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Weekly Report

China - sustainable growth ?

Recent Chinese data have relieved market participants after troubling developments in Europe had rekindled a double-dip scenario. Yet 1Q GDP growth of 11.9 % should sensibly cool down over the remaining year and inflation pressures may endure - both parameters could show stronger dynamics than the consensus actually anticipates. Sturdy export data with no sign of slowdown to Europe (representing 20 % of total exports) seem to have pleased investors particularly. Yet Europe may only start to impact the statistics over coming months. Additionally, the widely held view that the Yuan would appreciate led to anticipated purchases by overseas buyers. Importantly, all major commodity imports, except for crude oil, declined in volume terms and preliminary products seems also on a weakening trend. More difficult y-y comparisons and slowing fixed asset investments should furthermore result in slower growth. Rising salary increases could impact competitiveness, even more so should the Yuan be allowed to strengthen. While labor costs represent only about 5 % of the retail price of China's main exports, some negotiated labor contracts have been particularly steep. Recent strikes will likely have a signaling effect across industrial sectors placing pressures on firms to raise prices on their final product. Otherwise their margins had to shrink. Wages, rents and medical costs may now pressure core inflation, which is more resilient than commodity-induced inflation effects. The highly government-orchestrated growth dynamics, which have created a real estate bubble by excessive loan concessions, will therefore sensibly slow down.

Foreign Exchange

The publication of the very robust export figures triggered renewed discussions about a possible Yuan appreciation. Particularly in the US, the artificially low value of the Chinese currency is perceived as unfair. Increasingly, also European voices raise the issue. ECB member Lorenzo Bini Smaghi stated that China's foreign strategy was harming growth in industrialized economies as it was slowing down the adjustment of relative competitiveness. Indeed, many European countries struggle remaining competitive and they cannot use their currency as a tool. Booming Chinese economic growth, stemming partially from strong export growth, which is manipulated by a cheap currency, seems simply no longer just. International anger, particularly from Western countries, fail to impress Chinese leaders, which are unwilling to succumb to foreign requests. Additionally, there are signs that export growth may sensibly slow down. Nevertheless, we would expect China to increase the flexibility of the Yuan as inflation pressures may mount. Such a step must, however, be initiated by China.

	Short-term trend	Last
EURUSD	↓	1.2278
USDCHF	↑	1.1378
USDJPY	→	91.805
GBPUSD	→	1.4772

Fixed Income

Market participants interpreted various auctions, particularly those by Spain and Italy, as quite successful, despite light bid-to-cover ratios and sensibly higher yields. One disquieting fact is, however, that the involvement of the ECB is unknown, particularly after its president Trichet emphasized last week how important it was to intervene in markets, which was particularly true for money markets, but also sovereign debts. Italy, which shows the 2nd largest debt quote after Greece, faces a substantial rollover risk with issues in the order of EUR 241 billion expected only this year. The announced austerity measures perfectly reflect the "Italian way": politicians talk about enormous sacrifices, but measures only target some reductions in expenditures and additional chasing of some tax evaders. Serious doubts about their seriousness for debt reductions seem appropriate. Recent news from Spain are equally startling. BBVA commented that debt markets are shut to most companies in Spain and press reports highlighted dried up interbank lending to Spanish banks. This might better reflect investor behavior than obscure auctions.

	Forecast end 10	Last
US 10y T %	4.80	3.29
Fed funds	1.50	0-0.25
Bund 10y %	3.70	2.61
ECB rates	1.00	1.00

Stocks

The Semiconductor Industry Association anticipates that global microchips sales will increase 28 % in 2010, boosted by demand from China, India and other emerging markets. The forecast is markedly more optimistic than the 10 % growth expectation published last November. Healthy demand in all major product sectors and in all geographic markets have been driving semiconductor sales to record levels in the beginning of 2010, the association stated. Only recently, research organization Gartner also raised their projections for global chip sales to 27 % in 2010 from 20 % estimated in February. As semiconductors are perceived being economic-sensitive, market participants recently have reduced their estimates and some exposure to this sector as a consequence. We still believe that information technology will benefit from increased business investment spending this year and therefore consider the current attractive prices in the sector as a buying opportunity. Intel (INTC) is our favored name on technology and manufacturing leadership. In the semiconductor equipment space we prefer Applied Materials (AMAT).

	Forecast end 10	Last
S&P 500	1200	1103
NASDAQ	2400	2272
DJ STOXX 600	250	253
SMI	6700	6472