Economics Research

The UniCredit Chartbook

Monthly

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Monthly recap

- **EMU:** Recent growth data have shown signs of improvement, marginally so for the soft indicators, but more clearly for hard data. The bright spot was the surprising resilience of industrial production, which may tilt to the upside the risks to our -0.1% qoq GDP forecast for 2Q13. The ECB remains cautious but positive overall, as reflected in its newly updated GDP projections, which envisage the beginning of a slow recovery in the summer. We still see the refi rate on hold for the foreseeable future and no cut in the deposit rate, while new bold unconventional measures are unlikely in the near term.

- **US:** After the US economy expanded a solid 2.4% annualized in 1Q13, growth is on track to slow down to 1.8% in the current quarter. Most of this volatility reflects the (lagged) response to fiscal tightening and some renewed inventory adjustment. While business sentiment continued to deteriorate, the dynamic in the consumer sector already started to pick up again at the end of the quarter, in line with our view that the economy will regain momentum in the second half of the year. We continue to expect that the Federal Reserve will not begin to taper its asset-purchase program before September.

- **CEE:** Within CEE, external financing pressures have increased in the face of expectations of Fed tapering and higher UST yields, although this is materializing at a time of welcome improvements in activity in industry, less downward pressure from fiscal policy on activity and record low policy interest rates in many countries. Looking ahead, the risks from a normalization in Fed policy are non-negligible for the region, though much smaller in some countries than others. Current-account-deficit countries such as Turkey, Ukraine and Serbia risk proving particularly vulnerable.

- **Japan:** Overall, recent data continued to improve sharply, underpinning the strong acceleration of the economy following the regime shift of Japan's economic policy and fueled by the depreciation of the JPY. Leaving monetary policy setting unchanged more recently (thus disappointing some hopes of additional measures) reflects the BoJ's assessment that the Japanese economy is already expanding satisfactorily and that bond market volatility has decreased. We remain worried about a too timid approach to structural reforms to lift potential output, particularly in the context of strong demand stimulus.

- **China:** Partly reflecting the significant yen depreciation (and thereby the Renminbi appreciation), Chinese data releases over recent weeks have been disappointing on balance, thus fuelling worries that the tepid economic recovery will not gain further momentum, but rather ends up in an L-shaped development. While posing further downside risks to our expectation of a moderate uptick, we will wait for next month's 2Q13 GDP figures before fine-tuning our macro projections.

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	-0.2	81.7	79.2	76.9	6.4	5.9	5.5
France	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	1.7	1.5	-	-	-	-10.6	-6.5	-5.8	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	74.5	74.2	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
Other EU																		
UK	0.3	0.9	1.4	2.8	2.5	2.2	0.50	0.50	0.50	-6.3	-6.7	-6.1	90.0	94.0	97.1	-3.7	-2.7	-2.4
Sweden	1.1	1.7	2.4	0.9	0.1	1.6	1.00	1.00	1.50	-0.7	-0.7	0	38.7	37.0	35.8	7.1	7.4	7.2
Poland	1.9	1.7	2.3	3.7	1.1	2.0	4.25	2.50	2.50	-3.9	-3.9	-3.5	55.6	57.4	57.5	-3.5	-2.7	-3.1
Czech Rep.	-1.2	-0.8	2.1	3.3	1.5	1.7	0.05	0.05	0.50	-4.4	-2.9	-3.0	45.8	47.9	48.9	-2.4	-1.2	-1.1
Hungary	-1.7	0.4	1.0	5.6	2.0	3.3	5.75	3.50	3.50	-1.9	-2.7	-3.0	78.0	78.1	77.1	1.0	1.9	1.9
Others																		
US	2.2	2.0	2.6	2.1	1.5	2.3	0.25	0.25	0.25	-8.6	-5.9	-4.8	106.5	108.8	109.6	-3.1	-3.0	-3.1
Switzerland	1.0	1.5	1.8	-0.7	-0.4	0.6	0	0	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	-0.8	-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	6.00	-1.5	-2.1	-2.9	36.6	35.8	35.8	-6.1	-6.9	-7.9
China	7.8	7.8	7.7	2.7	2.5	3.0	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	-0.6	-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	0.2	0.1	0.6	0.5	0.6	0.6	0.6	0.6	0.7	0.7
Poland (% yoy)	1.3	0.7	0.5	1.5	2.0	2.5	2.9	2.2	2.2	2.1
Czech Rep.	-0.3	-0.3	-1.1	0.5	0.6	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	2.4	1.8	2.8	2.8	2.7	2.6	2.5	2.5
Switzerland	0.6	0.3	0.6	0.3	0.4	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	1.6	0.8	0.6	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	1.5	1.8	1.6	1.6
Germany	2.0	2.0	1.5	1.4	1.2	1.2	1.2	1.3	1.4	1.5
France	2.0	1.5	1.1	0.8	1.0	1.2	1.7	2.0	1.9	2.0
Italy	3.2	2.5	1.9	1.1	1.6	1.7	1.7	2.0	1.6	1.6
Spain (HICP)	2.8	3.2	2.8	1.8	1.0	1.1	1.0	1.8	1.7	1.6
Austria	2.3	2.8	2.5	2.2	1.8	1.4	1.6	1.9	1.9	2.0
Other EU										
UK	2.4	2.7	2.8	2.6	2.5	2.3	2.1	2.1	2.2	2.2
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	0.7	1.0	1.2	1.7	1.9	2.0	2.3
Czech Rep.	3.4	2.9	1.8	1.4	1.4	1.3	1.2	1.5	1.8	1.8
Hungary	6.6	5.0	2.9	1.6	1.5	1.6	2.1	2.2	2.8	3.5
Others										
US	1.7	1.9	1.7	1.3	1.4	1.4	1.7	2.4	2.5	2.6
Switzerland	-0.5	-0.3	-0.4	-0.5	-0.4	-0.1	0.2	0.6	0.8	0.8
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	6.4	6.1	6.3	5.6	6.2	6.4	6.3
China	1.9	2.5	2.4	2.3	2.5	2.8	2.8	2.9	3.1	3.2

Source: UniCredit Research

Table 3: Comparison of annual GDP and CPI forecasts

GDP (%)

	UniCredit			IMF (Apr-13)			European Commission (May-13)			OECD (May-13)		
	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	-0.5	-0.6	1.1
Germany	0.9	0.5	1.5	0.9	0.6	1.5	0.7	0.4	1.8	0.9	0.4	1.9
France	0	-0.3	0.8	0	-0.1	0.9	0	-0.1	1.1	0	-0.3	0.8
Italy	-2.4	-1.7	0.6	-2.4	-1.5	0.5	-2.4	-1.3	0.7	-2.4	-1.8	0.4
Spain	-1.4	-1.6	0.5	-1.4	-1.6	0.7	-1.4	-1.5	0.9	-1.4	-1.7	0.4
Austria	0.8	0.4	1.6	0.8	0.8	1.6	0.8	0.6	1.8	0.8	0.5	1.7
Greece	-6.5	-4.5	0.2	-6.4	-4.2	0.6	-6.4	-4.2	0.6	-6.4	-4.8	-1.2
Portugal	-3.2	-2.7	0.3	-3.2	-2.3	0.6	-3.2	-2.3	0.6	-3.2	-2.7	0.2
Other EU												
UK	0.3	0.9	1.4	0.2	0.7	1.5	0.3	0.6	1.7	0.3	0.8	1.5
Sweden	1.1	1.7	2.4	1.2	1.0	2.2	0.8	1.5	2.5	1.2	1.3	2.5
Poland	1.9	1.7	2.3	2.0	1.3	2.2	1.9	1.1	2.2	2.0	0.9	2.2
Czech Rep.	-1.2	-0.8	2.1	-1.2	0.3	1.6	-1.3	-0.4	1.6	-1.2	-1.0	1.3
Hungary	-1.7	0.4	1.0	-1.7	0	1.2	-1.7	0.2	1.4	-1.8	0.5	1.3
Others												
US	2.2	2.0	2.6	2.2	1.9	3.0	2.2	1.9	2.6	2.2	1.9	2.8
Switzerland	1.0	1.5	1.8	1.0	1.3	1.8	1.0	1.4	1.9	1.0	1.4	2.0
Russia	3.4	2.7	2.8	3.4	3.4	3.8	3.4	3.3	3.8	3.4	2.3	3.6
Turkey	2.2	3.8	3.6	2.6	3.4	3.7	2.2	3.2	4.0	2.2	3.1	4.6
China	7.8	7.8	7.7	7.8	8.0	8.2	7.8	8.0	8.1	7.8	7.8	8.4

CPI INFLATION (%)*

	UniCredit			IMF (Apr-13)			European Commission (May-13)			OECD (May-13)		
	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	2.5	1.5	1.2
Germany	2.0	1.3	1.4	2.1	1.6	1.7	2.1	1.8	1.6	2.1	1.6	2.0
France	2.0	1.0	1.9	2.0	1.6	1.5	2.2	1.2	1.7	2.2	1.1	1.0
Italy	3.0	1.7	1.7	3.3	2.0	1.4	3.3	1.6	1.5	3.3	1.6	1.2
Spain	2.4	1.7	1.5	2.4	1.9	1.5	2.4	1.5	0.8	2.4	1.5	0.4
Austria	2.4	1.9	1.8	2.6	2.2	1.9	2.6	2.0	1.8	2.6	2.0	1.5
Greece	1.5	-0.5	-0.1	1.0	-0.8	-0.4	1.0	-0.8	-0.4	1.0	-0.7	-1.7
Portugal	2.8	0.2	0.6	2.8	0.7	1.0	2.8	0.7	1.0	2.8	0	0.2
Other EU												
UK	2.8	2.5	2.2	2.8	2.7	2.5	2.8	2.8	2.5	2.8	2.8	2.4
Sweden	0.9	0.1	1.6	0.9	0.3	2.3	0.9	0.9	1.4	0.9	0.2	1.3
Poland	3.7	1.1	2.0	3.7	1.9	2.0	3.7	1.4	2.0	3.6	0.7	1.0
Czech Rep.	3.3	1.5	1.7	3.3	2.3	1.9	3.5	1.9	1.2	3.3	1.6	1.3
Hungary	5.6	2.0	3.3	5.7	3.2	3.5	5.7	2.6	3.1	5.7	2.8	3.5
Others												
US	2.1	1.5	2.3	2.1	1.8	1.7	2.1	1.8	2.1	2.1	1.6	1.9
Switzerland	-0.7	-0.4	0.6	-0.7	-0.2	0.2	-0.7	0	1.1	-0.7	-0.3	0.2
Russia	5.1	6.3	5.4	5.1	6.9	6.2	-	-	-	5.1	6.6	5.4
Turkey	8.9	6.7	6.1	8.9	6.6	5.3	9.0	6.6	5.6	8.9	6.7	5.2
China	2.7	2.5	3.0	2.6	3.0	3.0	-	-	-	2.6	2.5	2.6

*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	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
3M	0.21	0.25	0.30	0.40	0.50	0.55	0.55
2Y	0.17	0.15	0.25	0.35	0.50	0.65	0.85
5Y	0.60	0.50	0.70	0.90	1.20	1.45	1.65
10Y	1.57	1.50	1.70	2.00	2.25	2.40	2.60
30Y	2.42	2.40	2.55	2.80	3.00	3.10	3.25
2/10	140	135	145	165	175	175	175
2/5/10	-27	-33	-28	-28	-18	-8	-8
10/30	85	90	85	80	75	70	65
2Y SwSp	-37	-35	-30	-30	-30	-25	-25
10Y SwSp	-26	-25	-20	-20	-20	-15	-15
10Y BTP/bund	274	250	250	230	210	195	190
US							
Key rate	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
2Y	0.27	0.25	0.35	0.45	0.65	0.85	1.00
5Y	1.08	1.10	1.38	1.53	1.70	2.10	2.45
10Y	2.21	2.10	2.40	2.70	2.85	3.10	3.30
30Y	3.37	3.20	3.50	3.70	3.85	4.00	4.20
2/10	193	185	205	225	220	225	230
2/5/10	-16	-8	0	-5	-5	13	30
10/30	116	110	110	100	100	90	90
2Y SwSp	-17	10	10	5	5	5	5
10Y SwSp	-18	60	70	70	60	70	70
UK							
Key rate	0.50	0.50	0.50	0.50	0.50	0.50	0.75
10Y	2.14	2.10	2.40	2.80	2.95	3.30	3.50
SZ							
Key rate	0	0	0	0	0	0	0
10Y	0.79	0.65	0.80	1.00	1.25	1.40	1.60

FX	Current	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
EUR-USD	1.34	1.33	1.35	1.35	1.36	1.37	1.38
EUR-JPY	128	146	155	155	159	162	166
EUR-GBP	0.86	0.88	0.90	0.90	0.91	0.91	0.92
EUR-SEK	8.67	8.63	8.60	8.58	8.55	8.53	8.50
EUR-NOK	7.69	7.67	7.63	7.60	7.57	7.55	7.55
EUR-CHF	1.23	1.30	1.33	1.35	1.37	1.39	1.41
EUR-AUD	1.41	1.25	1.25	1.25	1.24	1.22	1.23
EUR-NZD	1.67	1.53	1.53	1.53	1.51	1.49	1.48
EUR-CAD	1.36	1.40	1.40	1.38	1.36	1.34	1.34
USD-JPY	96	110	115	115	117	118	120
GBP-USD	1.56	1.51	1.50	1.50	1.50	1.50	1.50
USD-SEK	6.49	6.49	6.37	6.36	6.29	6.23	6.16
USD-NOK	5.76	5.77	5.65	5.63	5.57	5.51	5.47
USD-CHF	0.92	0.98	0.99	1.00	1.01	1.01	1.02
AUD-USD	0.95	1.06	1.08	1.08	1.10	1.12	1.12
NZD-USD	0.80	0.87	0.88	0.88	0.90	0.92	0.93
USD-CAD	1.02	1.05	1.04	1.02	1.00	0.98	0.97

Source: Bloomberg, UniCredit Research

Eurozone

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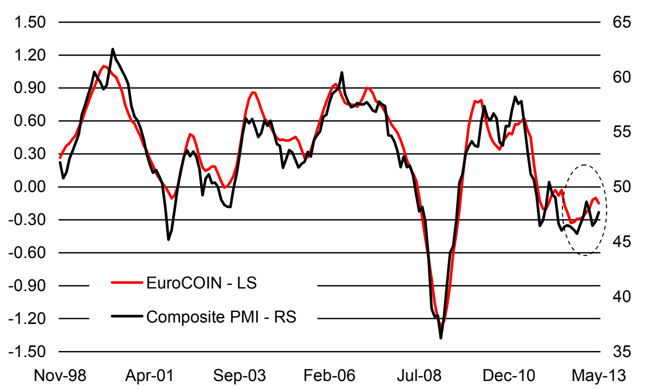
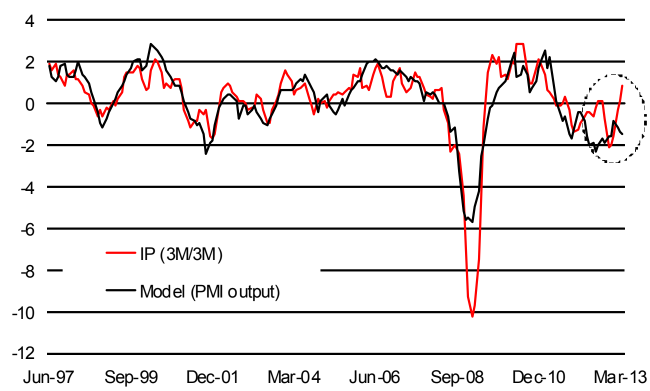
- Recent growth data have shown signs of improvement, marginally so for the soft indicators, but more clearly for hard data. The bright spot was the surprising resilience of industrial production, which rose 0.4% mom in April. This was the third consecutive improvement – the fourth in five months – which pushed the 3M/3M IP growth rate to 0.9%, the fastest pace since early 2011. The IP entry in 2Q looks very promising, and bodes well for a further easing in the pace of GDP recession in the spring, when we also expect a recovery in construction activity after some weather-related weakness in 1Q. A downward adjustment in IP will be difficult to escape in May: the size of the contraction will be key to understanding whether risks to our -0.1% qoq GDP forecast for 2Q may start moving to the upside.
- Surveys in May have been somewhat mixed, but overall positive. The Composite PMI improved for the second consecutive month: at 47.7, it remains in contraction territory, but the recent trend supports our view that growth momentum is heading north. Most national business surveys rose as well, while the weak spot was the EuroCOIN, which deteriorated slightly (-0.15% vs. -0.10%) for the first time since last summer. In general, the rising disconnection between hard and soft data suggests treating surveys with some caution.
- April proved to be the trough of the inflation path, in line with our expectations. In May, all the main spending items recorded faster price growth, pushing headline inflation up to 1.4% yoy vs. 1.2%. After some volatility related to the early timing of Easter, core prices rose 1.2% yoy after 1.0% in April. We see headline inflation rising further in June, mostly due to an unfavorable base effect on energy. In our projections through 2014, price growth hovers around 1.5% and never exceeds the 2% mark.
- The ECB remained on hold at the 6 June meeting. The central bank's assessment was cautious but overall positive, as shown by its newly updated growth projections, which still envisage the beginning of a slow recovery in the summer followed by a gradual re-acceleration. However, with growth risks tilted to the downside and inflation expected to stay clearly below 2% throughout the forecast horizon, the ECB stands ready to act further if needed. We still see the refi rate on hold for the foreseeable future, with risks skewed towards a final 25bp cut in case growth indicators disappoint in the next few months. We do not expect a negative deposit rate, which is unlikely to kick-start lending and may generate unwelcome side effects, such as hurting the profitability of the banking sector and inducing an acceleration in the (already fast) pace of repayment of 3Y LTRO funds. New bold unconventional measures are unlikely in the near term.

SURVEYS: STILL MIXED EVIDENCE…



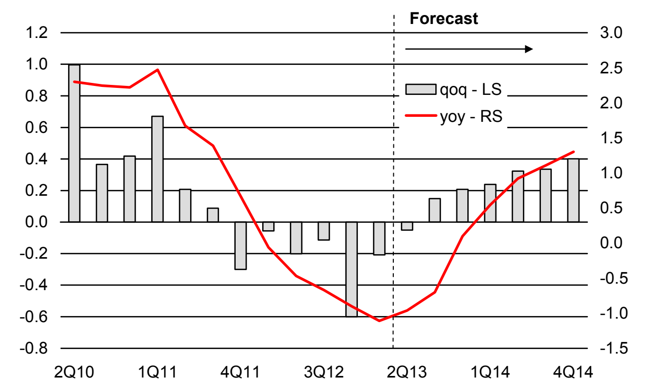
…WHILE IP SHOWS SURPRISING STRENGTH



Source: BoI, Eurostat, Markit, UniCredit Research

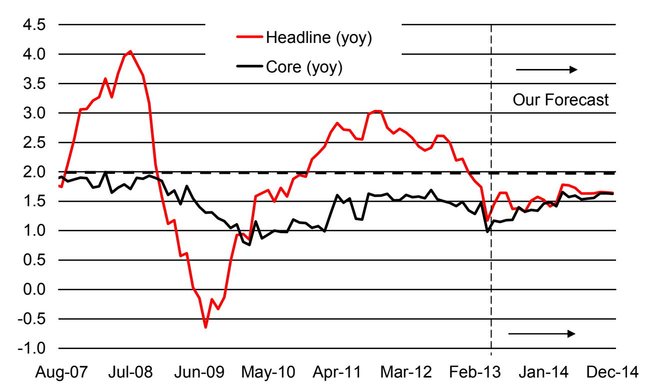
Eurozone

GDP



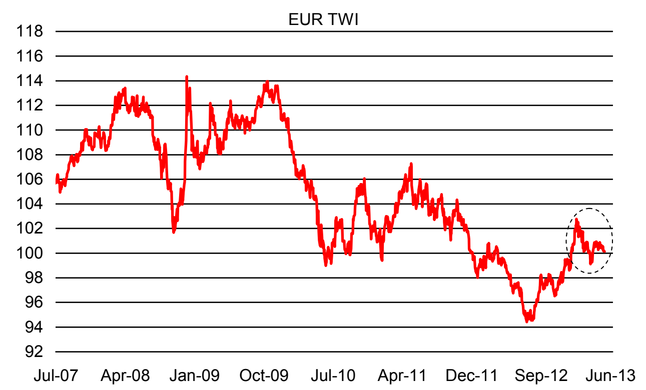
- The economy is close to bottoming out.

CPI INFLATION



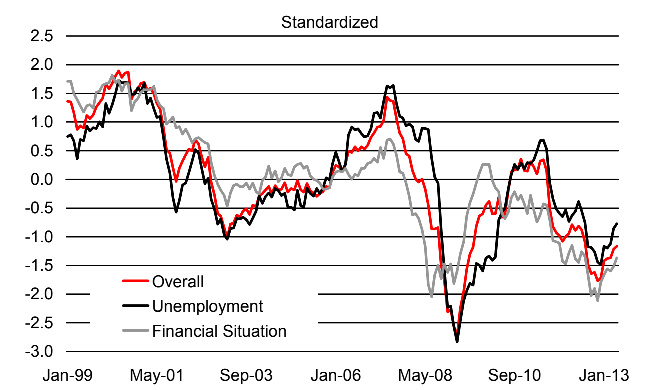
- Inflation has troughed.

EUR



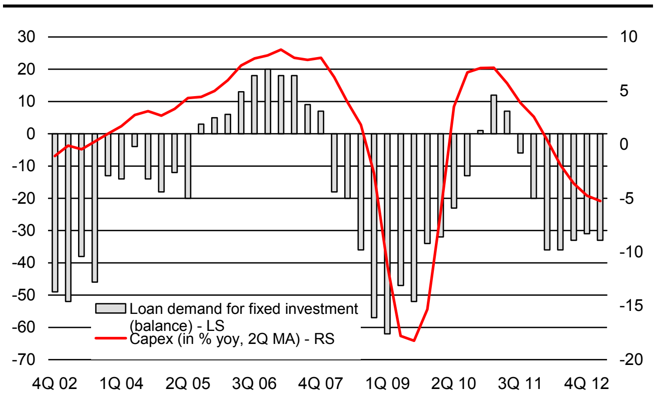
- Trade-weighted EUR holds at a comfortable level.

CONSUMER CONFIDENCE



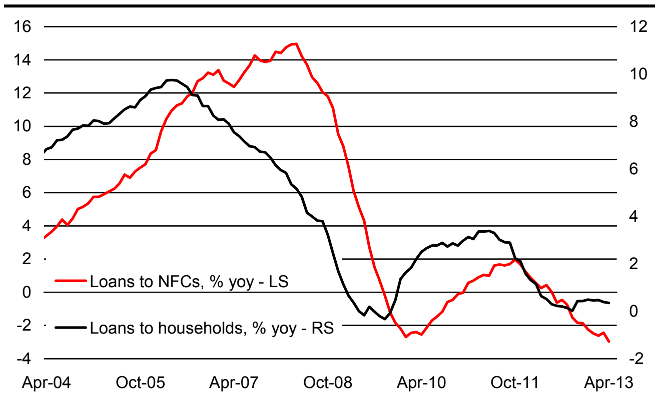
- Signs of moderate recovery.

INVESTMENT



- Capex still under pressure.

LENDING



- Downward trend in corporate lending continues.

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

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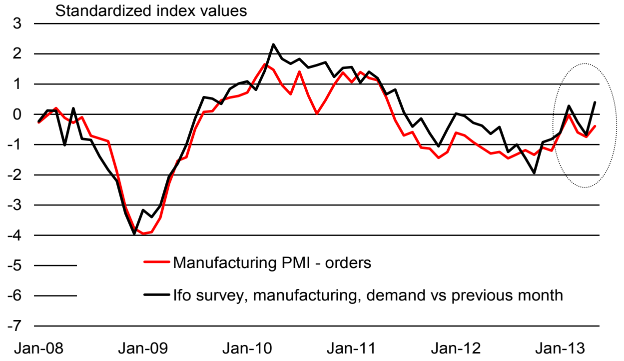
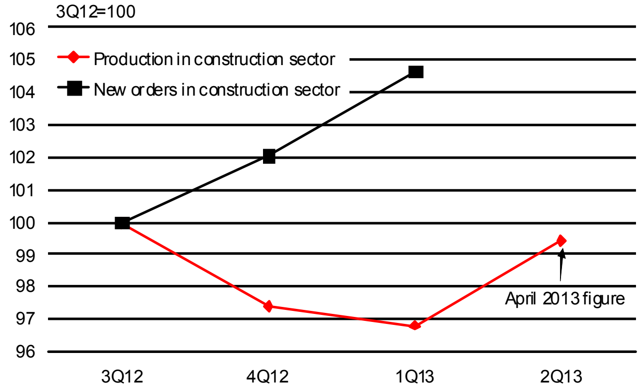
- Overall, both soft and hard data in the last four weeks came in on a comparatively strong note, thereby confirming our picture of a substantial increase in economic momentum. The mini-increase of 0.1% qoq in real GDP at the start of the year does therefore not reflect the "true" underlying pace of the German economy. We expect plus 0.6% qoq for real GDP in 2Q13 and plus 0.5% qoq in 3Q13.
- The Ifo business climate index and the manufacturing PMI surprised on the upside in May. While the current situation component of the Ifo index rose strongly, the third consecutive decline in business expectations did not materialize (flat reading). Usually, three monthly and strong decreases in a row are consistent with less dynamic growth going forward. Especially encouraging is the higher level of the order subcomponent both in the Ifo and PMI survey. The Ifo new orders subcomponent even climbed to a new cyclical high in May (see left chart).
- Hard data in form of industrial production and exports also came in on a strong footing. Industrial production increased a very strong 1.8% mom in April after already +1.2% mom in the previous month. Overall construction production even jumped 6.7% mom in April, thereby reflecting the expected catching-up process after the unusually harsh winter weather in 1Q13. The huge gap between new orders and construction activity is expected to narrow further in coming months (see right chart), although monthly volatility might remain high. In any case, construction activity will substantially contribute to overall economic activity in the second quarter. Exports also rose markedly in April with +1.5% mom.
- The only weak spot were new orders (minus 2.3%). However, the decline should clearly be seen in the light of two strong increases in the previous months. Furthermore, bulk orders were below-average in April. Given the latest signals from the new orders surveys included in the Ifo index and the Manufacturing PMI (see above), the upwards trend is intact.

ENCOURAGING SIGNAL FROM NEW ORDERS COMPONENT



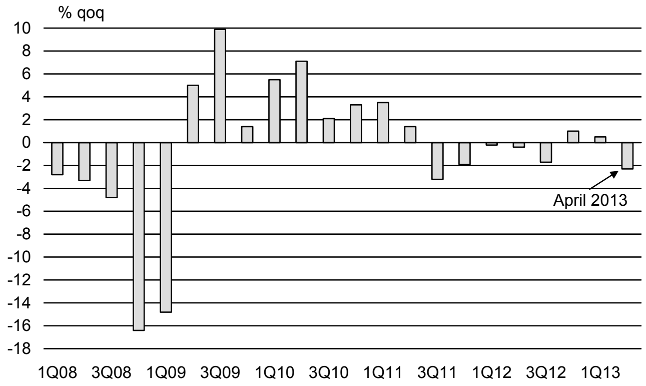
CLOSING THE GAP BETWEEN PRODUCTION & NEW ORDERS



Source: Markit, Feri, UniCredit Research

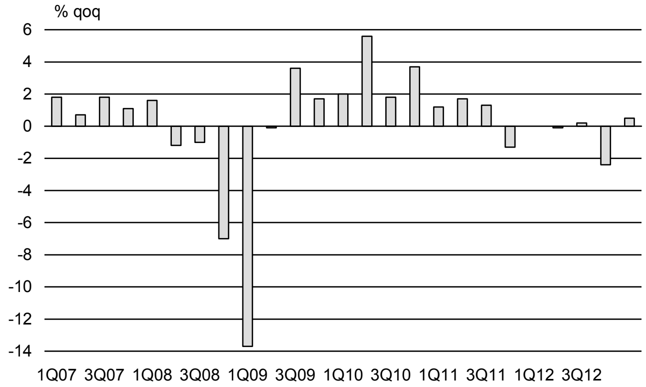
Germany

NEW ORDERS



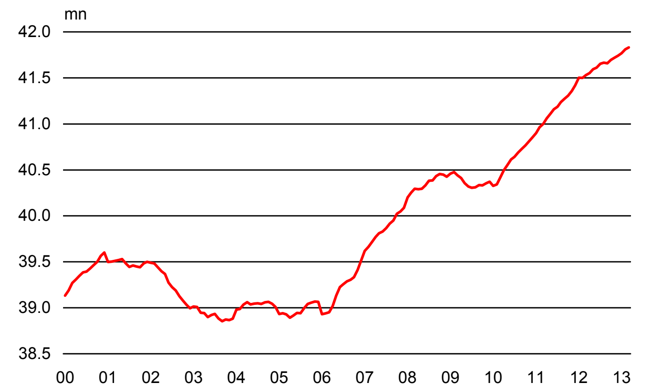
- New orders declined 2.3% in April after two consecutive strong increases (March: +2.3%; February: +2.2%).

PRODUCTION



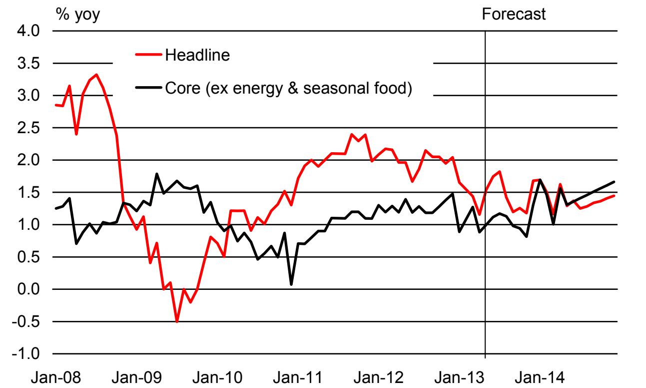
- Production in the manufacturing sector (ex construction) rose 1.5% mom in April after plus 1.2% in the previous month.

EMPLOYMENT



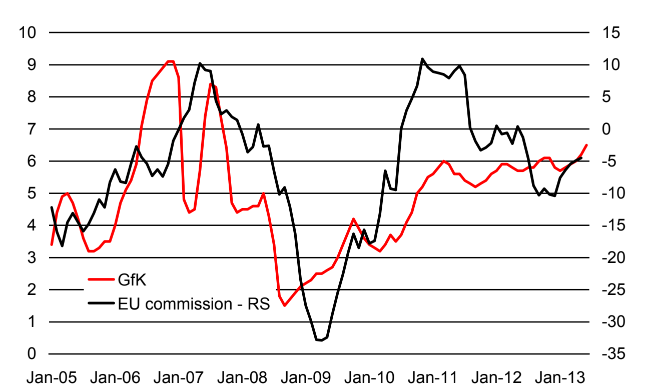
- Employment took a breather in April, rising by only 1,000 mom after a strong plus of 85,000 in 1Q13.

INFLATION



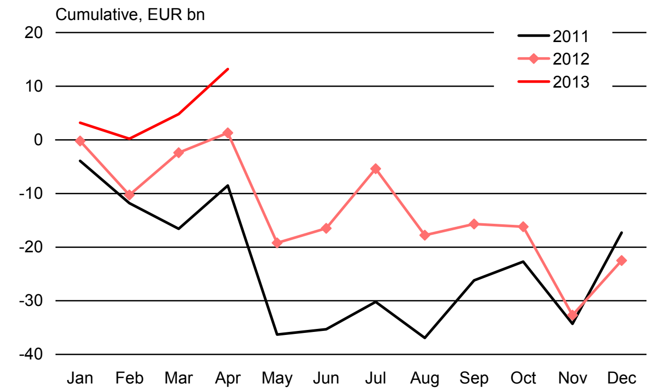
- Consumer price inflation accelerated to 1.5% yoy in May after hitting its lowest increase (+1.2%) since September 2010.

CONSUMER CONFIDENCE



- Consumer confidence continued its upward trend. The GfK even hit its highest level since September 2007.

FEDERAL BUDGET BALANCE



- The federal budget balance improved markedly 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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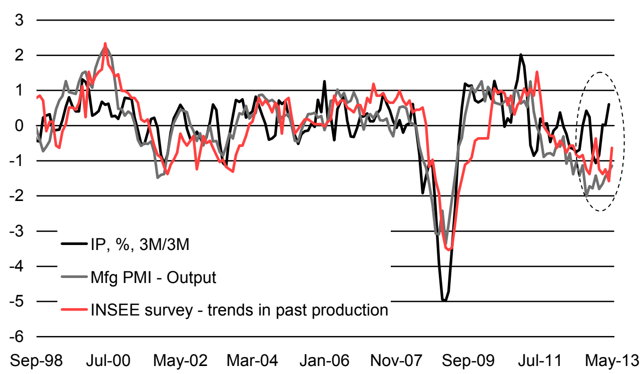
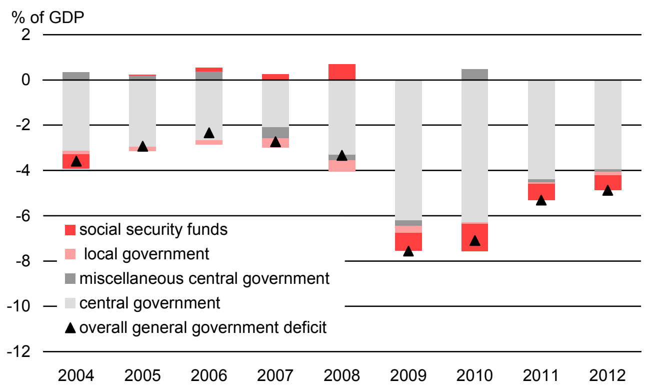
- The surge in April industrial production (+2.2% mom) is the most noteworthy data development since the last chartbook, as it showed a much stronger-than-expected start to the second quarter. The IP level now stands 2.1% above the 1Q average, while the less volatile 3M/3M growth rate stands at 0.9%. This strong outcome confirmed our view that, at present, manufacturing surveys, especially the PMI, may be underestimating the momentum in factory activity and, thus, the focus needs to be on hard data to obtain more accurate indications. Nevertheless, in the context of soft global demand for French products, a similar pace of monthly increase is unlikely to be continued in May and June. Moreover, in May there were several public holidays which most likely enabled businesses to extend midweek public holidays to create long weekend closures of in-plant activity. We therefore expect that industrial production will most likely show a meaningful correction in May. The size of this correction will give us insight into upside risks, if any, to our forecast for a broad stagnation in 2Q GDP, following the second-consecutive moderate contraction recorded in 1Q (-0.2% qoq, the same pace as in 4Q12).
- The European Commission has granted France two extra years, i.e. until 2015, to bring its deficit-to-GDP ratio below 3.0% provided the pace of structural reforms (i.e. pensions and services liberalization) is significantly accelerated. The new fiscal adjustment path foresees the headline deficit settling at 3.9% for 2013, 3.6% for 2014 and 2.8% for 2015. This is consistent with an annual improvement in the structural budget balance worth 1.3% of GDP in 2013 and 0.8% in both 2014 and 2015, according to calculations by the European Commission.
- In the context of a broader plan to streamline welfare spending and improve the sustainability of public finances, the French government has recently embarked on a reform of public spending on family benefits, which, however, accounts for only 15% of the overall social security deficit (worth nearly EUR 18bn in 2012). The government approved a reduction in the income tax allowance offered to families rather than cutting family allowance benefits (one option that was also widely discussed), restating its commitment to preserving the universality of public spending. Reform measures are expected to generate EUR 1bn. At the time of publication, the debate on the reform of the pension system is about to take center stage, focusing on the recommendations of the advisory panel commissioned by the government (i.e. the Moreau Report released on 15 June). Reform proposals consist of a further increase in the level of contributions, a limit on the indexation of pensions, tax rises for pensioners, and the alignment of the special public pension systems with the private sector. We rule out any increase in the retirement age.

APRIL IP CAME IN STRONGER THAN SURVEYS SUGGESTED



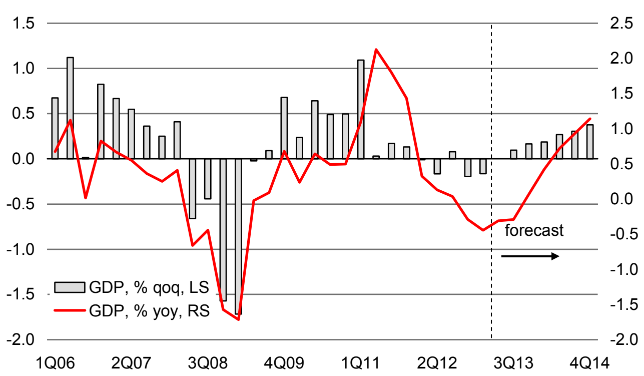
THE SOCIAL SECURITY DEFICIT IS IN THE SPOTLIGHT



Source: INSEE, Markit, UniCredit Research

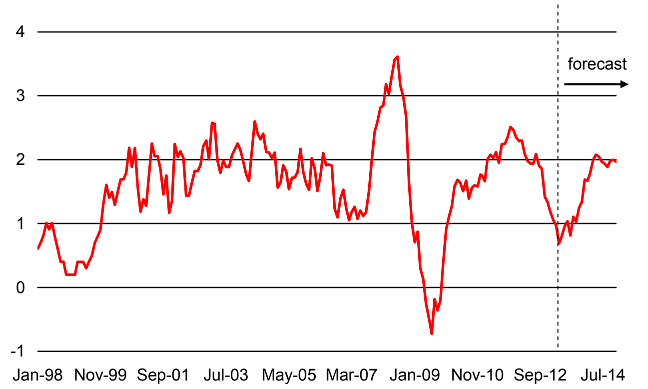
France

GDP



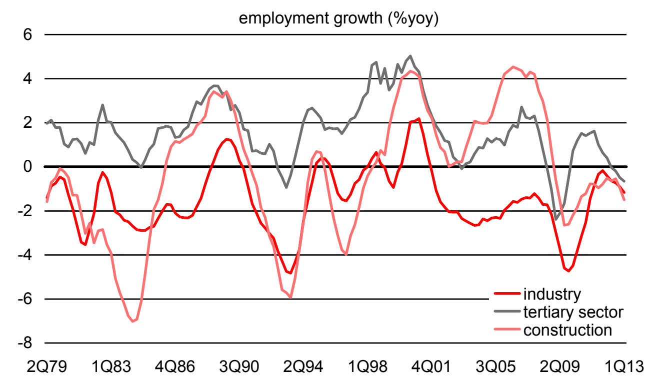
- We expect GDP to stabilize in 3Q12. We see annual GDP settling at -0.3% in 2013 and +0.8% in 2014.

INFLATION



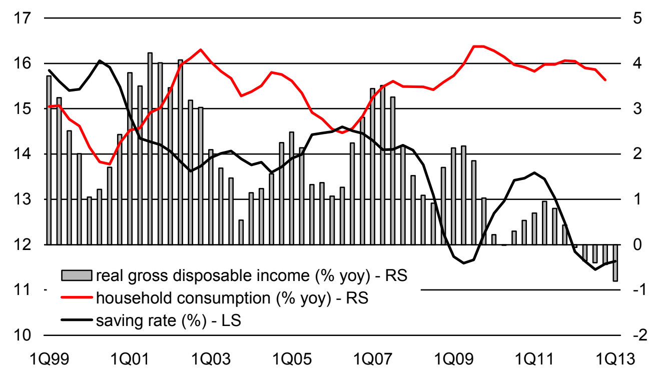
- CPI edged up 0.1pp to 0.8% in May. We currently estimate inflation averaging 1.0% in 2013.

EMPLOYMENT



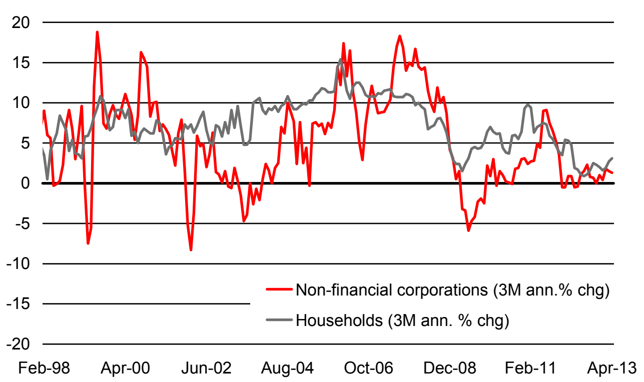
- Construction and industry have been the sectors most affected by job shedding.

HOUSEHOLD REAL DISPOSABLE INCOME



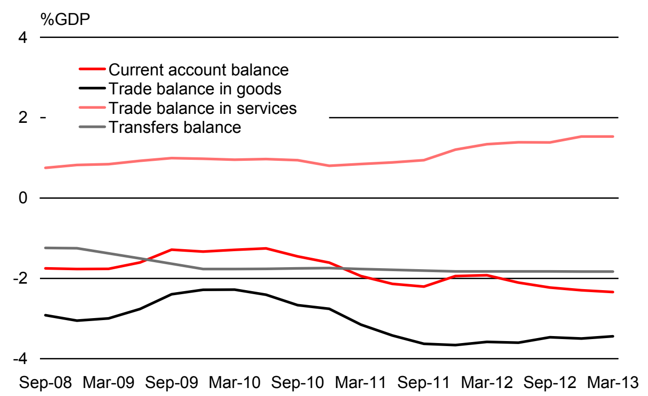
- The contraction in household real disposable income since early 2012 is unprecedented, as is the behavior of the saving rate.

LENDING TO THE PRIVATE SECTOR



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

CURRENT ACCOUNT



- The current account deficit stabilized at 2.3% of GDP by the end of 1Q13 and has slightly narrowed since then.

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

Italy

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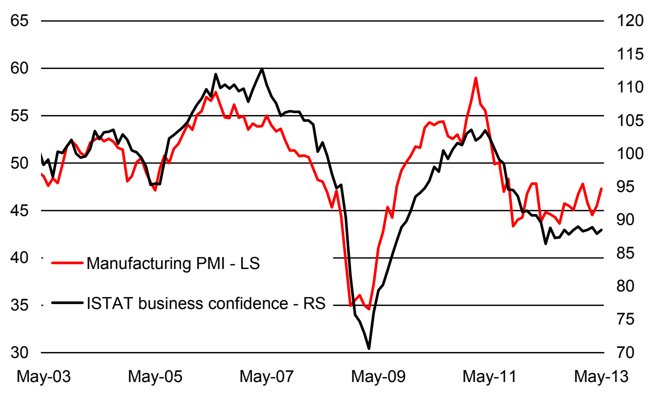
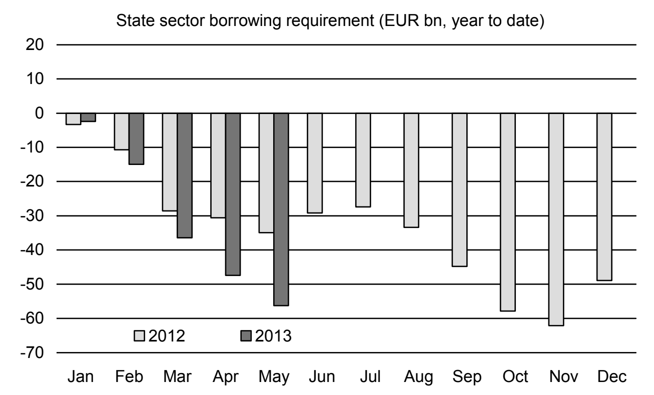
- After two sizeable declines in February and March, IP contracted further in April, by 0.3% mom. This prolonged decline in industrial activity did not come as a surprise, matching the weak signals from business surveys at the beginning of 2Q in a context of lagging domestic demand. Even assuming positive, albeit still modest, growth in May and June, the pace of industrial contraction will likely re-intensify in 2Q13, with factory activity shrinking by around 1.0% qoq, after -0.5% in 1Q13.
- Nevertheless, soft indicators have started to send some encouraging signs. Although remaining well below the expansion threshold, the manufacturing PMI posted another significant improvement in May. Should this upward trend be confirmed, then this will start to gradually feed through into factory and economic activity. Moreover, the export orders sub-component of the PMI survey continued to outperform and stands now well above the expansion threshold (at 52.1 vs. the previous 50.4), corroborating our expectations for an improvement in export prospects. Indeed, real exports of good and services showed a clear decline in 1Q13 (the first drop since 2Q09), but we see exports resuming a moderate growth from 2Q13 onwards.
- Bank lending to the private sector continued to contract in April in the wake of still weak loan demand and tight lending standards. A slower pace of deterioration in domestic demand suggests that credit aggregates may be close to bottoming out, although some supply-side constraints persist – they are mostly due to banks' risk aversion in a challenging economic environment. Credit quality continues to deteriorate, with the ratio of household and corporate bad debts to loans hitting a new high at about 6% and 10%, respectively, in April.
- As expected, on 29 May, the EC recommended the abrogation of the Excessive Deficit Procedure (EDP) for Italy. Over recent weeks, Italy's prime minister and finance minister reiterated the government's commitment to maintaining the fiscal deficit below 3%, while studying a reform of the property tax (IMU) and discussing possible amendments to the current plan to hike the VAT by 1pp in July (both a delay and outright scrapping are considered). In the meantime, in January-May, the state-sector borrowing requirement (SSBR) amounted to EUR 56.3bn vs. EUR 34.9bn last year. Given that the official target for 2013 as a whole is EUR 53.7bn (3.4% of GDP), the government's room to maneuver appears limited. Please note that, year-to-date, the SSBR has been affected by less favorable Treasury cash management with respect to 2012, as well as by payments related to the financial support to MPS bank and the underwriting of EIB capital. In contrast, the dynamic of revenues for 2013 is expected to be broadly in line with that of 2012 and it seems to be on track so far, notwithstanding the difficult economic environment.

ENCOURAGING BUSINESS SURVEYS IN MAY



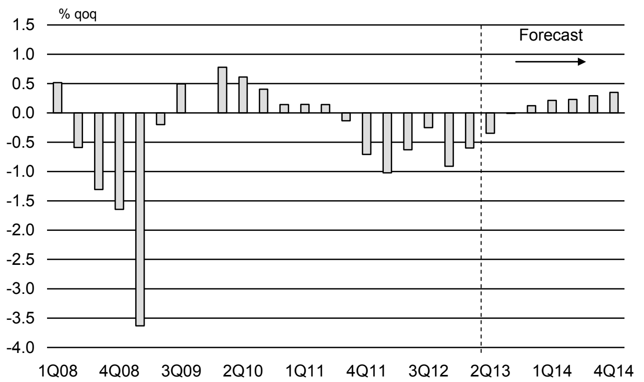
FISCAL TARGETS CALL FOR CLOSE MONITORING



Source: ISTAT, MEF, UniCredit Research

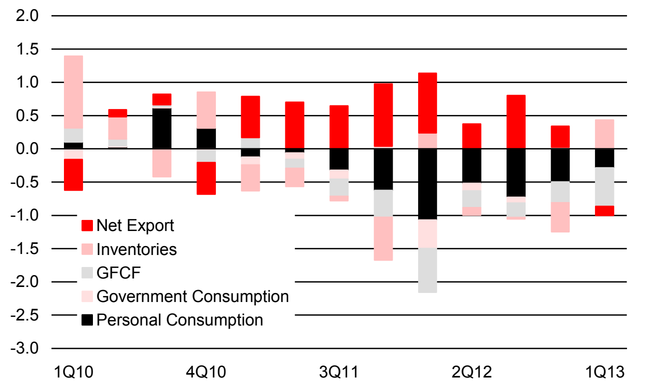
Italy

GDP



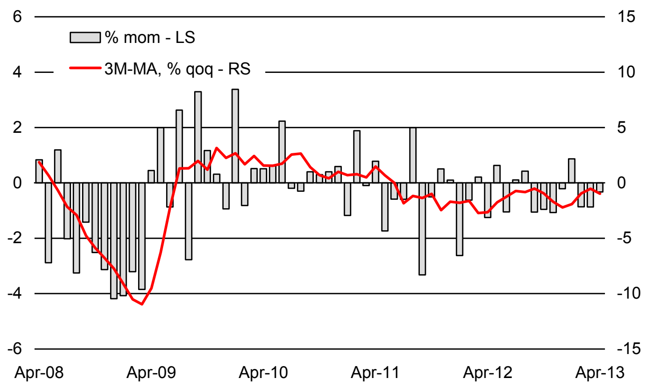
- After having contracted by 0.6% in 1Q13, GDP is expected to fall by 0.4% in 2Q13 and turn positive towards the end of the year.

EXPENDITURE BREAKDOWN



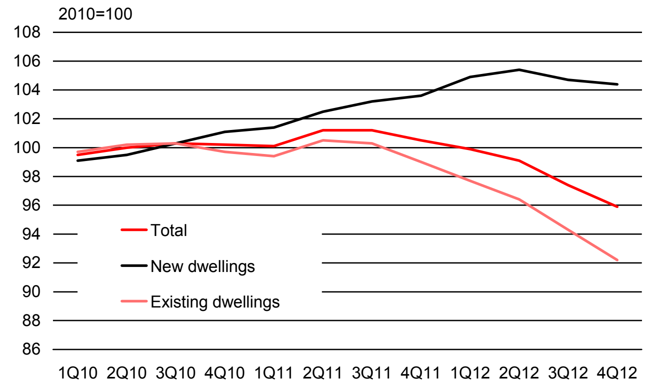
- In 1Q, the pace of private consumption moderated, while investment contraction (mainly constructions) accelerated. Exports declined 1.9% qoq, while imports contracted 1.6%.

INDUSTRIAL PRODUCTION



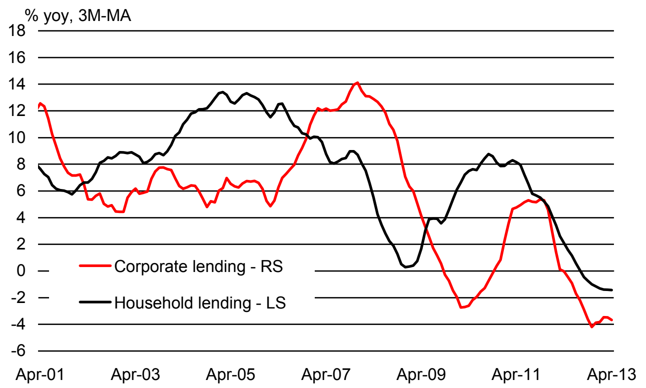
- Industrial production kept declining in April (-2.0% over the last three months), although at a more moderate pace.

HOUSE PRICE INDEX



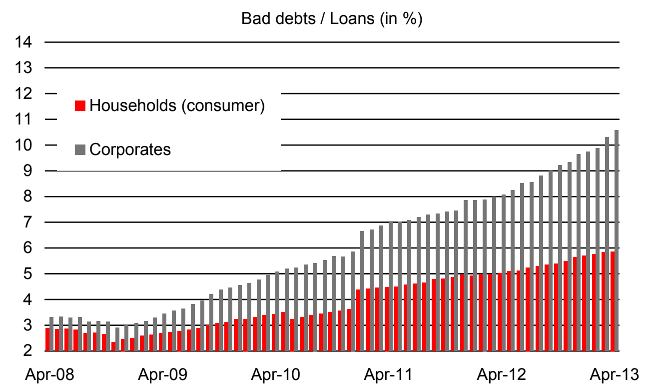
- A cyclical adjustment in house prices is ongoing.

LENDING TO HOUSEHOLDS AND CORPORATES



- Corporate and household lending both weakened in April.

CREDIT QUALITY



- The prolonged recession is still weighing on credit quality.

Source: ISTAT, Bank of Italy, UniCredit Research

Spain

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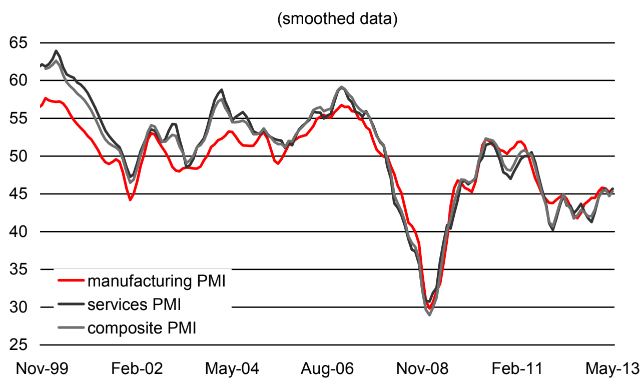
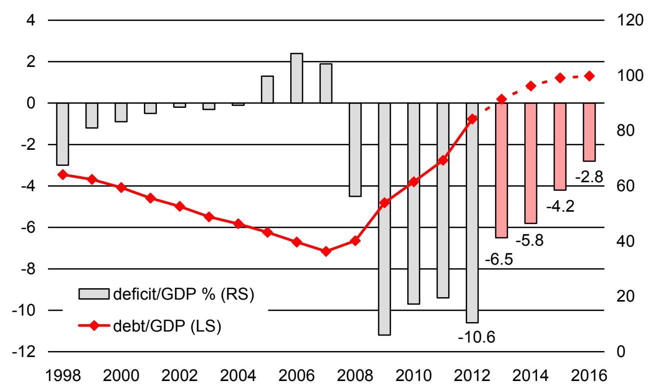
- Latest business surveys and hard data continue to support the idea that the economy is gradually improving despite still severe headwinds for the recovery in domestic demand. With respect to business sentiment indicators, PMI data marked a meaningful improvement in May, pushing the composite PMI up by three full points to 47.2. Unsurprisingly, the improvement was particularly pronounced in the manufacturing sector (from 44.7 to 48.1), where new orders rose to the highest level since 2011 (49.5). However, we caution that the PMIs have been overestimating the pace of Spanish economic activity recently. As regards hard data, industrial production showed a partial correction in April (-1.4% mom), following the strong increase recorded in March (+2.2% mom). The April outcome left the IP level broadly in line with the 1Q average, suggesting that the recovery in factory activity continues to unfold, albeit at a very gradual pace. In addition, registered unemployment declined significantly in May, although the decline was fully attributable to a seasonal (tourism-related) pick-up in job creation. Overall, we continue to expect a further easing of the pace of GDP recession in the second quarter (from -0.5% qoq to -0.3% qoq) and we see Spain exiting recession most likely at the end of year.
- On the fiscal front, the recently announced European Commission's opinion on the stability program for 2013-2016 includes headline deficit targets, which are slightly lower than those presented by the government last April (although the latter had been set in coordination with Brussels). The deficit path recommended by the EC now foresees the deficit declining from 7.0% of GDP in 2012 (excluding the one-offs related to bank recapitalization) to 6.5% in 2013, 5.8% in 2014, 4.2% in 2015 and 2.8% in 2016. However, this more gradual path of fiscal adjustment implies structural fiscal measures of around 0.3% of GDP in 2013, 2.0% in 2014, 1.0% in 2015 and 1.5% in 2016, i.e. nearly 5.0% of GDP during the whole forecast horizon (please note that this amount excludes the renewal of 1% of GDP of temporary measures that are set to expire by end-2013). The EC has asked the Spanish authorities to submit a detailed consolidation strategy by 1 October.
- Mr. Linde, governor of the Bank of Spain, recently confirmed press rumors that Spain may request an extension on the deadline to use EU bank bailout funds (currently set to expire by end-2013), with the aim to keep a safety net in place. Mr. Linde said that this request is unlikely to come before October, as the central bank needs to await the economic results of those lenders that were brought under state control. An extension would probably require a new memorandum of understanding, although the final decision would be up to the Eurogroup.

PMIS CONTINUE TO IMPROVE GRADUALLY



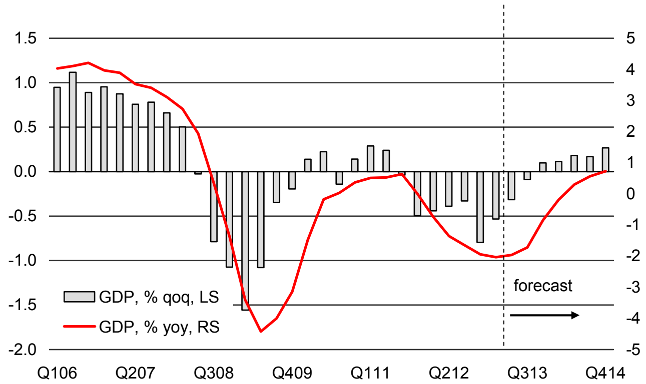
THE EU CALLS FOR A SLOWER PACE OF DEFICIT REDUCTION



Source: Markit, EC, UniCredit Research

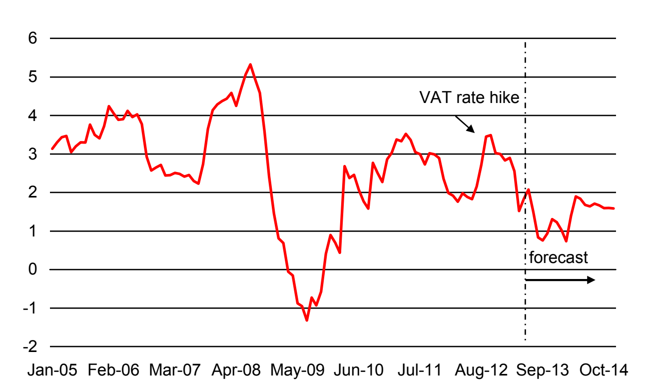
Spain

GDP



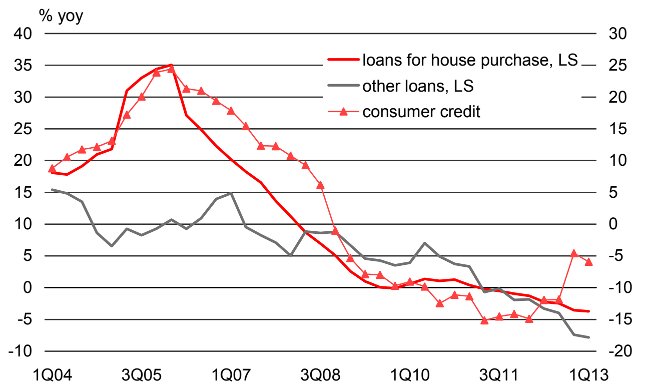
- The pace of recession eased further in 1Q13 and we expect GDP to return to positive territory by the end of the year.

INFLATION



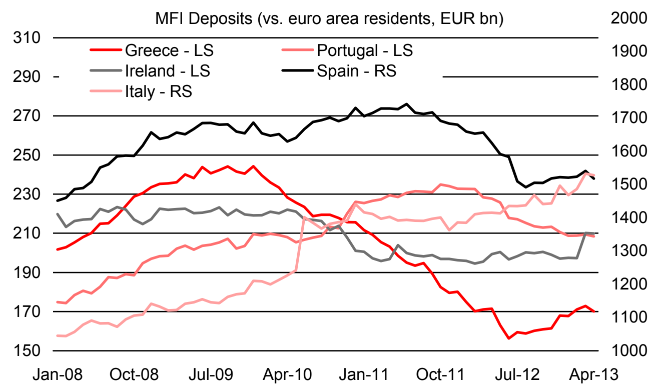
- We see inflation settling at 1.7% in 2013 and 1.5% in 2014.

HOUSEHOLD CREDIT GROWTH



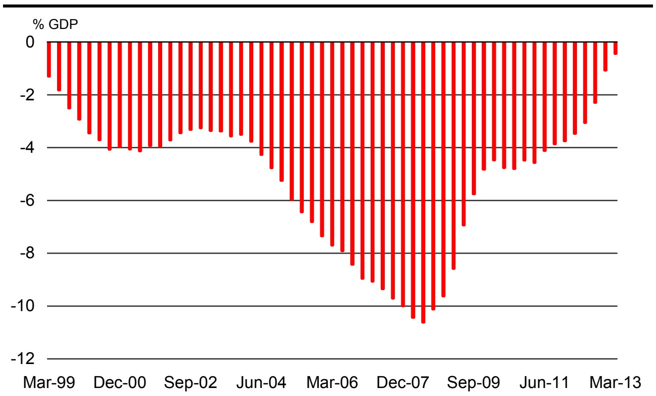
- The contraction in lending to households deepened further in 1Q13.

BANK DEPOSITS



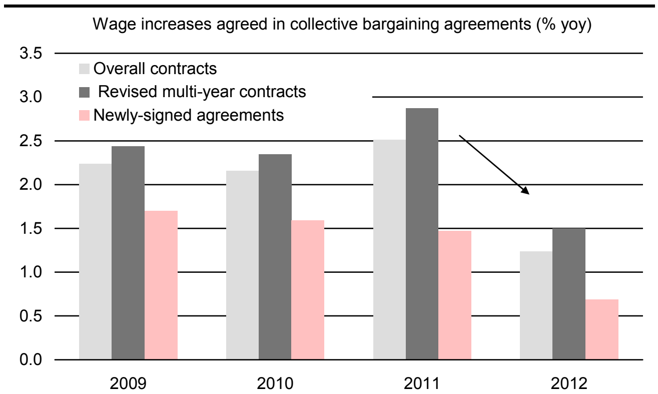
- The decline in deposits came to a halt in August 2012 and we have since been witnessing a moderate increase.

CURRENT ACCOUNT



- The current account deficit has been shrinking steadily, settling at only 0.4% of GDP at the end of 1Q13.

NEGOTIATED WAGES



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

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

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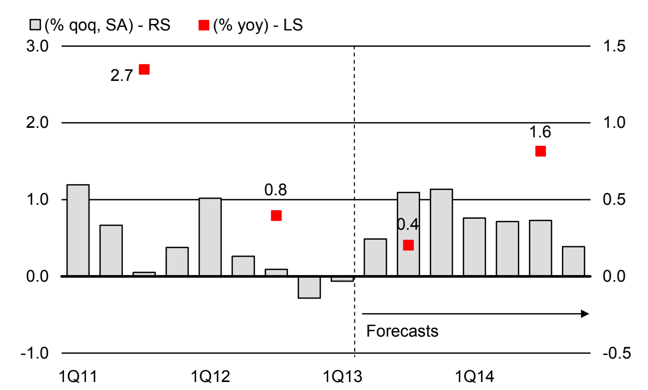
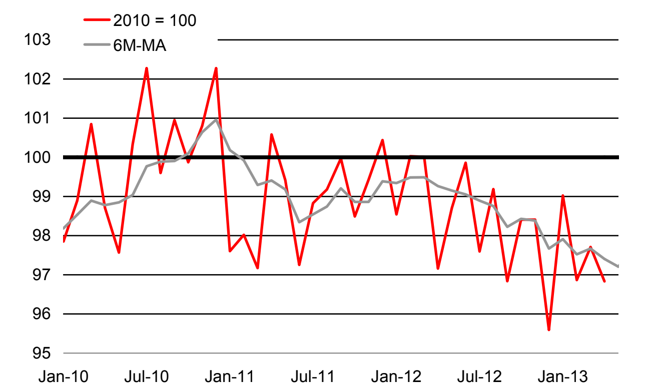
- The stagnation of the Austrian economy in the first quarter of 2013 has recently been confirmed in the second reading, as neither domestic nor foreign demand provided any impetus to growth. We are still convinced of a recovery in the second half of the year, which will enable the Austrian economy to grow by 0.4% in 2013 as a whole. In 2014, we expect the Austrian economy to grow by a much stronger 1.6%.
- From January to April 2013, nominal turnover in retail sales rose by no more than 0.5% compared with the same period of the previous year. In real terms, the first four months saw retail sales decline by an average of 1.3%. The short-term outlook for retail sales is not favorable as the deterioration of the labor market situation will impact the general trend. However, we expect sentiment to improve again after the temporary setback due to uncertainties such as the Cyprus crisis, and that, together with the downward inflationary trend, it will contribute to a slight recovery in retail sales in the course of 2013.
- Industrial activity in Austria has been showing serious signs of flagging since the second half of 2012, but now there is some light at the end of the tunnel. In May, Bank Austria's Purchasing Managers' Index reversed the downward trend seen since the start of the year, rising marginally to 48.2 (April: 47.8). However, the indicator remains below the growth threshold of 50, where it has now been for almost a year. The latest survey among Austrian purchasing managers shows much brighter prospects for industrial activity in many segments. Orders improved noticeably in May, and this resulted in an increase in production. By contrast, the still uncertain outlook for the economy is reflected, amongst other things, in further job cuts among Austrian industrial companies.
- The flagging economy has further aggravated the situation in Austria's labor market. In May, the number of registered unemployed rose to more than 280,000 on a seasonally-adjusted basis and employment is increasing only slightly. While one cannot fail to overlook the negative trend in Austria's labor market, the unemployment rate is not overly high in an international comparison. Based on EU criteria, the unemployment rate for April (most recent available data) is, at 4.9%, the lowest in the EU. We no longer expect the recovery process to commence early enough and with sufficient momentum to induce a turnaround in the labor market in the current year.

GDP STILL STAGNATING IN 1Q13



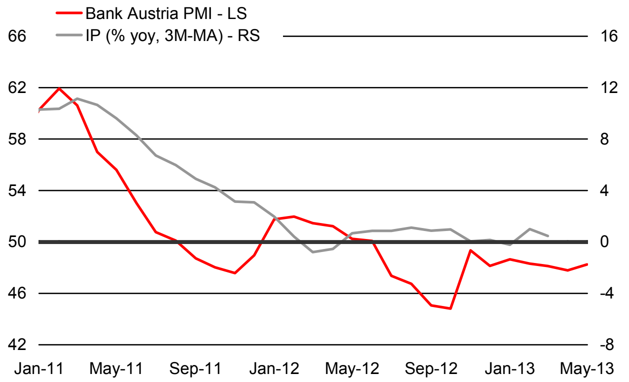
RETAIL SALES CONTINUE DOWNWARD TREND IN 2Q13



Source: Statistik Austria, UniCredit Research

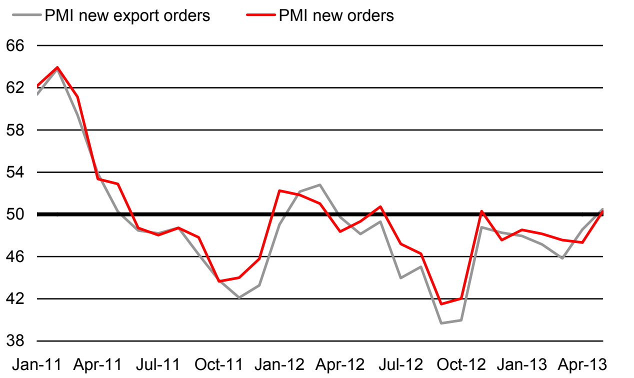
Austria

INDUSTRIAL OUTPUT AND PMI



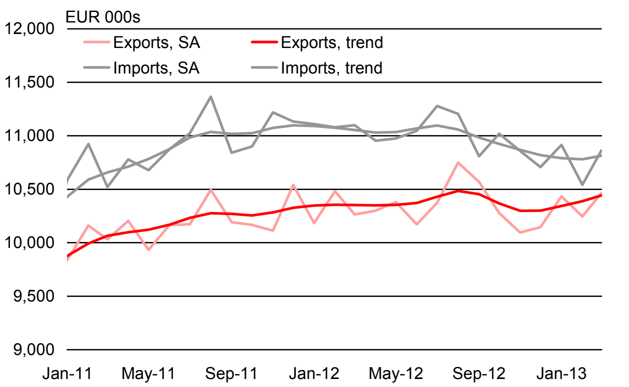
- The slight rise of the PMI in May underlines the stronger prospects for a recovery of the industrial sector in 2H13.

PMI NEW ORDERS



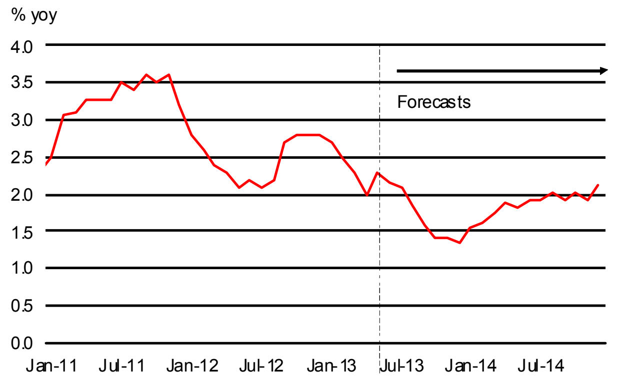
- Austrian industry posted more new orders in May, especially from abroad, for the first time in six months.

EXPORT AND IMPORT VOLUME



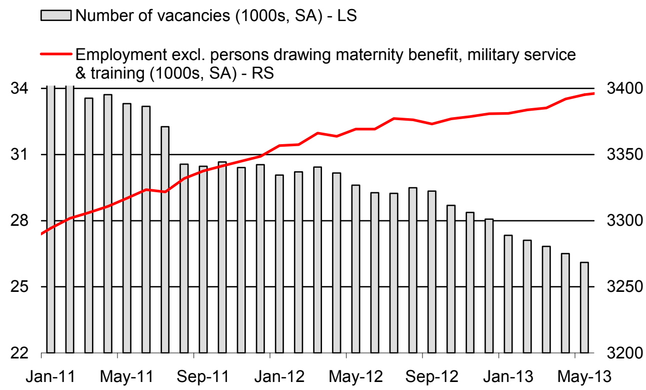
- Austrian exports (+2% mom in March) are performing relatively well in a challenging global environment.

INFLATION



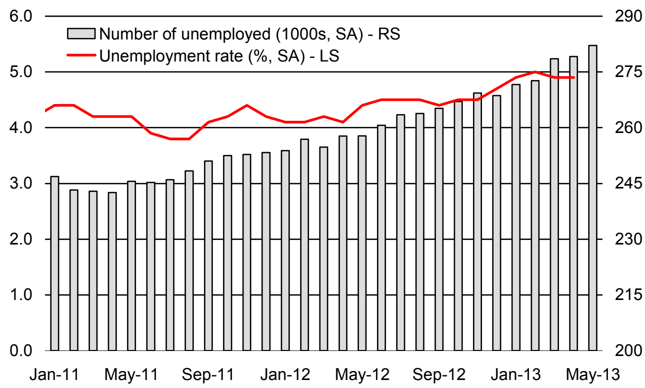
- Annual inflation increased to 2.3% in May (April 2.0% rev.), due to rising food prices, while the decline in fuel prices lost momentum.

EMPLOYMENT



- In May, the number of vacancies decreased for the ninth consecutive month while growth in employment abated.

UNEMPLOYMENT



- For two years the number of unemployed has been increasing. Nevertheless, the unemployment rate is still the lowest in Europe.

Source: Statistik Austria, UniCredit Research

Greece

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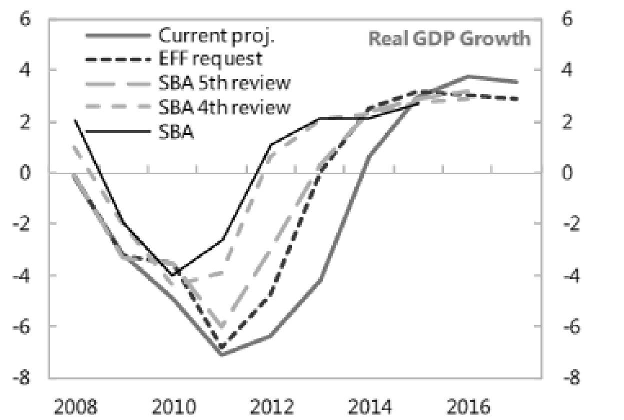
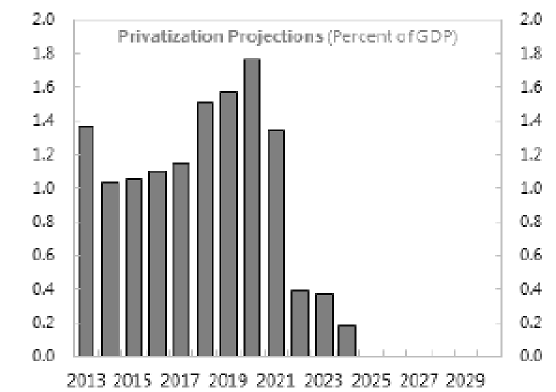
- On 6 June, the IMF published an assessment of Greece's first aid program, which was exceptional, especially with respect to the size of the Fund's financing as a percentage of the country's quota (3.212%). The IMF acknowledged that the design of the first program suffered from evaluation errors, particularly in terms of too optimistic growth forecasts, too limited financing being committed, and an overestimation of program ownership as well as capacity for reform. These shortcomings became apparent shortly after the program was implemented. However, the lack of political willingness by eurozone countries to commit more resources (on top of the EUR 110bn pledged) and systemic risks to financial stability prevented major amendments to the program and pushed the IMF to exempt Greece from satisfying the Fund's usual condition that public debt must be sustainable with "high probability" over the medium term. Ex-post, the IMF thinks that an upfront debt restructuring would have reduced the contraction in Greek output associated with prolonged market uncertainty. This is a consideration that it is not difficult to share, but only once we abstract from contagion effects and moral hazard issues that were heavily debated at the time.
- The new Troika's mission to Greece risks being more challenging than expected due to rising tensions within the government coalition that have brought to the fore, once again, the risk of an early election. The day after the government failed to attract a single bid for Depa, the state natural gas monopoly, whose privatization was considered crucial to fulfill the EUR 2.6bn privatization target by the end of this year, PM Samaras shut down public broadcaster ERT by decree, laying off roughly 2.5k employees. We recall that the government had indeed committed to lay off 2k public sector employees by the end of June. The move may be interpreted as an attempt to divert attention from the failed tender for Depa and secure Greece some margin for negotiations with the Troika to revise down this year's target for privatization proceeds and obtain a long-sought reduction of the VAT rate for hotels and restaurants (from 23% to 13%). Nevertheless, the ERT's sudden closure came as a shock for the Greek population and sparked strong protests from government coalition partners PASOK and DIMAR, which submitted to Parliament a proposal for the legislative act permitting ERT's immediate closure to be scrapped. Still, for the time being, we think that PASOK and DIMAR have little interest to pull out from the coalition and trigger early elections, which would barely favor Samaras' New Democracy over left-wing Syriza. At present, a compromise solution among government coalition party leaders appears the most likely outcome following the Council of State's recent ruling that the government had the right to close ERT but limited programming should continue to be aired (thus endorsing objections made by coalition partners to PM Samaras).

TROIKA'S GDP FORECASTS PROVED TOO OPTIMISTIC



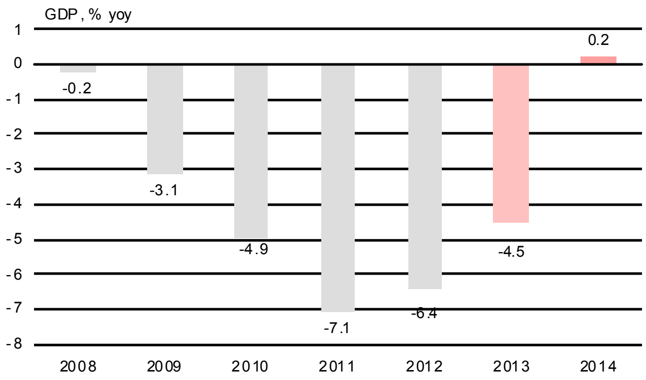
THE 2013 PRIVATIZATION TARGET LOOKS AMBITIOUS



Source: IMF, UniCredit Research

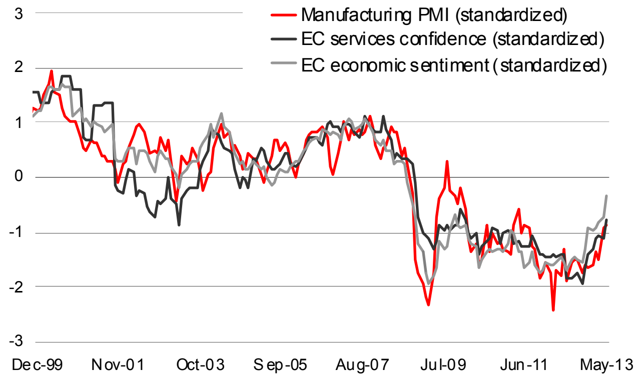
Greece

GDP



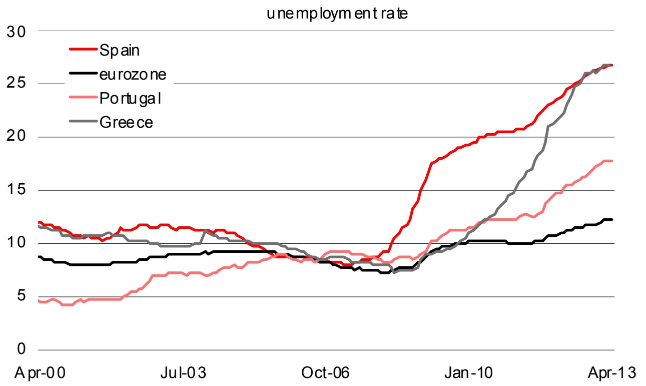
■ Greece may exit recession next year.

SURVEYS



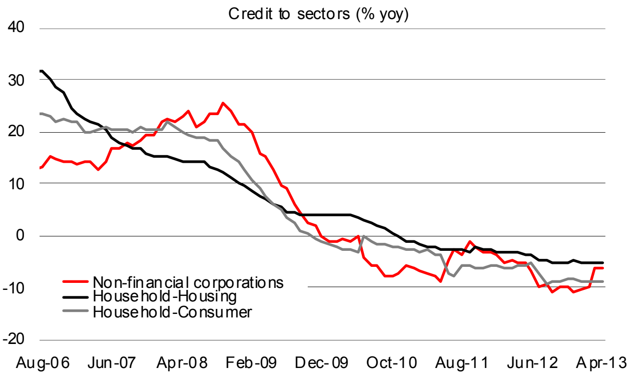
■ The EC economic sentiment rose to the highest level in May since October 2008.

UNEMPLOYMENT



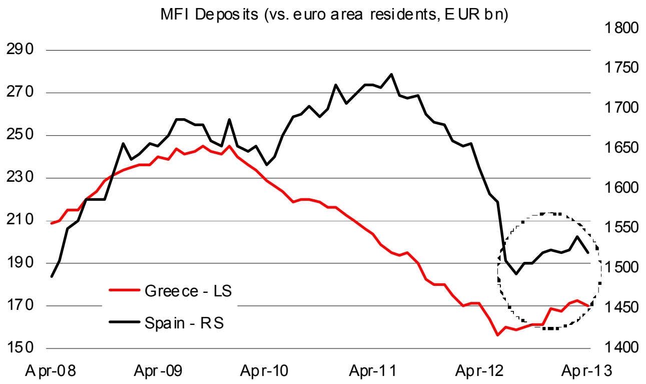
■ The unemployment rate is skyrocketing, having reached 26.8% in March (latest available data).

CREDIT GROWTH



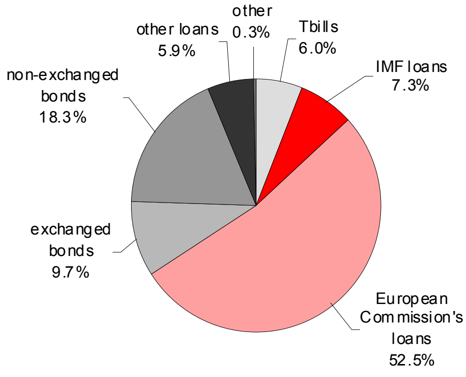
■ The pace of contraction in credit for NFCs eased significantly since the beginning of the year.

DEPOSITS



■ There has been a reflow of deposits since last summer.

GENERAL GOVERNMENT DEBT BY INSTRUMENT



■ The bulk of the debt stock is in the hands of Greece's official creditors.

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

Portugal

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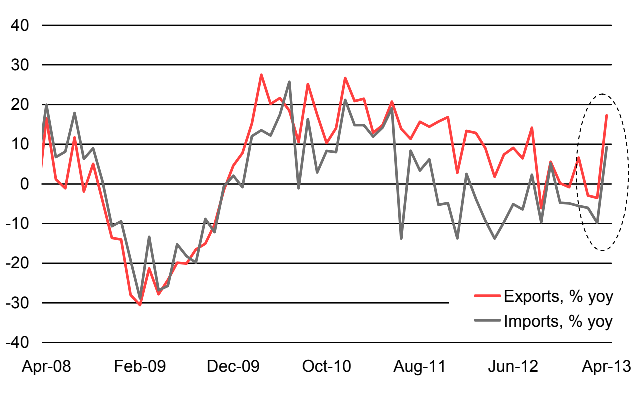
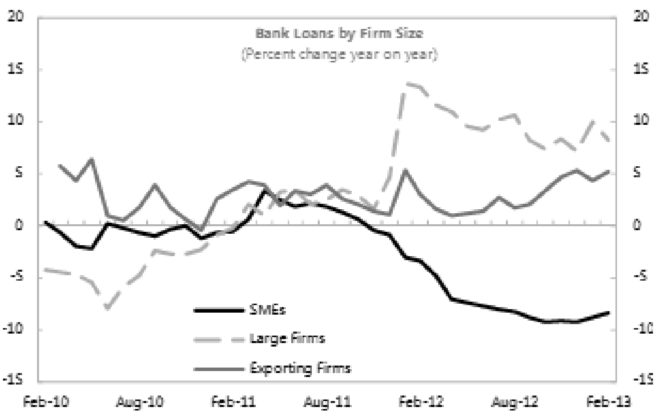
- The INE recently revised 1Q GDP down by 0.1pp to -0.4% qoq, mainly due to new trade data. This follows a 1.8% qoq GDP contraction in 4Q12. The easing in the pace of recession was explained by a strongly positive contribution from net exports (+1.9pp vs. -0.5pp in 4Q12), which partly compensated for the higher drag from domestic demand (-2.3pp vs. -1.3pp), as gross fixed investment dropped significantly (by 9.7% qoq vs. +1.9% qoq). However, it is worth highlighting that the firm rebound in exports (+2.6% qoq vs. -1.8% qoq) largely reflected a correction of temporary factors that weighed on the performance in 4Q12 (i.e. protracted strikes of port workers and the temporary shut-down of some factories). Therefore, the incoming trade data will be key to gauging whether Portuguese exporting firms continue to improve their competitiveness and so we can count on net export gains to stabilize output in the coming quarters. So far, April data are encouraging, showing a surge in exports, although imports also rebounded strongly.
- On 12 June, the IMF board gave the green light to the disbursement of the EUR 657mn loan tranche to Portugal. This finally concludes the seventh program review, which lasted nearly four months, also due to government difficulty in forging a consensus on new fiscal measures aimed at offsetting the impact of the unfavorable constitutional court ruling. Incidentally, these measures – including new spending ceilings on all ministries, cuts in public-private partnership contracts and an increase in working hours in the public sector to save on overtime pay – were approved by the parliament on 7 June.
- In the statement accompanying the decision, the IMF, while once again praising the Portuguese authorities' progress on fiscal (and external) adjustment, it seemingly rejected calls from Lisbon for a further relaxation of the 2014 deficit target. This was already revised from 2.5% to 4.0% earlier this spring in the context of a broader relaxation of fiscal targets until 2015. The IMF warned that the scope for deviating further from the revised deficit path is limited in view of the elevated medium-term financing need and debt ratios. The Fund also restated the role that continued external support and effective crisis management policies at eurozone level have to play in order to turn the Portuguese program into a success.
- German Finance Minister Wolfgang Schauble was recently quoted saying that Germany is also keen to grant loans to Portuguese SMEs via the development bank KfW, thus extending an offer originally made to Spain. This could prove significant in supporting employment and facilitating economic recovery given that conditions for Portuguese firms remain difficult, particularly for SMEs, with lending rates on new loans often higher than the eurozone average.

BOTH EXPORTS AND IMPORTS HAVE REBOUNDED STRONGLY



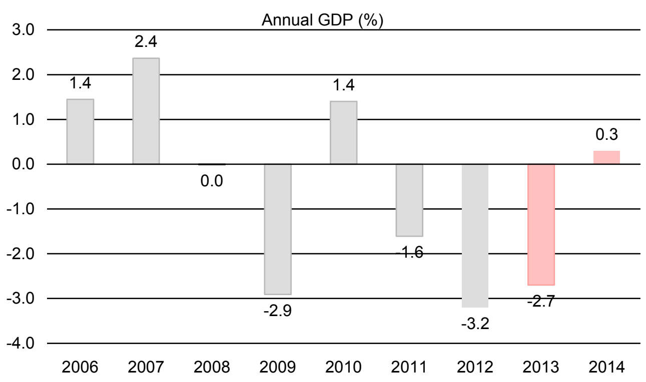
CREDIT TO SMES REMAINS DIFFICULT



Source: INE, IMF, UniCredit Research

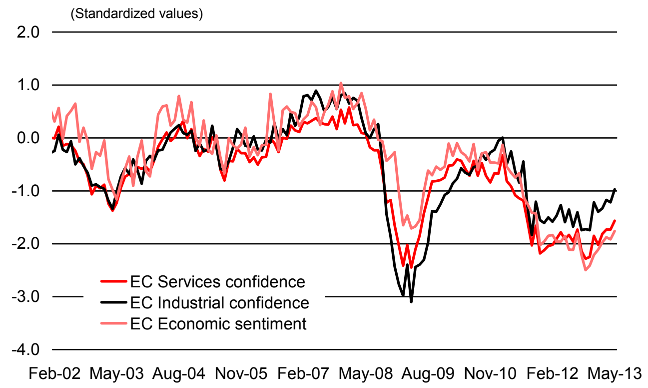
Portugal

GDP



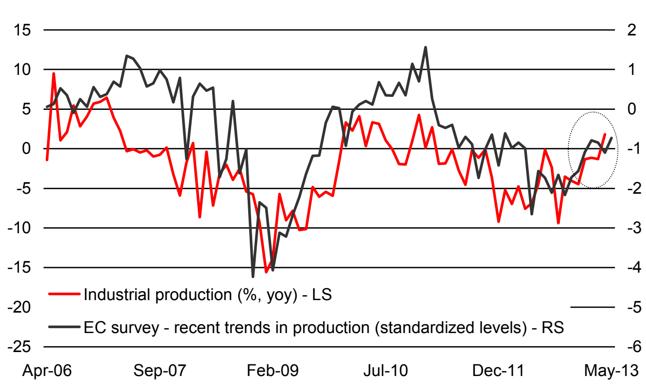
- We expect GDP to contract by 2.7% in 2013 and return to positive growth in 2014 (at an average annual pace of +0.3%).

SURVEYS



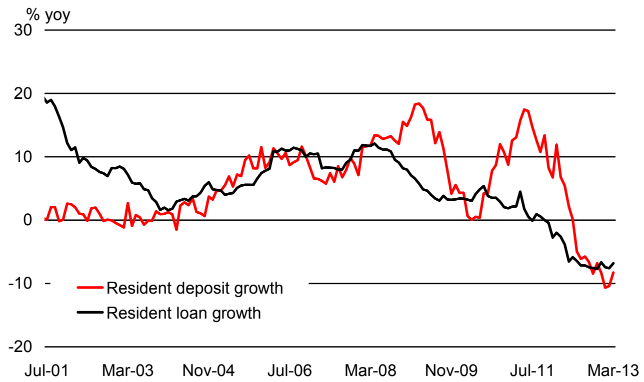
- Sentiment has been improving steadily, especially in the industrial sector.

INDUSTRIAL PRODUCTION



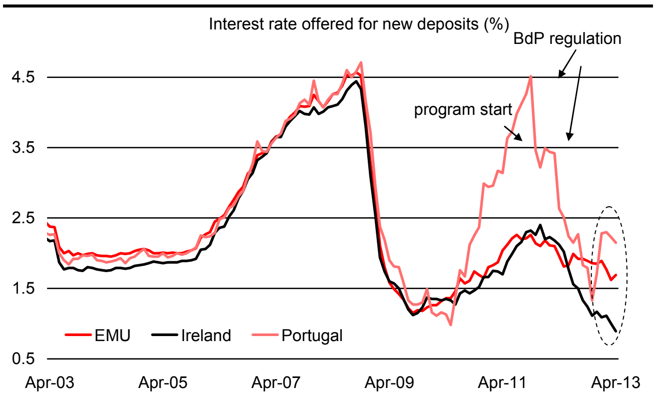
- Momentum in factory activity remains favorable.

DEPOSIT AND LOAN GROWTH



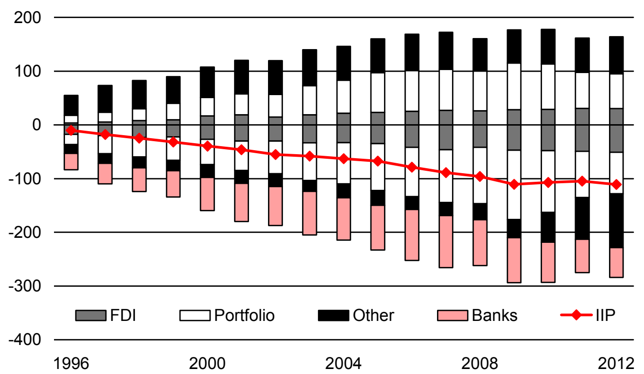
- Deposit growth continues to slow…

DEPOSIT RATES



- …although interest rates on new deposits recently rebounded.

NET IIP



- External deleveraging is only just beginning.

Source: INE, Bank of Portugal, UniCredit Research

UK

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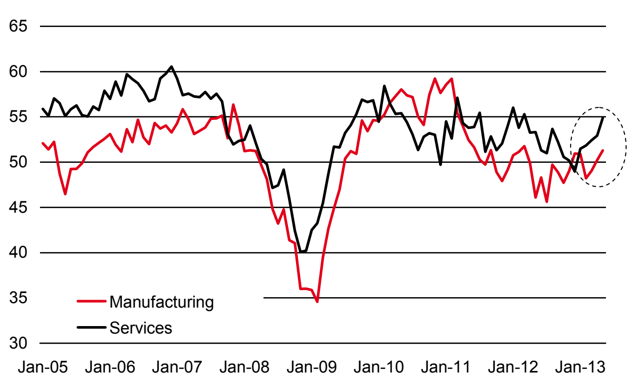
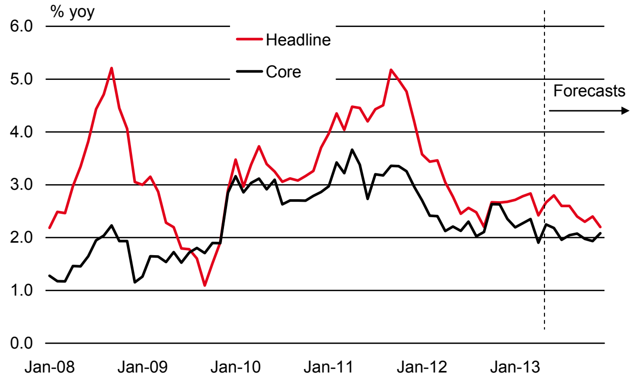
- The May round of PMIs was quite encouraging. Both the services and manufacturing PMI now show a clear upward trend (see left chart) and our composite index points to a growth rate of around 0.4% qoq for GDP in 2Q, slightly above our forecasts (0.2% qoq). IP rose 0.1% mom in April after two relatively strong monthly increases, and it is now 0.9% above the average in 1Q, boding well for an expansion of the sector in 2Q. House prices have continued to rise, while lending data, especially to businesses, remained weak. Overall, there now seem to be clearer signs of recovery, which, however, is likely to remain slow compared to past experience and subject to downside risks. We expect GDP growth to remain modest in the remainder of the year before gradually accelerating in 2014.
- After slowing sharply from 2.8% yoy to 2.4% yoy in April, CPI inflation accelerated to 2.7% yoy in May, slightly above our forecast, and is now back at the levels seen between October 2012 and March 2013. The main drivers were a sharp increase in air fares (22% mom), a base effect from fuel prices, and, to a lesser extent, clothing prices. Looking ahead, inflation is likely to edge up further in June, in part due to unfavorable base effects, before slowing gradually in the second part of the year, although still remaining above target due to the persistent upward contribution from administered and regulated prices.
- At governor Mervyn King's last MPC meeting, the BoE remained on hold on both Bank Rate and asset purchases. While the committee is likely to have remained divided on the need for more QE, the set of relatively good data over the past month and a half has probably weakened the case for more purchases. Looking ahead, it is unlikely that the MPC will opt for more asset purchases going forward, barring a deterioration of the growth outlook.
- Mark Carney's arrival on 1 July is unlikely to make a difference on QE. The BoE, however, will have to consider a new tool, a Fed-life forward guidance, and report on its feasibility in the UK along the August Inflation Report, as explicitly requested by chancellor George Osborne. While Mr. Carney is fond of this tool, various MPC members have expressed some skepticism about such a measure in the past months and, thus, its adoption does not appear to be a done deal, although it is a distinct possibility.

FURTHER IMPROVEMENT IN THE PMIS IN MAY



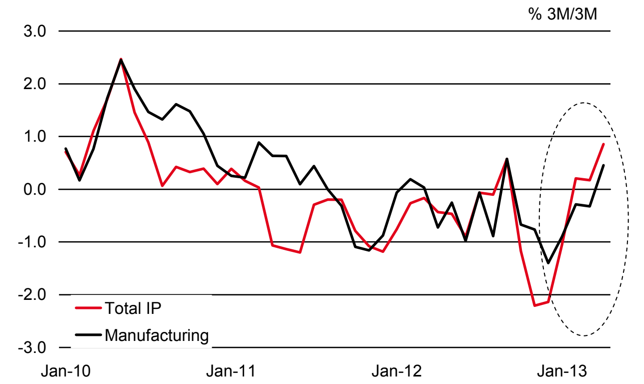
INFLATION



Source: Office for National Statistics, Markit, UniCredit Research

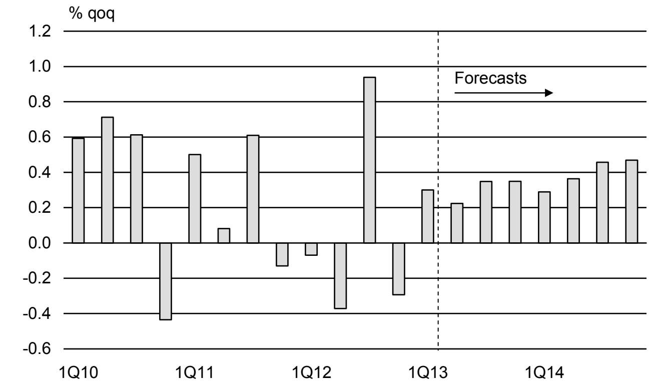
UK

INDUSTRIAL PRODUCTION



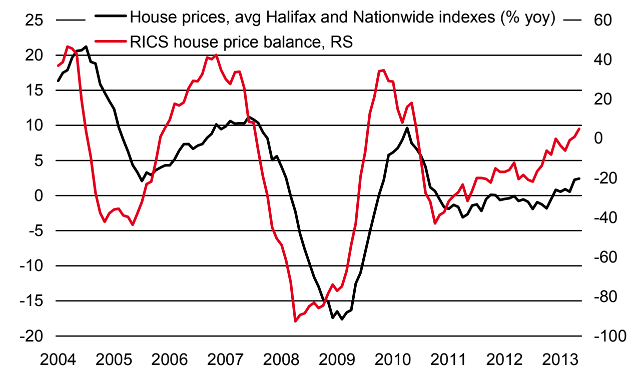
- Some signs of recovery in IP.

GDP



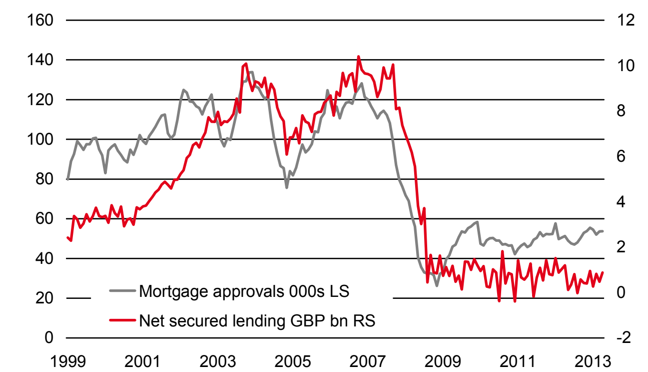
- We expect GDP growth to remain modest in the remainder of the year before gradually accelerating in 2014.

HOUSE PRICES



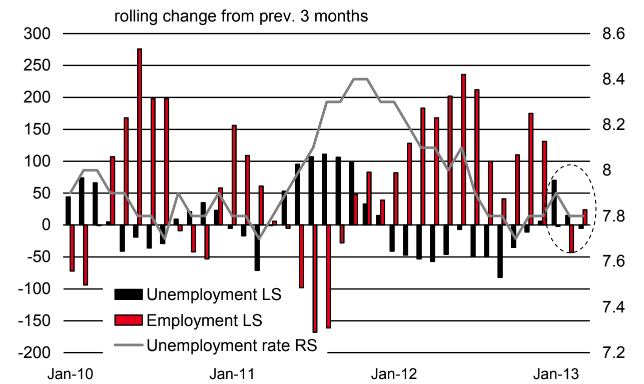
- House prices continued on their mild upward trend in May and forward-looking indicators point to further gains.

HOUSING MARKET



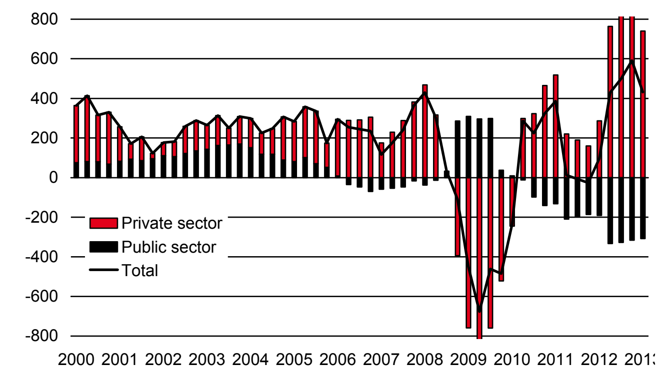
- While there has been an uptick in mortgage approvals, housing market activity remains low.

LABOR MARKET



- The labor market remains relatively resilient. Employment rose by 24k and unemployment fell by 5k in the three months to April compared to previous three months.

EMPLOYMENT



- The increase in private sector employment has more than offset the decrease in public sector employment since the beginning of 2012.

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

Sweden

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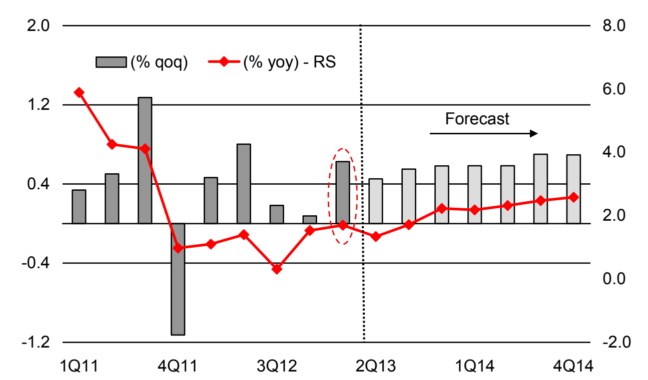
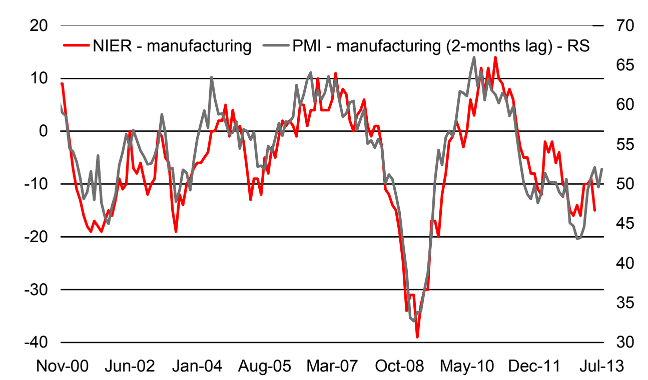
- GDP growth came in better than expected in 1Q, rising 0.6% qoq (vs. our expectation of 0.3% qoq). The expenditure breakdown showed that the main drivers were the buildup in inventories and private consumption, while investment was the weak spot and exports dipped further. In light of the higher 1Q figure, we increase our 2013 GDP estimate from 1.4% to 1.7%. We expect growth in 2013 to be mainly driven by household consumption, while exports are likely to continue to suffer due to the strength of the krona and weak activity in some key trading partners, in particular the euro area.
- Business survey indicators and hard data suggest that the economic recovery is likely to remain in place in 2Q, although probably at a slower pace than in 1Q. Following the sharp fall in April (down from 52.1 to 49.6), the manufacturing PMI bounced back to 51.9 in May. The NIER manufacturing confidence indicator fell from -9 to -15 in May, but as the index tends to lag the PMI by about two months, we expect that it will start improving in June (right chart below). Taken at face value, the surveys point to GDP growth of around 0.3% qoq, slightly weaker than our 2Q forecast of 0.5% qoq. In terms of hard data, both IP and production in the services sector fell in April, by 0.5% and 1.2% mom, respectively. IP in April was 0.1% higher than the average in the first quarter, broadly in line with the growth rate seen in 1Q (0.2% qoq). The services sector production, however, is 1.7% below the 1Q average and this, also taking account the monthly volatility, provides some signs of deterioration in the sector after the solid expansion in 1Q (0.8% qoq).
- In May, CPIF inflation, which excludes mortgage interest costs, rose from 0.5% yoy to 0.7% yoy, while CPI inflation remained negative at -0.2% yoy, less than the -0.5% recorded in April. Inflationary pressure remains very low. Looking forward, we expect CPIF inflation to hover below 1% during the whole of 2013, while CPI inflation is likely to remain around zero in the coming months and start to accelerate in the final quarter of 2013. CPI and CPIF inflation are both unlikely to reach the Riksbank's 2% target before the end of 2014.
- On the back of further signs of resilience for the Swedish economy and the fact that inflation is now closer to the Riksbank’s forecasts, we think that it’s unlikely that interest rates will be cut at the next monetary policy meeting in July. However, chances of a rate cut have significantly increased recently, as weak activity in Europe continues to weigh on Swedish manufacturers through lower exports, inflation pressure remains low, the unemployment rate is trending higher and the strong krona continues to put pressure on the export industry. In addition, high household indebtedness continues to be a cause for concern.

STRONG GDP GROWTH IN 1Q



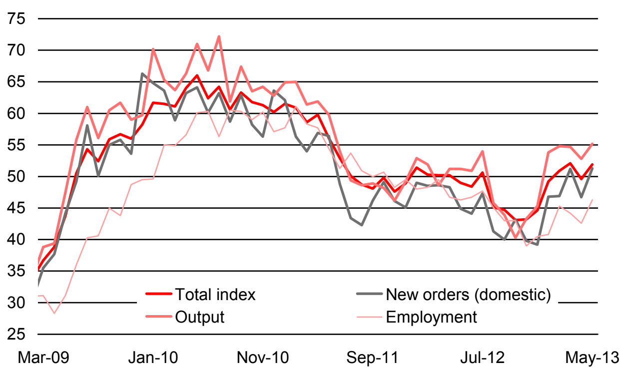
THE MANUFACTURING PMI BOUNCED BACK



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

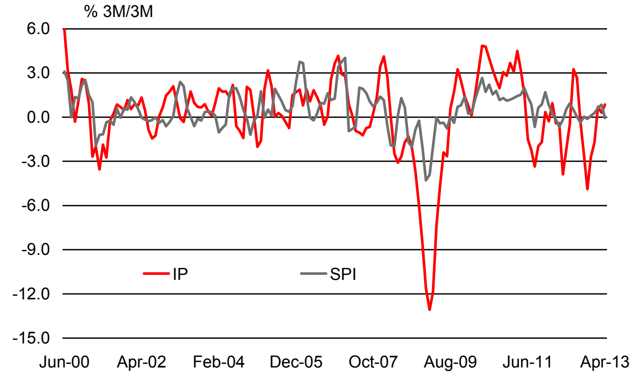
Sweden

MANUFACTURING PMI



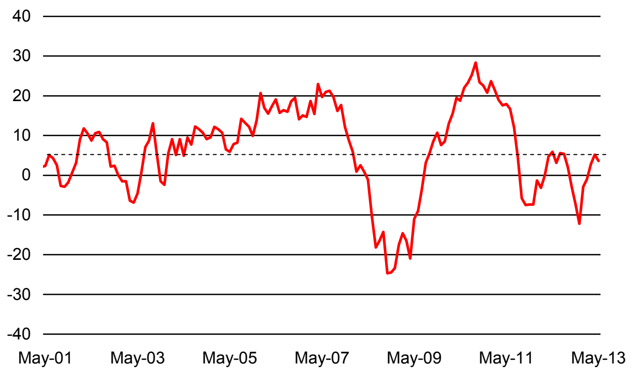
- The manufacturing PMI rose in May – bouncing from 49.6 to 51.9 – led by improvements in the sub-indices of new orders (domestic), employment and output.

INDUSTRIAL AND SERVICES PRODUCTION INDICES



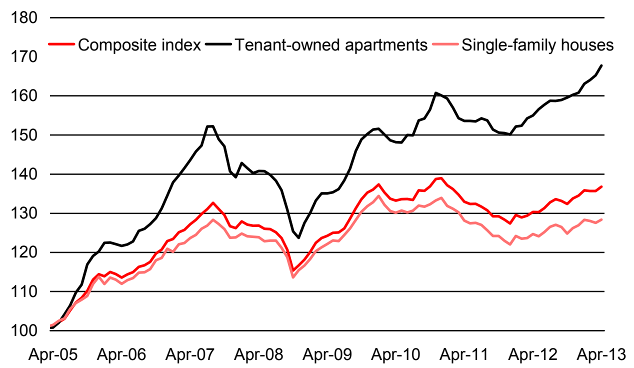
- Both industrial and services sector production fell in April, by 0.5% and 1.2% mom, respectively. The 3M/3M growth rate was 0.9% for IP and -0.1% for the service sector.

CONSUMER CONFIDENCE



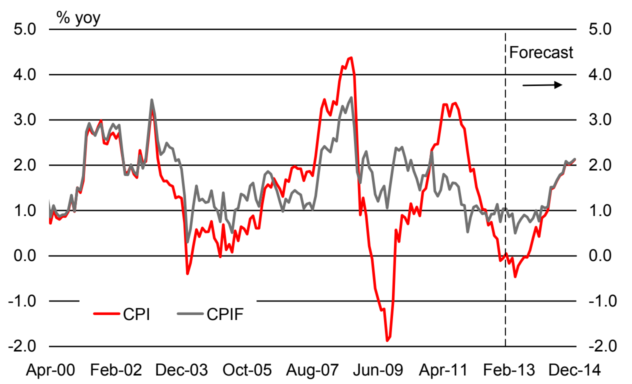
- Consumer confidence fell in May, from 5.2 to 3.6. The index returned to marginally below its historic average.

REAL HOUSE PRICES



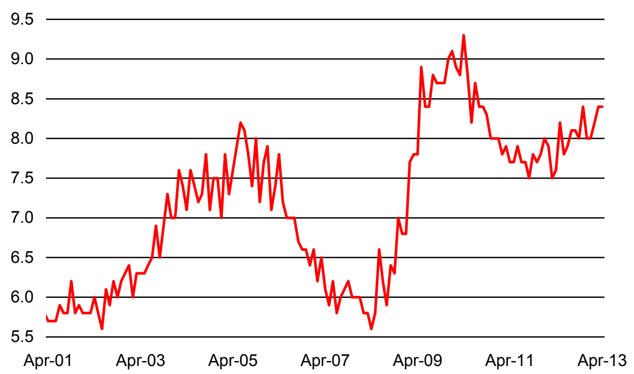
- House prices have been trending higher since December 2011. This is partly related to increasing household confidence and low interest rate expectations.

INFLATION



- Both CPI and CPIF inflation were higher in May (from -0.5% to -0.2% and from 0.5% to 0.7%, respectively).

UNEMPLOYMENT RATE



- The unemployment rate has been just over 8% since last August.

Source: NIER, Riksbank, Statistics Sweden, Valueguard, UniCredit Research

Poland

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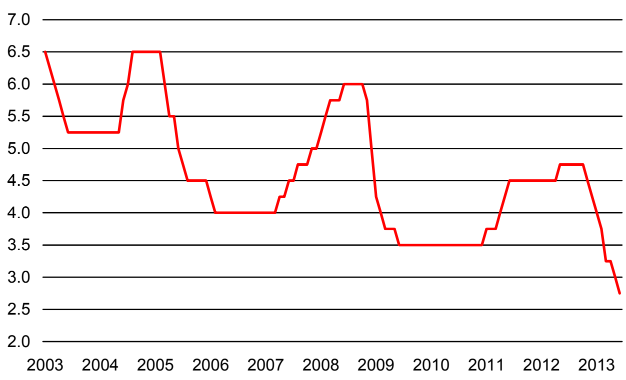
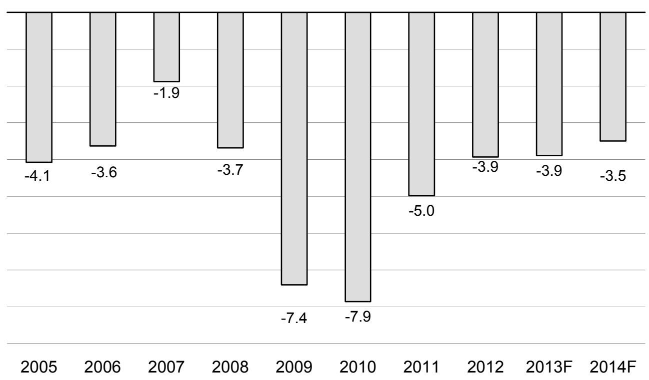
- The 1Q13 GDP report confirmed continued weakness in the Polish economy. The headline figure moderated from 0.7% yoy in 4Q12 to 0.5% yoy in 1Q13. In seasonally-adjusted terms, GDP expanded by only 0.1% qoq in 1Q13, after stalling (0.0% qoq) in 4Q12. This means that at the turn of the year Poland's economy was on the verge of recession. We think the economy bottomed out in 1Q13 and should gradually recover in the following quarters. However, the improvement is likely to be sluggish. In 2013 as a whole we still expect GDP to rise by 1.7%, but risks are clearly tilted to the downside as the recovery has been rather anaemic so far. In such an environment, inflationary pressure from domestic factors is likely to be virtually non-existent and, given the lack of global pressure, we expect headline inflation to remain well below the National Bank of Poland's (NBP) target until the end of the year.
- The Monetary Policy Council (MPC) delivered the expected 25bp rate cut in June (main policy rate slashed to an all-time low of 2.75%) and kept the door open for further policy accommodation in July. The NBP governor Marek Belka stated that the easing cycle was very close to an end. At the next meeting, policymakers will analyse the new inflationary projection and are expected to develop and communicate a medium-term monetary strategy. In our view, the council will cut rates by 25bp again (bringing the reference rate down to 2.50%) and shift its informal policy bias into neutral, meaning that the rates will likely be kept on hold for the next few quarters.
- Despite trimming the general government deficit by 1.1% of GDP, the government failed to meet its 2012 fiscal target of 3.5% of GDP (the gap amounted to 3.9% of GDP). Therefore the excessive deficit procedure will not be abrogated in 2013, however the European Commission assessed that Poland had undertaken effective measures in order to consolidate public finances and proposed to give Poland two more years to correct the excessive imbalance. Available data for 2013 confirm that slow growth and its unfavourable composition (shrinking domestic demand and imports) is still putting pressure on the revenue side of the budget. In the first five months of 2013, total tax revenues were PLN 8.2bn lower than in the corresponding period of 2012, while the state budget deficit (cash basis) was already higher than in 2012 as a whole. Given additional room from the European Commission, the government will slow the pace of fiscal consolidation in order to avoid hurting weak economic recovery. We expect the 2013 budget to be amended and the deficit limit to be raised by ca. PLN 10bn. We see 2013 general government broadly unchanged vs. 2012, i.e. at ca. 4% of GDP.

NBP REFERENCE RATE SLASHED TO ALL-TIME-LOW



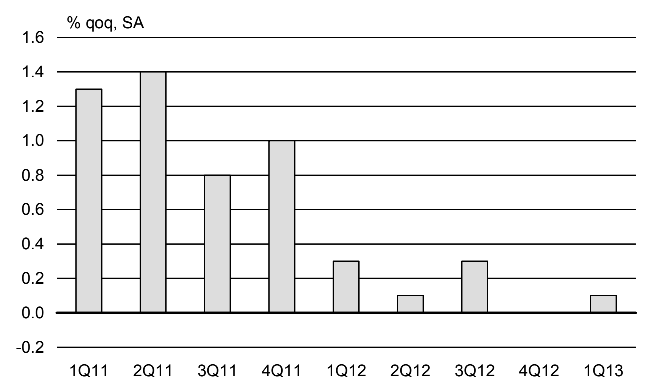
FISCAL TARGET MISSED IN 2012, DEFICIT TO REMAIN HIGH



Source: GUS, UniCredit Research

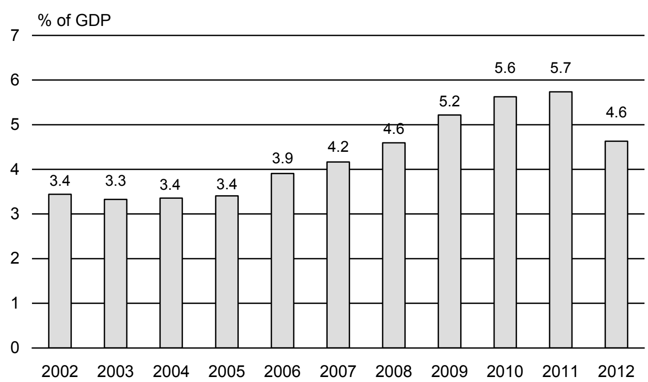
Poland

GDP



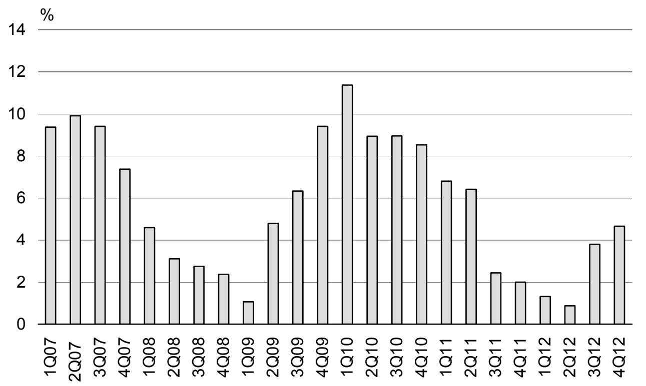
- Poland's economy was on the verge of recession at the turn of the year.

PUBLIC INVESTMENTS



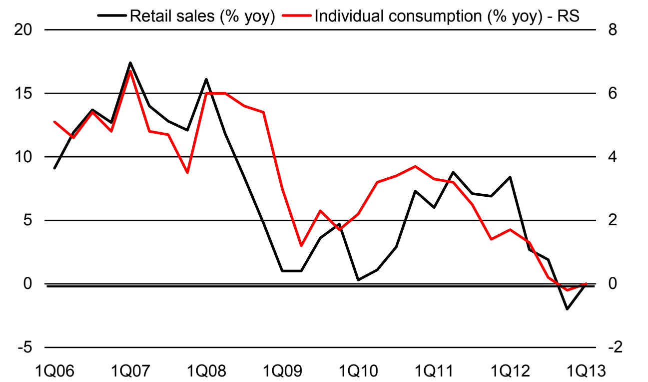
- Fiscal consolidation hit public investment, weighing on overall fixed investment performance last year.

HOUSEHOLD SAVING RATE



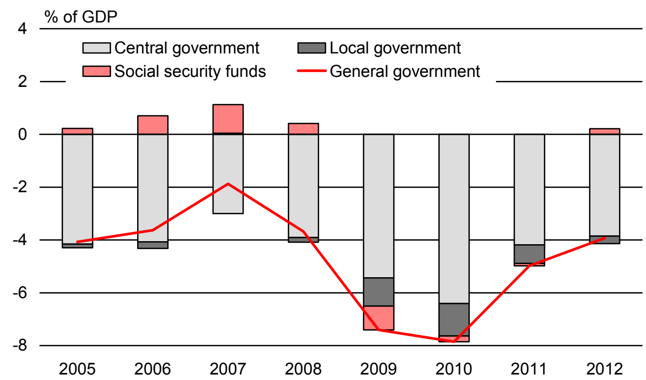
- High propensity to save is curbing household spending.

INDIVIDUAL CONSUMPTION



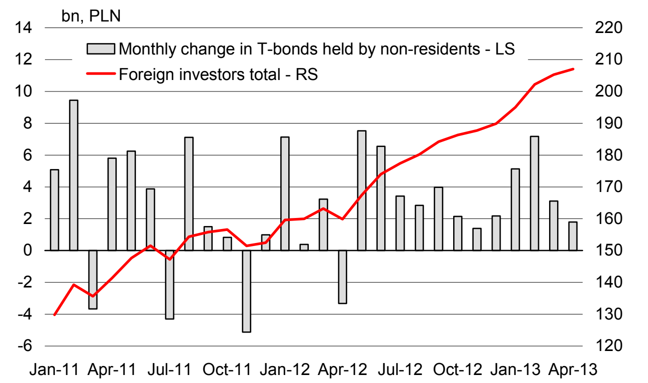
- Individual consumption has started stabilizing and is expected to recover gradually in the coming quarters amid low inflation.

GENERAL GOVERNMENT BALANCE



- General government deficit narrowed in 2012 as local governments and social security balances improved.

FOREIGN INVESTORS ON POLISH T-BONDS MARKET



- Foreign capital inflow into Polish T-bonds market has been losing momentum recently.

Source: GUS, NBP, Ministry of Finance, Eurostat, UniCredit Research

Czech Republic

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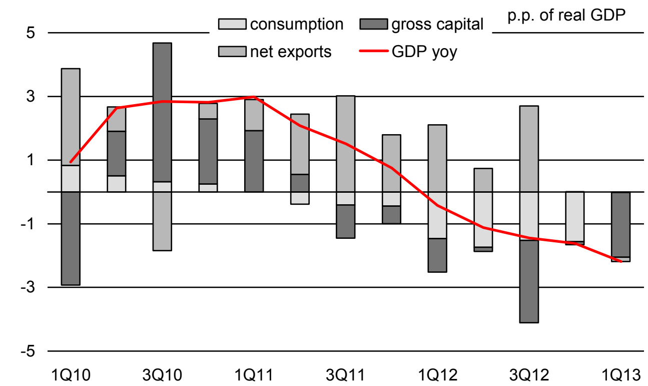
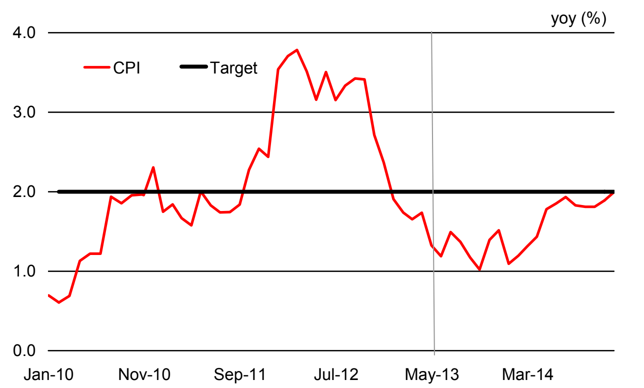
- Real 1Q GDP came in at a seasonally adjusted -1.1% qoq and -2.2% yoy, worse than indicated by the flash estimate. Gross capital formation replaced private consumption as the key drag on GDP, while net exports also failed to contribute to growth. That said, the detail of Q1 GDP data was better than the very weak headline print and supports our view of a continued recovery in activity, although a positive full year reading remains out of reach for 2013.
- All of the high-frequency data for April surprised moderately on the upside. Retail sales were up by (an unadjusted) 1.5% yoy, owing largely to higher demand in the auto segment. Industrial output ticked up (unadjusted) 0.5% yoy. Cross-border trade surplus widened yoy by CZK 13 billion on the growth rate of exports (6.4% yoy in CZK terms) exceeding that of imports (1.3% yoy). Also encouragingly, the May seasonal decline in the jobless was a bit stronger than last year. The signals lead us to believe that the economy stopped declining in qoq terms in 2Q13. The flooding that occurred in early June caused damage and some disruption but is unlikely to affect GDP in a measurable way.
- CPI sank to 1.3% yoy in May, closer to the lower level of the central bank's target range of 1.0% to 3.0%. Lower prices of natural gas and telecommunication services were largely responsible for the decline. In addition, the April PPI hit a three-year low of 0.5% yoy. We expect disinflation to continue over next few months.
- 1Q13 BoP data highlighted the country's firm external position. The C/A deficit, annualized, was unchanged from 2012 at a moderate 2.5%. Also 1Q13 FDI posted similar net inflows as in the same period of last year. Importantly, we envisage full-2013 basic balance (FDI plus C/A) to stay well in positive territory.

CAPEX ALTERED CONSUMPTION AS KEY DRAG OF GDP IN 1Q



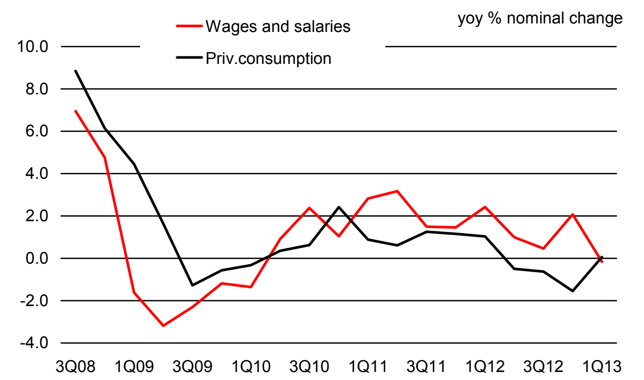
DISINFLATION IS UNDER WAY, WILL REMAIN OVER YEAR END



Source: CZSO, UniCredit Research

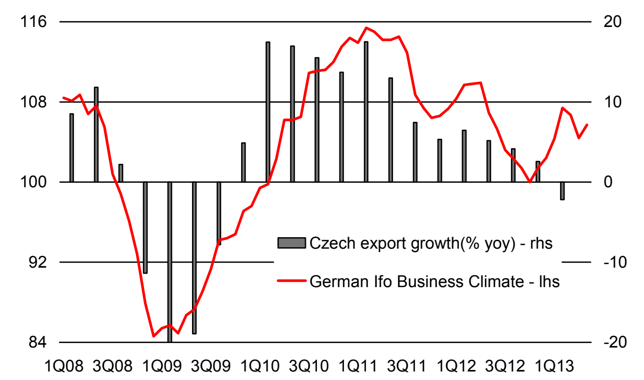
Czech Republic

PRIVATE CONSUMPTION VERSUS WAGES AND SALARIES



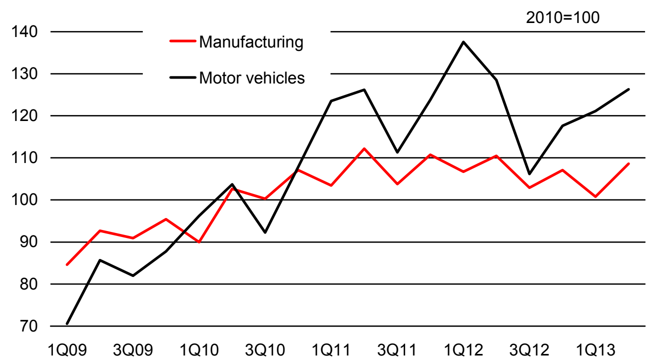
- A one-off wage boost helped break the spell of household spending contraction, no sustainable improvement seen though.

GERMAN IFO BUSINESS CONFIDENCE AND CZECH EXPORTS



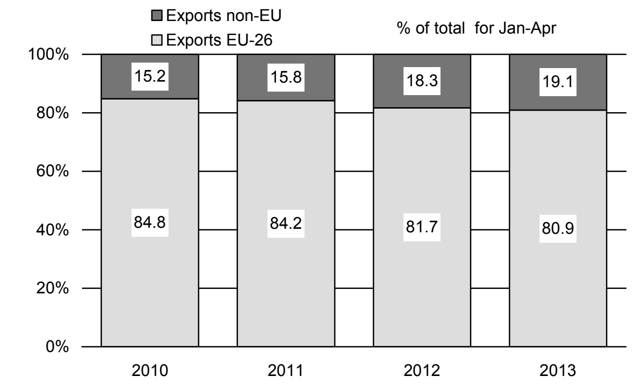
- A rebound of German Ifo observed since 2013 bodes well for Czech export growth going forward.

OUTPUT OF MANUFACTURING AND MOTOR VEHICLES



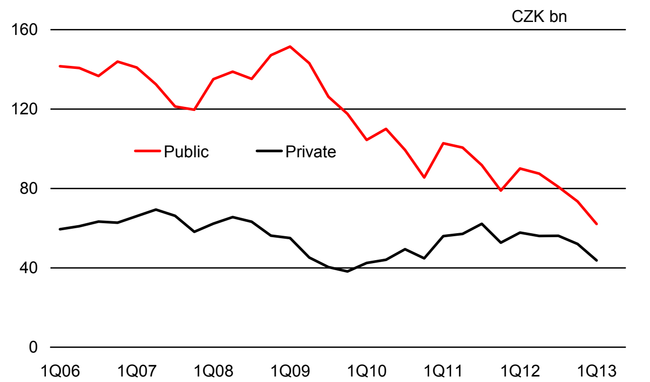
- A soft patch of the automotive industry may be over; yoy declines from 1Q13 caused above all by a firm base period.

EXPORTS TO EU-26 AND NON-EU



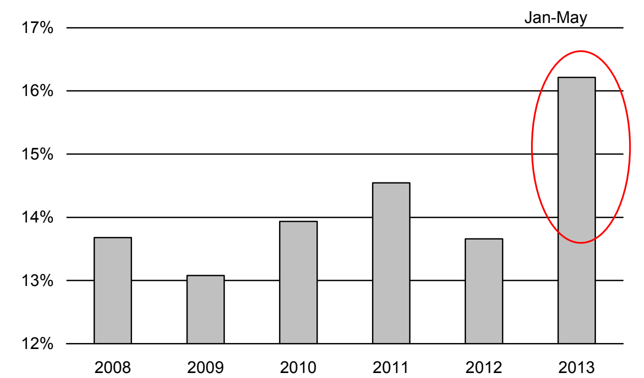
- Weak EU economies over last four years led to a sizeable shift of Czech exports outside the bloc.

STOCK OF ORDERS FOR CONSTRUCTION WORK



- Construction is set to remain the weak point of the economy; public orders continue to slump, private orders stagnate at best.

VAT COLLECTION AS % OF PRIVATE CONSUMPTION



- Improvement in VAT collection, observed in 1Q13, has extended through May and facilitates a boost in government spending in 2H13.

Source: CZSO, UniCredit Research

Hungary

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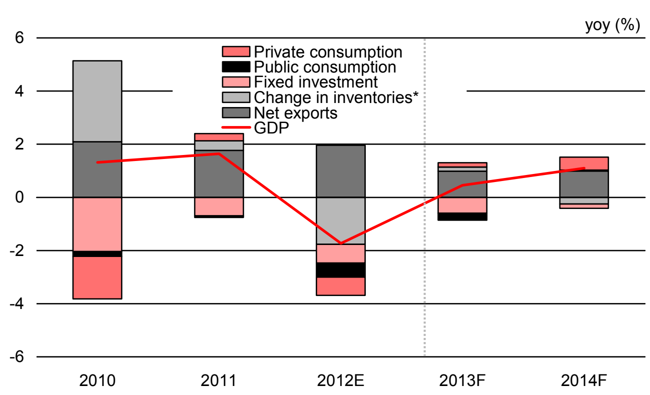
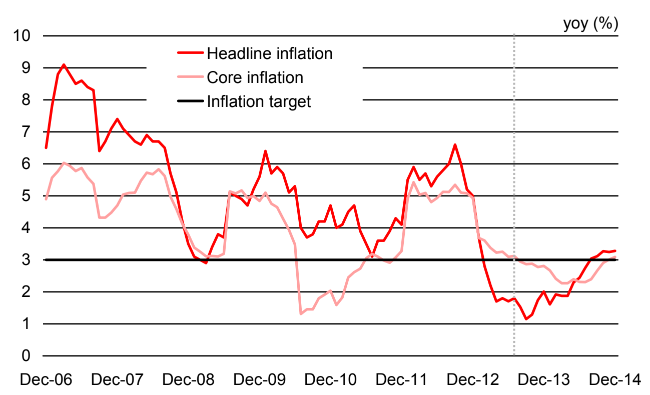
- Hungary's GDP fell 0.9% yoy in 1Q13, but rose by 0.7% qoq. On the demand side, only inventories made a positive contribution to quarterly growth, marking a slower speed of destocking than before. All other components fell: private consumption by 0.1% qoq, public consumption by 0.7% qoq, and investment by 1.4% qoq. Net exports made a negative contribution to GDP for a second consecutive quarter, due to a faster increase in imports (+3.3% qoq) than exports (+2.7% qoq). On a brighter note, exports recouped the losses from the very disappointing 2H12 and are now, in volume terms, at the highest level on record. In contrast, fixed investment fell to the level of 2Q99 and their quarterly contraction shows no signs of abating. Private consumption remains close to the level of 4Q02, adding to the lost decade of Hungarian domestic demand. Leaving aside agriculture, the value added in other economic sectors shrank 0.6% qoq in real terms. Some types of services (which accounts for 33.7% of the GDP volume) contributed to growth (transportation and storage +0.2% qoq, financial and insurance +0.2% qoq, real estate +0.9% qoq, public administration +0.3% qoq, arts and entertainment +0.5% qoq). Manufacturing dropped 1.4% qoq, the most since 1Q09, with the decline accelerating for the past three quarters. Assuming a gradual recovery of external demand, manufacturing could return to growth in 2H13, helping exports. At the same time, the approaching election year 2014 might trigger some populist spending that will boost imports. We maintain our call for 0.4% growth this year due to a better harvest, a smaller fiscal drag and improving foreign demand in 2H13. We expect growth to pick up to 1.0% in 2014.
- CPI inflation inched higher to 1.8% yoy in May due to higher food prices. We expect inflation to fall to around 1.1% by September and end the year at 2%, 1pp below the medium-term target.
- The National Bank of Hungary (NBH) cut its monetary policy rate to 4.50% on 28 May and we expect it to cut four times more. The NBH's preferred inflation measures fell in May to close to 1.7% and growth remains well below potential. Meanwhile, the recent risk-off episode affected the HUF less than other CEE currencies, increasing the scope for cuts.
- In April, the foreign liabilities of the banking system registered outflows of EUR 947mn, offsetting the good performance of 1Q13. The NBH started offering FX swap lines through its Funding for Growth Scheme, but demand amounted to just EUR 8mn vs. a supply of EUR 2.5bn. The poor demand postpones the reduction of the short-term external debt of the banking sector and of the currency basis.

GDP FORECAST UPGRADED AFTER POSITIVE SURPRISE IN 1Q



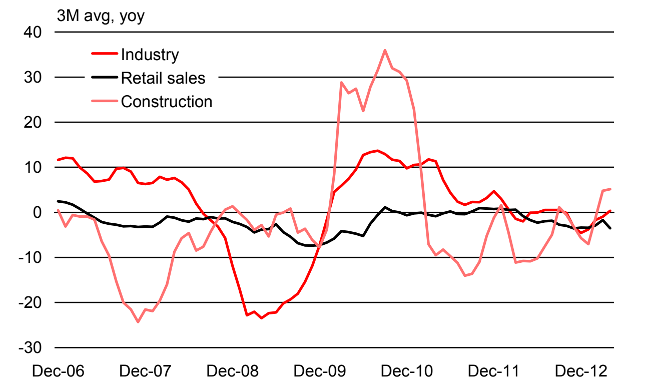
INFLATION FALLING ON ENERGY AND GAS PRICE CUTS



Source: KSH, UniCredit Research forecasts

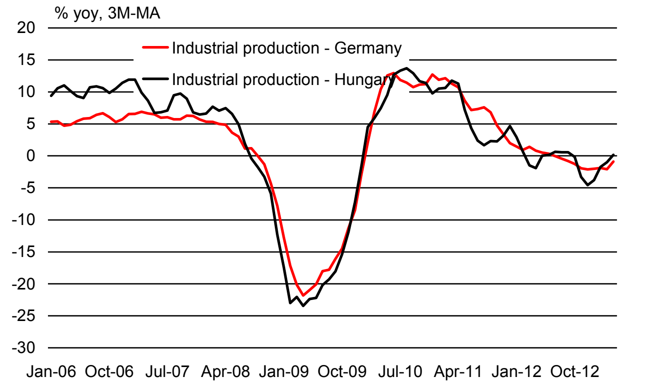
Hungary

INDUSTRY, RETAIL AND CONSTRUCTION



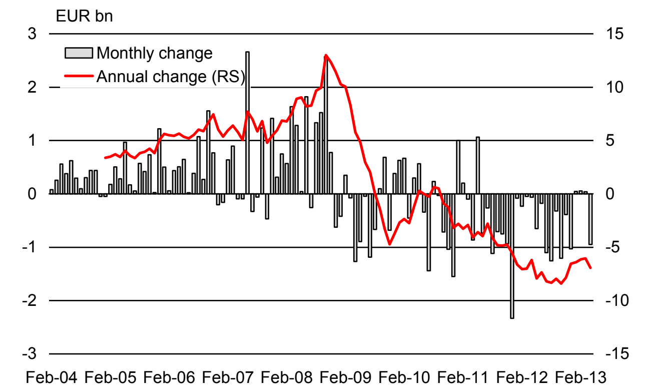
- The recovery is picking up…

INDUSTRIAL PRODUCTION IN HUNGARY AND GERMANY



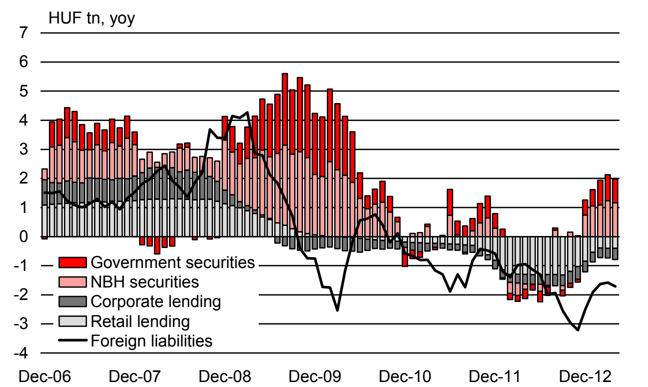
- …helped by external demand.

BANK DELEVERAGING



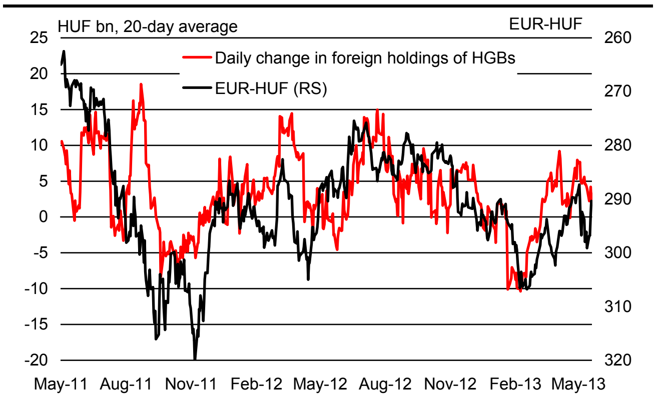
- The deleveraging resumed in April after the foreign liabilities of the banking system rose in 1Q13…

BANKING SECTOR ASSETS



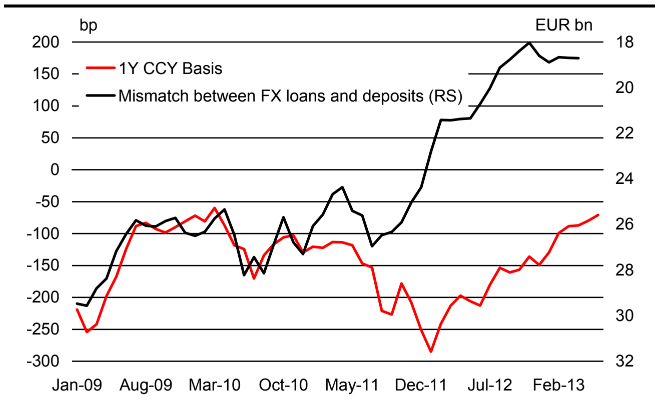
- …and the accumulation of HGBs and 2W bills decelerated.

HUF AND NET BOND PURCHASES BY FOREIGN INVESTORS



- The risk sell-off affected HGBs less than other bonds, thus allowing EUR-HUF to remain below 300

ROOM FOR THE CURRENCY BASIS TO NARROW



- The lower gap between FX loans and bonds and the FGS could allow the currency basis to narrow.

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

US

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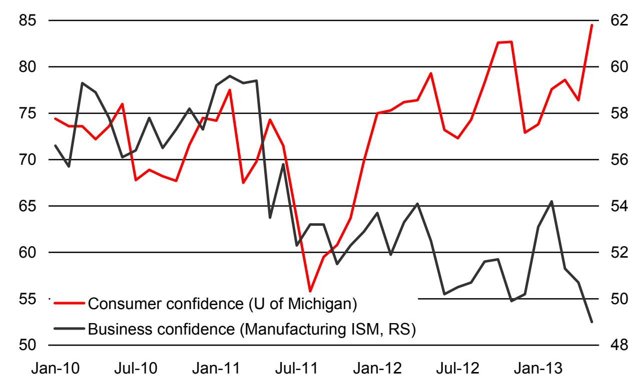
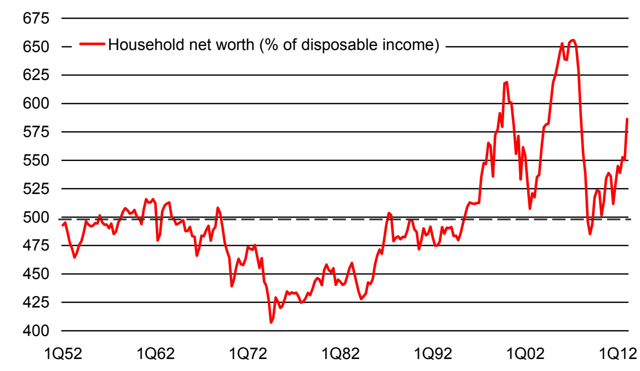
- US 1Q13 GDP growth was revised down slightly to 2.4% from the initially reported 2.5%. The composition of the growth, however, strengthened. Most importantly, real consumer spending is now reported up 3.4% (previously 3.2%), despite the expiration of the payroll tax cut at the end of 2012. The growth contribution of private inventories, on the other hand, was lowered to (a still strong) 0.6pp from 1.0pp, as businesses rebuilt their stockpiles somewhat slower than initially estimated.
- For the current quarter, we continue to expect that GDP growth slowed to 1.8%. Most of the volatility reflects the (lagged) response to fiscal tightening and some renewed inventory adjustment. The slowdown is particularly visible in the industrial sector, where production contracted an annualized 2% over the last three months and the manufacturing ISM fell to 49.0, the lowest level since the beginning of the recovery (see left chart).
- The consumer sector, on the other hand, is already showing signs of improvement again. Most measures of consumer confidence rose to multi-year highs in late May/early June, lifted by the combination of a gradual improvement in the labor market, rising financial and real estate wealth (see right chart), and lower gasoline prices. Gains in household spending reaccelerated in May, lifted by a rebound in car sales. The resilient consumer
- Accordingly, the second-quarter growth slowdown, in our view, will only be temporary. Healthy consumer spending, in combination with the ongoing housing recovery (the NAHB housing market index jumped to a 7Y high in June) 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.
- At its latest FOMC meeting, the Fed said that it will continue to buy USD 85bn in long-term securities per month, while the statement highlighted that the Committee is prepared to increase or reduce the pace of asset purchases. While markets felt that Chairman Bernanke indicated during his congressional testimony that the Fed could soon start to reduce the amount of asset purchases, we continue to expect that this tapering will not begin before September.

MIND THE GAP: CONSUMER VS. BUSINESS SENTIMENT



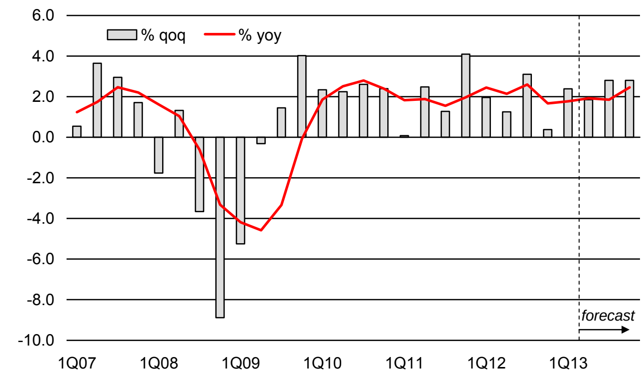
HOUSEHOLD WEALTH REBOUNDS



Source: Bloomberg, Federal Reserve, ISM, UniCredit Research

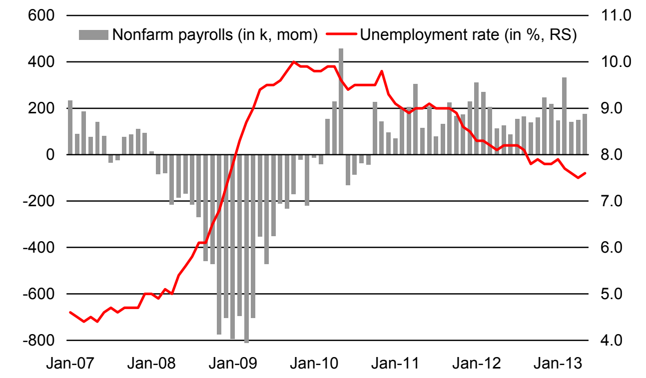
US

REAL GDP, ANNUALIZED RATES OF CHANGE



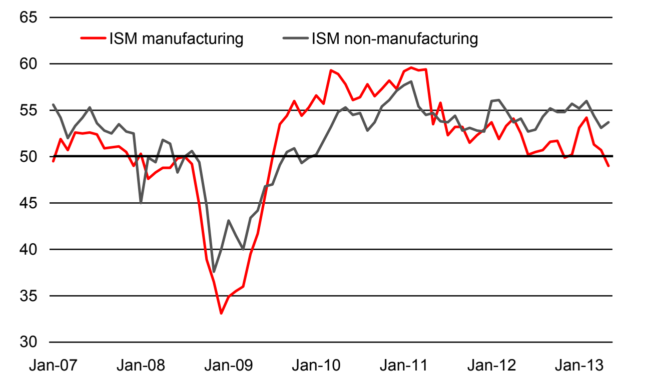
- GDP growth will likely slow to 1.8% in 2Q13, before reaccelerating to 2¾% in the second half of the year.

NONFARM PAYROLLS AND UNEMPLOYMENT RATE



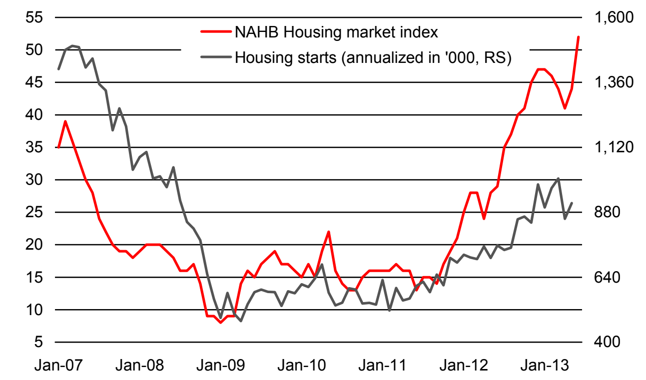
- Nonfarm payrolls gains accelerated to 175,000 in May, while the jobless rate edged up to 7.6%.

PMIS



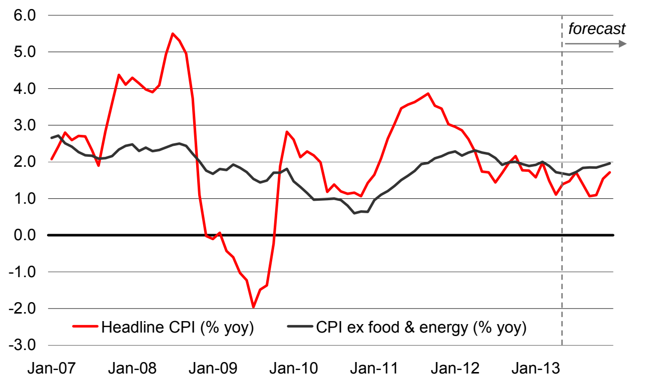
- The manufacturing ISM fell to a 4Y low of 49.0 in May. The non-manufacturing index improved slightly to 53.7.

HOUSING MARKET INDEX AND HOUSING STARTS



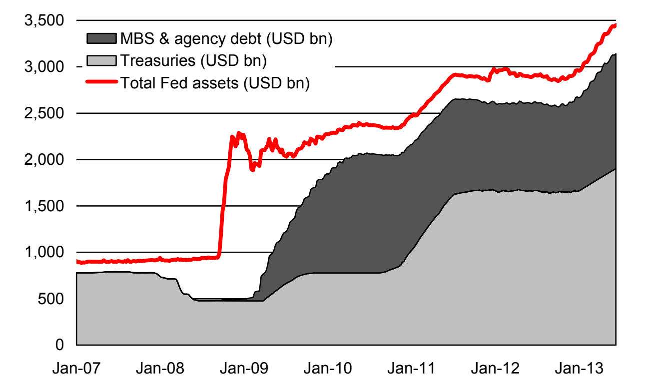
- The NAHB index jumped to a 7Y high of 52 in June, signaling further increases in construction activity.

CONSUMER PRICE INDEX



- The headline inflation rate edged up again to 1.4% yoy in May, while the core rate remained at an unchanged 1.7%.

FED'S BALANCE SHEET



- The size of the Fed's balance sheet is approaching USD 3½tn, as the Fed continues its large-scale asset purchase program.

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

Switzerland

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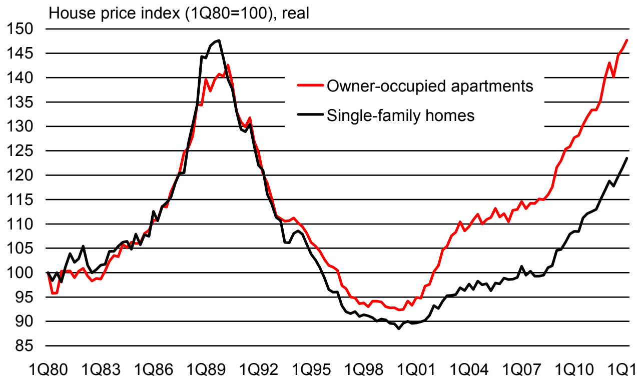
- The Swiss economy powered ahead in the first quarter. GDP rose a surprisingly strong 0.6% qoq, after +0.3% in the final quarter of last year. The recent generally negative dynamic in global industry was also a major drag on the Swiss economy, as reflected in declining exports and weaker business investment. But the continuously solid upward trend in household demand more than compensated for subdued industrial activity.
- Tailwind for private consumption remains robust. Although employment plans in industry weakened again in the spring and the gradual rise in unemployment continued in May, employment climbed to a new record high in the first quarter. The overall positive labor market situation is mirrored in declining unemployment expectations of private households. Together with rising purchasing power due to ongoing consumer price deflation, this bodes well for an ongoing solid expansion in consumer expenditures.
- Although some export sectors continue to suffer from the strong exchange rate, overall, industry showed further signs of stabilization of late. Notwithstanding the prolonged recession in the EMU periphery, stronger demand from other regions has been lifting export expectations (see left chart below). Thus, the economic upswing appears well supported and solid growth should continue during this year. Our KOF and PMI GDP models both currently indicate a quarterly growth rate of 0.3% for 2Q13. We expect GDP growth of 1.5% for 2013, up from 1.0% last year.
- Despite the comparatively favorable economic development, the SNB should keep its interest target rate at zero in the foreseeable future, with inflation not being an issue over the forecast horizon. At the same time, we regard the probability of both a higher minimum exchange rate target and negative interest rates as very low in the current environment. A higher minimum exchange rate target faces heavy resistance from other central banks and would complicate a future exit. And negative interest rates would possibly even increase tailwind for the housing boom, as indicated by the experience in Denmark.
- With respect to the continuously strong increase in house prices (see right chart below) and mortgage lending, policymakers currently favor the enforcement of existing rules, moral suasion of banks as well as a possible upward adjustment of counter-cyclical capital buffer (CCB) requirements later this year.

ONGOING STABILIZATION IN EXPORT SECTOR

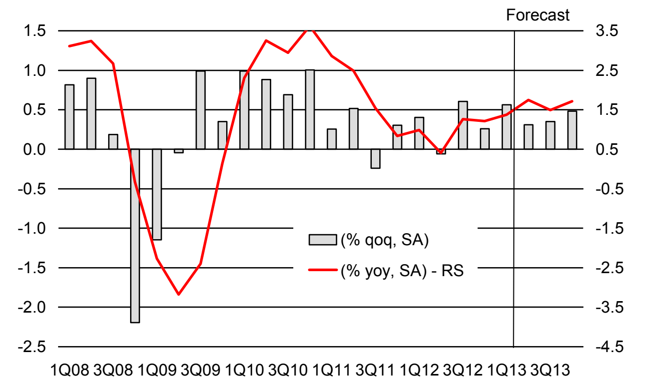
HOUSE PRICES CONTINUE THEIR UPWARD TREND



Source: KOF, SNB, UniCredit Research

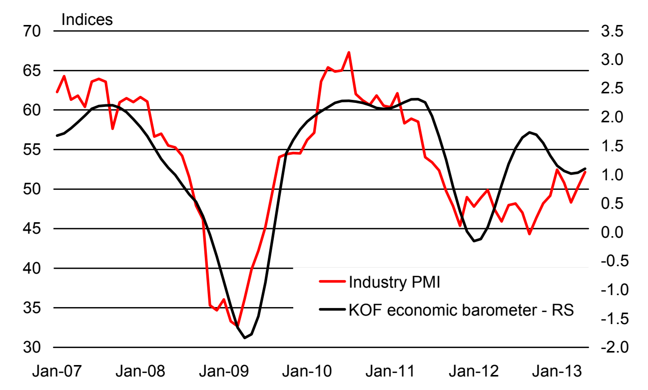
Switzerland

GDP



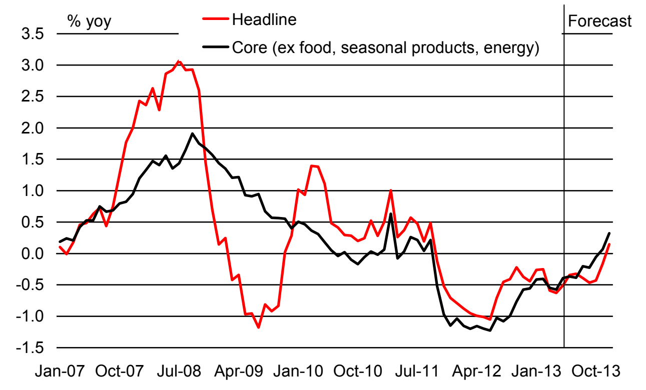
■ The Swiss economy expanded by a strong 0.6% qoq at the beginning of 2013.

BUSINESS SENTIMENT



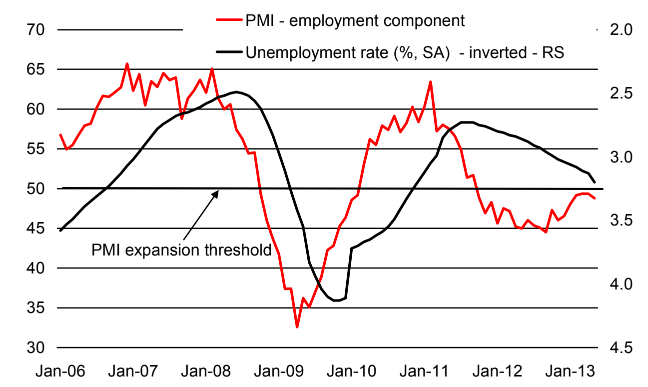
■ The convergence in business sentiment readings continued in May. Both indicators currently signal 0.3% qoq GDP growth.

INFLATION



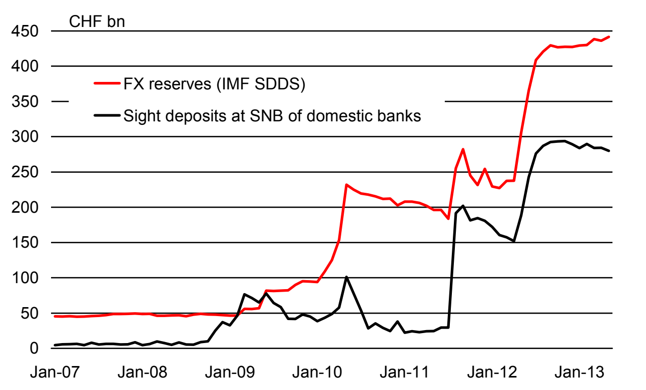
■ Swiss consumer prices were down 0.3% yoy in May. Moderate deflation should continue for most of this year.

LABOR MARKET



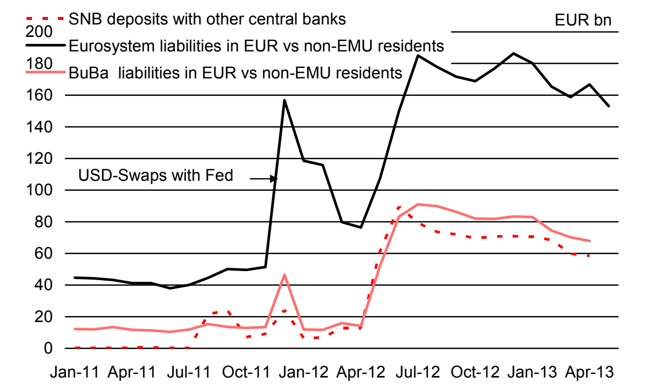
■ Employment plans in industry were somewhat weaker again in the spring, but overall employment has been rising nevertheless.

FX RESERVES



■ The SNB's FX reserves on a CHF basis rose in May on valuation effects, not new purchases, as underpinned by broadly stable sight deposit levels.

FX CURRENCY MANAGEMENT



■ A large amount of the EUR reserves purchased in 2012 is still parked at central banks and is invested only gradually.

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

Russia

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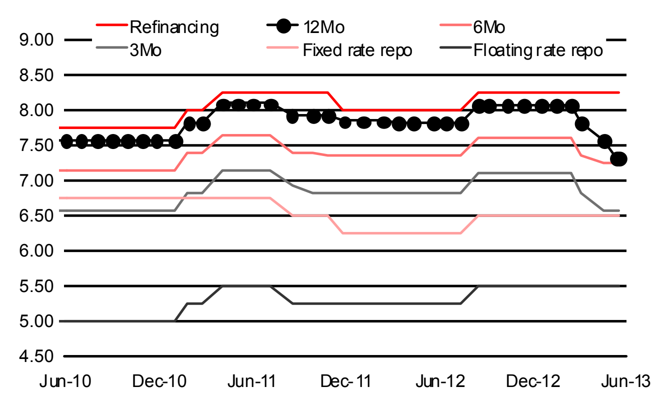
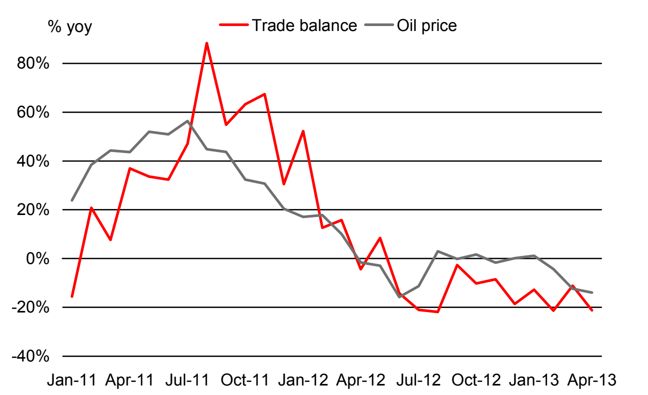
- The CBR recently cut non-key rates as expected. The regulator cut 6M - 1Y rates: 12-month repo and Lombard rates from 7.50% to 7.25%, the rate on 6-12 month loans backed by gold from 7.50% to 7.25% as well as 6-12 month non-marketable assets-pledged loans from 7.75% to 7.50%. As we noted in the meeting preview, the move serves the purpose of reducing the gap between long-term policy and market rates. Moreover, with every cut it becomes increasingly likely that the CBR will carry out a floating long-term refinancing later in the year. Since the move was broadly expected, it is neutral for the ruble and bonds. In its statement, the regulator noted that there were risks to a rise in inflationary expectations. The CBR is apprehensive of the food price effect and that of the regulated utilities' tariffs that will increase by 12-15% yoy on 1 July. However, should inflation expectations remain stable, inflation is likely to reach the target range (5-6%) in 2H13. The statement also hints that rate cuts cannot be ruled out in the future, as the CBR notes that there remain risks of an economic slowdown. Thus, we keep our forecast of a 25bp cut to the key policy rate (o/n repo auction) later this year.
- Both current and financial accounts are weighing on the ruble. Since mid-May, the ruble depreciated by around 5% against the basket. We believe ruble weakness has been caused by two factors. The first is global volatility, and it reflected upon the financial account through the exit from Russian assets which were perceived as risky ones. The second factor is the low current account balance driven by seasonal patterns as well as long-term trends. Over January-April, the trade balance shrank by 15% yoy as exports fell some by 4% and imports rose bu 6% yoy. This is not a surprise, since oil prices and oil production are stagnant, while consumption remains strong in Russia. Apart from this, high seasonal dividend payments are weighing on the external balance as well, so the current account might approach zero in June. Although we are long-term bearish on the ruble, we expect a reversal back to RUB 31-32/USD when risk appetite improves or oil prices as well as the Russian current account become higher.

THE CBR IS FINE-TUNING ITS INTEREST RATE TOOLBOX



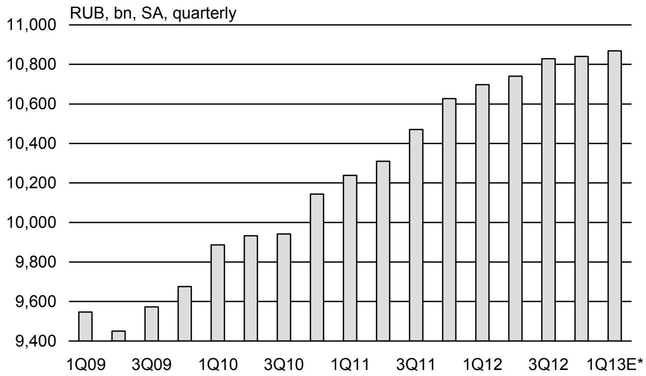
STRUCTURAL FACTORS WEIGH ON TRADE BALANCE



Source: CBR, Bloomberg, UniCredit Research

Russia

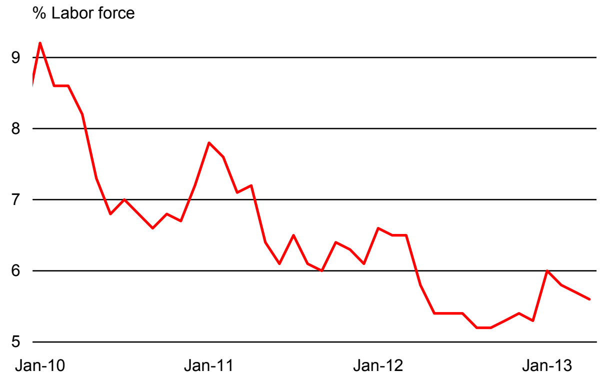
GDP



*MinEcon estimate

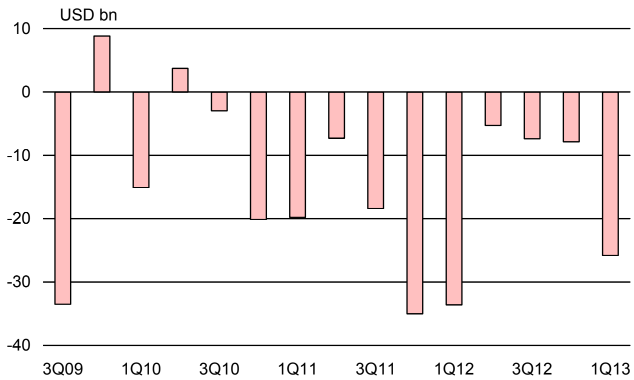
- Weaker domestic demand and stagnating exports are weighing on GDP that was estimated to have grown only 1% yoy in 1Q.

UNEMPLOYMENT



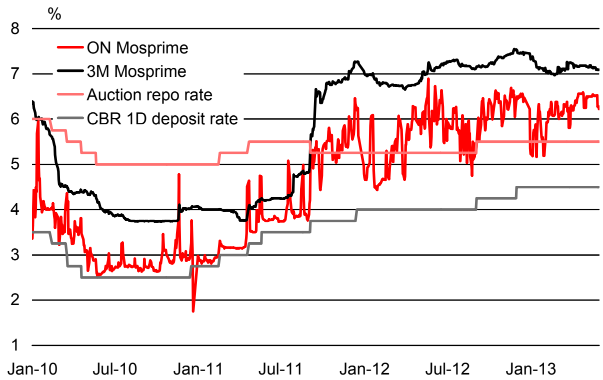
- However, unemployment remains far below historical levels.

CAPITAL OUTFLOW



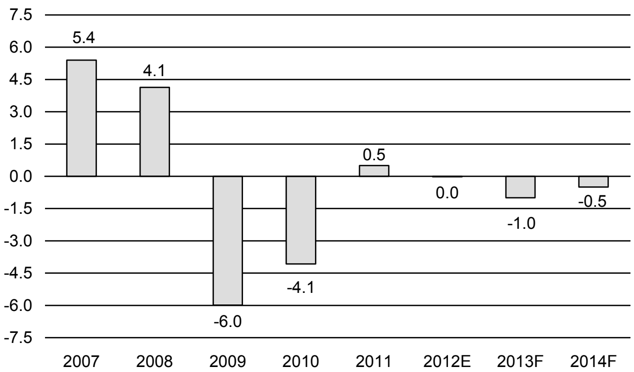
- Capital outflows are back to last year's levels, mostly driven by banks.

MONEY-MARKET RATES



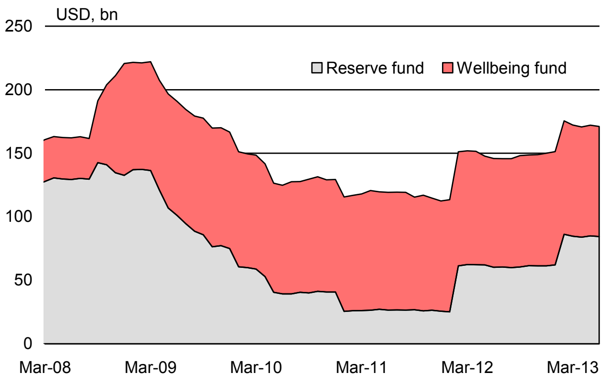
- The CBR provided some relief on the longer end, but overnight rates are still dominated by liquidity withdrawals of the budget.

BUDGET BALANCE



- While the Federal budget balance is likely to be in line with the fiscal rule, regional budgets are coming under pressure.

STATE FUNDS ACCUMULATION



- The difference between USD 110/bbl (base case) and USD 91/bbl cutoff price implies that the Reserve Fund will receive almost as much as in 2012.

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

Turkey

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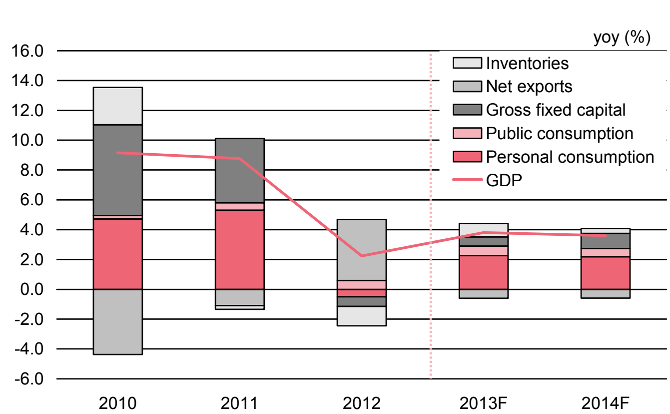
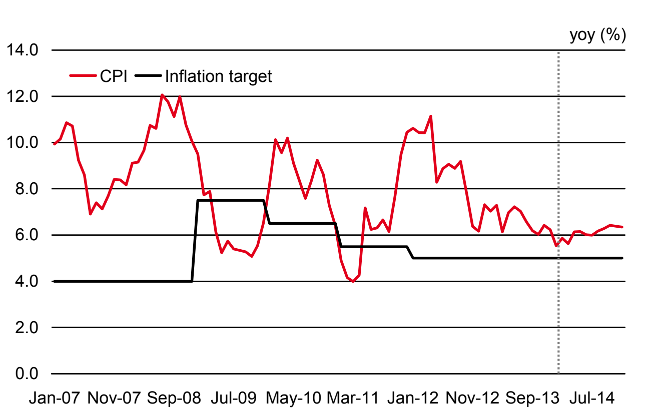
- The economy is showing clear signs of an unbalanced recovery in activity. Credit growth, at 28% on a 13-week average, FX-adjusted and annualized basis, is high and accelerating, supporting a rapid recovery in domestic demand. Fiscal policy is particularly expansionary, with current expenditure less interest up 10.5% yoy in real terms in the first four months of the year. Following a strong 1Q, April saw a further acceleration in import volume growth. 1Q GDP gained 1.6% qoq. In yoy terms, domestic demand not only contributed positively to GDP, but accounted for the full 3.0% increase.
- The beginning of a normalization in US interest rates also risks being particularly problematic for Turkey given its large C/A deficit and the accumulation of short-term external debt over recent years. The C/A deficit on a 12 month basis stood at USD 51bn in April, exceeding USD 50bn for the first time since October, in part because of net gold exports. Of the USD 225bn of foreign capital that has entered Turkey since the beginning of 2010, 75% or USD 170bn is short term in nature, e.g. portfolio capital, short term bank and non-bank corporate loans, trade credit and currency and deposits. Weaker global risk appetite means not only a risk of lower inflows at a higher cost but a risk of a reversal of past inflows.
- Following a two-to-three week period of TRY losses, the CBT has put forward a more decisive strategy to ease market volatility. This includes a reduction in TRY liquidity and forex selling auctions, though Governor Erdem Basci has signaled that direct FX intervention is unlikely. Simultaneously the ROC (reserve option co-efficient) mechanism also begins to take effect. The governor noted that via the ROC mechanism banks had withdrawn USD 2bn from FX reserves. The combination of the detail of this strategy and its timing (i.e. it has taken over a month and a 5% loss on the TRY for a more comprehensive CBT reaction) reinforces our view that the CBT is now willing to facilitate more TRY volatility than over the past 4-6 quarters. That said, the CBT's appetite for TRY losses has limits given **1.** the increase in the corporate sector's net open FX position in recent years, **2.** FX pass-through to inflation, **3.** large amounts of foreign capital inflows and **4.** Turkey's limited stock of FX reserves.
- Following a stable political environment over a multi-year period, uncertainty has increased. Early elections remain unlikely and, at this stage, we do not expect any changes to central positions within AKP, but the protests are historic. They represent the first challenge to the Prime Minister in a number of years and the first such peaceful protest by a variety of different interest groups in three decades. The protests also increase the potential for more populist fiscal policy ahead.

DOMESTIC DEMAND IS EXPECTED TO LEAD THE RECOVERY



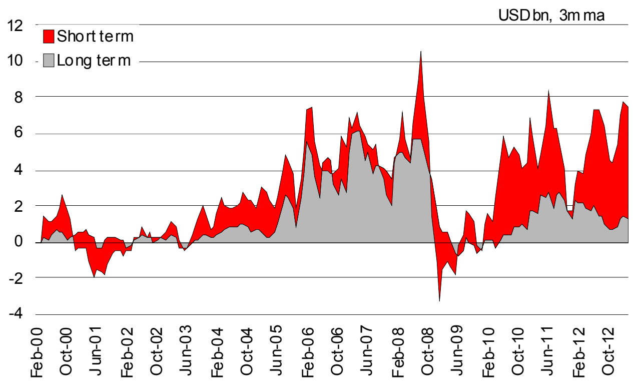
INFLATION TO EASE BUT REMAINS OFF TARGET



Source: CBT, TurkStat, UniCredit Research

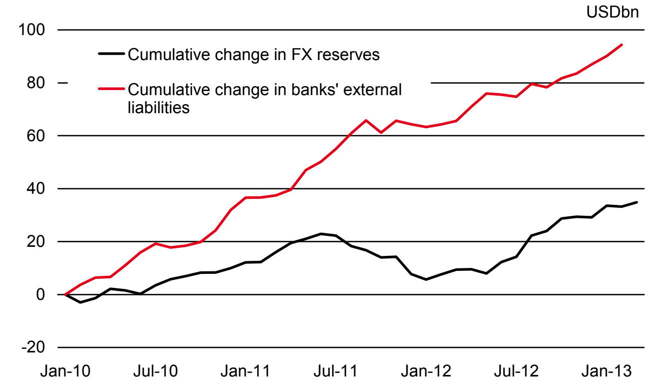
Turkey

FOREIGN CAPITAL FLOWS TO TURKEY



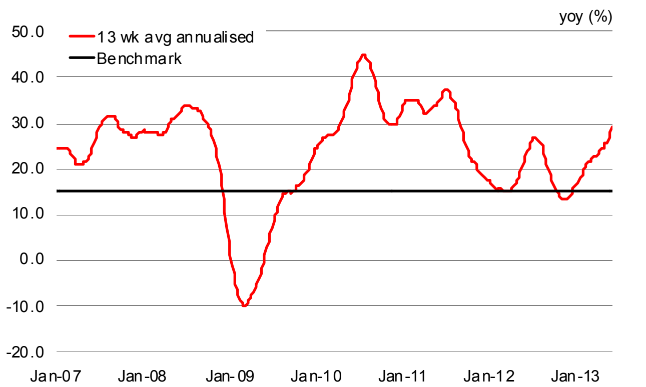
■ Close to 75% of all capital inflows to Turkey since early 2010 have been short-term in nature.

FX RESERVES VS. BANK EXTERNAL LIABILITIES



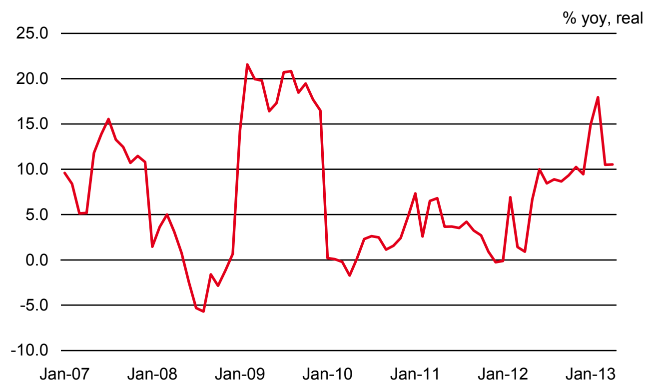
■ FX reserves have not kept pace with the increase in bank external liabilities.

CREDIT GROWTH VS. TARGET



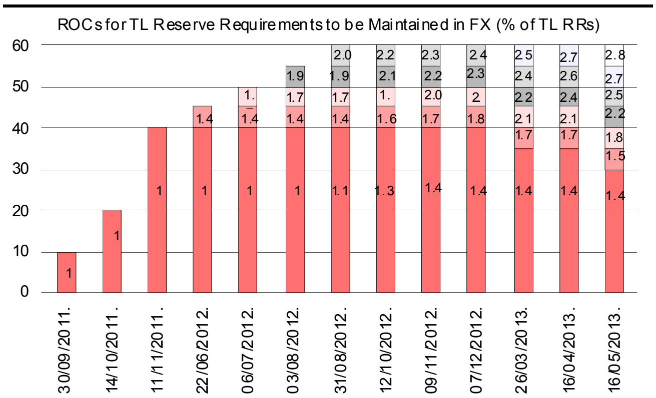
■ Credit growth is high and accelerating, with the 13-week average, FX-adjusted and annualized reading at 28% at end-May.

CURRENT EXPENDITURE LESS INTEREST



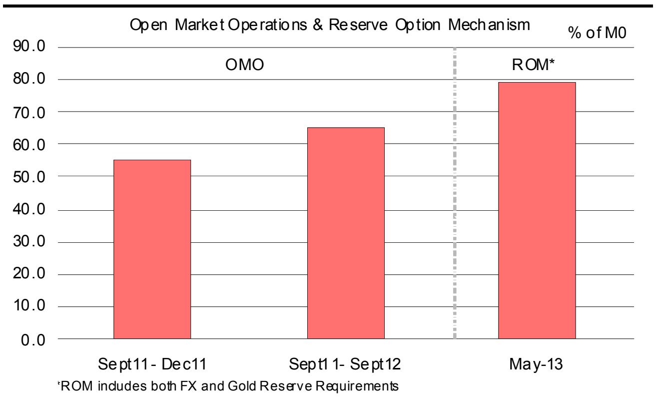
■ Current expenditure less interest up 10.5% yoy in the first four months of the year.

COVERING TRY RRR VIA FX



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

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



■ Via its ROM, related both to FX and gold, the CBT has the potential to absorb 78% of M0, well above that via OMOs.

Source: CBT, TURKSTAT, UniCredit Research

China

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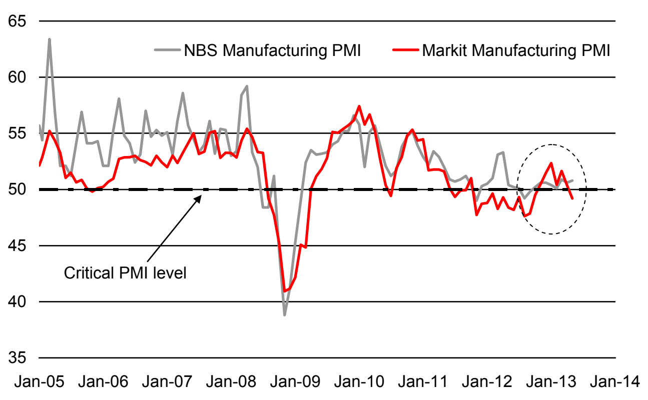
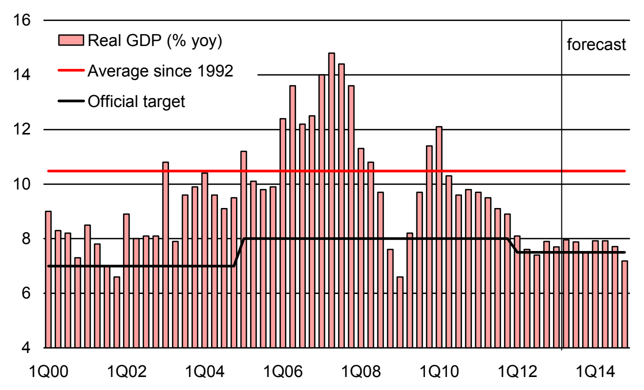
- China's data releases over the last few weeks disappointed expectations of an uptick in growth momentum, thus posing further downside risks to our expectation that GDP growth will pick up to 8% this spring (1Q13: +7.7% yoy; 2012: +7.8%). While China's two PMI readings sent conflicting signals (with the export-oriented Markit/HSBC down in contractionary territory and the inward-looking NBS index up slightly), hard activity data all came in on a weak(er) note, thus fuelling growth worries in the second largest global economy. We will wait for next month's 2Q13 GDP figures before fine-tuning our growth projections.
- Poor trade data show that the country is still facing formidable external headwinds that had thus far been masked by inflated export figures. And even if the attempts to clamp down on the dressing up of financial inflows as exports or the arbitrage trade to Hong Kong may have "over-deflated" May's meager export figure (+1%), the recent drop in the forward-looking new export orders in China's Markit/HSBC PMI does not bode well for a sustainable improvement of foreign demand further down the road – also as the CNY is firming.
- Chinese authorities will not have been pleased by domestic demand either. While the headline retail sales figure (+12.9%) may possibly be considered as being satisfactory, the composition will not – as housing items were the major drivers, with housing prices showing an unwanted surge. And it is still real estate (although slowing) together with local governments (where financial risks are looming) and infrastructure that is fuelling overall investment.
- Capex growth in manufacturing is clearly lagging, held down by cloudy sales expectations, shrinking profit margins as well as overcapacity in certain industries and de-stocking needs. It is therefore no wonder that industrial production growth in May remains in single-digit territory (+9.2%) and even fell slightly versus the prior month's reading.
- Unconvincing May activity numbers will eventually increase the pressure on the Chinese authorities to step up macroeconomic accommodation. But as the government does not seem overly alarmed yet, we do not expect any new large-scale fiscal programs (which could further fuel house prices and local government debt), but rather some additional selective measures.
- Monetary policy may have more room for maneuver as indicated by benign inflation. The likelihood of an interest rate cut (primarily RRR) has increased, in our opinion, although this is not without risk (and thus not a done deal), as it could refuel a house price bubble which the central bank has been attempting to contain.

BUSINESS CLIMATE IMPLIES UNCHANGED GROWTH MOMENTUM...



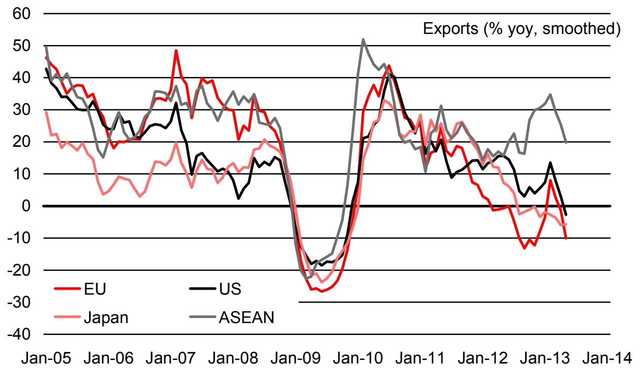
...WITH GDP GROWTH TO FLUCTUATE IN 7½%-8% REGION



Source: Thomson Datastream, Feri, UniCredit Research

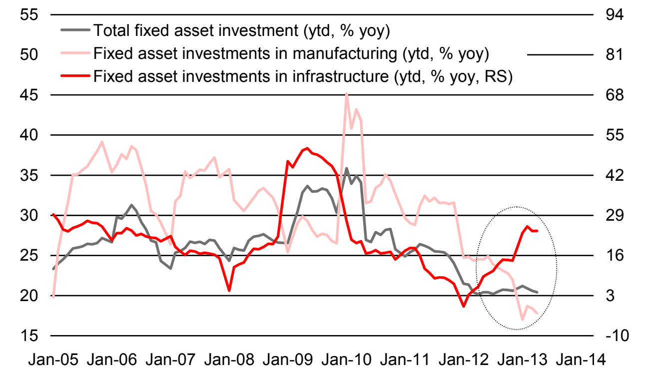
China

EXTERNAL ECONOMY



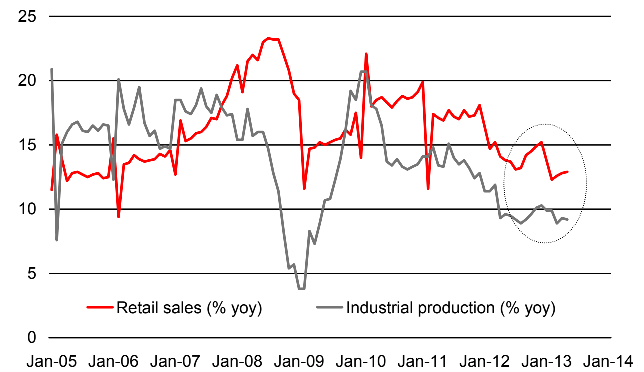
- Nominal export growth has been "doctored" earlier this year, but came down severely after the government stepped in – now painting a more realistic picture of the formidable external headwinds.

FIXED ASSET INVESTMENT



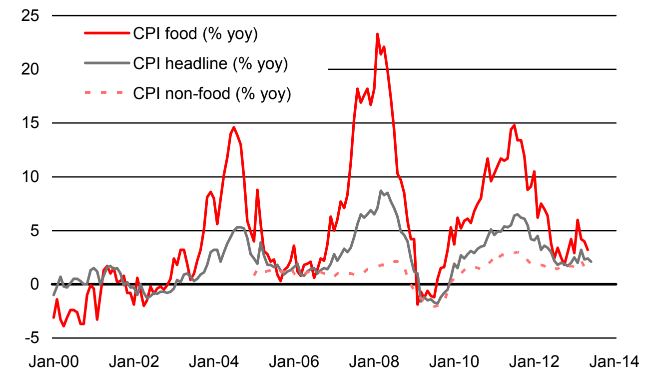
- Public investment has surged, as has residential investment (not shown in the chart). But capex growth in manufacturing is lagging, dragged down by overcapacities and weakening profit growth.

RETAIL SALES AND INDUSTRIAL PRODUCTION



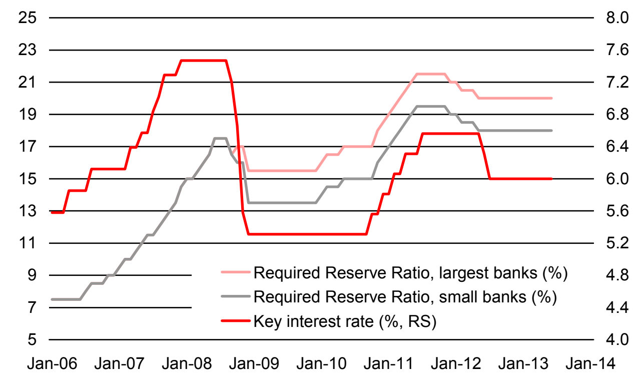
- Like business investment, private consumption is not yet showing a clear upward trend, which is weighing on the recovery momentum.

CPI INFLATION



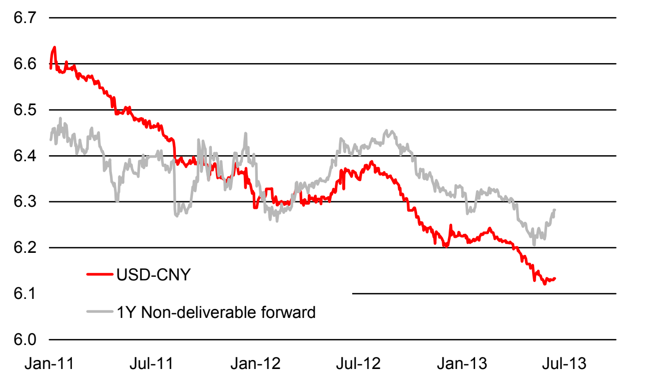
- Following the uptick earlier this, inflationary pressures eased again – helped by falling commodity & input prices….

MONETARY POLICY



- ...so the central bank has room for maneuver. While the likelihood has risen of late, cuts are not a done deal.

USD-CNY

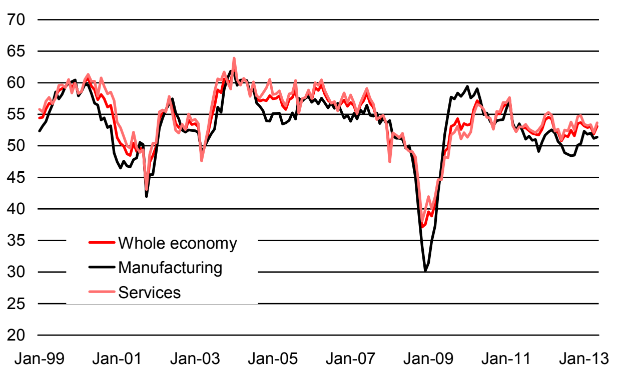


- After fluctuating sideways earlier this year, the CNY resumed its appreciation trend, not least on the back of a weakening JPY.

Source: Thomson Datastream, Feri, UniCredit Research

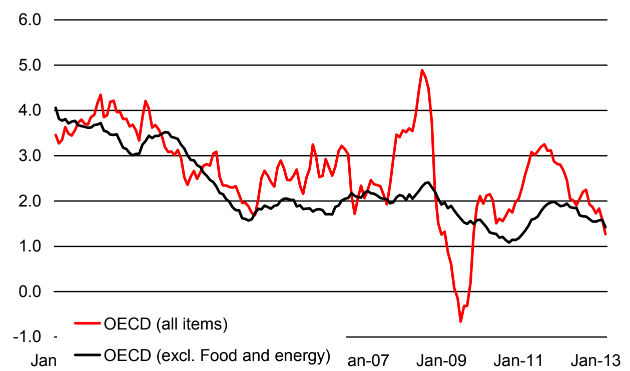
Global indicators

GLOBAL PMI OUTPUT



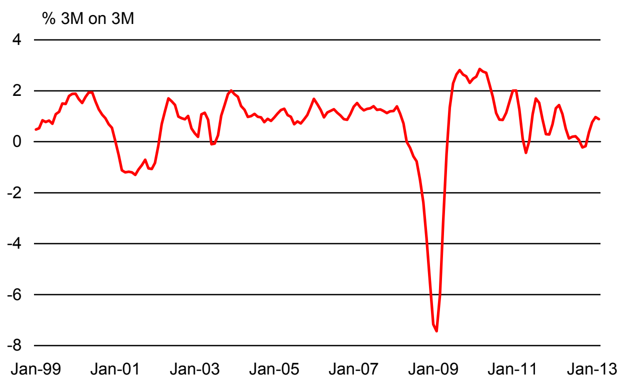
- The global composite PMI rose from 51.9 to 53.1 in May. The manufacturing output index rose from 51.2 to 51.4, and the services index was up from 52.1 to 53.7.

CPI INFLATION



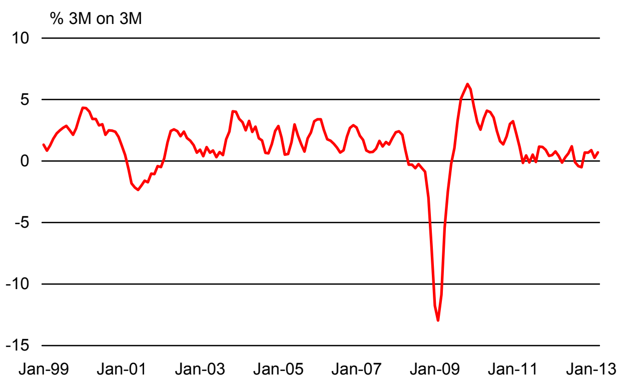
- Headline inflation in OECD economies slowed from 1.6% yoy to 1.3% yoy in April, with the core rate down from 1.6% yoy to 1.4% yoy.

INDUSTRIAL PRODUCTION



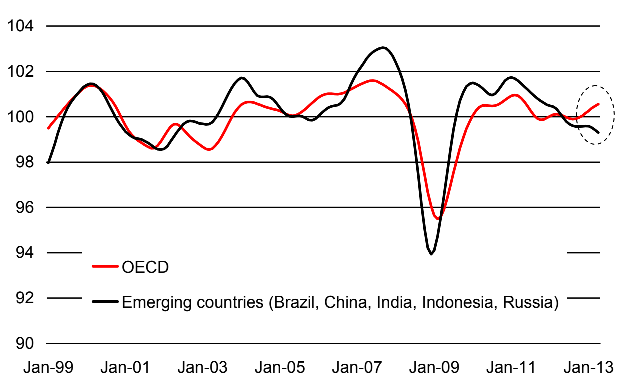
- Global IP rose 0.6% mom in March. The 3M/3M rate edged down slightly, from 1.0% to 0.9%.

WORLD TRADE



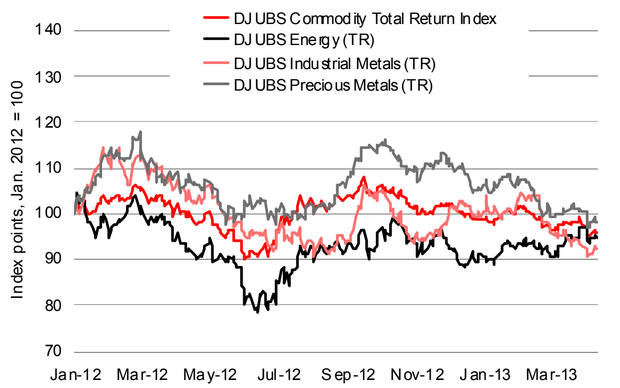
- World trade rose 0.2% mom in March. The 3M/3M rate accelerated from 0.3% to 0.7%.

OECD COMPOSITE LEADING INDICATORS



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

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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