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Monthly

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Monthly recap

- EMU: GDP dropped 0.6% qoq in 4Q12, and the negative carry-over effect of this contraction lowers by 0.2pp our yearly GDP forecast for 2013, to -0.1% from +0.1%. This is not concerning, given that the revision reflects backward-looking information. Encouragingly, and more importantly, timely soft indicators continue to trend higher, consistent with our view that eurozone GDP will stabilize already at the beginning of the year. President Draghi confirmed that the ECB does not target the exchange rate, and dismissed the view that recent FX developments reflect “deliberate competitive devaluation”. However, he also hinted that the ECB is ready to respond if currency appreciation were to tilt to the downside the balance of risk to medium-term price stability. Our feeling is that the bar for a rate cut remains fairly high, and that only a further significant appreciation of the trade-weighted EUR would force the ECB’s hand on rates.
- US: Following the unexpected GDP decline at the end of last year (which most likely will be revised to a small gain), the US economy is regaining momentum. And while growth in the current quarter is still restrained by tighter fiscal policy, the US economy, starting in spring, will most likely experience its strongest period of the recovery thus far. In addition to consumer spending, which remains the main growth engine, two key areas are set to support expansion going forward: the structural recovery in the housing market and pent-up demand in business investment. The Federal Reserve seems to share this view. They dismissed the weak 4Q12 GDP number and even toned down their risk assessment. That said, most board members continue to emphasize that the painfully slow recovery warrants a continuation of the ultra-easy policy. The large-scale asset purchase program (QE3) will therefore most likely continue until the end of this year.
- CEE: The end of 2012 saw a series of weak data from CEE, including a decline in IP on the back of weak external demand and struggling domestic demand. Upcoming GDP releases, as a result, are likely to show at best lackluster growth and, in some economies, another quarter of contraction. Fortunately, in many cases inflation also moved lower, allowing central banks to ease monetary conditions in some economies, e.g. Poland and Hungary. We expect 4Q12 to mark the bottom in the cycle for activity, with some signs of a gradual improvement to materialize already in 1Q13, led by external demand.
- China: Recent data imply that the Chinese economy is already recovering and will gain some traction further down the road. However, recovery momentum will be rather moderate by historical standards. Economic growth picked up again in 4Q12 for the first time in two years, with real GDP advancing by 7.9% yoy (although the 7.8% full-year growth was the weakest since 1999). High frequency activity data surprised on a stronger note as well, showing a healthy economic momentum starting 2013.

Table 1: Annual macroeconomic forecasts

	GDP (%)			CPI inflation (%)			Central Bank Rate (EoP)			Government budget balance (% GDP)			Government gross debt (% GDP)			Current account balance (% GDP)		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Eurozone	-0.5	-0.1	1.2	2.5	2.0	1.8	0.75	0.75	1.00	-3.2	-2.8	-2.6	92.9	94.7	94.3	1.0	1.2	1.3
Germany	0.9	0.8	1.5	2.0	1.8	1.9	-	-	-	0.1	0.0	-0.2	81.7	79.2	76.9	6.4	5.9	5.5
France	0.0	0.5	1.3	2.0	1.6	2.1	-	-	-	-4.5	-3.5	-3.1	90.1	92.3	93.4	-2.4	-2.0	-1.8
Italy	-2.2	-1.1	0.7	3.0	2.0	1.8	-	-	-	-2.8	-1.8	-1.6	126.3	127.9	126.4	-1.6	-1.1	-1.0
Spain	-1.4	-1.4	0.4	2.4	2.3	2.6	-	-	-	-7.3*	-6.0	-5.1	86.5	93.8	98.7	-2.0	-0.2	0.5
Austria	0.7	0.9	1.5	2.4	2.2	1.9	-	-	-	-3.2	-2.3	-1.7	75.1	75.7	75.3	1.9	1.5	1.8
Greece	-6.5	-4.5	0.2	1.5	0.4	0.7	-	-	-	-7.3	-5.3	-4.9	160.8	174.3	175.7	-4.5	-3.0	-1.8
Portugal	-3.2	-2.5	0.4	2.8	1.4	1.7	-	-	-	-5.2	-4.5	-3.2	121.0	122.5	123.1	-2.5	-1.9	-1.0
Other EU																		
UK	-0.1	0.9	1.4	2.8	2.7	2.3	0.50	0.50	0.75	-6.6	-6.9	-6.1	90.0	94.0	97.1	-3.1	-2.7	-2.4
Sweden	1.2	1.3	2.4	0.9	0.4	1.8	1.00	1.00	1.50	-0.2	-0.2	0.2	37.1	35.9	34.1	7.2	7.8	7.6
Poland	2.0	1.7	2.3	3.7	1.7	2.4	4.25	3.5	3.5	-3.5	-3.8	-3.0	55.7	57.5	57.4	-3.5	-2.9	-3.3
Czech Rep.	-1.1	0.4	2.2	3.3	2.1	2.1	0.05	0.05	1.00	-5.0	-3.4	-3.0	45.5	47.5	48.4	-2.2	-0.5	0.0
Hungary	-1.7	-0.6	0.7	5.6	4.0	4.1	5.75	5.00	6.00	-2.7	-2.8	-3.4	78.0	77.1	77.2	0.9	1.6	1.5
Others																		
US	2.2	1.9	2.7	2.1	1.8	2.5	0.25	0.25	0.25	-8.7	-7.1	-5.7	107.2	111.5	113.6	-3.1	-3.0	-3.1
Switzerland	1.0	1.2	1.7	-0.7	-0.1	0.7	0.0	0.0	0.5	0.5	0.3	0.3	36.5	35.8	34.7	13.1	12.0	11.0
Russia	3.6	3.6	3.8	5.1	6.0	5.1	8.25	7.5	7.00	0.0	-1.0	-0.5	10.2	11.2	12	4.5	1.6	0.5
Turkey	2.7	3.4	3.9	8.9	6.7	6.2	5.5	5.75	6.50	-2.1	-3.0	-2.5	36.9	36.2	35.1	-6.3	-6.5	-5.9
China	7.8	8.2	8.0	2.7	3.1	3.5	6.00	6.00	6.50	-	-	-	-	-	-	2.3	2.7	2.8

*This figure does not include the impact of the bank recapitalization's cost

Source: UniCredit Research

Table 2: Quarterly GDP and CPI forecasts

REAL GDP (% QOQ, SA)

	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Eurozone	-0.1	-0.6	0.0	0.2	0.3	0.3	0.3	0.3	0.4	0.4
Germany	0.2	-0.6	0.3	0.5	0.5	0.4	0.4	0.3	0.3	0.4
France	0.1	-0.3	0.2	0.2	0.3	0.4	0.3	0.3	0.4	0.4
Italy	-0.2	-0.9	-0.2	0.1	0.1	0.2	0.2	0.2	0.3	0.3
Spain	-0.3	-0.7	-0.5	-0.2	0.1	0.2	0.1	0.1	0.1	0.2
Austria	0.1	-0.2	0.1	0.5	0.6	0.5	0.3	0.2	0.2	0.3
Other EU										
UK	0.9	-0.3	0.1	0.2	0.3	0.3	0.4	0.3	0.5	0.5
Sweden	0.5	-0.3	0.3	0.5	0.6	0.6	0.6	0.6	0.6	0.7
Poland (% yoy)	1.4	1.0	0.4	1.3	2.0	2.9	2.9	2.2	2.2	2.0
Czech Rep.	-0.3	-0.2	0.1	0.5	0.6	0.6	0.5	0.6	0.5	0.6
Hungary	-0.4	-0.9	0.0	0.2	0.4	0.3	0.1	0.1	0.1	0.2
Others										
US (annualized)	3.1	-0.1	1.5	2.8	2.8	2.8	2.7	2.6	2.4	2.4
Switzerland	0.6	0.0	0.3	0.4	0.5	0.5	0.4	0.4	0.4	0.4
Russia	0.4	1.2	0.8	0.8	0.9	1.1	0.9	0.8	1.0	1.1
Turkey	0.2	0.7	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0
China (% yoy)	7.4	7.9	8.2	8.5	8.3	7.6	7.8	7.8	8.2	8.0

CPI INFLATION (% YOY)

	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Eurozone	2.5	2.3	1.9	1.9	1.9	2.0	2.0	1.9	1.7	1.6
Germany	1.9	2.0	1.8	1.8	1.8	1.8	1.8	1.9	1.9	1.9
France	2.0	1.5	1.3	1.5	1.7	1.9	2.1	2.1	2.0	2.1
Italy	3.2	2.5	2.1	1.6	2.1	2.2	1.9	1.9	1.5	1.5
Spain (HICP)	2.8	3.2	2.3	2.4	1.8	2.2	2.7	2.7	2.6	2.6
Austria	2.3	2.8	2.6	2.3	2.1	1.8	1.9	2.1	2.0	1.7
Other EU										
UK	2.4	2.7	2.8	2.9	2.8	2.4	2.3	2.3	2.4	2.3
Sweden	0.6	0.1	0.1	0.1	0.2	1.1	1.7	1.9	2.2	2.0
Poland	3.9	2.9	1.8	1.4	1.7	1.9	2.5	2.3	2.3	2.5
Czech Rep.	3.4	2.9	2.0	2.1	2.2	2.2	2.0	2.1	2.2	2.2
Hungary	6.6	5.0	3.7	4.0	3.3	4.2	3.8	3.9	4.3	4.3
Others										
US	1.7	1.9	1.5	1.8	1.9	2.0	2.4	2.4	2.5	2.6
Switzerland	-0.5	-0.3	-0.4	-0.2	-0.1	0.2	0.6	0.7	0.7	0.7
Russia	5.1	5.1	5.9	6.5	6.3	6.0	5.6	5.2	5.2	5.1
Turkey	9.0	6.8	6.3	6.9	7.2	6.4	6.4	6.2	6.2	6.0
China	1.9	2.1	2.8	2.9	3.2	3.3	3.4	3.5	3.5	3.6

Source: UniCredit Research

Table 3: Comparison of annual GDP and CPI forecasts

GDP (%)

	UniCredit (Jan-13)			IMF (Jan-13/Oct-12)*			European Commission (Nov-12)			OECD (Nov-12)		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Eurozone	-0.5	-0.1	1.2	-0.4	-0.2	1.0	-0.4	0.1	1.4	-0.4	-0.1	1.3
Germany	0.9	0.8	1.5	0.9	0.6	1.4	0.8	0.8	2.0	0.9	0.6	1.9
France	0.0	0.5	1.3	0.2	0.3	0.9	0.2	0.4	1.2	0.2	0.3	1.3
Italy	-2.2	-1.1	0.7	-2.1	-1.0	0.5	-2.3	-0.5	0.8	-2.2	-1.0	0.6
Spain	-1.4	-1.4	0.4	-1.4	-1.5	0.8	-1.4	-1.4	0.8	-1.3	-1.4	0.5
Austria	0.7	0.9	1.5	0.9	1.1	2.0	0.8	0.9	2.1	0.6	0.8	1.8
Greece	-6.5	-4.5	0.2	-6.0	-4.0	0.0	-6.0	-4.2	0.6	-6.3	-4.5	-1.3
Portugal	-3.2	-2.5	0.4	-3.0	-1.0	1.2	-3.0	-1.0	0.8	-3.1	-1.8	0.9
Other EU												
UK	-0.1	0.9	1.4	-0.2	1.0	1.9	-0.3	0.9	2.0	-0.1	0.9	1.6
Sweden	1.2	1.3	2.4	1.2	2.2	2.5	1.1	1.9	2.5	1.2	1.9	3.0
Poland	2.0	1.7	2.3	2.4	2.1	2.7	2.4	1.8	2.6	2.5	1.6	2.5
Czech Rep.	-1.1	0.4	2.2	-1.0	0.8	2.8	-1.3	0.8	2.0	-0.9	0.8	2.4
Hungary	-1.7	-0.6	0.7	-1.0	0.8	1.6	-1.2	0.3	1.3	-1.6	-0.1	1.2
Others												
US	2.2	1.9	2.7	2.3	2.0	3.0	2.1	2.3	2.6	2.2	2.0	2.8
Switzerland	1.0	1.2	1.7	0.8	1.4	1.8	1.0	1.4	1.9	0.8	1.1	2.3
Russia	3.6	3.6	3.8	3.6	3.7	3.8	3.7	3.9	4.0	3.4	3.8	4.1
Turkey	2.7	3.4	3.9	3.0	3.5	4.0	3.0	2.9	3.7	2.9	4.1	5.2
China	7.8	8.2	8.0	7.8	8.2	8.5	7.7	7.7	7.8	7.5	8.5	8.9

CPI INFLATION (%)**

	UniCredit (Jan-13)			IMF (Oct-12)			European Commission (Nov-12)			OECD (Nov-12)		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Eurozone	2.5	2.0	1.8	2.3	1.6	1.4	2.5	1.8	1.6	2.4	1.6	1.2
Germany	2.0	1.8	1.9	2.2	1.9	2.1	2.1	1.9	1.8	2.1	1.9	2.0
France	2.0	1.6	2.1	1.9	1.0	0.9	2.3	1.7	1.7	2.2	1.3	1.2
Italy	3.0	2.0	1.8	3.0	1.8	1.0	3.3	2.0	1.7	3.2	1.9	0.9
Spain	2.4	2.3	2.6	2.4	2.4	1.5	2.5	2.1	1.3	2.2	1.2	0.4
Austria	2.4	2.2	1.9	2.3	1.9	1.9	2.4	1.8	1.9	2.4	1.9	1.6
Greece	1.5	0.4	0.7	0.9	-1.1	-0.3	1.1	-0.8	-0.4	1.0	-0.2	-0.8
Portugal	2.8	1.4	1.7	2.8	0.7	1.1	2.9	0.9	1.3	2.7	0.8	1.0
Other EU												
UK	2.8	2.7	2.3	2.7	1.9	1.7	2.7	2.1	1.9	2.6	1.9	1.8
Sweden	0.9	0.4	1.8	1.4	2.0	2.0	1.0	1.3	1.8	1.0	0.9	1.7
Poland	3.7	1.7	2.4	3.9	2.7	2.5	3.8	2.6	2.4	3.6	2.1	2.1
Czech Rep.	3.3	2.1	2.1	3.4	2.1	2.0	3.6	1.1	1.1	3.2	2.0	2.1
Hungary	5.6	4.0	4.1	5.6	3.5	3.0	5.6	5.3	3.9	5.8	4.8	3.9
Others												
US	2.1	1.8	2.5	2.0	1.8	1.8	2.1	2.0	2.1	2.1	1.8	2.0
Switzerland	-0.7	-0.1	0.7	-0.5	0.5	1.0	-0.9	0.3	1.6	-0.6	0.1	0.2
Russia	5.1	6.0	5.1	5.1	6.6	6.5	7.7	7.4	7.4	5.0	6.4	4.3
Turkey	8.9	6.7	6.2	8.7	6.5	5.3	8.0	7.8	5.8	9.1	6.9	6.1
China	2.7	3.1	3.5	3.0	3.0	3.0	2.8	2.7	1.6	2.6	1.5	1.4

*The IMF GDP forecasts are those published in the WEO January 2013 update for all countries except Austria, Greece, Portugal, Sweden, Poland, Czech Rep., Hungary, Switzerland and Turkey, where the numbers are those published in October 2012; **UniCredit forecasts refer to CPI with the exception of Spain, where HICP is used. IMF and OECD inflation forecasts refer to the CPI except for eurozone countries, where HICP is used. EC inflation forecasts refer to the HICP, except for the US and Russia, where CPI is used. Please note that in the UK, CPI and HICP coincide.

Source: IMF, European Commission, OECD, UniCredit Research

Table 4: Global G10 FI/FX forecasts

EU	Current	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Key rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00
3M	0.23	0.35	0.45	0.55	0.65	0.75	0.85	0.95	1.10
2Y	0.17	0.10	0.25	0.40	0.55	0.75	1.00	1.25	1.50
5Y	0.63	0.60	0.85	1.00	1.20	1.38	1.60	1.88	2.10
10Y	1.61	1.60	1.75	1.90	2.05	2.20	2.40	2.60	2.80
30Y	2.41	2.45	2.60	2.75	2.85	2.95	3.10	3.25	3.40
2/10	144	150	150	150	150	145	140	135	130
2/5/10	-26	-25	-15	-15	-10	-10	-10	-5	-5
10/30	80	85	85	85	80	75	70	65	60
2Y SwSp	-39	-35	-35	-35	-35	-30	-30	-25	-25
10Y SwSp	-26	-30	-30	-30	-30	-25	-25	-25	-25
10Y BTP/bund	280	310	295	275	260	245	230	215	200
US									
Key rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3M	0.29	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
2Y	0.26	0.35	0.35	0.45	0.55	0.65	0.80	1.20	1.60
5Y	0.85	0.90	1.05	1.18	1.38	1.53	1.70	2.10	2.45
10Y	1.98	1.85	1.95	2.10	2.30	2.50	2.70	3.00	3.30
30Y	3.15	3.00	3.05	3.15	3.30	3.45	3.60	3.85	4.10
2/10	172	150	160	165	175	185	190	180	170
2/5/10	-28	-20	-10	-10	-5	-5	-5	0	0
10/30	116	115	110	105	100	95	90	85	80
2Y SwSp	-15	-10	-10	-10	-10	-5	-5	-5	-5
10Y SwSp	-7	-10	-10	-10	-5	0	0	0	0
UK									
Key rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
10Y	2.17	2.00	2.10	2.20	2.35	2.50	2.70	2.90	3.10
SZ									
Key rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10Y	0.77	0.60	0.75	0.90	1.05	1.20	1.40	1.60	1.80

	Current	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
EUR-USD	1.34	1.36	1.37	1.38	1.40	1.40	1.41	1.42	1.43
EUR-JPY	124	126	129	131	136	136	137	139	143
EUR-GBP	0.86	0.88	0.89	0.91	0.93	0.93	0.94	0.95	0.95
EUR-SEK	8.46	8.75	8.80	8.85	8.95	8.95	9.00	9.00	9.00
EUR-NOK	7.40	7.40	7.35	7.30	7.25	7.25	7.20	7.20	7.20
EUR-CHF	1.23	1.25	1.26	1.27	1.28	1.28	1.29	1.30	1.30
EUR-AUD	1.29	1.27	1.27	1.27	1.27	1.27	1.26	1.26	1.24
EUR-NZD	1.57	1.58	1.57	1.57	1.56	1.54	1.53	1.53	1.51
EUR-CAD	1.34	1.35	1.34	1.35	1.36	1.36	1.35	1.36	1.36
USD-JPY	93	93	94	95	97	97	97	98	100
GBP-USD	1.55	1.55	1.54	1.52	1.50	1.50	1.50	1.50	1.50
USD-SEK	6.32	6.43	6.42	6.41	6.39	6.39	6.38	6.34	6.29
USD-NOK	5.54	5.44	5.36	5.29	5.18	5.18	5.11	5.07	5.03
USD-CHF	0.92	0.92	0.92	0.92	0.91	0.91	0.91	0.92	0.91
AUD-USD	1.04	1.07	1.08	1.09	1.10	1.10	1.12	1.13	1.15
NZD-USD	0.85	0.86	0.87	0.88	0.90	0.91	0.92	0.93	0.95
USD-CAD	1.00	0.99	0.98	0.98	0.97	0.97	0.96	0.96	0.95

Source: Bloomberg, UniCredit Research

Eurozone

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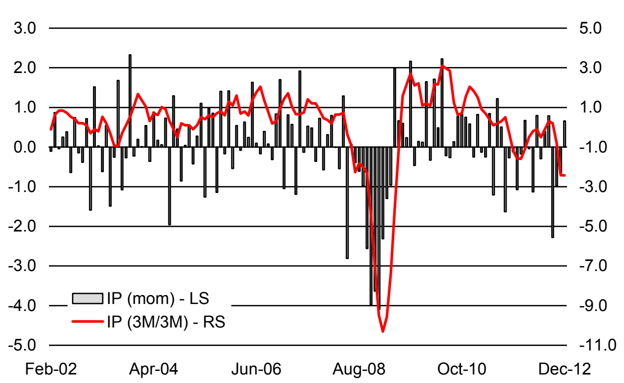
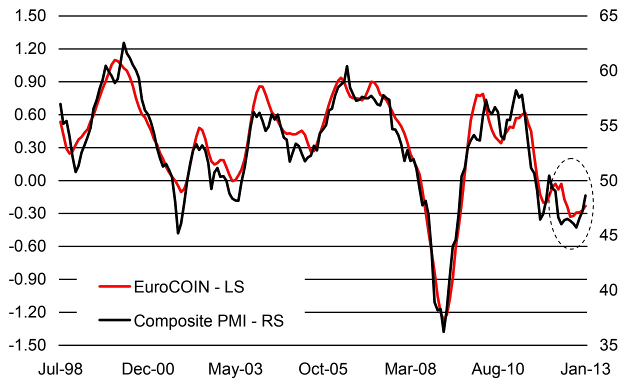
- As expected, 2012 closed with a poor growth performance. In 4Q12, GDP contracted 0.6% qoq (vs. -0.1% in 3Q12), the worst number post Lehman. No details are available at this stage, but we believe that the deterioration involved both domestic and external demand. The deepening pace of recession partly reflects a technical correction following better-than-expected resilience in 3Q12. This is particularly true for industrial production, which tends to be very sensitive to one-off factors – in this case, imperfect seasonal adjustment boosted output during the summer and depressed it in the fall. Hence, the GDP data for 4Q12 most likely overestimate the underlying pace of recession at the end of last year. The negative carry-over effect of a weak 4Q12 leads to a 0.2pp downward revision to our yearly GDP forecast for 2013, which drops to -0.1% from +0.1%. However, we are not concerned as this reflects backward-looking information.
- Encouragingly, and more importantly, timely soft indicators continued to trend higher in January, with France being the only notable exception. The EuroCoin indicator rose to -0.23% vs. -0.27%, while the Composite PMI improved to 48.6 vs. 47.2. At face value, they are consistent with a GDP contraction of 0.1-0.2% qoq at the beginning of 1Q13. This upward trend started to translate into better activity data already in December, when IP recorded the first increase in four months. If, as we expect, momentum in hard data will be broadly maintained in January, 1Q13 will start off on a positive footing, fully consistent with our view that eurozone GDP will stop contracting already at the beginning of the year.
- According to the preliminary estimate, the inflation rate in January slowed to 2.0% from 2.2%, the lowest reading since November 2010. The main driver of the deceleration appears to have been a favorable base effect on energy. Core prices probably eased a bit, but remained sticky. The downward trend in headline inflation is probably not over yet, and we expect consumer prices to bottom out in the spring, before rising back to the 2% area. We confirm our inflation forecasts for 2013 (2.0%) and 2014 (1.8%).
- On 7 February, the ECB left its interest rates unchanged, as widely expected. Draghi confirmed that the ECB does not target the exchange rate, and dismissed the view that recent FX developments reflect “deliberate competitive devaluation”. However, he also hinted that the ECB is ready to respond (presumably with a rate cut) if currency appreciation were to tilt to the downside the balance of risks to medium-term price stability. All in all, our feeling is that the bar for a rate cut remains fairly high, and only a further significant appreciation of the trade-weighted EUR would force the ECB’s hand on rates.

DEEP INDUSTRIAL RECESSION IN 4Q12…



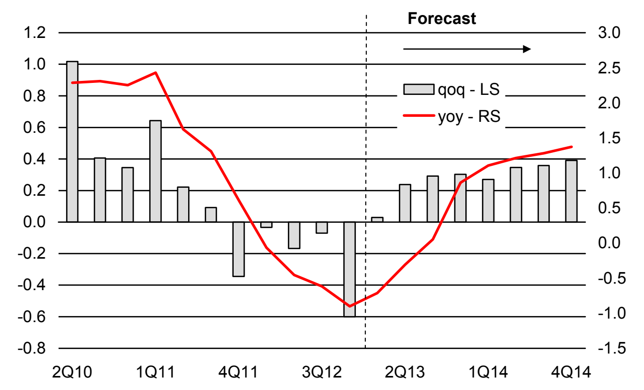
…BUT SOFT INDICATORS HAVE ALREADY TURNED



Source: BoI, Eurostat, Markit, UniCredit Research

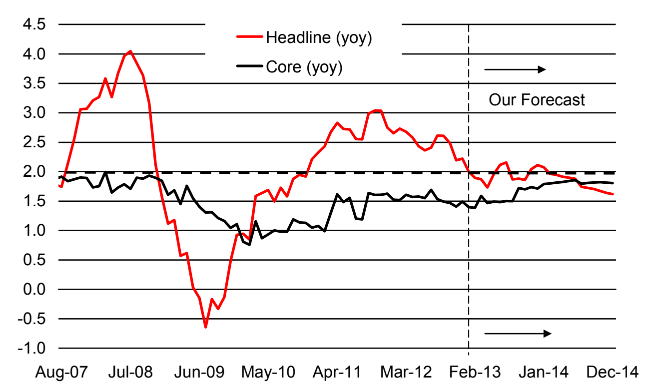
Eurozone

GDP



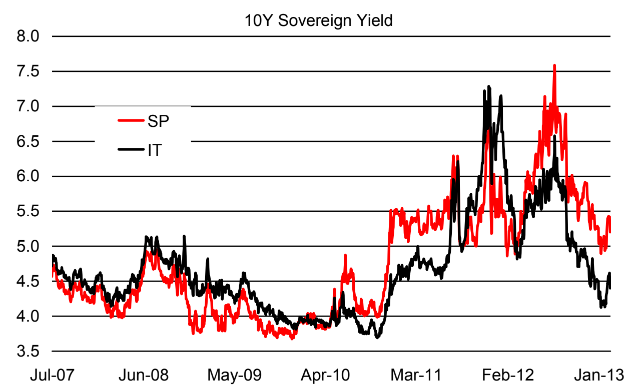
■ Our GDP forecasts: bad 4Q12, but no change to the 2013 path.

INFLATION



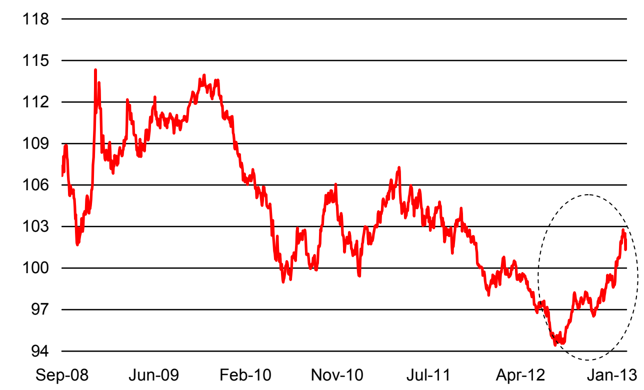
■ Our CPI forecasts.

SOVEREIGN YIELDS



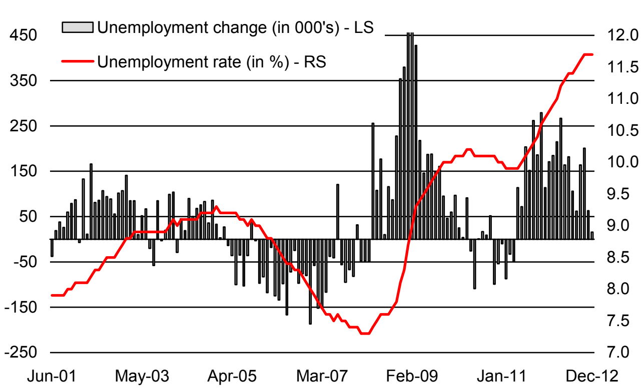
■ Some modest yield increase in Italy and Spain.

EUR



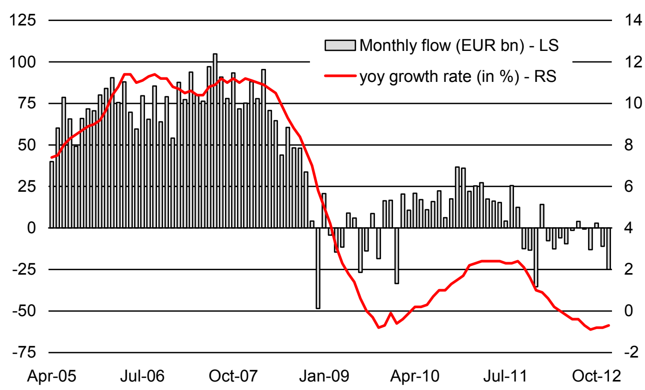
■ Trade-weighted EUR up 8% since end-July 2012.

LABOR MARKET



■ The unemployment rate is still on an upward trend.

LENDING TO THE PRIVATE SECTOR



■ Weakness is confirmed, but no crunch.

Source: Bloomberg, EC, ECB, Eurostat, Markit, UniCredit Research

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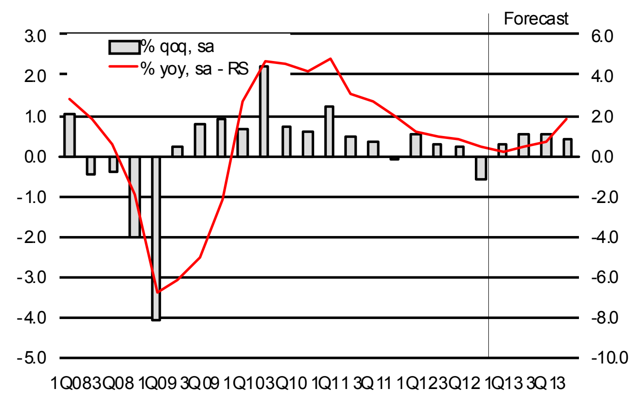
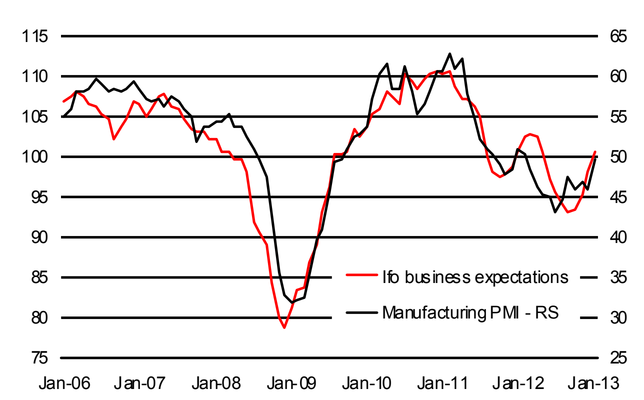
- The German economy shrank 0.6% qoq at year-end 2012 after plus 0.2% in the previous quarter (see first chart below). Hence, the pace of contraction was far more pronounced than we had anticipated at the start of 4Q12 (minus 0.2%). Although concise GDP components were not published yet, the Federal Statistical Office said that especially net exports weighed on economic activity. Furthermore, we think that a technical factor artificially aggravated the GDP decline by causing a zigzag pattern in auto production. Several car manufacturers canceled shutdowns of production sites during the summer holiday season in order to work off backlog orders more quickly. As a result, auto production jumped by 7.5% qoq in 3Q12 and plunged by 8.0% at year-end 2012. According to our calculations, this special effect shaved off 0.2% of overall economic activity in 4Q12.
- Given the very weak year-end, the real GDP level entering 2013 is lower than anticipated. Accordingly, we had to revise downwards our GDP growth forecast from 1.1% to 0.8% for this year. Please note that this downward revision is a purely statistical effect. We did not change our quarterly GDP forecasts for 2013 and stick to our long-held constructive growth story. We expect a growth comeback of the overall German economy already in the first quarter of 2013 (plus 0.3% qoq) with a further acceleration in the second and third quarter (plus 0.5% each or 2% on an annualized basis). Our optimistic story was further confirmed by forward-looking indicators in January which kept rising strongly. For instance, the Ifo business expectations component rose for the fourth consecutive month by another 2.5 points. The manufacturing PMI virtually jumped by nearly 4 points in January which was the strongest monthly improvement since July 2009 (see second chart).
- Besides accelerating industrial activity, we also expect private consumer expenditures to remain robust in 2013 fuelled by solid employment and wage hikes. Reassuringly, the labor market held up well in recent months despite the economic slack. In December 2012, employment rose by 22k mom. Furthermore, the figures in the previous months were significantly revised upwards (final November figure: plus 21k). The forward-looking UniCredit employment tracker based on companies' hiring plans stayed at reasonably high levels in line with no major dismissals in the next few months. Furthermore, we expect wage increases of slightly below 3% on a nationwide level for this year, thereby exceeding the expected rise in consumer price inflation (+1.8%).

ONLY A DIP IN ECONOMIC ACTIVITY AT YEAR-END 2012



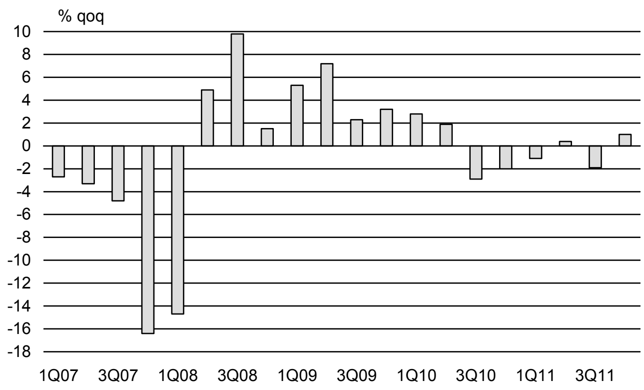
STRONG IMPROVEMENT IN BUSINESS SENTIMENT



Source: Ifo, Markit, UniCredit Research

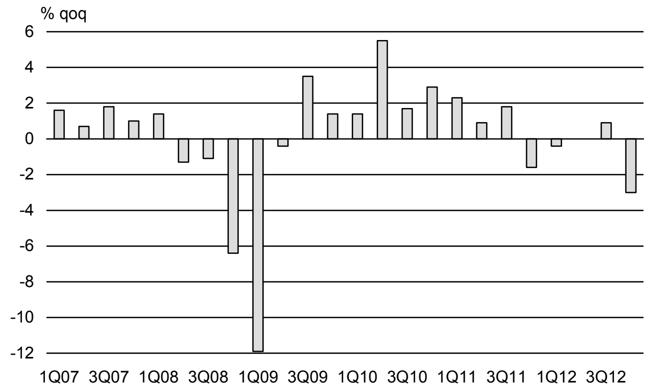
Germany

NEW ORDERS



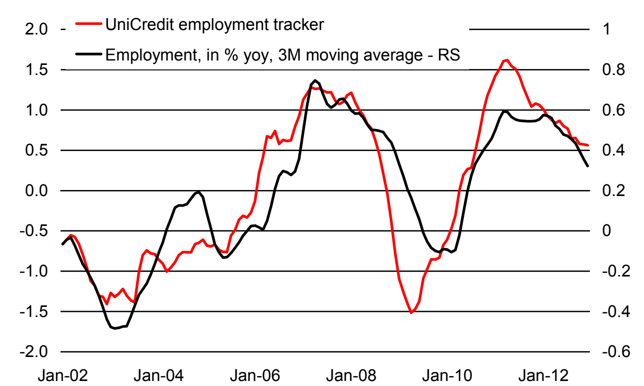
- New orders rose 0.8% mom in December. On a quarterly basis, they increased 1.0% at year-end 2012.

INDUSTRIAL PRODUCTION



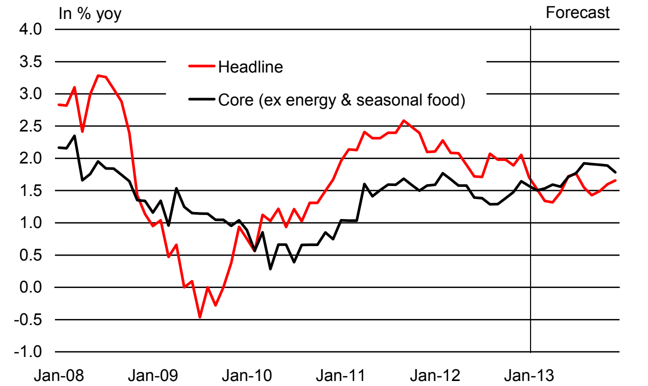
- Industrial production also increased slightly in December but showed its worst quarterly performance (-3.0%) since 1Q09.

EMPLOYMENT



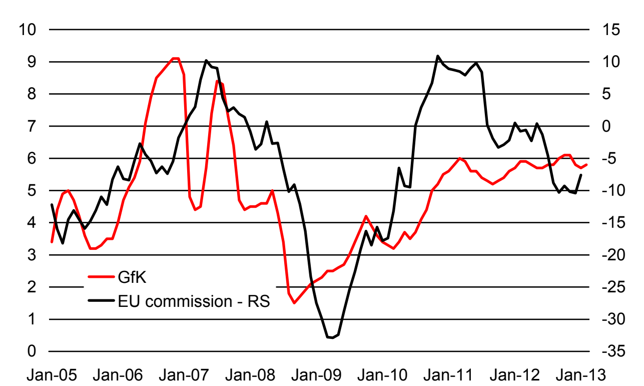
- The UC employment tracker slowed down further but stayed at levels consistent with a solid labor market.

INFLATION



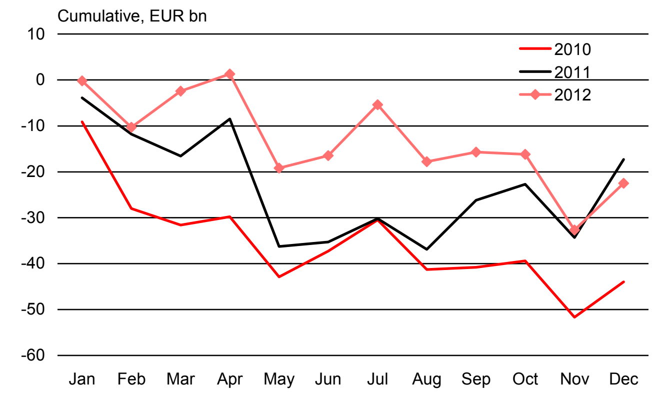
- Consumer price inflation declined from 2.1% to 1.7% in January. We expect a further slowdown in yoy terms in the next months.

CONSUMER CONFIDENCE



- Consumer confidence recently increased somewhat thanks to a robust labor market.

FEDERAL BUDGET BALANCE



- The federal budget at year-end was minus EUR 22bn (on a cumulative basis), comparable to the 2011 level.

Source: Bundesbank, GfK, EU Commission, FSO, Ministry of Finance, UniCredit Research

France

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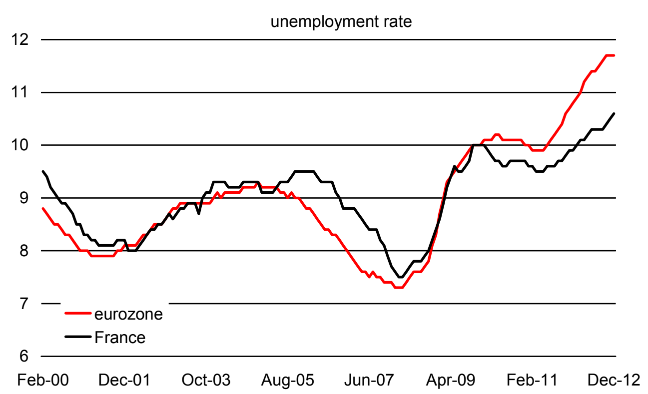
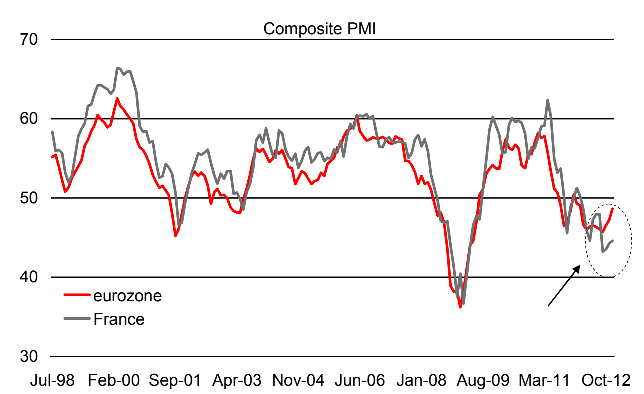
- French GDP shrank 0.3% qoq in the fourth quarter, a tad more than we expected. The annual rate edged down from 0.0% to -0.3%. As a result, full-year GDP stagnated in 2012, after a 1.7% increase in 2011. Looking at the GDP expenditure breakdown, a stronger-than-expected pace of destocking (which shaved 0.4pp off GDP) more than offset a mildly positive contribution from net exports (+0.1% pp, as imports shrank more than exports), while the contribution of domestic demand to GDP was nil.
- French PMIs surprised to the downside in January, when the underperformance of France vis-à-vis the eurozone intensified dramatically both in manufacturing and services. A look at the sub-components of the French manufacturing PMI shows a big record gap of nearly 8 points in overall orders: given that the underperformance of export orders is more contained (3.7 points), the weakness of domestic demand is a natural candidate to explain at least part of France's manufacturing PMI's underperformance. This interpretation seems to be confirmed also by unprecedented degree of weakness recorded by France vis-à-vis the EMU in the services PMI (-5.0 points). While there is no doubt that in France domestic demand fundamentals are deteriorating – due to a mix of deepening fiscal tightening and employment contraction – we do not regard this trend as sufficient to explain the puzzling underperformance of French PMIs. Accordingly, we would expect February PMI data to show a partial reversal, with France posting a more solid PMI increase than the eurozone as a whole.
- On structural reforms, the Employment Ministry has recently sent draft legislation to the Council of State transposing the agreement between the parties involved (employers and unions) on several measures intended to facilitate labor market adjustment to a cyclical downturn. In a nutshell, once the agreement becomes law, employers will be able to reduce wages and modify working hours in order to preserve jobs provided unions representing more than half of the workforce back the plan. Should employees reject the job proposal, the employer will not incur the (high) costs usually associated with economically-motivated dismissal. We consider the agreement positive news given that confrontations between employers and unions on labor market flexibility have been fraught with tension and the "status quo" has been largely preserved. The recent openness to dialogue is thus encouraging, especially in anticipation of a long-overdue reform of the welfare system, which will start being debated in the coming months

LABOR MARKET CONDITIONS KEEP DETERIORATING



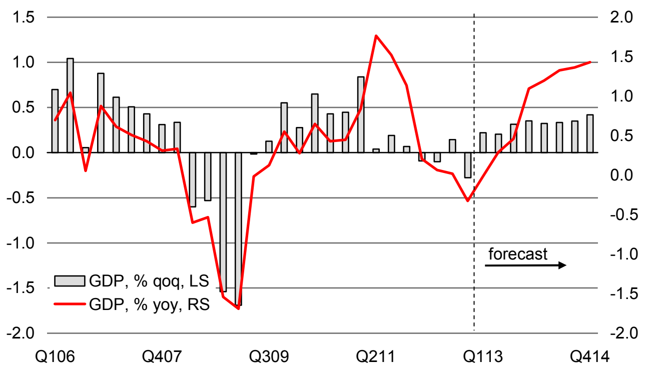
PMI DIFFERENTIAL ROSE SIGNIFICANTLY IN JANUARY



Source: INSEE, Markit, UniCredit Research

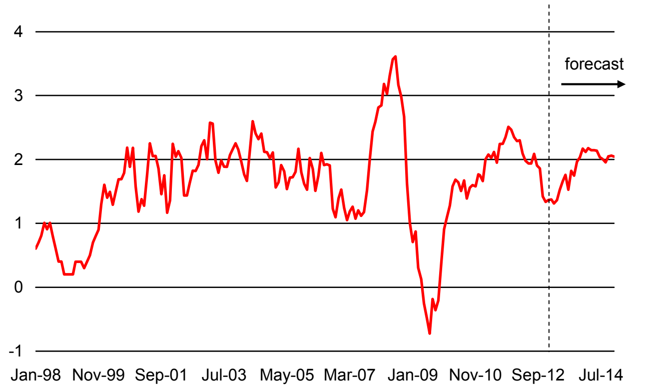
France

GDP



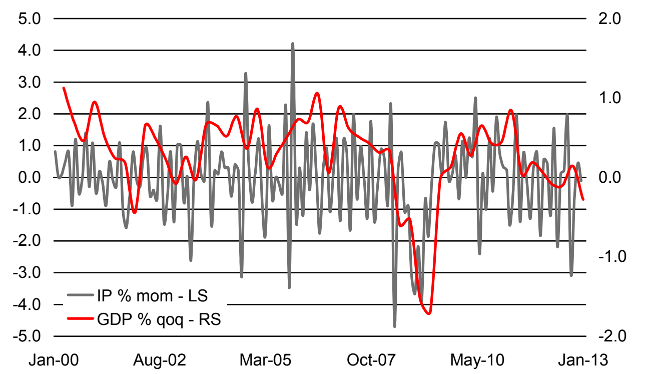
- We expect modest positive GDP growth already in 1Q, with a very gradual acceleration in qoq growth in the rest of the year.

INFLATION



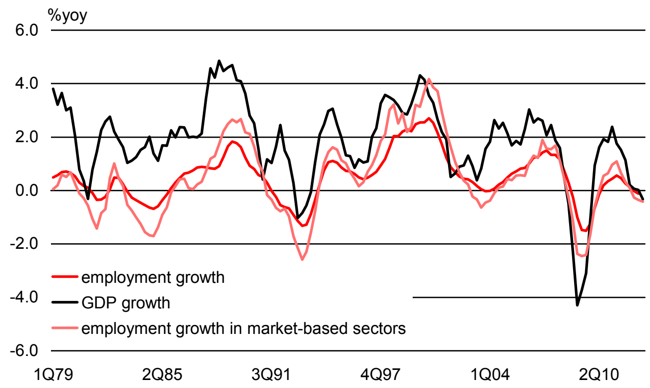
- CPI edged down to 1.3% in December, leaving the full-year average at 2.0%. We see inflation averaging 1.5% in 2013.

INDUSTRIAL PRODUCTION



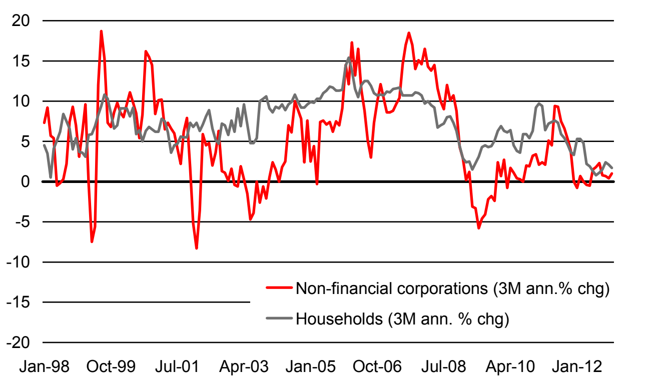
- IP showed large volatility in 2H12.

EMPLOYMENT



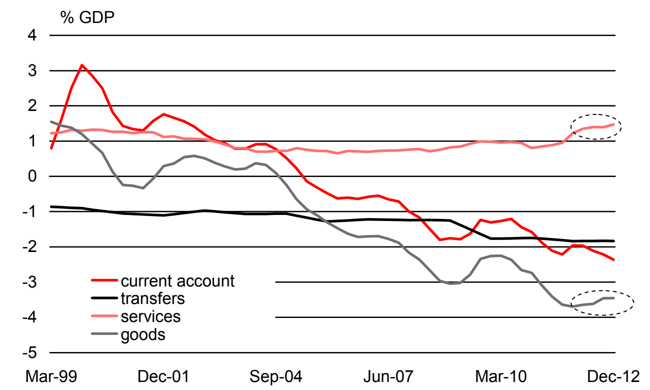
- Employment continues to contract.

LENDING TO THE PRIVATE SECTOR



- Lending growth to the private sector remains subdued but marginally positive.

CURRENT ACCOUNT



- The CA worsened from 2.0% to 2.3% of GDP in December 2012 in spite of an improvement in the balance of goods and services.

Source: INSEE, Markit, Banque de France, UniCredit Research

Italy

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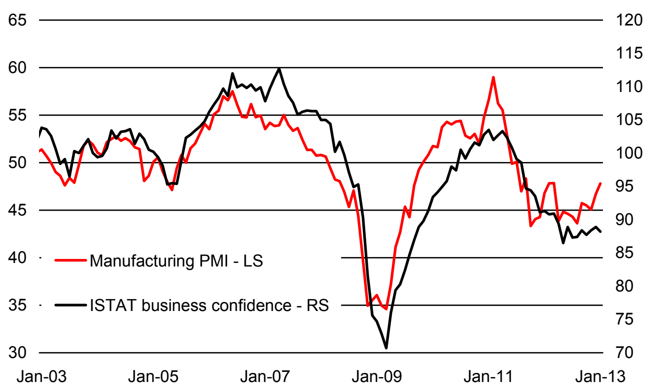
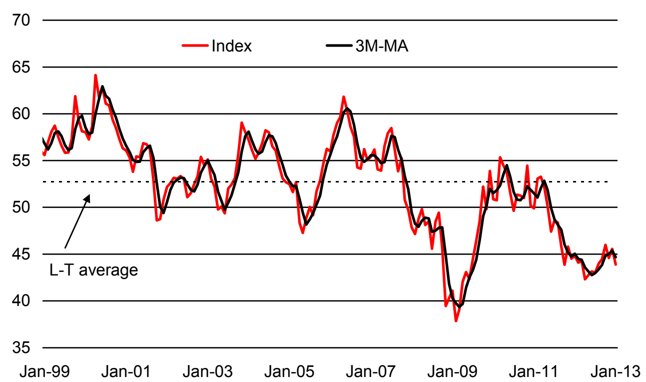
- According to the preliminary estimate, GDP for 4Q12 showed another marked qoq contraction, by -0.9% after -0.2% in 3Q. Component-wise, details will not be released until 11 March, but we expect a further contraction in final domestic demand – as hinted at by a continued contraction in the production of consumer and capital goods and construction output – and another positive contribution from net exports. Looking beyond 4Q12, our quarterly GDP path remains unchanged for the time being – we see an easing in the pace of the recession in 1Q and a return to marginally positive growth in 2Q. However, given the weaker entry in 2013, we now expect GDP to contract by 1.1% (vs. our previous -0.7%) for this year as a whole, after -2.2% in 2012.
- Early indications for industrial activity at the turn of the year have been mildly encouraging. Starting with hard data, the December increase in industrial production, albeit weaker than we had expected, paves the way for a better entry in 1Q. Moreover, it is important to note that the IP improvement was driven by a solid rebound in capital goods output (+4.0% mom), hinting that decent foreign demand is likely providing some support to production. Looking at soft indicators, the decline in the ISTAT business confidence index in January was not mirrored in the dynamics of the manufacturing PMI – in our view, the most reliable soft indicator to track factory activity – which picked up from 46.7 to 47.8. While we remain cautious, we are confident that IP is likely to recover some ground in January, and we expect an easing in the pace of contraction in factory activity in 1Q.
- Contrary to the ongoing, albeit moderate, improvement in the industrial sector, services activity is failing to show convincing signs of recovery, with the service PMI falling from 45.6 to 43.9 in January. This divergent trend of the two PMI indicators hints at a decoupling between factory and services activity, which is probably due to persistent weak domestic demand. The services PMI deserves close monitoring over the next couple of months in order to anticipate any further weakness in economic activity in 1Q.
- The Bank of Italy's Bank Lending Survey (BLS) for 4Q12 showed that banks have continued to tighten their credit standards, with the pace of net tightening easing somewhat for corporates and increasing slightly for households, in the wake of poor housing market prospects. Regarding loan demand, Italian banks continued to report a pronounced decline in demand for both loans to households and non-financial corporations. Overall, the 4Q12 BLS confirms our view that the still weak economic outlook will hold the key to lending dynamics over the coming few quarters.

MANUFACTURING PMI ON A CLEAR UPWARD TREND…



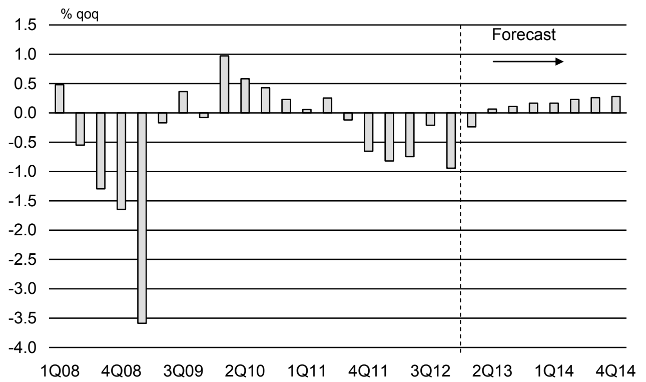
…WHILE THE SERVICE PMI HINTS AT STILL WEAK ACTIVITY



Source: ISTAT, Markit, UniCredit Research

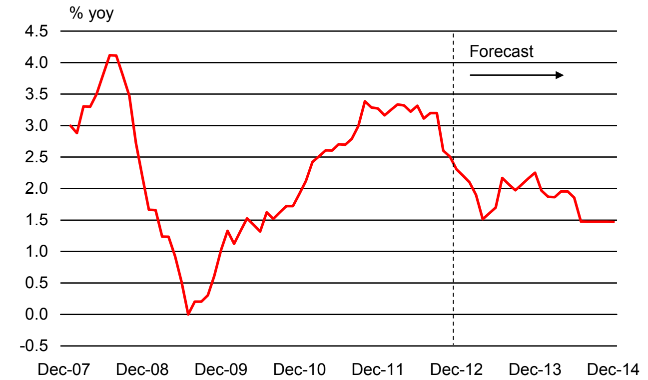
Italy

GDP



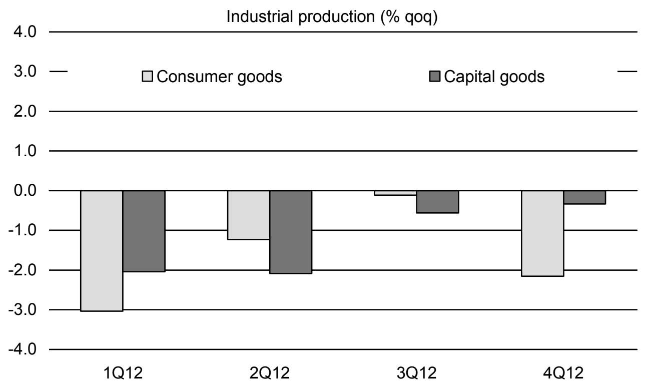
- We see GDP falling by 0.2% qoq in 1Q13 (after -0.9% qoq in 4Q12), indicating a 1.1% contraction for 2013 as a whole.

INFLATION



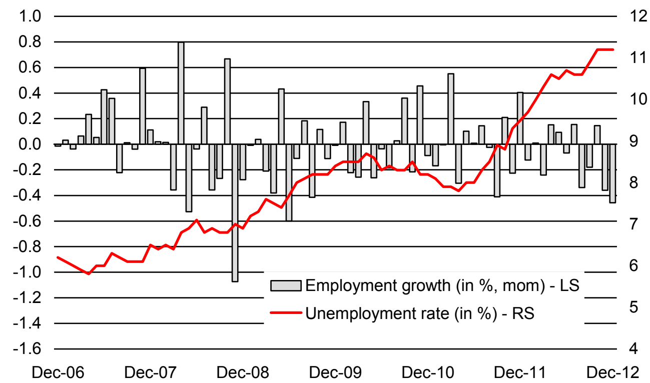
- According to the flash estimate, CPI inflation declined to 2.2% in January. We expect the downward trend to continue in 1H13.

INDUSTRIAL PRODUCTION



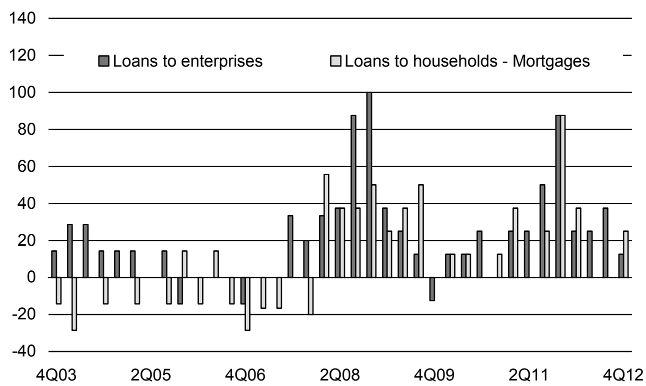
- The production of consumer and capital goods kept contracting in 4Q12.

LABOR MARKET



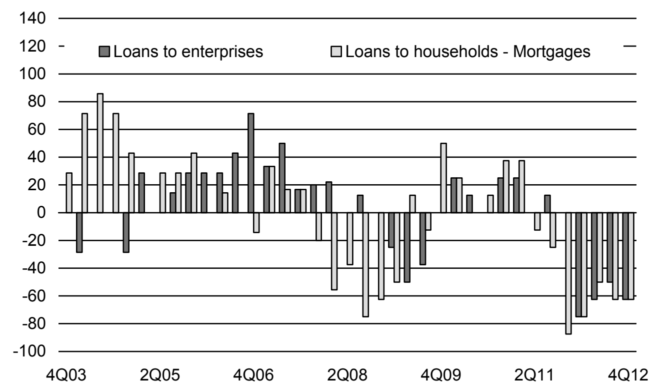
- The jobless rate stabilized in December at 11.2%, while employment fell by 0.5% from the previous month.

BANK LENDING SURVEY: CREDIT STANDARDS



- In 4Q12 the net tightening in credit standards slowed slightly for the corporate sector, but intensified somewhat for households.

BANK LENDING SURVEY: LOAN DEMAND



- Loan demand from the private sector (both households and firms) contracted substantially in 4Q12.

Source: Istat, Bank of Italy, UniCredit Research

Spain

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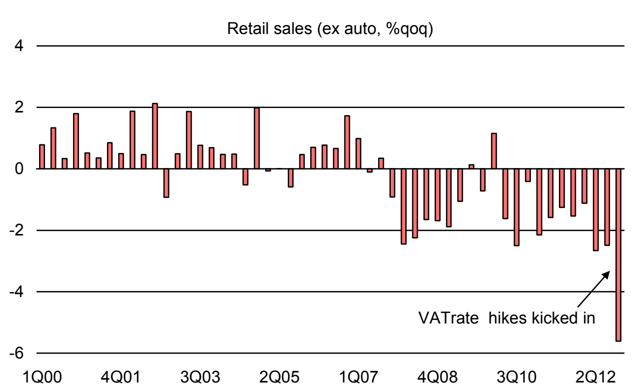
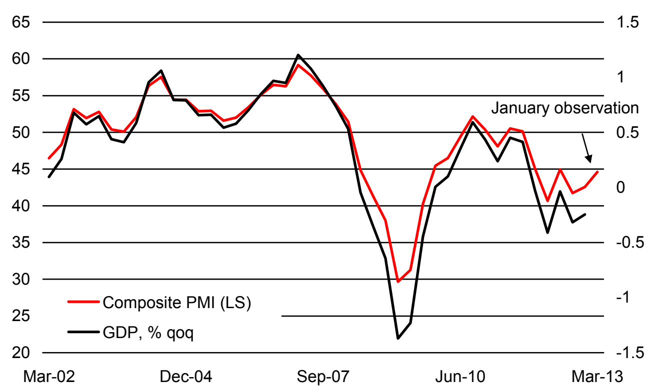
- Over the past few weeks, Spanish bond yields have started to (moderately) rise as allegations of irregularities in the funding of the ruling Partido Popular (PP) touched Prime Minister Rajoy and some of the members of his cabinet directly. Mr. Rajoy firmly denied the allegations and signaled that neither he nor his deputies intend to step down. In the meantime, a legal investigation has been launched. We regard these latest developments as potentially damaging for a government that needs to retain credibility both domestically and internationally to complete a bold adjustment program. However, at this stage we don't see any major fissure in political support for Mr. Rajoy from within his own party that could induce him to consider resigning and make the case for early elections. Still, the situation remains very fluid and we think it deserves close monitoring.
- The deepening of the pace of recession at the end of last year was in line with our expectations. GDP shrank 0.7% qoq in 4Q12 amid an intensification of the weakness in private consumption. This reflected the reversal of the bringing forward of purchases prior to the VAT hike in September, and the elimination of the Christmas bonus (one month's pay) for civil servants. Continuing tight financing conditions, despite the easing in recent months, and the weakness of the labor market, acted as an additional drag on GDP growth.
- From a forward-looking perspective, the latest bunch of data has been encouraging, supporting our expectations for a very gradual recovery in economic activity later in the year. In our baseline scenario, we expect quarterly GDP to return to positive territory in the second half of the year. Business sentiment improved markedly in January, while remaining at subdued levels. The composite PMI rose 2.7 points to 46.5, its highest level since June 2011. The improvement was broad based across sectors but particularly pronounced in services, with the PMI rising to 47.0 compared to the 44.3 recorded in December. However, we caution that PMIs have systematically underestimated the pace of Spanish GDP contraction since 2008, so our interest is in the survey's direction rather than its absolute value. At present, we forecast a 0.5% contraction in 1Q13 GDP.
- On 4 February, the Troika concluded its monitoring mission of the financial sector in the context of the EU financial assistance for bank recapitalization. The Troika said that the program remains on track but there is no room for any relaxation of the ongoing reform momentum, given that the risks to the economy and hence to the financial sector remain elevated. Among policy priorities, it would be key to make SAREB, the state-run bad bank, fully operational by updating its business plan as soon as possible – for now, lenders are still managing their assets.

UNPRECEDENTED CORRECTION IN RETAIL SALES IN 4Q12



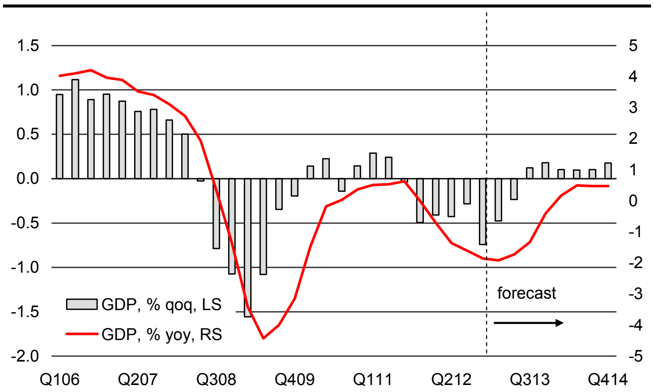
JANUARY PMIS SHOWED A MARKED IMPROVEMENT



Source: INE, Markit, UniCredit Research

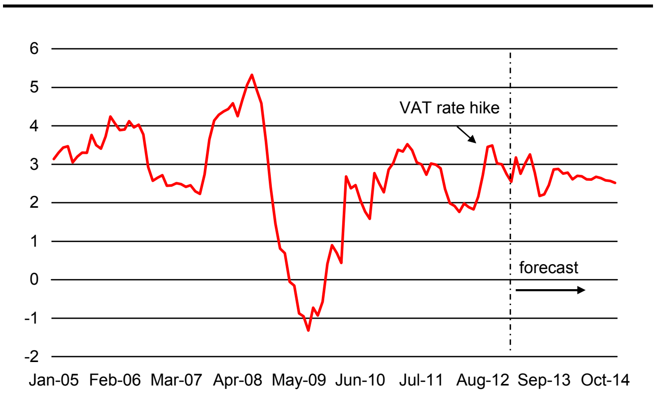
Spain

GDP



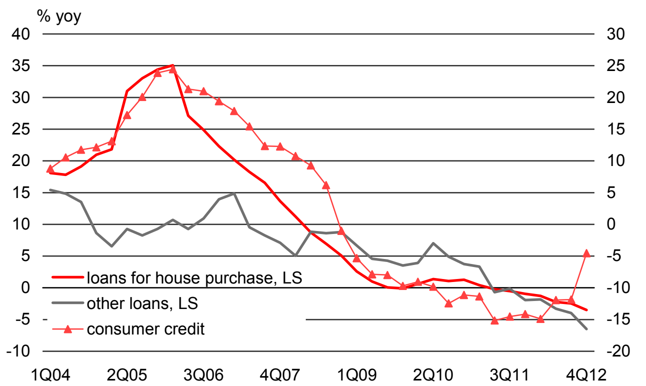
- We expect GDP to resume expanding in 2H13.

INFLATION



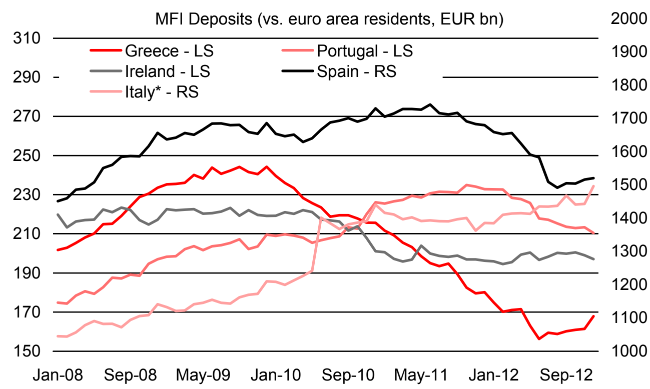
- In January, new tax increases partly offset a favorable base effect on energy. HICP slowed down to 2.8% yoy.

HOUSEHOLD CREDIT GROWTH



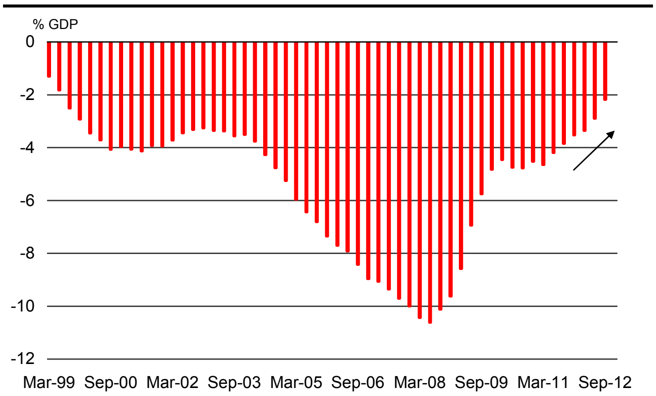
- The contraction in lending to households deepened further in 4Q12, with lending for consumer credit being the only exception.

BANK DEPOSITS



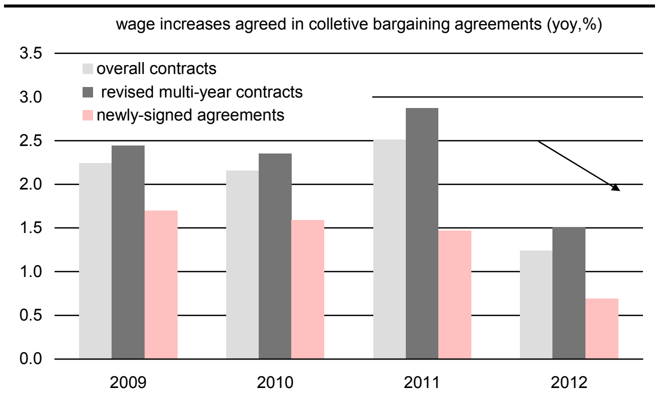
- The decline in deposits came to a halt in August 2012 and we have since been witnessing to a moderate increase.

CURRENT ACCOUNT



- The C/A deficit has been shrinking steadily, settling just above 2.0% of GDP in September.

NEGOTIATED WAGES



- Reforms of the collective bargaining framework have started bearing fruit.

Source: Bank of Spain, Eurostat, INE, UniCredit Research

Austria

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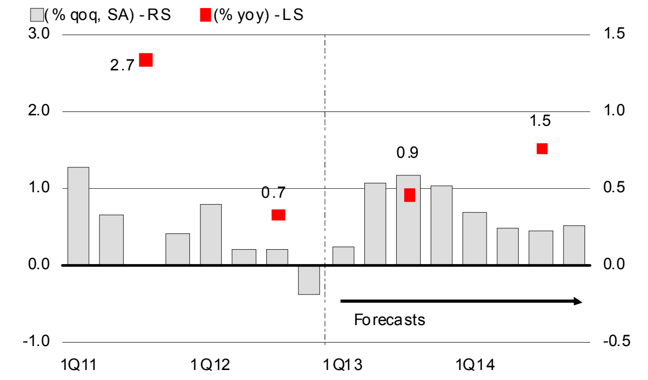
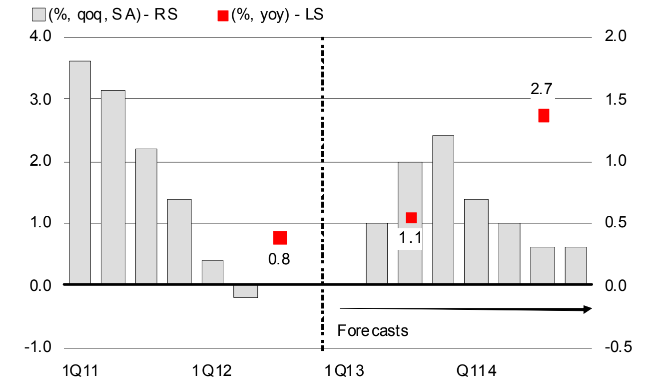
- In the final quarter of 2012, GDP declined by 0.2% compared with the previous quarter. Full-year economic growth in Austria amounted to 0.7% in 2012. The decline of GDP in 4Q12 was the result of flagging foreign demand (exports: -0.1% qoq), which was subdued due to the deepening recession in Austria's key export markets. Domestic demand was also very moderate. Private consumption decreased by -0.1%, impacted by a deterioration of the labor market, and public consumption fell by -0.3% qoq. Gross fixed capital formation stagnated again.
- Developments point to an economic recovery in the first quarter of 2013. Leading indicators suggest that the Austrian economy may again be on track for growth. GDP is expected to grow in 1Q13, even if this is only 0.1% compared with the previous quarter. The gradual improvement of the country's economy in the current year will likely be driven by two factors: stronger foreign demand and higher investment activity, which are set to lift economic growth in Austria to 0.9% in 2013.
- After again reaching 2.8% yoy in December, inflation remained unchanged at its peak 2012 level for the third consecutive month. At the end of last year, prices were again primarily driven by the category "housing, water, energy" and by rising food prices, with the latter gaining momentum. Inflation averaged 2.4% in 2012 (2011: 3.3%). In light of the hesitant nature of economic recovery, inflation will probably fall to an average rate of 2.2% in 2013. The downturn will likely commence only slowly and become more pronounced in the second half of the year.

GROWTH IS SLOWLY COMING BACK



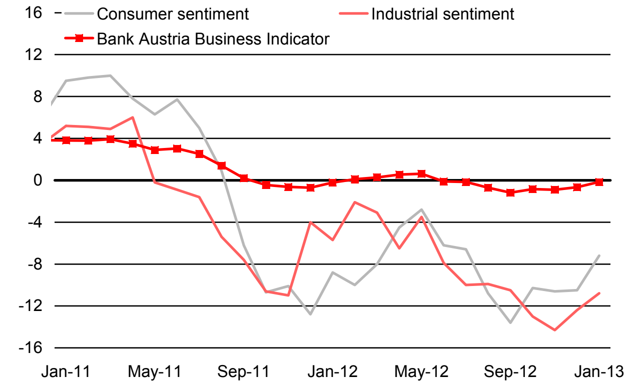
INVESTMENTS BRAKE WILL LOOSEN SOON



Source: Statistik Austria, WIFO, UniCredit Research

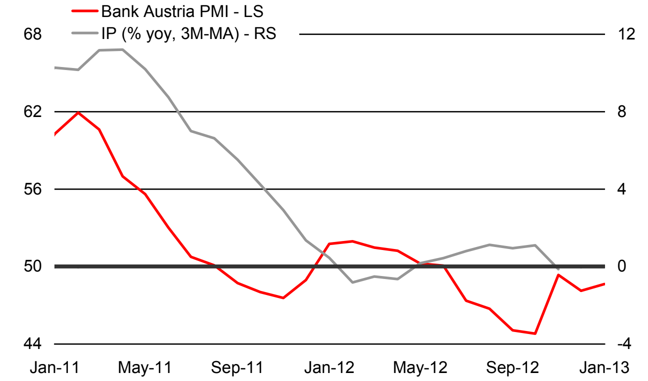
Austria

SENTIMENT



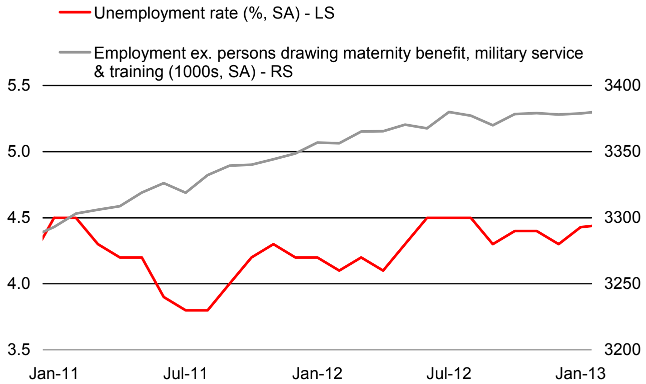
- Improved sentiment among consumers and industrial companies point to a recovery in the first quarter of 2013.

PMI AND INDUSTRIAL PRODUCTION



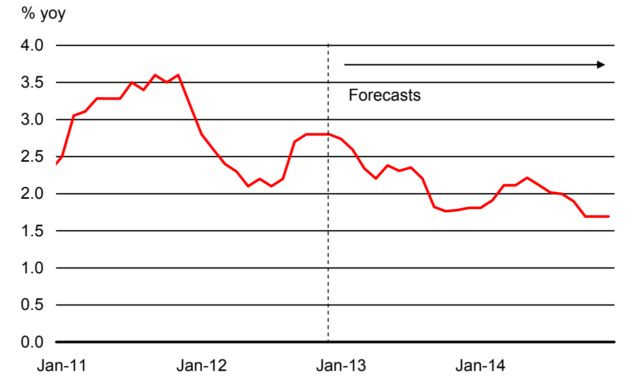
- The slight increase of the Purchasing Managers' Index in January to 48.6 indicates a stabilization of the production sector.

LABOR MARKET



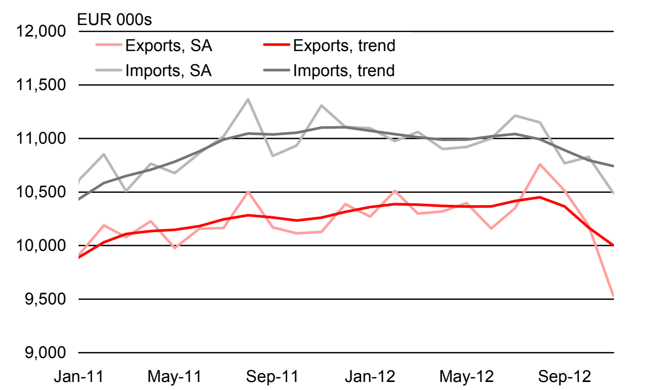
- In January, employment stagnated while the unemployment rate slightly increased. Further deterioration is expected.

INFLATION



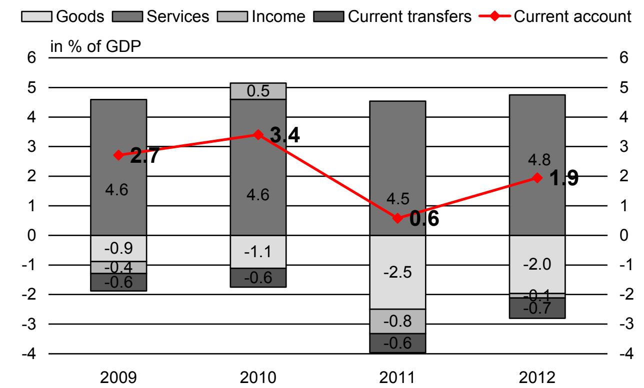
- Inflation remained unchanged at 2.8% in December and averaged 2.4% in 2012. We expect it to fall slightly in 2013.

EXPORT AND IMPORT VOLUME



- Since September, exports haven fallen mom, while the trade deficit is narrowing.

CURRENT ACCOUNT BALANCE



- We expect the current account balance in 2012 to have clearly improved to EUR 6bn or 1.9% of GDP.

Source: Statistik Austria, UniCredit Research

Greece

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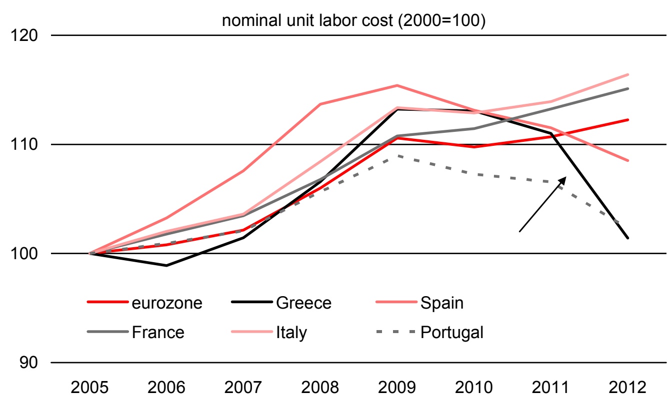
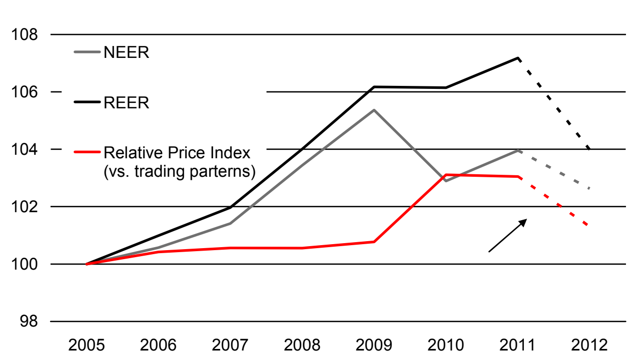
- According to preliminary data from the Greek Finance Ministry, the general government deficit settled at EUR 12.9bn (6.6% of GDP) at end-2012, pointing to a significant improvement in fiscal data with respect to 2011, when the deficit was up to 19.7bn, 9.4% of GDP. These numbers also compare favorably with the 7.3% deficit target for 2013 included in the MoU. Looking more closely at the data, the improvement is largely explained by a significant decline in interest spending in the aftermath of the PSI, although the primary balance also moved into modest surplus (0.2% of GDP). However, we caution that these estimates are just preliminary and the 2012 primary surplus is likely to be revised into a deficit when a more complete picture becomes available at end-February and the repayment of tax refunds/arrears will be fully taken into account. According to the Greek press, the forthcoming revisions should subtract a full percentage point of GDP from the primary balance, eventually bringing the balance in line with the 1.5% deficit target included in the MoU.
- At the conclusion of the latest review mission, the IMF praised the large fiscal efforts taken by the government so far, although the government needs to progress with the streamlining of tax administration in order to fight tax evasion and improve tax collection. Reforms aimed at sustaining a return to growth, such as privatizations, and the dismantling of extensive barriers to competition, also need to be promptly addressed in order to put ongoing economic adjustment on a sustainable path. In fact, the IMF acknowledges that recent gains in competiveness stem mainly from a sharp adjustment in wages, while there is little apparent relative price change to date. This explains why the economy is still adjusting via lower GDP and higher unemployment, raising questions about the sustainability of the adjustment.
- Regarding debt sustainability, the IMF highlighted the importance of further assistance by eurozone members to reduce debt substantially below 110% of GDP. The IMF currently estimates that additional financing needs could range between EUR 5.5bn and EUR 9.5bn for the whole 2015-2016 period. While, realistically, these needs would not materialize before 2015, the IMF thinks that eurozone partners will have to fulfill them in advance, most likely by the beginning of 2014. Haircuts to the loans granted by official creditors are not considered essential for this purpose, while forms of soft OSI, i.e. more generous terms on loans, could also be a viable option.

SIGNIFICANT DECLINE IN UNIT LABOR COSTS…



… BUT LITTLE APPARENT RELATIVE PRICE CHANGE TO DATE

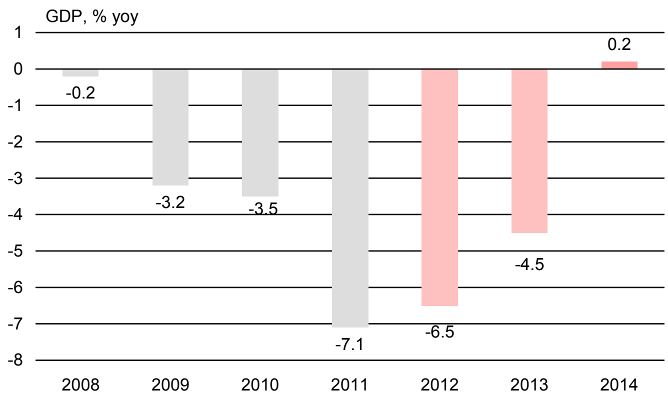


* broken lines represent forecasts

Source: Eurostat, UniCredit Research

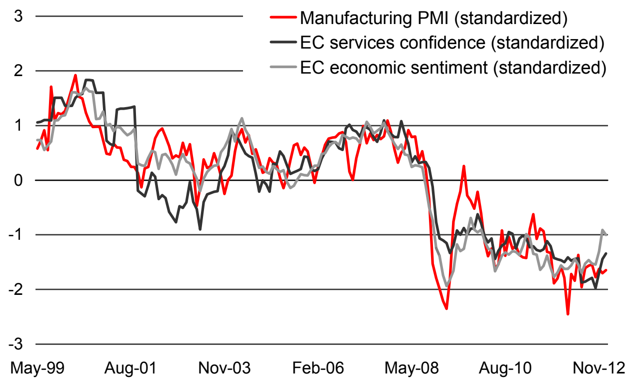
Greece

GDP



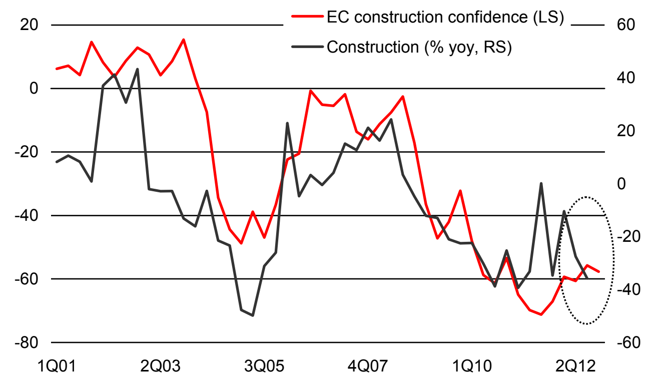
■ Greece is unlikely to exit recession next year.

SURVEYS



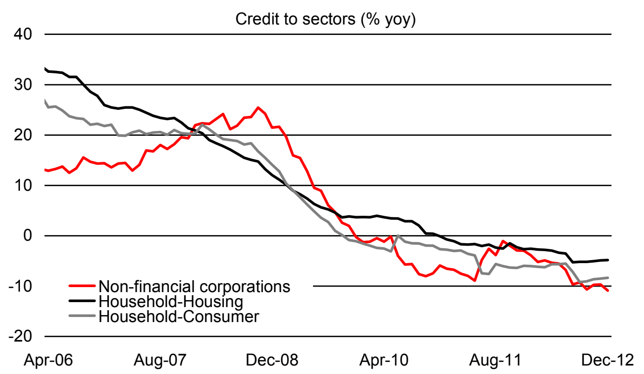
■ Sentiment is improving, albeit from very low levels.

CONSTRUCTION



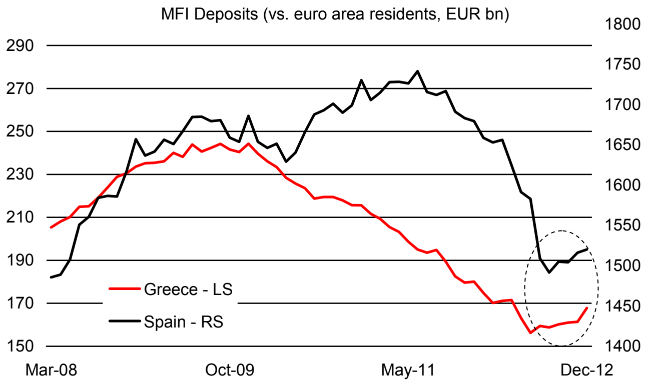
■ The EC survey of construction activity suggests that sectoral output may have bottomed.

CREDIT GROWTH



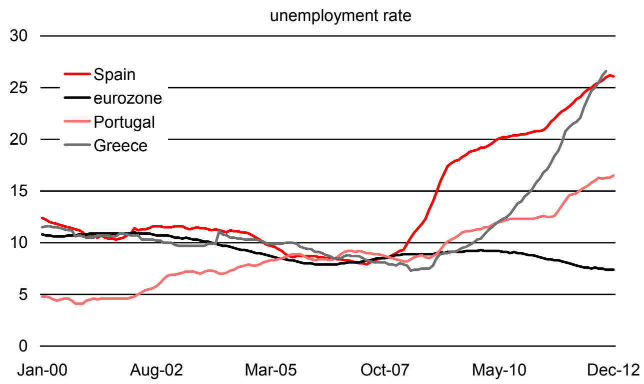
■ The pace of contraction in credit to households stabilized at the end of last year while it continued to deepen for NFCs.

DEPOSITS



■ Since the bottom was reached last year, there has been a re-flow of deposits worth about EUR 15bn.

UNEMPLOYMENT



■ The unemployment rate is skyrocketing, having reached 27% in November.

Source: Elstat, EC, Markit, Eurostat, ECB, Central Bank of Greece, UniCredit Research

Portugal

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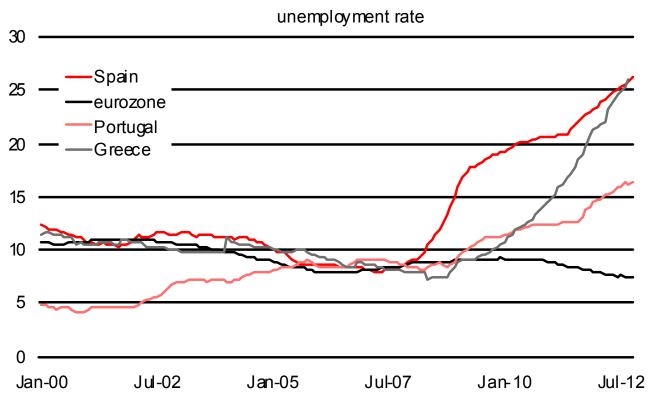
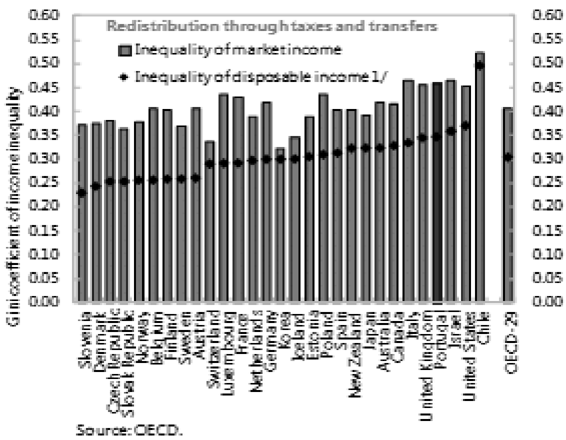
- The successful syndicated reopening of the PGB Oct17 at MS+395bp (4.89%) at the end of January has added to the clear positive momentum with which Portugal's borrowing costs have been coming down. It has also increased the chances that the government could obtain a more lenient amortization schedule for repaying official creditors, as eurozone members have long promised Portugal and Ireland provided they fulfilled the strict conditionality attached to their programs. This is expected to improve the sovereign's ability to fully access the market again and gradually rebuild the yield curve. We recall that Portugal faces a EUR 10bn debt repayment to official creditors in 2016. Discussions on these issues are expected to take place at the next Eurogroup meeting scheduled on 4 March. European Commissioner Olli Rehn has already hinted that the European Commission is in favor of granting Portugal more time to repay official creditors.
- As we write, the government is in the process of completing a planned spending review in time for the Troika's next mission, which should start mid-February. The government is expected to identify contingency reductions in public expenditure worth at least 0.5% of GDP should slippages occur in this year's deficit target (of 4.5% of GDP vs. 5.0% in 2012). Most importantly, it also has to identify EUR 4bn of additional savings for 2014 with the aim of making the consolidation program more balanced in terms of the proportion of expenditure cuts to revenue enhancing measures (the fiscal adjustment has so far heavily relied on the latter). This task is proving quite challenging given the considerable public disquiet with the planned austerity measures for 2013. At present, there is an indication that additional savings may largely rely on cuts in social security expenditure and, to a lesser extent, health and education.
- Concerning downside risks to the attainment of the planned deficit targets, it is worth highlighting that the Constitutional Court has not yet pronounced judgment on the legality of some of the measures, namely those on pensions, included in the 2013 budget. We don't think that a negative ruling by the court can put the fiscal adjustment off course, given that the budgetary provisions that have been submitted for review by the court represent a relatively small part. However, it will be worth keeping an eye on how this process unfolds as it has the potential to put some pressure on government bond yields, at least temporarily.

AS THE SOCIAL FABRIC IS SEVERELY TESTED…



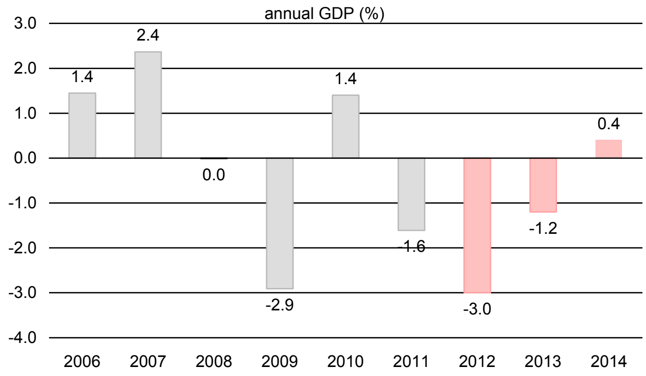
…EQUITY CONSIDERATIONS HAVE TAKEN CENTER STAGE



Source: Eurostat, IMF, UniCredit Research

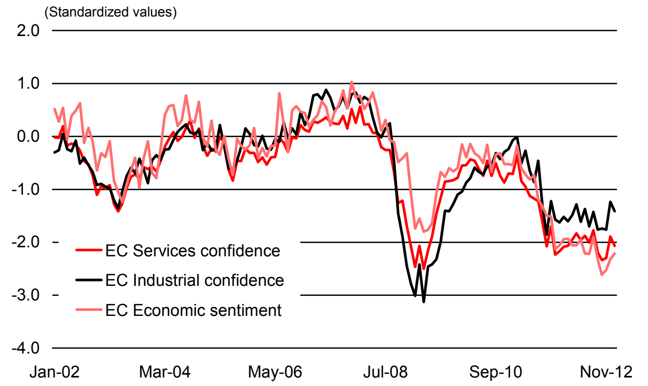
Portugal

GDP



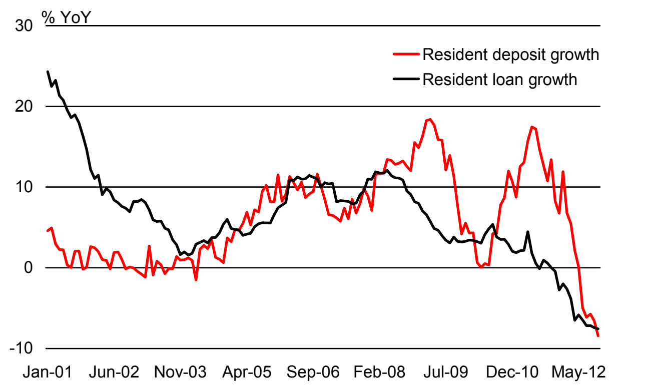
- The recession will stretch into 2013.

SURVEYS



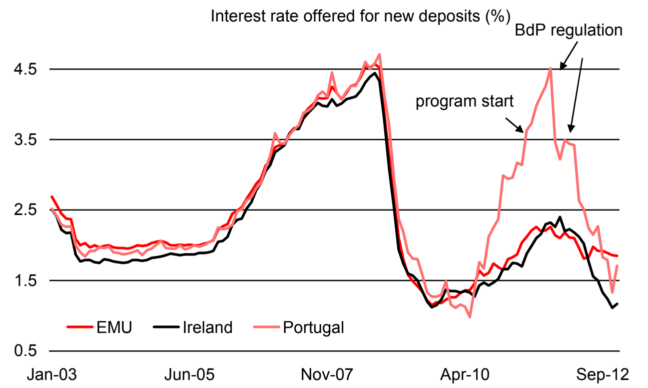
- Sentiment shows signs of improvement, although from low levels.

DEPOSIT AND LOAN GROWTH



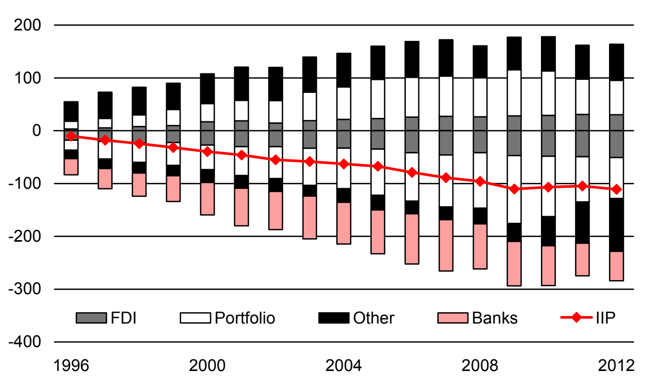
- Deposit growth continues to slow…

DEPOSIT REMUNERATION



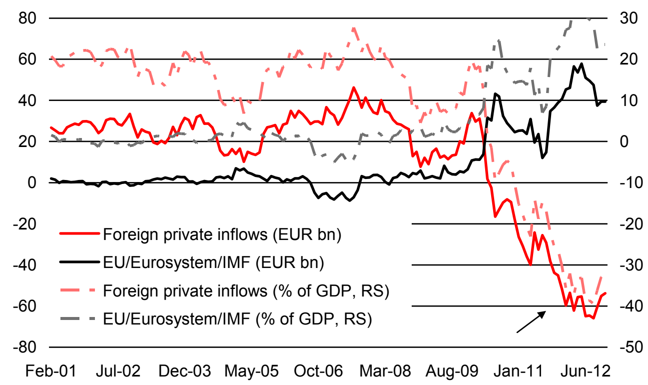
- …partly explained by regulatory changes in their remuneration

NET IIP



- External deleveraging is only just beginning.

C/A DEFICIT FINANCING



- C/A deficit financing switched from the foreign private sector to the foreign public sector, but there are tentative signs of reversal.

Source: INE, Bank of Portugal, UniCredit Research

UK

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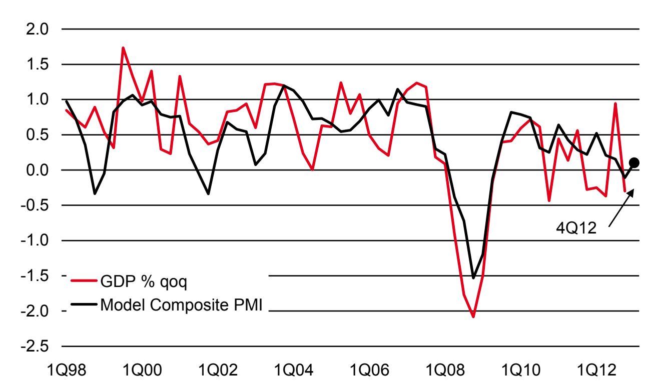
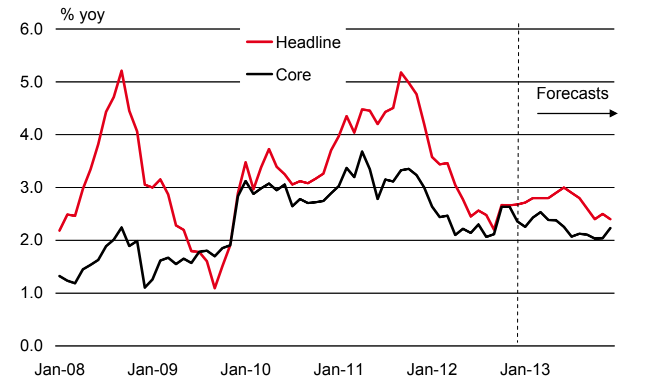
- After expanding 0.9% qoq in 3Q, GDP contracted 0.3% qoq in 4Q, slightly more than our and consensus expectations. This figure, however, should be interpreted with care as some temporary factors were at play: **1.** the reversal of the boost from the Olympics, which affected output in the services sector; and **2.** the sharp decline in output in the mining and quarrying sector due to the extended maintenance period at UK's largest North Sea oil field. We believe that the underlying picture is somewhat better than the 4Q GDP figure suggests.
- January PMIs were rather encouraging and point to modest positive growth in 1Q13. The manufacturing PMI fell slightly from 51.2 to 50.8 in January, but this follows two consecutive months of increases, including a sharp improvement in December (from 49.2 to 51.2), which brought the index above the 50-threshold for the first time since March 2012. The services PMI came in stronger than our and consensus expectations rising from 48.9 to 51.5. Our composite PMI is now consistent with modest positive growth in 1Q13, in line with our forecasts (0.1% qoq, see left chart below).
- Inflation remained stable at 2.7% for the fourth month in a row in January, as a slight deceleration of the core rate was offset by an acceleration in food and alcohol inflation. Looking forward, we expect inflation to hover around the current level in the first half of 2013, before slowing somewhat in the remainder of the year – although remaining above target.
- The Bank of England remained in wait-and-see mode in February, as expected. In its February Inflation Report, the BoE revised up significantly its inflation projection, reflecting the lower exchange rate and its assessment that administered prices will have a more persistent impact on inflation. The growth outlook was not changed much. The report did not show appetite for further monetary easing. However, the MPC clearly stated that it would look through this period of above-target inflation in order to support the recovery, provided that inflation expectations remain anchored. This means that, should the growth outlook deteriorate, the BoE will not hesitate to provide more stimulus, regardless of inflation. We expect no further stimulus measures going forward, barring a renewed deterioration of the growth outlook (which is not in our base-case scenario).

PMIS POINT TO MODEST POSITIVE GROWTH IN JANAURY



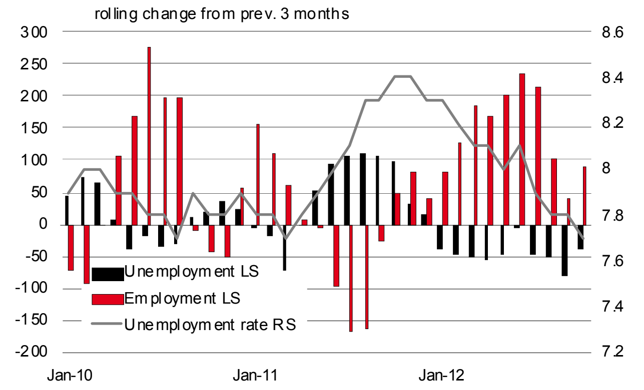
INFLATION (FORECASTS FOR 2013)



Source: Office for National Statistics, Markit, UniCredit Research

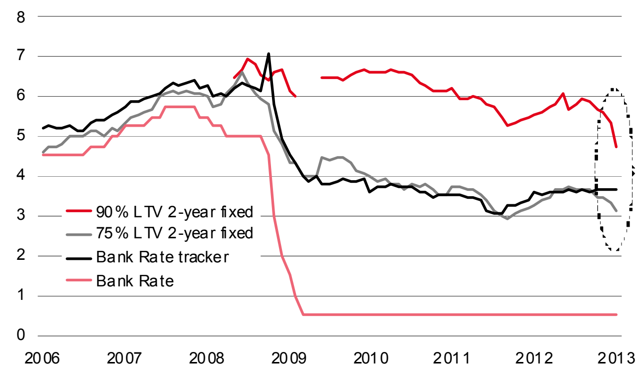
UK

LABOR MARKET



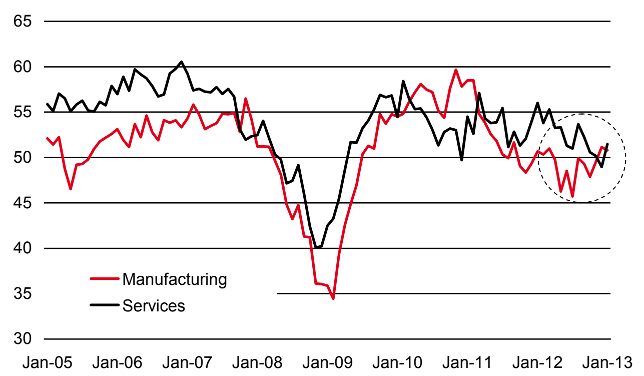
- The relatively strong performance of the labor market continues.

QUOTED MORTGAGE RATES



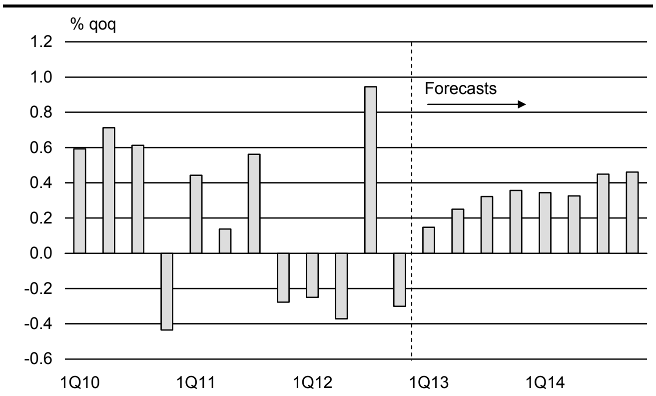
- Mortgage rates for the most popular products continued to ease in January, in line with expectations.

PMIS



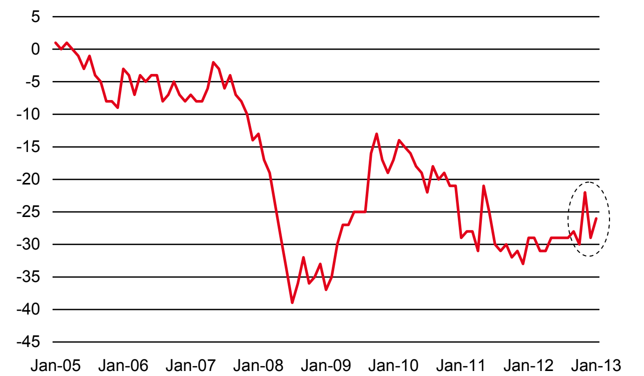
- The manufacturing PMI appears to have bottomed out, while the services index might have just started to turn.

GDP



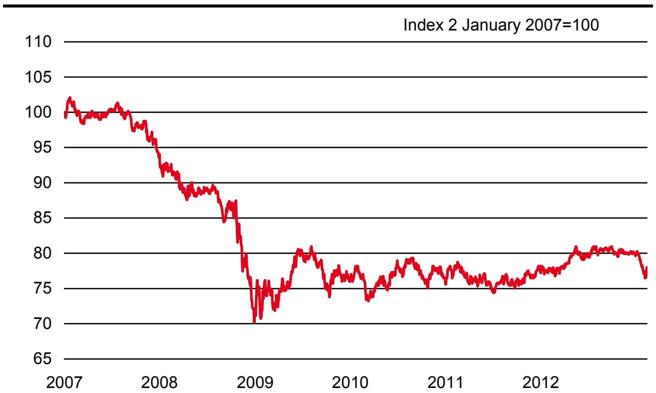
- We expect a very gradual recovery starting in 1Q13.

CONSUMER CONFIDENCE



- Consumer confidence rose slightly from -29 to -26 in January but remains low.

STERLING EFFECTIVE EXCHANGE RATES



- The sterling effective exchange rate fell back from its end-of-2012 highs.

Source: Office for National Statistics, Bank of England, Gfk, Markit, UniCredit Research

Sweden

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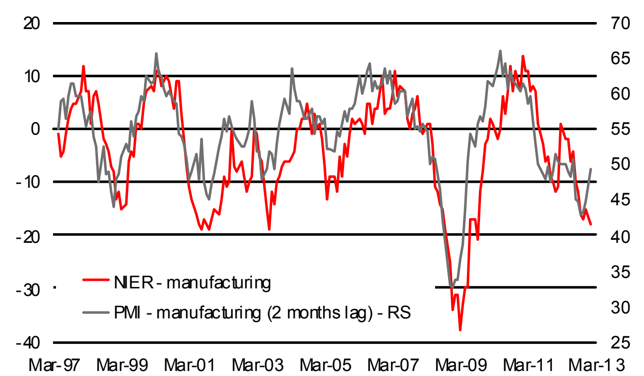
- We revise down our GDP forecast for 4Q12 from -0.1% qoq to -0.3%, in light of the weak 4Q EMU GDP, which implies a greater drag from exports (see left chart below) than we had anticipated. Overall, more recent data have been relatively encouraging and provide signs that the manufacturing sector might be approaching a turning point. The manufacturing PMI rose strongly from 44.6 to 49.2 in January, providing further indications that the index has bottomed out. The NIER manufacturing confidence indicator, however, fell three points from -15 to -18, although this index tends to lag the PMI by about two months (see right chart below), and is therefore likely to start improving next month. We expect GDP to show modest positive growth in 1Q13 already (0.3% qoq).
- In December, CPIF inflation, which excludes mortgage interest costs, accelerated from 0.8% yoy to 1.0% yoy, while CPI inflation remained stable at -0.1% yoy. Looking forward, we expect CPIF inflation to hover below 1% throughout 2013, while we foresee CPI inflation stabilizing in the near term, before gradually accelerating in the second part of 2013.
- At the February meeting, the Riksbank left the repo rate unchanged at 1.00% as expected, after having lowered it by 25bp at the previous meeting in December. Overall, while the central bank remains concerned about the weakness of the Swedish economy, the acknowledgement of recent positive developments – such as an easing in financial market tensions, the slight improvement in consumer and business sentiment both in Sweden and abroad, the continued recovery in the US, and strengthening growth in emerging countries – provided a less dovish tone compared to December. Looking forward, we expect the Riksbank to keep its policy rate at 1.00% in 2013.

CONTINUING SLOW DOWN IN SWEDISH EXPORT MARKETS

*The export market aims to measure demand for imports in the countries to which Sweden exports. This is calculated by the Riksbank by aggregating the imports of 32 countries and covers around 85% of Swedish export market.

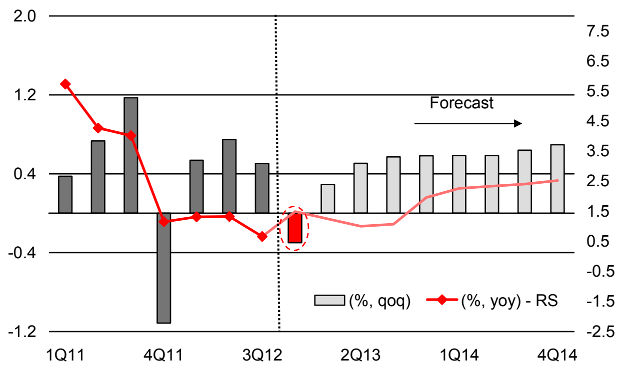
IS THE MANUFACTURING SECTOR CLOSE TO A TURN?



Source: NIER, Riksbank, Statistics Sweden, Swedbank and Silf, UniCredit Research

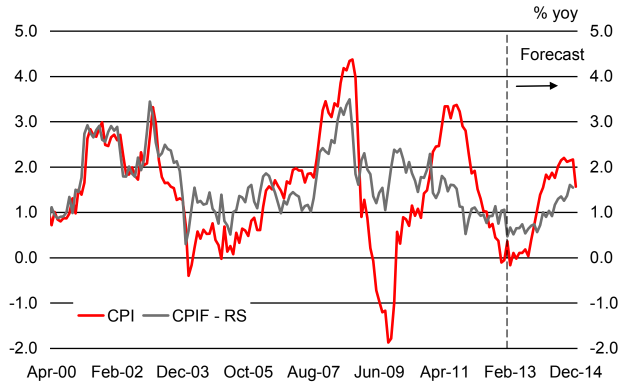
Sweden

GDP



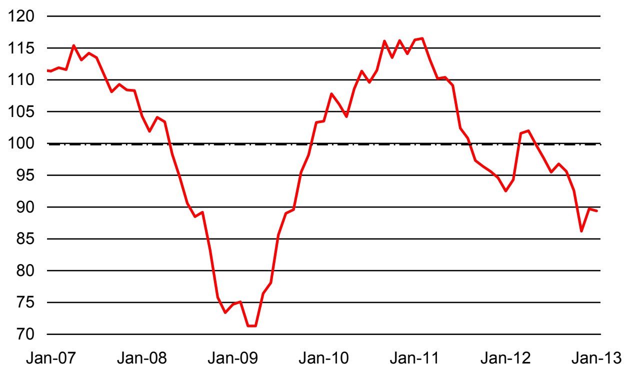
- We expect 0.3% GDP contraction in 4Q12.

INFLATION



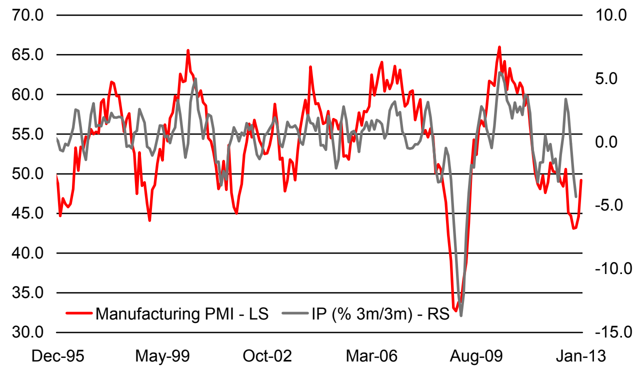
- After being stable for two consecutive months, we expect both CPI and CPIF inflation to accelerate in January.

ECONOMIC TENDENCY INDICATOR



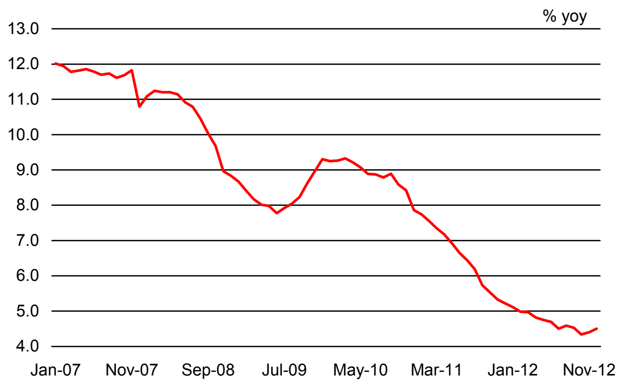
- The economic tendency indicator is more than 10 points below the historical average and hints at weak GDP growth in the short term.

INDUSTRIAL PRODUCTION



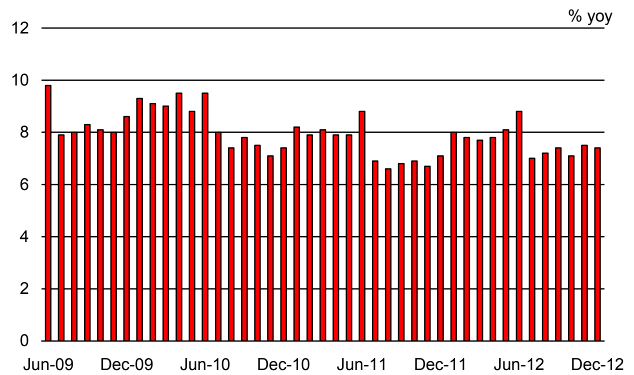
- IP is likely to have bottomed out in 4Q12.

MFI'S LOANS TO HOUSEHOLDS



- The loans to households annual growth rate is currently 4.6% yoy, the lowest level since 1997, and is likely to recover steadily going into 2H13.

UNEMPLOYMENT RATE



- Unexpectedly, the unemployment rate decreased from 7.5% to 7.4% in December. However we see this decrease as short-lived.

Source: Statistics Sweden, NIER, UniCredit Research

Poland

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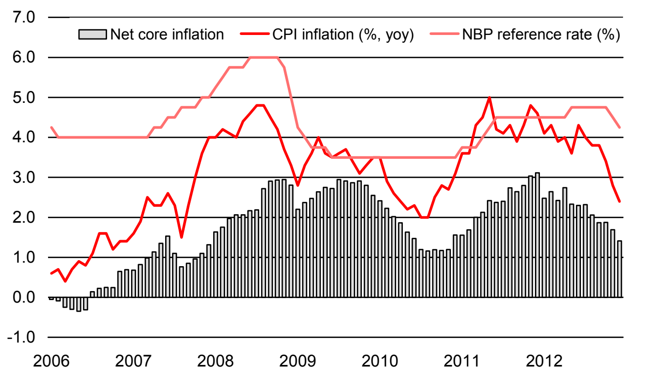
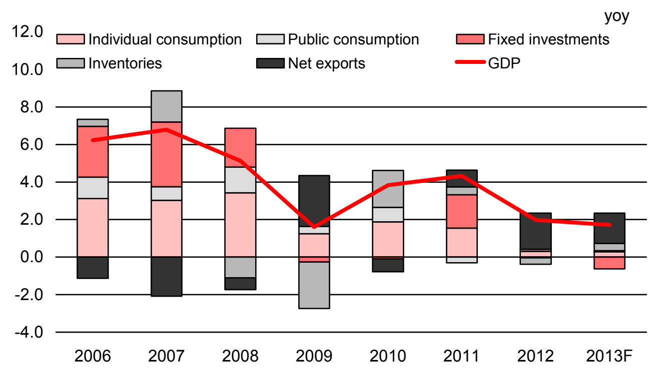
- 2012 GDP was in line with expectations at 2.0%, which indicates 4Q12 GDP growth of circa 1% yoy. The negative news came on the back of private consumption figures for 4Q, which were down by circa 1% yoy. This prompted us to lower our forecast for private consumption in 2013 to 0.5% yoy. A positive surprise came from investment statistics: the decline in 4Q12 of 0.4% yoy was much smaller than had been anticipated.
- We maintain our forecast of 1.7% yoy GDP growth for 2013, but recent data has slightly modified our estimate of its composition. As mentioned above, we revised the forecast of private consumption to the downside. And on the back of less-negative-than-expected news on investments, we have revised our expectation for investment decline up from -3.8% yoy to -3.1% yoy in 2013. The signals coming from the quarterly NBP corporate sector survey, as well as the relevant PMI series, both suggest that current inventory levels are relatively low. We foresee economic growth accelerating during the year and inventories being re-built, and have therefore revised upwards our forecast for inventories contribution to GDP, to 0.4pp from 0pp previously.
- Monthly data coming out in February will likely still be weak, particularly labour market data. Wage growth is likely to slow to a halt, mostly due to the fact that current (weak, but not deteriorating) data will be compared to very high January 2012 data, when the number was boosted by tax changes. The unemployment rate is set to see its seasonal jump in January; we estimate 14.3% vs. 13.4% in December. And we think the situation will improve in industrial output: after -10.6% yoy in December, we anticipate 0.2% yoy in January. In retail sales we look for an increase of 1.1% yoy, after a decline of 2.5% yoy in December. CPI will, in our opinion, continue its downward trend – after 2.4% yoy in December we look for 1.9% yoy in January.
- The MPC lowered interest rates in February by 25bp, and will likely make a further cut in March, when the release of the update to its inflation projection is set to bring another downward revision of CPI and GDP paths. This would push the reference rate back to the lowest levels of the past decade, matching those seen in 2010. This, combined with a probable willingness to “wait and see” the results of the steps taken to date, would likely convince the MPC to stop cutting, at least for a few months; in our baseline scenario, assuming an economic revival, that would be the end of the cutting cycle.
- We expect POLGB yields to continue rising, as investors are anticipating that an end to the rate-cutting cycle is on the cards, and the probability of economic rebound in the next few months is increasing.

FALLING INFLATION PUSHES REFERENCE RATE DOWN



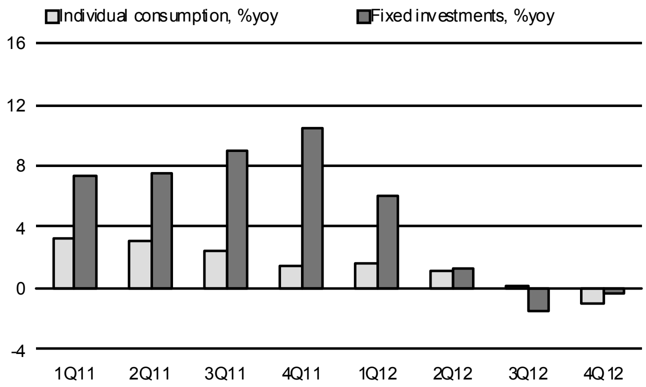
NET EXPORTS REMAINS THE KEY ENGINE OF GROWTH



Source: GUS, UniCredit Research

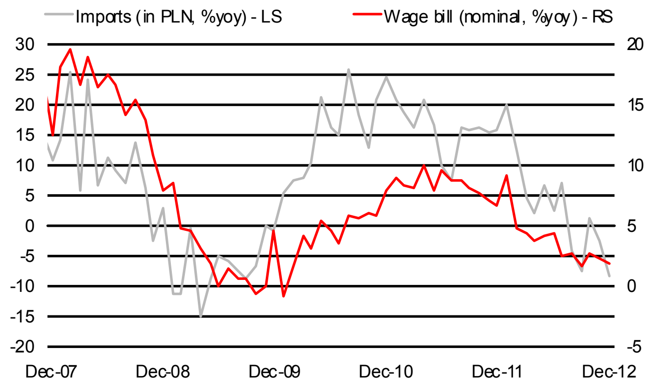
Poland

CONSUMPTION AND INVESTMENTS



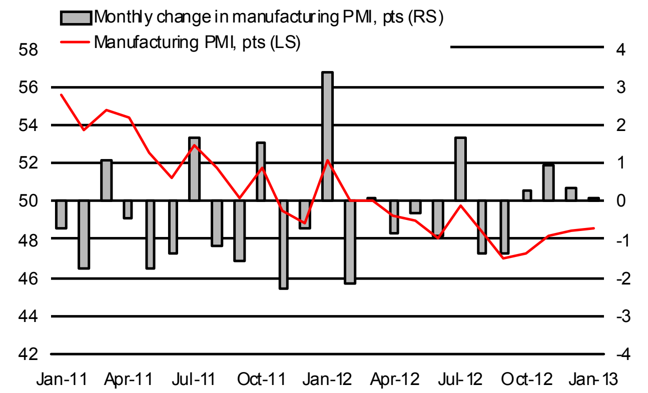
- 2012 GDP data showed a significant decline in individual consumption and ongoing weakness in fixed investments.

IMPORTS AND WAGE BILL



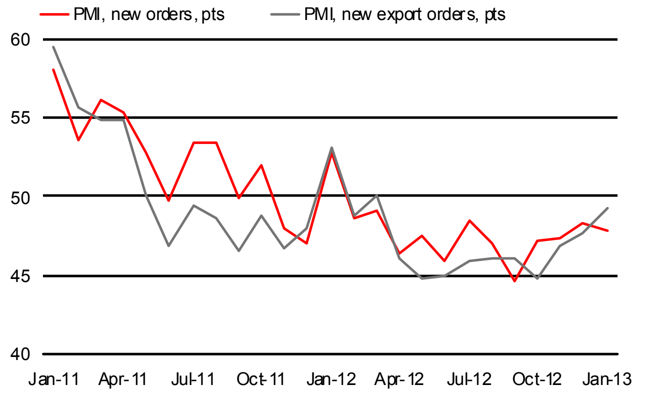
- Weak consumption means lower consumption imports, which is helping to push the C/A gap lower.

MANUFACTURING PMI



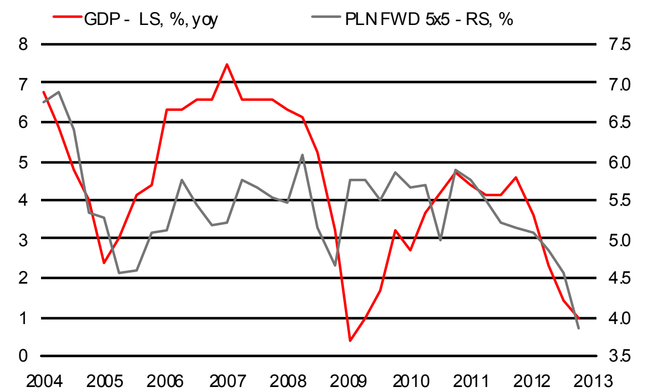
- Poland's manufacturing PMI remains in a negative range, but has been improving for four months in a row.

NEW ORDERS AND NEW EXPORT ORDERS



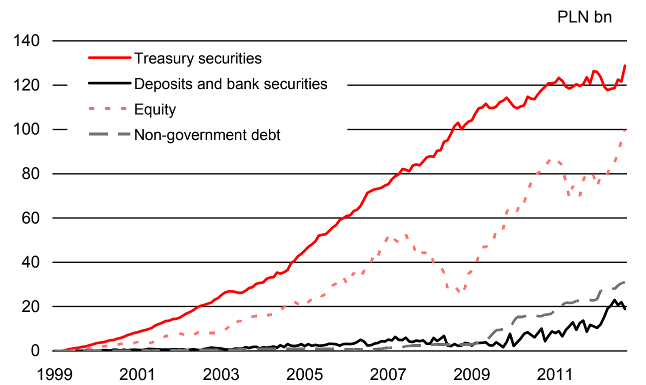
- In January 2013, exports orders shrunk at the slowest pace since March 2012.

GDP GROWTH AND 5X5 FORWARD



- Decelerating GDP helped to shrink PLN vs. EYR 5Y/5Y forward spread. As the economy is likely to accelerate from 2Q onwards, we are likely to see this trend reversing.

AGGREGATED PENSION FUND PORTFOLIO



- Pension funds started to increase equity purchases in a more aggressive way a few months ago, accelerating in January.

Source: GUS, NBP, PFSA, Markit, UniCredit Research

Czech Republic

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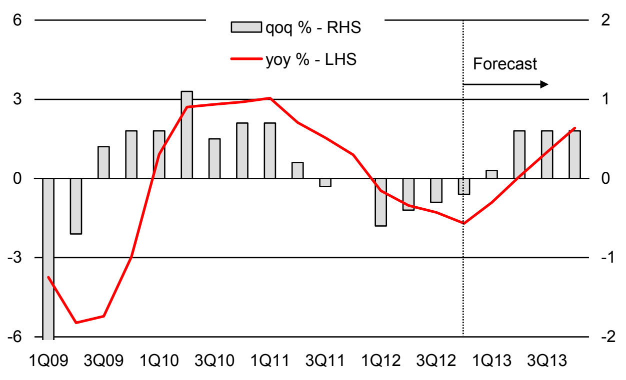
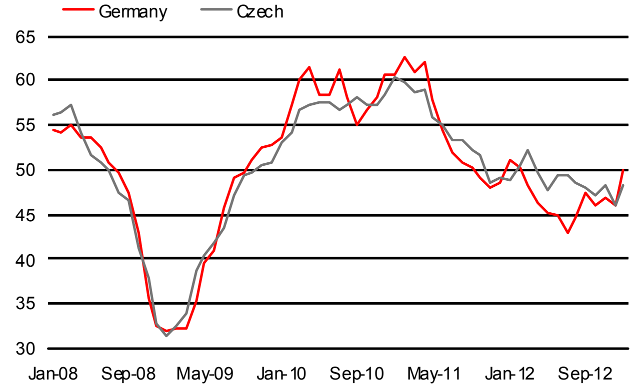
- The economy hit a truly soft patch at the end of 4Q12, with December industrial output and retail sales declining 12.5% and 5.1% yoy, respectively. Admittedly, both figures were dragged down by an exceptionally strong working day effect, but even the entire 4Q readings edged down versus the previous quarter to -3.9% yoy for industry and -1.7% yoy for retail sales.
- The flash GDP estimate for 4Q12 showed a seasonally-adjusted drop of 0.2% qoq and 1.7% yoy, suggesting that the recession in the economy extended to a fourth consecutive quarter. Comments by the statistics office on the GDP components confirmed general expectations that the lasting trend of the positive contribution of foreign demand failed to offset declining household consumption and gross capital formation. On the production side, all major sectors, including manufacturing industry, were reported to have been a drag on 4Q GDP. A positive impact, on the other hand, came from the tobacco tax hike (from January 2013) which brought forward purchases of tobacco products.
- January CPI added 1.3% mom, bringing the yoy index half a percentage point down to 1.9%. The mom rise was brought about by a 1pp VAT rise, which should have affected the price level by 0.8%. In fact, prices in most CPI basket groups (adjusted for seasonal effects) rose less. The inflation slowdown appears to be the function of a sluggish economy but also confusion regarding the VAT increase at the turn of the year. We expect that due to the uncertainty, which lasted until the final days of the year, many retailers have postponed their planned price adjustments, and this will push inflation a bit higher in the upcoming months. That said, although we expect CPI to return to or slightly above 2% soon, the inflation picture is set to remain favorable. This will result in the slowdown in household consumption easing significantly from 1Q onwards.
- Evidence of economic activity at the start of 2013 is still sparse, but it seems as if there is moderating risk that the soft patch would extend from late 2012. Manufacturing PMI added more than 2 points to reach 48.3 in January. The rise occurred on improvements of both current output and new orders, the latter coming at this stage more from inside the country than from exports. Retailers have reportedly boosted their post-Christmas sales, while consumer loan providers have reported more business. New car registrations went down 7% yoy in January, but this appears to be an acceptable outcome against the backdrop of the 1 p.p. VAT rise. We find it realistic to see the economy coming out of recession in 1Q13.

4Q12 LIKELY SAW A CYCLICAL BOTTOM IN GDP DYNAMIC



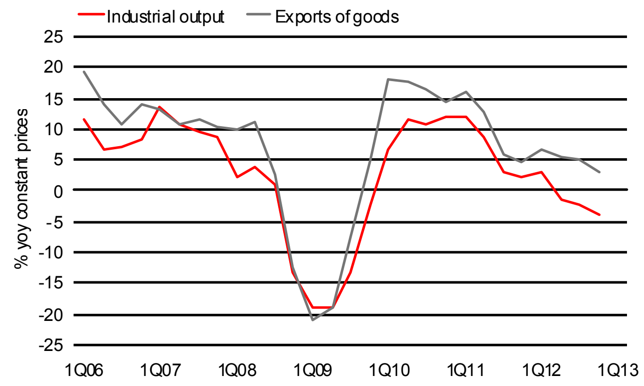
IMPROVEMENT IN JAN MANUFACTURING PMI IS PROMISING



Source: CZSO, Markit UniCredit Research

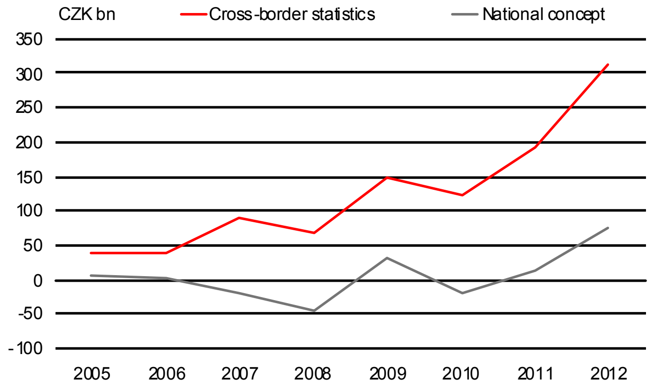
Czech Republic

INDUSTRIAL OUTPUT AND EXPORTS



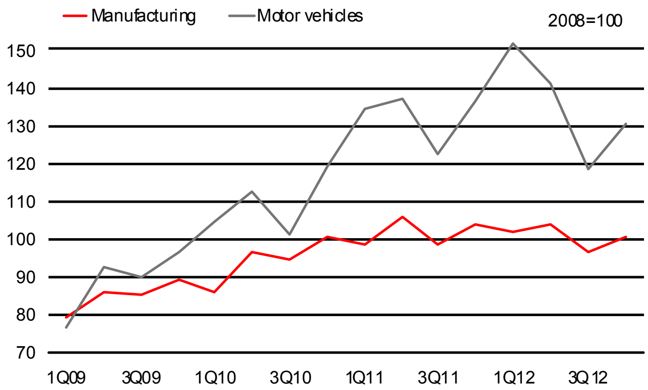
- Exports maintained yoy growth in 4Q12 despite industrial output contraction, as CZ has the role of a regional logistics hub.

TWO MEASURES OF TRADE BALANCE



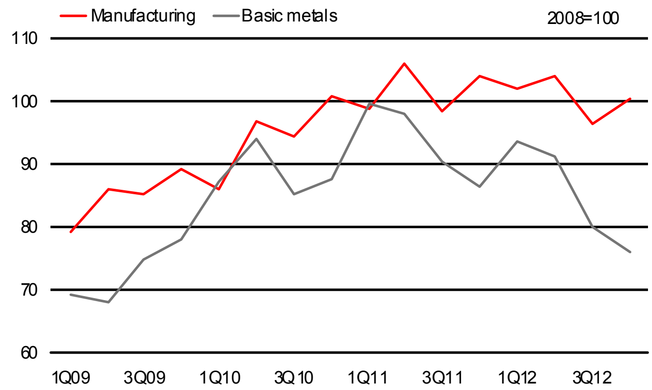
- The gap is constantly widening between cross-border statistics and the national concept, making external demand less GDP-supportive.

OUTPUT IN AUTOMOTIVE VERSUS MANUFACTURING



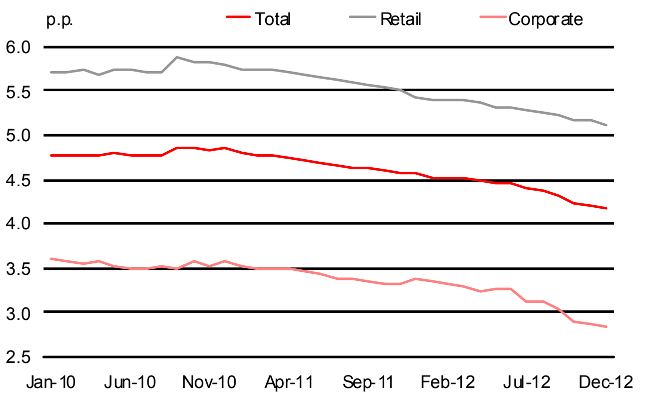
- Despite slowdown in demand for cars in Europe, the automotive sector has maintained its margin over manufacturing as a whole.

OUTPUT IN BASIC METALS VERSUS MANUFACTURING



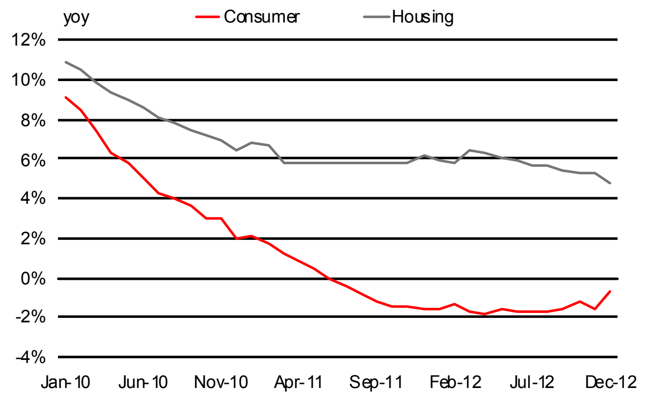
- Basic metals is the key loser among manufacturing sectors, with 4Q12 output declining 23% below its 2008 level.

BANK SPREADS



- Extremely low interest rate environment has pushed spreads between lending and deposit rates to a decade-low.

HOUSING AND CONSUMER LOAN DYNAMICS



- Compared to housing loans, consumer credit dynamic remains well subdued, albeit with signs of a bottoming-out.

Source: CZSO, CNB, UniCredit Research

Hungary

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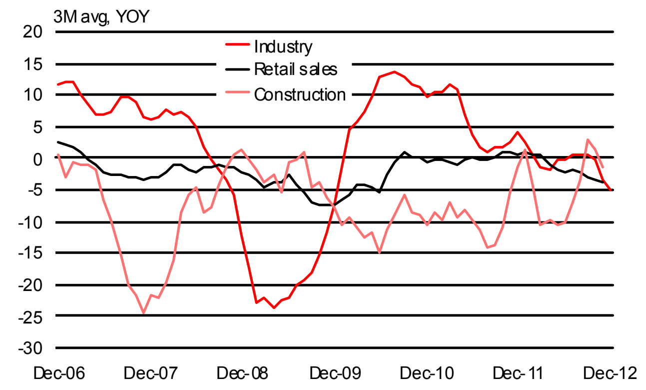
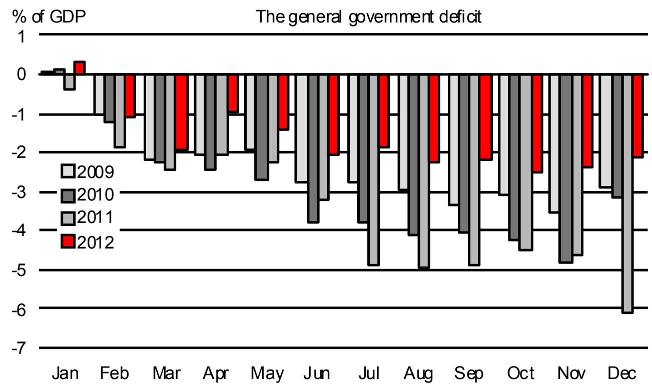
- At the end of 4Q12, economic data in Hungary deteriorated more than it did in other CEE countries. Industrial production fell by 7.6% yoy in December after decreasing by 7.1% yoy in November. The contraction was -2.5% mom on seasonally-adjusted data, mainly due to a sharp drop in demand from Western Europe. The new production capacities at Audi and Mercedes were likely offset by Suzuki's reduced output in November and December. Consequently, exports fell by 7.9% in December and the trade surplus decreased by 36% yoy. Better sentiment indicators (both GKI and PMI) and improving industrial orders in Germany are set to support a recovery of industrial output in 1Q13. Meanwhile, construction works and retail sales remain weak, although sentiment improved in January.
- The contraction of bank lending accelerated in December, with retail loans falling by the equivalent of HUF 1,267bn vs. December 2011, while corporate loans declined by HUF 812bn over the same period. Local banks' foreign liabilities fell by the equivalent of EUR 6.5bn in 2012. At the end of 2012, the take-up of the fixed-rate FX loan repayment scheme accelerated to 30% of total household FX loans. While the switch to fixed-rate repayments reduces the negative impact of HUF depreciation on household wealth, it also affects banking sector results, which are already burdened by high taxation.
- Inflation fell to 5.0% in December 2012, missing the 3% target. We expect the target to be missed again in 2013, but this is unlikely to stop the central bank from cutting the base rate to 4.5% from the current 5.5%. A new NBH governor will be appointed by the beginning of March, with markets likely to react negatively if the independence of the central bank will be jeopardized. EUR-HUF briefly touched 300 in late January on worries of a policy shift at the NBH.
- The 2013 deficit target of 2.7% of GDP is under threat, according to the IMF. Moreover, the Fiscal Council has warned that the potential shortfall in this year’s budget execution might exceed HUF 730bn (2.5% of GDP) and is only partly covered by budget reserves. A new fiscal package could be implemented by April in order to improve Hungary's chances of exiting the EDP.
- On 13 February, Hungary issued USD 1.25bn in new 5Y bonds and USD 2.0bn in 10Y bonds, borrowing on foreign markets for the first time since May 2011. The new USD bonds cover 55% of the IMF's 2013 repayments, leaving a gap of approximately EUR 2bn to be financed through bond issuance or from central bank reserves. Hungary faces redemptions of EUR 0.52bn in JPY and CHF bonds in March and May, respectively – these financing needs could be covered by the issuance of more EUR retail bonds.

ECONOMIC ACTIVITY WEAKENED FURTHER IN 4Q12



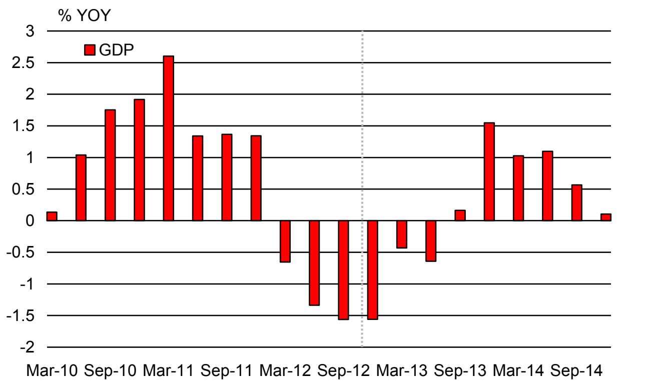
BUDGET EXECUTION IMPROVED IN 2012



Source: KSO, Ministry of Finance, UniCredit Research

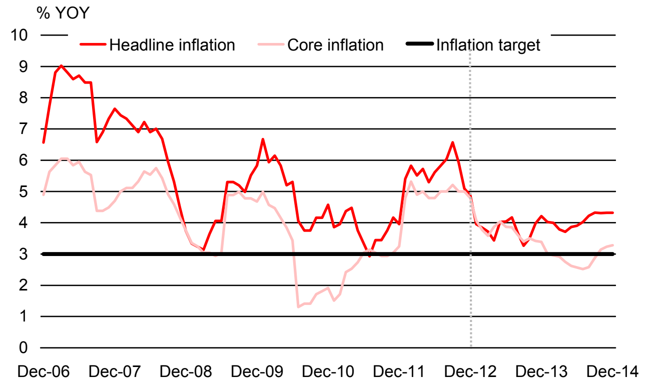
Hungary

GDP



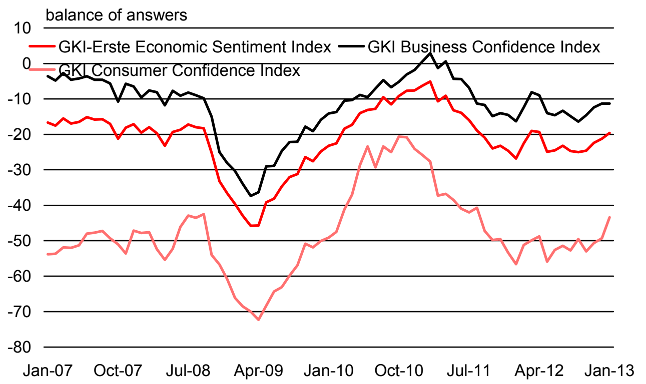
- The recession deepened in 4Q12. We expect GDP to bottom out in 1H13.

INFLATION



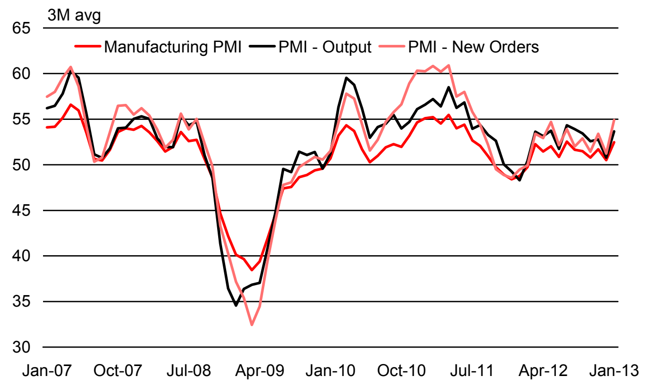
- Headline inflation is expected to remain above target over the next few years, pushed up by tax and administrative price hikes.

ECONOMIC SENTIMENT



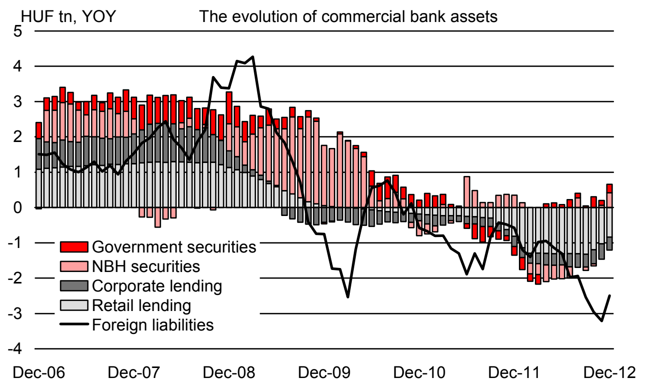
- The strong improvement in consumer confidence hints at the economy bottoming out in 4Q12.

PMI



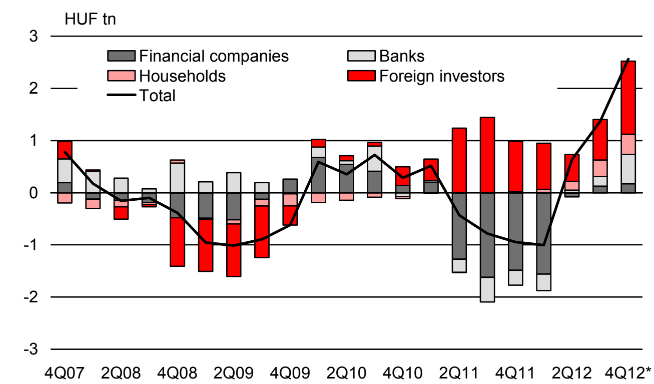
- Industrial production looks to have recovered in line with Western European manufacturing after a very weak 4Q12.

ASSET ALLOCATION BY COMMERCIAL BANKS



- Banks returned to the local debt market in 4Q12 and the decline of foreign liabilities slowed down for the first time since April 2012, in line with a smaller reduction of lending.

PURCHASES OF MARKETABLE DOMESTIC DEBT



- *4Q12 data for November 2012. Foreign investors bought more than half of the domestic marketable debt issued in October and November 2012.

Source: KSO, NBH, Ministry of Finance, Bloomberg, Haver, UniCredit Research

US

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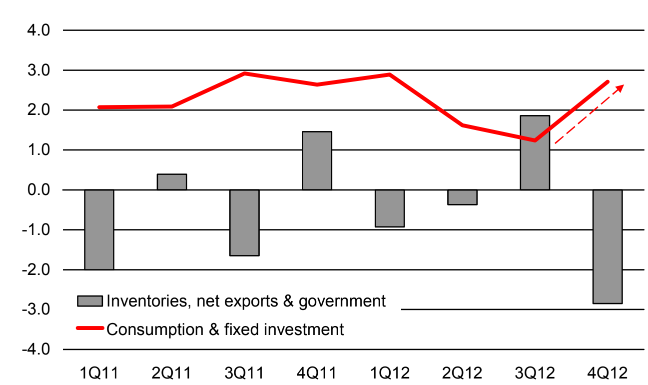
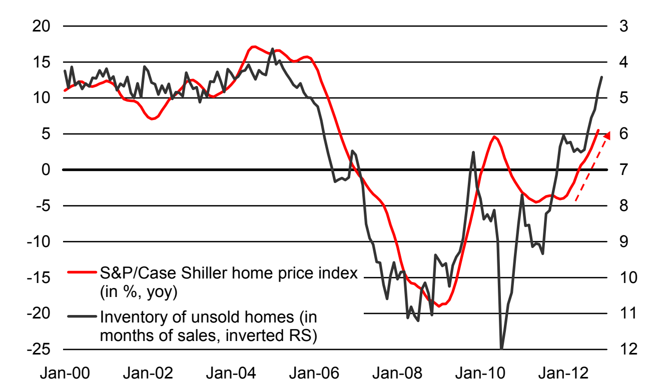
- The US economy unexpectedly contracted an annualized 0.1% at the end of last year. The weakness came exclusively from the three most volatile GDP components: inventories, net exports and government spending. Final domestic demand, on the other hand, accelerated in 4Q12 (see left chart below). Moreover, the growth number is likely to be revised up into positive territory thanks to improved December trade data.
- While the weak 4Q12 GDP primarily represents a technical payback from a strong third quarter, growth in the current quarter will likely be restrained by tighter fiscal policy, notably the expiration of the payroll tax cut. Thereafter, however, we continue to expect the US economy to experience its strongest period of the recovery thus far. In addition to consumer spending, which is set to remain the main growth engine, two key areas are likely to support expansion going forward: structural recovery in the housing market and pent-up demand in business investment.
- In line with this view, the US labor market has been remarkably resilient in recent months. Revisions (including the annual benchmark revision) have shown that the December employment level was no less than 647,000 higher than initially reported. The political uncertainty surrounding the fiscal cliff has, therefore, not deterred businesses from hiring at all. Along the same lines, nonfarm employment rose another solid 157,000 in January, despite higher taxes and the debt-ceiling debate.
- The most important development in the housing sector is the dwindling supply of homes. Due to a combination of an extended period of under construction and fewer foreclosures, in December the inventory-to-sales ratio fell to the lowest level since May 2005. At the current sales pace, it would take 4.4 months to sell all existing homes currently on the market. According to historical correlations, this inventory-to-sales ratio would be consistent with again double-digit increases in the Case Shiller index (see right chart).
- At its latest FOMC meeting, in late January, the Fed said that it will continue to buy USD 85bn in long-term securities per month. In line with our interpretation of the weak GDP numbers, the committee completely dismissed the economic contraction at the end of last year. Moreover, the FOMC has toned down its risk assessment (from significant downside risks to downside risks), as strains in financial markets have eased somewhat.

CONTRIBUTIONS TO REAL GDP GROWTH (IN PP)



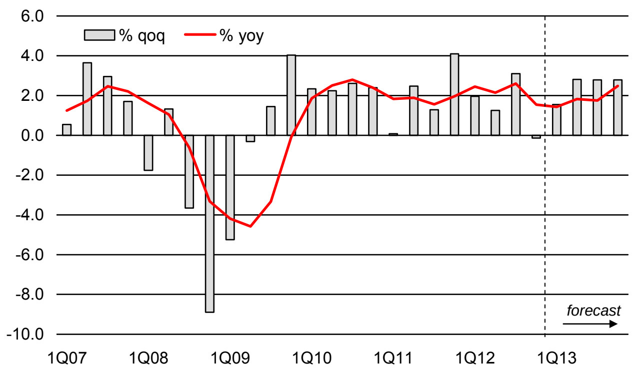
HOUSE PRICES TO RISE FURTHER



Source: BEA, Bloomberg, National Association of Realtors, UniCredit Research

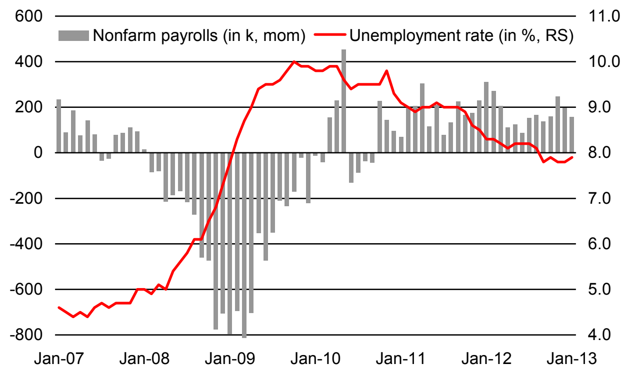
US

REAL GDP, ANNUALIZED RATES OF CHANGE



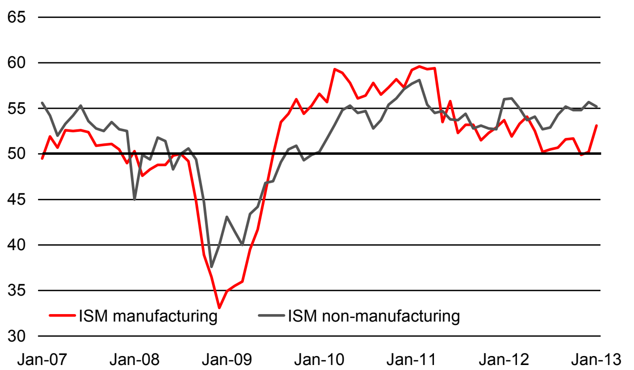
- Between 2Q13 and 4Q13, the US economy will likely have the strongest three-quarter period of the recovery thus far.

NONFARM PAYROLLS AND UNEMPLOYMENT RATE



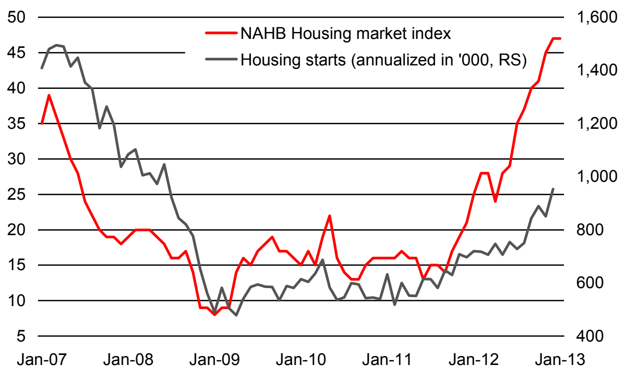
- Nonfarm payroll gains increased another 157,000 in January, while the jobless rate edged up to 7.9 %.

PURCHASING MANAGERS' INDEXES



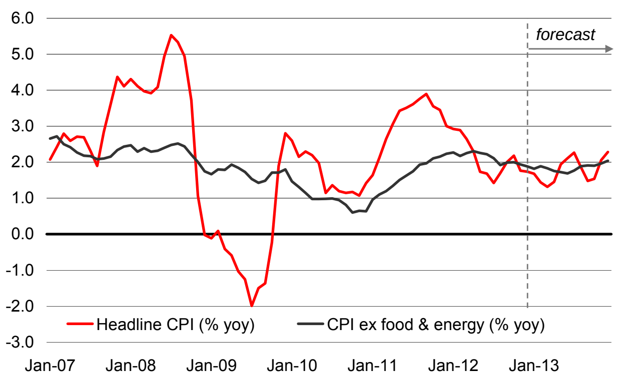
- The manufacturing ISM rose to a 9M high in January (53.1), while the non-manufacturing index stayed above 55 points.

HOUSING MARKET INDEX AND HOUSING STARTS



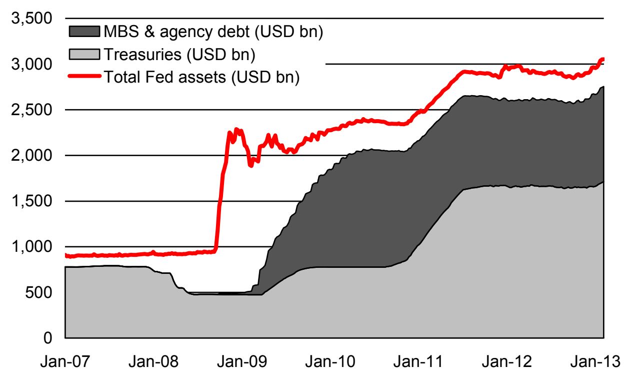
- The NAHB index remained at a 7Y high in January, while housing starts jumped to their highest level since mid-2008.

INFLATION



- Inflation pressures remain subdued. Headline inflation eased to 1.7% in December, while the core rate stabilized at 1.9%.

FED'S BALANCE SHEET



- The size of the Fed's balance sheet has exceeded USD 3tn, as the Fed continues its large-scale asset purchase program.

Source: BEA, BLS, Federal Reserve, Institute for Supply Management, NAHB, Census Bureau, UniCredit Research

Switzerland

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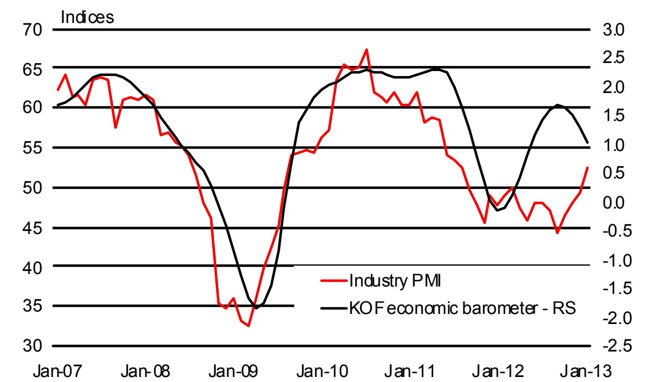
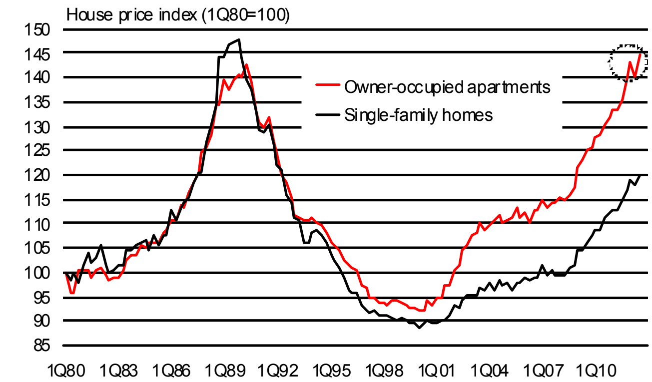
- The Swiss economy staged a solid rebound in 3Q12, growing 0.6% qoq after -0.1% in the previous quarter. However, quarterly growth figures were strongly biased upwards due to the chronically volatile inventories. Net imports of valuables, stemming from a temporary build-up in commodity inventories, as Switzerland has become the world's most important commodity trading hub, added 0.5pp to quarterly growth. We expect that this technically-driven support has been partially reversed in the final quarter, which should show a broadly unchanged GDP figure qoq. The first GDP release is due on 28 February.
- Looking into 2013, the gap between the two major business sentiment indices narrowed further at the beginning of the year (see left chart). The Industry PMI jumped above the expansion threshold in January. In contrast, the KOF Economic Barometer was down considerably again. However, its level remains consistent with moderately positive GDP dynamic. On average, the two indicators signal GDP growth of ¼% qoq for 1Q13, in line with our forecast.
- The major support factor of the economy remains consumption, underscored by the latest rebound in consumer confidence. Purchasing power continues to benefit from immigration and imported deflation. But the outlook for industry has also been brightening again, as reflected in the stabilizing PMI and, above all, clearly positive export expectations. The strong currency is still weighing on business investment, but on the other hand, ongoing solid housing demand is leading to overall rising construction output.
- House price growth has reaccelerated in 3Q12 (see right chart). Tighter capital rules and bank self-regulation have already been implemented. And in February the SNB initiated the activation of the newly available countercyclical buffer at a level of 1% of risk-weighted residential mortgage loans, in order to achieve a preventive effect on housing market dynamics. In any case, although EUR-CHF has moved visibly above the minimum rate target of 1.20, driven by strengthened confidence in the euro, the exchange rate will remain the unchanged priority of monetary policy. With no current inflationary tendencies in Switzerland over the medium-term horizon, and the continuation of monetary easing by other major central banks, we do not expect any change to the SNB's policy rate this year.

GAP IN BUSINESS SENTIMENT SURVEYS IS NARROWING



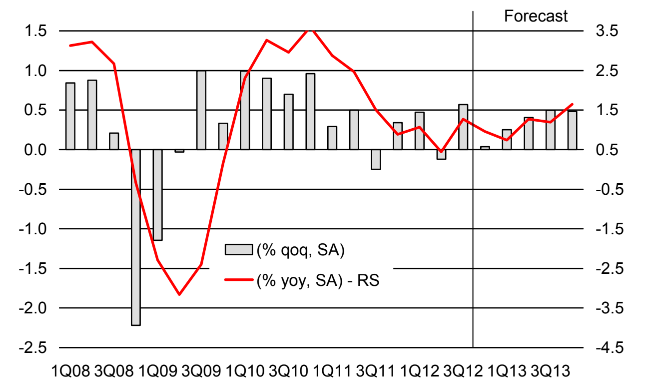
HOUSING BOOM CONTINUES



Source: SNB, KOF, Thomson Datastream, UniCredit Research

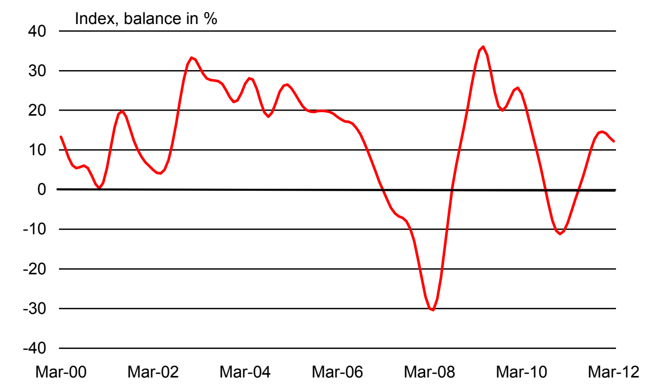
Switzerland

GDP



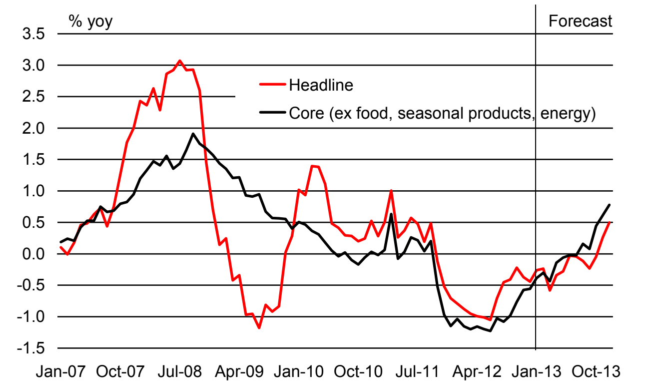
- After the strong rebound in 3Q12, which was driven by technical factors, we expect a broadly unchanged final quarter result.

EXPORT ORDER EXPECTATIONS



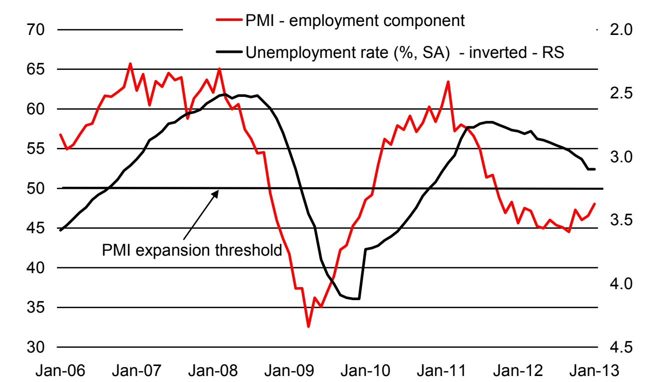
- Despite some moderation in January, order expectations in the export sector remain clearly positive.

INFLATION



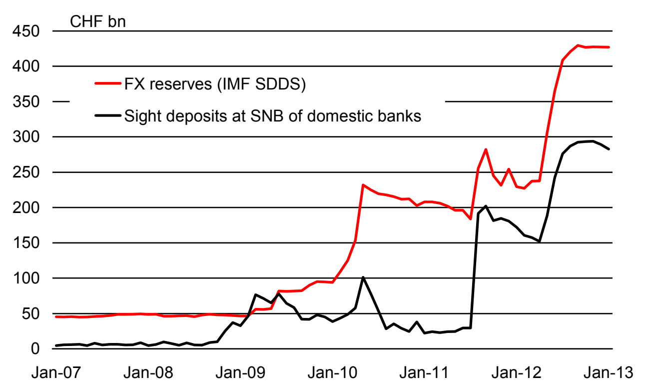
- Swiss consumer prices continued to decline moderately on an annual basis at the beginning of 2013.

LABOR MARKET



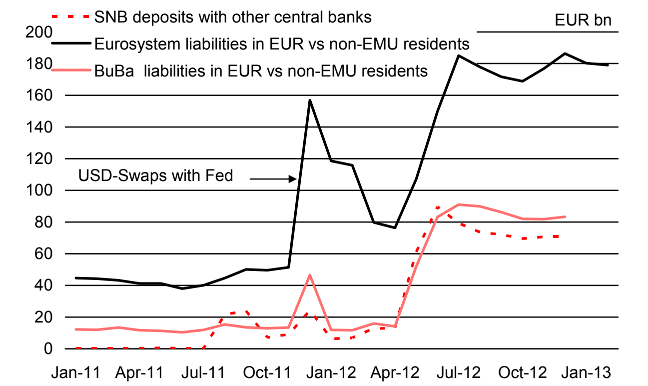
- Employment plans in industry have improved further of late, supporting the overall robust labor market situation.

FX RESERVES



- Stable reserves and slightly declining sight deposits continue to exert reduced pressure on the Swiss currency since the ECB's OMT announcement.

FX CURRENCY MANAGEMENT



- A large amount of the 2012 purchased EUR reserves is still parked at central banks, and will be invested only gradually.

Source: SECO, KOF, Thomson Datastream, Bloomberg, UniCredit Research

Russia

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- Euroclear and Russia's National Settlement Depository officially established facilities to settle trades in the OFZ market. This move significantly increases the potential for foreigners to invest in the RUB 4.0tn domestic government debt market, over 80% of which has been Euroclearable from 7 February. The OFZ market had already rallied in anticipation of this move, with yields across the curve down 200bp from last year's peak. Banks accumulated OFZs in excess of their standard liquidity management needs and are able to provide around RUB 100bn worth of OFZs to foreign investors, while in the risk-on environment, foreign inflows may reach RUB 250-300bn.

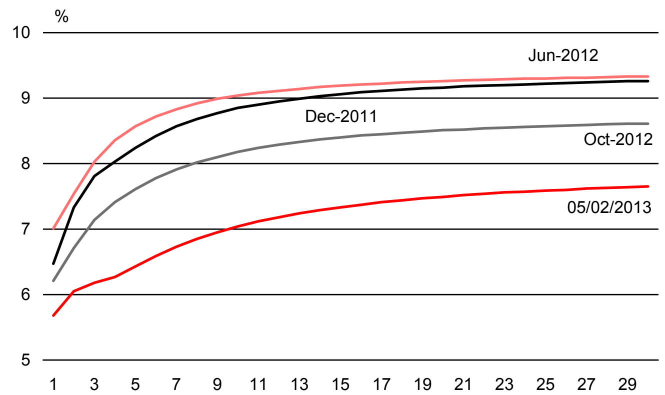
  We expect the budget to remain in surplus until November, which creates outflow from the system, so banks will have to increase refinancing volumes with the CBR. This will lead to increased levels of collateral utilization, adding to the presence of foreign investors and is, thus, positive for OFZ prices (although banks have other refinancing options, they prefer OFZs due to their low haircuts).

- The Bank of Russia decided to leave its target rates unchanged on the meeting of 12 February, so the refinancing rate will be 8.25% and the auction-based repo rate 5.5% next month. In its statement, the CBR warned against "inflation significantly higher than the target range" (January figure is 7.1%), and stressed again that real-sector indicators are close to their potential levels while not being excessively optimistic. The CBR stated that it would monitor inflation and growth dynamics when making future decisions.

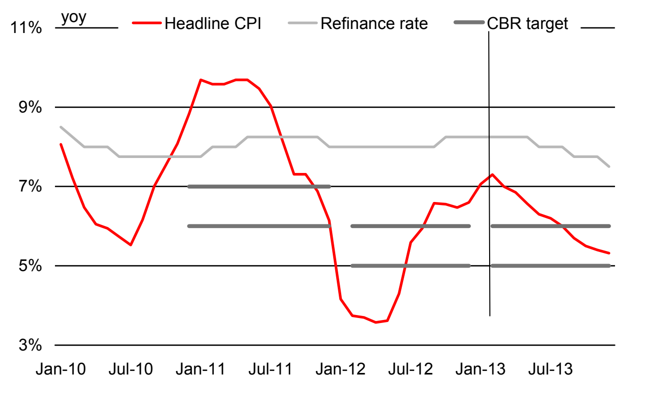
  At the same time, the CBR unified mandatory reserve requirements on foreign and local funding at 4.25%, including bank liabilities in the form of deposits and borrowing. Previously, reserve requirements on RUB funding had been lower than on foreign funding, i.e. 4.0% vs. 5.5%. The CBR explained that, as FX volatility has increased considerably, the tool is less influential in managing capital flows. The regulator hinted that it would not be against a greater reliance on foreign funding for the banking sector, given limited opportunities to attract local funding.

  We see this decision as a continuation of the rather neutral monetary policy in Russia, and think that the decision and the statement are positive for the RUB in the medium-term.

OFZ YIELDS HAVE FALLEN MARKEDLY IN THE LAST 6 MONTHS



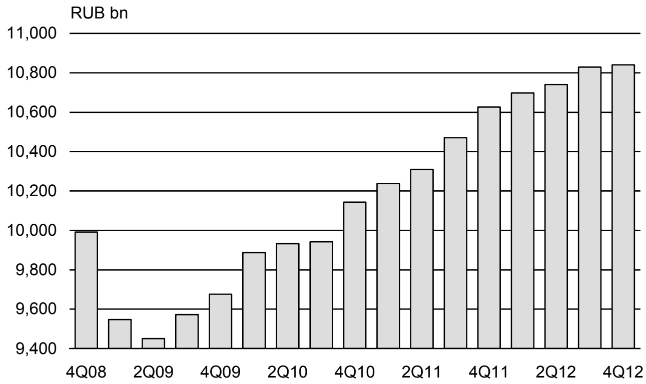
DESPITE INFLATION ACCELERATING ABOVE 7% YOY



Source: Bank of Russia, Federal Statistics Service, MICEX, UniCredit Research

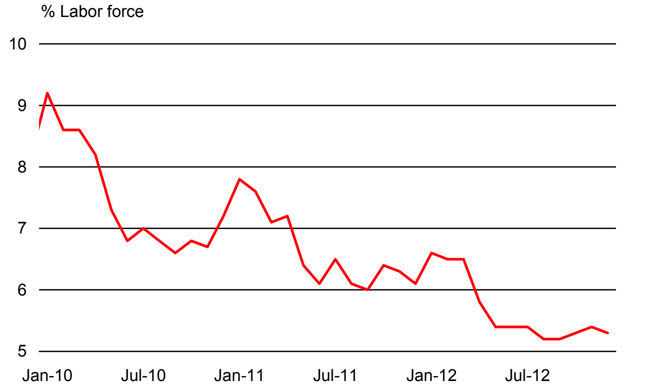
Russia

GDP (SEASONALLY-ADJUSTED QUARTERLY DATA)



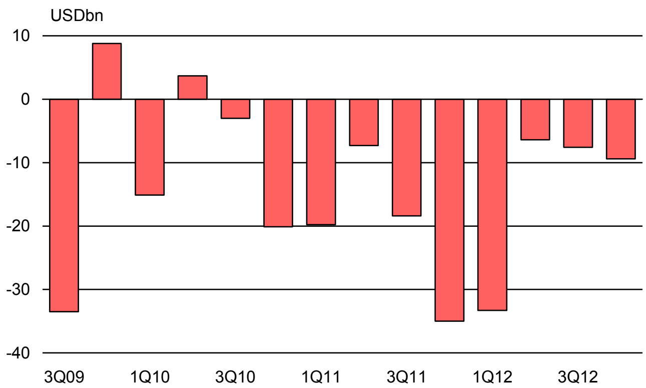
- Slowdown in investment and consumption demand in 4Q12 brought a significant deceleration in GDP growth…

UNEMPLOYMENT



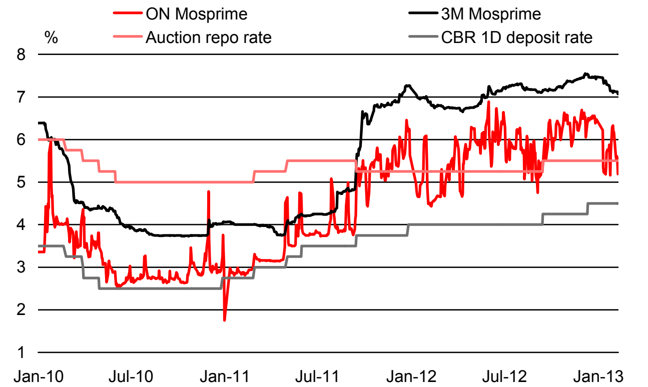
- …although unemployment remains far below historical levels.

CAPITAL OUTFLOW



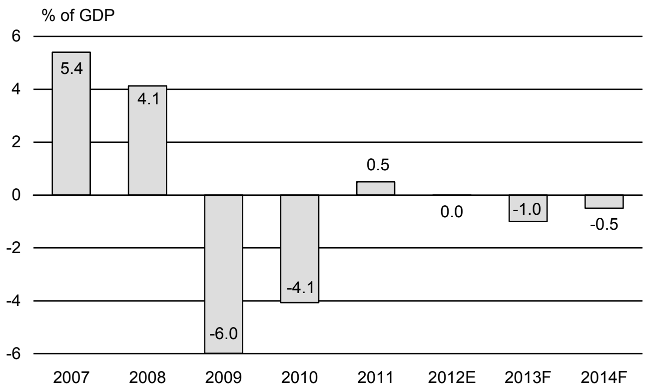
- A significant revision of outflow figures for 2Q-3Q brought FY12 capital outflow to only USD 57bn (down from USD 80bn in FY11).

MONEY-MARKET RATES



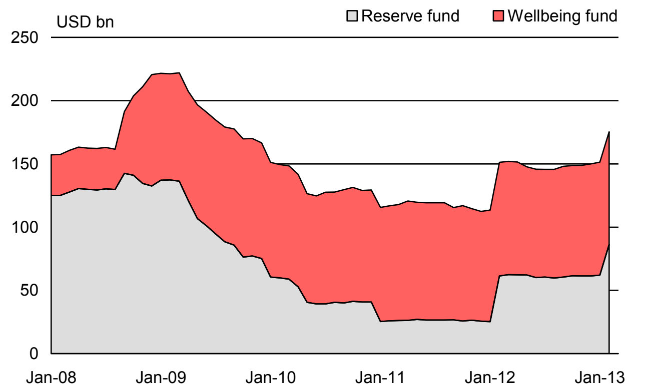
- Abundant liquidity brings money-market rates down, although rates are not likely to be sustainably lower…

BUDGET BALANCE



- Despite oil price volatility, the government followed a prudent budget policy, so its balance was close to 0% of GDP in 2012…

STATE FUNDS ACCUMULATION



- …and Russia added some USD 24bn more to its Reserve fund, bringing the total amount of sovereign funds to a solid USD 175bn.

Source: Ministry of Finance, Bloomberg, Bank of Russia, Federal Statistics Service, UniCredit Research

Turkey

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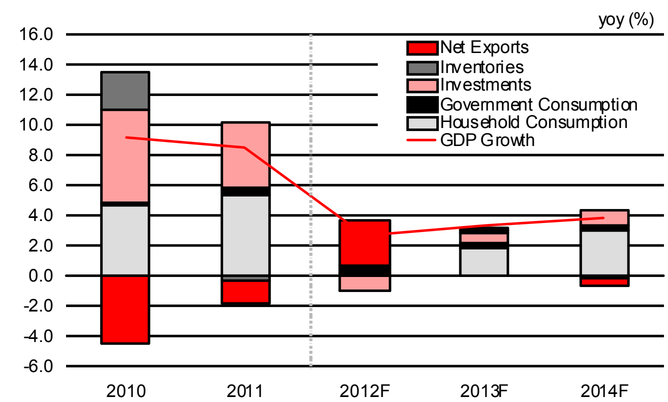
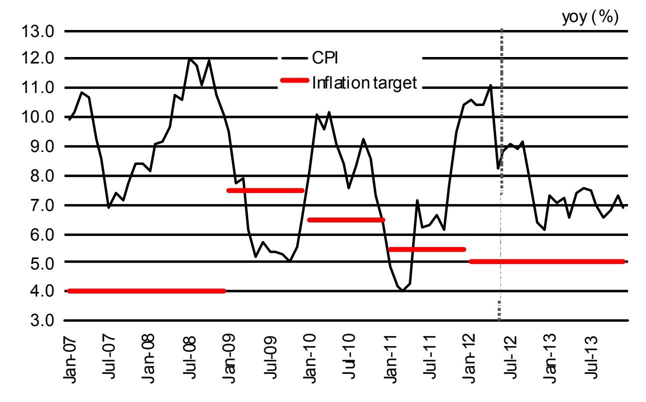
- Turkey's success in generating a soft landing in 2012 can be attributed to a combination of factors. Firstly, the structure of the CBT's balance sheet allowed it to soak up a considerable amount of TRY to stabilise the currency as we entered 2012. Secondly in the face of a sharp slowdown in external demand, Turkey managed to grow exports for much of last year, helping to compensate for the slump in domestic demand. Thirdly, for the first time in its recent history, ample financing and robust public debt dynamics meant that Turkey has not been forced towards significant counter-cyclical fiscal policy measures.
- From here now on, the government's focus is on improving GDP growth ahead of local and presidential elections in 2014. The government's medium term plan, published in October, put GDP growth in 2013, 2014 and 2015 at 4%, 5% and 5%, respectively. While these forecasts appear optimistic to us, there are reasons to expect an acceleration in growth from here. Firstly the impact of the slowdown in credit growth should, to a large extent, have already been captured by domestic demand. Secondly, facilitated by slowing GDP growth, easing inflation and ample foreign capital inflows, the CBT has been able to lower interest rates significantly. Thirdly while Turkey has been successful in diversifying its exports, this has been largely gold-related and others areas of exports have suffered from the global slowdown, much as elsewhere in the region. We expect 2013 to show a gradual improvement on this front.
- The CBT's challenge is to manage not only the pace, but also the composition of the recovery. Its room for error is limited, as it has set strict limits on real effective exchange rate moves to help it meet its objectives, i.e. 2% REER gains per annum. The CBT has concerns that appreciation beyond this 2% per annum will prompt a renewed widening of the C/A deficit, while depreciation will push inflation higher and threaten its projection. Most problematic at this stage is that despite enforcing these limitations, credit growth is accelerating and remains above the CBT's 15% target, threatening an unbalanced recovery in activity.
- The CBT has tools to manage a sudden stop in capital inflows which threaten currency depreciation. Via its ROM mechanism, it has the potential to return FX to the market while simultaneously soaking up a large portion of FX reserves. More problematic could be a scenario of continued foreign capital inflows which translates into above-target credit growth and renewed widening of the C/A deficit, particularly in light of higher oil prices. In such a scenario, inflation risks will build.

GDP GROWTH TO RECOVER GRADUALLY



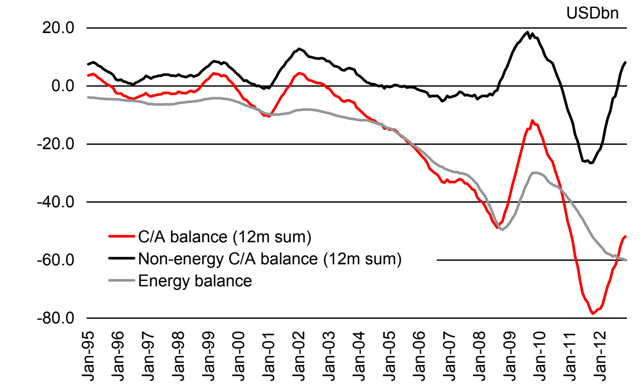
INFLATION IS NEARING TARGET



Source: CBT, TurkStat, UniCredit Research

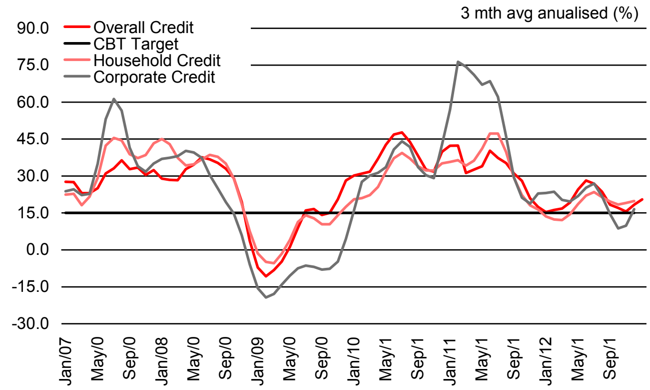
Turkey

THE C/A AND ENERGY AND NON-ENERGY BALANCE



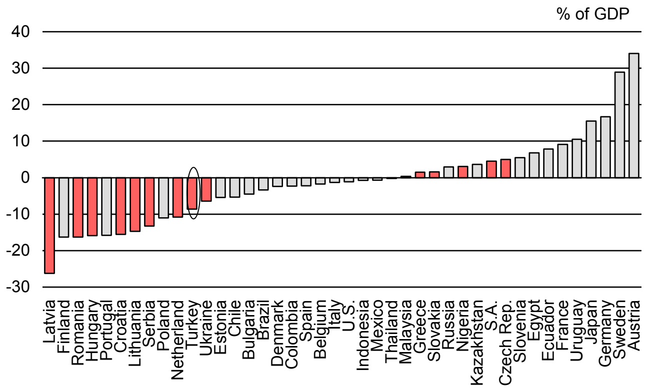
- The C/A deficit has narrowed significantly, aided by a contraction in domestic demand and an improvement in the non-energy balance.

CREDIT GROWTH ABOVE TARGET



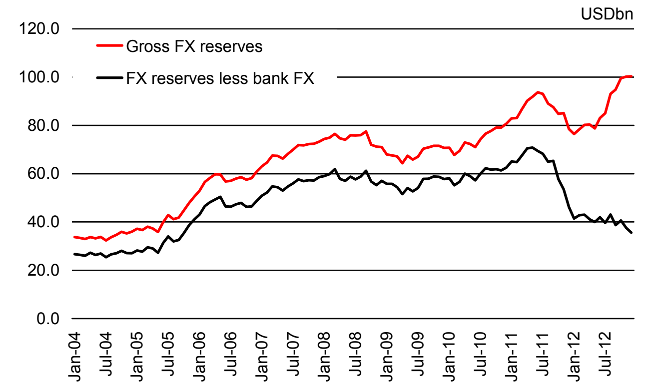
- The impact of slowing credit growth has fed through to domestic demand.

THE BANKING SECTOR'S NET FOREIGN ASSET POSITION



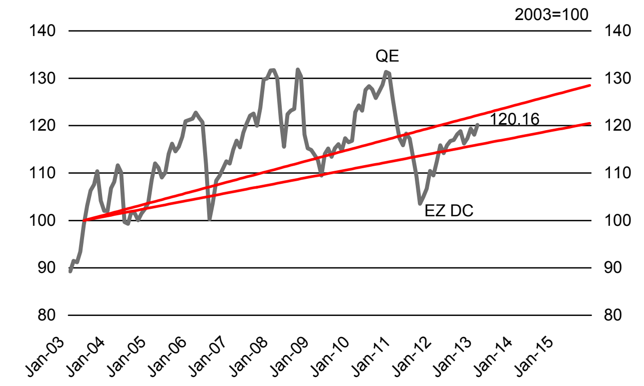
- The banking sector's net foreign asset position vs. international peers

FX RESERVES



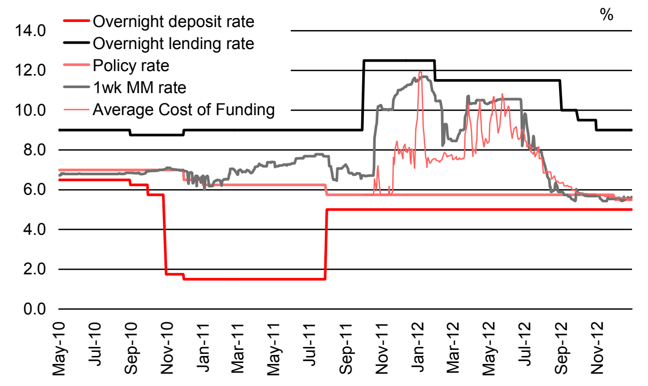
- A transfer of FX from banks to the CBT via its ROC mechanism has boosted gross reserves.

TURKEY'S REAL EFFECTIVE EXCHANGE RATE TARGET



- The CBT hopes not only to continue keeping currency volatility low, but also to limit real effective exchange rate appreciation within a narrow band

INTERST RATES WILL BEAR ANY ADJUSTMENT BURDEN



- The CBT acknowledged that with a stable FX, interest rates may have to bear more of the adjustment burden. Over 2012, ample capital flows have facilitated lower rates.

Source: CBT, TURKSTAT, UniCredit Research

China

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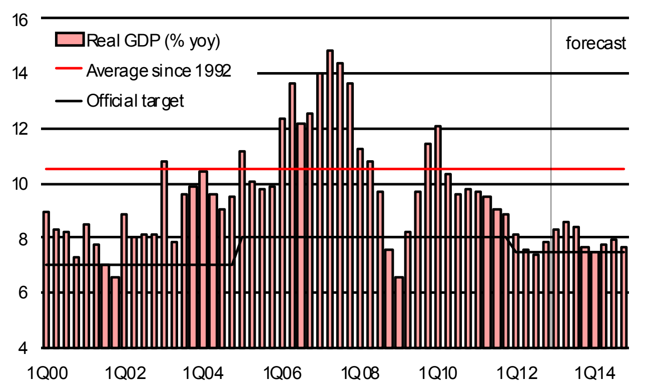
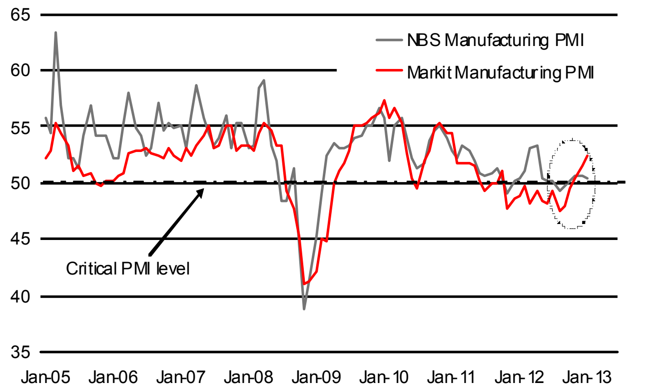
- Recent data imply that the Chinese economy is already recovering and will gain some traction further down the road. However, recovery momentum will be rather moderate by historical standards. Economic growth picked up again in 4Q12 for the first time in two years, with real GDP advancing by 7.9% yoy (although the 7.8% full-year growth was the weakest since 1999). High frequency activity data surprised on a stronger note as well, showing a healthy economic momentum starting 2013.
- Retail sales (December: +15,2% yoy) are supported by decent wage growth and consumption incentives, fixed asset investment is holding up via increased infrastructure outlays, while real estate investment is profiting from the gradual increase in sales figures and prices as well as social housing programs. But authorities are carefully looking at investment in high-end housing as well as (investment) spending of provinces and local entities.
- After lagging domestic demand initially, industrial production growth has recovered to double-digit rates again. Improving profitability, but first and foremost the now advanced destocking process (as indicated by the rapid normalization of the orders-to-inventories ratio) is fueling the industrial recovery. Gradually improving external demand should help, too, as shown by recent strong export data – although the figures may have been inflated by the shift in the Lunar New Year holidays.
- Improving sentiment figures underpin our constructive view as well. The HSBC/Markit PMI (biased towards small enterprises said to have their finger more on the cyclical pulse) advanced deeper into expansionary territory, rising to 52.3, the highest reading in two years. But the recent setback of the official NBS PMI is a reminder that that the recovery will likely be a moderate one (even if it was probably depressed by recent methodological changes).
- Overall, we expect 1H13 GDP growth to accelerate into the 8¼-8½% region, but level off thereafter, as the fiscal stimuli will gradually fade. Structural headwinds should weigh, too, as will the (new) leadership's efforts to change China's growth model towards a more qualitative, consumption-driven approach.
- Beyond New Year holidays induced volatility, the inflation trend is up, fueled by rising food and housing costs. Overall, however, the turnaround in CPI will not set off alarm bells. But any further monetary easing seems to be off the table for now, with risks to some upward fine-tuning in late 2013 tilted to the upside.

THE SEVEN-QUARTER-LONG SLOWDOWN HAS ENDED …



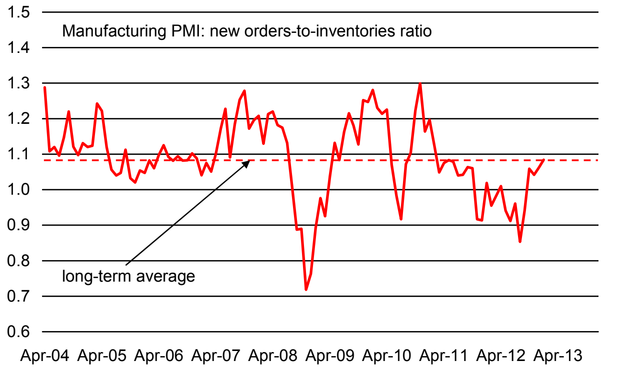
…GIVING WAY TO A MODERATE CYCLICAL RECOVERY



Source: Thomson Datastream, Feri, UniCredit Research

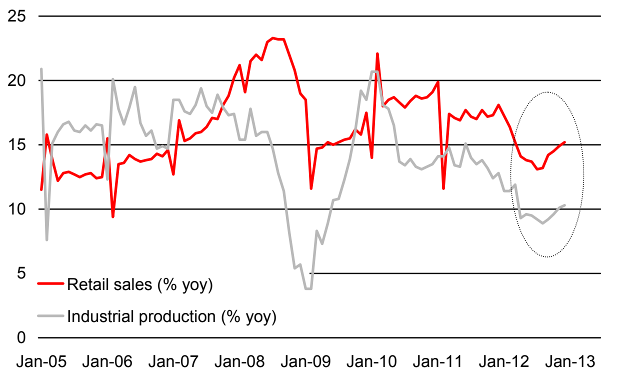
China

NEW EXPORTS-TO-INVENTORY RATIO



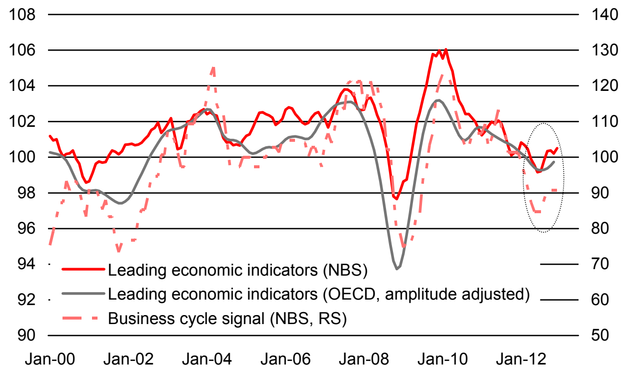
- After lagging the global inventory correction cycle, the destocking process gained traction more recently.

RETAIL SALES AND INDUSTRIAL PRODUCTION



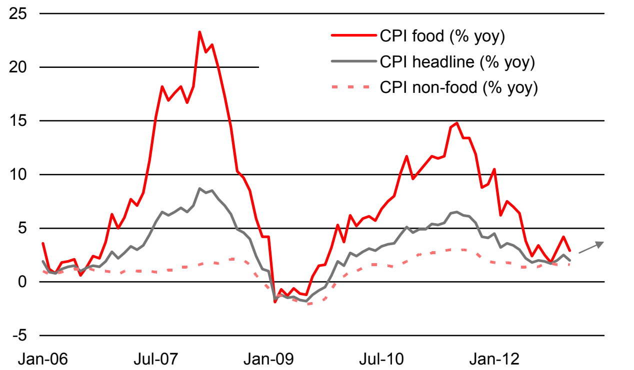
- This may fuel industrial production growth further down the road. Consumption should continue to recover.

LEADING INDICATORS



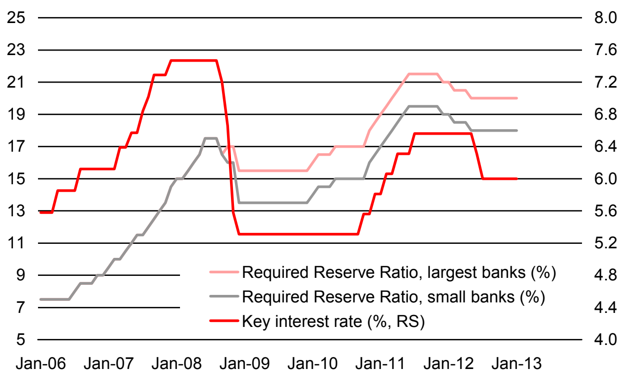
- A moderate economic recovery is also signaled by the various measures of leading indicators.

INFLATION



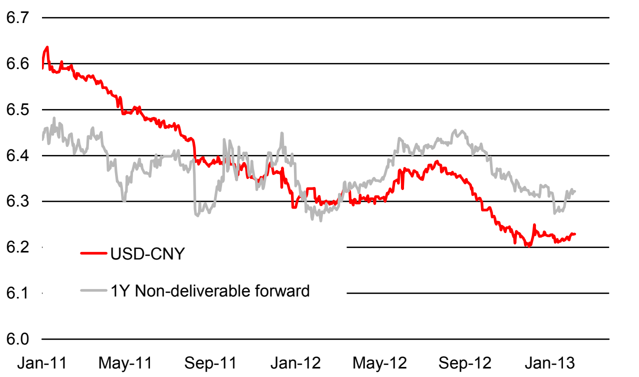
- The disinflation process seems to be over, with food and housing driving CPI higher. But price pressure will not be alarming ...

MONETARY POLICY



- ... prompting the central bank to remain on the sidelines this year.

USD-CNY

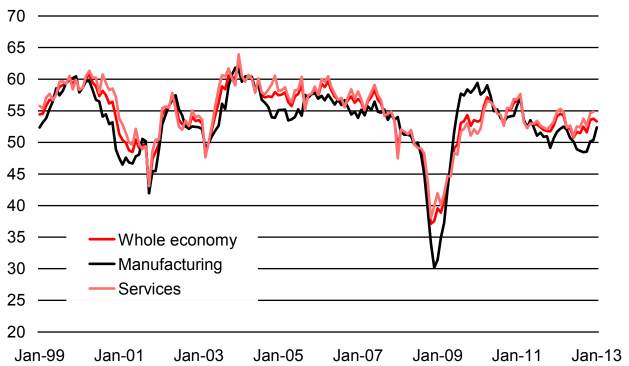


- After slightly depreciating last summer, the CNY resumed its controlled appreciation trend, but flattened out again recently.

Source: Thomson Datastream, Feri, UniCredit Research

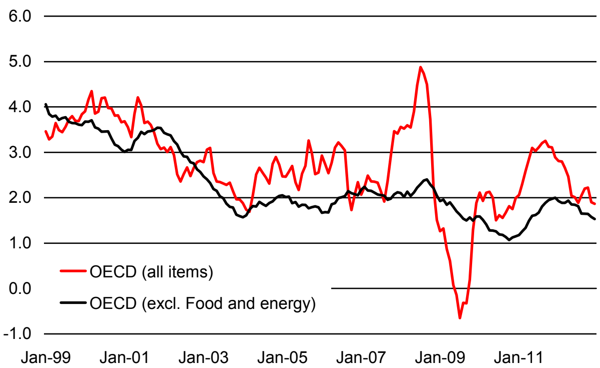
Global indicators

GLOBAL PMI OUTPUT



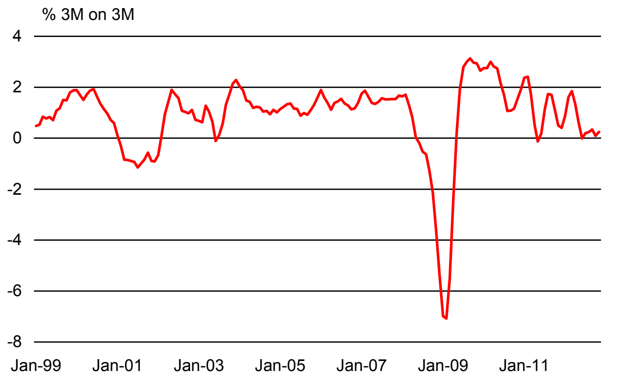
■ The global composite PMI fell slightly from 53.7 to 53.3 in January. The manufacturing output index rose from 50.4 to 52.4 while the services index fell from 54.8 to 53.6.

INFLATION



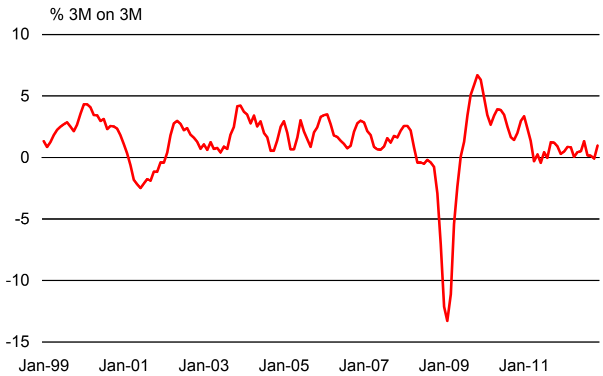
■ Headline inflation in OECD economies remained at 1.9% yoy in December, while the core rate slowed from 1.6% to 1.5% yoy.

INDUSTRIAL PRODUCTION



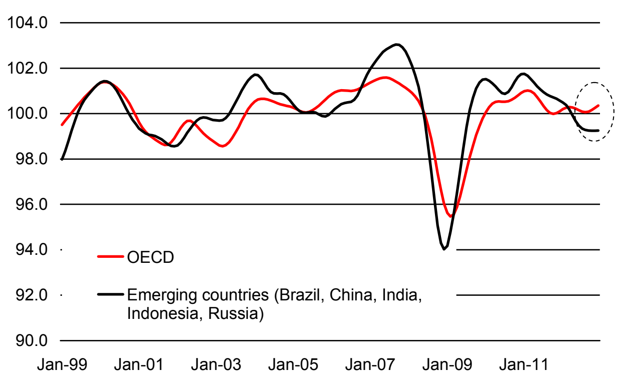
■ Global IP increased 0.6% mom in November. The 3M/3M rate accelerated from 0.1% to 0.2%.

WORLD TRADE



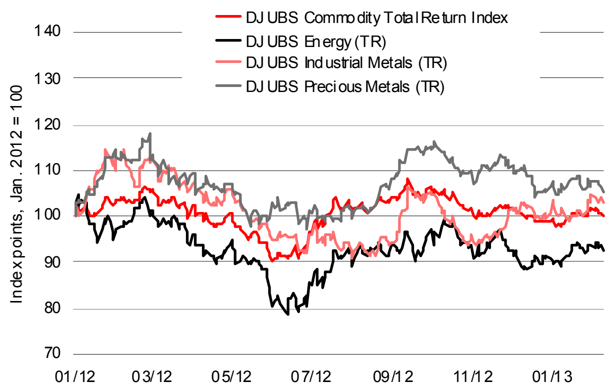
■ World trade increased 0.8% mom in November. The 3M/3M rate accelerated from -0.1% to 1.0%.

OECD COMPOSITE LEADING INDICATORS



■ OECD leading indicators for the OECD economies and key emerging countries (aggregated) edged up in December.

COMMODITIES



■ We expect only a sideways movement in the Brent oil price over the next two years, due to stronger supply from North America (shale oil) and Iraq. Precious metals will remain on an upward trend, with palladium being our favorite.

Source: CBP Netherlands, OECD, UniCredit Research

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