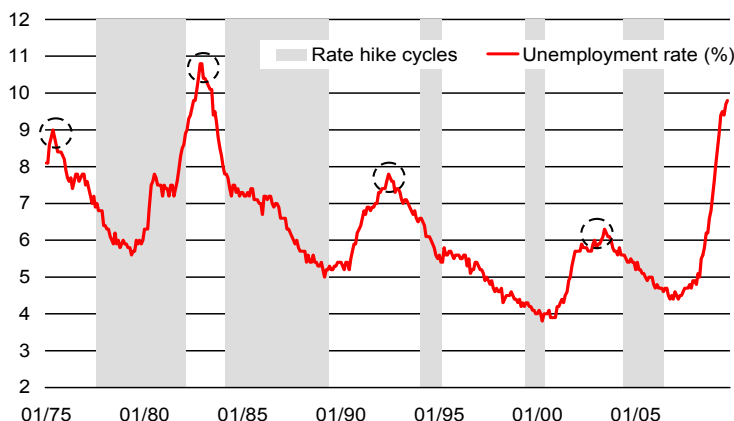


Labor markets are the Achilles Heel

- **Recovery.** The global economy is recovering, and there is mounting evidence that the third quarter was probably strong. Nevertheless, there are lingering doubts about the sustainability of the upswing. We are sticking to our picture of a W-shaped recovery – without expecting a relapse into recession.
- **Doubts.** The reason for our caution is the sluggish private sector. The spark of global trade will not make the jump to consumption and investment activity since households and businesses have to deleverage even further. As a result, the upswing will weaken once the stimulus programs and the inventory cycle come to an end.
- **US.** Strains on personal consumption are coming not least from the labor market. US businesses may be laying off fewer people than in the spring, but they are not hiring either. There will be no change in this situation over the next few months. For that reason, the unemployment rate will rise to roughly 10½% by the beginning of 2010. And the empirical evidence shows that the Fed will wait months before raising the Fed funds target rate (pages 3-5 & chart below).
- **Germany.** Labor market weakness is unfolding in Europe as well. The good numbers in Germany are a statistical anomaly. The development adjusted for special factors is, however, already worse than in previous cycles. And the usual deterioration in the second year following a recession should also materialize this time around. Excess capacity and the rapid rise in unit wage costs should see the jobless number spike to as high as 4¼ million by the middle of next year (pages 6-9).
- **Further topics:**
 - **Weekly Comment:** A jobless recovery? (page 2)
 - **EMU:** Residential investment still has some way to fall (page 10).
 - **Eastern Europe:** Relief, but no euphoria (page 12)
 - **Data outlook:** Ifo business climate to continue to improve (page 16).
 - **Market outlook:** EUR-USD to test 1.50 mark (page 23).

US: HIGHER INTEREST RATES ONLY WHEN UNEMPLOYMENT RATE FALLS



Source: Thomson Datastream, UniCredit Research

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MIB MACRO FORECASTS

as % yoy	2008	2009	2010
GDP EMU	0.6	-4.0	0.8
CPI EMU	3.3	0.3	1.3
GDP Germany	1.0	-4.7	2.0
CPI Germany	2.6	0.4	1.0
GDP Italy	-1.0	-4.9	0.4
CPI Italy	3.3	0.8	1.5
GDP US	0.4	-2.4	1.9
CPI US	3.8	-0.4	2.3

MIB FI/FX FORECASTS

	2009/10	31-Dec	31-Mar	30-Jun	30-Sept
EMU 3M (%)	0.80	0.90	1.05	1.20	
EMU 10Y (%)	3.45	3.60	3.85	4.10	
US 3M (%)	0.30	0.50	0.85	1.25	
US 10Y (%)	3.70	3.85	4.10	4.40	
EUR-USD	1.47	1.52	1.55	1.50	
USD-JPY	95	98	100	103	
Oil Price	65	70	70	75	

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A jobless recovery?

In this issue of our Friday Notes, we focus on the most socially painful consequence of the crisis: unemployment. Alexander Koch and Harm Bandholz take an in-depth look at labor market developments in Germany and the US. The picture that emerges is worrisome, although perhaps not as dramatic as one might have feared given the intensity of the downturn in the first part of the year.

In the US, unemployment has more than doubled from the pre-crisis lows of about 4½%, and is now rapidly heading towards 10%. This is a significantly worse deterioration than what we have observed in the euro zone as a whole, where unemployment has risen to 9.6%, but starting from a relatively high 7.2% at the beginning of last year. In Germany, the increase appears negligible, to 8.2% from 7.6%, at face value a very benign impact for a contraction in real GDP which should be in the region of 5%. The increase has been somewhat sharper in Italy, to 7.4% from a 2007 low of 5.6%, but here as well the rise is not as brutal as one might have feared given the magnitude of the recession (again in the region of 5%) – and interestingly, Italy outperforms the euro zone average on this measure. I should also warn up front that across these countries, as well as in the rest of the euro zone, we expect unemployment to keep trending higher even as economic activity stabilizes.

It would therefore appear that Europe's social model is serving its workers well, cushioning the impact of the most severe recession we have seen in a long time. In some cases, the picture might be skewed by changes in registration practices – as Alexander Koch highlights for Germany. But overall, what we are seeing at work is the impact of a number of measures taken to try and help firms to hold on to as large a share of their labor force as possible. In many cases, this is achieved by shortening working weeks, and in some cases governments have stepped in to top up the corresponding reduced wage payments. This was a rational strategy to adopt, and not just from a social perspective: this crisis is unprecedented, and as such it was impossible to predict both the speed and duration of the downturn, and the speed and duration of the recovery. It is therefore sensible for companies to hold on to their labor force to the extent possible, so as to minimize the turnover, especially if the government can mitigate the cost. In addition, limiting the increase in unemployment helps to support consumption, thereby reducing the intensity of the downturn.

Indeed, if this were to turn into a genuine V-shaped recovery, companies could quickly bring their employees back to full-time, and would be able to ramp up production much more rapidly than if they had to restart the hiring process. If this becomes a V-shaped recovery therefore the labor market measures adopted will help it to take off quickly.

If, however, the recovery loses steam as we expect, there is a significant risk that firms will be forced to lay off more workers, pushing the unemployment rate higher. Moreover, firms might end up weathering most of the recession with a higher-than-optimal number of employees – and as a consequence might be very reluctant to hire as the recovery gathers momentum. There is a significant risk therefore that the price some countries will pay for the relatively moderate rise in unemployment this year will be a jobless recovery in 2010-11.

Finally, it is important to consider the longer-term consequences of the current trends. A clear disadvantage of the European strategy of helping firms to hold on to their workers is that it slows down the painful but necessary process of reallocating resources from sectors which will be permanently damaged by the crisis to sectors that will provide stronger growth opportunities in the future. To the extent that surmounting the crisis requires a rebalancing within national economies, slowing the rise in unemployment hinders this process and might therefore slow down the recovery and hamper potential growth. Moreover, one should look with greater attention at the differential impact of the rise in unemployment on different cohorts of workers. We have not yet developed a full-fledged analysis, but anecdotal observation suggests this might be a serious problem in labor markets characterized by a sharp insider/outsider dichotomy. Outsiders are generally younger workers with fixed-term contracts, which accounted for the largest share of employment creation before the crisis. These are the workers who are now quickly being laid off, and will find it difficult to find another job in the near future. Especially if their previous working history has been "checkered", a succession of short-term assignments, these young individuals will find themselves with an extremely weak work background once the economy has recovered, having missed the chance for consistent professional development. If this affects a significant share of the young workforce in some countries, it would imply a tremendous loss in human capital with potentially damaging effects on growth potential.

Bottom line: the jury is still out on whether labor market policies implemented during the crisis were the right ones; but in any case, governments should already take a much closer look at the longer-term impact on the labor force and potential growth – especially as robust growth will be essential to facilitate a return to fiscal sustainability.

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US: Fewer layoffs, but hardly any new hires

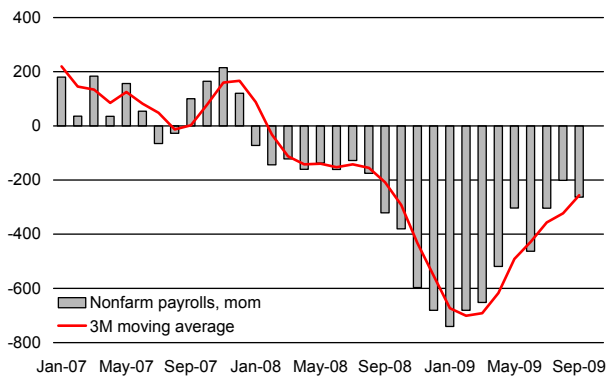
- Since the beginning of the recession, roughly 8 million Americans have lost their job. The only good news is that the pace of layoffs has slowed appreciably in recent months.
- About the only reason for this relative improvement is a sharp decline in the number of layoffs. Hiring activity, in contrast, has recovered only marginally.
- Industry reports suggest many businesses do not intend to hire new employees in the coming months either. The ongoing decline in the number of job openings underscores this bleak outlook.
- Against this backdrop, we expect the unemployment rate to rise to 10½% by early 2010. That is an important reason why the Fed will probably not raise its target rate until the second half of 2010.

Decline in the number of job losses

The labor market remains the Achilles heel of the US economy. Since the beginning of the recession, 7.2 million jobs have been eliminated – and during the annual benchmark revision, this number will probably even be revised up to 8 million. The only “good” news is that since the beginning of the year the pace of payroll declines has slowed from 700k per month to 250k (see chart). Virtually the only reason for this relative improvement is a sharp decline in the number of separations. According to the Bureau of Labor Statistics, voluntary departures and involuntary layoffs & discharges have fallen by just over 600k per month since the beginning of the year (see chart).

EMPLOYMENT STILL FALLING STRONGLY

Non-farm payrolls, change in k

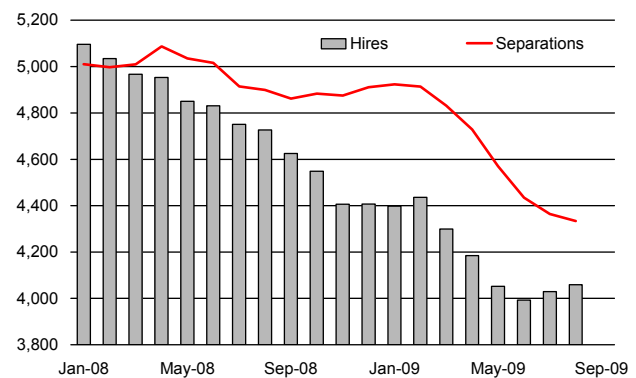


Source: BLS, Thomson Datastream, UniCredit Research

After the slash and burn of recent months and the related productivity gains, it looks as if more and more businesses have finally completed their workforce reduction. On the other hand, however, the number of new hires has recovered only marginally. After hitting an all-time low in June, they may have increased again by 60k, but are still 400k shy of the level recorded in January 2009 and even 1 million below the level recorded in January 2008.

SOLID DECLINE IN LAYOFFS – BUT HIRES REMAIN WEAK

Hires and separations in k (3M moving averages)



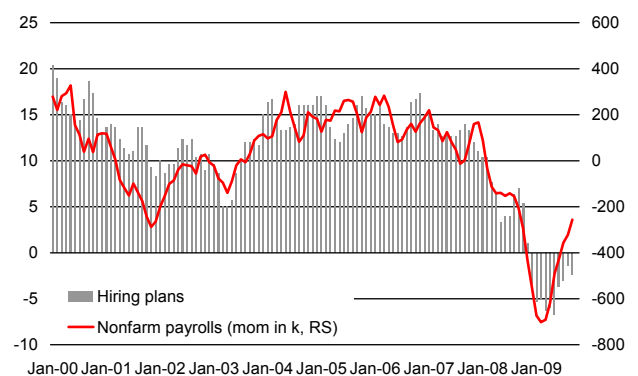
Source: BLS, Thomson Datastream, UniCredit Research

Companies are not hiring

If one believes the latest industry reports, small businesses do not intend to change this situation rapidly. According to the National Federation of Independent Business (NFIB), the hiring plans of these companies fell again in September to their lowest level since May (-4).

SMALL BUSINESSES DO STILL NOT PLAN TO HIRE

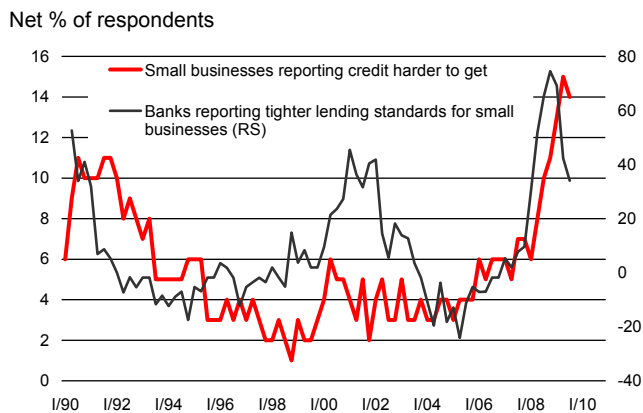
Moving 3M averages



Source: BLS, NFIB, Thomson Datastream, UniCredit Research

As illustrated by the chart, only a survey reading of +10 points would be consistent with stable non-farm payrolls. Alongside low sales expectations and considerable underutilization of capacities, an important reason for this reluctance to hire is that businesses still have only very tight access to credit. According to the US Small Business Administration (SBA), commercial banks and other depository institutions are by far the largest lenders of debt to small businesses, as they account for almost 65% of total traditional credit provided. The Fed's Senior Loan Officer Survey shows that a sizeable majority of these banks have continued to tighten their lending standards for small businesses. Accordingly, a net 14% of businesses still complain that they have a hard time obtaining credit. That is only two percentage points shy of the all-time high of 16% reached in May (see chart). Just how important these small businesses are for the US labor market is illustrated by the following numbers, provided by the SBA: Firms with less than 500 employees represent 99.7% of all employers in the US, and employ more than half of all private-sector employees. Most importantly, they have generated 64% of net new jobs between 1993 and 2008. But this employment motor now appears to be sputtering until further notice.

STILL DIFFICULT TO OBTAIN CREDIT



Source: Federal Reserve, NFIB, Thomson Datastream, UniCredit Research

No vacancies

A further indication of the tense situation on the US labor market is the declining number of job openings. Since mid-2007, vacancies have fallen by 50% (!), and in August they posted a new all-time low of 2.4 million. Since the jobless rolls are rising steadily at the same time, more and more unemployed people are competing for fewer and fewer jobs. The ratio of job seekers to vacancies recently increased to a new all-time high of 6¼ – that is more than four times the level before the beginning of the current crisis and also more than double the previous peak reached after the 2001 recession (see chart next column).

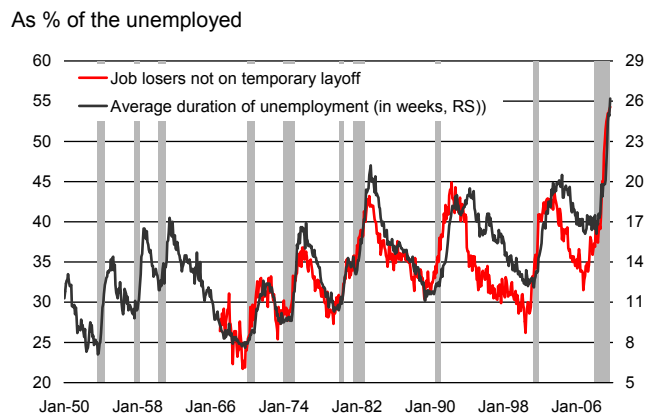
STIFF COMPETITION FOR VACANCIES



Source: BLS, Thomson Datastream, UniCredit Research

The fact that in September the average duration of unemployment increased to a new all-time high of 26¼ weeks, i.e. more than half a year, gels with this picture (see chart). At the same time, the share of job losers not on temporary layoff has hit a new record of 54¼%. Before the current crisis, the peak was still 45%; it stems from the year 1992. With these bleak prospects, it is hardly surprising that the labor market is weighing heavily on consumer sentiment. The Conference Board survey even fell again in September, despite the ongoing stock market rally and slightly lower gasoline prices. The backdrop was the growing frustration over the situation on the labor market: Only 3.4% of respondents stated, "jobs are plentiful". That is the most downbeat assessment since 1982.

NEW SAD RECORDS ON THE LABOR MARKET



Source: BLS, NBER, Thomson Datastream, UniCredit Research

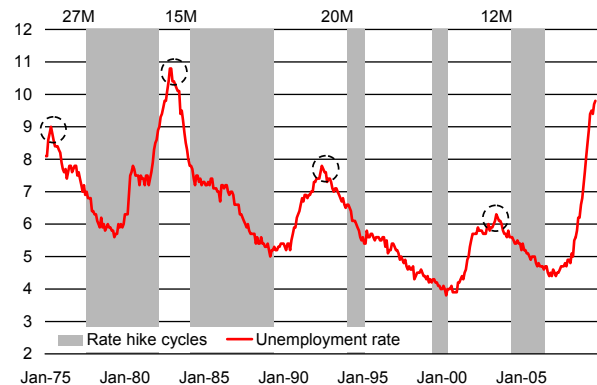
Weak labor market preventing the Fed from raising rates any time soon

The good news first: The number of layoffs will continue to decline in the coming months. This trend is evident on a weekly basis in the slow but steady decline in initial jobless claims. As a result, the monthly decline in non-farm payrolls should also slow down from month to month – but fewer layoffs alone are not sufficient for a labor market U-turn. For that to happen, there would also have to be a strong increase in business hiring. But this is apparently not in the cards right now. Due to ongoing sales problems, considerable underutilization of capacity and significant funding problems, most businesses are still steering clear of the labor market. This week's FOMC minutes talked about indications from business contacts, "that their firms would also be cautious in hiring and investing even as demand for their products picked up." Against that backdrop, we expect the average duration of unemployment will continue to increase and that the unemployment rate will rise to 10½% by the beginning of 2010. In September, the unemployment rate would have already been at 10.1% (instead of the officially reported 9.8%), had it not been for the 571k decline in the workforce. But the reversal of this effect will probably trigger a stronger rise in the unemployment rate as soon as October.

The ongoing rise in the unemployment rate is at the same time an important reason why we think the rate hike speculation in the markets (2/3 probability for a first rate hike in April) is exaggerated. James Bullard, President of the St. Louis Fed, said at the beginning of this week in a Bloomberg interview that employment growth and a decline in the unemployment rate are, from his standpoint, a prerequisite for rate hikes. Bullard therefore contradicted the President of the Richmond Fed, Jeffrey Lacker, who at the beginning of October still stated that the Fed could raise rates even without a decline in the unemployment rate – "provided growth reestablishes itself firmly enough". From our standpoint, these two developments are difficult to separate, even though the unemployment rate is a lagging indicator. The empirical evidence also speaks volumes: Since the early 70s, the Fed has not initiated a tightening cycle as long as the unemployment rate was still rising – quite the contrary. After the unemployment rate had peaked, an average of 18 months went by before the first rate hike! The most rapid reaction came after the last recession, but here too the Fed still needed one year before raising rates for the first time (see chart next column).

HIGHER INTEREST RATES ONLY ONCE THE UNEMPLOYMENT RATE IS ON THE DECLINE

Unemployment rate as %



Source: BLS, Federal Reserve, Thomson Datastream, UniCredit Research

The relevance of the unemployment rate for monetary policy decisions is obvious: The first mandate of the Fed "full employment" relates directly to the labor market, while the second mandate "stable prices" is influenced indirectly by the unemployment rate. In a service society such as the US, wage costs are the most important determinant of core inflation; and the most important determinant of wage costs is in turn the unemployment rate. For that reason, we think the Fed is in no rush to raise its benchmark interest rate, and do not expect the first rate hike until the second half of 2010.

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Germany: Pressure on the labor market is still increasing

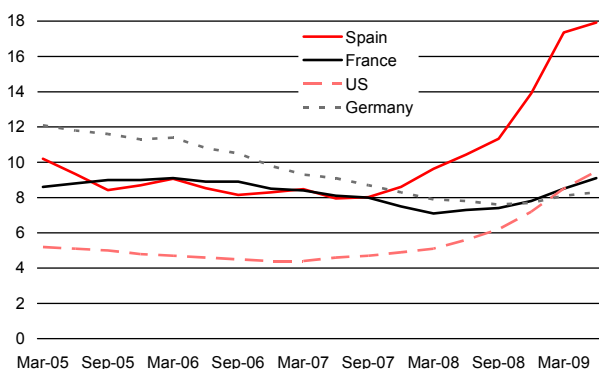
- The German labor market proved astonishingly resilient recently with three consecutive declines in the jobless rolls. The unemployment statistics have, however, profited greatly from special factors.
- Statistical changes, the strong use of short-time work, the reduction of overtime and a decline in the supply of labor succeeded in substantially slowing the labor market downswing.
- Nevertheless, after close to one year the extent of the current cycle is even slightly above the average of previous labor market downswings. And the usual intensification in the second year should also materialize this time.
- High excess capacities and a rapid increase in unit labor costs should see the jobless rolls increase strongly from currently below 3.5 million to up to 4¼ million by the middle of next year.

Labor market resilient recently

The German labor market was astonishingly resilient recently. In September, seasonally-adjusted unemployment was down for the third consecutive month. At first sight, the severe recession, which is now over, appears therefore to have had only a relatively small negative impact on the employment situation in Germany. Since the low of 7.6% last October, the unemployment rate has increased to "only" 8.2% in eleven months. In other large industrialized countries, the unemployment rate has risen much more strongly. In some cases, it has more than doubled (see chart).

FINANCIAL CRISIS HITS LABOR MARKETS

Unemployment rate as %, seasonally adjusted



Source: Bloomberg, UniCredit Research

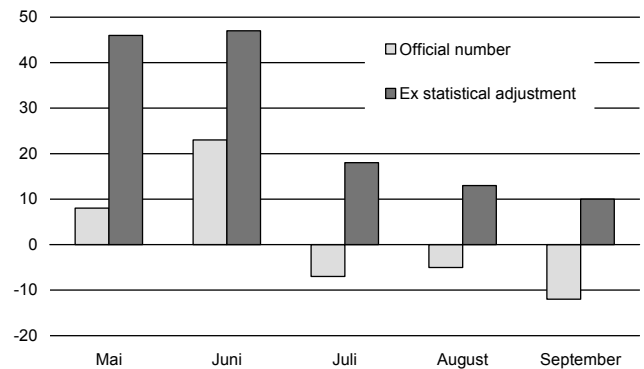
Strong dampening factors

The official unemployment statistics have, however, profited greatly from special factors in recent months:

- The upshot of the new legislation governing labor policy instruments passed at the beginning of this year is that job seekers who look for employment through third parties (private employment agencies not associated with the Federal Employment Agency) are no longer recorded in the official unemployment statistics. In April, private employment agencies across Germany were mandated to find employment for roughly 200,000 people. Since May, participation in this measure has been gradually winding down. This takes considerable pressure off the unemployment statistics. According to the Federal Employment Agency, unemployment without the statistical change would have increased in each of the last three months and not fallen (see chart). Overall, the effect has slowed the rise in unemployment since May by roughly 130,000. And in September, there were still 67,000 registered with private employment agencies. This will continue to slow the rise in unemployment in the short term.

STATISTICAL EFFECT

Unemployment, adjusted, mom in thousand

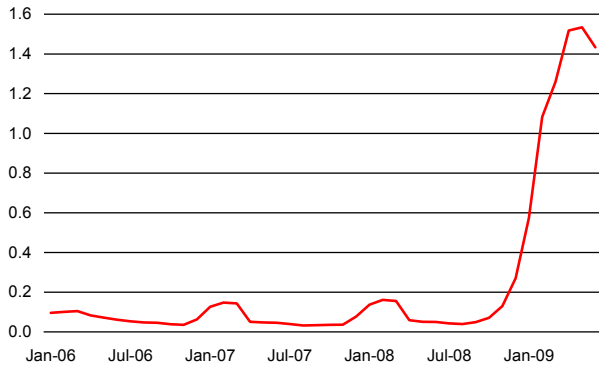


Source: Federal Employment Agency, UniCredit Research

- The expansion of the short-time work rule as part of the economic stimulus plan has triggered a rapid increase in the number of short-time workers since the end of last year. Even though the number recently peaked (see chart on the next page), the level remains very high at well over one million and is a major factor in stabilizing the workforce. An average reduction in working hours of one-third translates into a full-time equivalency of almost 400,000 jobs.

SHORT-TIME WORK HAS PASSED A PEAK

Short-time workers in mn

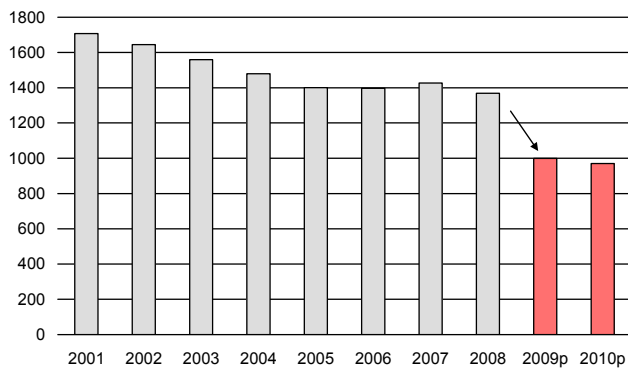


Source: Federal Employment Agency, UniCredit Research

– Furthermore, the volume of overtime is down sharply this year (see chart). The reduction of short-time work accounts and the return to balanced working hours succeeded in offsetting part of the slump in demand without reducing employment. According to the estimates from the Institute for Employment Research (IAB), the adjustment should however now be extensively completed here.

SHARP DECLINE IN OVERTIME

Overtime in millions of hours

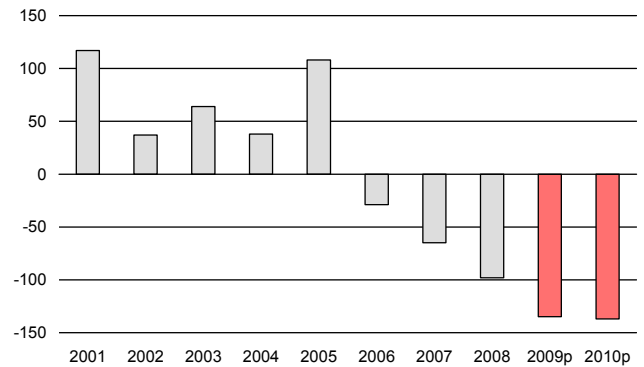


Source: IAB, UniCredit Research

– Above and beyond that, the demographic development is already having a dampening effect on the unemployment statistics. According to calculations by the IAB, the potential workforce has been declining steadily since 2006. The annual decline this year should increase to 135,000 and continue to increase slightly also in the coming year.

LABOR SUPPLY ON THE DECLINE

Potential workforce, change in thousands



Source: IAB, UniCredit Research

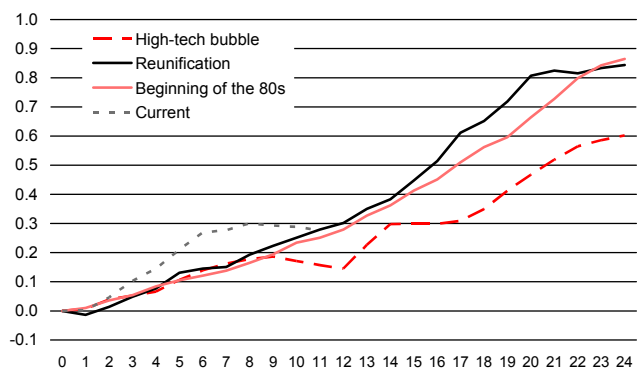
Labor market downswing average so far

Were it not for the aforementioned dampening factors, the rise in unemployment this year would already be substantially stronger. In a worst-case scenario, the unemployment rate adjusted for special factors could therefore have been over half a million higher. The unemployment rate would therefore have climbed not to 8.2% but as high as 10%.

But even with the slight declines in recent months, adjusted unemployment has so far increased by a total of 276,000 since October 2008. As a result, and despite the supporting factors, the current labor market downswing is – after close to one year – already slightly stronger than the average of the preceding severe recessions (see chart).

AVERAGE CYCLE SO FAR

Cumulative rise in unemployment in mn; x-axis: months after the low

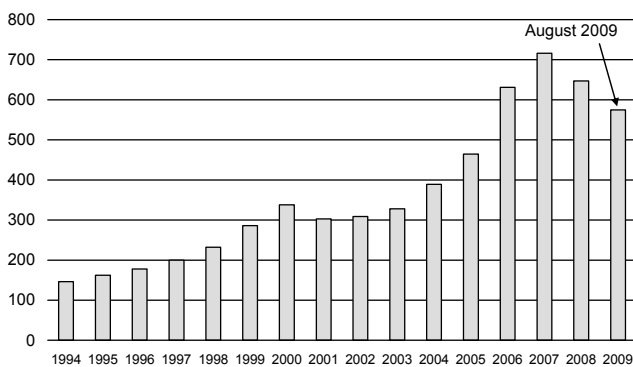


Source: Federal Employment Agency, UniCredit Research

The comparatively more rapid rise in unemployment at the beginning of the current labor market downswing was exacerbated by the strong expansion of temporary work in recent years as a flexible instrument to steer the workforce. Since the liberalization of this instrument under the Schröder administration, the number of temporary workers more than doubled to 716,000 at the end of 2007. According to the temporary work index compiled by the Federal Association for Temporary Work (*Bundesvereinigung für Zeitarbeit, BZA*), the number did, however, fall 20% to 575,000 by August 2009 (see chart). By reducing temporary work, businesses were able to react quickly to the slump in demand.

TEMPORARY WORK ADAPTS QUICKLY

Temporary workers in thousands



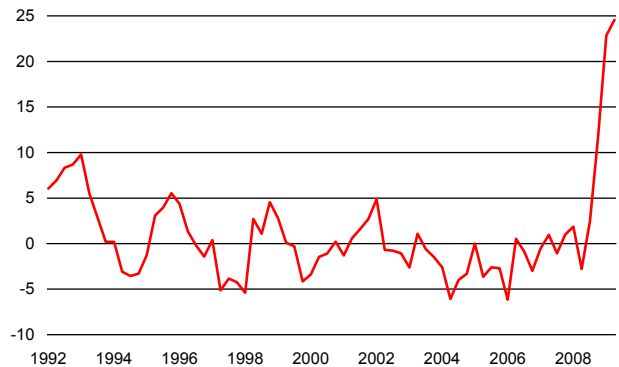
Source: BZA, UniCredit Research

Labor market remains under pressure

At the moment, there can still be no talk of an end to the labor market downswing, even though sentiment in industry has improved strongly recently with the revival of global trade and production activity should move clearly away from its trough in the coming months. Numerous companies have announced they will cut back short-time work appreciably by the end of the year – well before the maximum period of 24 months. Most short-time workers will then probably return to regular employment. The recent improvement in capacity utilization will, however, not be enough to return all short-time workers to full employment. The pre-crisis production levels are unlikely to be revisited in the foreseeable future. As a result, there remains in some cases high excess capacity. Recently, this has put massive upward pressure on unit labor costs, first and foremost in the manufacturing sector. Despite a slight decline qoq, they were up 25% yoy in the spring (see chart in the next column)!

UNIT LABOR COSTS SKYROCKETING

Unit labor costs in manufacturing, as % yoy



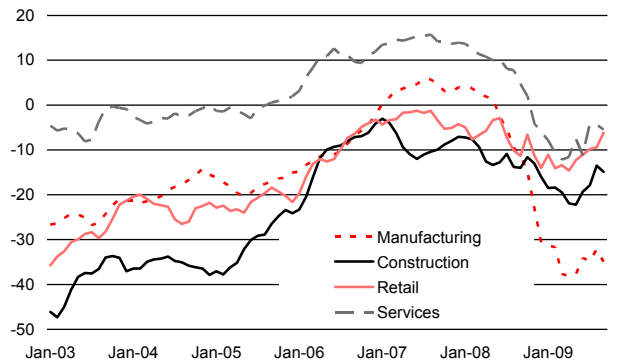
Source: Bundesbank, UniCredit Research

Increase until well into next year

The recent stabilization of the economy may have eliminated the worst fears for the labor market – the scary number of 5 million unemployed is no longer mentioned – but the unemployment numbers will likely continue to rise strongly well into next year. In earlier cycles, the downward dynamic on the labor market regularly accelerated in the second year – even after the end of the recession in the economy as a whole (see chart further above). The current situation should be no exception here. Hiring plans in the key manufacturing sector remained strongly negative recently. And in the retail trade, the recent upward trend in employment expectations will probably not be sustainable because of the deteriorating outlook for private consumption. In contrast, the economic stimulus program should at least help prevent further marked job losses in construction in the coming quarters (see chart).

HIRING PLANS REMAIN NEGATIVE

Hiring plans, balances as %



Source: EU Commission, UniCredit Research

The growth rates for unemployment should increase appreciably up to the turn of the year. By then, the statistical effects will also have ended. Short-time work and the decline in the supply of labor will probably continue to slow the rise in unemployment somewhat, but overall we still expect an increase in adjusted unemployment from currently still below 3.5 million to up to 4¼ million by the middle of next year. The labor market should therefore play a very important role in the current coalition negotiations between the CDU/CSU and FDP. Further measures to avert layoffs or incentives for more rapid hiring would be very welcome. This would support the domestic economy more effectively than direct income tax relief, since when unemployment is rising strongly households will probably also hold back on purchases even in the event of tax relief.

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Euro zone: Residential investment still has some way to fall

- The credit crisis has heavily affected residential investment, which started to decline fast in spring 2008. Though clearly slowing, house prices have proved more resilient.
- Housing investment is unlikely to revive in the near term because both supply and demand indicators look weak.
- We see another leg of correction in residential investment that will last for the whole of 2010, though the pace of contraction is set to ease progressively.
- House prices, which follow with a lag and probably started declining outright at the beginning of this year, should continue to fall throughout 2010, though in an orderly way.

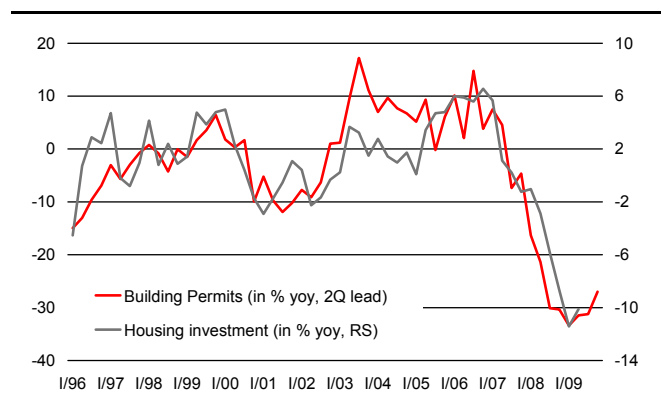
Residential investment falling fast

Residential investment in the euro zone has been severely hit by the effects of the credit crisis. After having peaked at 6.6% yoy at end-2006, housing investment entered a steep downward trajectory and plunged to an all-time low of -11.4% yoy in 1Q09, before inching up to -10.1% in 2Q. The bulk of weakness has been recorded starting in 2Q08: in the last five quarters for which data are available, qoq contraction rates have hovered in the 2-3.5% (non annualized) range, leading to a cumulative decline of 13.2%. However, it's interesting to note that in this tough environment house prices at the area-wide level have proved fairly resilient: in 2H08 (the last data available), the yearly rate of change was still in positive territory at 0.6%, down from the 2005 peak of about 7.5%. In the following, we argue that a recovery in euro area residential investment is not in sight and that the contraction is set to continue throughout 2010, though at a progressively slower pace. House prices, which follow with a lag and probably started declining outright at the beginning of this year, should continue to fall throughout 2010, though in an orderly way.

No signs of recovery in 2H09

We see several elements that argue for another leg of correction in residential investment. In the near term, most supply indicators continue to depict a weak outlook: while showing signs of bottoming out, they don't point yet to a recovery. Building permits, which lead housing investment by two quarters, in 2Q marked the first qoq increase since late-2006, but were still down by almost 30% yoy, just off the all-time lows hit at the turn of the year. In mid-2009, permits were down 50% from early 2007. Moreover, the EC construction sector survey in September still reveals a record number of firms reporting limits to activity due to demand factors, with orders and price expectations holding close to historically low levels.

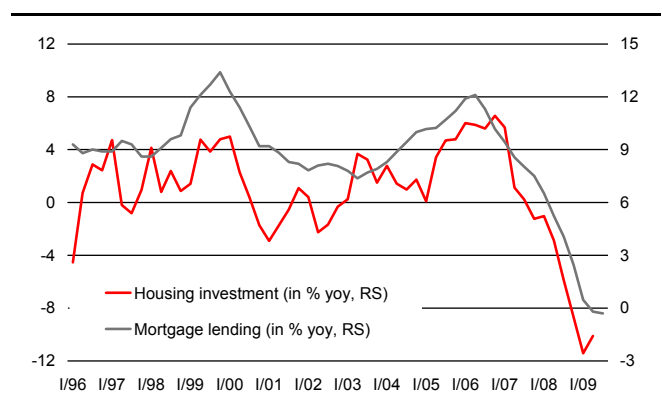
BUILDING PERMITS REMAIN DEPRESSED



Source: OECD, ECB, Eurostat, UniCredit Research

Also on the demand front, the overall message remains pessimistic, though with some tentative signs that the bottom may have been reached. On the one hand, mortgage lending growth, which displays a good correlation with residential investment, in 3Q hovered in slightly negative territory with no tendency yet to resume an upward trajectory.

NO SIGN OF REVIVAL IN MORTGAGE LENDING YET



Source: OECD, ECB, Eurostat, UniCredit Research

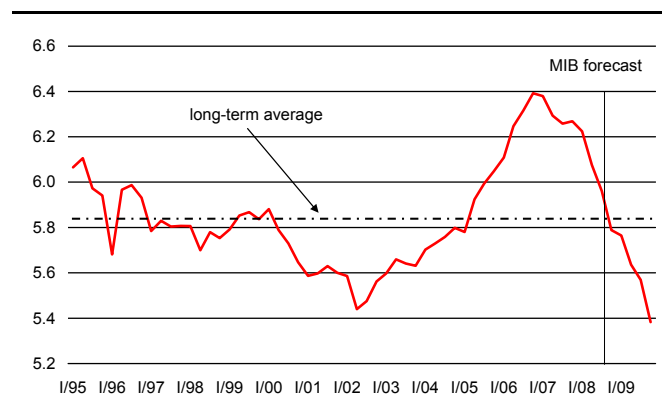
On the other hand, the ECB's Bank Lending Survey (BLS) provides slightly more positive indications. In fact, while in 2Q banks continued to tighten credit standards for mortgage lending, they also reported the first (tiny) increase in home loan demand in almost three years. We recall that loan demand as reported by the BLS started to contract in 3Q06, in synch with the beginning of the slowdown in mortgage growth (the peak was around 12% yoy in spring 2006), and about six months before housing investment started to lose momentum. Based only on the BLS evidence, it's still premature to say whether we reached a turning point in mortgage lending, even because banks do not expect this pick-up in loan demand to be sustained (expected mortgage demand remains in negative territory).

However, if confirmed, the improvement flagged by the BLS would signal that higher housing affordability is eventually pushing some buyers back into the market, validating the idea that the worst is behind us for housing demand and the mortgage market – and, possibly with a lag, residential investment as well. Note that the stickiness in house prices seen so far coupled with the downward trend in the growth rate of household disposable income imply that higher housing affordability is due primarily to falling mortgage rates. Summing up, supply and demand indicators suggest that the yoy rate of change in residential investment may have troughed, but will remain very depressed in 2H09 and, presumably, also moving into 2010.

A look at 2010: expect further easing

On a medium-to-longer term perspective, it is the supply side that plays the most important role in the adjustment process. In this respect, one of the key variables to watch is the ratio between nominal housing investment and GDP, which measures the size of the housing sector with respect to the whole economy. The value of this ratio vs. its long-term average provides a rough approximation of the upside/downside potential for housing investment beyond the short term. In 2Q09, the ratio dropped further and reached 5.6%, significantly below the 6.4% peak hit at end 2006/early 2007, and just below the long-term average of 5.8-5.9% (computed starting from 1995 due to data availability). While per se this is an indication that the size of the housing sector is now “about right” in historical terms – and therefore, at least in theory, the correction relative to GDP could already be over – one shouldn’t forget that dynamics in the residential sector tend to be very persistent and characterized by long cycles, due to the inertia of housing supply in the short term. It’s therefore likely that the strong overshooting of residential investment recorded in 2005-2007 will be corrected through a phase of significant undershooting before the ratio starts reverting to its long-run equilibrium. Admittedly, there is high uncertainty on the true downside potential for residential investment, even because identifying the long-run equilibrium of the ratio simply with the average of the last fifteen years poses the risk of assuming reversion around a biased mean, due to the short time span. Just to give an idea, in the US the residential investment-to-GDP ratio computed starting in 1950 averages 4.7%, one full percentage point below the euro zone average in 1995-2009. This leaves open the discussion on the true equilibrium level of the ratio in the euro zone in the long run. In our baseline scenario, housing investment as a share of GDP falls steadily over the next few quarters and bottoms out at 5.0% at the end of 2010, by far the lowest level since the inception of the series.

HOUSING/GDP SET TO FALL FURTHER

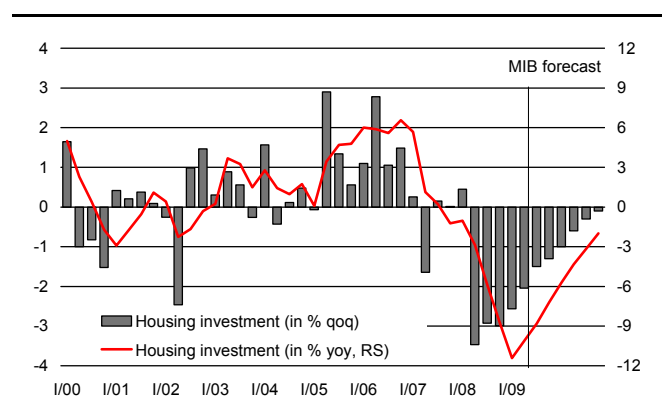


Source: Eurostat, UniCredit Research

If this may seem aggressive considering the 6.4% peak of the cycle and the estimated long-run average of 5.8-5.9%, we recall that in the US the ratio peaked at 6.3% at the end of 2005, and troughed at 2.4% in 2Q09.

In our projections, after the nasty figures of the last five quarters, the contraction in residential investment becomes progressively less severe, but levels off only towards the end of next year. In yearly average terms, we forecast that housing investment will drop 9.4% in 2009 and contract by another 3.8% in 2010. As the housing supply continues to fall to adjust to the lower level of demand, house prices are seen declining throughout the forecast horizon, but we are not overly pessimistic: we suspect that the drop will remain in single digit territory.

OUR FORECASTS FOR HOUSING INVESTMENT



Source: Eurostat, UniCredit Research

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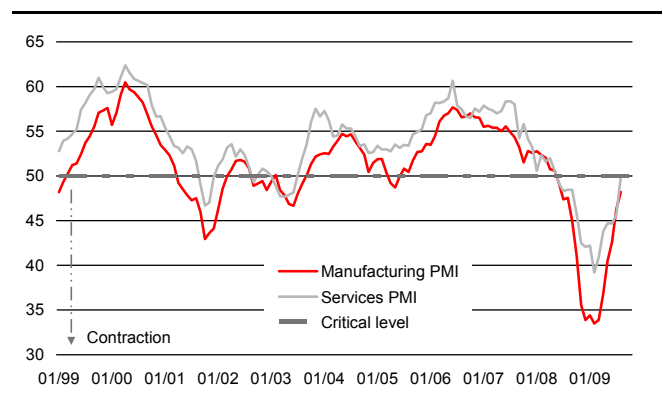
Emerging Europe: Relief, not euphoria

- On the back of the healthier-than-anticipated rebound in global growth, we have marginally raised our broad CEE17 growth forecast to 1.4% in 2010. The revision signals that we feel more confident about the economic recovery in EME, but certainly not euphoric, as headwinds at both the global and local level will limit the pace of recovery.
- The global economy is rebounding faster than anticipated, driven by a robust recovery in global trade. Germany has also surprised on the upside, and the rapid improvement in the euro zone should quickly spill over to CEE. The open economies (Czech Republic, Hungary, Slovakia) are best positioned, but Poland for now remains the outperformer.
- CEE vulnerabilities have shifted from external to fiscal balances, as the growth contraction has narrowed C/A gaps and widened fiscal deficits, including in Poland and Turkey. Hungary and to some extent Romania are bucking this trend, with a prudent fiscal stance in the context of IMF-supported programs. Political ramifications of these adjustments have, however, been demonstrated by the recent collapse of the Romanian government.
- Key macro forecast highlights: **1.** Although Poland is outperforming at the moment, we believe this reflects the late cycle nature of its economy, and we expect this to turn into underperformance in 2010-2011. We hence increased our 2009 GDP forecast but slightly reduced that for 2011. **2.** We expect the Turkish economy to significantly outperform the region in 2010 and we see GDP growing at 3.2%. **3.** Despite the recent surge in oil prices, we expect the Russian economy to only grow by 1.3% in 2010 due to weak domestic demand. **4.** We expect Hungary, the Baltic Countries, Bulgaria, Croatia and Serbia to remain in recession in 2010.

CEE to benefit from global recovery ...

The recent round of 2Q GDP releases has confirmed that the global economy has rebounded sooner and faster than markets had been anticipating. The evidence in terms of hard data suggests that this recovery is genuine, and in coming months will probably continue to look V-shaped, fueling market optimism. In the euro zone, economic activity contracted a mere 0.2% on a quarterly basis, much less than expected, thanks to upside surprises in France and in Germany, where quarterly growth has already returned to positive territory. In the US, 2Q GDP showed a 0.7% annualized contraction, while the UK was the only developed economy to disappoint, showing a 0.8% qoq decline. In Asia, the main emerging economies grew by an average annualized rate of more than 10%, and even sluggish Japan rebounded by a solid 0.9% qoq.

HEALTHY RECOVERY IN THE EURO ZONE

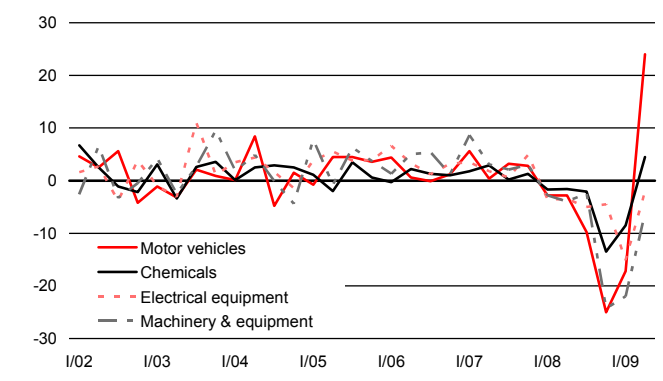


Source: Thomson Datastream, UniCredit Research

The resilience of Latin America, especially Brazil, has also surprised on the upside. While policy stimulus has played a key role, it is global trade that has become the main engine of the recovery (see chart): the acceleration in economic activity has started most decisively in Asia, and its robust pace has helped turn net exports into an important contributor to growth – together of course with the ongoing contraction in imports.

GLOBAL TRADE DRIVING THE RECOVERY

German foreign new orders

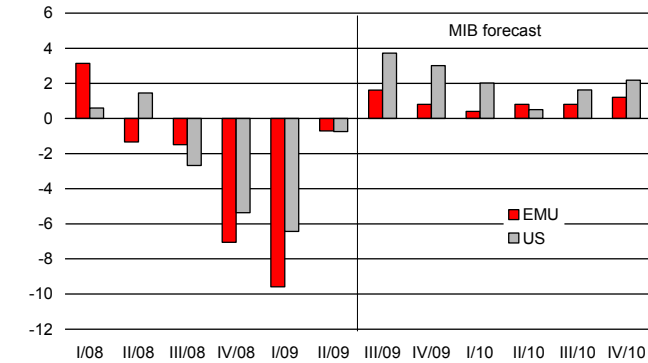


Source: Thomson Datastream, UniCredit Research

The positive momentum of data surprises is likely to continue until the end of the year and possibly into early 2010, pushed by three main drivers: **1.** Global trade will continue to provide support; **2.** The inventory cycle is only now kicking in with gusto, and will start showing up in the GDP growth data beginning in 3Q (inventories subtracted as much as 0.7pp from euro zone growth in 1Q and 2Q); and **3.** Already enacted policy stimulus will continue to come on line and propel the economy. However, growth momentum is fated to fade in 2010, especially in the developed economies (see chart).

RECOVERY UNDERWAY, BUT MOMENTUM WILL WEAKEN IN 2010

Real GDP, as % annualized



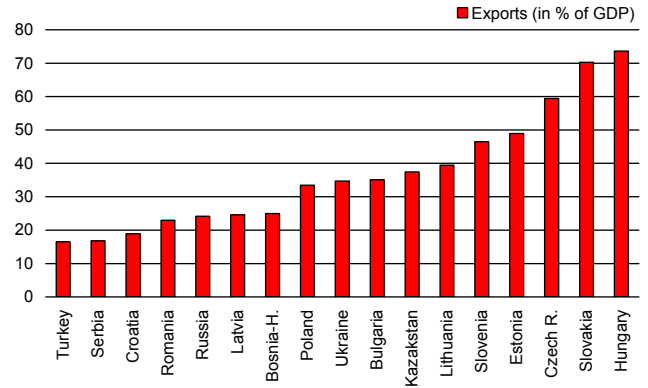
Source: Thomson Datastream, UniCredit Research

Even though supportive policies will remain in place, policy-makers will not provide fresh stimulus as the economy improves, and the policy impulse will therefore abate. Private sector demand should take up the baton, but both investment and consumption face important headwinds: **1.** Consumption will be held back by rising unemployment; and **2.** Investment will be restrained by historically low levels of capacity utilization and the already high levels of leverage of companies.

...but concerns persist on fiscal imbalances and lending

The sharp pick-up in euro zone sentiment indicators is already reflected in better CEE business sentiment – CEE should benefit very soon from the strong German recovery. This will primarily support countries with more open economies (Czech Republic, Hungary, Slovakia). Besides net exports, a further contribution to growth should come from a turnaround in the inventory cycle: the sharp recession registered throughout the region in 1Q and 2Q included an unprecedented rapid downward adjustment in inventories – which now bodes well for near-term recovery prospects. Poland remains the outperformer in terms of growth. The country has successfully avoided recession, and is poised for growth of 1.5% this year, as private consumption has remained resilient in the face of rising unemployment. This outperformance, however, in part reflects a late-cycle phenomenon: we expect investment and consumption to struggle, restraining the acceleration of growth to rates well below potential in 2010-11.

MORE OPEN ECONOMIES SET TO CAPITALIZE ON GLOBAL TRADE RECOVERY

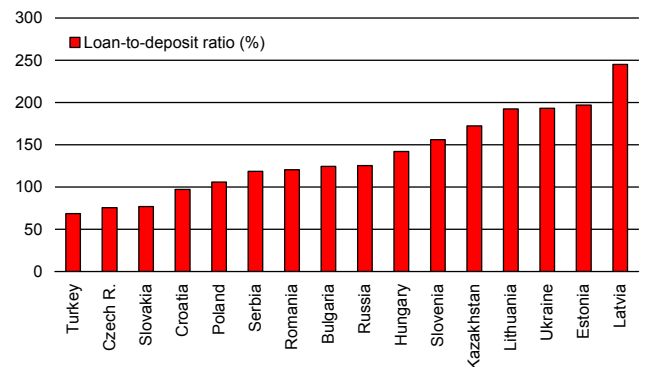


Source: Thomson Datastream, UniCredit Research

Sentiment indicators failed to improve in the CEE services sector, however, which suggests that domestic demand is set to remain weak in the coming quarters:

1. CEE retail sales correlate highly with credit, and hence household demand will remain weak where the banking sector relied heavily on external financing, and is currently reducing its loan-to-deposit ratios by moderating lending. The winners here are Turkey and Poland, where loan-to-deposit ratios are below 100%; and which are therefore less vulnerable to deleveraging in the banking sector (see chart).
2. Investment will remain extremely soft given that significant spare capacity gives firms leeway to increase production and delay new investment until they have greater confidence in the recovery.

LOWER BANKING SECTOR LEVERAGE = LOWER RISK TO LENDING LEVELS

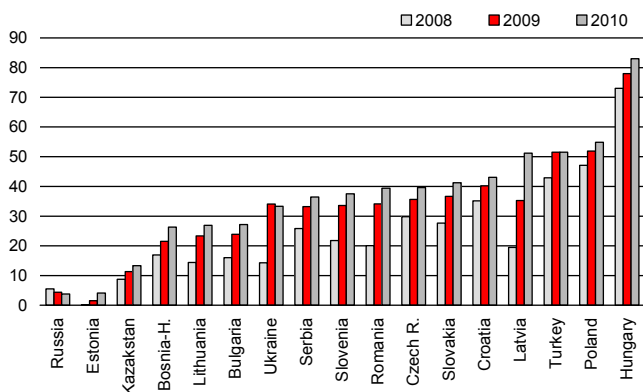


Source: Fitch, UniCredit Research

This implies that, after the deep recession, the structure of CEE growth is changing in favor of net exports. This has already helped to drive a fast and significant reduction in external current account imbalances, which were the region's Achilles Heel – external financing risks are therefore declining quickly. Turkey, where the adjustment has been helped significantly by lower energy prices, is a case in point: we project the C/A deficit to narrow to 1.5% this year from nearly 6% last year. In some countries, however, fiscal imbalances are becoming a concern. In Kazakhstan and Russia, falling commodity prices and lower revenues are pushing deficits wider – although the low level of total public sector debt (Russia: 4.4% of GDP estimated for the end of 2009) (Kazakhstan: 11.3% of GDP estimated for the end of 2009) is a supportive factor. Within CEE, Hungary is the strong performer on this front: in the context of its IMF program, it is running a tight fiscal policy to balance the highest debt ratio in the region (79% of GDP estimated for the end of 2009). In contrast, fiscal deficits are widening rapidly in Poland and Turkey.

CEE VULNERABILITIES SHIFTING FROM THE EXTERNAL SECTOR TO THE FISCAL SIDE

Public sector debt (as % of GDP)



Source: Thomson Datastream, UniCredit Research

Just as in the euro zone, there is concern that a contraction in lending could hamper the recovery in the EEMEA region. In the euro zone, this concern has been clearly articulated by the ECB: the worry is that as non-performing loans rise due to the recession, their adverse impact on banks' balance sheets will trigger another round of deleveraging via a contraction in lending. Given the strong inter-relationship between the banking system in the euro zone and in EEMEA, this credit squeeze would then most likely manifest itself across the whole European region.

This concern needs to be taken seriously, as some lending markets have already come under stress, notably in Romania. However, conditions in the banking sector are improving: **1.** Banks' profitability has increased recently, with support coming also from the recovery in asset prices, which has led the IMF to lower its estimate of total financial sector losses; **2.** The improvement in the growth outlook reduces the downside risks to the NPL forecasts; and **3.** Some banks have already begun to strengthen their capital positions, thereby putting themselves on a stronger footing to sustain credit growth. Within the euro zone, there are some encouraging signs of ongoing normalization in financial markets, including a much-reduced demand for liquidity at the ECB's Long Term Refinancing Operation on 29 September.

Bottom line: the growth outlook for the EEMEA region has improved – even though the region remains in a more vulnerable position than Emerging Asia and Latin America – and vulnerabilities have now shifted from the external to the fiscal side. With the recovery getting underway, rate-cutting cycles are coming to an end: Turkey, Hungary and Russia are the only countries where we expect further rate cuts before year-end. It is too early, however, to start betting on a turn in the monetary policy cycle. With growth outlooks still uncertain and more dependent on exports, and hence competitiveness, central banks will remain wary of fuelling currency strength and will maintain a dovish bias for longer than markets expect. Even in the cases of the Czech Republic and Poland, where central banks have signaled the end of the easing cycles, markets are in our view too aggressive in pricing future hikes.

FI/FX market strategy

Following a stellar second quarter when EEMEA-USD was up by 13.5%, EEMEA FX started to decouple from other asset classes in 3Q09. Our EEMEA/USD basket closed only 3.8% higher vs. a near 15% jump in SPX and the average 100bp spread tightening in their own 5Y sovereign CDS. The divergence is even bigger when measured vs. the EUR given the general USD weakness observed in the last quarter. Moreover EEMEA FX has also underperformed the local rates market. This decoupling trend is even more spectacular considering the significant improvements in the region's current account balances during the third quarter. We attribute these developments to the following two factors:

1. As domestic demand is still very weak and net exports have taken the lead in GDP growth, central banks have become less tolerant toward stronger currencies, particularly given painful competitiveness gains at the end of last year. This is evidenced by ongoing rate cuts in Turkey (150bp in 3Q), the restart of the easing cycle in Hungary (200bp in 3Q vs. no change in 2Q) and the 150bp rate cuts together with increased intervention efforts by the Central Bank of Russia. The strength of this factor is also demonstrated by the fact that the two best performing currencies in the CEE region were PLN and CZK, where central banks hinted that they are finished with rate cuts (for now) and yield curves started pricing in rate hikes (forward rate agreements indicate around 80bp rate hikes from both central banks over the next 12M).
2. Non-resident holding data suggest that non-resident real money positioning is still relatively light in the local markets. This indicates that the rally in local markets was mostly driven by domestic participants. For instance, the non-resident ownership of Hungarian government bonds has failed to increase since the end of July, non-resident ownership of Turkish government bonds was up by 8% but a significant part of this was driven by valuation effects. And finally, we believe that inflows into dedicated euro zone convergence funds have not been remarkable in the last quarter.

Looking ahead, we expect the external balance improvement to put further appreciation pressure on FX, which central banks will continue to resist. On top of a temporary inventory-driven deterioration, we expect CEE current accounts to continue delivering positive surprises as household demand is still very weak (lower wages, soft lending growth) vs. a somewhat improved outlook for exports. We believe that the associated FX appreciation pressure is still unwelcome and central banks will continue to resist it with low rates and intervention. Against this backdrop, although both Poland and the Czech Republic signaled the end of their easing cycles, we think that no imminent rate hikes are on their agenda. On the other hand, we expect Hungary (further 50bp by year-end), Turkey (at least further 50bp by year-end) and Russia (further 100bp by year-end) to continue the easing cycle in the next quarter. We believe this trend will continue to support the short end of yield curves and we are particularly positive about Russia (as CBR tries to draw a line under the basket), Czech Republic and Poland (where the curves are pricing in rate hikes). Additionally, we see scope for further downside in TRY and HUF short end.

While external financing risks have been broadly addressed, the focus will remain on fiscal policies with associated pressure on the long end of curves. This can be best assessed, in our view, through ASW spread developments and on the shape of yield curves. According to our estimates, although the level of Polish and Czech long end yields are relatively high, only the Turkish yield curve includes a fair amount of risk premium, while the other curves have steepened on the back of falling short ends and a steeper EUR yield curve. We think that risk premium vs. fiscal risks will continue to hang over the long end of curves vs. the short ends in Poland, the Czech Republic and potentially in Russia in the coming quarter.

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Data Monitor – Preview Europe

Thursday, October 22

FRANCE, BUSINESS CONFIDENCE

October	MIB	Cons.	Sept	Aug
	87	87	85	82

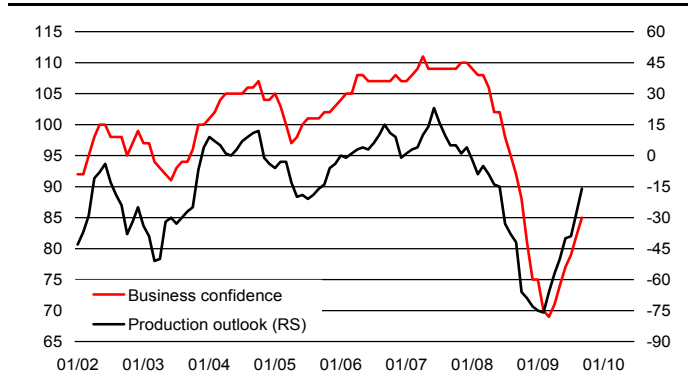
The INSEE business confidence should register a further improvement in October, in the wake of a further pick-up in global orders and a rosier outlook for manufacturing output. The current level remains well below the survey's long-term average (at 99), so we see scope for an increase in the survey in order to match strengthening momentum in economic activity.

UK, RETAIL SALES

September	MIB	Cons.	Sept	Aug
as % mom	1.3	0.5	0	0.1

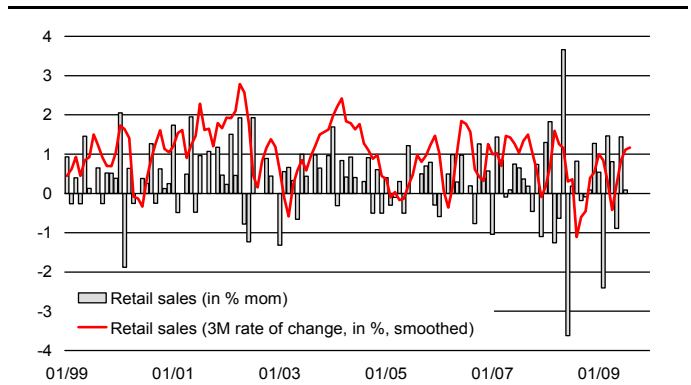
In line with indications from the BRC survey, we expect a firm rebound in September retail sales, partly correcting the subdued performance over the summer (also negatively impacted by the timing of the August bank holiday). An outcome in line with our forecast would lift retail sales 1.2% above the 2Q average, pointing to a significant contribution to 3Q GDP.

POINTING NORTH



Source: INSEE, UniCredit Research

SET TO REBOUND



Source: ONS, UniCredit Research

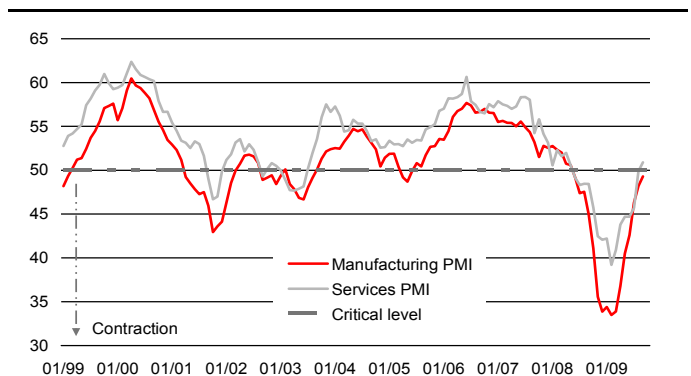
Friday, October 23

EMU, PURCHASING MANAGERS INDICES (PMIs)

October	MIB	Cons.	Sept	Aug
Manufacturing PMI	50.5	50.1	49.3	48.2
Services PMI	51.1	51.3	50.9	49.9

In September, the activity components of the manufacturing PMI showed a slower pace of improvement (output: 51.2 vs. 51.3, new orders 52.1 vs. 51.1). However, the new orders-to-stock ratio is virtually stable at a three-year high, suggesting further improvements in the headline PMI over the coming months. In October, the manufacturing PMI should eventually climb above the 50 threshold, while the services pendant will continue to proceed on its ongoing upward trajectory.

MANUFACTURING TO ENTER EXPANSIONARY TERRITORY



Source: Thomson Datastream, UniCredit Research

GERMANY, IFO BUSINESS CLIMATE INDEX

October	MIB	Cons.	Sept	Aug
Index	92.0	92.0	91.3	90.5

Business sentiment and the new order situation worldwide recently continued to trend higher across the board. In many cases, however, the improvement was no longer as strong as in the preceding months. Accordingly, above all German businesses' assessment of the current situation probably continued its recovery process. Expectations should also still have upside potential in the short term, although by no means on the same scale as in the preceding two months.

FRANCE, CONSUMER SPENDING

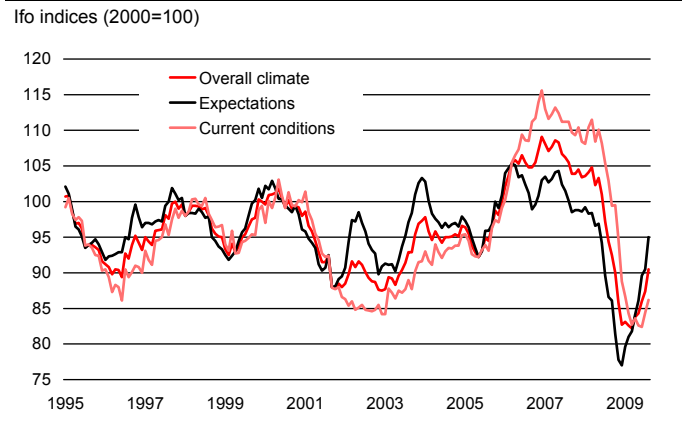
September	MIB	Cons.	Sept	Aug
as % mom	1.2	-0.1	-1.0	-1.2

Consumer spending should mark a rebound in September, thanks to a bounce-back in clothing and car spending. This would still leave household spending on manufactured goods -0.6% below 2Q, pointing to a flattish performance in private consumption in the third quarter.

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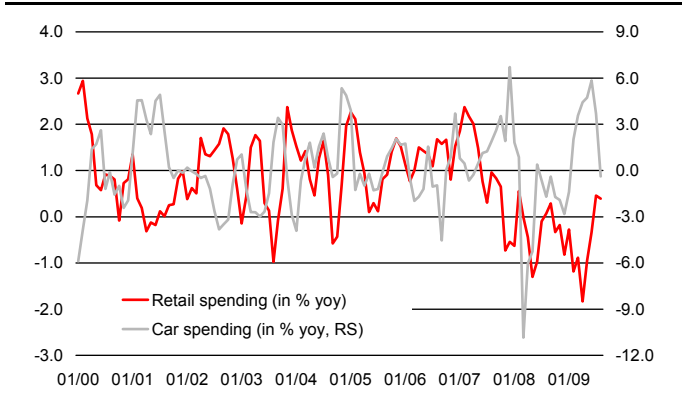
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BUSINESS EXPECTATIONS STAGE STRONG RECOVERY



Source: Feri, UniCredit Research

AWAITED CORRECTION IN CAR SPENDING



Source: Thomson Datastream, UniCredit Research

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Data Monitor US – Preview of the coming week

Tuesday, October 20

PRODUCER PRICES

September	MIB	Cons.	Aug	July
Headline, as % mom	0.1	0.1	1.7	-0.9
Core rate, as % mom	0.1	0.1	0.2	-0.1

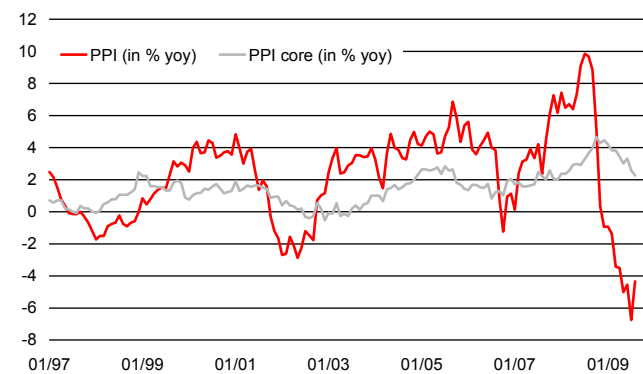
The increase in producer prices ex food and energy was pretty steady at 0.1% during the last couple of months, indicating that pipeline pressures are benign amid the significant underutilization of resources. Only recently did huge fluctuations in prices for cars and light trucks add some volatility to the series. As a result of our forecast, the yoy rate would decline to 2% from 2¼% – the lowest level since 2007. The headline yoy rate, in contrast, is likely to increase to -4.1%, as the negative base effect from lower energy prices fades out.

HOUSING STARTS & BUILDING PERMITS

September	MIB	Cons.	Aug	July
Housing starts, in k (annualized)	610	610	598	589
Building permits, in k (annualized)	590	590	580	564

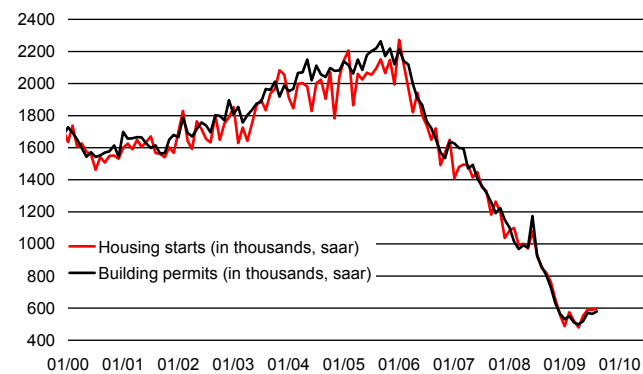
Residential construction activity has celebrated a remarkable rebound in recent months. Since the trough in April, starts surged 25% and permits are up 16%. Backdrop is most likely that construction activity had been reduced too much during the last 3½ years, so that some projects are implemented now as the economy stabilizes and access to credit is slightly easier. However, due to the still high excess supply of real estate, we expect the pace of the recovery to slow down in the next few months. This should become visible first in building permits, which are the leading indicator.

PIPELINE PRESSURE REMAINS BENIGN



Source: Thomson Datastream, UniCredit Research

IMPROVEMENT IN RESIDENTIAL CONSTRUCTION CONTINUES



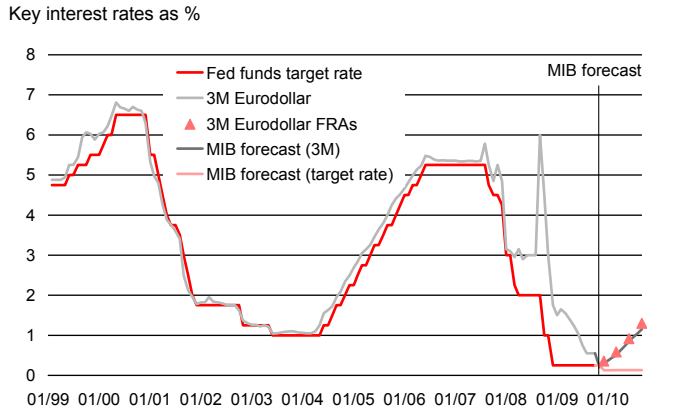
Source: Thomson Datastream, UniCredit Research

Wednesday, October 21

BEIGE BOOK

The Beige Book summarizes comments received from businesses and other contacts in the twelve Fed districts. The previous report stated, “economic activity continued to stabilize,” while the outlook “remained cautiously positive.” The current report, which is for the month of September, is likely to reiterate this view. We are looking in particular for comments of businesses on the following two areas: First, are there any regions or sectors in which companies have stepped up their hiring activity? Second, how far advanced is the inventory cycle, i.e. are there sectors in which the liquidation of inventories is finally over? In addition, we expect some positive comments about the housing market as sales and prices picked up in September.

BEIGE BOOK TO CONFIRM STABILIZATION OF ECONOMY



Source: Thomson Datastream, UniCredit Research

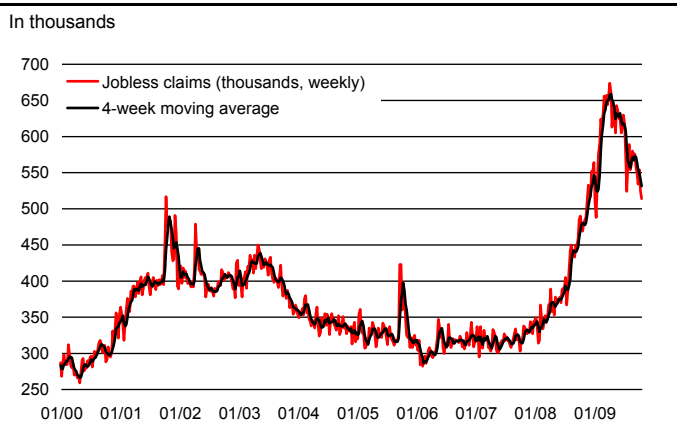
Thursday, October 22

INITIAL JOBLESS CLAIMS

October 17	MIB	Cons.	10 Oct	3 Oct
in thousands	510	519	514	524

This initial jobless claims number is particularly important as the week ending October 17 is the survey week for the October employment report. In early October, claims continued to trend lower as the pace of layoffs is slowing down. That indicates that the decline in nonfarm payrolls will be much more benign than the disappointing -267k in September. However, in order to indicate stable payrolls, initial jobless claims would have to fall to about 400k. In addition, hiring activity had to pick up in order to support the labor market (see this week’s Research Note).

BETTER PAYROLL NUMBER IN OCTOBER?



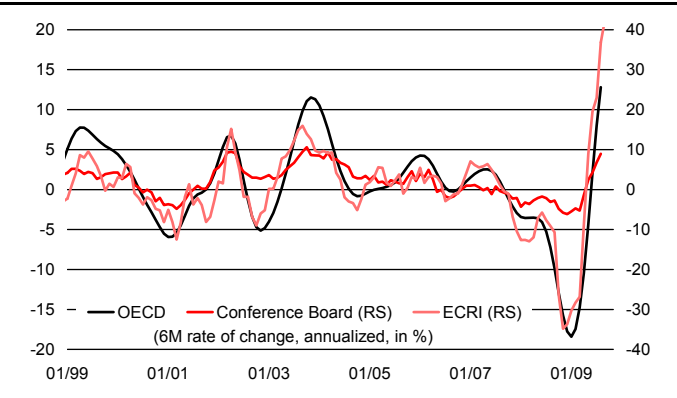
Source: Thomson Datastream, UniCredit Research

INDEX OF LEADING INDICATORS

September	MIB	Cons.	Aug	July
as % mom	0.9	0.8	0.6	0.9

The Conference Board’s Index of Leading Indicators (LEI) soared during the last five months, thereby correctly signaling the end of the recession. While the annualized 3M change has slowed slightly of late, the growth rate remains very high. The LEI most likely kept its high momentum as a surge in consumer expectations (U of Michigan) and a higher yield spread lifted the composite index significantly. Lower initial jobless claims and the higher S&P500 also added solidly.

LEADING INDICATORS KEEP RISING STRONGLY



Source: Thomson Datastream, UniCredit Research

Friday, October 23

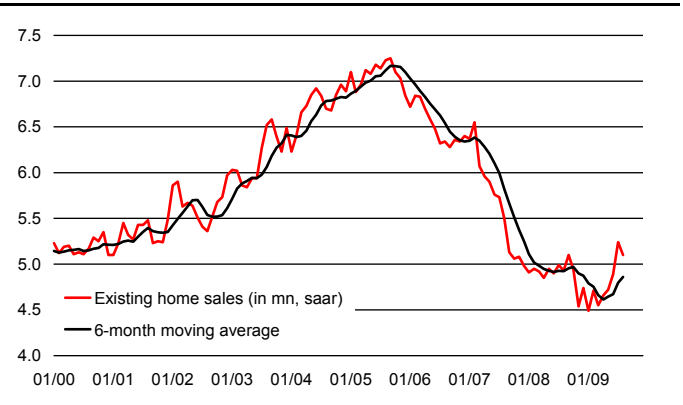
EXISTING HOME SALES

September	MIB	Cons.	Aug	July
In mn annualized	5.50	5.38	5.10	5.24

Existing home sales have rebounded from the all-time low reached in January. Despite their 2¼% decline in August, they are still up an annualized 36¼% during the last six months. As a result, the excess supply of homes has eased to (a still high) 8.5 months of sales, which is the lowest level since spring 2007. Most of the improvement still reflects higher sales of distressed properties. But more recently, demand for other (non-distressed) homes has started to pick up as well as more and more buyers are taking advantage of falling prices, tax incentives for first-time buyers and low mortgage rates. The Pending Home Sales Index, a reliable leading indicator for sales activity, rose another 6½%, indicating the solid increase for September.

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REBOUND IN HOME SALES CONTINUES



Source: Thomson Datastream, UniCredit Research

Review Europe

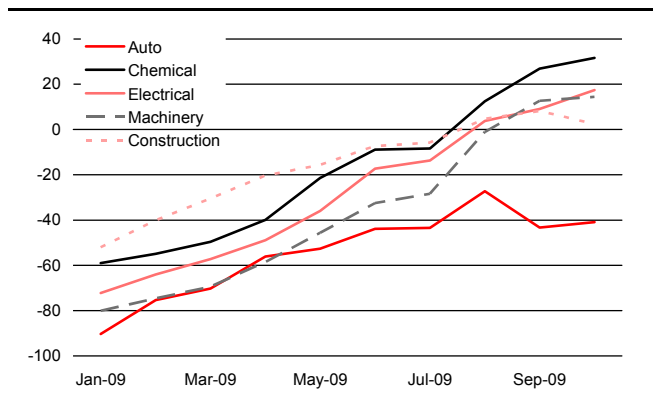
ZEW: First signs of leveling off

The German ZEW growth expectations were down moderately from 57.7 to 56.0 in October. Following a strong upward trend since November last year, the current level still remains well above the long-term average of around 26.5. The continuing stock market rally over the last month, which drove the DAX a total of 57% above the trough from March, was not enough to prevent a moderate setback in growth expectations. Notwithstanding the lower overall growth expectations reading, the sector outlook continued to improve in most areas in October. Among the industrial sectors only construction was down after a solid upward trend in the previous months (see chart). The data confirm the support of the recent pick-up in global demand for the German export sector. After the positive effects of the German car scrapping premium are phased out, similar subsidy schemes abroad help to stabilize expectations in the auto sector. In contrast, the leveling off in construction expectations might suggest that after the imminent boost from the public infrastructure program construction activity will suffer again later next year – not least due to the strong decline in tax revenues.

But the leveling off of the growth expectations together with the relatively weaker expectations performance for the auto and construction sectors reminds us that strong temporary factors are at work, which should increasingly fizzle out and partly become a drag in the course of next year.

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ZEW REVENUE EXPECTATIONS FOR SECTORS



Source: ZEW, UniCredit Research

The latest decline in the ZEW doesn't mean a quick end to the current recovery. This is backed by the sector outlook and the latest impressive broad-based rebound in new manufacturing orders. Orders in August/July were up a hefty 7.8% compared to the second quarter, the strongest dynamic since reunification after +5.5% qoq in 2Q. The outlook for a solid export-driven recovery until spring definitely remains in- tact.

US Review

Fed is in no hurry to raise rates

As the recession ended in late August, the FOMC acknowledged the relative economic improvement. According to the minutes, “*most [participants] thought an economic recovery was under way,*” and many admitted that they had revised up their forecasts for 2H09 and for subsequent years. But at the same time, “*many participants noted that the economic recovery was likely to be quite restrained*”. Apart from still tight access to credit, the major problem is the weak labor market. Participants mentioned that their “*business contacts indicated that their firms would also be cautious in hiring and investing even as demand for their products picked up.*” Overall, the economy was projected to expand over the remainder of 2009 and during 2010 “*at a pace that was unlikely to reduce the unemployment rate appreciably*.” The central tendency of the Fed’s unemployment rate forecast provided in June was 9.5%-9.8% (2010) and 8.4%-8.8% (2011). In other words, the Fed is concerned about an (almost) jobless recovery. Against this backdrop, it is no surprise that “*participants expressed considerable uncertainty about the likely strength of the upturn once those [government] supports were withdrawn or their effects waned.*” Given this subdued economic outlook, in particular the significant underutilization of resources, inflation is not a problem for the time being. The staff even forecast “*core inflation to slow somewhat further over the next two years from the pace of 1H09.*” The Fed is therefore in no hurry to raise rates.

Retail sales decline after cash for clunkers program ended

US retail sales fell 1.5% in September after a downward revised increase of 2.2% (formerly 2.7%) in August. The large monthly swings were triggered by car sales, which increased by 7.8% (revised down from 10.6%) in August and fell again by 10.4% in September as the cash for clunkers program ended. The report therefore provides an initial taste of what happens once the positive effects of fiscal programs have run their course. The spending for other categories remained fairly resilient, echoing earlier reports on chain-store sales. Those reports also said that shoppers continued to look for bargains and to favor low prices. This is consistent with the above-average sales increases of general merchandise and department stores. Amid real income declines, those expenditures are still paid in part by earlier government transfers. This consumption smoothing is reflected in the pattern of the savings rate, which rose to 6% when the transfers were made in May and now dropped again to 3%.

Core inflation edges up in September, but downward trend remains intact

US consumer prices rose 0.2% mom in September, while the yoy rate increased to -1.3% from -1.5%. The core CPI, which excludes food & energy, also rose 0.2% (0.16%), and the yoy rate edged up to 1.5% from 1.4%. Despite this uptick, the underlying trend in the core inflation rate remains down. Even as the recession most likely ended in August, there are a number of factors that continue to weigh on consumer prices. First, resource utilization remains historically low. In particular, the high unemployment rate has significantly reduced wage pressure. While the number of separations is steadily falling – as indicated by the solid decline in initial jobless claims – companies are still reluctant to hire. In addition, very high vacancy rates will continue to weigh on rents (including the owners’ equivalent rent), which makes up 40% of the core basket. During the last three months, the OER fell already by a 0.5% annual rate, which is the first decline over a 3M period since the beginning of the series in 1983. Finally, the index for new & used vehicles increased in eight of the last nine months and is up 1% yoy. As higher prices are completely at odds with sluggish car sales, we expect a reversal of this trend in the coming months.

Pace of layoffs slows down

Initial jobless claims in the week ending October 10 fell to 514k, which is the lowest level since early January. The 4W moving average eased to 531k. For the first time since late March, the number of continuing claims slipped below 6 million (5.99 million), and the insured unemployment rate eased to 4.5%. The report confirms our view that the relative improvement in the labor market continues, as the pace of layoffs slows down. However as companies are still reluctant to hire, the labor market situation will remain weak for the time being, and we expect the unemployment rate to rise to 10½% by early 2010 (for more information, please have a look at the corresponding research note).

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Fixed Income Outlook

- Indestructible trends!
- Strategy for the faint-hearted: Duration-neutral barbells focusing on country allocation.

Indestructible

The trends on financial markets are currently indestructible. As demonstrated by the update of the returns of various asset classes, it was (at least on a risk-adjusted basis) with the exception of EGBs largely irrelevant into which asset class investors put their money.

ANNUAL RETURNS OF VARIOUS ASSETS AS %

	2005	2006	2007	2008	- 09/14/09
EGBs	5.3	-0.3	1.8	9.3	4.5
Corp. bonds: iBoxx Financials	4.7	0.3	-1.1	-7.9	15.8
Corporate bonds: iBoxx Corp	3.5	0.5	0.7	0.9	14.4
Equities: EuroStoxx 50	24.3	18.0	9.65	-42.4	23.2
Commodities: DJ UBS in USD	21.4	2.1	16.2	-35.6	12.2
Gold in USD	17.8	23.2	31.9	4.3	21.6

Source: Bloomberg, UniCredit

The impulses are known. Central banks and governments went "all-in" in spring and succeeded with the money they injected in kick-starting a sustained improvement in sentiment. It will only become apparent in a few years to what extent governments and central banks overstretched with stimulus packages and liquidity infusions. There was, in contrast, never an alternative to the "L'etat, c'est moi" decision. Since then, there has been a positive feedback loop between market participants and companies. Rising returns on risky asset classes and generally improved conditions on financial markets trigger sustained improvements in corporate sentiment, which ultimately leads to positive growth and earnings revisions, which in turn is the fuel for further profits in risky asset classes. A prime illustration of this is provided by the recently published "World Economic Outlook" and the "Global Financial Stability Report" of the IMF. The two tables below show the shift from initially predominantly downward revisions for growth and the reversal of this constellation over the last six months. The delta of the global growth expectation for 2010 is now +1.2% (euro zone +0.7%) compared to the spring forecast. The growth revisions are for their part one of the key aspects behind the downward revision of loss and writedown expectations in the financial sector. Logically, there is also an extremely close correlation between the trend of loss expectations and the performance of the equity market and other risky asset classes.

ODYSSEY OF THE GROWTH EXPECTATIONS IN 2009 ...

IMF forecasts for 2009 real GDP (as % yoy)						Diff. from Jul-08 (in pp)
as of:	Apr-08	Jul-08	Oct-08	Jan-09	Apr-09	
World	3.8%	3.9%	3.0%	0.5%	-1.3%	-5.2%
US	0.6%	0.8%	0.1%	-1.6%	-2.8%	-3.6%
euro zone	1.2%	1.2%	0.2%	-2.0%	-4.2%	-5.4%
Germany	1.0%	1.0%		-2.5%	-5.6%	-6.6%
Austria	1.7%		0.8%		-3.0%	-4.7%
Italy	0.3%	0.5%	-0.2%	-2.1%	-4.4%	-4.9%
Japan	1.5%	1.5%	0.5%	-2.6%	-6.2%	-7.7%
UK	1.6%	1.7%	-0.1%	-2.8%	-4.1%	-5.8%
Canada	1.9%	1.9%	1.2%	-1.2%	-2.5%	-4.4%
Brazil	3.7%	4.0%	3.5%	1.8%	-1.3%	-5.3%
Russia	6.3%	7.3%	5.5%	-0.7%	-6.0%	-13.3%
India	8.0%	8.0%	6.9%	5.1%	4.5%	-3.5%
China	9.5%	9.8%	9.3%	6.7%	6.5%	-3.3%

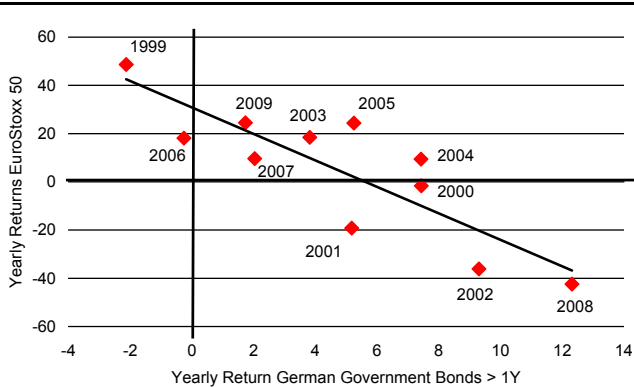
... FOLLOWED BY GROWING OPTIMISM

IMF forecasts for 2010 real GDP (as % yoy)					Diff. from Apr-09 (in pp)
as of:	Jan-09	Apr-09	May-09	Sep-09	
World	3.0%	1.9%	2.5%	3.1%	1.2%
US	1.6%	0.0%	0.8%	1.5%	1.5%
euro zone	0.2%	-0.4%	-0.3%	0.3%	0.7%
Germany	0.1%	-1.0%	-0.6%	0.3%	1.3%
Austria		0.2%		0.3%	0.1%
Italy	-0.1%	-0.4%	-0.1%	0.2%	0.6%
Japan	0.6%	0.5%	1.7%	1.7%	1.2%
UK	0.2%	-0.4%	0.2%	0.9%	1.3%
Canada	1.6%	1.2%	1.6%	2.1%	0.9%
Brazil	3.5%	2.2%	2.5%	3.5%	1.3%
Russia	1.3%	0.5%	1.5%	1.5%	1.0%
India	6.5%	5.6%	6.5%	6.4%	0.8%
China	8.0%	7.5%	8.5%	9.0%	1.5%

Source: IWF, UniCredit Research

But unlike the very fluid feedback process between growth/writedown expectations and the performance of risky asset classes, the mono-causal impulse for persistently low yields is, in contrast, still a problem when it comes to tactical duration timing. Here, the peaceful coexistence of positive returns on the equity market and positive returns on the bond markets is not unusual. This has at least been more the norm than the exception since the introduction of the euro (see the years 2003, 2004 and 2005 in the following chart). The only combination not seen – at least since the introduction of the euro – is falling stock prices and strongly rising yields, i.e. monetary policy overkill.

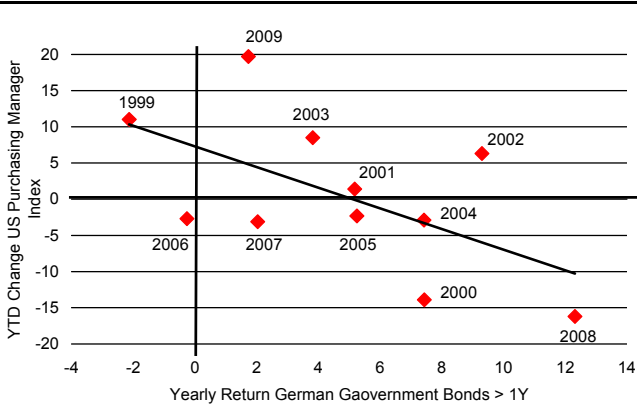
EQUITY MARKET RETURN REGRESSED AGAINST GERMAN BOND MARKET RETURN



Source: Bloomberg, UniCredit Research

The strong rise of the leading economic indicators (exemplified in the following chart by the US purchasing managers index) and the fact it has been completely ignored by the bond market is, in contrast, ugly.

CHANGE IN THE US PURCHASING MANAGERS INDEX VERSUS RETURN ON THE GERMAN BOND MARKET



Source: Bloomberg, UniCredit Research

Like it or not, central bank rhetoric remains the only relevant factor. When this will really change on a sustained basis is currently still anyone's guess. But it will certainly not be based on next week's Ifo index. In the short term, that would leave only the current earnings season, which has been excellent so far. The last few days could be used as an indicator in this respect, but even the biggest bond bears have probably become cautious after some failed attempts in recent months.

Strategy for the faint-hearted

What remains below the line? At some point, the Fed and the ECB will also follow the example of Israel and Australia. Shortly beforehand, this will probably trigger a strong yield increase. Since, however, the current consensus expectation is that this is still several months away, there appears to be no reason for haste. Investors wishing to sleep peacefully until then should opt for a duration-neutral barbell strategy (if push comes to shove, the underperformance of the belly of the curve will then probably trigger a relative outperformance versus the benchmark) and focus otherwise on EGB portfolios on yield pick-up strategies in the cross country allocation. That means: Until there are concrete warnings of impending key rate normalization, spreads between the individual countries must logically continue to narrow (key rate normalization is ultimately not possible without an ongoing global recovery, if one ignores full-blown inflation hysteria).

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Forex Outlook

- It was yet another painful week for the USD, with risk appetite still well supported on better-than-expected 3Q09 earnings releases.
- We see EUR-USD trading in the 1.47-1.50 range next week, while the 1.59-1.61 range should be of reference for cable.

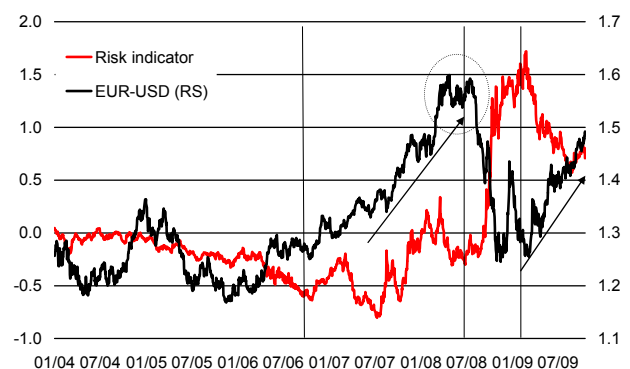
EUR-USD: handle with care above 1.50

It has been a triumphant week for risk appetite, supported by good news from 3Q earnings releases. On Wednesday, on better-than-expected JPM 3Q data, the Dow Jones Index climbed above the 10,000 threshold for the first time since October 2008. Needless to say, the US dollar was heavily sold across the board, with the only exception being vs. the JPY.

Next week, the calendar looks still favorable for risk appetite. Aside from another round of 3Q earnings releases from the financial and corporate sectors (Apple, Coca Cola, BoNY, Credit Suisse and MS, for example), China will also release 3Q09 GDP, which is expected to mark a further increase to 8.9% from 7.9%, as well as retail sales and industrial production data. Further evidence of recovery in China should lift global optimism and thus support stocks, while dragging both the USD and JPY further down. On the other hand, the US calendar will be quite light next week, with a few housing data and the Fed's Beige Book being scheduled. Interestingly, many Fed Regional Governors will make speeches but the main focus should be on two delivered by Fed Chairman Bernanke. On the other side of the Atlantic, the advanced release of euro zone PMIs is likely to surprise on the strong side, especially the services survey. All these factors point to further EUR-USD strength over the coming week. Nevertheless, a risk factor may well be represented by the Fed's official speeches, as they could easily reiterate the strong US dollar rhetoric. However, as market optimism should ultimately prevail, Fed remarks should have just a transitory impact, if any, on the USD, and the Fed's Beige Book should have little effect too, as it will likely just reiterate the "jobless recovery" argument, already highlighted in the FOMC Minutes this week. In any case, the key question here is whether EUR-USD is set for a definite break of the key 1.50 threshold next week. To analyze this possibility in depth, we make a few considerations based on trend analysis. The chart below shows that the last time EUR-USD broke through the psychologically important level of 1.50 was in March 2008. After breaking 1.50, EUR-USD accelerated towards 1.60 and kept trading in the 1.55-1.59 band just until early August. Back then, EUR-USD had been moving on an upward trend for the previous two years and the pace of appreciation has been much slower than in the current episode (EUR-USD had appreciated by 28% since March 2008 over the two years vs. 18% over the last seven months or so),

so the upward trend was less steep. Not surprisingly, given the abrupt acceleration of the recent EUR-USD rally, our over/under valuation indicator, that shows how much an exchange rate is over/undervalued at the moment with respect to its prior 6M trend, shows that back then in March 2008, EUR-USD remained overvalued by 2% on average until the end of April 2008. Interestingly, as EUR-USD has been moving towards 1.50 quite abruptly this time, our trend analysis points at a slight undervaluation of the euro right now. Just looking at the chart, a further rally towards 1.52 in case of a full break of 1.50 can be expected at this stage. However, while the current scenario favors more EUR-USD strength going forward, some profit taking may easily emerge, simply triggered by macroeconomic data just below expectations, less robust 3Q earnings releases and especially more hawkish rhetoric by the Fed on the FX front. On balance, we see EUR-USD remaining in the 1.47-1.50 trading range during most of next week. The outlook for sterling next week appears rather interesting, especially in case of encouraging UK economic data. Slightly positive surprises on the advanced GDP for 3Q09 and retail sales figures, coupled with more dollar weakness, should thus support cable. On the other hand, it is worth noting that both the BoE's minutes and the bank's Lending Report could still argue against a sustained sterling pullback, as they should add further elements to the debate over more potential QE at the November 5 BoE meeting. Actually, we suspect that the debate over QE policy will remain the pivotal element to drive the sterling performance until the next BoE meeting, thus counterbalancing to some extent USD weakness. On balance, cable could thus remain in the 1.59/1.61 range next week.

EUR-USD: TWO APPRECIATION EPISODES



Source: Bloomberg, UniCredit Global Research

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MIB View – Our Global Picture

Global economy

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

US

- The US economy exited the recession already in 3Q09. GDP should have been able to report pretty robust growth in the summer months of 3¼% (annual rate). But that is merely "borrowed" growth. We expect an expansion of "only" 1% for the first half of 2010. Support of private consumption is still missing for a self-sustaining upswing. The recovery will be W-shaped.
- After slashing the federal funds target rate by a total of a whopping 425 basis points (bp) to 1% in the wake of the housing recession and the deep financial market crisis, the Fed switched to a zero-rate interest policy in mid-December of last year. The Fed is now pursuing a Quantitative Easing Policy. Since the economic upswing should not be sustainable, the US central bank will likely adhere to its current ultra-expansionary monetary policy well into next year.

Euro zone

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

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

Government bond markets

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

Exchange rates

- After a temporary consolidation phase, EUR-USD should strengthen again and, over the medium term, advance to the 1.50-1.55 range. The upward primary trend is – analogous to the W-shaped recovery of the global economy – subject to considerable fluctuations. We expect JPY to weaken steadily for the remainder of this year and in 2010.

OUR MACRO FORECASTS

as % yoy	2008	2009	2010
GDP EMU	0.6	-4.0	0.8
CPI EMU	3.3	0.3	1.3
GDP Germany	1.0	-4.7	2.0
CPI Germany	2.6	0.4	1.0
GDP Italy	-1.0	-4.9	0.4
CPI Italy	3.3	0.8	1.5
GDP US	0.4	-2.4	1.9
CPI US	3.8	-0.4	2.3

OUR FI/FX & OIL PRICE FORECASTS

	2009/10	31-Dec	31-Mar	30-Jun	30-Sept
EMU 3M (%)		0.80	0.90	1.05	1.20
EMU 10Y (%)		3.45	3.60	3.85	4.10
US 3M (%)		0.30	0.50	0.85	1.25
US 10Y (%)		3.70	3.85	4.10	4.40
EUR-USD		1.47	1.52	1.55	1.50
USD-JPY		95	98	100	103
Oil Price		65	70	70	75

Macro Forecasts

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

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

GDP, real (% , qoq)	III/08	IV/08	I/09	II/09	III/09p	IV/09p	I/10p	II/10p
US (annualized)	-2.7	-5.4	-6.4	-0.7	3.7	3.0	2.0	0.5
Euro area	-0.4	-1.8	-2.5	-0.2	0.4	0.2	0.1	0.2
Germany	-0.3	-2.4	-3.5	0.3	1.0	0.7	0.5	0.2
France	-0.2	-1.4	-1.3	0.3	0.6	0.3	0.2	0.2
Italy	-0.8	-2.1	-2.7	-0.5	0.6	0.0	0.1	0.1
Spain	-0.6	-1.1	-1.6	-1.1	-0.1	-0.1	-0.2	-0.2
Austria	-0.4	-1.0	-2.7	-0.5	0.3	0.5	0.2	0.3
UK	-0.7	-1.8	-2.5	-0.6	0.3	0.3	0.2	0.4
Switzerland	-0.4	-0.6	-0.9	-0.3	0.6	0.5	0.4	0.2
Sweden	-1.0	-5.0	-0.9	0.2	0.0	0.3	0.3	0.3
Japan	-1.0	-3.5	-3.1	0.9	1.5	0.8	0.5	0.1

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

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

Interest & Exchange Rate Forecasts (I)

INTEREST RATE FORECASTS (% , END QUARTER)

2009/10	current	end-4Q	end-1Q	end-2Q	end-3Q
Euro zone bond market					
Refi rate	1.00	1.00	1.00	1.00	1.00
3M Euribor	0.74	0.80	0.90	1.05	1.20
2Y	1.42	1.30	1.45	1.90	2.40
5Y	2.50	2.43	2.58	2.93	3.25
10Y	3.31	3.45	3.60	3.85	4.10
30Y	4.07	4.15	4.30	4.45	4.60
10Y swap spread (inbp)	22	20	15	15	10
US Treasury Market					
Fed funds target rate	0.13	0.25	0.25	0.25	0.75
3M USD Libor	0.28	0.30	0.50	0.85	1.15
2Y	0.96	1.15	1.40	1.80	2.40
5Y	2.39	2.58	2.78	3.10	3.50
10Y	3.47	3.70	3.85	4.10	4.40
30Y	4.31	4.45	4.60	4.80	5.10
10Y swap spread (inbp)	18	20	10	10	10
Japan					
Target rate	0.10	0.10	0.10	0.10	0.10
3M JPY Libor	0.34	0.40	0.45	0.50	0.55
10Y JGB	1.34	1.40	1.50	1.60	1.80
United Kingdom					
Repo rate	0.50	0.50	0.50	0.50	0.50
3M GBP Libor	0.57	0.60	0.80	0.90	0.95
10Y Gilt	3.64	3.75	3.90	4.15	4.50
Switzerland					
3M CHF Libor mid target rate	0.25	0.25	0.25	0.25	0.50
3M CHF Libor	0.27	0.35	0.40	0.50	0.70
10Y Swissie	2.081	2.25	2.40	2.75	3.15

EXCHANGE RATE FORECASTS (END QUARTER)

	current	end-4Q	end-1Q	end-2Q	end-3Q
EUR-USD	1.4899	1.50	1.52	1.55	1.50
EUR-JPY	135.97	143	149	155	155
EUR-GBP	0.9112	0.89	0.85	0.85	0.83
EUR-CHF	1.5180	1.56	1.57	1.58	1.59
USD-JPY	91.27	95	98	100	103
GBP-USD	1.6350	1.68	1.79	1.83	1.81
USD-CHF	1.0190	1.04	1.03	1.02	1.06

COMMODITY PRICE FORECASTS

	current	end-4Q	end-1Q	end-2Q	end-3Q
Oil price (Brent, USD/b)	73.40	65	70	70	75
DJ commodity price index	267.46	275	290	290	310

Interest & Exchange Rate Forecasts (II)

INTEREST RATE FORECASTS (% , END QUARTER)

2009/10	current	end-4Q	end-1Q	end-2Q	end-3Q
Sweden					
Key rate	0.25	0.25	0.25	0.50	0.50
3M rate	0.50	0.60	0.75	0.95	1.00
10Y government bond yield	3.31	3.55	3.75	4.10	4.40
10Y spread to Bunds (inbp)	-1	10	15	25	30
Norway					
Key rate	1.25	1.50	1.75	2.00	2.25
3M rate	2.06	2.25	2.40	2.55	2.70
10Y government bond yield	4.07	4.30	4.55	4.85	5.15
10Y spread to Bunds (inbp)	76	85	95	100	105
Canada					
Key rate	0.25	0.25	0.25	0.25	0.25
3M rate	0.50	0.60	0.65	0.70	0.80
10Y government bond yield	3.55	3.40	3.60	4.00	4.30
10Y spread to Bunds (inbp)	24	-5	0	15	20
Australia					
Key rate	3.25	3.75	4.00	4.25	4.50
3M rate	3.85	4.15	4.40	4.80	5.00
10Y government bond yield	5.58	5.50	5.75	6.05	6.30
10Y spread to Bunds (inbp)	226	205	215	220	220
New Zealand					
Key rate	2.50	2.50	2.50	2.75	3.00
3M rate	3.10	2.80	2.95	3.25	3.50
10Y government bond yield	5.73	5.80	6.05	6.40	6.65
10Y spread to Bunds (inbp)	242	235	245	255	255

EXCHANGE RATE FORECASTS (END QUARTER)

	current	end-4Q	end-1Q	end-2Q	end-3Q
EUR-SEK	10.3797	9.95	9.80	9.60	9.50
EUR-NOK	8.3580	8.25	8.20	8.15	8.10
EUR-CAD	1.5430	1.58	1.55	1.53	1.52
EUR-AUD	1.6179	1.74	1.71	1.68	1.61
EUR-NZD	2.0037	2.11	2.05	2.01	1.88
USD-SEK	6.9676	6.63	6.45	6.19	6.33
USD-NOK	5.6087	5.50	5.39	5.26	5.40
USD-CAD	1.0357	1.05	1.02	0.99	1.01
AUD-USD	0.9209	0.86	0.89	0.92	0.93
NZD-USD	0.7434	0.71	0.74	0.77	0.80
EUR-USD	1.4899	1.50	1.52	1.55	1.50

Economic Event & Data Release Calendar

Date	Time (ECB)	Country	Indicator	Period	MIB est.	Consensus (Bloomberg)	Prev. period
16 October to 23 October 2009							
Fri, 16 Oct '09	15:00	US	Net long-term capital inflows (TIC, USD bn)	Aug		30	15.288
	15:15	US	Capacity utilization (as %)	Sep		69.8	69.6
	15:15	US	Industrial production (as % mom)	Sep		0.2	0.8
	16:00	IT	ECB's Bini Smaghi Speaks in Florence				
	16:00	US	University of Michigan consumer confidence	Oct		73.3	73.5
	16:10	US	Fed's Fisher Speaks in Dallas on Globalization				
	17:30	GE	ECB's Weber Speaks in Konstanz				
Mon, 19 Oct '09	3:00	US	Bernanke, Yellen Give Remarks at S.F. Fed Conference				
	19:00	US	NAHB housing market index	Oct		20	19
Tue, 20 Oct '09	8:00	GE	Producer price index, PPI (as % yoy)	Sep		-7.1	-6.9
	10:00	IT	Industrial orders (as % mom)	Aug			3.2
	14:30	US	Housing starts (in thousands)	Sep	610	610	598
	14:30	US	Building permits (in thousands)	Sep	590	590	580
	14:30	US	PPI ex food & energy (core, as % yoy)	Sep		2.0	2.3
	14:30	US	Producer price index, PPI (as % yoy)	Sep		-4.2	-4.3
	14:30	US	PPI ex food & energy (core, as % mom)	Sep	0.1	0.1	0.2
	14:30	US	Producer price index, PPI (as % mom)	Sep	0.1	0.1	1.7
	21:15	UK	Bank of England Governor King to Make Speech				
	Wed, 21 Oct '09	2:00	US	Fed's Plosser to Speak at Stanford on Monetary Policy			
10:30		UK	Bank of England Releases Minutes of Interest Rate Decision				
13:00		US	MBA mortgage applications	Oct 16			-1.8
Thu, 22 Oct '09	8:45	FR	Business confidence expectations	Oct		-9	-11
	8:45	FR	Business confidence production outlook	Oct			-16
	8:45	FR	Business confidence overall (INSEE)	Oct	87	87	85
	10:00	IT	Retail sales (as % mom)	Aug		0.0	-0.4
	10:00	EMU	Current account balance (EUR bn)	Aug			6.6
	10:30	UK	Retail sales (as % mom)	Sep	1.3	0.5	0.0
	14:15	GE	Former ECB Chief Economist Otmar Issing Speaks in Frankfurt				
	14:30	US	Initial jobless claims (in thousands)	Oct 17	510	519	514
	16:00	US	OFHEO house price index (as % mom)	Aug		0.3	0.3
	16:00	US	Leading indicators (Conference Board, as % mom)	Sep	0.9	0.8	0.6
Fri, 23 Oct '09	8:45	FR	Household consumption (manufactured goods, as % mom)	Sep	1.2	-0.1	-1.0
	9:00	FR	Services PMI (index)	Oct		53.9	53.2
	9:00	FR	Manufacturing PMI (index)	Oct		53.2	53.0
	9:30	GE	Services PMI (index)	Oct		52.5	52.1
	9:30	GE	Manufacturing PMI (index)	Oct		50.1	49.6
	10:00	GE	Ifo business climate (index)	Oct	92.0	92.0	91.3
	10:00	EMU	Composite PMI (index)	Oct		51.5	51.1
	10:00	EMU	Services PMI (index)	Oct	51.1	51.3	50.9
	10:00	EMU	Manufacturing PMI (index)	Oct	50.5	50.1	49.3
	10:30	UK	Real GDP (as % yoy)	3Q	-4.5	-4.6	-5.5
	10:30	UK	Real GDP (as % qoq)	3Q	0.3	0.2	-0.6
	11:00	EMU	New orders (as % mom)	Aug		1.0	2.0
	11:15	GE	ECB Council Member Weber Speaks in Frankfurt				
	14:30	US	Fed's Bernanke Speaks on Regulation at Boston Fed Conference				
	16:00	US	Existing home sales (in mn)	Sep	5.5	5.4	5.1

*: 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
26 October to 30 October 2009							
Mon, 26 Oct '09		JP	Tankan survey small business	Oct			43.5
		UK	House price (Nationwide, as % yoy)	Oct			0.0
	9:10	GE	GfK consumer confidence	Nov			4.3
Tue, 27 Oct '09	9:50	FR	Consumer confidence (index)	Oct			-36
	10:30	IT	Consumer confidence (ISAE, index)	Oct			113.6
	11:00	EMU	3M money supply (as % yoy, 3M moving average)	Sep			3.0
	11:00	EMU	3M money supply (as % yoy)	Sep			2.5
	15:00	US	S&P/Case-Shiller home priceindex (as % yoy)	Aug	-11.4		-13.3
	16:00	US	Conference Board consumer confidence	Oct	57.0	57.0	53.1
	17:00	US	Geithner Speaks at SIMFA Annual Meeting in New York				
Wed, 28 Oct '09		GE	Harmonized CPI (as % yoy)	Oct			-0.5
		GE	Consumer price index, CPI (national, as % yoy)	Oct			-0.3
	10:30	IT	Business confidence overall (ISAE, index)	Oct			74
	14:30	US	Durable goods orders ex transportation (as % mom)	Sep			-0.3
	14:30	US	Durable goods orders (as % mom)	Sep	1.0	0.8	-2.6
	16:00	US	New home sales (in thousands)	Sep	435	437.5	429
Thu, 29 Oct '09	1:50	JP	Industrial production (as % yoy)	Sep			-19.0
	10:55	GE	Unemployment change (in thousands)	Oct			-12
	11:00	IT	Large industry employment (as % yoy)	Aug			-1.8
	11:30	UK	Mortgage approvals (in thousands)	Sep			52.317
	12:00	EMU	European Commission services sentiment (index)	Oct			-9.1
	12:00	EMU	European Commission manufacturing sentiment (index)	Oct			-24.3
	12:00	EMU	European Commission economic sentiment (index)	Oct			82.8
	12:00	EMU	European Commission consumer confidence climate (index)	Oct			-19
	12:00	EMU	European Commission business climate (index)	Oct			-2.07
	14:30	US	PCE deflator (as % qoq annualized)	3Q			2.0
	14:30	US	Real GDP (as % qoq annualized)	3Q	3.8	3.0	-0.7
	16:00	JP	BOJ to Hold Regular Policy Board Meeting, Release Outlook				
Fri, 30 Oct '09		JP	Bank of Japan key rate (as %)	Jan 1			0.1
		GE	Retail sales (real, as % mom)	Sep			-2.4
	1:30	JP	Unemployment rate (as %)	Sep			5.5
	1:30	JP	Core consumer price index (as % yoy)	Sep			-0.9
	1:30	JP	Consumer price index (ex fresh food, as % yoy)	Sep			-2.4
	1:30	JP	Consumer price index (as % yoy)	Sep			-2.2
	2:01	UK	Consumer confidence (GfK, index)	Oct			-16.0
	9:45	FR	Producer price index, PPI (as % mom)	Sep			0.4
	12:00	IT	Producer price index, PPI (as % yoy)	Sep			-7.8
	12:00	IT	Consumer price index (as % yoy)	Oct			0.2
	12:00	EMU	Consumer price index, CPI (as % yoy, flash estimate)	Oct			-0.3
	12:00	EMU	Unemployment rate (as %)	Sep			9.6
	12:30	SZ	KOF business climate	Oct			0.85
	14:30	US	PCE core inflation (as % mom)	Sep	0.2		0.1
	14:30	US	Personal expenditures (as % m-om)	Sep			1.3
	14:30	US	Personal income (as % mom)	Sep			0.2
	14:30	US	Employment cost index (as % qoq)	3Q	0.3	0.4	0.4
	15:45	US	Chicago Purchasing Managers Index	Oct			46.1

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

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