FIXED INCOME RESEARCH

Global Markets Weekly

August 25, 2008

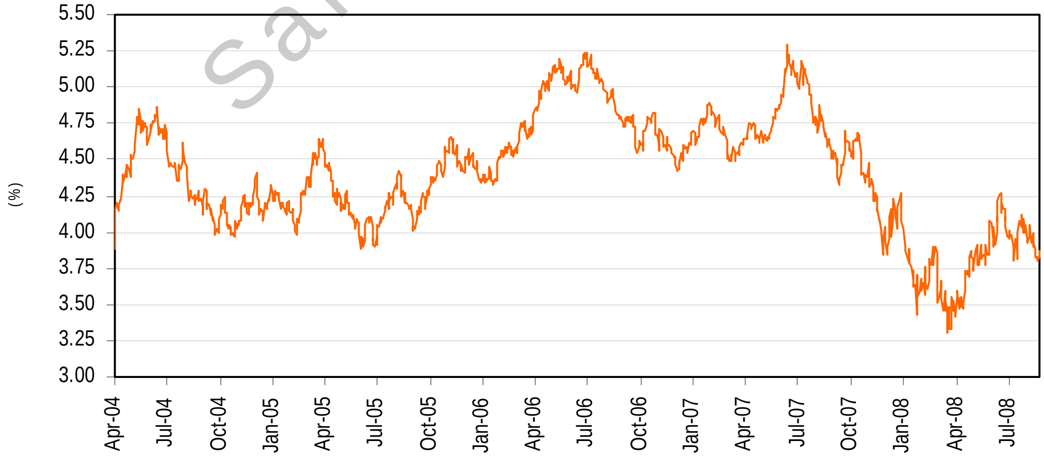
Namrata Padhye
+91 22 66177922
namrata@idbigilts.com

United States

Yields Harden on Jobless Claims and Fed Comments

The Treasury market traded on a bullish note in the earlier part of the week tracking re-emergence of concerns over the financial health of mortgage houses like Fannie Mae and Freddie Mac. The data on housing sector too was considerably week. Moreover, concerns over the health of UK economy, also boosted the demand for Treasuries. These events led the yields to ease across the curve, especially sharply at the shorter tenors. However, the yield movement reversed course tracking lower than expected reading on jobless claims. The yields were also hurt by comments from Fed Chairman Ben Bernanke at the close of the week, whereby he mentioned that the central bank remained "committed to achieving medium-term price stability and will act as necessary to attain that objective". Nonetheless, while presenting the outlook he also stated the economy would remain weak with the pace of growth likely to fall short of potential for a time" and inflation was largely expected to "moderate later this year and next year".

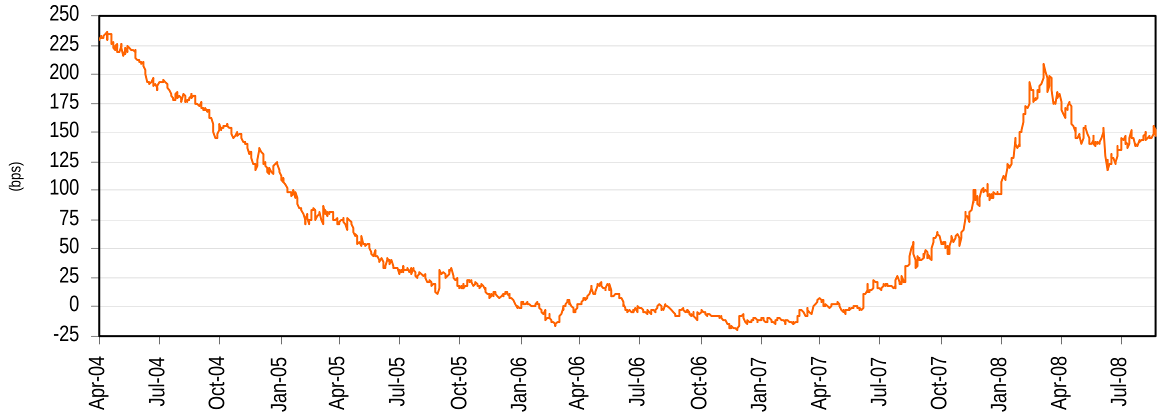
Figure 1: US 10Y Treasury yield



Source: IDBI Gilts Limited, Bloomberg

The benchmark 10Y treasury yield closed at 3.87%, a hardening of 4bps over the week. The 10-year yield had eased to 3.80% levels during the course of the week. At the short end of the curve, the 2Y treasury yield ended higher by 2bps at 2.40%. The 5Y treasury yield closed 4bps higher at 3.14%. The 30Y treasury yield closed largely rangebound at 4.47%.

Figure 2: US 2Y-10Y Spread



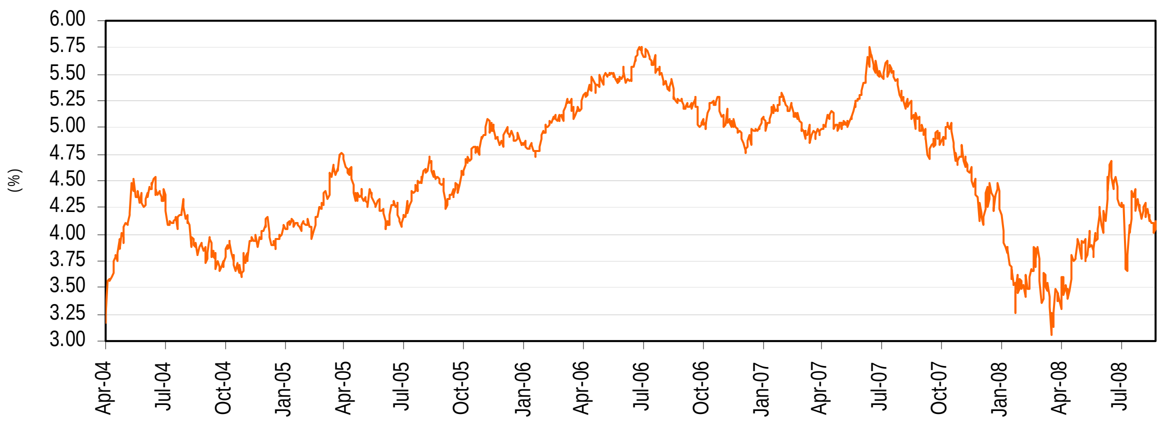
Source: IDBI Gilts Limited, Bloomberg

The US yield curve ended largely stable at the short end over the week. The yield curve had steepened considerably during the course of the day. The 2Y - 10Y spread is currently at 147bps; the spread had widened to 156bps during the course of the week. At the longer end, the yield curve flattened over the course of the week. The 10Y - 30Y spread closed at 60bps, a contraction of 3bps.

Swap Rates Rise at Short End

The USD Libor swap rates hardened slightly at the short tenors over the course of the week, while closing rangebound at longer end. This led the swap curve to flatten over the course of the week. The 3Y swap rate closed the week higher by 3bps at 3.74%. The 5Y swap rate closed at 4.13%, a rise of 3bps. At the longer end of the swap curve, the 10Y swap rate ended rangebound at 4.58%.

Figure 3: 5Y Libor Swap Rate

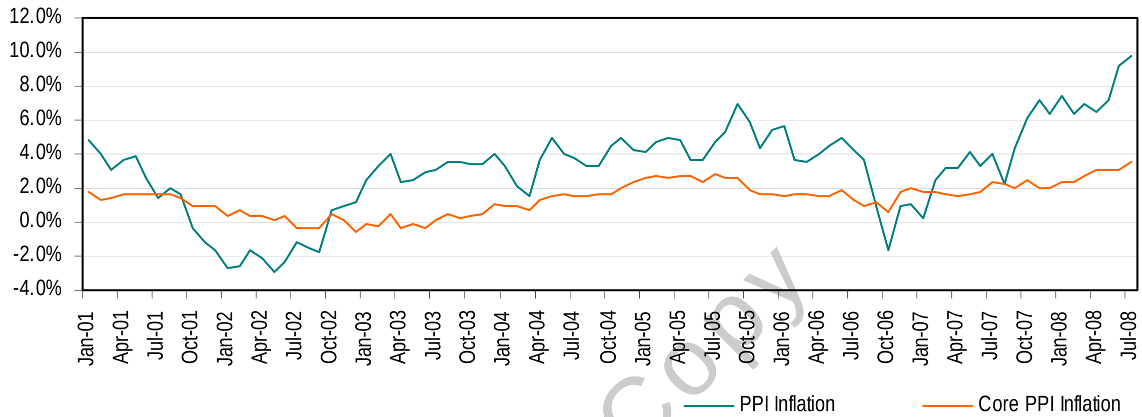


Source: IDBI Gilts Limited, Bloomberg

Economic Data

Inflation based on PPI for July was noted at 9.8% higher than consensus estimates of 9.3%. This inflation reading was the highest in 27 years. The core PPI inflation for July was noted at 3.5% higher than market expectations of 3.2%.

Figure 4: Inflation based on Producer Price Index



Source: IDBI Gilts Limited, Bloomberg

The Housing Starts for July was noted at 965,000 higher than market expectations of 960,000. The figure for the previous month was revised upwards from 1.066 million to 1.084 million. The Building Permits for July was noted at 937,000 lower than market expectations of 970,000. The figure for the previous month was revised higher from 1.138 million to 1.091 million.

The Initial Jobless Claims for the week ended 17 August 2008 were noted at 432,000 that was lower compared to 440,000 as expected by analysts.

The Philadelphia Fed Business Outlook Survey for the month of August was noted at negative 12.7, an improvement from a reading of negative 16.3 seen previous month. The Leading Indicators Index for July noted a decline of 0.7%, higher compared to a fall of 0.2% as per the consensus analyst estimate.

Outlook

Economic Data releases scheduled during the course of the week are; Existing & New Home Sales, Durable Goods Order, Provisional GDP estimate for second quarter, Personal Income & Spending, PCE Deflator, etc.

The Dec 08 Fed Funds Futures is currently trading at 97.94. The futures imply a Fed Funds rate of 2.06%. The Fed Funds futures indicate that larger segment of the market expects the Fed to maintain interest rate at the current level of 2.0% till end 2008.

Table 1: Data Releases in the Current Week

Date	Indicator	For the Period	Analyst Estimates	Prior
25/8/2008	Existing Home Sales	JUL	4.91M	4.86M
26/8/2008	Consumer Confidence	AUG	53	51.9
26/8/2008	New Home Sales	JUL	525K	530K
26/8/2008	House Price Index MoM	JUN	-0.40%	-0.30%
27/8/2008	Durable Goods Orders	JUL	0.00%	0.80%
28/8/2008	GDP QoQ (Annualized)	2Q P	2.70%	1.90%
28/8/2008	GDP Price Index	2Q P	1.10%	1.10%
29/8/2008	PCE Deflator (YoY)	JUL	4.50%	4.10%
29/8/2008	Chicago Purchasing Manager	AUG	50	50.8
29/8/2008	U. of Michigan Confidence	AUG F	62	61.7

Source: IDBI Gilts Limited

Table 2: Meeting Schedule of the Federal Open Market Committee

Date	Fed Funds Rate	Change	Economic Assessment	Monetary Policy Stance
30-31 January 07	5.25%	–	Balanced	Data Dependent
20-21 March 07	5.25%	–	Balanced	Data Dependent
9 May 07	5.25%	–	Balanced	Data Dependent
27-28 June 07	5.25%	–	Balanced	Data Dependent
7 August 04	5.25%	–	Balanced	Data Dependent
18 September 07	4.75%	- 0.50%	Balanced	Easing
30-31 October 07	4.50%	- 0.25%	Balanced	Easing
11 December 07	4.25%	- 0.25%	Growth Concerns	Easing
22 January 08*	3.50%	- 0.75%	Growth Concerns	Easing
29-30 January 08	3.00%	- 0.50%	Growth Concerns	Easing
18 March 08	2.25%	-0.75%	Growth Concerns	Easing
29-30 April 08	2.00%	-0.25%	Balanced	Easing
24-25 June 08	2.00%	–	Balanced	Data Dependent
5 August 08	2.00%	–	Balanced	Data Dependent
16 September 08				
28-29 October 08				
16 December 08				

* Inter-meeting

Source: IDBI Gilts Limited, Bloomberg

United Kingdom

BoE Minutes - Two members dissent

The Bank of England's Monetary Policy Committee was divided over its decision to maintain Bank Rate at 5.0% at its meeting held on 6&7 August 2008. The committee voted 7-2 to hold interest rates at this juncture. One member, Tim Besley, preferred an increased of 25bps since for him, the risk of inflation was more persistent than in central projection. Moreover, "a pre-emptive increase in Bank Rate would held to keep inflation expectations anchored to the target and lessen the need for more restrictive policy in the future. Another member, David Blanchflower, preferred a reduction of 25bps at this juncture. According to him, "the downside risks to activity growth were greater than the majority view expressed in Inflation Report." The member felt that "there was less risk of inflation being persistent and more risk of undershooting the inflation target in the medium term", which warranted an immediate cut in the Bank Rate.

Economic Indicators

Rightmove House Prices for the month of August noted a decline of 4.8%, higher than a fall of 2.0% noted previous month.

Retail Sales for month of July rose by 2.1%, slightly higher than 1.8% as per consensus analyst estimates. However, the reading was lower compared to 2.2% seen previous month.

The provisional estimate for the GDP growth in second quarter was noted at 1.4% (y-o-y), lower than 1.5% as per consensus analyst estimate. However, GDP growth q-o-q was estimated at 0%.

Table 3: Official Rates in Select Countries

Country	Benchmark	Rate	Last Change	Date of Change
USA	Fed Funds Rate	2.00%	-0.25%	30-Apr-08
UK	Official Bank Rate	5.00%	-0.25%	10-Apr-08
Euro Area	Repo Rate	4.25%	0.25%	3-Jul-08
Japan	Uncollateralized Overnight Call Rate	0.50%	0.25%	21-Feb-07
Australia	Cash Rate Target	7.25%	0.25%	4-Mar-08
New Zealand	Official Cash Rate	8.00%	-0.25%	24-Jul-08
Canada	Overnight Rate	3.00%	-0.50%	22-Apr-08
Switzerland	3M CHF LIBOR Ceiling	3.25%	0.25%	13-Sep-07
India	Repo Rate	9.00%	0.50%	29-Jul-08

Source: IDBI Gilts Limited

IDBI Gilts Limited (A wholly owned subsidiary of IDBI Ltd.)
1st Floor, Janmabhoomi Bhavan, Janmabhoomi Marg, Fort, Mumbai – 400 001.
Phone: (91-22) 6617 7900. Fax: (91-22) 66177999