8 January 2008

Stress Test Charts

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Overview

In the context of both a commitment of liquidity and expectations of rate cuts, things continued to improve in the interbank market yesterday. Spreads are still coming down, and volumes– even out to 3 and 6 months – are picking up. But with credit market stress still increasing, the underlying source of pressure on the market is not abating. As a result, central banks will have no choice but to keep the market adequately supplied with liquidity.

As expectations of a 50bp cut continued to build, 1m and 3m US Libor fixed 8bp lower yesterday. Together with a small sell-off in 3m Treasuries, that drove a 12bp fall in the 3m BOR-T-Bill spread to its lowest level since November 6, and BOR-OIS spreads moderated despite a further modest fall in OIS rates. Swap spreads, with strong SAS issuance still weighing, also continued to come in. Since peaking at over 100bp in mid-December, 2 year US swap spreads are below 80bp.

In Europe, the interbank markets also continued to normalise also continued but at a more modest pace. Euribor and UK Libor rates were flat or down by 1-2bp. There were similar sized falls in the 3m BOR-T-Bill and BOR-OIS spreads in the eurozone, though not in the UK where there were offsetting moves in 3m T-Bills and OIS rates.

In contrast, credit market indices continued to almost uniformly deteriorate. CDX IG rose by 4bp to a new crisis high of 92bp, while CDX crossover gained 10bp – at 295bp it is at its highest level since early August. The iTraxx indices also rose – the master, crossover and sub-financial series are all at or approaching their late November highs. Elsewhere, high yield benchmark spreads continued to hit new crisis highs, while ABX and CMBX both fell further below par. The majority of their tranches are now at or approaching late November lows. And the cost of CDS protection on leveraged loans rose in the US and Europe.

N.B. All data to the close of business yesterday

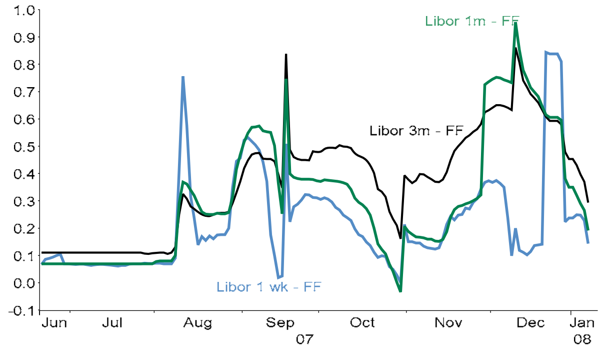
Eoin O'Callaghan
Market Economist
Tel.: 44 20 7595 8226
Email : eoin.ocallaghan@bnpparibas.com

Nathalie Fillet
Interest Rate Strategist
Tel.: 44 20 7595 8650
Email : nathalie.fillet@bnpparibas.com

Rajeev Shah
Credit Portfolio Strategy
Tel.: 44 207 595 8175
Email : rajeev.shah@bnpparibas.com

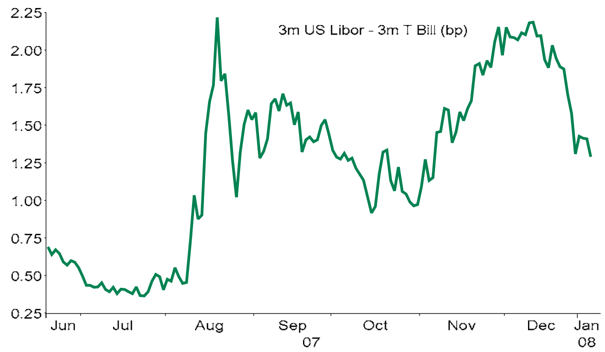
US

1: Libor Spread - Fed Funds



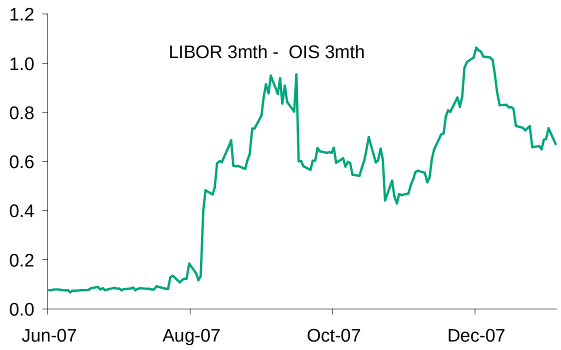
Source: Reuters EcoWin Pro

2: 3m Libor – 3m T-Bill



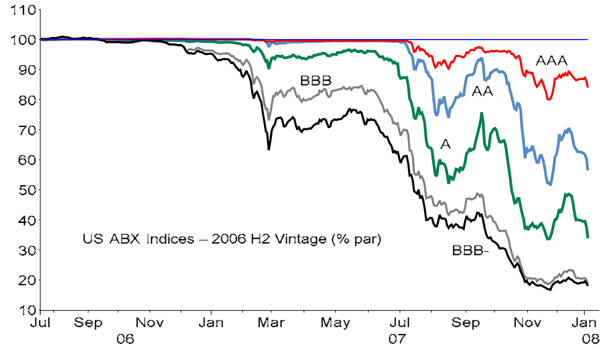
Source: Reuters EcoWin Pro

3: OIS/BOR 3mth



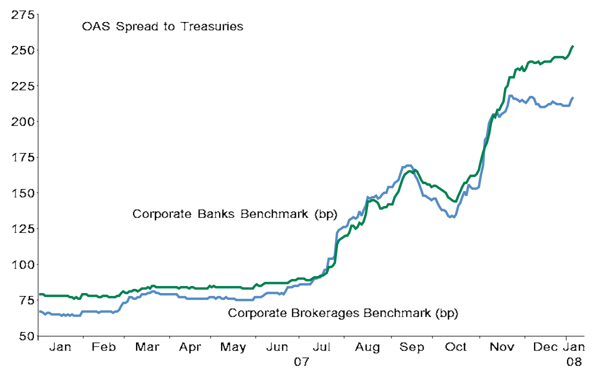
Source: Reuters EcoWin Pro

4: US ABX Indices – 2006 H2 Vintage



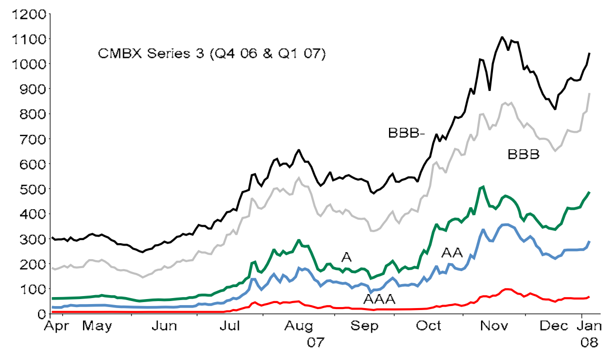
Source: BNPP

5: Corporate Benchmarks



Source: Reuters EcoWin Pro

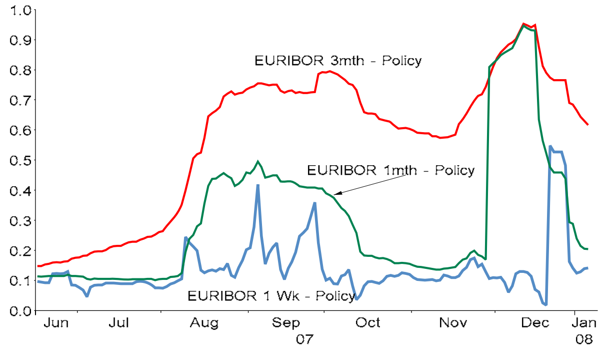
6: US CMBX



Source: Reuters EcoWin Pro

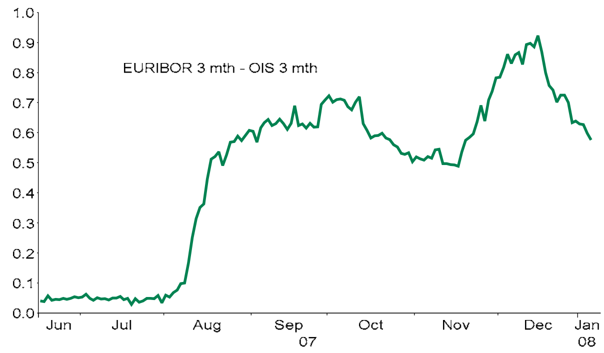
Eurozone

1: Euribor- ECB Rate Spread



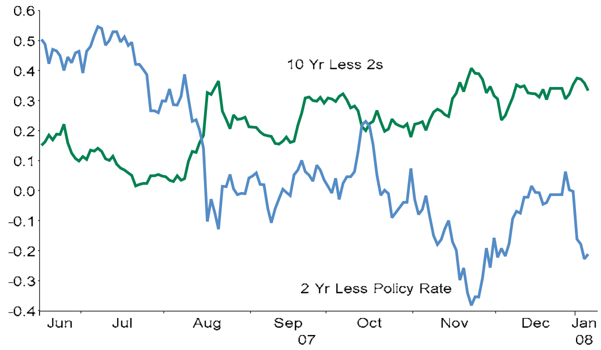
ource: Reuters EcoWin Pro

2: Euribor- OIS Spread 3 mth



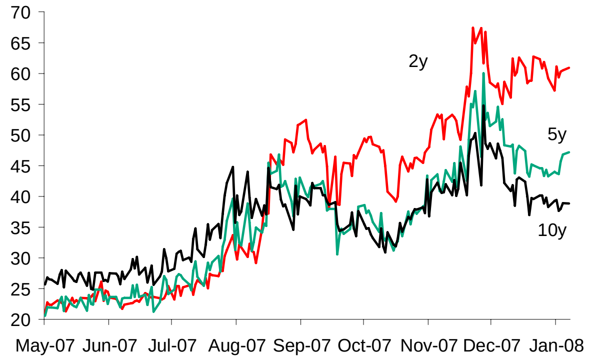
Source: Reuters EcoWin Pro

3: 10s – 2s, 2s-Policy Rate



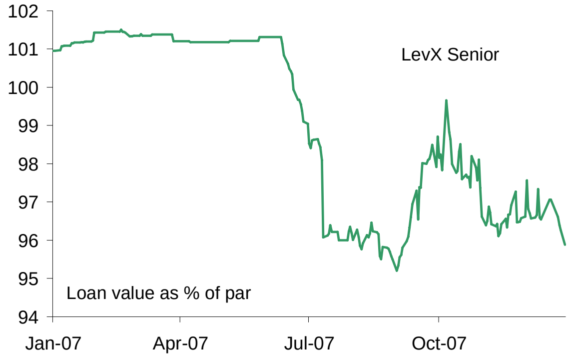
Source: Reuters EcoWin Pro

4: Swap Spreads



Source: Bloomberg

5: LevX CDS Senior



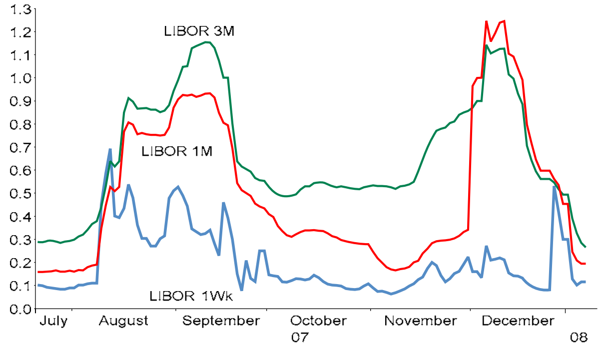
Source: Bloomberg

6: iTraxx 5yr Crossover

Source: BNP Paribas

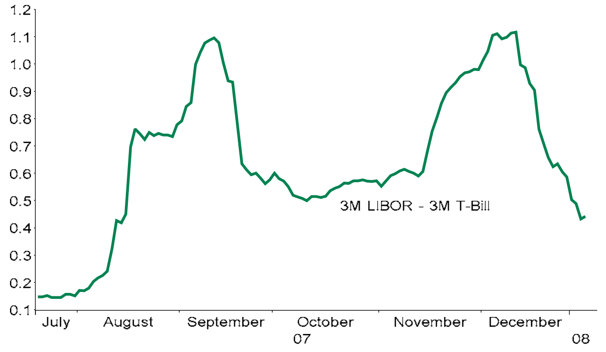
UK

1: Libor – Bank Rate Spreads



Source: Reuters EcoWin Pro

2: 3M Libor – T Bill Spread

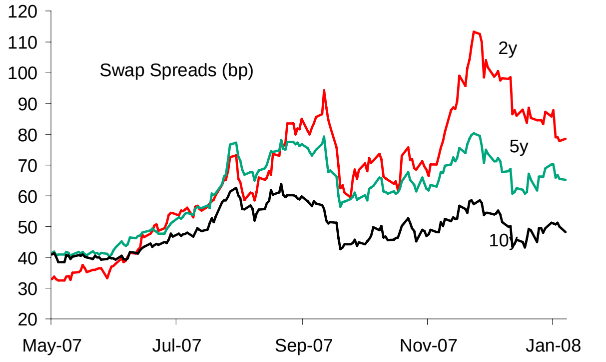


Source: Reuters EcoWin Pro

3: 10s-2s, 2s-Bank Rate

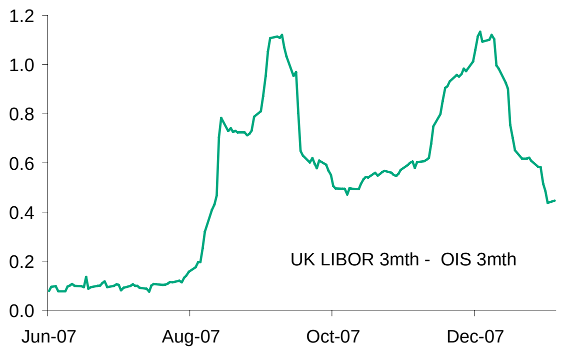
Source: Reuters EcoWin Pro

4: Swap Spreads



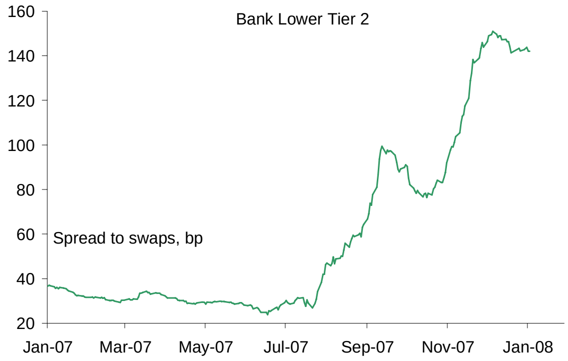
Source: Bloomberg

5: OIS-BOR 3mth



Source: Bloomberg

6: iBoxx Banks Lower Tier 2



Source: BNP Paribas, iBoxx

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Recommendation System:

Type	Terminology	Horizon
Credit Trend (1)	Positive/ Stable/ Negative	6 months
Investment Recommendation (2)	Buy/ Add/ Hold/ Reduce/ Sell (*)	Up to 6 months

(1) Credit Trend is based on underlying Credit fundamentals, business environment and industry trends;
(2) Investment Recommendations are as follows:

BUY – Maximise exposure based on improving financial profile and/or significant under
ADD – Overweight exposure within industry sector/index, based on improving financial profile, and/or defensive characteristics and/or cheap valuation.
HOLD – Maintain position based on stable credit fundamentals and/or average expected return characteristics within peer group.
REDUCE – Underweight exposure within industry sector/index based on weakening financial profile, increased volatility and/or rich valuation.
SELL – Sell exposure/Maximise protection largely based on deteriorating credit fundamentals, negative headline/event risks and/or significant over valuation.

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