

Euro Mkt Summary: EGBs Higher on Risk Aversion, German IFO
by Charanjeev Chana

EGBs were trading higher on risk aversion, with little bias. Bunds held near session highs following the release of weaker than expected September US consumer confidence. EGBs opened higher, taking cue from risk aversion gains in US Treasuries overnight, after wall street stocks closed lower led by financials following the release of the IMF Global Financial Stability Report. Bunds hit morning session highs and the 2-/10-year Bund yield curve steepened following the release of weaker than expected September German IFO data - which posted its fifth consecutive decline. Short dates pared gains on hawkish comments by ECB official Nicholas Garganas, who suggested the ECB would not follow the Federal Reserve in cutting interest rates, saying "in setting our interest rates, we never look at what other central banks are doing." Garganas added that he believed inflation would accelerate towards the end of the year, and any downward impact of the current credit market crunch on economic growth, would be "marginal." In supply news, Italy sold E2.0bln of the June 2009 CTZ, covered 1.45 times.

In the forex markets, the dollar traded mixed against the major currencies. The EUR/USD was at 1.414 (+0.003), cable at 2.019 (-0.007) and USD/JPY at 114.16 (-0.75).

European equities were weaker in afternoon trade. The DAX was trading -0.68%, CAC 40 -1.42% and the FTSE -1.22% on the day. US stocks were also weaker with the S&P 500 -0.52% and the NASDAQ -0.17%.

Gilts were also trading higher, outperforming trade in Europe, whilst short dated Gilts outperformed on the Gilt curve. The move follows dovish comments on Monday evening from BOE MPC member Andrew Sentance, who said the recent wage data and evidence from business surveys have gone some way towards mitigating previously-held concerns about inflationary pressures. Sentance, widely seen as a "hawk", appeared to move more into the dovish camp, stressing that a strong pound had helped to tone down price pressure whilst welcoming the recent decline in CPI inflation in the UK.

10:49 09/25 **GILT 2037 LINKER AUCTION PREVIEW:** The UK Debt Management Office (DMO) is due to tap the 1.125% Nov 2037 index-linked Gilt on Wednesday for Stg900mln nominal size. Following this auction, the total amount outstanding will rise to Stg3.85bln. Breakevens are no longer at historic wide levels, which was the case at the last tap of this issue, and may attract demand for this 3-month lag Gilt. Pension and institutional funds have in the past shown a strong appetite for this issue, and given the duration on the new 30-year linker is considered a better match for long-term liabilities by pension funds, rather than the ultra-long 50-year linker -- decent demand is anticipated, in line with historic results. That said, this issue will be tapped again on Oct 24, a new 30-year linker is due to be sold on Nov 20 and a tap of the 15-year linker is scheduled on Dec 12, i.e. a heavy quarter of linker issuance. This issue was last tapped on June 26 for Stg1.0bln and then covered 1.71 times vs tap on Apr 24 for Stg950mln covered 1.83 times.

10:39 09/25 **ECB LIEBSCHER:** EMU economy still in good shape
- Downward risks to growth are predominant
- ECB must wait and see further developments

GERMAN BOBL AUCTION PREVIEW: Germany is due to sell a new 4.25% Oct 2012 Bobl issue on Wednesday for up to E6.0bln. Grey market pricing is currently at 4.160% or -34.5bps vs swaps. This equates to a 0.5bps premium to the old Bobl 150. This new Bobl is expected to be become the Cheapest-To-Deliver (CTD) into the March 07 contract, and also will be the new 5-year benchmark. In addition, increased expectations for an ECB rate cut is likely to keep demand buoyant. Historic results have been decent. The old Bobl 150 was last sold on June 20 for E5.0bln and was then covered an impressive 2.26 times. Prior to this, the issue was topped-up on May 2 also for E5.0bln and then covered 1.90 times. The average cover ratio for the past 3 auctions is 2.187 times. This new series Bobl 151 is scheduled to be topped up twice more in Q4 -- by E5bln in Oct and by another E5bln in Nov. Based on past issuance practices, the Finanzagentur will presumably launch the Series 152 issue in March 2008.