



Morning FI Analysis: EGBs Lower Ahead Of Fed, Data 04:08 EDT / Oct 30

LONDON (MNI) - European Government bonds are opening lower on Tuesday, amid profit-taking ahead of plethora of economic releases, slew of Q3 earnings from some major Wall Street houses and most importantly the key 2-day FOMC meeting, which kicks off today.

The market is expecting the Federal Reserve to cut the Fed funds rate by 25bps on Halloween to 4.50%, amid return of credit crunch jitters and liquidity fears after major investment banks announced large writedowns.

"The FOMC does not have an easy choice to make on Wednesday. A case can be made for waiting awhile before cutting rates again. But in the final analysis, in the current environment, a risk-managing group of policymakers is apt to conclude they can afford to err on the side of providing some additional "insurance" against the unlikely, but potentially very costly, chance that the economy could be headed for deeper, more enduring weakness than they expect", writes MNI's Steve Beckner.

Wall Street Journal's Greg Ip writes today that while the market is convinced the Federal Reserve will cut interest rates by at least a quarter-point tomorrow, for the Fed itself, it is a closer call, with the decision between that quarter-point reduction and no cut at all.

"Both courses of action have risks," Ip writes. "Perhaps the biggest is that the market's certainty that rates will be cut creates a burden on the Fed to deliver." But Ip says the Fed can mitigate risks with its accompanying statement. "No rate cut could be accompanied by a statement opening the door to a future cut. A cut could be accompanied by a statement damping expectations of more reductions."

Also this week, the US Treasury will announce new supply that will be sold next week. The market is expecting \$10.0 billion in new 10-year notes and \$6.0 billion in reopened 30-year bonds.

Sweden's Riksbank announces its interest rate decision at 0830GMT and also publishes its Monetary Policy Report (MPR). Markets expect a 25bps rate hike to 4.00%. The last MPR implied rates rising to 4.00% and peaking at 4.25-4.50% -- and most strategists expect the Riksbank to leave these forecasts unchanged given the strong domestic economy and countered by weaker external outlook.

The long-end of the Gilt curve outperformed yesterday, amid speculation that the UK Debt Management Office (DMO) is looking to prepare the market for a reduction in long-dated issuance given the potential cut in gilt sales and the DMO's desire to provide liquidity in the 5- and 10-year sector and in the index-linked programme in FY2008/09.

In a telephone interview, DMO Chief Executive Robert Stheeman told MNI that the DMO will bring forward the annual consultation meeting with market participants, which is usually held in February, to December. Stheeman also rejected the case for syndicated issuance and downplayed the need for a new long conventional gilt next year. Supply this week in the eurozone comes from Italy and Germany -- totalling around E12.5bln vs E6.0bln last week. In addition, this supply is countered by strong reinvestment flows to leave net cash flows positive to the tune of E21.79bln. Redemption payments are due from Spain (4.25% Oct 2007 Bono) for E12.0bln and Italy (6.00% Nov 2007 BTP) for E14.75bln. Coupon payments are from Spain E5.75bln and Italy E1.79bln. Italy yesterday tapped E1.0bln of the 2.10% Sept 2017 BTP issue at average yield of 2.14% and covered 1.869 times

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Italy sells 7-year CCT, 3-year BTP and 10-year BTP issues on Tuesday for E1.5bln, E2.5bln and E2.5bln respectively. Italian bonds have underperformed recently as political jitters return to Italian politics after Justice Minister Mastella -- part of the Centrist Catholic Party, who is being investigated for embezzlement -- and seen impacting on Prime Minister Romano Prodi's majority of one in the Senate. Traders also note Italian public sector workers have also been on strike over pension reforms.

The 4.50% Aug 2010 BTP issue trades at 4.167% or at -25.6bps vs swaps, i.e. richer end of recent range. This auction adds to the E9.0bln current amount outstanding. This issue was last sold on Sept 27 for E2.5bln and then covered 1.54 times. The 4.50% Feb 2018 BTP issue trades at 4.518% or -5.3bps vs swaps, and has cheapened in spread terms vs benchmark 10-year Bund. This auction adds to the current amount outstanding of E7.0bln. This issue was last sold on Sept 27 for E3.0bln and then covered 1.35 times.

Looking ahead, Germany tops-up the Oct 2012 BOBL 151 issue on Wednesday for up to E5.0bln. For full details of forthcoming issues, please see eurozone/UK bond auction calendar & MNI/SMRA Eurozone Net Cash Flow Matrix.

In the UK, the DMO will also announce the size of the Dec 2030 Gilt on Tuesday, which is due to be sold on November 6 - strategists expect the size to be between Stg2.0-2.25bln.

European data starts at 0700GMT with Germany September ILO employment and wholesale sales data, followed at 0745GMT by the France October quarterly industry survey and September housing starts.

Spain October flash HICP is due at 0800GMT, while shortly after, at 810GMT, ECB Governing Council member Erkki Liikanen speaks on "ITC Supporting Productivity, Structural Changes and Knowhow, in Finland.

Sweden's Riksbank announces its interest rate decision at 0830GMT and also publishes its Monetary Policy Report (MPR) - see above. The main German October unemployment report is due at 0855GMT and forecasts are for a m/m change of -30k and an unemployment rate of 8.7%.

Italy September PPI comes shortly after, at 0900GMT. The UK October CBI distributive trades survey is due at 1100GMT.

At 1500GMT, ECB Governing Council member Axel Weber speaks on "European Monetary Policy," in Giessen, Germany, while at 1530GMT, ECB Governing Council member Erkki Liikanen peaks on "Finland, the Bank of Finland and ECB Monetary Policy," in Helsinki.

Late European data at 1800GMT sees the France September registered job seekers expected to come in at -10k.

Also at 1800GMT, BOE's MPC member David Blanchflower speaks at Lancaster University, U.K.

Late US data sees the ABC News/Washington Post weekly survey of US consumer sentiment.

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[Times for Market News International stories are ET]

07:33 10/30 **BUND SUMMARY:** European bond prices are lower on profit-taking ahead of plethora of economic releases, slew of Q3 earnings from some major Wall Street houses and most importantly the key 2-day FOMC meeting, which kicks off today. The market is expecting the Fed to cut the Fed funds rate by 25bps to 4.50%, amid return of credit crunch jitters and liquidity fears after major investment banks announced large writedowns. Bunds attempted a bounce after ECB Wellink exclusively told MNI that stronger economic slowdown expected. However, prices came back under pressure, weighed by Swedish bonds following the expected rate hike from the Swedish Riksbank, but the accompanying Monetary Policy Report (MPR) was hawkish, and said it is "probable that the interest rate will need to be raised slightly further over the coming year." Elsewhere, Italian BTPs underperformed Bunds ahead of the 7-year CCT (cover 1.47), 3-yr BTP (cover 1.416) and 10-yr BTP (cover 1.475) auctions. The 10-year BTP/Bund yield spread rose to +34bps -- widest level since Sept 17.

07:38 10/30 **GILT SUMMARY:** Gilts are lower, and underperformed Bunds as the 10-year Gilt/Bund yield spread widened to +74.7 bps vs +73.6 bps on Monday. The short-dated issues underperformed following comments from Bank of England's Monetary Policy Committee member Kate Barker. The comments come in article published yesterday on the Guernsey Press and Star website, where she is reported to have said that there had not been much change in attitudes since the disruption started in financial markets on August 9. Barker is one of the dovish members of the committee and these comments pour cold water over potential rate cut at next week's meeting. The SONIA swap curve is pricing in around one in five chance of a 25bps rate cut. The long-dated issues continued to outperform, amid LDI demand and on speculation that the UK Debt Management Office (DMO) is looking to prepare the market for a reduction in long-dated issuance and bought forward the annual consultation meeting with market participants to Dec.

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07:38 10/30 **FX:** The dollar ended Tuesday morning marginally firmer against the euro and yen, with traders reporting a relatively quiet session as the market became reluctant to take on additional risk ahead of Wednesday's keenly awaited FOMC rate announcement. Euro-dollar recovered from early session lows at \$1.4374 to go into US trade at \$1.4390, with dollar-yen again running into supply ahead of Y115.00, topping out just shy of Monday's Y114.91 NY high Sterling was trading with a firm tone in late European trade with cable recovering back from early lows of \$2.0566 to post fresh 26-year highs above \$2.0660. Carry trades were the main driving force through Asia and into Europe. Early outflows, prompted by an article on US interest rates in the Wall Street Journal, led to strong sales of sterling-yen, but a reversal of sentiment in the middle of the European morning saw a stronger recovery.

02:57 10/30 **JGB SUMMARY:** Japanese government bonds ended Tuesday's session mixed, with the curve steepening as the front of the curve outperformed ahead of the Bank of Japan and Federal Reserve rate decisions due Tuesday. JGBs were modestly higher from the getgo, helped by weaker domestic stocks. However, prices soon retreated in afternoon trade as stocks rallied. But traders said volumes were light, with many players sidelined ahead of the central bank decisions. Solid demand at the Ministry of Finance's two-year sale supported the front of the curve, while hedge selling ahead of Thursday's 10-year auction helped push the longer-end lower.

-- Benchmark 10-year yield was bps higher at 1.625%.

-- Benchmark 5-year yield was 0.5 bps lower at 1.090%.

-- Benchmark 20-year yield was 1.5 bps higher at 2.210%.

-- Benchmark 30-year yield was 1 bps higher at 2.475%.

-- Lead Sept JGB futures contract was unchanged at 135.04.

07:59 10/30 **LIBOR:** Ongoing compression overnight: for the eleventh consecutive session of lower LIBOR sets, the 3 month LIBOR set 4.87 bps lower at 4.9113%, in 7.25 bps for week.

Meanwhile, 1-month LIBOR set 3.62 bps lower at 4.9113%, in 7.62 bps for week. Net weekly

recap: 3-Month LIBOR 1-Month LIBOR

Oct 22-26	-16.75 bps	-15.75 bps
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