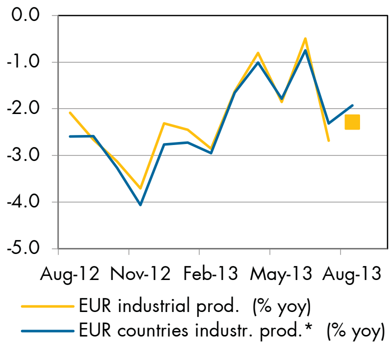
Market Outlook Bond markets

weekly

11 October 2013

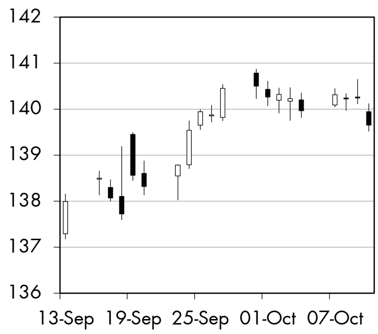
Raiffeisen RESEARCH

Production resumes upward trend



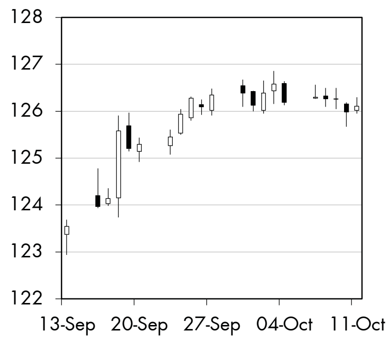
** weighted consisting of DE, FR, IT, ES, NL, FN, PT*
Source: Thomson Reuters, Raiffeisen RESEARCH

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	1.42	1.80	1.90	2.30
Yield 10Y	2.68	3.00	3.10	3.30
Euro area				
Key rate	0.50	0.50	0.50	0.50
Euribor 3M	0.23	0.25	0.30	0.50
Yield 5Y	0.85	1.10	1.30	1.90
Yield 10Y	1.86	2.10	2.30	2.80
Swaprate 5Y	1.29	1.60	1.85	2.50

1 as of 11 October 2013, 09:06 p.m. CET
Source: Thomson Reuters, Raiffeisen RESEARCH

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

USA

The **budget dispute** continues to be unresolved. An early reopening of the closed federal authorities is not foreseeable. Yet, there are first signs of a convergence, at least with regard to the debt ceiling. As part of negotiations with President Obama, Republicans yesterday proposed a debt-cap raise until 22 November in order to prevent a looming payment default. The remaining time should then be used for negotiations on a sustainable plan to reduce expenditure. As soon as an agreement is reached, the debt upper limit is to be raised for a long period of time. Obama, however, rejected the proposal as insufficient. He keeps insisting on a longer-term increase in the debt ceiling as well as unconditional agreement to a budget plan, which makes an immediate reopening of all federal agencies possible.

A solution in which Republicans approve a budget plan while the debt ceiling is increased only by three months is surfacing as a possible compromise. Currently, Democrats and Republicans are jointly preparing an appropriate proposal in the Senate. Just as this week, numerous economic data releases will fall victim to the government shutdown also in the week ahead. What will, however, be published are the first regional manufacturing sentiment surveys. With the US central bank being unaffected by the federal agency closures, nothing stands in the way for both the **Empire State Manufacturing Index** (Tue) and the **Philadelphia Fed Index** (Thurs) to be published. Yet, interpreting the data might be difficult, as it will hardly be possible to find out to what extent sentiment deterioration is attributable to the budget dispute in case such deterioration materializes. What will also be published is the **NAHB housing market index** (Wed), which has seen a massive increase over the last months. Due to the lack of relevant data, also **initial jobless claims** (Thurs) will again be closely followed. In the previous week, these shot up steeply by 66K to an annualized 374K. Yet, this had less to do with the downturn in the labour market situation than with computer problems experienced by the competent authorities in California. Moreover, staff dismissals by companies who

Key figures

USA					RBI	Cons.	prior
Tue,	15.	14:30	Empire State Manufacturing Index	Oct.	**n.a.**	8.0	6.3
Wed,	16.	16:00	NAHB housing market index	Oct.	**n.a.**	57	58
Thu,	17.	14:30	Initial jobless claims (thsd, ann.)	CW42	**n.a.**	n.a.	374
Thu,	17.	16:00	Philadelphia Fed Index	Oct.	**n.a.**	16.0	22.3
Europe							
Mon,	14.	11:00	EUR: Industrial production (% mom)	Aug.	**1.2**	0.6	-1.5
Tue,	15.	11:00	EUR: ZEW Survey Expectations	Oct.	**56.0**	n.a.	58.6
Tue,	15.	11:00	DE: ZEW Survey Expectations	Oct.	**46.0**	51.0	49.6
Wed,	16.	11:00	EUR: Consumer price index (% yoy), final	Sep.	**1.1**	1.1	1.1
Wed,	16.	11:00	EUR: - core rate (% yoy), final	Sep.	**1.1**	1.2	1.3
Thu,	17.	11:00	EUR: Construction output (% mom)	Aug.	**-0.4**	n.a.	0.3
Events							
Wed,	16.	20:00	Fed releases Beige Book	Sep/Oct			

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	0.14	0.1	0.2	0.2
Yield 10Y	0.66	0.8	0.9	1.0
FX				
EUR/USD	1.35	1.30	1.31	1.28
EUR/JPY	133.08	130	135	138
USD/JPY	98.33	100	103	108
EUR/CHF	1.23	1.25	1.28	1.29
Crude				
Brent (USD)	111.69	110	112	118

1 as of 11 October 2013, 09:06 a.m. CET
Source: Thomson Reuters, Raiffeisen RESEARCH

had to restrict their output because of the government shutdown, accounted for almost a quarter of the increase. The **Beige Book** published by the Fed on Wednesday might not provide any new pieces of information and depict economic activity again as moderately positive. Whether or not it will contain reliable indications as to the effects of the government shutdown is rather questionable as it covers in particular information from September.

The **ten-year US government bond yield** has so far appeared quite unimpressed by the budget dispute. In the previous week, it rose marginally to slightly less than 2.7%. Some market participants still do not seem particularly worried about a payment default in the US. Currently, the effects are observed only at ultra-short-term US securities as well as credit default swaps. In fact, some money market funds parted from treasury bills maturing between mid-October an early November as a precautionary measure. Subsequently, yields on four-week T-bills shot up to 0.25% from 0%. Since mid-September, the two-year CDS has risen from 10 to 70 basis points. Yet, we continue to assume a compromise solution between Democrats and Republicans and forecast a timely debt ceiling increase while ruling out a payment default. Factoring out the budget dispute, the US economy is in a robust state. If this burden ceases to apply, we expect a noticeable pick-up in economic momentum. In so far, there is also no reason to be in any doubt as to a continuation of the labour market recovery. Sooner or later, also the Fed will have to accept this and start to cut back on its bond purchases. We therefore stick to our estimation of increasing US government bond yields.

Euro area

There will be a limited volume of data in the coming days. In addition, indications for upcoming interesting indicators are already available. The **ZEW economic surveys** in Germany and in the euro area are well signaled by the Sentix inquiries. Accordingly, a decrease in future expectations is to be expected. The assessment of the current situation should have been left unchanged for the most part. As for the estimation of the **industry and construction output** in August, the available results in individual countries can be taken as a basis for the euro area. While construction output might have diminished from the previous month, industry production should have seen clear gains from July to August. These releases mark the end of the data cycle, which is necessary for already obtaining good calculations on euro area GDP growth in the past third quarter. Our assessment of the industry and construction output given a gain of GDP from the previous quarter has to be expected, which is, however, estimated to be smaller than in Q2. Hence, the monthly data should not produce the need for any changes to our Q3 GDP growth forecast of 0.1% qoq.

Since data will likely offer little potential for surprises in the coming days, the **government bond market** will continue to be moved by the up and down of negotiations on the debt and budget dispute in the US. If one goes beyond short-term political tactics in the coming days and assumes a (probably temporary) compromise to be achieved by 17 October, safe-haven bonds will soon run out of air. Since the ECB is still giving the short end powerful support (time and again, council members indicate either an interest rate cut or liquidity measures), we expect especially mid- and longer-term German government bond yields will be unscrewed to the upside. That's why the interest rate curve will soon again become steeper. At the same time risk premiums versus Germany will continue to decline.

On the **primary market,** Germany, Spain and France will auction bonds in the coming days. Moreover, Germany, France, Spain, Malta, Belgium and Portugal will issue money market papers.

Overview government bonds

Yields 10Y	curr.[1] (%)	1W Δ (BP)	52W H (%)	52W L (%)	Ytd Δ (BP)
AT	2.25	4.3	2.47	1.48	50.1
DE	1.87	7.6	2.05	1.17	55.3
FR	2.39	4.3	2.63	1.66	39.2
BE	2.62	3.1	2.91	1.92	56.4
NL	2.24	6.3	2.47	1.49	74.0
FN	2.09	8.0	2.32	1.33	56.5
IE	3.73	-4.1	4.29	3.43	n.a.
IT	4.34	-3.1	5.03	3.76	-15.5
ES	4.34	9.7	5.94	4.04	-92.4
PT	6.39	-21.2	8.90	5.23	-61.7
GR	9.08	-17.4	18.19	8.13	-282.2
UK	2.75	7.2	3.02	1.62	92.1
CH	1.03	-1.5	1.19	0.39	50.1
US	2.67	3.0	2.99	1.58	91.7
JP	0.66	0.7	0.93	0.45	-13.2

1 as of 11 October 2013, 07:25 a.m. CET
Source: Bloomberg

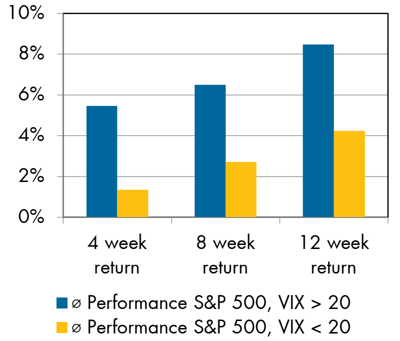
Debt issuance calendar

Issuer	Date	Maturity	Coupon (%)	Vol*
		Bonds		
DE	Wed, 16.	2015	0.25	5
ES	Thu, 17.	n.a.	n.a.	n.a.
FR	Thu, 17.	n.a.	-	n.a.
		Bills		
DE	Mon, 14.	6M	-	3
FR	Mon, 14.	n.a.	-	n.a.
ES	Tue, 15.	6M,12M	-	n.a.
MT	Tue, 15.	n.a.	-	n.a.
BE	Tue, 15.	n.a.	-	n.a.
PT	Wed, 16.	3M,9M	-	n.a.

** EUR bn*
Source: Bloomberg

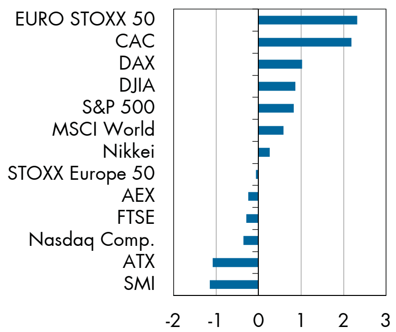
Raiffeisen RESEARCH

It's time to be brave



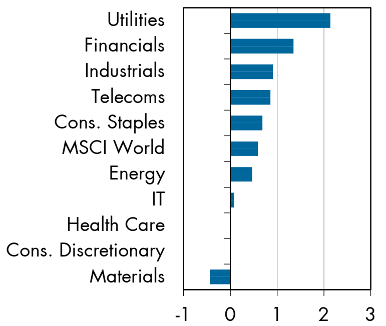
** Ø Performance after the 4 periods with VIX > 20 (equally weighted, last 1,5 years); ** Ø Performance after periods with VIX < 20 (last 1,5 years)*
Source: Thomson Reuters, Raiffeisen RESEARCH

Market performance (%, 1 week)*



** performance from 3 – 10 Oct 2013*
Source: Thomson Reuters

Sector performance (%, 1 week)*



** weekly performance of global MSCI sector indices from 3 – 10 Oct 2013; Source: Thomson Reuters*

Forecasts

	current[1]	Dec-13	Mar-14
Euro STOXX 50	2,976	3,050	3,150
DAX	8,721	9,000	9,300
FTSE	6,478	6,850	7,100
SMI	7,914	8,400	8,700
DJIA	15,126	16,000	16,500
S&P 500	1,693	1,770	1,830
Nasdaq Comp.	3,761	3,950	4,100
Nikkei 225	14,405	15,300	16,200
ATX	2,521	2,630	2,750

1 as of 11 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

Also the previous week's stock market development was perfectly consistent with the flow of news on the tough US budget dispute. The longer the government shutdown continues and the "technical" government default keeps hanging over the markets like a Sword of Damocles, the more can (temporarily) negative economic effects be presumed. Given the consequences, which are desired by neither party, we believe that reason will ultimately prevail and the crop damage will remain limited. Part of the reason is that those economic activities, which are currently compelled to stand still, will largely be made up for after a solution to the problems will have been found. Meanwhile, the smoldering political conflict no longer leaves investors indifferent. This is also revealed by the sudden increase in the VIX volatility index. Here, a fluctuation margin of around 20% in the next 30 days was priced in this week for the S&P 500 by market participants. In the last one and a half years, there were, broadly summarized, only four stages in which the fear barometer had reached similar levels. All of them offered excellent entry opportunities! That it is worthwhile to display courage in times of increased instability is underscored by the S&P 500's above-average performance of more than 8.5% twelve weeks after the stages mentioned above. Earnings season on the third quarter, which is now getting well into its stride, should contribute its share to a positive conclusion to the year. Here, expectations have once again been markedly conducted downwards in advance. According to consensus estimates, a 1.7% profit growth is currently anticipated for the S&P 500 companies while it still accounted for 5.5% early in July. Against the backdrop of the most recently strong economic data, we therefore expect largely positive profit surprises. Yet, investors also have to be aware that considering the already very high margins, corporate America's medium-term profit growth potential can at best match the nominal GDP growth of the world's largest economy. In Europe, instead, the catch-up potential for corporate profits in peripheral countries (uptick in demand, more favourable refinancing conditions) provides clearly more considerable leverage. A solution to the budget dispute, preponderantly better-than-expected company results, attractive valuations in many places and a global economy subject to further impetus with a view to 2014 provide the basis for our assumption of price increases. At the same time, we consider the increased volatility levels to be a further indication that an upward movement on international stock markets might set in shortly.

Expected corporate releases

USA		
Tue,	15	Citigroup, Intel, Johnson & Johnson, Coca-Cola, Yahoo!
Wed,	16	Amer. Express, Bank of America, Ebay, IBM, Mattel, Pepsico, US Bancorp
Thu,	17	Google, Goldman Sachs, Philip Morris Intern., Stryker, Verizon
Fri,	18	General Electric, Morgan Stanley, Schlumberger
Europe		
Wed,	16	ASML Holding, Actelion
Fri,	18	Svenska Cellulosa

Source: Bloomberg, Raiffeisen RESEARCH

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