




**10:32 08/22 BONDS:** The 2-year Schatz is bearing most of the brunt of selling after comment from the ECB that "monetary policy stance was expressed by ECB President Trichet on Aug 2". The yield on the 2-year Schatz is now up 21bps at 4.07% -- highest since Aug 15, having fallen to 3.81% intra-day yesterday, on back of US rate cut expectations. This comment is a clear reference to ECB chief Jean-Claude Trichet's reinsertion into his prepared remarks at his impromptu press conference three weeks ago that the central bank is monitoring risks to price stability with "strong vigilance." In the past, that phrase has served to flag a rate hike one month later in the absence of major risks to the real economy or financial stability. Today's remark suggests that the ECB is not yet prepared to rule out a rate hike in two weeks. However, that option remains, depending on developments up until the next Governing Council meeting on Sept 6. Trichet also reminded on August 2 that the ECB does not "pre-commit" on future policy moves.

by Charanjeev Chana

**EGBs** traded lower with short dates underperforming after the ECB underlined its strongly vigilant stance in a statement released on Wednesday afternoon, thereby reinforcing expectations of a September interest rate hike. In a statement following the announcement of a 3-month liquidity provision refi for E40bln, the ECB said the banks monetary policy stance was expressed by the President on August 2nd. Ahead of the statement, the market was underpinned by dovish comments from French Finance Minister Christine Lagarde, who urged the ECB to cut rates to help markets and growth. Bonds opened lower taking cue from overnight weakness in US Treasuries after expectations of an emergency inter-meeting Federal Reserve rate cut were pared back. The change in expectations came following comments by US Treasury Secretary Hank Paulson yesterday, who suggested the volatility in credit markets will "take time" to subside.

**European equities** were stronger in afternoon trade. The DAX was trading +0.90%, CAC 40 +1.77% and the FTSE +1.31% on the day. US stocks were also stronger with the S&P 500 +0.89% and the Nasdaq +0.96%.

**Sep-07 Bunds** were 57 ticks lower at 113.18. In cash, German government benchmark yields were 4bps to 18bps lower with 2s underperforming. The 2s/10s spread was 26bps vs. 37bps and the 10s/30s spread was 21bps vs. 25bps.

**Gilts** also traded lower, with the short end of the curve underperforming on safe-haven unwinding. Gilts dipped slightly on the Bank of England announcement that financial participants made no use of the banks standing lending facility on Tuesday - after it emerged overnight that Barclays Bank made use of the facility for £312mln on Monday. Also weighing on sentiment was stronger than expected CBI industrial trends data, which rose to its highest level since

**Jun-07 Gilts** were 71 ticks lower at 106.53. In cash, UK government benchmark yields were 7bps to 11bps higher with the short end of the curve underperforming. The 2s/10s spread was -28bps vs. -27bps and the 10s/30s spread was -55bps vs. -53bps.