

VOLATILITY GRIPS MARKETS ON BACK OF CONTINUED UNCERTAINTY

This week uncertainty has gripped the markets, with every bit of news flow having a large impact. The FED said they might hold off on rate rises, markets rallied; Saudi Arabia said it wouldn't cut oil production, markets fell; the ECB said it might think about some QE, markets went up and then down again. Global markets are being confronted with some new situations they haven't quite got its head round, as the dust settles we expect long term expectations to be mostly unchanged; the world economy is growing a bit, it might grow a bit slower, but the risk of it collapsing in on itself remains low, although not zero. This is likely to be what passes for normal for a while.

To further add to the confusion, the Bank of Japan cut interest rates to negative levels. This means some finance institutions will be paying the bank to keep money on deposit. It is not entirely unprecedented, as the European Central Bank has already done something similar. The move has broadly been interpreted as more monetary stimulus and judged as positive, but such are the times, that sentiment could easily reverse.

THE MARKETS THIS WEEK

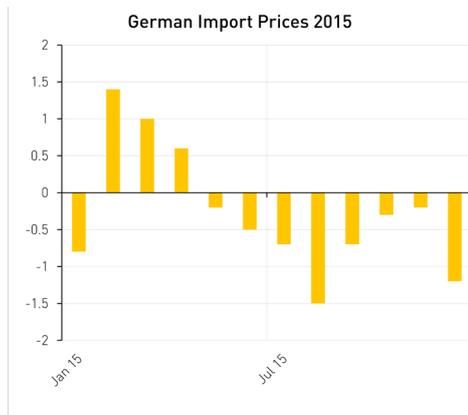
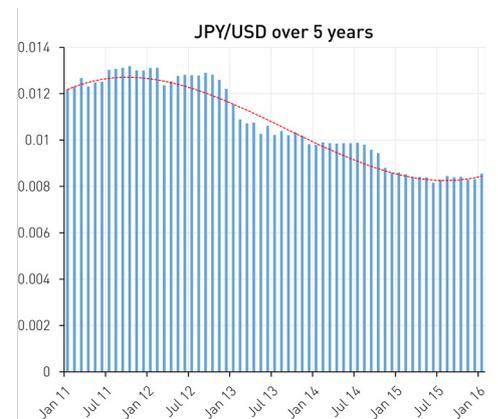
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|-----------------|--------------------|-------------------|------------------|---------------|---------------|----------------|--------------------|--------------------|-------------|--------------|
| FTSE 100 | S&P 500 | Nikkei 225 | Hang Seng | Dax 30 | CAC 40 | Ibex 35 | Brent Crude | Natural Gas | Gold | Wheat |
| 0.54% | 0.75% | 0.49% | 0.60% | -1.28% | -0.34% | -1.52% | 6.65% | 1.57% | 1.58% | -0.68% |



JAPAN: NEGATIVE INTEREST RATES IN JAPAN

Japan cut interest rates below zero on Friday morning, citing deflationary forces as the reason. The Bank of Japan said that it was becoming more difficult to reach their target of 2% inflation thanks to a falling oil price and "volatility" in global markets, although they claimed the data showed the Japanese economy was recovering moderately.

On the other hand, industrial production data was very poor in December, down 1.6% from a year earlier. Exports were also down for the third straight month, suffering the biggest decline since September 2012. This raises the question whether the rate cut was targeting the Yen, which has strengthened in recent months as risk aversion leads investors to sell emerging markets currencies and buy Japanese money. The Yen has fallen 2% against the dollar so far at the time of writing.



EU: EUROPEAN DATA WEAK

The news is not much better in Europe. This week saw poor data across a number of countries, most importantly Germany. Businesses economic sentiment fell in January, as the country reacted to the falling equity markets and uncertainty around policy. Meanwhile retail sales were up at a slower rate than December. Data also showed evidence of deflationary forces in the country in 2015: import prices fell 2.6% on average over that year, and more than expected in December. Frankly, it all points to more "easing" in the Eurozone too, which implies a lower currency as well and a higher dollar.

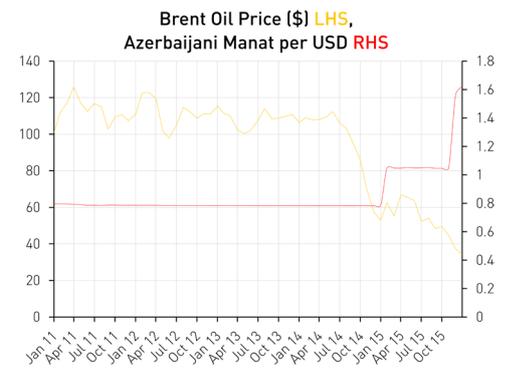
Meanwhile Italy is grappling with a banking crisis: the FTSE Banks index is down by a quarter in 2016 so far on concerns about the massive amount of non-performing loans in the system. On Friday there were positive signs that a solution which doesn't violate EU state aid rules was near.



AZERBAIJAN: RESCUE LOAN FOR AZERBAIJAN

Officials from the International Monetary Fund and the World Bank headed to Azerbaijan on Thursday to discuss a possible \$4bn emergency loan package in what risks becoming the first of a series of bailouts stemming from the tumbling oil price. The Baku visit, which follows a currency crisis triggered by the collapse in crude, comes amid concern at the two global institutions over emerging market producers from central Asia to Latin America.

Azerbaijan depends on oil and gas for 95 per cent of its exports and the fallout of its currency weakness has sparked a series of protests across the country rattling the government of President Ilham Aliyev. Last week the former Soviet republic became one of the first countries in the world to resort to capital controls in response to the collapse in oil prices, imposing a 20 per cent tax on exporting foreign currency. The Azerbaijani currency, the Manat, has fallen 35 per cent since the central bank in late December abandoned a dollar peg after spending more than half its reserves in a year.



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