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Eurobank EFG

GLOBAL ECONOMIC & MARKET OUTLOOK

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- Economic growth in most developed and emerging economies has slowed in the second quarter of 2012, as rekindled concerns about a likely euro area break-up have eroded economic confidence**.** Global economic growth is expected to pick up in the second half of the year, however, headwinds are expected to hold back economic activity.

- The euro area is expected to contract slightly in Q2 as a result of fiscal consolidation. Policy response is expected to assuage markets' concerns, allowing for a gradual improvement in economic sentiment in H2. GDP growth is likely to pick up in the second half of the year on the ground of improving global demand, accommodative monetary policy and robust growth in Germany.

- Fears of disruptive events in the euro area have resurfaced due to political instability in Greece. While we expect further muddling through, we believe the euro area will remain intact. A balance between austerity and growth is required to ease the pain of adjustment in the euro area periphery, while an increased focus on growth in the short term could render fiscal austerity and unpopular reforms more feasible from both a political and a social point of view.

- In the US, real economic activity is expected to remain subdued around 2.0% for the remainder of 2012, with domestic fiscal policy and potential financial market spillovers from the European crisis being the major source of uncertainty to the US outlook.

- The US faces its own fiscal crisis at the end of 2012; without new legislation passed by the Congress, scheduled increases in taxes and reductions in spending should impose a recession-sized fiscal tightening. We believe that policymakers will probably act to avoid most of the restraint called for under current law in 2013. Our baseline scenario includes a fiscal restraint of at least 1% in 2013, even with the extension of the Bush-era income tax cuts and estate and gift tax provisions.

- In China, we expect a significant growth deceleration but not a hard landing. Barring a collapse of the property sector and a deeper recession in the Euro area, we expect China's growth to pick up during the second half of the year, after bottoming in Q2, as policy loosening will start to show its impact on the real economy more visibly.

- Further monetary policy easing by major central banks is likely in 2012 if tensions in Europe persist. The ECB could inject additional liquidity to the banking sector or even reactivate its Securities Markets Program. The Fed could launch a third round of quantitative easing, involving the purchase of Treasuries and mortgage-backed securities. The Bank of Japan could upsize is Assets Purchases Program to contain persistent appreciation pressures on the yen.

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Executive Summary

Economic confidence has deteriorated substantially in Q2 2012, as the respite provided by bold response by the ECB at the end of 2011 proved to be short lived. The unresolved banking and sovereign solvency issues in the euro area has caused markets' concerns to intensify, leading to a slowing down of economic activity in Q2. We expect policy response by euro area policymakers to assuage markets' concerns of a euro break up. Hence, the global economy is likely to pick up some momentum in the period ahead. That said, GDP growth is expected to remain subdued due to the lack of a permanent solution to the European crisis, the ongoing consolidation of the public and private sector in developed economies, and subdued global demand. Overall, global GDP is projected to grow by 3% and 3.5% in 2012 and 2013, respectively.

Uncertainty to our global economic outlook stems mainly from the lingering euro area debt crisis. A disorderly Greek exit would spread shockwaves to global financial markets, most likely throwing the world economy into a new recession. Political uncertainty is expected to remain acute in Greece in the short term, as the outcome in the second round of elections (due three days after writing this report) is unlikely to allow any party to form a government on its own and a broader coalition will need to be formed. Nonetheless, in our baseline scenario, the euro area will remain intact, with Greece part of the monetary union. We expect prudence to prevail whether a pro-troika or an anti-troika government is formed, as both the euro area and Greece will enter uncharted territory if Greece departs. A devalued currency would not solve Greece's deeply rooted economic problems and painful reforms would still be needed. Moreover, a Greek exit would not solve the sovereign debt crisis in the euro area, as the latter would still need to build a complete institutional framework ensuring the proper functioning of the monetary union.

In our view, enhanced fiscal solidarity is the key ingredient of a permanent resolution to the euro area crisis, capable of convincing investors that the euro area will not break apart. Fiscal solidarity needs to be built on centralized fiscal governance which seems to be required by creditor countries to ensure fiscal discipline among the euro area members. Yet, enhanced federalism implies loss of sovereignty, which is opposed by debtor countries. Thus, a permanent solution requires both sides, creditors and debtors, to reach a compromise and accept what currently seems to be an anathema for either part. In a positive scenario, the intensification of the crisis in an economy as big and systemic as Spain would precipitate the delivery of concrete decisions on the creation of a fiscal and banking union. However, given the cumbersome political procedures in Europe, we believe bold steps towards this direction are rather unlikely in the immediate future. Instead, euro area policymakers will most likely keep handling the sovereign crisis with further muddling through and brinkmanship.

While the European sovereign debt crisis is at the epicenter of investors' interest, the US faces its own fiscal crisis at the end of 2012. US policymakers have postponed the important budgetary decisions in order to reduce budget deficits to right after the US elections in November. Without new legislation passed by the Congress, scheduled increases in taxes and reductions in spending should impose a recession-sized fiscal tightening with significant implications for the global economy. We believe that policymakers will probably act to avoid most of the restraint called for under current law in 2013. However, eliminating the fiscal restraint scheduled to occur in 2013 will probably be a difficult task, given the risk of a substantially higher US debt in future years that could weigh in the long run on real economic activity and investors' confidence in the government's ability to manage its public finances.

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 the 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. Furthermore, easing inflationary pressures and a broad-based slowdown in global growth has led central banks in most EM to either hold interest rates unchanged or ease. The relative stabilization of oil prices and a weakening in the pace of global growth is expected to maintain the slowing path of inflation this year. This creates significant room for monetary policy to support growth.

Dimitris Malliaropulos

Economic Research Advisor

I. Global Outlook

Dimitris Malliaropulos, Vasilis Zarkos, Maria Prandeka, Olga Kosma

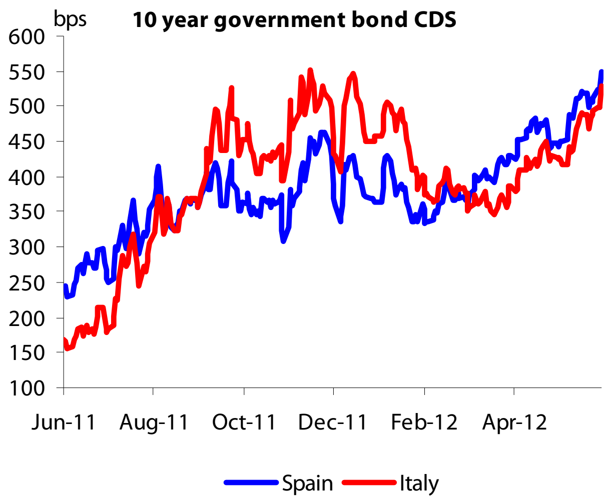
Elevated uncertainty has likely cut into global economic growth in Q2

Economic confidence has deteriorated substantially in the second quarter of the year, which is expected to show up in lower Q2 GDP growth readings in several developed and emerging markets. Bold response by the ECB at the end of 2011 managed to reverse the gloomy economic sentiment that prevailed in the second half of 2011, as the debt crisis spread to Spain and Italy, while brinkmanship in the US over the debt ceiling revealed difficulties of US policymakers to reign over the country's unsustainable public debt dynamics. However, the respite proved to be short lived. Markets' concerns rekindled as banking and sovereign solvency issues in the euro area remain unsolved. Existential fears of the euro itself intensified after the Greek elections outcome, which raised concerns about the country's ability to preserve its membership in the monetary union. Rising CDS spreads (Figure 1) and falling stock prices (Figure 2) illustrate heightened investors' uncertainty. Poor economic sentiment is expected to weigh on consumption and capital formation, as households refrain from spending while firms respond by postponing investment plans.

Global economic growth is expected to pick up in the second half but remain subdued

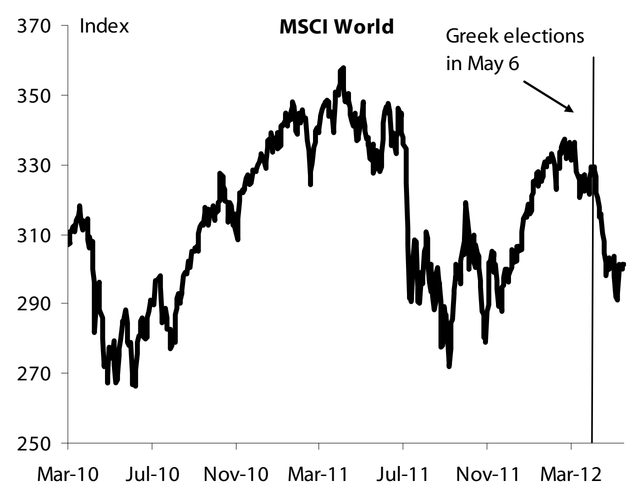
We expect policy response by euro area policymakers to assuage markets' concerns of a euro break up. Hence, the global economy is likely to pick up some momentum in the period ahead on the ground of improved economic sentiment and reduced uncertainty about tail risks. That said, GDP growth is expected to remain subdued for several reasons. While European authorities are expected to address tail risks, they are not likely to take bold steps with respect to banking and fiscal integration of the euro area. Thus, the lack of a permanent solution will most likely continue to spook markets and feed uncertainty in global financial markets. The banking sector in both the euro zone and the US is slowly healing, affecting adversely the economy. Emerging Europe is particularly affected due to its strong ties with the ailing European banking sector. Moreover, fiscal consolidation and deleveraging is expected to weigh on economic activity in developed economies, while reduced capital flows and lower global demand are likely to put a lid on growth in emerging markets. Overall, global GDP is projected to grow by 3% and 3.5% in 2012 and 2013, respectively.

Figure 1



Source: Bloomberg

Figure 2



Source: Bloomberg

Country/regional economic outlook

Below-trend growth for the US economy in 2012, with domestic fiscal situation and spillovers from Europe weighing on growth. Real economic activity decelerated in Q1 2012 compared with the strong momentum that we saw at the end of 2011, due to the fading boost from inventory accumulation and a slowing in the business sector spending growth. Incoming economic data suggest that real economic activity will remain subdued for the remainder of 2012, with domestic fiscal policy and potential financial market spillovers from the European crisis being the major source of uncertainty to the US outlook. The apparent loss of momentum in the labor market recovery and the recent softness in leading economic indicators and high-frequency data have pushed the latest consensus GDP numbers downwards, moving closer to our forecasts. Our longer-term view of the US economy remains intact for a below-trend growth in 2012 and 2013, averaging at around 2%.

The euro area is expected to resume growth in H2 2012. After a flat reading at the beginning of the year, the euro area will most likely experience a slight contraction in Q2 as fears of a Greek exit resurfaced and tensions in Spanish banks escalated. Although uncertainty will remain elevated in the short term, policy response is expected to assuage markets' concerns, allowing for an improvement in economic sentiment later in the year. GDP growth is likely to re-enter expansionary territory in the second half of the year on the ground of solid global demand, accommodative monetary policy and robust growth in Germany. Nonetheless, economic growth is expected to remain uneven and weak in the next couple of years, as fiscal consolidation will remain a drag on growth, while domestic demand will remain constrained by private deleveraging in most euro area members, with the notable exception of Germany.

Japan is expected to outperform its DM peers due to reconstruction. Public investment and private consumption gave a significant boost to GDP growth in the first quarter of the year. Eco-car subsidies and reconstruction in the disaster areas are expected to drive growth in 2012, partially shielding the Japanese economy from weaknesses in external demand due to uncertainty in Europe. However, economic growth is likely to recede to a lower trajectory later this year and in 2013, as the sources of growth are of temporary nature. In the short term, downside risks to the economy stem mainly from stresses in the euro area which exert appreciation pressure on the yen due to its safe heaven status and likely electric power shortages in the summer. Longer term, excesses in public finances may pose risks to the economy if they remain unaddressed.

Growth in most EM economies is expected to pick up in the second half of the year and remain relatively robust. With the global economic environment deteriorating over the second quarter of the year and domestic conditions softening, emerging markets' activity has been surprising to the downside. Negative spillovers from the situation in Europe are weighing on EM through the trade and capital flows channels. We believe that downside risks to external demand, particularly from the euro area, will persist as long as tail risks remain in Europe. In our view, most emerging economies are well-positioned to withstand a deepening turbulence in the global economy and sustain moderate growth in 2012. Growth in most of the EM world is expected to rebound in the second half of the year, thanks in part to the lagged effects of monetary policy easing. Recent data on economic sentiment indicators across all EM regions point to some improvement in economic activity over the next six months.

Significant growth deceleration but not a hard landing in China. Barring a collapse of the property sector and a deeper recession in the Euro area, we expect China's growth to pick up during the second half of the year, after bottoming in Q2, as policy loosening will start to show its impact on the real economy more visibly. In recent data releases there were glimmers of a turnaround towards the second half of the year. China's economy has entered a period of subdued growth, with weak export, credit and property cycle. The three decades of double digit growth is over and China's potential GDP growth could gradually slow below the current 8.0% over the coming years. The 2012 outlook is expected to be dominated by the continued weakness in external demand and further property market adjustment.

Risks to our global growth outlook stem mainly from the European debt crisis and the US fiscal crisis

Uncertainty to our global economic outlook remains high due to the unresolved euro area debt crisis. Risks for a disruptive event have escalated after the Greek elections outcome in May, which raised concerns about the country's ability to maintain its participation in the euro area. A disorderly Greek exit would spread shockwaves to global financial markets, most likely throwing the world economy into recession. Political uncertainty is expected to remain acute in Greece in the short term, as the outcome in the second round of elections (due three days after writing this report) is unlikely to allow any party to form a government on its own and a broader coalition will need to be formed. Nonetheless, in our baseline scenario, the euro area will remain intact, with Greece part of the monetary union. We expect prudence to prevail whether a pro-troika or an anti-troika government is formed, as both the euro area and Greece will enter uncharted territory if Greece departs. A devalued currency would not solve Greece's deeply rooted economic problems and painful reforms would still be needed. Moreover, a Greek exit would not solve the sovereign debt crisis in the euro area, as the latter would still need to build a complete institutional framework ensuring the proper functioning of the monetary union.

The recent intensification of the Spanish banking sector woes has underscored the imperative need of a pan-European mechanism to monitor, resolve, recapitalize and insure the deposits of banks in the euro area. The country will very soon receive financial assistance through the ESM to recapitalize its ailing banks. However, more concrete steps towards a banking union are required in order to protect the euro zone from future bank instabilities. Moreover, markets' concerns remain elevated as regards to debt sustainability in Spain and Italy. Given that both countries have been engaged in strict fiscal austerity amidst a recessionary environment, fears that both countries may eventually ask for a sovereign bail-out are looming. In such a case, the rescue capacity of the ESM would be challenged.

In our view, enhanced fiscal solidarity is the key ingredient of a permanent resolution to the euro area crisis, capable of convincing investors that the euro area will not break apart. Fiscal solidarity needs to be built on centralized fiscal governance which seems to be required by creditor countries to ensure fiscal discipline among the euro area members. Yet, enhanced federalism implies loss of sovereignty, which is opposed by debtor countries. Thus, a permanent solution requires both sides, creditors and debtors, to reach a compromise and accept what currently seems to be an anathema for either part. In a positive scenario, the intensification of the crisis in an economy as big and systemic as Spain would precipitate the delivery of concrete decisions on the creation of a fiscal and banking union. However, given the cumbersome political procedures in Europe, we believe bold steps towards this direction are rather unlikely in the immediate future. Instead, euro area policymakers will most likely keep handling the sovereign crisis with further muddling through and brinkmanship.

While the European sovereign debt crisis is at the epicentre of investors' interest, the US faces its own fiscal crisis at the end of the year. US policymakers have postponed the important budgetary decisions in order to reduce budget deficits to right after the US elections in November. Without new legislation passed by the Congress, scheduled increases in taxes and reductions in spending should impose a recession-sized fiscal tightening with significant implications for the global economy. According to the CBO's estimates, the so called "fiscal cliff" (more than 4.0% of GDP) would constitute a significant drag for real economic activity, causing a recessionary contraction of -1.3% in H1 2013. We believe that policymakers will probably act to avoid most of the restraint called for under current law in 2013. However, eliminating the fiscal restraint scheduled to occur in 2013 will probably be a difficult task, given the risk of a substantially higher US debt in future years that could weigh in the long run on real economic activity and investors' confidence in the government's ability to manage its public finances.

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 the 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 slowing momentum of the economy and the risk of spill-over from Europe into US financial markets have increased the likelihood of further monetary policy easing. A likely outcome could be an extension of the "Operation Twist", selling short-term Treasury securities and reinvesting the proceeds in longer-term securities. However, given the increased uncertainty on how authorities plan to recapitalize the Spanish banking system and on how markets will respond to the outcome of the Greek elections on June 17, the Fed could launch a third round of quantitative easing (QE3), involving the purchase of both long-term Treasuries and mortgage-backed securities to help support conditions in the housing market. 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. The ECB will likely address uncomfortable levels of borrowing costs for Spain and Italy or a deposit flight by additional LTROs. The ECB may also resume its securities purchases program in case tensions exacerbate. The Bank of Japan is expected to maintain its accommodative policy to contain appreciation pressures on the yen and fight deflation. We expect additional expansion of its Asset Purchase Program, as inflation is most likely to remain below the inflation target of 1%, set out last February as its "understanding" of medium/long-term price stability. Easing inflationary pressures and a broad-based slowdown in global growth has led central banks in most EM to either hold interest rates or ease. The relative stabilization of oil prices and a weakening in the pace of global growth is expected to maintain the slowing path of inflation this year. This creates significant room for monetary policy to support growth.

II. Global Economic Outlook

1. The US economy

Dimitris Malliaropulos, Olga Kosma

- Real economic activity decelerated in Q1 2012 compared with the strong momentum in Q4 2011, due to the fading boost from inventory accumulation and a slowing in the business sector spending growth.
- Incoming economic data suggest that real GDP growth will remain subdued at around 2.0% for the remainder of 2012, with domestic fiscal policy and potential financial market spillovers from the European crisis being the major source of uncertainty to the US outlook.
- The US faces its own fiscal crisis at the end of the year; without new legislation passed by the Congress, scheduled increases in taxes and reductions in spending should impose a recession-sized fiscal tightening.
- We believe that policymakers will probably act to avoid most of the restraint called for under current law in 2013. Our baseline scenario includes a fiscal restraint of at least 1% in 2013, even with the extension of the Bush-era income tax cuts and estate and gift tax provisions.
- The recent weakness in employment growth, as well as the significant downside risks to the US outlook stemming from the Euro area fiscal crisis, have increased the likelihood of further monetary policy easing at the June 19-20 FOMC meeting.

Overview

Real economic activity decelerated in the first quarter of the year compared with the strong momentum that we saw at the end of 2011, due to the fading boost from inventory accumulation and a slowing in the business sector spending growth. Incoming economic data suggest that real economic activity will remain subdued for the remainder of 2012, with domestic fiscal policy and potential financial market spillovers from the European crisis being the major source of uncertainty to the US outlook. The apparent loss of momentum in the labor market recovery and the recent softness in leading economic indicators (Figure 1.1) have pushed the latest consensus GDP numbers downwards, moving closer to our forecasts. Our longer-term view of the US economy remains intact for a below-trend growth in 2012 and 2013, averaging at around 2% (Figure 1.2).

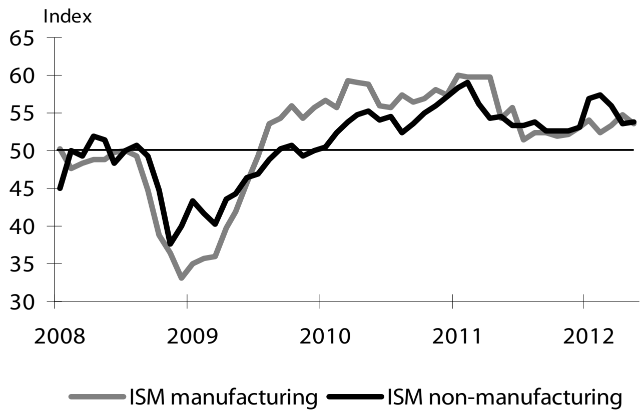
While the European sovereign debt crisis is at the epicentre of investors' interest, the US faces its own fiscal crisis at the end of the year. US policymakers have postponed the important budgetary decisions in order to reduce budget deficits to right after the US elections in November. Without new legislation passed by the Congress (both the House and the Senate), scheduled increases in taxes and -to a lesser degree- reductions in spending[1], should impose a recession-sized fiscal tightening. According to CBO's estimates, the expected expirations of tax provisions and the automatic enforcement procedure[2] scheduled to lower spending in 2013 will reduce the federal budget deficit by more than $600bn in 2013, or more than 4.0% of GDP. The so called "fiscal cliff" would constitute a significant drag for real economic activity, with an average growth rate of 0.5% for 2013. In such a case, the above-mentioned CBO's estimations include a recessionary

[1] See Table 1.1.

[2] Established in the Budget Control Act of 2011.

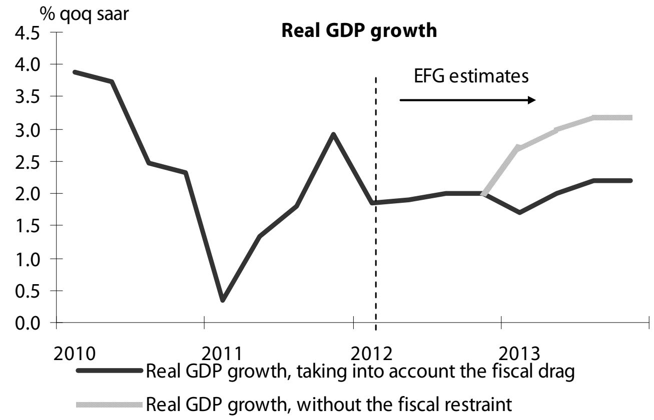
contraction of -1.3% in H1 2013, before rebounding to 2.3% in the second half of the year. However, the CBO analyzed an alternative fiscal scenario that assumes possible changes to current law in order to reduce fiscal restraint in 2013, with an average growth rate of 2.1% in 2013. We believe that policymakers will probably act to avoid most of the restraint called for under current law in 2013. Our baseline scenario includes the expiration of the payroll tax cuts and emergency unemployment benefits, as well as a deceleration in federal government spending. In such a case, fiscal restraint would reduce growth by at least 1% in 2013, even with the extension of the Bush-era income tax cuts and estate and gift tax provisions (Figure 1.2).

Figure 1.1



Source: Bloomberg

Figure 1.2



Source: US Bureau of Economic Analysis, EFG estimates

Table 1.1

Scheduled change in the Federal Budget Deficit between fiscal years 2012 and 2013

Changes in Revenue Policies	
Expiration of income taxes and estate and gift tax provisions and of indexing the Alternative Minimum Tax (AMT) for inflation	$221bn
Expiration of the reduction in the employee's portion of the payroll tax	$95 bn
Other expiring provisions	$65 bn
Taxes included in the Affordable Care Act	$18 bn
Changes in Spending Policies	
Effects of the automatic enforcement procedures specified in the Budget Control Act	$65 bn
Expiration of eligibility to start receiving emergency unemployment benefits	$26 bn
Reduction in Medicare's payment rates for physicians	$11 bn
Other Changes in Revenues and Spending	**$105 bn**
TOTAL change in Deficit	**$607 bn**

Source: Congressional Budget Office

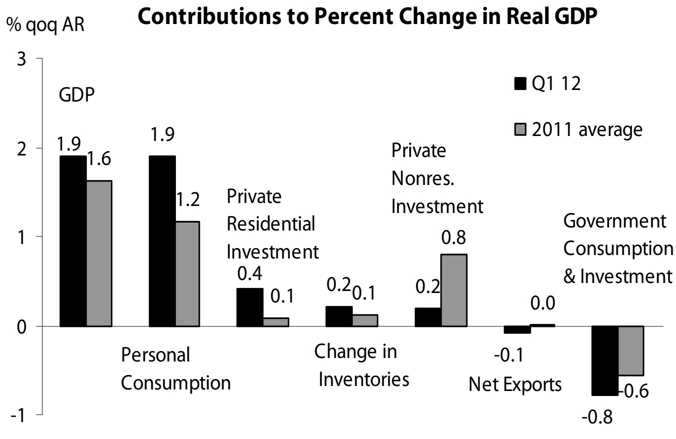
GDP growth deceleration, due to softer inventory accumulation and weaker business investment

According to the second estimate of the Bureau of Economic Analysis (BEA), real GDP decelerated to 1.9% q-o-q saar in Q1 2012 from 3.0% in the final quarter of 2011, on the back of a softer pace of inventory accumulation and weak nonresidential investment growth (Figure 1.3). In particular, real private consumption helped to drive economic activity, reporting its strongest gain since Q4 2010 and adding 1.9 percentage points to growth in the quarter. Furthermore, residential investment surprised to the upside, increasing by roughly 20%, the strongest quarterly increase in almost two years. The change in private inventories added a mere 0.2pp to real GDP growth, after a strong contribution of 1.8% in the previous quarter. As a result, real final sales of domestic product (GDP less change in inventories) accelerated in the first quarter of the year, increasing 1.7% after a gain of 1.1% in Q4 2011. Net trade had a neutral impact on GDP growth, as exports increased 7.2% and imports grew 6.1%. The major drag on growth was for a second consecutive quarter the government sector, subtracting 0.8% from real economic activity. The public sector consolidation remains a prevailing headwind for the US economy at the beginning of 2012, with national defense spending falling by 8.3%, after a 12.1% drop in Q4 2011, and State and local government spending dropping 2.5% after a 2.2% fall in Q4 2011.

Cautious on the US consumer, due to the softening in jobs growth, a payback from warm weather and negative wealth effects

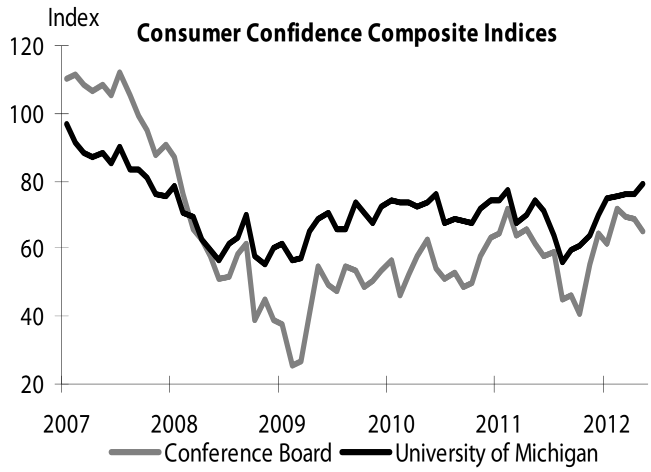
Real personal consumption spending increased by a solid 2.7% q-o-q saar in Q4, higher than the 2.1% reported growth in Q3. The acceleration was broad-based with gains across durable goods (14.3%), non-durable goods (2.3%) and services (1.0%). Some of the strength in real consumption growth at the start of the year was probably due to the unusually warm weather, which prompted some purchases to be brought forward. Meanwhile, households' consumption was also funded by a reduction in the personal savings rate, as the rapid rise in equity prices and the improving trend in employment growth in the first quarter improved consumers' confidence about their financial situation. Indeed, the personal savings rate fell to 3.6% in Q1 2012 from 4.2% in Q4 2011, so real personal spending increased by 2.7% while real disposable income increased by a mere 0.4% in the quarter.

Figure 1.3



Source: US Bureau of Economic Analysis, EFG estimates

Figure 1.4

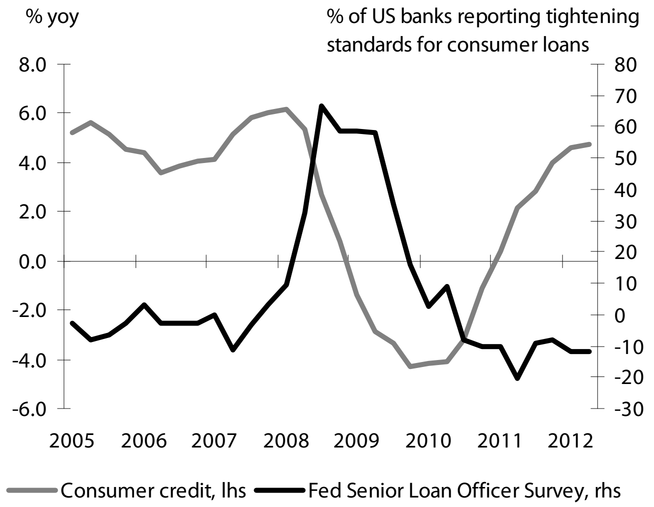


Source: The Conference Board, Thomson Reuters/University of Michigan

The April personal income and spending accounts revealed a 0.3% monthly gain in real personal spending, bringing the annual growth above 2.0% from 1.5% at the end of 2011. Nominal personal income increased by 0.3% and, after accounting for inflation and personal taxes, real disposable income grew by 0.2%, with the annual reported growth increasing to 0.6% from 0.1% two months ago. Meanwhile, the University of Michigan's index of consumer sentiment increased to 79.3 in May, reporting its highest reading since October 2007 (Figure 1.4). Looking ahead, the recent softening in headline consumer price inflation led by lower gasoline prices should contribute positively to real incomes and spending growth in the coming months.

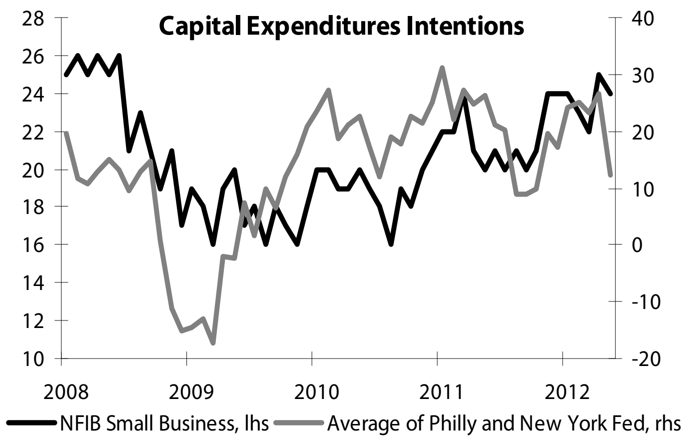
Nevertheless, we do not change our medium-term consumption outlook for the US economy, as there are several important factors which prompt us not to expect a significant acceleration in private spending growth for the remainder of the year. The evident loss of momentum in the labor market recovery could be a drag on consumer confidence and, consequently, income and spending gains. The recent deceleration of the Conference Board's index of consumer confidence over the last couple of months (Figure 1.4), which tracks labor market conditions more closely, reflects the apparent softening in employment growth. Furthermore, the upward trend in equity prices observed in Q1 has reversed in the second quarter of the year, while credit standards for consumer loans are currently easing at a slower pace (Figure 1.5). Indeed, the soft retail sales for May reinforces our view that private spending is on a weaker footing in the second quarter of the year, partly reflecting some payback from warm winter weather. According to our estimates, real personal consumption growth will remain subdued around 2.0% throughout 2012, close to the 2.2% annual average growth reported in 2011.

Figure 1.5



Source: Federal Reserve, Ecowin

Figure 1.6



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

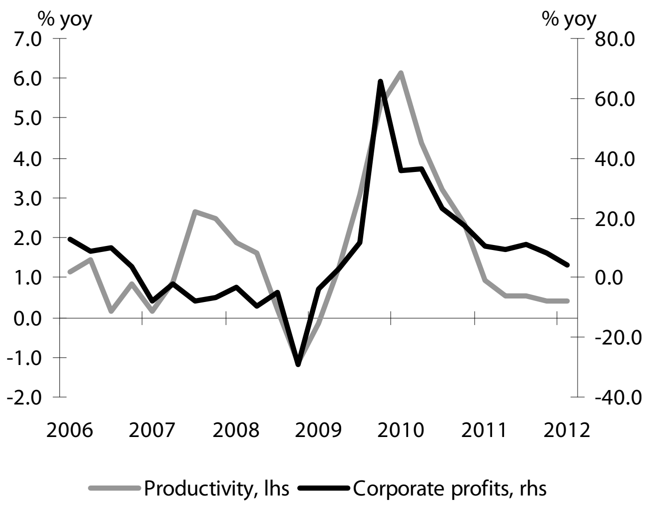
Increased uncertainty and labor productivity slowdown weigh on the business sector

Real business investment surprised to the downside, decelerating in Q1 2012 to 1.9% q-o-q saar from 5.2% in Q4 2011, with structures investment falling by 3.3% and equipment and software increasing by 3.9%. Although non-residential investment was one of the main drivers of growth in 2011, it actually contributed a mere 0.2% to real GDP growth at the start of the year. Although the weakness partly reflects the expiry of the bonus depreciation tax allowances at the end of 2011, the slowdown in business sector activity seems to continue in the second quarter of the year. Core capital goods shipments, which are the main input for equipment and software, contracted 1.5% m-o-m in April, while business surveys regarding capital expenditures intentions have recently declined (Figure 1.6). Even though the decline could be partly attributed to the seasonal pattern for core orders and shipments to decline in the first month of the quarter and rebound in the following two months, we believe that increased uncertainty and loss of business confidence stemming from the European as well as the US fiscal crisis looms as a significant negative factor for business investment in 2012. Meanwhile, the labor productivity slowdown may lead to further deceleration in corporate profit growth, dampening prospects for capital spending and investment (Figure 1.7). Hence, we expect real non-residential investment growth to decelerate to an average of 5.5% in 2012 from 8.8% in 2011.

The US housing market is gradually recovering

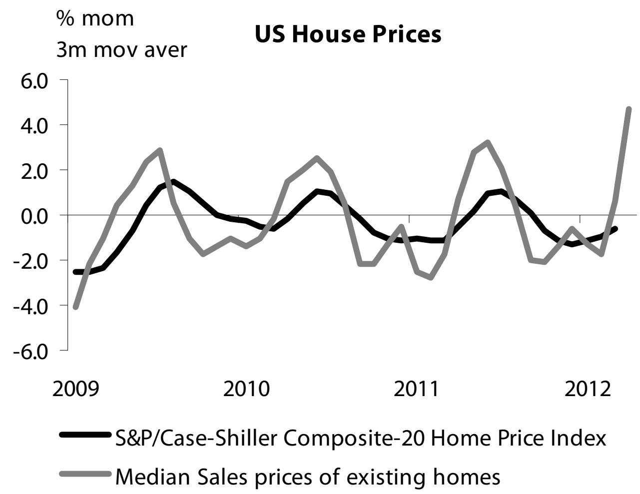
Residential investment growth rebounded to 19.4% q-o-q saar in Q1 2012 from 11.6% in Q4 2011, reporting the biggest contribution to real economic activity since Q2 2010. The warm winter weather explains some of the rapid increase in residential investment in the quarter, and we expect a continued gradual recovery in the US housing market to contribute positively to real GDP growth in the following quarters. Housing starts and building permits have increased by a total of 3.0% since the end of last year, with an annual growth rate of about 25-30%. Meanwhile, the National Association of Home Builders (NAHB) index of home builder sentiment has risen to its highest level in five years, reinforcing our view for improving housing conditions. All measures of US house prices have shown an upward momentum over the last couple of months (Figure 1.8), and the trend in the supply of unsold homes points towards a gradual decline in the stock of properties as demand for housing is recovering. We look for a gradual recovery process in residential construction spending and investment, with an average growth rate of about 10.5% in 2012 from -1.3% in 2011.

Figure 1.7



Source: US Bureau of Economic Analysis, US Bureau of Labor Statistics

Figure 1.8



Source: Standard & Poor's, Ecowin

Slowing momentum of the economy and fiscal risks increase the probability for further monetary easing

The recent weakness in employment growth, as well as the significant downside risks to the US outlook stemming from the Euro area fiscal crisis, have increased the likelihood of further monetary policy easing at the June 19-20 FOMC meeting. At his recent testimony to Congress on the US outlook, Chairman Ben Bernanke highlighted the significant downside risks to growth posed by the fiscal situation in both the US and Europe, and repeated the Fed's baseline scenario for a moderate pace of growth. Although he did not give a clear signal for additional monetary easing at the upcoming June meeting, he reiterated that the Fed is ready to act as needed in order to support the economic recovery.

In light of the US economy's slowing momentum, Fed officials have started to raise the probability of further monetary easing measures in recent days. Fed Vice Chair Janet Yellen and New York Fed President William Dudley, who are members of the Federal Open Market Committee, have recently indicated that the risk of spillover from Europe into US financial markets, as well as deteriorating prospects for US growth, would warrant further monetary easing. Given that conditions in financial markets have recently tightened and economic prospects have deteriorated, it is very likely that the FOMC will downgrade their economic projections based on participants' revised outlook for growth and the labor market. With no apparent inflation risks currently, there is a great chance that the Fed will provide additional monetary easing at its June meeting. A likely outcome could be an extension of the "Operation Twist", selling short-term Treasury securities and reinvesting the proceeds in longer-term securities. However, given the increased uncertainty on how authorities plan to recapitalize the Spanish banking system and on how markets will respond to the outcome of the Greek elections on June

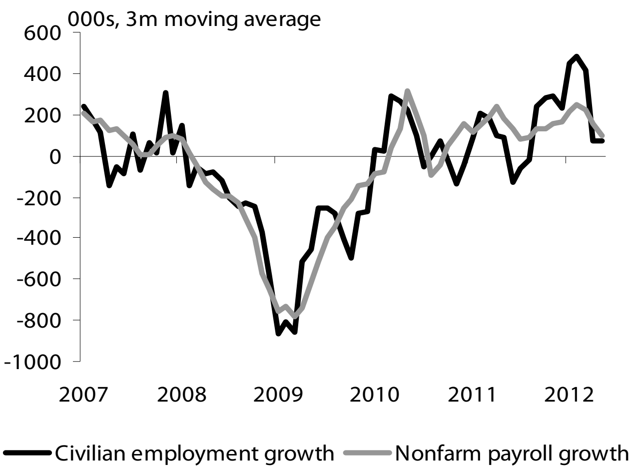
17, the Fed could launch a third round of quantitative easing (QE3), involving the purchase of both long-term Treasuries and mortgage-backed securities to help support conditions in the housing market.

1.1 Special US Focus: A closer look at the US labor market

The labor market recovery has recently lost significant steam

The May employment report revealed that the labor market recovery has lost its strong momentum observed in recent months. Payroll employment rose only 69k, reporting the weakest monthly increase in a year. Over the past three months, nonfarm payroll growth has decelerated from an average of 252k per month from December to February to 96k from February to May (Figure 1.9). Some of the apparent slowdown can be attributed to a payback from unusually warm winter weather, which has pushed forward some of the seasonal boost to hiring that usually occurs in the spring. Weakness in the weather-dependent sectors such as construction, leisure and hospitality was evident, as construction employment declined by 26k, and leisure and hospitality shed 9k after increasing by an average of 37k per month in the three months from December to February. However, the loss of momentum was also apparent in other sectors that are not so weather-dependent such as manufacturing, which added only 12k in May, following an average monthly growth of 40k between December and March. The household survey gave a more mixed picture, as civilian employment increased by a robust 422k, but we do not attach too much attention on this reading, given the high volatility in the series and the 200k reported decline over the past couple of months. Despite the sharp increase in civilian employment, the unemployment rate, which has gradually fallen to a three-year low of 8.1% in April, edged up slightly to 8.2% in May, due to a rebound in labor force participation.

Figure 1.9



Source: U.S. Bureau of Labor Statistics, Eurobank Research

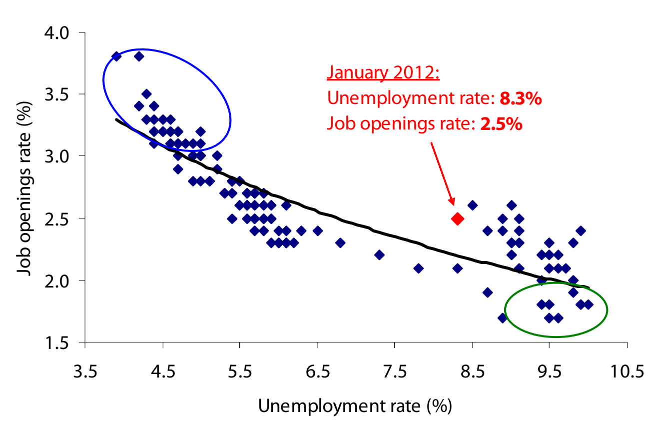
Figure 1.10

Source: U.S. Bureau of Labor Statistics, Eurobank Research

Mismatches between available jobs and workers weigh on the pace of the recovery

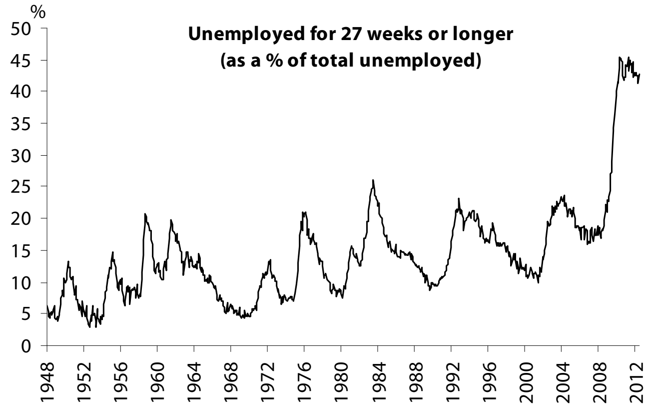
The Job Openings and Labor Turnover (JOLTs) report has shown an upward trend in job openings, with an estimated 3.4 unemployed job seekers for each opening, significantly lower than the recent peak of 6.7 in July 2009 (Figure 1.10). Unemployment and job openings rates tend to vary in a systematic way during the business cycle. The negative slope between the two variables is widely known as the Beveridge curve (Figure 1.11). The dots in the green cycle represent low job openings and high unemployment with a position low and to the right on the curve, indicating a period of economic contraction. On the contrary, the dots in the blue cycle (high and to the left on the curve) represent high job openings and low unemployment rates, indicating a period of economic expansion. Figure 1.11 shows that there is increased recruiting activity on the part of the business sector as is evident by the high openings rate, while there is a relatively small decline in the unemployment rate (red dot). The 2.7% job openings rate reported in March 2012 would correspond to an unemployment rate of about 7%, while the current rate of unemployment currently stands at the high level of 8.2%.

Figure 1.11



Source: Bureau of Labor Statistics, Eurobank Research

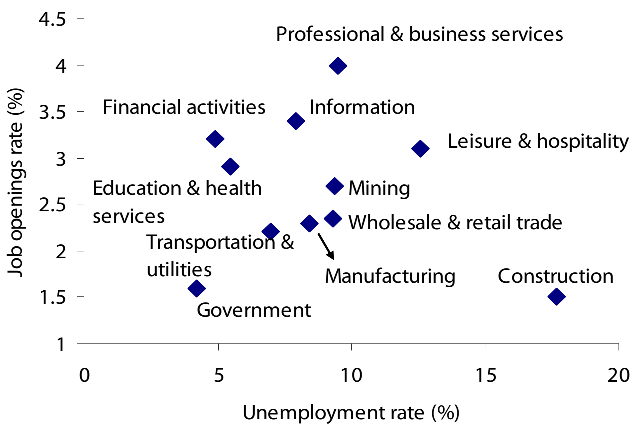
Figure 1.12



Source: Bureau of Labor Statistics, Eurobank Research

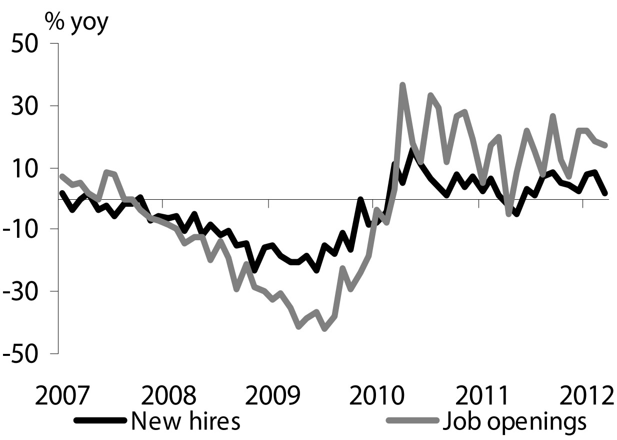
There are different theories about the mismatch between available jobs and the unemployed. According to the cyclical viewpoint, the economy usually takes time to adjust to changes in job openings and unemployment as it may take longer for unemployment to decline than for job openings to increase. This could be attributed to the re-entry into the labour force of jobseekers who had stopped looking for a job when the economy was in decline. On the other hand, there are structural forces that create mismatches between the types of job openings and the skills of available workers. Long-term joblessness, which has been a key feature of the latest recession and recovery (Figure 1.12), tends to create structural unemployment, as long-term unemployed workers tend to lose skills and contacts and find it difficult to get a job. Furthermore, structural shifts in the Beveridge curve could be industry or geography-related. In particular, looking at the unemployment rates and the job openings rate among different sectors of the economy (Figure 1.13), we find that there is high unemployment in the construction sector (17.7%) but there is not high demand for workers in that sector (1.5%). On the contrary, there is high demand for workers in financial services (3.2%), where the unemployment rate is currently hovering around the low level of 5.0%. In addition, geographic disparity may also exist due to the difficulty of jobseekers to sell a house in order to accept a job in a different region. Taking this into account, high unemployment may persist due to potential employees' inability to move to another location to fill new job openings. The negative impact of mismatches on the labor market recovery is also evident in Figure 1.14, which portrays job openings versus new hires growth. The number of openings in the nonfarm sector has increased by about 21% since the start of 2011, while actual hiring has risen by less than 6%.

Figure 1.13



Source: Bureau of Labor Statistics, Eurobank Research

Figure 1.14

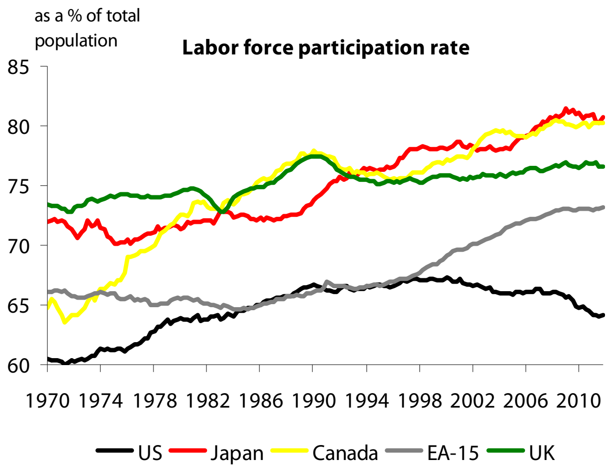


Source: Bureau of Labor Statistics, Eurobank Research

Reentrants into the labor force should not reverse the downward trend in the unemployment rate

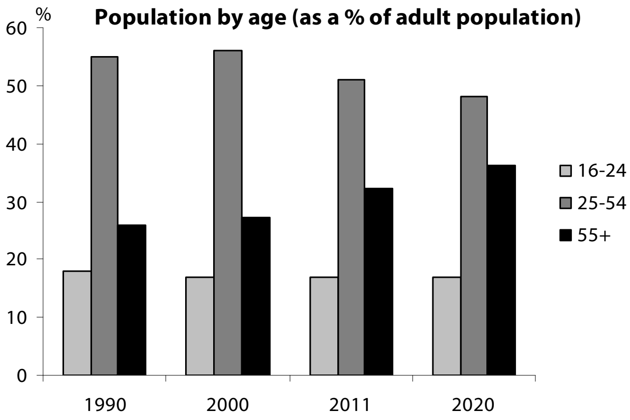
Although May's employment report included a 0.1% increase in the rate of unemployment, the increase did not reflect a drop in civilian employment but rather a rebound in the labor force participation (+642). The unemployment rate is computed as the number of unemployed people actively looking for a job as a proportion of the overall labor force and, therefore, is vulnerable to fluctuations of the active labor force. Many investors and economists believe that a number of discouraged workers who exited the labor market during the recession will turn back into the labor force and reverse the ongoing downward trend in the unemployment rate.

Figure 1.15



Source: OECD

Figure 1.16

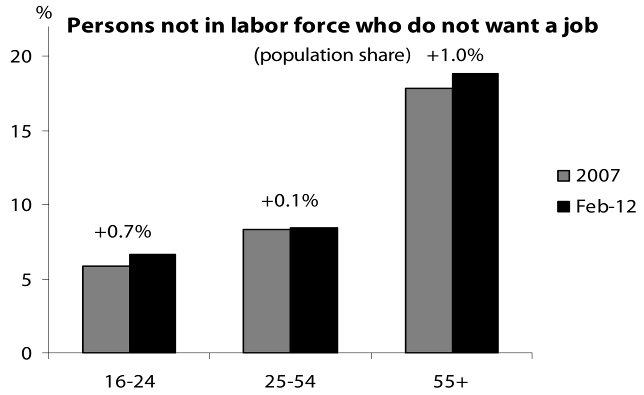


Source: U.S. Census Bureau, Eurobank Research

Labor force participation, which measures the proportion of the population in the active labor force, has gradually declined from 66% in December 2007 to 63.8% in May 2012. The participation rate has actually been on an upward trend between 1970 and 2000, due to the entering of women into the labor force. After reaching its peak at the beginning of 2000, the participation rate in the US has been trending lower due to demographic factors, in contrast to the euro zone countries and other major industrialized countries (Figure 1.15). The baby boom generation reached their 50s, and early retirement has accounted for a steady downward pull on the total participation rate. Indeed, the share of over 55s in the adult population has increased substantially over the last decade, and is projected to continue rising above 36% by 2020 (Figure 1.16). Nevertheless, the decline in the participation rate since December 2007 was not entirely due to the above mentioned structural shift, but was rather reinforced by cyclical factors during the 2008-2009 recession, as many workers became discouraged by fewer labor market opportunities and quit their efforts to find a job.

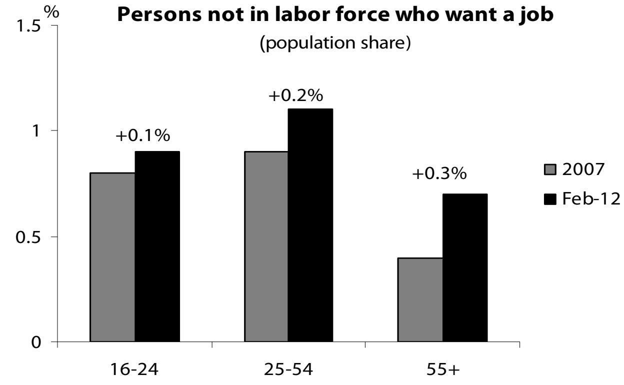
Trying to quantify the structural and cyclical factors that have led to the decline in the labor force participation rate since the onset of the last recession, we use the breakdown of persons not in the labor force from the Bureau of Labor Statistics (BLS). In particular, the labor force participation rate fell by about 2.4% during the last 4 years, from 66% in December 2007 to 63.6% in February 2012 (not seasonally adjusted data). In other words, persons not in the labor force as a percentage of total population increased by about 2.4%, from 34% to 36.4%. The majority of this increase (1.9% out of 2.4%) represents persons who do not want a job, providing a proxy for how much of the labor force participation decline has been structural. Besides, most of those who do not want a job are 55 years and over, reinforcing the view that the aging of the baby boomer generation has led to an increase in the rate of retirement, contributing to the decline in the labor force participation rate since the 2008-09 recession. Only 0.6% of out the 2.4% decline in the labor force participation rate is attributed to persons who want a job, suggesting that the cyclical decline in the labor force participation has been essentially smaller than the structural (Figures 1.17 & 1.18).

Figure 1.17



Source: Bureau of Labor Statistics, Eurobank Research

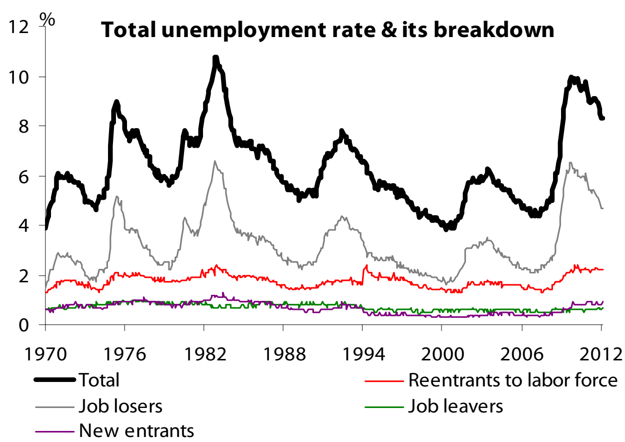
Figure 1.18



Source: Bureau of Labor Statistics, Eurobank Research

To sum up, the decline in the labor force participation rate since December 2007, when the latest recession started, has been due to structural as well as cyclical forces. The aging of the population will keep pushing towards lower labor force participation. Although there should be some cyclical rebound in the participation rate as the recent strength in the labor market should encourage more potential workers to join the labor force, the upward pressure from new entrants will not fully offset the downward trend driven by demographic factors. The participation rate may increase slightly in the following months as previously discouraged job seekers enter the labor force, but in the medium term the participation rate is expected to keep on falling due to the exit of older workers from the labor force. The exit of old workers exerts downward pressure on the unemployment rate, as lower labor force growth means that less employment growth is necessary to keep the unemployment rate stable. Hence, we do not believe that a large come back of job seekers to the labor force will reverse the downward trend in the unemployment rate. Meanwhile, unemployed re-entrants as a share of the civilian labor force has already increased from its recent trough of 1.3% in mid-2007 to 2.2% in February 2012, and does not seem to play a determinant role in the development of unemployment rate dynamics. Figure 1.19 portrays the breakdown of the unemployed with regards to reasons for unemployment to job losers and persons who completed temporary jobs, job leavers, re-entrants and new entrants. The Figure suggests that movements in the rate of unemployment have historically been driven mainly by fluctuations in the number of workers that have lost their job and looked for a new position.

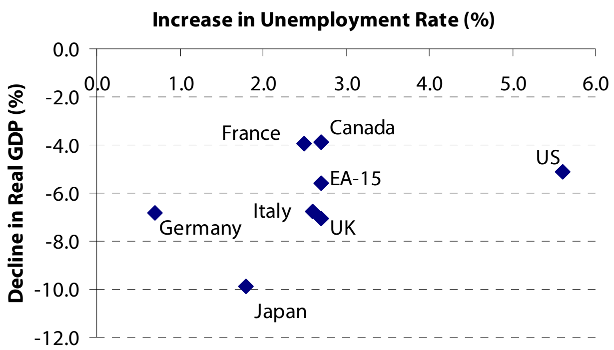
Figure 1.19



Source: Bureau of Labor Statistics, Eurobank Research

Figure 1.20

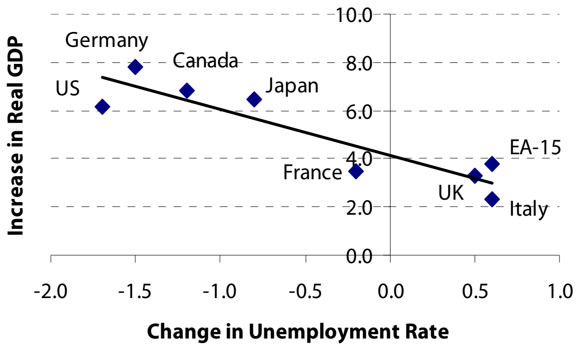
The impact on GDP & Unemployment during the 2007-09 recession



Source: OECD, Ecowin

Figure 1.21

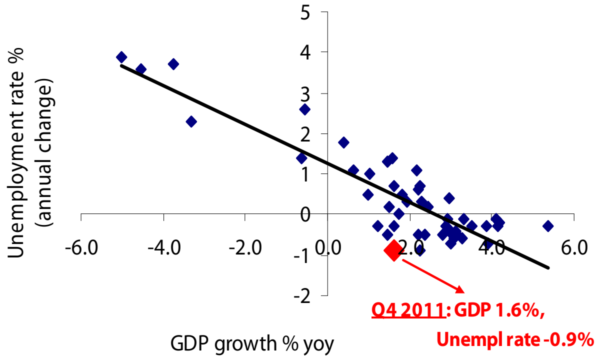
The impact on GDP & Unemployment during the 2009-11 recovery



Source: OECD, Ecowin

Figure 1.22

US: Relationship between change in economic activity and unemployment (2000-2011)



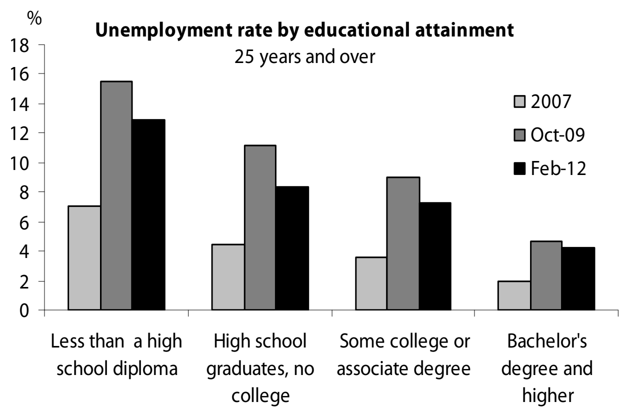
Source: Bureau of Economic Analysis (BEA), Bureau of Labor Statistics (BLS)

The relationship between economic and employment growth

Although the US had one of the lowest unemployment rates among major advanced economies in the prior two decades before the 2007-09 recession, it actually experienced the largest increase in the unemployment rate among G7 countries and EA-15 as a whole. However, the sharp increase in the unemployment rate of about 5.6% was not proportional to the relatively small decline in the US real GDP of about 5.0%. Although the US reported the third smallest decline in real GDP among major advanced economies (after Canada and France), it actually experienced the largest increase in its unemployment rate (Figure 1.20). The same story exists for the 2009-2011 recovery period; the US experienced the largest decline in the unemployment rate, while it has not reported such a large increase in its real economic activity (Figure 1.21).

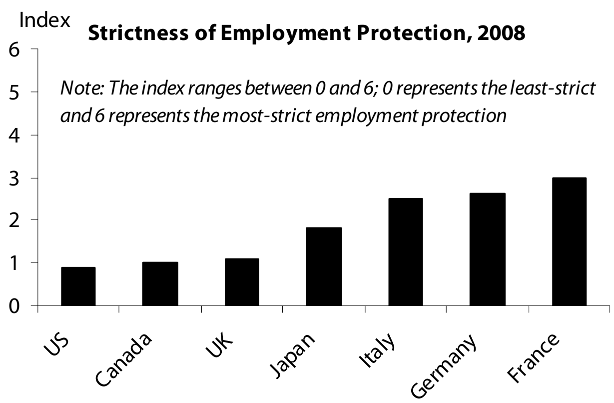
The historical relationship between movements in the unemployment rate and real GDP growth, known as Okun's law, has broken down since the latest recession. According to Okun's law, when the economy increases faster/slower than its long-run trend, the unemployment rate falls/increases by about half as much as the gap between the actual and the potential GDP growth in percentage points. For example, 2011 GDP growth of 1.7% y-o-y, which was about 0.8% above a long-run trend of 2.5%, would normally bring down the unemployment rate by 0.4% in 2011, a low estimate compared with the actual decline of 0.9% reported in 2011 (Figure 1.22).

Figure 1.23



Source: Bureau of Labor Statistics, Eurobank Research

Figure 1.24

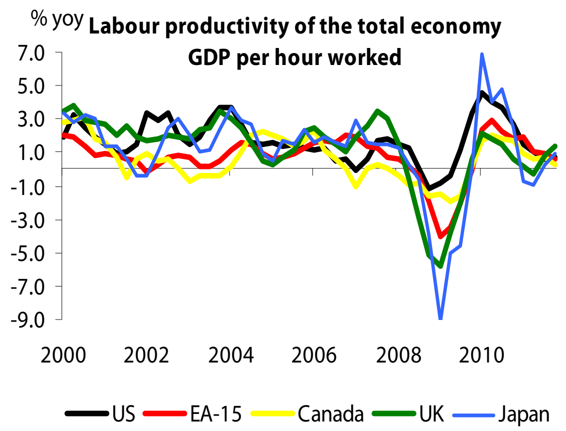


Source: OECD

One explanation for the deviation from Okun's law could be the massive layoffs that occurred during 2008 and 2009 and, consequently, the reversal of these layoffs during the 2010-2011 recovery. Looking at the employment status of the civilian population (25 years and over) by educational attainment, we find that low-skilled workers are affected the most during a typical recession. Figure 1.23 shows that the unemployment rate for people with less than a high school diploma increased by 8.4% from 2007 to October 2009, while the corresponding increase for people with bachelor's degree and higher was only 2.7%. The massive layoffs, which were largely concentrated in workers with a lower level of education, suggest that business managers are more able to lay off workers in the US compared to other advanced economies. The Organization for Economic Co-operation and Development (OECD) has constructed an index to measure the strictness of employment protection for G-7 countries, based on a set of employment protection indicators that measure rules and costs concerning layoffs and the use of temporary contracts. As is evident in Figure 1.24, the US do have the least-strict employment protection, a significant factor that gives firms the flexibility to shed workers or hire temporary workers.

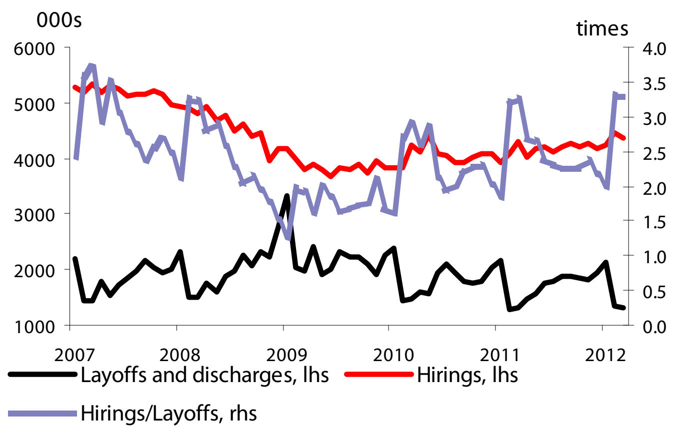
Outsized job losses during the most recent recession and the reversal of these layoffs that accompanied the recovery are highly correlated with shifts in productivity growth. The US experienced a relatively small decline in labor productivity growth compared to other advanced economies during the recession, allowing firms to economize on labor (Figure 1.25). Labor productivity growth in the US has increased well above labor productivity growth in the EA-15 or other advanced economies (with the exception of Japan) during the first year of the recovery, but has slowed significantly since mid-2010, resulting in more job growth per unit of output.

Figure 1.25



Source: OECD

Figure 1.26



Source: Bureau of Labor Statistics, Eurobank Research

An alternative explanation for the relatively strong payroll growth from December 2011 until the first quarter of the year is that exceptionally warm winter weather may have boosted employment both in absolute terms and relative to economic activity compared to previous years. The minutes of the March 13 FOMC meeting revealed that several participants acknowledge that unseasonably warm weather may account for a portion of the recent improvement in employment indicators. The ongoing weather payback over the last couple of months could contribute to a more moderate pace of payroll growth, reducing the discrepancy between GDP and employment growth.

Meanwhile, as Chairman Ben Bernanke highlighted in a recent speech on the labor market, the increase in the employment growth since the end of the recession has been largely attributed to a significant decline in layoffs but only a moderate improvement in hiring. Looking at the balance between hirings and firings (Figure 1.26), we conclude that the ratio of hirings to layoffs has declined from 3.7 at the beginning of 2007 to 1.3 at the beginning of 2009, not only due to a decline in hirings (-1179k) but also due to a sharper increase in layoffs (+1889k). Two years later, although hiring has remained essentially flat, the ratio has trended upwardly to 3.2 on the back of a reversal of the unusually large layoffs that occurred since 2007 (-2059k). The ratio of nonfarm hirings to layoffs has declined to 2.0% at the beginning of 2012 and currently stands at the level of 3.3, mainly due to a decline in layoffs as hirings have improved modestly. Hence, further significant improvement in the labor market should be accompanied by an acceleration in the hirings rate and, consequently, a faster expansion of production and demand from households and businesses. Our GDP growth forecast for 2012 is close to the US economy's average growth during the last decade, suggesting modest and gradual progress reducing unemployment. We expect the unemployment rate to move slightly lower, averaging at around 8.1% in 2012 from 8.9% in 2011.

2. The Euro area economy

Dimitris Malliaropulos, Vasilis Zarkos

- We expect a slight contraction in Q2 to be followed by weak rebound in the second half of the year. Our economic outlook relies on the assumptions of abating financial tensions, solid global demand and accommodative monetary policy by the ECB.
- Fears of disruptive events in the euro area have resurfaced due to political instability in Greece and tensions in the Spanish banking sector. Political will for burden sharing remains weak, therefore we expect further muddling through on fundamental issues. Nonetheless, in our baseline scenario, the euro area will remain intact, i.e. we see no Greek exit from the monetary union.
- Austerity-growth balance is required to ease the pain of adjustment in the periphery. Growth initiatives in the short term could render fiscal austerity and unpopular reforms more feasible from both a political and a social point of view.
- The ECB should remain active in the stabilization of sovereign and financial markets to safeguard the euro. Progress towards a lasting solution to the euro area woes in the upcoming EU summit would facilitate action by the ECB.

Slight contraction in Q2 to be followed by weak rebound in H2 2012.

We expect the euro area economy to experience a shallow recession in 2012 due to the ongoing sovereign debt crisis and simultaneous deleveraging of the private and public sector. We have lowered our forecast for GDP growth in 2012 to -0.3% from a flat reading three months ago, as intensified downside risks are expected to restrain confidence of economic agents. Our baseline scenario relies on the assumptions that the debt crisis will remain contained and the ECB will maintain its accommodative policy to mitigate the negative effects of frontloaded fiscal adjustment across the monetary union.

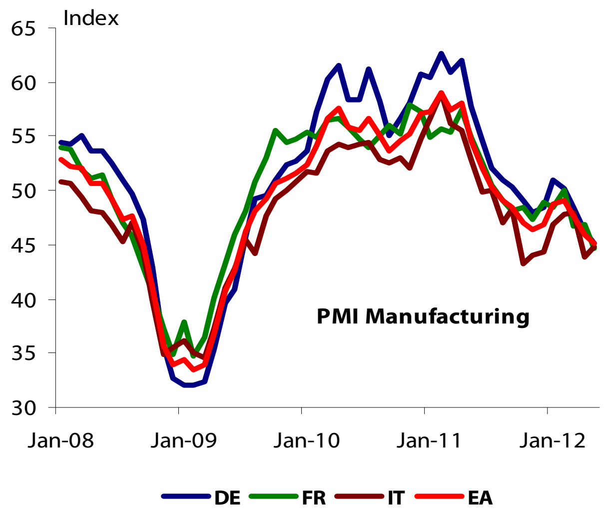
The euro area avoided a technical recession around the turn of the year, as GDP growth in the first quarter surprised on the upside posting zero growth. This was mainly due to firmer private consumption and export growth in Germany. Abundant liquidity provision through the ECB's 3-year operations has led to a period of complacency in the first months of the year, with leading indicators beating expectations. However, the respite proved to be short lived. Markets' concerns have been refueled by political instability in Greece, which have raised the likelihood of an imminent Greek exit from the monetary union. Meanwhile, doubts over Spain's ability to restructure its banking sector, while simultaneously keeping its debt dynamics in check, have intensified. Spain's failure to contain budget slippages in the autonomous regions resulted in a budget deficit as high as 8.9% of GDP in 2011, about 50% higher than its target (6%).

The Greek elections stalemate has affected adversely economic sentiment throughout the euro area, as is evident by declining PMI indicators (Figure 2.1), both in the periphery and in core members. The euro area aggregate manufacturing component has plunged to 45.1, its lowest level since June 2009. The gloomy picture revealed by leading indicators bodes well with our projection of a slight contraction of economic activity in the second quarter. Signs of economic recovery are likely to emerge in the second half of the year, on the backdrop of policy response leading to abatement of debt crisis concerns and solid growth in Germany and other parts of the world. Further ahead, economic conditions in the euro area are likely to keep improving in 2013. However, continuing fiscal consolidation and the slowly healing banking sector is expected to allow only for a moderate annual GDP growth in 2013 (0.8%), well below potential output growth.

Credit conditions remain a headwind to the euro area economy, as credit expansion remains anemic in most member-countries. Liquidity provision by the ECB around the turn of the year (ca €1tn) has substantially removed liquidity risk from the ailing banking sector, contributed to the normalization of money markets and averted the risk of a credit crunch. However, excess liquidity has failed to translate to credit expansion. Banks remain reluctant to finance the real economy due to elevated uncertainty. In addition, loan demand by the private sector is weak as households are struggling to reduce their debts and firms have largely postponed their investment plans.

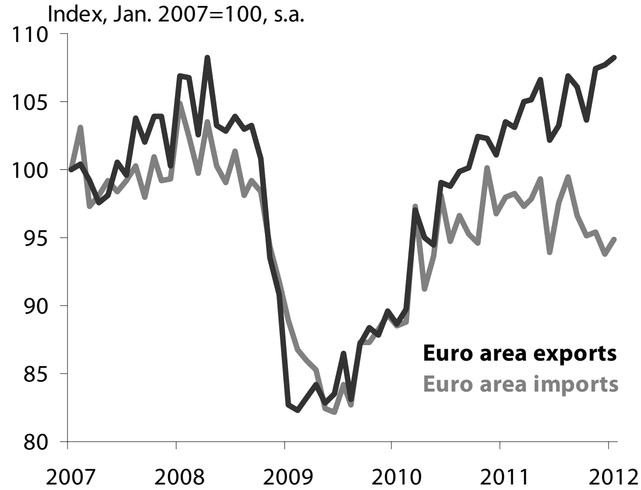
Exports remain the main growth engine for the euro area. Members with particularly open economies, such as Germany and Ireland are expected to benefit significantly from solid growth in the US and several emerging markets. In the Netherlands, export activity is likely to mitigate the adverse impact of a plunge in private consumption, as households try to reduce their indebtedness. A likely acceleration of GDP growth in the US and China in the second half of the year is likely to boost euro area's exports. On the other hand, we expect imports to decline sharply due to subdued domestic demand (Figure 2.2). Overall, we anticipate a substantial contribution to annual GDP growth from net exports in 2012.

Figure 2.1



Source: Bloomberg

Figure 2.2



Source: Eurostat

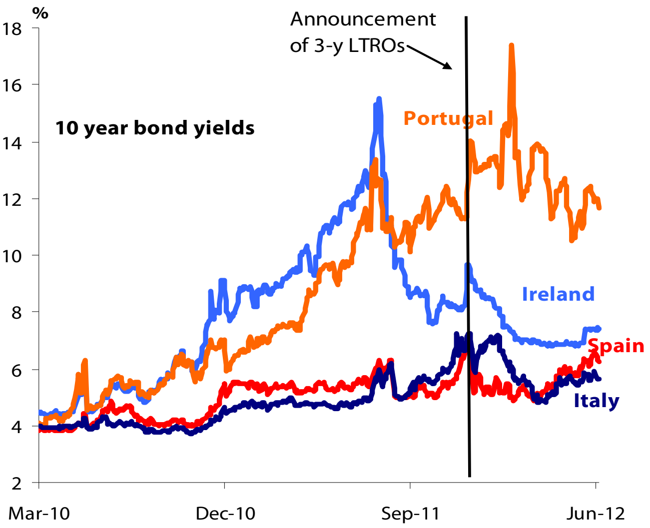
Germany is expected to keep outperforming other euro area members due to a strong production base and healthier fundamentals. German GDP growth is likely to become more broad-based, as large wage increases both in the private and the public sector are expected to encourage private consumption. Pay hikes are likely to reduce households' tendency to save. The saving rate increased in the past decade in large part due to pension and labor market reforms leading to a less generous pension system and lower unemployment benefits. While uncertainty about potential bail outs in the future are likely to obstruct a fast decline of the savings ratio, we expect reduced need for further reforms and record low unemployment to boost German consumers' confidence. To the extent that the recent pay increases signal a new trend, rebalancing of the German economy towards higher domestic demand would facilitate adjustment in embattled periphery members towards a more export oriented growth model. It would also shield the German economy from reduced exports to the rest of the euro area members.

Downside risks have intensified due to political uncertainty in Greece and tensions in Spanish banks.

The sovereign debt crisis has recently escalated (Figure 2.3) due to political uncertainty in Greece. The inconclusive result of the early May legislative elections showed anti-austerity parties gaining significant traction, illustrating voters' austerity fatigue. A potential failure of the Greek electorate to send a clear cut result in the new round of elections in June 17 will intensify fears about the country's ability to preserve its membership in the monetary union. The increased likelihood of a Greek exit and the shockwaves such an event could generate around the world has caused market tensions to intensify. Although we acknowledge that the risk is elevated, in our baseline scenario we do not expect Greece to renege on its obligations and leave the euro. We expect prudence to prevail whether a pro-troika or an anti-troika government is formed, as both the euro area and Greece will enter uncharted territory if Greece departs. A devalued currency would not be enough to solve Greece's deeply rooted economic problems and painful reforms would still be needed. Moreover, a Greek exit would not solve the sovereign debt crisis in the euro area, as the latter would still need to build a complete institutional framework ensuring the proper functioning of the monetary union. It is somewhat reassuring that the vast majority of the Greek population desires to remain in the monetary union. Nevertheless, uncertainty is likely to remain high in the short term as it may take some time until a stable government is formed in Greece. On the positive side, Greek banks have regained access to the ECB operations after the injection of €18bn to strengthen their capital base.

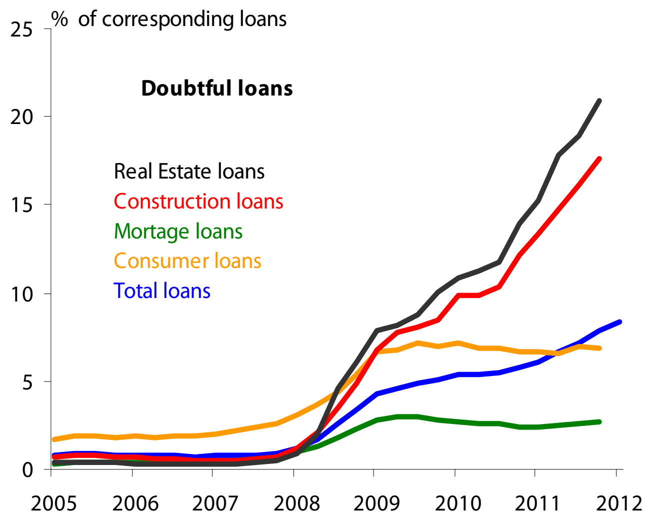
The Greek elections gridlock has reinforced the link between sovereign risk and banking sector tensions in the euro area. Fears that a Greek exit may trigger a deposit flight from banks located in weak countries have intensified. Spanish financial institutions are particularly vulnerable to a loss of depositors' confidence as their strength is eroded by real estate related toxic loans (Figure 2.4). Moreover, the interdependence between banks and sovereigns has gained strength as a result of the recent ECB's 3-year LTROs. The ECB's operations increased banks' capacity to absorb government debt while it offered them the opportunity to secure a profit by borrowing at 1% and investing in government paper at much higher yield. Spanish and Italian banks in particular, have channeled excess liquidity to the sovereign debt market, increasing their exposure to domestic government debt (Figure 2.5).

Figure 2.3



Source: Bloomberg

Figure 2.4



Source: Bank of Spain

The intensification of the Spanish banking sector woes has underscored the imperative need of a pan-European mechanism to monitor, resolve, recapitalize and insure the deposits of banks in the euro area. Given the dramatic capital outflow the country is experiencing, Spain has become the fourth member to receive external financial aid to support its banks. Financial assistance will most likely come through the FROB, the Spanish fund for banks restructuring, weighing on public finances. Should the ESM be allowed to lend directly to banks, bank recapitalization would enjoy two advantages: it would prevent the recapitalization costs from weighing on public finances and stretching even further borrowing costs; it might also accelerate the clean up of the financial sector., as countries would avoid the stigma in the sovereign debt markets, thus incentivating them to ask for assistance for banks in trouble.

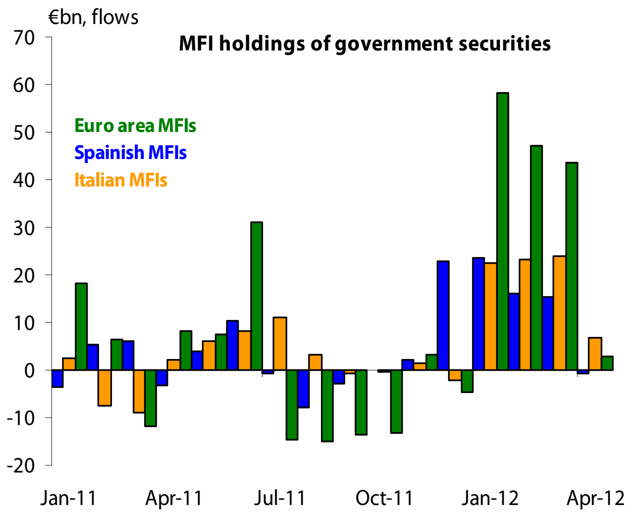
Austerity-growth balance is required to ease the pain of adjustment.

Since the eruption of the sovereign debt crisis, emphasis has been placed on tough frontloaded fiscal austerity expected to serve two goals: a) eliminate moral hazard through the imposition of strict conditionalities for the provision of financial support; b) restore markets' confidence that debt laden euro area members will reign in their public finances. Thus, weak countries are required to embark on fiscal retrenchment and adopt structural reforms. However, rebalancing measures are expected to pay off in the long term whereas in the short run fiscal austerity and structural reforms have intensified the economic contraction. Poor economic activity leads to fiscal slippages which then need additional spending cuts to be addressed, thus feeding a negative cycle between fiscal consolidation and economic recession. As a result, sovereign bond spreads remain elevated, reflecting investors' fears that embattled members of the euro area will fail to restore sustainability of their public finances despite their adjustment efforts.

In addition, voters' distrust about the tough fiscal austerity programs implemented across the euro area has been revealed in recent elections in Greece, France and Italy. Social fatigue due to the short term repercussions of the rebalancing of the economy is quite evident in Greece, where the electorate expressed its discontent with the fiscal austerity imposed by the memorandum in the May elections. Discomfort is likely to rise, as several euro area countries are sliding deeper into recession. Already elevated unemployment among young people (Figure 2.6) exhibits clear signs of further deterioration, with the exception of Ireland where stabilization in labor market overhang is likely due to support from export activity.

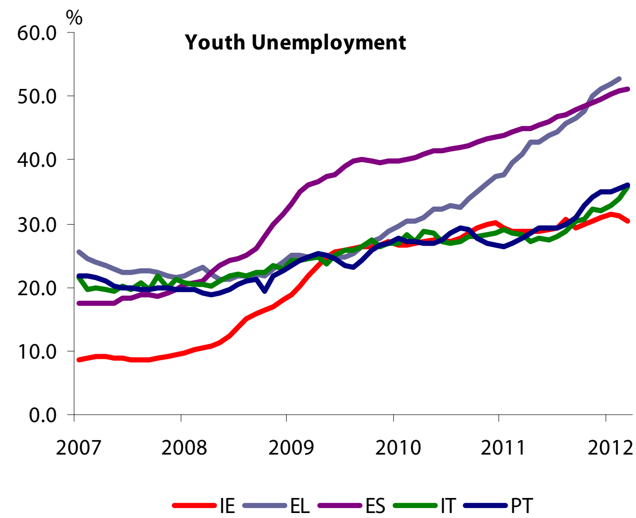
A growth pact, besides the fiscal compact recently set forth emerges as an urgent necessity in order to reignite growth in the euro area, alleviate the adverse short term effect of strict fiscal consolidation on the real economy and contain the rise of unemployment. It is encouraging that sentiment in Europe is changing towards a more balanced austerity-growth policy mixture. Policymakers should coordinate actions to mobilize available EU funds and increase capital of the European Investment Bank to support SMEs as well as infrastructure, energy and high technology plans in the periphery countries. Funds from the EFSF could be allocated to the EIB, for the latter to raise private funds and finance growth projects. We also favor the issuance of euro project bonds targeting infrastructure projects. Project bonds are likely to take the riskiest part of the investment, thus encouraging the participation of private and institutional investors in the infrastructure plans. Nevertheless, details about the growth proposals are still missing, leaving questions about the size of the initiatives and their effectiveness in boosting confidence among households and firms unanswered.

Figure 2.5



Source: ECB

Figure 2.6



Source: Eurostat

Meanwhile, it is essential that policymakers in the periphery countries push through ambitious reform agendas and privatizations in order to recoup lost competitiveness, increase long term growth potential and persuade markets of debt sustainability in the euro area. Policymakers should overcome obstacles set by interest groups and make all efforts to ensure that the adjustment burden is fairly distributed. We believe that initiatives to support economic growth in the short term, along with a reduced pace of fiscal consolidation, could render fiscal austerity and unpopular reforms more feasible from both a political and a social point of view.

A clear vision towards enhanced fiscal integration is needed to complement the monetary union. Growth initiatives along with prospects of banking and fiscal union may be discussed in the upcoming EU summit. Decisions on growth initiatives are likely. However, in our view, discussions are unlikely to deliver any concrete results with respect to fiscal and banking union. The sovereign debt crisis will most likely keep lingering, given that creditor core countries tend to yield the least possible ground each time assistance is required. We believe it will take a long time until the issuance of the first euro-bond takes place, as Germany will not consent to public debt mutualization before enough sovereignty is surrendered in favor of centralized fiscal governance. On the other hand, debtor countries will have a hard time accepting reduced sovereignty in favor of enhanced federalism. Hence, we expect temporary responses to banking stresses and the debt overhang, which although they may calm markets, they will fall short of resolving fundamental weaknesses.

What the ECB can do

Thus far, the ECB has proven the quickest, the most reliable and efficient institution to contain the sovereign debt crisis. Clearly, the ECB alone cannot solve the crisis, as was evident by the short-lived assuaging effect of its 3-year LTROs.

Nonetheless, the ECB should remain active in the stabilization of sovereign and financial markets in case of adverse developments. Comments by Mr. Draghi that bold governmental action is required suggests that progress in the upcoming EU summit later in June will facilitate action by the ECB, We state below actions the ECB can take to safeguard the euro:

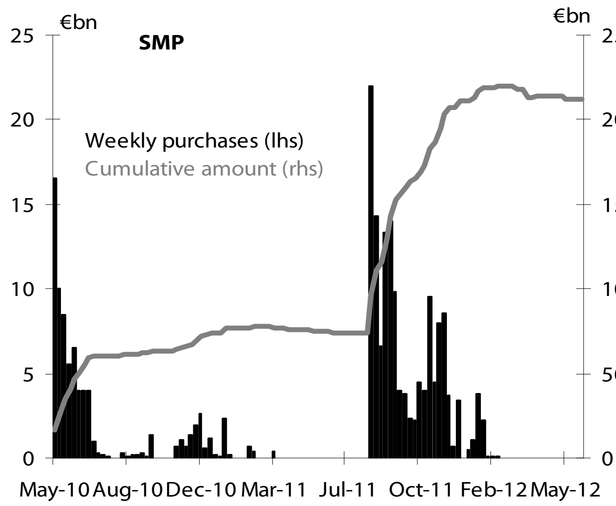
i) Maintain accommodative monetary policy (very likely). In our view, the ECB will keep its policy rate unchanged at 1% until at least the end of 2013. However, further rate cuts should not be excluded if tensions aggravate. The ECB may also express commitment to keep rates low for a prolonged period of time. That said, the effect of conventional monetary easing is limited, given tight credit supply conditions and low demand for loans by the private sector.

ii) Inject additional liquidity through unconventional measures (quite likely) (Figure 2.7). Provision of liquidity seems to be the first line of defense in the event of bank runs or in the event Spanish or Italian bond yields soar up to levels observed last November i.e. higher than 7%. With Spanish yields very close to that level, additional liquidity provision is likely to be announced in the ECB's next meeting in July. Nevertheless, the vicious circle between banking sector woes and tensions in the sovereign debt market poses limitations on how much sovereign debt banks would be willing to accumulate. Moreover, the ECB might find difficulty in justifying additional long-term operations, as bank funding issues, the official target of exceptional liquidity provision, has been to a large part addressed.

iii) Reactivate the Securities Market Program (unlikely) (Figure 2.8). The ECB's highly controversial SMP program has risen significantly last summer, when the central bank started buying Spanish and Italian bonds to calm markets but ever since it remains dormant. Yet, it is not finished and remains the most effective ammunition in the possession of the ECB. On the negative side, the more sovereign debt the ECB accumulates the more it adds to the fragmentation of the government bond market, as the ECB enjoys a preferred creditor status, thus shying away private investors. The recent exemption of the ECB from the Greek PSI losses adds to subordination concerns.

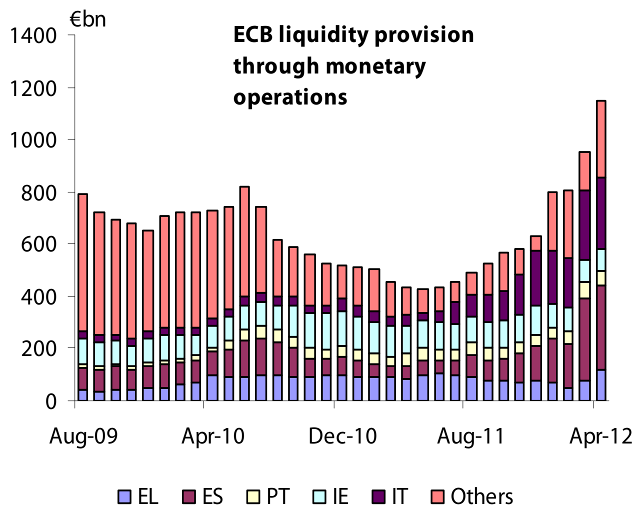
iv) Lend to the ESM to recapitalize banks (very unlikely). As already mentioned, abundant liquidity injection by the ECB is quantitative easing in disguise. While this way the ECB circumvents objections arisen by funding governments directly through bond purchases, it transforms sovereign risk into banking insolvency risk. As a result, the ECB may be required to lend the ESM to recapitalize monetary institutions.

Figure 2.7



Source: Bloomberg

Figure 2.8



Source: ECB

3. The Japanese Economy

Dimitris Malliaropulos, Vasilis Zarkos

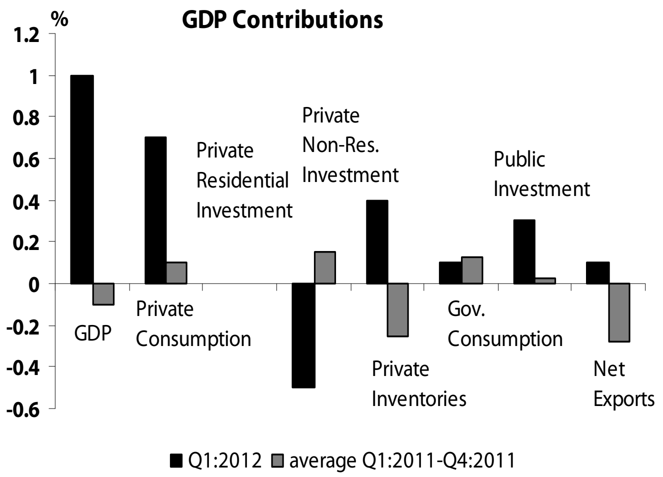
- The Japanese economy will likely outperform its G3 peers due to public investment in the disaster afflicted areas. GDP growth may have peaked in Q1 and is likely to recede to a more sustainable trajectory in the following quarters.
- Downside risks stem mainly from intensification of the sovereign debt crisis in Europe and likely energy shortages which could obstruct industrial production in the summer. While muted for the time being, concerns about the unsustainable public finances are brewing.
- The Bank of Japan is likely to increase further its Asset Purchase Program to fight deflation and contain appreciation pressures on the yen.

Japan will likely outperform other developed economies due to reconstruction

Following a stall in the last quarter of 2011, real GDP grew by 4% annual rate, significantly above expectations (Figure 3.1). The main drivers of the economic rebound were private consumption and a jump in public investment. Subsidies for the purchase of eco-friendly cars supported consumption of durable goods, while public fixed investment benefited from reconstruction in the disaster hit areas. Revived net exports also printed a positive contribution, as firms benefited from restoration of supply chain disruptions caused by floods in Thailand.

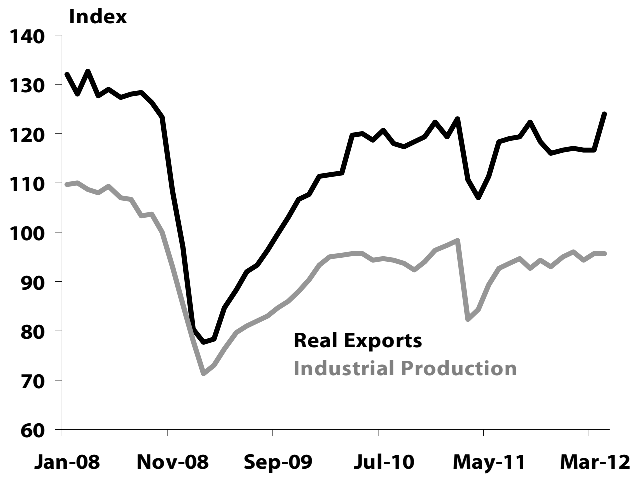
A strong boost from reconstruction is expected to partially shield Japan from external developments, which traditionally affect considerably the country's economic activity. As a result, Japan is expected to outperform other major developed economies in 2012, many of which experience fiscal consolidation. The PMI manufacturing Index has been broadly stable slightly above the expansion threshold (i.e. 50). Hard data corroborates the strength of the economy, as is evident by pick up in exports and resilient industrial production (Figure 3.2). In Q2, industrial production is likely to fall due to uncertainty in Europe. However, baring an escalation of turmoil in the euro area front, solid growth in the US and China are likely to boost Japanese exports. A rise in machinery orders suggests that, private capital expenditures are likely to rebound after a decline in Q1.

Figure 3.1



Source: Cabinet Office

Figure 3.2



Source: Bloomberg

Looking forward, the Japanese economy is likely to recede to a lower growth trajectory, as the sources of growth that played out in Q1 are of temporary nature. Both exports and public capex overshot expectations in Q1, however, they are likely to grow at a more sustainable pace in the following period. In addition, the eco-car program, which came into effect last December keeping consumption brisk in Q1, is set to expire in August, suggesting a decline in private spending in the second half of the year. In 2013, GDP growth is likely to grow at a lower pace as public investment will turn into a drag for the economy, while the absence of fiscal stimulus will no longer support private consumption. In addition, households' purchasing power will likely be constrained by income tax hikes and higher energy prices

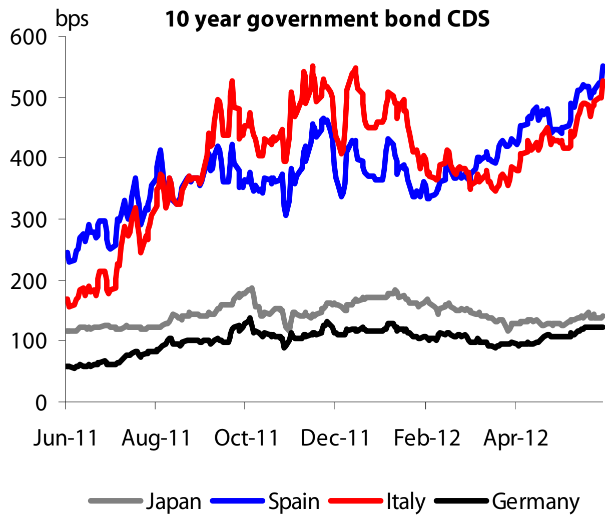
Japan faces both domestic and external downside risks

Tensions in the euro area affect adversely Japanese exports as risk-off sentiment strengthens the yen which enjoys safe heaven status. According to our baseline scenario which excludes a Greek exit, the impact of the recent escalation in the sovereign debt crisis on the overall GDP growth in Japan will be muted due to strong public investment. In the positive scenario that sovereign crisis woes in Europe will have been meaningfully addressed by the time the boost from reconstruction fades, the Japanese economy may benefit from solid external demand and domestic private capex.

Likely electricity shortages remain a downside risk for industrial production over the summer. All nuclear plants which provided about 30% of the electric energy are shut down, while reactivation plans are unclear. The government plans to address shortages by shifting production from high demand to low demand hours and encourage power savings in households.

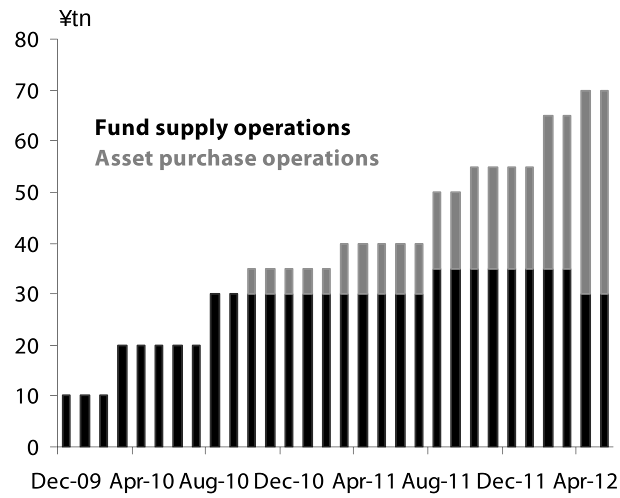
Longer term concerns stem from unsustainable public finances, which are expected to be adversely affected by government expenditures due to reconstruction. Gross public debt has surpassed 200% of GDP, while the economy keeps producing large budget deficits. While the debt crisis in Europe overshadows fiscal excesses in Japan (figure 3.3), the recent downgrade of the sovereign rating by Fitch came as a reminder of the rising discomfort on the Japanese debt level. Recent talks about doubling consumption tax from 5% currently by 2015 is a step towards the right direction but a rapidly ageing society implies that more drastic spending cuts are required to achieve primary surpluses.

Figure 3.3



Source: Bloomberg

Figure 3.4



Source: Bank of Japan

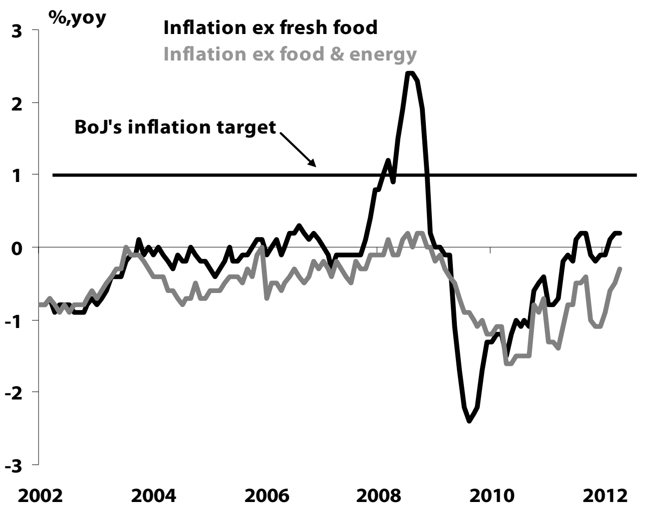
The BoJ is expected to deliver more QE to fight deflation.

The Bank of Japan is expected to maintain its accommodative monetary policy to contain appreciation pressures on the yen and ensure the country will ultimately escape deflation. Since the beginning of the year, the Bank has already expanded twice its Asset Purchase Program (APP), which consists of Fed-type outright bond purchases and ECB-type liquidity provision against pooled collateral. An expansion of Japanese government bond purchases announced in February by ¥10tn was followed by additional increase in the purchase of JGBs by an equal sum in April. To aim smooth conduction of bond purchases the BoJ has also extended the maturity limit to 3 years from 2 years previously. Bond purchases have also been extended until June 2013 (previously scheduled to finish by December 2012). Overall, taking also into account the reduction of liquidity provision by ¥5tn, the APP currently stands at ¥70tn (Figure 3.4).

In our view additional monetary expansion of the APP is required to fight deflation (Figure 3.5). In its recent Economic Outlook, the BoJ anticipates core inflation (i.e. excl. fresh food) of 0.7% in the fiscal year 2013. This is close to the Bank's goal of 1% set in February, implying that the BoJ will likely remain on hold in the short term. Moving to the sidelines also helps the BoJ to contain markets' perceptions that having set an inflation goal implies automatic action by the Bank to achieve it. Nonetheless, in our view, the BoJ's expected inflation for next year seems overestimated. If the BoJ is committed to achieve its inflation goal, additional expansion of its asset purchases in the medium term should be anticipated. In addition, political pressure for additional easing will remain high and the BoJ will very likely keep giving in.

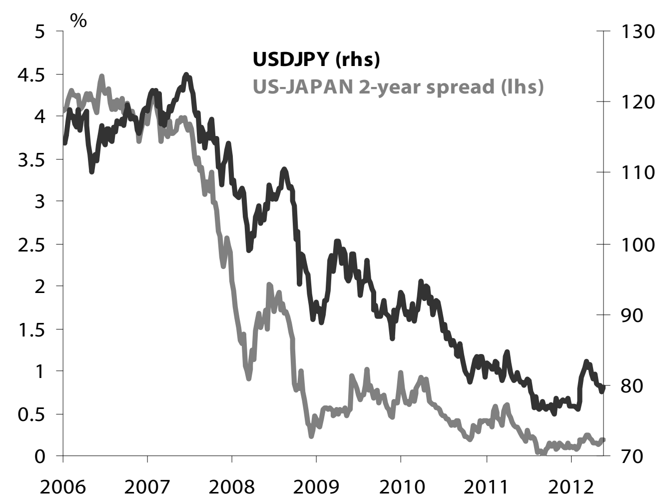
Additional monetary action may be precipitated by a third round of QE by the Fed, in the event US data deteriorate sharply or policy response in Europe fails to contain the crisis. The USD/JPY cross is strongly correlated with yield differentials between US and Japanese bonds (Figure 3.6). Even if the Fed remains on hold, we see scope for the BoJ to expand its bond purchases to widen yield differentials and boost yen depreciation. More aggressive easing could include increasing the ceiling of the APP, the monthly pace of purchases as well as the maturity limit of bond purchases.

Figure 3.5



Source: Bloomberg

Figure 3.6



Source: Bloomberg

4. Emerging Markets

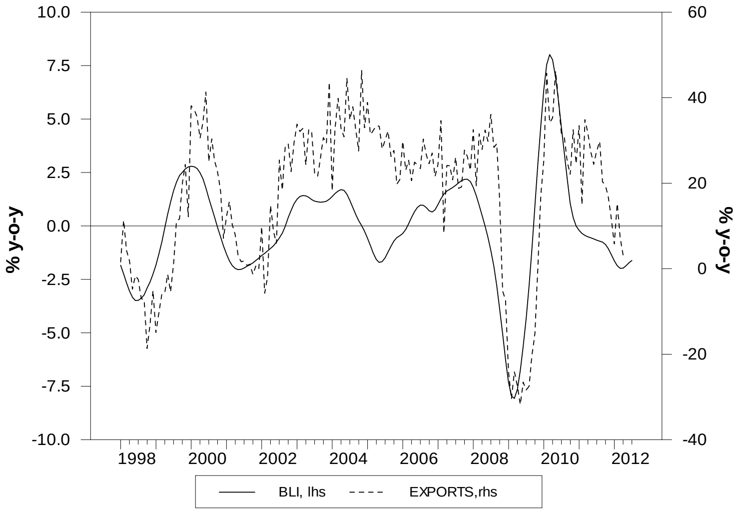
Dimitris Malliaropulos, Maria Prandeka

- With the global economic environment deteriorating over the second quarter of the year and domestic conditions softening, emerging markets' activity has been surprising to the downside.
- Recent data on economic sentiment indicators across all EM regions point to some improvement in economic activity over the next six months.
- The main challenge of emerging economies is the negative spillover from the situation in Europe that is weighing on EM through the trade and capital flows channels.
- We expect EM's exports to recover gradually in the second half of the year, as global economic growth is expected to pick up over this period. However, annual growth rates of exports are likely to remain relatively modest. Risks remain to the downside as long as the recovery in the global economy remains fragile.
- Net private inflows to emerging markets are expected to decline further in 2012, as there are elevated risks for a further intensification of the situation in Europe that would trigger new capital outflows.
- Easing inflationary pressures and a broad-based slowdown in global growth has led central banks in most EM to loose monetary policy. The latter is expected to remain supportive of growth, helping stem the deterioration in credit conditions.
- A deeper recession in the euro area constitutes the main risks to our emerging markets outlook.

Economic activity undermined mainly by renewed tensions in Europe

With the global economic environment deteriorating over the second quarter of the year and domestic conditions softening, emerging markets' (EM) activity has been surprising to the downside. With regard to the global backdrop, the main issue is the negative spillover from the situation in Europe that is weighing on EMs through the trade and capital flows channels. The sharp decline of European import demand has played a significant role in dampening EM's export growth (Figure 4.1). 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 as long as tail risks remain in Europe. Generally, we expect EM's exports to recover gradually in the second half of the year, as global economic growth is expected to pick up over this period. This is also confirmed by our BRIC's leading indicator which has improved slightly over the past month (Figure 4.1). However, annual growth rates of exports are likely to remain relatively modest and below historical standards. Generally, risks remain to the downside as long as the recovery in the global economy remains fragile and, thus, vulnerable to sudden shocks, all of which could dampen global demand.

Figure 4.1
BRICs Leading Indicator* & Exports



** 3 month forward*

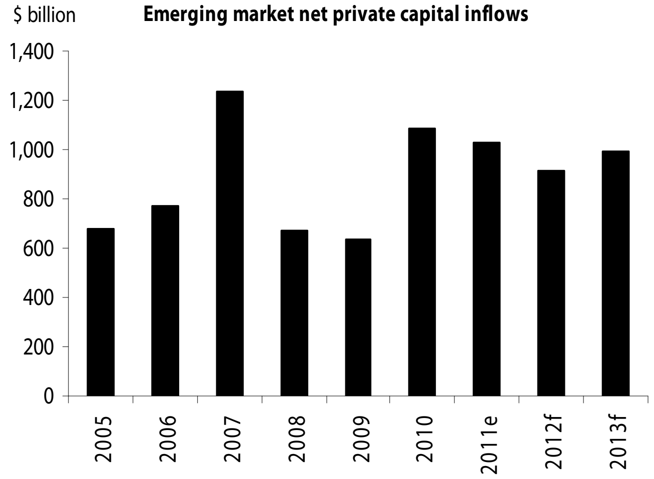
Source: Eurobank EFG

Capital flows to remain quite subdued in 2012

Meanwhile, capital flows to emerging markets fell in 2011 compared to 2010, 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 $1030 bn in 2011, down from $1,088 bn in 2010 (11.4% below those recorded in 2011) (Figure 4.2). For 2012, net private inflows are projected to decline further to $912 billion, as there are elevated risks for a further intensification of the situation in Europe that would no doubt trigger new capital outflows. 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 for a second consecutive quarter in Q4 2012 compared with the previous quarter by a total of about $158 billion (Figure 4.3). Overall, in the second half of 2011, European banks' claims on EM economies decreased almost $400 billion. This was the biggest cumulative decline since 2008.

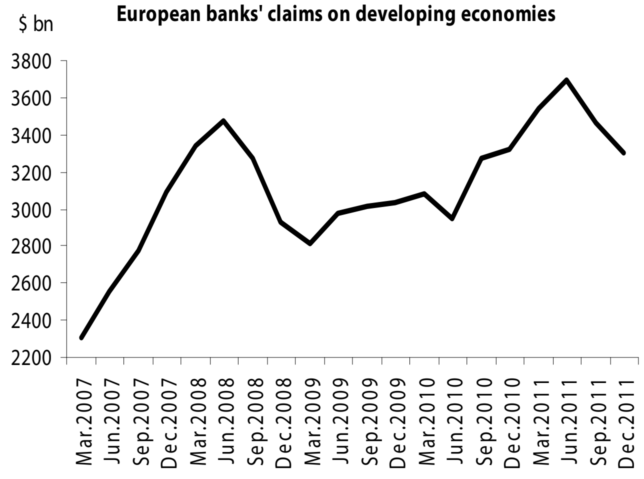
Regarding portfolio investment, concerns about the risk to growth from the deteriorating global economic environment weighed on investors' sentiment since March, leading to a flight to safe heaven assets, such as the US dollar. Emerging market equities underperformed developed market equities by almost 8% since early-March (Figure 4.4). We believe that as long as the global economic backdrop is unsustainable, risk aversion will remain and, consequently, appetite for EM risk will be weakening.

Figure 4.2



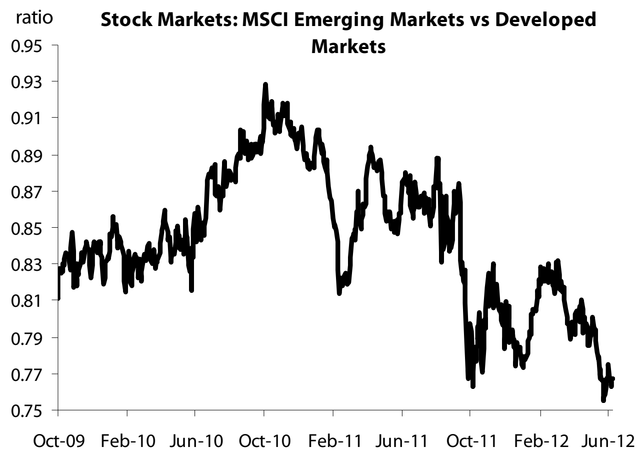
Source: IIF

Figure 4.3



Source: BIS

Figure 4.4



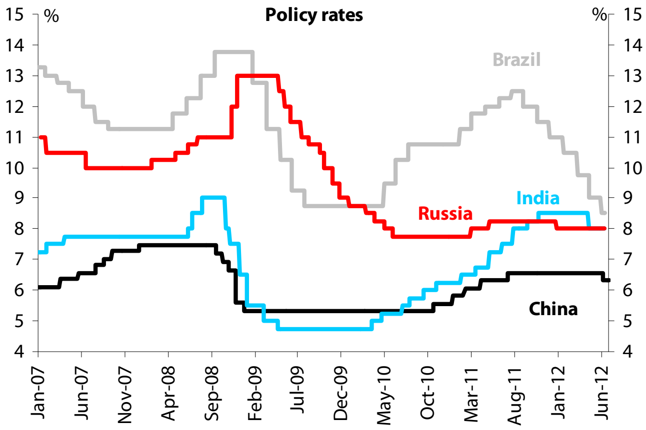
Source: Bloomberg

Monetary policy supportive for growth, helping stem the deterioration in credit conditions

Easing inflationary pressures and a broad-based slowdown in global growth has led central banks in most EMs to either hold interest rates or ease (Figure 4.5). Average headline inflation across major EM economies has started to lose momentum during the second half of 2011 and into 2012, 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 (Figure 4.6). Average inflation eased to 4.6% over the first four months of 2012 from 6.0% in 2011. The relative stabilization of oil prices and a weakening in the pace of global growth is expected to maintain the slowing path of inflation this year. This creates significant room for monetary policy to support growth.

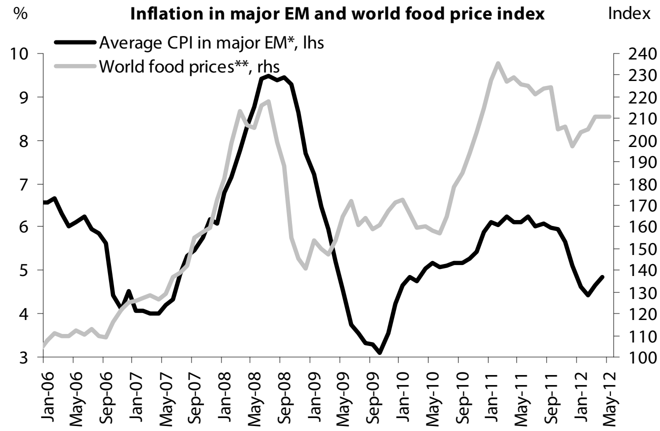
Encouragingly, the pace of the deterioration in EMs credit conditions has eventually started to ease in Q1 2012, according to the latest EM Bank Lending Conditions Survey conducted by the Institute of International Finance (IIF). Specifically, although the IIF index of emerging markets bank lending conditions remained below the threshold of 50 that indicates deterioration, it rose to 48.6 in Q1 2012 from 44.7 in Q4 2011. This was the first increase since the third quarter of 2010. It seems that policy measures taken by central banks in both emerging and developed economies have helped to this development. The most significant improvement in external funding conditions has occurred in emerging Europe, which was the region that suffered the most due to its close links with the euro area. Apparently, abundant liquidity provision through the ECB's 3-year operations enabled some banks in the region to access international funding more easily.

Figure 4.5



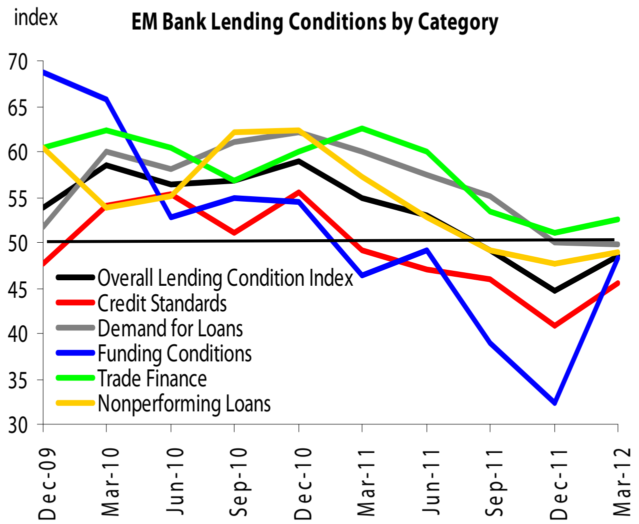
Source: Bloomberg

Figure 4.6



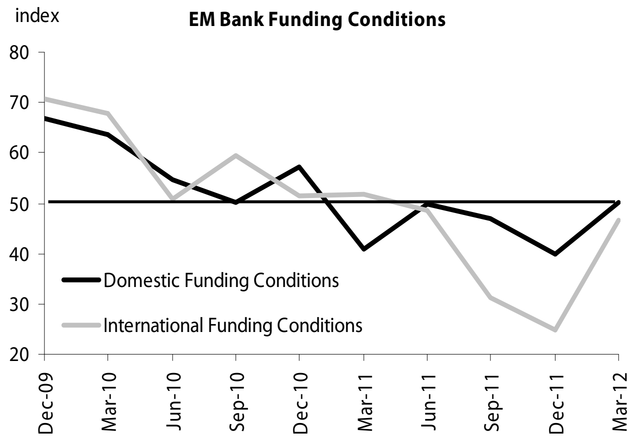
** Brazil, Chile, China, India, Indonesia, Philippines, Russia, Singapore*
*** The Economist Food Price Index*
Source: Ecowin

Figure 4.7



Source: IIF

Figure 4.8



Notes: Values above 50 indicate improving conditions. Values below 50 indicate deteriorating conditions. The sample size more than doubled in 11Q1, introducing a statistical break in the data.
Source: IIF

Growth in most EM economies is expected to pick up in the second half and remain relatively 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. Their relatively healthy fiscal situation leaves them room to provide a cushion for growth in the event of a sudden shock to their economies. Growth in most of the EM world is expected to rebound in the second half of the year, thanks in part to the lagged effects of monetary policy easing. Indeed, recent data on economic sentiment indicators across all EM regions point to some improvement in economic activity over the next six months (Figure 4.9). According to the latest IMF forecasts[3], in 2012 growth in emerging and developing economies is expected to moderate to a still buoyant rate of 5.7% from 6.2% in 2011 and rebound slightly to 6.0% in 2013. The

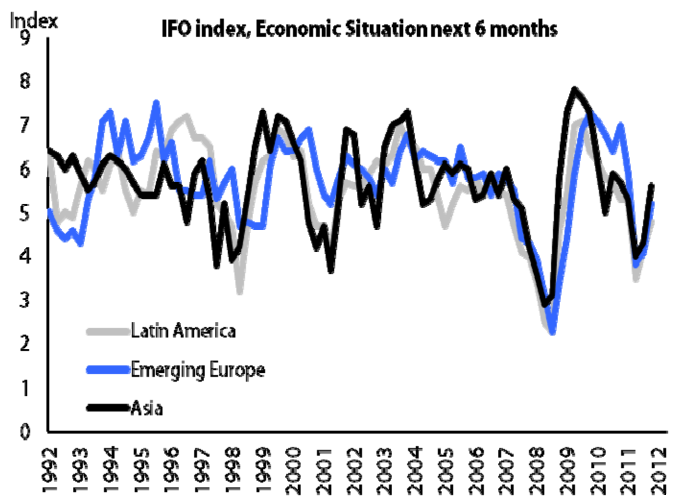
[3] *IMF, World Economic Outlook Update, April 2012*

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 7.8% in 2011 (Figure 4.10). China will continue to play the most important role in the region and robust domestic demand will spread from the country to its Asian peers. The regions high reliance on exports means that its countries are vulnerable to a prolonged softening in global demand. In Latin America, growth will be supported by sound macroeconomic policies and resilient domestic demand. However, subdued growth in the US –a key trading partner- during the remainder of 2012 will weigh on the region's growth. Moreover, a sharper than expected slowdown in China would also create downside risks, particularly for the commodity exporters in the region. Emerging Europe is the region most exposed to the troubles in the euro area, with negative implications for trade, investment and bank financing. Therefore, its economic performance in 2012 will rely mainly on the depth of the euro area's recession expected in the second quarter of the year.

Major risk to our emerging market outlook: *a deeper recession in the euro area*

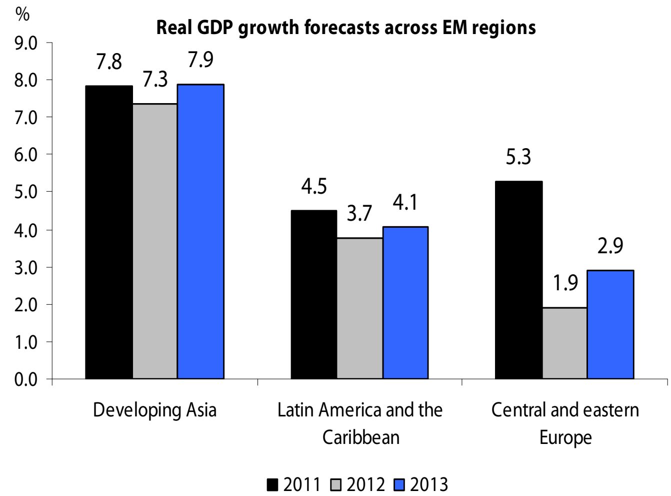
The situation in Europe presents a significant source of risk going forward. Should conditions in the euro area deteriorate sharply, GDP growth in emerging economies would be much weaker than expected, reflecting mainly a drying up of international capital flows, trade effects and a significant degree of deleveraging of European banks. In particular, risk aversion could escalate further and international capital flows could decline even more. The economies that are more exposed to a sudden stop of capital flows are the ones that have witnessed the greatest capital inflows over the past few years. 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 4.9



Source: Ecowin

Figure 4.10



Source: IMF

4.1 China Economic Outlook

Dimitris Malliaropulos, Maria Prandeka

- In the first half of 2012 growth momentum has been particularly weak, creating heightened worries about a possible hard landing of China's economy.
- The main reasons lying behind the weakness of economic activity were the slowdown in external demand and the lingering impact of monetary policy tightening since October 2010.
- Investment and net trade were the major drags on growth, while robust consumption growth helped cushion the negative impact on the economy.
- After tightened during most of 2011, the macro policy stance was eventually relaxed towards the end of the year, but only incrementally. Tight credit conditions along with the significant slowdown in growth since the beginning of the year has caused concerns among policymakers that a hard landing of the economy would be an increasing risk, if there was no change in policy stance. As a result, policymakers have accelerated the pace of loosening recently so as to ensure a significant pick up in the level of activity growth.
- We expect economic policy to remain supportive of growth. However, a big stimulus seems unlikely, unless economic conditions deteriorate further.
- Barring a collapse of the property sector and a deeper recession in the Euro area, we expect China's growth to pick up during the second half of the year, after bottoming in Q2, as policy loosening will start to show its impact on the real economy more visibly. Our main scenario is a soft landing for the economy, with growth moderating to 8.2% in 2012 and 2013 from 9.2% in 2011.
- A greater than expected slowdown in Europe and a sharp correction in the real estate market constitute the main risks to our China economic outlook.

Overview

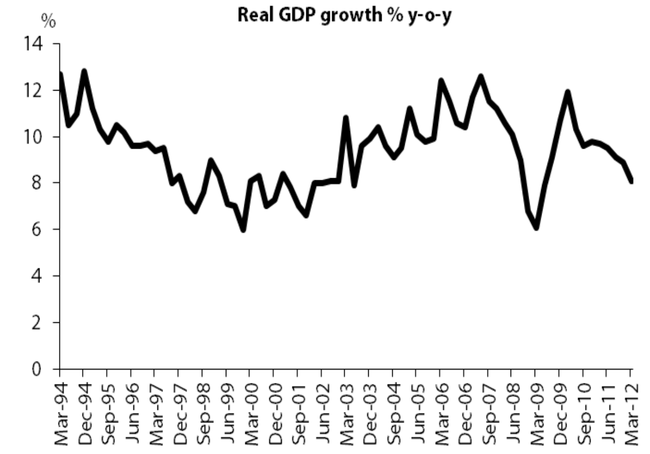
A weaker global economic environment and tighter domestic policy conditions, initiated in mid-2010, led the Chinese economy to a gradual slowdown over the past year, with real GDP growth slowing from 10.4% y-o-y in 2010 to 9.2% in 2011. The slowdown became more pronounced in late 2011 and early 2012 as exports decelerated significantly. Slow growth in advanced economies, particularly in Europe, led to a negative contribution of net exports, as export growth slowed more rapidly than import growth. In addition, the contribution of investment to real GDP growth decreased due to the winding down of earlier stimulus package and government's measures to cool the property market. However, robust consumption growth, underpinned by solid labor market conditions, sustained consumer confidence and growing household income, helped cushion the negative impact of the abovementioned factors on the economy. After tightened during the most of 2011, the macro policy stance was eventually relaxed towards the end of the year to protect growth. More effective policy support combined with the ongoing policy reforms aim at rebalancing the economy is expected to be supportive for domestic demand this year. As fiscal and monetary policy become more expansionary, growth is expected to pick up in the second half of 2012.

First quarter GDP growth disappointing

Although the slowdown in 2011 has been benign, suggesting that China was on course for a soft landing, in the first half of 2012 growth momentum has been particularly weak, creating heightened worries about a possible hard landing of the economy. Real GDP growth declined to 8.1% y-o-y in Q1 2012, the slowest pace in almost three years, from 8.9% y-o-y in Q4 2011 (Figure 4.11). The main reasons lying behind the weak economic activity over this period were the slowdown in external demand and the lingering impact of monetary policy tightening since October 2010.

Meanwhile, all the main activity indicators confirmed the weakening of the economy. Industrial production, the most reliable monthly proxy for overall activity and highly correlated with GDP, decelerated to an average of 10.3% y-o-y over the first five months of the year from 13.8% in 2011, its lowest rate since 2009 (Figure 4.12). The slowdown of industrial production was mainly the result of weak exports and investment. Primary and tertiary industry fell much more than secondary industry. Bad weather and weak property sector are the main culprits regarding the slowdown of the primary and tertiary sector, respectively.

Figure 4.11



Source: Bloomberg

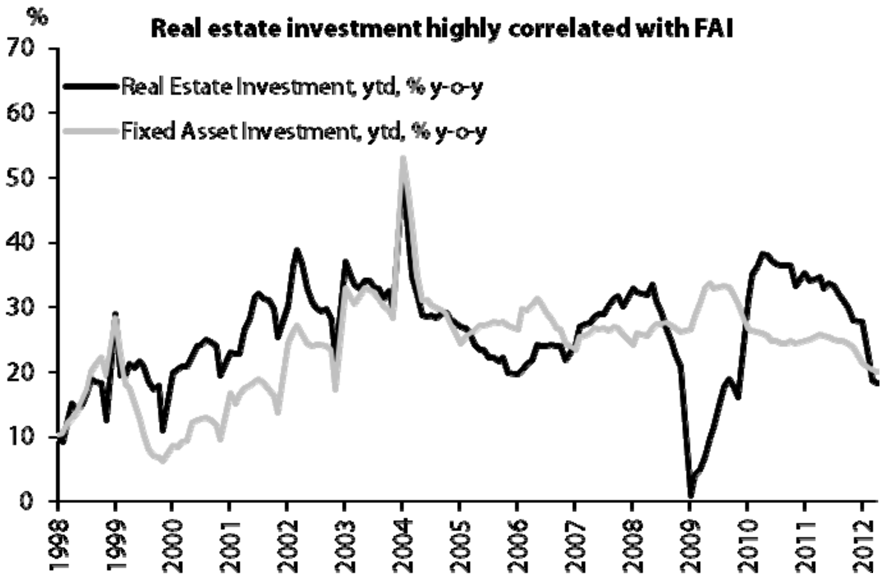
Figure 4.12

Source: Bloomberg

Investment was the main reason for the slowdown in growth

In terms of percentage point contribution to real GDP y-o-y growth, final consumption expenditure contributed the most (6.2 pp), followed by investment (2.7 pp), and net exports, which subtracted 0.8 pp from growth. The 2.7 pp contribution from investment expenditure was the smallest one since Q4 2008. It is worth noting that investment was the main engine of GDP growth over the past decade. There were two main reasons behind the marked slowdown of investment growth: the moderation in manufacturing mainly due to the exports slowdown and the deceleration in real estate investment as a result of persistent tightening measures to ease property price increases. Funding constraints have also curbed investment growth. The slowdown of gross fixed capital formation was particularly noted in infrastructure and real estate (Figure 4.13). Fixed asset investment excluding rural households and not adjusted for inflation rose 20.1% in the first five months of 2012. That was the weakest increase for the Jan-May period since 2001. Property development investment for the first five months of the year was up 18.5% from a year earlier compared to 27.9% in 2011.

Figure 4.13

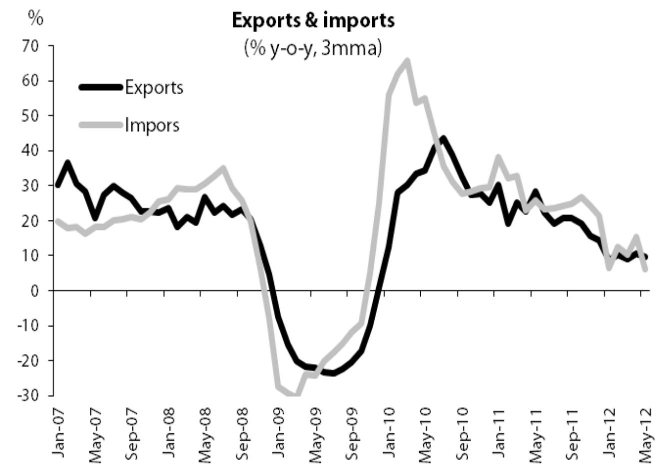


Source: Ecowin

Net trade continued to be a drag on GDP growth

Trade growth momentum remained relatively weak over the first four months of the year. Export and import growth came in at 7.9% y-o-y and 7.8% y-o-y over this period, down from 20.6% and 25.5% in 2011, respectively (Figure 4.14). While export demand weakened across all markets, the slowdown of demand from the EU constituted the major drag on exports (Figure 4.15). In particular, exports to the EU, which accounts for 17% of total Chinese exports, declined by a total of about 10 percentage points since the beginning of the year. By contrast, growth of exports to the US is still hovering in double digit rates. Indeed, shipments to the US surpassed those to the EU for the first time since 2007.

Figure 4.14



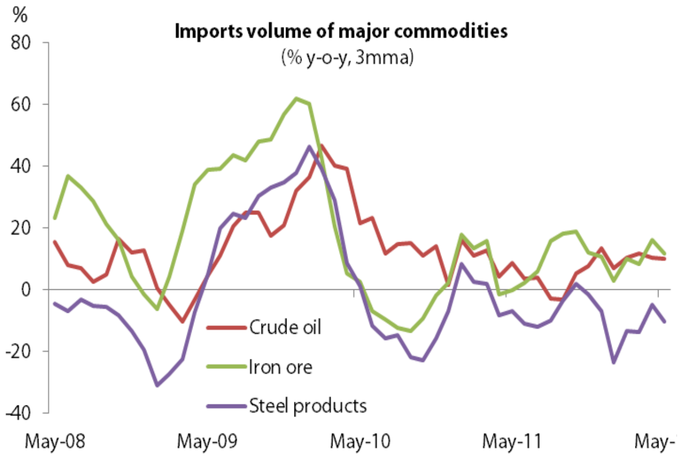
Source: Bloomberg

Figure 4.15

Source: Bloomberg

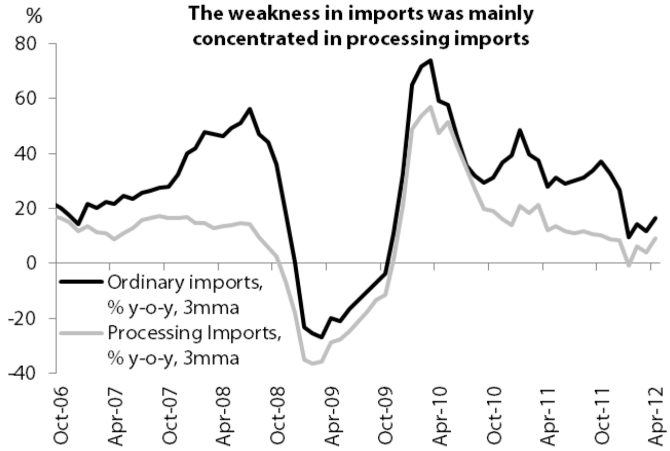
Meanwhile, import growth surprised to the downside in April, with the y-o-y rate almost flat at 0.3%, compared to an average of 10.2% in the first three months of the year. This rate was the lowest reading since 2009. The weakness in China's imports has mainly been driven by a broad-based slowdown in major commodity imports, which is attributed to both volume and price drops. Weak imports volume of major commodities reflects mainly the sustained weakness of investment demand (Figure 4.16). Interestingly, general trade, which is a good indicator of underlying Chinese demand, was also weak, though not as bad as processing. As Figure 4.17 depicts, ordinary import growth (i.e. imports for domestic use rather than processing and re-export) had largely outpaced processing imports since 2006. After a sharp slowdown since 2011, ordinary imports have rebounded recently. Given that domestic demand is projected to remain more resilient than export demand, external demand and processing imports will likely remain a drag on China's trade in 2012.

Figure 4.16



Source: Bloomberg

Figure 4.17



Source: Bloomberg

The gloomy outlook for China's trade is also confirmed by the Canton Fair, a leading indicator of China's exports. The Canton Fair is China's largest trade fair being held twice a year and a barometer of China's external trade. The 111th session of the Canton Fair concluded on May 5th and reported the first decline (2.3% y-o-y) in turnover value since the spring of 2009. The Canton Fair announced also a decline in new orders. It should be noted though that the Canton Fair tends to have a particularly heavy representation of small and medium sized enterprises, that are being squeezed the most by the weakness in global economic environment. In contrast, the government's PMI index for export orders, which covers larger and state supported businesses with greater access to credit, has been above the threshold of 50 that indicates expansion since February 2012.

Robust consumption growth compensated for weak exports and investments

Consumer spending remained robust over the first four months of the year, supported by still-solid labor market fundamentals, healthy income growth and lower projected inflation. Urban household disposable income per capita increased 14% y-o-y and rural household cash income per capita surged 17% y-o-y, both grew significantly faster than the economy as a whole (GDP growth in nominal terms was 12.1% in Q1). Increased subsidies from government and the steady increase in wages were the main drivers of the strong growth of household income.

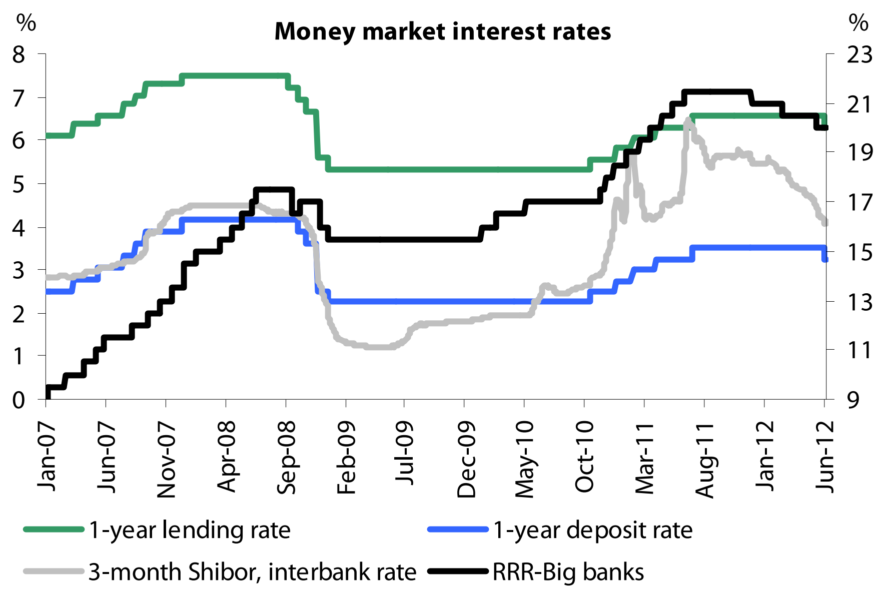
Both fiscal and monetary policy action has been quite muted so far this year…

In the meantime, as the Chinese economy has slowed gradually over the past year, there were increased expectations for macro policy to reverse its tightening earlier in 2011 and to turn more supportive of growth. However, since the last quarter of 2011 the government has loosened fiscal policy only incrementally. In particular, Chinese authorities have introduced new favorable terms concerning lending and tax policies to support small and medium sized enterprises (SMEs). With these targeted easing measures the government was aiming to facilitate restructuring of economic growth. In addition, on the monetary policy front, the central bank has generally been very cautious, since taming inflation was its top priority. As a result, it has delivered two belated reserve requirement ratio (RRR) cuts this year. As far as credit is concerned, credit supply has been weaker than expected over the first four months of the year, partially on the back of the lingering impact of credit tightening last year.

…but faster policy easing is now on the way

Tight credit conditions along with the significant slowdown in growth since the beginning of the year has caused concerns among policymakers that a hard landing of the economy would be an increasing risk, if there was no change in policy stance. As a result, policymakers now appear to have accelerated the pace of loosening so as to ensure a significant pick up in the level of activity growth. Indeed, recent statements from the State Council underscores that macro policy is again focusing on growth. For instance, on the fiscal front, the NDRC, China's top planning agency, has sped up the approval of investment projects since April, with a focus on clean energy, infrastructure, airports and water conservation. Furthermore the State Council has announced a subsidy program (totaling 36.3 billion yuan) to encourage consumption in home appliances. On early-June the People's Bank of China took a significant step towards a more loosening policy stance, announcing a cut of both benchmark lending and deposit rate by 25bp to 6.31% and 3.25%, respectively (Figure 4.18). This cut was the first since 2008, when the government unveiled a 4 trillion yuan stimulus package to counter the effects of the global financial crisis. The current move reflects Chinese policymakers' efforts to combat a deepening slowdown in China's economy as Euro area's worsening debt crisis threatens global growth. Furthermore, the lending rate cut will help boost market confidence and reduce financing costs. The central bank also raised the ceiling on the deposit rate and lowered the floor of the lending rate. In other words commercial banks will be able to raise the deposit rate offered by 10% and lower the lending rate by 20%. This move can be interpreted as an important step towards interest rate liberalization in China. Commercial banks now will have increasing flexibility to set their own lending rates. The implication is that the pricing of capital would be more market-based and benchmark interest rates would be less important. This should help reduce financial risks and economic imbalances.

Figure 4.18

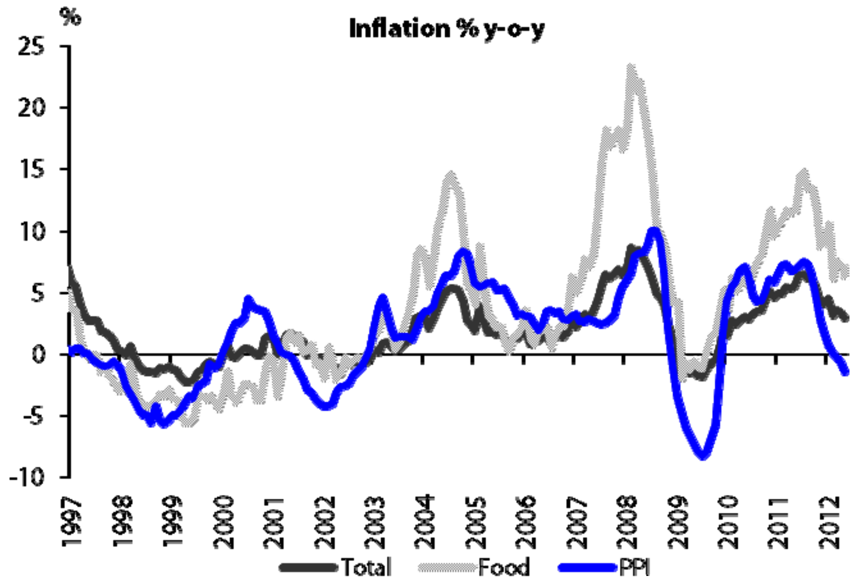


Source: Ecowin

Clear loosening bias from the central bank in the coming months

Looking ahead, we expect the PBoC to proceed with another 25bp cut to its leading benchmark rates, likely in Q3. In addition, we expect the reserve requirement ratio to be cut by 100-150bp before year end. Subdued inflation allows for further monetary easing to respond to rising downside risks to growth. Since mid-2011 inflation has fallen back steadily as a result of the introduction of a range of measures by the PBoC to limit credit growth and the significant decline in food prices. In May, inflation slowed to 3.0% y-o-y, down from an average of 3.7% y-o-y in January-April period and well below the central bank's target of 4.0%. The fall came from both food and non-food inflation, as well as PPI (Figure 4.19). We believe that the moderating trend in CPI inflation is due to continue amid a slowing economy and the index is likely to fall below 3% in the following months.

Figure 4.19



Source: Bloomberg, Ecowin

Fiscal policy supportive, but a big stimulus is not expected, unless economic conditions deteriorate further

As we have already mentioned, the government is now shifting its attention towards growth. At the same time, economic restructuring remains a key policy priority. Indeed, in March, Prime Minister lowered the annual growth target for the first time in eight years from 8.0% to 7.5%. This change entails China's government commitment to rebalance demand away from investment and exports and towards consumption, in order to achieve more sustainable and higher quality economic growth. In other words, the government is simply accepting that trend growth has slowed. This implies that any policy stimulus will likely be moderate and targeted. Otherwise, a bigger fiscal stimulus would entrench the economy's bias towards investment. However, it can not be ruled out in the case under which economic conditions deteriorate much more sharply than are currently expected.

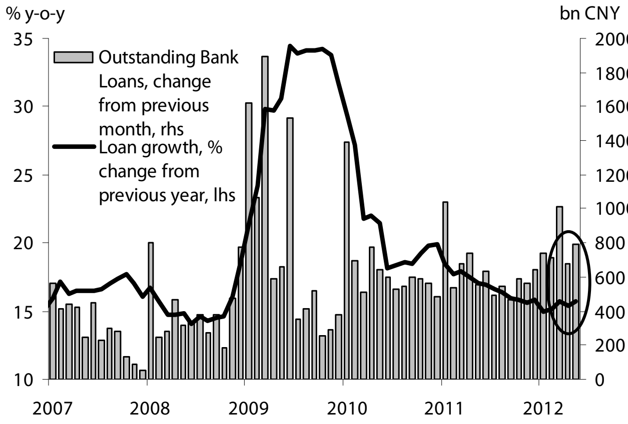
GDP growth is due to bottom in the second quarter…

Industrial production accounts for about 40% of China's GDP and, thus, is the best indicator for GDP growth. Recent data releases show underlying activity growth since April has been very weak. In April industrial production growth fell to a three-year low of 9.3% y-o-y from 11.9% y-o-y in March, and May data shows that there was no major rebound as industrial production rose to 9.6% y-o-y, below market expectations. In view of the recent development in industrial production and based on the linear relationship between IP and GDP growth, we estimate real GDP growth to decline to 7.7% y-o-y in Q2 2012 from 8.1% in Q1.

…picking up likely in the second half

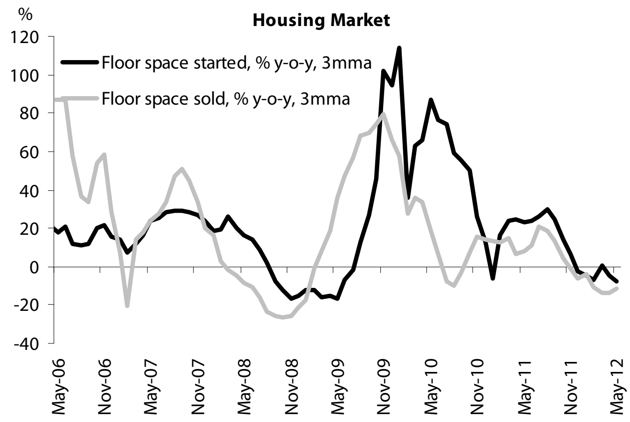
Barring a collapse of the property sector and a deeper recession in the Euro area, we expect China's growth to pick up during the second half of the year, after bottoming in Q2, as policy loosening will start to show its impact on the real economy more visibly. In recent data releases there were glimmers of a turnaround towards the second half of the year. In particular, there was a slight improvement in credit, as a result of the government's intentional monetary and fiscal policy loosening (Figure 4.20). The rebound in credit supply is a key factor for the stabilization of growth and the pick up of infrastructure investment. Indeed, both infrastructure and manufacturing investment recovered in May. A slight improvement witnessed also in the property sector, since the decline in both floor space sold and floor space started eased significantly, alleviating concerns about downside risks to growth (Figure 4.21).

Figure 4.20



Source: Ecowin

Figure 4.21



Source: Ecowin

Significant growth deceleration but not a hard landing

To sum up, China's economy has entered a period of subdued growth, with weak export, credit and property cycle. The three decades of double digit growth is over and China's potential GDP growth could gradually slow below the current 8.0% over the coming years. The 2012 outlook is expected to be dominated by the continued weakness in external demand and further property market adjustment. Our main scenario is a soft landing for the economy, with growth moderating to 8.2% in 2012 and 2013 from 9.2% in 2011. In our view, China's economy is in a better-positioned than advanced economies to withstand a sharp deterioration in the global economic backdrop, mainly due to its flexible policy regime. In general, authorities have significant room to react to sudden shocks to the economy. We believe that a sharp external growth slowdown would trigger a quick policy response, with the introduction of a new stimulus package, albeit not on the scale unleashed during the global credit crisis in 2008. China's fiscal situation is relatively healthy. National government debt (including local governments' debt) is about 45% of GDP, well below that of advanced economies, enhancing the government's capability to respond to a marked slowdown in growth. Moreover, moderating inflation allows policymakers to ease further monetary policy if necessary. In any case, a sustained economic rebound is far from assured, given that risks still remain mainly in the export and property sector.

Main risks to our China outlook

A greater than expected slowdown in Europe

The situation in Europe presents a significant source of risk. Should conditions in the euro area deteriorate sharply, GDP growth would be much weaker than our baseline scenario, reflecting mainly trade effects and a decline in capital inflows. Risk aversion could escalate further and financial conditions would become tighter. The persistent fragility of the global economy would dampen demand for Chinese exports, which still account for a significant percentage of GDP (about 25%). Given that China's exports to the EU make up about 20% of total Chinese exports, we estimate that a 1 percentage point decline of European Union's real GDP growth would subtract China's export growth to the EU by about 5% and, consequently, shave about 0.3 percentage points off China's GDP growth.

A sharp correction in the real estate market

One of the major risks to China's growth outlook is a sharp correction in the real estate market. A sharp decline in home prices could hit private sector balance sheets through a decline in bank credit availability. It could also directly affect negatively fixed asset investment by undermining property investment and construction activity, which together account for about 25% of total FAI. A sharp correction in property prices can also affect total investment indirectly by affecting demand for investment in related sector, such as construction machinery, cement, steel and transportation. According to IMF[4], in a scenario under which property downturn result in both corporate and bank distress, output in China could fall to as much as 4 percent below baseline after two years. In contrast to the negative impact on investment, the negative repercussions of a sharp correction in the property sector on private consumption seem limited. First, the debt level of the household sector is relatively low. Chinese households do not appear to finance residential property to a large extent with debt. The household liability-to-asset ratio is 22.5% in China, well below the above 30 percent level in developed countries. Second, income from real estate, including rental income and gains from property transactions, does not seem to be considerable in total household income. Property income accounts for 2.3% of China's total per capita income in both urban and rural areas. It is worth noting that so far the government has managed an orderly correction in the property market, given that property policies have been relaxed at the margin. More specifically the government has been fine-tuning policies to support first-time home buyers and developers of smaller-sized apartments. It has been also providing support to social housing construction. Moreover, as we have already mentioned, May's property sector data releases alleviated concerns about downside risks to growth. Thus, a sharp correction in the real estate market is not our baseline scenario.

A non-smooth transmission to a more consumption-driven model and consequently a lower trend growth

While rebalancing the economy away from its dependence on exports and investment, China is facing the challenge to sustain growth through a soft landing. The prospects for a gradual slowdown are high, since there is enough room for policy to respond to downside risks. However, there are significant concerns that growth could slow too quickly, should policymakers prove too slow to address ongoing growth risks.

[4] *IMF, Regional Economic Outlook, Asia and Pacific, April 2012*

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 (1.7 – 3.5)	2.0	2.4 (1.4 – 4.4)
EA	1.9	1.5	-0.3	-0.4 (-1.0 – 0.7)	0.7	1.0 (-2.5 - 1.6)
Japan	4.5	-0.7	2.6	2.5 (1.6 – 2.8)	1.4	1.5 (0.9 – 2.1)
China	10.4	9.2	8.2	8.2 (7.9 – 8.5)	8.2	8.5 (7.5 – 9.0)
India	8.4	7.5	6.6		7.2	
Russia	4.3	4.3	4.0	3.7 (3.0 – 5.0)	4.2	3.9 (2.5 – 5.1)
Brazil	7.6	2.8	3.0	2.9 (2.5 – 3.5)	4.2	4.5 (3.4 – 5.5)

Inflation						
	2010	2011	2012f		2013f	
			Eurobank EFG	Consensus	Eurobank EFG	Consensus
US	1.6	3.2	2.3	2.2 (1.4 – 3.4)	2.1	2.1 (1.0 – 4.5)
EA	1.6	2.7	2.3	2.4 (1.5 – 2.8)	1.9	1.8 (1.0 – 2.9)
Japan	-0.7	-0.3	0.1	0.1 (-0.2 – 0.2)	0.3	0.1 (-0.3 – 0.5)
China	3.3	5.4	3.2	3.4 (2.9 – 3.8)	4.0	3.6 (2.6 – 4.0)
India (WPI)	9.6	9.5	6.5		6.0	
Russia	6.9	8.5	4.7	5.0 (4.4 – 7.2)	5.5	6.5 (5.6 – 7.6)
Brazil	5.0	6.6	5.2	5.2 (4.8 – 5.4)	5.5	5.8 (5.0 – 6.7)

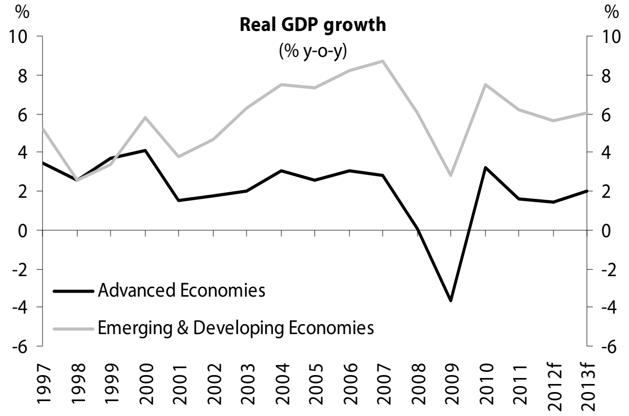
Note: Range of forecasts by Bloomberg's survey in parentheses below point estimates.

Policy Rates					
		Eurobank EFG			
	Current	Q2 12f	Q3 12f	Q4 12f	Q1 13f
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	6.31	6.31	6.06	6.06	6.06
India	8.00	8.00	7.50	7.50	7.50
Russia	8.00	8.00	8.00	8.00	8.00
Brazil	8.50	8.50	8.00	8.00	8.00

IV. GRAPHS

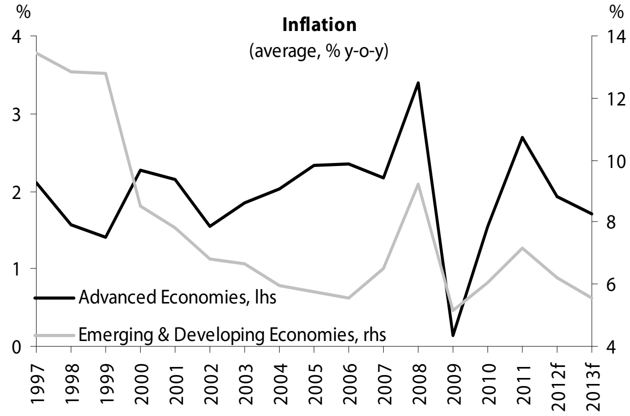
Global Economic Indicators – World Economy

World Economy

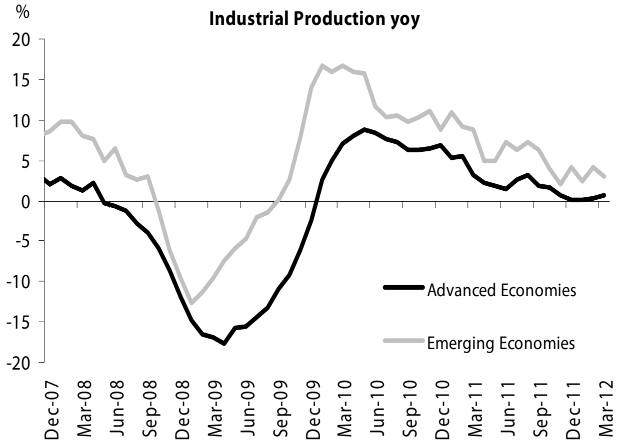


Source: IMF

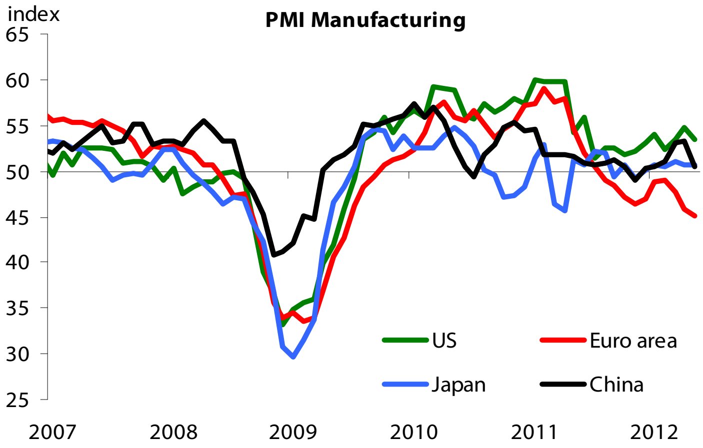
World Economy



Source: IMF

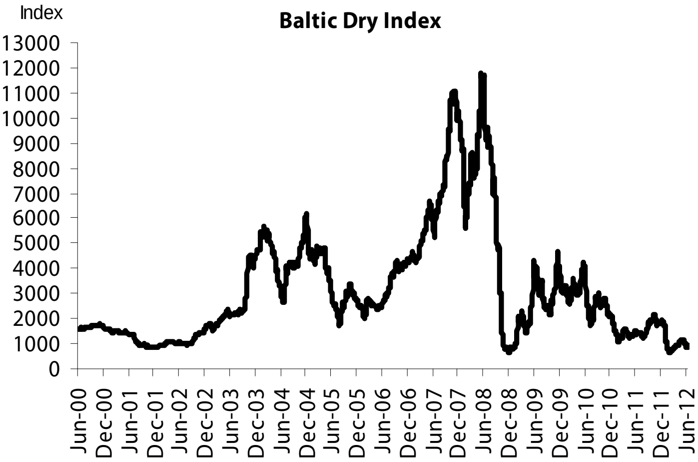


Source: CPB Netherlands Bureau for Economic Policy



Source: Bloomberg

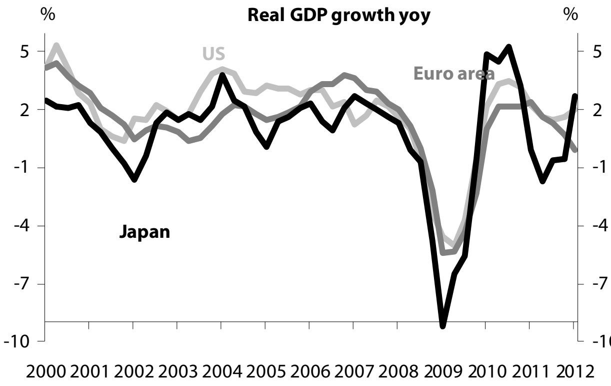
Source: CPB Netherlands Bureau for Economic Policy Analysis

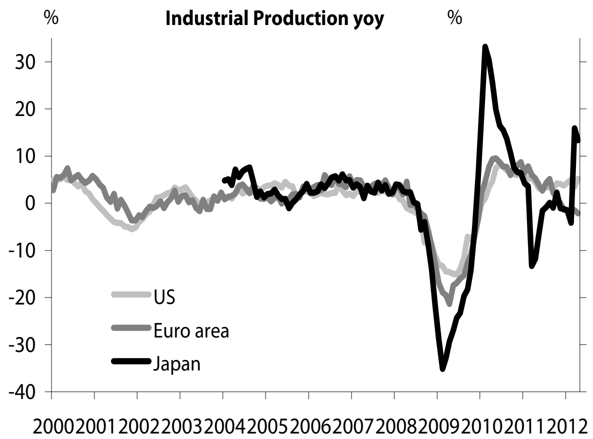


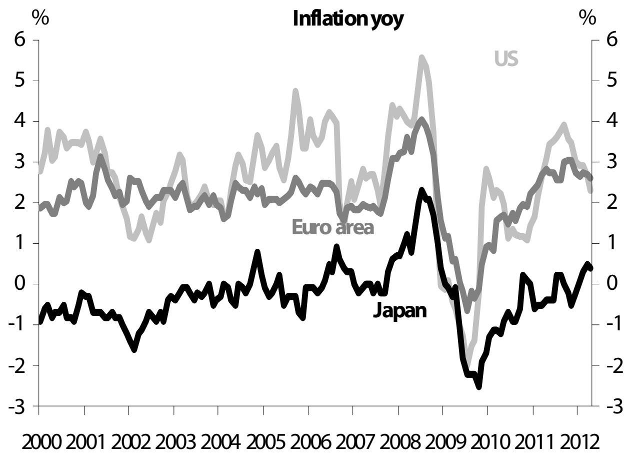
Source: Bloomberg

Global Economic Indicators

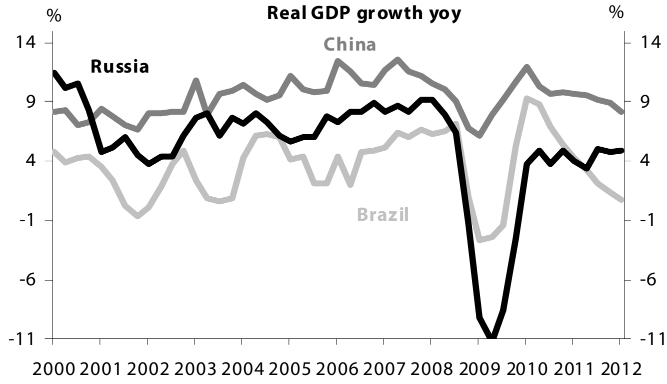
Advanced Economies

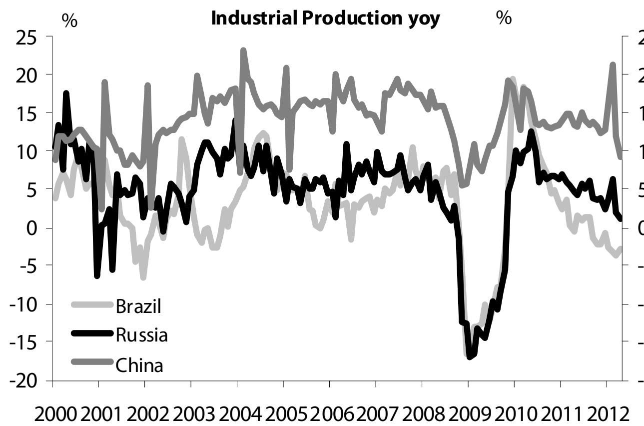


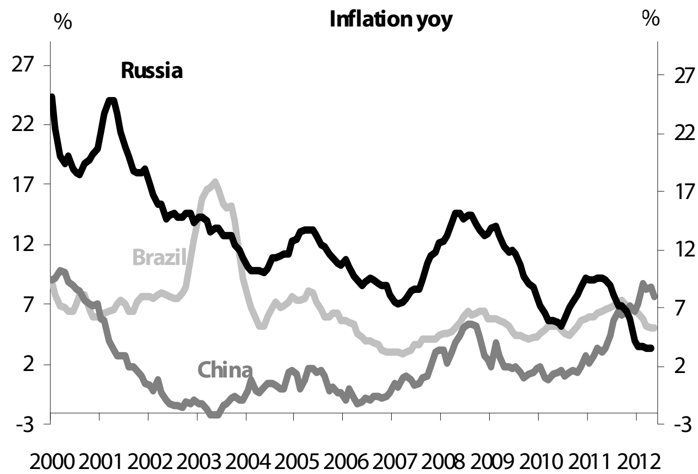




Emerging Economies



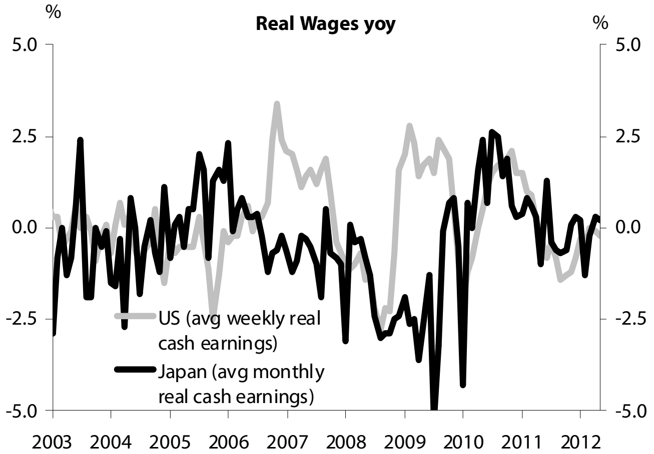




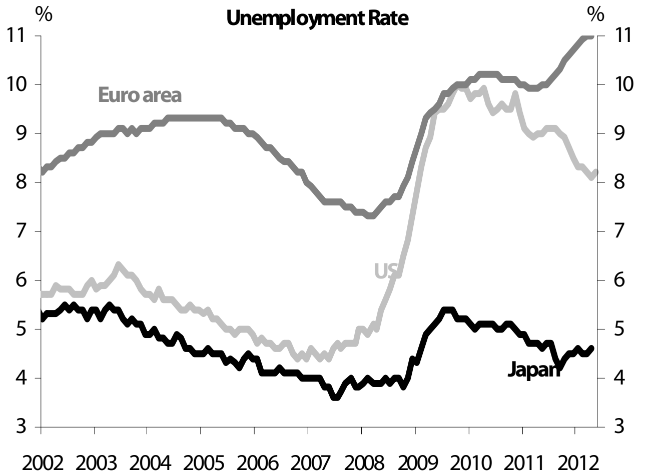
Source: Bloomberg, Ecowin

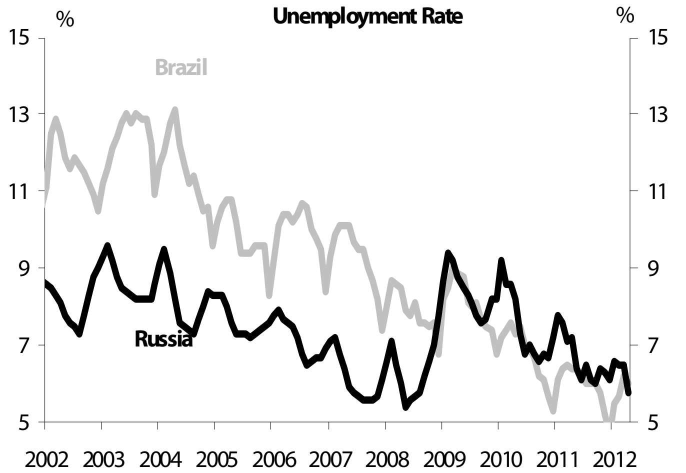
Global Economic Indicators

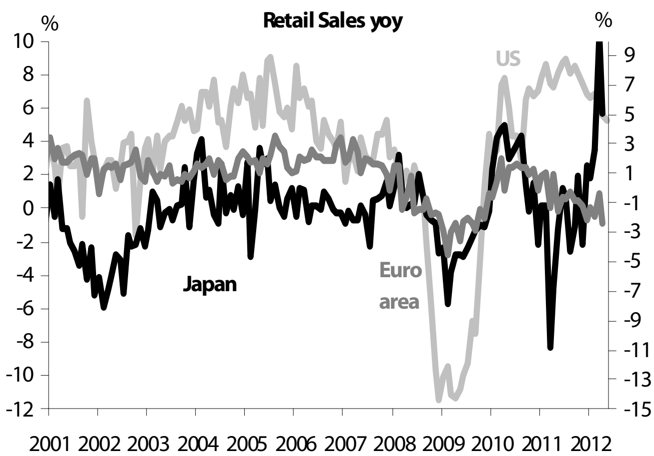
Advanced Economies

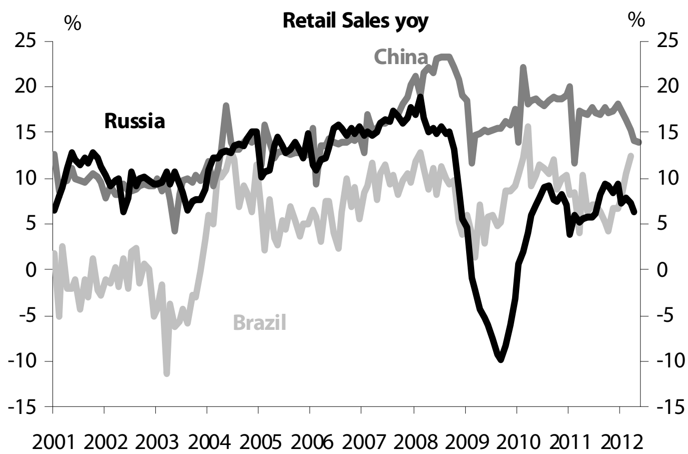


Emerging Economies





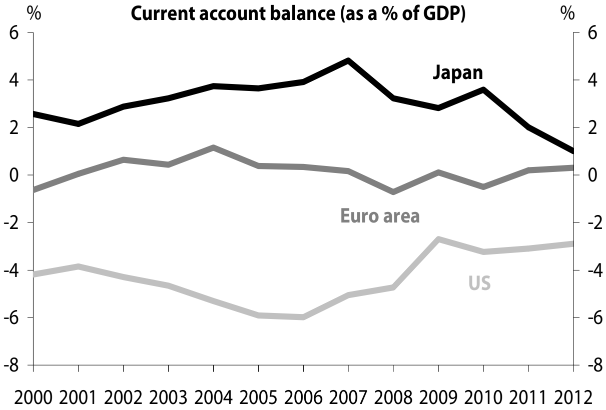


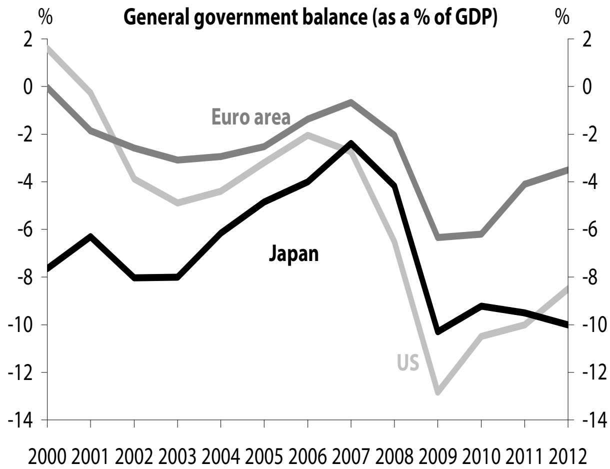


Source: Bloomberg, Ecowin

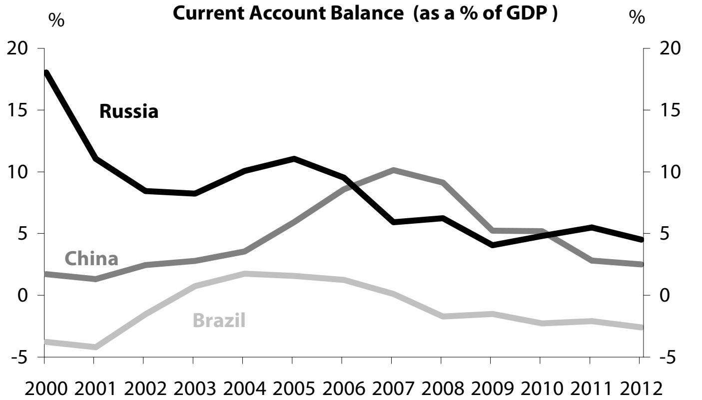
Global Economic Indicators

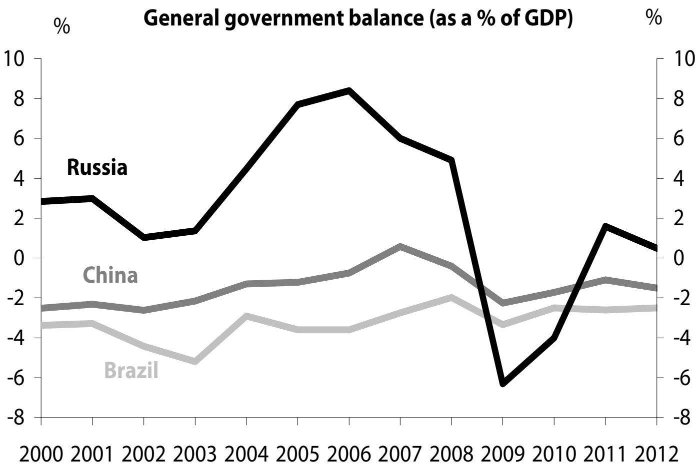
Advanced Economies

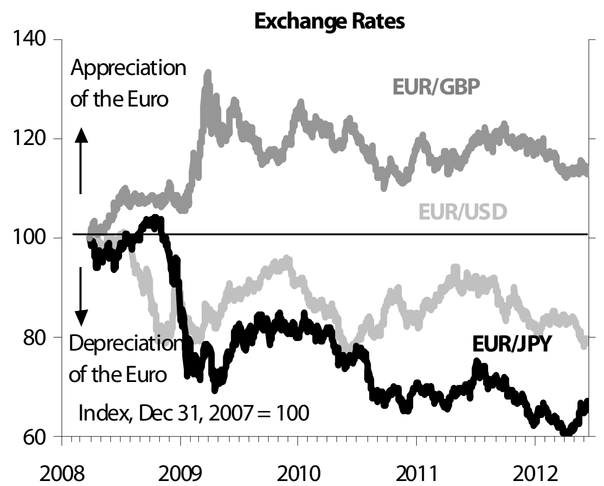


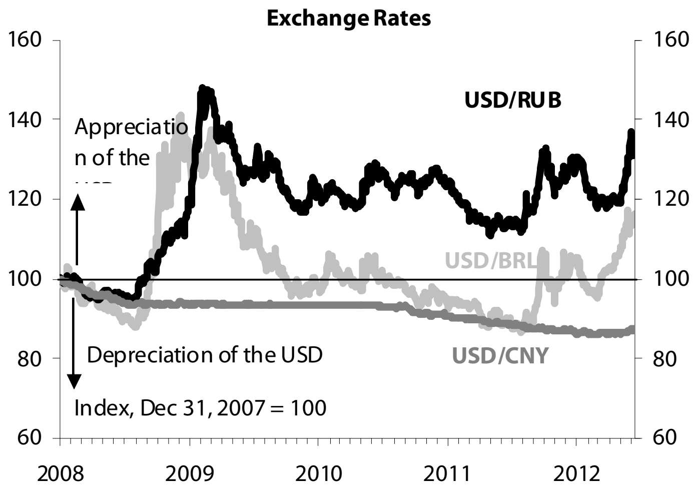


Emerging Economies



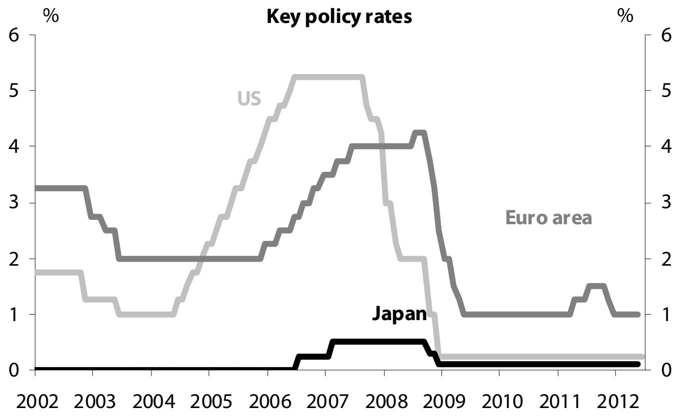


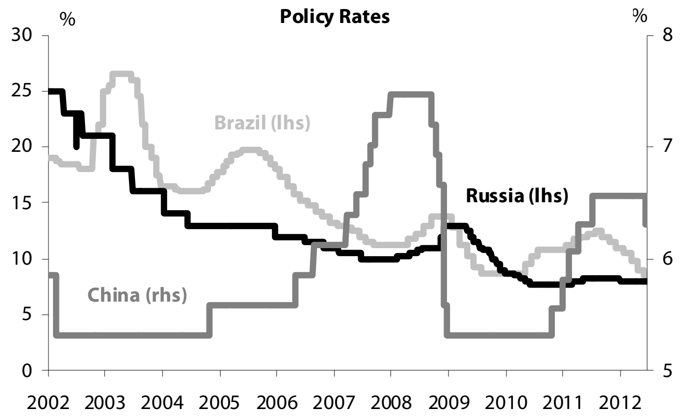




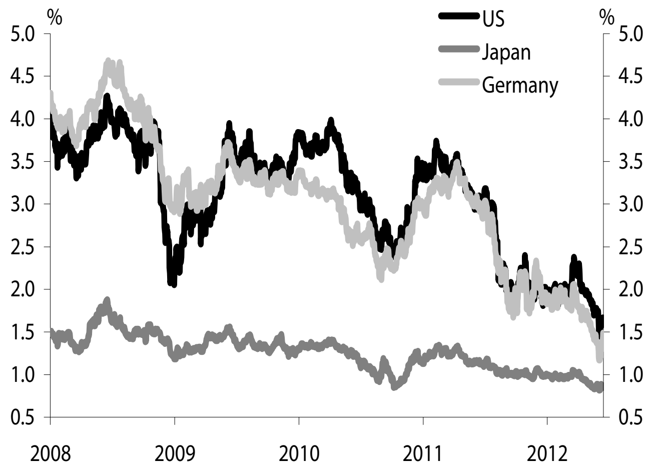
Source: Bloomberg, Ecowin, IMF, Eurobank EFG

Global Economic Indicators

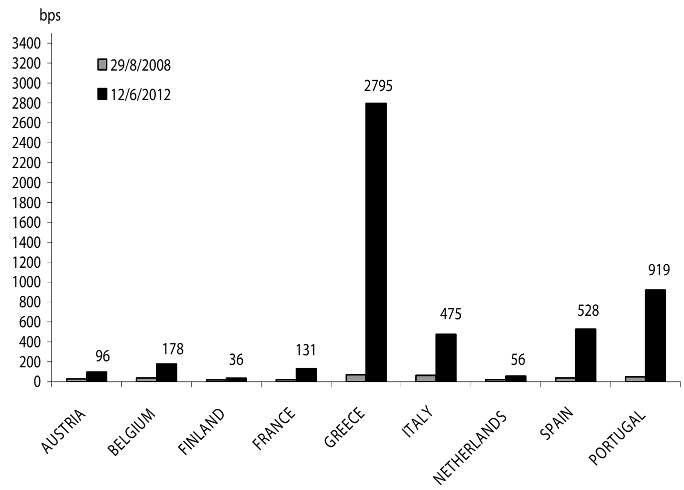




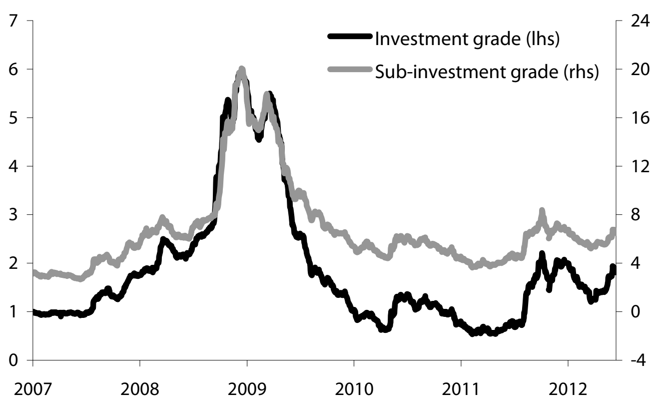
10y Government Bonds



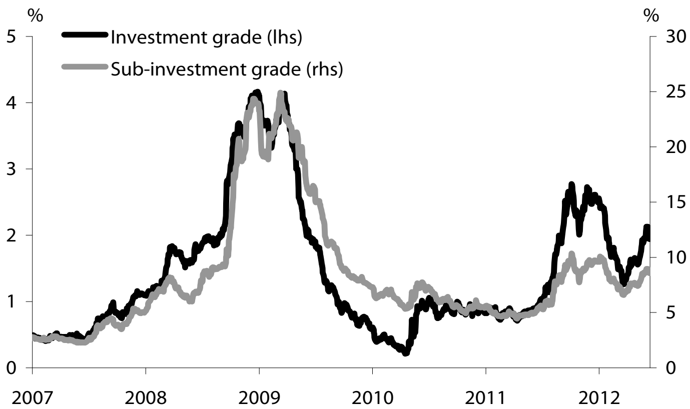
10yr government spreads vs Germany



US Corporate bond yield spreads vs 10-yr government bond



EU Corporate bond yield spreads vs 10-yr government bond



Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Total Return (%) as of June 12, 2012

Global Equity Indices (in local currency)

Region	Index	Last Price	1w	1m	6m	12m	YTD	2011
US	S&P 500	1324.2	0.7	-2.2	8.0	4.1	5.3	0.0
EURO AREA	DJ Euro Stoxx 50	2143.4	0.3	-4.9	-5.2	-21.6	-7.5	-17.1
GERMANY	DAX	6161.2	1.1	-6.4	6.7	-13.0	4.5	-14.7
FRANCE	CAC 40	3046.9	-0.4	-2.6	-1.0	-20.0	-3.6	-17.0
UK	FTSE 100	5473.7	1.7	-1.8	-0.3	-5.2	-1.8	-5.6
JAPAN	Nikkei	8536.7	0.0	-4.9	0.2	-10.6	1.0	-17.3
CHINA	CSI 300	2540.2	-0.7	-2.9	6.0	-15.1	8.3	-25.0
INDIA	SENSEX	16862.8	2.5	3.5	5.4	-7.7	9.1	-24.6
RUSSIA	MICEX	1338.1	3.2	-3.9	-4.2	-20.5	-4.6	-16.9
BRAZIL	IBOV	55049.0	4.9	-7.4	-4.3	-11.2	-3.0	-18.1

Source: Bloomberg

Sector performance as of June 12, 2012

US Sector Indices (in USD)

US – S&P 500	Last	1w	1m	6m	12m	YTD	2011
1. Consumer Discretionary	427.4	2.7	-2.3	11.3	16.2	11.2	6.1
2. Consumer Staples	524.5	2.7	0.4	9.3	13.8	5.8	14.0
3. Energy	725.4	3.5	-3.5	-4.0	-8.8	-5.8	4.7
4. Financials	278.5	3.8	-4.8	11.4	-3.1	8.9	-17.1
5. Health Care	565.2	2.2	-1.1	10.9	7.8	6.2	12.7
6. Industrials	423.6	4.6	-1.8	6.8	1.9	4.3	-0.6
7. Information Technology	498.6	2.5	-2.5	9.7	16.1	11.0	2.4
8. Materials	321.0	3.5	-1.1	5.5	-4.5	4.0	-9.8
9. Telecommunication Services	262.1	3.4	3.7	17.8	16.8	13.1	6.3
10 Utilities	384.7	2.4	2.6	8.6	16.7	3.5	19.9

Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Sector performance as of June 12, 2012

European Sector Indices (in €)

Europe - DJ Stoxx 600	Last	1w	1m	6m	12m	YTD	2011
1. Consumer Discretionary							
Automobiles & Components	424.3	-0.3	-9.5	10.3	-15.4	10.5	-22.7
Travel & Leisure	203.5	1.1	-3.8	13.3	2.2	9.1	-13.3
Media	262.0	1.9	-2.9	3.7	-5.7	0.3	-7.4
Retail	407.9	1.3	-4.4	-0.6	-6.7	-4.3	-4.2
2. Consumer Staples							
Food & Beverage	679.2	1.5	-1.4	12.8	15.1	8.1	8.0
Personal & Household Goods	786.1	2.5	-1.9	14.1	15.5	11.3	3.3
3. Energy							
Oil & Gas	619.6	1.6	-2.5	-2.8	1.6	-5.1	4.8
4. Financials							
Banks	252.1	0.8	-3.9	1.0	-28.6	-1.6	-30.4
Financial Services	396.9	1.4	-3.6	4.9	-14.9	3.4	-19.3
Insurance	228.0	0.5	-5.1	6.5	-13.6	3.1	-10.5
Real Estate	109.4	-1.7	-3.0	10.9	-12.4	5.7	-12.1
5. Health Care	668.8	2.0	0.1	8.4	12.4	3.9	15.3
6. Industrials							
Industrial Goods & Services	462.8	1.8	-3.2	10.1	-8.9	5.9	-14.1
7. Information Technology	189.7	1.7	-2.8	1.2	-10.3	0.8	-12.8
8. Materials							
Basic Resources	752.0	0.9	-5.5	-3.0	-21.5	-4.2	-28.8
Chemicals	964.0	1.9	-3.8	14.4	-5.1	8.4	-7.9
Construction & Materials	373.9	-0.7	-6.0	2.7	-18.7	-2.2	-17.4
9. Telecommunication Services	470.5	3.2	-0.3	-2.2	-2.9	-3.3	-0.7
10. Utilities	531.0	1.1	-3.4	-1.1	-15.2	-3.5	-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

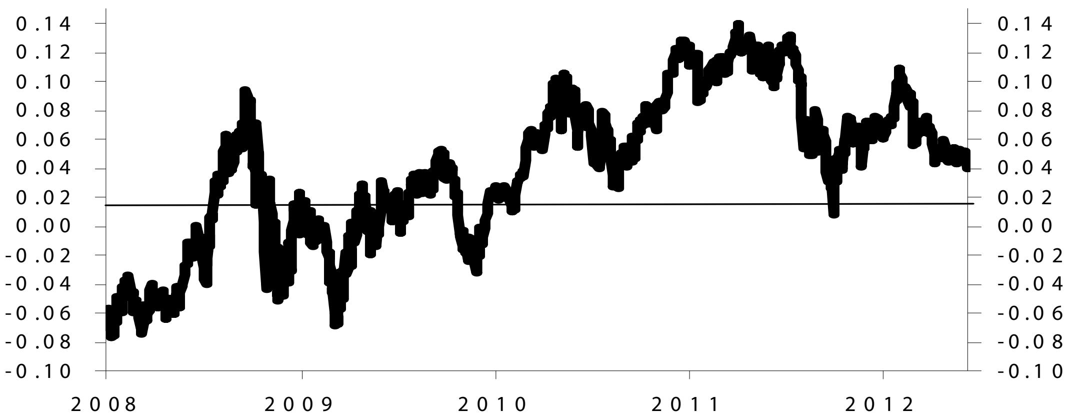
Source: Ecowin

US Style Equity Indices

Total Return (%) as of June 12, 2012

US Style Indices (in USD)								
Index	**Last Price**	**1w**	**1m**	**6m**	**12m**	**YTD**	**2011**
Russell 1000 (Large Cap)	730.1	0.5	-2.5	8.1	3.3	5.3	-0.5
Russell 2000 (Small Cap)	761.5	-0.5	-3.6	6.1	-2.0	2.8	-5.5
Relative performance (Small vs Large)		-1.0	-1.1	-2.0	-5.3	-2.5	-4.9
Russell 1000 Value	648.7	0.7	-2.2	7.3	0.0	3.6	-2.1
Russell 1000 Growth	621.5	0.3	-2.9	8.8	6.7	7.0	1.1
Relative performance (Value vs Growth)		0.4	0.7	-1.5	-6.7	-3.4	-3.1

Relative Performance (small vs large)
(logarithmic scale)



Relative Performance (value vs growth)
(logarithmic scale)

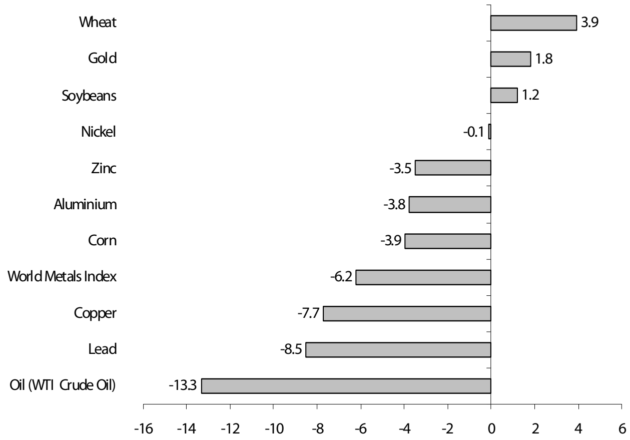
Source: Bloomberg

Commodities

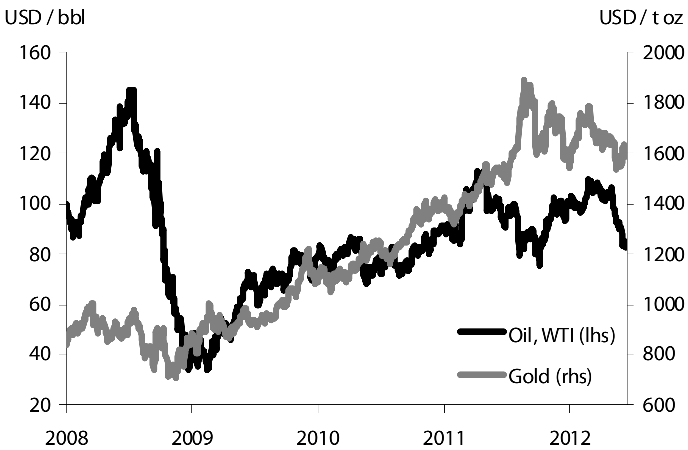
Commodity Performance (%) as of June 12, 2012

Commodities	Units	Last Price	1w	1m	6m	12m	YTD	2011
Oil (WTI Crude Oil)	USD/bbl	83.3	-2.0	-13.3	-16.8	-14.4	-15.7	8.2
Gold	USD/t oz	1612.7	-1.2	1.8	-2.8	6.4	2.9	10.2
Base Metals								
World Metals Index		3209.8	0.2	-6.2	-3.0	-19.7	-2.9	-21.5
Aluminium	USD/lb	1968.0	-0.2	-3.8	-2.3	-24.9	-2.6	-18.2
Copper	USD/mt	7395.0	0.5	-7.7	-2.8	-17.3	-2.7	-20.8
Lead	USD/mt	1895.5	-0.2	-8.5	-10.0	-25.5	-6.9	-20.2
Nickel	USD/mt	17175.0	6.7	-0.1	-6.9	-24.8	-8.2	-24.4
Zinc	USD/mt	1880.0	-0.5	-3.5	-2.7	-16.6	1.9	-24.8
Agriculture								
Corn	USD/bu	584.0	-0.4	-3.9	-0.8	-25.4	-9.7	2.8
Soybeans	USD/bu	1337.0	2.9	1.2	17.1	-2.3	11.0	-2.4
Wheat	USD/bu	616.0	-1.3	3.9	4.1	-17.1	-5.6	-17.8

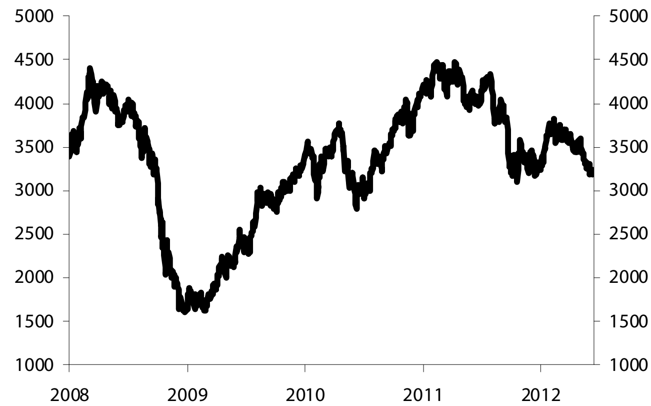
1-Month Return



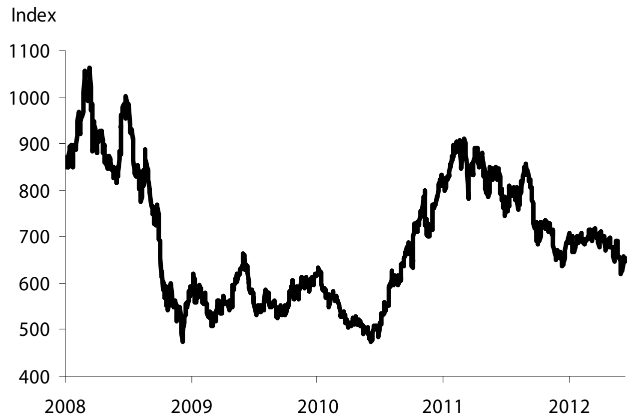
Oil & Gold



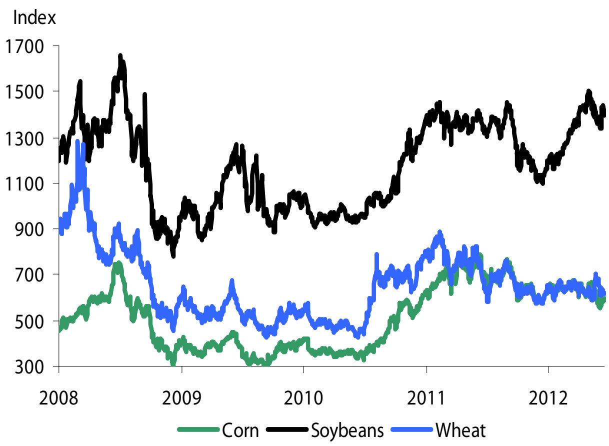
World Metals Index



Agricultural Index



Agricultural Indices



Source: Bloomberg, Ecowin

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

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