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British Arab Commercial Bank

BACB Weekly Capital Markets Commentary

Politics become market mover.

For the last few weeks' markets have steered away from following economic fundamentals to watching political and fiscal news. Greece has of course been at the forefront highlighting the inadequacies the single European currency. With the UK coming in a close second.

When the smaller European countries such as Portugal, Italy, Ireland, Greece and Spain (PIIGS) entered the EUR they did so by distorting their domestic economic environment by reducing interest rates well below their norm in most cases the day of entry. This had the effect of inflating small economies, further swelled with a wealth of EU subsidised grants, producing asset bubbles and housing booms. Unfortunately these smaller economies did not reap the rewards fiscally of this growth and hence when the bubbles burst it has left a hole in public finances.

Countries that have their own freely tradable currency in this situation would have seen that currency devalued by the market, making exports cheaper and imports dearer. This in turn would over time create positive growth internally. This growth is taxed and the fiscal hole is plugged. Unfortunately the PIIGS cannot devalue their currency because the do not have one they share it with much larger better off Nations not suffering to the same extent. So the only weapon in the armoury is domestic fiscal policy. Higher taxes and pay cuts do little to encourage a countries workforce and in the case of Greece people will no doubt vote with their feet, downing tools and walking out on strike. At least this will save the public sector wage bill a few Euros.

This taken aside Greece managed to float €5 billion of 10-year bonds at 300bp over swaps. The issue was 3 times over subscribed not bad considering their CDS spread was through the roof last week. Price is steady at re-offer in the secondary market. This bond was never going to fail as it would have a major knock on effect to any further debt issuance by the PIIGS. European sovereign funds will no doubt underwrite these issues in the short term but unless real market confidence returns for these assets the future might still be grim.

Bond Auctions for the week ahead

Country	Date	Upcoming Auctions
Holland	9/03	€ 3-4bln DSL
Austrian	9/03	€ 1.65bln 2020 2015 bonds
UK	9/03	£ 3bln 2022 Gilt
US	9/03	$ 40bln 3yr
US	10/03	$ 21bln 10yr
US	11/03	$ 13bln 30yr

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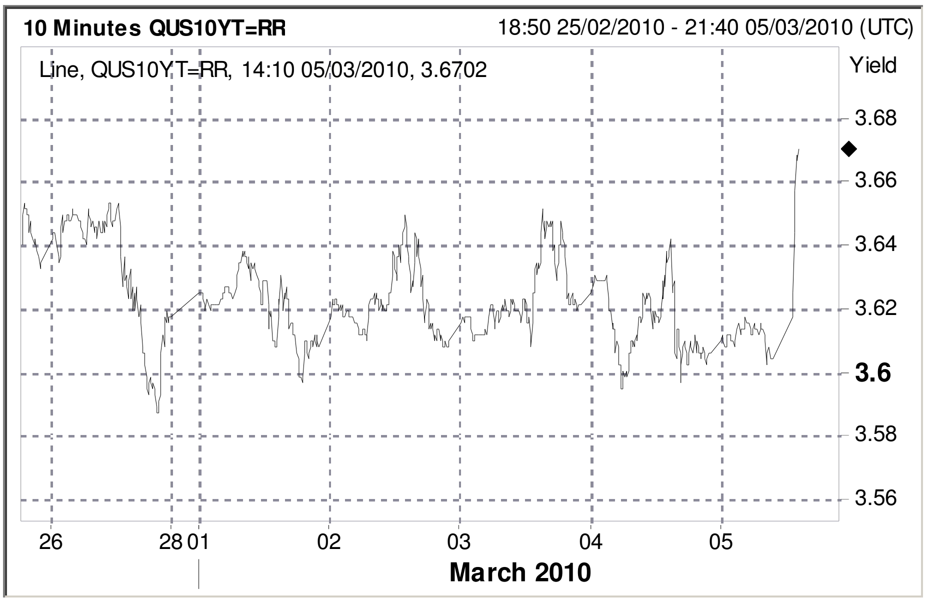
MARKET WRAP

US

Before NFP, Treasuries have taken a back seat this first week in March. Range bound 10yr Tsy bond notes have traded 3.65%/ 3.60% all week ahead of large supply and not broken out of Friday's 26/2 range! Mixed data irking on the weak side, as well as softish Fed member signals have had little affect, indeed causing an anaemic week. NFP`s slightly better figures, pushed yields up through topside resistance levels indicating a possible return to jobs growth and increased economic strength.

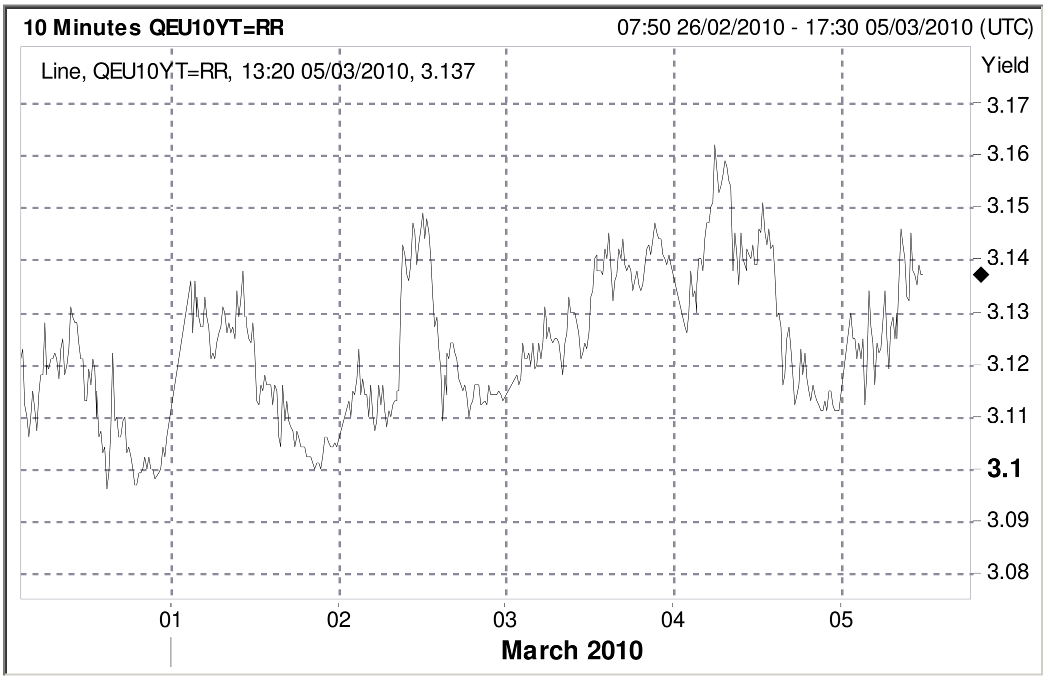


All charts supplied by Thomson Reuters

EU

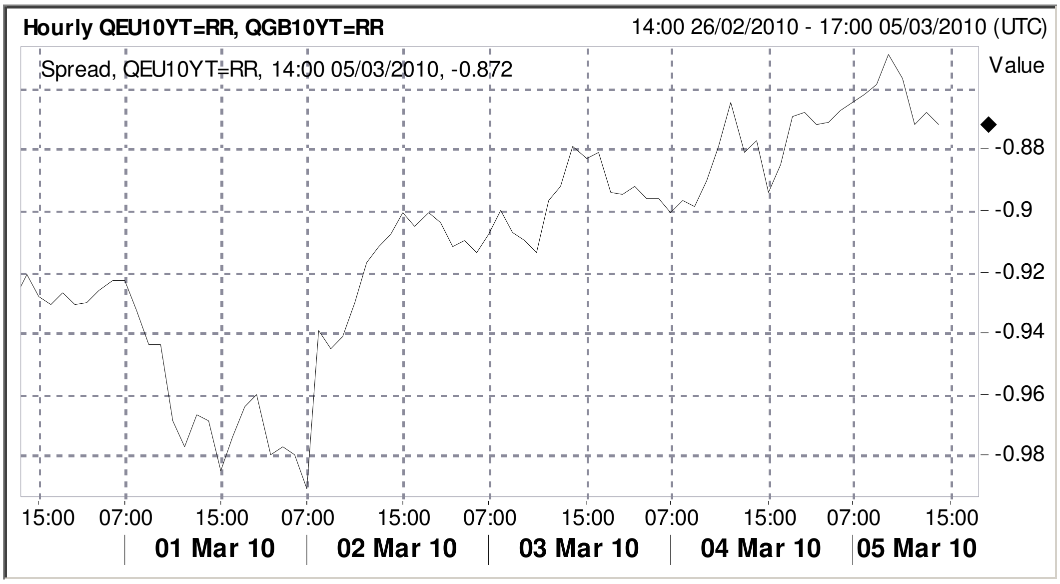
European Government debt continues to be dominated by Greece. Sentiment in the region has improved as the fading Greece worries driven by the €4.8bln austerity plan and rumours of German Gov assistance have seen the GGB/Bund spread tighten. Greece CDS has continued to tighten and now trades at around 300, from 400 last week.

The ECB announced the withdrawal of extra-ordinary liquidity measures in its monthly rate-setting meeting. Mr Trichet set out a plan that gives the market access- via weekly MROs at the Refi rate - to unlimited funds at least until the 9th maintenance period on 12th October this year. 3monthly LTRO will switch to a variable rate set against the Weekly MRO. 6monthly LTRO will switch to indexation at the min. average MRO rate.



UK

Gilts outperformed bunds as a strong 30 yr auction demand driven by pension funds, helped push yields lower. This comes after worries over a hung parliament and u huge FX sell order sent yields higher earlier in the week. The uncertain political landscape has triggered underperformance in the debt sector; MPs need to step up and show their commitment in bringing down the huge public deficit, hopefully boosting external investor appetite for UK Gov debt.



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	GILTS	Close	wk change	BUNDS	Close	wk change	US Treasuries	Close	wk change
2yr	UK GILT 2YR	1.07	0.13	BUND 2 YR	0.87	0.03	US TREAS 2 YR	0.91	0.10
5yr	UK GILT 5 YR	2.83	0.09	BUND 5 YR	2.17	0.05	US TREAS 5 YR	2.35	0.04
10yr	UK GILT 10 YR	4.03	-0.01	BUND 10 YR	3.16	0.06	US TREAS 10 YR	3.67	0.06
30yr	UK GILT 30 YR	4.54	-0.04	BUND 30 YR	3.92	0.08	US TREAS 30YR	4.61	0.06
	XOVER	428.7	-41	**CDX HY**	520.69	-26			

CDS Selections

	UK	Close	wk change	Europe	Close	wk change	US	Close	wk change
	-	-		-	-		-	-	
Industrial	ANGLO AMERICAN	128.00	-25.00	LAFARGE	190.00	-2.00	GE	203.00	8.00
Financial	BARCLAYS	87.00	-21.00	BNP	74.00	-11.00	WELLS FARGO	105.00	-4.00
Consumer	KINGFISHER	107.00	-4.00	SODEXHO	66.00	-2.00	JC PENNEY	144.00	-15.00
Energy	BP	45.00	-2.00	TOTAL	46.00	-2.00	EXXON MOB	22.00	-1.00
Utilities	RWE	50.00	0.00	E.ON	56.00	-3.00	ENEL	87.00	-6.00
Aerospace	BAE SYSTEMS	92.00	-4.00	AIR FRANCE	342.00	-25.00	BOEING	62.00	-3.00
Telecom	BT	131.00	-7.00	FRANCE TEL	47.00	-5.00	AT+T	48.00	0.00
Autos				BMW	96.00	-13.00	FORD	662.00	-22.00
GCC Selection	NAT BK ABU DHABI	165/195	-55	ABC CORP	330/380	-45	GULF BK	385/435	-20
	NAT COM BK	155/185	-25	BBK	360/410	-30	HSBC ME	85/105	-10

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