Summary

Emerging Markets ("EM") fundamentals continued to improve overall, but most EM assets treaded water with small gains for EM corporate high yield and currencies as the recent wave of appetite for US assets continued. This demand is due in part to the unwinding of long positions in Euros and Yen which continues apace, providing yet another manifestation of the "ugly contest" between the currencies of the HIDCs (Heavily Indebted Developed Countries). US equities are also rallying, thus, in our view, increasing the likelihood of a correction sooner rather than later due to the still major structural impediments to higher sustained growth. The likely approaching corrections are now a familiar phenomenon, which usually generates excellent opportunities to add to existing Emerging Markets exposures at attractive levels.

Global

In HIDC currency space, the rotation out of Euros and Yen into US Dollars continued over the past week, taking EURUSD from a 1.31 handle to a 1.29 handle and USDJPY from 94.80 to 95.70. Better US data in the form of stronger than expected payrolls and retail sales added to the bid for US Dollars, but is unlikely to materially change the trend growth rate in the US, which remains suppressed by major structural and political challenges. Italy's political uncertainty and Japan's barely concealed efforts at currency manipulation continue to give ground for selling Euros and Yen, respectively. These flows are now going into the US Dollar. In our view this rotation is more about positioning and momentum trading than material changes in the fundamentals. All three regions are struggling to find ways to come to terms with their serious lingering structural drags on growth. And that, in turn, means that these currency moves are likely to mean-revert as they have been doing for the past five years, pending movement in relative growth rates, relative inflation, and relative interest rates.

US stocks rose about 60bps over the week on the back of the better data, which helped to push the main US stock indices close to their all-time highs, despite evident risks to growth arising from fiscal drags and political risks, notably the Continuing Resolution deadline of 27 March and the debt ceiling challenge in Q2. So far, the start of 2013 closely resembles the start of 2012 which also saw a very strong US stock market performance, which ultimately proved unsustainable leading to a correction. The US Treasury market did not change much over the week with the 10-year yield rising a modest 3bps to 2.03%. German industrial production was flat versus an expectation of a 0.4% rise, while French IP came at -1.2% versus -0.2% expected. Fitch downgraded Italy from A- to BBB+ with negative outlook. Japan also had weak machinery orders, which declined 13.1% yoy versus an expected decline of 1.7% yoy. Commodities rose 1.8% on the week, but there were significant differences across the complex with oil prices falling 1.9%, copper flat, and softs rising between 2% and 4%. In EM, currencies rose 24bps against the stronger US dollar, while local bonds traded flat on the week. Sovereign external debt was down 40bps on the week, but corporate high yield continued its strong run this year with returns of 25bps on the week. EM stocks were marginally lower on the week. The Asian and Latin American regions are performing strongest as the Eastern European and Middle East/Africa regions are feeling the lack of love for Europe.

Latin America

Mexico's outlook was revised to positive from stable by Standard & Poor's. The central bank cut policy interest rates by 50bps from 4.50% to 4.00% and flagged the move as a one-off adjustment. The Federal Government and the main political parties also jointly presented a proposal for a telecommunications reform, a positive development in our view. Mexico is likely to pursue further reforms in the fiscal and energy areas later in the year after July's Senate elections. **Brazilian** industrial production rose faster than expected at 2.5% mom versus 1.6% mom expected. Capacity utilisation was also higher than expected at 84%, while consumer price inflation as measured by the IPCA index rose 0.6% in February versus 0.48% expected. This means that inflation is now running at an annualised pace of 6.31% in Brazil. The net effect of all this news was that the market moved further toward pricing in a hike from the central bank at the next meeting in April. In **Colombia** February consumer confidence declined somewhat from higher levels in January. In **Argentina**, the government extended existing price control until June. **Chile's** CPI rose just 0.1% mom in February; less than expected (0.3% mom). In **Venezuela** Nicolas Maduro was sworn in as interim president at the National Assembly after the Supreme Court cleared his appointment.

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Asia

China issued a slew of macroeconomic data. Highlights include:

a) CPI rose to 3.2% yoy versus 3.0% yoy expected and 2.0% yoy prior

b) industrial production expanded 9.9% yoy in February

c) fixed asset investment expanded at a rate of 21.2% yoy in Jan-Feb from 19.8% yoy in December

d) exports accelerated to 23.6% yoy in Jan-Feb from 19.2% in December.

New loans declined somewhat but governor of the central bank Zhou Xiaochuan struck a hawkish tone on inflation. In Malaysia industrial production expanded +4.6% yoy in January, up from +3.5% yoy in December. January exports were also stronger than expected at +3.5% yoy, versus -5.8% yoy in December. Indonesia's central bank left rates unchanged at 5.75% as retail sales slowed in the first month of 2013 to 7.2% yoy versus +15.1% in December. Sri Lanka's central bank kept reference rates at 7.5%.

Eastern Europe, Africa, and Middle East

Russia's President Putin nominated a former economy minister and technocrat to the post of the next Central Bank of Russia governor. In Turkey, January's current account deficit was wider than expected at $5.6bn versus the market consensus of $5.4bn. Industrial production surprised to the upside at +2.1% versus +1.6% expected. In Hungary, inflation dropped to just 2.8% in February from 3.7% in January. Newly appointed Economy Minister Mihaly Varga said that the recent bout of currency weakness would prompt the government to act and reiterated that the government has a EURHUF exchange rate target for 2013 of 285. Czech Republic CPI inflation slowed to 1.7% yoy in February from 1.9%, which was below consensus expectations of 1.8% and the Czech National Bank's own forecast of 2.0%. By contrast, Egyptian CPI inflation rose to 8.2% yoy from 6.3% previously.

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