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Summary

Global market sentiment soured towards the end of the week as the Fed Minutes talked about phasing out Quantitative Easing. Ahead of possible US spending cuts and against the backdrop of recent fresh highs for US stocks such comments sat uneasily with investors. But the impact of the Fed Minutes also has to be put into the context of broader market focus on global currency markets following the recent more aggressive easing by Japan. Money printing by central banks in the HIDCs (Heavily Indebted Developed Countries) holds up about half of global GDP and most HIDC bond and stock markets. Going into next week, news about the US spending sequester and the Italian election remain the main potential source of volatility.

Global

Commentary from policy makers in the HIDCs continues to be responsible for the main movements in global markets. The issue of global currency realignment is now front and centre on the global economic agenda following the decision by Japan to pursue a more aggressive policy of Yen weakening. But Friday's G-20 meeting in Moscow failed to define a strategy and overall framework for coordinating a realignment of global currencies. The G20 was therefore also unable to deal specifically with the issue of Japan, which was given the green light to continue to stimulate (and weakening the Yen) under the guise of stimulating domestic demand. In drawing attention to the currency issue, but failing to address it, the G20 has increased market sensitivity to the single most important element of uncertainty in the global economy today (and likely for several years into the future, in our view). Currency credibility is the single largest source of risk today, because half of the world's GDP and valuations in the bulk of HIDC stock and bond markets now rest, in effect, on continuing stimulus from HIDC central banks. This also explains why the market reacted so sharply to a more hawkish tone in yesterday's Fed Minutes. Earlier in the past week, the US S&P500 Index had reached a new high of 1,530 despite mixed economic data (industrial production and housing starts were below expectations, but consumer confidence was better than expected). After the Fed Minutes, the S&P500 slipped 1.2% to 1,511 and ten year yields in the US Treasury market fell to 1.99% after trading at 2.05% earlier in the week, illustrating the fragility of the current rally in US markets. One silver lining is that Emerging Market central banks are clearly showing signs of understanding the need for further currency appreciation as the HIDCs inflate and devalue their way out of trouble. Mexican Central Bank Agustin Carstens said, "Emerging Markets must concede some degree of FX gains". Elsewhere, USDJPY stabilised around 93.50 as uncertainty continues to surround the appointment of a new Bank of Japan governor and comments from Finance Minister Taro Aso saying the government does not (yet) intend to buy foreign bonds directly via its fund with the Bank of Japan. In the UK, Bank of England Governor Mervyn King voted in favour of increasing the securities purchase programme, which was seen as a dovish signal, triggering a big fall in GBPUSD, now down 6.5% year to date. In Europe, PMI numbers were poor but German investor confidence picked up. The Italian elections look set to produce a coalition outcome.

Commodities had a poor week with metals falling the most with oil down 2.6%, though Brent still trades at $114.5, despite a soft growth outlook for the HIDCs this year. Emerging Markets continued to see strong inflows, but failed to move much. MSCI EM was down 0.6%, currencies were mildly down with the JP Morgan ELMI -0.1% and Local bonds were flat. External debt saw some profit-taking, down 0.2%, while Corporate bonds ended the week higher at +0.3%.

Latin America

Colombia's trade surplus reached 677 million in December, much higher than expected. The National Statistics Institute of Peru reported weaker-than-expected growth in December of 4.3% yoy. Brazil retail sales disappointed at -0.5% versus +0.9% expected. In Ecuador the incumbent Correa was re-elected with 57% of the vote. Mexico's economy expanded 3.2%. Hugo Chavez returned to Venezuela, triggering speculations that he will be sworn in only to hand over power to Vice President Nicolas Maduro, which would then call fresh elections.

Continued overleaf

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Asia

India's budget is a key focus this week ahead of an expected vote on the 28th February. **Chinese** authorities launched measures to curb property market speculation on back of strong credit growth. **Thailand's** economy grew 6.4% in 2012 (versus 5.5% expected), while the Central Bank maintained the benchmark rate at 2.75% in line with expectations. **Malaysia's** 4Q GDP grew 6.4% from the previous year versus 5.5% expected, pushing cumulative 2012 growth to a solid 5.6%.

Eastern Europe, Africa, and Middle East

Turkey's Central Bank cut both borrowing and lending rates to 4.5% and 8.5% respectively, and left the benchmark repo rate unchanged at 5.5%. The modest increase in the reserve requirement was intended to keep credit acceleration under control. **Poland's** January industrial production rebounded 5.4% versus 2.7% expected. **Nigeria's** inflation fell sharply to 9% from 12% previously. **South Africa's** January CPI unexpectedly declined to 5.4% yoy. Tanzania announced it will issue in global markets, which, if the security is index-eligible, could make the country the 56th Emerging Market country to enter the main benchmark indices.

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