

# Global Markets Weekly

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**FOMC reiterates its concern over "elevated" levels of core inflation in the economy**

## Treasury Yields Hardened Over the Week

The Federal Open Market Committee, at its meeting held on 12 December 06, decided to maintain the target Fed Funds rate at 5.25% for a fourth consecutive time. In a related move, the Federal Reserve also kept the Federal Discount Rate at 6.25%. One of the Committee members, Jeffery M. Lacker, dissented and preferred an increase of 25bps in the Fed Funds Rate. The Committee mentioned that the economy seemed "likely to expand at a moderate pace on balance over coming quarters", despite visible cooling in the housing market. The Committee remained apprehensive over "elevated" levels of core inflation in the economy. Moreover, the high level of resource utilization held "potential to sustain inflation pressures".

The US Treasury market opened higher in the backdrop of FOMC maintaining interest rate at 5.25%. The sentiment reversed and yields hardened upto 10bps post data releases that hinted at existence of buoyancy in the economy. The data on Import Price Index, Advance Retail Sales, and regional manufacturing was substantially stronger than market expectations. However, the Treasuries ended on a positive note tracking lower reading on Consumer Price inflation data. The market continues to remain cautious over the outlook on monetary policy.

The benchmark 10Y treasury yield closed higher over the week at 4.59%. At the short end of the curve, the 2Y treasury yield rose by 5bps to end at 4.72%. The 5Y treasury yield too hardened to 4.57% from 4.52% seen last week. The 30Y treasury yield closed higher by 6bps at 4.71%.

Figure 1: US 10Y Treasury yield

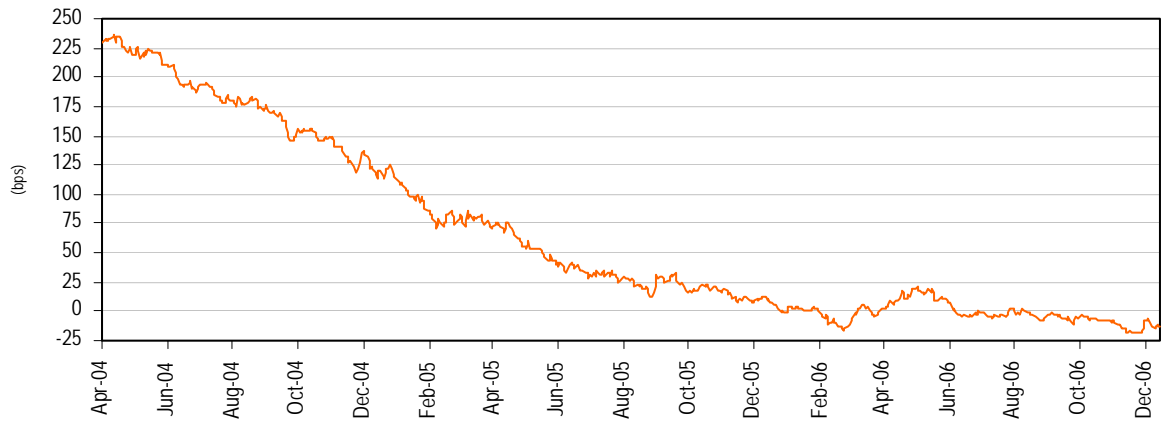


Source: Bloomberg

**10Y-30Y spread currently at 12bps**

The US yield curve remained steady over the week in the wake of term spreads remaining rangebound. The 2Y - 10Y spread is currently at negative 12bps. The 2Y-30Y spread closed at negative 1bps.

Figure 2: 2Y-10Y Spread



Source: Bloomberg

### Swap Rates Rise

Swap rates tracked hardening of US Treasury yields

The USD Libor swap rates hardened by 3bps across the maturity spectrum. The swap rates escalated in the wake of rise in US Treasury yields and subsequent paying pressure in the market. The 3Y and 5Y swap rate closed the week higher at 4.98% each. At the longer end of the swap curve, the 10Y swap rate ended at 5.07%.

Figure 3: 5Y Libor swap rate



Source: Bloomberg

### Economic Data

Import Price Index rose unexpectedly by 1.2% in November

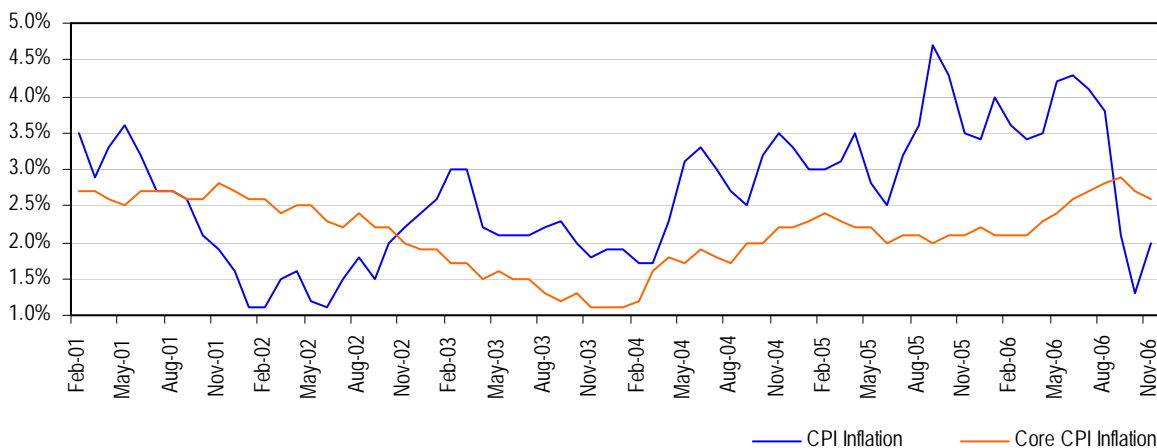
Trade Deficit for the month of October narrowed to USD 58.9 billion, from USD 64.3 billion noted previous month. Import Price Index for the month of November depicted a rise of 1.2%, as compared to a decline of 0.9% (revised) seen a month back. The inflation based on Consumer Price Index for the month of November was at 2.0%, tamer than consensus analyst estimates of 2.2%. The Core CPI inflation was at 2.6%, mildly lower than 2.7% seen a month back.

Figure 4: US Trade Deficit



Source: Bloomberg

Figure 5: Inflation based on Consumer Price Index



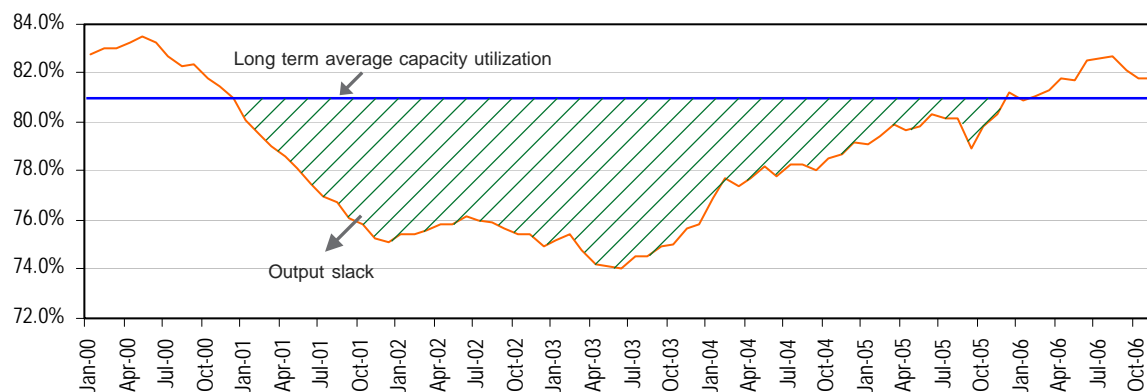
Source: Bloomberg

Initial Jobless Claims for the week ended 10 December 2006 were noted lower at 304,000, as compared to 324,000 (revised) seen previous week. Continuing Claims for the week ended 3 December 2006 were also seen lower at 2.47 million, against 2.51 million (revised) seen previous week.

Capacity Utilization continues to remain above average

Industrial Production for November noted a growth of 0.2%, higher than consensus analyst expectations of a 0% growth. Capacity Utilization for November was at 81.8%, marginally lower than analyst estimates of 82.1%. Empire Manufacturing Index for the month of December rose substantially to 23.1, when compared to analyst estimates of 17.7.

Figure 6: Capacity Utilization & Output Slack

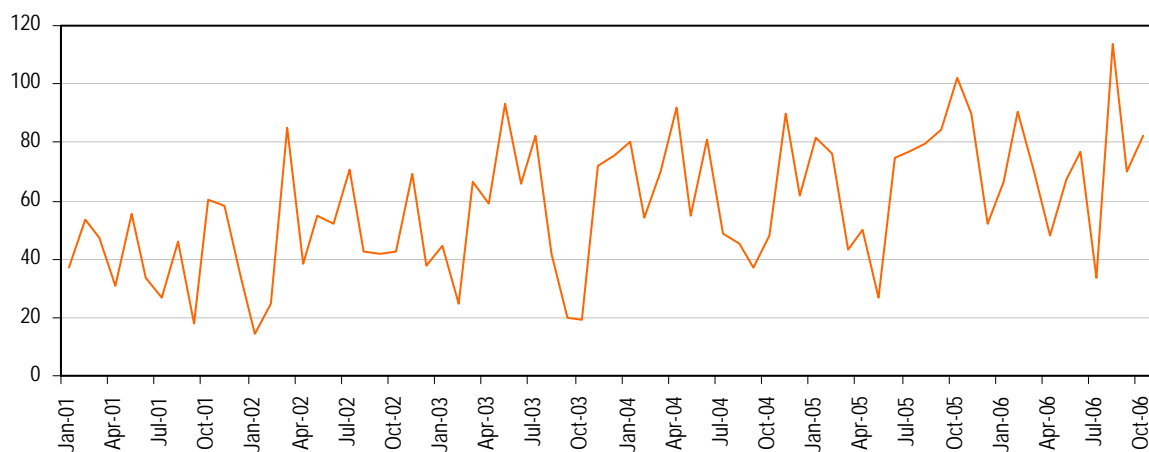


Source: Bloomberg

Wholesale inventories for October rose by 0.8%, stronger than expectations of 0.6%. Business inventories for October too depicted a healthier rise of 0.4%, against 0.3% (revised) seen previous month. Advance Retail Sales for the month November rose sharply by 1.0%, as compared to a decline of 0.1% (revised) seen previous month.

The Net Long Term TIC flows for October were at USD 82.3 billion, considerably higher than USD 70.2 billion seen previous month.

**Figure 7: Net Long-term TIC Flows**



Source: Bloomberg

## Outlook

Important economic data releases are also scheduled during the week. These include data on Inflation based on PPI, Housing Starts & Building Permits, GDP, PCE Deflator, etc. Market will closely watch these data releases for further cues on the economy.

The Mar 07 Fed Funds Futures is currently trading at 94.75. The futures imply a Fed Funds rate of 5.25%. The Fed Funds futures, thus, indicated that the market expects Fed to maintain interest rates till first quarter of 2007.

**Table 1: Data Releases in the current week**

Date	Indicator	For the Period	Analyst Estimates	Prior
18/12/2006	Current Account Balance	3Q	-\$225.0B	-\$218.4B
19/12/2006	Producer Price Index (YoY)	NOV	-0.60%	-1.60%
19/12/2006	Housing Starts	NOV	1540K	1486K
19/12/2006	Building Permits	NOV	1540K	1535K
21/12/2006	GDP Annualized	3Q F	2.20%	2.20%
21/12/2006	GDP Price Index	3Q F	1.80%	1.80%
21/12/2006	Initial Jobless Claims	17-Dec	315K	304K
21/12/2006	Continuing Claims	10-Dec	2480K	2477K
21/12/2006	Leading Indicators	NOV	0.10%	0.20%
21/12/2006	Philadelphia Fed Business Outlook Survey	DEC	3.8	5.1
22/12/2006	PCE Deflator (YoY)	NOV	1.90%	1.50%
22/12/2006	Durable Goods Orders	NOV	1.50%	-8.30%
22/12/2006	University of Michigan Survey of Consumer Confidence	DEC F	90.2	90.2

Source: Bloomberg

Table 2: Meeting Schedule of the Federal Open Market Committee

Date	Fed Funds Rate	Change	Economic Assessment	Monetary Policy Stance
1-2 February 05	2.50%	+ 0.25%	Balanced	Tightening
22 March 05	2.75%	+ 0.25%	Balanced	Tightening
3 May 05	3.00%	+ 0.25%	Balanced	Tightening
30 June 05	3.25%	+ 0.25%	Balanced	Tightening
9 August 05	3.50%	+ 0.25%	Balanced	Tightening
20 September 05	3.75%	+ 0.25%	Balanced	Tightening
1 November 05	4.00%	+0.25%	Balanced	Tightening
13 December 05	4.25%	+0.25%	Balanced	Tightening
31 January 06	4.50%	+0.25%	Balanced	Tightening
27-28 March 06	4.75%	+0.25%	Balanced	Tightening
10 May 06	5.00%	+0.25%	Balanced	Data Dependent
28-29 June 06	5.25%	+0.25%	Balanced	Data Dependent
8 August 06	5.25%	–	Balanced	Data Dependent
20 September 06	5.25%	–	Balanced	Data Dependent
24-25 October 06	5.25%	–	Balanced	Data Dependent
12 December 06	5.25%	–	Balanced	Data Dependent

Source: IDBI Capital Fixed Income Research

Table 3: Official Rates in Select Countries

Country	Benchmark	Rate	Last Change	Date of Change
USA	Fed Funds Rate	5.25%	0.25%	29-Jun-06
UK	Official Bank Rate	5.00%	0.25%	09-Nov-06
Euro Area	Repo Rate	3.50%	0.25%	07-Dec-06
Japan	Uncollateralized Overnight Call Rate	0.25%	0.25%	14-Jul-06
Australia	Cash Rate Target	6.25%	0.25%	08-Nov-06
New Zealand	Official Cash Rate	7.25%	0.25%	08-Dec-05
Canada	Overnight Rate	4.25%	0.25%	24-May-06
Switzerland	3M CHF LIBOR Ceiling	2.25%	0.25%	14-Sep-06
India	Reverse Repo Rate	6.00%	0.25%	25-Jul-06

Source: IDBI Capital Fixed Income Research

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