The outlook for 1999

The global emerging market (EM) meltdown that began in Asia in 1997 and culminated in the Russian devaluation/default in 1998 can justifiably claim to be one of the most turbulent episodes in the financial markets since the second world war.

Bond yields in the US and Europe collapsed to new lows as investors shocked by the scale of the EM price declines moved money back to safe havens in core markets. Contagion effects moved on to Latin America with increased speculation about a devaluation of the real seeing a $30bn decline in Brazil's foreign exchange reserves. In the event, the IMF and the G7 put together a massive $41.5bn re-financing package for Brazil.

However, the dramatic EM events should not detract from the extremely encouraging inflation environment, with OECD inflation at the lowest level for several decades. This is partially driven by the weakening in commodity prices, with oil ending the year under $10/bbl.

The three main factors that are likely to drive the bond markets in 1999 are:

- **global growth** – Deutsche Bank Research believes that global growth will decelerate and move to a below-trend 1.7%. We look for the US to grow by 2.5%, Europe by 2% but with Japan recording -1%. The inability of the Japanese authorities to kickstart recovery will remain a drag on global growth;
- **inflation** – sub-trend global growth suggests demand pressures are unlikely to reverse the encouraging inflation backdrop bond markets have enjoyed in 1998. In addition, the outlook for commodity prices also looks bleak so we expect G7 inflation of 1.7 % next year; and
- **equities** – if corporate earnings disappoint in the US next year as a result of a slowing economy, then a correction to the Dow would probably benefit bond markets on asset allocation switches.

Hence we expect that bond yields will stay low in 1999 with the potential for further declines if global growth disappoints and inflation decelerates to an even greater extent than we had anticipated. We do not expect the Fed to cut rates again but do look for the European Central Bank to ease by a further 25bp in the first half of 1999, following the surprises rate cuts seen from the 'euro-land' central banks in early December. The largest monetary easing is expected to be in the UK, as little or no growth in the economy persuades the Bank of England to cut rates to 5% by the end of 1999. The risk to this favourable outlook for bond markets is that the Japanese economy eventually turns around as consumer sentiment responds to the major tax cuts and/or the banking system finally recovers.

Another risk is that European politicians, led by new German finance minister Lafontaine, attempt to tackle unemployment by easing fiscal policy which would pose a supply concern in European bond markets as well as triggering a potential reversal of low short-term rates in euro-land.

However, our central scenario remains that 1999 will be another year of low global interest rates driven by subdued inflation as a result of weak commodity prices and excess spare global productive capacity. ■

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INTERNATIONAL BONDS

These are a selection of bonds announced recently. The details were supplied by *IFR Securities Data, London* and other sources.

Issuer	Launch rating M	Launch rating S&P	Amount (m)	Coupon (%)	Price	Maturity	Launch Spread (bp)	Fees (%)	Bookrunner
Abbey National	Aa3	AA-	USD600	5	99.410 99.410R	07 Jan/00	95	0.4	JP Morgan Securities
Halifax	Aa1	AA	USD73	2.25	100.100 100.00R	17 Dec/04	-8	2.250	Deutsche Bank (Suisse) SA
Nestlé Holding (UK)	Aaa	AAA	USD250	5	101.333 99.7080R	08 Dec/03	40	1.8750	JP Morgan Securities
Premier Pub Finance Company	NR NR NR	A BBB A	USD133 USD58 *USD67	7.153 7.74 8	100.00 100.00 100.00R	15 Dec/22 15 Dec/26 15 Sep/08	ND	0.750 1.000 0.350	Nomura International
Rolls-Royce	A3		USD293	4.5	101.7860 99.4360R	22 Dec/05	75	2.750	Deutsche Bank AG
Shell Finance UK	Aaa	AAA	USD500	5	99.9960 99.9960R	19 Nov/03	50	0.250	ABN AMRO Bank NV Morgan Stanley Dean Witter
Telekom SA Finance	NR	NR	USD352	13	85.0616 85.0616R	31 May/04	120	0.00	JP Morgan Securities Standard Bank of South Africa

** Floating rate note. Launch ratings are from Moody's (M) or Standard & Poor's (S&P). NR = Not Rated. R = fixed re-offer price. Launch spread is over comparable government bond.*