Economic and Capital Market Outlook 2012

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“The crisis is still in the real economy – When will we return to normality?”

- Euro zone:
  - Stagnating GDP growth for 2012
  - Still, return to a 1.2% growth rate expected for 2013
  - Inflation for 2012 at 1.8%
- US
  - Positives growth of 2% expected for 2012
  - Return of EUR/USD to 1.25

Euro zone sovereign debt crisis: neither “breakthrough” nor “break-up”
For 2012 we expect the slow and painful process of solving the sovereign debt crisis to continue. A further escalation followed by additional measures – especially more financial support – seems probable. “We do not expect a breakthrough, but neither do we believe that the euro zone will break up. Generally, all signs indicate that the euro zone will ‘stumble through’ the next year,” explained Mildred Hager, macro analyst at Erste Group.

Macro outlook euro zone: Insecurity depresses sentiment, stagnation expected for 2012
Expectations regarding the debt crisis imply that sentiment is likely to stabilize at a low level. Households and companies are slowly returning to their “everyday" business. Exports stopped their catching-up process after the crisis and for this reason the analysts of Erste Group expect slower but nonetheless positive growth in external demand. In contrast to a “classic recovery”, businesses have not yet started increasing their capacities. This is lowering capital expenditure and weighing on the labour market. The high unemployment rate is a burden on consumption. On the whole, we expect stagnation for euro zone GDP in 2012,” stated Mildred Hager. The signs are pointing to a return to growth at a rate of 1.2% in 2013.”The overall capacity utilization rate is also expected to rise again which should contain inflation over the medium term (1.8% for 2012).

Interest rates and yields in the euro zone: ECB even more expansive, yields remain low
As a consequence of the persistently high unemployment and the entailing downside pressure on inflation, the analysts at Erste Group expect the ECB to lower rates to 0.5%. “M. Draghi is more 'American’ in some respects than J.C. Trichet, and therefore, has a stronger focus on the downside risks that may emanate from economic developments,” said Mildred Hager. This is clear from the proactive interest rate cuts carried out up to now and in the drastic widening of the liquidity made available. The latter is not much unlike quantitative easing and the analysts of Erste Group generally expect the ECB to stick to its more expansive course. Therefore, the upside pressure on German yields should also remain limited. Expectations for the economy, inflation and interest rates are subdued due to the sovereign debt crisis and are keeping yields low. From the standpoint of investors, Germany government bonds are still a safe haven.

Macro outlook US: Clearly improved sentiment; moderate, positive growth perspectives
The improved development of exports and investment activity in the US in comparison to pre-crisis times will continue in the opinion of Erste Group analysts. This partly compensated the lack in demand from households. The negative effects on the housing and labour markets are lowering the medium-term growth prospects. Still, no recession is expected. Sentiment has clearly improved and short-lived negative factors of influence such as oil prices, supplier chain problems as a consequence of Japan will disappear. Analysts of Erste Group therefore expect moderate growth close to 2% for the US.

Interest rates and yields in the US: Inventive Fed, Treasury yields down
"We expect the Fed to develop additional inventive and creative measures to support the labour market," said Mildred Hager. "Well-communicated announcements of interest rate moves by the Fed could push down interest rate expectations in the market even further, and buying in the mortgage-backed securities segment might provide slight support for the housing market," explained Mildred Hager. Another aspect that speaks against a yield increase is the expected inflow of funds into US bonds and the role of the USD as reserve currency. The analysts of Erste Group expect yields of around 2.5% on 10-year Treasury bonds near the end of the year.

EURUSD: Between the Fed, ECB and debt crisis – Return to fair value of 1.25 expected
The US dollar developed into a safe haven in the second half of the year with respect to the debt crisis. This trend will continue in 2012. But also indirect effects such as a more expansive ECB than the Fed are contributing factors. "We therefore expect the USD to return to a fair value of EURUSD 1.25 after years of 'undervaluation'," stated Mildred Hager