UniCredit
Markets & Investment Banking

June 26, 2009

Economics & FI/FX Research

Friday Notes

Ballooning government debt

- **Stabilization.** Even though the "green shoot" euphoria has been replaced by a greater sense of reality recently, the worst is nonetheless behind us, and the global economy should stabilize in the second half of the year – thanks primarily to the billions in economic stimuli programs.

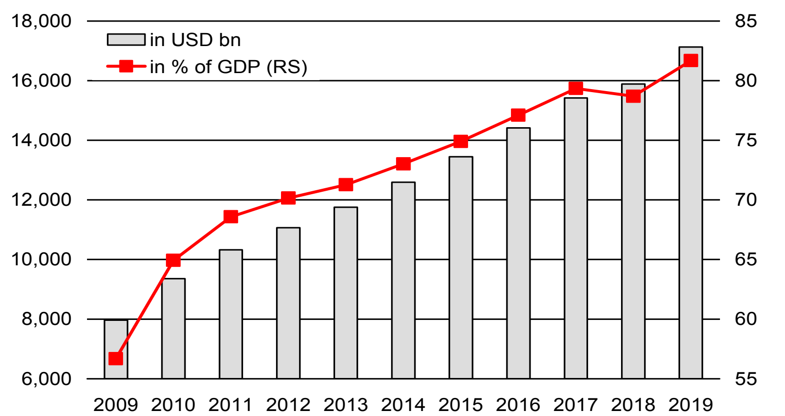
- **Debt.** The flip side of this is ballooning government borrowing. The US budget deficit will probably rise to 13% of GDP this year and also remain in double digits in 2010. The dimensions may be smaller in the eurozone, but here too deficit ratios of 5% and more are unavoidable. In addition, the prospects of a pronounced improvement here any time soon are lower (pages 3-6, 7-10 & 11-12).

- **Risks.** Even in case of a quick return to trend growth, debt ratios would continue to rise. Without sustained consolidation efforts, there is the definite threat of running into a debt trap longer term. The Maastricht norm will be obsolete for years to come. Even if the primary balance in Germany were to be 2 percentage points higher than in our base case, it would take 20 years before the debt ratio falls below 60% again.

- **Market reactions.** It is, however, not only future generations that will be saddled with the burdens. There is already the threat of tangible market reactions in the shorter term. Ballooning budget deficits drive up inflation expectations, resulting in increasing government bond yields. Furthermore, investors – in the case of the US primarily foreign investors – will presumably not accept a meager yield for much longer. High or rising twin deficits are, moreover, poison for the USD on a longer-term horizon.

- **Further topics:**
  - **Weekly Comment:** The OECD versus the ECB (page 2).
  - **US:** Business investment restraint will retard recovery (page 13).
  - **Data outlook:** EMU-wide economic climate to improve slowly; more layoffs in the US again (page 15).
  - **Market outlook:** Yield curve to steepen; EUR-USD at 1.40 (p. 23).

PUBLIC-SECTOR DEBT IN THE US RISES AND RISES AND...



Source: Congressional Budget Office, UniCredit Research

Contents

MIB MACRO FORECASTS

in % y-o-y	2008	2009	2010
GDP EMU	0.6	-4.5	0.1
CPI EMU	3.3	0.3	1.3
GDP Germany	1.0	-6.2	0.4
CPI Germany	2.6	0.3	1.1
GDP Italy	-1.0	-5.2	-0.3
CPI Italy	3.3	0.8	1.5
GDP US	1.1	-2.6	1.3
CPI US	3.8	-0.8	2.1

MIB FI/FX FORECASTS

2009/10	30-Sept	31-Dec	31-Mar	30-Jun
EMU 3M (%)	1.25	1.25	1.25	1.35
EMU 10Y (%)	3.40	3.50	3.75	4.00
US 3M (%)	0.60	0.60	0.60	0.65
US 10Y (%)	3.60	3.75	4.00	4.30
EUR-USD	1.35	1.45	1.50	1.52
USD-JPY	98	102	105	110
Oil Price	70	65	70	70

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

Editorial deadline
Friday, 26. Jun., 12:00H

Bloomberg
UCGR

Internet
www.globalresearch.unicreditmib.eu

The OECD versus the ECB

The major central banks continue to handle a very difficult and uncertain economic environment, under the constant scrutiny and criticism of investors, politicians, and other policy institutions. This Wednesday, the OECD today called on the ECB to cut interest rates further. The new OECD forecasts still see the eurozone as an underperformer, with a contraction in real GDP of nearly 5% this year followed by stagnation next year (cf. table), signaling the need for the ECB to exhaust the remaining scope for interest rate cuts sooner rather than later. The OECD's macro analysis is right on the mark, and confirms that the eurozone will need sustained policy stimulus for quite a while still – it is way too early to implement an exit strategy. The pressure on the ECB to cut rates further, however, is perhaps a bit ungenerous.

A WEAK RECOVERY FROM WIDESPREAD RECESSION

OECD forecasts; OECD area, unless noted otherwise

	2007	2008	2009	2010
Real GDP growth (%)	2.7	0.8	-4.1	0.7
US	2.0	1.1	-2.8	0.9
Eurozone	2.6	0.5	-4.8	0
Japan	2.3	-0.7	-6.8	0.7
Inflation (%)	2.3	3.2	0.6	0.8
Fiscal balance (% GDP)	-1.4	-3.2	-7.7	-8.8
Memorandum items:				
World trade (%, real)	7.1	2.5	-16.0	2.1
Global growth (%)	4.5	2.4	-2.2	2.3

Source: OECD Economic Outlook, June 2009

On Wednesday, the first ECB 12-month refinancing operation was a success: While there was a wide range of expectations on the likely take-up, the EUR 442 bn allocation represents a substantial amount, and confirms that this new 1-year refinancing is an important addition to the ECB's arsenal. The ECB remains focused on the need to ensure sufficient and reliable longer-term funding to the banking sector, and both the longer maturity refinancing operations and the covered bonds purchase program go in this direction. While I would also have favored a more transparent zero interest rate policy, there is no doubt that these quantitative measures are very well targeted and should prove effective in averting the risk of a credit crunch. The launch of the ECB's 1-year refinancing operations should allow for some more narrowing of eurozone money market spreads, whereas EUR-USD remains rangebound. Credit will play a pivotal role in the coming months: The banking sector will come under pressure because of the rise in NPLs (non-performing loans), and a tightening of credit supply just as the real economy attempts to stabilize would be extremely damaging. The ECB appears to be well aware of this and is reacting appropriately. Meanwhile, the OECD forecasts confirm that key emerging markets will display the fastest and strongest exit from the recession, followed by the US – in fact, the somewhat brighter prospects for the US are the main reason for the improvement in the OECD's forecasts. The OECD also calls on some countries to provide further fiscal stimulus, and identifies Germany as one of the countries that should do more, in sharp contrast to the German government's emphasis on the need for consolidation.

Next week, the ECB will once again be under the spotlight. It will almost certainly keep its policy unchanged, holding the Refi rate at 1.0% and refusing to commit to any increase in the covered bonds asset program. In so doing, the ECB will continue to expose itself to the criticism that since it is willfully aiming to undershoot its inflation target, given that its own staff forecasts point to HICP at just 1.0% next year. However, the ECB will not be ready to provide further stimulus just as the data start to indicate a stabilization of economic activity – especially as its new, longer term liquidity provisions promise to support credit supply. Meanwhile the Fed stays the course, with no major changes in the FOMC statement released this week. In particular, the statement still includes the key sentence "…economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period", and re-affirms the existing targets for asset purchases. Nearly two months after the previous statement, the Fed shows no great enthusiasm for the additional signs of stabilization: The assessment of economic activity is largely unchanged, with activity likely to remain weak for some time – although the Fed reiterates its confidence that policy action and market forces will successfully restore growth, eventually. The FOMC statement scales down the risk of deflation or persistently low inflation: the Fed now believes that "inflation will remain subdued for some time", whereas in April it saw "…some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term." On this note, the statement acknowledges the recent rise in commodity prices, but remains confident that this will be offset by "substantial resource slack".

So the statement is imperceptibly more hawkish, but overall confirms that the Fed is in no hurry at all to launch an exit strategy, and we would expect markets to push further back expectations of rate hikes, as we have already seen in the past days. As discussed last week, we are set for a prolonged wait-and-see period, with the Fed on hold and the markets nervously watching.

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

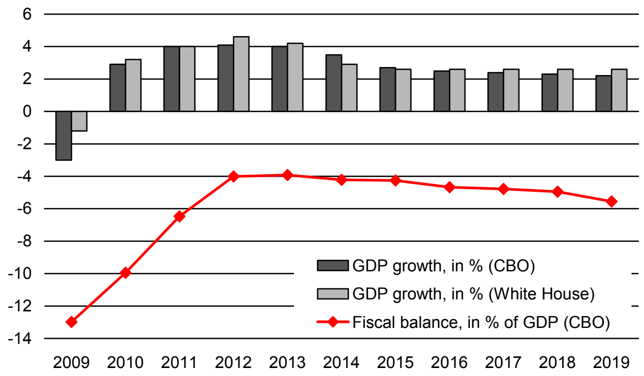
US budget deficits will continue to be funded by foreign investors

- According to estimates released by the independent Congressional Budget Office, the US budget deficit will be 13% of GDP in the current fiscal year and 10% in the following. By 2019, the federal debt will likely increase to 82% of GDP.
- The funding of this deficit will continue to be assumed primarily by foreign investors. The interim surge in domestic interest in Treasuries is, in contrast, not sustainable.
- With the debt position increasing, investors will demand higher interest rates. The US administration expects a pronounced bear flattening of the yield curve. To lock in the currently low interest rates, the administration has recently begun to issue more longer-dated Treasuries.
- Because of the mutual dependence between the US and its creditors, the so-called Bretton Woods II System will continue to function in the future. The negotiating position of creditor countries such as China or the oil exporters has, however, improved substantially.

US federal debt rises and rises and...

Last week, the independent Congressional Budget Office (CBO) released its revised projections of the US budget deficit for the years 2009 through 2019. Factoring in the stimulus and reform programs proposed by President Obama, the CBO expects a deficit of USD 1.8 trillion (or 13.0% of GDP!) for the current fiscal year, followed by USD 1.4 trillion (9.9% of GDP) in 2010. For the following nine years (2011-2019), the CBO is projecting an average deficit of no less than 4¾% of GDP (cf. chart in the next column). The disconcerting aspect here is that these projections are based on extremely solid GDP numbers. For the entire period from 2011 to 2019, the CBO expects average GDP growth of more than 3%. Between 2011 and 2013, annual growth is even expected to exceed 4%. This optimistic economic outlook is roughly in line with the assumptions of the US administration; in some cases, the responsible Office of Management and Budget (OMB) assumed even higher economic growth rates when it released its 2010 budget draft in May. (How fast would the economy then have to grow for the US administration to achieve a balanced budget or even a budget surplus ... ?!)

HIGH DEFICIT DESPITE STRONG ECONOMY!

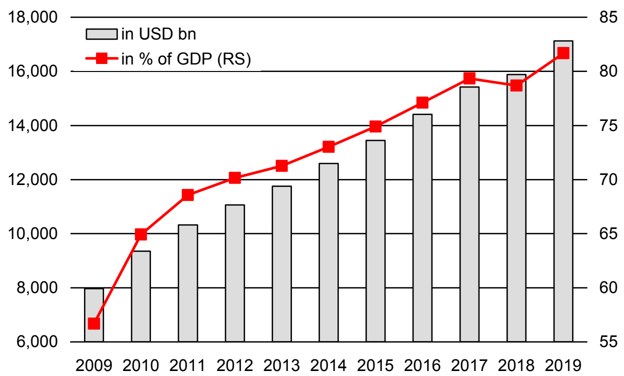


Source: CBO, OMB, UniCredit Research

Because of these persisting deficits, the CBO expects the federal debt to more than double in the next ten years (from close to USD 8 trillion in 2009 to over USD 17 trillion in 2019). As a percentage of GDP, it would increase from 57% to 82% (cf. chart). How will this additional debt be funded?

DEBT DOUBLES

Federal debt (CBO projection)



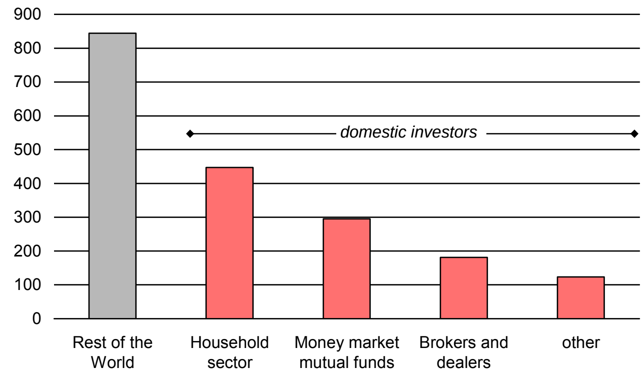
Source: CBO, UniCredit Research

Interest of domestic investors not sustainable

After foreign investors had purchased basically all newly-issued Treasuries between 1995 and 2008, the leaf turned amid the financial market crisis. According to the Federal Reserve, domestic investors purchased slightly more than half (55%) of all newly-issued Treasuries in the past three quarters. Buyers were the household sector, money market mutual funds as well as brokers & dealers (cf. chart next page). The Treasury purchases of the Fed, in contrast, played only a subordinate role in this context.

TREASURIES FACE DEMAND FROM FOREIGN AND DOMESTIC INVESTORS

Net purchases of Treasuries, in USD bn (III/08-I/09, annualized)

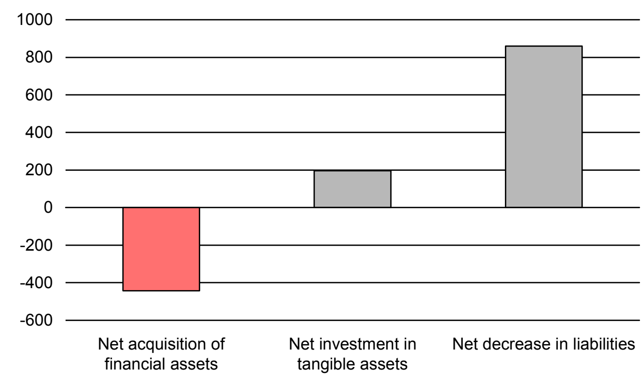


Source: Federal Reserve, UniCredit Research

It is, however, highly doubtful that this trend will continue. Domestic financial investors (money market mutual funds, dealers and brokers) had been strong buyers of Treasuries above all in the second half of 2008. With the general decline in risk aversion, however, they did already start to reduce their holdings of Treasuries again in the past quarter. And while households have increased their personal savings rate considerably and will continue to do so in the future[1], they are currently using their savings primarily to reduce liabilities. Their net financial worth has, in contrast, contracted by an annualized USD 400 bn in the past two quarters (cf. chart)

HOUSEHOLDS REPAYING LIABILITIES

Derivation of personal savings, in USD bn
(IV/08 and I/09, annualized)

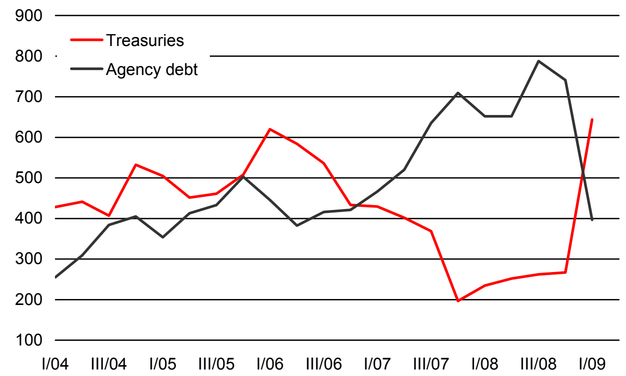


Source: Federal Reserve, UniCredit Research

The strong purchases of Treasuries were, therefore, probably more an "asset swap" from Agency debt (e.g. Fannie or Freddie bonds) to Treasuries: In the same measure as households sold Agencies in the past quarter, they purchased Treasuries (cf. chart). The overall holdings of Treasuries plus Agencies remained roughly unchanged at one trillion USD. Such a "swap" on the same scale as in the past quarter can only happen one more time, since households would then have sold their entire holdings of Agency bonds.

SWAPPING AGENCIES FOR TREASURIES

Household assets, in USD bn



Source: Federal Reserve, UniCredit Research

Still dependent on foreign investors

Consequently, the funding of the US economy and the budget deficit will continue to depend primarily on foreign investors. It was no coincidence that Treasury Secretary Geithner traveled to China at the beginning of the month to convince the US administration's biggest creditor that Treasuries are still a lucrative investment. Furthermore, the US was presumably relieved to hear that in the run-up to the BRIC meeting Russia had (for the time being) accepted the position of the greenback as the global reserve currency. However, the meeting last week did make clear once again that the BRIC countries are not happy with the status quo. It is solely the lack of reasonable alternatives to the US dollar that is currently ensuring that these countries continue to buy US securities and, therefore, fund the US budget deficit.

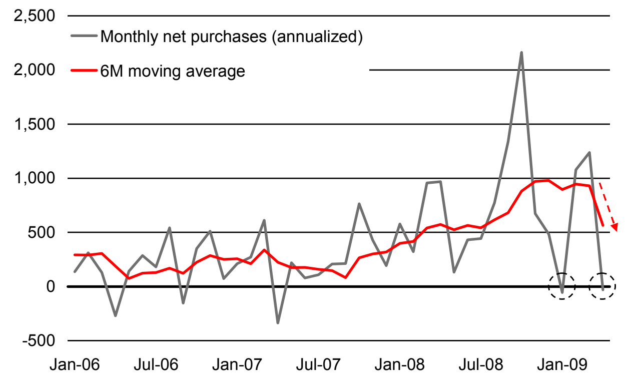
But an alternative to the USD as reserve currency will probably not emerge in the near future either. Furthermore, China is apparently willing to pay for the (artificially) slow appreciation of the CNY. Foreign demand for long and short-dated Treasuries has been correspondingly robust. The TIC (Treasury International Capital) data show that foreign investors purchased US Treasuries valued at more than half a trillion USD (annualized) in the six months between November and April (cf. chart). But at the same time, it is apparent that demand has almost halved compared to H2 2008. In April, the last available

[1] See: H. Bandholz, Rising US savings rate slows impending upswing, Friday Notes dated June 19, 2009.

reporting month, foreigners were even net sellers of Treasuries. This is primarily the result of dwindling risk aversion in markets – but perhaps also an expression of rising dissatisfaction in creditor countries such as China.

HIGH FOREIGN DEMAND, BUT…

Foreign net purchases of US Treasuries, in USD bn



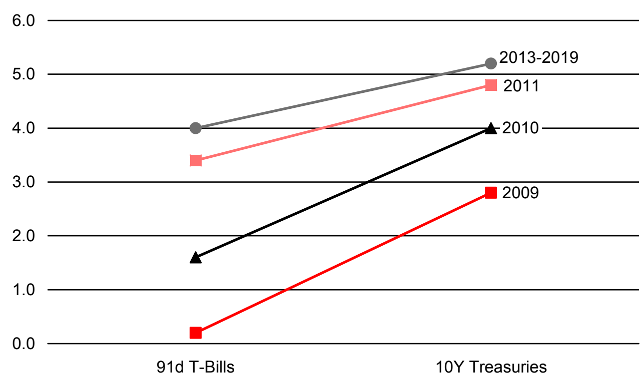
Source: US Treasury, UniCredit Research

Debt management

Nevertheless, the US administration will continue to be in a position to fund its immense budget deficits in the coming years. But investors – foreign and domestic alike – will demand higher interest rates as public debt mounts. The US administration itself expects short-term interest rates (3M T-Bills) to rise to 4% in the coming years and long-term yields (10Y Treasury Notes) to rise to 5¼%. The upshot is a pronounced bear flattening of the yield curve (cf. chart).

ADMINISTRATION EXPECTS BEAR FLATTENING

Interest rates and yields, in % (OMB projection)

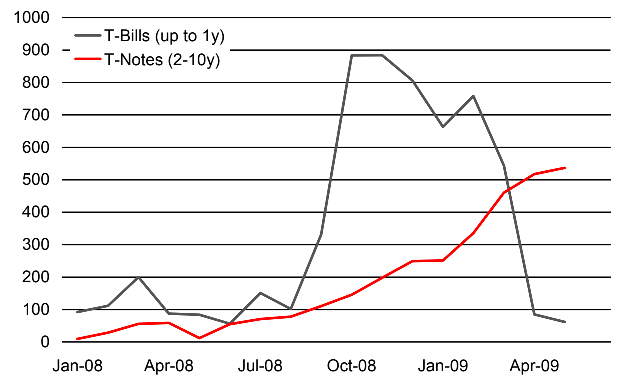


Source: OMB, UniCredit Research

Assuming an average public debt level of USD 10 trillion in the coming five years (CBO projection for 2009 to 2013), every one percentage point rise in interest rates increases debt service by USD 100 bn per year. For that reason, it is in the interest of the administration – and the taxpayer – to lock in the currently still low interest rates for the future. To this end, the administration would have to issue more longer-dated bonds. While that is slightly more expensive in the short term, it should pay off over the medium term. Yields on 2Y T-Notes are after all currently at 1%-1¼%, and for 5Y Treasuries at 2½%-2¾%. That is clearly lower than the interest rate level projected in the coming years. That the administration has apparently some confidence in its own projections is demonstrated by the fact that in recent months it has issued more T-Notes with a maturity of two to ten years, while at the same time reducing the issuance of short-dated T-Bills (maturity up to one year; cf. chart).

MORE NOTES, LESS BILLS

Issues of US Treasuries, in USD bn (6M average, annualized)

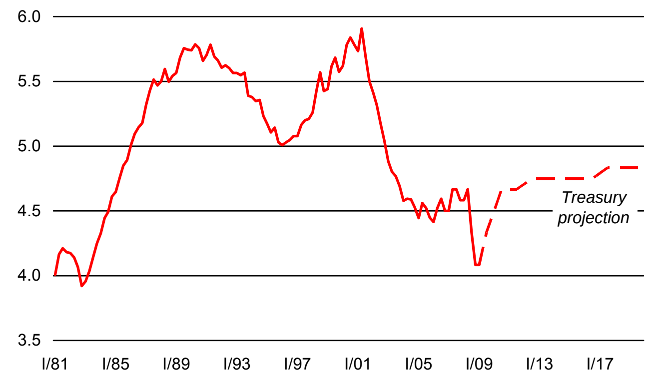


Source: US Treasury, Thomson Datastream, UniCredit Research

If we take the projections of the Treasury's Office of Debt Management as a yardstick, the administration's objective is to lengthen the average maturity of the federal debt from currently just over four years to close to five years (cf. chart next page). To this end, the administration plans to step up the issuance of above all 5Y and 7Y T-Notes.

MATURITY OF FEDERAL DEBT IS CURRENTLY FOUR YEARS

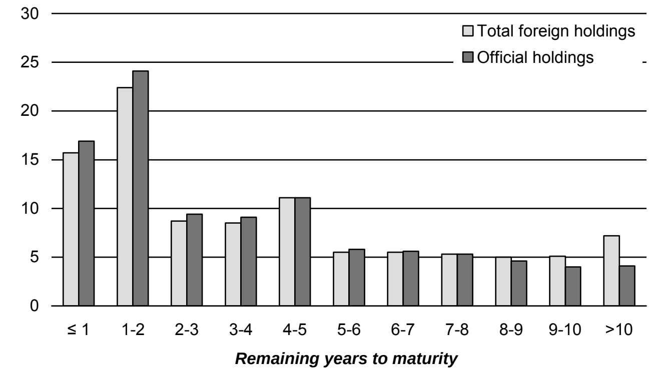
Average maturity of the US federal debt, in years



Source: US Treasury, UniCredit Research

FOREIGN INVESTORS PREFER SHORT MATURITIES

US Treasuries held by foreign investors,
Percentage breakdown by remaining maturities (position: mid-2008)



Source: US Treasury, UniCredit Research

This approach could, however, result in a (or aggravate the) mismatch between supply and demand, because foreign investors, who will purchase the lion's share of the newly issued Treasuries, apparently prefer shorter maturities (cf. chart). 47% of all foreign holdings of Treasuries have a residual maturity of less than three years. At institutional investors, such as central banks or sovereign wealth funds, the preference for short maturities is even more pronounced. If these foreign investors do not adjust their investment behavior towards longer maturities, the smaller supply of shorter maturities would tend to result in curve steepening. And relatively lower interest rates at the short end are definitely exactly the opposite of what foreign investors want.

Level playing field

China needs the US to buy its goods, and the US needs China to fund its excess consumption. Because of this mutual dependence, the Bretton Woods II System will continue to function in the future. The negotiating position of creditor countries such as China but also the oil exporters has, however, improved further in recent months, since a couple of unsuccessful Treasury auctions due to a lack of demand from abroad could have devastating ramifications for yields and the USD. Both Chinese and Americans authorities are aware of this.

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

Germany: Threat of public debt getting out of hand

- The combination of capital infusions for the financial sector, the economic stimulus program and the deep recession is proving to be a heavy burden for the public-sector budgets. By next year, the budget deficit should balloon to 5½%. The debt ratio would therefore climb to over 77%.
- Even after a return to trend growth, the structural budget deficit will remain above the Maastricht ceiling. Without consolidation, the debt ratio would then continue to rise and by 2030 hit the 100% mark.
- To return public debt to a sustainable path, we calculate that the primary balance would have to be increased by close to 1 pp or almost EUR 25 bn. To bring the debt ratio back below 60% in the next 20 years, the primary balance would have to be increased by roughly 2 pp.

Financial crisis weighing heavily on public-sector budgets…

The grand coalition's original plan to consolidate the federal budget by 2011 has receded into the distance since last autumn. Even worse, following on the heels of a virtually balanced federal budget in the last two years, this year Germany will in all probability already exceed the Maastricht deficit criterion of 3% of GDP. The financial crisis and its transmission effects to the real economy are having a very negative impact on both public-sector expenditures and revenues.

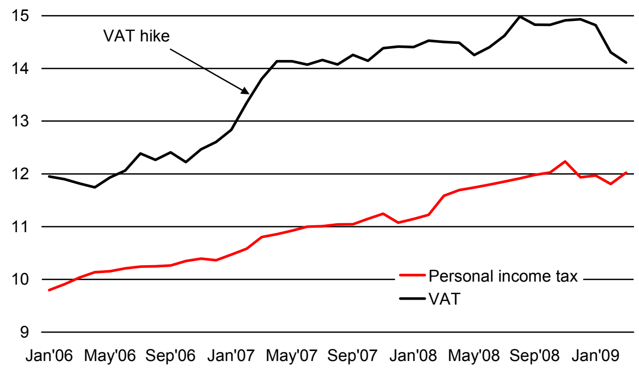
The bail-out program for the financial sector and the federal government's economic stimulus packages have already proved to be a heavy burden on the public-sector budgets. To date, the financial market stabilization fund (SoFFin) created by the federal government has approved equity capital infusions totaling EUR 24.5 bn. On top of that, several billion EUR are being spent to nationalize Hypo Real Estate. Alongside the federal government, some federal states have had to raise close to EUR 15 bn so far this year to rescue their *Landes-banken* (BayernLB, HSH Nordbank and LBBW). While these measures need not necessarily have a lasting negative impact on public debt – in the event of a successful restructuring of the institutions, the government can generate privatization proceeds in the future as was, for example, observed after the financial crisis in Sweden – the bail-out measures are, however, currently a massive direct burden on government coffers.

In addition to the expenditures via the rescue package, the federal government's economic stimulus program is triggering a massive increase in government expenditures and a reduction in revenues. Meanwhile, the volume of the numerous measures for this year and next totals roughly EUR 60 bn. More than half of this is temporary in nature and will no longer burden the budget from 2011 at the latest. By far the largest bloc here is the investment program of the federal government, state governments and local authorities totaling EUR 17.3 bn. The remainder of the fiscal measures of more than EUR 25 bn will, however, be a permanent strain on the budget.

Beyond that, the deep recession is having an increasingly negative impact on government finances. Above all corporate tax revenues have already deteriorated strongly. In contrast, the important personal income tax and VAT revenues were still respectable at the beginning of the year (cf. chart). These two taxes account for roughly 60% of aggregate tax revenues.

TAX REVENUES TRACK THE ECONOMY WITH A TIME LAG

Monthly tax revenues in EUR bn



Source: Federal Statistical Office, UniCredit Research

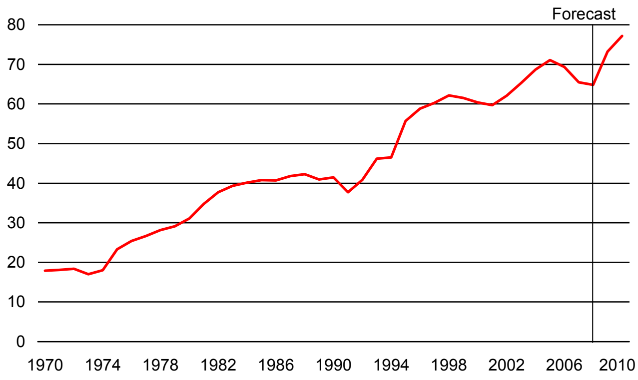
The delayed trend reversal on the labor market, helped by the extensive use of short-time work, will impact tax revenues fully only in the later course of this year and above all next year. According to OECD calculations, the public-sector budget deficit had a stable growth elasticity of 0.5 in the past. This means that a 1% contraction of GDP triggered an overall deterioration in the budget balance of 0.5 percentage points. After a growth rate of still 1.0% in the past year, we expect GDP to contract by more than 6% in 2009. This translates into a deterioration totaling at least 3 percentage points, which – given the delayed effects on the labor market – should be fully reflected in government finances by next year.

…and causing public debt to balloon

The combination of capital infusions for the financial sector, the fiscal program and the deep recession is having a dramatic overall impact on the public-sector budget. All in all, we already expect this year will produce a deficit of roughly EUR 90 bn or close to 4% of GDP. Above all potential further capital requirements in the financial sector harbor further downside risk. Next year, the deficit will probably balloon to well above the EUR 100 bn mark or roughly 5½% of GDP. As a result, the debt ratio will also increase strongly after the downtrend of recent years. After a level of 65% of GDP at the end of 2008, our base scenario calls for over 73% at the end of 2009 and over 77% at the end of 2010 (cf. chart).

PUBLIC DEBT RATIO RISING

Gross public debt as % of GDP



Source: Federal Statistical Office, UniCredit Research

Without budget consolidation, the debt ratio will increase further

Alongside the temporary incremental expenditures under the rescue package and the economic stimulus program, which are increasing government debt on a one-time basis, the weaker economy and the permanent tax cuts/incremental expenditures contained in the fiscal program will continue to impact the budget balance beyond 2010. Once the economy returns to trend growth of an assumed 1¾%, the European Commission calculates that the deficit will decline by roughly 2 percentage points. Based on our deficit projection of 5.5% for 2010, this translates into a structural deficit – adjusted for growth and non-recurring effects – of 3.5% of GDP.

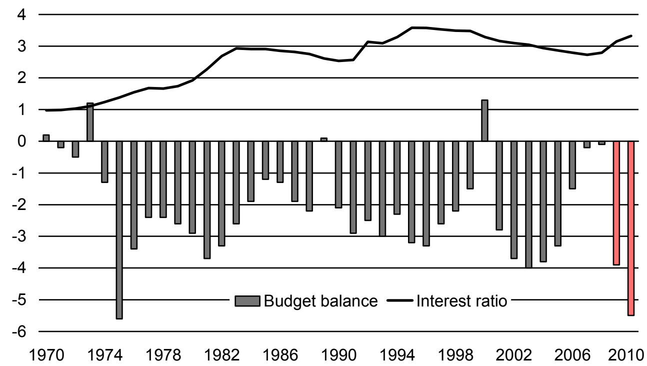
Without discretionary measures to consolidate government finances, both the debt ratio and the deficit ratio would, therefore, continue to violate the Maastricht criteria, even after the economy returns to a sustainable growth path. But what does this mean in concrete terms for the sustainability of German government debt? One helpful analysis tool here is Domar's Law, which states that the dynamic of the debt ratio is determined by the following factors[2]:

$$\Delta d_t \equiv d_t - d_{t-1} = (i_t - g_t) \cdot d_{t-1} - p_t$$

The change in the public-sector debt ratio d (debt/GDP) depends on the difference of the nominal interest rate on public-sector debt i and the nominal potential growth of the economy g, as well as on the primary balance ratio p (primary balance/GDP). The primary balance is the government budget balance minus the interest payments of the public sector. We calculate that the public-sector's annual interest bill next year will total roughly EUR 80 bn or 3.4% of GDP. In 2007, the ratio was still 2.7% (EUR 66 bn, cf. chart). With an interest ratio of 3.4%, this therefore produces – in conjunction with the structural budget deficit of 3.5% defined earlier – a virtually balanced primary balance once the economy has returned to potential growth.

INTEREST RATIO RISING

In % of GDP



Source: Federal Statistical Office, UniCredit Research

[2] DeGrauwe, P. (2005). Economics of Monetary Union

The average nominal interest rate on public-sector debt in Germany is traditionally above the nominal potential growth rate, and this situation is unlikely to change in the future either primarily because of the demographic development. According to Domar's Law, this implies that the German federal budget must permanently generate a primary surplus to be able to keep the debt ratio stable or reduce it. The equilibrium condition for the debt ratio here is:

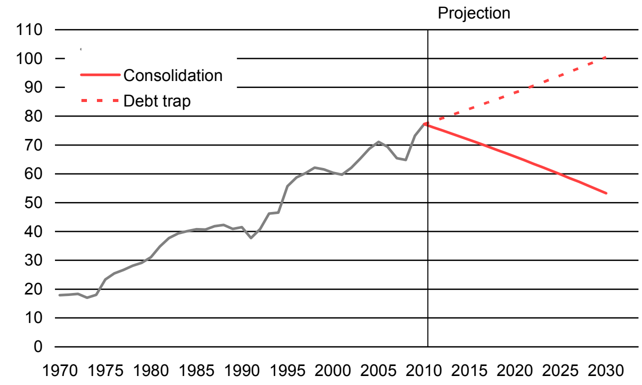
$$p = \frac{b^{*} \cdot (i - g)}{1 + (i/100)}$$

To calculate the primary surplus required for an equilibrium debt ratio b*, we make the following assumptions. The potential growth rate of the German economy is a nominal 3¼%. For the deflator, we assume a value of 1½%. The real growth rate is, therefore, 1¾%. We assume a rate of 4½% as the average interest rate on the debt. Starting from a debt ratio b* for 2011 of 78% of GDP, this produces a necessary primary surplus of close to 1% of GDP or almost EUR 25 bn to keep the debt ratio constant in the following years.

Adjusted for the interest expense, our calculations show in the debt trap scenario a virtually balanced primary balance once the economy returns to potential growth and, therefore, clearly below the threshold value of close to 1%. Accordingly, the public-sector debt ratio would continue to rise steadily. By 2030, it would – based on our assumptions outlined above – climb to 100% of GDP (cf. chart, debt trap). A sustained reduction of the budget deficit by, for example, 2 percentage points would lift the primary deficit above the threshold value of +1%. Consequently, by 2030 the debt ratio could be lowered again below the Maastricht level of 60% of GDP (cf. chart, consolidation). Alongside a reduction of the budget deficit via a net tax hike, structural reforms are also candidates for a long-term reduction of the debt ratio, since a potential growth rate increased via fiscal incentives can also make a contribution to consolidating the debt ratio over the medium to long term.

WITHOUT CONSOLIDATION, THE UPTREND WILL CONTINUE

Gross public debt as % of GDP



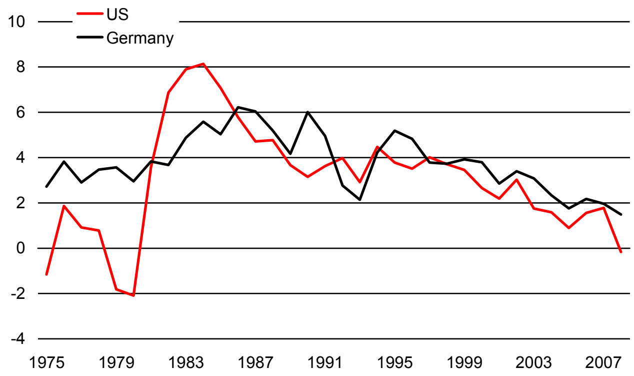
Source: Federal Statistical Office, UniCredit Research

Inflation is no alternative

One alternative to consolidating public finances via tax and structural reforms that is mentioned occasionally is the possibility to lower the debt ratio via inflation. The assumption here is that government-induced higher nominal GDP growth driven by higher inflation will in the short term not trigger a corresponding increase in the average nominal interest rate on the public-sector debt. The reason for this is the structure of the residual maturities of the public-sector debt. More than half of German public debt has a residual maturity of more than four years. Only new issues can immediately command higher interest rates in the market. As a result, the nominal interest rate could in the short term fall below the level of the potential growth rate and thereby help reduce the debt ratio even without a primary surplus. However, we think this method is not conducive to lowering the debt ratio on a sustained basis, since the related loss of confidence in fiscal policy will over the long term probably result in a higher risk premium for government bonds, which then neutralizes the initial positive effects. An impression of the possible consequences can be gleaned from the development of real interest rates in the period of high inflation after the second oil price crisis. At the time, the real yield on Bunds in Germany and above all Treasuries in the US rose to record levels for several years (cf. chart).

INFLATION DESTROYS CONFIDENCE

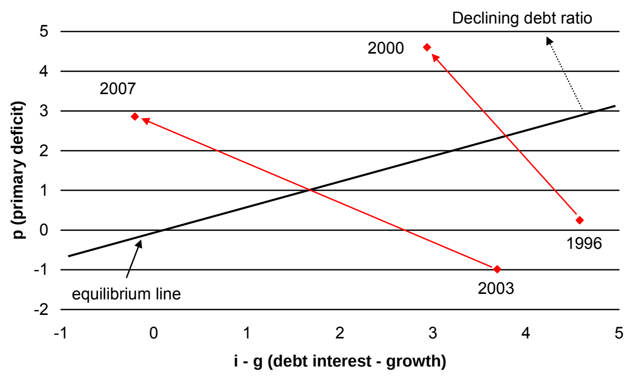
Real yields of 10Y Bunds/Treasuries



Source: Feri, UniCredit Research

All told, the fallout of the financial market crisis is currently triggering a material deterioration in the public-sector debt situation. But even though there are indications that the debt ratio will continue to rise steadily without fiscal reforms, this need not necessarily lead to a vicious circle and ultimately government bankruptcy. Although the German debt ratio has risen steadily in recent decades, the German government has so far always reacted and succeeded in bringing the debt dynamic back to a sustainable path (cf. chart on the next page) – and more rapidly than in many other countries[3]. The next *Bundestag* elections are scheduled for September 27. The new government must then demonstrate whether it, too, can sustain the markets' confidence in a solid long-term fiscal policy.

RETURN TO SUSTAINABLE DEBT PATH IN THE PAST



Source: Federal Statistical Office, UniCredit Research

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

[3] Collignon, S. (2006). The Sustainability of Public Finances and Europe's Fiscal Rules

Italy: Fiscal outlook is cloudy, but the rating is not under pressure

- Italy's public finances have been hit hard by the economic downturn. The government expects the budget deficit to climb to 4.6% of GDP this year vs. 2.7% in 2008. But we think this estimate will prove to be overly optimistic.
- Lower tax receipts account for most of the deficit increase. Unsurprisingly, VAT and corporate tax – the most sensitive to the economic cycle – have recorded the largest drop.
- Public debt will probably rise toward 120% of GDP by the end of next year, some 15 pp higher than its pre-crisis level. But we doubt that the sovereign rating will come under pressure, at least in the near term.
- On a medium-term perspective, however, structural reforms on the spending side of the government's balance sheet are needed for Italy to retain its current rating.

Recession takes its toll on public finances

On May 2, the Ministry of Economy and Finance published the RUEF (*Relazione Unificata sull'Economia e la Finanza pubblica*), which contains the most updated set of macroeconomic and public finances projections for 2009-2011. In a nutshell, the RUEF shows that the financial crisis and the ongoing deep recession are taking a heavy toll on Italy's public finances. Nevertheless, the government tinks that Italy will weather the economic storm better than other industrialized countries – thanks to a relatively solid banking system and a low level of households' indebtedness – and the situation will start to improve in 2010 when a moderate GDP recovery is expected. Obviously, the degree of uncertainty surrounding the baseline scenario is extremely high, and the government, therefore, acknowledged that all the projections contained in the RUEF should be taken with a pinch of salt.

The government's growth projections show Italy's GDP shrinking 4.2% this year (following -1.0% in 2008), before resuming growth in 2010 at +0.3%. The 2009 number is broadly in line with the estimates provided by both the OECD and the IMF less than two months ago, and was not too different from our own projection on the day the RUEF was published. However, at the time we noted the government's 2009 GDP forecast risks being too optimistic: after the very weak Q1(-2.6% q-o-q), it's likely that real GDP this year will drop by at least 5%. We currently project -5.2%. Recent comments by Treasury officials suggest that the government will correct downwards its official GDP forecast in the -5% area when it will present the DPEF, the multi-year planning document that sketches the guidelines and identifies the targets for the government's fiscal policy.

The impact of the crisis on Italy's public finances started to become visible already in 2008, when the budget deficit edged up from 1.5% to 2.7% of GDP (EUR 43 bn). However, the government expects the negative effects to be much more severe this year, with the deficit seen increasing substantially to 4.6% (0.9 pp higher than envisaged in the Update of the Stability Program presented in February). But this estimate risks being too conservative: based on our last GDP and revenue forecasts, we believe the deficit this year will climb to at least 5.3% of GDP. In the government's projections, the deficit should remain stable at 4.6% in 2010, before starting to decline in 2011 (to 4.3%). Accordingly, Italy's public debt is seen on an upward trajectory and is expected to rise from 105.8% of GDP in 2008 to 114.3% this year and 117.1% in 2010. We believe risks to the government's debt forecasts are clearly to the upside, and a number for 2010 in line with the IMF projection (121%) wouldn't be surprising.

Tax revenues are contracting

The RUEF shows that the crisis is affecting Italy's public finances mostly via the revenues channel. Tax receipts contracted by 0.7% in 2008 and are expected to shrink even faster in 2009 (-2.1%, with direct and indirect taxes falling, respectively, by 1.3% and 3%).

GOVERNMENT'S FISCAL PROJECTIONS

in % y-o-y, unless otherwise specified

	2006	2007	2008	2009	2010	2011
Current expenditures (ex int.)	3.3	3.5	4.5	3.6	1.3	1.9
Civil servant compensations	4.3	0.5	4.3	2.3	0.2	0.6
Pension payments	3.4	3.9	4.3	4.2	3.1	3.4
Other social payments	7.1	9.5	8.7	7.2	-0.9	1.1
Tax receipts	10.1	6.0	-0.7	-2.1	0.7	2.7
Direct taxes	12.7	9.1	3.5	-1.3	0.1	3.6
Indirect taxes	8.7	3.1	-5.1	-3.0	1.3	1.6
Budget deficit (as % of GDP)	**3.3**	**1.5**	**2.7**	**4.6**	**4.6**	**4.3**
Public debt (as % of GDP)	**104.5**	**103.5**	**105.8**	**114.3**	**117.1**	**118.3**

Source: Ministry of Economy and Finance, UniCredit Research

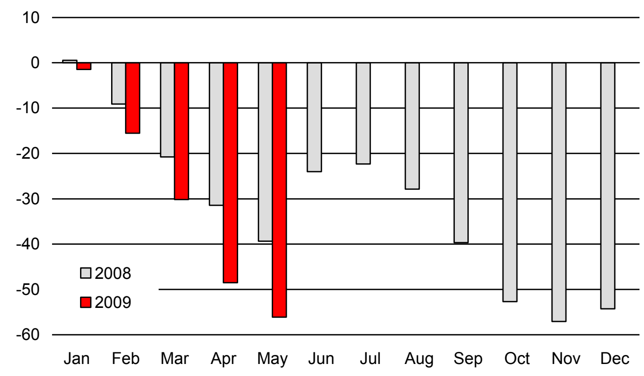
The latest data published by both the Bank of Italy and the Ministry of Economy and Finance show for the first four months of 2009 a contraction in tax receipts of 3.5% and 3.8%, respectively, vs. the same period of 2008. Treasury's tax data, which are compiled on accrual basis and are more detailed than the BoI's statistics (complied on a cash basis), reveal that the largest decline is recorded in indirect taxes, down 5.7% y-o-y, with a 10.2% contraction in VAT revenues. Direct taxes performed slightly better, being down "only" 2.0%, with corporate tax revenues at -6.3%. How do these numbers fit with the scenario envisaged by the government?

One point worth highlighting: the government's estimate of tax revenues in 2009 implies that this year the elasticity of tax receipts to nominal GDP (seen at -2.8%) falls below 1, the elasticity having risen well above the historical average of slightly above 1 in 2006-2007. The 2009 revenue forecast could, therefore, be a bit too optimistic, particularly if one considers that in 2008 tax revenues contracted outright despite a 1.8% increase in nominal GDP. So, what are the variables that need to be monitored more carefully going forward to assess the risks to the government's deficit and debt forecasts in a timely manner? Given that ISTAT's data on public deficit (Maastricht definition) are provided only on a quarterly basis and with a relatively long lag, a more useful indicator is the state sector borrowing requirement (SSBR or *fabbisogno di cassa*[4]) which is published on a monthly basis by the Ministry of Economy and Finance.

The last data available show that in January-May the SSBR was up to EUR 56 bn, a meaningful deterioration (almost +50%) compared to the same period of 2008 when the deficit stood at EUR 39 bn. The government estimates that the SSBR will reach EUR 82.1 bn at end-2009, which is about 50% higher than the 2008 figure. Given that the SSBR projection for this year includes also EUR 10 bn of bank recapitalization funds (the so called Tremonti Bonds) that have not yet been recorded in the *fabbisogno di cassa* up to May, the government implicitly assumes that the pace of SSBR deterioration seen in January-May will ease in the remainder of the year. SSBR is, therefore, the key variable to watch.

WORSENING DEFICIT TREND

SSBR, in EUR bn, cumulated



Source: Ministry of Economy and Finance, UniCredit Research

Public debt on the rise, but no rating threat

The government's most updated macroeconomic and fiscal forecasts probably risk being too optimistic, but this "bias" can be considered at least in part physiological at a time when growth projections are cut aggressively every month by virtually all private forecasters and international organizations. Given that Italy at the end of next year will probably have to face a debt-to-GDP ratio in the 120% area, and that the country's growth potential should not be affected significantly by the financial crisis, what counts more on a sovereign rating perspective is that the fiscal deterioration will continue to be perceived as mostly cyclical. This means that the government needs to refrain from any significant expansionary measure that is not backed by structural spending cuts. Judging from the way the Economy Minister Tremonti has handled the crisis up to now, we regard the risk of a fiscal slippage driven by discretionary measures as low. Accordingly, the sovereign rating should be firmly on hold, and recent comments by rating agencies point clearly in this direction.

However, we suspect that Italy won't be able to sit back and relax for too long, and what happened last year tells why. In 2008, the acceleration in current expenditures net of interest payments (the growth rate was 4.5% vs. 3.5% in 2007) had little to do with fiscal stimulus or the working of the safety nets as the recession unfolded; rather, it was mostly due to a significant acceleration in civil servants' compensations due to several contract renewals, and higher pension payments. This is why, as soon as the recovery starts to materialize, the call for structural reforms on the spending side of the government's balance sheet will probably intensify. At that point, Italy will necessarily have to deliver in order to retain its current rating.

Chiara Corsa (HVB Milan),
+39 02 8862 2209
chiara.corsa@unicreditgroup.de

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

[4] SSBR data are compiled on cash basis rather than on accrual basis and refer to the state sector rather than the whole public sector, so they are not compliant with the Maastricht definition of deficit. Caution is therefore needed when SSBR data are used to predict the public deficit computed according to the Maastricht definition.

Business investment restraint will retard US economic recovery

- The United States is now in the middle of a steep contraction in business investment, sharper than the one that precipitated the recession after the collapse of the high-tech bubble at the beginning of this decade.
- Looking forward, the problem is that firms in troubled industries such as autos will be forced to retain stringent limits on equipment and software purchases. So will many companies in the services sector, including banks, retailers, hospitals, schools and universities. And wide swings in commodity prices have dulled the enthusiasm for ambitious expansion plans in the energy sector, among others.
- The likely absence of a dynamic recovery of capital spending, along with continuing negative effects on household spending from lower values of their homes and pension investment and uncertain export prospects, will leave the US economy even more dependent on the federal government at a time when financial markets are already concerned about the bulging deficits that stimulus measures have fostered.
- The Federal Open Market Committee, FOMC, left the stance of monetary policy unchanged at this week's meeting. It indicated that the recession is decelerating but not over yet, an attempt to dampen market expectations of any early move to raise the federal funds rate. The weakness of business fixed investment surely was a key factor in that decision.

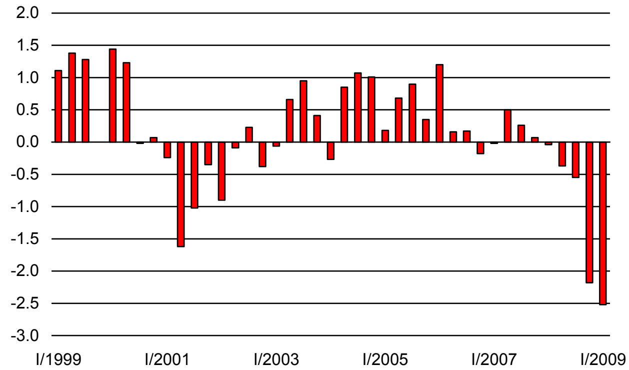
Prolonged shift to services alters both investment composition & dynamics

A services economy is ordinarily thought of as labor-intensive, while an economy with a large share of manufacturing in GDP is thought of as capital intensive. That assumption has led some analysts to conclude that cyclical fluctuations of overall business capital expenditures would tend to be dampened. However, both the assumption and the conclusions are flawed. Both sectors have substantial capital requirements, and the shift to a services economy does not mean that the share of capital spending to GDP necessarily should decline over time, while also becoming less cyclically sensitive. Many industries in the broad services sector are heavily capital intensive: for example, electric power generation. Others have large capital investments in information technology, IT, such as banks, insurance companies, and giant retailers such as Wal-Mart. Hospitals have a mix of investments in buildings, conventional IT, and high-tech equipment like MRI machines. Universities, especially those oriented toward scientific research, have huge capital spending needs, over and above building classrooms and dormitories. In a recession as deep as the US contraction has turned out to be, numerous portions of the services sector, which ordinarily would have been able to ride through a normal economic slowdown without major alterations in their capital spending programs, have had to make significant downward adjustments.

The standard GDP statistics calculated by the Bureau of Economic Analysis, BEA, divide business fixed investment into two categories: equipment & software and structures (also known as commercial real estate). For the period October 2008-March 2009, lower spending on equipment and software subtracted 2.35 percentage points per annum from real GDP. That brought the total negative contribution since the recession began in December 2007 to an annualized 1.0 pp. By comparison, in the severe downturn in business equipment & software spending during and just after the 2001 recession, the negative contribution was an annualized 0.8 pp.

BUSINESS INVESTMENT PLUNGE DEEPENS RECESSION

Contribution of equipment & software to annualized GDP in pp



Source: BEA, UniCredit Research

For structures, the timing is different because of the long time lags normally associated with developing large-scale industrial and commercial building projects. So the impact of the credit crunch on actual commercial construction put-in-place has been delayed. It began to be obvious in the Q1 2009 figures when reduced commercial construction subtracted an annualized 2.05 pp from GDP. For the recession as a whole, structures made a negative contribution of 0.15 pp per annum in all.

Less familiar is the more detailed breakdown of business fixed investment that the BEA also compiles on the main components of equipment & software investments. The following table shows how quantity indexes for these categories have evolved over the past two decades. (Technical Note: for longer-term comparisons, the BEA prefers using quantity indexes rather than real magnitudes that are calculated by using chain-linked price deflators.)

IT DOMINATES EQUIPMENT & SOFTWARE SPENDING, AS INDUSTRIAL MACHINERY TAILED OFF OVER PAST 2 DECADES

Equipment & Software 2000=100	I/90	abs. peak	I/09
Equipment & Software, total	39.2	118.6, (IV/07)	95.3
Information processing	21.6	150.3 (I/08)	132.6
of which: software	21.9	262.6 (I/08)	129.3
Industrial equipment	71.4	101.7 (III/00)	76.4
Transportation equipment	50.1	108.6 (III/99)	30.6
Other equipment	74.9	121.0 (II/06)	97.8

Source: Bureau of Economic Analysis, UniCredit Research

As the economy has moved from manufacturing into services, equipment & software investments have risen faster than overall real GDP through the peak of the business expansion that ended December 2007. By contrast, both industrial equipment and transportation equipment installed by private businesses peaked around the beginning of this decade and never recovered. The category "other equipment" peaked in 2006, even as the economy was still growing, but has subsequently fallen by more than 20%. This set of capital goods includes equipment used in construction, so it is not surprising that it tracks more closely the start of the housing slump a few months before.

The fact is that over time more and more of IT investment has taken the form of replacement investment rather than acquisition of entirely new technologies. To be sure, computers have continued to get better and cheaper, but at the margin the rate of change has been slowing down. Thus, it no longer pays for companies to install the most sophisticated machines. Instead, relatively modest expenditures on software improvement have been sufficient to bring about productivity improvements that in the past would have required scrapping obsolete systems entirely. Similarly, functionality on the Internet is well established and improvements in websites have become incremental and discretionary.

The bottom line is that where only a few years ago the major growth element in business fixed investment, the IT portion of equipment & software, could be relied upon as an informal stabilizer of the business cycle, over time IT has become a cyclically-sensitive segment of the economy. Management of services companies are particularly aware of this evolution, and when cost considerations rule, as they do in the current recession, they show great ingenuity in "getting by," rather than splurging on the newest computer systems.

Fed to retain aggressive monetary accommodation well into next year

The FOMC met this week to determine monetary policy against a backdrop of widening disparity in private-sector views of the outlook. In general, business executives are wary, sensing that a relatively fragile, irregular recovery is the most probable outcome. (Famed investor Warren Buffett goes further, asserting he has seen "no hopeful signs.") By contrast, many US government officials and numerous private-sector economists have been stressing the upside. The Fed itself has been trying to play both sides, stressing the so-called "green shoots" that suggest an early end to the recession, while acknowledging the obstacles, financial and otherwise, that still remain. We lean toward the business view, not least because we anticipate the capital spending contraction will last longer and go further than in previous cycles.

In leaving the stance of monetary policy unchanged, the Fed released a policy statement that discourages financial market expectations of an imminent increase in the federal funds rate. Also at this meeting, Fed officials contributed quarterly revisions of their projections for real GDP, the unemployment rate, and consumer inflation. They are released in three weeks along with the minutes of the June 23-24 meeting. They are unlikely to be as optimistic as the pronounced V-shaped rebound that White House economists predict for 2010-11. Such an outcome is not impossible, but it is hard to see where it will come from.

Roger Kubarych (HVB)
+1 212 672 5668
roger.kubarych@us.unicreditgroup.eu

Data Monitor Europe - Preview of the coming week

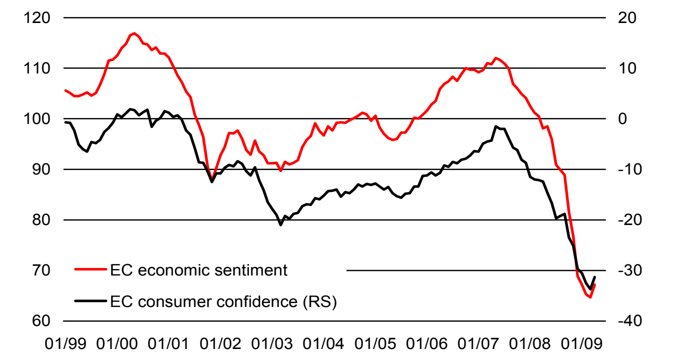
Monday, June 29

EMU, ECONOMIC CONFIDENCE

June	MIB	Cons.	May	Apr
	72.0	71.0	69.3	67.2

In May, economic confidence rose to the highest level since November, mirroring the further improvement of the composite PMI. Though less than expected, the composite PMI kept rising in June, suggesting that the upside potential for economic sentiment has not been exhausted. However, we remain far from the 90 threshold that, according to our estimates, signals the end of the recession.

AT A TURNING POINT



Source: European Commission, UniCredit Research

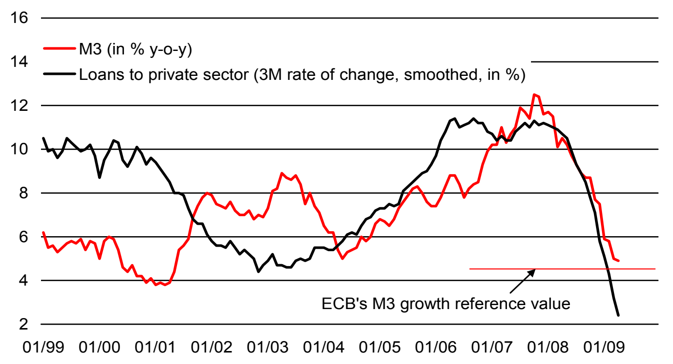
Tuesday, June 30

EMU, M3

May	MIB	Cons.	Apr	Mar
in % y-o-y	4.6	4.6	4.9	5.0

M3 growth has been on a slowing trend for one year and a half. Looking at lending dynamics, in April the flow of credit to the private sector was negative for the fourth time in the last five months: household lending is at a standstill while corporate lending continues its deceleration from April 2008's peak. As economic activity continues to shrink, in May we see a further easing in M3 growth and slower loans growth, particularly to firms.

SEVERE CREDIT DOWNTURN



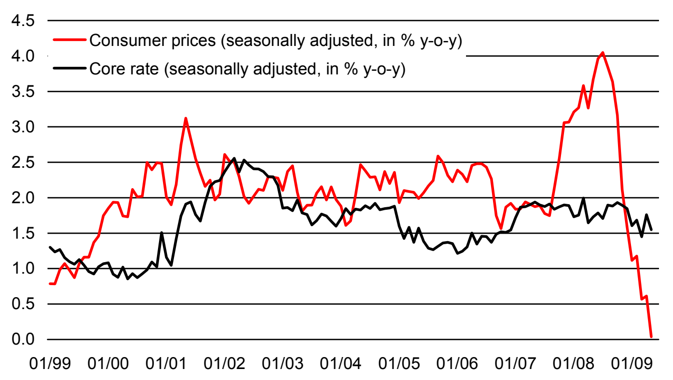
Source: ECB, UniCredit Research

EMU, CONSUMER PRICES

June	MIB	Cons.	May	Apr
in % y-o-y	-0.1	-0.2	0.0	0.6

For the first time in its history, in June euro-zone inflation should dip into negative territory due to a further deceleration in the food component. Energy inflation is expected to remain broadly stable as a favorable base effect offsets a large monthly increase in the price of oil-related products, and core inflation will likely hold steady. The inflation rate should trough in July.

INFLATION FALLING INTO NEGATIVE TERRITORY



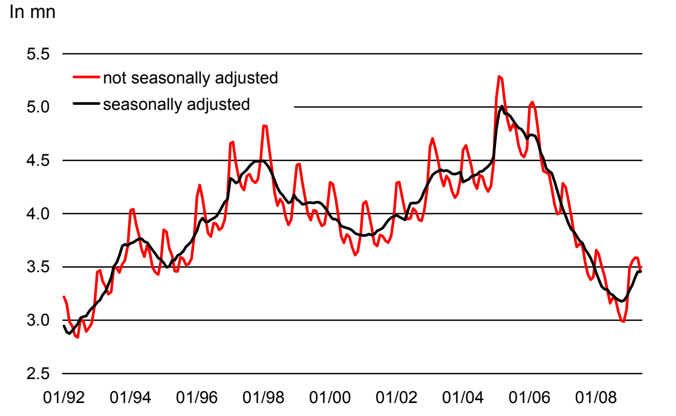
Source: Eurostat, UniCredit Research

GERMANY, UNEMPLOYMENT

June	MIB	Cons.	May	Apr
in '000 m-o-m, sa	35	40	1	57
in '000 m-o-m, nsa	-15		-127	-1

The spring recovery in May probably continued at a much slower pace in June ahead of the beginning of the main holiday season and should trigger another decline in non-adjusted unemployment. In contrast, the adjusted number should rise more strongly again than in the previous month, despite the dampening effects of short-time work and a statistical change concerning private job placement. Hiring plans, above all in the manufacturing sector, remain clearly negative.

DOWNSWING ON THE LABOR MARKET



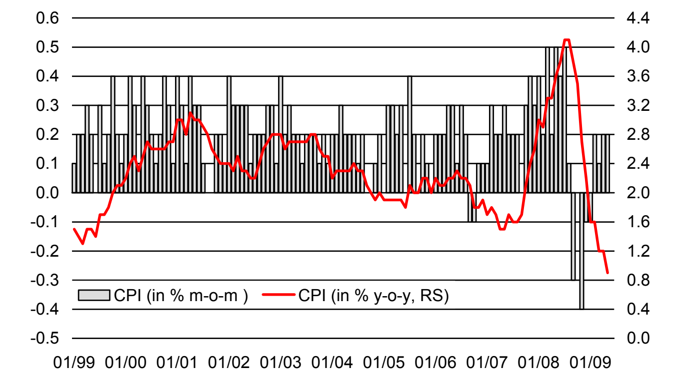
Source: Federal Labor Agency, UniCredit Research

ITALY, CONSUMER PRICES

June	MIB	Cons.	May	Apr
in % m-o-m	0.2		0.2	0.2
in % y-o-y	0.7		0.9	1.2

After two consecutive months of stability, in May Italy's inflation rate slipped to 0.9%. We expect a further slow-down in June, due mostly to easing food inflation. Inflation will probably bottom out in July.

DISINFLATION COURSE CONTINUES



Source: ISTAT, UniCredit Research

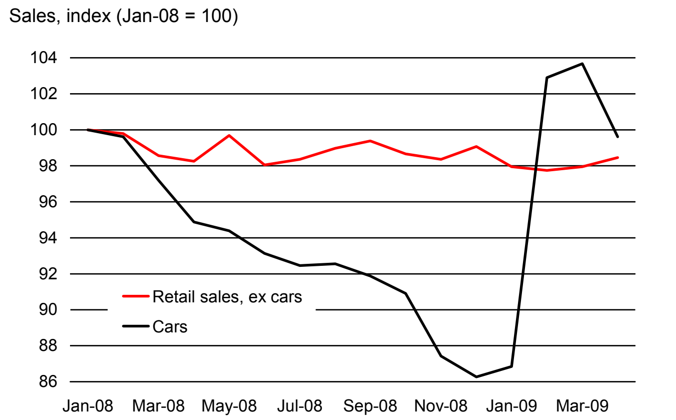
Wednesday, July 1

GERMANY, RETAIL SALES

May	MIB	Cons.	Apr	Mar
in % m-o-m, real	0.3	-0.1	0.5	0.2

The moderate increase in retail sales in the two preceding months should have continued in May. Despite the bleak labor market prospects, massive disinflation is still providing a temporary boost to purchasing power. The correction in auto sales from last month will likely continue. The preceding boost from the scrapping premium is fizzling again rapidly. The number of applications for the premium has declined strongly recently.

AUTO BOOM FIZZLES RAPIDLY



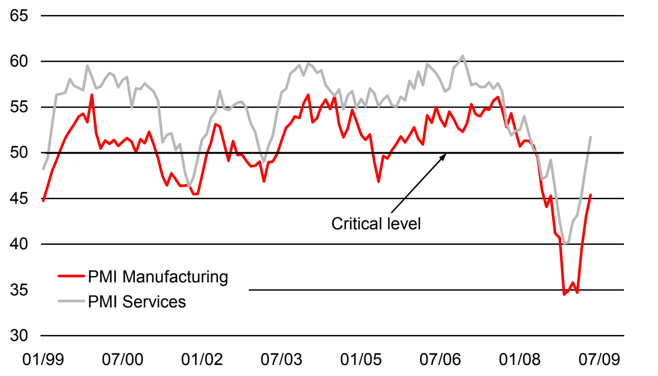
Source: Bundesbank, UniCredit Research

UK, PURCHASING MANAGERS INDICES (PMIs)

June	MIB	Cons.	May	Apr
Manufacturing	46.0	46.0	45.4	43.1
Services (Thursday)	51.2		51.7	48.7

The May PMIs showed a sizeable improvement, sweeping away any doubts that the worst of the recession is behind us. Now, the question remains about the speed of the recovery, given the impressive pace of improvements we have seen in business surveys. While we think that the manufacturing PMI might mark a further improvement to 46 in June, the services counterpart could hardly keep rising at the same speed seen in the last months. We are penciling in a modest decline to 51.2 points.

THE WORST IS BEHIND US



Source: Markit, UniCredit Research

Chiara Corsa (HVB Milan)
+39 02 8862-2209
chiara.corsa@unicreditgroup.de

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

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

Data Monitor US - Preview of the coming week

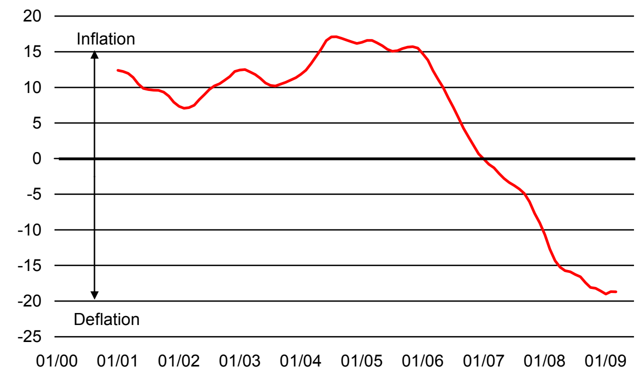
Tuesday, June 30

S&P/CASE SHILLER HOME PRICE INDEX

April	MIB	Cons.	Mar	Feb
In % y-o-y	-18.5	-18.75	-18.7	-18.6

A tiny deceleration in the pace of home price declines is hardly a so-called "green shoot." The main story is unchanged: Housing prices will continue to go down as long as inventories of unsold homes stay high and banks repossess houses from owners who are in default on their mortgages.

TOO MUCH INVENTORY, TOO MANY FORECLOSURES



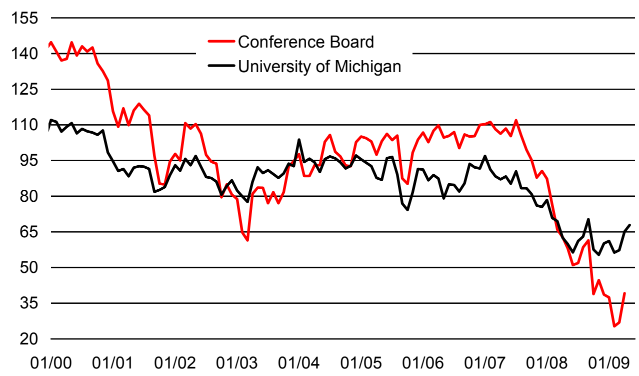
Source: Thomson Datastream, UniCredit Research

CONSUMER CONFIDENCE (CONFERENCE BOARD)

June	MIB	Cons.	May	Apr
Index	56.0	56.4	54.9	40.8

The Conference Board's confidence survey has jumped in the past few months, no doubt reflecting a growing sense that the recession won't last indefinitely. The rally on Wall Street certainly helped. But the labor market situation is still shaky, and solid improvement depends on renewed hiring. That is several months away.

END OF ACUTE PESSIMISM DOES NOT SIGNIFY OPTIMISM



Source: Thomson Datastream, UniCredit Research

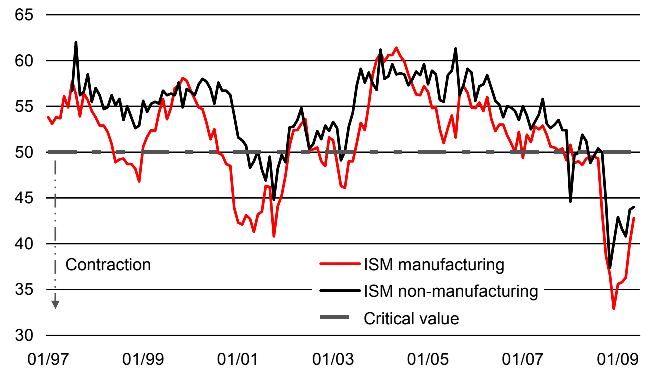
Wednesday, July 1

ISM MANUFACTURING

June	MIB	Cons.	May	Apr
	44.0	44.0	42.8	40.1

New orders are starting to be registered and production schedules are being extended. The main problem is that businesses in the manufacturing sector are far from actively hiring staff, and the large numbers of workers who have been laid off in the past two years have little hope of regaining the jobs they lost. This is a situation consistent with the late stage of a recession, not an imminent sharp economic rebound.

FIRMS SEE STABLE CONDITIONS BUT NOT A "V" RECOVERY



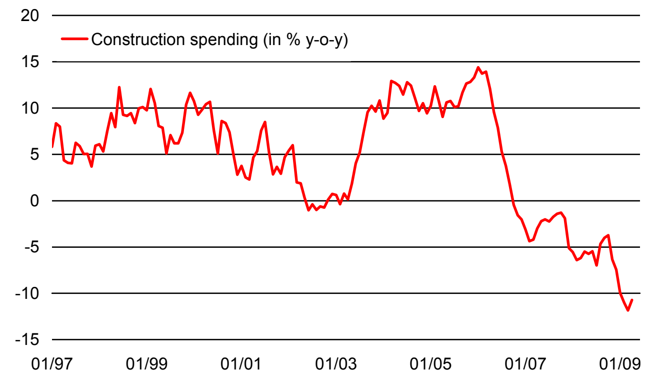
Source: Thomson Datastream, UniCredit Global Research

CONSTRUCTION SPENDING

May	MIB	Cons.	Apr	Mar
In % m-o-m	-1.0	-0.5	0.8	0.5

Residential construction has not bottomed out yet, and state & local governments are facing daunting budget problems that continue to weigh on spending plans. The main question these days concerns commercial real estate. Developers who face financing constraints are cutting back, but those with access to funding are benefiting from lower construction costs and are thus likely to go ahead with planned projects.

HOUSING, STATE & LOCAL CONSTRUCTION KEEP DECLINING



Source: Thomson Datastream, UniCredit Research

Thursday, July 2

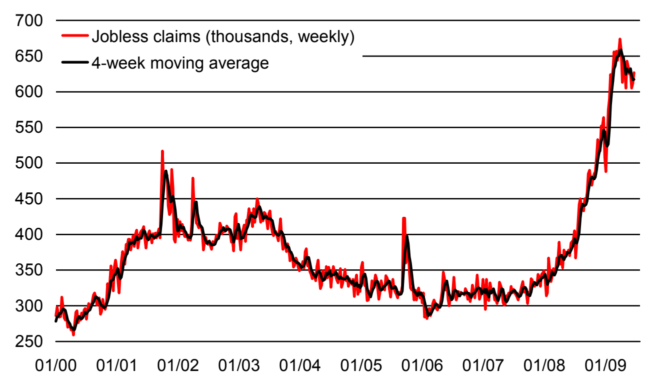
INITIAL JOBLESS CLAIMS

June	MIB	Cons.	Jun 20	Jun 13
in thousands	575		627	612

Last week's report showed layoffs of 600k but a 148k decline in the number of unemployed workers continuing to receive benefits. That is a hopeful development but hardly proof that the labor market is on the verge of a recovery. These are still the worst labor market conditions since the 1982 recession, and conditions in many industries are actually worse than at that time.

DETERIORATING LABOR MARKET FOR A WHILE LONGER

In thousands



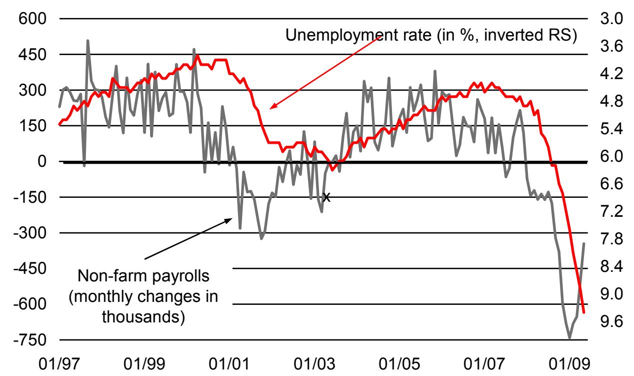
Source: Thomson Datastream, UniCredit Research

MONTHLY EMPLOYMENT REPORT

June	MIB	Cons.	May	Apr
Nonfarm payrolls in k	-450	-370	-345	-504
Unemployment rate in %	9.5	9.6	9.4	8.9

The wild card in this month's employment report has to do with graduating college students. Widespread, but informal, reports from campuses confirm that this is the worst job market since the early 1970s. Such realities don't always get reflected in the Bureau of Labor Statistics data because their assumptions of hiring practices of small businesses (where many graduates get their first jobs) may not reflect the depth of this recession.

NON-FARM PAYROLLS STILL FALLING



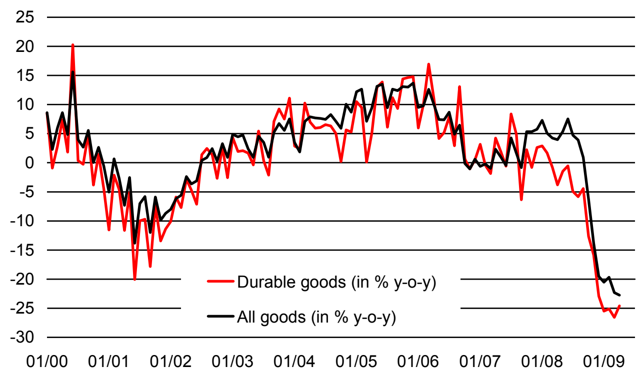
Source: Thomson Datastream, UniCredit Research

FACTORY ORDERS

May	MIB	Cons.	Apr	Mar
in % m-o-m	0.4	0.4	0.7	-1.9

Based on the ISM manufacturing report, new orders were better in May than at any time since last fall. The orders component inched above the 50-50 break-even point. About eight percentage points more respondents saw increases than decreases (although more than half reported unchanged new orders). Given the big revised increase in April orders, a small positive reading for May seems most probable.

INDUSTRIAL SECTOR WEAK BUT NO LONGER PLUNGING



Source: Thomson Datastream, UniCredit Research

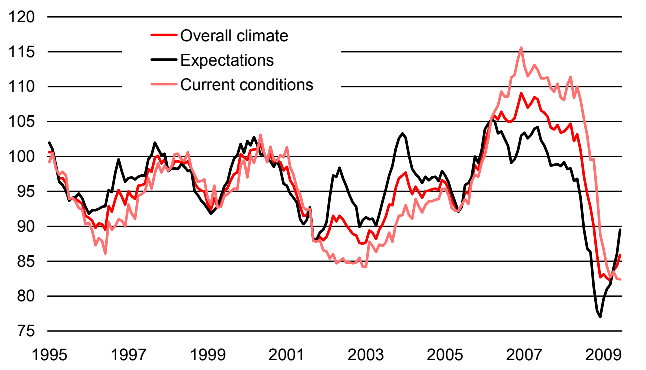
Roger M. Kubarych (HVB)
+1 212 672-5668
roger.kubarych@us.unicreditgroup.eu

Review Europe

Ifo: Pessimism declined further

The Ifo business climate index rose for the third month in a row from 84.3 to 85.9. Business expectations were up strongly from 86.0 to 89.5 and hence at the highest level since July last year. It was the sixth rise in a row. Moreover, after already a strong improvement in the previous month, the Ifo reported that the important export expectations were less pessimistic also in June. In contrast, the current assessment reading disappointed again. It was down slightly from 82.5 to 82.4 to a new record low, after a substantial drop already in May.

STILL DIVERGING COMPONENTS



Source: Ifo, UniCredit Research

Following the free-fall in business expectations last autumn, the current recovery is also evolving more rapidly than after past trend reversals in business sentiment. Although the forward-looking expectations has risen for six consecutive months now, the current level of 89.5 still remains below the historical threshold level for zero annual growth in industrial production of 93. And the record low situation component clearly underscores that the German economy was still in recession in the second quarter. All in all, after the terrible first quarter for German industrial production, despite the still depressed level of the current situation component, a strong easing in the rate of decline of GDP can be expected for spring. We expect GDP to contract "only" ½% q-o-q in Q2 after -3.8% at the beginning of the year. And although sentiment still has a long way to go in order to confirm a sustainable recovery, considering the latest massive destocking process and the size of the impending fiscal measures worldwide, even a modest pick-up in overall demand should be sufficient to bring the monthly production dynamic back into positive territory after mid-year – at least temporarily.

Disinflation supports consumer sentiment

German consumer climate GfK improved from 2.6 to 2.9 in June. Consumer price inflation has fallen to zero in May from a very high level of +3.3% y-o-y still in July last year. In combination with on average noticeable wage increases, purchasing power of employees has strengthened. 2009 should bring the first increase in real wages in several years. In addition, private households have already benefited or will soon benefit from the massive fiscal spending programs of the federal government. These are the main factors which help to keep consumer sentiment above its low of 1.5 from September 2008, although the German economy still remains in the worst recession since WW II. Private consumption was the only component which contributed significantly to GDP growth in the first quarter and thus helped to prevent an even worse outcome than the already record high contraction of 3.8% q-o-q. The performance was supported by the car scrapping premium which boosted car sales, which have been leveling off again lately. Nevertheless, the current retail sales figures suggest another positive reading in spring. For the coming quarters, the outlook remains, however, more subdued. Despite the strong disinflation and fiscal policy support, the expected continuing worsening situation on the labor market should increasingly affect consumer behavior. This is underscored by extensive lay-off plans of companies and record high unemployment expectations. Furthermore, the number of new applications for the car scrapping premium has decelerated dramatically of late, signaling a setback in domestic new car purchases ahead.

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

US Review

FOMC: Deflation threat is gone

As expected, the FOMC decided on Wednesday to keep its target range for the federal funds rate at 0% to 0.25%. The Committee reiterated its pledge to leave the federal funds rate at "*exceptionally low levels […] for an extended period.*" In addition, the timeline and amount of the Treasury, MBS and agency debt purchases have been left unchanged.

The tone of the statement was somewhat more sanguine than after the previous meeting. In the economics paragraph, the statement stressed, "*the pace of economic contraction is slowing*" as businesses "*appear to be making progress in bringing inventory stocks into better alignment with sales,*" while "*conditions in financial markets have generally improved in recent months*." Largest change in the inflation outlook is that the Committee no longer sees the risk that "*inflation could persist for a time below rates that best foster economic growth and price stability.*" This means in plain language that the deflation threat is gone. Nevertheless, the Fed still expects inflation to remain subdued, as the resource slack will dampen cost pressures, thereby offsetting the recent rise in commodity prices. The paragraph on monetary policy has been left completely unchanged. In particular, it still includes the pledge to keep rates at, "*exceptionally low levels […] for an extended period*" and confirmed the timeline and amount of Treasury purchases. While the statement leaves the door open for an expansion of its long-term asset purchase program ("*The Committee will continue to evaluate the timing and overall amounts of its purchases.*"), we do not expect this to happen.

US new orders jump for the second straight month

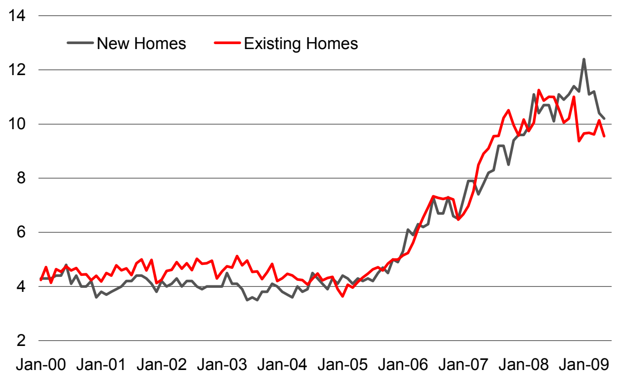
Orders for US durable goods jumped 1.8% in May, following a similar rise in April. As a result, the annualized 3M change improved to +5¼% after reaching a cyclical low of -50½% (!) in December. Orders for civilian aircraft surged 68.1% and defense orders were up 7.4%. But orders in the core group of non-defense capital goods ex aircraft also increased a strong 4.8%, which is the biggest monthly rise since September 2004. Behind the rise in new orders are two factors. First, manufacturers, wholesalers and retailers have significantly reduced their inventories in recent months. As this process is gradually coming to end, businesses are again placing new orders. Second, the massive Chinese fiscal stimulus is spurring US exports. The machinery and IT industries, which have seen the largest increases in new orders in May, are particularly export oriented. These orders are not only stemming directly from China but also from China's neighbors, which have benefited from the Chinese stimulus in recent months.

Reduced excess supply of homes

The National Association of Realtors reported that sales of existing homes in May rose for the second straight month to 4.77 million units. This is the highest level since last October and confirms the view that home sales have finally found a bottom. As a result, the excess supply of unsold homes (inventory-to-sales ratio) fell back to 9.6 months of sales (cf. chart). New home sales, in contrast, fell slightly in May to an annualized 342k units. But at this level, sales are still higher than they were in December, suggesting that sales of new homes have bottomed out as well. Moreover, the inventory-to-sales ratio for new homes fell to 10.2 months, which is the lowest level since July.

INVENTORY-TO-SALES RATIO EASES GRADUALLY

Supply of unsold homes, in months of sales



Source: NAR, Census Bureau, Bloomberg, UniCredit Research

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

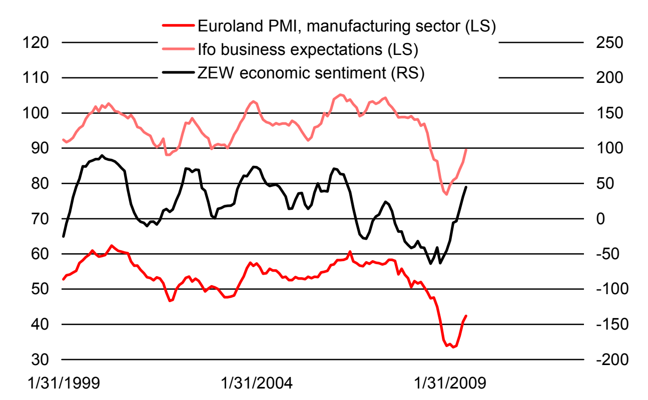
Fixed Income Outlook

- "Green shoots" are still being ignored but…
- …significant changes in the FOMC statement are changing the risk profile, and not only for Treasuries.
- The brisk demand at the ECB's first 12M tender triggered strong declines in money market rates.

Green shoots are still being ignored…

After the past week already saw the ZEW growth barometer for the eurozone and Germany climb to its highest level since 2006, the improved sentiment also continued this week, at least in Germany. The Ifo business climate was a surprise, rising from 84.3 to 85.9 (the consensus expectation had been 85.0), the situation component fell – almost as expected – from 82.5 to 82.4 (an all-time low), but the most forward-looking expectations component again recorded a strong jump from 86.0 to 89.5 (its highest reading since July 2008). The data in the eurozone were not quite as homogenous. The eurozone Manufacturing PMI rose from 40.7 to 42.4, while the Services PMI weakened, with a decline from 44.8 to 44.5. Hope therefore remains the dominant principle without, however, even one of these indicators being able to advance into expansion territory. Below the line, therefore, there is still euphoria at a low level instead of the better combination of lamentations at a high level.

GERMAN BUSINESS CLIMATE DATA IN TOP SHAPE



Source: Bloomberg, UniCredit Research

Once again, however, the domestic bond market ignored the data. It appears that it has now priced in an upswing; the only bone of contention is its sustainability.

… but FOMC statement changes the risk profile, and not only for Treasuries

Even though the FOMC statement made no mention of the emotional phrase "exit strategy", a few - in some cases striking- changes in the FOMC's written risk assessment did, however, raise some eyebrows. Growth, for example, was presented in a less negative light, and the implicit deflation danger was deleted entirely from the statement. Consequently, it is also clear which two issues will dominate the coming weeks and months: When will the quantitative easing be scaled back, and when can we expect the key rate normalization cycle to get under way? Admittedly, there is probably still a long road ahead of us in terms of the historical timing between diverse economic data and the first key rate hike (see table).

TIMING OF US MONETARY POLICY

Indicator	Low/high in	First key rate hike	Gap in months
1990/1991 recession			
US unemployment rate	June 1992	February 1994	20
US capacity utilization	March 1991	February 1994	35
US ISM Index	January 1991	February 1994	37
US leading indicators	January 1991	February 1994	41
2000/2001 recession			
US unemployment rate	June 2003	June 2004	12
US capacity utilization	December 2001	June 2004	30
US ISM Index	October 2001	June 2004	32
US leading indicators	April 2001	June 2004	32

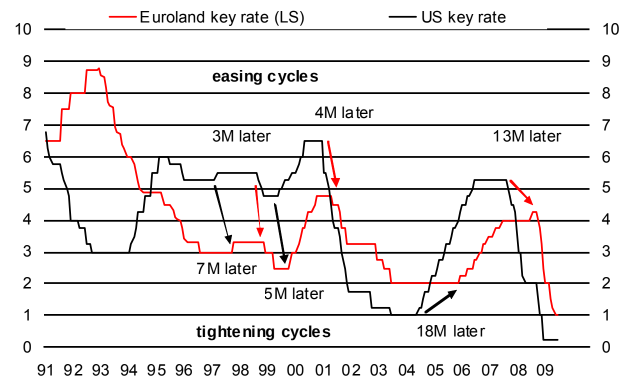
Source: Bloomberg, UniCredit Research

Since we have, so far, not seen either the low in capacity utilization or the high in the unemployment rate, and it was only recently that the ISM and the diverse measures of the leading indicators saw their turning points (December 2008 and March 2009), there is little evidence to support the first key rate hike on January 27, 2010 as implied by the federal fund futures. But the critical aspect for the bond market is: Even though our economists do not expect the first key rate hike before the beginning of H2 2010, against the backdrop of the altered statement, the speculation on an earlier date can gain momentum with every half-way positive economic report.

There are, however, also positive aspects that – even in this event – argue against a full-blown sell-off. If improved data were to push the timing of the first rate hike even farther into the future, this will, on the other hand, also allay the concern of a possible (albeit far distant) loss of the AAA status of USTs, i.e. if anything relief for long-term yields. The constellation is also a double-edged sword with respect to inflation expectations. On the one hand, further stabilization of the economic environment in the US argues generally for rising commodity prices based on the cyclical growth argument and a generally rising propensity to invest in risky asset classes. On the other hand, the expectation of the Fed possibly normalizing sooner defuses the inflation fears.

The implications for the eurozone are similar. Even though we will probably have a much harder time with a recovery than the US and there are still prominent voices (this week the OECD) calling for further key rate cuts, market participants will probably ignore these calls. Here, the debate will not be about the direction of the next key rate move but solely about the question of the time lag relative to US monetary policy. If we use historical data as the benchmark expectation, the average lag so far for key rate hikes was 10 months; this is, however, distorted by the huge time lag in 2005 (the median is 7 months).

US AND EURO ZONE KEY INTEREST RATE



Source: Bloomberg, UniCredit Research

This action has at least shifted the short-term risk towards rising yields. Against this backdrop, the risk tends to be biased towards rising yields, especially in light of the US highlights in the coming week (US employment report and ISM Index). It is, however, doubtful whether further details from the ECB on the purchase of covered bonds will trigger noticeable and above all sustained distortions.

12M ECB tender pushes money market rates to record low

At its first-ever 12M tender, the ECB allocated the huge amount of EUR 442 bn. No fewer than 1,121 banks participated in the tender at the rate of one percent. A numbers game may illustrate the dimensions involved: If we assume that each of the 1,000 "smallest" banks received EUR 100 mn, that would mean the remaining 121 "big" institutions were allocated an average of EUR 2.8 bn. All told, the liquidity in various maturities in the euro system now totals roughly EUR 900 bn. All money market rates in the eurozone will presumably come under major pressure. On the day following the allocation, the 1W Euribor rate fell 24 bp, and the 12M rate was fixed 4 bp lower. The benchmark 3M Euribor fell 5 bp to a new low of 1.145%.

Michael Rottmann (HVB),
+49 89 378 15121
michael.rottmann1@unicreditgroup.de

Kornelius Purps (HVB),
+49 89 378 12753
kornelius.purps@unicreditgroup.de

Forex Outlook

- The road to an environment where currencies are mainly correlated to local economic fundamentals and monetary policies has started. But it will be a long way to go.
- Next week, the ECB meeting and the US labor market report will be the main events. On balance, we expect EUR-USD trading mostly in the 1.38-1.41 range.

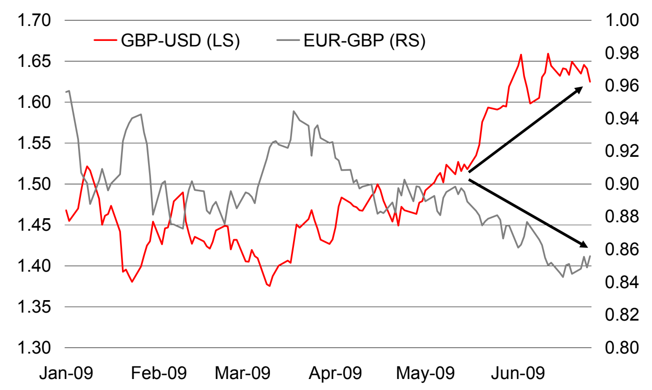
EUR-USD still trapped, but resilient

This week, investors' mood has been quite skittish. This is reflected in a quite complex picture for the FX world. Local factors – for example rumors of SNB and BIS intervention to weaken the CHF vs. both the EUR and the USD – made the G-10 currency performance even more random. Going forward, we expect investors to progressively focus their attention on these local issues. The road to a scenario where currencies are mainly correlated to local economic fundamentals and monetary policies has started, but it will be a long way to go.

EUR-USD: Last Wednesday was painful for the EUR, as it was first hit by a record EUR 442 bn liquidity injection at the ECB 12M tender and then dragged further down by investors reading the Fed's statement as hawkish. While the reaction to the higher-than-expected liquidity injection was no surprise, we think that markets have overreacted to the Fed statement, just focusing on the removal of deflation risks while totally dismissing the main message that inflation will remain subdued and rates will stay low for a prolonged period. Moreover, the supposed double SNB and BIS intervention on both USD-CHF and EUR-CHF, pushing the USD-CHF sky high above 1.10, acted as a drag on the EUR-USD. Next week, the picture looks quite complex given the heavy data and event calendar. The market should start to correct the excessive reaction after the FOMC meeting. There are no evident reasons for the time being to be bullish on the greenback, at least until the commitment to keep rates low for some time is removed. Fed's Bullard speech on exit strategy on Tuesday could offer a reason for more speculation on the topic. But if anything, this will just spur some volatility. Moreover, we should get further details about the asset purchase program at the ECB meeting next Thursday. The "wild card" is still the sterilization issue, on which the ECB was again quite vague at its last meeting. The announcement of a partial or a complete sterilization of the asset program would be positive for the EUR, while we expect a rather neutral reaction in case the current status is maintained. Data-wise, non-farm payrolls will be the main focus in the US next week. Note that, due to the US holiday on Friday, they will be published already on Thursday, just in tandem with Trichet's press conference. Markets expect a slight increase in job cuts. Last time a positive surprise helped the USD across the board. It was interpreted as a sign that the US is on its way to recover and speculation on the Fed exit strategy started to arise. EUR-USD was sent to the 1.39 area, where it stayed until recently. Even in case of a positive surprise in NFP, we do not expect a reaction similar to the last one. Investors have already reacted over-enthusiastically to the FOMC statement and we see high risk of some book squaring ahead of the long weekend in the US. On balance, next week we expect EUR-USD trading mostly in the 1.38/1.41 range. However, from a technical point of view, EUR-USD is still trading within a head & shoulder pattern and thus we would not recommend going long until the 1.42 resistance level is definitely broken.

GBP: BoE officials' attempts to talk down sterling have proven effective on EUR-GBP, while GBP-USD continues to be mainly driven by the USD performance. The two rates are currently diverging (cf. chart). Next week, the focus will be on the two PMI releases, with more good news coming from the manufacturing component. Surveys are pointing to a quicker-than-expected recovery. This might keep cable well bid, while charts show that the pace of appreciation in GBP-USD has slowed down over the last two weeks. 1.66 still remains the next target. Given that we do not see any reason for an appreciation of the greenback for the time being, we remain basically bullish on GBP-USD. On the other hand, the current trading range on EUR-GBP of 0.8450 - 0.86 could be of reference also for next week. Even in the event of better-than-expected PMIs, we would not return short on EUR-GBP until 0.845 is definitely broken.

DIVERGING TREND IN EUR-GBP AND GBP-USD



Source: Bloomberg, UniCredit Research

Chiara Cremonesi (HVB),
+44 207 8261771
chiara.cremonesi@unicreditgroup.co.uk

MIB View – Our Global Picture

Global economy

– The global economy is still in recession. But there are growing signs of stabilization during the second half of this year followed by a mild recovery in 2010. Nevertheless, PPP based real global GDP will post its first minus in 2009 since WW II (-1¼%; 2008: +3%). Based on market exchange rates, it will even shrink massively (by roughly 2½%)! For next year, we expect the global economy to grow at around 2½% (PPP-based), which is well below trend.

– Real GDP in the industrialized countries will most probably shrink by 4.0% this year – more severely than during all the recessions in the 70s and 80s. Japan is hit most (-7.5%), followed by the eurozone (-4.5%) and the US, where we expect a minus of 2.6%. Next year, the industrialized world will show only meager growth (+¾%; US: +1.3%, EMU: +0.1%). Emerging Asia and especially China will continue to lead the growth rankings.

US

– After shrinking dramatically at the turn of 2008/09, the US economy is currently stabilizing and should grow out of recession late this year helped by the massive unprecedented monetary and fiscal policy impulses. But the ongoing, inevitable deleveraging process of the private sector will prevent a V-shaped recovery that normally follows severe recessions.

– After having lowered its target rate by 425 bp since September 2007 to 1%, the FOMC decided to reduce the key rate to 0%-0.25%, adopting a virtually Zero Interest Rate Policy (ZIRP) in December 2008. The Fed is now pursuing a Quantitative Easing Policy.

– Rising inflation expectations and improved economic data fuelled rate hike speculation recently, which is exaggerated in our view. The US tightening cycle should not start before summer 2010.

Eurozone

– The eurozone economy is still mired in recession. But the worst is now definitely behind us, although real GDP should continue to shrink until the end of this year. And for 2010, we expect EMU-wide economic activity to just stagnate (+0.1%).

– The ECB started its easing cycle in October last year. With the presumably last 25 bp cut in May 2009 to 1.0%, the cumulative easing amounts to 325 bp. In addition to the full-allotment of refi-operations up to 12 months, the ECB is starting to purchase covered bonds.

– Given this fragile economic outlook, the ECB should not start to hike its refi rate next year.

Government bond markets

– After consolidating over the next few weeks (too much too soon, profit taking), declining risk aversion combined with improving macroeconomic data and corporate news will see government bond yields trending upward again for the rest of this and also next year.

– Since the supply of government bonds will surge, US 10Y yields reach the 4%-mark as soon as at the beginning of 2010 and are expected to near the 4½% threshold by summer of next year.

– 10Y Bund yields should roughly mimic the pattern of their US counterparts, reaching 4% by the middle of next year.

Exchange rates

– Beyond a temporary pause, EUR-USD is expected to strengthen further, heading toward 1.45 at the end of 2009 and jumping above the 1.50 threshold by the middle of next year.

– JPY should weaken over the course of this as well as next year.

OUR MACRO FORECASTS

in % y-o-y	2008	2009	2010
GDP EMU	0.6	-4.5	0.1
CPI EMU	3.3	0.3	1.3
GDP Germany	1.0	-6.2	0.4
CPI Germany	2.6	0.3	1.1
GDP Italy	-1.0	-5.2	-0.3
CPI Italy	3.3	0.8	1.5
GDP US	1.1	-2.6	1.3
CPI US	3.8	-0.8	2.1

OUR FI/FX & OIL PRICE FORECASTS

2009/10	30-Sept	31-Dec	31-Mar	30-Jun
EMU 3M (%)	1.25	1.25	1.25	1.35
EMU 10Y (%)	3.40	3.50	3.75	4.00
US 3M (%)	0.60	0.60	0.60	0.65
US 10Y (%)	3.60	3.75	4.00	4.30
EUR-USD	1.35	1.45	1.50	1.52
USD-JPY	98	102	105	110
Oil Price	70	65	70	70

Macro Forecasts

GDP, real (%, y-o-y)	2003	2004	2005	2006	2007	2008	2009f	2010f
World economy *	3.7	4.9	4.4	4.9	4.9	3.0	-1.2	2.5
Industrialized countries *	1.9	3.1	2.5	2.9	2.6	0.7	-4.0	0.7
US	2.5	3.6	2.9	2.8	2.0	1.1	-2.6	1.3
Euro area	0.8	1.9	1.8	3.0	2.7	0.6	-4.5	0.1
Germany **	-0.2	0.7	1.0	3.2	2.6	1.0	-6.2	0.4
France	1.1	2.2	1.9	2.4	2.3	0.3	-3.1	0.2
Italy	0.1	1.4	0.8	2.1	1.5	-1.0	-5.2	-0.3
Spain	3.1	3.3	3.6	3.9	3.7	1.2	-3.5	-0.8
Austria	0.8	2.5	2.9	3.4	3.1	1.8	-3.5	-0.3
UK	2.8	3.3	2.1	2.8	3.0	0.7	-4.0	0.0
Switzerland	-0.2	2.5	2.4	3.2	3.3	1.6	-1.7	0.4
Sweden	2.1	3.5	3.3	4.4	2.9	-0.5	-5.2	1.0
Japan	1.4	2.7	1.9	2.0	2.4	-0.7	-7.5	0.5
Developing countries *	6.6	7.6	7.4	8.1	8.6	6.3	2.9	5.3
Asia	8.2	8.6	9.0	9.8	10.6	7.7	5.7	7.5
China	10.0	10.1	10.4	11.1	13.0	9.0	7.0	8.5
India	6.9	7.9	9.1	9.7	9.3	7.3	4.5	6.5
Latin America	2.2	6.0	4.7	5.7	5.7	4.2	-1.5	2.5
Brazil	1.1	5.7	3.2	3.8	5.9	5.1	-1.5	3.5
Central and Eastern Europe	5.8	6.9	5.5	6.3	6.5	4.1	-3.4	0.8
Russia	7.3	7.2	6.4	6.7	8.1	5.6	-3.9	0.6

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

GDP, real (%, q-o-q)	I/08	II/08	III/08	IV/08	I/09	II/09p	III/09p	IV/09p
US (annualized)	0.9	2.8	-0.5	-6.3	-5.7	-0.7	0.1	1.7
Euro area	0.7	-0.3	-0.3	-1.8	-2.5	-0.6	-0.2	-0.1
Germany	1.5	-0.5	-0.5	-2.2	-3.8	-0.5	-0.2	0.2
France	0.4	-0.4	-0.2	-1.5	-1.2	-0.6	-0.3	-0.1
Italy	0.5	-0.6	-0.8	-2.1	-2.6	-0.5	-0.2	-0.3
Spain	0.4	0.1	-0.3	-1.0	-1.9	-0.7	-0.4	-0.4
Austria	0.6	0.2	0.0	-0.4	-2.6	-0.5	-0.2	-0.1
UK	0.3	0.0	-0.7	-1.6	-1.9	-0.5	-0.3	-0.1
Switzerland	0.4	0.0	-0.2	-0.6	-0.8	-0.4	-0.2	0.0
Sweden	-0.6	-0.5	-1.0	-5.0	-0.9	-0.5	0.0	0.3
Japan	0.8	-0.9	-0.6	-3.8	-4.0	-0.5	0.2	0.2

Consumer prices, CPI (%, y-o-y)	I/08	II/08	III/08	IV/08	I/09	II/09p	III/09p	IV/09p
US	4.2	4.3	5.2	1.5	-0.2	-1.1	-2.1	0.4
core rate (ex food & energy)	2.4	2.3	2.5	2.0	1.7	1.8	1.1	1.1
Euro area, HICP	3.4	3.6	3.8	2.3	1.0	0.2	-0.3	0.5
core rate (ex food & energy)	1.8	1.7	1.8	1.9	1.6	1.6	1.3	1.1
Germany	2.3	3.0	2.9	2.9	3.1	1.7	0.8	0.2
France	2.9	3.3	3.3	1.8	0.6	-0.2	-0.2	0.7
Italy	3.1	3.6	4.0	2.8	1.5	0.9	0.2	0.8
Spain	4.5	4.7	5.0	2.5	0.5	-0.8	-1.1	0.8
Austria	3.3	3.6	3.7	2.2	1.1	0.3	-0.2	0.3
UK	2.4	3.4	4.8	3.9	3.0	1.9	0.8	0.8
Switzerland	2.5	2.7	3.0	1.6	0.0	-0.7	-1.1	-0.3
Sweden	3.2	3.8	4.3	2.4	0.7	-0.5	-1.2	0.0
Japan	1.0	1.4	2.2	1.0	-0.1	-0.7	-2.0	-1.4

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; ** GDP growth unadjusted, 2008: 2.5%

Interest & Exchange Rate Forecasts (I)

INTEREST RATE FORECASTS (%, END QUARTER)

2009	current	end-Q3	end-Q4	end-Q1	end-Q2
Eurozone bond market					
Refi rate	1.00	1.00	1.00	1.00	1.00
3M Euribor	1.15	1.25	1.25	1.25	1.35
2Y	1.32	1.40	1.40	1.55	1.90
5Y	2.50	2.50	2.50	2.70	2.95
10Y	3.43	3.40	3.50	3.75	4.00
30Y	4.27	4.20	4.20	4.45	4.60
10Y swap spread (in bp)	27	5	5	5	5
US Treasury Market					
Fed funds target rate	0.13	0.25	0.25	0.25	0.25
3M USD Libor	0.60	0.60	0.60	0.60	0.65
2Y	1.13	1.10	1.25	1.50	1.90
5Y	2.63	2.50	2.55	2.80	3.15
10Y	3.58	3.60	3.75	4.00	4.30
30Y	4.36	4.60	4.75	5.10	5.40
10Y swap spread (in bp)	21	20	20	10	10
Japan					
Target rate	0.10	0.10	0.10	0.10	0.10
3M JPY Libor	0.47	0.50	0.50	0.50	0.50
10Y JGB	1.41	1.30	1.45	1.70	1.85
United Kingdom					
Repo rate	0.50	0.50	0.50	0.50	0.50
3M GBP Libor	1.20	1.10	1.00	0.90	0.90
10Y Gilt	3.73	3.70	3.85	4.10	4.30
Switzerland					
3M CHF Libor mid target rate	0.25	0.25	0.25	0.25	0.25
3M CHF Libor	0.40	0.40	0.40	0.45	0.45
10Y Swissie	2.336	2.50	2.60	2.85	2.85

EXCHANGE RATE FORECASTS (END QUARTER)

	current	end-Q3	end-Q4	end-Q1	end-Q2
EUR-USD	1.4032	1.35	1.45	1.50	1.52
EUR-JPY	134.58	132	148	158	167
EUR-GBP	0.8530	0.88	0.87	0.86	0.85
EUR-CHF	1.5302	1.53	1.55	1.58	1.60
USD-JPY	95.91	98	102	105	110
GBP-USD	1.6451	1.53	1.67	1.75	1.79
USD-CHF	1.0906	1.13	1.07	1.05	1.05

COMMODITY PRICE FORECASTS

	current	end-Q3	end-Q4	end-Q1	end-Q2
Oil price (Brent, USD/b)	70.66	70	65	70	70
DJ commodity price index	253.17	265	275	290	290

Interest & Exchange Rate Forecasts (II)

INTEREST RATE FORECASTS (%, END QUARTER)

2008/09	current	end-Q3	end-Q4	end-Q1	end-Q2
Sweden					
Key rate	0.50	0.50	0.50	0.50	0.50
3M rate	0.96	0.70	0.70	0.75	0.75
10Y government bond yield	3.47	3.65	3.75	3.90	4.10
10Y spread to Bunds (in bp)	4	25	25	15	10
Norway					
Key rate	1.25	1.00	1.00	1.00	1.00
3M rate	1.97	1.25	1.25	1.25	1.25
10Y government bond yield	4.21	4.30	4.50	4.90	5.10
10Y spread to Bunds (in bp)	77	90	100	115	110
Canada					
Key rate	0.25	0.25	0.25	0.25	0.25
3M rate	0.60	0.75	0.75	0.75	0.75
10Y government bond yield	3.42	3.40	3.60	4.00	4.30
10Y spread to Bunds (in bp)	-2	0	10	25	30
Australia					
Key rate	3.00	3.00	3.00	3.00	3.00
3M rate	3.51	3.50	3.50	3.60	3.70
10Y government bond yield	5.60	5.60	5.70	6.00	6.30
10Y spread to Bunds (in bp)	217	220	220	225	230
New Zealand					
Key rate	2.50	2.50	2.50	2.50	2.50
3M rate	3.14	3.10	3.10	3.20	3.30
10Y government bond yield	6.02	6.05	6.20	6.50	6.80
10Y spread to Bunds (in bp)	259	265	270	275	280

EXCHANGE RATE FORECASTS (END QUARTER)

	current	end-Q3	end-Q4	end-Q1	end-Q2
EUR-SEK	11.0529	10.70	10.50	10.30	10.10
EUR-NOK	9.0487	8.75	8.55	8.35	8.15
EUR-CAD	1.6148	1.55	1.64	1.68	1.67
EUR-AUD	1.7445	1.73	1.75	1.72	1.67
EUR-NZD	2.1807	2.25	2.23	2.14	2.03
USD-SEK	7.8773	7.93	7.24	6.87	6.64
USD-NOK	6.4490	6.48	5.90	5.57	5.36
USD-CAD	1.1508	1.15	1.13	1.12	1.10
AUD-USD	0.8044	0.78	0.83	0.87	0.91
NZD-USD	0.6433	0.60	0.65	0.70	0.75
EUR-USD	1.4032	1.35	1.45	1.50	1.52

Economic Event & Data Release Calendar

Date	Time (ECB)	Country	Indicator	Period	MIB est.	Consensus (Bloomberg)	Prev. period
26 June to 03 July 2009							
Fri, 26 Jun '09	14:30	US	PCE core inflation (in % m-o-m)	May		0.1	0.3
	14:30	US	Personal expenditures (in % m-om)	May		0.3	-0.1
	14:30	US	Personal income (in % m-o-m)	May		0.3	0.5
	16:00	US	University of Michigan consumer confidence	Jul		69.0	69.0
Mon, 29 Jun '09	1:50	JN	Industrial production (in % y-o-y)	May		-28.8	-30.7
	10:00	GE	Retail PMI (index)	Jun			46.3
	10:00	EMU	Retail PMI	Jun			47.1
	11:00	EMU	European Commission economic sentiment (index)	Jun	72.0	71.0	69.3
Tue, 30 Jun '09		UK	House price (Nationwide, in % y-o-y)	Jun		-10.8	-11.3
		GE	Retail sales (real, in % m-o-m)	May	0.3	-0.1	0.5
	1:01	UK	Consumer confidence (GFK, index)	Jun		-25.0	-27.0
	1:15	JN	PMI (Nomura)	Jun			46.6
	7:00	JN	Tankan survey small business	Jun			34.1
	8:45	FR	Producer price index, PPI (in % m-o-m)	May		-0.1	-0.9
	9:55	GE	Unemployment rate (in %)	Jun		8.3	8.2
	9:55	GE	Unemployment change (in thousands)	Jun	35	40	1
	10:00	IT	Producer price index, PPI (in % y-o-y)	May			-5.3
	10:00	EMU	M3 money supply (in % y-o-y)	May	4.6	4.6	4.9
	10:30	UK	Real GDP (in % q-o-q)	Q2		-2.2	-1.9
	11:00	IT	Consumer price index (in % y-o-y)	Jun	0.7		0.9
	11:00	EMU	Consumer price index, CPI (in % y-o-y, flash estimate)	Jun	-0.1	-0.2	0.0
	15:00	US	S&P/Case-Shiller home priceindex (in % y-o-y)	Apr	-18.5	-18.8	-18.7
	15:45	US	Chicago Purchasing Managers Index	Jun		38.5	34.9
	16:00	US	Conference Board consumer confidence	Jun	56.0	56.4	54.9
	18:00	US	Fed's Bullard Speaks on Fed Exit Strategies in Philadelphia				
Wed, 01 Jul '09		UK	House price (HBOS, in % 3M y-o-y)	Jun			-16.3
		US	Auto sales (in mn)	Jun		9.8	9.9
	1:50	JN	Tankan survey large enterprises manuf. (forecast)	Q2		-34.0	-51.0
	9:30	SZ	Manufacturing PMI (index)	Jun		41.2	39.8
	9:45	IT	Manufacturing PMI (index)	Jun		42.5	41.1
	9:50	FR	Manufacturing PMI (index)	Jun			45.5
	9:55	GE	Manufacturing PMI (index)	Jun		40.5	40.5
	10:00	EMU	Manufacturing PMI (index)	Jun		42.4	42.4
	10:30	UK	Manufacturing PMI (index)	Jun	46.0	46.0	45.4
	14:15	US	ADP employment index (change in thousands m-o-m)	Jun		-375	-532
	16:00	US	Pending home sales (in % m-o-m)	May		1.1	6.7
	16:00	US	Construction spending (in % m-o-m)	May	-1.0	-0.5	0.8
	16:00	US	ISM manufacturing (index)	Jun	44.0	44.0	42.8
	19:00	IT	Budget balance (EUR bn)	Jun			-7.6
Thu, 02 Jul '09	11:00	EMU	Producer price index, PPI (in % y-o-y)	May		-5.6	-4.6
	11:00	EMU	Umemployment rate (in %)	May		9.3	9.2
	13:45	EMU	ECB refi rate (in %)	Jun 26		1.0	1.0
	14:30	US	Unemployment rate (in %)	Jun		9.6	9.4
	14:30	US	Non-farm payrolls (change in thousands m-o-m)	Jun	-450	-370	-345
	14:30	US	Initial jobless claims (in thousands)	Jun 26	575		627
	16:00	US	New orders (in % m-o-m)	May		0.2	0.7
Fri, 03 Jul '09	9:15	SZ	Consumer price index (in % y-o-y)	Jun		-1.1	-1.0
	9:45	IT	Services PMI (index)	May			42.0
	9:50	FR	Services PMI (index)	Jun			47.5
	9:55	GE	Services PMI (index)	Jun		44.3	44.3
	10:00	EMU	Composite PMI (index)	Jun			44.4
	10:00	EMU	Services PMI (index)	Jun		44.5	44.5
	10:30	UK	Services PMI (index)	Jun		51.5	51.7
	11:00	EMU	Retail sales (volume, in % m-o-m)	May		-0.1	0.2

*: 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
06 July to 10 July 2009							
Mon, 06 Jul '09	10:30	GE	Sentix growth expectations	Jul			-27.0
	16:00	US	ISM Non-manufacturing (index)	Jun	44.0	46.0	44.0
Tue, 07 Jul '09	8:45	FR	Trade balance (EUR bn)	May			-3792
	10:30	UK	Industrial production (in % m-o-m)	May			0.3
	12:00	GE	Industrial orders (in % m-o-m)	May			0.0
Wed, 08 Jul '09	7:45	SZ	Unemployment rate (in %)	Jun			3.5
	11:00	EMU	Private consumption (in % q-o-q)	Q1			-0.5
	11:00	EMU	Government consumption (in % q-o-q)	Q1			0.0
	11:00	EMU	Gross fixed capital formation (in % q-o-q)	Q1			-4.2
	11:00	EMU	Real GDP (in % q-o-q)	Q1			-4.8
	11:00	EMU	Real GDP (in % y-o-y)	Q1			-2.5
	12:00	GE	Industrial production (in % m-o-m)	May			-1.9
	12:00	GE	Industrial production (in % y-o-y)	May			-21.6
	21:00	US	Consumer credit (USD bn)	May			-15.7
Thu, 09 Jul '09	8:00	GE	Exports (in % m-o-m)	May			-4.8
	8:00	GE	Imports (in % m-o-m)	May			-5.8
	10:00	EC	ECB Publishes July Monthly Report (Text)				
	10:30	UK	Trade balance (EUR bn)	May			-3014
	13:00	UK	Bank of England repo rate (in %)	Jun 26		0.5	0.5
Fri, 10 Jul '09	8:45	FR	Budget balance (EUR bn)	May			-71.922
	8:45	FR	Current account balance (EUR bn)	May			-3.1
	8:45	FR	Industrial production (in % m-o-m)	May			-1.4
	10:00	IT	Industrial production (in % m-o-m)	May	0.0		1.1
	10:30	UK	Producer price index, manuf. products (in % m-o-m)	Jun			0.4
	14:30	US	Import prices (in % m-o-m)	Jun	0.4		1.3
	14:30	US	Trade balance (USD bn)	May	-31.5		-29.163

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

Disclaimer

Our recommendations are based on information obtained from, or are based upon public information sources that we consider to be reliable but for the completeness and accuracy of which we assume no liability. All estimates and opinions included in the report represent the independent judgment of the analysts as of the date of the issue. We reserve the right to modify the views expressed herein at any time without notice. Moreover, we reserve the right not to update this information or to discontinue it altogether without notice.

This analysis is for information purposes only and (i) does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for any financial, money market or investment instrument or any security, (ii) is neither intended as such an offer for sale or subscription of or solicitation of an offer to buy or subscribe for any financial, money market or investment instrument or any security nor (iii) as an advertisement thereof. The investment possibilities discussed in this report may not be suitable for certain investors depending on their specific investment objectives and time horizon or in the context of their overall financial situation. The investments discussed may fluctuate in price or value. Investors may get back less than they invested. Changes in rates of exchange may have an adverse effect on the value of investments. Furthermore, past performance is not necessarily indicative of future results. In particular, the risks associated with an investment in the financial, money market or investment instrument or security under discussion are not explained in their entirety.

This information is given without any warranty on an "as is" basis and should not be regarded as a substitute for obtaining individual advice. Investors must make their own determination of the appropriateness of an investment in any instruments referred to herein based on the merits and risks involved, their own investment strategy and their legal, fiscal and financial position. As this document does not qualify as an investment recommendation or as a direct investment recommendation, neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever. Investors are urged to contact their bank's investment advisor for individual explanations and advice.

Neither Bayerische Hypo- und Vereinsbank AG, Bayerische Hypo- und Vereinsbank AG, London Branch, UniCredit CAIB AG, Bayerische Hypo- und Vereinsbank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank, nor any of their respective directors, officers or employees nor any other person accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

This analysis is being distributed by electronic and ordinary mail to professional investors, who are expected to make their own investment decisions without undue reliance on this publication, and may not be redistributed, reproduced or published in whole or in part for any purpose.

Responsibility for the content of this publication lies with:

a) Bayerische Hypo- und Vereinsbank AG, Am Tucherpark 16, 80538 Munich, Germany, (also responsible for the distribution pursuant to §34b WpHG). The company belongs to UCI Group.
Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Lurgiallee 12, 60439 Frankfurt, Germany.

b) Bayerische Hypo- und Vereinsbank AG, London Branch, Moor House, 120 London Wall, London EC2Y 5ET, United Kingdom.
Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Lurgiallee 12, 60439 Frankfurt, Germany and subject to limited regulation by the Financial Services Authority (FSA), 25 The North Colonnade, Canary Wharf, London E14 5HS, United Kingdom. Details about the extent of our regulation by the Financial Services Authority are available from us on request.

c) Bayerische Hypo- und Vereinsbank AG Milan Branch, Via Tommaso Grossi, 10, 20121 Milan, Italy, duly authorized by the Bank of Italy to provide investment services.
Regulatory authority: "Bank of Italy", Via Nazionale 91, 00184 Roma, Italy and Bundesanstalt für Finanzdienstleistungsaufsicht, Lurgiallee 12, 60439 Frankfurt, Germany.

The UniCredit CAIB Group, consisting of
d) UniCredit CAIB AG, Julius-Tandler-Platz 3, 1090 Vienna, Austria
Regulatory authority: Finanzmarktaufsichtsbehörde (FMA), Praterstrasse 23, 1020 Vienna, Austria

e) UniCredit CAIB Securities UK Ltd., Moor House, 120 London Wall, London EC2Y 5ET, United Kingdom
Regulatory authority: Financial Services Authority (FSA), 25 The North Colonnade, Canary Wharf, London E14 5HS, United Kingdom

f) UniCredit Securities, Boulevard Ring Office Building, 17/1 Chistoprudni Boulevard, Moscow 101000, Russia
Regulatory authority: Federal Service on Financial Markets, 9 Leninsky prospekt, Moscow 119991, Russia

g) UniCredit Menkul Değerler A.Ş., Büyükdere Cad. No. 195, Büyükdere Plaza Kat. 5, 34394 Levent, Istanbul, Turkey
Regulatory authority: Sermaye Piyasası Kurulu – Capital Markets Board of Turkey, Eskişehir Yolu 8.Km No:156, 06530 Ankara, Turkey

h) UniCredit Bulbank, Sveta Nedelya Sq. 7, BG-1000 Sofia, Bulgaria
Regulatory authority: Financial Supervision Commission, 33 Shar Planina str.,1303 Sofia, Bulgaria

i) Zagrebačka banka, Paromlinska 2, HR-10000 Zagreb, Croatia
Regulatory authority: Croatian Agency for Supervision of Financial Services, Miramarska 24B, 10000 Zagreb, Croatia

j) UniCredit Bank, Na Príkope 858/20, CZ-11121 Prague, Czech Republic
Regulatory authority: CNB Czech National Bank, Na Příkopě 28, 115 03 Praha 1, Czech Republic

k) Bank Pekao, ul. Grzybowska 53/57, PL-00-950 Warsaw, Poland
Regulatory authority: Polish Financial Supervision Authority, Plac Powstańców Warszawy 1, 00-950 Warsaw, Poland

l) UniCredit Bank, Prechistenskaya emb. 9, RF-19034 Moscow, Russia
Regulatory authority: Federal Service on Financial Markets, 9 Leninsky prospekt, Moscow 119991, Russia

m) UniCredit Bank, Šancova 1/A, SK-813 33 Bratislava, Slovakia
Regulatory authority: National Bank of Slovakia, Stefanikovo nam. 10/19, 967 01 Kremnica, Slovakia

n) Yapi Kredi, Yapi Kredi Plaza D Blok, Levent, TR-80620 Istanbul, Turkey
Regulatory authority: Sermaye Piyasası Kurulu – Capital Markets Board of Turkey, Eskişehir Yolu 8.Km No:156, 06530 Ankara, Turkey

o) UniCredit Tiriac Bank, Ghetarilor Street 23-25, RO-014106 Bucharest 1,Romania
Regulatory authority: CNVM, Romanian National Securities Commission, Foişorului street, no.2, sector 3, Bucharest, Romania

p) ATFBank, 100 Furmanov Str., KZ-050000 Almaty, Kazakhstan
Agency of the Republic of Kazakhstan on the state regulation and supervision of financial market and financial organisations, 050000, Almaty, 67 Aiteke Bi str., Kazakhstan

POTENTIAL CONFLICTS OF INTEREST

Bayerische Hypo- und Vereinsbank AG acts as a Specialist or Primary Dealer in government bonds issued by the Italian, Portuguese and Greek Treasury. Main tasks of the Specialist are to participate with continuity and efficiency to the governments' securities auctions, to contribute to the efficiency of the secondary market through market making activity and quoting requirements and to contribute to the management of public debt and to the debt issuance policy choices, also through advisory and research activities.

ANALYST DECLARATION

The author's remuneration has not been, and will not be, geared to the recommendations or views expressed in this study, neither directly nor indirectly.

ORGANIZATIONAL AND ADMINISTRATIVE ARRANGEMENTS TO AVOID AND PREVENT CONFLICTS OF INTEREST

To prevent or remedy conflicts of interest, Bayerische Hypo- und Vereinsbank AG, Bayerische Hypo- und Vereinsbank AG, London Branch, UniCredit CAIB AG, Bayerische Hypo- und Vereinsbank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank have established the organizational arrangements required from a legal and supervisory aspect, adherence to which is monitored by its compliance department. Conflicts of interest arising are managed by legal and physical and non-physical barriers (collectively referred to as "Chinese Walls") designed to restrict the flow of information between one area/department of Bayerische Hypo- und Vereinsbank AG, Bayerische Hypo- und Vereinsbank AG, London Branch, UniCredit CAIB AG, Bayerische Hypo- und Vereinsbank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank and another. In particular, Investment Banking units, including corporate finance, capital market activities, financial advisory and other capital raising activities, are segregated by physical and non-physical boundaries from Markets Units, as well as the research department. In the case of equities execution by Bayerische Hypo- und Vereinsbank AG Milan Branch, other than as a matter of client facilitation or delta hedging of OTC and listed derivative positions, there is no proprietary trading. Disclosure of publicly available conflicts of interest and other material interests is made in the research. Analysts are supervised and managed on a day-to-day basis by line managers who do not have responsibility for Investment Banking activities, including corporate finance activities, or other activities other than the sale of securities to clients.

ADDITIONAL REQUIRED DISCLOSURES UNDER THE LAWS AND REGULATIONS OF JURISDICTIONS INDICATED

Notice to Austrian investors
This document does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for any securities and neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever.
This document is confidential and is being supplied to you solely for your information and may not be reproduced, redistributed or passed on to any other person or published, in whole or part, for any purpose.

Notice to Czech investors
This report is intended for clients of Bayerische Hypo- und Vereinsbank AG, Bayerische Hypo- und Vereinsbank AG, London Branch, UniCredit CAIB AG, UniCredit CAIB Securities UK Ltd. or Bayerische Hypo- und Vereinsbank AG Milan Branch in the Czech Republic and may not be used or relied upon by any other person for any purpose.

Notice to Italian investors
This document is not for distribution to retail clients as defined in article 26, paragraph 1(e) of Regulation n. 16190 approved by CONSOB on October 29, 2007.
In the case of a short note, we invite the investors to read the related company report that can be found on UniCredit Research website **www.globalresearch.unicreditmib.eu.**

Notice to Russian investors
As far as we are aware, not all of the financial instruments referred to in this analysis have been registered under the federal law of the Russian Federation "On the Securities Market" dated April 22, 1996, as amended, and are not being offered, sold, delivered or advertised in the Russian Federation.

Notice to Turkish investors
Investment information, comments and recommendations stated herein are not within the scope of investment advisory activities. Investment advisory services are provided in accordance with a contract of engagement on investment advisory services concluded with brokerage houses, portfolio management companies, non-deposit banks and the clients. Comments and recommendations stated herein rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not suit your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely on the information stated here may not result in consequences that meet your expectations.

Notice to Investors in Japan
This document does not constitute or form part of any offer for sale or subscription for or solicitation of any offer to buy or subscribe for any securities and neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever.

Notice to UK investors
This communication is directed only at clients of Bayerische Hypo- und Vereinsbank AG, Bayerische Hypo- und Vereinsbank AG, London Branch, UniCredit CAIB AG, UniCredit CAIB Securities UK Ltd. or Bayerische Hypo- und Vereinsbank AG Milan Branch who (i) have professional experience in matters relating to investments or (ii) are persons falling within Article 49(2)(a) to (d) ("high net worth companies, unincorporated associations, etc.") of the United Kingdom Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 or (iii) to whom it may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This communication must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this communication relates is available only to relevant persons and will be engaged in only with relevant persons.

Notice to U.S. investors
This report is being furnished to U.S. recipients in reliance on Rule 15a-6 ("Rule 15a-6") under the U.S. Securities Exchange Act of 1934, as amended. Each U.S. recipient of this report represents and agrees, by virtue of its acceptance thereof, that it is such a "major U.S. institutional investor" (as such term is defined in Rule 15a-6) and that it understands the risks involved in executing transactions in such securities. Any U.S. recipient of this report that wishes to discuss or receive additional information regarding any security or issuer mentioned herein, or engage in any transaction to purchase or sell or solicit or offer the purchase or sale of such securities, should contact a registered representative of UniCredit Capital Markets, Inc. ("UCI Capital Markets").
Any transaction by U.S. persons (other than a registered U.S. broker-dealer or bank acting in a broker-dealer capacity) must be effected with or through UCI Capital Markets.
The securities referred to in this report may not be registered under the U.S. Securities Act of 1933, as amended, and the issuer of such securities may not be subject to U.S. reporting and/or other requirements. Available information regarding the issuers of such securities may be limited, and such issuers may not be subject to the same auditing and reporting standards as U.S. issuers.
The information contained in this report is intended solely for certain "major U.S. institutional investors" and may not be used or relied upon by any other person for any purpose. Such information is provided for informational purposes only and does not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933, as amended, or under any other U.S. federal or state securities laws, rules or regulations. The investment opportunities discussed in this report may be unsuitable for certain investors depending on their specific investment objectives, risk tolerance and financial position. In jurisdictions where UCI Capital Markets is not registered or licensed to trade in securities, commodities or other financial products, transactions may be executed only in accordance with applicable law and legislation, which may vary from jurisdiction to jurisdiction and which may require that a transaction be made in accordance with applicable exemptions from registration or licensing requirements.
The information in this publication is based on carefully selected sources believed to be reliable, but UCI Capital Markets does not make any representation with respect to its completeness or accuracy. All opinions expressed herein reflect the author's judgment at the original time of publication, without regard to the date on which you may receive such information, and are subject to change without notice.
UCI Capital Markets may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. These publications reflect the different assumptions, views and analytical methods of the analysts who prepared them. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is provided in relation to future performance.
UCI Capital Markets and any company affiliated with it may, with respect to any securities discussed herein: (a) take a long or short position and buy or sell such securities; (b) act as investment and/or commercial bankers for issuers of such securities; (c) act as market makers for such securities; (d) serve on the board of any issuer of such securities; and (e) act as paid consultant or advisor to any issuer.
The information contained herein may include forward-looking statements within the meaning of U.S. federal securities laws that are subject to risks and uncertainties. Factors that could cause a company's actual results and financial condition to differ from expectations include, without limitation: political uncertainty, changes in general economic conditions that adversely affect the level of demand for the company's products or services, changes in foreign exchange markets, changes in international and domestic financial markets and in the competitive environment, and other factors relating to the foregoing. All forward-looking statements contained in this report are qualified in their entirety by this cautionary statement

This document may not be distributed in Canada or Australia.

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.co.uk

Economics & Commodity Research

Global Economics

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

European Economics

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

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

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

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

Chiara Silvestre
chiara.silvestre@unicreditgroup.de

US Economics

Roger M. Kubarych, Chief US Economist
+1 212 672-5668
roger.kubarych@us.unicreditgroup.eu

Dr. Harm Bandholz
+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

Martin Blum, Head
+43 50505 823-63, martin.blum@caib.unicreditgroup.eu

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 Holzhacker, Chief Economist, Kazakhstan
+7 727 244-1463, h.holzhacker@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.osakovsky@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.rottmann1@unicreditgroup.de

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

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

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

Bloomberg
UCGR

Internet
www.globalresearch.unicreditmib.eu

* UniCredit Research is the joint research department of Bayerische Hypo- und Vereinsbank AG (HVB), UniCredit CAIB Group (CAIB), UniCredit Securities (UniCredit Securities), UniCredit Menkul Değerler A.Ş. (UniCredit Menkul), UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank and ATFBank.