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EMU Bonds Lower; Short End Underperforms On Strong HICP , by Market News , 31 October 2007

LONDON Oct. 31 (MNI) - European bond prices are lower on Wednesday, with the short-dated issues underperforming following release of much stronger than expected eurozone HICP data.The curve flattened on reported month-end duration-extension buying in a strong volume session ahead of the key FOMC rate decision.

The Federal Reserve concludes its two-day meeting today and markets are fully priced for a 25bps rate cut in the key Fed Funds rate to 4.50%, the second cut in as many months amid a return of liquidity concerns after major investment banks announced large write-downs. The accompanying statement will be key to signal any further rate cuts, which are implied in the Fed funds futures strip, which give a 42% chance of another 25bps rate cut by year-end. Bunds fell sharply following release of eurozone preliminary HICP inflation, which accelerated to 2.6% in October from an unrevised 2.1% in September, marking the highest reading since September 2005. The result was well above the median forecast (2.3%) of an MNI survey of 16 economists, none of whom expected an outcome above 2.4%.

Traders reported strong stop-loss selling in the December Bund futures contract, with around 95k contracts sold in the 5 minutes following the eurozone HICP data.Also weighing on Bunds was eurozone unemployment, which fell in September to 7.3% after two months at 7.4%, thus reaching a new all-time low since the series began in 1993. Bunds were further weighed by supply factors, as Germany allotted E4.508bln in the top-up auction of the 4.25% Oct 2012 BOBL 151 at average yield 4.05% and covered 1.7 times.Elsewhere, long-dated Bunds were seen underpinned by month-end demand, given the iBoxx Euro sovereign index extends by +0.10 yrs into November and is higher than the historical average for this time of the year (+0.08 yrs).

In addition, redemption payments due from Spain (4.25% Oct 2007 Bono) for E12.0bln and Italy (6.00% Nov 2007 BTP) for E14.75bln, are seen underpinning European government bonds. Coupon payments are also due from Spain (E5.75bln) and Italy (E1.79bln). In the UK, Gilts are lower and underperforming Bunds in the wake of upbeat UK Nationwide house price data, which showed a rise of 1.1% m/m in October, the highest rise since June. The annual rate of growth was 9.7%. This compares with a 0.7% monthly rise in September, when prices rose 9.0% on the year. Analysts had anticipated a median 0.2% rise on the month and an 8.5% increase on the year.

The 10-year Gilt/Bund yield spread widened to +75.1 bps -- level not seen since September 25. Short-dated Gilts continued to extend their underperformance in the wake of hawkish comments earlier this week from Bank of England's Monetary Policy Committee member Kate Barker, who was 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 her comments pour cold water over a potential rate cut at next week's meeting. The long-dated issues continued to outperform, amid LDI demand and month-end buying, despite the iBoxx sterling index extending by a small +0.03 yrs. The Gilt 2-/10-year yield spread was 0.3 bp flatter at -25.2 bps, whilst the 10-/30-year yield spread was 2.0 bps flatter at -38.6 bps. Dec Gilts are down 37 ticks at 107.36.

In cross-border flows, US Treasuries outperformed against Bunds, as the 10-year UST/Bund yield spread narrowed to +23.0 bps vs +26.0 bps Tuesday -- approaching support at the multi-year low at +21 bps.

European equity markets are higher. In London the FTSE-100 was up 0.44%. In Paris the CAC was higher by 0.53.% and in Frankfurt the DAX was up 0.19%. U.S. index futures are also trading higher. The S&P Dec contract was up by 5.5 points at 1541.5 and the Nasdaq Dec contract was up 7.5 points at 2225.25.

The yield on the 4.00% Sept 2009 Schatz was up 6.3 bps at 4.02%. The yield on the 4.25% Oct 2012 Series 151 Bobl was up 6.2 bps at 4.11%. The yield on the benchmark 4.25% July 2017 Bund was up 3.8 bps at 4.23%. The yield on the 4.25% July 2039 Bund was up 2.5 bps at 4.48%.

Subsequently, the Bund curve traded flatter from Tuesday's close, with the 2-/10-year yield spread at +21 bps vs +23 bps, whilst the 10-/30-year yield spread was at +25 bps vs +26 bps.

[Times for Market News International stories are ET]

08:11 10/31 **LIBOR**: Correction to 7:59 bullet, lower LIBOR sets have continued now for twelve consecutive sessions. Some traders said they've "never seen LIBOR compress at such a rate for so long," positing 3mo LIBOR may be as low as 4.0% by year end "in order to compensate for lower ARM resets."

07:28 10/31 **GILT SUMMARY:** Gilts are lower and underperformed Bunds, in the wake of upbeat UK Nationwide house price data, which showed a rise of 1.1% m/m in October, the highest rise since June, when prices also rose 1.1%. The annual rate of growth was 9.7%. These compare with a 0.7% monthly rise in September when prices rose 9.0% on the year. Analysts had anticipated a median 0.2% rise on the month and an 8.5% increase on the year. The 10-year Gilt/Bund yield spread widened to +75.1 bps -- level not seen since Sept 25. The short-dated Gilts continued to extend their underperformance in the wake of hawkish comments earlier this week from Bank of England's Monetary Policy Committee member Kate Barker. The long-dated issues continued to outperform, amid LDI demand and moderate month-end buying, despite UK, the iBoxx sterling index extending by a small +0.03 yrs. The Gilt 2-/10-year yield spread was 0.3 bps flatter at -25.2 bps, whilst the 10-/30-year yield spread was 2.0 bps flatter at -38.6 bps. Dec Gilts are down 37 ticks at 107.36.

07:15 10/31 **BUND SUMMARY**: Bunds opened little changed ahead of the key FOMC rate decision later this session. The short-dated issues then fell sharply following release of eurozone preliminary HICP inflation data, which accelerated to 2.6% in October from an unrevised 2.1% in September, marking the highest reading since September 2005 (also 2.6%), and coming in much higher than 2.3% expectations. Also weighing on Bunds was eurozone unemployment data, which fell in September to 7.3% after two months at 7.4%, thus reaching a new all-time low since the series began in 1993. Traders reported strong stop-loss selling in December Bund futures contract, with around 95k contracts sold in the 5 minutes following the eurozone HICP data. Bunds were also weighed by supply factors, where Germany alloted E4.508bln in the top-up auction of the 4.25% Oct 2012 BOBL 151 issue at average yield 4.05% and covered 1.7 times. Elsewhere, long-dated Bunds were seen underpinned by month-end demand, with iBoxx Euro sovereign indexindex extending by lge +0.10 yrs.

(Cont.)

07:18 10/31 **JAPAN**: Reported comments from Japanese officials Wednesday,
** FUKUI: BOJ Governor Toshihiko Fukui said,
- Downside risks in long term can be fairly big
- Longer term risk of keeping rates low
- Must not overstress near-term downside risks
- Public's inflation expectations rising
- Watching both CPI, public inflation expectations
- Downside risks to global economy growing
- Uncertainties not necessarily slowing rate hike pac
- Board member Mizuno calls for 25bp rate hike
- No major discord among board on economic outlook
- Must monitor smaller firms hit by high costs
- Japan jobless rate still on downtrend on average
- Most likely scenario is sustained Japan growth

08:00 10/31 **JGB RECAP**: Prices ended lower amid a bull flattener in the 7Y and beyond. Month-end flows pushed the 2-7Y sectors lower while pension accts bought across the curve. Other accts sold the front-end or barbelled out of 5Y and 7Y into the short-end and 20Y and 30Y paper. Receiving in the longer-end also flattened the curve.