

Brief summary of key market developments

HIGHLIGHTS

- ❖ **Major European bourses** were modestly higher in early trade today supported by market optimism for a solid earnings season.
- ❖ **JPY** weakened on renewed political uncertainty.
- ❖ **US Treasuries** were little changed today ahead of a \$35bn in 3-year bond auction later today. Meanwhile, with short-dated German government bonds outperforming, the **2/10-yr Bund yield curve** undertook some bullish steepening today. The corresponding spread widened to 187.7bps earlier today after ending at 186.5bps in the prior session, the narrowest since early December 2009.
- ❖ **The Greek debt management agency (PDMA) will hold a €1.25bn in 26-week T-bill auction on Tuesday, July 13.** The previous auction of 6-month T-bills was conducted on April 13 with a 4.55% yield, up sharply from 1.38% in January. The initial plan for a 52-week T-bill on the same day, was finally dropped. Another auction of a 13-week paper will follow on July 20 to roll over maturing short-term government paper. A total of €2.16bn of one-year and six-month government paper expires on July 16th while an additional €2.4bn of T-bills matures on July 23.
- ❖ **Poland's** deputy head of the finance ministry debt department said that the government is mulling on lowering its debt supply in H2 2010.
- ❖ **Serbia's** Prime Minister Mirko Cvetkovic said on Friday that preliminary data showed that real GDP growth accelerated to 1.8%yoy in Q2 from 0.6%yoy in Q1.
- ❖ **Bulgaria's** industrial production declined 0.9%mom in May for a 0.4%yoy rise and sales rose by 1.0%mom, bringing the annual rate of growth to 12.7%.
- ❖ **CEE stock markets and currencies broadly weakened in early trade on Monday.**

Equity markets

US equity markets enjoyed a positive session on Friday supported by expectations for another solid quarter of corporate results. The Q2 earnings season starts with Alcoa Inc after the closing bell on Monday and, according to Thomson Reuters data, expectations are for a 27% increase compared to the same period a year earlier, up from a +22.4%yoy consensus at the beginning of the year. The **Dow Jones industrial average index** was up 0.58% at 10,198.03, the **Standard & Poor's 500 Index** gained 0.72% at 1,077.95 and the **Nasdaq Composite Index** rose by 0.97% at 2,196.45. In addition to Alcoa, companies reporting this week include Intel Corp (Tuesday), JPMorgan Chase & Co (Thursday), Bank of America Corp and General Electric Co (Friday).

The positive tone on Wall Street was passed through to the majority of **Asian bourses** today with worries over the pace of the global economic recovery and upcoming results of the European bank stress-tests taking a back seat ahead of forthcoming company Q2 earnings results. Encouraging **trade figures** from **China**, also helped boost market sentiment. Chinese exports rose by 43.9%yoy in June and imports were up 34.1% taking the trade surplus at \$20bn, higher than \$13.8bn expected compared with a surplus of \$19.5bn in May. Data showing that **Chinese banks** extended 603.4 billion yuan in net new local-currency loans in June, in line with expectations, but down from May's 639.4 billion yuan and less compared to 1.53 trillion yuan in June last year in view of authorities' efforts to avoid overheating, were broadly shrugged off. The **MSCI index of Asia-Pacific shares outside Japan** was up 0.3%mom at the time of writing while **Japan's Nikkei 225 average index** ended 0.3% lower on renewed political concerns. The **Japanese ruling DPJ lost its upper house majority at Sunday's elections winning just 44 seats**, far short of its election goal of 54, leaving Primer Minister Naoto Kan vulnerable to a challenge from inside his own political party ahead of a September party leadership vote.

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Elsewhere, **European bourses** were modestly firmer in early trade today, adding to last week's hefty gains. Indicatively, the **FTSEurofist 300 index** was standing 0.6% higher at the time of writing after posting a cumulative gain of 5.4% last week, its biggest weekly advance this year. Looking at this **week's global calendar**, China's CPI, GDP, IP and retail sales on Thursday are likely to be the main highlights. German ZEW survey (Tuesday), US retail sales (Wednesday) and CPI data (Friday) as well as the US Empire State survey and US IP data (Thursday) also lure market attention.

FX markets

The **JPY** was weaker in early trade today after the upper house election result pointed to political uncertainty ahead. Improved market sentiment on expectations for another solid quarter of corporate results, added to JPY's negatives. The **USD/JPY** was hovering around 88.90/95 in early European trade, up from 88.35 last Friday's session lows. But with investors remaining cautious ahead of upcoming European stress-test results, due on July 23, any further JPY depreciation in coming sessions is likely to be limited. Next major upside target for USD-bulls now stands at 90.60 (June 21 high) while on the downside, a sustainable break below 88.35 recent lows would open the way for a retest of 86.95 seven-month lows (July 1 low). Elsewhere, the **EUR/USD** gave back some of its recent gains standing close to 1.2575/78 at the time of writing after hitting a two-month high of 1.2722 last Friday supported by the latest bounce in risk appetite. Focus is on a Greek debt auction on Tuesday which is likely to have an impact on the euro's near-term FX direction. Technically, strong resistance lies at 1.2720 recent highs ahead of 1.2790 (May 11 high) while on the downside, immediate support stands at 1.2588 today's lows in the way to 1.2465 (55-day MA). Against this background, **the dollar index DXY** was hovering around 84.256 in early European trade, having recovered some ground from last Friday's 83.622 two-month lows.

Government bond markets

US Treasuries were little changed in early trade with investors awaiting upcoming bond auctions. The Treasury Department will sell \$35bn in three-year debt later in the day, \$21bn in 10-year notes on Tuesday and \$13bn in 30-year bonds on Wednesday. **The 2/10-year UST yield spread** was hovering around 240bps at the time of writing, some 2.7bps narrower relative to a two-week closing high recorded in the prior session. **German government bonds** were modestly higher in early European trade in spite of robust Chinese trade figures. Euro area fiscal jitters persist while anxiety ahead of upcoming bank stress-test results lingers. Periphery pre-auction concessions, might also had an impact. Spain auctions a key 15-bond on July 15 while Portugal has a bond sale on July 14. Short-dated German government bonds outperformed with the **2-yr Schatz** yielding levels near 0.75% at the time of writing, slightly lower from a two-month closing high near 0.77% marked last Friday. **The 2/10-yr Bund yield curve** undertook some bullish steepening today with the corresponding spread widening to 187.7bps earlier today after ending at 186.5bps in the prior session, the lowest since early December 2009. In other news, the **10-yr Greek/German bond yield spread** was hovering around 762bps at the time of writing, some 1.5bps narrower compared to last Friday's settlement. Greece will return to the primary market this week for the first time since securing a €110bn EU/IMF emergency funding package in May. **The Greek debt management agency (PDMA) will hold a €1.25bn in 26-week T-bill auction on Tuesday, July 13.** The previous auction of 6-month T-bills was conducted on April 13 with a 4.55% yield, up sharply from 1.38% in January. Only primary dealers will be allowed to participate and no commission will be paid. The initial plan for a 52-week T-bill on the same day, was finally dropped. Another auction of a 13-week paper will follow on July 20 to roll over maturing short-term government paper. A total of €2.16bn of one-year and six-month government paper expire on July 16th while an additional €2.4bn of T-bills matures on July 23. The previous auction in April had seen the yield for 6-month bills at 4.55%.

News & Macro data releases

US wholesale inventories rose by 0.5%mom in May to \$398.81bn, slightly higher than +0.4%mom expected following a downwardly revised gain of 0.2%mom (from +0.4%mom initially) in the prior month. But sales fell unexpectedly for the first time in more than a year taking the **stock/sales ratio** up at 1.14months' worth from April's 13 months. Inventory rebuilding from record low levels has been one of the key drivers of the economic recovery from the worst recession since the 1930s. Business inventories contributed 1.9 percentage points to Q1 growth, but their positive impact is expected to fade later in the year.

French industrial production rose by 1.7%mom in May, higher than +0.4%mom expected following a downwardly revised -0.5%mom (from -0.3%mom initially) in the prior month.

UK trade deficit surprised negatively widening to -GBP8.062bn in May, the highest in five months, from -GBP7.411 in the prior month, suggesting that trade remains a drag on GDP. The deterioration in May was led by imports, which rose by 2.4%mom while exports were broadly flat. Separately, **UK PPI output prices** dropped

by 0.3%mom in June, the first monthly fall since November 2008, taking the annual rate down to 5.1% from April's 5.5% and lower than 5.7% expected on the back of falling fuel costs. Despite the bigger-than-expected May drop, PPI output stood on an annual basis slightly below April's 18-month high of 5.9%. UK **PPI input prices** slipped for a second consecutive month after falls in crude oil and imported metal prices more than offset the biggest monthly jump in farm produce costs since June 2008. This monthly decline took the annual rate down to 10.7% from 11.5% in May.

Greek industrial output dropped by 4.9%yoy in May vs. -5.1%yoy in the prior month with manufacturing production shrinking 4.4%yoy adding to April's 3.9%yoy decline. Separately, **Greek construction activity**, measured by the number of new building permits, resumed its downward trend in April falling by 15.8%yoy after rising by 3.8%yoy in the prior month.

G10 Event Risk Calendar this week

Monday, July 12: EU President Van Rompuy speaks about economic governance reform, Eurogroup/Ecofin meetings, UK Q1 GDP (final), Fed's Lacker (non-voter) speaks, Fed Chairman Bernanke speaks on "financing needs of small business".

Tuesday, July 13: Switzerland's PPI for June, German ZEW for July, UK CPI for June, UK RICKS house price balance for June, Japan's industrial production for May, US trade balance for May, US budget statement for June

Wednesday, July 14: Eurozone CPI for June, Eurozone industrial production for May, UK claimant count for June, US retail sales for June, US import prices for June, US business inventories for May, FOMC minutes (22/23 meeting), N.Zeland's retail sales for May

Thursday, July 15: Australian's inflation expectations for July, Switzerland's ZEW survey for July, China's CPI for June, China's Q2 GDP, China's industrial production for June, China's retail sales for June, Eurozone monthly economic bulletin, BoJ rate decision, US Empire State manufacturing survey for July, US initial jobless claims, US PPI for June, US industrial production & capacity utilization for June, Fed's Lacker (non-voter) speaks

Friday, July 16: Eurozone trade balance for May, Greek bond redemption (around €2.0bn), Japan's tertiary industry index for May, US CPI for June, US TIC flows for May, US UM consumer confidence for July (first estimate)

Emerging Markets

Poland's deputy head of the finance ministry debt department, Anna Suszynska, said last week that the government is mulling on lowering its debt supply in H2 2010 as it has already met around 70% of its borrowing requirements for the year. Separately, central bank Governor Marek Belka said recently that real GDP growth may come in at about 3.0%yoy in 2010 and pick up further, to around 3.5%yoy in 2011.

Serbia's Prime Minister Mirko Cvetkovic said on Friday that preliminary data showed that real GDP growth accelerated to 1.8%yoy in Q2 from 0.6%yoy in Q1, adding that for the whole of this year it could reach 2%yoy following a 3%yoy contraction in 2009.

Bulgaria's industrial production declined 0.9%mom in May due to falls registered in electricity and heating output. On an annual basis, industrial production grew 0.4% signaling a small improvement from a 0.2% rise in the prior month and an 18.2%yoy drop marked in the same month last year. Furthermore, industrial sales rose by 1.0%mom in May following a revised 1.7%mom decline in April, bringing the annual rate of growth to 12.7% vs. a 23.9%yoy plunge registered in May 2009. Meanwhile, Finance Minister Simeon Djankov said on Sunday that the domestic economy is likely to growth by 3.0%yoy in 2011 after expanding by 1.0%yoy this year.

CEE stock markets broadly stood in a negative territory in early trade on Monday. Hungary's main stock index **BUX** which led last week's gains in the region ending nearly 7% higher, led the losers' pack sliding ca 0.5% at the time of writing. Similarly, most **CEE currencies** weakened earlier today as the euro retreated with the Turkish lira and the Polish zloty posing among the region's underperformers. In detail, the **USD/TRY** bounced as far as multi-session highs of 1.5583 earlier today from a 3-week trough of 1.5395 on Friday. Meanwhile, the **EUR/PLN** inched up to 4.0832 session highs on Monday, vs. a 2-week trough of 4.0605 touched late last week.

CEE Event Risk Calendar this week

Monday, July 12: Trade balance for May (Ukraine), trade balance for May, CPI for Jun, RON 750mn of 1-year T-bills auction (Romania), current account for May (Turkey), CPI for Jun (Bulgaria), HICP for Jun (Serbia)

Tuesday, July 13: CPI for Jun (Hungary), current account for May (Romania), CPI for Jun, current account for May (Poland)

Wednesday, July 14: Industrial production for May (Hungary)

Thursday, July 15: Industrial production for June (Ukraine), unemployment rate, MPC rate announcement (Turkey), current account for May (Bulgaria), government budget for June (Poland)

Friday, July 16: Average gross wages for May (Hungary), consumer confidence for Jun (Turkey), corp. sector wages, employment for Jun (Poland)

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