3.72	SGD	-5.1	-4.3			
Singapore	102.600	0.493	106.800	1.467	SENSEX	17431.85	131.27	THB	17.75	18.5			
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	4.175	4.235	4.56	4.615	JPY	0.18	CNY	-0.025	-0.02				
JPY	0.425	0.485	0.93	0.99	CNY	5.25	TWD	-0.085	-0.065				
CNY	3.92	4.02	3.92	4.12	AUD	4.6	KRW	1125.3	1126.2				
HKD	0.9	0.98	1.67	1.75	NZD	2.95	INR	50	50.1				
TWD	1.03	1.04	1.27	1.31	HKD	0.38	MYR	3.036	3.04				
INR	5.9	6.15	5.8	6.2	SGD	0.25	PHP	42.73	42.83				
KRW	3.415	3.455	3.565	3.605			IDR	8970	9070				
SGD	1.01	1.04	1.84	1.89									

EYE ON LATAM

LATAM TOP STORIES

Brazil economy seen growing faster in 2012-c.bank

The Brazilian economy should expand faster in 2012 than the previous year, the country's central bank governor said, helped by further cuts in interest rates. Alexandre Antonio Tombini, who was speaking to reporters on the sidelines of a banking conference in Mumbai, said economic growth would be close 3 percent in 2011.

"(The) economy is picking up some speed as we speak and Brazil (is seen) growing more in 2012 than in 2011 and growing more in second half of the year than in first half because of lags involved in monetary policy," Tombini said.

Tombini said there is room for further monetary easing without jeopardising the central bank's inflation target of around 4.5 percent in 2012. Tombini said the gains in the real, which has risen sharply in 2012, have been in line with other currencies. "2012 started on an optimistic note as far as markets are concerned. So, this is reflected in currencies around the world, real included." Tombini said the country's foreign exchange reserves were modest as compared to the size of the economy and other countries.

Brazil to restore tariff on Mexican autos - report

Brazil's President Dilma Rousseff has ordered the termination of a long-standing deal with Mexico for tariff-free bilateral trade in automobiles and parts, Valor Economico newspaper said, in another possible sign of growing protectionism in emerging markets.

The deal has existed between the two countries since 2002. But Valor said Rousseff was concerned about Brazil's own large auto industry after its deficit in automobile trade with Mexico more than doubled in 2011 to \$1.7 billion. The decision would be announced in coming days, the paper said, citing officials working on the issue. The original agreement stipulates a 14-month notice period to end the deal, meaning tariffs on Mexican imports of automobiles and parts would only be applicable from early 2013.

The newspaper said that until 2009, the deal had worked in Brazil's favor with higher exports to Mexico than imports but Mexico has turned the tide as it is now more competitive on cost. Brazilian officials brought up the issue with their Mexican counterparts at the World Economic Forum in Davos, Valor said. The Mexicans suggested adjusting the terms of the contract but the paper reported Brazil would only cancel the deal outright.

Argentina January tax up 29.6 pct to record high

Argentina's January tax revenue rose 29.6 percent from a year earlier to a record high, boosted by consumer taxes and social security contributions even as economic growth eases, the government said.

Last month's tax take of 52.84 billion pesos (\$12.19 billion) came in just above expectations for 52.29 billion pesos, according to the median in a Reuters poll. Despite January's all-time high revenue, slower economic activity is starting to cool tax revenue growth in Latin America's No. 3 economy. Revenue in the same month a year ago surged by 40 percent to 40.77 billion pesos.

High tax revenue growth has helped President Cristina Fernandez maintain public spending. She announced a 17.6 percent

LATAM MARKETS TODAY

TREASURIES:

- Mexican 10-yr notes were down, yielding 6.05 pct and 30-yr bonds fell yielding 7.43 pct.
- Brazilian 10-yr notes surged, yielding 11.19 pct and 2-yr notes gained, yielding 10 pct.

FOREX:

- Brazilian real was down 0.8 pct to 1.7193 per dollar.
- Mexico's peso lost 0.73pct to 12.803.
- Chile peso slumped 1.2 pct to 481.1 per dollar.
- Colombia's peso fell 0.31 pct to 1,793.4 to the dollar and Peru sol was unchanged at 2.688 to the dollar.

STOCKS:

- MSCI Latin American stock index rose 0.57 pct to touch its highest level since early August, but shares in Brazil reversed early gains.
- Brazil's benchmark Bovespa index edged up 0.04 pct to 64,593.1.
- Gafisa rose 5.94 pct, while Petrobras fell 1.68 pct.
- Mexico's IPC index was unchanged at 37,711.16.
- Televisa fell 3.8 pct, while Cemex jumped 10 pct.
- Chile's IPSA was up 0.51 pct as retailer Falabella rose 3.99 pct.

LATAM TOP STORIES

(continued)

increase for pensioners that will take effect in March, highlighting January's record tax take. The minimum monthly pensions will rise to 1,687 pesos (\$389) from the current 1,434 pesos, Fernandez said, without estimating the fiscal cost. January's revenue from the value-added tax jumped 27.8 percent to 15.13 billion pesos, while income from employers' social security contributions surged 32.8 percent to 16.33 billion pesos.

Peru CPI surprises with first fall since May

Consumer prices in metropolitan Lima fell 0.10 percent in January, the first time prices have fallen in eight months, Peru's government said on Wednesday. Economists polled by Reuters had expected the index to rise 0.15 percent, but analysts said the surprise fall in inflation is not likely to prompt the central bank to cut the benchmark interest rate when it meets on Feb. 9.

Transportation costs measured in the Peruvian capital rose sharply in December due to holiday travel, but fell 0.94 percent in January, according to INEI. Consumer prices in metropolitan Lima rose 0.27 percent in December. January was the first drop in prices since May 2011, when prices dropped by 0.02 percent.

Even with the January fall, inflation in the past 12 months was 4.23 percent, much higher than 3 percent, the upper edge of the central bank's target range. "Inflation expectations have not changed, so the monetary policy authority should maintain the reference rate, Tuesta said. Some analysts forecast a rate cut in Peru in the second half of 2012, when inflation is expected to fall back into the target range.



DEEP DIVE Commentary and Analysis

Fed's transparent contradictions

By James Saft

The Federal Reserve is a bit like a pilot who comes on the intercom to tell the cabin that it is projecting that it won't reach its destination but will coast for a while before deploying emergency measures.

The Fed made a host of changes last week to the way it sets and communicates monetary policy, firstly adopting an explicit longer run goal for inflation of 2 percent and secondly making public its rate projections and participants' forecasts for when rates will first increase. The moves are supposed to increase the transparency of monetary policy, something some studies indicate tends to lead to better outcomes.

That's laudable, and in the long run probably even true, but under the current alignment of the universe it may only make the central bank's job more difficult.

That's because it's clear the easy monetary policy tools have already been used, and what remains are less well understood and probably offer less potential reward and more risk.

For one thing the Fed pushed back by 18 months, to late 2014, the period it thinks economic conditions will continue to justify the current exceptionally low 0.25 basis point official rate, an apparent nod to the difficulty it is having in kindling a sustained and healthy recovery.

"The Fed's new policy is an act of desperation rather than something to celebrate. The FOMC has used all of its conventional weapons and a lot of unconventional ones and is essentially out of ammunition," fund managers Comstock Partners, led by Charlie Minter, wrote in a note to clients.

"The banking system is swimming in excess reserves that it is not using; adding more won't make much of a difference. This is a classic liquidity trap where further easing will not be much help. The stock market strength assumes that the economy is getting stronger and that company earnings will remain at elevated levels. We think that this will not be the case, and that the market is subject to substantial downside risk."

The irony is that by many of the Fed's newly transparent measures you can make a strong case that they should be more actively easing conditions. While extending the period of expected low rates is a sort of easing, it is not much given the insight into Fed thinking the new data allows. The most common view among Fed policymakers is that rates will remain at 0.25 percent at the end of 2014. This is difficult to reconcile with a "longer-term" forecast for the fed funds rate of 4 to 4.5 percent. The longer term keeps getting longer, it seems.

And though the Fed wants inflation to be 2 percent, it is saying that it sees it as only being between 1.4 and 2 percent over the next three years, begging the question of what exactly it intends to do about this shortfall against its own explicit desires.

QE WHATEVER

Despite that there is real drama over what, if anything, the Fed will do to address this malaise, and the slack economy and high jobless rate it implies. That's probably because its obvious next move - another round of quantitative easing - is messy, contentious and highly uncertain to work. There is much dissent within the Fed about what to worry about, with two participants of the interest rate hike survey saying they thought rates would rise this year. It also cannot be an easy decision to uncork quantitative easing in an election year, and with such political gridlock over future budget policy.

And again there are real doubts about what policy can achieve once interest rates fall to very low levels. As it stands, investors in fixed income get very little pickup in extra yields for making longer-term loans, despite the extra risks. Bill Gross of bond investors Pimco argues that this may make investors and banks

decide to hold cash rather than take on risk.

"What incentive does a bank have to buy two-year Treasuries at 20 basis points when they can park overnight reserves with the Fed at 25?" Gross wrote to clients.

"What incentives do investment managers or even individual investors have to take price risk with a five-, 10- or 30-year Treasury when there are multiples of downside price risk compared to appreciation?"

After all, your upside is small and your downside is unlimited.

Gross argues that investors may instead choose to put their cash into commodities and gold, prompting further distortions. A look at farmland prices, which have been surging in the U.S., provides some support for that thought.

Amazingly, the stock market has taken all this reasonably well, clinging tenaciously to the view that monetary policy can re-levitate asset prices.

That doesn't square with the Fed's own view of a few years of low inflation and low growth.

(James Saft is a Reuters columnist. The opinions expressed are his own. At the time of publication he did not own any direct investments in securities mentioned in this article. He may be an owner indirectly as an investor in a fund.)

What Obama should be saying about Social Security

By Mark Miller

The remaining major Republican presidential contenders managed to escape their debate prior to yesterday's Florida primary without being asked to answer a single question about Social Security. That's remarkable, considering the state's aging population and the outlandish statements the candidates have made about the program.

But they aren't the only ones getting a pass on the subject. President Barack Obama mentioned Social Security briefly during his State of the Union address last week, but his comments raised more questions than they answered.

"This nation is great because we get each other's backs," the President said, invoking populist themes of fairness, an even playing field and an activist role for government in restoring economic security.

No government program helps us get each other's backs more than Social Security. The program embodies the idea of inter-generational compact - the payroll tax contributions we make fund an insurance backstop for one another against the loss of income due to old age, disability or death of a wage-earning family member.

The President said last week that he wants to "strengthen Social Security, so long as those programs remain a guarantee of security for seniors." But in the same breath, he signaled that he's prepared to make benefit cuts in exchange for tax reforms that reduce the deficit. This despite the fact that Social Security has no direct impact on the deficit. By law, Social Security can't borrow a dime; in fact, it currently is a huge lender to the federal government as its surplus is invested in Treasury notes.

The President should stop tying Social Security to the deficit, and instead start explaining that Social Security is an affordable, essential program.

Current outlays were equal to 4.7 percent of GDP last year, a figure that will slowly rise to 5.3 percent by 2021, according to the Congressional Budget Office. Likewise, the argument that Social Security is in dire straits because it's gone cash-flow negative doesn't hold up. While the program has been paying out more than its receipts from FICA taxes, it's still comfortably cash positive when you include bond redemptions and interest, and income taxes paid by some beneficiaries.



DEEP DIVE Commentary and Analysis

"If you look at just the next 25 years, you have 100 percent cash flow adequacy," says Ken Buffin, president of Buffin Partners, Inc., an actuarial and economic research firm, speaking at last week's annual conference of the National Academy of Social Insurance. "If you look out farther over 50 years, it has 90 percent adequacy, a deficit that is not difficult to manage."

Buffin was alluding to Social Security's only real problem: it's on track to exhaust its surplus around 2036, at which point it will have enough incoming revenue to pay only 77 percent of promised benefits. But that problem can be solved without cutting benefits; for example, removing the cap on income subject to FICA tax would close most of the projected gap.

Obama should be embracing that change and rallying young Americans around the idea that Social Security can meet its promises to them when their time to retire rolls around.

Beyond playing good defense, Obama should mount an offensive strategy by calling for an expansion of Social Security - and describing how he'd pay for it. And while he's at it, Mitt Romney and Newt Gingrich should be asked how they justify their claims that Social Security's finances are a fraud, considering that the program is sitting on a \$2.6 trillion surplus and is projected to be 100 percent solvent for the next 25 years. Ron Paul should be asked to explain his comment that Social Security isn't Constitutional, considering that the Supreme Court settled that question back in 1937.

The financial crisis has wrecked the retirement security of many Americans, and Social Security is the most important source of income for most seniors. Yet current benefits are modest - the average is \$1,177 per month. That could be boosted across-the-board by 20 percent over time. Or, more targeted increases could be implemented - higher benefits for the oldest old and

widows; benefit credits for childcare; or by putting a floor underneath benefits for low-income workers.

Off-setting revenue could come from a tax on financial transactions, or by allowing the Social Security trustees to invest a portion of the trust fund in equities to earn better return. Or the FICA tax rate could be increased incrementally over time.

Numbers aside, Americans need to hear more during this campaign year about the moral aspect of Social Security - the idea that this is the mother of all programs when it comes to getting each other's backs. Here's what one Democratic senator said about Social Security in 2005, during the battle over President George W. Bush's plan to privatize the program:

"... Families face more risk and greater insecurity than we have known since FDR's time, even as those families have fewer resources available to help pull themselves through the tough spots. Whereas people were once able to count on their employer to provide health care, pensions, and a job that would last a lifetime, today's worker wonders if suffering a heart attack will cause his employer to drop his coverage, worries about how much he can contribute to his own pension fund, and fears the possibility that he might walk into work tomorrow and find his job outsourced. "Yet, just as the naysayers in Roosevelt's day told us that there was nothing we could do to help people help themselves, the people in power today are telling us that instead of sharing the risks of the new economy, we should shoulder them on our own. In the end, this is what the debate over the future of Social Security is truly about."

That senator, by the way, was Barack Obama of Illinois.

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

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