29 March 2010

Global Markets Weekly

Uncertainty over outcome of EU summit overshadowed better-than-expected data.

Equity markets trod water last week despite generally better-than-expected data. Investors were more concerned with a number of significant events, notably the EU summit. Uncertainty over the outcome undermined the euro for most of the week – the currency fell to its lowest level since May 2009 against the dollar. US government bonds also came under pressure, with 10–year Treasury yields spiking by almost 25 points to their highest level in nine months.

The eurozone's plans to aid Greece should reassure investors - at least temporarily.

Eurozone leaders finally gave more detail on plans to support Greece. **Athens will be able to access a joint EU/IMF emergency lending facility, if it is unable to obtain financing from the bond markets.** This measure should suffice to reassure markets for now. The ECB also announced that, from the beginning of 2011, it would not (as it had previously planned) tighten its minimum eligible collateral requirements against which it lends cash. Critically, banks will be able to continue presenting Greek bonds as collateral to the ECB. However, in a setback for the eurozone, the rating agency Fitch downgraded Portugal's long-term credit rating by one notch to AA- from AA.

UK budget prompts little reponse from investors.

The budget was the main event in the UK. While cider drinkers will be disappointed by a 10% above inflation duty increase, the reaction from financial markets was fairly muted, with sterling and gilt markets little changed. **The government plans to gradually restore the public finances to health through a mixture of tax increases, departmental spending cuts and efficiency savings.** The Treasury is also relying on strong growth slowly shrinking the national debt burden. Interestingly, the Chancellor announced a phased increase in fuel duty – to reduce upward pressure on consumer inflation. Fiscal consolidation often involves higher sales taxes, which adds to consumer inflation, albeit temporarily.

Activity surprised on the upside in the eurozone, the USA and the UK.

Despite the political uncertainty, eurozone economic data produced positive surprises. The Ifo survey of German businesses jumped to its highest level since June 2009. The PMI surveys for the eurozone were also generally stronger than expected. **Furthermore, economic data in the USA boosted hopes of a gradual economic recovery.** Non-defence capital goods orders excluding aircraft, a proxy for business investment, rose in February, suggesting companies are increasing investment - having slashed employment and investment during the recession. The IT sector could be a major beneficiary. Weekly initial jobless claims fell, indicating that the US labour market is gradually improving. Retail sales in the UK were better than expected, while inflation in February ebbed more quickly than forecast, after jumping in January.

Jump in US bond yields could presage difficulties ahead.

Finally, a spike in US bond yields saw 10-year Treasury yields rise by almost 25 basis points in two days to their highest levels in nine months. This followed weak auctions of $42 bn of five-year and $32 bn of seven-year Treasuries on Wednesday and Thursday respectively. A lower bid/cover ratio than has been the case in recent months was cited by some as an explanation. While it is too early to identify a new trend, the jump in yields indicates that the amount of issuance required to fund large budget deficits can leave bond markets vulnerable when demand is soft.

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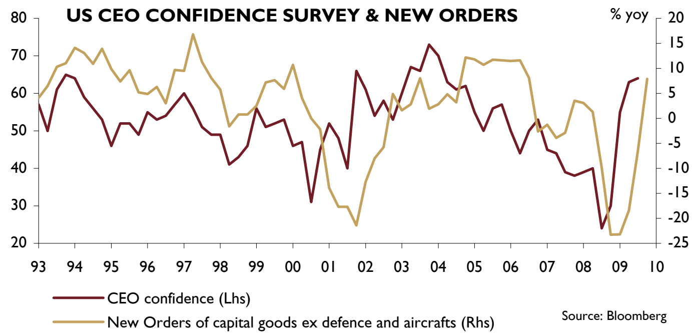
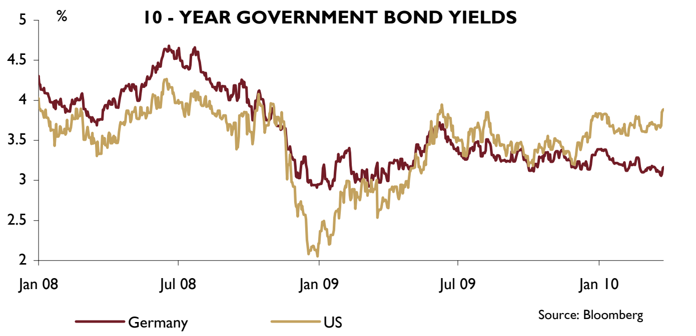
Charts of the Week

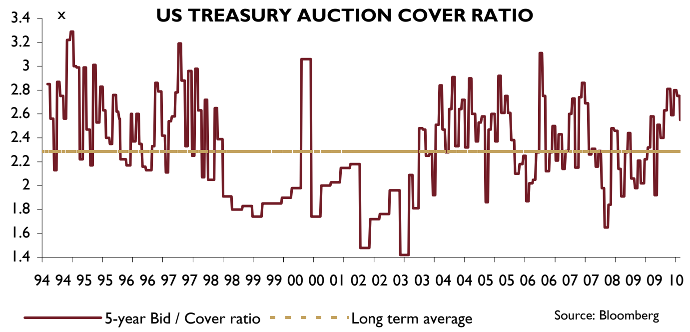
Improving US business confidence points to an increase in investment and raises hopes of a sustainable recovery



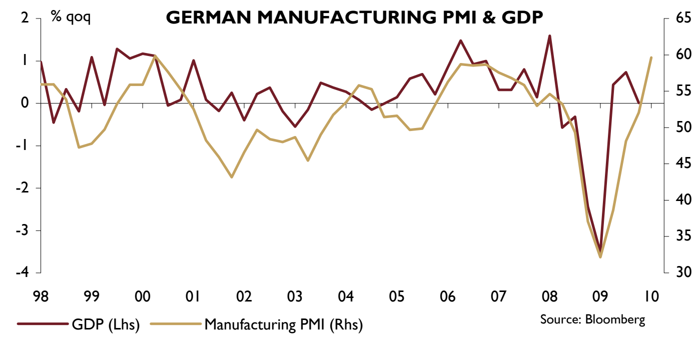
US Treasury yields reach their highest level in nine months as auction demand softens...



…leading to concerns about the longer term outlook



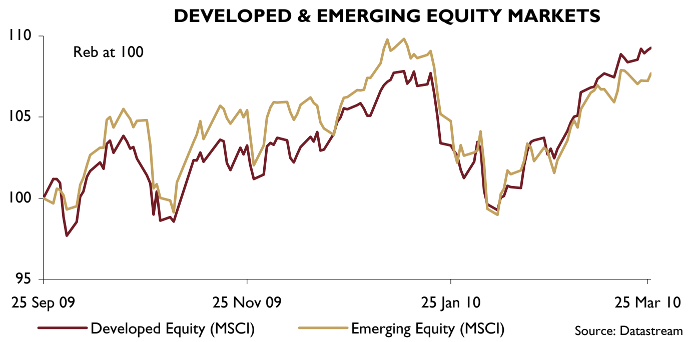
German business confidence improves to its highest level in nine months, signalling stronger growth



Market Performance

Equity Markets		Performance (%, local)				
As of: 26-Mar-10	**Current**	**-1W**	**-1M**	**-3M**	**YTD**	**09**
Developed Equity (MSCI)	**866**	**0.8**	**6.1**	**3.6**	**4.0**	**22.8**
FTSE All Share	2,923	1.1	6.8	6.2	5.9	25.0
FTSE 100	5,703	0.9	6.5	5.6	5.4	22.1
S&P 500	1,167	0.6	5.6	3.6	4.6	23.5
Nasdaq Composite	2,395	0.9	7.0	4.8	5.6	43.9
DJ EuroStoxx	278	1.7	8.3	1.6	1.3	23.4
Nikkei 225	10,996	1.6	8.6	4.8	4.3	19.0
Hang Seng	21,053	-1.5	2.2	-2.2	-3.8	52.0
Emerging Equity (MSCI)	**43,236**	**0.0**	**5.2**	**1.4**	**0.2**	**58.6**
BRIC (MSCI)	529	-0.7	4.3	0.5	-0.9	68.0

Source: Datastream



10-Year Bond Yields		Change (basis points)				
As of: 26-Mar-10	**Current**	**-1W**	**-1M**	**-3M**	**YTD**	**09**
US Treasuries	3.9	16	24	5	2	158
UK Gilts	4.0	8	0	-7	-8	102
Euro Bonds	3.2	4	5	-15	-23	44
Japanese Bonds	1.4	2	8	11	9	11

Source: Datastream

Commodity Markets		Performance (%)				
As of: 26-Mar-10	**Current**	**-1W**	**-1M**	**-3M**	**YTD**	**09**
Commodities (TR)	260	-2.0	-3.1	-6.0	-6.8	18.9
WTI Oil Price (Spot)	80	-0.7	0.5	3.0	1.0	102.4
Gold Bullion (Spot)	1104	0.1	-0.1	1.6	0.8	27.1
Industrial Metals (TR)	353	0.2	4.5	1.8	1.1	80.0

Source: Datastream

Interest Rates & Inflation

Inflation & Interest Rates		Current Inflation (%)	RBS Interest Rates Forecast (%)			Rate Announcement Next Date
			Current	**Jun '10**	**Sep '10**	
United States	(Fed Funds)	2.1	0.25	0.25	0.75	28-Apr
United Kingdom	(Base Rate)	3.0	0.50	0.50	0.50	08-Apr
Eurozone	(Repo Rate)	0.9	1.00	1.00	1.00	08-Apr
Japan	(Call Rate)	-1.1	0.10	0.10	0.10	07-Apr

Source: Coutts, RBS, Datastream