Global Economic & Market Monthly Review: Asymmetrical Movements

ECONOMIC ANALYSIS & RESEARCH DIVISION

Executive Summary

March 2013

- Despite the recent rise in uncertainty in the Eurozone (EZ), markets have reacted only marginally, maybe because complacency has set in due to the fact that, after three years of crisis, a process of institutional integration is now underway. This framework, however, will not cover past losses and as these are being dealt with (Cyprus), we are likely to find ourselves in a period of heightened uncertainty. Markets probably underestimate at this stage the major obstacles involved in the implementation of the agreed framework. Moreover, the persistence of tight fiscal policies continues to cause economic deterioration in the EZ.

- In parallel with developments in the EZ, the performance of the Chinese economy is another cause of uncertainty. The first economic indications of 2013 were disappointing, exacerbating concerns in emerging equity markets and commodities.

- The combination of positive surprises in the US economy and the Fed's decision to maintain the intensity of its quantitative easing policies counterbalance concerns about China and the Eurozone and, if continued, could cause overheating of US markets mainly, as the data in the rest of the world still do not provide an excuse for attracting any excess liquidity. In this context, US monetary policy remains a potential source of volatility, not only with respect to the rhetoric of exit strategies, but also in relation to the factors behind possible changes in the Fed's stance (growth or inflation).

- The result of these forces is an "asymmetrical" movement of markets, as we observe strong growth in US equity markets, weak emerging market equities and commodities, along with strong German government bonds. Compared to the previous month, we note an improving technical picture for US shares (with a marginal deterioration in the fundamental picture), a significant improvement of the technical picture of Bunds, a marginally improving fundamental picture for the euro and significant overvaluation (deterioration in the fundamental picture) in the price of crude oil.

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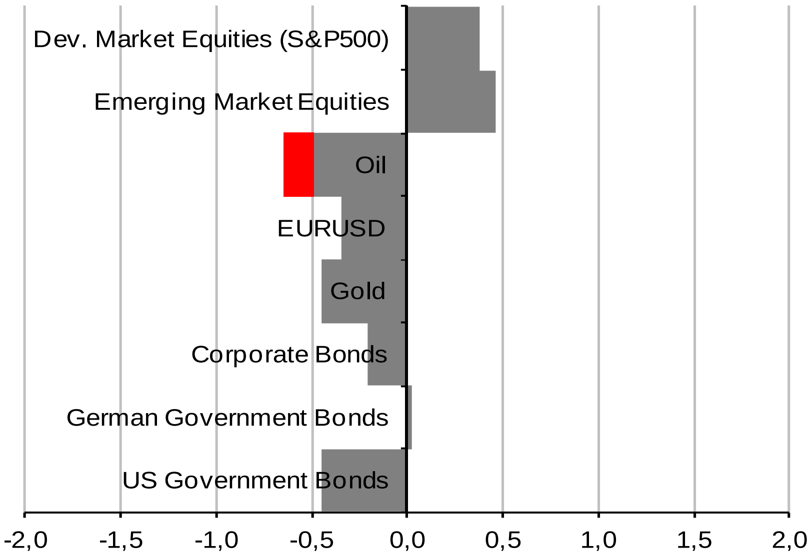
Global Market Risk-Return Scoring

(6-9 month horizon)

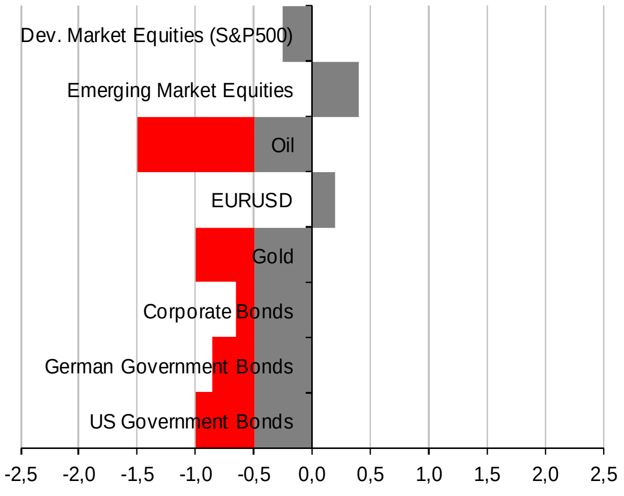


Scoring between -2.5 and 2.5, reflects an average estimate (50%) quantitative fundamental, & (50%) technical factors affecting individual markets.

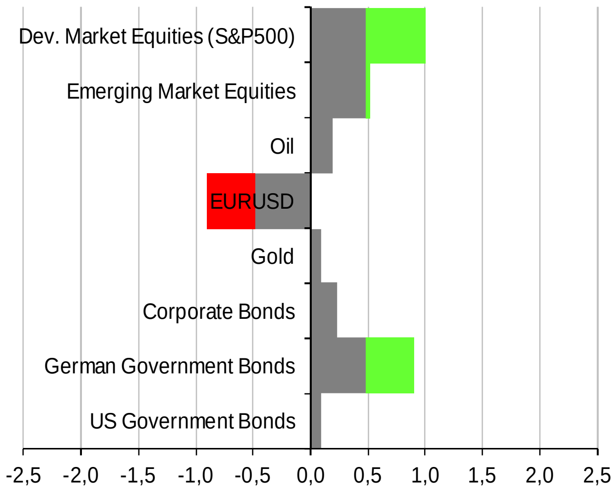
- *-0.49 to 0.49 neutral assessment*
- *0.5 to 1.49 positive assessment (-0.5 to -1.49 negative assessment)*
- *> 1.5 very positive assessment (<-1.5 very negative assessment)*

For long-term estimates (+9 months), more weight should be given to fundamental and quantitative factors, while for the medium term (3-6 months), more weight should be given to technical factors.

Fundamental & Quantitative Estimates



Technical Picture



undamental & Quantitative Estimates: Deviations from long-term average value measures (e.g. P/E for stocks, nominal growth for bonds, ppp for fx) as quantified by estimated "fair values" using for each the appropriate market & economic fundamentals. Technical Picture: Standardized display of figures such as MACD, RSI and other technical analysis measures

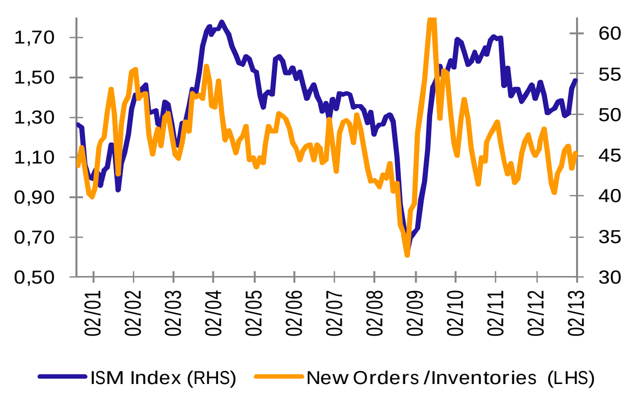
Economic Developments

USA: Maintaining positive momentum

- Economic announcements in the US were mostly positive. Contrary to our expectations, there was a significant positive surprise in the manufacturing sector where the ISM index rose to 54.2 from 53.1, while a significant increase was observed in the ratio of new orders to inventories, and orders of durable goods (except transportation) remained strong. As far as manufacturing is concerned, we continue to expect that the historic relationship of the ISM index with new order (and sales) to inventory ratios, not only in manufacturing but in the broader economy as well, is consistent with lower levels (51) of this indicator.
- On the other hand, we observed (as we expected) positive surprises in retail sales but also in employment, where unemployment fell to 7.7% from 7.9%, while the property market maintained an overall positive picture, despite mixed evidence presented in the previous month.
- The combination of even a mild labour market recovery, a stronger housing market, combined with existing low borrowing costs is expected to continue to provide support to consumer spending. Still on the positive side, a recent decision of the House of Representatives and the Senate effectively prevents the closing of part of the federal government, which was initiated as a result of the failure to reach an agreement on the fiscal front. Furthermore, the Fed's decision to maintain the current rate of bond purchases ($85 billion/month), despite signs of improvement in the economy, is a positive development for both markets and the economy. Within this framework, the Fed's possible exit strategies could start coming to the fore, and the focus will shift to the inflation dynamics. At this stage, both core and overall inflation trends are stabilizing after the downward pressure observed since mid-2011.

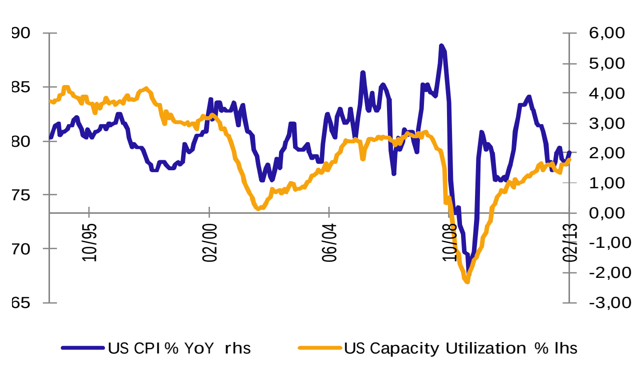
- Although the gradual improvement in the labour market and the rising capacity utilization in manufacturing might suggest a rise in inflationary pressures over the medium term, the still weak credit growth, the high level of unemployment and the dynamics of commodity prices counterbalance any such tendencies. Overall, evidence from leading economic indicators and markets, are consistent with a positive surprise in the rate of US economic growth above the 1.9% expected by analysts for 2013 (Bloomberg).

ISM Index vs. New Orders / Inventories



Source: Bloomberg, Piraeus Bank Research

Inflation vs. Capacity Utilization



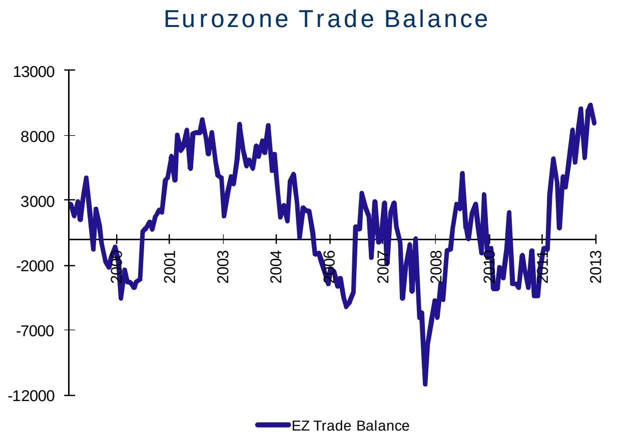
Source: Bloomberg, Piraeus Bank Research

The Eurozone: Political Uncertainty – A negative drag on the Economy

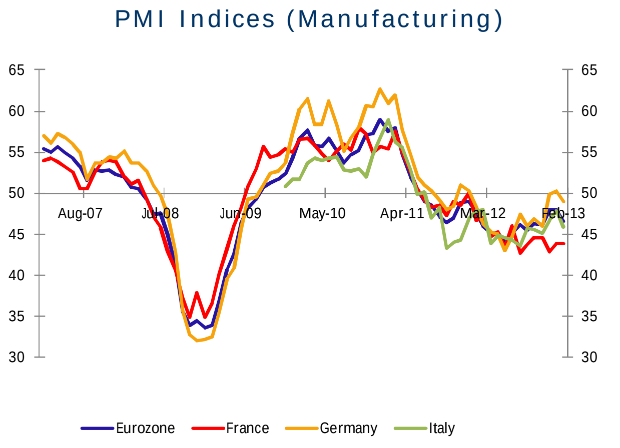
- Most economic signs in the Eurozone remained negative despite the fact that in some cases marginal improvements and surprises were reported. So, for example, the annual rate of decline in retail sales slowed from -3% to -1.3%, while in industrial production the rate of contraction fell from -1.7% to -1.3%. At the same time, we observed a rise in unemployment to 11.9% (from 11.8%), and the PMI indices in manufacturing and services declined well below expectations to 46.5. A small decrease was observed in the trade surplus while it remains close to the all-time high.

- The situation in the Eurozone remains one in which both markets and many leading indicators show improvement compared to the summer of 2012, driven mainly by the actions of the ECB and the EU decisions on banking and financial integration. As we have observed, markets initially reacted very positively to these announcements and, until recently, this was mirrored by improvements in various leading indicators and specific economic data. We noted then that markets, through the movements in yields of German bonds and the euro (upward) and regional spreads (downward), overestimated the expected effect of the summer announcements in the real economy. Recent developments in Italy and Cyprus have reduced market optimism in relation to future growth, but this is still at implied levels (a yearly rate of around 1.1% according to our estimates) that are not possible without an effective and quick solution to the problem of the sharing of financial and banking risks and removing the present tight fiscal-policy framework.

- At the same time, trends of leading indicators in the EZ are consistent with only marginal growth of 0.3%. So, given that progress towards deeper integration is expected to remain slow and uncertain, especially given the upcoming German elections, risks tilt towards deterioration in the investment and economic climate.



Source: Bloomberg, Piraeus Bank Research



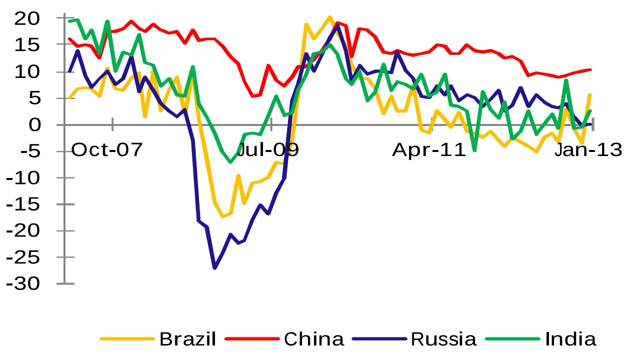
Source: Bloomberg, Piraeus Bank Research

Uncertainty in the Rest of the World

- Japan reported a larger-than-expected fall in prices of -0.3% yoy (from -0.1%) along with a contraction in capital expenditures for the fourth quarter of 2012 of -8.7%. Along the same lines, machinery orders and industrial production are still contracting on a yearly basis, by -9.7% and -11% respectively. Moreover, the trade balance recorded a deficit of 1086 billion yen, which is an all-time record. On the positive side, there was a rise in household spending (2.4% yoy). At this stage, attention is focused on the central bank's announcements in relation to a possible extension of the quantitative easing program that aims to achieve inflation of 2%. Currently, the central bank makes bond purchases worth $807 billion of no more than 3-year maturities, and there has been growing concern that the inflation target of 2% in 2 years is very ambitious. One view, that we share, is that a number of structural factors lie behind the long-term trend of falling prices (imports from countries with lower costs, aging population) and monetary factors alone will not be able to reverse this. Nevertheless, it seems that at this stage the markets are willing to accept the more positive scenario, paving the way for a future disappointment.

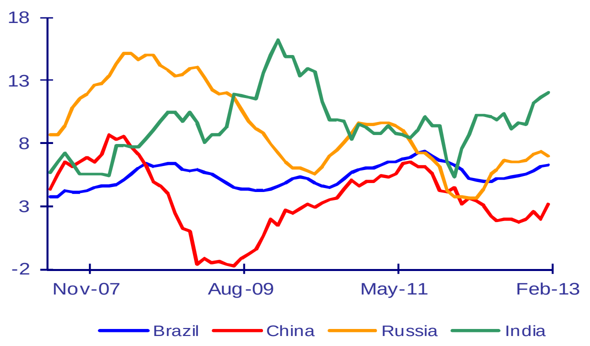
- In China, the economic data continue to appear mixed. Despite the recent rise in the manufacturing PMI (HSBC) to 51.6 and the rise in the rate of foreign direct investment, the figures for industrial production (10.3% yoy), retail sales and monetary expansion continue to exhibit deceleration. At the same time, the unexpected rise in inflation to 3.2% from 2% in the previous month was a cause for concern. Apart from China, an increase in inflation was observed in India (to 11.6%) in Russia (to 7.3%) and in Brazil (to 6.3%). Conversely, as an annual rate, industrial production expanded by 2.4% in India, shrank by -2.1% in Russia and expanded by 5.7% in Brazil. Compared with existing real growth rates of GDP, Brazil is growing at an annual rate of 1.4%, Russia at 2.9%, India at 4.5% and China at 7.9%. All the BRIC economies, with the exception of Russia, are growing at a rate below their respective 10-year averages, but are exhibiting an accelerating medium-term trend

BRIC Industrial Production (annual %)



Source: Bloomberg, Piraeus Bank Research

BRIC Inflation Rate (annual %)



Source: Bloomberg, Piraeus Bank Research

Markets: Asymmetrical Movements

- Despite the rise of political uncertainty in Europe, the investment climate remains generally positive, but displays a significant "asymmetry". On the one hand, we see US and Japanese equity markets retaining their respective positive trends, mainly driven by both macroeconomic surprises in the US and the weakening of the yen, while, on the other hand, we observe weakness across the rest of the spectrum of risky securities, even those not directly related to the crisis in the Eurozone. So, last month, while the S&P500 index increased by 3.5% and the Nikkei225 by 5%, European stocks were nearly unchanged (Eurostoxx +0.50%) and emerging equities incurred losses (MSCI Emerging Markets -1.4%). Regarding commodities, the general CCI Index rose marginally by 0.4%, while cyclical metals, which are usually positively correlated with future growth, declined (Copper -4%, London Metal Exchange Index -4.4%). Additionally, government bonds in the US showed a marginal increase in prices (despite positive data) while in Germany they appeared stronger (-16 bps). Apart from German bonds, Eurozone worries pressured the EURUSD rate (-2.4%) and European banks (-6%), but exerted only marginal pressures on the European periphery bonds, resulting in a 146 bps increase of ten-year yields for Greek bonds and across the rest of the region, bonds remained essentially unchanged, despite the upward trend in the second half of March.

- In relation to the crisis in the Eurozone, markets remain very patient given recent signs of increased uncertainty. Thus, despite the inability to form a government in Italy and the very poor handling of the crisis in Cyprus, there appeared no significant pressures on international markets, and volatility in European values was contained. One reason for this behaviour is that the German election is a cause for limited response by Eurozone officials to the economic and political news flow, hence irradiating a source of noise propagation. In addition to this, in recent years, the Eurozone has created a multitude of institutions that offer several lines of defence as part of a broader set of decisions aiming to gradually deepen European institutions. For example, following the decisions of June 2012, a framework was created in order to 1) establish central control of the banking sector and the economy, 2) facilitate the proposal, supervision and assistance in implementing corrective measures in case of deviations (structural in principle and cyclical onwards) and finally 3) the crystallization of a framework for absorbing asymmetric shocks. This framework is the result of lessons learnt during the three years of crisis and shows that the EU authorities have actually received the markets' message for deeper integration and that we are now at the stage of implementation. As the final stage of full economic integration is essentially a "mutual insurance contract" between the participants. Theoretically this insurance would feature "reciprocity", covering future losses thus leaving us with the problem of managing existing losses – the "legacy assets", which by definition cannot be part of such an agreement.

- The Cyprus crisis should be seen in these terms, and so the recent solution, although clumsily implemented, does not indicate the absence of a banking union (and solidarity), but is indicative of the pressures (which became more pronounced because of the German elections) for settling past losses as the prospect of a banking union draws closer. The same ideas should be used to rationalize the very strict framework for the re-capitalization of the Greek banks as well as the insistence on restrictive fiscal policy in the Eurozone. This approach, although sound in theory, does not take into account the medium-term negative effects on the cyclical dynamics of the Eurozone economy and also on the sentiment of societies mostly in the European periphery. Thus we have the phenomenon of a possible revival of strong centrifugal forces as a result of routing measures aimed in the long term, at more substantial economic integration. The danger at this stage is that these pressures will be strong enough to suspend or cancel any tendency for deeper integration. Markets have reacted only moderately to recent European developments, as they are likely to have been "satisfied" by the institutional framework, launched after the three-year crisis. This is probably why investors remain cool so far to new developments like the haircut on deposits. Still, investors likely underestimate the major obstacles involved in implementing the agreed framework, and we are probably entering a period where markets will start discounting the centrifugal forces which we described leading to a rise in volatility. If proven temporary this will only affect European values with emphasis on the currency and the banking sector, if it persists it could turn into a global shock similar to that of 2010 or 2012.

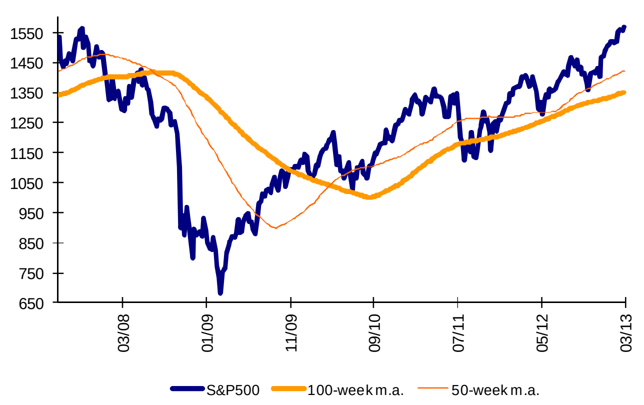
- In parallel to developments in the EZ, the performance of the Chinese economy is another cause of uncertainty. The first economic indications of 2013 were disappointing, exacerbating concerns in emerging equity markets and commodities. The combination of positive surprises in the US and the Fed's decision to maintain the intensity of its quantitative easing policies counterbalance concerns about China and the EZ and, if continued, could cause overheating of US markets mainly, as the data in the rest of the world still do not provide an excuse for attracting any excess liquidity. In this context, US monetary policy remains a potential source of volatility, not only with respect to the rhetoric of exit strategies, but also in relation to the factors behind possible changes in the Fed's stance. If, for example, it is due to unexpectedly positive economic data, or, in an unlikely scenario, to inflationary pressures.

Equity Markets

- During the last month, the strong performance of the US and JP equity markets continued. In the US, the combination of positive economic releases and the Fed's reassurance of loose monetary policy along with the expected continuation of the corporate profitability rate of 10% for the next few years helped to maintain the upward trend. On the other hand, the valuations seem to be marginally expensive, as we continue to be worried about possible negative surprises in manufacturing, but to maintain them in outlays. Warning signs about global growth are the deteriorating trend in emerging markets and cyclical metals. At this stage, there is no impact from the higher euro uncertainty on the US equity market. However, it will certainly not stay unaffected if the euro uncertainty continues to heighten. These factors delineate a neutral (with negative predisposition) fundamental picture for the US equity market. Simultaneously, we observe an improvement in the technical picture. New post 2007 high levels have been realized with diminishing volatility, which along with the overall lack of a broader exuberant market sentiment could lead to a continuation of the positive trend in the short to medium term.

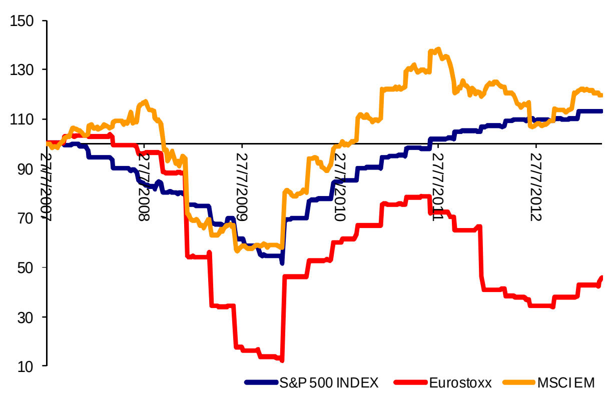
- Mixed economic data in emerging economies (in China, mainly), combined with the JPY weakening and the USD strengthening, are negative factors for emerging equity markets, while the trend in the corporate profit annual growth rate remains negative. On the other hand, emerging markets seem to be relatively cheap according to the P/E ratio (at 11.8 for the MSCI Emerging Market Index) and our fair model that incorporates corporate profitability, monetary conditions and inflation rate in China and the USA. Overall, the picture continues to be neutral (with positive predisposition according to fundamental and technical tools)

S&P500



Source: Bloomberg, Piraeus Bank Research

Corporate Profitability (base 31/07/2007)



Source: Bloomberg, Piraeus Bank Research

Bond Markets

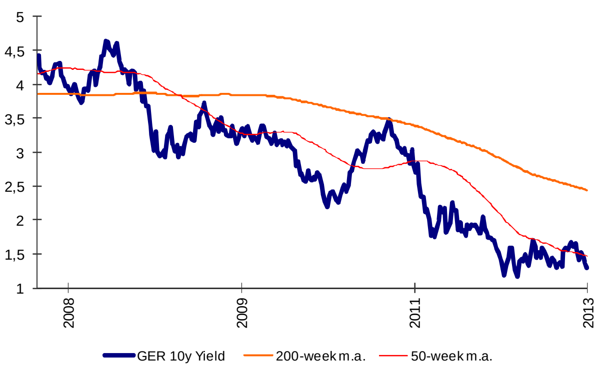
- During the last month, Treasuries and Bund yields posted downward pressures, because of the euro uncertainty, despite the US positive economic releases. It is worth noting that it is the first time (since January 2012) that there have been two consecutive months with positive returns in both equity and bond markets. This happened due to the Fed's reassurance about maintaining the current Treasuries purchase pace, which is plausibly positive for both markets. Given that this mechanism is mostly discounted though, a more likely scenario is just a marginal increase in the demand for safe assets, due to the increasing euro uncertainty, that is mainly realised in bond markets. Even though the euro developments had an impact on the exchange markets (JPY, USD and CHF strengthening), there was no broader impact on non-euro assets. The US economic releases about the increase in inflation rate, employment – payrolls and capacity utilization rate combined with the decrease in equity market volatility are conducive to an increase in yields. On the other hand, the lower growth rate in M2 compared to M1 money supply and the increase in oil price favour a falling trend in US yields. Adopting the scenario of no more escalating euro uncertainty, we believe that the more likely development will be the reversal in the downward trend in US yields.

- In Germany, the fall in Bund yields can be explained by the increase in the unemployment rate, fall in the IFO indicator and deceleration in the M3 money supply growth rate. Both in the US and Germany, the move in yields increased the degree of overvaluation in bonds, even in Germany, where despite the deteriorating economic releases, the fall in yields was greater than expected. Even though the degree of overvaluation increases more and more, the technical picture has improved significantly, mainly in Germany, where the positive picture will become even more positive in the case of further deterioration in the euro crisis and worse economic releases (such as higher unemployment rates).

10-year US Treasury Yields

Source: Bloomberg, Piraeus Bank Research

10-year German Bund Yields



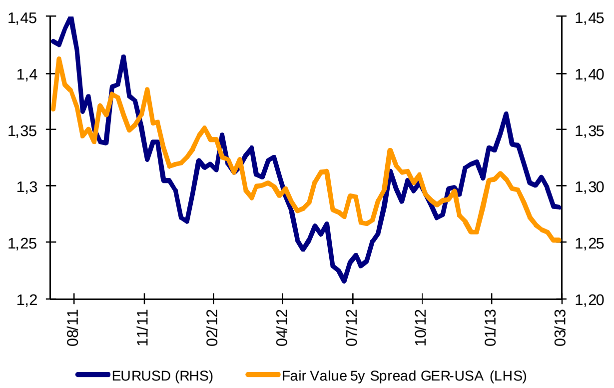
Source: Bloomberg, Piraeus Bank Research

FX

- The EURUSD exchange rate was under pressure last month, declining by 2.4%. This pressure is partly related to the increase in political risk in the Eurozone (Italy and Cyprus) as it was reflected in periphery bond markets, but mostly it is due to the difference between US and Eurozone economic releases (much better in the US). It is quite possible that we are entering a period of wider periphery spreads, justifying the current level of 1.28 in the EURUSD exchange rate. Indeed, the relatively negative technical picture of the exchange rate and Italian and Spanish bonds affirms this scenario.

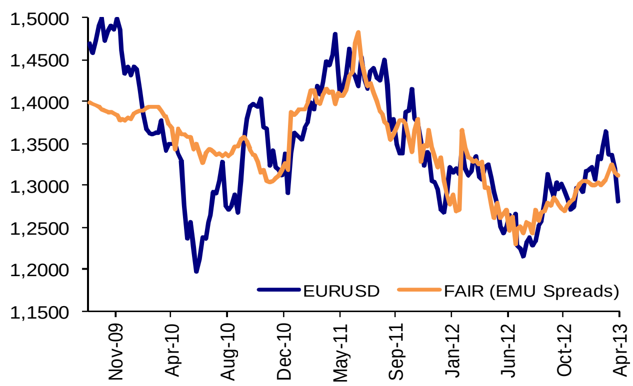
- According to our fair valuation models, we should note that the EURUSD exchange rate remains relatively expensive (compared to the previous month) if we take into consideration the relative cyclical dynamics between the US and the Eurozone, as they are reflected in the difference between US and German yields and in other metrics, such as supply money growth rates, leading business indicators and other interest rate differentials. In contrast, the EURUSD exchange rate remains relatively cheap if we take into account the Eurozone trade surplus and periphery's bond spreads. Therefore, we track an improvement in the fundamental picture (from neutral with negative predisposition to neutral with positive predisposition). On the other hand, we observe a deterioration in the technical picture (from neutral with positive predisposition to clearly negative), as increasing political risks are taken into consideration. Hence, the overall picture has deteriorated to neutral with negative predisposition. For the following 1 – 3 months, we expect volatility within the 1.2600 – 1.2980 range. On the six-month horizon, we expect the 1.2250 – 1.3100 range. Our twelve-month target stands at 1.26.

EURUSD vs. 5year Spread Germany-US



Source: Bloomberg, Piraeus Bank Research

EURUSD & Intra EZ Spreads vs. Germany

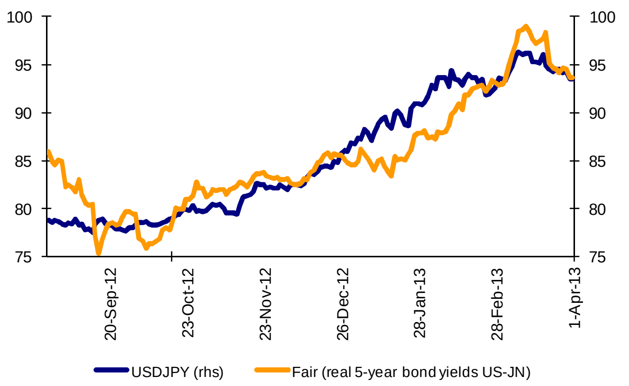


Source: Bloomberg, Piraeus Bank Research

- The USDJPY rate continued to experience upward pressure (+2%), because of the better economic releases in the US compared to Japan. Additionally, the expectation of the first BoJ conference under the new president (Kuroda) plays a critical role. Markets expect aggressive monetary policy announcements in order to achieve an increase in the inflation rate to 2% in two years. We have built a model which uses the difference in the 5-year real yield between the US and Japan as an explanatory variable for the natural logarithm of the USDJPY exchange rate. Since September of 2012, when Abe's election win became obvious, we have observed that an increase of 0.01% in the explanatory variable leads to an increase of 0.23% in the exchange rate. We believe that the short-term upward trend will probably continue up to 100, as political decisions play a critical role on real yields at this stage. In the long run, uncertainty about the achievement of the 2% inflation rate, the contingency of the re-operation of nuclear power stations and a possible increase in the demand for safe haven currencies (JPY is still considered one of them, which is wrong in our opinion) lead us to maintain our 12-month target of 89.

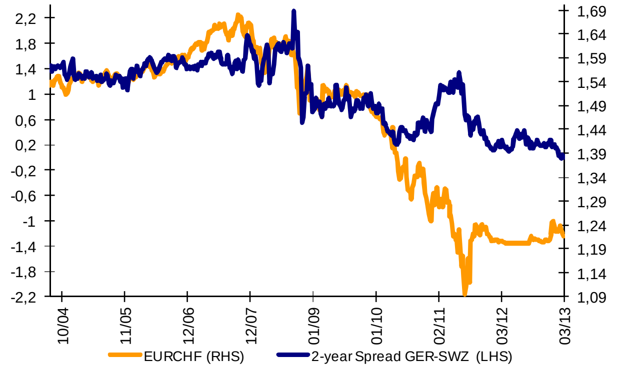
- The EURCHF exchange rate was under pressure due to the Italian election results and the Cyprus crisis, moving towards the 1.2170 area. In Switzerland, there were some signs of better economic activity such as the increase in the inflation rate (from -0.1% to 0.1%) and the acceleration in the money supply annual growth rate. These are judged as insignificant improvements, and consequently they do not pose any doubt about the 1.20 limit in EURCHF being maintained. At the same time, the FOREX reserves were maintained at CHF 429B (September 2012 level), indicating the reduction in the inflow size related to the Eurozone crisis effect.

USDJPY



Source: Bloomberg, Piraeus Bank Research

EURCHF



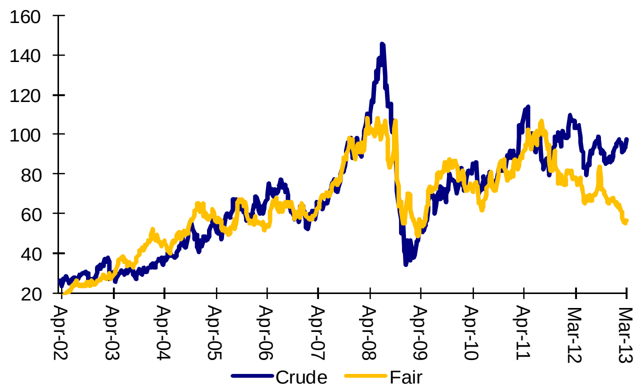
Source: Bloomberg, Piraeus Bank Research

Commodities

- The overall picture for commodities and raw materials remains relatively negative, as positive economic releases in the US are counterbalanced by the uncertain conditions in the Eurozone, China and other emerging economies. This leads to a combination of a strong USD and uncertainty about the future demand for cyclical commodities (metals, energy). Therefore, since the beginning of the year, the CCI index has been almost stable (0.5%), while the LME index decreased by 4% and agricultural products by 7%. On the other hand, positive returns were posted by crude oil (up 7%) and natural gas (up 20%).

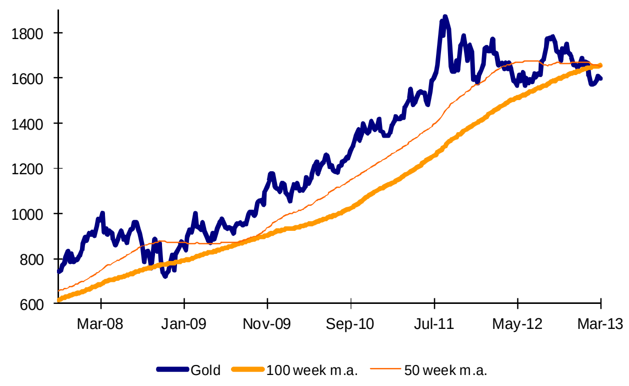
- The oil price returned to its upward trend, posting a positive return of 6% during the last month. This increase cannot be justified by the fundamentals, apart from the US data. Oil reserves increased by 3.3M to 385.9M barrels, which is the highest level since last July, while oil production approached the record high level of 7.2M barrels. In tandem with the cyclical metals, the economic developments in emerging economies and a strong USD suggest significantly lower oil price levels. We observe a significant deviation between the actual and projected (by our model which incorporates demand – supply and USD variables) fair price. On the other hand, we observe an improvement in the technical picture from neutral with negative predisposition to neutral with positive predisposition. The overall picture remains negative. The positive US economic releases combined with the possibly escalating crisis in Eurozone (that increases the demand for USD) cause pressures on the gold price (-4.5% since the beginning of the year), which remains overvalued according to our estimates. On the other hand, the technical picture remains neutral with marginally positive predisposition. The overall picture is neutral with negative predisposition.

Crude Oil vs. Fair Value



Source: Bloomberg, Piraeus Bank Research

Gold Price



Source: Bloomberg, Piraeus Bank Research

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