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The main points at a glance

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As of last spring, the corporate sector has been implementing some of the spending plans that were shelved abruptly when Lehman Brothers went to the wall. We have warned repeatedly against assuming that this year would see the same encouraging figures, and there are in fact growing signs that, in contrast with China, the western industrial countries will be experiencing somewhat weaker growth now. The aftermath of the debt bubble bursting will evidently be with us for quite some time.

USA: slower growth ahead

US GDP was up an annual 5.9% from the third quarter of last year to the fourth, but two thirds of this exceptional result can be attributed to the corporate sector's investment in inventories. This component will now be contributing considerably less to the country's economic growth, which points to a slowdown, as does the high level of consumer debt. Having actually reduced their savings ratio latterly, consumers will now have to raise it substantially. Moreover, the banks will find it difficult to increase their lending, given the rise in defaults. We expect the US economy to grow by only 2.8% this year, which is not much by US standards.

The pace of job losses has eased off, and it was probably only the extreme winter weather that prevented an upturn in February. We envisage a slight increase in employment over the coming months, but widespread unemployment is likely to remain a problem for quite some time. As a result, wage growth has already been reined in. The core inflation rate excluding energy and food should remain very low, so the Fed will probably not raise interest rates before the end of the year.

Eurozone lagging behind US

The region's economy has been expanding since the middle of last year, but at a restrained pace. Fourth-quarter GDP was only 0.1% higher in than the third-quarter. We envisage the trend continuing over the coming quarters, owing in part to the debt crisis, which can be expected to hamper growth in the eurozone peripheral nations quite considerably. No more than 1.0% growth overall this year seems likely, and the eurozone is clearly trailing behind the US in this respect. The ECB will hardly raise interest rates before next spring.

Bond markets: yields to remain low

Low capacity utilisation, declining wage and inflation pressure, late rate hikes by central banks and the need for many institutional investors to commit their funds in some way all suggest that the era of structurally low yields at the long end of the curve in both the USA and Germany is not over yet. However, Bunds might find themselves facing some head-wind for a while once the crisis in Greece grows less severe.

Outlook for euro and equities

The debt crisis of countries in the eurozone periphery has put enormous pressure on the euro, but the crisis should be overcome in the medium term: Either Greece will fend for it-self or, if the worst comes to the worst, the EU will bail it out. We expect the euro to recover a little, but it will probably come under pressure again in the second half of the year, as rate hikes will then be looming in the USA. There is still scope for equity gains, given their low price-earnings ratios, and they should reap the benefit of companies managing to increase their earnings steadily despite a difficult economic climate.

TABLE 1: **Economic forecast 2010/2011**

Region	Growth			Inflation *)		
	2009	2010	2011	2009	2010	2011
USA	-2.4	2.8	3.0	1.7	1.1	1.4
Eurozone	-4.0	1.0	1.7	0.3	1.1	1.7
Germany	-5.0	1.8	1.5	0.4	0.9	1.4

**) USA: consumer prices excl. energy and food. Sources: Global Insight, Commerzbank Research*

USA: loss of momentum this year

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Following a strong 2009 fourth-quarter result, the US economy seems likely to slow down considerably this year. For one thing, the massive boost from inventories is now ebbing rapidly, and the country has not yet dealt with all the excesses of the past.

The 2009 fourth-quarter growth figure has meanwhile been revised up to an annual rate of 5.9% quarter on quarter. Initially, this would appear to point to a completely normal upturn, since as a rule post-recession growth in the US has amounted to around 6% for several quarters. However, we expect an early reversal, with a first-quarter result of no more than 2½%.

One reason for this assumption is that growth has been supported latterly by a stronger-than-usual boost from investment in inventories. This accounts for roughly two thirds of the growth achieved. By this stage, manufacturers were not running down stocks to the extent previously seen, but were raising output to meet demand. A major boost from inventories is a typical phenomenon when an economy turns the corner. There will still be a certain degree of support from this front, since stocks are still being depleted, and the build-up generally seen during a recovery has not yet begun. However, inventories' contribution to economic growth will be considerably weaker this year, as apparent from the first inventory data available for January.

In addition, the fact that the excesses of the past have not yet been overcome in full suggests that this year's quarterly results will be below the trend. Consumers are still heavily in debt, for example, and need to save more. This is hitting private consumption, which accounts for 70% of GDP. Consumers have actually cut their savings ratio recently, resulting in a brief spurt in spending, but in the medium term this will mean people having to tighten their belts again. Moreover, the banking sector is facing widespread write-downs, mainly on loans and to a lesser extent on securities. This ties their hands as regards new loans. We therefore envisage only below-average economic growth this year. The large statistical overhang (2009 fourth-quarter GDP was considerably stronger than the average for the year) will nevertheless mean a respectable growth rate this year of 2.8% on average.

Hesitant recovery on labour market

Despite our cautious view of this year's economic prospects, we do not envisage the US dropping back into recession. One major pre-requisite for a sustained upturn will be met soon when employment rises. This will trigger an upward spiral of more jobs, higher income and higher consumption, reducing the risk of setbacks. With the exception of last November, though, there have still been job losses in recent months. The pace has eased off,

TABLE 2: **USA – economic forecast 2010/2011**

Indicator		2008	2009	2010	2011	2009			2010				2011	
						Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Consumer spending [1]	yoy/qoq	-0.2	-0.6	1.8	3.0	-0.9	2.8	1.7	2.2	1.8	1.8	2.0	3.2	3.2
Business investment [1)2)]	yoy/qoq	1.6	-17.7	2.7	9.3	-9.6	-5.9	6.5	2.9	5.1	5.8	8.2	8.7	8.8
Domestic demand [1]	yoy/qoq	-0.7	-3.3	2.9	3.3	-2.3	3.0	5.5	2.9	2.6	2.5	2.7	3.3	3.3
Exports [1]	yoy/qoq	5.4	-9.6	10.9	6.5	-4.1	17.8	22.4	12.6	4.9	5.3	5.7	6.6	6.6
Imports [1]	yoy/qoq	-3.2	-13.9	9.7	7.9	-14.7	21.3	15.3	12.6	6.1	6.1	6.1	8.2	8.2
GDP [1]	**yoy**	**0.4**	**-2.4**	**2.8**	**3.0**	**-3.8**	**-2.6**	**0.1**	**2.5**	**3.2**	**3.2**	**2.4**	**2.5**	**2.7**
	qoq					**-0.7**	**2.2**	**5.9**	**2.5**	**2.3**	**2.3**	**2.6**	**3.0**	**3.0**
Unemployment rate [3]	%	5.8	9.3	9.4	8.6	9.3	9.6	10.0	9.7	9.5	9.3	9.2	9.0	8.7
Consumer prices	yoy	3.8	-0.3	1.8	1.5	-1.0	-1.6	1.5	2.5	2.3	1.5	1.1	1.0	1.2
- Core rate [4]	yoy	2.3	1.7	1.1	1.4	1.8	1.5	1.7	1.4	1.1	1.1	1.0	1.3	1.3
Current-account balance [3]	bn $	-707	-425	-520	-549	-	-	-	-	-	-	-	-	-

1) Real (chain-weighted), quarterly figures: seasonally adjusted change on quarter, expressed as annual rate; 2) equipment and software and commercial buildings; 3) quarterly figures seasonally adjusted; 4) consumer prices excluding food and energy; yoy/qoq = percentage change on year/quarter; forecasts shaded. Sources: Global Insight, Commerzbank Research

however, and it was probably only the extreme winter weather this February that stood in the way of new recruitments. Employment levels have meanwhile stabilised, constituting the necessary first step on the road to higher employment. And increasing investment in machinery and equipment suggests new jobs being created over the coming months. The labour-market leading indicators are likewise already pointing upwards – more temporary workers being taken on, for example, which in the past has been an infallible sign that a general rise in employment would soon follow (see chart 1).

No threat from inflation

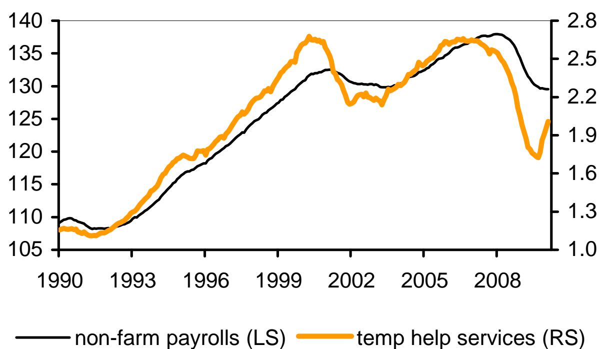
There should be no problems on this score in the short to medium term. Industry, for example, has still only made up for a quarter of the ground lost in the recession, despite strong growth since last June. And an unemployment rate of 9.7% indicates that there is ample free capacity available. In this climate, wages – the main determinant of inflation – can be expected to rise less than last year. Labour costs in the final quarter of 2009 were up only 1.2% year on year – the lowest figure since these data were first recorded (see chart 2). We expect consumer prices to rise 1.8% this year, and by only just over 1% when energy and food are excluded.

Fed taking gradual approach

Now that the financial markets have stabilised and the US economy has found its feet again, the Fed is getting ready to abandon zero interest rates. Most of the one-off liquidity programmes launched expired at the end of February, and the Fed will be buying up mortgage bonds for the last time at the end of March. It has also already raised the premium on discount loans versus the Federal Funds Rate from 25 to 50 basis points, although this 'penalty' on short-term liquidity loans will still be below the pre-crisis level of 100 points.

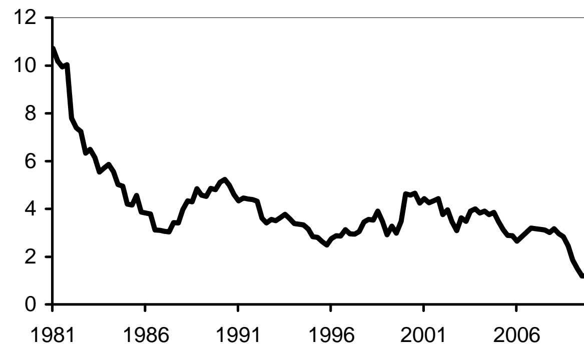
In a climate of low inflationary pressure, however, the Fed is moving very slowly towards its exit point. It has continued to pledge to keep interest rates exceptionally low for an extended period, so the Fed Funds Rate is unlikely to be raised in the near future. We envisage the first move in the fourth quarter, i.e. roughly a year after unemployment probably peaked at 10.1% last October. This would be in line with the pattern of the last two lacklustre recoveries, when the Fed waited 12 and 20 months respectively after unemployment had reached its cyclical high.

CHART 1: : **Demand for temps already increasing**
employment in millions



Sources: Global Insight, Commerzbank Research

CHART 2: **low cost pressure suggests low inflation ahead**
employment cost index (ECI), year-on-year change in %



Sources: Global Insight, Commerzbank Research

Eurozone: pulled back by the periphery countries

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Together with the high corporate and private debt and the ongoing correction on the housing markets in some eurozone countries, the debt crisis of eurozone periphery countries will put the brakes on domestic demand in 2010 and beyond. The impetus from exports is not enough to support a durable upswing. The eurozone economy will not expand by more than 1% in 2010. The ECB is unlikely to begin to increase its key interest rates until 2011.

The eurozone economy is struggling to get going. In the closing quarter of 2009, GPD rose by only 0.1% on the third quarter. The underlying pace of growth of an annualised 1% will not accelerate in the course of 2010 either. Our slightly stronger GDP growth forecast in the second quarter is based solely on the fact that companies will catch up on a part of the production that was halted in the winter months.

The recovery of the eurozone economy has so far been essentially driven by exports. Alone in the closing quarter of 2009, foreign trade contributed an arithmetical ½ percentage points to growth, thanks to the revival of exports. On the back of strong demand from Asia, exports will also increase sharply in the first half of the year. Even so, the economic outlook for the eurozone is modest, as the impetus from exports is unlikely to spill over to domestic demand.

Investments will only slowly recover. The huge underutilisation of production capacities and the restrained sales prospects in the eurozone are having too heavy an impact. Investment in machinery and equipment stagnated at a very low level in the second half of 2009, after slumping by 20%. The picture is even gloomier for building investments, which have continued to nosedive up to now. In the third and fourth quarter of 2009, investment in the construction sector fell at a rate of 1½% quarter on quarter. We do not expect a change for the better until 2011.

Private consumption will barely pick up either. Private households lack the financial means to increase their demand. Rising unemployment and a higher tax burden are weighing on the disposable income. Furthermore, governments' buying incentive schemes, such as the scrapping bonus for old cars, has resulted in purchases being brought forward and this demand is now lacking.

There will be no further government support measures. States have to consolidate their public finance. Not only will taxes and other charges be increased to consolidate state finances; spending will also be cut. This is likely to affect public investment especially.

TABLE 3: **Eurozone - economic forecast 2010/2011**

Indicator		2008	2009	2010	2011	2009			2010				2011	
						Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Consumer spending 1)2)	yoy/qoq	0.4	-1.0	0.3	0.8	0.1	-0.2	0.0	0.1	0.2	0.1	0.2	0.2	0.2
Capital investment [1)2)]	yoy/qoq	-0.7	-11.0	-0.8	2.7	-1.7	-0.9	-0.8	-1.1	2.1	0.4	0.3	0.5	0.7
Domestic demand [1)2)]	yoy/qoq	0.6	-3.4	0.4	1.1	-0.8	0.4	-0.2	0.0	0.6	0.2	0.3	0.2	0.2
Net exports [2)3)]	%	0.0	-0.7	0.7	0.3	0.7	0.1	0.3	0.2	-0.1	0.0	0.0	0.1	0.1
GDP [1)2)]	**yoy**	**0.5**	**-4.0**	**1.0**	**1.3**	**-4.9**	**-4.1**	**-2.1**	**0.6**	**1.2**	**1.0**	**1.2**	**1.2**	**1.1**
	qoq					**-0.1**	**0.4**	**0.1**	**0.2**	**0.5**	**0.2**	**0.2**	**0.3**	**0.3**
Unemployment rate [2)]	%	7.5	9.4	10.4	10.7	9.3	9.6	9.9	10.2	10.3	10.5	10.6	10.7	10.8
Consumer prices	yoy	3.3	0.3	1.1	1.7	0.2	-0.4	0.4	0.9	0.9	1.3	1.3	1.6	1.7
- Core rate [4)]	yoy	1.8	1.4	0.7	1.1	1.6	1.3	1.1	0.8	0.6	0.8	0.5	1.0	1.0
Current-account balance	bn €	-61.1	-57.5	-40.0	20.0	-21.7	-2.7	4.8	-	-	-	-	-	-

1) In constant prices; 2) quarterly figures seasonally adjusted; 3) percentage change in GDP; 4) consumer prices excl. energy, food, drink and tobacco; yoy/qoq = percentage change on year/quarter; forecasts shaded. Sources: Global Insight, Commerzbank Research

Strong regional differences in growth

The growth gap between the core and peripheral countries of the eurozone will widen in 2010, for several reasons: (1) The peripheral countries are compelled to begin consolidating public finances already in 2010. Germany and France will not begin to reduce their deficits until 2011. (2) Several peripheral countries are still suffering from the after-affects of the bubbles that have burst on the housing markets. (3) Most peripheral countries have lost substantial price competitiveness in the past few years.

Deflation fears should increase again

Wage inflation has weakened considerably. At the same time, the low level of utilisation is reducing companies' pricing scope. Consequently, the underlying inflationary trend will ease more. The inflation rate excluding energy, food, drink and tobacco is still falling. In February, it dropped to 0.8%. We expect a further decline to ½% by the summer.

ECB: no rate hike until 2011

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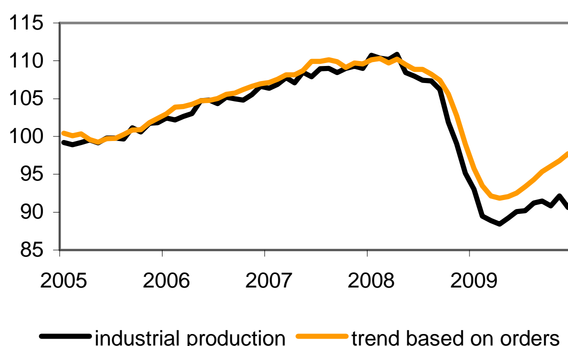
In line with its cautious outlook for economic growth, the ECB still views the current key interest rate of 1.0% as "appropriate". This can also be demonstrated by our Taylor rule, which calculates an estimated level for the ECB key interest rate based on inflation and growth forecasts that gives a satisfactory explanation of the interest-rate trend so far. If the central bank's projections of March are used to apply the rule, a value of just under 1% is the outcome (chart 4). The Taylor rule rate has thus approximated the actual main refi rate again from below, but also speaks against a rate hike to above 1%. At the same time, the unconventional measures that are currently depressing money-market rates to well under 1% in part, are not so necessary according to the Taylor rule. Consequently, the ECB is continuing its gradual exit from unconventional monetary policy. The last 1-year tender was conducted in December, the last 6-month tender will follow at the end of March. The remaining longer-term refi operations with a three-month maturity will be executed as a variable rate tender from the second quarter, i.e. by the procedure that was normal prior to the crisis.

We expect the key interest rate to be left unchanged this year. Firstly, our forecast for economic growth in 2010 practically corresponds to the ECB's projection so we see no reason for the ECB to alter its current assessment. Secondly, the central bank fears that a restricted credit supply could impede the economic recovery. Overall, we expect the first rate hike to be made in the spring of 2011, as a turnaround in lending should be clearly visible by then.

CHART 3: **Eurozone – industrial production on a moderate upward trend**

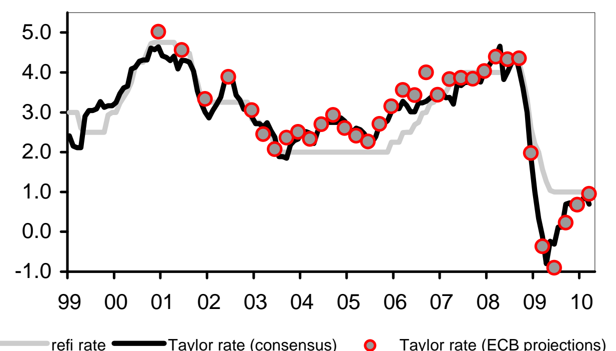
Index, 2005=100, seasonally adjusted monthly figures



Sources: Global Insight, Commerzbank Research

CHART 4: **Inflation and growth expectations determine ECB refi rate**

Key rate and Taylor rate based on growth and inflation forecasts



Sources: Economist, ECB, Commerzbank Research

Germany: industry remains the driving force

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German industry started the year with slight growth. The positive trend in orders and rising indicators suggest the recovery will continue. However, from mid-year, the pace should slow considerably, as corrections of previous exaggerations are still ongoing in many countries and this is curbing the demand for German products. That said, Germany's economy is likely to show the highest growth rate in the euro-zone.

In January, industrial orders rose on December by 4.3%. Industrial output also climbed by 0.9%, although this only partly compensated for the fall in December. At the same time, the January figures confirm our view that the calendar effects adversely affected production figures at the end of the year and stagnation of GDP in the closing quarter of 2009 underestimates the underlying momentum.

Industry will continue to pick up in the months ahead. The upward trend in orders is still intact (chart 5). In the manufacturing sector, both the purchasing managers' index and the Ifo business climate have risen so far. In the current quarter, we therefore expect a slight plus in GDP (quarter-on-quarter), which would have been even greater without the weak figures in the building sector owing to the harsh winter. Many building projects will be delayed into the second quarter, thus boosting the Q2 quarter-on-quarter rate.

Pace of growth will ease over the year

The general economic outlook remains also favourable. Our "Early Bird" indicator, outlining the overall cyclical conditions, remained close to an all-time high in February. The continued low-interest-rate environment and reviving demand from abroad should encourage firms to invest more. On the back of the global recovery, foreign trade is set to be the main driver of growth in the coming months, supported, too, by the euro's sharp depreciation recently.

That said, Germany's economy should lose some momentum in the second half of the year. The corrections on several housing markets and consolidation of bursting public finances will weigh on economic growth in many countries for quite a while yet and thus dampen the demand for German products. This is reflected by order of capital goods, which are a focus of the German industry: Although the trend is upwards, we have not seen significant gains in relation to the preceding slump. Excluding the large orders, the demand for capital goods actually fell in January (chart 6). Expectation indicators should peak soon or have already passed the peak, like the ZEW index. This means that the export-driven German economy will not experience a strong upswing, but register moderate quarterly growth rates in the second half of the year.

TABLE 4: **Germany - economic forecast 2010/2011**

Indicator		2008	2009	2010	2011	2009			2010				2011	
						Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Consumer spending [1) 2]	yoy/qoq	0.4	0.2	-0.4	0.8	0.8	0.9	-1.0	-1.0	0.3	0.1	0.2	0.2	0.2
Capital investment [1)2)]	yoy/qoq	3.1	-8.9	2.8	3.8	-7.9	0.8	0.9	-0.7	-2.5	6.0	0.7	0.2	0.4
Domestic demand [1) 2]	yoy/qoq	1.7	-2.1	-0.2	0.8	-1.1	-1.3	1.3	-2.1	-0.2	1.1	0.2	0.2	0.1
Exports [1) 2]	yoy/qoq	2.9	-14.2	8.9	7.6	-10.4	-0.7	3.4	3.0	2.3	1.8	1.5	1.5	1.8
Imports [1) 2]	yoy/qoq	4.3	-8.9	4.6	6.9	-5.4	-5.1	5.2	-1.8	1.4	2.7	1.5	1.5	1.5
GDP [1) 2]	**yoy**	**1.3**	**-5.0**	**1.8**	**1.5**	**-6.4**	**-7.0**	**-4.7**	**-1.7**	**1.5**	**1.8**	**1.4**	**1.7**	**1.8**
	qoq					**-3.5**	**0.4**	**0.7**	**0.0**	**0.3**	**0.8**	**0.3**	**0.3**	**0.3**
Unemployment rate [2)]	%	7.8	8.1	8.7	10.5	8.0	8.2	8.2	8.1	8.2	8.4	8.8	9.4	10.0
Consumer prices	yoy	2.6	0.4	0.9	1.4	0.9	0.3	-0.3	0.4	0.6	0.7	0.7	0.9	1.2
- Core rate [3)]	yoy	1.8	1.0	0.8	1.1	1.2	1.2	0.9	0.7	0.7	0.7	0.7	0.8	0.9
Current-account balance [2)]	bn €	165	121	156	178	18	28	31	45	41	38	38	40	42

1) In prices of the previous year; 2) quarterly figures seasonally adjusted; 3) Consumer prices excl. energy and food; yoy/qoq = percentage change on year/quarter; forecasts shaded. Sources: Global Insight, Commerzbank Research

Given the adverse factors in the eurozone periphery countries, we have revised our growth forecast for 2010 downwards to 1.8%. However, we stick to our view that, with growth exceeding the potential, Germany will fare better than the eurozone, which will show much weaker growth than the long-term average.

Capacity utilisation remains low, unemployment rises

Even assuming our predicted recovery, the German economy will still only have made up for two fifths of the slump experienced in the crisis by the end of 2010 (chart 6). We will see huge underutilisation of production capacities for a longer period. Companies will have to adjust their headcounts to this lower level. Unemployment will rise this year and exceed the 4 million mark in 2011. Wages will hardly rise in this climate, as the collective pay deals have shown so far. Effective wages are actually more likely to fall.

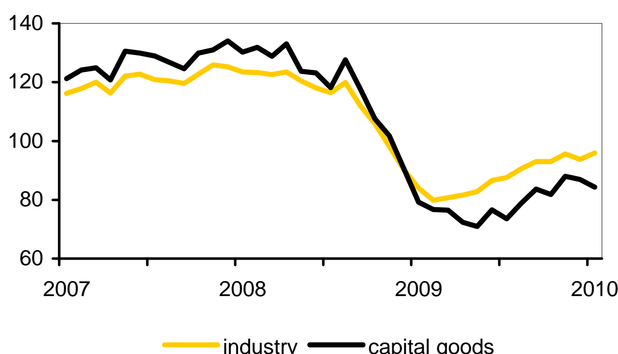
Inflation is not an issue for now

The virtual stagnation of wages and rising production – albeit moderately – will depress unit labour costs noticeably. This means there is no necessity for companies to increase prices significantly. The current underutilisation of capacities provides little scope for this in any case. The inflation rate will remain low in 2010, at 0.9%, the core inflation rate (excluding food and energy prices) will not increase again until the turn of the year. Consequently, inflation does not present a risk in the near future.

Deficit back on Maastricht course by 2013

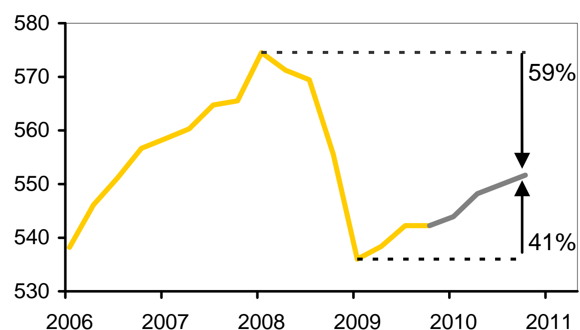
Even in the crisis year of 2009, Germany only just broke through the Maastricht ceiling of 3% (with a deficit ratio of 3.3%) and is therefore in a much better position than most other euro area countries. Spending on stabilising the economy will lift the ratio to an anticipated 5½% this year. A reduction of the deficit by 1 percentage point in both 2011 and 2012 will then be enough to cut it back to 3% in 2013. Under the German government's stability programme, this should be achieved by reducing public spending by 1 percentage point of GDP per year. The expiry of the economic stimulus packages will also help to reach this objective.

CHART 5: **Recovery loses momentum**
Industrial orders excluding cars and other vehicles, index 2005 = 100, volumes



Sources: Global Insight, Commerzbank Research

CHART 6: **The slump will only be partly worked off**
German GDP, price adjusted, in €bn, highs and lows during the crisis are highlighted, forecast for 2010



Sources: Global Insigh, Commerzbank Research

United Kingdom: steps in the right direction

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Activity growth has apparently turned the corner, with upward revisions to Q4 GDP growth and solid PMI data in both the manufacturing and services sectors in the early months of 2010. But there are indications that the housing market has lost momentum with data for January showing a fall in the number of mortgage approvals, and prices declining sharply in February. One year after the start of the BoE's asset purchase programme, the annual growth rate of monetary aggregates continues to decelerate which is a clear indication that the QE programme is not operating in the way the BoE expected. We doubt that the BoE will extend the asset purchase ceiling following the pause announced in February.

Over the coming months we expect that GDP growth will continue to proceed slowly, and look for a growth rate this year around 1.0% versus the BoE's projection of 1.4%. The BoE forecast has been revised down compared to November and we are now not far apart in terms of the 2010 growth profile. In a similar vein to the BoE, we look for CPI inflation to slow sharply over the remainder of the year as the distortions posed by a sharp rise in oil prices and an unwinding of the temporary VAT cut begin to fade away. In this environment, monetary policy is likely to remain on hold for a considerable time, with no changes to interest rates or the asset purchase targets in the immediate future. Attention will increasingly focus on fiscal policy and bond markets are impatiently awaiting details of how the government intends to reduce the deficit. But with a general election looming in the spring (date not yet fixed), it is likely that the substance of any deficit-cutting plans will be delayed until at least mid-year.

Switzerland: bucking eurozone trend

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The Swiss economy grew 0.8% in the second half of 2009 compared with the first, a far better result than in the eurozone. It should continue its recovery over the course of this year, albeit at a slower pace, as the country cannot escape indefinitely the impact of weak EU growth. This is after all where almost 60% of Swiss exports go. We envisage GDP growth of 1.2% this year, following a decline of 1.5% in 2009. As capacity utilisation increases, deflationary tendencies should continue to recede. Another pointer to higher inflation in the medium term is strong growth in the money supply and bank loans. We expect consumer prices to rise 1% this year.

The Swiss National Bank also acknowledges that the deflation risk narrowed. Nevertheless, the central bank will continue to invene against 'excessive' franc appreciations although there seems to be no clear threshold any longer. As the bank's President Jordan has stressed, a strong franc means the bank having to steer interest rates back to normal at a later date. We only expect a first hike of the key interest rate – the target rate for three-month Libor – at the start of next year. Prior to this, the bank will no doubt scale down the unconventional measures introduced, in fact the first step has already been taken: The bank has ended its purchases of Swiss franc bonds from private issuers, and abandoned dollar auctions and currency swap agreements at the end of January.

TABLE 5: **United Kingdom – economic forecasts 2010/2011**

Indicator		2008	2009	2010	2011
Consumer spending [1]	yoy	0.9	-3.1	1.3	2.6
Capital investment [1]	yoy	-3.5	-14.6	-2.2	1.3
Domestic demand [1]	yoy	0.1	-5.2	1.5	2.0
Exports [1]	yoy	1.1	-10.9	4.1	3.0
Imports [1]	yoy	-0.5	-11.9	5.6	3.2
GDP [1]	**yoy**	**0.5**	**-5.0**	**1.0**	**2.0**
Unemployment rate	%	5.7	7.6	8.1	8.3
Consumer prices	yoy	3.6	2.2	2.4	1.4
Current-account balance	bn £	-22.0	-15.1	-22.0	-28.9

1) In constant prices; yoy = percentage change on year; forecasts shaded.
Sources: Global Insight, Commerzbank Research

TABLE 6: **Switzerland - economic forecasts 2010/2011**

Indicator		2008	2009	2010	2011
Consumer spending [1]	yoy	1.7	1.2	1.1	1.9
Capital investment [1]	yoy	0.1	-7.5	6.7	3.3
Domestic demand [1]	yoy	1.1	0.1	2.2	2.0
Exports [1]	yoy	2.9	-10.0	3.9	4.1
Imports [1]	yoy	0.4	-5.9	3.6	5.9
GDP [1]	**yoy**	**1.8**	**-1.5**	**1.2**	**1.4**
Unemployment rate	%	2.6	3.7	4.6	4.3
Consumer prices	yoy	2.4	-0.5	1.0	1.2
Current-account balance	bn sfr	13	43	50	55

1) In constant prices; yoy = percentage change on year; forecasts shaded.
Sources: Global Insight, Commerzbank Research

Eastern Europe

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Poland: announces fiscal reform programme

Following Poland's encouraging Q4 2009 GDP (3.1% y-o-y) we have revised up our 2010 growth forecast to 3.5%. Inflation has been moderating, but we remain cautious regarding H2 pressures as Poland does not have significant spare capacity. The central bank, too, has recently revised up its inflation projections (to the upper limit of its target by 2012), and policymakers are now debating a move to a 'tightening' policy bias. The government has announced a new fiscal reform package, which lays down the roadmap for meeting EU fiscal criteria by 2012. The package contains a spending cap, the reduction of mandatory fixed expenses within the budget and government pension reforms. The spending cap, which purports to limit fiscal spending growth to inflation plus 1%, could be crucial for achieving the EU's mandated 2.9% fiscal deficit by 2012. Even with this package, however, we do not expect euro entry any time before 2017.

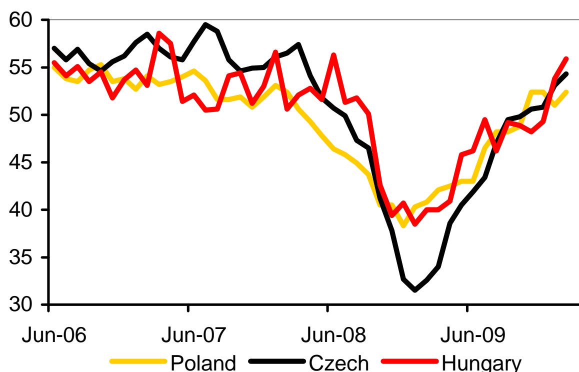
Czech Republic: all eyes on May elections

The Czech economy carries relatively few structural imbalances. However, tough fiscal consolidation means that growth in 2010 will be limited to only 1.9% GDP. However, as Q4 2009 GDP had been hit by one-off factors, a punchy catch-up during Q1 2010 is possible. Czech manufacturing growth has returned to positive for the first time since the crisis; export momentum has picked up, and the February PMI reading was punchy (chart 7). We see risks of adverse inflation surprises over the coming months (see chart 8), which could trigger a change in the central bank's policy guidance. Nevertheless, all eyes are on the May parliamentary elections, after which the government's commitment to fiscal discipline and social spending cuts would become clearer. Polls indicate that the CSSD party holds on to a narrow lead, but that the new TOP 09 party has captured about 10% of the vote. No single majority is likely from the elections. But, the outcome would be crucial for fiscal discipline and the roadmap for euro entry (we do not expect euro adoption until 2017).

Hungary: markets await post-election policy guidance

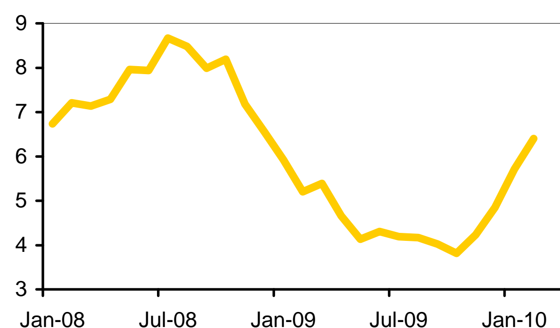
Hungary's heavy external debt and ongoing fiscal contraction make the economy vulnerable to external shocks, especially developments in Ukraine, to which the local banking sector carries significant exposure. Cyclical indicators are, however, turning up (see chart 7), and growth could surprise to the upside over the coming quarter, although sustainable recovery hinges on German demand momentum. The key structural risk in Hungary is the unpredictable stance of the incoming administration (elections in April). Would the Fidesz party's policies *raise* currency risk and interest rate spreads? Would these policies clash with IMF/EU targets? The central bank holds that the 2010 budget target is unlikely to be met unless the new government introduces further austerity measures (considered unlikely). Hence, the markets eagerly await the first signals from the Fidesz administration after the elections.

CHART 7: **Growth cycle still accelerating**
Purchasing Managers' Index



Sources: CEIC, Commerzbank Research

CHART 8**: But, inflation gaining momentum too**
CE + Turkey: CPI inflation rate, y-o-y



Sources: CEIC, Commerzbank Research

Japan: domestic demand still weak

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The Japanese economy is expanding at a healthy rate, thanks largely to exports. However, we envisage a slowdown here later on in the year. Since domestic demand will be increasing only gradually, economic growth over the coming quarters will no doubt be somewhat lower.

Japan's economy staged a sound recovery in the final three months of last year, with GDP up 0.9% on the third quarter. Moreover, growth has meanwhile established a somewhat broader basis. For the first time in a long while, corporate investment has risen again. Improving indicators of sentiment, more solid industrial output and continuing strong exports suggest that the recovery should have continued at the start of the year. Later on, though, the pace of growth can be expected to ease off a little as exports lose some momentum. The entire world will after all still be feeling the after-effects of the financial-market crisis, and there will be less support from the inventory front. This will also hit foreign demand for Japanese products. In addition, the yen's strong gains will be an obstacle to exporters.

There will be little real support from domestic demand over the coming months, although it no longer contracted in the fourth quarter of 2009. For one thing, the government will continue to scale down public-sector investment, and private investment will be increasing at only a modest pace until such time as capacity utilisation and earnings have made a sufficient recovery. The corporate sector is still endeavouring to raise its earnings by cutting costs, and as a result the employment outlook is sombre. We expect the unemployment rate to remain at 5% this year. Limited job growth and virtually stagnant wages will hardly fuel consumption to any great extent, especially since there will be less boost to private consumption from government measures than was the case last year. We envisage no more than 1.5% economic growth over the year as a whole.

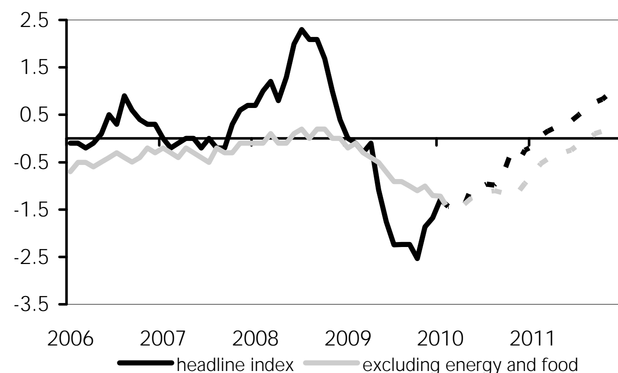
The decline in consumer prices continues, with a figure of -1.3% year on year in January. Higher energy prices mean that the year-end inflation rate will be only marginally negative. There has been no let-up in underlying deflationary pressure, though, and in January inflation excluding energy and fresh food was -1.2%. Under these circumstances, the Bank of Japan will no doubt leave its key interest rates close to zero this year. If necessary, it could expand the supply of liquidity again to support the economy.

TABLE 7: **Japan - economic forecast 2010/2011**

Indicator		2008	2009	2010	2011
Consumer spending [1)]	yoy	-0.6	-1.1	1.6	1.1
Capital investment [1)]	yoy	-2.6	-14.6	-2.5	2.1
Domestic demand [1)]	yoy	-1.3	-4.0	0.2	1.1
Exports [1)]	yoy	1.7	-24.2	14.5	6.9
Imports [1)]	yoy	0.9	-17.1	5.0	4.7
GDP [1)]	**yoy**	**-1.2**	**-5.2**	**1.5**	**1.5**
Unemployment rate	%	4.0	5.1	5.0	4.5
Consumer prices	yoy	1.4	-1.3	-1.0	0.5
Current-account balance	trn yen	16.4	13.3	17.3	19.4

1) In constant prices; yoy = percentage change on year; forecasts shaded.
Sources: Global Insight, Commerzbank Research

CHART 9: Japan – deflation continues
Consumer prices, percentage change on year, forecast as of February 2009



Sources: Global Insight, Commerzbank Research

China: Moderate policy responses only

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China's economy continues to expand briskly while activity in the property sector is fueling concerns that the economy is at risk of developing into a full-scale bubble owing to loose monetary policy. The focus is on how the government and the PBoC will manage that concern, whether it be via additional quantitative limits on lending, further hikes in reserve requirements, interest rate hikes and/or allowing for an accelerated appreciation or even a one-off lift in the exchange rate. Government targets revealed at the National People's Congress show little change in policy intentions.

GDP data for Q4 was released in January and showed the economy expanded by 10.7%, leaving overall 2009 growth at 8.7% - well above the government's target of 8%. Activity data in Q1 has been generally firm with imports for January surging by over 80% year-on-year. This partly reflects a recovering global economy and low base-level effects but also strong domestic demand in China. There have been some recent wobbles – China's PMI fell sharply in February suggesting reduced growth in manufacturing output. However, the timing of the Lunar New Year, which fell in February this year but January last year, makes interpreting Q1 activity data problematic and we will need to look at average data over the whole of Q1 to properly assess underlying demand. For now our assessment is that demand and activity remains firm.

The primary story of 2010 so far has been the surge in bank lending. New loans in January amounted to 1.39 trillion yuan, up from a more typical 379 billion yuan in December. The government has set a target for loans of 7.5 trillion yuan over 2010, which will require a reduction in monthly aggregate lending. The central bank has also ordered increases in banks' reserve requirements. We don't think a reduction in lending will affect underlying growth at this juncture since lending is usually front loaded while actual spending of borrowed funds takes time. A portion of the loans is illegally ending up in the stock market and the government is taking steps to crack down on such lending.

On the fiscal front, the government targets a budget deficit of -2.8% of GDP for 2010 following last year's 2.2% deficit outcome. The focus is shifting away from construction to social outcomes as demonstrated by the 8.8% increase on social spending and 12.8% increase on rural outlays.

A key issue for China and the world is whether China can rely less on exports and investment as a driver of growth and more on consumption. A very large one-off shift in the exchange rate would help achieve that outcome but would be too disruptive in a year where there is still uncertainty about the strength of underlying demand in major trading partners. Instead, comments by Commerce Minister Zhong suggest China will try to lift imports via cutting tariffs and otherwise making imports easier. We are not expecting any return to Chinese yuan appreciation this year.

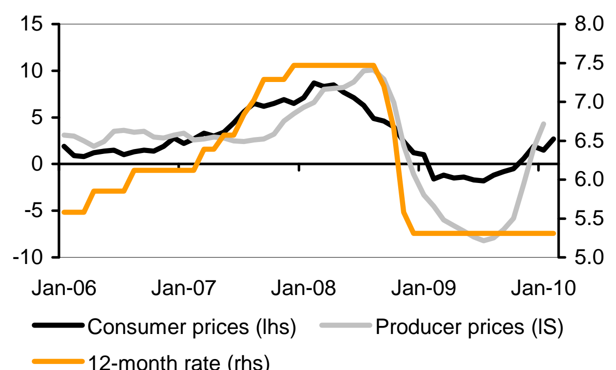
There is a risk this year that excessive growth in money supply could feed through to higher inflation, although there is no direct evidence of that occurring just yet. We continue to forecast stronger GDP growth and CPI inflation over 2010 at 9.5% and 2.4% respectively, up from 8.7% and -0.7% in 2009.

TABLE 8: **China - economic forecast 2010/2011**

Indicator		2008	2009	2010	2011
GDP [1]	**yoy**	**9.6**	**8.7**	**9.5**	**8.2**
Consumer prices	yoy	5.9	-0.7	2.4	3.1
Current-account balance	%GDP	9.8	5.8	6.0	6.2

1) In constant prices; yoy = percentage change on year; forecasts shaded.
Sources: Global Insight, Commerzbank Research

CHART 10: China: inflation and key interest rate
Inflation year on year in %, interest rate % p.a.



Sources: Peoples' Bank of China, National Bureau of Statistics.

Bond markets

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Are yields finally about to rise?

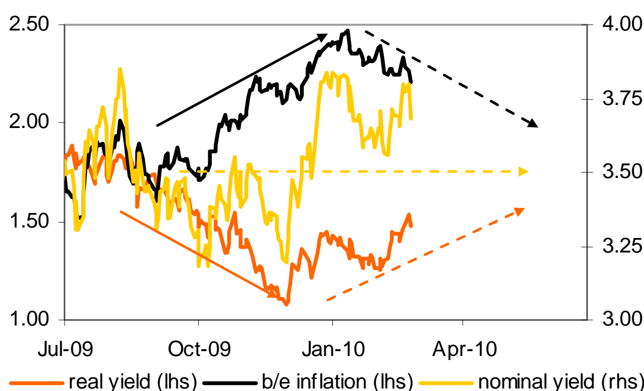
Yields have been trending sideways since about the middle of last year. Beneath the surface, however, we have seen massive shifts in relative valuations. Real yields have been rising since the beginning of this year while inflation expectations declined. We are still of the view that yields will remain structurally low, though some headwind might arise on a short-term perspective.

Bunds and US Treasuries are still moving within their long-established trading ranges. This has not even changed with the debt crisis in the euro-zone periphery and the ECB and Fed's emerging exit from quantitative monetary policy. Yields of ten-year US Treasuries are currently trading at the upper end and yields of ten-year Bunds are trading at the lower end of the range from 3% to 4% that largely prevailed in 2009 and will be the preferred territory for these yields also in 2010.

Beneath the surface, however, we have seen massive shifts in relative valuations. The increase in the real yields of ten-year Treasuries and Bunds since the beginning of this year was offset by a decline in inflation expectations (charts 11 and 12). This movement appears logical in a world where central banks are taking the first small steps towards a normalisation of monetary policy while the economic outlook remains very subdued. We are still in a deflationary environment, which is further intensified by the upcoming consolidation of public finances, especially in the euro-zone countries. We expect that relative valuations will shift somewhat further still. In spite of the recent focus on a normalisation of monetary policy, we are not on the brink of a notable bear-market trend in bonds. Higher real yields will probably be offset by lower inflation expectations, and so the rise in nominal yields should remain under control.

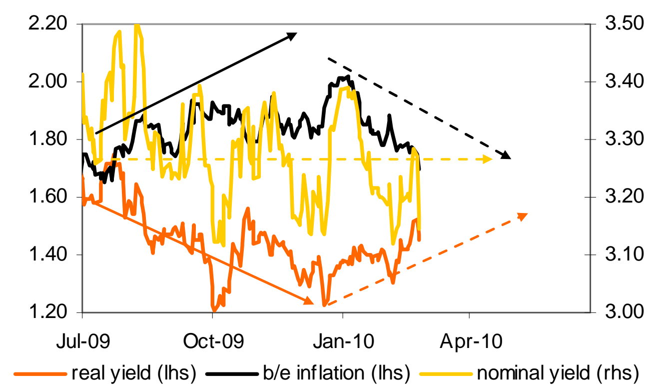
Nevertheless, we see a chance of marginally higher bond yields short-term if macroeconomic and sentiment indicators recover after having been depressed by the unusually cold weather. Moreover, the Fed and the ECB are gradually starting to normalise their monetary policies. We could even argue that the forecast yield rise is sort of a seasonal pattern. In both crisis years 2008 und 2009, markets experienced selloffs in spring, and we see a risk of a similar pattern developing this year. In the further course of the year, though, bond markets should see more favourable developments globally as the environment of structurally low yields remains in place.

Chart 11: **Bund rally but no broad bond rally!**
Yields on ten-year government bonds, p.a.



Sources: Bloomberg, Commerzbank Research

CHART 12: **Greek refinancing risks in coming months**
Principal and interest on Greek bonds, bn €



Sources: Bloomberg, Commerzbank Research

Specifically, we expect the yield of ten-year Bunds to rise to 3.5% in the weeks ahead, but this movement will not last and we expect the yield to dip to 3% again by mid-year. Only in the second half of the year will the yield rise be sustained, but this increase may turn out more moderate that we previously forecast as we now think the ECB will not start to raise interest rates before spring of 2011. We are somewhat less optimistic for the US bond market. The ten-year yield of US Treasuries should fall only to 3.25% by mid-year owing to a higher credit and supply premium. We are sticking with our swap spread tightening call and now assume that ten-year US Treasuries will trade neutral vs. swaps later this year.

The era of the “great curve flattening” has not yet come

Both the US and euro-zone curves traded (nearly) at extremes. We have repeatedly argued that especially the euro-zone curve will remain fairly steep for some time yet – and most of all, it will be steeper than the forward market implies. Though a normalisation of monetary policy is increasingly becoming a focus, we think the era of the “great flattening” has not yet come. It should occur only when the central banks start to ponder rate hikes or the economy suffers a setback. In case of the latter, we would see a bullish flattening, a scenario we do not expect. On a near-term perspective, we therefore recommend a fairly neutral curve exposure.

Yield premiums to decline slightly in the euro-zone periphery

We have changed our view as regards euro-zone spreads. Up to now we were quite conservative and selective and only recommended exposure to several rather solid peripheral issuers such as Austria, Belgium or – after the recent emergency budget – Ireland. Now we are confident that we can increase the risk. We are of the view that near-term default of one of the European issuers is now out of the question, and so short-term contagion risk should pale as well. We therefore recommend buying paper at the short end of the Greek curve, for instance, but assume that investors will focus more on medium-term prospects.

TABLE 9: **Interest rate forecasts**

		2010						2010			
USA	**12/3/10**	**Q1**	**Q2**	**Q3**	**Q4**	**Euro**	**12/3/10**	**Q1**	**Q2**	**Q3**	**Q4**
3m OIS	**0.16**	0.20	0.45	1.00	1.45	3m OIS	**0.33**	0.65	0.80	1.00	1.30
3m Libor	**0.26**	0.35	0.65	1.25	1.75	3m Libor	**0.59**	1.00	1.20	1.45	1.75
2y	**0.94**	0.90	1.30	2.00	2.45	2y Bunds	**0.95**	1.10	1.25	1.75	2.10
5y	**2.41**	2.00	2.35	2.75	3.10	5y Bunds	**2.19**	2.10	2.40	2.55	2.70
10y	**3.74**	3.25	3.40	3.65	3.75	10y Bunds	**3.18**	3.00	3.30	3.45	3.60
30y	**4.70**	4.10	4.20	4.30	4.80	30y Bunds	**3.96**	3.95	4.20	4.45	4.55
Swap spread						**Swap spread**					
2y	**23**	30	20	20	20	2y	**50**	35	20	15	10
5 y	**27**	20	30	35	35	5y	**29**	30	15	15	20
10y	**5**	0	0	20	30	10y	**17**	15	10	20	25
30y	**-16**	-15	-10	0	5	30y	**-18**	-15	-15	-10	-5

Foreign-exchange markets

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EUR-USD exchange rate: Greece continues to weigh on euro

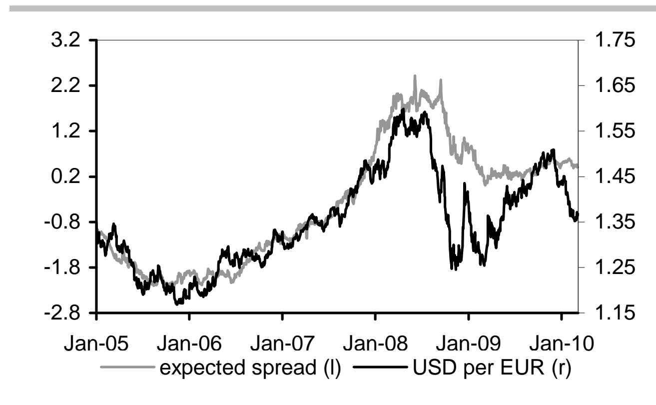
Despite the successful issue of the ten-year Greek government bonds, the euro has recovered little so far. This disappointing performance is likely to be mainly due to fresh concerns on the appropriateness of political reactions to Greece's debt crisis – and fears that the ECB will adjust its monetary policy to a greater extent because of this crisis. But EUR short positions are still very high on the market and therefore carry the risk of correction towards 1.40. In the medium term, though, the dollar will maintain the upper hand.

For nearly three weeks, EUR-USD was caught in a narrow range of 1.3430-1.3750. Despite the successful issue of the ten-year Greek government bonds, the euro was not able to recover. Its weak performance was probably due, firstly, to market scepticism about the political reactions to the debt crisis in Greece and, secondly, to expectations that the ECB could possibly adjust its monetary policy to the crisis more than anticipated and raise interest rates later and more slowly as a result. It has shown no signs yet that it is would like to steer a course of normalisation of monetary policy. If refinancing costs become more expensive, this could ultimately be problematic for several countries in the eurozone or at least make the consolidation of public finances more difficult. Although the Fed still emphasises that the federal funds rate will stay at the current low level for an extended period of time, it has made it clear by increasing the discount rate in February that it has begun to normalise monetary policy. It seems increasingly risky, therefore, to rely on a continued interest-rate disadvantage of the US dollar.

As long as the Greek issue and the vague plans of those responsible occupy the market, it will therefore remain sceptical about the euro. That said, a recovery of the euro is possible. Speculative investors still have a very one-sided bias towards EUR short positions. This means that with increasing euro weakness, further strong EUR selling will become less likely and the chance of a correction will rise. Furthermore, there is also a risk that the very high EUR-short positioning will accelerate the momentum of a potential correction. Consequently, a short-term and swift recovery of the euro towards the 1.40 range is quite possible.

CHART 13: **FX markets are still counting on an unchanged interest rate spread**

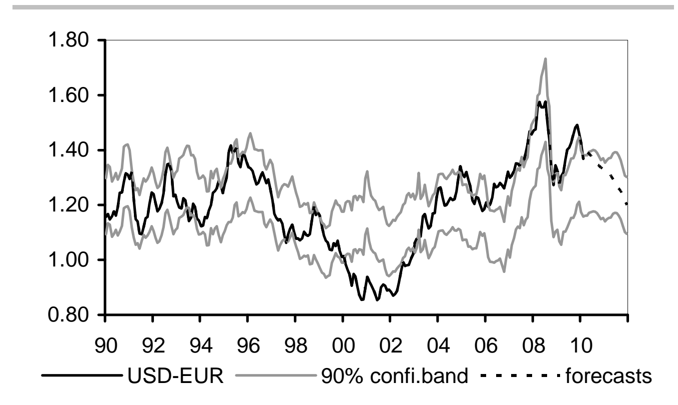
Euro exchange rate and interest rate spread, calculated from forwards for three-month funds six months forward



Sources: Bloomberg, Commerzbank Research

CHART 14: **Regression model – euro's exchange rate has recently been less affected by US current account deficit**

Explanatory variables: yield spread in capital market and differences in productivity, prior to 1999: D-mark/dollar



Sources: Bloomberg, Commerzbank Research

However, in the medium term, the euro will suffer more losses against the US dollar. When it becomes clear at mid-year that the Fed will take action in the foreseeable future and hike the federal funds rate at the end of the year, the US dollar will gain ground on a broad front. The euro will not hinder this, especially as the ECB will wait a bit longer and then raise interest rates more gradually.

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Sterling: concerns about the budget increase the pressure

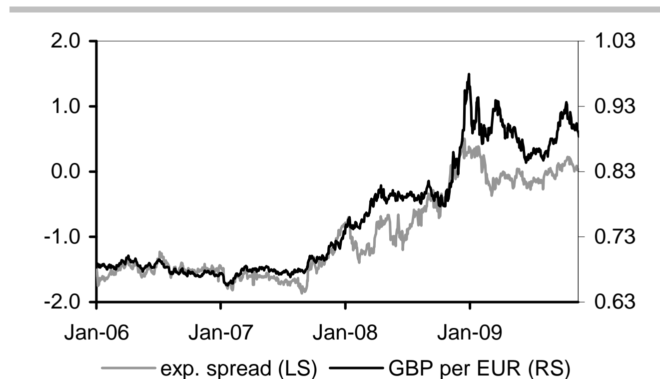
Concerns about the state of the budget in the UK have put strong pressure on the pound recently. Like in Greece, the budget deficit last year probably exceeded 12% of GDP. Consolidation efforts are not in evidence so far and will probably only start in 2011. But this is not certain either. According to the latest surveys, the parliamentary elections in May or June could produce a minority government. A hung parliament would make it much more difficult to carry out the consolidation of public finances that is so essential. On 24 March, the final budget for fiscal 2010/2011 will be presented. A change of course is hardly likely, though, given the forthcoming elections and the still very fragile economic recovery.

Against the backdrop of an uncertain election result and budget concerns, the pound is likely to stay under pressure for a while yet. Economic data in the next few weeks should continue to indicate a rather weak recovery. Furthermore, the expansionary monetary policy of the Bank of England is a negative factor. EUR-GBP is therefore likely to remain above the 0.90 mark, GBP-USD close to 1.50.

Swiss franc: SNB puts the brake on again

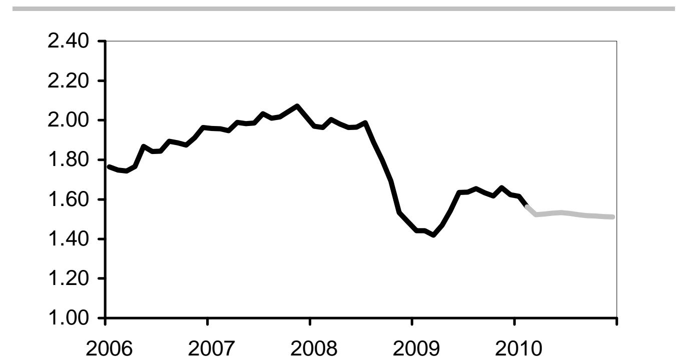
Especially the weakness of the euro has recently pushed down EUR-CHF again and prompted the Swiss National Bank (SNB) to intervene on the market several times at the range of 1.4600-14620 CHF per euro. The Greek crisis is likely to maintain the pressure on EUR-CHF for a while and the market will test the 1.46 mark. The Swiss National Bank has repeatedly said it would take firm action against an excessive appreciation of the franc versus the euro and it is therefore likely to continue putting the brakes on the franc by means of intervention. This does not mean, though, that EUR-CHF cannot dip under the 1.46 mark. But the SNB will probably want to prevent any sharp movement towards 1.45 initially, though, especially since EUR-CHF has not seen this level since 2001/2002 and the downwards momentum could well accelerate below the 1.45 mark.

CHART 15: **EUR-GBP: Sterling appreciation vs. euro is imminent**
EUR-GBP exchange rate and interest rate spread, calculated from forwards for three-month funds six months forward



Sources: Bloomberg, Commerzbank Research

CHART 16: **GBP-USD: Sterling remains weak**
GBP-USD, month-end levels, forecast from March 2010 onwards



Sources: Bloomberg, Commerzbank Research

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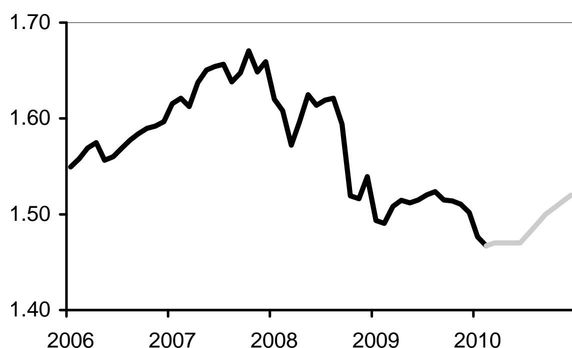
Yen: still strong – but for how long?

The yen is still acting as an alleged safe haven and normally appreciates when uncertainly rises. This means that the yen will still tend towards strength as long as the Greece crisis occupies financial markets. In addition, the yen is profiting from repatriations (repayments of Japanese investments to Japan) at the end of the fiscal year (31 March).

Fundamentally, the strength of the yen lacks foundation in our view. Deflationary pressure is still high and an end to quantitative easing by the Bank of Japan is not in sight. At the same time, public debt is rising on account of economic stimulus measures and lower tax revenues. A firmer yen is not welcome politically either, as it weighs on exports as the main driver of economic growth. In addition, cheaper exports increase deflation pressure. Should the yen continue to rise against the dollar, interventions cannot be ruled out. We believe the pain threshold for the Japanese is 85 yen per dollar.

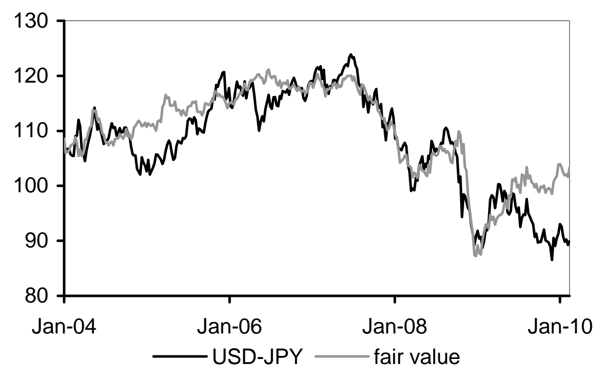
However, in the medium term, we expect a weaker yen, which will come under pressure at the latest when it becomes clear that other central banks begin to hike interest rates. As the Bank of Japan hardly has the option to follow other central banks due to low inflation and high public debt, the yen's attractiveness as a currency for financing carry trades will increase, which means depreciation.

CHART 17: **A slightly softer CHF is expected**
CHF-EUR, month-end levels, forecast from March 2010 onwards



Sources: Global Insight, Commerzbank Research

CHART 18: **Yen strength is temporary in nature**
USD-JPY, week-end levels, forecast from March 2010 onwards



Sources: Bloomberg, Commerzbank Research

Equity markets

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Rising earnings trend supports

After the setback in January and the sideways movement in February, equity markets have started to recover in March. Owing to a steadily rising trend in earnings expectations, the P/E valuation of stocks has fallen recently. Consequently, despite the modest start to the year, we confirm our price targets of 6,900 for the DAX and 3,300 for the Euro Stoxx 50.

TABLE 10: **Equity markets make a shaky start to the year in 2010**

					Earnings 10e					
		Performance (%) since			Index points		Growth (%)		KGV 10e	
	Index	1/01	9/30	6/30	Index	3/30	Index	6/30	Index	1/01
DAX 30	5,886	5.1	-1.2	22.4	468	480	38.6	34.4	12.6	10.0
MDAX	7,827	5.9	4.3	36.0	507	452	102.0	100.3	15.4	12.7
Euro Stoxx 50	2,881	5.6	-2.8	19.9	253	262	16.2	19.9	11.4	9.2
S&P 500	1,140	3.3	2.3	24.1	78	74	30.7	25.5	14.6	12.5

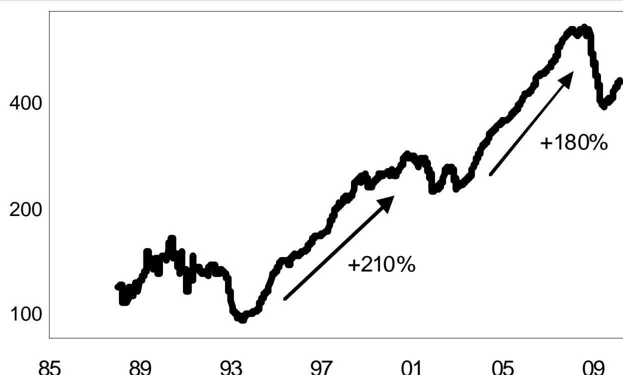
Sources: Commerzbank Research, I/B/E/S

The stagnation of the German economy in the fourth quarter shows that equity investors should prepare themselves for a below-average economic recovery. Against this backdrop, the earnings trend on equity markets is proving surprisingly resilient. The positive revisions of earnings meanwhile dominate on the DAX index and the earnings expectations trend for the coming twelve months has risen by 20% since May 2009 (chart 19). The recovery of the earnings trend is thus reminiscent of the recovery after the recession lows in 1993 and 2003. And the earnings expectations trend for the S&P 500 has been even better than the DAX, with a recovery of 30% since the trough (chart 20).

Thanks to the robust earnings trend, the DAX P/E ratio is also still in an attractive level of 12x. Sceptics argue that the market currently expects a DAX earnings growth of 40% for 2010. We believe that this ambitious growth is realistic, however; firstly because the expected DAX earnings growth drops towards 20% when the biggest net-loss-makers of 2009 are excluded from the calculation and secondly because only a moderate sales growth of 3.6% is currently predicted for DAX companies.

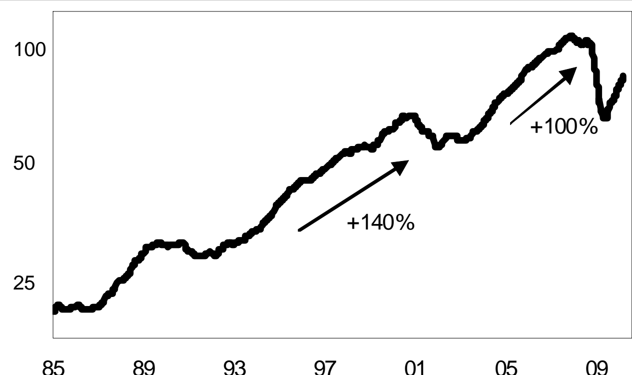
We expect, therefore, the robust earnings trend on equity markets to continue. Strong growth in Asia and continued strict cost management are helping to compensate for the below-average economic recovery in the developed economies. We therefore confirm our price targets of 6,900 for the DAX, 3,300 for the Euro Stoxx 50 and 1,250 for the S&P 500, even if the start to the trading year in 2010 has been relatively disappointing so far.

CHART 19: **DAX earnings trend – plus 20% since its low**
DAX: earnings expectations (12 months) in index points



Source: Factset, I/B/E/S, Commerzbank

CHART 20: **S&P 500 earnings trend – plus 30% since its low**
S&P 500: earnings expectations (12 months) in index points



Source: I/B/E/S, Commerzbank

Equity markets: economy, earnings, valuation, sentiment

(+) Bond yields in Germany stable at 3.15%

(+) Long-term inflation expectations have fallen recently

(+) Weaker euro helps German exporters

(+) Oil price above $80, Dow Transport above 4.000, DRAM index above 4000

(+) iTraxx Crossover has fallen from 500 towards 400

(+) Earnings expectations for 2010 stable at 460 (DAX), 250 (Euro Stoxx 50) and 78 (S&P 500)

(-) How realistic is an expected 2010 earnings growths of 39% (DAX), 16% (Euro Stoxx 50) and 31% (S&P 500)?

(+) P/E 12-month forward at historically attractive level of 12 (DAX), 11 (Euro Stoxx 50) and 14 (S&P 500)

(+) Expected dividend yield of Euro Stoxx 50 (12-month forward) at 4.4% significantly above bond yield

(-) Share of pessimists in the US has fallen to 26%

(-) VDAX and VIX have fallen below 20

(-) RSI signals 'over-

Economy	**Current**	**-1M**	**-3M**	**-12M**
€ 10Y bond yield in %	3.13	3.17	3.22	2.99
$ 10Y bond yield in %	3.71	3.61	3.59	2.98
€ inflation expectations (swaps)	2.60	2.57	2.68	2.60
$ inflation expectations (swaps)	3.12	3.12	3.31	3.18
€ yield curve (10Y/Euribor 3M)	4.80	4.82	4.50	1.77
$ yield curve (10Y/Libor 3M)	14.50	14.63	14.16	2.24
€/US$	1.358	1.378	1.456	1.275
US$/YEN	90.3	89.0	89.6	98.7
Oil (WTI) in $ per barrel	81.3	72.9	70.7	45.7
US Dow Transport Index	4,269	3,814	4,164	2,302
DRAM Index	4,089	3,900	3,651	2,135
Baltic Dry Index	3,210	2,715	3,902	2,262
iTraxx Crossover	411	496	495	1,145
Earnings in index points	**current**	**-1M**	**-3M**	**-1Y**
DAX EPS 2009/10e	468 / 568	463 / 563	463 / 563	510 / 560
Earnings growth 2009/10 in %	39 / 21	46 / 22	48 / 22	16 / 10
MDAX EPS 2009/10e	507 / 673	503 / 664	501 / 659	575 / 735
Earnings growth 2009/10 in %	108 / 33	62 / 32	66 / 32	20 / 28
Euro Stoxx 50 EPS 2009/10e	253 / 300	255 / 302	257 / 304	290 / 312
Earnings growth 2009/10 in %	16 / 18	21 / 18	21 / 18	15 / 10
S&P 500 EPS 2009/10e	78 / 94	77 / 92	77 / 93	78 / 95
Earnings growth 2009/10 in %	31 / 20	30 / 20	25 / 22	26 / 22
Valuation: P/E, yield in %	**current**	**-1M**	**-3M**	**-1Y**
DAX P/E / dividend yield	11.8 / 3.4%	11.3 / 3.7%	12.4 / 3.7%	8.5 / 5.3%
MDAX P/E / dividend yield	14.2 / 1.9%	13.7 / 1.9%	14.7 / 2.2%	8.7 / 5.2%
Euro Stoxx 50 P/E / yield	10.9 / 4.4%	10.1 / 4.5%	11.2 / 4.4%	7.3 / 8.4%
S&P500 P/E / dividend yield	13.9 / 2.3%	13.5 / 2.3%	14.4 / 2.3%	10.8 / 3.8%
Sentiment	**current**	**-1M**	**Avg. 3-M**	**Avg. 1-Y**
Eurex put-call ratio (14 days)	0.92	1.01	1.01	0.94
CBOE put-call ratio (14 days)	0.88	0.90	0.86	0.86
US AAII % of optimists	35.9	36.8	38.8	38.7
US AAII % of pessimists	26.2	41.9	32.4	39.0
VDAX-New	19.0	26.2	22.8	28.8
VIX	17.9	26.1	21.0	27.0
DAX RSI (14 days)	63.4	34.8	50.8	54.9
S&P500 RSI (14 days)	67.5	34.6	53.2	56.8

Sourcese: Bloomberg, Datastream, I/B/E/S, Eurex, CBOE, Sentix, AAII, CBCM

Commodity markets

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Oil prices are too high from the fundamental point of view

The current price of crude oil over $80 a barrel is fundamentally unsound. Prices are essentially being driven by the greater market optimism. Disappointment that industrial countries have not experienced a sharper upswing is likely to take oil prices back down to about $70 a barrel by the end of the year. Gold prices should advance only moderately in 2010.

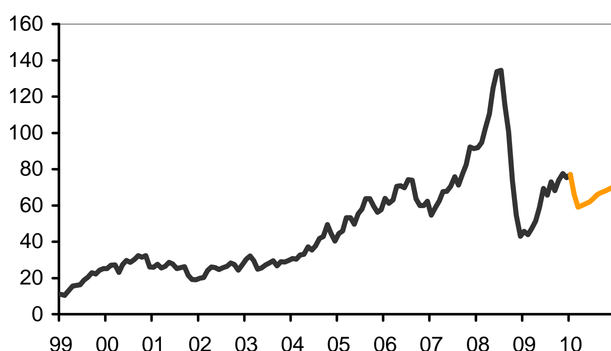
Oil prices have risen again in past weeks to $80 a barrel (Chart 20). We primarily attribute this to growing economic optimism after the US and Chinese economic data were better than expected. Speculative financial investors have significantly increased their net long positions in crude oil accordingly. In fundamental terms, the situation on the oil market has not improved. The rise in global demand for oil, anticipated this year, is coming almost exclusively from the emerging countries, especially China. The recovery of demand in the industrial countries is taking its time, however.

There is currently too much oil on the market rather than too little. High prices are increasing the incentive to overproduce. OPEC members' level of compliance with production quotas was only just over 50% in February, compared to 80% a year ago. Commercial stocks of crude oil and oil products in the US are at a very high level again, despite the harsh winter and higher refinery utilisation. The flattening of the futures curve is making it less attractive to store crude oil in deep sea tankers for arbitrage purposes. According to estimates, 100 million barrels of crude oil and oil products were still being stored in tankers offshore in February. This will gradually be brought on land and appear on official onshore inventories.

Gold: Moderate price increase in the course of the year

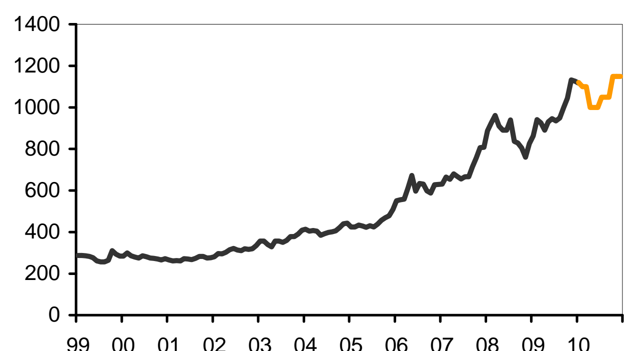
Gold has shown considerable relative strength in past weeks (Chart 21). Despite the continued appreciation of the dollar, gold prices have topped the $1,100 dollar-a-troy-ounce mark. Especially jewellery demand from India is propping up gold prices at present. This support should decrease, though, in the second quarter, so prices should be expected to retreat towards $1,000 at mid year. Private investors and central banks will continue to demand gold as an instrument for hedging and diversification of their portfolios. We see the price of gold at $1,200 by the end of the year, after which the air should get thinner, though, against the backdrop of an expected firmer dollar, the lack of short-term inflation risks and a growing gold supply.

CHART 19: **Oil prices should see a correction short term**
Brent Blend, in dollars per barrel



Sources: Bloomberg, IEA; Commerzbank Research

CHART 20: **Gold prices expected at $1200 by year-end**
Dollars per troy ounce



Sources: Bloomberg, Commerzbank Research

Growth and inflation

TABLE 11

	Gross Domestic product at constant prices, percentage change on year			Consumer prices percentage change on year		
		Forecast			Forecast	
	2009	2010	2011	2009	2010	2011
Eurozone	-4.0	1.0	1.3	0.3	1.1	1.7
Germany	-5.0	1.8	1.5	0.4	0.9	1.4
France	-2.2	1.3	1.5	0.1	1.3	1.5
Italy	-5.1	0.8	1.3	0.7	1.0	1.5
Spain	-3.6	-0.3	0.5	-0.3	1.0	1.3
Netherlands	-4.0	0.9	1.7	1.2	1.1	1.6
Belgium	-3.1	1.3	1.5	-0.1	1.2	1.5
Austria	-3.6	1.4	1.6	0.5	0.8	1.4
Greece	-2.0	-3.0	-0.7	1.2	2.1	1.8
Finland	-7.5	1.0	1.3	0.0	1.0	1.5
Portugal	-2.8	0.8	0.9	-0.9	1.0	1.6
Ireland	-6.7	0.3	1.0	-1.2	-0.5	0.9
United Kingdom	-5.0	1.0	2.0	2.2	2.4	1.4
Sweden	-4.7	1.5	2.3	-0.3	1.1	2.0
Denmark	-5.1	1.3	1.8	1.3	1.5	1.5
Switzerland	-1.5	1.2	1.4	-0.5	1.0	1.2
Norway	-1.5	2.0	2.5	2.2	1.8	2.0
USA	-2.4	2.8	3.0	-0.3	1.8	1.5
Canada	-2.6	2.8	3.0	0.3	1.8	1.8
Japan	-5.2	1.5	1.5	-1.3	-1.0	0.5
Australia	1.3	2.8	3.0	1.8	2.3	2.4
New Zealand	-1.6	2.0	2.5	2.1	2.3	2.5
Poland	1.7	3.5	4.8	3.5	2.7	3.3
Hungary	-6.5	1.0	3.2	4.2	4.5	4.2
Czech Republic	-4.1	1.9	3.7	1.0	3.0	2.6
Slovakia	-4.7	2.8	5.0	1.7	2.7	2.5
China	8.7	9.5	8.2	-0.7	2.4	3.1
South Africa	-1.8	3.5	4.4	6.7	7.4	6.0

Source: Global Insight, Commerzbank Research

Interest rates

TABLE 12: **in per cent p.a.** [1)]

Land		12.3.10	Forecast horizon Jun 10	Sep 10	Dec 10	Mar 10	Jun 10
Eurozone	10 years [2)]	3.19	3.00	3.30	3.45	3.60	3.85
	3 months	0.65	1.00	1.20	1.45	1.75	1.95
	Minimum bid rate	1.00	1.00	1.00	1.00	1.25	1.50
United Kingdom	10 years	4.13	3.75	4.00	4.25	4.50	4.75
	3 months	0.64	0.75	1.10	1.50	1.85	2.35
	Repo rate	0.50	0.50	0.50	1.00	1.25	1.75
Sweden	10 years	3.27	2.90	3.30	3.80	3.85	3.85
	3 months	0.49	0.80	1.10	1.40	1.70	2.00
	Repo rate	0.25	0.25	0.25	1.00	1.25	1.50
Switzerland	10 years	1.93	1.25	1.50	1.50	1.40	1.35
	3 months	0.25	0.25	0.25	0.35	0.60	0.85
	Target rate for 3 mo.Libor	0.25	0.25	0.25	0.25	0.50	0.75
USA	10 years	3.73	3.25	3.40	3.65	3.75	3.90
	3 month (T-Bills)	0.15	0.10	0.20	0.75	1.25	1.75
	3 month Eurodollar	0.26	0.35	0.65	1.25	1.75	2.25
	Fed funds rate	0.25	0.25	0.25	0.75	1.25	1.75
Canada	10 years	3.52	2.75	3.00	3.30	3.45	3.60
	3 months	0.46	0.50	1.05	1.55	2.05	2.60
	Overnight rate target	0.25	0.25	0.25	0.75	1.25	1.75
Japan	10 years	1.35	1.10	1.25	1.50	1.50	1.70
	3 months	0.45	0.30	0.30	0.30	0.30	0.30
	Overnight rate target	0.10	0.10	0.10	0.10	0.10	0.10
Australia	10 years	5.68	4.90	5.15	5.35	5.35	5.50
	3 months	4.45	4.55	4.80	4.95	5.20	5.40
	Overnight rate target	4.00	4.25	4.50	4.75	5.00	5.25
Poland	10 years	5.93	6.15	6.25	6.50	6.50	6.50
	3 months	4.02	4.10	4.55	4.90	5.00	5.25
	Intervention rate (7 days)	3.50	3.50	3.75	4.00	4.50	5.00
Hungary	10 years	7.26	7.50	7.50	7.50	7.75	8.00
	3 months	5.72	5.55	5.60	5.75	6.00	6.00
	2 week deposit rate	6.25	5.50	5.50	5.50	5.50	5.50
Czech Republic	10 years	4.10	4.50	4.75	5.00	5.25	5.50
	3 months	1.45	1.50	1.75	2.00	2.25	2.50
	Repo rate (2 weeks)	1.00	1.00	1.25	2.00	2.50	3.00
South Africa	10 years	8.93	9.10	9.50	10.00	10.00	10.00
	3 months	7.15	7.25	7.50	7.50	7.75	8.00
	Repo rate	7.00	7.00	7.00	7.00	7.50	7.50

Source: Bloomberg, Commerzbank Research; 1) 10 years government bond yields; 3 months money market rates; 2) Bunds

Exchange rates

TABLE 13

Currency		12.3.10	Forecast horizon Jun 10	Sep 10	Dec 10	Mar 10	Jun 10
Dollar	USD per EUR	1.38	1.38	1.35	1.33	1.32	1.28
Japanese yen	JPY per EUR	125	132	132	140	145	147
	JPY per USD	90	96	98	105	110	115
British pound	GBP per EUR	0.91	0.90	0.89	0.88	0.88	0.87
	USD per GBP	1.52	1.53	1.52	1.51	1.50	1.47
Swiss franc	CHF per EUR	1.46	1.47	1.50	1.52	1.53	1.54
	CHF per USD	1.06	1.07	1.11	1.14	1.16	1.20
Swedish krona	SEK per EUR	9.72	9.80	9.75	9.70	9.65	9.60
	SEK per USD	7.05	7.10	7.22	7.29	7.31	7.50
Norwegian krone	NOK per EUR	8.02	7.90	7.80	7.75	7.70	7.70
	NOK per USD	5.82	5.72	5.78	5.83	5.83	6.02
Canadian dollar	CAD per EUR	1.40	1.42	1.42	1.46	1.47	1.43
	CAD per USD	1.02	1.03	1.05	1.10	1.11	1.12
Australian dollar	AUD per EUR	1.50	1.48	1.48	1.49	1.50	1.47
	USD per AUD	0.92	0.93	0.91	0.89	0.88	0.87
New Zealand dollar	NZD per EUR	1.96	1.92	1.90	1.90	1.91	1.88
	USD per NZD	0.70	0.72	0.71	0.70	0.69	0.68
Polish zloty	PLN per EUR	3.89	4.00	3.95	3.90	3.85	3.80
	PLN per USD	2.82	2.90	2.93	2.93	2.92	2.97
Hungarian forint	HUF per EUR	266	270	268	265	265	260
	HUF per USD	193	196	199	199	201	203
Czech koruna	CZK per EUR	25.53	26.00	25.80	25.60	25.40	25.20
	CZK per USD	18.53	18.84	19.11	19.25	19.24	19.69
Romanian leu	RON per EUR	4.09	4.00	4.00	4.00	4.05	4.05
	RON per USD	2.97	2.90	2.96	3.01	3.07	3.16
Russian rouble	RUB per EUR	40.37	42.43	41.40	40.53	39.81	38.65
	RUB per USD	29.29	30.74	30.67	30.47	30.16	30.20
Ukrainian hryvnia	UAH per EUR	11.00	11.04	10.80	10.64	10.56	10.24
	UAH per USD	7.98	8.00	8.00	8.00	8.00	8.00
Turkish lira	TRY per EUR	2.10	2.15	2.10	2.10	2.05	2.00
	TRY per USD	1.53	1.56	1.56	1.58	1.55	1.56
South African rand	ZAR per EUR	10.19	10.07	9.72	9.44	9.24	8.90
	ZAR per USD	7.39	7.30	7.20	7.10	7.00	6.95
Chinese Renminbi	CNY per EUR	9.41	9.43	9.22	9.08	9.02	8.74
	CNY per USD	6.83	6.83	6.83	6.83	6.83	6.83

Source: Bloomberg, Commerzbank Research

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