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Main Macro Views and Market Strategy

- The release of good economic news since the beginning of the year, along with the effect of the ECB's recent unconventional measures, has led to an improvement in the global economic sentiment. The recent pick up in global manufacturing PMIs suggests that the industrial business cycle is likely to gain momentum in the course of the year.

- The global economy is set to grow at a slower, albeit decent rate in 2012 as a result of the ongoing fiscal consolidation in developed economies, most notably in Europe. Our estimates suggest global growth to decelerate to 3.3% in 2012 from 3.8% last year and rebound to 4.0% in 2013.

- The slowdown in world trade growth is expected to be contained, as external demand is likely to improve in the following months. We estimate world trade growth to fall to 4.9% in 2012 from 6.9% in 2011, before it rebounds to 7.0% in 2013.

- The generous provision of financial aid by the ECB has reduced meaningfully the liquidity risk of the euro area's banking system. Banks have used part of this low cost liquidity to buy government paper at much higher returns. This form of indirect quantitative easing has reduced yields on Spanish and Italian government bonds.

- In our view, a permanent solution to the lingering debt crisis involves both fiscal discipline in the periphery members and fiscal solidarity from the core countries. Recent agreements on enhanced fiscal surveillance in the euro area should facilitate the provision of increased financial help from core countries to weak euro area members. It should also facilitate more decisive intervention by the ECB in the secondary sovereign bond market, if needed.

- In the US, despite stronger short-term momentum late in 2011, our longer-term view includes a below-trend growth around 2% in 2012, mainly due to the expected fiscal retrenchment and spillovers from the European sovereign debt crisis.

- After going through a mild recession around the turn of the year, the euro area economy is expected to gain some traction later in 2012 on the backdrop of improving sentiment and solid external demand.

- Japan should avoid a technical recession, with real economic activity regaining momentum particularly in the second quarter of the year as reconstruction-related activity and inventory restocking should start exerting a positive influence on GDP growth.

- Emerging and developing economies are expected to gain momentum in the second half of the year, thanks in part to the lagged effects of monetary policy easing.

- The main risks to our global growth outlook are related to a re-escalation of the sovereign debt tensions in the euro area, mainly in Spain and Italy, and a sharp rise in oil prices due to geopolitical tensions.

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Executive Summary

Global economic activity has slowed remarkably over the previous year, owing to a lower growth trajectory in most advanced economies, as well as to an escalation of the debt crisis to systemic countries of the euro area. Uncertainty over the European debt crisis and the US debt ceiling debacle led to a sharp plunge of investors' confidence in the second half of 2011. Thus, risk aversion increased significantly and global financial conditions deteriorated sharply. World trade decelerated significantly in 2011, on the back of the deterioration in the global economic environment, with momentum stalling particularly in the second half of the year.

However, the release of good economic news in the US since the beginning of the year, alongside the last December's decision of the ECB to provide ample liquidity through two 3-year operations, has led to an improvement in the global economic environment. Industrial production data of major economies have shown signs of stabilization, while the recent pick up in global manufacturing PMIs suggests that the industrial business cycle is likely to maintain its momentum in the course of the year. In the US, despite stronger short-term momentum late in 2011, our longer-term view includes a below-trend growth around 2% in 2012, mainly due to the expected fiscal retrenchment and spillovers from the European sovereign debt crisis. After going through a mild recession around the turn of the year, the euro area economy is expected to gain some traction later in 2012. The growth divergence between core and periphery members is expected to continue this year, although less marked than in 2011, as core countries are also affected by the protracted debt crisis tensions. Japan should avoid a technical recession, with real economic activity regaining momentum particularly in the second quarter of the year as reconstruction-related activity and inventory restocking should start exerting a positive influence on GDP growth. Emerging and developing economies are expected to remain the locomotive of global growth, with better growth prospects in the second half of the year, thanks in part to the lagged effects of monetary policy easing. We believe that easier monetary conditions this year, compared to 2011, will support the global economy in 2012. Overall, we expect global economic growth to decelerate to 3.3% in 2012 from 3.8% in 2011.

We believe that a permanent solution to the euro area debt crisis involves both fiscal discipline in the periphery members and fiscal solidarity from the economically stronger core countries. Weak members need to readjust their economies through heavy programs of structural reforms, which, in the near term, cause deep recession. Increased financial help from the stronger countries would assist the weak economies to re-stabilize and attract private investors again. We are cautiously optimistic that the agreement on enhanced fiscal discipline should facilitate the provision of additional aid to backstop weak members' borrowing costs. In particular, it should curb German resistance to raise the firepower of the European Stability Mechanism, sending a strong message to the markets that euro area policymakers are determined to protect the monetary union from a full blown debt crisis. What is more, increasing the resources of the ESM seems to be vital to persuade non-Europeans to raise the resources of the IMF.

Binding agreements on increased fiscal discipline in the future should also facilitate more decisive intervention of the ECB in order to stabilize sovereign bond markets, whenever the need arises. In our view, the ECB remains the most credible mechanism to contain the liquidity threat on the Spanish and Italian sovereign bond markets. The success of the 3-year operations provides evidence that the ECB possesses a lot of ammunition to assuage financial and sovereign debt tensions. The indirect quantitative easing currently taking place, signals a new stance of the ECB, which seems to have realized that countries may not be able to sort out their fiscal woes by themselves without some assistance by the ECB.

The main risks to our global growth outlook are related to a re-escalation of the sovereign debt tensions in the euro area and higher oil prices. Markets remain concerned about the ability of weak euro area members to achieve their fiscal targets and implement painful structural reforms amidst a recessionary environment and record high unemployment. Downside risks to the global economy would materialize if investors loose confidence on Spain's or Italy's ability to stabilize their public finances. The second risk is associated with higher oil prices and sanctions on Iranian crude oil imports. Oil prices have increased significantly since the start of the year. In our view, geopolitical tensions, along with easy money globally and tight fundamentals will maintain oil prices at current elevated levels across 2012, with upside risks to energy prices rising markedly on the back of recent developments in Syria and Iran. A sharp rise in oil prices would affect the global economy mainly through the terms of trade channel, transferring income from oil importing to oil exporting countries.

Dimitris Malliaropulos

Economic Research Advisor

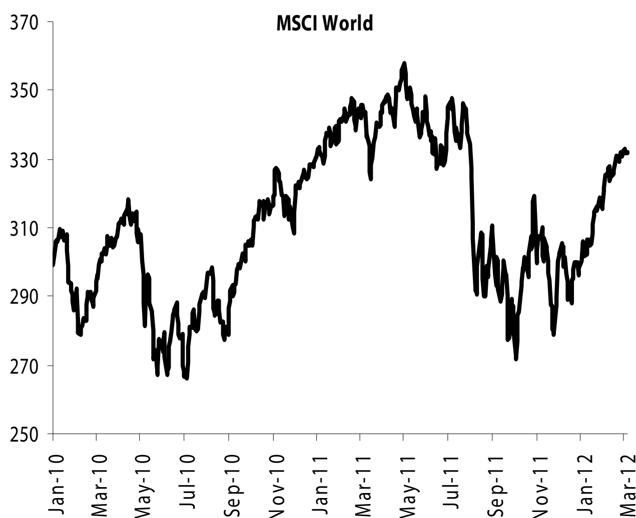
I. Global Outlook

Dimitris Malliaropulos, Maria Prandeka, Olga Kosma, Vasilis Zarkos

The expansion of the global economy continued in 2011, albeit at a much slower pace than in 2010

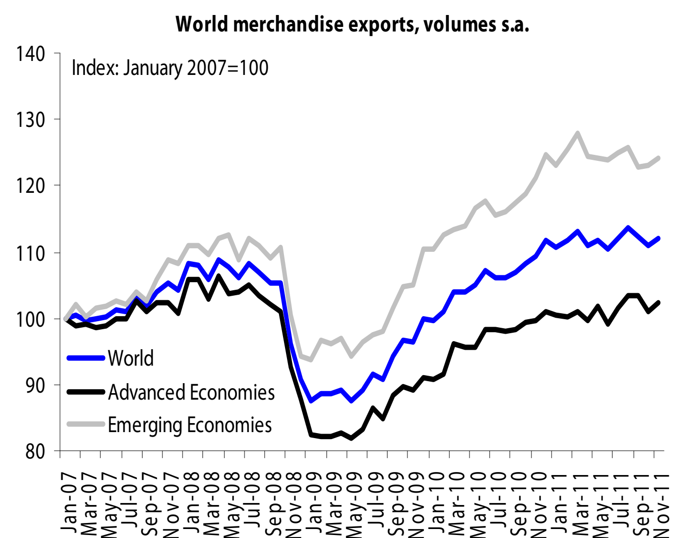
Global economic activity has slowed remarkably over the previous year, owing to a lower growth trajectory in most advanced economies, as well as to fiscal and financial uncertainty attributed mainly to the euro area sovereign debt crisis. World economic growth fell to 3.8% in 2011 from 5.2% in 2010 (in purchasing power terms). Uncertainty over the European debt crisis and the US debt sustainability and its debt ceiling debacle led to a sharp plunge of investors' confidence in the second half of 2011. Thus, risk aversion increased significantly and global financial conditions deteriorated sharply, with global stock markets falling by about 24% from their peak in early May 2011 (Figure 1). World trade decelerated significantly in 2011, on the back of the deterioration in the global economic environment, with momentum stalling particularly in the second half of the year. The volume of international trade in both goods and services returned to single digit growth rates in 2011, decelerating to 6.9% from around 13% in 2010. Most of the weakness in world trade volumes reflects the relatively sluggish recovery of exports in advanced economies. According to the latest data from the CPB Netherlands Bureau for Economic Policy Analysis, the level of merchandise export volumes for advanced economies has yet to recover fully from the 2008-2009 global recession. Indeed, it is hovering about 4.0% below its pre-recession peak. In contrast, the corresponding level for emerging economies is 10.2% above its pre-crisis peak (Figure 2).

Figure 1



Source: Bloomberg

Figure 2



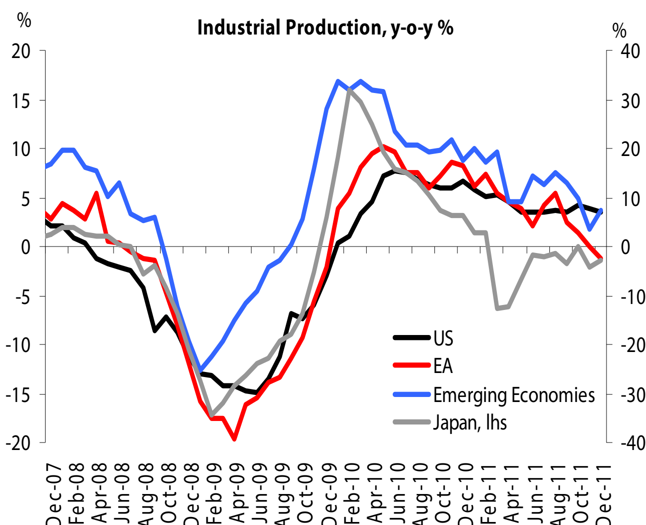
Source: CPB Netherlands Bureau for Economic Policy Analysis

The global economy is set to grow at a slower but decent rate in 2012

The release of good economic news since the beginning of the year, particularly in the US, alongside the last December's decision of the ECB to provide ample liquidity through two 3-year operations, has led to an improvement in the global economic environment. Industrial production data of major economies have shown signs of stabilization (Figure 3), while the recent pick up in global manufacturing PMIs (Figure 4) suggests that the industrial business cycle is likely to maintain its momentum in the course of the year.

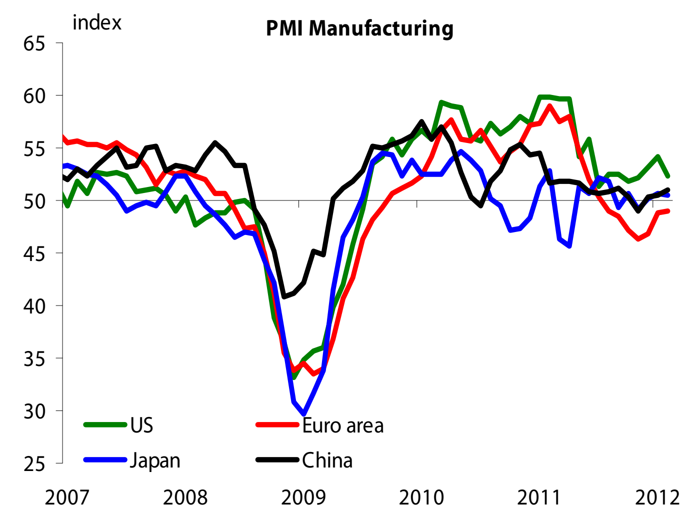
That said, global economic growth is set to slow further in 2012 as a result of the ongoing fiscal consolidation in developed economies, most notably in Europe. Our estimates suggest global growth to decelerate to 3.3% in 2012 from 3.8% in 2011 and rebound to 4.0% in 2013. Weaker growth prospects are anticipated to take a toll on trade growth. However, the slowdown in world trade growth is expected to be contained, as external demand is likely to improve in the following months. Better demand prospects are stemming particularly from the US, where private demand is forecast to gain strength on the back of improving labor market conditions. In EMs that are playing a significant role in determining the prospects of world trade, robust growth and, in particular, strong domestic demand is expected to be supportive for world trade in the years ahead. Overall, we estimate world trade growth to decelerate to 4.9% in 2012 (below its 30-year average rate of 5.8%), before it rebounds to 7.0% in 2013.

Figure 3



Source: CPB Netherlands Bureau for Economic Policy Analysis

Figure 4



Source: Bloomberg

Indirect QE by the ECB has improved the economic sentiment.

The recent improvement of the economic sentiment is in large part attributed to bold action by the ECB. Last December, the central bank's governing council decided to provide ample liquidity through two 3-year operations, while it relaxed the collateral rules and reserve requirements in order to facilitate banks to take up the liquidity offered. This generous provision of financial aid (€1.02tn injected in the two 3y LTROs) has reduced meaningfully the liquidity risk of the euro area's banking system, diminished the likelihood of bank collapse and decreased the risk of excessive deleveraging. Banks for which money markets are closed have particularly benefited from the recent series of measures. As a result of the measures, inter-bank lending improved, as is evident by a decline in the Euribor-OIS spread (Figure 5). Overall, the ECB's action mitigated the dynamics of the vicious cycle between the sovereign debt crisis and tensions in the euro area's banking sector.

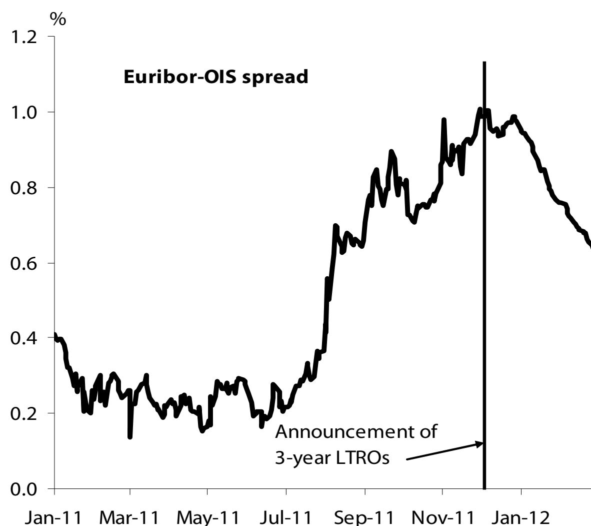
Besides the alleviation of stresses in the banking system, the 3-year refinancing operations reduced yields on government bonds, defying downgrades by credit rating agencies. Spanish and Italian government bond yields declined across the curve (Figure 6), with yields on medium-term bonds having receded the most, as their maturity matches the term of the liquidity operations. Apart from funding or pre-funding their maturing bonds, banks have used some of the liquidity offered to buy government paper. The carry trade with government bonds is profitable. Banks borrow at a fixed rate equal to 1% and buy government bonds at returns much higher than the borrowing cost. In this sense, the new ECB measures can be viewed as indirect quantitative easing. In effect, the ECB's liquidity provision increased the ability of domestic banks to absorb debt issued by governments. It also gave governments time to implement the extensive program of structural reforms, necessary to improve their growth prospects and convince investors about the sustainability of their debt dynamics.

Additional financial support is needed to resolve the European sovereign debt crisis.

The recent agreement on a compact aiming at enhancing the fiscal discipline and monitoring among the euro area members is a right step towards strengthening the fiscal pillar of the monetary union and improving the long term solvency outlook of the euro area countries. However, the agreement on enhanced fiscal surveillance and economic governance can do little to resolve the current sovereign debt crisis. The reason is that it takes long to rehabilitate the public debt and correct the structural imbalances across euro area members, while its short-term effect on growth is recessionary.

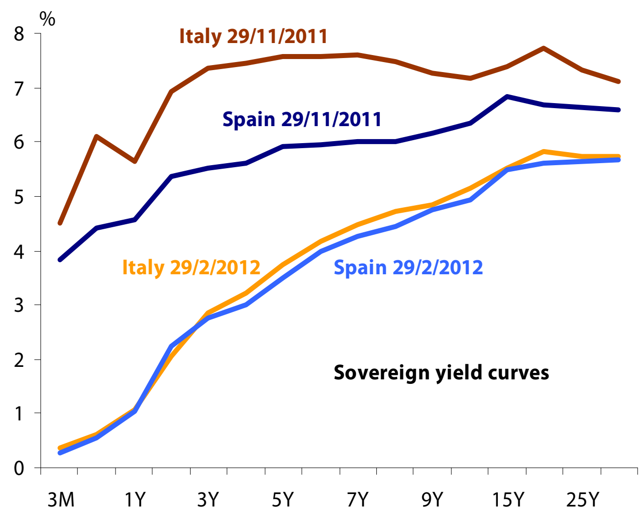
We believe that a permanent solution to the lingering debt crisis involves both fiscal discipline on behalf of the periphery members and fiscal solidarity on behalf of the economically stronger core countries. Weak members need to readjust their economies through heavy programs of structural reforms, which, in the near term, cause deep recession. Increased financial help from the stronger countries would assist the weak economies to come out of recession and attract private investors again. We are cautiously optimistic that the agreement on enhanced fiscal discipline should facilitate the provision of additional aid to backstop weak members' borrowing costs. In particular, it should curb German resistance to raise the firepower of the European Stability Mechanism, sending a strong message to the markets that euro area policymakers are determined to protect the monetary union from a full-blown debt crisis. What is more, increasing the resources of the ESM seems to be vital to persuade non-Europeans to raise the resources of the IMF.

Figure 5



Source: Bloomberg

Figure 6



Source: Bloomberg

Binding agreements on increased fiscal discipline in the future should also facilitate more decisive intervention of the ECB in sovereign bond markets, whenever the need arises. In our view, the ECB remains the most credible institution to contain the liquidity threat on the Spanish and Italian sovereign bond markets. The success of the 3-year operations provides evidence that the ECB possesses a lot of ammunition to assuage financial and sovereign debt tensions. The indirect quantitative easing signals a new stance of the ECB, which seems to have realized that countries may not be able to sort out their fiscal woes by themselves without some assistance by the ECB.

Country/regional economic outlook

Stronger near-term momentum in the US economy, albeit weak growth trajectory ahead. Incoming economic data for the US economy suggests that the recent improvement in economic momentum that we saw at the end of 2011 has continued into the first part of 2012. Private sector employment growth has accelerated, with the unemployment rate falling to 8.3% at the beginning of the year, while manufacturing activity has rebounded significantly in recent months.

Despite stronger short-term momentum late in 2011, our longer-term view of the US economy includes a below-trend growth around 2% in 2012, mainly due to the expected fiscal retrenchment and spillovers from the European sovereign debt crisis. Given the agreement that has been reached between the House of Representatives and the Senate for the extension of the 2% payroll tax cut and the emergency unemployment benefits through the end of 2012, the average fiscal effect on 2012 real growth is expected to be around 0.6-0.7%, similar to the fiscal drag on 2011 growth.

The euro area economy is expected to resume growth in H2 2012. The Euro area economy is expected to go through a mild recession around the turn of the year, gaining some traction later in 2012. Overall, the economy is expected to stall, printing zero annual growth in 2012. The growth divergence between core and periphery is expected to continue this year, although less marked than in 2011, as core countries are also affected by the protracted debt crisis tensions. Domestic demand is anticipated to be a drag on growth due to private and public sector deleveraging. On the other hand, the euro area economy is likely to benefit from a revival of the economic sentiment, while external demand due to brighter economic prospects in emerging markets and the US are likely to boost euro area exports.

The Japanese economy will benefit from reconstruction activity. Although the Japanese economy contracted in the final quarter of 2011, mainly due to particularly weak external demand, recent economic data suggest that economic conditions are slowly improving. In our view, Japan should avoid a technical recession, with real economic activity regaining momentum in 2012 and, particularly in the second quarter of the year as reconstruction-related activity and inventory restocking should start exerting a positive influence on GDP growth. The timing of the implementation of the third supplementary budget, which includes the bulk of post-earthquake reconstruction plans, as well as the fourth supplementary budget which is a key factor for the consumption outlook, will be crucial for the recovery of the Japanese economy. The risk of a slowdown may appear again in FY2013, when reconstruction demand will probably have run its course and tax hikes would have to take effect in order to finance the increased government consumption and investment.

Emerging and developing economies are expected to remain the locomotive of global growth. We expect better growth in most emerging economies in the second half of the year, thanks in part to the lagged effects of monetary policy easing. Although EM economies are slowing down, they are expected to remain the leaders of global growth, growing substantially faster than advanced economies over the next few years. The significant momentum in Emerging Asia's economic activity implies that the region will continue to outperform its peers. In Latin America, most countries are expected to benefit from elevated commodity prices and relatively strong performance of Asian economies, particularly China, a key destination of the region's exports. Emerging Europe is the region most exposed to the troubles in the euro area, so its economic performance in 2012 will likely be most severely hit by the euro area recession.

Risks to our global growth outlook

An escalation of the sovereign debt tensions in Spain or Italy

Uncertainty to our global economic outlook remains high due to the unresolved euro area debt crisis. Approval of the second bail-out program for Greece has eased concerns stemming from a disorderly Greek default. However, markets remain concerned about the ability of weak periphery members to achieve their fiscal targets and implement painful structural reforms amidst a recessionary environment and record high unemployment. Downside risks to the global economy would materialize if markets loose confidence on Spain or Italy. In particular, risk aversion could escalate further, financial conditions would become tighter and international capital flows could decline even more. Countries with close trade links with the euro area would experience a sharper deceleration in export growth. Other economies particularly reliant on European banks (mainly in emerging Europe) would be affected by a sharp reduction in wholesale funding and domestic bank activity. Slower commodity demand growth due to a deeper recession in the euro area could result in a major decline in commodity prices. Incomes of major commodity exporters would be hard hit, affecting negatively their fiscal conditions.

Higher Oil Prices

The second risk is associated with higher oil prices and sanctions on Iranian crude oil imports. Oil prices have increased about 17% year-to-date, and are already 13% above the 2011 average. Geopolitical tensions along with easy money globally and tight fundamentals, in our view, will maintain oil prices at current elevated levels across 2012, with upside

risks to oil prices rising markedly on the back of recent developments in Syria and Iran. A sharp rise in oil prices would affect the global economy mainly through the terms of trade channel, transferring income from oil importing to oil exporting countries. Higher oil prices would result in increased production costs for businesses and reduced disposable income for households, weighting on economic activity. From the producer perspective, higher oil prices would lead to increased input costs and a simultaneous decrease in demand for their products, thus limiting profit margins and resulting in a potential reduction of production and investment. What's more, sanctions on Iranian crude imports, including a US and EU embargo, may introduce a significant headwind to economies that rely heavily on Iran for their energy needs.

Easier monetary conditions compared to 2011 are expected to be supportive for global growth

Over the second half of 2011, easing inflationary pressures and a broad-based slowdown in global growth has led to an easing bias across the board. We believe that easier monetary conditions this year compared to 2011 will support global economic growth path in 2012. In our view, given that growth in advanced economies will likely remain subdued, monetary authorities should maintain monetary policy loose, even if that means tolerating inflation persistently above their targets. In the US, the Fed's conditional commitment to keep fed funds rates at exceptionally low levels was extended from "at least through mid-2013" to "at least through late 2014", providing a more dovish tone than market participants had previously thought. Further policy action could become appropriate if the economy lost momentum over the next few months. In such a case, renewed purchases of treasuries and MBS of the Fed would be the major tool, as it could help inflate away some public and private sector debt and, therefore, aid the deleveraging process. Given the broken monetary transmission mechanism in the euro area, unconventional measures may be more effective to calm rising stresses than an outright rate cut might be. Hence, if borrowing costs of Spain and Italy rise to uncomfortable levels again, the ECB will likely address them by additional LTROs. The ECB may also resume the longer term operations in case financial tensions intensify anew. The Bank of Japan surprised markets at its February monetary policy meeting with a decision to increase long-term JGB purchases JPY10trn under the Asset Purchase Program, and turn its "understanding" of medium/long-term price stability into an inflation target of 1%. We believe that the central bank's move came amid heavy political pressure, as fiscal policy intervention has not yet moved forward with a decision on consumption tax hikes. The expansion of JGBs purchases focuses on bonds with remaining maturities of two years or less, whose yields are now hovering at very low levels. Given that there is little room for the new purchases to depress the above-mentioned yields further, the BoJ should extendthe duration of JGBs purchased. EMs policy tightening cycle reached its peak in H2 2011, causing a number of countries to either hold interest rates or ease. However, central banks in most EMs, and especially in emerging Asia, are now expected to cut rates less than before in tandem with stabilization in global growth and the persistence of some upside risks to commodity prices.

II. Global Economic Outlook

1. The US economy

Dimitris Malliaropulos, Olga Kosma

- Real GDP growth reported in Q4 11 its strongest gain since Q2 2010, on the back of inventory accumulation and real personal consumption growth.
- Incoming economic data suggest that the recent improvement in economic momentum that we saw at the end of 2011 has continued into the first part of 2012, supported by softer consumer price inflation and further gains in employment.
- However, a sharp rebound in personal consumption growth is not on the cards, with US households focusing on reducing their existing debts.
- Despite stronger short-term momentum, our longer-term view of the US economy remains intact for a below-trend growth in 2012, averaging at around 2%, mainly due to fiscal retrenchment and spillovers from the European sovereign debt crisis.
- Further policy action could become appropriate if the economy lost momentum over the next few months. In such a case, renewed purchases of Treasuries and MBS of the Fed would be the major tool, as it could help inflate away some public and private sector debt and, therefore, aid the deleveraging process.

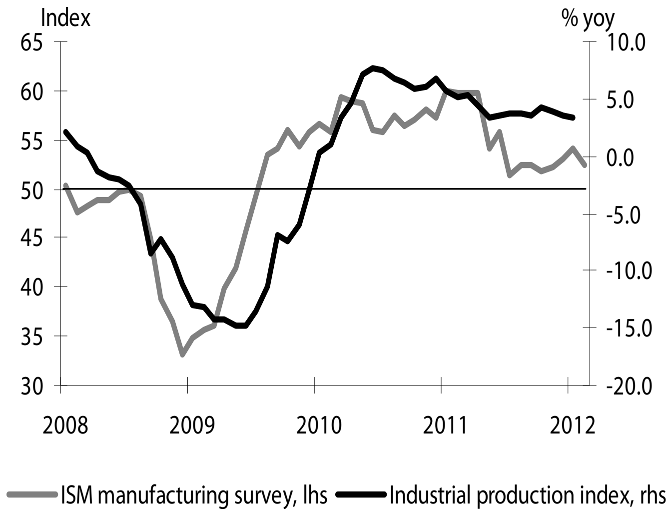
Overview

Incoming economic data suggest that the recent improvement in economic momentum that we saw at the end of 2011 has continued into the first part of 2012. Private sector employment growth has accelerated, with the unemployment rate falling to 8.3% at the beginning of the year, while manufacturing activity has rebounded significantly in recent months. Although the ISM manufacturing index fell to 52.4 in February from 54.1 in the previous month, the overall activity remained above the 50-threshold that signifies expansion in the manufacturing sector (Figure 1.1). According to our estimates, real GDP growth is expected to hover around 1.5-2.0% q-o-q saar in Q1 2012, supported by softer consumer price inflation and further gains in employment. However, a sharp rebound in personal consumption growth is not on the cards, with US households focusing on reducing their existing debts. Despite stronger short-term momentum, our longer-term view of the US economy remains intact for a below-trend growth in 2012, averaging at around 2%, mainly due to fiscal retrenchment and spillovers from the European sovereign debt crisis. Given the agreement that has been reached between the House of Representatives and the Senate to extend the payroll tax cut and the emergency unemployment benefits through the end of 2012, the average fiscal effect on 2012 real growth is expected to be around 0.6-0.7%, similar to the fiscal drag on 2011 growth (Figure 1.2).

Apart from the fiscal tightening which is expected to build as we head towards 2013, the US economy remains particularly vulnerable to the Euro area sovereign debt crisis. The euro area is going through a mild recession, and this could have a lagged impact on US growth through the direct effect of trade, the financial market conditions channel as well as the bank lending channel. As far as trade linkages are concerned, the US is a relatively closed economy, with exports accounting for roughly 15% of GDP. About 33% of US exports go to North America (Canada and Mexico), while US exports to the Euro area account for roughly 14% of total US exports. Given that the elasticity of US exports to the Euro area with respect to US growth is about 2-2.5, a 1% decline in Euro area's real GDP could be a relatively small drag to US real GDP growth, no more than 0.05pp. But there are also indirect effects via trade, as the appreciation of the dollar relative to the euro due to the escalation of the European crisis and the unfavorable growth outlook for the euro area could lead to a loss of competitiveness of US exports. Meanwhile, the financial and banking linkages to the US are very important and could have

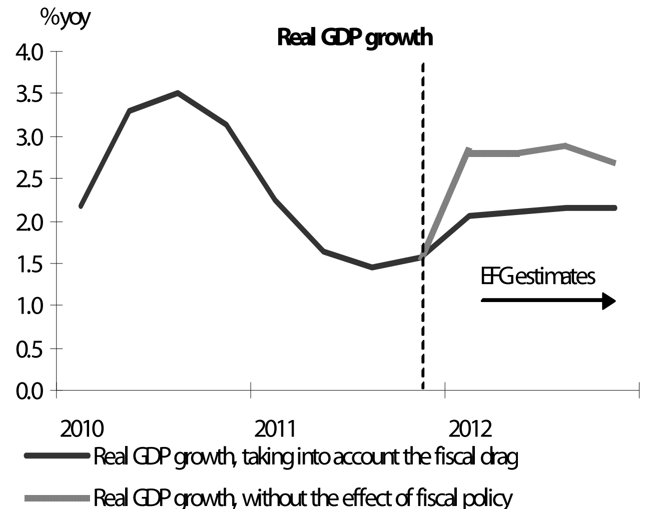
a significant negative impact on US growth. Although the exposure of US banks to European peripheral debt is relatively low compared with the rest of the world, the main risk for the US centers on a potential increase in risk aversion in capital markets and a corresponding tightening in financial conditions. Last but not least, European financial stress could affect US growth through restricted availability of credit, weighing in turn on business investment and consumer spending.

Figure 1.1



Source: Bloomberg, The Conference Board

Figure 1.2

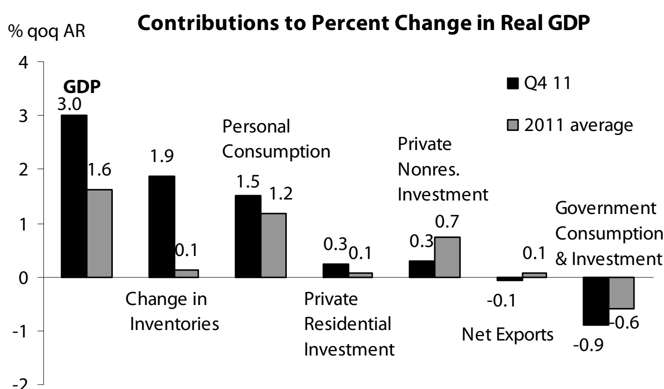


Source: US Bureau of Economic Analysis, EFG estimates

GDP growth accelerated in Q4 11, on the back of inventory accumulation and private consumption

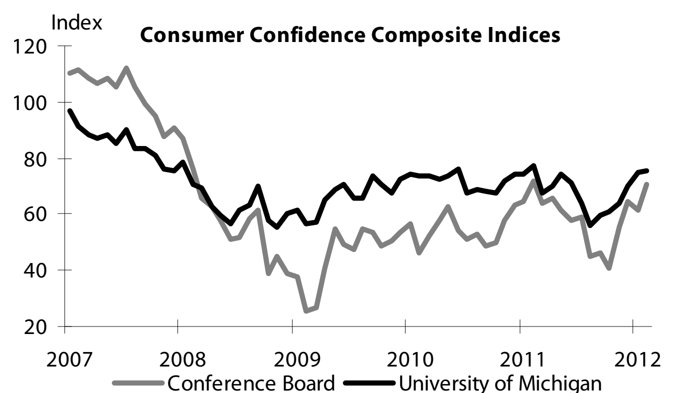
According to the second estimate of the Bureau of Economic Analysis (BEA), real GDP accelerated to 3.0% q-o-q saar in Q4 2011 from 1.8% in Q3, in line with our forecast and the consensus estimate (both equaled 3.0%). Although real GDP growth in the final quarter of 2011 was the strongest reported gain since Q2 2010, the majority of the gain was due to a faster pace of inventory accumulation and personal consumption growth, adding 1.9% and 1.5% to real GDP growth, respectively. Given that the public sector consolidation is a prevailing headwind for the US economy, the government sector was the major drag on growth, reporting the largest decline since Q1 2011 and, hence, subtracting 0.9% from real economic activity (Figure 1.3).

Figure 1.3



Source: US Bureau of Economic Analysis, EFG estimates

Figure 1.4



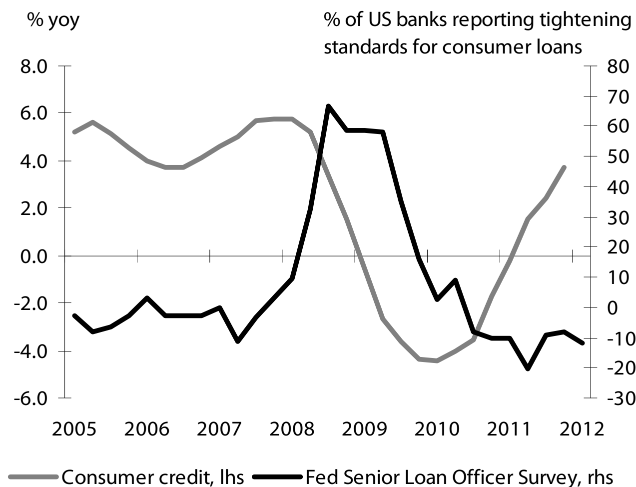
Source: The Conference Board, Thomson Reuters/University of Michigan

Private consumption on a decent upward trend

Real personal consumption spending increased by 2.1% in Q4, slightly higher than the 1.7% reported growth in Q3. As expected, the strong pick-up in durable goods spending (from 5.7% qoq saar in Q3 to 15.3% in Q4) was driven by motor vehicles consumption, as auto spending has finally rebounded from the hit by supply constraints due to the events in Japan. However, the rebound in durable goods was almost completely offset by much weaker services spending, with declines in the housing and utilities and financial services components.

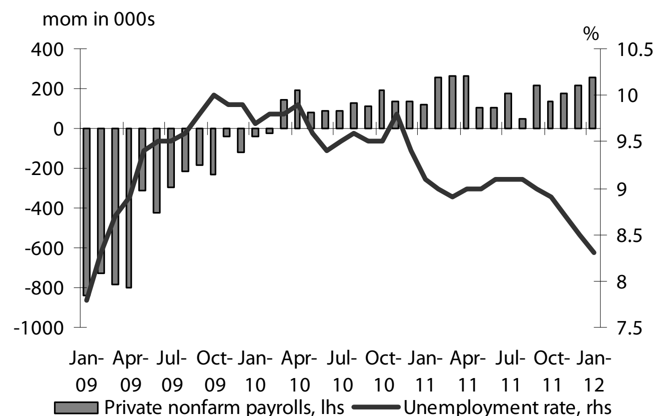
High-frequency data suggest that the poor performance of private spending at the end of last year has continued in January 2012, with real personal consumption reporting flat growth readings over the last three months. The recent weakness of consumption is at odds with strong core retail sales[1] -which increased by a solid 0.7% m-o-m in January after a 0.4% decline in December- and a surge in vehicle sales in February, which rebounded to their highest level since March 2008. Meanwhile, both consumer confidence indices surged to a 12-month high in February, with significant gains in both the present situation and the expectations sub-indices (Figure 1.4). In addition, a majority of US banks have loosened their credit standards for mortgage and consumer loans, while consumer credit has been recently increasing at its fastest pace since the recession began (Figure 1.5).

Figure 1.5



Source: Federal Reserve

Figure 1.6

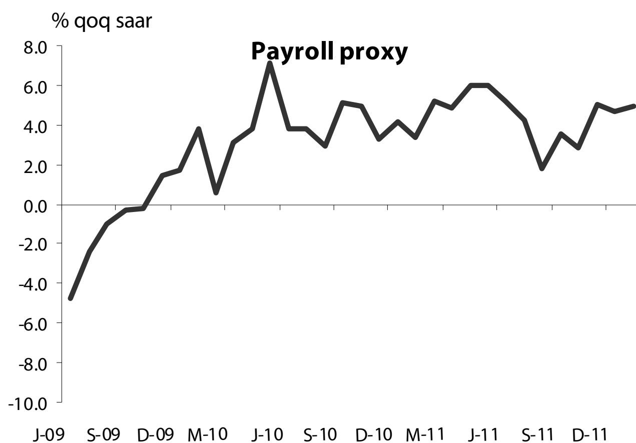


Source: National Federation of Independent Business, Federal Reserve Banks of Philadelphia and New York

We believe that the recent soft consumption reports will be followed by an upward momentum in February, with real consumption growth cruising around 1.5-2.0% q-o-q saar in Q1 2012. The recent improvement in labor market conditions should support personal outlays, as the pace of job gains moves higher and labor income continues its upward trend. In particular, private payroll gains have accelerated to roughly 260k in January from an average of roughly 180k over the past three months, while civilian employment increased by a remarkable 847k, leading to a decline in the unemployment rate to 8.3% from 8.5% in December 2011 (Figure 1.6). The substantial increase in civilian employment may have largely been attributed to the annual update to the population estimates, but even controlling for the population effect, civilian employment would have increased by a robust 630k. Moreover, the payroll proxy for labor income, i.e. the product of weekly hours, hourly earnings and private payrolls, increased by an annualized rate of 4.9% q-o-q through January from 4.7% in Q4 (Figure 1.7). However, the deleveraging process of US households as they try to bring their finances back on a firmer footing suggests that real personal consumption growth will remain subdued around 2.0% throughout 2012, close to the 2.2% annual average growth reported in 2011.

[1] *Core retail sales exclude gasoline, vehicles and building material sales, components that do not affect real personal consumption.*

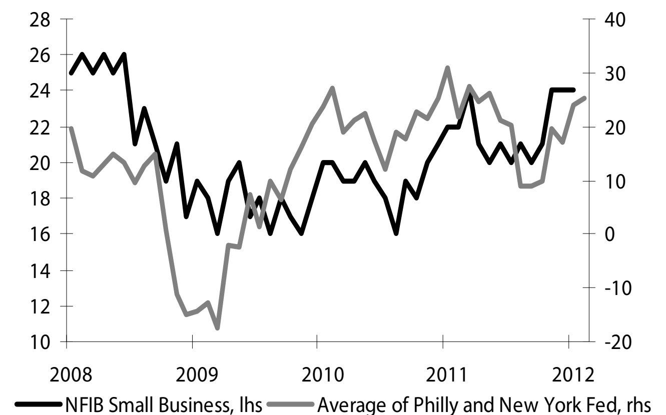
Figure 1.7



Source: U.S. Bureau of Labor Statistics

Figure 1.8

Capital Expenditures Intentions



Source: National Federation of Independent Business, Federal Reserve Banks of Philadelphia and New York

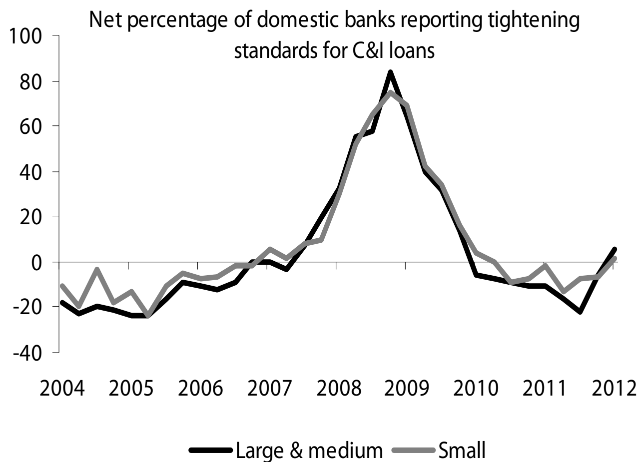
Business investment set for a rebound in Q1 2012

Confirming our projections, real business investment decelerated significantly in Q4 to 2.8% q-o-q saar from 15.7% in Q3, with structures investment falling by 2.6% after a 14.4% increase in Q3 and equipment and software easing to 4.8% from 16.2% in Q3. Hence, although real non-residential investment was the main driver of growth over the last couple of quarters, it contributed a mere 0.3% to real GDP growth in Q4. However, the recent improvement in several business surveys (Figure 1.8) suggests that non-residential investment growth will reaccelerate again in the first quarter of the year. According to our estimates, real non-residential investment growth will move towards 6.0% q-o-q saar from 1.7% in Q4, as the recent improvement in financial markets will help businesses become less cautious to invest. Although core capital goods orders and shipments contracted in January, the decline is likely due to the seasonal pattern for orders to decline in the first month of a quarter and rebound in the following months, as firms want to have a clearer picture for demand before they firm up their orders and shipments. Furthermore, the recent improvement in the US architecture firms' billing index is an encouraging sign for non-residential construction spending that has slowed after its surge in H2 2011. Nevertheless, we expect real non-residential investment growth to decelerate to an average of 6.5% in 2012 from 8.6% in 2011, as the labor productivity slowdown underscores further deceleration in corporate profit growth. Meanwhile, the Fed's Senior Loan Officer Survey in January suggests that credit standards have tightened for commercial and industrial loans (Figure 1.9). A severe tightening of credit conditions and a loss of business confidence in the US triggered by the European sovereign debt crisis looms as a significant risk factor for business investment in 2012.

Gradual recovery in residential investment

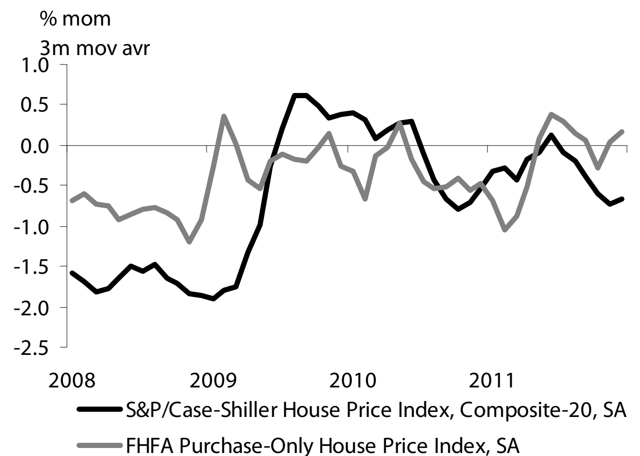
Residential investment growth rebounded to 10.9% q-o-q saar in Q4 from 1.3% in Q3, reporting the biggest contribution (+0.23%) since the second quarter of 2010. Housing starts and building permits have been on an upward trend in recent months, while the National Association of Home Builders (NAHB) index of home builder sentiment has reached a cyclical high in February (highest reading since May 2007), pointing to a corresponding surge in housing starts. Existing home sales surged in January to their highest level since May 2010, and pending home sales, which tend to lead existing home sales in the next couple of months, increased by a solid 2.0% m-o-m in January, pointing to further gains in home sales ahead. House prices have shown signs of stabilization, with the FHFA purchase-only house price index increasing by a total of 1.4% in December 2011 and January 2012. Although house price declines in states with high foreclosures continue to weigh on headline home price indices, with the S&P/Case-Shiller house price indices and the median price of existing homes still contracting on a m-o-m basis (Figure 1.10), the decline in the supply of unsold homes gives a hope that prices may finally stop falling. Hence, although housing conditions are improving, pointing to a continued rebound in residential construction spending and investment, the recovery process will be gradual, with residential investment picking up from an average of -1.4% y-o-y in 2011 to 8.0% y-o-y in 2012.

Figure 1.9
Credit standards tighten modestly for C&I loans



Source: Federal Reserve

Figure 1.10
US House Price



Source: Standard & Poor's, OFHEO, Ecowin

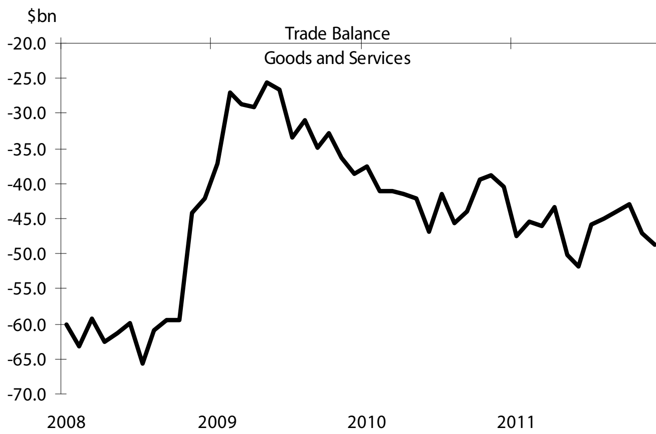
Net trade not a strong impetus for real GDP growth

As far as external demand is concerned, real export growth continued at a slow rate of 4.3% q-o-q saar in the last quarter of 2011, while import growth accelerated to 3.8% q-o-q saar from 1.2% in Q3 (Figure 1.11). As a result, net exports subtracted 0.1% from overall GDP growth in Q4, after a positive contribution of 0.4% in Q3 2011. The recent deceleration of US export growth is in line with the ongoing decent of global economic activity. The escalation of the European sovereign debt crisis over the summer has led to a slowdown of euro area imports, as domestic demand remains anemic or even contracts in several member countries. The slowdown has been more pronounced in weak member countries, i.e. Greece, Ireland, Portugal and Spain, where the deceleration in imports from the US has ranged between 21% (for Ireland) and 60% (for Portugal) since their recent peak in 2011. Furthermore, a slowdown in US export growth to developing Asia is another important factor that explains the deceleration in US trade's contribution to real economic activity. The most important partner in Asia for the US is China (which represents about 6.5% of total US exports, Figure 1.12), whose growth prospects have weakened in 2011, strongly affected by monetary tightening in response to rising inflation, global demand slowdown and supply-side bottlenecks. Looking ahead, export demand to the euro area is expected to remain subdued, as no economic growth is expected in the area in the following months. However, robust growth in emerging Asian economies is expected to be supportive for US export growth in the quarters ahead. Emerging economies are well-positioned to withstand deepening turbulence amid global slowdown, with domestic demand being the main driver of real GDP growth. Although we do expect a narrower trade deficit in 2012 as demand in emerging Asia is expected to partly offset the deceleration of US export demand to euro area countries, net trade is not expected to be a strong impetus for real economic activity, as global GDP growth is expected to slow further in 2012. The deceleration of US personal consumption to a lower growth trajectory may affect global demand through global trade linkages, given that global growth remains highly dependent on US consumption.

Stimulative monetary policy at least through late 2014

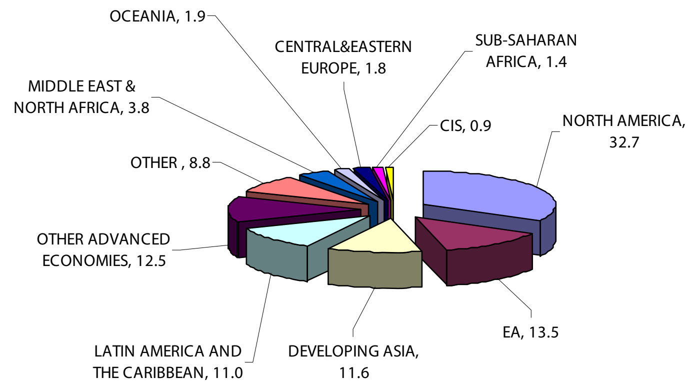
In a historic US monetary policy shift, the FOMC announced for the first time its policy objectives and fed funds rate forecasts at its January 24-25 meeting, including an explicit goal on the inflation rate in the long run. The Fed has made a major step towards greater transparency, in an effort to shape market interest-rate expectations. In particular, the FOMC released committee participants' assessments of the appropriate timing of policy firming, while providing policymakers' specific projections for the appropriate federal funds rate over the next few years and in the longer run. The Fed's conditional commitment to keep fed funds rates at exceptionally low levels was extended from "at least through mid-2013" to "at least through late 2014", providing a more dovish tone than market participants had previously thought.

Figure 1.11



Source: US Census Bureau

Figure 1.12
US export weights to partners (%), Q2 11

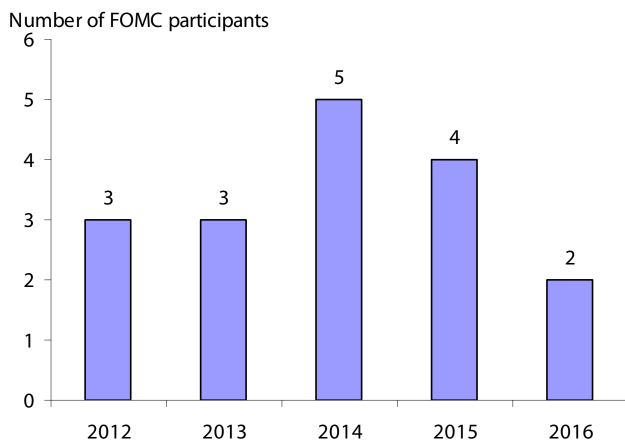


Source: IMF, Eurobank EFG estimates

Participants' rate projections: less dovish than the statement

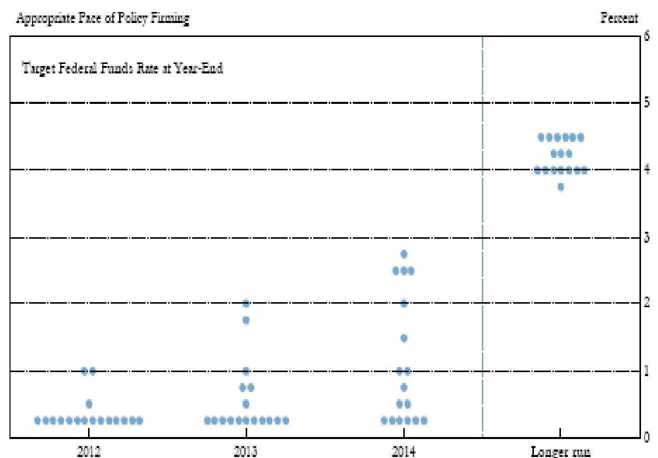
The FOMC participants' projections of the first rate hike were distributed quite evenly between 2012 and 2016, revealing a high degree of dispersion. Three members are expecting a rate increase already in 2012, three in 2013, five in 2014, four in 2015 and two in 2016 (Figure 1.13). Hence, the individual rate projections gave a less dovish picture than the FOMC statement, with the latter signaling a somewhat later start to the tightening cycle. Should we take into account both the FOMC statement and the FOMC participants' assessments, "exceptionally low rates" does not necessarily mean unchanged rates, given that 11 out of 17 members expect a higher fed funds rate than the current rate in late 2014 (Figure 1.14). In addition, should we estimate the "central tendency" FOMC projections of the fed funds rate, excluding the three highest and the three lowest projections, we find that the median FOMC participant expects a fed funds rate of about 0.75% at the end of 2014.

Figure 1.13
Appropriate Timing of Policy Firming



Source: Federal Reserve

Figure 1.14
Appropriate Pace of Policy Firming



Source: Federal Reserve

In his press conference, Chairman Bernanke commented on the difference between the FOMC statement and the participants' forecasts, arguing that the forward guidance, i.e. the FOMC policy statement, should be given priority over

the reported projections. It seems that the FOMC voters as a group have a more dovish bias than the participants, given that the hawks usually come from the Federal Reserve Bank Presidents, only some of whom actually vote in any given year. Regarding the voting rights from the Federal Reserve Bank Presidents in 2012, the three hawkish dissents who had previously voted against easing (Narayana Kocherlakota, Charles Plosser and Richard Fisher) are no longer voters and were replaced by only one hawk, Jeffrey Lacker, who dissented[2], and three more centrist/dovish voters (Sandra Pianalto, John Williams and Dennis Lockhart). As a result, the Fed members' estimates for the fed funds rate reveal a more hawkish bias among non-voters.

Fed's economic outlook: optimistic relative to its dovish signal to stay on hold through late 2014

Although the dovish tone of the FOMC statement and extension of the forward guidance was accompanied by a more downbeat assessment of the US economic outlook over the next couple of years (compared to the committee's November projections), Fed's growth forecast was revised down by only 0.25% for 2012 and 2013 (2012: 2.2-2.7% from 2.5-2.9%, 2013: 2.8-3.2% from 3.0-3.5%), and was actually revised higher by about 0.2% for 2014 (Table 1.1). It is worth noting that the consensus real GDP forecast currently stands at 2.4% for 2013, 0.6% higher than the midpoint of the FOMC's "central tendency" forecast, suggesting a relatively optimistic outlook for its dovish signal to stay on hold for longer than most expected. In addition, the Fed announced a new explicit longer-run target for personal consumption expenditures price index (PCE) at 2%, slightly higher than the previous longer-run projection of 1.75-2% that was part of the November economic projections, but not stated as explicit goal. The dovish tone was expanded in the inflation outlook by removing the ever-present sentence that "the Committee will continue to pay close attention to the evolution of inflation and inflation expectations". We believe that the removal of this sentence is a signal that the Fed will not be largely concerned about fluctuations in current inflation readings above its target, as low rates of capital and labor utilization will exert downward pressure on wages, costs, and prices, preventing a sustained rise in personal consumption expenditures price inflation.

Table 1.1: Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, January 2012

	Central Tendency*			
	2012	**2013**	**2014**	**Longer**
Change in real GDP	**2.2 - 2.7**	**2.8 - 3.2**	**3.3 - 4.0**	**2.3 - 2.6**
November forecast	(2.5-2.9)	(3.0-3.5)	(3.0-3.9)	(2.4-2.7)
Unemployment rate	**8.2 – 8.5**	**7.4 - 8.1**	**6.7 - 7.6**	**5.2 - 6.0**
November forecast	(8.5-8.7)	(7.8-8.2)	(6.8-7.7)	(5.2-6.0)
PCE inflation	**1.4 - 1.8**	**1.4 - 2.0**	**1.6 - 2.0**	**2.0**
November forecast	(1.4-2.0)	(1.5-2.0)	(1.5-2.0)	(1.7-2.0)
Core PCE inflation	**1.5 - 1.8**	**1.5 - 2.0**	**1.6 - 2.0**	
November forecast	(1.5-2.0)	(1.4-2.0)	(1.5-2.0)	
Fed Funds Rate	**0.00 - 0.25**	**0.00 - 0.75**	**0.00 - 2.50**	**4.00 - 4.50**

*The central tendency excludes the three highest and three lower projections for each variable in each year.

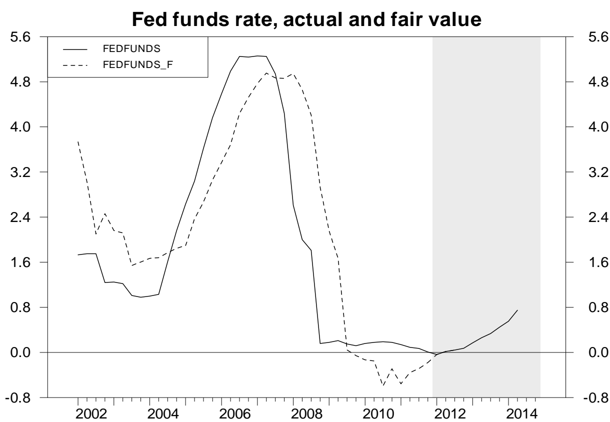
Source: Federal Reserve, Eurobank EFG Research

[2] *Jeffrey M. Lacker was the only FOMC voter who preferred to omit the description of the time period over which economic conditions are likely to warrant exceptionally low levels of the federal funds rate.*

A much earlier tightening of monetary policy, if the Fed responded to the economic conditions in the same way that it did in the past

Trying to assess the appropriate timing of policy firming if the Fed responded to the economic conditions in the same way that it did historically, we find that the conditional commitment to keep rates exceptionally low though late 2014 implies a more dovish stance by the Fed, compared to its reaction function in the past. In particular, in order to estimate the path of the fed funds rate, we use a Taylor rule estimated with labor market tightness[3] (standardized) and core PCE inflation over the period 1987:Q1-2011:Q4. Given that the Fed is relatively slow in responding to changes in inflation and labor market conditions, i.e. the Fed smoothes interest rates, our Taylor rule includes the federal funds rates three periods earlier (interest rate smoothing). Using the midpoint of the Fed's "central tendency" forecasts[4], Figure 1.15 shows that the Fed would likely begin tightening its policy at the end of 2013 or at the beginning of 2014 under its forecasts, with the federal funds rate increasing to 0.75-1.00% at the end of 2014. This is actually the median rate that the FOMC participants currently project for the end of 2014. However, the dovish FOMC statement is committing to keep rates near the record low of 0-0.25% through the end of 2014. As the market participants took into account the Fed's dovish stance, expectations of the fed funds rate for the end of 2014 were revised down from about 0.80% before the January meeting to about 0.65%.

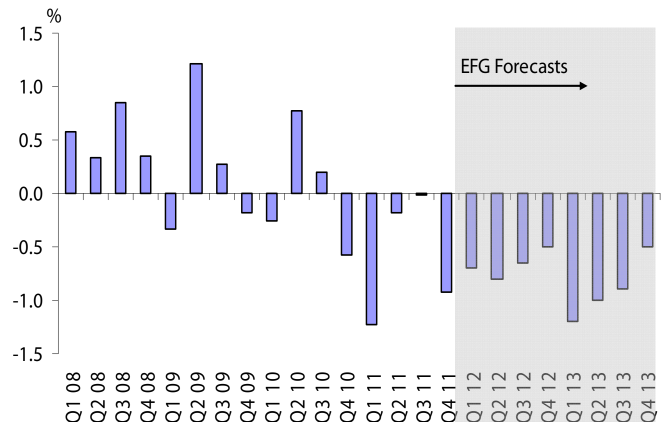
Figure 1.15



Source: Eurobank EFG model estimates

Figure 1.16

Fiscal drag on US GDP growth



Source: U.S. Bureau of Economic Analysis (BEA), EFG model estimates

QE3 will be considered if growth disappoints over the next few months

In the FOMC statement, the committee highlighted that it continues Operation Twist by the middle of 2012 and renewed its promise to review its balance sheet policy as appropriate. The January FOMC minutes suggested that a few members believe further policy action could become appropriate only if the economy lost momentum over the next few months. In such a case, renewed asset purchases is the major tool FOMC members have repeatedly highlighted, as it could help inflate away some public and private sector debt and, therefore, aid the deleveraging process. Bernanke's expressed concern about the housing market likely means that a considerable part of any additional asset purchases would be in agency mortgage-backed securities (MBS). To sum up, the FOMC dovish rhetoric suggests the committee wants to keep monetary policy very stimulative for the following three years unless the economy performs substantially better than the Fed projects, i.e. there is a surprising improvement in labor market conditions or a sudden surge in consumer inflation. If the Fed decided to continue with further policy action due to a deterioration in the economic outlook, we believe that it would move to a third round of $500-750bn of long-term Treasury and MBS purchases towards the middle of 2012 that the Operation Twist will be completed. We expect the first rate hike in mid-2014, with a year-end target of about 0.75%.

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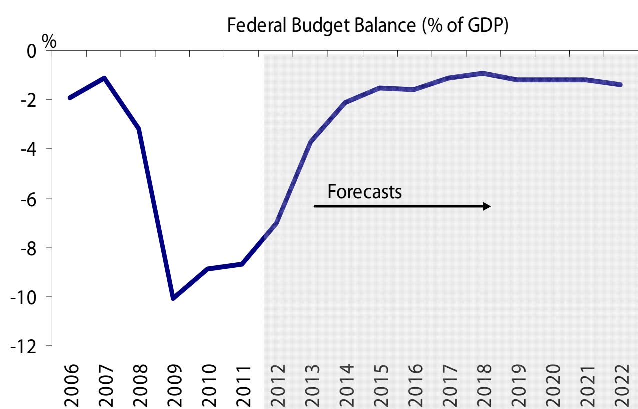
[3] *Labor market tightness is the product of the unemployment rate and the median duration of unemployment.*
[4] *See Table 1.1.*

1.1 Special US Focus: The fiscal drag on US GDP growth

Trying to assess the potential fiscal drag on US growth, we modified our US GDP model so that it takes into account the expected deficit reduction. In particular, we use the expected budget deficit (as a % of GDP) -among other independent variables- in order to project the ISM manufacturing index and the unemployment stress (i.e. the product of the unemployment rate and the median duration of unemployment). Hence, our GDP model, which is a function of the unemployment stress, the ISM manufacturing index, nonfarm payrolls and US house prices, will include the effect from fiscal consolidation. Figure 1.16 shows the overall effect of fiscal policy on US real GDP growth, which reflects the extension of the payroll tax cut and emergency unemployment benefits through the end of 2012. According to our estimates, the average fiscal effect on 2012 US growth is about 0.6-0.7%, similar to the fiscal drag on 2011 US growth. As is evident in Figure 1.2, our model-based estimates produce a 2.8% real GDP growth in the US, without taking into account the effect of fiscal consolidation. The growth rate of real economic activity declines to about 2.0% for a budget deficit reduction of about 1.7%, from 8.7% in 2011 to 7.0% in 2012[5].

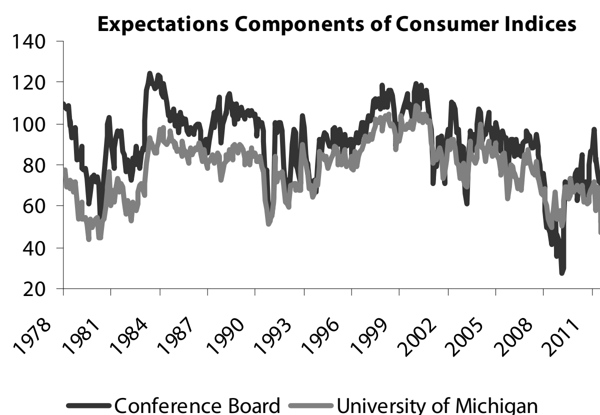
Our results are consistent with the IMF staff calculations for the macroeconomic effects of fiscal consolidation[6]: according to their findings, a budget deficit reduction by 1% of GDP typically reduces real economic activity by about 0.3% and 0.5% in the first and the second year, respectively. The output cost for tax-based consolidation exceeds that for spending-based consolidation by 0.3% in the first year (0.6% versus 0.3%, respectively) and by about 1% in the second year (1.3% versus 0.3%, respectively). Taking these numbers into account, a federal budget deficit reduction of about 1.7% would have a maximum effect on 2012 US real GDP growth of about 0.6%.

Figure 1.17



Source: Congressional Budget Office

Figure 1.18



Source: The Conference Board, Thomson Reuters/University of Michigan, Ecowin

Looking ahead, we expect the fiscal drag on US growth to increase to roughly 1% in 2013, given that the payroll tax cut and the unemployment benefits are left to expire at the end of 2012 (Figure 1.16). However, this forecast does not take into account the expiration of 2001/2003 tax cuts at the end of 2012, which would constitute an additional significant drag on US growth. CBO's baseline forecasts, which assume the expiration of the 2001/2003 tax cuts, report a federal budget deficit of roughly 3.7% of GDP in 2013 (Figure 1.17), constituting a negative impact of about 1.5-2% on US real GDP growth in 2013. Meanwhile, the Super Committee's[7] failure to pass a new deficit reduction plan leads to automatic spending cuts of about $1.1trn for both discretionary and mandatory spending for the next 9 years starting in January 2013[8]. The automatic spending cuts would reduce spending by about $70bn in 2013. Although lawmakers may intervene sometime in 2012 to pass legislation to avoid -or at least delay- the sequestration process, the lack of political agreement points out that several important issues for medium and long-term US public finances (like the Bush tax cuts first passed in 2001 and 2003 and a new deficit reduction plan during 2013-2021) are difficult to be resolved before the November 2012 elections, elevating the amount of uncertainty for the US economic outlook in the medium-term.

[5] *See "The Budget and Economic Outlook: Fiscal Years 2012 to2022", Congressional Budget Office, January 2012.*
[6] *IMF (October 2010), "Will it hurt? Macroeconomic effects of fiscal consolidation", World Economic Outlook, Chapter 3, pp. 93-124.*
[7] *The Super Committee is the Joint Select Committee charged with finding $1.5trn of additional budgetary savings through 2013-2021.*
[8] *See CBO's analysis, "Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act", September 12, 2011.*

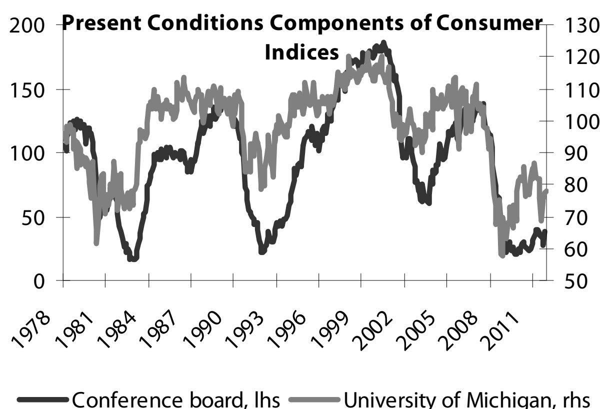
1.2 Special US Focus: The predictive ability of US consumer confidence indices

The University of Michigan's Consumer Sentiment Index and the Conference Board's Consumer Confidence Index are the two most closely watched leading indicators for the US economy from the perspective of the consumer (Figure 1.4). Although business firms, financial institutions and federal agencies closely track both indices, most academic researchers use the Michigan index due to its longer time series. The University of Michigan Consumer Sentiment Index was constructed in the late 1940s by Professor George Katona at the University of Michigan. Even though it started as an annual survey, it was converted into a quarterly survey in 1952 and since 1978 it is published every month by the University of Michigan and Thomson Reuters based on telephonic household interviews. The Conference Board began its consumer confidence index as a mail survey conducted every two months in 1967, and moved to monthly collection and publication in 1977.

Although both consumer indices are a barometer of the public confidence in the US economy, gauging current consumer attitudes and expectations about future economic conditions, they sometimes give conflicting signals at turning points of the economy. Looking at the behavior of the two indices at the current business cycle, the University of Michigan's consumer sentiment index rebounded first in September 2011 and continued increasing thereafter, while the Conference Board's consumer confidence index kept declining until October 2011, and was followed by a sharp increase only in November 2011. Hence, the Michigan's index gave the right signal two months before the Conference Board's one, as Q4 2011 GDP data for the US economy confirm the acceleration of real economic activity. In the following study, we are trying to find what is behind the divergence between the two indices and assess their predictive ability for economic activity.

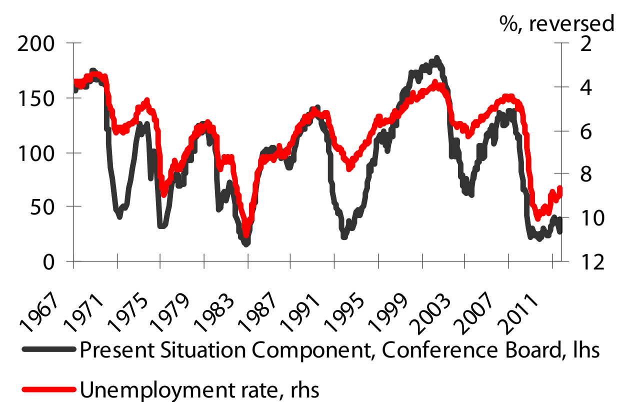
The composite indices of consumer confidence are based on five equally weighted questions, concerning consumers' perceptions of current economic conditions and expectations about future business conditions as well as their own financial situation (Table 1.2). On each survey, three of the five questions ask about consumers' expectations; the Conference Board survey asks about expected changes in business conditions, employment conditions and respondents' income over the next six months. The Michigan survey asks respondents about expected business conditions over the next year and over the next five years and about expected changes in their financial situation over the next year. The difference in the content or the time horizons of questions asked between the two surveys seems to have a minor effect on response patterns, as the expectations components in the above mentioned surveys are highly correlated with each other. As Figure 1.18 portrays, the trend between Michigan's and Conference Board's expectations components is fairly comparable even in the turning points of the economy, with a correlation of 82% for the whole period of 1978-2011 as well as during the economic rebounds.

Figure 1.19



Source: The Conference Board, Thomson Reuters/University of Michigan, Ecowin

Figure 1.20



Source: The Conference Board, Thomson Reuters/University of Michigan, Ecowin

Table 1.2: Component Questions of Consumer Confidence Indices

University of Michigan Survey	Conference Board Survey
PRESENT CONDITIONS INDEX	*PRESENT CONDITIONS INDEX*
1) Do you think now is a good or bad time for people to buy major household items? [good time to buy/uncertain, depends/bad time to buy]	1) How would you rate general business conditions in your area? [good/normal/bad]
2) Would you say that you (and your family living there) are better off or worse off financially that you were a year ago? [better/same/worse]	2) What would you say about available jobs in your area right now? [plentiful/not so many/hard to get]
EXPECTATIONS INDEX	*EXPECTATIONS INDEX*
3) Now turning to business conditions in the country as a whole, do you think that during the next 12 months, we'll have good times financially or bad times or what? [good times/uncertain/bad times]	3) 6 months from now, do you think business conditions in your area will be? [better/same/worse]
4) Looking ahead, which would you say is more likely, that in the country as a whole we'll have continuous good times during the next 5 years or so or that we'll have periods of widespread unemployment or depression, or what? [good times/uncertain/bad times]	4) 6 months from now, do you think thre will be [more/same/fewer] jobs available in your area?
5) Now looking ahead, do you think that a year from now, you (and your family living there) will be better off financially, or worse off, or just about the same as now? [better/same/worse]	5) How would you guess your total family income to be 6 months from now? [higher/same/lower]

Looking at the present conditions components of the two consumer indices, while they do have a high correlation with each other for the whole period of 1978-2011 (78%), they actually have a different cyclical behavior at turning points of economic activity. As is evident in Figure 1.19, the Michigan's present conditions component begins its upward trend in the early stages of economic recovery, when negative GDP growth rates are followed by strong quarterly growth rates. On the contrary, the Conference Board's present situation component generally starts to increase in the later stages of economic expansion (on average, 3-4 months after the Michigan's index), when the labor market has improved and the level of economic activity is higher. Indeed, the correlation between the two present conditions components at turning points of the economy declines from 78% to about 50%.

The different cyclical behavior between the two present conditions components is mainly attributed to the different questions asked for their construction. The Michigan survey for the Current Conditions Index asks respondents whether it is a good or bad time for expensive household purchases and to evaluate changes in their personal financial situation. In contrast to the University of Michigan's consumer survey, the Conference Board survey for the Present Situation Index asks not only about current business conditions, but also about changes in the employment outlook. Therefore, the Conference Board's present situation component closely tracks labor market conditions, asking specifically about job availability in the respondent's area. This is particularly evident in Figure 1.20, which portrays the strong negative correlation (-90%) between the rate of unemployment and the Conference Board's Present Situation Index. In contrast, the Michigan's Current Conditions Index is less closely tied to labor market developments, with a correlation with the unemployment rate of -70%.

Investigating the predictive ability of the two composite indices and their sub-indices for real personal consumption and industrial production during 1978-2011, we find that the expectation components of each of the two composite indices have the strongest predictive ability for changes in real personal consumption and industrial production in the following month, compared to the composite indices and the present conditions ones. In addition, the predictive ability of each of the expectation sub-indices for monthly changes in industrial production is much stronger than the one for personal consumption (Table 1.3). Indeed, the correlation between both indices and personal consumption is just 20%, while the correlation between Michigan's and Conference Board's components and industrial production is 32% and 40%, respectively.

Table 1.3: Vector Autoregression Estimates

	DIP	DCONSUMPTION
CONF(-1)	0.02 [3.54]* R^2=0.216	0.01 [1.86]* R^2=0.093
CONF_EXP(-1)	0.01 [3.24]* R^2=0.222	0.01 [2.85]* R^2=0.138
CONF_PR(-1)	0.02 [4.26]* R^2=0.212	0.01 [1.22]* R^2=0.081
MICH(-1)	0.03 [4.38]* R^2=0.224	0.02 [3.26]* R^2=0.136
MICH_EXP(-1)	0.02 [3.77]* R^2=0.217	0.02 [3.44]* R^2=0.145
MICH_PR(-1)	0.03 [4.46]* R^2=0.207	0.01 [1.91]* R^2=0.106

Source: Eurobank EFG estimates

Notes: Table 1.3 reports the coefficients of the dependent variables Dip and DConsumption on the independent variables Conf(-1), Conf_exp(-1), Conf_pr (-1), Mich(-1), Mich_exp(-1), Mich_pr(-1). Numbers in parenthesis are the t-statistics of the coefficients. R^2 is the R-squared. In addition,

Conf= Conference Board's Consumer Confidence Index
Conf_exp= Conference Board's expectations component
Conf_pr= Conference Board's present situation component
Mich=University of Michigan's Consumer Sentiment Index
Mich_exp= Michigan's expectations component
Mich_pr= Michigan's current conditions component
Dip= % monthly change in industrial production index
DConsumption= % monthly change in real personal consumption expenditures
R^2=R-squared
**Numbers in parethnesis are t-statistics.*

Looking separately at turning points of real economic activity, the most important outcome of our research is that the Michigan's expectations index has a way stronger predictive ability for real personal consumption (with an average correlation of about 30%, compared to an average correlation of 20% for the whole sample of 1978-2011), whereas the Conference Board's expectations index has no predictive ability for personal consumption at economic rebounds (Table 1.4). This evidence may reflect the fact that the Conference Board survey asks specifically about job availability over the next six months, while the Michigan survey asks respondents to assess the general economic situation during the next five years (good times or periods of widespread unemployment or depression, see Table 1.2).

As far as industrial production is concerned, we find mixed evidence, as the Michigan's expectations index has a stronger predictive ability at economic rebounds in the 1980s and the 2000s, while the Conference Board's index has a stronger predictive ability in the 1990s (Table 1.5). Last but not least, both expectations indices fail on average to predict real personal consumption and industrial production growth in economic downturns. This may be attributed to the fact that during expansionary periods consumers become overconfident for their own financial situation as well as general business and economic conditions, so they do not expect a worsening if economic conditions.

Table 1.4

Correlations between the Expectation Components of Consumer Confidence Indices and changes in Real Personal Consumption in the following month at economic rebounds (6-month period around each trough)

	Michigan	Conf Board
April '80	**15%**	**-41%**
March '82	**31%**	**-6%**
October '90	**19%**	**-6%**
July '93	**20%**	**1%**
October '98	**52%**	**35%**
March '03	**26%**	**-7%**
February '09	**32%**	**32%**
Average	**28%**	**1%**

Source: Eurobank EFG estimates

Table 1.5

Correlations between the Expectation Components of Consumer Confidence Indices and changes in Industrial Production Index in the following month at economic rebounds (6-month period around each trough)

	Michigan	Conf Board
April '80	**85%**	**67%**
March '82	**63%**	**23%**
October '90	**82%**	**71%**
July' 93	**23%**	**41%**
October '98	**50%**	**60%**
March '03	**45%**	**72%**
February '09	**63%**	**32%**
Average	**59%**	**52%**

Source: Eurobank EFG estimates

We conclude that the University of Michigan's consumer expectations index is a better indicator for future consumption growth at turning points of the economy. This is also evident at the most recent economic rebound, where the Michigan's expectations index reached its trough in August 2011, and has increased by more than 30% since then, while the Conference Board's expectations index -which is way more volatile- began increasing only in November 2011.

2. The Euro area economy

Dimitris Malliaropulos, Vasilis Zarkos

- After a mild recession around the turn of the year the euro area economy is likely to gain some traction in the second half of 2012. Tensions stemming from the protracted debt crisis are expected to confine GDP growth well below potential rates in the next couple of years.
- Generous liquidity provision by the ECB has had a significant stabilizing effect both in the banking sector and in sovereign bond markets. Leading indicators imply that downside risks have abated for core countries. However, the periphery is expected to experience deeper recession.
- Concerns about the ability of debt laden euro area members to tackle their structural imbalances and bring their public finances in order amidst a recessionary environment are expected to maintain their borrowing costs elevated.
- The recent agreement on a strict fiscal compact aiming at ensuring fiscal surveillance and discipline among the euro area members should facilitate the provision of more generous support by core countries and the ECB to stabilize sovereign debt markets of weak periphery members.
- In our view, upsizing the ESM is necessary to contain contagion risks. Moreover, it would persuade non-Europeans to support the IMF's firepower.

The euro area economy is expected to resume growth in the second half of 2012.

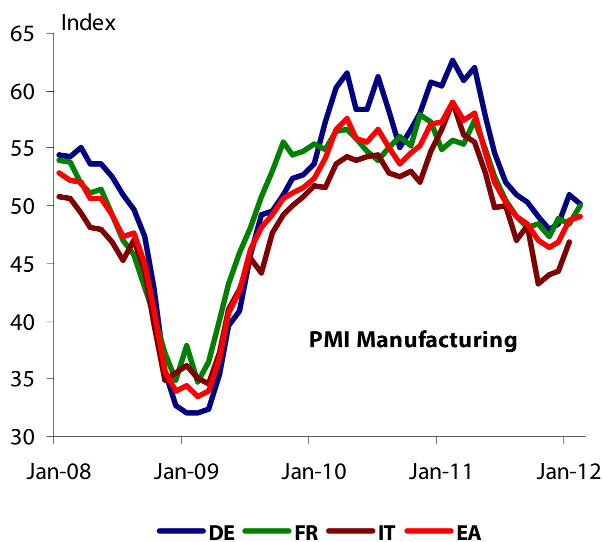
Our baseline scenario for the euro area economy points to a mild recession around the turn of the year, followed by a weak recovery in the second half of 2012. Overall, the economy is expected to stall this year printing zero annual growth, as frontloaded fiscal austerity programs are expected to keep dragging the economy, while lingering uncertainty stemming from the unresolved sovereign debt crisis is expected to confine sentiment to low levels. As a result, the euro area economy is expected to lag other developed countries. Further ahead, the euro area economy is likely to grow at a rate substantially below the potential rate in 2013 (forecast growth 0.8%), due to the long term effect of debt deleveraging and persistently elevated unemployment.

The sharp deterioration of economic confidence in the second half of 2011 due to the materialization of downside risks with respect to the sovereign debt crisis has played out as a downturn of the real economy at the end of the year. According to preliminary data, euro area GDP contracted in the final quarter of 2011 by 0.3% q-o-q for the first time since the second quarter of 2009. While we expect GDP to contract in Q1 2012, the economy is likely to gain some traction later in the year mainly for two reasons. First, generous provision of liquidity by the ECB has eased financial tensions, averting a credit crunch. Second, euro area exports are expected to benefit from external demand due to robust growth in the US and emerging markets. Our economic outlook relies on the assumption that progress towards enhanced fiscal discipline within the European Union should pave the way for increased support to weak euro area members, mitigating contagion risks to systemic countries, mainly Italy and Spain.

Rising leading indicators signal an improvement in economic sentiment, corroborating our baseline scenario that the current recession in the euro area will likely be a mild one (Figure 1.1). However, leading indicators of periphery countries have stabilized at very low still recessionary levels, suggesting that their economies are not out of the woods yet. While these countries have made progress in correcting their fundamental imbalances, structural reforms take time to pay off. Growth prospects in the periphery remain bleak as the short-term impact of the reforms cause both employment and domestic demand to slump. As a result, the divergent growth pattern is set to continue in 2012: the recession in the periphery is set to deepen while in core countries the economy is expected to grow on the backdrop of healthier fundamentals. The German economy most likely will experience a soft patch, as it is expected to return to growth in Q1 after contracting by 0.2% q-o-q in the last quarter of 2011. However, simultaneous fiscal consolidation across the euro area is expected to take a toll on German GDP, which we project to grow by 0.5% annually as opposed to 3.1% in 2011.

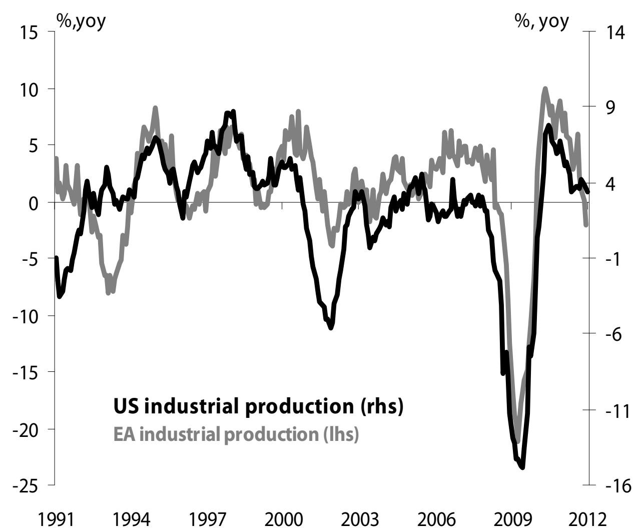
On the positive side for the euro area economy, the external environment is gradually improving, suggesting that rising external demand may boost the Euro zone's export activity. Recent data for the US economy keep surprising on the upside. We expect the rise in industrial production in the US to lift industrial activity in the euro area as well, as the business cycles of the two regions are highly correlated (Figure 2.2). In line with the US, the outlook for developing economies is supportive to euro area exports. Although emerging market economies are expected to grow at a lower rate than in 2011, they are likely to avoid a hard landing in large part due to easier monetary policy on the backdrop of abating inflationary pressures. In turn, euro area exports are likely to benefit form easier monetary conditions in emerging markets, which are expected to boost domestic demand and industrial production in those regions. In line with our view of stronger support from external demand, French and German PMI indicators on new orders are gradually improving, rising above the 50 threshold in February for the first time in several months.

Figure 2.1



Source: Bloomberg

Figure 2.2



Source: Bloomberg

Indirect QE by the ECB has improved economic sentiment.

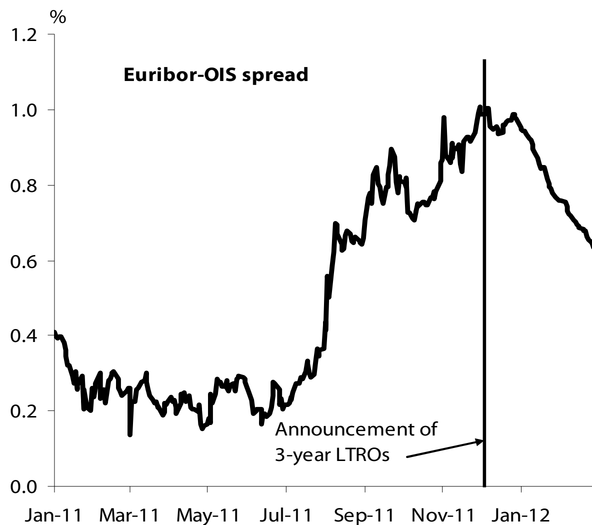
The recent improvement of economic sentiment in the euro area is in large part attributed to bold action by the ECB. Last December, the central bank's governing council decided to provide ample liquidity through two 3-year operations, while it relaxed the collateral rules and reserve requirements in order to facilitate banks to take up the liquidity offered. This generous provision of financial aid (€1.02tn injected in the two 3y LTROs) has reduced meaningfully the liquidity risk of the euro area's banking system, diminished the likelihood of bank collapse and decreased the risk of excessive deleveraging. Banks for which money markets are closed have particularly benefited from the recent series of measures. As a result of the measures, inter-bank lending improved, as is evident by a decline in the Euribor-OIS spread (Figure 2.3). Overall, the ECB's action mitigated the dynamics of the vicious cycle between the sovereign debt crisis and tensions in the banking sector.

Besides the alleviation of stresses in the banking system, the 3-year refinancing operations reduced yields on government bonds, defying downgrades by credit rating agencies. Apart from funding or pre-funding their maturing bonds, banks have used some of the liquidity offered to buy government bonds (Figure 2.4). The carry trade with government bonds is profitable. Banks borrow at a fixed rate equal to 1% and invest at returns much higher than the borrowing cost. In this sense, the new ECB measures can be viewed as indirect quantitative easing. In effect, the ECB's liquidity provision increased the ability of domestic banks to absorb debt issued by governments. It also gave governments time to implement the extensive program of structural reforms, necessary to improve their growth prospects and convince investors about the sustainability of their debt dynamics.

Spanish and Italian government bond yields declined across the curve (Figure 2.5), with yields on medium-term bonds having receded the most, as their maturity matches the term of the liquidity operations. Bank lending data released in

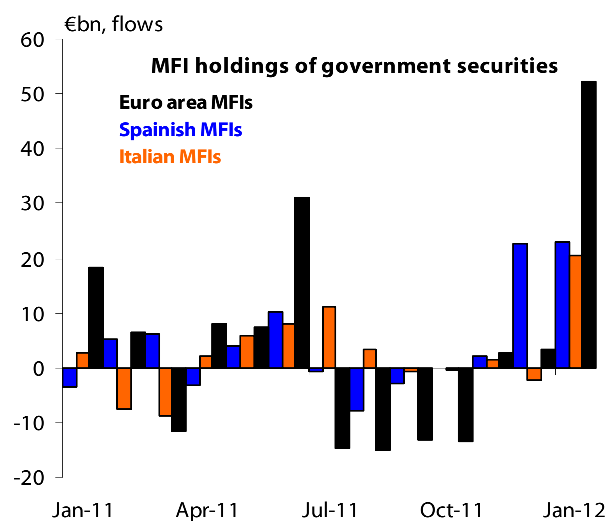
January suggested a revival of banks' appetite for government paper, markedly of Spanish banks. We expect some of the liquidity injected in the second operation will also be used for carry trade purposes. That said, extensive carry trade is not likely due to the lingering sovereign debt risks and higher capital requirements.

Figure 2.3



Source: Bloomberg

Figure 2.4



Source: ECB

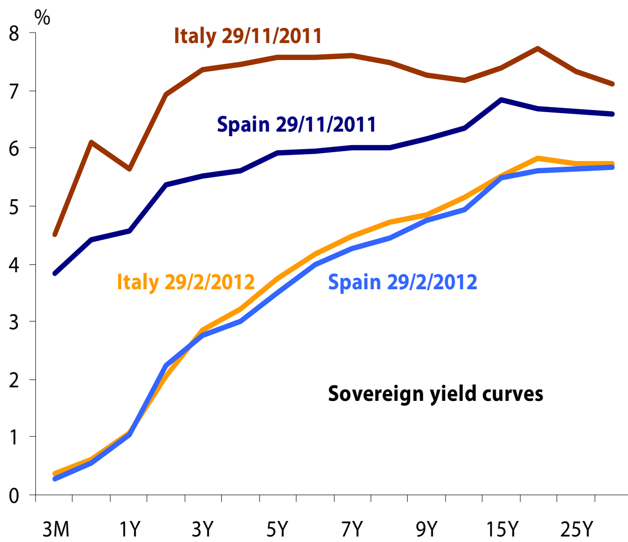
In our view, the ECB remains the most credible institution to contain the liquidity threat on the Spanish and Italian sovereign bond markets. The success of the 3-year operations provides evidence that the ECB possesses a lot of ammunition to assuage financial and sovereign debt tensions. The indirect quantitative easing signals a new stance of the ECB, which seems to have realized that countries may not be able to sort out their fiscal woes by themselves without some assistance by the ECB. The recent agreement on a binding fiscal compact entailing an increased degree of automaticity has largely addressed the ECB's requests for enhanced fiscal discipline among the euro area members. We are cautiously optimistic that this should facilitate more decisive intervention of the ECB in sovereign bond markets, whenever the need arises.

The agreement on the fiscal surveillance framework should also curb Germany's resistance to provide additional financial help to backstop weak members' borrowing costs. In our view, a permanent solution to the debt crisis should combine fiscal discipline in the periphery with fiscal solidarity from the core. An agreement on increasing the firing power of the ESM by adding to it the unutilized EFSF resources would raise the available aid to about €750bn. Adding €150bn of European funds allocated to the IMF would total to a €900bn firewall. To put this amount in perspective, it is enough to cover the refinancing needs of Spain and Italy until 2014. In our view, upsizing the ESM could send a strong message to the markets that the euro area policymakers are determined to protect the monetary union from a full blown debt crisis. What is more, a decision by European policymakers to upsize the rescue fund seems to be vital for non-Europeans to raise the IMF funds. Such a development would most likely create a positive market momentum.

Uncertainty to our economic outlook remains high due to the lingering debt crisis.

Risks to our euro area economic outlook remain on the downside, mainly due to the unresolved sovereign debt crisis. While the ECB has relieved the refinancing stress for banks and government bond markets, the insolvency risk remains. Adjustment efforts for Spain and Italy amidst a recessionary environment are challenging. Both countries need to push through their reform programs decisively to convince markets about their debt sustainability, or else the positive impact from the ECB operations will quickly fade away. Delays or failure to adopt structural measures would result in investors' confidence loss and intensification of the debt crisis.

Figure 2.5



Source: Bloomberg

Table 2.1

Change of cyclically adjusted budget balances (as % of GDP)

	2010	2011	2012	2010-2011 adjustment	2011-2012 adjustment
Austria	-2.9	-2.4	-2.1	0.5	0.3
Belgium	-2.9	-3.1	-2.3	-0.2	0.8
Finland	-0.3	-0.3	0.3	0	0.6
France	-5.1	-3.9	-2.3	1.2	1.6
Germany	-3.3	-1.1	-0.8	2.2	0.3
Greece	-6.5	-1.8	2	4.7	3.8
Ireland	-25.5	-6.6	-5.3	18.9	1.3
Italy	-3.1	-2.5	-0.3	0.6	2.2
Holland	-4.2	-3.8	-2.8	0.4	1
Portugal	-9.1	-4.6	-1.7	4.5	2.9
Spain	-7	-3.6	-1.4	3.4	2.2

Source: OECD

Fiscal consolidation is expected to remain a drag on the economy in 2012, as most euro area members will continue struggling to bring their public finances in order. According to the OECD data (Table 2.1), the fiscal adjustment in 2012 in cyclically adjusted terms is forecasted to remain intense. Italy is expected to ramp up its fiscal consolidation, implying a larger negative impact on the country's economic output. In a similar vein, the need for fiscal retrenchment in Spain and France raises concerns about their economic performance. Strict fiscal consolidation in a recessionary environment may exacerbate the GDP contraction in several members. As achievement of fiscal goals remains heavily dependent on GDP growth assumptions, larger losses of output would result in countries missing their fiscal targets. Given that markets remain extremely cautious to fiscal slippages, the latter have to be addressed with even sharper fiscal discipline, fueling a vicious cycle between fiscal consolidation and GDP contraction, affecting negatively borrowing costs

In the Greek debt front, the Greek government has recently reached a deal with private sector bond holders, aiming at rehabilitating the country's debt. Private bond holders will suffer a loss of 53.5% in face value terms in order to reduce the Greek debt to GDP ratio 120.5% by 2020. In addition, a second bail-out package was decided in order to complete the PSI, recapitalize the Greek banks and cover government borrowing requirements. The agreement has mitigated markets concerns about a disorderly default. It will also reduce the debt burden and give the country breathing space to rebalance its economy. It is noteworthy in Table 2.1 that Greece is one of the very few countries that are forecasted to run a budget surplus in 2012 in cyclically adjusted terms. However, the uncertainty due to implementation risk is likely to remain, as the new financial aid package entails additional austerity and is conditional to a heavy load of structural reforms that need to be pushed through in a short period of time.

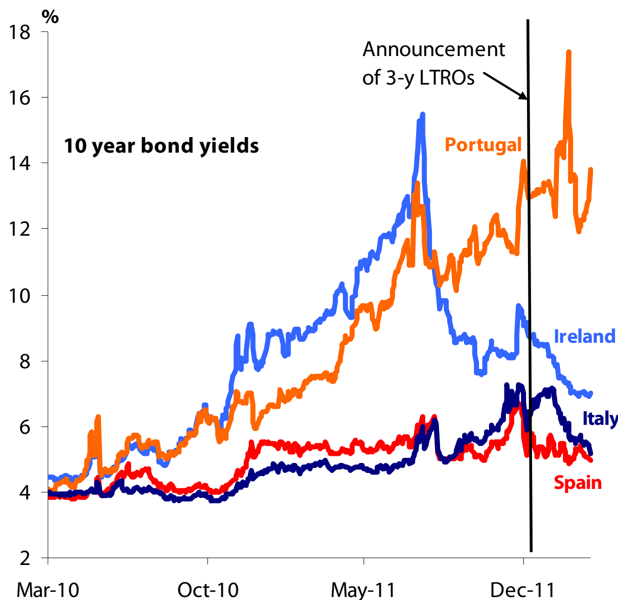
The need of a second bail-out program for Portugal is likely to increasingly concern markets later in the year. Structural reforms are on track and the country has achieved its 2011 budget deficit reduction target, although in large part through one-off measures. However, the country has started from a low base, with low levels of competitiveness, high unit labor costs, weak public finances and a poorly educated labor force which confines its potential output. Stubbornly high yields on Portuguese government bonds (Figure 2.6) reveal investors' fears about the impact of anemic growth prospects on the country's ability to achieve its fiscal targets. As a result, Portugal may be unable to borrow from the markets at sustainable rates beyond the expiration of the first bail-out program in July 2013, implying that a second package may be needed.

Credit growth is likely to remain subdued.

The ECB's generous action has given banks leeway to adjust their balance sheets gradually, averting a disorderly deleveraging. However, lending to the real economy will likely remain weak. Elevated risks due to the spillover of the fiscal

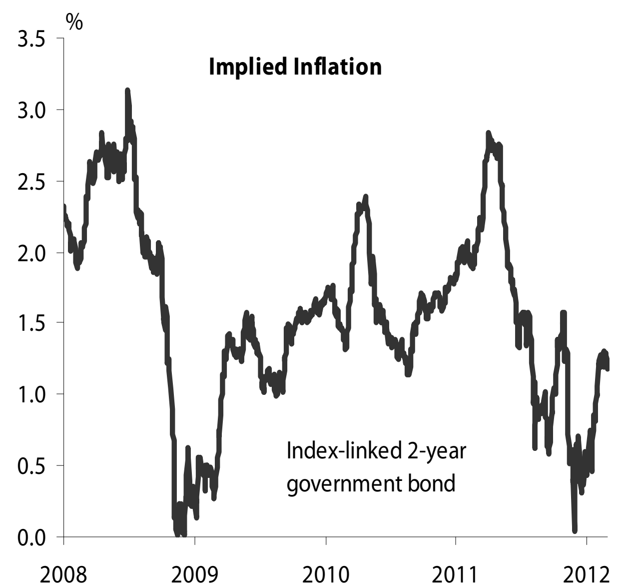
crisis in the banking sector have impaired the monetary transmission mechanism, obstructing the super-loose monetary policy to translate into substantial credit growth. According to the ECB's bank lending survey, banks are expected to tighten further their credit standards suggesting that a rebound in lending in the near term is unlikely. The banks' balance sheets adjustment process is expected to continue mainly due to bleak economic prospects, difficulties in access to money markets, and higher capital and liquidity requirements. Yet, it remains crucial for the euro area economy that adequate funding to the private sector is reassured.

Figure 2.6



Source: Bloomberg

Figure 2.7



Source: Ecowin

Monetary policy: A rate cut by the ECB is not likely.

No rate cut is expected in the near term as the ECB is set to allow time to assess the impact of the liquidity provision through the two 3-year LTROs on the real economy. In addition, the stabilization of leading indicators points to stable rates in the period ahead. Given the broken monetary transmission mechanism, unconventional measures may be more effective to calm rising stresses than an outright rate cut might be. Hence, if borrowing costs of Spain and Italy rise to uncomfortable levels again, the ECB will likely address them by additional LTROs. The ECB may also resume the longer term operations in case financial tensions intensify anew.

The ECB's assessment of balanced risks with respect to inflationary pressures corroborates our view of no rate cuts. Inflation expectations as derived from 2-year inflation-linked euro area government bonds are on the rise. However, the implied inflation remains well below the ECB's threshold of 2% (Figure 2.7). Short-term risks are skewed to the upside, as distortions in the Iranian oil supply result in rising pressures on energy prices. However, feeble domestic demand across all euro area countries is anticipated to keep second round inflationary pressures in check.

Overall, based on our central scenario which calls for a gradual improvement of economic activity in the second half of 2012, we expect the main refinancing rate to remain at 1% throughout the year.

3. The Japanese Economy

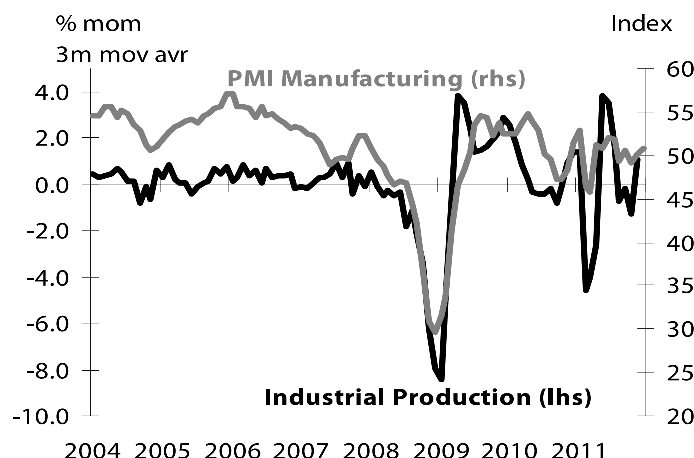
Dimitris Malliaropulos, Olga Kosma

- Although the Japanese economy marked in Q4 2011 the fourth GDP contraction in five quarters, recent economic data suggest that economic conditions are slowly improving.
- In our view, Japan should avoid a technical recession, with reconstruction-related activity and inventory restocking offsetting any further weakness in net trade.
- The risk of a slowdown may appear again in FY2013, when reconstruction demand would have run its course and tax hikes would have to take effect in order to finance the increased government consumption and investment.
- The Bank of Japan surprised markets at its February policy meeting with a decision to increase long-term JGB purchases and turn its “understanding” of medium/long-term price stability into an inflation target of 1%.
- Although the recent monetary easing was warranted to support the fragile Japanese economy, additional support from fiscal policy is needed to help the economy return to a sustainable growth path.

Overview

Although the Japanese economy contracted in the final quarter of 2011 mainly due to particularly weak external demand, recent economic data suggest that economic conditions are slowly improving. Private domestic demand sustains growth, with the manufacturing PMI index hovering above the 50-threshold that signals expansion (Figure 3.1). In our view, Japan should avoid a technical recession, with real economic activity regaining momentum in 2012 and, particularly in the second quarter of the year as reconstruction-related activity and inventory restocking should start exerting an influence on GDP growth. However, we have further downgraded our Japanese growth projection for 2012 to 1.6% from 2.3% a quarter earlier, as the recovery is starting from a very low base and gloomy global economic conditions should take their toll on the Japanese economy.

Figure 3.1



Source: Bloomberg

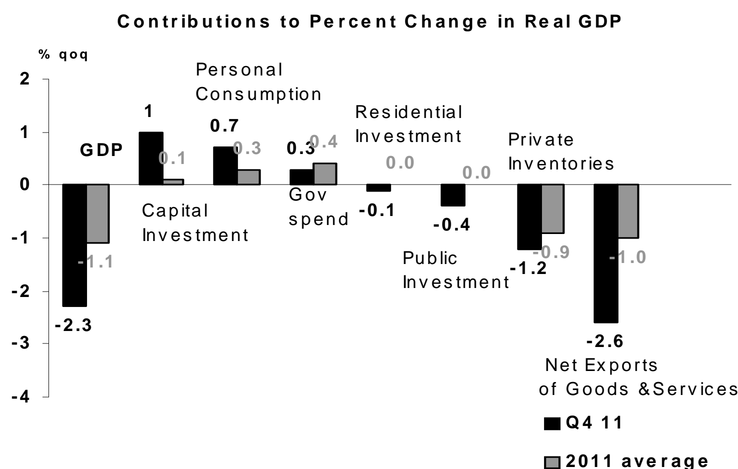
Although we do not expect net trade to rebound quickly given persisting global economic stagnation in H1 2012, export volumes should be supported by a rebound from Thailand flooding. The timing of the implementation of the third

supplementary budget, which includes the bulk of post-earthquake reconstruction plans, as well as the fourth supplementary budget[9] which is a key factor for the consumption outlook, will be crucial for the recovery of the Japanese economy. The risk of a slowdown may appear again in FY2013, when reconstruction demand would have run its course and tax hikes would have to take effect in order to finance the increased government consumption and investment.

GDP plunged in Q4 2011 due to external slowdown and a huge decline in inventories

Real GDP was much weaker than expected in Q4 2011, reporting a contraction of 2.3% q-o-q annualized versus the market forecast of -1.4% (Figure 3.2). Although the negative growth was partly attributed to unfavorable base effects, as Q3 growth was revised upwardly from 5.6% to 7.0%, the key factor for the economic plunge was a sharp slowdown for external demand. Exports declined significantly by -11.9% q-o-q annualized due to the global economic slowdown, the appreciation of the yen and the impact of Thailand flooding. Given that imports sustained growth (+4.1% q-o-q annualized), boosted by fossil fuel imports for power generation, net trade had a large negative contribution to real economic activity of -2.6%.

Figure 3.2



Source: Cabinet Office

Private domestic demand had a positive contribution of 0.5% to real GDP growth, with consumer spending increasing for a third quarter by 1.2% q-o-q annualized and private capex rebounding to 7.9% growth after four quarters of decline. In contrast, housing investment declined by -3.1% q-o-q annualized, reversing its upward momentum in the previous quarter due to the eco-point program[10] and the Flat 35S mortgages[11]. In addition, private inventory investment contributed negatively to real GDP, subtracting -1.2% from the annualized quarterly growth. As far as the public sector is concerned, public domestic demand declined for a second quarter, subtracting 0.2% from real economic activity. The contraction in the public sector was entirely attributed to public fixed investment, which contracted by 9.5% q-o-q annualized. This marked a second consecutive decline and reinforced our view that the implementation of the JPY12.1trn third

[9] The FY2011 fourth supplementary budget passed at the beginning of 2012 amounts to JPY2.5trn and includes JPY300bn for eco car subsidies (for environment-friendly vehicles), JPY493.9bn for medical treatment for the elderly, child raising and welfare, and JPY133.9bn for welfare benefits. The budget also includes JPY740 bn for cash flow assistance for small businesses hit by last March's earthquake and tsunami.

[10] The eco-point program was designed to promote energy-efficient home appliances in an effort to cope with power shortages caused due to the earthquake and tsunami in March.

[11] *The Flat 35S mortgages are loans with duration of 35 years maximum, offering preferential lending rates for the purchase of high-quality residences.*

supplementary budget which contains the bulk of post-earthquake reconstruction will not spur renewed growth earlier than Q2 2012.

Private consumption to sustain positive momentum in the coming quarters

According to our estimates, real economic activity will most likely rebound in Q1 2012 towards 1.5% q-o-q ann, avoiding a technical recession, i.e. a second consecutive quarter of GDP contraction. Personal consumption is expected to sustain positive momentum in the coming quarters, supported by reconstruction and the eco-car subsidies revived as part of the fourth supplementary budget. In particular, the eco-car subsidies should underpin consumption in 2012, offsetting the fall in sales of flat-panel TVs due to the end of earlier policy supports. Indeed, recent economic data suggest that personal outlays should continue to support real economic activity. Retail sales rose sharply in January (4.1% m-o-m versus market expectations of 1.0%), reversing its recent downward trend. Much of the increase was attributed to a surge in auto sales, which increased to their highest level since August 2010 due to the reintroduction of the subsidy for purchases of fuel efficient cars. In addition, according to the Cabinet Office's Household Survey, the headline index of consumer confidence continued to edge up at the beginning of 2012, increasing to 39.6 in January from 38.1 in the previous month (Figure 3.3). However, we anticipate a rather moderate acceleration of personal expenditures, to an annual average of 1.2% from 0.0% in 2011, as unfavorable labor market conditions continue to weigh on wage growth (Figure 3.4).

Figure 3.3

Source: Cabinet Office

Figure 3.4

Source: Bloomberg

Public fixed investment to be the major source of growth in 2012

In line with the January's EWS's optimism on the reconstruction outlook, we believe that public fixed investment will be the major source of growth in 2012, starting to boost real GDP in the second quarter of the year. According to Cabinet Office estimates, the third supplementary budget passed on November 21, 2011 will provide a real GDP boost of about 1.7%, i.e. about JPY8.6trn, with JPY4.3trn in public investment and the rest JPY4.3trn in private capex (JPY1.9trn), government consumption (JPY1.4trn) and private consumption/housing investment (JPY1.0trn).

Trade deficit to continue through 2012, albeit at a lower level

Export growth continued to trend down at the beginning of 2012, with the trade balance reporting the largest deficit Japan has ever posted in a single month (-JPY1.48trn). Exports declined for the fourth consecutive month (-9.3% yoy after a decline of -8.0% in December), while imports maintained their upward trend, increasing by 9.8%. However, much of this deficit is due to special factors, i.e. seasonality[12] and China's Lunar New Year which was in January[13]. Therefore, although Japan's trade deficit will likely continue through 2012 as import growth will probably outweigh export growth due to continuing demand for energy and support from post-quake reconstruction, we do not expect a larger deficit in the following months. The global manufacturing cycle is showing signs of recovery, contributing positively to Japan's export volumes. Meanwhile, the negative impact of the above-mentioned special factors should fade, and the rebound from Thailand flooding should soon materialize.

Additional monetary easing by the BOJ surprised markets

The Bank of Japan (BOJ) surprised markets at its February 13-14 monetary policy meeting with a decision to increase long-term (with maturities of 1-2 years) JGB purchases JPY10trn under the Asset Purchase Program, from JPY55trn to JPY65trn (Table 1), and turn its "understanding" of medium/long-term price stability (median 1%) into a price stability goal of 1% "for the time being". The BOJ will complete its planned purchases by the end of 2012, as was scheduled before the increase, suggesting that the monthly pace of JGB purchases should accelerate towards JPY1.4trn/month. We believe that the central bank's move came amid heavy political pressure, as fiscal policy intervention has not yet moved forward with a decision on consumption tax hikes. Although the Bank of Japan's governor has highlighted central bank's independence when it implements monetary policy, recent calls in Japan's parliament to move to a more accommodative policy -given that other major central banks[14] have enhanced their monetary easing measures- have urged the BOJ to go along with additional monetary easing and change its language in order to increase its transparency and credibility.

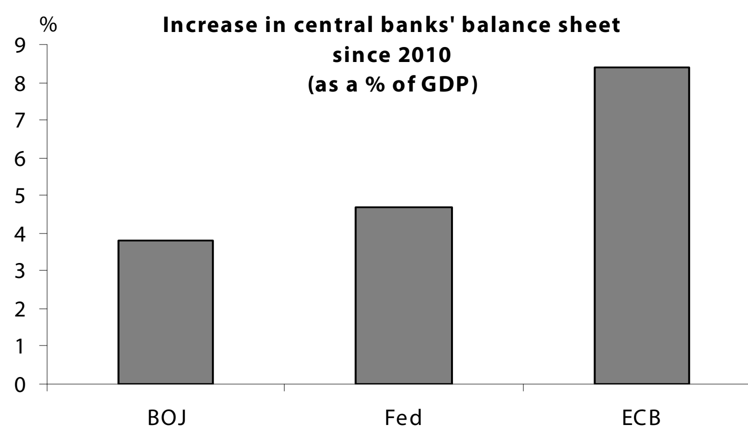
The last time the BOJ increased the size of its long-term purchases was in October 2011, as a result of yen appreciation. That said, the recent move of the central bank partly reflects exchange rate considerations. Indeed, the recent monetary easing has led to a further depreciation of the yen, mainly against the dollar (about 3%), while equity prices have extended recent gains since the latest Bank of Japan's actions (about +7.5%). We remain cautious about the longer term impact of the recent monetary easing, given that central banks overseas move toward additional easing, posing upward pressure on the yen. While the BoJ has made steps toward easing since 2010, it has a long way to go before it catches up with the easing already done by its G10 counterparts (Figure 3.5). Should the Fed move forward with a third round of quantitative easing, then additional easing by the BoJ will be inevitable to deter a further strengthening of the yen. Meanwhile, the recent expansion of JGBs purchases focuses on bonds with remaining maturities of two years or less, whose yields are now hovering at very low levels (around 0.1%). Given that there is little room for the new purchases to depress the above-mentioned yields further, the BoJ should go ahead with an expansion of its asset purchase program, extending the duration of JGBs purchased. The monetary policy effort to help Japan escape from deflation (Figure 3.6) and return to sustainable growth should be underpinned by fiscal policy, so as to reform the tax system and introduce a credible plan to improve public finances and, therefore, increase the momentum of the economy.

[12] January is prone to deficits due to seasonality.

[13] *In contrast to last year's Lunar New Year, which was in February 2011.*

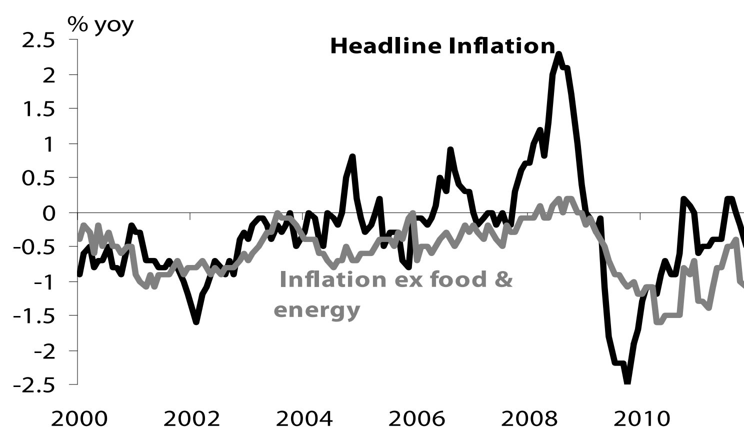
[14] *The Bank of England, the European Central Bank, the US Federal Reserve.*

Figure 3.5



Source: Bloomberg, Eurobank EFG Research

Figure 3.6



Source: Bloomberg

Table 1: BOJ's Asset Purchase Program

(JPY bn)	Initial program (Oct 2010)	1st expansion (Mar 2011)	2nd expansion (Aug 2011)	3rd expansion (Oct 2011)	4th expansion (Feb 2012)	Maximum Amount Outstanding	Amount Outstanding as of Feb 10, 2012
Asset purchases	**5,000**	**+5,000**	**+5,010**	**+5,000**	**+10,000**	**30,010**	**10,316**
Long-term JGBs	1,500	+500	+2,000	+5,000	+10,000	19,000	3,816
Treasury bills	2,000	+1,000	+1,500			4,500	2,367
CP	500	+1,500	+100			2,100	1,539
Corporate Bonds	500	+1,500	+900			2,900	1,679
ETFs	450	+450	+500			1,400	848
JREITs	50	+50	+10			110	67
Collateral fund supply	**30,000**		**+5,000**			**35,000**	**32,825**
Total	**35,000**	**+5,000**	**+10,010**	**+5,000**	**+10,000**	**65,010**	**43,140**

Source: Bank of Japan (BOJ)

4. Emerging Markets

Dimitris Malliaropulos, Maria Prandeka

- The significant deceleration of economic growth in advanced economies along with monetary tightening has resulted in the moderation in emerging markets' economic expansion over the previous year.
- Recent data on economic sentiment indicators across all EM regions point to some improvement in economic activity, after several months of deterioration.
- Export growth in EMs has dampened significantly due to the stagnation in world trade, though we expect the slowdown to be contained.
- Capital flows to emerging markets have fallen sharply since the third quarter of 2011, mainly because of intensifying financial stresses in the euro area. Concerning portfolio inflows, the prospects are more positive in 2012, compared to the previous year.
- Headline inflation in most EMs has stabilised, as food prices have started to recede from their 2011 peaks. Nevertheless, some upward price pressures still remain.
- Monetary policy is expected to be supportive for growth this year. However, credit conditions are still tight.
- We believe that most emerging economies are well-positioned to withstand deepening turbulence in the global economy and growth is expected to remain robust, despite the ongoing slowdown.
- Higher oil prices and a deeper recession in the euro area constitute the main risks to our emerging markets outlook.

Leading indicators point to some improvement in emerging market economic activity

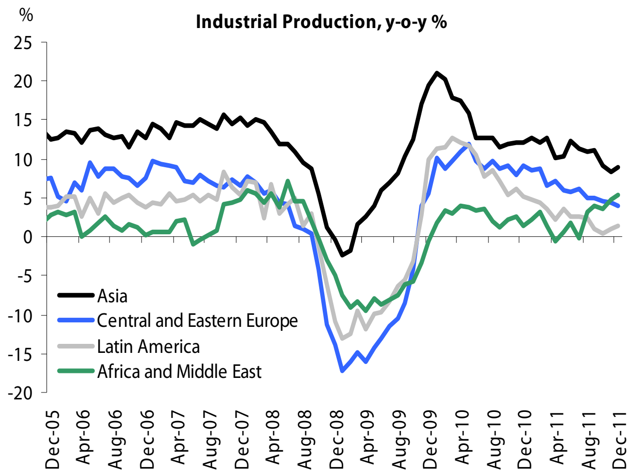
The significant deceleration of economic growth in most parts of the developed world along with monetary tightening has taken its toll on emerging market (EM) economies over the past year. Emerging economies' real GDP growth slowed to 6.2% (in ppp terms) in 2011 from 7.3% in 2010. However, this growth rate is considered still robust as it hovers well above the thirty year average of 4.5%. Moreover, it is substantially faster than that of advanced economies which expanded by 3.8% in 2011, down from 5.2% in 2010. Industrial production data across emerging market regions suggest a slight improvement in industrial activity over the last quarter of 2011 compared with a year earlier (Figure 4.1). The only exception is Central and Eastern Europe, as it is the region that affected the most by the recession in the euro area. In line with the pick up of industrial production, recent data on economic sentiment indicators across all EM regions point to some improvement in their economic activity, after several months of deterioration (Figure 4.2).

Export growth in EM has dampened significantly due to the stagnation in world trade, though we expect the slowdown to be contained

In line with the deterioration in global economic environment, emerging markets' export demand declined significantly in 2011, with momentum stalling particularly in the second half of the year. Emerging Asian exports suffered the most due to the region's close trade links with developed economies. We believe that downside risks to external demand, particularly from the euro area, will persist at least for the first quarter of the year. This is also confirmed by our BRIC's leading indicator[15] (Figure 4.3).

[15] *We compute the BRICs leading indicator as the weighted sum of each country's monthly OECD composite leading indicator. The weights are the corresponding gross domestic product based on purchasing-power-parity (PPP) share of world total. BRIC's leading indicator identifies the signals of changes in the economy almost three months before the actual turning points are found in the economic activity.*

Figure 4.1



Source: CPB Netherlands Bureau for Economic Policy Analysis

Figure 4.2

Source: Ecowin

However, we expect the slowdown to be contained, due to several reasons. In particular, commodity prices are expected to remain elevated compared to historical levels over the course of the year. Furthermore downside risks to global growth have receded substantially, suggesting that external demand in EM would likely improve in the coming months. Better demand prospects are stemming, particularly, from the US where leading indicators point to accelerating economic activity. Indeed, according to the latest data from the CPB Netherlands Bureau for Economic Policy Analysis, the level of merchandise export volumes for emerging economies has already recovered fully from the 2008-2009 global recession and it is hovering about 10.2% above its pre-crisis peak. In contrast, the corresponding level for advanced economies is 4.0% below its pre-recession peak (Figure 4.4).

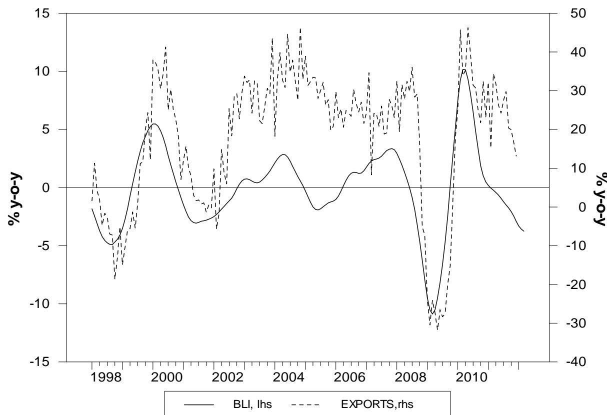
Among emerging economies, those having a larger degree of openness to international trade are more vulnerable to a sudden global shock. Figure 4.5 illustrates that China and India are likely to see a quicker transmission of slowing external demand into domestic activity than Russia and Brazil. However, it is worth noting that trade openness has been shrinking in recent years, particularly in China, where a rebalancing of the economy towards consumption is underway, a fact that helps in cushioning spillovers from weakening advanced economies.

It is worth noting that EMs importance in world trade has increased considerably over the past two decades. Between 1990 and 2011, their share of merchandise exports in world merchandise exports has increased gradually from about 20% to more than 40%, while that of advanced economies has decreased from 80% to 60% over the same period. Thus, EMs are playing a significant role in determining the prospects of world trade. Their robust growth and, particularly, their strong domestic demand is expected to be supportive for world trade in the years ahead.

Capital flows to EMs weakened sharply in 2011

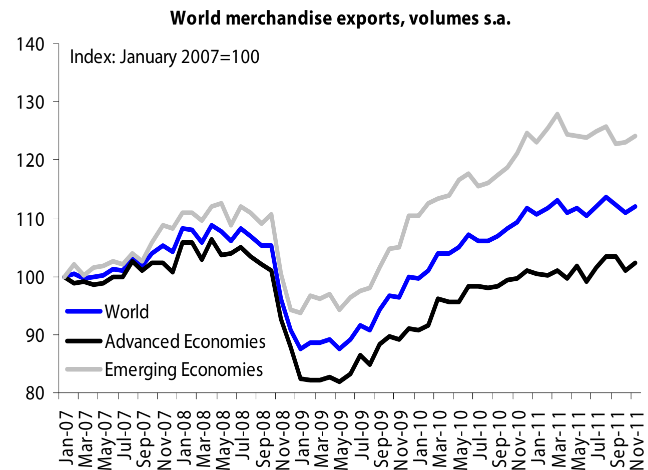
Capital flows to emerging markets have fallen sharply since the third quarter of 2011, mainly because of intensifying financial stresses in Europe that reduced the willingness of lenders to fund emerging economies and reduced investors' appetite for EM assets. According to the Institute of International Finance (IIF), net private inflows are estimated to have been $910 bn in 2011, down from $1,040 bn in 2010 and projected to decline further to $746 billion in 2012 (18% below those recorded in 2011) (Figure 4.6). Euro area's external deleveraging has weighed the most on EM capital flows. In particular, claims of European banks on EMs, which account for about 20% of their GDP, appear to have been particularly affected by the ongoing debt crisis. Bank's of International Settlement (BIS) data on cross-border bank claims indicate that European banks reduced their claims on EM economies by a total of about $233 billion in Q3 2011 compared with the previous quarter. This was the first quarter-on-quarter decline in European banks claims on EMs since Q2 2010.

Figure 4.3
BRICs Leading Indicator* & Exports



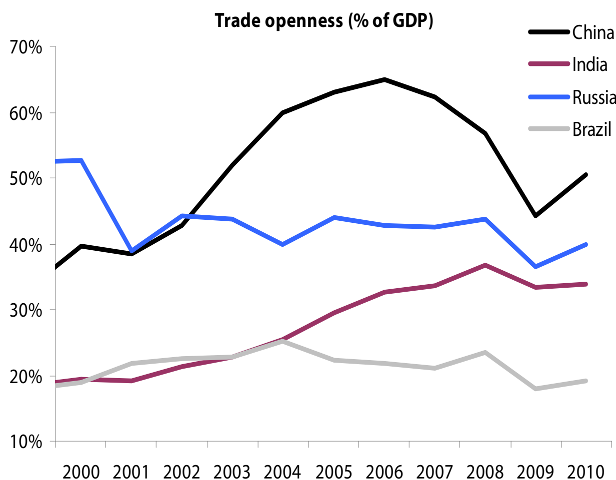
** 3 month forward*
Source: Eurobank EFG

Figure 4.4



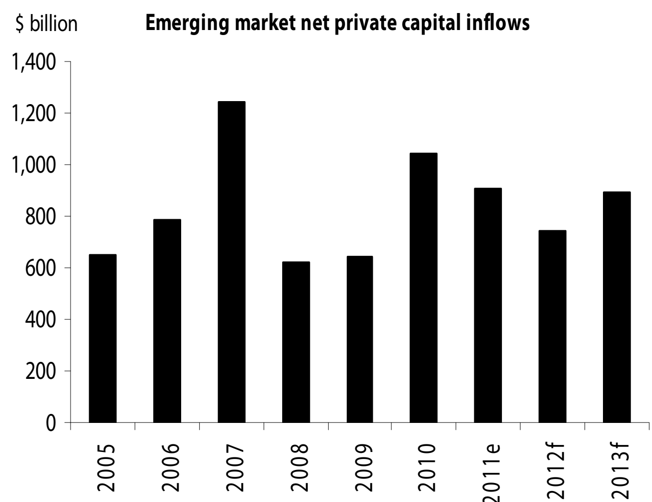
Source: CPB

Figure 4.5



Source: IMF, Directional of Trade Statistics & World Economic Outlook Database September 2011

Figure 4.6



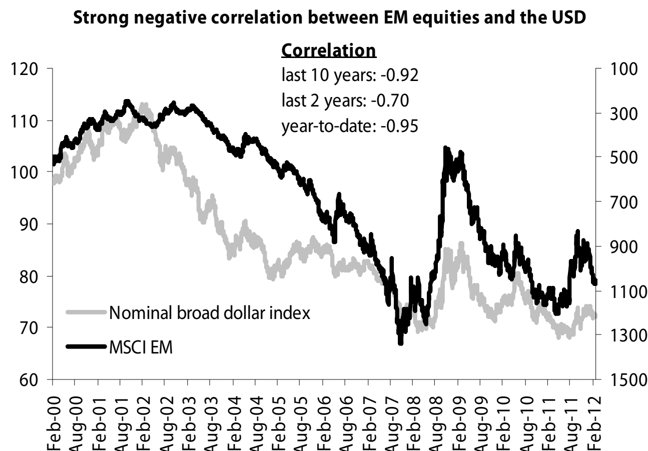
Source: IIF

More positive prospects for portfolio inflows in 2012 compared to the previous year

Regarding portfolio investment, concerns about the risk to growth from the deteriorating global economic environment weighed on investors' sentiment over the previous year, leading to a flight to safe heaven assets like the US dollar (Figure 4.7). Indeed, historically, it has been witnessed a strong negative correlation between EM equities and the US dollar. Emerging market equities underperformed developed market (DM) equities by almost 15% in 2011. In tandem with other risky asset markets, since the beginning of 2012, portfolio equity flows in emerging markets have revived, on the back of expectations of an improvement in the global economic environment. This is confirmed by the overperformance of emerging market equities versus developed market equities (Figure 4.8). In fact, EM has almost doubled the return of DM for the year-to date. We believe that the recent rally in EM equities is vulnerable to setbacks, particularly if the effectiveness of policy efforts to stabilize the euro area prove insufficient and risk aversion returns to investors. However, given that the decline in portfolio inflows was attributed mainly to external factors and that economic fundamentals in EMs continue to be robust, we believe that portfolio inflows are likely to increase in 2012 compared to the previous year. Furthermore, in

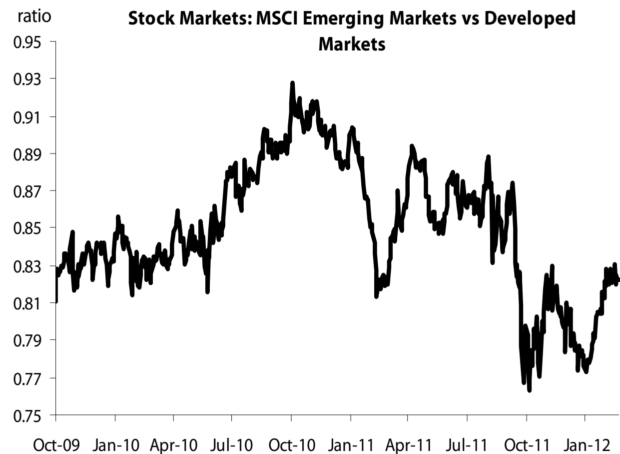
2011, EM equities suffered mainly due to rising inflation, decelerating growth, monetary tightening and elevated fears about contagion from European crisis. Now, inflation pressures have eased significantly and developments in advanced economies have become supportive for risky assets. In the US, leading indicators point to accelerating economic activity and the euro area is expected to avoid a deep recession. In addition, in most advanced economies monetary policy continues to be extremely loose and the tightening cycle in emerging economies has already come to an end.

Figure 4.7



Source: Bloomberg

Figure 4.8



Source: Bloomberg

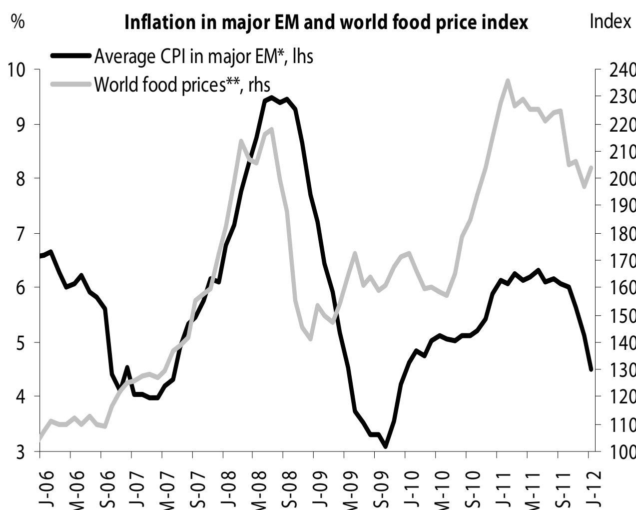
Inflation has receded significantly, though upside risks persist

Average headline inflation across major EM economies had been on the rise since 2009, on the back of rising food and commodity prices. In fact, it increased from 4.5% in 2009 to 5.1% in 2010, while over the first half of 2011 it rose further to an average of 6.2% y-o-y (Figure 4.6). However, since mid-2011, headline inflation in most EM has started to lose momentum, since at the same time food prices, which have a large weight in the consumer price baskets across the emergers, have started to recede from their 2011 peaks. Nevertheless, as figure 4.6 depicts, world food prices remain elevated compared to historical levels, with the 2011 average food price index being 24% above its average in 2010. Besides this, in January, they posted a significant increase. Generally, some upward price pressures still remain. Low inventories, climate change, expanding income and population growth and structural changes in consumption patterns in developing countries are just some of the leading causes that keep food prices relatively elevated and volatile. Moreover, high oil prices push up input costs which in turn is translated into higher producer prices and, consequently, into higher non-food inflation. In addition, there are also others sources of upside risks for inflation. Super expansionary monetary policy in the major developed economies creates a glut of money which pumped into economies and magnify upside risks to inflation. Moreover, prices in most commodity prices remain elevated, creating significant price pressures in emerging economies.

Monetary policy supportive for growth, while credit conditions are still tight

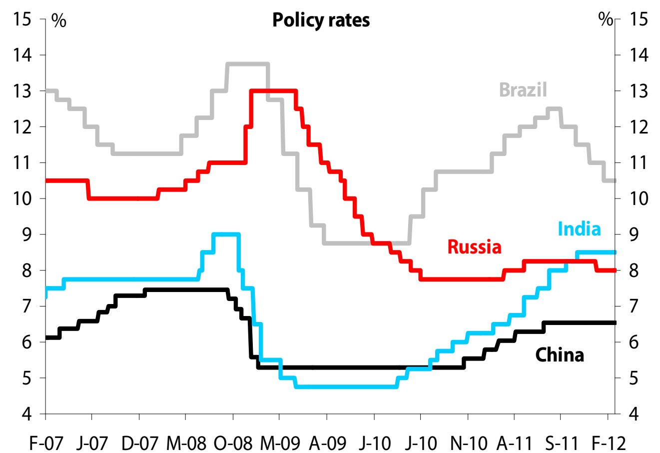
In 2011, easing inflationary pressures and a broad-based slowdown in global growth, led the EMs policy tightening cycle to an end, causing a number of countries to either hold interest rates or ease (most notably in Latin America) (Figure 4.10). However, central banks in most EMs, and especially in emerging Asia, are now expected to cut rates less than before in tandem with stabilization in global growth and the persistence of upside risks to prices. Monetary policy easing should be beneficiary for EMs growth in 2012. Nevertheless, despite the positive impact from monetary support, EMs continue to face the challenge of tight credit conditions, mainly from international tight funding conditions. According to the Institute's of International Finance (IIF) EM Bank Lending Conditions Survey, over the past three months funding conditions worsened and credit standards became stricter, resulting in a significant tightening in bank lending standards. The most significant deterioration has occurred in emerging Europe, reflecting spillover from the euro area crisis (Figures 4.12, 4.13).

Figure 4.9



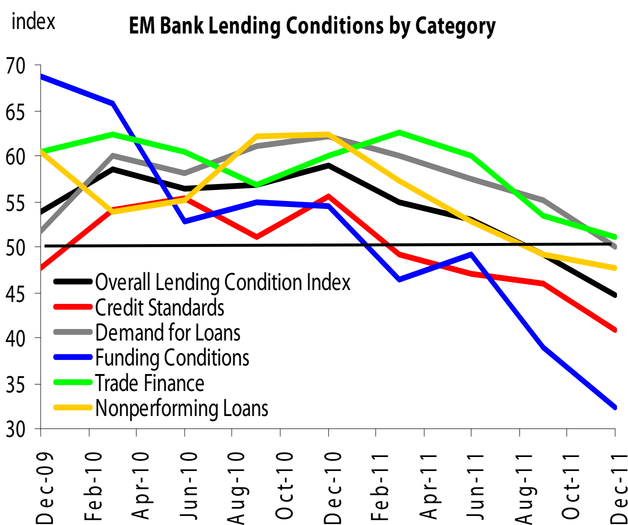
** Brazil, Chile, China, India, Indonesia, Philippines, Russia, Singapore*
*** The Economist Food Price Index*
Source: Ecowin

Figure 4.10



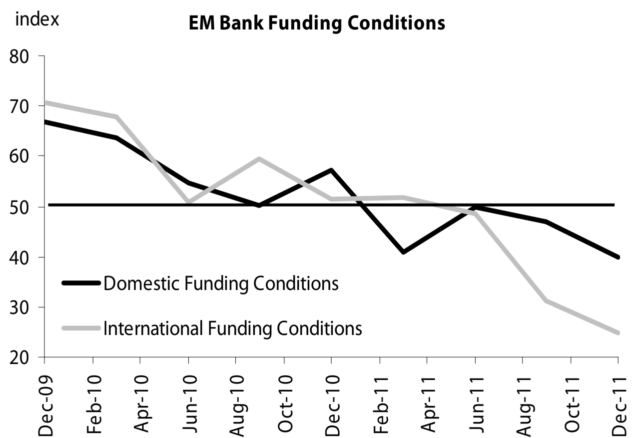
Source: Bloomberg

Figure 4.11



Source: IIF

Figure 4.12



Note: Values above 50 indicate improving conditions. Values below 50 indicate deteriorating conditions

Source: IIF

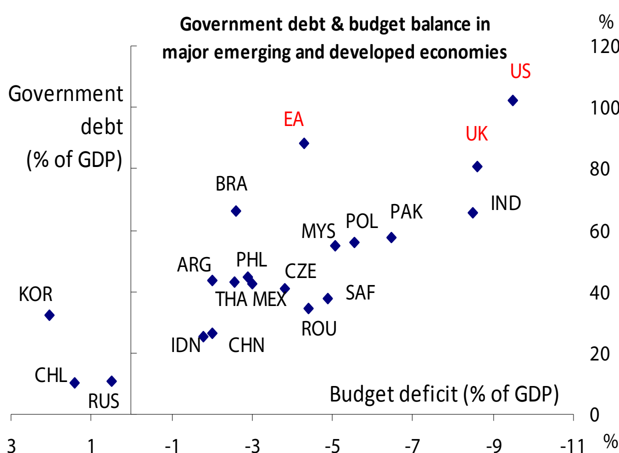
Despite the ongoing slowdown, growth in most EM economies is expected to remain robust

Looking forward, we believe that most emerging economies are well-positioned to withstand deepening turbulence in the global economy and sustain moderate growth in 2012. First, there is still room for fiscal easing to support growth, if the global economic backdrop worsens further, given that EMs' fiscal situation is relatively healthy compared to advanced economies. General government gross debt in emerging and developing economies was 37.8% of GDP in 2011, well below that of advanced economies (103.5% of GDP in 2011) (Figure 4.13). Second, part of the slowing of EM growth in 2011 was due to the withdrawal of policy accommodation. However, in 2012, monetary policy easing in EMs is expected to provide a cushion for growth. Third, domestic demand in EMs is particularly strong. On top of this, a number of EMs, in particular

China, have already indicate policy reforms aiming at rebalancing their economies from foreign to domestic demand and, thus, supporting steady improvement in private consumption.

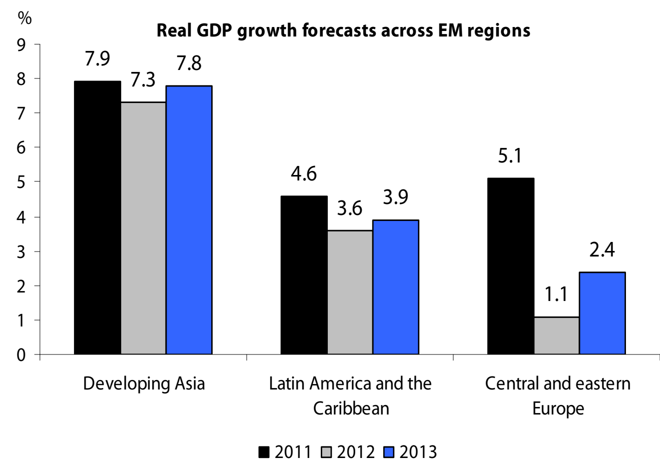
All in all, we expect better growth in most of the EM world in the second half of the year, thanks in part to the lagged effects of monetary policy easing. Although EM economies are slowing down, they are expected to remain the leaders of global growth, growing substantially faster than advanced economies over the next few years. According to the latest IMF forecasts[16], in 2012 and 2013, growth in emerging and developing economies is expected to moderate to still buoyant growth rates of 5.4% and 5.9%, respectively. Over the past decade, EM economies have increased significantly their share in global GDP (from 37% in 2000 to 49% in 2010) and from 2013 onward are expected to surpass advanced economies, becoming gradually the world's largest economies. The significant momentum in Emerging Asia's economic activity implies that the region will continue to outperform its peers, with growth of 7.3% this year versus 7.9% in 2011 (Figure 4.14). China and India will continue to play the most important role in the region and robust domestic demand will spread from these countries to their Asian peers. In Latin America, weaker commodity imports from China played a significant role in the deterioration of the region's export growth. As major commodity exporters, most countries in the region are expected to benefit from elevated commodity prices and relatively strong performance of Asian economies, particularly China, a key destination of the region's exports. Emerging Europe is the region most exposed to the troubles in the euro area, so its economic performance in 2012 will rely mainly on the depth of the euro area's recession, which we expect to be mild.

Figure 4.13



Source: IMF

Figure 4.14



Source: IMF

We anticipate two major risks to our emerging market outlook

Higher oil prices

The first risk is associated with higher oil prices and sanctions on Iranian crude oil imports. Oil prices have increased about 17% year-to-date, and are already 13% above the 2011 average. Geopolitical tensions along with easy money globally and tight fundamentals, in our view, will maintain oil prices at current elevated levels across 2012, with upside risks to oil prices rising markedly on the back of recent developments in Syria and Iran. Should oil prices remain at current levels, this would mean that 2012 average oil prices would be at record highs. Indeed, Brent averaged $110/barrel in 2011, setting an all-time high and surpassing the previous annual record of $98.3/barrel in 2008. What's more, sanctions on Iranian crude imports, including a US and EU embargo, may introduce another headwind to emerging economies that rely heavily on Iran for their oil imports needs. Crude oil imported from Iran accounts for 11% of China's and India's total crude oil imports, and 10% of South Korea's imports. As a result, a cut of supplies from Iran that will drive oil prices even higher would hurt growth in these countries and translate into higher consumer prices. The vulnerability of each individual country to higher oil prices depends mainly on whether the country is net oil importer, its oil intensity and its flexibility to substitute less

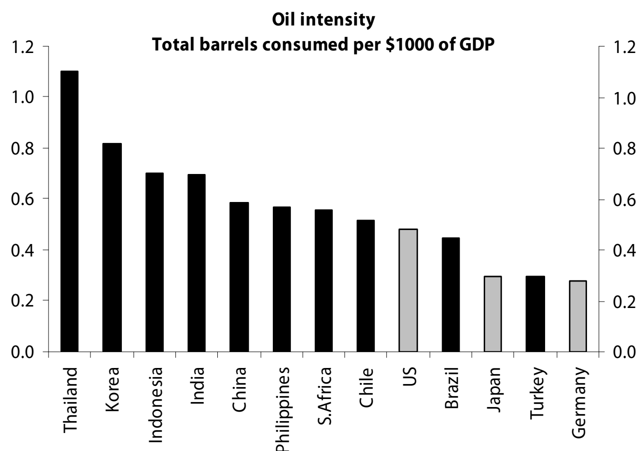
[16] *IMF, World Economic Outlook Update, September 2011*

expensive sources of energy for oil. As Figure 4.15 shows, energy intensity in emerging Asian countries, which are net oil importers, is higher compared to other EMs and major advanced economies. Consequently, these countries are expected to be most negatively affected. Indeed, according to IMF (2000)[17], a permanent $5/barrel increase in the price of oil will cut approximately 0.4% and 0.1% off emerging Asia's and Latin America's GDP growth, respectively, after one year. The corresponding effect for emerging Europe and Africa is +0.1%, due to the larger positive influence of net oil exporters in aggregate activity (Table 4.1). Apart from economic growth, higher oil prices have also a key impact on inflation. Again, emerging Asia is expected to experience the largest increase in inflation. The impact on inflation can be shielded, by existing fuel subsidies in countries, such as India, Indonesia, Malaysia and Thailand. However, in some of these cases, government finances will suffer instead, as large fiscal deficits may not allow governments to bear the escalating costs of higher fuel subsidies for longer.

A deeper recession in the euro area

The situation in Europe also presents a significant source of risk going forward. Should conditions in the euro area deteriorate sharply, GDP growth in emerging economies would be much weaker than expected, reflecting mainly a drying up of international capital flows, trade effects and a significant degree of deleveraging of European banks. In particular, risk aversion could escalate further and international capital flows could decline even more. EM countries with close trade linkages with the euro area would experience a sharper deceleration in export growth. Other economies particularly reliant on European banks (mainly in emerging Europe) would be affected by a sharp reduction in wholesale funding and domestic bank activity. Slower commodity demand growth due to a deeper recession in the euro area could result in a major decline in commodity prices. Incomes of major commodity exporters would be hard hit and their fiscal conditions would deteriorate rapidly.

Figure 4.15



Source: EIA

Table 4.1

Emerging Markets

Estimated effects after 1 year of a $5 oil price hike

	Real GDP	Inflation
Latin America	**-0.1**	**0.6**
Argentina	-0.2	0.1
Brazil	-0.2	1.0
Chile	-0.2	1.0
Mexico	0.0	0.1
Asia	**-0.4**	**0.7**
China	-0.4	0.4
India	-0.5	1.3
Indonesia	0.1	1.0
Korea	-0.9	0.8
Malaysia	-0.2	1.0
Philippines	-0.8	0.8
Thailand	-0.9	0.4
Emerging Europe & Africa	**0.1**	**0.3**
Pakistan	-0.5	0.4
Poland	-0.3	0.0
Russia	0.7	0.0
South Africa	-0.4	1.2

Source: IMF

[17] *IMF, 2000, "The impact of higher oil prices on the global economy".*

III. Macro Forecasts

Real GDP growth

	2010	2011	2012f		2013f	
			Eurobank EFG	Consensus	Eurobank EFG	Consensus
US	3.0	1.7	2.0	2.2 (1.5 – 3.5)	2.3	2.5 (1.4 – 4.2)
EA	1.9	1.4	0.0	-0.4 (-1.5 – 0.6)	1.0	0.9 (-2.5 - 1.7)
Japan	4.4	-0.9	1.6	1.5 (-0.9 – 2.0)	1.6	1.4 (0.0 – 2.5)
China	10.3	9.2	8.6	8.5 (7.9 – 8.6)	8.7	8.4 (7.5 – 8.8)
India	8.9	7.1	7.0		7.3	
Russia	4.0	4.3	4.0	3.5 (1.7 – 5.0)	4.2	3.7 (2.5 – 5.0)
Brazil	7.5	3.0	3.4		4.1	

Inflation

	2010	2011	2012f		2013f	
			Eurobank EFG	Consensus	Eurobank EFG	Consensus
US	1.6	3.1	2.3	2.1 (1.5 – 3.2)	2.1	2.0 (1.4 – 3.4)
EA	1.6	2.7	2.0	2.1 (1.5 – 2.5)	1.7	1.8 (0.3 – 2.5)
Japan	-0.7	-0.3	-0.1	-0.3 (-0.8 – 0.0)	0.1	-0.2 (-0.4 – 0.3)
China	3.3	5.4	3.2	3.3 (2.0 – 4.4)	4.0	3.8 (2.6 – 4.5)
India (WPI)	9.6	9.4	6.0		6.0	
Russia	6.9	8.5	5.5	5.9 (4.6 – 7.2)	6.0	6.1 (5.0 – 7.5)
Brazil	5.0	6.5	5.2		5.5	

Note: Range of forecasts by Bloomberg's survey in parentheses below point estimates.

Policy Rates

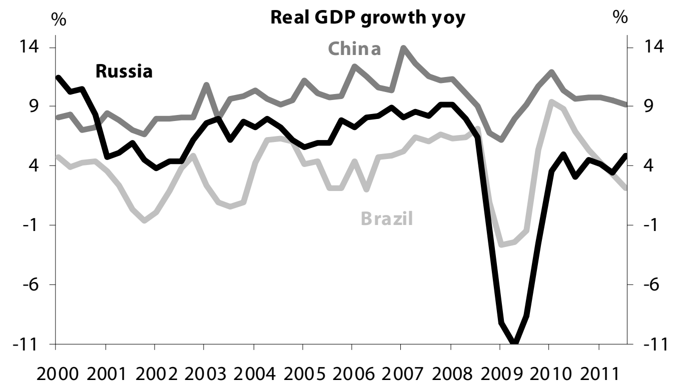
		Eurobank EFG			
	Current	Q1 12f	Q2 12f	Q3 12f	Q4 12f
US	0.00 – 0.25	0.00 – 0.25	0.00 – 0.25	0.00 – 0.25	0.00 – 0.25
EA	1.00	1.00	1.00	1.00	1.00
Japan	0.10	0.10	0.10	0.10	0.10
China	6.56	6.56	6.56	6.56	6.56
India	8.50	8.50	8.00	7.75	7.50
Russia	8.00	8.00	7.50	7.50	7.50
Brazil	10.50	10.00	9.50	9.50	9.50

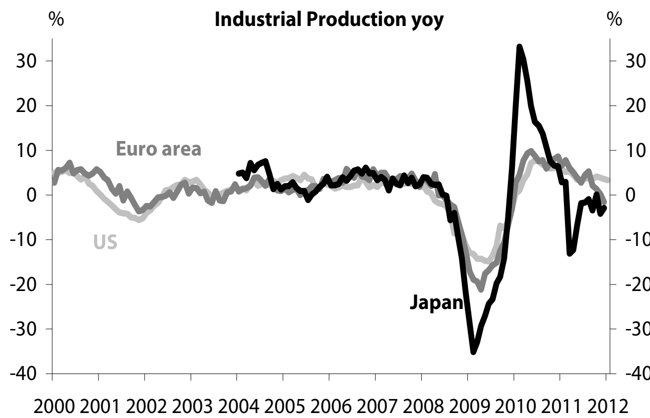
IV. GRAPHS

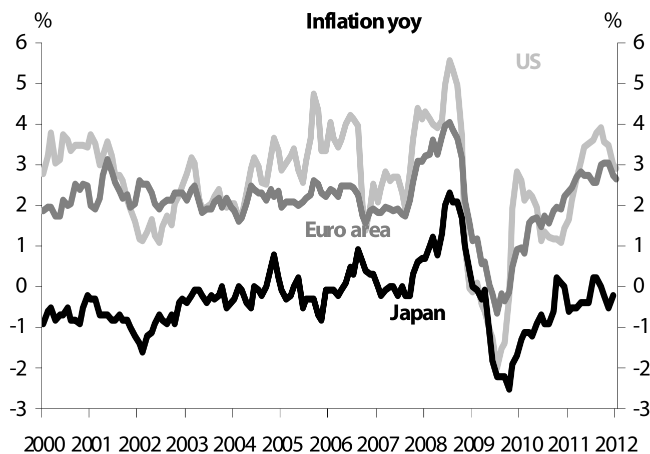
Global Economic Indicators

Advanced Economies

Emerging Economies



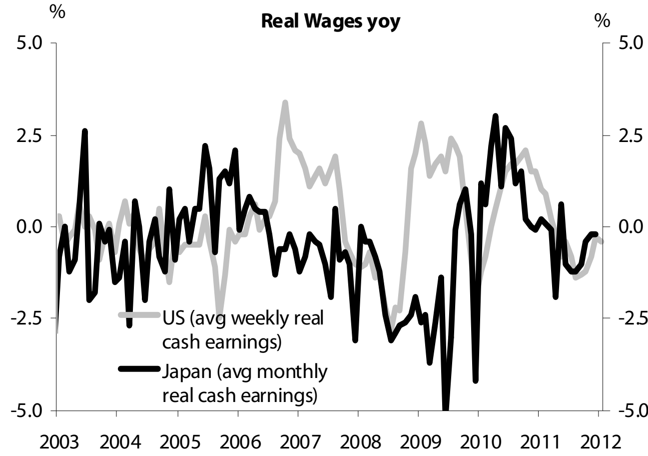


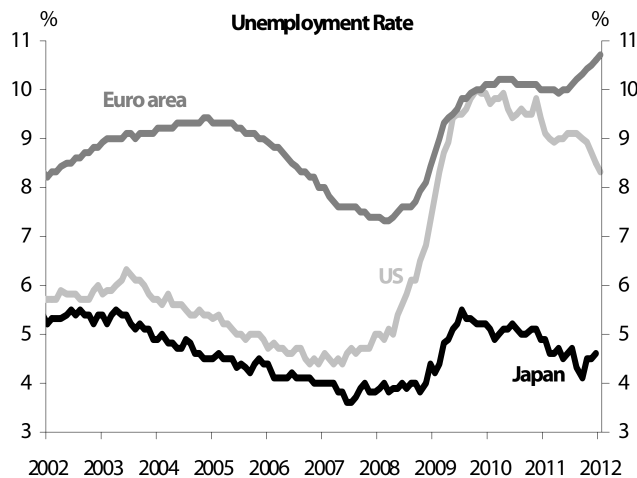


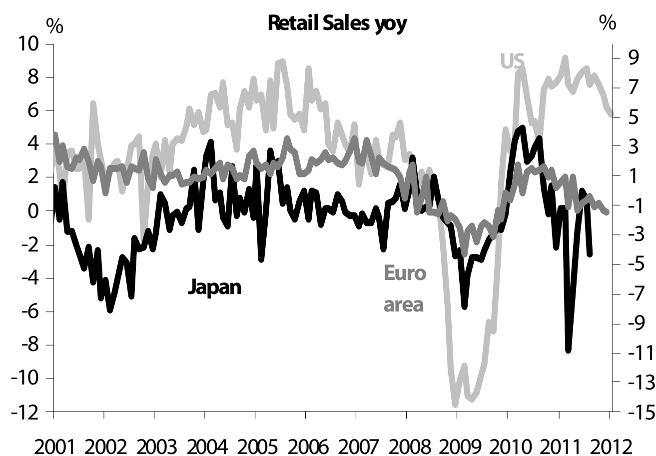
Source: Bloomberg, Ecowin

Global Economic Indicators

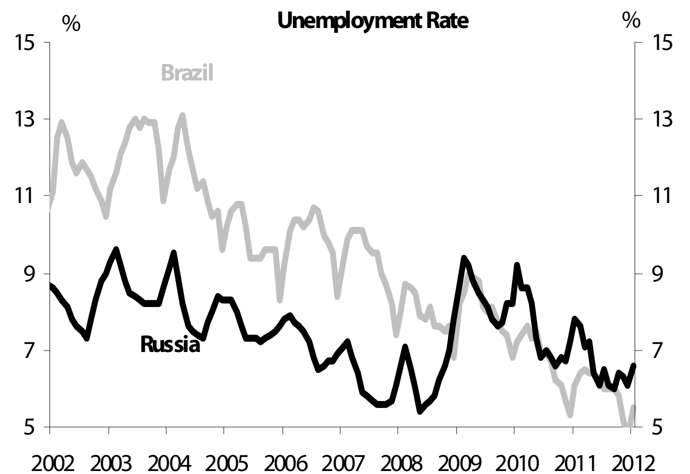
Advanced Economies

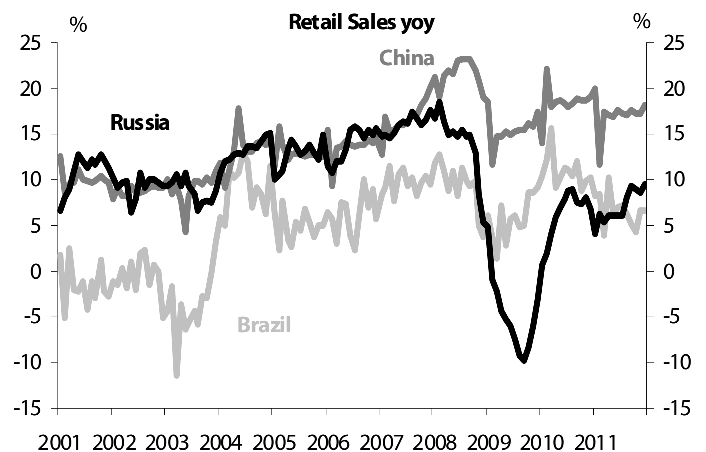






Emerging Economies

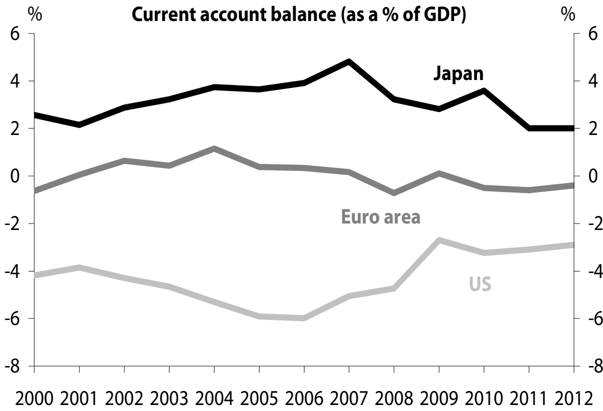




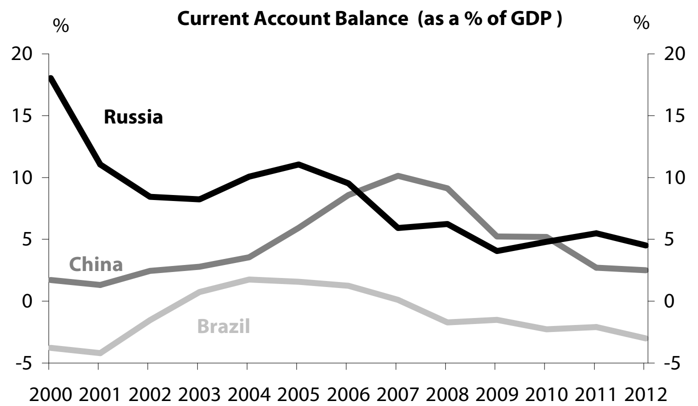
Source: Bloomberg, Ecowin

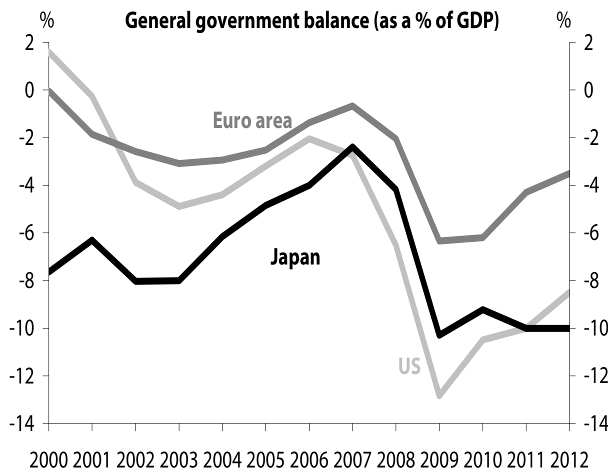
Global Economic Indicators

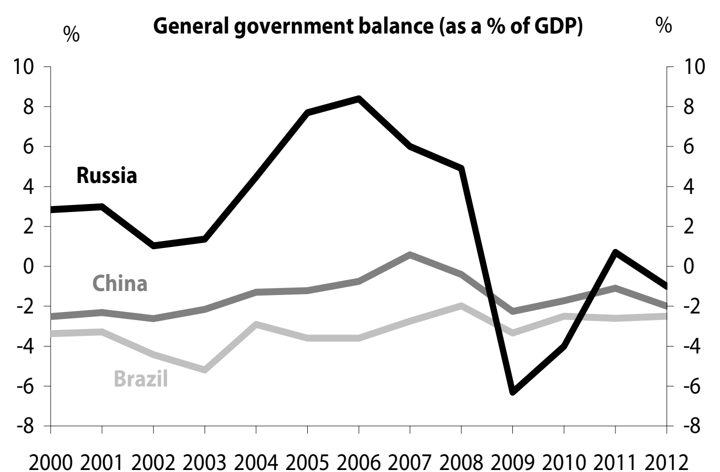
Advanced Economies

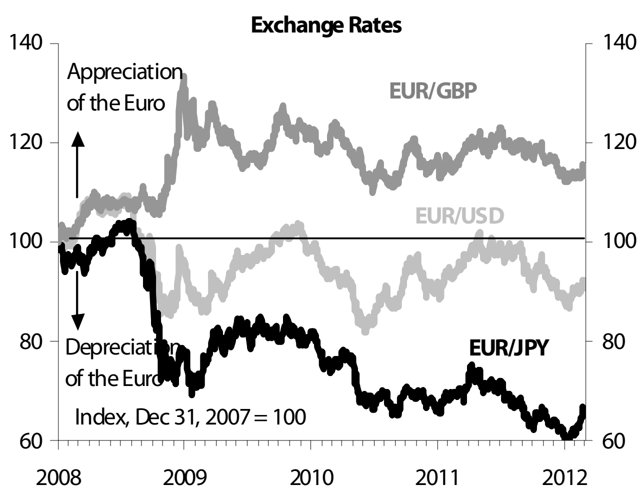


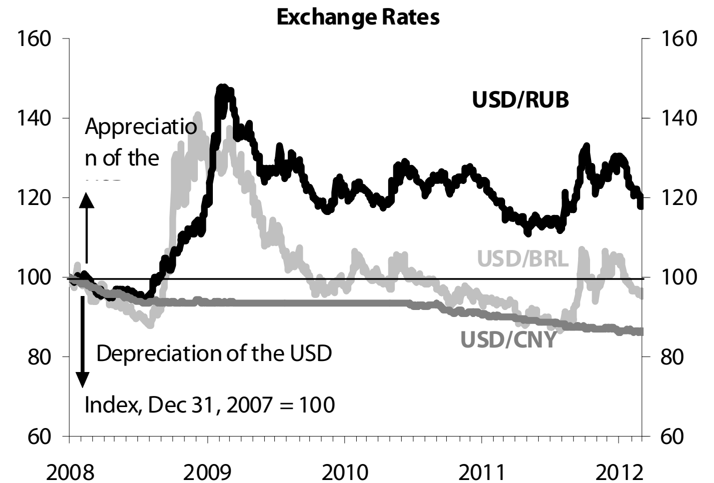
Emerging Economies





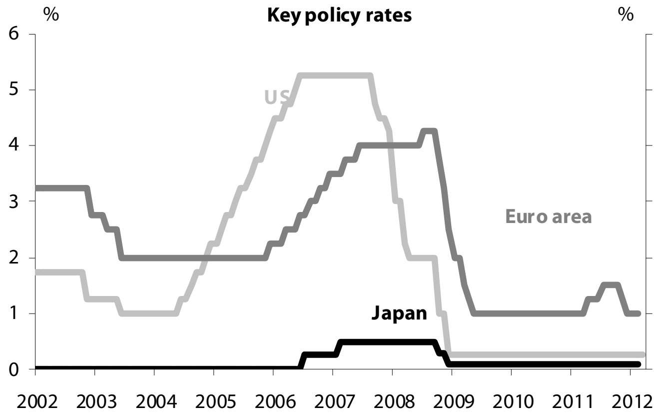


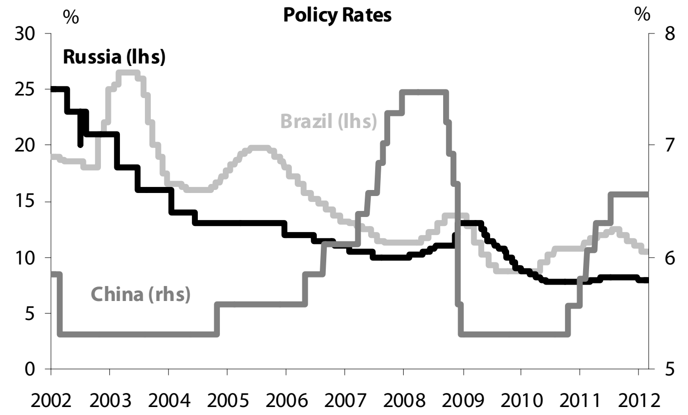


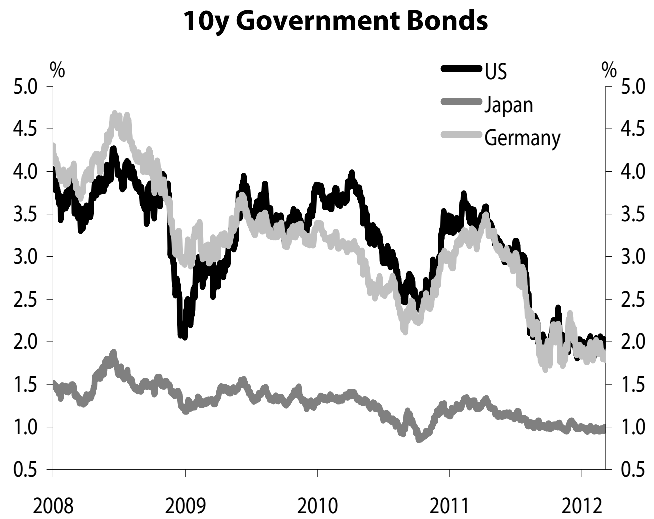


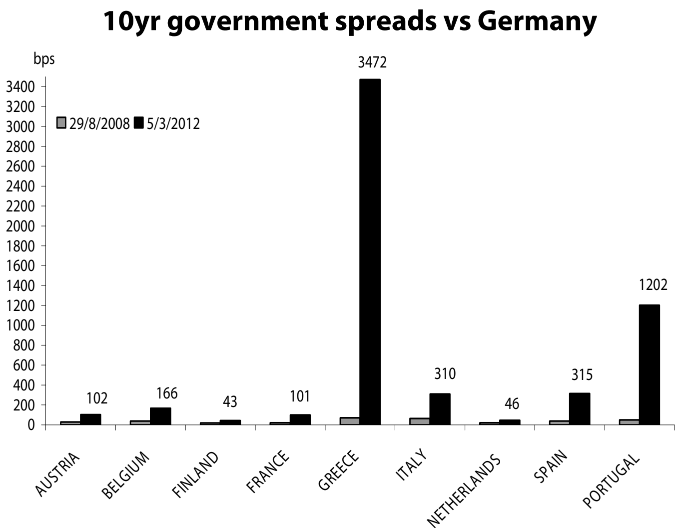
Source: Bloomberg, Ecowin, IMF

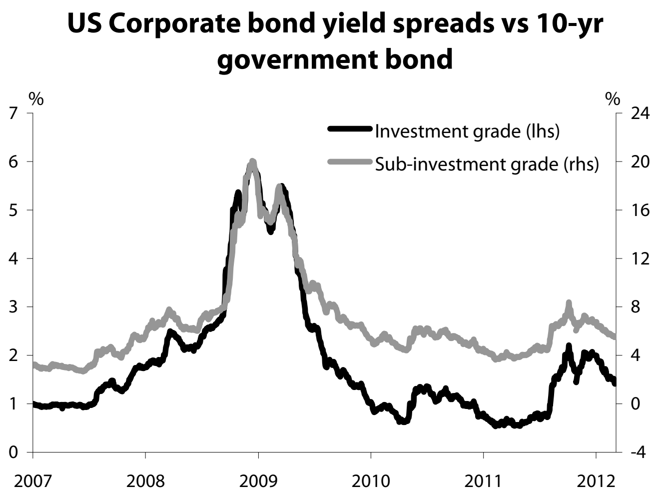
Global Economic Indicators

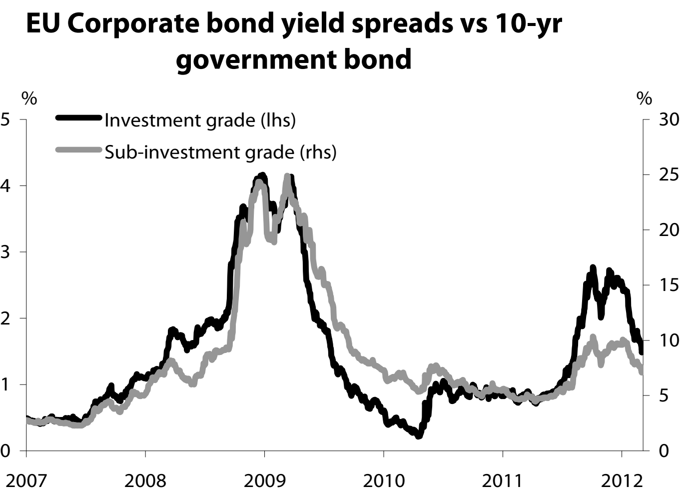












Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Total Return (%) as of March 5, 2012

Global Equity Indices (in local currency)

Region	Index	Last Price	1w	1m	6m	12m	YTD	2011
US	S&P 500	1364.3	-0.2	1.5	17.1	3.3	8.5	0.0
EURO AREA	DJ Euro Stoxx 50	2529.9	0.4	0.9	21.6	-14.2	9.2	-17.1
GERMANY	DAX	6866.5	-0.3	1.5	32.2	-4.4	16.4	-14.7
FRANCE	CAC 40	3487.5	1.0	2.4	17.6	-13.2	10.4	-17.0
UK	FTSE 100	5874.8	-0.9	-0.3	13.9	-1.9	5.4	-5.6
JAPAN	Nikkei	9698.6	-0.2	8.6	12.9	-9.3	14.7	-17.3
CHINA	CSI 300	2662.7	0.0	6.3	-2.2	-18.6	13.5	-25.0
INDIA	SENSEX	17362.9	-2.1	-1.9	3.0	-6.1	12.3	-24.6
RUSSIA	MICEX	1625.7	3.3	4.0	8.4	-8.7	15.9	-16.9
BRAZIL	IBOV	66964.0	2.6	2.7	18.3	-1.5	18.0	-18.1

Source: Bloomberg

Sector performance as of March 5, 2012

US Sector Indices (in USD)

US – S&P 500	Last	1w	1m	6m	12m	YTD	2011
1. Consumer Discretionary	428.3	1.1	3.0	21.8	12.9	11.5	6.1
2. Consumer Staples	507.5	1.0	2.5	11.0	15.8	2.4	14.0
3. Energy	823.6	-1.7	2.5	14.4	-2.5	6.9	4.7
4. Financials	291.4	0.1	0.5	19.4	-8.8	14.0	-17.1
5. Health Care	556.5	0.1	0.2	13.2	12.0	4.6	12.7
6. Industrials	442.3	-1.5	-0.9	20.8	1.9	8.9	-0.6
7. Information Technology	516.7	-0.1	4.1	25.2	11.1	15.0	2.4
8. Materials	339.3	-2.3	-3.1	10.0	-2.6	9.9	-9.8
9. Telecommunication Services	236.5	1.4	3.3	11.0	10.9	2.0	6.3
10 Utilities	362.1	0.1	0.7	7.6	14.4	-2.5	19.9

Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Sector performance as of March 5, 2012

European Sector Indices (in €)

Europe - DJ Stoxx 600	Last	1w	1m	6m	12m	YTD	2011
1. Consumer Discretionary							
Automobiles & Components	501.5	-0.1	0.7	36.2	4.1	30.6	-22.7
Travel & Leisure	202.6	2.0	-1.3	19.4	-1.2	8.7	-13.3
Media	270.6	-0.9	-1.0	16.2	-7.3	3.6	-7.4
Retail	423.8	0.2	0.1	12.9	-0.6	-0.6	-4.2
2. Consumer Staples							
Food & Beverage	660.4	1.7	3.9	18.3	19.1	5.1	8.0
Personal & Household Goods	786.9	1.9	3.0	24.1	18.1	11.4	3.3
3. Energy							
Oil & Gas	702.7	0.5	3.2	33.5	4.0	7.6	4.8
4. Financials							
Banks	301.8	1.3	0.3	23.2	-23.5	17.8	-30.4
Financial Services	437.4	-0.1	-0.1	11.9	-10.4	13.9	-19.3
Insurance	257.0	1.0	0.3	30.8	-8.4	16.3	-10.5
Real Estate	111.0	2.2	-0.7	3.7	-9.8	7.2	-12.1
5. Health Care	650.7	1.1	0.8	15.9	15.5	1.1	15.3
6. Industrials							
Industrial Goods & Services	494.8	0.2	1.1	23.7	-3.4	13.2	-14.1
7. Information Technology	209.8	-1.1	3.0	18.2	-9.9	11.4	-12.8
8. Materials							
Basic Resources	869.0	-4.3	-9.0	11.0	-18.9	10.8	-28.8
Chemicals	1016.0	-0.9	2.7	29.6	5.2	14.2	-7.9
Construction & Materials	434.8	0.1	1.8	24.1	-8.2	13.7	-17.4
9. Telecommunication Services	478.3	-0.1	-1.8	8.3	-6.7	-1.7	-0.7
10. Utilities	573.4	2.8	1.5	12.9	-11.2	4.3	-12.5

Source: Bloomberg

Sector performance as of March 5, 2012

Asia Sector Indices (in USD)

Asia – S&P 50 Index*	Last	1w	1m	6m	12m	YTD	2011
1. Consumer Discretionary	10391.2	5.0	4.1	6.3	-3.8	9.1	-10.4
2. Consumer Staples	13528.6	-2.2	-10.2	-3.2	9.3	-2.0	5.0
3. Energy	14193.7	0.1	-0.2	23.5	5.1	20.4	-11.1
4. Financials	3531.9	0.1	2.1	8.9	2.6	18.6	-24.0
5. Industrials	2945.7	3.5	4.8	9.5	-8.7	22.7	-24.2
6. Information Technology	10447.3	1.0	7.5	32.4	11.6	14.4	-4.4
7. Materials	4525.4	0.7	4.8	1.9	-9.2	16.6	-21.6
8. Telecommunication Services	2638.0	0.3	1.9	0.8	8.0	4.4	0.1
9. Utilities	3563.4	2.6	4.3	3.1	13.2	4.2	7.2

Source: Ecowin

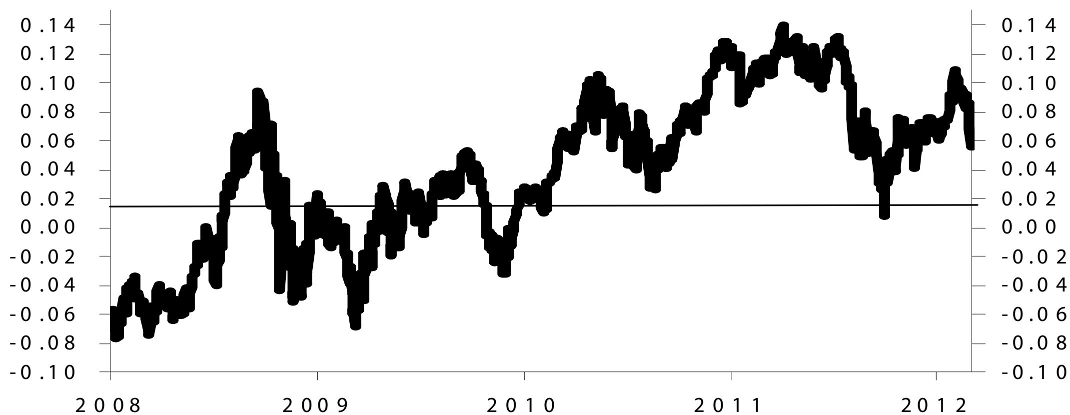
US Style Equity Indices

Total Return (%) as of March 5, 2012

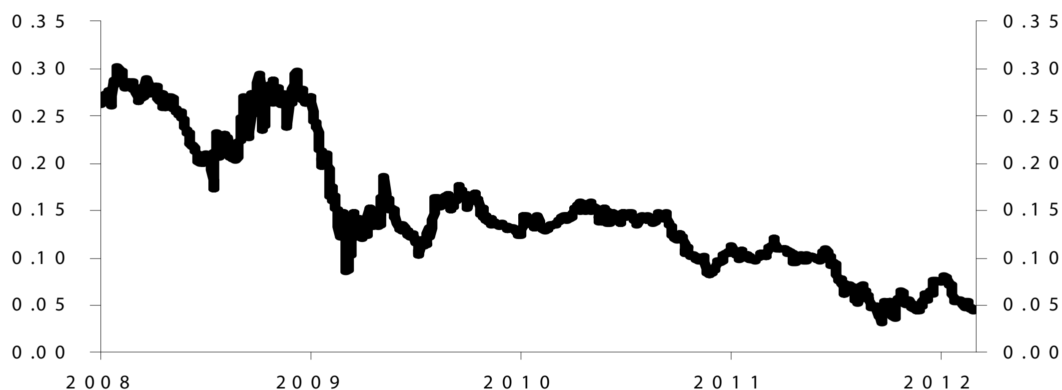
US Style Indices (in USD)

Index	Last Price	1w	1m	6m	12m	YTD	2011
Russell 1000 (Large Cap)	755.4	-0.3	1.4	17.2	3.0	8.9	-0.5
Russell 2000 (Small Cap)	803.7	-2.8	-3.0	18.0	-2.6	8.5	-5.5
Relative performance (Small vs Large)		-2.4	-4.4	0.8	-5.6	-0.5	-4.9
Russell 1000 Value	672.5	-0.4	1.0	17.2	0.3	7.4	-2.1
Russell 1000 Growth	641.7	-0.3	1.8	17.2	5.9	10.5	1.1
Relative performance (Value vs Growth)		-0.1	-0.8	0.0	-5.6	-3.0	-3.1

Relative Performance (small vs large)
(logarithmic scale)



Relative Performance (value vs growth)
(logarithmic scale)

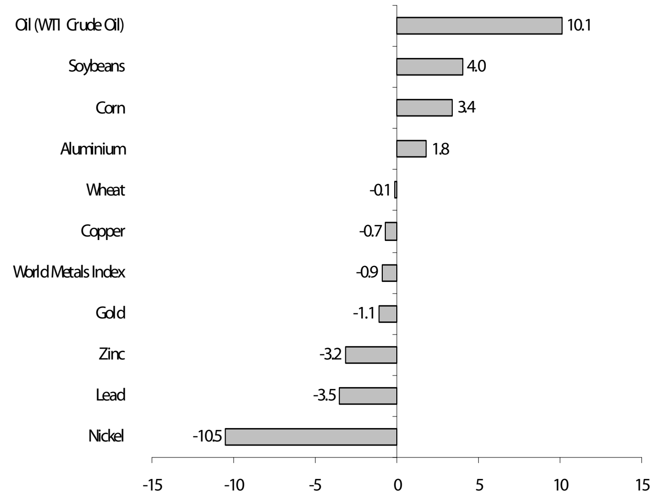


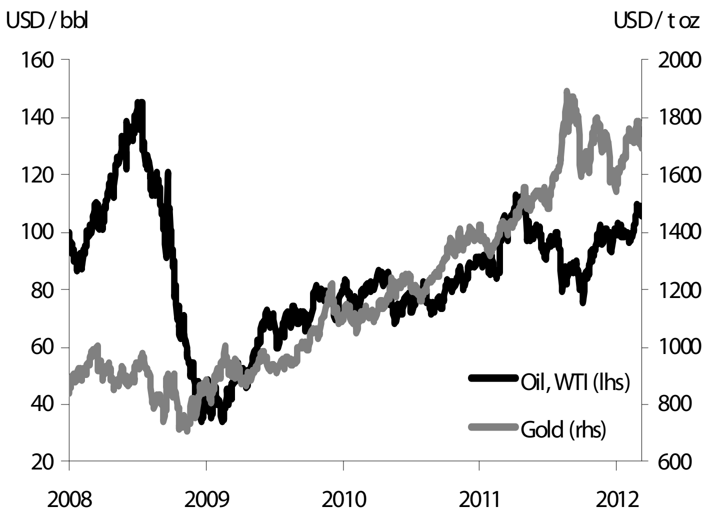
Source: Bloomberg

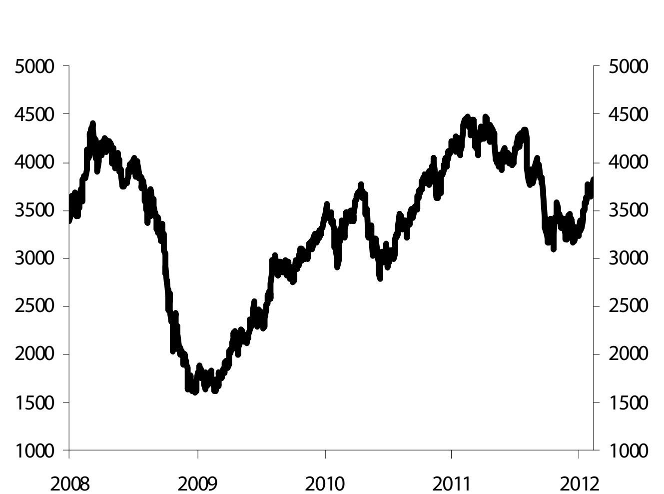
Commodities

Commodity Performance (%) as of March 5, 2012

Commodities								
	Units	Last Price	1w	1m	6m	12m	YTD	2011
Oil (WTI Crude Oil)	USD/bbl	106.7	0.2	10.1	24.1	2.2	8.0	8.2
Gold	USD/t oz	1703.9	-4.7	-1.1	-8.9	19.3	8.8	10.2
Base Metals								
World Metals Index		3682.1	-1.9	-0.9	-5.0	-16.8	11.4	-21.5
Aluminium	USD/lb	2288.0	-1.8	1.8	-4.2	-12.0	13.3	-18.2
Copper	USD/mt	8505.0	-0.1	-0.7	-5.1	-14.0	11.9	-20.8
Lead	USD/mt	2147.0	-4.5	-3.5	-11.8	-18.4	5.5	-20.2
Nickel	USD/mt	19075.0	-5.4	-10.5	-8.7	-33.8	2.0	-24.4
Zinc	USD/mt	2087.0	-0.5	-3.2	-3.9	-15.2	13.1	-24.8
Agriculture								
Corn	USD/bu	666.3	2.0	3.4	-10.8	-7.6	3.1	2.8
Soybeans	USD/bu	1289.0	0.0	4.0	-7.0	3.6	7.0	-2.4
Wheat	USD/bu	667.8	0.8	-0.1	-6.8	-16.6	2.3	-17.8







Source: Bloomberg

A few words about EFG Eurobank Ergasias S.A. (Eurobank EFG)

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