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Summary

Global market sentiment remained positive on the back of further promises of easy money from the US. Meanwhile, the UK government is moving towards further easing, including possibly further weakening of the Great British Pound. We believe this is the broad direction of travel for the HIDCs (Heavily Indebted Developed Countries) as they run out of other policy options. The week saw gains for external debt, corporate debt, and stocks in Emerging Markets.

Global

In the past week, there were three important global macroeconomic developments. First, FOMC member Janet Yellen reaffirmed the earlier stance adopted by Fed Chairman Ben Bernanke that Quantitative Easing (QE) policies will be maintained. Second, US data was stronger, though not strong enough to suggest a meaningful departure from the "2%" economy, i.e. the current sub-trend pace of expansion. Notable releases included better than expected ISM, ADP, and Chicago PMI prints. Thirdly, there are growing indications that the Bank of England is setting out to emulate Japan with further aggressive easing, thus increasing the odds that the UK becomes the second HIDC, which resorts to deliberate currency weakness in a bid to escape the domestic economic malaise. Of these three developments, the latter is by far the most important, in our view. The HIDCs have hitherto restricted their policy choices to rate cuts, QE, fiscal spending, and (very limited) structural reforms. But these policies have failed to restore growth. Facing declining political capital, policy makers are now looking deeper into the economic toolbox and discovering currency manipulation (they have not yet dared to use trade protection). Currency weakness is part of the solution, but it is tricky, because unless it is coordinated it can lead to a disorderly realignment of currencies.

Mainly on the back of the dovish statements from Fed officials, US stock markets rallied 1.7%, while US 10 year treasury yields remained largely flat at around 1.9%. Elsewhere, the sentiment was more mixed. The Euro and Japanese Yen both lost ground to the US Dollar. VIX was unstable, rising to 15.50 before dropping to 13.50, and oil continued to trade lower, ending the week down a buck at $111. In Emerging Markets, external debt continued to perform well, rising 30bps on the week and continuing the rally which began on 21st February after an earlier period of weakness caused by profit taking following very strong performance in 2012. Broad corporate debt also continued its stronger performance irrespective of volatile global sentiment, rising 26bps on the week, with high yield corporates rising 48bps. Local currency bonds ended the week flat and continue to pay 5.5% yield (versus 79bps for the same duration in the US Treasury market). Emerging Markets currencies softened 21bps over the past week, but this did not prevent Emerging Markets stocks from rallying more than 1% over the same period.

Latin America

The central bank in **Brazil** kept rates unchanged at 7.25%, but was clearly more hawkish in the commentary. Coming on the back of somewhat higher inflation prints, the importance of this change in direction by the COPOM is that it illustrates that keeping control of inflation is of paramount importance in most Emerging Markets countries, not least in Brazil. In **Venezuela**, President Chavez passed away after long illness. According to the constitution, fresh elections must be called within 30 days. We expect Vice-President Nicholas Maduro to win, in which case 'Chavismo' will continue in Venezuela for some time yet. **Chile's** economy expanded at a rate of 6.7% yoy in January. Five years into the global crisis, the strong resilient growth rates in many Emerging Markets countries illustrate that these countries can grow quite healthily under their own steam. Sentiment about **Argentina** improved sharply over the past week following a request by the New York Appeals Court to the government to propose a way to resolve the question of paying holdout investors. The government of **Honduras** launched a road show ahead of a possible inaugural bond issue. If Honduras issues, it would potentially become the 58th country to enter the Emerging Markets external debt asset class (up from 26 countries in 1999). In **Mexico**, the ruling PRI party voted internally in favour of introducing reform of the oil sector and VAT reform. Fitch raised the outlook for Colombian sovereign external debt from stable to positive.

Continued overleaf

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Asia

China began the process of defining policies, budget targets, and appointing key personnel following the appointment of the political leadership earlier in the year. One of the important and positive developments in our view, is that China will expand the volume of local government bond issuance by some 50% in the coming year as transparent funding replaces less transparent financing vehicles. China also introduced prudential measures to prevent overheating in sections of the housing market. In **India**, PMI slowed to 54.2 from 57.5 as businesses exercised more caution ahead of the budget. The central bank eased capital controls marginally. **South Korean** PMI in February rose to 50.9 from 49.9 in January. The opposition in **Thailand** won the governorship of Bangkok, but with a much reduced margin compared to previous elections, suggesting that the ruling party's political standing is currently very solid.

Eastern Europe, Africa, and Middle East

Poland's central bank reduced the policy rate by 50bps to 3.25% due to a cyclical slowdown in growth, which is likely now to be nearing completion. **Kenya's** elections passed with less violence than last time, although the results are disputed. **Uganda's** central bank left rates unchanged at 12 per cent. **Hungary** indicated that it would seek to pass various laws, which have previously drawn criticism from the European Union. New central bank governor Matolcsy introduced restrictions to powers for deputies at the central bank in a bid to exercise more control over communications. **Turkey's** CPI inflation in February was 0.3% versus 0.4% expected, taking yoy inflation rates to 7.03% from 7.31% last. **South African** producer price inflation dropped sharply from 6.3% in December to 5.8% in January. **Serbia** announced plans to hold early elections in order to pave the way for accelerated EU accession talks. **Ghana** announced a tighter budget relative to the outturn of 2012 amidst an expectation of 8% real GDP growth in 2013. **Latvia** announced intentions to join the Eurozone. **Russian** inflation moderated to 0.1% wow from 0.2% in the previous week. **Ukraine** recorded its second consecutive month of reserve accumulation – reserves now stand at $25bn.

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