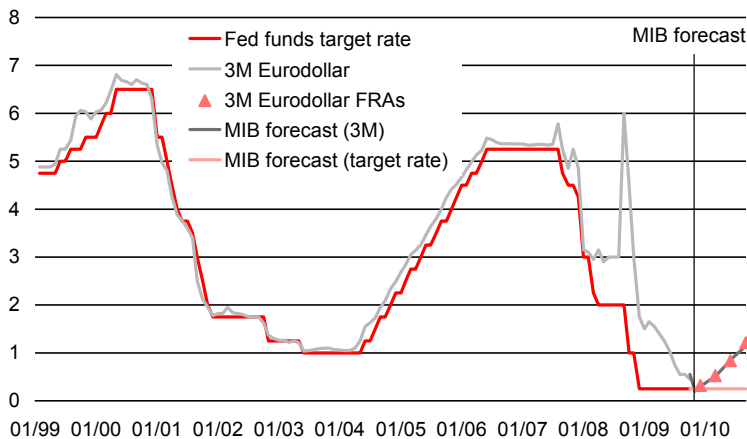


Fed rate hike still a long way off, but...

- **Pressure.** The monetary policy debate has started to heat up recently. Robust growth, normalization of financial markets, rising equity and commodity prices and a weaker USD are fueling demands for a rapid removal of the Fed's ultra-expansionary policy. Even near-term rate hikes are a subject of speculation.
- **Facts.** We, however, think such demands are excessive. Most Fed officials harbor doubts – and rightly so – about the sustainability of the current strength of the upswing. Furthermore, a tighter monetary policy at a time of record-high unemployment and low (and still falling) core inflation would not be compatible with the Fed's dual mandate.
- **Fed.** The FOMC could, however, "tighten verbally" already this year – not at next week's meeting, but possibly at its December gathering. That would, however, not be an indication of an imminent rate hike. It would, however, give the central bank more flexibility. We do not expect the first rate hike until the second half of 2010 (pages 4-7 & chart below).
- **ECB.** The European Central Bank will most probably give itself even more time – also with an initial verbal tightening. The upswing in the euro zone remains shaky, core inflation is moderating, and the credit cycle – despite some points of light – continues to point south. For the first time in the history of the series, loans to the private sector were below the level of a year ago in September (pages 8-10).
- **Further topics:**
 - **Weekly Comment:** Soul-searching (page 2).
 - **TINA** comes to Germany – the new economic policy (page 11).
 - **Dollar** developments should not simply be extrapolated (page 13).
 - **Data outlook:** ECB to leave monetary policy unchanged, BoE likely to top up the Asset Purchase Facility (page 15).
 - **Market outlook:** Government bonds well supported (p. 23).

US TARGET RATE WILL REMAIN UNCHANGED UNTIL AUTUMN 2010, BUT MONEY MARKET RATES WILL TEND TO RISE



Source: Thomson Datastream, UniCredit Research

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MIB MACRO FORECASTS

in % yoy	2008	2009	2010
GDP EMU	0.6	-4.0	0.8
CPI EMU	3.3	0.3	1.3
GDP Germany	1.0	-4.7	2.0
CPI Germany	2.6	0.4	1.0
GDP Italy	-1.0	-5.1	0.4
CPI Italy	3.3	0.8	1.5
GDP US	0.4	-2.4	1.9
CPI US	3.8	-0.4	2.3

MIB FI/FX FORECASTS

	2009/10	31-Dec	31-Mar	30-Jun	30-Sept
EMU 3M (%)	0.80	0.90	1.05	1.20	
EMU 10Y (%)	3.45	3.60	3.85	4.10	
US 3M (%)	0.30	0.50	0.85	1.25	
US 10Y (%)	3.70	3.85	4.10	4.40	
EUR-USD	1.50	1.52	1.55	1.50	
USD-JPY	95	98	100	103	
Oil Price	65	70	70	75	

Global Head of Research & Chief Strategist

Thorsten Weinelt, CFA (HVB)
 +49 89 378-15110
 thorsten.weinelt@unicreditgroup.de

Head of Economics & FI/FX Research

Marco Annunziata, Ph.D. (HVB)
 Chief Economist
 +44 20 7826-1770
 marco.annunziata@unicreditgroup.co.uk

Editor

Nikolaus Keis (HVB)
 +49 89 378-12560
 nikolaus.keis@unicreditgroup.de

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Bloomberg

UCGR

Internet

www.globalresearch.unicreditmib.eu

Soul-searching

The good news is that Central and Eastern Europe (CEE) 2009 is not Asia 1997; the bad news is that it is not Asia 2009 either, but looks more like Western Europe 2009. Whereas emerging Asia is confidently leading the global recovery, most CEE countries are just beginning to break free of the grip of a severe recession, which in some cases is undermining political stability – witness the recent government crisis in Romania. Overall, the picture is much brighter than most commentators expected not so long ago – but it leaves open important questions on the region's growth strategy going forward.

Early this year, many thought that CEE was doomed to suffer a systemic regional crisis similar to that which ravaged Asia in 1997-98. The parallels were ominous: large current account deficits had opened up, as rapid economic growth was driven by a credit boom fueled by foreign capital inflows. The region as a whole was heavily dependent on external financing, which dried up quickly in the aftermath of Lehman's bankruptcy. The ensuing depreciation pressure on exchange rates was particularly pernicious as in several countries households and firms had accumulated debt in foreign currency, mainly euro and Swiss franc. In addition, CEE banking systems were dominated by Western European banks, which were already under severe stress. Banks risked a fatal blow from rising non-performing loans in the region, and the region risked a fatal blow from a sudden halt in credit supply. There was disagreement on which would come first, but a wide consensus that CEE countries and the involved Western banks would go down together.

That view, as is now clear, underestimated both the intrinsic resilience of CEE countries and the value of their integration within the European Union. The ECB quickly put in place swap lines with CEE central banks faced with suddenly rising domestic demand for euros. The EU offered financial assistance to complement that provided by the IMF, which put in place a number of financial stabilization programs at record speed. IMF programs, moreover, were quite flexible in terms of the fiscal adjustment required – unlike in Asia 1997. As for the interdependence with Western European banks, it proved once more the stabilizing power of mutually assured destruction strategies: foreign banks remained fully involved and played a crucial role in restoring financial stability – in sharp contrast to Asia in the late 1990s and Latin America in the 1980s.

The CEE region is not yet out of the woods, however. External imbalances have narrowed rapidly over the last twelve months (Turkey's current account deficit should shrink to just 1.5% of GDP this year from 6% last year), but this improvement reflects a sharp recession with severe social and fiscal implications. In some countries, fiscal deficits have widened sharply. In those countries which needed to keep public finances under control, the adverse social impact has undermined support for governments – as exemplified by the recent political crisis in Romania. Nowhere is the tension more obvious than in Latvia, where the effort to maintain the exchange rate peg to the euro is costing a 16% contraction in real output and a doubling of the unemployment rate to nearly 17%. Should social costs become unbearable and lead to a currency devaluation, the region's resilience would face another severe test – a scenario that the EU's financial support will hopefully avoid.

The growth outlook will soon start improving – reflecting the recent turnaround in economic activity in the eurozone, which attracts as much as 70% of the exports of several CEE countries (Germany's healthy rebound is particularly encouraging in this respect). But for the CEE region as a whole, unlike Asia, exports are just the kindling wood to ignite the recovery, not the main fuel of growth. While exports are the main growth driver for the smaller economies like Czech Republic and Slovakia, the larger players like Poland and Turkey rely more heavily on domestic consumption and investment – indeed Poland has avoided the recession altogether, thanks to the resilience of its domestic demand.

Comparing their hesitant and fragile recovery with Asia's confident rebound, CEE governments might go through some serious soul searching, wondering whether they should also switch strategy towards the accumulation of sizeable FX reserves and a more decisive promotion of exports. After all, Asia's strategy appears to have served the region well, and its governments are scoffing at the IMF's proposal to rely more on its insurance policies rather than on FX reserves accumulation. This soul-searching will be accentuated by the suspicion that integration with the EU was not only part of the solution, but also part of the problem. Of the twelve new IMF stand-by agreements launched during the crisis, ten are in CEE: in other words, in the midst of the worst crisis since the Great Depression, CEE is the only emerging region which had to seek the IMF's help. A misplaced sense of confidence that domestic currencies would steadily appreciate as countries converged to eurozone membership, providing an easy one-way bet, was the main driver behind the accumulation of imbalances at the household, corporate, and national level.

However, it would be a mistake for CEE to imitate Asia. Capital should continue to flow downhill from Western Europe to CEE, where it can finance much better prospects for faster growth of productivity, output, and living standards. The quick and decisive mobilization of financial assistance by the EU and the IMF during this crisis proves that CEE countries do not need to over-insure themselves with excessive FX reserves accumulation. But at the same time, something should be done to prevent a renewed accumulation of imbalances by households and companies. The current euro-convergence framework is flawed: new EU member countries have no opt out clause, but they have no fixed accession date either. The result has been in most cases a rolling target date, with policies always falling short of the Maastricht criteria, and of domestic expectations for a fail-safe currency appreciation. Of course, prospects for medium-term real FX appreciation remain intact, supported by the catching-up process in real per capita GDP, but volatility remains a risk. CEE countries could consider either giving a decisive acceleration to the euro-accession process, or alternatively de-emphasizing the timing of eurozone accession, thereby injecting more uncertainty into the FX outlook and discouraging FX exposure at the household and corporate level.

Marco Annunziata, Ph.D. (HVB)
+44 20 7826-1770
marco.annunziata@unicreditgroup.eu

US: First verbal tightening of monetary policy before year-end?

- At the upcoming FOMC meeting, the Federal Reserve will leave the Fed funds target rate unchanged, and presumably hint again that interest rates should remain at this exceptionally low level for an extended period.
- According to recent speeches and comments, the majority of Fed officials still harbors doubts about the sustainability of the current upswing. Furthermore, a tighter monetary policy at times of record-high unemployment as well as low (and still falling) core inflation would be hardly compatible with the Fed's dual mandate.
- In light of the improving economy, the stabilization of financial markets, rising equity and commodity prices, as well as the weaker US dollar, the pressure on the Fed to gradually scale back its ultra-expansionary monetary policy has, however, increased recently. Among some Fed officials, that is already falling on receptive ears.
- We, therefore, deem it possible that the Fed will toughen the wording of the statement after the December FOMC meeting a bit. Such a move would, however, not be a harbinger of an imminent rate hike, but would simply give the Fed slightly greater flexibility. We still do not expect the first rate increase until the second half of 2010.

C'mon Ben!

In the coming week, the Federal Reserve's Open Market Committee (FOMC) will meet again to debate the future direction of monetary policy. The outcome appears to be a done deal: The Fed will leave interest rates unchanged and state again, "economic conditions are likely to warrant exceptionally low levels of the federal fund rate for an extended period." The markets see the probability of a rate hike at the upcoming meeting at 0%, and for the meeting in mid-December at slightly more than 6%. Recently, however, the monetary policy debate has started to heat up. At the beginning of last week, the influential financial magazine "Barron's" – it belongs to the same publishing house as the Wall Street Journal – wrote, "It's time to raise rates, Ben." Instead of only talking about an exit strategy, the Fed should finally start to implement one. The call to action is clear: Commodity prices are rising, the dollar is falling and the stock market is surging, underscoring the renewed health of markets. Barron's continues that keeping interest rates at these super low levels is "fueling financial speculation, angering our economic partners and foreign creditors, and potentially stoking inflation." Among some Fed officials, this call is probably already falling on receptive ears. Jeffrey Lacker, President of the Richmond Fed and currently a FOMC voting member, said at the beginning of the month

that rates may need to be raised even with the unemployment rate still rising. In his view, the downside risks for the economy have declined, and he is confident that the economic recovery will continue in the coming year. Similarly, Tom Hoenig, President of the Kansas City Fed (non-voting member), stated that the Fed should remove the very accommodative monetary policy sooner rather than later. "Even if we were to start immediately, much time would pass before incremental increases could be considered tight or even neutral policy." Officials with similar views include regional Fed Presidents Richard Fisher (Dallas, non-voting member), Charles Plosser (Philadelphia, non-voting member) and – with reservations – Fed Governor Kevin Warsh (he said nothing about the starting point, but stated that the Fed would then "have to tighten with greater force than is customary"). But even though the calls for a tighter monetary policy have become louder, they still represent merely a minority view within the Fed. The vast majority of Fed officials, in contrast, still harbors doubts about the sustainability of the current economic upswing.

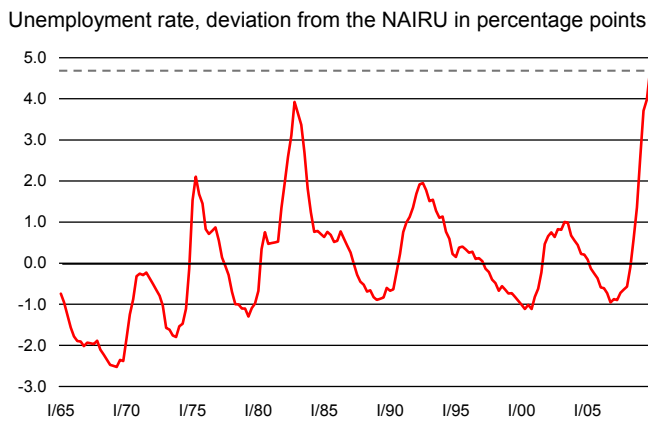
Doubts about the sustainability of the upswing

The US economy grew a solid 3,5% annual rate in the third quarter and, therefore, emerged from the recession with gusto. A closer look reveals, however, that the economic expansion in the entire second half of this year is being supported almost exclusively by the inventory cycle and federal fiscal programs. At the previous FOMC meeting, some Fed officials already, "expressed considerable uncertainty about the likely strength of the upturn once those supports were withdrawn or their effects waned." Eric Rosengren, President of the Boston Fed (non-voting member), said at the beginning of last week that he expects growth rates of around 3% for both the third and the fourth quarter. For the beginning of 2010, he is, however, much more skeptical ("the one issue that we have is what happens as we get into the beginning of next year"), and even sees the danger of a relapse. The backdrop to these doubts expressed by Rosengren and many other Fed officials is the persisting weakness of the labor market. Without its support, households will not (be able to) increase their expenditures enough to ensure a strong, sustainable upswing. Vice-President Don Kohn underscored that the "difficult conditions in labor markets and the consequent implications for household incomes are important reasons for my expectations that the recovery in overall economic activity moving into next year will be restrained." Above and beyond that, the Fed is of course committed to a dual mandate:

The Fed's dual mandate

The dual mandate stipulates that monetary policy should be geared to promote effectively the goals of "full employment" and "price stability". With an unemployment rate of 10%, there can hardly be any talk of full employment. If we take into account that the equilibrium unemployment rate (or non-accelerating inflation rate of unemployment, NAIRU) has declined since the 80s, the unemployment gap – i.e. the deviation of the current unemployment rate from the NAIRU – is currently even at its highest level since World War II (cf. chart). In other words, the US economy has never been farther away from full employment than it is right now! And the unemployment rate has probably not even peaked yet.

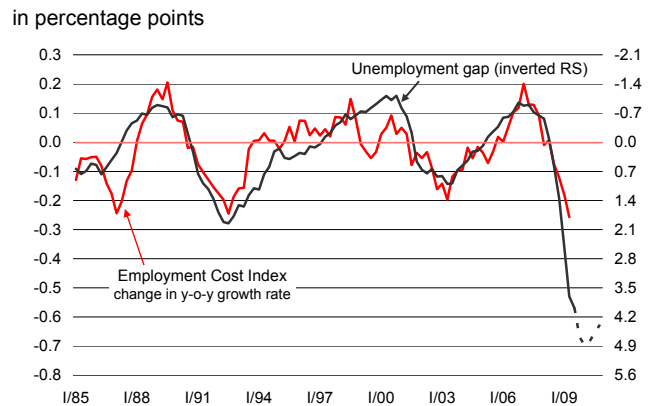
US ECONOMY IS FARTHER AWAY FROM FULL EMPLOYMENT THAN EVER BEFORE



Source: BLS, Thomson Datastream, UniCredit Research

As a consequence of this significant underutilization of the factor labor, the second Fed mandate, price stability, is also at risk. But the current threat is not from excessively high inflation rates but from excessively low ones. In a service society such as the US, labor costs are the most important determinant of core inflation; and the most important determinant of labor costs is in turn the unemployment rate. The following chart illustrates that the increase of the Employment Cost Index slows with a widening unemployment gap and vice versa. In its press statements after the previous FOMC meetings, the Fed has also stated repeatedly that *"with substantial resource slack likely to continue to dampen cost pressures [...] the Committee expects that inflation will remain subdued for some time."* And according to the current Beige Book, *"districts reported little or no increase to either price or wage pressure, but references to downward pressures were occasionally noted."*

RISE IN LABOR COSTS TO SLOW FURTHER



Source: BLS, Thomson Datastream, UniCredit Research

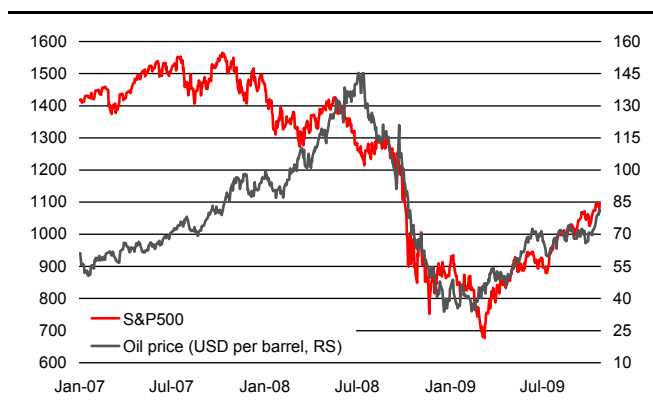
Amid easing labor cost pressure, falling rents and declining import prices, we expect the core rate will fall to ½% by mid-2010. This would be the lowest rate since the beginning of the series in the late 1950s. The Fed's expansionary monetary policy is unlikely to change the picture. While the Fed's balance sheet has more than doubled since September 2008, the banks are holding this additional liquidity almost exclusively as excess reserve balances at the central bank. And according to the Fed staff, there will be no rapid change in this situation as *"many banks were currently comfortable holding high levels of reserves."* Moreover, any change to this behavior, e.g. as the economy improves, *"would likely emerge only gradually and [...] their magnitude could be quite limited."* Against this backdrop, Bill Dudley, President of the New York Fed, also stated that inflation concerns based on the Fed's expansionary monetary policy would not be particularly well founded. He, instead, cited concerns that inflation could slow too much.

Further reasons for higher rates

Alongside the Fed's classical targets, the labor market and inflation, there are currently two further developments that might justify an earlier rate hike: Rising asset prices and the weak US dollar. According to the Financial Times, those developments have added a new "wild card" to the monetary policy matrix.

The US equity market has rallied strongly in recent months. Since the beginning of March, the broad S&P500 has risen more than 60%, and the Dow Jones Industrial Average even broke the 10,000 mark in mid-October. At the same time, the oil price rose for the first time in a year above USD 80 per barrel – that is an increase of 140% versus the cyclical low posted in mid-December 2008. Among some market observers, those developments are fueling the fear of renewed asset price bubbles and accelerating inflation rates. One counter-argument is, however, that these rallies were preceded by unprecedented sell-offs. Even now, equity prices and oil prices are still clearly below the highs posted in 2007 and 2008 (cf. chart).

THREAT OF A NEW BUBBLE?



Source: Bloomberg, UniCredit Research

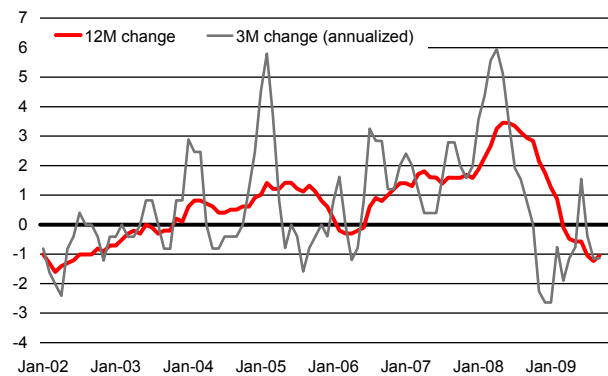
Even more important is that the Fed does not consider the rally on financial markets a threat – quite the contrary. In a recent speech, Don Kohn made clear once again that the reflation of asset prices is in fact an important component of the Fed’s strategy to stabilize the economy and financial markets. In response to the question of what should support economic activity as fiscal stimulus wanes, Kohn said: “*Most importantly [...] low market interest rates should continue to induce savers to diversify into riskier assets.*” That would stabilize bank balance sheets and should contribute to easing up lending. And easier credit in combination with rising household wealth is likely to spur private demand.

But what about the direct effect of rising oil prices on the inflation rate? We had mentioned previously that core inflation will likely continue to fall – with rising energy prices, the headline rate will, however, move in the opposite direction. If oil and natural gas prices were to remain at the current level, the headline inflation rate could stand at close to 3% again by the end of the year. Compared with the current inflation rate of -1¼%, that is quite an impressive development. However, even that will probably not be enough to really unsettle the Fed. First, most of this rapid rise can be explained by the expiring base effect of falling energy prices from last year. Second, somewhat higher inflation is perhaps not an unwelcome thing for the Fed – many market observers now demanding an earlier rate hike have themselves voiced the fear that in light of the high federal debt the Fed could tolerate slightly more inflation than normal. Third, an inflation rate of 3% is not particularly high considering that the average inflation rate between January 2000 and September 2008 was 2.9%.

Analogous to this, the weakening US dollar will probably not influence the coming rate decisions either. It is true that the low interest rate level in the US is contributing to the current dollar weakness, since in this way the greenback is one of the most important, perhaps even the most important, funding currency for carry trades. But to fundamentally alter this situation, interest rates would have to rise strongly; and that is something that in the current situation presumably not even the biggest hawks would support. Furthermore, the current depreciation of the US dollar must be seen in combination with the strong appreciation of the greenback during the onset of the financial market crisis, when risk-averse investors poured into the dollar in search of a safe-haven. Despite the recent sell-off, the trade-weighted dollar is, therefore, still more than 5% above the low posted in March 2008. Above and beyond that, Boston Fed President Rosengren made clear that the Fed cares about the dollar “*to the extent that it impacts inflation and unemployment.*” On the one hand, there is no question that a weak US dollar supports the export industry and, therefore, takes some pressure off the labor market. On the other hand, however, a weak currency tends to add to inflation. But that is probably not unwelcome either given the ongoing decline in the core rate. Furthermore, import prices for consumer goods have been unimpressed by the recent slide of the US dollar so far and continued to fall (cf. chart).

US CONTINUES TO IMPORT DEFLATION

Import prices for consumer goods, rates of change in %



Source: Bureau of Labor Statistics, Thomson Datastream, UniCredit Research

Hawks and doves

Amid the uncertain economic recovery, the weak labor market and falling (core) inflation rates, the list of Fed officials who are against too rapid rate hikes is long. Based on our interpretation of recent statements, the position is at least 8:2 among the voting members, and 3:1 among the alternate members (active if a voting member drops out). This situation is unlikely to be altered by the annual rotation of the FOMC members, as Jeffrey Lacker (Richmond) will be replaced by Tom Hoenig (Kansas City), another "hawk". In the following overview, we have shaded the names of those Fed officials whose recent statements suggest they tend to support earlier and more aggressive rate hikes. Since, however, we do not anticipate any dissenters at the upcoming meeting, we have not used different shades of gray – even though Governor Warsh must undoubtedly be considered much less "hawkish" than, for example, the regional Fed Presidents Lacker or Hoenig.

THE FEDERAL OPEN MARKET COMMITTEE

2009	2010
Voting members	Voting members
Bernanke	Bernanke
Dudley	Dudley
Duke	Duke
Kohn	Kohn
Tarullo	Tarullo
Warsh (with reservations)	Warsh (with reservations)
Evans	Bullard
Lacker	Hoenig
Lockhart	Pianalto
Yellen	Rosengren
Alternate members	Alternate members
Bullard	Cumming
Cumming	Evans
Hoenig	Fisher
Pianalto	Plosser

Source: Federal Reserve, UniCredit Research

First verbal tightening in December?

Despite the mounting pressure on the Federal Reserve to tighten the monetary policy reins, we expect that at the upcoming meeting the Fed will not only hold the Fed funds target rate at the current level but that it will also retain the passage "*exceptionally low levels of the federal funds rate for an extended period*" unchanged. In light of the solid GDP growth in the third quarter, the assessment of the economic situation could be slightly more sanguine than after the previous meeting in late September. In contrast, there is, in our view, currently little reason to change the inflation outlook ("*inflation will remain subdued for some time*"). Only the recent spike in energy prices might be mentioned.

If – as we expect – the US economy continues to post solid growth in the current quarter, the statement could, however, be modified slightly in mid-December. If so, the Fed is likely to prepare markets through speeches ahead of the meeting. One possibility is to soften the passage "*keep interest rates at exceptionally low levels for an extended period*" by replacing it with "*keep interest rates at exceptionally low levels for some time.*" This was exactly the formulation that the Fed had used up to the end of January. The modification would, therefore, be a small step back towards normality. But it certainly would not herald an imminent rate hike! At the end of 2003, when the Fed last issued a similar commitment to sustained low interest rates ("*the Committee believes that policy accommodation can be maintained for a considerable period.*"), it took roughly six months after this passage was first watered down before the federal funds target rate was finally raised. Hence, this first "verbal tightening" would not mechanically set the process of rate increases into motion. It would simply give the Fed more flexibility to respond to faster economic growth and to a rising inflation threat, thereby reducing the danger of monetary policy falling behind the curve. But for now, most Fed officials are still harboring doubts about the sustainability of the recovery. And given the fact that the unemployment rate will continue to rise until the beginning of next year, we do not expect the first rate hike before the beginning of the second half of 2010.

Dr. Harm Bandholz, CFA (HVB)

+1 212 672-5957

harm.bandholz@us.unicreditgroup.eu

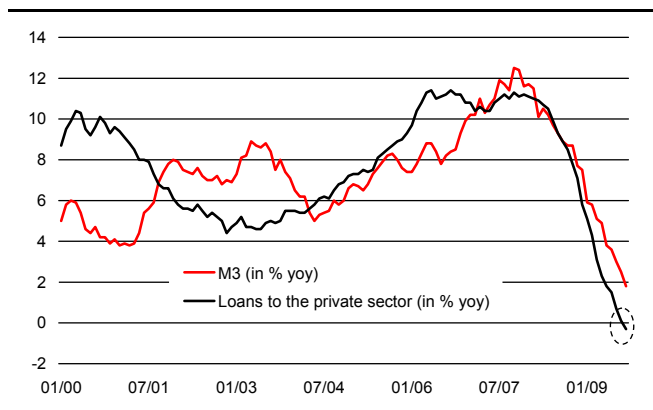
EMU: First encouraging signs for the credit cycle

- For the first time, in September, growth of loans to the private sector entered negative territory on a yoy basis. Growth of loans to NFCs was hit the most, while a mildly more favorable picture stems from the household sector
- The Bank Lending Survey (BLS) keeps showing a net tightening in banks' credit standards. The good news is that such a figure is lower than before, especially for NFCs. Expectations point to a further moderation in the pace of tightening.
- Although some positive spots are starting to appear, the credit cycle remains the biggest question mark on the timing and the extent of the recovery in the eurozone.

The credit cycle is still a critical area

Money and credit figures released this week by the ECB suggest that, although showing some signs of improvement, the credit cycle remains one of the most critical areas in the eurozone. In fact, while the BLS showed some moderation in net tightening of lending standards, with encouraging expectations for the current quarter, bank lending standards remain tighter, while loans to the private sector entered into negative territory for the first time since the inception of the series. Figures on money supply showed that M3 yearly growth slowed more than expected, to 1.8% vs. 2.6% in August. The M3 counterparts' details revealed that growth of loans to the private sector entered into negative territory for the first time since the inception of the series and now stands at -0.3% yoy (from 0.1% in August). However, the speed of the decline seems to be moderating, as confirmed by monthly flow dynamics: on an adjusted basis, loans to the private sector increased from EUR -3bn to EUR 17bn.

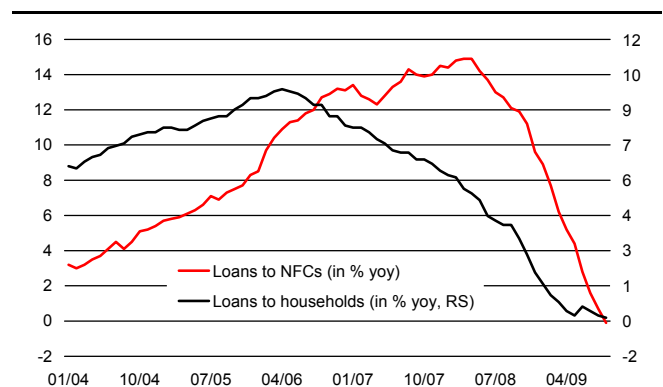
LOANS IN NEGATIVE TERRITORY



Source: ECB; UniCredit Research

Once again, growth of loans to NFCs was hit the hardest, marking another strong decline from 0.7% yoy in August to -0.1% in September, with short-term loans (up to 1 year) remaining deeply in negative territory (from -9.3% to -9.7% yoy) and longer-term ones (over 1 year) increasing the speed of deceleration. A mildly more favorable picture stems from the household sector: growth of household lending remained slightly negative (-0.3% yoy), but marked a further increase in monthly flow, from EUR 9bn to EUR 14bn, stemming mainly from lending for house purchase (increasing from EUR 6bn to EUR 9bn).

LOANS TO HOUSEHOLDS LEAD LOANS TO NFCS



Source: ECB; UniCredit Research

BLS: Encouraging, but some weak spots remain

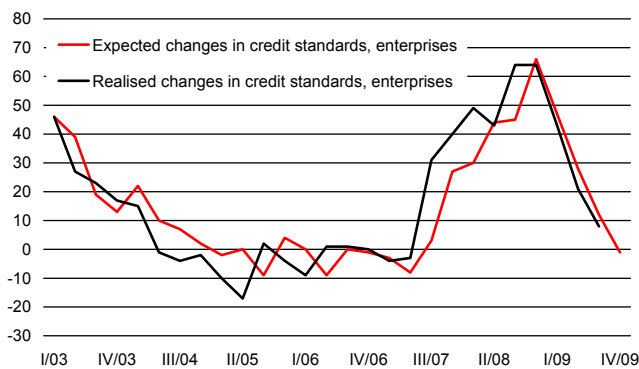
This week, the ECB published the BLS for the third quarter of 2009. While the survey keeps showing a net tightening in banks' credit standards, the good news is that such a figure is lower than in the second quarter, especially for enterprises, where the net tightening more than halved. More encouragingly, expectations point to a net easing for NFCs in the next quarter.

Enterprises: In the third quarter, the net percentage of banks reporting a tightening of credit standards for loans to enterprises declined substantially, from 21% in the second quarter to 8%. This is even more remarkable, as the net tightening in the first quarter was still a substantial 43%, not to mention the values above 60% reached in the worst hour of the crisis in 3Q and 4Q last year. However, one should keep in mind that the net tightening which occurred during past quarters has not yet started to reverse and still represents a significant degree of restraint in credit standards. The most important driving force for the net tightening continued to be expectations in general economic activity (but the percentage declined substantially from 46% to 26%) and the firm/sector specific outlook (38% after 47%). What is encouraging is the fact that supply side factors such as banks' access to market financing and their liquidity position even contributed to an

easing of credit standards for loans to NFCs. This is important, as we have already voiced concerns that lending growth could suffer because of “elements of supply” taking the upper hand in driving credit dynamics. Banks continued to report that the increase of margins on average and on riskier loans remains the main condition through which the tightening is implemented. Encouragingly enough, the net tightening of the margins both on average and on riskier loans was reduced significantly, respectively, to 13%, from 35% and to 31% from 56% in 2Q.

NFCs: THE WORST IS OVER...

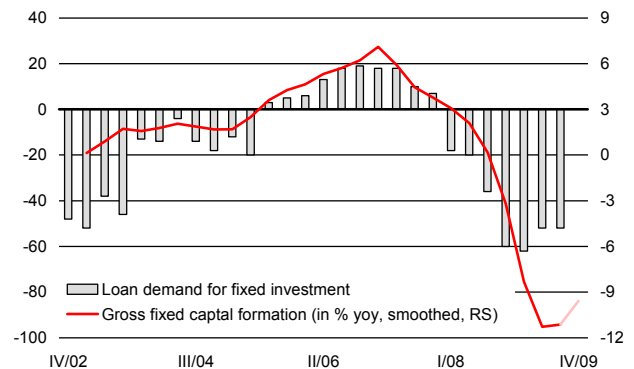
Net percentage of banks contributing to tightening standards, NFCs



Source: ECB, UniCredit Research

Loan demand kept declining, but at a moderately slower pace than in 2Q 2009 (-20% vs. -29%); net demand was significantly more negative for large firms (-27%) than for SMEs (-17%). However, financing needs for fixed investment, a very good gauge of capex, remains in free-fall (-52%, unchanged with respect to 2Q). This bears important consequences for the investment outlook: the chart below shows that loan demand for fixed investment so far has done a good job in tracking actual investment growth. We have already noted that this is valuable indicator given its high persistence (i.e., a positive value tends to be followed by another positive value and vice versa). Therefore, this allows us to identify turning points with a reasonable degree of confidence. Looking at the chart on the right, we can see that net demand for loans for investment has passed its trough (thus confirming that the investment cycle has likely bottomed out), but there is still a long way to go before entering a sustainable recovery. The most encouraging note of the report comes probably from expectations: banks envisage a net easing in credit standards for 4Q (-1%), while net demand for loans is expected to be slightly positive. A note of caution is necessary, though, as expectations should be taken with a grain of salt at this juncture. Keep in mind that banks were expecting positive net demand for loans from NFCs in 3Q, something that actually did not happen, as net demand is still negative.

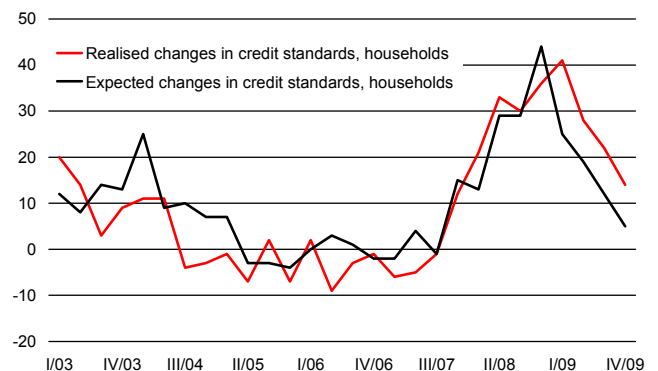
...BUT THE WAY TO RECOVERY IS STILL LONG FOR CAPEX



Source: Eurostat, ECB, UniCredit Research

Households: The net percentage of banks reporting a tightening of credit standards for mortgages decreased further to 14%, from 22% in 2Q 2009, on the back of expectations on general economic activity and housing market prospects. As for consumer credit and other lending to households, the net percentage of banks reporting a tightening of credit standards declined to 13%, from 21% in the second quarter. The main factor behind the net tightening was again banks’ perception of risk, mainly related to the creditworthiness of consumers.

CREDIT STANDARDS FOR HOUSEHOLDS ARE LESS TIGHT



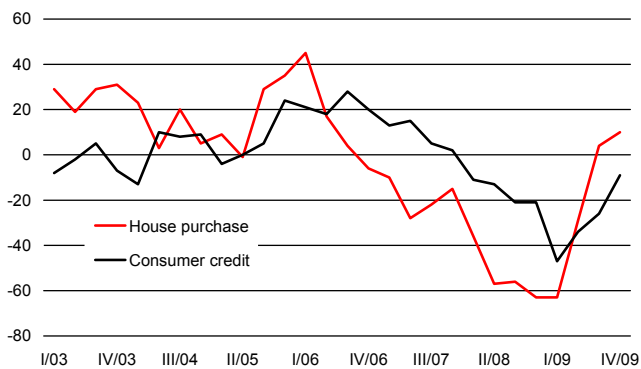
Source: UniCredit Research

Quite interestingly, net demand for housing loans remained in positive territory (10% from 4%), confirming that demand for housing loans is likely to have passed its turning point. Indeed, we have argued several times that dynamics in housing loans is an important indicator in the credit cycle as it tends to anticipate by several months developments in corporate loans. The increase in net demand for loans for house purchase was driven by a considerably less negative assessment of housing market prospects and of consumer confidence. Net demand for consumer credit and other lending remained negative, albeit substantially less so than in the previous

quarter (-9%, up from -26%). Also for household lending, figures on expectations were quite comforting: banks expect the net tightening in credit standards to weaken further to 5%, while credit standards for consumer credit and other lending to households are expected to tighten by 9%. As opposed to the gap between expected and realized tightening noted for lending to NFCs, it is encouraging that the net tightening expected in 2Q was actually realized in the third quarter, something that bodes well for a further slowing of the pace of net tightening in the fourth quarter.

NET DEMAND FOR HOUSING LOANS IN POSITIVE TERRITORY

Net % of banks reporting a positive contribution to demand, loans to households



Source: ECB, UniCredit Research

As already happened last quarter, the BLS contains also a set of ad hoc questions to assess the extent to which financial market tensions have affected banks' credit standards. The first question relates to the access to wholesale funding: banks reported that their access to wholesale funding was less impaired compared to the second quarter, with 15% and 32% of responding banks reporting hampered market access in very short term and short term money market. However, almost half of the responding banks (44%) find difficulties in financing in medium to long-term securities, although this is a substantial improvement from the nearly 80% in the first quarter. The second question relates to the impact of the financial turmoil on bank lending: while the effect stemming from hampered market access declined in 3Q 2009, it remained much stronger for margins than for the amount of loans granted to borrowers.

The recovery in the credit cycle has still some way to go

This week's figures showed that, although some positive spots have started appearing in some areas, the credit cycle remains the biggest question mark on the timing and the extent of the recovery in the eurozone. First, while household lending seems to have started leveling off, a further deceleration in corporate lending is in the cards and we continue to expect a further significant slowdown in loans to NFCs through mid-2010. Second, the October BLS shows that measures aimed at relieving strains in the banking sector are starting to feed through, while the improvement in the global outlook is another important factor in helping the banking sector to get out of the woods. Third, the BLS signals that household lending dynamics should have passed its trough, a sign that should be seen with some hope, given the leading property of housing loans in the broader credit cycle. It is true that, in net terms, lending standards for the corporate sector remain tight, but the amount of tightening has substantially declined from 3Q.

However, while banks are starting to expect a net easing in the current quarter and credit demand is expected to turn slightly positive, cumulated net tightening, together with some moderation in the pace of corporate re-leveraging, will keep corporate lending subdued for some time. While all this seems to confirm that there is as yet no evidence of a credit crunch, we will keep monitoring the credit cycle, as it can no longer be considered just one element of the ECB's monetary analysis, but rather the key macroeconomic factor to determine the timing of the upturn.

Loredana Federico (HVB Milan)
+39 02 8862 3180
loredana.federico@unicreditgroup.eu

Davide Stroppa (HVB Milan)
+39 02 8862 2890
davide.stroppa@unicreditgroup.de

TINA comes to Germany – economic policy of the new government

- The coalition deal was sealed over last weekend, paving the way for a new government to take office on Wednesday.
- Next year, there will be additional fiscal relief for private households and companies of about EUR 8 billion. From 2011 onwards, structural changes in the tax system are planned to be implemented. There shall also be significant modification in the national health-care system.
- In our view, there is no alternative to the chosen strategy of consolidating public finances not in 2010 but only later. It does not make sense to cut public spending already next year when unemployment is expected to soar.
- Overall, the new policy measures do not change our economic view that the German economy will grow by 2% in 2010, while unemployment will rise to up to 4¼ mn.

The TINA principle

Over the previous weekend, a coalition deal between the conservatives and the liberals in Germany had been sealed. This agreement paves the way for a new government to take office this week, to be led by Chancellor Merkel (CDU) and her deputy Mr. Westerwelle (FDP). From an economic viewpoint, the coalition agreement contains the following major points:

- Next year, there will be additional fiscal relief for private households and companies of about EUR 8 billion. Families will get EUR 5 billion in the form of higher child benefits and a lower tax burden. Tax cuts for companies amount to approximately EUR 3 bn. After the Lehman collapse, the former Grand Coalition had already implemented two fiscal stimulus packages, which also included a lower tax and social security burden. Taking the old and new measures together, net relief for the German economy next year compared to 2009 will be EUR 16 billion or 0.6% of GDP. Other figures circulating are obviously not adjusted for fiscal measures which will or already have expired. For example, this is true for the car-scrapping premium, which provided a temporary fiscal boost in purchasing power for consumers.
- The financial crisis already led to increased spending of the Federal Employment Agency via extending short-time employment and higher unemployment benefits. Moreover, there will probably be shrinking revenue in the national health care system due to the lower level of employment. These two effects will add up to at least EUR 25 billion and will have to be financed via higher debt.

- From 2011 onwards, structural changes in the tax system are planned to be implemented. The new government intends to replace the continuously increasing tax rate by several tax brackets depending on the respective income. This in turn will lead to total relief of EUR 24 billion by 2013 (including the tax cuts next year). Additional details are, however, not available.
- There shall also be significant modification in the national health-care system. So far, rising health-care costs in Germany have been shared by employers and employees. From 2011 onwards, rising costs will only be shouldered by employees. Low-income households will be awarded a grant from the government for compensation. No additional details were provided.

In difficult and challenging times, Margaret Thatcher often used a slogan called “TINA” or “There is no alternative”. This principle holds as well for the coalition agreement of the new center-right government in Germany. Of course, one can argue that public debt will balloon further next year. The mix of tax cuts and higher spending make this outcome a certainty. We expect a deficit of at least 5% in terms of nominal GDP. Moreover, many questions are unanswered. For example, what will the new tax and national health care system look like exactly? However, in our view, there is no alternative to the chosen strategy of consolidating public finances not in 2010 but only later. It does not make sense to cut public spending already next year when unemployment is expected to soar by at least 500,000. Such a pro-cyclical fiscal policy would literally have been Russian roulette with possibly devastating effects on growth and employment. Please keep in mind that German exports may take a renewed hit next year when the fiscal stimulus measures in many countries fizzle out. Reducing the public deficit in such times equals accepting the significant risk of a double-dip recession. Moreover, a tax reform which really deserves the name can at least partly contribute to the rebalancing of the export-dependent German economy. Given the huge structural imbalances in the global economy, German export growth will be less dynamic in the next years. We are therefore in need of an additional growth pillar which makes the economy less dependent on the well-being of other countries.

On the negative side, there are two points worth mentioning. First, the new government said nothing concrete about what the medium-term fiscal exit strategy will look like. New Finance Minister Mr. Schaeuble only mentioned that a balanced budget is not feasible in the next four years. Moreover, some politicians believe that tax cuts will finance themselves, since the growth path is assumed to be higher. According to our calculations, this will be only partly true. For example, if Germany wants to reduce its public debt level to 60% by 2020 (in line with the Maastricht criteria), the economy has to grow by 4½% on average each year. It goes without saying

that this is a mission impossible. Hence, after 2010, structural cuts in public spending are absolutely necessary. More transparency in this respect would have been helpful and should also lie in the self-interest of the new government. Otherwise, the loss in confidence and credibility may backfire sooner or later. Second, tax cuts make undoubtedly sense on a medium-term perspective. However, we are skeptical as to whether a lower tax burden already in 2010 is the appropriate tool for fighting the macroeconomic crisis. Admittedly, low-income families may partly spend the increased benefits, given that their propensity to purchase is rather high. However, there is some uncertainty involved. The fear of becoming unemployed may quickly drive up the personal savings ratio, thereby outweighing the positive impact.

The new coalition agreement does not change our overall macroeconomic picture for 2010. We stick to our view that the German economy will grow by 2% next year. Unemployment will rise to up to 4¼ million.

Andreas Rees (HVB)
+49 89 378-12576
angreas.rees@unicreditgroup.de

Do not extrapolate the weakness of the US dollar

- The US dollar has depreciated by about 20% against the euro over the last seven months. In mid-October, it even tested the mark of 1.50 again – but falling back afterwards again.
- Behind this weakening are two main factors. First, the US dollar is now one, if not the most important funding currency for carry trades. Second, it is a reversal of the flight-to-quality during the onset of the crisis.
- But even now, the trade-weighted USD is more than 5% above the low reached in March 2008. Against this backdrop, the recent weakening of the dollar should not be extrapolated. Fears that the greenback is on the brink of losing its status as a reserve currency are vastly exaggerated.
- With the economic recovery coming to a halt again in spring 2010, the dollar might even strengthen temporarily. Over the medium term, however, we expect that the dollar will continue to weaken. But that will happen at a much more gradual pace than in recent months.

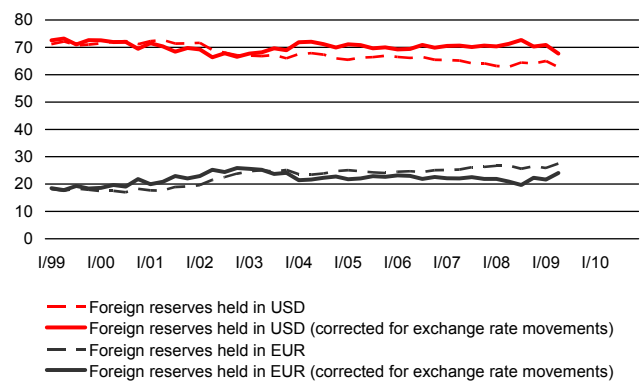
Under pressure

Just like most other asset classes, currencies have experienced a high degree of volatility during the global recession of 2008/2009. And while large exchange rate fluctuations are a godsend for traders, they are making it extremely difficult for companies to do business, predict cash flows, and time investment decisions. Between mid-2008 and early 2009, EUR-USD fell from a record-high of 1.60 to a three-year low of 1.23, as risk-averse investors sought the safe-haven of dollar-denominated assets. With the notion that the global recession is not cascading into another depression, risk aversion started to fade again in spring. Since then, the ongoing stabilization in financial markets and more encouraging economic numbers did not only lead to a further significant decline in risk aversion, but have even spurred the reemergence of risk appetite. Investors have shifted their portfolios back from cash into riskier assets and investments, such as equities but also carry trades. The latter are exploiting interest rate differentials between two countries by borrowing money in a low-interest rate country (L) and investing those funds in a country with higher rates (H). This transaction, therefore, increases demand for the currency of H and puts upward pressure on it. At the same time, the currency of country L comes under downward pressure. With historically low interest rates, and as other traditional low-interest rate currencies (e.g. the Japanese yen or the Swiss franc) were at the same time less attractive for investors than usual, the US dollar became the main funding currency for carry trades in recent months. In a nutshell, these two developments, the decrease in risk aversion

and the (related) increase in carry trades, explain the rapid depreciation of the US dollar in the summer of 2009. The pace of this decline should, therefore, not be extrapolated. And fears that the greenback is even on the brink of losing its status as the global reserve currency are certainly overdone (cf. chart).

DOLLAR REMAINS THE DOMINANT RESERVE CURRENCY

As percentage of allocated reserves (worldwide)



Source: IMF, Thomson Datastream, UniCredit Research

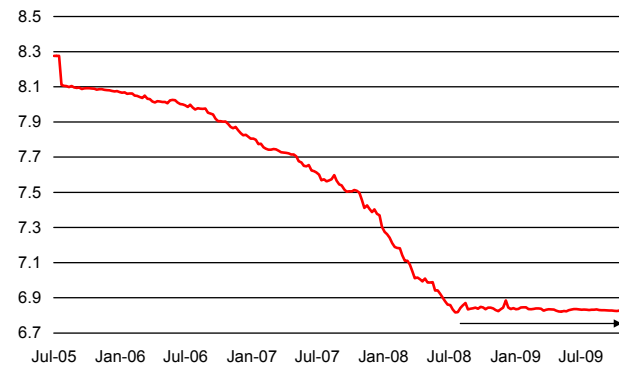
Calls for an alternative reserve currency are, in our view, nothing more than political games played by some emerging market officials in order to show that the balance of power has shifted. While those countries are undoubtedly concerned about the strength of the dollar, there are no serious alternatives to the dollar. Moreover, all proposals – be it a currency basket, the euro, or the IMF's special drawing rights – would inevitably lead to a faster appreciation of domestic currencies against the US dollar. And this is exactly what most emerging markets do not want. China even repegged its currency (CNY) to the dollar in mid-2008, allowing no appreciation of the renminbi at all (cf. chart next page).

Return of risk aversion might help temporarily

Over the medium term, we even see some upward potential for the dollar. The main reason is that we expect the economic recovery in the US to stall in spring 2010 after the positive impacts from the fiscal stimulus and the inventory cycle have run their course. More mixed economic data and mounting uncertainty about the economic outlook should then increase again nervousness on markets and raise risk aversion. This would be good for the US dollar, and present a short-term opportunity for investors and businesses – depending on which side of the Atlantic they are. But eventually, the US economy will also weather this setback, and at the end of the year growth rates should be almost back to potential. Amid rising global activity, higher commodity prices

RE-PEGGED!

USD-CNY exchange rate



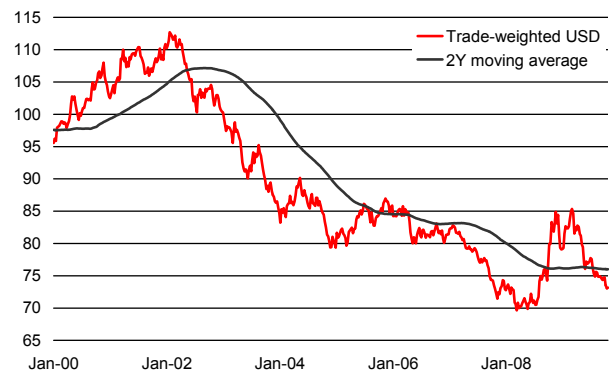
Source: Bloomberg, UniCredit Research

and once again rising risk appetite, the US dollar is likely to come under pressure again at the end of 2010, and EUR-USD might even test the all-time high of 1.60. But those forces will be partly offset by a gradual tightening of monetary policy. We expect that the Federal Reserve will start hiking interest rates in the third quarter of 2010. As the interest rate level in the US gradually rises, the US dollar will become less attractive as a funding currency for carry trades.

Gradual depreciation to continue

Beyond 2010, the global downward pressure on the US dollar will persist. While it will almost certainly weaken against most emerging markets' currencies, it might also depreciate further against the euro. Apart from fundamentals, which may or may not be sounder in Europe than in the US, the decisive factor is the reserve allocation of emerging markets. As none of these countries is in a position, let alone willing, to let its currency float freely, they will move from a currency peg to the US dollar to a currency basket, which undoubtedly contains a certain amount of euros. That means that demand for the US dollar decreases at the same time as demand for the euro increases. And this combination inevitably puts upward pressure on EUR-USD. But one thing is crystal clear: A disorderly depreciation of the dollar is not in the interest of any party – neither the US, nor Europe, nor Asia. For that reason, any weakening of the dollar will take place rather gradually, leaving businesses with enough time to adjust to the new situation.

ON A DOWNWARD TREND SINCE 2002



Source: Bloomberg, UniCredit Research

Dr. Harm Bandholz, CFA (HVB)
+1 212 672-5957
harm.bandholz@us.unicreditgroup.eu

Data Monitor – Preview Europe

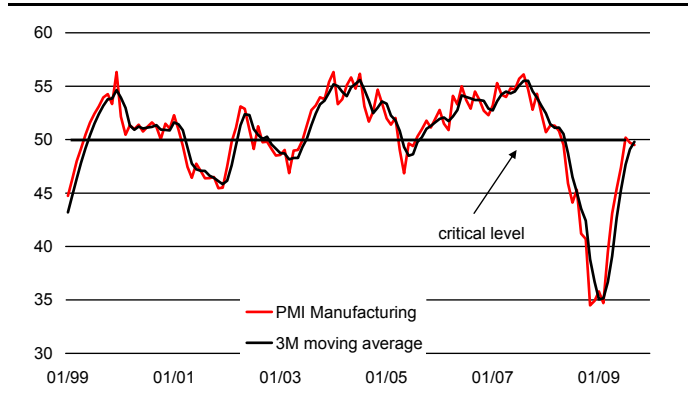
Monday, November 2

UK, MANUFACTURING PMI

October	MIB	Cons.	Sept	Aug
	49.8	50.0	49.5	49.7

The recovery in manufacturing PMI has lagged well behind the pace of improvement in its services counterpart. Given that the September decline was totally explained by a significant correction of the output sub-component (while the other categories fared much better), we expect a moderate increase in October, which will bring the headline index slightly above the August level.

SUBDUED PICTURE



Source: ONS, UniCredit Research

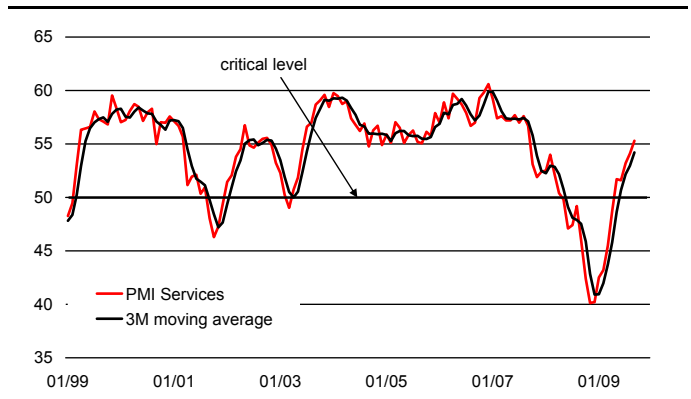
Wednesday, November 4

UK, SERVICES PMI

October	MIB	Cons.	Sept	Aug
	55.5	55.2	55.3	54.1

The services PMI has improved significantly over the last few months, marking in September the highest level in two years. National account data suggest that the improvement was largely driven by transport, storage and communication as well as business services and finance. We see scope for a further mild improvement in October to 55.5.

STRONG IMPROVEMENT



Quelle: ONS, UniCredit Research

Thursday, November 5

UK, INDUSTRIAL PRODUCTION

September	MIB	Cons.	Aug	July
in % mom	0.7	1.3	-2.5	0.5

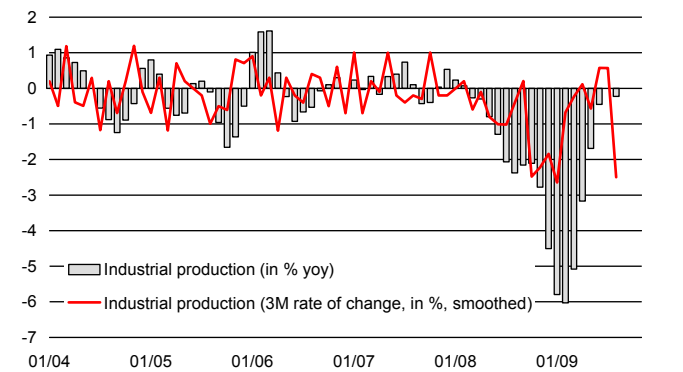
August industrial production turned out exceptionally weak (-2.5% mom), against (survey-based) forecasts for a moderate monthly increase. The sizeable discrepancy with respect to surveys' indications could be possibly due to difficulties in getting the seasonal adjustment of data right, so that an upward revision of the August reading is a realistic outcome. On the basis of the preliminary estimate of 3Q GDP, we expect a 0.7% pick up in September industrial production, largely driven by manufacturing (1.8%).

UK, BANK OF ENGLAND (BoE)

November	MIB	Cons.	Oct	Sept
Policy rate (%)	0.5	0.5	0.5	0.5
Asset Purchase Facility (GBP bn)	225	225	175	175

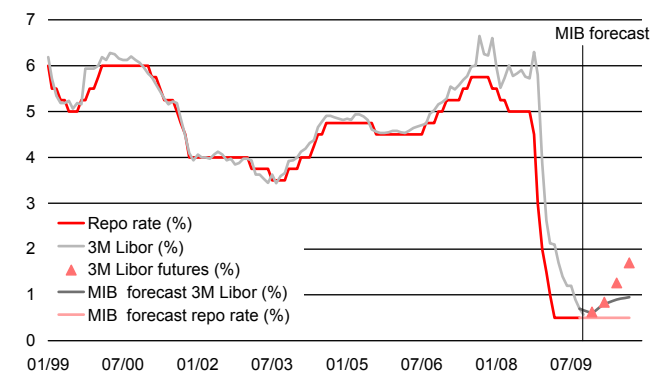
Following the unexpected (sixth consecutive) contraction in 3Q GDP (-0.4% qoq vs. -0.6% in 2Q), we now expect that the BoE will revise up the QE scale to GBP 225bn at the November 5 meeting. The Monetary Policy Committee would rather risk doing "too much" to prevent a possible rise in yields, which have decline substantially thanks to the BoE's asset purchases.

PICK UP IN SEPTEMBER



Source: ONS, UniCredit Research

RATES ON HOLD, QE UP



Source: Thomson Datastream, UniCredit Research

Friday, 6 November

GERMANY, NEW ORDERS

September	MIB	Cons.	Aug	July
in % mom	-0.5	1.0	1.4	3.1
in % yoy	-14.7	-13.7	-21.1	-20.3

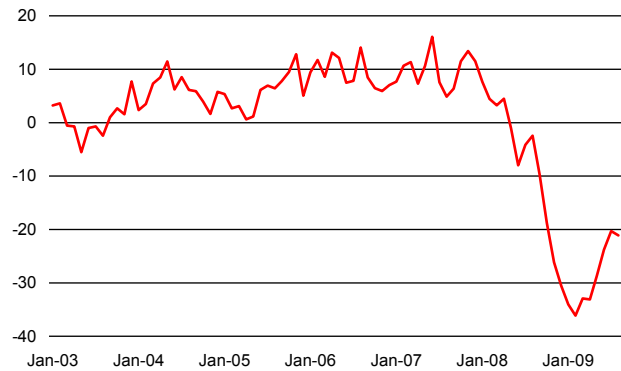
With the recovery of global demand from industry, orders have increased a strong 17% since February and thereby made good roughly one third of the preceding demand slump. Recently, the dynamic was supported by large orders. In August, an order push in the automotive sector contributed roughly 4 percentage points to the monthly reading. A noticeably weaker assessment of demand by businesses thereafter points to a technical correction in September.

Tullia Bucco (HVB Milan)
 +39 02 8862-2079
 tullia.bucco@unicreditgroup.de

Chiara Silvestre (HVB Milan)
 chiara.silvestre@unicreditgroup.de

DEMAND RECENTLY STAGED A RAPID RECOVERY

New orders, in % yoy



Source: Federal Statistical Office, UniCredit Research

Alexander Koch, CFA (HVB)
 +49 89 378-13013
 alexander.koch1@unicreditgroup.de

Marco Valli (HVB Milan)
 +39 02 8862-8688,
 marco.valli@unicreditgroup.de

Data Monitor US - Preview of the coming week

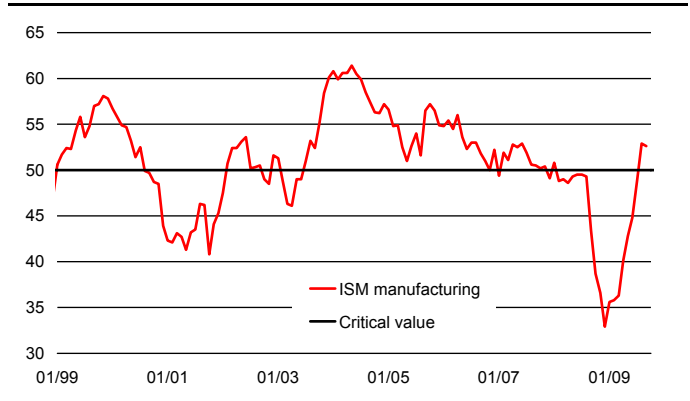
Monday, November 2

ISM MANUFACTURING

October	MIB	Cons.	Sept	Aug
	53.0	53.0	52.6	52.9

While regional manufacturing surveys were on average slightly weaker than in September, they still indicated that the sector was able to carry the momentum over into the fourth quarter. But as the production rebound in the car sector is over, additional demand is now focused more on infrastructure-related products. And as the destocking process in many industries is gradually coming to a halt, the composition of the ISM is likely to change too. Gradual declines in new orders and production should be offset by higher inventories. While the overall impact might be a small increase in the composite index, this shift indicates that the upward potential for industrial production is gradually slowing down.

GAP BETWEEN NEW ORDERS AND INVENTORIES NARROWS



Source: Thomson Datastream, UniCredit Research

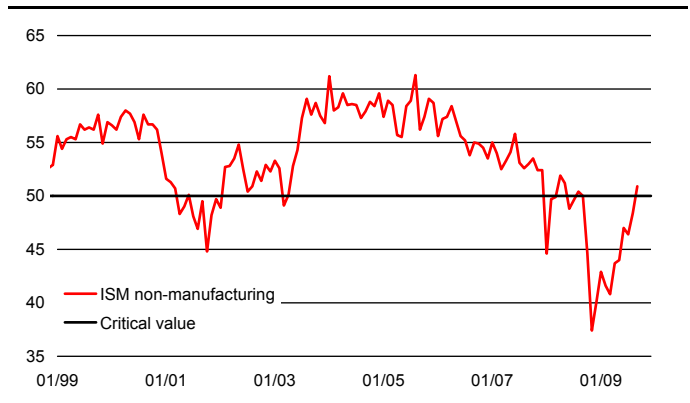
Wednesday, November 4

ISM NON-MANUFACTURING

October	MIB	Cons.	Sept	Aug
	51.0	51.6	50.9	48.4

In September, the non-manufacturing ISM surpassed the threshold of 50 points for the first time in more than one year, and rose to the highest level since May 2008. The index was lifted by solid increases in the important activity and new orders sub indicators, which both rose to the highest levels since October 2007. While the employment index edged up as well, there were still twice as many industries reporting an employment decrease than industries reporting an increase. According to the Beige Book, demand for high-tech, telecommunications and healthcare services generally increased between late August and mid-October; tourist activity was mixed, and consumer spending remained weak. While the employment situation should have been less bad in October, production and new orders likely moderated a bit from the strong September levels. The result is a stabilization of the non-manufacturing ISM at about 51 points.

STABILIZATION ABOVE 50 POINTS



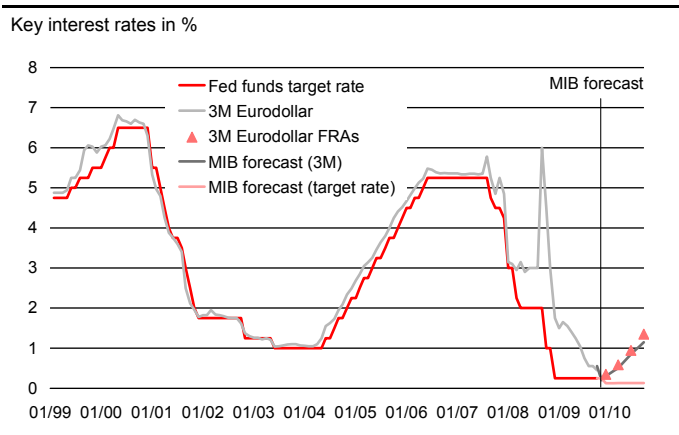
Source: Thomson Datastream, UniCredit Research

FOMC MEETING

	MIB	Cons.	current	before
Target rate in %	0.25	0.25	0.25	0.25

The Fed is in no hurry to raise interest rates. While the US economy came with gusto out of the deep recession, the Fed is still skeptical about the sustainability of the recovery. In addition, the unemployment rate continues to rise, while inflation is pointing south. Vice Chairman Don Kohn made clear that the stock market rally is no reason for concern right now, but should help to repair the damage on households' and banks' balance sheets. Finally, the recent weakness in residential construction underscores that higher rates would come much too early for the housing sector. While there might be a few participants arguing in favor of an earlier policy tightening, we think the large majority is still supporting an unchanged monetary policy stance for the time being (please see my research note for further information).

FED IS IN NO HURRY TO ACT



Source: Thomson Datastream, UniCredit Research

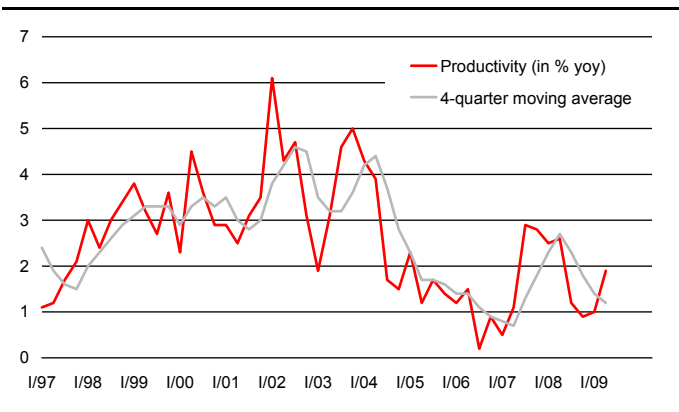
Thursday, November 5

PRODUCTIVITY & UNIT LABOR COSTS

III/09	MIB	Cons.	II/09	I/09
Nonfarm productivity (in %, qoq)	6.2	6.0	6.6	0.3
Unit labor costs (in %, qoq)	-4.0	-3.8	-5.9	-5.0

According to the advance estimate, real GDP rose a solid 3.5% in the third quarter. As at the same time the index of aggregate working hours fell another 3¼%, nonfarm productivity (output per hour) surged again. The increase in compensation per hour was most likely more benign than in previous quarters – and certainly lower than the strong rise in output per hour. As a result, unit labor costs fell again significantly in 3Q. Both developments, the rise in productivity and the decline in unit labor costs, reflect the successful attempts of companies to cut costs and to streamline their businesses amid the severe economic recession. In addition, they indicate that inflation pressures continue to point south.

ANOTHER JUMP IN PRODUCTIVITY



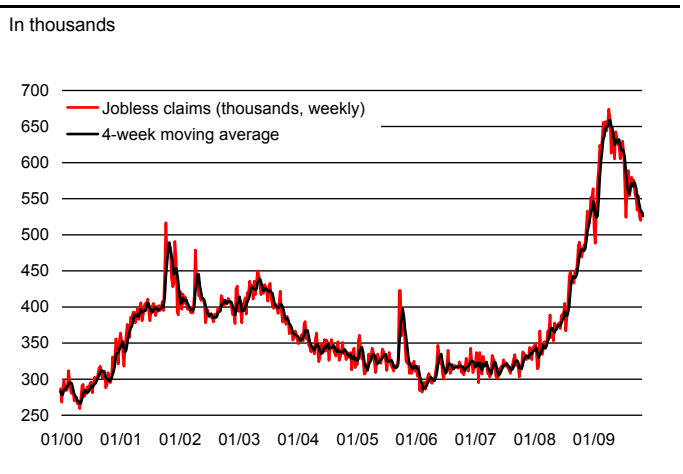
Source: Thomson Datastream, UniCredit Research

INITIAL JOBLESS CLAIMS

October 31	MIB	Cons.	24 Oct	17 Oct
in thousands	520	520	530	531

Despite the recent stagnation, initial jobless claims are more than 20% below their cyclical peak of 674k reached in late March, indicating that the pace of layoffs has slowed perceptibly. However, in order to indicate stable payrolls, initial claims would have to fall further to about 400k. In addition, hiring activity has to pick up in order to support the labor market and to stop the upward trend in the unemployment rate. The significant decline in continuing claims is largely attributable to the fact that many unemployed are running out of eligibility to make regular state claims as they exceed the time limit of 26 weeks.

CLAIMS CONTINUE TO TREND LOWER



Source: Thomson Datastream, UniCredit Research

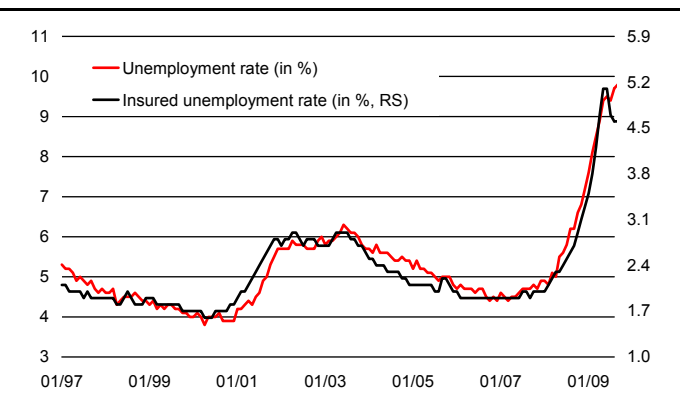
Friday, November 6

MONTHLY EMPLOYMENT REPORT

October	MIB	Cons.	Sept	Aug
Non-farm payrolls in k	-190	-175	-263	-201
Unemployment rate in %	10.1	9.9	9.8	9.7

The decline in non-farm payrolls likely continued to slow down in October. Most important factor behind the deceleration was once again the decline in layoffs. Initial jobless claims in the mid-month reporting week were 530k, about 20k less than in September. But as hiring activity remains lackluster, the US labor market is still far away from stabilization – even as our forecast implies the smallest payroll decline since last August. This is corroborated by the employment indexes of the regional manufacturing surveys, which on average did not improve in the last month. If it were not for a 571k decline in the civilian labor force, the unemployment rate would have already risen above 10% in September (for the first time since June 1983). As this special factor is likely to reverse in October, we expect a more pronounced increase in the unemployment rate.

UNEMPLOYMENT RATE TO SURPASS 10%



Source: Thomson Datastream, UniCredit Research

Dr. Harm Bandholz, CFA (HVB)
+1 212 672 5957
harm.bandholz@us.unicreditgroup.eu

Review Europe

German labor market still remains resilient

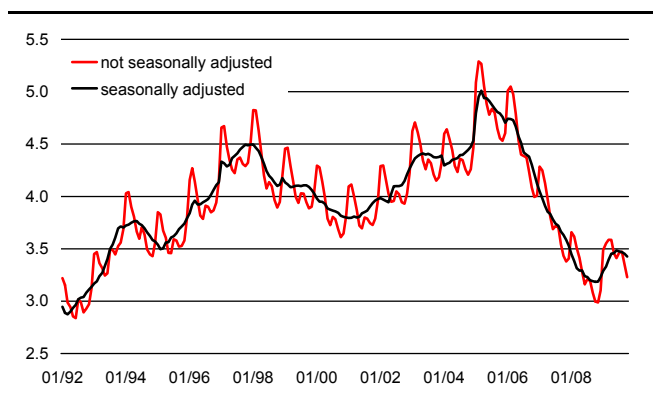
German unemployment was down a stronger-than-expected 118,000 mom on a non-seasonally adjusted basis to 3.229 million in October, driven by the seasonal autumn recovery. Adjusted unemployment was also down 26,000. It was the fourth consecutive decline. The recession of the German economy ended in spring and a further solid rebound in the short term is foreseeable. Hence, the recent resilient labor market performance and especially the improvement in adjusted employment over the last four months could be interpreted as a turnaround also on the labor market. We, however, do not think this is the case. The official unemployment figures are still dampened due to statistical changes. Already since May, unemployed undergoing job training measures arranged by private job agencies are being continuously purged from official data. Without this effect, the number of adjusted unemployment would have declined by 20,000 in October and even risen in the preceding months. All in all, the measure dampened the rise in unemployment by a total of more than 130,000 on a permanent basis. Furthermore, the high number of government-subsidized short-term employees strongly helps to mitigate the rise in unemployment. The level remains close to its peak level of around 1.4 million, translating into more than 400,000 full-time equivalents.

Public employment schemes and statistical changes so far helped to prevent a strong deterioration in the unemployment figures and even improved the situation compared to the first half of 2009, when companies terminated temporary work contracts on a large scale. In any case, still very low capacity utilization rates in industry and the subsequent "explosion" in unit labor costs are exerting high pressure on firms to eventually reduce their workforce. We stick to our forecast that we will still see a substantial acceleration in unemployment from the end of this year well into 2010, lifting unemployment from the current adjusted 3.427 million towards 4¼ million.

In the light of the adverse outlook for the labor market and public finances, the limited tax breaks included in the final coalition agreement of the new government should not be enough to bring back consumer sentiment on a sustained upward trend in the months to come. In contrast, hard retail sales data pointed already south lately. Driven by a setback in car sales, private consumption should have declined in 3Q09. But also other retail categories showed a weak performance and the business situation in the retail sector was rated significantly weaker in October, according to the Ifo business survey. Retail sales were down a marked 0.8% qoq in the third quarter.

Alexander Koch, CFA (HVB)
+49 89 378-13013
alexander.koch1@unicreditgroup.de

UNEMPLOYMENT IN MILLION



Source: Bundesagentur fuer Arbeit, UniCredit Research

US Review

US came out of the “Great Recession”

The US economy has emerged with gusto from the deepest recession since WW II. According to the BEA’s advance estimate, real GDP rose a solid 3.5% qoq after declining in the previous four quarters. Private consumption expenditures increased 3.4% and added 2.4 pp to growth. Private inventories added another 0.9 pp, as the pace of inventory liquidation slowed down, and residential investment surged by 23.4% (added 0.5 pp) after declining for quarters. Government consumption rose 2.3% as a 7.9% increase in federal spending more than offset a 1.1% decline in expenditures of state & local governments. It is worth mentioning that 75% of the increase in federal expenditures was for national defense! Business fixed investment, in contrast, remained lackluster. The largest problem here is commercial real estate, where activity fell another 9%. Net exports subtracted 0.5 pp from growth even as exports rose by 14.7%. Backdrop is that imports rebounded even more (+16.4%), partly due to higher car imports. The car sector as a whole, i.e. sales, net exports and inventories, added 1.6 pp to growth in 3Q.

Consumer confidence slips on job market frustration

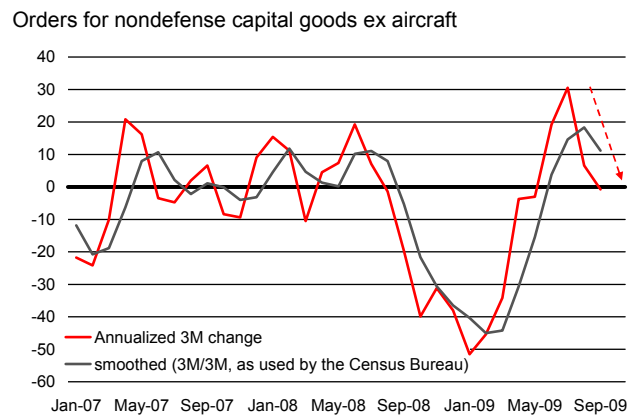
The Conference Board’s consumer confidence indicator unexpectedly fell in October to 47.7 from an upwardly revised 53.4. The assessment of the current situation deteriorated to 20.7, which is not only a cyclical low, but the worst reading since early 1983. The mood is, therefore, worse than during the peak of the recent recession when real GDP fell by about a 6% annual rate, and the stock market was some 30% to 40% lower than it is today. Backdrop is the growing frustration of US households about the current labor market situation. Only 3.4% of respondents said that “jobs are plentiful”, while 49.6% said, “jobs are hard to get”. Accordingly, the spread between the two series, the so-called “labor differential”, fell to the lowest level since the early 80s. Consumer expectations also decreased to 65.7 from 73.7. But they at least remain perceptibly above the all-time low of 27.3 points, reached in February.

Increase in orders loses momentum

Orders for durable goods rose 1.0%, following a downwardly revised 2.6% decline in August. Defense orders surged 10.0%, while orders for civilian aircraft (-2.1%) and cars (-0.1%) moderated. Orders in the core group of nondefense capital goods ex aircraft increased by 2.0%, after decreasing in the previous two months. The annualized 3M change, however, fell to -0.7%, after peaking at +30½% only two months ago (cf. chart). The monthly increase was mostly due to a 7.9% increase in machinery. Shipments of nondefense capital

goods, which directly enter the GDP calculation either as investment in equipment & software or as exports, rose 2.2% in September. But in 3Q as a whole, they were 0.2% (annualized) below the 2Q average. As exports rebounded solidly in the third quarter, this might indicate that business investment declined once again.

REBOUND ALREADY OVER AGAIN?



Source: Census Bureau, Thomson Datastream, UniCredit Research

House prices rose again

The S&P/Case Shiller national home price index for 20 metropolitan areas rose another 1.2% mom in August. As a result of the fourth straight monthly increase, the yoy rate improved to -11.3%, which is the smallest decline since January 2008. When interpreting the recent move, one must not forget, however, that the Case Shiller index is not seasonally adjusted. Therefore, prices in spring and summer tend to be higher due to firmer demand. More fundamentally, the downward pressure on home prices is weakening as: (i) house prices have corrected already noticeably in recent months, and (ii) the excess supply of homes is declining. The inventory-to-sales ratio dropped to (a still high) 8 months from a record high of 11 months in late 2008. While a large part the transactions are still reflecting sales of distressed properties, demand for other (non-distressed) homes has started to pick up as well, as more and more buyers are taking advantage of falling prices, low mortgage rates and tax-incentives for first-time buyers. Looking forward, we think that house prices might decline again in the winter months. Those decreases, however, should not be larger than the increases of prior months, which means that the US housing market has indeed found a bottom.

Dr. Harm Bandholz, CFA (HVB)
+1 212 672 5957
harm.bandholz@us.unicreditgroup.eu

Fixed Income Outlook

Under the sway of the central banks

There can be little doubt that the coming week will be dominated by the central bank meetings of the Fed (4 November), ECB and BoE (both 5 November). The most fascinating will be the FOMC meeting of the Federal Reserve, after an article in the Financial Times on Friday of last week speculated on a change in the wording of the Fed's written risk assessment. However, this does not reflect the consensus view. As the following table shows, there has been no change in expectations relating to the timing of the first Fed rate hike based on the Fed fund futures. A probability of over 50% for a key rate hike is still only priced in for 28 April 2010, and this probability has decreased marginally compared to the previous week and month.

PROBABILITY OF US KEY RATE HIKES BASED ON THE FED FUND FUTURES

FOMC meeting on	Current	1 week ago	1 month ago
16 March 2010			
No change	43.6	45.2	41.2
Cut to 0.0	17.9	16.3	11.6
Hike to 0.5	30.7	31.1	36.9
Hike to 0.75	7.4	7.4	10.3
28 April 2010			
No change	32.0	31.5	21.9
Cut to 0.0	9.8	8.6	4.0
Hike to 0.5	36.5	37.6	39.7
Hike to 0.75	17.9	18.5	27.6

Source: Bloomberg, UniCredit Research

Even then, we see only a small risk of a serious rhetorical shift. Without inflationary pressure (be it in the actual data or based on surveys and/or financial market data) and given the still lingering doubts about the sustainability of an economic recovery, the FOMC will probably retain the core statement "... *exceptionally low levels of the federal funds rate for an extended period*". But even an only marginal softening of the wording would probably not present a serious problem for the bond market. A strong upturn in yields should only be expected once there is a crystal-clear statement on imminent key rate hikes. That is at least the experience from the past. The last extreme low-rate phase in the US between mid-2003 and 2004 does, however, give us a general idea of the interaction of changes in the FOMC statement and the feedback from the yield curve.

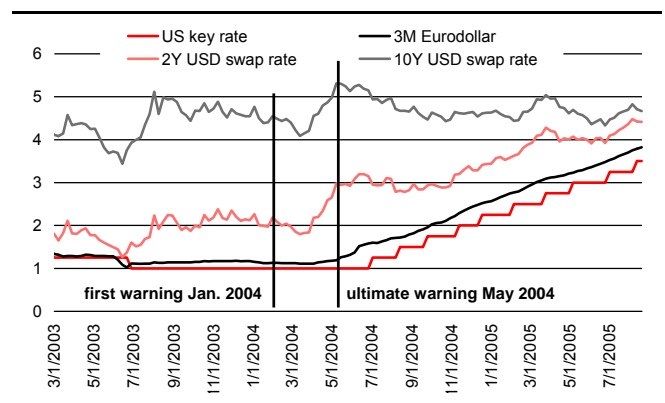
FOMC RHETORIC AND US RATES IN THE 2003/2004 CYCLE

FOMC Meeting	Action	Statement	3M USD	2Y USD Swap	10Y USD Swap
25.07.03	Cut to 1%		1.00	1.33	3.62
12.08.03		... policy accommodation can be maintained for a considerable period.	1.14	2.08	4.83
16.09.03		dto.	1.14	1.92	4.73
28.10.03		dto.	1.17	2.23	4.71
09.12.03		dto.	1.17	2.23	4.62
28.1.04		... patient in removing its policy accommodation.	1.12	1.97	4.42
16.03.04		dto.	1.11	1.87	4.16
04.05.04		... policy accommodation can be removed at a pace that is likely to be measured.	1.18	2.65	5.00
30.06.04	Hike to 1.25%		1.61	3.19	5.11

Source: Bloomberg, UniCredit Research

The rhetorical tactic at the time corresponded to a 2-1-GO pattern. 2-1-GO means: 2 statements, in which there was talk of the coming key rate normalization ("*... removing its policy accommodation*") were followed by a further statement that clearly announced an initial key rate hike at the next meeting ("*...can be removed ...*"). There were, therefore, 2 meetings with a slight warning and one meeting with a yellow alert before rates were actually raised. The lowest swap rates were already reached at the time of the last key rate cut; pressure emerged thereafter, but eased again rapidly in the subsequent period. It only got down to the nitty-gritty immediately before the yellow alert (cf. chart).

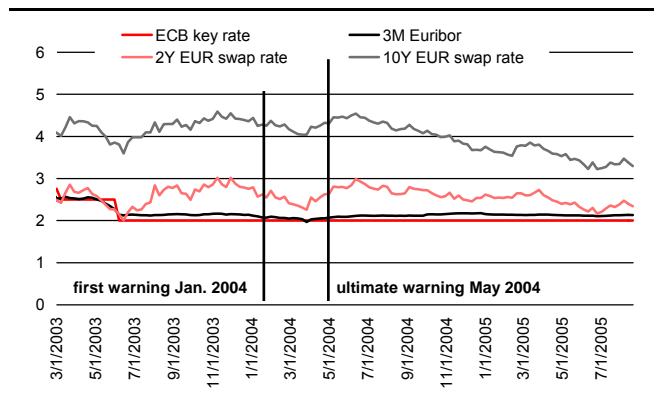
US INTEREST RATE ENVIRONMENT BETWEEN 2003 AND 2005



Source: Bloomberg, UniCredit Research

Ironically, the tightening cycle at the time triggered a pronounced twist in the curve. Money market rates and the short end continued to rise, but the long end headed slightly lower, driven by questions about the sustainability of the economic recovery and the very measured pace of the key rate normalization, which never exceeded 25bp per meeting. The development in the euro zone was extensively parallel initially. The lowest yield levels were reached initially with the last ECB rate cut, which was made almost at the time of the last US key rate cut. Thereafter, there was a moderate upturn in yields, and the highest rhetorical warning stage in US monetary policy again triggered a tightening of EUR rates, although – contrary to the US – there were no new highs. It was only once the US tightening cycle got under way that there was a clear decoupling from the US with new yield lows at the long end, not least because of the huge lag of the ECB tightening cycle, which only started in December 2005, i.e. roughly 1 ½ years later than in the US.

EURO ZONE INTEREST RATE ENVIRONMENT BETWEEN 2003 AND 2005



Source: Bloomberg, UniCredit Research

The developments in the current cycle are largely identical to the experiences at that time (see table). Long-dated US yields hit their low at the time of the last key rate cut. Subsequently, there was a pronounced coincident upturn in yields, which transitioned into a sideways move. Unlike in 2003/2004, only short-term rates have declined steadily this time because of the infinite creativity of central banks. If we take the development in 2003/2004 as our script, the next 12 months will look as follows: The first US key rate hike should, in our view, be expected on 10 August 2010. Accordingly, the 16 March and 28 April statements will probably mention a "removal" of the ultra-accommodative monetary policy. Push should only come to verbal shove on 23 June 2010, and even at this time a clearer trend towards higher yields should be expected. The movements are not linear or extensively gradual but follow – at least according to the script – a sort of jump diffusion process as already in 2004.

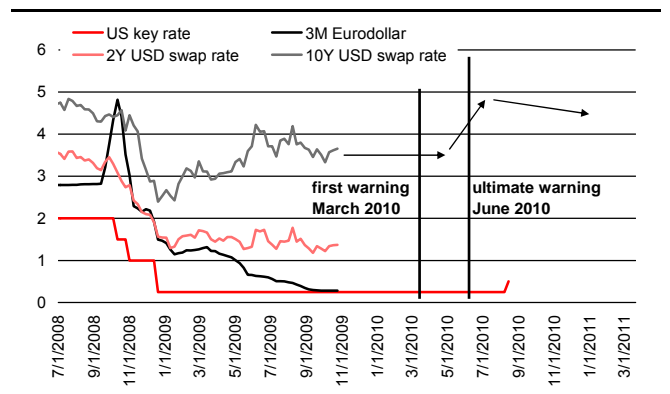
FOMC RHETORIC AND US RATES IN THE CURRENT CYCLE

FOMC Meeting	Action	Statement	3M USD	2Y USD Swap	10Y USD Swap
16.12.08	Reduction to 0-0.25%	... exceptionally low levels of the federal funds rate for some time.	1.85	1.82	2.73
28.1.09		dto.	1.17	1.46	2.77
18.3.09		... exceptionally low levels of the federal funds rate for an extended period.	1.29	1.60	3.16
29.4.09		dto.	1.03	1.49	3.14
24.6.09		dto.	0.60	1.60	3.92
12.8.09		dto.	0.45	1.59	3.99
Currently			0.28	1.29	3.60

Source: Bloomberg, UniCredit Research

Will there be a flattening of the US curve? Most definitely; the only question is whether it will take the pure form of a bear flattening or the form of a curve twist, as already in 2004/2005. There is probably no doubt that rates at the short end will rise steadily, while the long end will in contrast probably experience the strongest rise in 2Q10. With the beginning of the tightening cycle, yields at the long end will edge slightly higher again, but be very stable in 2011. From 2H10, the flattening in the US will, therefore, be characterized once again primarily by an increase at the short end.

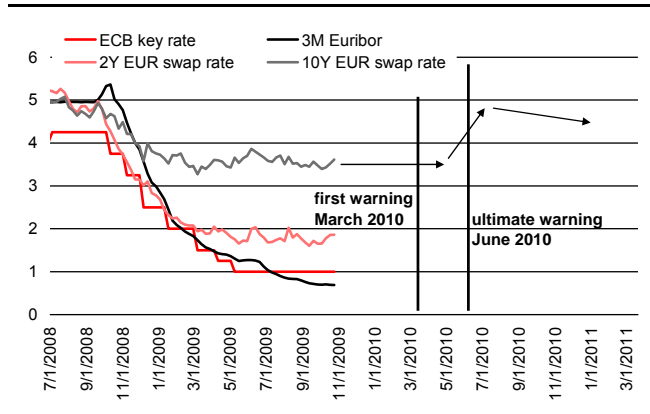
CURRENT US INTEREST RATE ENVIRONMENT



Source: Bloomberg, UniCredit Research

Are new yield lows possible again in the euro zone as in 2005, despite the US tightening cycle? This is highly unlikely. This time, we expect a substantially shorter time lag between the start of the EC and ECB tightening cycles. At most we would put it at 6 months and - also in contrast to 2004/2005 – we see no markedly different trends in the growth dynamic between both regions. The euro-zone yield curve will, therefore, probably also copy the jump diffusion process in the US in 2Q and 3Q 2010 in marginally weaker form. More pronounced flattening should, however, only emerge with a slight time lag, because the ECB will start tightening later.

CURRENT EURO ZONE INTEREST RATE ENVIRONMENT



Source: Bloomberg, UniCredit Research

Bottom Line: A striking rhetorical shift in the wording of the ECB and Fed is not an issue in the coming week. If the BoE – not least because of the disappointing economic contraction in 3Q09 of 0.4% qoq – were to announce an expansion of asset purchases, there is definitely still scope for slightly falling yields in the euro zone as well. 10Y EUR swap rates (currently 3.53%) will likely remain in the dominant range since the beginning of 2009 between roughly 3.2% and 3.9% into spring 2010; only thereafter will the level shift in the form of a jump-diffusion process to an almost 100bp higher level.

Michael Rottmann (HVB)
+49 89 378-15121
michael.rottman1@unicreditgroup.de

Forex Outlook

- The main event of this week was an abrupt shift in investor sentiment back towards risk aversion. The stronger US GDP data for 3Q09, released yesterday, were not enough to reverse investors' mood.
- Given that we do not expect surprises from the Fed and ECB meetings next week, only very strong NFP could imply a shift of market sentiment (not our central scenario). The EUR-USD should thus remain on a weak footing also next week.
- The BoE likely to upgrade the Asset Purchase Facility to GBP 225bn at next Thursday's meeting should lead to a weakening of sterling across the board.

Re-pricing of risk to weigh further

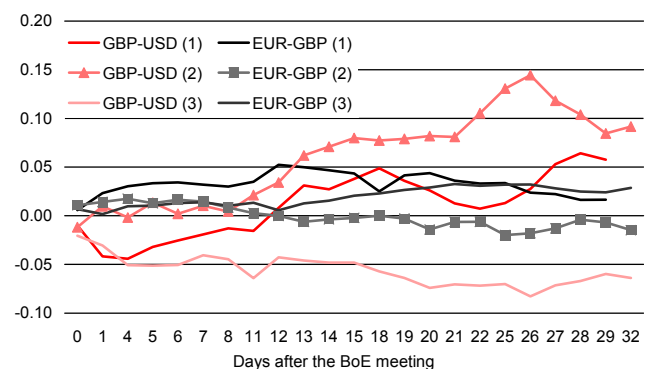
After a few weeks of optimism in the market, this week the abrupt shift in investor sentiment and the return of risk aversion came as a cold shower. Currencies in the G-10 world reacted within the traditional risk appetite/risk aversion framework observed over the past year, with the dollar trade-weighted index coming back to trade above the 76 threshold. Interestingly, the Norges Bank 25bp rate hike and the upward revision of the rate path last Wednesday were not enough to counter-balance the effect of the return of risk aversion, with the Norwegian krona remaining on a weak footing across the board. Here, one could argue that investors were disappointed by the Norges Bank declaration, "*should the krona appreciate considerably more than projected, the interest rate may be increased to a lesser extent or later than currently envisaged*". However, the similar performance of NOK and SEK as well as of commodity currencies (all weakening) suggest that swings in risk aversion/risk appetite are still the most important driver in the FX world. At this stage, market sentiment has clearly deteriorated, and the stronger US GDP for 3Q09 was not enough to reverse investors' mood.

Looking at the next week, the focus will be on central bank meetings (the Fed's FOMC is scheduled on Wednesday, the ECB and BoE are scheduled on Thursday), on the G-20 meeting in Scotland (starting on Friday) and on the labor market data in US. The Fed meeting should not bring any relevant surprise. After the last round of disappointing data, we expect the statement to reiterate once again, "rates will remain low for a prolonged period of time". No changes are expected as well from the ECB meeting and in the current scenario of EUR back on a weakening path, intervention against a too strong EUR is rather unlikely. Hence, at the end of the day, the wild card for a shift in market sentiment will likely be the US payroll data next Friday. Consensus expects an improvement to -167K from the previous -263K, with the unemployment rate rising to 9.9%. Our view is that we would

observe a shift in market sentiment only in the event of very strong NFP (i.e. well above -100K) implying a sharp rally of Wall Street and thus the Dow Jones back above 10,000. As this is not our central scenario, risk aversion should dominate investors' behavior also next week. With the US dollar likely to remain on a strong footing, EUR-USD should continue to suffer: the definite break of the 1.4670 support level could send it easily to the 1.45 area. Keep also an eye on the G-20 meeting, as this could be a great opportunity to issue a stronger statement on FX with a more explicit warning against EUR strength and the need for coordinated intervention. Our impression at present is that the sell-off seen on the EUR-USD this week could again lead to a relatively mild statement in which the G-20 countries will merely reiterate that disorderly moves on FX are unwelcome and that the US Administration considers the strong USD as being in the US favor. Such wording would clearly not alter the current picture in the FX world. Lastly, pay attention to sterling too. Despite the resurfacing of risk aversion and the dollar strength, cable managed to hold ground, probably due to the EUR weakness, which kept both EUR-USD and EUR-GBP under siege. In line with consensus, next week we expect the BoE to upgrade the APF by GBP 50bn to GBP 225bn. This should ultimately weaken sterling, as it is perceived as an easing monetary policy move. A useful exercise in this respect is to look at what happened to sterling each time the BoE has upgraded the APF over the past months. We distinguish three episodes:

- (1) March 5, when QE measures were first announced (GBP 75bn was the first tranche of measures),
- (2) May 7 with the first upgrade by GBP 50bn to GBP 125bn and
- (3) The last upgrade at the MPC meeting of August 6 by GBP 50bn to GBP 175bn.

STERLING REACTION TO EACH EPISODE OF APF UPGRADE



Source: Bloomberg, UniCredit Global Research

The chart above shows the movement over the month after the meeting in both cable and in EUR-GBP. As a starting point, we take the value of the two exchange rates on the day before the BoE meeting. While during the first two episodes sterling weakened only temporary and mainly vs. the EUR, during the last episode, sterling moved gradually on a weakening path both against the USD and the EUR over the following month (depreciating by 3.5% vs. USD and by 2.8% vs. EUR in one month). For the next meeting, we would take as a reference the movement observed during the last episode, as in the first two the sterling performance was more correlated with rising risk appetite, making it difficult to gauge the QE effects. Taking this into consideration, should the BoE increase the APF to GBP 225bn as expected, we see the case for cable to move gradually towards the 1.60 area and for EUR-GBP to 0.93 over the following weeks.

Chiara Cremonesi (HVB)
+44 207 8261771
chiara.cremonesi@unicreditgroup.eu

MIB View – Our Global Picture

Global economy

- The global recession has run its course. Real global GDP looks to have expanded again in the third quarter. It is, however, mostly a technical rebound that is already facing the threat of another setback in the first half of 2010 (though not a renewed recession), then followed by a slight upward trend (W shape). For the first time since World War II, global economic activity will, however, fall 1.1% on average for 2009, weighted for purchasing power parities. At market exchange rates, the decline is even twice as strong. For 2010, we expect real GDP to rise 2.9% on a PPP basis. That is, however, clearly below trend.
- GDP in industrialized countries will contract by 3.6% this year. All recessions of the 70s and 80s pale in comparison. The regions most strongly affected are Japan (-5.5%), followed by the euro zone (-4%) and the US (-2.4%). Next year, the industrialized countries will post only modest growth. China and Emerging Asia were the first to achieve the trend reversal. They will remain clearly at the top of the growth league also in 2010.

US

- The US economy exited the recession already in 3Q 2009. GDP should have been able to report pretty robust growth in the summer months of 3¾% (annual rate). But that is merely "borrowed" growth. We expect an expansion of "only" 1% for the first half of 2010. Support of private consumption is still missing for a self-sustaining upswing. The recovery will be W-shaped.
- After slashing the federal funds target rate by a total of a whopping 425 basis points (bp) to 1% in the wake of the housing recession and the deep financial market crisis, the Fed switched to a zero-rate interest policy in mid-December of last year. The Fed is now pursuing a Quantitative Easing Policy. Since the economic upswing should not be sustainable, the US central bank will likely adhere to its current ultra-expansionary monetary policy well into next year.

Euro zone

- The euro zone left the recession sooner than expected previously. Real GDP should have grown again in 3Q. There is, however, a striking dichotomy within the EMU. Germany and France already turned the corner, the rest is lagging behind. Similar to the US, the upswing is not likely to be sustainable. The initial V should soon become a W. On average for 2009, real GDP will nevertheless contract by a whopping 4%. And growth of 0.8% in 2010 is attributable partly to a statistical overhang.

- Since the beginning of October 2008, the ECB has lowered its key interest rate by a total of 325bp. At the same time, it extended the maturity of the refi transactions to up to 12 months. It is also buying covered bonds. Since the economic upswing shouldn't be sustainable, the ECB probably won't raise its key interest rate from currently 1% in 2010.

Government bond markets

- Beyond short-term consolidation periods (profit taking), declining risk aversion combined with improving macro-economic data and corporate news will see government bond yields trending upward again.
- Since the supply of government bonds will surge, US 10Y yields will reach the 4% level in spring 2010, and are expected to trend higher also thereafter. 10Y Bund yields should roughly mimic the pattern of their US counterparts, reaching 4% by summer next year.

Exchange rates

- After a temporary consolidation phase, EUR-USD should strengthen again and, over the medium term, advance to 1.55. The upward primary trend is – analogous to the W-shaped recovery of the global economy – subject to considerable fluctuations. We expect JPY to weaken steadily for the remainder of this year and in 2010.

OUR MACRO FORECASTS

in % yoy	2008	2009	2010
GDP EMU	0.6	-4.0	0.8
CPI EMU	3.3	0.3	1.3
GDP Germany	1.0	-4.7	2.0
CPI Germany	2.6	0.4	1.0
GDP Italy	-1.0	-5.1	0.4
CPI Italy	3.3	0.8	1.5
GDP US	0.4	-2.4	1.9
CPI US	3.8	-0.4	2.3

OUR FI/FX & OIL PRICE FORECASTS

	2009/10	31-Dec	31-Mar	30-Jun	30-Sept
EMU 3M (%)		0.80	0.90	1.05	1.20
EMU 10Y (%)		3.45	3.60	3.85	4.10
US 3M (%)		0.30	0.50	0.85	1.25
US 10Y (%)		3.70	3.85	4.10	4.40
EUR-USD		1.50	1.52	1.55	1.50
USD-JPY		95	98	100	103
Oil Price		65	70	70	75

Macro Forecasts

GDP, real (% , yoy)	2003	2004	2005	2006	2007	2008	2009f	2010f
World economy *	3.7	4.8	4.4	4.9	4.9	2.8	-1.1	2.9
Industrialized countries *	1.9	3.0	2.5	2.9	2.6	0.5	-3.6	1.4
US	2.5	3.6	3.1	2.7	2.1	0.4	-2.4	1.9
Euro area	0.8	1.9	1.8	3.0	2.7	0.6	-4.0	0.8
Germany **	-0.2	0.7	0.9	3.4	2.6	1.0	-4.7	2.0
France	1.1	2.2	1.9	2.4	2.3	0.3	-2.0	1.1
Italy	0.1	1.4	0.8	2.1	1.5	-1.0	-4.9	0.4
Spain	3.1	3.3	3.6	3.9	3.7	1.2	-3.5	-0.7
Austria	0.8	2.5	2.5	3.5	3.5	2.0	-3.8	1.1
UK	2.8	3.3	2.1	2.8	3.0	0.7	-4.4	1.1
Switzerland	-0.2	2.5	2.6	3.6	3.6	1.8	-1.2	1.4
Sweden	2.1	3.5	3.3	4.5	2.7	-0.4	-4.7	1.0
Japan	1.4	2.7	1.9	2.0	2.4	-0.7	-5.5	2.0
Developing countries *	6.6	7.6	7.4	8.2	8.6	6.2	2.7	5.4
Asia	8.2	8.6	9.0	9.8	10.6	7.6	6.2	7.3
China	10.0	10.1	10.4	11.6	13.0	9.0	8.5	9.0
India	6.9	7.9	9.1	9.7	9.3	7.3	5.4	6.4
Latin America	2.2	6.0	4.7	5.7	5.7	4.2	-2.5	2.9
Brazil	1.1	5.7	3.2	3.8	5.7	5.1	-1.5	3.5
Central and Eastern Europe	5.7	6.9	5.5	6.7	6.5	4.0	-5.7	1.3
Russia	7.3	7.2	6.4	7.7	8.1	5.6	-7.4	1.3

Consumer prices, CPI (% , yoy)	2003	2004	2005	2006	2007	2008	2009f	2010f
US	2.3	2.7	3.4	3.2	2.9	3.8	-0.4	2.3
core rate (ex food & energy)	1.5	1.8	2.2	2.5	2.3	2.3	1.7	0.8
Euro area, HICP	2.1	2.1	2.2	2.2	2.1	3.3	0.3	1.3
core rate (ex food & energy)	1.8	1.8	1.4	1.4	1.9	1.8	1.4	0.5
Germany	1.0	1.7	1.6	1.6	2.3	2.6	0.4	1.0
France	2.1	2.1	1.7	1.7	1.5	2.8	0.1	1.0
Italy	2.7	2.2	1.9	2.1	1.8	3.3	0.8	1.5
Spain	3.0	3.4	3.6	2.8	2.8	4.1	-0.1	1.6
Austria	1.3	2.1	2.3	1.5	2.2	3.2	0.4	1.2
UK	1.4	1.3	2.0	2.3	2.3	3.6	2.0	1.9
Switzerland	0.6	0.8	1.2	1.1	0.7	2.4	-0.5	1.1
Sweden	1.9	0.4	0.5	1.4	2.2	3.5	-0.2	0.6
Japan	-0.2	0.0	-0.3	0.2	0.1	1.4	-1.0	0.0

GDP, real (% , qoq)	III/08	IV/08	I/09	II/09	III/09p	IV/09p	I/10p	II/10p
US (annualized)	-2.7	-5.4	-6.4	-0.7	3.5	3.5	2.0	0.5
Euro area	-0.4	-1.8	-2.5	-0.2	0.4	0.2	0.1	0.2
Germany	-0.3	-2.4	-3.5	0.3	1.0	0.7	0.5	0.2
France	-0.2	-1.4	-1.3	0.3	0.6	0.3	0.2	0.2
Italy	-0.8	-2.1	-2.7	-0.5	0.6	0.0	0.1	0.1
Spain	-0.6	-1.1	-1.6	-1.1	-0.1	-0.1	-0.2	-0.2
Austria	-0.4	-1.0	-2.7	-0.5	0.3	0.5	0.2	0.3
UK	-0.7	-1.8	-2.5	-0.6	-0.4	0.3	0.2	0.4
Switzerland	-0.4	-0.6	-0.9	-0.3	0.6	0.5	0.4	0.2
Sweden	-1.0	-5.0	-0.9	0.2	0.0	0.3	0.3	0.3
Japan	-1.0	-3.5	-3.1	0.9	1.5	0.8	0.5	0.1

Consumer prices, CPI (% , yoy)	III/08	IV/08	I/09	II/09	III/09p	IV/09p	I/10p	II/10p
US	5.2	1.5	-0.2	-0.9	-1.6	1.1	2.1	2.5
core rate (ex food & energy)	2.5	2.0	1.7	1.8	1.5	1.6	1.3	0.8
Euro area, HICP	3.8	2.3	1.0	0.2	-0.4	0.4	1.0	1.1
core rate (ex food & energy)	1.8	1.9	1.6	1.6	1.3	1.0	0.8	0.6
Germany	2.9	2.9	3.1	1.7	0.8	0.2	-0.1	0.6
France	3.3	1.8	0.6	-0.2	-0.4	0.3	0.8	0.9
Italy	4.0	2.8	1.5	0.9	0.1	0.7	1.3	1.3
Spain	5.0	2.5	0.5	-0.7	-1.0	0.6	1.2	1.4
Austria	3.7	2.2	1.1	0.3	0.0	0.7	1.3	1.3
UK	4.8	3.9	3.0	2.1	1.5	1.6	2.3	1.9
Switzerland	3.0	1.6	0.0	-0.7	-0.9	-0.2	0.9	1.2
Sweden	4.3	2.4	0.7	-0.5	-1.2	0.0	0.0	0.3
Japan	2.2	1.1	-0.1	-1.1	-2.1	-1.5	-1.0	-0.7

Comments: * The GDP shares used for aggregation are based on the purchasing-power-parity (PPP) valuation of country GDPs
 GDP = Gross Domestic Product, HICP = Harmonized Index of Consumer Prices, CPI = Consumer Price Index, f = forecast

Interest & Exchange Rate Forecasts (I)

INTEREST RATE FORECASTS (% , END QUARTER)

2009/10	current	end-Q4	end-Q1	end-Q2	end-Q3
Eurozone bond market					
Refi rate	1.00	1.00	1.00	1.00	1.00
3M Euribor	0.72	0.80	0.90	1.05	1.20
2Y	1.34	1.30	1.45	1.90	2.40
5Y	2.48	2.43	2.58	2.93	3.25
10Y	3.29	3.45	3.60	3.85	4.10
30Y	4.04	4.15	4.30	4.45	4.60
10Y swap spread (in bp)	26	20	15	15	10
US Treasury Market					
Fed funds target rate	0.13	0.25	0.25	0.25	0.75
3M USD Libor	0.28	0.30	0.50	0.85	1.15
2Y	0.96	1.15	1.40	1.80	2.40
5Y	2.41	2.58	2.78	3.10	3.50
10Y	3.47	3.70	3.85	4.10	4.40
30Y	4.31	4.45	4.60	4.80	5.10
10Y swap spread (in bp)	17	20	10	10	10
Japan					
Target rate	0.10	0.10	0.10	0.10	0.10
3M JPY Libor	0.33	0.40	0.45	0.50	0.55
10Y JGB	1.42	1.40	1.50	1.60	1.80
United Kingdom					
Repo rate	0.50	0.50	0.50	0.50	0.50
3M GBP Libor	0.59	0.60	0.80	0.90	0.95
10Y Gilt	3.65	3.75	3.90	4.15	4.50
Switzerland					
3M CHF Libor mid target rate	0.25	0.25	0.25	0.25	0.50
3M CHF Libor	0.26	0.35	0.40	0.50	0.70
10Y Swissie	2.082	2.25	2.40	2.75	3.15

EXCHANGE RATE FORECASTS (END QUARTER)

	current	end-Q4	end-Q1	end-Q2	end-Q3
EUR-USD	1.4837	1.50	1.52	1.55	1.50
EUR-JPY	134.96	143	149	155	155
EUR-GBP	0.8954	0.89	0.85	0.85	0.83
EUR-CHF	1.5104	1.56	1.57	1.58	1.59
USD-JPY	90.97	95	98	100	103
GBP-USD	1.6569	1.68	1.79	1.83	1.81
USD-CHF	1.0180	1.04	1.03	1.02	1.06

COMMODITY PRICE FORECASTS

	current	end-Q4	end-Q1	end-Q2	end-Q3
Oil price (Brent, USD/b)	77.72	65	70	70	75
DJ commodity price index	270.39	275	290	290	310

Interest & Exchange Rate Forecasts (II)

INTEREST RATE FORECASTS (% , END QUARTER)

2009/10	current	end-Q4	end-Q1	end-Q2	end-Q3
Sweden					
Key rate	0.25	0.25	0.25	0.50	0.50
3M rate	0.48	0.60	0.75	0.95	1.00
10Y government bond yield	3.26	3.55	3.75	4.10	4.40
10Y spread to Bunds (in bp)	-3	10	15	25	30
Norway					
Key rate	1.50	1.50	1.75	2.00	2.25
3M rate	1.99	2.25	2.40	2.55	2.70
10Y government bond yield	4.08	4.30	4.55	4.85	5.15
10Y spread to Bunds (in bp)	79	85	95	100	105
Canada					
Key rate	0.25	0.25	0.25	0.25	0.25
3M rate	0.50	0.60	0.65	0.70	0.80
10Y government bond yield	3.50	3.40	3.60	4.00	4.30
10Y spread to Bunds (in bp)	21	-5	0	15	20
Australia					
Key rate	3.25	3.75	4.00	4.25	4.50
3M rate	3.91	4.15	4.40	4.80	5.00
10Y government bond yield	5.54	5.50	5.75	6.05	6.30
10Y spread to Bunds (in bp)	225	205	215	220	220
New Zealand					
Key rate	2.50	2.50	2.50	2.75	3.00
3M rate	3.03	2.80	2.95	3.25	3.50
10Y government bond yield	5.73	5.80	6.05	6.40	6.65
10Y spread to Bunds (in bp)	244	235	245	255	255

EXCHANGE RATE FORECASTS (END QUARTER)

	current	end-Q4	end-Q1	end-Q2	end-Q3
EUR-SEK	10.3751	9.95	9.80	9.60	9.50
EUR-NOK	8.3571	8.25	8.20	8.15	8.10
EUR-CAD	1.5807	1.58	1.55	1.53	1.52
EUR-AUD	1.6204	1.74	1.71	1.68	1.61
EUR-NZD	2.0273	2.11	2.05	2.01	1.88
USD-SEK	6.9924	6.63	6.45	6.19	6.33
USD-NOK	5.6330	5.50	5.39	5.26	5.40
USD-CAD	1.0654	1.05	1.02	0.99	1.01
AUD-USD	0.9155	0.86	0.89	0.92	0.93
NZD-USD	0.7318	0.71	0.74	0.77	0.80
EUR-USD	1.4837	1.50	1.52	1.55	1.50

Economic Event & Data Release Calendar

Date	Time (ECB)	Country	Indicator	Period	MIB est.	Consensus (Bloomberg)	Prev. period
30 October to 06 November 2009							
Fri, 30 Oct '09	14:45	US	Chicago Purchasing Managers Index	Oct		49	46.1
	15:00	US	University of Michigan consumer confidence	Nov		70	69.4
Mon, 02 Nov '09		UK	House price (HBOS, in % 3M yoy)	Oct		-4.8	-7.4
	8:30	SZ	Manufacturing PMI (index)	Oct		54.9	54.3
	8:45	IT	Manufacturing PMI (index)	Oct		48.8	47.6
	8:50	FR	Manufacturing PMI (index)	Nov		55.3	55.3
	8:55	GE	Manufacturing PMI (index)	Nov		51.1	51.1
	9:00	EMU	Manufacturing PMI (index)	Nov		50.7	50.7
	9:30	UK	Manufacturing PMI (index)	Oct	49.8	50.0	49.5
	15:00	US	Pending home sales (in % mom)	Sep		0.4	6.4
	15:00	US	Construction spending (in % mom)	Sep		-0.3	0.8
	15:00	US	ISM manufacturing (index)	Oct	53.0	53.0	52.6
	17:00	IT	New car registration (in % yoy)	Oct			6.77
	18:00	IT	Budget balance (EUR bn)	Oct			-11.8
	Tue, 03 Nov '09		US	Auto sales (in mn)	Oct		9.85
15:00		EC	ECB's Mersch and Weber Speak in Luxembourg				
15:00		US	New orders (in % mom)	Sep		1.0	-0.8
Wed, 04 Nov '09	8:45	IT	Services PMI (index)	Oct			48.5
	8:50	FR	Services PMI (index)	Nov		57.8	57.8
	8:55	GE	Services PMI (index)	Nov		50.9	50.9
	9:00	EMU	Composite PMI (index)	Nov		53	53
	9:00	EMU	Services PMI (index)	Nov		52.3	52.3
	9:30	UK	Services PMI (index)	Oct	55.5	55.2	55.3
	10:00	EMU	Producer price index, PPI (in % yoy)	Sep		-7.7	-7.5
	12:00	US	MBA mortgage applications	Oct 30			-12.3
	13:15	US	ADP employment index (change in thousands mom)	Oct		-190	-254
	15:00	US	ISM Non-manufacturing (index)	Oct	51.0	51.6	50.9
	19:15	US	Federal funds target rate (in %)	Oct 30	0.25	0.25	0.25
	Thu, 05 Nov '09	0:50	JN	BOJ to Release Board Meeting Minutes			
6:45		SZ	Consumer confidence (Nationwide, index)	Aug		-39	-42
8:15		SZ	Consumer price index (in % yoy)	Oct		-0.8	-0.9
9:30		UK	Industrial production (in % mom)	Sep	0.7	1.3	-2.5
10:00		EMU	Retail sales (volume, in % mom)	Sep		0.4	-0.2
12:00		UK	Bank of England repo rate (in %)	Oct 30	0.5	0.5	0.5
12:45		EMU	ECB refi rate (in %)	Oct 30	1.0	1.0	1.0
13:30		US	Unit labor costs (in % qoq annualized)	Q3	-4.0	-3.8	-5.9
13:30		US	Non-farm productivity (in % qoq annualized)	Q3	6.2	6.0	6.6
13:30		US	Initial jobless claims (in thousands)	Oct 31	520	520	530
14:30		EC	Trichet Speaks at ECB Monthly News Conference				
Fri, 06 Nov '09		UK	G20 Finance Ministers, Central Bankers Meet in Scotland				
	6:45	SZ	Unemployment rate (in %)	Oct		4.2	4.1
	7:45	FR	Budget balance (EUR bn)	Sep			-127.6
	7:45	FR	Trade balance (EUR bn)	Sep		-3000	-3411
	9:30	UK	Producer price index, manuf. products (in % mom)	Oct		0.4	0.5
	11:00	GE	Industrial orders (in % mom)	Sep	-0.5	1.0	1.4
	13:30	US	Average weekly hours	Oct		33.1	33
	13:30	US	Average hourly earnings (in % mom)	Oct		0.1	0.1
	13:30	US	Unemployment rate (in %)	Oct	10.1	9.9	9.8
	13:30	US	Non-farm payrolls (change in thousands mom)	Oct	-190	-175	-263
	20:00	US	Consumer credit (USD bn)	Sep		-10	-12

*: Asterisked releases are scheduled on or after the date shown; sa = seasonal adjusted, nsa = not seasonally adjusted, wda = working day adjusted

Economic Event & Data Release Calendar – The week after

Date	Time (ECB)	Country	Indicator	Period	MIB est.	Consensus (Bloomberg)	Prev. period
9 November to 13 November 2009							
Mon, 09 Nov '09	7:00	GE	Exports (in % mom)	Sep			-2.8
	7:00	GE	Imports (in % mom)	Sep			0.5
	8:00	GE	Germany Marks 20th Anniversary of the Fall of the Berlin Wall				
	9:30	GE	Sentix growth expectations	Nov			-12.5652
	11:00	GE	Industrial production (in % mom)	Sep			1.7
	11:00	GE	Industrial production (in % yoy)	Sep			-16.8
Tue, 10 Nov '09		UK	House price (RICS, balance)	Oct			22
	7:00	GE	Harmonized CPI (in % yoy)	Nov			0
	7:00	GE	Consumer price index, CPI (national, in % yoy)	Nov			0
	7:45	FR	Industrial production (in % mom)	Sep			1.8
	9:00	IT	Industrial production (in % mom)	Sep			7
	9:30	UK	Trade balance (EUR bn)	Sep			-2318
	10:00	GE	ZEW survey - current situation (index)	Nov			-72.2
	10:00	GE	ZEW survey - expectations (index)	Nov			56
Wed, 11 Nov '09	9:30	UK	Average earnings (in % yoy, 3M moving average)	Sep			1.6
	9:30	UK	Jobless claims (change in thousands)	Oct			20.8
	9:30	UK	Unemployment rate (in %)	Oct			20.8
	11:30	UK	Bank of England Releases Quarterly Inflation Report				
Thu, 12 Nov '09	7:45	FR	Current account balance (EUR bn)	Sep			-3.7
	10:00	EMU	Industrial production (in % yoy)	Sep			-15.2
	19:00	US	Federal budget (USD bn)	Oct			-46.605
	20:00	EC	ECB's Trichet Speaking in Frankfurt				
Fri, 13 Nov '09	4:30	JP	Industrial production (in % yoy)	Oct			-18.9
	5:00	JP	Consumer confidence (Nationwide, index)	Oct			40.7
	7:00	GE	Real GDP (in % yoy)	Q3			-5.9
	7:00	GE	Real GDP (in % qoq)	Q3			0.3
	7:45	FR	Non-farm payrolls (in % qoq)	Q3			-0.7
	7:50	FR	Real GDP (in % yoy)	Q3			-2.8
	7:50	FR	Real GDP (in % qoq)	Q3			0.3
	9:00	IT	Real GDP (in % yoy)	Q3			-6
	9:00	IT	Real GDP (in % qoq)	Q3			-0.5
	10:00	EMU	Core CPI (in % yoy)	Oct			1.2
	10:00	EMU	Consumer price index, CPI (in % yoy)	Oct			-0.3
	10:00	EMU	Real GDP (in % yoy)	Q3			-4.8
	10:00	EMU	Real GDP (in %qoq)	Q3			-0.2
	13:30	US	Import prices (in % mom)	Oct	-0.5		0.1
	13:30	US	Trade balance (USD bn)	Sep	-31.0		-30.71
	17:30	US	Fed's Evans, Noyer to Speak On Asset-Price Bubbles in Paris				

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k) Bank Pekao, ul. Grzybowska 53/57, PL-00-950 Warsaw, Poland

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UniCredit Research*

Thorsten Weinelt, CFA
Global Head of Research & Chief Strategist
+49 89 378-15110
thorsten.weinelt@unicreditgroup.de

Dr. Ingo Heimig
Head of Research Operations
+49 89 378-13952
ingo.heimig@unicreditgroup.de

Economics & FI/FX Research

Marco Annunziata, Ph.D., Chief Economist
+44 20 7826-1770
marco.annunziata@unicreditgroup.eu

Economics & Commodity Research

Global Economics

Dr. Davide Stroppa, Global Economist
+39 02 8862-2890
davide.stroppa@unicreditgroup.de

European Economics

Dr. Aurelio Maccario, Chief Eurozone Economist
+39 02 8862-8222
aurelio.maccario@unicreditgroup.de

Andreas Rees, Chief German Economist
+49 89 378-12576
andreas.rees@unicreditgroup.de

Marco Valli, Chief Italian Economist
+39 02 8862-8688
marco.valli@unicreditgroup.de

Stefan Bruckbauer, Chief Austrian Economist
+43 50505 41951
stefan.bruckbauer@unicreditgroup.at

Tullia Bucco
+39 02 8862-2079
tullia.bucco@unicreditgroup.de

Chiara Corsa
+39 02 8862-2209
chiara.corsa@unicreditgroup.de

Dr. Loredana Federico
+39 02 8862-3180
loredana.federico@unicreditgroup.eu

Alexander Koch, CFA
+49 89 378-13013
alexander.koch1@unicreditgroup.de

Chiara Silvestre
chiara.silvestre@unicreditgroup.de

US Economics

Dr. Harm Bandholz, CFA
+1 212 672 5957
harm.bandholz@us.unicreditgroup.eu

Commodity Research

Jochen Hitzfeld
+49 89 378-18709
jochen.hitzfeld@unicreditgroup.de

Nikolaus Keis
+49 89 378-12560
nikolaus.keis@unicreditgroup.de

EEMEA Economics & FI/FX Strategy

Cevdet Akcay, Ph.D., Chief Economist, Turkey
+90 212 319-8430, cevdet.akcay@yapikredi.com.tr

Dmitry Gourov, Economist, EEMEA
+43 50505 823-64, dmitry.gourov@caib.unicreditgroup.eu

Hans Holz hacker, Chief Economist, Kazakhstan
+7 727 244-1463, h.holz hacker@atfbank.kz

Anna Kopetz, Economist, Baltics
+43 50505 823-64, anna.kopetz@caib.unicreditgroup.eu

Marcin Mrowiec, Chief Economist, Poland
+48 22 656-0678, marcin.mrowiec@pekao.com.pl

Vladimir Osakovsky, Ph.D., Head of Strategy and Research, Russia
+7 495 258-7258 ext.7558, vladimir.osakovskiy@unicreditgroup.ru

Rozália Pál, Ph.D., Chief Economist, Romania
+40 21 203-2376, rozalia.pal@unicredit.ro

Kristofor Pavlov, Chief Economist, Bulgaria
+359 2 9269-390, kristofor.pavlov@unicreditgroup.bg

Goran Šaravanja, Chief Economist, Croatia
+385 1 6006-678, goran.saravanja@unicreditgroup.zaba.hr

Pavel Sobisek, Chief Economist, Czech Republic
+420 2 211-12504, pavel.sobisek@unicreditgroup.cz

Gyula Toth, Economist/Strategist, EEMEA
+43 50505 823-62, gyula.toth@caib.unicreditgroup.eu

Jan Toth, Chief Economist, Slovakia
+421 2 4950-2267, jan.toth@unicreditgroup.sk

Global FI/FX Strategy

Michael Rottmann, Head
+49 89 378-15121, michael.rottman1@unicreditgroup.de

Dr. Luca Cazzulani, Deputy Head, FI Strategy
+39 02 8862-0640, luca.cazzulani@unicreditgroup.de

Chiara Cremonesi, FI Strategy
+44 20 7826-1771, chiara.cremonesi@unicreditgroup.eu

Dr. Stephan Maier, FX Strategy
+39 02 8862-8604, stephan.maier@unicreditgroup.eu

Giuseppe Maraffino, FI Strategy
+39 02 8862-2027, giuseppe.maraffino@unicreditgroup.de

Armin Mekelburg, FX Strategy
+49 89 378-14307, armin.mekelburg@unicreditgroup.de

Roberto Mialich, FX Strategy
+39 02 8862-0658, roberto.mialich@unicreditgroup.de

Kornelius Purps, FI Strategy
+49 89 378-12753, kornelius.purps@unicreditgroup.de

Herbert Stocker, Technical Analysis
+49 89 378-14305, herbert.stocker@unicreditgroup.de

Publication Address

UniCredit Markets & Investment Banking
Bayerische Hypo- und Vereinsbank AG
UniCredit Research
Arabellastrasse 12, D-81925 Munich
Tel. +49 89 378-12559
Fax +49 89 378-13024

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UCGR

Internet
www.globalresearch.unicreditmb.eu

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