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Summary

The week was dominated by the ongoing debate in the US on the postponement of the fiscal cliff, which was due to trigger on 1 January 2013. Whilst a solution has not been reached, both parties agreed to push back the effective date to 1 March 2013, giving them time to reach an agreement. This news provided a strong boost in Global market sentiment. US Treasuries fell sharply, with yields reaching 1.845% up 15bps from 31 December 2012. Despite US Treasury weakness, Emerging Markets Fixed Income performed well during the week. Local Currency bonds were up 1%, Currencies +0.5%, External Debt +0.4% and Corporate Debt +0.3% with High Yield outperforming Investment Grade.

Global

US politicians agreed to postpone, once again, the deadline to legislate a definitive solution for the US's long-term fiscal problems. The agreement which avoided the much debated fiscal cliff merely moved the trigger date for the 'sequester' of automatic spending cuts totalling $1.2tn over a decade, from 1 January to 1 March. The only effective measure was raising income taxes for families with an income of $450k or above and for individuals with an income in excess of $400k and reversing payroll tax cuts. The 'cliff postponement' aligns the fiscal consolidation negotiations with the debt-ceiling deadline that is likely to be reached somewhere between the middle and end of February. Currently, the only certainty is that the fierce 'spending cuts vs. tax raising discussions' will continue throughout the next two months. Whilst Republicans may have a stronger hand in this new chapter of negotiations, they are also more divided after the recent election loss and a painful first round of negotiations.

Despite the inability to reach agreement in the US, the risk of politically induced recession in the global economy is now out of the way for nearly two months. This led to a collapse in implied volatilities with markets rallying strongly as a consequence. Over the last week, the S&P 500 traded up +2.9%, Euro Stoxx 50 up +1.8%, Nikkei +3.5% and Shanghai +5.1%. Commodities traded up +1.5% in the week with oil prices (Brent) bouncing from $109.5 to $112, strong metal performance (silver up +3.4%), but weaker soft commodity prices (Soybean down -2.3%).

In Europe, the euro has failed to consolidate its gains, falling to 1.31 after printing 1.33 against the dollar, but peripheral European bonds remained strong. Mario Monti announced that he plans to form a centrist coalition to run for the Italian presidential elections on 24-25 February 2013. Meanwhile in France, President Hollande insisted that the wealthy must pay more after seeing his flagship 75% tax rate for incomes over EUR 1m a year blocked by the constitutional court. Spanish unemployment fell for the first time in five months. German unemployment remained at a twenty year low of 6.9%.

The Japanese Yen fell 1.1% as the newly elected government adds pressure on the BoJ to do more to weaken the currency and support the economy.

Latin America

Venezuela: Hugo Chavez's health remains delicate, increasing the likelihood of a new election being called in case the 'Caudillo' does not take power on 10 January 2013.

Colombia: Cut rates by 25bps to 4.25%.

Mexico: PMI rose to an all-time high of 57.1 in December 2012.

Chile: Was upgraded by S&P to AA-.

Brazil: Recorded a primary deficit of R$ 5.5bn in November 2012, the worst monthly result since 2002 on the back of tax incentives conceded to boost a stalled economy.

Continued overleaf

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Asia

Manufacturing PMI data from December 2012 suggests that the region is recovering from a cyclical dip.

China: Strong PMI data corroborates an improvement in the Chinese Economy driven by domestic consumption and construction despite weak exports.

India: Manufacturing PMI printed a six months' high at 54.7 with strong new orders.

Taiwan: PMI printed an encouraging 50.6

South Korea: PMI printed a modest 50.1 expansion, but Industrial Production bounced to 2.9% vs. an expected 0.8%.

Hong Kong: Retail Sales grew 9.5% vs. the 4.2% expected.

Eastern Europe, Africa, and Middle East

Turkey: PMI rose to 53.1 from 51.6 as CPI printed +0.38% vs. 0.15% expected.

Poland: HSBC PMI came at 48.5, the ninth consecutive month below 50.

Hungary: PMI printed 48.9.

Israel: Unemployment rate went down from 7% to 6.7%.

South Africa: Trade deficit was better than expected at ZAR 7.9bn vs. ZAR 17bn expected.

Uganda: Kept its benchmark rate at 12%.

Zambia: Kept its benchmark rate at 9.25%.

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