



Global Markets Weekly

Good news on China's FX policy gets overshadowed by recovery doubts.

Equities reacted positively to China's increased exchange-rate flexibility at the start of the week, but came under pressure thereafter. There was evidence that the global economic recovery, after a sharp 'V-shaped' phase, is becoming more sluggish as policy stimulus is withdrawn. The S&P 500 fell more than 1.5% on both Tuesday and Thursday. Indeed, the G-20 meeting over the weekend recognised the need for fiscal consolidation, setting a target that advanced economies' budget deficits should be halved by 2013.

Active fiscal tightening is bad for growth in Europe, but good for Gilts and sterling.

It is in Europe that fiscal consolidation is most severe. On Tuesday, UK Chancellor Osborne delivered the tightest budget in a generation, with a fiscal tightening of 8% of GDP by 2015-16, driven primarily by spending cuts with some contribution from tax rises, including an increase in VAT to 20%. Gilts and sterling are the clearest winners from the Budget, and both have reacted positively so far. Positive comments from credit-rating agencies suggest that the UK will keep its coveted triple-A status. The Bank of England is likely to keep interest rates lower for longer to offset the fiscal squeeze.

US growth could disappoint next year.

In the US, new and existing May home sales were well below expectations, with a worse impact than anticipated from the expiry of the home-buyer tax credit. Weekly jobless claims data improved, but remain indicative of a weak labour market. Indeed, we think US GDP growth in 2011 will disappoint, coming in at around 2% compared to the consensus forecast of 3.1%. This suggests annual earnings growth for US equities will slow to a 10-12% range in 2011, and is only partly reflected in a recent moderation in consensus forecasts from 20% to 18%. However, even based on our more bearish growth and earnings outlook, we believe valuations still leave room for further positive gains this year and next, but investors should be prepared for more modest returns, accompanied by greater volatility.

A dovish Fed and risk aversion push Treasury yields lower; Europe's debt crisis bubbles under the surface.

The US Federal Reserve (Fed) kept interest rates at emergency lows last week, and adopted a neutral tone compared to previous statements, simply recognising that growth was ongoing rather than accelerating. Evidence of sluggish growth, a dovish Fed statement and reduced risk appetite pushed US 10-year Treasury yields to their lowest levels in 15-months. The Fed also made an oblique reference to the euro-zone's debt problems, which were still bubbling below the surface last week. Yields on Greek and Portuguese government debt continued to increase and many smaller banks in the euro-zone periphery are heavily reliant on ECB loans.

Modest tightening is still taking place in emerging markets.

While developed economies will be keeping monetary policy loose for some time, modest tightening is still taking place in emerging markets. Taiwan raised interest rates last week, and more importantly China allowed its currency to appreciate a little against the dollar. The latter was partly a well-timed political move, just ahead of the G-20 meeting, to deflect criticism that it is not doing enough to offset global imbalances or contribute to global demand. But it also suggests China is confident in its outlook for domestic economic growth, although it is unlikely to abandon its policy of gradualism. Indeed, in its statement on the currency move, the People's Bank of China repeatedly noted that the renminbi's value would be determined with reference to a currency basket. The renminbi has risen 17% against the euro this year, while Europe accounts for 25% of China's exports. A rapid appreciation against the dollar as well could therefore be problematic for China.

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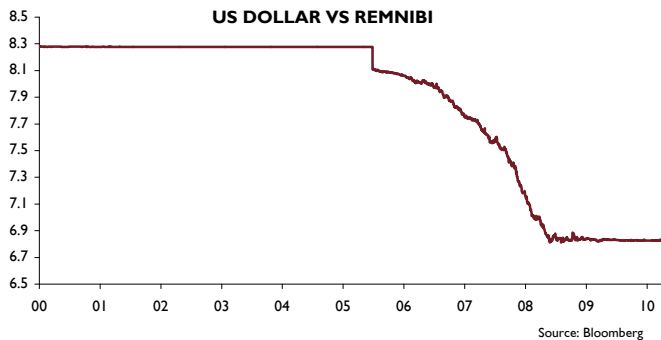
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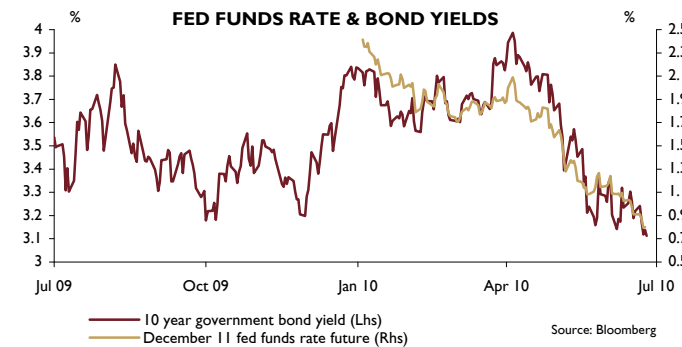
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Charts of the Week

Chinese authorities allow currency to appreciate modestly against dollar ahead of G-20



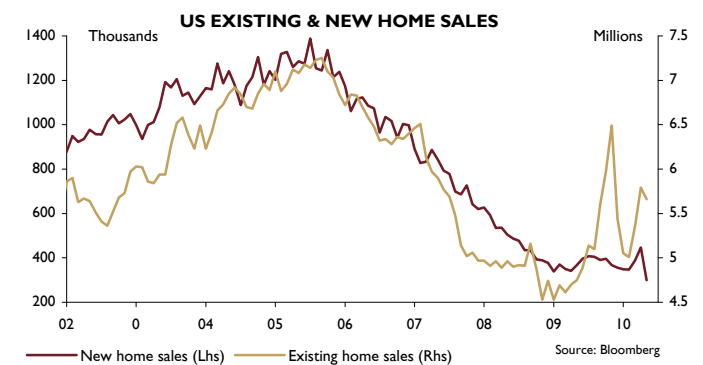
Expectations for Federal Reserve rate increases are pushed back, bringing 10-year yields down too



Sterling rallies against euro and dollar in reaction to the UK emergency Budget



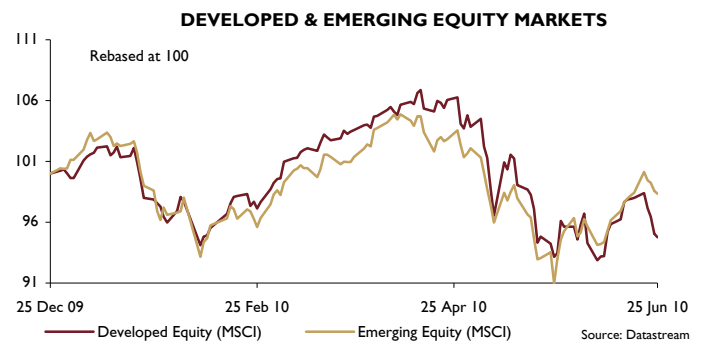
US home sales decline after stimulus measures expire



Market Performance

Equity Markets As of: 25-Jun-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
Developed Equity (MSCI)	792	-3.3	1.7	-8.4	-4.9	22.8
FTSE All Share	2,609	-3.8	2.4	-11.0	-5.5	25.0
FTSE 100	5,046	-3.9	2.1	-11.9	-6.8	22.1
S&P 500	1,077	-3.7	0.3	-7.6	-3.4	23.5
Nasdaq Composite	2,223	-3.7	0.6	-7.3	-2.0	43.9
DJ EuroStoxx	252	-3.7	6.2	-9.5	-8.2	23.4
Nikkei 225	9,737	-2.6	2.9	-10.1	-7.7	19.0
Hang Seng	20,691	2.0	9.0	-0.4	-5.4	52.0
Emerging Equity (MSCI)	41,946	-0.1	8.1	-2.6	-2.7	58.6
BRIC (MSCI)	506	0.3	9.5	-3.8	-5.3	68.0

Source: Datastream



10-Year Bond Yields As of: 25-Jun-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	3.1	-11	-5	-77	-72	158
UK Gilts	3.3	-15	-8	-70	-78	102
Euro Bonds	2.6	-11	8	-52	-78	44
Japanese Bonds	1.4	-7	-7	-21	-13	11

Source: Datastream

Commodity Markets As of: 25-Jun-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	258	0.2	5.2	-0.8	-7.4	18.9
WTI Oil Price (Spot)	79	2.1	14.4	-1.9	-0.4	102.4
Gold Bullion (Spot)	1254	-0.4	4.6	14.8	14.5	27.1
Industrial Metals (TR)	310	4.9	-0.9	-11.7	-11.4	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	10-Aug
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)	-0.9	0.10	0.10	0.10	15-Jul

Source: Coutts, RBS, Datastream

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