Brief summary of key market developments

- The JPY lost some ground on news that S&P downgraded Japan’s sovereign credit rating. The GBP was firmer as BoE minutes showed that two policy members voted for a rate hike.
- German government bonds moved lower following a poorly received €2bn in 30-yr Bunds auction y-day. In the EMU sovereign debt space, Ireland underperformed on mounting political jitters.
- Greece: Following comments earlier this week from the influential Bruegel think-tank that Greece’s debt is unsustainable and should be restructured, Beatrice Weder di Mauro, an adviser to the German economy and a member of the European Parliament, suggested y-day that a EU crisis resolution would have to include restructuring of Greek debt.
- CEE stock markets moved lower after Japan’s sovereign credit downgrade, regional currencies were broadly firmer earlier today.

Latest Developments/News & Macro releases

The FOMC meeting that concluded y-day, the first meeting of the year, did not yield major surprises. The FOMC’s policy statement was in line with market expectations. The committee maintained an overall dovish stance with the statement reiterating the committee’s pledge to keep interest rates at “exceptionally low levels for an extended period” and continue its QE2 by the end of Q2 2011. The Fed remains deeply concerned about the outlook of the labor market with the statement reading that, although “the economic recovery is continueing”, the pace of recovery has been “insufficient to bring about a significant improvement in labor market conditions”. On the inflation front, the committee acknowledged that commodity prices have risen, continuing though to characterize core inflation as “trending downward” in spite of an uptick in the December core CPI index.

US new home sales surprised positively in December rising by 17.5%mom with the annual rate standing at 329k, the highest level in eight months and higher than 300k expected from November’s 280k. The number of new homes available for sale came in at 190k, the lowest in eight months, down from 195k a month earlier. At the current sales pace, it would take 6.9 months to clear that supply, vs. 8.4 months’ worth in November. The national median price rose by 8.5%yoy, to $241,500, the highest since April 2008.

The US Mortgage Bankers Association’s seasonally adjusted index of mortgage applications, which includes both purchase and refinance loans, declined by 12.9% in the week ended January 21. Mortgage applications for home purchases dropped by 8.7% and demand for home refinancing loans fell by 15.3% as borrowing costs in 30-yr fixed-rate mortgages increased by 3bps to 4.80%.

Greece: Following comments earlier this week from the influential Bruegel think-tank that Greece’s debt is unsustainable and should be restructured, Beatrice Weder di Mauro, an adviser to the German economy and a member of the European Parliament, suggested y-day that a EU crisis resolution would have to include restructuring of Greek debt. The German official added that negotiations about a lengthening of maturities and lower interest rates would help. The above comments were echoed by Wolf Klinz, a member of Germany’s ruling Free Democrats (FDP) who chairs a crisis-response committee in the European Parliament.

Equity markets

US equity markets moved higher overnight on Q4 earnings optimism. According to Thomson Reuters data, 69 of the 144 S&P 500 companies that have reported earnings so far have exceeded estimates. The Fed’s unanimous decision to maintain a $600 billion bond-buying plan to fuel an economic recovery, also favored market sentiment. The Dow Jones industrial average index edged up 0.07% to end at 11,985.44 following a
temporary increase above the psychologically important of 12,000 for the first time since June 2008. The Standard & Poor's 500 Index advanced 0.42% to 1,296.63, the highest level in 29 months. Short-term support stands at 1,284 (14-day MA) while strong resistance lies within the 1,300-1,305 area, closing highs reached in August 2008. The Nasdaq Composite Index gained 0.74% to 2,739.50.

Taking their lead from firmer US equity markets, Asian bourses moved higher today. Japan’s Nikkei 225 average rose 0.7% and Chinese shares advanced for a second day in a row with Shanghai’s key stock index gaining 1.0% in spite of fresh measures to cool the country’s real estate market. More specifically, China increased the minimum down payment for second-home purchases to 60% from 50%, and told local governments to set price targets on new properties. Among the underperformers in the region was the Australian equity market which closed a touch lower after the government announced a one-off tax levy, a program of spending cuts and deferred spending to meeting the AUD $5.6bn cost from the Queensland flood.

FX markets
The JPY moved lower in early European trade on Thursday on news that rating agency S&P downgraded Japan’s sovereign credit rating to AA- from AA citing concerns that the country’s government debt ratio would continue to rise more than it had previously expected. Specifically, the S&P statement read that “the downgrade reflects our appraisal that Japan’s government debt ratios -already among the highest for rated sovereigns- will continue to rise further than we envisaged before the global economic recession hit the country and will peak only in the mid-2020s”. The USD/JPY was hovering around 82.75/80 at the time of writing, having recovered from session lows near 82.00 recorded earlier today ahead of the S&P announcement. Despite the latest upside attempt, range trading within 81.50-83.50 prevails. Elsewhere, the EUR retained a positive tone with the EUR/USD hovering around 1.3670/75 at the time of writing, not far from a ten-week high near 1.3730 hit earlier today. The Fed’s dovish stance added to the notion that the ECB might hike interest rates ahead of the Fed, especially following recent tough talk by ECB President Jean Claude Trichet on keeping inflation in check. Adding to EUR positives, demand for the EFSF first bond sale earlier this week was exceptionally strong reflecting market optimism that European officials are coming close to a comprehensive solution for the debt crisis. Technically, as long as 1.3570 support holds (50% retracement of its decline from November 4 highs to 10 January lows) risks are for some further appreciation towards 1.3740 (61.8% retracement of its decline from November 4 highs to 10 January lows) in the way to 1.3785 (November 22 high. Elsewhere, the GBP gained some ground on revived rate hike expectations after the MPC minutes showed that two members voted for a 25bps rate hike. The GBP/USD recovered some of its recent losses to stand close to 1.5920/25 at the time of writing after falling near 1.5750 y-day. But on the back of market fears that the UK economy will probably experience a period of stagflation, there is little to suggest that the GBP is poised for further meaningful gains in the coming sessions.

Government bond markets
US Treasuries were modestly weaker in early European trade with investors braced for a $29 billion of 7-year paper auction today after y-day’s $35 billion of 5-year debt sale was well received. The 2/10-yr UST yield spread was trading close to 280.7bps at the time of writing, the widest in a week, after ending near 279bps in the prior session. Elsewhere, German government bonds moved lower in early European trade following a poorly received €2bn in 30-yr Bunds auction y-day. The more hawkish-than-expected tone in the BoE’s MPC minutes, also weighed. Short-dated notes continued to underperform with the 2-yr yield rising to 1.338% earlier today, the highest in a year. The 2/10-yr Bund yield curve undertook some further bearish flattening with the corresponding spread hovering around 2-month lows of 185bps at the time of writing after ending close to 186.5bps on Wednesday. EMU sovereign debt spreads were generally wider today. Ireland underperformed on mounting politician jitters.

G10 Event Risk Calendar this week (January 17 – January 21)

Monady, January 24
Australia’s Q4 CPI, France’s INSEE business survey for January, Eurozone PMI-manufacturing for January (prel.), Eurozone industrial new orders for November

Tuesday, January 25
**Wednesday, January 26**
ECB’s Stark speaks, **UK** BBA home loans for December, **UK** BoE MPC minutes of the January 13 meeting, **US** new home sales for December, **FOMC rate decision**

**Thursday, January 27**
Japan’s trade balance for December, **ECB**’s Bini Smaghi speaks, **ECB**’s Gonzalez-Paramo speaks, **ECB**’s Tumpel Gugerell speaks, **Eurozone**’s consumer confidence for January (final), **UK** Nationwide house prices for January, **US** durable goods orders for December **US** initial jobless claims

**Friday, January 28**
Japan’s CPI for December, **Japan**’s household spending for December, **Japan**’s unemployment rate for December, **Japan**’s retail sales for December, **Switzerland**’s KoF leading indicator for January, **Eurozone**’s M3 money supply for December, **German Chancellor Merkel** speaks (addresses at World Economic Forum), **US** Q4 GDP (first estimate), **US** UM consumer confidence for January (final), **US** Q4 employment cost index

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**Emerging Markets**
CEE stock markets moved lower in morning trade on Thursday, paring part of their recent gains after S&P downgraded Japan’s sovereign credit ratings. Nevertheless, Turkey’s main stock index, XU100, bucked the region’s trend bouncing by 0.7% to a 1-week high of 66,393.03 intraday receiving support from retailer Kiler Alisveris’s entrance in the Istanbul Stock Exchange today. On the flipside, Romania’s BETI and Poland’s WIG20 led the losses in the region, falling by ca 1% each at the time of writing. Separately, CEE currencies broadly firmed in early trade. The Turkish lira regained some ground with the USD/TRY sliding 0.7% on the day to session lows of 1.5650. However, the pair remains not far off a multi-month peak of 1.5935 hit 2-weeks ago and the Turkish lira is likely to remain under pressure in the short-term in view of the CBT’s recently employed policy mix. Technically, major resistance for the USD/TRY lies at 1.5825 (January 26 highs) ahead of 1.5868 (January 21 high). On the downside, strong support stands at 1.5625 (14-day MA) in the way to 1.5500 (January 25 lows). In the local rates markets, the yield of Turkey’s benchmark November 7, 2012 government bond spiked as far as 7.91% earlier today from 7.65% on Wednesday’s close, following the Central Bank’s recent decision to hike by 200bps reserve requirement ratios on TRY deposits for short-term maturities in order to offset a potentially inflationary impact from a 25bps cut in its key policy rate (at 6.25% presently) aimed at containing capital inflows. The recent depreciation of the lira also appears to bear a negative impact on Turkish government paper.

CEE Event Risk Calendar for this week
**Monday, January 24:** CBT assembly meeting - will possibly discuss a hike in required reserve ratios, capacity utilization, manufacturing confidence for Jan (Turkey), MPC rate announcement (Hungary), real gross wages for Dec (Serbia)

**Tuesday, January 25:** CBT inflation report, foreign arrivals for Dec (Turkey), retail sales for Nov (Hungary), gross external debt for Nov, BGN 30mn 2016 bond auction (Bulgaria)

**January 25 - February 8:** IMF mission visits Romania for the seventh review of the Stand-By Arrangement

**Thursday, January 27:** Bond auction (Hungary)

**Friday, January 28:** Trade balance for Dec (Turkey), retail sales, unemployment rate for Dec (Poland), 3-month unemployment rate for Oct (Hungary)

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Financial Markets Research Division
Paraskevi Petropoulou
Galatia Phoka