

14 August 2008

Economic News

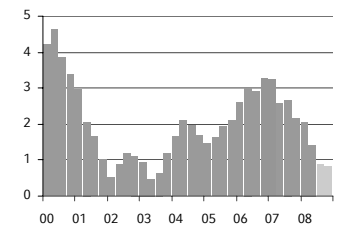
GDP GROWTH AND EXCHANGE RATE

Risks of recession in the eurozone – weaker euro

Economic activity in the eurozone slowed significantly in the second quarter, with GDP down a seasonally adjusted 0.2% q/q. The downswing was not limited to individual countries; all member countries reported a sharp slowdown from the first quarter. In Germany the slump was especially pronounced on the heels of the strong first-quarter results. The significantly gloomier economic outlook also led to a turnaround in the foreign exchange markets. We have therefore revised our exchange rate forecast and now expect a firmer dollar.

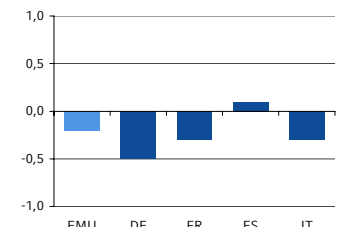
- In the **eurozone**, GDP in the second quarter contracted for the first time since 2003. It was down 0.2% on the previous quarter after rising 0.7% in the first quarter. Thus the downswing that had already hit the USA and the UK has now also reached the eurozone. Detailed figures will not be published until 3 September, but both private consumption – retail sales contracted – and lower investments are likely to have curbed growth. The sentiment indicators suggest that growth will remain weak, and a renewed decline in GDP in the third quarter – and thus a recession – cannot be ruled out, although we do not expect this will be the case for the moment.
- The downturn affected all member states of the eurozone. In **Germany**, however, GDP fell a particularly steep 0.5% q/q due to the strong growth induced by the relatively mild weather in the first quarter. In **France**, too, economic activity weakened significantly, with GDP growth down 0.3% from the previous quarter. A closer look at the details reveals that the mainspring of French growth, i.e. private consumption, rose by only a very modest 0.1% q/q. Investments dropped significantly by 1.5% q/q, and the growth contribution of exports turned negative. In **Spain**, GDP expanded by only 0.1% q/q in the second quarter. The downswing in the property market is now having a significant impact there. **Italy's** GDP declined by 0.3% in the second quarter, as already reported last week. In the **Netherlands**, economic activity stagnated, in **Austria** GDP grew by 0.4% q/q and in **Greece** GDP was up 0.6%.
- With the second quarter turning out worse than had been expected a few weeks ago and given the recent decline in the sentiment indicators, **we have had to correct our EMU forecast**. On an annual average basis we look for real GDP growth of 1.3% for this year, revised down from 1.7%. We see downside risks to our growth forecast of 1.2% for the coming year.

Eurozone – GDP
% y/y



Source EcoWin, WestLB Research

Comparison of EMU countries
GDP in % q/q



Source EcoWin, WestLB Research

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- Revised dollar forecast:** The gloomier economic outlook for the eurozone is also the main reason for the euro's depreciation against the US dollar since mid-July. While the downside risks to growth are tending to increase in the Monetary Union, the better than expected figures recently published in the US have inspired confidence that the economic situation could gradually stabilise in the USA. We had already forecast the dollar would chart an underlying firming trend, but this has now occurred earlier than we had expected. We have therefore revised our exchange rate forecast for the US dollar. Since the US recovery is expected to be bumpy, the dollar is quite likely to be exposed to setbacks in the short term. Over the next three months, therefore, we expect dollar exchange rates in the vicinity of 1.50 USD/EUR. In the medium to longer term, the brightening economic outlook for the USA and accompanying tightening of US monetary policy suggest a firmer dollar. We expect exchange rates of around 1.45 USD/EUR in six months and 1.40 USD/EUR over a one-year horizon.

Euro area

	2003	2004	2005	2006	2007	2008	2009
GDP (in % y/y)	0.8	1.9	1.7	2.9	2.6	1.3	1.2
Consumer prices (in % y/y)	2.1	2.1	2.2	2.2	2.1	3.6	2.4
Unemployment rate (in %)	8.7	8.8	8.9	8.2	7.4	7.3	7.5
Current account bal. (in % of GDP)	0.4	0.8	0.1	-0.2	0.1	-0.2	-0.1
Budget Balance (in % of GDP)	-3.1	-2.8	-2.5	-1.5	-0.6	-1.1	-1.0

Source Eurostat, ECB. – 2008-09: WestLB forecast.

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