AFME and ICMA Joint Members’ Briefing Call – Outlook for Europe

04 March 2013

Simon Lewis, Chief Executive, AFME
Martin Scheck, Chief Executive, ICMA
Dr Thomas Mayer, Chief Economist, Deutsche Bank
Steven Major, Global Head of Fixed Income Research, HSBC
Agenda

- Martin Scheck, Chief Executive, ICMA
- Simon Lewis, Chief Executive, AFME
- Dr Thomas Mayer, Deutsche Bank
- Steven Major, HSBC
- Q&A
After the Yield Grab
Central bank liquidity dominates

**Steven Major**, Global Head of Fixed Income Research, HSBC
Eurozone fiscal responsibility and ECB liquidity

- Zero-bound rates & large ECB balance sheet
  - There is a de facto tightening from LTRO pay-backs
  - ECB hawks pushing for an exit from crisis mode
  - But weaker economies need ECB to stay loose

- Lack of growth means deficit targets missed
  - European Commission to highlight progress
  - Extra time likely, more detailed forecasts in May
  - France cut structural deficit by 2.5% to 2.0%
Developed world growth remains sluggish:

<table>
<thead>
<tr>
<th>Forcasts for:</th>
<th>GDP</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>%Year</td>
<td>2013</td>
<td>2014</td>
</tr>
<tr>
<td>World</td>
<td>2.2 f</td>
<td>2.8 f</td>
</tr>
<tr>
<td>Developed</td>
<td>1.0 f</td>
<td>1.6 f</td>
</tr>
<tr>
<td>Emerging</td>
<td>5.4 f</td>
<td>5.7 f</td>
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<tr>
<td>US</td>
<td>1.7 f</td>
<td>2.5 f</td>
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<tr>
<td>UK</td>
<td>1.1 f</td>
<td>2.0 f</td>
</tr>
<tr>
<td>Eurozone</td>
<td>-0.2 f</td>
<td>1.0 f</td>
</tr>
<tr>
<td>Japan</td>
<td>0.9 f</td>
<td>0.2 f</td>
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<tr>
<td>Brazil</td>
<td>3.0 f</td>
<td>3.8 f</td>
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<tr>
<td>Russia</td>
<td>2.5 f</td>
<td>2.0 f</td>
</tr>
<tr>
<td>India*</td>
<td>5.7 f</td>
<td>7.2 f</td>
</tr>
<tr>
<td>China</td>
<td>8.6 f</td>
<td>8.4 f</td>
</tr>
</tbody>
</table>

*Note: * = Based upon Indian fiscal year  
Source: HSBC Economics estimates
Negative real yields – Japan joining in

Real swap rate = Nominal swap rate – Inflation swap rate

Source: HSBC, Bloomberg
Eurozone funding rates provide stability

Source: HSBC
Currency basis normalisation, a win for central banks

Source: HSBC, Bloomberg, Federal Reserve

In basis swaps the denominator currency is held flat at zero. When the spread is negative the said currency is viewed as ‘riskier’.
Spread curve shows 10yr Bonos treading water

Source: HSBC, Bloomberg
ECB OMT means a steeper curve for Spain

Source: HSBC, Bloomberg
More modest return expectations for 2013

• Growth still too weak in the developed world so...
• Central bank balance sheet deployment now key
  • Competitive stimulation not devaluation
• Benefits of this policy probably outweigh the risks
  • So early exit is not an option
• Q1 upward pressures on yields not unusual
Question and answer

James White, Communications Manager, AFME