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UBS daily guide Europe

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No "all clear" for southern Europe

In their latest "**European sovereign debt update**", my colleagues Daniel Kalt, Thomas Flury and Thomas Wacker remain pessimistic about south European sovereign bonds. Their conclusion: hands off Greece, maximum caution with Italy, Spain and Portugal. Conversely, Austria, Finland, Luxembourg and the Netherlands remain attractive. WMR expects a further slight recovery for the Eurozone, but this will not have the same effect everywhere. The weaker EUR is primarily a boost for exporters in the north of the continent, with the south benefiting less. And while interest rates will stay low for some time (which helps everybody on balance), the austerity programs are basically counterproductive for the economy. In other words, the gap between north and south Europe will continue to widen. This is a really dubious outlook for the Old World. At least, the low interest rates are a sign that hyperinflation is not lurking around the corner. Money in the banking system (or under the mattress) is not enough by itself to cause inflation – the money also has to be (1) spent (which would be great!) and (2) hit full capacity working (when suppliers would no longer be able to increase volume, but would be able to mark up prices). Instead, Europe is saving, spending less money on balance, which leaves spare capacity and no room for pressure on prices. And if that sounds Japanese to you, you're not so far wrong.

Thomas Kruemmel,
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Major Stock Indices	Spot	1D%	YTD%
SMI	5942.25	-0.54	-9.22
DAX	5816.20	-0.31	-2.37
DJ EURO STOXX 50	2507.83	-0.58	-15.42
FTSE 100	4823.53	-0.30	-10.89
DJIA	9686.48	-0.47	-7.11
S&P 500	1022.58	-0.47	-8.30
NASDAQ	2091.79	-0.46	-7.82
NIKKEI 225	9181.78	-0.92	-12.94

Commodities	Spot	1D%	YTD%	9-12 m
Gold (USD/oz)	1206.15	-0.17	9.18	1500.00
Oil (USD/bl)	71.41	-1.01	-13.47	90.00

Foreign Exchange	Actual	Forecast	
		3m	6m
EURCHF	1.33	1.30	1.30
USDCHF	1.06	1.08	1.04
GBPCHF	1.61	1.57	1.54
JPYCHF	1.21	1.14	1.04
EURUSD	1.25	1.20	1.25
EURGBP	0.83	0.83	0.84
GBPUSD	1.51	1.45	1.48

Interest Rates	Short rates (3m)		Bond yields (10y)	
	Current	Fcst 12m	Current	Fcst 12m
Switzerland	0.12	0.25	1.43	1.90
EMU	0.73	0.75	2.54	2.90
UK	0.73	0.75	3.32	3.90
USA	0.53	0.50	2.92	3.50
Japan	0.25	0.30	1.11	1.50

Source: UBS WMR, Bloomberg 06-Jul-10, 04:54 am CET

Past performance and forecasts provided is no indication of future performance. The market prices provided are closing prices on the respective principle stock exchange. The returns on investments in foreign currencies can increase or decrease as a result of currency fluctuations. This applies to all performance charts and tables in this publication.

Economic Indicators Expected Today

Time	Country	Indicator	Unit	Month / Quarter	Freq.	UBS	Cons.	Prev.
9:15	Switzerland	Consumer Price Index	% m/m	Jun	m	n.a.	-0.1	-0.1

Source: UBS WMR, Bloomberg
EMU refers to European Monetary Union

q/q=quarter on quarter / m/m=month on month / y/y=year on year / lev.=level / sa=seasonally adjusted

06-Jul-10, 04:54 am CET

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The debt crisis

European sovereign debt update

Full report
https://bw.gpwb.ubs.com/SBC_jct/app/SBC/6/ResearchNavigator/gzg/document.do?id=5002524

- We stick to our base case for a moderate recovery. Fiscal tightening should partly be counter-balanced by low interest rates and a weaker EUR. Consumer and business sentiment are key indicators to watch.

- FX: The EUR has found support versus the USD, GBP and JPY, which are similarly challenged by the costs of the financial crisis. Clearing euro short positions might drive the euro up quickly in the short term.

- Equities: Economic growth concerns and uncertainties regarding refinancing needs of European banks weighed on markets. We remain cautious on Eurozone banks and keep our preference for German equities within the Eurozone.

- Bonds: We maintain our Sell recommendation for the government bonds of Greece and the bonds issued or guaranteed by Spain, Portugal and Italy with maturities of more than two years.

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