欧洲经济周评

Issue No: 10/16

2010年5月6日

高华全球经济研究网站
经济研究来自高华客户网
https://portal.ghsl.cn

对西班牙状况的分析和瑞士央行的困局

Javier Pérez de Azpillaga
javier.perezdeazpillaga@gs.com
+44 (0)20 7774 5205

Dirk Schumacher
dirk.schumacher@gs.com
+49 (0)69 7532 1210

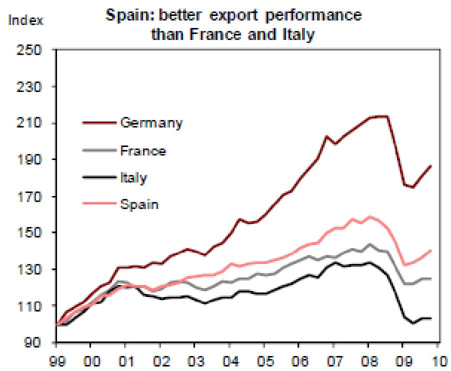
Nick Kojucharov
nick.kojucharov@gs.com
+44 (0)20 7774 1169

Adrian Paul
adrian.paul@gs.com
+44 (0)20 7552 5748

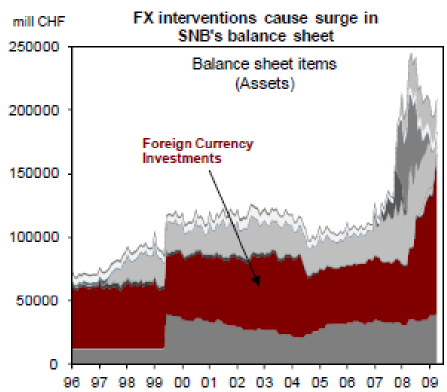
以IMF为首的对希腊经济1,100亿欧元的援助计划未能缓解对希腊长期偿付能力的担忧。投资者的疑虑扩大到了欧元区其他边缘国家，尤其是葡萄牙和西班牙，本周两国的固定收益市场和股市均遭重创。

我们重申一个观点，即西班牙的财政调整计划可信且其财政基本面前景稳健。虽然这一核心情景假设存在下行风险——尤其是西班牙的增长前景艰难且银行体系存在薄弱环节——但该国仍具备抵御以上负面因素和阻止财政形势极端恶化的良好条件。而且，政府将采取有力措施加速开展部分待定的改革措施，哪怕只是为了缓解投资者的担忧。

我们关注的第二个焦点是瑞士。当前瑞士经济增长强劲，因而瑞士央行可能没有理由继续实施汇率干预政策，特别是央行资产负债规模扩张还会带来相关资本损失风险。但是如果停止干预（尤其是在当前欧元区边缘国家经济陷入困境时），这可能导致瑞士法郎大幅升值，进而可能带来通缩风险，瑞士央行对此感到担忧。我们预计可能受官方支持性言论的推动，欧元区边缘国家的资金状况将企稳。这将降低“避风港”货币瑞士法郎升值的可能性。



Source: Eurostat



Source: SNB

Editor
Javier Pérez de Azpillaga
javier.perezdeazpillaga@gs.com
+44 (0)20 7774 5205

European Weekly Analyst

Issue No: 10/16

May 6, 2010

Gao Hua Economics Research
at https://portal.ghsl.cn

The case for Spain and the SNB's dilemma

Javier Pérez de Azpillaga
javier.perezdeazpillaga@gs.com
+44 (0)20 7774 5205

Dirk Schumacher
dirk.schumacher@gs.com
+49 (0)69 7532 1210

Nick Kojucharov
nick.kojucharov@gs.com
+44 (0)20 7774 1169

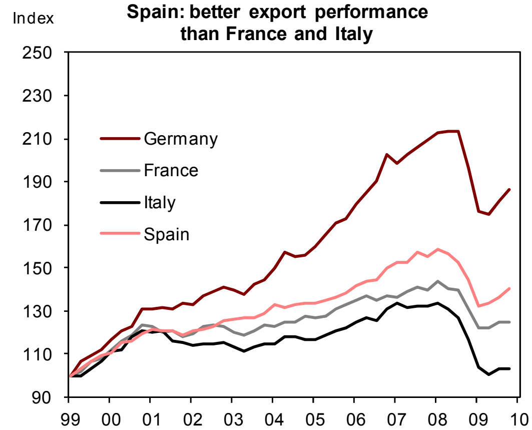
Adrian Paul
adrian.paul@gs.com
+44 (0)20 7552 5748

The IMF-led €110bn rescue plan for the Greek economy has failed to alleviate concerns about the country's long-term solvency. Investors' scepticism has spread to other countries in the Euro-zone periphery, in particular to Portugal and Spain, where fixed income and equity markets took a beating this week.

In our first focus, we reiterate our view that Spain's fiscal consolidation plans are credible and its fiscal prospects fundamentally sound. While there are downside risks to this central scenario—in particular, the country's difficult growth outlook and fragility in parts of the banking system—the country remains well-equipped to weather those headwinds and limit extreme fiscal deterioration. Still, the government would do well to speed up some pending reforms if only to assuage investors' concerns.

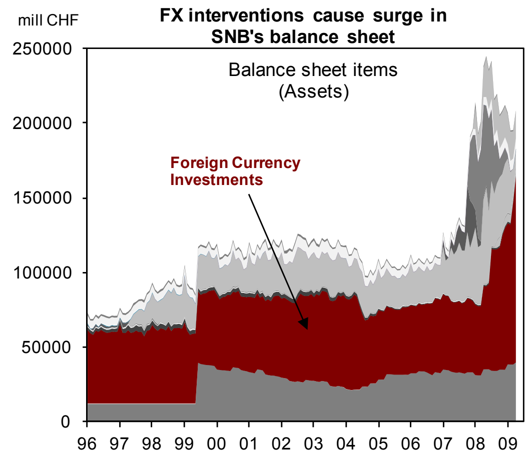
The second focus turns to Switzerland. The economy is now growing strongly and the SNB's FX interventions may therefore no longer be justified, not least because of the risk of capital losses associated with the expansion of the Central Bank's balance sheet. However, the SNB remains concerned by the deflationary risks that could stem from a sharp appreciation of the CHF if it were to stop intervening, especially in the context of current tensions in the Euro-zone's periphery. We expect the funding situation of peripheral countries to stabilise, perhaps prompted by statements of official support. This would reduce the likelihood of a 'safe haven' appreciation of the Swiss Franc.

Spain: better export performance than France and Italy



Source: Eurostat

FX interventions cause surge in SNB's balance sheet



Source: SNB

Editor
Javier Pérez de Azpillaga
javier.perezdeazpillaga@gs.com
+44 (0)20 7774 5205

Week in review

The ECB meeting today passed uneventfully, as expected, with Trichet offering no new details about the ECB's exit strategy or about specific policy responses to recent tensions in sovereign markets. Other central bank meetings in Europe saw the Norges Bank hike rates by 25bp, as expected, and the Czech National Bank deliver a surprise 25bp cut.

On the data front, the latest flash estimate of Euro-zone CPI showed headline inflation easing slightly in April, and we suspect this was mostly on account of continued slowing in core inflation, a process that is likely to continue through the remainder of the year on the back of lingering spare capacity across various economic sectors. There is certainly plenty of such slack in labour markets, as evidenced by high and still-increasing unemployment rates across the Euro-zone in March, although the German labour market continues to be the notable exception.

ECB meeting: Uneventful

The ECB kept rates unchanged at its May meeting, and offered little new information about its exit strategy or any other policy responses to recent sovereign tensions in the Euro-zone. Some highlights:

- When probed about whether the ECB stands ready to implement unconventional measures, Trichet confirmed that such measures will indeed be used if it is deemed necessary. He also reaffirmed that Euro-zone countries need to address their fiscal imbalances and their lack of competitiveness, and to work towards cleaning up their banking systems.

- With regards to the exit strategy, Trichet confirmed that the gradual strategy outlined in previous press conferences is still alive, which lends support to our forecast that the ECB will slowly withdraw liquidity over the remainder of the year in order to reattach the EONIA to the main refinancing rate, but will not deliver any hikes before the first quarter of 2011.

- Finally, on the topic of the Euro, Trichet dodged several questions regarding its recent depreciation. He didn't even resort to the "US favours a strong dollar" response that he usually pulls out when asked about FX. We take this is a continued sign that the weaker Euro is not of any major concern to the ECB.

New EC forecasts: Up slightly, but still downbeat

The European Commission (EC) yesterday released the Spring update of its 2010-2011 forecasts for EU countries. Relative to the projections of last October, the new outlook is slightly more optimistic—real GDP growth in the EU-27 has been upgraded from 0.7% to 1.0% in 2010, and scaled back from 1.6 to 1.5% in 2011; for the Euro-zone, 2010 has been bumped up from 0.7% to 0.9%, while 2011 remains unchanged at 1.5%.

The upward revisions to 2010 stem primarily from improved prospects for export growth, as economic recoveries in emerging markets have thus far proven to be more buoyant than the EC initially envisioned. Despite this external tailwind, the EC still sees the recovery proceeding at a subdued pace on the back of continued weakness in domestic demand. Fixed investment, in particular, is projected to languish in the face of lingering uncertainties in financial markets and the still-weak lending capacity of many banks. Private consumption, on the other hand, is expected to be constrained by fragility in the labour markets, as well as the deleveraging that debt-ridden households in certain countries have to undergo.

We broadly agree with the EC's assessment of these risks, but we think their ultimate impact on the recovery will be relatively more benign. To this end, we continue to emphasise the strong readings coming from the business surveys, which have shown consistent improvement in recent months (especially in the manufacturing sector). Moreover, we think the impulse to Euro-zone exports from dynamic foreign demand will be even stronger than most expect, and, coupled with the boost from a reversing inventory cycle, should be enough to push Euro-zone growth to 1.7% this year. With domestic demand joining the recovery more meaningfully next year, we also think 2011 will be relatively stronger (2.2%). These forecasts put us clearly above the expectations of not only the EC, but also other official institutions and Consensus (Table 1).

Inflation eases a touch...

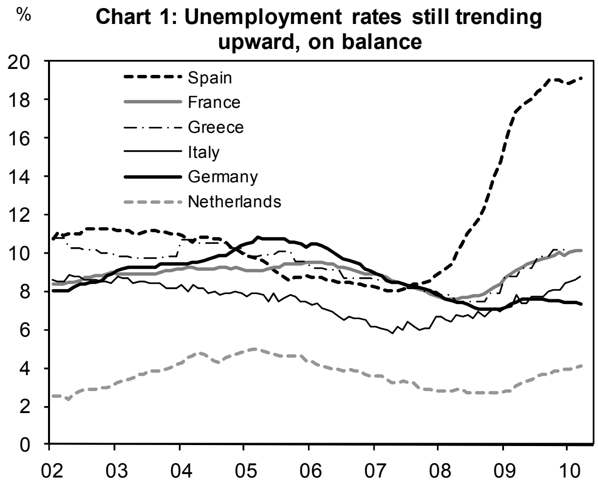
The flash estimate of Euro-zone CPI for April showed a minor slowing in the headline rate from 1.5%yoy to 1.4%. The decline primarily reflected a downward surprise in Germany (1.0% after 1.2%) but was tempered by the higher-than-expected Italian print (1.6% after 1.4%). Since we do not yet have a breakdown of the underlying components, there is not too much to be gleaned from these headline numbers, but we suspect that core inflation either continued to come down or was stable across the EMU economies, reflecting the lingering spare capacity across various economic sectors. The full inflation report will be out in two weeks' time.

Table 1: Euro-zone GDP forecasts

%yoy	GS	EC	ECB	IMF	Consensus
2010	1.7	0.9	0.8	1.0	1.2
2011	2.2	1.5	1.5	1.5	1.5

Source: IMF World Economic Outlook April 2010, ECB, European Commission Spring 2010 Forecast, ECB, GS Global ECS Research

Chart 1: Unemployment rates still trending upward, on balance



Source: Eurostat.

...while unemployment is broadly stable

Aggregate unemployment in the Euro-zone was stable at 10% of the labour force in March, but at the individual country level, the general trend is still upward (Chart 1), suggesting more job losses on the horizon before labour markets begin to recover in earnest. Indeed, although the unemployment rate came down a touch in Germany (7.3% after 7.4%) and was steady in France at 10.1%, it crept up from 8.6% to 8.8% in Italy, from 19.0% to 19.1% in Spain, and from 4.0% to 4.1% in the Netherlands. We expect the jobless recovery to continue through the rest of this year, which means the unemployment rate is unlikely to peak until early 2011 (at around 11.2%), at which point we should begin to see the first bouts of meaningful employment growth.

Norges Bank tightens as expected...

The Norwegian Central Bank hiked rates by 25bp today to 2.00%, as expected by us and the market consensus. The statement was roughly in line with our expectations, but the one 'surprise' is that they discussed the alternative of keeping the policy rate unchanged.

The Norges Bank's alternative consideration is likely rooted in their assessment that developments in Europe increase the uncertainty around their projections. Given the very strong data coming out of core EMU, presumably this uncertainty refers to the situation in Greece (although this is not made explicit). We think that Norges Bank's Euro-zone forecast of 1% growth in 2010 is cautious as it is, and given they are now talking about downside risks, there is increased potential for upside surprises later in the year.

Despite the downside risks that Norges Bank now perceives, it is clear that they are also concerned about the effects of leaving interest rates at low levels for a long period of time. The statement notes that the 'gradual' movement in interest rates to normal levels is important to prevent future imbalances from developing.

Against this backdrop, we expect Norges Bank to pause with its rate hikes at the next meeting in June, but then to deliver three more 25bp increases by year-end, bringing the policy rate to 2.75%.

...but the Czech CNB delivers surprise cut

The CNB cut its main policy rate by 25bp to 0.75%, against our and consensus expectation of no change. The policy rate corridor was also compressed further, as the lombard rate was reduced to 1.75% from 2.0% and the discount rate left unchanged at 0.25%.

In addition, the CNB published the main projections from the new Inflation Report. The Bank's staff lowered assumptions for external inflation and, most significantly, for 3M Euribor, by 0.2pp in 2010 and 0.7pp in 2011. The forecast for Czech GDP was left at +1.4% in 2010 (GS: +2.3%), and revised down for 2011 to +1.8% from +2.1% (GS: +3.1%).

The surprise cut and new staff forecasts send a strong dovish message. The CNB is concerned that the 2010 recovery will be hampered by a slowdown in external demand and weak domestic consumption. We are much more upbeat on the prospects of the recovery in the Czech economy, and, in conjunction with our more bullish oil price assumptions, we see headline inflation above the CNB's 2% target from 2010Q3 onwards.

We therefore expect the first rate hike to come sooner than 2011Q1 (the timing implied by the new CNB forecast). That said, our current forecast of 50bp in rate hikes in 2010H2 now looks rather optimistic, and we will be reviewing it in the light of the incoming inflation and GDP data over the next two weeks.

Nick Kojucharov

The case for Spain

We reiterate our view that Spain's fiscal consolidation plans are credible and its fiscal prospects fundamentally sound. While there are downside risks to this central scenario —in particular, the country's difficult growth outlook and fragility in parts of the banking system – the country remains well-equipped to weather those headwinds and limit extreme fiscal deterioration. Still, the government would do well to speed up some pending reforms if only to assuage investors' concerns.

Investors are looking nervously at Spain as they come to terms with the crisis in Greece. The market reaction appears driven by heightened risk aversion and by some of the similarities between Greece and Spain: both are highly leveraged countries where economic re-balancing (towards exports) and job creation is hampered by a fixed exchange rate with their main trading partners. In addition, Spain and its banks are still digesting the bust of a monumental housing boom. While the low level of public debt, 53.2% of GDP in 2009, offers some comfort, the concern is that private-sector stagnation and the cost of recapitalising the banking system will prevent fiscal consolidation and result in a much faster build-up of public debt in the future.

In our view, the economic and fiscal fundamentals of the Spanish economy are, with all its risks and problems, solid enough to avert the worst-case scenario that some of the recent price action seems to imply. In what follows, we summarise the main planks of this basic view, spelt out in more detail in recent publications.[1]

Spain's fiscal plans are credible

There are three reasons for this positive assessment:

- The government has implemented unpopular tax hikes, proof of the authorities' resolve to deal with fiscal imbalances. The 2010 Budget raised income tax by €400 per taxpayer in January, and the VAT rates (from 7% to 8%, and from 16% to 18%) from July. The tax base is broad and tax collection is efficient; the fiscal information provided by the government is reliable.
- The fiscal plans map out clear performance signposts against which the markets can assess the consolidation, in particular spending cuts worth 4.3pp of GDP tabled for 2011-2013, with a deficit target of 3% in 2013 (11.2% in 2009). This is a credibility-enhancing strategy as the authorities will find it difficult to deviate from those plans without unnerving investors. Moreover, the main opposition party is, if anything, asking for even more spending austerity.
- The low level of debt, 53.2% of GDP in 2009, allows the adjustment to be gradual, reducing the risk of a fiscally-driven relapse into recession. In addition, it provides room to manoeuvre (i.e., more drastic fiscal measures) if and when some of the downside risks to fiscal performance materialise.

A difficult re-balancing act

One of the key downside risks to fiscal performance is the prospect of a stagnant economy for years to come. After 15 years of strong domestic demand growth, the private sector (and now also the public sector) needs to deleverage, and export growth (and import substitution) have to replace domestic demand as the engine of growth. With no possible resort to currency depreciation

Table 1: An ambitious stability plan

	2008	2009	2010	2011	2012	2013
General government, % of GDP						
Revenues	37.0	34.5	35.7	36.7	37.5	38.3
Spending	41.1	45.7	45.5	44.2	42.8	41.3
Interest bill	1.6	1.8	2.2	2.6	2.9	3.1
Primary spending	39.5	43.9	43.3	41.6	39.9	38.2
of which, investment	3.8	4.8	4.1	3.4	3.1	2.9
Primary balance	-2.5	-9.4	-7.7	-4.9	-2.3	0.1
Primary structural balance	-3.4	-8.1	-5.9	-3.5	-1.7	0.1
Structural balance	-5.0	-9.9	-8.1	-6.1	-4.6	-3.0
Balance	**-4.1**	**-11.2**	**-9.8**	**-7.5**	**-5.3**	**-3.0**
Goldman Sachs	-4.1	-11.2	-10.2	-8.9	-	-
Debt	39.7	53.2	65.9	71.9	74.3	74.1
Goldman Sachs	39.7	53.2	66.6	74.0	-	-
Macroeconomic variables						
GDP growth	0.9	-3.6	-0.3	1.8	2.9	3.1
Goldman Sachs	0.9	-3.6	-0.3	1.4	-	-
Unemployment rate	11.3	18.0	19.0	18.4	17.0	15.5
Goldman Sachs	11.3	18.0	19.7	19.5	-	-
Output gap	2.1	-3.2	-4.1	-3.2	-1.6	-0.1

Source: Finance Ministry; Goldman Sachs Global ECS Research

1. In particular, see Box entitled "Spain's public finances: Another turn of the screw" in *European Weekly Analyst*, February 4, 2010; and "Spain: The crash behind, the task ahead" in *European Weekly Analyst*, April 8, 2010.

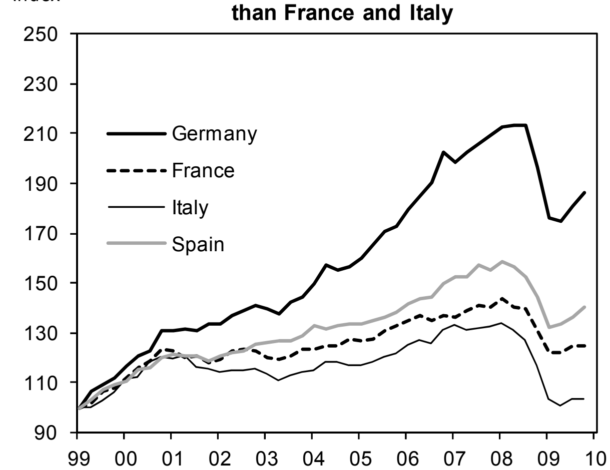
(at least relative to its Euro-zone trading partners), the outlook for a quick return to significant growth, say 2%-3%, would appear limited, impairing the prospects of fiscal consolidation.

Two key issues shape our view of what can achieved in terms of export performance:

- First, the widespread belief that Spain has an uncompetitive export sector is at odds with the country's recent export performance. The belief is probably based on the fast rise in unit labour costs and export prices relative to its competitors over the last 10 years. Yet, despite this rise, exports have risen faster than in France or Italy, and, more generally, have become less sensitive to export prices, see Chart 1. This suggests that there has been an improvement in competitiveness not captured by prices and costs—perhaps achieved through quality improvements or shifts into higher value-added segments of production on the back of an intense build-up of capital stock for many years, see Chart 2. If this non-price improvement continues—and there is no reason why it shouldn't—then the reduction in costs and prices relative to competitors doesn't need to be as large as it would have been otherwise.

- Second, and despite the previous remark, a substantial and fast improvement in cost and price competitiveness would greatly assist in the rebalancing required. To achieve this, the wage formation process has to become more flexible. Currently, trade unions set a wage increase that is binding for large parts of the economy (individual companies can only opt out in special circumstances, such as near bankruptcy). As a minimum, these binding agreements should be greatly relaxed. This looks unlikely in the short term: our central scenario remains one in which Spanish wages grow in line with wages in the Euro-zone this year, with below-average growth only in 2011. Needless to say, a more open stance on the convenience of wage cuts would help to raise the growth trajectory of Spanish exports and the Spanish economy.

Chart 1: Spain: better export performance than France and Italy



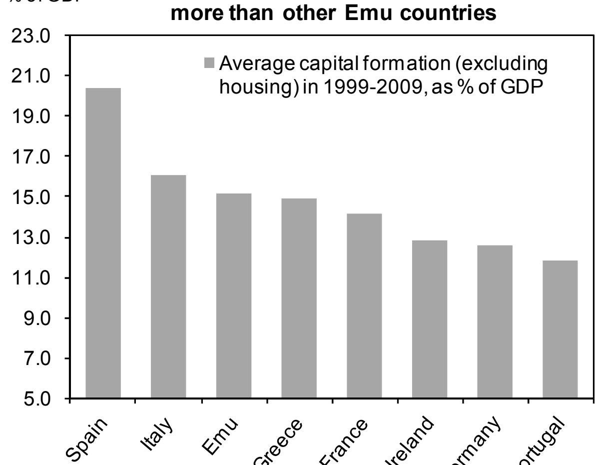
Source: Eurostat

Taking these factors together, we project a lasting return to growth in 2011 (+1.4% after -0.3% in 2010), when the adjustment of the housing sector will have a much smaller negative impact on growth, see Chart 3. We acknowledge that prospects are not bright: fiscal consolidation and private deleverage will remain clear headwinds, preventing the economy from creating enough jobs to reduce the unemployment rate meaningfully for years to come. Yet nominal growth of 2%-4% from next year onwards appears feasible and should limit fiscal underperformance.

Restructuring the banking sector

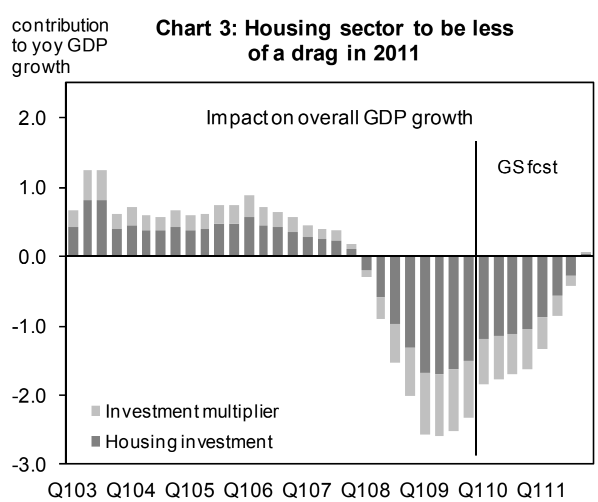
The second key risk that could send Spanish public debt along an unsustainable trajectory is the potential cost of a government bailout of parts of the banking system. The argument could look like this: the private sector is highly leveraged, with real estate companies alone having outstanding loans worth €445bn (45% of GDP), and banks may not be able to recoup large parts of those loans, either through normal re-payment or through sales of the collateral (at deeply discounted prices). These latent losses will have to be recognised eventually, bringing down many institutions and forcing the

Chart 2: Spain has invested substantially more than other Emu countries



Source: Eurostat

Chart 3: Housing sector to be less of a drag in 2011



Source: INE, GS Global ECS Research

government to recapitalise them, with the ensuing build-up in public debt.

We would make the following remarks about this risk:

- Santander and BBVA, the two largest banks in Spain (and some of the largest in a European context), are in excellent shape. Their capitalisation levels are high (with core Tier 1 above 8% for both), and they continue to generate substantial profits. Over the past week, these two banks alone reported some €9.2bn of 2010Q1 pre-provisions profits, or 3.5% of their gross loan book (annualised). Additionally, these two banks are well diversified, with only 33% of Santander's and 59% of BBVA's loan book attributable to Spain, with the rest skewed towards Latin America. In short, the largest banks are not that Spanish. Having the top two institutions in a healthy state is all-important, in our view (for example, they can help to organise the rescue of smaller institutions (see below), which is something that was difficult to achieve in the UK crisis)
- Spain's banking system is split between the private-sector and public-sector banks (Cajas). In terms of size, Cajas account for 40% of total assets of the banking system (€1.3trn), 48% of total loans (€0.9trn), 54% of mortgages, 53% of deposits of domestic residents (€0.8trn) and 37% of capital and reserves (€0.1trn). Cajas currently report a non-performing loan (NPL) ratio of 5.4%. Even if one assumes loan book deterioration towards an NPL of 20% and a 50% loss given default, these extreme losses to the system would add up to around €90-100bn. hypothetical losses are approximately equal to the outstanding balance of capital and reserves reported by the public-sector banks.
- Not all Cajas are equal—something the Bank of Spain readily admits in its reports. We believe that the healthy private-sector banks would be willing buyers of select troubled Cajas, and in particular of their deposit franchises and distribution networks.
- We acknowledge that the ongoing Greek crisis could have an additional negative impact on the Spanish banking system. This is not so much through direct exposure to Greece (the linkages between Greek and Spanish banks is minimal, virtually nil), which cannot be said for the Portuguese and Spanish banks. The exposure to Portugal is large and takes the form of originated loans (i.e., direct presence), as well as interbank exposures and sovereign bond holdings. In addition, a deterioration of the Greek crisis could eventually lead to a shutdown of wholesale funding markets, akin to what occurred in 2008Q4 and 2009Q1.
- The response of the government and the Bank of Spain to deal with undercapitalised institutions has been to set up a Fund to provide capital or funding to those entities that present viability plans (usually involving the consolidation of Cajas into bigger institutions). The Fund has not yet invested in any of these projects and the Bank of Spain has voiced several times the need for a faster re-structuring. PM Zapatero and the leader of the Opposition, Rajoy, agreed yesterday to work to accelerate the process (both parties control most of the regions that own the Cajas), setting July 30 as the deadline to apply for the FROB's financial assistance. That said, the Bank of Spain would always intervene in any institution that fails to fulfil the minimum solvency standards, whether they ask for the FROB's assistance or not.

Overall, the strategy seems appropriate to us: it allows the healthier institutions to consolidate with the weaker ones; it gives them time to make the most of their assets as the economy recovers; it provides a backstop, a safety net; it strikes the right balance between the property rights of the banks' owners and the preservation of financial stability. Even in a worst-case scenario, we doubt that public funds in excess of €100bn (10% of GDP) would have to be committed to recapitalise the Cajas.

Managing risks, managing perceptions

In our central scenario, the deterioration of Spain's fiscal accounts should be contained: we think it unlikely that debt will rise much beyond 85%. But even if some of the downside risks start to materialise, the deterioration should come through gradually, giving the government ample time to take additional measures.

Yet even if the fiscal consolidation plans look realistic and attainable, the recent bout of market instability raises the chances that the Spanish authorities will up the ante and pre-empt future episodes of market turmoil. The ongoing travails of Greece should help to focus minds in this respect: this week's high-level decision to accelerate the restructuring and consolidation of the banking sector sets the right tone. In addition, we think that the following proposals could go a long way to providing further reassurance to markets:

- **Publication of quarterly reports on the progress of tax collection and spending**, and how they compare with the government's plans. This should include the contribution from regional and local authorities to the consolidation effort.
- **Preparation and publication of a batch of contingent fiscal measures** that the government stands ready to take immediately in case of slippages.
- **A reform of the wage formation process** to allow wider divergence in wage deals including wage cuts (in addition to the reduction of dismissal costs likely to be agreed). The government should take the lead in preparing public opinion for the possibility and, in some cases, the convenience of agreeing to wage reductions—perhaps in exchange for payroll preservation or expansion. In time, lower labour costs will lead to lower domestic prices—deflation should be welcome—and to rising profits in the export sector (which will attract investment and job creation).

Javier Pérez de Azpillaga

Switzerland: FX interventions, the Euro-zone periphery and the risk of financial losses

The Swiss economy is growing strongly and there is now little need for the SNB to continue its exceptionally expansionary monetary policy. However, the SNB remains concerned about the deflationary risks stemming from a sharp appreciation of the CHF, which could occur if the central bank stopped intervening in FX markets. On our estimates, the trade-weighted CHF would need to appreciate by around 5%-10% from current levels before bringing Switzerland close to deflationary territory.

Given the levels that the CHF has reached already, an appreciation of this magnitude seems unlikely, but the current tensions in the Euro-zone's periphery accentuate the risk of such a move, particularly if the SNB were to end its interventions. That said, we expect the funding situation of peripheral countries to stabilise as markets realise the fundamental differences between Greece and others, perhaps prompted by statements of official support if needed. This would reduce the likelihood of a 'safe haven' appreciation of the Swiss franc.

Another important factor to consider is the increasing financial risk piling up on the SNB's balance sheet by virtue of the central bank's rapid accumulation of FX reserves. In one of the possible scenarios we consider, the value of Euro-denominated assets on the SNB's balance sheet could quadruple in 12 months' time.

In the end, the SNB will have to weigh the probability of a 'safe haven'-induced appreciation of the CHF against the risk of falling behind the curve and incurring potential financial losses on its FX investments. If the situation in Europe's periphery calms down, we view the latter as constituting the larger risk and we would expect an end to interventions by the SNB in this case.

The Swiss economy is growing at a very healthy rate, as signalled by the latest round of business surveys. In particular, the surge in the Manufacturing PMI since March suggests that Swiss exporters have little problem in coping with the strength of the CHF.

Despite this forceful recovery, the SNB asserts it will continue to intervene in FX markets if necessary. The most recent statement along these lines came from SNB President Hildebrand, who in his speech at the annual SNB shareholders' meeting last week said: "*Any threat to currency stability would, by definition, have a negative impact on Switzerland, above all if the Swiss Franc were to appreciate sharply due to its role as a safe haven currency. The SNB will not, however, allow such a development to turn into a new deflation hazard for Switzerland. For this reason, it is acting decisively to prevent an excessive appreciation of the Swiss Franc.*"

Interventions are not risk-free either

The SNB's cautionary stance with respect to the exchange rate seems understandable given that (i) the trade-weighted CHF remains close to its record high (Chart 1), and (ii) tensions in the Euro-zone's periphery have not yet abated. That said, we continue to expect the SNB to ease its stance on FX interventions at its June monetary policy meeting. There are two main reasons underlying this view:

- Weighing the risk of deflation against the risk of the SNB falling behind the curve suggests that the latter is now clearly the larger risk.

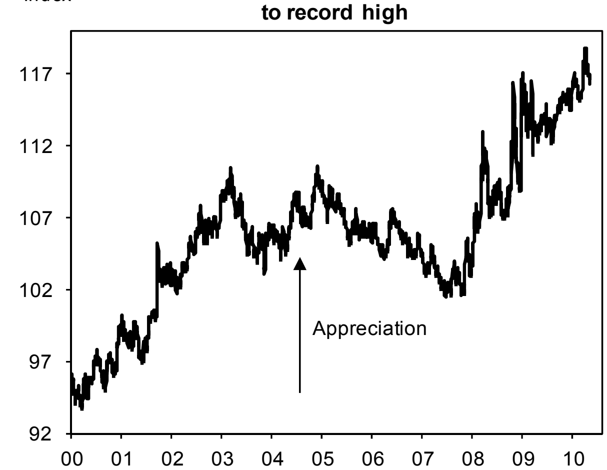
- Given the size of its FX interventions in the past year, the SNB has acquired a record amount of foreign-denominated assets over the last 12 months. This implies that the potential for significant losses on these assets is also considerably higher.

The Swiss economy can cope with a strong CHF

Swiss exports are recovering despite the strength of the CHF. Real exports rose by around 4%qoq in the first quarter of this year, after approximately 2% growth in 2009Q4. The overall level of exports remains very low, but there can be little doubt that there is now an established upward trend in Swiss exports (Chart 2).

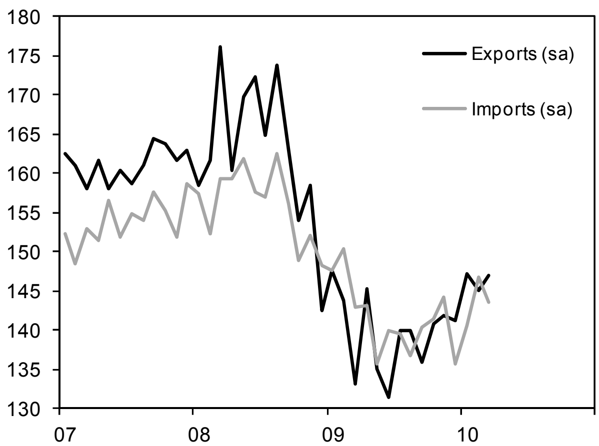
Strong external demand is the main factor behind this rebound in trade, and Swiss exporters in particular are benefiting from the acceleration of growth in the rest of Europe. We forecast that the EU-27 will grow by 1.8% this year and 2.5% next year, implying further strength in external demand for Swiss exports.

Chart 1: Swiss franc TWI remains close to record high



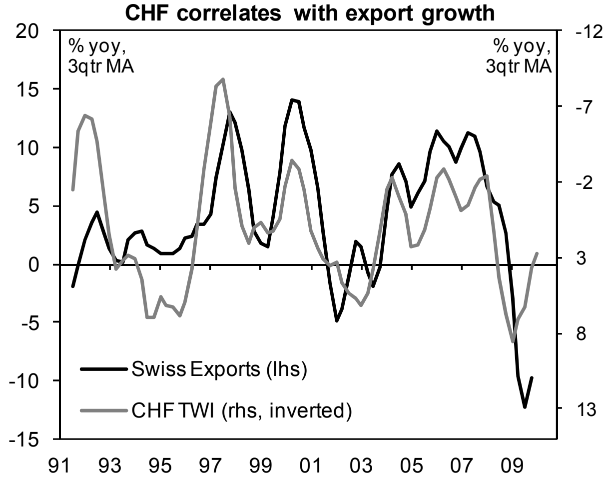
Source: SNB

Chart 2: Swiss exports picking up, albeit from a low level



Source: Administration Federal des Douanes, Haver Analytics

Chart 3: The *change* in the trade-weighted CHF correlates with export growth



Source: State Secretariat of Economic Affairs, SNB, GS.

Fluctuations in the exchange rate remain a risk factor in all of this, albeit a smaller one than is often assumed. Our relatively benign assessment of the growth outlook is based on the view that it is the *change* in the exchange rate—rather than its level—that influences growth (Chart 3). Put differently, once the currency stabilises, the dampening effect of the exchange rate becomes smaller, such that only a renewed appreciation of the CHF would endanger Swiss exports.

To be sure, it is not the level of the CHF that the SNB is worried about, but rather the potential for a significant overshoot once the market is 'left on its own'. The risk that an explicit or implicit end to intervention could, in the current situation, lead to a significant appreciation of the CHF raises the question of how large the appreciation would need to be in order to push Switzerland into deflation.

An exchange rate appreciation influences price developments through two channels. The *direct* impact comes from lower import prices, while the *indirect* effect works through lower exports and weaker growth, which eventually results in slower inflation.

We expect Swiss inflation to stay a little below 1% for the remainder of this year (core inflation should hover around 0.5%). Based on our estimates of the elasticity of inflation with respect to exports, the output gap and import prices, an appreciation of the trade-weighted CHF of somewhere between 5% and 10% would be needed to bring inflation down to zero, all else equal.[1] Of course, this would still not push Switzerland into outright deflation—which is defined as a lasting decline in prices that is also incorporated into expectations—but it could bring the Swiss economy uncomfortably close to the deflationary spiral that the SNB fears.

In 'normal' times, such a strong (5-10%) appreciation would look very unlikely given the already high level of the CHF. However, times are not 'normal' now: current tensions in the Euro-zone's periphery imply—due to its safe haven characteristics—a considerable risk of such a move in CHF once the SNB calls an end to its interventions.

The risk of deflation against the risk of being late

All this does not mean, however, that the SNB can simply continue to intervene indefinitely. This is because the likelihood that an appreciation would pose a deflationary threat needs to be weighed against the risk of the central bank falling behind the curve. We forecast CPI inflation reaching 1.7%yoy by this time next year and see the Swiss output gap closing by the end of 2011. The steady flow of robust data coming out of Switzerland also suggests that the SNB should soon tighten from its current super-accommodative interest rate stance (our central forecast is for a hike in September). Moreover, interventions themselves are not risk-free, as the SNB's balance sheet comprises a growing share of foreign-denominated assets. While we can see why the SNB wants to minimise the deflationary tail risk, we think such a policy would no longer be justified as long as the situation in peripheral Europe normalises.

The potential cost of FX interventions

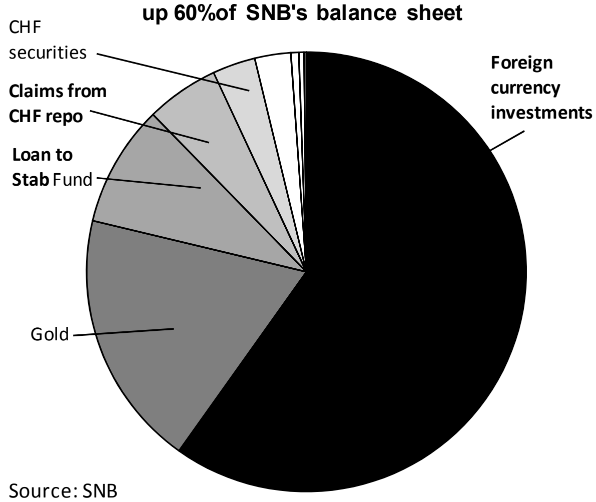
Besides the question of the right monetary policy stance, FX interventions also imply increasing financial risks for the SNB. Aggregate FX reserves on the SNB's balance sheet have now increased to such an extent that they call into question the sustainability of further currency interventions.

The asset side of the SNB's balance sheet consists mainly of foreign currency investments, gold and financial assets (securities and claims from repo transactions). Chart 4 illustrates the composition of the SNB's balance sheet as of March 2010: valued in CHF terms, foreign currency investments make up 60% of the assets held by the SNB.

What is most striking (though not surprising) is the rate of expansion of these foreign currency investments: in

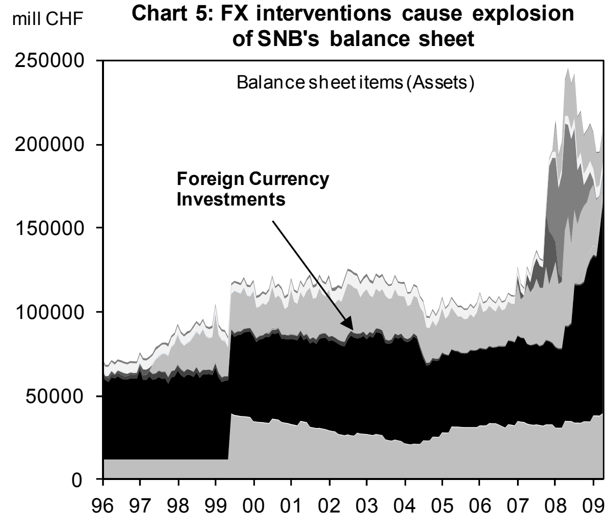
1. We are fully aware of the uncertainties involved in these estimates, and therefore report a rather broad range.

Chart 4: Foreign currency investments make up 60%of SNB's balance sheet



Source: SNB

Chart 5: FX interventions cause explosion of SNB's balance sheet



Source: SNB

the 12 months to March 2010, the value of the SNB's assets has surged 2¼ times from a 10-year historical average of around CHF50bn to CHF125bn (Chart 5). As Tables 1 and 2 show, foreign currency investments have made by far the largest contribution to the growth of the SNB's balance sheet from pre-crisis levels—the accumulation of FX assets has accounted for almost 50% of balance sheet expansion.

The predominant risk run by the SNB in pursuing this investment strategy is *market* risk: the risk that gold prices, exchange rates, share prices and interest rates will move against the central bank in the future and thus devalue the assets held on its balance sheet. Although it claims that these risks are managed through diversification, sufficient to create 'an even risk/return profile for the currency reserves,' recent FX intervention by the SNB has clearly increased the scope for currency fluctuations to become problematic. The Bank's balance sheet has also become progressively more skewed towards an overweight EUR position (Chart 6).

The SNB now holds 64% of its foreign currency reserves (mainly government bonds) in EUR and 22% in USD. While it is indeed sensible for a central bank to maintain reserves denominated in the most liquid currencies in the world, the SNB itself concedes that "*absolute risk [has] increased substantially due to the increase in the overall level of currency reserves"*. Furthermore, the SNB does not hedge its exchange rate risk against Swiss Francs, as this would affect its capacity to loosen or tighten policy to meet its mandate of macroeconomic stability.

Changes in the value of the Swiss Franc do, of course, have a direct effect on the value of the FX assets held by the SNB. Chart 5 suggests that, in aggregate, the SNB's

Table 1: SNB Balance Sheet (Assets)

	Pre-crisis level (Sep-08) CHFbn	Feb-10 CHFbn	Mar-10 CHFbn	Change since Sep-08	Contribution to b/s growth since Sep-08	Change since Feb-10	Contribution to b/s growth since Feb-10
Foreign currency investments	**50**	**109**	**125**	**75**	**46**	**16**	**8**
Claims from CHF repo transactions	43	15	11	-32	-20	-4	-2
Claims from USD repo transactions	32	0	0	-32	-20	0	0
Balances from swap transactions against CHF	0	0	0	0	0	0	0
CHF securities	4	6	7	3	2	0	0
Loans to StabFund	0	19	19	19	11	0	0
Other	35	46	47	12	8	1	1
Total	164	196	209	45	28	13	7

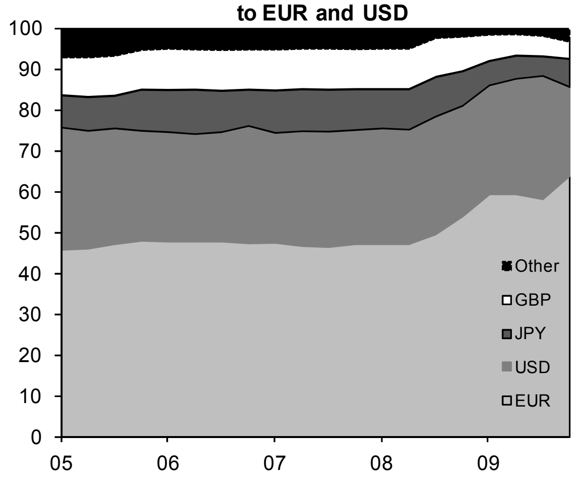
Source: SNB

Table 2: SNB Balance Sheet (Liabilities)

	Pre-crisis level (Sep-08) CHFbn	Feb-10 CHFbn	Mar-10 CHFbn	Change since Sep-08	Contribution to b/s growth since Sep-08	Change since Feb-10	Contribution to b/s growth since Feb-10
Bank notes in circulation	41	47	48	7	4	1	1
Sight deposits of domestic banks	**9**	**43**	**49**	**40**	**24**	**5**	**3**
SNB debt certificates	0	28	26	26	16	-2	-1
Other liabilities, provisions and capital	114	77	86	-28	-17	8	4
Total	164	196	209	45	28	13	7

Source: SNB

Chart 6: The SNB has increased its exposure to EUR and USD



Source: SNB

Table 3: FX losses can exacerbate poor 'local' returns

	Total return in CHF	of which: Currency return	Local return
1999	9.7%	9.2%	0.4%
2000	5.8%	-2.0%	8.0%
2001	5.2%	-1.2%	6.4%
2002	0.5%	-9.1%	10.5%
2003	3.0%	-0.4%	3.4%
2004	2.3%	-3.2%	5.7%
2005	10.8%	5.2%	5.5%
2006	1.9%	-1.1%	3.0%
2007	3.0%	-1.3%	4.4%
2008	-8.7%	-8.9%	0.3%
2009	4.7%	0.4%	4.4%

Source: SNB

assets are exposed to currency fluctuations as never before. Chart 6 suggests that the accumulation of EUR reserves (mainly at the expense of USD and JPY reserves) means that the SNB's balance sheet is particularly sensitive to CHF appreciation/depreciation against the EUR. On a historical comparison, currency movements have sometimes been considerably detrimental to the returns made by the SNB. As Table 3 indicates, in 2008, currency losses compounded poor 'local' returns on the SNB's investments: the central bank made a 9% loss on investments in that year as a result of the FX component.

An unsustainable path

With this in mind, we have run a series of scenario analyses to understand how the composition of the SNB's FX reserves may evolve in the next 12 months. As discussed, the CHF value of the SNB's foreign currency investments has ballooned due to the FX interventions conducted to prevent an *'excessive appreciation'* of the Franc (Chart 7).

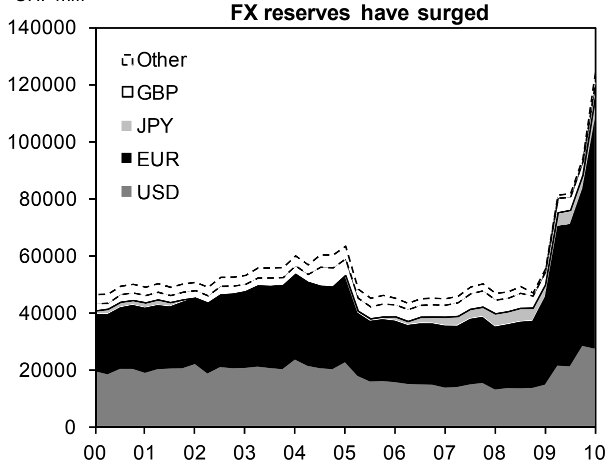
Our currency strategists forecast a short-term strengthening of the Swiss currency—expecting EUR/CHF to trade at 1.40, 1.38 and 1.40 in 3, 6 and 12 months respectively. Under these projections, and assuming FX interventions grow at their *average* qoq growth rate since March 2009 (with no change in the composition of currency allocation), there would be an explosion of the SNB's balance sheet. In 12 months' time, the CHF value of USD assets would reach *twice* their current value, while the CHF value of EUR assets would reach almost *four* times their current value (Chart 8, note the change in scale). This reflects only a small FX valuation effect, but high rates of interventions (+17%qoq in USD, +30% in EUR and +15% in JPY). It is of course unrealistic—and not our forecast—to expect the SNB to continue intervening at this rate through 2011, but this scenario analysis highlights the unsustainability of the SNB's current path of FX intervention.

Another look at the track record of SNB returns in Table 3 suggests that such an inflated balance sheet would pose significant financial risks for the SNB.

Overall, the increased financial risks of FX interventions are a further reason why the SNB will need to change its stance. Conditional on our view that the situation in the Euro-zone's periphery stabilises in the coming weeks, we expect the SNB to announce an end to interventions at its June monetary policy meeting.

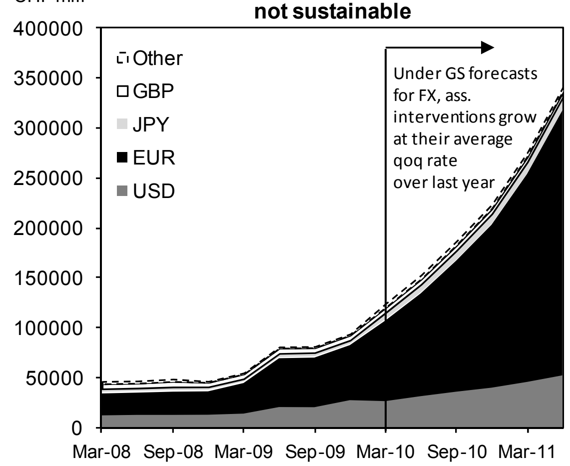
Dirk Schumacher and Adrian Paul

Chart 7: In the last 12 months, FX reserves have surged



Source: SNB

Chart 8: Current rate of FX interventions is not sustainable

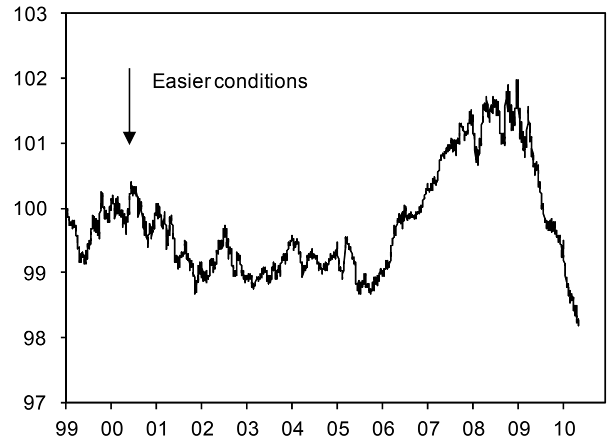


Source: SNB

Weekly Indicators

After having peaked in the immediate aftermath of the financial crisis, the *GS Euroland Financial Conditions Index* has eased significantly and is now at its lowest levels since the beginning of the series in 1999. More than half of this easing can be explained by the fall in corporate bond yields. The drop in short-term rates and the decline in the real trade-weighted Euro account for the bulk of the remaining easing, with developments in equity prices playing a limited role.

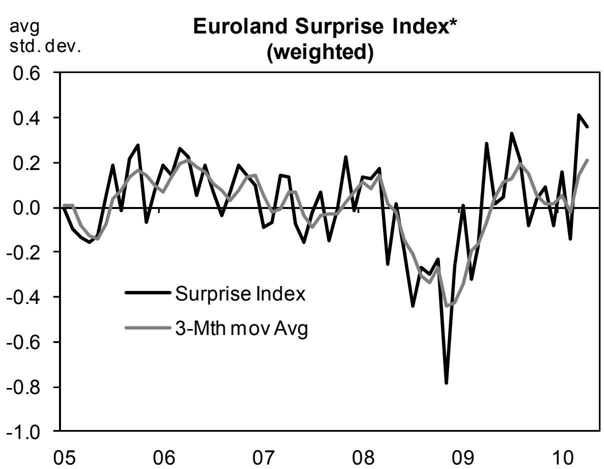
Euro-zone data releases in April surprised to the upside, mainly reflecting stronger-than-expected readings in the business surveys.



Source: GS Global ECS Research

Source: GS Global ECS Research

Source: GS Global ECS Research



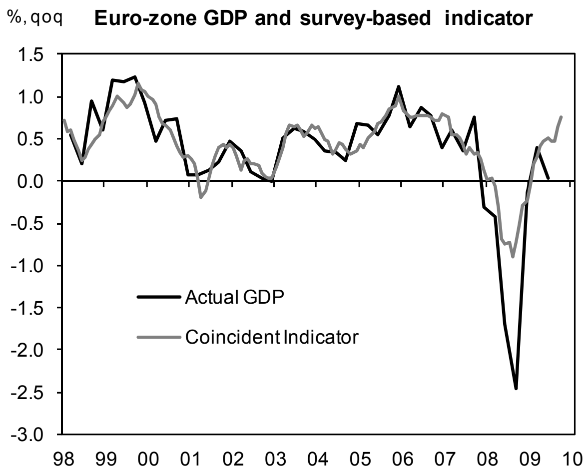
*excluding US non-farm payrolls
Source: GS Global ECS Research

Indicator	Latest Reading	Month	Consistent with (qoq) growth of:
Services PMI	55.5	Apr	0.6
Composite PMI	57.3	Apr	0.8
German IFO	101.6	Apr	1.0
Manufacturing PMI	57.5	Apr	0.9
French INSEE	97.0	Apr	0.3
Belgian Manufacturing	-4.5	Apr	0.5
EC Cons. Confidence	-15.0	Apr	0.3
EC Bus. Confidence	-7.3	Apr	0.5
Italian ISAE	85.5	Apr	0.3
Weighted* Average			**0.6**

* Weights based on relative correlation co-efficients

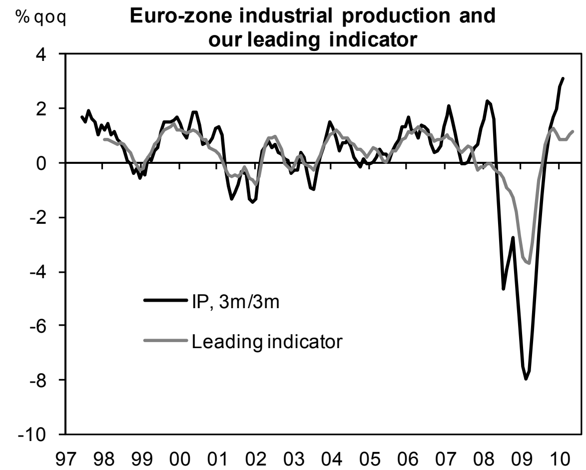
GS Leading Indicators

Our survey-based GDP indicator is now pointing to a +0.6 to 0.7%qoq expansion in Q1.



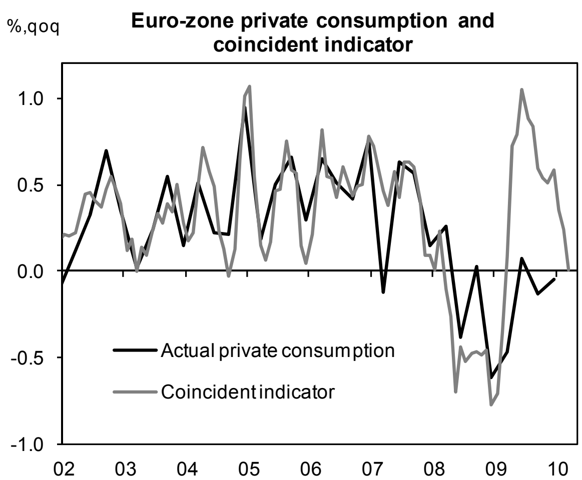
Source: Eurostat, GS Global ECS Research

Our leading indicator, calibrated on IP, is showing accelerating industrial momentum.



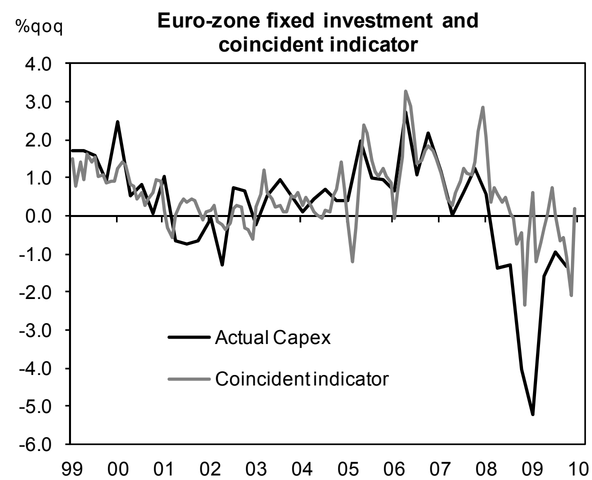
Source: Eurostat, Ifo, Markit, GS Global ECS Research

Our consumption indicator suggests subdued consumption growth.



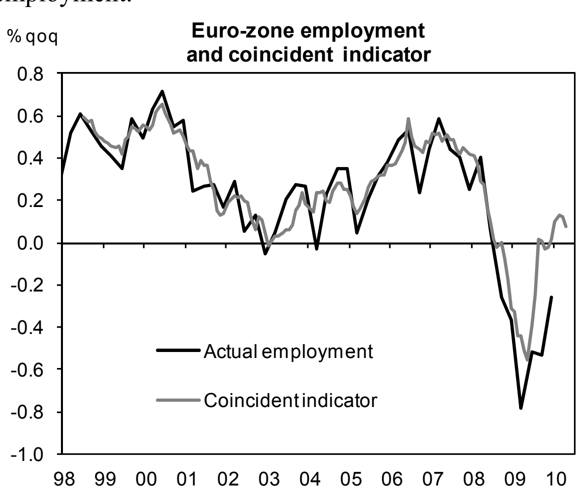
Sorce: Eurostat, GS Global ECS Research

Our capital expenditure indicator points to some near-term firming of investment.



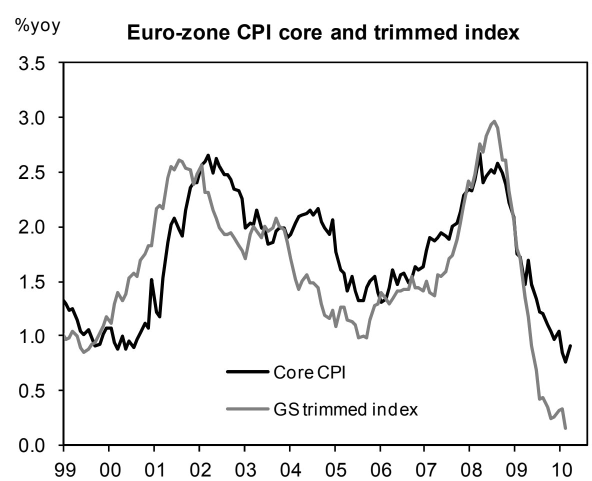
Source: Eurostat, GS Global ECS Research

Our labour market model suggests a stabilisation in employment.



Source: Eurostat, Markit, Labour office, GS Global ECS Research.

The GS trimmed index indicates further easing in Euro-zone core CPI.



Source: Eurostat, GS Global ECS Research

Main Economic Forecasts

	GDP (Annual % change)			Consumer Prices (Annual % change)			Current Account (% of GDP)			Budget Balance (% of GDP)		
	2009	2010(f)	2011(f)	2009	2010(f)	2011(f)	2009(e)	2010(f)	2011(f)	2009	2010(f)	2011(f)
Euro-zone	-4.0	1.7	2.2	0.3	1.6	1.7	-0.7	0.1	0.5	-6.3	-6.7	-5.6
Germany	-4.9	2.3	2.4	0.2	1.3	1.7	5.0	3.5	3.4	-3.3	-5.6	-4.5
France	-2.2	2.5	2.7	0.1	1.6	1.5	-2.0	-2.0	-1.6	-7.5	-7.8	-6.3
Italy	-5.1	1.5	1.9	0.8	1.4	1.9	-3.2	-2.2	-1.4	-5.4	-5.3	-4.9
Spain	-3.6	-0.3	1.4	-0.3	1.7	1.8	-4.8	-2.7	-1.8	-11.2	-10.2	-8.9
Netherlands	-4.0	2.1	2.3	1.0	1.0	1.6	5.4	8.4	8.9	-5.3	-5.6	-4.1
UK	-4.9	1.6	3.4	2.2	2.7	1.6	-1.3	-0.3	0.5	-11.8	-10.8	-8.2
Switzerland	-1.5	2.3	2.0	-0.5	0.8	1.2	7.4	8.1	8.6	-0.7	-1.4	-1.3
Sweden*	-4.7	2.0	3.6	1.5	2.1	2.1	7.4	8.1	9.1	-0.5	-3.4	-2.5
Denmark	-4.9	1.5	2.7	1.1	2.0	1.8	4.1	4.7	1.2	-2.7	-4.6	-3.7
Norway**	-1.4	2.5	3.5	2.6	1.6	2.2	13.8	17.2	17.9	—	—	—
Poland	1.7	3.5	4.6	3.5	2.2	2.6	-1.6	-2.6	-3.5	-7.1	-7.0	-5.0
Czech Republic	-4.1	2.3	3.1	1.0	1.5	2.3	-1.0	-0.1	-0.9	-5.9	-5.4	-5.1
Hungary	-6.2	0.1	3.2	4.2	4.8	2.8	0.2	0.4	-1.4	-4.0	-4.5	-4.0

*CPIX **Mainland GDP growth, CPI-ATE

Quarterly GDP Forecasts

% Change on Previous Quarter	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4
Euro-zone	-2.5	-0.1	0.4	0.0	**0.6**	**0.8**	**0.5**	**0.4**	**0.6**	**0.6**	**0.5**	**0.5**
Germany	-3.5	0.4	0.7	0.0	**0.4**	**1.3**	**0.6**	**0.3**	**0.6**	**0.7**	**0.6**	**0.6**
France	-1.3	0.3	0.2	0.6	**0.6**	**0.9**	**0.8**	**0.7**	**0.7**	**0.7**	**0.5**	**0.5**
Italy	-2.7	-0.5	0.5	-0.3	**0.7**	**0.8**	**0.4**	**0.4**	**0.5**	**0.4**	**0.4**	**0.4**
Spain	-1.7	-1.0	-0.3	-0.1	**0.1**	**0.3**	**-0.3**	**0.2**	**0.4**	**0.5**	**0.7**	**0.7**
Netherlands	-2.3	-1.1	0.5	0.2	**0.8**	**0.9**	**0.6**	**0.6**	**0.5**	**0.5**	**0.6**	**0.6**
UK	-2.6	-0.7	-0.3	0.4	**0.2**	**0.9**	**0.9**	**0.8**	**0.8**	**0.7**	**0.8**	**0.9**
Switzerland	-1.0	-0.1	0.5	0.7	**0.8**	**0.6**	**0.3**	**0.4**	**0.5**	**0.5**	**0.6**	**0.6**
Sweden	-0.9	0.0	-0.1	-0.6	**1.2**	**0.8**	**0.8**	**0.9**	**0.9**	**0.9**	**0.9**	**0.9**
Denmark	-2.0	-1.8	0.3	0.2	**0.4**	**0.9**	**0.7**	**0.7**	**0.7**	**0.6**	**0.7**	**0.7**
Norway*	-0.9	0.1	0.3	0.3	**0.6**	**0.9**	**1.0**	**1.0**	**0.6**	**0.7**	**1.0**	**1.0**
Poland	0.3	0.7	0.6	1.2	**0.9**	**0.7**	**0.8**	**1.0**	**1.3**	**1.3**	**1.3**	**1.2**
Czech Republic	-4.1	-0.3	0.6	0.7	**0.5**	**1.0**	**0.3**	**0.6**	**0.8**	**1.0**	**0.9**	**0.9**
Hungary	-2.3	-1.4	-1.2	-0.4	**0.4**	**0.5**	**0.8**	**0.9**	**0.8**	**0.8**	**0.8**	**0.8**

*Mainland GDP

Interest Rate Forecasts

%		Current	3-Month Horizon Forward	3-Month Horizon Forecast	6-Month Horizon Forward	6-Month Horizon Forecast	12-Month Horizon Forward	12-Month Horizon Forecast
Euroland	3M	**0.7**	0.9	**1.2**	0.9	**1.3**	1.0	**1.5**
	10Y	**2.8**	2.9	**3.3**	2.9	**3.3**	3.0	**3.4**
UK	3M	**0.7**	0.9	**0.7**	1.0	**1.3**	1.4	**2.3**
	10Y	**3.8**	3.9	**4.0**	4.0	**4.0**	4.3	**4.3**
Denmark	3M	**1.3**	1.8	**1.4**	2.0	**1.7**	1.8	**0.0**
	10Y	**3.0**	3.1	**3.6**	3.2	**3.6**	3.4	**0.0**
Sweden	3M	**0.6**	0.7	**0.5**	0.9	**1.0**	1.5	**2.5**
	10Y	**2.7**	2.8	**3.3**	2.9	**3.4**	3.0	**3.8**
Norway	3M	**2.3**	2.3	**2.6**	2.9	**2.9**	2.8	**0.0**
	10Y	**4.4**	4.5	**4.7**	4.5	**4.7**	4.7	**0.0**
Switzerland	3M	**0.2**	0.3	**0.3**	0.4	**0.5**	1.5	**1.0**
	10Y	**1.5**	1.6	**2.0**	1.7	**2.1**	1.8	**2.3**
Poland	3M	**3.9**	4.1	**4.3**	4.4	**4.5**	4.7	**5.1**
	5Y	**5.4**	5.5	**6.1**	5.6	**6.3**	5.8	**6.3**
Czech	3M	**1.4**	1.8	**1.5**	2.1	**1.7**	1.9	**2.2**
Republic	5Y	**2.9**	3.0	**3.8**	3.2	**4.0**	3.6	**4.4**
Hungary	3M	**5.2**	5.1	**5.3**	5.0	**5.1**	5.6	**5.1**
	5Y	**6.2**	6.3	**6.0**	6.4	**6.1**	6.6	**6.2**
Euroland-US	10Y	**-75**	-84	**-23**	-93	**2**	-110	**-13**

Close 05 May 10, mid-rates for major markets. We are currently using June 2010, September 2010 and March 2011 contracts for 3-month forward rates.

Recent European Research

Date	Related-Research Archive	Publication	Author
06-May-10	Summary of ECB press conference	European Views	Erik Nielsen
02-May-10	Greece - update - and Correction on size of loan	European Views	Erik Nielsen
30-Apr-10	Recovery not unusually slow so far	UK Economics Analyst 10/05	Ben Broadbent and Kevin Daly
29-Apr-10	Portugal: Taking a risk with passive consolidation	European Weekly Analyst 10/15	Nick Kojucharov
29-Apr-10	UK Sovereign Rating Under Scrutiny	European Views (UK)	Ben Broadbent
29-Apr-10	Greece: BIG number indeed	European Views	Erik Nielsen
28-Apr-10	Greece update; after an ugly day	European Views	Erik Nielsen
27-Apr-10	Update from Washington: Greece and more	European Views	Erik Nielsen
22-Apr-10	SME financing and inflation: No risks in sight	European Weekly Analyst 10/14	Dirk Schumacher and Natacha Valla
21-Apr-10	Greece initiates formal negotiations with the IMF/EU - Q&As on the most important issues for the weeks to come	European Views	Erik Nielsen
19-Apr-10	Further thoughts on possible impact on Europe of the volcano	European Views	Erik Nielsen
15-Apr-10	European recovery accelerates	European Weekly Analyst 10/13	Erik Nielsen and Ben Broadbent
12-Apr-10	Summary of where we stand – and what remains to be done on the Greek package	European Views	Erik Nielsen
08-Apr-10	ECB press conference summary	European Views	Erik Nielsen
08-Apr-10	Greek update; IMF deal likely in coming weeks	European Views	Erik Nielsen
08-Apr-10	Spain and Italy: out of the crisis, in for a long haul	European Weekly Analyst 10/12	Javier Perez de Azpillaga and Natacha Valla
07-Apr-10	European central bank meetings tomorrow: Very important stuff to come out of the ECB	European Views	Erik Nielsen
06-Apr-10	Greece: A bad day at the office	European Views	Erik Nielsen
01-Apr-10	Housing and spare capacity	UK Economics Analyst 10/04	Ben Broadbent, Kevin Daly and Adrian Paul
25-Mar-10	The Greek crisis: Why and when the IMF will be involved, and what a support package might look like	European Weekly Analyst 10/11	Erik Nielsen
25-Mar-10	Summary of thoughts on today's news out of EU and ECB with regards to Greece	European Views	Erik Nielsen
24-Mar-10	EU-clearance imminent for IMF involvement in Greece; Program negotiations could start shortly	European Views	Erik Nielsen
24-Mar-10	Workmanlike indeed	European Views (UK)	Ben Broadbent and Adrian Paul
24-Mar-10	Expect a busy but small-scale Budget - big picture still to show only gradual correction of deficit	European Views (UK)	Ben Broadbent, Kevin Daly and Adrian Paul
18-Mar-10	Euro-zone to expand East, despite problems in the South	European Weekly Analyst 10/10	Anna Zadornova
18-Mar-10	Taking stock of Euro-zone's banks' balance-sheet adjustments	European Weekly Analyst 10/10	Dirk Schumacher
18-Mar-10	Greece and the IMF	European Views	Erik Nielsen
16-Mar-10	Euro-zone pledges support for Greece; but little details and no cash	European Views	Erik Nielsen
11-Mar-10	Norway: Hiking with a strong currency	European Weekly Analyst 10/09	Jonathan Pinder
11-Mar-10	The Euro-zone recovery: Riding on external demand	European Weekly Analyst 10/09	Nick Kojucharov
10-Mar-10	Heads-up for SNB March meeting: No change in tone yet; expect first hike in September	European Views	Dirk Schumacher
04-Mar-10	ECB liquidity, Euro-zone disinflation, and the fiscal tale of Belgium	European Weekly Analyst 10/08	Javier Perez de Azpillaga and Nick Kojucharov
04-Mar-10	ECB - summary of press conference	European Views	Natacha Valla

General disclosures

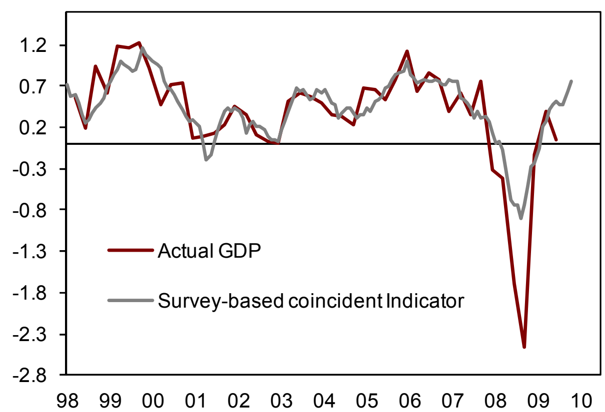
This research is disseminated in China by Gao Hua Securities.
This research is for our clients only. This research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Other than some industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the analyst's judgment.
Goldman Sachs Gao Hua, an affiliate of Gao Hua Securities, conducts an investment banking business. Gao Hua Securities, Goldman Sachs Gao Hua and their affiliates have investment banking and other business relationships with a substantial percentage of the companies referred to in this document.
Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our proprietary trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.
Gao Hua Securities and its affiliates, officers, directors, and employees, excluding equity analysts, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities or derivatives (including options and warrants) thereof of covered companies referred to in this research.
This research is not an offer to sell or the solicitation of an offer to buy any security where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.
Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

Focus for the Week Ahead

The first estimate of **Q1 Euro-zone GDP growth** on Wednesday will be the clear highlight of next week's releases. After turning in a flat reading in Q4, we expect it to have rebounded at a rate of +0.6%qoq in Q1. Business surveys have been pointing to an expansionary pace of this magnitude for some time now, and although IP data has suggested a slightly slower rate, we expect a strong March reading (+1.4%mom, due out on Wednesday) to bring it more in line.

At the individual country level, we see GDP growth in Germany at +0.4%qoq in Q1, in France at +0.5%, in Italy at +0.7%, and in Spain at +0.1% (all due out on Wednesday). Hungary and the Czech Republic will also report GDP numbers the same day, and we expect modest gains in both.

%, qoq **PMI-based indicator pointed to +0.6%qoq GDP growth in Q1**



Source: Eurostat, GS Global ECS Research

Economic Releases and Other Events

Country	Time (UK)	Economic Statistic/Indicator	Period	Forecast mom/qoq	Forecast yoy	Previous mom/qoq	Previous yoy	EMEA MAP Relevance
Friday 7th								
Switzerland	06:45	Unemployment Rate.	Apr	+4.1%	—	+4.1%	—	4
Czech Republic	08:00	Trade Balance	Mar	—	—	+CZK15.3bn	—	0
Czech Republic	08:00	Industrial Output	Mar	—	+7.0%	—	+7.0%	4
Czech Republic	08:00	Retail Sales	Mar	—	—	—	–2.1%	3
Switzerland	08:15	Retail Sales	Mar	—	—	—	+3.1%	0
Sweden	08:30	Industrial Production	Mar	+1.0%	—	–0.8%	–1.5%	3
Norway	09:00	Manufacturing Production	Mar	+0.2%	—	+0.8%	—	4
Germany	11:00	Industrial Production	Mar	+2.5%	—	flat	—	5
USA	13:30	Civilian Unemployment Rate	Apr	+9.7%	—	+9.7%	—	—
USA	13:30	Non-Farm Payroll Employment	Apr	175,000	—	162,000	—	—
USA	13:30	Average Earnings	Apr	+0.1%	—	–0.1%	—	—
USA	20:00	Consumer Credit	Mar	—	—	–$11.5bn	—	—
Monday 10th								
Germany	07:00	Trade Balance	Mar	+EUR14.5bn	—	+EUR12.6bn	—	3
France	07:45	Industrial Production	Mar	0.5	+5.4%	flat	+3.3%	5
Czech Republic	08:00	Consumer Prices	Apr	+0.2%	+1.0%	+0.3%	+0.7%	0
Czech Republic	08:00	Unemployment Rate	Apr	—	—	+9.7%	—	3
Hungary	08:00	Trade Balance	Mar P	—	—	+EUR373.6m	—	1
Norway	09:00	Consumer Prices (CPI-ATE)	Apr	—	+1.6%	—	+1.7%	0
Italy	09:00	Industrial Production	Mar	+0.2%	+6.8%	+0.0%	+2.7%	5
Tuesday 11th								
Hungary	08:00	Consumer Prices	Apr	+0.6%	+5.6%	+0.7%	+5.9%	0
Sweden	08:30	CPI	Apr	—	+1.2%	+0.2%	+1.2%	0
USA	15:00	Wholesale Trade	Mar	—	—	+0.6%	—	—
Wednesday 12th								
Spain	07:00	Flash GDP	Q1	+0.1%	—	–0.1%	—	5
Germany	07:00	GDP	Q1	+0.4%	—	flat	—	5
France	07:45	Harmonised CPI	Apr	—	+1.8%	—	+1.7%	0
France	07:45	GDP	Q1	+0.5%	—	+0.6%	+1.4%	5
Czech Republic	08:00	GDP	Q1 P	+0.5%	+1.5%	+0.7%	–3.1%	—
Hungary	08:00	GDP	Q1 P	+0.4% sa	–0.6%	–0.4%, sa	–4%	—
Switzerland	08:15	Producer & Import Prices	Apr	—	—	+0.5%	Flat	—
Italy	09:00	GDP	Q1	+0.7%	—	–0.3%	—	—
Euroland	10:00	Industrial Production	Mar	+1.4%	—	+0.9%	+4.1%	5
Euroland	10:00	GDP	Q1	+0.6%	—	+0.0%	–2.2%	—
USA	13:30	Trade Balance	Mar	—	—	–$39.7bn	—	—
USA	19:00	Federal Budget Balance	Apr	—	—	—	—	—
Thursday 13th								
USA	13:30	Initial Jobless Claims	—	—	—	—	—	—
USA	13:30	Import & Export Prices	Apr	—	—	+0.7%	—	—
Friday 14th								
Czech Republic	08:00	Minutes of MPC Meeting	May-06	—	—	—	—	—
Poland	13:00	Consumer Prices	Apr	+0.3%	+2.4%	+0.3%	+2.6%	—
USA	13:30	Retail Sales	Apr	—	—	+1.9%	—	—
USA	13:30	Retail Sales - Ex Autos	Mar	—	—	+0.9%	—	—
USA	14:15	Industrial Production	Apr	—	—	+0.1%	—	—
USA	14:15	Capacity Utilization	Apr	—	—	+73.2%	—	—
USA	14:55	U. of Michigan Consumer Sentiment - Provisional	May	—	—	72.2	—	—
USA	15:00	Business Inventories	Mar	—	—	+0.5%	—	—

Economic data releases are subject to change at short notice in calendar. Complete calendar available via the Portal — https://360.gs.com/gs/portal/events/econevents/.