

# Economic Outlook Update



May 2009

- First signs of improvement...
- ...point to the end of the recession in the autumn
- The effects of the current crisis will be felt nevertheless for a long time afterwards
- Threat of deflation continues to take precedence over inflationary risks

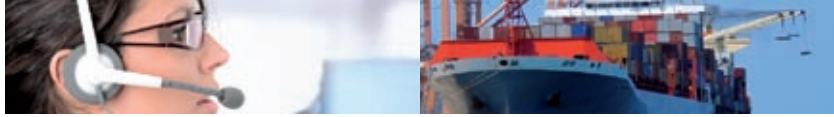
Spring is here, and with it the first signs of renewed optimism in the economic and financial world have appeared in recent weeks. Many leading indicators – primarily in the US, but also in countries such as China – have seen a reversal of the steep downward trend in the last few months. For instance, the US ISM indicator has improved slightly every month since the beginning of the year. The financial markets have also seen some signs of improvement. The US stock market indices rose by just under 30% between mid-March and mid-April. However, it would be premature to celebrate the end of the recession on the basis of today's positive signals. Despite the somewhat better data, virtually all indicators are still pointing towards a severe economic slump. Primarily, the slight improvement in the leading indicators means that the free fall affecting the global economy in the second half of 2008 has come to an end. An end to the recession depends on confirmation of this positive trend in the

months ahead. There will be no return to positive economic growth figures before the autumn at the earliest. And there are bucket-loads of bad economic news to come before then. There are still significant downside risks for the months to come, and further disappointments cannot be ruled out.

## Correction goes on

The current crisis began in the US, so the US economy is the furthest advanced in the downward phase of the cycle. And the most positive signals have come from the US in the last few weeks. There are, however, still many problems in store in the months to come. On the housing market, the stock of unsold houses is still close to historical highs. This will continue to depress the market, and hence house prices, for some time to come. In addition, the labour market is in the full throes of a correction. As many as two million jobs were lost in the first quarter,

and there is the prospect of a further three million job cuts in the months ahead. In turn, the difficult labour-market situation could prompt fresh difficulties in the housing market and financial sector due to people having difficulties in meeting mortgage payments. On top of this comes the recent collapse in the commercial property market. The economic reality of increasing bankruptcies and payment default could mean fresh problems in the financial sector. It does not look as if the US Treasury's current initiatives – including the stress test for banks – will be enough to help the entire sector recover quickly. In the meantime, households are under pressure because of the worsening labour-market situation, their rapidly diminishing wealth and still heavy debt burden. Against the backdrop of very modest income growth, the required efforts of households to bolster up their financial position again will depress consumer spending for some time yet.



There is still a long way to go, but there are signs that the worst of the correction may be over. An average house has never been so affordable for an American family as it is today, theoretically at least, which tends to suggest that the exaggerated price rises of the previous upturn have been corrected. In addition, households have already increased their savings rate from 0% a year ago to more than 4% of their income. The correction will continue for a while yet, but cannot go on indefinitely. Moreover, the raft of monetary and budgetary stimuli in the US, and in many other countries too, should start to have an impact in the next six months or so. The recent modest improvement in the leading indicators confirms that the economy could level off in the second half of the year, after a very weak first half. As a result, we may see the return to positive growth figures in the autumn, although any subsequent recovery will be very modest. The past has provided ample evidence that the effects of international economic crises that are combined with a financial crisis continue to be felt for a long time afterwards. It could be years before we see a return to normality. But every recovery starts with signs of a halt to the downturn, and the recent signs give grounds for hope in that respect at least.

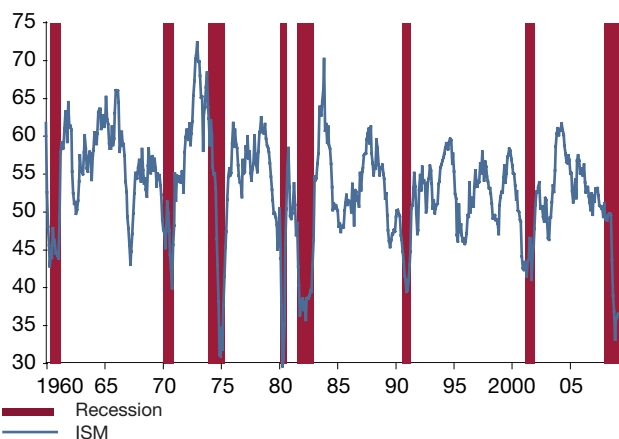
In the meantime, it has become abundantly clear that the European economy has suffered just as badly as the US. There has not been a property bubble in Germany, but the German economy's very high dependence on exports is having a negative impact on Europe. Although the European governments have already launched some rescue packages, they fall well short of the measures in the US. It looks as if Europe is waiting for an external recovery.

### Deflation threat prevails over inflationary risks

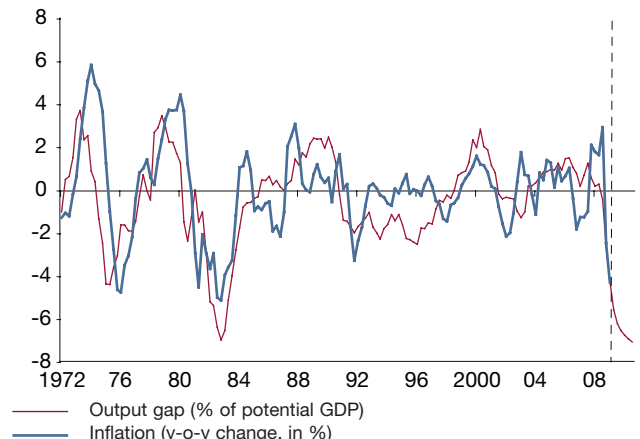
Inflation fell to -0.4% in the US in March, and slowed to 0.6% in the euro area (down from 5.4% in the US and 4.1% in the euro area at the beginning of last summer). The dramatic fall in inflation in recent months was mainly due to the fall in energy prices. Underlying economic activity will have an increasing impact in the months ahead. As a result of the downturn, all economies are running well below their normal capacity. In this climate, there is inevitably downward pressure on inflation. For instance, the problems on the labour market mean a sharp tail-off in wage growth. The combination of significant downward pressure on inflation, overly high debt in certain economies and the problems in the financial sector means there is a real threat of harmful deflation (as in the US in

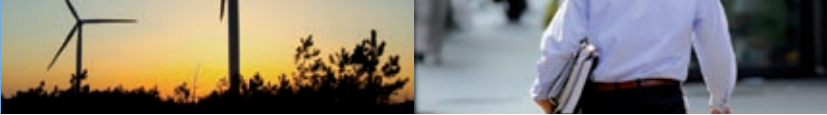
the thirties and Japan in the nineties). The recent actions by the monetary authorities have focused primarily on combating the threat of deflation. These actions will fuel inflation in the long run, but we will probably have to wait until there is a decent economic recovery before that happens. If the monetary authorities do not claw back the current stimuli in time once recovery begins, that could result in significant upside inflationary risks. The transition from the threat of deflation to upside inflationary risks will be a tricky balancing act for central banks, and one that is bound to go with hitches. Higher inflation within a few years is almost inevitable. However, deflation will remain the major threat in the next year or two.

ISM bottoms out

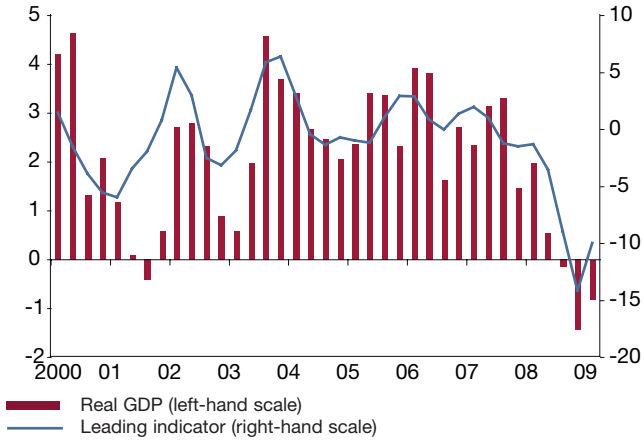


Economic downturn generates severe downward pressure on inflation (US)

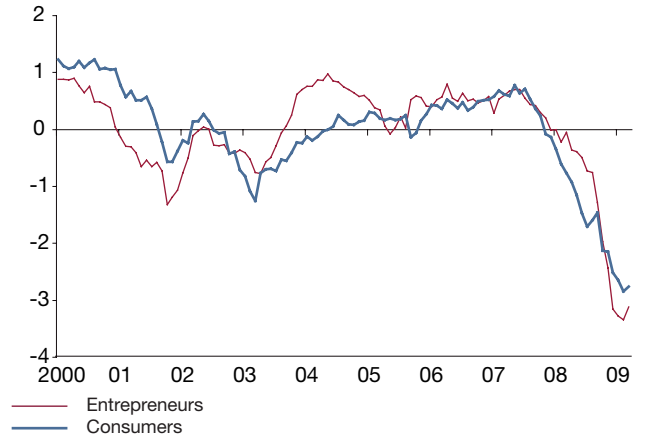




**Economic activity in the OECD**  
(annualised quarterly change in %)

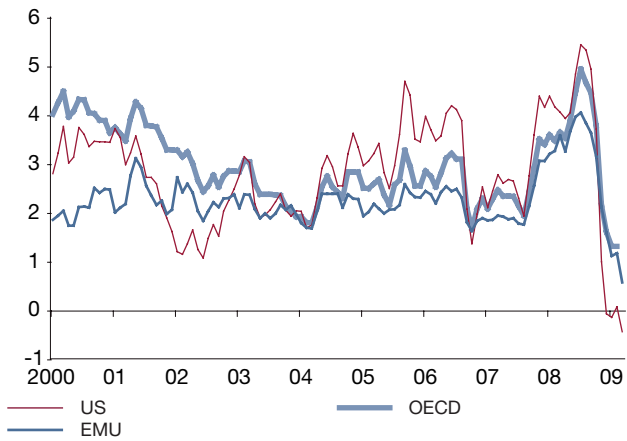


**G4 confidence**  
(standard deviation from the long-term average)



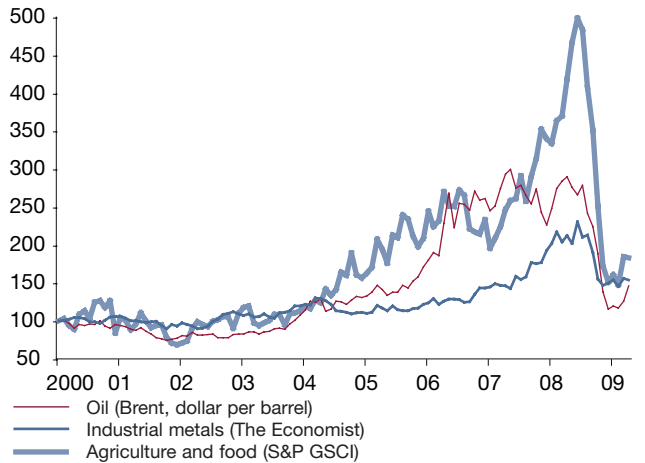
**Inflation**

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

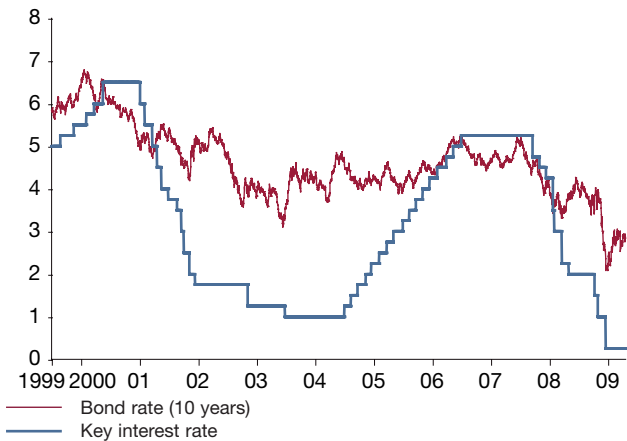


**Commodity prices**

(January 2000=100)



**Interest rate movements US**



**Interest rate movements EMU**



Policy rate				
	21-04-09	+3m	+6m	+12m
US	0.25	0.25	0.25	0.25
EMU	1.25	0.50	0.50	0.50
UK	0.50	0.25	0.25	0.25
Denmark	2.00	1.50	1.00	1.00
Sweden	0.50	0.25	0.25	0.25
Norway	2.00	1.50	1.50	1.50
Switzerland	0.38	0.25	0.25	0.25
Poland	3.75	3.25	3.00	3.00
Czech Republic	1.75	1.25	1.25	1.25
Hungary	9.50	9.00	8.00	7.50
Roumania	10.14	11.00	11.00	11.00
Bulgaria	-	-	-	-
Russia	-	-	-	-
Turkey	9.75	11.00	10.50	10.50
Japan	0.10	0.10	0.10	0.10
China	5.31	5.04	4.77	4.77
Australia	3.00	2.75	2.50	2.50
New Zealand	3.00	2.25	2.25	2.50
Canada	0.25	0.25	0.25	0.25

10-year rate				
	21-04-09	+3m	+6m	+12m
US	2.81	2.40	2.80	3.15
EMU	3.12	2.60	2.90	3.15
UK	3.19	2.70	3.00	3.35
Denmark	3.63	3.15	3.30	3.45
Sweden	3.06	2.60	2.80	3.00
Norway	3.96	3.45	3.65	3.85
Switzerland	2.07	1.55	1.85	1.90
Poland	6.20	5.60	5.60	5.25
Czech Republic	5.41	4.80	4.90	4.65
Hungary	10.98	10.35	10.30	9.60
Roumania	-	-	-	-
Bulgaria	-	-	-	-
Russia	11.59	10.97	10.46	9.99
Turkey (1-year rate)	13.14	13.10	12.65	15.00
Japan	1.46	1.35	1.45	1.55
China	4.26	4.11	4.03	3.92
Australia	4.36	3.95	4.45	4.75
New Zealand	5.11	4.60	5.10	5.00
Canada	2.89	2.50	2.90	3.20

Exchange rate				
	21-04-09	+3m	+6m	+12m
USD per EUR	1.29	1.24	1.24	1.24
GBP per EUR	0.89	0.89	0.89	0.91
DKK per EUR	7.45	7.45	7.45	7.45
SEK per EUR	11.27	10.95	10.75	10.00
NOK per EUR	8.82	8.50	8.30	8.10
CHF per EUR	1.51	1.51	1.51	1.52
PLN per EUR	4.45	4.41	4.18	4.00
CZK per EUR	27.22	27.20	26.45	25.60
HUF per EUR	301.71	297.00	296.00	287.00
RON per EUR	4.25	4.54	4.54	4.46
BGN per EUR	1.96	1.96	1.96	1.96
RUB per EUR	43.83	42.99	42.43	41.40
TRY per EUR	2.16	2.20	2.16	2.07
JPY per EUR	126.37	126.67	130.39	147.50
CNY per USD	6.83	6.82	6.79	6.70
USD per AUD	0.70	0.71	0.73	0.76
USD per NZD	0.55	0.55	0.55	0.58
CAD per USD	1.24	1.24	1.24	1.20

	Real GDP growth		Inflation	
	2009	2010	2009	2010
US	-2.8	0.8	-0.8	0.9
EMU	-3.1	0.5	0.4	0.9
UK	-3.4	0.1	0.2	0.5
Denmark	-2.5	0.5	1.0	1.3
Sweden	-3.5	0.8	0.3	1.0
Norway	-1.0	1.0	1.5	1.5
Switzerland	-2.0	0.6	0.0	0.8
Poland	-0.6	2.1	3.1	1.9
Czech Republic	-1.8	1.7	1.8	2.2
Hungary	-5.3	0.2	2.4	2.9
Roumania	-2.7	0.4	6.0	4.1
Bulgaria	-2.5	0.1	5.7	4.5
Russia	-2.4	1.8	12.0	9.6
Turkey	-2.3	1.4	6.0	0.0
Japan	-5.6	0.6	-0.8	0.1
China	6.5	8.0	0.2	1.8
Australia	-0.5	2.0	2.0	1.8
New Zealand	-2.0	1.5	2.2	1.6
Canada	-1.8	1.1	0.2	1.3

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