

# INSIDE DEBT

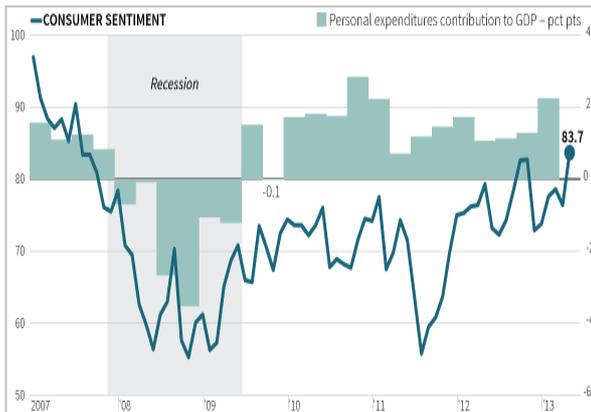
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Friday, May 17, 2013

## CHART OF THE DAY

### U.S. consumer sentiment

Click on the chart for full-size image



In early May Consumer sentiment rose to its highest level in nearly six years as Americans felt better about their financial and economic prospects.

## TODAY'S TOP NEWS

- U.S. May consumer sentiment highest in nearly 6 years
- ECB to keep monetary policy loose for as long as needed
- Japan PM sets targets in latest growth strategy tranche
- Obama budget would cut U.S. deficit by \$1.1 trillion over decade-CBO
- Bank of England's Weale sees chance of stimulus after Carney arrival
- Fed has not lowered interest rates enough: Kocherlakota
- China president takes charge of sweeping economic reform plans-sources
- Italy PM Letta seeks to smooth property tax standoff
- French finmin sees growth returning in H2, 2013
- Canada April inflation well under forecast, Bank of Canada range

## ECON WATCH

FOR MONDAY MAY 20

ET	Indicators	Unit	Reuters	Prior
08:30 US	Chicago fed index	ind	--	-0.23

- 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:** Americans felt better about their economic and financial prospects in early May as consumer sentiment rose to the highest level in nearly six years, an encouraging sign after other recent data had suggested broader U.S. growth is cooling.

**For more please click here**

**TREASURIES:** Treasuries fell after data showed consumers grew more optimistic in May and an index of leading indicators pointed to economic growth ahead.

- The 10 year treasuries fell 21/32 in price to yield 1.95.
- 30-year bonds fell 1-10/32 in price to yield 3.17.

**FOREX:** The dollar rallied across the board, topping the 103-yen level as it hit a 4-1/2-year high against the Japanese currency, after data showing a robust rebound in U.S. consumer sentiment prompted investors to add to bullish bets.

- The dollar rose as high as 103.30 yen and last traded at 103.27, up 1.01 pct.
- The euro was down 0.43 pct at \$1.2826.
- Against the yen, the euro was at 132.44 yen, up 0.58 pct.

**CORPORATES:** Corporate bond spreads tightened as gauges for leading indicators and consumer sentiment advanced more than estimated.

- The CDX.IG-20 index tightened by 1 bps to 70 bps.
- New issuers include Pacific Drilling S.A. and Murray Energy.

**STOCKS:** Stocks continued their climb into uncharted territory, racking up the fourth week of gains in a row as encouraging economic data prompted investors to pick up shares of growth companies. Both the Dow and the S&P 500 finished Friday's session at record highs.

- The Dow shot up 121.18 points, or 0.80 pct, to end at 15,354.40, the S&P rose 15.65 points, or 0.95 pct, to finish at 1,666.12 and the Nasdaq gained 33.72 points, or 0.97 pct, to close at 3,498.97.
- For the week, the Dow rose 1.6 pct, the S&P 500 climbed 2 pct and the Nasdaq advanced 1.8 pct.
- Boeing climbed 2.42 pct, JPMorgan added 2.61 pct, General Motors shot up 3.18 pct, JC Penney lost 4.15 pct and Tableau Software surged 63.71 pct.
- S&P industrial sector index rose 1.44 pct.

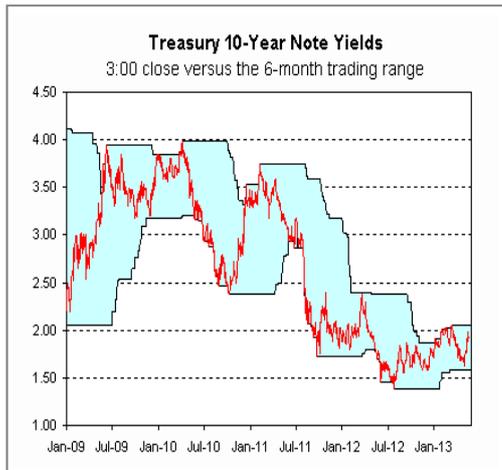
**C & E:** Gold fell for a seventh straight session, its longest losing streak in four years, as the dollar rose to the highest since 2008 after some Federal Reserve officials said the central bank should end its stimulus for the U.S. economy.

- "With a few more hard losing sessions, we could be down to between \$1,050 and \$1,100. It could happen over two weeks or it could happen in a couple of days if the market plunges \$100 a dip," said Frank McGhee, head precious metals trader at Integrated Brokerage Services in Chicago. "There's heavy rotation of money from gold into the stock market as the U.S. economy keeps getting better and the need for Fed stimulus gets weaker by the day," McGhee added.
- Spot gold fell 2.07 pct to \$1,357.0 an ounce. Crude oil rose 0.88 pct to \$96.0 per barrel. Reuters Jefferies index up 0.47 pct to 288.12.

- 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	0.010	0	0.01	0.002
3-Mo Bill	0.035	0.030	0.035	0.005
6-Mo Bill	0.075	0.070	0.076	-0.001
1-Year	0.105	0.100	0.107	0.002
2-Year	99.750	99.789	0.254	-0.023
3-Year	99.555	99.594	0.400	-0.055
5-Year	98.984	99.031	0.835	-0.184
7-Year	98.742	98.789	1.315	-0.367
10-Year	98.156	98.219	1.954	-0.641
30-Year	94.289	94.352	3.172	-1.344

EQUITIES

	INDEX	CHANGE
DJIA	15337.74	104.52
NASDAQ	3493.66	28.42
S&P 500	1665.20	14.73

COMMODITIES

	PRICE	CHANGE
NYMEX	96.0	0.9
BRENT	107.8	0.9
SPOT GOLD	1363.1	-22.6
PALLADIUM	736.0	0.0
SILVER	22.3	-0.4

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.090	O/N	0.120
2-Week	0.110	2-Week	0.150
1-Month	0.140	1-Month	0.190
3-Month	0.140	3-Month	0.220
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.110	10:00 AM	0.062
2-Week	0.150	3:00 PM	0.061
1-Month	0.160		
3-Month	0.180		

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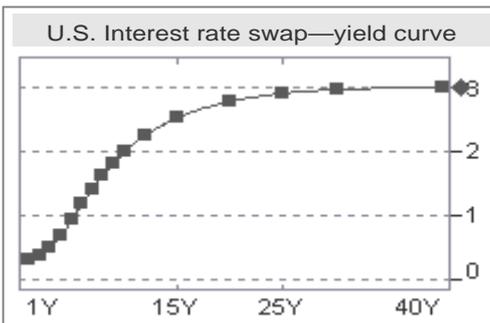
	SPREAD		RATE	
2-Year	12.50	16.50	0.37	0.40
3-Year	11.25	15.25	0.51	0.54
5-Year	14.25	18.25	0.97	1.00
7-Year	16.75	20.75	1.48	1.50
10-Year	11.50	15.50	2.07	2.08
30-Year	-10.00	-6.00	3.07	3.07

EURODOLLAR FUTURES

	CLOSE	CHANGE
Jun-13	99.723	0.000
Sep-13	99.690	-0.015
Mar-14	99.635	-0.020
Sep-14	99.565	-0.025
Mar-15	99.435	-0.035
Sep-15	99.235	-0.050

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.110	0.140		
1-Month	0.140	0.220	0.112	0.122
3-Month	0.180	0.280	0.112	0.122
6-Month	0.220	0.420		
12-Month	0.360	0.560	0.127	0.137



FUTURES

	PRICE	CHANGE
CBOT 5 yr	123.91	-0.27
CBOT 10 yr	131.31	-0.09
CBOT 30 yr	143.22	-0.09

CURRENCIES

	BID	ASK
Euro	1.2825	1.2828
Sterling	1.5165	1.5168
JP Yen	103.2200	103.2400
Swiss Franc	0.97	0.97
Can Dollar	1.0286	1.0290
Mexico	12.3414	12.3544

EBS PRECIOUS METALS

	Bid	Ask
SPOT GOLD	1361.61	1362.38
PALLADIUM	1454.24	1461.75
SILVER	22.27	22.31

FED FUNDS

	Open	High	Low
FED FUNDS	0.1200	0.2500	0.0500

ACTIVE FANNIE MAE AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
3-Year	0.5	03/30/2016	10.75	3.25
5-Year	0.875	05/21/2018	19.25	16.25
7-Year	-	-	-	-
10-Year	-	-	-	-
30-Year	6.625	11/15/2030	-5	-8

ACTIVE FREDDIE MAC AGENCIES

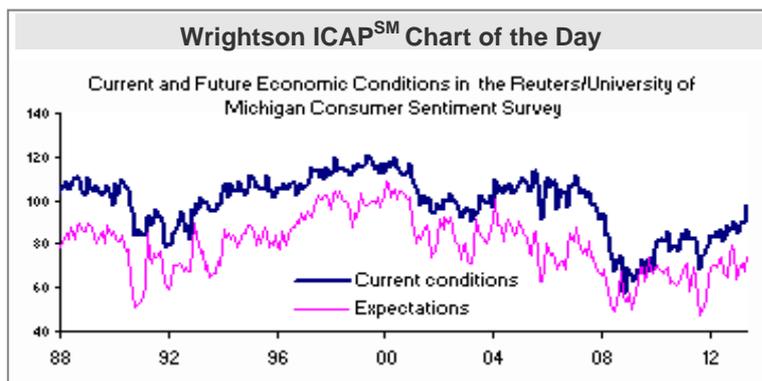
TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
3-Year	0.5	05/13/2016	7.25	4.25
5-Year	0.875	7/3/2018	13	10
7-Year	1.375	01/5/2020	22	19
10-Year	2.375	01/13/2022	0.5	-2.5
30-Year	6.25	07/15/2032	-0.5	-3.5

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	2.5	103.1070	103.1130	1.495
FHLMC	2.5	103.0660	103.0720	1.510

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	-	-	-	-
FHLMC	2.5	97.2660	97.2720	2.805
GNMA	2.5	98.2760	98.2820	2.652



## TODAY'S TOP NEWS

**U.S. May consumer sentiment highest in nearly 6 years**

Americans felt better about their economic and financial prospects in early May as consumer sentiment rose to the highest level in nearly six years, an encouraging sign after other recent data had suggested broader U.S. growth is cooling.

Economists expect growth will likely slow in the second quarter from the 2.5 percent pace at the beginning of the year as tighter fiscal policy starts to bite. But recent stronger than expected improvement in several areas, including the labor market and retail sales, has suggested the recovery remains resilient.

The Thomson Reuters/University of Michigan's preliminary reading on the overall index on consumer sentiment rose to 83.7 from 76.4 in April, topping economists' expectations for 78. It was the highest level since July 2007.

The barometer of current economic conditions jumped to 97.5 from 89.9, the highest since October 2007, while the gauge of consumer expectations gained to 74.8 from 67.8.

A separate report from the Conference Board showed its Leading Economic Index increased 0.6 percent to 95.0 last month, the highest level since June 2008.

**Japan PM sets targets in latest growth strategy tranche**

The latest tranche of Japan's growth strategy will aim to triple infrastructure exports and double farm exports by 2020, as well as boost private investment, Prime Minister Shinzo Abe said.

The government will set a target for domestic private-sector investment of 70 trillion yen (\$687 billion) annually, Abe said in a speech to business executives and academics, the level before the 2008 financial crisis and up about 10 percent from the current figure.

Abe said the growth strategy would focus intensively on boosting domestic private investment over the next three years, triple infrastructure exports by 2020 and double farm, fisheries and marine exports to 1 trillion yen by the same date.

Abe also said the growth strategy would aim to boost the number of annual foreign visitors to Japan to 20 million a year from about 8 million now and triple the overseas sales of "Cool Japan" content such as anime in five years.

Meanwhile, Japanese core machinery orders jumped a bigger-than-expected 14.2 percent in March, the quickest monthly pace in eight years. The March increase in core orders was much bigger than a median market forecast for a 2.8 percent gain and followed a revised 4.2 percent rise in February.

**Weale sees chance of stimulus after Carney arrival**

The Bank of England may have more scope to boost the economy after Mark Carney starts as governor because of tentative signs of lower inflation ahead, a member of its policymaking body said.

Martin Weale, who serves on the BoE's rate-setting Monetary Policy Committee, said the central bank's ability to support demand had recently been constrained by its need to keep public confidence in its commitment to get inflation back to 2 percent.

Inflation has exceeded its target for most of the past five years, something Weale said made him - and the majority of the MPC - reluctant to approve more economy-stimulating bond purchases. "Failure to damp sufficiently any new shock pushing up on inflation would result in inflation expectations becoming more entrenched. That, in my view, limits the scope we have to support demand at the current juncture," Weale said in a speech.

"So it is quite possible that (Carney) will be coming to the Bank at a time when there is more room for manoeuvre than there has been for some time," he added.

**ECB to keep monetary policy loose for as long as needed**

The European Central Bank will keep its loose and growth-supportive monetary policy stance in place for "quite a long time", ECB executive board members said.

The ECB's Joerg Asmussen told journalists in Berlin the bank's monetary policy would remain expansive for as long as needed. His colleague Benoit Coeure hit a similar tone when speaking at a conference in Orleans in France, saying the ECB was committed to providing the euro zone with abundant liquidity for as long as necessary.

"We are saying that because we are well aware that rigidities and difficulties of transmission in the euro zone mean that the monetary policy will have to stay accommodative for quite a long time," Coeure said.

Separately, German ECB board member Joerg Asmussen expects growth in his country to pick up in the second quarter but warned that Europe's largest economy risked becoming the "sick man of Europe" again if it did not carry out further reforms. Meanwhile, ECB policymaker Yves Mersch said that The European Central Bank keeps the option of a deposit rate cut on the table, but it is not certain to use it. "We have this possibility, but whether we are going to use it is a different pair of shoes," Mersch told a financial seminar in London.

**Obama budget would cut U.S. deficit by \$1.1 trillion over decade-CBO**

Near-term deficits under President Barack Obama's 2014 budget plan would be higher than those forecast by the Congressional Budget Office this week but would be \$1.1 trillion lower over the coming decade, CBO said.

The non-partisan congressional budget referee agency said that due to proposed spending increases, Obama's budget proposal would lead to a \$669 billion deficit for fiscal 2013 and a \$675 billion deficit for fiscal 2014 year starting Oct. 1.

Obama's budget increases revenues by \$974 billion over the next decade, largely by raising taxes and limiting deductions for the wealthy, it would result in a \$5.2 trillion cumulative deficit over the fiscal 2014-2023 period, CBO said, compared with its own \$6.3 trillion current-law estimate on Tuesday and hence has little chance of being passed by Congress.

Earlier in the day the Obama administration notified Congress it was prepared to take a series of steps to free up about \$260 billion so it can keep paying the nation's bills once a temporary suspension in the government's debt ceiling lapses this weekend.

**Fed has not lowered interest rates enough: Kocherlakota**

The Federal Reserve has not done enough to lower borrowing costs to boost economic growth, a top Fed official said, citing his outlook for overly low inflation and overly high unemployment over the next two to three years.

"The (Fed) has still not lowered the real interest rate sufficiently in light of the changes in asset demand and asset supply that I've described," Kocherlakota added.

"The increase in asset demand, combined with the fall in asset supply, implies that households and firms spend less at any level of the real interest rate - that is, the interest rate net of anticipated inflation," he said. A second hole, he said, is the Fed's "vagueness" about how long it will continue to buy assets, currently at a pace of \$85 billion a month. Clarity on what constitutes a substantial improvement in the labor market outlook - the Fed's stated milestone before it ends its bond-buying program - would make Fed policy more effective, he said.



## TODAY'S TOP NEWS

**China president takes charge of sweeping economic reform plans-sources**

Chinese President Xi Jinping has taken charge of drawing up ambitious reform plans to revitalise the economy, sources close to the government said, shunning policy stimulus for fear it could worsen local government debt and inflate property prices.

A consensus had been reached among top leaders that reforms would be the only way to put the economy on a more sustainable footing, said the sources, who are familiar with the plans and Xi's involvement. Xi will present the reforms at a key meeting of the ruling Communist Party later this year that will set the agenda for the next decade, signalling his seriousness to see breakthroughs, the sources told Reuters.

Broadly, the measures would liberalise interest rates and overhaul the fiscal system for local governments to ensure they had a steady stream of tax revenues rather than relying on volatile land sales to raise funds.

**Italy PM Letta seeks to smooth property tax standoff**

Italian Prime Minister Enrico Letta promised a wide reform of property taxes, addressing one of the main issues dividing his coalition government, but gave no details on where he would find the billions of euros to pay for it.

He confirmed pledges to suspend the widely hated IMU tax on principal residences brought in by his predecessor Mario Monti but held back from the demands of centre right members of his fragile left-right coalition for it to be scrapped entirely.

Nonetheless the suspension of payments due next month was welcomed by centre-right leader Silvio Berlusconi.

Separately, Italy's Foreign Minister Emma Bonino said that French President Francois Hollande's call for a joint European economic government should be considered. "We take note with satisfaction the French position," Bonino told a news conference. She added Hollande's proposal "must be taken into consideration and must be explored".

**French finmin sees growth returning in H2, 2013**

Finance Minister Pierre Moscovici said he believed the French economy could begin to grow again in the second half of 2013, after data this week showed the country had slipped into recession.

"I think it will return during the course of the second half of 2013 - already in the second quarter even - and then we can make sure it develops in 2014," Moscovici told RTL radio, when asked about the outlook for Europe's number two economy.

"As the president said, we don't expect a year of strong growth in 2014, but new momentum... should help to improve the situation," he said.

Separately, Budget Minister Bernard Cazeneuve said France would continue consolidating its budget deficit next year by reducing spending, and not raising taxes further after broad increased this year.

"I want public accounts to be consolidated in 2014 and in the following years essentially by savings," he told BFM television.

**Canada April inflation well under forecast, Bank of Canada range**

Cheaper gasoline and cars helped Canada's annual inflation rate fall dramatically in April to 0.4 percent from 1.0 percent in March - its lowest rate since 0.1 percent in October 2009, below expectations and well outside the Bank of Canada's target range of 1 to 3 percent.

Prices fell by 0.2 percent on a monthly basis from March to April. Core inflation dropped to 1.1 percent from 1.4 percent in March; on a monthly basis core prices rose 0.1 percent.

Gasoline prices tumbled 6.0 percent from a year earlier, the largest decline since October 2009. Excluding gasoline, annual inflation fell to 0.8 percent in April from 1.1 percent in March. The price of passenger vehicles also fell 0.7 percent from April 2012.

Meanwhile, wholesale trade rose 0.3 percent in March from February on autos, agricultural supplies and building materials, Statistics Canada said. In volume terms, wholesale sales increased by 0.1 percent.

## NEXT UP

**BOJ may seek ways to calm bond yields, policy on hold**

The Bank of Japan is expected to stand pat on monetary policy next week despite jitters over the recent jump in bond yields, hoping it can stem the volatility by fine-tuning market operations. The central bank may front-load bond purchases or offer funds via market operations more frequently if the bond market turbulence persists, which are technical steps that can be taken by its bureaucrats without approval by the nine-member board.

It is expected to hold off on easing policy through further increases in asset purchases. By gobbling up 70 percent of the bonds newly issued by the government, it hopes to nudge Japanese investors out of the safety of bonds and into riskier assets like equities. BOJ officials say they would accept a natural rise in long-term interest rates that reflect prospects of an economic recovery and future inflation. The BOJ may thus revise up its assessment of the economy to say it is picking up, compared with the previous month's view that it is "bottoming out with some signs of a pick-up." For now, the central bank hopes to use market operations to stem the volatility. If volatility persists, the BOJ may also consider increasing the amount of bonds it buys each month from the current 7.5 trillion yen until bond prices stabilise, sources say.

**Junk rating risk casts shadow over Spanish bonds**

Spain's borrowing costs will rise if its credit rating is cut as much as market prices imply.

The cost of insuring against a Spanish default suggests investors expect another cut in its sovereign ratings, to junk, according to financial information firm Markit.

For JPMorgan's EMU Government Bond Investment Grade index, a cut to junk by one firm would be enough.

Citigroup indices require Spanish bonds to be downgraded by both S&P and Moody's for them to fall out of those indices.

Given the 11.8 percent weighting of Spanish bonds in the JPMorgan's EMU Government Bond Investment Grade index, the bank estimates a downgrade to junk would trigger Spanish bond sales of up to 500 million euros.

The fallout could push 10-year Spanish/German yield spreads to 350-400 basis points from their current 293 bps, according to JPMorgan asset allocation strategist Nikolaos Panigirtzoglou. Spanish bonds would fall out of the Barclays Euro-Aggregate Index and the Barclays Global Aggregate Index if two of three rating firms cut Spain's rating to speculative grade. An exclusion from all indices could cause 30-40 billion euros of selling, Panigirtzoglou said.



## EYE ON ASIA

## POLL &amp; PREVIEW

## Thai Q1 GDP may have contracted 0.8 pct q/q

Thailand's economy probably contracted in January-March for the first time in five quarters as global woes and a strong baht crimped exports while domestic demand grew more slowly after a surge following 2011's bad floods, a Reuters poll showed.

GDP is forecast to have shrunk 0.8 percent in January-March from the previous three months on a seasonally-adjusted basis, according to the median forecast of 10 economists. In the last three months of 2012, the economy grew a faster-than-expected 3.6 percent from the prior quarter.

On a yearly basis, according to the poll's median forecast, Thailand expanded 5.7 percent in the first quarter. In the first quarter of 2013, exports rose 4.5 percent from 2012 but were flat from the previous three months. Factory output rose 2.9 percent on the year but dipped a seasonally adjusted 0.5 percent on the quarter, central bank data showed.

Private consumption increased a seasonally adjusted 3.7 percent in January-March from a year earlier and 0.3 percent from the previous period. Private investment rose 3.4 percent on the year but fell 2.7 percent on the quarter.

## In blow for India, S&amp;P affirms negative rating outlook

Standard & Poor's reiterated its negative outlook on India's credit rating, which is one notch above "junk", warning of the need to follow through on reforms and dealing a blow to a government that had recently pitched for an upgrade.

The rating agency said the main drag on India's rating is a high fiscal deficit and heavy government borrowing, although it also said India's position had improved over the past year.

"We have indicated compared to one year ago, there (is) some easing of the pressure towards the downgrade of the rating," S&P credit analyst Takahira Ogawa said on a conference call.

"But nonetheless there is still more than one-third of chance for downgrade unless we see significant improvement of the factors that we mentioned," he said.

## EVENTS

For May 20

## THAILAND

- GDP growth (yy) for Q1: Expected 5.7 pct Prior 18.9 pct
- S/A GDP growth (qq): Expected -0.80 pct Prior 3.60 pct

## POLL &amp; PREVIEW

(continued)

## Indonesia's March retail sales growth slows to 10.3 pct y/y

Retail sales in Indonesia rose 10.3 percent in March bolstered by information and communication equipment, a Bank Indonesia survey showed.

The growth rate was slower than a revised 13.5 percent in the previous month, due to a slowdown in food, beverages and tobacco purchases. The survey also showed sales in culture and recreation dropped 4.9 percent on an annual basis.

The survey of 600 retailers in 10 major cities across the archipelago expected sales in April to rise 13.1 percent, again supported by information and communication equipment.

Retailers expect price pressures will continue to rise in the next six months as higher domestic demand and likely fuel price hikes increase production and distribution costs.

## NZ consumer confidence bounces higher in May

New Zealand consumer confidence rose to a three-year high in May, a survey showed.

The ANZ-Roy Morgan consumer confidence index rose to 123.7 from 119.2 in April.

The bank said the survey showed confidence in the current state of the economy was at its highest since December 2007, and pointed to consumers ready to spend more.

The number thinking it was a good time to buy a major household item rose to 44 percent from 40 percent the previous month.

The ANZ's composite growth indicator suggested growth of around 3.5 percent by mid-year.

## MARKET SNAPSHOT as of 3:00 pm EST

## GOVERNMENT BOND BENCHMARKS

	5-Year		10-Year	
	Bid	Yield	Bid	Yield
Australia	112.054	2.730	119.219	3.220
Japan	100.156	0.367	98.177	0.800
China	100.117	3.120	100.738	3.430
Hong Kong	100.260	0.476	95.150	1.090
Singapore	100.050	0.490	115.100	1.386

## ASIA FUTURES

	Close	Change
SGX Nikkei 225	15310.00	115.00
SGX MSCI Taiwan	303.00	0.40
SGX FTSE China	8300.00	50.00
SGX MSCI Singapore	389.30	0.30
SGX CNX Nifty	6196.50	8.00
SGX AC ASIA P xJP	479.48	-1.43

## FORWARDS 3 months &lt;FORWARDS&gt;

	Bid	Ask
JPY	-4.17	-3.77
AUD	-63.33	-63.04
NZD	-51	-50.4
HKD	-35	-30
SGD	-0.7	-0.4
THB	14.9	15.3

## INTEREST RATE SWAPS

## &lt;SWAPS&gt;

	5-Year		10-Year	
	Bid	Ask	Bid	Ask
AUD	3.2175	3.2775	3.7925	3.8475
JPY	0.475	0.535	0.91	0.97
CNY			3.93	4.13
HKD	0.89	0.97	1.71	1.79
TWD			1.275	1.33
INR			6.2	6.5
KRW	2.61	2.65	2.815	2.855
SGD	0.865	0.885	1.77	1.8

## DEPOSITS 3 months &lt;DEPOS&gt;

	Bid
JPY	0.03
CNY	3.6
AUD	2.8
NZD	2.7
HKD	0.23
SGD	0.25

## NDF's 3 months

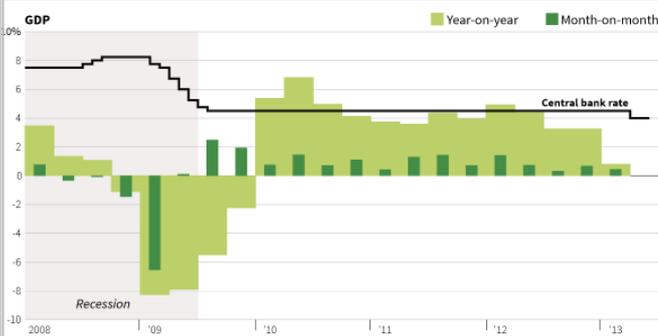
## &lt;NDFS&gt;

	Bid	Ask
CNY	0.003	0.005
TWD	0.07	0.09
KRW	1120.5	1121.4
INR	55.673	55.773
MYR	3.0363	3.0393
PHP	41.17	41.27
IDR	9980	10030

EYE ON LATAM

LATAM TOP STORIES

Mexico GDP



Source: INEGI; Central bank of Mexico  
5 May 17/05/2013

Mexico economic growth slows sharply in early 2013

Mexico's annual growth slumped sharply at the start of 2013 to its weakest in three years despite unexpected strength in the services sector, backing expectations of a further interest rate cut later in 2013.

Figures showed that although Mexico escaped an expected contraction in the first quarter, annual growth dived to its lowest since a deep recession in 2009.

Mexico's economy grew 0.45 percent in the first quarter compared with the final quarter of last year the national statistics agency said, outdoing forecasts in a Reuters poll for a 0.05 percent contraction. But growth compared to a year earlier came in at just 0.80 percent, falling short of expectations for a 1.25 percent expansion in a Reuters poll and below year-on-year growth in the previous quarter of 3.2 percent.

Argentina economy grew 2.6 pct in March vs year ago

Argentina's economic activity grew 2.6 percent in March from a year earlier and expanded 0.7 percent versus February, the national statistics institute said.

The official year-on-year rate beat the 2.3 percent median growth forecast in a Reuters poll of 10 analysts, whose estimates ranged from 0.6 percent to 3.1 percent.

Accumulated growth in the 12 months through March was 1.3 percent, down from 1.9 percent in full-year 2012.

March's economic data was likely boosted by industrial production, which expanded 0.2 percent year-on-year after slumping 4.4 percent in February. In February, economic activity rose 2.3 percent year-on-year and 0.3 percent from the prior month.

Chile's finance minister says economy in mild slowdown

Chile's relatively small economy is in a mild slowdown phase, Finance Minister Felipe Larrain told reporters.

"All of the CPI (consumer price index) measurements are showing very low inflation, at the same time the economy is decelerating, and there's been an important moderation in domestic demand," Larrain said. "This is a different situation from what we had a few months ago, and I think it's something the monetary authorities are evaluating."

When asked if the autonomous central bank would start mulling future rate cuts, Larrain said the monetary authority would likely take into account below-target inflation, softening domestic demand and milder growth.

The central bank on Thursday held its key interest rate steady, as expected, and said first-quarter indicators showed decelerat-

LATAM MARKETS TODAY

TREASURIES	Yield	Price
Mexican 30-Year	5.81	-88 /32
Mexican 10-Year	4.67	-28 /32
Brazilian 10-Year	9.87	-83 /32
Brazilian 5-Year	9.28	-23 /32
Chilean 30-Year	1.12	2 /32
Chilean 10-Year	0.62	12 /32
Venezuela 2-Year	6.56	6 /32
Venezuela 4-Year	7.71	20 /32
Venezuela PDVSA 10 year	10.93	21 /34
Venezuela PDVSA 20 year	9.78	8 /35

EQUITY	Close	Pct Change
MSCI Latin American Index	3698.06	-0.08
Brazil's Bovespa Index	55076.96	0.56
Mexico's IPC Index	41806.73	0.11
Chile's IPSA Index	4258.98	-0.05
Banco do Brasil	26.02	3.38
Fallabella	5600.00	2.44
Cencosud	2540.00	-0.73
Grupo Mexico	41.22	-0.43

CURRENCIES	Last	Pct Change
Brazilian Real	2.073	0.34
Mexican Peso	13.225	0.16
Chile Peso	484.3	0.16
Columbian Peso	1824.1	-0.01
Peru Sol	2.6089	0.23

LATAM TOP STORIES

(continued)

ing local output and demand. Economic activity is expected to recover somewhat in April, though a port strike that slammed exports from commodities-dependent Chile from late March to early April will weigh, Larrain added. Inflation in the 12 months through April came in at 1.0 percent, well below the central bank's 2 percent to 4 percent tolerance range and the lowest figure since at least April 2012.

Brazil port modernization bill clears Congress

Brazil's Congress approved legislation that opens up state-owned ports to private investment and lifts restrictions on the building of private ports in a bid to eliminate serious bottlenecks strangling the country's export growth.

The reform bill, which may yet change if President Dilma Rousseff decides to veto parts of it, is an effort to make Brazil's clogged, costly and badly managed ports more efficient. That, backers believe, can help restore robust growth to Brazil's once-booming economy. However, negotiations over the bill set off a pitched battle between supporters and those who benefit from the status quo. While labor unions opposed the bill because it would loosen their grip on work contracts, port contractors, suppliers and other interest groups resisted changes to existing port business. For Rousseff, an overhaul of 20-year-old port regulations is an essential step to move ahead with a \$26 billion public-private investment drive to modernize gateways for Brazil's crucial commodity exports.



## DEEP DIVE Commentary and Analysis

## Top four central banks may change the tune

By Mike Dolan

The world's major central banks may be shifting their tone subtly from "whatever it takes" to "we can only do so much".

Financial markets supercharged this year by the extraordinary monetary stimuli of the top four central banks are once again asking how long this can last.

Friday's stall of this year's global stocks market rally was blamed by many on fresh policymaker chatter about when the U.S. Federal Reserve will or should start to wind down its bond-buying and money printing programmes, or "quantitative easing".

Ironically, the latest concern about the 'beginning of the end' of QE is flaring after a week of data from both sides of the Atlantic showing persistent weakness in the western economies and an absence of any discernible inflation pressures.

So while few strategists reckon the end of QE is nigh, the very debate itself may now force investors to rethink the long-term horizon even if a reversal of investment flows is unlikely.

The U.S. and world economy is probably not strong enough to end the QE effort any time soon," said Philippe Gijssels, head of research at BNP Paribas Fortis Global Markets. But "the market itself has had a very steep run and so a pause or consolidation becomes more likely and would be in fact desirable."

Yet if the big four central bankers are listening to the counsel of their monitors at the International Monetary Fund and Bank for International Settlements, then the tone of the debate has indeed changed this week.

While applauding central banks' success in stabilising the financial system over the past five years, the two global monetary bodies on Thursday detailed the risks both of persisting with extraordinary QE for too long and also the potentially disruptive effects of turning off the taps.

And highlighting the lack of traction in boosting growth and jobs, the common theme from the IMF and BIS was that monetary policy alone may have reached the limits of what it can do and other reforms and approaches now needed to be considered.

"If the medicine does not work as expected, it's not necessarily because the dosage was too low," said BIS chief Jamie Caruana. "Refocusing the policy mix to rely more on repair and reform and not to overburden monetary policy is crucial because the balance of risks of prolonged very low interest rates and unconventional policies is shifting."

Echoing that, IMF assistant director for monetary and capital markets Karl Habermeier wrote: "Monetary policy cannot do everything."

## BIG 4 AND DRAGHI'S REPRISAL

In the coming week, leaders of all four top central banks - the Fed, Bank of Japan, European Central Bank and Bank of England - deliver keynote speeches amid all the unease at a disconnect between seemingly euphoric markets, struggling economies and evaporating inflation.

Fed chairman Ben Bernanke testifies to Congress on Wednesday, Bank of Japan governor Haruhiko Kuroda speaks after the bank's latest policy meeting earlier that day and outgoing BoE head Mervyn King speaks in Helsinki on Friday.

Pointedly, ECB chief Mario Draghi returns to the financial community in London on Thursday for the first time since July when he drew a line under the euro crisis by pledging to do "whatever it takes" to protect the shared currency.

Given that phrase also neatly framed the determination of all G4 central banks to plough ahead with extraordinary monetary easing - the Fed's stepped up bond-buying plan to cut U.S. jobless or the 'shock-and-awe' tactics of the new Japanese government and Bank of Japan - they may all now be taking stock.

What's clear is that investors, if not the real economy, have run with their plan so far.

Total returns on Spanish or Greek equities and euro zone bank stocks are up between 40 and 50 percent since last July. Italian, French and German equities and Spanish and Irish 10-year government bonds have all returned 30 percent or more. While these have outperformed the 25 percent gains in Wall St's S&P 500 since then, the latter has powered to all-time highs. All pale in comparison with the eye-popping 75 percent rise in Japan's Nikkei 225 in just six months and bond borrowing rates from the highest to lowest rated sovereigns and corporates across the globe have fallen or remained close to historic lows.

So if central banks now want to flag an inflection point in policy thinking, should investors take their cue from that too?

For many, the seismic shift in investor flows is still not as speculative as it may appear.

Flows to both corporate bonds and largely defensive dividend-heavy equities this year are still fuelled largely by an exit from near zero-yielding money markets funds in search of long-term income rather than quick price rises or capital growth.

It's the success of the central banks in convincing investors they will not tolerate another systemic or growth shock that is still driving that exit from cash bunkers.

Far from being excessively optimistic about the world economy per se, many strategists reckon that investors will only change that behaviour when the central banks actually succeed in generating faster growth and credit expansion in the real economy - changing the inflation and interest rate horizon.

Credit Suisse economists said this was the peculiarity of the current QE-related "yield grab" - faster growth rather than low growth or stagnant economies was the bigger risk.

"This vulnerability likely becomes exposed in an environment of strengthening growth, which should in principle favour higher yielding assets, but would in practice be dominated by excess positioning."

## QE and the portfolio puzzle

By James Saft

Quantitative easing may well be pushing investors to hold more cash rather than risk assets, blunting its impact as monetary policy.

Known as the portfolio rebalancing channel, the thinking behind QE rests partly on the assumption that buying up government bonds will drive interest rates down and entice investors to tilt their holdings towards riskier investments like stocks. That in turn is supposed to goose investment and consumption.

Unfortunately, that assumption may be running afoul of, or fouling up, the way in which most investors construct their portfolios, according to Toby Nangle, head of multi-asset investments at London-based Threadneedle Investments.

He argues, convincingly, that by driving rates to rock-bottom levels, government debt can no longer properly play its role as ballast in an overall portfolio, steadying the ship and allowing investors to take on more risk than they otherwise would dare.

"Despite working in asset management for sixteen years, I have never met a major, sophisticated, institutional end-investor who did not believe (with a good degree of confidence) that on a five-year horizon stocks outperform bonds," Nangle writes in a note to clients.

"This begs the questions of why give out bond mandates at all when clients could go all out on their favorite asset? The answer, of course, is that they care about the volatility of their overall portfolio returns."

In a normal market, government bonds and stocks are complementary assets; owning the former allows you to hold more of

## DEEP DIVE Commentary and Analysis

the latter for a given level of risk tolerance. That's because although both assets are quite volatile, when held together in a portfolio they actually produce less volatility.

Investors care about volatility - deeply. Suffering swings in value isn't just stomach-sickening, it can be ruinous, both for the careers of the asset managers involved and for the real needs of the owners of the capital.

And indeed, the data shows - and this is elementary portfolio construction - that mixing longer-dated government bonds with equities leads to less volatility than would be suffered if you held either asset in isolation.

Government bonds, therefore, are not just a hedge, but a hedge with a positive yield. That, in fact, is a principal reason for their popularity.

## THE QE EFFECT

Now consider what happens when government bond-buying lowers the yields on those bonds to essentially nothing, or to a negative yield in inflation-adjusted terms. And also consider that under QE you as an investor are participating in a market dominated by one buyer - one whose motivation isn't profit but jobs and inflation and who might if it served its purposes at some point in the future become a massive seller.

"Most developed government bond markets now achieve little for my portfolio and I have sold them down to zero. I prize those markets that do offer the promise of offsetting equity volatility with a positive yield and use them to maintain chunky exposures to the most attractive equity markets," says Nangle.

So, what then to hold?

The problem is that most of the available assets other than government bonds which have a positive yield, such as corporate bonds, are much more highly correlated with equities. That means that they add risk and volatility to a portfolio.

That leaves cash, which has zero return but which doesn't have the capital loss downside of a bond. Sadly, if you hold more cash you need to cut your exposure to equities or again take on more risk. Either way, QE may be having the unintended effect of driving some to hold more cash.

So what are investors really doing?

A look at markets would seem to indicate that most are stepping up their risk, but the evidence isn't all one way. While money market holdings, in the U.S. at least, are down substantially from credit crisis peaks, they are still at historically high levels. And cash assets at commercial banks have skyrocketed, undoubtedly for complex reasons, but something which can be clearly read as showing household and corporate caution about the future.

As for QE, this all adds to the impression that its success as monetary policy is unproven.

For investors the bottom line is that the world has become a riskier place, and central bankers are forcing you to share the burden.

(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.)

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