

Economic Outlook Update



August 2008

- US economy remains on track for a normal recession
- Increasing recession signals outside the US
- Emerging economies also not immune
- Weaker growth will eventually neutralise inflation risks

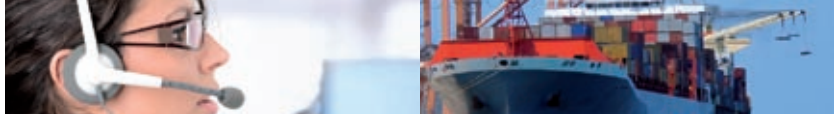
After the relief in April and May, when the financial markets responded as though the problems had all been solved, recent weeks have been a painful disillusionment. The macroeconomic figures suggested that the worst was by no means over. Recent indicators even show that the problems are increasingly manifesting themselves outside the US. The high oil prices are undermining household purchasing power almost everywhere, while various economies are grappling with major problems in the property market. More and more countries are confronted by serious recession risks. In addition the US faced a number of nasty surprises that have rekindled fears of financial systemic risk. Against this background the equity markets took some heavy blows and bond rates fell significantly.

Recession ripples spread in the US

Throughout the spectacular fluctuations in the financial markets and despite the ominous reports from the financial sector, the US economy remains more or less on course for a 'normal' recession. While the tax rebates provided the consumer with a fillip in May and June, now that these have all been distributed, the reality of high inflation, falling house prices, the difficult credit situation and rising unemployment are once again in the centre of attention. The next few quarters will therefore be extremely difficult for American households (consumption accounts for 70% of economic activity in the US). Other branches of the economy are also in a tight spot. In the housing market, where the problems began over two years ago, the bottom is still not in sight. The large stock of unsold houses

suggests that house prices could continue falling for some time yet. The other major pillar of the economy apart from the consumer – the corporate sector – is of course not immune to the recession. Although companies went into this difficult period in a relatively healthy financial position, they are nevertheless being forced to scale down their investment and recruitment plans.

Despite all the bad news, the present situation still has the appearances of a 'normal' (and even relatively mild) recession. On average such a recession lasts 10 months. If the recession began in January, this implies another three or so months of deteriorating macro-data. The US economy is likely to shrink in the third quarter, but some improvement will then gradually become discernible. The fair wind will need to come in particular from a stabilisation in construction activity



and a recovery in household purchasing power as inflation eases. But even if the recession comes to an end in the autumn, the US economy is likely to face weak growth for at least a year. It will take some time before the combination of the credit and housing market boom, that fuelled the previous economic upswing, can become a positive factor of any significance again. Eliminating the excesses in the credit and property markets could take years. The below-par level of economic activity will inevitably bring down the high level of inflation. Although inflation rose in June to 5%, that was almost exclusively attributable to food and energy prices. Once those markets stabilise somewhat, inflation could come down quite rapidly. At that point the central bank will even be able to contemplate interest rate cuts again.

Recession alarm reverberates outside the US

In the first few months of the year the euro zone held up notably well in the midst of all the economic turmoil. This underwent a striking change in recent months. The signs are that the European economy slowed sharply in the spring. The possibility cannot even be excluded that economic growth dipped into the red in the second quarter, which would be unprecedented. Leading indicators

paint a disquieting picture for household and company expenditures. In addition exports appear at last to be succumbing to the combination of a strong currency and a deteriorating external climate. The likelihood that the euro zone will go into recession for the first time this year has therefore increased appreciably. Even so the ECB increased interest rates once more in early July, a step primarily designed to influence the wage negotiations in the autumn. After a few years of handsome economic growth and given the high inflation, there is inevitably a risk that the negotiations will result in exaggerated pay rises. The ECB is determined at all cost to avoid the disastrous effect that this would have on inflation. If the pay talks in the autumn turn out better than expected and inflation comes down significantly as the price of oil eases, the ECB is likely to change tack entirely around the end of the year. Interest-rate cuts to support the economy will then be back on the agenda.

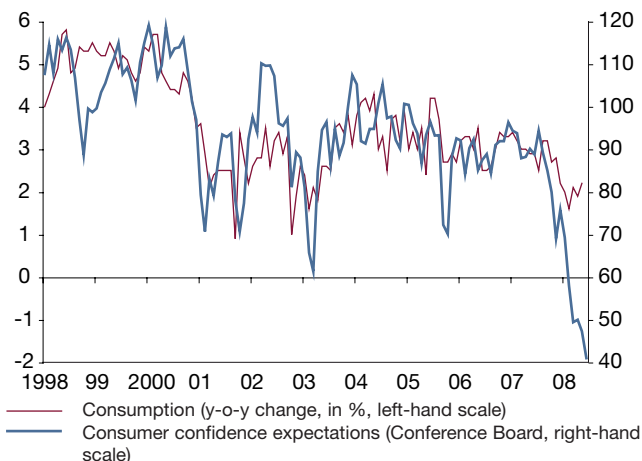
The UK and Japan are in even worse shape than the euro zone. Both economies are flirting with recession, with no improvement in prospect in the short term; in neither case is the central bank in a position to intervene. In the UK the rising inflation is blocking the badly needed interest-rate cuts, while in Japan the very low interest rates mean that the central

bank has hardly anything left in its locker.

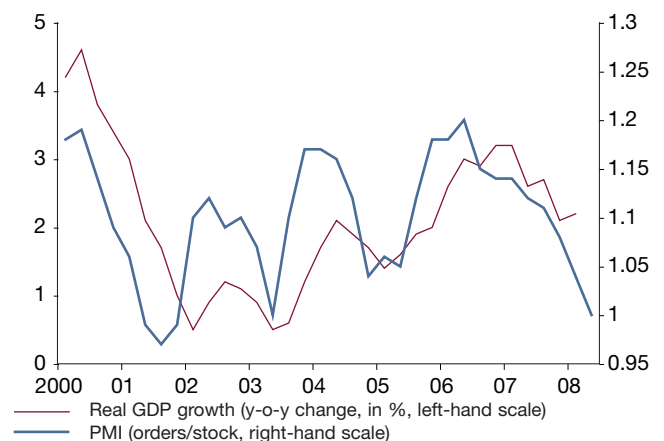
Emerging economies not immune

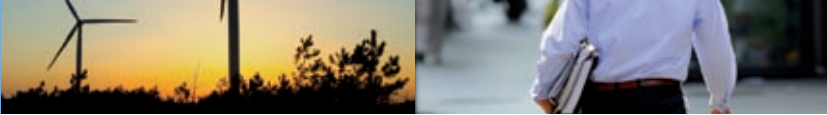
Rising energy and food prices are also driving up inflation sharply in emerging economies. Throughout the region governments accordingly took measures to curb economic growth and inflation. Further steps in this area are to be expected in the coming months. In addition a good many (mainly Asian) countries cut their energy subsidies appreciably. These subsidies protected households from higher oil prices but were no longer affordable. Such measures will depress the domestic economy in the coming quarters. Apart from that the slowdown in the western world is clearly beginning to cloud export prospects. As in the western world, the emerging region therefore also faces some difficult quarters. In contrast to previous downswing phases, however, the consequences could be moderate. The financial and economic fundamentals in many of the leading emerging economies are a good deal more solid than 10 years ago. The risk of a recessionary wave sweeping through the region accordingly looks very limited. Some (economically less orthodox) economies, such as Vietnam, could get into problems, but without any immediate risk of infecting the entire region.

US consumers in a tight spot

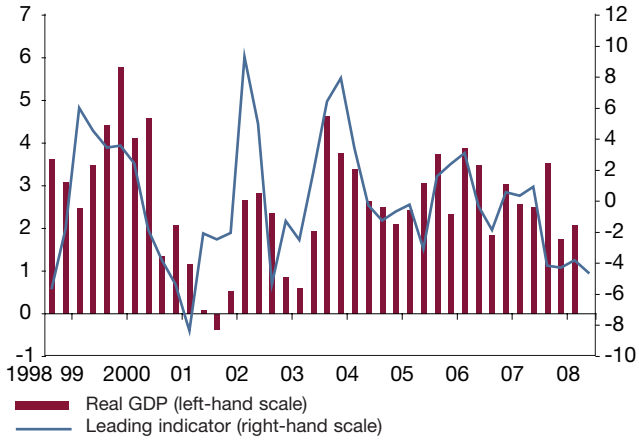


Euro area slowing down considerably

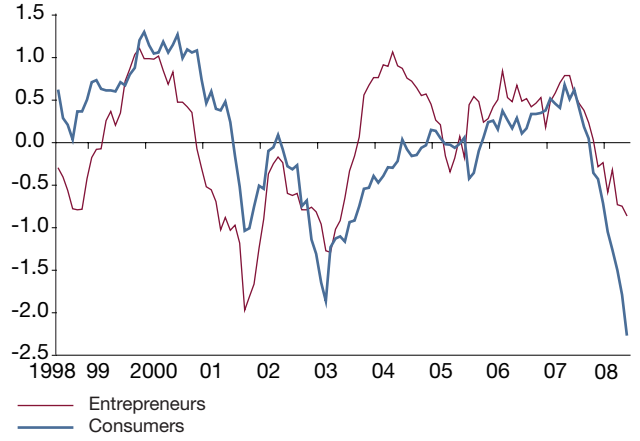




Economic activity in the OECD
(annualised quarterly change in %)

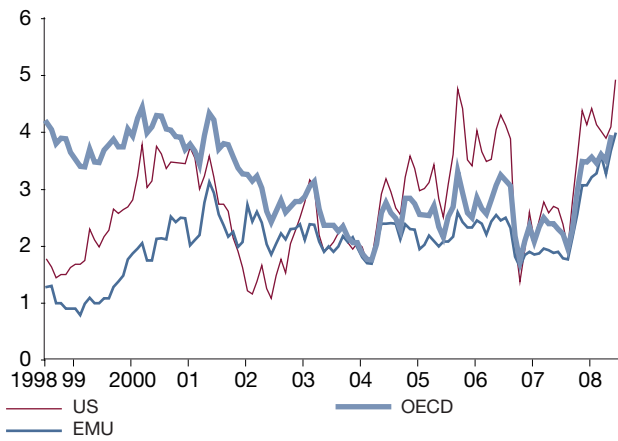


G4 confidence
(standard deviation from the long-term average)

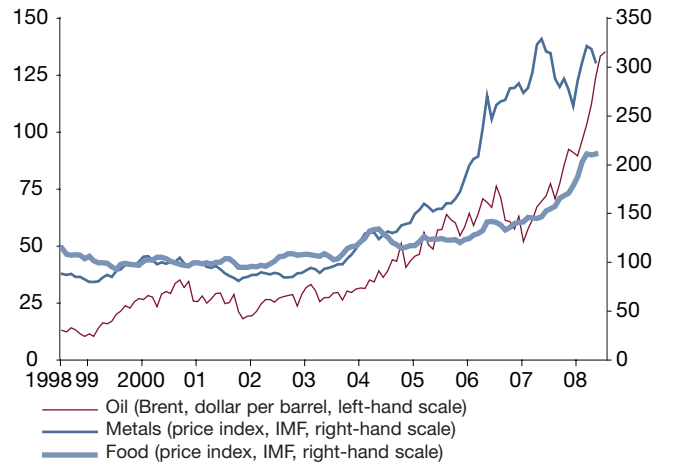


Inflation

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



Commodity prices



Interest rate movements US



Interest rate movements EMU



Policy rate				
	18-07-08	+3m	+6m	+12m
US	2.00	2.00	1.50	1.50
EMU	4.25	4.25	4.25	3.75
UK	5.00	5.00	4.50	4.00
Denmark	4.60	4.60	4.60	4.10
Sweden	4.50	4.50	4.50	4.00
Norway	5.75	5.75	6.00	5.75
Switzerland	2.75	3.00	3.00	2.50
Poland	6.00	6.25	6.25	6.25
Czech Republic	3.75	3.75	3.75	3.75
Hungary	8.50	8.50	8.50	7.75
Slovakia	4.25	4.25	4.25	3.75
Roumania	9.75	10.25	10.25	9.75
Bulgaria	-	-	-	-
Russia	-	-	-	-
Turkey	16.25	16.75	16.75	14.50
Japan	0.50	0.50	0.50	0.50
China	7.47	7.74	7.92	8.19
Australia	7.25	7.25	7.25	7.00
New Zealand	8.25	8.00	7.50	7.00
Canada	3.00	3.00	3.00	3.00

10-year rate				
	18-07-08	+3m	+6m	+12m
US	3.97	3.70	3.75	4.05
EMU	4.45	4.25	4.05	4.00
UK	4.90	4.50	4.20	4.05
Denmark	4.73	4.55	4.35	4.30
Sweden	4.28	4.20	4.00	4.05
Norway	4.88	4.85	4.75	4.70
Switzerland	3.11	2.90	2.70	2.65
Poland	6.37	6.05	5.65	5.50
Czech Republic	4.82	4.50	4.30	4.20
Hungary	7.87	7.50	7.05	6.85
Slovakia	5.02	4.70	4.40	4.20
Roumania (5-year rate)	5.01	5.15	5.15	5.10
Bulgaria	-	-	-	-
Russia	6.78	6.68	6.28	5.83
Turkey (1-year rate)	21.04	20.70	20.50	19.50
Japan	1.58	1.45	1.45	1.65
China	5.02	5.09	5.16	5.18
Australia	6.36	6.00	5.85	5.95
New Zealand	6.04	5.65	5.60	5.70
Canada	3.78	3.65	3.80	4.10

Exchange rate				
	18-07-08	+3m	+6m	+12m
USD per EUR	1.59	1.56	1.53	1.45
GBP per EUR	0.79	0.79	0.79	0.79
DKK per EUR	7.46	7.46	7.46	7.46
SEK per EUR	9.48	9.50	9.50	9.40
NOK per EUR	8.06	7.90	7.80	7.80
CHF per EUR	1.62	1.62	1.62	1.62
PLN per EUR	3.23	3.23	3.19	3.19
CZK per EUR	23.09	23.10	22.85	22.85
HUF per EUR	229.69	238.00	238.00	238.00
SKK per EUR	30.33	30.35	30.13	30.13
RON per EUR	3.56	3.67	3.63	3.60
BGN per EUR	1.96	1.96	1.96	1.96
RUB per EUR	36.86	36.31	35.79	34.92
TRY per EUR	1.90	1.86	1.85	1.83
JPY per EUR	168.33	163.33	163.24	159.50
CNY per USD	6.82	6.67	6.55	6.24
USD per AUD	0.97	0.97	0.96	0.88
USD per NZD	0.76	0.76	0.75	0.69
CAD per USD	1.00	1.00	1.02	1.05

	Real GDP growth		Inflation	
	2008	2009	2008	2009
US	1.3	0.9	4.4	1.9
EMU	1.3	1.1	3.5	2.1
UK	1.3	1.0	3.3	2.2
Denmark	1.5	1.3	3.1	2.4
Sweden	2.4	2.3	3.5	2.5
Norway	3.5	2.3	3.3	2.5
Switzerland	2.2	1.8	2.4	1.5
Poland	5.5	4.9	4.5	3.5
Czech Republic	5.0	4.6	7.0	3.2
Hungary	1.8	3.0	6.2	4.5
Slovakia	7.2	6.0	3.9	3.0
Roumania	6.0	5.0	7.5	4.5
Bulgaria	5.5	5.5	12.0	8.0
Russia	7.2	6.4	12.5	10.5
Turkey	3.5	4.6	10.2	6.5
Japan	2.0	1.6	1.3	0.5
China	9.8	9.0	6.3	4.0
Australia	2.8	2.9	3.2	2.7
New Zealand	2.0	2.5	2.7	2.6
Canada	0.4	0.0	2.4	2.1

Questions: KBC branch or KBC-Telecenter on 078 152 153 (weekdays from 8 a.m. to 10 p.m., Saturdays from 9 a.m. to 5 p.m.). E-mail: kbc.telecenter@kbc.be

Questions relating to the contents of this publication: Bart Van Craeynest (32) (0)2 429.59.91 bart.vanraeynest@kbc.be

Publisher:

Johan Van Gompel, Havenlaan 6, B-1080 Brussel

Address for correspondence & subscription management: KBC Asset Management NV, APC, Havenlaan 6, 1080 Brussel, E-mail: info.publicaties@kbc.be

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