U.S. Daily Directions: March 4, 2008, NY Edition

Today: **FedSpeak, same-store sales, ABC Consumer confidence.** FedSpeak includes Bernanke (foreclosures), Fisher (voter, inflation/growth), and Mishkin (voter, economy). The weekly same-store sales are not forecast, but both the ICSC and Redbook measures have trended (13-wk mvg avg) towards their weakest rates since 2003. The ABC consumer confidence index is not forecast, but has recently stabilized at its weakest level since 1993.

Overnight: **Berry does damage control, Citi needs more money, euro worries European officials, ICICI.** Columnist John Berry's article attempts to "do" damage control, suggesting accounting rules are exaggerating bank losses and that the banking sector remains strong. However, he concedes that Bernanke himself indicated that the mark to market requirements prevent allowing losses to build, and ignores not only that banks are widely estimated to take an order of magnitude greater losses, but also that the "strong" banking sector is bracing for hundreds of bank failures in coming quarters. The head of Dubai International Capital has gone on record to state that Citigroup, which has already received cash transfusions totaling $22bn, will require "a lot more capital" to be rescued. With the dollar collapsing as a result of the financial system crisis, European officials are taking note of the deleterious effect of the record-strong European currency. India's 2nd-largest largest bank, ICICI, reported a $264mm writedown related to the credit crisis. This development provides further evidence of the global scope of the credit crisis and the global investor pullback from US securities.

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields narrowly mixed.** Yields ranged from -0.5bp - +1.75bp. The strip now suggests a trough in the fed funds rate between 2.00% and 2.25% in Sep'08. We retain our view that the Fed will cut the overnight rate to 2.00% by Q2'08. As to the March Fed meeting, the futures price in not only a 50bp cut, as we expect, but also significant chance of a 75bp cut.

Treasuries: **Overnight, yields lower, curve steeper.** Yields rose early in Asia along with equities in reaction to the HSBC earnings, but have fallen hard in European trading as equities fell sharply (the Dow futures are down 82). The 2yr yield is off 1.6bp to 1.61%, and it appears to be consolidating near multi-year lows. The 10yr yield is off 1.7bp to 3.53%. This yield also appears to be consolidating after correcting lower from the Jan-Feb rebound, although it remains above the Jan23 low of 3.285%. We believe the short-end can continue to make new multi-year lows as financial losses mount and the economy falls further, but that the long end will at least lag, if not leak higher, due to ongoing inflation pressures and fear that the Fed will let inflation get out of control. Our 2s30s steepener (entry 268bp, stop-loss at 255bp, initial target of 300bp) rose 1.3bp to 281bp.

Swaps: **Yesterday, spreads under pressure, led by the short end.** The 2/10 spread curve finished the day roughly 4 flatter and mortgages continue to trade poorly. Additionally, the short-end calendar spreads remain under pressure (Whites/Reds) despite the fact that short end rates actually backed up. This relationship has been flattening in the uptrade (lower rates) and had no relief today. So it feels like some challenged positions at the moment as the tendency here appears to be to receive short end spreads and pay out the curve. There appears to be a lack of conviction here in general at the same time the market continues to deleverage across various asset classes. We are priced for an aggressive Fed at the moment and despite this, swap spreads continue to widen on the short end. For now this continues to be less about the Fed for short end spreads and more about the continued deleveraging of various credit markets.

RATES STRATEGY | **RESEARCH**

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