# Weekly Market Analysis 23 November 2009

## European Bourses

Having posted 12-month highs during trading on Monday, European equities registered consecutive daily declines for the remainder of the week. Initial gains were driven by the Asia-Pacific Economic Corporation's commitment to maintain stimulus, which had a positive impact on commodity prices and related equities, as well as strong economic data from the US. However, the rest of the week was characterised by concerns over the prospects for ongoing global growth, how central banks may handle the withdrawal of stimulus packages and the state of the European banking sector, which bore the brunt of the equity market's downside. Irish and Greek banks saw the largest falls, with the latter brought lower by Greece's weak fiscal position, the possibility of windfall taxes and European Central Bank comments suggesting that liquidity provision may be coming to an end. The sector ended the week 3.56% lower. Other decliners included the real estate (-3.6%), travel and leisure (-3.1%) and retail (-2.7%) sectors, all suffering from concerns over economic recovery. On the upside, the chemicals, basic resources and utility sectors were the only risers, albeit modestly, with none gaining more than 0.3%. The DJ STOXX 600 ended the week 1.7% lower. The Italian MIB was the largest decliner, followed by falls of over 2% in the Netherlands and France. The German DAX and the UK's FTSE 100 were the best relative performers, falling by 0.4% and 0.8% respectively.

## Currencies

Both UK pound and the euro initially strengthened versus the US dollar, but lost ground late on in the week to end lower. The dollar was initially weak after investors questioned the Federal Reserve's commitment to a strong dollar. Ben Bernanke, the Fed Chairman, had said that the central bank would be 'attentive' to changes in its value, but investors felt that it will actually have to keep rates low for an extended period of time in order to support the currency, discouraging demand. However, falling stock markets in the second-half of the week saw investors move back towards perceived safe havens. The dollar also gained as investor bought short-term treasuries on concern that recent rallies in equity markets may be overdone. The UK pound fell harder than the euro due to concerns that the worst budget deficit since record began will put the brakes on any recovery. By the close on Friday the UK pound was worth $1.649 (having closed the previous week at $1.6676), while the euro was valued at $1.485 (versus its previous weekly close of $1.49).

## Commodities

The price of oil strengthened early on in the week, pushing briefly above the $80/barrel level during trading on Wednesday. This strength was driven by a weaker dollar and a notable move back into risk assets, with crude registering its largest one-day gain in six weeks on Monday. Better-than-expected US retail sales and Japanese third quarter GDP growth of 4.8% helped buoy investor sentiment, while a fall in US supplies during the previous week (according to the US Department of Energy) suggested that demand may be improving. However, oil prices moderated later in the week as the dollar rebounded slightly from its recent lows and as equity markets began to string together days of consecutive losses. By the close on Friday, a barrel of crude was trading at $76.72, little changed on the previous week's close.

Among metals, gold continued to move higher during the week, reaching fresh all-time highs during trading on Wednesday, before moderating slightly. Bullion was pushed higher as investors continued to buy precious metals (with silver, platinum and palladium reaching 14 months highs) as an alternative to holding a weakening US dollar. Sentiment towards gold was also raised after the IMF said that it had sold further stocks to countries as governments look to increase their holdings. The price of an ounce of gold ended the week at $1,144, but has already moved over the $1,165 level during early Asian trading this morning.

Copper saw its largest weekly gain in four weeks as speculation mounted that the dollar has further to fall, which in turn could increase demand for hard assets as an inflation hedge. The price of copper reached a new 14-

month high during the week ($6,992 per metric ton) and has more than doubled during 2009. By Friday's close, copper for 3 month delivery was trading at $6845 per metric ton, having ended the previous week at $6520, a 5% gain.

## Economic Commentary

European Central Bank (ECB) President Jean Claude Trichet made a number of comments in a speech at a banking conference in Frankfurt that were perceived as increasingly hawkish. He said that "not all of the liquidity measures will be needed to the same extent as in the past," and that "any non-standard measure whose continuation would pose a threat to the achievement of price stability must be undone promptly and unequivocally." Our economists note that the wording of Mr. Trichet's comments, one day after the mid-month ECB Governing Council meeting, is more hawkish than it was before. This suggests to them that the Governing Council has made progress in finding a compromise on the implementation of the ECB's exit strategy. It seems that Trichet would like to prepare the market for the council to announce more far-reaching measures at the beginning of December than just the determination of the 12-month open market operations beyond December. Our economists think that the ECB may limit the use of the long term funding facility, as well as reduce the speed of covered bond purchases.

Our economists highlight that the UK's inflation and fiscal data continue to disappoint, overshooting consensus expectations (October's CPI inflation of 1.5% represented a rise from September's 1.1% and was the eighth time in 12 months that it had come in ahead of expectations). They note that with the upcoming reversion of VAT from 15% to 17.5% and lagged effects from the weak pound, they expect CPI inflation to rise into "letter-writing territory" above 3% year over year in the first half of 2010. Moreover, they share the OECD's fears that, without major medium-term fiscal consolidation, the UK's fiscal deficit will stay extraordinarily high for many years. Our economists think that economic recovery plus high inflation data are likely to prompt the Bank of England to raise rates in the second or third quarter of 2010, rather earlier than the European Central Bank. As a result, they think that the return to fiscal sustainability is likely to prove painful and protracted.

Germany announced that it will introduce a substantial fiscal easing, amounting to around €50 billion ($74bn), or 2% of GDP in 2010. This is aimed at helping to boost GDP growth to around 2% next year. It is expected to propel the deficit-to-GDP ratio to around 6%, from around 4% in this year. Our economists note that with a better starting position than in many other euro area countries, Germany should be able to meet the Excessive Deficit Procedure deadline to bring the deficit-to-GDP ratio back to 3% by 2013. However, the government plan to reduce taxes by an additional €20 billion in 2011 would make the consolidation more difficult. They expect that the government will eventually drop the tax-cutting plans, but still see a small chance for "neutral" tax-rate reductions, which would come in combination with a widening of the tax base.

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