

**Euro Mkt Summary: EGBs Higher, Wk H/Sales, ECB Lends at Penalty Rate**

by Charanjeev Chana

**EGBs** were trading higher with long dates outperforming. Bunds traded higher, after US new home sales came in below expectations, although better than earlier rumours had suggested. Ahead of homes sales data, US Q2 final core PCE data and weaker than expected initial claims data weighed on Bunds in afternoon trade. Also noted for the decline, was pre-auction short setting in UST's ahead of the \$13bln 5-year note auction. EGBs opened lower on overnight weakness in JGBs following asset allocation trades out of bonds into stocks. Bunds bounced higher in morning trade on reports that the European Central Bank loaned E3.9bln at 5.00% at the 84-day Refi tender on Wednesday - the highest amount of funds issued at its penalty interest rate since October 2004. Hawkish comments by ECB President Trichet then weighed on sentiment; after he said the ECB's baseline scenario remained broadly intact despite the recent financial market turbulence. The market however pared losses ahead of afternoon trade on talk of a sharply weaker than expected outcome for August US new home sales. In supply news, the AFT announced a cut in 2007 medium-term borrowing by E5.0bln to E97.5bln - the lowest financing programme net of buybacks since 2002.

....**In the forex markets**, the dollar traded weaker against the major currencies. The EUR/USD was at 1.416 (+0.003), cable at 2.025 (+0.009) and USD/JPY at 115.48 (-0.09).

**European equities** were stronger in afternoon trade. The DAX was trading +0.59%, CAC 40 +0.85% and the FTSE +1.09% on the day. US stocks were also stronger with the S&P 500 +0.32% and the NASDAQ +0.34%.

**Gilts** were also trading higher, but underperforming trade in Europe on stronger than expected September house price data from the Nationwide. However, underpinning Gilts on Thursday was a stark warning from the OECD, which warned, "The outlook for both growth and inflation [for the UK] has now become more uncertain and there is a risk that growth will become weaker going forward, which could imply a need for interest rate reductions." The market was unchanged in wake of September CBI distributive trades data, which reported UK retail sales falling to their lowest level since last November - inline with consensus forecasts...

**European Banks Tap ECB Lending Facility**

By NINA KOEPPEN and NIKKI HOUSTON

September 27, 2007 7:00 a.m.

[Source: Wall Street Journal]

FRANKFURT -- Banks unexpectedly borrowed close to €3.9 billion (\$5.51 billion) in overnight funds at a penalty rate of 5.00% Wednesday, indicating that financial-market conditions remain tense, data from the European Central Bank showed Thursday.

The heavy use of the marginal lending facility -- the highest since October 2004, when banks borrowed €7.9 billion -- surprised money-market dealers, as it is regarded as lending of last resort.

**WSJ Headlines**

-The OECD said the **Bank of England** may have to cut its key bank rate if the recent turmoil in global financial markets has a negative impact on U.K. economic growth.

-**U.K. banks** cut lending during the third quarter and are expected to do so more sharply in the fourth quarter, a Bank of England survey found.

[Source: Wall Street Journal]



07:15 09/27 **GILT SUMMARY:** Gilts are higher, with the belly of the curve underperforming the wings. However, Gilts underperformed Bunds after Nationwide house price survey showed that UK monthly house prices accelerated in September, despite the credit crunch, coming in well above analysts' median forecast. Three monthly growth in house prices, however, slowed to its lowest level since July 2006, supporting the view the trend is still one of easing UK housing market inflation. The Nationwide survey showed prices rose 0.7% on the month in September, with the annual rate falling back to 9.0% from 9.6% in August. The September outturn was well above analysts' median forecast for a 0.3% monthly and an 8.7% year-on-year outturn. The Gilt 2-/10-year yield spread was 0.2 bps steeper at -9.4 bps, whilst the 10-/30-year yield spread was 0.6 bps flatter at -41.5 bps. Dec Gilts are unchanged at 106.55.

07:07 09/27 **UK: Data released** in the UK Thursday,

\*\* BOE: No lending via Special Lending Facility on Wednesday.

\*\* UK DATA: July Services Output Steady At 1.0% 3m/3m

- UK July Services Output Up 0.3% m/m; Up 4.4% y/y

- UK Services Output Up 1.0% In 3 Mths To July Versus Previous 3 Months

- UK Q2 Output Per Worker Up 2.7% y/y

- UK July Services Output y/y Rise Largest Since May 2006

\*\* Sep House Price Rise Above Expectations - Nationwide

- Nationwide: UK Sep House Prices Rise 0.7% m/m; Up 9.0% y/y

- Nationwide: UK Sep 3M/3M House Prices Up 1.6%; Lowest Since July 2006

\*\* BBA Aug mortgage approvals 61,051 vs 66,965 July

- AUG remortgaging approvals 62,970 vs 68,814 July.

\*\* Inflation expectations rise to 2.6% in Sep from Aug-Citigroup/YouGov

\*\* Sep UK Retail Sales Weaken As Expected - CBI

- UK CBI Dist. Trades: Sep Sales Vol Balance +12% Vs +15% Aug

06:53 09/27 **EUROZONE:** Data released in the eurozone Thursday,

\*\* ECB: Aug EMU sa M3 growth 11.6% y/y; MNI median 11.6%

- Aug EMU sa private loan growth 11.2% y/y; July 11.0%

\*\* GERMANY: Germany Sep s/adj jobless -50,000 m/m, rate 8.8%

- Sep unadj jobless total 3.543 mln; s/adj 3.694 mln

\*\* GERMANY: Sept. CPI in the German state of Saxony +0.3% m/m -- above all forecasts in an MNI survey of analysts (median: flat). The annual inflation rate surged to +2.6% from August's +2.0% reading.

\* Brandenburg Sep CPI +0.2% m/m, +2.4% y/y; Aug +1.9% y/y

\* Hesse Sep CPI +0.3% m/m, +2.3% y/y; Aug +1.6% y/y

(cont.)

07:08 09/27 **BUND SUMMARY:** Bunds opened lower, taking their cue from weakness in Japanese Government Bonds overnight amid asset-allocation trades into stocks. Traders cited technical selling in Sept Bund contract following break below key Fibonacci level at 112.19. However, Bunds recovered poise after reports circulated that the European Central Bank yesterday loaned E3.9bln at 5.00% at the 84-day Refi tender -- the most money at its penalty interest rate since October 2004. No further details about who asked for the money from the ECB. In addition, Bunds moved higher after report from the German Labour Office, which said the number of jobless fell by s/a 50k in Sept to 3.694 million vs 20k fall forecast. Prices eased lower after ECB Trichet said that the ECB's baseline scenario for growth in the 13-country zone remains broadly intact. However, prices turned higher after Euro 3-month Libor was fixed at 4.78688% -- highest fix since May 9, 2001. Traders reported strong receiving interest in long-dated issues. 10/30-yr spread 1bps flatter.

06:59 09/27 **JAPAN: Reported comments from Japanese officials** Thursday,

\*\* BOJ SUDA: Comments from BOJ board member Suda:

- Japan rate hikes every 6 months not too slow

- US subprime crisis not hurting real econ so far

- US housing market correction to last until late 2008

- US '08 growth outlook may be lowered but not serious

- To watch subprime influence on confidence in Japan

- Capex may be hurt by raw material costs

- Recently concerned about health of smaller forms

- No need to change outlook, overall Japan capex up

- But capex may be hit by high material cost

- Need to hike rates early on signs of unstable prices

- Monetary policy not bound by other banks' actions

- Forward looking gradualism desirable for Japan

06:50 09/27 **FX:** Euro-dollar again extended recent gains in European morning, though on this occasion the move was marginal as the pair edged up through Wednesday's \$1.4163 high to \$1.4166 in early dealing. Euro-yen demand aided the move, with carry trades benefiting across the board, though gains in dollar-yen were contained ahead of Wednesday's NY high as the pair got caught between the renewed appetite for carry versus the weakertone in the greenback. Euro-yen pushed through Wednesday's highs to trade just shy of Y163.80, while Eastern European demand for sterling drove cable up to early highs of \$2.0247. The move allowed euro-sterling to dip back under stg0.7000, but was contained above stg0.6990. Cable was trading off highs ahead of the New York open but remained buoyed above \$2.0200.