

BayernLB Forecast Update

Please note the information at the last page!

January 2012

Gross Domestic Product¹

After price adjustments, year-on-year change in %

	2009	2010	2011	2012
Germany	-5.1	3.7	2.9	0.5
Euro area	-4.2	1.8	1.6	-0.1 (0.2)
United Kingdom	-4.9	1.4	0.9	0.5 (1.0)
United States	-3.5	3.0	1.7	1.8
Japan	-6.3	4.0	-0.4	2.0

1) Previous forecast in brackets.

US: Despite structural problems – very high unemployment, major loss of wealth among consumers, problems on the housing market, continued need for budget consolidation measures – US economic growth should trend higher in 2012 than in 2011. Monetary and fiscal policy will remain accommodative but very risky in the election year of 2012 due to persistently high unemployment. Because of the political disagreement between the president and Congress, there is a risk that budget consolidation will be undesirably pronounced unless the measures that are due to expire at end-2011 (social security tax cut, unemployment benefits) are extended.

Euro area/Germany: The uncertainty of companies and consumers regarding the sovereign debt crisis has increased in the Euro area during recent weeks. This loss of confidence will curb growth in the winter half-year to a greater extent than was previously assumed. The planned consolidation measures are also likely to be stepped up in several countries in 2012. We expect economic output to show a slight decline in the Euro area, with significant differences between member states. At the same time, it would be misleading to talk of a recession in the Euro area as the trends in northern Europe (excluding Ireland) and southern Europe are fundamentally different. We look for economic growth of 0.5% for Germany in 2012.

Consumer Prices¹

Year-on-year change in %

	2009	2010	2011	2012
Germany	0.4	1.1	2.3	1.6
Euro area ²	0.3	1.6	2.7	1.8 (1.5)
United Kingdom ²	2.2	3.3	4.5	2.6
United States	-0.4	1.6	3.2	2.0
Japan	-1.4	-0.7	-0.3	0.1

1) Previous forecast in brackets. 2) Harmonised Index of Consumer Prices.

US: The annual inflation rate dropped to 3.4% in November and should head towards 2½% in the winter half-year. The risk of inflation remains limited in the forecast horizon due to the underutilisation of overall economic capacities.

Euro area/Germany: The inflation rate in the Euro area was 3% again in November. Core inflation should fall considerably in 2012 given the muted economic outlook. However, we now look for an annual average rate of 1.8% (Germany: 1.6%) in 2012 due to the high level of inflation at the end of 2011.

Key interest rate forecast

In percent p.a.

		in 3 months Apr 12	in 6 months Jul 12	in 9 months Oct 12	in 12 months Jan 13
Euro area	Main refin. rate	1.00	1.00	1.00	1.00
United Kingdom	Base rate	0.50	0.50	0.50	0.50
United States	Fed funds rate	0.0 - 0.25	0.0 - 0.25	0.0 - 0.25	0.0 - 0.25
Japan	Overnight call rate	0.10	0.10	0.10	0.10

US: We expect that the Fed will keep the key rate at 0% to 0.25% until the end of 2013. In light of the slow economic recovery and declining inflation rates, the central bank is likely to announce a third round of bond purchases (QE3) next year. In addition, the forward guidance for the key rate should be enhanced and an explicit inflation target may be introduced.

Euro area: The ECB will keep the key rate at 1.0% until the end of next year given the deteriorating economic outlook and high level of uncertainty stemming from the sovereign debt crisis.

Interest rate and yield forecast¹

In percent

		in 3 months Apr 12	in 6 months Jul 12	in 9 months Oct 12	in 12 months Jan 13
United States	3m USD-Libor	0.3	0.3	0.3	0.3
	2y	0.3	0.4	0.5	0.6
	5y	0.9	1.3	1.5	1.6
	10y	1.9	2.0	2.3	2.5
	30y	2.8	2.9	3.1	3.3
Euro area	3m Euribor	1.3	1.1	1.1	1.1
	2y	0.2	0.3	0.4	0.4
	5y	0.8	0.9	1.2	1.5
	10y	1.8	2.0	2.2	2.4
	30y	2.4	2.6	2.8	3.0
Yield spread forecast ²					
Bund curve	steepness 2/10	160	170	185	200
US curve	steepness 2/10	160	160	175	190
Treas. vs. Bunds	spread 10y	10	0	5	10
	spread 2y	10	10	15	20
Swap vs. Bund	spread 10y	60	50	45	40

1) Government bonds: USA - Treasuries; euro area - Bunds 2) basis points

Euro area: The sovereign debt crisis is still outweighing all other fundamental factors. After the crisis spread to the core euro countries, the greater involvement of state institutions in the short term and a major solution (fiscal union) in the medium term seem inevitable. Key steps towards this were taken at the EU summit on 9 December. Nonetheless, there is a risk that the crisis will temporarily escalate further, which could prompt the 10Y Bund yield to drop below 2% and risk premiums on non-Bund euro govies to climb to critical levels. We do not expect the market to finally settle down, with shrinking risk premiums and rising Bund yields, until spring 2012. Yields in the short maturity range remain stable due to the continued support of government institutions and the yield curve should accordingly steepen to around 200 basis points in the medium term.

US: Despite unsolved debt problems and the threat of rating downgrades, Treasuries will remain in demand as a safe haven in the election year of 2012. The 10Y US yield is therefore unlikely to exceed 2.5% on a six-month horizon and the yield curve should remain steep.

Exchange rate forecast

		in 3 months Apr 12	in 6 months Jul 12	in 9 months Oct 12	in 12 months Jan 13
Dollar	USD per EUR	1.33	1.38	1.42	1.45
Yen	JPY per EUR	104	108	114	117
	JPY per USD	78	78	80	81
British pound	GBP per EUR	0.85	0.86	0.87	0.88
	USD per GBP	1.56	1.60	1.63	1.65
Swiss franc	CHF per EUR	1.23	1.25	1.25	1.26
	CHF per USD	0.92	0.91	0.88	0.87

Dollar: We still expect an exchange rate of USD 1.33 per euro on a three-month horizon. If policy measures are implemented to prevent the government debt crisis from escalating, the euro will recover in the course of 2012. Market participants should also increasingly focus on the US budget deficit, which is massive by international standards, with the dollar consequently depreciating to USD 1.45 per euro on a twelve-month horizon.

Japanese yen: We continue to assume that the yen will gradually depreciate to JPY 81 per USD in 2012. 10Y US government bond yields should climb on a one-year horizon as interest rates in Japan remain little changed. This, combined with falling risk aversion on the capital markets, should boost Japanese demand for investments abroad and lead to a weaker yen.

UK sterling: As previously, we assume that the sterling will reach around GBP 0.85 per euro during the coming months given the prolonged sovereign debt crisis in the Euro area. However, if the outlook for 2013 becomes the focus of attention for many market participants from mid-2012 onward, we expect that receding consolidation pressure in the Euro area will support the euro, while the sterling is set to suffer from the prospect of increased budget consolidation in the UK from 2013 onward.

Swiss franc: We still project that the franc will depreciate to CHF 1.26 per euro on a one-year horizon. The strong franc will exert considerable pressure on Switzerland's current account until end-2012. In addition, persistently negative inflation rates or an economic slump in Switzerland could prompt the Swiss National Bank to raise the exchange rate floor for the franc of CHF 1.20 per euro.

Equity markets forecast

	in 3 months Apr 12	in 6 months Jul 12	in 9 months Oct 12	in 12 months Jan 13
DAX	5900	6400	6500	6700
DJ Euro Stoxx 50	2240	2400	2430	2490
S&P 500	1250	1330	1350	1390
Nikkei 225	8500	9300	9500	9800

Equity markets: The equity markets are currently weighed down by the government debt crisis and a downturn of the Euro area economy. Surprisingly robust US economic data, which have largely quashed fears of a US recession, and monetary policy measures are having a positive impact. In this setting and given investors' current defensive positioning, the blue-chip indices will remain relatively stable on a three-month horizon, but will not return to a sustained uptrend. In addition, the sideways trend will initially remain dominated by high fluctuations, with the risk of a drop back towards annual lows.

Consensus earnings forecasts for 2012 and 2013 will continue to be revised down palpably. Company earnings are likely to fall moderately on the whole in 2012. This will provide negative stimulus in the months ahead. In turn, implicit equity market risk premiums rose sharply, especially in Q3 2011, and are at a high level. Accordingly, the equity markets have already priced in negative developments to a considerable extent. In our baseline scenario, risk premiums will fall again in 2012 as the global economy picks up moderately during the course of the year, the sovereign debt crisis eases and expansionary monetary policy is supportive, leading to a recovery in share prices despite slightly weaker company earnings.

A detailed analysis and further forecasts are given in our publication “Konjunktur- und Finanzmarkt-Perspektiven” for February 2012, published in the beginning of February. In case of the arrival of any new information or changes in market developments before the publication of “Konjunktur- und Finanzmarkt-Perspektiven” we may change our forecasts.

General Note

This publication constitutes research of a non-binding nature on the market situation and the investment instruments cited here at the time of the publication of this information on **2011-12-19**. This research is, to the best of our knowledge, based on generally accessible sources which are reliable and accurate. However, no liability can be accepted for any errors or inaccuracies in information derived from these sources. The information used in this publication has not been checked for accuracy, completeness or relevance to current events. Consequently, no guarantee can be assumed for the completeness and accuracy of this report. This publication is for information only. It is not intended as a substitute for individual professional advice on investments and assets. Our investment consultants are at your disposal should you wish to procure additional up-to-date information.

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