Ashmore

Summary

The past week was characterised by severe bouts of volatility arising from actual and perceived risks in the HIDCs (Heavily Indebted Developed Countries). As in previous HIDC risk-off events, central banks in Europe and US were quick to step in with reassuring fresh money printing. Money printing helps as long as structural constraints to growth prevent inflation from taking hold, but it is not a sustainable strategy.

Global

Global sentiment was extremely volatile in the past week due to a series of events, which took place in the HIDCs. The main market moving events were: (a) The Fed Minutes, which revealed discussions about unwinding Quantitative Easing, caused a sell-off in stocks to underline the importance of QE to HIDC asset prices; (b) The Italian election produced a hung parliament, which raised concerns about Italy's willingness to continue reforms and significantly increased the intensity of the sell-off; (c) Fed Chairman Ben Bernanke and ECB President Mario Draghi reassured markets about their dovish inclinations, triggering a rally; and (d) Japan's government announced the appointment of Haruhiko Kuroda – a dove – as the new governor of the Bank of Japan, which restored the recent trend of weakness in the Japanese Yen. The events of the past week confirmed a number of by now familiar patterns. First in our view, the main risks to the global economy are emanating from the HIDCs, while Emerging Markets produce only idiosyncratic risks. Second, confidence in the HIDCs markets is critically linked to continued stimulus from their central banks. The HIDC central banks are able to restore confidence by printing money only as long as inflationary pressures do not mount, but over time as the HIDC economies slowly heal this condition becomes more difficult to satisfy. The greatest risk facing the global financial markets is a collapse in the confidence in HIDC currencies and the central banks printing them. For now, the excess liquidity created by the HIDC central banks is creating problems for the pegged and managed economies, such as Singapore, Hong Kong, Switzerland and China, which all had to implement macro-prudential measures in the past week in order to rein-in escalating real estate prices. As a result of these measures, base metals like iron ore, nickel and aluminium were down 2.5% to 4.5%, pushing commodity prices down during the week. In other price action, US stocks initially sold off nearly 3%, but recouped most of the losses by the end of the week. As a result of the volatility, the VIX Index shot up from a 14 handle to 19 and right back and Emerging Market stocks traded 1.3% lower, though they were well off the lows by the end of the week. Chairman Bernanke's reassurance that QE will not be reversed also triggered a 10bps rally in US 10 year treasuries, which traded down to 1.9% in yields terms. This helped Emerging Market dollar Sovereign and Corporate credit. After a few weeks of underperformance, Emerging Market Sovereign debt rallied 21bps on the week to trade 280bps over US treasuries (from 290bps earlier and 170bps before the 2008/2009 crisis). Corporate High Yield rallied 17bps and Corporate High Grade rallied 39bps due to their greater US treasury sensitivity. The US dollar traded stronger against most currencies on account of the volatility, pushing EURUSD to 1.3080 from 1.3280 and Emerging Market currencies down 60bps on the week. Emerging Market bonds also gave up some ground, down 35bps. USDJPY fell from 93.60 to 92.74, but was well off the bottom as sentiment improved late in the week. In other notable market developments, oil prices continued their decline to a $112 handle from $115.50, partly aided by the stronger dollar. In Europe, Italian 10-year benchmark yields rose to 4.90% on Monday from the 4.20% levels last Friday. On the data front, US consumer confidence came at 69.6 versus 62.0 expected, while new home sales rose to 417k units versus 380k expected. German business confidence also improved.

Latin America

Colombia cut its benchmark rate to 3.75% as industrial production and retail sales in December were softer than expected. Venezuela 4Q GDP growth was higher than expected at 5.5% year over year. Mexico unemployment rate climbed slightly to 5.42%. Brazil's monthly inflation was 0.68%. The Appeals Court in New York heard arguments from the interested parties in the dispute between the Republic of Argentina and holdout investors – a decision on the 2nd District Court's ruling that Argentina must pay holdout investors could now happen before April.

Continued overleaf

Asia

China's currency fixed lower from a peak of 6.29 to reach a 6.27 handle. **Taiwan's** 4Q GDP grew 3.7% vs. 3.4% expected. **Singapore's** 4Q GDP grew at 1.5% versus 1.2% expected, but industrial production in January contracted 9.2% yoy and CPI was lower than expected at 3.6%. **Thailand** current account balance in January was in deficit to the tune of USD2.2bn. **Hong Kong** GDP grew 1.4% in 2012. **India's** finance minister presented a budget with a sharply lower deficit, although the budget presentation was short on announcements of structural reforms.

Eastern Europe, Africa, and Middle East

Israel maintained its benchmark rate at 1.75%. **Hungary** cut its benchmark rate by 25bps to 5.25% as December retail sales contracted 2.1%. **Poland** retail sales printed a higher than expected growth rate of 3.1% yoy. **South Africa** GDP grew 2.1% qoq. **Tanzania** entered the global capital markets with a USD600m quasi-private placement at Libor+600bps.

Contact Information

Head Office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE

T: +44 (0)20 3077 6000

www.ashmoregroup.com

Other Locations

Beijing
T: +86 10 5764 2601

Bogota
T: +57 1 347 0649

Jakarta
T: +6221 2953 9000

Istanbul
T: +90 212 349 40 00

Melbourne
T: +61 0 3 9653 9524

Moscow
T: +74 9566 04258

Mumbai
T: +91 22 6608 0000

New York
T: +1 212 661 0061

Washington
T: +1 703 243 8800

Sao Paulo
T: +55 11 3556 8900

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

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