

# EURO VISIONS: Economic and Capital Market Outlook

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## Government deficits: Euro zone consolidates, USA ignores, CEE in line

- Interest expected to remain low on major markets (euro zone, US)
- Divergent development of CEE countries, but overall solid growth
- Stabilisation of corporate credit quality will prevent any extreme widening of risk premiums

### Euro zone recovering only slowly

“The euro zone is recovering at differing paces. There are enormous disparities between North and South,” said Gudrun Egger, Head of Fixed-Income Research at Erste Group. For example, in Germany, foreign demand has already resulted in high capacity utilization. For this reason, investments and hirings have already picked up and this is also helping to boost private consumption. In Spain, capacity utilization is still very weak. Due to the sustained adverse situation on the real estate market, no upswing is expected there in the coming year.

The export-driven recovery might slow slightly in the euro zone by 1Q 2011, also considering that growth in some emerging markets (export markets) stands to decelerate and the temporary effects (e.g. contribution from inventories) will disappear.

Analysts expect investments to add only minor amounts to GDP, likewise private consumption. The moderate economic growth of +1.3% (2011) should keep inflation low (on average 1.7% in 2011).

### Consolidation of government debt is checking public sector consumption

Deficits are expected to decline considerably already in 2011 (vs. 2010). However, they still have to be cut further – to a viable level. “There is a certain risk that a premature implementation of consolidation plans could hinder economic growth in some countries. Especially when monetary policy cannot compensate more restrictive financial policy,” according to Egger. The diverse approaches to the topic of debt clearly revealed the differences between the US and the euro zone. While there is a strong focus on deficit reduction in the euro zone, in the US, measures have yet to be initiated in this respect.

However, corporate investments have been developing positively in the US again since the start of the year. Nonetheless, any upwards trend will remain moderate in future, because consumption demand will expand only gradually and companies will remain cautious. The outlook for private consumption is based on the shrinking assets of US households after the real estate bubble burst. The slight improvement on the labour market will not be enough to drive up consumption spending.

For Central and Eastern Europe, analysts of Erste Group generally expect private consumption to pick up. As regards financial policy savings measures, the CEE countries have already implemented these or plan to do so at the start of the year 2011. In this context, one should take note of the fact that there are enormous differences within CEE from country to country.

However, overall it may be assumed that even though the measures will have a dampening effect, albeit to varying degrees, this will not stand in the way of robust economic growth. For example, Romania which suffered the most from the financial crisis and the entailing austerity regime has already implemented sufficient measures to achieve next year’s deficit target. Therefore, no additional burdens are expected in this country.



Gudrun Egger

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### Staatsanleihen – Renditen weiter niedrig

Das moderate Wirtschaftswachstum und die Konsolidierung der Budgets halten die Zinserwartungen niedrig. Je mehr die Regierungen unter Druck geraten und sparen müssen, umso mehr müssen die Notenbanken unterstützen (niedrige Zinsen, Liquiditätsversorgung), damit das Wachstum nicht abgewürgt wird. Seit Jahresbeginn trennt sich am europäischen Rentenmarkt die Spreu vom Weizen, zumal die Bonität der einzelnen Staaten viel stärker in den Mittelpunkt des Investoreninteresses gerückt ist. Während insbesondere die Renditen der liquiden Benchmark Anleihen (Deutsche Bundesanleihen) aufgrund von starken Zuflüssen („sicherer Hafen“) stark gesunken sind, stehen nach Griechenland nun die Staatsanleihen von Irland oder Portugal auf dem Prüfstand. In Summe gibt es zwar kaum noch Kurspotenzial bei 10-jährigen Laufzeiten, aus Sicht der Erste Group Analysten sind aber weiter deutsche Bundesanleihen gegenüber US Treasuries zu bevorzugen. Wenngleich die USA 2011 das höchste Haushaltsdefizit der G7 [1]-Länder einfahren dürfte, kommt von den Finanzmärkten derzeit noch kein Konsolidierungsdruck. In Summe sind bis Jahresmitte 2011 nur geringe Anstiege der Renditen zu erwarten. Vorläufig sollte die Fed jedenfalls allfälligen deutlichen Renditeanstiegen mit Treasury Käufen begegnen.

Die Unternehmensinvestitionen haben sich in den USA allerdings seit Jahresbeginn wieder positiv entwickelt. Der weitere Aufwärtstrend wird aber eher moderat ausfallen, da die Konsumnachfrage nur schwach wachsen wird und die Unternehmen daher vorsichtig bleiben werden. Der Ausblick für den privaten Konsum basiert auf Vermögensverlusten, die die US-Haushalte durch das Platzen der Immobilienblase erlitten haben. Auch eine leichte Verbesserung des Arbeitsmarktes wird die Konsumausgaben nicht beschleunigen.

Für Zentral- und Osteuropa erwarten die Analysten der Erste Group allgemein ein Anspringen des privaten Konsums. Was die finanzpolitischen Sparmaßnahmen betrifft, so haben die CEE-Länder diese zum Großteil bereits umgesetzt oder werden es mit Jahresbeginn 2011 tun. Wobei zu beachten ist, dass besonders bei diesen Themen in CEE von Land zu Land stark unterschieden werden muss.

Insgesamt ist aber davon auszugehen, dass die Maßnahmen dämpfend wirken werden, wenn auch in sehr unterschiedlichem Ausmaß, einem soliden Wirtschaftswachstum aber nicht im Wege stehen werden. So hat beispielsweise Rumänien, das am stärksten unter der Finanzkrise und dem darauf folgenden Sparkurs gelitten hat, bereits ausreichend Maßnahmen umgesetzt, um das Defizitziel des nächsten Jahres zu erreichen. Damit sind dort keine zusätzlichen Belastungen mehr zu erwarten.

### Government bonds – Yields persist at low level

The moderate economic growth and the consolidation of the budget are keeping interest rate expectations low. The stronger the governments come under pressure and are forced to cut spending, the more the central banks have to provide support (low interest rates, liquidity supply) in order to keep growth from being throttled. Since the start of the year, the wheat has been separating from the chaff on the European bond market, also because investors have increasingly been shifting their attention to the creditworthiness of the individual states. While yields on liquid benchmark bonds (German Bunds) have decreased sharply due to heavy inflows (“safe haven”), after Greece, now the government bonds of Ireland and Portugal are under scrutiny. Overall, there is hardly any price upside in the ten-year segment, but in the view of Erste Group analysts German government bonds should continue to be given preference over US Treasuries. Even though the US will probably report the highest budget deficit of the G7



Alihan Karadagoglu, Credit Analyst der Erste Group

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[1] countries in 2011, no consolidation pressure is being felt from the financial markets at present. Overall, by mid-year 2011 only a slight yield widening is expected. For the time being, the Fed will counteract any rise in yields on German bonds by buying Treasuries.

#### **Corporate bonds – Investor confidence is high**

The debt crisis of the peripheral euro countries continues to be a factor of uncertainty for corporate bonds. “However, it is to be expected that the low interest level and the improvement of the credit ratios of companies will prevent an excessive widening of risk premiums on corporate bonds,” explained Alihan Karadagoglu, Credit Analyst at Erste Group. The positive development of the rating outlook means that credit quality in the corporate sector stabilized further. Companies are expected to continue to stay focused on ensuring sound balance sheets and sufficient liquidity. Decisive for the future development of risk premiums will be, above all, the further course of the economic recovery.

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[1] Federal Republic of Germany, United States, Japan, United Kingdom, France, Italy, Canada

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