U.S. Daily Directions: November 26, 2007, NY Edition

Today: **No data, but watch liquidity.** The key risk for the week will be the potential for a liquidity squeeze going into Nov 30, which represents fiscal yearend for four major US banks. Despite no data today, the week includes heavy economic data reporting. The overall economic outlook will be characterized in the Fed's Beige Book, which the FOMC will use for its Dec 11 meeting. Regarding housing, the S&P/CaseShiller index for Sep is expected to show a 4.8%y/y decline, while new and existing home sales are both expected to fall m/m (-2.6% and -0.8%, respectively). And construction spending is expected to have fallen 0.2%m/m. Business activity will be evidenced by the Chicago, Milwaukee, and Richmond activity indicators as well as durable goods orders. The Chicago indicator is expected to move back into expansionary territory (from 49.7 to 50.5). The other two surveys are not forecast, but the Richmond index weakened considerably in Oct while the Milwaukee measure remains very high. The always volatile durable goods orders are expected to rise modestly (0.2% overall and 0.3% ex-trans). The revision to Q3 GDP, now a very stale report given the developments in financial markets, is expected to be revised significantly higher from a robust 3.8% to a clearly unsustainable 4.8%. Finally, personal income and spending are expected to remain stable at moderate paces of 0.4%m/m and 0.3%, respectively. Consumer confidence is expected to fall to a post-Hurricane Katrina low.

Overnight: **US consumer hanging in. SIVs workouts coming. Monolines loom. China diversifying. Oil near record.** Initial reports from Black Friday show that retail stores earned more sales with discounts, although individual shoppers spent less. However, internet shopping rose over 20% both Thanksgiving Day and Black Friday. Personal consumption will remain weighed by housing and energy, but the dynamics so far remain buoyant enough to avoid recession. HSBC announced it will take $45bn of SIV assets on its balance sheet in an attempt to consolidate and restructure 2 ailing SIV vehicles. HSBC is the second largest SIV “player”, behind Citi, which has already taken losses and still has $41bn sitting in SIV’s. RBC’s credit analysts have published a report detailing the problems in monolines and potential far-reaching ramifications. The Nikkei reported that an “unnamed Chinese official” stated that China’s FX Reserve Fund would invest in Japanese stocks, reigniting fears about US dollar selling. Ironically, the dollar fell against all currencies BUT the yen overnight. Oil traded back to $98.72/bl, near the new record high of $99.29 on dollar weakness and concerns regarding supply.

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields higher 3-5bp.** The largest gains were in the ’08 contracts, and the strip suggests a trough in the Fed Funds rate below 3.50% by Dec’08. The futures market prices the chance for a 25bp ease in Dec at 96% and the odds of a move to 4% or lower by Mar’08 at 95%.

Treasuries: **Yields higher in Asia, before stabilizing in Europe.** The 2yr rose 5bp in Asian trading before stabilizing in Europe. It continues to rebound after testing below 3.0% last weak. The 10yr yield rose 5bp in Asian trading before partially retracing in Europe. The 10yr is consolidating just above 4.00%, which remains psychological support. The 2s10s curve has flattened 2bp to 90bp, while our 5s30s position (target 130bp) gave up 3bp to 99bp. The flattening follows a pattern in which the curve flattened 9 of the past 10 month ends, and could additionally derive from Treasury supply (2- and 5-yr auctions) this week.

Swaps: **Spreads narrower overnight.** Spreads tightened overnight, following on aggressive tightening on Friday. The 2yr is in 2.2bp to 93.8, while the 10yr is 1.8bp tighter to 74.5bp.

MBS: **Basis tightened Friday.** Mtge's continued their tightening trend on Friday's short day of trading. MBS opened up a couple tighter vs the curve and unch vs swaps. Very light flows and all buyers left mtge's 9 ticks tighter vs treasuries and 2 tighter vs swaps. Overseas accts bought 10/20's and Gold 6's early. Money managers added mtge's as well. Rolls also firmed up a little too, w/ the 6 and the 6.5 roll bid 1/8 of a tick better.

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