Economic Outlook Update




september 2008

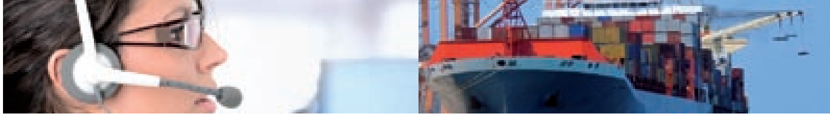
- New wave of bad news from the US is imminent
- Europe on the brink of recession
- Risks of recession in emerging regions limited
- Beginning of the end for inflation hype

The spring's inflation hysteria has given way in recent weeks to increasing unrest about the worldwide slowdown of growth. After the US, Japan, the UK and even the EMU now appear to be heading towards recession, while the emerging economies are also losing steam. The deteriorating economic outlook has also trickled down to the commodity markets, where just about all prices have clearly fallen. Especially the fall in the oil price (down about 25% since its peak in the middle of July) heralded a dramatic change in the inflation scenario for the coming months. The exaggerated concerns about inflation that dominated recent months could now very rapidly ebb away. The combination of lower growth and inflation prospects has caused bonds rates to fall over the past few weeks, while equity markets have continued to struggle on. Furthermore, the definite end of the euro area's 'decoupling myth' provided a firm boost for the US dollar, potentially an initial step in a long-term correction of the euro-dollar exchange rate.

More bad news coming from the US

Over the past few weeks, economic news from the US seemed to be somewhat better than in the preceding months, but that was due mainly to tax stimuli (tax refunds amounting to 1% of GDP). Now that their effect has worn off, the coming months will again bring much worse news. Leading indicators suggest that both households and businesses will further scale down their spending. Unemployment will climb to even higher rates and worse is still to come on the housing market. According to a new analysis by the IMF, the dynamics of US house prices are driven mainly by the stock of unsold houses and the number of forced sales. Both indicators are near historical peaks. This implies that US house prices could continue to fall for a considerable time to come, with an additional decline of 20% from current levels looking likely. Furthermore, the number of households with problems repaying their mortgages is also set to increase even more.

In spite of all the bad news expected in the months ahead, there should also be some hesitant signs of improvement. The 2.5-year-long correction has scaled back residential building to well below the trend level. Historical levels suggest that the bottom is in sight and that this will be confirmed by the apparent stabilisation of confidence indicators for the construction sector. Even a certain stabilisation in building activity would have an immediate positive impact on total economic growth. During the coming quarters, moreover, cooling inflation and earlier monetary easing should provide a considerable boost. If the oil



price stabilises during the coming year at the current level of 110 US dollars a barrel, inflation will fall from its present level of 5.5% to 1.5% by the middle of 2009. This would considerably enhance the purchasing power of US households. The impact of monetary policy also needs to be taken into account. The Fed has already slashed its key rate by 325 basis points since September 2007 which, given the usual delay of one to two years, is a spectacular shot in the arm for the real economy. The problems in the money and credit markets, however, are disrupting the normal gearing of monetary policy. This means that the impact of monetary easing will be more limited and subject to more delay than normal, but the positive effects of monetary policy should ultimately make themselves felt. Nevertheless, each recovery during the course of 2009 (and possibly 2010 as well) will be very modest, since eliminating the excesses in the credit and property markets could drag on for years. The spectacular increase in lending was a vital contributory factor during the previous economic boom, and that will not rapidly return in the years to come. Therefore, the US can expect several years of very moderate growth.

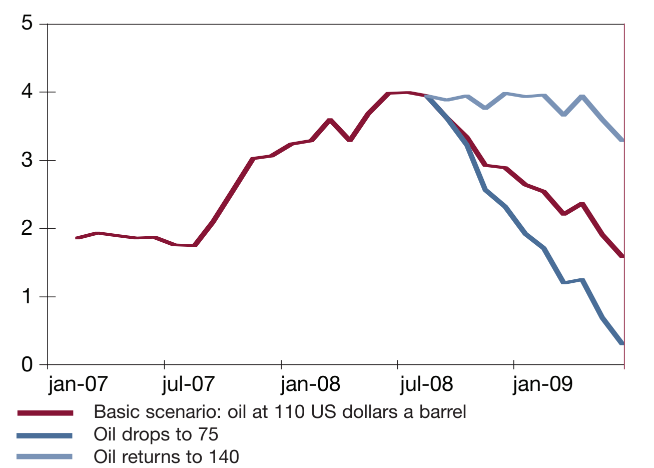
Europe on the brink of recession

Against the background of recession in the US, a strong euro, the high price of oil and the credit crunch, the European economy held up remarkably well during the opening months of the year. However, the ‘decoupling myth’ has given way to reality in recent months. Virtually all of Europe’s economic indicators have nosedived since the start of the summer. Household spending is under pressure from high inflation, corporate spending is being scaled down due to the gloomy outlook for domestic and foreign demand, and export possibilities are feeling the effect of the strong euro and the economic problems facing Europe’s main trading partners. Just as in the US, rapidly cooling inflation could bring some solace, but that is not likely to be enough to avoid a period of stagnation or even negative growth. After the interest rate hike at the beginning of July (intended to restrict inflation risks), the ECB will soon be confronted with a totally different situation. Towards the end of this year, the European economy will have come to a complete standstill, the most important wage negotiations will have been wound up and inflation will be cooling off rapidly, thanks to the recent fall in oil prices. This combination will pave the way for the ECB to slash interest rates and ultimately lay the foundations for the next recovery phase. However, that is not in sight for the time being.

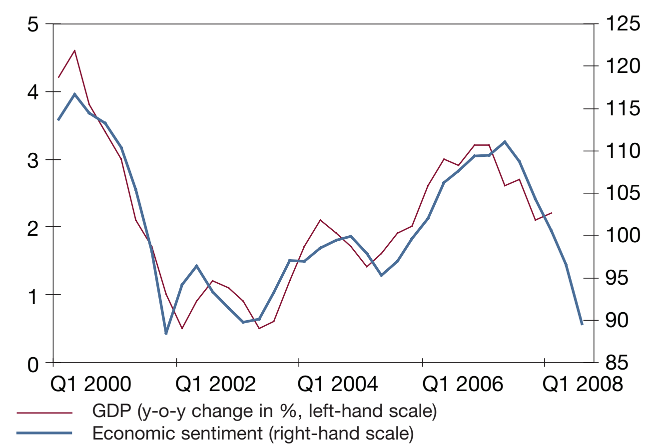
Increasing concerns in the emerging economies

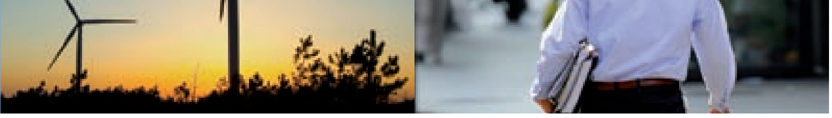
Increasingly more cracks are also appearing in the fairy-tale growth of the emerging markets. The fact that virtually all the ‘developed’ world is sliding towards recession, together with domestic measures in the fight against inflation, has gradually but inevitably had an impact on economic growth. Nevertheless, there are still sufficient reasons to be cautiously optimistic about emerging region markets. During previous downswings in the economic cycle in the Western world, the emerging economies were often badly hit, mainly because the economic problems were magnified out of all proportion by the financial markets. At present, however, many emerging economies are built on much healthier economic and financial foundations. The risk of a recession sweeping through the emerging region therefore remains very restricted. Some (less orthodox) economies, such as those of Venezuela and Argentina, however, could get into trouble, but contagion throughout the entire region does not appear to be an immediate threat.

Fall in the price of oil implies a considerable easing of European inflation



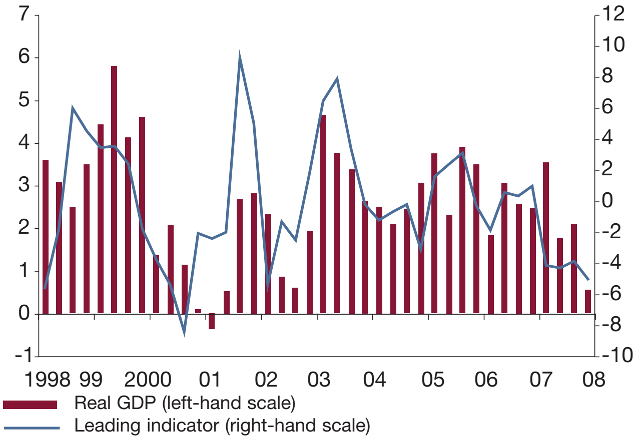
European economy slamming on the brakes





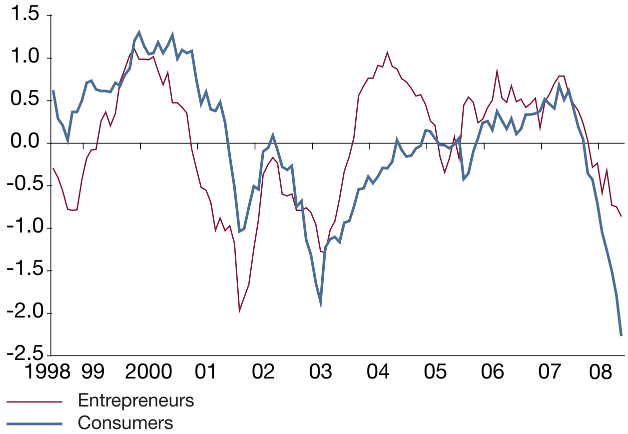
Economic activity in the OECD

(annualised quarterly change in %)



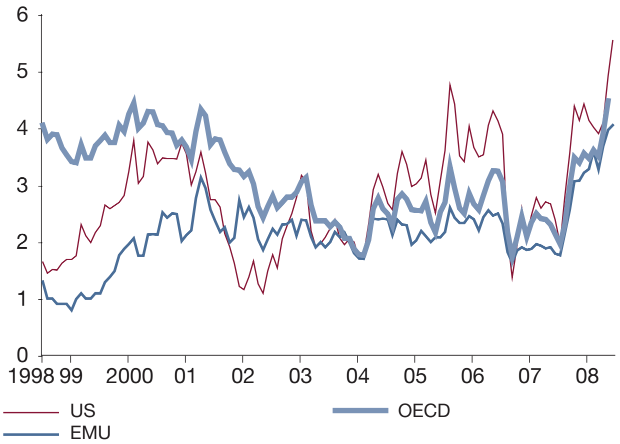
G4 confidence

(standard deviation from the long-term average)

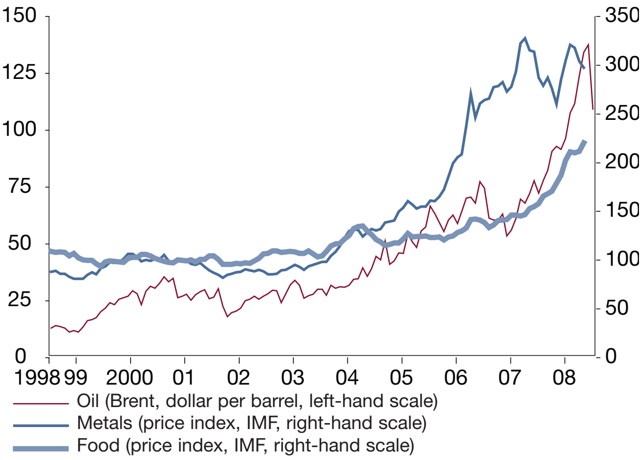


Inflation

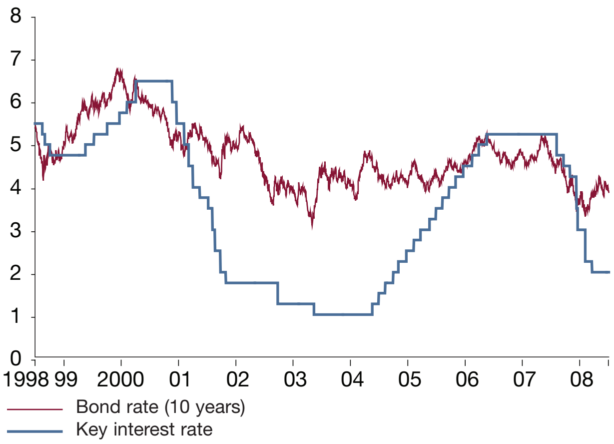
(consumer price index, y-o-y change, in %)



Commodity prices



Interest rate movements US



Interest rate movements EMU

Policy rate

	18-08-08	+3m	+6m	+12m
US	2.00	2.00	1.50	1.50
EMU	4.25	4.25	4.00	3.00
UK	5.00	5.00	4.50	3.50
Denmark	4.60	4.60	4.35	3.35
Sweden	4.50	4.50	4.25	3.50
Norway	5.75	6.00	6.00	5.75
Switzerland	2.75	2.75	2.50	2.00
Poland	6.00	6.25	6.25	6.25
Czech Republic	3.50	3.50	3.50	3.50
Hungary	8.50	8.50	8.25	7.75
Slovakia	4.25	4.25	4.00	3.00
Roumania	10.25	10.50	10.50	10.50
Bulgaria	-	-	-	-
Russia	-	-	-	-
Turkey	16.75	17.00	17.00	14.50
Japan	0.50	0.50	0.50	0.50
China	7.47	7.47	7.74	8.01
Australia	7.25	6.75	6.50	6.25
New Zealand	8.00	7.50	7.00	6.50
Canada	3.00	3.00	3.00	3.00

10-year rate

	18-08-08	+3m	+6m	+12m
US	3.82	3.60	3.65	4.00
EMU	4.15	3.95	3.75	3.80
UK	4.60	4.20	3.90	3.85
Denmark	4.45	4.25	4.05	4.10
Sweden	4.08	4.00	3.80	3.85
Norway	4.60	4.55	4.45	4.55
Switzerland	2.85	2.65	2.45	2.50
Poland	6.12	5.75	5.40	5.35
Czech Republic	4.47	4.25	4.05	4.10
Hungary	7.74	7.40	6.95	6.85
Slovakia	4.86	4.55	4.25	4.25
Roumania (*5-year rate)*	5.01	5.15	5.15	5.10
Bulgaria	-	-	-	-
Russia	6.91	6.51	5.91	5.36
Turkey *(1-year rate)*	19.35	19.00	18.80	19.50
Japan	1.45	1.35	1.40	1.55
China	4.62	4.69	4.78	4.85
Australia	5.82	5.50	5.45	5.50
New Zealand	6.18	5.75	5.70	5.70
Canada	3.57	3.45	3.60	3.85

Exchange rate

	18-08-08	+3m	+6m	+12m
USD per EUR	1.47	1.44	1.43	1.40
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	9.36	9.35	9.35	9.30
NOK per EUR	7.97	7.80	7.80	7.80
CHF per EUR	1.62	1.62	1.62	1.62
PLN per EUR	3.32	3.35	3.28	3.28
CZK per EUR	24.28	24.05	24.05	24.05
HUF per EUR	235.85	240.70	240.70	240.70
SKK per EUR	30.32	30.30	30.13	30.13
RON per EUR	3.55	3.62	3.62	3.59
BGN per EUR	1.96	1.96	1.96	1.96
RUB per EUR	36.13	35.60	35.25	34.91
TRY per EUR	1.74	1.76	1.76	1.78
JPY per EUR	162.17	160.07	161.37	161.00
CNY per USD	6.87	6.75	6.53	6.39
USD per AUD	0.87	0.86	0.85	0.84
USD per NZD	0.71	0.71	0.70	0.66
CAD per USD	1.06	1.06	1.08	1.10

	Real GDP growth		Inflation	
	2008	2009	2008	2009
US	1.4	0.7	4.1	2.4
EMU	1.3	1.1	3.5	2.2
UK	1.3	1.0	3.3	2.2
Denmark	1.1	0.9	3.1	2.5
Sweden	2	1.9	3.7	2.7
Norway	3.3	2.1	3.5	2.7
Switzerland	2.1	1.4	2.6	1.6
Poland	5.4	4.9	4.4	3.5
Czech Republic	4.4	4.3	6.5	3.2
Hungary	1.5	3.0	6.3	4.3
Slovakia	7.2	6.0	3.9	3.0
Roumania	6.8	5.0	8.1	5.3
Bulgaria	6.0	5.8	11.5	7.2
Russia	7.5	6.8	13.9	11
Turkey	3.5	4.6	10.2	6.5
Japan	1.0	1.6	1.6	0.5
China	9.8	9.0	6.3	4.0
Australia	2.8	2.7	4.5	3.2
New Zealand	0.7	1.4	4.2	3.3
Canada	0.4	0.0	2.4	2.1

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