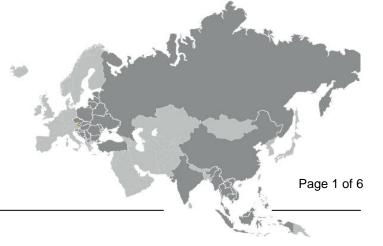
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## Global overview

Equity markets started the month with sharp losses, followed by a vigorous rally towards the end of November

Debt crisis in the Eurozone, weakening in China and another breakdown of debt talks in the USA are the main negative factors

New governments in power, political surprises and hectic crisis diplomacy in the Eurozone, but still no viable solution on the table

Concerted intervention by all major central banks at the end of November

During November the capital markets were once again buffeted by intense volatility. Equity markets in the Emerging Markets suffered some sharp losses, especially in China and India. Falling prices were driven by the renewed rise in yield premiums on bonds issued by Eurozone peripheral countries (Greece, Portugal, Ireland, Italy, Spain), as well as by the repeated episodes of sometimes quite surprising political developments in the Eurozone debt crisis and mounting worries about a stronger economic slowdown in China. In addition to all of this, US politicians were once again unable to reach an agreement on the future plans for budget consolidation. As a result of this, the budget compromise announced back in August is essentially dead, a development which was discussed as a possible scenario in this publication back in August. At the same time, this also ultimately confirms the correctness of S&P's decision to lower the USA's AAA rating immediately before the "August compromise", which was justified in part by the political resistance to following through with any kind of sustained budget consolidation efforts. Other than a cry of insulted indignation, both Republicans and Democrats quite obviously do not have any real arguments against S&P's very accurate assessment of the situation. Nevertheless, despite the enormous debts, as the issuer of the world's No.1 reserve currency, the USA still has some leeway to set its public finances in order. In this regard, the Eurozone is in a much more difficult situation, and there is still no solution in sight. Europe's decision-makers are racing from one crisis meeting to the next, and the political uncertainties are becoming greater and greater. The very surprising announcement of a referendum in Greece on the second aid package which had been bindingly agreed by all heads of government (and on the related conditions of this package) came as a bolt out of the blue for all of these governments and the financial markets as well. But this referendum was then cancelled, as the Papandreou government bowed out and a new caretaker government of "technocrats" was installed. Of course, in light of the catastrophic conditions, it is unlikely that this new government will be able to work any miracles either. In Italy, the newly formed government is now working hard to restore financial market confidence with an austerity package of around EUR 30 bn, hoping to end the disastrous rise in yields on Italian government bonds. If the Italians are not successful in this undertaking, the country will face the prospect of not being able to refinance itself on the financial markets, as has already been seen with Greece, Portugal and Ireland. In light of the sheer size of Italy's public debts, a scenario of this kind would no doubt render all of the previous Eurozone bail-out strategies useless, in particular since these plans have all included Italy as one of the countries doing the rescuing, not one of the ones being rescued.

Despite all of this, a strong rebound was seen on the equity markets in the last week of November. This was fostered by the surprisingly good US economic data, the easing of interest rate conditions in China, and last but not least by a massive, concerted intervention by the world's most important central banks. The central banks are obviously interested in avoiding a



Emerging Markets are

increasingly feeling the

impact of the Eurozone

debt crisis

Current capital market report on the Emerging Markets

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situation similar to that seen following the collapse of the US investment bank Lehman Brothers at any cost.

In the Emerging Markets, economic growth continues to decelerate and the effects of the Eurozone debt crisis and the tensions in the European banking system are becoming increasingly obvious. European banks, for example, have pulled back sharply from global trade financing, a field which they had previously dominated. Although it is likely that banks from other regions will gradually step in to fill this gap, business for exporters and importers will still suffer in the meantime. We feel that most of the Emerging Markets are relatively well prepared for a further slowdown in the global economy, thanks to their improved financial resources and robustly growing domestic markets. At the same time, it is clear that these markets will not be able to decouple from the developments in the EU and the USA. With regard to the economies of Central and Eastern Europe in particular, there is still a risk of a more severe downturn as a result of a long, deep recession in the Eurozone, especially if the Eurozone's debt crisis continues to escalate and/or the governments pass even more draconian austerity measures than already planned.

### Country focus

#### China

Mounting worries about a hard landing in China; central bank launches some initial measures to ease monetary policy

In October, the economic data in China were pointing less and less towards a hard landing, but the other side of the coin was then seen in November, as the purchasing managers' index dropped to the lowest level since March 2009. At the same time, it was amazing that the subindex for "new export orders" managed to reflect gains in 5 straight months in a row. Government advisors think that the situation for Chinese exports could deteriorate significantly next year, possibly even leading to a trade deficit. Compared to the other Emerging Markets, China's exposure to exports is relatively significant, as exports to Europe account for around 21% of total exports (equivalent to a roughly 5.6% share of GDP). This also explains the strong correlation between negative news on the European debt crisis and losses on the Chinese equity market. Accordingly, there are now more calls for the Chinese government to take fiscal policy measures to stimulate domestic demand. There are certainly plenty fields available for government infrastructure investment. But of course, the guestion is if and when more investments totalling in the hundreds of billions of dollars will lead to corresponding returns, for example in the form of fees or tax revenues. Because despite China's massive currency reserves, the financial situation in the Chinese economy is hardly free of risks. For instance, there is the problem of provincial debt in so-called financing vehicles, which totals 28% of GDP in "official" terms. Adding this to the official figure of 17% for sovereign debt (2010), one arrives at a debt level of 45% of GDP. And one must recall that companies and households have also been laying on debt, which has now expanded to 140% of GDP. Nonetheless, at 185% of GDP, China's total



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Numerous uncertainties will probably continue to hamper the performance of China's equity market debt is still much lower than the levels seen in countries such as France or Japan in particular. The banking sector risks recently pointed out by the IMF are also related to this issue. It is quite possible that the government in Beijing will soon have to bail Chinese banks out of a credit crisis, in particular if the booming real estate market quickly sours. Together with the European debt crisis, this set of uncertainties should weigh on the Chinese equity markets for some time to come. This market was one of the weakest Emerging Market performers in November, with declines of around 10% (Hong Kong) and 6% (Shanghai).

### India

India struggling with economic deceleration and (too) high inflation

Many investors remain sceptical about India right now. On the one hand, the country is faced with home-made problems, such as high inflation, massive gaps in the state budget and a possible deterioration in the current account balance, whereas on the other hand there are also negative impacts to be expected from the European debt crisis and the ensuing recession in the Eurozone. India's economy is now slowing down more quickly than expected. At the same time, a significant decline in inflation (WPI) has failed to materialise, and the rates are still over 9.0%. There now appears to be very little realism to the government's expectations that inflation rates will drop to 6.5%-7.0% by the spring. Obviously, the 13 rate hikes have had little impact so far. The increases in inflation are still being driven by developments in primary goods (weighted at 20.1%), and within this by food in particular (weighted at 14.3%). On a more positive note, the core measure of inflation (excluding food, oil and metals) is now easing. This can be interpreted as meaning that companies' price-setting power is now fading rapidly, due to the significant deceleration in economic activity (industrial production has fallen to just +1.8% yoy now). For the Indian financial market, this could mean more falling prices on the equity market and more weakness for the rupee in 2012. A change in the monetary policy stance should not be expected any time before Q2 2012, after there is a significant decline in the rates of inflation.

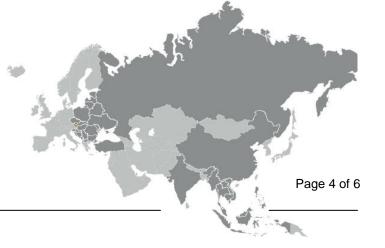
#### Brazil

Economic growth tapered off faster than generally expected in October, and leading indicators are pointing to further deceleration. The central bank responded by lowering interest rates again, with a cut of 0.5% to 11%. At the same time, the government is trying to help exporters using tax incentives. The situation on the domestic economy, however, is still quite robust, both in terms of retail sales and the rate of unemployment. The latter rate is officially at 5.8%, a very low level by Brazilian standards. Indeed, in many industries it continues to be difficult to find enough qualified workers. As a result, there is also upward pressure on wages, and thus vigilance is still called for in relation to inflation, which presents the central bank with a difficult balancing act. In line with most of the other EM equity markets, the Brazilian stock exchange also slipped considerably lower in November, but with a loss of just about 2.5% it was nonetheless one of the stronger Emerging Markets. Producers of base materials (e.g. steel, paper) felt the heat in particular.

Growth in Brazil is slowing down more quickly than expected; domestic economic activity is still quite robust



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### Russia

Russian economic growth picked up slightly in the third quarter, as the annual rate accelerated to 4.8% from the previous figure of 3.4%. Despite this, growth still fell just shy of the government's estimates and the market's expectations. Industrial production, on the other hand, jumped unexpectedly higher, along with the purchasing managers' index. Both of these indicators are signalling a quite sharp rebound in the productive sector. On the other hand, inflation continues to fall and may drop below 7% for the year as a whole. The outlook for private consumption is (still) positive right now: unemployment is declining consistently, retail sales are robust and real wages are growing at a stable pace. Over the entire month, the price of oil (Brent) remained quite stable at around 110 USD/barrel, a level that is quite beneficial for the Russian economy. Russian parliamentary elections in early December resulted in the anticipated victory of the Putin-aligned party "United Russia". While this party confirmed its absolute majority in parliament, it suffered massive losses and can no longer change the constitution on its own. In light of the presidential and gubernatorial elections in the spring of 2012, one can expect that the Kremlin will pull forward spending programmes in the regions in particular, in order to have a positive influence on voter sentiment. Russian bonds and the rouble were hardly changed during the month.

Putin's party wins the election, but suffers a massive loss of support

Russian shares, bonds and currency relatively unchanged on the whole Towards the end of the month Russia's equity market bounced back after some initial losses and closed with essentially no change, measured in terms of the MICEX. Mining stocks came under pressure, whereas defensive companies focusing on the domestic market – such as telecoms and utilities – did better than average.

#### Turkey

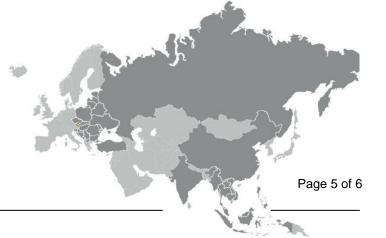
Turkey's economy is still looking quite robust. Industrial production continues to show strong gains, mainly driven by export business right now. Inflation increased quite significantly in October, due in large part to hikes in government taxes and levies; as a result, this did not come as a surprise to the markets. The central bank left the key interest rates unchanged. In the future, liquidity supply is to depend more strongly on whether credit growth is above or below the Turkish central bank's target values. The Turkish lira remained relatively unchanged versus the euro in November. The Istanbul's stock exchange index ISE-100 lost about 2.5%. Corporate results for Q3 2011 were most in line with analysts' expectations or better.

#### Poland

Economic data continue to weaken in Poland. In October, the result for industrial production was disappointing, as the increase was much smaller than anticipated. The purchasing managers' index was also below the expectations, clearly reflecting the negative impact of the Eurozone sovereign debt crisis on Polish manufacturing. Both industrial production and export growth are expected to fall significantly, possibly dropping back to stagnation. At the same time,



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Poland's economy slowing more quickly than anticipated; government plans new taxes on the use of Polish natural resources

Czech economy stagnating; CZK weakens significantly

Rate hike in Hungary to support the currency; credit rating downgraded due to the dismal growth outlook and high levels of FX indebtedness inflation produced an unpleasant surprise, as the rate increased significantly versus September. Nonetheless, there are signs that inflationary pressure may subside in the months ahead. As investor risk appetite has deteriorated considerably again, prices of Polish bonds and the zloty exchange rate both weakened.

The Polish WIG stock index lost 3.5% in November. Pressure was mainly felt by construction firms, miners, and oil&gas companies, after the government announced new taxes on the exploitation of Polish natural resources.

#### **Czech Republic**

The economic data published for the Czech Republic in November were weak, signalling that the country will also be dragged down by the economic slowdown in Western Europe. Retail sales and industrial production are growing much more slowly than in the previous months and GDP merely stagnated in the third quarter. Similarly to other countries in the region, the purchasing managers' index dropped well below 50 points, pointing to contraction in Q4. Compared to Poland for example, the Czech Republic would be much more severely affected by a protracted decline in Western European demand, in particular since Czech domestic demand still shows no signs of recovery. During October Czech inflation jumped sharply to 2.3%, in part due to the weaker exchange rate of the Czech koruna. Despite this development, there is no significant inflationary pressure on the horizon, and inflation should soon drop back below 2% again. Accordingly, there is no need for the Czech central bank to take action at the moment. The Czech koruna had been a haven of stability and strength in the region, but in November the currency faltered and weakened significantly against the euro; Czech bonds also suffered.

Czech equities were also among the weakest in the region in November, with the market falling around 6%, led mostly by financials.

#### Hungary

In economic terms, Hungary had a tough time in November. First, the Hungarian forint was hit by intense depreciation, prompting the central bank to hike interest rates (from 6% to 6.5%). The rating agency Moody's downgraded Hungary's credit rating, removing the country from the investment grade segment. This move was explained in part by the high level of FX debt, in combination with an extremely weak growth outlook. Shortly thereafter, Hungary approached the IMF for help, after months of stating that no help was needed. One positive note was that economic growth during the third quarter was better than expected. Nevertheless, leading indicators are pointing to contraction for the Hungarian economy in Q4. Turning to inflation, there are some signs of sustained upward pressures on prices, which will be exacerbated by the weakness of the forint and the resulting increases in import prices. Consequently, it is possible that the central bank will raise rates again to bolster the currency, even though a rate cut would be needed to stimulate the economy. The Hungarian government's erratic economic policy approach and its quite frequently bumbling communication of measures are additional negative



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influences on the currency and the economy, and will probably also not make the negotiations with the IMF (probably starting in January) any easier. Prices of Hungarian government bonds declined considerably in November.

By contrast, the Hungarian equity market was one of the strongest in the region, and the index ended the month almost unchanged. The oil company MOL posted a strong gain of almost 9%, whereas the major bank OTP suffered painful declines.

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