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Summary

Cyprus is yet another reminder of the deep structural problems facing the HIDCs (Heavily Indebted Developed Countries). Global sentiment went up and down in yoyo-like fashion when it became clear that Cypriots were unwilling to inflict the haircut on depositors required by the European Union in exchange for bail out support. While Emerging Markets are not immune to the resulting asset price volatility it remains the case that actual risks – such as the ability or willingness to pay – in Emerging Markets are unlikely to be materially affected by anything that happens in Cyprus, except if events lead to a wholesale collapse of the European banking system (extremely unlikely, in our view). Indeed, the broad conclusion from the past five years of repeated HIDC crises has been that the best times to add to positions in Emerging Markets are precisely during HIDC panics. As such, we encourage those investors who need to allocate further to Emerging Markets to consider doing so during this and future bouts of HIDC-led fear.

Global

The eruption of yet another HIDC mini-panic – this time over Cyprus – pushed market sentiment lower over the past week. US stocks fell 30bps, US 10 year treasury yields rallied 8bps to 1.95%, commodities fell, and EURUSD and USDJPY were both lower on the week. Emerging Market asset prices were moderately impacted by the negative global sentiment. External debt and Corporate debt spreads widened 13bps, currencies dropped 10bps, and local bonds lost 25bps. Despite the draconian proposals to confiscate Cyprus bank deposits in a bid to stave off yet another HIDC default, market sentiment has not been as severely impacted as in previous HIDC episodes. We believe this is due to the combined effects of the ECB's OMT program, the prospects of a deal involving Russia, and the fact that Cyprus is a very small country and a somewhat special case within the Eurozone. The US Federal Reserve also provided support in the past week by maintaining the current easy stance on monetary policy. US housing starts came in line with expectations, but homebuilder sentiment declined. In other global developments, Japan's parliament approved the new team in charge at the Bank of Japan, while Masayoshi Amamiya – a Quantitative Easing specialist – was appointed to oversee the monetary policy department. Italy this week embarked on efforts to form a government as industrial production data for January came in at 0.8% versus -0.3% expected. Austrian National Bank governor Ewald Nowotny proposed to broaden the range of collateral accepted by the ECB to include packages of SME loans. Spain's Prime Minister Rajoy said that the growth forecast for 2013 will be cut. France and Germany both saw their main PMI manufacturing surveys disappoint significantly, though these numbers will be attributed in part to the Italian election and hence discounted somewhat. The UK government lowered its growth forecast further amidst talk of increasing the scope for the Bank of England to pursue more aggressive easing. Finland scrapped one of its fiscal targets to "avoid excessive austerity and ensure economic growth". Portugal was granted another year to meet its deficit target.

Latin America

In **Brazil**, President Dilma Rousseff's personal approval rating rose to 79% from 77% in December 2012, while her administration's approval rating rose by 1% to 63%. In the month of February, the labour market added 123K new jobs, well above the expected 95K figure. In a positive development, President Santos in **Colombia** submitted a health reform to parliament, which aims to contain health care expenditures within the available resource envelope. **Peru's** central bank indicated that pension funds could be allowed to invest more overseas as the sophistication of institutional investors in Latin America continues to increase. In **Venezuela**, polls continue to show a strong lead for Nicholas Maduro ahead of elections on 14 April as the government launches a new system for providing dollars to importers amidst signs of liquidity problems at PDVSA, the state oil company. The pace of Mexican aggregate demand accelerated in the last quarter of 2012, rising to 3.6% yoy from 2.6% in Q3. The union of PEMEX workers endorsed President Enrique Pena Nieto's proposals to reform the energy sector. **Argentina's** parallel exchange rate reached a new low of 8.47 versus the US dollar and inflation expectations continued to rise as Moody's downgraded the foreign law bonds to Caa1 with negative outlook on account of the pending ruling in the New York Appeals Court. **Chile's** economy grew 5.7% yoy in Q4 2012 and the central bank left rates unchanged at 5.0%.

Continued overleaf

Asia

China's HSBC Flash PMI for March was stronger than expected at 51.7. The previous number was 50.4 and the expectation has been for a modest rise to 50.8. FDI flows also picked up strongly, rising 6.3% yoy versus an expectation of a fall of 4.8%. The National People's Congress confirmed a raft of broadly pro-growth reforms, including reducing the role of the state. China also announced that foreigners with QFII quotas will now be able to access the interbank market. **Malaysian** inflation was in line with expectations at 1.5% yoy for the month of February as the political parties move towards finalising candidates ahead of the upcoming election. **India's** central bank cut the benchmark interest rate by 25bps to 7.5%, but continued to highlight current account concerns as a barrier to further cuts. **Thailand's** central bank continued to signal that it is not overly concerned with currency appreciation, while the finance minister expressed greater concern. **South Korean** exports rose sharply, while **Singapore** non-oil domestic exports declined. Remittances in the **Philippines** rose 8.0% yoy in January, slowing slightly on account of seasonal effects.

Eastern Europe, Africa, and Middle East

South Africa's central bank left rates unchanged after a unanimous decision. **Saudi Arabia's** sovereign outlook was raised to positive by Fitch, the ratings agency. **Nigeria's** central bank left rates unchanged at 12% as Lamido Sanusi, central bank governor, confirmed that he does not intend to seek another term as governor. **Egyptian** tourism arrivals rose 12% yoy in February. **Russia's** central bank left rates unchanged at 8.25%, maintaining that inflation is still too high for its liking. **Poland's** inflation dropped from 1.7% yoy in January to 1.3% yoy in February and the current account deficit narrowed to 3.4% of GDP. **Israeli** inflation was 1.5% in February. **Turkey** privatised electricity power grids, raising some $500m. This figure is expected to rise to $2bn this year.

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