FED KEEPS FOCUS

This week all attention has been on the US Federal Reserve, which decided to raise interest rates on Wednesday. The continued strengthening of the US economy is at odds with most other developed markets, where low rates and quantitative easing are still the norm. The challenge for the US central bank, and indeed all central banks, is that they are mostly running on empty. Everything that could be done, has been done, and yet economic growth is still modest at best. This is ok assuming things stay as they are, but should there be another recession there will be little monetary policy can do to react. For this reason, we should be envious of the US being able to take the first steps towards interest rate normalization.

Elsewhere markets reacted not to the hike but the suggestion of more hikes that were included in the fed's dot plot. The signalling of intentions is a common ploy for central banks, and is often used as a way to encourage good behaviour rather than genuinely signalling a genuine desired policy. Keeping the market guessing has long been the preferred role of central bankers.

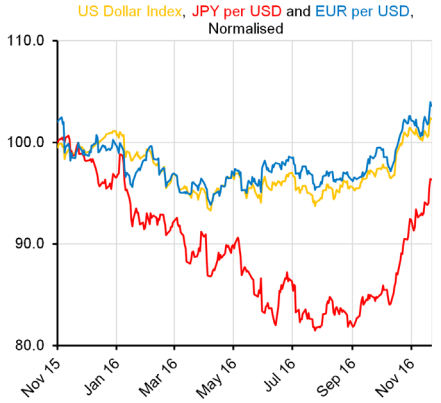
THE MARKETS THIS WEEK

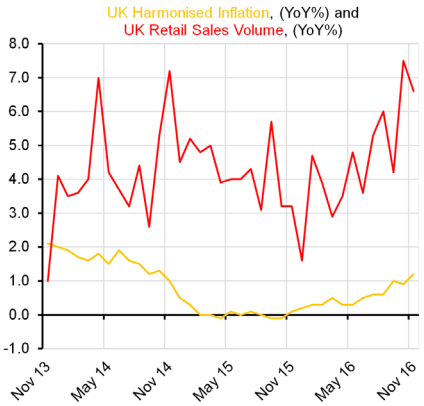
FTSE 100	S&P 500	Nikkei 225	Euro Stoxx 500	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Wheat	GBP USD
+0.93%	+0.71%	+2.13%	+2.05%	-3.25%	+0.10%	-0.01%	-0.90%	-2.13%	+1.81%	-1.01%

US: MARKETS REACTION TO FED DECISION

The US Federal reserve hiked borrowing rates by 0.25 per cent on for the first time this year. Although the decision to hike was widely expected, the steepened pace of increases for 2017 has somewhat surprised markets. The futures market puts the chance of another hike by June at 78 per cent and the likelihood of three hikes at 50 per cent. It's worth remembering the Fed has repeatedly overestimated the number of rate hikes with at least four originally planned for 2016. The Fed's decision to increase interest rates has sent yields soaring. As a result, the 2-year US bond yield climbed to its highest level since 2009 and the 10-year Treasury yield reached 2.56 per cent.

The US dollar reached a 13-year high against the euro and a 10 month high versus the yen. The continuing strength of the US dollar against its major peers pushed the dollar index above 103 – its highest reading since 2003. Some emerging market currencies such as the Brazilian real, the South African rand and the Mexican peso have experienced big falls as investors fear a strengthening dollar will attract capital back to the US.





UK: CARNEY KEEPS RATES LOW

The Bank of England chose to keep interest rates at a record low of 0.25 per cent this week and the future direction of monetary policy remains uncertain. The UK's economy continues to provide mixed signals after June's referendum with UK inflation jumping more than expected in November. The increase to 1.2 per cent from 0.9 per cent was the largest monthly increase since October 2014.

Retail sales were the main contributor to this November rise in inflation as Black Friday discounts sent customers to the shops and the number of household goods purchased rose 6 per cent. Sales volumes grew 2.1 per cent during the three months to the end of November and by 5.9 per cent year to date. Despite these positive numbers the drop in sterling is yet to have an effect on consumer spending. The scale of the upward pressure on inflation remains an unknown with UK import costs surging nearly 15 per cent last month.

EU: GREEK DEBT RELIEF SUSPENDED

The European Union opted to freeze Greece's debt relief plans this week, a U-turn from last weeks' agreement. The change of plans was a result of some EU member states objecting to Syriza (Greece's left wing political party) laying out plans to top up pensions for low-income retiree's, a move potentially costing the government €617m. Greek 10-year government bond yields rose sharply to 7.06 per cent, an increase of 0.34 per cent, after the announcement and the ASE index (Athens's main stock index) dropped a further 2.5 per cent to reach a two-week low.

Elsewhere in Europe Italy's major banks are performing better than expected rising 4.4 per cent and potentially on course for a third straight week of gains. The appointment of Prime Minister Paolo Gentiloni is providing a stable political environment. Meanwhile in the Eurozone the Markit Manufacturing Purchasing Managers' Index reached 54.9 in December up from 53.7 the previous month (above 50 is seen as expansion). The majority of this increase can be attributed to the depreciation of the euro which has increased competitiveness amongst producers.