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Global Financial Market: Results of January 2012

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Results of January 2012

Macroeconomic reports published in January, including data on GDP of some countries in 2011, evidenced a significant slowdown in world economic growth at the end of the last year.

Given this, forecasts for GDP growth in 2012 continued to degrade in January. The World Bank has also lowered the forecast of annual global GDP growth from 3.6% to 2.5%.

The World Bank expects the annual recession by 0.3% in euro area, while U.S. growth forecast was lowered from 2.6% to 1.9%; growth in developing countries is expected to reach 5.4%, whereas the previous forecast was 6.2%.

A more optimistic forecast for global economy growth in 2012 – by 3.3% – was provided by the IMF, but the Fund expects GDP of the euro area to decline by 0.5% and that of U.S. to grow by just 1.8%.

The results of 2011, the published data and forecasts for 2012 have reaffirmed that the U.S. model of dealing with the consequences of the financial crisis is much more effective than the European model so far.

The first month of the year also was marked by increased attempts to resolve the current debt crisis in the eurozone area. Talks about restructuring the Greek debt are nearing finish.

But despite the continued presence of negative background in the system, financial markets were very positive during the first month of 2012.

At the world stock market January was the best month since October 2011, and some indexes of emerging markets have shown double-digit percentage price increases.

But compared to previous years, January 2012 was the best since 1998 for many indexes of developed countries.

The bond market was also dominated by positive trends, including the PIIGS sector, except for the Portuguese securities, which were chosen by the speculators to be the next victim in January (-16% on 10-year securities).

Good growth was observed in the sector of corporate debts of developing countries, whose index CEMBI rose by 3% over a month, and Russian corporate securities grew by more than 4%.

In the currency market the month was relatively quiet, and dollar showed a slight drop to the rest of the world's leading currencies, following growth during two previous months.

In the commodity markets the month was more volatile, and gold prices resumed growth, the price of an ounce jumping by 11% to reach $1740.

Silver demonstrated even greater price increase, where the price of an ounce increased by 19% over the month!

In the oil market, diverse movements in prices of Brent and WTI oil were observed in January. Price of barrel of the former increased by 2% during the month, while that of the latter declined by 3%, resulting in the spread between them growing from $11 to $14.

Situation in financial and economic system

Preliminary GDP data for Q4 2011 in Japan and the UK have shown a negative growth, and the Bank of Japan expects the country to finish the fiscal year (ending March 2012) with GDP decrease of 0.4%.

In the U.S., the data were more positive: the GDP growth over the quarter was 2.8% (the best one in 2011), which will lead to annual GDP growth by 1.7%.

Moreover, data published in early February showed a drop in unemployment in January to 8.3% – the minimum for the last three years.

Whereas in the euro area, on the contrary, unemployment figures for December showed an increase to new maximum since 1998 – 10.4%.

This is another proof of the U.S. model of dealing with the consequences of the financial crisis being much more effective than the European model so far.

Nevertheless, judging by the FRS forecasts published after the end of the central bank meeting in January, the rates in the U.S. could remain at a record low until 2014.

The FRS also did not reject the possibility of performing new QE in the future (but so far the monetary base and balance of the Central Bank show a certain decline, given the growth of M1; see Fig. 1).

Perhaps such policy of the FRS is not only aimed at achieving the declared goal of stimulation of the economy, but is also supposed to prevent the crisis at the public debt market.

Fig. 1. Dynamics of the U.S. monetary aggregates M0 M1, monthly lines.

Source: Thomson Reuters

The European Central Bank, by contrast, has begun to strengthen its balance, which, in particular, points to the revision of the ECB strategy after Draghi became the ECB president.

Only in the last two months, the balance of the ECB rose from €2.4 trillion to €2.7 trillion, largely due to the first three-year no-limit credit auction of €489 billion held by the central bank on 21 December.

A year ago, the balance of the ECB amounted to only €1.95 trillion, and its growth was also furthered by buying of government bonds of problematic countries, which enhanced since August 2011, and their amount held by the Central Bank rose to €625 billion (the amount of loans to commercial banks amounted to €810 billion as at the end of January).

Crisis in the euro area: year 2012

Most developed countries, including countries of the euro area, ended the year 2011 with a sizeable budget deficit, thus contributing to continued growth of the already 'exorbitant' public debt (see Fig. 2).

Fig. 2. Table of public debt and budget deficits of some countries with high debt

	2011 (forecast)			2010		2009		2008		2007	
Country	Public debt	Public debt to GDP	Budget to GDP	Public debt to GDP	Budget to GDP	Public debt to GDP	Budget to GDP	Public debt to GDP	Budget to GDP	Public debt to GDP	Budget to GDP
Japan	$12 trillion	233%	-10%	220.3%	-9.5%	216.3%	-10.3%	195%	-4.2%	187.7%	-2.4%
Greece	€345 bn	165%	-7.4%	142.8%	-10.5%	127.1%	-15.4%	110.7%	-9.8%	105.4%	-6.4%
Italy	€1.9 trillion	121%	-4.4%	119.0%	-4.6%	116.1%	-5.4%	106.3%	-2.7%	103.6%	-1.5%
Ireland	€177 bn	106%	-10.8%	96.2%	-32.4%	65.6%	-14.3%	44.4%	-7.3%	25.0%	0.1%
Belgium	€355 bn	100%	-3.9%	97.1%	-4.1%	96.2%	-5.9%	89.6%	-1.3%	84.2%	-0.3%
USA	$15 trillion	100%	-10.3%	91.6%	-10.6%	84.6%	-12.7%	71.2%	-6.4%	62.2%	-2.7%
Portugal	€156 bn	93%	-5.6%	93.0%	-9.1%	83.0%	-10.1%	71.6%	-3.5%	68.3%	-3.1%
France	€1.7 trillion	87%	-6.0%	81.7%	-7.0%	78.3%	-7.5%	67.7%	-3.3%	63.9%	-2.7%
England	£1.3 trillion	86%	-8.4%	80.0%	-10.4%	69.6%	-11.4%	54.4%	-5.0%	44.5%	-2.7%
Germany	€2.1 trillion	85%	-2.3%	83.2%	-3.3%	73.5%	-3.0%	66.3%	0.1%	64.9%	0.3%
Spain	€693 bn	68%	-6.1%	60.1%	-9.2%	53.3%	-11.1%	39.8%	-4.2%	36.1%	1.9%

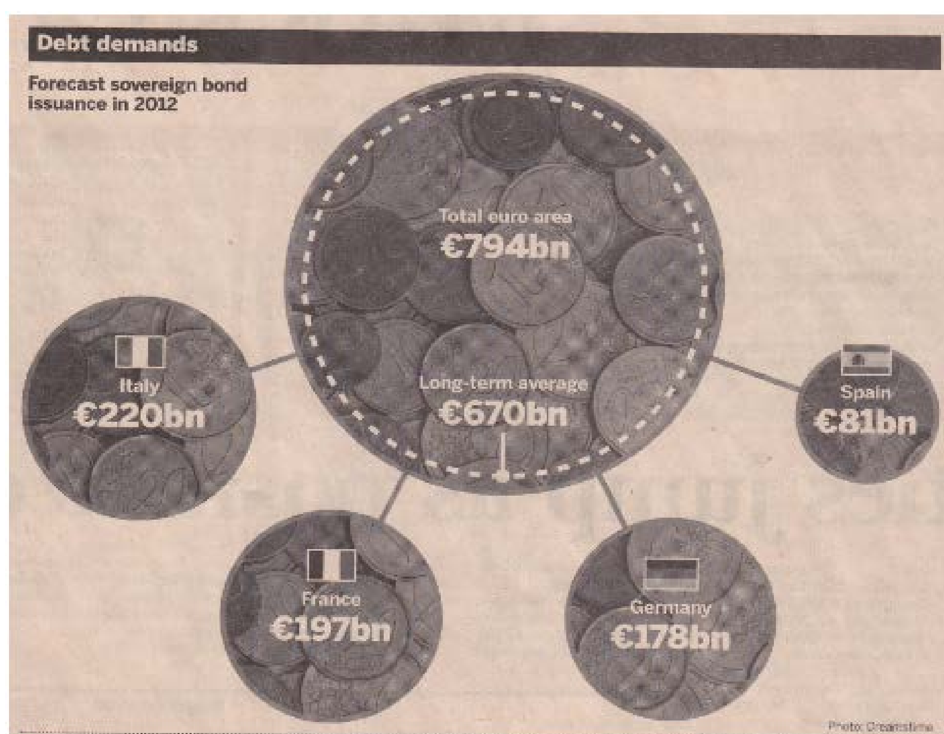
Source: Bloomberg, Eurostat, EconomyWatch

The year 2012 promises to be very difficult for the euro area, given the expected decline in economic growth, which might even lead to entry of the entire economy of the area into recession.

And this means that conditions of the currently adopted "stability pact" are unlikely to be reached this year, and debts will continue to grow, although at a slower rate.

Even without taking into account the growth of debt, the euro area countries will need to place government securities worth nearly €800 billion on the market just to refund the redeemed issues (see Fig. 3).

Fig. 3. Amount of public debt placement in the euro area in 2012



Source: Financial Times

And there is a risk that the market can take advantage of this situation to attack the market price and yield of some of the countries of euro area.

Moreover, on 13 January S&P has downgraded the sovereign credit ratings of 9 of the 17 euro area countries, including that of France (the second largest economy in the euro area), which was lowered from the highest AAA to AA+ for the first time.

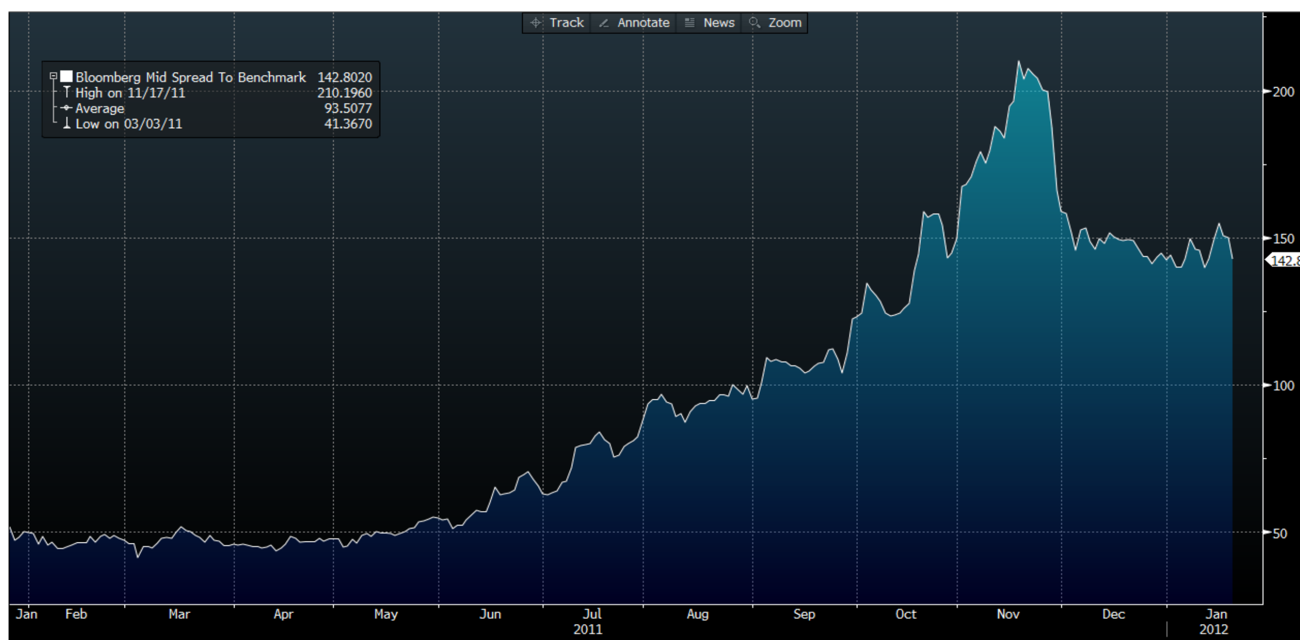
The rating of four countries – Italy, Spain, Portugal and Cyprus – was cut by two levels at once! And all this might lead to more expensive refinancing of debt of these countries in the market.

Germany, having the highest rating of AAA, was not affected. Greece also did not suffer – its pre-default rating CC was left unchanged (Luxembourg, Netherlands, Belgium, Finland, Ireland and Estonia also retained their ratings).

S&P also downgraded rating of the European Financial Stability Fund (EFSF) by one level – from AAA to AA+, which was natural after the massive downgrades of ratings of countries acting as a guarantors of this fund.

However, the market has "downgraded" rating of the EFSF securities long time ago, and their spread to German securities widened from 50 basis points at the time of the first issue in early 2011 to 150 basis points (at some moments reaching 200 basis points, see Fig. 4).

Fig. 4. Dynamics of spread between the EFSF bonds and German bunds



Source: Bloomberg

The extraordinary summit of the EU leaders, which took place in late January in Brussels, was also devoted to fighting the crisis.

Its main result was the signing of the treaty on launching the European Stability Mechanism (ESM) with a capital of €500 billion a year earlier than planned – from 1 July 2012.

Paid-in capital of the ESM is €80 billion and €420 billion will be provided as guarantees of the euro area countries. The possibility of increasing the fund to €1 trillion in future was also discussed.

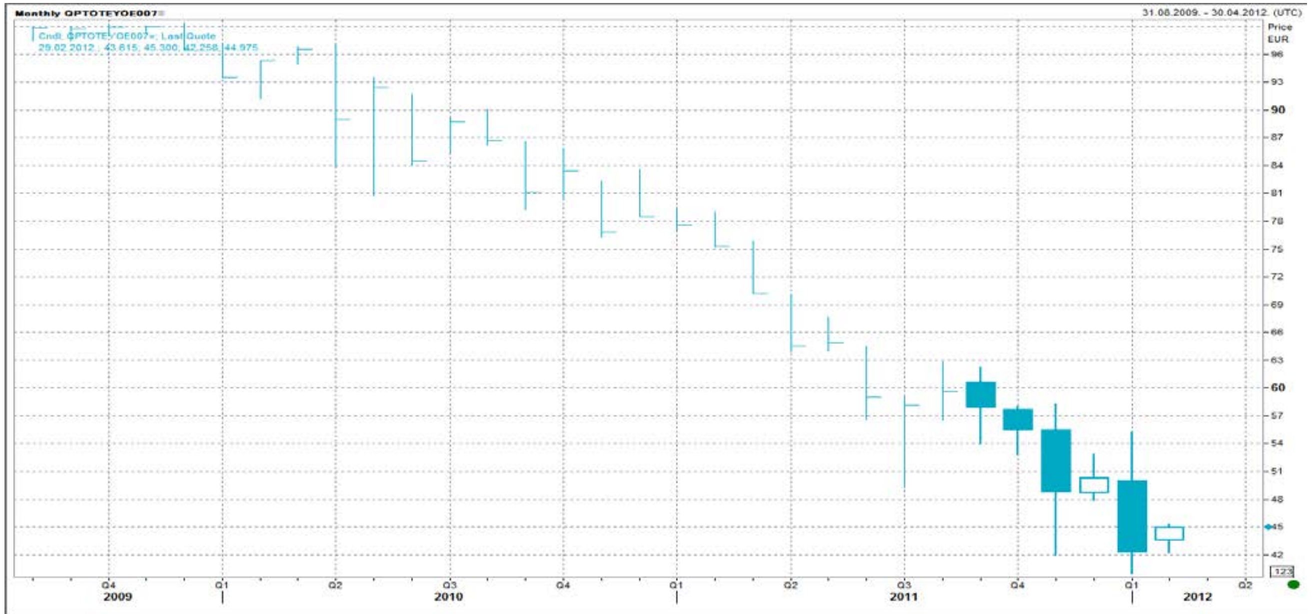
In addition, at the summit it was agreed to adopt the final version of the European fiscal pact, but the UK and also the Czech Republic refused to sign the document.

As far as situation on the debt market is concerned, despite the remaining negative background, operations for a rise of prices of bonds of problematic countries dominated in this market in January.

In particular, 10-year Italian securities showed an increase of more than 6% and their yield has gone far from the recently achieved "critical" level of 7%, dropping to 5.7%.

But the market found a victim in operations for a fall – securities of Portugal, whose 10-year bonds fell by 16% last month and their yield soared from 14% to 16% (see Fig. 5). However, for the first few days of February, almost all this decline has been recovered.

Fig. 5. Price dynamics of Portuguese bonds 2021, monthly bars



Source: Thomson Reuters

Greece: Better a horrible end than an endless horror?

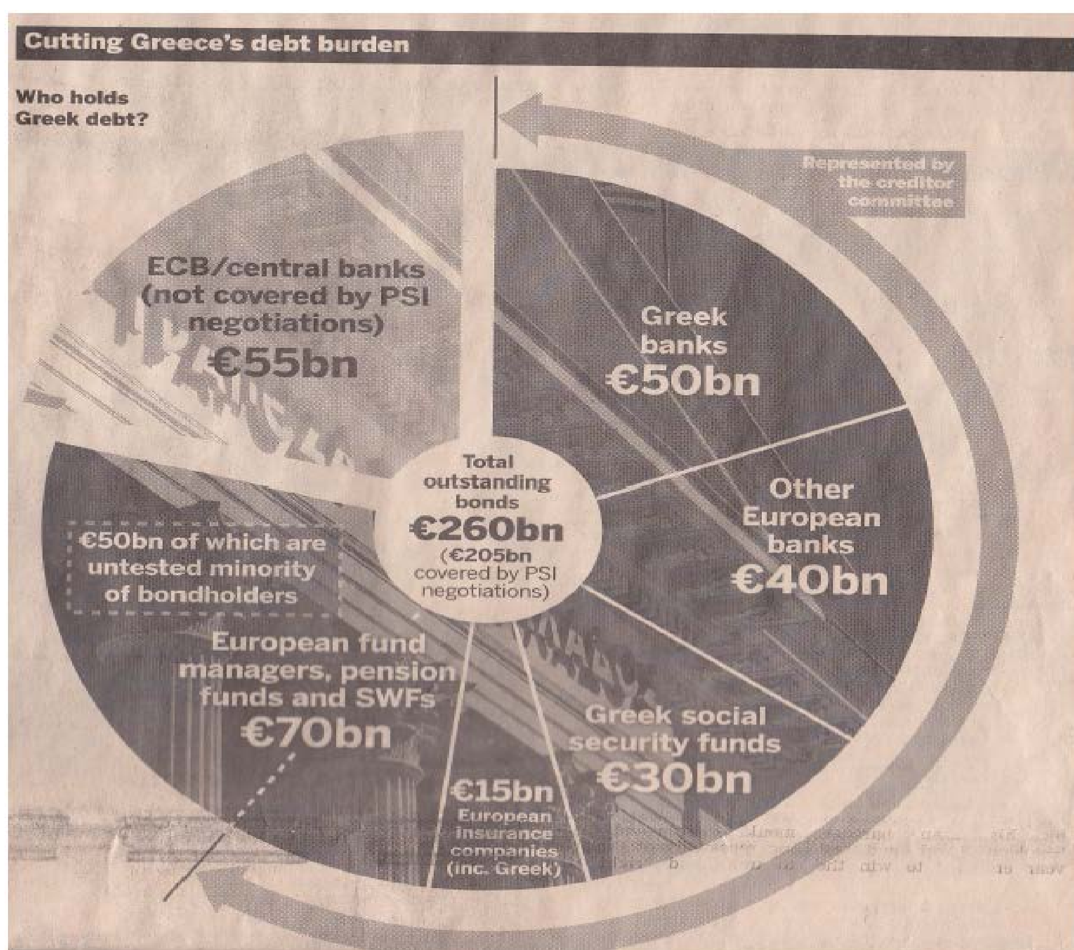
During the entire second half of January there were intense negotiations between the leaders of Greece and representatives of private creditors to bring the programme of writing off part of the market debt of the country (PSI) to an end.

We would like to remind that a tentative agreement on the voluntary writing off of 50% of Greek debt by private creditors was reached in talks with major banks as early as at the October summit of the leaders of the euro area in 2011.

The official goal of this programme is to reduce the debt to GDP of Greece to 120% by 2020.

An interesting aspect of this program was the release of the write-off of one of the largest holders of debt – the ECB (€55 billion, see Fig. 6), which "to put it mildly" is a non-standard solution in a situation of insolvency restructuring of the borrower.

Fig. 6. Breakdown of holders of Greek government bonds



Source: Financial Times

Therefore only €100 billion of the €260 billion-large debt are expected to be written off, alongside replacement of short securities with new, longer securities.

Of course, it will be an extremely severe blow to the European financial institutions and private investors and also a very dangerous precedent having unpredictable consequences in the future.

Inter alia, because of such unequal conditions of restructuring, which may put before the international investment community a question of reputation of trust with European borrowers.

However, in case the programme is not accepted, EU, ECB and IMF have threatened not to give Greece the next tranche of the loan, without which the country might face an uncontrollable default.

In this case, losses of the bondholders would be even greater, and this is the argument the Greek authorities use for intimidating.

In turn, the lack of agreement (i.e. the absence of voluntary writing off) will lead to the fact that the ISDA (International Swaps and Derivatives Association) recognizes the situation as credit event.

This will lead to triggering of CDS (credit default swaps), which will have drastic consequences for European financial system, and this is used by creditors to put pressure on Greece and EU, ECB and IMF behind it.

Therefore, the agreement is likely to be achieved, but the stumbling block remains yield of new bonds.

Creditors would like it to be about 4%, and Greece – about 3.5%, which will determine the general creditors' losses at 'net present value' of 65% to 70% (in case of purchasing old securities at 100% of face value).

The deadline for implementation of PSI programme is considered to be in March 2012, since on 20 March Athens will have to repay €14.5 billion. And in case PSI is not accepted, Greece, without having received funds from the EU, ECB and IMF, will be forced to default.

Global stock market

In the global stock market, the first month of 2012, despite the persistence of negative macroeconomic background, was extremely positive, and some indexes of emerging markets have shown double-digit percentage growth in prices (see table). But compared to previous years, January 2012 was the best since 1998 for many indexes of developed countries.

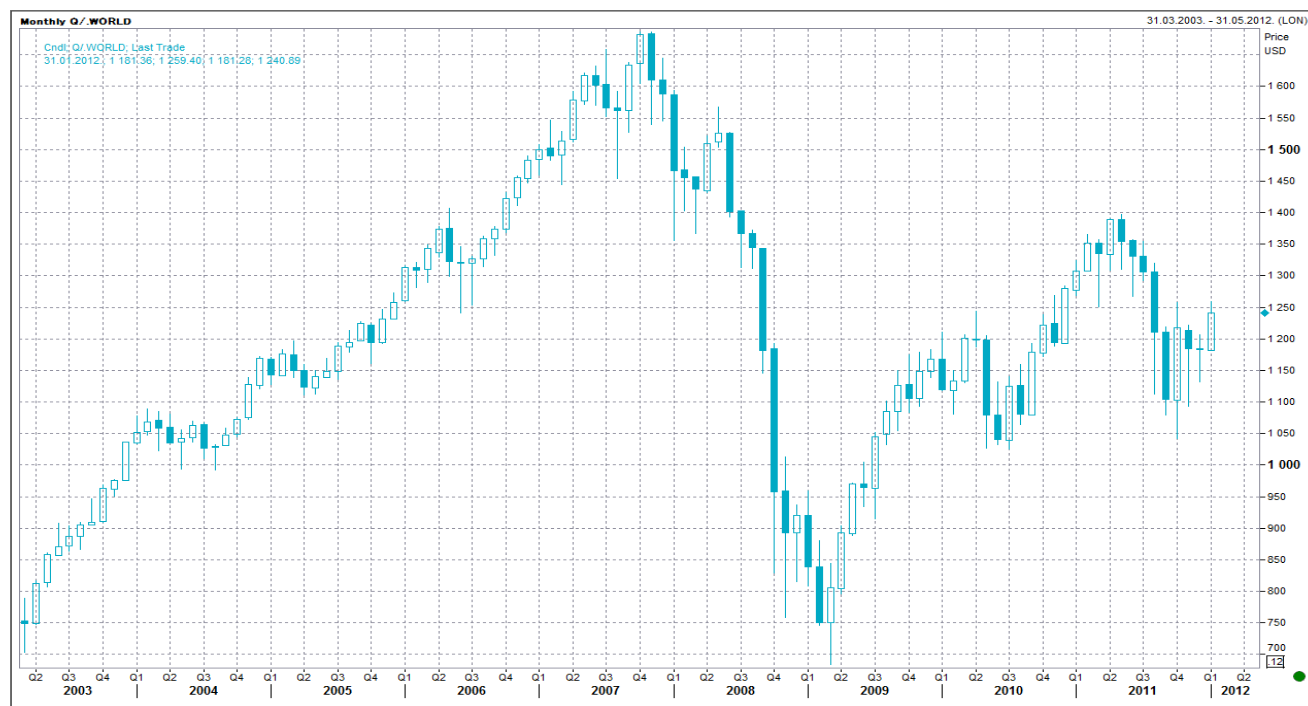
Fig. 7. The results of the dynamics of movements of several leading stock market indexes

Stock index	P/E (Bloomberg)	Div.Yeld (Bloomberg)	2003-2007	2008	2009	2010	2011	January 2012	2012
DJI (USA)	12.6	2.6	59.0%	-33.8%	18.8%	11.0%	5.5%	3.4%	3.4%
S&P 500 (USA)	13.2	2.1	66.9%	-38.5%	23.5%	12.7%	0.0%	4.4%	4.4%
Nasdaq Comp. (USA)	22	1.1	98.6%	-40.5%	43.9%	16.9%	-1.8%	8.0%	8.0%
GDAX (Germany)	10.3	4	178.9%	-40.4%	23.8%	16.1%	-14.7%	9.5%	9.5%
N225 (Japan)	16.6	2.2	78.4%	-42.1%	19.0%	-3.0%	-17.3%	4.1%	4.1%
FTSE (England)	10	4	61.5%	-31.0%	23.2%	9.0%	-5.6%	2.0%	2.0%
CAC (France)	9.4	4.9	83.2%	-42.7%	22.3%	-3.4%	-17.0%	4.4%	4.4%
RTS (Russia)	5.2	2.4	537.9%	-72.4%	128.6%	22.5%	-22.0%	14.3%	14.3%
MICEX (Russia)	5.2	2	492.3%	-67.2%	121.1%	23.2%	-16.9%	8.0%	8.0%
SSEC (China)	11.5	2.2	287.4%	-65.4%	80.0%	-14.3%	-21.7%	4.2%	4.2%
HSI (Hong Kong)	8.5	3.6	198.4%	-48.3%	52.0%	5.3%	-20.0%	10.6%	10.6%
KOSPI (Korea)	14.3	1.5	202.3%	-40.7%	49.7%	21.9%	-11.0%	7.1%	7.1%
TWII (Taiwan)	15.9	4.7	91.0%	-46.0%	78.3%	9.6%	-21.2%	6.3%	6.3%
SENSEX (India)	14.5	1.6	500.7%	-52.4%	81.0%	17.4%	-24.6%	11.3%	11.3%
BOVESPA (Brazil)	9.4	4.1	467.0%	-41.2%	82.7%	1.0%	-18.1%	11.1%	11.1%
IPC (Mexico)	18.1	1.4	382.1%	-24.2%	43.5%	20.0%	-3.8%	0.9%	0.9%
TOP40 (South Africa)	11.2	2.8	202.4%	-25.9%	28.6%	14.6%	-0.6%	6.0%	6.0%
MSCI WD (World)			100.6%	-42.1%	27.0%	9.6%	-7.7%	4.9%	4.9%
MSCI EM (Emerging)			326.6%	-54.5%	74.4%	16.4%	-20.4%	11.2%	11.2%

Source: Thomson Reuters, Bloomberg, ABLV Bank

The rise in prices according to MSCI World index was 4.9% (see Fig. 8) over the month, which "returned" much of the fall of the index by 7.7% in 2011.

Fig. 8. Dynamics of the MSCI WORLD index, monthly bars



Source: Thomson Reuters

The rise in prices according to emerging countries' index MSCI EM was significant: 11.2% (see Fig. 9), but its fall in 2011 was stronger – by 20.4%.

Fig. 9. Dynamics of the MSCI EMERGING MARKETS index, monthly bars

Source: Thomson Reuters

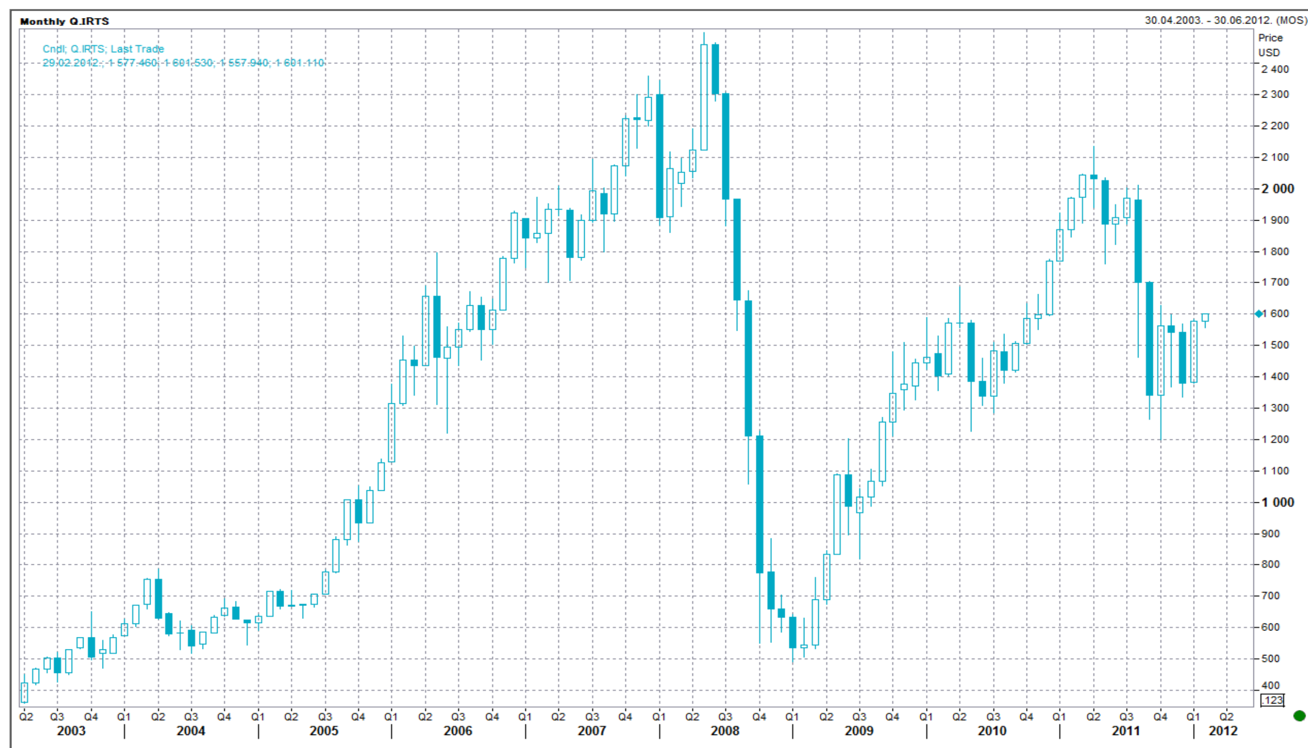
Among the indexes of developed countries, the highest growth in January was displayed by German DAX, which increased by 9.3% (see Fig. 10), which has returned more than half of its fall for the whole 2011 equal to 14.7%.

Fig. 10. Dynamics of DAX index, monthly bars

Source: Thomson Reuters

In January, one of the biggest increases among the indexes monitored by us was shown by Russian RTS, which grew by 14.3% (see Fig. 11). However, almost half of this growth was ensured by growing rouble, and rouble index of the Russian market MICEX rose only by 8% over the month.

Fig. 11. Dynamics of RTS index, monthly bars



Source: Thomson Reuters

Our assessment of future scenarios

The situation in the global stock market remains uncertain. If the debt crisis in Europe is not stopped in 2012, it is likely that strong negative trends will return to the market.

Nevertheless, one can continue to follow the strategy proposed in our previous reviews – entry into this market, choosing strong companies (or indexes) with low P/E and high dividend payouts Div. Yeld (see table), increasing the disposition under fall in prices.

The high level of dividends will allow investors to outwait possibly long period of market decline, receiving a steady cash flow in the form of dividends, which exceeds current coupon yield on government bonds of the leading countries.

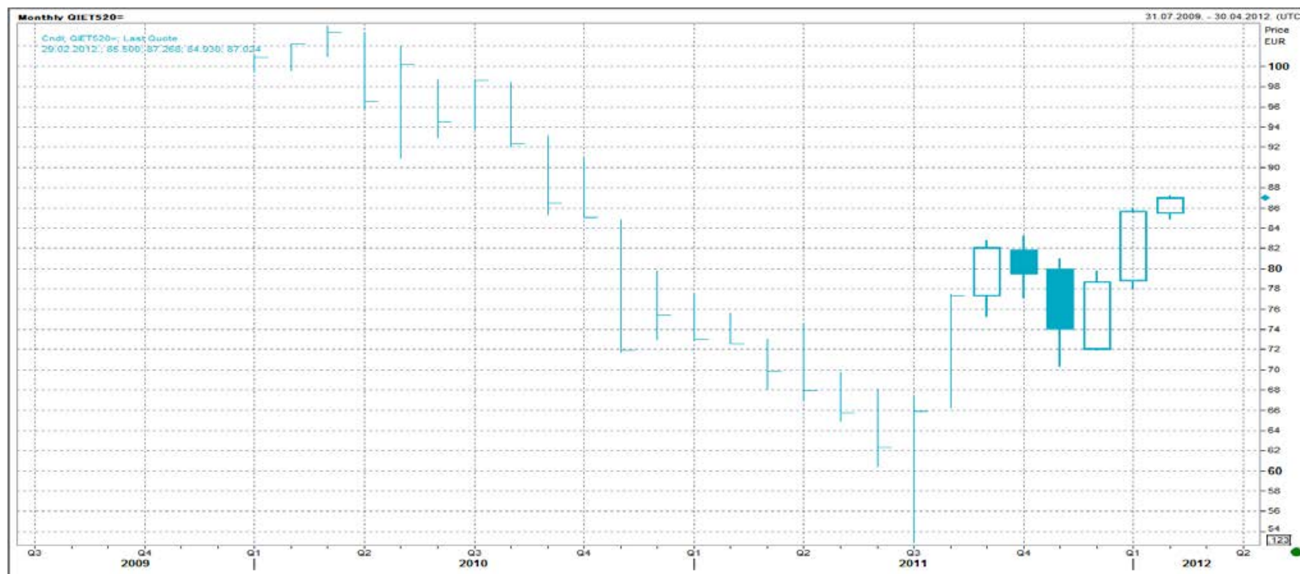
Whereas in case stable growth is resumed, the investor will gain considerable profit due to price increase.

Global bond market

The situation in the global bond market in January was also positive both in the developing sector, and for the securities of most PIIGS countries.

The largest growth among these securities was displayed by bonds of Ireland, where the price of a 10-year bonds rose by 8.8% (see Fig. 12), and their yield has fallen from 8.5% to 7.4%.

Fig. 12. Dynamics of price movements of 10-year bonds of Ireland, monthly bars



Source: Thomson Reuters

Considerable growth was displayed by Italian bonds with 10-year securities growing by more than 6%, and their yield has left the recently achieved "critical" level of 7%, dropping to 5.7%.

However, the market in January found a "whipping boy" – the securities of Portugal, whose 10-year bonds fell by 16% last month, and their yield soared from 14% to 16% (see Fig. 5).

In the sector of public debt of developing countries, the growth was not so significant, and the index EMBI + rose by 1.5% last month, and its spread to treasuries narrowed by 9 basis points to 3.7% (see Fig. 13).

Fig. 13. Dynamics of the EMBI + index spread, the monthly closures line

Source: Thomson Reuters

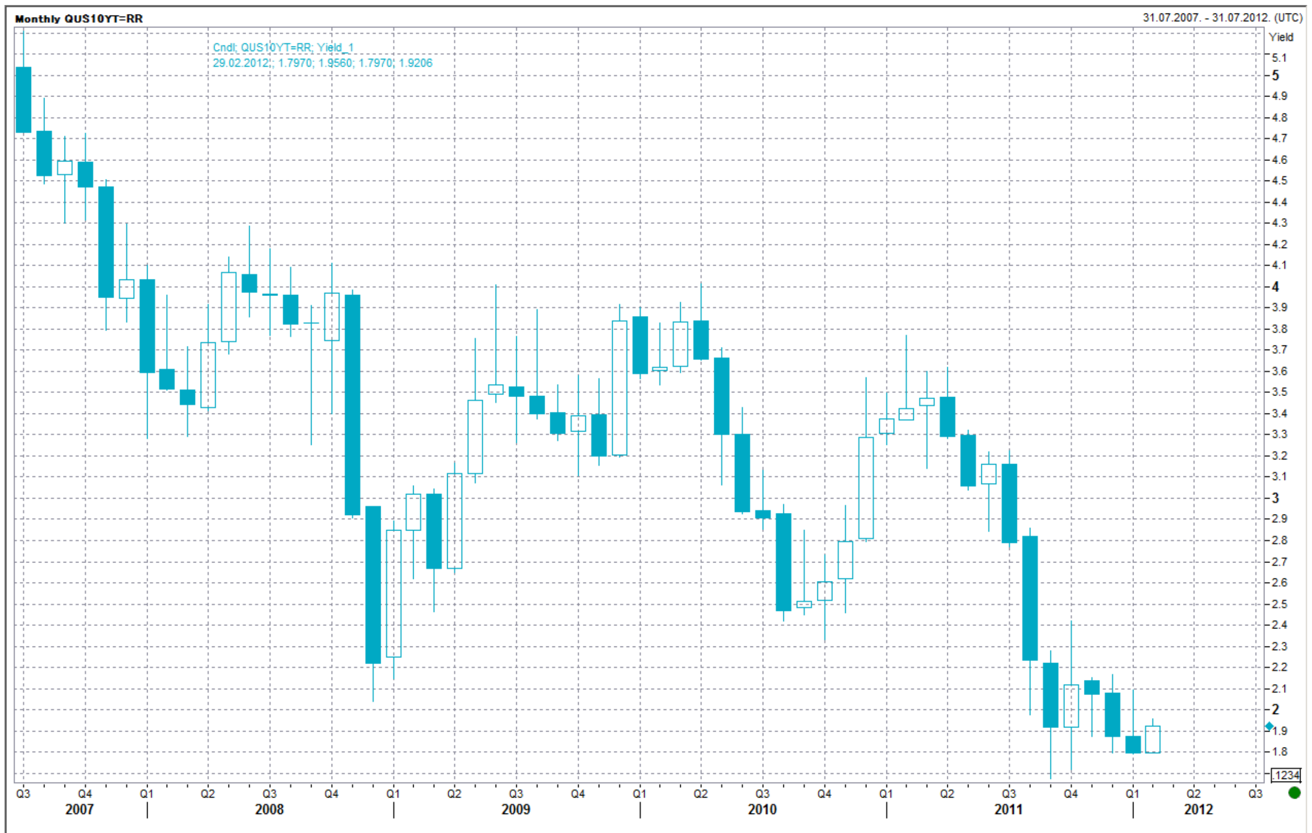
Growth in emerging market corporate bonds has been more significant, and the index CEMBI rose by 3% over the month, whereas growth in Russian corporate securities exceeded 4%.

In the markets of U.S. bonds and German bunds, which play the role of safe haven for dollar and euro zones, there were little price movements observed during the moth.

As far as U.S. long securities are concerned, there were some differences in dynamics observed, and 30-year securities declined slightly, while their yield rose from 2.9% to 2.95%.

At the same time, the benchmark 10-year treasuries were able to show a monthly increase of 1% and their yield has fallen from 1.9% to 1.8% (see Fig. 14), but in early February the securities began to fall, and their yield was back above 1.9%.

Fig. 14. Yield dynamics of the U.S. 10-year government bonds, monthly bars



Source: Thomson Reuters

The movement in German securities was also insignificant, and the yield of 10-year bunds remained near the level of 1.8%, and that of 30-year securities rose from 2.4% to 2.5%.

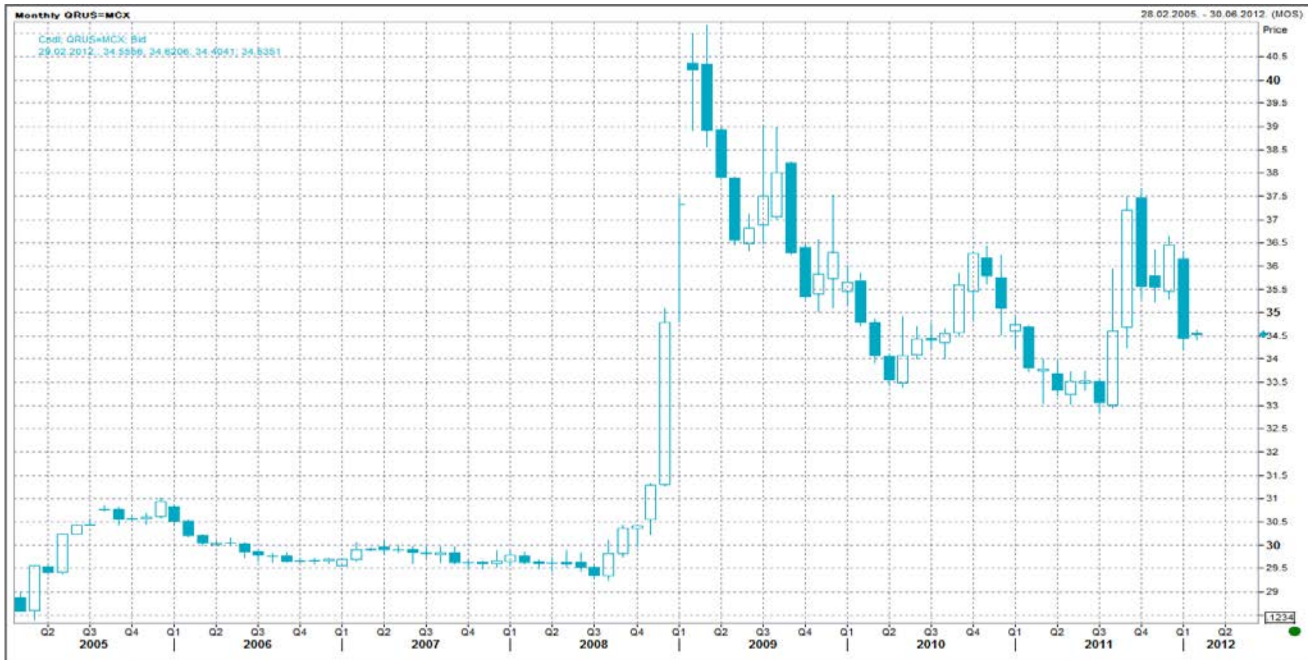
Global currency market

On the global currency market January was marked by a slight fall of dollar against the rest of the world's leading currencies and its greater losses to a number of emerging currencies, given easing of tension and regained interest in risking.

The greatest increase against dollar was shown by leaders of the fall of the previous few months – the Hungarian forint, which grew by 7.6%, the Indian rupee, which grew by 7.2%, and the Mexican peso, which grew by 7%.

Russian rouble rose against dollar by significant 6%, and its growth to the euro-dollar basket reached almost 5% (see Fig. 15).

Fig. 15. Dynamics of the Russian rouble to euro-dollar basket, monthly bars



Source: Thomson Reuters

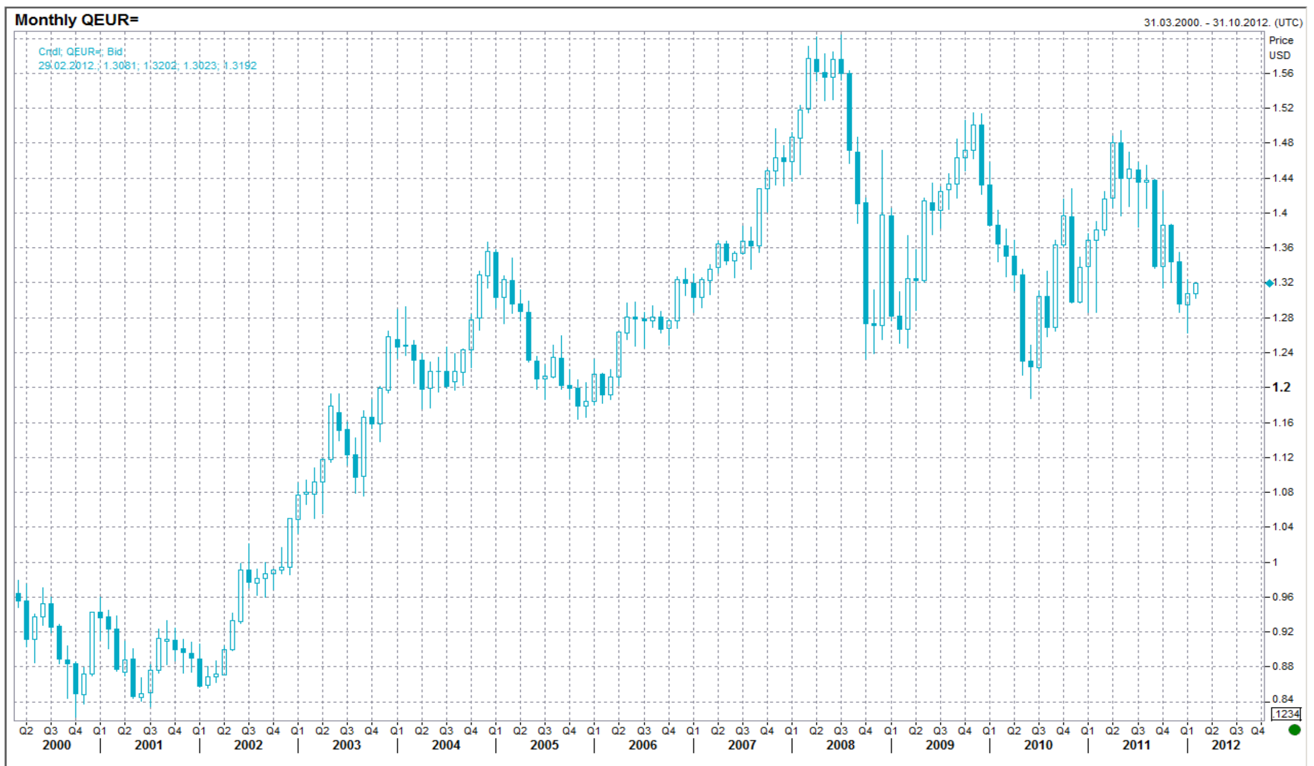
The dollar index – dollar's rate against six leading world currencies – fell by 1.1% over the month (see Fig. 16).

Fig. 16. Dollar index dynamics, monthly bars

Source: Thomson Reuters

As for the main rival of the dollar – euro, the fall of the U.S. currency was around 1.5% (see Fig. 17).

Fig. 17. Dynamics of euro against dollar, monthly bars



Source: Thomson Reuters

Our assessment of future scenarios

Our main scenario for the euro-dollar market remains unchanged. According to this scenario, the dollar minimum reached in July 2008 at the level of 1.6040 EUR/USD, is the end point of the long-term trend of the dollar falling against euro and the beginning of the trend for its long-term growth.

Consequently, we do not change our fundamental outlook for the market, according to which exchange of the euro to the dollar will fall to parity-close levels (1 EUR/USD) in 1-1.5 years.

Gold

Gold, after a noticeable decline in December, in January showed a significant increase in the price, and the price of an ounce jumped by 11% to $1740 (see Fig. 18).

Fig. 18. Dynamics of gold prices, monthly bars

Source: Thomson Reuters

Our assessment of future scenarios

Gold prices have already entered the hall reached $1750-$2000 per ounce, which at the beginning of the year 2011 was considered a target one for the current growth trend and a level where the basis for the trend reversal will be formed. However, given the strength of the growth trend, it is still very likely that prices will continue to grow, reaching the level of $2000-$2500 per ounce.

At the same time, the speculative nature of the movement in gold prices suggests that prices will not remain at high levels for long. Later, we are likely to see a rapid fall in prices, often observed in other speculative bubbles. Of course, it is possible that prices do not go back to previous levels of $300-$400 per ounce, but return to levels near $1000 is very likely.

A possible signal for the bubble break can be a sharp rise in prices for a short time, similar to that of August, but with greater amplitude and during a shorter time.

Silver

In January, the price of silver increased even more significantly, and the price of an ounce grew by 19% to reach $33 over the month (see Fig. 19), showing a return of the correlation between price movements in this market and gold market.

Fig. 19. Dynamics of silver prices, monthly bars

Source: Thomson Reuters

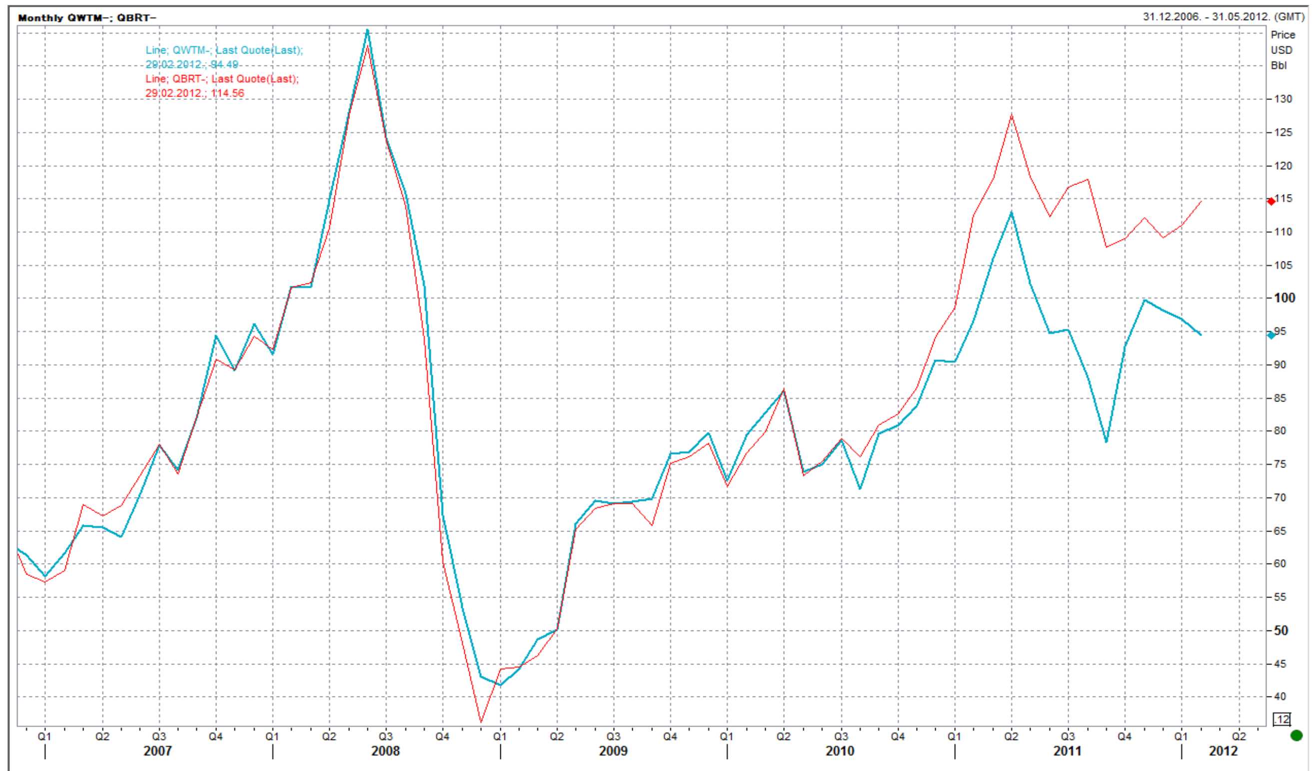
Our assessment of future scenarios

The sharp rise and the subsequent strong drop in the price of silver in 2011 indicate that the price bubble of 2010-2011 actually burst in this market.
However, the dynamics of further movement in prices is still uncertain and may depend on price movements in the gold market.

Oil

In the oil market, diverse movements in prices of Brent and WTI oil were observed in January. Price of barrel of the former increased by 2% during the month, while that of the latter declined by 3%, resulting in the spread between them growing from $11 to $14 (see Fig. 20) and continuing to grow at the beginning of February.

Fig. 29. Brent and WTI price dynamics, monthly lines



Source: Thomson Reuters

Our assessment of future scenarios

We continue to believe that the price maximum of $128 per barrel achieved in May is a local maximum. Accordingly, in the medium term fall in prices close to $90-$100 per barrel and below is more likely than the resumption of growth of prices to new maximum above $128.

Review information

This review is supposed to be for information only and cannot be treated as investment advice, investment research, or a consultation on investment.

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