

Economic Outlook Update



March 2008

- Recession in the US confirmed
- Robust monetary and budgetary stimuli must give the recovery shape
- Europe slows, with recession risks in the UK, Italy and Spain
- Emerging economies holding up reasonably

The dramatic start to the year was confirmed in recent weeks with an unabating stream of adverse economic news. The bad news is no longer confined to the US but applies increasingly to Europe and Asia. Following the significant losses in the first few weeks of January, equity-markets paused for breath. The leading indices have edged up again in recent weeks, pulling up bond rates in their wake. These are probably not signals that the worst is over but just temporary upticks in a downward trend. The high volatility and growing turbulence in the credit markets, where the spreads on corporate bonds widened still further, are clear symptoms of vulnerable financial markets.

Recession fever in the US ...

In recent weeks a range of US economic indicators slipped towards recession levels. Virtually all housing market indicators have been around this level

for some time, but recently the disquieting news also extended to the rest of the economy. Business confidence in the service sector and consumer confidence dropped to levels that had only been seen in previous periods of recession. In addition employment in January fell for the first time in nearly five years, while the number of hours worked had already tumbled sharply in the last few months of 2007. The latter in particular has proved to be a clear recession symptom in the past. The dominoes appear to be falling at an accelerating rate. The property market has now been undergoing a painful correction for the past two years, with no immediate end in sight. In addition, declining confidence and tighter credit terms have squeezed company spending in recent months, while household income growth has slowed sharply. Together with the marked decline in consumer confidence this does not augur well for household spending.

Recent macroeconomic indicators suggest that the US economy slipped into recession in January. In the past US recessions have always led to a good deal of turmoil in the financial markets, but the real impact has tended to vary. During the recession of the mid-1970s economic activity declined by 3.1%, whereas in 2001 it barely stagnated. The current situation probably most closely resembles the recession of the early 1990s (when GDP fell by 1.3% and the hits taken by the sharemarkets remained confined to around 20%). On that occasion too there was a sharp correction in the property market, earned income was under pressure and there were severe problems in the financial sector (the Savings and Loan crisis). The length and depth of the current slump may not be so bad. The US business community (with the exception of certain elements of the financial and real estate sector) is fundamentally in better shape than on the eve of previous recessions, so that a painful



correction from that quarter is not in prospect. In addition the monetary and budgetary authorities have stepped in fairly rapidly and heavily. The Fed has already cut its key interest rate by 225 basis points and is likely to make further cuts. Furthermore Congress granted approval with notable speed for a fiscal package designed to support growth. Each of the eight recessions since 1948 have been followed by a budgetary policy response, but only in 2001 was this implemented before the end of the recession (and then largely by chance). This time a start will be made by the summer on tax rebates for households totalling some 100 billion dollars or around 1% of disposable income on an annual basis. The budgetary measures will provide no more than a temporary stimulus but, combined with the monetary easing, could prove sufficient to get the economy going again in the second half of the year.

... contagious for the rest of the (industrialised) world

While the US economy slipped as expected into recession, the disappointing news over the past month has come primarily from Europe. Economic growth in the EMU halved in the last few months of 2007 and recent indicators provide little comfort for this year. In particular the German consumer, frightened off by

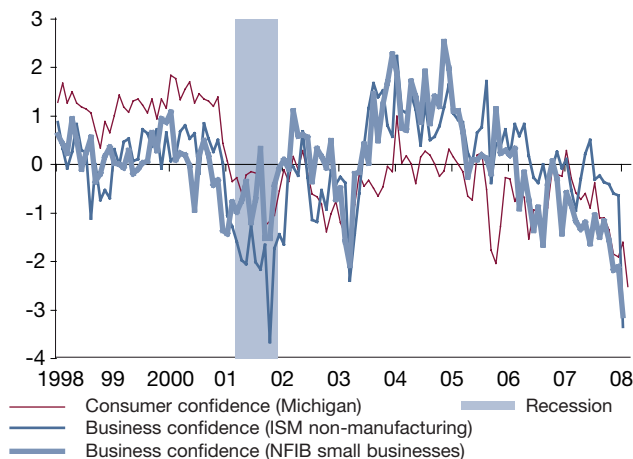
the rising inflation, is holding back. The dynamics of German consumption are at their weakest since the reunification of the country. Even so there would appear to be no immediate prospect of recession at eurozone level. That does not however apply to certain member states: the Italian economy is probably already in recession, while Spain is well on the way. In determining monetary policy the ECB is not really required to take account of divergent economic performance within the area. Nevertheless the signs are that the ECB will be unable to sustain its aggressive anti-inflation rhetoric for much longer and that it will have to concentrate more on the deteriorating growth outlook. The first interest-rate cut may be expected before summer.

The economic climate also changed fairly radically in the UK in recent months. Broadly in line with earlier developments in the US, the UK property market is also under pressure. In the past house prices have often been a crucial factor for household spending in the UK. The latest developments in this area suggest a spectacular slump in consumption. Although the rising inflation is a source of concern for the Bank of England, the deteriorating growth prospects will force it to continue down the path of interest-rate cuts.

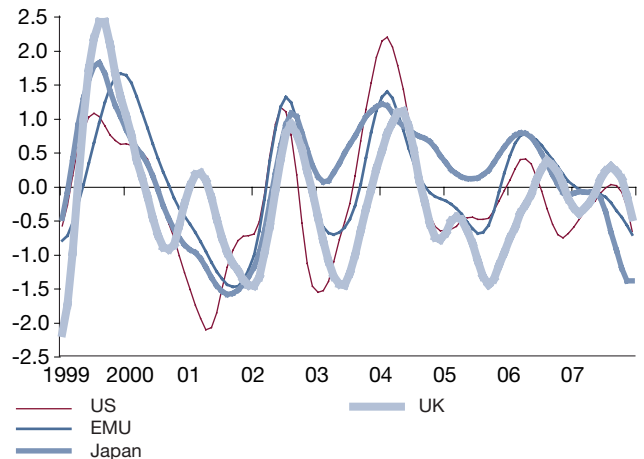
Finally the Japanese economy is also under pressure. While the last two months of 2007 saw a surprising growth surge, that trend is unlikely to be sustained. Most indicators suggest that a recession scenario is not to be ruled out in Japan either.

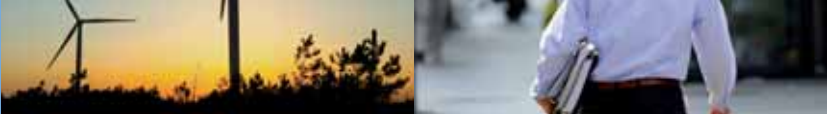
The problems in the western industrialised countries are in sharp contrast to the relative strength of the emerging economies. Most of these are at present in fundamentally better shape than in the past, while there are also specific positive factors in the individual regions concerned. In Central Europe most countries are benefiting from the convergence process with the EU, at both financial (lower interest rates) and real (foreign investment, favourable competitive position) level. In Asia many countries are feeding off the strength of the Chinese economy. While the emerging economies will not remain totally immune to developments in the US they will suffer significantly less than in the past.

US recession signals
(standard deviation from long-term average)

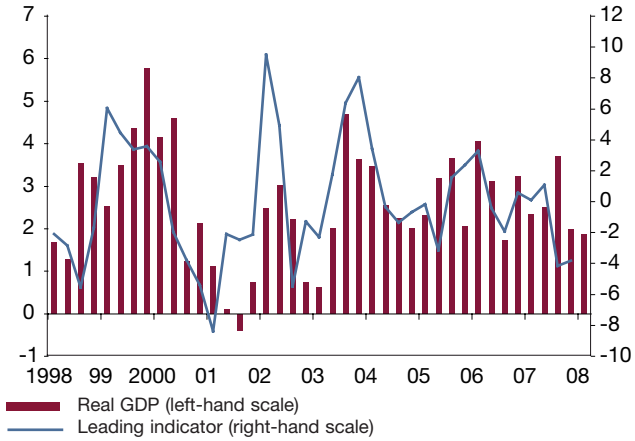


'Old' economies under pressure
(OECD leading indicator, six-months change, standard deviation from long-term average)

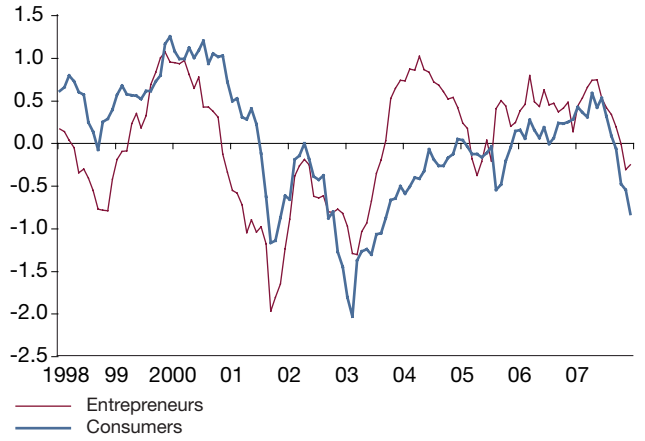




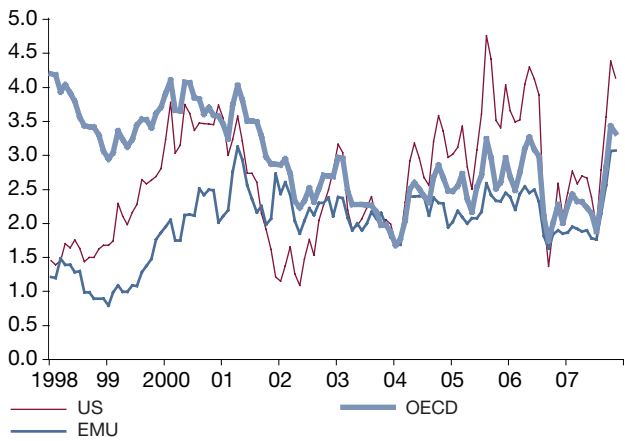
Economic activity in the OECD
(annualised quarterly change in %)



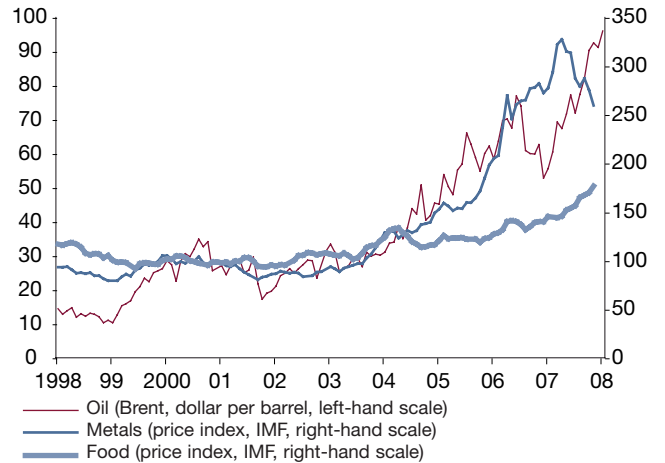
G4 confidence
(standard deviation from the long-term average)



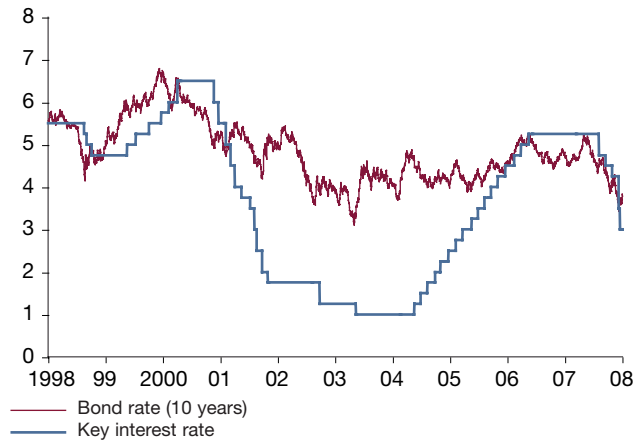
Inflation
(consumer price index, y-o-y change, in %)



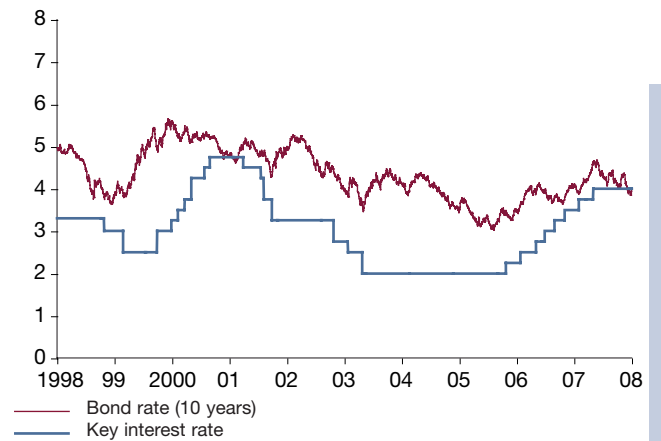
Commodity prices



Interest rate movements US



Interest rate movements EMU



Policy rate				
	18-02-08	+3m	+6m	+12m
US	3.00	2.25	2.00	2.00
EMU	4.00	3.75	3.25	3.00
UK	5.25	5.00	4.50	4.00
Denmark	4.25	4.25	4.25	3.25
Sweden	4.25	4.25	4.00	3.50
Norway	5.25	5.50	5.50	5.25
Switzerland	2.75	2.75	2.75	2.25
Poland	5.25	5.50	5.50	5.50
Czech Republic	3.75	3.75	3.75	3.75
Hungary	7.50	7.50	7.50	7.00
Slovakia	4.25	4.25	4.00	3.00
Roumania	7.50	8.50	9.00	9.00
Bulgaria	-	-	-	-
Russia	-	-	-	-
Turkey	15.25	15.25	15.25	14.50
Japan	0.50	0.50	0.50	0.50
China	7.47	7.74	7.92	8.19
Australia	7.00	7.25	7.25	7.25
New Zealand	8.25	8.25	8.25	7.75
Canada	4.00	3.50	3.25	3.00

10-year rate				
	18-02-08	+3m	+6m	+12m
US	3.77	3.65	3.75	3.85
EMU	3.99	3.85	3.75	3.80
UK	4.63	4.35	4.25	4.00
Denmark	4.11	3.95	3.85	3.90
Sweden	4.09	4.00	3.90	3.95
Norway	4.42	4.40	4.40	4.30
Switzerland	2.87	2.70	2.60	2.50
Poland	5.94	5.80	5.65	5.70
Czech Republic	4.46	4.20	4.10	4.10
Hungary	7.55	7.40	7.15	7.15
Slovakia	4.52	4.25	4.15	4.00
Roumania (5-year rate)	5.02	5.15	5.20	5.20
Bulgaria	-	-	-	-
Russia	6.41	6.37	6.22	6.13
Turkey (1-year rate)	16.96	17.10	16.80	16.50
Japan	1.46	1.35	1.25	1.30
China	4.27	4.34	4.43	4.51
Australia	6.38	6.25	6.30	5.90
New Zealand	6.42	6.20	6.20	5.90
Canada	3.82	3.80	3.90	3.90

Exchange rate				
	18-02-08	+3m	+6m	+12m
USD per EUR	1.46	1.43	1.42	1.40
GBP per EUR	0.75	0.75	0.75	0.75
DKK per EUR	7.46	7.46	7.46	7.46
SEK per EUR	9.29	9.30	9.30	9.20
NOK per EUR	7.90	7.70	7.70	7.70
CHF per EUR	1.61	1.61	1.61	1.60
PLN per EUR	3.58	3.58	3.54	3.54
CZK per EUR	25.26	25.25	25.25	25.00
HUF per EUR	262.85	260.20	257.70	254.96
SKK per EUR	33.02	32.70	32.70	32.50
RON per EUR	3.64	3.75	3.75	3.71
BGN per EUR	1.96	1.96	1.96	1.96
RUB per EUR	36.02	35.73	35.01	34.94
TRY per EUR	1.75	1.78	1.77	1.77
JPY per EUR	158.31	154.93	154.85	155.40
CNY per USD	7.25	7.15	7.05	6.80
USD per AUD	0.91	0.91	0.90	0.86
USD per NZD	0.79	0.78	0.78	0.73
CAD per USD	1.01	1.02	1.03	1.05

	Real GDP growth		Inflation	
	2007	2008	2007	2008
US	2.2	1.3	2.9	2.7
EMU	2.7	1.4	2.1	2.6
UK	3.1	1.8	2.3	2.5
Denmark	1.9	1.8	1.6	2.0
Sweden	3.4	3.1	1.8	2.3
Norway	5.4	3.4	0.7	2.5
Switzerland	2.7	2.1	0.6	1.5
Poland	6.4	5.3	2.5	4.0
Czech Republic	6.0	5.0	2.9	7.0
Hungary	1.5	2.5	8.0	5.6
Slovakia	9.0	7.2	2.8	3.6
Roumania	5.8	5.2	4.8	6.5
Bulgaria	6.0	5.9	8.4	6.6
Russia	7.5	6.7	9.0	11.5
Turkey	4.0	4.2	8.8	6.5
Japan	1.8	1.1	0.0	0.5
China	11.4	9.9	4.7	3.8
Australia	3.9	3.6	2.3	3.2
New Zealand	3.0	2.0	2.4	2.7
Canada	2.6	1.7	2.1	1.8

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