INFLATION COOLS BUT HIGHER ENERGY PRICES COMPLICATE THE OUTLOOK FOR CENTRAL BANKS

This week there have been a number of small victories in the ongoing battle with global inflation. Both Spain and Germany reported prices rising slower than expected, which led to a cooler overall inflation picture for the Eurozone as a whole. There was further good news from the US, as the annual rate for Core PCE inflation, the Federal Reserve's preferred measure of inflation, came in more or less in live with expectations as it continued its steady decline.

Elsewhere, inflation is preparing for a fightback with rising oil prices and a strong US dollar being bad omens for countries that import a lot of their energy, UK and large parts of Europe especially. While this is bad news for central banks, and indeed everyone with a gas bill, these two factors will also be bad for growth, slowing down economies further and hopefully negating the need for more rate rises designed to do the same.

THE MARKETS THIS WEEK

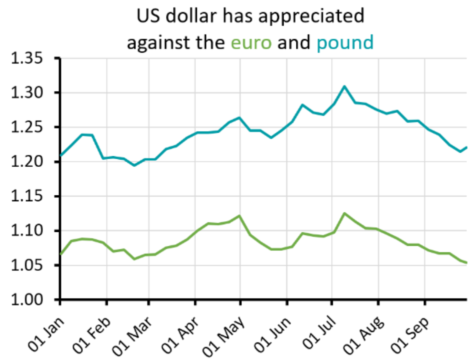
FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
-0.66%	-0.46%	+1.82%	-1.16%	-1.51%	+0.10%	+0.18%	-0.44%	-2.20%	-1.64%	-0.51%

CURRENCIES: US DOLLAR STRENGTH CONTINUES

£ $ € ¥

The US dollar's rally continued as it reached its highest value against the pound since March and its highest against the euro since early January. Currency markets appear to have accepted the Federal Reserve's intention to leave interest rates higher for longer. The pound's decline has been particularly steep as poor economic data means the Bank of England is seen as likely to cut rates earlier than the Fed.

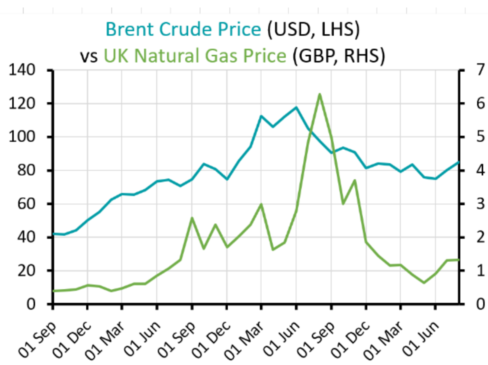
The prospect of US interest rates remaining high have contributed to the recent drop in US equity and bond markets. The S&P 500 has fallen around 5% this month, while the decline in US government bonds has pushed yields to levels last seen in 2007. In contrast, the FTSE 100 is up around 1.5% as overseas earnings have been inflated by the weaker pound. The rise in the dollar is putting pressure on other currencies. The Japanese yen and Chinese yuan are at their lowest value against the dollar for about a year and markets are speculating about whether their central banks will intervene to prevent any further decline.



OIL: BRENT TIPPED TO HIT $100 AS US INVENTORIES FALL

The price of oil increased after US stockpiles unexpectedly fell. This helped push the price of Brent crude to $97 a barrel as the impact of production caps by Saudi Arabia and Russia are digested, although it has since fallen back. Many analysts are predicting that oil will rise above $100 a barrel, despite weaker demand as the global economy cools. The high oil price is compounded by the recent rise of the US dollar and countries which are oil importers may see energy prices begin pushing inflation up.

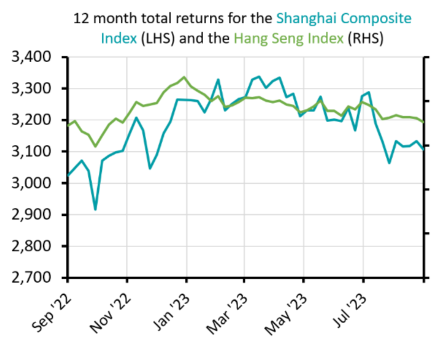
The price of natural gas has also been rising as the UK and Europe continue to build up reserves. National Grid has warned of a small risk of blackouts this winter as scheduled maintenance is due to take some nuclear power stations offline in January. National Gas Transmission, the company that runs the UK's gas network, expects demand this winter to be similar to last year. It says although the UK is better placed to ensure its energy supply than this time last year it expects gas prices to remain volatile.



CHINA: POLITICAL TENSIONS DETER INVESTMENT

Chinese and Hong Kong equities fell this week as the Chinese economy struggles to regain momentum. Profitability at China's industrial manufacturers fell for the second month in a row while China's balance of trade fell again as exports and imports both declined. Meanwhile investors are trying to adjust to the increase in political tension between China and western governments. The rising risks of Chinese government interference or retaliatory tariffs mean some companies are considering moving production away from China, while others search for alternative sources of goods and raw materials.

China's property market also continues to struggle. Two years ago China Evergrande sparked the property crisis by defaulting on its huge pile of debt. Last week it defaulted again and this week its shares were suspended as it emerged the company's founder and chairman has been detained by the police. The suspension was announced after Chinese markets closed for a holday but overseas companies with links to Chinese property fell slightly.



Data sourced from FE Analytics, Office for National Statistics, Eurostat and Federal Reserve Bank of St Louis