

28 January 2009

Economic News

FORECAST REVISION

Global stagnation

After just two months, the growth projections we published at the end of November need to be revised sharply down. The main reason lies in the data so far available for the final quarter of last year which are significantly weaker than expected. In addition, in the **industrialised countries** - notably the **USA** – the data point to a further contraction in economic activity in H1 2009. Growth in the emerging markets is also likely to slow further.

In many countries, **policymakers** initially underestimated the scale of the recession, but over time, more and more details of national economic packages are surfacing. Still, in our view they will take effect with a time lag. Even if virtually no facts are known about the new US president's programme, we assume that the most aggressive economic policy stimulus will be applied in the US.

Given the unexpected severity of the recession, its overlapping with the financial market crisis and the scale of the economic policy response, all forecasts remain subject to **huge uncertainty**.

Bond markets reflect this too. Up to the end of 2008, they had been driven largely by recession and even deflation concerns. Today, there are growing concerns on the negative impact of aggressive issuance to finance the stimulus measures and on the possible emergence of inflationary trends later. While we have raised our yield forecast accordingly, we do not expect government bond yields to rise appreciably over the coming six months.

GDP

in %/y	new		old	
	2009	2010	2009	2010
USA	-2.3	1.0	-1.0	1.0
Japan	-3.0	1.0	-0.2	0.8
EMU	-1.8	1.1	-0.5	1.0
Germany	-2.5	1.3	-1.0	1.3
Industrial Countries	-2.2	1.0	-0.6	1.1
China	5.8	7.0	7.8	8.0
Emerging Markets overall	2.7	4.2	4.0	4.8
World	0.1	2.5	1.6	2.9

Source WestLB Research

FORECASTS

Interest rates / yields in %	current	in 3 in 6 in 12 months		
		in 3	in 6	in 12
Main refi rate	2.00	1.50	1.50	1.50
3M money	2.13	1.80	1.70	1.70
10Y Bunds	3.27	3.20	3.20	3.8
Fed funds	0.25	0.25	0.25	0.25
3M money	1.18	1.20	1.20	1.20
10Y Treasuries	2.53	2.70	3.00	4.00
EUR-USD	1.32	1.30	1.30	1.40

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Global stagnation

Considerably lower growth forecasts for 2009 and 2010

After just two months, the growth projections we published at the end of November 2008 need to be revised sharply down. The main reason is the data so far available for the final quarter of last year. They are far weaker than expected. For example, GDP growth in China officially slowed from 9% to just 6.8% in Q4, and there is already evidence of a further deceleration. After extremely weak monthly indicators, the consensus now expects US GDP to fall by an annualised 5.5% (Bloomberg). We also expect a marked contraction in GDP in Europe at the end of 2008.

The weak basis at the turn of the year per se justifies a substantial revision to the 2009 forecasts. Moreover, virtually all indicators point to further falls in economic activity in the first half of this year – even though economic support measures of governments and central banks worldwide have begun to take shape.

Hope of an effective US economic stimulus package...

It is only in the US that the change of government has led to delays in the urgently needed stimulus package. However, hopes are growing that it will have the structure and size – in contrast to its German counterpart – to be effective in trying to stabilise the economy. Even if so, one can possibly assume only a muted recovery next year. Our fear regarding the US economy is largely based on the still high level of private household debt and the need for adjustments in saving and expenditure pattern that is likely to be triggered by falling asset values. In our view, a sustainable recovery in private consumption – the prerequisite for a broadly based and lasting economic upturn – is unlikely to set in before 2011 at the earliest.

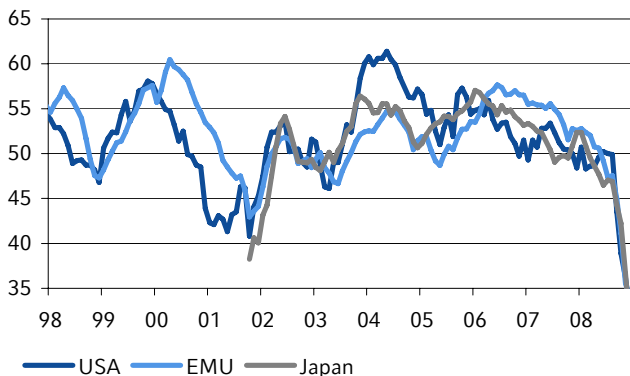
...but a sustainable upswing cannot be expected

Global GDP will stagnate in 2009

Against this backdrop, we expect GDP in the US and industrialised states overall to contract markedly in 2009 and that this will be followed by a muted recovery in 2010. As the emerging markets are increasingly suffering from demand weakness, our forecast predicts that the world GDP will stagnate this year.

G3 Purchasing manager Indices

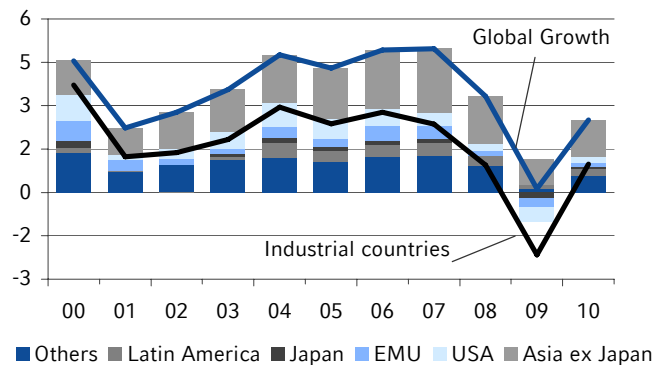
USA, Japan, EMU



Source EcoWin, WestLB Research

Global Growth

Growth contributions (% points) y/y



Source EcoWin, WestLB Research

Uncertainty makes forecasts difficult and leads to increased financial market volatility

Predicting interest rate and yield trends is also difficult given the ongoing uncertainty on the depth and duration of the global recession as well as the scale and effectiveness of the economic measures. At the end of last year, deflation fears had depressed yields on US and German government bonds to new lows. Now, inflation concerns are gradually

emerging, fuelled by the aggressive nature of the economic measures – in particular the zero rate policy that the Fed has been pursuing since December, together with quantitative liquidity management. Further, upcoming new issuance volumes to fund the stimulus packages and bank rescue plans are also a cause of concern for market participants.

Fixed income market less affected by inflationary concerns and more by a fear of a wave of new issues

In view of the global economic weakness, we believe inflation concerns are unreasonable over the coming six to twelve months. However, in our view, the government bond markets are likely to be hit by strong issuance activity and asset allocation decisions (reversal of past safe-haven flows into government bonds). We have therefore raised our yield forecasts. In our opinion, these negatives, combined with ongoing unusually low central bank rates, will probably result in a yield curve that is unusually steep in the context of the given economic situation.

Key rates continue to be extremely low

Finally, we have not adjusted our exchange rate forecasts since the growth revisions affect all regions equally. In addition, we see no reason to revise our assumptions on the central banks' interest rate policies. These can be summarised as follows. Whoever has room to cut rates will exploit this in the coming months. However, outside the US, Japan and Switzerland we expect no explicit zero rate policy for the time being, especially in EMU, where we expect key rates to bottom at 1.5% in the spring.

Forecast risks

Balance of payments and debt levels of several emerging economies are causing headaches

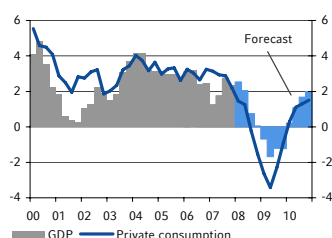
The overlapping of recession and financial market crisis implies that financial markets are highly sensitive towards risks that go beyond cyclical ones. Thus, it is not clear if, how and when the financial market crisis will come to an end and who will actually face a credit crunch as a result. The state of the balance of payments and debt levels make several emerging economies particularly vulnerable and they are thus suffering massive capital outflows. Some, including countries in Central and Eastern Europe, have already asked the IMF or the EU for assistance.

Risks must remain under observation

It is currently not possible to properly estimate the degree to which this trend could escalate. In our core scenario, we explicitly assume that the measures to support economic growth in the industrialised countries will be effective to also prevent the situation from in the emerging economies from deteriorating significantly further. We also assume there will be no major move towards protectionism that would hamper world trade and heighten the crisis. However, both these and other unquantifiable factors must remain under observation; they harbour unclear risks for the future development of the global economy and the financial market.

USA

GDP and private consumption
in % y/y



In the final quarter of last year, nearly all economic indicators fell short of already modest expectations. The consensus expects GDP to decline 5.5% on an annualised basis. The ensuing statistical overhang by itself requires a substantial downward revision to our growth forecast for this year to -2.3%. Next year, we expect a weak recovery of 1%. However, uncertainty in this regard will remain extremely high until details emerge on structure and scope of the Obama administration's stimulus package.

- The indications are that the slump in economic activity in the USA in the winter half-year is much greater than expected. We have therefore markedly lowered our forecast for real GDP and now expect overall output to contract by 2.3% this year.
- On the assumption that the new government quickly implements an economic stimulus package of some 850bn dollars – nearly 6% of nominal GDP – we expect economic activity to stabilise in the second half of the year and a very weak recovery to set in.
- We do not expect the fiscal policy stimulus to strengthen the expansionary forces and to lead to a strong, broadly based upturn. Private consumption in particular is unlikely to drive the US economy forward. Looking ahead to 2010, we therefore expect a sub-average increase in real GDP of just 1.0%.

Key data USA

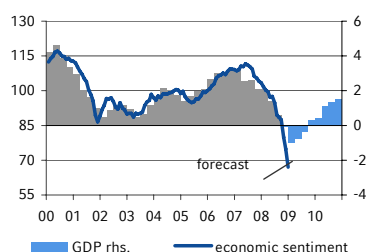
	2007	2008	2009	2010
		in % y/y		
GDP	2.0	1.2	-2.3	1.0
Consumption	2.8	0.2	-2.3	1.0
Residential investment	-17.9	-20.5	-11	1.7
Investment in equipment and software	1.7	-2.1	-10.5	0.5
Net exports ¹⁾	0.6	1.4	0	-0.5
Unemployment rate (in %)	4.6	5.8	8.0	8.5
Consumer prices	2.9	3.8	-1.0	2.0
Budget balance (as % of GDP)	-2.9	-5.3	-11	-6.5
Current account balance (as % of GDP)	-5.3	-5.0	-4.5	-4.2

¹⁾ Contribution to GDP growth

Source EcoWin, WestLB Research forecasts

Eurozone

GDP
in % y/y



The economy in the eurozone has cooled down massively this winter. The industry in particular is suffering from the worldwide collapse in demand. Overall economic output is unlikely to pick up again before the second half of the year. However, any recovery will probably remain weak. GDP is likely to fall by 1.8% this year, and for 2010 we expect an increase of 1.1%.

- In terms of its severity and its synchronous nature, the current recession is similar to the first oil price shock of the 1970s. Moreover, Spain can no longer be counted on as a growth engine due to its own real estate crisis.
- The Eurozone is pursuing a very much expansionary fiscal policy (economic stimulus programmes amount to more than 1.5% of GDP), and according to our forecasts the ECB will cut its key interest rates to new record lows. However, the effect of fiscal policy will be partially counteracted by the increase in the level of household savings. In addition, there are first indications suggesting that as the financial crisis unfolds monetary policy measures are not achieving the usual effects. For example, ECB rate cuts were only partially passed on when granting loans.
- And finally, the US can no longer be relied upon to act as a growth driver of upswings as it did in the past. In previous upswings, even after the first oil price shock, growth in the US picked up earlier than in the eurozone. Overall, we therefore expect only a feeble recovery next year. However, due to the relatively large output gap this implies, we do not expect any demand-side inflationary pressure during the forecast period.

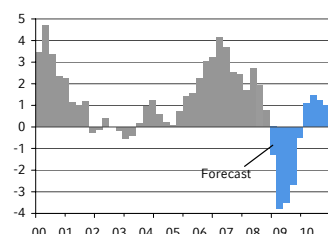
Key data EMU

	2003	2004	2005	2006	2007	2008	2009	2010
% year-over-year								
GDP								
1995 prices, calendar adjusted	0.8	1.9	1.7	2.9	2.6	0.8	-1.8	1.1
Domestic demand	1.3	1.6	2.1	2.8	2.3	0.8	-0.5	1.4
Private consumption	1.2	1.5	1.8	2.0	1.6	0.3	0.0	0.8
Public consumption	1.7	1.6	1.5	1.9	2.3	2.0	3.0	3.8
Gross fixed capital investm	1.3	1.8	3.4	5.8	4.2	1.2	-4.8	0.8
Inventories	0.1	0.2	-0.1	0.0	0.0	0.0	-0.1	0.0
Exports	1.4	6.7	5.2	8.5	5.9	2.3	-3.7	1.9
Imports	3.2	6.5	5.8	8.3	5.4	2.4	-1.3	2.7
Net exports*	-0.6	0.2	-0.2	0.2	0.3	0.0	-1.1	-0.4
* Contribution to growth in percentage points								
Consumer prices	2.1	2.1	2.2	2.2	2.1	3.3	0.5	1.7
Current account balance (in %)	0.4	0.8	0.1	-0.2	0.1	-0.8	-0.4	-0.1
Budget balance (in % of GDP)	-3.1	-2.9	-2.5	-1.3	-0.6	-1.8	-4.1	-3.9
Labor force	0.4	0.8	1.0	1.6	1.8	1.0	0.2	0.6
Unemployment rate (in %)	8.7	8.8	8.9	8.3	7.4	7.5	8.7	9.8

Source EcoWin, WestLB Research forecasts

Germany

GDP
in % y/y



It is becoming increasingly clear that the German economy is in the worst recession since the Federal Republic of Germany has existed. The collapse in global growth is having a huge impact on the German economy, which is heavily reliant on exports. We expect gross domestic product will contract this year by 2.5%. We believe the German government's economic stimulus package will bring about a slight recovery in the second half of the year and that economic product will increase again in 2010 as a result.

- In the industrial sector demand – especially from abroad – has suffered a downright collapse and exports have declined appreciably. A further contraction in exports is inevitable this year. German companies have reacted to the downturn in their international business by reducing their capital expenditure. Experience teaches that they will continue to do so at least until the end of the year especially as the credit conditions have deteriorated substantially in many cases.
- Falling revenues flanked by a simultaneous increase in the cost of lending as a result of the crisis in the financial markets are increasing the pressure to restructure. Although many businesses will try to avoid lay-offs by making increased use of short-time working arrangements the number of unemployed will most probably increase. In this environment a substantial part of the existing income-growth is likely to be reflected in a higher saving rate. As a result, this year will probably see at most a moderate increase in consumer spending.
- All the same, we assume that the increase in government spending within the framework of the economic stimulus package will lead to a moderate economic upswing, albeit not until the second half of the year. Until then, German GDP is likely to continue to contract whereby we expect it will fall roughly as steeply in the current quarter as at the end of last year.

Key figures

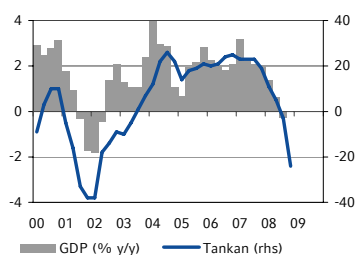
	2005	2006	2007	2008	2009E	2010E
	% y/y					
Real GDP	0.8	3.0	2.5	1.6	-2.5	1.3
Domestic demand	0.0	2.1	1.1	1.1	-0.8	1.2
Private consumption	0.1	1.0	-0.4	-0.4	0.5	0.2
Public consumption	0.4	0.6	2.2	1.8	2.0	1.7
Capital expenditure	1.1	7.7	4.3	3.5	-5.0	2.8
Equipment	6.0	11.1	8.2	3.5	-10.5	0.5
Buildings	-3.0	5.0	1.8	3.0	-1.5	4.5
Other PPE	4.9	8.0	8.0	5.3	2.2	4.3
Inventory ¹⁾	-0.4	0.0	0.1	0.2	-0.5	0.2
Balance of trade ¹⁾	0.7	1.0	1.4	0.5	-1.7	0.1
Exports	7.7	12.7	7.5	4.5	-6.3	3.0
Imports	6.5	11.9	5.0	4.2	-3.2	3.0
Consumer prices	1.5	1.6	2.3	2.6	0.5	1.3
Public balance (as % of GDP)	-3.2	-1.6	-0.2	-0.1	-3.0	-4.0
Unemployed persons (m)	4.86	4.49	3.78	3.27	3.5	4.2

¹⁾ Contribution to GDP growth %

Source Federal Statistical Office, WestLB Research forecasts

Japan

GDP and Tankan
in % y/y and points

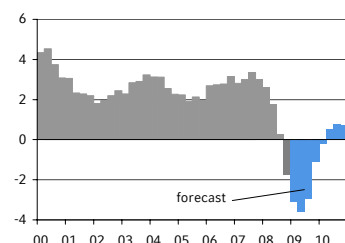


The disastrous development of industrial output and exports, which slumped by 17% and 35% y/y in December, clearly shows that the Japanese economy is in the midst of a dramatic economic downturn.

- Although the Bank of Japan's unorthodox measures have eased the terms of borrowing for companies, capital expenditure is nonetheless likely to fall substantially given the sharp downturn in the business climate. In addition, the dispute between the governing and opposition parties is preventing the economic stimulus package that has been put together by the government from being implemented and is also undermining confidence in the government's crisis management.
- The strains that are appearing in the employment market and the drastic deterioration in consumer confidence that this is causing put the finishing touches to this gloomy picture. With foreign trade likely to continue to contract and with Japanese companies increasingly reluctant to invest and consumption slackening, we assume GDP will decline by 3% in 2009. The Japanese economy should then stabilise again as of autumn this year as the economic situation improves slightly in the important US and eurozone markets and as the Japanese government's economic stimulus package begins to bite.

UK

GDP
in % y/y

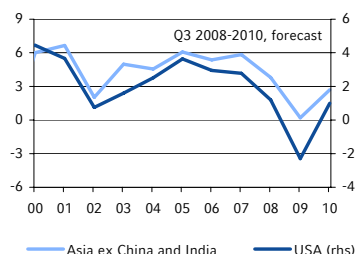


In the UK, the recession is proving to be more severe than we had expected up to now. In Q4, economic output contracted by 1.5% q/q, which is the sharpest fall since 1980. In particular, the construction sector is suffering from the slump in the real estate market. We expect GDP to decline by 2.7% this year and believe that 2010 will only see a very weak increase of 0.5%.

- The UK government's economic stimulus package, which centres around a temporary reduction in VAT and an expansion of infrastructure investment, will provide an economic boost that is equivalent to about 1.5% of GDP this year. However, this may well merely be sufficient to limit the depth of the recession. Private consumption will be hit by negative wealth effects and the savings rate up until now remained at an all-time low level and is supposed to increase in the future.
- The Bank of England can now buy up commercial paper and syndicated credit, etc., directly. This means that it can now also pursue a policy of quantitative easing, i.e., directly control the money supply. This is a welcome move because there are mounting signs that the Bank of England's rate cuts are only feeding through to lenders in a limited fashion.

Emerging Markets

GDP
in % y/y



Last year the emerging markets were still expanding, posting GDP growth of 6%. This year GDP is only likely to grow by a meagre 2½%. Although most emerging markets have not been directly affected by the US subprime crisis and despite the fact that most of them—barring a few black sheep—also have a sound banking system, the international financial markets crisis is now also taking its toll on Central and Eastern Europe, Asia and Latin America. The close trade ties with the industrialised countries, their reliance on inflows of foreign capital and the increased risk-aversion among investors are all exacerbating the economic downturn here.

- **Central and Eastern Europe** The average regional GDP for the EU member states of Central and Eastern Europe is likely to stagnate this year. We also expect that it will recover only slightly next year. However, the regional average conceals the fact that the situation in the individual countries differs considerably: the Baltic countries and Hungary are in a deep recession, while the two largest countries, Poland and the Czech Republic, are still posting moderate annual average growth rates.
- **Asia** The economies of Asia will be drawn down in the wake of the continuing slow-down in growth in the industrialised countries because today they are integrated in the global value-added chain more than ever before. Due to the fundamental slackness of demand in overseas markets, the Asian emerging markets' exports are contracting sharply and the economic indicators are pointing to a dramatic economic downturn in some cases. Not even China will be able to escape a substantial slow-down in growth: GDP will probably grow by less than 6% in 2009. The fiscal and monetary-policy counter measures taken in the individual countries will have hardly any impact before the summer so growth is likely to contract significantly in H1 2009.
- **Latin America** The Latin American economies are also affected by the steep decline in demand in all classes of goods (consumer and capital goods as well as commodities). Because of their close trade relations with the United States, the US recession will also have a severe impact on growth here.

Key figures:

	2007	2008	2009E	2010E
Central and Eastern Europe	6.4	4.8	0.0	1.5
Poland	6.7	5.5	1.0	1.5
Czech Republic	6.6	4.3	0.8	2.0
Hungary	1.3	0.9	-2.5	1.0
Asia ex Japan	9.7	7.0	3.6	5.7
China	13.0	9.1	5.8	7.0
India	9.3	7.0	5.0	6.0
Asia ex China and India	6.0	3.8	0.0	2.7
Latin America	5.6	4.7	1.4	3.0
Brazil	5.4	5.3	2.0	3.0

Source EcoWin, WestLB Research forecasts

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