07 June 2010

Global Markets Weekly

Disappointing Chinese data and Spanish downgrade hit equities.

Equity markets were soft early in the week on the back of some weaker-than-expected manufacturing surveys from China and the Spanish government debt downgrade. The latter development highlighted the need for substantial fiscal consolidation by Spain and other periphery euro-zone states to regain investor confidence, which was also emphasised at the G-20 meeting of finance ministers over the weekend. Investors are coming to terms with the implications of the euro-zone's difficulties, pricing in weaker growth for the region on the back of fiscal consolidation, as well as recognising that at a global level a gradual recovery is continuing. The new Hungarian government's claim that it would have difficulty meeting the IMF's austerity measures, together with a mixed US labour market report, also unnerved investors at the end of the week.

Fiscal consolidation to weigh on euro-zone growth and the single currency.

Fiscal retrenchement will weigh on euro-zone growth for some years, but the region was never a significant driver of global growth. We believe that provided the euro-zone's fiscal problems do not mutate into a full-blown banking crisis, the global recovery can continue, supporting risk assets. But the failure of euro-zone policymakers to coordinate their actions suggests that a banking crisis is a significant 'tail risk' and will weigh on the performance of the euro-zone's financial sector in particular. A significantly weaker euro is also likely. The currency hit a four-year low against the dollar last week, and fell through the 1.40 mark against the Swiss Franc, a level the Swiss National Bank was seeking to defend only a few weeks ago. Sterling has also been regaining ground against the euro.

Generally encouraging figures on global growth.

Monthly manufacturing and service sector surveys for the advanced economies suggest decent growth in the second quarter. Thus, the non-manufacturing ISM survey in the US held at 55.4 for a third month in May, with the employment component inching above the 50 expansion/contraction mark for the first time since December 2007. UK business activity data was also encouraging, while the core euro-zone countries Germany, France and Italy continue to expand.

Mixed data on US labour market.

However, the all-important US non-farm payroll report suggests that although the US labour market continues to heal, the pace is slow. Employment jumped by 431,000 in May, but the figures were boosted by public sector hiring for the US 10-year census survey. Investors focused on the trend in private sector employment, which increased by only 41,000, after an increase of 218,000 the prior month. Given the problems in the euro-zone, investors are particularly sensitive to even modestly disappointing news out of either the US or China.

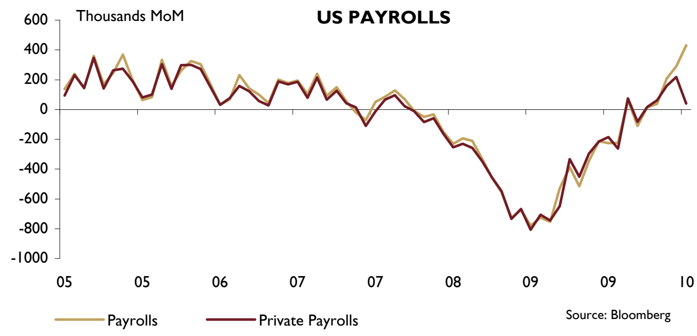
UK housing market may come under pressure from weak jobs market.

In the UK, there were conflicting reports on the housing market with the Halifax house price index showing a 0.4% m/m decline, while Nationwide reported a 0.5% m/m increase. UK house prices have recovered about a third of the value lost during the credit crisis, but we think they will struggle to make further progress from here given a weak labour market and a lack of credit growth. Given the coming fiscal consolidation, we would expect regions where the government is a major employer to underperform, whereas those areas which are attractive to overseas investors, i.e. London and the South East, look set to outperform.

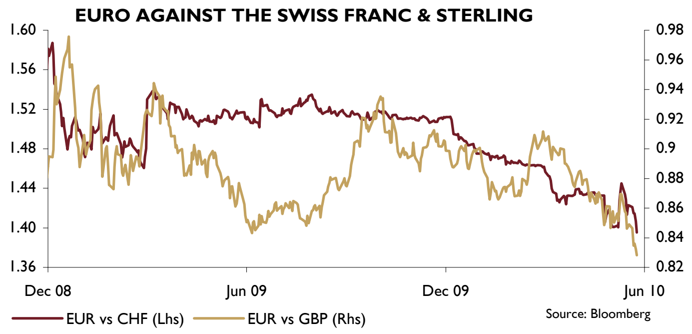
Carl Astorri	Jean-Maurice Ladure	Henry Lancaster	Georgios Tsapouris
+ 44 20 7753 1612	+44 20 7753 1469	+44 20 7957 2426	+44 20 7753 1888

Charts of the Week

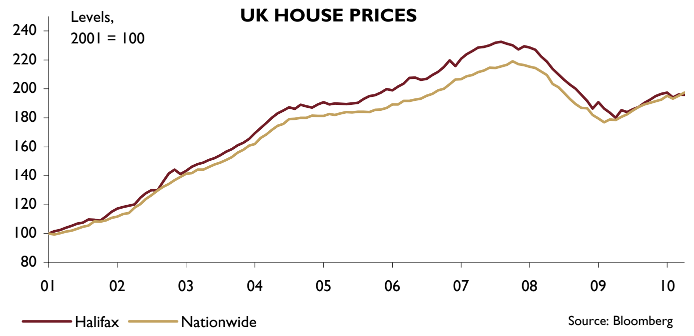
US labour market improving, but only slowly in terms of private-sector job growth



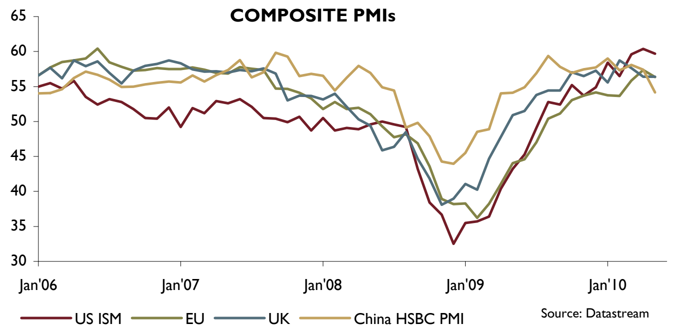
Euro continues to weaken on sovereign debt and banking sector concerns



UK house prices may have peaked, as fiscal consolidation in the UK kicks in



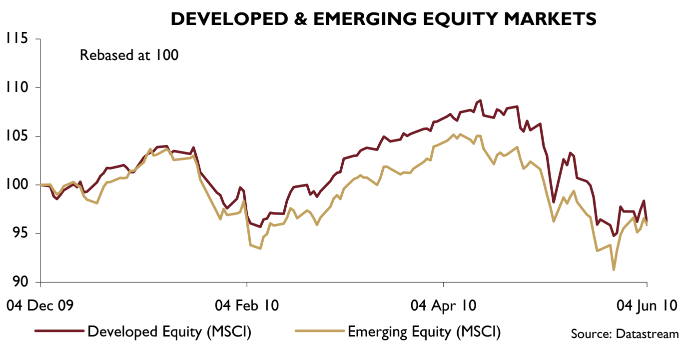
PMIs suggest global recovery continuing, especially in the US, but China may be slowing down



Market Performance

Equity Markets		**Performance (%, local)**				
As of: 4-Jun-10	**Current**	**-1W**	**-1M**	**-3M**	**YTD**	**09**
Developed Equity (MSCI)	**788**	**-1.4**	**-7.7**	**-5.3**	**-5.3**	**22.8**
FTSE All Share	2,645	-1.1	-5.3	-6.4	-4.2	25.0
FTSE 100	5,126	-1.2	-5.3	-7.3	-5.3	22.1
S&P 500	1,065	-2.3	-9.3	-5.2	-4.5	23.5
Nasdaq Composite	2,219	-1.7	-8.5	-3.2	-2.2	43.9
DJ EuroStoxx	246	-1.7	-5.4	-7.6	-10.6	23.4
Nikkei 225	9,901	1.4	-10.5	-2.4	-6.1	19.0
Hang Seng	19,780	0.1	-4.7	-3.9	-9.6	52.0
Emerging Equity (MSCI)	**40,799**	**0.4**	**-4.4**	**-2.6**	**-5.4**	**58.6**
BRIC (MSCI)	491	0.2	-4.2	-5.3	-8.1	68.0

Source: Datastream



10-Year Bond Yields		**Change (basis points)**				
As of: 4-Jun-10	**Current**	**-1W**	**-1M**	**-3M**	**YTD**	**09**
US Treasuries	3.2	-9	-39	-41	-64	158
UK Gilts	3.4	-7	-34	-55	-66	102
Euro Bonds	2.6	-3	-32	-54	-80	44
Japanese Bonds	1.4	-3	-6	-10	-6	11

Source: Datastream

Commodity Markets		**Performance (%)**				
As of: 4-Jun-10	**Current**	**-1W**	**-1M**	**-3M**	**YTD**	**09**
Commodities (TR)	245	-2.7	-7.6	-8.9	-12.3	18.9
WTI Oil Price (Spot)	71	-4.1	-14.1	-11.5	-10.4	102.4
Gold Bullion (Spot)	1205	0.2	2.8	6.5	9.9	27.1
Industrial Metals (TR)	284	-10.8	-16.5	-18.9	-18.7	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)	2.2	0.25	0.25	0.25	23-Jun
United Kingdom	(Base Rate)	3.7	0.50	0.50	1.00	10-Jun
euro-zone	(Repo Rate)	1.6	1.00	1.00	1.00	10-Jun
Japan	(Call Rate)	-1.2	0.10	0.10	0.10	15-Jun

Source: Coutts, RBS, Datastream

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