

# INSIDE DEBT

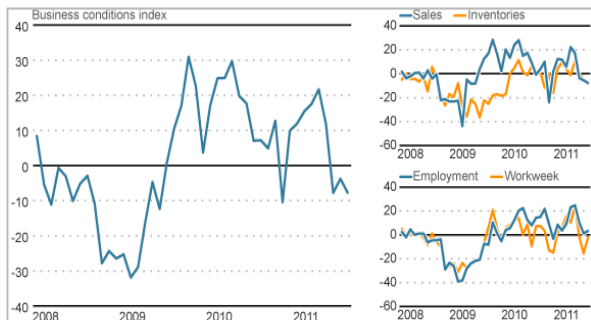
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Monday, August 15, 2011

## CHART OF THE DAY

### New York manufacturing

Click on the chart for full-size image



New York manufacturing contracted for the third month in a row in August as new orders fell to their lowest level since November 2010. Employment gauges showed a slight improvement in both number of employees and the workweek index.

## TODAY'S TOP NEWS

- ECB reactivates bond-buy plan with record amount
- NY factory index contracts for 3rd month
- Foreigners sell Treasuries, other U.S. assets in June
- World Bank head warns markets heading to new danger zone, policymakers must act
- Fed's Lockhart says U.S. recession risks have risen
- Japan on cusp of recovery after Q2; yen clouds outlook
- China plays down local govt debt risks, but concerns remain

## ECON WATCH

FOR TUESDAY AUGUST 16

ET	Indicators	Unit	Reuters	Prior
0.083 DE	GDP flash qq sa	%	0.5	1.5
0.083 DE	GDP flash yy nsa	%	3.2	5.2
05:00 EZ	GDP flash estimate qq	%	0.3	0.8
05:00 EZ	Eurostat trade nsa	bln	0.0	0.0
08:30 US	Housing starts	mln	0.600	0.629
08:30 US	Build permits	mln	0.605	0.617
08:30 US	Import prices	%	-0.1	-0.5
08:30 US	Export prices	%	0.1	0.1
09:15 US	Indust output mm	%	0.5	0.2
09:15 US	Cap utilization	%	76.9	76.7

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

## U.S. MARKETS TODAY

**TODAY'S TOP STORY:** The European Central Bank spent a record 22 billion euros on government debt last week, reactivating its controversial bond-buying plan to try to halt the spread of the euro zone debt crisis to Spain and Italy. **For more please click here**

• **TREASURIES:** Most U.S. Treasuries were stable, while long bond prices dropped, as stocks recovered and investors looked for signs of stability after a volatile week whipsawed prices and sent buyers scurrying to U.S. government debt.

For a graphic on foreign holders of U.S. Treasuries, [click here](#).

• "The front end is pretty much locked in. With the Fed statement last week the volatility in the front end is going to drop off the table," said Charles Comiskey, head of Treasury trading at Bank of Nova Scotia in New York. 10-yr notes were down 11/32 yielding 3.0 pct from 2.26 pct while 2-yr notes were unchanged to yield 0.19 pct.

- 5-yr notes lost 4/32 to yield 0.99 pct from 0.96 pct.
- 30-yr bonds dropped 22/32 to yield 3.76 pct from 3.73 pct.

• **FOREX:** The Swiss franc fell to its lowest level in two weeks against the euro and dollar on Monday on speculation the Swiss National Bank could further intervene to curb appreciation in the currency by setting an exchange-rate target this week.

- The euro was up 1.53 pct at 1.13 francs.
- The dollar was at 0.7851 franc, up 0.27 pct, far above last week's record low of 0.70676 francs.
- The euro was up 1.27 pct at \$1.444. Markets blew past an options barrier at \$1.44 and stops in the \$1.4450-60 region to trade at \$1.44779, its strongest level since July 27.
- The dollar was down 0.13 pct at 76.78 yen.

• **CORPORATES:** Corporate bond spreads tightened as stocks added gains and investors saw signs of stability as European leaders will end the debt woes soon.

- The CDX.IG-16 index tightened by 6 bps to 109 bps.
- New issuers included AT&T, Occidental Petroleum, Kinross Gold.

• **STOCKS:** Stocks rallied for a third day as investors saw Google's offer for Motorola Mobility as a signal to jump back in after weeks of sharp selling.

- Dow was up 1.90 pct at 11,482.83, S&P added 2.17 pct to 1,204.42 and Nasdaq gained 1.88 pct to 2,555.20.
- The VIX index lost 12.62 pct to 31.77.
- Motorola Mobility Holdings surged 55.82 pct, Google lost 1.16 pct and RIM was up 9.47 pct.

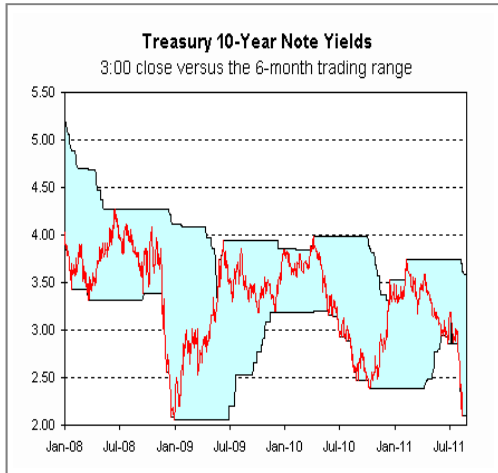
• **C & E:** Oil rose almost \$2 a barrel, supported by optimism that European leaders will come up with solutions to the region's debt crisis and by broader gains in global markets.

- Oil added 2.83 pct to \$87.80 per barrel.
- Gold was up 0.94 pct at \$1,762.29 an ounce.
- Reuters-Jefferies index added 1.22 pct to 330.52.

- 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	0.015	-0.015	0.015	-0.001
3-Mo Bill	0.015	0.005	0.015	-0.002
6-Mo Bill	0.075	0.055	0.076	0.001
1-Year	0.105	0.095	0.107	0.004
2-Year	100.344	100.375	0.200	-0.004
3-Year	100.438	100.469	0.354	-0.070
5-Year	102.469	102.516	0.989	-0.121
7-Year	104.344	104.391	1.588	-0.133
10-Year	98.500	98.563	2.294	-0.297
30-Year	100.016	100.078	3.749	-0.375

EQUITIES

	INDEX	CHANGE
DJIA	11450.24	181.60
NASDAQ	2543.33	35.17
S&P 500	1200.89	22.06

COMMODITIES

	PRICE	CHANGE
NYMEX	87.6	2.3
BRENT	109.6	1.6
SPOT GOLD	1762.7	16.9
PALLADIUM	745.7	2.7
SILVER	39.7	0.7

IR SWAPS <19901>

	SPREAD	RATE
2-Year	23.50 27.50	0.43 0.46
3-Year	23.50 27.50	0.58 0.61
5-Year	24.75 28.75	1.23 1.25
7-Year	24.50 28.50	1.83 1.84
10-Year	12.50 16.50	2.42 2.42
30-Year	-40.00 -36.00	3.35 3.34

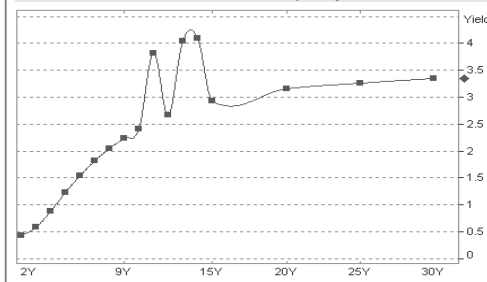
EURODOLLAR FUTURES

	CLOSE	CHANGE
Aug-11	99.71	0.01
Sep-11	99.60	0.03
Dec-11	99.50	0.03
Mar-12	99.54	0.01

REPURCHASE AGREEMENTS

G/C	MORTGAGE REPOS
O/N	0.160 O/N 0.220
2-Week	0.140 2-Week 0.200
1-Month	0.150 1-Month 0.230
3-Month	0.200 3-Month 0.280
AGENCY REPOS	i-REPO <sup>SM</sup> INDEX
O/N	0.180 10:00 AM 0.130
2-Week	0.180 3:00 PM 0.122
1-Month	0.200
3-Month	0.220

U.S. Interest rate swap—yield curve



FUTURES

	PRICE	CHANGE
CBOT 5 yr	123.17	-0.16
CBOT 10 yr	129.55	-0.33
CBOT 30 yr	136.13	-0.81

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.140	0.180	-	-
1-Month	0.200	0.250	0.092	0.102
3-Month	0.260	0.370	0.092	0.102
6-Month	0.400	0.520	-	-
12-Month	0.760	0.950	0.082	0.092

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

1m	0.2488
3m	0.3548

FED FUNDS

Open	0.1700
High	0.1700
Low	0.0700

CURRENCIES

	BID	ASK
Euro	1.4450	1.4452
Sterling	1.6385	1.6390
JP Yen	76.76	76.78
Swiss Franc	0.7841	0.7846
Can Dollar	0.9809	0.9814
Mexico	12.2024	12.2068

ACTIVE FANNIE MAE AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.5	09/08/2013	16 - 13	0.352
3-Year	0.875	28/08/2014	20.75 - 17.75	0.556
5-Year	2.375	11/04/2016	17 - 14	1.154
7-Year	-	-	- -	-
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	6.25 - 3.25	3.81

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPON	MATURITY	YIELD-SPREAD	YIELD
2-Year	0.75	28/03/2013	9 - 6	0.282
3-Year	1	27/08/2014	20.75 - 17.75	0.556
5-Year	-	27/05/2016	- -	-
7-Year	-	-	- -	-
10-Year	-	-	- -	-
30-Year	6.25	15/07/2032	18.25 - 15.25	3.93

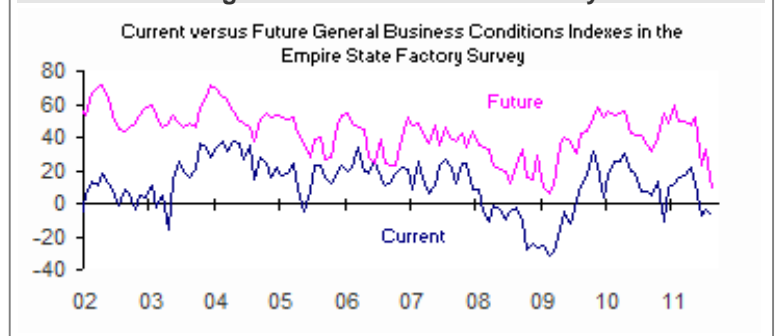
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	3.5	104.1050	104.1110	2.555
FHLMC	3.5	104.1060	104.1120	2.422

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.0	104.0400	104.0500	3.249
FHLMC	4.0	103.2550	103.2610	3.157
GNMA	4.0	106.0370	106.0430	2.962

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



## TODAY'S TOP NEWS

**ECB reactivates bond-buy plan with record amount**

The European Central Bank spent a record 22 billion euros on government debt last week, reactivating its controversial bond-buying plan to try to halt the spread of the euro zone debt crisis to Spain and Italy.

The amount bought, reported by the ECB, was the most the central bank has spent in any week since it began the program in May last year, surpassing the 16.5 billion euros spent in the first week, when it targeted Greek bonds.

Victoria Cadman, an economist at Investec, said the ECB would need to be active in the bond market for a few weeks yet. The ECB reactivated the program after leaving it dormant for 19 weeks, and despite opposition from a four-man group on its policymaking Governing Council, led by Germans Jens Weidmann and Juergen Stark.

French President Nicolas Sarkozy and German Chancellor Angela Merkel will discuss on Tuesday how to make the euro zone work more effectively amid persistent doubts in financial markets over Europe's ability to solve its debt crisis.

One of Germany's leading economic associations came out in favour of joint euro zone bond issuance, raising pressure on Merkel to consider bolder crisis steps ahead. The ECB also said no bonds held under the program matured last week. Thus, when rounded to the nearest half billion, the overall value of the purchases -- albeit not marked to market -- rose to 96 billion euros (\$135.2 billion).

Meanwhile, no euro zone member states will be allowed to quit the currency bloc, ECB Governing Council member Yves Mersch said in an interview published in the China Business News. [For a graphic on euro zone bond yields and the ECB Securities Markets Program, click here.](#)

**Foreigners sell Treasuries, other U.S. assets in June**

Foreigners unloaded U.S. assets in June for a second straight month and were net sellers of Treasuries for the first time in more than two years as concern about a U.S. credit downgrade soured overseas demand.

U.S. government notes and bonds suffered a net outflow of \$4.5 billion, the first since May 2009, as heavy selling by private investors outweighed buying from central banks.

Analysts said a host of factors, including confusion about what the end of the Federal Reserve's \$600 billion bond-buying program would have on Treasury yields, hurt demand in June.

Private foreign investors sold a net \$18.9 billion in Treasury notes and bonds in June, overwhelming a \$13.8 billion inflow from official institutions such as central banks.

**Fed's Lockhart says U.S. recession risks have risen**

The risk of a new U.S. recession has risen over the last couple of months, but an outright contraction will most likely be avoided, Atlanta Federal Reserve Bank President Dennis Lockhart said.

Lockhart said there is plenty the central bank could do if the economy does deteriorate further, including ramping up asset purchases or shifting their composition.

Recent market volatility, driven in part by concerns of slowing economies both in the United States and Europe, threatens consumer confidence and could put a crimp on spending, Lockhart told a Rotary Club meeting.

Meanwhile, U.S. banks continue to ease lending standards and most terms on all major non-real estate loans during the past three months, the Federal Reserve reported in its quarterly survey of senior loan officers.

**NY factory index contracts for 3rd month**

The New York state manufacturing sector contracted for the third straight month in August, tempering hopes that the first-half slowdown in the U.S. economy might be turning around.

Manufacturing led the U.S. recovery in the past couple of years, even though it only represents about 12 percent of overall economic activity, but growth in the sector has slowed sharply in recent months.

The general business conditions index fell to minus 7.72 from minus 3.76 the month before, the New York Federal Reserve's Empire State index showed.

New orders fell to their lowest level since November 2010, slipping to minus 7.82 from minus 5.45, while inventories fell to minus 7.61 from minus 5.56.

But the employment gauge showed a slight improvement. The index for the number of employees inched up to 3.26 from 1.11 and the average employee work week index rose to minus 2.17 from minus 15.56. The index of business conditions six months ahead dropped to 8.70 from 32.22.

Separate data also showed U.S. homebuilder sentiment remained stuck at historic lows in August, as a glut of distressed homes, tight credit, and economic uncertainty kept new buyers out of the market.

Separately, more U.S. homeowners prefer to pay off their mortgages sooner as interest rates have stayed near rock-bottom and weak labor conditions have caused them to reduce their debt loads, a survey showed.

**World Bank head warns markets heading to new danger zone, policymakers must act**

The loss of market confidence in economic leadership in key countries like the United States and Europe coupled with a fragile economic recovery have pushed markets into a new danger zone, something that policymakers have to take seriously, the head of the World Bank said on Sunday.

Speaking at the Asia Society dinner in Sydney, Robert Zoellick also said the global economy was going through a multi-speed recovery, with developing countries now the source of growth and opportunity. Zoellick said the process of dealing with the sovereign debt problem and some of the competitive issues in the euro zone have tended to be done "a day late", leaving markets worried that authorities may not be ahead of the problem or moving in the right direction.

**Japan on cusp of recovery after Q2; yen clouds outlook**

Japan's economy shrank much less than expected in the second quarter as companies made strides in restoring output after the devastating earthquake in March, but a soaring yen and slowing global growth cloud the prospects for a sustained recovery.

Analysts expect the world's third-largest economy to rebound in July-September, probably expanding at the fastest rate among major industrialized nations as exports and factory output return to pre-disaster levels. But growing risks to this scenario could strain a depleted arsenal of policy tools.

Gross domestic product fell 0.3 percent in the second quarter, less than a median forecast for a 0.7 percent contraction and a 0.9 percent decline in January-March.

However, worries that Europe's sovereign debt woes could escalate into another global crisis could rob Japan of much-needed export demand, increasing the chance of further yen-selling intervention and monetary easing to secure economic recovery.

## TODAY'S TOP NEWS

**China plays down local govt debt risks, but concerns remain**

Chinese state media and government officials have declared an initial victory in dealing with piles of local government debt, but analysts warn debt risks remain a big threat to the Chinese banking system and the world's second-largest economy.

In an attempt to quell investor jitters, China's state auditor in June laid the groundwork for a debt clean-up by releasing a review that said local governments had borrowed 10.7 trillion yuan (\$1.67 trillion) by the end of 2010.

Chinese regulators have been reclassifying local government debts to ease banks' provisioning requirements for potential bad loans, the China Securities Journal reported, citing a source who said that more than 40 percent of local government debt will fall due this year and next.

The "authoritative source" told the paper that about a third of loans granted to local government financing vehicles, or some 2.8 trillion yuan, were determined to be low-risk and would be booked as general corporate loans.

Meanwhile, U.S. is not satisfied with the rate of China's currency appreciation and Vice President Joe Biden will emphasize that during his trip to Beijing, a U.S. official said.

**Indirect bids rebound at U.S. T-bill sales**

Demand from foreign central banks and other indirect bidders for U.S. Treasury bills rebounded after plunging last week in the wake of Standard & Poor's stripping the United States of its top-notch credit rating.

High anxiety over the public debt problem in Europe and wild swings in global stock markets due to economic worries also have rekindled safe-haven bids for ultra short-dated U.S. government securities.

Indirect bidders bought 30.5 percent of the \$29 billion in three-month bills offered by the U.S. Treasury Department. That was up sharply from prior week's 7.6 percent, according to Treasury data. At the same time, indirect bidders purchased 35.8 percent of the \$27 billion in new six-month bill supply. That was nearly double the amount they bought last week.

**BoE's Miles says more QE not needed for now**

Britain's economy does not need more stimulus from quantitative easing now, though there could be times where it would do, Bank of England policymaker David Miles said in an interview.

"There could be circumstances under which I would judge the right policy would be to embark on further asset purchases but that's not how I've seen things thus far," Miles said in the interview with Dow Jones Newswires, which was conducted on Friday.

The BoE conducted 200 billion pounds of asset purchases with newly created money between March 2009 and February 2010, and there has been speculation that the weakness of the global economy may prompt it to do more this year.

But Miles said that Britain's economy was strengthening. His outlook broadly corresponds with the central scenario in the BoE's quarterly inflation report published last Wednesday.

**SNB poised to set Swiss franc target vs euro-paper**

The Swiss National Bank is poised to set a lower limit for the euro-Swiss franc exchange rate and will use all means to defend this as it fights against the soaring franc, Swiss newspaper *SonntagsZeitung* reported on Sunday.

The newspaper said insiders expect the SNB to formulate a concrete exchange rate target and if necessary, intervene in the foreign exchange market.

The target was likely to be a little over 1.10 francs per euro so that the SNB can gradually raise it, *Sonntags Zeitung* said.

The newspaper said the Swiss government would support this move when it meets on Wednesday and justify it as necessary for the health of the country's economy.

The Swiss government is also likely to outline a range of measures on Wednesday that it wants to take to help protect the Alpine country from the ill effects of the franc's rapid rise against the euro.

The central bank has so far refrained from a return to outright intervention in markets after a campaign of franc-selling in 2009-2010 saw it rack up substantial losses to little effect, prompting calls for Chairman Philipp Hildebrand to step down.

## NEXT UP

**POLL-More stress ahead in euro zone money markets**

Stress in euro zone funding markets has yet to peak despite the European Central Bank already promising unlimited funding and additional liquidity with a six-month duration, according to a slim majority of money market traders polled by Reuters.

The poll showed 11 of 20 traders thought tensions in money markets would continue to increase as banks remained nervous about lending to one another.

Of those who thought money market stress had yet to peak, most said this would happen by the year-end.

Indeed, the three-month Euribor rate, the main gauge of unsecured interbank euro lending, rose to 1.538 percent from 1.535 percent on Friday, even as liquidity remained high.

The European Central Bank announced this month that it would continue giving unlimited funds in its main refinancing operation and also introduced extra liquidity in a six-month tender, in a bid to support banks facing a liquidity crunch in the funding market.

The ECB spent a record 22 billion euros buying government debt last week, via its bond-buying program, in an attempt to prevent the euro zone debt crisis spreading to bigger economies Italy and Spain.

In the regular weekly poll, euro money market traders said the ECB would allot 148 billion euros at its regular seven-day auction, 9 billion less than last week, despite renewed fears about the health of banks and financial institutions in the currency bloc.

**PREVIEW-Canada's July inflation seen going below 3 pct**

Both all-items and core inflation annual rates should move closer to the Bank of Canada's target of 2 percent.

The biggest effect on the main headline number will be that the July 2010 introduction of higher sales taxes in Ontario, British Columbia and Nova Scotia will no longer be included in the calculations, which the bank estimated had added 0.7 points when introduced.

The bank had always said it would look through the first-round effects of the sales tax increase. Yet the boost kept total inflation embarrassingly outside the central bank's 1 to 3 percent range, so this will improve the optics.

Among factors adding upward pressure on a month-on-month basis are food and automobiles, where heavy discounting in June appears to have been partly reversed.



## EYE ON ASIA

## POLL &amp; PREVIEW

**More than half of market players see JGB yields flat this week**

More than half of market players expect Japanese government bond yields to stay flat this week, a Reuters weekly survey showed, with the market tending to encounter profit taking by investors as the 10-year yield nears a nine-month low but drawing support from a decline in U.S. and European bond yields.

The survey's JGB bull-bear DI, calculated by subtracting the number of bearish market players from the number of bullish players, fell to plus 12 from plus 26 in the previous survey.

The median forecast of 58 market players for the 10-year JGB yield at the end of the week was 1.040 percent, compared with the close on Friday at 1.045 percent.

Most participants were focused on bond market developments in the United States and Europe, as well as the supply and demand balance in JGB market.

Some market players said the recent pace of gains in JGBs has been slow relative to U.S. Treasuries and German Bunds, other debt considered safe havens.

**India July inflation seen easing slightly to 9.2 pct**

India's wholesale price index likely rose an annual 9.2 percent in July, slightly slower than June's 9.44 percent, as policy tightening by the Reserve Bank of India was partially offset by surging food prices, a Reuters poll showed.

The forecasts for India's main inflation gauge, from 27 economists, ranged from 8.9 to 10.0 percent.

The RBI has aggressively increased rates since March last year and is expected to tighten them further, despite the global economic uncertainty.

The central bank, which is scheduled to meet on Sept. 16 for its next policy review, raised rates by a steeper-than-expected 50 basis points last month.

## EVENTS

For Aug 16

**CHINA**

- People's Bank of China is expected to sell 1-year bills and could conduct 28-day repos.

**INDIA**

- WPI inflation yy for July: Expected 9.20 pct Prior 9.44 pct

**INDONESIA**

- President Yudhoyono is expected to give a speech ahead of Independence Day on Aug 16, when he is likely to comment on the current global market turmoil and its effects on Indonesia, as well as policy priorities for the year ahead.
- Indonesia's finance ministry aims to raise 7 trillion rupiah and is expected to conduct debt auction on Aug. 16, and to offer five-, 10- and 21-year bonds as well as three-month and one-year T-bills.
- The finance ministry is expected to announce an indicative target for a sukuk auction scheduled August 23.

**NEW ZEALAND**

- Producer prices-input final for Q2: Prior 2.2 pct
- Producer prices-output final: Prior 1.7 pct

**PHILIPPINES**

- Philippines is expected to hold auction for \$209 million worth of 4-year T-bonds.

**SOUTH KOREA**

- Export growth revised for July: Expected 17.4 pct Prior 27.3 pct
- Import growth revised for July: Expected 26.8 pct Prior 24.8 pct
- Trade balance revised: Expected 2.80 bln Prior 7.20 bln

## MARKET SNAPSHOT as of 3:00 pm EST

GOVERNMENT BOND BENCHMARKS					EQUITIES			FORWARDS 3 months <FORWARDS>		
5-Year		10-Year				Close	Change		Bid	Ask
	Bid	Yield	Bid	Yield						
Australia	102.900	4.080	109.146	4.575	S&P/ASX200	4282.86	110.24	JPY	-6.85	-6.35
Japan	99.781	0.346	100.490	1.045	NIKKEI 225	9086.41	122.69	AUD	-113.21	-111.96
China	98.390	3.810	99.350	4.070	HKSE	20260.10	640.09	NZD	-55.9	-53.9
Hong Kong	103.100	0.915	102.868	1.999	SHANGHAI	2626.77	33.60	HKD	-98	-88
Singapore	102.850	0.501	104.550	1.742	STRAITS TIMES	2874.40	23.81	SGD	-12	-5
					SENSEX	16839.63	-219.77	THB	17.75	15.5
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	4.74	4.8	5.215	5.27	JPY	0.1		CNY	-0.0356	-0.0316
JPY	0.44	0.5	1.02	1.08	CNY	4.9		TWD	-0.31	-0.29
CNY	4.15	4.25	4.35	4.55	AUD	4.75		KRW	1076.5	1077.5
HKD	1.14	1.22	2.2	2.28	NZD	2.7		INR	45.625	45.725
TWD	1.1	1.14	1.36	1.41	HKD	0.18		MYR	2.9885	2.9925
INR	5.5	5.8	5.8	6.15	SGD	0.1875		PHP	42.87	42.97
KRW	3.43	3.47	3.57	3.61				IDR	8585	8685
SGD	1.02	1.08	2.05	2.15						

## EYE ON LATAM

## LATAM TOP STORIES

**Analysts cut Brazil inflation outlook for 2nd week**

Economists trimmed for a second straight week their forecast for Brazil's benchmark inflation index this year, signaling that a debt crisis in the United States and Europe will likely help stem price pressures and further slow economic growth.

A weekly central bank survey published showed the benchmark IPCA consumer price at 6.26 percent by year-end, compared with a previous 6.28 percent forecast.

The shift in expectations comes amid faltering market confidence on Central Bank President Alexandre Tombini's strategy to stem the fastest surge in inflation in six years. Investors have largely bet for most of this year that inflation will breach the government's 4.5 percent target plus or minus 2 percentage points for this year for the first time in nine years.

The survey found that forecasts for economic growth this year fell for a second week to 3.93 percent in the week ended Aug. 12. The decline in growth estimates goes in line with a rise in borrowing costs, a tightening of the credit market and the international situation that is clouding the scenario for local investment, analysts said.

The year-end inflation forecast for 2012 fell to 5.23 percent from 5.27 percent, the survey showed. But some short-term overshooting risks remain -- the forecast for inflation in the 12 months ahead accelerated to 5.44 percent from 5.42 percent in the prior week, the survey showed.

**Mexico says 2011 growth may be weaker than thought**

Mexico's finance ministry said on Sunday its economic growth could come in weaker than previously expected due to uncertain demand from the United States.

While the finance ministry had forecast growth of 4.3 percent this year, Finance Minister Ernesto Cordero said growth could come in as low as 4 percent.

Mexico's economic fate is closely tied to that of the United States and economists have been trimming their expectations for Mexican growth this year due to uncertainty north of the border. Mexico's central bank last week said Mexico's economy should grow between 3.8 and 4.8 percent in 2011, and between 3.5 and 4.5 percent in 2012.

The bank had previously forecast growth of 4 to 5 percent this year and 3.8 to 4.8 percent next year.

**Peru's economy grows 5.3 pct in June from year ago**

Peru's economy grew a less-than-expected 5.3 percent in June from the same month a year ago, official data showed, due to a deceleration in mining, fishing and construction.

Economists surveyed by Reuters were expecting growth of about 6.1 percent. Year on year growth in May was 7.1 percent, its slowest pace in 15 months.

Output rose 0.69 percent in June from May, the government's statistics agency said.

The mining sector decelerated by 6.17 percent on falling metals production while fishing dropped by 15.78 percent. Construction decelerated by 2.75 percent.

A building boom in Lima had helped Peru's economy expand nearly 9 percent last year, one of the world's fastest rates.

But growth in the sector fell off as investors put projects on hold, fearing leftist President Ollanta Humala would roll back free-market reforms after he won the June 5 election.

The national statistics agency also said the average unemployment rate in the three months through July was 7 percent.

## LATAM MARKETS TODAY

**TREASURIES:**

- Mexican 10-yr notes added 5/32 yielding 6.11 pct and 30-yr bonds rose 17/32 to yield 7.55 pct.
- Brazilian 10-yr notes rose 12-30/32 to yield 12.14 pct and 2-yr notes were up 30/32 yielding 11.95 pct.

**FOREX:**

- Brazil's real was down 1.31 pct to 1.5893 to the dollar, firming below 1.60 to the dollar for the first time in three days.
- Mexico's peso lost 0.68 pct to 12.22 to the dollar.
- Chile's peso gained 0.02 pct to 470.75 to the dollar.
- Columbian peso was unchanged at \$1,784 to the dollar.
- Peru's sol was little changed at 2.739 to the dollar.

**STOCKS:**

- The MSCI index was up 2.88 pct as the region's stocks extended a rally from last week that pulled the gauge off its lowest point in more than a year.
- Brazil's Bovespa rose 1.95 pct as Telesp added 5.1 pct, Petrobras added 2.46 pct and Vale rose 1.61 pct.
- PDG Realty rose 3.43 pct.
- Mexico's IPC index added 1.62 pct as America Movil rose 0.75 pct.
- Cemex gained 7.73 pct.
- Chile's IPSA index rose 0.89 pct as SQM gained 2.32 pct, and retailer Falabella rose 1.44 pct.

## LATAM TOP STORIES

*(continued)***Bickering U.S. sees Canada-Colombia deal take force**

U.S. Republican lawmakers fumed over potential lost American exports because of a free trade deal between Canada and Colombia that has taken force before President Barack Obama has even sent a five-year-old U.S-Colombia agreement to Congress for a vote.

The administration of former President George W. Bush, a Republican, negotiated all three agreements but was not able to get them through the Democratic-controlled Congress.

The Obama administration, in a move to the center after Republicans won control of the House in the November 2010 elections, renegotiated with each country to address concerns raised by Democrats.

But its hope of passing the three trade deals by the end of July fell victim to the battle over raising the U.S. debt ceiling and a separate fight over Trade Adjustment Assistance, a nearly 50-year-old program to help retrain Americans thrown out of work by imports or companies moving overseas.

Republicans objected to a White House plan to include a TAA extension in the implementing bill for the South Korea agreement and demanded a separate vote on the program.

That appears now to be the plan for TAA and the pacts when lawmakers return to Washington in September, although some Democrats remain suspicious that Republicans will try to kill the worker retraining program if it is not shielded by the South Korea deal.

Meanwhile, a free trade pact between the EU and South Korea went into force on July 1.



## DEEP DIVE Commentary and Analysis

## Glimmers of hope for U.S. deficit-cutting panel

By Donna Smith and Richard Cowan

Having said no to taxes for months, Republicans now are saying maybe, in the face of public disgust over a deadlock in the U.S. Congress, a near government default and a worsening global economic crisis.

Prompting some hope for a return to fiscal order are the statements and reputations of some of the six Republicans named this week to join with six Democrats on a special committee to end the standoff over the U.S. deficit.

In one of his first interviews after being named to the "Joint Select Committee on Deficit Reduction," Representative Dave Camp told Reuters, "I don't want to rule anything in or out" when the panel starts its work.

That's a far cry from what had been a Republican wall of opposition to any tax increases when President Barack Obama negotiated a \$917 billion deficit-reduction downpayment with Republicans that also was aimed at raising U.S. borrowing authority by Aug. 2.

Public disgust with the long, bitter budget and debt limit fight that has consumed Washington all year could have played a role in the less confrontational tone.

A Reuters/Ipsos poll released this week found 49 percent of those polled had a negative view of Republicans in the wake of the debt limit deal, compared to 42 percent for Obama and 40 percent for Democrats broadly.

John Feehery of Quinn Gillespie Communications and a former Republican congressional staffer said lawmakers may now be more willing to reach a deal on additional deficit reductions given the public reaction to the debate over the debt ceiling.

"People are going back home (during the August recess) and they are finding the intense partisanship does not really work in the rest of the country," Feehery said.

Further evidence that the "super committee" is taking its responsibilities seriously: members are considering cutting short their August recess to start work, knowing a Nov. 23 deadline allows little time to tackle major tax and budget questions that could lead to another \$1.5 trillion in savings over the next decade.

Representative Chris Van Hollen, a Democratic member of the panel, told Reuters, "There's a good argument in favor of getting an early start." "There have been a number of conversations on both sides of the aisle" about it, he added.

## HISTORY OF DEAL-MAKING

Feehery and other analysts feel the composition of the committee also bodes well for agreement.

"These are folks who are deal cutters," Feehery said of Camp, Republican Senator Rob Portman, a former White House budget director, and Representative Fred Upton. Upton worked on some major tax and spending agreements during a stint at the White House budget office under President Ronald Reagan. Even conservative partisan Representative Jeb Hensarling may be ready to deal, analysts say. "In the right context I do not see him as a guy that would just stick himself in concrete," said Steve Bell, a former Senate Budget Committee aide who is now with the Bipartisan Policy Center.

These Republicans will be sitting across the table from some experienced Democratic deal-makers, notably Senators John Kerry, a former presidential candidate, and Max Baucus, who has deep experience in taxes and healthcare benefits, which will dominate the talks. Meanwhile, House Democrat Xavier Becerra, a liberal stalwart, has urged members to keep an open mind.

Becerra and fellow House Democrat James Clyburn could be instrumental in building support in the liberal wing of their party

for any potential deal.

The group's work will be getting underway against the backdrop of global market turmoil, a European debt crisis and rising concerns the U.S. economy could reverse its recovery from the deepest recession since the Great Depression.

And later this month, the Congressional Budget Office is expected to release its latest economic outlook and quantify its impact on Washington's deep budget deficits, which have been hovering around \$1.5 trillion annually.

All these factors put pressure on the panel to produce.

Also working in the committee's favor is that \$1.5 trillion in savings over 10 years is not insurmountable in the context of a \$3.7 trillion annual budget.

Negotiations earlier this year led by Vice President Joe Biden have identified many possible ways to pare deficits.

So, if Republicans were to go along with modest revenue increases, Democrats might find it easier to say yes to equally modest savings to the Medicare healthcare program for the elderly, some of which already have been suggested by Obama.

But even if the super committee settles on around \$1.5 trillion in new savings, it likely will not be enough to satisfy global financial markets demanding a more ambitious result -- as much as double that amount -- accomplished through long-term reforms of government benefit programs and a broad revamp of the U.S. tax code.

## Italy auctions to test success of ECB bond buying

By William James

Italy faces a crucial test when it resumes bond auctions later this month -- convincing investors to purchase new bonds at artificially low yields in return for the reassurance that the ECB will step in as a buyer of last resort.

The European Central Bank became the reluctant owner of billions of euros of Italian and Spanish bonds last week, bought in a bid to stop the euro zone debt crisis spreading to the Italian bond market, the bloc's largest.

In all, the ECB spent 22 billion euros on bonds of the euro zone's lower-rated sovereigns after reactivating its purchase program on Aug. 4.

The ECB purchases, during a seasonal lull in bond auctions, brought yields back to levels at which Italy can afford to issue -- 10-year yields fell from a peak of almost 6.5 percent, seen as close to unsustainable, to 5 percent.

But the real test is whether the ECB's support is enough to convince investors to buy new bonds which could offer 100 basis points less yield than the market demanded just two weeks ago. If long-term investors cannot be swayed, the ECB quickly becomes the only buyer in a market too large for it to prop up alone, or else yields rise again, with the risk that Italy will not be able to afford to refinance its debt.

Market participants expect auctions penciled in for Aug. 30 to be backed by domestic investors with few alternatives to holding Italian bonds and by primary dealer banks.

However, demand from the wider investor community, essential if Italy is to keep financing its deficit, remains in doubt.

"It's not like now that yields are back at 5 percent real money accounts are saying the fundamental story has changed," said Leister at WestLB.

Italy has sped up reforms, bringing forward plans to balance its budget and passing new austerity measures, though the steps have quickly drawn criticism.

Markets remain on edge as question marks also persist over how much the ECB is prepared to spend and how long it will continue to support the debt-laden state.



## DEEP DIVE Commentary and Analysis

"If the ECB is in there buying with open-ended pockets then that should encourage end-investors to invest alongside it, but the problem is that they've done this before and they haven't been committed to it," said Gary Jenkins, head of fixed income research at Evolution Securities in London.

## BAILED OUT

The ECB tried to stave off bond market pressure last year but failed. It bought roughly 75 billion euros of Portuguese, Greek and Irish bonds but could not prevent each country's debt costs spiraling and all three were eventually bailed out.

Italy and Spain together are too large to be bailed out under the region's current rescue mechanism, making a successful Italian return to market essential for the euro zone as whole.

Italy is expected to resume debt auctions with the launch of a new 10-year benchmark, requiring more bonds to be sold than if it was reopening an existing issue.

Current yields suggest the coupon on the new bond could be set at 5.25 percent, attractive compared to secondary market levels of 5.02 percent, but well off the return of nearly 6.5 percent investors demanded before the ECB intervention.

"There are obviously some concerns about risk/reward if we get a coupon at 5.25 percent... Is it really attractive enough if you can't really bank on the (bond-buying program) to be there to really put a floor under the market?," said Commerzbank strategist David Schnautz.

## FIRST HURDLE

Even if Italy clears the first supply hurdle, investors will scrutinize subsequent auctions for sign of waning support from end-investors or the ECB. Rome still needs to raise up to 95 billion euros of long-term debt this year, according to Reuters estimates.

Any sign the debt agency was lowering auction targets or skewing supply towards less risky, shorter-dated bonds could reignite worries over Italy's ability to fund itself, analysts said.

And investors face new concerns later in the year when the euro zone's beefed-up rescue fund is expected to take over from the ECB as buyer of last resort.

The European Financial Stability Facility was given new powers to intervene in secondary bond markets as part of a package announced last month to reassure investors.

But the rescue fund's size is limited to 440 billion euros, with bailouts already shrinking its firepower and leaving it undergunned to tackle Italy's 1.6 trillion euro bond market.

Market intervention will also require a more lengthy consultation than the current ECB bond buying program -- a problem given the speed at which investor sentiment can turn.

"I'm not sure with the makeup of the EFSF and the political will-ingness required to step in to the market that they'll be anything other than hugely reactive," said Evolution's Jenkins.

## REUTERS SPECIAL REPORT – The bonds that turned to dust



When hedge fund manager Alberto Micalizzi bought bonds backed by oil from an obscure Russian republic he trapped his investors in a secret—and very global—web

After his fund lost hundreds of millions of dollars in the credit crunch, Micalizzi quietly moved most of its assets into bonds in late 2008.

For more on the report, [click here](#)

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