

Notz Stucki Macro and Market Review

December 2011

Macro and Market Review

- The Eurozone crisis dominated news flows, spurring a broad flight to safety even as the ECB shifted to a looser policy stance. After cutting interest rates by another 25 bps, taking the main rate to 1%, the ECB announced new measures such as new three-year loans, easier collateral requirements and lower reserve requirements for banks, in order to improve liquidity and to alleviate the European banks' funding problems. Urged by policymakers, these banks took up a record EUR 489 billion in the ECB's liquidity facility in a concerted effort to cover next year's funding needs, i.e. borrowing from the ECB at 1% and buying domestic sovereigns at 5-7%. In Italy, the new technocratic government approved tough austerity measures and reforms including tax increases, pension changes and spending cuts. However, the UK's prime minister refused to agree an EU proposed legislation to reinforce fiscal discipline in the absence of safeguards for the City of London, causing anger across Europe. Governments must now take the legislation to their respective parliaments. Better global economic data were released in Europe and in the US with improving unemployment numbers, manufacturing and consumer confidence. In EM, China's annual inflation fell to 4.2% in November from 6.5% in July, while the manufacturing sector contracted, home prices fell, and Chinese export and import growth both decelerated. Hence, the CCB announced a new round of monetary easing with a cut in the reserve ratio for banks for the first time in three years. Of note, Fitch changed its US credit rating outlook to negative from stable, while S&P said the AAA rating of Germany, France, Austria, Finland, the Netherlands and Luxembourg were under review.
- December was another difficult month with markets more influenced by headline news than fundamentals. Liquidity dried up.
 - Equities did well generally, with the S&P 500 ending the month up +0.85% versus +2.04% for the MSCI Europe, while the MSCI EM was down -1.29% and the MSCI World was flat.
 - Volatility on stock markets fell sharply, with the VIX down -15.83% to 23.40.
 - In fixed income, US Treasuries and German Bunds benefited from a flight to quality, while yields on Italian BTPs fell to 6.98% from 7.56% on November 29.
 - In Credit, spreads were almost unchanged in a challenging liquidity environment.
 - In currencies, while the USD strengthened, the euro depreciated against most currencies falling to 1.296 against the USD and to below 100 against the Yen, reaching a 10 year low.
 - In Commodities, gold (-10.24%) and silver (-14.84%) sold off. Energy and industrial metals were also weak, unlike agriculturals.

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