Economics Research

The UniCredit Economic Chartbook

Monthly

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

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Contents

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Monthly recap

- **EMU:** We revise up our 2013 GDP forecast to -0.3% from -0.6%, to take into account stronger-than-expected growth in 2Q13 and upward revisions to GDP data referring to late 2012/early 2013. We maintain our quarterly trajectory going forward and hence the full-year GDP forecast for 2014 at +1.0%, but we acknowledge that downside risks to this estimate have started to fade as peripheral countries are already stabilizing. The brightening of the growth picture in the eurozone reflects the first signs of improvement in domestic demand at a time when exports are regaining traction. This bodes well for the sustainability of the upswing. Despite recent good growth news, the ECB remains cautious, trying to prevent market-imposed monetary tightening by employing "forward guidance". Yet, they stand "ready to act" on liquidity, which we read as a sign that the central bank's preferred option to counter a possible tightening of money market conditions may be another LTRO, rather than a rate cut.

- **US:** 2Q13 GDP growth was revised up to an annualized 2.5% from the initially reported 1.7%. The bulk of the revision came from foreign trade. Private inventories also rose faster than initially reported, while consumer spending expanded solidly. For the second half of this year, we continue to expect GDP growth to accelerate to 2.8%, as the drag from fiscal tightening fades. In line with this view, many sentiment indicators rose to multi-year highs in August. At its upcoming FOMC meeting, the Federal Reserve will likely announce its decision to moderate the pace of its asset purchases.

- **UK:** We have also revised up our GDP forecasts for the UK, reflecting both the better-than-expected start to the year and a somewhat stronger recovery going forward, as indicated by survey data. Like the ECB, the BoE is more cautious on the recovery and is fighting the market-imposed monetary tightening with "forward guidance", in the case of the UK even by articulating a threshold for unemployment. While the UK recovery is likely to be strong enough to continue even as yields move higher, we worry that it is excessively skewed towards real estate and consumer loans.

- **CEE:** The ability of economies to take advantage of the recovery in EMU, while managing the risks emanating from Fed tapering and persistent outflows of portfolio capital from emerging markets, will be central to country-specific growth performance across CEE over the coming twelve months. We expect the newer EU states to enjoy faster growth rates, as already reflected in stronger industry performance, which should, in turn, feed through to domestic demand. However, Russia's failure to diversify its economy away from energy means that we have reduced our growth expectations there. Turkey will continue to be forced towards a narrower C/A deficit, given the absence of sufficient external funding, which will push growth lower.

- **China:** Recent data indicate that the protracted growth slowdown came to an end this summer. Business sentiment as well as activity data stabilized or gained some traction. The shift in Chinese economic policy and improving global demand seem to have lent a helping hand. While better monthly numbers imply upside risks to our forecast that GDP will stabilize this quarter and settle between the 7½% growth target and the 7% pain threshold thereafter, it would still be premature at this stage to say that the Chinese economy is set to face a sustainable acceleration in growth.

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	-0.3	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	0.6	1.5	2.0	1.5	1.4	-	-	-	0.2	0.0	-0.2	81.7	79.2	76.9	6.4	5.9	5.5
France	0.0	0.2	0.9	2.0	1.0	1.9	-	-	-	-4.8	-4.0	-3.5	90.2	92.6	94.7	-2.0	-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	-0.5	0.4	0.7
Spain	-1.6	-1.4	0.4	2.4	1.9	1.6	-	-	-	-10.6	-6.5	-6.1	84.2	91.5	97.0	-1.1	1.0	2.1
Austria	0.9	0.4	1.8	2.4	1.9	1.8	-	-	-	-2.5	-2.3	-1.7	74.1	75.2	74.8	1.8	2.5	2.7
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	-2.0	0.3	2.8	0.5	0.7	-	-	-	-6.4	-5.6	-4.0	123.6	127.9	129.0	-1.6	0.3	0.2
Other EU																		
UK	0.2	1.6	3.1	2.8	2.8	2.8	0.50	0.50	0.50	-6.3	-5.9	-4.9	90.0	94.0	96.0	-3.7	-3.2	-2.7
Sweden	1.1	1.2	2.6	0.9	0.1	1.6	1.00	1.00	1.25	-0.7	-0.7	0.0	38.6	37.0	35.8	6.9	7.4	7.2
Poland	1.9	1.3	2.3	3.7	1.1	2.3	4.25	2.50	2.50	-3.9	-4.9	-3.9	55.6	57.9	51.1	-3.5	-1.4	-2.6
Czech Rep.	-1.2	-0.9	2.0	3.3	1.5	1.5	0.05	0.05	0.05	-4.4	-2.5	-2.9	45.8	47.0	48.2	-2.5	-1.1	-1.0
Hungary	-1.7	0.7	1.7	5.7	1.7	1.7	5.75	3.50	3.50	-1.9	-2.7	-3.0	79.2	81.6	82.3	1.7	1.8	1.4
Others																		
US	2.8	1.7	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	1.8	1.8	-0.7	-0.2	0.6	0.00	0.00	0.50	0.5	0.3	0.3	36.5	35.8	34.7	13.1	12.0	11.0
Russia	3.4	1.7	1.8	5.1	6.7	4.9	5.50	5.25	4.75	0.0	-0.7	-0.7	10.2	11.7	12.8	4.0	2.1	0.7
Turkey	2.2	3.9	2.0	8.9	7.4	6.7	5.50	4.50	6.00	-1.5	-1.5	-3.5	36.6	36.5	37.1	-9.7	-6.1	-7.1
China	7.8	7.4	7.2	2.7	2.6	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	-0.5	-0.2	0.3	0.1	0.2	0.2	0.3	0.3	0.4
Germany	0.2	-0.5	0.0	0.7	0.5	0.4	0.4	0.3	0.3	0.4
France	0.2	-0.2	-0.2	0.5	0.1	0.2	0.2	0.3	0.3	0.4
Italy	-0.2	-0.9	-0.6	-0.3	0.0	0.1	0.2	0.2	0.3	0.4
Spain	-0.4	-0.8	-0.4	-0.1	-0.1	0.1	0.1	0.2	0.2	0.3
Austria	0.7	-0.1	0.1	0.1	0.4	0.6	0.5	0.4	0.4	0.3
Other EU										
UK	0.7	-0.2	0.3	0.7	0.9	1.0	0.7	0.7	0.6	0.5
Sweden	0.1	0.0	0.6	-0.1	0.6	0.6	0.7	0.7	0.8	0.8
Poland (% yoy)	1.3	0.7	0.5	0.8	1.4	2.3	2.7	2.3	2.2	2.1
Czech Rep.	-0.3	-0.3	-1.3	0.6	0.6	0.5	0.4	0.5	0.5	0.5
Hungary	0.0	-0.5	0.6	0.1	0.4	0.6	0.5	0.4	0.1	0.3
Others										
US (annualized)	2.8	0.1	1.1	2.5	2.8	2.8	2.6	2.5	2.4	2.4
Switzerland	0.7	0.3	0.6	0.5	0.4	0.5	0.4	0.4	0.4	0.4
Russia	0.5	0.2	0.4	0.3	0.4	0.6	0.5	0.2	0.5	0.7
Turkey	0.1	0.0	1.6	1.8	1.0	-0.3	0.2	0.4	0.7	0.7
China (% yoy)	7.4	7.9	7.7	7.5	7.4	7.2	7.3	7.2	7.2	7.1

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	1.7	1.5	1.5
Germany	2.0	2.0	1.5	1.5	1.6	1.2	1.2	1.2	1.4	1.5
France	2.0	1.5	1.1	0.8	1.0	1.2	1.8	2.1	2.0	2.0
Italy	3.2	2.5	1.9	1.2	1.1	1.7	1.7	2.0	2.0	1.5
Spain (HICP)	2.8	3.2	2.8	1.8	1.5	1.7	1.5	2.1	1.4	1.3
Austria	2.3	2.8	2.5	2.2	1.8	1.3	1.5	1.8	1.9	2.0
Other EU										
UK	2.4	2.7	2.8	2.7	2.8	3.1	2.9	2.9	2.8	2.7
Sweden	0.6	0.1	-0.1	-0.3	0.1	0.6	1.0	1.7	1.9	2.1
Poland	3.9	2.9	1.3	0.5	1.1	1.3	2.1	2.4	2.1	2.5
Czech Rep.	3.4	2.9	1.8	1.5	1.4	1.3	1.0	1.3	1.6	1.7
Hungary	6.1	5.3	2.8	1.7	1.2	1.2	0.9	1.1	2.0	2.7
Others										
US	1.7	1.9	1.7	1.4	1.6	1.7	1.9	2.6	2.5	2.6
Switzerland	-0.5	-0.3	-0.4	-0.4	-0.1	0.1	0.4	0.8	0.6	0.7
Russia	6.0	6.5	7.2	7.2	6.4	5.9	5.4	5.1	4.5	4.8
Turkey	9.0	5.8	7.2	7.0	8.3	8.1	7.4	8.0	7.3	7.9
China	1.9	2.1	2.4	2.4	2.7	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	-0.3	1.0	-0.6	-0.6	0.9	-0.6	-0.4	1.2	-0.5	-0.6	1.1
Germany	0.9	0.6	1.5	0.9	0.3	1.3	0.7	0.4	1.8	0.9	0.4	2.0
France	0.0	0.2	0.9	0.0	-0.2	0.8	0.0	-0.1	1.1	0.0	-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	-1.6	-1.4	0.4	-1.4	-1.6	0.0	-1.4	-1.5	0.9	-1.4	-1.7	0.4
Austria	0.9	0.4	1.8	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	-2.0	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	1.6	3.1	0.3	0.9	1.5	0.3	0.6	1.7	0.3	0.8	1.5
Sweden	1.1	1.2	2.6	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	-0.9	2.0	-1.2	0.3	1.6	-1.3	-0.4	1.6	-1.2	-1.0	1.3
Hungary	-1.7	0.7	1.7	-1.7	0.0	1.2	-1.7	0.2	1.4	-1.8	0.5	1.3
Others												
US	2.8	1.7	2.6	2.2	1.7	2.7	2.2	1.9	2.6	2.2	1.9	2.8
Switzerland	1.0	1.8	1.8	1.0	1.3	1.8	1.0	1.4	1.9	1.0	1.4	2.0
Russia	3.4	1.7	1.8	3.4	2.5	3.3	3.4	3.3	3.8	3.4	2.3	3.6
Turkey	2.2	3.9	2.0	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	1.5	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	1.9	1.6	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	0.5	0.7	2.8	0.7	1.0	2.8	0.7	1.0	2.8	0.0	0.2
Other EU												
UK	2.8	2.8	2.8	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	1.1	2.3	3.7	1.9	2.0	3.7	1.4	2.0	3.6	0.7	1.0
Czech Rep.	3.3	1.5	1.5	3.3	2.3	1.9	3.5	1.9	1.2	3.3	1.6	1.3
Hungary	5.7	1.7	1.7	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	-0.2	0.6	-0.7	-0.2	0.2	-0.7	0.0	1.1	-0.7	-0.3	0.2
Russia	5.1	6.7	4.9	5.1	6.9	6.2	-	-	-	5.1	6.6	5.4
Turkey	8.9	7.4	6.7	8.9	6.6	5.3	9.0	6.6	5.6	8.9	6.7	5.2
China	2.7	2.6	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	0.22	0.25	0.25	0.35	0.40	0.45
2Y	0.23	0.30	0.30	0.45	0.55	0.85	1.20
5Y	1.00	0.90	1.00	1.20	1.40	1.68	1.95
10Y	2.00	1.90	2.00	2.20	2.40	2.60	2.80
30Y	2.75	2.65	2.75	2.95	3.10	3.25	3.40
2/10	177	160	170	175	185	175	160
2/5/10	-11	-20	-15	-13	-8	-5	-5
10/30	76	75	75	75	70	65	60
2Y SwSp	-40	-35	-35	-30	-30	-25	-25
10Y SwSp	-27	-30	-30	-25	-25	-20	-20
10Y BTP/bund	256	250	250	230	210	200	190
US							
Key rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3M	0.25	0.26	0.26	0.30	0.30	0.35	0.35
2Y	0.44	0.40	0.45	0.60	0.70	1.00	1.35
5Y	1.68	1.65	1.75	2.02	2.20	2.47	2.73
10Y	2.88	2.90	3.00	3.20	3.40	3.60	3.80
30Y	3.82	3.80	3.90	4.05	4.20	4.30	4.40
2/10	245	250	255	260	270	260	245
2/5/10	2	0	2	12	15	17	15
10/30	94	90	90	85	80	70	60
2Y SwSp	-16	-15	-15	-15	-15	-15	-15
10Y SwSp	-17	-20	-20	-20	-20	-20	-20
UK							
Key rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50
10Y	2.96	2.90	3.00	3.20	3.30	3.50	3.70
SZ							
Key rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10Y	1.15	1.15	1.25	1.40	1.60	1.80	2.00

FX	Current	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
EUR-USD	1.33	1.33	1.35	1.35	1.36	1.37	1.38
EUR-JPY	132	140	144	149	152	156	157
EUR-GBP	0.84	0.88	0.90	0.90	0.91	0.91	0.92
EUR-SEK	8.69	8.63	8.60	8.58	8.55	8.53	8.50
EUR-NOK	7.86	7.90	7.80	7.70	7.60	7.55	7.55
EUR-CHF	1.24	1.26	1.30	1.35	1.37	1.39	1.41
EUR-AUD	1.44	1.43	1.42	1.39	1.37	1.37	1.35
EUR-NZD	1.63	1.66	1.69	1.67	1.68	1.67	1.68
EUR-CAD	1.37	1.40	1.40	1.38	1.36	1.34	1.34
USD-JPY	99	105	107	110	112	114	114
GBP-USD	1.58	1.51	1.50	1.50	1.50	1.50	1.50
USD-SEK	6.53	6.49	6.37	6.36	6.29	6.23	6.16
USD-NOK	5.91	5.94	5.78	5.70	5.59	5.51	5.47
USD-CHF	0.93	0.95	0.96	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	0.82	0.80	0.80	0.81	0.81	0.82	0.82
USD-CAD	1.03	1.05	1.04	1.02	1.00	0.98	0.97

Source: Bloomberg, UniCredit Research

Eurozone

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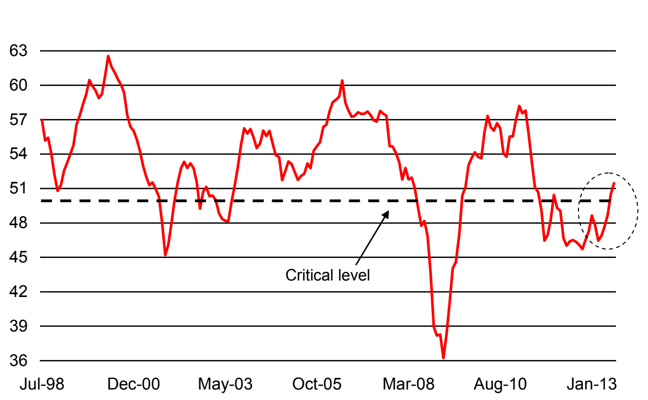
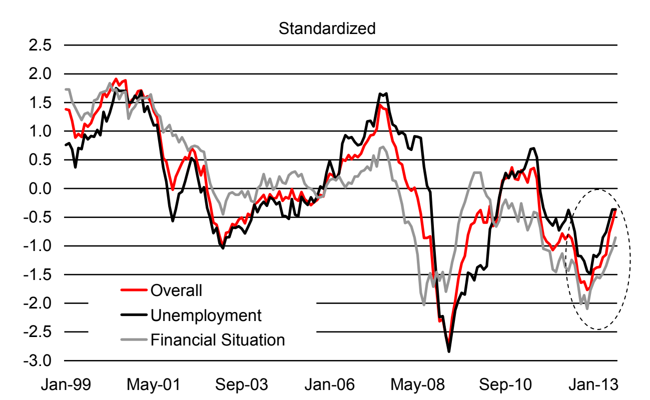
- We revise up our 2013 GDP forecast to -0.3% from -0.6%, to take into account stronger-than-expected growth in 2Q13 (+0.3% qoq) and upward revisions to GDP data referring to late 2012/early 2013. The qoq GDP path from 3Q13 onwards remains unchanged: we see a (technical) deceleration in the summer quarter, followed by a slow but steady pick-up. Sequential GDP growth is expected to reach potential (1.2%-1.3% annualized) by mid-2014, and strengthen further thereafter. We maintain the full-year GDP forecast for 2014 at +1.0%, but downside risks to this estimate have started to fade as peripheral countries are already stabilizing.
- Signs of improvement in domestic demand come at a time when exports are regaining traction. This bodes well for the sustainability of the recovery. Household sentiment has increased for nine consecutive months and is now close to its long-term average, indicating that the consumption recession is coming to an end. This is mostly due to a slowing pace of fiscal consolidation and low inflation, which tend to offset the drag from ongoing job shedding – but note that the unemployment rate (12.1%) shows signs of stabilization. Concurrently, investment fundamentals have started to improve, as productivity is finally recovering and capacity utilization is back on the rise. And while financing conditions for firms and households remain tight, the second derivative of credit standards – which matters the most for sequential GDP growth – does show signs of easing supply-side constraints.
- According to the flash estimate, inflation decelerated to 1.3% in August from 1.6%. The bulk of the downward move was due to an energy base effect, while core inflation was stable at 1.1%. Looking through the monthly volatility, price growth is set to remain weak and never exceed the 2% mark for the foreseeable future.
- At the September ECB meeting, Draghi sounded cautious and retained an easing bias, underpinned by the updated macroeconomic projections, which continue to show a slow recovery amid low inflation. The ECB is "particularly attentive" to money market conditions and their implications for the stance of monetary policy, and "stands ready to act on liquidity". This high alert suggests that the central bank is indeed concerned about a potential upward move in (spot) money market rates as excess liquidity declines. It also seems consistent with our view that the ECB's preferred option to counter tighter money market conditions may be another LTRO, rather than a rate cut, which would be difficult to justify amid gradually improving economic conditions. The ECB also discussed the forward guidance, and the GC was unanimous in keeping the current qualitative version, which Draghi defined as the most appropriate one. This seems to rule out any ECB move towards complementing its guidance with a numerical CPI threshold.

STRONG ACCELERATION IN THE COMPOSITE PMI



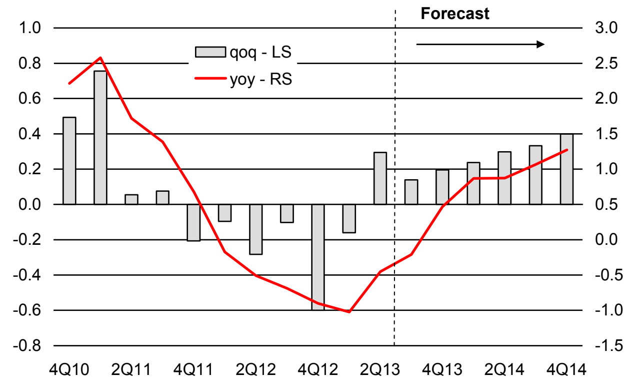
CONSUMER CONFIDENCE ON THE RISE



Source: EC, Markit, UniCredit Research

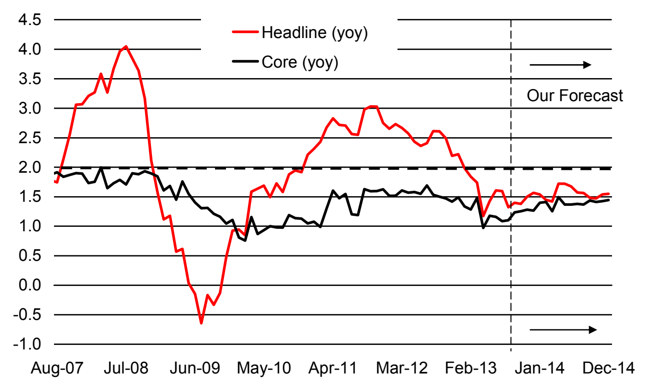
Eurozone

GDP



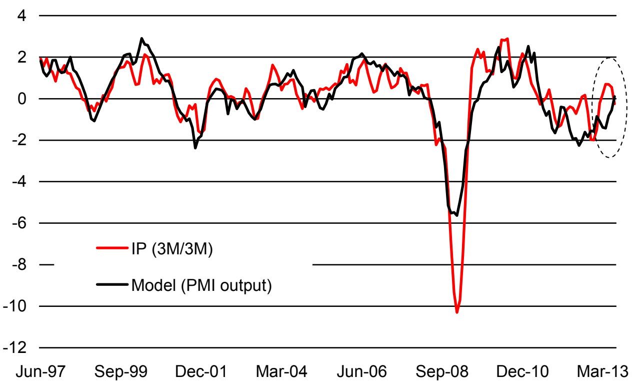
■ Eurozone exited the recession sooner than expected.

INFLATION



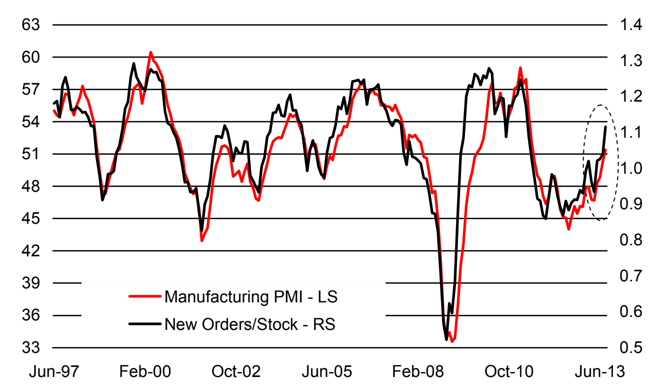
■ Despite higher oil prices, inflation remains muted.

IP AND PMI OUTPUT



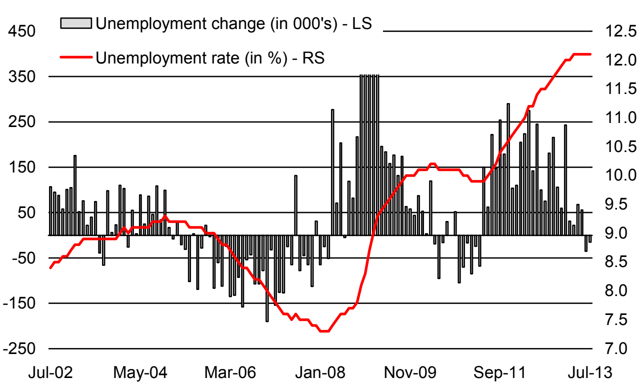
■ Hard vs. soft data: the "gap" has closed.

MANUFACTURING PMI



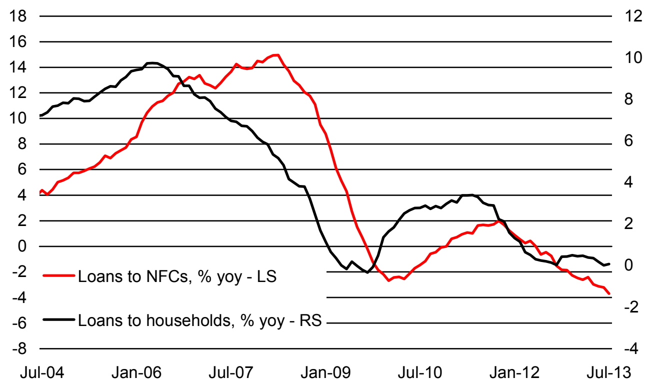
■ Forward-looking indicators paint a constructive picture.

LABOR MARKET



■ Unemployment rate stabilizes.

LENDING



■ Downward trend in corporate lending persists.

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

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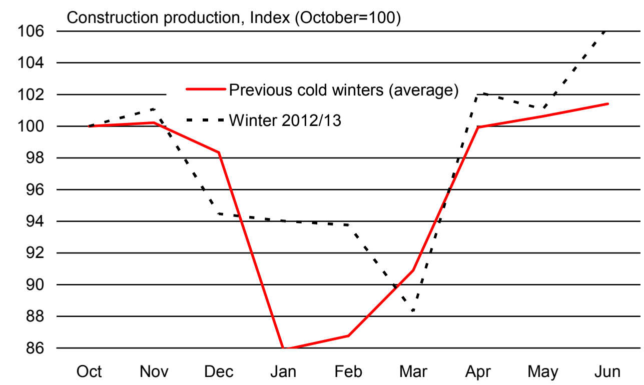
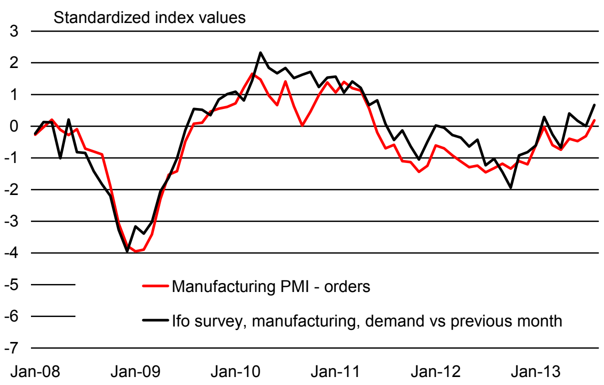
- The German economy staged a formidable growth rebound of +0.7% qoq in the spring quarter, amplified by catch-up effects after the long and cold winter (see left chart below). But also adjusted for the weather impact, the 2Q13 GDP details presented a robust growth picture. Quarterly dynamic was driven primarily by domestic demand as well as a moderate pick-up in net exports. Consumption continued its upward trend, with ongoing tailwinds from the solid labor market situation. And in addition to the weather-related jump in construction investment, gratifyingly investment in machinery and equipment rose after five negative quarters in a row.
- The latest business sentiment readings confirm our view that the German economy will be able to maintain a somewhat more moderate but still robust momentum in 2H13, following the exceptional rebound in the spring. The latest rise in the Ifo business expectations, not least due to improved export expectations in manufacturing, together with the jump in the August PMI's new orders component from 50.6 to 54.2 (the highest level since May 2011; see right chart below), bodes well for an ongoing recovery in industrial output.
- The imminent recovery in foreign demand should translate into a further improvement of export dynamics in 2H13, driven by sales to non-EMU countries, but also supported by the observable stabilization in EMU demand, which still accounts for almost 40% of German exports. Accordingly, recent investment surveys showed plans for a further moderate expansion in business investment over the coming quarters. Moreover, the solid labor market situation and thriving building permits indicate that domestic demand should remain a major growth pillar, currently adding to an overall broad-based recovery path. Hence, after the strong 2Q13 result we revise up our GDP forecast for 2013 slightly to +0.6% (on an adjusted basis).

WEATHER-RELATED REBOUND IN CONSTRUCTION



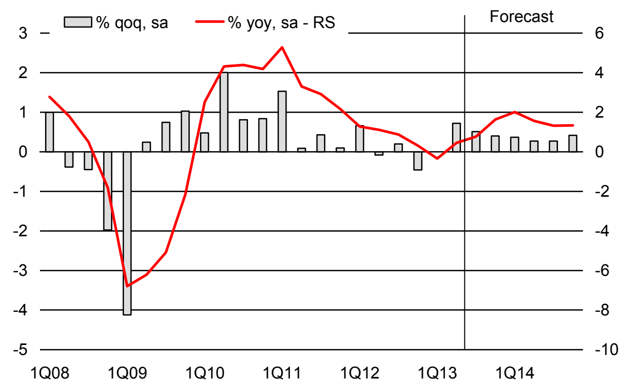
NEW ORDERS ASSESSMENT POINTING NORTH



Source: Feri, Ifo, Markit, UniCredit Research

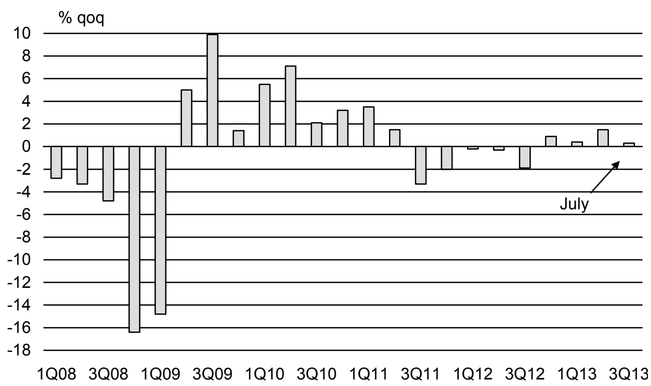
Germany

GDP



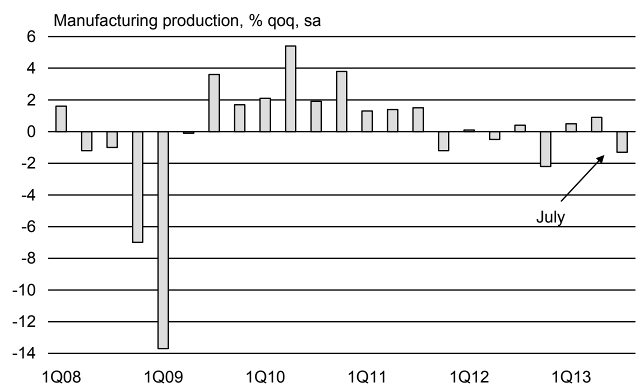
■ GDP rebounded a solid 0.7% qoq in the spring, following stagnation in 1Q13.

NEW ORDERS



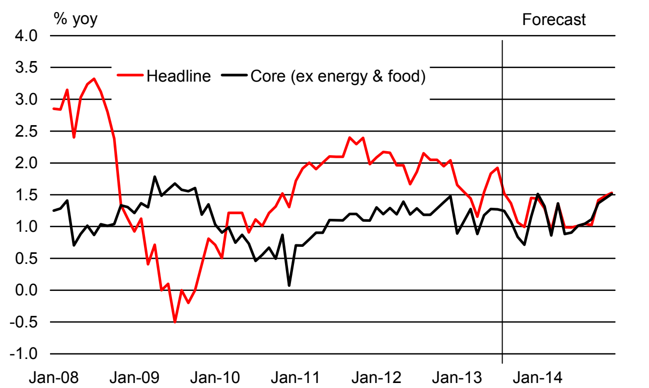
■ New orders in July still up a moderate 0.3% versus 2Q13, despite strong -2.7% mom setback.

MANUFACTURING PRODUCTION



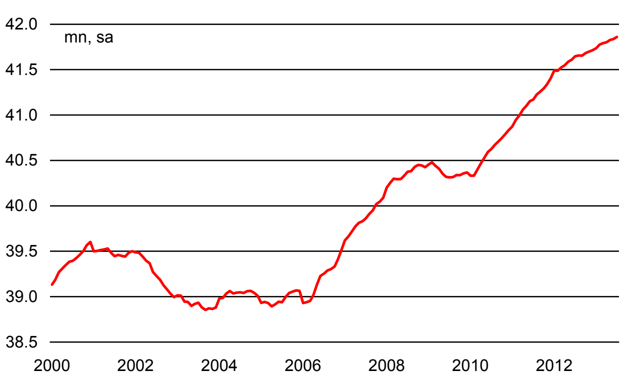
■ Manufacturing output corrected a strong -2.1% in July. Business surveys signal, however, a rebound in the further course of 3Q13.

INFLATION



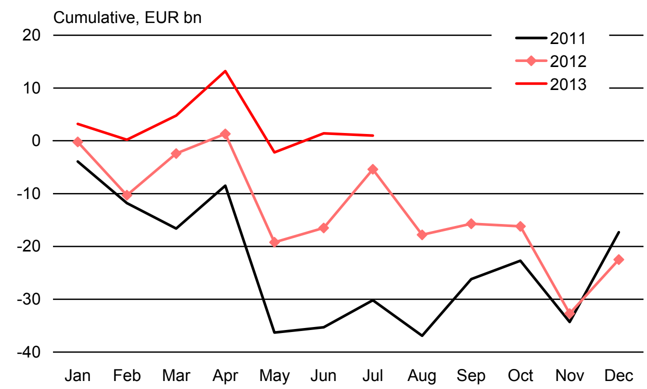
■ Consumer price inflation eased from 1.9% to 1.5% in August, driven by a base effect in energy prices.

EMPLOYMENT



■ Employment continued its upward trend at the beginning of 2H13, rising 21,000 in July.

FEDERAL BUDGET BALANCE



■ The federal budget balance improved markedly compared to the last two years, driven by increasing tax revenues.

Source: Bundesbank, FSO, Ministry of Finance, UniCredit Research

France

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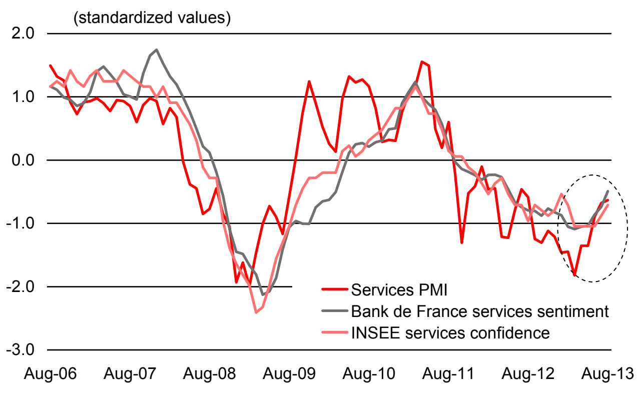
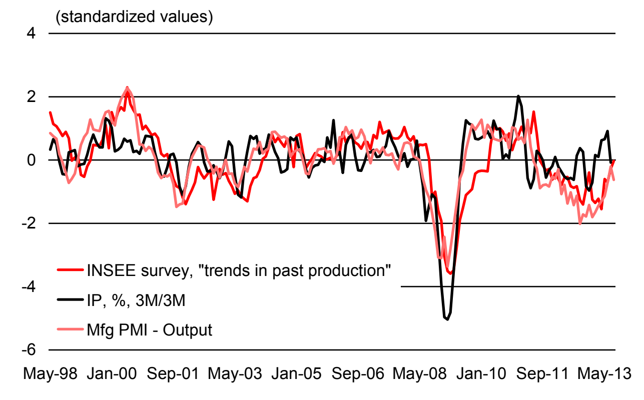
- France exited recession on very strong footing in 2Q13 with GDP rising 0.5% qoq. This outcome was much more solid than suggested by business surveys and even hard data. The better-than-expected GDP number was mainly explained by the fact that services activity, usually difficult to track down, expanded at a pace (+0.7% qoq) that could have hardly been foreseen from the very weak level of services surveys. Looking ahead, some payback for unusually high energy consumption and for strong exports of big-ticket items is likely to materialize in 3Q13. It will thus translate into a material GDP slowdown (+0.1% qoq). Still, a large carryover effect has caused us to revise our 2013 GDP growth forecast from -0.3% to +0.2%.
- The latest data developments are consistent with a clear GDP deceleration in 3Q. IP contracted for the third month in a row in July (-0.6% mom) and pointed to a weaker-than-expected entry into 3Q. However, we are not particularly concerned about this performance. According to our models, July's IP outcome just closes the gap between hard data and manufacturing surveys. In 2Q13, this gap had become unusually large, as production consistently surprised to the upside while soft indicators of manufacturing activity remained at low levels. Now, it looks like the opposite is happening (i.e. IP is coming in more subdued amid clearly-improving sentiment indicators). This dynamic has already been included in our GDP forecasts.
- On the policy front, PM Ayrault recently announced the main guidelines for the reform of the general public pension scheme that covers private-sector workers (the most important of the nearly 40 schemes that form the French pension system). From 2020 onwards, the government plans to gradually increase the mandatory contribution period required to be eligible for a full pension by extending the framework introduced in 2003. While this approach based on changes to the system's main parameters may fall short of what is needed to reach full sustainability, we regard the increase in the full contribution period as a step in the right direction towards addressing the longer-term impact of ageing on the scheme. However, the government's pending decisions on the "special schemes" covering public servants and workers at state-controlled companies will be a key test of the government's commitment to addressing the persistent deficit of the overall pension system – special schemes are far more generous than private ones and they account for the largest share of the overall system's deficit.

SENTIMENT IN SERVICES RECOVERING FROM LOW LEVELS IN 3Q



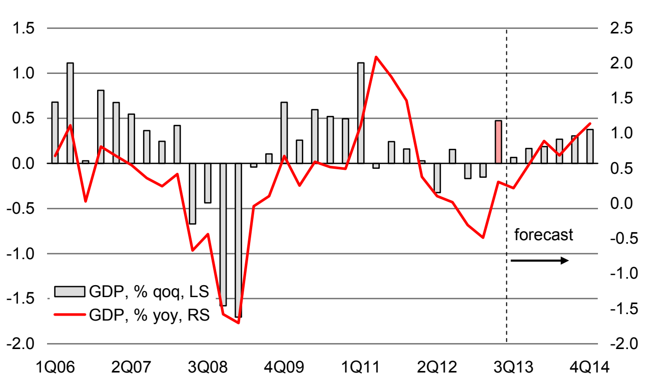
GAP BETWEEN SURVEYS AND IP DATA HAS CLOSED EARLY



Source: INSEE, BdF, Markit, UniCredit Research

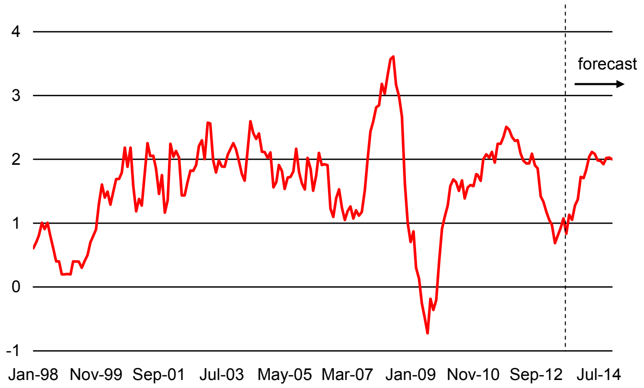
France

GDP



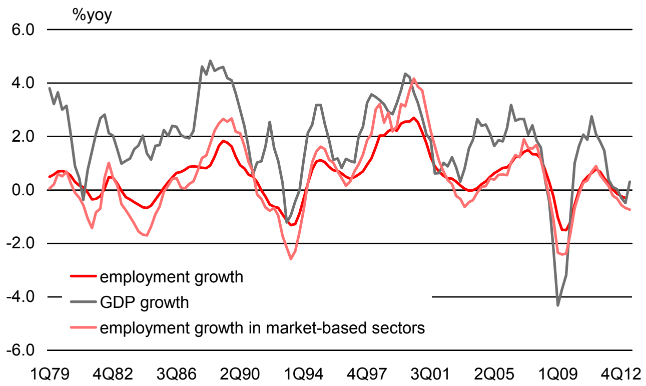
- Following a strong 2Q GDP, we revised our annual GDP forecast from -0.3% to +0.2% in 2013 and from +0.8% to +0.9% in 2014.

INFLATION



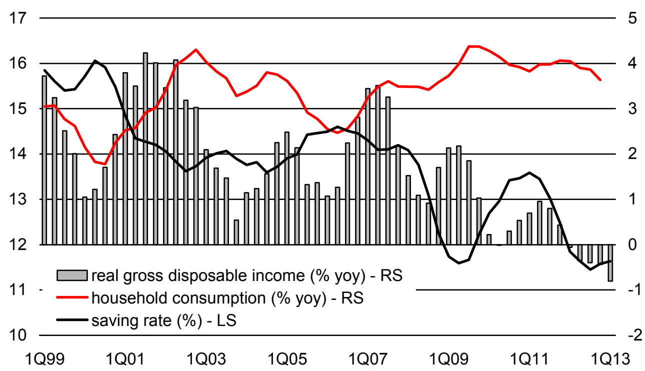
- CPI edged up 0.2pp to 1.1% in July. We currently estimate inflation to average 1.0% in 2013.

EMPLOYMENT



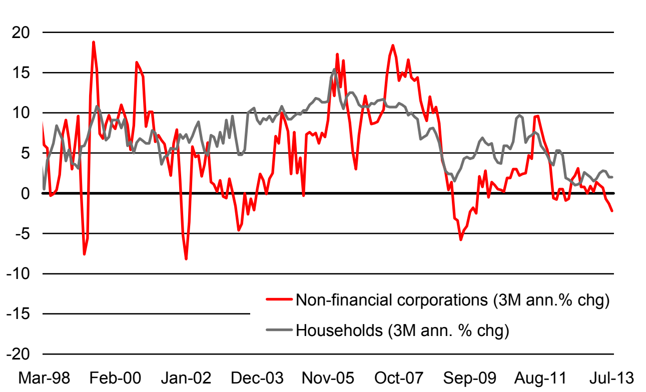
- The pace of job destruction slightly accelerated in the market-based sectors in 2Q13.

REAL DISPOSABLE INCOME



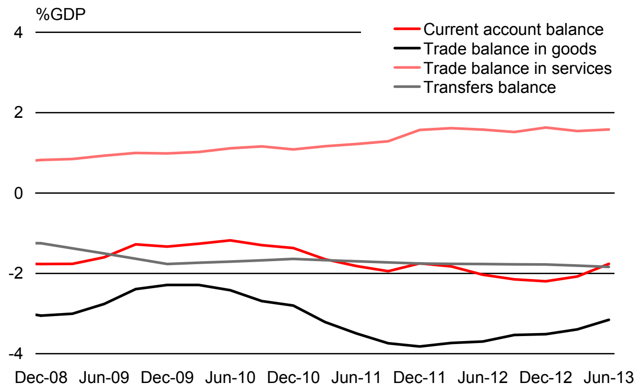
- The contraction in real disposable income since early 2012 is unprecedented, as is the behavior of the savings rate.

LENDING TO THE PRIVATE SECTOR



- Lending to NFCs has started to contract anew from May.

CURRENT ACCOUNT



- The current account deficit stabilized at 1.8% of GDP by the end of 2Q13, the lowest reading since March 2012.

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

Italy

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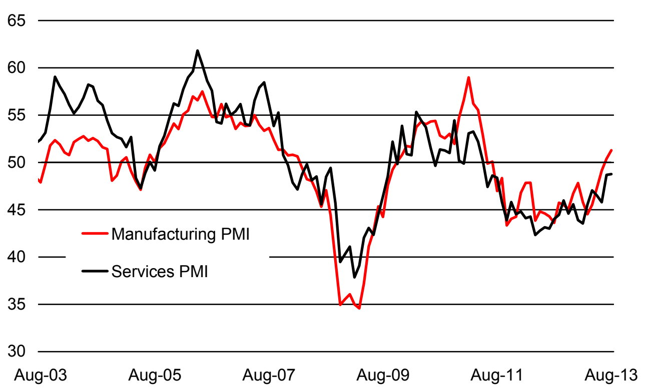
- Manufacturing surveys continued to surprise on the upside during 3Q13, showing a clear upward trend which is supported by a recovery in foreign demand. The manufacturing PMI was up to 51.3 in August, two points above the June level. Its new exports orders index improved further, hitting 55.8 vs. 52.2 in June. Contrary to the industrial sector, the improvement in sentiment in services is proceeding at a slower pace. The service PMI stabilized at 48.8 in August, although it improved in comparison to the June level. This divergent trend is consistent with our view that the weakness in internal demand is gradually receding, while an export recovery is already in the cards.

- Among hard data available so far, IP started 3Q13 on a weak footing, showing a 1.1% mom decline in July. This seems to be at odds with the encouraging indications coming from manufacturing surveys, therefore we expect a rebound in output in the final part of the quarter, with IP seen broadly stabilizing in 3Q13 (after -1.0% qoq in 2Q13). This would be consistent with our forecast of flat GDP in the third quarter. We continue to expect modest positive growth in 4Q13 and an acceleration thereafter, fueled by strong support from foreign demand and a stabilization (and then recovery) in investment and consumer spending. The investment pick-up is expected to be helped by easing liquidity conditions for firms related to the payments of PA arrears (totaling up to EUR 50bn in 2013-14). All in all, we stick to our call of GDP contracting 1.7% in 2013 and expanding 0.6% in 2014. Downside risks are mainly associated with the uncertain political environment.

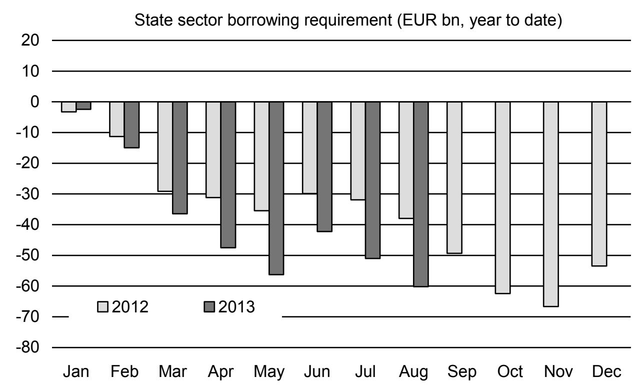
- On the labor-market front, the unemployment rate fell back to 12.0% in July, after hitting 12.2% in May. The decline in the unemployment rate was a result of broad stabilization in employment and a slight increase in the number of inactive people. However, as employment lags real activity, we see this improvement as being short-lived and expect employment to contract in the coming few quarters. This is also suggested by the still low level of the employment index in the composite PMI survey.

- On the fiscal side, the cash deficit in the first eight months of 2013 was EUR 60.2bn, higher than the deficit recorded in the same period of 2012 (EUR 34.0bn). Until now, the underperformance of the cash deficit can be explained by several one-off factors, including re-payments of PA arrears. Going forward, the government is committed to funding the potential shortfall (estimated at about EUR 4/4.5bn) coming from: **1.** its commitment to cancel the December tranche of the property tax on primary residences; **2.** its plan for a further delay of the 1pp VAT hike, currently scheduled for 1 October; **3.** other resources needed for the labor market. The government is due to present its macro and fiscal forecasts in the updated *Documento di Economia e Finanza* later in September.

FACTORY ACTIVITY LEADS SERVICES IN THE RECOVERY TREND



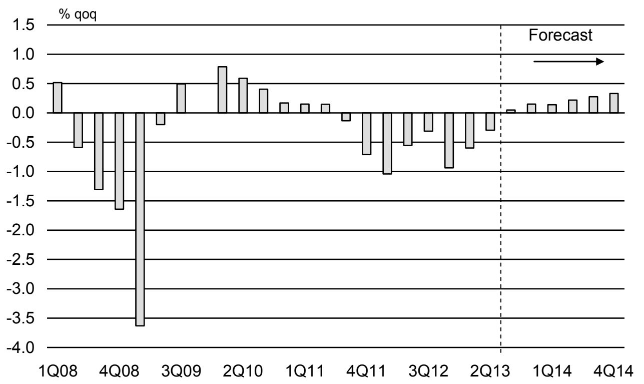
TEMPORARY FACTORS WEIGH ON CASH DEFICIT



Source: Markit, MEF, UniCredit Research

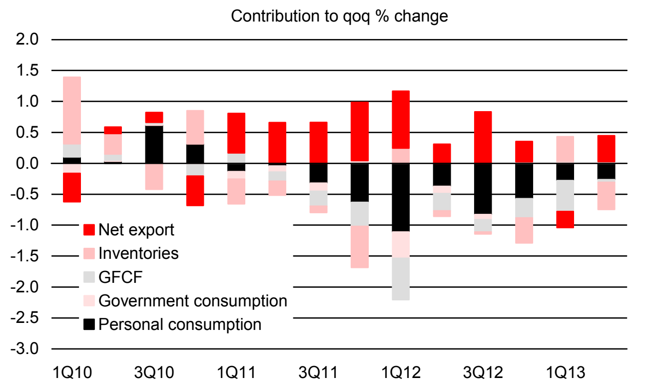
Italy

GDP



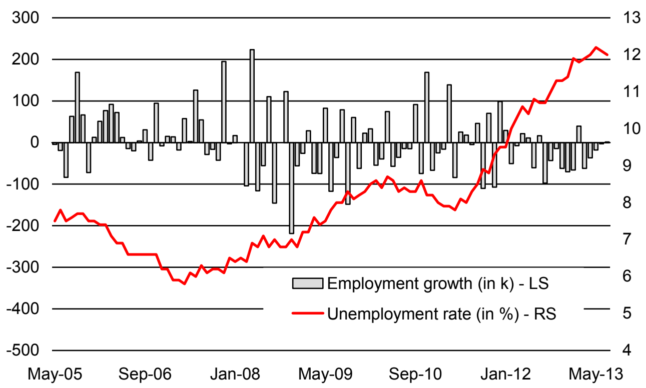
- According to the final reading, Italy's GDP contracted by 0.3% qoq in 2Q13 vs. our expectation of -0.4% and the preliminary estimate of -0.2% qoq.

EXPENDITURE BREAKDOWN



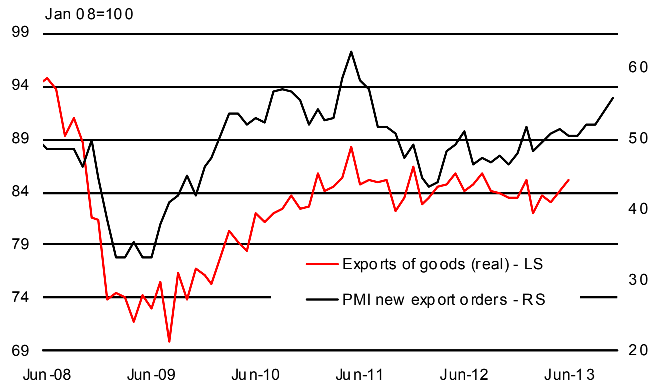
- In 2Q, the pace of private consumption and, above all, investment contraction moderated, while exports expanded by 1.2% qoq and imports declined by 0.3%.

LABOR MARKET INDICATORS



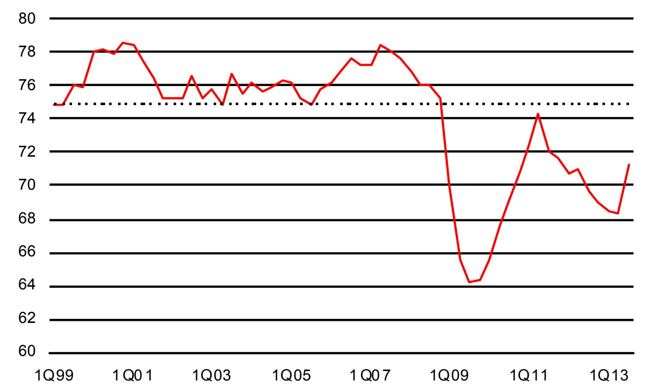
- We expect the unemployment rate to resume its rise in the coming quarters, averaging 12.1% in 2013 and 12.6% in 2014.

EXPORTS



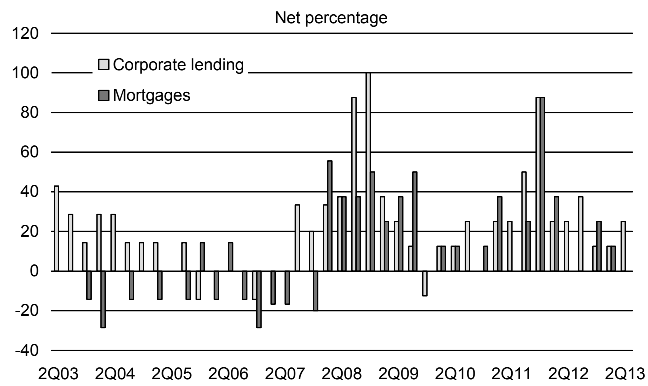
- The exports recovery seems to be well-entrenched.

CAPACITY UTILIZATION RATE



- Capacity utilization came back on an upward trend, although it is still far from its long-term average.

BANK LENDING SURVEY: CREDIT STANDARDS



- In 2Q13, Italian banks reported a further tightening of credit standards for corporate loans, with the outlook for firms as their main concern.

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

Spain

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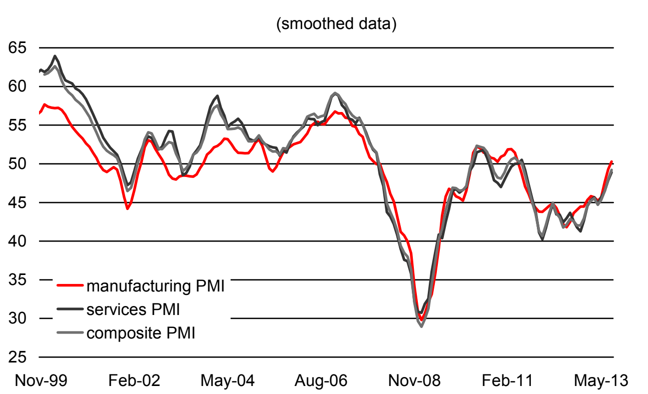
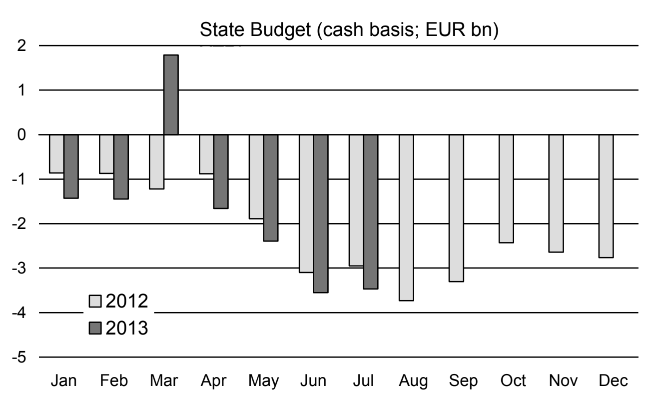
- Recent business surveys suggest that the GDP outlook has continued to gradually improve mid-way through the third quarter. The composite PMI breached the 50 threshold in August for the first time since May 2011 and settled at 50.8, vs. 48.6 in July. This large improvement was driven by meaningful increases in both the manufacturing (up from 49.8 to 51.1) and the services indexes (up from 48.5 to 50.4). Concerning hard data, readings for July were mixed, but the underlying trend remains supportive of a gradual improvement in the growth outlook. Industrial production recorded a further decline in July (-0.5% mom vs. -0.2% mom in June), although this was partly due to a correction of the previous strong resilience in consumer and capital goods production. On an encouraging note, retail sales stood resilient in July (0.0% mom after a fairly strong performance in 2Q) and mirrored the steady improvement recorded in the retail confidence survey compiled by the European Commission, which rose by 6 points in July-August. Overall, these data validate our long-standing expectation that Spain will exit recession by the end of the year.
- The labor market is showing some encouraging signs of stabilization. The latest data released by the Ministry of Labor and Social Security point to an encouraging decline in the number of registered jobless claims in August (-31K vs. +38K in the same period one year ago, on a non-seasonally-adjusted basis). The decline also compares favorably to an historical perspective, given that, in August, the number of jobless usually increases as contracts set to cover the tourist season expire. However, job creation keeps lagging behind the pace of decline in the number of jobless. This suggests that part of the decline in the number of jobless is explained by discouraged workers leaving the labor force or simply exhausting their unemployment benefits. This was also the message of the latest quarterly Labor Force Survey.
- On the fiscal front, the YTD central government deficit, on a national-account basis, settled at 4.4% of GDP in July vs. 4.5% for the same period one year ago. This limited improvement is partly explained by the fact that the settlement of indirect tax revenues corresponding to the year "t" between the state and autonomous communities – which usually takes place in July of the year "t+2" – resulted in significantly-lower transfers to the state compared to July 2012. In addition, interest payments rose significantly (by nearly +15%), weighing on the overall performance of total expenditure relative to the same period one year ago. Nevertheless, we think that the 3.8% full-year deficit target for 2013 still remains within reach, thanks to favorable evolution in overall revenues. The risk of missing the target is mainly associated with developments in expenditure.

PMIS HAVE MOVED INTO EXPANSION TERRITORY



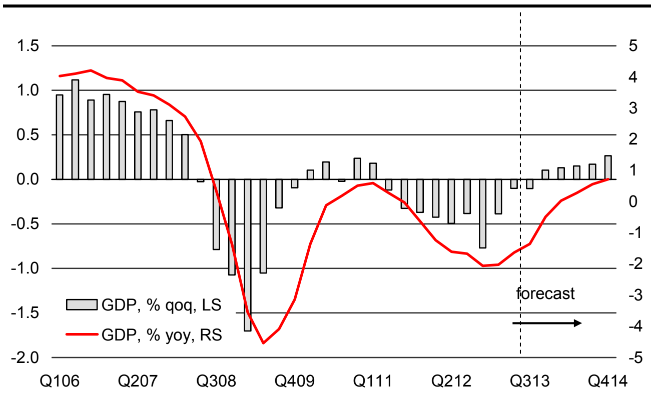
ONE-OFF FACTORS WEIGHING ON BUDGETARY PERFORMANCE



Source: Markit, Ministry of Finance, UniCredit Research

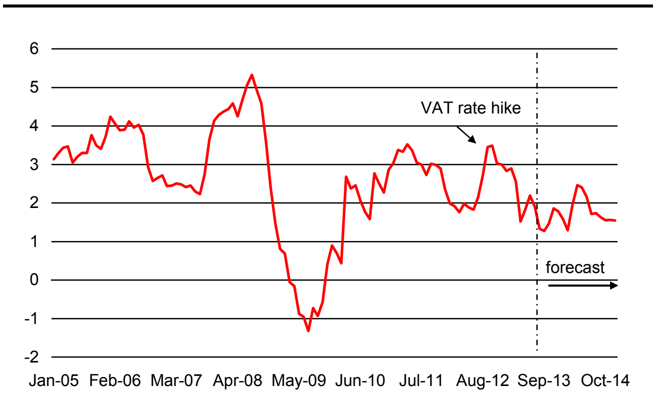
Spain

GDP



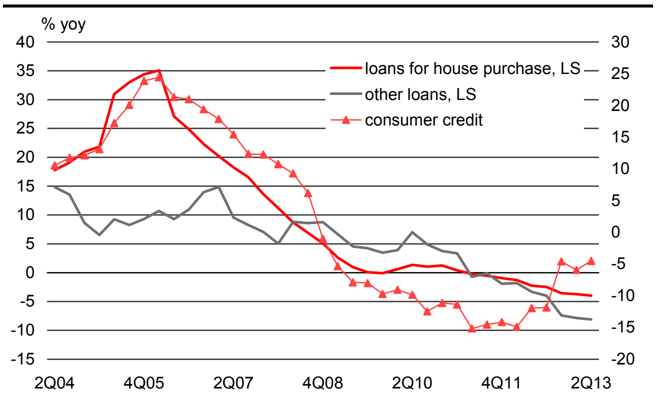
- The pace of recession eased further in 2Q13, and we expect GDP to return to positive territory by the end of the year.

INFLATION



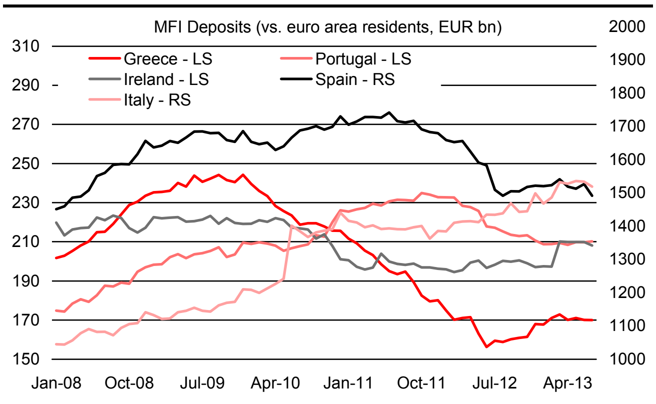
- We see inflation settling at 1.9% in 2013 and 1.6% in 2014.

HOUSEHOLD CREDIT GROWTH



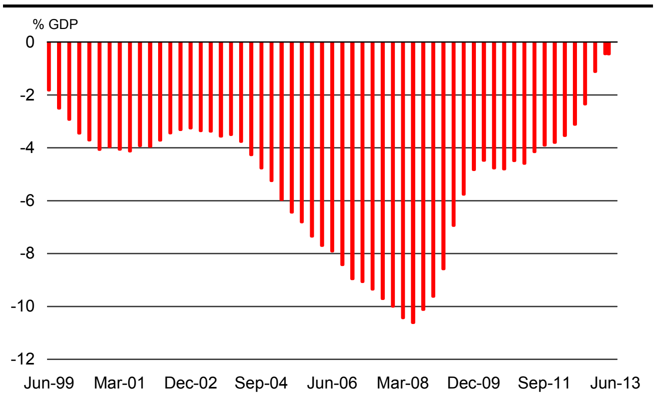
- The contraction in lending to households took a breather in 2Q13, mainly due to a pick-up in loans for consumer credit.

BANK DEPOSITS



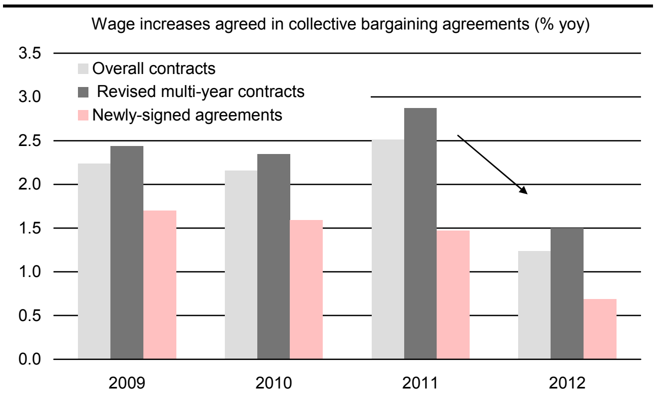
- The decline in deposits came to a halt in August 2012, and we have since witnessed a broad stabilization.

CURRENT ACCOUNT



- The current account deficit has been shrinking steadily, settling at only 0.4% of GDP at the end of 2Q13.

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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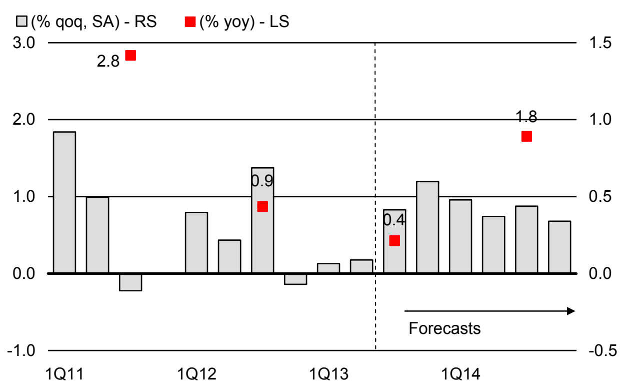
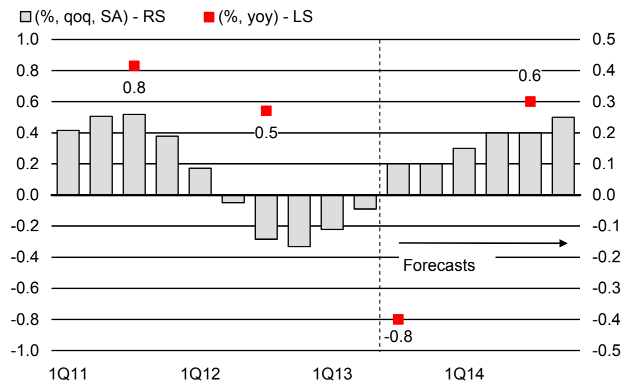
- The latest official estimate confirms our forecast of moderate economic growth in Austria in 2Q13. GDP increased by a real 0.1% over the previous quarter, following a revised GDP increase of 0.1% in 1Q13. Net exports were the main factor behind the upward trend in GDP. Exports increased again by 0.3% qoq thanks to a slight improvement in economic conditions in Europe, while imports fell by 0.1% qoq. (1Q13: -0.4% qoq). Stronger global demand and less uncertainty slowed the decline in investments to 0.9% qoq (1Q13: -1.2% qoq). The tight labor market mirrors the consistent weakness of private consumption, which stagnated in 2Q following a decrease of -0.1% qoq at the start of 2013.
- After the sound upturn in industrial sentiment and the improvement in the Bank Austria Purchasing Managers' Index in August to 52.0 points (July: 49.1), the GDP figures for 2Q13 now also suggest that an improvement in the Austrian economy may be getting under way. In the second half of the year, we are looking at growth of around 0.5% qoq, with support from foreign demand. After a sluggish start to the year, with the first half of 2013 actually seeing a fall in economic output of 0.2% yoy, we expect the second half of the year to see positive GDP growth for 2013 as a whole. We are forecasting economic growth of 0.4% for 2013. With GDP growth revised slightly upward to 1.8%, we believe that growth prospects for 2014 are significantly brighter than for the current year.
- The current economic climate in Austria is associated with both influential factors from abroad, whose positive impact is growing, and still rather faltering developments at home. However, confidence among domestic consumers improved in August, albeit from a very low level. Sentiment among consumers is largely attributable to the ongoing tight labor market. The increase in unemployment has accelerated and the negative trend will continue beyond the current year. We expect the unemployment rate to increase to an annual average of 4.8% for 2013. This means unemployment is noticeably higher than during the economic crisis of 2009, which is naturally acting as a brake on consumption.

AUSTRIA'S ECONOMY BACK ON A GROWTH PATH



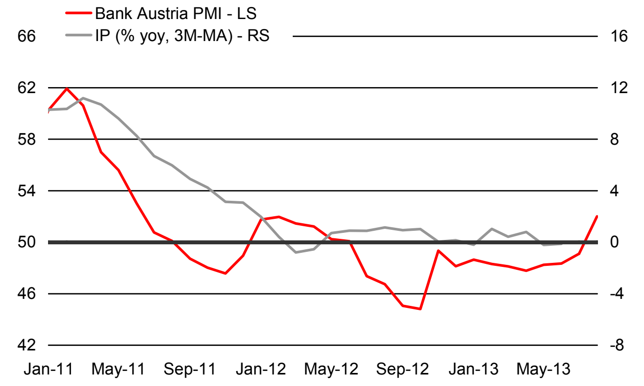
PRIVATE CONSUMPTION STILL THE MAIN WEAKNESS



Source: Statistik Austria, UniCredit Research

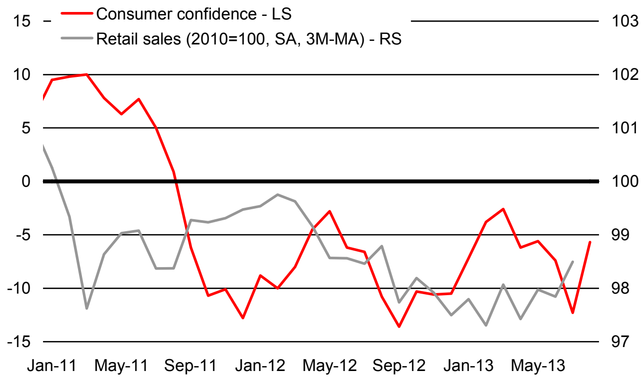
Austria

INDUSTRIAL OUTPUT AND PMI



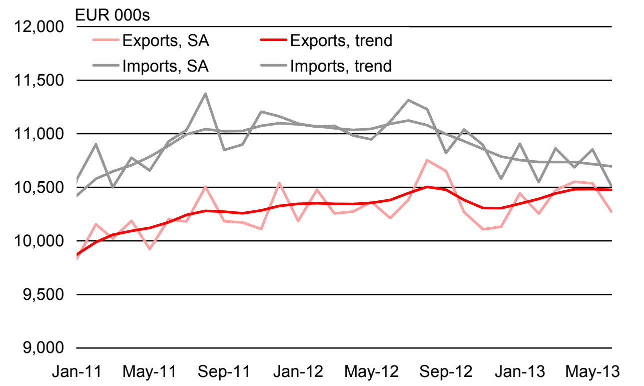
■ The rise in the PMI to 52.0 in August shows that industrial activity is experiencing an upturn, after stagnating in 1H13.

RETAIL SALES AND CONSUMER CONFIDENCE



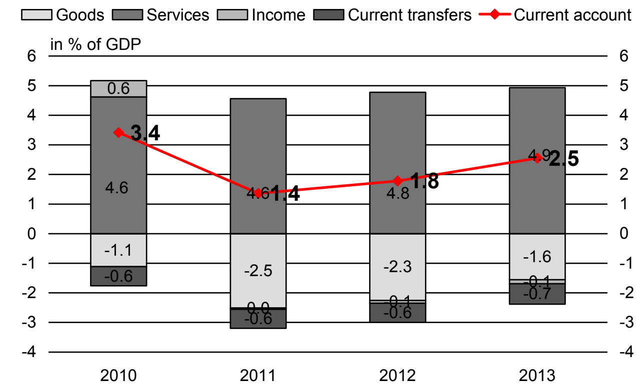
■ Retail sales declined by a real 0.5% in 1H13. As sentiment improves, the prospects for 2H13 are somewhat brighter.

EXPORT AND IMPORT VOLUME



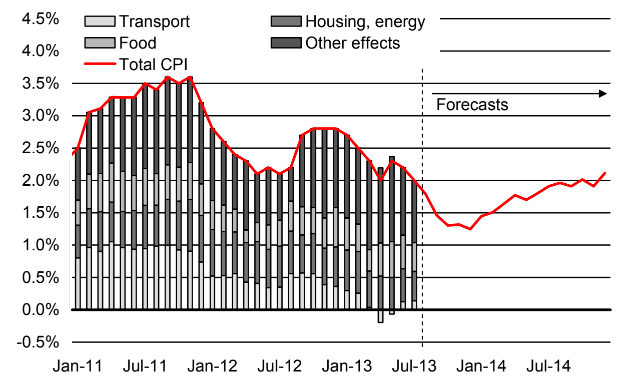
■ Merchandise exports increased by only a nominal 1.1% yoy in 1H13 due to weak demand from Europe.

CURRENT ACCOUNT BALANCE



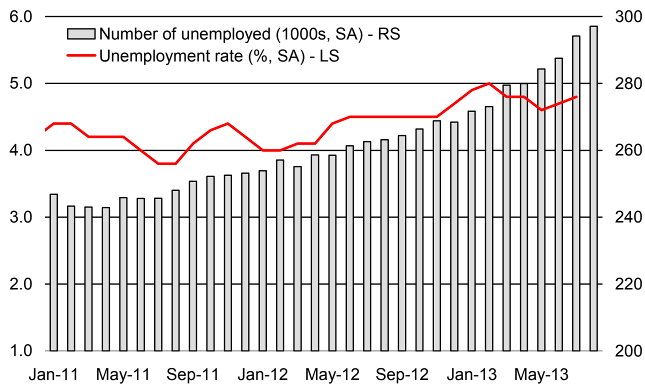
■ Thanks to a lower merchandise trade deficit, we expect Austria's current account surplus to increase to 2.5% of GDP in 2013.

INFLATION



■ Annual inflation decreased to 2% in July. We expect the inflation rate to average only 1.9% in 2013 as a whole.

UNEMPLOYMENT



■ Despite initial signals of economic recovery, the number of unemployed continued to increase in August.

Source: Statistik Austria, UniCredit Research

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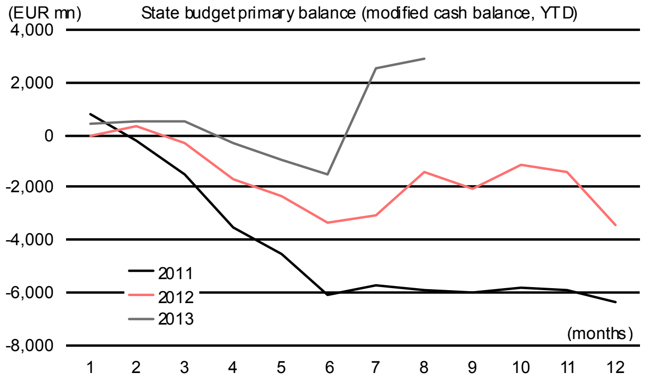
Greece

- Major news on Greece is centered around the forthcoming arrival of the Troika's mission chiefs to Athens on 22 September; as usual, mission chiefs will be preceded by a team of technical experts, arriving on 16 September. The Troika is set to first evaluate whether the conditions are in place for the disbursement of the next EUR 1bn loan tranche installment scheduled for October. These conditions consist of the fulfillment by the government of some "milestone" reforms, including the placement of 12.5K civil servants in the mobility scheme; the adoption of a new code for lawyers; the settlement of arrears to EYDAP and EYATH, two semi-private utilities in charge of water supply and sanitation, and progress on the privatization of three state-owned companies (Hellenic Vehicle Industry/ELVO, Hellenic Defense System/HDS, and General Mining and Metallurgical Company/LARCO).
- A preliminary draft of the medium-term fiscal strategy for 2014-2017 will be discussed in order to identify budgetary measures necessary to close the projected fiscal gaps for 2015-2016 (equal to EUR 4bn in total) so as to reach the targets of a primary surplus of 3.0% of GDP in 2015 and 4.5% in 2016. In July, the IMF identified that, from 2014 on, part of the necessary savings may come from the gradual elimination of existing exemptions in the current social-security contributions system. However, the government is concerned about further fuelling of political tensions, and will most likely try to negotiate a further postponement of the decision. Finance Minister Stournaras recently said that he is hoping to avoid any new fiscal measures that weigh on households' disposable income.
- Once the appropriate fiscal measures are indentified and the disbursement of the loan installment is settled, discussions between the government and the Troika could focus on the envisaged shortfalls in the financing program for 2014 and 2015. These shortfalls have gained center-stage in the policy debate since German finance minister Schäuble publicly acknowledged that Greece is likely to need a third bailout package. Our baseline scenario is that, the Troika will focus on covering the 2014 shortfall and postpone discussions about how to finance the 2015 shortfall until sometime next year. This two-stage approach would have the advantage of starting discussions on the 2015 financing gap under conditions that are more favorable for EU political leaders to reach a consensus on additional official financing to the country. Greece's primary balance is expected to turn into a sustainable surplus in 1H14.

STATE BUDGET PRIMARY BALANCE MOVED INTO SURPLUS



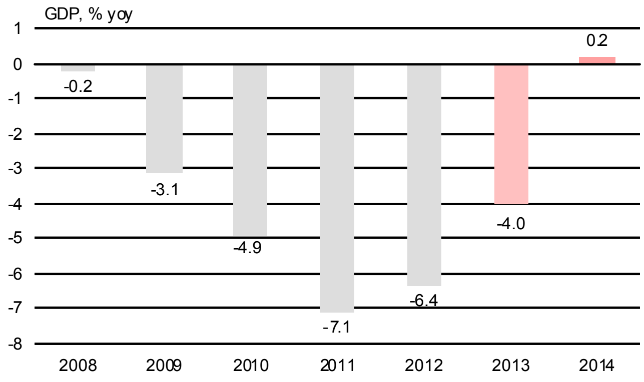
MEDIUM-TERM FISCAL PROJECTIONS IN THE MEMORANDUM

In % of GDP	2012	2013	2014	2015	2016
Primary balance	-1.3	0.0	1.5	3.0	4.5
General government balance	-6.3	-4.1	-3.3	-2.1	-0.8

Source: Greek Finance Ministry, European Commission, UniCredit Research

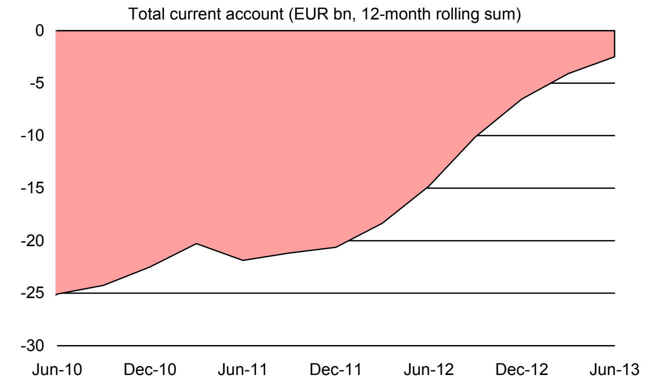
Greece

GDP



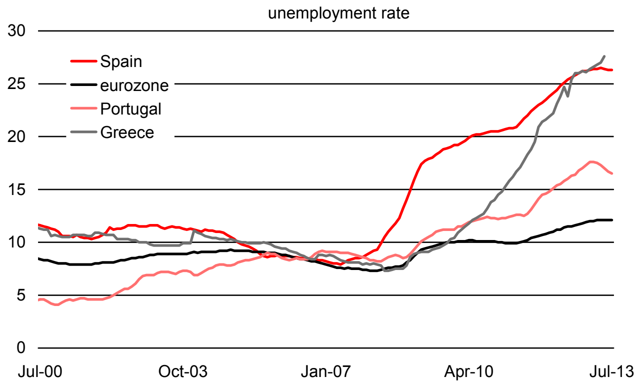
- Greece may exit recession next year.

CURRENT ACCOUNT



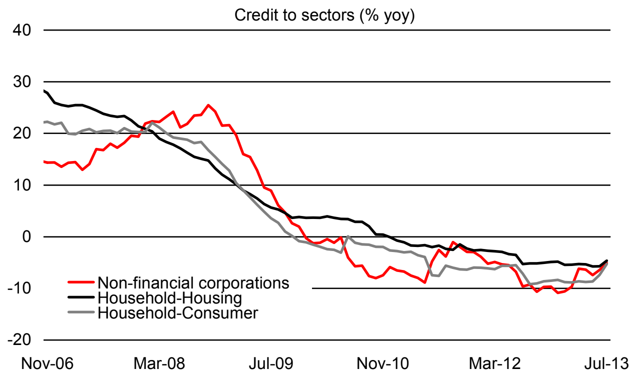
- The current account deficit has been shrinking steadily and settled at nearly EUR 2.5bn in June.

UNEMPLOYMENT



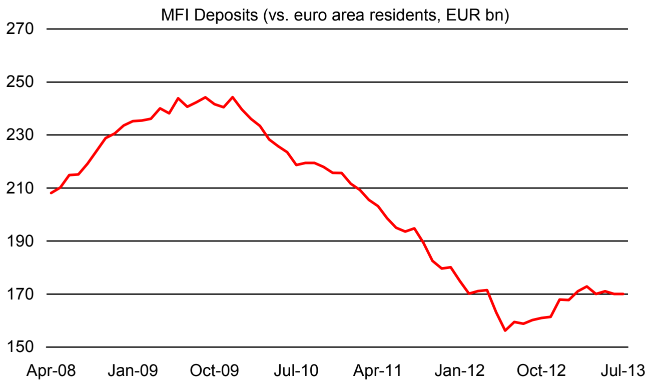
- The increase in the unemployment rate has shown no letup.

CREDIT GROWTH



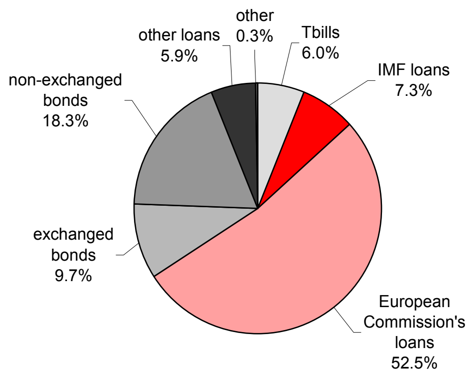
- The pace of contraction in credit to the private sector continues to ease, albeit gradually.

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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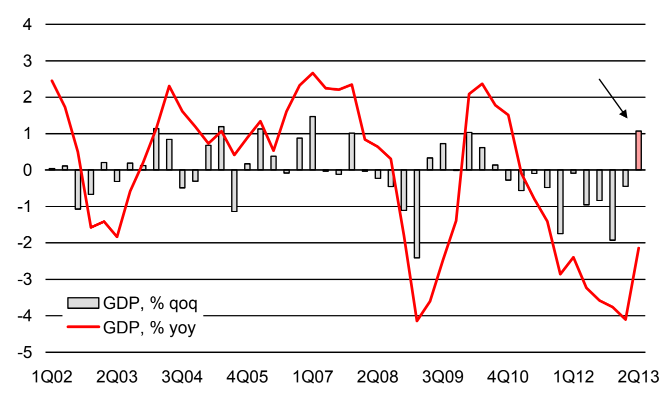
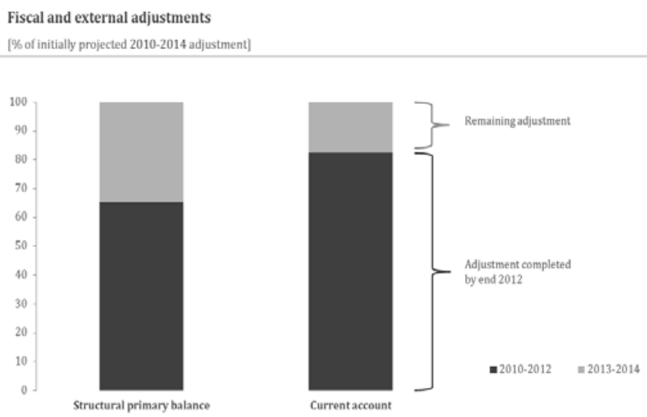
- The Portuguese political agenda looks particularly heavy with the arrival of the Troika's mission to Lisbon in the coming days and municipal elections scheduled for 29 September. The Troika's mission should have started on 15 July, but was postponed at the request of the Portuguese government due to political tensions that had threatened the center-right coalition in power. The government also requested that the eighth and ninth review missions take place simultaneously. The Troika review comes at a sensitive time for the government coalition, which is scoring poorly in opinion polls ahead of local elections and recently suffered a further setback in its attempt to complete the public expenditure review for 2013-2014. The constitutional court declared unconstitutional a measure according to which public employees that enter the retraining/mobility scheme, but are unable to find a job after 12 months, would be dismissed. The court's ruling is not expected to have a major impact on the 2013 budget but risks jeopardizing the government's efforts to introduce voluntary redundancies of public workers (with a far greater impact on the 2014 budget).
- On top of the usual review of progress on budget execution and structural reform implementation, discussions between the government and the Troika are expected to focus on Portugal's "exit strategy" from the current program, which is set to expire by mid-2014. In line with ongoing talks of Ireland being offered an enhanced conditions credit line (ECCL) to help the country fully re-access the market, we think that the Troika will make a similar proposal to Portugal. As we discussed in the July Chartbook, we regard an enhanced conditions credit line as a more appropriate form of aid rather than a second full program, which could be interpreted as an outright failure by the Portuguese authorities to address the country's economic imbalances. For reference, an ECCL facility has an initial duration of one year and is renewable twice, for six months each time, and its size is capped at 2-10% of the recipient country's GDP. Therefore, a 12-month ECCL might help to cover the country's financing needs for 2014 and possibly some for 2015 (depending on how the public finances develop). Currently, the (uncovered) financing needs of the country amount to around EUR 13bn in 2014 and EUR 18.5bn in 2015, according to our calculation.
- With respect to the latest macro developments, after ten consecutive quarters of contraction, GDP rose by a whopping 1.1% qoq in the second quarter, thanks to favorable temporary factors (which we expect to be reversed in 3Q). The GDP rebound was explained by a largely positive contribution from domestic demand (+0.8pp) as both gross fixed capital investment (+3.3% qoq vs. -8.9% in 1Q) and, to a lesser extent, private consumption (+0.4% qoq vs. -0.7% qoq) performed strongly.

SURPRISINGLY STRONG GDP REBOUND IN 2Q13



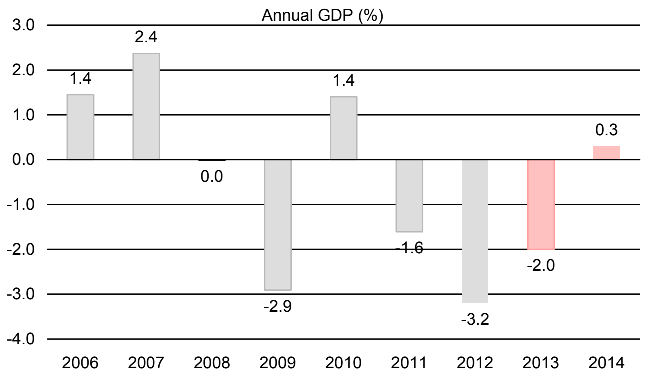
STRUCTURAL ADJUSTMENT HAS BEEN FRONT-LOADED



Source: INE, IGCP, UniCredit Research

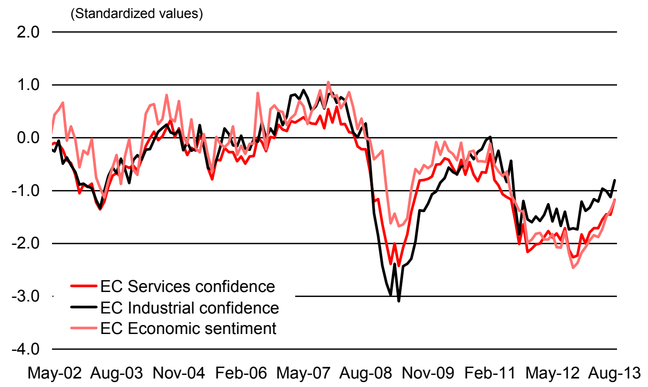
Portugal

GDP



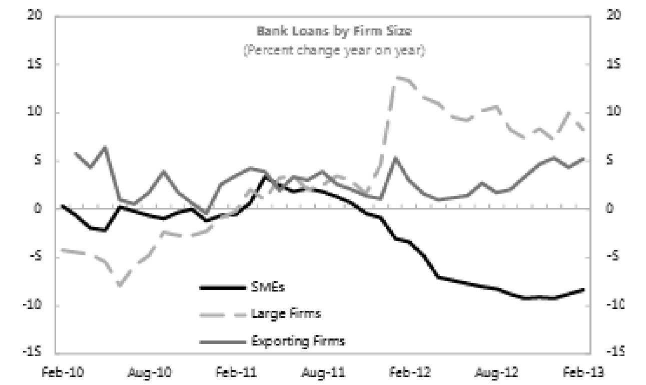
- We expect GDP to contract by 2.0% in 2013 and to return to positive growth in 2014 (at an average annual rate of +0.3%).

SURVEYS



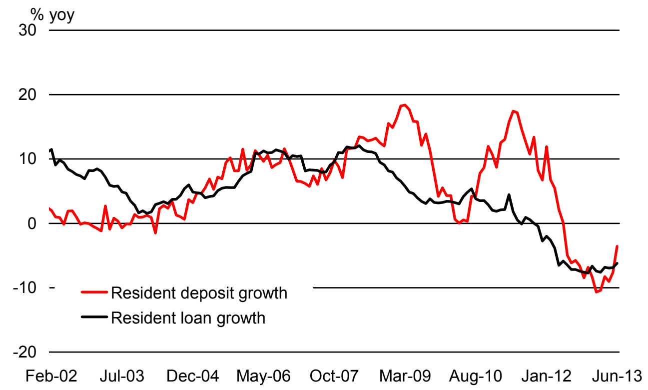
- Sentiment has been improving steadily, especially in the industrial sector.

BANK LOANS BY FIRM SIZE



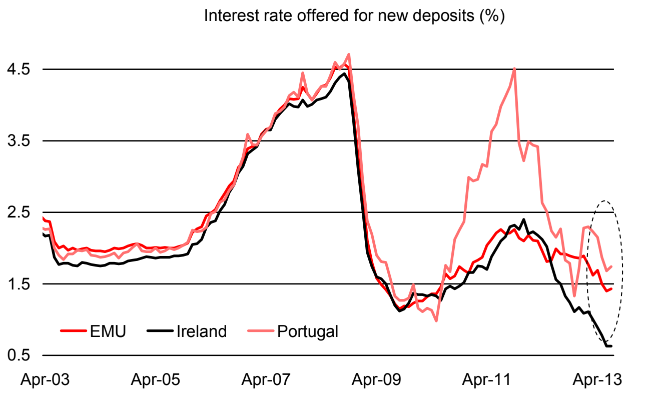
- Credit to SMEs remains difficult.

DEPOSIT AND LOAN GROWTH



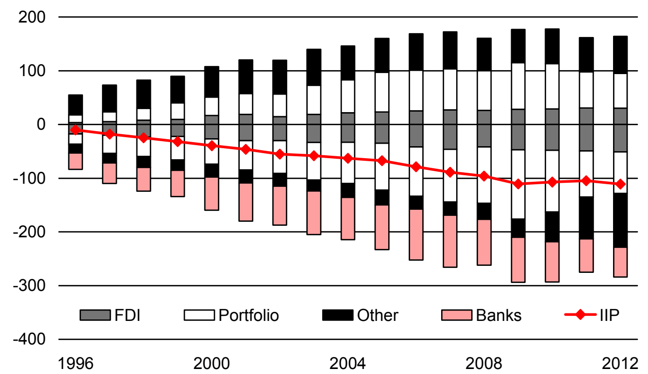
- The pace of contraction in deposit growth has been easing since April…

DEPOSIT RATES



- …although interest rates on new deposits have been declining.

NET IIP



- External deleveraging is only just beginning.

Source: INE, Bank of Portugal, UniCredit Research

UK

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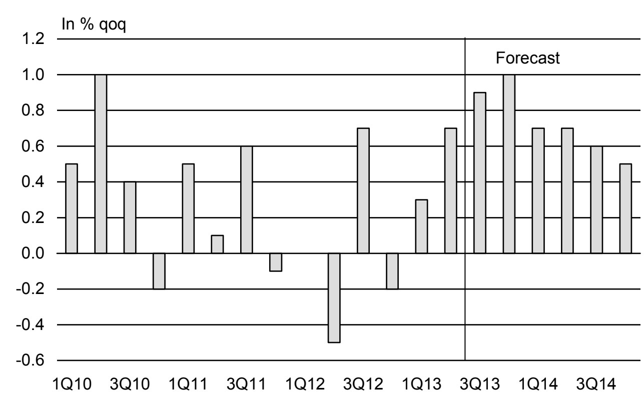
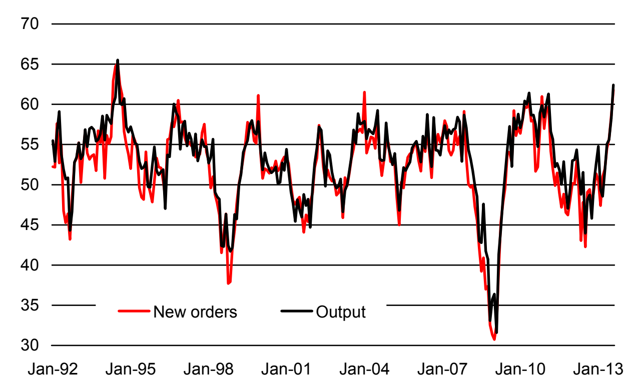
- We strongly increased our GDP forecasts for this year and next. We now expect an increase of 1.6% in 2013 and 3.1% in 2014 (compared to +0.9% and +1.4%, respectively). In terms of quarterly dynamics, a hump-shaped pattern is likely. After already increasing 0.7% qoq in 2Q13, momentum should accelerate further in the second half of this year. We expect GDP growth to peak at 1% qoq (or 4% on an annualized basis; see first chart) at year-end 2013. Although still growing briskly and above potential afterwards (we estimate potential growth to be around 2%), some loss in dynamics might materialize (1H14: +0.7% or 2.8% on an annualized basis).
- Our optimistic view is underpinned by recently surging sentiment indicators for the UK. The Manufacturing PMI rose for the sixth consecutive month from 54.6 to 57.2 and hence to its highest level since February 2011. Especially encouraging was the jump in the new orders and output subcomponents (see second chart). Both figures reached their highest level since August 1994! Although the improvement in the Services PMI was less pronounced in August 2013 (from 60.2 to 60.5), both its level and recent dynamics also point to further accelerating GDP growth. The Services PMI increased for the eighth month in a row, now having risen by a total of 11.5 points since hitting its trough.
- Encouraging news also came from the construction sector. The construction PMI increased from 57.0 to 59.1, thereby hitting its highest level in the last six years. House price increases also accelerated further in recent months. In August 2013, the Halifax house price index rose more than 6% yoy (Nationwide: 3.5%).
- In August 2013, the BoE announced its forward guidance (FG) alongside the inflation report. The FG is state-contingent. The BoE decided not to raise the bank rate, at least until the unemployment rate falls to a threshold of 7%. Furthermore, the MPC would consider additional asset purchases if the unemployment rate stays above 7% and further monetary stimulus is judged to be warranted. Until the unemployment threshold is reached, the BoE does not plan to reduce the stock of asset purchases. The BoE did not introduce unconditional FG. Instead, there is an escape clause in the form of three so-called "knockouts". The first knockout refers to inflation at 2.5% at the 18 to 24-month horizon. The second refers to medium-term inflation expectations remaining sufficiently well anchored. The third knockout deals with financial stability.

FURTHER ACCELERATING GDP GROWTH



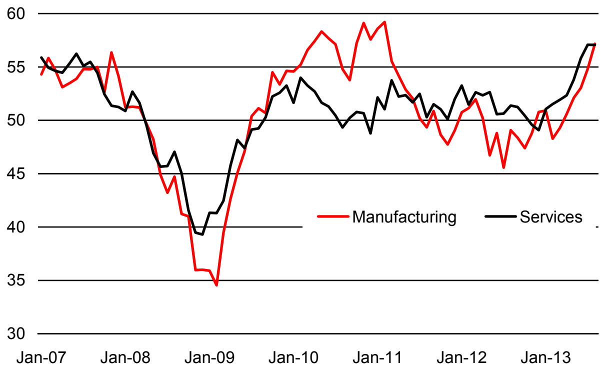
HIGHEST MANUFACTURING PMI (NEW ORDERS & OUTPUT) SINCE 1994



Source: Feri, Markit, UniCredit Research

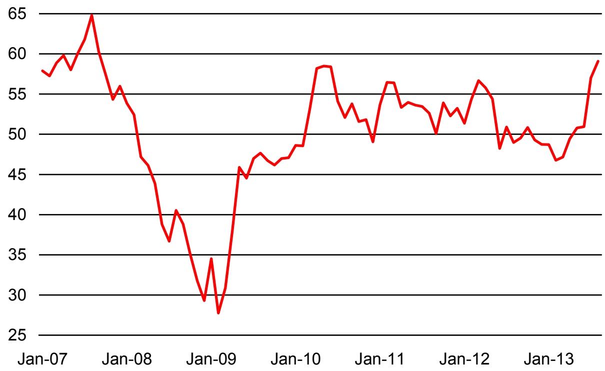
UK

PMIS



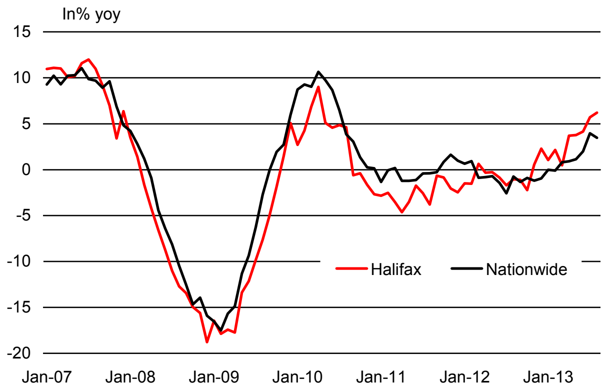
■ Both the headline manufacturing and services PMIs improved substantially of late, indicating strong expansion in both sectors.

CONSTRUCTION PMI



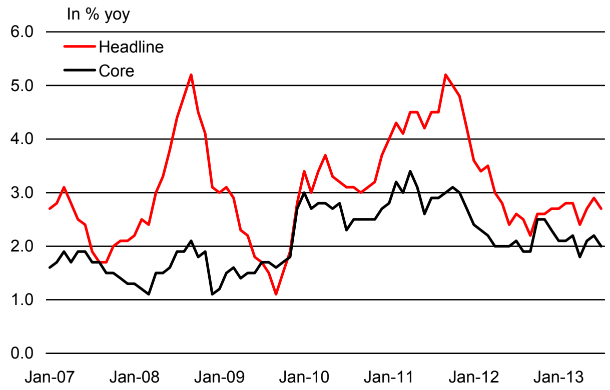
■ The construction PMI increased further, thereby hitting its highest level in six years.

HOUSE PRICES



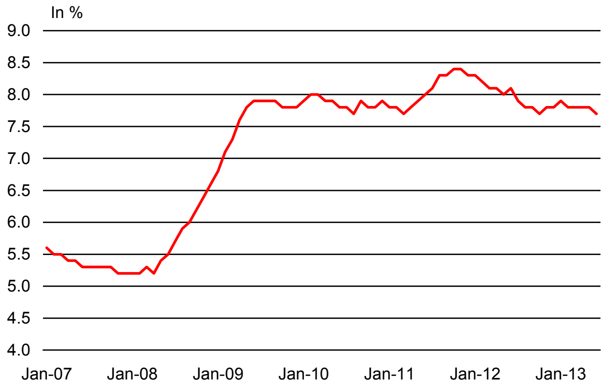
■ House price increases accelerated further. The Halifax house price index rose about 6% yoy recently (Nationwide: 3.5%).

INFLATION



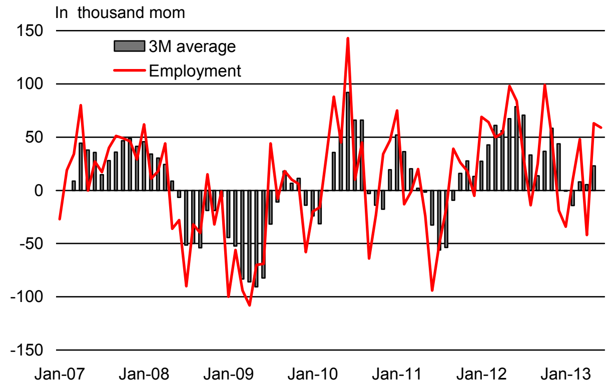
■ Headline inflation came down slightly in July from 2.9% to 2.8% yoy. The core rate stood at 2.0% yoy after 2.2%.

UNEMPLOYMENT



■ The unemployment rate declined slightly from 7.8% to 7.7% recently.

EMPLOYMENT



■ Employment has started rising comparatively strongly of late.

Source: Feri, UniCredit Research

Sweden

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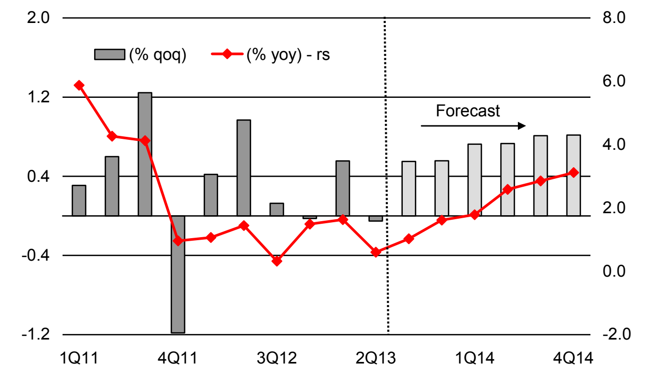
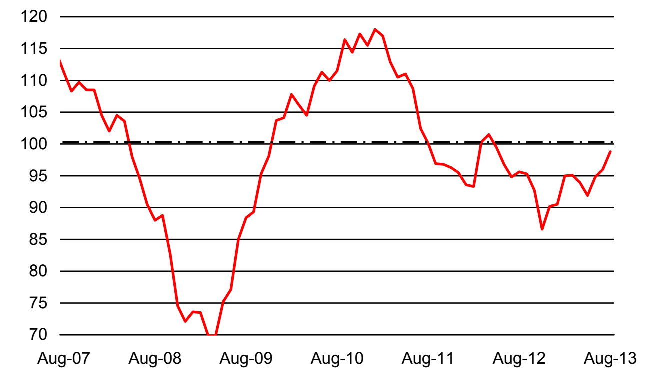
- The preliminary 2Q13 GDP reading was surprisingly low: -0.1% qoq vs. +0.6% in 1Q, mainly due to the ongoing weakness of exports and a disappointing contraction of private consumption – the expected growth pillar in 2013. Despite the contraction in 2Q, we continue to expect the Swedish economy to resume stronger growth during the coming quarters (+0.6% qoq both in 3Q and 4Q). The dip in household consumption in 2Q should be temporary, as indicated by still favorable conditions for households (improving sentiment, solid income growth supported by the government's fiscal stimulus measures, low inflation and positive wealth effects from rising housing prices). Moreover, good GDP growth news from Sweden's main trading partners (the EMU and the US) indicates that demand in Swedish export markets is picking up. Although GDP in 2013 is likely to grow less than we had expected until July (1.2% vs. 1.7%), in 2014 GDP growth will probably reach 2.6%, higher than the 2.4% level we previously envisaged (see left chart).
- Household and company sentiment has improved steadily since May, indicating that the recovery of the Swedish economy is still on track. The economic tendency indicator (ETI) gained an additional 2.8 points, rising from 96.0 in July to 98.8 in August, after increasing by around 7 points in the previous three months (see right chart below). The increase in the ETI was led particularly by the NIER manufacturing confidence indicator, which rose more than 5 points – from 94.9 in July to 100.1 in August. The consumer confidence indicator rose as well, albeit more moderately, improving from 98.3 in July to 99.3 in August.
- In August, both CPI and CPIF inflation were stable at 0.1% and 1.2% yoy, respectively. Inflationary pressure remains very low. We expect both CPI and CPIF inflation to remain below the Riksbank's target until the end of 3Q14.
- At September meeting, the Riksbank (RB) left the repo rate unchanged at 1.00%, as widely expected. With respect to July, the RB postponed – until late 2014 (from 2H14) – its expectation for the first rate hike and slightly changed its macroeconomic forecasts. 2013 and 2014 GDP projections were revised down (from 1.6% to 1.2% in 2013 and from 2.9% to 2.8% in 2014), while the assessment of the labor market was upgraded (2013 and 2014 unemployment rate is now expected at 8.1% and 7.9%). As regards household indebtedness, the RB welcomed the government's plan to introduce a new framework to safeguard financial stability. The RB stated, however, that it will carefully monitor developments in household debt and credit growth until the new measures become operational. On the back of a brighter economic outlook in 2H13 and 2014, increasing household indebtedness, and expectations that inflation will remain below the central bank's target during the next 12-15 months, we expect the RB to keep the repo rate at 1.00% until 3Q14 and to start the monetary tightening cycle thereafter.

GDP IS LIKELY TO ACCELERATE IN 2H13…



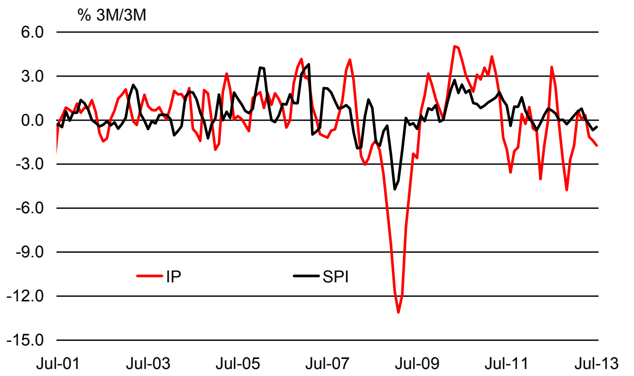
…AS INDICATED BY RISING OVERALL ECONOMIC SENTIMENT



Source: NIER, Statistics Sweden, UniCredit Research

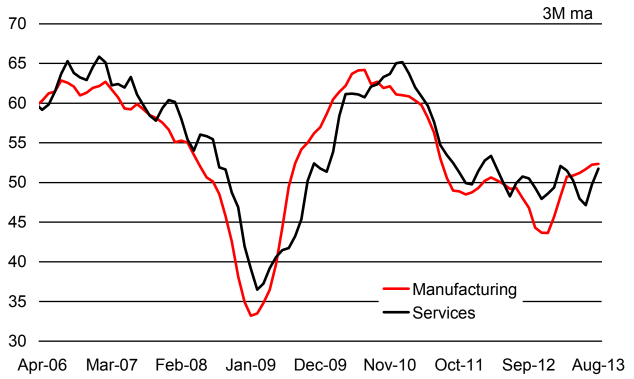
Sweden

INDUSTRIAL AND SERVICE PRODUCTION



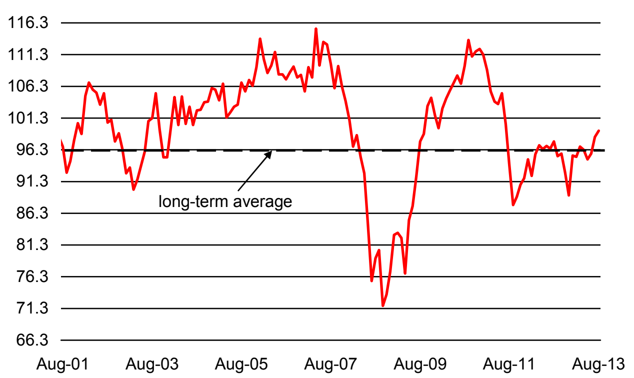
- Both industrial and services sector production declined in July, by 1.0% and 0.2% mom, respectively. The 3M/3M growth rate was -1.7% for IP and -0.5% for the service sector.

PMIS



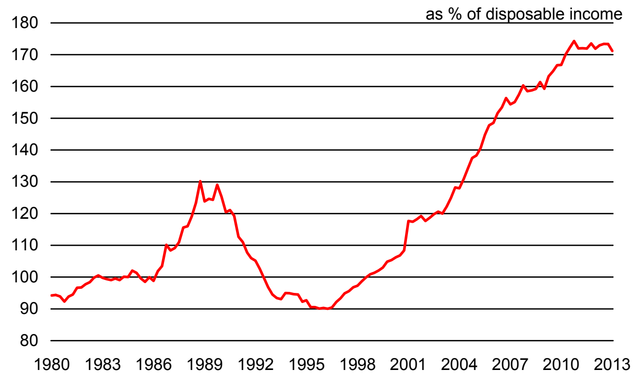
- Both the manufacturing and services PMIs show that improvement in economic activity might be in sight.

CONSUMER CONFIDENCE



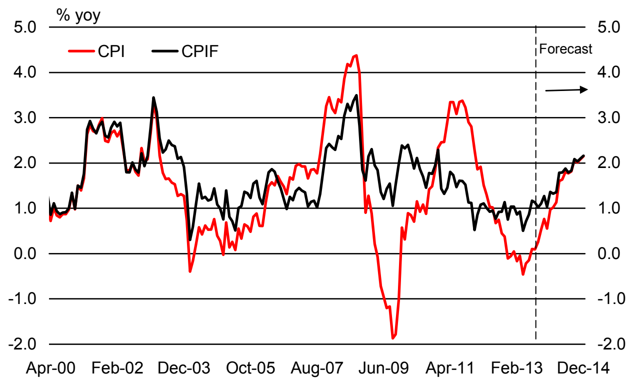
- Consumer confidence rose in August, from 98.3 to 99.3. The index is above its long-term average.

HOUSEHOLD DEBT



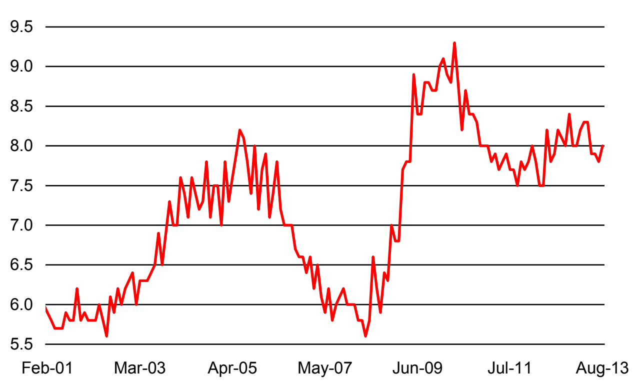
- Household debt continues to be very high, but showed signs of easing in 1H13.

INFLATION



- Both CPI and CPIF inflation were stable at 0.1% and 1.2% yoy in August.

UNEMPLOYMENT RATE



- The seasonally-adjusted unemployment rate returned to 8% in August, after a decline to 7.9% in July.

Source: NIER, Riksbank, Statistics Sweden, UniCredit Research

Poland

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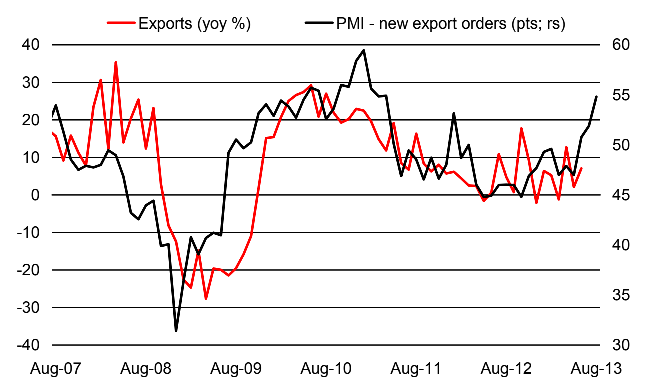
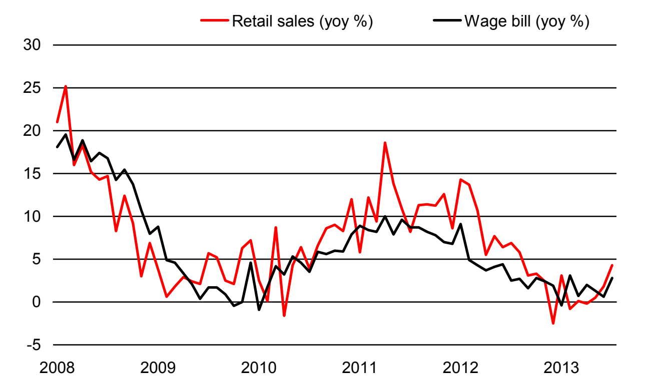
- Dataflow in the last two months confirmed that the economy is on the road to recovery. The manufacturing PMI rose to 52.6 in August. The rise was driven mostly by output (56.6) and new orders (55.6). Industrial output shot up to 6.3% yoy in July, the highest level in 18 months, whereas retail sales increased to 4.3% yoy (nominal), the highest reading in 11 months. Strong dataflow from Western European markets (and especially from Germany) bodes well for exports' performance in the coming months. The data released in September will be slightly weaker than those released in August (due to the negative impact of number of working days), but in working-day-adjusted terms should prove that the economic recovery is accelerating.
- CPI inflation hit bottom in June at 0.2% yoy, and is set to increase towards 1.5% at the end of this year. The surprise in inflation came in July when it spiked to 1.1% yoy on the back of a 47% increase in garbage collection prices. This modifies the expected path of inflation – it will likely approach the lower end of the MPC target (1.5%) by end-2013.
- The MPC finished the 225bp easing cycle in July and announced "a prolonged period of unchanged rates". President Belka emphasized that there's a wide consensus in the MPC on that. Specifically, Belka said that rates will be unchanged at least till year-end. Our baseline scenario assumes that this period will extend till end-2014, as we assume unchanged rates at the ECB until then.
- In July, the Cabinet announced a revision of the 2013 budget bill, as it estimated that budget revenues will be ca. PLN 24bn lower than initially assumed. To counteract this, the Cabinet decided to curb spending by circa PLN 7.7bn and to increase the deficit by ca. PLN 16bn (to PLN 51.6bn). However, given the improving growth outlook, we expect this year's deficit to come in at around PLN 50bn.
- We expect curve steepening to continue. Short-term POLGBs are well anchored by rate expectations. Portfolio outflows from EM remain the key external risk factor.
- The zloty should keep rebounding vs. the EUR, supported by gradually improving macro readings. We still see value in the zloty and maintain our last call to go long PLN vs. EUR at around (or better: above) 4.30 EUR-PLN.

EXPORT MARKETS WILL SUPPORT GDP GROWTH



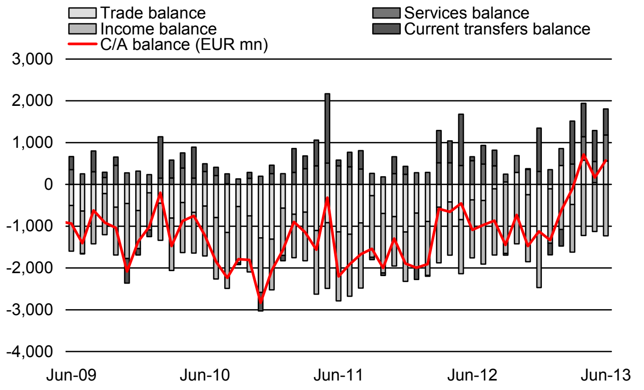
THERE ARE FIRST SIGNS OF DOMESTIC DEMAND RECOVERY



Source: GUS, NBP, Markit Economics, UniCredit Research

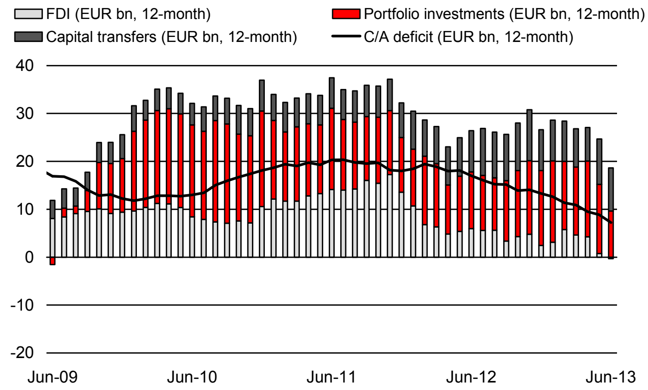
Poland

STRUCTURE OF CURRENT ACCOUNT BALANCE



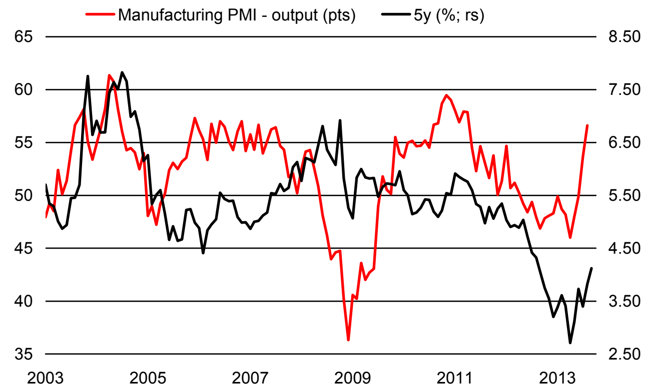
- Trade surpluses that have been recorded this year resulted in surpluses of the entire current account.

FINANCING OF CURRENT ACCOUNT DEFICIT



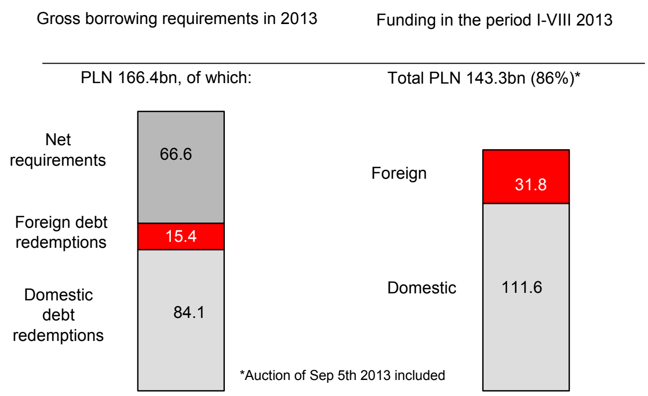
- Both foreign direct investment and portfolio investment weakened in 2013, but financing needs are also considerably smaller.

MANUFACTURING PMI AND 5Y BOND YIELD



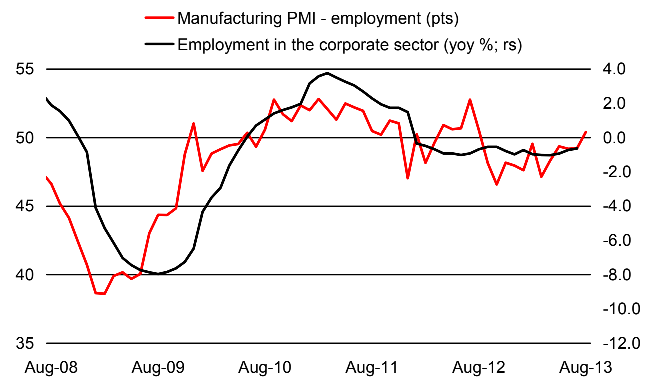
- Economic recovery may still affect bonds in 4Q13.

BORROWING NEEDS



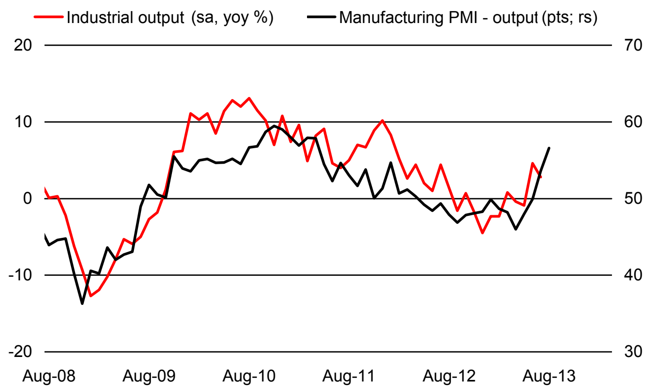
- Poland secured some 86% of borrowing needs after the budget amendment.

EMPLOYMENT AND MANUFACTURING PMI



- Domestic labor market starts to recover.

INDUSTRIAL PRODUCTION AND MANUFACTURING PMI



- Polish manufacturing sector shows clear signs of rebound.

Source: GUS, NBP, MoF, Markit Economics, UniCredit Research

Czech Republic

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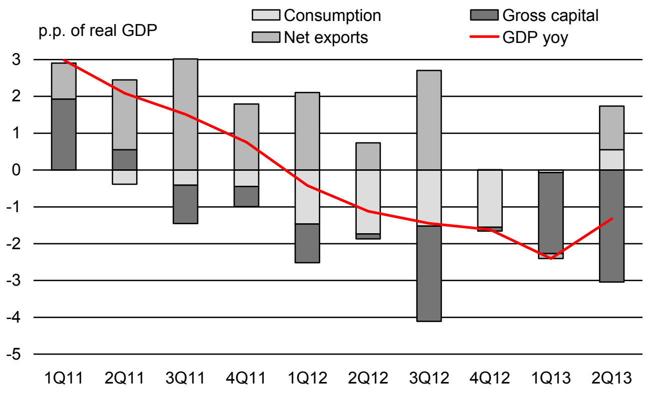
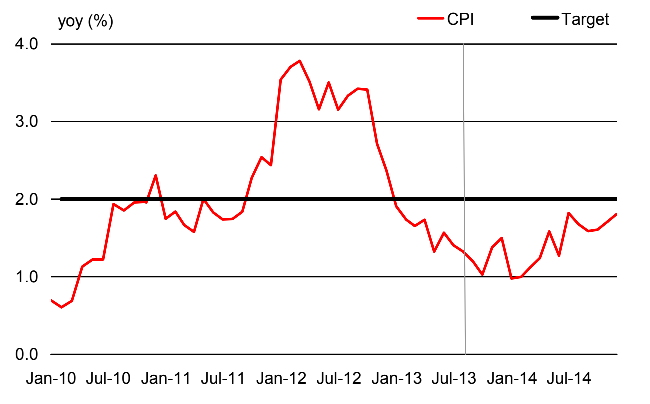
- Early general elections have been called for on October 25 and 26. Opinion polls point to a sweeping victory of the left, represented by the Social Democrats (approval rating of 28%), the Communists (15.5%) and SPOZ – the party of President Zeman (5.5%). Ratings for traditional right-wing parties (TOP09 and ODS) are, in contrast, much lower (13% and 9.5%, respectively). The number of undecided voters or of supporters of parties currently not represented in Parliament is at a long-term high.
- The growth of 2Q13 GDP by 0.6% qoq has terminated the longest recession in 20 years and offset a great part of the negative surprise from 1Q's 1.3% qoq decline. Consequently, the yoy contraction of GDP almost halved to 1.3% in 2Q13. As to demand-side components, net exports have started again to add to GDP growth yoy after two quarters of their close-to-zero contributions. Private consumption surprised on the upside with 0.5% yoy real growth, despite work incomes declining in real terms 1.0% yoy. Gross capital investment, in contrast, subtracted a full 3.0pp from GDP and was more of a drag than in 1Q (when its negative input posted 2.2pp of GDP).
- High frequency data depict a more constructive picture. The August manufacturing PMI jumped to 53.9, recording its third above-50 reading in a row. Retail sales rose by 4.0% yoy, while exports in CZK terms and real industrial output resumed growth (3.2% yoy and 2.1% yoy, respectively) in July. New industrial orders increased as much as 9.0% yoy in the same month. While such trends are surely welcome, we caution that further evidence will be needed to separate the signs of genuine economic recovery from a strong working-day effect (two days more yoy this July).
- Focusing on possible FX interventions, the CNB recently indirectly revealed its goal, as its macro model shows a need to ease monetary conditions by an amount roughly equal to 40bp of an interest rate reduction. Given no more scope to cut rates, we estimate that a 1.4% weakening of CZK is required relative to the CNB's baseline of EUR/CZK 25.7. The deviation of monetary conditions from their optimal setting is probably too small to become a trigger for FX interventions on its own. Hence, chances for an introduction of market interventions have, in our view, sunk below 50%.

NET EXPORTS PROVE TO BE INITIAL DRIVER OF RECOVERY



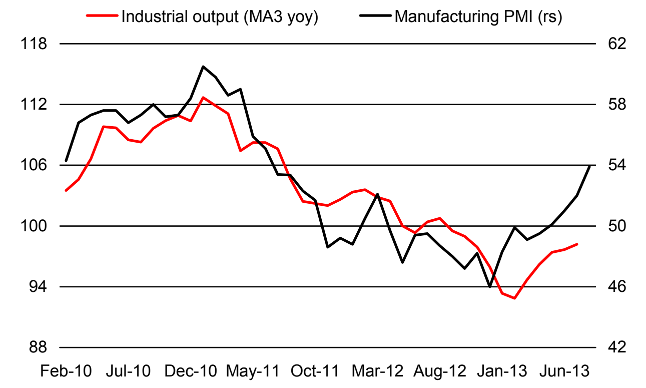
INFLATION TO HIT TROUGH AT THE BEGINNING OF 2014



Source: CZSO, UniCredit Research

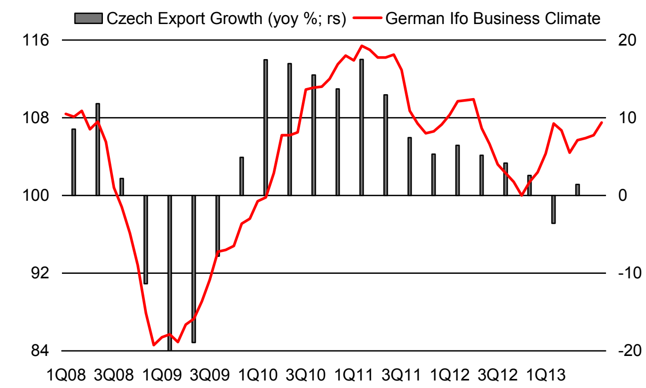
Czech Republic

MANUFACTURING PMI AND INDUSTRIAL OUTPUT



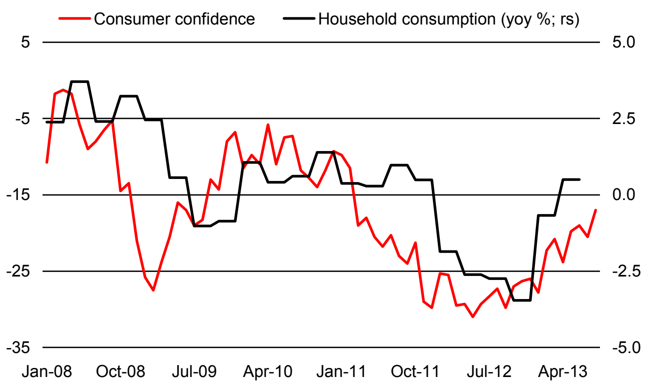
■ Manufacturing PMI's advance has gained momentum, while industrial output has so far struggled to keep pace.

GERMAN IFO BUSINESS CONFIDENCE AND CZECH EXPORTS



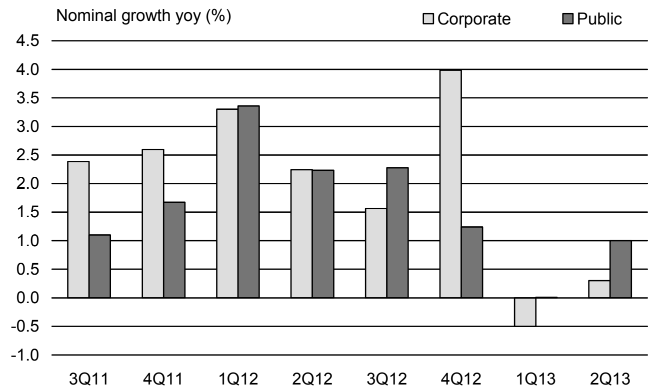
■ Solid gains in the German Ifo mean room for faster growth of Czech exports going forward.

CONSUMER CONFIDENCE AND PRIVATE CONSUMPTION



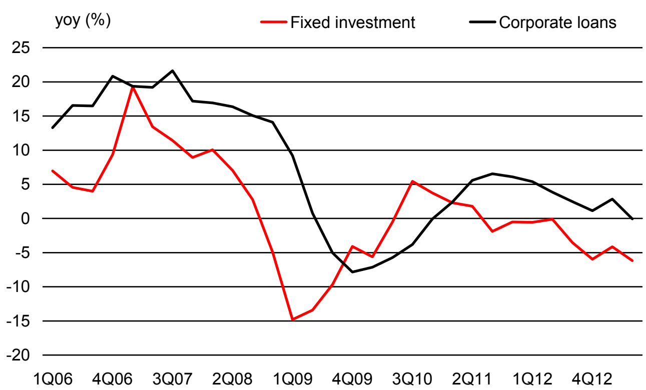
■ Private consumption has moved into growth territory, but more improvement in confidence is needed for the trend to continue.

NOMINAL WAGE GROWTH IN PRIVATE AND PUBLIC SPHERE



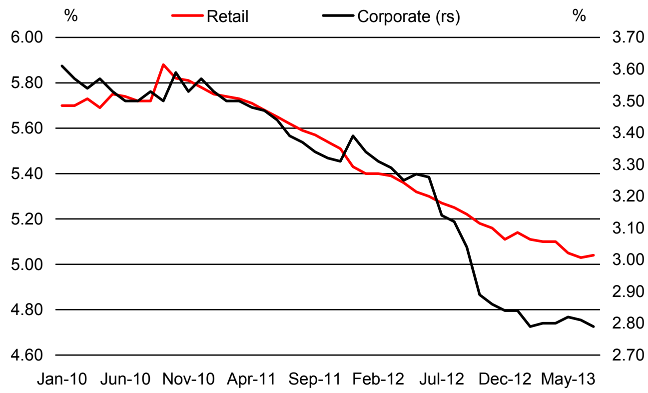
■ Nominal wages were on the brink of stagnation. The bonuses pre-paid in the corporate sector in 4Q12 serve as a partial explanation.

FIXED CAPITAL FORMATION AND CORPORATE LOANS



■ Corporate loans' upturn seems far off, given the observed 2-3 quarters lag behind still struggling fixed investment.

BANK INTEREST RATE SPREADS



■ Declining interest rate spreads have been advantageous for bank customers; the trend lower is over but low spreads are set to persist.

Source: CZSO, CNB, UniCredit Research

Hungary

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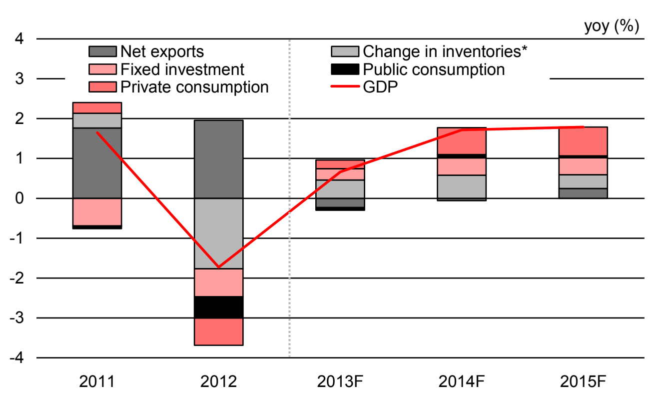
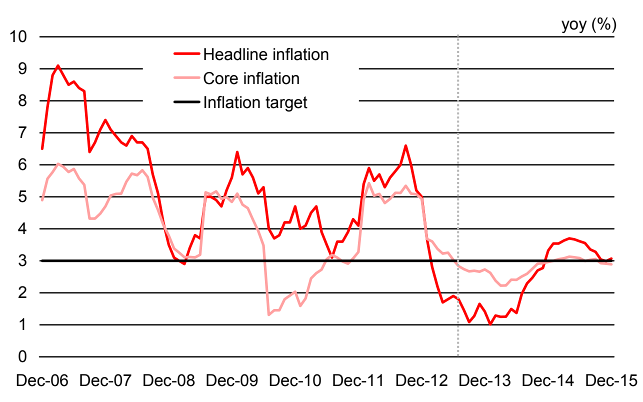
- GDP growth slowed down in quarterly terms to 0.1% qoq in 2Q13 after +0.6% qoq in 1Q13. The annual growth rate was 0.5%. The economic recovery in 1H13 had two major drivers: foreign demand (net exports up 2.6% yoy) and government investment (+9.0% yoy). Private consumption slumped 0.1% yoy despite three years of efforts to reduce taxes, increase social spending and provide protection against a weaker HUF. On the supply side, agriculture (+12.9% yoy in 1H13) and construction (+5.1% yoy) outperformed industry (-1.6% yoy), trade (-1.7% yoy) and financial services (-1.1% yoy). With external demand recovering only gradually, the government cannot singlehandedly revive domestic demand without compromising its fiscal goals. Hence, we expect GDP growth to reach 0.7% in 2013 and to remain below 2% in 2014 (+1.7%).
- Headline inflation slowed down to 1.8% in July and will probably end 2013 close to 1.5% yoy due to a further 11.1% energy price cut on 1 November. This is 1.5pp below the medium-term target. The NBH's preferred inflation measures point towards very weak demand pressure on prices: in July, tax-adjusted core inflation rose slightly to 1.5% yoy, demand-sensitive inflation was 1.4% yoy and sticky-price inflation fell to 1.2% yoy.
- The National Bank of Hungary (NBH) cut the monetary policy rate to 3.80% on 27 August, and we expect it to cut it to 3.50% by the end of the year. The 20bp rate cut suggests that the NBH fears a deterioration of risk appetite until the end of the year. Markets have so far endorsed the long easing cycle, but recent pressure on the HUF, and especially on the long end of the yield curve, shows that the central bank risks deploying other instruments (such as direct or indirect interventions) to support HUF assets in case of stress.
- The government is currently negotiating with the Banking Association (BA), the conversion of FX mortgage loans and maybe mortgage-backed consumer loans to HUF, with a solution expected before 1 November. The conversion will probably be covered from FX reserves, but a parallel reduction of the banks' short-term foreign liabilities will ensure good coverage of short-term external debt with FX reserves. The BA might try to extend the bargain in order to appease its tax burden and address the treatment of NPLs. While the loan conversion will not result in significant new lending, it could reduce the FX mismatch for local banks and improve the chances of recovering some of the overdue loans.
- The budget deficit widened to HUF 961.2bn at the end of August, 110.2% of the annual deficit target. The deficit is expected to end 2013 close to 3% of GDP.

GDP FORECAST SHOWS A GRADUAL RECOVERY



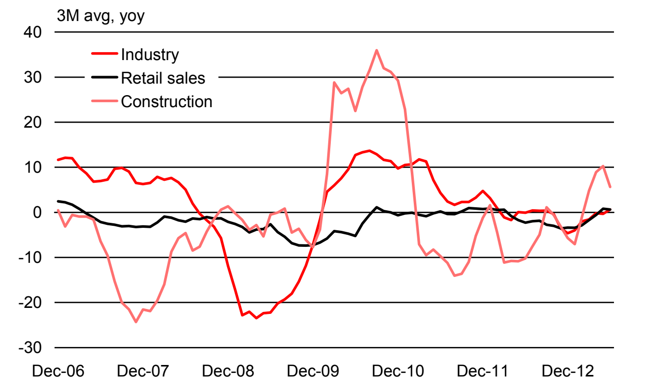
INFLATION FALLING ON ENERGY AND GAS PRICE CUTS



Source: KSH, UniCredit Research

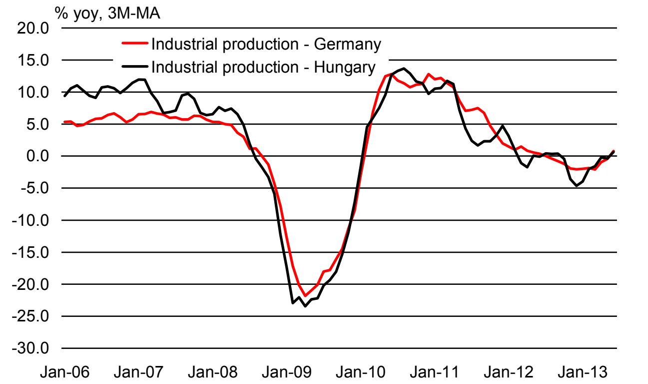
Hungary

INDUSTRY, RETAIL AND CONSTRUCTION



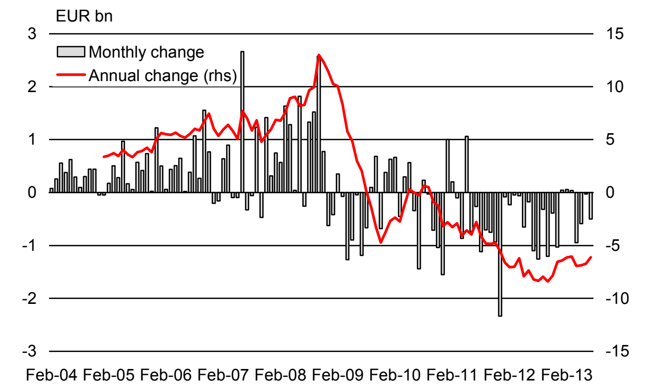
- Domestic demand is finally picking up…

INDUSTRIAL PRODUCTION IN HUNGARY AND GERMANY



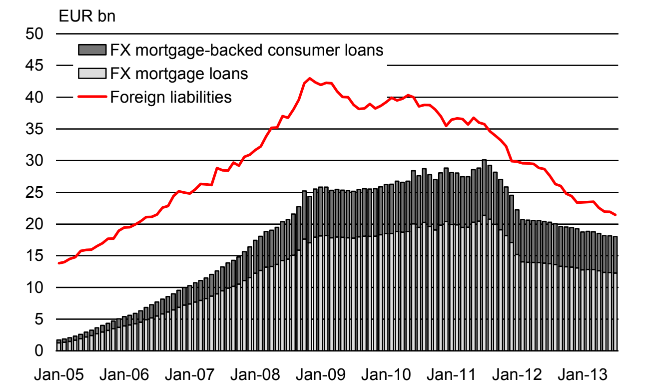
- …but external demand remains the main growth driver.

BANK DELEVERAGING



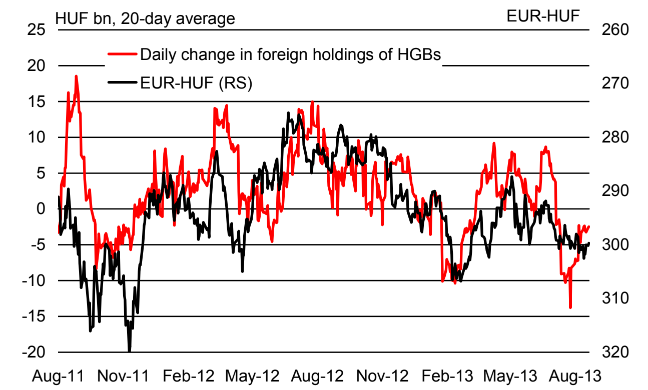
- Deleveraging continues, with outflows from the foreign liabilities of the banking sector exceeding EUR 6bn, 12M-rolling…

FX MORTGAGE AND MORTGAGE-BACKED CONSUMER LOANS



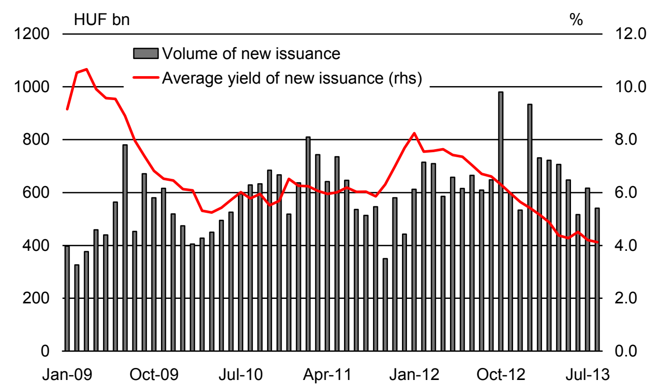
- …but the government aims to speed up the decline of FX loans by converting them to HUF.

HUF AND NET BOND PURCHASES BY FOREIGN INVESTORS



- Almost two months of outflows from HGBs put a strain on the HUF…

ROOM FOR THE CURRENCY BASIS TO NARROW



- … and forced the AKK to issue less and/or shorter maturities in order to contain borrowing costs.

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

US

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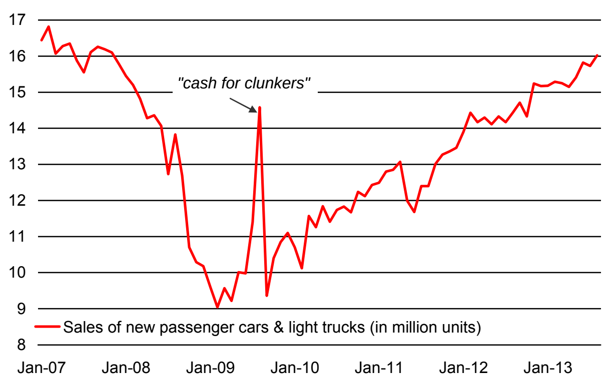
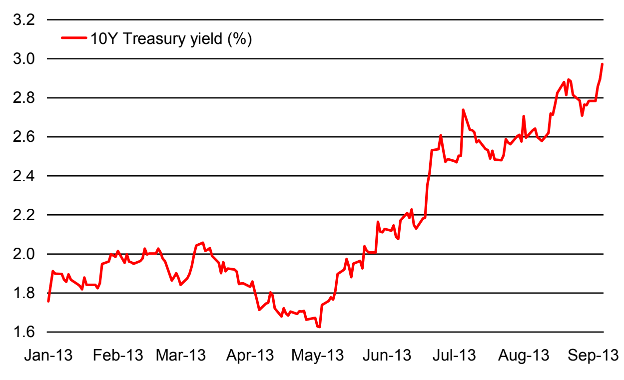
- 2Q13 GDP growth was revised up to an annualized 2.5% from the initially reported 1.7%. The bulk of the revision came from foreign trade, as the growth contribution from net exports was raised from -0.8pp to 0.0pp. Private inventories also rose faster than initially reported. After the revision, 1H13 growth averaged 1.8%, a very resilient number amid a period of dramatic fiscal tightening. Most impressive were the solid back-to-back gains in consumer spending (2.3% and 1.8%). As a result of a comprehensive benchmark revision, which brought lower growth in late 2012 and early 2013, the forecast for 2013 as a whole was lowered to 1.7%.
- For the second half of the year, we continue to expect that growth will accelerate to 2.8%, as the drag from fiscal tightening fades. Recent reports have, however, raised some moderate downside risks for current-quarter growth. These include upward revision to inventory gains in the second quarter (see above), which limit the upside potential for the current quarter, as well as the mere stagnation of real consumer spending in July.
- Nevertheless, the underlying fundamental improvement of the US economy continues. Car sales rose to a 6Y high in August. Homebuilder sentiment hit an 8Y high despite higher mortgage rates. Moreover, the national ISM purchasing managers' indexes for both the manufacturing and non-manufacturing sectors reached multi-year highs as well. And while employment numbers came in on the lower side of expectations, the labor market dynamic is picking up. Payroll gains accelerated further in August.
- Later this week, the Federal Reserve will end its sixth regular FOMC meeting of the year. It will potentially be an important meeting. In line with most market participants, we expect the Fed will announce its intention to moderate the pace of its asset purchases. The monthly purchase amount will most likely be reduced moderately from currently USD 85bn to USD 70bn or USD 75bn. The reduction will either be evenly split between MBS and Treasuries, or more heavily geared towards Treasuries, so that MBS purchases continue for longer. A change in the forward guidance, e.g., through lowering the unemployment rate threshold, will also be debated, but is unlikely to be agreed on at this meeting.

CAR SALES AT HIGHEST LEVEL SINCE 2007



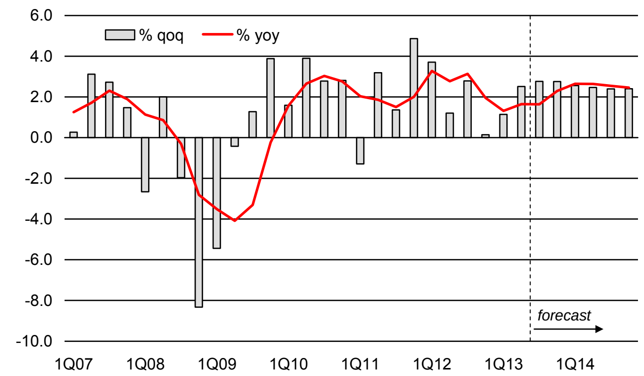
FINANCIAL MARKETS EXPECTING THE FED TO TAPER



Source: Bloomberg, UniCredit Research

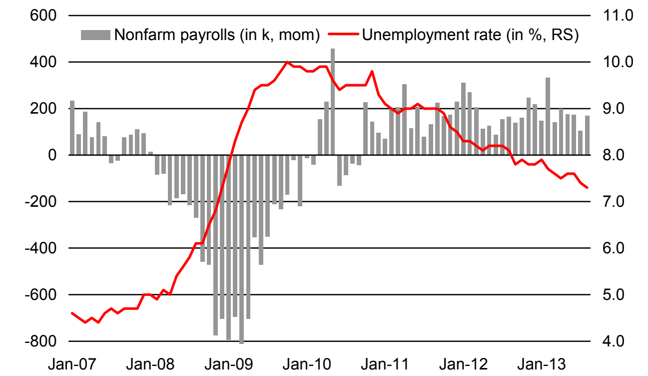
US

REAL GDP, ANNUALIZED RATES OF CHANGE



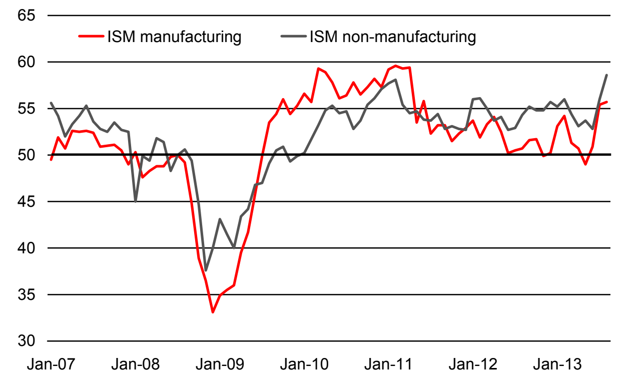
- The US economy expanded a solid 2.5% in 2Q13, and growth is expected to accelerate further towards 2¾% in 2H13.

NONFARM PAYROLLS AND UNEMPLOYMENT RATE



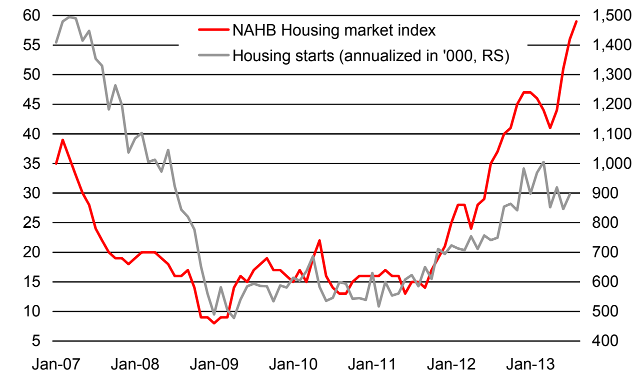
- Nonfarm payrolls accelerated once again in August to 169,000, from a downward revised 104,000. The jobless rate fell to 7.3%.

PMIS



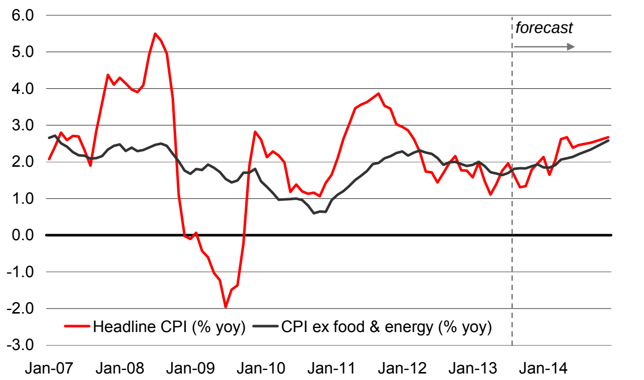
- The manufacturing ISM rose to a 2Y high of 55.7 in August, while the non-manufacturing index even hit an 8Y high at 58.6.

HOUSING MARKET INDEX AND HOUSING STARTS



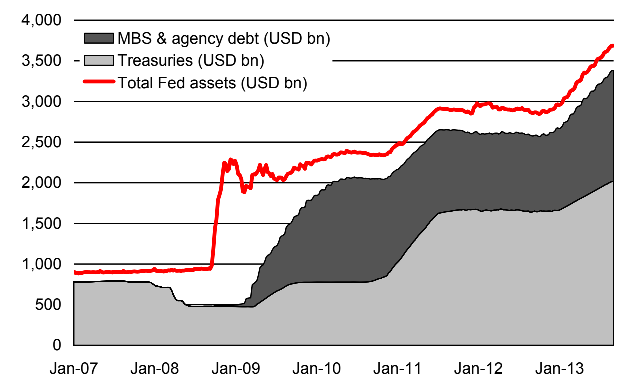
- The NAHB index jumped to an 8Y high of 59 in August, signaling further increases in construction activity.

INFLATION



- The headline inflation rate rose to 2.0% yoy in July, the highest level since February. The core rate edged up to 1.7% 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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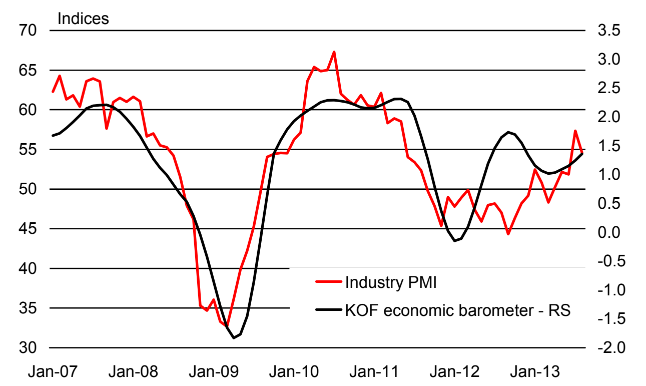
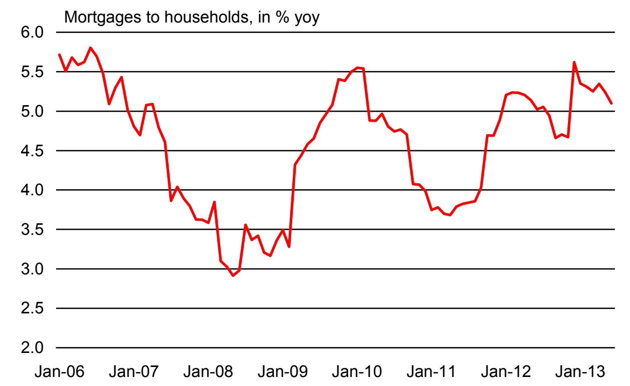
- Swiss GDP was up a solid 0.5% qoq in 2Q13, following an already strong reading of +0.6% in the previous quarter. Support came predominantly again from private consumption, which contributed 0.4pp to quarterly growth, confirming the solid situation of Swiss households. Employment continues to point north, net immigration remains elevated, and despite only moderate nominal wage increases consumer price deflation means the highest rise in real incomes among major European countries.
- On the other hand, merchandise exports were down for the third consecutive quarter in 2Q13, still suffering from the strong franc and the recent general weakness in global industrial demand. But the latest business sentiment data clearly underscored an imminent recovery in Swiss industry. The fifth consecutive rise in the KOF economic barometer was driven by a substantial improvement in the industry component. In contrast, the PMI was down strongly mom in August, from 57.4 to 54.6. But this was widely expected, as a correction of the partially seasonally-related jump in the previous month. Looking through volatility, the PMI level remains elevated, boding well for an upward trend in industry (see left chart below). Hence, we revise upward our 2013 GDP forecast from 1.5% to 1.8%.
- Together with a considerable rebound in EMU business sentiment across the board, recent Swiss macro releases will likely lead to a slightly more positive growth assessment of the SNB. This should, however, not trigger any shift in the central bankers' monetary policy stance, as underpinned by a detailed newspaper interview of SNB President Thomas Jordan earlier this week. He reiterated that there is currently no reason at all to announce an exit from the minimum exchange rate regime. It cannot be excluded that the CHF strengthens again in the current environment. Moreover, he confirmed the SNB's projections that inflation will stay low over the next years.
- Concerning the booming housing market, Jordan mentioned gratifying anecdotal evidence that dynamics will possibly cool down. Nevertheless, mortgage growth is still high (see right chart below) and it is not the time to signal an all-clear. According to a SNB survey, the interest burden of around 40% of new mortgages would exceed the 1/3-threshold of household income if mortgage rates rise to 5%. Hence, the SNB can be expected to continue to ring the warning bells and probably raise the counter-cyclical capital buffer (CCB) requirements later this year. In contrast, a change in the target rate and in the exchange rate cap is not in the cards in the foreseeable future.

ELEVATED BUSINESS SENTIMENT LEVELS



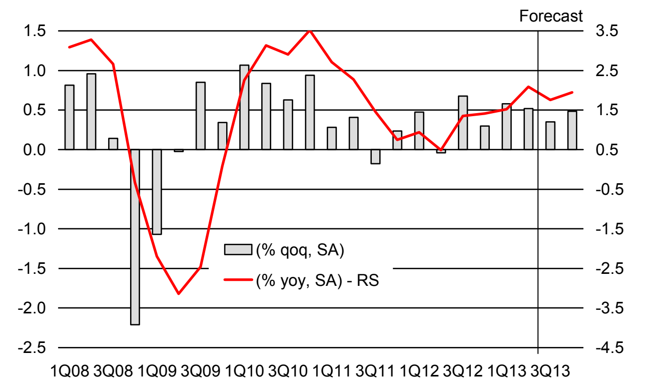
MORTGAGE DYNAMICS HAVE DECELERATED SLIGHTLY



Source: KOF, Thomson Datastream, SNB, UniCredit Research

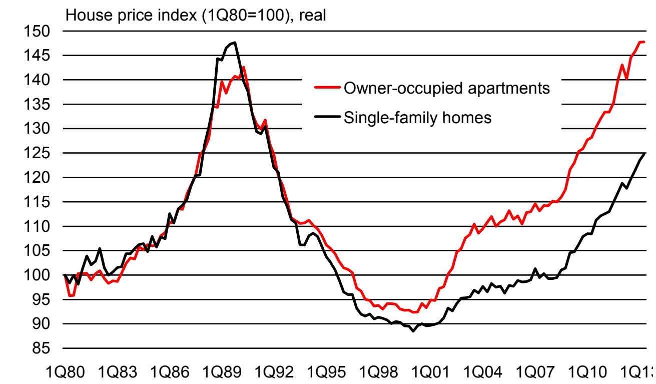
Switzerland

GDP



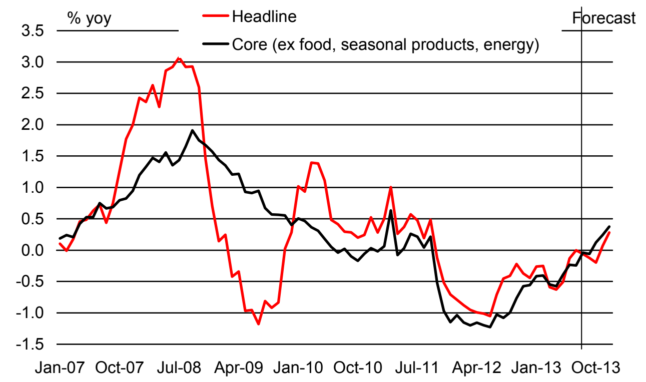
- The Swiss economy expanded by a solid 0.5% qoq in the spring, after an already solid 0.6% in 1Q13.

HOUSE PRICES



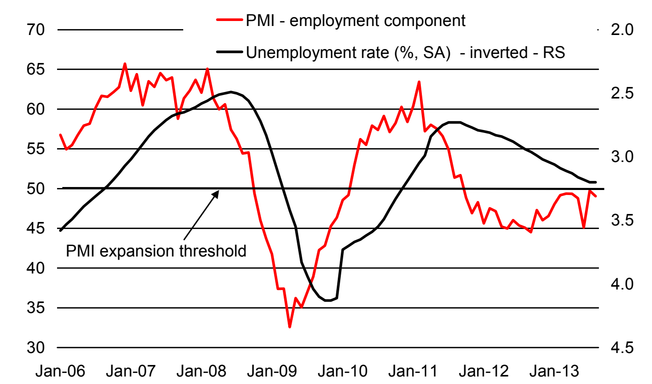
- House price dynamics for owner-occupied apartments slowed in 2Q13.

INFLATION



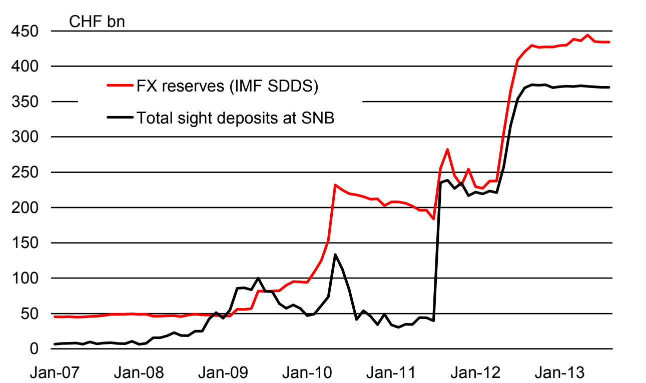
- Swiss consumer prices were flat yoy in August. We expect the headline rate to trend broadly sideways for the rest of 2013.

LABOR MARKET



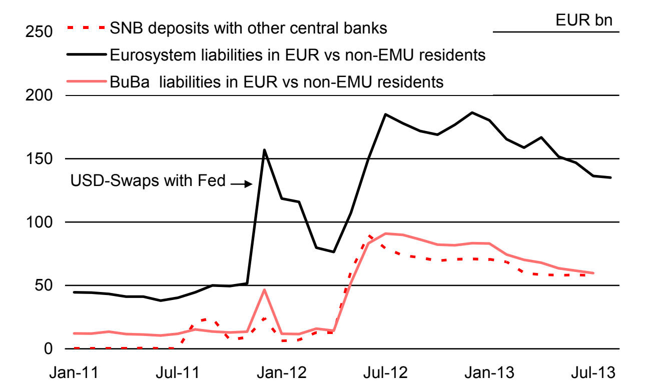
- The upward trend in unemployment almost came to a halt in August.

FX RESERVES



- The SNB's FX reserves on a CHF basis basically trend sideways since autumn last year, similar to the level of total sight deposits.

FX CURRENCY MANAGEMENT



- A substantial share 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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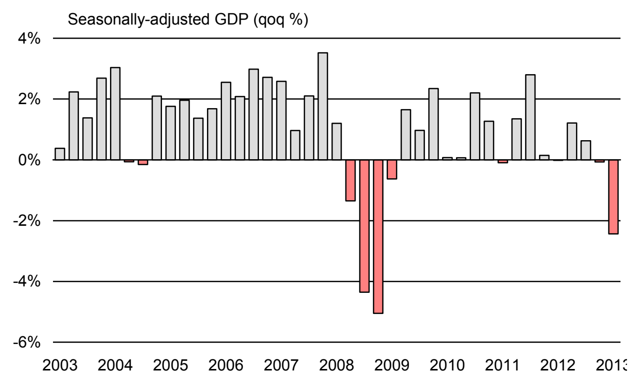
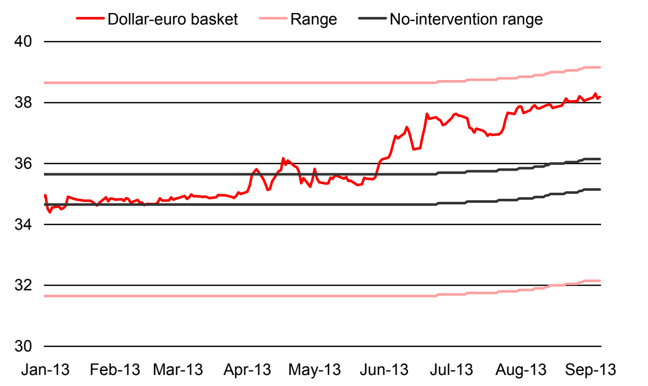
- The Ministry of Economic Development in August downgraded its GDP growth forecast for 2013 to 1.8% from 2.4%, despite the fact that oil price is expected to average USD 106/bbl (almost unchanged from the previous estimate of USD 105). In 1H13, GDP expanded by only 1.4% yoy, and although the key macroeconomic indicators demonstrated a moderate improvement in July (e.g., capex rose 2.5% yoy), we do not expect a major boost in economic activity in 2H13 due to the absence of major drivers. Even private consumption demand, which still seems to be somewhat overheated, may face headwinds: according to the Ministry of Economic Development, real disposable income declined by 0.5% mom in July on a seasonally-adjusted basis. Furthermore, the positive contribution of the agricultural sector appears to be slightly overrated, as harvest forecasts are being revised downward due to unfavorable weather conditions. Following a lackluster performance of the economy in 1H13, and also our outlook on oil prices in the medium term, we downgraded growth expectations for 2013 and subsequent years. We expect growth to stabilise at low 1.7-1.9% range for 2013-2014. For details see CEE quarterly 4Q13.
- The Russian ruble remained under serious pressure throughout the last two months. The CBR bi-currency basket rose above RUB 38 by the end of August (from RUB 37.5 at the beginning of July), and the regulator has shifted the borders of the indicator's corridor ten times over the same period (up by a total RUB 0.50). At the same time, daily interventions by the CBR increased from USD 200mn in July to USD 300-400mn in August. The fact that the ruble depreciated despite high and rising oil prices demonstrates the increased influence of financial flows on exchange rate. The CBR expects the net outflow to exceed USD 70bn in 2013 (approximately USD 50bn YTD).
- Monetary policy stance has not changed since the appointment of the new CBR Governor (although a greater attention is being paid to bank regulation). Key interest rates were kept unchanged in July and August, and Elvira Nabiullina (in a recent interview) pointed out that the current economic downturn is not cyclical in nature, and therefore cannot be overcome with the aid of monetary instruments. Recent developments in the foreign exchange market further complicate the regulator's task, as monetary easing may amplify ruble fluctuations. However, we still believe that the regulator might cut key interest rates at the next board meeting (scheduled for 13 September) to loosen the currently tight stance of policy and provide economic agents with the necessary and long-awaited signal.

ECONOMIC DOWNTURN IS BECOMING MORE EVIDENT



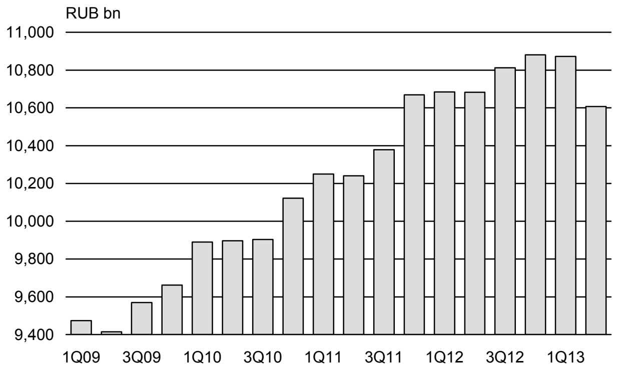
CBR CONTINUED SHIFTING CORRIDOR BORDERS



Source: CBR, Rosstat, UniCredit Research

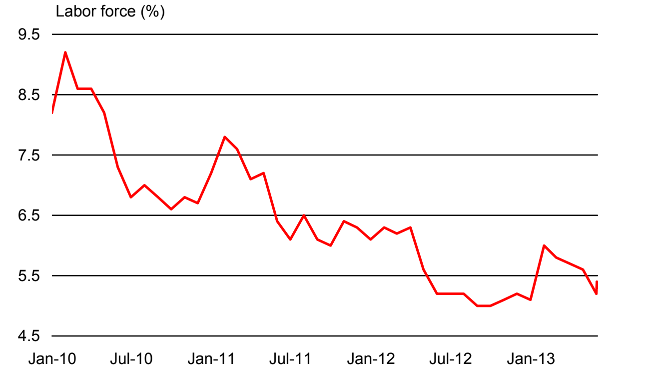
Russia

GDP (SEASONALLY-ADJUSTED QUARTERLY DATA)



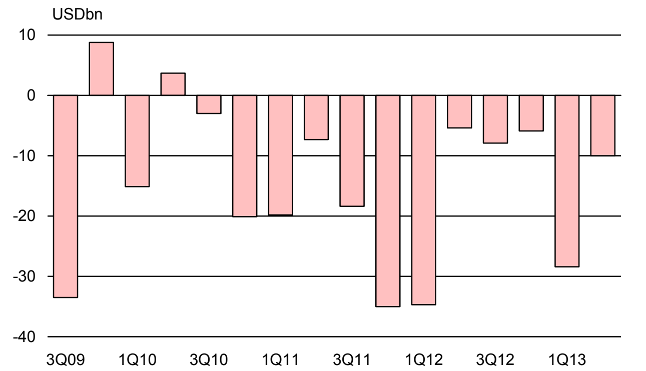
- GDP was estimated to have grown 1.2% yoy in 2Q (-0.7% yoy on a seasonally-adjusted basis).

UNEMPLOYMENT



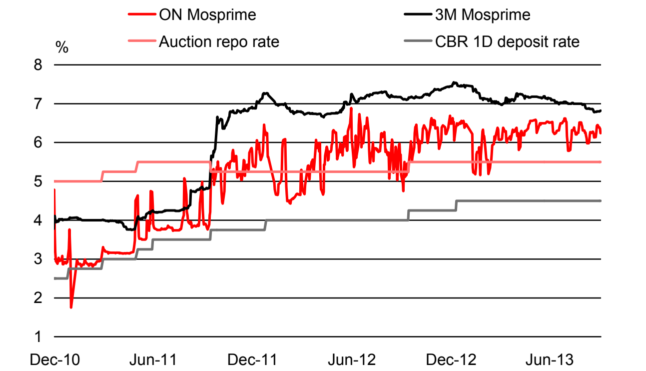
- However, unemployment remains far below pre-crisis levels.

CAPITAL OUTFLOW



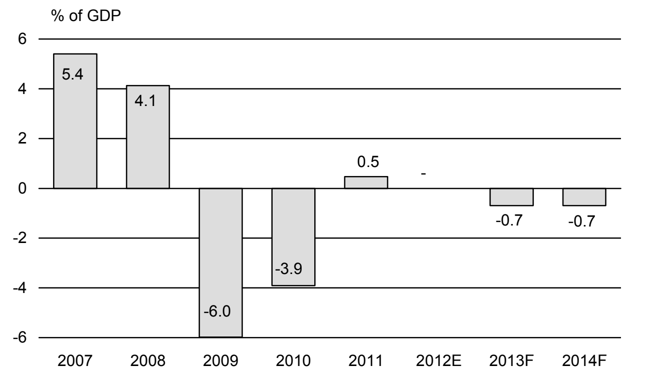
- Capital outflow slowed down in 2Q, but has likely accelerated in July – August.

MONEY-MARKET RATES



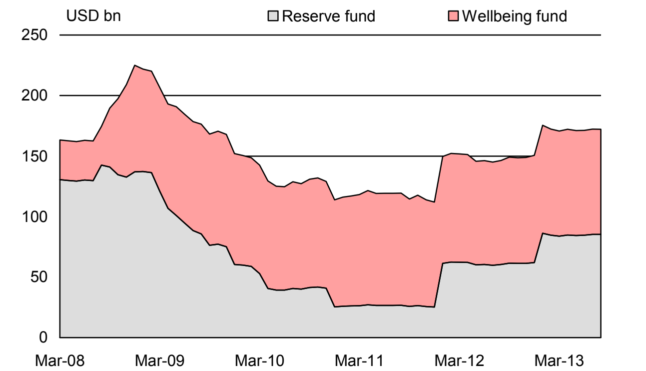
- Overnight rates are still dominated by liquidity withdrawals of the budget despite extensive liquidity supply from the CBR.

BUDGET BALANCE



- Federal budget deficit may turn out to be bigger than expected, as revenues seem to be falling short of forecast.

STATE FUNDS ACCUMULATION



- Government may fail to top up Reserve Fund in 2013, and may draw on accumulated funds instead for financing.

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

Turkey

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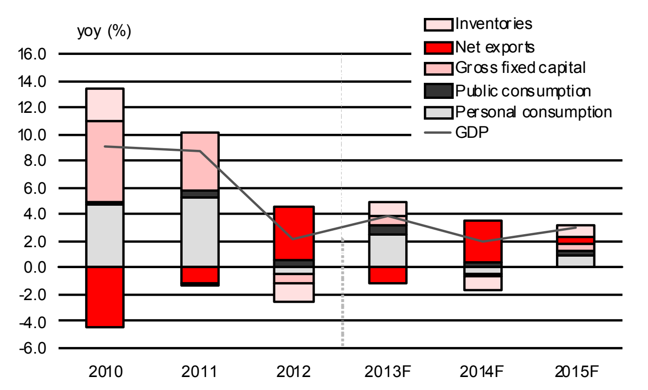
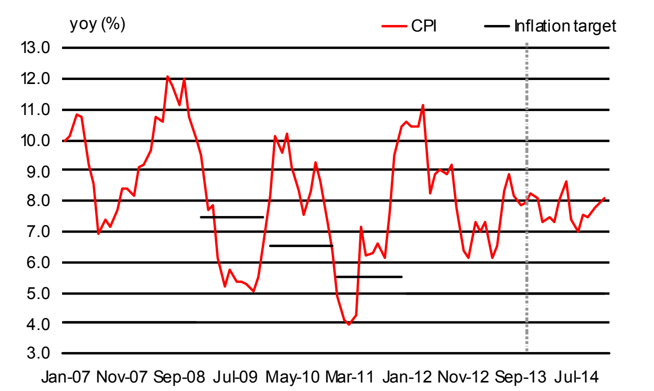
- The Turkish economy is undergoing a fundamental shift, triggered by much less favourable external financing conditions. Turkey's Achilles heel has long been its C/A deficit, but a shift in the financing of this deficit over recent years away from long-term towards short-term capital flows has further added to this vulnerability. These short-term flows have represented the majority of C/A deficit financing since 2010, but have now ground to a halt as part of a broader shift in short-term flows to emerging markets. Meanwhile, over the 12 months to June, Turkey's C/A deficit stood at 6.5% of GDP, 0.6pp of GDP wider than 6 months ago, attributable largely to a deterioration in the gold balance.
- Adjustment of the C/A balance at this stage is unavoidable. To ensure a stable gross external debt ratio and stable currency, Turkey can run a C/A deficit of between 4-5% of GDP, but this does not take account of financing. Long-term financing is currently running at only 1.4% of GDP (USD 11.2bn) on a 12-month basis, 2.5% of GDP (USD 20.1bn) on average since January 2011. Assuming no further short-term inflows and an improvement in long-term inflows in line with their average since January 2011 suggests that Turkey needs to more than halve its C/A deficit. Should past short-term inflows reverse, the required adjustment will be even larger, given the CBT's limited holding of foreign reserves.
- The CBT has adopted a more timid approach of late compared to June-July. While July saw the central bank put USD 5.15bn in FX through the market via intervention, over the month to 5 September, this fell to USD 2.1bn. We view this as an acknowledgement that current pressure risks being much more than temporary, while the CBT's FX reserves do not facilitate persistent aggressive TRY intervention. Developments in Syria also seem to have played a role. Looking ahead, the ROM provides valuable protection to the banking sector, while changes in ROM coefficients and reserve requirements on FX deposits are also possible in an effort to provide the economy with more FX. But we still do not exclude rate hikes, even if the CBT has been more reluctant this time than in the past.
- This leaves us marking down our growth forecasts for next year as well as narrowing our C/A deficit projection. Exports and government consumption, as well as a positive carryover from 2013, will help. According to the Q2 GDP release government consumption rose 7.4% yoy. With the government heading into local elections in March and presidential elections in the summer, we expect continued support from fiscal policy. Moreover, we see little scope for monetary policy to offset the slowdown heading into 2014. The CBT already revised upwards its year-end inflation projection at end-July to 6.2%, but the increase in oil prices and further TRY losses mean that another increase is unavoidable.

DOMESTIC DEMAND IS EXPECTED TO LEAD THE RECOVERY



Source: CBR, Rosstat, UniCredit Research

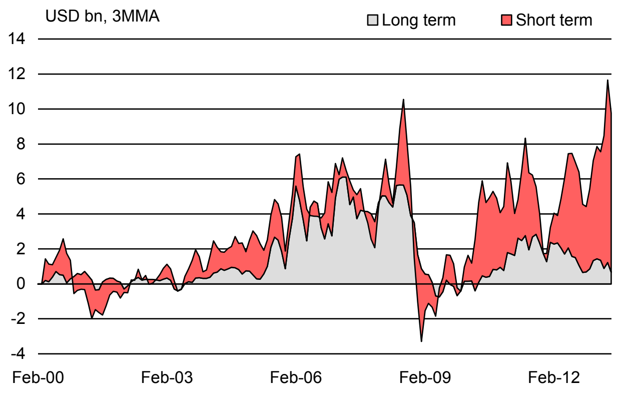
INFLATION TO EASE BUT REMAINS ABOVE TARGET



Source: CBT, TurkStat, UniCredit Research

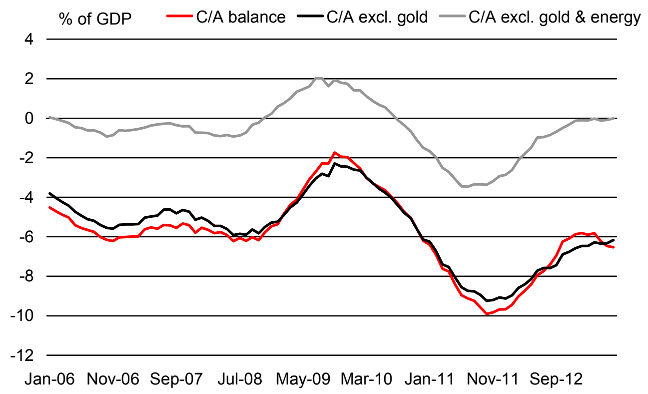
Turkey

FOREIGN CAPITAL FLOWS INTO TURKEY



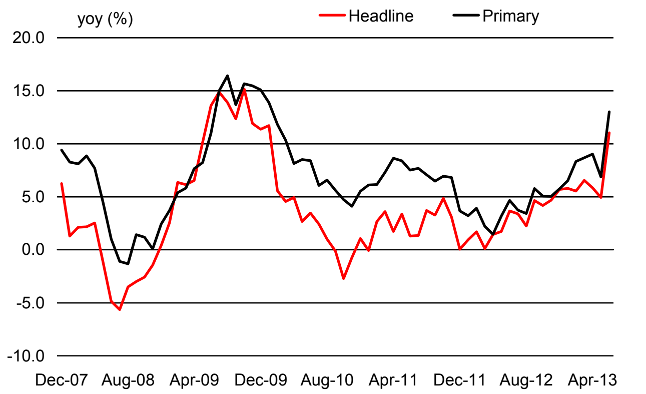
■ There has been a shift from long-term to short-term capital flows.

CURRENT ACCOUNT BALANCE



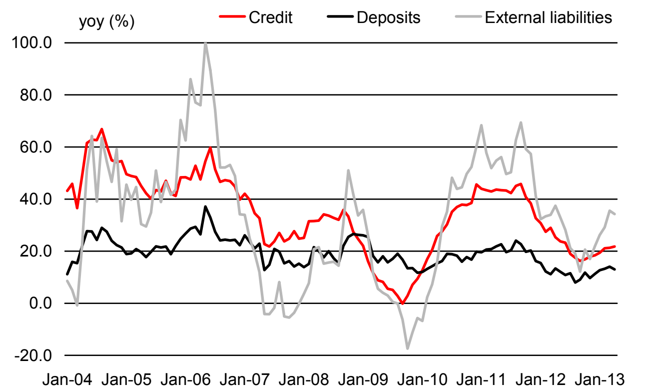
■ The C/A deficit has improved but remains wide at this stage.

GOVERNMENT EXPENDITURE



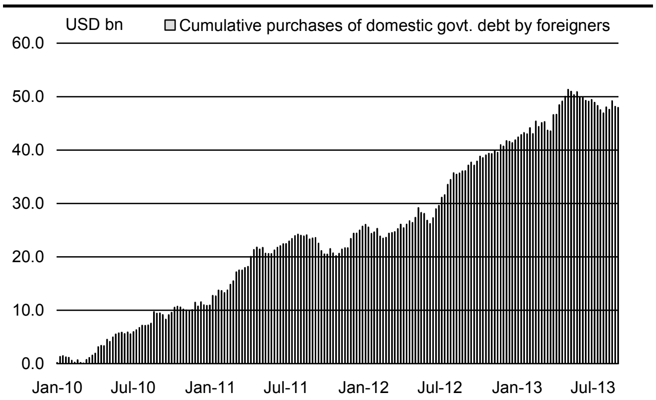
■ The government is supporting activity…

CREDIT VS. DEPOSIT GROWTH



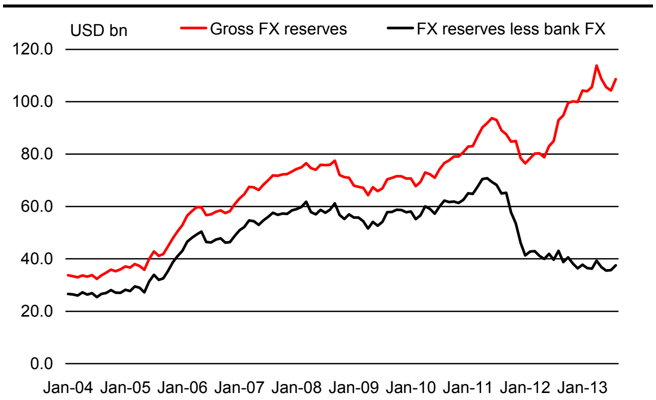
■ …but funding will constrain credit growth going forward.

FOREIGN INFLOWS TO DOMESTIC DEBT



■ Foreign holdings of domestic debt have barely corrected…

GROSS VS. NET FX RESERVES



■ …while the CBT has limited ammunition for outright interventions.

Source: CBT, TURKSTAT, UniCredit Research

China

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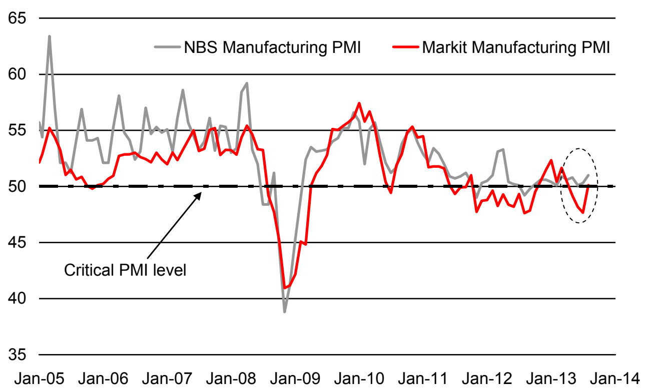
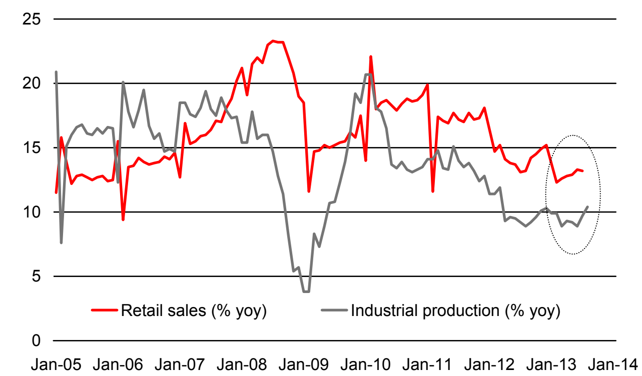
- Economic data published over the last few weeks indicate that the protracted slowdown in China's economic growth has come to an end.
- Following the solid-to-strong improvement in business sentiment – the NBS manufacturing PMI rose to a 16M high, while its Markit/HSBC pendant jumped back into expansionary territory, the recent round of hard numbers shows that economic activity is stabilizing or even gaining some traction: industrial production growth rebounded to a 17-month high, while overall investment and retail sales expansion seem to be firming gradually.
- The recent shift in Chinese economic policy – now combining efforts to restructure its economic model and to stabilize economic growth, together with targeted supportive measures al-ready implemented – seems to be already showing the first signs of success.
- At the beginning of 2H13, Chinese authorities not only signaled their intention to decidedly defend the 7½% GDP growth target, but also activated a "mini stimulus" program to support investment (infrastructure, railway, social housing, energy, environment protection) as well as tax relief and financial incentives for service SMEs.
- In addition, the delayed effects of the credit surge seen earlier this year and, last but not least, improving global demand (from the developed world) also seems to have lent a helping hand. Chinese export growth was reported to have accelerated to 7.2% yoy in August after an al-ready improved July reading, while solid import numbers confirmed that domestic demand re-mains buoyant.
- The fact that all three key drivers of China's economy – investment, consumption (not least helped by benign inflation) and exports – are gradually improving, means upside risks to our forecast that GDP will stabilize this quarter at around the official growth threshold (UniCredit: +7.4%, 2Q13: +7.5%) and settle between the target and the 7% pain threshold thereafter.
- But given the tighter monetary conditions amid efforts to squeeze shadow banking and limit credit growth coupled with measures to dampen house price rises and high-end housing activity, as well as potential external headwinds emanating from EMs facing financial pressure and the CNY appreciation seen earlier, it would still be premature at this stage to say the Chinese economy is set to face a sustainable acceleration in growth.

SENTIMENT IS IMPROVING AGAIN...



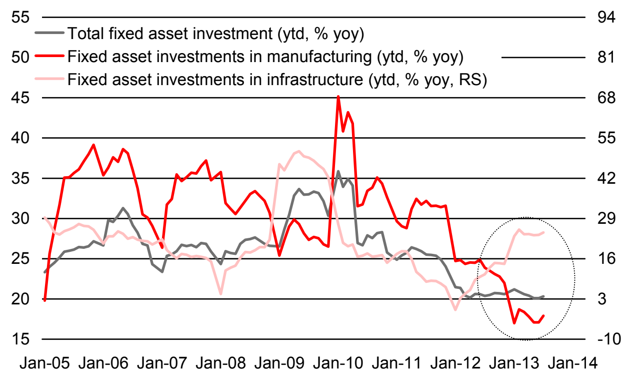
...AND ACTIVITY FIRMING GRADUALLY



Source: Thomson Datastream, Feri, UniCredit Research

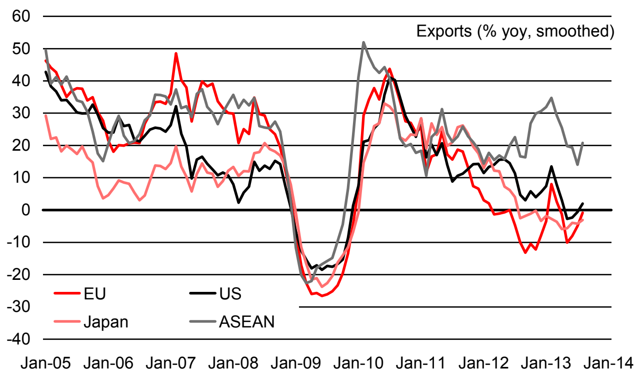
China

FIXED ASSET INVESTMENT



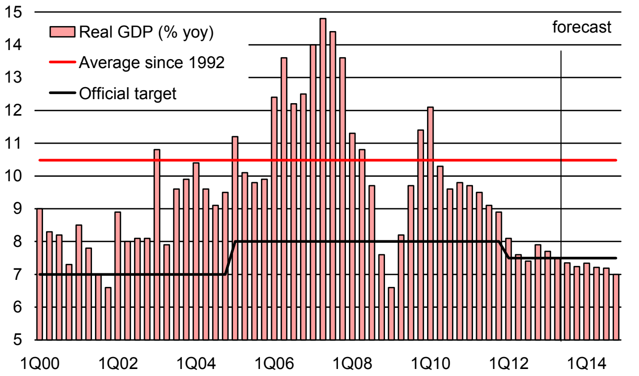
- Thus far, overall investment was helped by continuing brisk infrastructure spending. But more recently, capex growth seems to have stabilized as well.

EXTERNAL ECONOMY



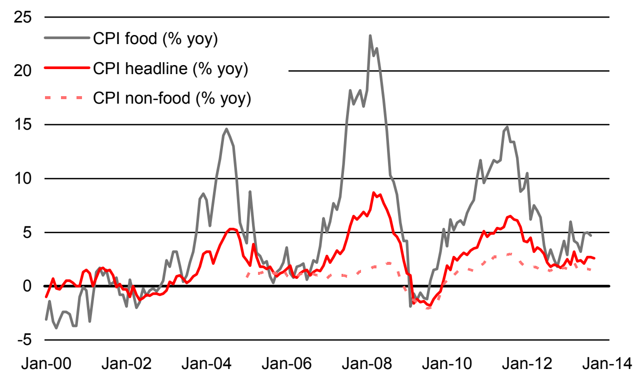
- Following accentuated ups & downs earlier this year caused by incorrect accounting and government intervention, export growth is strengthening again on the heels of improving global demand.

GDP



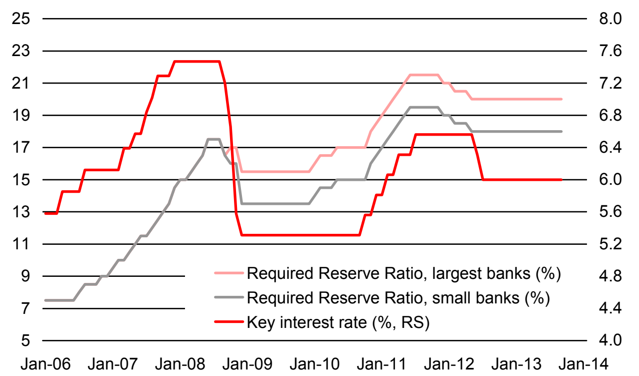
- Improving sentiment and activity data are posing some upside risks to our forecast of GDP growth settling between the 7½% target and the 7% pain threshold further down the road.

INFLATION



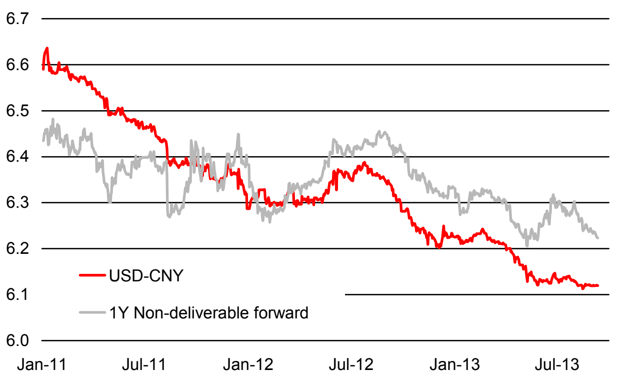
- Following the January 2013 uptick, inflation is fluctuating well below target (3.5%) – helped by lower input prices...

MONETARY POLICY



- ...so the PBoC would have room for maneuver. But its stance got tougher in the spring, unwilling to accept excessive credit growth.

USD-CNY

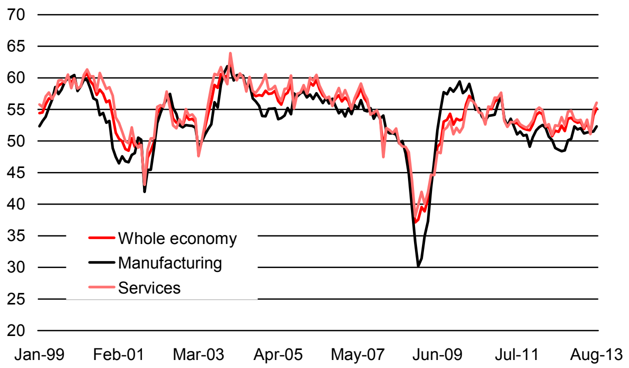


- After having appreciated earlier this year, the CNY moved into quieter waters more recently.

Source: Thomson Datastream, Feri, UniCredit Research

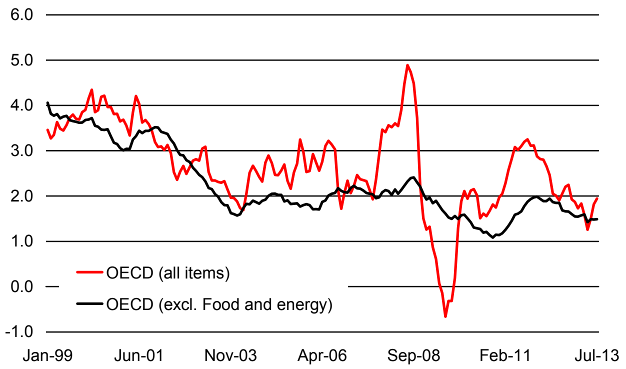
Global Indicators

GLOBAL PMI OUTPUT



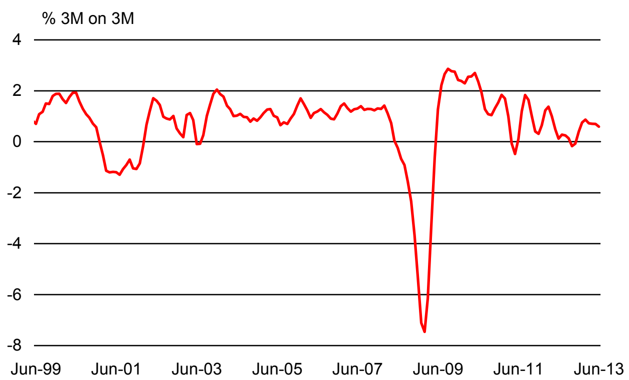
- The global composite PMI rose from 54.0 to 55.2 in August. The manufacturing and services indices rose from 51.5 to 52.3 and from 54.9 to 56.1, respectively.

CPI INFLATION



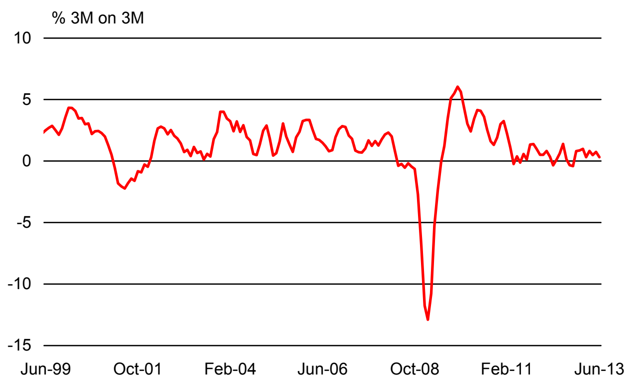
- Headline inflation in OECD economies edged up from 1.8% yoy to 1.9% yoy in July, with the core rate stable at 1.5% yoy for the third consecutive month.

INDUSTRIAL PRODUCTION



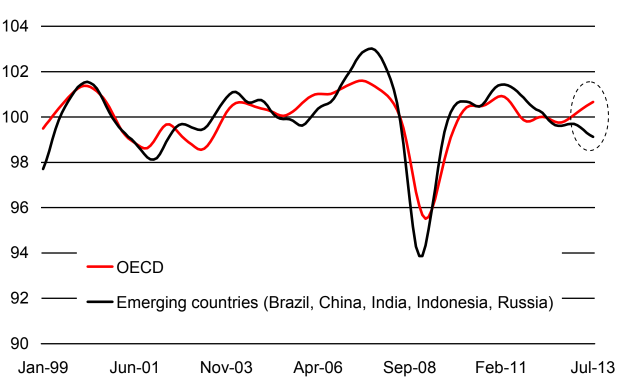
- Global IP was flat in June (vs. 0.1% in May). The 3M/3M rate edged down slightly from 0.7% to 0.6%.

WORLD TRADE



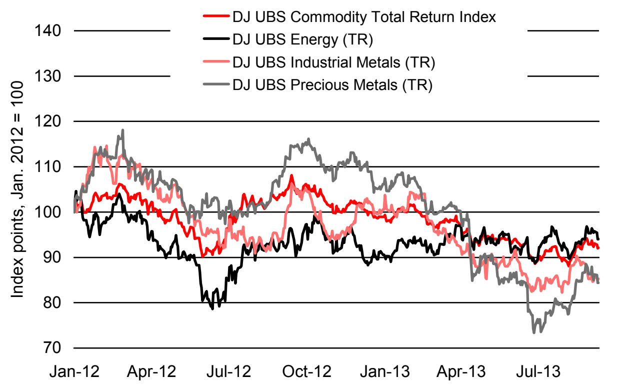
- World trade decreased -0.5% mom in June after -0.9% mom in May. The 3M/3M rate slowed from 0.7% to 0.3%.

OECD COMPOSITE LEADING INDICATORS



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

COMMODITIES



- We expect only a sideways movement in the Brent oil price, due to stronger supply from North America and Iraq. The gold price should recover towards USD 1500 per troy ounce at the end of 2014.

Source: Bloomberg, CBP Netherlands, OECD, UniCredit Research

Disclaimer

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