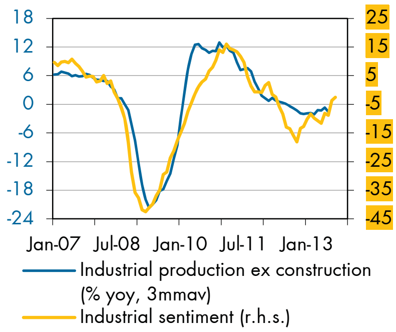
Market Outlook
Bond markets
weekly

4 October 2013

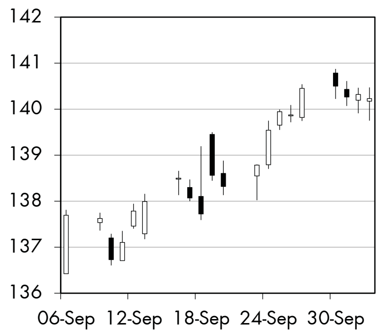
Raiffeisen RESEARCH

DE: Production about to improve



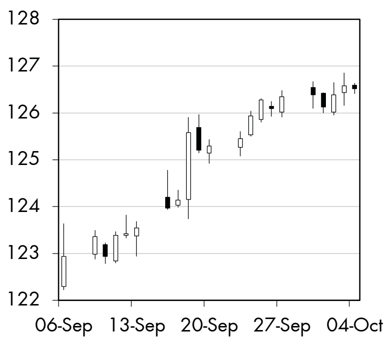
Source: Thomson Reuters, Raiffeisen RESEARCH

Bund Future



Source: Bloomberg

T-Note Future



Source: Bloomberg

Forecasts

USA	curr.[1]	Dec-13	Mar-14	Sep-14
Key rate	0.25	0.25	0.25	0.25
Libor 3M	0.24	0.30	0.30	0.30
Yield 5Y	1.37	1.80	1.90	2.30
Yield 10Y	2.62	3.00	3.10	3.30
Euro area				
Key rate	0.50	0.50	0.50	0.50
Euribor 3M	0.22	0.25	0.30	0.50
Yield 5Y	0.82	1.10	1.30	1.90
Yield 10Y	1.81	2.10	2.30	2.80
Swaprate 5Y	1.25	1.60	1.85	2.50

1 as of 4 October 2013, 08:22 p.m. CET
Source: Thomson Reuters, Raiffeisen RESEARCH

Recommendation (Horizon: December 2013):
Sell: USD bonds, DE bonds

USA

The **budget dispute** between Democrats and Republicans **will remain the dominant issue** also in the coming week. So far, there have been no signs of a convergence between the two parties so that large parts of the administration as well as many authorities will arguably remain closed for the whole next week. Almost all planned economic data releases might therefore be postponed as was today's labour market report. The only exceptions are initial jobless claims as well as data from non-governmental authorities (NFIB business confidence, University of Michigan consumer confidence). Against this backdrop, market participants will watch the **minutes** of the most recent **FOMC interest rate decision** due to be released on Wednesday even more closely than they would have done anyway. Just as all the other financial market actors, we hope to gain insight into what prompted central bankers to perform their unexpected swing with regard to the cutback on bond purchases.

The economic consequences of the **government shutdown** have so far remained within limits. Yet, starting from next week, the potential damage of the budget block would likely grow exponentially with every further week of standstill. Some larger US companies have already announced that thousands of employees will be placed on mandatory leave as the absence of administrative authorizations does not permit orders to be processed. Also the closure of customs authorities entails massive impairments in foreign trade. If companies cannot ship their goods for a longer period of time and/or are not able to unload the needed in-

Key figures

USA					RBI	Cons.	prior
Tue,	8.	13:30	NFIB Small Business Optimism survey	Sep.	**n.a.**	n.a.	94
Tue,	8.	14:30	Trade balance (USD, bn)	Aug.	**-37.0**	-39.3	-39.1
Thu,	10.	14:30	Initial jobless claims (thsd, ann.)	CW41	**n.a.**	307	308
Thu,	10.	14:30	Import price index (% mom)	Sep.	**0.1**	0.3	0.0
Fri,	11.	14:30	Producer price index (% yoy)	Sep.	**0.5**	0.6	1.4
Fri,	11.	14:30	- core rate (% yoy)	Sep.	**1.2**	1.3	1.1
Fri,	11.	14:30	Retail sales (% mom)	Sep.	**0.0**	0.2	0.2
Fri,	11.	14:30	- less autos (% mom)	Sep.	**0.5**	0.4	0.1
Fri,	11.	15:55	U. of Michigan consumer confidence, prel.	Oct.	**72.0**	77.0	77.5
Fri,	11.	16:00	Business inventories (% mom)	Aug.	**n.a.**	0.3	0.4
Europe							
Mon,	7.	10:30	EUR: Sentix investor confidence	Oct.	**7.5**	10.6	6.5
Tue,	8.	09:00	ES: Industrial output (% yoy)	Aug.	**-1.2**	-0,6	-1.4
Tue,	8.	12:00	DE: Factory orders (% mom), mom	Aug.	**1.3**	1.0	-2.7
Wed,	9.	12:00	DE: Industrial production (% mom)	Aug.	**1.8**	0.9	-1.7
Thu,	10.	08:45	FR: Industrial production (% mom)	Aug.	**0.7**	0,5	-0.6
Thu,	10.	10:00	IT: Industrial production (% mom)	Aug.	**0.9**	0.7	-1.1
Events							
Wed,	9.	20:00	US: Minutes FOMC meeting	17 Sep.	**n.a.**	n.a.	n.a.

Source: Bloomberg, Raiffeisen RESEARCH

GDP (real %yoy)

	2013e	2014f	2015f
Austria	0.5	1.5	2.3
Germany	0.5	1.8	2.5
France	0.1	1.0	1.8
Belgium	0.1	1.7	2.3
Netherlands	-1.1	1.3	1.6
Finland	-0.4	1.5	2.7
Ireland	0.1	2.5	3.0
Italy	-1.7	0.7	1.5
Spain	-1.5	1.5	2.0
Portugal	-1.6	1.5	2.2
Greece	-4.0	-0.5	1.5
Euro area	-0.3	1.5	2.0
UK	1.4	1.9	2.1
Switzerland	1.8	2.0	2.0
USA	1.5	2.5	3.2
Japan	2.2	2.3	1.1

Source: Thomson Reuters, Raiffeisen RESEARCH

Consumer price index (% yoy)

	2013e	2014f	2015f
Austria	1.9	2.1	2.3
Germany	1.5	1.5	2.0
France	1.1	1.7	1.7
Belgium	1.3	1.4	2.1
Netherlands	2.7	1.3	1.7
Finland	2.2	1.7	2.2
Ireland	0.7	1.4	1.7
Italy	1.4	1.7	1.6
Spain	1.5	1.1	1.5
Portugal	0.6	1.3	1.5
Greece	-0.7	-0.3	0.6
Euro area	1.5	1.6	1.8
UK	2.5	2.8	3.1
Switzerland	-0.1	0.4	1.1
USA	1.5	2.0	2.5
Japan	0.1	1.5	0.9

Source: Thomson Reuters, Raiffeisen RESEARCH

Forecasts

	current[1]	Dec-13	Mar-14	Sep-14
CHF				
Libor 3M	0.02	0.0	0.0	0.0
Yield 10Y	1.05	1.2	1.4	1.7
YEN				
Key rate	0.10	0.1	0.1	0.1
Libor 3M	0.15	0.1	0.2	0.2
Yield 10Y	0.66	0.8	0.9	1.0
FX				
EUR/USD	1.36	1.30	1.31	1.28
EUR/JPY	132.32	130	135	138
USD/JPY	97.10	100	103	108
EUR/CHF	1.22	1.25	1.28	1.29
Crude				
Brent (USD)	109.30	110	112	118

1 as of 4 October 2013, 08:22 a.m. CET
Source: Thomson Reuters, Raiffeisen RESEARCH

termediate goods because of non-existing customs clearing, production might soon be restricted. The longer this state of affairs will persist, the more companies will be dragged into this negative whirlpool. Although such development would be extremely unfavourable for all the companies and employees concerned, it would likely not bring the US economy down to its knees but only put a temporary damper on it. With the NFIB business confidence and the University of Michigan consumer confidence, two indicators will be released next week. These will give us an impression of the extent to which the budget dispute has so far depressed companies' and consumers' sentiment.

From an economic point of view, **it might get really dangerous if the budget dispute would remain unresolved until 17 October**. Starting from this day, the US will likely to no longer have any chance of taking on new debt as the debt ceiling of USD 16,700 bn would be reached at that point. As of most recently, though, only around 80% of government spending was covered by revenue. In other words, the government would have to cut back on spending by 20% starting from that day, which means overnight, and without the transition periods used in the case of sequester. An abrupt cutback on government spending to such an extent would, however, inevitably choke off the economy. **In conjunction with the unresolved budget dispute**, this might be a deadly cocktail for the US economy and would **definitely lead to recession**.

Though the two parties are currently deeply entrenched in their positions, we, however, consider it to be highly unlikely that they will ultimately allow for this economic maximum credible accident to really happen. **We are firmly convinced that a compromise solution will be found**, as part of which both the settlement of the budget dispute and a raising of the debt limit will be achieved. Among the ranks of Republicans, increasing criticism against the fundamental opposition of the ultra-conservative Tea Party movement is voiced, albeit still off the record. Is seems as though a whole series of delegates do not want their own country's wellbeing at risk because of utopian demands from a small group of fundamentalists. In addition, some Republican delegates seem to increasingly fear that their chances at the 2014 midterm elections to the Senate and the House of Representatives might dwindle as a result of the obstructive approach. It is therefore even possible that a smaller group of Republican delegates will ultimately reach a compromise with Democrats and push it through the House of Representatives against the vote of their own fellow party members – Democrates hold a Senate majority anyway.

At any rate – that is, even if no solution will be found until 17 October – **we exclude a US default on government bonds**. Even in the event of massive spending cuts, the top priority would be given to debt servicing until the end. Such default would entail unforeseeable consequences for the US and the world financial system. That's why one would never let this happen.

Over the last few days, **yields on ten-year US government bonds** have leveled off at slightly above 2.6%. Although it sounds like a paradox, the budget dispute and the possible negative economic consequences actually support to US government bonds. Increased economic risks make an early reduction of bond purchases by the US Fed less likely. If the disputes continues to escalate and if there are indications that the US economy is suffering, yields might drop further. We consider already the current level of yields to be a good opportunity to position on the sell-side. This applies all the more if yields continue to fall. As described, the current political dispute has an expiration date in our view and will (have to) be resolved within the next weeks. In the ideal case, this will be a lasting solution and not again a mere postponement of the problem. As soon as this Gordian knot will be finally cut, we expect to see noticeable economic recovery starting in early 2014. Sooner or later, also the Fed QE3 will then have to be terminated. In the medium term, we will then see yields on US government bonds clearly above 3%.

Euro area

The coming days, mostly **industrial activity data** will be released in many euro countries. July figures and thus the start into the third quarter turned out to be very weak for the most part. Yet, industrial sector surveys (purchasing managers' indices, EU Commission sentiment indicators) have improved markedly over the last few months. That's why we forecast clear gains in the industrial output and incoming orders for the German industry from July to August. With the expected rebound the economic path we estimate might receive support (Q3 EUR GDP growth was weaker than in Q2 but still positive). Moreover, the first leading economic indicator for the current month will be published with the **Sentix index**. We expect to see a further small increase, which should be backed by an improvement in the current situation.

After Italian Prime Minister Enrico Letta once again managed to prevent the looming end to the government, tension on the **government bond market** has eased somewhat. The main beneficiaries are, of course, Italian debt securities. All in all, however, politics remains the chief driver of market events, whereby the fuss between Democrats and Republicans in the US is setting the pace (see US section). Under these circumstances, save havens like German government bonds still remain wanted. But as soon as reason prevails over calculation in the US (i.e. as soon as an agreement is reached), yields will again turn upwards. After all, the economic outlook has lately improved and positive "soft" survey values will be reproduced by "hard" real economic data in the coming days. That's why levels, on the one hand, are attractive enough for a strategic position for rising yields of medium and long term German government bonds by the end of the year. On the other, the "war of faith" over health services in the US may last for a while, which would speak against active bets/positioning in the short term.

On the **primary market**, the Netherlands, Germany, Italy and Belgium will issue bonds in the following days. In addition, the Netherlands, France, Malta and Italy will auction money market papers.

Overview government bonds

Yields 10Y	curr.[1] (%)	1W Δ (BP)	52W H (%)	52W L (%)	Ytd Δ (BP)
AT	2.21	1.7	2.47	1.48	46.6
DE	1.81	3.0	2.05	1.17	49.2
FR	2.35	1.3	2.63	1.66	35.4
BE	2.60	1.3	2.91	1.92	54.3
NL	2.19	1.2	2.47	1.49	69.4
FN	2.03	-0.2	2.32	1.33	50.1
IE	3.77	-10.2	4.29	3.43	n.a.
IT	4.38	-4.0	5.11	3.76	-12.1
ES	4.25	-10.9	5.94	4.04	-101.2
PT	6.60	-24.2	8.90	5.23	-41.6
GR	9.28	-18.9	18.47	8.13	-261.7
UK	2.68	-7.1	3.02	1.62	84.9
CH	1.04	-2.4	1.19	0.39	51.6
US	2.62	-0.4	2.99	1.58	86.4
JP	0.65	-2.9	0.93	0.45	-13.8

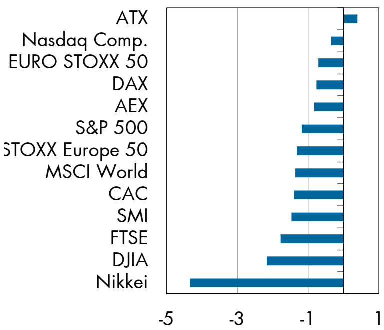
1 as of 4 October 2013, 08:15 a.m. CET
Source: Bloomberg

Debt issuance calendar

Issuer	Date		Maturity	Coupon (%)	Vol*
			Bonds		
NL	Tue,	8.	2019	1.25	2.5
DE	Wed,	9.	2018	1	4
IT	Fri,	11.	n.a.	n.a.	n.a.
BE	Fri,	11.	n.a.	n.a.	n.a.
			Bills		
NL	Mon,	7.	3M,9M	-	4
FR	Mon,	7.	n.a.	-	n.a.
MT	Tue,	8.	n.a.	-	n.a.
IT	Thu,	10.	n.a.	-	n.a.

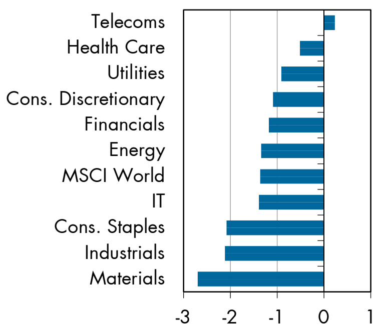
** EUR bn*
Source: Bloomberg

Market performance (%, 1 week)*



** performance from 26 Sep – 3 Oct 2013*
Source: Thomson Reuters

Sector performance (%, 1 week)*



** weekly performance of global MSCI sector indices from 26 Sep – 3 Oct 2013*
Source: Thomson Reuters

Forecasts

	current[1]	Dec-13	Mar-14
Euro STOXX 50	2,919	3,050	3,150
DAX	8,608	9,000	9,300
FTSE	6,456	6,850	7,100
SMI	7,906	8,400	8,700
DJIA	14,996	16,000	16,500
S&P 500	1,679	1,770	1,830
Nasdaq Comp.	3,774	3,950	4,100
Nikkei 225	14,024	15,300	16,200
ATX	2,522	2,630	2,750

1 as of 4 October 2013, 12:00 noon CET
Source: Bloomberg, Raiffeisen RESEARCH

Recommendations

Markets:	**Buy:** Europe, USA, Japan
Favoured sectors:	Energy, Materials, Industrials, Consumer discretionary, IT

Established equity markets

Currently, politics plays yet again an essential role on equity markets. Although the situation in Italy has eased for the time being, tensions are, however, likely to increase at the upcoming crucial government decisions. Yet, of greater importance to the economy and stock markets is the flaring budget dispute in the United States. Though the political bickering is depressing the mood, it has not yet left any dramatic traces, especially with regard to the most important US indices. Investors obviously still hold out hopes for a compromise to be reached in this matter. Moreover, also the again better-than-expected ISM manufacturing index might have strengthened economic confidence. Due to the obvious immobility of the parties involved in the conflict, however, this topic will continue to be with us at least in the coming week, while some variety should be added by the upcoming reporting season. The latter will be ushered in by Alcoa, which is traditionally the first company in the Dow Jones Industrials to release its results. JPMorgan and Wells Fargo will provide first insights into the financial sector. All in all, the bar for companies is once again not set too high. Along similar lines to the past, analysts' expectations have again been sent downwards. While third quarter consensus estimates of S&P 500 companies' profit growth early in July were still at +5.5%, their current level is as low as +1.8%. Against the backdrop of increasing improvements in economic indicators, we therefore also expect to see mostly positive surprises once again. The fact that local events are currently also having an impact on international stock markets – apart from the ubiquitous government shutdown debate – became apparent in Japan last week, where the Nikkei 225 lost significant ground in relative terms. Especially the published government plans that indicate an intended value-added tax increase to 8% from 5%, was obviously met with little approval among investors. Even if this leads many to fear that economic recovery will be impaired, we are more relaxed about the issue, for the Bank of Japan is prepared at any time to provide additional stimulus measures. Although the discussion surrounding large central banks' liquidity measures and the US debt ceiling will stay with us, we consider economic development in the coming months to remain a decisive influence factor. Since we essentially hold out the prospect of the world economy's steady gaining momentum and do not expect a recurrence of upheavals, moderate valuations of equities compared to other asset classes should once again come to the fore. Accordingly, we forecast positive development on international stock markets.

Expected corporate releases

USA		
Tue,	08	Alcoa, YUM! Brands
Wed,	09	Costco Wholesale, Family Dollar Stores
Thu,	10	Micron Technology, Safeway
Fri,	11	JPMorgan Chase, Wells Fargo
Europe		
Thu,	10	Suedzucker

Source: Bloomberg, Raiffeisen RESEARCH

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Publisher: Raiffeisen RESEARCH GmbH, A-1030 Vienna, Am Stadtpark 9, Phone: +43 1 717 07-1521
Editorial Department: Raiffeisen RESEARCH / RBI A-1030 Vienna, Am Stadtpark 9, Phone: +43 1 717 07 - 1521