



Global Markets Weekly

Risk appetite increases, even as Greece's sovereign debt is downgrade to 'junk'.

Risk appetite returned last week, with equity markets enjoying a decent rally and oil perking up, though industrial metals such as copper fell back. The S&P500 broke back above the 1100 mark on Wednesday, while the VIX index of expected volatility fell back sharply. By contrast, yield spreads widened in the euro-zone periphery after ratings agency Moody's cut Greek government debt to below investment-grade. Downgrades to euro-zone periphery debt are now becoming somewhat of a weekly occurrence and global equity markets appear to have become immune to the euro-zone's travails. The euro rallied to its highest since the May crisis.

Global growth continues despite euro-zone's travails, but banking remains the weak link in any further crisis.

As we have stated before, as long as the euro-zone's difficulties do not mutate into a full-blown banking crisis, global economic recovery can continue and support risk assets. However, headwinds such as fiscal consolidation and consumer deleveraging suggest it could be a sluggish recovery. In this respect, the announcements from both Spain and Germany that they will now release the results of bank stress tests, having earlier said they would not, was encouraging. The release of the US Federal Reserve's stress tests at the start of 2009, and subsequent recapitalisation of weaker financial institutions, went a long way in restoring confidence.

Risk appetite is up, but investors stomachs still turn on peripheral euro-zone bonds.

Yields spreads in peripheral euro-zone bond markets continued to widen early in the week, with 10-year Spanish bond yields touching almost 5% at one stage, compared to 4.5% on Monday. However, they did fall back a little after Spain said stress test results would be released and successfully auctioned €3.5bn of 10-year government bonds. All told, Spain has already raised enough to refinance €24 of bonds due to be repaid by the end of July, yet investors remain nervous over these issues. While German ten-year bund yields drifted up to 2.7%, this 'safe haven' asset still trades close to the previous week's all-time lows and gold hit a new high of \$1258 per ounce.

Tighter budget and tighter regulation for the UK, part of a wider trend in the developed world.

In his Mansion House speech UK Chancellor Osborne transferred financial sector regulation back to the Bank of England and set up a panel to look into the future of banking. This comes ahead of the new government's Budget on 22 June, which is widely expected to consist of a swathe of spending cuts and tax increases, including a levy on UK banks. While such fiscal rectitude will be broadly welcome by investors, especially in the gilt market, it will further slow the current sluggish recovery.

Inflationary pressures ebbing in developed economies, as recovery remains muted and unemployment high.

UK and US economic data this past week indicated moderating inflation and growth. UK CPI appears to have peaked, with a decline from 3.7% to 3.4%, while inflation continued to slide in the US to 2.2% from 2.0%. This pushed down US and UK government bond yields. US jobless claims backed up to 472,000, indicating a slow and erratic recovery in the labour market. If growth becomes more sluggish, below-trend inflation could persist for some time, reinforcing our view that inflation-linked bonds had become expensive. By contrast, India's wholesale price index unexpectedly jumped to a new high of 10.2% in May from 9.6% previously. This reflects continuing capacity constraints amid robust growth in Asian and emerging economies, where we forecast further policy or exchange-rate change, such as the recent announcement from China on the renminbi.

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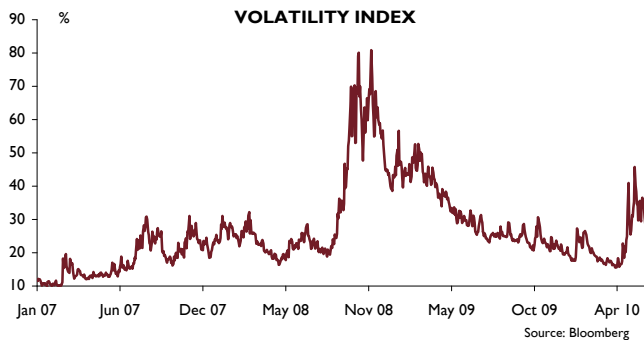
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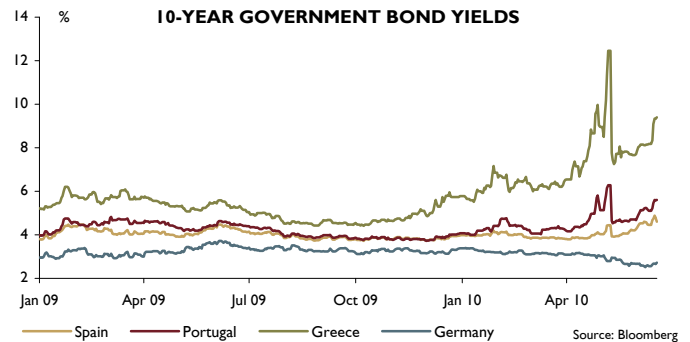
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Charts of the Week

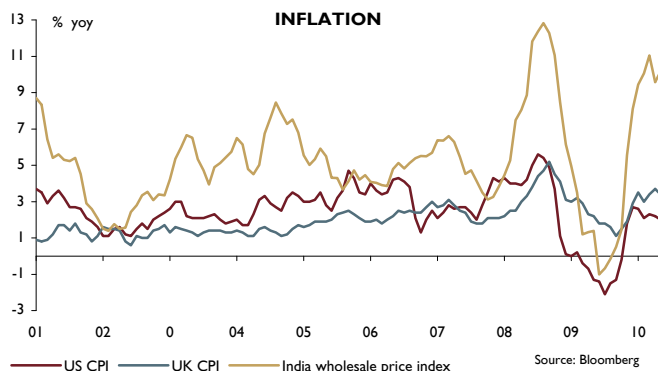
Volatility has fallen back sharply as risk appetite returns to equity markets after recent sell-off



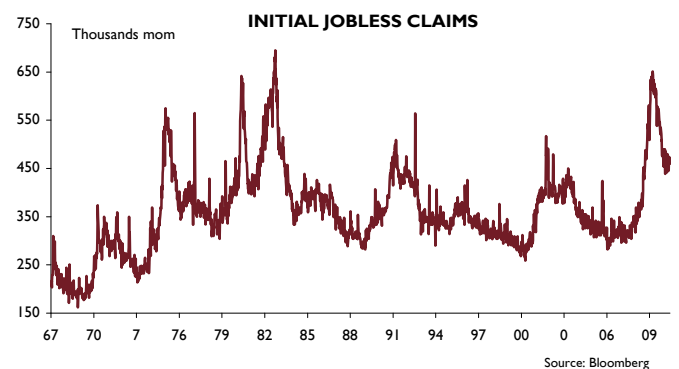
Peripheral euro-zone yield spreads widen further, as bond investors continue to shun fiscal miscreants



Divergence in inflation reflects robust growth, excess capacity in Asia, sluggish growth and spare capacity in developed world



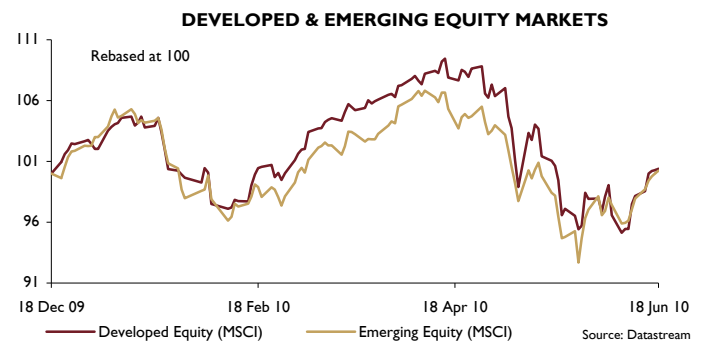
Some of the recent decline in US jobless claims has been reversed, reinforcing concerns about a jobless recovery



Market Performance

Equity Markets As of: 18-Jun-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
Developed Equity (MSCI)	819	2.3	-0.3	-4.8	-1.6	22.8
FTSE All Share	2,712	1.8	-1.0	-6.1	-1.8	25.0
FTSE 100	5,251	1.7	-1.1	-6.9	-3.0	22.1
S&P 500	1,118	2.4	-0.3	-4.1	0.2	23.5
Nasdaq Composite	2,310	3.0	-0.3	-3.4	1.8	43.9
DJ EuroStoxx	262	3.4	1.6	-4.7	-4.7	23.4
Nikkei 225	9,995	3.0	-2.4	-7.0	-5.2	19.0
Hang Seng	20,287	2.1	1.7	-4.9	-7.3	52.0
Emerging Equity (MSCI)	41,975	2.3	2.1	-3.1	-2.7	58.6
BRIC (MSCI)	504	2.0	2.5	-5.7	-5.6	68.0

Source: Datastream



10-Year Bond Yields As of: 18-Jun-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	3.2	-1	-13	-46	-61	158
UK Gilts	3.5	7	-20	-50	-63	102
Euro Bonds	2.7	14	-5	-40	-67	44
Japanese Bonds	1.4	-1	-7	-14	-6	11

Source: Datastream

Commodity Markets As of: 18-Jun-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	258	2.7	2.1	-3.8	-7.7	18.9
WTI Oil Price (Spot)	77	4.5	11.7	-5.8	-2.5	102.4
Gold Bullion (Spot)	1259	2.7	3.4	11.8	14.9	27.1
Industrial Metals (TR)	295	-0.4	-7.2	-17.1	-15.6	80.0

Source: Datastream

Interest Rates & Inflation

Inflation & Interest Rates		Current Inflation (%)	RBS Interest Rates Forecast (%)			Rate Announcement Next Date
			Current	Sep '10	Dec '10	
United States	(Fed Funds)	2.0	0.25	0.25	0.25	23-Jun
United Kingdom	(Base Rate)	3.4	0.50	0.50	1.00	08-Jul
euro-zone	(Repo Rate)	1.6	1.00	1.00	1.00	08-Jul
Japan	(Call Rate)	-1.2	0.10	0.10	0.10	15-Jul

Source: Coutts, RBS, Datastream

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