



EMU Bonds Lower As Stocks Rebound In Low Volume Session by Market News, 23 October 2007

LONDON, Oct. 23 (MNI) - European bond prices are lower on Tuesday amid the unwinding of recent risk-aversion trades following a rebound in stocks and hawkish comments from ECB Governing Council member Axel Weber. However, volumes were low, according to traders as attention turns to the heavy slew of quarterly earnings reports, where Amazon.com, AT&T, Juniper Networks, UPS and Whirlpool are amongst the biggest names to report.

Bunds opened lower, taking direction from the profit-taking in U.S. Treasuries towards the Chicago close and gains in stock futures in the wake of better than expected results from Apple in after-hours session. This comes in addition to hawkish comments from ECB Governing Council member Axel Weber who had in an interview with the German daily Boersen-Zeitung said the ECB only interrupted the tightening of interest rates because of turmoil in the financial markets. The comments add to a previous hawkish view noted on the sidelines of the annual meeting of the International Monetary Fund, where Weber said: "I am somewhat concerned that inflation is rising strongly in Germany and we have to counteract this."

Bunds were also weighed by stronger than expected French consumer spending data, which rose 0.1% m/m, +5.8% y/y in September after a revised +0.7% m/m and +2.9% y/y in August (was +1.0% m/m, +3.6% y/y). Traders reported selling from real money and leverage accounts in the 10-year sector.

However, prices bounced back on market rumours that Merrill Lynch's third-quarter earnings report due on Wednesday will show substantial losses on top of the \$5 billion write-down it pre-announced less than two weeks ago.

According to a NY Post article, "rumors started circulating late Friday that Merrill might have an additional write-down and that a special board meeting had been called to discuss the matter". The charge will actually turn out to be just "the tip of the iceberg", writes the NY Post.

Whilst the rumours have been circulating for some time, the fact that the write-down is rumoured to be closer to \$12bln in trading losses added to the safe-haven bid.

Bunds paid little attention to eurozone industrial orders data, which bounced back less than expected in August at +0.3% m/m, +5.1% y/y after July's plunge turned out to be much less severe than reported last month. July orders were revised up to -2.6% from -4.0%. Traders reported light buying from a central bank in 10-year Notes and fast money accounts buying the belly of the curve. European real money account was seen buying intermediate corporate paper.

In the U.K., Gilts are lower with the longer-dated Gilts outperforming, albeit in thin volume session. Gilts pared losses in line with Bunds following the Merrill Lynch rumour in addition to the weaker than expected U.K. CBI industrial trends survey, where total orders balance fell to -6% in October vs +6% in September. This was the weakest outturn since July, and well below the median forecast in a Market News survey calling for a 4% balance. The Gilt 2-/10-year yield spread was 0.2 bp steeper at -21.4 bps, whilst the 10-/30-year yield spread was 1.1 bps flatter at -36.6 bps. Dec Gilts are down 24 ticks at 107.52.

In cross-border flows, U.S. Treasuries extend their underperformance versus Bunds as the 10-year UST/Bund yield spread widened to +27.8 bps vs +27.0 bps Monday. This yield spread narrowed to +21.2 bps last week, which was the narrowest level seen since October 2004.

European equity markets are higher. In London, the FTSE-100 was up 0.91%. In Paris the CAC was higher by 0.66% and in Frankfurt, the DAX was up 0.42%. U.S. index futures are also trading higher. The S&P Dec contract was up 3.2 points at 1516.6 and the Nasdaq Dec contract was up 13.25 points at 2185.0.

The yield on the 4.00% Sept 2009 Schatz was up 2.0 bps at 4.00%. The yield on the 4.25% Oct 2012 Series 151 Bobl was up 2.4 bps at 4.09%. The yield on the benchmark 4.25% July 2017 Bund was up 2.3 bps at 4.21%. The yield on the 4.25% July 2039 Bund up 2.2 bps to 4.49%. Subsequently, the Bund curve traded unchanged from Monday's close, with the 2-/10-year yield spread at +21 bps, whilst the 10-/30-year yield spread was at +26 bps.



[Times for Market News International stories are ET]

07:26 10/23 **BUND SUMMARY:** Bunds opened lower, taking direction from the profit-taking in US Treasuries towards the Chicago close and gains in stock futures in the wake of better than expected results from Apple in after-hours session. In addition, hawkish comments from ECB Governing Council member Axel Weber who in an interview with the Boersen-Zeitung said the ECB interrupted the tightening of interest rates because of turmoil in the financial markets. Bunds were also weighed by stronger than expected French consumer spending data. Traders reported selling from real money and leverage accounts in the 10-yr sector. However, prices bounced back on market rumours that Merrill Lynch's Q3 earnings report due on Wednesday, will show a substantial losses on top of the \$5 billion write-down it pre-announced less than two weeks ago. Bunds paid little attention to eurozone industrial orders data, which bounced back less than expected in August at +0.3% m/m, +5.1% y/y, but July's 4.00% plunge turned out to be much less severe after revision to -2.6%.

07:30 10/23 **GILT SUMMARY:** Gilts are lower, with the longer-dated Gilts outperforming, albeit in thin volume session. Gilts pared losses in line with Bunds following the Merrill Lynch rumour in addition to the weaker than expected UK CBI industrial trends survey, where total orders balance fell to -6% in October vs +6% in September. This was the weakest outturn since July, and well below the median forecast in a Market News survey for a 4% balance. Long-dated linkers came under pressure after proposals which allow employers to cap future inflationary escalation at 2.5% (currently 5%), according to strategists. This comes ahead of the Stg925mln 1.125% Nov IL Gilt 2037 auction on Wednesday, and also weighed on long-dated linkers. Elsewhere, the UK Debt Management Office (DMO) today announces size of the 5.00% 2018 Gilt, which is due to be sold on November 1. Strategists expect size to be Stg2.5bln. Attention turns to comments from Bank of England Monetary Policy Committee member Kate Barker at 1145GMT. Dec Gilts are down 24 ticks at 107.52.

08:11 10/23 **LIBOR:** Sixth consecutive session of LIBOR compression, 3 month LIBOR set 0.88 bps lower at 5.0838%, -6.75 bps for the week. Meanwhile, 1-month LIBOR set 2.00 bps lower at 4.8725%, -7.75 bps for the week. Net weekly recap:

| | <u>3-Month LIBOR</u> | <u>1-Month LIBOR</u> |
|-------------|----------------------|----------------------|
| Oct 15-19 | -6.31 bps | -9.50 bps |
| Oct 8-12 | -1.93 bps | -6.19 bps |
| Oct 1-5 | +1.43 bps | -0.19 bps |
| Sep 24-28 | +2.63 bps | -0.75 bps |
| Sep 17-21 | -44.38 bps | -48.25 bps |
| Sep 10-14 | -7.87 bps | -21.00 bps |
| Sep 3-7 | +10.37 bps | +10.38 bps |
| Aug 27-31 | +11.57 bps | +21.75 bps |
| Aug 20-24 | +1.00 bps | -0.75 bps |
| Aug 13-17 | -7.50 bps | -10.88 bps |
| August 6-10 | +21.50 bps | +36.63 bps |

(Cont.)

07:45 10/23 **BOE BARKER SPEECH:** Market Turmoil Shifts UK Growth Risks To Downside
 --BOE Barker: Upside Price Pressures From Commodity Markets A Concern
 --BOE's Barker: Business Surveys Have Not Yet Shown Marked Weakening
 --BOE Barker: Housing Business Surveys Key In Assessing Risks
 --BOE'S Barker: Some Downside Risk Around UK Housing Market

09:38 10/23 **JAPAN:** In a report Tuesday, Moody's Investors Services says the conversion of the Japan postal savings system to Japan Post Bank (JPB), "will pose diverse potentially systemic and regulatory challenges, but should not pose a danger to the Japanese financial system or the government bond market." With assets of Y232trn (\$2.02trn) and deposits of Y187 trn (\$1.63trn) as of March 2007, JPB will be larger than any of Japan's current megabanks, Moody's says. Its presence will "add a competitive factor" to Japanese banking, "and its entry as a commercial institution into non-JGB markets, if not controlled properly, could introduce a systemic disturbance in the banking system -- although we think this scenario highly unlikely," notes Moody's. The new entity is expected to only diversify gradually, but will "seek higher returns either in private sector securities in Japan or elsewhere, including foreign bonds." JPB is a subsidiary of Japan Post Group, that was only recently privatized (Oct 1).

03:48 10/23 **JAPAN:** Japan Post Insurance (Kampo) plans to manage more directly its stock holdings and invest in a wider range of foreign currencies, but any shift will be gradual. (Rtrs interview)

02:25 10/23 **JGB SUMMARY:** Japanese government bond prices were knocked lower in Tokyo trade Tuesday as Japanese stocks moved higher and took some of the attraction away from bond markets. The Nikkei-225 index of Japanese stocks got off to a firm start, following a recovery on Wall street overnight. This placed some pressure on JGBs from the start of trade, although traders said volumes were generally light. The Nikkei held gains through the session, though retreated in late Tokyo to end just 0.07% higher. JGBs, which had only seen yields rise around one basis point in the session remained steady in late trade, failing to gain any support from the late retreat in the Nikkei, however.
 -- Benchmark 10-year yield was 1 bps higher at 1.595%.
 -- Benchmark 5-year yield was 0.5 bps higher at 1.115%.
 -- Benchmark 20-year yield was unchanged at 2.150%.
 -- Benchmark 30-year yield was 1 bps higher at 2.410%.
 -- The Nikkei 225 ended 12.11 points, or 0.07% higher, at 16,450.58.