Economics Research

The UniCredit Chartbook

Monthly

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Credit Research
Equity Research
Cross Asset Research

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Monthly recap

- **EMU:** We lower our 2013 GDP forecast to -0.6% (from -0.1%) and our 2014 forecast to +1.0% (from +1.2%). There are three reasons for the revisions: **1.** marginally weaker-than-expected GDP in 1Q; **2.** while we came out of 1Q with strong hard data, the soft indicators, including the PMIs, are recovering a tad slower than expected; and **3.** our global leading indicator[1] suggests that global growth and trade over the summer may be softer than previously envisaged. As a result, we now forecast that 2Q will post marginally negative GDP growth (instead of marginally positive) and that the 2H recovery will unfold at a somewhat slower pace than previously anticipated. The qoq GDP trajectory for 2014 remains broadly unchanged. With slower global trade, the recovery in fixed investment will likely be delayed. The inflation rate has probably troughed, but a return to 2% is not in the cards anytime soon. As a result, we now see the beginning of the ECB's refi rate normalization in mid-2015, rather than at the end of 2014.
- **US:** The US economy expanded by 2.5% annualized in 1Q13, driven by a strong increase in credit-fueled consumer spending. Following this solid start to the year, GDP growth is likely slowing to 1.8% in the current quarter. Most of this volatility reflects the (lagged) response to fiscal tightening and some renewed inventory adjustment. This (temporary) growth slowdown, in combination with falling inflation rates, has increased the probability that the Federal Reserve's asset-purchase program (QE3) will remain in place for longer than we currently think (i.e. into 2014).
- **CEE:** CEE is a region of increasing differentiation. Accompanying changes to our other European forecasts, we downgrade our growth projections for Russia and the Czech Republic, leave Poland unchanged, while upgrading our growth forecasts for Hungary and Turkey. The downgrade to our forecast for the Czech Republic reflects a particularly weak 1Q (-0.8% qoq). In Russia, the downgrade reflects a negative terms of trade shock, capacity constraints and limitations on credit growth. In contrast, Hungary posted a surprisingly strong 1Q while the slowdown in the pace of deleveraging by foreign banks should aid domestic demand. Turkey benefits from increased capital inflows, ever lower interest rates, and support from fiscal policy.
- **China:** We think that tepid 1Q data are likely to carry over into spring, posing some downside risks to our expectation that growth will pick up to around 8% in the current quarter. For now, we keep our GDP growth forecast of 7¾% for both 2013 and 2014.
- **FI:** We remain convinced that real yields in so-called safe havens are overstretched and that nominal yields will therefore have to rise to reflect a more balanced asset allocation and risk appetite. That said, we have lowered the trajectory of our Bund and UST forecasts. We expect the 2/10Y spread, both in the EMU and the US, to remain close to the current levels until year-end and to rise during 2014 as central banks keep their monetary policy accommodative, while the long end will start to reflect an improvement in the growth outlook. We see room for additional tightening in core-periphery spreads.
- **FX:** US dollar strength has been the name of the game in May with EUR-USD retreating below 1.29 and USD-JPY rising by more than 5%. In the short term, we think the euro is likely to consolidate at current levels, but we still expect EUR-USD to drift higher on the back of the gradual uplift in European activity that we foresee in 2H. Nonetheless, upside potential may be limited toward 1.35 due to the likelihood of ECB verbal intervention. We also expect traditionally safe-haven, zero-yielding currencies like the JPY and CHF to remain under pressure as investors continue their quest for higher returns.

[1] Our new proprietary global leading indicator points to moderately weaker momentum of the global economy over the summer. After reaching a cyclical high in 1Q13, our indicator declined, albeit not dramatically, staying at above-average levels. Typically, changes in the indicator precede variations in global exports activity by about three months. The global leading indicator consists of 15 component series, which are found to be frontrunners of economic activity worldwide. Examples are business sentiment surveys but also hard data in form of cargo activity at major Chinese sea ports and global steel production. Our proprietary global leading indicator is yet-to-be-published research in our Global Themes series, which will be released soon.

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	-0.6	-0.6	1.0	2.5	1.6	1.6	0.75	0.50	0.50	-3.7	-3.0	-2.7	90.6	92.9	92.5	1.2	1.9	2.3
Germany	0.9	0.5	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	-0.3	0.8	2.0	1.0	1.9	-	-	-	-4.8	-4.0	-3.5	90.2	92.6	94.7	-2.3	-2.0	-1.7
Italy	-2.4	-1.7	0.6	3.0	1.7	1.7	-	-	-	-3.0	-3.1	-2.3	127.0	131.0	130.3	-0.6	0.2	0.4
Spain	-1.4	-1.6	0.5	2.4	1.8	2.5	-	-	-	-10.6	-6.4	-5.5	84.2	91.5	97.0	-1.1	1.0	2.1
Austria	0.8	0.4	1.6	2.4	1.9	1.8	-	-	-	-2.5	-2.3	-1.7	73.4	74.1	73.7	1.8	1.9	1.8
Greece	-6.5	-4.5	0.2	1.5	-0.5	-0.1	-	-	-	-10.0	-5.0	-4.2	156.9	179.0	175.0	-2.9	-1.2	-0.3
Portugal	-3.2	-2.7	0.3	2.8	0.2	0.6	-	-	-	-6.4	-5.6	-4.0	123.6	125.6	128.2	-1.6	-0.5	0.0
Other EU																		
UK	0.3	0.9	1.4	2.8	2.5	2.2	0.50	0.50	0.50	-6.6	-6.9	-6.1	90.0	94.0	97.1	-3.7	-2.7	-2.4
Sweden	1.2	1.4	2.4	0.9	0.1	1.6	1.00	1.00	1.50	-0.5	-0.5	0.0	38.2	36.5	35.3	7.2	7.5	7.3
Poland	1.9	1.7	2.3	3.7	1.1	2.0	4.25	2.75	3.25	-3.9	-3.9	-3.5	55.6	57.6	57.6	-3.5	-2.7	-3.1
Czech Rep.	-1.2	-0.6	2.1	3.3	1.6	1.6	0.05	0.05	0.50	-4.4	-2.9	-3.0	45.8	47.9	48.9	-2.4	-2.2	-1.8
Hungary	-1.7	0.4	1.0	5.6	2.1	3.3	5.75	4.00	4.50	-1.9	-2.7	-3.0	78.0	78.1	77.1	1.0	1.5	1.5
Others																		
US	2.2	2.0	2.6	2.1	1.5	2.3	0.25	0.25	0.25	-8.5	-6.5	-5.4	106.5	108.1	109.2	-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	2.7	2.8	5.1	6.3	5.4	5.50	5.25	5.00	0.0	-0.8	-0.5	10.2	11.0	11.7	4.0	1.0	1.4
Turkey	2.2	3.8	3.6	8.9	6.7	6.1	5.50	4.50	5.00	-1.5	-2.1	-2.9	36.6	34.7	34.2	-6.2	-6.7	-7.1
China	7.8	7.8	7.7	2.7	2.8	3.3	6.00	6.00	6.00	-1.3	-1.7	-1.5	-	-	-	2.6	2.7	3.0

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	-0.2	-0.1	0.1	0.2	0.2	0.3	0.3	0.4
Germany	0.2	-0.7	0.1	0.6	0.5	0.4	0.4	0.3	0.3	0.4
France	0.2	-0.3	-0.2	0	0.1	0.2	0.2	0.3	0.3	0.4
Italy	-0.2	-0.9	-0.5	-0.4	0	0.1	0.2	0.2	0.3	0.4
Spain	-0.3	-0.8	-0.5	-0.3	-0.1	0.1	0.1	0.2	0.2	0.3
Austria	0	-0.1	0	0.2	0.5	0.6	0.4	0.4	0.4	0.2
Other EU										
UK	0.9	-0.3	0.3	0.2	0.3	0.3	0.3	0.4	0.5	0.5
Sweden	0.3	0	0.3	0.5	0.6	0.6	0.6	0.6	0.6	0.7
Poland (% yoy)	1.3	0.7	0.4	1.4	2.0	2.5	2.9	2.2	2.2	2.0
Czech Rep.	-0.3	-0.3	-0.8	0.3	0.5	0.5	0.5	0.6	0.5	0.6
Hungary	0	-0.4	0.7	0.2	0.4	0.3	0.1	0.1	0.1	0.2
Others										
US (annualized)	3.1	0.4	2.5	1.8	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	0.6	0.8	-0.2	1.1	0.8	1.0	0.9	0.6	0.5	0.8
Turkey	0.1	0	1.6	1.2	1.1	1.0	0.8	0.8	0.9	0.9
China (% yoy)	7.4	7.9	7.7	8.0	7.9	7.5	7.9	7.9	7.7	7.2

CPI INFLATION (% YOY)

	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Eurozone	2.5	2.3	1.9	1.4	1.5	1.5	1.4	1.8	1.6	1.7
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	1.1	0.8	1.0	1.2	1.7	2.0	1.9	2.0
Italy	3.2	2.5	1.9	1.2	1.6	1.6	1.6	1.9	1.6	1.7
Spain (HICP)	2.8	3.2	2.8	1.7	1.1	1.5	1.7	2.8	2.7	2.7
Austria	2.3	2.8	2.5	1.9	1.7	1.5	1.6	1.9	1.9	1.7
Other EU										
UK	2.4	2.7	2.8	2.6	2.5	2.2	2.0	2.1	2.2	2.1
Sweden	0.6	0.1	-0.1	-0.3	0	0.5	0.9	1.5	1.9	2.1
Poland	3.9	2.9	1.3	0.8	1.0	1.1	1.9	2.0	2.0	2.3
Czech Rep.	3.4	2.9	1.8	1.6	1.6	1.5	1.6	1.5	1.5	1.6
Hungary	6.6	5.0	2.8	1.8	1.5	1.8	1.7	2.0	2.8	3.1
Others										
US	1.7	1.9	1.7	1.4	1.4	1.5	1.7	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	5.1	5.1	5.9	6.7	6.6	6.3	6.0	5.6	5.4	5.4
Turkey	9.0	6.8	7.2	6.6	6.4	6.4	5.6	5.8	5.9	5.7
China	1.9	2.5	2.4	2.6	2.9	3.2	3.2	3.2	3.4	3.5

Source: UniCredit Research

Table 3: Comparison of annual GDP and CPI forecasts

GDP (%)

	UniCredit			IMF (Apr-13)			European Commission (May-13)			OECD (Nov-12)		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Eurozone	-0.6	-0.6	1.0	-0.6	-0.3	1.1	-0.6	-0.4	1.2	-0.4	-0.1	1.3
Germany	0.9	0.5	1.5	0.9	0.6	1.5	0.7	0.4	1.8	0.9	0.6	1.9
France	0	-0.3	0.8	0	-0.1	0.9	0	-0.1	1.1	0.2	0.3	1.3
Italy	-2.4	-1.7	0.6	-2.4	-1.5	0.5	-2.4	-1.3	0.7	-2.2	-1.0	0.6
Spain	-1.4	-1.6	0.5	-1.4	-1.6	0.7	-1.4	-1.5	0.9	-1.3	-1.4	0.5
Austria	0.8	0.4	1.6	0.8	0.8	1.6	0.8	0.6	1.8	0.6	0.8	1.8
Greece	-6.5	-4.5	0.2	-6.4	-4.2	0.6	-6.4	-4.2	0.6	-6.3	-4.5	-1.3
Portugal	-3.2	-2.7	0.3	-3.2	-2.3	0.6	-3.2	-2.3	0.6	-3.1	-1.8	0.9
Other EU												
UK	0.3	0.9	1.4	0.2	0.7	1.5	0.3	0.6	1.7	-0.1	0.9	1.6
Sweden	1.2	1.4	2.4	1.2	1.0	2.2	0.8	1.5	2.5	1.2	1.9	3.0
Poland	1.9	1.7	2.3	2.0	1.3	2.2	1.9	1.1	2.2	2.5	1.6	2.5
Czech Rep.	-1.2	-0.6	2.1	-1.2	0.3	1.6	-1.3	-0.4	1.6	-0.9	0.8	2.4
Hungary	-1.7	0.4	1.0	-1.7	0	1.2	-1.7	0.2	1.4	-1.6	-0.1	1.2
Others												
US	2.2	2.0	2.6	2.2	1.9	3.0	2.2	1.9	2.6	2.2	2.0	2.8
Switzerland	1.0	1.4	1.8	1.0	1.3	1.8	1.0	1.4	1.9	0.8	1.1	2.3
Russia	3.4	2.7	2.8	3.4	3.4	3.8	3.4	3.3	3.8	3.4	3.8	4.1
Turkey	2.2	3.8	3.6	2.6	3.4	3.7	2.2	3.2	4.0	2.9	4.1	5.2
China	7.8	7.8	7.7	7.8	8.0	8.2	7.8	8.0	8.1	7.5	8.5	8.9

CPI INFLATION (%)*

	UniCredit			IMF (Apr-13)			European Commission (May-13)			OECD (Nov-12)		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Eurozone	2.5	1.6	1.6	2.5	1.7	1.5	2.5	1.6	1.5	2.4	1.6	1.2
Germany	2.0	1.3	1.4	2.1	1.6	1.7	2.1	1.8	1.6	2.1	1.9	2.0
France	2.0	1.0	1.9	2.0	1.6	1.5	2.2	1.2	1.7	2.2	1.3	1.2
Italy	3.0	1.7	1.7	3.3	2.0	1.4	3.3	1.6	1.5	3.2	1.9	0.9
Spain	2.4	1.8	2.5	2.4	1.9	1.5	2.4	1.5	0.8	2.2	1.2	0.4
Austria	2.4	1.9	1.8	2.6	2.2	1.9	2.6	2.0	1.8	2.4	1.9	1.6
Greece	1.5	-0.5	-0.1	1.0	-0.8	-0.4	1.0	-0.8	-0.4	1.0	-0.2	-0.8
Portugal	2.8	0.2	0.6	2.8	0.7	1.0	2.8	0.7	1.0	2.7	0.8	1.0
Other EU												
UK	2.8	2.7	2.3	2.8	2.7	2.5	2.8	2.8	2.5	2.6	1.9	1.8
Sweden	0.9	0.1	1.6	0.9	0.3	2.3	0.9	0.9	1.4	1.0	0.9	1.7
Poland	3.7	1.1	2.0	3.7	1.9	2.0	3.7	1.4	2.0	3.6	2.1	2.1
Czech Rep.	3.3	1.6	1.6	3.3	2.3	1.9	3.5	1.9	1.2	3.2	2.0	2.1
Hungary	5.6	2.1	3.3	5.7	3.2	3.5	5.7	2.6	3.1	5.8	4.8	3.9
Others												
US	2.1	1.5	2.3	2.1	1.8	1.7	2.1	1.8	2.1	2.1	1.8	2.0
Switzerland	-0.7	-0.1	0.7	-0.7	-0.2	0.2	-0.7	0	1.1	-0.6	0.1	0.2
Russia	5.1	6.3	5.4	5.1	6.9	6.2	-	-	-	5.0	6.4	4.3
Turkey	8.9	6.7	6.1	8.9	6.6	5.3	9.0	6.6	5.6	9.1	6.9	6.1
China	2.7	2.8	3.3	2.6	3.0	3.0	-	-	-	2.6	1.5	1.4

*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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3M	0.20	0.20	0.25	0.30	0.40	0.50	0.55	0.55
2Y	-0.02	0.05	0.15	0.25	0.35	0.50	0.65	0.85
5Y	0.38	0.40	0.50	0.70	0.90	1.20	1.45	1.65
10Y	1.36	1.40	1.50	1.70	2.00	2.25	2.40	2.60
30Y	2.29	2.30	2.40	2.55	2.80	3.00	3.10	3.25
2/10	138	135	135	145	165	175	175	175
2/5/10	-29	-33	-33	-28	-28	-18	-8	-8
10/30	93	90	90	85	80	75	70	65
2Y SwSp	-37	-35	-35	-30	-30	-30	-25	-25
10Y SwSp	-25	-25	-25	-20	-20	-20	-15	-15
10Y BTP/bund	252	235	250	250	230	210	195	190
US								
Key rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3M	0.27	0.35	0.35	0.35	0.35	0.35	0.35	0.35
2Y	0.24	0.25	0.25	0.35	0.45	0.65	0.85	1.00
5Y	0.84	0.90	1.10	1.38	1.53	1.70	2.10	2.45
10Y	1.96	1.95	2.10	2.40	2.70	2.85	3.10	3.30
30Y	3.18	3.15	3.20	3.50	3.70	3.85	4.00	4.20
2/10	172	170	185	205	225	220	225	230
2/5/10	-26	-20	-8	0	-5	-5	13	30
10/30	121	120	110	110	100	100	90	90
2Y SwSp	-15	10	10	10	5	5	5	5
10Y SwSp	-14	55	60	70	70	60	70	70
UK								
Key rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
10Y	1.92	1.95	2.10	2.40	2.80	2.95	3.30	3.50
SZ								
Key rate	0	0	0	0	0	0	0	0
10Y	0.63	0.65	0.65	0.80	1.00	1.25	1.40	1.60

FX	Current	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
EUR-USD	1.29	1.31	1.33	1.35	1.35	1.36	1.37	1.38
EUR-JPY	132	138	146	155	155	159	162	166
EUR-GBP	0.85	0.87	0.88	0.90	0.90	0.91	0.91	0.92
EUR-SEK	8.58	8.65	8.63	8.60	8.58	8.55	8.53	8.50
EUR-NOK	7.52	7.70	7.67	7.63	7.60	7.57	7.55	7.55
EUR-CHF	1.25	1.27	1.30	1.33	1.35	1.37	1.39	1.41
EUR-AUD	1.31	1.26	1.25	1.25	1.25	1.24	1.22	1.23
EUR-NZD	1.58	1.54	1.53	1.53	1.53	1.51	1.49	1.48
EUR-CAD	1.32	1.34	1.34	1.36	1.36	1.36	1.34	1.34
USD-JPY	103	105	110	115	115	117	118	120
GBP-USD	1.52	1.51	1.51	1.50	1.50	1.50	1.50	1.50
USD-SEK	6.66	6.60	6.49	6.37	6.36	6.29	6.23	6.16
USD-NOK	5.84	5.88	5.77	5.65	5.63	5.57	5.51	5.47
USD-CHF	0.97	0.97	0.98	0.99	1.00	1.01	1.01	1.02
AUD-USD	0.98	1.04	1.06	1.08	1.08	1.10	1.12	1.12
NZD-USD	0.82	0.85	0.87	0.88	0.88	0.90	0.92	0.93
USD-CAD	1.03	1.02	1.01	1.01	1.01	1.00	0.98	0.97

Source: Bloomberg, UniCredit Research

Eurozone

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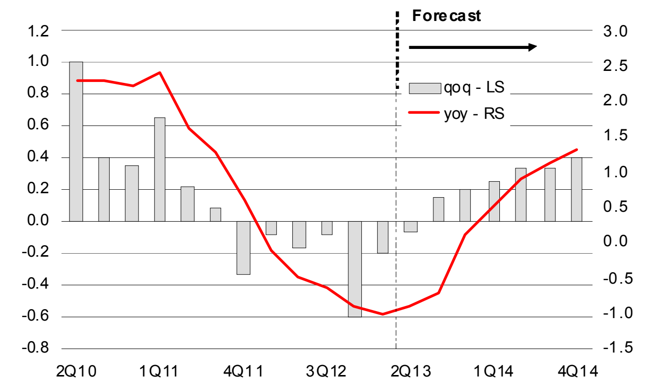
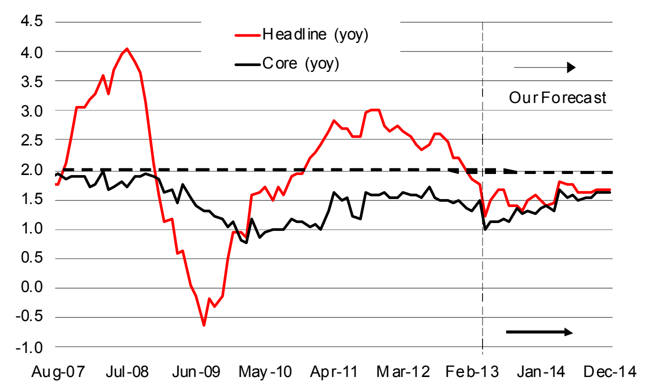
- We lower our 2013 eurozone GDP forecast to -0.6% (from -0.1%) and our 2014 forecast to +1.0% (from +1.2%). There are three reasons for the revisions: **1.** marginally weaker-than-expected GDP in 1Q; **2.** while we came out of 1Q with strong hard data, the soft indicators, including the PMIs, are recovering a tad slower than expected; and **3.** our global leading indicator suggests that global growth over the summer may be softer than previously envisaged. As a result, we now think that 2Q will post marginally negative GDP growth (instead of marginally positive) and that the 2H recovery will unfold at a somewhat slower pace than previously anticipated. The qoq GDP path for 2014 remains broadly unchanged.
- The softer growth outlook is explained by a lower trajectory for exports and, especially, domestic demand. Fixed investment remains restrained by still weak business sentiment and a disappointingly slow normalization of the transmission mechanism of monetary policy. With slower global trade, the capex recovery will likely be delayed. Moreover, private consumption looks set to be slightly weaker than previously envisaged, as the deepening labor market deterioration and ongoing fiscal tightening will be only in part offset by the inflation slowdown. Given this backdrop, we now think that GDP will expand 0.7% annualized in 2H13, vs. the previous estimate of 1.2%. Our full-year GDP forecast for 2013 is now slightly below consensus, although the latest forecasts were collected before the 1Q GDP report, and we expect the consensus estimate to soon converge to (or fall below) our own projection.
- In April, CPI inflation was surprisingly weak, slowing to 1.2% yoy vs. 1.7%. Energy subtracted 0.2pp from the overall rate, while core inflation decelerated strongly (1.0% vs. 1.5%), largely due to the unwinding of the early-Easter effect. Inflation has probably troughed, although it is likely to remain below 2% throughout the forecast horizon.
- On 2 May, the ECB cut the refi rate by 25bp to 0.50%, while keeping the depo rate at zero percent. The central bank stands ready to act further if needed – presumably with another refi rate cut, if most growth indicators do not show any convincing upward trend within the next few months. The ECB also remains open-minded about the possibility of cutting the depo rate into negative territory. However, there is the risk that the side effects of this move could outweigh the benefits. Therefore, the bar for a negative depo rate seems higher than for another refi rate cut. In terms of unconventional policy, the ECB extended the full allotment until the end of 2Q14, in a move that provides liquidity insurance to the banking sector. Moreover, the GC started consultations with the EIB and the EC to promote a functioning market for ABS collateralized by loans to non-financial corporations. Given the weaker GDP/CPI outlook, we now see the beginning of the ECB's refi rate normalization in mid-2015, rather than at the end of 2014.

PACE OF RECESSION EASES



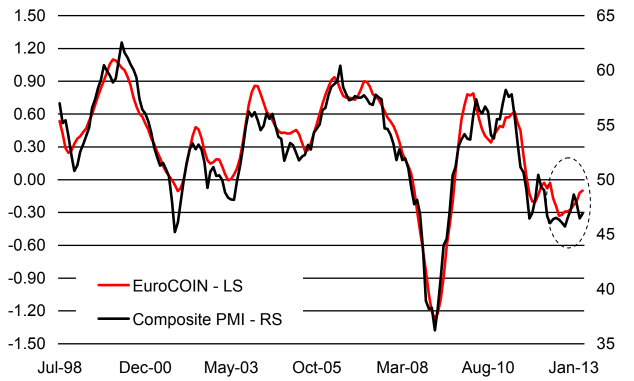
INFLATION HAS PROBABLY TROUGHED



Source: Eurostat, UniCredit Research

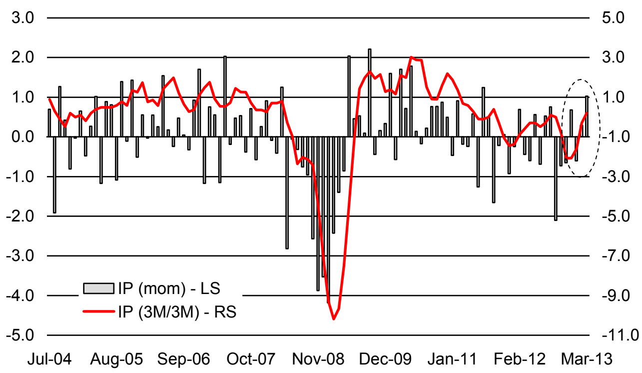
Eurozone

SURVEYS



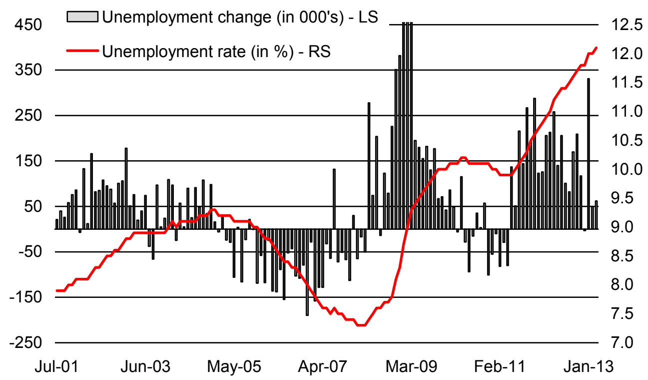
- EuroCOIN more optimistic than the Composite PMI.

INDUSTRIAL PRODUCTION



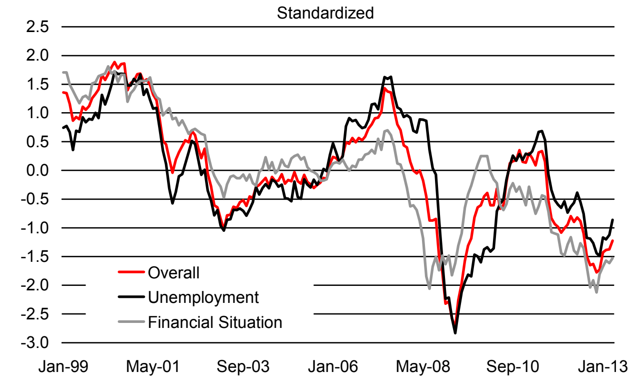
- Good resilience in 1Q13.

LABOR MARKET



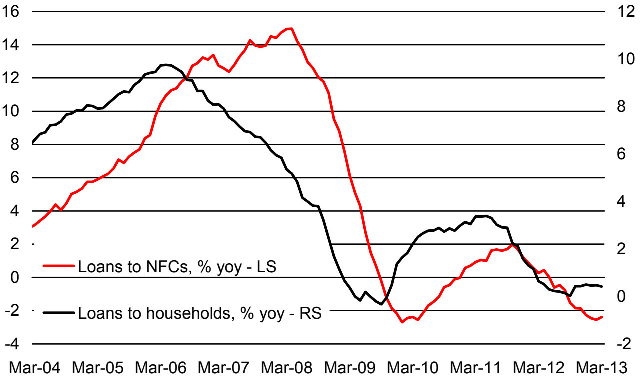
- Unemployment rate keeps climbing.

CONSUMER CONFIDENCE



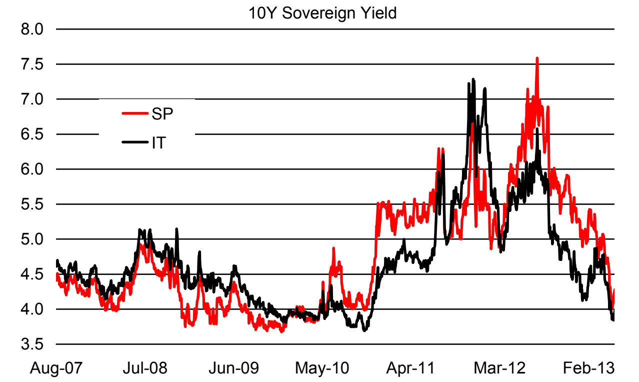
- Consumer confidence off the lows, but still weak.

LENDING



- Signs of stabilization in lending aggregates.

SOVEREIGN YIELDS



- Sovereign financing conditions in the periphery remain favorable.

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

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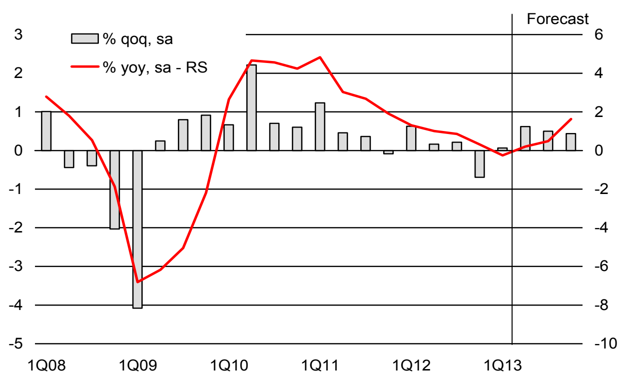
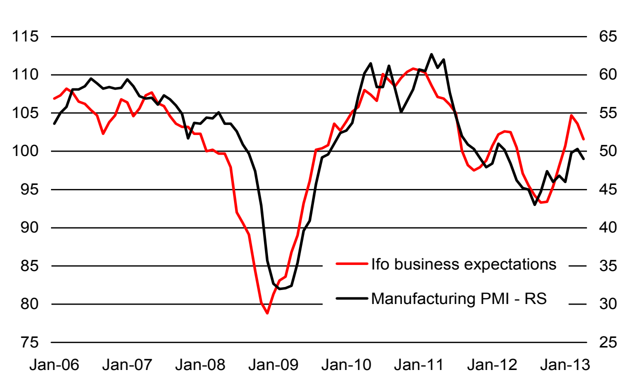
- In contrast to our expectations, German real GDP increased only a meager 0.1% qoq in 1Q13 after minus 0.7% at year-end 2012. The Federal Statistical Office (FSO) said that growth impulses came nearly exclusively from private consumer expenditures, whereas investment activity decreased further. Furthermore, the FSO said that the unusually harsh weather weighed on economic activity, thereby hinting to weak construction output.
- In our view, the weak 1Q13 GDP figure (and also partly 4Q12) does not reflect the "true" underlying strength of the German economy. Major reason is the freak weather which artificially depressed construction activity and cannot be taken into account by standard seasonal adjustment methods. Total construction output was down more than 3% in 1Q13 compared to 3Q12. Tellingly, at the same time, new orders in the construction sector (latest available figures January-February 2013) were up nearly 6% compared to 3Q12. As a result, a whopping gap between new orders and construction output emerged. This is very good news for overall economic activity in 2Q13, since a catching-up effect will kick in. Furthermore, the recent jump in domestic capital goods orders signals that the dry spell in investment in machinery & equipment will soon be over. To put it in a nutshell, we think that there is a very high probability of a strong growth comeback in 2Q13. Both construction and investment in machinery & equipment will likely bounce back. We revise upwards our growth forecast for 2Q13 from 0.5% to 0.6% qoq (see first chart).
- While economic activity should accelerate strongly in the second quarter, downside risks for 2H13 have popped up recently. Both the Ifo business expectations component and the Manufacturing PMI shifted into reverse gear. In April, the two business surveys declined strongly for the second consecutive month (see second chart). While we stick to our growth forecasts for the second half for the time being (3Q13: +0.5% qoq; Q413: +0.4%), we will scrutinize the next two monthly rounds of sentiment indicators very carefully. Given the very weak start into 2013, we have to revise downwards our growth forecast for the whole year from 0.8% to 0.5%.
- In contrast to subdued growth data, the good news from the German labor market continued recently. In March (latest available data), employment rose 22,000 mom after plus 44,000. In 1Q13 as a whole, the number of jobs increased by 90,000 and hence by the fastest pace in the last four quarters, boding well for ongoing positive growth contributions from private consumption.

BETTER 2Q13 GDP FIGURE IN THE PIPELINE



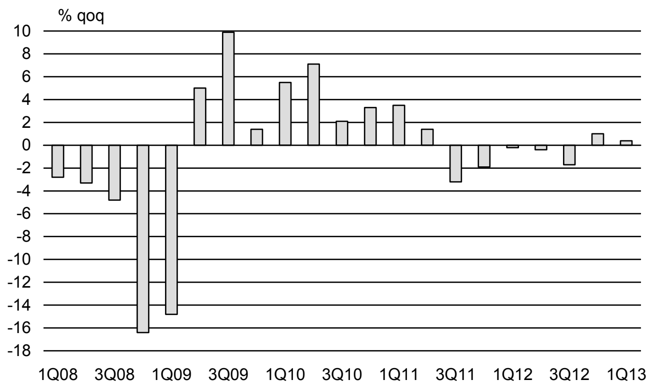
RECENT BUSINESS SENTIMENT DETERIORATION



Source: Feri, UniCredit Research

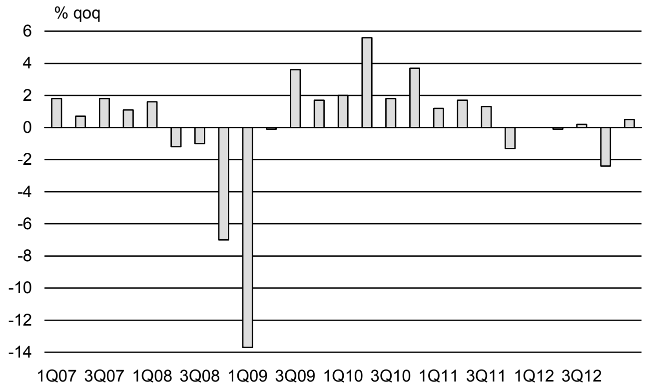
Germany

NEW ORDERS



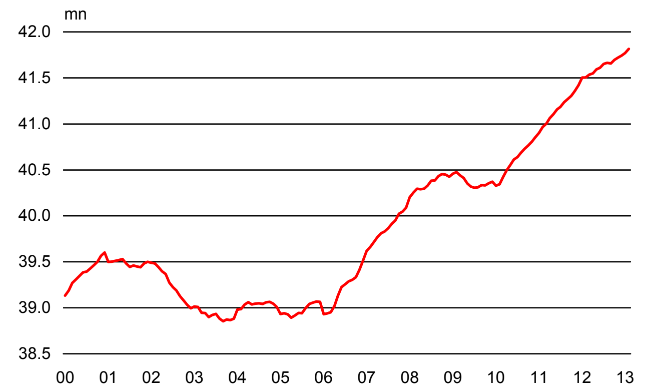
- New orders increased 2.2% mom in March. It was the second consecutive strong rise (1Q13: plus 0.4% qoq).

INDUSTRIAL PRODUCTION



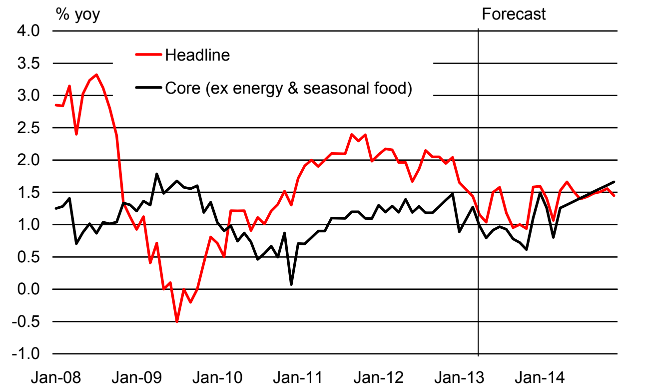
- Industrial production also rose for the second month in a row (March: +1.2% mom; 1Q13: +0.5% qoq).

EMPLOYMENT



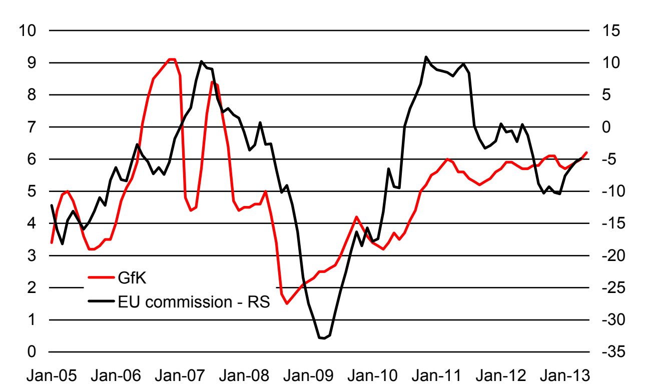
- Employment increased further markedly (1Q13: plus 90,000 qoq).

INFLATION



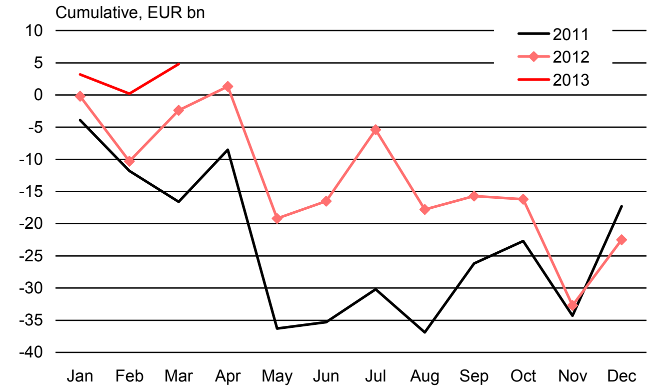
- Consumer price inflation was 1.2% yoy, which was the lowest rise since September 2010.

CONSUMER CONFIDENCE



- Consumer confidence continued its moderate upward trend, thanks to lower inflation and a rising number of jobs.

FEDERAL BUDGET BALANCE



- The federal budget balance improved further compared to the last two years. Major driver was increasing tax revenues.

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

France

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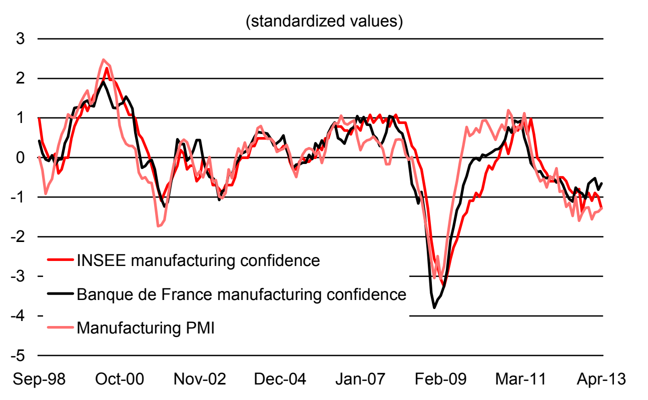
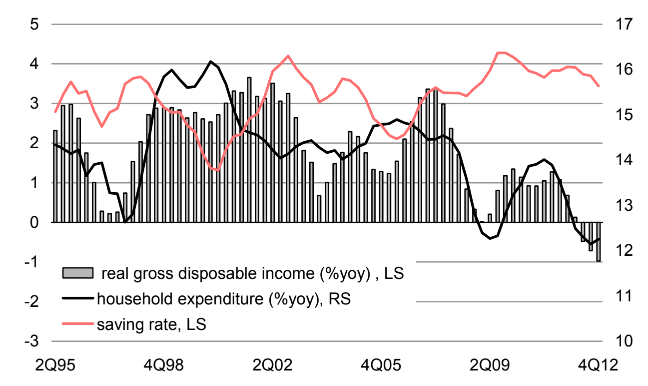
- GDP shrank 0.2% qoq in the first quarter, pushing France into a technical recession, i.e. two consecutive quarters of negative economic growth. The negative GDP number was explained by a further negative contribution from final domestic demand (-0.1pp, same as in 4Q12) and from net exports (-0.2pp vs. +0.2pp in 4Q12, as exports kept shrinking while imports rose marginally). This was only partly offset by the positive contribution from inventories (+0.1pp vs. -0.3pp). Regarding the domestic demand components, as expected, private consumption recorded a mild decline (-0.1% qoq, after the stagnation in 4Q12), while the contraction in gross fixed investment intensified (-0.9% vs. -0.8% qoq), especially in household investment (-1.3% vs. -0.8% qoq).
- Looking at the second quarter, the levels of the business surveys remained low in April, showing improvement, but at a very slow pace. This strengthened our suspicion that the GDP recovery may be proceeding in a more hesitant fashion than we expected mostly due to a lower trajectory for domestic demand. Accordingly, we have made some downward adjustments to our baseline GDP scenario, postponing the first signs of a recovery in output till 2H13. We now expect GDP to post a broad stagnation in 2Q and resume modest positive expansion from 3Q. This new GDP path brings our estimate for full-year average GDP to -0.3% compared to our previous 0.5% forecast.
- In the context of unimpressive external demand and fiscal tightening at home, the prospects for private consumption and capex are likely to remain subdued due to weakening fundamentals. Specifically, the deterioration in household real disposable income due to rising unemployment and tax increases will be only partly offset by a slowdown in inflation, while planned income and value-added taxes should weigh on the already weakened profits of non-financial corporates, further denting their capacity to invest out of their own resources. In addition, uncertainty about the outcome of a long-overdue reform of the welfare system (to be finalized by year-end) could weigh on consumer expectations, while the possibility of reversal of some recently-introduced measures to support investment may keep firms from investing.
- The European Commission has granted France two extra years, i.e. until 2016, to bring its deficit-to-GDP ratio below 3.0% provided the pace of structural reforms (pensions, services liberalization) is significantly accelerated. The commission will formally publish its opinion on the French stability program on 29 May.

BUSINESS SURVEYS ARE IMPROVING BUT AT A SLOW PACE



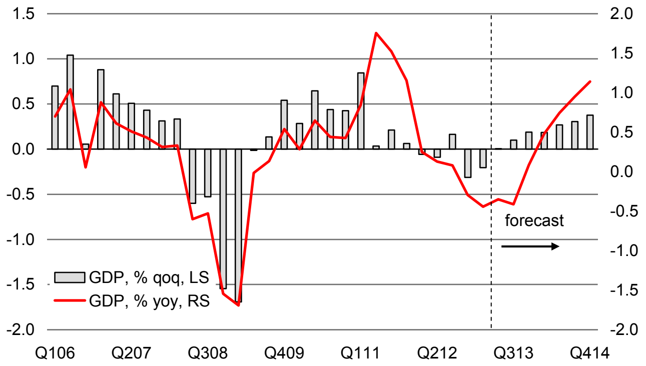
FUNDAMENTALS ARE WEIGHING ON PRIVATE CONSUMPTION



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

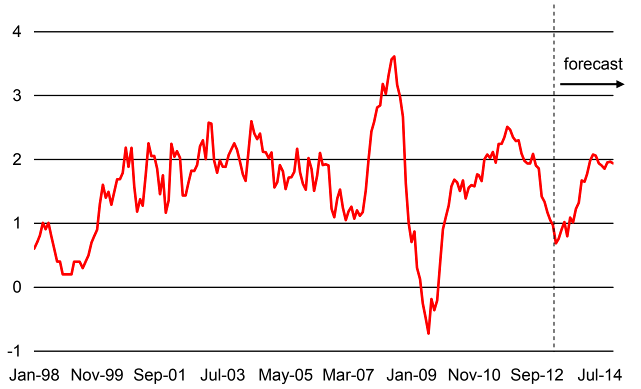
France

GDP



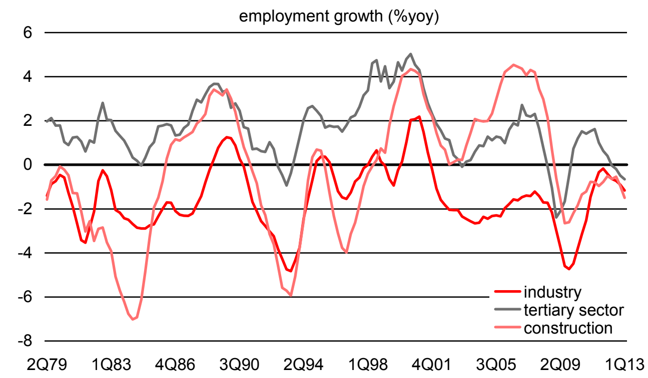
- We revise down our GDP forecasts from 0.5% to -0.3% for 2013, and from 1.2% to 0.8% for 2014.

INFLATION



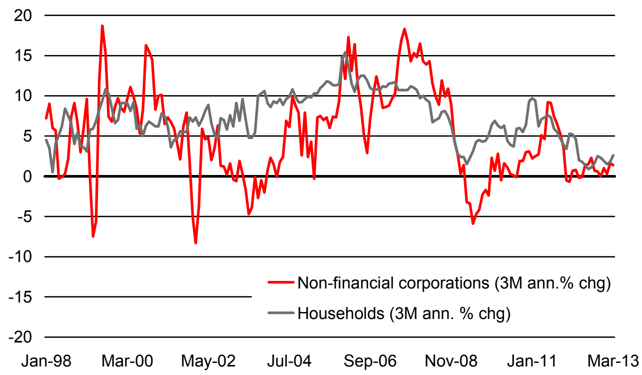
- Inflation probably troughed in April.

EMPLOYMENT



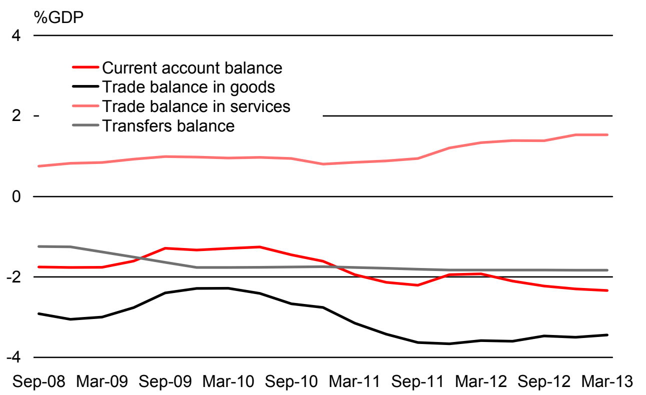
- The recent intensification of job shedding has weighed on the services sector.

LENDING TO THE PRIVATE SECTOR



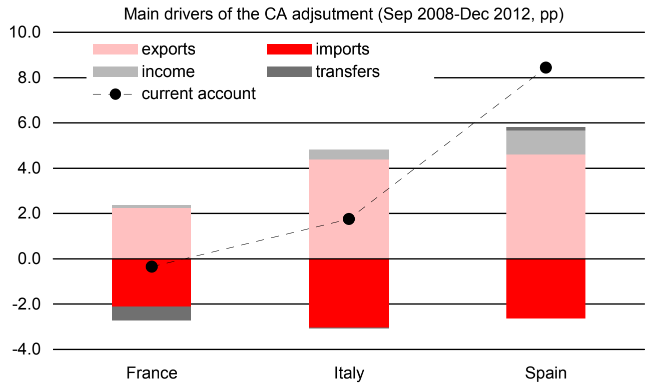
- Lending growth to the private sector regained some traction at the end of the first quarter.

CURRENT ACCOUNT



- The current account deficit stabilized at 2.3% of GDP in March.

CURRENT ACCOUNT – MAIN DRIVERS



- Exports nearly totally offset the drop in imports and transfers in the aftermath of the 2008 financial crisis.

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

Italy

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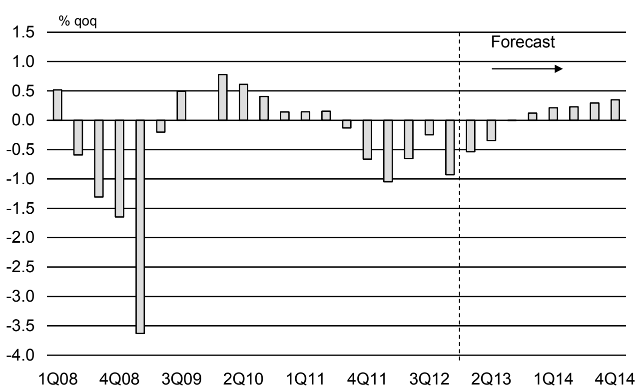
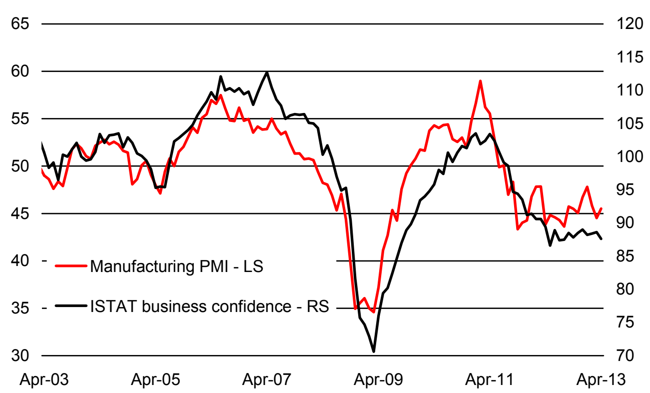
- We lower our GDP forecasts to -1.7% (vs. -1.3%) and to 0.6% (vs. 0.7%) for 2013 and 2014, respectively. Our downward revisions reflect a weaker-than-expected 1Q GDP (-0.5% qoq vs. -0.4%) and a lower growth profile in the remainder of the year. We now see 2Q GDP contracting by 0.4% qoq (vs. +0.1%), as business surveys at the beginning of 2Q have shown virtually no improvement versus the first quarter and continue to flag weakness in factory and economic activity. In addition, the failure of private sector surveys to resume a clear upward trend suggests that a return to mildly positive growth is likely to be postponed to late 2013 when the benefit of the injection of liquidity into the economy through the clearance of arrears will start to materialize[2]. This liquidity is expected to underpin the recovery in domestic demand and, hence, in GDP growth during 2014.
- The bulk of the revision to our estimates comes from domestic demand. We have lowered our household consumption forecasts to take into account: **1.** a steeper decline in real disposable income of households this year, albeit at a slower pace than in 2012 (-2.0% vs. -4.6%); **2.** consumer sentiment still at a two-decade low, and **3.** a greater-than-expected desire on the part of households to lift their savings – note that in 4Q12 the total household savings rate declined to an all time-low of 11.4% (vs. its long-term average of 15%). While we previously anticipated a recovery in capex (mostly export-led) in 2013 – in a context of still declining construction investment – tight financing conditions (in spite of the ECB's liquidity support), continued high uncertainty over internal demand prospects, and firms' weak financial position are likely to postpone the beginning of private investment recovery to end-2013. This unfavorable environment is expected to make adjustment in construction activity even more severe. In contrast, we assume the export recovery will continue to unfold, although at a slightly slower pace.
- In line with the new GDP outlook, we fine-tune our fiscal forecast for 2013-2014: we now see the fiscal deficit at 3.1% (vs. the previous 2.2%) in 2013 and 2.3% (vs. 2.0%) in 2014. In particular, the 3.1% deficit for 2013 includes a 0.5pp negative impact from the payment of arrears by the PA, as well as a more benign projection for interest expenditure than previously penciled in. Accordingly, the debt-to-GDP ratio should rise to 131.0% in 2013 and start declining slightly in 2014 to 130.3%. The unfavorable economic situation continues to challenge the government's commitment to holding the 2013 deficit to less than 3.0%, in order to escape from the EC's excessive deficit procedure. The decision is expected by the end of May, and we think the outcome will be positive.

OUR NEW GDP FORECAST



BUSINESS SURVEYS FLAG ONGOING WEAKNESS IN 2Q

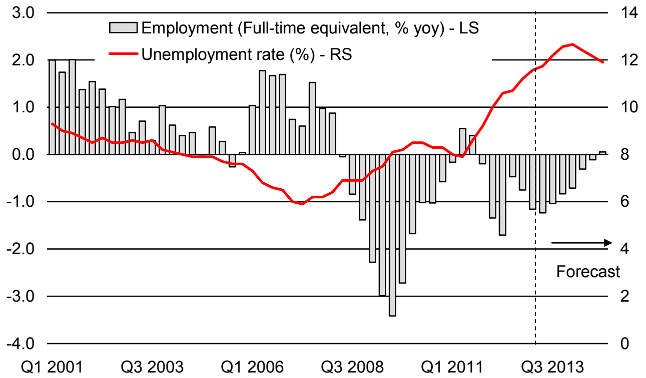


Source: ISTAT, Markit, UniCredit Research

[2] For more on this, please refer to "Italy: The impact of arrears payments on GDP" – Economic Flash, 3 May.

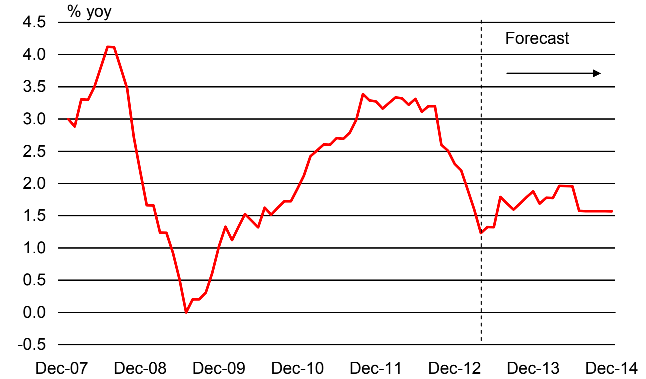
Italy

LABOR MARKET INDICATORS



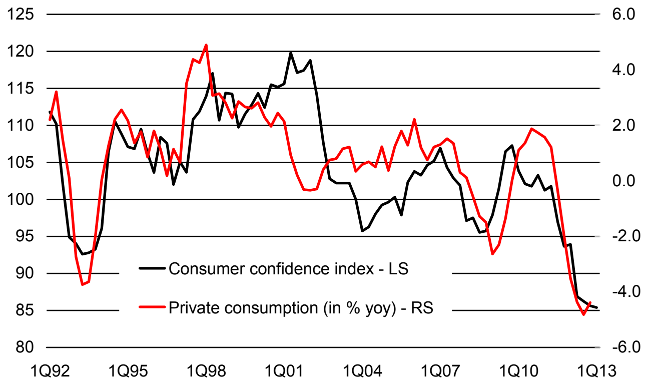
- The unemployment rate is rising and will continue to do so in the coming quarters, averaging 12.0% in 2013 (and 12.3% in 2014).

INFLATION



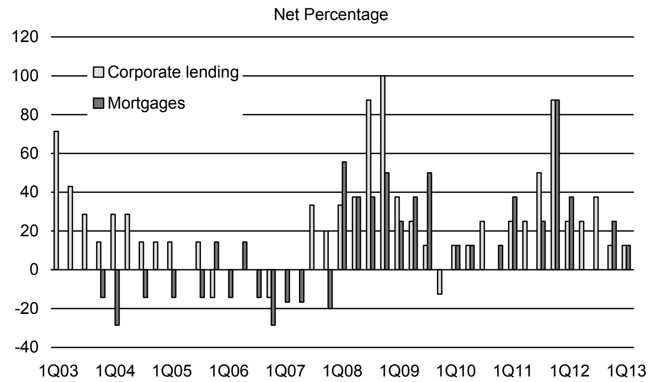
- CPI inflation slowed to 1.2% in April, but an upward trend is likely to resume in May.

CONSUMER CONFIDENCE



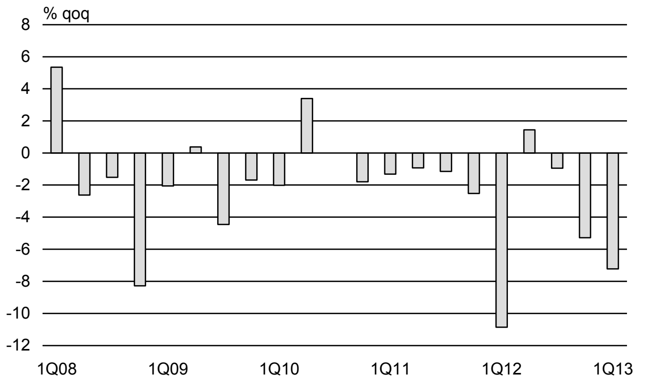
- Consumer sentiment still at two-decade low.

BANK LENDING SURVEY: CREDIT STANDARDS



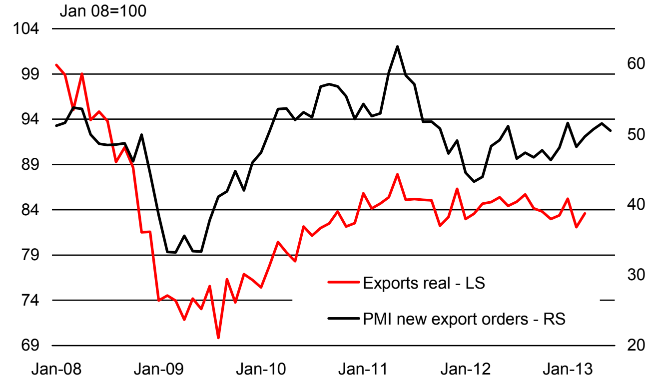
- In 1Q13, Italian banks reported a further tightening of credit standards for corporate loans and mortgages.

CONSTRUCTION OUTPUT



- Construction activity performed quite poorly in 1Q13, contracting by 7.2% qoq (vs. 5.3% in 4Q12).

EXPORTS



- Improving exports prospects.

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

Spain

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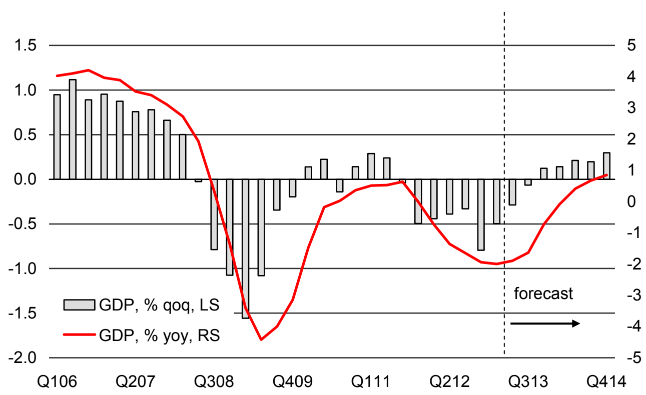
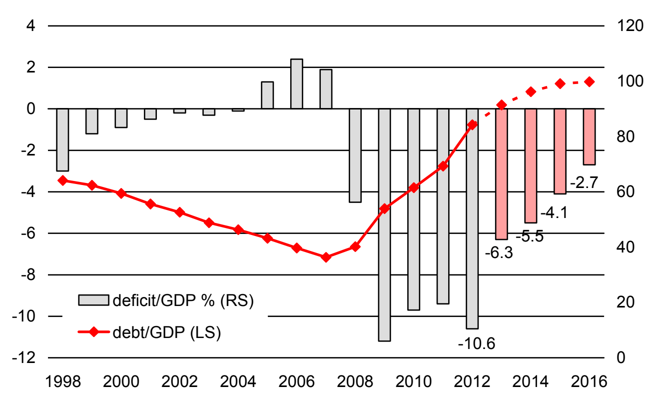
- Spain's 1Q GDP came in at -0.5% qoq, pointing to an easing in the pace of the recession compared to the final quarter of 2012 (when GDP shrank 0.8% qoq). The yearly rate settled at -2.0% vs. -1.9% in 4Q12. While the GDP breakdown is not yet available, the national statistics office stated that the slower pace of recession was mainly explained by a less pronounced contraction in domestic demand (which shrank by 1.8% qoq in 4Q12), while net exports continued to add to GDP. The softer GDP contraction was most likely driven by a partial correction of the sharp drop in private consumption recorded in 4Q (-1.9% qoq).
- Notwithstanding the fact that 1Q GDP came in line with our forecast, we have made some small downward adjustments to our baseline GDP scenario due to indications of a softer global growth and trade in 2H than previously expected. In a nutshell, we now foresee Spain exiting recession only in the fourth quarter of this year, with GDP recovering gradually through 2014. The new GDP path brings down the full-year GDP average by 0.2pp to -1.6%. The 2014 GDP average settles at +0.5%. In our new baseline scenario, domestic demand continues to be a drag on GDP growth until 2014, although at a diminishing rate. As a mitigating factor, net exports continue to add to GDP growth over the forecast horizon. We see their contribution declining gradually in the coming quarters, as import growth slowly normalizes.
- HICP inflation slowed down by 1.1pp to 1.5% in April, the lowest level since August 2010. The sharp decline was driven by a large favorable base effect on housing and transport as well as a significant monthly drop in communication (-2.5% mom) and leisure (-0.9% mom) prices. The sharp drop in fuel prices (-2.0% mom after -1.0% in March) also amplified the base effect on transport inflation. Inflation will probably re-accelerate in May before declining towards 1.0% in the summer.
- On 29 May the European Commission will deliver its opinion on the national reform and stability program for 2013-2016, which the government presented at the end of April. Given that the smoother path of deficit reduction penciled into the stability program (6.3% in 2013, and 5.5% in 2014 instead of the 4.5% and 2.8% previously forecasted) was set "in coordination" with the European Commission, the main highlight will be new policy guidelines. The Commission recently called on the government to step up its efforts regarding the creation of an independent fiscal authority, the approval of the long-overdue electricity sector law, the deregulation of professional services and a new pension reform.

PACE OF RECESSION EASES



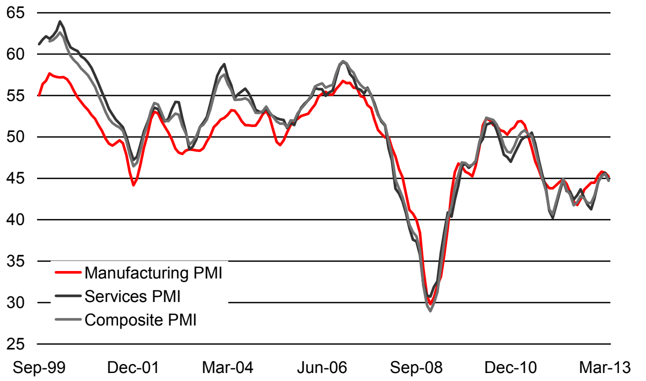
THE GOVERNMENT'S NEW DEFICIT AND DEBT FORECASTS



Source: INE; Spanish Treasury, UniCredit Research

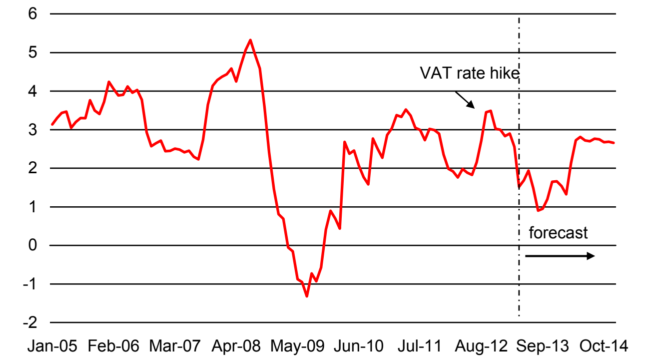
Spain

PMIS



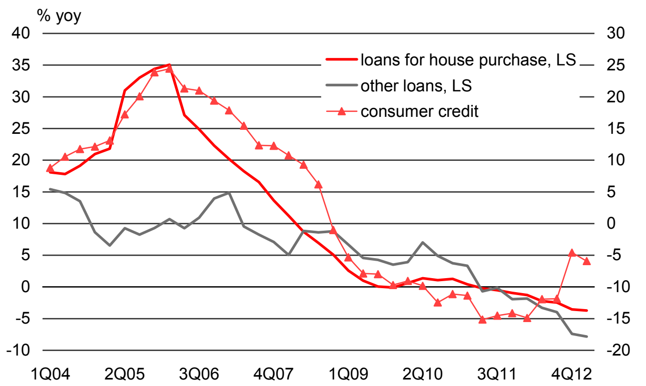
■ PMI surveys have improved in 1Q13, although they still remain at subdued levels.

INFLATION



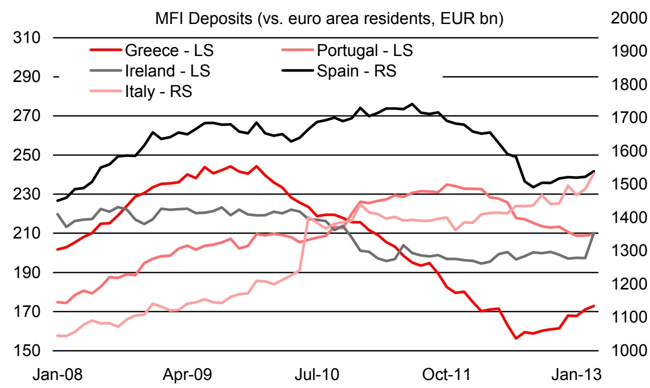
■ Inflation will probably re-accelerate in May before declining towards 1.0% in the summer.

HOUSEHOLD CREDIT GROWTH



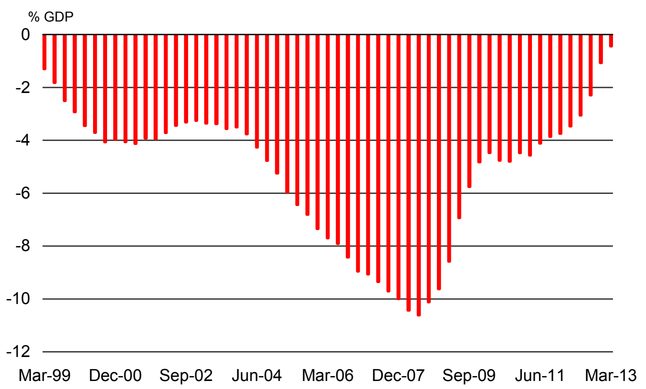
■ The contraction in lending to households deepened further in 1Q13.

BANK DEPOSITS



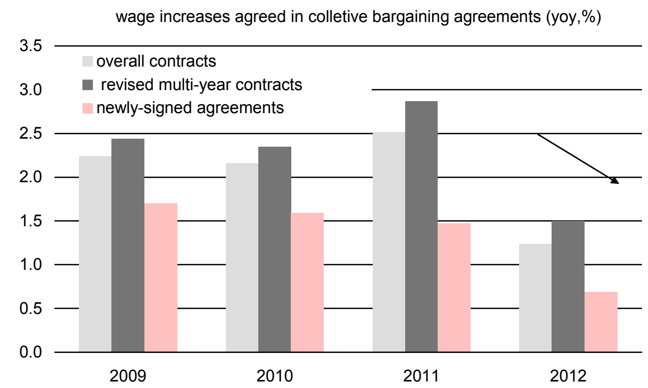
■ The decline in deposits came to a halt in August 2012 and we have since been witnessing a moderate increase.

CURRENT ACCOUNT



■ The current account deficit has been shrinking steadily, settling at only -0.4% of GDP in February 2013 (latest data available).

NEGOTIATED WAGES



■ Reforms of the collective bargaining framework have started to bear fruit.

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

Austria

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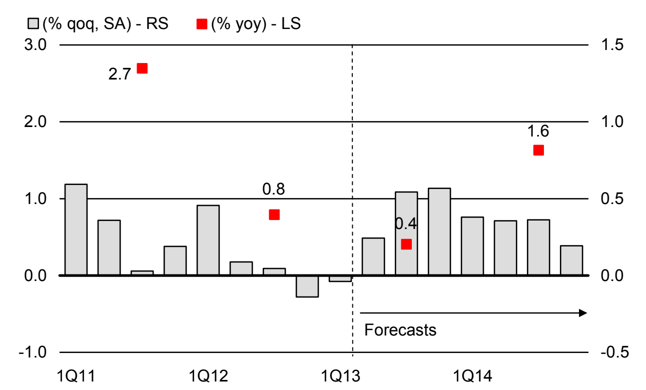
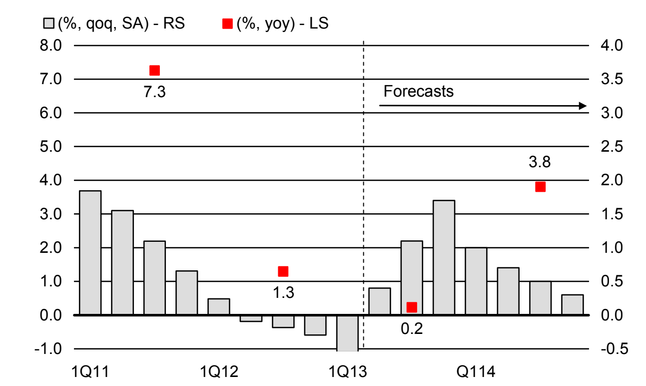
- According to an initial estimate, Austrian GDP stagnated in 1Q13 compared to the previous quarter, continuing the sluggish pattern of growth (2Q12: +0.1%, 3Q12: +/-0%, 4Q12: 0.1%. Domestic demand stagnated again, growth in public consumption (+0.5%) caused total consumption to increase by a moderate 0.1% only, while private consumption decreased slightly. Gross fixed capital formation decreased again, this time at a faster pace, by -0.5% (vs. 4Q12: -0.3%). Moreover, net exports were unable to provide any impetus to the economy, with exports and imports each growing by just 0.3%.
- After the lackluster performance at the beginning of the year, we expect the economy to continue to flag in 2Q. Investment activity and consumption are very low under the current conditions, and domestic demand remains the economy's main weakness. Foreign trade should offset these trends to a certain extent in the coming months. Exports look set to grow moderately only because of the soft economy in many European countries. At the same time, import demand should grow more slowly, allowing foreign trade to make a positive contribution to economic growth in 2Q. In light of the continued weak domestic demand, our original forecast of 0.5% qoq economic growth for 2Q13 has proven to be too optimistic. We now expect GDP to expand by no more than about 0.2%.
- The Austrian economy is likely to see an improvement in the second half of the year, as the moderate recovery of the global economy is continuing. Further, there are also growing signs of economic stabilization in the European Union. It is quite likely that the Austrian economy will see a late economic spring in the second half of the year with support from foreign trade, and that this will offset the weaker developments over the past months to a certain extent. Nevertheless, we have lowered our forecast for 2013 slightly to 0.4%. In 2014, Austria's economy should grow by a much stronger 1.6%.
- Inflation: Modest price increases of commodities, especially crude, led to a reduction in average inflation to 2.5% in 1Q. In April, inflation declined further to 1.9% yoy and with economic activity lackluster, inflationary pressure in the coming months should remain weak. In view of the stronger-than-expected downwards trend of inflation at the start of the year, we have lowered our forecast for annual average inflation in 2013 from 2.2% to 1.9%.

GDP STAGNATING SINCE 2Q12



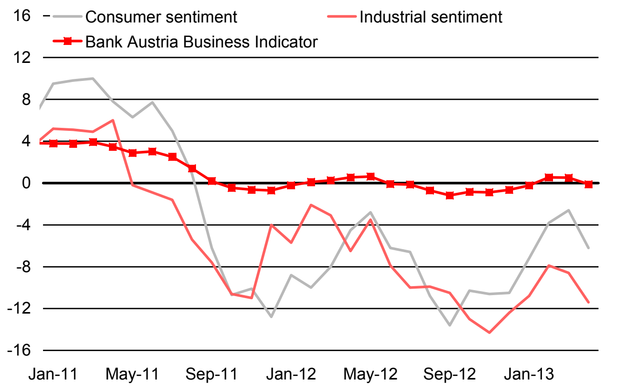
INVESTMENT FALLS FOR FOUR CONSECUTIVE QUARTERS



Source: Statistik Austria, UniCredit Research

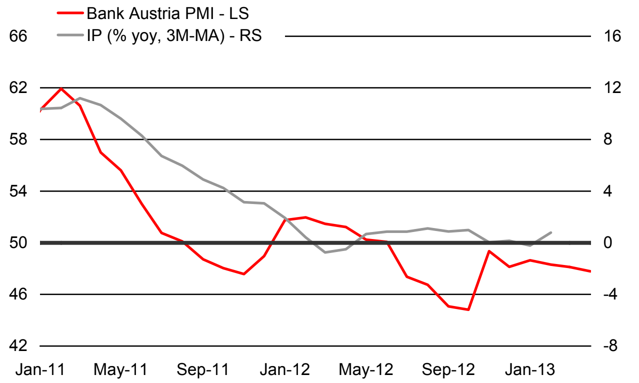
Austria

CONFIDENCE



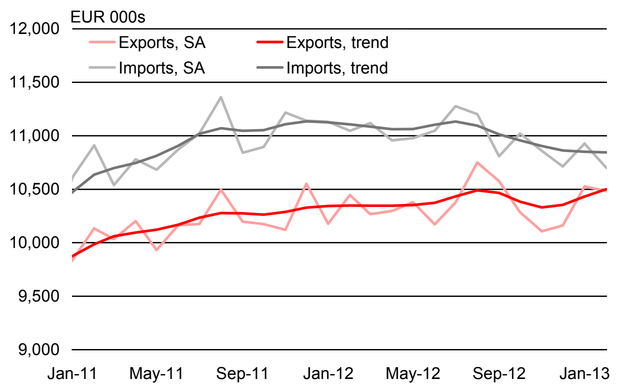
- In April, sentiment deteriorated among Austrian consumers and manufacturers, driving our business indicator downwards.

PMI AND INDUSTRIAL OUTPUT



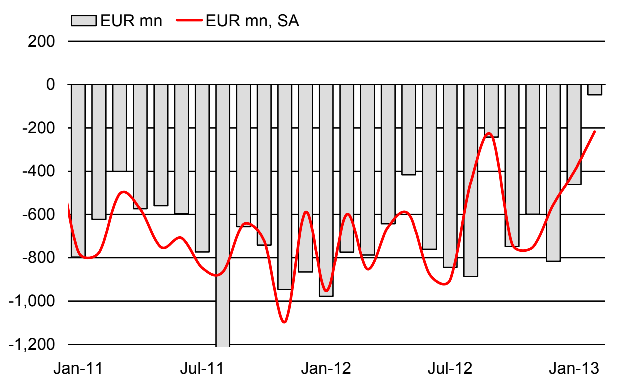
- Manufacturing PMI came in at 47.8 points in April, once again below the growth threshold due to lack of demand.

EXPORT AND IMPORT VOLUME



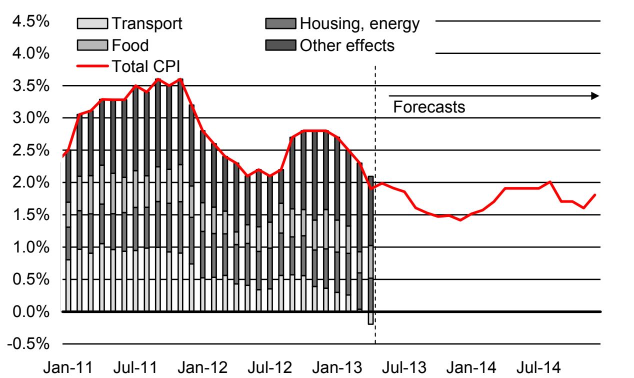
- Export growth accelerated slightly in early 2013 after a weak year-end 2012, but foreign demand remains low.

TRADE BALANCE



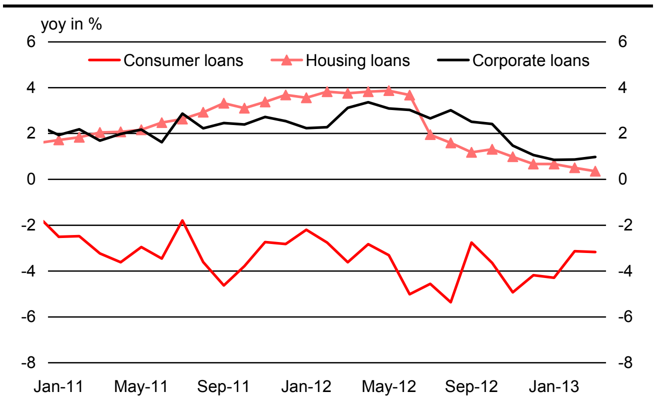
- Trade deficit narrowed significantly in early 2013 due to lower prices for imported raw materials (among other reasons).

INFLATION



- Inflation continued its downward trend in April, amounting to 1.9% compared to the previous year.

LENDING TO HOUSEHOLDS AND CORPORATES



- Lending volumes fell again in March by 0.2% yoy, mainly as a result of decreasing volumes of loans to private households.

Source: Statistik Austria, UniCredit Research

Greece

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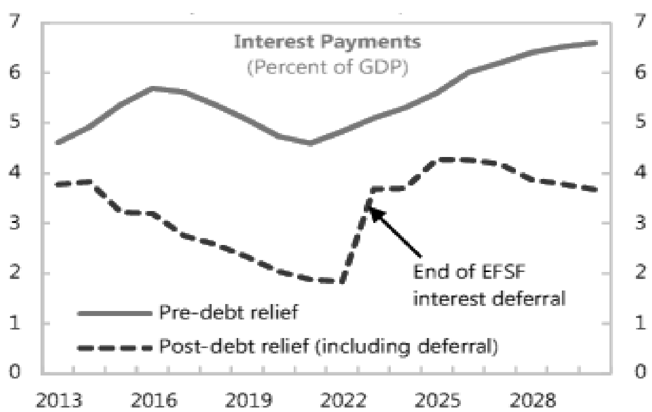
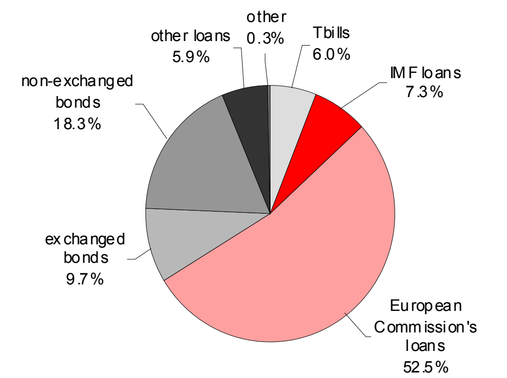
- In a context in which fears of a euro exit have receded, strong investor demand for high-yield assets has recently prompted renewed interest in Greece as reflected in the sizeable compression of the GGB-Bund spread at the 10Y tenor, and the recent rally in the domestic equity market. Demand from hedge funds and private banks has reportedly been channeled towards GDP warrants, issued after last year's debt restructuring, and bonds issued by large Greek companies, which have been tapping the credit markets in increasing numbers of late. This improvement in sentiment was accompanied by Fitch's recent decision to upgrade the sovereign credit rating from CCC to B- (outlook stable). While this new rating leaves the sovereign in deep junk territory, this is the first upgrade of the sovereign rating by Fitch since the start of the bailout and is clearly welcome. The rating agency explained the revision by citing clear progress on the rebalancing of the economy and the reduction in the twin deficits. We recall that Greece is currently rated C by Moody's and B- by S&P.
- With market sentiment improving, restoring growth remains the overarching precondition for the Greek program to succeed. This requires the adjustment process to rely more on measures aimed at fostering an early supply-side response rather than across-the-board expenditure cuts and higher taxes on those earning a salary or a pension. The latter have so far proved successful in reducing imbalances but this has come at the expenses of GDP growth. Against this background, the key risks concern the government's perseverance vis-à-vis vested interests, not least given the vulnerability of a coalition government with a relatively thin majority. The Troika recently explicitly acknowledged the risk that positive economic growth could fail to return in 2014 as foreseen if product and services market reforms do not accelerate as envisaged under the program. Moreover, the economic recovery is still facing the headwinds of the pronounced fiscal consolidation in 2013 and weak economic growth in the euro area. In the first quarter, the pace of GDP recession eased but only moderately so (from -5.7% yoy to -5.3%).
- The fiscal outlook beyond 2014 remains inherently uncertain as it hinges greatly on progress in strengthening the tax and social security revenue administrations. Within the current macroeconomic framework, the Troika estimates that the fiscal gap is worth about 1.7% of GDP in 2015 and 2.1% of GDP in 2016. The task of filling this gap in 2015-16 will be taken up in the context of the 2014 budget negotiations in the fall. The Troika recently reminded Greece's eurozone peers of their pledge to provide the country with additional debt relief (provided Athens fulfils its fiscal targets). This could include more generous terms on loans, or outright transfers (least likely).

INTEREST PAYMENTS WERE REDUCED SIGNIFICANTLY



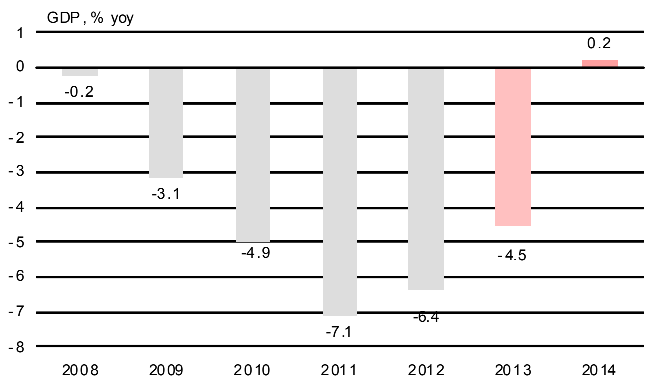
2012 GENERAL GOVERNMENT DEBT BY INSTRUMENT



Source: IMF, UniCredit Research

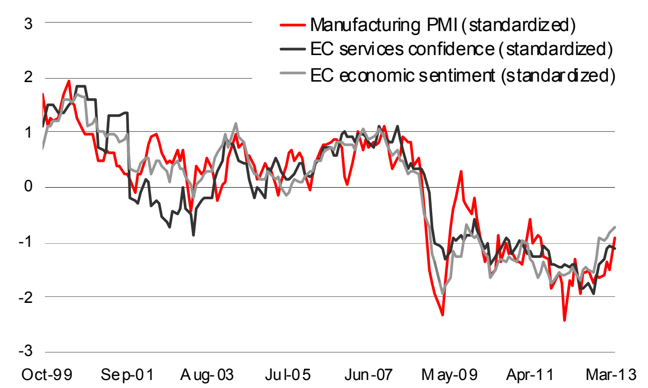
Greece

GDP



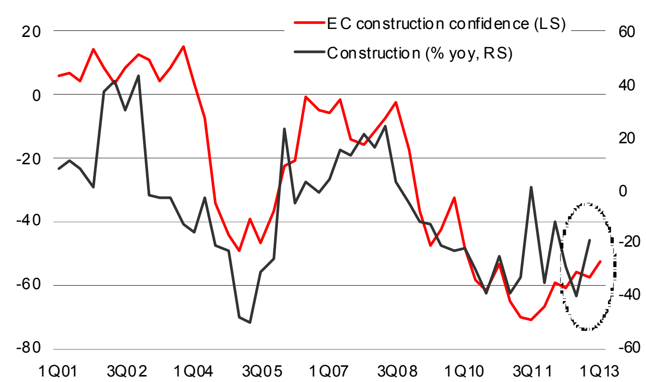
- Greece may exit recession next year.

SURVEYS



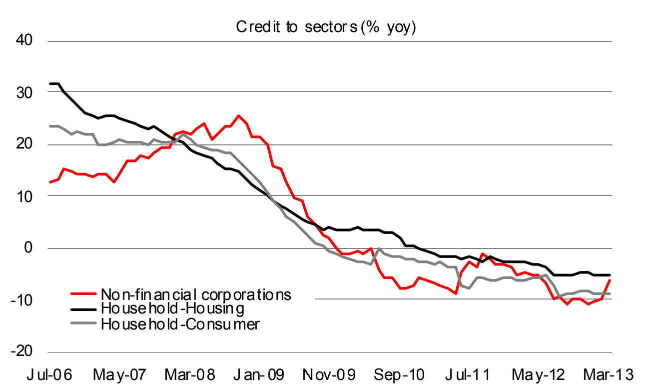
- The EC economic sentiment rose to the highest level since October 2008 in April.

CONSTRUCTION



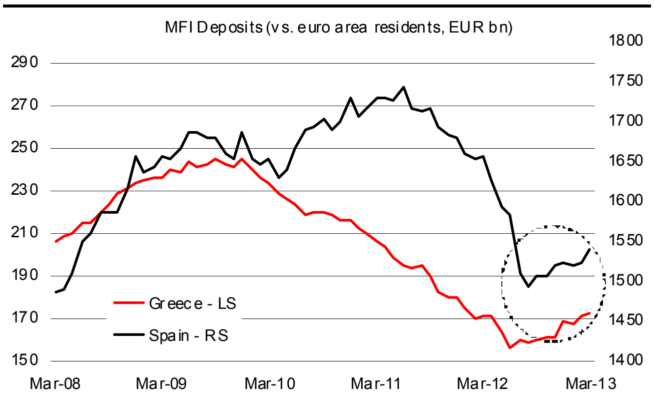
- The EC survey of construction activity suggests that sectoral output fared well in 1Q13.

CREDIT GROWTH



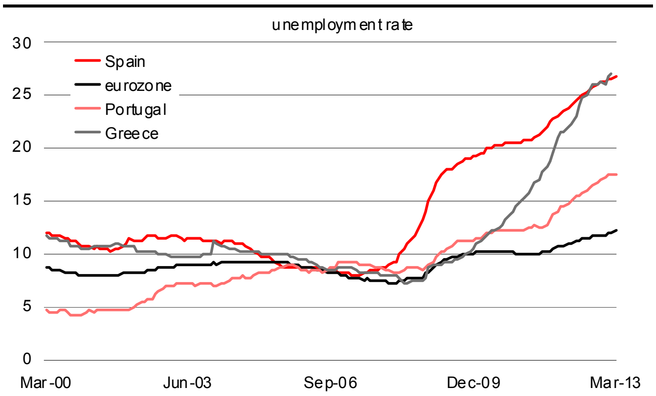
- The pace of contraction in credit for NFCs eased significantly in 1Q13 (to -6.2% from -9.6% in 4Q12).

DEPOSITS



- There has been a reflow of deposits since the last summer.

UNEMPLOYMENT



- The unemployment rate is skyrocketing, having reached 27% in February.

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

Portugal

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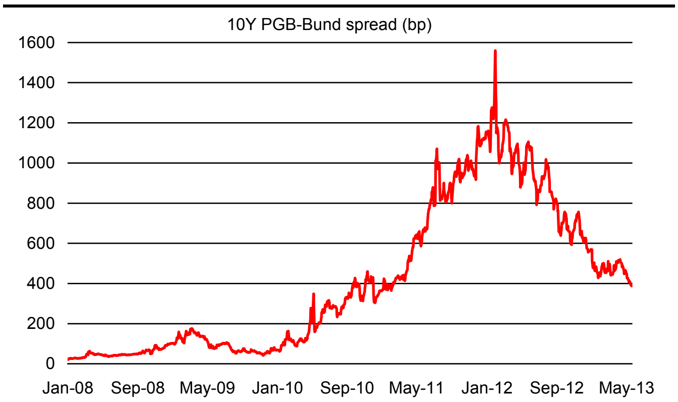
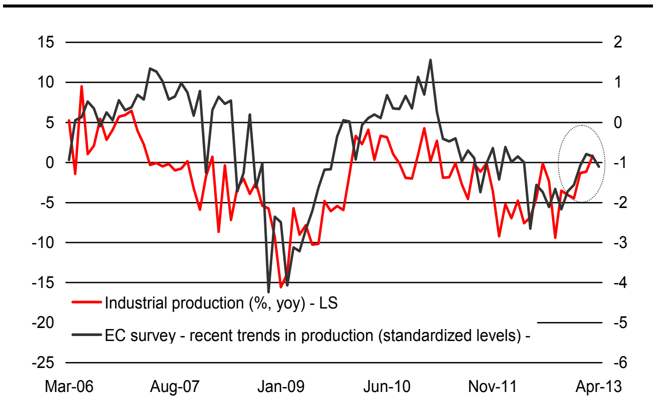
- The sovereign outlook keeps improving gradually amid better financing conditions and more generous terms from official creditors in terms of loosed fiscal targets and extended maturities of EFSF and EFSM loans. This rewards the Portuguese government for its firm commitment to program conditionality against the background of institutional complications for the adjustment process and rising divisions within the governing coalition about the composition of the needed austerity package. Should the market remain as constructive as it is now, although regaining full market access as soon as next year will be challenging, it may prove manageable. Of course, financing pressures continue to be a risk due to a slower-than-assumed recovery in economic activity, a more moderate pace of fiscal adjustment and higher demands on the government to cover shortfalls in SOEs, PPPs and of regional and local governments. We thus cannot completely rule out the possibility that Portugal will have to request additional help from its EU peers as the program expires in mid-2014. The positive news is that the Troika repeatedly affirmed its pledge to continue to support the country "as long as needed", provided Lisbon's commitment remains genuine and broadly held.
- Against a background of declining market yields, on 7 May the Portuguese authorities issued a new 10-year bond – the first since the start of the bailout program – raising EUR 3bn at a yield of 5.669%. The syndicated issue attracted total bids in excess of EUR 13bn from just under 370 investors. As with the previous syndicated tap of PGB Oct17 held in January, there was broad investor interest by geography, with the majority taken up by European investors, especially from the U.K. Distribution by type of institution was similarly broad, including insurance and pension funds as well as banks and asset managers, with a relatively lower uptake by hedge funds compared to January. With this issuance, Portugal is in a very comfortable position in terms of funding for this year.
- On 13 May, the Eurogroup acknowledged the conclusion of the seventh program review, which took longer than expected due to the government's difficulties in forging consensus on new fiscal measures aimed at offsetting the impact of the unfavorable constitutional court ruling. The disbursement of the EUR 1.3bn EU tranche by the EFSF remains, however, conditional on the Troika's approval of the new saving measures committed to covering the additional financing needs arising from the revised fiscal targets. This reportedly reflects lingering divisions within the coalition government about the composition of the savings package.
- The pace of the recession eased significantly in the first quarter, with the GDP printing at -0.3% vs. -1.8% in 4Q12. While no expenditure breakdown is available at this stage, the INE reported that the net exports contribution rose on falling imports.

MARKET CONDITIONS HAVE IMPROVED FURTHER



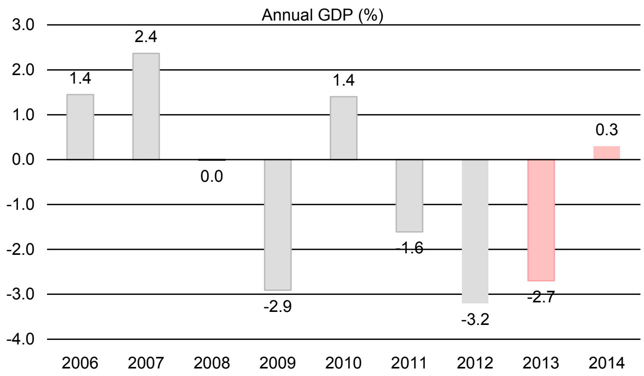
IP POSTED A SEIZABLE REBOUND IN 1Q13



Source: Bloomberg, Eurostat, UniCredit Research

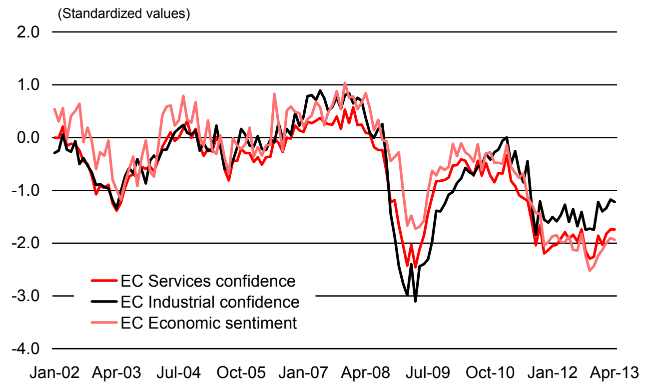
Portugal

GDP



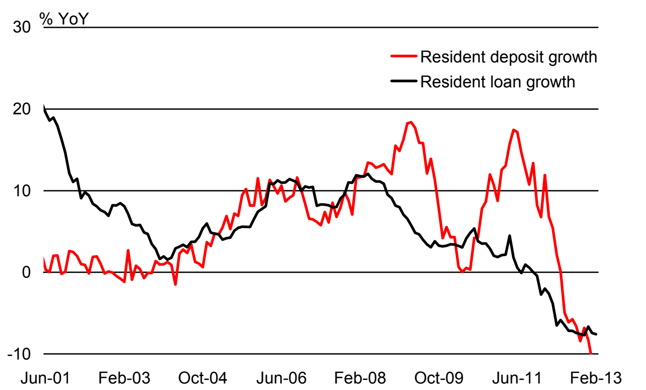
- We revise marginally down our GDP forecasts to -2.7% for 2013 (vs. -2.5%) and to +0.3% (vs. +0.4%) for 2014.

SURVEYS



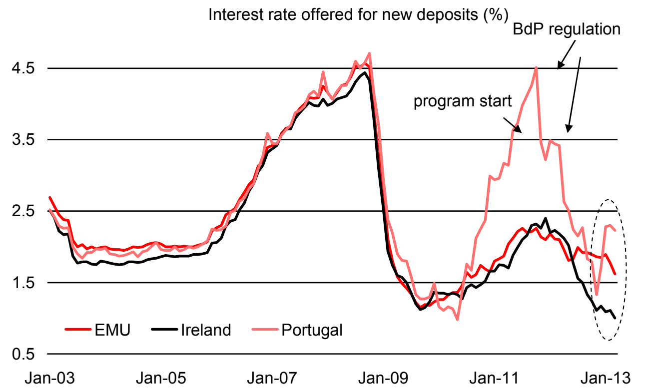
- Sentiment has been improving steadily, especially in the industrial sector.

DEPOSIT AND LOAN GROWTH



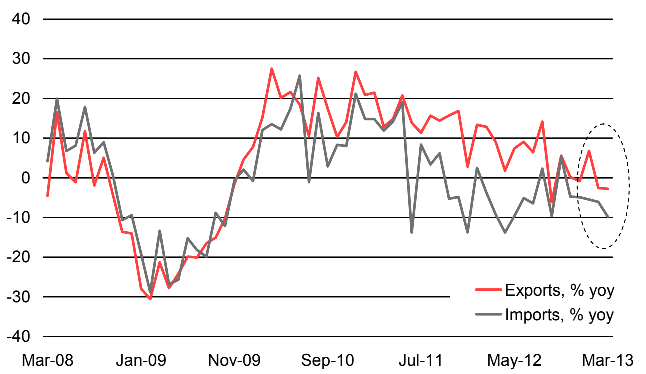
- Deposit growth continues to slow…

DEPOSIT RATES



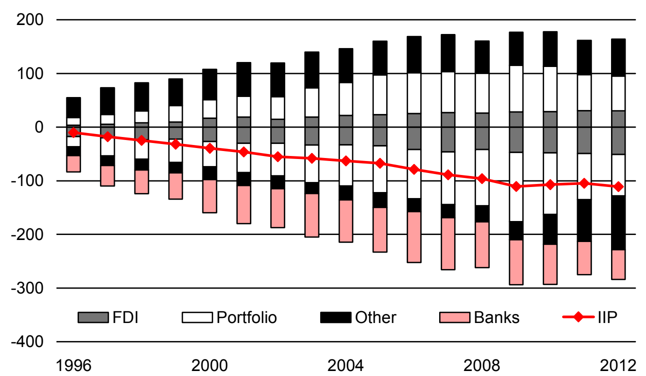
- …although interest on new deposits recently rebounded.

EXPORT AND IMPORT GROWTH



- The contraction in imports intensified in 1Q13.

NET IIP



- External deleveraging is only just beginning.

Source: INE, Bank of Portugal, UniCredit Research

UK

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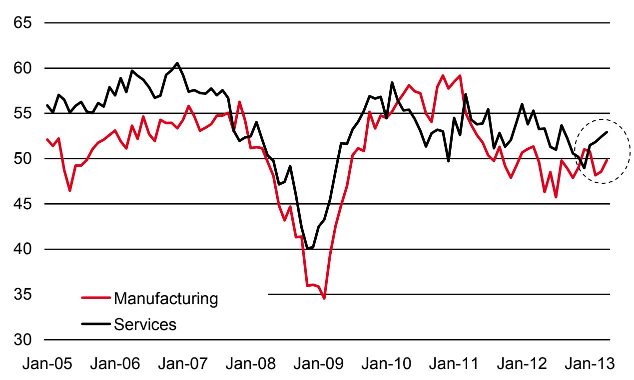
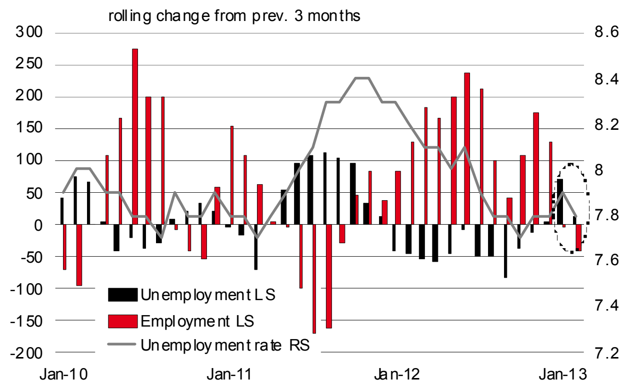
- According to the preliminary estimate, GDP rose by 0.3% qoq in 1Q13, slightly more than expected (0.1%). The positive surprise came from stronger growth in the services sector and a less negative figure for construction than we had anticipated. The sector breakdown shows that the main driver was the services sector output, in line with the greater resilience of the services PMI seen in 1Q13. Looking forward, we expect GDP growth to remain modest in the remainder of the year before gradually accelerating in 2014.
- The April round of PMIs was relatively encouraging (see left chart). The services PMI rose from 52.4 to 52.9, suggesting that the services sector remained resilient at the beginning of 2Q. The manufacturing index climbed back close to the 50-threshold, indicating a stabilization of activity. Taken at face value, April PMIs are consistent with GDP growth of around 0.3%, slightly higher than our forecast (+0.2%). The labor market showed some deterioration in the three months to March (see right chart) after the good performance in 2012. However, it is still too early to say whether this constitutes a trend inversion.
- CPI inflation slowed from 2.8% to 2.6% in April, mainly driven by transport prices, which subtracted 0.3pp from headline inflation. Looking forward, we see inflation picking up in May and June, in part due to unfavorable base effects. However, in light of today's data, we now see inflation peaking below 3.0% in June (vs. 3.0 previously). We expect inflation to slow in the second half of the year, although still remaining above target. We revise the annual averages from 2.7% to 2.5% for 2013 and from 2.3% to 2.2% for 2014.
- The Bank of England published its May Inflation Report. Overall, the tone was slightly more positive compared to the February report. GDP growth projections for the next three years were revised up slightly, while the inflation projections were revised down slightly. However, the underlying story of a modest economic recovery, with inflation remaining above target for much of the next two years, remains essentially the same. In terms of policy implications, the May Inflation Report is consistent with our expectation of no further monetary easing going forward, barring a renewed deterioration of the growth outlook.
- We have pushed back the timing of the first Bank rate hike from 4Q14 to the first half of 2015. This reflects two factors. First, despite the recent relatively good set of data, growth in the UK is likely to remain modest and unlikely to meaningfully decouple from our (weaker) GDP outlook in the euro area. Second, in light of the ECB rate cut in May and our postponement of the timing of the first refi rate hike from 4Q14 to mid-2015, we believe that the BoE will be willing to wait longer before starting to normalize policy.

BOTH PMIS ROSE IN APRIL



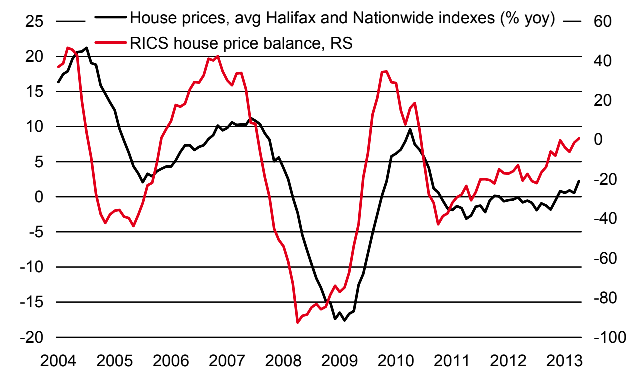
EMPLOYMENT DOWN IN THE THREE MONTHS TO MARCH



Source: Office for National Statistics, Markit, UniCredit Research

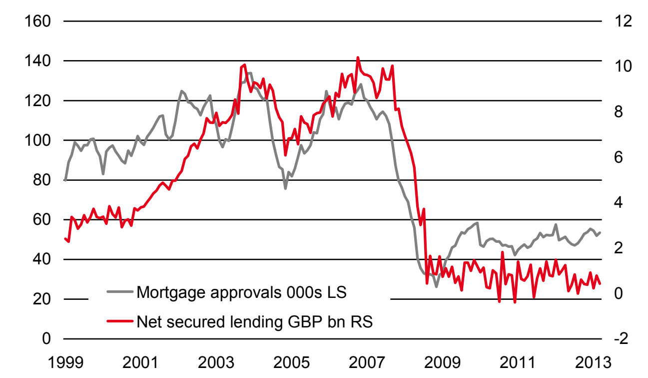
UK

HOUSE PRICES



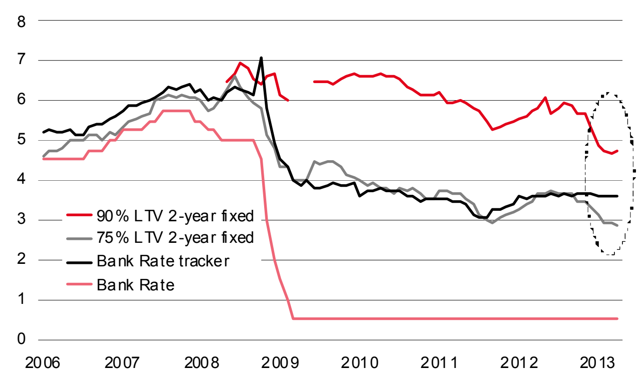
- House prices are on a mild upward trend and forward-looking indicators point to further gains.

HOUSING MARKET



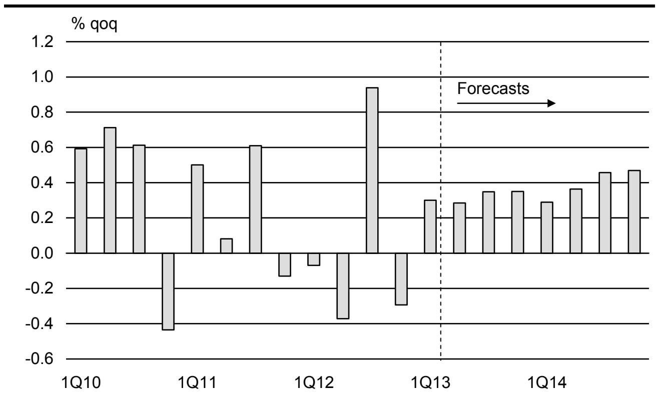
- While there has been an uptick in mortgage approvals, housing market activity remains low.

QUOTED MORTGAGE RATES



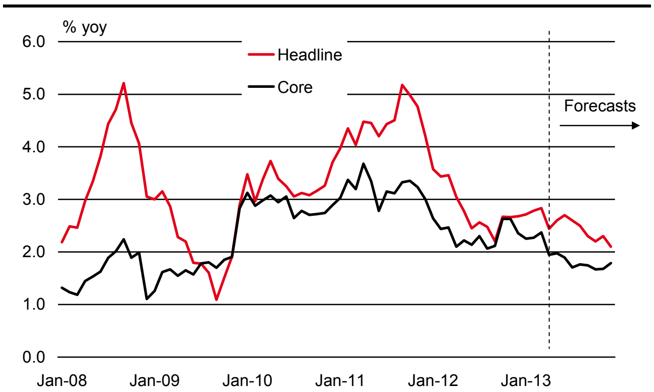
- The downward trend in mortgage rates for the most popular products seems to have halted in March and April.

GDP FORECASTS



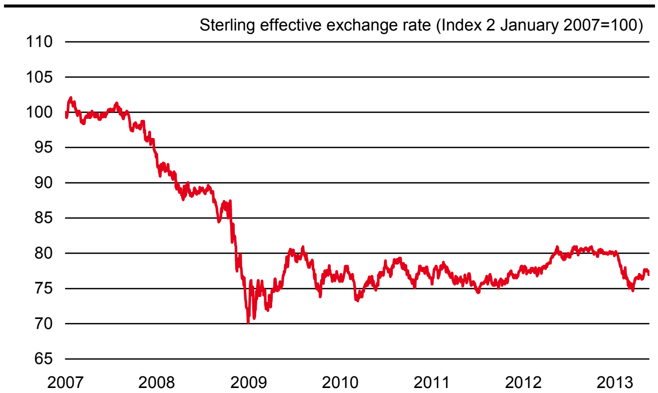
- We expect GDP growth to remain modest in the remainder of the year before gradually accelerating in 2014.

CPI INFLATION (FORECAST FOR 2013)



- Inflation fell from 2.8% to 2.4% in April, mainly driven by transport prices.

STERLING EFFECTIVE EXCHANGE RATE



- The sterling effective exchange rate has reversed part of its decline since January.

Source: Office for National Statistics, Bank of England, Halifax, Nationwide, UniCredit Research

Sweden

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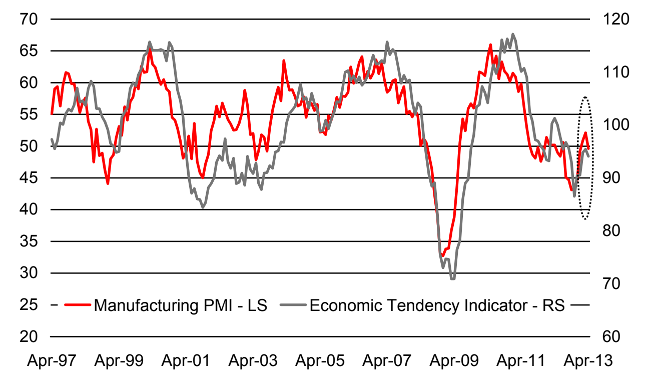
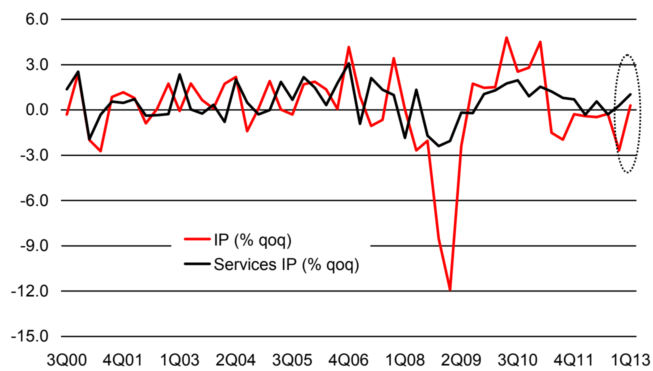
- The April round of surveys reflected more downbeat business sentiment, with the economic tendency indicator (ETI) losing 1.3 points (from 95.4 to 94.1) and the manufacturing PMI abruptly falling into contractionary territory, from 52.1 to 49.6 (see left chart below). This follows four months of improvement for both the ETI and manufacturing PMI. We think that the weakness of business sentiment in April will likely be temporary and most probably reflects a correction following the strong gains recorded in the previous months.
- Hard data show that economic activity was in good shape in 1Q13. IP grew by 0.3% qoq in 1Q (vs. a 2.6% decline qoq in 2Q12). The service production index rose 1.0% qoq in 1Q13 (vs. 0.2% in 4Q12; see right chart). The performance of retail trade also improved, with sales up 1.6% qoq vs. -0.3% in 4Q12. Overall, hard data available for 1Q13 are in line with our forecast of 0.3% qoq GDP expansion in 1Q13, following a stagnation in 4Q12.
- In April, CPIF inflation, which excludes mortgage interest costs, slowed to 0.5% vs. 0.9% in the previous month, while CPI inflation turned negative at -0.5%, down from 0.0% in March, reflecting the continuing strengthening of the krona and persisting low domestic price pressure. Both figures came in lower than expected. In light of the April data, we revise down our 2013-2014 CPI inflation forecast (from 0.4% to 0.1% in 2013 and from 1.8% to 1.6% in 2014).
- At its April meeting, the Riksbank left the repo rate unchanged at 1.00%. The timing of the first rate increase was postponed compared to February, from 1Q14 to 4Q14, and the Riksbank's projections now show that the probability of a rate cut in the near term is 25% (vs. 20% in February). Pressures on the Riksbank to cut rates are mounting, as the ECB cut the refi rate in May on the back of low inflation and weaker EMU growth prospects, while in Sweden unemployment is high, inflation is in negative territory, and the strong krona continues to add pressure on the export industry. However, we continue to expect steady interest rates for full-year 2013, as incoming data overall reflect the resilience of the Swedish economy; nevertheless, the latest minutes showed that the board majority is concerned about credit growth and high household indebtedness.

MANUFACTURING CONFIDENCE CORRECTED IN APRIL



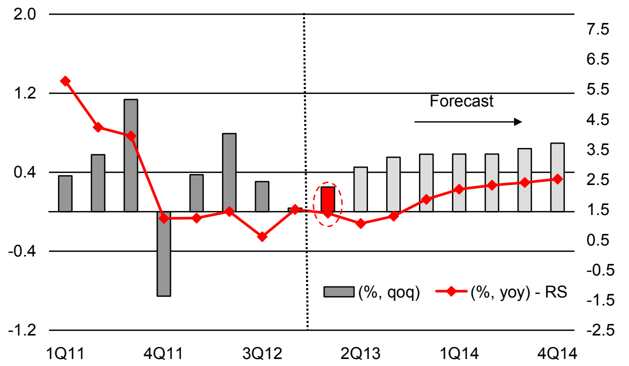
MANUFACTURING AND SERVICE SECTORS WERE UP IN 1Q13



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

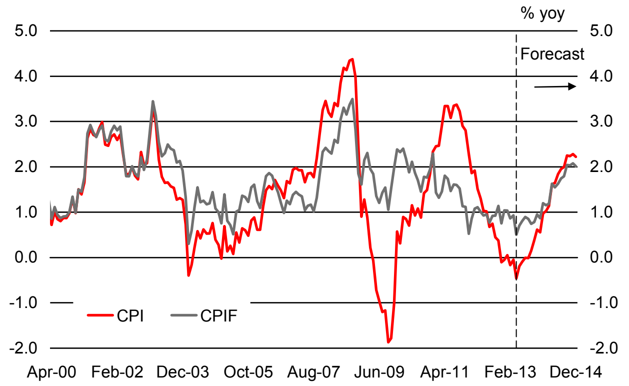
Sweden

GDP



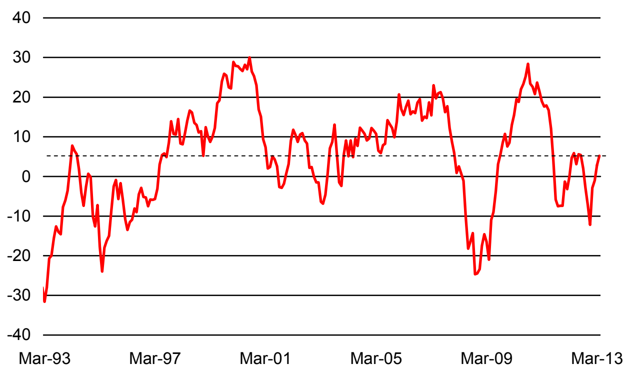
- We expect sluggish growth in 1H13 and a more sustained recovery in 2H13.

INFLATION



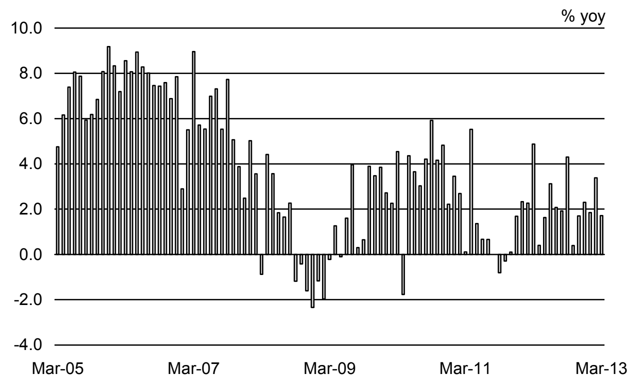
- In April, CPI inflation was -0.5%, down from 0.0% in March, while CPIF inflation edged down to 0.5% (from 0.9% in March).

CONSUMER CONFIDENCE



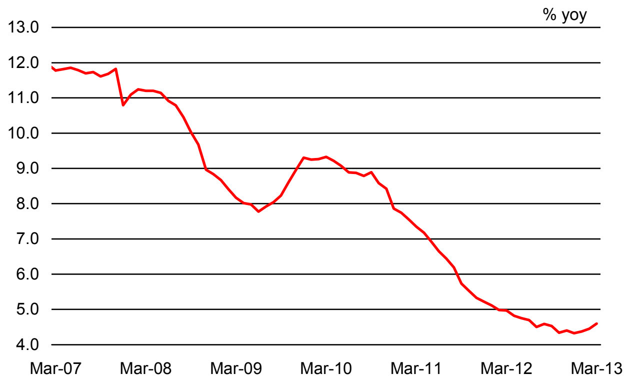
- Consumer confidence continues to improve. In April, it rose just above the historic average (to 5.2 from 2.8 in the previous month).

RETAIL SALES



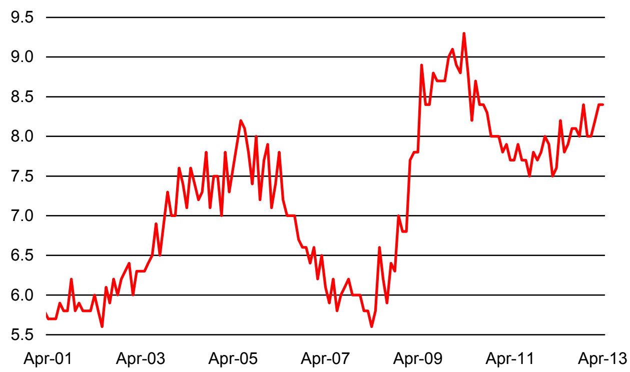
- In March, retail sales slipped 0.4% mom (1.8% yoy). We regard this decrease as a temporary correction following four consecutive monthly gains.

LENDING TO HOUSEHOLDS



- The annual growth rate of lending to households was stable at 4.6% in March.

UNEMPLOYMENT RATE



- In April, seasonally adjusted unemployment rate was stable at 8.4% from the previous month.

Source: NIER, Statistics Sweden, UniCredit Research

Poland

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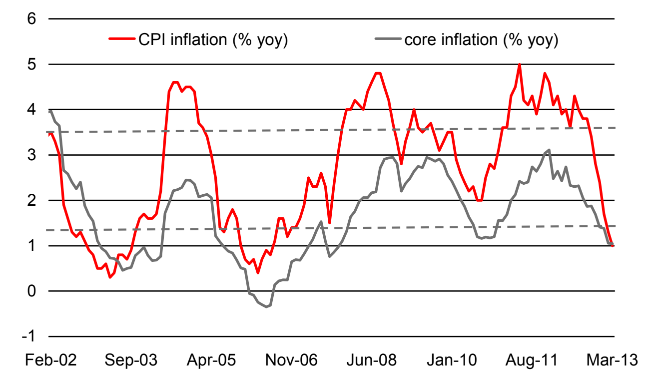
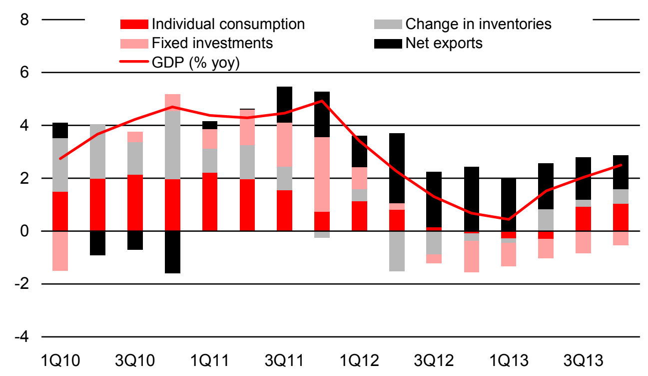
- The 1Q13 GDP flash estimate showed 0.4% yoy GDP growth. We think GDP has now bottomed out and we look for accelerating GDP in the remainder of the year. The key driver will be net exports, with private consumption (hopefully) kicking in later in the year.
- April CPI came in at 0.8% yoy, a touch above expectations. We expect CPI to continue down till June (0.5% yoy expected) and then rebound towards 1.2% at the end of 2013.
- The most interesting monthly data release this month will be industrial output. We expect 4.0% yoy growth vs. the median of market expectations at 2.9% yoy. Working-day effects will play a role, but there are reports of improvement in domestic car production, which, along with increased output in exporting industries, should mark the beginning of improvement in industrial output. Our forecast assumes the first growth of industrial production in yoy terms since January this year and the highest growth rate since October 2012.
- The Monetary Policy Council took everyone by surprise and cut the reference rate by 25bp in May. There's quite a high probability that they will also cut it in June (another 25bp) amid low inflation and strong pressure from continued weak global data and disappointing newsflow.
- The POLGB market is still "hot", with yields at all-time lows, and the potential for further T-bond price upside seems very limited. The MPC thinks the economy is getting close to the end of the cycle, and we expect economic data to improve visibly in the coming months.
- The zloty is under pressure from weak data and disappointing newsflow. However, as we expect improved macro data in the coming months, the next couple of weeks might be a good period to look for attractive EUR-PLN levels to go long PLN. We consider levels around 4.25-4.30 as attractive to buy PLN.

CPI HAS FALLEN BELOW THE LOWER END OF TARGET



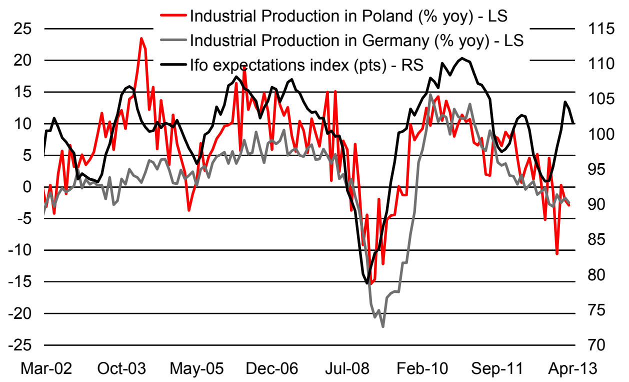
GDP MOST LIKELY BOTTOMED OUT IN 1Q13



Source: GUS, UniCredit Research

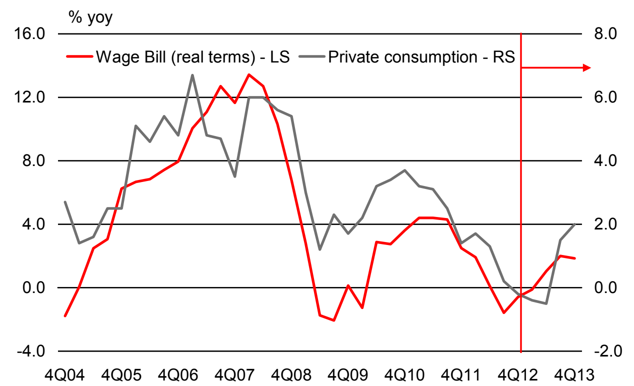
Poland

INDUSTRIAL PRODUCTION



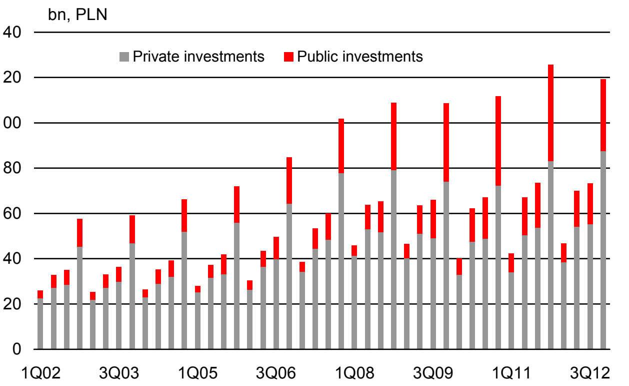
- The improving outlook for German exports should help lift Polish domestic industrial output soon.

PRIVATE CONSUMPTION



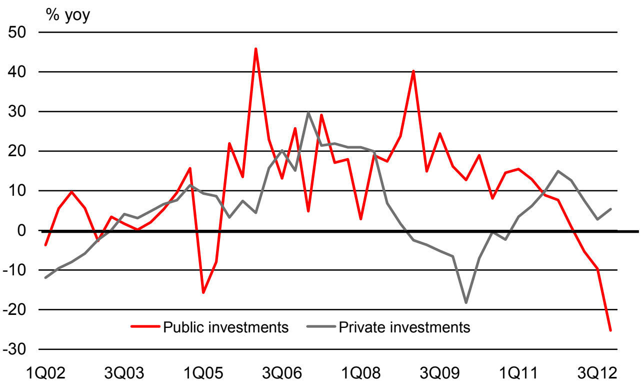
- Falling inflation will help real wage bill, especially in 2H13.

STRUCTURE OF INVESTMENT



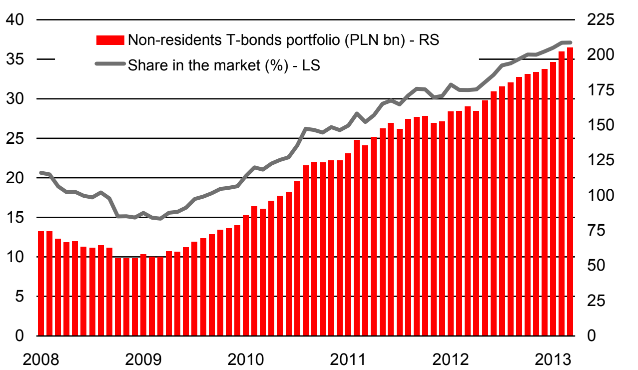
- Pubic investment is about a third of private investment…

INVESTMENT DYNAMICS



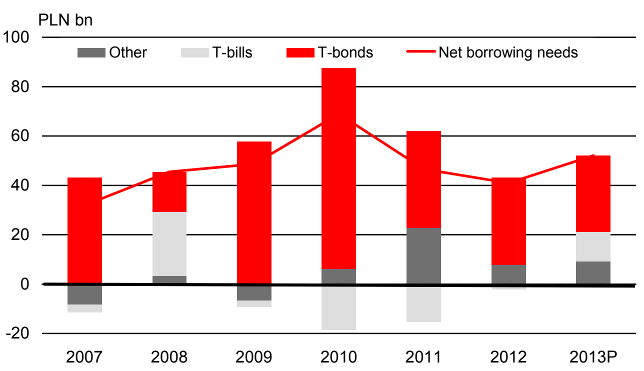
- …however, its decline, triggered by falling of EU funds inflow, is having a serious impact on total investment.

NON-RESIDENT POLGB PORTFOLIO



- Foreign investors keep adding to their POLGB holdings.

FINANCING OF NET BORROWING NEEDS



- Net borrowing needs in 2013 will exceed the previous year's, but this should not be a problem for the "booming" T-bond market.

Source: NIER, Statistics Sweden, UniCredit Research

Czech Republic

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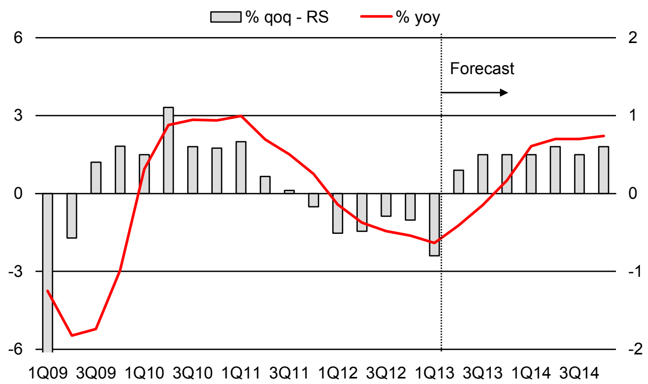
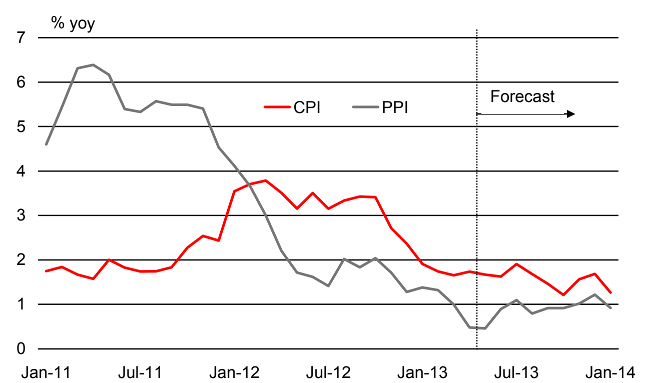
- Flash 1Q GDP posted a contraction of 0.8% qoq and 1.9% yoy in adjusted terms, lagging behind all expectations. Given the negative working-day effect, the unadjusted yoy figure would be even worse (around -2.5%). The qoq reading came as a surprise mainly in the context of seasonally adjusted qoq increases in industrial output (1.2%) and sales in services (0.5%) in 1Q. Without revealing the detailed figures, CZSO reported that consumer spending stopped being the major drag to GDP, while foreign trade started contributing negatively to growth. On the production side, the deterioration was said to be led by export-oriented industries, namely car manufacturing, and by a sharp drop in the collection of excise tax on tobacco. We believe that one-offs in the data are keeping alive the chance of the economy pulling out of recession in 2Q. That said, full-2013 GDP is now set to post a decline for the second year in a row (-0.6%), which last happened in 1997-98.
- High-frequency data for March suggest that economic activity remained weak at the end of 1Q. Industrial output and cross-border exports unexpectedly increased their declines to unadjusted 6.0% and 7.1% yoy, respectively. This weakness was mainly concentrated in the automobile industry, which is suffering from a global lack of demand for cars. March retail sales painted a somewhat better picture, easing their drop to unadjusted 3.3% yoy. Whereas the auto segment remained significantly depressed, ex-auto sales showed signs of stabilization.
- Leading indicators do not signal a turnaround in the economy at the start of 2Q. CZSO's economic confidence index fell across the board in April, with the indices for construction, services and retail hitting lows last seen in 2009. The industrial component approached the four-year low of last November, reversing its previous four monthly moderate gains. Consumer confidence was disappointing as well, coming in below the levels of the previous two months. Only the separate PMI for manufacturing went up slightly in April, to 49.5, driven by improvements in the output and domestic-order components.
- As widely expected, the CNB left the repo rate unchanged at 0.05% at its May meeting. It repeated its intention of intervening against the CZK, if necessary, and stated it would keep interest rates close to zero until inflationary pressures increase significantly. The CNB also revised its 2013 GDP outlook down to negative 0.5% and shifted the EUR/CZK forecast up to an average of 25.6.

THE RECESSION HAS EXTENDED TO SIX QUARTERS…



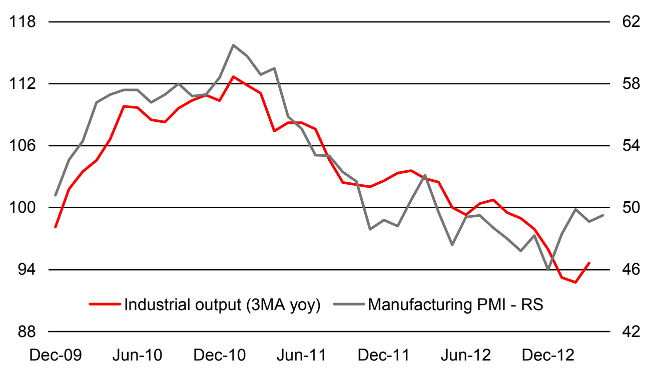
…PUSHING LOWER BOTH CPI AND PPI



Source: CZSO, UniCredit Research

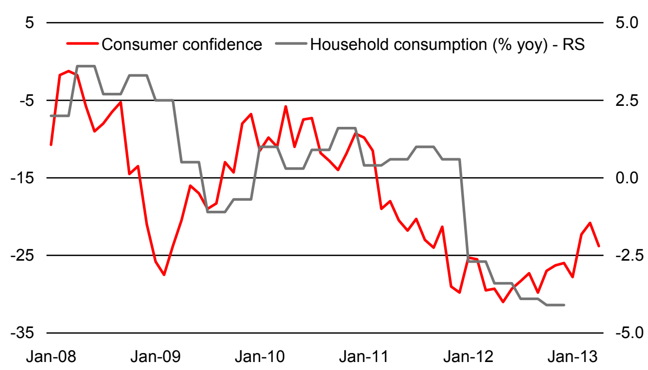
Czech Republic

MANUFACTURING PMI AND INDUSTRIAL OUTPUT



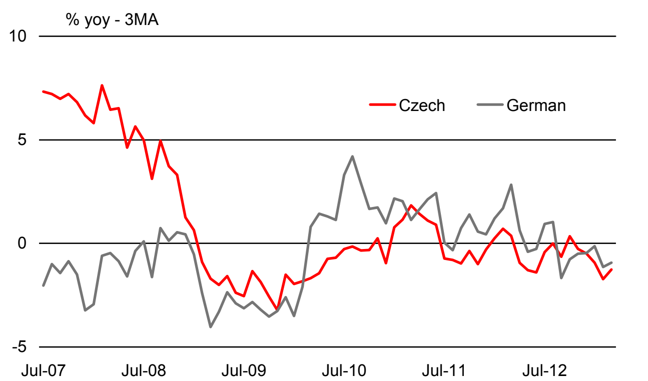
- It looks too early to say that the decline in industrial output has ended but the PMI provides tentative signs of stabilization.

CONSUMER CONFIDENCE AND PRIVATE CONSUMPTION



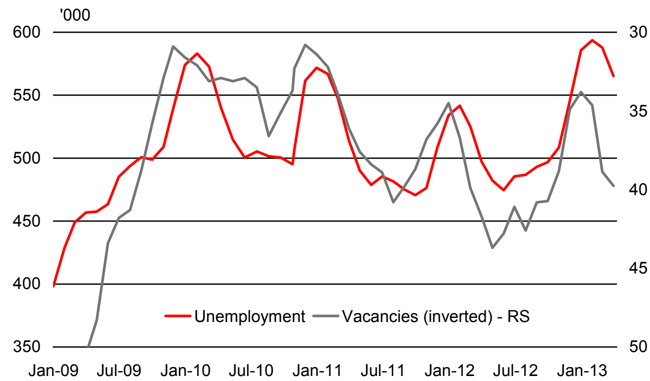
- Evidence is mounting that the worst is over for private consumption.

RETAIL SALES EXCL. CARS



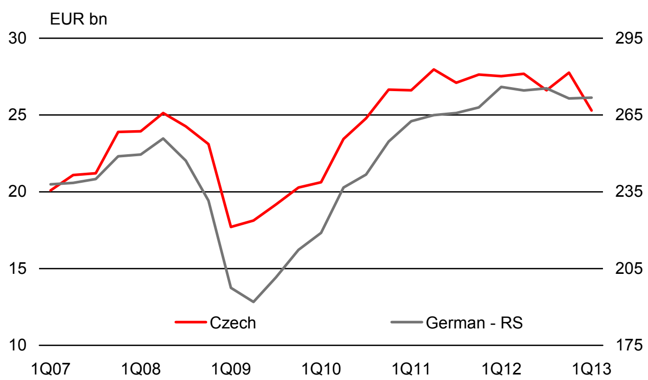
- Similar patterns for retail sales in both countries are apparent but lately Czech sales have been underperforming in most months.

UNEMPLOYMENT AND VACANCIES



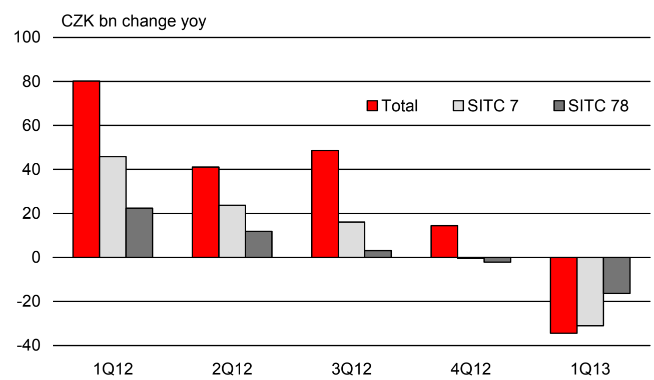
- The recession has increased unemployment; the lack of reaction by the number of vacancies points to a structural problem in the labor market.

EXPORT VALUES



- Trends in German and Czech exports remain similar; the decline in Czech 1Q13 exports has become greater though.

CZECH CROSS-BORDER EXPORTS BY SITC GROUPS



- Machinery and transport equipment (SITC 7) and notably vehicles (SITC 78) are chiefly to blame for export shrinkage.

Source: CZSO, UniCredit Research

Hungary

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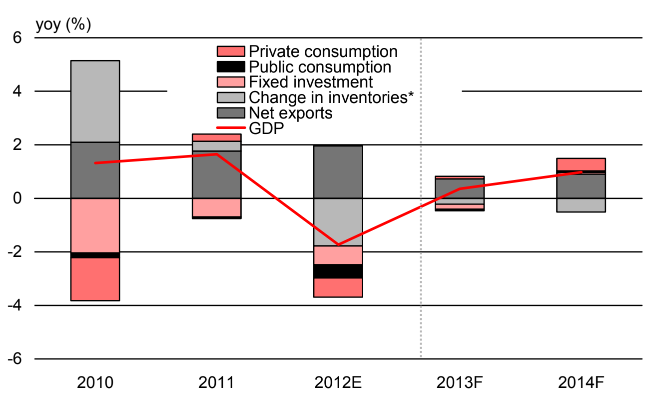
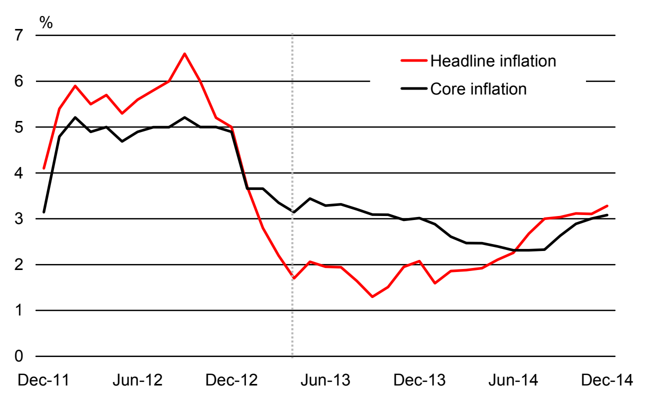
- Hungary's GDP fell 0.9% yoy in 1Q13, but rose by 0.7% qoq (a positive surprise). The statistical office revised the quarterly numbers for 2012, lifting 4Q to -0.4% qoq from -0.9% previously, thus paving the way for the positive surprise due to a smaller negative carry-over. At the same time, it revised downwards the growth numbers for the first two quarters of 2012, providing a positive base effect for annual growth in 1Q13. High frequency data supports a moderate rebound in 1Q14. Industrial production rose by 2.1% qoq in 1Q13, but fell by 3.1% yoy, and construction increased by 3.9% qoq. The rebound in both building and infrastructure works bodes well for performance in 2013, as the construction sector seems to have bottomed out after hitting a 10-year low in 2Q12. Retail sales fell in annual terms in each month of 1Q13 (by 2.6% yoy, 1.1% yoy and 2.8% yoy, respectively) but were flat vs. 4Q12. We raise our GDP outlook from -0.1% to 0.4% for 2013, followed by a moderate pickup in 2014 to 1.0% growth. The main risks to our outlook remain weak external demand from the euro area and poor investment, while bumper crops could drive the growth rate higher.
- CPI inflation fell to 1.7% yoy in April, the lowest level on record. Core inflation slowed down to 3.2% yoy, but remains above the headline figure because it excludes the price cuts for energy and gas from January 2013. The central bank's preferred inflation measures remain well below the 3% target: sticky-price and demand-sensitive inflation were 1.7% in April, while the tax-adjusted core inflation fell 0.1pp to 1.6%. We expect inflation to moderate further during the summer as the better harvest weighs on food prices and significant administered price hikes are unlikely before the general elections, which are due to be held in May 2014. Consumer price inflation will probably end 2013 close to 2%, but could rise again above the target in 2014, absent any price cuts for energy or utilities.
- In this low-growth, low-inflation environment, the National Bank of Hungary (NBH) cut the monetary policy rate to 4.75% on 23 April, and we expect at least three further cuts to 4%. The market is pricing in a lower monetary policy rate (3.5%) and the NBH could pursue the easing cycle as long as market conditions permit.
- In 1Q13, the foreign liabilities of the banking system rose by EUR 100mn, a turnaround of EUR 500mn from the same period in 2012. Even if the deleveraging process resumes over the next quarters, the outflows from the banking sector are unlikely to come close to the EUR 6.5bn registered in 2013. This bodes well for the HUF and reduces Hungary's reliance on short-term, volatile external funding.

GDP FORECAST UPGRADED AFTER POSITIVE SURPRISE IN 1Q



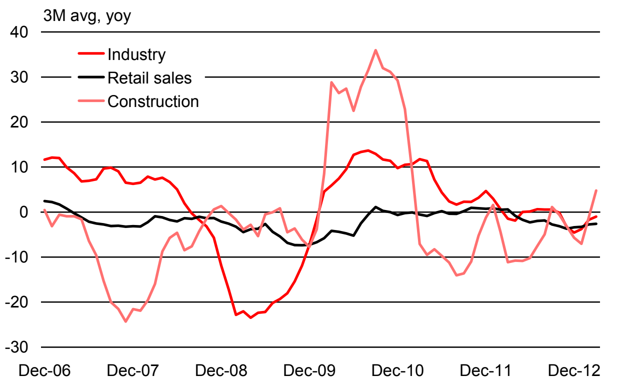
INFLATION FALLING ON ENERGY AND GAS PRICE CUTS



Source: KSH, UniCredit Research forecasts

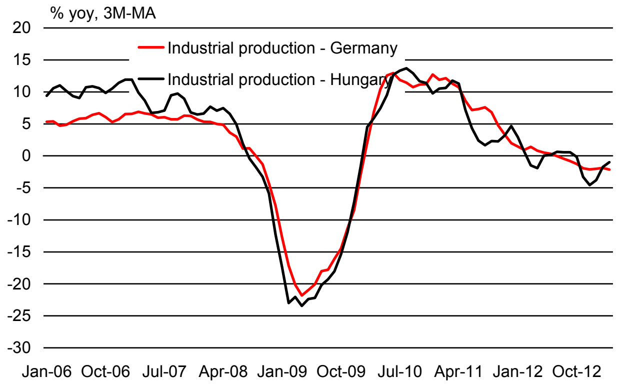
Hungary

INDUSTRY AND RETAIL AND CONSTRUCTION



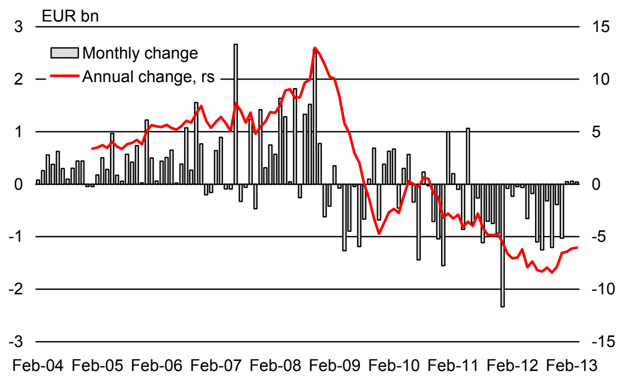
- Industry failed to recover in 1Q13 compared to a year earlier…

INDUSTRIAL PRODUCTION IN HUNGARY AND GERMANY



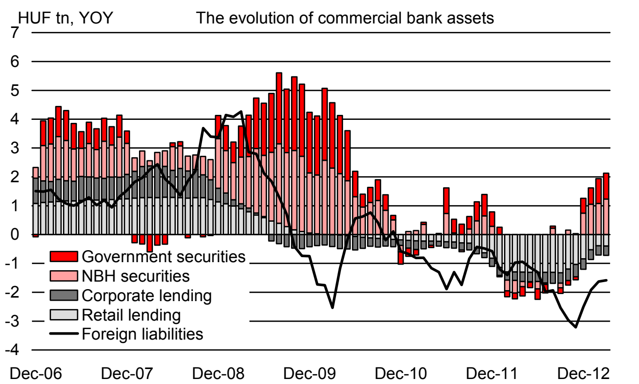
- …dragged down by falling output in Germany.

BANK DELEVERAGING



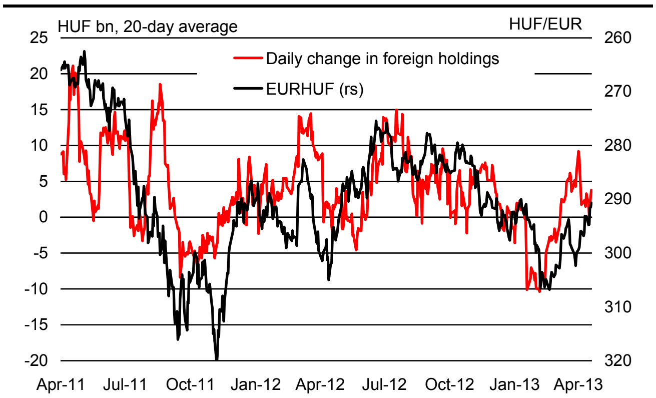
- The foreign liabilities of the banking sector rose in 1Q13 in a sharp turnaround from 1Q12…

BANKING SECTOR ASSETS



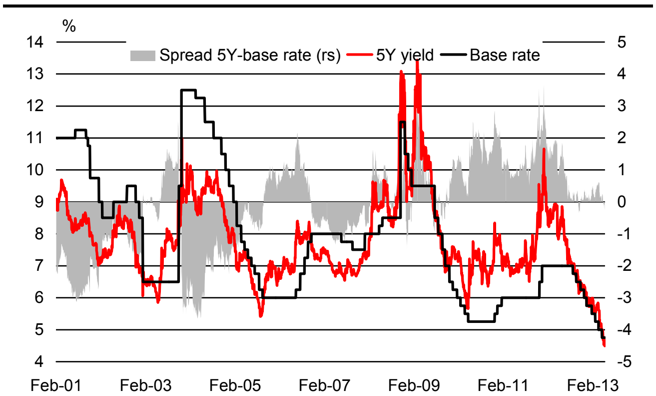
- …but banks prefer to invest in T-bills and T-bonds, keeping liquidity in the central bank, rather than lending.

HUF AND NET BOND PURCHASES BY FOREIGN INVESTORS



- Strong demand for HGBs from foreign investors continues to support the HUF...

SCOPE FOR MORE MONETARY POLICY EASING



- …as markets are already pricing in further monetary policy rate cuts.

Source: KSH, NBH, AKK, Haver, UniCredit Research

US

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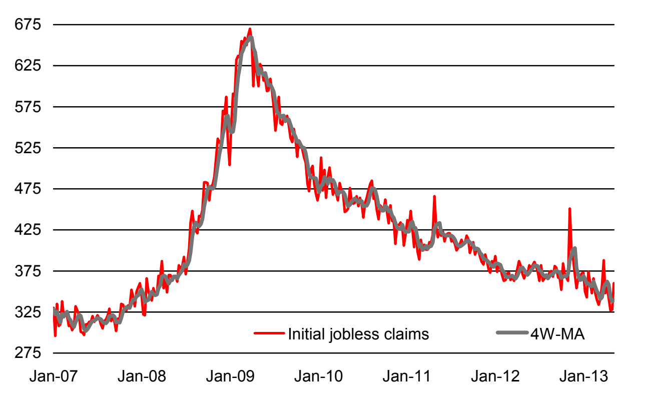
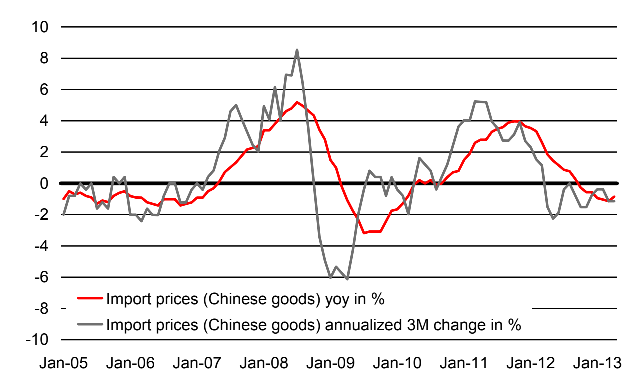
- The US economy grew a solid 2.5% annualized in the first quarter. Despite the expiration of the payroll tax cut at the end of 2012, real consumer spending rose a strong 3.2% – the fastest quarterly increase since 4Q10. Additional positive contributions came from private inventories, residential investment, and non-residential investment. These were partly offset by negative contributions from net exports and government spending.
- Following the solid start to the year, GDP growth likely slowed again to 1.8% in the current quarter. Most of this volatility reflects the (lagged) response to fiscal tightening and some renewed inventory adjustment. The impending slowdown in the current quarter is now indicated by several factors. The manufacturing and non-manufacturing ISMs dropped in March and April from multi-month highs, car sales fell for second consecutive months, and the NAHB housing market index even eased for three straight months (before rising again in May).
- However, we do not think that any of these developments are a concern for the medium-term outlook, particularly as most of the declines come on the back of strong gains in the previous few months. Moreover, initial jobless claims fell to a 5-year low in early May, suggesting that businesses, too, see the latest slowing in activity as being temporary (see left chart). The ongoing improvement in the labor market, in combination with the housing recovery and some pent-up demand on the capex side, should lift the economy again in the second half of the year, for which we continue to expect 2¾% real GDP growth.
- Inflationary pressures continue to ease. The core PCE deflator – the Fed's preferred inflation gauge – even dropped to a 2-year low of 1.1% yoy. Pressure from labor and input costs remains muted. Import prices for Chinese goods, for example, declined by 1% over the last twelve months, after still rising close to 4% in late 2011 (see right chart).
- At its latest FOMC meeting, the Fed said that it will continue to buy USD 85bn in long-term securities per month. In a sign that the internal debate has been more balanced than at the previous couple of meetings, the statement highlighted that the Fed is prepared to increase or reduce the pace of asset purchases if needed. While we think that the bar for increased asset purchases is high, there is a growing risk that the current asset-purchase program will remain in place for longer than we currently think (end 2013), and only end in the first half of 2014.

JOBLESS CLAIMS AT A 5-YEAR LOW



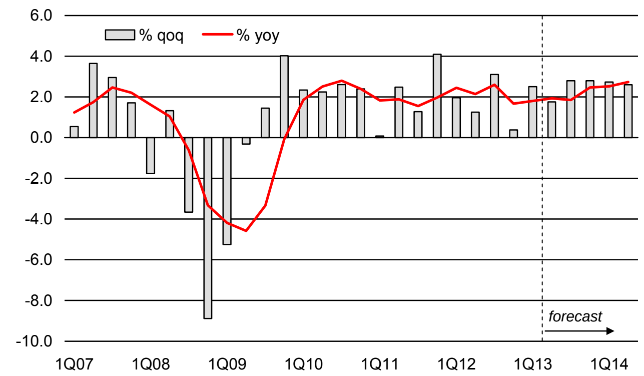
US (AGAIN) IMPORTS DEFLATION FROM CHINA



Source: BLS, Department of Labor, UniCredit Research

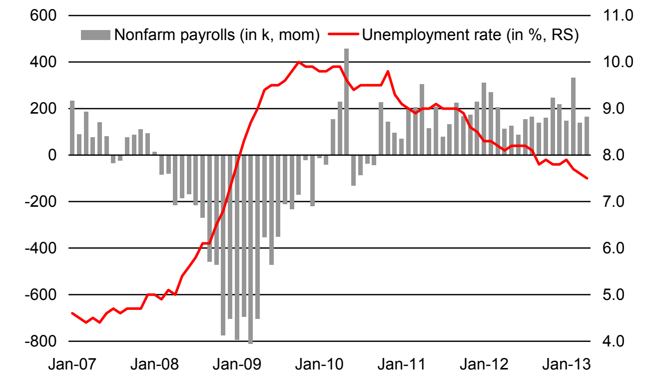
US

REAL GDP, ANNUALIZED RATES OF CHANGE



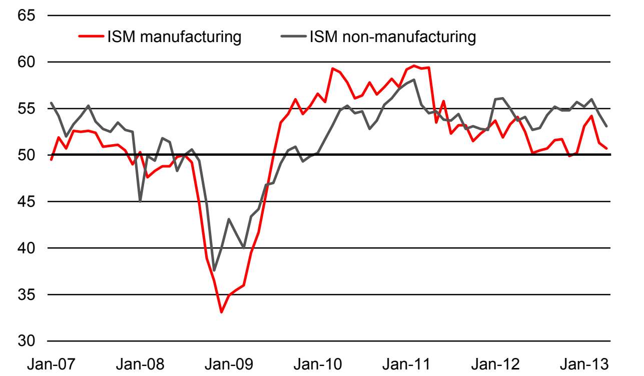
■ GDP growth will likely slow to 1.8% in 2Q13, before reaccelerating to 2¾% in the second half of the year.

NONFARM PAYROLLS AND UNEMPLOYMENT RATE



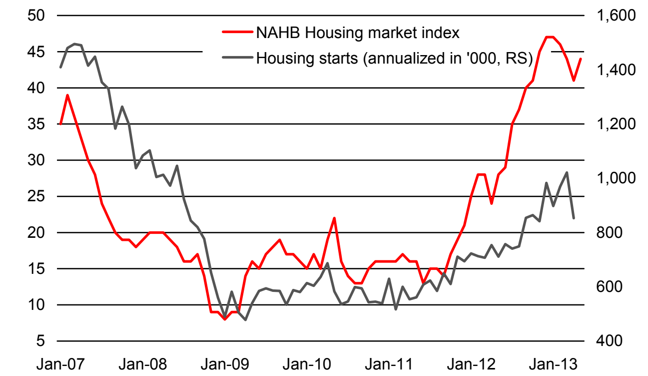
■ Nonfarm payrolls gains accelerated to 165,000 in April, while the jobless rate fell to 7.5%, the lowest since late 2008.

PMIS



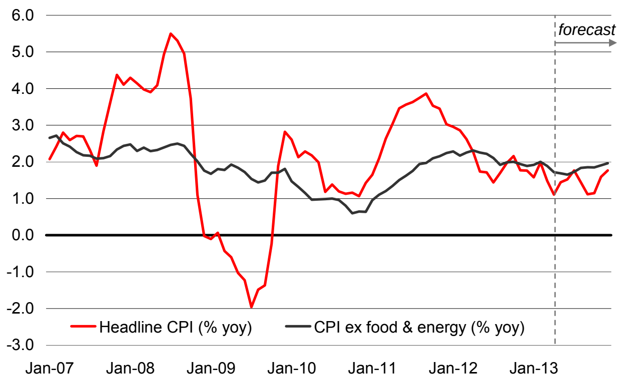
■ Both ISMs dropped for the second straight month in April after hitting multi-month highs in February.

HOUSING MARKET INDEX AND HOUSING STARTS



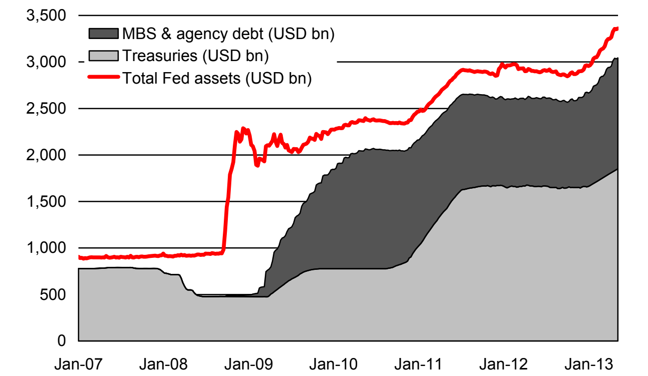
■ The NAHB index rose again in May, after three straight declines. Its level signals further increases in construction activity.

CONSUMER PRICE INDEX



■ The headline inflation rate fell to 1.1% yoy in April, the lowest since 2010, while the core eased to 1.7%.

FED'S BALANCE SHEET



■ The size of the Fed's balance sheet is approaching USD 3½ tn, 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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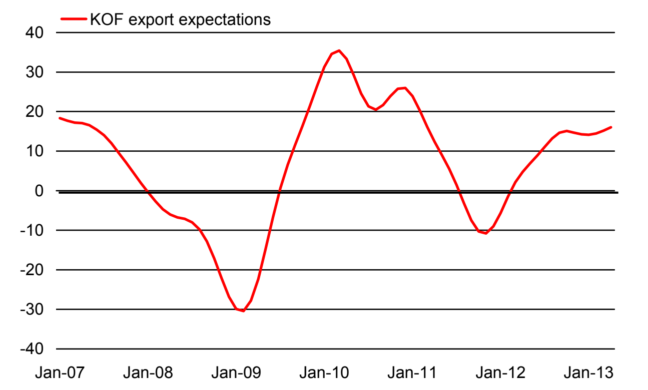
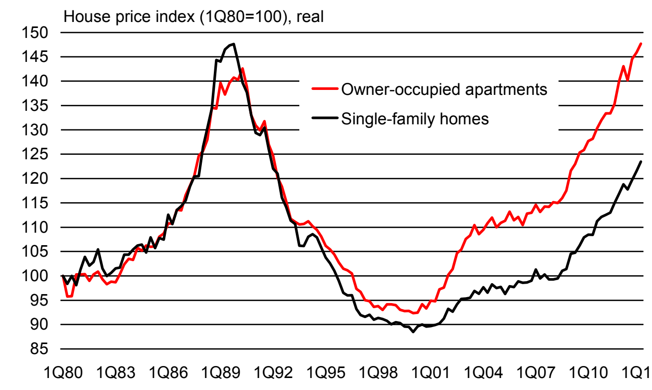
- The generally negative dynamic in global industry in the final quarter was also a major drag on the Swiss economy. However, in contrast to most other industrialized countries, Switzerland maintained positive growth momentum thanks to robust domestic demand. GDP was up 0.2% qoq. Private consumption alone contributed 0.6pp to quarterly growth.
- Notwithstanding the prolonged recession in the EMU periphery, stronger demand from other regions boosted Swiss real goods exports in the first three months of 2013. Supported by a positive growth contribution from net exports, the upcoming GDP release can be expected to show modest acceleration. We forecast a rise of 0.3% qoq, broadly in line with the signals of our PMI and KOF Economic barometer models.
- Business sentiment points to an ongoing recovery in spring. The Industry PMI climbed back slightly above the 50-threshold in April, and the KOF staged the first increase after six consecutive declines. Furthermore, the important export expectations of Swiss firms remain clearly expansionary and even improved somewhat of late (see left chart). Together with healthy domestic demand, this bodes well for our forecast for ongoing, modest growth acceleration throughout 2013.
- Despite the sound economic situation, the annual inflation rate fell further to -0.7% in April, driven by lower energy prices. Although the preceding massive exchange rate appreciation has now largely fed through to consumer prices, downward pressure on the elevated domestic price level is still reflected in the comparatively muted selling price expectations of firms. Accordingly, deflation should peter out only gradually, which is in line with the SNB's risk assessment that there are currently no inflationary tendencies in Switzerland over the medium-term horizon.
- Consequently, the SNB is still far away from exiting the minimum-rate policy. Concerning the strong housing market dynamics, the SNB is relying 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 countercyclical buffer at 1% of risk-weighted residential mortgage loans in order to achieve a preventive effect on housing market dynamics, which remained strong at the beginning of this year (see right chart).

POSITIVE EXPORT EXPECTATIONS



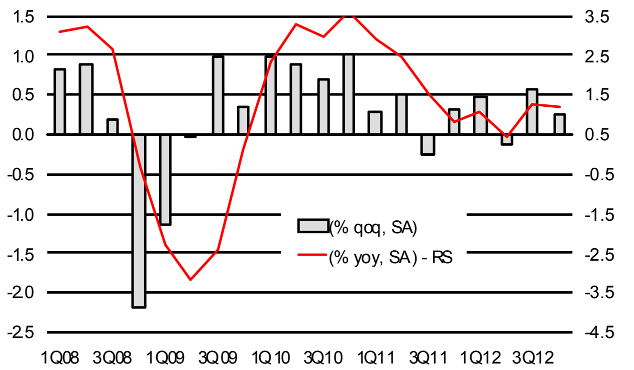
HOUSE PRICES CONTINUE UPWARD TREND



Source: KOF, SNB, UniCredit Research

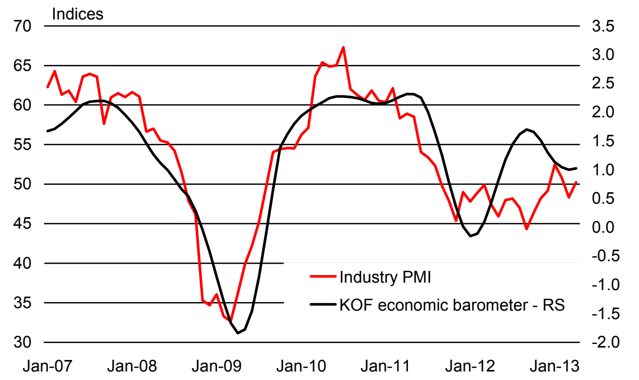
Switzerland

GDP



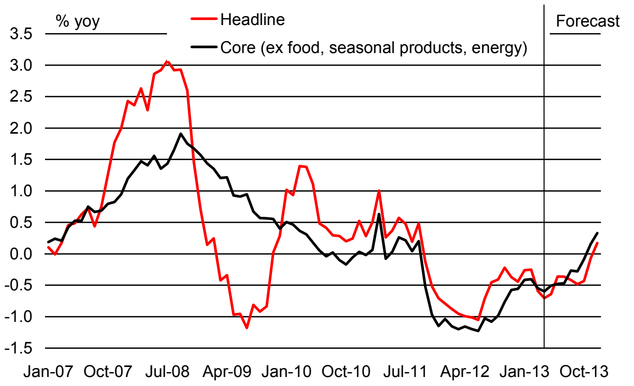
- The Swiss economy maintained positive growth momentum in 4Q12, supported by robust consumption.

BUSINESS SENTIMENT



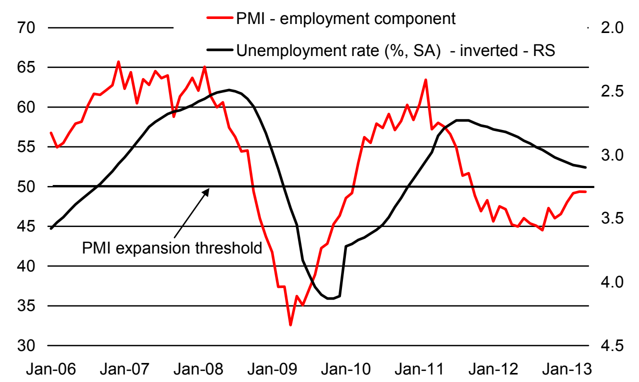
- The KOF stabilized in April, and, overall, business sentiment levels continue to signal positive growth dynamics.

INFLATION



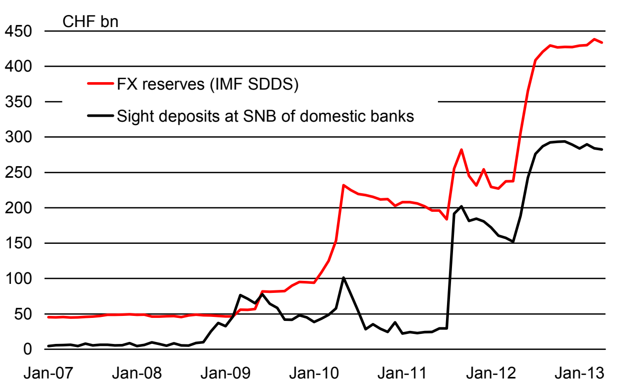
- Swiss inflation fell further to -0.7% yoy in April, driven by lower energy prices.

LABOR MARKET



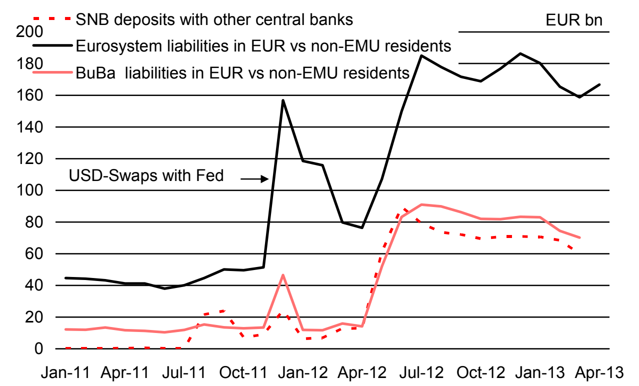
- Employment plans in industry stabilized just below the 50-threshold, supporting the overall robust labor market situation.

FX RESERVES



- The SNB's FX reserves on a CHF basis declined slightly in April, and remain broadly on a sideways trend since September 2012.

FX CURRENCY MANAGEMENT



- A large amount of the EUR reserves purchased in 2012 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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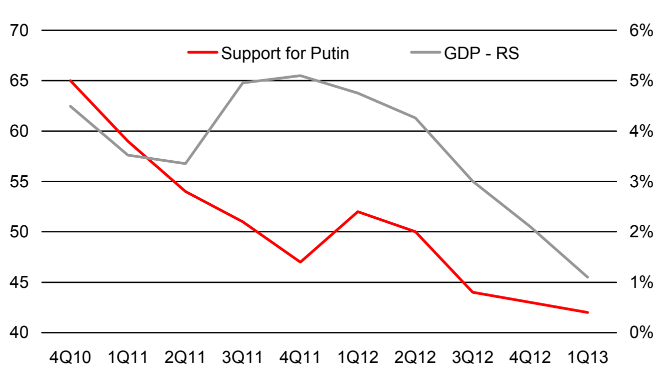
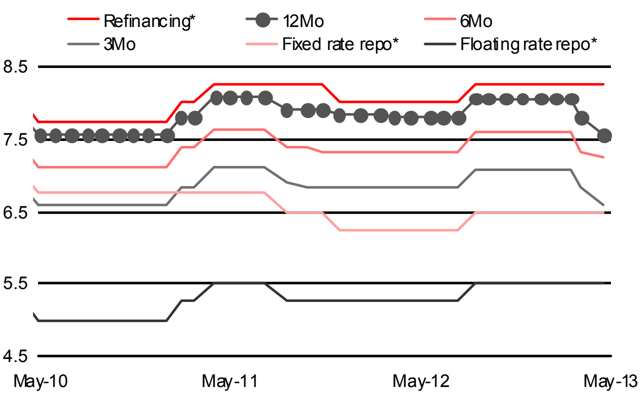
- One year ago, when Vladimir Putin was inaugurated into his third term, he issued a series of "May decrees". The decrees are aimed at improving business and social conditions in the country and also set goals for 2013-2018. While progress has been mixed so far, it seems that certain reforms have been initiated, however it is still too early to draw any conclusions. We expect further progress on the reforms, which also implies that the current government is likely to stay in office during this period.
- Recent economic data were mixed. We particularly highlight weak production and investment, which showed zero or negative growth in 1Q13. Manufacturing PMIs declined to 50.6, a four-month low, albeit staying in the optimistic zone. However, going forward the base effect should be supportive of yoy growth numbers. Moreover, consumption remains quite strong. Although passenger car sales plunged 8% yoy in April, this can be attributed to the satiation effect, in our view: wages are growing at double-digit rates and retail lending is adding 37% yoy.
- We think that Russia's GDP will grow by only 2.7% this year, with growth next year also expected to be subdued (2.8% yoy), as a result of the observed structural changes in the industry, lower investment volumes and weakening consumption demand. We also expect that average inflation will be 6.3% this year and 5.4% in 2014 (slightly above our initial projection) to reflect the weakening ruble and accumulated inflation year to date.
- The CBR remained dovish at its latest meeting (on 15 May). The regulator cut the non-key policy rates by 25bp and reiterated its concerns regarding growth. Thus, we believe that the easing cycle will likely last well into the summer. The cut in the key auction based and the fixed repo rates will probably occur in June or July when inflation will substantially decelerate. Moreover, we expect further cuts in non-key rates, especially in the refinancing rate, given the unusually high spread between this rate and other instruments (50bp). Still, we do not believe that the CBR will get involved in excessive easing. First, the somewhat negative output gap for 1Q13 might be closed in 2H, leaving fewer arguments for further rate cuts. Second, CPI will either exceed or stay very close to the upper range of the 5-6% target.

BOTH GROWTH AND PUTIN'S POPULARITY ARE DECLINING



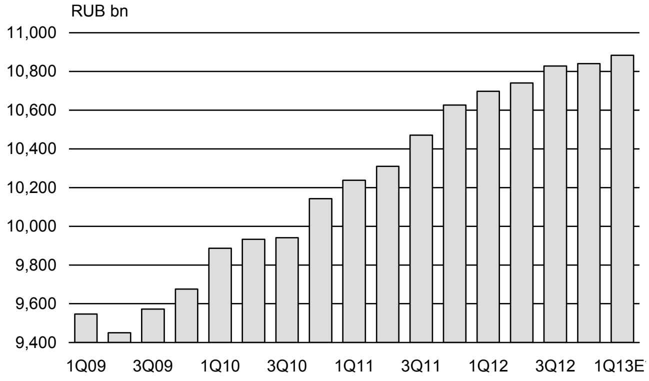
THE CBR CUTS NON-KEY RATES



Source: Bank of Russia, Customs Service, UniCredit Research

Russia

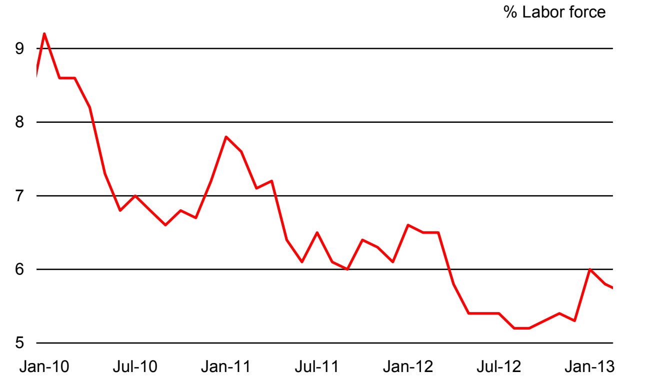
GDP (SEASONALLY-ADJUSTED QUARTERLY DATA)



*MinEcon estimate

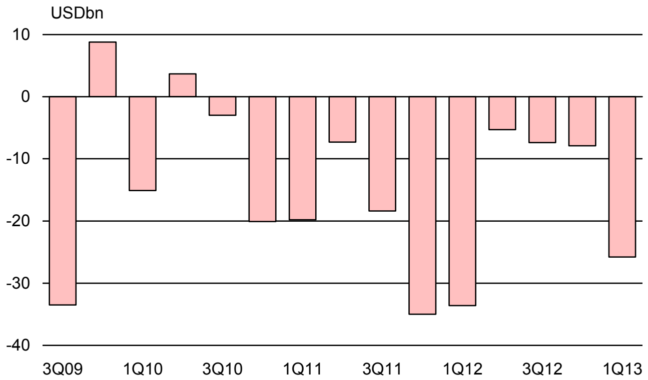
- Weaker domestic demand and stagnating exports are weighing on GDP

UNEMPLOYMENT



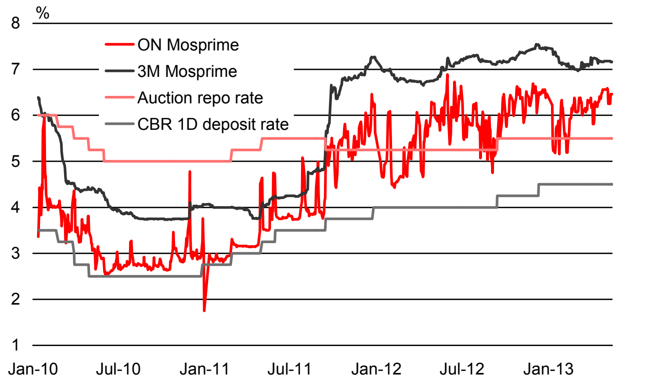
- However, unemployment remains far below historical levels.

CAPITAL OUTFLOW



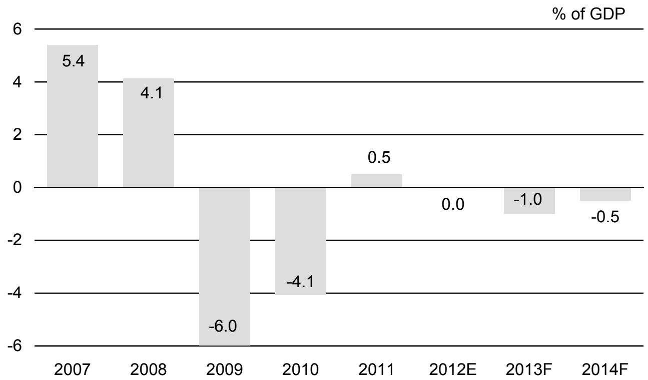
- Capital outflows have reached prior-year levels, mostly driven by banks.

MONEY MARKET RATES



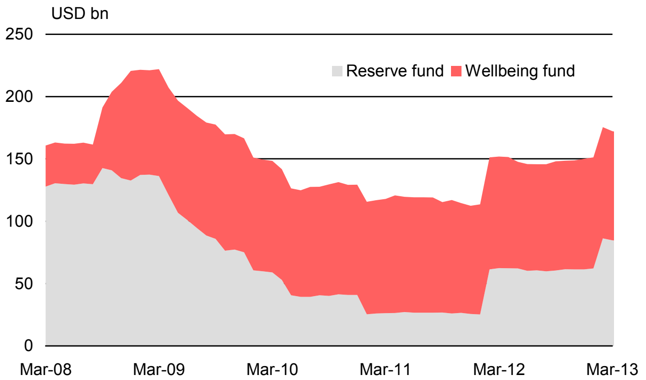
- The CBR provided some relief at the longer end, but overnight rates are still dominated by liquidity withdrawals.

BUDGET BALANCE



- While the federal budget balance is predictable as the budget rule is in place, regional budgets are coming under pressure.

STATE FUNDS ACCUMULATION



- With the oil price exceeding USD 91/bbl (cut-off price), the reserve fund will see similar inflows this year as in 2012.

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

Turkey

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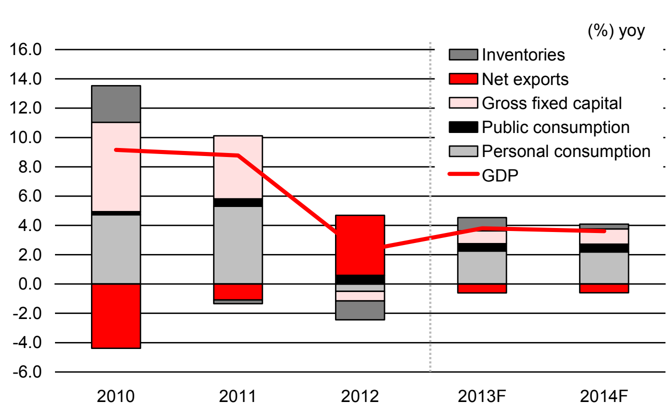
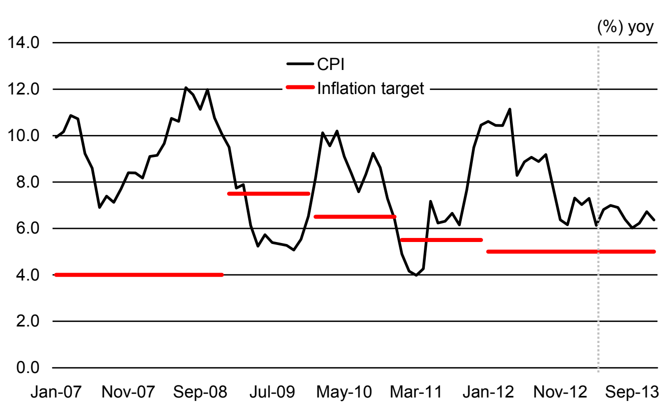
- We are increasing our growth forecast for Turkey for 2013 by 0.4pp to 3.8%, to capture a number of factors. These include a further acceleration of capital flows to Turkey at ever-lower interest rates, and a continued acceleration in credit growth combined with a lower cost of credit, aided by central bank rate cuts. The government is drawing off its strong headline fiscal position to boost activity, with current expenditure less interest up over 10% over the first four months of the year in real terms. Lower oil prices are also of help to Turkey, both narrowing the C/A deficit and easing inflation, increasing the CBT's scope to act. YTD industrial production has shown improvement, while imports have rebounded strongly (17.7% 3m/3m, sa and annualized). Moody's decision to upgrade Turkey to investment grade is a clear positive, and follows a similar move by Fitch late last year, giving Turkey two investment grade ratings. Our quarterly GDP model points to a 1.6% for 1Q after a stagnant 4Q last year.
- Over the coming months, the CBT's interest rate policy is likely to remain centered on the pace of capital inflow. The Bank will be keen to gauge the immediate impact of the investment grade rating on capital flows. Latest weekly data on foreign holdings of domestic debt and equity shows a tiny USD 36mn outflow for the week ended 10 May, but this follows six weeks of particularly strong inflows which were of clear concern to the Bank. In an environment of continued strong capital inflows, the CBT's reaction function suggests further rate cuts, potentially accompanied by a further tightening in reserve requirements and another increase in the ROC. In a less favourable environment, whereby the recent backup in treasuries contributes to a slowdown to EM funds and more than neutralises the impact of the investment grade rating, rate cuts will be put on hold. The CBT favours a gradual depreciation of the TRY basket to return the currency closer to fair value over time, but once indicated that it was willing to quickly adjust money market rates via liquidity provision higher if capital inflows slow excessively and the pace of depreciation accelerates.
- More broadly, the CBT's challenges remain multifold. Its negative real interest rate risks derailing the balance between domestic and external demand. The goal of that interest rate policy, namely a stable rather than appreciating currency, risks attracting more rather than less capital flows. Meanwhile, the composition of financing of the C/A deficit is also of concern, with financing remaining heavily reliant on short term capital flows. Hopefully the shift to investment grade helps the authorities complement last year's narrowing of the C/A deficit with an improvement in the composition of foreign capital inflows.

GDP GROWTH FORECASTS REVISED UPWARDS



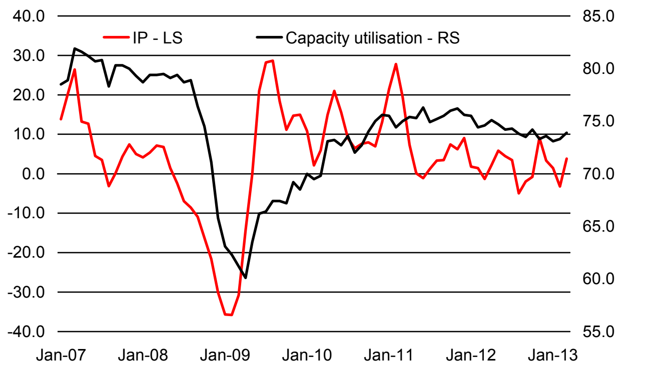
INFLATION REMAINS ABOVE TARGET



Source: CBT, TurkStat, UniCredit Research

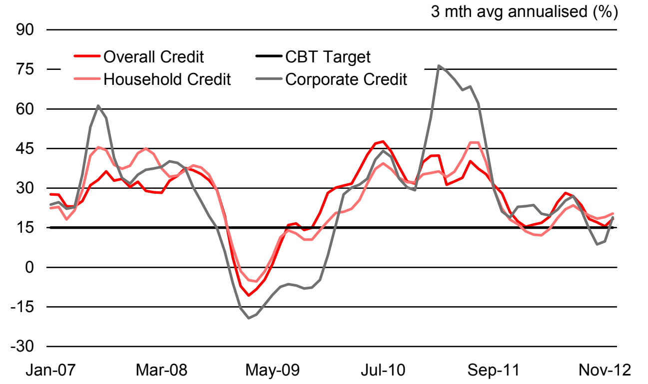
Turkey

INDUSTRIAL PRODUCTION VS. CAPACITY UTILIZATION



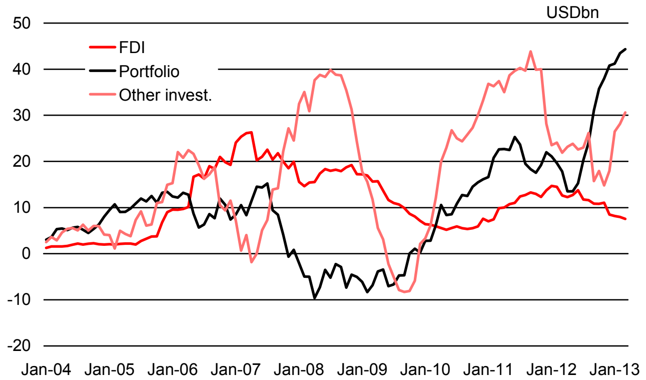
■ Industrial production has improved YTD while capacity utilization remains stable.

CREDIT GROWTH VS. TARGET



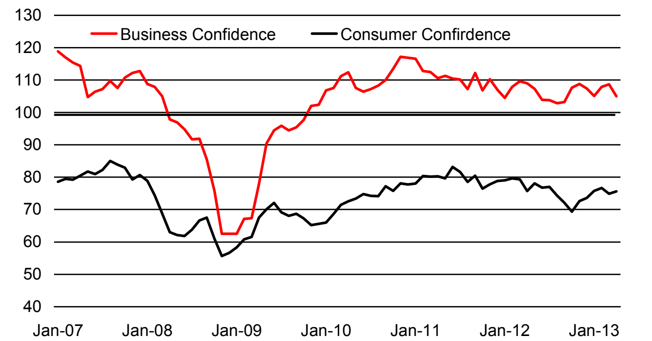
■ The impact of slowing credit growth has fed through to domestic demand.

C/A FINANCING



■ Portfolio inflows continue at record highs, constituting the main source of financing of the C/A.

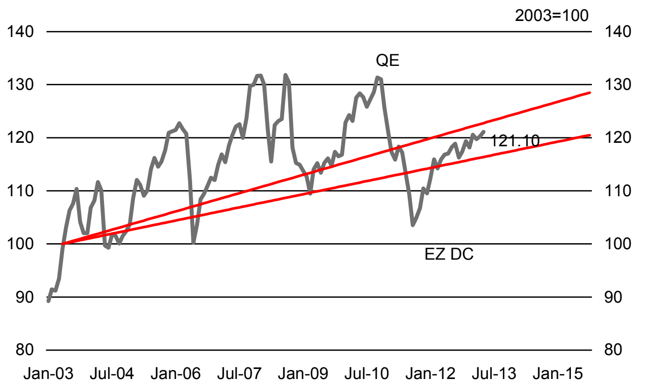
CONSUMER AND BUISINESS CONFIDENCE



Index = 100 represents a stable economic outlook; Index > 100 (<100) represents an optimistic (pessimistic) outlook.

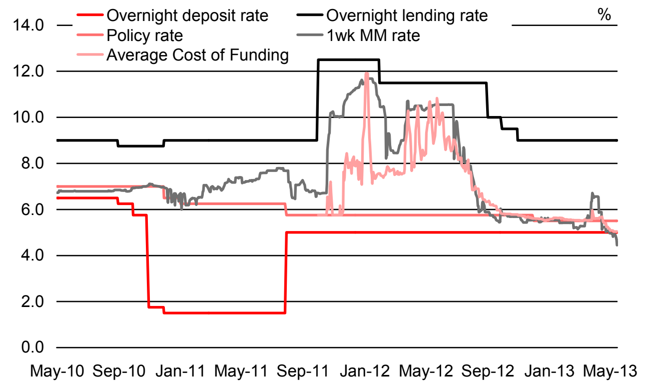
■ Strong and stable business confidence levels continue to weigh positively on investments.

TURKEY'S REAL EFFECTIVE EXCHANGE RATE TARGET



■ The CBT has remained successful in limiting real effective exchange rate appreciation.

INTEREST RATE POLICY



■ Strong capital inflows suggest the CBT could cut rates further, potentially accompanied by a tightening in reserve requirements and another hike in the ROC.

Source: CBT, TURKSTAT, UniCredit Research

China

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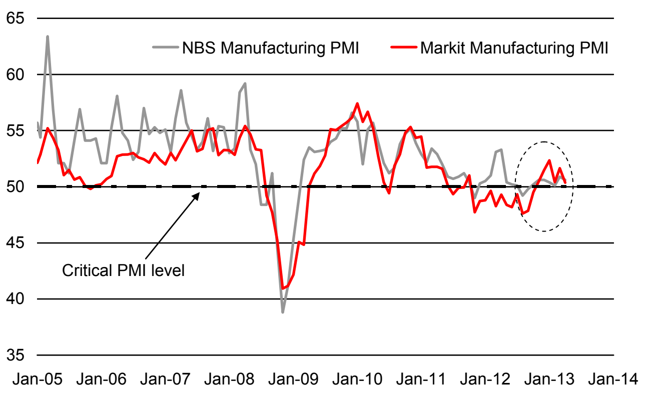
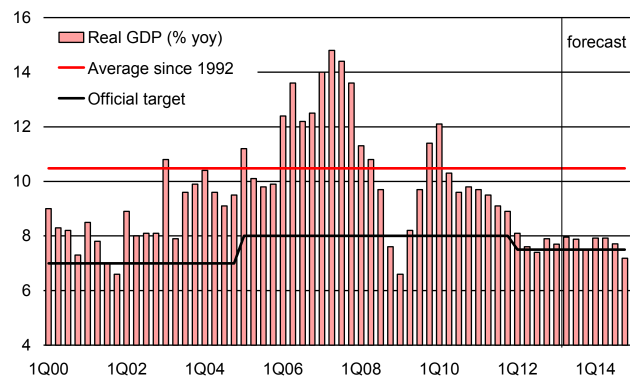
- China's economic data releases over the last few weeks were weak(er) on balance, indicating that the tepid growth momentum seen in 1Q13 is carrying over into spring. That poses some downside risks to our expectation that growth will pick up to around 8% in the current quarter (1Q13: +7.7% yoy; 2012: +7.8%).
- Both, the Markit/HSBC and NBS manufacturing PMIs eased in April, but managed to stay in expansionary territory. At around 50½ not only were the headline readings almost perfectly in sync again, but the details also sent identical messages. The slowdown was broad-based, led by new export orders falling back below the critical threshold.
- The low export order component readings reflect still formidable external headwinds for the Chinese economy, namely weaker global demand from the eurozone, the country's major trading partner, which is only gradually growing out of recession and the US recovery taking a breather in spring. Solid export growth figures so far this year seem to be inflated by firms masking capital flows to China.
- But domestic factors are limiting recovery momentum as well. China's authorities are trying hard to prevent the property market from overheating again, to slow down rapid credit growth and limit excessive social spending. At 12.8% yoy, April's retail sales growth was again well below the 15% registered in 4Q12. Fixed-asset investment growth fell further to 20.6% yoy, with capex momentum way below residential and infrastructure investment growth, while overcapacities in sectors like steel are still weighing on factory output.
- Up until recently, the Chinese authorities did not appear overly alarmed by the relatively slower expansion as they were focusing on improving the quality and efficiency of growth. But the People's Bank of China's recent warning that there is still no solid foundation for stable growth may signal some weakening in policymakers' tolerance for slower growth. Nevertheless, we do not expect any broad-based step-up of macro accommodation.
- Overall, we feel comfortable with our GDP growth forecast of 7¾% for both 2013 and 2014. Over the medium term, the underlying (structural) trend continues to head south. Potential growth is weakening given the slowdown in the investment (and thus the growth of capital stock) as well as labor supply growth – accentuated by the (new) leadership's efforts to change China's growth model.

BUSINESS CLIMATE IMPLIES MODEST RECOVERY ONLY...



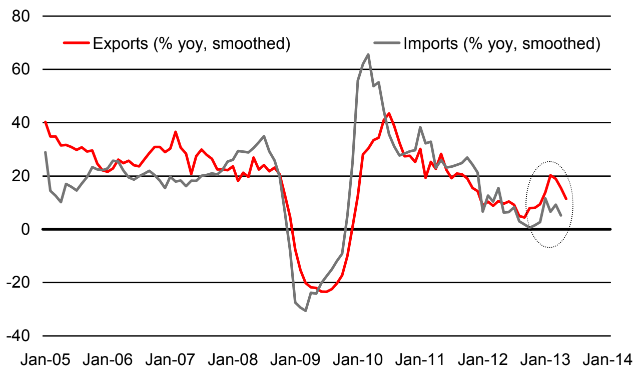
...WITH GDP GROWTH TO FLUCTUATE IN 7½%-8% REGION



Source: Thomson Datastream, Feri, UniCredit Research

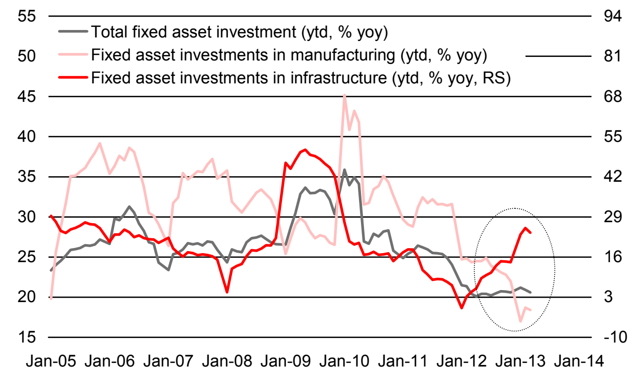
China

EXTERNAL ECONOMY



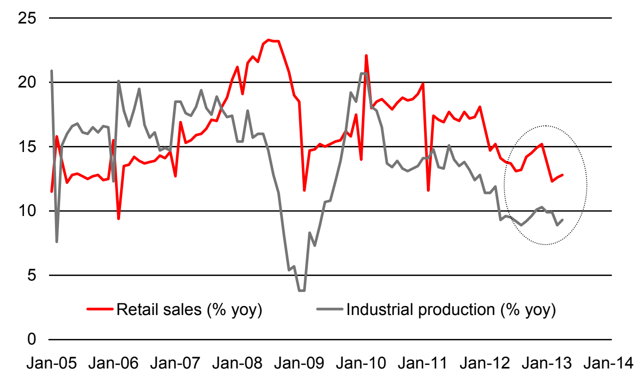
- Nominal exports soared earlier this year, but have started to normalize more recently. Even at these lower levels, they seem inflated.

FIXED ASSET INVESTMENT



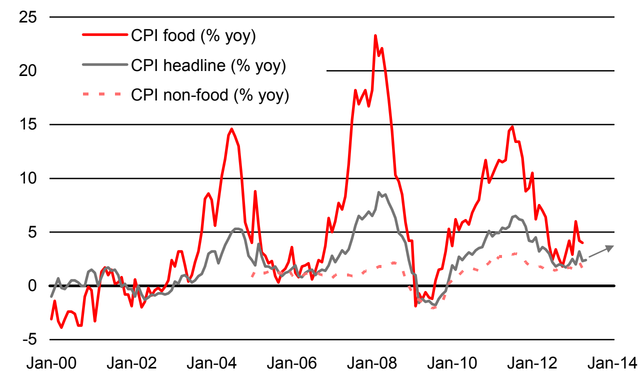
- Public investment has surged, as has residential investment. But capex growth is lagging, dragged by overcapacities and weakening profit growth.

RETAIL SALES AND INDUSTRIAL PRODUCTION



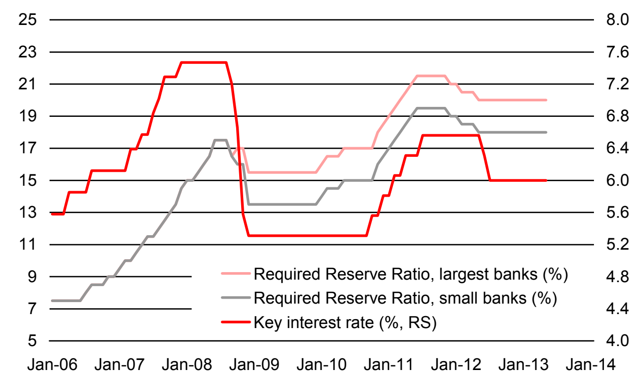
- Like business investment, private spending is not yet showing a clear upward trend, which is weighing on the recovery momentum.

CPI



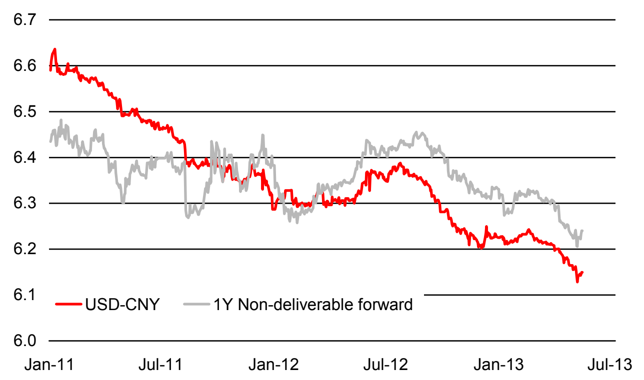
- Disinflation has come to an end, with food and housing driving CPI higher. But price pressure will not be a worry...

MONETARY POLICY



- ...so the central bank can remain on the sidelines. However, credit measures will be tightened.

USD-CNY

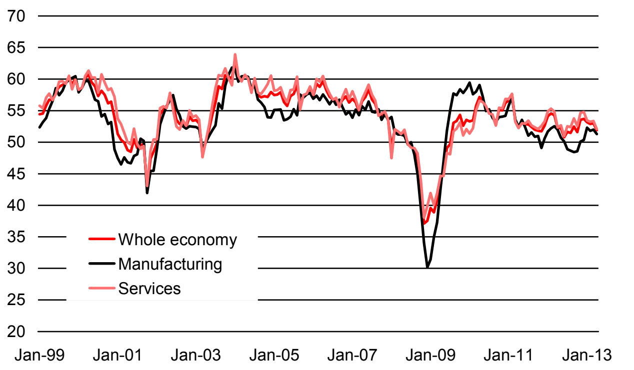


- After fluctuating sideways earlier this year, the CNY resumed its appreciation trend, not least on the back of a weakening JPY.

Source: Thomson Datastream, Feri, UniCredit Research

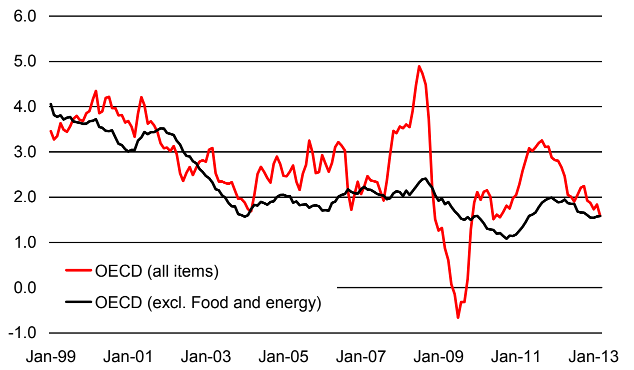
Global indicators

GLOBAL PMI OUTPUT



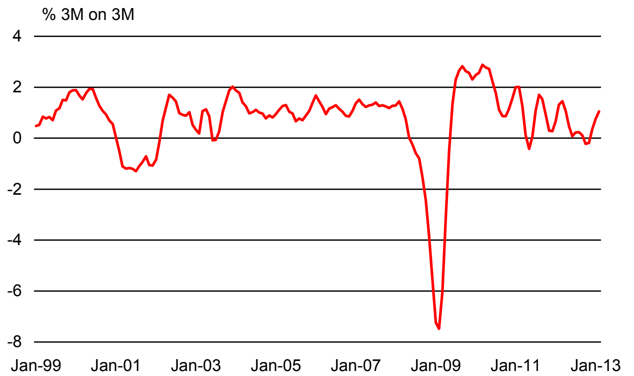
- The global composite PMI fell from 53.0 to 51.9 in April. The manufacturing output index declined from 52.0 to 51.3, and the services index was down from 53.4 to 52.2.

CPI INFLATION



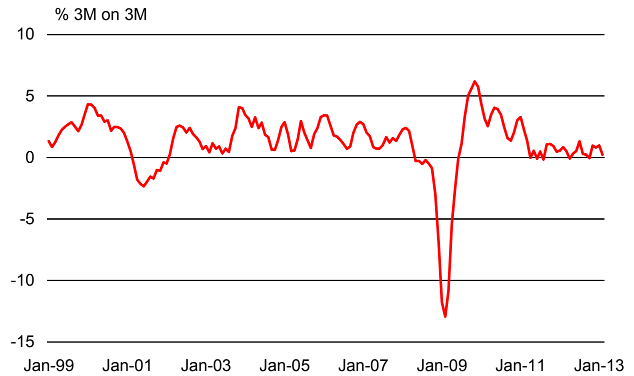
- Headline inflation in OECD economies slowed from 1.8% yoy to 1.6% yoy in March, while the core rate remained at 1.6% yoy.

INDUSTRIAL PRODUCTION



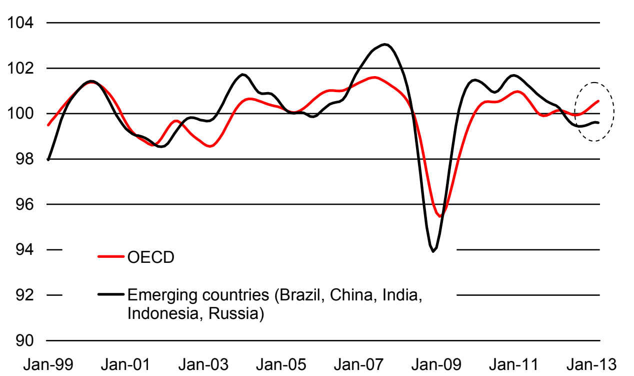
- Global IP rose 0.5% mom in February. The 3M/3M rate accelerated for the third month in a row, from 0.8% to 1.0%.

WORLD TRADE



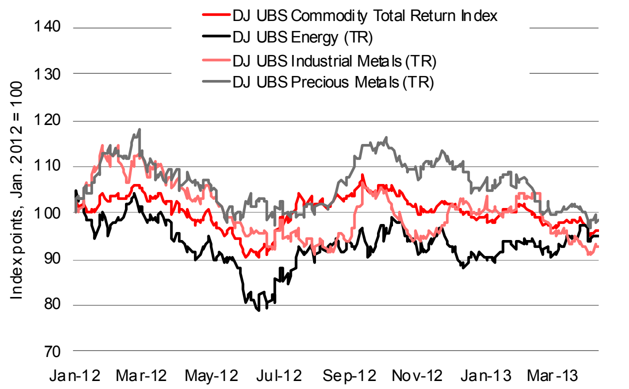
- World trade fell 0.7% mom in February. The 3M/3M rate slowed from 1.0% to 0.2%.

OECD COMPOSITE LEADING INDICATORS



- The OECD leading indicator for the OECD countries (aggregated) edged up further in April, while that for the emerging economies (aggregated) remained stable.

COMMODITIES



- We expect the price of Brent crude to move sideways over the next two years, due to strong supply from North America (shale oil) and Iraq. The gold price will likely remain under pressure.

Source: Bloomberg, CBP Netherlands, OECD, UniCredit Research

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