Global Economic & Market Monthly Review:

Possible Increase in Market Volatility

ECONOMIC ANALYSIS & RESEARCH DIVISION

Executive Summary

February 2013

- After a period of extremely low and declining volatility, we expect a significant increase in the likelihood of heightened fluctuations in international markets as investors reassess the factors affecting them. We are not expecting a change in the existing long-term trends.

- At the macro level, in the US a period of negative surprises is likely, centred on the manufacturing sector, while investors are likely to become increasingly anxious about exit scenarios from the Fed's monetary easing strategies. However, the turmoil on these fronts is not expected to derail the broader growth dynamics.

- After a positive second half of 2012, political developments, starting with the elections in Italy, are likely to lead investors to form a more realistic picture of both the process of deeper European integration and the broader growth prospects in the Eurozone.

- In Japan, the yen-weakening occurs as a consequence of an internationally acceptable effort on the part of the Japanese government to guide the country out of deflation, a positive development for the international economy. In China, the transition to a consumer model remains uncertain, but we maintain that the likelihood of a positive surprise remains significant. At the same time, the downward trend in inflation is expected to prevent a substantial monetary contraction in the effort to cool down the real estate market.

- We observe deterioration in the overall picture for risky assets with a parallel improvement in the (primarily technical) picture for bond markets. We note the significant deterioration in our assessment of commodity markets. We hold a negative assessment of crude oil, while gold has lost its positive technical picture and remains overvalued. For German bonds we observe a significant improvement in the technical picture, with a marginal improvement in the fundamental one. The overall picture remains marginally negative. The high Eurozone trade surplus of offers support to the EURUSD.

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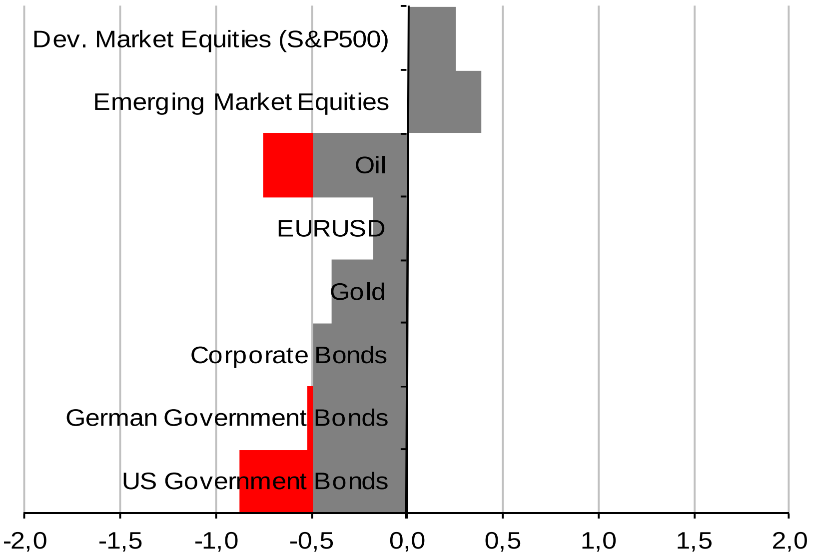
Global Market Risk-Return Scoring

(6-9 month horizon)

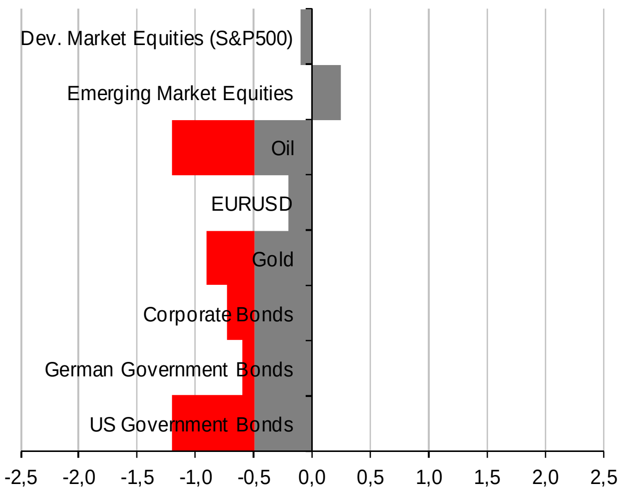


Scoring between -2.5 and 2.5, reflects an average estimate (50%) quantitative fundamental, & (50%) technical factors affecting individual markets.

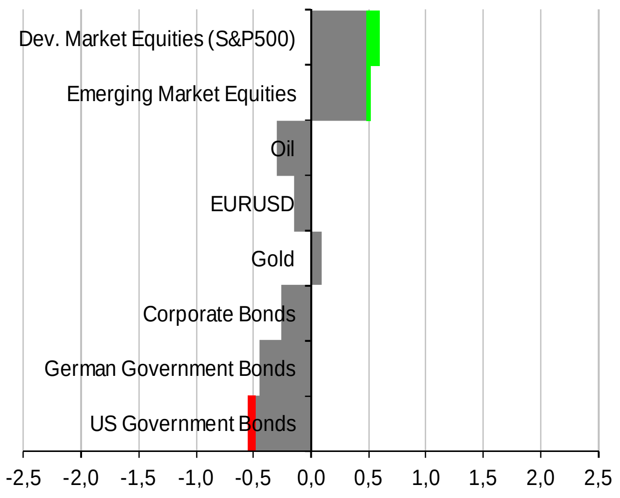
- *-0.49 to 0.49 neutral assessment*
- *0.5 to 1.49 positive assessment (-0.5 to -1.49 negative assessment)*
- *> 1.5 very positive assessment (<-1.5 very negative assessment)*

For long-term estimates (+9 months), more weight should be given to fundamental and quantitative factors, while for the medium term (3-6 months), more weight should be given to technical factors.

Fundamental & Quantitative Estimates



Technical Picture



Fundamental & Quantitative Estimates: Deviations from long-term average value measures (e.g. P/E for stocks, nominal growth for bonds, PPP for fx) as quantified by estimated "fair values" using for each the appropriate market & economic fundamentals. Technical Picture: Standardized display of figures such as MACD, RSI and other technical analysis measures

Economic Developments

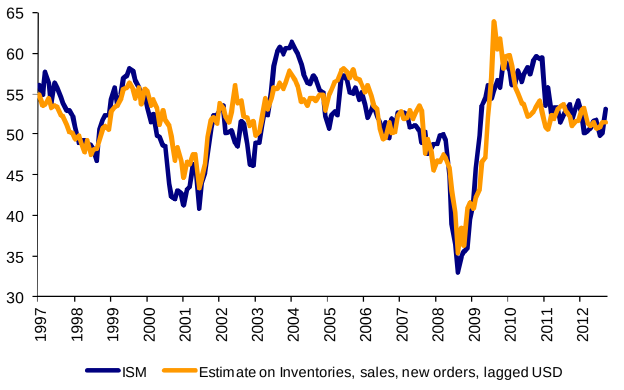
The US: Possible Negative Surprises in Manufacturing, Maintenance of Medium-Term Positive Trend

- US data appeared mixed last month, while maintaining a positive trend overall: Manufacturing data appeared strong. There was a positive surprise in the ISM index and a significant increase in durable goods orders. On the other hand, industrial production appeared marginally negative, while new orders and sales compared to inventories in manufacturing would be consistent with an ISM at significantly lower levels than the current one.

- Indications on the consumer front were positive overall. Retail sales (excluding autos) were marginally positive, while trends in consumer confidence and the labour markets were encouraging. In the real estate markets most surprises were negative, but mainly in the context of a consolidation phase and not of a broader downturn. Declining inventories of unsold homes, low interest rates and improving labour markets should lead to a continuation of the current housing market recovery. In real GDP terms, there has been a significant negative surprise for the 4th Quarter of 2012, namely it was reported as -0.1% from 3.1% (annualized). This negative performance was mainly due to sharp contraction of defence spending (-24% annualized) and should not be indicative of the prevailing trend. It is expected to be revised upwards to 0.5%. At this stage the US economy is growing by 1.5% annually.

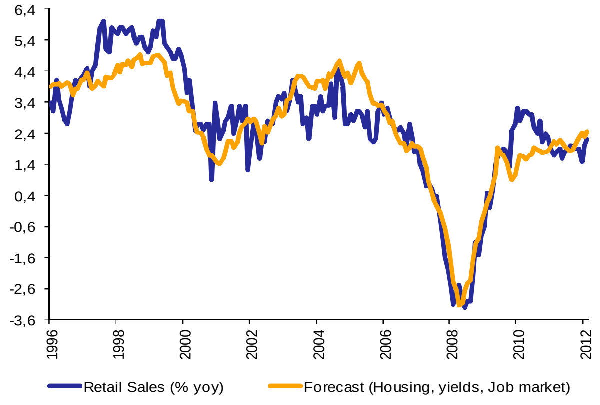
- Using market movements (equities, cyclical commodities slope of bond yields, etc) to "read" the embedded expectations for recovery, we estimate that investors expect an annual rate of 2.4% in 6 months' time. Using a series of leading indicators (inventories, sales, new orders, new unemployment claims) we estimate a growth rate of 2.7%. Overall, although we are expecting a deterioration in US economic indications in the short to medium term (as possible negative surprises in manufacturing outweigh positive ones in consumption), our expectations are consistent with satisfactory US growth rates.

ISM Index & Estimate



Source: Bloomberg, Piraeus Bank Research

Retail Sales & Estimate



Source: Bloomberg, Piraeus Bank Research

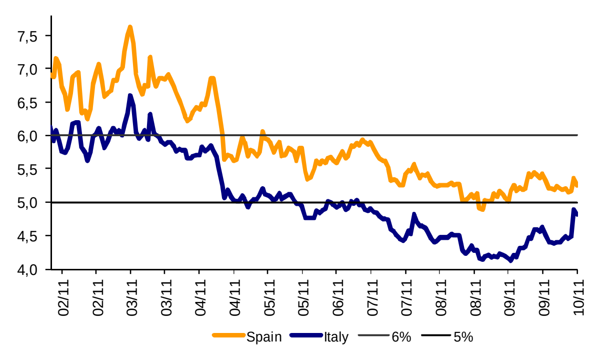
The Eurozone: Marginal Improvements-Increased Political Risks.

- The Eurozone (EZ) economy remains on a trajectory of marginal improvement within the context of a broadly negative economic environment. Within this framework the EZ economy is contracting by an annual rate of 0.9%, while the PMI not only remains below 50 (indicating a recession in manufacturing) but also surprised negatively. On the positive side, PMI numbers remain higher than the October 2012 lows. Negative trends were also present in industrial production (-2.4% annually, higher than the -4% of November 2012) and in retail sales, which contracted at a 3.4% annual rate, almost as fast as during the worst of 2012.

- In line with recent experience, we continue to observe a divergence between hard economic data and, primarily German, confidence indicators. Recently the IFO index (business confidence) and the ZEW Index (analyst confidence) rose and surprised positively in contrast to most real economic data. It could be the case that these indices are more sensitive to markets that have recovered almost solely thanks to the ECB's assertive summer rhetoric and not based on any concrete data or policy actions/decisions. It would be very interesting to observe if these improvements, withstand the rising political turmoil in Italy and possible upward pressures on borrowing costs.

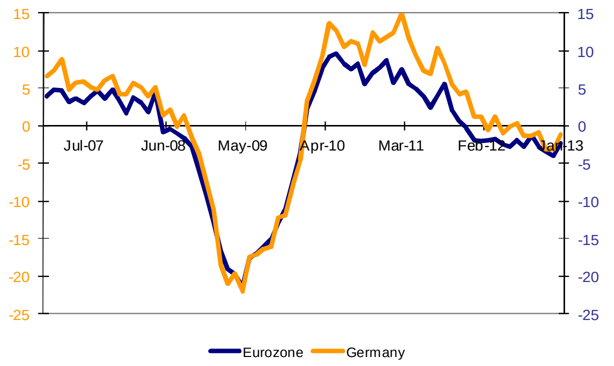
- These trends are also present in our quantitative measurements: Using a number of leading economic indicators, we estimate that growth in the Eurozone could improve over the next six months to an annual growth rate of around 0.23% from -1% two months ago, after taking into account the reported marginal improvements. This picture contradicts growth expectations as exhibited by markets (German bond yields, regional country spreads, stock exchanges, the euro and raw materials) which point to a very high rate of 2.4%.

10 year yields Italy & Spain



Source: Bloomberg, Piraeus Bank Research

Industrial Production



Source: Bloomberg, Piraeus Bank Research

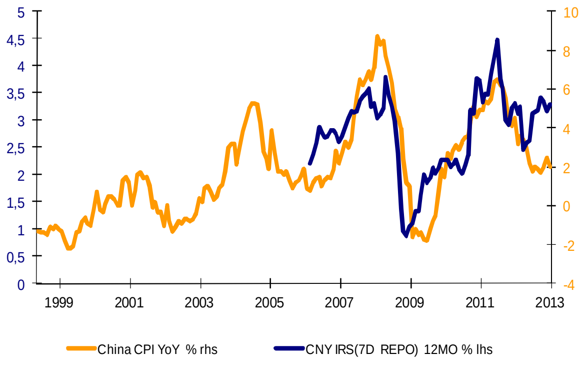
China & Japan Remain In The Spotlight

- In China, the picture appeared mixed. Particularly important is the improvement in the services sector, as the planned transition from an export to a consumer model implies a boom in services and particularly employment in the sector, so that the added value generated through labour income can support a higher level of consumption. In this framework, the rise of the PMI services to 54 (from 51.7) is encouraging. According to recent figures from the Ministry of Labour the percentage of workers in services totalled 35.7% in 2011, higher than the figures for both the agricultural and manufacturing sectors for the first time. It is also interesting that, according to the IMF, this figure is lower than that of Japan in 1955. in addition to these announcements, the increase in the annual rate of monetary expansion M2 to 15.9% from 13.8% was encouraging. The adjustment of the external sector is taking place very gradually; the trade surplus declined to $29bil from $31.6 billion, but still stands close to the all-time high ($39bil 31/12/2008).

- On the negative side, the slowdown of growth in manufacturing was worrying as the PMI index (HSBC) fell unexpectedly to 50.5 from 52.3. In this context, the central bank's effort to curb the overheating property market could lead to a further slowdown, as the Central Bank of China is absorbing liquidity from the market. (During the week 17-22 February, it absorbed 910 billion yuan ($146bil) the most since 2008, according to Bloomberg). This trend if continued could be an important counterweight to economic recovery. The reduction in inflation in consumer prices (to 2% from 2.5%) is expected to counterbalance the real estate markets effect cancelling out any monetary tightening trends (first chart).

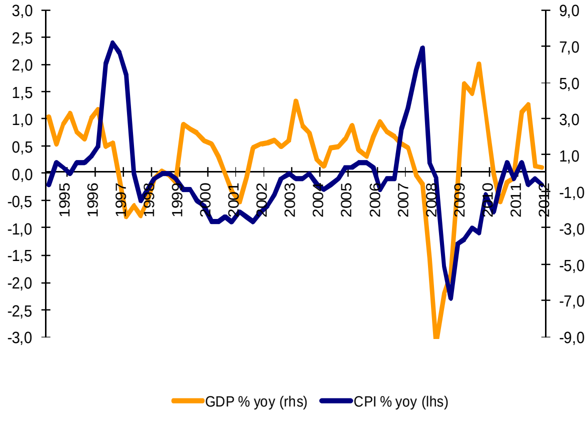
- Japan remains a focal point due to the government's effort to lead the economy out of the current deflationary spiral using expansionary fiscal and especially monetary policy. At this stage, the economic data remain negative. GDP contracted by 0.4% annualized in the fourth quarter of 2012 (annual real growth of 0.3%), while the GDP deflator fell by -0.6% per year and consumer prices by -0.1%. In addition, industrial production and machine orders appeared negative and there was a significant further expansion of Japan's trade deficit to 567bil yen mainly due to rising energy imports.

China: Inflation & Interest Rate



Source: Bloomberg, Piraeus Bank Research

Japan: Growth & Inflation



Source: Bloomberg, Piraeus Bank Research

Global Markets: Possible Increase in Volatility

- At this stage, the positive investment climate that has prevailed since the beginning of the year is maintained. Equity markets remain mostly in positive territory, with the US and Japan outperforming: The S&P500 is (end of February) up by 6.3% and the Nikkei225 by 11.2%, while both European stocks and emerging markets remained broadly in neutral territory (Eurostoxxx50 -0.3%, MSCI EM -0.8%). Bond markets came under pressure and ten-year yields were higher, by 15 bps in Germany and 14 bps in the US. In the European periphery, Italian bond yields were 29 bps higher in the aftermath of the election, they were essentially unchanged in Spain, while they declined by 53 and 67 bps in Portugal and Greece respectively. The US dollar is 2.7% higher (in trade-weighted terms) with the EURUSD exchange rate slightly negative (-0.5%) and the USDJPY rate 7% higher. Most commodities came under pressure (CCI index -1%) apart from the price of oil (Brent 1.05%, Crude 1.08%). Significant declines were observed in market volatility. In the US equity markets, the VIX volatility index fell from 18% to 12% (having recently recovered to 14%) while the volatility in the currency markets was relatively unchanged, but remains low (3m implied volatility for the EURUSD at 8.6%) with the exception of the yen volatility, which has increased (3m to 12% from 8%).

- By observing the co-movements of macroeconomic data, corporate results, the announcements of the various officials and markets, we can draw the following conclusions:

  - International markets remain driven by the (positive) forces of the increased liquidity provided by major central banks (Fed, BoE, BoJ), the relatively positive economic and corporate data and the anticipation of implementations of specific policy actions that have been announced directly (further monetary and fiscal expansion in Japan), or indirectly (effective fiscal and banking union in the Eurozone).
  - Existing monetary easing policies support the positive momentum of risky securities but, in the US, we are probably entering a period where the probability of negative surprises has increased substantially, as made evident after the recent publication of the minutes of the 29-30 January Fed meeting, where markets perceived as negative the desire of many members for increased freedom in deciding future monetary policies. In addition to this, on the macroeconomic front, we could be entering a period where negative surprises are more likely than positive ones.
  - As far as Japan is concerned, we are probably at the beginning of an expansionary policy cycle (no measures having been implemented yet) and markets have already begun to anticipate positive results. We expect that markets will give the benefit of doubt to the new government in its effort to end the 13-year deflationary state, and this positive momentum is likely to continue.

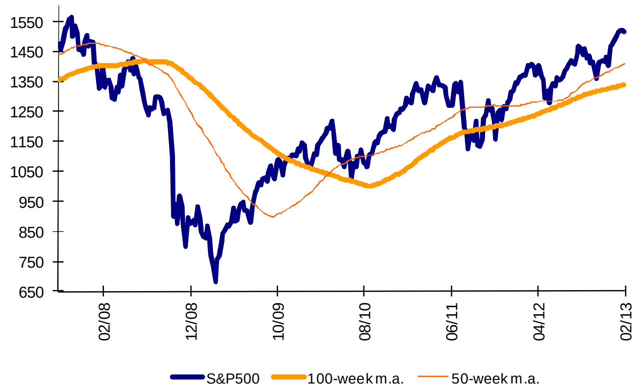
  - In the Eurozone we have seen a deterioration in the overall climate after the Italian elections and we could be exiting a rather long period of anticipation, as the significant improvements in market sentiment (due to a series of announcements but no substantive decisions) in combination with a prolonged European election period – with the September German vote at the epicentre – have given rise to policy inertia. As we have mentioned in the past, such inaction increases the likelihood of “accidents” and negative surprises. We could be entering a period where sociopolitical developments will underline the difficulties of deeper economic integration in Europe.
  - The final factor affecting markets is linked to developments in China where signs of economic acceleration remain tentative, especially in light of the resurgence of the authorities' efforts to cool the property market. Nevertheless, we continue to believe that the weight of probability is still tilted towards a positive surprise as the issue of the slowing Chinese economy and the overheated real estate market are long known and at current valuations, are probably discounted by markets.

Equity Markets

- For one more quarter (4th 2012), corporate profitability announcements have surprised positively in the US. After 444 of the S&P500 companies have announced results, 75% of them have surprised positively with respect to profits (by an average of 5.4%), while 64% have surprised positively with respect to sales (by an average of 0.58%). Overall, since the end of 2011, earnings per share have grown by 10.6%. Despite this positive development, valuations are less supportive as the P/E ratio has increased to 15 from 14.4 (end of 2012). Apart from this valuation measure, equities look less cheap lately as the rise of US treasury yields in conjunction with stable corporate spreads, result in increases in funding costs affecting our estimated fair values in a negative way. In addition to this, declines in money velocity (M2/Nominal GDP) to 1.54 from 1.57 in the 3rd quarter of 2012 have a negative effect. Overall, these forces have had a negative effect on US equity valuations, rendering them marginally expensive (from marginally cheap lately). Moreover, possible negative surprises from the manufacturing sector and a slowing down of profitability towards the mean of our expected range of 7% should add to a more negative environment for equities. Therefore, we shift our fundamental/quantitative view on US equities from positive to neutral with a small negative predisposition. The technical picture remains positive. Overall we maintain a neutral view (with now only a marginal positive predisposition).

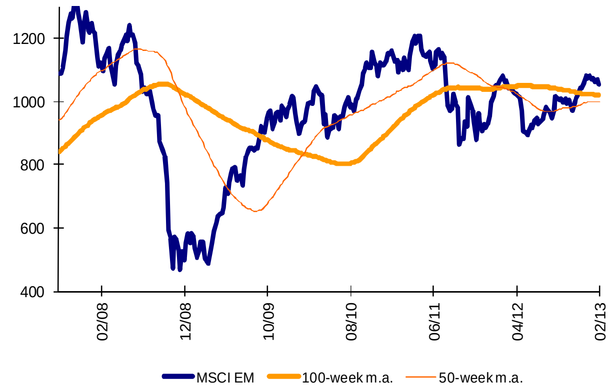
- In emerging markets after recent developments, the picture remains mixed. Despite recent worries about the real estate market in China and the probability of monetary policy tightening, the declining trend in Chinese inflation to 2% from 6% in 2011 is historically a very positive factor for emerging market equities. In addition to this, the P/E ratio of 12.7 renders them marginally cheap. On the other hand, we note a deterioration in the cyclical indications of the Russian and Indian economies, where the sudden deceleration in industrial production has led to a deterioration in the overall industrial production-inflation relationship. Profitability trends not only remain negative (-5% on a yearly basis) but in basic markets such as China and India we note a significant (double digit) negative surprise in the current corporate profitability announcements period. Overall these factors add up to a neutral fundamental-quantitative stance with a positive predisposition (from a positive one) with the technical picture also deteriorating to marginally positive from positive.

S&P500



Source: Bloomberg, Piraeus Bank Research

MSCI Emerging Market Index



Source: Bloomberg, Piraeus Bank Research

Bond Market

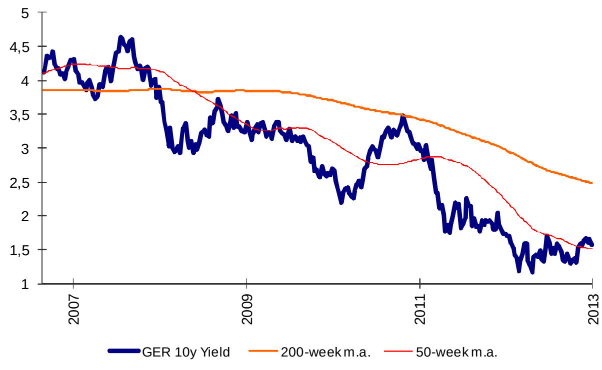
- Bonds have been under pressure since the beginning of the year, due to the better investment climate, more positive economic data releases and restrictive signals from the central banks. The ECB appears less intent on lowering policy interest rates, while the discussion on the consequences of the withdrawal from current excessive easing policies from the Fed has begun. Still we maintain that the Fed has not substantially changed its stance. On the other hand, during the last BoE conference, the president and two other MPC members supported the extension of the easing programme. Likewise, the BoJ has decided to drastically extend its easing programme, but it has not yet started applying this. The BoJ actions in particular will affect international bond markets. The direct purchase of foreign currency bonds would be positive mainly for US Treasuries. In the absence of this, the ongoing JPY depreciation would push up German Bunds, as Japan would be more competitive than Europe in the global car market, leading to another drag on the European growth path. The final effect on US Treasuries is more uncertain, as the US trade deficit makes US Treasuries more vulnerable to the increase in the Japanese, and consequently the global, inflation rate.

- Despite the negative trend in the bond market since the beginning of the year, the general picture for German Bunds has improved considerably, due to the higher political risk in the aftermanth of the Italian elections. As a result, the yield of German Bunds fell by 20 bps during the last month. Moreover, economic data releases were mostly negative. Apart from the increase in the IFO indicator, the reduction in the inflation rate, the increase in the unemployment rate and the deceleration in the M2 money supply growth rate, combined with the higher volatility plausibly justify the fall in the yield. Simultaneously, the yield of the US 10Y Treasury fell by 10 bps, due to the higher volatility, lower payroll increases, and the deceleration in the (M2 compared to M1) money supply growth rate, which reasonably justify the fall in the yield.

10-ετεις Αποδόσεις Ομολόγων ΗΠΑ

Source: Bloomberg, Piraeus Bank Research

10-ετεις Αποδόσεις Γερμανικών Ομολόγων



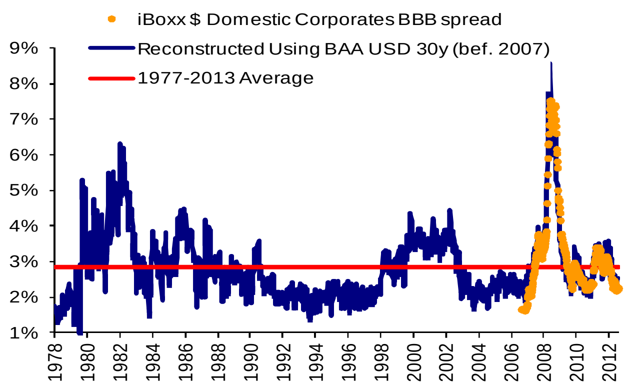
Source: Bloomberg, Piraeus Bank Research

- The UK Gilt yield declined, despite the downgrade (to Aa1 from AAA) by Moody's. This is similar to what happened to the US Treasury yield after the downgrade by S&P (Aug 2011). During a period characterised by very low growth rates, the increased possibility of austerity policy implementation is given more weight than the increase in the default probability reflected by a downgrade action. It needs to be noted that this kind of reaction is valid only in the large developed economies, which present low initial probabilities of default.

- The picture in bond markets remains negative according to both fundamental and technical indicators. However, both have improved since last month. Specifically, the technical picture for the German Bund has become neutral (with negative predisposition) from very negative. Additional worries about the political prospects in for Eurozone country members would make it positive.

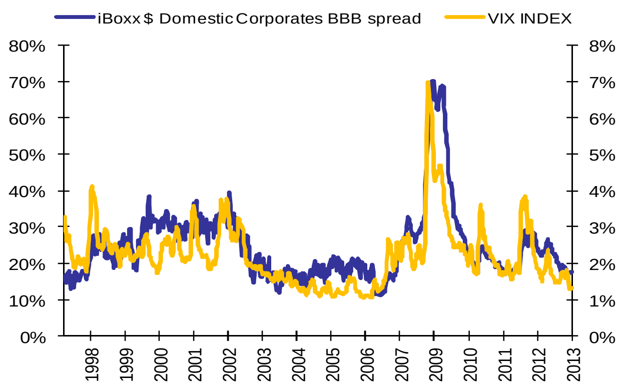
- Our view of corporate bonds is neutral (with marginally negative predisposition compared to sovereign bonds), as their (BBB$) spreads are marginally lower than their long-term average levels. Moreover, they are also lower than their fair values according to the fundamental evaluation, using corporate profitability, S&P500 implied volatility and the US Treasury yield curve slope (10Y minus 2Y).

BBB $ Spreads



Source: Bloomberg, Piraeus Bank Research

BBB Spreads & **Μετοχική Μεταβλητότητα**



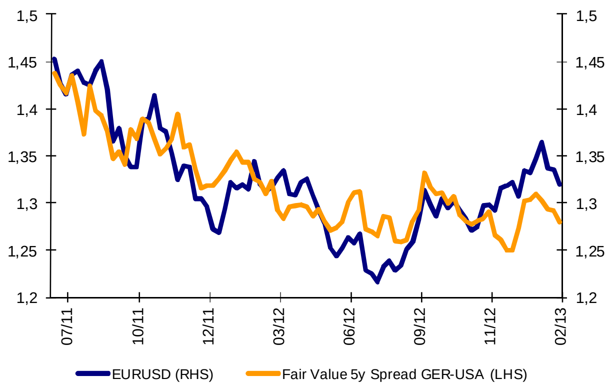
Source: Bloomberg, Piraeus Bank Research

FOREX

- The EURUSD rate started 2013 on a strongly positive trajectory, climbing up to 1.37, due to the promising Draghi's speech (in 2012) the change in the stance of Germany and the ECB's relatively strict rhetoric. As we have mentioned, those high levels can be justified by the Eurozone trade surplus, which has climbed to a record high level, the substantial fall in the periphery's spreads and the high gold price. However, the gold price has started to decline, as markets worry about the Fed's exit strategy from easing, leading to a USD appreciation. Additionally, the Italian spreads have started to climb again, as the results of the Italian elections led to greater uncertainty, concerning Eurozone integration prospects, possibly ending the recent "truce" between Eurozone officials and markets.

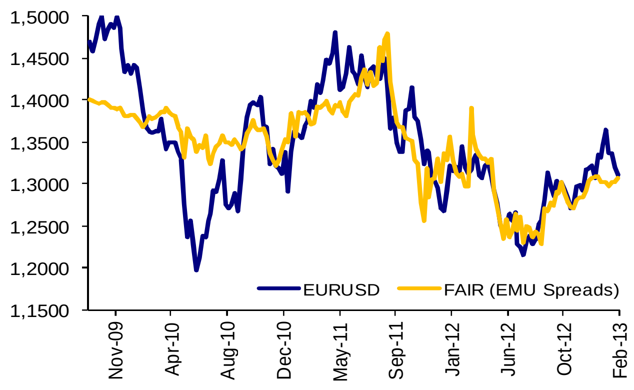
- Currently, the EURUSD cross stands at 1.31, which is consistent with the fair value associated with the higher periphery's spreads. However, it is higher than the one implied by the difference between US and Eurozone cyclical dynamics, as reflected by the difference in (Bund and Treasury) yields, money supply growth rates, leading business indicators and other interest rate differences. At this stage, both the fundamental and the technical picture remain neutral (with negative predisposition). We maintain our 12-month target of 1.26. For the next 1 – 2 months we expect variation within the 1.2880 – 1.3420 band, and for the next 6 months within the 1.2450 – 1.3510 band.

EURUSD, 5-year German-US Yield Spread



Source: Bloomberg, Piraeus Bank Research

EURUSD & Eurozone Spreads

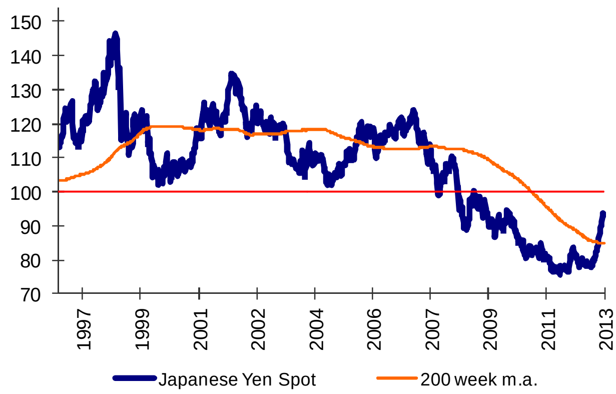


Source: Bloomberg, Piraeus Bank Research

- Although the JPY remained under pressure, heightened political uncertainty in Italy fomented demand for safe havens, leading the USDJPY exchange rate to fall to 91 from 95. We believe that this move was purely a by-product of "inertia", as the JPY has started losing its safe haven status, due to Japan's trade deficit and extremely high debt to GDP ratio (230%) and as the international economic community seems to support the intention of Abe's government to create inflation, despite the JPY depreciation. Moreover, the new BoJ's Chairman Kuroda seems to agree with the government's plan for additional easing. The USDJPY exchange rate shows a high degree of volatility as it is primarily affected by future inflation expectations and not real data. Its ascending trend is expected to continue, maybe up to 100. In the long run, worries persist, as a) it is highly uncertain that the BoJ will achieve the new 2% inflation rate target, given that it has not achieved the previous 1% mark, b) the possible restart of operations of the nuclear power stations would lead to lower imports and consequently lower USD demand and c) in an environment characterized by weak growth, sudden JPY depreciation would lead to a steep production cost increase, especially in a country lacking energy and raw material reserves. Therefore, the final result of such a sudden depreciation could prove to be negative. We slightly modify our 12-month target from 88 to 89.

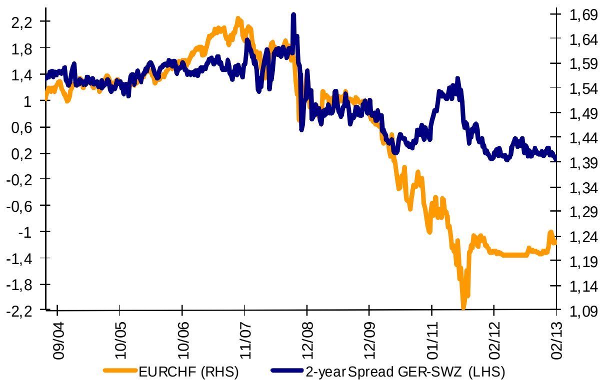
- The EURCHF exchange rate has risen by 1% since the beginning of the year (to the 1.22 area) after testing 1.26 in parallel with the 1.38 EURUSD exchange rate. The EURCHF exchange rate is very sensitive to fluctuations in the intra–Eurozone spreads, which combined with the political uncertainty in Italy generate pressures towards 1.21. According to our models, the stabilization of the EURCHF exchange rate at the recent high level of 1.26 needs much lower periphery's spreads than are currently observed. For example, the spread between the ten-year Italian sovereign bond and ten-year German Bund must be lower than 200 bps, instead of the current level of 340 bps (after the results of the Italian elections). Moreover, the SNB's Chairman places emphasis on the overvalued CHF and rules out the abolition of the 1.20 lowest limit. Economic data releases post a mixed picture, as the leading manufacturing PMI indicator and the trade surplus surprised positively, while the leading KOF indicator fell, unemployment rate increased and inflation rate remained negative (-0.3%).

USDJPY



Source: Bloomberg, Piraeus Bank Research

EURCHF & 2-year German-Swiss Yield Spread



Source: Bloomberg, Piraeus Bank Research

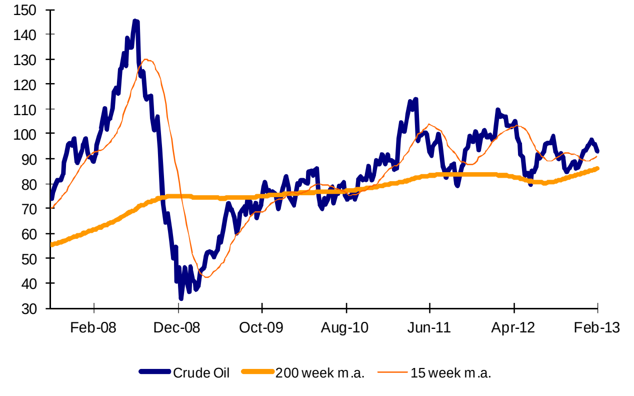
Commodities

- The general commodities picture remains negative (at the moment), as the sense is that we have entered the last stage of the Fed's easing procedure (leading to USD appreciation), which combined with the uncertain growth prospects of China's economy exert pressures on prices. The factor associated with China's economy has become less supportive than in the past. In the short term, China's officials are trying to cool the real estate market, resulting in absorption of market liquidity. In the long run, the desired transition from exports and manufacturing to consumption and services could result in a considerable reduction in the demand for cyclical commodities and raw materials. As the Chinese stock market (h-shares) rallied by 31% during September 2012 - February 2013, commodities came under slight pressure (1% in the CCI Index). It must be mentioned that this relation was strongly positive in the past. Consequently, it is quite possible that we are experiencing the first results of the turnaround in China's economy.

- Since the beginning of the year, most of the cyclical commodities posted negative or marginally positive returns. For example, crude oil rose by 1.1%, gold -4%, aluminium -2% and copper -1%. On the other hand, metals like palladium and platinum posted positive returns (4% and 5%), as the JPY depreciation will probably lead to an increase in the demand for Japanese cars, in the manufacture of which these metals are used. Simultaneously, agricultural commodities posted a significant fall of 6%.

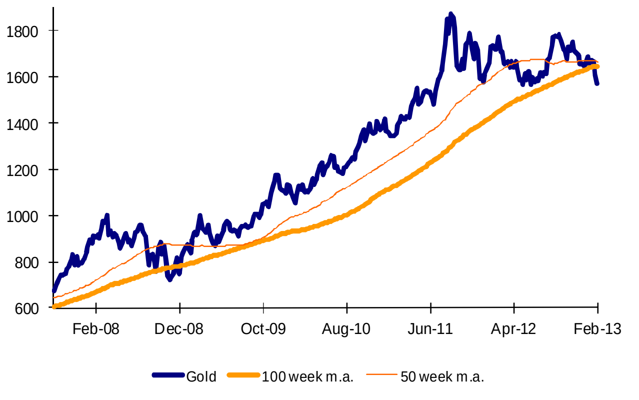
- The aforementioned reasons negatively affect the oil price, which is deviating from its upward trend. Another important reason is the high oil inventories and the highest (since 1992) oil production in the US that have lead to a decline in the supply – demand outlook. Overall, the general picture for the oil price has turned to negative, as the fundamental view is clearly negative (from neutral with negative predisposition), while the technical view is neutral (with negative from positive predisposition). The worries about the possible end to the Fed's easing policies and a possible re-ignition of the Eurozone crisis (which will lead to an increase in demand for the USD) exert downward pressures on the gold price, which remains overvalued according to our fair value estimations, but to lesser extent than in the past. On the other hand, the technical picture has changed from positive to neutral, but with marginally positive predisposition. The general picture is neutral with negative (from neutral) predisposition.

Crude Oil



Source: Bloomberg, Piraeus Bank Research

Gold



Source: Bloomberg, Piraeus Bank Research

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