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Eurobank EFG

GLOBAL ECONOMIC & MARKET OUTLOOK

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Main Macro Views and Market Strategy

- The world economy continued expanding in H2 2010 and the global recovery remains firmly on track. Looking forward, the global economy is expected to recede to a lower growth rate in 2011, as tailwinds that boosted the economic recovery are expected to turn to headwinds in the year ahead. Emerging markets will probably remain the locomotive of the global economy.

- In the US, most recent indicators suggest a continuation of the recovery, although at a slower pace, but no double-dip. While currently markets do not seem very concerned about the US debt sustainability, in the longer term we view budget imbalances as a potential threat to the US economy if policymakers fail to address them successfully.

- In the Euro area, the sovereign debt issues remain the main risk factor and will probably be a recurring issue in 2011. We expect the recovery to loose momentum in 2011, as the euro appreciates and fiscal policy tightens, with continuing growth divergence between core and periphery countries.

- Given that fiscal stimulus is running its course, lingering uncertainties have led central bankers to shift away from exit strategies, in order to support the economic recovery. Therefore, monetary policy on a global basis is expected to remain loose for an extended period of time. The ECB is expected to hike rates before the Fed towards the end of 2011.

- Despite intense government competition for funding, we expect government bond yields of developed economies to remain subdued in the near term. Fed's QE2 is expected to keep US bond yields at low levels. While the Irish crisis is not likely to derail the euro area recovery, we believe investors' nervousness will take some time to recede, keeping the European bond market segmented between core and periphery countries.

- Looking forward, we expect investors' fears to shift from tensions in the euro area to the weaker than expected US growth, putting again downward pressure on the US dollar.

- Prospects for commodities are favourable in the long-term, as the global recovery is expected to remain firmly on track and fears for a double-dip in the US have receded.

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Executive Summary

The world economy continued expanding in H2 2010 and the global recovery remains firmly on track, with emerging markets being the locomotive of the global economy. Fears for a double dip in the US that could throw the global economy in turmoil have receded, as a stream of recent data suggest lower but stable growth. However, sovereign issues in the euro area are on the rise again even after the bailout of Ireland, with markets doubting about the sustainability of Portugal's and Spain's debt levels. Overall, the recovery of the global economy seems to have entered a mature phase with global GDP expected to grow by 4% in 2010 and 3.5% in 2011.

The global economy is expected to recede to a lower growth rate in 2011 because tailwinds that boosted the economic recovery are expected to turn to headwinds in the year ahead. While fiscal support helped a great deal in preventing the collapse of the global economy, it has raised budget deficits in several advanced economies to rather uncomfortable levels, triggering bond markets' concerns. Thus, fiscal austerity adopted in 2011 budget plans is expected to drag economic growth. The impact will be more intense in the euro area, where fiscal imbalances in the periphery have led to frontloaded budgetary discipline.

Structural deficiencies in developed economies are expected to take a toll on their post-crisis economic performance. In the US, although the scenario of a W-dip recession becomes increasingly remote, the economy will continue to struggle in the next quarters. While currently markets do not seem very concerned about the US debt sustainability, in the longer term we view budget imbalances as a potential threat to the US economy if fiscal authorities fail to address them successfully.

In the Euro area, the sovereign debt issues remain the main risk factor and will probably be a recurring issue in 2011. Faced with the pressing need to recapitalize its broken banks, Ireland has agreed to accept a €85bn rescue package, while fears have spread across the rest of periphery countries, raising significantly the cost of insuring sovereign debt against default. We expect the recovery to loose momentum in 2011, as the euro appreciates and fiscal policy tightens, with continuing growth divergence trend between core and periphery countries.

Given that fiscal stimulus is running its course, lingering uncertainties have led central bankers to shift away from exit strategies, in order to support the economic recovery. Therefore, monetary policy is expected to remain loose on a global basis for an extended period of time. In contrast to its counterparts in the G3, the ECB follows a more hawkish stance and is expected to hike rates before the Fed towards the end of 2011.

Despite intense government competition for funding, we expect government bond yields of developed economies to remain subdued in the near term. Fed's QE2 in the form of Treasuries purchases is expected to keep US bond yields at low levels. While the Irish crisis is not likely to derail the euro area recovery, we believe investors' nervousness will take some time to recede, contributing further to the segmentation of the European bond market between core and periphery countries.

The increased focus of the current debate among Euro area leaders on "orderly restructuring" of the debt of fiscally weak member countries has spooked financial markets and has led to an outright increase in borrowing costs and a further deterioration of debt-dynamics in these countries. In order to calm markets, the permanent crisis resolution mechanism (PCRM) should be combined, in our view, with two additional mechanisms: First, the launch of a euro-bond, which guarantees the refinancing of 60% of each EA country debt-to-GDP ratio at a low interest rate. Second, with a quantitative easing programme of the ECB, similar to QE2 of the Fed. The euro area cannot survive in the long term without an effective mechanism of fiscal policy coordination. Any such mechanism should aim at preserving the integrity of the euro area as a whole and not draw dividing lines between north and south or centre and periphery.

Dimitris Malliaropulos

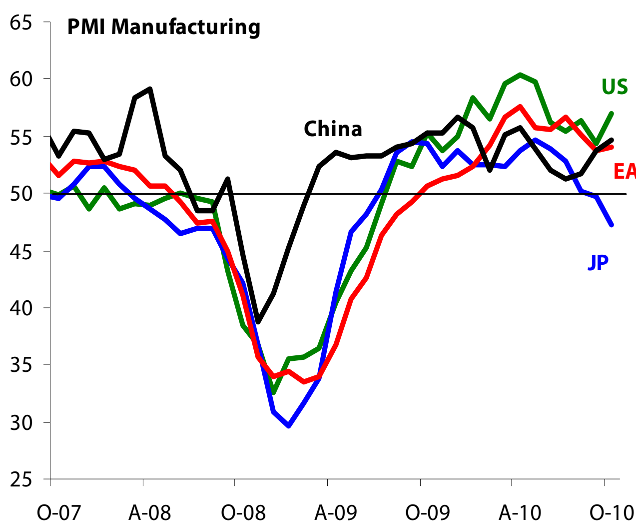
Research Advisor

I. Global Outlook

Dimitris Malliaropulos, Vasilis Zarkos

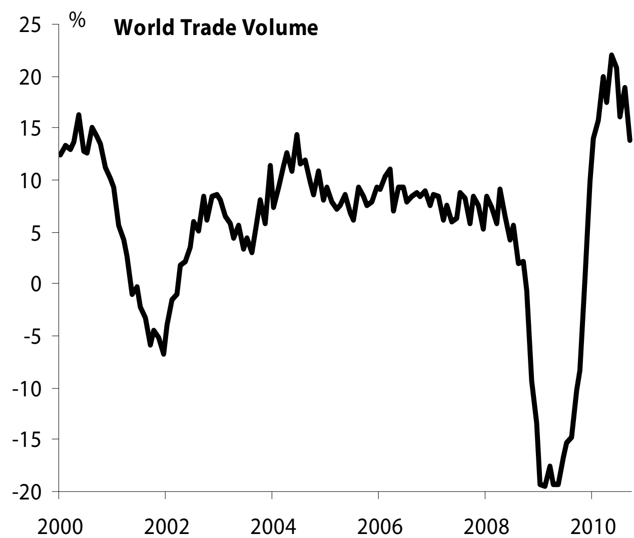
The world economy continued expanding in the second half of the year and the global recovery remains firmly on track. Fears for a double dip in the US that could throw the global economy in turmoil have receded, as a stream of recent data suggest lower but stable growth. Chinese economic prospects remain bright, despite the likely normalization of China's economy to a more sustainable growth path. However, sovereign issues in the euro area are on the rise again even after the bailout of Ireland, with markets doubting about the sustainability of Portugal's and Spain's debt levels. PMI manufacturing indices remain above the threshold of 50 (with the exception of Japan), suggesting further expansion. Global trade has increased 20% since mid-2009, the fastest pace in more than a decade, pointing to the importance of trade in pulling the world out of the worst post-war recession. Overall, the recovery of the global economy seems to have entered a mature phase with global GDP expected to grow by 4% in 2010 and 3.5% in 2011.

Figure 1



Source: Bloomberg

Figure 2



Source: CPB Netherlands Bureau for Economic Policy Analysis

Global growth is expected to recede to a lower trajectory in 2011

After reaching its peak in H1 2010 (5.2% annual rate), the global economy is expected to recede to a lower growth rate in 2011, as tailwinds that boosted the economic recovery are expected to turn to headwinds in the year ahead. While fiscal support helped a great deal in preventing the collapse of the global economy, it has raised budget deficits in several advanced economies to rather uncomfortable levels, triggering bond markets' concerns. Thus, fiscal austerity adopted in 2011 budget plans is expected to drag economic growth. The impact will be more intense in the euro area, where fiscal imbalances in the periphery have led to frontloaded budgetary discipline. While fiscal support measures have boosted consumption and helped constrain the rate of job shedding during the crisis, consumption and job creation in developed economies failed to gather significant momentum so as to support a robust rate of growth in the medium term. Hence, slowly receding unemployment rates, sluggish wage growth and the expiration of several tax credit programs are expected to put a lid on consumption growth.

Moreover, cyclical factors that boosted the economic rebound are expected to recede to a more sustainable path in the year ahead. Inventories have played an important role in dragging advanced economies out of recession but they seem close to running their course by year end. Industrial activity rebounded strongly on the ground of increasing global demand. However, recent data suggest that production has peaked, while leading indicators of manufacturing activity in the three biggest economies bode well with a slower pace of industrial production growth. Consistent with the slowing momentum of global demand, world trade has already peaked, while its dynamics suggest a slowdown to a more sustainable rate of growth.

Tight credit conditions are an important factor that constrains domestic demand in developed countries. Despite ample liquidity, the remaining uncertainties about the sustainability of the economic recovery and difficulties in funding have led to a very gradual rebound of bank lending growth. Consistent with the fragile financial environment in the euro area, the ECB bank survey reveals continuing tightening standards. Lending conditions will most likely take a long time to return to their long-term average, however, there are signs of improvement. Lending growth to the private sector has entered positive territory in the US and the euro area, while data from bank surveys in the US and Japan reveal an improvement in lending conditions. Also important, these surveys show improving conditions in C&I loans for both large and small firms. In the euro area, net tightening in lending conditions is likely to stabilize in Q4. Money markets are normalizing and banks are gradually repairing their balance sheets. Absent another shock that might interrupt the improvement of banking fundamentals, (as it has been the case with the sovereign crisis in Europe), bank lending may grow in a sustainable manner and become more supportive to the global recovery, as we are heading into 2011. While in the short term the Basel III call for higher capital and liquidity requirements may restrain lending growth, in the long run, the clarification of the regulatory system will contribute to the strengthening of the global banking system on sounder foundations.

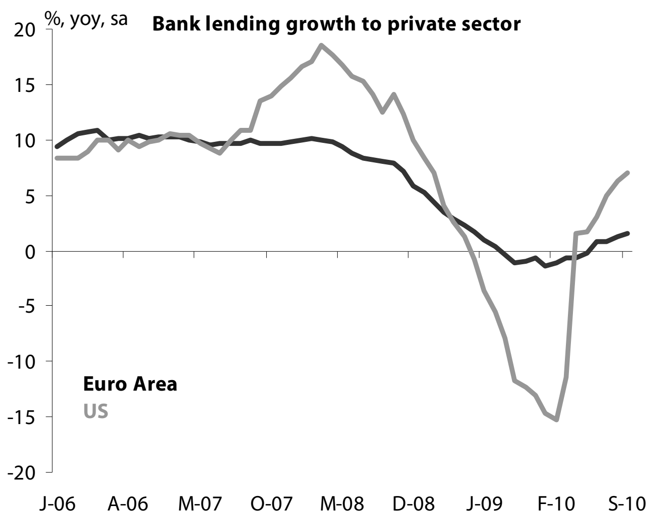
Structural deficiencies in developed countries are expected to weigh on their growth prospects.

Structural deficiencies in developed economies are expected to take a toll on their post-crisis economic performance. In the US, although the scenario of a double-dip recession becomes increasingly remote, the economy will continue to struggle in the next quarters. The deleveraging process of the over-indebted households is expected to continue for a long time. The withdrawal of fiscal stimulus along with the impaired job creation mechanism suggest modest growth for the largest economy of the world. At the same time that the private sector deleverages, the public debt has risen to rather uncomfortable levels. In contrast to the euro area, the US authorities resist front-loaded fiscal austerity. While currently markets do not seem very concerned about the US debt sustainability, in the longer term we view budget imbalances as a potential threat to the US economy if policymakers fail to address them successfully. Authorities should convey a clear course of action in terms of public finances, monetary policy, taxes and healthcare reform, for the growth and job creation to gather momentum.

In the euro area, the sovereign crisis will be a recurring issue in the next year. Faced with the pressing need to recapitalize its broken banks, Ireland has agreed to accept a €85bn rescue package, while fears have spread across the rest of periphery countries, raising significantly the cost of insuring sovereign debt against default. Tensions increase in Portugal and Spain over the right policy mix to reign over their public deficits. Meanwhile, Greece has got off to a good start in reducing its twin deficit, with the budget deficit declining by six percentage points of GDP in 2010 to 9.4% of GDP and aimed to reduce it to 7.4% in 2011. Yet, the size of the adjustment remains challenging given the depth of the recession. Therefore, a new round of systemic sovereign and financial turmoil could spark, if investors loose confidence on the weak members' ability to perform the necessary drastic adjustments. On the other hand, Germany has proven more resilient to the global slowdown and the appreciating euro, leading to a deeper divergence in the growth rates between core members and the periphery. Recent data provide evidence that the slowdown in Germany in H2 proved less pronounced than initially perceived. We expect Germany to remain the locomotive of the euro area recovery in 2011. Overall, our baseline scenario for the euro area is modest growth in a slowly stabilizing environment.

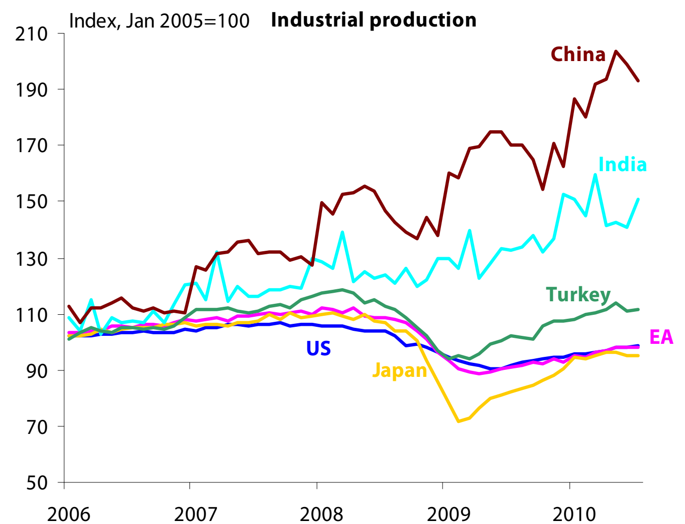
In Japan, the economy is particularly vulnerable to external demand, as poor domestic demand deprives it from autonomous factors. Therefore, lower export volumes due to weaker global growth and the expiration of tax credit that boosted demand for eco friendly durable goods are expected to weigh on the Japanese growth in the period ahead.

Figure 3



Source: Bloomberg

Figure 4



Source: Bloomberg

Emerging markets are expected to remain the locomotive of the global economy

Emerging markets proved rather resilient during the crisis and better fundamentals than those in developed economies suggest that they will remain the locomotive of the global economy. Unlike the debt laden developed countries, several emerging markets run primary surpluses that are expected to boost credit growth. Furthermore, higher potential growth and younger population imply outperformance of the emerging markets compared to developed economies. Although Chinese growth is bound to recede to a lower trajectory, we view this more as a normalization to prevent overheating of the economy and a real estate bubble, than a worrisome slowdown. The Chinese PMI indicator expanded in August and September, after contracting during the previous two months, suggesting a pick up in industrial activity as fears of a double dip in the developed economies have receded. A rebound of the Chinese economy in H2 after its slowdown in Q2, is expected to feed through to other countries in the region, via the trade channel. On the negative side, emerging economies are most likely to loose some momentum, as slower global trade dynamics due to weaker demand in developed countries is expected to have an adverse impact on their growth prospects.

We view that downside risks for emerging markets stem mainly from protectionist measures that these countries may be tempted to adopt, in order to protect their economies from capital imports that lead to the appreciation of their currencies. Such a policy could motivate developed countries to respond in a similar manner. Emerging markets have benefited a great deal from the globalization of the economy and the sharp increase in global trade. As domestic demand in many developing countries remains moderate, trade restrictions could hurt substantially their economy. The risk escalates due to additional quantitative easing by the Fed, as abundant liquidity coupled with the search for yield may cause capital inflows to emerging markets to swell. Surging portfolio inflows raise the risk for asset bubbles that could burst when the trend is reversed and capital flows out of emerging markets. While monetary easing could discourage portfolio inflows, it comes with risk of higher inflation expectations in an already inflationary environment in emerging markets.

Policy mix: Unwinding of fiscal stimulus calls for loose monetary policy.

Given that fiscal stimulus is running its course, lingering uncertainties have led central bankers to shift away from exit strategies, in order to support the economic recovery. Therefore, monetary policy is expected to remain loose on a global basis for an extended period of time. Weak data in the US has led the Fed to revise downwards its growth forecasts and announce an additional round of quantitative easing. Meanwhile, the Bank of Japan is making plans of asset purchases in order to lower long term rates, after cutting intervention rates to almost zero. We believe that the Fed is unlikely to start

raising the federal funds rate until Q3 2011, and expect the key policy rate in Japan to remain unchanged until at least the beginning of 2012.

In contrast to its counterparts in the G3, the ECB follows a more hawkish stance. The phasing out of excess liquidity suggests declining dependence on ECB for liquidity provision and implies a more confident banking system in the euro area. The ECB is expected to hike rates before the Fed towards the end of 2011. Nonetheless, we expect the ECB to move cautiously towards monetary normalization for three reasons. First, it wants to ensure that the recovery in core members remains on track. Second, given the remaining hurdles in periphery members, we expect the ECB to maintain extra liquidity provision to the banking system and accept poor rated assets as collateral. Third, additional easing by the Fed will weaken the US dollar, raising the risk of global currency intervention, which would most likely weigh negatively on the euro and euro area exports.

Bond market outlook

Despite intense government competition for funding, we expect government bond yields of developed economies to remain subdued in the near term. The Fed additional quantitative easing in the form of Treasuries purchases is expected to keep US bond yields at low levels. Moreover, low inflation expectations on the backdrop of lingering excess spare capacity favor low bond yields. Modest economic growth coupled with risk aversion due to the remaining uncertainties in the euro area is expected to restrain US Treasuries and German bunds yield increases. While the Irish crisis is not likely to derail the euro area recovery, we believe investors' nervousness will take some time to recede, contributing further to the segmentation of the European bond market between core and periphery countries. However, as we are heading into 2011 and the recovery becomes more sustainable, risk aversion abates and inflation expectations rise, we expect bond yields to start rising.

Weaker US dollar ahead

The Irish crisis has put a temporary break on the downward trend of the US dollar since the summer. Looking forward, we expect investors' fears to shift from tensions in the euro area to the weaker than expected US growth, putting pressure on the US dollar. However, in the long-term, the US dollar is likely to appreciate, as stronger US exports will lead to a narrowing current account deficit in the US.

Commodities

Commodity index returns have rebounded strongly during the third quarter of 2010. In particular, the S&P 500 GSCI, the most heavily tracked commodity index, rose by 10.7% in Q3, in contrast to a negative performance of -11.7% in Q2 2010. Industrial metals and agriculture were the top performers across the four commodity complexes. Gold prices have picked up to all-time highs, as the announcement of quantitative easing (QE2) by the Fed has shaken investors' confidence in the US dollar. In the short-term commodities, and particularly industrial metals, agriculture and energy, are more vulnerable to further measures by Chinese authorities to tame inflation. Indeed, the PBoC announced on November 19 an official 50bp hike in the reserve requirement ratio (RRR) for all commercial banks, which was the fifth increase in the RRR this year. However, prospects for commodities are favourable in the long-term, as the global recovery is expected to remain firmly on track and fears for a double-dip in the US have receded. Moreover, the Fed's second round of QE2 will likely favor commodity prices. Indeed, with QE2 US bond yields are being kept at low levels. As a result, investors will increasingly seek for higher returns, thus pushing commodity prices up. In addition, as QE2 increases the amount of US dollars in circulation, the latter depreciates against major currencies, favouring dollar-traded commodities.

II. Global Economic Outlook

1. The US economy

Dimitris Malliaropulos, Olga Kosma

- As the effects of fiscal stimulus and the restocking cycle are gradually fading, economic activity in the US has slowed in H2 2010.
- Most recent economic indicators suggest a continuation of the recovery, although at a slower pace, but no double-dip, as the latter usually coincide with aggressive monetary policy tightening (US 1981-83), oil shocks and high inflation.
- Comparing a broad range of indicators in the current recovery with those following the W-dip recession of 1980, the mild and the deeper recessions in the post-war period, we conclude that the current recovery converges rather to a weak US rebound due to: the ongoing deleveraging of households and the public sector, weak credit growth and continuing weakness in the labour market.
- We expect the US economy to grow by 2.7% in 2010 and 2.4% in 2011, well below the potential rate of growth of the past decade. We believe that net trade will dominate real economic activity over the coming quarters, taking over the growth driver from the inventory cycle.
- The risk of deflation remains low; Fed's QE2 has already led to an increase in inflation expectations, a key factor affecting future inflation, and will weaken the dollar, increasing imported inflation.

No double-dip but a sluggish US recovery

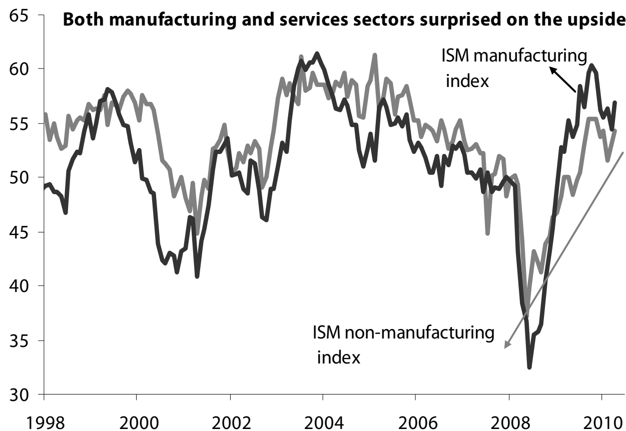
The US economy continues its recovery into 2010, although at a sluggish pace. Federal fiscal stimulus and the restocking cycle accounted for most of the increase in real economic activity in late 2009 and early 2010. We believe that the recent slowdown in Q2 and Q3 real GDP growth in response to the withdrawal of fiscal stimulus and the end of the inventory accumulation is not a trend reversal, but rather a normalization of growth towards potential. Our baseline scenario is that the US economy will grow by 2.7% this year and 2.4% in 2011, well below the potential growth rate (about 2.75-3%) that is needed to encourage job creation. We expect quarterly GDP growth rates to gather speed gradually towards 3.5% q-o-q saar by the end of 2011, as easier financial conditions and accelerating global growth offset the drag from persistent weakness in housing activity and the fiscal drag from state and local governments[1]. We believe that net trade will dominate real growth over the coming quarters, taking over the growth driver from the inventory cycle.

Meanwhile, the recent economic data suggest a continuation of the recovery and diminish the risk of a double-dip of the US economy. The early signs of improvement in Q4 increase the likelihood that the recent economic slowdown was not a major cause for concern about the sustainability of the US recovery, but rather a return to sub-par growth. The October ISM report surprised on the upside, both for the manufacturing and the services sectors. In particular, the ISM non-manufacturing survey increased from 53.2 to 54.3, due to improvements in the business activity, the new orders and the employment indexes. Furthermore, the ISM manufacturing index rose from 54.4 to 56.9, the highest reading since May 2010, reflecting strong growth in new orders and production (Figure 1.1). Overseas demand -especially in China- has been a key driver of the manufacturing rebound, reflected also in the new export orders index that surged to 60.5 from 54.5. In addition, the gap between the ISM new orders and inventories indexes, which is regarded as a good short-term indicator for industrial growth, improved sharply in October (to +5 from -4.5). However, it should be noted that even after this

[1] *Looking forward, the robust expansion of the global economy and the weak dollar is likely to boost exports significantly.*

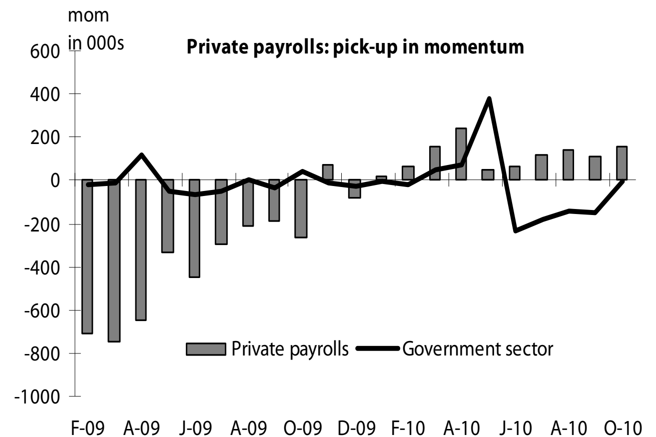
improvement, the orders-inventories gap is still at relatively low levels that tend to point towards a headline ISM index around 50. Therefore, the ISM manufacturing index will likely resume its downward trend in the coming months.

Figure 1.1



Source: Bloomberg

Figure 1.2

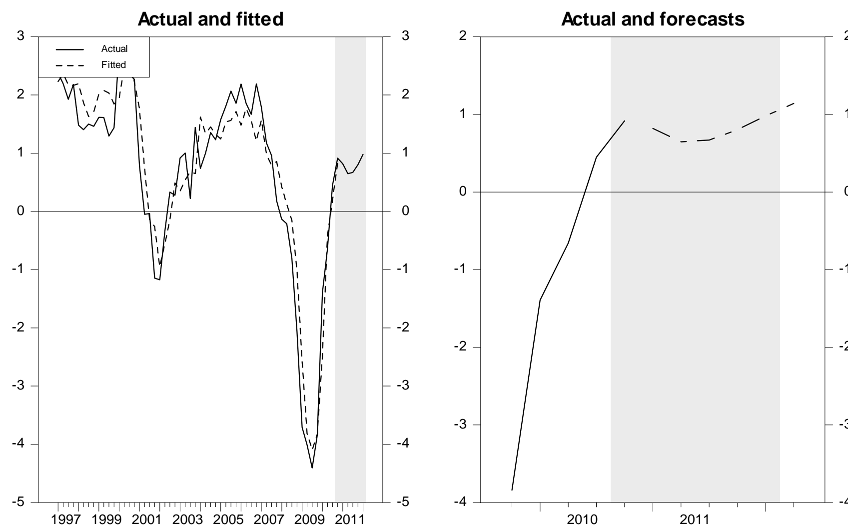


Source: Bloomberg

In addition, the October employment report showed encouraging signs that the US labour market is finally picking up steam. Total nonfarm payrolls rose to 151k, with private payrolls' increasing by 159k (Figure 1.2). Taking into account the upward revisions made to the previous two months, private payrolls have gained 136k per month over the past three months. As shown in Figure 1.6, the pace of nonfarm payrolls growth is currently similar to the past two weak recoveries following the 1991-92 and 2001 recessions. Despite government's negative impact on employment figures in H2 2010 as the government census hiring was ending (Figure 1.2), the surge in nonfarm employment in October after four months of consecutive declines, suggests that the labour market recovery is under way. Moreover, the hiring intentions in both the manufacturing and the services sectors improved in October, with the ISM's Employment index increasing in both sectors. In line with our forecasts in our June Global issue, monthly payrolls gains have led to positive civilian employment growth on a y-o-y basis over the last couple of months. Our job market model suggests that this positive trend will continue well into 2011, with civilian employment growth increasing to a year average of 0.7% in 2011 from -0.2% in 2010 (Figure 1.3). However, according to the Household Survey the unemployment rate held steady at 9.6% in October. A 330k decline in the Household measure of employment and a 254k decline in the labor force took the participation rate down to 64.5%, the lowest level in more than 25 years. The exhaustion of benefits may have discouraged people to seek for work. A cyclical recovery in employment, however, should lead to a labor force participation increase, leaving the unemployment rate sticky to the upside by year-end. With the private labor market picking up momentum in 2011, we expect higher gains in employment to effectively push the unemployment rate down to 9% by the end of 2011.

Figure 1.3

Civilian Employment y-o-y



Source: Bureau of Economic Analysis (BEA), Eurobank EFG estimates

Historical evidence in line with a weak rebound of the US economy

Double-dips are very rare and coincide with aggressive monetary policy tightening (US 1981-83), oil shocks and high inflation. On the contrary, at this point in time, the low level of inflation provides room for the Fed to maintain a more aggressive monetary expansion stance. In addition, comparing a broad range of indicators in the current recovery with those following a W-dip recession, mild as well as deeper recessions since 1947, we conclude that the current recovery converges rather to a weak rebound due to the ongoing deleveraging of households and the public sector, weak credit growth and continuing weakness in the labour market.

More specifically, we go over the evolution of six major economic indicators (real GDP, ISM manufacturing, nonfarm payrolls, IP, consumption, non-residential investment) over the course of each recession (last 4 quarters) and recovery, with period zero set as the end of each recession. According to the NBER business cycle dating committee, the US recession ended in June 2009 in the current business cycle. Each of the following figures (1.4-1.9) compares the current business cycle with the prior ones in the post-war period: the W-dip recession of 1980-1983, the weak recovery episodes following the 1991 and 2001 recessions and the strong rebounds following the deep recessions of 1948, 1953, 1957, 1960, 1969 and 1973[2]. According to our estimates, the underlying trend in real GDP, real personal consumption expenditures and total nonfarm payrolls are in line with a weak rebound of the US economy (Table 1.1). The rebound in ISM manufacturing and (to some extent) in real nonresidential investment appears to be closer to a strong rebound. Only industrial production growth comes closer to a double-dip, but it is probably too early to say.

[2] *We compare the path of evolution of each indicator in the current recovery with its path of evolution in each type of previous rebounds and choose the type of recovery where the* distance between the current evolution and the type X evolution is minimized (Root Mean Squared Error criterion).

Table 1.1

	Type of Recovery		
Indicator	Strong	Weak	W-dip
GDP		√	
Real Personal Consumption		√	
Nonfarm Payrolls		√	
IP			√
Real Nonresidential Investment	√		
ISM Manufacturing	√		

Source: Eurobank EFG estimates

Q3 GDP growth consistent with the trend of subpar growth

According to the second estimate of, real GDP grew 2.5% q-o-q saar in Q3 2010, marking a considerable improvement from the 1.7% growth reported in the previous quarter (Figure 1.10). Inventory accumulation provided a considerable boost to growth, contributing 1.3% to headline growth. Real final sales of domestic product increased 1.2% q-o-q saar in Q3, compared with an increase of 0.9% in Q2.

Final demand was dragged down again by net exports, which subtracted 1.8% from Q3 growth. Strength in imports continued to outweigh the benefits of export growth for a second consecutive quarter. Indeed, the major drag from trade reflects a 16.8% surge in imports, which more than offset the 6.3% increase in exports. We do not believe that this is sustainable. Indeed, the US trade deficit narrowed to -$44bn in September from -$46.3bn in the previous month, with imports falling 1% m-o-m while exports increasing by 0.3%. Looking ahead, we believe that solid growth in exports due to accelerating global economic activity (notably in EMs) and a weak US dollar and a correction in imports due to modest growth in domestic demand will likely help net exports to turn positive for growth over the next few quarters. The October ISM manufacturing survey is consistent with our view, with the exports index increasing to 60.5 from an average of 55.5 in Q3 and the imports index dropping to 51.5 from an average of 55.2 in Q3.

In particular, some of the surge in imports in Q2 and Q3 2010 was rather temporary, since it has actually resulted from Chinese exporters accelerating shipments to the US, in order to benefit before the removal in July of export tax rebates on several items (medicine, steel, glass, fertilizers etc). Furthermore, historical evidence suggests that in the period 2006-2009 faulty seasonal adjustment factors seem to have magnified import surge in Q3 in favor of Q4 (Figure 1.11). Given that the same seasonal pattern is distorting import data this year, the anticipated correction in imports and the probable boost in exports from the ongoing depreciation of the US dollar and the increasing EM demand are expected to turn the -1.8% drag to Q3 growth into a 2-3% positive contribution to Q4 real GDP.

Meanwhile, the 1.2% growth in final demand reflects a continued increase in personal consumption. Consumer spending has picked up steadily in recent quarters, marking in the third quarter of the year the biggest contribution to growth since Q4 2006 (+2%). Although the 2.8% quarterly annualized growth reported in Q3 2010 is still historically soft, private consumption has so far showed some incremental improvement. Reinforcing the positive outlook, the University of Michigan Consumer Sentiment index increased from 67.7 in October to a preliminary November reading of 69.3, while retail sales increased by 1.2% m-o-m, on the back of strong auto sales, with upward revisions of August and September headline numbers. However, real disposable personal income –a reliable proxy for consumer spending power- fell by 0.3% in September, as transfer payments reversed their August increase. Large government transfers have played a key role in supporting income and consumption in Q3 2010, and this support will probably fade in Q4 as unemployment insurance benefits begin to expire (at the end of November 2010). Overall, higher gains in private payrolls anticipated in 2011, along with continued recovery in household net worth, will support income and consumer spending. According to our estimates, personal consumption growth will accelerate gradually on a y-o-y basis in 2011, with an average growth rate close to 2% in 2011 from 1.5% in 2010.

Figure 1.4: Real GDP growth

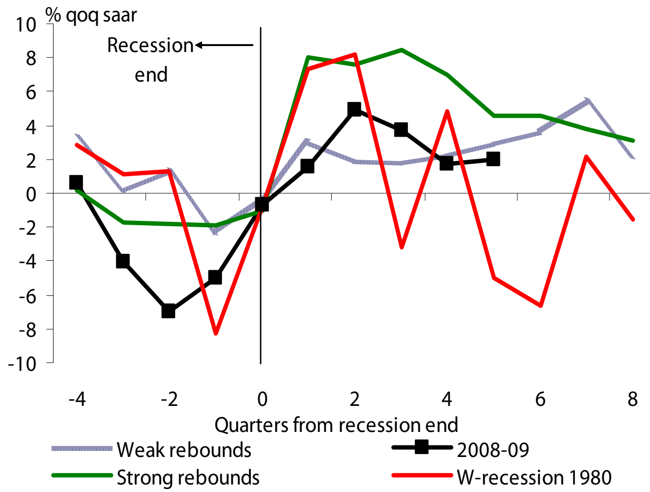


Figure 1.5: ISM Manufacturing: PMI Composite Index

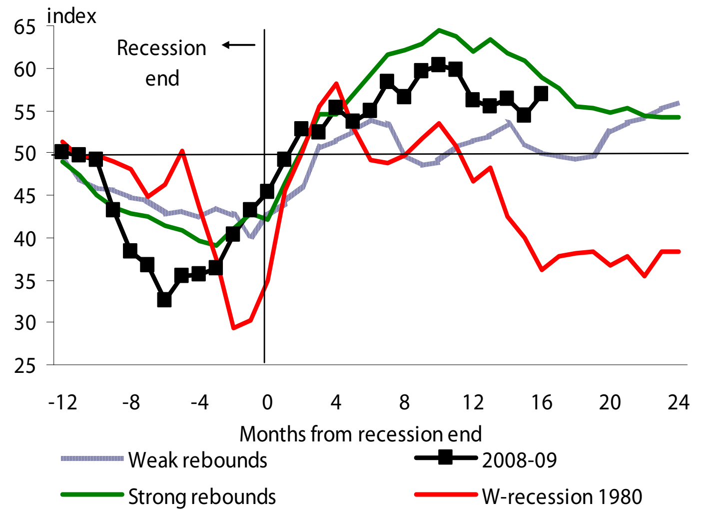


Figure 1.6: Total Nonfarm Payrolls

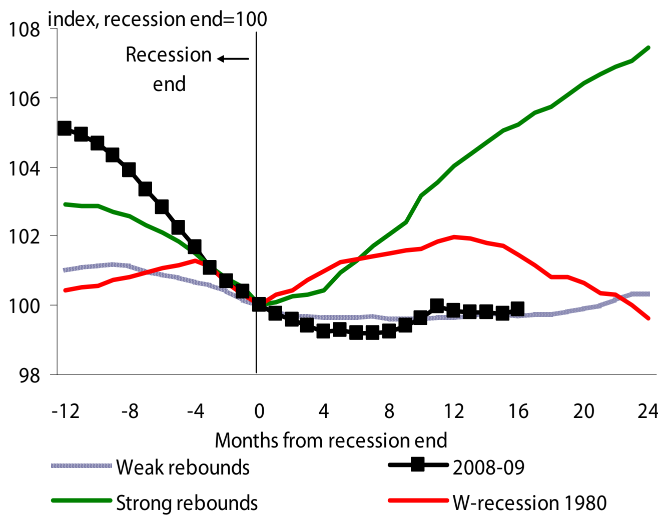


Figure 1.7: Industrial Production

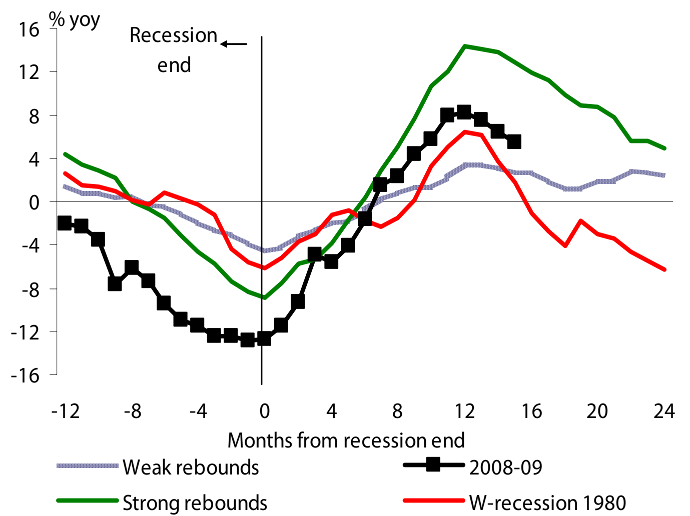


Figure 1.8: Real Personal Consumption

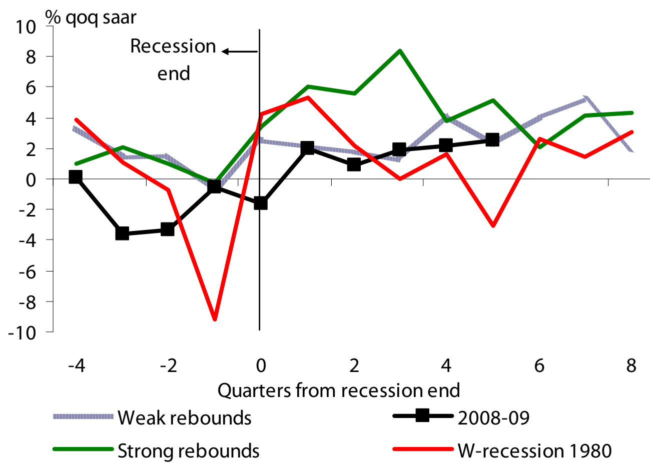
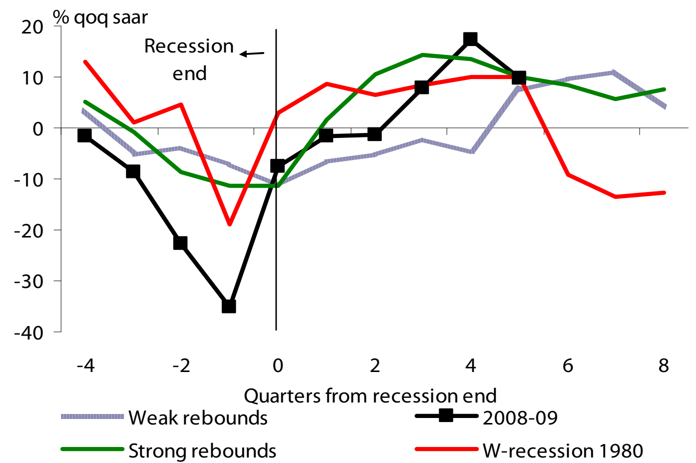


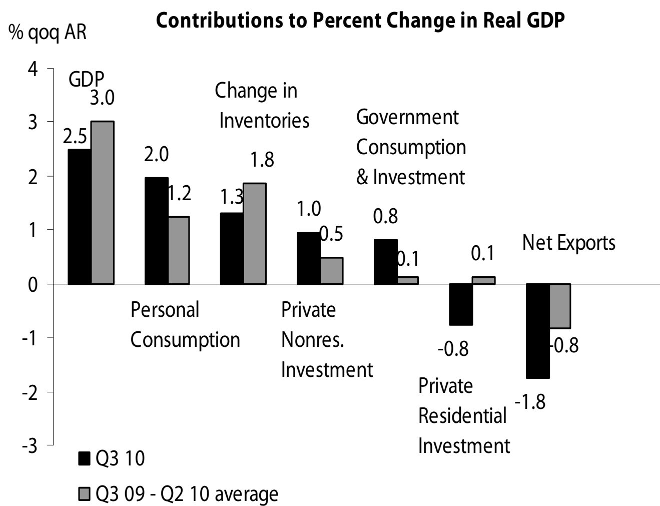
Figure 1.9: Real Nonresidential Fixed Investment



Source: Bloomberg, Fed of St. Louis, Eurobank EFG estimates

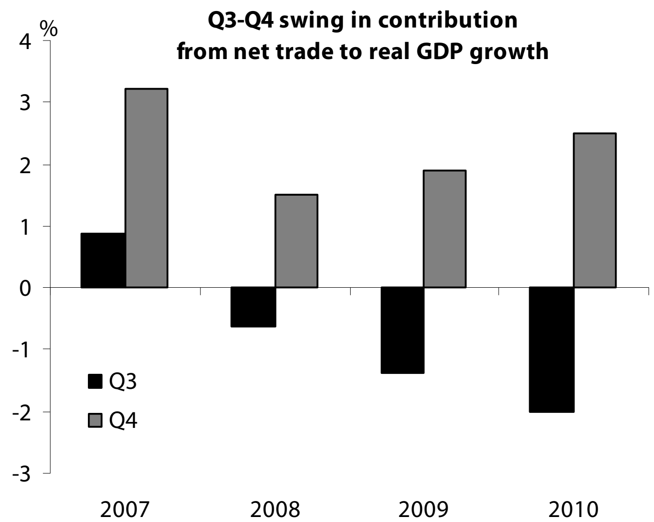
Equipment and software spending added 1.1% to growth in Q3, slowing to a 16.8% q-o-q saar from readings above 20% in the prior two quarters. As we have already stated in our June Global Issue, momentum in capital expenditures have probably picked up in Q2 2010. Although durable goods orders -supported by bookings for aircrafts- increased by a total of 3.3% mom in September, orders actually fell by 0.8% mom after excluding transportation orders. The 0.6% decline in nondefence capital goods orders (ex aircraft) -a key indicator for domestic capital spending on equipment and software- point to a deceleration in investment in equipment and software ahead.

Figure 1.10



Source: Bureau of Economic Analysis (BEA), Eurobank EFG estimates

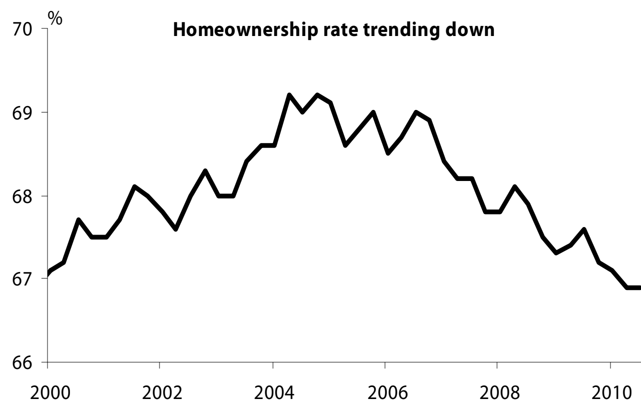
Figure 1.11



Source: Bureau of Economic Analysis (BEA), Eurobank EFG estimates

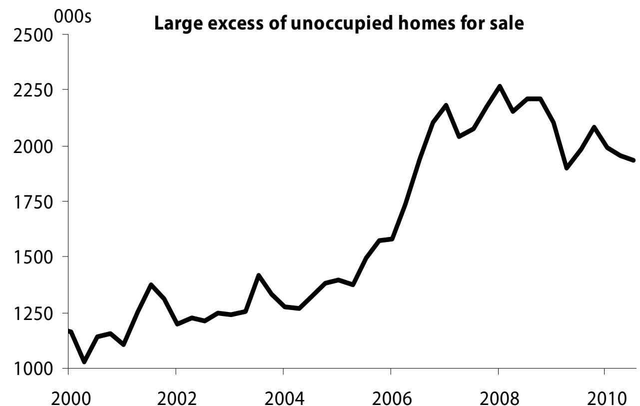
Residential construction collapsed in Q3 2010, but this came as no surprise, following the expiration of the first-time homebuyer tax credit. In particular, residential investment contracted 27.5% qoq saar in Q3, after a 25.7% surge in the previous quarter. Incoming data on housing activity do not point to a robust recovery in this sector (large excess of unoccupied homes for sale, depressed household formation, falling homeownership-see Figures 1.12,1.13), but rather suggest a stabilization at severely depressed levels. We expect residential investment to start contributing moderately to real economic activity in 2011, adding no more than 0.5% by H2 2010.

Figure 1.12



Source: US Census Bureau

Figure 1.13

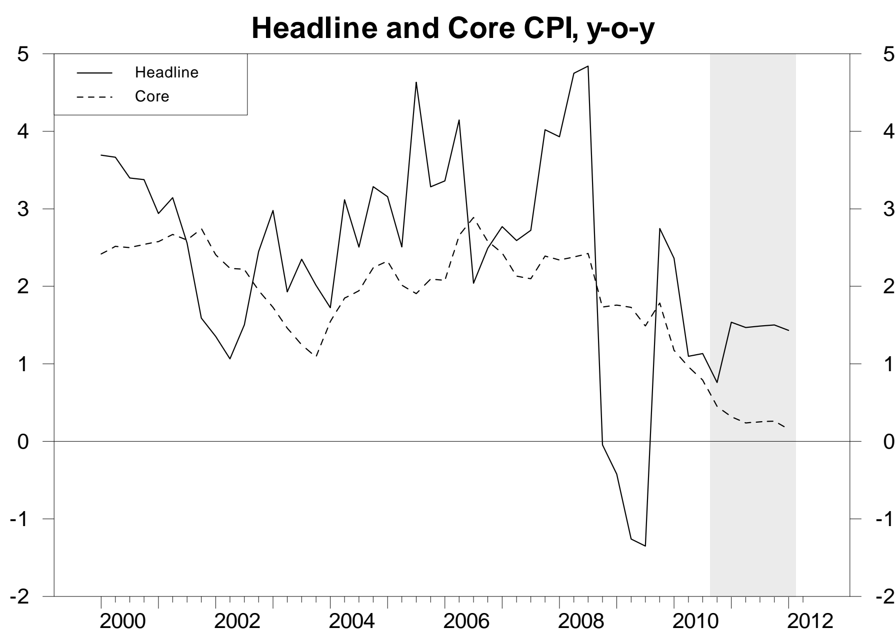


Source: US Census Bureau

Deflation is not a high risk

Headline consumer price inflation currently stands at relatively low levels (1.2% y-o-y in October from 1.1% in September), while core consumer price inflation dropped to the lowest reading ever reported since 1957 that the series started in October (0.6% y-o-y), well below the Fed's comfort zone. However, the risk of deflation remains low, thanks to Fed's aggressive action that has resulted in increasing inflation expectations, a key factor affecting future headline inflation. One-year inflation expectations increased from 2.7% in October to a preliminary November reading of 3%. This is the second consecutive monthly increase in one-year inflation expectations and the highest reading since May 2010. Furthermore, five-year inflation expectations held steady at 2.8%, staying in the narrow 2.7-2.9% range over the past twelve months. In addition, longer term expectations, measured by subtracting the real yield on 10-y TIPS from the nominal yield on 10-y Treasuries, were boosted by 50 bps over the 21/2-month period that QE2 has been increasingly in play in the markets. Meanwhile, soaring commodity food prices (many commodity prices are up 20-65% over the past 6 months) will soon start to push up food costs for consumers. A weaker dollar due to QE2 and increased excess demand from abroad will likely boost food prices further, increasing imported inflation and, therefore, pushing up overall consumer price inflation. We expect headline CPI inflation to increase to 1.5% in 2011 from 1.3% in 2010, while core inflation will continue moving downwards, averaging at about 0.5% y-o-y in 2011 (Figure 1.14).

Figure 1.14



Source: Eurobank EFG estimates

Fed's new large-scale asset purchase program (LSAP) to help limit downside risks to growth and inflation

As the huge budget deficit and high debt levels keep the door closed for further fiscal stimulus, the US authorities are following the path of raising money supply via a second round of quantitative easing (QE2) in order to promote a stronger pace of economic recovery. Indeed, the Fed announced at its November policy meeting its intentions to buy $600bn in longer-term US Treasuries by June 2011, with purchases of $75bn per month. On top of the $600bn in the new purchase program, reinvestment of income from assets already held by the Fed (MBSs, Treasuries) will amount to $250-300bn over the same period, taking the total amount of Treasury purchases to $850-900bn. The size, the pace and the horizon of purchases will be adjusted in view of incoming economic data, so further expansion of QE is highly likely, given that the

unemployment rate and the inflation rate are far from "mandate-consistent levels". Meanwhile, we maintain our forecast that the Fed is unlikely to start raising the federal funds rate until Q3 2011 at the earliest.

The Fed's new round of unconventional policy easing, which is equivalent to between 50-75 basis points of easing, has the potential to offer a boost of about 0.5-0.75% to headline growth over the next year. The main transmission channels of QE2 to the real economy are the following: (a) low real cost of capital throughout the economy by effectively keeping real yields at low levels. This could provide a boost to growth through consumption and investment and help refinancing high government deficits and debt. (b) Increasing inflation expectations, both providing a floor to inflation and supporting economic activity through higher wages, income and, thus, consumption. (c) Weaken the dollar to promote net exports and imported inflation. (d) Prevent a sharp increase of longer-term interest rates, driven by concerns about US fiscal sustainability. In particular, we believe that a double-dip would not come from a continuation of deflation, but rather from a sharp increase of real interest rates, given increased concerns of bond investors about high budget imbalances and a fast-rising federal debt. This could effectively happen should investors become more pessimistic about debt and budget dynamics, so large-scale asset purchases (LSAPs) should hinder this from happening. Overall, real economic activity and inflation will respond positively over time to the abovementioned changes as private spending and investment that are sensitive to interest rates are boosted, as net exports rise and as domestic prices are raised by the depreciation of the US dollar, higher oil prices and increased inflation expectations.

2. The Euro area economy

Dimitris Malliaropulos, Vasilis Zarkos

- The euro area recovery is expected to loose momentum as the euro appreciates and fiscal stimulus is running its course. We view this as a normalization of the economic growth rather than a worrisome slowdown.
- The growth divergence trend is expected to continue. The recovery in core members reveals signs of broadening, whereas debt laden periphery countries struggle to bring their public financials in order, amid sluggish or even negative growth. The strong euro erodes periphery countries' efforts to improve their competitiveness.
- The Irish crisis is not likely to derail the euro area recovery as the EFSF is now fully operational. However, sovereign debt issues are likely to be a recurring theme in 2011.
- Inflation in the euro area is expected to remain moderate due to moderate growth and fiscal retrenchment in the periphery. We view risks on the upside due to rising commodity prices.
- We expect the first rate hike in Q4. However there is risk for an earlier tightening.
- Overall, our base line scenario for the euro area is modest growth in a slowly stabilizing environment.

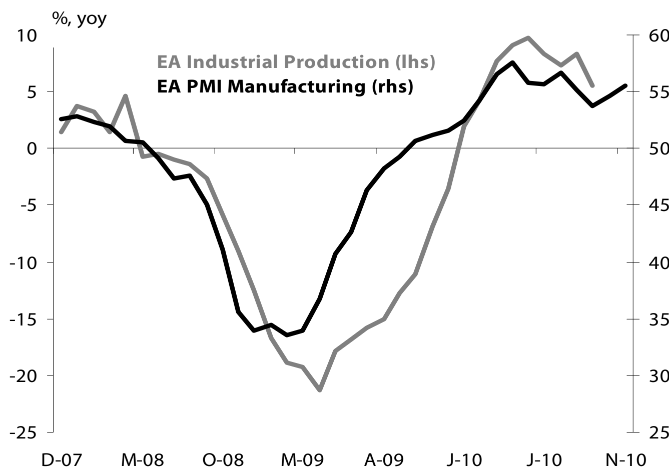
Lower, solid but uneven growth ahead

The euro area GDP growth receded to 0.4% in Q3 after posting an impressive 1% in the previous quarter, the fastest rate of growth since the onset of the recession. Looking forward, the euro area economy is expected to recede to a lower trajectory. We view this as a normalization of growth down to a more sustainable recovery path than a worrisome slowdown. Besides the fading impact of base effects, declining global demand, mainly a result of the normalization in emerging markets, is expected to weigh on euro area exports. The strengthening of the euro is expected to affect adversely demand for euro area goods. The unwinding of fiscal stimulus along with strict fiscal austerity in the periphery is expected to keep domestic demand growth moderate. Assuming a fiscal multiplier of 0.5, our calculations suggest that the direct impact of fiscal consolidation is expected to shave 0.5% off the GDP growth in 2011. On the negative side for domestic demand, bank lending growth is expected to remain moderate, as banks are still repairing their balance sheets, while sovereign debt concerns have raised their refinancing risk.

Nonetheless, we remain confident that the euro area recovery will remain on track. Last quarter's data revealed signs of a broadening recovery, as besides net exports, private consumption and gross fixed capital formation contributed significantly to GDP growth. Meanwhile, business expectations indicators reveal an improving sentiment in Q4. Both manufacturing and services PMI indices increased noticeably in November. The EA PMI manufacturing index rose from 54.6 to 55.5, due to an improvement in both new orders and output (Figure 2.1). As far as domestic demand is concerned, although its growth has most likely ebbed to a lower rate in Q3, we anticipate it to keep posting positive contributions. On the backdrop of improving labor market conditions in core members, confirmed by the recent improvement in the PMI employment indices in both manufacturing and services sectors, we expect private consumption growth to continue, thus supporting a self-sustained recovery in the euro area.

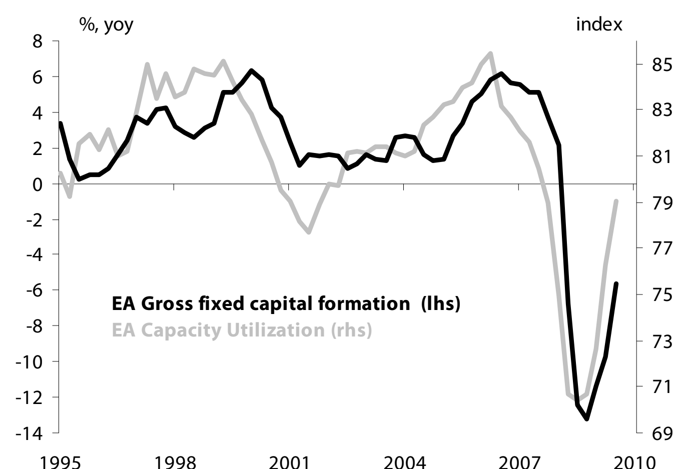
Further support to the recovery is expected from capital expenditures, which had a positive contribution to Q2 GDP growth for the first time since Q1 2008. We see scope for further capital formation in the following period for a number of reasons. First, firms had postponed replacing depreciated equipment for a long time. Second, more capital expenditures bode well with rising capacity utilization (Figure 2.2), which penciled its third quarterly increase in the second quarter, after hitting bottom in mid-2009. Third, firms are cash rich due to savings during the crisis therefore, they can finance capital expenditures. Fourth profits are expected to remain robust in 2011. Finally, although lending conditions remain in tightening mode, the trend is expected to stabilize and reverse in 2011.

Figure 2.1



Source: Bloomberg

Figure 2.2



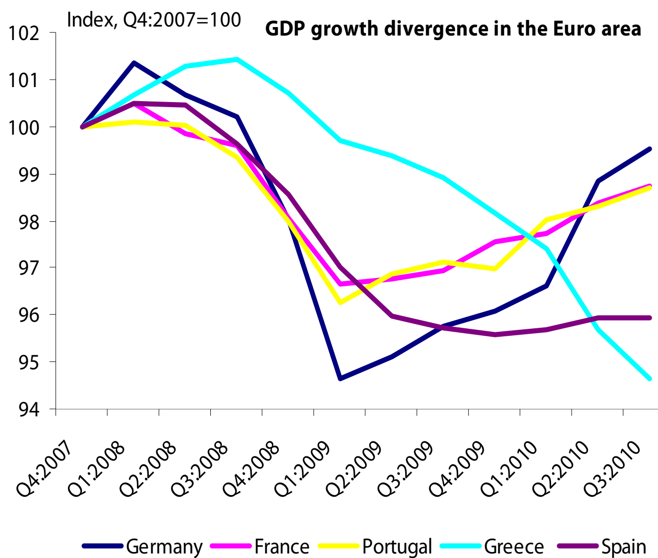
Source: Bloomberg

Aggregate euro area data mask an ongoing divergence in growth among euro area members (Figure 2.3), which is expected to persist in the following year (Figure 2.4). Germany has so far been an outlier in terms of economic growth and is expected to remain the growth engine of the euro area. Its open economy takes advantage of solid growth in emerging markets, while improving labor market conditions are expected to support private consumption growth. Leading indicators confirm the robustness and the resilience of the German recovery. On the other hand, frontloaded fiscal retrenchment programs in the periphery have caused growth to stagnate, as in Spain and Portugal, or even contract, as in Greece. Wage cuts along with tight credit conditions will constrain households pending. Structural deficiencies in these countries will take long to cure and are expected to take a heavy toll on their growth prospects. Poor economic performance and labor market rigidities are anticipated to put a lid on employment. As a result, income growth is expected to stagnate and the savings ratio to remain elevated, both affecting adversely domestic demand.

Fiscal adjustments pose downside risks to the euro area economy.

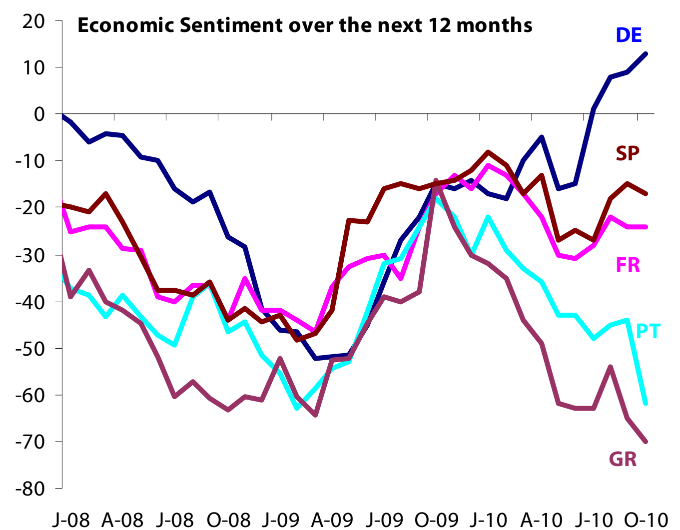
The sovereign debt issues remain the main risk of the euro area recovery and it is very likely to be a recurring theme in the next year. The recent resurface of sovereign tensions in Ireland prove that periphery economies are not out of the woods, yet. Markets are concerned about the size of the fiscal adjustment that debt burdened members need to undergo, amid an anemic or even negative growth environment. Sluggish private consumption hurts government revenues, while the appreciating euro erodes periphery markets competitiveness. The latter poses a serious threat to growth prospects in debt laden countries, as exports are the main growth engine, amid a deleveraging private and public sector. Also important, social fatigue remains a serious concern, as it could blow up any progress made so far. Greece, the member which faces the most challenging fiscal adjustment, has got off to a good start and is making fast progress on passing on key reforms, while social consent is supporting the government efforts. Further ahead, additional support from the European authorities is possible, as long as conditionalities are successfully met.

Figure 2.3



Source: Eurostat

Figure 2.4



Source: Bloomberg

The Irish Crisis

Irish bonds have come under heavy pressure as spreads started widening considerably in light of Ireland's need to fully recapitalize its broken banking system. On November 28, EU finance ministers have agreed to a bailout package of €85bn. The financial assistance will be financed from the European financial stabilization mechanism (EFSM) and the European financial stability facility (EFSF), supplemented by bilateral loans from EU members. The EU/IMF programme aims at financing a significant part of the Irish government's financing needs and includes "a fund for potential future capital needs of the banking sector".

The restructuring of the Irish banking system poses a huge challenge on the country's public finances. It is estimated to cost about €50bn, adding about 20 percentage points to the 2010 budget deficit, which has skyrocketed to 32%. The government has announced a front-loaded fiscal austerity program worth €15bn, (€6bn in 2011), in order to bring the budget deficit down to 3% of GDP by 2015 as required by the European Union. The €15bn fiscal consolidation includes €10bn of expenditure measures and €5bn in revenue measures (Table 2.1).

Meanwhile, the prospect of elections in Ireland in early 2011 has added to investors' uncertainty, keeping Irish bond yields at historical peaks even after the announcement of the bailout package. Furthermore, the downgrade of Ireland by S&P and the warning of a "multi-notch" downgrade by Moody's are adding to market tensions for Ireland and the Euro area. Fears have spread across the rest of periphery countries, with Portuguese and Spanish borrowing costs moving sharply higher since Ireland accepted an EU-IMF bailout, as investors have become increasingly worried that Portugal's and Spain's debt levels will prove unsustainable, putting them next in line for a European bailout. In contrast to Portugal which accounts for less than 2% of the EA's gross domestic product, Spain is EU's fourth-largest economy, so a potential bailout would probably involve dramatic repercussions for the entire bloc. While both countries are not at any immediate need to roll over maturing debt, bond yield increases contribute to a worsening of their debt dynamics, as the higher cost to roll over debt is more than offsetting the decline in their public deficits through austerity measures.

BOX 1.

The "Permanent Crisis (Resolution) Mechanism"

For the first time since the creation of the common currency, the euro area appears to be deeply divided into a core and a periphery. Euro area leaders will soon decide on the structure of a permanent crisis resolution mechanism (PCRM), where private investors must bear part of the cost of any bailout of euro area member countries in need of fiscal support.

The increased focus of the current debate on the clause of an "orderly restructuring" (in form of a CAC – Collective Action Clause) of the debt of fiscally weak member countries has spooked financial markets and has led to an outright increase in borrowing costs and a further deterioration of debt-dynamics in these countries. In this sense, the current discussion on the structure of the PCRM introduces a permanent crisis element into euro area bond markets rather than help to resolve the current crisis. This is because CACs introduce a formal segmentation of euro area bond markets, thus, increasing the likelihood of speculative attacks on sovereign debt in the future.

In order to calm markets, the PCRM should be combined, in our view, with two additional mechanisms: First, the launch of a euro-bond, which guarantees the refinancing of 60% of each EA country debt-to-GDP ratio at a low interest rate. Countries with debt in excess of the 60% rule, will be forced to finance their excess debt at market interest rates. This will create a strong incentive for countries to converge to the 60% rule in the long run.

Second, with a quantitative easing programme of the ECB, similar to QE2 of the Fed. By increasing its bond purchases, the ECB would smooth the pain for the private sector from a likely future debt restructuring without exposing itself to potential losses, since it purchases government bonds of periphery countries at a heavy discount.

It is well known that the euro area suffers from a problem of economic governance: it is a monetary union but no fiscal union. This, in turn, makes the euro area vulnerable to financial market instability. The euro area cannot survive in the long term without an effective mechanism of fiscal policy coordination. Any such mechanism should aim at preserving the integrity of the euro area as a whole and not draw dividing lines between north and south or centre and periphery.

Table 2.1
Ireland: Fiscal consolidation measures

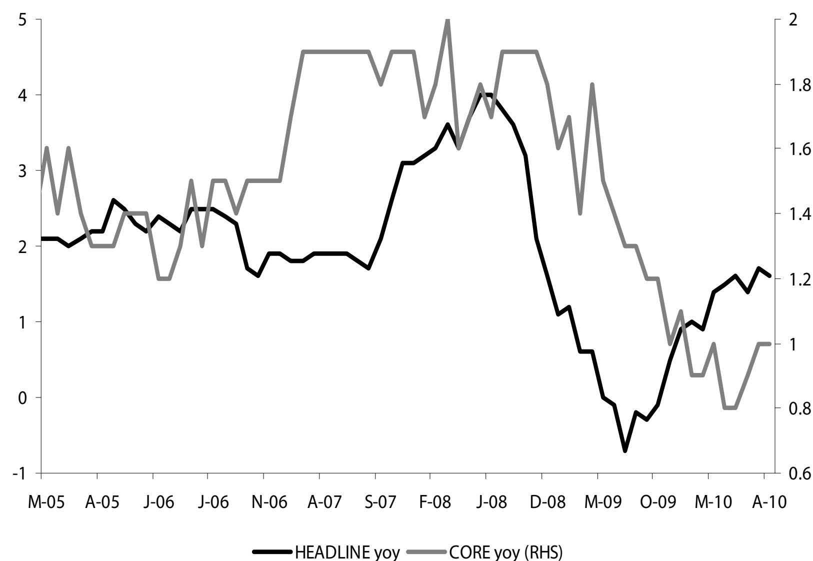
Expenditure Measures	Revenue Measures
Reduction of the public sector pay bill by about €1.2 bn between 2010-2014.	No change in the corporate income tax.
Introduction of a reformed pension scheme for new entrants to the public service and reduction of their pay by 10%.	Income tax changes will contribute €1.9 bn to fiscal revenues.
Public service staff is planned to be cut by 24,750, back to 2005 levels.	Pension-related tax changes and tax expenditures curtailment will contribute almost €1.5 bn to fiscal revenues.
Social welfare expenditure will be reduced by €2.8 bn.	Increase in VAT from 21% to 22% in 2013 and to 23% in 2014.
Redeployment of staff within and across sectors of the public service.	A Site Value Tax will be introduced to fund essential locally-delivered services, yielding €500 million.
Reforms on work practices to modernize public services.	Increase in the price of carbon gradually from €15 to €30 per tonne
Increase in the student contribution to the costs of third level education.	Reforms in capital acquisitions and capital gains tax are expected to yield €145 million.
Introduction of water metering by 2014.	

Inflation is expected to remain moderate.

We expect headline inflation to remain modest at 1.5% and 1.7% in 2010 and 2011, respectively, within the ECB's comfort zone. Upside risks for headline inflation stem from stronger performance in core members, likely depreciation of the euro as we are heading into 2011, and higher than expected growth in emerging countries that could trigger sharp increases in commodity prices. Additional liquidity offered by the Fed also contributes to inflationary fears. Ample liquidity coupled with the fact that central banks in emerging markets are on a tightening mode may swell capital inflows and raise the risk of bubbles in commodity prices.

Core inflation seems to have entered on a rising trajectory after bottoming in Q2 (Figure 2.5), while it is likely to edge higher, reflecting improving economic conditions in the euro area as a whole. However, negative unit labor cost projections due to high unemployment, along with modest domestic demand growth are expected to keep core inflation muted in the period ahead. In line with our projections, the EC consumer price expectations survey points to contained inflation in the next 12 months. Overall, we see neither inflationary nor disinflationary threats ahead.

Figure 2.5



Source: Bloomberg

The ECB is expected to keep its policy rate unchanged until end-2011.

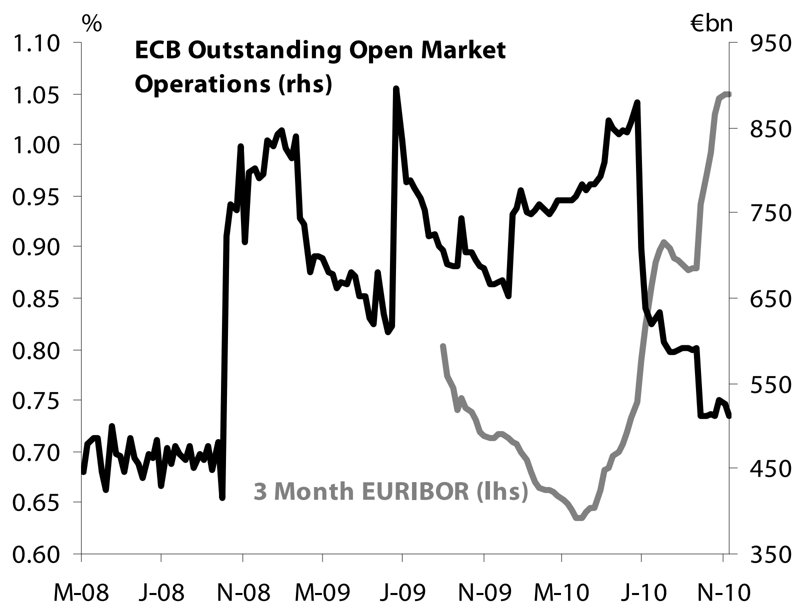
Given the lack of inflationary pressures and the muted growth outlook of the Euro area economy, we expect monetary policy to remain accommodative well into 2011. However, with economic activity picking up and conditions in money markets normalizing, we expect the ECB to gradually prepare the ground of a tightening of monetary conditions. It is worth noting that total liquidity provided by the ECB has declined sharper since June (from nearly € 900 bn to just above € 500 bn) as the ECB has withdrawn emergency liquidity provision through 12-month and 6-month LTRO (Figure 2.6). After the remaining 12-month LTRO mature by year-end, the ECB will be providing liquidity for only up to three months.

However, monetary policy normalization is likely to become increasingly complex, as the growth divergence between core members and periphery countries is anticipated to become more prominent. Given the outstanding growth pace of the German recovery, the right policy mix for Germany may include tighter monetary policy. Furthermore, money market funding becomes cheaper, while declining liquidity is indicative of a healing banking system, as it suggests less dependence on the ECB for liquidity provision. At the same time, banks in periphery members rely heavily on the ECB for liquidity, while they need low refinancing costs. Ted spreads show that the lending risk among euro area banks remains elevated compared to their G3 counterparts Moreover, debt laden members have to reorient their economies towards exports thus they need a low real effective exchange rate. Under these conditions, we believe the ECB should maintain its

non standard lending measures, such as accepting poor rated assets as collateral, and continue its government bond purchase program.

Overall, our baseline scenario for ECB's policy is that it will proceed cautiously towards monetary consolidation as long as it doesn't hurt the recovery of the euro area as a whole. We expect the ECB to start hiking rates in the fourth quarter of 2011. Meanwhile, given that bond markets push for fiscal restraint, monetary conditions in the euro area are expected to remain accommodative, so as to allow governments to tighten fiscal policy without jeopardizing the economic recovery. Systemic risks may force the ECB to bring its exit strategy to a halt and take action, while minor problems will be left to be dealt at a national level.

Figure 2.6



Source: Bloomberg

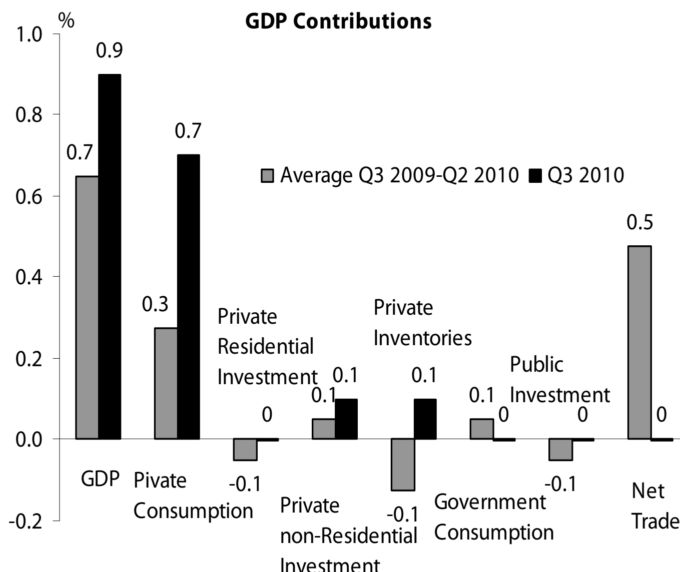
3. The Japanese economy

Dimitris Malliaropulos, Vasilis Zarkos

- After peaking in Q3, the Japanese economy will most likely slow down in the period ahead due to unwinding of fiscal stimulus, appreciating yen and weaker global demand.
- The economy may peak up later in 2011, as the exports engine is expected to regain steam on the backdrop of improving conditions in the US, solid growth in China and a likely depreciation of the yen.
- In the short term, we view a significant deterioration of the economy or the USD/JPY rate stubbornly below 80 as triggering events for a second round of currency intervention by the government and additional asset purchases by the Bank of Japan.
- The key policy rate is expected to remain unchanged at 0.1% until at least the beginning of 2012.

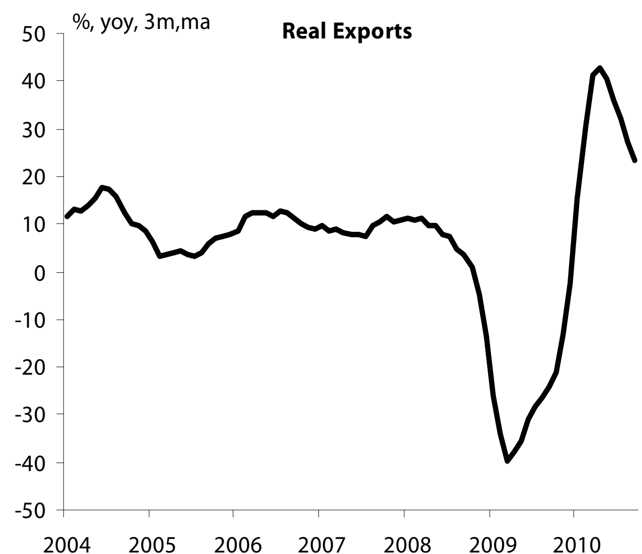
The Japanese economy grew at 0.9% q-o-q in the third quarter, while household consumption was the key driver (Figure 3.1). Household expenditures jumped by 1.1% q-o-q relative to the previous quarter as consumers rushed to take advantage of the expiring tax credit for eco friendly cars. Net exports stalled posting a zero contribution. This comes after five consecutive positive contributions from net exports that essentially dragged the Japanese economy out of recession. Looking forward, the economy will most likely slow down in the fourth quarter, as private consumption is expected to decline. Furthermore, lower global demand and the rising yen are the major headwinds that are expected to take a toll on exports. Real exports are increasing on a yearly basis but at a diminishing pace (Figure 3.2). Besides base effects, this implies lower demand for Japanese goods.

Figure 3.1



Source: Cabinet office

Figure 3.2

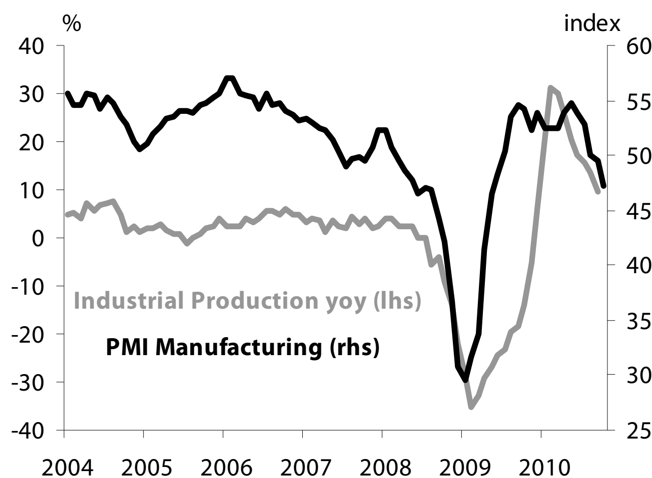


Source: Ecowin

Later in 2011, we expect growth to benefit from improving global conditions, leading to a pick up in exports. Recent US data suggest that the economy has escaped the danger of a double dip and remains sustainable. Encouraging data on employment and gains in the ISM indicator suggest increasing demand that may benefit Japanese goods in the medium term. The anticipated appreciation of the US dollar later in 2011 may alleviate depreciating pressures on JPY and help exports to regain momentum. Furthermore, production is expected to benefit from solid growth in China and the spill over effect to other emerging and commodity exporting countries.

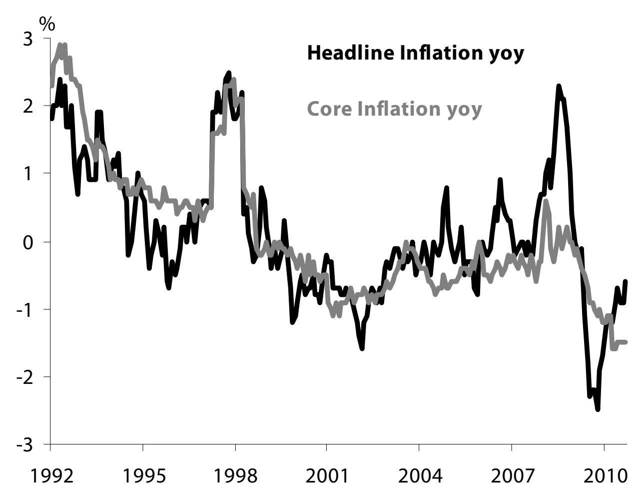
Recent data bode well with lower economic performance towards the end of the year. The industrial production index is declining on a monthly basis since June (Figure 3.3), while the PMI manufacturing indicator remains below the expansion threshold of 50 since September, suggesting further cuts in production. The recent Tankan survey revealed improving business conditions for the third quarter both for the manufacturing and non-manufacturing industry, but it points to a clear deterioration in business sentiment as we are heading towards the fourth quarter. In line with the Tankan data, the recent Eco Watchers survey conveys deteriorating expectations sentiment among both households and firms.

Figure 3.3



Source: Bloomberg

Figure 3.4



Source: Bloomberg

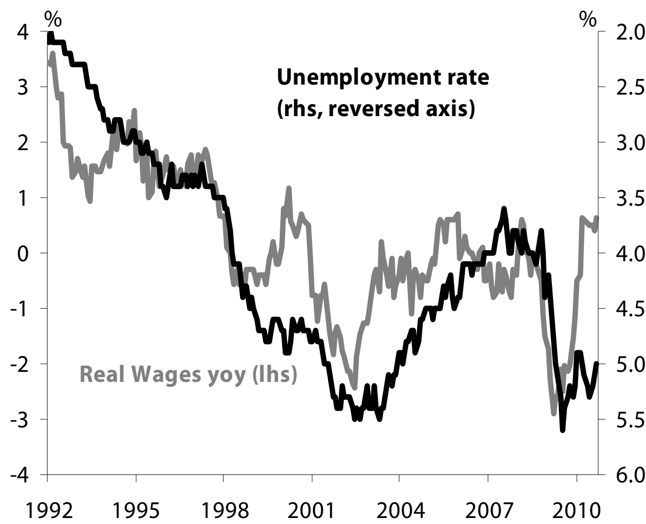
On the backdrop of weakening industrial production, capital spending grew by 0.8% q-o-q in Q3 down from 1.8% in Q2. Declining exports and weaker production in the period ahead will most likely drag corporate outlays. Capacity utilization remains on a declining trend since June, suggesting that firms may postpone capital expenditures until later in 2011, when the exports engine may regain steam on the backdrop of improving external conditions. A drop in machinery orders in October suggests modest capital expenditure plans in the following period. According to the Tankan survey, capital spending of large manufacturers for the fiscal year 2010 is forecasted to increase by 2.4% down from 4.4%, which was the previous projection.

Household consumption is set to lose momentum in view of fading fiscal stimulus. Declining consumer confidence bodes well with lower personal expenditures. As the program of subsidies for eco-friendly cars expired in September, vehicles sales plunged the same month by -4.1% yoy, followed by an even sharper decline of 26.7% in October. Vehicle sales had jumped by 46.7% yoy in August, as customers rushed to take advantage of the subsidies. On the positive side for the Japanese consumer, household expenditures are expected to benefit from an extension of the tax credits for eco-friendly appliances until next March. However, we believe the impact of the extension will be muted as the credit is expected to be smaller, while the previous credit program has most likely brought forward much of future demand. Persistent deflationary environment remains a drag for domestic demand (Figure 3.4).

Consumers' spending is adversely affected by high unemployment (Figure 3.5). Although a decreasing number of firms report excessive employment, unemployment is expected to remain elevated. Uncertainty about the sustainability of household consumption beyond the expiry of fiscal measures, along with lower global demand, results in companies

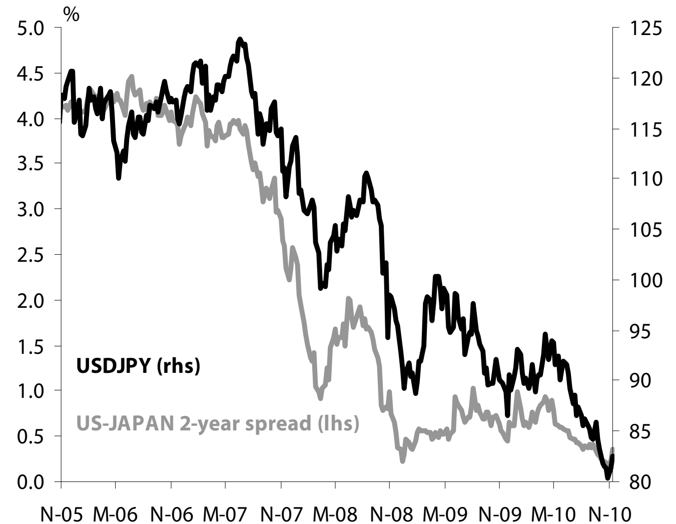
being reluctant to hire aggressively. The jobs-to-applicants ratio has been inching higher the last few months, but it remains low. Real wages growth entered positive territory in March but it has stalled ever since. Employment will likely improve in 2011 as firma are likely to step up hiring in order to address growing global demand.

Figure 3.5



Source: Ecowin, Bloomberg

Figure 3.6



Source: Bloomberg

The appreciating yen has reached the highest value against the dollar since its last peak in early April and is holding back the Japanese economic growth. The strong yen hurts exports while it reduces corporate profits from sales overseas. This raises the risk of firms cutting capital investment, transferring production abroad and cutting domestic jobs. In view of the currency risk, the government intervened in the forex market for the first time since 2004 to temper the yen's strength. However, additional easing by the Fed is not likely to let the yen depreciate soon. The spread differential between the US and Japanese bonds are expected to remain low, suggesting the yen will remain strong relative to the dollar (Figure 3.6). Therefore, additional currency intervention by the government is in the cards.

In light of the economic weaknesses, the BoJ announced that it will embark on assets purchases of 5 trillion yen total value, in order to encourage a decline in long term interest rates. The bank announced that it will target J-REITs and ETFs that track the Topix and Nikkei indices. This measure puts the BoJ in the camp of the banks that have embarked on quantitative easing, along with the Fed and the Bank of England. Assets purchases will come on top of liquidity provision through the fund supplying program, which in total, will allocate 30tn yen at three and six month fixed rate operations. The BoJ did not expand its QE after the Fed's second round of quantitative easing. We assume that it will scale up its assets purchase program if the economy deteriorates significantly or the yen appreciates substantially (possibly if the USD/JPY persists below 80). The bank authorities cut the intervention rate from 0.1% to the range 0-0.1%, which, as expected, has had little impact as the rate on deposits in BoJ remains at 0.1%. We expect the intervention rate to remain unchanged until at least H1 2012.

4. Emerging Markets

Dimitris Malliaropulos, Maria Prandeka

- The global growth recovery is expected to continue to be fueled by emerging economies, where domestic demand remains resilient.
- Increasing capital inflows generate currency appreciation pressures and feed credit and asset bubbles, raising substantive concerns for EMs' central banks.
- The major challenge to the Emerging Asia's upbeat growth outlook is inflationary pressures that have already started to mount, owing to rising food and commodity prices and accelerating credit growth.
- The sustainability of Emerging Europe's recovery is vulnerable, due to the downside risks of the strengthening euro and fiscal austerity measures on EA's -its main trading partner- industrial activity.
- In Latin America, the recovery in economic activity continues to gain ground, on the back of strong domestic demand and favourable business and consumer confidence.

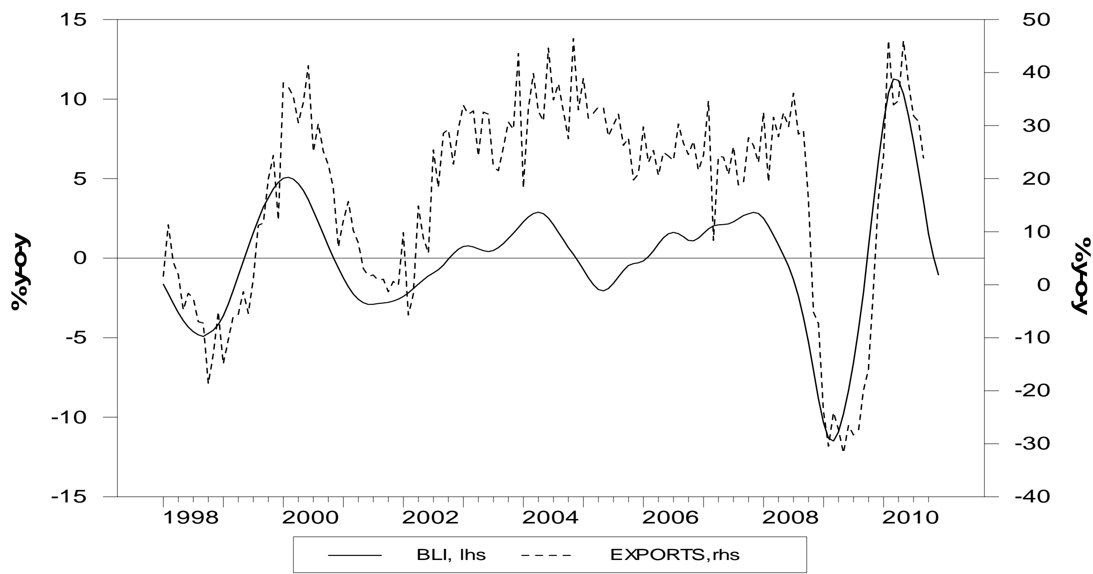
With domestic demand particularly resilient, improving labor market conditions and a strong bounce back in external trade, emerging markets expanded more than twice as much as advanced economies over the first half of 2010 (8% and 3.5%, respectively)[3]. Their economic prospects remain robust due to stronger fundamentals, such as a less leveraged private sector and better external balances. Thus, they are expected to remain the leaders of global growth, growing substantially faster than advanced economies over the next few years. According to the latest IMF forecasts[4], in 2010, emerging and developing economies will contribute 3.7% to global growth (measured in ppp), almost double the contribution of advanced economies (1.9%). Although advanced economies account for the biggest fraction of global GDP in terms of purchasing power parity (53%), EM economies have increased significantly their share in global GDP since 2000 (from 37% to 47%) and they are expected to surpass advanced economies over the next five years, becoming gradually the major engine of the world economy. It is worth noting that advanced economies' share in global GDP has declined through time (63% in 2000).

In the monetary policy front, EMs' central banks have already started a gradual tightening of monetary policy to prevent their economies from overheating. Meanwhile, G3 central banks are keeping interest rates at historical lows and are not expected to proceed with rate hikes before the second half of 2011. As a result, interest rate differentials are widening further. The latter along with the Fed's second round of quantitative easing, which put downward pressure on the dollar, and better growth prospects of EM economies have encouraged increasing capital inflows into commodities and other assets in EMs. The persistent strength in private capital inflows raises substantive concerns for EMs' authorities, as it generates currency appreciation pressures and feed credit and asset bubbles. Indeed, this happens at a time when inflation and overheating constitute major concerns, given that EM economies are growing at or above potential. In order to curb currency appreciation, policymakers in several countries have recently engaged in foreign exchange intervention and capital controls, thus fuelling trade tensions. For example, Brazil has already introduced taxes on foreign investment in fixed income securities, as its currency appreciated sharply versus the US dollar. Nevertheless, while EMs are trying to prevent a nominal appreciation via foreign exchange intervention, as Figure 4.2 depicts, the real effective exchange rates appreciate, given that inflation is rising in these countries. As a result, EMs are worried about loss of competitiveness and, consequently, a moderation in exports. Indeed, our BRICs leading indicator points to easing exports growth ahead (Figure 4.1). Additionally, increasing capital inflows are holding off EMs from raising short term interest rates further, as this will fuel further capital inflows, adding to inflation pressures and asset bubbles. In our view, it is difficult for central banks to devalue their currencies against the US dollar, as the Fed is expected to keep its easy monetary stance until at least Q3

[3] *IMF, World Economic Outlook, October 2010*
[4] *IMF, World Economic Outlook, October 2010.*

2011. Indeed, the risk is that competitive devaluations, exchange rate volatility and constraints on capital inflows may destabilize global trade flows, putting a brake on the recovery of the world economy. Hence, EMs will increasingly get under pressure to allow their currencies to appreciate, even gradually, which is a positive step towards global rebalancing.

Figure 4.1
BRICs Leading Indicator*

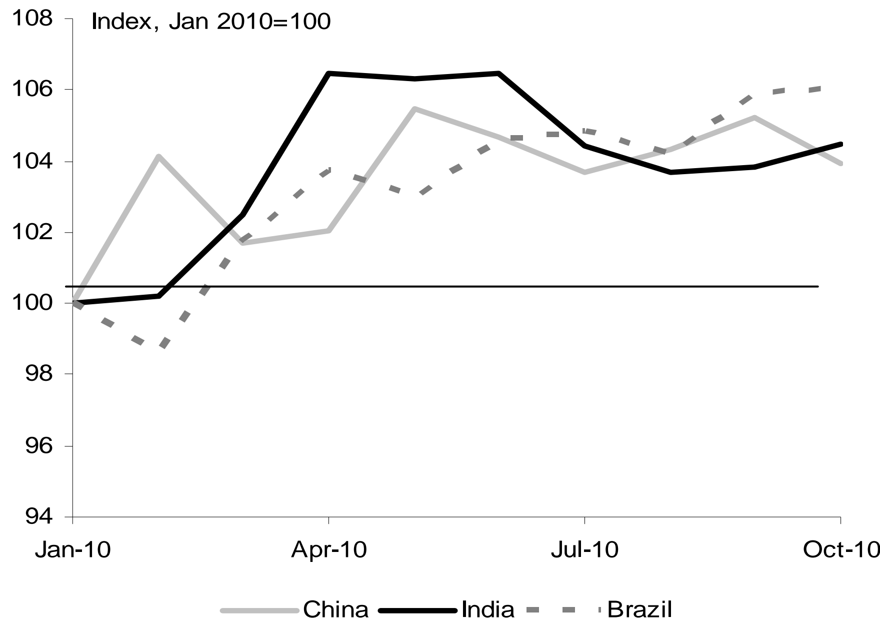


** 3 month forward*
Source: Eurobank EFG

We continue to believe that a major risk to the EMs' upbeat growth outlook is inflationary pressures, stemming mainly from rising commodity prices and the rebound in capital inflows. A significant challenge for EM economies, such as China, that rely mainly on exports, while private consumption comprises only a small fraction of GDP, is a worse-than-anticipated recovery in advanced economies. In contrast, countries, such as Brazil, are more resilient given their limited dependence on exports and their reliance on domestic demand. Thus, it is less likely that these economies will be significantly affected by a slow recovery in advanced economies, unless there is a new bout of global risk aversion, putting increased pressure on commodity prices and, hence, export of commodity-producing countries. Indeed, such a shock should weigh on these economies also through the capital flows channel, as they run current account deficits.

As far as particular EM regions are concerned, Emerging Asia is leading the recovery, due to aggressive monetary and fiscal policy easing. In Latin America, economic activity continues to gain ground, on the back of strong domestic demand, favourable business and consumer confidence and rising commodity prices. Elsewhere, Emerging Europe has been a clear underperformer among EM regions. Its main challenge is a slowdown in the Euro area -its main trading partner-, due to the effects of the strengthening euro and the impact of fiscal austerity measures on EA's real economic activity.

Figure 4.2
Real Effective Exchange Rate



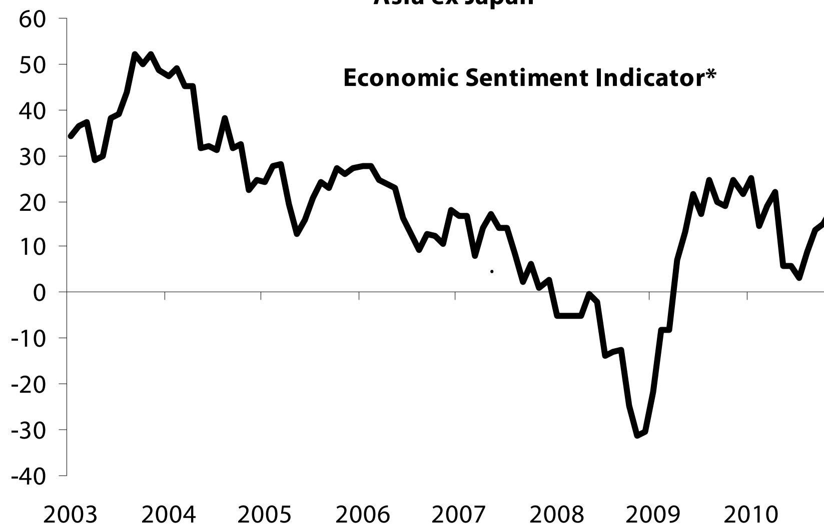
Source: Ecowin, BIS

Emerging Asia

After having bounced back from the global downturn much more strongly than others, emerging Asian economies' growth momentum remains particularly strong. Leading indicators suggest improving economic activity across the region, with the Asia ex Japan economic sentiment indicator being on an upward trend (Figure 4.3). Real GDP growth is generally expanding at or above pre-crisis levels, on the back of robust private consumption, large fiscal spending, surging exports and a healthy state of the region's banks that ensured credit availability. China and India are playing the most important role in the region and robust domestic demand spread from these countries to other Asian economies. In China, real GDP growth is expected to return to a double digit growth rate on a yearly basis, accelerating to 10% y-o-y. In addition, according to our estimates, India's real GDP will expand by 8.5% in 2010.

The major challenge to the region's upbeat growth outlook is inflationary pressures that have already started to mount, owing to rising food and commodity prices, large capital inflows and accelerating credit growth. It is important to point out that food accounts for a large proportion of the consumer price baskets in the region. In India WPI inflation (ex food) increased by an average of 9.6% y-o-y in the first ten months of the year, forcing the Reserve Bank of India to follow China in tightening policy. The latter has raised both the reserve requirement ratio (by a total of 150 bps) and the benchmark interest rates. Moreover, it has proceeded with a number of measures, such as raising mortgage rates, in order to curb lending. Another challenge for the region is the withdrawal of fiscal stimulus, now that the recovery is well established. Countries in the region should rebalance their economies towards domestic sources of growth, as they are highly dependent on external demand and, consequently, vulnerable to a sudden shock in the global economy.

Figure 4.3



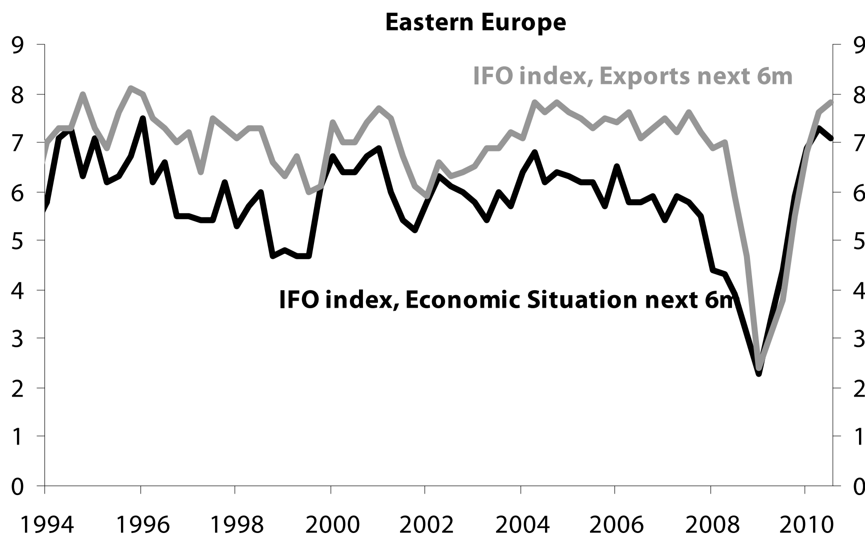
The sentix sentiment indicator is a monthly survey among financial analysts and institutional investors about the expected economic situation.

Source: Ecowin

Emerging Europe

Although the region continues to lag behind emerging Asia and Latin America in the recovery, its Q3 GDP data generally surprised on the upside, with industry being the main driver of growth. Indeed, in Q3 10, both the Eastern Europe IFO economic situation index and the index for export volumes over the next six months remain above the 5-point-level that indicates expansion since the last quarter of 2009 (Figure 4.4). Manufacturing PMI indices across the region improved further in recent months, and this has already shown in industrial production numbers. In Russia, for example, the PMI rose again above the threshold of 50, which indicates expansion, in October, while industrial production expanded by an average of 8.7% y-o-y, since the beginning of the year, in contrast to a contraction of 9.2% in 2009. This is reasonable if we think of the manufacturing led recovery in Germany, which is Emerging Europe's key export destination. However, this may constitute a major vulnerability for the region, as the strengthening of the euro and fiscal austerity measures will start to take their toll on Euro area's industrial activity over the next few quarters. Capital is generally returning in the region, but inflows are moderated, compared to Emerging Asia and Latin America. This reflects a fragile banking sector and weaker growth prospects. We expect that exchange rate appreciation and currency intervention will constitute a more preferred response to capital inflows than capital controls. Meanwhile, sizeable deterioration in public finances, due to massive fiscal stimulus, suggests that there is little scope for further fiscal easing, impeding the recovery in the region. On the upside, higher commodity prices will benefit energy exporters in the region, most notably Russia.

Figure 4.4



Source: Ecowin

Latin America

The region's real GDP growth picked up strongly over the first half of 2010, on the back of strong domestic demand, favourable business and consumer confidence, solid macroeconomic fundamentals and strong commodity revenues. In H2 2010, economic activity is expected to moderate slightly, as a result of tightening monetary policy. This is strongly confirmed by the Latin America IFO expectations index that has declined gradually from its peak in Q1 10 (Figure 4.5). Overall for 2010 Latin America is expected to grow at about 6%, significantly up from -1.7% in 2009. In addition, the benign growth outlook of Asian economies, particularly China, a key destination of LA's exports, will also be beneficiary for the region. The Latin America IFO index for export volumes over the next six months has increased further in Q3 10 (Figure 4.6). Meanwhile, labor market conditions remain favorable. In Brazil, the rate of unemployment has fallen significantly to 6.2% in September, the lowest rate since December 2008, due to significant gains in employment. Indeed, net formal job creation reached 2,201k since the beginning of the year, while the total level for the whole 2009 was 995k net new jobs. We continue to believe that a key issue for the region will be widening current account deficits, mainly due to the continuation of domestic demand expansion. Nevertheless, strong capital inflows will finance the deficits, deterring balance of payments risks. Moreover, solid commodity prices will continue to contribute positively to growth in the region and support LA currencies. On the other hand, sharply increased capital inflows are resulting in stronger local currencies, a case that brings important challenges to policymakers that are becoming more cautious about tightening. In Brazil, where the real has appreciated sharply, policymakers have already proceeded with the imposition of capital controls, namely increasing the financial transaction tax applicable to foreign investment in fixed income securities. Furthermore, deteriorating inflation dynamics have prompted the Brazilian Central Bank (BCB) to initiate the tightening cycle in the region in an effort to re-anchor inflation expectations. Indeed, the BCB has raised the selic rate by 200 basis points since April.

Figure 4.5

**Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Venezuela*

Source: Eurobank EFG, Ecowin

Figure 4.6

Source: Ecowin

III. Special Issue: The small cap cycle

Dimitris Malliaropulos, Maria Prandeka

In our previous issue (June 2010) we projected that the outperformance of small capitalization stocks relative to large capitalization stocks in the US since the market lows in March 2009 -typical during the early stages of economic recovery- was bound to continue. In line with our projections, small caps continue to outperform large caps over the second half of 2010. We continue to believe that the small cap cycle has yet to come to a cyclical peak, as financial repair and economic recovery in the US should bode well for small businesses in the near term.

Measured by the Russell indices, small caps are up 109.7% since their March 2009 low, while large caps are up 80.2% over the same period. In addition, year-to-date, small stocks have advanced by 15.1%, whereas the Russell 1000 has increased by 8.2% (Figure 1). The crucial question continues to be whether small caps will continue to outperform large caps. As table 1 shows, the small versus large caps performance so far (10%, 20 months after the market trough) is roughly in line with the corresponding average of the four major bull markets in the S&P500 (12.6%). However, the average overall out-performance of small caps was 27.9% over the past four bull markets and lasted on average 29 months (Table 1). In the current cycle we have not seen yet such a performance. Hence from this perspective, the Russell 2000 has some scope to rise further versus the Russell 1000.

Small business surveys, that have begun to improve since the first half of 2010, continue to reflect positive prospects for the sector. According to the October 2010 Fed Senior Loan Officer Survey, a net balance of 7.1% of domestic banks reported easing standards on commercial and industrial (C&I) loans to smaller firms, compared to a net balance of 16.1% of banks reporting tighter standards a year ago.

Table 1
Relative performance between small and large cap stocks during four major bull markets

NBER US	Market Trough	Market Peak	Small vs Large Trough	Small vs Large Peak	Duration from trough to peak (months)	Relative Performance Small vs Large from trough to peak	Relative Performance Small vs Large 20 months after market trough
01/80 - 07/80	Feb-78	Nov-80	Dec-78	Nov-80	23	23.4%	
07/81 - 11/82	Jul-82	Aug-87	Aug-82	Jul-83	11	24.1%	11.1%
07/90 - 03/91	Oct-90	Aug-00	Oct-90	Feb-94	40	33.4%	14.3%
03/01 - 11/01	Sep-02	Oct-07	Oct-02	Mar-06	41	30.6%	12.6%
	Average				**29**	**27.9%**	**12.6%**
12/07 - Q2 09	Feb-09	-	Feb-09	-	20*	10.0%*	10.0%

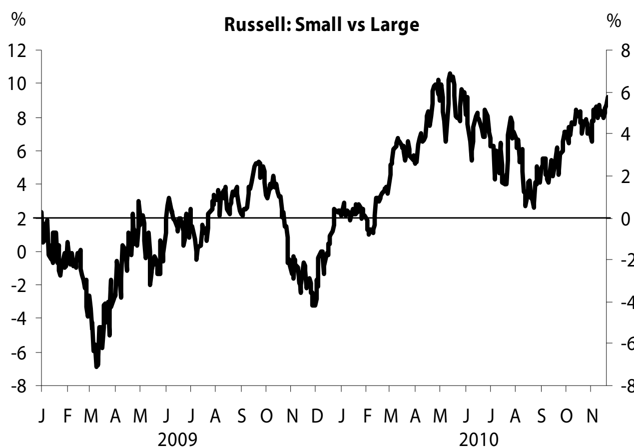
** From end-February 2009 to end-October 2010*

This was the second consecutive survey recording such an easing. Indeed, banks had been reporting tightening terms on C&I loans to small firms since the last quarter of 2006. Moreover, on the demand side, although the ratio of banks reporting that demand for C&I loans from small businesses weakened further over the past three months was somewhat larger compared to the July survey, it has improved substantially to -9.3% from its bottom of -63.5% in Q1 09. As Figure 2 depicts, the above indicators of credit conditions in small businesses have yet to reach the pre-crisis levels, suggesting that the recovery in the sector has further way to go.

In the meantime, the National Federation of Independent Business (NFIB) Small Business Optimism Index increased by 2.7 points to 91.7 in October (Figure 2, left). According to the survey, trends in sales have started to show significant signs of improvement, as the net percentage of firms reporting higher nominal sales picked up to -13% from -17%, which is a significantly better reading than mid-2009 (end of the recession) when the index started to improve (Figure 3, right). Moreover, the net percentage of employers reporting increasing employment has improved by 19 points to -6% since its trough in April 2009. Indeed, hiring plans are encouraging as an increasing percentage of firms reported higher earnings and plans to build up inventories (Figure 3, right). Another piece of somewhat encouraging news came from the ADP small business employment report, according to which private employment among small businesses increased by a total of 21,000 in October for the eighth consecutive month. The main driving force of this increase was gains in the service-providing sector. It should be noted that small businesses account for about one half of US private nonfarm employment.

Another fact suggesting that small stocks may continue to outperform large stocks in the near term is the low interest rate environment. Small companies tend to perform better during such periods, because they are more dependend on bank finance than large stocks. Indeed, we expect the Fed to keep interest rates near historical lows for at least the first half of 2011, in order to ensure that the economy will settle back to a more sustainable path. Thereafter, the Fed will probably not embark on a large-scale tightening right away, so as to avoid any adverse effects by a likely market overreaction.

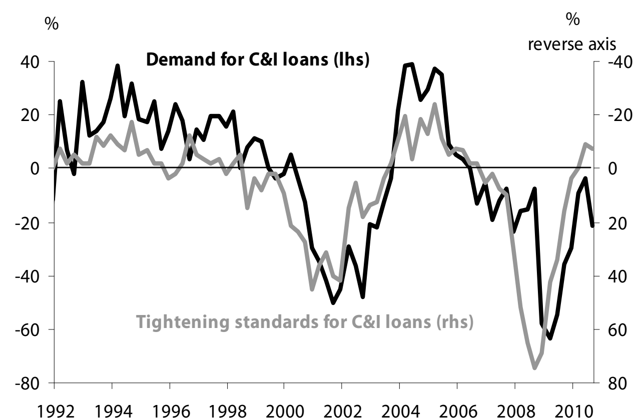
Figure 1



Source: Ecowin

Figure 2

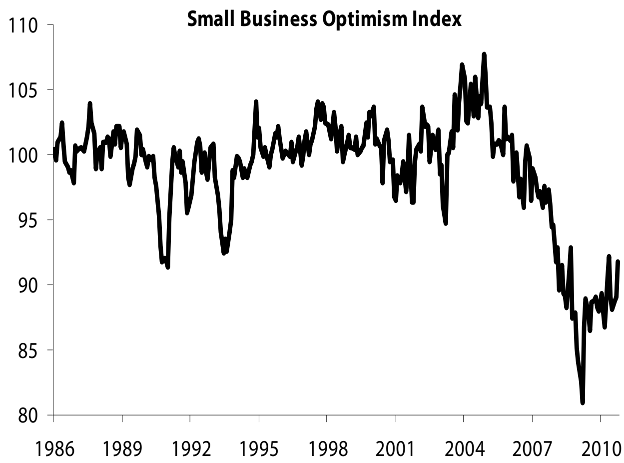
Fed Senior Loan Officer Survey, Small Businesses



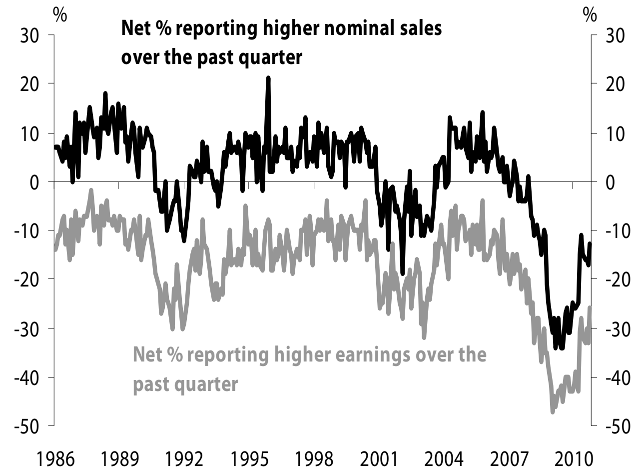
Source: Ecowin

Will the depreciation of the US dollar in H2 2010 benefit large companies relative to small caps? Small companies are more dependent on domestic demand conditions, in contrast to their larger peers, whose earnings are more internationally diversified. Thus, the recent depreciation of the US dollar against major currencies should be more beneficial for large companies as it will make their products more competitive. However, small businesses account for a significant share of US exports (about 31.3% in FY2009). It is worth noting that one of the Small Business Administration's (SBA) strategies for the fiscal years 2011-2016 is to promote small business exports. Therefore, the recent weakening of the US dollar is not a clear negative on the relative outperformance of small company stocks in 2011.

Figure 3
Federation of Independent Business (NFIB) survey
Small Businesses



Source: Ecowin



Source: Ecowin

Macro Forecasts

Real GDP growth						
	2008	2009	2010f		2011f	
			Eurobank EFG	Consensus	Eurobank EFG	Consensus
US	0.4	-2.6	2.7	2.7 (1.9 – 3.3)	2.4	2.4 (1.0 – 3.8)
EA	0.6	-4.1	1.7	1.7 (1.4 – 1.8)	1.7	1.3 (1.0 – 2.2)
Japan	-0.7	-5.2	2.9	3.1 (2.8 – 3.2)	1.1	1.4 (0.9 – 2.2)
China	9.6	9.1	10.0	10.0 (8.9– 10.3)	9.0	9.0 (8.4 – 10.0)
India	7.5	6.7	8.5	8.7 (8.3 – 9.0)	8.7	8.6 (8.5 – 8.6)
Russia	5.6	-7.9	4.0	4.1 (2.5 – 5.0)	4.5	4.3 (3.0 – 5.0)
Brazil	5.2	-0.2	7.5	7.1 (4.1 – 7.9)	4.5	4.5 (3.0 – 5.1)

Inflation						
			2010f		2011f	
	2008	2009	Eurobank EFG	Consensus	Eurobank EFG	Consensus
US	3.8	-0.3	1.6	1.6 (1.0 – 3.4)	1.8	1.6 (0.5 – 4.5)
EA	3.3	0.3	1.5	1.5 (1.5 – 1.7)	1.7	1.7 (1.1 – 1.9)
Japan	1.4	-1.4	-1.0	-1.0 (-1.4 – -0.7)	-0.4	-0.3 (-0.8 – -0.1)
China	5.9	-0.7	3.2	3.0 (2.5 – 3.5)	3.8	3.5 (2.5 – 5.7)
India (WPI)	8.4	2.2	9.0	9.0 (8.4 – 11.6)	6.5	7.7 (5.2 – 10.2)
Russia	14.1	11.7	6.8	6.9 (6.2 – 9.2)	8.2	8.4 (6.8 – 9.9)
Brazil	5.7	4.9	5.5	5.0 (4.4 – 5.8)	5.0	4.7 (4.2 – 5.6)

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

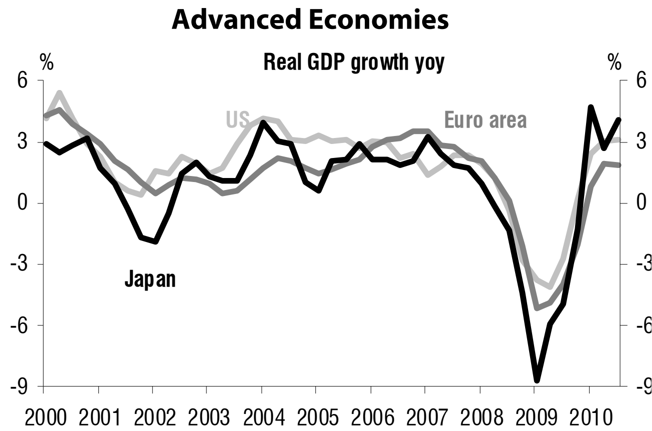
Policy Rates						
			Eurobank EFG			
	Current	Q4 10f	Q1 11f	Q2 11f	Q3 11f	Q4 11f
US	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.50
EA	1.00	1.00	1.00	1.00	1.00	1.25
Japan	0.10	0.10	0.10	0.10	0.10	0.10
China	5.56	5.75	5.75	6.00	6.00	6.00
India	6.30	6.30	6.30	6.50	6.75	7.00
Russia	7.75	7.75	7.75	8.00	8.50	8.50
Brazil	10.75	10.75	11.00	11.50	11.50	11.50

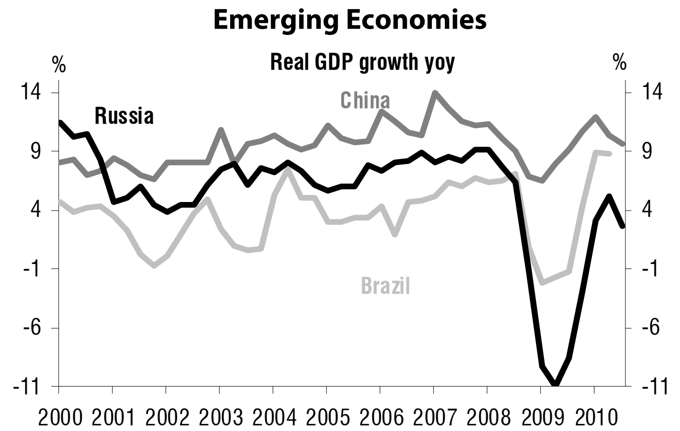
IV. GRAPHS

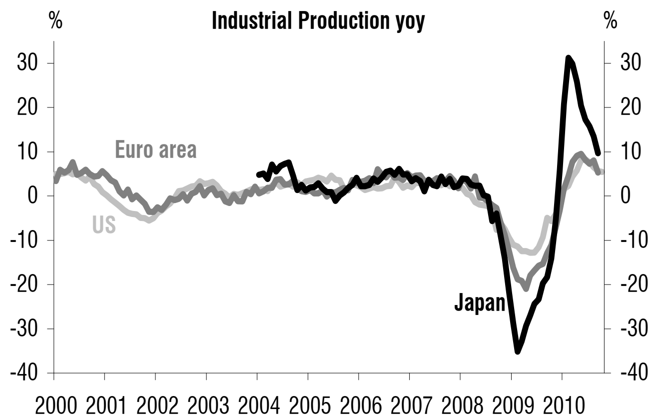
Global Economic Indicators

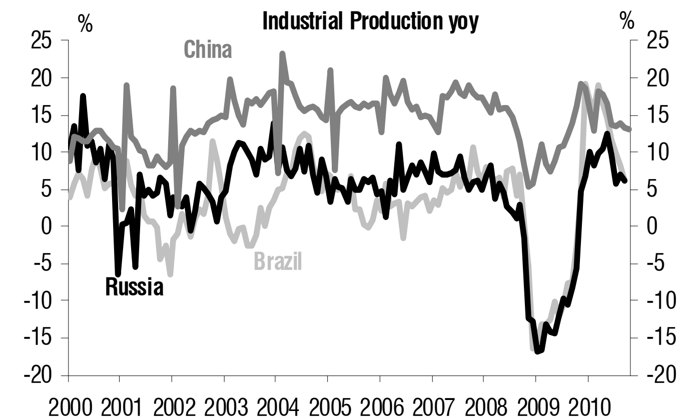
Advanced Economies

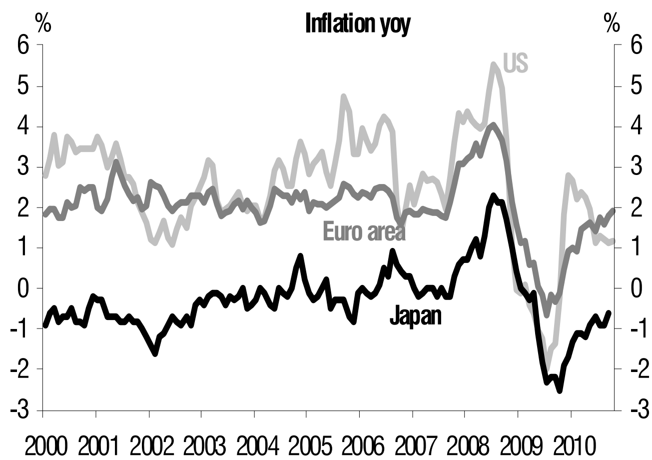
Emerging Economies

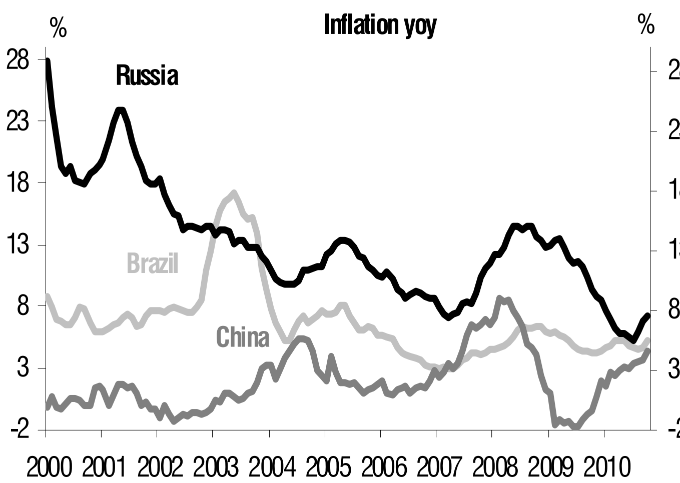










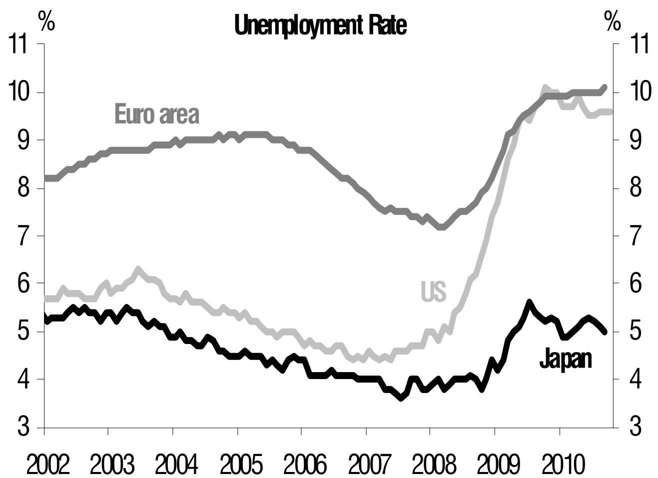


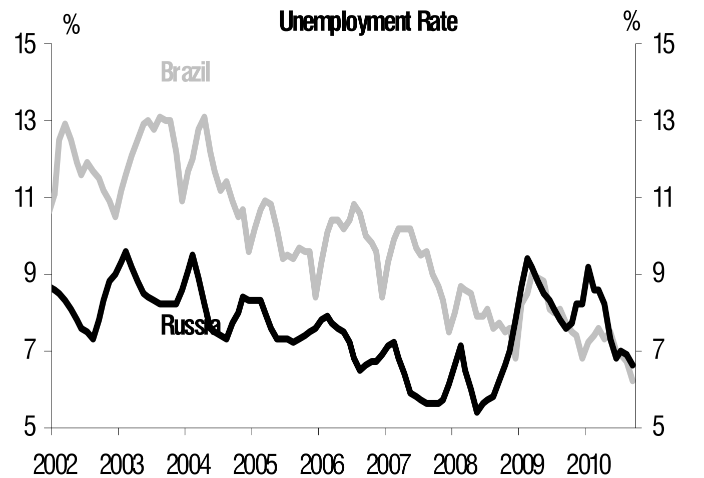
Source: Bloomberg, Ecowin

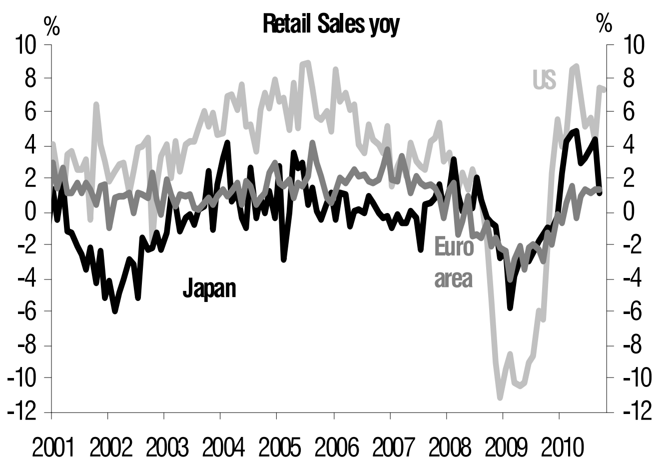
Global Economic Indicators

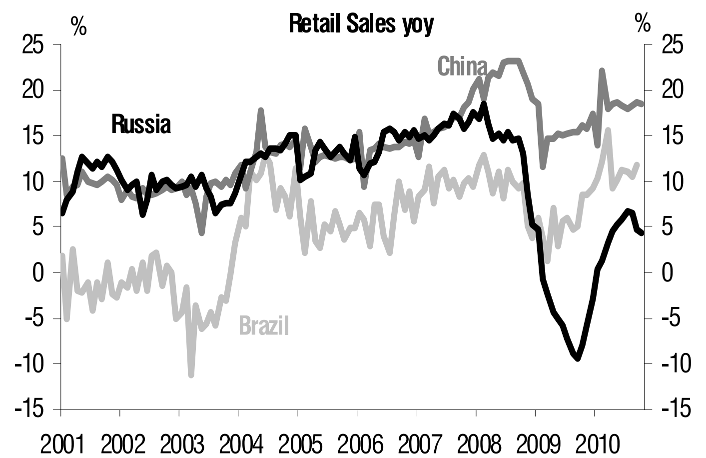
Advanced Economies

Emerging Economies





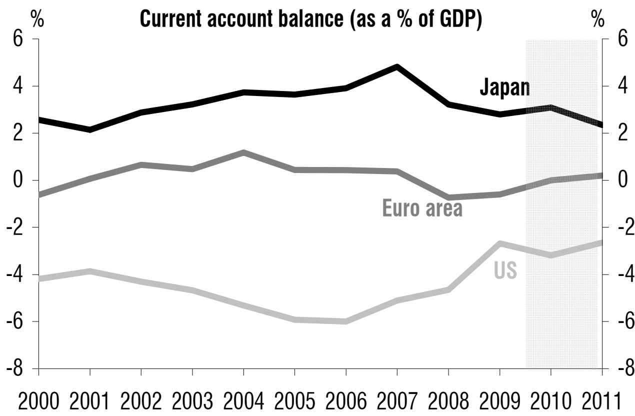




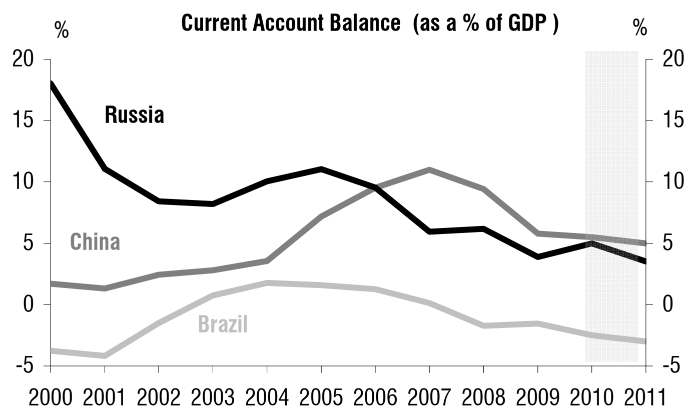
Source: Bloomberg, Ecowin

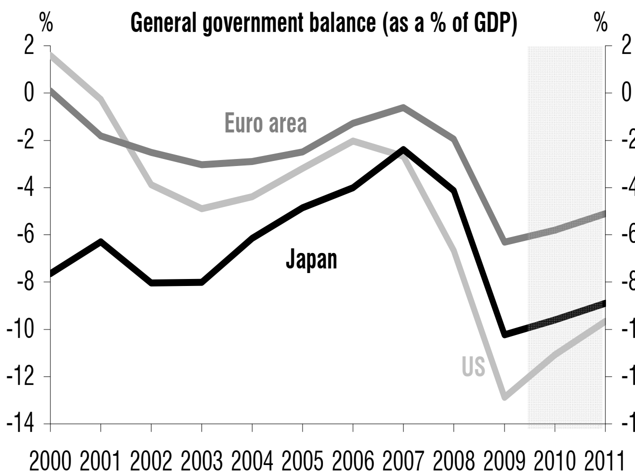
Global Economic Indicators

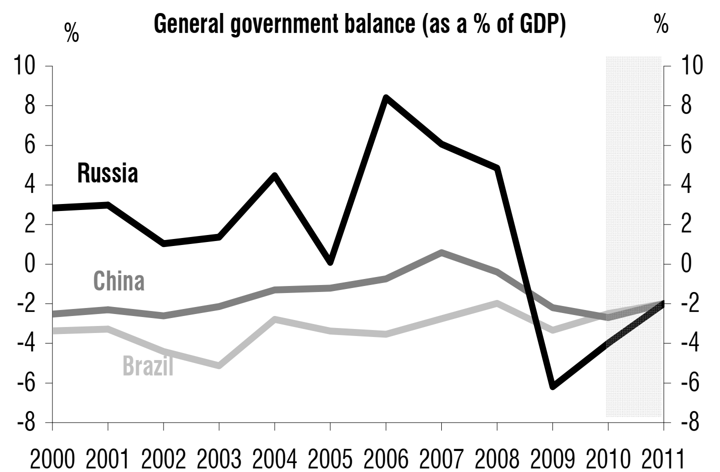
Advanced Economies

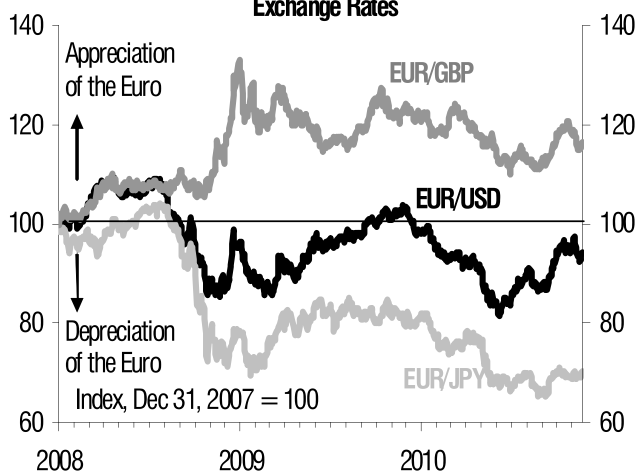


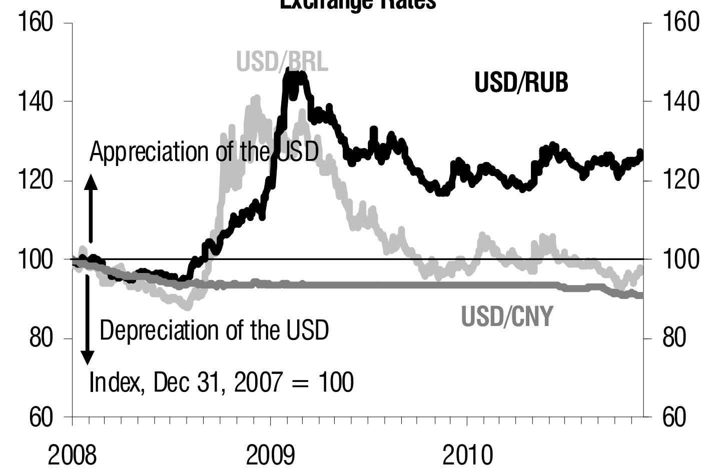
Emerging Economies





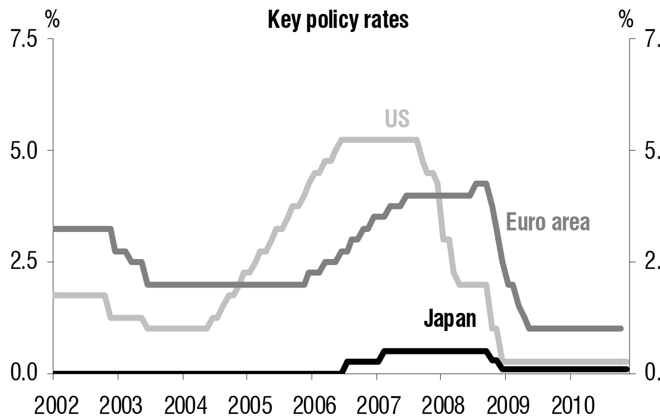


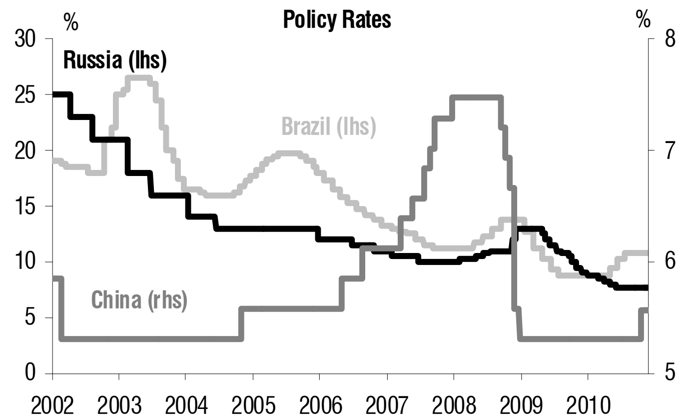


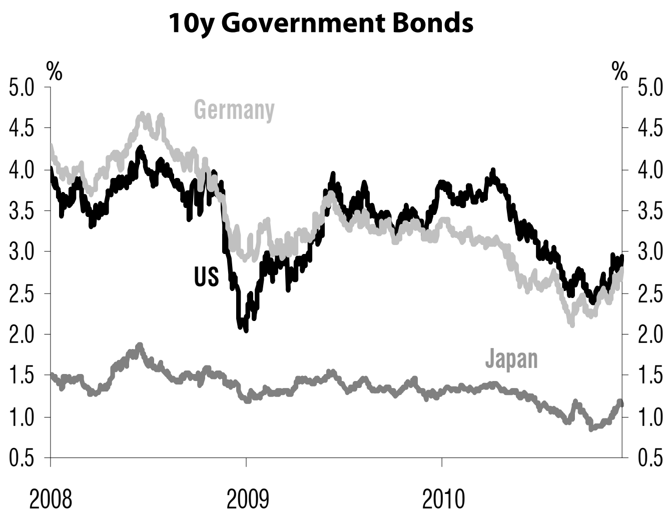


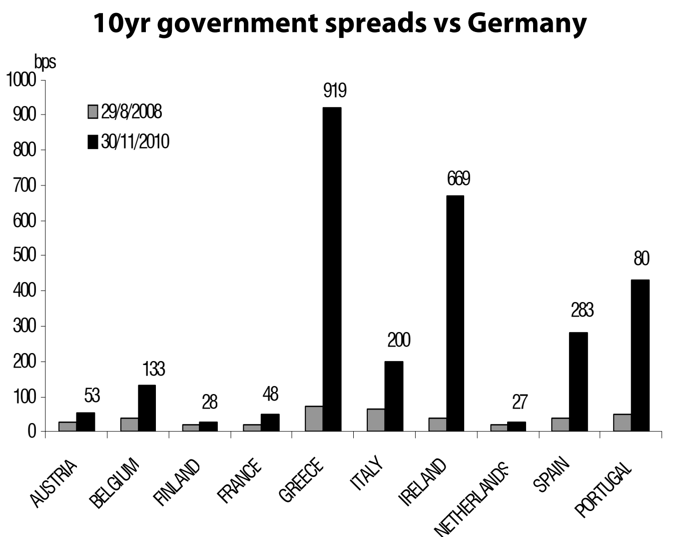
Source: Bloomberg, Ecowin, IMF

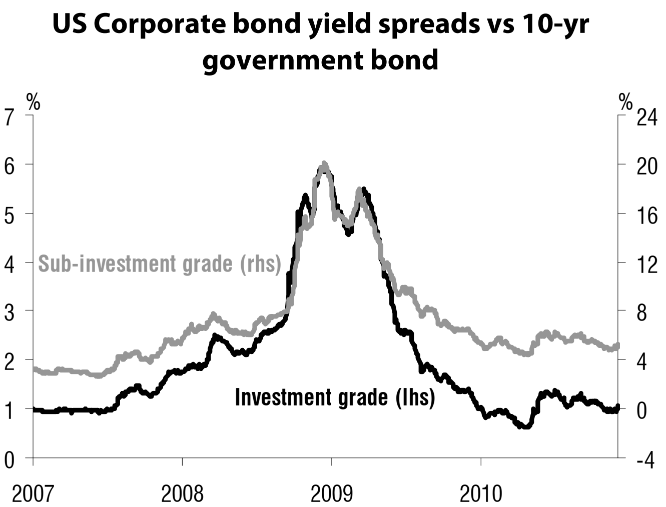
Global Economic Indicators

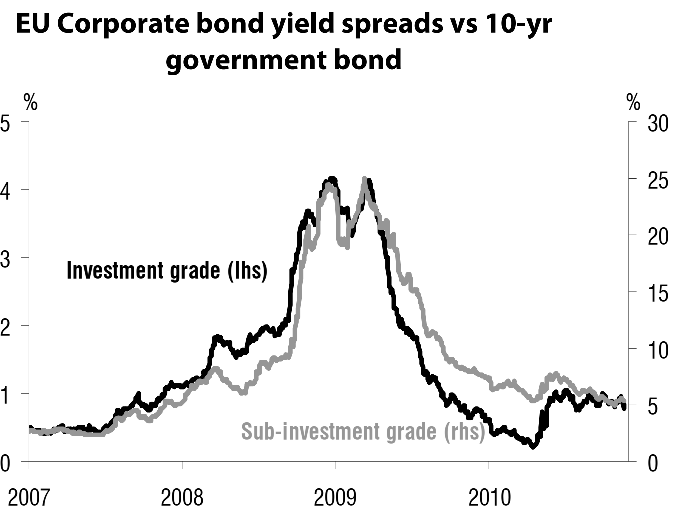












Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Total Return (%) as of November 30, 2010

Global Equity Indices (in local currency)

Region	Index	Last Price	1w	1m	6m	12m	YTD	2009
US	S&P 500	1180.6	-1.4	-0.3	10.3	6.5	5.9	23.5
EURO AREA	DJ Euro Stoxx 50	2651.0	-3.9	-6.5	1.7	-7.7	-10.6	21.1
GERMANY	DAX	6688.5	-2.0	1.3	11.8	15.8	12.3	23.8
FRANCE	CAC 40	3610.4	-3.7	-6.0	3.1	-4.4	-8.3	22.3
UK	FTSE 100	5528.3	-2.3	-2.9	7.1	4.1	2.1	22.1
JAPAN	Nikkei	9937.0	-0.9	8.5	2.3	3.8	-5.8	19.0
CHINA	CSI 300	3137.0	-1.3	-9.7	14.3	-11.9	-12.3	96.7
INDIA	SENSEX	19521.3	0.3	-4.1	17.8	13.5	11.8	81.0
RUSSIA	MICEX	1565.5	0.2	2.1	18.1	18.7	14.3	121.1
BRAZIL	IBOV	67705.4	-2.8	-5.4	9.5	-1.0	-1.3	82.7

Source: Bloomberg

Sector performance as of November 30, 2010

US Sector Indices (in USD)

US – S&P 500	Last	1w	1m	6m	12m	YTD	2009
1. Consumer Discretionary	347.5	-0.6	2.6	12.5	28.1	22.5	41.3
2. Consumer Staples	417.2	-1.6	-1.2	10.0	9.2	9.5	14.9
3. Energy	675.0	-1.1	5.5	18.7	9.5	10.5	13.8
4. Financials	278.4	-1.3	-0.7	-1.0	-0.3	1.3	17.2
5. Health Care	451.9	-2.3	-2.9	6.2	0.5	-1.5	19.7
6. Industrials	379.2	-0.2	1.1	10.4	19.1	17.6	20.9
7. Information Technology	416.7	-2.2	-1.6	9.8	10.6	4.7	61.7
8. Materials	310.0	-0.7	1.1	18.3	12.5	10.7	48.6
9. Telecommunication Services	202.3	-1.5	-1.4	20.2	15.5	10.4	8.9
10 Utilities	300.6	-1.5	-3.0	9.5	8.0	2.3	11.9

Source: Bloomberg, Ecowin

Global Equities & Sector Performance

Sector performance as of November 30, 2010

European Sector Indices (in €)

Europe - DJ Stoxx 600	Last	1w	1m	6m	12m	YTD	2009
1. Consumer Discretionary							
Automobiles & Components	476.9	-3.2	6.2	36.1	43.7	39.6	19.4
Travel & Leisure	207.5	-0.7	2.2	10.5	30.0	23.9	18.5
Media	266.1	-2.3	-3.6	7.7	17.4	10.7	23.4
Retail	451.3	-0.6	-1.3	6.1	16.5	14.7	37.4
2. Consumer Staples							
Food & Beverage	553.2	-1.2	1.9	7.8	23.1	16.3	35.2
Personal & Household Goods	656.0	-1.2	1.8	13.9	33.4	25.3	42.0
3. Energy							
Oil & Gas	574.4	-1.3	-0.3	4.1	-0.6	-4.8	29.9
4. Financials							
Banks	355.5	-3.6	-8.3	-1.7	-13.7	-12.7	50.7
Financial Services	442.1	-1.1	-0.4	12.1	13.4	10.2	33.6
Insurance	228.7	-4.3	-7.3	0.8	-0.3	-3.1	17.0
Real Estate	109.2	-0.3	-6.0	11.6	5.4	3.7	27.0
5. Health Care	542.3	-0.5	0.0	4.3	11.2	6.0	16.8
6. Industrials							
Industrial Goods & Services	474.0	-0.1	1.7	15.2	31.7	26.3	41.2
7. Information Technology	199.4	-0.1	-0.9	1.0	11.6	8.0	20.5
8. Materials							
Basic Resources	987.1	-0.5	3.7	16.7	22.3	15.2	105.9
Chemicals	918.4	-1.6	2.7	23.3	25.1	19.1	48.7
Construction & Materials	421.3	-2.6	1.9	2.0	-0.8	-4.7	39.9
9. Telecommunication Services	484.9	-1.6	-4.6	13.9	9.1	7.7	17.5
10. Utilities	602.4	-2.8	-4.8	0.7	-2.6	-8.5	6.2

Source: Bloomberg

Sector performance as of November 30, 2010

Asia Sector Indices (in USD)

Asia – S&P 50 Index*	Last	1w	1m	6m	12m	YTD	2009
1. Consumer Discretionary	10340.8	0.0	-3.0	25.3	46.0	29.6	116.2
2. Consumer Staples	13140.8	-1.4	-10.5	9.4	-0.5	1.5	47.6
3. Energy	12286.8	0.0	-0.3	30.1	26.8	26.3	58.0
4. Financials	3842.0	1.2	-2.0	17.7	11.7	7.0	69.1
5. Industrials	2875.2	-1.8	-1.7	55.6	70.5	58.6	32.5
6. Information Technology	8272.7	-2.3	3.1	14.0	15.1	5.3	91.4
7. Materials	4445.5	-0.6	-2.2	17.4	8.0	-0.8	72.7
8. Telecommunication Services	2511.7	-0.6	-2.1	9.2	8.8	7.1	-0.2
9. Utilities	3182.1	-0.3	-2.0	10.2	14.6	10.3	25.3

Source: Ecowin

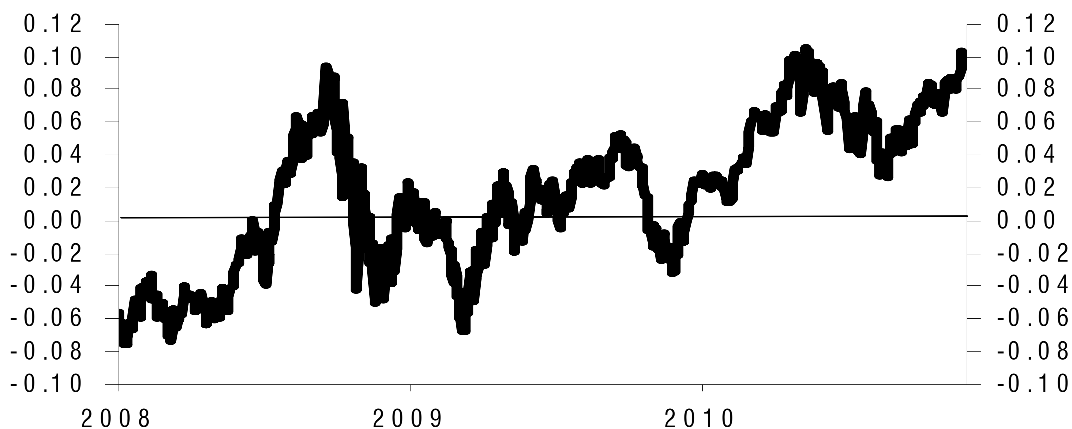
US Style Equity Indices

Total Return (%) as of November 30, 2010

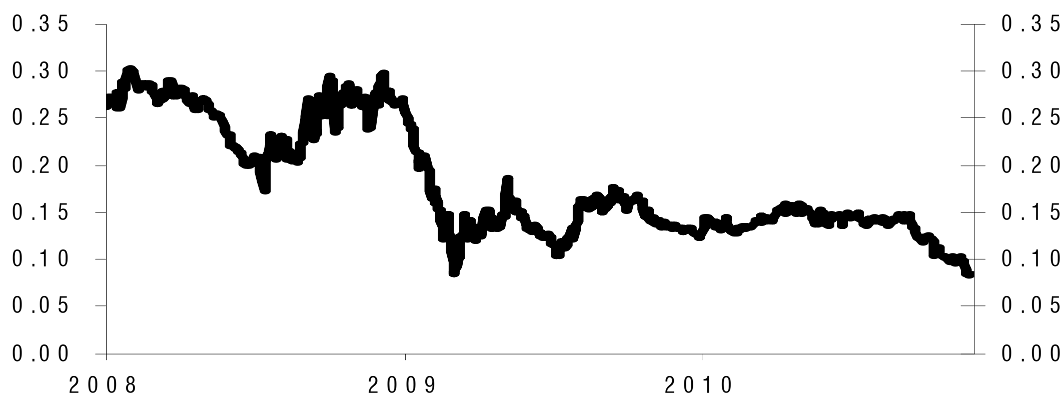
US Style Indices (in USD)

Index	Last Price	1w	1m	6m	12m	YTD	2009
Russell 1000 (Large Cap)	654.2	-1.4	0.0	10.7	8.0	6.9	25.5
Russell 2000 (Small Cap)	727.0	0.0	4.1	13.4	23.4	16.2	25.2
Relative performance (Small vs Large)		1.3	4.1	2.7	15.4	9.3	-0.3
Russell 1000 Value	593.6	-1.6	-0.8	7.7	5.2	4.8	16.3
Russell 1000 Growth	545.2	-1.2	0.8	13.8	10.8	9.0	34.8
Relative performance (Value vs Growth)		-0.4	-1.5	-6.1	-5.5	-4.2	-18.5

Relative Performance (small vs large)
(logarithmic scale)



Relative Performance (value vs growth)
(logarithmic scale)

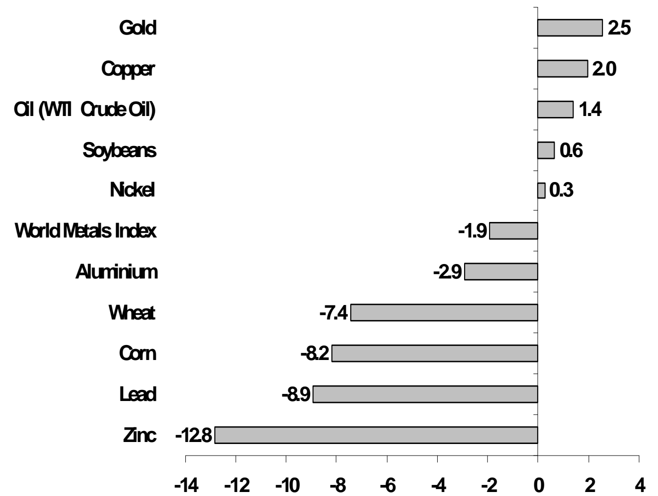


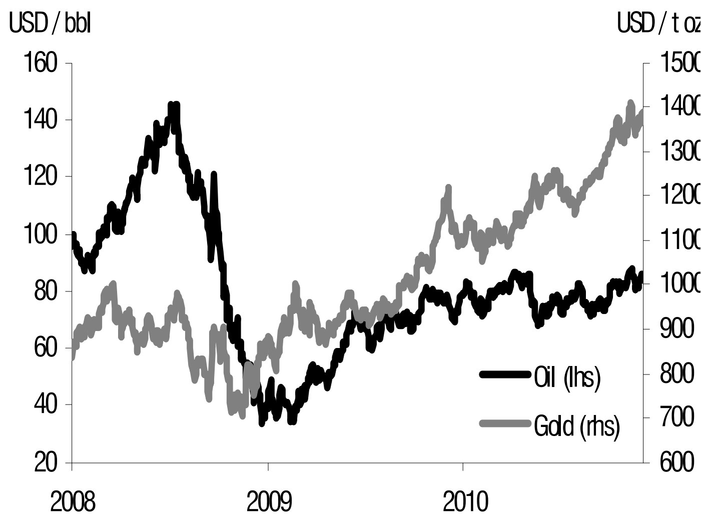
Source: Bloomberg

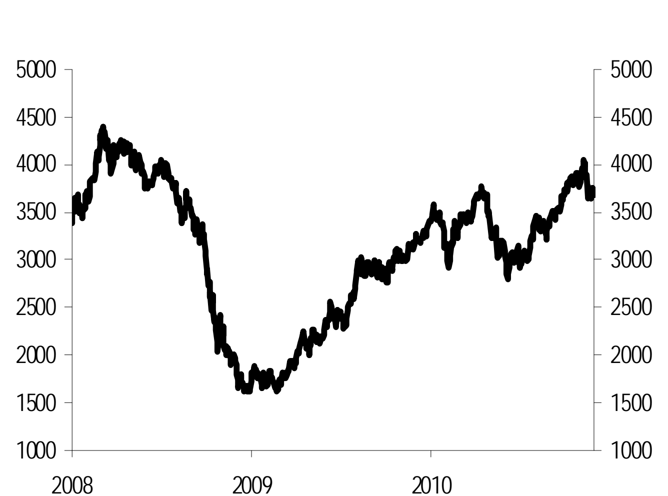
Commodities

Commodity Performance (%) as of November 30, 2010

Commodities	Units	Last Price	1w	1m	6m	12m	YTD	2009
Oil (WTI Crude Oil)	USD/bbl	84.1	3.5	1.4	15.9	7.3	6.0	77.9
Gold	USD/t oz	1385.0	0.5	2.5	13.1	15.5	26.3	24.0
Base Metals								
World Metals Index		3736.3	1.2	-1.9	21.2	16.0	9.8	97.5
Aluminium	USD/lb	2275.0	0.9	-2.9	11.4	10.5	2.0	44.8
Copper	USD/mt	8360.0	2.7	2.0	20.5	20.6	13.4	140.2
Lead	USD/mt	2230.0	2.0	-8.9	20.5	-4.9	-8.3	143.4
Nickel	USD/mt	23050.0	6.7	0.3	8.0	40.5	24.4	58.3
Zinc	USD/mt	2112.0	1.2	-12.8	9.1	-9.0	-17.5	111.9
Agriculture								
Corn	USD/bu	530.0	0.3	-8.2	49.7	32.6	27.9	1.8
Soybeans	USD/bu	1243.0	0.3	0.6	36.2	17.9	21.7	0.2
Wheat	USD/bu	650.3	1.3	-7.4	44.3	15.6	20.1	-11.3







Source: Bloomberg

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