U.S. Daily Directions: April 7, 2008, NY Edition

Day ahead: **Consumer credit – light start to light data week.** The only data release today is the Feb consumer credit report, which the consensus is for a decline from $6.9bn to $6.0bn consistent with the decline in place since Aug'07. Policyspeakers include Paulson, Yellen and Kohn, but none are speaking regarding topics likely to move markets. The key event this week will be the FOMC minutes, which will help guide markets regarding the Fed's thinking regarding the offsets between growth, financial crisis and inflation. This week begins earnings reports for equities, although larger banks do not report until next week.

Overnight: **Markets take a breather, specters of inflation.** Equities generally, with US futures higher on news that a major US bank might obtain a liquidity injection. The news on rice continues, with the grain's price rising another 2.4% to a record $20.985/100 lbs and exporters cutting back in order to ensure adequate domestic food supplies. The price of coal continues strong, with Asia's 3rd-largest steelmaker, based in South Korea, agreeing with Australian suppliers to price increases in excess of 200%.

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields higher, curve steeper.** Yields rose 2.5-6.0bp along the curve. The odds of a 50bp hike on Apr30 stand at 30%, down from 36% Friday. The potential trough for the Fed Funds is now priced at between 1.75% and 2.00% by Q3'08. This view is less dovish than our base case of 1.50% by mid-year.

Treasuries: **Overnight, yields higher, curve flatter.** Yields jumped higher in Asian trading, and continued drifting higher in the European session. The 2s30s fell 3bp to 246bp and has now breached support at the Feb20 (248bp) low. Further flattening would suggest the potential, from a purely technical analysis perspective, for a sharp flattening towards 200bp. However, the sharp flattening price action appears to be closely linked to the Fed's selling of short-term Treasuries since early March, as compared to fundamental, economic considerations.

Swaps: **Friday, spreads tightened.** Some of the move (5yr) was driven by the swapping back of one large deal. Other deals will likely pop up over the next few weeks as the sentiment (at the moment) seems somewhat better. On the short end, 2 year spreads traded inside of 80, and Libor is being called lower as we head into next week.

MBS: **Friday, MBS ended mixed**, tightening to the treasury curve but widening to swaps as swap spreads. MBS strengthened into the rally post non-farm, initially keeping up with swap spreads and getting as much as ~9/32nds tighter to the treasury curve on FN 5.5's. 5's led the stack most of the day on better convexity related buying. As vol started to creep higher MBS lost steam and ended the session only ~1.5bps to 2bps tighter to the curve and ~3.5bps wider to swaps. The tone still remains positive for the basis as real money continues to add and with factors released tonight we could see good buying early next week. Mortgages are still historically cheap but relative to other sectors they have done very well and we are slightly concerned about where all the supply will be placed as rates move lower.

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