



Morning FI Analysis: EGBs Higher Amid Risk-Aversion 02:53 EDT / Oct 19

LONDON (MNI) - European Government bonds opened Friday, taking their direction from gains in US Treasuries and JGBs, amid risk-aversion buying following sharp losses on Nikkei-225.

Stock markets are seen trading nervous today, given it is the anniversary of the 1987 stock market crash, where the Dow fell almost 22% in a single-day.

Traders note many parallels with the market back then, i.e. it was also a pre-election year, the dollar was also weak then, and there was also a relatively new Fed Chairman then in Greenspan.

Also, program-trading was key behind the sell-off back then and many now blame risk-management models behind the huge quantitative strategies related to the current problems in credit market.

The Bund curve is trading steeper, with 2-/10-year yield spread at +28bps vs +26bps yesterday, with short-dated issues outperforming and underpinned by euro-dollar strength, which hit fresh life-time highs above \$1.4311.

Attention turns to the G-7 finance ministers and central bankers meeting today on the sidelines of the annual IMF/World Bank meetings in Washington (Oct 20-22).

Also eyed are comments from ECB member's Gonzalez-Paramo, Weber and Stark, along with Fed's Poole and Fed Chairman Bernanke. WTI Nymex crude oil hits fresh record highs at \$90.02 in after-hours electronic session, amid continued geo-political tensions between Iraq/Turkey and also weaker dollar. However, the risk is on sharp profit-taking ahead of the expiry of the November Nymex contract on Monday.



[Times for Market News International stories are ET]

06:51 10/19 **LIBOR FIXINGS:** Euro o/n Libor fixed at 4.04875% vs 4.06250% Thur.

06:52 10/19 **GILT SUMMARY:** Gilts are higher but underperformed Bunds following release of stronger than expected UK Q3 first estimate GDP data, which rose 0.8% q/q, +3.3% y/y vs MNI median forecast of +0.7% q/q, 3.2% y/y. The annual rate at 3.3% was the strongest growth in over three years through the third quarter of 2007. The 10-year Gilt/Bund yield spread widened to +71.6 bps vs +70.7 bps Thursday. The Gilt 2-/10-year yield spread was 0.2 bps flatter at -20.7 bps, whilst the 10-/30-year yield spread was 0.1 bps flatter at -39.1 bps. Traders said volumes were light, with focus on G7 meeting and perhaps more importantly, the Rugby World Cup final on Saturday between England and South Africa. Dec Gilts are up 8 ticks at 107.10.

06:45 10/19 **BUND SUMMARY:** Bunds opened higher, taking their direction from gains in US Treasuries and JGBs, amid risk-aversion buying following sharp losses on Nikkei-225. Stock markets are seen trading nervous today, given it is the 20-year anniversary of the 1987 stock market crash, where the Dow fell almost 22% in a single-day. In addition, stocks are also seen jittery ahead of the S&P-500 Oct option expiry today. The short-dated issues outperformed on safe-haven buying and also underpinned by euro-dollar strength, which earlier hit fresh life-time highs at \$1.4319, in turn steepening the Bund yield curve. The 2-/10-year yield spread at +27 vs +26 bps, whilst the 10-/30-year yield spread was at +25 bps vs +24 bps. Attention turns to the G-7 finance ministers and central bankers meeting today on the sidelines of the annual IMF/World Bank meetings in Washington (Oct 20-22). Also eyed are comments from ECB member's Gonzalez-Paramo, Weber and Stark, along with Fed's Poole and Fed Chairman Bernanke.

09:07 10/19 **ECB GONZALEZ-PAREMO:** Baseline scenario still intact

- Some signs of financial market normalisation
- Consumers recently more worried about inflation
- Can't tolerate medium-term inflation expectations over 2.0%
- Inflation risks still on upside; no recent change
- Monitoring all incoming data closely

(Cont.)

08:29 10/19 **SHORT-STERLING:** Traders report strong option flows in red contracts, with decent bullish trades put on, amid speculation of lower rates from the BoE by Q4 2008. In the futures market, flows were largely mixed, with leverage accounts seen selling in the wake of stronger than expected UK Q3 preliminary GDP data.

- Paper sold 1.6k Dec 07 95.125/94.25/94.375/95.50 call condor for 1
- Paper bought 5k Jan 08 Jan 94.25/94.00/94.75 put fly for 5.5-6 ticks
- Paper sold 10k Mar 08 94.00/93.75 put spread @ 6.5 ticks.
- Paper bought 10k Sept 08 95.00/95.50/96.00 call fly for 6 ticks
- Paper bought 60k Dec 08 95.25/95.50/95.75/96.00 call condor for 3.5.

08:35 10/19 **EURIBOR:** Traders say flows today have been skewed to further upside positioning in Euribor targeting a neutral ECB move.

- Paper bought 5k Dec 07 95.50/95.625/95.75 call fly for 2.5
- Paper bought 2k Mar 08 95.625 call at 22.5
- Paper bought 20k Mar 08 95.50/95.75 1x2 call spread for 5.5
- Paper bought 7k June 07 96.00 calls for 5.5
- Paper to Paper 2k Dec 08 96.00/96.50/97.00 call fly at 7
- Paper sold 15k Dec 08 97.00 calls at 1 -- seen as liquidation.

08:38 10/19 **JGB RECAP:** Prices ended higher, in line with the Tsy rally, with the curve bull flattening into the 7Y sector while steepening was seen in longer maturities. Weak stocks cited along with the technical move in Tsys and ongoing credit concerns. Banks bought 2-, 5- and 10Y JGB poaper while funds put money to work across the curve, sources said. Better bid reported in Linkers.