UniCredit

Economics Research

The UniCredit Chartbook

Monthly

Economics, FI/FX & Commodities Research
Credit Research
Equity Research
Cross Asset Research

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Monthly recap

- **EMU:** In February, survey indicators maintained their recovery trend, although the pace of improvement remained slow, and the evidence was somewhat mixed. In the manufacturing sector, the forward-looking components look increasingly promising, suggesting that the process of gradual stabilization in industrial activity will continue. We do not expect the handling of the Cyprus bailout to pose any material systemic risk. The ECB remains reluctant to further relax conventional policy, despite inflation falling below 2% and a very weak CPI projection for 2014 (at only 1.3%). However, the central bank committed itself to keeping its stance accommodative for "as long as needed", clearly suggesting that an exit is still some time away.

- **US:** The US economy is regaining momentum. While growth in the current quarter is still being held back by tighter fiscal policy, notably the expiration of the payroll tax cut, we expect GDP growth of 1.5% (annualized) – and the risks to this forecast are clearly skewed to the upside. The two factors behind this are the impending reacceleration in inventory investments, and resilient consumer spending, supported by a better labor market and a renewed pick-up in borrowing. Despite the improved economic situation, the Federal Reserve will continue its bond-purchasing program. The two most influential FOMC members, Chairman Bernanke and Vice Chair Yellen, unequivocally made clear that they have no intention to scale back the current degree of monetary accommodation.

- **CEE:** The CEE region is showing signs of a recovery in growth, supported by stronger external demand and a bottoming out in the credit cycle. Following a particularly weak 4Q, led in part by vehicle manufacturing, January data is already showing improvement. Meanwhile inflation pressures are easing in many cases, allowing central banks to ease rates and/or leave them on hold for longer. The primary risk remains a normalisation of G7 monetary policy.

- **China:** Recent data releases in China have been mixed, painting a picture of an ongoing but rather moderate and uneven economic recovery. Rising inflation and growing concerns about a (renewed) housing bubble and financial risks are posing additional challenges to China's economic policy. The new government will most likely react with a combination of further selective fiscal stimuli and prudent monetary policy, but no rate hike this year. Overall, we stick to our expectation of 1H13 GDP growth accelerating modestly to the 8¼-8½% region, but levelling off thereafter.

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	1.2	1.3	1.4
Germany	0.9	0.8	1.5	2.0	1.3	1.4	-	-	-	0.2	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	1.3	2.0	-	-	-	-4.5	-3.7	-3.1	90.1	92.3	93.4	-2.4	-2.0	-1.7
Italy	-2.2	-1.1	0.7	3.0	2.0	1.8	-	-	-	-3.0	-2.2	-2.0	127.0	128.1	126.8	-0.6	-0.1	0.0
Spain	-1.4	-1.4	0.4	2.4	2.3	2.6	-	-	-	-6.7*	-6.0	-5.1	84.1	91.4	98.7	-0.8	0.5	1.4
Austria	0.8	0.9	1.5	2.4	2.2	1.9	-	-	-	-3.2	-2.3	-1.7	74.9	75.6	75.1	1.9	1.4	1.8
Greece	-6.5	-4.5	0.2	1.5	0.4	0.7	-	-	-	-6.9	-5.3	-4.9	158.0	179.0	175.0	-4.5	-2.8	-1.5
Portugal	-3.2	-2.5	0.4	2.8	1.4	1.7	-	-	-	-6.6**	-5.5	-4.0	121.0	123.5	124.3	-1.6	-1.1	-0.9
Other EU																		
UK	0.2	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	1.4	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	1.4	2.4	4.25	3.25	3.50	-3.5	-3.8	-3.0	55.7	57.2	57.1	-3.5	-2.9	-3.3
Czech Rep.	-1.2	0.4	2.2	3.3	1.9	2.1	0.05	0.05	1.00	-5.2	-3.1	-3.0	45.5	47.5	48.4	-2.4	-2.2	-1.8
Hungary	-1.7	-0.1	0.9	5.6	3.1	3.9	5.75	4.50	5.50	-2.7	-3.1	-3.4	78.0	78.1	77.1	1.0	1.5	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	1.4	1.8	-0.7	-0.1	0.7	0.00	0.00	0.50	0.5	0.3	0.3	36.5	35.8	34.7	13.1	12.0	11.0
Russia	3.4	3.6	3.9	5.1	6.3	5.1	5.50	5.25	5.00	0.0	-1.0	-0.5	10.2	11.2	12.0	4.0	1.6	0.4
Turkey	2.7	3.4	3.9	8.9	6.7	6.3	5.50	6.00	7.00	-2.1	-2.4	-2.9	36.9	35.3	34.7	-6.1	-6.8	-7.5
China	7.8	8.1	8.0	2.7	3.1	3.5	6.00	6.00	6.50	-	-	-	-	-	-	2.6	2.7	3.0

* This figure does not include the impact of the bank recapitalization cost (including this cost the figure would be -10.0%).

** This figure is in line with the Eurostat ruling against the use of revenues from the airport concession for the purpose of deficit reduction.

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	-0.1	0.1	0.5	0.6	0.5	0.3	0.2	0.2	0.3
Other EU										
UK	1.0	-0.3	0.1	0.2	0.3	0.3	0.4	0.3	0.5	0.5
Sweden	0.3	0.0	0.3	0.5	0.6	0.6	0.6	0.6	0.6	0.7
Poland (% yoy)	1.4	1.1	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	0.5	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	2.5	2.5
Switzerland	0.6	0.2	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	1.9	1.9	1.8	1.7	1.6
Germany	2.0	2.0	1.5	1.4	1.2	1.2	1.2	1.3	1.4	1.5
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	2.5	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	0.0	0.1	0.4	0.9	1.3	1.6	2.0	2.2
Poland	3.9	2.9	1.4	0.9	1.3	1.6	2.5	2.3	2.3	2.5
Czech Rep.	3.4	2.9	1.8	1.8	2.0	1.9	2.0	2.1	2.2	2.2
Hungary	6.6	5.0	3.0	2.8	3.3	3.3	3.5	3.4	4.5	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	-0.3	-0.2	0.2	0.6	0.7	0.8	0.7
Russia	5.2	5.0	5.6	6.4	6.6	6.4	6.0	5.5	5.2	5.1
Turkey	9.0	6.8	7.1	6.8	6.6	6.5	6.0	6.3	6.4	6.4
China	1.9	2.5	2.7	3.0	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			IMF (Jan-13/Oct-12)*			European Commission (Feb-13)			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	-0.6	-0.3	1.4	-0.4	-0.1	1.3
Germany	0.9	0.8	1.5	0.9	0.6	1.4	0.7	0.5	2.0	0.9	0.6	1.9
France	0.0	0.5	1.3	0.2	0.3	0.9	0.0	0.1	1.2	0.2	0.3	1.3
Italy	-2.2	-1.1	0.7	-2.1	-1.0	0.5	-2.2	-1.0	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	0.8	0.9	1.5	0.9	1.1	2.0	0.7	0.7	1.9	0.6	0.8	1.8
Greece	-6.5	-4.5	0.2	-6.0	-4.0	0.0	-6.4	-4.4	0.6	-6.3	-4.5	-1.3
Portugal	-3.2	-2.5	0.4	-3.0	-1.0	1.2	-3.2	-1.9	0.8	-3.1	-1.8	0.9
Other EU												
UK	0.2	0.9	1.4	-0.2	1.0	1.9	0.0	0.9	1.9	-0.1	0.9	1.6
Sweden	1.2	1.3	2.4	1.2	2.2	2.5	1.0	1.3	2.7	1.2	1.9	3.0
Poland	2.0	1.7	2.3	2.4	2.1	2.7	2.0	1.2	2.2	2.5	1.6	2.5
Czech Rep.	-1.2	0.4	2.2	-1.0	0.8	2.8	-1.1	0.0	1.9	-0.9	0.8	2.4
Hungary	-1.7	-0.1	0.9	-1.0	0.8	1.6	-1.7	-0.1	1.3	-1.6	-0.1	1.2
Others												
US	2.2	1.9	2.7	2.3	2.0	3.0	2.2	1.9	2.6	2.2	2.0	2.8
Switzerland	1.0	1.4	1.8	0.8	1.4	1.8	1.0	1.4	1.9	0.8	1.1	2.3
Russia	3.4	3.6	3.9	3.6	3.7	3.8	3.4	3.7	3.9	3.4	3.8	4.1
Turkey	2.7	3.4	3.9	3.0	3.5	4.0	2.5	3.0	3.8	2.9	4.1	5.2
China	7.8	8.1	8.0	7.8	8.2	8.5	7.8	8.0	8.1	7.5	8.5	8.9

CPI INFLATION (%)**

	UniCredit			IMF (Oct-12)			European Commission (Feb-13)			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	1.5	2.4	1.6	1.2
Germany	2.0	1.3	1.4	2.2	1.9	2.1	2.1	1.8	1.7	2.1	1.9	2.0
France	2.0	1.3	2.0	1.9	1.0	0.9	2.2	1.6	1.5	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	2.4	1.7	1.0	2.2	1.2	0.4
Austria	2.4	2.2	1.9	2.3	1.9	1.9	2.6	2.2	1.9	2.4	1.9	1.6
Greece	1.5	0.4	0.7	0.9	-1.1	-0.3	1.0	-0.8	-0.4	1.0	-0.2	-0.8
Portugal	2.8	1.4	1.7	2.8	0.7	1.1	2.8	0.6	1.2	2.7	0.8	1.0
Other EU												
UK	2.8	2.7	2.3	2.7	1.9	1.7	2.8	2.6	2.3	2.6	1.9	1.8
Sweden	0.9	0.4	1.8	1.4	2.0	2.0	0.9	1.1	1.6	1.0	0.9	1.7
Poland	3.7	1.4	2.4	3.9	2.7	2.5	3.7	1.8	2.3	3.6	2.1	2.1
Czech Rep.	3.3	1.9	2.1	3.4	2.1	2.0	3.5	2.1	1.6	3.2	2.0	2.1
Hungary	5.6	3.1	3.9	5.6	3.5	3.0	5.7	3.6	3.3	5.8	4.8	3.9
Others												
US	2.1	1.8	2.5	2.0	1.8	1.8	2.1	1.8	2.2	2.1	1.8	2.0
Switzerland	-0.7	-0.1	0.7	-0.5	0.5	1.0	-	-	-	-0.6	0.1	0.2
Russia	5.1	6.3	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	6.3	8.7	6.5	5.3	8.0	7.7	5.6	9.1	6.9	6.1
China	2.7	3.1	3.5	3.0	3.0	3.0	-	-	-	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	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	1.00
3M	0.21	0.45	0.55	0.65	0.75	0.85	0.95	1.10
2Y	0.02	0.25	0.40	0.55	0.75	1.00	1.25	1.50
5Y	0.37	0.85	1.00	1.20	1.38	1.60	1.88	2.10
10Y	1.39	1.75	1.90	2.05	2.20	2.40	2.60	2.80
30Y	2.30	2.60	2.75	2.85	2.95	3.10	3.25	3.40
2/10	138	150	150	150	145	140	135	130
2/5/10	-33	-15	-15	-10	-10	-10	-5	-5
10/30	90	85	85	80	75	70	65	60
2Y SwSp	-42	-35	-35	-35	-30	-30	-25	-25
10Y SwSp	-31	-30	-30	-30	-25	-25	-25	-25
10Y BTP/bund	327	295	275	260	245	230	215	200
US	**Current**	**Jun-13**	**Sep-13**	**Dec-13**	**Mar-14**	**Jun-14**	**Sep-14**	**Dec-14**
Key rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3M	0.28	0.35	0.35	0.35	0.35	0.35	0.35	0.35
2Y	0.24	0.35	0.45	0.55	0.65	0.80	1.20	1.60
5Y	0.79	1.05	1.18	1.38	1.53	1.70	2.10	2.45
10Y	1.94	1.95	2.10	2.30	2.50	2.70	3.00	3.30
30Y	3.16	3.05	3.15	3.30	3.45	3.60	3.85	4.10
2/10	169	160	165	175	185	190	180	170
2/5/10	-30	-10	-10	-5	-5	-5	0	0
10/30	122	110	105	100	95	90	85	80
2Y SwSp	-15	-10	-10	-10	-5	-5	-5	-5
10Y SwSp	-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	0.75
10Y	1.88	2.10	2.20	2.35	2.50	2.70	2.90	3.10
SZ								
Key rate	0	0	0	0	0	0	0	0
10Y	0.75	0.75	0.90	1.05	1.20	1.40	1.60	1.80

	Current	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
EUR-USD	1.29	1.36	1.38	1.40	1.40	1.41	1.42	1.43
EUR-JPY	123	128	131	136	136	137	139	143
EUR-GBP	0.86	0.92	0.93	0.97	0.97	0.98	0.99	0.99
EUR-SEK	8.34	8.80	8.85	8.95	8.95	9.00	9.00	9.00
EUR-NOK	7.50	7.35	7.30	7.25	7.25	7.20	7.20	7.20
EUR-CHF	1.22	1.26	1.27	1.28	1.28	1.29	1.30	1.30
EUR-AUD	1.25	1.26	1.27	1.27	1.27	1.26	1.26	1.24
EUR-NZD	1.57	1.56	1.57	1.56	1.54	1.53	1.53	1.51
EUR-CAD	1.32	1.43	1.45	1.46	1.43	1.41	1.39	1.39
USD-JPY	95	94	95	97	97	97	98	100
GBP-USD	1.51	1.48	1.48	1.45	1.45	1.44	1.44	1.44
USD-SEK	6.44	6.47	6.41	6.39	6.39	6.38	6.34	6.29
USD-NOK	5.80	5.40	5.29	5.18	5.18	5.11	5.07	5.03
USD-CHF	0.95	0.93	0.92	0.91	0.91	0.91	0.92	0.91
AUD-USD	1.04	1.08	1.09	1.10	1.10	1.12	1.13	1.15
NZD-USD	0.82	0.87	0.88	0.90	0.91	0.92	0.93	0.95
USD-CAD	1.02	1.05	1.05	1.04	1.02	1.00	0.98	0.97

Source: Bloomberg, UniCredit Research

Eurozone

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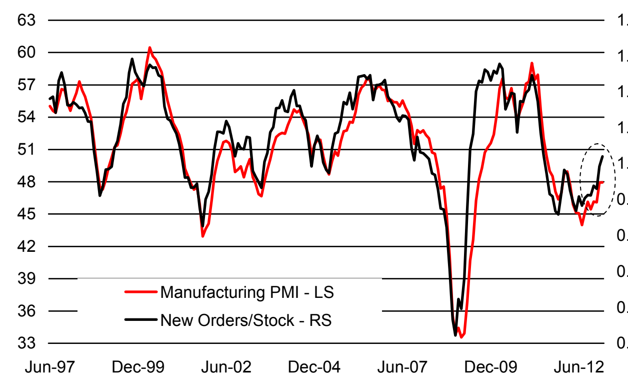
- In February, survey indicators maintained their recovery trend, although the pace of improvement remained slow, and the evidence is somewhat mixed. The EuroCOIN rose to -0.20% vs. -0.23%, while the Composite PMI fell back to 47.9 vs. 48.6. At face value, the figures point to a GDP contraction of 0.1-0.2% qoq so far in 1Q13. National business surveys were generally on the rise, with the German Ifo (particularly expectations) being the bright spot. We expect the upward trajectory in soft indicators to continue in the coming months, mostly driven by the manufacturing sector, where the forward-looking components look increasingly promising. For example, the new orders/inventory ratio of the factory PMI reached its highest level since mid-2011, while the export orders index was the first to climb into expansion territory (up to 51.7 from 49.5).

- In January, IP contracted 0.4% mom, thus losing some of the ground recovered at the end of last year. However, the 0.2pp upward revision to the December number (now at a healthy +0.9%) still allows for a decent entry into the first quarter: the January IP level is flat vs. 4Q12, when IP dropped heavily by 2.2% qoq. Monthly IP data are often very volatile, and the turn of the year was no exception. Looking through the volatility of hard data, the ongoing moderate improvement in manufacturing surveys suggests that the gradual process of stabilization in industrial activity will continue in the near term.

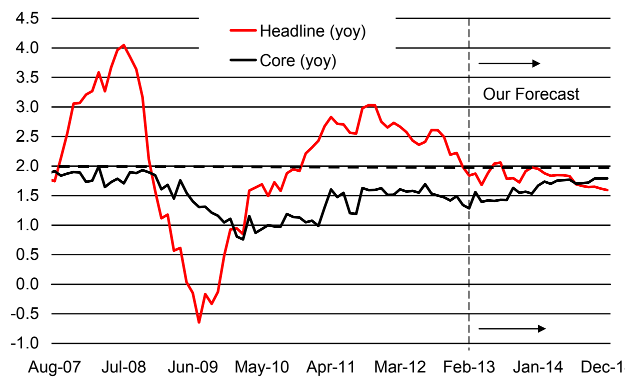
- In February, inflation slowed by 0.2pp to 1.8%, the first reading below 2% since late 2010. The main driver of the deceleration was food prices, while both energy and core inflation were broadly stable. In March, an early Easter may put some temporary upward pressure on the price of holiday-sensitive spending items. However, the downward trend in inflation is not over: we expect the low point to be hit in April at 1.6-1.7%. In yearly average terms, we see CPI at 1.9% in 2013 (-0.1pp from last month) and 1.8% in 2014.

- On 7 March, the ECB left all its interest rates unchanged. The modest dovish revisions to the macroeconomic forecasts did not lead to any material softening in Mario Draghi's rhetoric. Despite a very weak CPI projection for 2014 (at only 1.3%) and the fact that someone in the GC wanted to cut the refi rate, the ECB remains reluctant to further relax conventional policy. However, the central bank committed itself to keeping its stance accommodative for "as long as needed", clearly suggesting that an exit is still some time away. We continue to think that the refi rate will stay at 0.75% for the foreseeable future. Risks are tilted towards one final 25bp cut later in the year if a gradual growth recovery fails to materialize in 2H13.

ORDERS/INVENTORY BALANCE LOOKS PROMISING



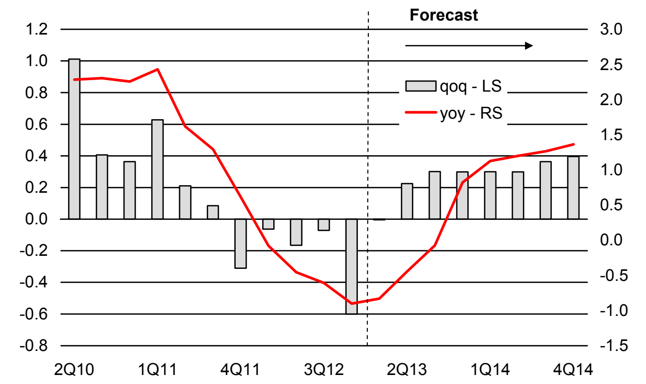
INFLATION FALLS BELOW 2%



Source: Eurostat, Markit, UniCredit Research

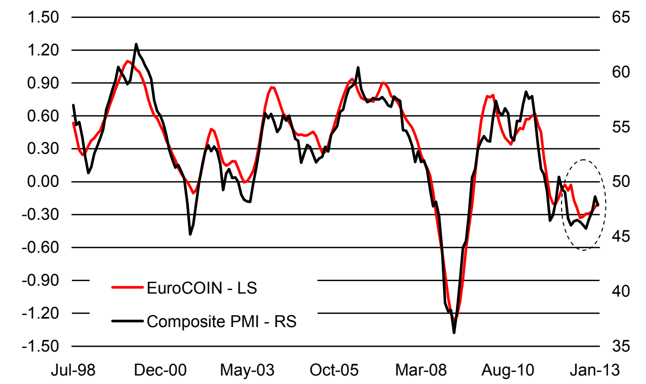
Eurozone

GDP



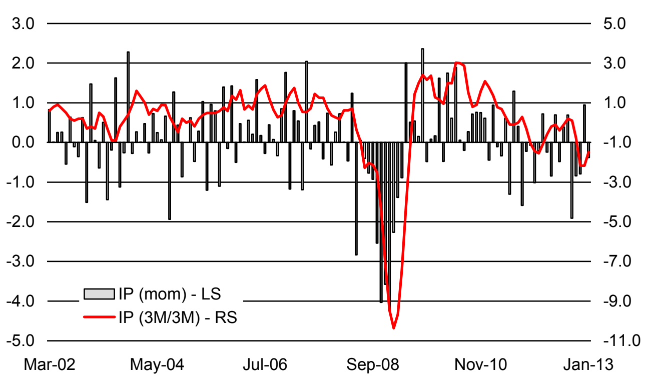
■ Our GDP forecasts.

SURVEYS



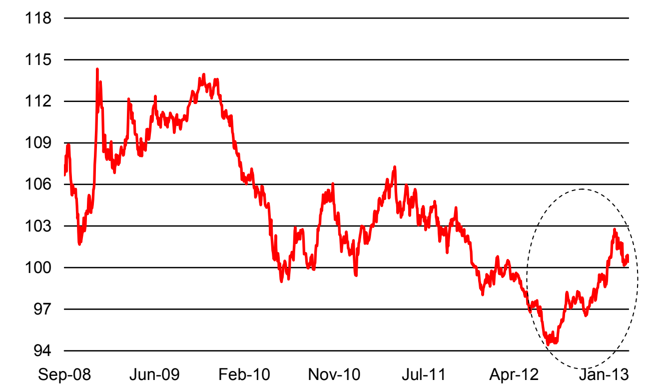
■ Moderate recovery trend remains intact.

INDUSTRIAL PRODUCTION



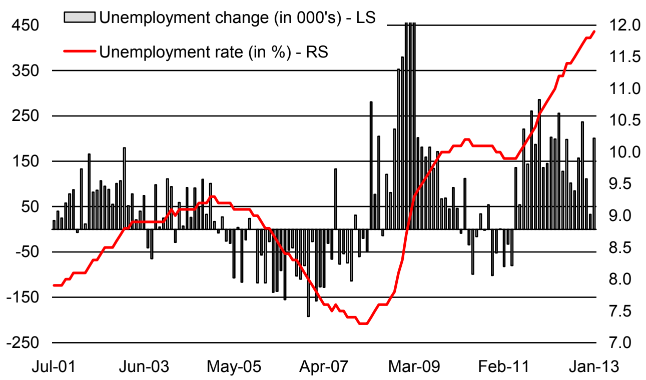
■ Industrial activity: signs of stabilization.

EUR



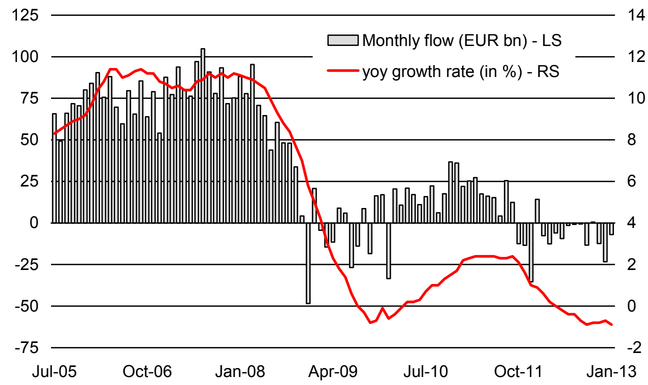
■ Trade-weighted EUR off peak.

LABOR MARKET



■ Unemployment rate still on 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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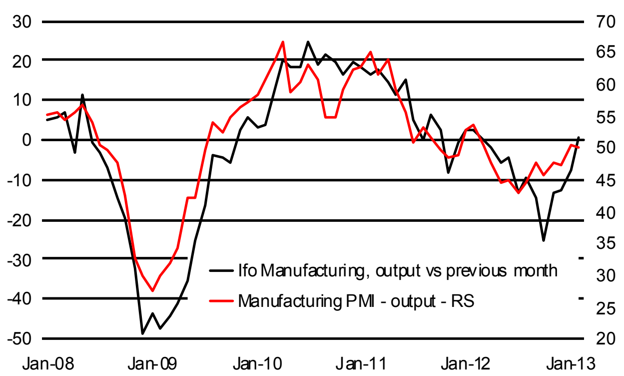
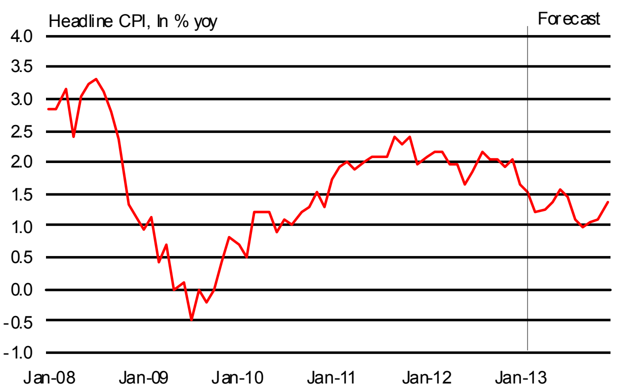
- German GDP was down a strong 0.6% qoq in the final quarter of 2012. The weakness was driven by industry. Exports were down substantially after still showing resilience in the preceding summer quarter. Moreover, investment in machinery & equipment declined for the fifth consecutive quarter. In contrast, consumption made another moderate positive contribution to quarterly GDP growth.
- Industrial production did not jump start into 2013, either. Output stalled in January. However, we remain confident that hard data will follow the recent pronounced rebound in business sentiment. It has not only been firms' expectations – which could paint an overly optimistic picture of the business outlook – that have contributed to the improved sentiment. But also the assessment of actual demand and production has climbed back above the expansion threshold in both, the Ifo as well as the Manufacturing PMI survey, in the first two months of 2013 (see left chart below).
- Moreover, the latest surveys on corporate investment plans and domestic industrial sales of capital goods bode well for a turnaround in investment in machinery & equipment. Construction, on the other hand, might still be negatively affected by the cold and snowy winter weather in February. But considering the good start into the year in construction output, the impact on GDP should not be large. Last but not least, although monthly retail sales figures are very volatile and revision-prone, the jump of 3.1% mom for January clearly argues for at least another moderate GDP impulse from private consumption at the beginning of 2013.
- The positive trend in domestic consumption is backed by the solid labor market and decent wage hikes. Employment continued its upward trend at the beginning of 2013 and already available tariff agreements for this year signal wage growth of close to 3%. Public sector employees just negotiated an average annual wage increase of 2.8% for this and next year. Together with ongoing disinflation, this leads to visible real income gains. Headline inflation fell further to 1.5% in February. In addition to lower pressure from commodity prices, administrative price declines and also statistical changes should bring down the inflation rate more than expected this year. We now expect average annual inflation of 1.3%, after 2.0% in 2012 (see right chart below).

MANUFACTURERS REPORT INCREASING OUTPUT AGAIN



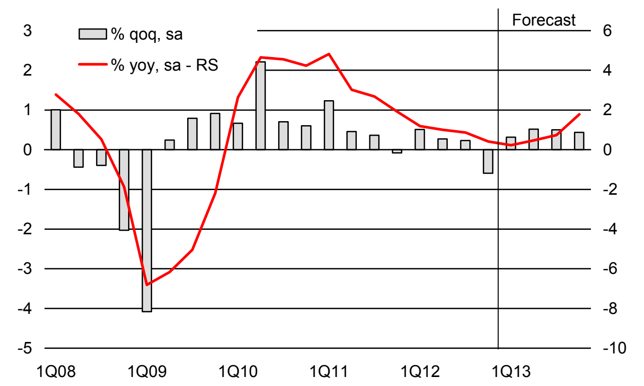
INFLATION EASES FURTHER IN 2013



Source: Ifo, Markit, FSO, UniCredit Research

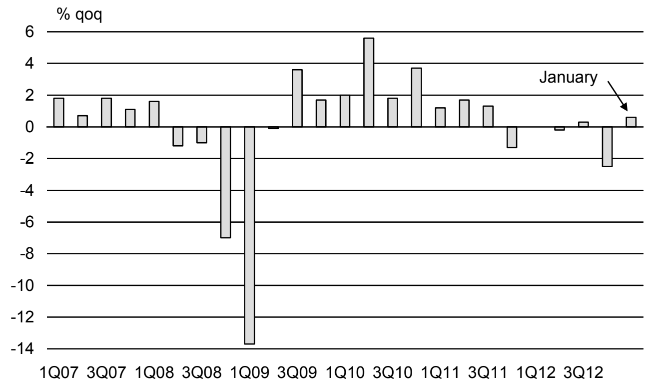
Germany

GDP



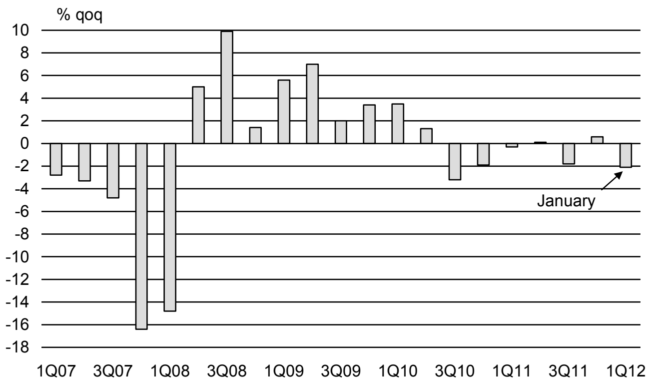
- GDP fell a strong 0.6% qoq in 4Q12, dragged down by industry. In contrast, consumption made a positive contribution.

PRODUCTION



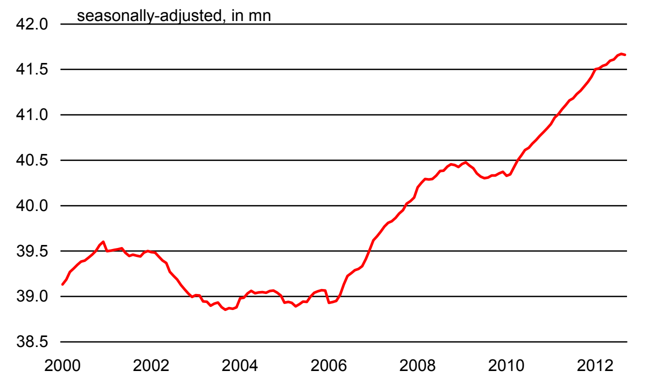
- Manufacturing production was down 0.2% mom in January, but is up 0.4% versus 4Q12, after the slump in the previous quarter.

NEW ORDERS



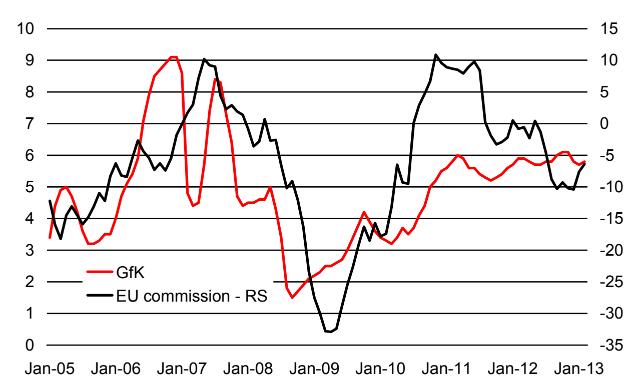
- New orders disappointed in January, down 1.9% mom. However, govt. officials reported strongly below-average bulk orders.

EMPLOYMENT



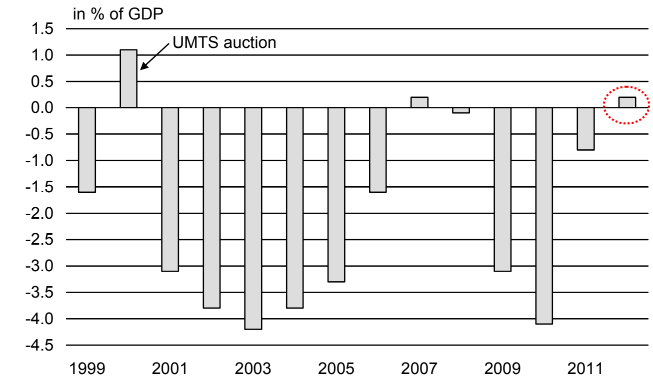
- Employment increased another 25k mom at the beginning of 2013.

CONSUMER CONFIDENCE



- Consumer confidence recently increased again, thanks to the resilient labor market.

GENERAL GOVERNMENT BUDGET BALANCE



- The general government balance was +0.2% of GDP in 2012, strongly supported by a high social security insurance surplus.

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

France

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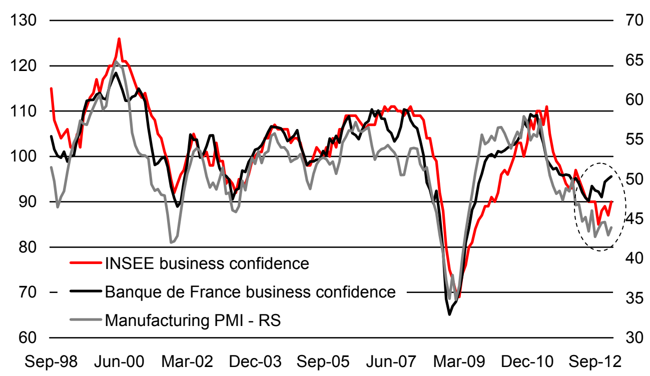
- Following a temporary blip in January, business sentiment indicators recorded a generalized (moderate) improvement in February, although current levels remain soft compared to long-term averages. The momentum in economic activity is apparently driven by manufacturing, whereas the services sector appears to be lagging behind to date, most likely reflecting ongoing pressure on domestic demand – the services PMI rose marginally to 43.7 in February, leaving the January-February average well below the fourth quarter of last year (43.6 vs. 45.2 in 4Q12). At face value, the latest readings for manufacturing surveys other than the PMI – the latter has been recently more volatile and, in general, tended to underestimate hard data developments – point to a 0.2% qoq expansion in 1Q13 GDP, in line with our forecast. The INSEE's business confidence rose from 87 to 90 in February, while the Banque de France's business sentiment indicator was up from 95.1 to 95.6. In general, we expect the ongoing improvement in business surveys to continue, albeit at a moderate pace, and remain driven by the manufacturing sector, at least in the very near term.

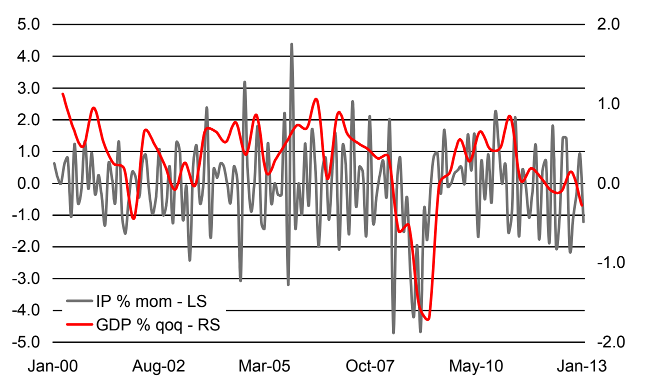
- Industrial production was particularly volatile at the turn of the year. Industrial output fell by a weaker-than-expected -1.2% mom in January, but the plunge followed a strong upward revision to the December reading from -0.1% to 0.9% mom, so that the entry into the first quarter was only slightly weaker than envisaged. Moreover, the output sub-component of the manufacturing PMI points to a moderate rebound already in February – the index rose from 40.8 to 41.8 in February. This suggests that the process of stabilization in industrial activity will continue in the near term, albeit at a gradual pace.

- Earlier this week, President Hollande announced that the 2013 fiscal deficit will most likely overshoot the 3.0% of GDP deficit target by 0.7pp, confirming previous indications that the target was out of reach. This brings the government's deficit target in line with the European Commission's deficit forecast, which is still based on barely flat GDP growth for this year. In this regard, Hollande refrained from commenting on the GDP forecast underlying the new deficit target. He only said that the government will try to make the deficit lower. Essentially, he appealed the European Commission for a more flexible approach to deficit reduction consisting of focusing on the structural rather than the headline deficit. Meanwhile, the French press is dominated by speculation about how to generate EUR 5bn savings in public expenditure in 2014. Ministers will have to submit their proposals to the ministry of finance by the end of the month.

MANUFACTURING PMI IS LAGGING BEHIND OTHER SURVEYS



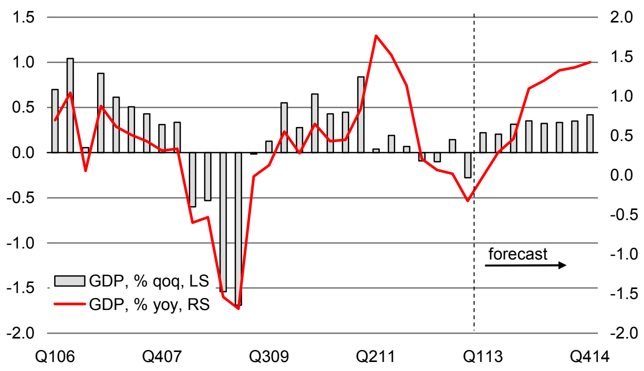
IP WAS VERY VOLATILE AT THE TURN OF THE YEAR



Source: INSEE, Markit, UniCredit Research

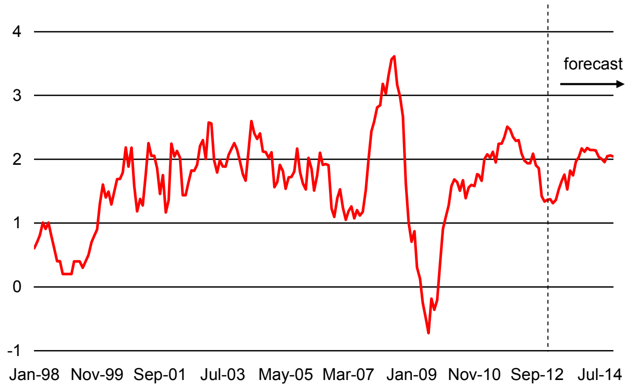
France

GDP



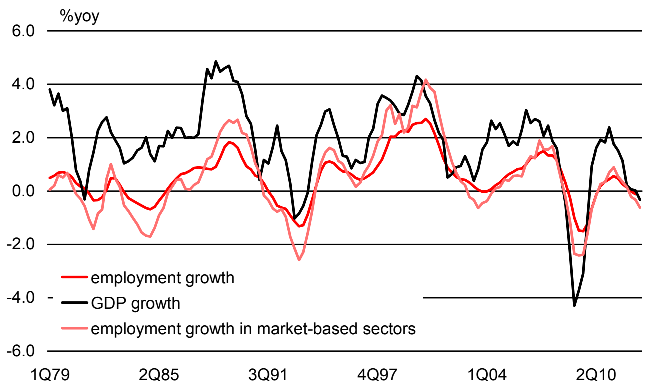
- We expect modest positive GDP growth in 1Q, with a very gradual acceleration in qoq growth in the rest of the year.

INFLATION



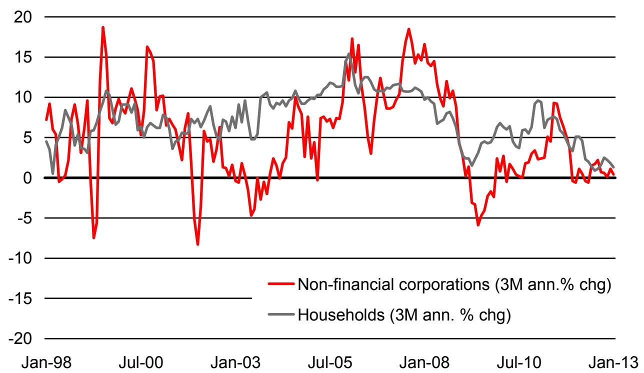
- CPI edged down to 1.0% in January. We currently see inflation averaging 1.3% in 2013.

EMPLOYMENT



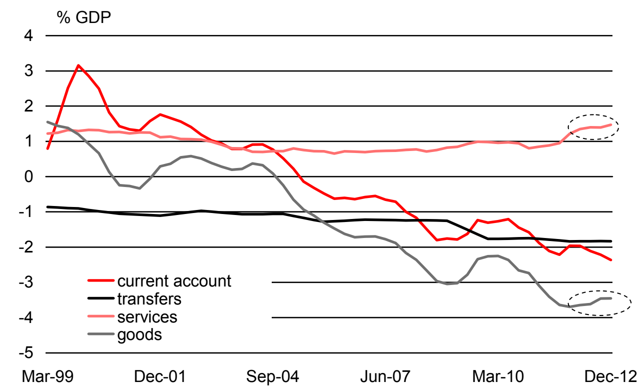
- Employment continues to contract. At the end of last year, private-sector employment shrank by 0.3% qoq.

LENDING TO THE PRIVATE SECTOR



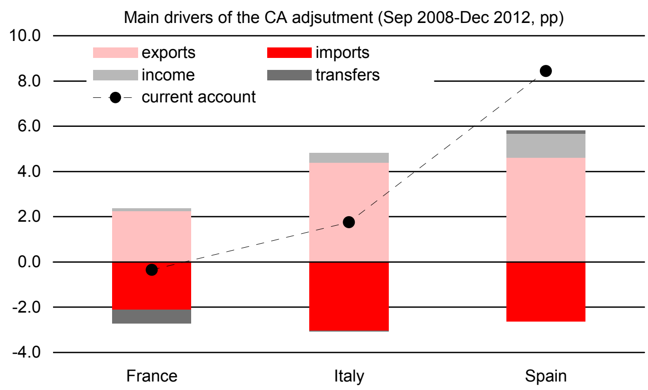
- Lending growth to the private sector remains subdued but marginally positive.

CURRENT ACCOUNT



- The CA settled at 2.4% of GDP in 2012.

CURRENT ACCOUNT – MAIN DRIVERS



- Exports nearly totally offset the drop in imports and transfers.

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

Italy

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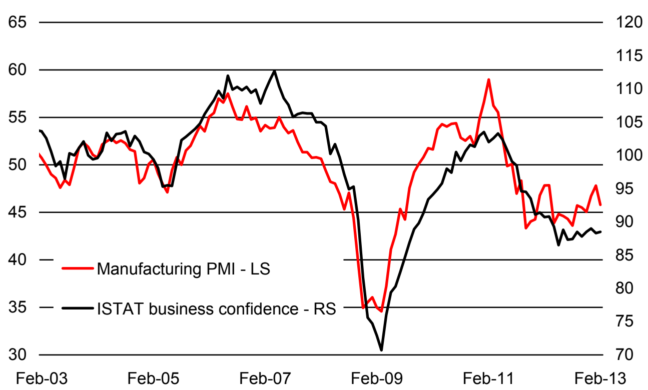
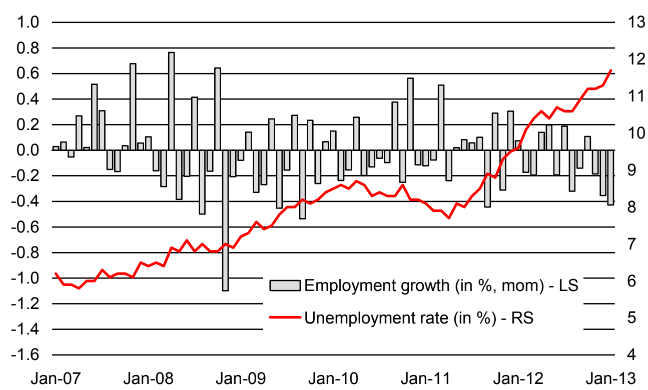
- Business surveys showed some sign of fatigue in industrial activity at the beginning of the year. The ISTAT business confidence recorded only a modest recovery in February (88.5), following a sizeable decline in January (to 88.3 from 89.0). The manufacturing PMI, while performing very well at the turn of the year, turned to be particularly weak in February (falling to 45.8 vs. 47.8), interrupting the recovery trend. All this implies continued weakness in factory activity – with soft indicators suggesting an outright contraction at the beginning of the year and a contained easing in the pace of industrial recession in 1Q13. This subdued dynamic is mostly due to persistently weak domestic demand, which is likely to offset the support coming from solid foreign demand: the new exports orders sub-index of the manufacturing PMI, for example, now stands well above the 50 expansion threshold.
- On the labor market front, the unemployment figure for January showed a sizeable increase from 11.3% to 11.7%, the highest level since January 2004 (when referring to the monthly series). The surge in the unemployment rate was due to a significant further decrease in the number of employed (-98k vs. -81k in December), together with a new slight decline in the number of inactive people (-10k). The latter had showed an acceleration (+103k) between November and December 2012, providing preliminary evidence of an increasing discouragement effect. The ISTAT also stated that the 2012 unemployment rate was 10.7%, compared to 8.4% in 2011.
- Two weeks after the election, political uncertainty remains in Italy. President Giorgio Napolitano will start government consultation on 20 March and he will most probably first give Pier Luigi Bersani (as head of the coalition having the absolute majority in the Lower House) the task of trying to form a government. The Five Star Movement (M5S) has made it clear that the movement should not ally with any party or back any confidence vote in parliament. This makes it increasingly difficult that we will see a Bersani-led minority government (with some support from M5S in the Senate). This would leave two ways for President Napolitano to form a government: he could try to put together a grand coalition, including at least the PD and Silvio Berlusconi's PDL, but if this solution proves to be too difficult, then we would see a temporary government and new elections within the next twelve months.

BUSINESS SURVEYS: SEARCHING FOR A RECOVERY TREND



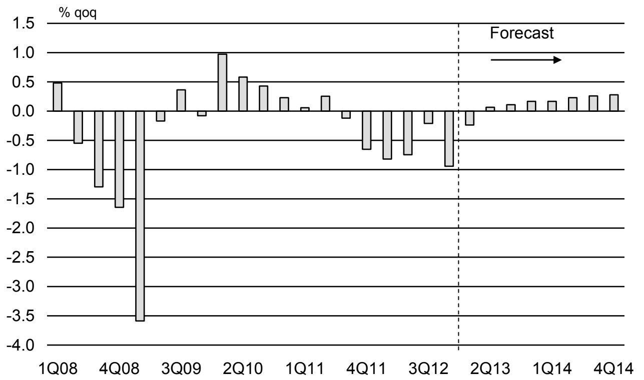
THE UNEMPLOYMENT RATE HAS RISEN SHARPLY



Source: Markit, ISTAT, UniCredit Research

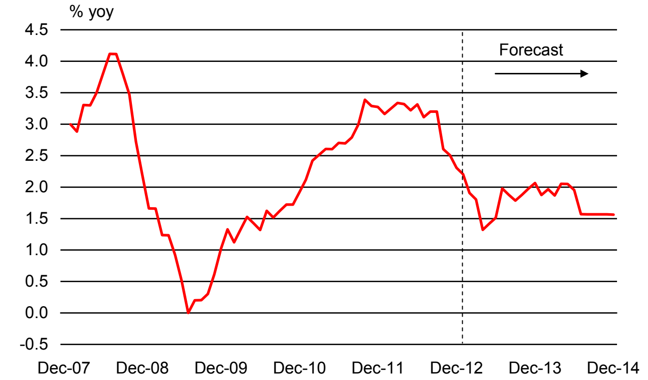
Italy

GDP



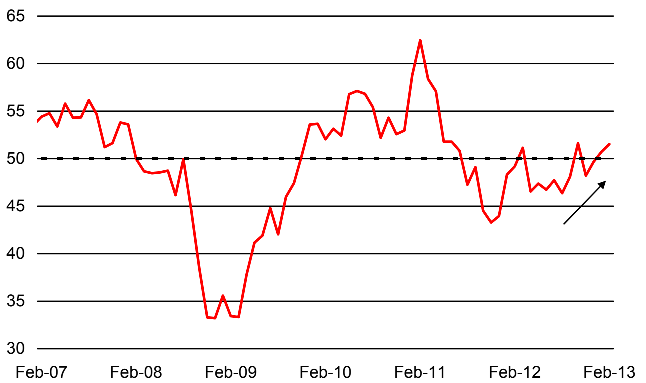
- We continue to expect GDP to fall by 0.2% qoq in 1Q13, although we acknowledge some downside risks to our call.

INFLATION



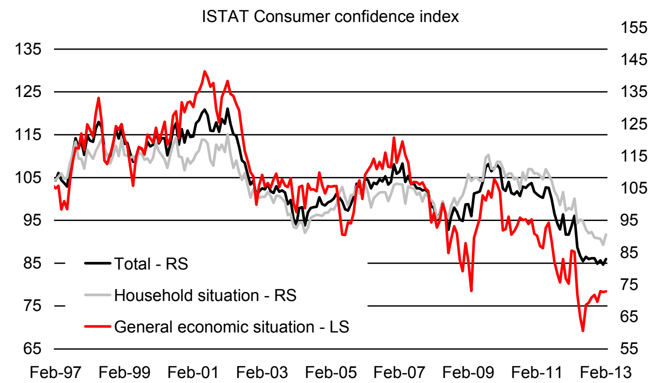
- CPI inflation showed a further decline to 1.9% in February (vs. 2.2%). We expect the downward trend to continue in 1H13.

MANUFACTURING PMI: NEW EXPORT ORDERS INDEX



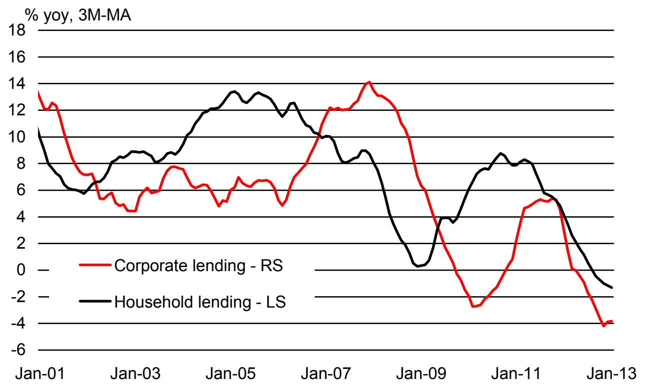
- The export orders component of the manufacturing PMI rose for the third consecutive month in February (to 51.5).

CONSUMER CONFIDENCE



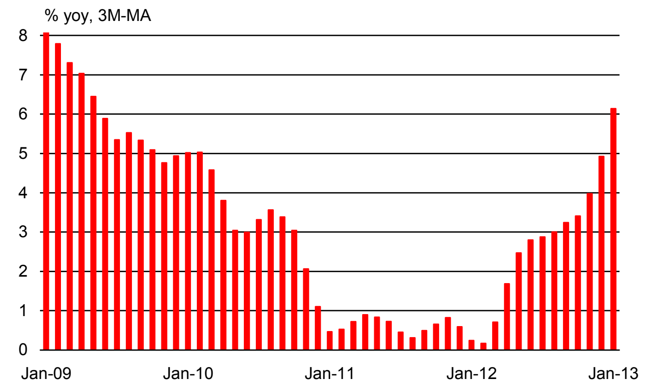
- Consumer confidence remains near its all-time low.

LENDING TO HOUSEHOLDS AND CORPORATES



- Corporate lending continued contracting at a significant pace in January.

HOUSEHOLD DEPOSITS



- The recovery in household deposits looks well entrenched: the yearly growth (3-month average) rose to about 6.0% in January.

Source: Istat, Markit, Bank of Italy, UniCredit Research

Spain

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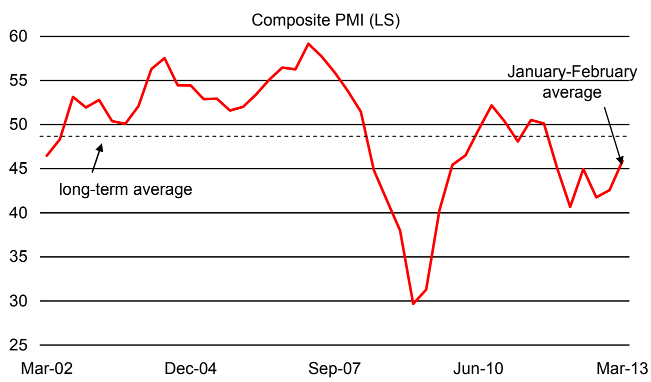
- Latest business surveys and hard data suggest that the pace of recession slowed down at the beginning of the year. In February, the composite PMI dropped from 46.5 to 45.3, but this decline reversed less than one-half of the rise recorded in the previous month. The January-February PMI average thus compares favorably with the fourth quarter of last year (45.9 vs. 42.9). Concerning hard data, industrial production edged down 0.1% mom in January, supporting a gradual softening of the pace of recession in factory activity (IP slumped -2.0% qoq in 4Q12). Retail sales (excluding cars) also marked an encouraging increase at the beginning of the year (ca. 1.0% mom in seasonally adjusted terms), although this was not enough to compensate for the large drop recorded in December (-2.2% mom). Overall, these data appear supportive of our expectation that 4Q12 GDP (-0.8% qoq) most likely represented the trough of this cycle. Our quarterly GDP profile foresees economic activity gradually recovering in the coming months, with GDP possibly returning into positive territory in 2H13.

- At the end of February, the government reported that the 2012 general government deficit settled at 6.74% of GDP (vs. 9.0% in 2011), excluding the one-off contribution to the financial sector, worth an additional 3.3pp. This better-than-expected outcome – the European Commission was expecting a reading slightly exceeding 7.0% – results from a successful consolidation at the regional level. The deficit of autonomous communities was up to 1.7%, undershooting the 1.5% target by a very thin margin. For this year, Spain still forecasts a 4.5% budget deficit, but it will probably revise up its target once the European Commission will officially allow the Spanish government more time to correct the deficit. We expect the European Commission to give a greenlight in the coming weeks.

- The Bank of Spain has recently released its estimate for the 2012 general government debt at 84.1%, slightly better than we had expected (our forecast was 86.5%). The 14.8pp increase compared to 2011 reflects, among other factors, the banking sector recapitalization cost, the impact of the non-recourse factoring operation (0.5pp) and operations related to the regional liquidity fund, FLA (1.6pp).

PMIS SIGNAL THAT THE WORST IS BEHIND US



2012 BUDGET DEFICIT WAS A TAD BETTER THAN EXPECTED

Net lending/borrowing position (% GDP)

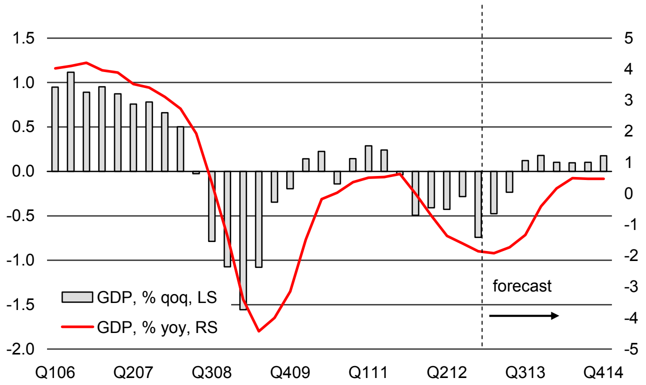
	2011	2012
Central government	-5.13	-3.83
Regional government	-3.31	-1.73
Local entities	-0.45	-0.20
Social securities	-0.07	-0.96
General government ***	-8.96	-6.74
Financial sector aid	0.48	3.25
General government	-9.44	-9.99

*** net of one-offs to the financial sector

Source: Markit, Spanish Treasury, UniCredit Research

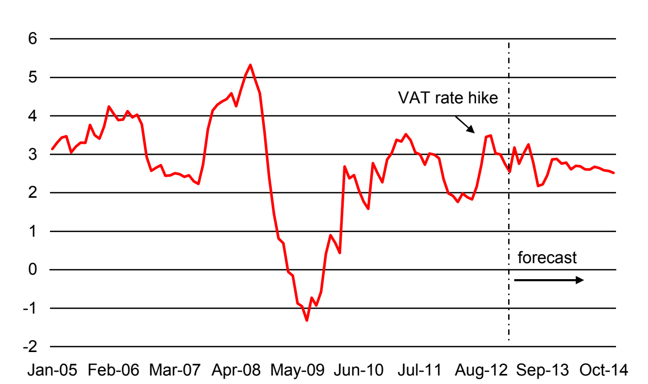
Spain

GDP



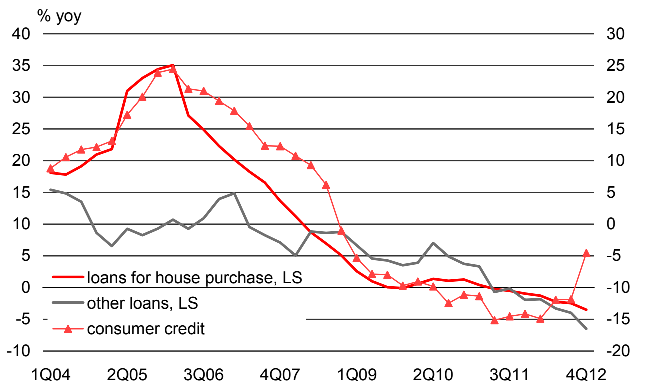
- We expect GDP to resume expanding in 2H13.

INFLATION



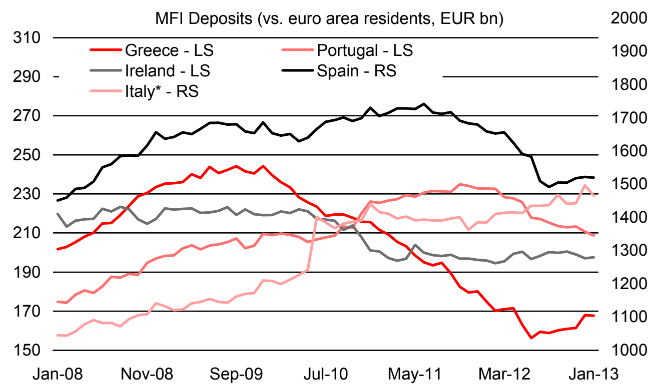
- In February, harmonized inflation edged up by a further 0.1pp to 2.9%.

HOUSEHOLD CREDIT GROWTH



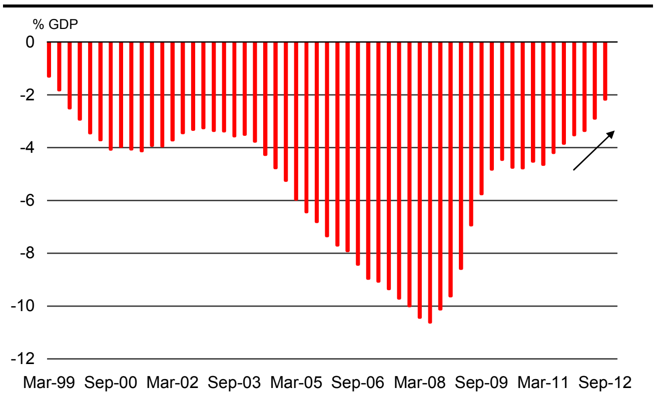
- The contraction in lending to households deepened further in 4Q12, with lending for consumer credit being the only exception.

BANK DEPOSITS



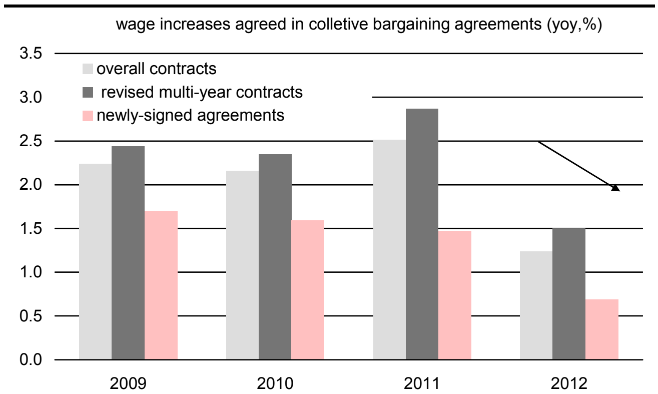
- The decline in deposits came to a halt in August 2012 and we have since been witnessing to a moderate increase.

CURRENT ACCOUNT



- The C/A deficit has been shrinking steadily, settling at 0.8% of GDP by end-2012.

NEGOTIATED WAGES



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

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

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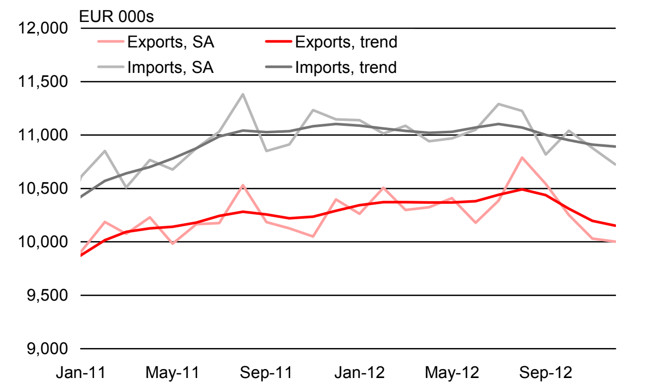
- In the second official estimate, Austria's GDP for 4Q12 was revised from -0.2% to -0.1% qoq. This leads to a minor change in GDP growth in 2012 as a whole from 0.7% to 0.8%. The revision affected mainly investments, with growth here slightly stronger. Gross fixed capital formation increased at least a little in every quarter, instead of the stagnation initially reported for 2H12. Gross fixed capital formation increased by 1.3% in 2012 as a whole (previous estimate: 0.8%) and was therefore a main driver of economic expansion, besides foreign trade. Exports increased by an unrevised 1.7% and imports rose by 0.8% in 2012.

- These minor changes to GDP in 4Q12 and 2012 as a whole are fully in line with our initial forecast and therefore we do not change our view on 2013. We still expect a turnaround in 1Q with a small GDP increase of 0.1% qoq and stronger growth in the subsequent quarters of 2013, bringing full-year GDP growth to 0.9%.

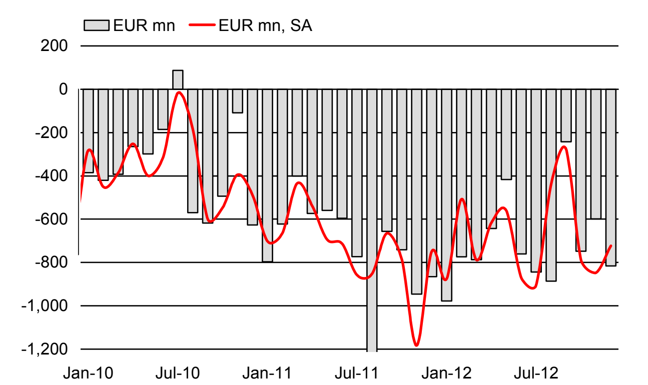
- In February the annual inflation rate of the consumer price index amounted to 2.5% (January: 2.7% revised). Yearly inflation was mainly driven by prices for "housing, water and energy" (+3.2% yoy) as well as by prices for "food and non-alcoholic beverages" (+3.3% yoy). The price increase for mineral oil products declined to +0.4% yoy and only had a small impact on inflation this month. Due to the very sluggish economic recovery, we expect a yoy decline in average inflation to 2.2% for 2013, after 2.4% in 2012. However, the downwards trend will emerge only slowly and not become more pronounced until the second half of the year. Food prices, among other things, continue to drive inflation up. We consider the risk of commodity prices providing another surprise and pushing the rate up even further as very low in view of the rather restrained trend of global demand in 2013.

- The deepening recession in Austria's most important export destinations during the fourth quarter of 2012 is clearly reflected in the performance of foreign trade. Exports recorded their fourth consecutive month-on-month decline (seasonally adjusted), with the pace slackening slightly in December. For 2012 as a whole, this results in an increase in exports of goods of only 1.4% on average in comparison with the prior-year period (2011: +11.3 %). At 0.7%, import growth was slightly lower, leading to an improvement in the balance of trade. At EUR 8.5bn, the trade balance deficit in 2012 was around EUR 700m lower than in the previous year.

FOREIGN DEMAND CONTINUES TO DECLINE



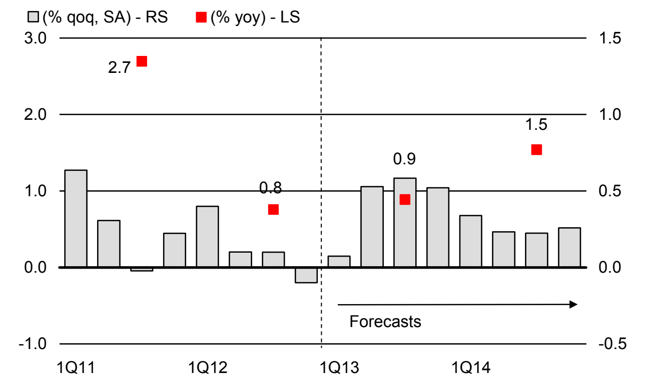
TRADE BALANCE SLIGHTLY IMPROVED IN 2012



Source: Statistik Austria, WIFO, UniCredit Research

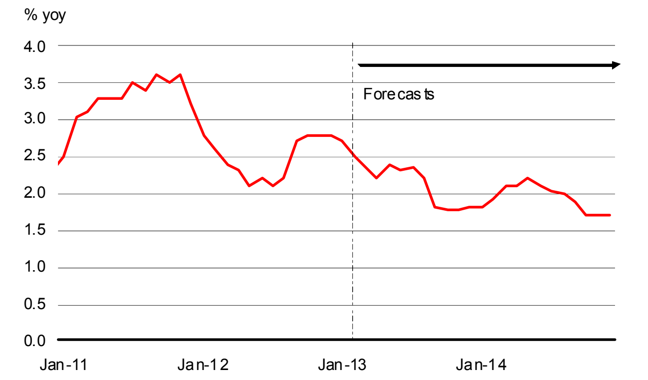
Austria

GDP



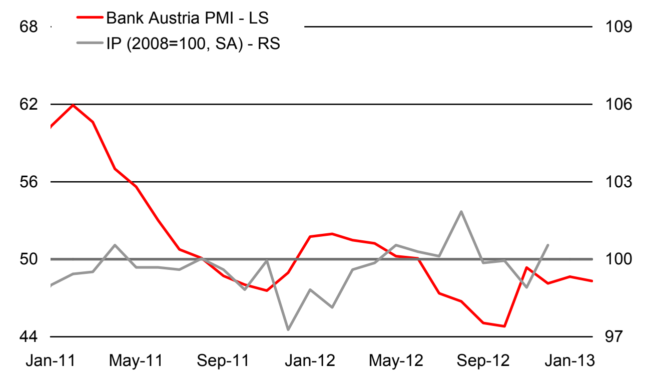
- GDP in 4Q12 was recently revised from -0.2% qoq to -0.1% qoq, mainly due to better investment data.

INFLATION



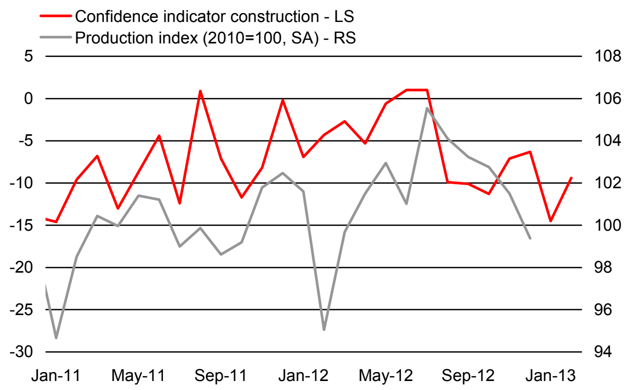
- The downwards trend continued in February, bringing annual inflation to 2.5%. Compared to January, prices are up by 0.3%.

PMI AND INDUSTRIAL OUTPUT



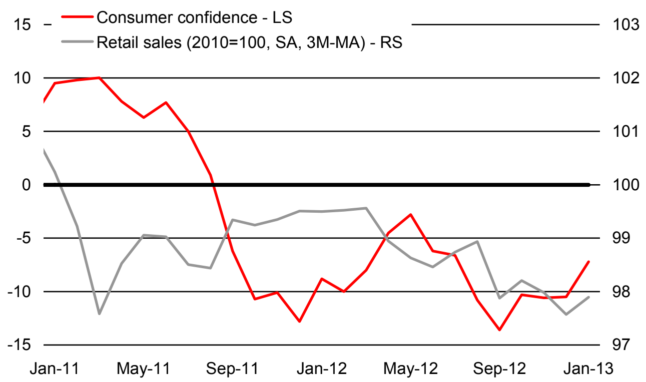
- Manufacturing companies have made it out of the economic slump, but there are still no signs of a marked improvement.

CONSTRUCTION



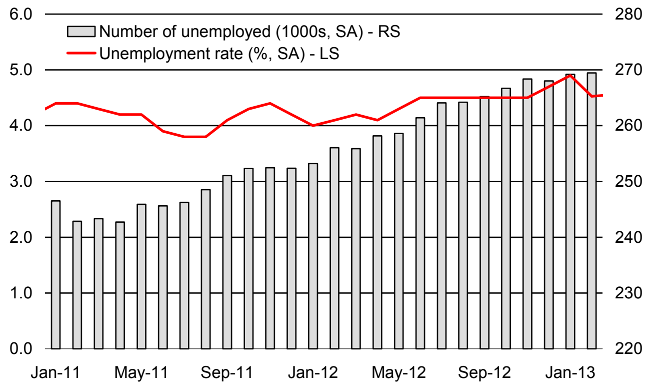
- Growth in the construction sector averaged 1.7% in 2012, but falling sentiment points to a weak start to 2013.

RETAIL SALES



- Recent slightly brighter consumer sentiment suggests a slight improvement in the prospects for retail sales in 2013.

LABOR MARKET



- The deterioration of the situation on the Austrian labor market continued at the start of 2013.

Source: Statistik Austria, UniCredit Research

Greece

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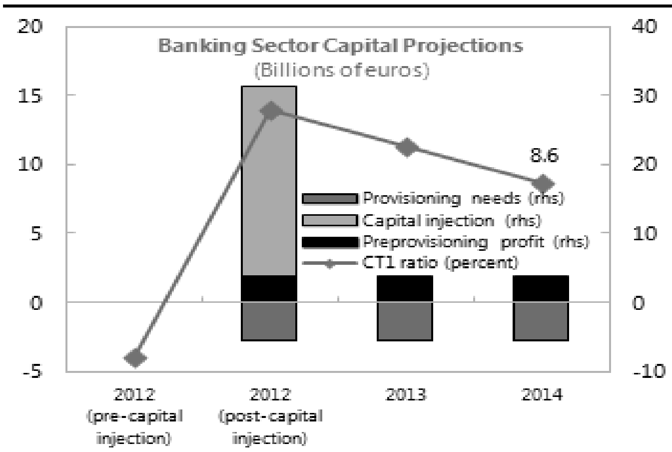
- Major news on Greece concerns the Troika's new review mission which is set to evaluate whether the conditions are in place for the disbursement of the next loan installment of EUR 8.8bn (including the last EUR 2.8bn sub-tranche of the December tranche and the EUR 6bn tranche earmarked for 1Q13). This review is still pending. After two weeks of discussion, the Troika decided that additional work was necessary to finalize a few issues and it left Athens. Talks with the national authorities will probably resume in early April, raising the chances that the loan tranche disbursement will be delayed. In this regard, government officials called for splitting the EUR 8.8bn tranche into two parts, so that the EUR 2.8bn tranche could be possibly released earlier.

- The main outstanding issues for negotiation consist in the details of the transfer of additional 25k public sector employees to the labor mobility scheme in 2013, the replacement of the special property tax (FAP) that was levied in 2010-2012 with a new tax that aims at covering properties that are currently exempted, and a new framework for the settlement of arrears. Specifically, the details of the labor mobility arrangement are reported as the main source of friction between the troika and the national authorities, who have so far mainly relied on natural attrition and the application of the agreed hiring rules to reduce the number of public sector employees.

- In regard of bank recapitalization, the Greek press reports that the banking sector will probably obtain a one-month extension of the April 2013 deadline for recapitalization. The main challenge for banks is to reach the threshold of 10% for the participation of private investors in the new common equity capital. Recent talks have focused on the room for offering private investors some incentives to participate in the capital of credit institutions but no conclusions have reportedly been reached.

BANKS RECEIVING AID WILL NEED TO ENSURE MLT VIABILITY



Sources: Bank of Greece; and IMF staff estimates.

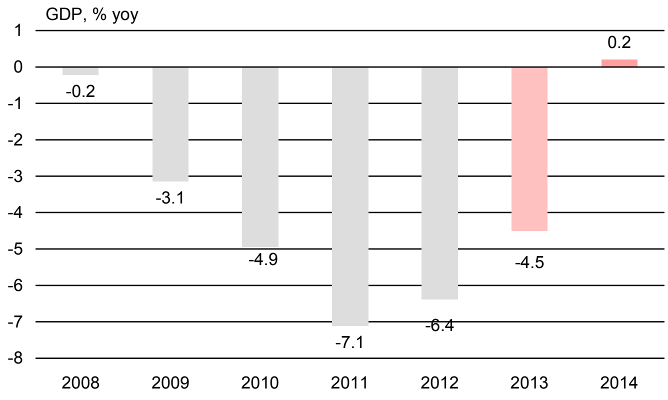
UPDATED CAPITAL NEEDS OF THE BANKING SECTOR, 2012

Banking sector envelope, EFF	**50.0**
Factors increasing the envelope	**2.4**
Higher recap. costs for the core banks	0.6
Resolution of cooperatives	1.3
Higher ATE resolution costs	0.5
Factors decreasing the envelope	**3.0**
Lower resolution cost for banks other than ATE	1.0
Capital from acquisition of foreign subs	0.7
Conversion of hybrids into equity	0.6
Reduction of CT1 target to 9 percent	0.7
Debt buy-back	0.0
Banking sector envelope, Dec. 2012	**49.4**
Memorandum item:	
Deferred tax credit	0–4.4

Source: IMF, UniCredit Research

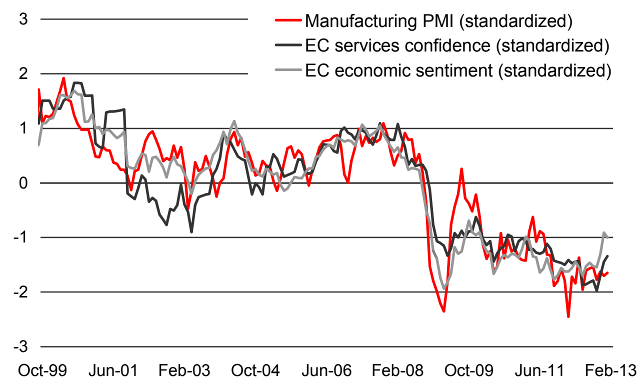
Greece

GDP



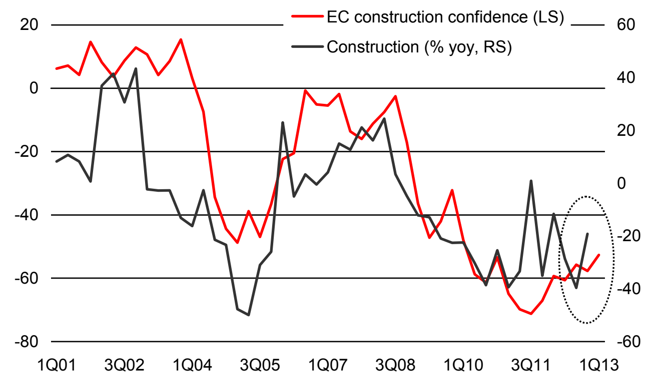
■ Greece may exit recession next year.

SURVEYS



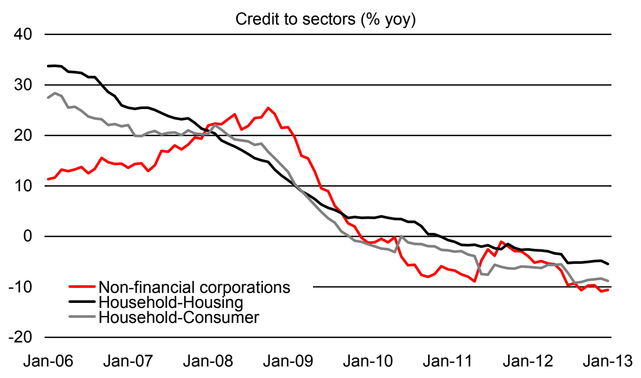
■ Sentiment is improving, albeit from very low levels.

CONSTRUCTION



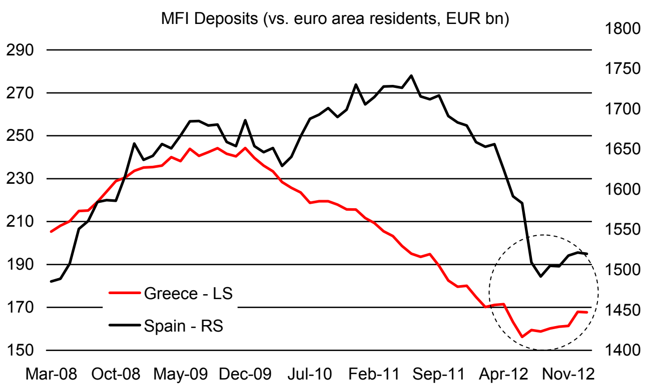
■ The EC survey of construction activity suggests that sectoral output fared well in 1Q13.

CREDIT GROWTH



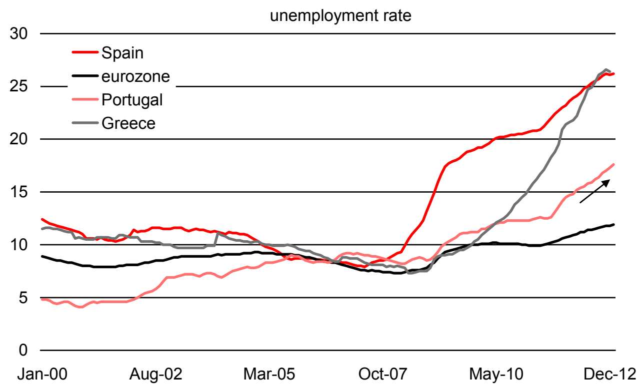
■ Credit continues to shrink, albeit at a modest pace and especially for NFCs.

DEPOSITS



■ There has been a re-flow of deposits since the last summer.

UNEMPLOYMENT



■ The unemployment rate is skyrocketing, having reached 26.4% by end-2012.

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

Portugal

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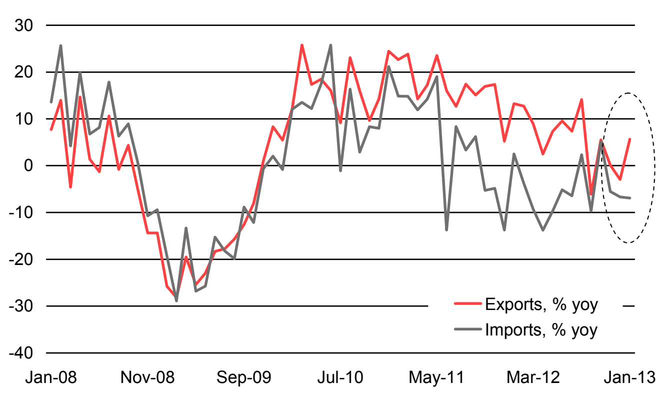
- The few surveys and available hard data suggest that the pace of recession slowed down in the first quarter, and the slump in economic activity recorded in 4Q12 (-1.8% qoq) probably marked the trough of this cycle. On an encouraging note, the European Commission economic sentiment marked a firm rebound in February (from 79.2 to 81.5), more than offsetting the January decline. Moreover, after the soft performance recorded at the end of last year, export growth appeared to have regained traction in January (+5.6% vs. -2.9% yoy in December), also benefiting from firmer demand from within the eurozone, whereas import growth broadly stabilized at the December level (-6.9% vs. -6.7% yoy in December). Our quarterly profile foresees GDP recovering gradually in the coming quarters, with the economy returning to modest positive growth towards the end of the year. Please note that the Troika's has recently aligned its GDP forecast to our projection (-2.5%) and now foresees GDP shrinking 2.3% in 2013, after -3.2% in 2012.

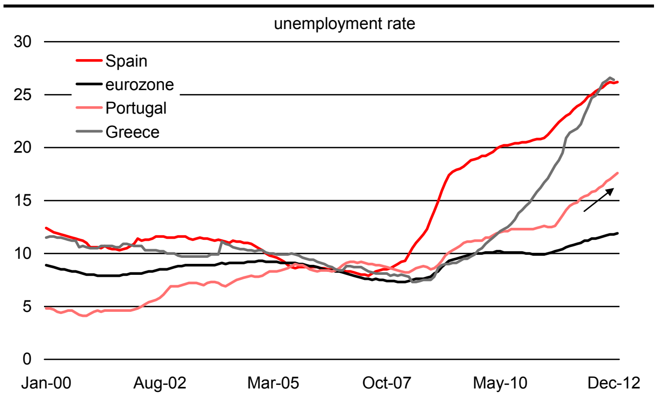
- The Troika concluded its seventh review mission in Lisbon last week amid reportedly less smoothed than usual discussions with national authorities. Eventually, the Troika supported Portuguese authorities' request for a less frontloaded path of deficit correction to allow the free operation of automatic fiscal stabilizers. This concession stems from the recognition of the considerable public disquiet with the planned austerity measures for 2013, in a context in which the number of unemployed has reached record highs (17.6% in January 2013). Incidentally, the Troika revised up, once again, its unemployment forecast, and now expects unemployment to peak at over 18%. Deficit targets were revised up from 4.5% to 5.5% of GDP in 2013, and from 2.5% to 4.0% in 2014. The target for 2015 was set at 2.5%. It is worth highlighting that Eurostat ruled against the use of revenues from the airport concession for the purpose of deficit reduction. This implies that the 2012 deficit will be ca. 1.7% higher than initially announced by the government including the proceeds of the concession (about 6.6%).

- 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. Following the Troika's decision to provide the country with more time to correct its fiscal balances, we think that a negative ruling by the court has little (if any) chance of putting the fiscal adjustment off course.

EXPORTS REGAINED TRACTION IN JANUARY



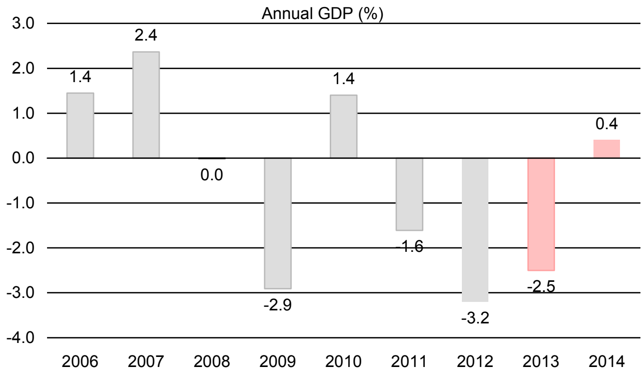
UNEMPLOYMENT HAS BEEN RAISING SHARPLY



Source: Eurostat, IMF, UniCredit Research

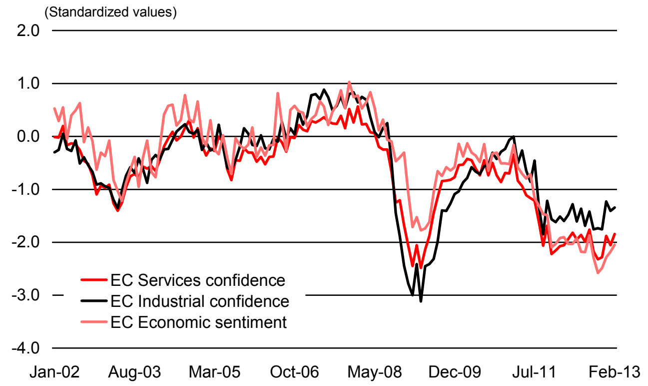
Portugal

GDP



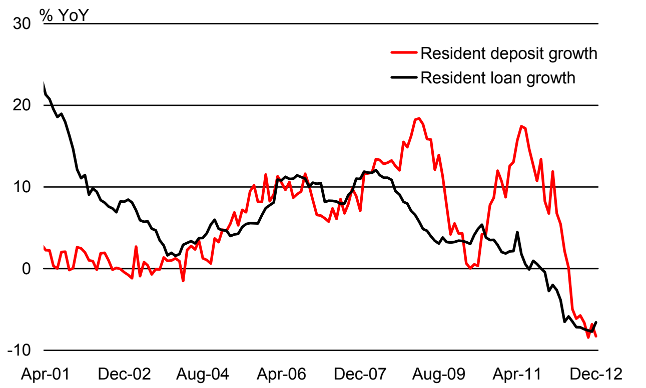
■ The recession will stretch into 2013.

SURVEYS



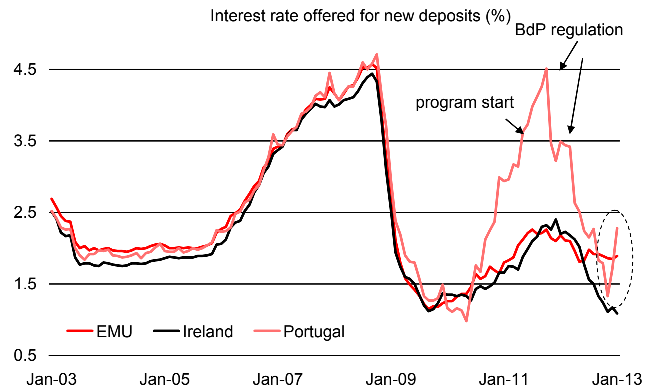
■ Sentiment shows signs of improvement, although from low levels.

DEPOSIT AND LOAN GROWTH



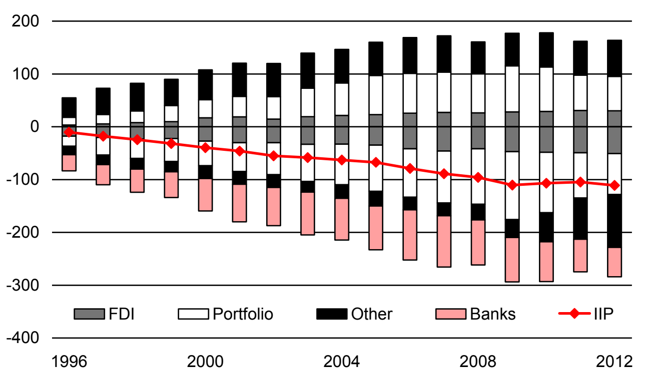
■ Deposit growth continues to slow…

DEPOSIT REMUNERATION



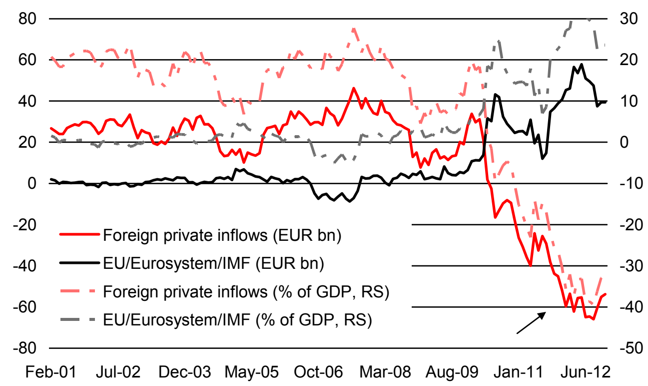
■ …partly explained by regulatory changes in their remuneration. However, the interest on new deposits recently rebounded.

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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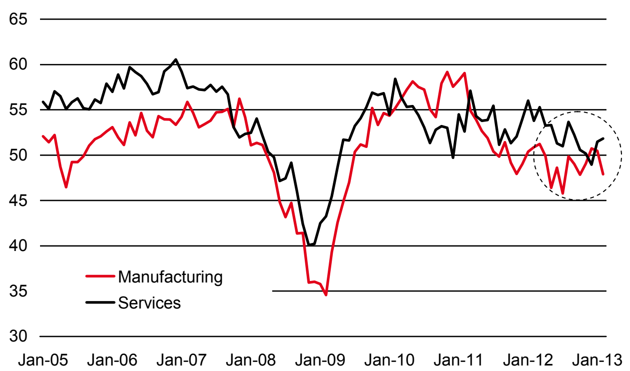
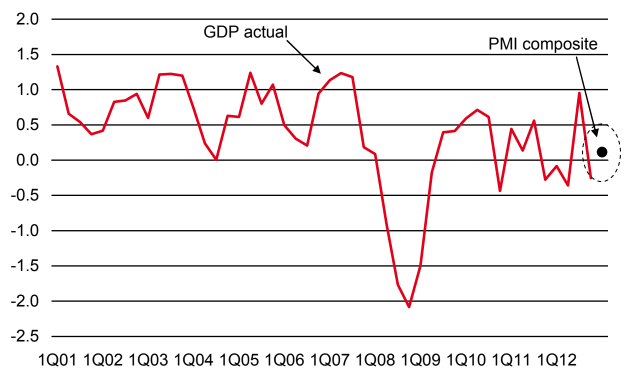
- Overall, activity data over the past month were on the weak side. The manufacturing PMI fell sharply from 50.5 to 47.9 in February, fully reversing the improvement seen between October and January. However, as the services PMI didn't mirror this fall (it rose from 51.5 to 51.8), our composite PMI remains consistent with our 1Q GDP forecast of +0.1% qoq (see charts below). IP fell 1.2% mom in January (manufacturing output was down 1.5%), more than expected, posing some downside risks to our GDP forecast, especially as the sharp fall in the manufacturing PMI in February indicates that there is little chance of a convincing IP rebound next month.
- There have been no new data on inflation since the previous Chartbook. After having remained at 2.7% for four months in a row, we expect inflation to rise to 2.9% in February, mainly driven by transport and a base effect from utility prices. 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 still remaining above target.
- It was an interesting month on the monetary policy side. First, the minutes of the February MPC meeting unexpectedly showed that three members of the MPC (including the governor) had voted in favor of more QE and that there was a broader discussion about other possible tools to provide more stimulus if needed. Overall, the minutes suggested that the MPC has more of an easing bias than we had previously thought. Second, various MPC members appearing before the Treasury Select Committee said that the BoE is considering new schemes to boost lending to SMEs. Therefore, we may see some news on this front in the coming months. Third, the BoE remained on hold on asset purchases at its March meeting, although we believe it was a relatively close call. Looking forward, our baseline does not anticipate further QE, although the risk has clearly increased, also in light of recent data. The April meeting will most likely be another close call.

MIXED PMI PERFORMANCE IN FEBRUARY



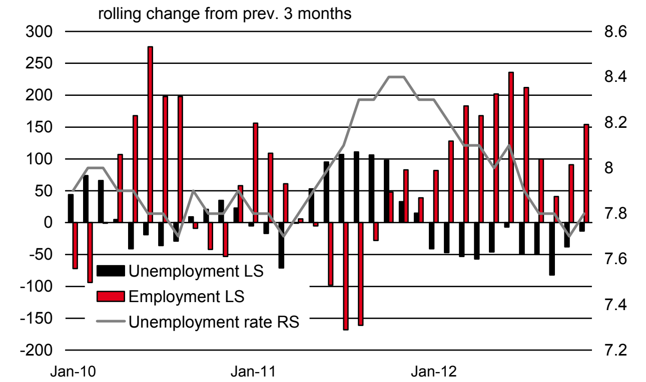
WE STILL EXPECT MODEST POSITIVE GROWTH IN 1Q



Source: Office for National Statistics, Markit, UniCredit Research

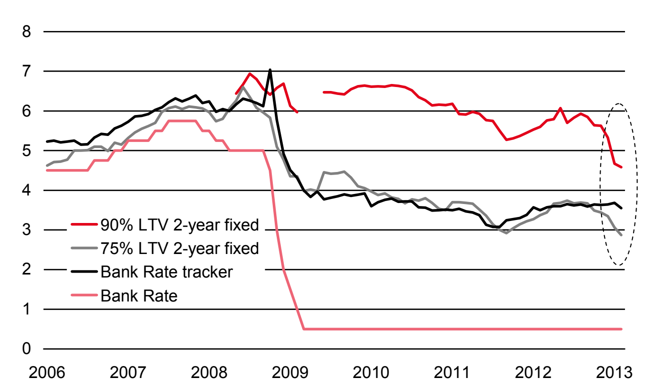
UK

LABOR MARKET



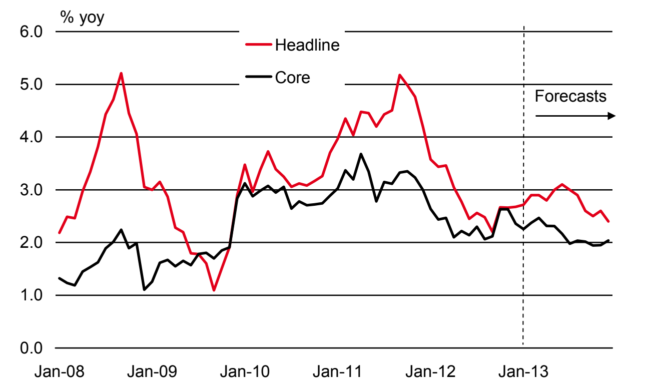
- Labor market continues to be relatively resilient.

QUOTED MORTGAGE RATES



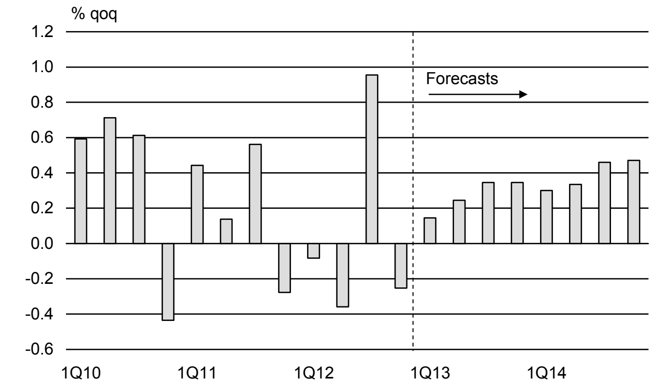
- Mortgage rates for the most popular products continued their downward trend in February.

CPI INFLATION (FORECAST FOR 2013)



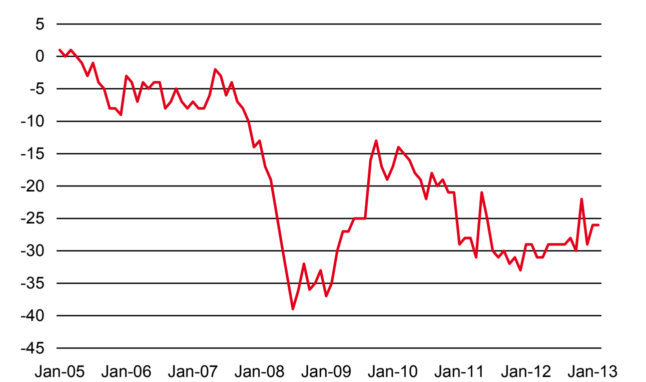
- Inflation remained stable in January but is likely to tick up in the coming months.

GDP FORECASTS



- We expect a very gradual recovery starting in 1Q13, but downside risks are increasing.

CONSUMER CONFIDENCE



- Consumer confidence remained stable at -26 in February.

STERLING EFFECTIVE EXCHANGE RATE

- The sterling effective exchange rate continues to point south.

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

Sweden

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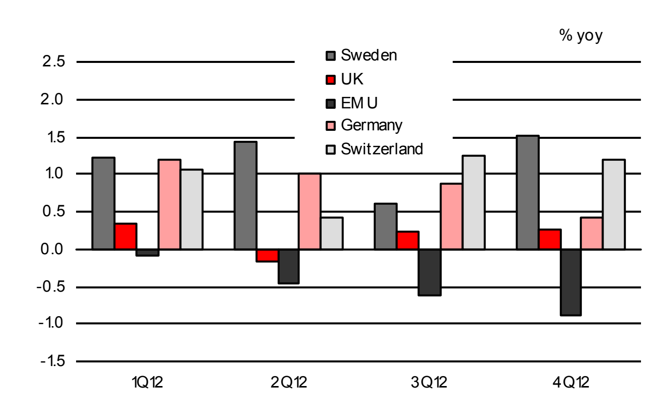
- GDP stagnated in 4Q12, a better outcome than we had expected (-0.3% qoq). This implies a slight upward revision to our GDP forecasts for 2013 (from 1.3% to 1.4%) due to the positive carry-over effect. Sweden's overall 2012 growth performance was enviable when compared to most other European countries (see left chart) and was due to the ability of the Swedish economy to shift its growth engine away from exports towards household consumption. In addition, the strength of investment was greater than expected (+4.0% in 2012), although this might change in 2013, as also indicated by the investment survey published by Statistics Sweden in February (see right chart).

- Business and consumer surveys continued to trend up in February. Consumer confidence improved from -2.9 to -1.0. The NIER manufacturing confidence rose from -17 to -11, while the manufacturing PMI rose from 49.2 to 50.9 in February, back above the 50-point threshold, indicating expansion. Taken at face value, these indicators suggest GDP expansion of 0.3% qoq (1.4% yoy) in 1Q13.

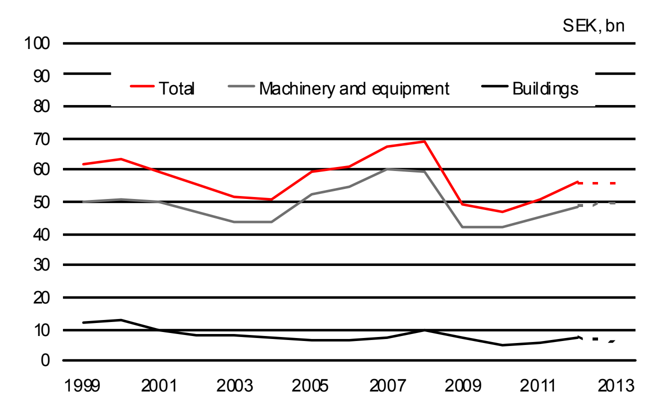
- In February, CPIF inflation, which excludes mortgage interest costs, edged down from 1.0% yoy to 0.9% yoy, while CPI inflation returned to negative territory at -0.2% yoy (vs. 0.0% in January). Looking forward, we expect CPIF inflation to oscillate around 1% during the full year 2013, while CPI inflation will likely resume a gradual accelerating trend after spring. Inflation expectations on a 5Y horizon, as reported by Prospera's quarterly Riksbank survey (covering purchase managers and labor market organizations), fell further from 2.0% to 1.9% in 1Q13. Respondents expect inflation to hover below the 2% target, even on a longer-term horizon, while expectations on a 1Y and a 2Y horizon remained well below 2%.

- High unemployment, low inflation and low inflation expectations might increase pressure on the Riksbank to cut rates. However, we think that the Riksbank will probably continue to assign more weight to the recent positive developments, which include the 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. Hence, we expect the Riksbank to remain on hold in April, also on the back of concerns about rising household indebtedness.

SWEDEN: GOOD GDP PERFORMANCE IN 2012



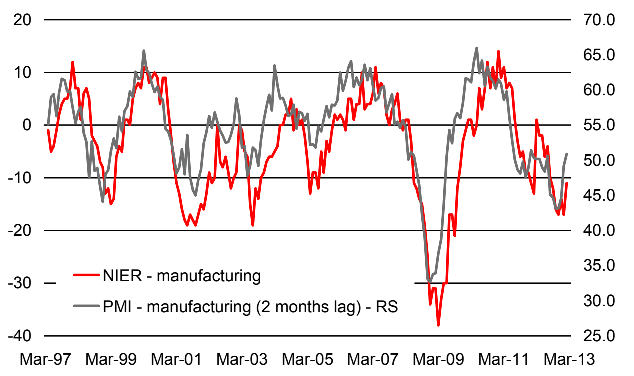
EXPECTED DECLINE IN INVESTMENT VOLUMES IN 2013



Source: Eurostat, FSO, ONS, SECO, Statistics Sweden, UniCredit Research

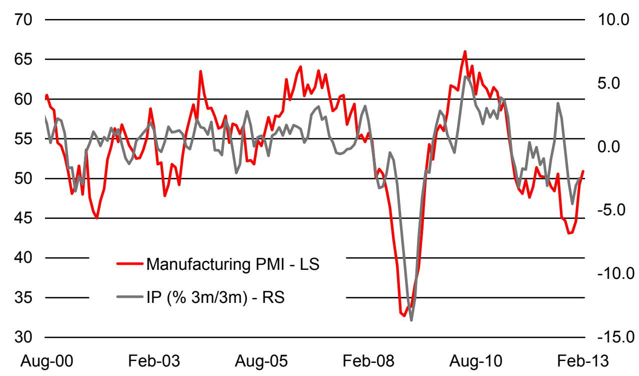
Sweden

BUSINESS SURVEYS



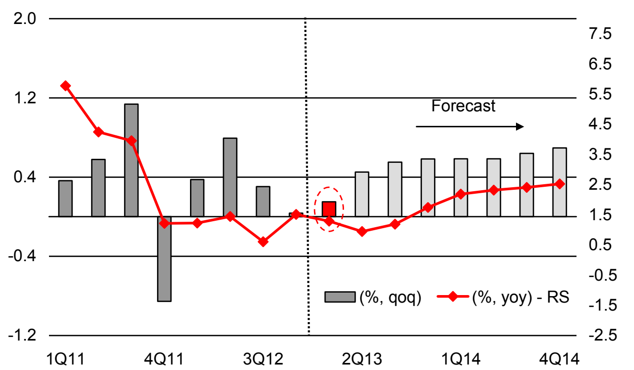
- The manufacturing sector seems to have approached a turning point.

INDUSTRIAL PRODUCTION



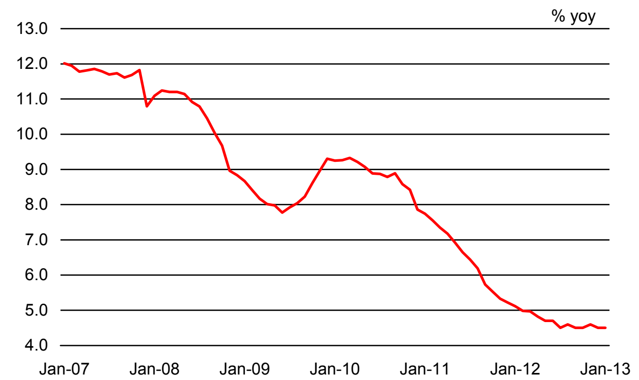
- IP fell abruptly to 2.0% mom in January. We regard this as a temporary setback and expect a rebound in February.

GDP



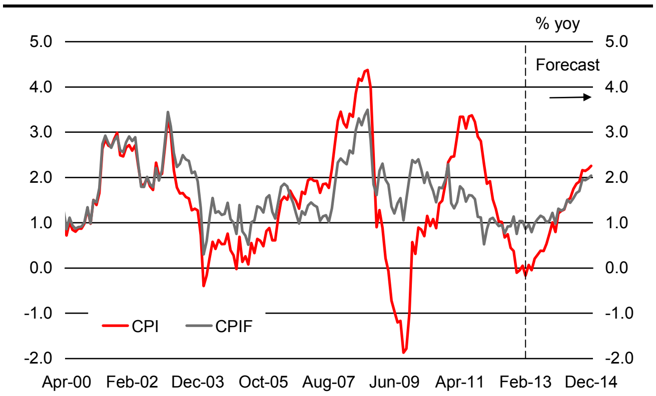
- After zero growth in 4Q12, the Swedish economy is expected to recover in 1Q13 (0.3% qoq, 1.4% yoy).

LENDING TO HOUSEHOLDS



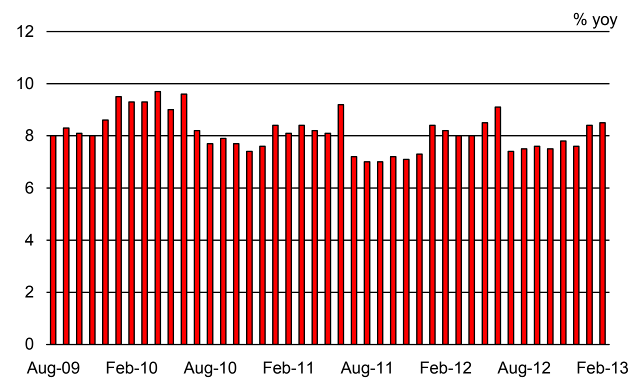
- Household credit growth was unchanged compared to the previous month and stood at 4.5% yoy in January.

INFLATION



- After being flat in January, inflation turned negative in February (-0.2% yoy). We expect it to resume a gradual accelerating trend following spring.

UNEMPLOYMENT RATE



- Non-seasonally adjusted unemployment has resumed its upward trend since January, when it accelerated to 8.4% (from 7.6% in December). The upward trend continued in February (8.5%).

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

Poland

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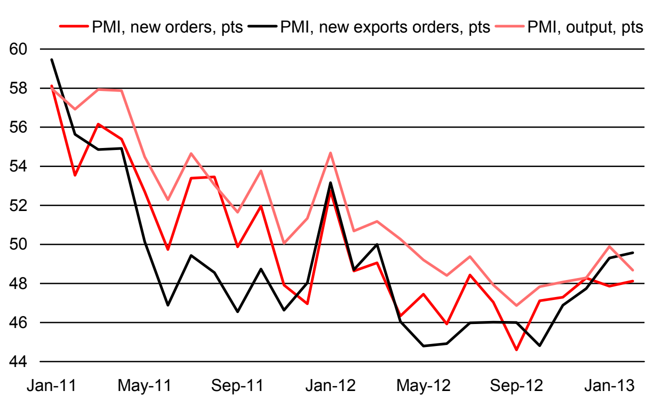
- Official statistical office data for 4Q12 did not shed any new light on the economy compared to estimates based on previous data. A sharp drop in individual consumption (-1.0% yoy) and a continued decline in fixed investments (-0.3% yoy), indicate that Poland's economy entered 2013 on a weak footing with poor domestic demand and GDP growth still being driven by net exports.

- In our view, Poland's economy is close to the bottom of the current downturn and after a soft first quarter (0.4% yoy), we foresee a gradual, albeit slow recovery in the second part of the year. Early indications of a bottoming out are already visible (and displayed in the charts below): the Polish PMI keeps edging higher, we have seen a strong rebound in new exports orders and, German IFO expectations, the primary leading indicator for Germany, recently jumped, suggesting surging demand also for exports from Poland (Germany is the single biggest recipient of exports from Poland – 25% of Polish exports go to Germany).

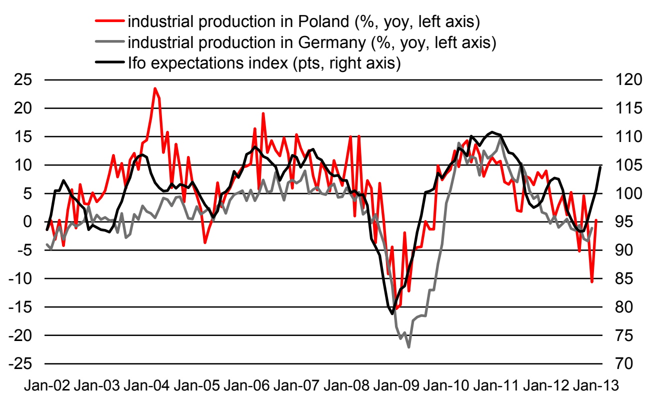
- The upcoming set of high-frequency data will likely confirm that the first quarter of 2013 was a difficult time for the economy. We forecast that industrial output fell 4.0% yoy and real retail sales dropped as well (nominal growth of merely 1.1% yoy). CPI surprised on the downside (1.3% yoy in February vs. 1.5% consensus). After very low wage dynamics in January (+0.4% yoy), stemming mainly from a high reference base in January 2012, when wages surged ahead of the disability pension contribution rise, February saw wage growth return to more fundamental levels (+4.0% yoy). Employment continued shrinking (-0.8% yoy) and the unemployment rate is expected to have trended upwards (to 14.6% yoy).

- The MPC surprised markets by slashing rates by 50bp – the majority of analysts had expected a 25bp rate cut. There were also some players who were speculating about there being no policy move at all. In the post-meeting press release, the Council stated that the March rate cut "complements" the monetary policy easing cycle initiated in autumn 2012. At the press conference, Governor Marek Belka declared that the MPC is now in "wait-and-see" mode. In our baseline scenario, we assume that the easing cycle has been completed and that rates are to remain at a record-low of 3.25% until the end of the year.

PMI KEEPS INCHING UP



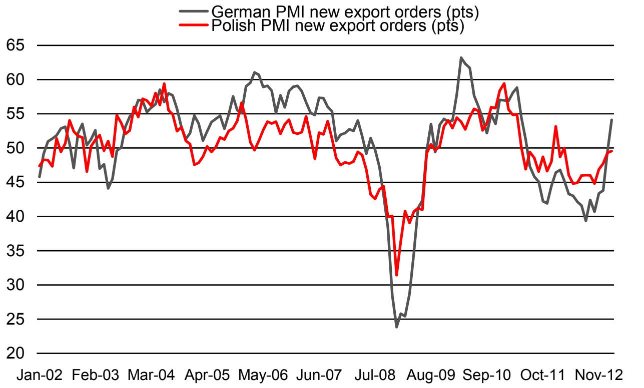
GERMAN REBOUND SET TO SUPPORT POLAND'S GROWTH



Source: GUS, UniCredit Research

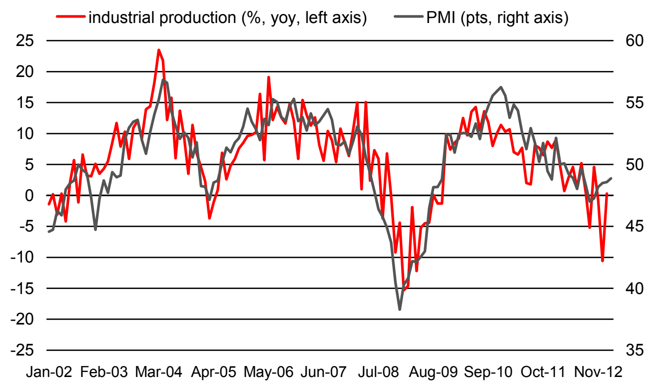
Poland

PMI NEW EXPORT ORDERS



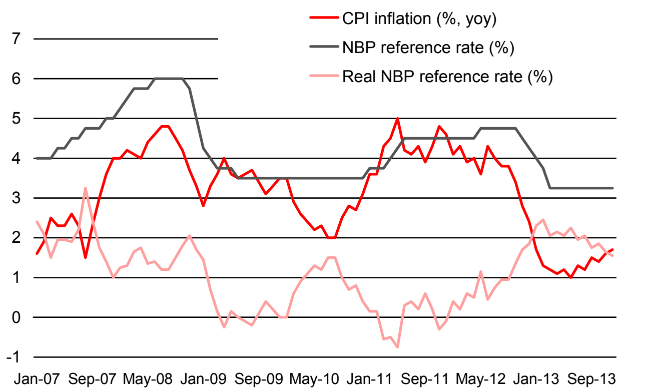
- Rebound in PMI – new export orders, both in the German as well as in the Polish PMI, seem to indicate a trough has been reached.

PMI AND INDUSTRIAL OUTPUT



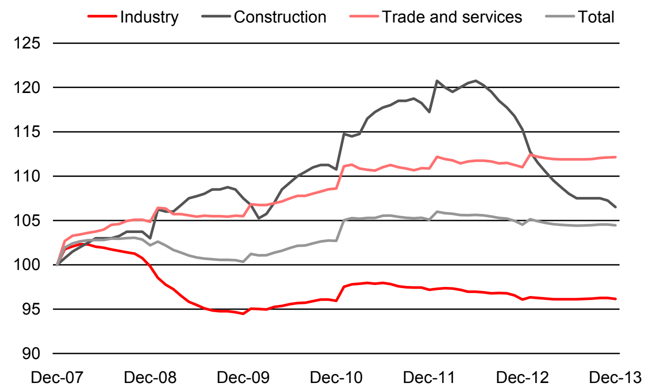
- Rebound in PMI suggests industrial output numbers are likely to keep improving in the coming months.

CPI INFLATION



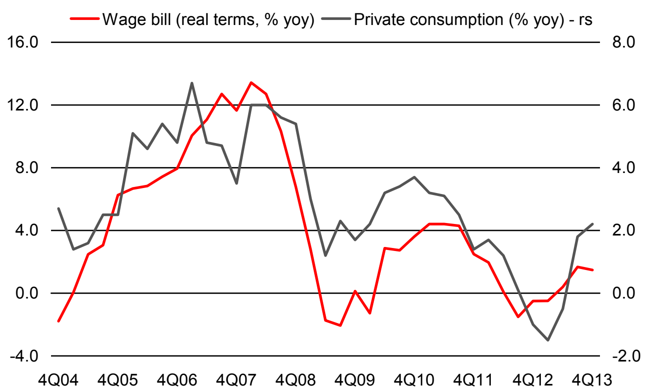
- CPI will likely continue its downward trend, towards 1.0% yoy in June, and then slightly rebound.

EMPLOYMENT



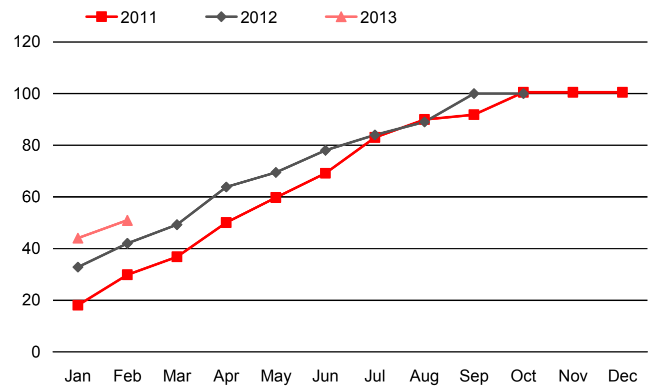
- Employment in industry and services will likely stay broadly stable in 2013; construction to see the largest adjustment.

CONSUMPTION AND WAGE BILL



- The wage bill and consumption are expected to rebound in 2H13, as inflation declines and consumer sentiment improves.

FINANCING OF BORROWING NEEDS (% OF YEARLY PLAN)



- The Ministry of Finance makes substantial pre-financing of state borrowing need, thus stabilizing secondary T-bond market.

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

Czech Republic

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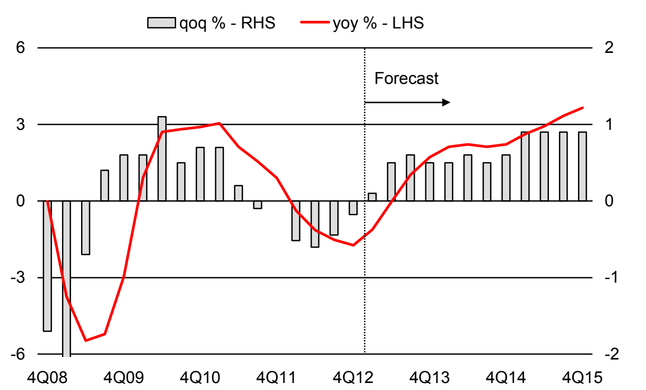
- GDP for 4Q12 was confirmed at -0.2% qoq and -1.7% yoy. However, revisions to previous quarters deepened the FY12 real GDP decline to -1.2% (from the preliminary figure of -1.1%) and moved the bottom of qoq recession to 2Q12 (from the previously reported 1Q12). The shift occurred primarily in private consumption, where a moderation of decline throughout 2012 in the previous figures was altered to a gradual deepening, to as much as -4.1% yoy in 4Q12. Private spending thereby reduced 4Q GDP by 2.1pp, whereas other components were only marginal (positive or negative) contributors to it (government consumption +0.2pp, gross capital -0.1pp, net exports +0.2pp).

- Foreign trade data provide the only hard evidence on January economic activity to date. While the cross-border balance was unsurprising, posting a marginal yoy improvement, the yoy decline in volumes of both exports and imports looked somewhat worrying. In contrast, leading indicators are more hopeful, with the PMI manufacturing new-orders component exceeding the 50-mark for the first time in 12 months and CZSO's consumer confidence hitting a level unseen since late 2011.

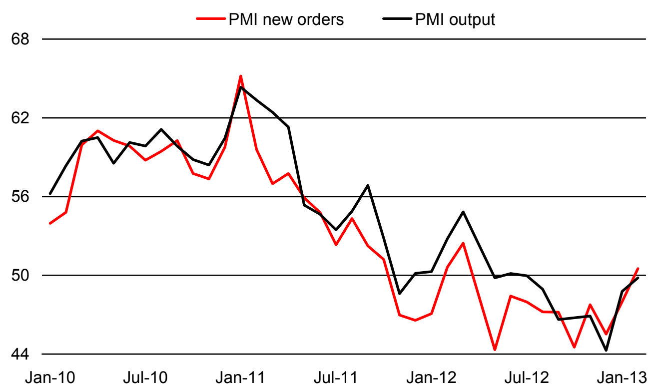
- February CPI eased further to 1.7% yoy from the previous 1.9% yoy, as food inflation turned milder. Weak consumer demand appeared to tame inflationary pressure, leaving the weak CZK as the only upside risk for inflation in the remainder of 2013. We are revising our average-2013 CPI call downwards to 1.9%, and expect declining real wages to have a better chance to stabilize.

- With the CNB policy interest rate at a technical zero, the central bank has no space to react to weakening inflation on the monetary policy front. Nevertheless, the CNB may be more comfortable with its policy of a weak CZK, hesitating less to intervene on the market should EUR-CZK suddenly drop below 25.0. We expect the zero interest rate to remain in place at least until end-2013. EUR-CZK is forecast to stay within the 25.0-26.0 band.

1Q13 SHOULD BE A PERIOD OF GDP STABILIZATION



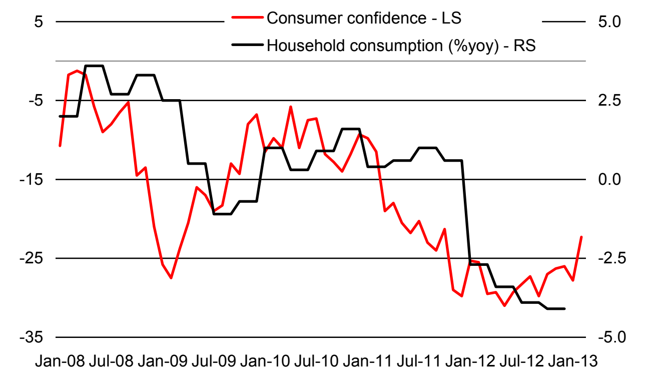
PMI MANUFACTURING ORDERS ARE BACK ABOVE 50-MARK



Source: CZSO, Markit, UniCredit Research

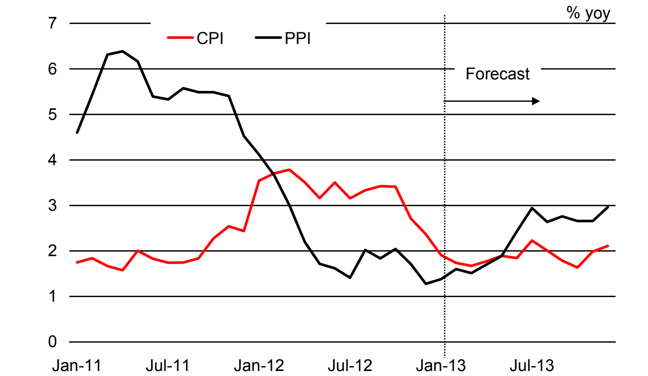
Czech Republic

CONSUMER CONFIDENCE AND HOUSEHOLD CONSUMPTION



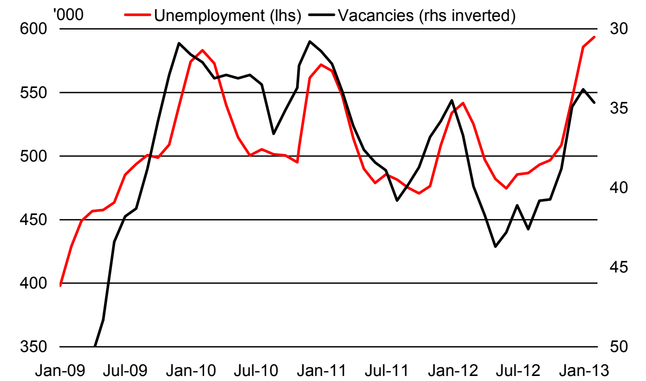
- Consumer confidence is showing signs of an upturn. The question is how fast this is translated into higher consumption.

CPI AND PPI



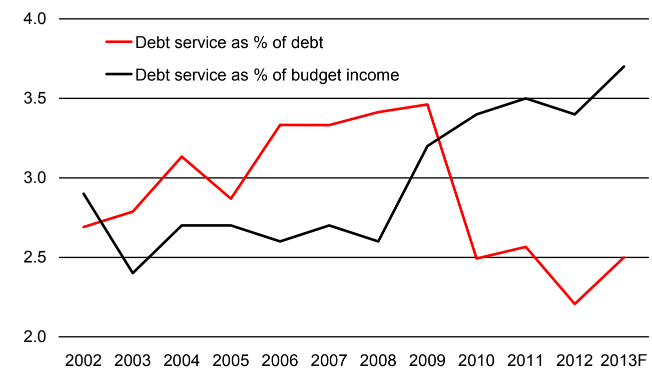
- It is hoped that the CPI dip below 2% will bolster household spending. PPI shouldn't be harmful either – unlike in 2011.

UNEMPLOYMENT AND VACANCIES



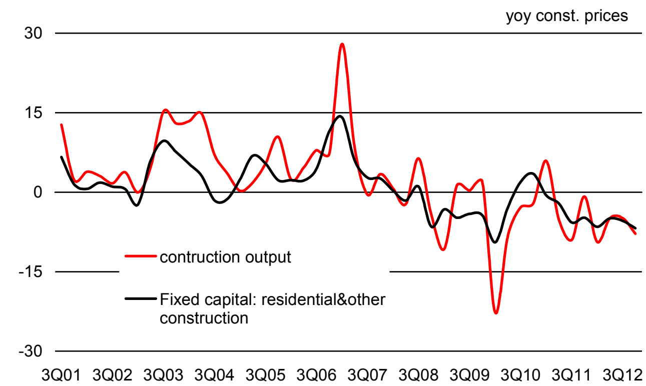
- Unemployment hit an all-time high, with vacancies providing little comfort. Poor labor market data are typical for a turn in the cycle.

DEBT SERVICE



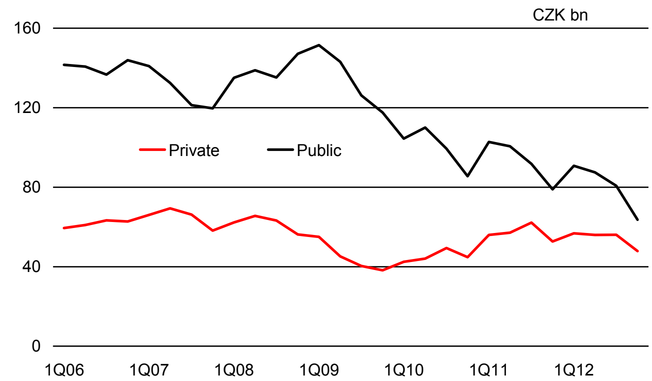
- Debt service as a percentage of state budget income continues to rise, despite very favorable debt financing terms.

CONSTRUCTION OUTPUT AND FIXED CAPITAL FORMATION



- Decreasing construction output has long been an Achilles heel of the economy, dragging GDP growth.

STOCK OF CONSTRUCTION ORDERS



- The stock of construction orders from the public sector has halved since 2006-08, while private orders have broadly stagnated.

Source: CZSO, MoF, UniCredit Research

Hungary

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- GDP fell by 0.9% qoq in 4Q12 and 1.7% in 2012, the worst performance among new EU members. Industrial production plunged 4.1% qoq in the last quarter of 2012. Exports fell 7.9% and the trade surplus decreased by 36% yoy in December and by 8.0% yoy in 4Q12. Construction and retail sales contracted in 4Q12 by 5.7% yoy and 3.5% yoy, respectively.

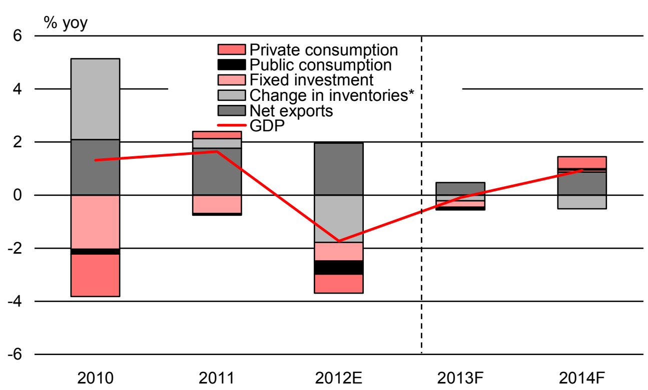
- Despite the very poor growth numbers, we believe that GDP bottomed out in 4Q12. Better sentiment indicators (both GKI and PMI) and improving industrial orders in Germany might support a recovery of industrial output in 1Q13. Nevertheless, weak lending remains a strong drag on domestic demand, limiting investment, consumption and future potential growth. Even if GDP recovers gradually, the negative carryover into 2013 is -1%, meaning that the economic growth could remain flat in 2013 (-0.1%), with risks skewed to the downside. In 2014, real GDP could grow 0.9%, but not enough to return to the 2010 level.

- The new central bank governor and former economy minister, György Matolcsy, declared that the central bank should have three tasks: fighting inflation, maintaining financial stability and supporting the economic recovery by collaborating more closely with the government. Going forward, quick changes in central bank policies are unlikely, but uncertainties regarding the conduct of monetary policy might add to EUR-HUF volatility. Rate cuts will probably continue (we expect three more to 4.5%), despite foreign investors reducing their HGB portfolios.

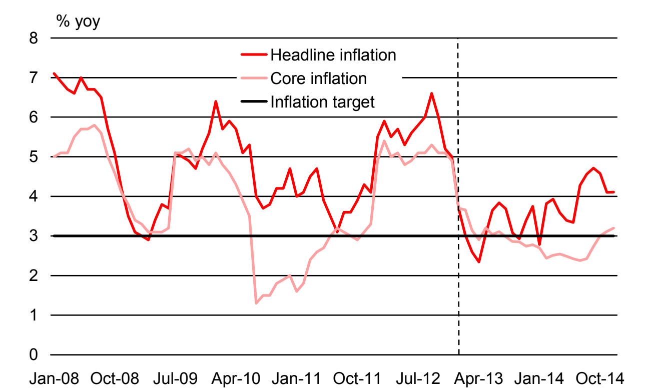
- Annual headline inflation fell from 6.6% in September 2012 to 2.8% in February 2013. Moreover, the underlying inflation figures followed by the NBH point to very low demand pressure on prices: the tax-adjusted core inflation rate stood at 1.7% in February 2013, with demand-sensitive inflation at 1.8% and sticky-price inflation at 1.6%. Were it not for administered price increases and potential tax hikes, all three measures would be compatible with headline inflation remaining close to the medium-term target of 3%.

- The incoming NBH management declared it could implement at least three policy changes before the end of the year. First, the central bank could start providing cheap liquidity to banks that want to lend, but the scheme will have limited effects at best due to weak demand. Second, the NBH and the government could try to reduce the FX exposure of households and local administrations in order to increase the scope for HUF weakness, but authorities will be uncomfortable with FX spikes ahead of elections. Third, the NBH could intervene in the secondary market and buy HGBs if risk appetite sours.

VERY SLOW RECOVERY LED BY EXTERNAL DEMAND



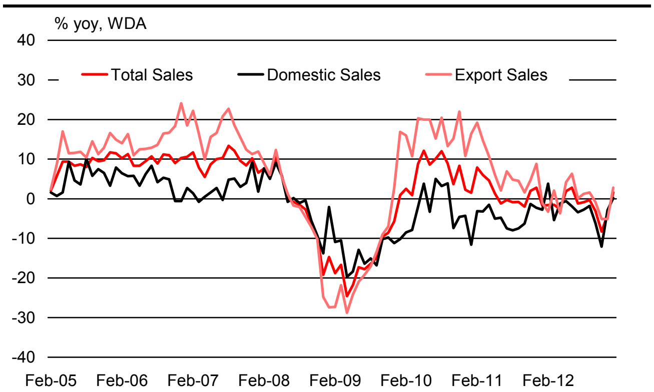
INFLATION FALLING ON ENERGY AND GAS PRICE CUTS



Source: KSH, UniCredit Research

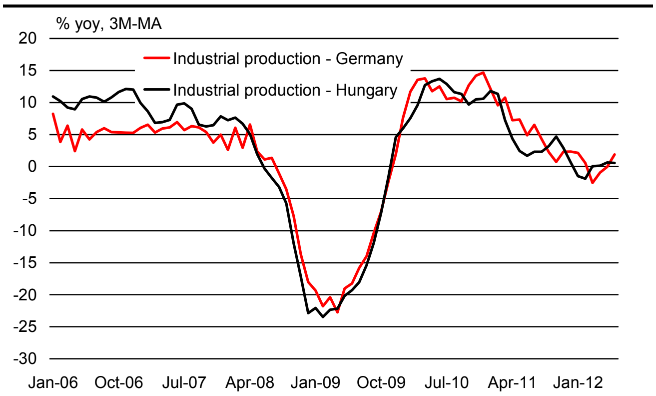
Hungary

INDUSTRIAL SALES



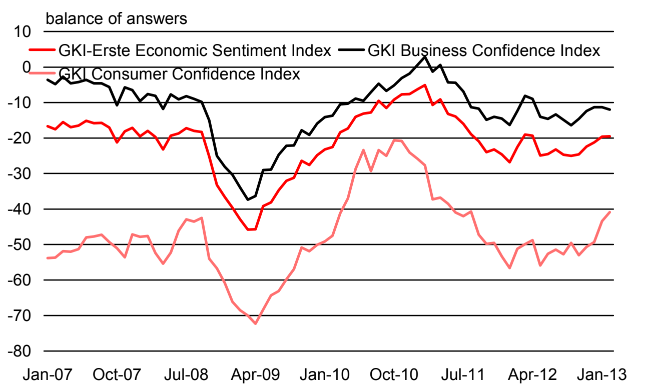
- Sales recovering before industrial production on better external demand.

INDUSTRIAL PRODUCTION



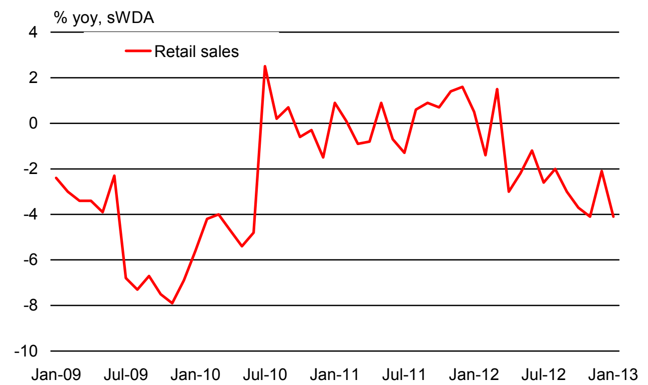
- The rebound in German industrial production is expected to help Hungarian industry already in 1Q13.

CONSUMER AND BUSINESS CONFIDENCE



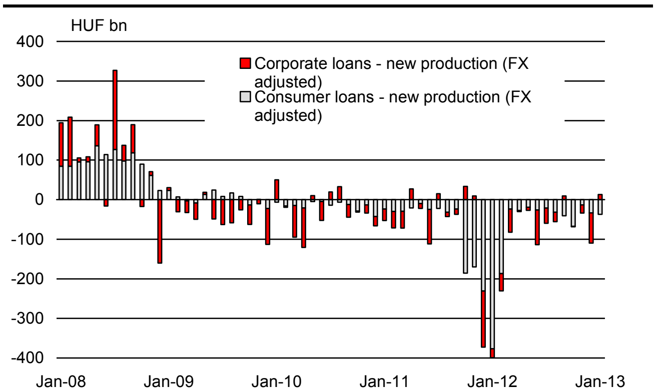
- Consumer confidence continues to improve abruptly following energy and gas price cuts

RETAIL SALES



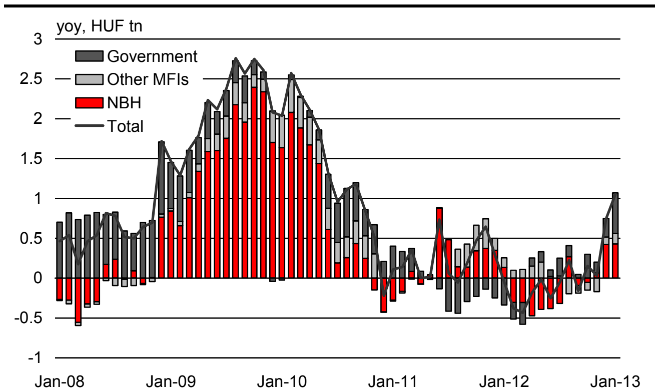
- Despite improved consumer confidence, retail sales continued to fall in early 2013.

LENDING TO HOUSEHOLDS AND CORPORATES



- A slight recovery of corporate lending was unable to offset the decline of new household loans.

THE SECURITY PURCHASES OF LOCAL BANKS



- Hungarian banks are parking liquidity at the central bank and in HGBs.

Source: KSH, NBH, Haver, UniCredit Research

US

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- The US economy is regaining momentum. After the pitiful 0.1% increase in 4Q12 (revised up from -0.1%), we expect GDP growth of 1.5% for the current quarter. The reason why growth will likely remain below par is the drag from fiscal policy, notably the expiration of the payroll-tax cut. That said, the risks to our 1Q13 forecast are clearly tilted to the upside.

- One factor is the very slow inventory accumulation at the end of the previous year (the 4Q12 number was revised down further from the BEA's initial estimate). Depending on when (not if) businesses ramp up their stockbuilding again, private inventories will add significantly to GDP growth, possibly as soon as the current quarter (see left chart below).

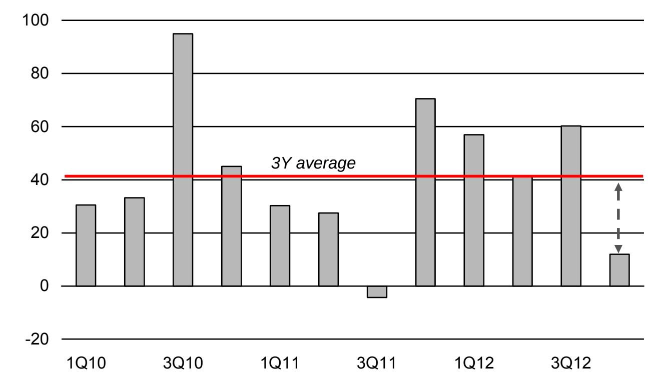
- The other factor is the resilient consumer. Despite the drag from higher payroll taxes, real consumption expenditure started the current quarter up 1¾%, more than the 1¼% factored into our forecast. Consumer spending is supported by a combination of a better labor market and a renewed pick-up in household borrowing (see right chart below).

- Nonfarm payrolls were up a strong 236,000 in February; employment gains over the last five month have averaged 196,000. Moreover, the unemployment rate declined to 7.7%, the lowest since late 2008. Consumer confidence has recovered from the payroll-tax shock, as the combination of a better labor market, record-high stock prices and rising real estate valuations dwarf the negative impact of higher gasoline prices.

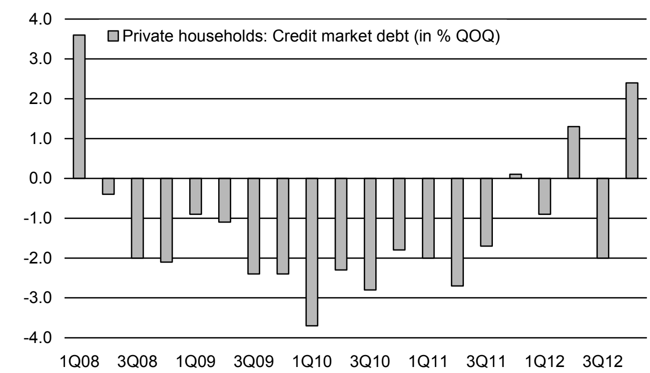
- Goods-producing industries continue to make significant progress. First, the housing market (read: prices and construction activity) has improved further on the basis of dwindling supply. Second, capex spending has started to rebound. Nondefense capital goods orders ex aircraft rose over the three months to January at the fastest pace since the early 90s. These developments, in combination with faster inventory investment, lifted the manufacturing ISM in February to a 20M high.

- At the latest FOMC meeting, in late January, the Fed said that it will continue to buy USD 85bn in long-term securities per month. While the minutes of the meeting reveal that several FOMC members were concerned about adverse consequences of the current bond-buying program, in recent speeches Chairman Bernanke and Vice Chair Yellen, the two most influential Fed officials, indicated that they have no intention whatsoever of scaling back the current degree of monetary accommodation.

REAL PRIVATE INVENTORIES (QOQ IN USD BN)



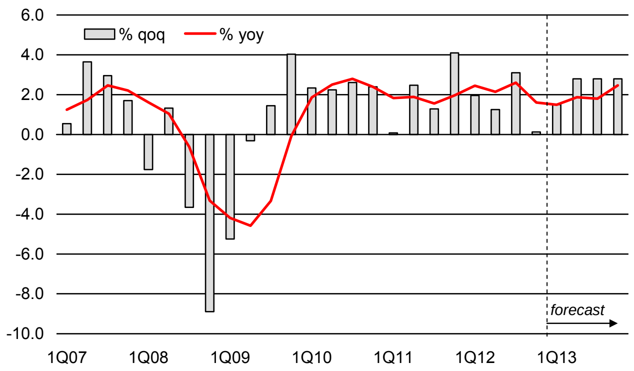
HOUSEHOLD DELEVERAGING HAS ENDED



Source: BEA, Federal Reserve, UniCredit Research

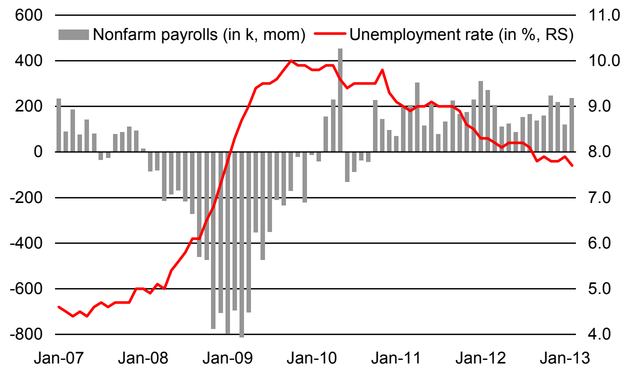
US

REAL GDP, ANNUALIZED RATES OF CHANGE



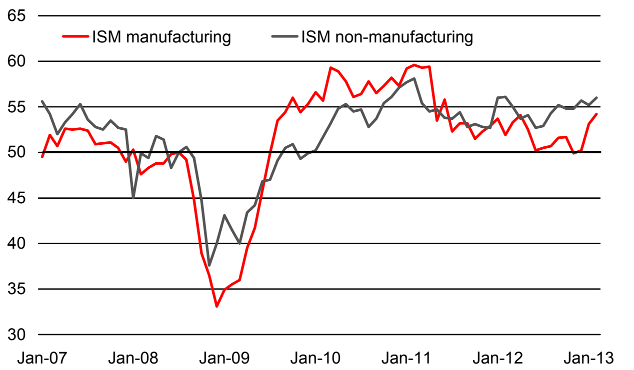
- GDP growth is accelerating from the disappointing 4Q12. Upside risks to our 1Q13 growth forecast are rising.

NONFARM PAYROLLS AND UNEMPLOYMENT RATE



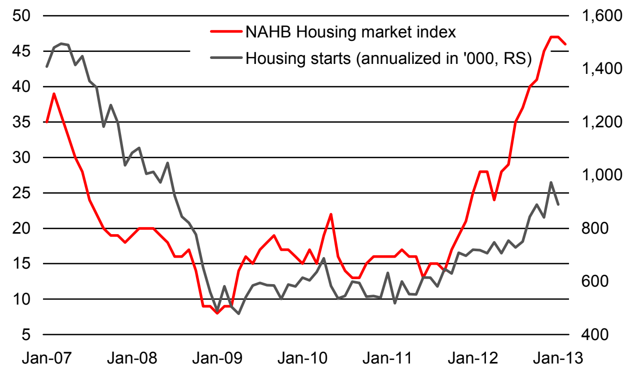
- Nonfarm payrolls increased a strong 236,000 in February, while the jobless rate fell to 7.7%, the lowest since late 2008.

PMIS



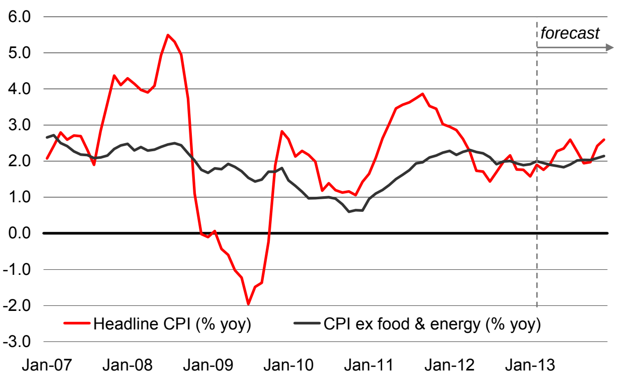
- The manufacturing ISM rose to a 20M high in February (54.2), while the non-manufacturing index hit a 12M high (56.0).

HOUSING MARKET INDEX AND HOUSING STARTS



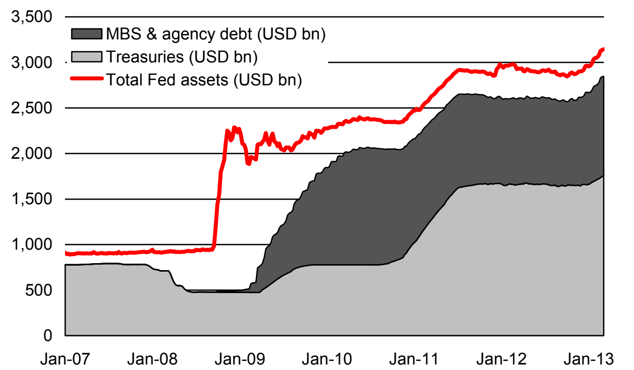
- The NAHB index remained close to a 7Y high in February, signaling further increases in construction activity.

CONSUMER PRICE INDEX



- Due to higher energy prices, headline inflation picked up from 1.6% to 2.0% in February, with the core rate up from 1.9% to 2.0%.

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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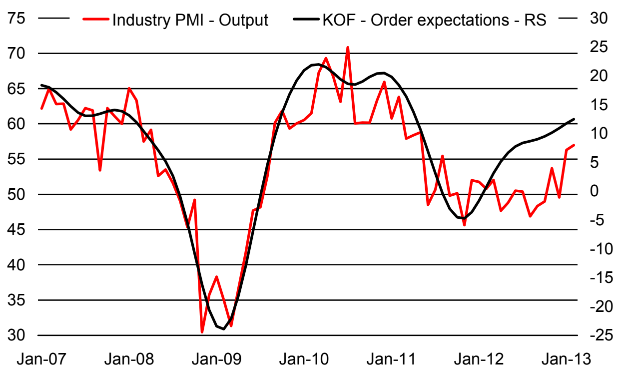
- The Swiss economy maintained positive growth momentum at the end of 2012. GDP was up 0.2% qoq, predominantly supported by robust consumption. Private consumption alone contributed 0.6pp to quarterly growth. Investment was also slightly up qoq, and net services exports contributed moderately, likely driven by the positive impact of higher commodity prices on margins in the important commodity-trading sector, as Switzerland is the world's biggest commodity trading hub. In contrast, net goods exports (without valuables) were a substantial drag, subtracting 0.7pp. The weakness in goods exports was in line with the generally negative dynamic in global industry in the final quarter.

- Looking forward, despite diverging trends of the headline KOF and PMI figures, their various demand and activity components, which exhibit a higher explanatory power for quarterly GDP growth, are sending a uniform message of an imminent rebound in industrial activity (see left chart below). Swiss exporters have, in most cases, managed to cope with the strong currency and the recent stabilization in global demand has brought tailwinds for export expectations. Together with the continuously robust household situation, we stick to our forecast of modest growth acceleration throughout 2013, broadly in line with the SNB's latest growth expectations of 1.0-1.5% for this year, after 1.0% in 2012.

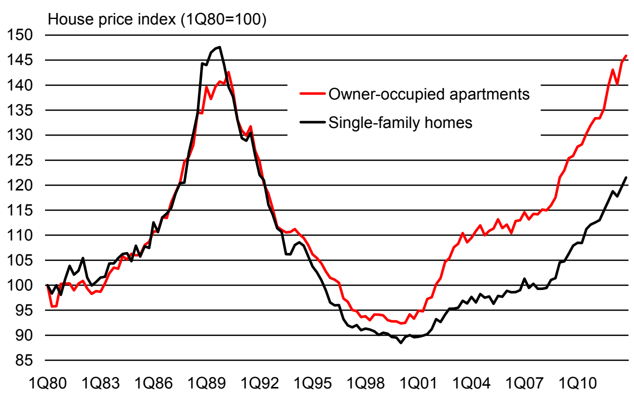
- Additionally, as Swiss annual inflation remains in moderately negative territory, the recent data flow has not changed the SNB's risk assessment. The latest quarterly monetary policy meeting confirmed that the central bankers do currently not see inflationary tendencies in Switzerland over the medium-term horizon. They continue to adhere to their zero interest rate policy and to the minimum exchange rate, not least also due to the renewed market jitters after the Italian election. This was also underscored in a recent newspaper interview by the SNB's president Thomas Jordan, where he states, "We are still far away from an exit from the minimum rate policy."

- Concerning the strong housing market dynamics (see right chart below), the SNB relies on other non-conventional measures. 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.

BUSINESS ACTIVITY INDICATORS POINT NORTH



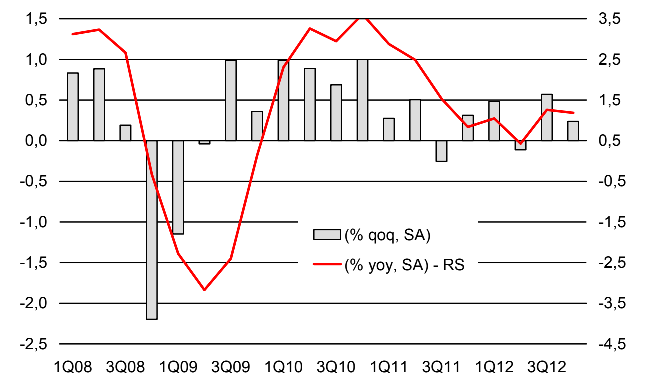
HOUSING BOOM CONTINUES



Source: SNB, KOF, Thomson Datastream, UniCredit Research

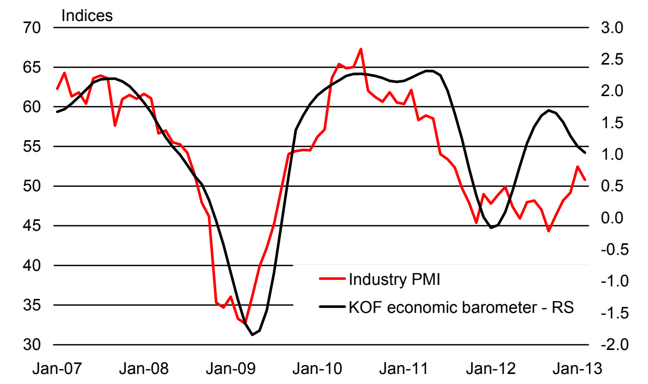
Switzerland

GDP



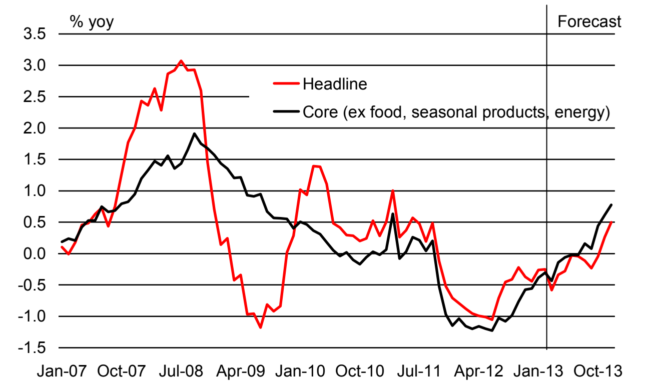
■ The Swiss economy maintained positive growth momentum in 4Q12, supported by robust consumption.

BUSINESS SENTIMENT



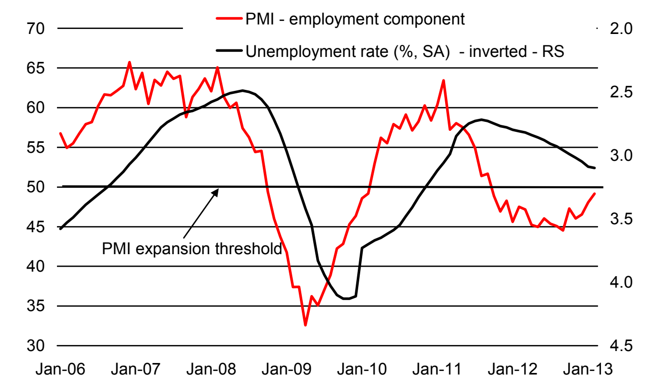
■ Gap between major business sentiment indices has been closing, with current levels signaling moderate positive growth dynamics.

INFLATION



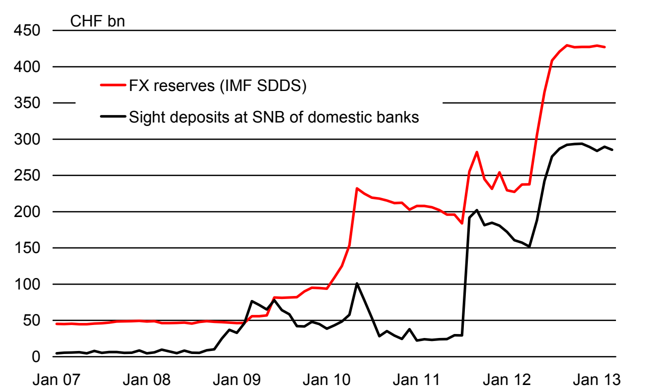
■ Swiss consumer prices continued to decline moderately on an annual basis in February.

LABOR MARKET



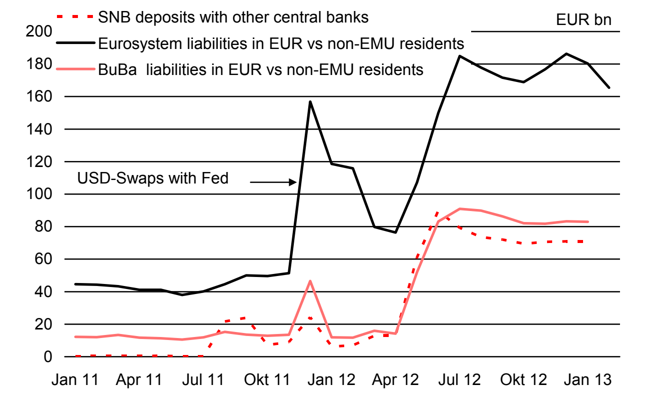
■ Employment plans in industry improved further in February, supporting the overall robust labor market situation.

FX RESERVES



■ The political stalemate in Italy did not trigger renewed reserves accumulation, underpinned by broadly stable sight deposits.

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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- The Russian trade balance decreased by 13% yoy in January to USD 18bn as imports added 10% yoy and exports declined by 2%. The weakness of external trade numbers is mostly attributable to the drop in real export volumes of crude oil by 5% yoy and fuels by 11% yoy. At the same time, CBR intervention in the FX market remained fairly stable in January compared to January 2012, at around USD 0.5bn, which indicates a temporary slowdown in capital outflow. In February, however, the CBR sold only USD 0.2bn of FX compared to 2.7bn in February 2012, which implies that capital outflow probably intensified in the second month of the year.

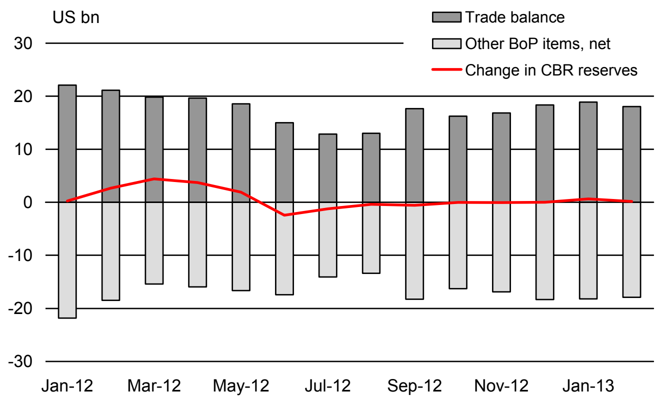
  In February, Euroclear Bank officially started operations with Russian government debt, but it is likely that active operations did not start immediately, thus we believe that March will see a larger inflow when OFZs become traded not only OTC but also on the market.

- President Vladimir Putin nominated his aide and former economic minister Elvira Nabiullina to become the new chairman of the CBR. During her work in the Ministry of Economic Development, Mrs. Nabiullina established herself as an active advocator of pro-growth policy. She is also known for her anti-offshore views and belief in the need for local financial market development (including privatization deals via local exchange) as well as active anti-crisis economic management.

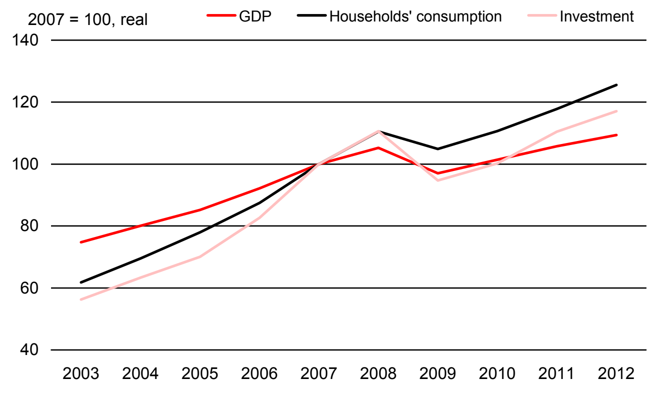
  In our view, Mrs. Nabiullina's appointment to the CBR should be positively perceived by investors who seem to view her as a pro-liberal politician. We do not rule out the regulator shifting the focus somewhat away from inflation towards growth.

  That said, we think that the CBR's key policies will remain unchanged over the next few months for two reasons: **1.** most decisions are collegial and the "old team" are likely to maintain their positions, and **2.** the CBR has been quite independent in its policies, and the new chairman will likely preserve this independence.

TRADE BALANCE WEAKER, CAPITAL OUTFLOW PROBABLY NOT



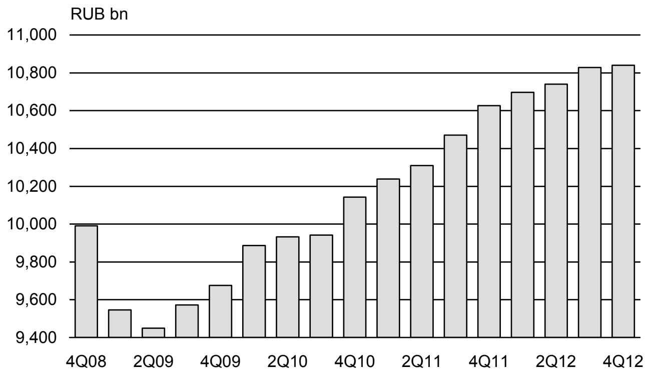
POST-RECOVERY GROWTH IS LOW



Source: Bank of Russia, Customs Service, UniCredit Research

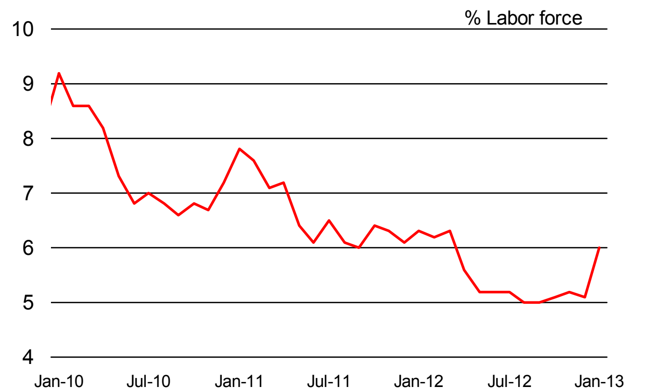
Russia

GDP (SEASONALLY-ADJUSTED QUARTERLY DATA)



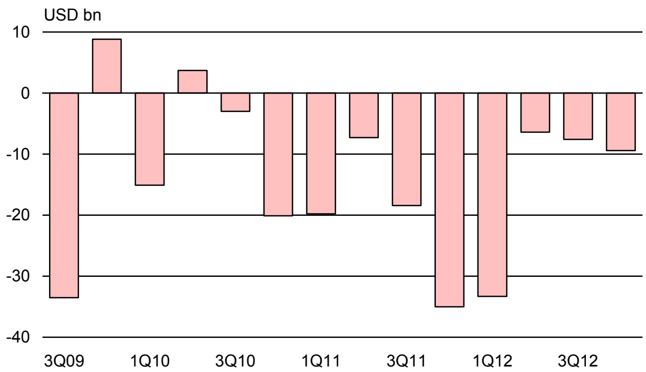
■ Slowdown in investment and consumption demand in 4Q12 brought a significant deceleration in GDP growth…

UNEMPLOYMENT



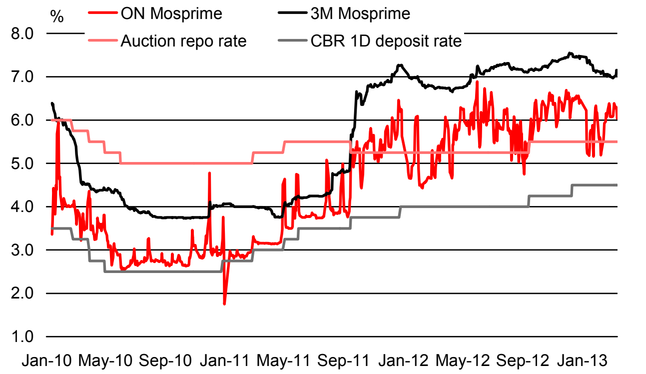
■ …although unemployment remains far below historical levels.

CAPITAL OUTFLOW



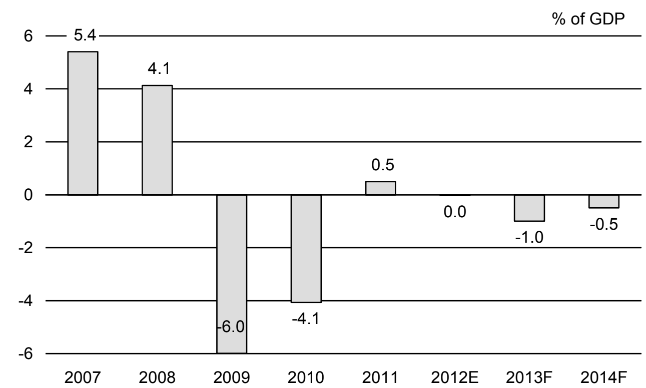
■ A significant revision of outflow figures for 2Q-4Q brought FY12 capital outflow to only USD 57bn (down from USD 80bn in FY11).

MONEY MARKET RATES



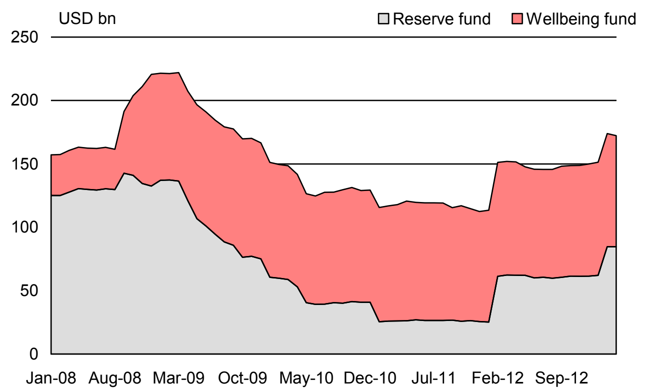
■ Abundant liquidity has brought money market rates down, although rates are not likely to be sustainably lower.

BUDGET BALANCE



■ Despite oil price volatility, the government has 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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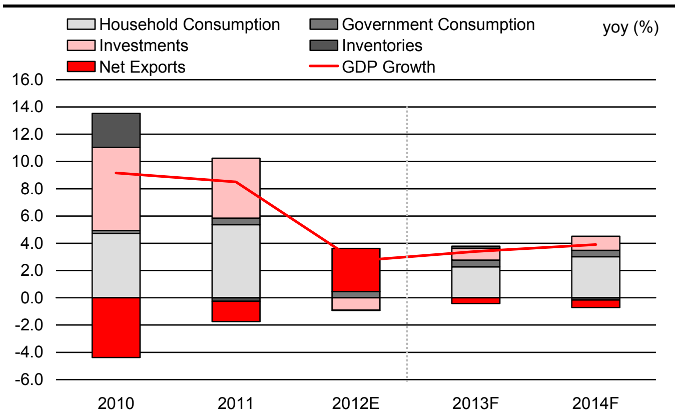
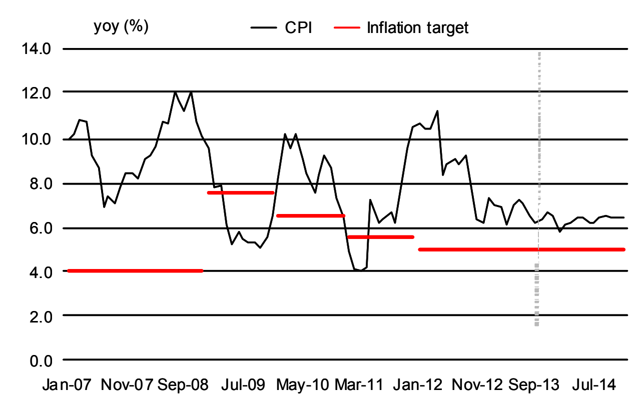
- Following an impressive adjustment last year, 2013 is at risk of seeing rising credit growth, higher inflation and a wider C/A deficit. Over January-February, CPI was up 1.9pp, eroding 36% of the CBT's full year target. For year-end, we currently forecast inflation at 6.5%, attributable mainly to rising food prices and moderate weakening of the TRY. Moreover, we see some renewed widening of the C/A this year, as January data showed some tentative evidence that the gold balance is deteriorating. In particular, we assume a deterioration in net gold exports of USD 4.0bn, followed by another USD 2.0bn in 2014. This, combined with stronger import growth, will see the C/A deficit widen towards 7% of GDP this year and to 7.5% of GDP next year. Lastly, the CBT's soft target for credit growth of 15% this year looks unrealistic, as the 13-week annualized average measure currently exceeds 22%.
- This however does not mean a return to the sort of imbalances posted in 2010/11. First, the banking system is unlikely to be able to fund credit growth much in excess of its current rate given that the loan-to-deposit ratio has hit one. Secondly, at least the initial impact from the decline in interest rates that Turkey has enjoyed since 2009 has fed through. Thirdly, the CBT has adopted a stable currency policy to prevent excessive appreciation from contributing to a wider C/A deficit, and excessive depreciation from pushing inflation higher. More specifically, the Bank has signaled that it sees scope for REER gains of 2% per annum. This implies a 1% NEER loss annually, 1pp lower than our 2% loss projection.
- That said, Turkey's primary vulnerabilities remain both an excessive reliance on short-term foreign capital inflows and a shortage of FX reserves. While it is true that the overall size of capital inflows fell, other flows like FDI did so as well, with the share of short-term capital inflows still remaining at 80% of the total. As for FX reserves, these have increased by USD 20bn to USD 100bn at end-2012, to a large extent because of the CBT's new ROM. But this increase does not cover the increase in banks' foreign liabilities, while other measures, including net reserves and reserves to short-term debt, remain unimpressive.
- In terms of policy actions from here on, expect the CBT to remain active. In particular, we think further modest reductions in the interest rate corridor are possible, as are hikes in reserve requirements, but not necessarily at the next rate decision meeting. In the event that capital inflows slow to the extent that they are insufficient to fund the C/A deficit, we expect the Bank's ROC mechanism to be the first tool that it draws on, shifting the adjustment burden from the exchange rate to interest rates. Thereafter, we expect a shift to the use of reserve requirements, in this case reducing RRs to release FX into the system.

GDP GROWTH TO RECOVER GRADUALLY



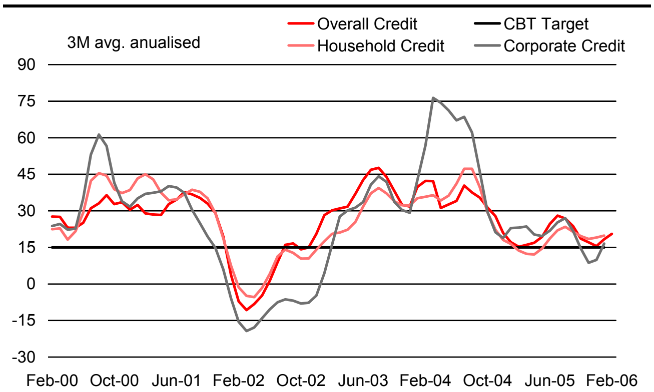
INFLATION REMAINS ABOVE TARGET



Source: CBT, TurkStat, UniCredit Research

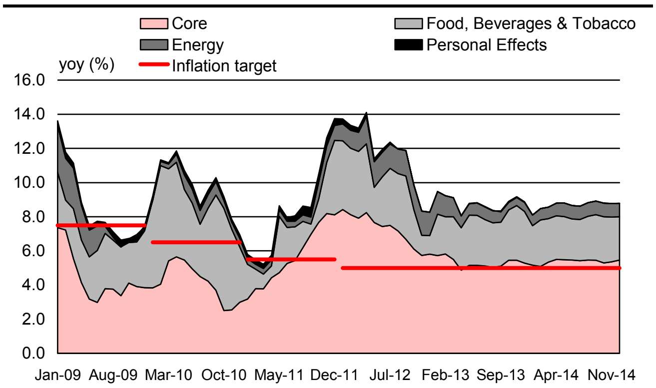
Turkey

CREDIT GROWTH VS. TARGET



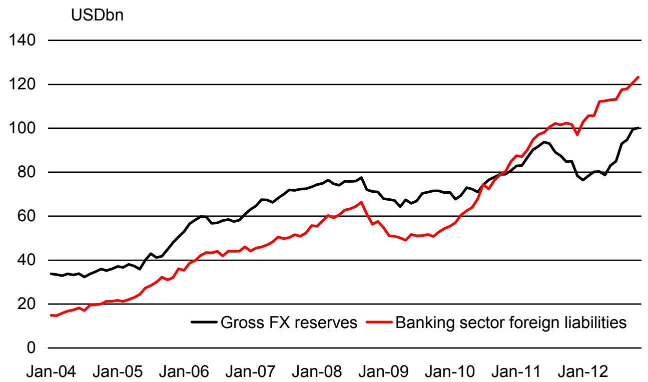
- The impact of slowing credit growth has fed through to domestic demand.

DIFFERENT CONTRIBUTIONS TO INFLATION VS. TARGET



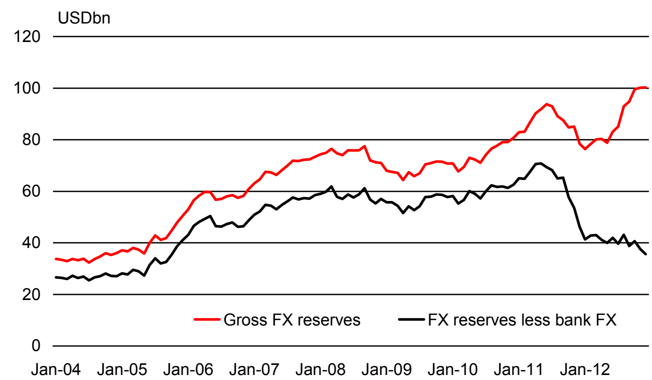
- Inflation this year will remain above target on account of rising food prices.

FX RESERVES VS. EXTERNAL BANK BORROWING



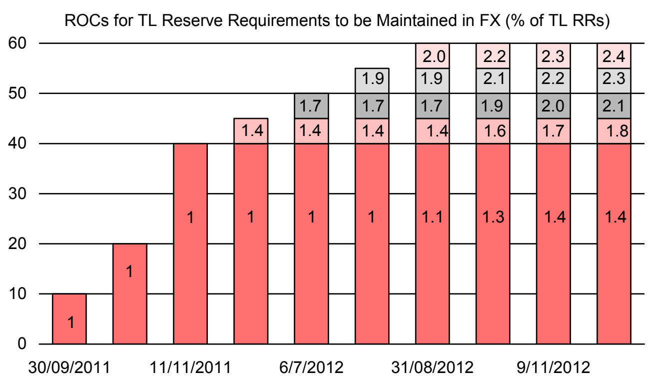
- FX reserves cannot keep pace with external bank borrowing.

GROSS RESERVES RISE, NET RESERVES FALL



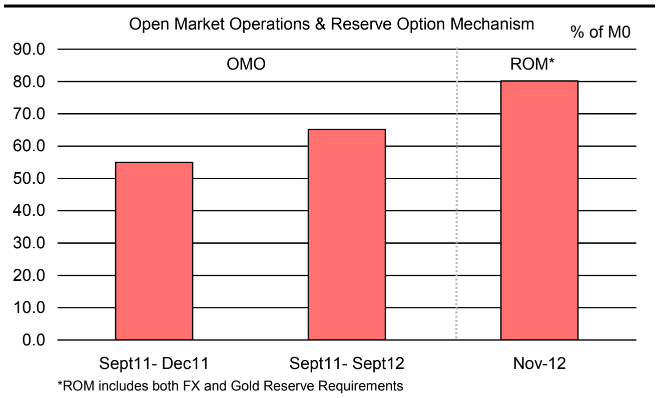
- A transfer of FX from banks to the CBT via its ROC mechanism has boosted gross reserves.

COVERING TRY RRR VIA FX



- The CBT's reserve option mechanism (ROM) has allowed banks to cover TRY reserve requirements with FX but with restrictions.

OMO VS. ROM ON FX & GOLD: SOAKING UP M0, IF NECESSARY



- Via its ROM, related both to FX and gold, the CBT has the potential to absorb 80% of M0, well above that via OMOs.

Source: CBT, TURKSTAT, UniCredit Research

China

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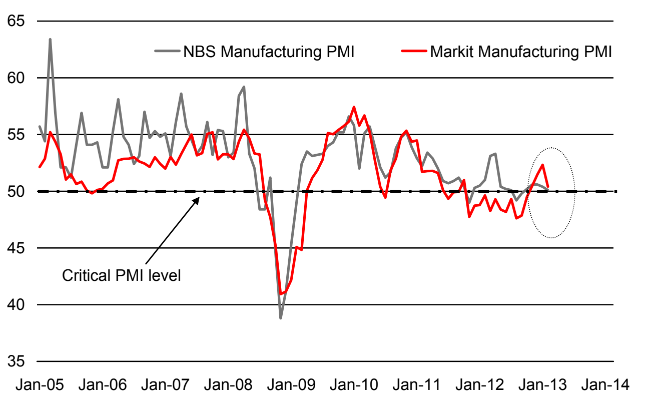
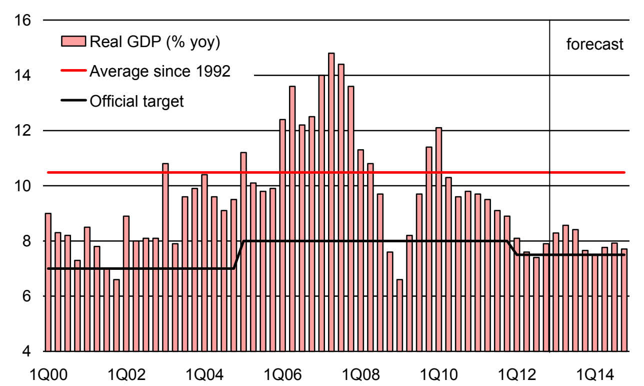
- Recent data releases have been mixed (even beyond Lunar New Year distortions), thus painting a picture of an ongoing but rather moderate and uneven recovery in China. Demand-side figures revealed that the recovery is evolving along old-fashioned lines with infrastructure spending, exports and housing still the key drivers at the start of the year.
- Following last year's step-up in macro accommodation, state-mandated investment in infrastructure accelerated to 26% yoy in February (4Q12: +16%). Export growth also returned to the twenties, averaging almost 24% so far this year, while housing soared. Starts, floor space sold as well as property sales were up massively on the back of rising home prices.
- However, private consumption and business investment are lagging. Retail sales growth in January-February weakened almost 3pp to only 12% yoy (partly depressed by the crackdown on the lavish spending of government officials and state-owned enterprises), while business spending is held back by weak profitability and ample spare capacities in some industries such as steel.
- Slowing personal and business spending weighs on industrial production. Output growth has fallen back into single-digit territory. Continued destocking may have also played a role – despite the improved orders-to-inventories ratio. And recent PMI setbacks to just above the 50 threshold argue against a strong rebound in industrial growth over the next few months.
- Unbalanced demand dynamics not only show the long and winding road to transforming the export and public investment-driven model into a consumption-led and quality-based strategy, they also accentuate the short-term policy dilemma of the new government.
- While rising inflation and growing concerns about a (renewed) housing bubble and financial risks (shadow banking, local government balances) would require more "restrictive" measures, the still fragile recovery needs further stimuli. The answer will likely be ongoing selective fiscal initiatives flanked by prudent monetary policy with tighter rules for housing as well as private, business and local government borrowing, however no rate hikes this year.
- Overall, we can stick to our expectation of 1H13 GDP growth accelerating only moderately to the 8¼-8½% region (4Q12: +7.9% yoy), but leveling off thereafter, as the macro accommodation will start to gradually fade. Structural headwinds should weigh as well. Beyond holiday-induced distortions, CPI should creep higher, but remain under control.

THE CYCLICAL RECOVERY WILL REMAIN MODERATE …



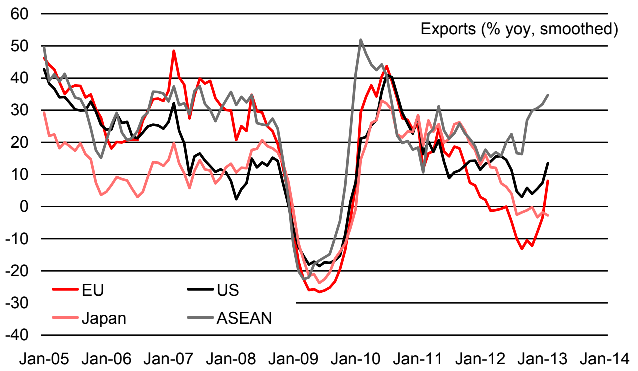
…AND IS EXPECTED TO FLUCTUATE AROUND TARGET



Source: Thomson Datastream, Feri, UniCredit Research

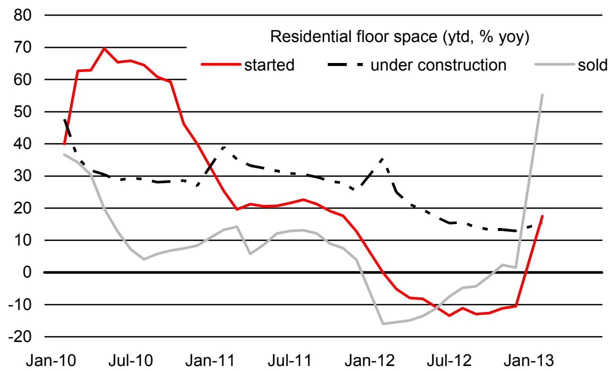
China

EXPORTS



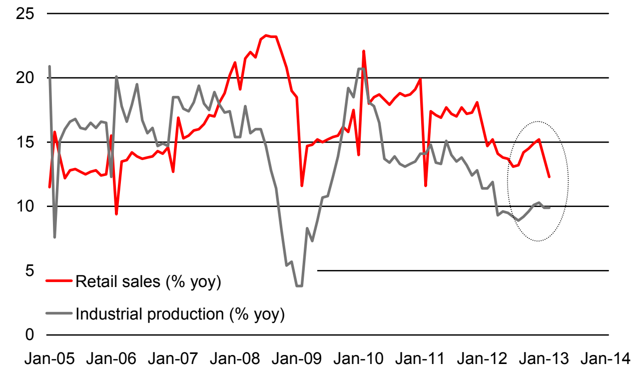
- Exports accelerated at the beginning of this year, with shipments to ASEAN countries, the EMU and the US up substantially.

HOUSING



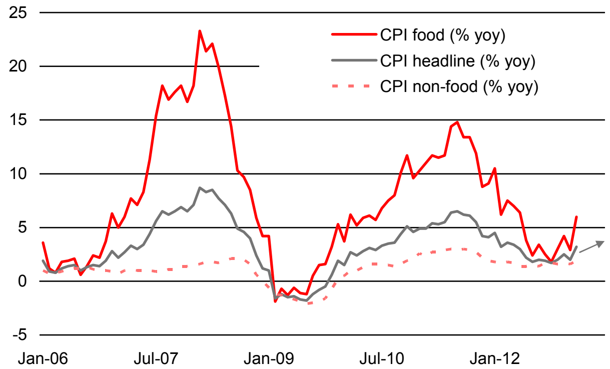
- Housing and construction activities strengthened significantly (against tighter rules and restrictions) – as did public investment.

RETAIL SALES AND INDUSTRIAL PRODUCTION



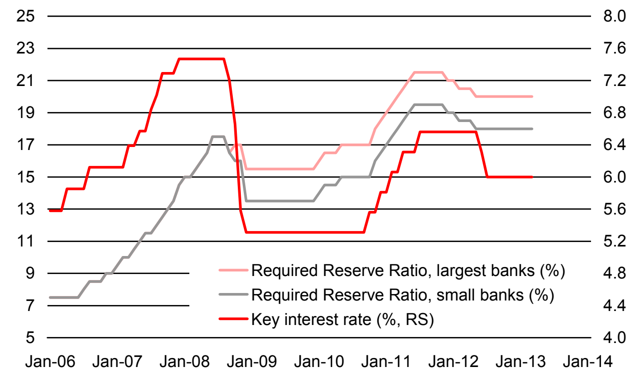
- Nevertheless, private and business spending are still lagging, thus further delaying the industrial recovery.

INFLATION



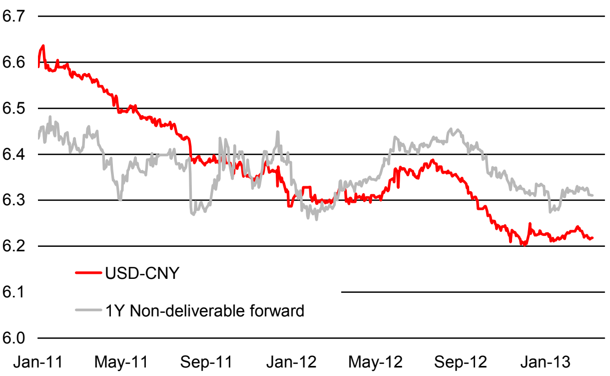
- Disinflation has come to an end, with food and housing driving CPI higher. But price pressure will not be alarming ...

MONETARY POLICY



- ... so that the central bank can remain on the sidelines with its interest rate policy. However, credit measures will be tightened.

USD-CNY

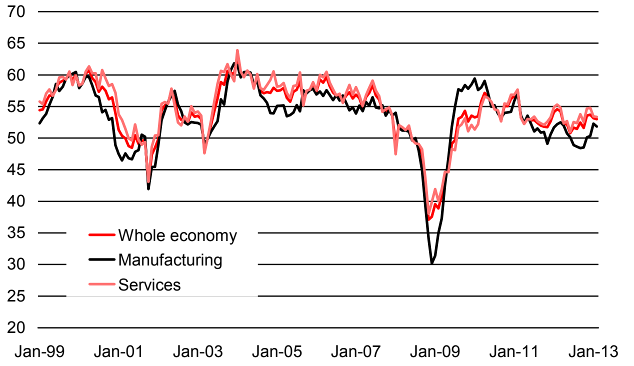


- After slightly depreciating last summer, the CNY resumed its controlled appreciation trend, but has flattened out again recently.

Source: Thomson Datastream, Feri, UniCredit Research

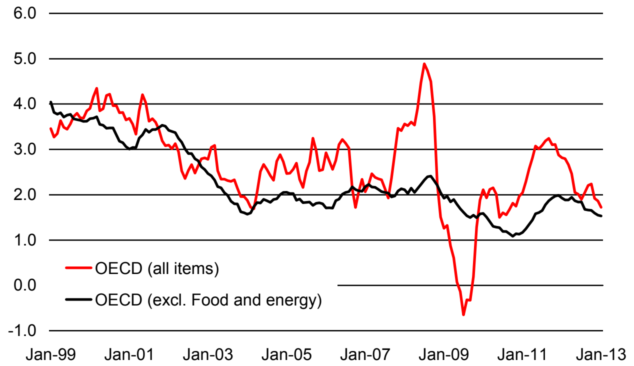
Global indicators

GLOBAL PMI OUTPUT



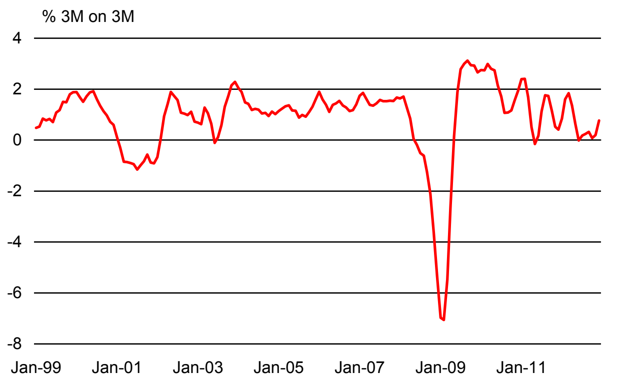
- The global composite PMI fell slightly from 53.2 to 53.0 in February. The manufacturing output index fell from 52.3 to 51.8, while the services index fell from 54.3 to 53.3.

INFLATION



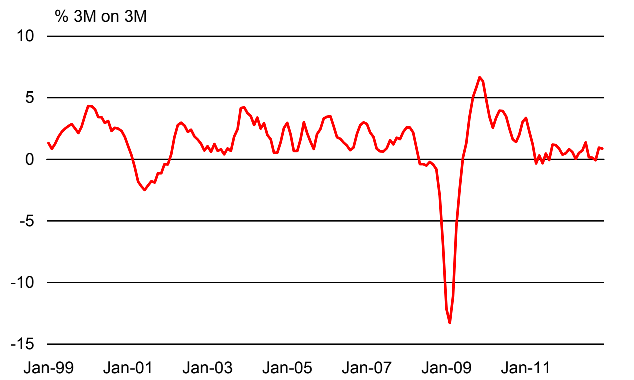
- Headline CPI inflation in the OECD economies slowed from 1.9% yoy to 1.7% yoy in January, while the core rate remained stable at 1.6% yoy.

INDUSTRIAL PRODUCTION



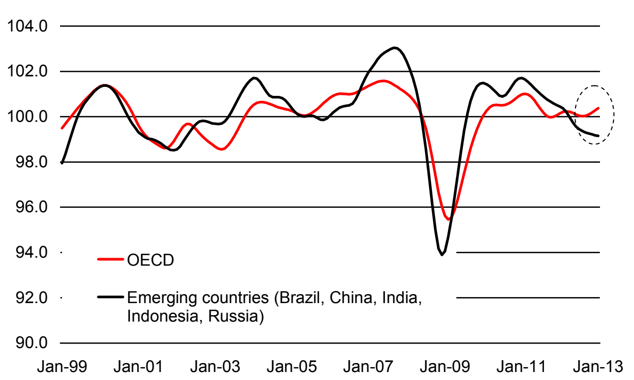
- Global IP increased 0.6% mom in December. The 3M/3M rate accelerated from 0.2% to 0.8%.

WORLD TRADE



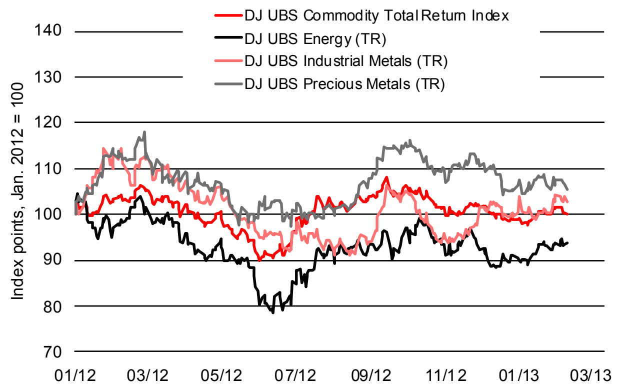
- World trade fell 0.5% mom in December. The 3M/3M rate slowed from 1.0% to 0.9%.

OECD COMPOSITE LEADING INDICATORS



- OECD leading indicators for the OECD economies edged up in January, while for key emerging countries (aggregated) they remained broadly stable.

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 in an upward trend.

Source: CBP Netherlands, OECD, UniCredit Research

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