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- **US crude oil prices, gold and benchmark US Treasury 10-year bonds** were among the best performing assets in 2011.
- The **EUR** kicked off the new year on a weak tone as the sovereign debt crisis remains in the epicenter of market attention. For the whole of 2011, the common currency lost 3.2% against the US dollar, adding to a 6.6% decline in 2010.
- **Hungary's** parliament passed a central bank law on Friday, aggravating concerns about a potential derailment of the country's negotiations over a new EU/IMF loan agreement.
- **CEE stock markets** were marginally firmer on Monday, regional currencies broadly flat on the first trading day this year, having suffered hefty losses in 2011.

Latest Developments/News & Macro releases

Greece: According to the Wall Street Journal, the IMF has warned that a 50% write-down on Greek sovereign debt may not be enough to bring it down to sustainable levels. Quoting an IMF official who declined to be named, the report also read that the IMF is working on a "starker economic assessment" for Greece than the one outlined last month in its 5th review of the country's economic adjustment programme. The same press report added that some IMF officials think "the debt sustainability analysis is not valid anymore" under the new economic forecasts and the IMF is of the view that, for Greece's debt to be sustainable now, "requires either a deeper haircut or additional loans from Europe".

Turkey's seasonally-adjusted PMI manufacturing slipped to a 3-month trough of 52.0 in December from 52.3 a month earlier. In spite of the decline, the index remained above the 50-level for the fourth consecutive month indicating ongoing expansion in the sector. On the inflation front, CBT Deputy Governor Turalay Kenc noted on Friday that annual consumer inflation would likely end 2011 at a double digit figure and be around 10% in May, before converging towards the CBT's 5% 2012 target towards the end of this year. He added that the CBT will continue along its monetary tightening policy for some time. As a reminder, CPI stood at 9.5%yoy in November.

Hungary's parliament passed a law on Friday, in spite of EU/IMF caution that the legislation could weigh on the Central Bank's (MNB) independence. The law passed with 293 votes in favor in the 386-seat parliament, where the ruling Fidesz-KDNP government enjoys a 2/3 majority. Reportedly, the MNB said on Friday that such bills "create the possibility for influence over central bank decision making based on government and party interests, which ... goes against... the basic treaty of the European Union". The bill's recent endorsement in parliament aggravates concerns about a potential derailment of the country's negotiations over a new EU/IMF loan agreement, which are expected to start early this year. As a reminder, a disagreement over two laws - among them the central bank law - resulted to a halt in informal financial aid discussions with the EU and the IMF in December. European Commission President Jose Manuel Barroso requested last month from Prime Minister Viktor Orban to withdraw these two bills, while according to local media U.S. Secretary of State Hillary Clinton expressed worries over the government's policies in a letter to the prime minister in December.

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On the other hand, Fidesz member Antal Rogan highlighted in the run up to the vote on Friday that the new law strengthens rather than weakens the MNB's independence. In other news, Hungary's seasonally-adjusted PMI manufacturing crept up to 48.5 points in December from 47.8 a month earlier. In spite of the increase, the index remained below the 50-point threshold indicating contraction in the sector.

Poland's PMI manufacturing eased further below the 50-level in December, coming in at 48.8 vs. 49.5 in November and indicating contraction in the sector for the second month running. The market's median forecast was for a rise to 49.9. In spite of the recent evidence of economic slowdown, the head of the Polish statistical office Janusz Witkowski was quoted as saying to local media on Friday that real GDP growth will likely slow marginally to 4.0% in Q4:2011 from 4.2% in the prior quarter, bringing growth for the whole of 2011 to 4.0%. Separately, Finance Minister Jacek Rostowski said in an interview to Newsweek today that the central bank may purchase government bonds in the secondary market in the short-term if yields rise amid "panic or on the back of a (crisis) contagion from the outside".

Equity markets

US equity markets fell on Friday, the last trading day of 2011 amid lingering worries over the eurozone's sovereign debt crisis and fears of a renewed global recession. However, for the whole year, the **Dow Jones industrial average index** rose by 5.5% and the **Nasdaq Composite Index** was down 1.6%. A steady flow of positive US data macro data releases over the last few months allowed the **Standard & Poor's 500 Index** to erase losses and end 2011 barely changed compared to the closing level of 2010, posting the smallest percentage change in either direction since 1970. The **CBOE VIX volatility index** rose about 30% for the year, the first increase since 2008. **European shares** were trading in positive territory in early trade on Monday, the first trading day of the new year, but posted their biggest annual drop in three years in 2011 as debt tensions in the euro zone strained the financial sector and threatened to derail a fragile economic recovery. Turning to **Asia**, the majority of equity markets were closed today. The **MSCI All-Country World Index** finished 2011 with losses of around 9.5% weighed down by the ongoing debt crisis, a devastating Japanese earthquake and tsunami in March as well as heightened uncertainty about the outlook of the global economy. Elsewhere, **US crude oil prices** were among the best performing assets in 2011 ending the year with gains of 8.1% as instability in oil producing countries more than offset concerns about the evolution of the eurozone debt crisis. **Gold** also recorded a strong performance in 2011 ending the year with gains of 10.5%, marking its eleventh consecutive year of gains.

FX markets

The **EUR** kicked off the new year on a weak tone as the sovereign debt crisis remains in the epicenter of market attention. The EFSF may not have sufficient firepower to support fiscally vulnerable eurozone sovereigns while it remains to be seen whether the agreement at the December 9th EU Summit to provide up to €200bn in bilateral loans to the IMF will come into effect. Separately, Eurozone banks remain wary of lending to each other or to extend credit to the domestic economy as the sovereign debt crisis shows no signs of abating soon. Against this background, most of the official liquidity support eurozone banks absorbed by the ECB at its first-ever 3-year LTRO on December 21 has been re-deposited back at the central bank. Eurozone banks have to offset the impact of, among other factors, deposit withdrawals while they are concerned about the risk of running out of eligible collateral at the time that sovereign credit rating jitters linger. S&P put the long-term sovereign credit ratings of 15 eurozone nations on negative watch in early December and is expected to announce any rating changes "as soon as possible" after the December 9 EU Summit failed to deliver a comprehensive solution to the debt crisis. Separately, Fitch placed on credit watch negative –which traditionally signals the possibility of a downgrade within three months– the sovereign credit rating of six eurozone countries –Belgium, Cyprus, Ireland, Italy, Slovenia and Spain– citing that "the systemic nature of the eurozone crisis is having a profoundly adverse effect on economic and financial stability across the region". The rating agency revised the outlook of France's AAA rating to negative and warned that a possible downgrade could come in two years.

Against this background, the **EUR/USD** was hovering around 1.2945/50 at the time of writing, not far from a 11-month low of 1.2855 recorded late last week and within distance from 2001 lows of 1.2870 tested in early January. For the whole of 2011, the common currency lost 3.2% against the US dollar, adding to a 6.6% decline in 2010. Looking ahead, the EUR looks vulnerable and risks are skewed to further downside amid fears that a lasting solution to the debt crisis remains some way off. Fears over a renewed Eurozone recession, are also expected to keep the EUR under pressure in the weeks/months ahead especially if the US economy will continue to outperform

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the Eurozone's economy. The US dollar index DXY finished last year up 6.8%, its second consecutive annual rise.

Government bond markets

German government bonds remained supported in European trade on Monday after posting stellar returns in 2011 favored mostly by lingering worries over the debt crisis and the lack of a comprehensive solution so far. Looking ahead, German sovereign paper is expected to retain a positive tone supported by concerns about the Eurozone's growth outlook, expectations for easing inflation pressures and uncertainty over an imminent bold solution to the debt crisis. UK and US markets are closed today on New Year holidays. The 2/10-year Bund yield spread stood close to 168.5bps at the time of writing, ca 41bps lower relative to the settlement in the last trading year of 2010. Elsewhere, **US 10-year government benchmark bond yield** ended at a two week low of 1.876% in the last trading day of 2011, down sharply from the closing level of 3.36% in 2010, on the back of growing fears over the eurozone debt crisis combined with the Fed's pledge to keep interest rates low through mid-2013. The **2/10-UST yield** ended at on Friday, the narrowest in two weeks and some 109bp lower relative to the 2010's closing level.

Emerging markets

CEE stock markets were marginally firmer on Monday, the first trading day this year, having suffered significant losses in 2011 in view of the euro area's deepening debt crisis. With a comprehensive solution to the eurozone's woes still pending and with consequent headwinds to the 2012 economic growth outlook in Central and Eastern Europe looming, there is little to suggest that stock markets in the region will embark on a sustainable upturn in 2012. Indicatively, Hungary's main stock index **BUX** led the gains in the region in European trade today, bouncing by ca 0.6%. The index registered losses to the tune of 20% last year in view of growing external spillover risks and unorthodox policies pursued by the government. Separately, Poland's **WIG20** rose by 0.5% earlier today, while Turkey's **ISE 100** was 0.2% higher in morning trade, with each index having recoiled by nearly 22% last year. Other stock markets in the region were closed on holiday.

In a similar vein, **regional currencies** were broadly flat in European trade today, having come under significant pressure in 2011. The Turkish lira, underperformed its peers last year with its losses exacerbated by an unorthodox policy mix employed by the CBT. Although depreciating pressures will likely persist this year in view of the ongoing debt crisis in the euro area and a slowdown in economic activity in the coming months, monetary policy tightening ahead and a possible eventual switch to a conventional policy are likely to offer a lift and offset the currency's downtrend. Against this background, the **USD/TRY** hovered around levels of 1.8870/1.8920 earlier today having ended the year nearly 23% higher at 1.8840 and standing not far off a record peak of 1.9230 touched in late December. Separately, the Hungarian forint was marginally weaker in the wake of the endorsement of a new Central Bank law on Friday that exacerbated concerns about a derailment of negotiations over official financial aid deal. Along these lines, the **EUR/HUF** hovered around a 1-½-month peak of 315.55, within distance from November's 317.72 lifetime high and well above a 277.98 level at the beginning of 2011, with the MNB's resort to monetary tightening since late November in order to support the domestic currency having provided little respite.

In **the local rates markets**, government bonds ended last year mixed. Turkish paper has been the main underperformer in view of escalating inflation risks. In detail, the 2-year benchmark bond yield rose by 437bps over the last twelve months to end 2011 at a 2-½-year peak of 11.48%.

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