COMMERZBANK

# Week in Focus

5 July 2013

## A look into our forecast workshop

Every month, we meet to assess our world view. The discussions at these forecast meetings are often more interesting than the results themselves. This time we mainly discussed China, the Federal Reserve and the ECB. We outline our results as well as many of the points of discussion. **Page 2**

**China: How far will the cyclical downswing go?**
Real GDP, per cent change yoy; Purchasing Managers' Index (PMI), manufacturing

GDP (lhs) PMI (rhs)

*Source: Bloomberg, Commerzbank Research*

**Product idea: Target Forward on aluminium.** The price of aluminium has plummeted to a four-year low. We believe this to be exaggerated and look for a pick up in the months ahead. Investors can benefit from this recovery with the product presented here **Page 5**

## Outlook for week of 8 July to 12 July

**Economic data:** Following the strong German industrial production data in April we reckon with lower output in May, mainly due to seasonal factors, but a moderate pickup is expected in the second half of the year. **Page 7**

**Bond market:** The ECB's renewed commitment suggests lower money market interest rates and should further diminish risk premiums of peripheral countries. **Page 11**

**FX market:** The trend reversal in US monetary policy which had been signalled following the FOMC meeting of 19 June is more or less priced into USD exchange rates. The upward trend in the dollar is therefore likely to be less smooth in future. But there are still many indications pointing towards lower EUR-USD levels in the medium term. Investor patience is likely to pay off. **Page 12**

**Equity market:** This recent DAX trend is reminiscent of 1994 and 2004, and the current DAX consolidation might continue until the fourth quarter of this year until an upward trend can set in again. **Page 13**

**Commodity market:** Political unrest in the Middle East is continuing to support oil prices, whilst in the metal markets the focus is on Chinese trade data where rising imports should provide a boost to copper prices. Moreover, high Chinese gold imports from Hong Kong ought to support the gold price. **Page 14**

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# A look into our forecast workshop

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**Every month, we meet to assess our world view. The discussions at these forecast meetings are often more interesting than the results themselves. This time we mainly discussed China, the Federal Reserve and the ECB. For the first time in a long while, we lowered our already-conservative growth forecast for China. Unlike many other economists, we do not believe that a tapering of the Fed's bond purchases as early as September is by any means a "done deal". Another rate cut by the ECB is not off the table. Our discussion of exchange rate forecasts was short; we are more convinced than ever that the euro will depreciate markedly versus the dollar over a medium-term horizon.**

## China: Softer growth, but no banking crisis

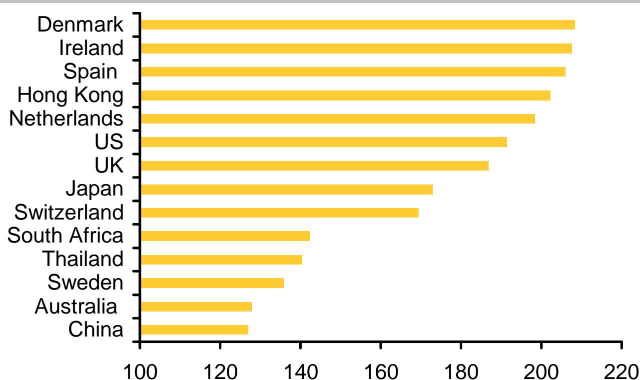
At the beginning of this year, we projected Chinese GDP growth of only 7.5% for 2013 while most economists expected a rate between 8% and 9%. We first highlighted the downside risks a month ago and have now lowered the forecast growth rate from 7.5% to 7.2% – mainly because seasonally adjusted GDP in the first quarter only expanded at an annualised rate of 6.6% versus the fourth quarter of 2012 (chart 1). This rate is low despite any reservations we may have about the seasonal adjustment process. Given the slower growth of industrial production and the recent decline of the Chinese purchasing managers' index, there is no reason to expect that growth will soon recover.

The recent rise in Chinese interbank rates played no significant role in this downward revision. Unlike in the euro zone in mid-2007, the turmoil in the Chinese money market is not signalling that Chinese property prices have fallen and torn a hole in banks' balance sheets. In China, lending to the private sector is not high compared with other countries (chart 2). Instead, there is much to suggest that the Chinese central bank has deliberately allowed interbank rates to rise so as to enhance banks' lending discipline and thereby prevent a credit-financed bubble such as we saw in the western world, the bursting of which is even today causing significant problems. But in the long-term, China will only be able to prevent speculative bubbles if it liberalises bank lending and deposit rates, which the government is currently fixing at levels that are too low, and permits them to rise. We agreed that the Chinese government will continue to relax interest rate regulation.[1] This also applies to regulation of foreign capital transactions, which argues for an appreciation of the renminbi versus the dollar (year-end forecast: 5.95).

## US: Tapering as early as September is no "done deal"

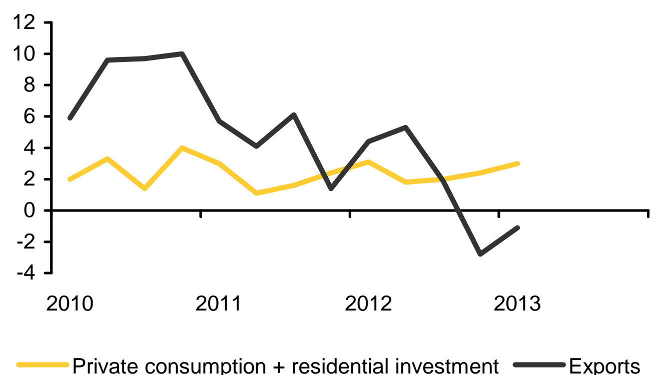
The second major issue at our forecast meeting was the emerging prospect of a change in Fed policy. Ben Bernanke's announcements have no doubt increased the risk of the Fed tapering its bond purchases sooner than we had assumed in our baseline scenario (towards the end of this year).

CHART 1: **Chinese debt level by no means unprecedented**
Loans as percentage of GDP, 2011 levels




*Source: World Bank, Commerzbank Research*

CHART 2: **US: Stable domestic demand, weak exports**
Per cent change qoq, real, annualised




*Source: Global Insight, Commerzbank Research*

[1] See "China: Ease the Squeeze", EM Country Briefing of 24 June 2013

However, for the following reasons our US economists are not as sure as many other analysts that the Fed will reduce its bond purchases as early as September:

- In September, the Fed will not yet be sure whether the economy has weathered the fiscal drag from the first half of the year. Furthermore, exports fell in the last two quarters (chart 2).
- The core rate of inflation, as measured by the deflator of personal consumption expenditures, was at 1.1% recently and thus far below the Fed's 2% target. Furthermore, already low inflation expectations declined somewhat over recent months. This will not have changed materially by September.
- In December, by contrast, it will be clearer that the economy remained on a stable growth path and that core inflation has bottomed out.

In our view, therefore, it is more likely that the Fed waits with the entry into the exit from QE3 until year-end.

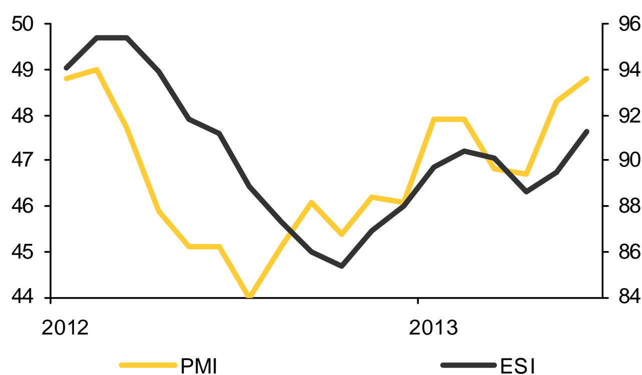
## Euro zone: How reliable is the improvement in sentiment?

Though we may have to wait a while for the exit from QE3, it is clear that the US has made much more progress in addressing its economic problems than the euro zone. This view remains unchanged despite a recovery in euro zone sentiment indicators in the last two months, following declines in March and April. But the ups and downs of sentiment indicators in recent months have taught us that in a less pronounced economic cycle such as this one, these indicators are not as reliable as they were in the past (chart 3).

This is even more the case because one important economic obstacle has obviously still not been cleared out of the way. Domestic order intake reported by German capital goods manufacturers has hardly increased, signalling that uncertainty arising from the sovereign debt crisis still lingers on in the minds of companies and continues to dampen their propensity to invest. We assume this is similar to other euro countries, especially since in many cases the economy is additionally constrained by a restrictive fiscal policy and the correction of past imbalances in the property market and household debt. Such problems are also increasingly dampening growth in the core of monetary union, and the Netherlands is a case a point. We have looked at the revised GDP numbers and were surprised by how sharply the Dutch economy contracted around end-2012/early-2013. The EU Commission's sentiment indicators for Belgium, Finland and France have even dropped to levels seen in the peripheral countries'.[2]

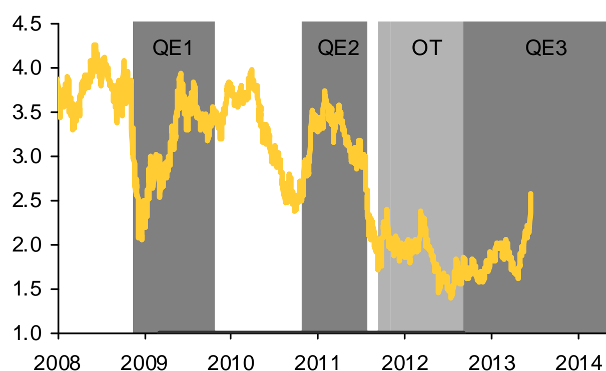
We therefore remain by our view that the euro zone economy will contract by 0.6% this year – particularly in view of the rise in uncertainty associated with the government crisis in Portugal. But should sentiment indicators in the euro zone continue rising, against expectations, we would probably raise our forecast a touch at our next meeting. After all, we assume only a tiny growth rate of 0.1% quarter-on-quarter for the second, third and fourth quarters of 2013.

CHART 3: **Euro zone – sentiment improving again**
Purchasing managers' index for manufacturing (PMI), Economic Sentiment Indicator (ESI)




*Source: Global Insight, Commerzbank Research*

CHART 4: **Bond market – words more important than deeds**
10-year Treasury yields




*Source Global Insight, Commerzbank Research*

[2] See "Euro area: The problems move north", Economic Insight of 17 June 2013

## ECB rate cut not off the table yet

Our forecast has long assumed that the ECB would lower its key rate in the third quarter. Since this prediction is highly uncertain, we have not given it more prominence and simply note that a rate cut is not generally off the table. But against the backdrop of the recent increase in sentiment indicators, we unanimously agreed at our forecast meeting that the data-sensitive ECB would probably not lower its key rate as early as September. This holds true even after yesterday's ECB press conference in which ECB President Mario Draghi for the first time in the history of the central bank announced a notable change of monetary policy, confirming that key interest rates would remain at their current or even lower levels for an extended period. At the same time, he claimed that another rate cut would invariably be dependent on trends in economic data.

We intensively debated whether we should strike the call for a rate cut altogether or simply postpone it to the fourth quarter. There is a strong case to be made for both alternatives. In the end, we agreed on postponement. If the euro zone economy grows at a barely perceptible rate in the second half as we assume, the recently much-increased sentiment indicators would likely start to move sideways in volatile manner. Two or three months of softer data could awaken fears of recession and prompt the ECB to act in a similar fashion to April. For this reason a rate cut is not generally off the table, as Mr Draghi suggested. This is all the more the case since the unemployment rate in the euro zone has already climbed to 12.2%. Moreover, the doves on the ECB Council will probably argue that the pace of wage inflation in the euro zone has slowed sharply, which should push core inflation to levels below the 2% mark for a long while.

## Bond markets: The worst is behind us for now

We have long forecast higher bond yields. But yields increased somewhat more rapidly and strongly in recent weeks than we had assumed. Since it is likely that the Fed will indeed announce the tapering of its bond purchases by the end of this year, interest rates are unlikely to fall noticeably, and so we have made a slight upward correction to our yield forecast for the coming months. We thus see ten-year US Treasury yields at 2.70% by year-end (previously: 2.40%).

However, we maintain our general outlook in which capital market yields will remain low. In the recent years markets have responded much more strongly to Fed announcements than to the implementation of monetary policy measures (chart 4). Since this rule will likely apply also to the tapering of QE3, yields look set to rise only slightly in the coming months. Bunds will probably outperform Treasuries because unlike the Fed, the ECB is showing no signs whatsoever of reducing the accommodative nature of its monetary policy. If it even lowers its key rate once more towards the end of the year, the outperformance of Bunds would receive a fresh boost.

## Euro softer on a medium-term perspective

The discussion of our forecasts for foreign exchange markets was comparatively short. The approaching reversal of Fed policy confirms our view that the euro will depreciate versus most currencies on a medium-term perspective. Whilst central banks around the globe are pondering a less expansive monetary policy, the ECB cannot take this route because it has to stabilise the monetary union. As a result, the euro looks set to depreciate sharply versus the dollar by the end of 2014 (forecast: 1.20). The only important exception besides the Swiss franc, which is under pressure as the euro zone crisis eases, is the Japanese yen because it is likely that the Bank of Japan will pursue an even more accommodative policy in future.

# Product idea: Target forward on aluminium

## Taking advantage of current attractive price levels

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**Led by across-the-board weak commodity prices, the price of aluminium has plummeted to a four-year low. We believe this to be exaggerated and argue that aluminium prices are likely to pick up again in the months ahead thanks to marked production cuts by leading producers.**

On the back of the looming policy change by the US Fed, weak economic data from China and concerns over systemic risks in the Chinese banking system, the price of aluminium in mid-June fell below USD 1,800 per tonne for the first time since October 2009. However, the negative news should now have been sufficiently priced in, which, in our view, argues against any further marked declines.

Looking forward to the medium term, prices look set to pick up again, as suggested by announcements of leading producers to cut production substantially. For the first time since 2009, the largest Chinese aluminium producer will temporarily shut down capacity amounting to several hundred thousand tonnes due to the challenging market environment. Moreover, leading producers outside China are also trimming back production. Thus, the world's largest producer of aluminium, Rusal in Russia, recently urged its competitors to shut down excess capacity to provide a lift to prices. Rusal puts average production costs in the aluminium industry at USD 2,300 per tonne. Given current price levels, many producers are therefore no longer generating profits. While the production cuts announced to date and already partially implemented are, in our opinion, not yet sufficient to trigger a sustainable reduction in the huge oversupply on the global aluminium market, we consider it an important signal that China has now also begun to trim back its output. Hence, in the months ahead, further production cuts ought to be on the cards.

If the production cuts are implemented as envisaged, supply would finally be more in line with demand. In the medium term, the price of aluminium should therefore be well supported. By year-end, we expect an increase to USD 1,950 per tonne. But unless further capacity is closed permanently, the upside remains limited. For this reason we recommend that clients take advantage of current price levels in order to participate in any expected price increases via the trading ideas described in this note.

**Trading ideas on aluminium in USD**

| | |
|---|---|
| Term: | 01/08/2013 – 31/07/2014, monthly price averaging and payments |
| Reference volume: | 75 mt per month, 900 mt total |
| Reference prices: | Aluminium LME cash, 3-month aluminium price USD 1,810 / mt |

**Fixed price agreement: Fixed price transaction (swap)**
Client pays fixed price of USD 1,935 per mt

**Target forward**
Under this alternative, a strike price is agreed that is lower than the fixed price of the swap. The transaction will end prematurely if the agreed target amount is reached or exceeded ("premature termination"). Only payments by the bank to the client are applied towards the target amount. If the target amount is reached or exceeded, the difference to 100% of the target amount will be paid and the transaction will be terminated prematurely.
**General data:**
Strike price: USD 1,685 per mt, target amount USD 1,750 per mt (maximum payout to the client: USD 131,250)

Alongside aluminium, Commerzbank currently offers hedging instruments on copper, lead, nickel, tin, zinc and steel in the base metals sector.

# Major publications from 28 June – 4 July 2013

## Economic Insight: Spain – Turn-around ahead?

The rise of the purchase managers' index to 50 gives grounds for optimism that the recession in Spain is gradually coming to an end. In fact, Spain's success on the global markets, the ebbing of the sovereign debt crisis, and a less restrictive fiscal policy all suggest that the economy will start to grow again in late 2013/early 2014. *more*

## FX Hotspot: Wall of Money – more than an illusion?

The Bank of Japan's far reaching purchases of Japanese bonds have fuelled speculation that this might lead to a massive outflow of capital from Japan (a "wall of money"). This is not to be expected, though. *more*

## Economic Briefing: Portugal – will the aid programme be derailed?

The resignation of two ministers' has plunged the government into a deep crisis. The most probable scenario is that the governing coalition will remain in office. If new elections were held, the implementation of the reforms and consolidation of public finances would be delayed. *more*

## Economic Briefing: Debt monitor Ireland – A stellar first half

Despite the fact that the real economy is in recession, public borrowing in the first six months of 2013 is notably lower than in the same period of 2012. Spending cuts continue to help. *more*

## Economic Briefing: Debt monitor – Belgium needs to save more

While Belgium registered a budget surplus in May, the public-sector deficit still rose in year-on-year terms during the first five months of the year. *more*

## Economic Briefing: Debt monitor – Encouraging signals from Spain

Higher tax revenue, in particular, ensured that the deficit of the Spanish central government in May was around €2½bn lower than in May 2012. Also, the regional numbers for the first quarter show that the regions are getting a better grip on their finances. *more*

## FX Hotspot: CEE FX – QE tapering effects

CEE currencies have weakened considerably on the back of the prospective shift in US monetary policy. We adjusted our EUR-PLN and USD-PLN-forecasts upward. We retain our bearish view on the HUF while remaining broadly neutral on the CZK, which is feeling the least impact of QE tapering speculation due to its safe haven status. *more*

## FX Hotspot: ZAR – Getting worse before it gets better

Year to date ZAR is the worst performing currency within the EMEA complex. Burdened by a large current account deficit and persistently high inflation, in our view there is more pain to come with USD-ZAR moving towards 10.80 by December of this year. *more*

## FX Hotspot: BRL – Higher US rates unmask BRL vulnerabilities

After the sizable depreciation, the prospect of a less expansionary monetary policy in the US should by now be priced into BRL exchange rates. However, we do not see much scope for a notable recovery of the real, as the fundamental situation in Brazil has deteriorated. *more*

## Commodity Spotlight Base Metals: Prices expected to bottom out

Discussions about a change in the monetary stance of the Fed and worries about Chinese growth have put base metal prices under heavy pressure. We see the current low price levels as presenting attractive buying opportunities on a long term view. *more*

## Emerging Markets H2 13 Outlook: EM is not much riskier than DM...

We provide an overview of emerging markets in H2, 2013. While they offer some advantages over developed markets, they seem set to soon experience major problems. Investors are likely to increasingly differentiate between individual countries. *more*

# Preview – The week of 8 to 12 July 2013

| Time | Region | Indicator | Period | | Forecast | Survey | Last |
|---|---|---|---|---|---|---|---|
| **Monday, 8 July 2013** | | | | | | | |
| # | FRA | Business confidence (Bank of France) | Jun | | 95.5 | – | 94.0 |
| 7:00 | GER | Exports | May | mom, sa | -0.5 | -0.2 | 1.7 |
| 11:00 | | Industrial production | May | mom, sa | -2.0 | -0.3 | 1.8 |
| | | | | yoy, wda | -2.0 | -0.8 | 1.0 |
| EUR: Eurogroup meeting in Brussels. | | | | | | | |
| **Tuesday, 9 July 2013** | | | | | | | |
| 2:30 | CHN | Consumer prices | Jun | yoy | 2.6 | 2.5 | 2.1 |
| 9:30 | GBR | Industrial production | May | mom, sa | 0.2 | 0.2 | 0.1 |
| | | | | yoy | -1.5 | -1.5 | -0.6 |
| | | Trade balance | May | £ bn, sa | -2.3 | -2.5 | -2.6 |
| EUR: ECOFIN meeting in Brussels. | | | | | | | |
| **Wednesday, 10 July 2013** | | | | | | | |
| 7:45 | FRA | Industrial production | May | mom, sa | 0.0 | – | 2.2 |
| | | | | yoy | 0.6 | 0.1 | -0.5 |
| 9:00 | ITA | Industrial production | May | mom, sa | 0.6 | – | -0.2 |
| • USA: Fed releases minutes of 18/19 June meeting. | | | | | | | |
| **Thursday, 11 July 2013** | | | | | | | |
| # | JPN | BoJ interest rate decision | | % | 0.10 | – | 0.10 |
| 0:50 | | Machinery orders | May | mom, sa | 3.5 | 1.6 | -9.1 |
| | | | | yoy | 5.1 | 3.6 | -1.1 |
| 6:30 | FRA | CPI | Jun | mom, sa | 0.0 | – | 0.1 |
| | | | | yoy | 0.8 | – | 0.8 |
| | | CPI ex tobacco | Jun | | 125.6 | – | 125.6 |
| 13:30 | USA | Initial claims | July 6 | k, sa | 335 | – | 335 |
| EUR: ECB releases monthly report for July (9:00). | | | | | | | |
| **Friday, 12 July 2013** | | | | | | | |
| 10:00 | EUR | Industrial production | May | mom, sa | -0.4 | -0.4 | 0.4 |
| | | | | yoy | -1.5 | -1.5 | -0.6 |
| 13:30 | USA | PPI | Jun | mom, sa | 0.7 | 0.5 | 0.5 |
| | | PPI excl. food & energy | Jun | mom, sa | 0.1 | 0.1 | 0.1 |
| 14:55 | | Consumer confidence (University of Michigan), preliminary | Jul | sa | 85.0 | 84.8 | 84.1 |

*Source: Bloomberg. Commerzbank Economic Research; *Time BST (subtract 5 hours for EDST. add 1 hour for CEST). # = Possible release; mom/qoq/yoy: change to previous period in percent. AR = annual rate. sa = seasonal adjusted. wda = working days adjusted; • = data of highest importance for markets*

# Economic data preview:

## Germany: Setback due to working-day effect

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**Following the very strong April data for German industry, we reckon with lower production in May: On one hand, the Pentecost holidays fell entirely in May this year, and on the other, April production was distorted upwards by the weather-induced delayed spring revival. Since business sentiment in Germany has recently improved significantly, we forecast moderate growth in industry for the second half of the year.**

We expect a setback in May German industrial production figures, to be released on Monday. Output is expected to have declined by 1.5% versus April (consensus: -0.3%). The first regional data, for instance from Baden-Württemberg, support our forecast of a notable drop in May.

However, this fall would come after three large consecutive increases. Production in April rose by 1.8% versus March, partly because of special factors that were likely corrected in May. On one hand, construction output revived in April after having suffered in the first quarter from the unusually harsh and long winter. On the other hand, April production profited from the early timing of Easter (chart 5).

The pendulum swung back in May because, as a result of this year's early Easter, the Ascension Day, Pentecost and Corpus Christi holidays all fell in May. Also, the Pentecost vacation in the large federal states Baden-Württemberg and Bavaria fell entirely in May. Since we do not believe that the seasonal adjustment process completely captures this working-day effect, production will likely be distorted to the downside.

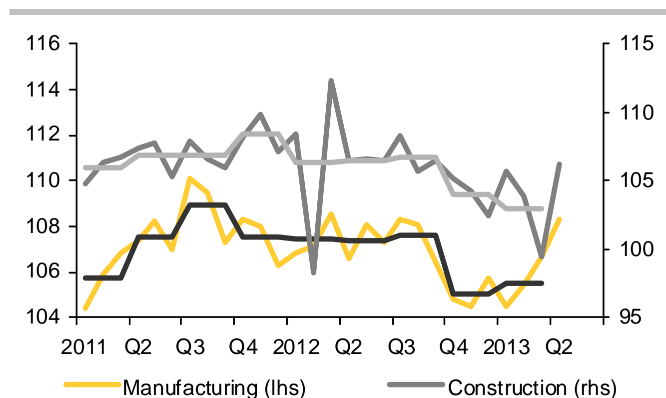
We assume that businesses will be able to expand production again in the coming months. According to the Ifo Institute's survey, businesses are viewing their demand situation much more positively than in spring. Since they simultaneously stated that their inventories are no longer as high as they were, it is likely that a revival in demand will soon be reflected in higher production (chart 6).

However, we would not expect a strong upturn. Domestic capital goods orders remain sluggish, signalling that businesses are still reluctant to invest, even though the sovereign debt crisis has ebbed somewhat.

## USA: Notable increase in producer prices, low core rate

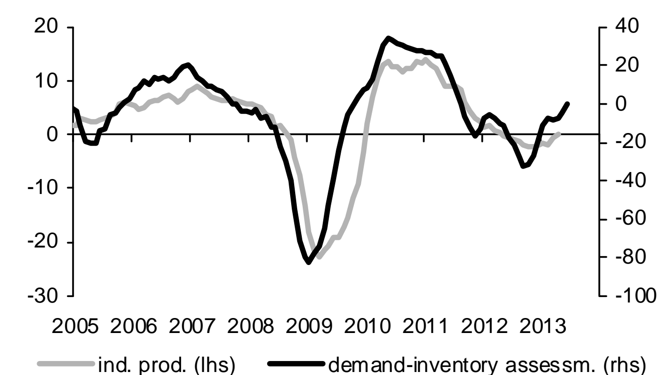
In the coming week, the US economy faces a lull on the side of data releases, with only minor indicators due for publication. In June, producer prices presumably increased by 0.7% on May (consensus: 0.5%), mainly owing to higher energy prices. Measured by the core rate, however, underlying inflation pressure remains low: Excluding energy and food, we expect prices to have increased by only 0.1% versus May.

CHART 5: **Germany – a good start into second quarter**
Production, index 2010=100; dashes mark quarterly averages




*Source: Destatis, Commerzbank Research*

CHART 6: **Germany – production moving up again**
Industrial production, year-on-year in percent, and Ifo component for demand minus component for assessment of inventories




*Source: Ifo, Commerzbank Research*

# Central Bank Watch (1)

## Fed

In recent days, members of the Federal Open Market Committee (FOMC) have taken great effort to explain the forthcoming reduction of bond purchases and re-assure markets that key interest rates will remain low for the foreseeable future. This was obviously meant to calm down markets.

New York Fed president William Dudley stressed in a speech that the Fed's monetary policy would depend on progress towards reaching the central bank's targets. If labour market performance or growth were to fall short of Fed expectations, Dudley said, he would expect a high volume of bond buying to continue for longer. However, the Fed is unlikely to push the start of the exit too far off as it has already put up with moderate growth in 2013. Dudley also referred to currently "mixed" data which he said were a consequence of the economy trying to overcome the hurdle of tight fiscal policy. In our view, only much weaker data in the next few months would likely prompt the Fed to delay tapering into next year.

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CHART 7: **Expected interest rate for 3-month funds (USD)**

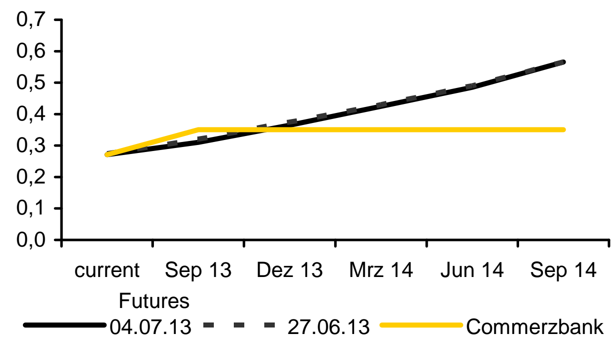


TABLE 1: **Consensus forecasts Fed funds rate**

| | Q3 13 | Q4 13 | Q2 14 |
|---|---|---|---|
| Consensus | 0.25 | 0.25 | 0.25 |
| High | 0.25 | 0.50 | 1.25 |
| Low | 0.25 | 0.25 | 0.25 |
| Commerzbank | 0.25 | 0.25 | 0.25 |

*Source: Bloomberg, Commerzbank Research*

## ECB

While leaving key rates unchanged, the ECB emphasised at its monthly press conference that "the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time". According to ECB president Draghi, this new form of forward guidance is an "unprecedented step". The Council's expectation of low rates for an extended period is "based on the overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the real economy and subdued monetary dynamics", Draghi explained. Its aim is "to inject a downward bias in interest rates for the foreseeable future" and to cope with increasing "external volatility", which is probably a reference to the recent increase of US bond yields. Draghi refused to elaborate what "extended period" exactly means.

On future key rates, Draghi highlighted that there was "an extensive discussion about a possible interest rate cut". With regard to a negative depo rate, the ECB remained "open-minded" and "technically ready". All in all, another rate cut is not off the table, but it remains completely data dependent: Should leading indicators decline for two or three months in a row, this may trigger another rate cut, including a negative depo rate.

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CHART 8: **Expected interest rate for 3-month funds (EUR)**

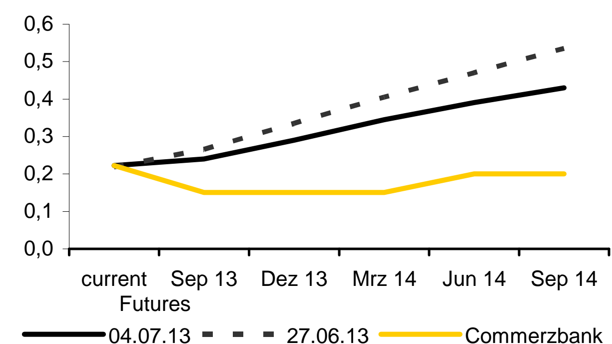


TABLE 2: **Consensus forecasts ECB minimum bid rate**

| | Q3 13 | Q4 13 | Q2 14 |
|---|---|---|---|
| Consensus | 0.50 | 0.50 | 0.50 |
| High | 0.50 | 0.50 | 0.75 |
| Low | 0.25 | 0.25 | 0.25 |
| Commerzbank | 0.50 | 0.25 | 0.25 |

*Source: Reuters, Commerzbank Research*

# Central Bank Watch (2)

## Bank of England (BoE)

Although Mark Carney's first MPC meeting turned out in line with expectations, sterling sold off heavily following the BoE's attempt to drive down bond yields which could “weigh on [the growth] outlook.” However, the moves in the immediate aftermath of the rate decision are unfounded in terms of fundamentals. Attention will next focus on the release of the MPC minutes later this month to see how the new governor voted on QE. But the case for additional QE is looking less convincing in the wake of recent data which point to more economic dynamism – notably the PMIs which in June reached their highest in two years, and the BoE's Credit Conditions Survey which pointed to recovery in demand and supply of credit in Q2. Looking further ahead, the presentation of the August Inflation Report will contain the MPC's assessment of using guidance as a monetary policy tool, which is likely to be formally adopted, and possibly as early as next month.

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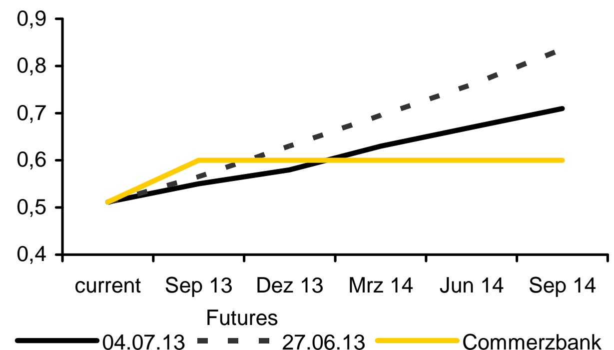
CHART 9: **Expected interest rate for 3-month funds (GBP)**




*Source: Bloomberg, Commerzbank Research*

## Bank of Japan (BoJ)

With the Tankan report having surprised to the upside at the start of the week, it has become unlikely that the central bankers will decide on further expansionary measures at next week’s meeting. A majority of the large enterprises in the manufacturing sector view their business situation positively, which reflects how well economic activity has picked up: Exports have been rising again since the start of the year, consumer sentiment has improved noticeably and equity prices have gained more than one third. Also, business expectations have increased significantly: Businesses are more optimistic about the future than they have been in the last five years.

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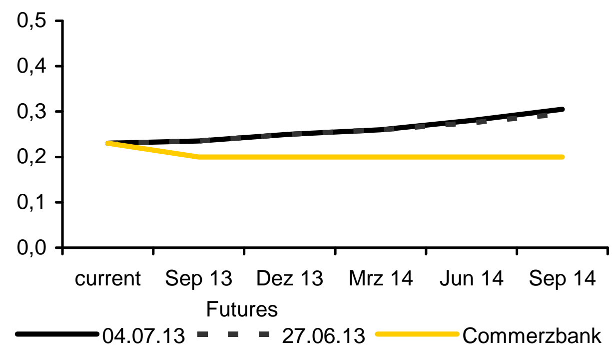
CHART 10: **Expected interest rate for 3-month funds (JPY)**




*Source: Bloomberg, Commerzbank Research*

## Norges Bank (Norway)

As expected, Norges Bank left the key policy rate unchanged at 1.5% in mid-June. More surprisingly, the central bank made a further downward revision to the interest rate outlook in its new monetary report, in which it signalled a 50% chance of a rate cut in September. The previous prospect of gradual rate hikes in early 2014 was postponed to the end of next year. However, data released since the last meeting have been somewhat better than expected. The only exception – the surprisingly sharp decline in the purchasing managers’ index – should be taken with a grain of salt given the extraordinarily low participation level. Another factor arguing against further rate reductions in the near future is the weaker krone. Therefore, we expect the Norges Bank to remain on hold for the time being.

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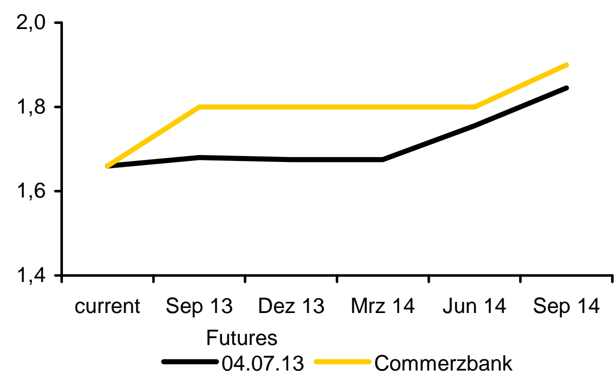
CHART 11: **Expected interest rate for 3-month funds (NOK)**




*Source: Bloomberg, Commerzbank Research*

# Bond market preview:
## Rewriting history

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**The ECB meeting has changed the euro area bond market dynamics once again. Explicit forward guidance on interest rates should push money market forward rates lower and help to sustain a decline in peripheral spreads. The political tensions in Portugal look like a storm in a teacup. The upside in Bund yields should be capped but inflation expectations have probably bottomed. US-Treasury yields are likely to stabilise near-term but could edge higher still over the medium-term.**

TABLE 3: **Weekly outlook for yields and curves**

| | Bunds | US Treasuries |
|---|---|---|
| Yield (10 years) | Sideways | Moderately rising |
| Curve (10 – 2 years) | steeper | steeper |

*Source: Commerzbank Research*

| Momentum outlook for Bund future 8 – 12 July | ↑ ↓ |
|---|---|
| Monetary policy | ↑ |
| Trend | → |
| Supply | → |
| Risk aversion | ↓ |

The ECB has rewritten history! ECB President Draghi rolled out specific forward guidance and a downward bias on interest rates for an extended period of time. This drives a wedge between US and €-curve dynamics and caps the upside in euro area real yields in particular.

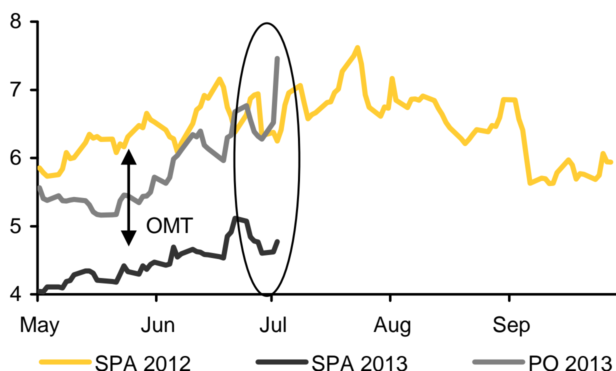
This week's political tensions in Portugal and strains in the implementation of the adjustment programmes in Greece and Cyprus almost posed a sense of crisis déjà vu ahead of the summer and reminded investors that the crisis is not over yet. The latest ECB action however should firmly combat contagion fears. We therefore expect the bullish spread tightening in peripherals to prevail in the second half of the year. At the same time, money market forward rates are likely to decline further, helping to cap upside in Bund yields. We reaffirm our year-end 10y Bund yield forecast of 1.5% and expect real yields to decline. This also implies that breakevens have most likely bottomed.

Half of the 100bp+ leap in Portuguese government bond yields on Wednesday has since been reversed. Italian and Spanish bond yields, on the other hand, edged up by a relatively moderate amount, but reversed course following the ECB action. This confirms that the ECB's OMT pledge continues to unfold its magic (chart 12).

In the short term, the general market picture also remains impacted by worries over the looming tapering of bond purchases by the Fed The bulk of the sharp upward correction of US Treasury yields is probably now behind us. Nevertheless, provided the economic data do not present major disappointments, yields are more likely to edge up than down. Today's labour market report should set the tone for the next week; no other market-moving data are due in the immediate future. The minutes of the latest Fed meeting should add further colour to the debate as this was the meeting when Bernanke revealed his tapering plans.

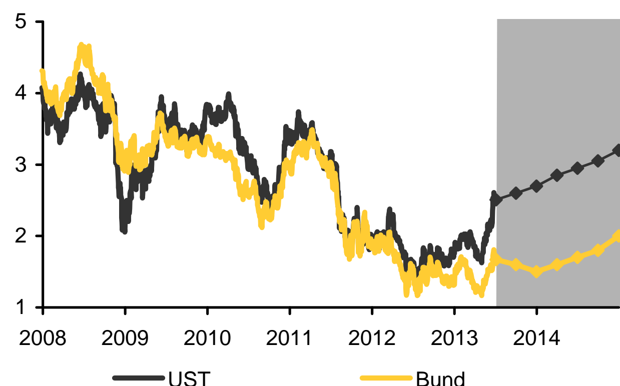
With the ECB starting to fight premature Fed-induced tightening as fundamentals diverge we see an even stronger case for US underperformance with 10y yields possibly even drifting in opposite directions later this year, boosting the UST-Bund spread firmly above 100 (chart 13).

CHART 12: **No summer crisis, thanks to OMT**
Yields on ten-year government bonds, in percent




*Source: Bloomberg, Commerzbank Research*

CHART 13: **Bunds should fare better than Treasuries**
Yields on ten-year Bunds and US-Treasuries, Commerzbank forecast from July 2013 onwards, in percent p.a.




*Source: Bloomberg, Commerzbank Research*

# FX market preview:
## Qualitative differences

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**The trend reversal in US monetary policy which had been signalled following the FOMC meeting of 19 June is more or less priced into USD exchange rates now. That means the dollar uptrend is unlikely to continue in as smooth a manner as has so far been the case. However, there are still many indications that point towards lower EUR-USD levels medium term. Investor patience is likely to pay off.**

TABLE 4: **Expected weekly trading ranges**

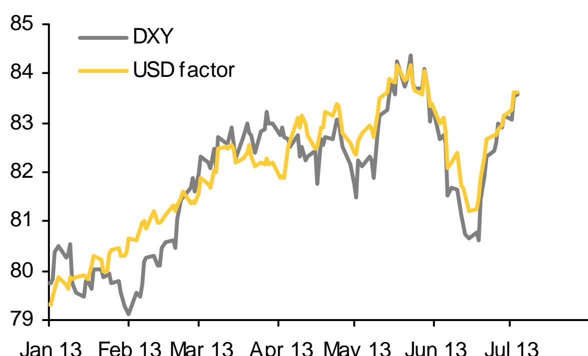
| | Range | Bias | | Range | Bias |
|---|---|---|---|---|---|
| EUR-USD | 1.2650-1.3100 | ↘ | EUR-GBP | 0.8450-0.8700 | → |
| EUR-JPY | 125.50-133.00 | → | GBP-USD | 1.4750-1.5300 | ↘ |
| USD-JPY | 97.50-104.00 | ↗ | EUR-CHF | 1.2200-1.2450 | ↘ |

*Source: Commerzbank Research*

With the clear breach of 1.3000 in EUR-USD and 100.00 in USD-JPY during the course of the week, the US dollar reached the targets which we had set following the FOMC meeting.[3] The ICE dollar index (DXY) and the USD factor in our G10 factor model have retraced approx. 75% of the previous USD weakness (chart 14). This means that the easier part of the USD recovery is likely to have taken place. So far the dollar benefitted from the fact that at last there is now a clearly discernible US monetary policy *rule*, which reduces uncertainty. The closer the different measures of USD strength come to the May highs, the more the debate about the timing of the tapering (i.e. the reduction in QE3 volumes) is likely to take over. As a result the development of the USD exchange rates is likely to become bumpier again. Which takes us to the more obvious: everything depends on the data, and above all the labour market report due for publication today.

Medium term the qualitative difference between the Fed and ECB policy remains the most important driver for EUR-USD. While a normalisation – albeit slow – of monetary policy is foreseeable from the Fed, ECB President Mario Draghi yesterday announced that interest rates would remain on their current or even lower levels for a long time to come. Combined with the notably stronger US economy over the foreseeable future and an increasing yield advantage of US bonds this is likely to lead to medium term EUR-USD losses. At present one thing in particular applies: patience will be rewarded. Investors who have the patience to accept the difficulty of predicting short term exchange rate fluctuations will be rewarded with a relatively secure medium term trend.

CHART 14: **Dollar has retraced June's collapse**
ICE dollar index (DXY) USD factor in our G10 factor model (unscaled index)




*Sources: ICE, Bloomberg, Commerzbank Research*

CHART 15: **...and risk appetite in FX markets slowly comes back**
Risk factor in our G10 factor model (up = risk off)

*Source: Commerzbank Research*

[3] See also *FX Hotspot* "Guidance" (19th June) and our *Daily Currency Briefing* "Guidance" dated 20th June.

# Equity market preview:
## DAX finds support at its 200-day moving average

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**In the current consolidation the DAX found support at its 200-day moving average around 7,700. This recent DAX trend is reminiscent of 1994 and 2004 when the markets anticipated a trend reversal in Fed policy. In our view the current DAX consolidation might continue until the fourth quarter of this year.**

TABLE 5: **DAX in a consolidation since Bernanke's signals of QE3 tapering**

| | | Performance (%) since | | | Earnings 2013e Index points | | Earnings 2013e Growth (%) | | P/E 2013e | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Index | 31/05 | 31/03 | 31/12 | current | 31/12 | current | 31/12 | current | 31/12 |
| DAX 30 | 7,829 | -1.6 | 0.4 | 2.9 | 676.8 | 683.6 | -8.0 | -1.0 | 11.6 | 11.1 |
| MDAX | 13,608 | -0.7 | 2.2 | 14.2 | 844.0 | 948.5 | -2.1 | 14.4 | 16.1 | 12.6 |
| Euro Stoxx 50 | 2,571 | -1.2 | -2.0 | -2.5 | 230.2 | 248.6 | -0.2 | 5.8 | 11.2 | 10.6 |
| S&P 500 | 1,615 | 0.6 | 3.0 | 13.3 | 109.7 | 111.3 | 6.9 | 9.1 | 14.7 | 12.8 |

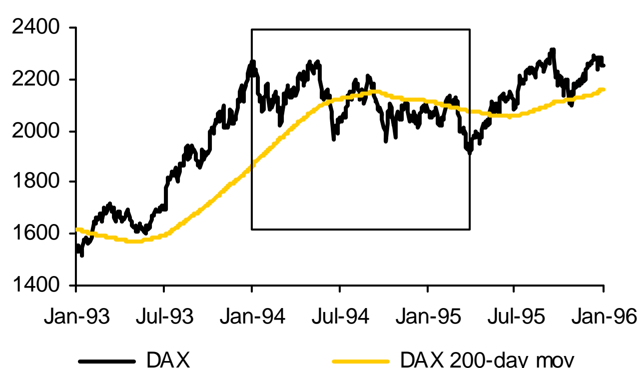
*Source: Commerzbank Corporates & Markets, I/B/E/S*

DAX bulls and DAX bears have continued their recent battle at the 200-day DAX moving average which is currently running at 7,700. Over the last few days, DAX bears found many catalysts to depress equity markets, e.g. Fed policy, China growth fears, Portugal, Greece, and Egypt/oil price. Against the backdrop of the current QE3 Fed tapering fears DAX bears point out that in 1994/95 the DAX suffered a 5-quarter consolidation around its 200-day moving average when the Fed moved to a less expansionary monetary policy (chart 16). Furthermore, in 2004/05 the DAX suffered a 3-quarter consolidation around its 200-day moving average when bond markets anticipated a trend reversal of Fed policy (chart 17). Similar to 1994 and 2004, Bernanke's signals of reduced bond buying have pushed the DAX back towards its 200-day moving average at 7,700.

In our view the Fed-policy-fears-driven DAX consolidation should continue in the coming months. The length of the DAX consolidation might depend on the trend of bond markets. If US bond yields move sharply higher (similar to 1994/95), then the DAX consolidation might take three to five quarters. If, by contrast, US bond yield show a muted reaction (similar to 2004/05), then the DAX consolidation might already end during the autumn 2013.

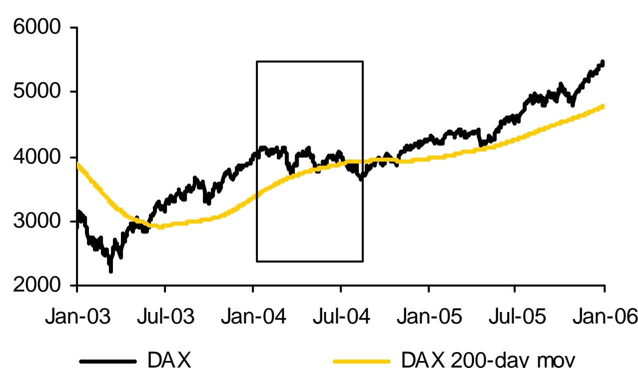
Our economic team and our bond strategists argue that for the US bond market, a 2004/05 replay is more likely than a 1994/95 correction. In this context, the DAX consolidation might already end in September or October 2013, in our optimistic view. Investors should therefore use DAX levels at the 200-day DAX moving average during summer 2013 to anti-cyclically increase exposure to equity markets. In our scenario the DAX should resume a new upward trend in Q4 2013, and we expect the DAX to move back to 8,500 by the end of this year.

CHART 16: **DAX consolidation in 1994/95 due to Fed policy**
DAX and DAX 200-day moving average from 1993 to 1996




*Source: Datastream, Commerzbank Research*

CHART 17: **DAX consolidation in 2004/05 due to Fed policy**
DAX and DAX 200-day moving average from 2003 to 2006




*Source: Datastream, Commerzbank Research*

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# Commodities market preview:
## Rising Chinese imports likely to provide a lift to metal prices

**Against the backdrop of political unrest in the Middle East, which continues to support oil prices, the three leading energy agencies' new demand and supply estimates are unlikely to prompt any movements. On the metal markets, the focus is on Chinese trade data. Rising imports should provide a boost to copper prices. Moreover, high Chinese gold imports from Hong Kong ought to support the gold price. As regards agricultural prices, we expect virtually no change, as the US Department of Agriculture (USDA) looks set to more or less confirm its crop estimates in its forthcoming monthly report.**

TABLE 6: **Tendencies in important commodities**

| | | Per cent change | | | Tendency | Commodity specific events |
|---|---|---|---|---|---|---|
| | 4 July | 1 week | 1 month | 1 year | short-term | |
| Brent (USD per barrel) | 105.2 | 2.3 | 1.9 | 5.4 | ⇨ | EIA:9, OPEC: 10, IEA: 11 |
| Copper (USD per ton) | 6940 | 2.8 | -6.9 | -10.2 | ⬀ | CHN: Trade balance June 10 |
| Gold (USD per troy ounce) | 1250 | 4.1 | -10.7 | -22.6 | ⬀ | China's gold imports from Hong Kong: ca. 8 |
| Corn (USD per bushel) | 5.03 | -7.6 | -10.2 | -25.5 | ⇨ | WASDE: 11 |

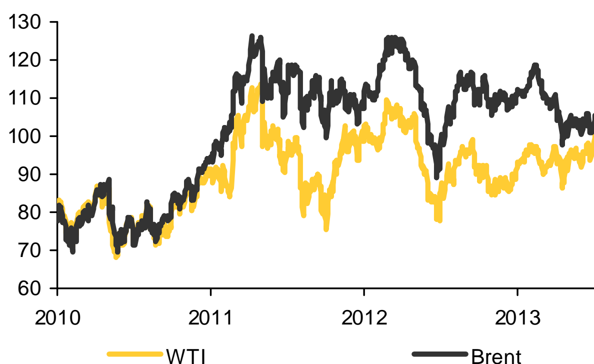
*Source: Bloomberg, Commerzbank Research*

Although the military has ousted the Egyptian president, the situation in the Middle East remains tense, which supports oil prices. Thus, the three leading energy agencies' monthly reports are unlikely to attract much attention, the more so as daily demand in the current year is still expected to rise by 0.8 to 0.9 million barrels. However, one issue of particular interest will be whether the International Energy Agency and OPEC, which will release their first forecasts for 2014, share the optimism of the US Energy Information Administration. The latter expects daily global oil demand to rise by 1.2 million barrels next year. We are sceptical whether the recent relative strength of WTI versus Brent will remain intact (chart 18). If inventories at Cushing rise, the price spread of WTI, which narrowed substantially in recent weeks, might widen slightly.

On the base metals markets, the focus is on Chinese trade data for June. Due to lower global market prices, China ought to have purchased more copper abroad, which should provide a lift to copper prices. Moreover, the gold market is awaiting the May figures on Chinese gold imports from Hong Kong. The country's leading gold producer puts Chinese demand in the first half of the year at roughly 800 tonnes. Given that only about half of China's demand is covered by its own production, imports should have risen correspondingly (chart 19). Gold demand from China is one of the key supports of gold prices.

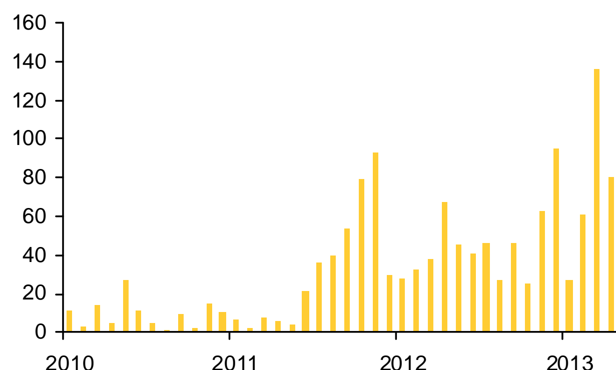
After the USDA left its estimate of corn acreage in the USA unchanged, a downward revision to US corn production this year seems unlikely. US corn inventories at the end of the current crop year, on the other hand, might be cut moderately, as reductions in the three months to 1 June came in above expectations. As regards wheat and soybeans, estimates on supply should also be left more or less unchanged, which argues for limited price potential.

CHART 18: **Back to old times? – WTI is catching up**
USD per barrel




*Source: Bloomberg, Commerzbank Research*

CHART 19: **China's gold demand on the uptrend**
Net imports from Hong Kong, tonnes




*Source: Statistics Office Hong Kong, Commerzbank Research*

# Commerzbank forecasts

TABLE 7: **Growth and inflation**

| | Real GDP (%) | | | Inflation rate (%) | | |
|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2012 | 2013 | 2014 |
| USA | 2.2 | 2.0 | 2.8 | 2.1 | 1.3 | 1.7 |
| Canada | 1.7 | 1.8 | 2.3 | 1.5 | 1.0 | 1.8 |
| Japan | 1.9 | 1.1 | 1.3 | 0.0 | -0.1 | 1.5 |
| Euro area | -0.5 | -0.6 | 0.7 | 2.5 | 1.5 | 1.5 |
| - Germany | 0.7 | 0.2 | 1.5 | 2.0 | 1.6 | 2.0 |
| - France | 0.0 | **-0.2** | **0.8** | 2.0 | 1.1 | 1.6 |
| - Italy | -2.4 | -1.7 | 0.2 | 3.0 | 1.3 | 1.2 |
| - Spain | -1.4 | -1.8 | -0.1 | 2.4 | 1.5 | 0.8 |
| - Portugal | -3.2 | -2.3 | 1.0 | 2.8 | 1.0 | 1.5 |
| - Ireland | 0.9 | 0.3 | 1.9 | 1.9 | 1.1 | 1.4 |
| - Greece | -6.4 | -4.1 | 1.9 | 1.5 | -0.5 | 0.0 |
| United Kingdom | 0.2 | **1.0** | 1.5 | 2.8 | **2.6** | 2.2 |
| China | 7.8 | **7.2** | 7.5 | **2.7** | 3.5 | 4.0 |
| India | 5.0 | **6.4** | 7.0 | **7.5** | **5.5** | **5.3** |
| Brazil | 0.9 | 2.7 | 3.4 | **5.4** | **5.6** | 5.7 |
| Russia | 3.4 | **1.9** | **2.5** | 5.1 | 6.5 | 6.5 |
| World | 2.9 | **2.9** | **3.6** | | | |

- The US economy will continue to grow at a moderate pace. The Fed looks set to taper bond purchases (QE3) by year-end at the latest.
- Growth in China seems set to be a little more than 7%.
- In the euro zone, growth in the second half of the year ought to be negligible, while unemployment looks set to rise further. An ECB interest rate cut is not yet off the table.
- EMU will survive the sovereign debt crisis, but is gradually evolving into an "Italian-style monetary union".
- The German economy looks set to continue to outperform the rest of the euro area – partly because ECB target rates are much too low for Germany.
- High unemployment in most countries is still keeping inflation at bay. In the long term, however, inflation is likely to rise, as central banks have given up some of

TABLE 8: **Interest rates (end-of-quarter)**

| | 04.07.13 | Q3 13 | Q4 13 | Q1 14 | Q2 14 | Q3 14 |
|---|---|---|---|---|---|---|
| **USA** | | | | | | |
| Federal funds rate | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 3-months Libor | 0.27 | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** |
| 2 years* | 0.36 | **0.40** | **0.50** | **0.60** | **0.70** | **0.85** |
| 5 years* | 1.42 | **1.50** | **1.70** | **1.90** | **2.00** | **2.15** |
| 10 years* | 2.50 | **2.60** | **2.70** | **2.85** | **2.95** | **3.05** |
| Spread 10-2 years | 214 | **220** | **220** | **225** | **225** | **220** |
| Swap-Spread 10 years | 23 | **15** | **10** | **10** | **10** | **10** |
| **Euro area** | | | | | | |
| Minimum bid rate | 0.50 | **0.50** | 0.25 | 0.25 | 0.25 | 0.25 |
| 3-months Euribor | 0.22 | **0.20** | 0.15 | 0.15 | 0.20 | 0.20 |
| 2 years* | 0.10 | **0.15** | **0.15** | **0.15** | **0.15** | **0.15** |
| 5 years* | 0.58 | **0.60** | **0.50** | **0.60** | **0.70** | **0.80** |
| 10 years* | 1.62 | **1.60** | 1.50 | **1.60** | **1.70** | **1.80** |
| Spread 10-2 years | 151 | **145** | **135** | **145** | **155** | **165** |
| Swap-Spread 10 years | 29 | 25 | 20 | 25 | 20 | 20 |
| **United Kingdom** | | | | | | |
| Bank Rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| 3-months Libor | 0.51 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 |
| 2 years* | 0.37 | **0.40** | **0.40** | **0.45** | **0.50** | **0.60** |
| 10 years* | 2.35 | **2.40** | **2.50** | **2.60** | **2.70** | **2.80** |

- The structurally low interest rate environment is set to persist, despite the latest increase in yields. The ECB's zero interest rate policy forces investors into longer duration or weaker credits in order to avoid negative real yields.
- As soon as it becomes clearer that hopes for an economic recovery will be disappointed in H2, Bund yields should decline again. By year end we expect 10y Bund yields to be at 1.50%. US Treasuries are likely to underperform further.
- The crisis continues to abate. Risk premiums of peripheral government bonds are set to decline further. The ECB's commitment to do "whatever it takes" reduces the systemic risks and the danger of contagion. Negative news flow out of individual countries thus no longer leads to broad increases in risk premiums.

TABLE 9: **Exchange rates (end-of-quarter)**

| | 04.07.13 | Q3 13 | Q4 13 | Q1 14 | Q2 14 | Q3 14 |
|---|---|---|---|---|---|---|
| EUR/USD | 1.29 | 1.27 | 1.24 | 1.23 | 1.22 | 1.21 |
| USD/JPY | 100 | 108 | 115 | 118 | 120 | 122 |
| EUR/CHF | 1.23 | **1.26** | **1.28** | **1.31** | **1.33** | **1.35** |
| EUR/GBP | 0.86 | 0.85 | 0.84 | 0.83 | 0.82 | 0.82 |
| EUR/SEK | 8.65 | 8.55 | 8.50 | 8.45 | 8.40 | 8.30 |
| EUR/NOK | 7.91 | **7.60** | **7.55** | **7.50** | **7.45** | **7.40** |
| EUR/PLN | 4.27 | **4.25** | **4.15** | **4.10** | **4.05** | **4.00** |
| EUR/HUF | 293 | 300 | 310 | 315 | 312 | 310 |
| EUR/CZK | 25.85 | 25.50 | **25.50** | 25.10 | 24.90 | 24.70 |
| AUD/USD | 0.91 | **0.92** | **0.90** | **0.88** | **0.87** | **0.88** |
| NZD/USD | 0.78 | **0.78** | **0.77** | 0.76 | **0.75** | **0.78** |
| USD/CAD | 1.05 | 1.05 | 1.06 | 1.07 | 1.05 | 1.04 |
| USD/CNY | 6.13 | 6.01 | 5.95 | 5.86 | 5.77 | 5.68 |

- While in the euro zone, the ECB is set to pursue expansionary monetary policies for a longer period according to President Draghi, in the US the discussion is focussing on an exit from QE3. This suggests EUR-USD will trend lower.
- In Q4/13, a possible ECB rate cut would weigh on EUR-USD.
- Prospects of a laxer monetary and fiscal policy will keep the yen under pressure, the more so as Japan's fiscal problems are becoming an issue.
- CEE currencies seem set to appreciate versus the euro in the mid to long term. Near term, however, the weak economy in the CEE countries is a negative factor for their currencies.

*Source: Bloomberg. Commerzbank Economic Research; bold change on last week; * Treasuries, Bunds, Gilts, JGBs*

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## Other publications (examples)

**Economic Research:** Economic Briefing (up-to-date comment on main indicators and events)
Economic and Market Monitor (monthly global view)
Economic Insight (detailed analysis of selected topics)

**Commodity Research:** Commodity Daily (up-to-date comment on commodities markets)
Commodity Spotlight (weekly analysis of commodities markets and forecasts)

**Interest Rate Strategy:** Ahead of the Curve (flagship publication with analysis and trading strategy for global bond markets
European Sunrise (daily comment and trading strategy for euro area bond markets)
Covered Bonds Weekly (weekly analysis of the covered bonds markets)
Rates Radar (ad-hoc topics and trading ideas for bond markets)

**FX Strategy:** Daily Currency Briefing (daily comment and forecasts for FX markets)
Hot Spots (in-depth analysis of FX market topics)
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Cross Asset Outlook (monthly analysis of global financial markets and tactical asset allocation)
Cross Asset Feature (special reports on cross-asset themes)

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