



WEEK ENDING

09 SEP

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Global Market Review

Liquidity

US Taxable

This was an extremely light, holiday-shortened week for economic data. The Institute for Supply Management (ISM) non-manufacturing report for August surprisingly edged higher—the first increase since May—to 53.3 (estimate: 51) from 52.7. The employment component posted a modest decline, while new orders posted a slight increase. Elsewhere, initial jobless claims rose by 2,000, to 414,000, in the week ending September 3, raising the four-week moving average by 4,000, to 415,000.

In a prepared speech, US Federal Reserve (Fed) Chairman Ben Bernanke noted that the recovery has been weaker than the Fed had predicted and that the downside risks to the economy remain substantial; however, he remained optimistic that growth would pick up in the coming months and that inflation would moderate. Bernanke reiterated the wide range of tools that the Federal Open Market Committee (FOMC) has available to provide additional stimulus; he said that policymakers would certainly discuss these options at the upcoming September FOMC meeting. The Beige Book showed that the US economy had grown at a slower pace, with some districts noting “mixed or weakening activity.” The report also indicated that labor markets were steady, with no real pressure on wages.

Short-term interest rates were modestly higher, as three- and six-month LIBOR each rose by 1 basis point (bps) on the week, to 0.34% and 0.49%, respectively. The LIBOR/OIS spread continued to rise, climbing 2 bps on the week to 0.26%, as European banking concerns persisted.

US Tax Exempt

Tax-exempt money fund assets were up \$1.70 billion this week, bringing the total assets to \$296.96 billion. The Securities Industry and Financial Markets Association (SIFMA) Index dropped 3 basis points (bps) to 0.15%, as dealers have been able to reduce their balances of Variable-Rate Demand Notes (VRDNs). There’s been

a lot of money floating around the tax-exempt space due to maturing Texas tax- and revenue-anticipation notes (TRANs) and the new Texas TRAN deal being held on a broker-dealers balance sheet. Over 93% of the \$9.8-billion deal was taken down by one dealer, J.P. Morgan, and the vast majority of that paper continues to be held on that dealer’s balance sheet. The dealer created and issued two tender-option bonds (TOBs) this week totaling \$200 million with its position. We expect to see more of TOBs coming to market as the dealer attempts to work down its sizable balance. VRDNs backed by European banks continued to be priced at a significant spread to SIFMA. The amount of spread varies depending on which bank is providing liquidity. We had a fairly robust new-issue calendar for a holiday-shortened week, with \$403.737 million getting priced across 36 deals. The largest deal was brought to market by Connetquot Central School District of Islip, N.Y. (Aa2), which sold \$43.8 million of TRANs, maturing on June 28, 2012, priced to yield 0.42%. The Municipal Market Data AAA One-Year Index was unchanged at 0.22%.

Eurozone

Eurozone		Change (bps)	09 Sep 11	02 Sep 11
LIBOR:	1 Month	-1	1.29	1.30
	3 Month	0	1.48	1.48
	12 Month	-2	2.03	2.05
	Slope (1-12 Month)	-1	75	75
OIS/LIBOR Spread:	3 Month	11	76	65
Swap Spread:	2 Year	4	97	93
	5 Year	6	99	93
Govt Bonds:	2 Year	-13	0.40	0.52
	10 Year	-20	1.81	2.01
	Slope (2-10 Year)	-7	142	149

Current Market Pricing for Key Policy Rate: Market consensus rate increase in 3Q12

Source: Bloomberg

As had been widely expected, the European Central Bank (ECB) Governing Council at its September 8 meeting left the official interest rate unchanged at 1.5%. Following the meeting, attention turned to the introductory statement by ECB President Jean-Claude Trichet. The statement was more dovish than expected, referring to inflation risks as broadly balanced while

emphasising that growth risks were to the downside. The ECB's macroeconomic projections for midpoint GDP growth for June 2011 and June 2012 were revised downward, while inflation projections were unchanged for the same period. The takeaway from the meeting caused the market to price in an easing bias by the ECB.

The eurozone purchasing managers index (PMI) composite was finalised at 50.7 in August from 51.1 in July; the decline in the composite was driven solely by the dip in the manufacturing PMI. The Sentix Investor Confidence Index reported further deterioration, falling to -15.4 in September from -13.5 in August. The second estimate of the 2Q11 Eurostat eurozone GDP was unchanged from the preliminary estimate of 0.2% quarter-over-quarter (QoQ). Retail sales activity eased over the month of July, increasing by 0.2% month-over-month (MoM) following a 0.7% MoM (revised) increase in June. In Germany, industrial production (IP) bounced back strongly in July, by 4.0% MoM, after declining by 1.0% (revised) in June.

UK

United Kingdom		Change (bps)	09 Sep 11	02 Sep 11
LIBOR:	1 Month	1	0.67	0.66
	3 Month	2	0.90	0.89
	12 Month	2	1.67	1.65
	Slope (1-12 Month)	1	100	99
OIS/LIBOR Spread:	3 Month	3	39	37
Swap Spread:	2 Year	0	69	69
	5 Year	0	51	51
Govt Bonds:	2 Year	-2	0.53	0.55
	10 Year	-14	2.30	2.44
	Slope (2-10 Year)	-12	177	189

Current Market Pricing for Key Policy Rate: Market consensus rate increase in 3Q12

Source: Bloomberg

Economic data releases over the week were soft. After remaining flat in June, IP declined by 0.2% in July. While manufacturing production was stronger than expected over the period, declines in utilities, and mining and quarrying drove the headline IP lower. The PMI services fell significantly to 51.1 in August from 55.4 in July—the largest decline since April 2001. The British Retail Consortium (BRC) reported that on a like-for-like basis, August retail sales were 0.6% lower year-over-year (YoY) than August 2010 figures. The BRC also reported that overall shop-price inflation slowed to 2.7% YoY in August from 2.8% YoY in July.

The National Institute of Economic and Social Research estimated that GDP output grew by 0.2% in the three months through August after growing 0.6% in the three months through July. The producer price index (PPI) revealed some easing in price pressures due to a drop in energy costs. PPI input declined by 1.9% MoM in August after increasing 0.5% MoM (revised) in July, while PPI output saw its smallest increase this year, to 0.1% MoM from 0.3% MoM (revised) over the same period. Also, the Bank of England's Monetary Policy Committee met on September 8 and left the key base rate unchanged at 0.5% and the asset purchase target unaltered at £200 billion.

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