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GLOBAL ECONOMIC & MARKET OUTLOOK

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- We expect global economic growth to pick up momentum in H2 2013
  - The euro area economy is expected to stabilize on the backdrop of slowly improving business sentiment and some relaxation in fiscal targets
  - In the US, we expect a modest acceleration of economic activity, as the negative drag from the 2013 tax increases diminishes over time
  - Economic activity in EMs is expected to improve marginally in H2 2013 after the soft patch recorded in H1 due to stronger growth in advanced economies and less volatile external conditions
- Risks to our economic outlook originate from multiple sources
  - Accumulating social fatigue in the euro area which jeopardizes fragile political stability and decelerates structural reforms
  - Disorderly market reaction to the Fed's exit policy
  - Lack of final agreement on bank resolution in Europe
  - A liquidity squeeze in China that could spill over to global economy

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I. Global Outlook

Olga Kosma, Vasilis Zarkos, Maria Prandeka

Global economic activity is expanding, albeit at a slower pace than we envisaged in our previous Global edition. Global growth in the first half of the year has been weaker relative to our prior expectations, owing to the euro area crisis taking a deeper toll on economic activity and lower than expected economic expansion in emerging market economies. We expect global economic growth to pick up momentum in the second half of the year due to a) a decline in financial volatility as markets will gradually digest the unwinding of monetary policy stimulus by the Fed and settle to a new equilibrium, b) accommodative monetary policy by major central banks, c) robust private domestic demand in the US and d) a gradual recovery of confidence in Europe. Overall, global economy is expected to grow by 3.1% and 3.8% in 2013 and 2014, respectively, after a 3.1% growth rate in 2012.

Country/regional economic outlook

In the **US**, we expect a modest acceleration of economic activity in the second half of the year, as the negative drag from the 2013 tax increases diminishes over time. Rising real estate and financial wealth is expected to support household balance sheets and underpin personal expenditures, allowing a modest and gradual pickup in consumer spending growth towards the end of the year. Unlike the Fed that forecasts a surge in real economic growth to about 3.0% in H2 2013, we look for softer growth throughout 2013 because the fiscal drag from across-the-board public spending cuts will still weigh on economic activity, given the lag between when budget authority cuts are made and when the actual spending cuts actually occur. Overall, we continue to expect a deceleration of real GDP growth to around 1.8% y-o-y in 2013 from 2.2% in 2012, with the weakening government spending offsetting the improvement in private domestic demand.

The **euro area economy** is expected to stabilize in the second half of the year on the backdrop of slowly improving financial conditions and business sentiment, some relaxation in fiscal targets and solid global demand. That said, the economy remains fragile and it is expected to lag its peers due to ongoing fiscal consolidation and harsh credit supply conditions. Risks to the economy remain on the downside, stemming mainly from social fatigue, failure of policymakers to persevere on structural reforms and a poorly addressed link between bank weaknesses and stressed public finances. The ECB is anticipated to remain on hold, unless the economic situation deteriorates substantially. Emphasis is expected to remain on fixing the monetary transmission mechanism and re-integrating the euro area financial markets. To this end, more unconventional measures aiming at injecting liquidity directly in periphery markets are likely.

The **Japanese economy** is expected to remain buoyant in 2013 due to expansionary fiscal and monetary policy. Consumer spending is expected to remain robust thanks to elevated economic confidence, while solid global demand and a weaker currency will keep supporting Japanese exports. Exit from deflation remains a challenge for the government. To that end, super accommodative monetary policy should be complemented with structural reforms to raise the country's potential growth, liberalize labor market and allow higher wage increases. In the short term, risks to the economy are mainly external, stemming mainly from an escalation of the euro area crisis and territorial disputes with China. The government should avoid a leisurely approach in addressing Japan's dire public finances and provide a credible fiscal consolidation plan.

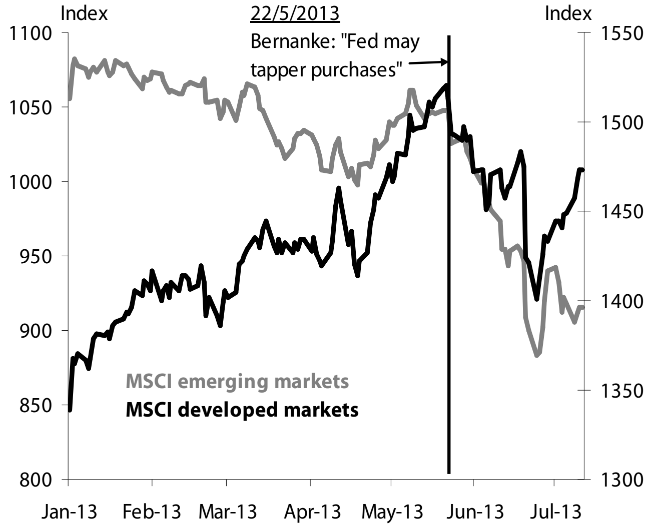
Tighter liquidity in the US, a stronger US dollar, declining capital inflows, weak growth in China and lower commodity prices would weigh on **EM economies** growth outlook. However, less volatile external conditions and somewhat stronger growth in advanced economies suggest a marginal improvement of EMs economic activity in the second half of 2013 after the slow patch recorded in H1. With fiscal consolidation continuing in most developed markets, however, growth rates of EMs exports will remain relatively modest and below historical standards. The weakening of many EM currencies, on the other hand, will support exports over time. Given that a significant share of the current slowdown in EM is structural in nature, the recovery is expected to be slow and growth rates would not return to the high levels recorded over the past decade. Moreover, adjustment may be more challenging for some than for others, reflecting different local economic and policy conditions. Countries that have attracted significant amounts of hot money (Central & Eastern Europe) are among the most vulnerable to a sudden reversal of capital flows on EM economies as these kind of flows tend to depart first in the face of heightened market volatility and waning risk appetite. Additionally, countries with high external financing requirements (notably Eastern Europe and Central Asia) would also be the most exposed to an abrupt slowdown or reversal of capital inflows. Generally, risks still remain as long as the recovery in the global economy remains fragile and, thus, vulnerable to sudden shocks, all of which could dampen global demand.

Risks to our global growth outlook

(a) Disorderly market reaction to the Fed exit

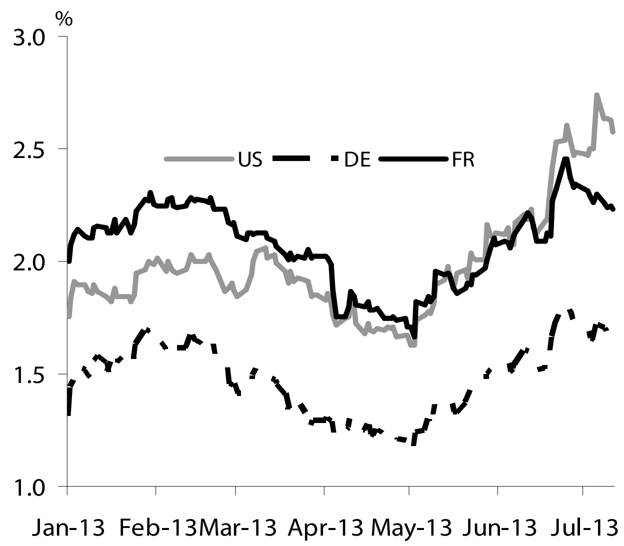
Global financial markets have been very volatile over the past couple of months, in anticipation of an exit from loose US monetary policy. The Fed's quantitative program has had a significant impact on financial markets, tending to reduce global yields, increase global equity values and lead to US dollar depreciation. Hence, as indications of Fed tapering have intensified, this tendency has switched, with rising longer-term interest rates in advanced economies and falling prices of risk assets (Figures 1 and 2). The generalized increase in risk aversion has already had a negative effect on emerging market economies, leading to capital outflows, equity market declines and currency depreciation. A new risk that has emerged is a potential disorderly market reaction to the exit of easy monetary policy by the Fed, with investors pricing an earlier onset of policy rate tightening. In our view, the anxiety over QE exit will remain the dominant factor in the following months, keeping global market volatility high. Nevertheless, our baseline scenario is that market tensions will prove to be temporary, with the Fed able to manage the transition from a loose to a tight monetary policy without significant market disruption.

Figure 1
Equity Markets



Source: Bloomberg

Figure 2
10-year government bond yields



Source: Bloomberg

(b) Social fatigue threatens political stability in the euro area. The vicious link between banks and public finances remains poorly addressed

Risks to our euro area outlook remain on the downside. Accumulating social fatigue amidst dire and still worsening unemployment conditions and deteriorating living standards jeopardise fragile political stability. Bold initiatives by policymakers in periphery countries to increase growth prospects and combat unemployment are critical. In this context, inadequate policy action both at the country and the European level poses, in our view, a serious risk of new bouts of volatility. The ECB's OMT program and a shift of focus from strict fiscal targets to structural reform implementation have led to an abatement of borrowing costs for sovereigns that may give rise to a complacent approach towards politically costly reforms. Yet, policymakers in weak countries should take advantage of reduced tensions and take quick steps towards reforming their economy and institutions in order to increase growth potential, keep borrowing costs in check and preserve debt sustainability.

Further muddling through is expected with respect to progress towards the euro area integration. While it is evident that some form of mutualisation of risks should be part of the solution to the debt crisis, dissenting views over the right mix of risk sharing and loss of sovereignty slow down the progress. This is evident in recent bank resolution decisions, which, in our view, do little to break the negative feedback loop between financial weaknesses and stressed fiscal positions. First, a very tight framework has been set with respect to the leeway of the ESM as a tool of direct bank recapitalization, both in terms of the amount and the conditions of intervention. Reduced pressure from markets and the upcoming German elections have most likely played a role in watering down the decisions

Second, while retroactive application of the instrument has been officially included as a possibility, it remains politically highly controversial. Third, direct recapitalization by the ESM will not be available during the bank stress tests scheduled in early next year (expected to come into effect not earlier than autumn 2014). Fourth, a European resolution fund has not been established while national resolution funds will several years to build.

Moreover, the inclusion of uninsured depositors in the bail-in pecking order may contribute to the intensification of likely tensions in the vulnerable European banking sector. The handling of the bank crisis in Cyprus has certainly set a negative precedent for the banking systems in other weak countries. Spanish banks in particular, continue facing pressures due to an ailing housing market, severe labor market conditions and poor economic prospects. The country's weakness and the unavailability of the ESM to act as a backstop would leave bank creditors to bear the brunt of any capital shortfalls. Hence, in the event of rekindled tensions, deposit outflows might prove difficult to stem. Fears of capital controls would create a negative feedback loop, further exacerbating the crisis.

(c) Structurally slower growth in China over the next few years

Weak activity growth so far in 2013 brought the risks on the annual GDP growth forecast to the downside and fueled renewed fears of a possible hard landing of the economy, namely an even sharper and sustained deceleration in GDP growth. However, this is not our base case, since there is still room for policy to respond to downside risks. In fact, policymakers tolerate slower growth in order to rebalance the economy and transform the growth model. There are significant concerns, though, that growth could slow too quickly, should policymakers prove too slow to address ongoing growth risks. Moreover, there is the risk that policymakers in their effort to reign in certain financial market activities could trigger another liquidity squeeze that could last too long, with the consequent spillover impact on the broader financial sector and the economy.

II. Global Economic Outlook

1. The US economy

Olga Kosma

- Despite the ongoing fiscal retrenchment, real GDP growth accelerated in the first quarter of the year due to a pickup in private consumption and a rebound in inventory accumulation.
- Nevertheless, real economic activity is set to decelerate in the second quarter of the year, with households' expenditures responding negatively to the large decline in disposable income in Q1 2013 due to tax increases.
- A modest acceleration of economic activity is on the horizon for H2 2013, as the negative drag from the 2013 tax increases diminishes over time. Rising real estate and financial wealth is expected to support household balance sheets and underpin personal expenditures, allowing a modest and gradual pickup in consumer spending growth.
- Overall, we continue to expect a deceleration of real GDP growth to 1.8% y-o-y in 2013 from 2.2% in 2012, with the restrictive fiscal policy taking a toll on the recovery going forward.
- The Fed seems closer to a slower pace of monetary easing, with an intention to moderate the monthly pace of purchases later this year and cut it to zero by mid-2014. Meanwhile, the first Fed rate hike is not expected to occur before Q1 2015.

Overview

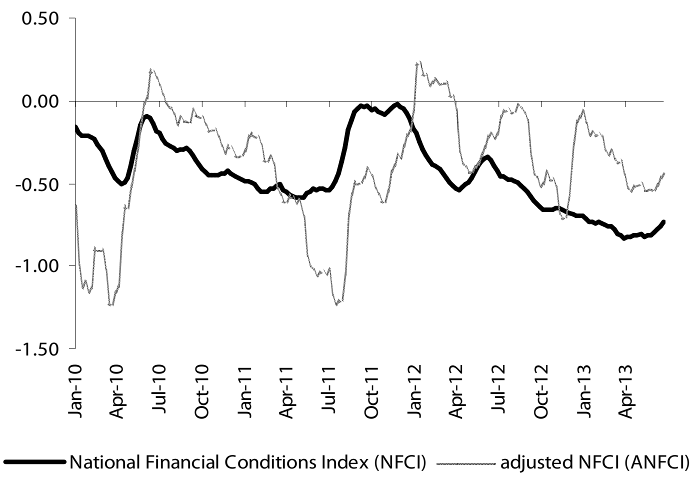
Real economic activity accelerated in the first quarter of the year to 1.8% q-o-q saar from 0.4% in the final quarter of 2012, on the back of stronger consumer spending growth and a surge in inventory rebuilding. Despite the significant drag from the ongoing fiscal adjustment, private demand remained resilient as credit and housing markets have been gradually recovering. At the same time, market confidence has been supported by improved economic fundamentals and accommodative actions by monetary authorities. As a result, financial conditions have eased considerably (Figure 1.1), given that credit growth has been gradually increasing, bank lending conditions have been easing -albeit at a slow pace- from very tight levels, equity markets have been rallying and market risk spreads have narrowed in a low bond-yield environment.

Despite the recent upward momentum of the US economy, high-frequency indicators suggest that growth is set to decelerate in the second quarter of the year. Real personal consumption is expected to slow given the tight fiscal policy and the huge decline in real disposable income in the first quarter of the year. The recent slowdown in industrial production growth and the downward trend in the ISM manufacturing index in April and May suggest that manufacturing production should slow in line with final demand growth (Figure 1.2). As a consequence, inventory accumulation, which provided a significant boost to Q1 13 real GDP growth, is not expected to be a strong impetus for economic activity in the second quarter. Meanwhile, the sequestration process put in effect starting the second quarter is expected to magnify the negative contribution from real government spending.

Looking ahead, we expect a modest acceleration of economic activity in the second half of the year, with real GDP growth ranging between 2-2.5% as the negative drag from the 2013 tax increases diminishes over time. Rising real estate and financial wealth is expected to support household balance sheets and underpin personal expenditures, allowing a modest and gradual pickup in consumer spending growth towards the end of the year. Unlike the Fed that forecasts a surge in real economic growth to about 3.0% in H2 2013, we look for softer growth throughout 2013 because the fiscal drag from across-the-board public spending cuts will still weigh on economic activity, given the lag between when budget authority cuts are made and when the actual spending cuts actually occur. Overall, we continue to expect a deceleration of real GDP growth to around 1.8% y-o-y in 2013 from 2.2% in 2012, with the weakening government spending offsetting the improvement in private domestic demand.

Figure 1.1

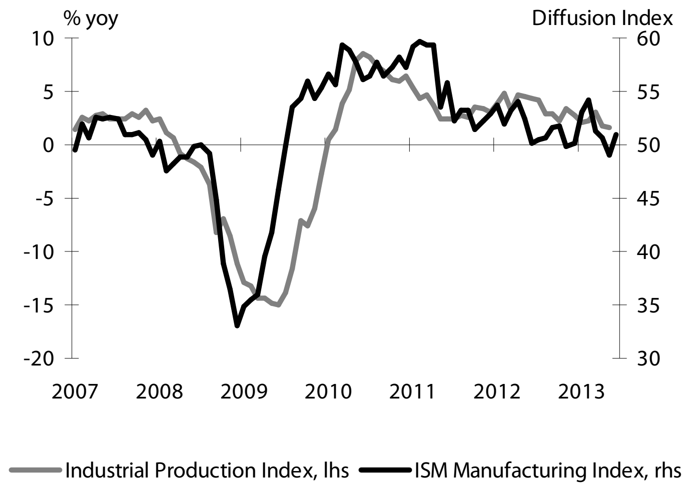
US: National Financial Conditions Index (NFCI)[1]



Source: Federal Reserve Bank of Chicago

Figure 1.2

US: Manufacturing slowdown in Q2 2013



Source: The Conference Board, Bloomberg

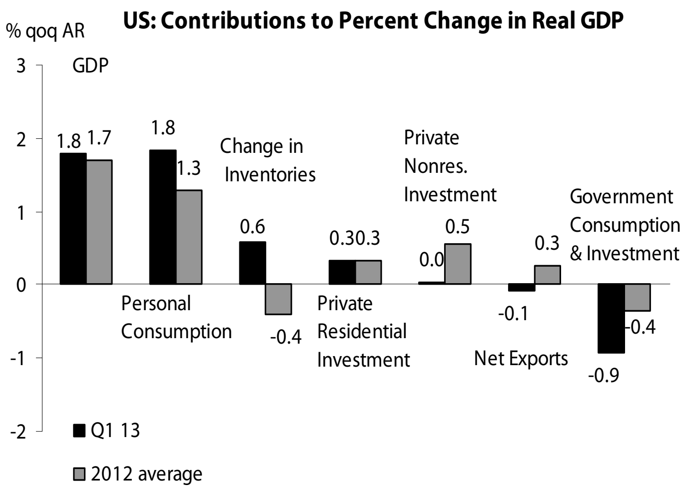
Acceleration in real GDP growth due to private consumption and inventory building

According to the third estimate of the Bureau of Economic Analysis (BEA), real GDP increased by 1.8% q-o-q saar in Q1 2013, after a 0.4% quarterly growth in Q4 2012. The acceleration in real economic activity was mainly attributed to a pickup in real private consumption growth and a rebound in inventory accumulation. Private residential investment continued to contribute positively in the first quarter of the year, given the recent strong upward trend in housing starts and building permits. The government sector was the major drag, subtracting roughly 1% from real economic activity, while net trade subtracted 0.1% off growth (Figure 1.3).

Real personal consumption growth accelerated to 2.6% q-o-q saar in Q1 2013 from 1.8% in Q4 2012, constituting the strongest part of the GDP report. Although goods consumption growth stayed relatively stable (4.4% q-o-q saar from 4.3% in Q4 2012), stronger consumption growth was mainly a result of a 1.7% increase in services, after a 0.6% increase in the final quarter of 2012. The massive gain in the consumption of household utilities in Q1 2013 was based on two factors: a payback after the large decline in utilities spending in Q4 2012 due to Hurricane Sandy, and the unusual cold weather this past March. Although consumer sentiment has not experienced signs of weakness up to now, we do expect consumer spending growth to slow in the second quarter of the year, given tax increases at the start of the year and the sequestration process set in effect at the beginning of March. Indeed, private consumption growth was downwardly revised in April (from +0.1% to -0.1% mom) and reported a mere increase of 0.2% in May, suggesting a loss of some momentum in the second quarter in lagged response to the large plunge in real disposable income in Q1 2013 (Figure 1.4). Besides, soft June retail sales and a downward revision to May retail sales are consistent with slower consumption growth in Q2.

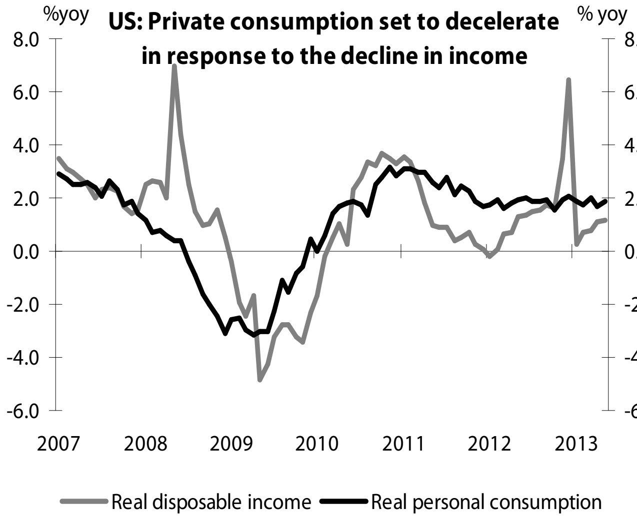
[1] The Chicago Fed's National Financial Conditions Index (NFCI) provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets, and the traditional and "shadow" banking systems. Because U.S. economic and financial conditions tend to be highly correlated, we also present an alternative index, the adjusted NFCI (ANFCI). The National Financial Conditions Index (NFCI) and adjusted NFCI (ANFCI) are each constructed to have an average value of zero and a standard deviation of one over a sample period extending back to 1973. Positive values of the NFCI indicate financial conditions that are tighter than on average, while negative values indicate financial conditions that are looser than on average. Similarly, a positive value of the ANFCI indicates financial conditions that are tighter on average than would be typically suggested by economic conditions, while a negative value indicates the opposite.

Figure 1.3



Source: US Bureau of Economic Analysis, Eurobank Research estimates

Figure 1.4



Source: US Bureau of Economic Analysis

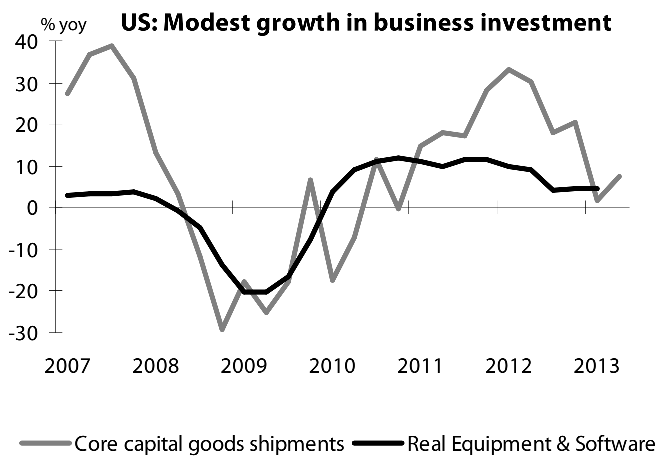
Modest growth in business investment

Fixed business investment was weaker than expected, as equipment and software rose only 4.1% q-o-q saar -compared to 11.8% previously- and structural investment fell -8.3% following a 16.7% increase in the previous quarter. Uncertainty about the US economic outlook due to tax increases and pending budget sequestrations has weighed on businesses, with nonresidential contributing a modest 0.04% in Q1 2013 after 1.28% previously. Core capital goods shipments, which are the main input for equipment and software, contracted in April suggesting that loss of business confidence will weigh on business investment in the second quarter of the year. However, the decline could be partly attributed to the seasonal pattern for core orders and shipments to decline in the first month of the quarter. Indeed, core capital goods shipments rebounded in May, rising 1.9% m-o-m in May (Figure 1.5). We expect a gradual acceleration in business investment growth towards the end of the year, provided that firms become more confident about a sustained economic recovery over the course of time and, therefore, more reluctant to invest. The upward trend in NFIB's small business optimism index over the past couple of months points to a continued improvement in respondents' expectations for the broader economy over the next six months, although small business sentiment remains at a low level by historical standards. On an annual basis, we expect real business investment to decelerate from 8.0% in 2012 to about 5.0% in 2013.

Housing turnaround looks sustainable

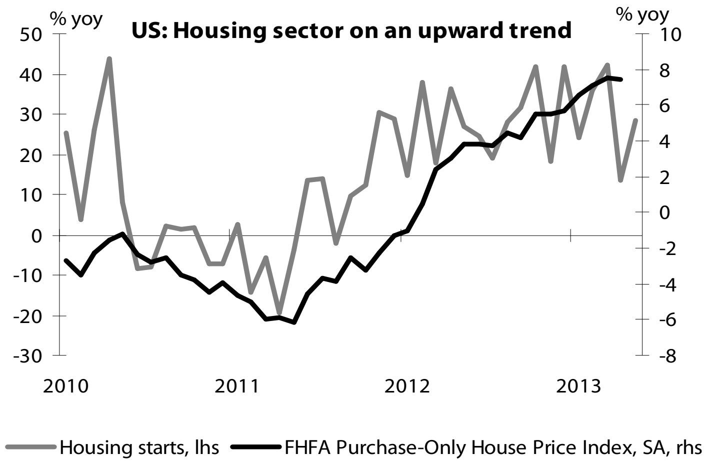
Residential investment remains a bright spot of the US economy, contributing an average of 0.3pp in real GDP quarterly growth since the end of 2011. The Federal Reserve's June Beige Book highlights an improved housing sector that provides a notable boost to real economic activity. According to Fed's Beige Book, which includes information collected on or before May 24, residential real estate and construction activity has been increasing at a moderate to strong pace in all districts. Indeed, home sales, house prices and residential construction have been on an upward trend over the past year (Figure 1.6). Meanwhile, the National Association of Home Builders (NAHB) index of home builder sentiment rose in June to its highest level in 7 years, suggesting that the gradual improvement in housing demand should continue to support the housing market recovery, despite the significant increase in mortgage rates in recent months. Nevertheless, there is still a long way to go before housing activity is back at its long-term trend. All in all, we expect the housing cycle to continue its upward momentum supported by broad-based home price appreciation, constituting a positive factor for growth in the coming quarters.

Figure 1.5



Source: US Census Bureau, Bureau of Economic Analysis

Figure 1.6



Source: US Census Bureau, OFHEO

Wider trade deficit points to a drag from external trade in Q2

Although external trade was a positive input for growth in 2012, it was actually a drag for economic activity in the first quarter of 2013. Real exports of goods and services declined by 1.1% q-o-q saar in Q4, more than double the reported decline in real imports (-0.4%). Net trade had contributed an average of 0.3 percentage points to GDP growth in the past four quarters (Figure 1.3). Nevertheless, it was particularly weak at the start of the year due to an economic deceleration in US major trade partners. Net trade is expected to remain a drag for real economic activity in the second quarter of the year, as export demand from its main partners and, particularly, China has probably lost steam due to a slower growth trajectory. Indeed, the US trade deficit widened more than expected in May, as real goods imports increased 3.1% m-o-m versus a mere 0.1% increase in real goods exports.

Monetary policy: Closer to a slower pace of easing

At its 18-19 June meeting, the Federal Open Market Committee decided to continue purchasing mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. Nevertheless, the Committee was more hawkish than expected, with Chairman Bernanke confirming in his press conference that it would be appropriate to moderate the monthly pace of purchases later this year if the incoming data are consistent with Fed's forecasts (Table 1.1). According to the FOMC's projections, the asset purchase program should be completed in mid-2014, provided that the unemployment rate will fall to 7.0% by then and core inflation will have increased from its recent low readings.

Although we are not as optimistic for US growth as the FOMC, we do expect a downward trend in the unemployment rate, given the downward pressures exercised on the labor force participation rate due to the retirement of the baby boomers. Based on our forecast of the unemployment rate falling to 7.2% by year-end and inflation pressures gradually beginning to accelerate, we expect the Fed to begin tapering asset purchases at the 17-18 September policy meeting. A deceleration in the pace of monthly asset purchases is not an act of tightening financial conditions, but rather a slower pace of easing warranted by the recent improvement in US economic conditions and the Fed's concerns about the costs of further balance sheet expansion. Fed officials should determine the initial size of the reduction so that QE is removed relatively quickly, but without scaring financial markets with a consequent large increase in long-term rates. We expect the FOMC to taper its purchases in September to $70bn per month from $85bn at present, reducing both mortgage and treasury securities purchases simultaneously ($35bn in Treasuries and $35bn in agency MBS). The $70bn in QE could then be reduced by $20-30bn per FOMC meeting, allowing the asset purchase program to be completed by the end of Q1 2014. However, the first Fed rate hike is not expected until the first quarter of 2015 (Figure 1.7).

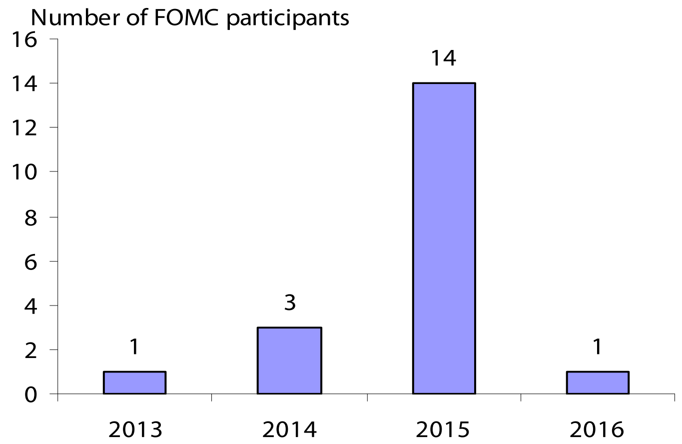
Table 1.1
Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, June 2013

	Central Tendency*			
USA	**2013**	**2014**	**2015**	**Longer run**
Change in real GDP	**2.3 – 2.6**	**3.0 - 3.5** (2.9-3.4)	**2.9 – 3.6**	**2.3 - 2.5** (2.3-2.5)
Unemployment rate March forecast	**7.2 – 7.3** (7.3-7.5)	**6.5 – 6.8** (6.7-7.0)	**5.8 - 6.2** (6.0-6.5)	**5.2 - 6.0** (5.2-6.0)
PCE inflation March forecast	**0.8- 1.2** (1.3-1.7)	**1.4 - 2.0** (1.5-2.0)	**1.6 - 2.0** (1.7-2.0)	**2.0** (2.0)
Core PCE inflation	**1.2 - 1.3** (1.5-1.6)	**1.5 – 1.8** (1.7-2.0)	**1.7- 2.0** (1.8-2.1)	
Fed Funds Rate	**0.00 -**	**0.00 –**	**0.75-**	**3.75 -**

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

Source: Federal Reserve, Eurobank EFG Research

Figure 1.7
Appropriate Timing of Policy Firming in the US



Source: Federal Reserve

2. The euro area economy

Vasilis Zarkos

- An anaemic economic recovery is likely in the second half of the year on the backdrop of slowly improving financial conditions and economic sentiment, some relaxation in fiscal targets and solid global demand.
- Risks to euro area economy remain on the downside. Social fatigue, weak political coalitions, leisurely approach towards essential structural reforms and a poorly addressed link between bank weaknesses and stressed public finances pose the risk of new bouts of financial turmoil. The inclusion of depositors in the bail-in process may fuel deposit outflows in the event of rekindled tensions in the banking sector.
- In view of our central scenario of economic stabilization in the second half of the year the ECB is expected to remain on hold. However, downward bias has been strengthened since the ECB's last meeting. In the event economic conditions deteriorate, the ECB could deliver additional rate cuts, combined with the provision of extra liquidity through long term refinancing operations.

Likely economic stabilization in the second half of the year

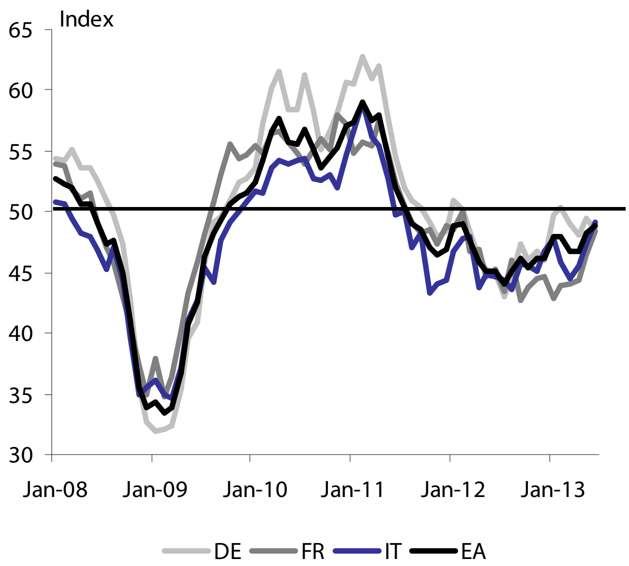
Our euro area economic outlook points to a stabilization of the economy in the second half of the year. Further muddling through in policy response is the most likely scenario, suggesting that the road ahead will likely remain bumpy. Absent any shock, gradual improvement in the financial sector, slow but steady improvement in business sentiment and solid global demand are expected to allow the euro area economic growth to enter positive territory in the quarters ahead, after six consecutive quarters of contraction. That said, headwinds remain strong, confining growth to anaemic levels. Ongoing fiscal retrenchment and constrained credit supply keep domestic demand low, while the contribution of net exports to GDP growth is likely to slow down, but remain positive. We have downgraded our GDP forecast for 2013 to -0.5% from 0% four months earlier, as depressed confidence has taken a heavier toll on economic activity.

Recent printings of leading indicators corroborate our view of economic stabilization in the second half of 2013 (Figure 2.1). Flash estimates show that the PMI composite index for the euro area improved for the third month in a raw in June. In a positive tone, the PMI manufacturing indices in April, May and June provided tentative signs of a widespread improvement, as they posted higher readings in both core and periphery economies. The Spanish PMI manufacturing turned above 50 in June for the first time since May 2011. Furthermore, the Ifo business climate index edged higher in May and June, adding to signs that growth of the German economy may gather pace in the quarters ahead. Nonetheless, recent improvements in business sentiment should only allow for hopes of a very gradual recovery as in most cases they remain below the threshold of 50 (which indicates expansion of business activity), while the increased volatility they exhibited in the previous months may continue given the multiple sources of uncertainty in the euro area.

Despite some relaxation in fiscal targets, the fiscal adjustment countries need to perform remains considerable (Figure 2.2). As a result, fiscal consolidation will remain a major headwind to the euro area economy in 2013, expected to recede in some major countries in 2014. Nevertheless, the fact that European policymakers seem to have realised that fiscal austerity as a means of adjustment has reached its limits augurs well for economic activity and contributes to the stability of sovereign bond markets.

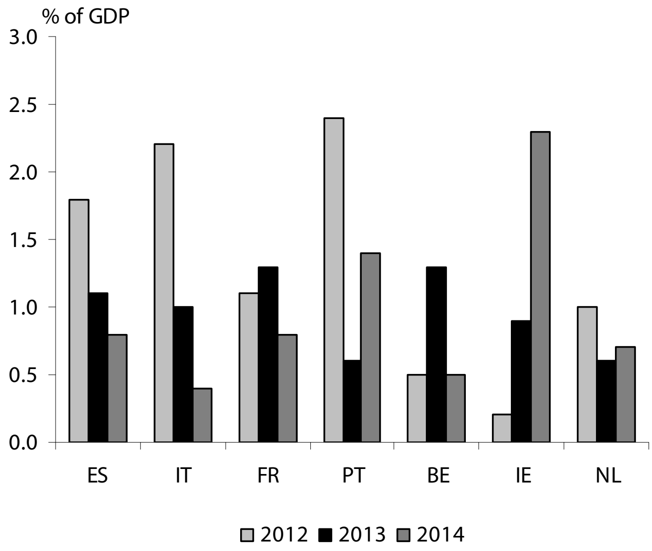
Tight credit conditions constitute another major headwind to the euro area economy. Excess liquidity provision has failed to translate to credit expansion. Amidst rising NPLs, euro area banks have continued tightening lending standards in Q1 2013, mainly on the backdrop of adverse economic expectations. The improvement in financial markets due to ECB interventions (liquidity provision through 3-year LTROs and the OMT program) averted a credit crunch and allowed lending rates to decline in both core and peripheral members. However, the euro area banking system remains fragmented, as is evident by the fact that banks in weak countries extend new loans at considerably higher rates than their German peers (Figure 2.3). Before taking into its supervision duties, the ECB will conduct thorough balance sheet reviews in order to clean up toxic assets. Unloading toxic assets and creating full transparency are necessary conditions to bring banks back to health and revitalize lending. However, in the short term, asset quality reviews are expected to act as a deterrent to loan provision, as the process is expected to reveal balance sheet weaknesses and the need for additional capital injection.

Figure 2.1
PMI Manufacturing in euro area countries



Source: Bloomberg

Figure 2.2
Change in Structural Budget Balance in euro area countries



Source: Stability Programs, Ecofin decision on June 21, 2013

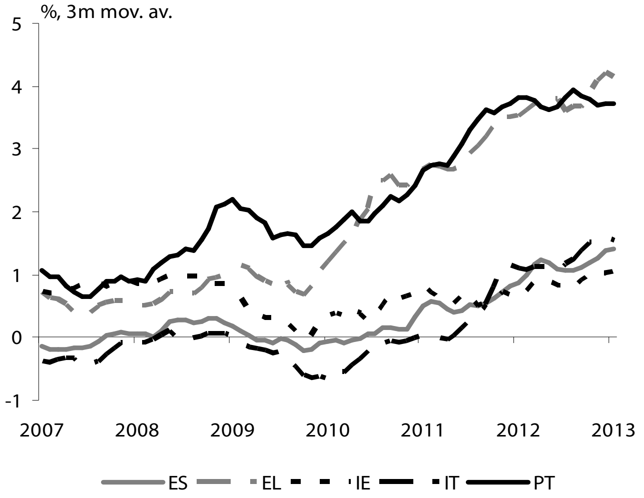
The divergent growth pattern between core and periphery countries is expected to continue. In Germany, strong fundamentals guarantee solid economic expansion. Temporary factors, including cold weather, have contributed to less than expected growth in Q1, suggesting that a payback is likely in Q2. Additional wage gains well above the inflation rate, positive wealth effects from a buoyant housing sector and relatively easy funding conditions should support private consumption and investment plans. Higher spending in Germany is a welcome development as part of the euro area rebalancing process. The French economy is expected to lag behind, and most likely contract slightly this year due to both structural (e.g. loss of competitiveness) and cyclical (e.g. fiscal adjustment and week economic sentiment) factors.

The road ahead will likely remain bumpy as risks are on the downside.

Risks to our euro area outlook remain on the downside. Accumulating social fatigue amidst dire and still worsening unemployment conditions (Figure 2.4) and deteriorating living standards jeopardise fragile political stability. Bold initiatives by policymakers in periphery countries to increase growth prospects and combat unemployment are critical. In this context, inadequate policy action both at the country and the European level poses, in our view, a serious risk of new bouts of volatility. The ECB's OMT program and a shift of focus from strict fiscal targets to structural reform implementation have led to an abatement of borrowing costs for sovereigns that may give rise to a complacent approach towards politically costly reforms. Yet, policymakers in weak countries should take advantage of reduced tensions and take quick steps towards reforming their economy and institutions in order to increase growth potential, keep borrowing costs in check and preserve debt sustainability.

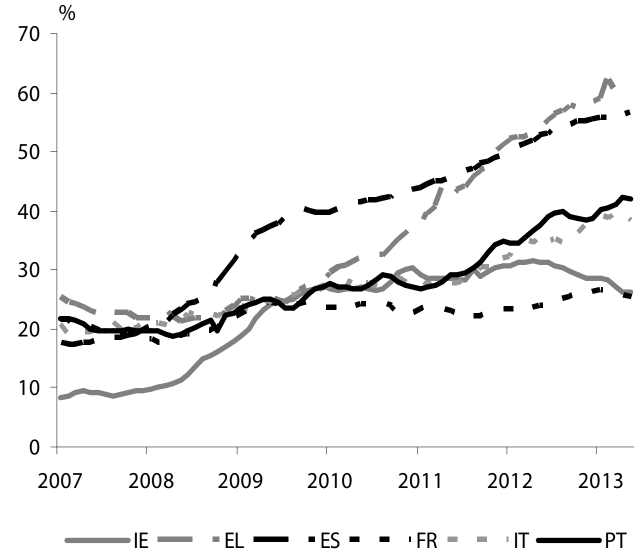
Further muddling through is expected with respect to progress towards the euro area integration. While it is evident that some form of mutualisation of risks should be part of the solution to the debt crisis, dissenting views over the right mix of risk sharing and loss of sovereignty slow down the progress. This is evident in recent bank resolution decisions, which, in our view, do little to break the negative feedback loop between financial weaknesses and stressed fiscal positions. First, a very tight framework has been set with respect to the leeway of the ESM as a tool of direct bank recapitalization, both in terms of the amount and the conditions of intervention. Reduced pressure from markets and the upcoming German elections have most likely played a role in watering down initial prospects. Second, while retroactive application of the instrument has been officially included as a possibility, it remains politically highly controversial and rather uncertain. Third, direct recapitalization by the ESM will not be available during the bank stress tests scheduled in early next year (expected to come into effect not earlier than autumn 2014). Fourth, a European resolution fund has not been established, while national resolution funds will take several years to build.

Figure 2.3
Lending rates to NFCs in euro area countries (spreads over German rates)



Note: Lending rates refer to new business loans with initial maturity up to 1 year
Source: ECB

Figure 2.4
Youth unemployment in euro area countries



Note: Youth unemployment refers to people under 25 years old.
Source: Eurostat

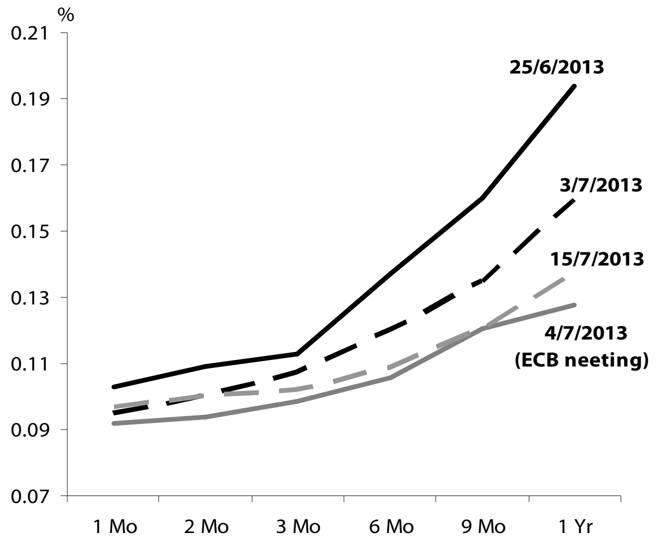
Moreover, the inclusion of uninsured depositors in the bail-in pecking order may contribute to the intensification of likely tensions in the vulnerable European banking sector. The handling of the bank crisis in Cyprus has certainly set a precedent for the banking systems in other weak countries. Spanish banks, in particular, continue facing pressures due to an ailing housing market, severe labor market conditions and poor economic prospects. The country's weakness and the unavailability of the ESM to act as a backstop would fan creditors' fears that they would be called to bear the brunt of any capital shortfalls. Hence, in the event of rekindled tensions, deposit outflows might prove difficult to stem. Fears of capital controls would create a negative feedback loop, further exacerbating the crisis.

ECB to remain on hold, though downward bias strengthened

In the June meeting, the ECB tied additional reduction of intervention rates to weaker incoming economic data. This link has been further strengthened in the July meeting, when President Draghi emphasized economic activity as a main pillar guiding the ECB's decisions. As our baseline scenario points to stabilization of economic activity, we do not forecast any additional policy rate cuts. Having said that, we believe the likelihood of more rate cuts has increased, meaning that it will probably take fewer signs of downside risks materializing to trigger monetary action. With respect to price developments, inflation has subsided well below 2% (1.6% in May), leaving room for a lower policy rate. However, the ECB interprets declining prices as part of the rebalancing process in periphery members and lower oil prices, seeing no risk of a disinflationary spiral that would call urgently for additional easing.

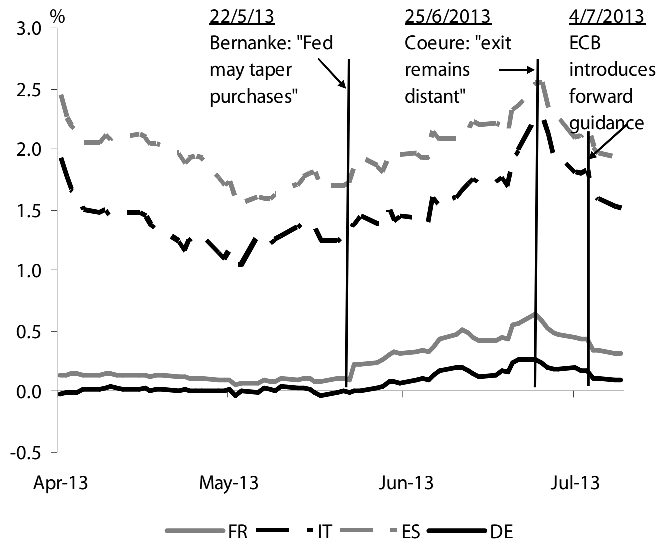
Ongoing credit contraction despite some normalization in financial conditions is a genuine concern for the ECB. The ongoing process of balance sheet healing and risk aversion due to dire economic conditions are the main factors behind bank's hesitation to extend new loans to the real economy. Hence, it is quite doubtful whether an additional rate cut would prompt credit growth as they would not address decisively these two factors. Instead, it would give banks a stronger incentive to profit from carry trade through the purchase of domestic government bonds. With respect to the deposit facility rate, in our view the ECB will remain hesitant towards cutting it below zero due to its uncertain impact on lending rates, which may actually prove opposite to the intended effect. In Denmark, banks passed costs due to negative rates to customers via higher lending rates. It also remains questionable whether penalizing idle liquidity would push banks to overcome their risk aversion and make new loans. Instead, some form of asset purchases that would lift credit risk from banks' balance sheets could be more effective in spurring credit growth. Finally, new long-term refinancing operations are likely in order to ensure that liquidity in the banking system remains ample.

Figure 2.5
euro area: EONIA Forward Curve



Source: Bloomberg

Figure 2.6
2-yr Government Bond Yields of euro area countries



Source: Bloomberg

In a move to shield European rates from the effect of Fed exit talks, the ECB abandoned its 14-year long stance to never pre-commit and introduced new forward guidance rhetoric. According to the new communication, "interest rates will remain at present or lower levels for an extended period of time". The ECB's overall dovish tone (starting with Mr. Coeure's statement of "exit remaining distant") has managed to talk short term rates down (Figures 2.5 and 2.6). The ECB provided neither a precise timeline of the forward guidance nor specific economic figures that are watched. However, as the Fed will be coming closer to tapering asset purchases and pressure on interest rates may mount, the ECB may be pushed to provide a clearer form of guidance with more specific exit criteria in order to boost the effectiveness of its new communication tool to stem increases in interest rates.

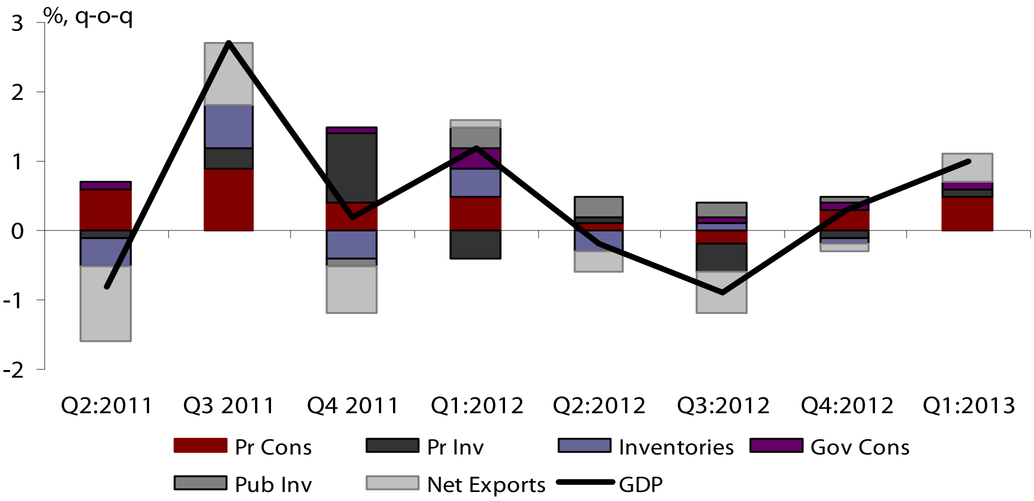
3. The Japanese economy

Vasilis Zarkos

- GDP growth in Japan is expected to remain firm in 2013 due to expansionary fiscal and monetary policy. Consumer spending is expected to remain buoyant thanks to elevated economic confidence, while solid global demand and a weaker currency will keep supporting Japanese exports.
- The narrowing of the output gap and yen depreciation are expected to allow inflation turn positive in 2013. However, achieving the target of 2% requires structural reforms, including labor market reforms, to work along with monetary easing.
- The government should avoid a leisurely approach in addressing Japan's dire public finances and provide a credible fiscal consolidation plan. In the short term, risks to the Japanese economy stem mainly from an escalation of the euro area crisis, slower growth in emerging markets and rekindled geopolitical tensions with China.

The Japanese economy grew by 4.1% q-o-q annualized in the first quarter of 2013 (Figure 3.1), owing to improved global conditions that allowed a significant contribution from net exports and improved economic sentiment along with stock market gains that led to higher private consumption. Real GDP growth is expected to remain firm in 2013 due to expansionary fiscal and monetary policy. Consumer spending is expected to remain buoyant thanks to elevated economic confidence, wealth effects and loose credit conditions. In addition, solid global demand and a weaker currency will keep supporting Japanese exports.

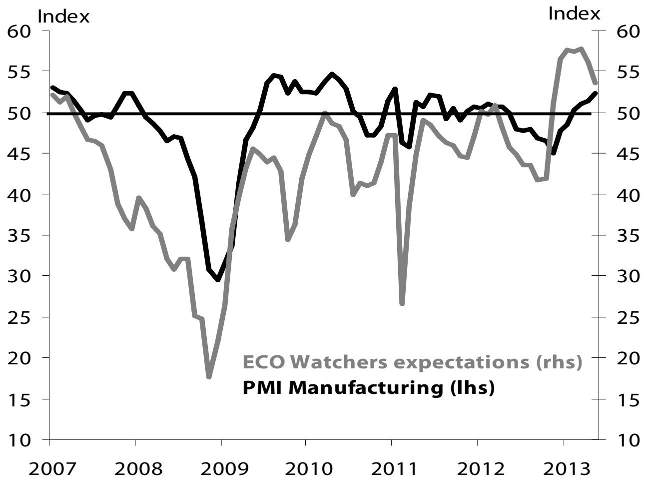
Figure 3.1
Japan: Contributions to quarterly GDP growth



Source: Cabinet Office

The PMI manufacturing index has been on a steady rise since December (when it troughed), reaching 52.3 in June (Figure 3.2). In a similar vein, the Eco Watchers expectations survey (a survey of frontline workers) has remained above the threshold of 50 (indicating improving economic sentiment) for seven consecutive months up until June. With respect to hard data, industrial production has been inching higher since the beginning of the year. Along with industrial production, real exports are recovering (Figure 3.3). The yen is expected to remain weak with respect to the USD due to the different policy stance between the Fed and the BoJ. Hence, industrial production and exports are likely to pick momentum in the period ahead, as the yen depreciation feeds through to external demand. On this backdrop, a pick up in capital expenditures may also be anticipated.

Figure 3.2
Japan



Source: Bloomberg

Figure 3.3
Japan

Source: Bloomberg

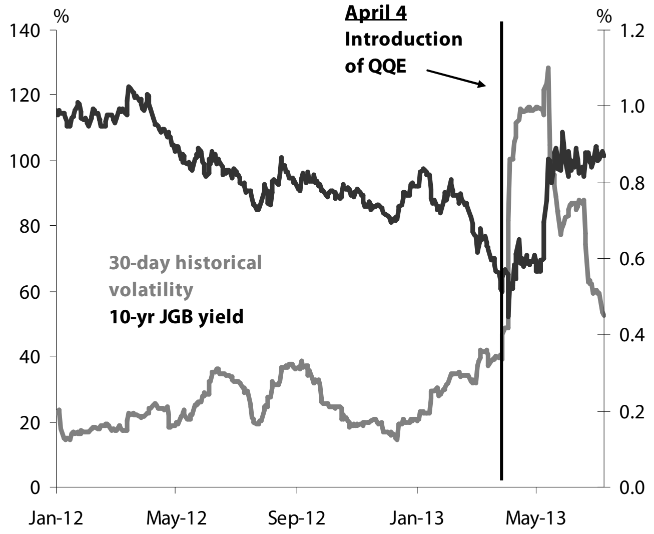
The narrowing of the output gap and yen depreciation are expected to allow inflation turn positive in 2013. On this backdrop, the Bank of Japan is expected to remain on hold in the period ahead. However, achieving the target of sustained annual price growth of 2% within two years set out in April may prove unlikely. As the BoJ may ultimately revise downwards its inflation forecasts, it may deliver additional easing later in the year or early in 2014, likely through increasing the pace of monthly asset purchases. A combination of easy monetary policy and structural reforms, such as those that would allow real wages to grow faster, is deemed indispensable for Japan to permanently escape deflation.

Clarification concerning the implementation of the BoJ's new quantitative easing program is required in order to allow the economy take full advantage of expansionary monetary policy. In April 4, the BoJ announced a massive QE program centered on sovereign bond (JGB) purchases with a view to end deflation. Since the introduction of the program, yields and volatility of the JGB market have increased considerably (figure 3.4), whereas the BoJ has sent confusing signals with respect to its view on long term yields. While in April the BoJ declared its intention to bring rates down along the yield curve, in May, it claimed higher rates as natural due to higher inflation expectations. Furthermore, in the June meeting, the BoJ refrained from extending the maturity of fund-supplying operations against pooled collateral to two years (from the current 1-year limit), an expected move that markets would interpret as a signal of BoJ's willingness to improve market stability. Mixed signals with respect to the JGB market have caused unrest in stock and forex markets (Figure 3.5), very likely reflecting investors' concerns about Japan's debt overhang[1]. An improvement in BoJ's communication is therefore necessary to assist JGB market settle in a new equilibrium under the new policy regime and establish market stability that would allow lax monetary policy to work.

In the short term, risks to the Japanese economy are mainly external, stemming from an escalation in the euro area crisis, which would hurt export activity, cause financial turmoil and yen appreciation. Moreover, Japanese exports to China would be hurt either by slower than expected growth of the Chinese economy or by new bouts of tensions over the disputed islands in East China Sea. Medium to longer term, Japan's main risk stems from policy failure to address its entrenched public finances. Super loose monetary policy without a credible plan for fiscal consolidation will likely permanently raise borrowing costs, aggravating the country's fiscal situation. In view of high pressures on state's budget due to a rapidly ageing population, the government should embark on structural reforms in order to increase the country's potential output growth and improve its debt sustainability.

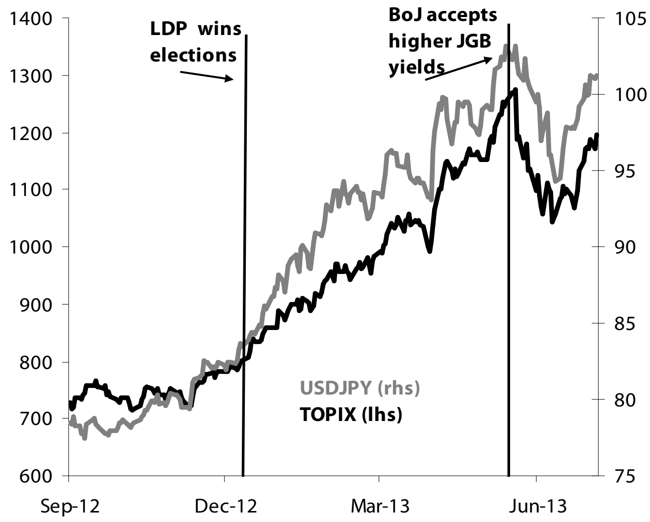
[1] Fed exit talks have most likely contributed to the correction in the Japanese stock market.

Figure 3.4
Japan



Source: Bloomberg

Figure 3.5
Japan



Source: Bloomberg

4. Emerging Economies

Maria Prandeka

- Less volatile external conditions and somewhat stronger growth in advanced economies suggest a marginal improvement of EMs economic activity in the second half of 2013 after the slow patch recorded in H1.
- Tighter liquidity in the US, a stronger US dollar, declining capital inflows, weak growth in China and lower commodity prices will be the main drags on EMs growth outlook.
- The outlook for favorable harvest on expectations of normal weather conditions should continue to restrain inflation over the near term. Currency depreciation will add to inflationary pressures, but generally few countries are under immediate pressure to raise interest rates.
- China has entered a period of structurally slower growth. The risk of a hard landing in China, namely an even sharper and sustained deceleration in GDP growth is not our base case, since there is still 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. Moreover, there is the risk that policymakers in their effort to reign in certain financial market activities could trigger another liquidity squeeze that could last too long, with the consequent spillover impact on the broader financial sector and the economy.

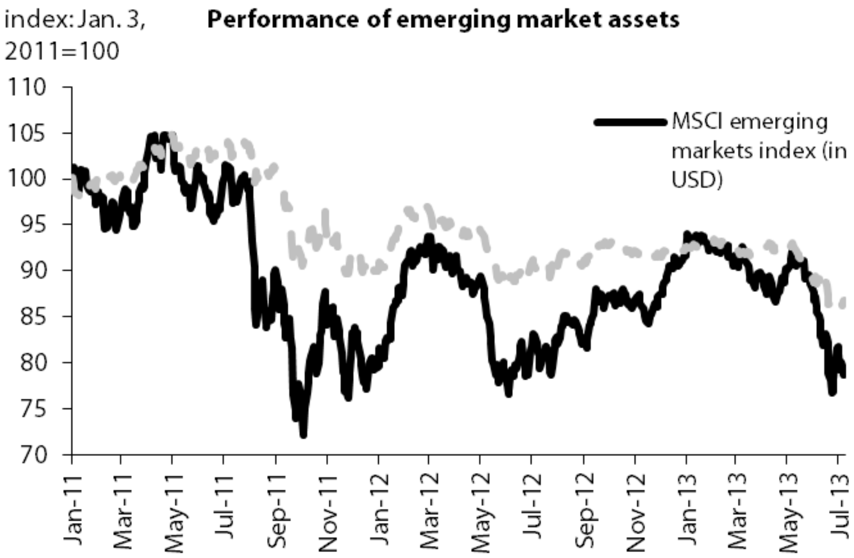
Economic activity in emerging economies has lost momentum since the beginning of the year

Over the past month, emerging market risk has been in the spotlight, as markets sold off heavily in anticipation of Fed commentary about winding down its QE programme (Figure 4.1). Both equities and bonds have witnessed significant outflows recently. The prospect of less liquidity have pushed up interest rates on US government debt, prompting investors to reposition away from emerging markets which had previously offered higher yields. Sentiment towards EMs has been negatively affected also by the fact that growth in many EMs has lost some momentum since the beginning of the year, while growth prospects for advanced economies brightened somewhat, thus making emerging economies less appealing at this juncture compared to advanced economies. First quarter GDP results across most EM economies were softer than expected, amid tepid external demand and lower commodity prices.

The continuing signs of sluggishness in China have largely added to the worse perception on EMs fundamentals. Indeed, economic activity has turned out slower than it was expected on the back of the government's anticorruption measures and the tightening of financial conditions. China's GDP growth rate declined to 7.7% y-o-y in Q1 2013 from 7.8% in 2012. Meanwhile, the spikes in Chinese interbank rates in late June, due to the People's Bank of China (PBOC) decision not to fully accommodate surging liquidity needs has created fears that China could be facing a severe credit crunch with substantial negative macroeconomic implications for China and the rest of the world. After reaching 20%, however, interbank rates eased, following the PBOC's assurance that it still stands behind regular liquidity needs and is ready to smooth excessive volatility in the markets.

Brazil's economy, in addition, grew by just 0.9% y-o-y in 2012, down from 2.7% in 2011 and 7.5% in 2010. Brazil's fast economic growth over the previous years was a consequence of structural reforms, prudent macroeconomic policies and a sharp increase in commodity prices led by increased Chinese demand. However, now, given the sluggish pace of structural reforms and a changing global environment Brazil's economic performance disappointed. In Q1 2013, GDP grew 0.55% q-o-q sa, down from 0.64% q-o-q sa in Q4 2012, mainly reflecting weak household consumption and a large negative contribution from net exports. Brazil's main risk is that fiscal policy remains strongly expansionary, while the government has signalled a tighter monetary policy. This mix of policies could lead to a further weakness of the currency, higher interest rates and even slower growth.

Figure 4.1



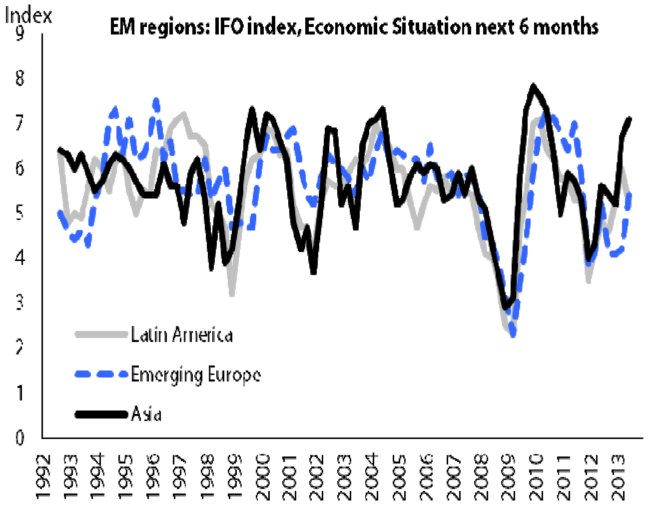
Source: Bloomberg

Growth in EM economies is expected to improve marginally in the second half of 2013

Tighter liquidity in the US, a stronger US dollar, declining capital inflows, weak growth in China and lower commodity prices would weigh on EMs growth outlook. However, less volatile external conditions and somewhat stronger growth in advanced economies suggest a marginal improvement of EMs economic activity in the second half of 2013 after the slow patch recorded in H1. Economic sentiment indicators across all EM regions are hovering above the threshold of 5 that indicates expansion in economic activity over the next six months (Figure 4.2). With fiscal consolidation continuing in most developed markets, however, growth rates of EMs exports will remain relatively modest and below historical standards. The weakening of many EM currencies, on the other hand, will support exports over time. Our BRICs leading indicator stabilized over the past months, confirming a moderate growth in emerging markets exports going forward (Figure 4.3). Given that a significant share of the current slowdown in EM is structural in nature, the recovery is expected to be slow and growth rates would not return to the high levels recorded over the past decade. Moreover, adjustment may be more challenging for some than for others, reflecting different local economic and policy conditions. Countries that have attracted significant amounts of hot money (Central & Eastern Europe) are among the most vulnerable to a sudden reversal of capital flows on EM economies as these kind of flows tend to depart first in the face of heightened market volatility and waning risk appetite. Additionally, countries with high external financing requirements (notably Eastern Europe and Central Asia) would also be the most exposed to an abrupt slowdown or reversal of capital inflows. Generally, risks still remain as long as the recovery in the global economy remains fragile and, thus, vulnerable to sudden shocks, all of which could dampen global demand.

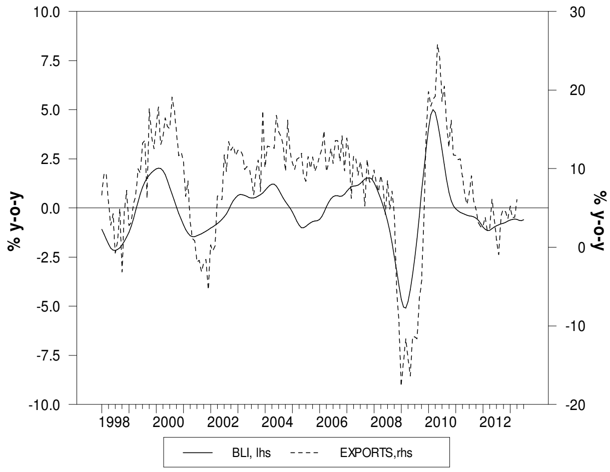
According to the latest IMF forecasts, in 2013, growth in emerging and developing economies is expected to increase only slightly from 4.9% in 2012 to 5.0% in 2013 and rise to 5.4% in 2014. Growth in Emerging Asia was mainly undermined by slower growth in China, which has started to shift away its economy from excessive reliance on investment and exports. However, the region will retain its status of the world's fastest growing region, with growth of 6.9% this year versus 6.5% in 2012 (Figure 4.4). Latin America's growth has slowed on the back of weakness in the region's main markets (US and Europe) and a sharp slowdown in Brazil. Furthermore, lower commodity prices and the risk of an early "QE tapering" in the US have triggered a weakening of local currencies against the dollar. The same factors will continue to weigh on economic activity over the next year. Growth in the region is expected to remain stable at 3.0% in 2013 and increase to 3.4% in 2014. Emerging Europe's output weakness has extended into the first half of 2013, on the back of sluggish domestic demand undermined by rising unemployment, slowing wage growth, slowing FDI flows and stalled bank lending. However, weaker currencies have helped exports to pick up in some countries. A sustained recovery in exports would be a key for the recovery of the region's growth later in the year. The projected recovery in the EU should support the region's exports, translated into stronger growth.

Figure 4.2



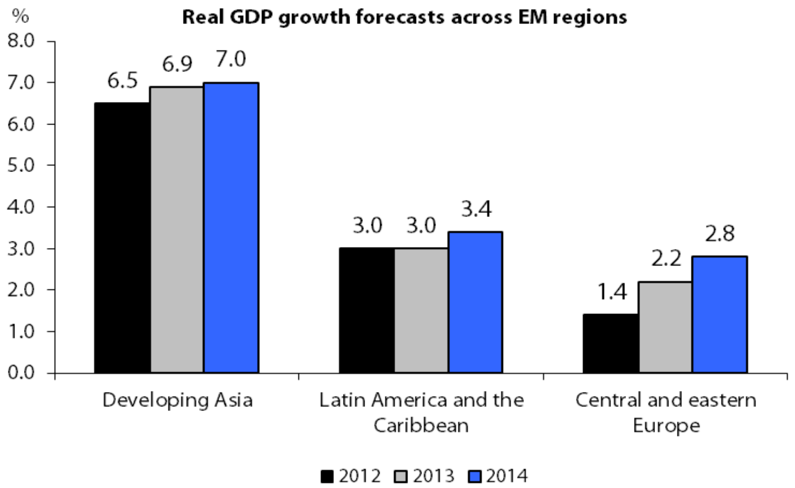
Source: Ecowin

Figure 4.3
BRICs Leading Indicator* & Exports



* 3 month forward
Source: Eurobank Research

Figure 4.4

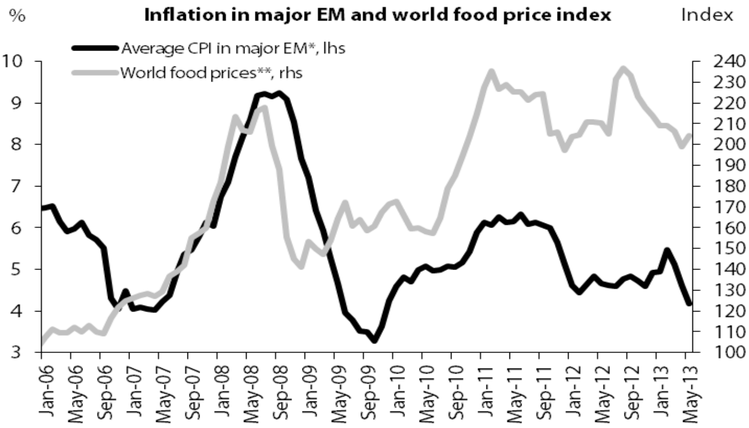


Source: IMF

Subdued inflation pressures are expected to allow central banks to maintain their accommodative policy stances

Falling commodity prices and moderate growth in domestic demand have all contributed to the downward trend in inflation. Average headline inflation across major EM economies has started to decline significantly since its recent peak in February, with the inflation rate falling from 5.5% to 4.2% in May, in tandem with a significant fall in world food prices (Figure 4.5). The outlook for favorable harvest on expectations of normal weather conditions should continue to restrain inflation over the near term. Currency depreciation will add to inflationary pressures, but generally few countries are under immediate pressure to raise interest rates. Generally, the backdrop of subdued inflation and soft global demand should allow most EM central banks to maintain their accommodative policy stances.

Figure 4.5



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

Structurally slower growth in China over the next few years

Weak activity growth so far in 2013 brought the risks on the annual GDP growth forecast to the downside and fueled renewed fears of a possible hard landing of the economy. Moreover, it escalated the risk that the government will miss its full year growth target of 7.5%. Many continue to worry about the risk of a hard landing in China, namely an even sharper and sustained deceleration in GDP growth. However, this is not our base case. China's economy has entered a period of subdued growth, with weak exports, credit and property prices. In fact, policymakers tolerate slower growth in order to rebalance the economy and transform the growth model. The structural reforms will take time to work and, thus, the economy will slow in the short term. Policymakers are determined to take measures to support growth and ensure social stability. Thought, we believe that they will be very cautious in implementing their policies and any stimulus will likely be moderate and targeted. We project growth to remain unchanged at 7.7% in 2013 and rebound slightly to 7.8% in 2014. The main risk to China's outlook is an insufficient domestic policy support and a non-smooth transmission to a more consumption-driven model and consequently a significantly lower trend growth. The prospects for a gradual slowdown are high, since there is enough room for policy to respond to downside risks. However, there are significant risks that growth could slow too quickly, should policymakers prove too slow to address ongoing growth risks. Moreover, policymakers in their effort to reign in certain financial market activities could trigger another liquidity squeeze that could last too long, with the consequent spillover impact on the broader financial sector and the economy.

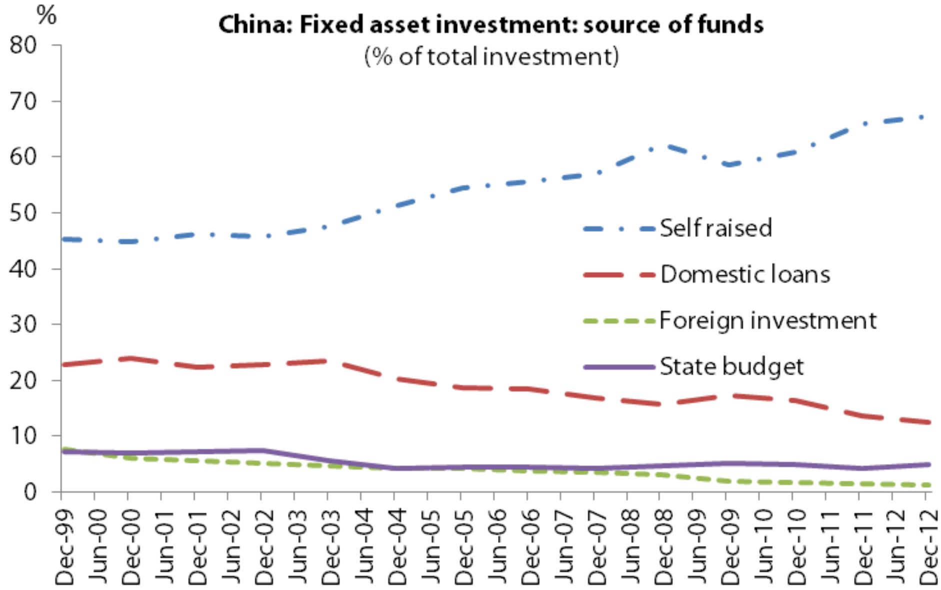
Implications of China's rebalancing for the world economy

The rebalancing of the Chinese economy will likely have several implications for the global economy, given its growing contribution to global output. China has contributed about 20% to global growth over the past decade. Given the sluggish growth in advanced economies, this rate is expected to surpass 30% over the coming years. Moreover, China's trade flows rose from less than 4% of the world total in 2000, to more than 10% in 2011, and is the second largest trading nation after the US. The transition to the new growth model weighs on global growth via reduced investment that lowers Chinese demand for raw materials and capital goods. China is a key player in global commodity markets. Consequently, slowing growth in China hurt commodity producers, such as Australia, Brazil, or South Africa, as well as capital goods manufacturing economies with sizeable exports to China, such as Germany and Japan. According to the IMF[1], the impact of a percentage point slowdown in Chinese investment would be a reduction of global growth of 0.1%. The impact is about five times larger than in 2002. It's worth noting, though, that since China's investment has been financed predominantly by self-raised funds, namely own savings and corporate profits, and not from foreign savings, we believe that China will manage a smooth rebalance (Figure 4.6). Meanwhile, the transition to a consumption-led growth does not indicate a significant positive impact on

[1] IMF Working Paper, Investment-Led Growth in China: Global Spillovers, November 2011

consumer goods exporters. China's share in global consumer imports has increased at a slower pace over the past fifteen years than its share in global consumption[1]. Currently, China's imports of goods as a share of global consumer goods imports stands only at 2%.

Figure 4.6



Source: Ecowin

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

III. Macro Forecasts

Real GDP growth						
	2011	2012	2013f		2014f	
			Eurobank	Consensus	Eurobank	Consensus
US	1.8	2.2	1.8	1.8 (1.4 – 3.0)	2.5	2.7 (1.0 – 4.2)
EA	1.5	-0.6	-0.5	-0.6 (-1.5 – -0.1)	1.0	1.0 (-1.0 – 2.3)
Japan	-0.6	2.0	1.8	1.8 (1.1 – 2.8)	1.4	1.4 (0.3– 2.5)
China	9.3	7.8	7.7	7.6 (7.2 – 8.1)	7.8	7.6 (6.2 – 8.8)
India	7.5	5.1	5.3		5.8	
Russia	4.3	3.4	3.0	2.8 (2.0 – 3.4)	3.5	3.5 (2.5 – 4.3)
Brazil	2.8	0.9	2.3	2.5 (2.0 – 3.6)	2.8	3.2 (1.5 – 4.0)

Inflation						
	2011	2012	2013f		2014f	
			Eurobank	Consensus	Eurobank	Consensus
US	3.2	2.1	1.7	1.5 (1.0 – 2.5)	2.2	1.9 (1.0 – 3.1)
EA	2.7	2.5	1.6	1.5 (1.2 – 2.5)	1.5	1.5 (0.5 – 2.2)
Japan	-0.3	0.0	0.1	0.0 (-0.5 – 0.7)	2.0	2.0 (0.5 – 3.2)
China	5.4	2.7	2.8	2.7 (1.8 – 4.0)	3.2	3.2 (2.5 – 4.4)
India (WPI)	9.5	7.5	6.5		5.5	
Russia	8.5	5.1	6.5	6.5 (5.7 – 6.9)	5.5	5.6 (4.8 – 6.6)
Brazil	6.6	5.4	6.0	6.3 (5.0 – 6.6)	5.5	5.7 (5.0 – 6.3)

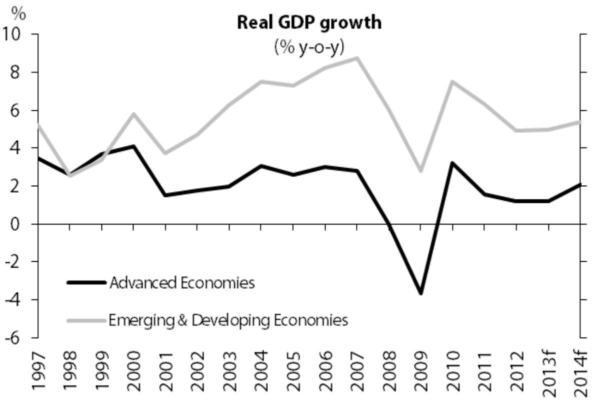
Note: Range of forecasts by Bloomberg's survey in parentheses below point estimates.

Policy Rates					
		Eurobank			
	Current	Q3 13f	Q4 13f	Q1 14f	Q2 14f
US	0.00 – 0.25	0.00 – 0.25	0.00 – 0.25	0.00 – 0.25	0.00 – 0.25
EA	0.50	0.50	0.50	0.50	0.50
Japan	0.10	0.10	0.10	0.10	0.10
China	6.00	6.00	6.00	6.00	6.00
India	7.25	7.00	7.00	6.75	6.75
Russia	8.25	8.00	7.75	7.50	7.50
Brazil	8.50	8.75	9.00	9.00	9.00

IV. Graphs

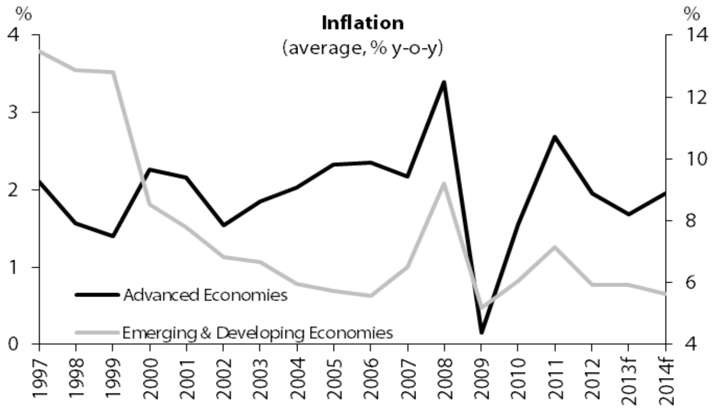
Global Economic Indicators – World Economy

World Economy

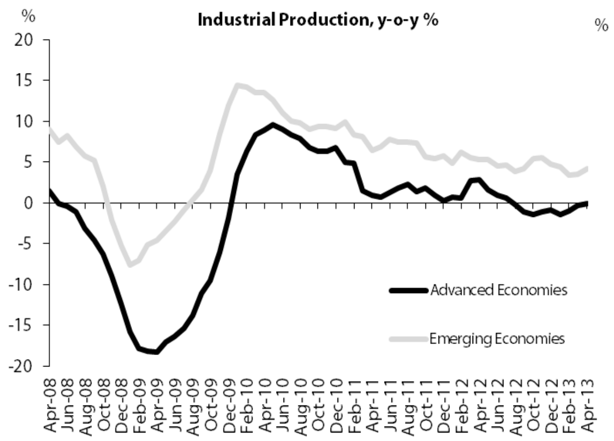


Source: IMF

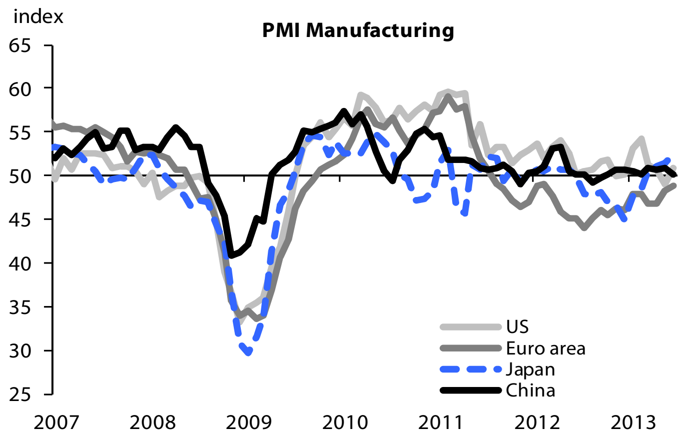
World Economy



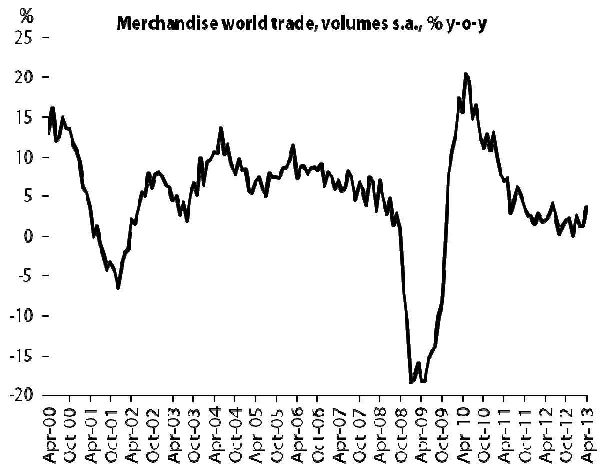
Source: IMF



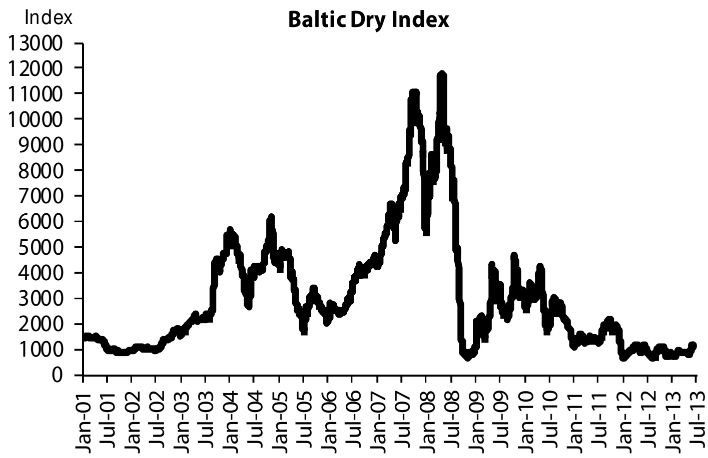
Source: CPB Netherlands Bureau for Economic Policy Analysis



Source: Bloomberg



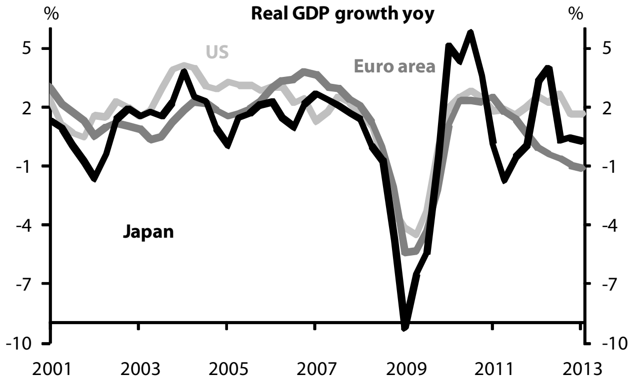
Source: CPB Netherlands Bureau for Economic Policy Analysis



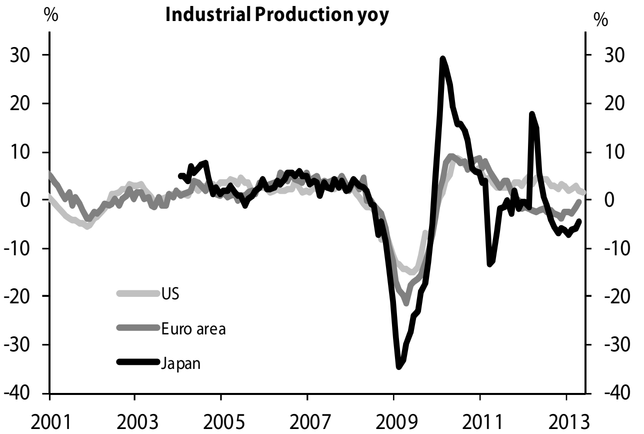
Source: Bloomberg

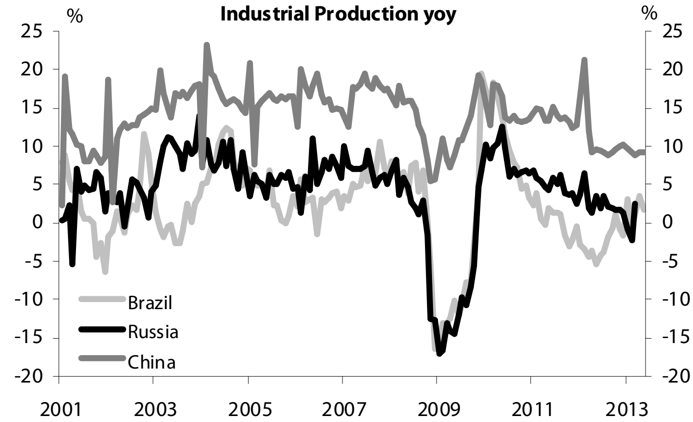
Global Economic Indicators

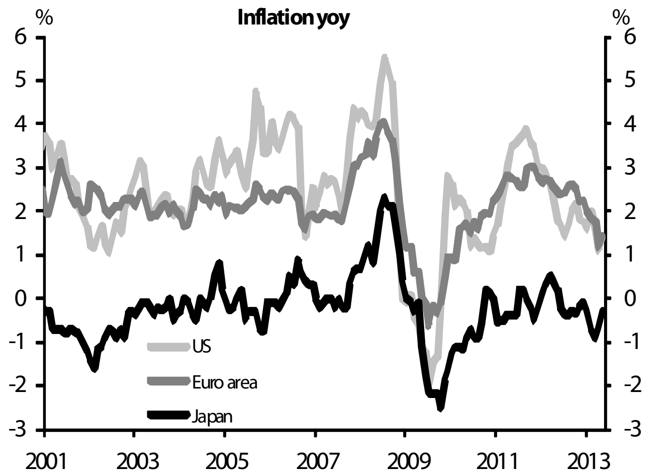
Advanced Economies

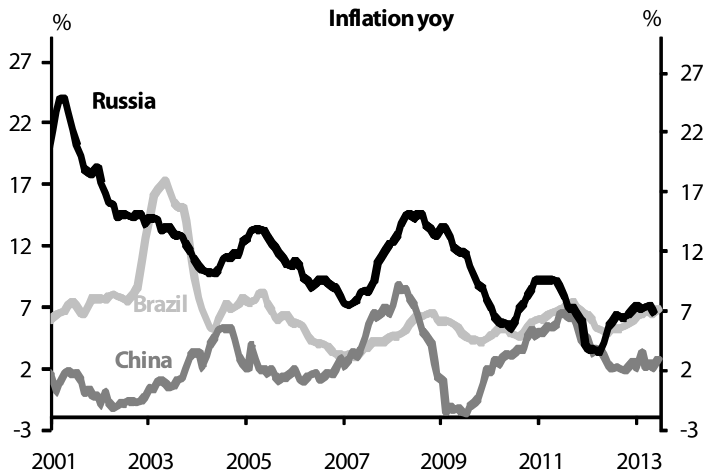


Emerging Economies







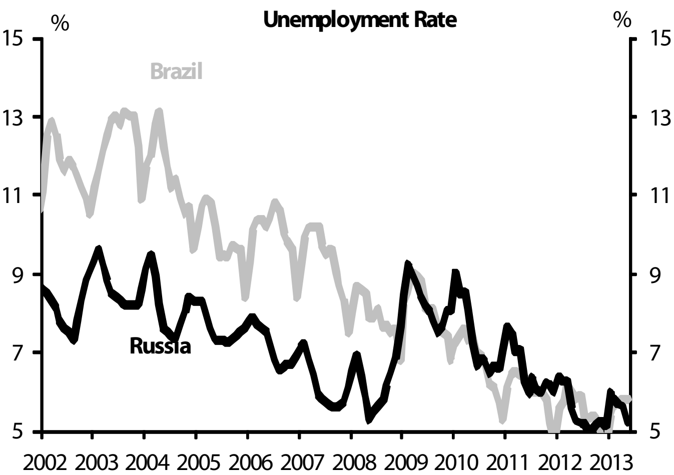


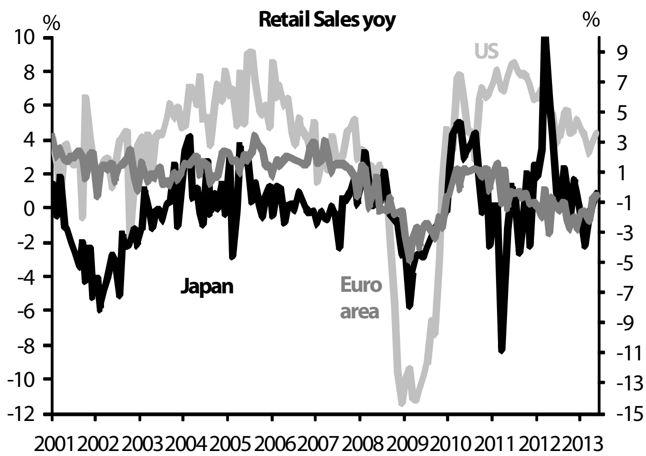
Source: Bloomberg, Ecowin

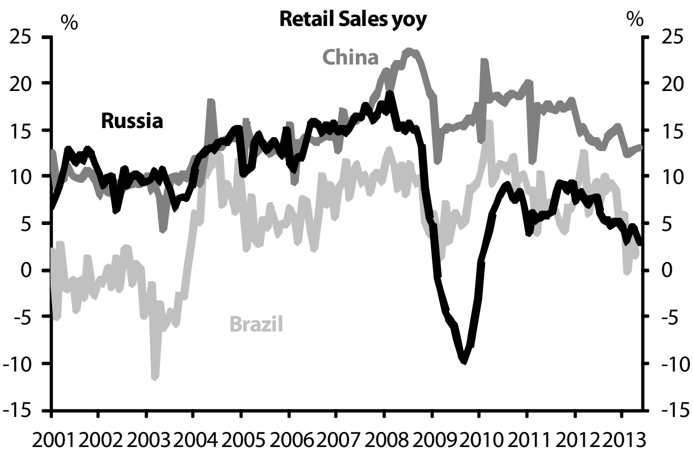
Global Economic Indicators

Advanced Economies

Emerging Economies



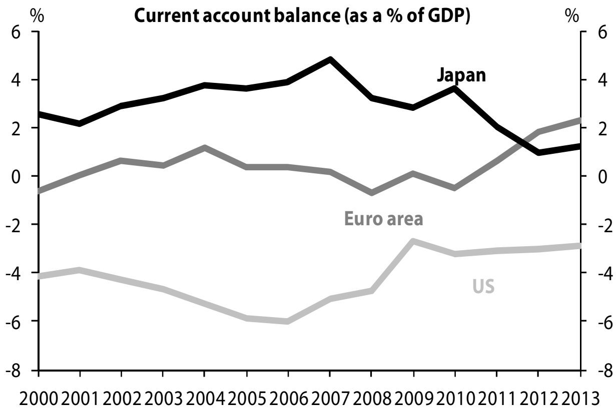




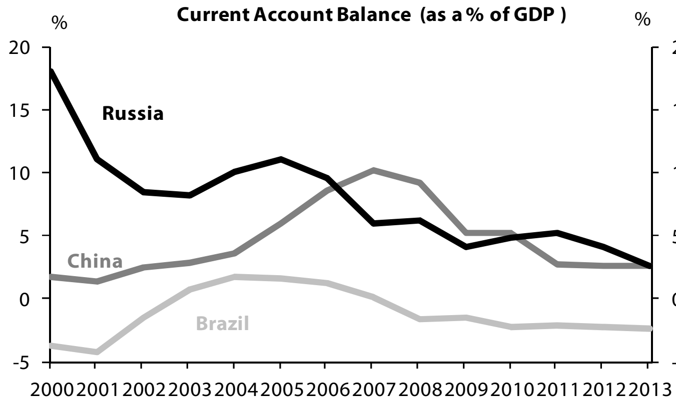
Source: Bloomberg, Ecowin

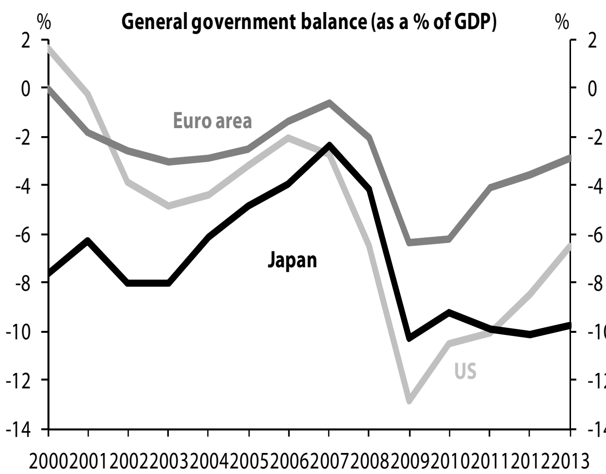
Global Economic Indicators

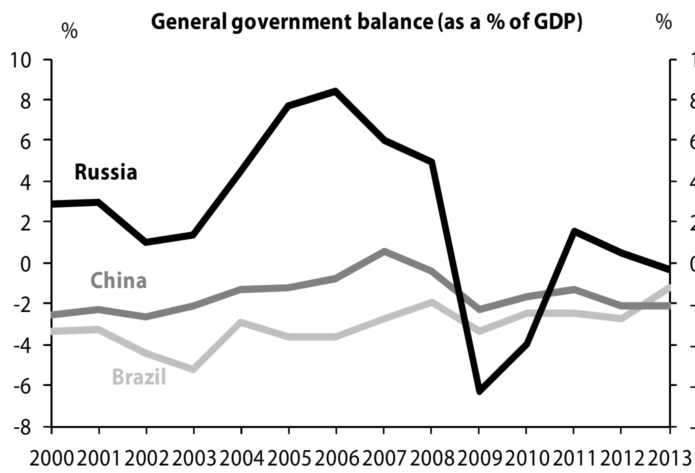
Advanced Economies

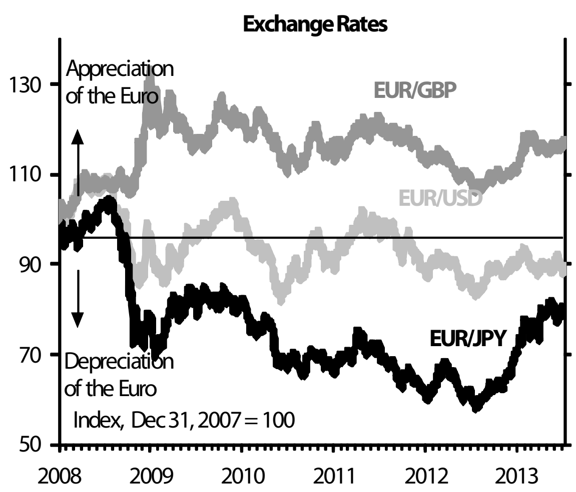


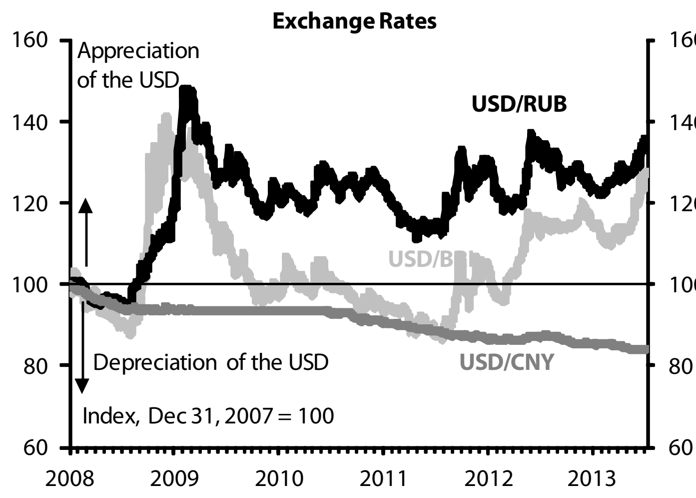
Emerging Economies







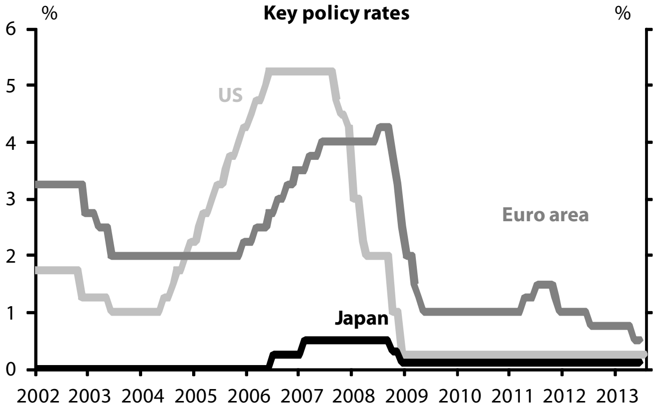




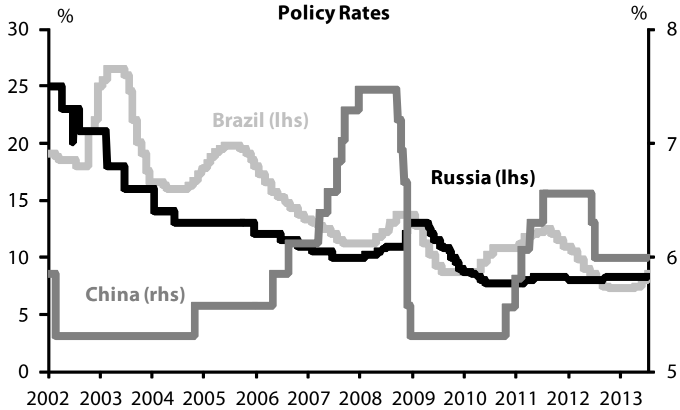
Source: Bloomberg, Ecowin, IMF, Eurobank Research

Global Economic Indicators

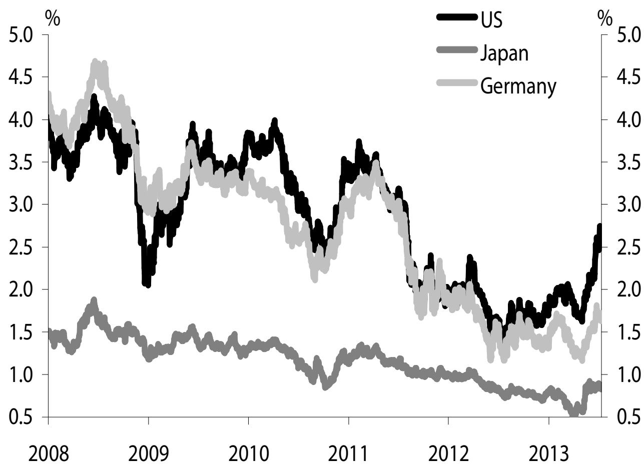
Key policy rates



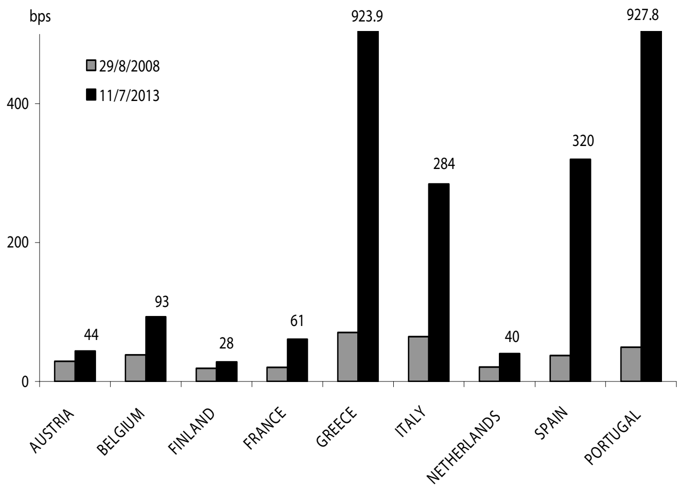
Policy Rates



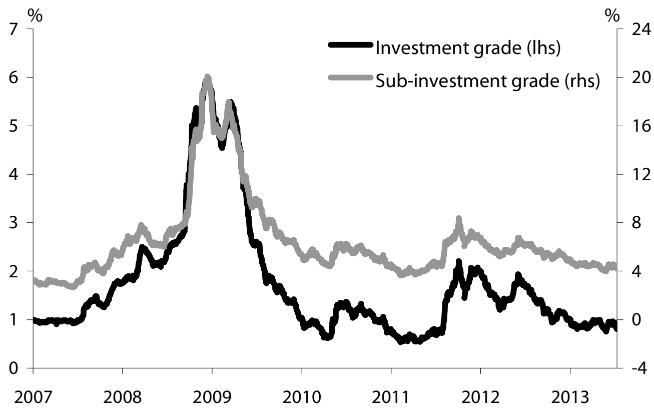
10y Government Bonds



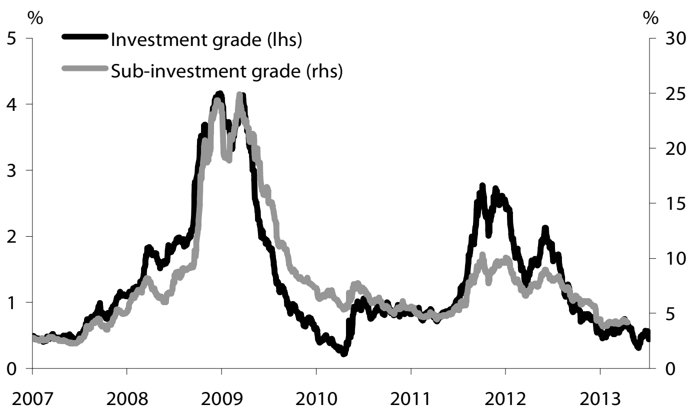
10yr government spreads vs Germany



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 July 11, 2013

Global Equity Indices (in local currency)

Region	Index	Last Price	1w	1m	6m	12m	YTD	2012
US	S&P 500	1675.0	3.7	3.9	13.8	25.5	17.4	13.4
EURO AREA	DJ Euro Stoxx 50	2681.3	3.3	0.6	-1.3	20.3	1.7	13.8
GERMANY	DAX	8158.8	4.5	0.2	5.7	27.1	7.2	29.1
FRANCE	CAC 40	3869.0	3.1	2.0	4.4	23.4	6.3	15.2
UK	FTSE 100	6543.4	2.6	3.9	6.9	16.7	10.9	5.8
JAPAN	Nikkei	14472.6	1.1	8.9	34.0	66.0	39.2	22.9
CHINA	CSI 300	2326.7	4.5	-6.3	-6.3	-5.0	-7.8	7.6
INDIA	SENSEX	19676.1	0.9	3.3	0.1	14.2	1.3	25.7
RUSSIA	MICEX	1368.1	1.9	5.1	-9.4	-1.9	-7.2	5.2
BRAZIL	IBOV	46626.3	3.5	-5.2	-24.2	-12.7	-23.5	7.4

Source: Bloomberg

Sector performance as of July 11, 2013

US Sector Indices (in USD)

US – S&P 500	Last	1w	1m	6m	12m	YTD	2012
1. Consumer Discretionary	471.1	3.9	7.4	21.5	38.8	25.3	21.9
2. Consumer Staples	427.5	3.7	3.0	15.1	18.5	18.5	7.5
3. Energy	602.1	3.2	3.5	9.4	21.3	13.0	2.3
4. Financials	272.2	3.7	4.1	18.0	41.2	23.0	26.3
5. Health Care	574.0	4.2	3.8	18.7	31.4	24.0	15.2
6. Industrials	387.5	4.8	4.5	14.4	30.3	17.9	12.5
7. Information Technology	511.4	3.1	2.5	7.7	14.8	10.3	13.1
8. Materials	253.2	4.4	1.9	2.8	17.6	6.6	12.2
9. Telecommunication Services	160.7	0.9	1.8	8.4	10.1	10.0	12.5
10 Utilities	195.8	3.9	4.1	8.8	4.2	10.2	-2.9

Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Sector performance as of July 11, 2013

European Sector Indices (in €)

Europe - DJ Stoxx 600	Last	1w	1m	6m	12m	YTD	2012
1. Consumer Discretionary							
Automobiles & Components	614.2	4.0	4.2	12.5	42.5	14.9	39.2
Travel & Leisure	293.3	1.0	5.5	15.3	37.2	17.8	33.6
Media	368.9	2.2	5.5	14.6	30.9	16.1	21.6
Retail	528.0	2.2	2.9	9.7	22.2	10.2	12.4
2. Consumer Staples							
Food & Beverage	833.1	2.6	2.6	8.8	15.4	9.0	21.7
Personal & Household Goods	995.3	3.0	2.6	12.4	24.3	13.5	24.2
3. Energy							
Oil & Gas	647.4	3.2	0.9	-3.0	-0.5	-0.3	-0.6
4. Financials							
Banks	343.2	2.2	0.2	-3.2	33.7	5.2	27.4
Financial Services	579.0	4.7	5.6	14.5	38.3	19.2	26.6
Insurance	350.7	3.1	4.8	10.6	42.0	14.3	38.7
Real Estate	133.6	3.3	4.2	4.5	13.0	3.3	24.9
5. Health Care	876.5	1.8	1.7	14.9	23.8	17.9	15.5
6. Industrials							
Industrial Goods & Services	604.0	3.2	2.4	8.0	28.3	10.4	25.2
7. Information Technology	255.1	3.6	4.5	6.5	35.5	11.2	21.8
8. Materials							
Basic Resources	653.2	7.0	-1.3	-22.6	-11.9	-22.3	7.1
Chemicals	1258.2	4.6	1.1	7.2	27.5	6.8	32.5
Construction & Materials	487.6	3.4	1.9	5.7	23.5	7.0	19.2
9. Telecommunication Services	508.7	1.6	2.7	4.9	4.4	10.2	-5.2
10. Utilities	584.0	2.0	-0.5	1.6	3.1	1.4	4.7

Source: Bloomberg

Sector performance as of July 11, 2013

Asia Sector Indices (in USD)

Asia – S&P 50 Index*	Last	1w	1m	6m	12m	YTD	2012
1. Consumer Discretionary	9386.8	1.7	-0.9	-5.1	-4.1	-6.2	5.3
2. Consumer Staples	12319.8	3.7	-3.5	-2.4	-3.1	-3.0	-9.1
3. Energy	11679.8	4.3	-1.5	-18.8	-2.0	-18.7	21.7
4. Financials	3559.6	3.8	-3.1	-8.7	3.4	-5.6	26.5
5. Industrials	2746.7	0.8	-2.6	-7.6	5.8	-5.8	21.9
6. Information Technology	11079.7	-1.5	-8.1	-14.8	14.8	-13.7	40.9
7. Materials	3450.8	3.8	-2.5	-15.1	-9.2	-11.6	-0.6
8. Telecommunication Services	2767.5	2.9	2.5	-4.7	-0.8	-4.5	14.8
9. Utilities	4022.5	3.0	1.0	2.0	13.2	2.0	15.0

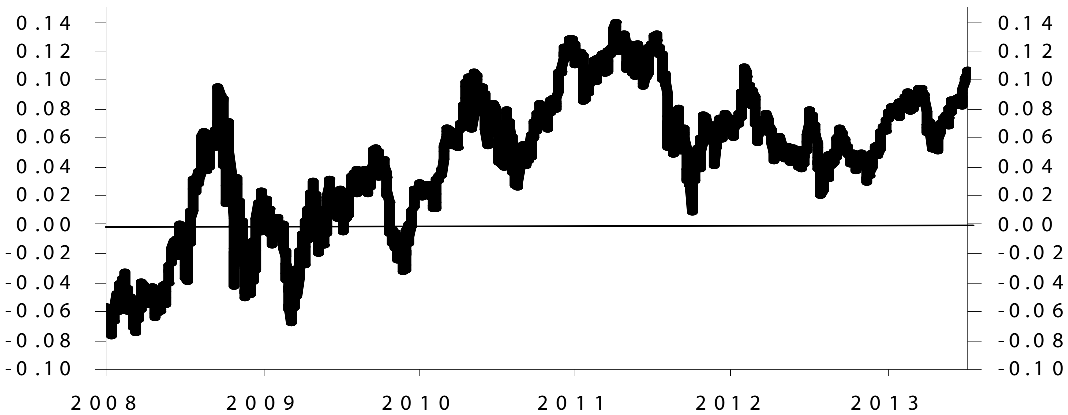
Source: Ecowin

US Style Equity Indices

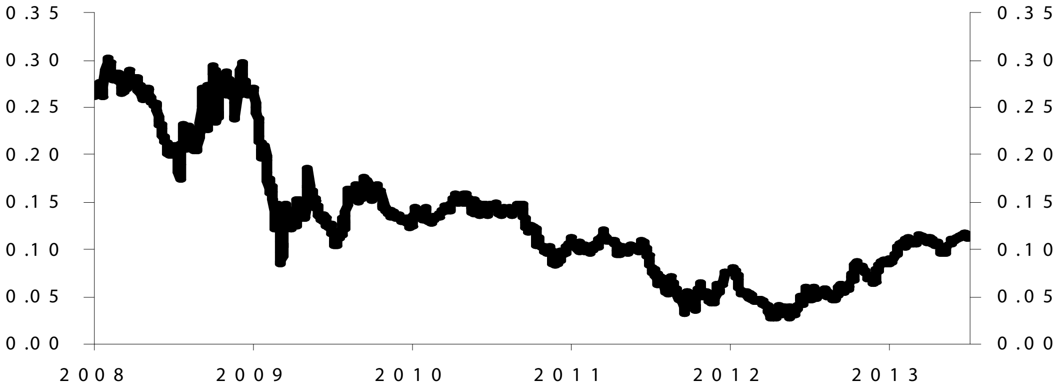
Total Return (%) as of July 11, 2013

US Style Indices (in USD)								
Index	**Last Price**	**1w**	**1m**	**6m**	**12m**	**YTD**	**2012**
Russell 1000 (Large Cap)	929.5	3.7	4.1	13.9	26.3	17.7	13.9
Russell 2000 (Small Cap)	1033.2	4.2	6.3	17.3	30.8	21.6	14.6
Relative performance (Small vs Large)		0.5	2.2	3.4	4.5	4.0	0.7
Russell 1000 Value	853.6	3.6	4.0	15.1	29.9	19.1	14.5
Russell 1000 Growth	764.1	3.8	4.1	12.5	22.7	16.1	13.3
Relative performance (Value vs Growth)		-0.1	-0.1	2.6	7.2	3.0	1.2

Relative Performance (small vs large)
(logarithmic scale)



Relative Performance (value vs growth)
(logarithmic scale)



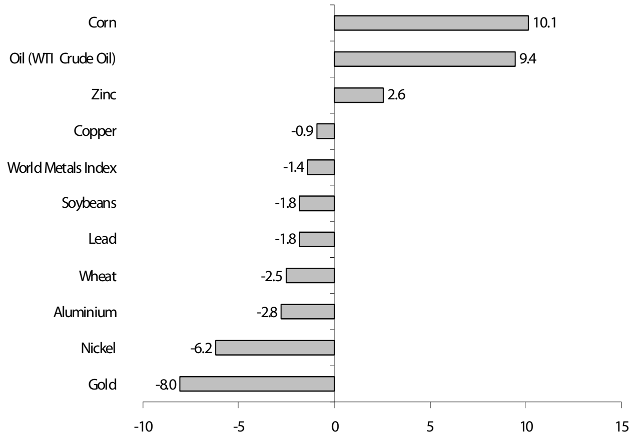
Source: Bloomberg

Commodities

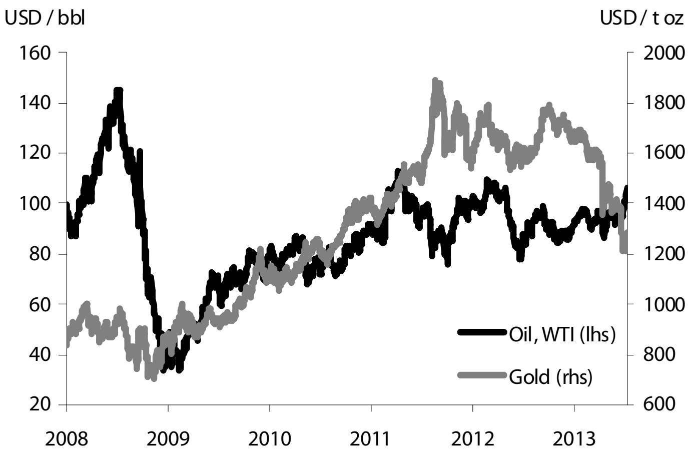
Commodity Performance (%) as of July 11, 2013

Commodities	Units	Last Price	1w	1m	6m	12m	YTD	2012
Oil (WTI Crude Oil)	USD/bbl	104.9	1.6	9.4	12.1	21.9	14.3	-7.1
Gold	USD/t oz	1279.9	5.5	-8.0	-22.9	-18.2	-23.6	7.0
Base Metals								
World Metals Index		3031.6	3.4	-1.4	-13.5	-5.0	-12.2	4.5
Aluminium	USD/lb	1835.0	1.3	-2.8	-12.5	-3.5	-11.5	2.6
Copper	USD/mt	7000.0	0.7	-0.9	-13.0	-7.2	-11.7	4.4
Lead	USD/mt	2080.0	0.3	-1.8	-9.8	11.3	-10.7	14.5
Nickel	USD/mt	13635.0	-1.4	-6.2	-22.5	-15.3	-20.1	-8.8
Zinc	USD/mt	1900.0	2.2	2.6	-5.7	2.6	-8.7	12.7
Agriculture								
Corn	USD/bu	716.8	4.7	10.1	1.1	-7.1	2.6	8.0
Soybeans	USD/bu	1290.8	5.1	-1.8	1.9	-0.3	-0.9	9.8
Wheat	USD/bu	679.3	3.3	-2.5	-10.0	-15.9	-12.7	19.2

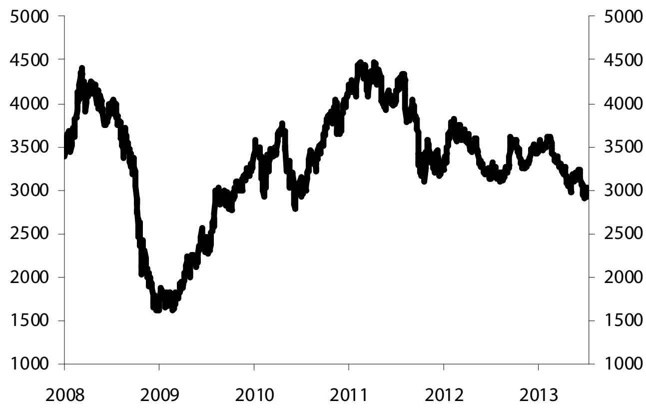
1-Month Return



Oil & Gold

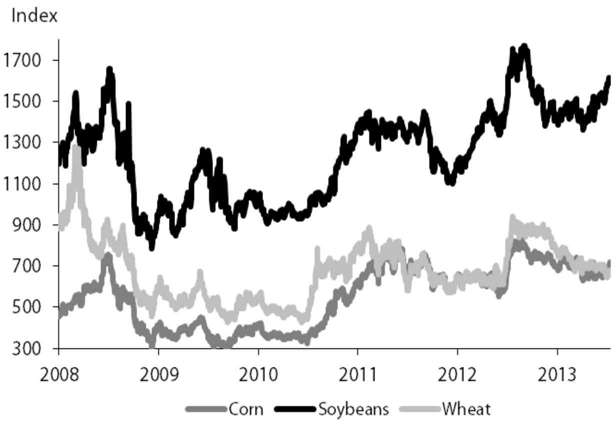


World Metals Index



Agricultural Index

Agricultural Indices



Source: Bloomberg, Ecowin

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