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Mind the gap: Managing the economic recovery

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Content

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2. Mind the gap: factors driving the inflation outlook
3. Are we blowing new bubbles?
4. Outlook for interest rates and currencies

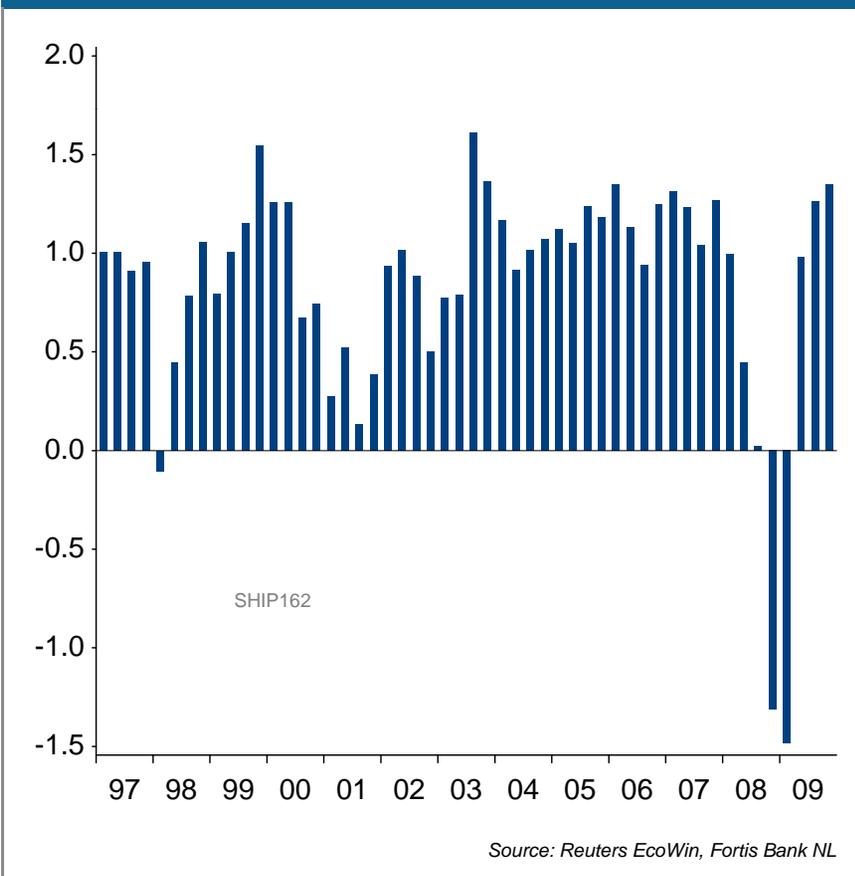
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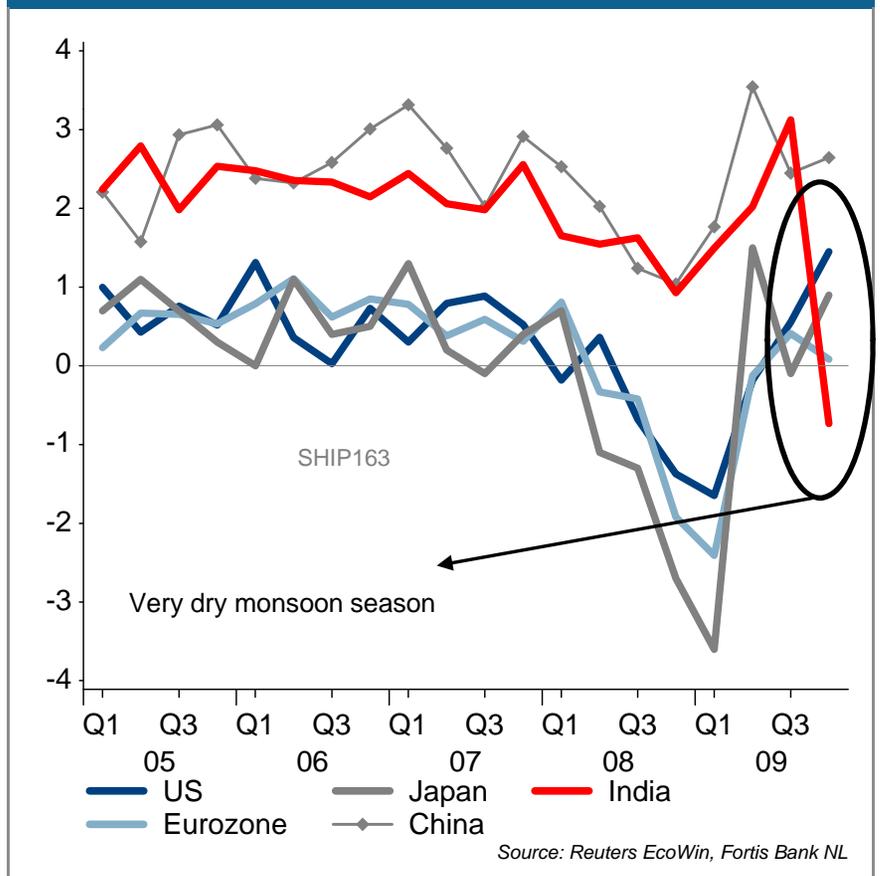
It's a V-shaped recovery!

Just as suddenly as the world economy fell into recession in the fourth quarter of 2008, it has begun to recover from the second quarter of 2009 onwards

World GDP growth (% QoQ)



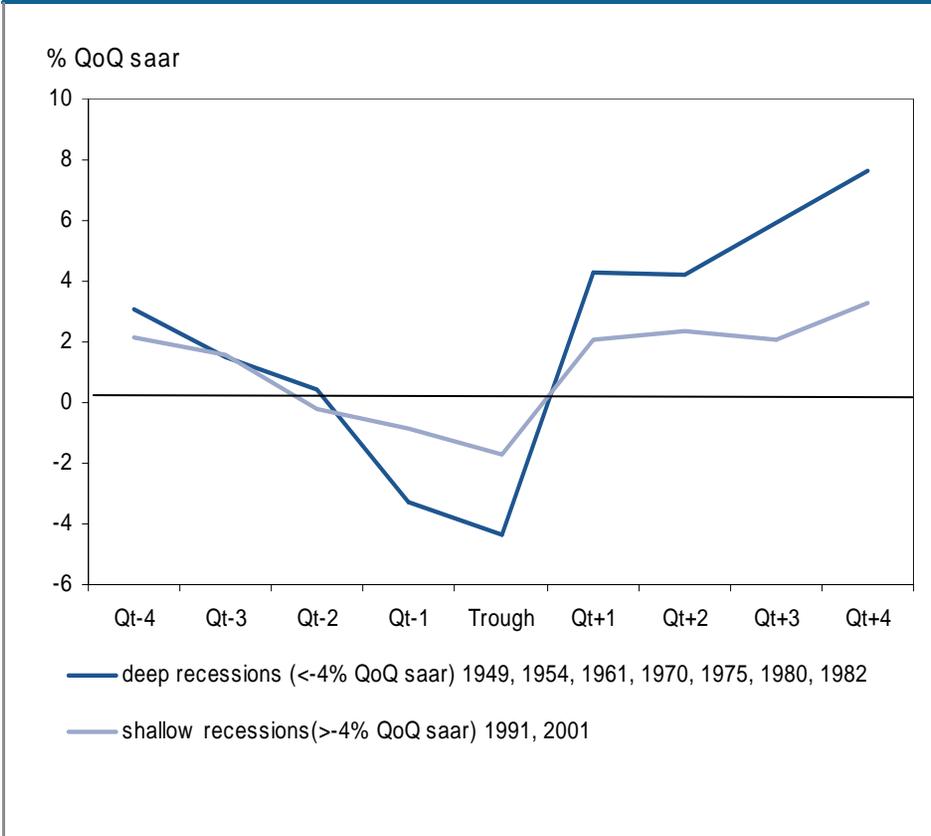
Quarterly growth in some major economies



This continues a post-WWII tradition

Deep recessions were always followed by steep recoveries

US quarterly annualised growth in real GDP



average GDP growth over four quarters after trough %QoQ saar

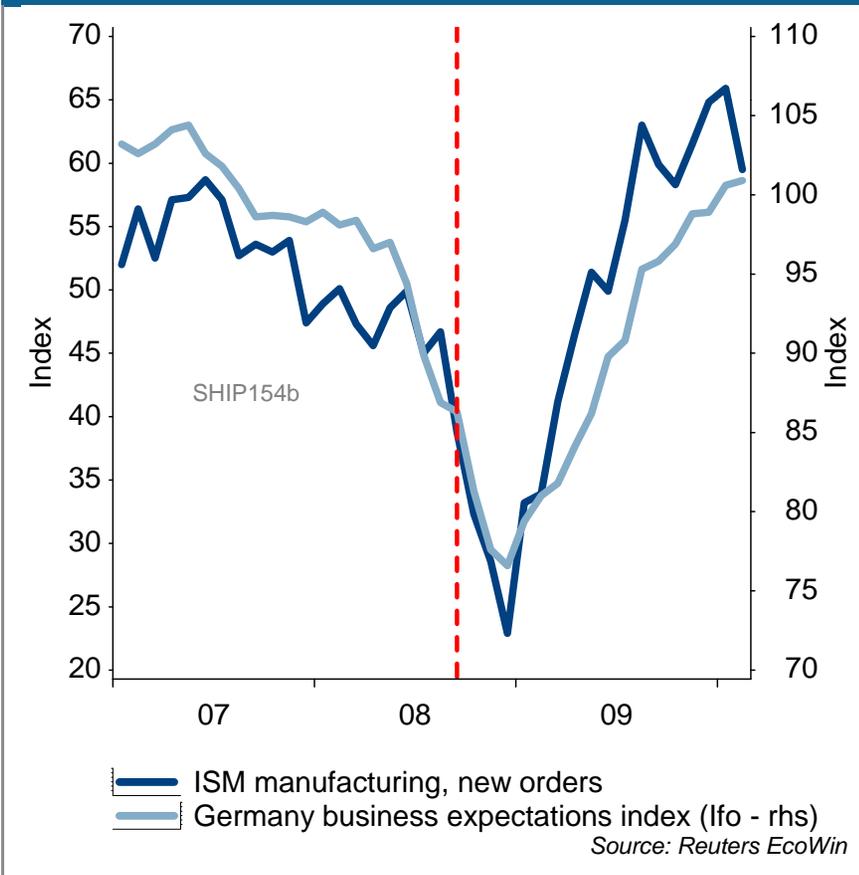
1948	7.61
1954	6.26
1958	7.34
1961	6.31
1970	4.55
1975	6.14
1980	4.46
1982	1.51

Source: Fortis Bank NL

Households and businesses are more confident...

With the financial system largely stabilised, worst case scenario's didn't become reality, and household and business confidence rose

Business confidence



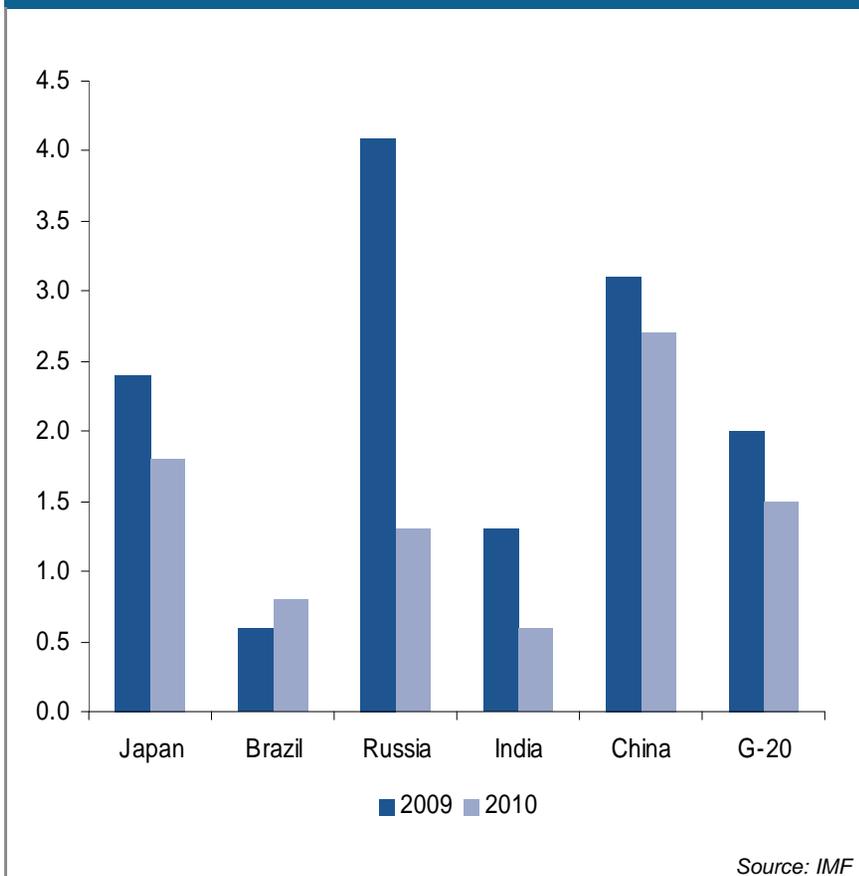
Consumer confidence



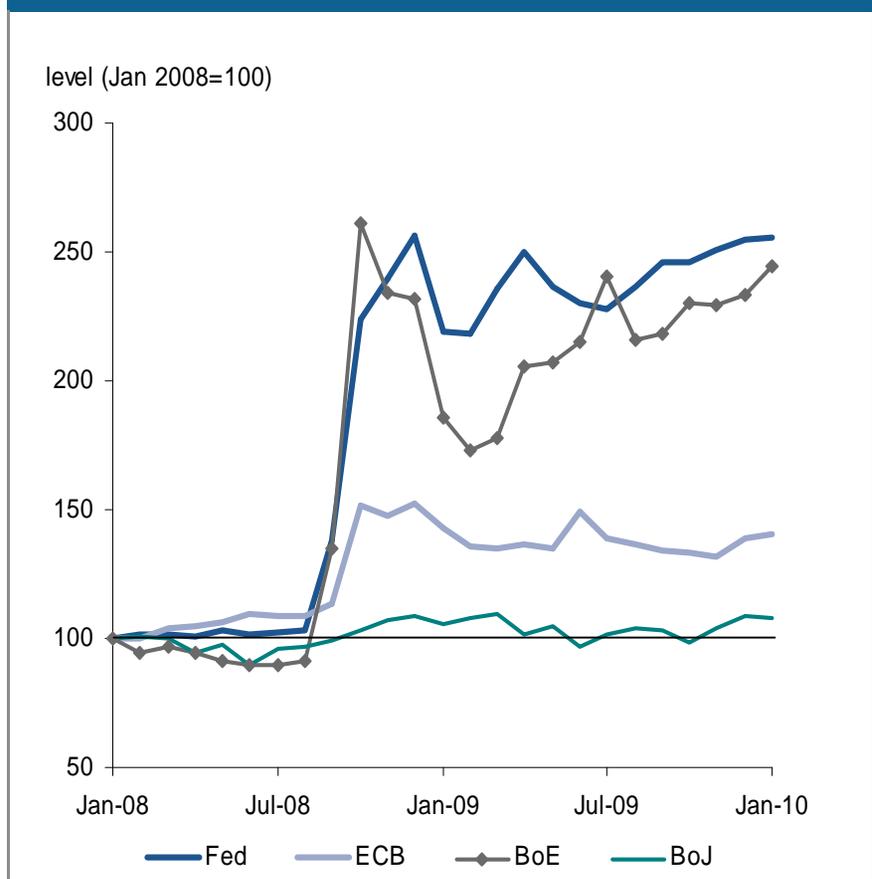
...allowing policy stimulus to have a positive impact

This allowed the strongest fiscal and monetary policy stimulus since WW II to do its healing work

Stimulus packages 2009-2010 (% GDP)

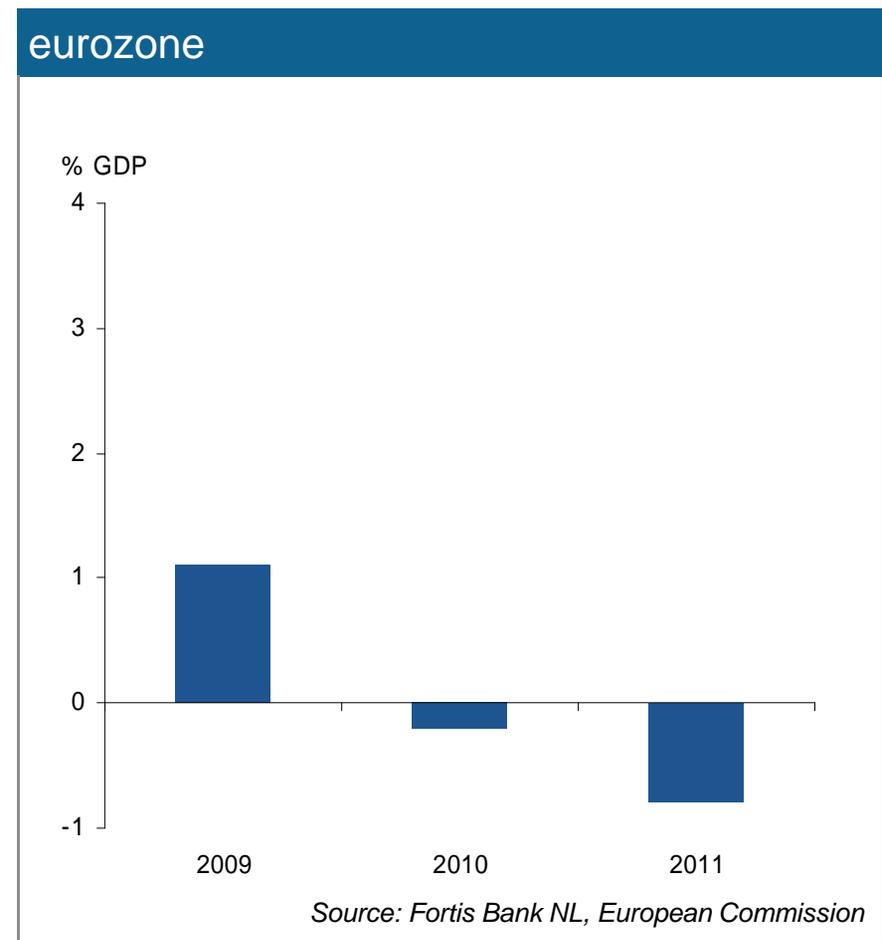
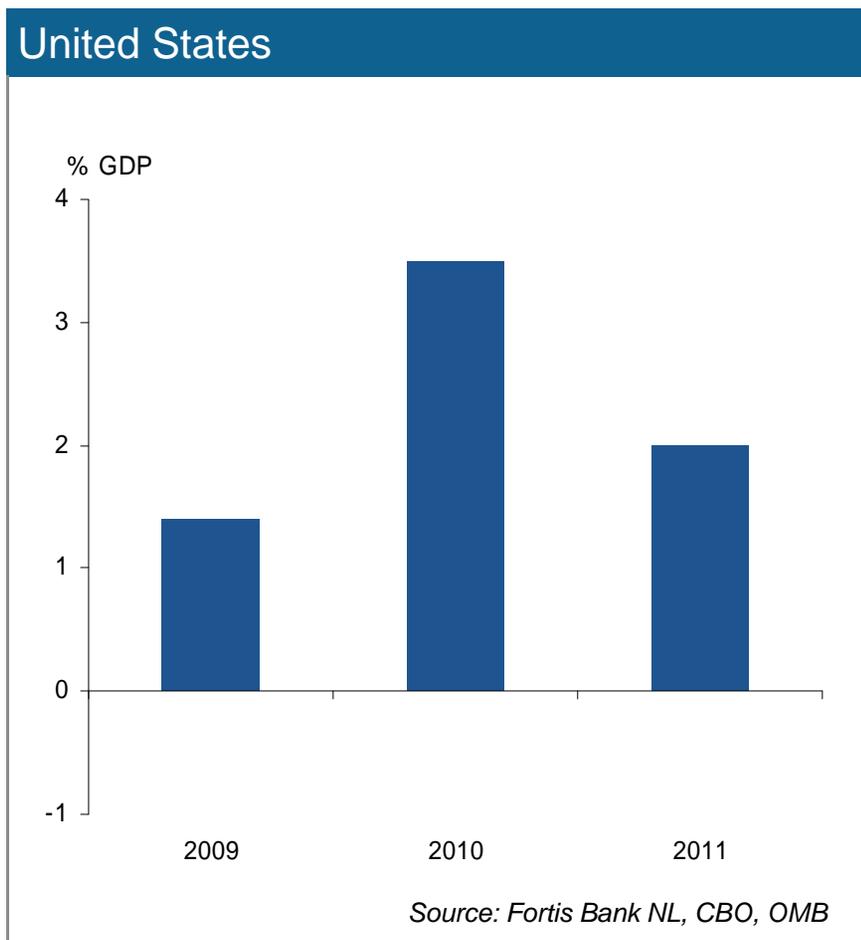


Central bank assets



Fiscal stimulus: United States versus eurozone

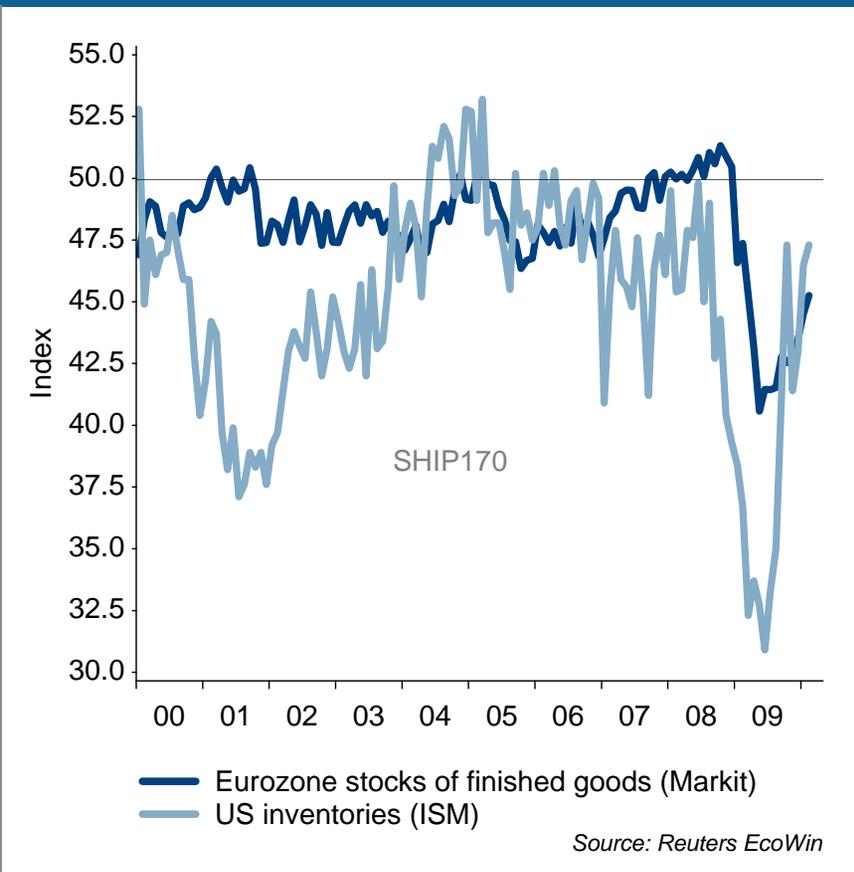
US stimulus package peaks in 2010 and then tapers off gradually in 2011; eurozone package is much smaller, and starts tapering off in 2010



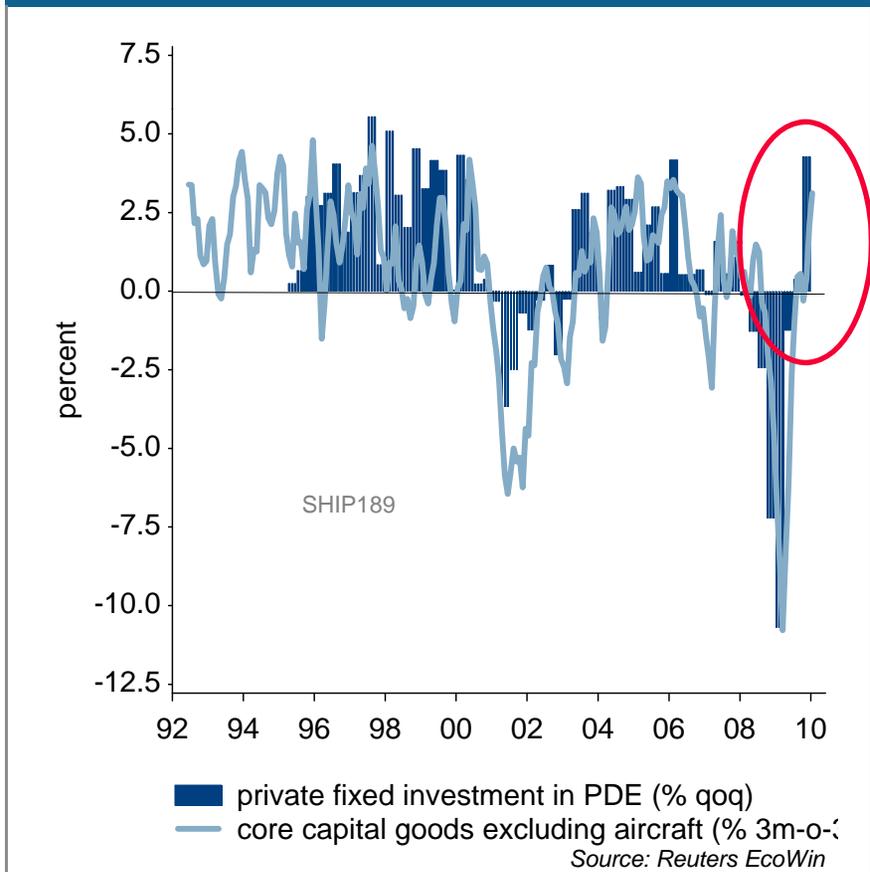
Strong feed-back effects have begun to take effect

Initially via stockbuilding, but in the United States – with its flexible labour market – now also via investment

Stockbuilding much less negative

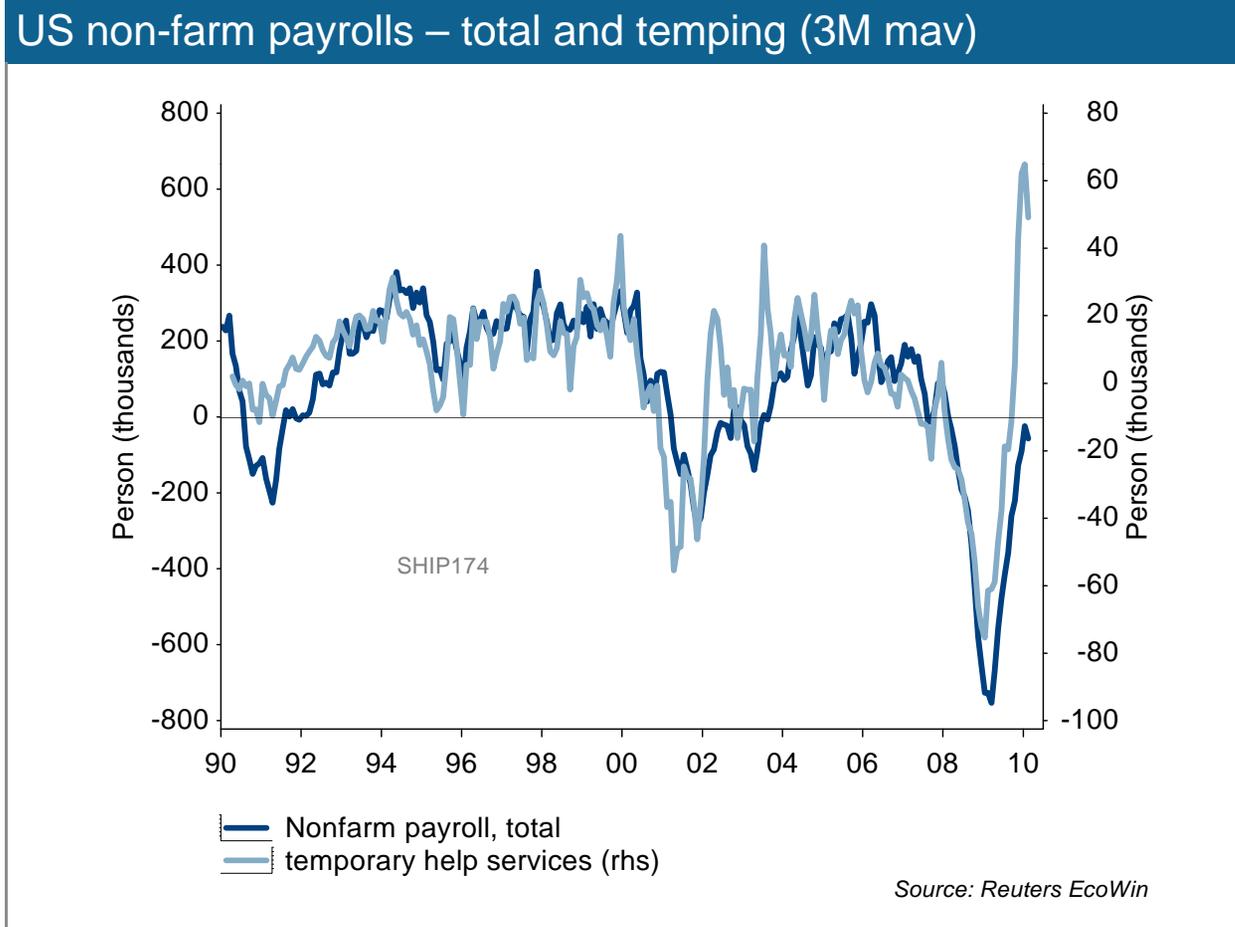


US investm. in PDE, core cap. goods shipm.



US labour market on the verge of a sharp recovery

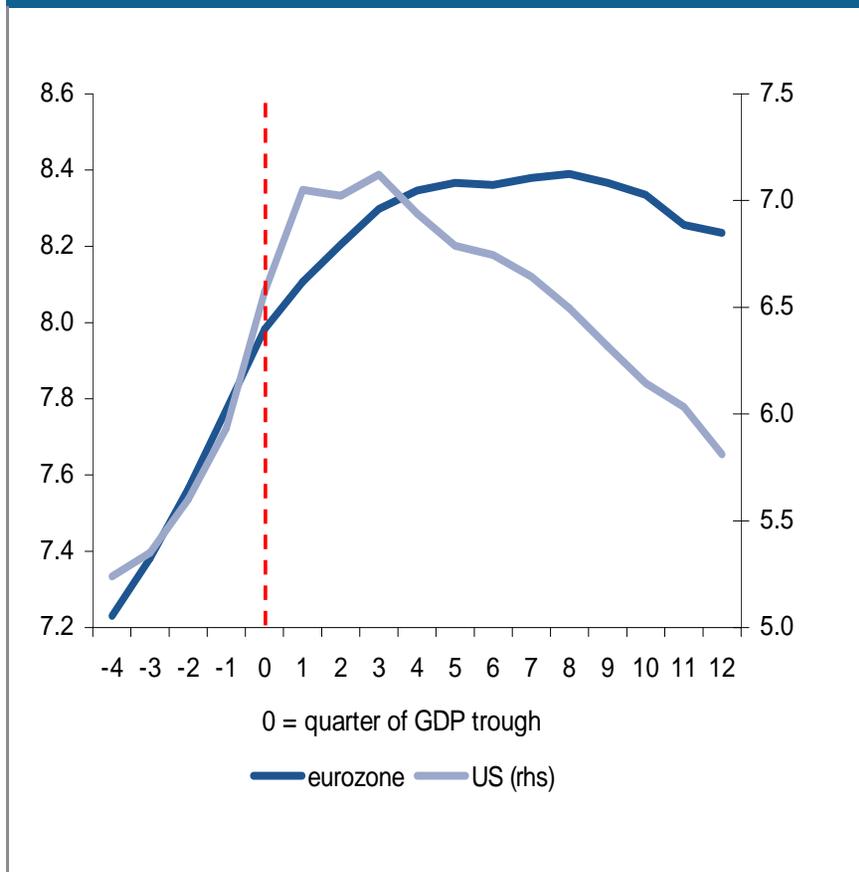
Given the aggressiveness of lay-offs during the past recession, positive feedback effects via the labour market could be stronger than usual in the US



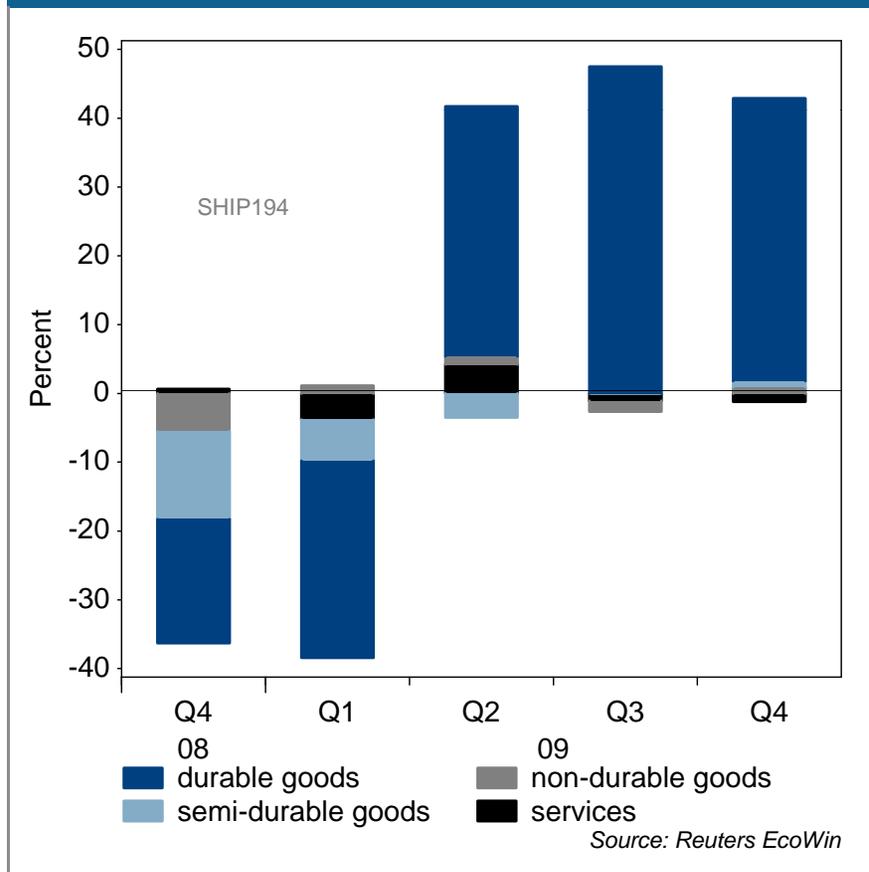
More eurozone and Japanese peculiarities

Eurozone recovery slowed down by its inflexible labour market (short-time working schemes make this worse); Japan's consumer boom is artificial

Euroz. Unemploy. rate during past cycles



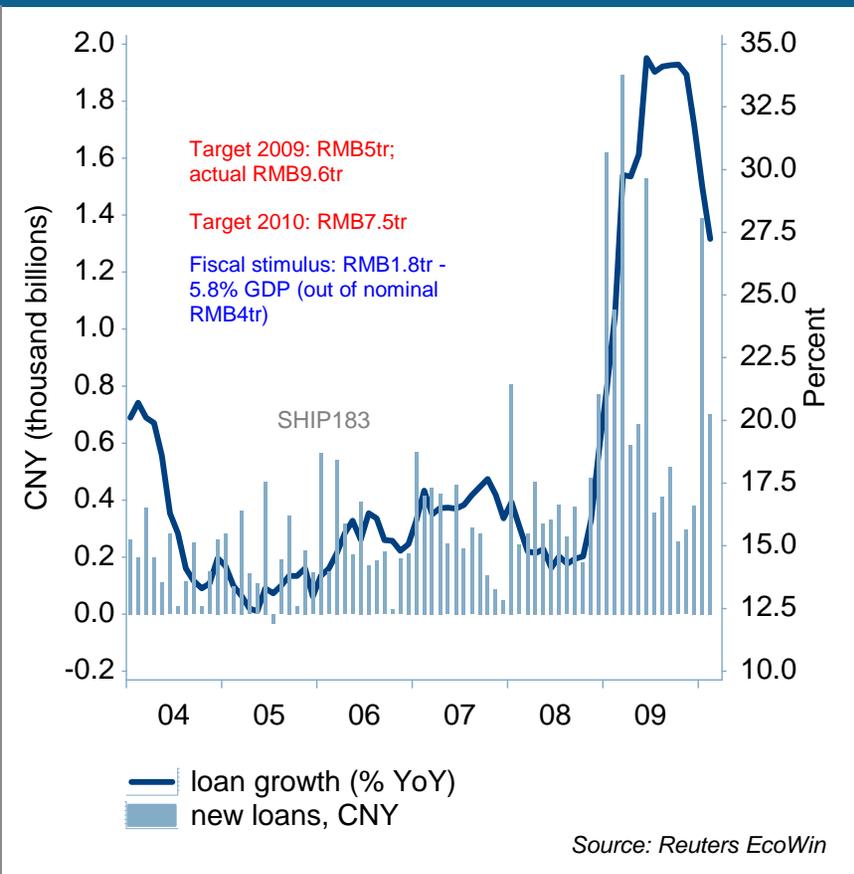
Japanese consumption driven by subsidies



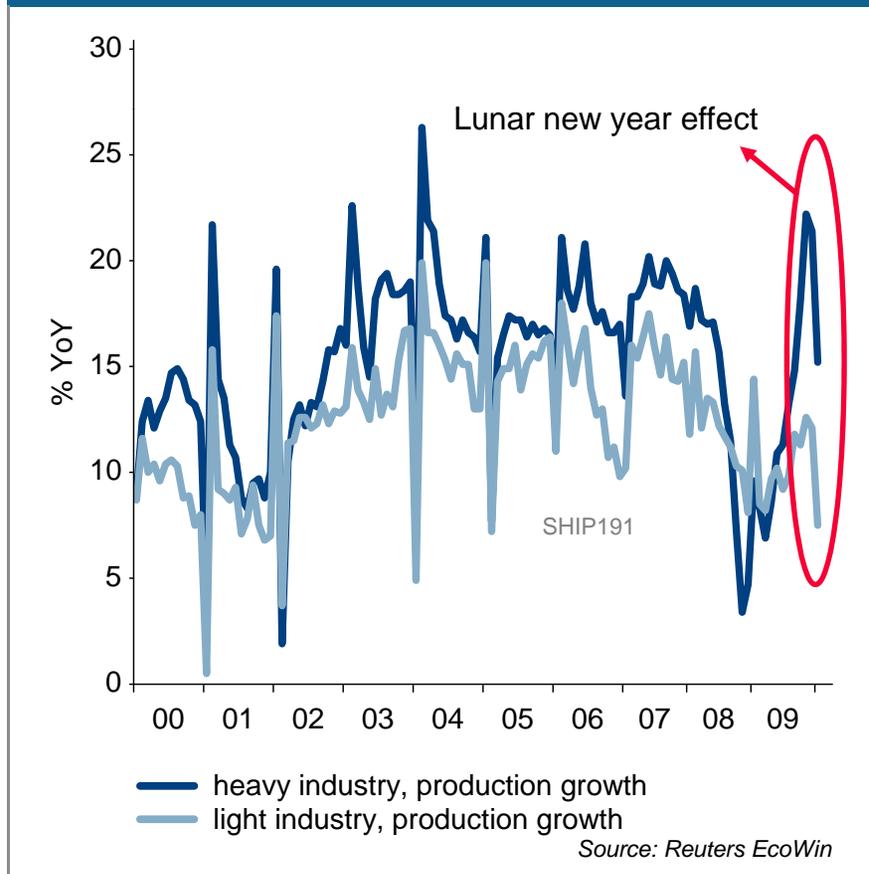
China: still the growth engine of the world

Very easy fiscal and monetary policies have resulted in sharp pick-up in industrial production, mainly in heavy industries

China: bank lending



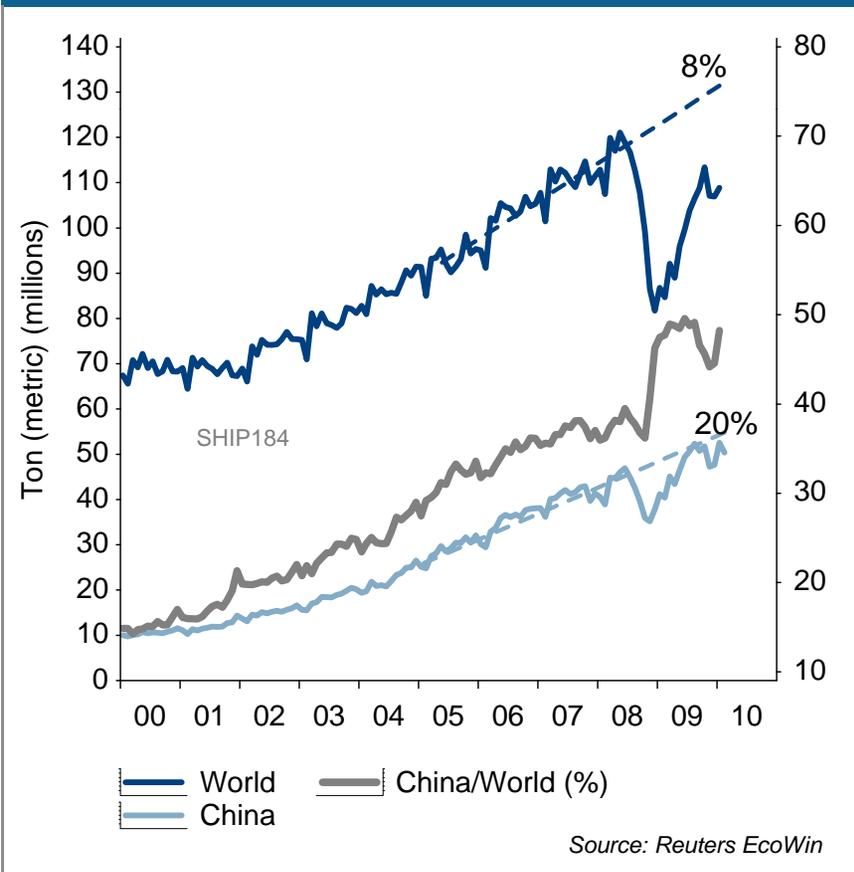
China: a temporary farewell to rebalancing



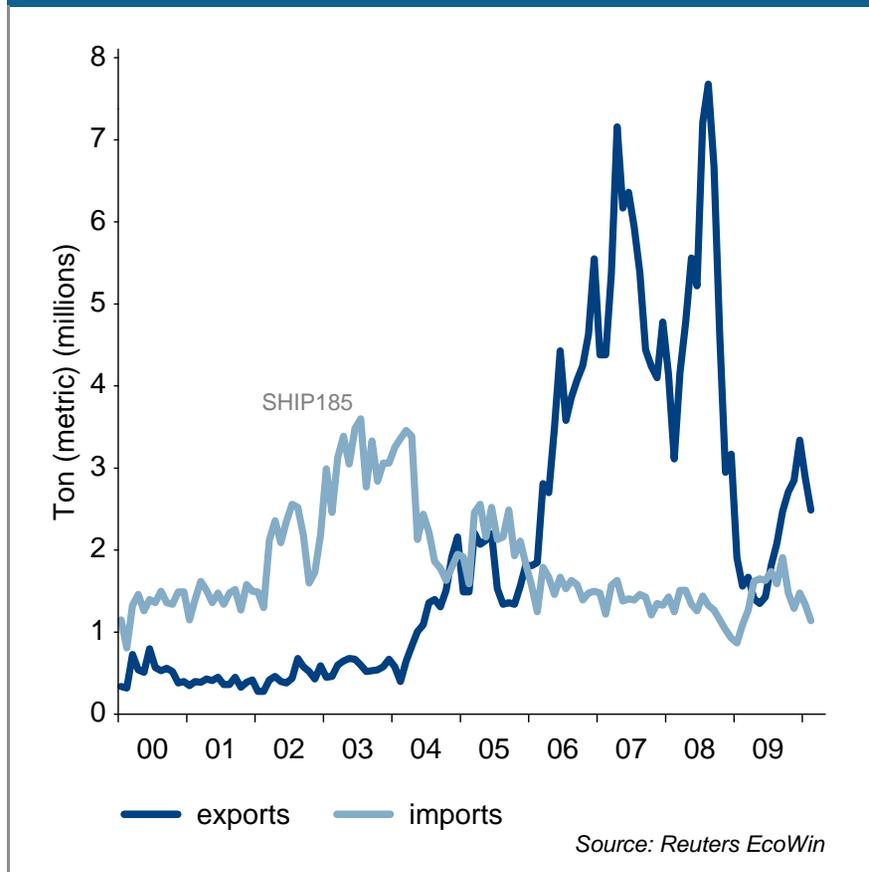
China: crude steel production almost back to trend

China currently produces 45% of all crude steel; most is for domestic use, although exports of steel products have increased sharply in recent years

China: crude steel production



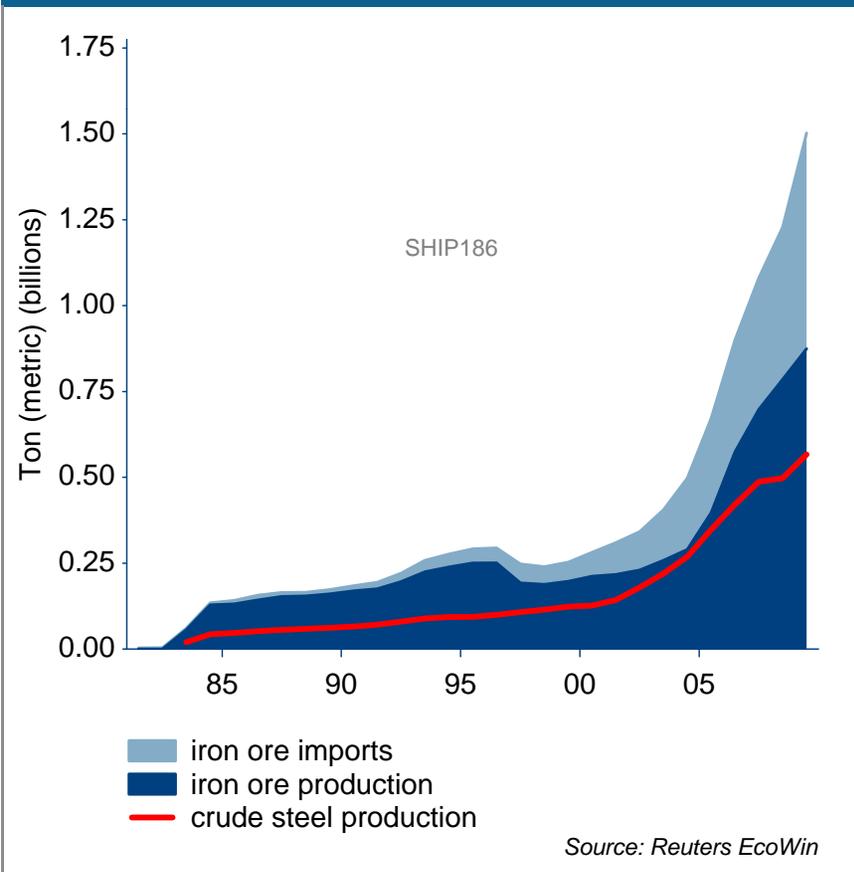
China: trade in steel products



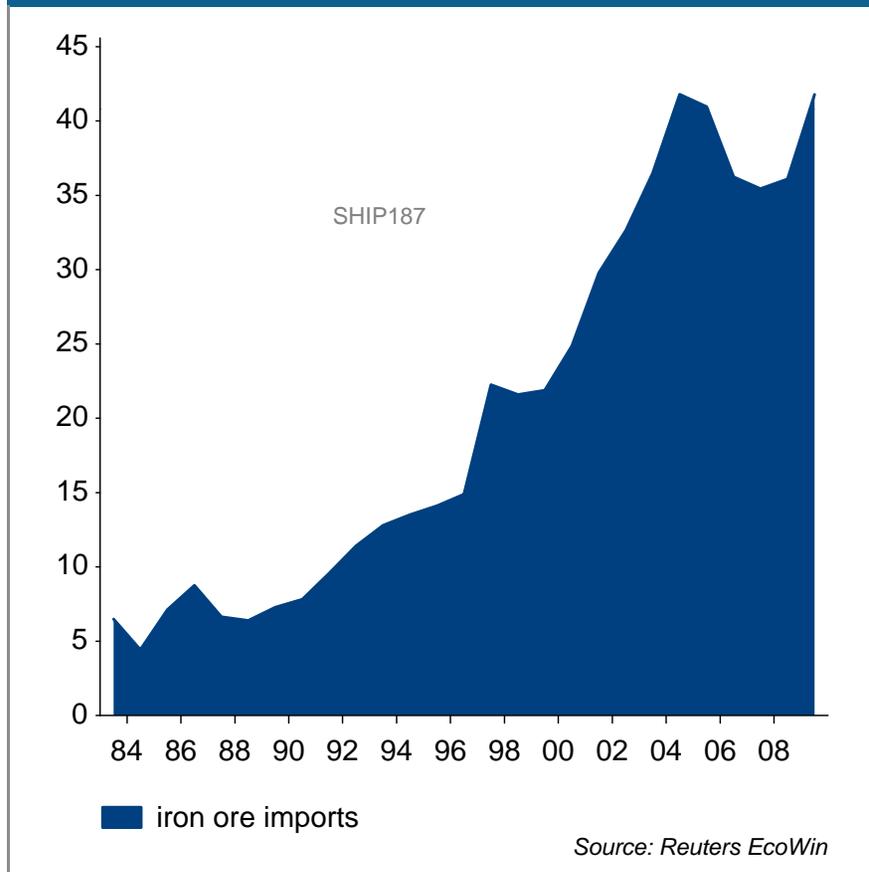
China: increasingly dependent on iron ore imports

China is increasingly dependent on iron ore imports (42% of overall usage); Its iron ore imports currently stand at 52% of world total

China: crude steel production & iron ore use



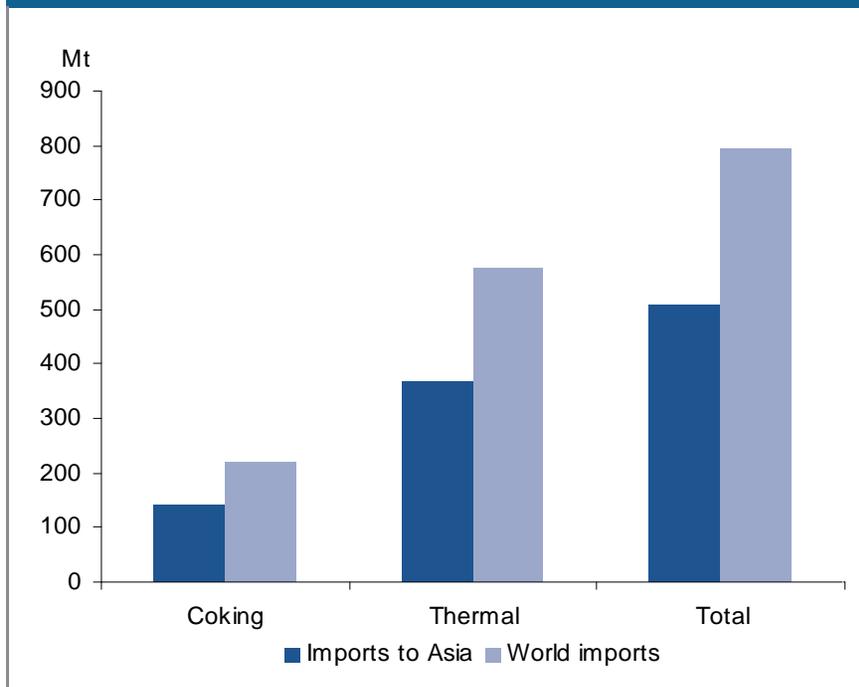
China: iron ore import penetration



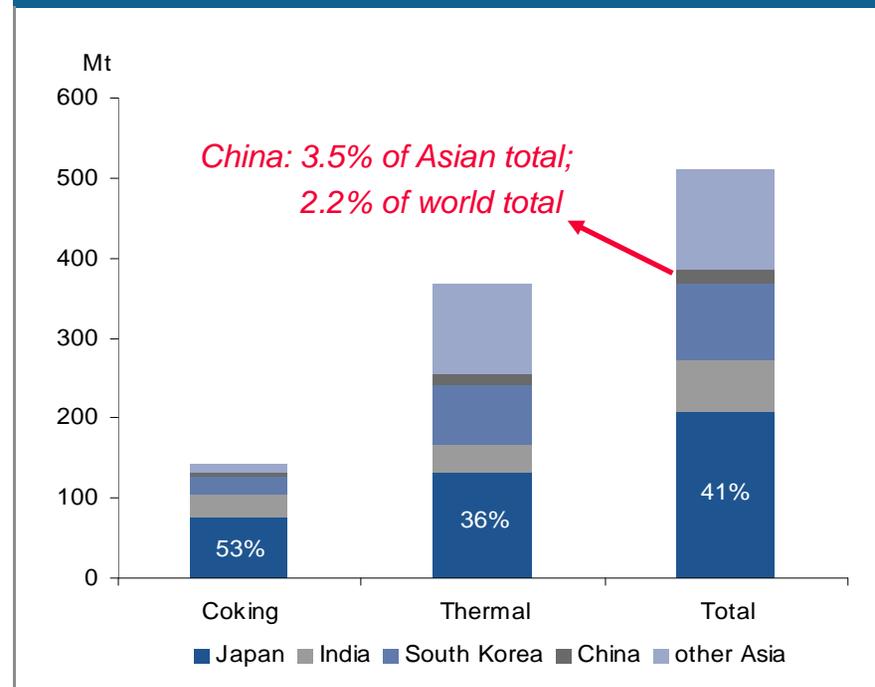
Coal trade dominated by Asia (not China) and set to slow

Asian coal imports are roughly 60% of world imports; thermal coal imports are 75% of total; within Asia, Japan is the main importer; import growth set to slow

Coal imports (2008)



Decomposition of Asian imports (total, 2008)



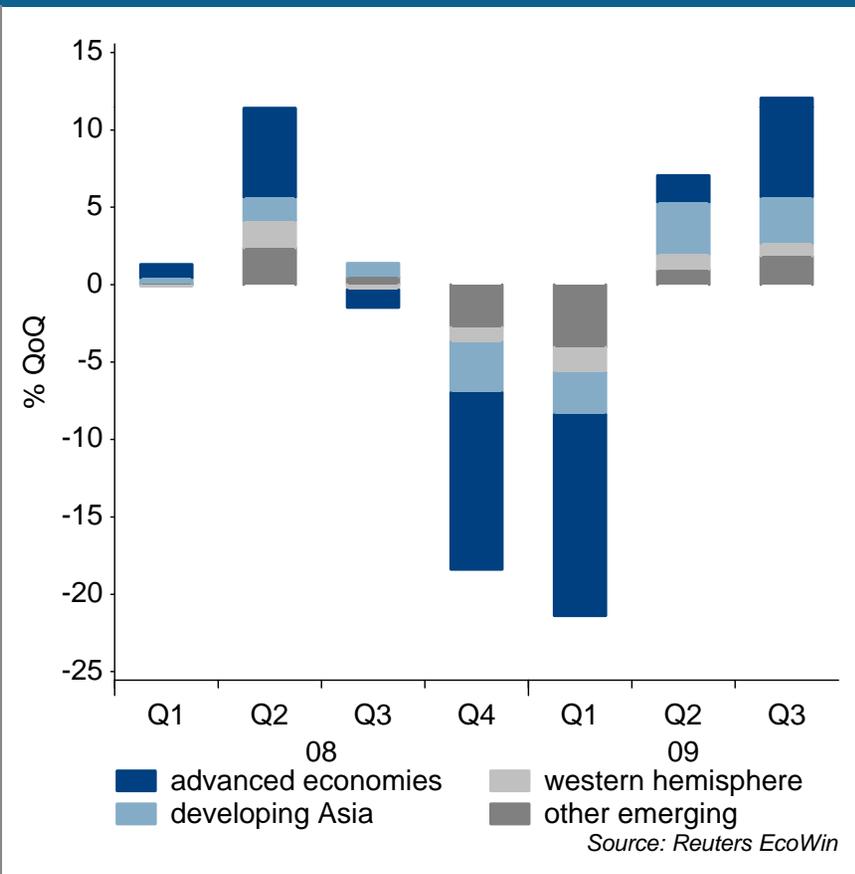
Total coal imports – avg. ann. growth rates

	2005-2009	2007-2015	2015-2019
imports to Asia	7.3	2.0	1.5
world imports	3.8	1.6	1.1

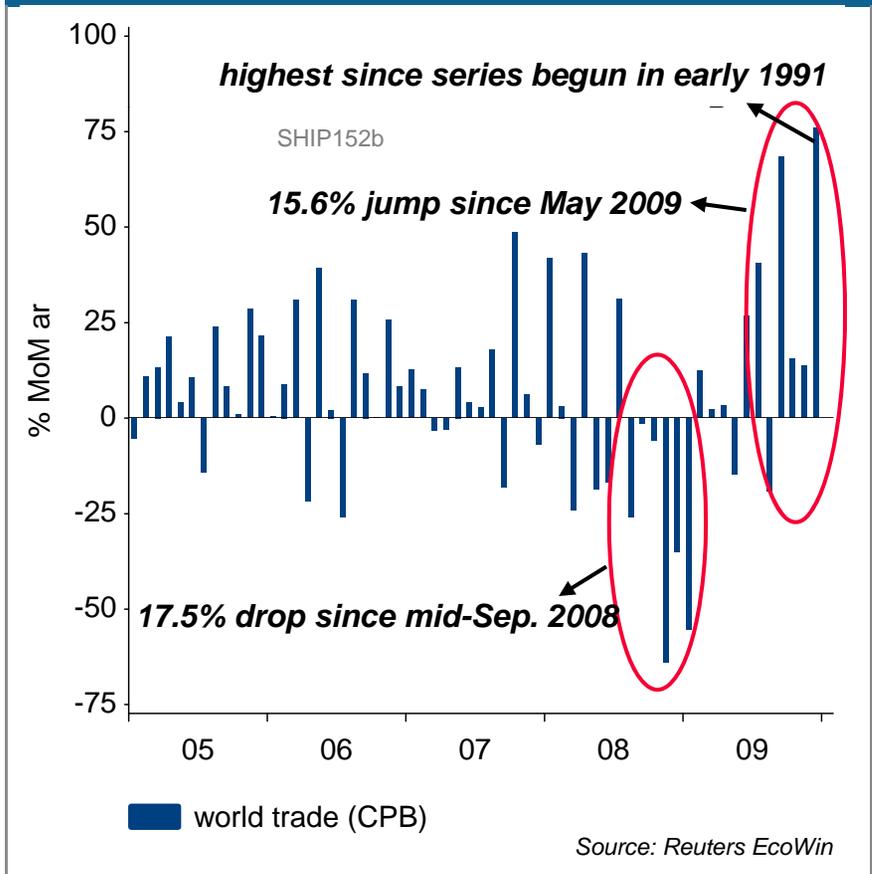
World trade has rebounded sharply

Helped by stimulus packages and monetary easing; and it is not just developing Asia, although this has dominated the rebound

Decomposition of world import growth

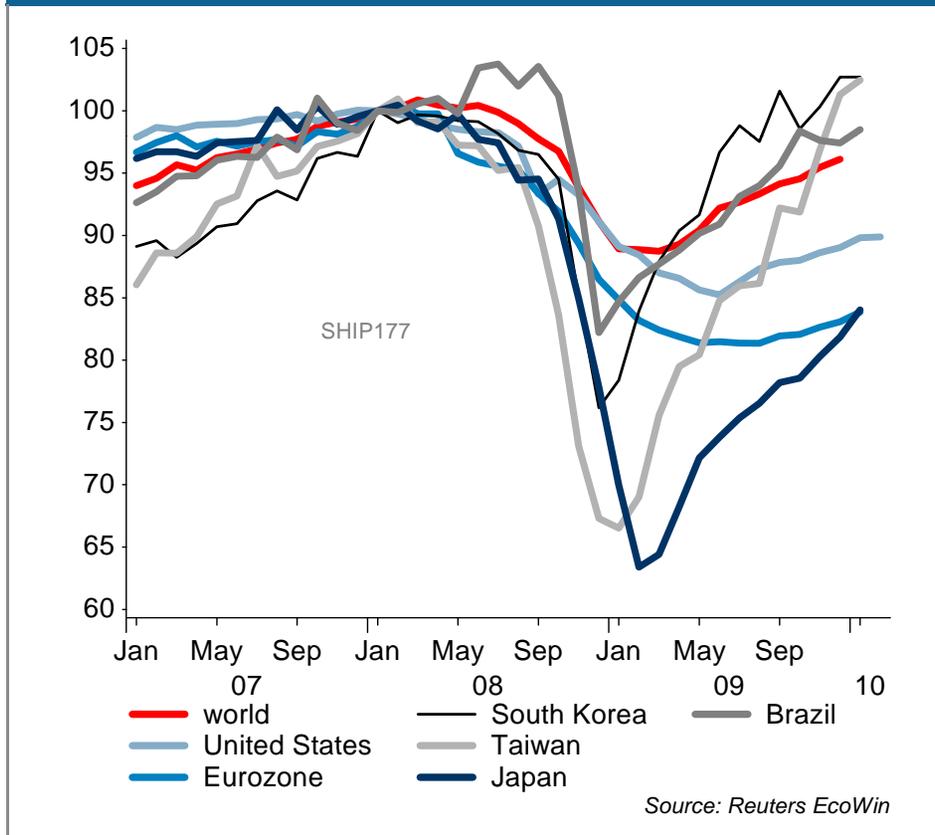


World trade nearly recovered from past loss



Like world trade, industrial production has recovered sharply

Industrial production (Jan. 2008 = 100)

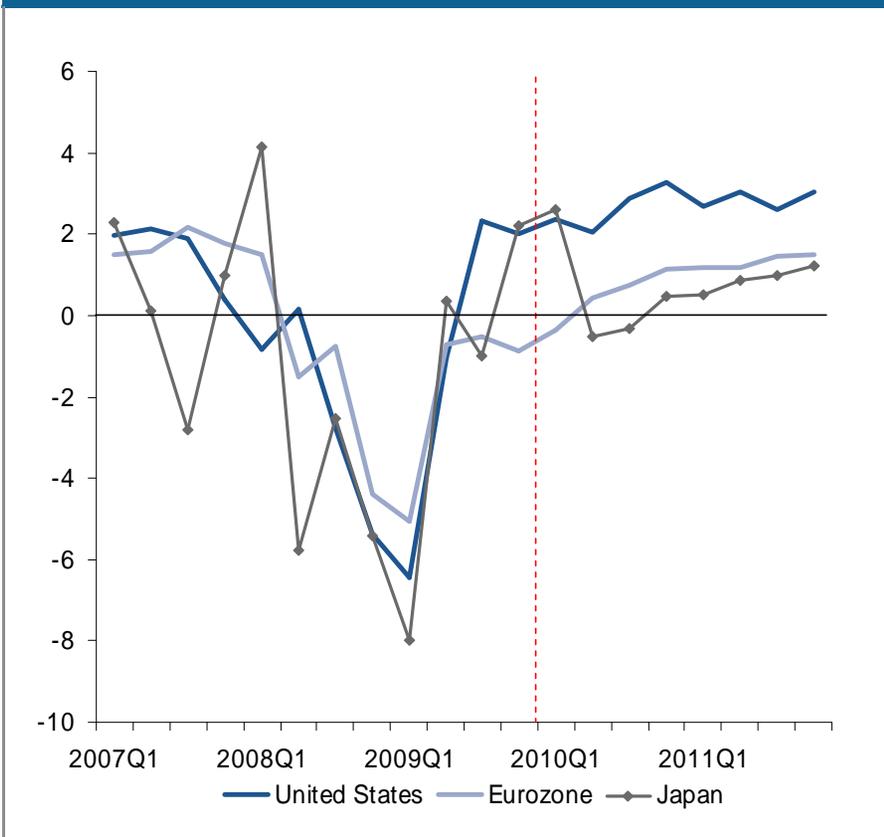


Industr. prod.: cum. loss and % recovered

	% decline from peak	% recovered
World	-12	61
United States	-15	31
eurozone	-21	22
Japan	-37	56
S-Korea	-27	99
Taiwan	-44	89
Brazil	-21	76

Outlook for main economies: eurozone & Japan lag behind

Final domestic demand growth (%QoQ saar)



	2007	2008	2009E	2010E	2011E
GDP					
United States	2.1	0.4	-2.4	3.2	3.1
Eurozone	2.7	0.5	-4.0	1.1	1.6
Japan	2.3	-1.2	-5.2	1.9	1.5
United Kingdom	2.6	0.5	-4.8	1.6	2.7
China	13.0	9.6	8.5	10.0	9.0
India	9.3	7.3	5.6	7.0	8.0
Western Hemisphere	5.8	4.2	-2.3	3.7	3.8
Advanced economies	2.7	0.4	-3.2	2.3	2.5
Emerging economies	8.4	6.2	2.0	5.9	6.2
World	5.3	3.1	-0.8	4.0	4.2
World trade					
	7.3	3.0	-13	12	7

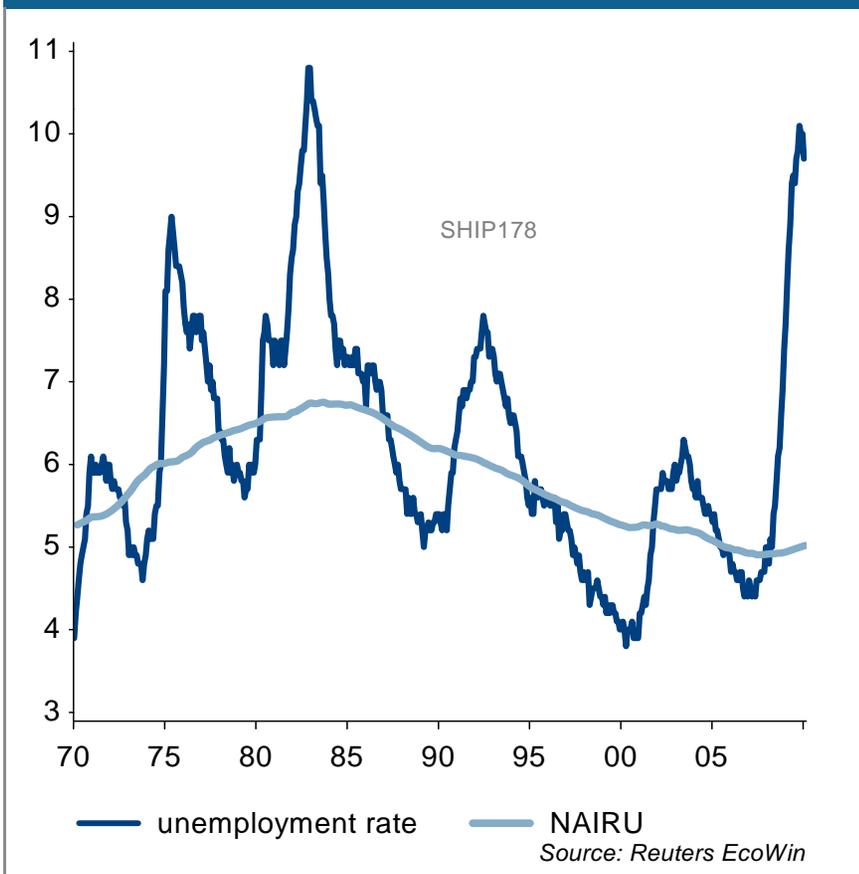
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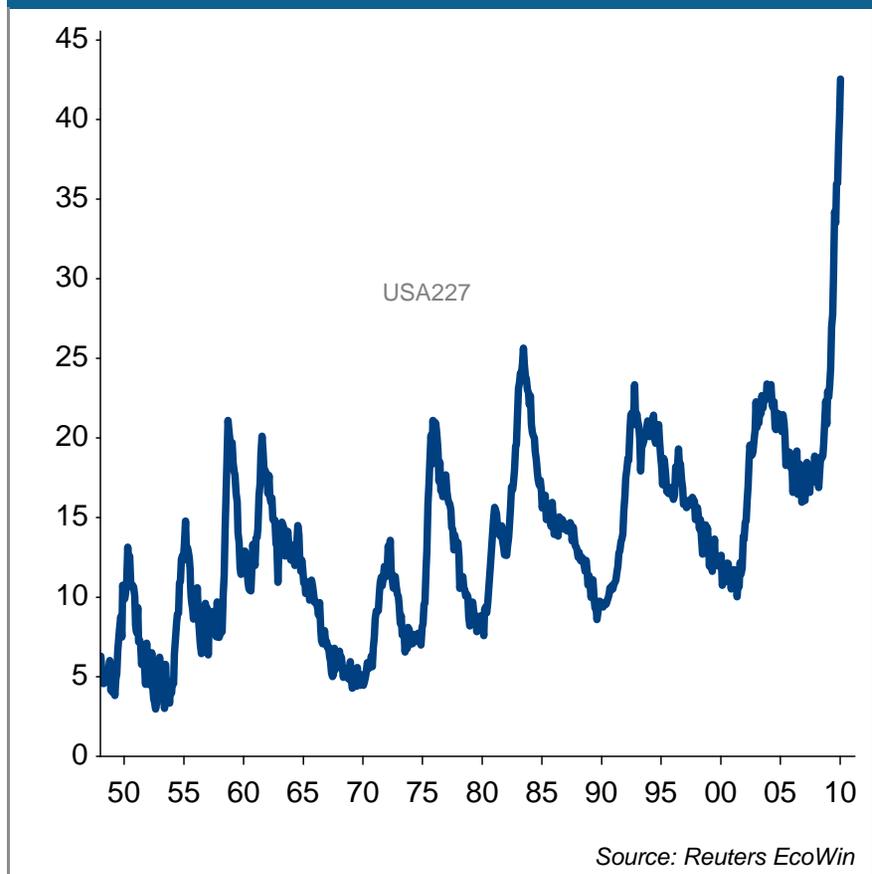
It's difficult to estimate excess capacity after deep recession

Estimates of excess capacity are highly uncertain following deep recessions
(permanent destruction of productive capacity)

What will US NAIRU do...



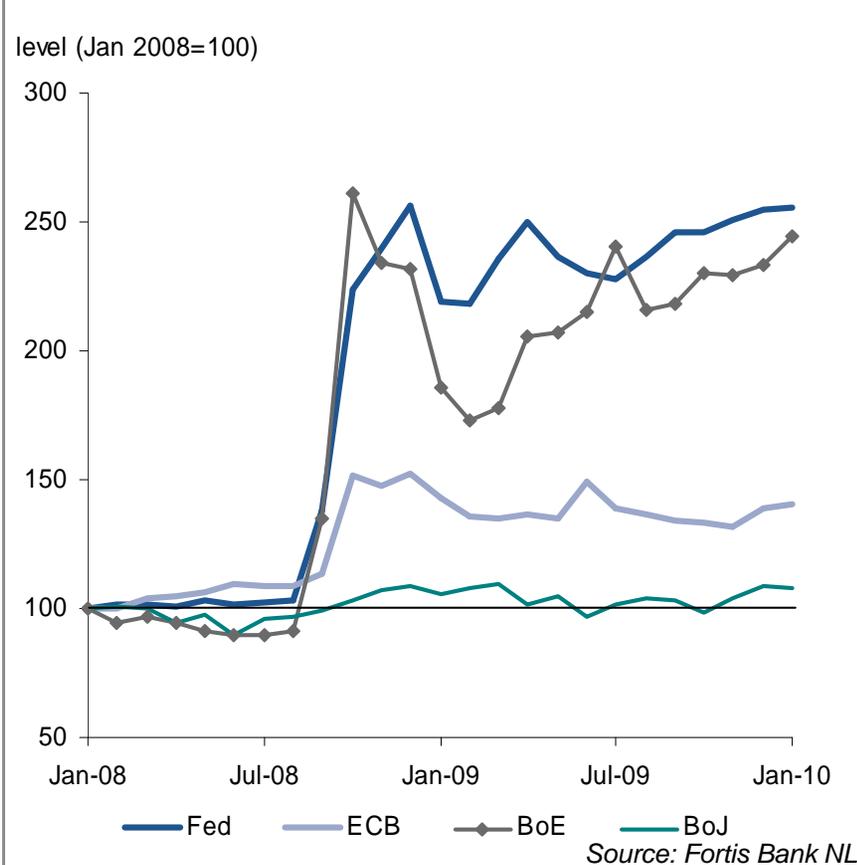
...now share LT unemployed is exploding?



Reserve overhang risks driving inflation expectations higher

Inflation expectations are another important driver of inflation (in addition to excess capacity)

What if bank reserves begin to move?



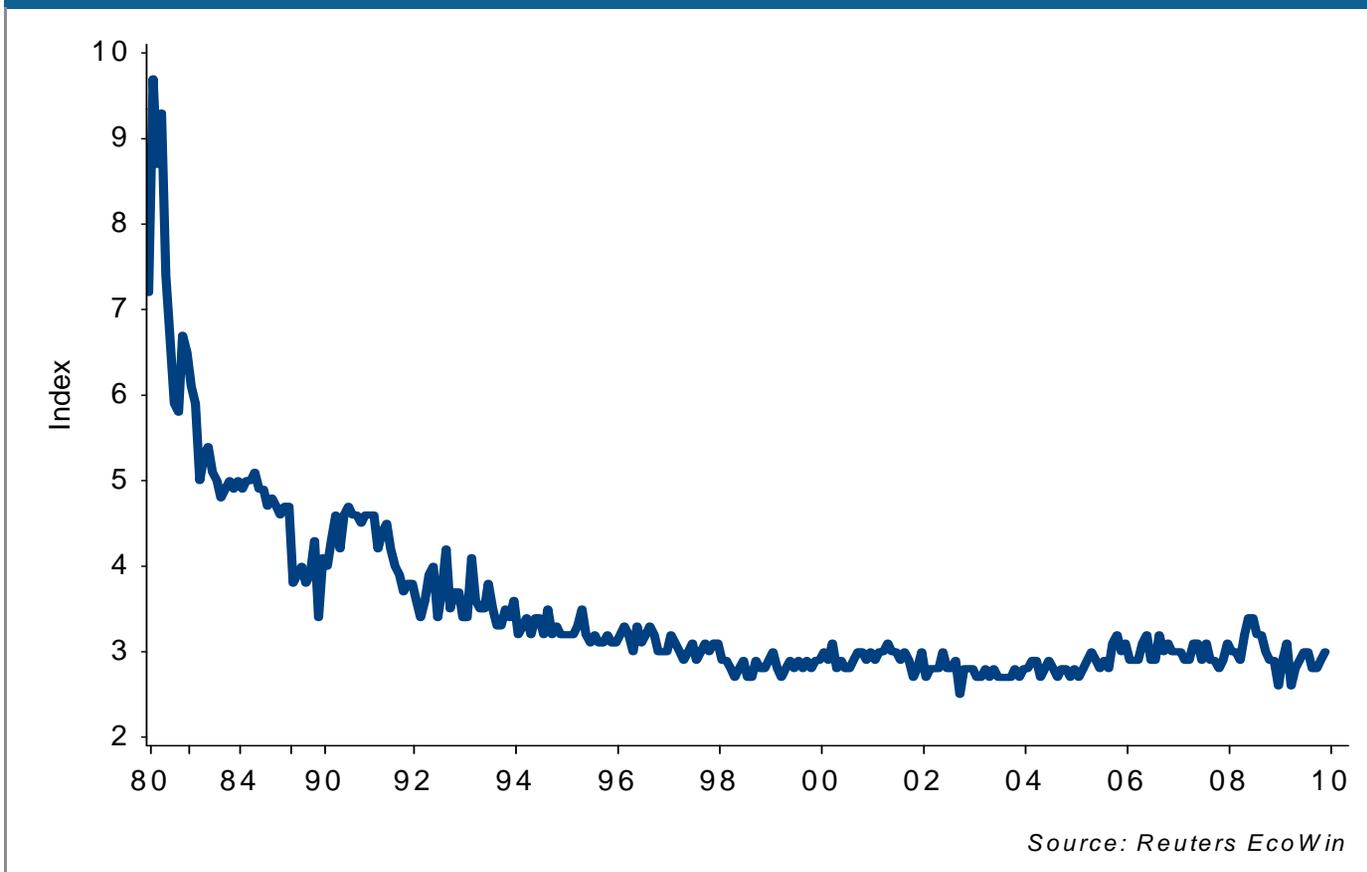
...and central banks are slow to react?

- Money supply would become hard to control, creating risk of new asset bubbles and/or goods inflation
- This could create a process such as in the 1970s, with inflation expectations moving higher, driving actual inflation higher, driving inflation expectations higher etc. (STAGFLATION!!!!!!)

Inflation expectations remain well-behaved, for now

The good news is that, for now, inflation expectation remain under control, and central banks remain relaxed about excess reserves

5-Y inflation expectations (Un. of Mich. Cons. Sent Survey)



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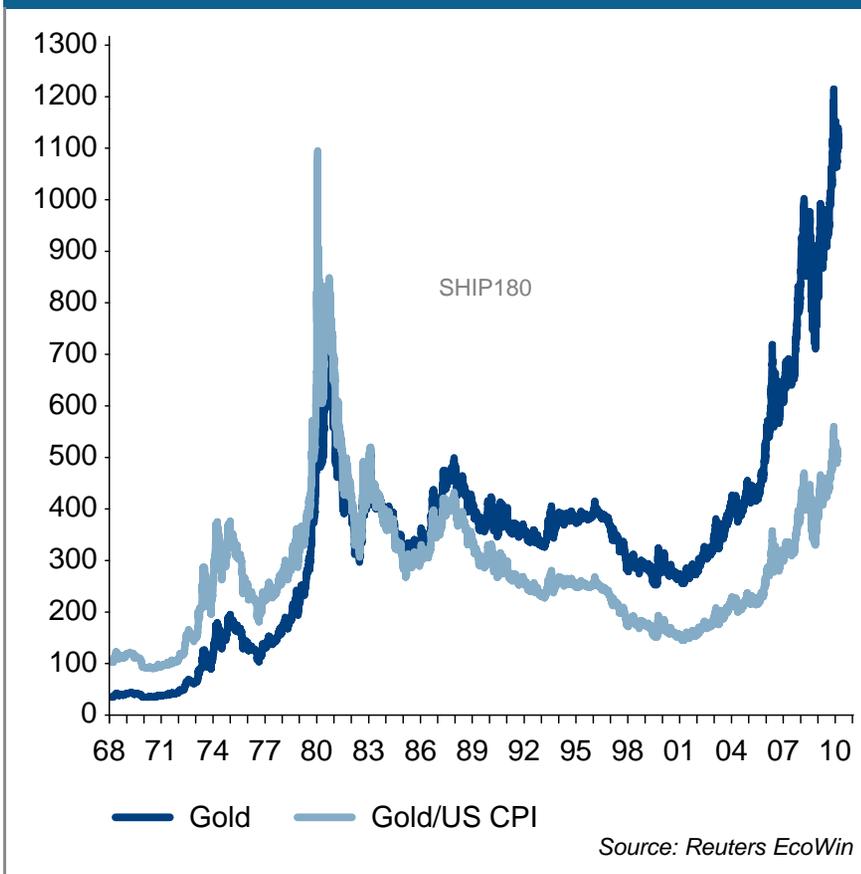
Not yet, but this is clearly a risk for the future!

Equity valuations are at levels last seen in the mid 1990s; neither cheap nor expensive



Commodities are expensive, but not yet 'bubbly'

Gold price in USD



World ind. prod. and Reuters/CRB index

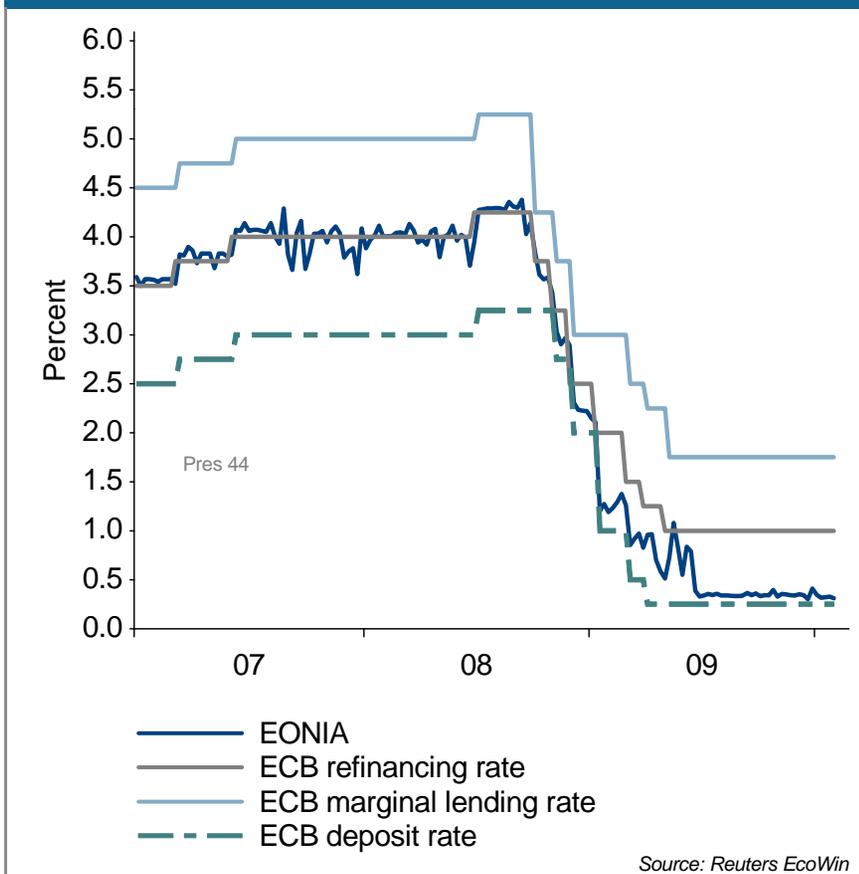


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Rates likely to start moving up from 2010Q4 onwards

ECB policy rates



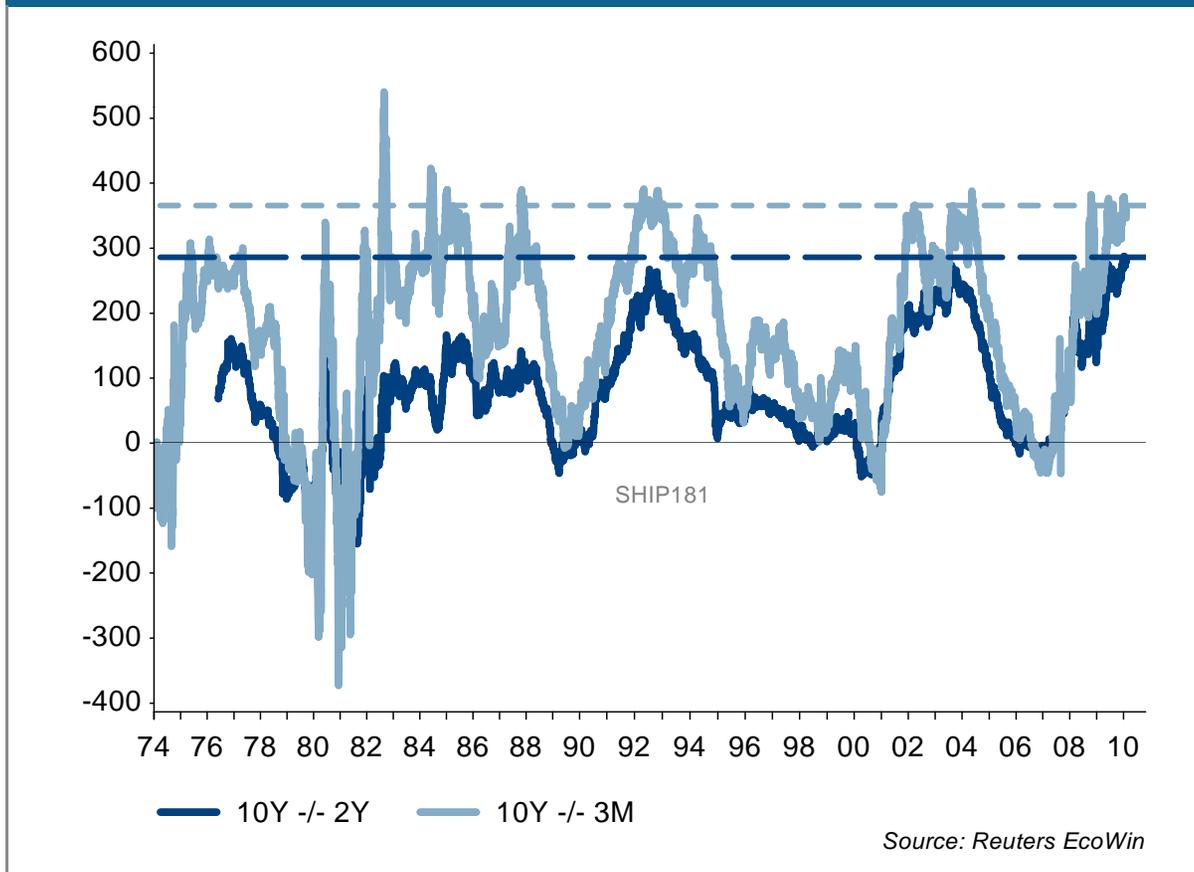
Fed will push up deposit rate

- Excessive liquidity in Eurozone has anchored EONIA at deposit rate (currently 0.25%) rather than refi rate (1%), which is the norm. ECB will gradually withdraw liquidity (pushing EONIA back to refi) before hiking refi rate by 100bp in 2011
- It will be much more difficult for the Fed to withdraw liquidity, but it will try to bind liquidity and reduce money demand by hiking the deposit rate. This should push fed funds rate to 0.75% by end-2010 (from 0.25% now).

Yield curve to remain steep

Yield curve to remain steep, as record-issuance keeps long-term interest rates under upward pressure

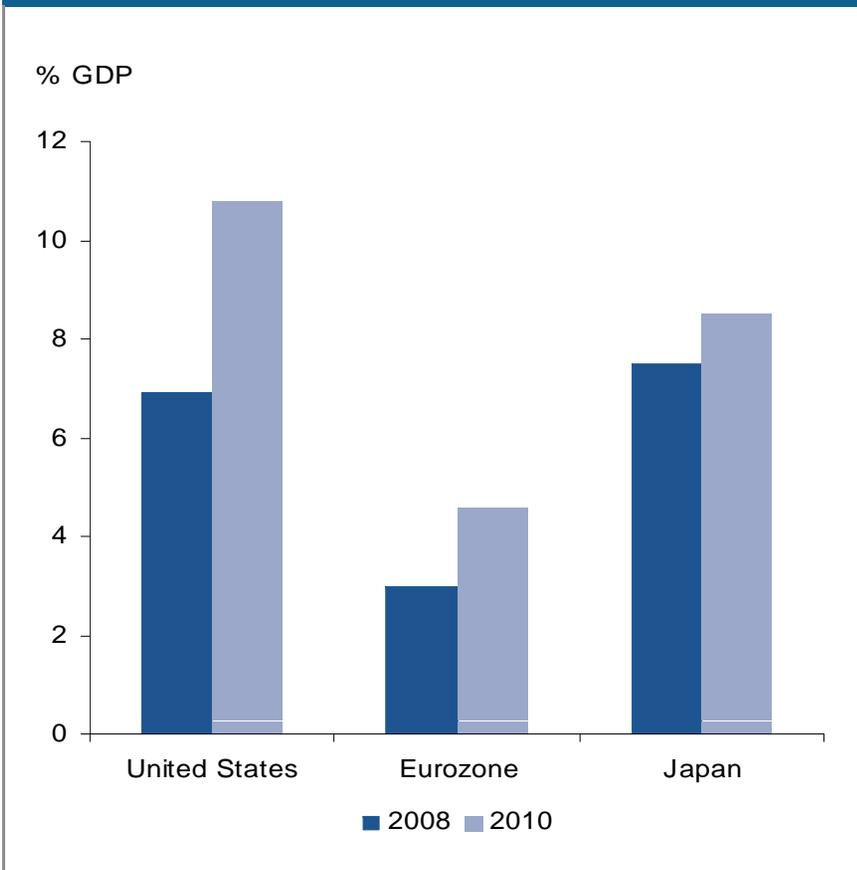
10-Y yields anchored by CB's promise of low interest rates



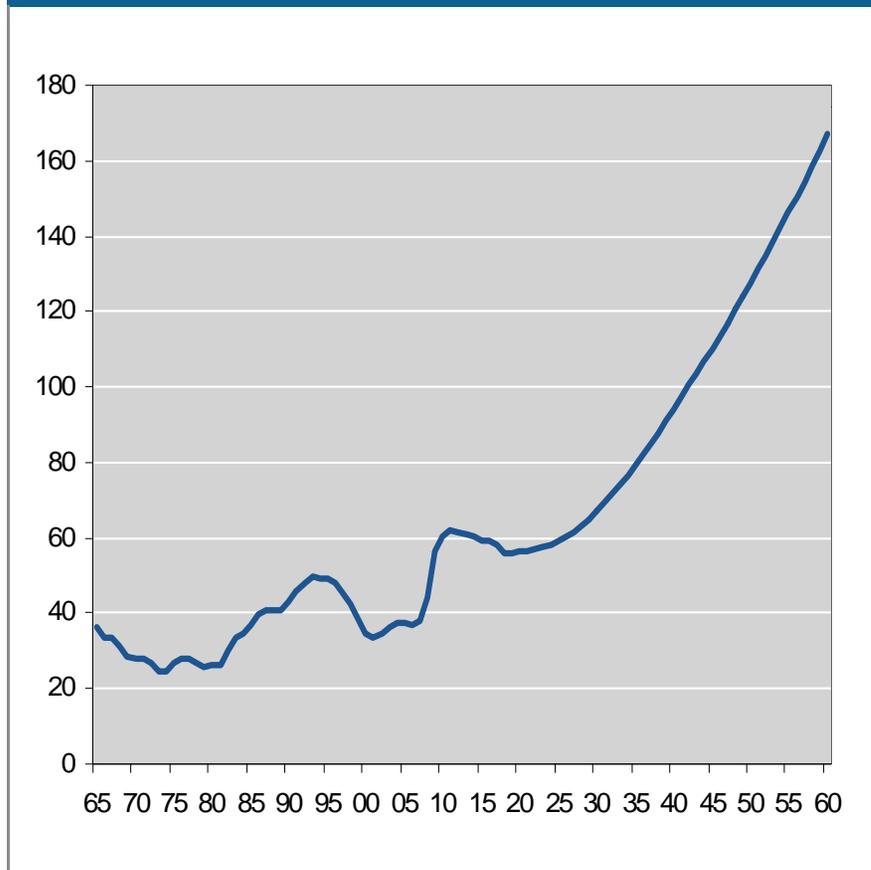
Issuance/sovereign credit concerns to bother govies

Government bond market could get spooked by increased issuance/sovereign credit concerns

Fiscal correction necessary to stabilise debt



US debt ratio will explode if nothing is done!



	<i>17-Mar</i>	<i>3 mth</i>	<i>12 mth</i>	<i>2010 yr-end</i>	<i>2011 yr-end</i>
<i>3-month interbank</i>					
US	0.27	0.30	1.20	1.00	2.90
Euro-zone	0.59	0.80	1.40	1.20	2.20
Japan	0.24	0.25	0.20	0.20	0.20
UK	0.65	0.65	2.20	1.70	3.20
<i>10-year yields</i>					
US	3.64	3.80	4.40	4.10	5.30
Euro-zone	3.12	3.30	3.80	3.50	4.20
Japan	1.36	1.40	1.60	1.50	1.70
UK	3.99	4.20	5.20	4.80	5.80
<i>currencies</i>					
EUR/USD	1.37	1.38	1.34	1.35	1.30
GBP/USD	1.53	1.55	1.53	1.53	1.51
USD/JPY	90	90	105	95	120

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