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The UniCredit Chartbook

Monthly

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Monthly recap

- **EMU:** The latest hard data increase the likelihood of a positive growth surprise in 2Q13. Much-better-than-expected IP resilience, a technical rebound in construction output and decent consumer spending data are shifting to the upside the risks to our -0.1% qoq GDP forecast for the second quarter. Soft indicators have also been constructive, although their pace of improvement is slower than that of hard data, and not without mixed signals. At the July meeting, the ECB adopted a new communication strategy to shield the eurozone from the premature tightening of financial conditions induced by the Fed's rhetoric. This new communication, which aims to "inject downward bias" in interest rates, is unlikely to be a silver bullet when it comes to fragmentation and the lack of transmission of monetary policy. We think the ECB will resort to a new LTRO (with maturity of up to 5Y) before year-end, in order to maximize the liquidity insurance for banks when loan demand will start to bottom out and bank funding costs could be affected by higher government bond yields.
- **US:** Economic growth in the first half of the year was slower than initially reported due to downward revisions in consumer spending. Those revisions not only affected the first quarter, in which GDP growth was lowered to 1.8% from 2.4% (annualized), but also the second quarter. As a result, the upside risks to our 2Q13 GDP forecast we stressed a month ago have given way to downside risks. For now, we stick to our 2Q13 estimate of 1.8%. Looking forward, we continue to expect growth to pick up to 2¾% in the second half of the year. Due to the weaker growth in the first quarter, our 2013 forecast declined from 2.0% to 1.8%. In line with our view of an accelerating economy, the Federal Reserve is likely to moderate the pace of asset purchases later this year (most likely beginning in September) and end the program around the middle of 2014. Rate hikes, however, remain far off. The vast majority of Fed officials does not foresee the first rate hike arriving before 2015.
- **CEE:** Financing of emerging markets has deteriorated, predominantly because Fed tapering is nearing. The initial impact on emerging markets has been negative, but we expect more differentiation from here. Countries such as Russia and Czech Republic are much less at risk given a limited accumulation of foreign capital in both countries and comfortable foreign reserves. Poland's access to the IMF's FCL offers it more protection while the combination of low inflation and a gradual recovery in activity means monetary policy is set to remain accommodative over the coming quarters. Turkey is more at risk given its reliance on foreign capital. This is pushing the central bank towards a more hawkish stance.
- **China:** Recent hard and soft data showed that economic growth in China weakened further over the spring to 7½% yoy, with soft momentum carrying over into the summer. External headwinds will remain significant, brisk credit growth is likely to decelerate and the government is primed to tolerate slow(er) growth. Thus we expect GDP growth to settle down to between the government's target of 7½% and its pain threshold of around 7% over the next few quarters. We revise down our annual GDP forecasts from 7.8% to 7.4% for 2013 and from 7.7% to 7.2% for 2014.

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	1.5	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	1.5	1.8	-	-	-	-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	-6.1	84.2	91.5	97.0	-1.1	1.0	2.1
Austria	0.9	0.4	1.6	2.4	1.9	1.8	-	-	-	-2.5	-2.3	-1.7	74.1	75.3	74.9	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	0.2	0.9	1.4	2.8	2.6	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	1.3	2.3	3.7	0.8	1.9	4.25	2.50	2.50	-3.9	-3.9	-3.5	55.6	57.8	57.9	-3.5	-2.2	-3.3
Czech Rep.	-1.2	-0.8	2.1	3.3	1.5	1.6	0.05	0.05	0.05	-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	2.2	2.4	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	1.8	2.6	2.1	1.6	2.4	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	7.4	7.2	2.7	2.5	3.0	6.00	6.00	6.00	-1.7	-1.8	-1.8	-	-	-	2.3	2.1	2.2

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	-0.3	-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	0.1	-0.2	-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	0.7	-0.2	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	0.7	1.4	2.3	2.7	2.3	2.2	2.1
Czech Rep.	-0.3	-0.3	-1.3	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	1.8	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	7.5	7.3	7.1	7.2	7.1	7.2	7.0

CPI INFLATION (% YOY)

	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Eurozone	2.5	2.3	1.9	1.4	1.4	1.5	1.5	1.8	1.7	1.6
Germany	2.0	2.0	1.5	1.5	1.3	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	2.0	2.0
Italy	3.2	2.5	1.9	1.2	1.2	1.7	1.7	2.0	2.0	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	2.7	2.7	2.4	2.2	2.2	2.3	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	0.5	0.5	0.7	1.4	1.8	2.1	2.4
Czech Rep.	3.4	2.9	1.8	1.5	1.2	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	1.4	1.7	1.7	2.0	2.6	2.5	2.6
Switzerland	-0.5	-0.3	-0.4	-0.4	-0.5	-0.1	0.3	0.6	0.7	0.7
Russia	5.1	5.1	5.9	6.7	6.6	6.3	6.0	5.6	5.4	5.4
Turkey	9.0	6.8	7.2	6.4	6.1	6.3	5.6	6.2	6.4	6.3
China	1.9	2.5	2.4	2.4	2.6	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 (July-13/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	-0.6	0.9	-0.6	-0.4	1.2	-0.5	-0.6	1.1
Germany	0.9	0.5	1.5	0.9	0.3	1.3	0.7	0.4	1.8	0.9	0.4	2.0
France	0	-0.3	0.8	0	-0.2	0.8	0	-0.1	1.1	0	-0.3	0.8
Italy	-2.4	-1.7	0.6	-2.4	-1.8	0.7	-2.4	-1.3	0.7	-2.4	-1.8	0.4
Spain	-1.4	-1.6	0.5	-1.4	-1.6	0	-1.4	-1.5	0.9	-1.4	-1.7	0.4
Austria	0.9	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	-1.3
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	0.2	0.9	1.4	0.3	0.9	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	1.3	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	1.8	2.6	2.2	1.7	2.7	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	2.5	3.3	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	7.4	7.2	7.8	7.8	7.7	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	1.5	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	1.5	1.8	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	2.6	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	0.3	1.3
Poland	3.7	0.8	1.9	3.7	1.9	2.0	3.7	1.4	2.0	3.6	0.7	1.0
Czech Rep.	3.3	1.5	1.6	3.3	2.3	1.9	3.5	1.9	1.2	3.3	1.6	1.3
Hungary	5.6	2.2	2.4	5.7	3.2	3.5	5.7	2.6	3.1	5.7	2.8	3.5
Others												
US	2.1	1.6	2.4	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

*The IMF GDP forecasts are those published in the WEO July 2013 update for all countries except Austria, Greece, Portugal, Sweden, Poland, Czech Rep., Hungary, Switzerland and Turkey, where the numbers are those published in April 2013;

**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	0.22	0.25	0.30	0.40	0.50	0.55	0.55
2Y	0.10	0.25	0.30	0.35	0.50	0.65	0.85
5Y	0.54	0.80	0.90	1.00	1.20	1.45	1.65
10Y	1.56	1.75	1.85	2.00	2.20	2.40	2.60
30Y	2.38	2.55	2.65	2.75	2.95	3.10	3.25
2/10	146	150	155	165	170	175	175
2/5/10	-29	-20	-18	-18	-15	-8	-8
10/30	83	80	80	75	75	70	65
2Y SwSp	-42	-35	-30	-30	-30	-25	-25
10Y SwSp	-33	-25	-20	-20	-20	-15	-15
10Y BTP/bund	290	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	0.32	0.30	0.35	0.45	0.65	0.85	1.00
5Y	1.37	1.30	1.40	1.60	1.90	2.20	2.45
10Y	2.53	2.45	2.55	2.70	2.90	3.10	3.30
30Y	3.58	3.50	3.60	3.75	3.85	4.00	4.15
2/10	221	215	220	225	225	225	230
2/5/10	-6	-8	-5	3	13	23	30
10/30	106	105	105	105	95	90	85
2Y SwSp	-17	10	10	5	5	5	5
10Y SwSp	-21	60	70	70	60	70	70
UK							
Key rate	0.50	0.50	0.50	0.50	0.50	0.50	0.75
10Y	2.26	2.40	2.60	2.80	2.95	3.30	3.50
SZ							
Key rate	0	0	0	0	0	0	0
10Y	1.01	0.65	0.80	1.00	1.20	1.40	1.60

FX	Current	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
EUR-USD	1.31	1.33	1.35	1.35	1.36	1.37	1.38
EUR-JPY	131	146	155	155	159	162	166
EUR-GBP	0.87	0.88	0.90	0.90	0.91	0.91	0.92
EUR-SEK	8.68	8.63	8.60	8.58	8.55	8.53	8.50
EUR-NOK	7.89	7.67	7.63	7.60	7.57	7.55	7.55
EUR-CHF	1.24	1.30	1.33	1.35	1.37	1.39	1.41
EUR-AUD	1.43	1.43	1.42	1.39	1.37	1.37	1.35
EUR-NZD	1.67	1.66	1.65	1.63	1.60	1.61	1.59
EUR-CAD	1.37	1.40	1.40	1.38	1.36	1.34	1.34
USD-JPY	100	110	115	115	117	118	120
GBP-USD	1.51	1.51	1.50	1.50	1.50	1.50	1.50
USD-SEK	6.61	6.49	6.37	6.36	6.29	6.23	6.16
USD-NOK	6.01	5.77	5.65	5.63	5.57	5.51	5.47
USD-CHF	0.94	0.98	0.99	1.00	1.01	1.01	1.02
AUD-USD	0.92	0.93	0.95	0.97	0.99	1.00	1.02
NZD-USD	0.79	0.80	0.82	0.83	0.85	0.85	0.87
USD-CAD	1.04	1.05	1.04	1.02	1.00	0.98	0.97

Source: Bloomberg, UniCredit Research

Eurozone

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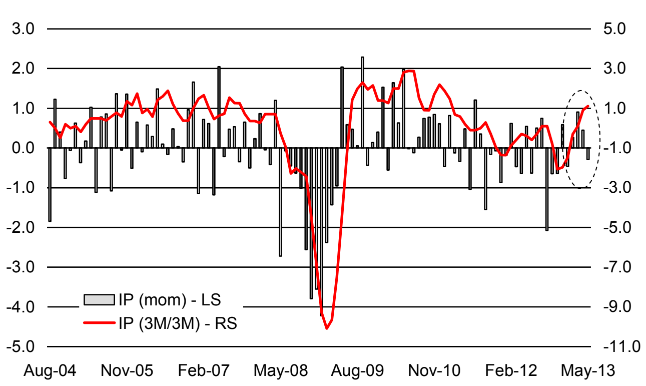
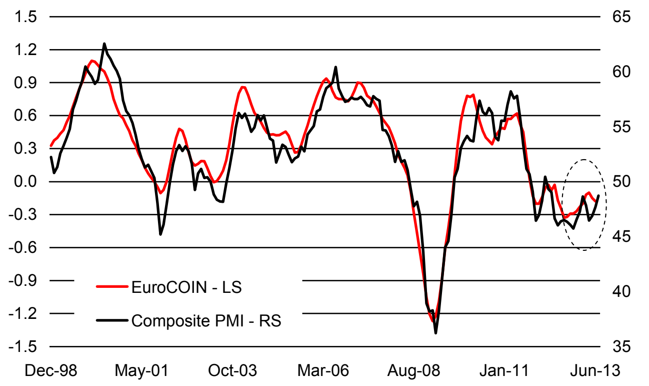
- The latest hard data increase the likelihood of a positive growth surprise in 2Q. IP contracted by 0.3% in May, which is a very good outcome as it comes after three consecutive increases and remarkable resilience so far in 2013. The less volatile 3M/3M IP growth rate accelerated to 1.1% from an already respectable 0.9% – this is more favorable than we had expected, and much stronger than implied by all manufacturing surveys. With construction output set for a technical rebound and decent consumer spending data, risks to our -0.1% qoq GDP forecast for 2Q have shifted to the upside.
- Soft indicators have also been constructive, although their pace of improvement is slower than that of hard data, and not without mixed signals. In June, the Composite PMI rose for the third consecutive month to 48.7: at face value, this indicates a 0.1% qoq GDP contraction, although in the last few quarters the PMIs have tended to underestimate real economic activity. The usually reliable EuroCOIN was the weak spot in a generally upbeat round of survey indicators. It was down slightly for the second consecutive month to -0.18% from -0.15%, due to the poor performance of financial markets.
- Inflation accelerated further in June, as expected. The move to 1.6% from 1.4% was fully driven by a negative base effect on energy, while core inflation remained at 1.2%. Inflation will probably broadly stabilize in July, and fall back in August. Looking through the monthly volatility, price growth is set to remain weak for the foreseeable future. In our projections through 2014, inflation hovers around 1.5-1.6% and never exceeds the 2% mark.
- At the July meeting, the ECB adopted a new communication strategy to shield the eurozone from the premature tightening of financial conditions induced by the Fed's rhetoric. The key sentence of the introductory statement goes as follows: "the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time". The ECB regards this change in communication as "unprecedented", but we note the following: **1.** This new rhetoric spells out an expectation, not a commitment; **2.** Draghi refrained from defining "extended period"; **3.** The GC rate expectations are based on the outlook for CPI, GDP, and monetary dynamics, i.e. the three key variables of the ECB's two-pillar strategy. In other words, the ECB has not changed its reaction function, but has only made more explicit the link between these variables and its monetary policy. Overall, the big issue for the ECB remains fragmentation and the lack of transmission of monetary policy, and here the forward guidance is not a game changer. We think the ECB will resort to a new LTRO (with maturity of up to 5Y) before year-end. This will maximize the liquidity insurance for banks when loan demand starts to bottom out and bank funding costs could be affected by higher government bond yields.

IP SHOWS UNEXPECTED RESILIENCE…



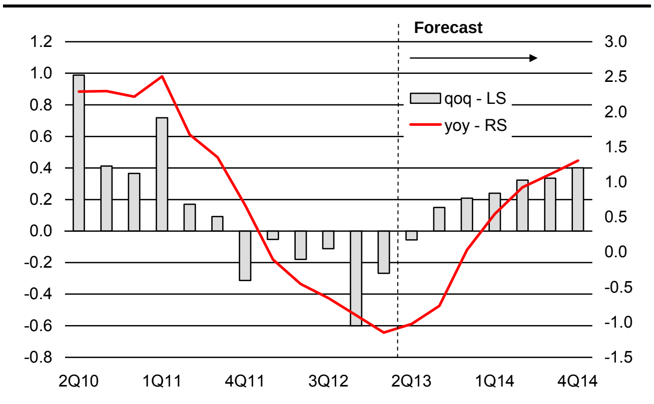
… WHILE SURVEYS REMAIN MIXED



Source: BoI, Eurostat, Markit, UniCredit Research

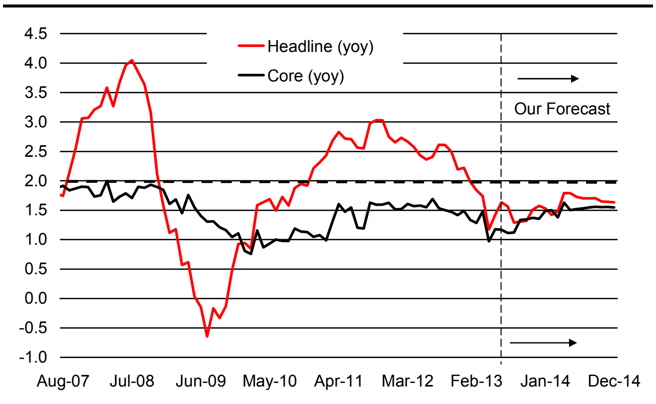
Eurozone

GDP



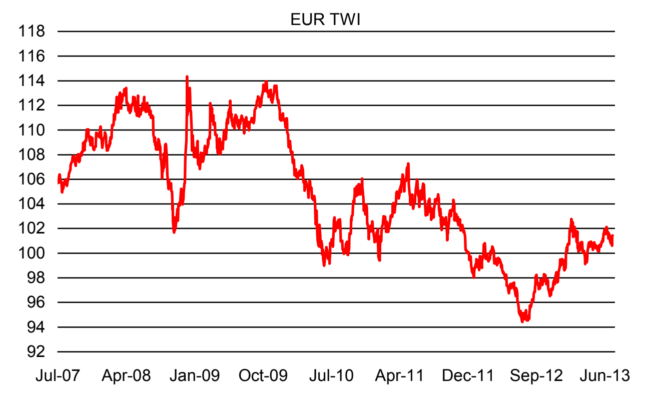
- Upside risks to our -0.1% qoq GDP forecast for 2Q.

INFLATION



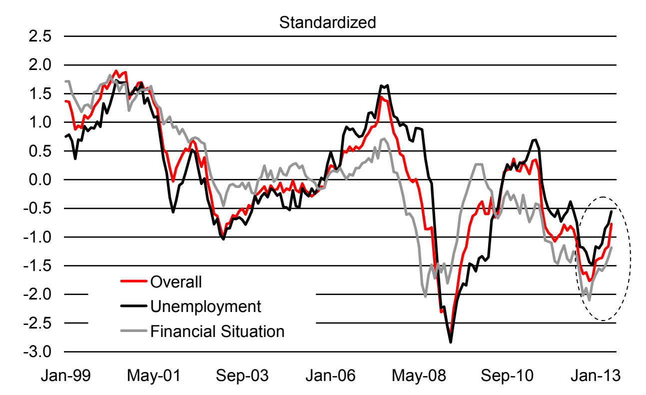
- Inflation has troughed.

EUR



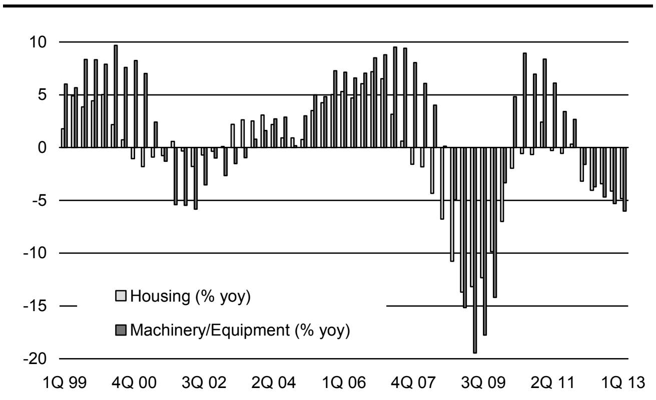
- Trade-weighted EUR holds at a comfortable level.

CONSUMER CONFIDENCE



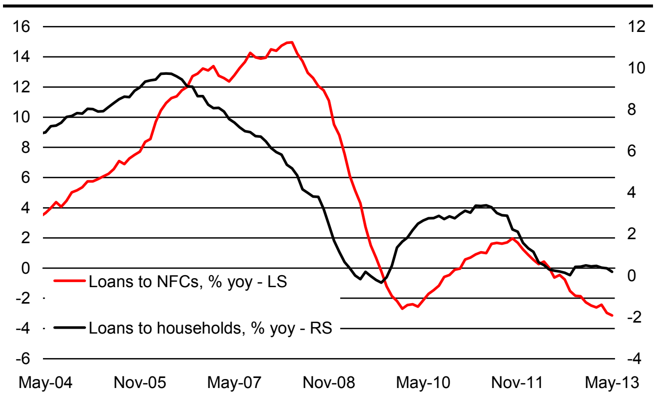
- Recovery gathers momentum.

INVESTMENT



- Weakness continues.

LENDING



- Downward trend in corporate lending is not over.

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

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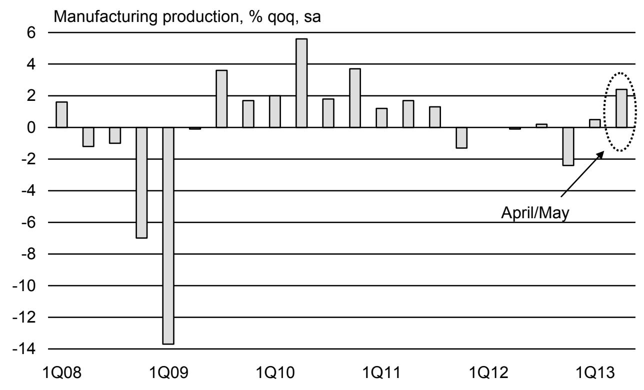
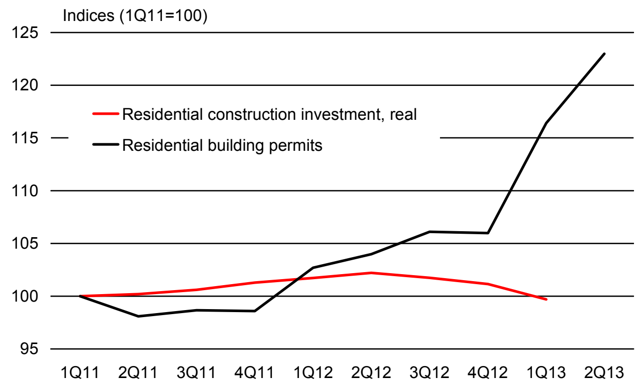
- The May round of German industrial data didn't really paint a rosy picture. The sizeable drop in production was accompanied by a surprising decline in new manufacturing orders and a strong 2.4% mom fall in exports. However, the weakness in all three data reports has to be seen as a technical correction rather than an end to the recent recovery trend. On a less volatile basis, real merchandise exports and especially manufacturing output remain above their 1Q13 averages (see left chart below), thanks to the strong performance in the preceding months.
- Moreover, construction figures reaffirmed the expected massive spring rebound. The exceptionally long and cold winter weather weighed on construction investment in the first quarter, preventing a stronger pick up in GDP growth. Construction subtracted 0.2pp from quarterly GDP growth in the first quarter. All in all, the observed jump in construction, continuously rising consumer expenditure and also the intact upward trend in manufacturing bode well for our expectation of a solid 2Q13 GDP reading of +0.6% qoq after the subdued +0.1% at the beginning of the year.
- Looking ahead, the latest PMI and Ifo survey results confirmed stable production plans in the manufacturing sector for the coming months. The recent Manufacturing PMIs in France, Italy and Spain indicated an enormous increase in confidence. At the same time, the US economy is doing comparatively well. In our view, these positive impulses should outweigh the headwind coming from China. After all, 25% of all German exports are shipped to France, Italy, Spain and the US, whereas the share of exports to China is "only" 6%.
- Although firms are still cautious with respect to new investment, the situation in the domestic economy remains robust overall. The Ifo current assessment component for the construction sector shows a level only slightly below its all-time high, driven by strong housing demand (see right chart below). In addition, sizeable real wage hikes – together with the recently more subdued, but nevertheless ongoing, upward trend in employment – indicate that private spending will remain a reliable growth pillar. The GfK consumer confidence index increased for the sixth consecutive month in June, to the highest level since summer 2007.

REBOUND IN MANUFACTURING



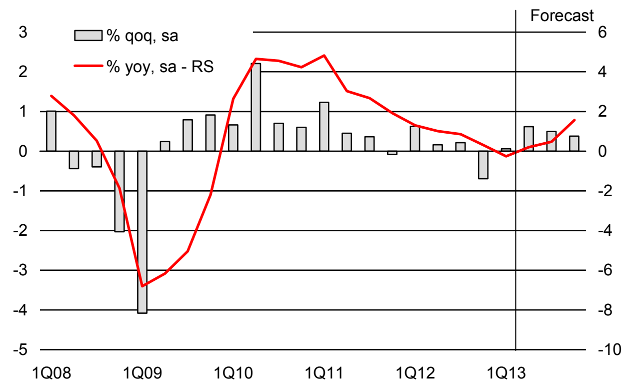
ACCELERATING HOUSING DEMAND



Source: Feri, UniCredit Research

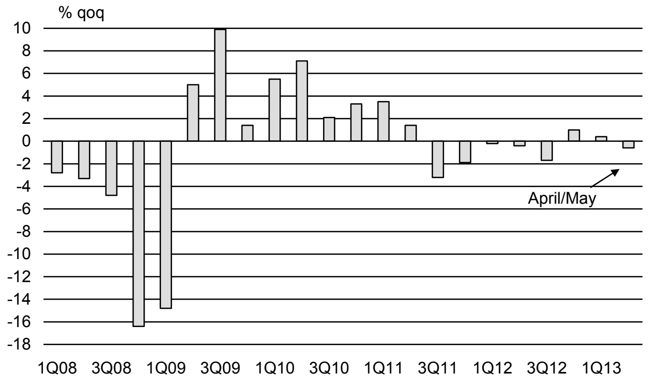
Germany

GDP



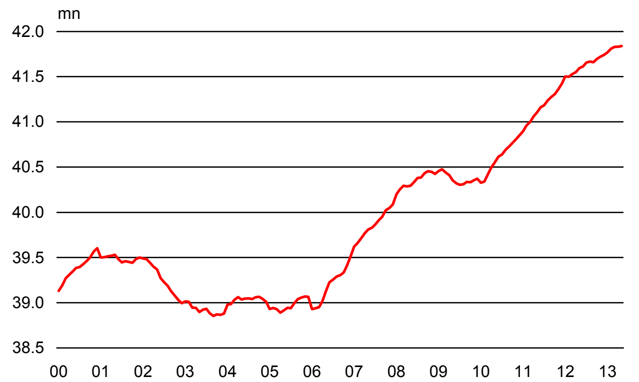
- Following the disappointing +0.1% qoq in the first quarter, we expect solid GDP growth of 0.6% for 2Q13.

NEW ORDERS



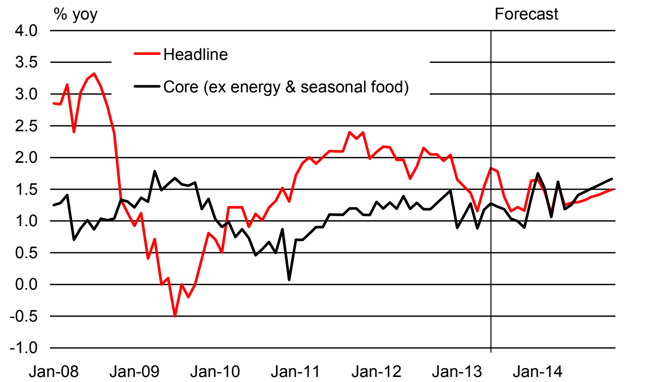
- New orders surprisingly declined again 1.3% mom in May. But, adjusted for bulk orders, orders remained on an upward trend.

EMPLOYMENT



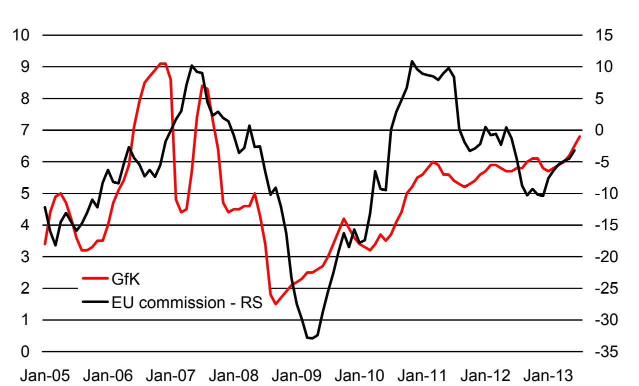
- Following still solid gains in 1Q13, employment was up only slightly in April and May.

INFLATION



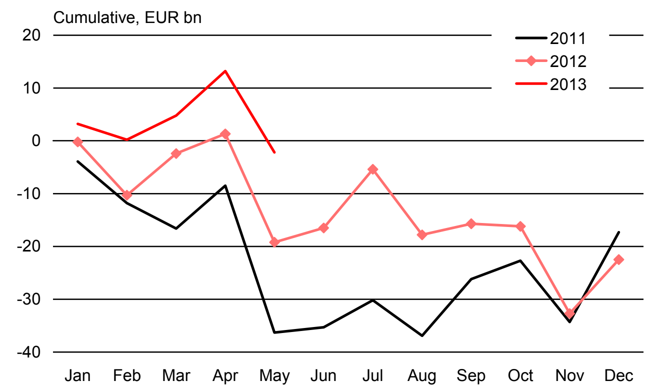
- Consumer price inflation accelerated to 1.8% yoy in June, driven by a base effect in energy prices.

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 compared to the last two years, driven by increasing tax revenues.

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

France

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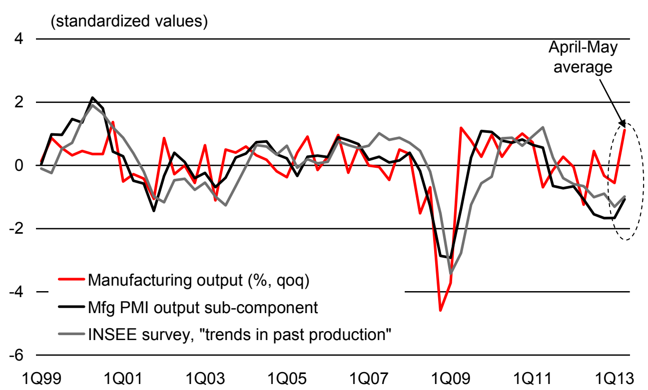
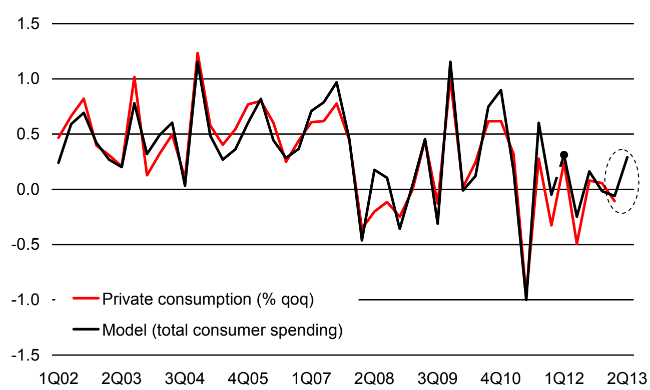
- Latest hard data for 2Q have come in on a stronger note than surveys had suggested. They indicate that momentum accelerated in the spring, following two consecutive quarters of GDP contraction. We stick to our 0.0% qoq GDP forecast, but we acknowledge that a positive number looks increasingly likely.
- Specifically, industrial production showed a stronger-than-expected resilience in May, coming in at -0.4% mom after a +2.2% mom surge in April. The April-May average thus settled 2.0% above the 1Q average. Even assuming a further sizeable correction in June, IP is likely to provide a positive contribution to 2Q GDP. Household spending on manufactured goods has also performed better than expected, hinting at a stronger performance for 2Q private consumption (ca. +0.2/0.3% qoq vs. -0.1% qoq in 1Q). These spending developments stand in stark contrast to the message coming from the INSEE consumer confidence reading, which hit a record low in June. Households reported that it was a bad time to make big purchases and prospects for future savings had significantly deteriorated. However, this discrepancy between hard data and consumer sentiment is not unusual and thus we caution about reading too much into it.
- Abstracting from temporary factors that may have supported GDP in 2Q, underling economic conditions, albeit gradually strengthening, remain soft. Encouragingly, the manufacturing PMI, which eventually caught up with the INSEE and BdF surveys, suggests that the industrial sector's prospects are steadily improving, although at a slow pace and from low levels. However, with services activity still lagging behind – the INSEE services confidence showed no improvement in June, while the services PMI improved markedly, although from low levels – the upside potential to GDP is likely to remain moderate in the near term. Our baseline scenario foresees a gradual recovery in economic activity in 2H13, with GDP momentum accelerating more firmly in 2014.
- On July 12, Fitch downgraded France from AAA to AA+, thereby aligning itself with S&P and Moody's, who both revised their AAA ratings last year. Fitch kept a stable outlook, while the two US rating firms have a negative outlook. Fitch stated that the rating move was mainly driven by expectations that the debt/GDP ratio will peak at a higher level (94% of GDP in 2014) than that envisaged at the time of the revision of the outlook to negative in December 2011, and it will also decline more gradually over the medium term (to 92% in 2017). Considerations about the growth outlook also weighed on the agency's assessment, reflecting a weakening of growth prospects since the last rating review. We don't expect that the rating action will have any impact on the sovereign bond market as France's loss of the triple-A rating had already been fully priced in.

STRONG IP PERFORMANCE IN 2Q



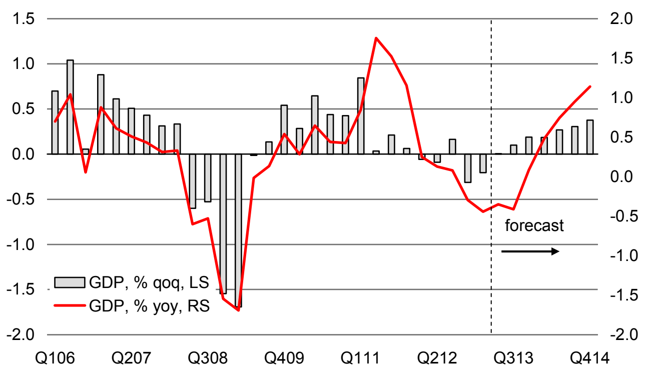
PRIVATE CONSUMPTION MOST LIKELY REBOUNDED IN 2Q



Source: INSEE, Markit, UniCredit Research

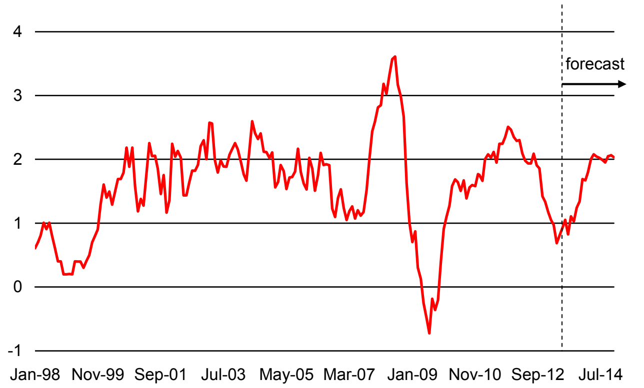
France

GDP



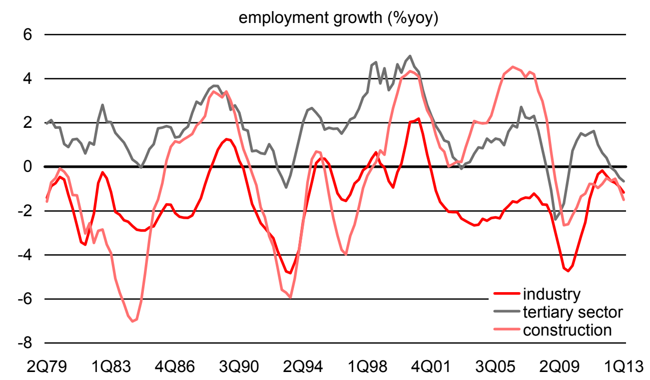
- We see annual GDP settling at -0.3% in 2013 and +0.8% in 2014.

INFLATION



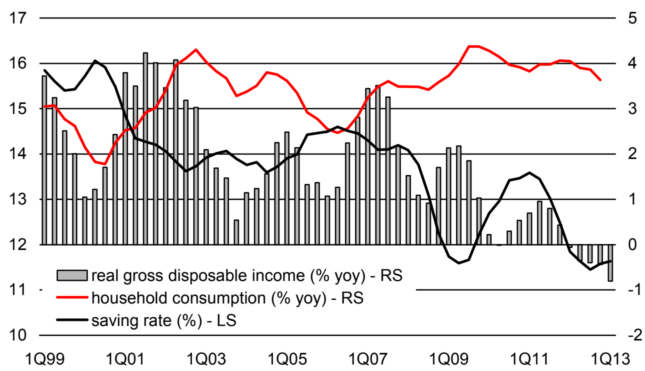
- CPI edged up 0.1pp to 0.9% in June. We currently estimate inflation averaging 1.0% in 2013.

EMPLOYMENT



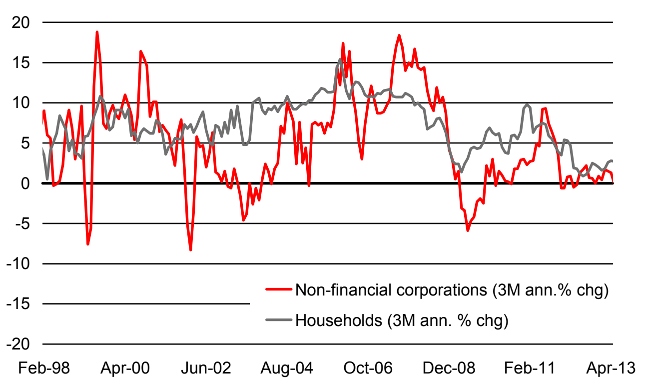
- The recent intensification of job shedding has weighed on the services sector.

REAL DISPOSABLE INCOME



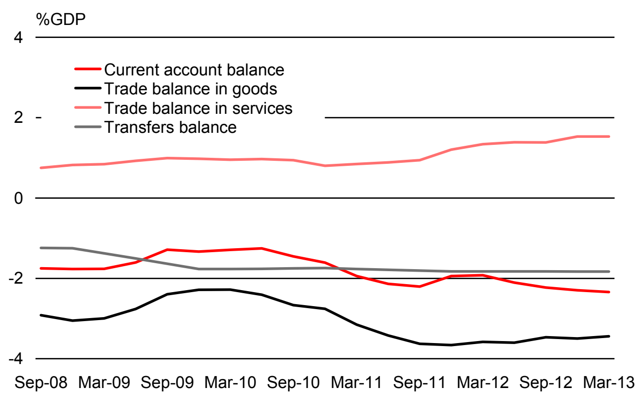
- The contraction in real disposable income since early 2012 is unprecedented, as is the behavior of the savings rate.

LENDING TO THE PRIVATE SECTOR



- Lending growth to the private sector, especially households, has regained some traction from March.

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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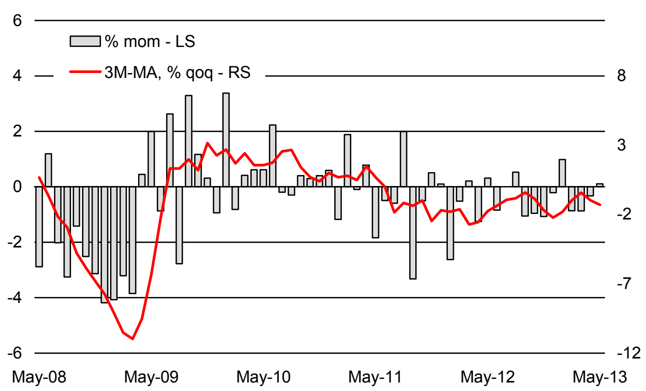
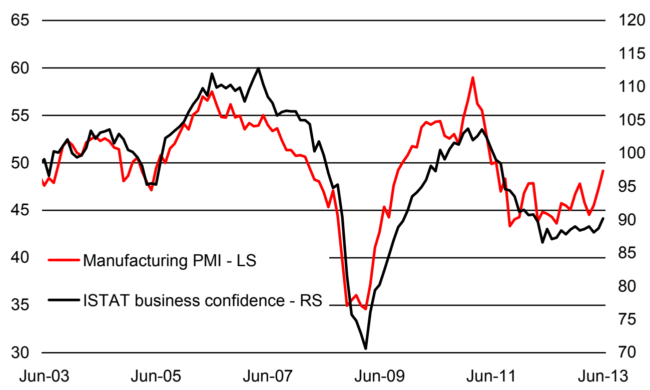
- Hard indicators for 2Q13 to date remain consistent with our expectations of a moderation in the pace of GDP contraction in 2Q: our forecast of -0.4% qoq (vs. -0.6% qoq in 1Q) remains on track, with balanced risks. Industrial production showed a marginal increase in May, the first plus after three significant declines, but in April-May IP still points to a deeper pace of recession compared to 1Q (-1.3% qoq vs. -0.4%). While we see IP moderately expanding in June, this would not change the overall picture. On the other hand, other hard data support our view of a less negative outcome in 2Q: seasonally adjusted car registrations showed a good recovery during the quarter, while construction output posted a good rebound in April (+5.5% mom) that bodes well for a smaller GDP drag from construction investment compared to 1Q13 (when it was -0.3pp).
- Business surveys continue to move in the right direction. The upward trend in the manufacturing PMI proved to be well entrenched, following three consecutive increases that left the April-June average above that of 1Q (47.3 vs. 46.1). More importantly, business surveys clearly indicate an easing in the pace of decline of domestic orders. The services PMI recently provided more mixed signals, but the trend is now also heading north (see chart on the next page). The visible improvement in soft indicators seems to support our view of a stabilization in economic activity in 3Q.
- On the labor market front, the unemployment rate hit another all-time high in May, to 12.2% vs. 12.0%. While part of this increase was the result of a new drop in the number of inactive people (-35k or -0.2% mom), employment again contracted significantly (-27k vs. -25k, on average, in January-May). With fiscal tightening gradually slowing and inflation subdued, the evolution of employment currently remains the main concern for the outlook for private consumption.
- On 9 July, S&P downgraded Italy by one notch to BBB (outlook negative) in the wake of weakening economic prospects as well as the increasing risk of fiscal slippage for this year. S&P's rating action seems to us oddly timed[1] and, unsurprisingly, its market impact was short lived. Still, after this latest rating action, Italy's rating is now just two notches above non-investment grade at both Moody's and S&P – and both with negative outlook (Fitch rates Italy BBB+ with negative outlook). This leaves Italy in a less comfortable situation going forward, and ratings will deserve monitoring from here.

IP SUGGESTS A DEEPER INDUSTRIAL RECESSION IN 2Q…



…BUT BUSINESS SURVEYS NOW POINT NORTH

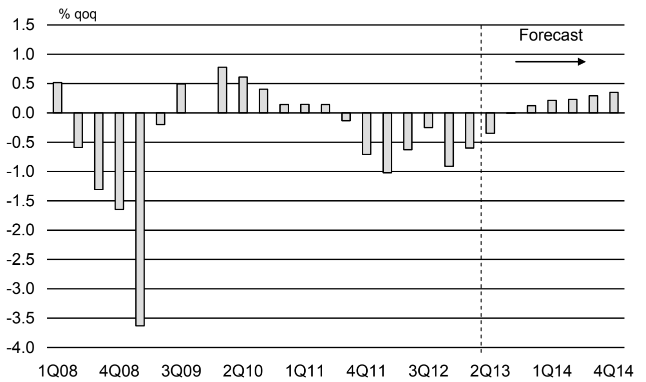


Source: ISTAT, Markit, UniCredit Research

[1] For a detailed discussion, see *"S&P cut Italy's rating to BBB – A Macro View"*, Economic Flash, 10 July 2013

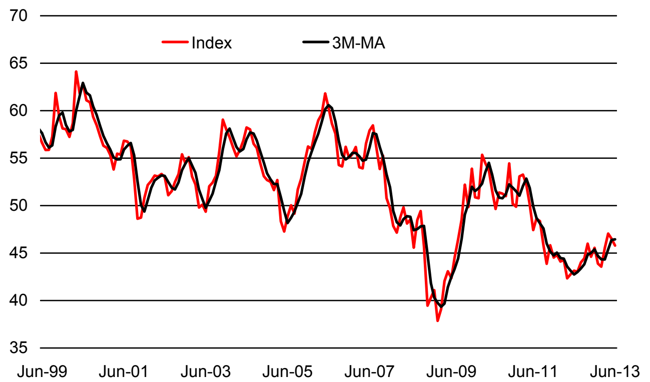
Italy

GDP



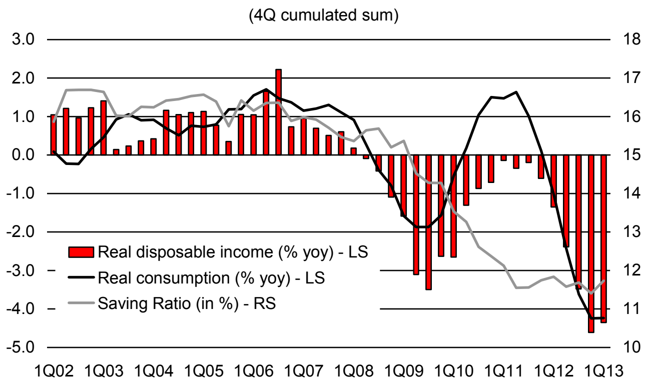
- GDP is expected to have fallen by 0.4% in 2Q13 and so far the risks to our expectation seem to be broadly balanced.

SERVICES PMI



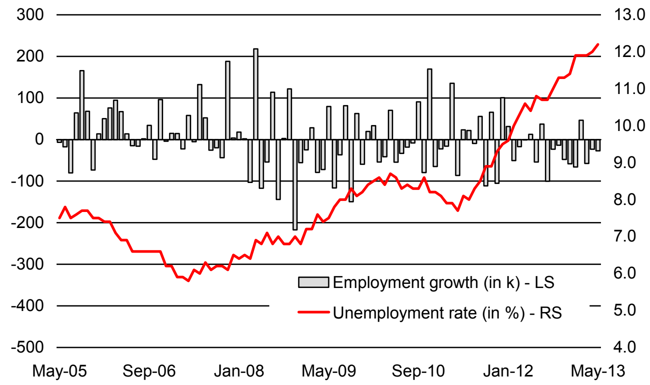
- The services PMI has shown a partial downward correction over the last two months, but it is clearly above its 1Q13 average (46.4 vs. 44.3).

HOUSEHOLDS: INCOME AND SAVINGS



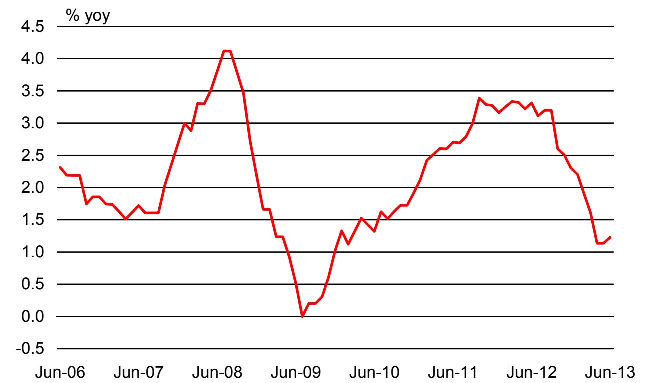
- The household saving rate rose to 11.7% in 1Q13 (vs. 11.4%), indicating that it has probably found its floor.

LABOR MARKET



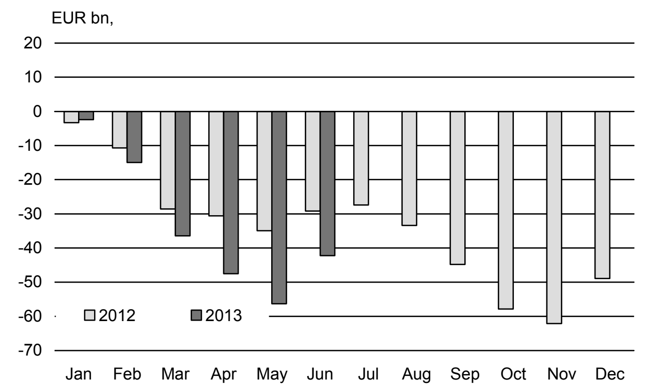
- The jobless rate rose from 12.0% to 12.2% in May.

INFLATION



- In June, inflation was up to 1.2% yoy vs. 1.1%. After the delay in the VAT hike, we have lowered our 2013 forecast to 1.5% (vs. 1.7%).

STATE SECTOR BORROWING REQUIREMENT



- The state sector's budget balance was EUR 14.1bn in June vs. EUR 5.7bn in June 2012, reducing the potential slippage in the first six months of 2013 to EUR 13bn.

Source: ISTAT, Bank of Italy, UniCredit Research

Spain

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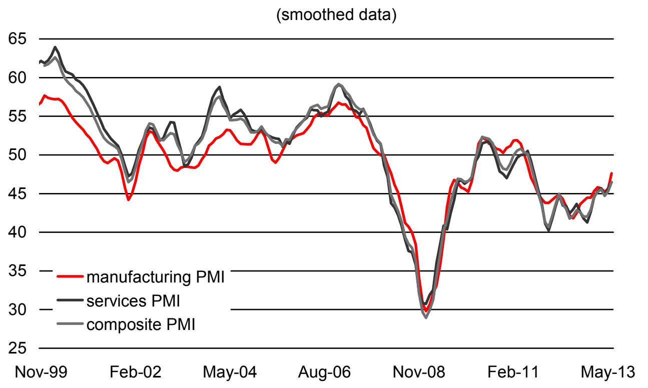
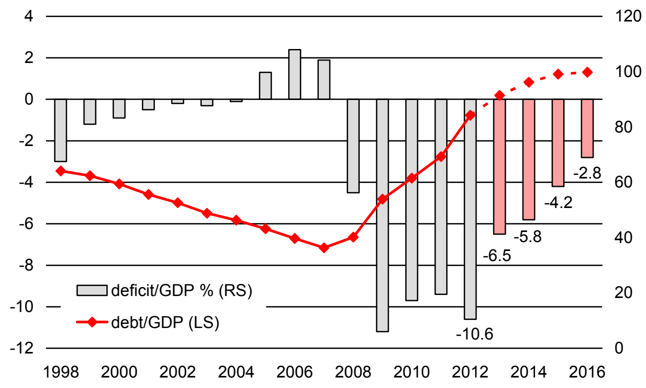
- Latest business surveys and hard data suggest that the pace of recession has further eased in the second quarter. The composite PMI rose by an additional full point to 48.1 in June, largely driven by a sizeable improvement in the manufacturing index (up from 48.1 to 50.0, the highest level since April 2011). The services PMI, albeit lagging behind, also moderately strengthened (from 47.3 to 47.8). As regards hard data, retail sales were up firmly, with the April-May average settling 0.5% above the 1Q average. Exports also accelerated significantly in April (latest available data), although this seems to have not much spilled over to industrial production data up to May (which showed a broad stabilization around the 1Q level). Overall, we stick to our -0.3% qoq GDP forecast for 2Q and continue to expect that Spain will exit recession at the end of the year.
- On the fiscal front, in May the central government deficit (on a national account basis) settled at 3.2% of GDP. This compares with a deficit of 3.4% for the same period one year ago (full-year 2012: 3.8%), suggesting that the 3.8% deficit target for 2013 remains within reach. The 3.8% deficit target for the central government is consistent with a 6.5% deficit target for the broader general government. The 2013 deficit target for the autonomous communities (AC) was set at 1.3%, although the AC that embarked on a sizeable fiscal consolidation in 2012 are negotiating a slightly looser fiscal target with the central government.
- Concerning the ongoing banking sector restructuring, market attention has recently shifted from bank exposure to real estate developers, which has been adequately provisioned last year, to the quality of non-real estate related loan portfolios. To help mitigate any concern, the Bank of Spain has recently issued new criteria for determining the classification of refinanced and restructured loans, which are mostly non-real estate related. The results of this reclassification are expected to be known by September. According to private sector estimates, the negative impact on banks via further provisioning is however likely to be manageable (EUR 10-20bn, i.e. 1-2% of GDP). Moreover, should further provisions translate into fresh capital needs, Spain could still tap the remaining EUR 60bn of the pledged EU funds. In the meantime, banks are negotiating with Madrid to be allowed to reclassify deferred tax assets into tax credits, as the latter count as capital under Basel III. This would certainly help ease pressure on banks at a time when capital remains difficult to raise.

PMIS CONTINUE TO IMPROVE GRADUALLY



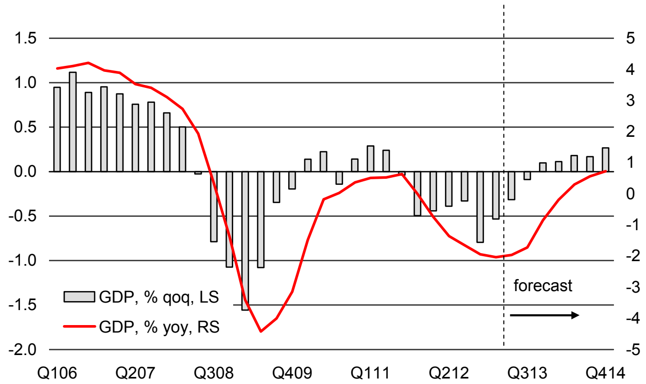
THE EU ALLOWS A SLOWER PACE OF DEFICIT REDUCTION



Source: Markit, EC, UniCredit Research

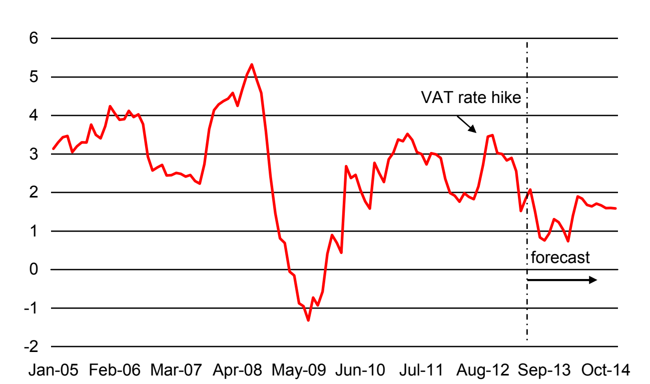
Spain

GDP



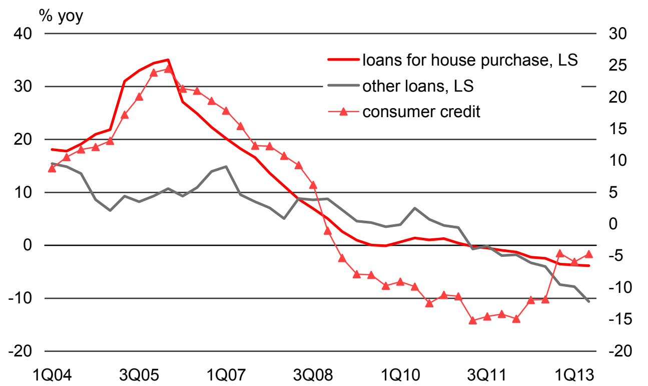
- The pace of recession eased further in 1Q13 and we expect GDP to return to positive territory by the end of the year.

INFLATION



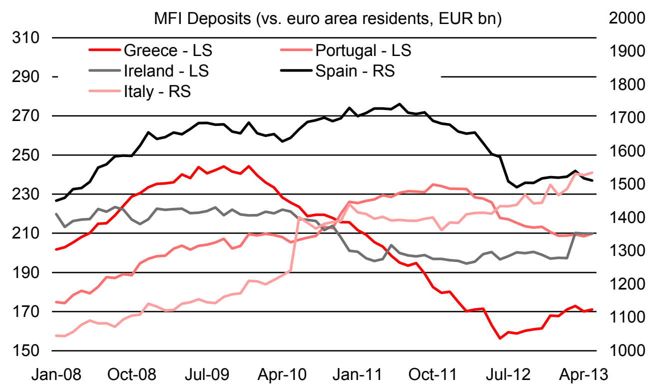
- We see inflation settling at 1.7% in 2013 and 1.5% in 2014.

HOUSEHOLD CREDIT GROWTH



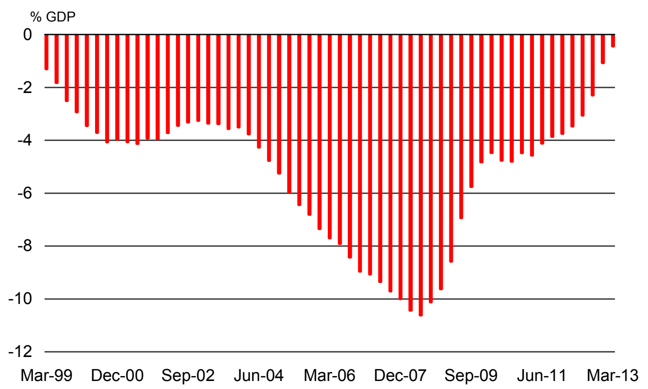
- The contraction in lending to households deepened further in 2Q13 (latest available data is May).

BANK DEPOSITS



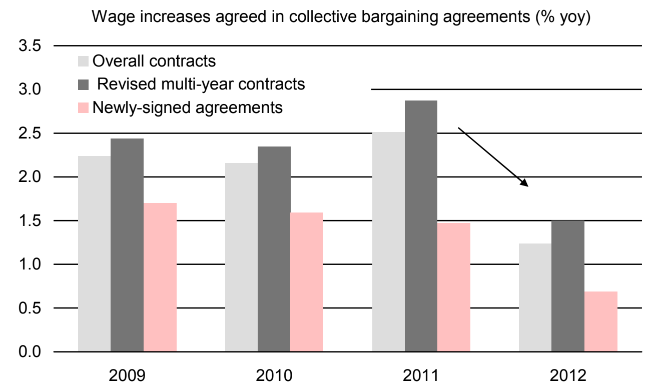
- The decline in deposits came to a halt in August 2012 and we have since been witnessing a moderate increase.

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

Austria

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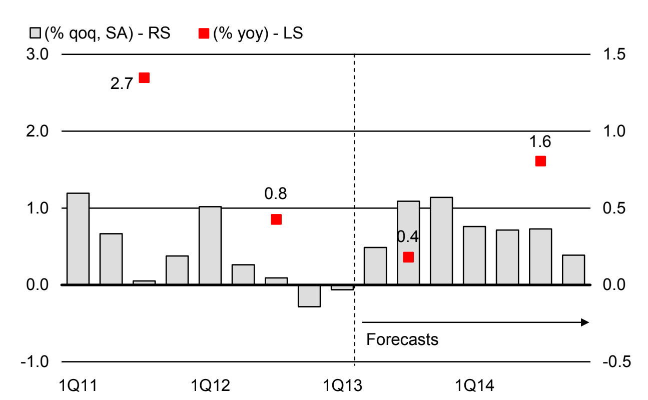
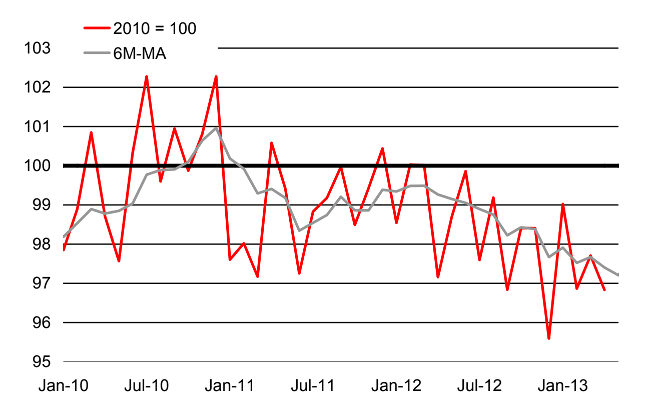
- GDP growth for 2012 increased slightly to 0.9%, and Austria's economy grew by 0.0% in 1Q13. For the second quarter, we continue to expect growth of 0.2%, supported by slight improvements in industrial output and exports in April. However, trends in retail sales suggest continued weakness, which means that there is some downside risk to our expectations for 2Q.
- Industrial output rose by 0.8% month-on-month in April after a 1% decline in March; output was also slightly higher, by 0.4%, than a year earlier. The trend of very low output growth thus continued in April, indicating that industrial activity is at near-stagnation levels. This situation is confirmed by the Bank Austria Purchasing Managers' Index, which has been moving just below the growth threshold since December 2012. In June, it rose marginally to 48.3 (May: 48.2).
- Over the past few months, exports have been recovering from the dip seen at the turn of the year, although global trends are weak. April saw year-on-year growth in exports after a decline during the previous three months. Exports are now showing a clear upward trend. Estimates of new orders, as reflected in the Bank Austria Purchasing Managers' Index, have been moving above the growth threshold since May. Although, the indicator of new export orders declined to a level of just under 50 in June.
- Austria's labor market remains robust as far as employment is concerned. Employment continued to grow in June at a low rate of 0.6% year-on-year. Unemployment also rose, though more slowly; while the unemployment rate based on the EU definition declined slightly and remained at the lowest level in the euro area.

GDP STILL STAGNATING IN 1Q13



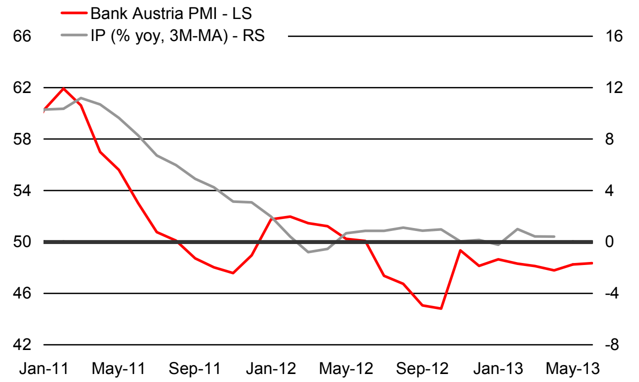
RETAIL SALES CONTINUE DOWNWARD TREND IN 2Q13



Source: Statistik Austria, UniCredit Research

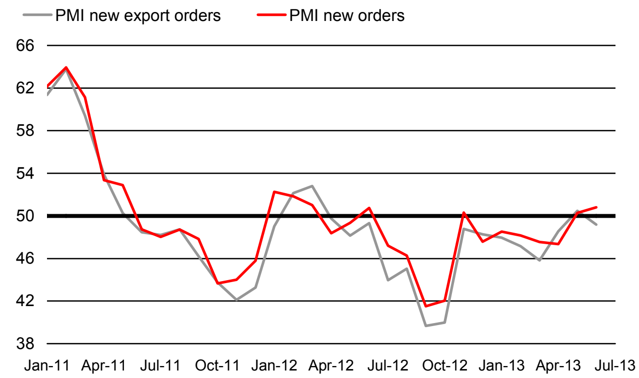
Austria

INDUSTRIAL OUTPUT AND PMI



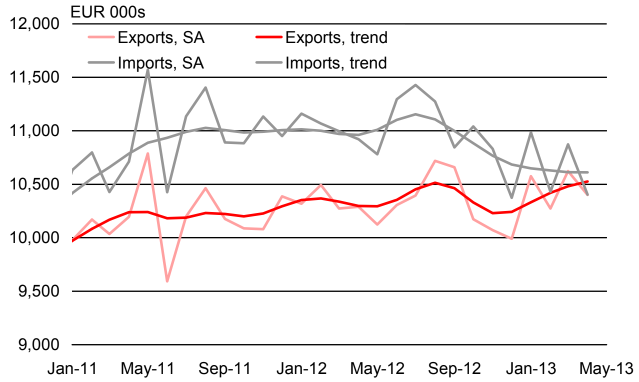
- The PMI continued to rise in June but is still below 50. Industrial output has been stagnating.

PMI NEW ORDERS



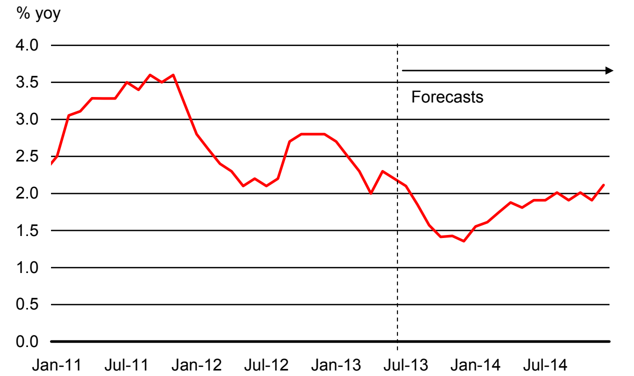
- Austrian industry posted more new orders in June. Although, orders from abroad fell back to a level below 50.

EXPORT AND IMPORT VOLUME



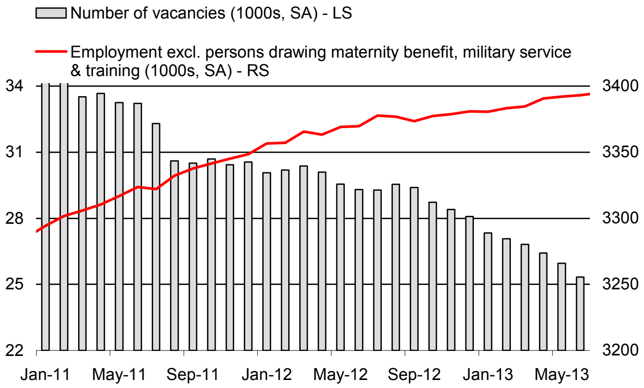
- Austrian exports, although slightly decreasing in April compared to March, continue their upward trend.

INFLATION



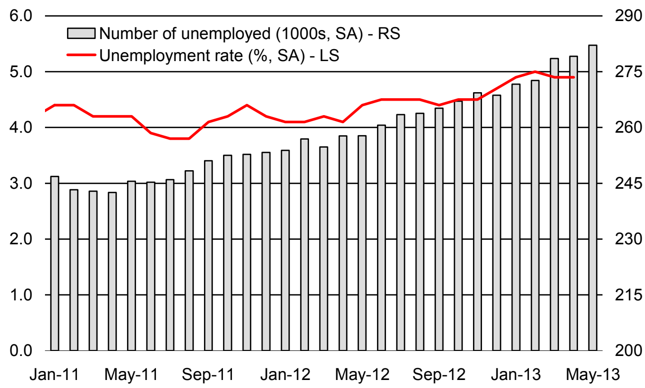
- Annual inflation slightly declined in June, to 2.2%, due to a slowdown in still high food inflation.

EMPLOYMENT



- In June, the number of vacancies decreased for the tenth consecutive month while growth in employment slowed.

UNEMPLOYMENT



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

Source: Statistik Austria, UniCredit Research

Greece

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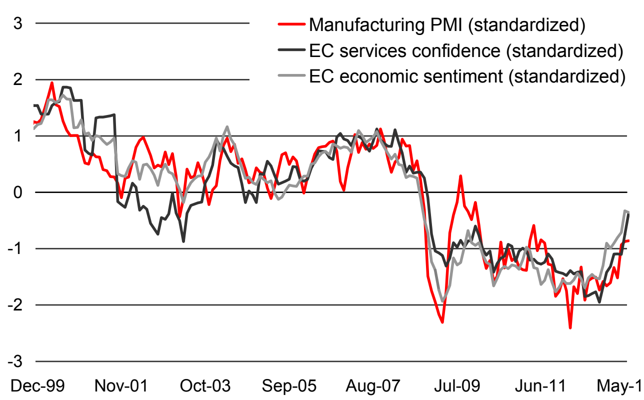
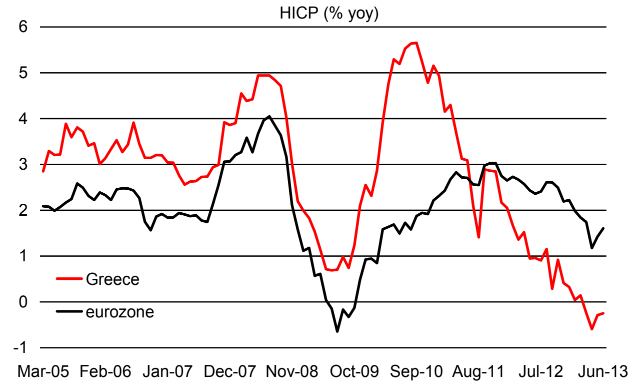
- On July 8, the Eurogroup gave the green light to the disbursement of the next EUR 6.8bn loan tranche to Greece. This will include EUR 3bn from the EFSF, EUR 2bn from SMP income accruing to national central banks and EUR 1.8bn from the IMF. However, eurozone finance ministers decided to disburse the tranche in two installments, with the payments being conditional upon implementation of the agreed upon prior actions – this would ensure that the Greek government remains under pressure to deliver on its reform pledges. The first sub-tranche (worth EUR 5.8bn) is expected to be released by the end of July following the parliamentary approval of a multi-purpose bill addressing a large number of reforms, including an overhaul of the tax system and a streamlining of the public sector. As we write, the bill has already been sent to Parliament and may be voted on the next few days. We expect it to be passed, given that the ND/PASOK coalition government retains an absolute parliamentary majority following the recent defection of DIMAR, the junior coalition party. The second tranche (worth EUR1bn) is to be disbursed in October.
- The agreed on disbursement schedule implies that discussions between the IMF and the EU on how to eliminate the projected 2014 financial gap will intensify towards year-end, with a decision most likely to be delivered by December, at the latest. Incidentally, Eurogroup President Dijsselbloem recently stated that "if there is a financing gap, it will be at the end of 2014", suggesting that he expects the IMF to continue to see the program as fully financed until the end of 2013. We recall that the IMF's policy is that any program needs to be fully financed for the next 12 months to give the green light to a tranche disbursement.
- On the economic front, there are encouraging signs that the easing of the pace of recession keeps unfolding, although at a gradual pace. In particular, the European Commission economic sentiment indicator (ESI) has been rising steadily up to June. This trend of improvement has so far been mainly driven by services – tourism is expected to make a positive contribution to 2Q GDP – but sentiment in manufacturing is also catching up. In addition, CPI inflation has turned negative since March (it currently stands at -0.6%), suggesting that the policy of internal devaluation is beginning to bear fruit and the labor cost reduction is being transferred to prices, albeit at a slower price. This is expected to support real disposable income over the near to medium term.

SENTIMENT HAS BEEN STEADILY IMPROVING



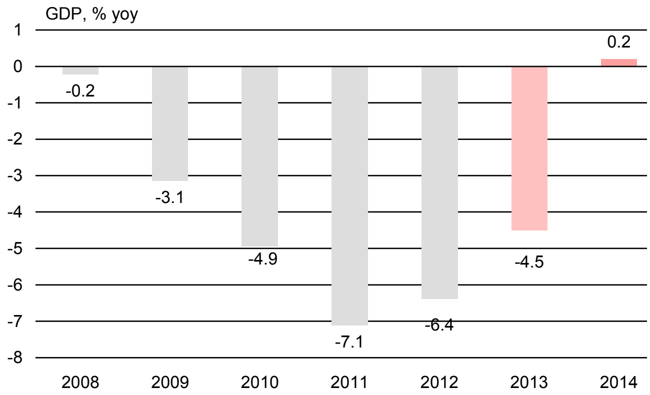
CONSUMER INFLATION HAS FALLEN SUBSTANTIALLY



Source: Markit, EC, Elstat, UniCredit Research

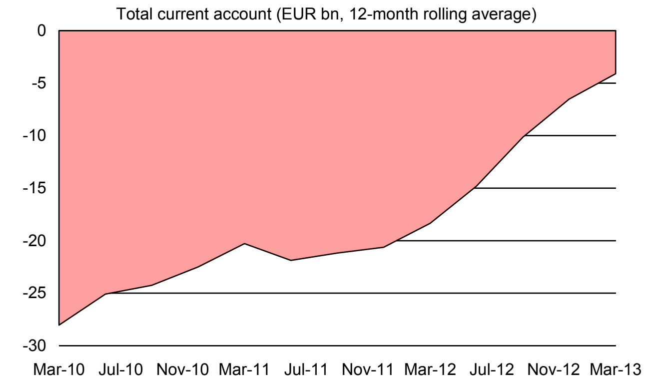
Greece

GDP



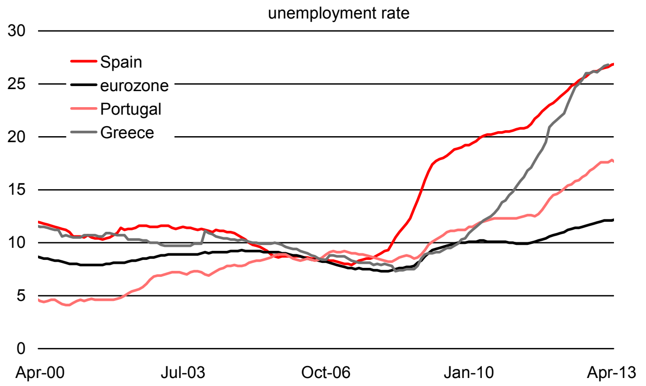
- Greece may exit recession next year.

CURRENT ACCOUNT



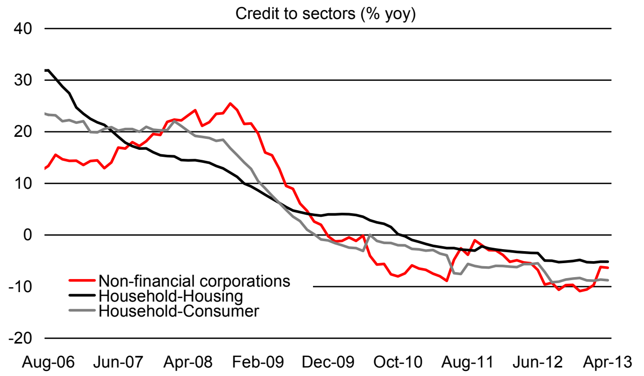
- The current account has been shrinking steadily, settling at nearly EUR 4bn in April.

UNEMPLOYMENT



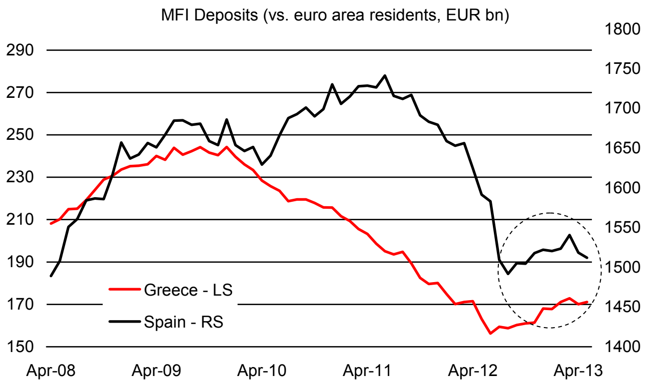
- The unemployment rate is skyrocketing, having reached 26.8% in March (latest available data).

CREDIT GROWTH



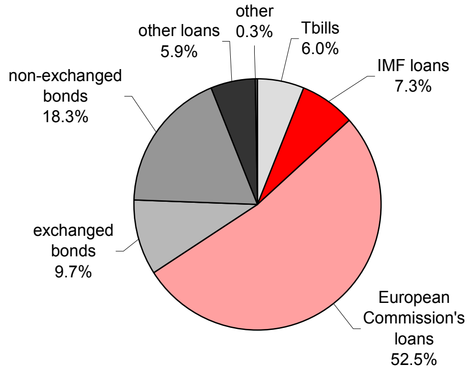
- The pace of contraction in credit for NFCs eased significantly since the beginning of the year.

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, Eurostat, ECB, Central Bank of Greece, UniCredit Research

Portugal

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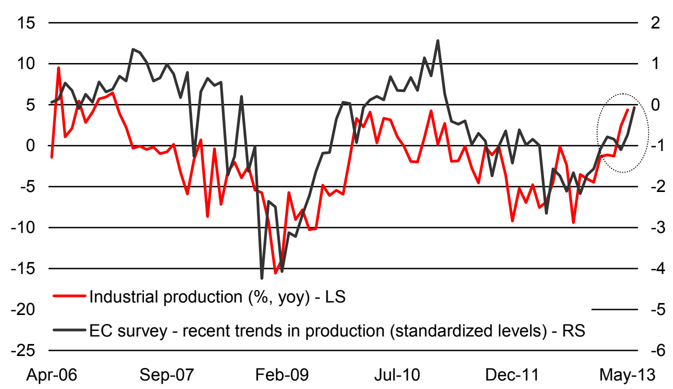
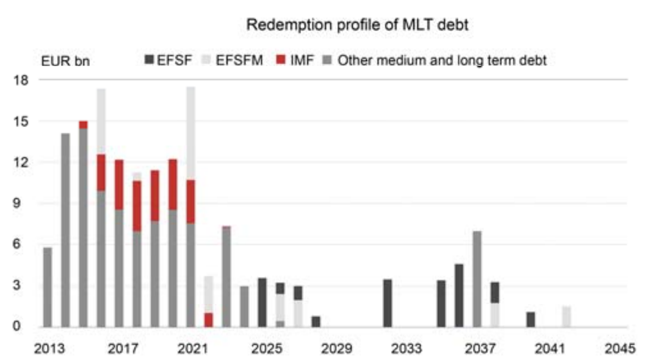
- The political crisis remains center stage in Lisbon. At the time of writing, the two government coalition parties, PSD and CDS-PP, and the main opposition party, PS, have set 21 July as the deadline for reaching agreement on a "national salvation" cross-party pact, as requested by the president on 10 July. The president himself recently urged the parties to finalize an agreement "in a very short period of time" to avoid any further escalation of market pressure on Portuguese government bonds (10Y PGB yield rose to nearly 8% the day the president intervened and called for a quick conclusions of talks).
- Which are the main implications of the latest political crisis for the successful completion of the aid program? While the prospects of Portugal regaining full market access at the end of the program were already low before the current political tensions emerged, we think that the recent credit-spread increase makes it very unlikely that Portugal will be able to tap markets on a regular basis next year. Portugal will probably be compelled to ask for additional financial support before the current program expires (mid-2014). This will most likely happen regardless of whether in the near term a tripartite deal is struck among the main political parties or the PSD/CDS-PP coalition continues to govern (perhaps after a government reshuffle). Of course, the latest political developments may cause some delays in the implementation of the program. However, assuming these delays remain contained (which we deem likely), they would most likely impact only the size of any new aid program Portugal will have to request.
- As regards the new program, we think that Portugal will be offered an enhanced conditions credit line, i.e. ECCL, rather than a second full program, as the latter could be interpreted as an outright failure by the Portuguese authorities to address the country's economic imbalances. An ECCL facility – which has an initial duration of one year and is renewable twice, for six months each time, while its size is capped at 2-10% of the recipient country's GDP – appears to be the most appropriate form of aid for accompanying Portugal towards the "exit". In terms of funding, a 12-month ECCL might help cover the country's 2014 financing needs and possibly some of its 2015 needs (depending on how public finances develop). In our calculations, the (uncovered) financing needs of the country amount to around EUR 13bn in 2014 and EUR 18.5bn in 2015.

STRONG IP PERFORMANCE IN 2Q



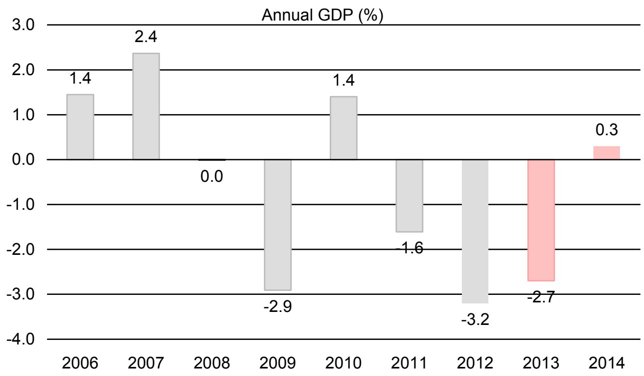
EXIT FROM THE PROGRAM LOOKS CHALLENGING



Source: INE, EC, IGCP, UniCredit Research

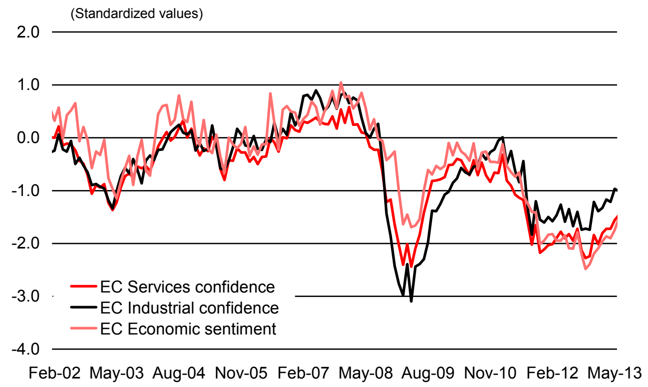
Portugal

GDP



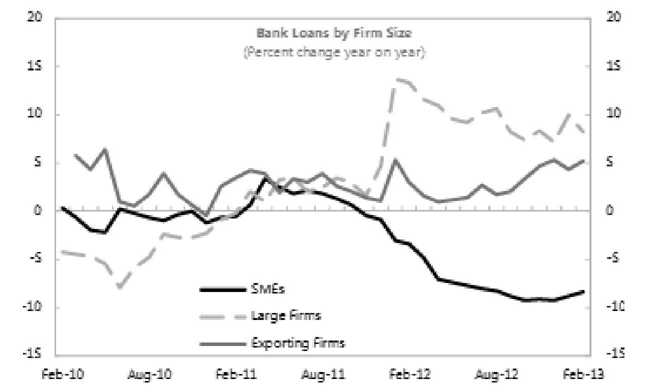
- We expect GDP to contract by 2.7% in 2013 and return to positive growth in 2014 (at an average annual rate of +0.3%).

SURVEYS



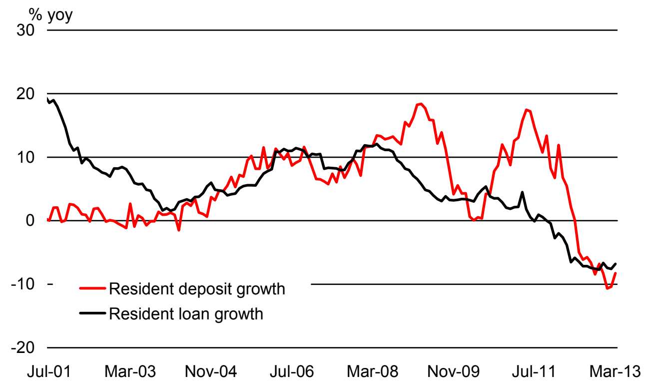
- Sentiment has been improving steadily, especially in the industrial sector.

BANK LOANS BY FIRM SIZE



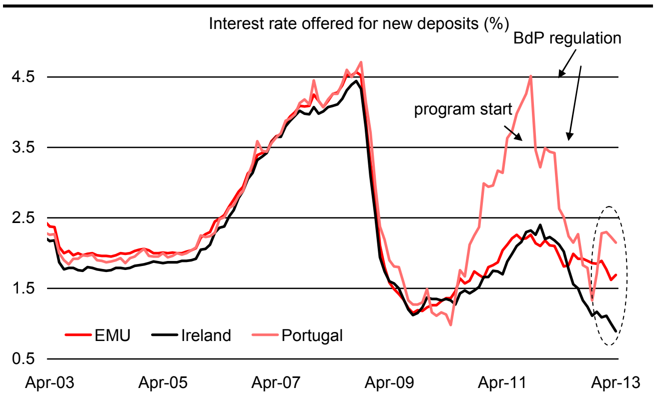
- Credit to SMEs remains subdued.

DEPOSIT AND LOAN GROWTH



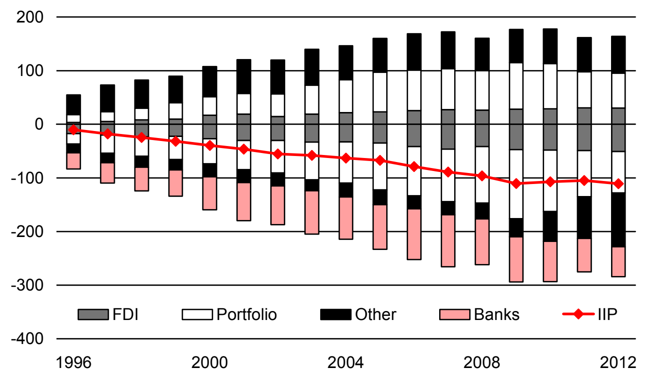
- Deposit growth continues to slow…

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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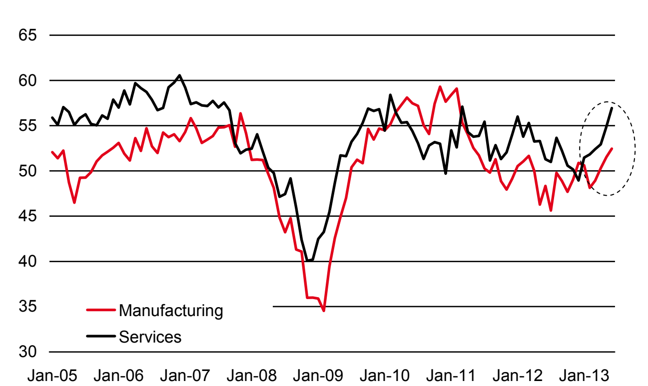
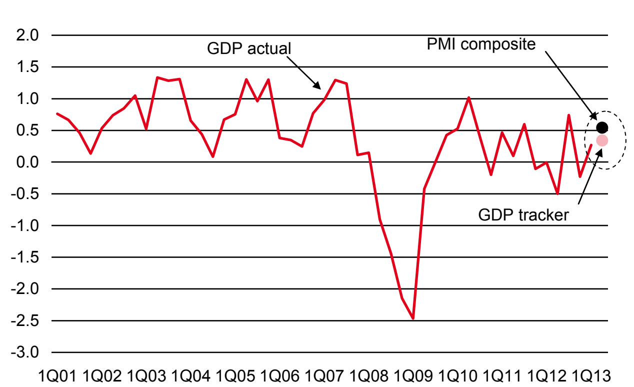
- On balance, data over the past month continued to be positive. The PMIs improved further in June, providing further confirmation of the economic recovery. The manufacturing index rose from 51.5 to 52.5 in June and the services index was up from 54.9 to 56.9 (see left chart), the fifth and sixth consecutive increases, respectively. Our composite PMI points to 0.5% GDP growth in 2Q, suggesting upside risks to our forecast (0.2% qoq). Looking at hard data, IP was unchanged in May and revisions show a somewhat weaker path in recent months, while the Index of Services rose 0.2% in April. May retail sales came in strong (+2.1% mom). Our GDP tracker, based on hard data, is now consistent with 0.3% qoq GDP, only slightly above our forecast. Looking forward, we stick to our view of modest GDP growth in the remainder of the year followed by a gradual acceleration in 2014.
- Inflation accelerated from 2.7% to 2.9% in June, mainly driven by base effects on fuel and clothing. In the second part of the year, inflation is likely to gradually slow, although still remaining above target due to the persistent upward contribution from administered and regulated prices.
- Mark Carney took over as the new governor of the Bank of England. At its first MPC meeting on 4 July, the BoE remained on hold on both Bank Rate and asset purchases, but issued a statement highlighting the BoE's concerns about the recent increase in market interest rates induced by the Fed's indications of its plans to gradually reduce its purchases of bonds, and paving the way for a possible announcement of forward guidance at the August meeting. The minutes of the July meeting showed that the MPC voted unanimously to keep the stock of asset purchases unchanged at GBP 375bn, after a 6-3 vote split which persisted for five months. It is important to stress that the new vote split does not represent a hawkish turn of the MPC. Members remain divided between a majority that does not believe more stimulus is warranted and a minority that believes more stimulus is needed. The latter voted against QE this month simply to wait for the conclusion of the ongoing debate on the forward guidance next month. The minutes provided further hints that an agreement on a formal forward guidance might be close. We expect an announcement on this in August.

FURTHER IMPROVEMENT IN THE PMIS IN JUNE



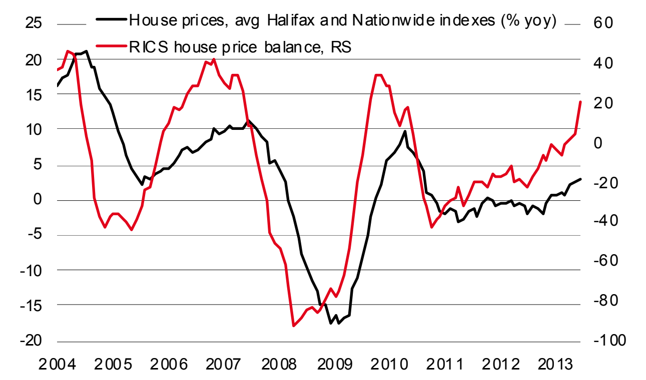
SOME UPSIDE RISKS TO OUR GDP FORECAST



Source: Office for National Statistics, Markit, UniCredit Research

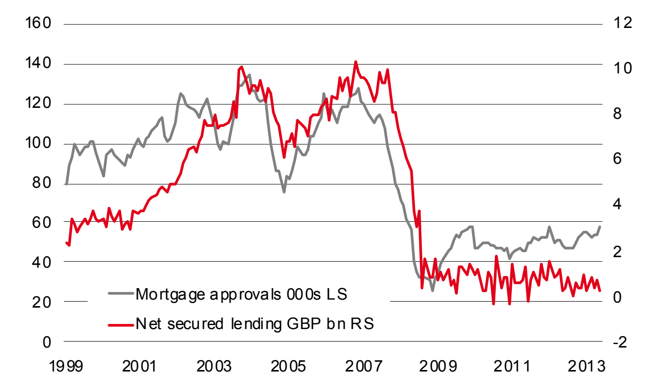
UK

HOUSE PRICES



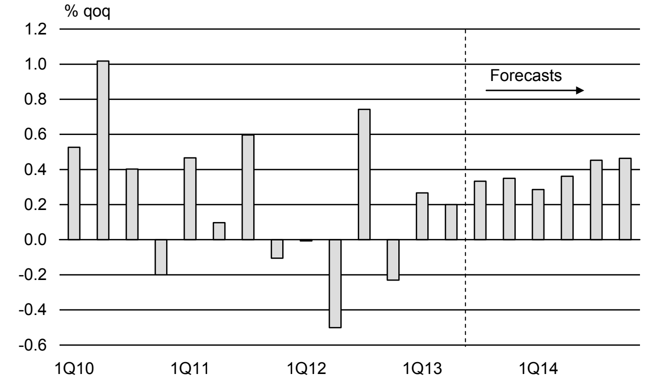
■ The forward-looking indicator RICS house prices balance climbed to its highest level since January 2010.

HOUSING MARKET



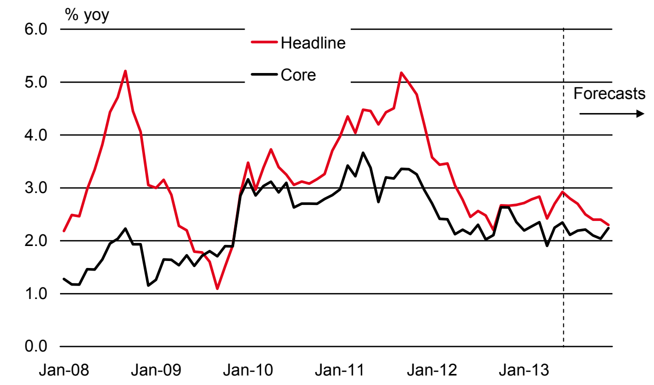
■ There has been an uptick in mortgage approvals recently, but housing market activity remains low compared to the pre-crisis period.

GDP



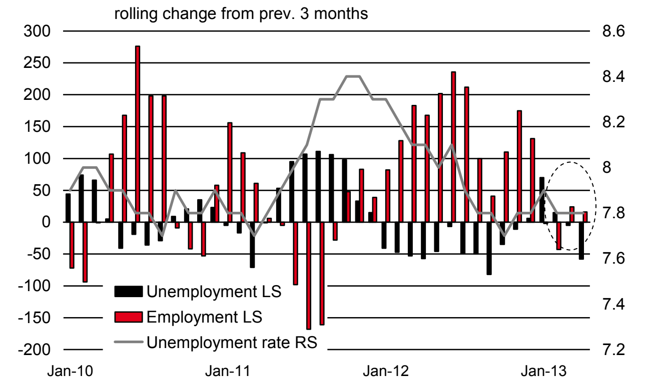
■ We expect modest GDP growth in the remainder of 2013, followed by a gradual acceleration in 2014.

INFLATION



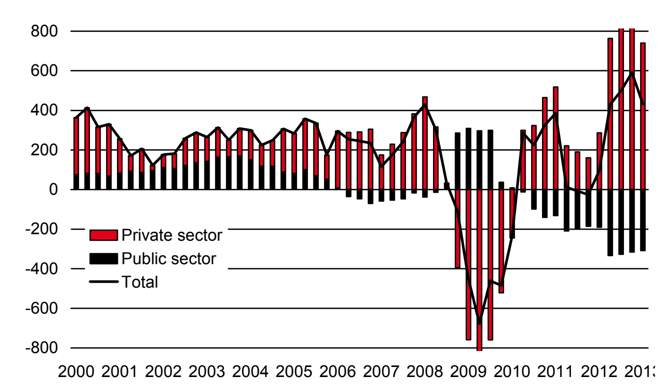
■ Inflation accelerated from 2.7% to 2.9% in June, mainly driven by base effects on fuel and clothing.

LABOR MARKET



■ The labor market remains relatively resilient.

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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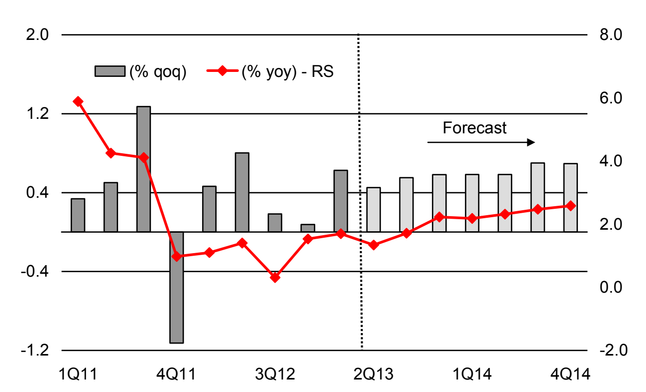
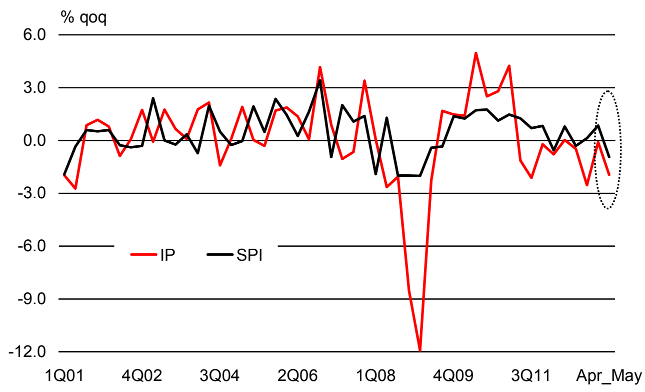
- Data over the past month were mixed. IP fell 2.6% mom in May, more than expected, following an already significant contraction in April. The average for the first two months of 2Q is down a sharp 2.0% compared to 1Q. Service production did better, rising 1.4% mom, but the average for April and May is now 0.9% below the average in 1Q. In light of these data, we see significant downside risk to our forecast of 0.5% qoq GDP growth in 2Q. On a more positive note, business surveys improved in June, suggesting that a gradual but slow recovery in manufacturing and service production is likely in the coming months. The economic tendency indicator (ETI) gained 2.7 points, rising from 91.8 to 94.5, while the manufacturing PMI strengthened from 51.9 to 53.5. In addition, consumer confidence improved further, and the unemployment rate fell below 8% for the first time in a year.
- In June, CPIF inflation, which excludes mortgage interest costs, accelerated from 0.7% yoy to 0.9% yoy, while CPI inflation remained negative, settling at -0.1% yoy, slightly higher than the -0.2% recorded in May. 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 negative during the summer and resume an accelerating trend during 4Q13. CPI and CPIF inflation are both unlikely to reach the 2% target before the end of 2014.
- At its meeting in early July, the Riksbank held its main interest rate steady at 1.00% as expected. With respect to the previous meeting in April, there was no big news on the expected interest rate path and on the GDP and inflation forecasts. Gradual increases in the repo rate are expected to begin during the second half of 2014, as assessed in April. However, the rhetoric seemed less dovish this time as the Riksbank stated that “the repo rate needs to remain at the current low level for around one year to support the economy and to contribute to inflation rising towards the target”, while in April it gave a less defined time horizon: “the repo rate needs to remain at a low level for a longer period of time to support the recovery to ensure that inflation rises towards the target”. The Riksbank now expects GDP growth of 1.5% in 2013 (vs. April’s 1.4%) and 2.8% in 2014 (vs. April’s 2.7%), while both CPI and CPIF inflation were revised down. CPI inflation is now expected at 1.3% in 2014 (from April’s 1.4%) and CPIF inflation at 0.9% in 2013 (from April’s 1.0%). On the back of an overall still constructive growth outlook, and increasing risks related to high household debt, we continue to expect the repo rate to remain unchanged in 2013 and the first rate hike in mid-2014.

DOWNSIDE RISKS TO OUR 2Q GDP FORECAST…



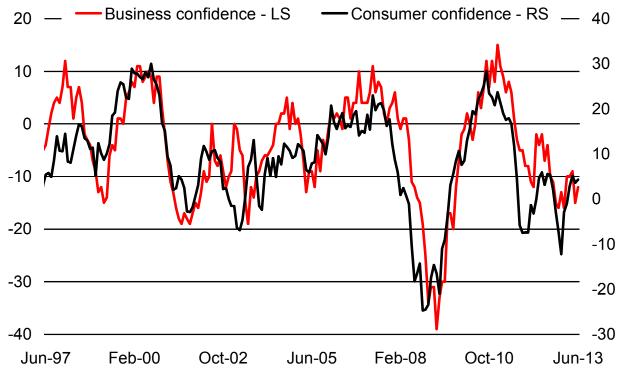
…DUE TO WEAK IP AND SERVICE PRODUCTION DATA



Source: NIER, Statistics Sweden, UniCredit Research

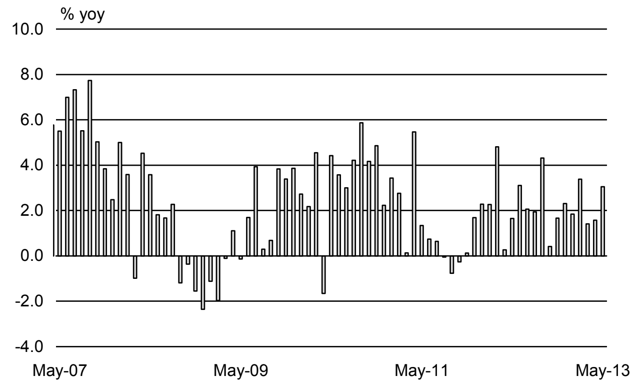
Sweden

BUSINESS AND CONSUMER CONFIDENCE



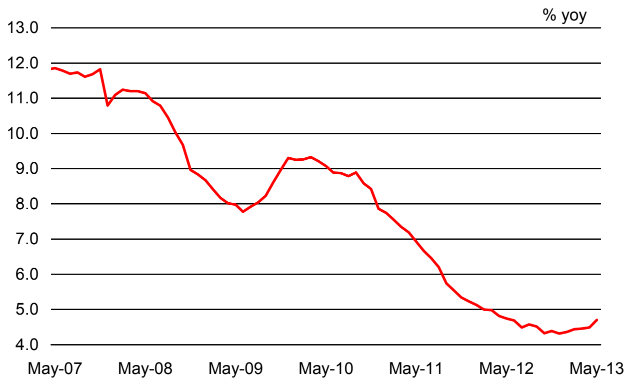
- Both consumer and manufacturing confidence strengthened in June – from 3.6 to 4.3 and from -15 to -12 – and are now less than 2 and 5 points below their historic averages.

RETAIL SALES



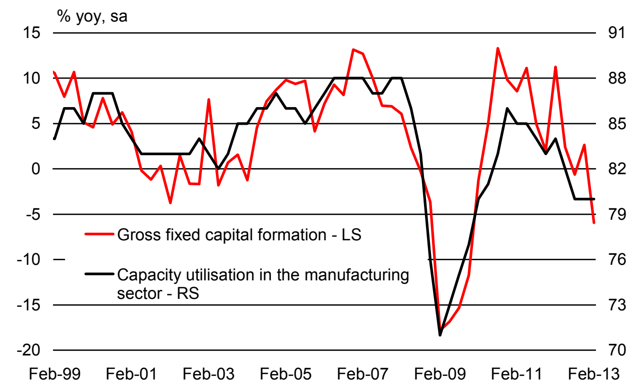
- Retail sales rose by 0.8% mom and 3.1% yoy in May (after -0.1% mom and 1.6% yoy in April).

LENDING TO HOUSEHOLDS



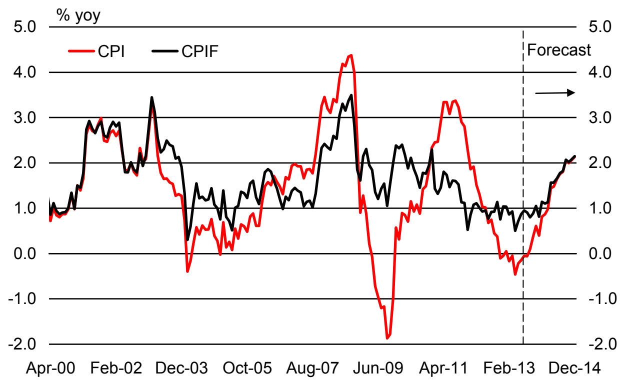
- Lending to households picked up to 4.7% yoy in May (from 4.5% in April).

GFCF AND CAPACITY UTILISATION



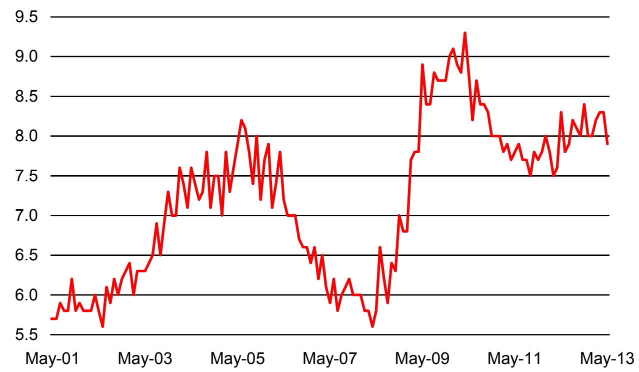
- Lower-than-normal capacity utilization rates in the manufacturing sector signal lower investment rates ahead.

INFLATION



- Both CPI and CPIF inflation were up in June (from -0.2% to -0.1% and from 0.7% to 0.9%, respectively).

UNEMPLOYMENT RATE



- In May, the seasonally adjusted unemployment rate fell below 8% for the first time in a year.

Source: NIER, Riksbank, Statistics Sweden, UniCredit Research

Poland

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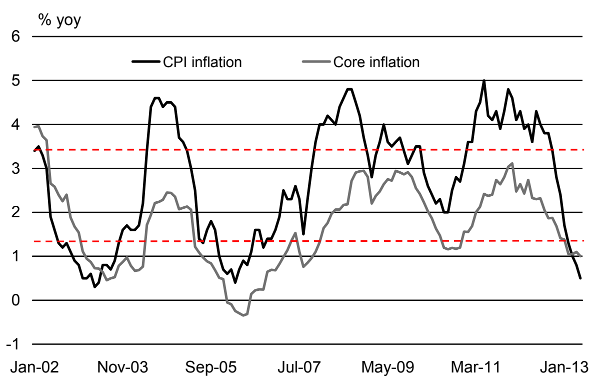
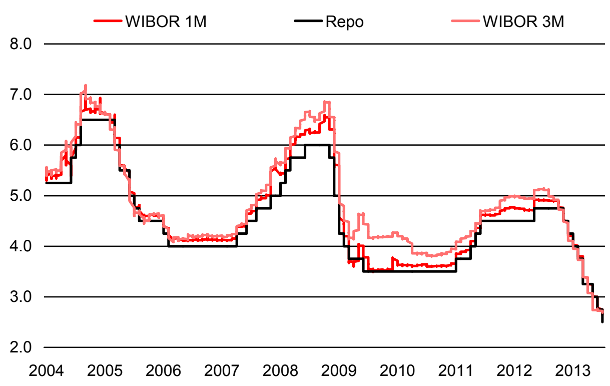
- The July MPC sitting saw the last rate cut in this cycle and the post-meeting communiqué, as well as the NBP president Marek Belka's statements during the press conference, show a willingness to stabilize expectations regarding monetary policy. Mr. Belka clearly said that interest rates would remain unchanged at least until the end of 2013. In our view, interest rates might stay unchanged for longer time period – the new inflation projection suggests that inflation will stay below or close to the lower end of the MPC target for another three years. The MPC will likely be unwilling to hike rates earlier than the ECB – and there we assume rates will remain unchanged until the end of next year.
- The performance of the economy in 2Q turned out to be weaker than our earlier estimates, which, coupled with some downward revision of expectations regarding the second half of the year, leads us to revise our 2013 GDP growth forecast. Currently we assume that GDP will increase by 1.3% yoy in 2013 (vs 1.7% assumed earlier), with private consumption increasing by 0.6% yoy (unchanged), investments at -3.0% (-3.7%) and the contribution of net exports at 1.3pp (1.6pp). This, however, does not change the expected "shape" of the recovery – we continue to assume that the low in economic activity took place in 1Q, and the following quarters will see a continuation of the rebound, which will be first seen in industrial output numbers (mostly "pulled" by exports, which in turn is supported by the relatively weak zloty) followed by stabilization and then a gradual improvement in employment and real wages.
- When it comes to monthly macroeconomic indicators, in June we expect an improvement in industrial output and retail sales numbers. Apart from the positive impact from the number of working days, we see the first signs of improvement in business sentiment. The industrial sector is supported by an improvement in the German economy as well as by the weaker zloty, and the increase of retail sales is driven by increased purchasing power of households after the series of interest rates cuts and low inflation. CPI will bottom out in June, at around 0.2-0.3% yoy (the lowest reading in history). The very weak pace of recovery continues to make the situation in the labor market difficult.
- The zloty should continue to rebound against the EUR, supported by gradually improving macro readings.

CPI WILL BOTTOM OUT IN JULY, AT AROUND 0.3% YOY



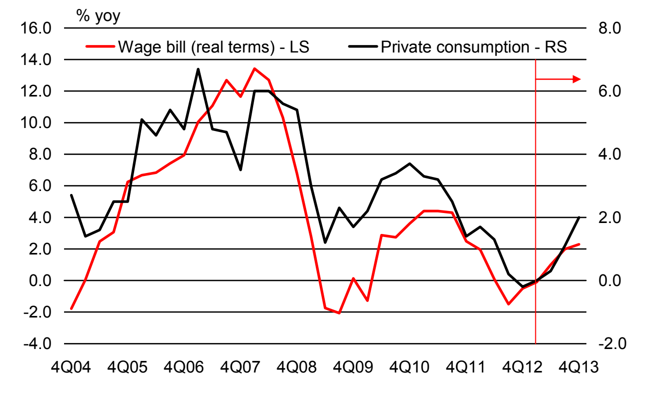
MPC RATES WERE CUT TO 2.5% – THE LOWEST IN HISTORY



Source: GUS, UniCredit Research

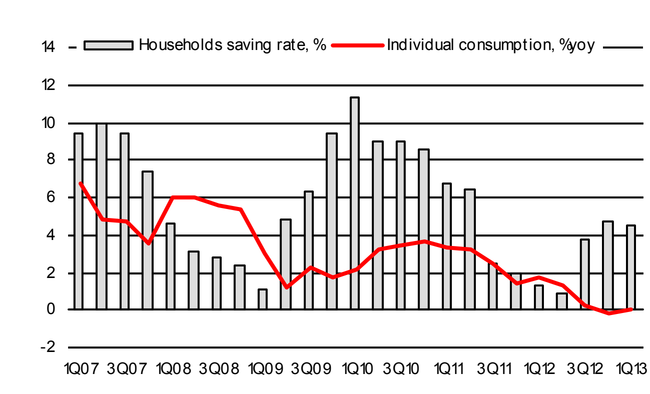
Poland

WAGE BILL AND PRIVATE CONSUMPTION



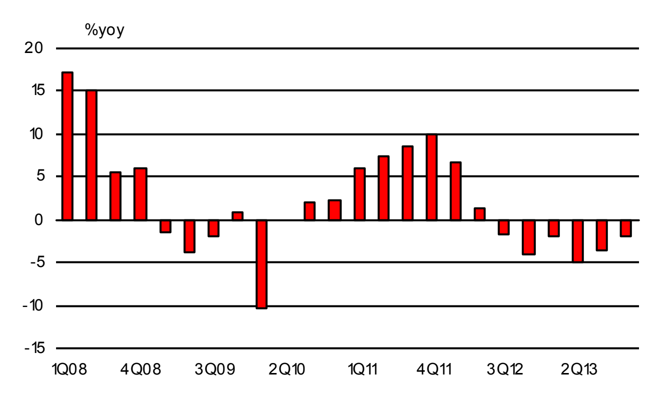
- Improving wage bill should lift consumption in 2H13.

HOUSEHOLD SAVING RATE



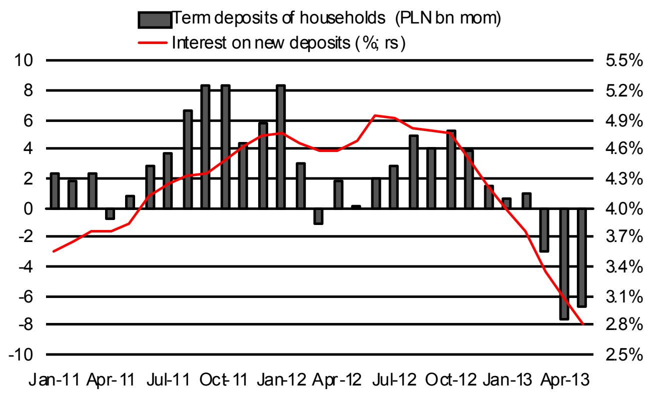
- Increased savings rate will moderate the impact of the wage bill on consumption.

FIXED INVESTMENTS



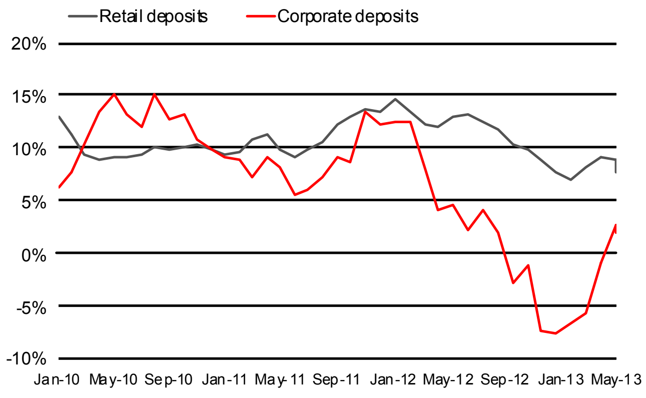
- Investments will remain negative throughout 2013.

TERM DEPOSITS



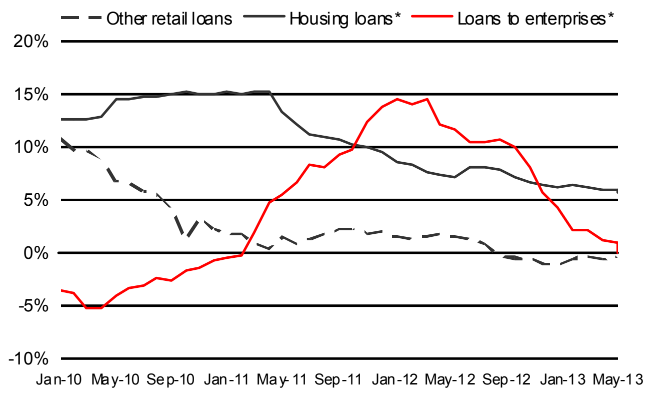
- Record low interest rates reduced the total amount of term deposits. This was, however, offset by current accounts.

RETAIL AND CORPORATE DEPOSITS



- Corporate deposits are rebounding as the financial situation of enterprises remains positive – and they are not investing.

RETAIL AND CORPORATE LOANS



- Loan growth (adjusted for FX movements) remains moderate.

Source: GUS, NBP, PFSA, Markit UniCredit Research

Czech Republic

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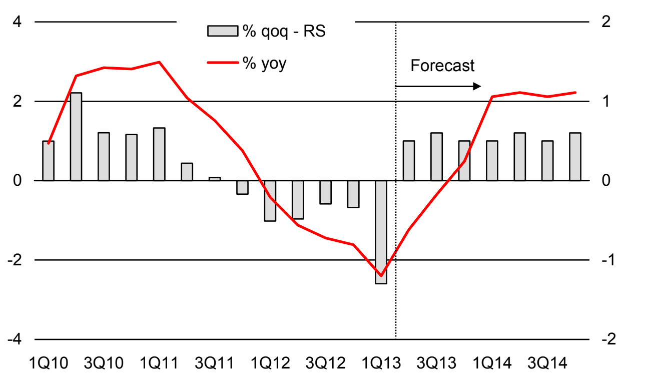
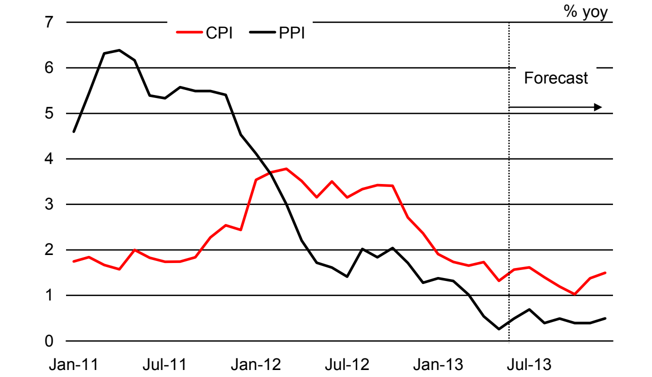
- A revision has brought 1Q GDP two notches down to a seasonally adjusted -1.3% qoq and -2.4% yoy. With inventory building shown as the key area of deterioration from the estimate released three weeks earlier, we see solid chances for a payback in 2Q.
- High-frequency data for May gave up some of their April optimism but didn't alter the overall picture. Industrial output saw a 2.2% decline yoy, but a seasonally adjusted 0.7% increase mom. Foreign trade data came in equally mixed, as yoy dynamics of exports and imports were poor but the surplus turned wider. Retail sales went up 1.2% yoy, with sales in the auto segment rising 3.8% yoy, but sales in core retail adding just 0.2% yoy. Construction output has continued tumbling. On balance, we see the data supporting our assumption of a moderate GDP upturn qoq in 2Q13.
- June CPI came in at 0.4% mom and 1.6% yoy, posting the first yoy pick-up since September of last year. However, the rise was largely caused by an unusually strong "potato effect", which we expect to fade away within a couple of months. We don't see any material inflationary pressures on the horizon.
- The CNB surprised the markets with the news that at its June meeting several policy makers had proposed an immediate launch of market interventions to weaken the CZK. The ongoing need of some central bankers to take a pro-active approach boosts the likelihood of interventions after the CNB's next policy meeting in early August. Alternatively, the CNB may just shift its EUR-CZK forecast higher, which could as well cause CZK to weaken. In any case, we count on EUR-CZK moving at least temporarily above the 26.0 level. The interest rate implication of the increased dovish stance at the CNB might be that the switch to monetary tightening will come later than we previously thought. Hence, we now expect the CNB to keep the repo rate flat at 0.05% also throughout the whole of 2014, with the first hike to be delivered as late as 1H15.

GDP IS EXPECTED TO HAVE RESUMED QOQ GROWTH IN 2Q



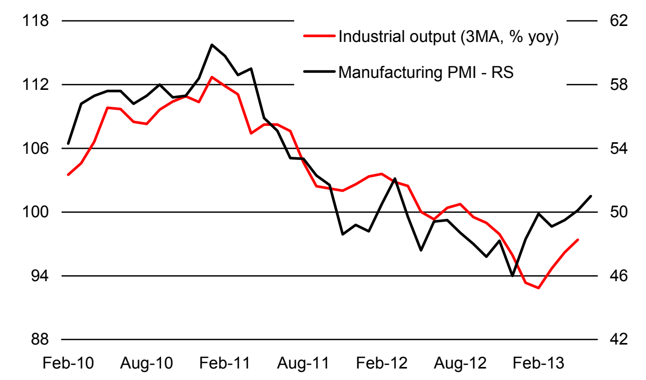
NO INFLATIONARY PRESSURES ARE ON THE HORIZON



Source: CZSO, UniCredit Research

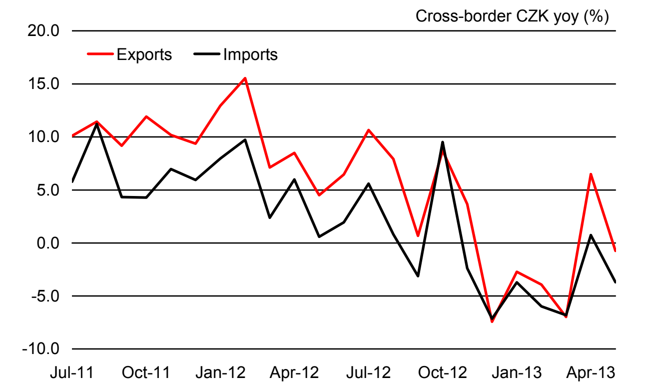
Czech Republic

MANUFACTURING PMI AND INDUSTRIAL OUTPUT



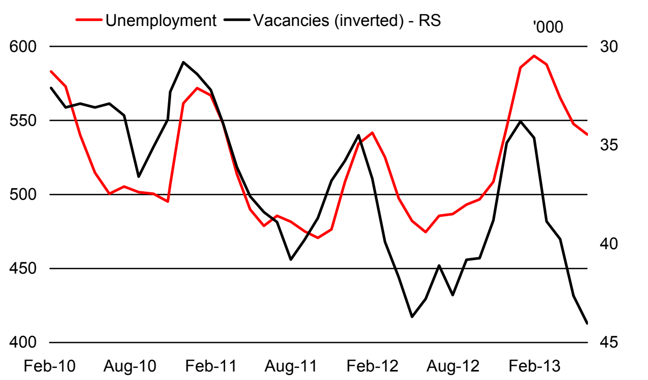
- Manufacturing PMI has broken above the 50-mark, industrial output has yet to follow with yoy growth.

EXPORT AND IMPORT DYNAMICS



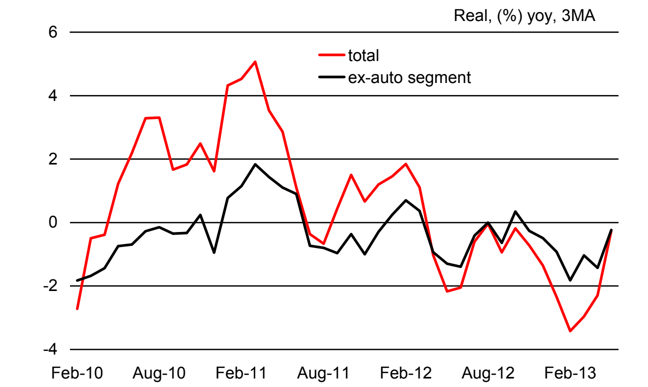
- Both the exports and imports momentum remain depressed but trade surplus surged in April and May.

THE NUMBERS OF UNEMPLOYED AND VACANCIES



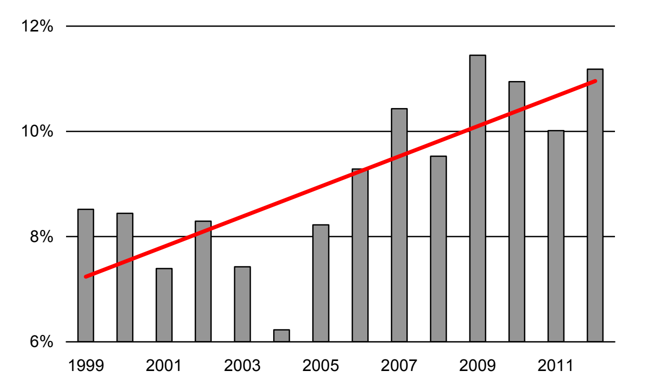
- Unemployment is being inflated by recession but vacancies rise; we suspect demand is for short-term sub-standard contracts.

RETAIL SALES TOTAL AND EX-AUTO



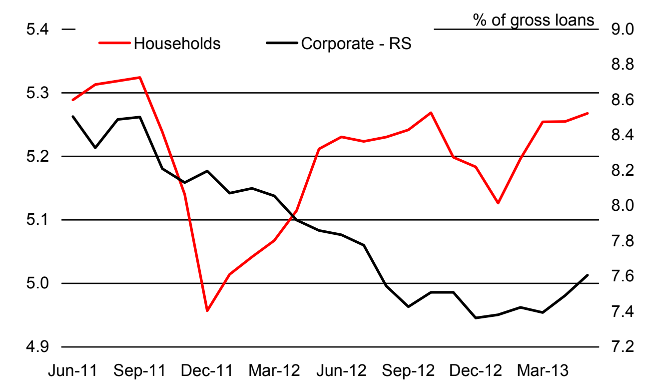
- No upturn for total retail sales; the auto-segment, though, shows signs of improvement from the depressed 1Q level.

HOUSEHOLDS SAVINGS RATIO AFTER REVISION



- Data revision altered the picture of last three years; while 2012 is no more shown at record high, LT upward drift remains unchanged.

NON-PERFORMING LOANS HOUSEHOLDS AND CORPORATES



- While NPLs for households have been creeping up for some time, the upturn for corporates appears to be a new phenomenon.

Source: CZSO, CNB, UniCredit Research

Hungary

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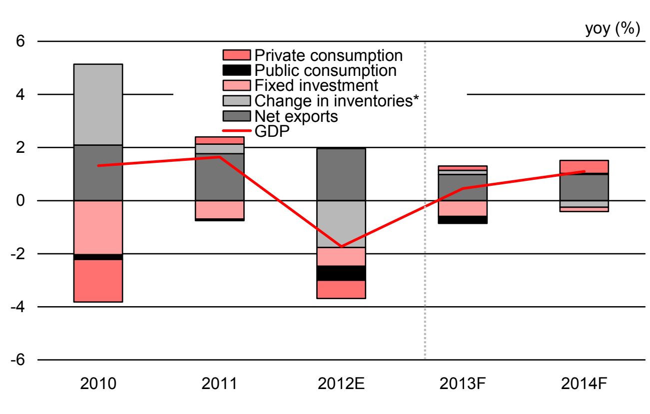
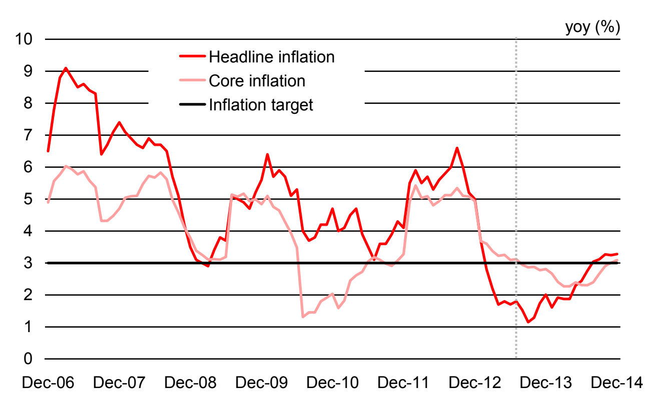
- The combination of an improvement in external demand, new production capacities, low inflation and less fiscal consolidation is supporting a recovery, albeit muted, in activity. Hungary's GDP rose by 0.7% qoq, erasing much of the losses over 2Q-4Q 2012. On the demand side, only inventories made a positive contribution to quarterly growth. Examining GVA, agriculture and construction showed gains. Data available to date for 2Q show a better quarter for industry while following over 6 years of decline, retail sales volumes are finally showing recovery, capturing increased purchasing power from the government's efforts to reduce utility prices. 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 has been below 2.0% yoy since April compared with in excess of 5.0% yoy in the first half of last year. An 8.7% yoy decline in electricity, gas and other fuels prices has a large role to play. We expect inflation to fall to around 1.1% by September and end the year at 2%, 1pp below the medium-term target. That said, evidence of underlying inflation stickiness remains present in the economy. Services inflation stood at 4.0% yoy in June while core inflation stood at 3.0%, despite capturing some of the decline in energy prices.
- The NBH continues to lower its policy rate which now stands at 4.25%, down 275bp from its peak in mid-2012. The ability of Hungarian assets to withstand recent market pressures across emerging markets and outperform many other countries in the region (for the first time in a period of stress in many years) will bolster the NBH's confidence in its rate cutting cycle and we see scope for another 50-75bp in gradual rate cuts from here.
- After a pause in 1Q, external bank deleveraging has resumed once again and is only slightly slower than was the case in the first five months of last year. We should see more of an improvement in the second half of this year relative to 2012. In the interim, the NBH's efforts to reduce short term external debt have generated little. 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.
- As general elections near (scheduled for 2Q next year), the government is beginning to take measures to boost expenditure while maintaining the budget deficit within 3% of GDP. To date this includes another increase in taxation on the banking sector but is likely to spread to other industries.

GDP FORECAST UPGRADED AFTER POSITIVE SURPRISE IN 1Q



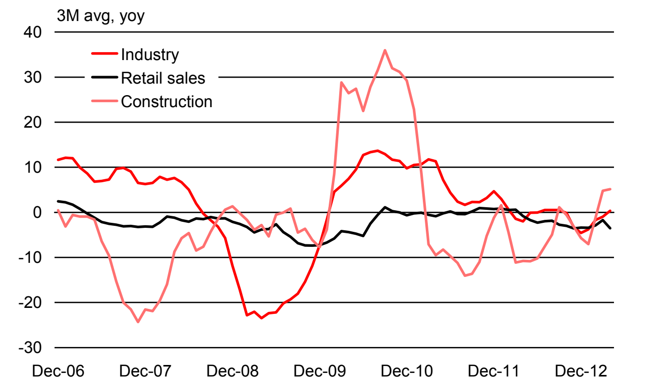
INFLATION FALLING ON ENERGY AND GAS PRICE CUTS



Source: KSH, UniCredit Research forecasts

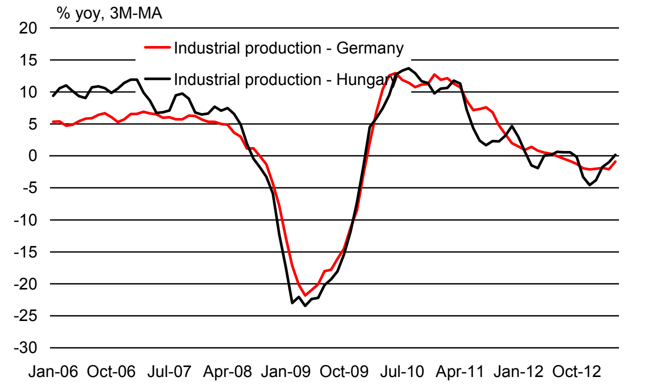
Hungary

INDUSTRY, RETAIL AND CONSTRUCTION



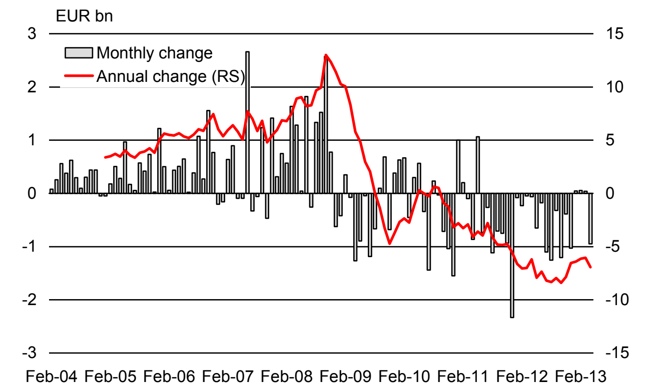
■ The recovery is picking up…

INDUSTRIAL PRODUCTION IN HUNGARY AND GERMANY



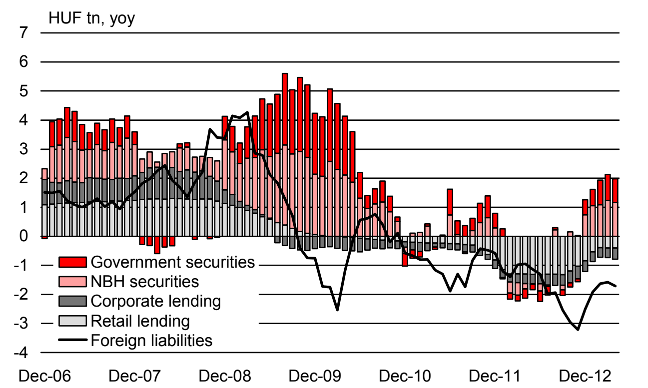
■ …helped by external demand.

BANK DELEVERAGING



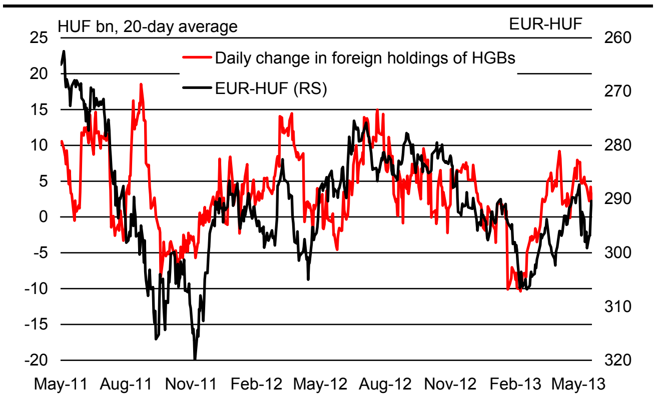
■ The deleveraging resumed in April after the foreign liabilities of the banking system rose in 1Q13…

BANKING SECTOR ASSETS



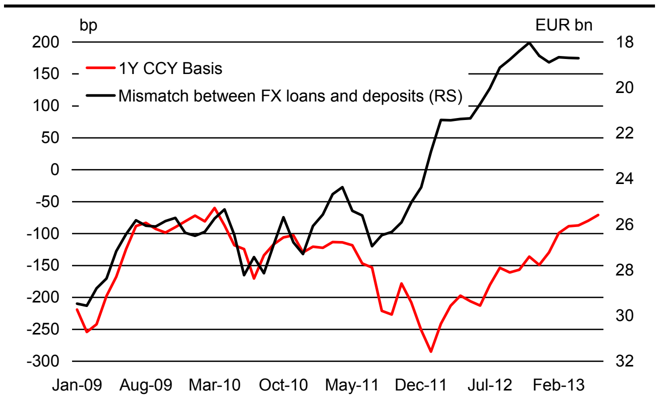
■ …and the accumulation of HGBs and 2W bills decelerated.

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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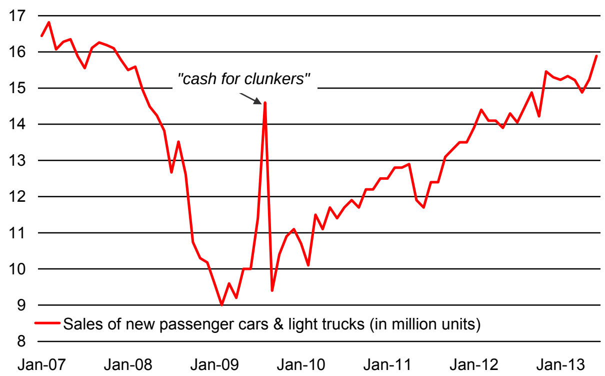
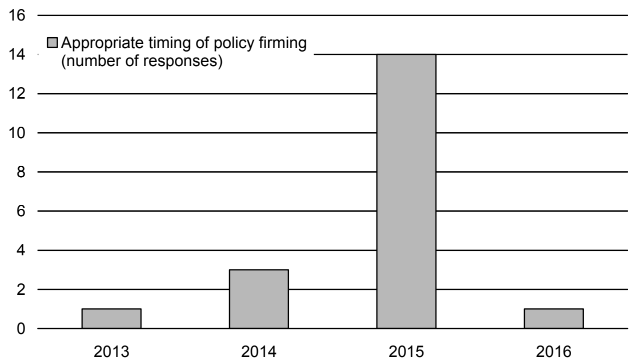
- Growth in the first half of the year was slower than initially reported due to downward revisions to consumer spending. Not only was 1Q13 GDP growth reduced to 1.8% (from 2.4%), but the revisions also lowered the consumption trajectory for the second quarter. As a result, the upside risks to our 2Q13 GDP forecast that we still stressed a month ago have given way to downside risks. For now, we stick to our 2Q13 estimate of 1.8%.
- For the second half of the year, we continue to expect that growth will accelerate to 2.8%. Most importantly, the consumer sector is already regaining momentum. Measures of consumer confidence rose to multi-year highs in June, lifted by a combination of the gradual improvement in the labor market, rising financial and real-estate wealth and lower gasoline prices. Car sales jumped another 4½% in June to reach their highest level since November 2007 (see left chart).
- Goods-producing sectors are also beginning to show signs of improvement. Homebuilders' sentiment hit an 8Y high in July; building permits trend higher and house prices continue to rise at double-digit rates. Similarly, on the manufacturing side, sentiment indicators picked-up, while manufacturing output rose for the second straight month in June, following two consecutive declines. Moreover, capex orders rose by 1% and more for three straight months, pointing to a rebound in investment spending.
- After the latest FOMC meeting, Chairman Bernanke, for the first time, outlined a somewhat specific, albeit still data dependent, timeline for the gradual wind down of QE3, the current asset purchase program. Accordingly, the Fed may moderate the pace of asset purchases later this year and end the program around the middle of 2014. Rate hikes, however, remain far off. The vast majority of Fed officials does not foresee the first rate hike before 2015 (see right chart).

CAR SALES AT HIGHEST LEVEL SINCE 2007



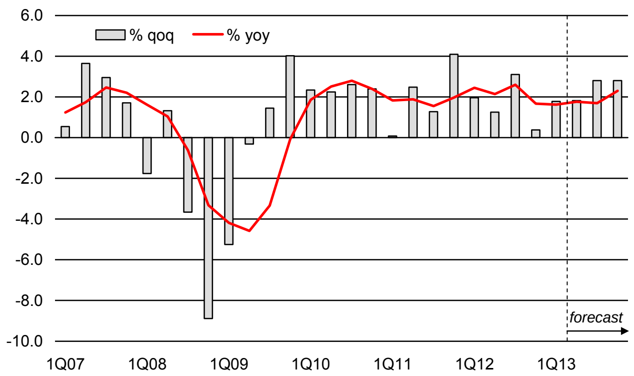
FED OFFICIALS DO NOT SEE FIRST RATE HIKE BEFORE 2015



Source: Bloomberg, Federal Reserve, UniCredit Research

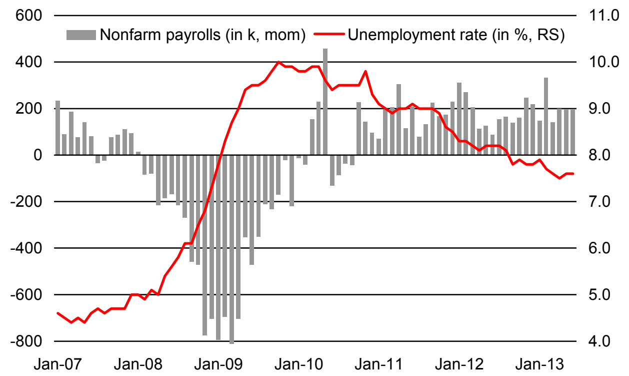
US

REAL GDP, ANNUALIZED RATES OF CHANGE



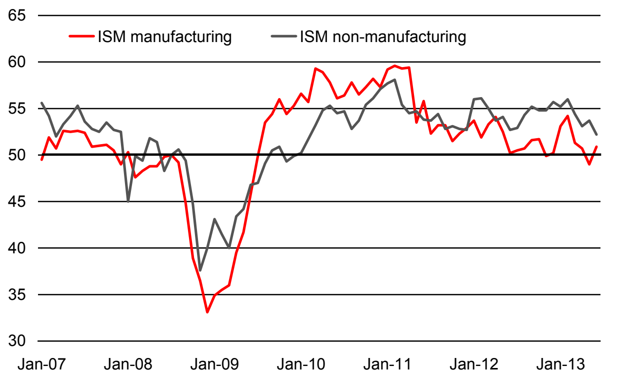
- The US economy likely expanded another 1.8% in 2Q13 (the same as in 1Q13), before accelerating towards 2¾% in 2H13.

NONFARM PAYROLLS AND UNEMPLOYMENT RATE



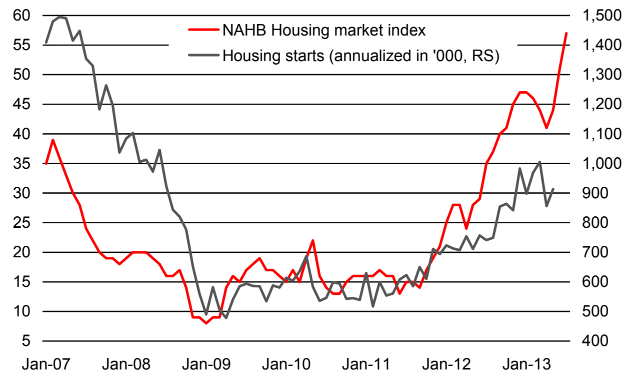
- Nonfarm payrolls rose 195,000 in June following similar gains in the previous two months. The jobless rate remained at 7.6%.

PMIS



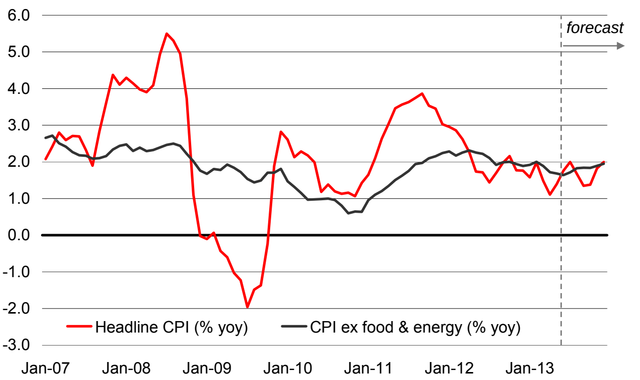
- After hitting a 4Y low in May, the manufacturing ISM rose back to 50.9. The non-manufacturing index fell to a 3½Y low of 52.2.

HOUSING MARKET INDEX AND HOUSING STARTS



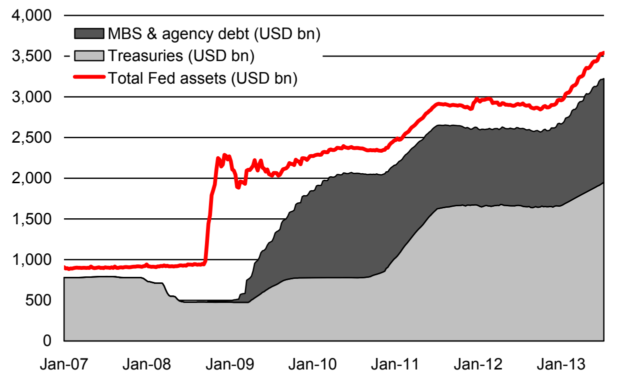
- The NAHB index jumped to an 8Y high of 57 in July, signaling further increases in construction activity.

INFLATION



- The headline inflation rate rose back to 1.8% yoy in June on higher energy prices. The core rate eased further to 1.6% yoy.

FED'S BALANCE SHEET



- The size of the Fed's balance sheet now exceeds USD 3½tn, as the FOMC 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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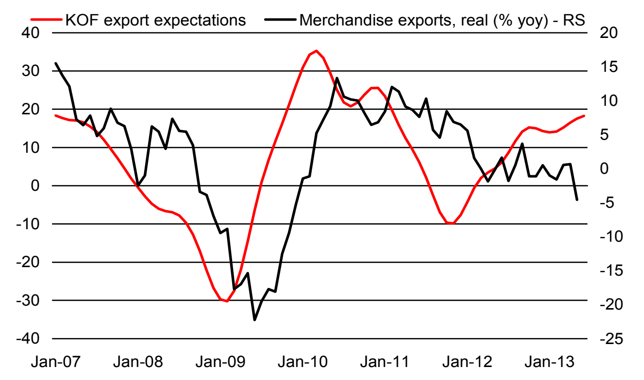
- The Swiss economy outperformed most other industrialized countries at the beginning of 2013. GDP increased a surprisingly strong 0.6% qoq, after +0.3% in 4Q12. The major growth pillar was once again private spending. Also, construction contributed positively despite adverse winter weather conditions. In contrast, the generally subdued dynamic in global industry at the turn of the year continued to weigh on industry, as reflected in lower exports and a further reduction in business investment.
- However, the latest business sentiment readings for June provided further evidence of a gradual improvement in manufacturing. The KOF Economic barometer posted its third consecutive rise. The PMI was slightly down mom, but remains clearly in expansionary territory at 51.9. Notwithstanding the prolonged recession in the EMU periphery, stronger demand from other regions supports the upward trend in export expectations, boding well for an imminent turnaround in export dynamics (see left chart below).
- Due to persisting overcapacities in manufacturing, firms plan to reduce their workforce in the coming months. This should, however, be more than compensated for by ongoing employment gains in other sectors. Together with high immigration and soft consumer price deflation, this maintains tailwind for private consumption, as reflected in recent robust retail sales figures. Overall, although we expect some payback for the surprisingly strong dynamic in the first quarter, the economic recovery appears well supported. Our KOF and PMI GDP models indicate a quarterly GDP growth rate of +0.3% for 2Q13.
- Despite the comparatively favorable economic development, the SNB didn't announce any change to its monetary stance at the quarterly meeting in June, as expected. The interest rate target remains at zero, with inflation not being an issue over the forecast horizon. As economic uncertainty is still regarded as high, especially for the EMU periphery, an exit from the minimum exchange rate target remains far away. Moreover, a fine-tuning of the FX cap level is not envisaged by the central bankers.
- The booming housing market has shown no sign of deceleration thus far this year (see right chart below). The SNB is increasingly concerned and will continue with moral suasion and the enforcement of existing stricter capital rules and is considering a possible upward adjustment of the counter-cyclical capital buffer (CCB) requirements from the current 1% level later this year.

STABILIZATION IN EXPORT DYNAMICS INDICATED

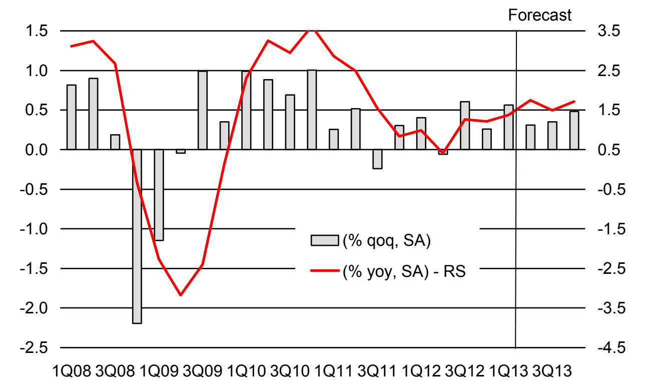


UNABATED MORTGAGE DYNAMICS

Source: KOF, SNB, UniCredit Research

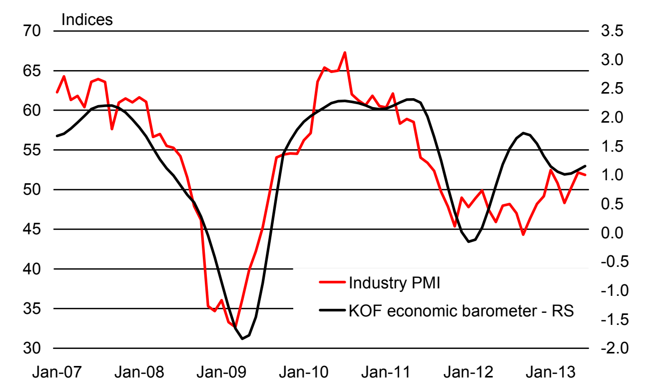
Switzerland

GDP



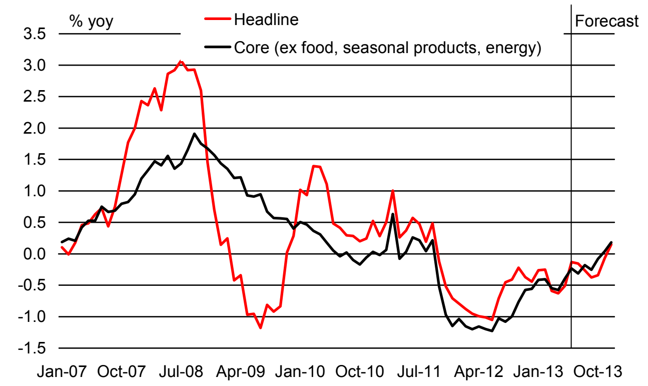
- The Swiss economy expanded by a strong 0.6% qoq at the beginning of 2013.

BUSINESS SENTIMENT



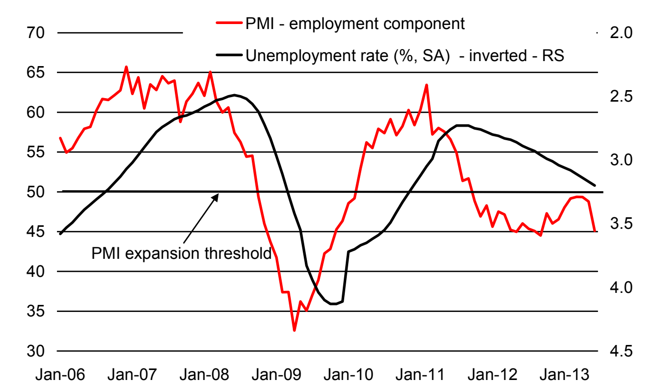
- Business sentiment surveys on average signal 0.3% qoq GDP growth for 2Q13.

INFLATION



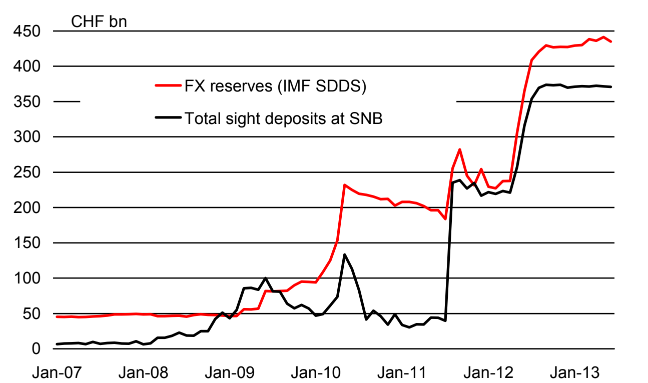
- Swiss consumer prices were still slightly down 0.1% yoy in June. And moderate deflation should continue for most of this year.

LABOR MARKET



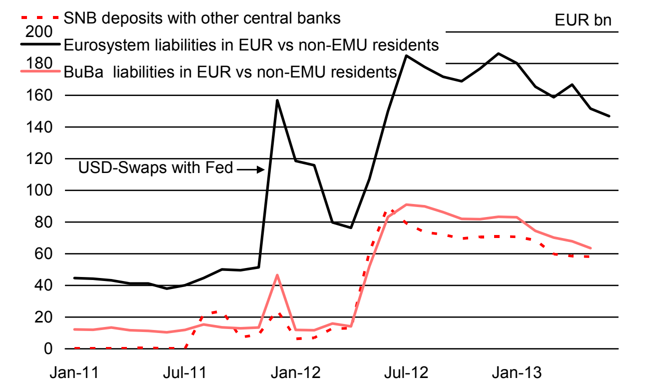
- Manufacturers plan to reduce their workforce further, signaling a continuing moderate rise in unemployment.

FX RESERVES



- The SNB's FX reserves on a CHF basis were down due to valuation losses in June, whereas the level of total sight deposits remained broadly stable.

FX CURRENCY MANAGEMENT



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

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

Russia

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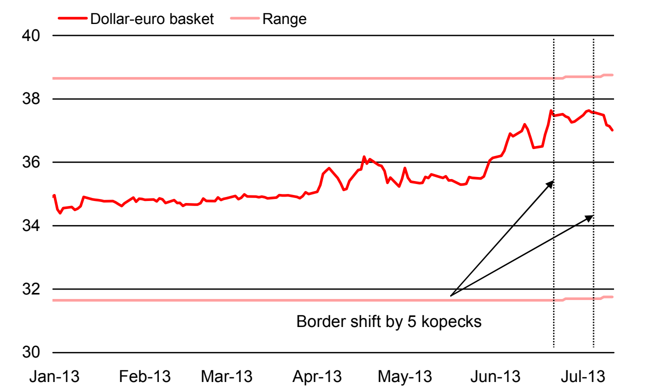
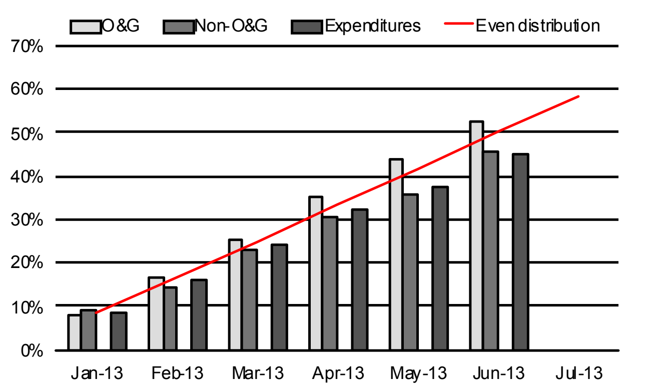
- The CBR decided to keep key interest rates unchanged at its latest policy meeting, which was the first one chaired by Elvira Nabiulina. This is a signal that the CBR has likely opted to demonstrate its independence from the government. At the same time, the regulator stated that inflation is expected to return to the target level (5-6%) in 2H13, whereas the risk of economic slowdown remains. If the CBR's point-of-view on these issues does not change in the near future, a further step towards monetary policy easing may soon follow, although the timing for the decision may no longer be optimal. The next meeting is scheduled to take place on 9 August.
- According to the CBR's preliminary estimate, the current account balance shrank to just USD 6.9bn in 2Q13 (-57% yoy) as a result of growing imports of goods and services together with the deteriorating balance of investment income. Combined with continuing capital outflow, albeit at a slower pace, this exerts pressure on the Russian ruble. The value of the CBR's dual currency basket jumped to RUB 37.89 on 21 June, prompting the regulator to increase interventions to a daily average of USD 200mn and to shift the borders of the corridor, in which the currency basket is allowed to float, upwards by a total of 10 kopecks since 26 June. In the short term, we believe that the ruble is likely to demonstrate a modest rebound, especially as pressure on the USD increased after the release of the Fed's minutes from the latest FOMC meeting. In the longer-term, we do not expect fundamentals to improve, which justifies a weaker ruble.
- The Russian government approved the draft budget for 2014-2016, revising expenditures down compared to previous projections (by 2.8% for 2014 and by 2.6% for 2015) for the first time since the early 2000s. Currently, the slowdown of revenue growth in the non-oil and gas sectors has become a major concern for fiscal authorities, and the Russian budget is at risk of being run with a deficit already in 2013. Finance minister Anton Siluanov recently stated that current FY revenues may fall short of forecasted values by as much as RUB 1.0tn. Over the first six months of 2013, approximately 48.6% of the total expected yearly revenues were collected. However, even this outcome was primarily the result of favorable conditions in the international commodity markets in 1H13.

CBR INTERVENTIONS LED TO A SHIFT OF CORRIDOR BORDERS



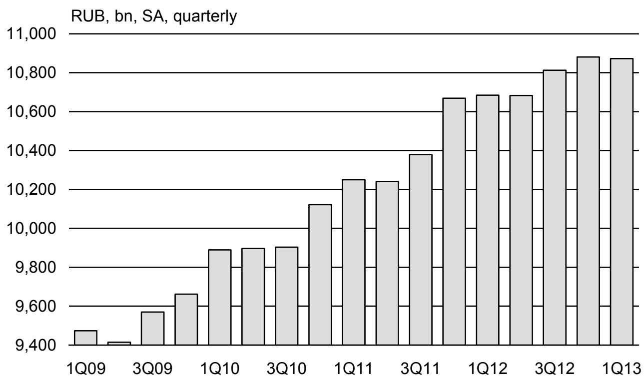
RATE OF REVENUE COLLECTION BECOMES THE KEY ISSUE



Source: CBR, Bloomberg, Ministry of Finance, UniCredit Research

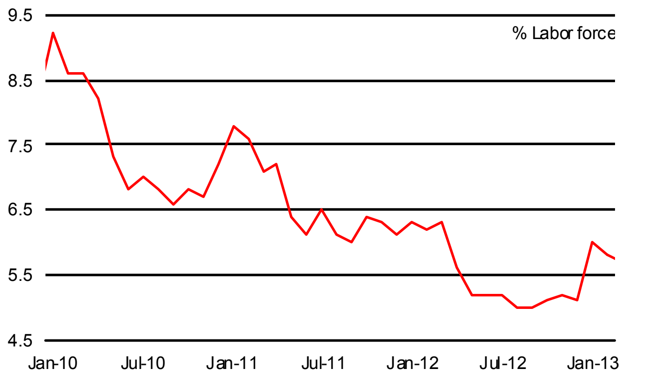
Russia

GDP



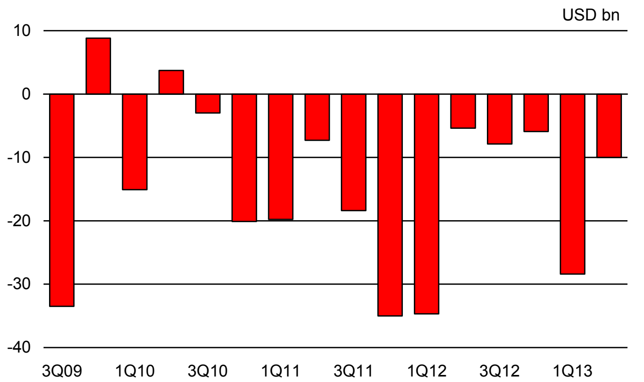
- Weaker domestic demand and stagnating exports are weighing on GDP, which was estimated to have grown 1.8% yoy in 1Q.

UNEMPLOYMENT



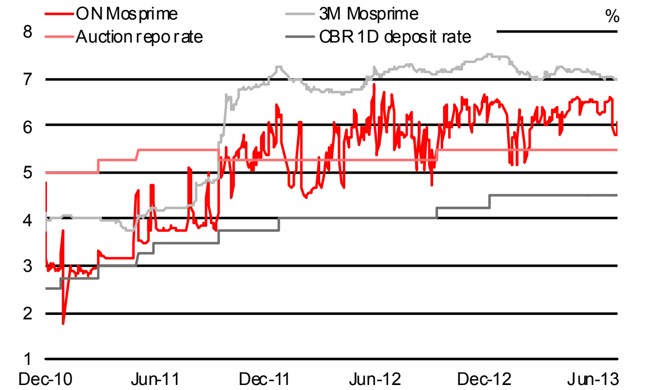
- Unemployment remains far below historic levels.

CAPITAL OUTFLOW



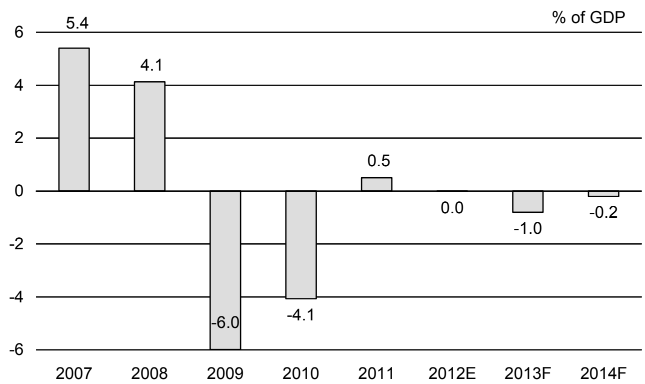
- Trailing the shrinking current account balance, capital outflow slowed in 2Q.

MONEY-MARKET RATES



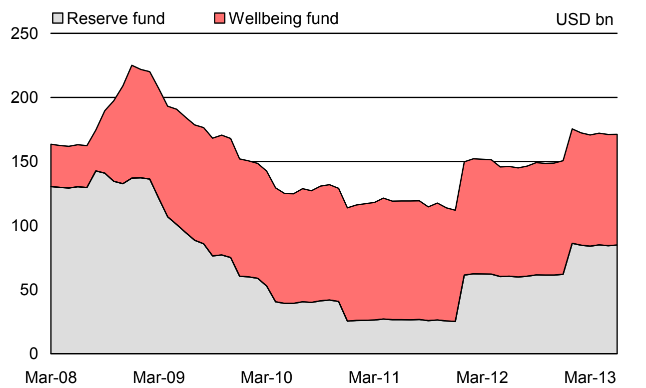
- The CBR provided some relief at the longer end, but overnight rates are still dominated by liquidity withdrawals of the budget.

BUDGET BALANCE



- The federal budget deficit may turn out to be bigger than expected, as revenues may be lagging behind schedule.

STATE FUNDS ACCUMULATION



- The government may fail to top-up the Reserve Fund in 2013 and may draw on accumulated funds instead for financing.

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

Turkey

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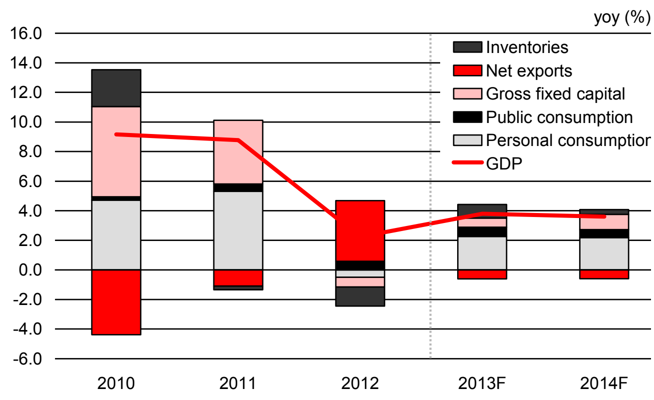
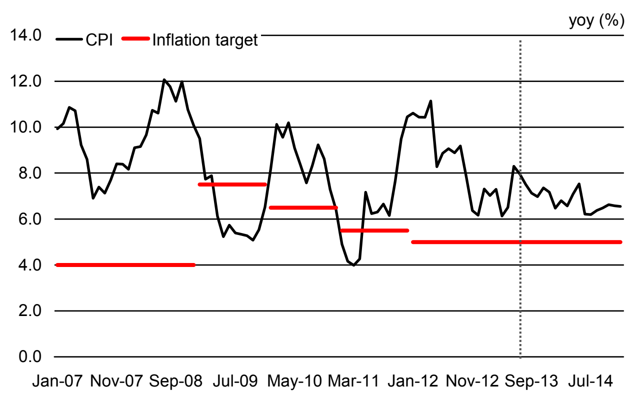
- The adjustment in Turkish assets over the past couple of months has been large and speedy amidst more broad-based negative newsflow from EM and more firm signals on Fed tapering. Meanwhile the CBT continues to signal that it will act to stabilize markets but gradually. The CBT has intervened to the tune of USD 6.3bn since 11th July, USD 3.6bn of which was concentrated over 8-12 June. Governor Basci has announced an increase in the lending rate at next week's rate meeting, i.e. the upper end of the rate corridor (currently 3.5-6.5%) and an increase in amount of TRY loans to exporters. As these are repaid with export proceeds, it will increase FX reserves.
- The crux of the issue is that the CBT is trying to achieve a balance between protecting the economy from a sudden stop and recession while minimising the impact of its near term actions on activity. This, at least in part, explains its reliance on FX intervention over rate hikes to date. Governor Basci remains reluctant to increase the policy rate.
- This shift in the external environment will impact Turkey's domestic demand prospects. The banking sector has increased its reliance on short term external funding. Even assuming some stabilisation in risk appetite, it is unlikely that the Turkish banking sector will be able to increase external funding at the same pace as was the case earlier this year. The government will use fiscal policy to support activity but this will not compensate in full.
- It is difficult to see pressure on the CBT abate in full for long. Even in an environment of improved risk appetite, we believe it very unlikely that foreign flows to emerging even close to their peak. Meanwhile there has been little to no clean-up in foreign positioning in domestic fixed income. It is not only that Turkey cannot afford for foreigners to dispose of assets but to finance the C/A deficit, Turkey needs foreigners to continue to increase their exposure. Over the 12 months to May, Turkey experienced USD 75.4bn in short term capital flows but only USD11.7bn in long term capital flows.
- Meanwhile the tail risks remain significant. Political instability across the region is increasing (e.g. Egypt, Syria), with the potential for some spillover/costs for Turkey. Relative to the size of Turkey's C/A deficit and the accumulation of short term external capital in recent years, the ability of the CBT to defend any lasting pressure is limited and has the potential to prompt more significant dislocation in markets. Finally the domestic banking system will not be able to provide the same cushion that it did in the past, both in terms of domestic demand growth and its ability to absorb foreign sales of debt.

DOMESTIC DEMAND IS EXPECTED TO LEAD THE RECOVERY



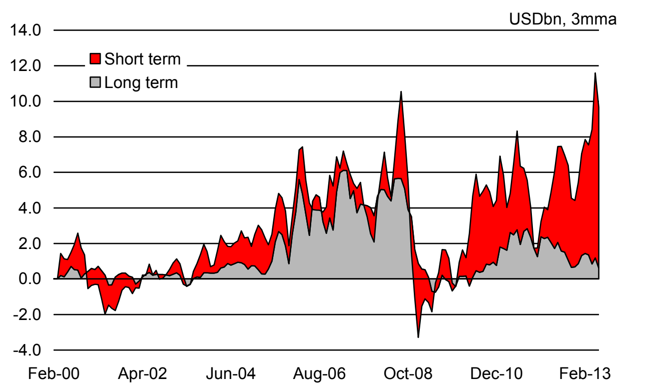
INFLATION TO EASE BUT REMAINS OFF TARGET



Source: CBT, TurkStat, UniCredit Research

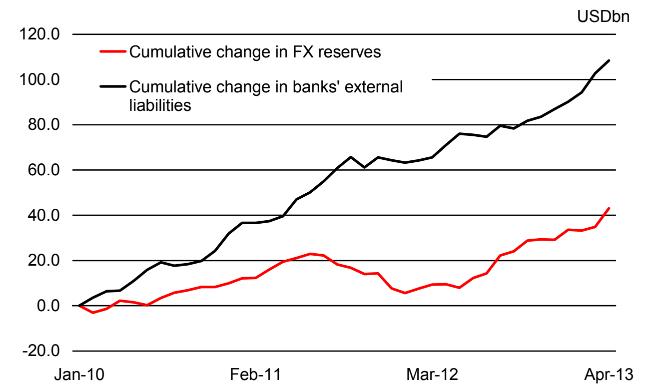
Turkey

FOREIGN CAPITAL FLOWS TO TURKEY



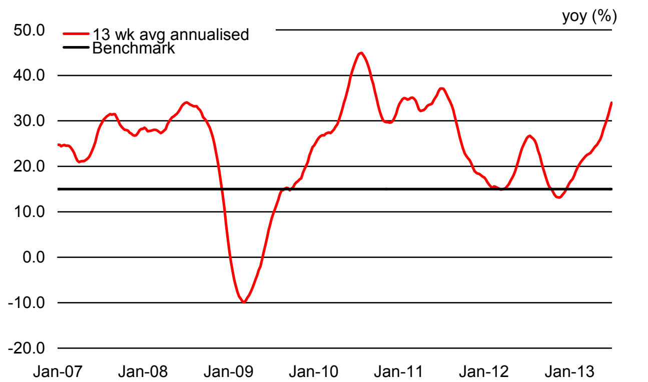
- Close to 75% of all capital inflows to Turkey since early 2010 have been short-term in nature.

FX RESERVES VS. BANK EXTERNAL LIABILITIES



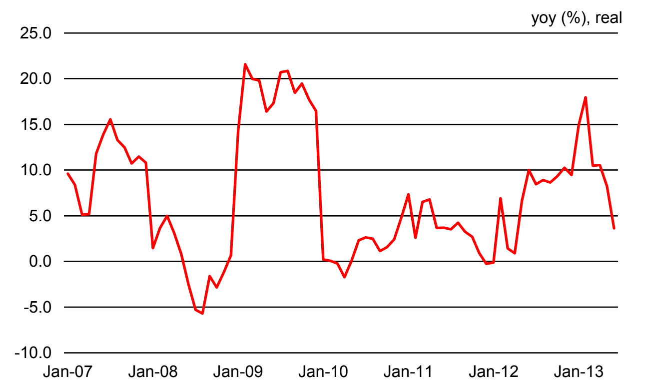
- FX reserves have not kept pace with the increase in bank external liabilities.

CREDIT GROWTH VS. TARGET



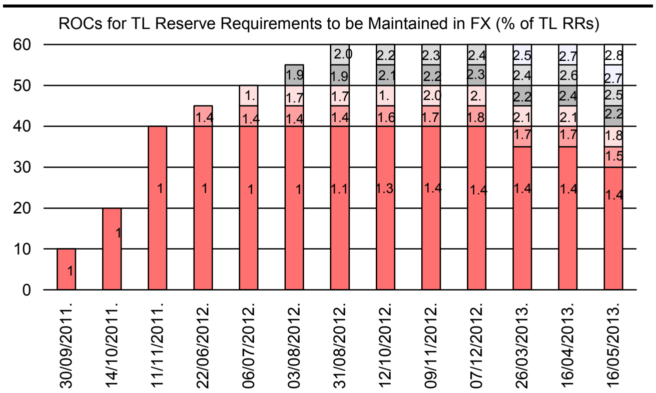
- Credit growth is high and accelerating, with the 13-week average, FX-adjusted and annualized reading at 34% on 5 July.

CURRENT EXPENDITURE LESS INTEREST



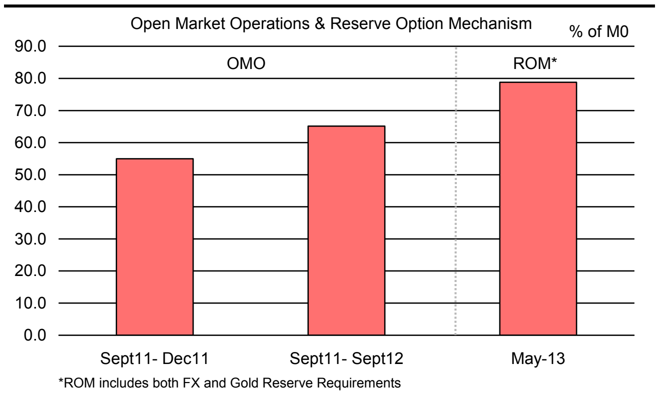
- Current expenditure less interest down to 3.6% yoy in June.

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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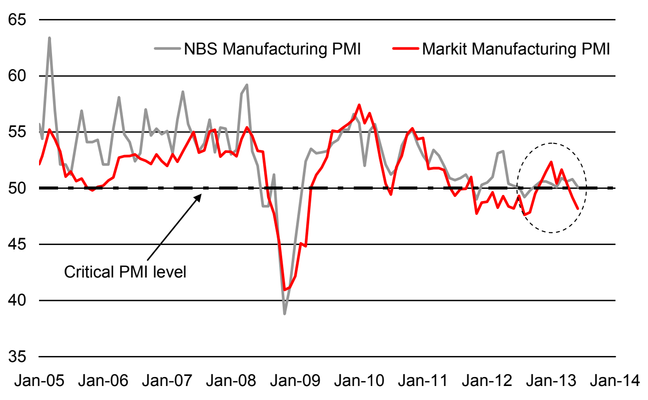
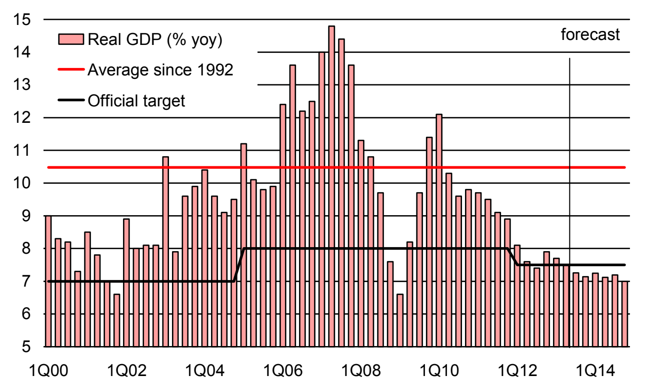
- Recent economic data showed that GDP growth in China has weakened over the spring, with soft economic momentum carrying over into the summer. Real GDP expansion of the second largest world economy eased again two notches in 2Q13 to 7.5% yoy. Economic growth has now slowed in nine out of the last ten quarters. Net exports have been a major drag, contributing only a mere 0.1pp to 1H13 growth. Subdued global demand, the stronger CNY, as well as efforts to crack down on capital imports masked as exports were weighing.
- Growth of domestic demand, however, held up better. After having eased earlier this year, consumption showed some resilience of late, and overall investment expansion – still contributing most to China's economic expansion – cooled down only slightly thanks to fast-growing infrastructure spending. But while restraint on (high-end) housing is showing its first desired results, capex in manufacturing continues to disappoint, held back by muted sales perspectives, profit margin pressures, overcapacity in certain sectors as well as ongoing destocking needs.
- Looking ahead, weaker growth momentum most likely carries over into 2H13. We expect GDP growth to settle down to between China's growth target of 7½% and the government's pain threshold of around 7%. External headwinds will remain formidable, as shown by forward-looking PMI subcomponents. Consumption growth is held back by muted wage growth and tighter regulations on social spending, while the ongoing grip on high-end housing and efforts to contain provincial and local indebtedness will weigh on investment expansion.
- In addition, the recent liquidity crunch is exerting some downside pressure, too, as it indicated that the PBoC is unwilling to further tolerate brisk credit growth (beyond CNY bank lending to the real economy) and misallocation of capital. We expect credit expansion in 2H13 (and beyond) to decelerate.
- But economic downside risks seem manageable and the government is primed to tolerate slow(er) growth as being the "price" of pushing ahead for structural reforms in order to avoid economic and social imbalances to accentuate further. Authorities are, therefore, not inclined to add major fiscal and monetary stimulus to revive the economy – as long as GDP does not fall persistently below the government's pain threshold (main risk scenario).
- Given the lower past numbers coupled with indication of slower momentum carrying over into 2H13 and the government's increased tolerance of weaker growth, we revise down our GDP forecast to 7.4% (from 7.8%) for this year and 7.2% for next (from 7.7%).

WEAKER GROWTH TO CARRY OVER INTO 2H13



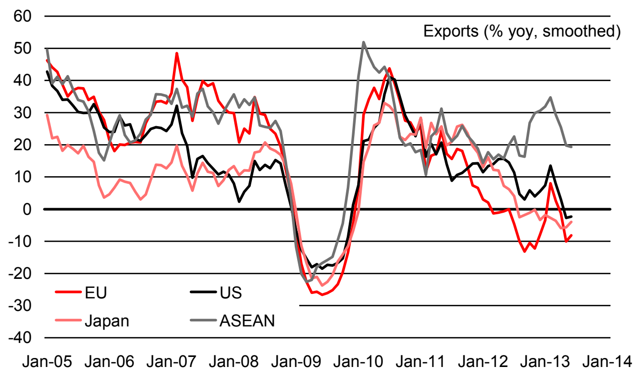
GDP GROWTH RATES TO SETTLE DOWN BETWEEN TARGET AND PAIN THRESHOLD



Source: Thomson Datastream, Feri, UniCredit Research

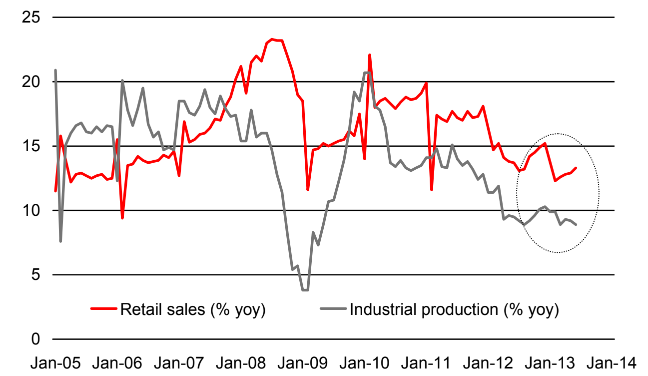
China

EXTERNAL ECONOMY



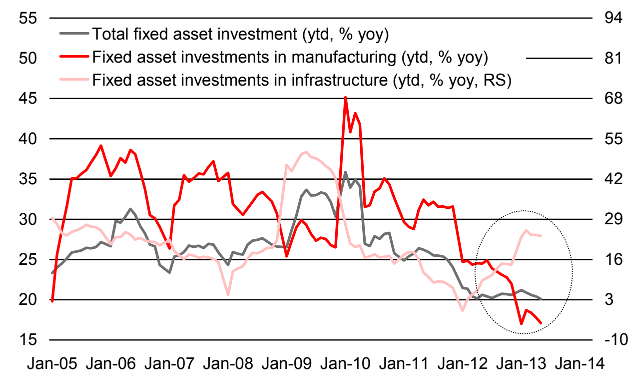
- Nominal export growth has been "doctored" earlier this year, but came down severely after the government stepped in – now painting a more realistic picture of ongoing external headwinds.

RETAIL SALES AND INDUSTRIAL PRODUCTION



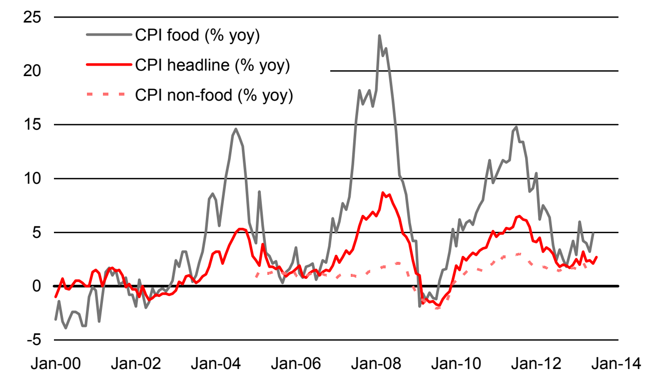
- Domestic demand shows more resilience – especially consumption, after having eased in early 2013. Factory output is not profiting yet, with overcapacities & destocking needs weighing.

FIXED ASSET INVESTMENT



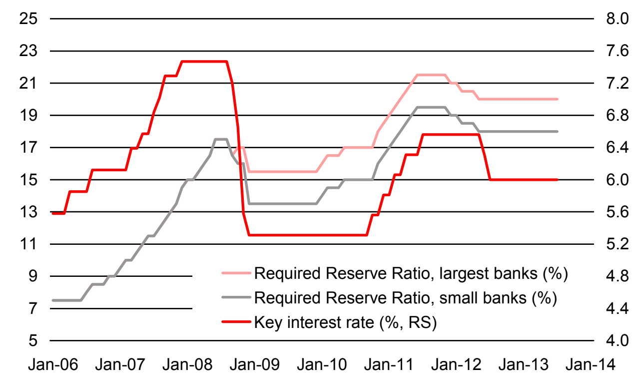
- Overall investment is slowing despite brisk infrastructure spending – with housing investment (intended) and capex growth slowing.

INFLATION



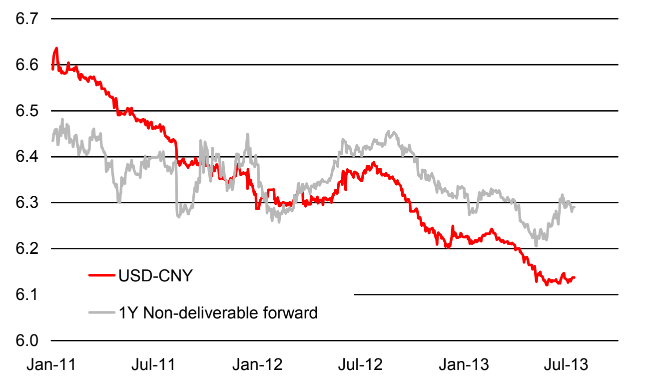
- Following the January uptick 2013, inflation is fluctuating well below target (3.5%) – helped by falling commodity and input prices…

MONETARY POLICY



- ...so the PBoC would have room for maneuver. But its stance got tougher, not willing to accept overshooting credit growth.

USD-CNY

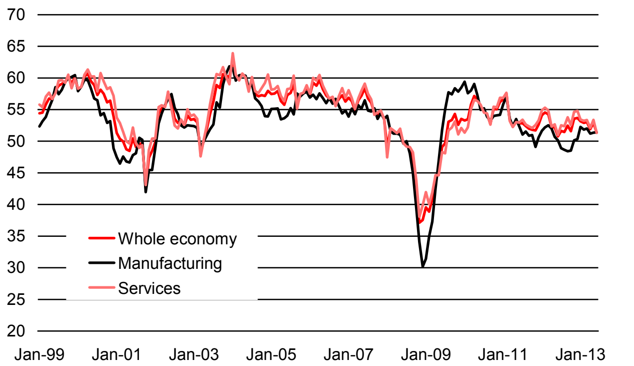


- After having appreciated substantially over the last two year, the CNY is expected to be directed into quieter waters.

Source: Thomson Datastream, Feri, UniCredit Research

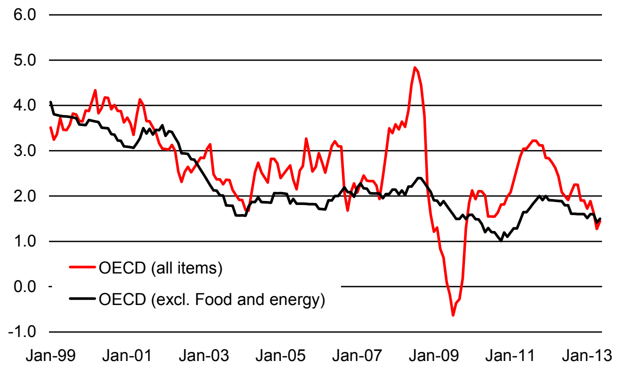
Global indicators

GLOBAL PMI OUTPUT



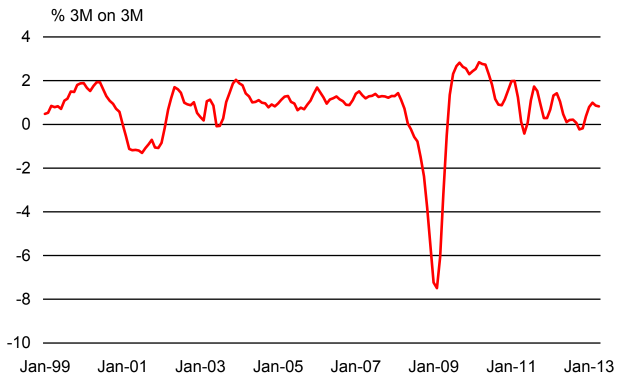
- The global composite PMI fell from 52.9 to 51.4 in June. The manufacturing output index rose from 51.3 to 51.4, while the services index fell from 53.4 to 51.3.

CPI INFLATION



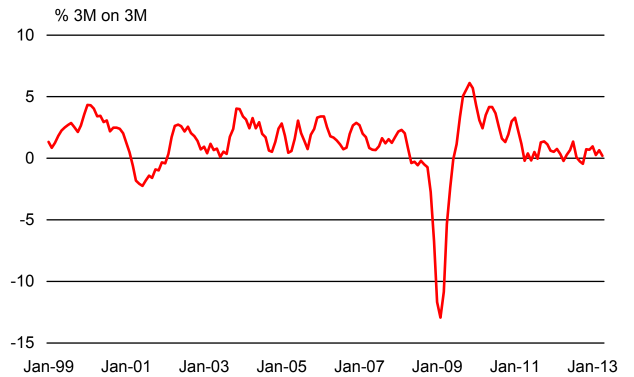
- Headline inflation in OECD economies edged up from 1.3% yoy to 1.4% yoy in May with the core rate up from 1.4% yoy to 1.5% yoy.

INDUSTRIAL PRODUCTION



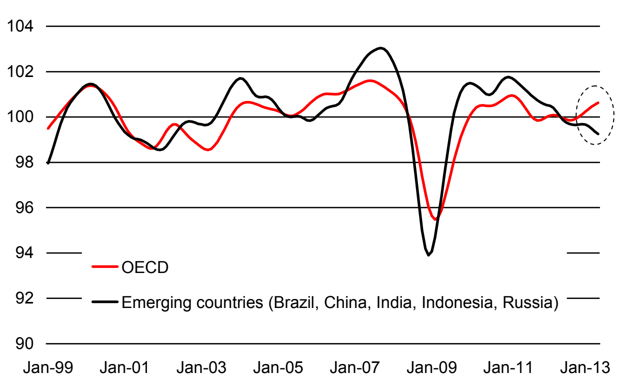
- Global IP rose 0.2% mom in April (0.4% in March). The 3M/3M rate edged down slightly from 0.9% to 0.8%.

WORLD TRADE



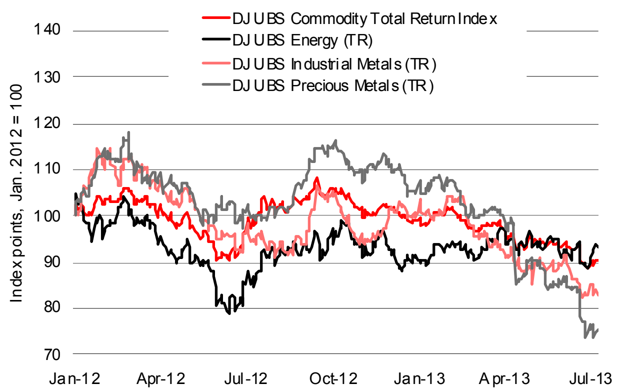
- World trade rose 1.4% mom in April after -0.1% mom in March. The 3M/3M rate slowed from 0.6% to 0.2%.

OECD COMPOSITE LEADING INDICATORS



- The OECD leading indicator for OECD countries (aggregated) edged up further in May, 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.

Source: Bloomberg, CBP Netherlands, OECD, UniCredit Research

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