Economic View

April 2010

Summary

Macro economic developments

Euro area

Since the end of February the sentiment on financial markets has been severely influenced by the Greek monetary issues. The European member states do not agree on the conditions for a loan to Greece which, amongst others, puts a tremendous pressure on the value of the euro.

United States

Confidence with respect to the American economy seems to restore slowly. Producers and consumers are moderately positive with respect to the economic developments and growth of unemployment seems to stagnate.

Interest rates

Last Thursday the Europan Central Bank (ECB) decided not to change its most important interest rate; the refinancing rate. Therefore, the rate remains at it's historical low level of 1%. Both the Bank of England and the Bank of Japan also decided not to change their refinancing rates.

Foreign exchange

The Greek problems and the fear for the economic developments in Portugal have put a strong pressure on the value of the euro currency. This has resulted in a depreciation of the euro as compared to the US dollar and the yen.

Furthermore, China is considering to revaluate its artificially low yuan, which has been a concern for the United States of America for quite some time now.

	Euro area		**United States**	
	Q4	Q1	Q4	Q1
GDP growth (%YoY)	-2.1	*	0.1	*
Unemployment (%)	9.9	*	10.0	9.7
	9-Mar-10	**6-Apr-10**	**9-Mar-10**	**6-Apr-10**
Refinance rate (%)	1.00	1.00	0.25	0.25
10-year swap rate (%)	3.33	3.32	3.73	3.94
EUR/USD	1.36	1.34		

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Euro area

Since the end of February the sentiment on financial markets has been severely influenced by the Greek monetary issues. For almost a month it seemed that the European Union (EU) was not prepared to provide any financial help to Greece. This has put a tremendous pressure on the value of the euro currency. On the 25th of March however, an agreement was reached between the EU and the International Monetary Fund (IMF) to provide a loan to Greece. The IMF will provide the initial loan and if necessary the EU would provide additional financing. However, the European Member states have not yet reached an agreement on the conditions of this loan. Most member states would like to receive a subsidized interest of approximately 4%, whereas Germany wants to receive an interest that is in line with the current rates. Due to these discussions the financing costs on the Greek bonds increased to 7.6%, which is more than 400 basis points above the yield on the German Bund.

Besides Greece also other European member states are experiencing problems with their monetary state of affairs. The rating of Portugal for example, was downgraded from AA to AA- by rating agency Fitch. Portugal was accused of not doing all means necessary to diminish its budget deficit.

The Irish government implemented a €81 billion fund where banks can place their 'bad property loans'. Via this fund the Irish government is trying to help out the national banks by giving them the opportunity to clean up their balance sheets.

As a result of the monetary issues that are at hand in the Eurozone, the European Commission decided to implement stronger regulation with respect to the usage of Credit Default Swaps. A lot of countries have used these products to keep certain parts of their national debt out of the picture.

Date		GDP	Gov.	Cons.	Inv.	Imp.	Exp.	Unemp.
2008	Q1	2,2	1,6	1,6	2,6	9,7	7,2	7,2
	Q2	1,5	2,1	0,6	1,2	12,7	8,3	7,4
	Q3	0,4	2,1	0	-0,7	13,1	5,1	7,6
	Q4	-1,8	2,3	-0,7	-5,9	-2,2	-4,9	8,0
2009	Q1	-5,1	2,4	-1,4	-11,6	-20,9	-21,1	8,8
	Q2	-4,9	2,2	-1	-11,9	-27,2	-23,1	9,3
	Q3	-4,1	2,5	-1,1	-11,6	-25,7	-19,4	9,7
	Q4	-2,1	1,8	-0,6	-8,7	-13,9	-7,6	9,9
2010	Q1	*	*	*	*	9,0	12,8	7,4

Table 1: GDP components (%YoY) + unemployment (%)
Source: Bloomberg (see Appendix for definitions)

Due to the problems of the European member states with respect to public finance the economic forecasts are somewhat mixed. The Markit Economics Industrial Purchasing Manager Index, as it was published earlier this week, showed a score of 56.6. This is an increase compared to the score in February of 54.2, which indicates that there is significant economic growth. However, consumer prices increased with 1.5% as compared to the prices in March 2009. This was contrary to the expectations of an increase of 1.1%. This large increase in consumer prices was mainly caused by the increasing price for oil. Furthermore, unemployment in the Eurozone rose to 10% of the working population in February. The last time unemployment was reported in double digits was in 1998.

Despite the decreasing value of the euro, the European budget deficit was much higher than expected. Due to a sharply diminished export the deficit totaled €8.9 billion, whereas the expectation was €4 billion.

United States of America

Figures, as presented by the Institute for Supply Management (ISM), indicate that the American Purchasing Manager Index has unexpectedly increased in March. The Index showed an increase to 55.4 from 53.0 in February.

Figures with respect to Consumer Confidence in the United States showed no differences as compared to the month of February. The index remains at 73.6 whereas analysts had expected a slight decrease towards 72.5. Figures with respect to producer confidence showed a slight increase.

Employment increased less than expected. Last week the United States Department of Labor published figures that indicated 164,000 new jobs were created, whereas 200,000 new jobs were expected. For the 26th consecutive month the number of unemployed increased. However, this increase seems to slow down. The unemployment therefore remains at 9.7% of the working population, which is the same percentage as published in February.

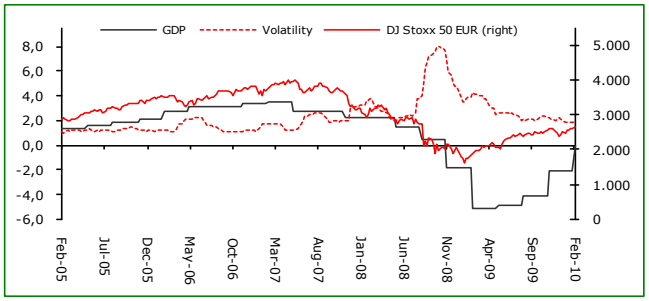

Figure 1: GDP (YoY), DJ Stoxx 50 EUR + volatility

The expected sales of houses for the months April and May indicate an increase of 8.2% as compared to the figures that were published in January of this year.

President Barack Obama managed to get its controversial health care plan through the American senate. This new plan will most probably have a significant positive impact on the sales of the pharmaceuticals. The "YES" for the new plan therefore resulted in large stock price increases for the listed pharmaceuticals.

Appendix

Table 1
Gross Domestic Product (GDP) is equal to the sum of private consumption, investment, government spending and trade balance (i.e. export minus import). All GDP components are calculated on a year-to-year basis. Table 1 is further expanded with statistics about the unemployment rate.

Figure 1
Economic growth should among others be reflected in higher stock levels, while the certainty of the financial markets can be measured by some volatility level. This latest measure is here calculated as a 60-day deviation around the DJ Stoxx 50 EUR average and scaled (i.e. multiplied by 0.1).

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Interest rates

Europe

Yesterday, the European Central Bank (ECB) announced that it will not change its most important interest rate; the refinancing rate. Therefore, this rate remains at 1%, which was expected by all economists that were interviewed by Bloomberg. These economists also expect that the ECB will not change this interest rate in the course of 2010. The refinancing rate for the Eurozone has been decreased with 325 basispoints between October 2008 and May 2009, and has been on the 1% level ever since with the intention to support economic recovery. This level is the lowest percentage since the ECB was founded ten years ago.

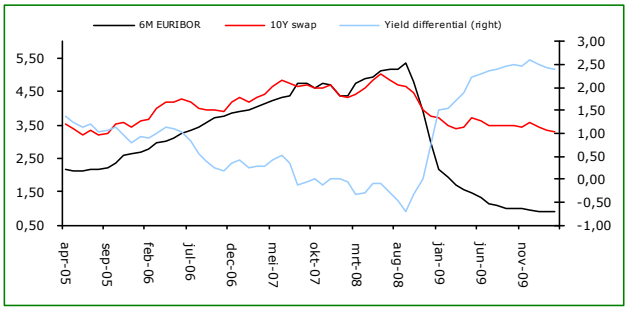

Figure 2: 6M EURIBOR (%), 10Y swap (%) + yield differential (%). Source: Bloomberg (see Appendix for definitions).

During the statement with respect to the ECB decision Trichet mentioned that Greece is not in danger and will be capable to pay their debts. However, Greece will have to implement intensive budget cuts to resolve the current matters. Last Thursday, financial markets where again very uncertain about the Greek situation which resulted in a yield on the 10 year obligation of 7,6%, which is the highest level since the accession to the Eurozone in 2001.

3M Euribor	Q2	Q3	Q4	Q1 '11
Raiffeisen (Apr/02/10)	0,70	1,00	-	1,80
ING (Mar/12/10)	1,00	1.30	1.60	-
Danske Markets (Mar/15/10)	0,75	1,20	-	1,55
Forward curve (Apr/07/10)	0,99	0,99	0,99	0,99

Table 2: Forecasts for the3M EURIBOR.

10Y Swap	Q2	Q3	Q4	Q1 '11
ING (Mar/12/10)	3,50	3,80	4,00	-
Deutsche Bank (Apr/01/10)*	3,25	-	3,60	3,75
Danske Markets (Mar/15/10)	3,50	3,70	-	3,90
Forward curve (Apr/07/10)	4,61	4,68	-	4,74

*Table 3: Forecasts for the10Y Eur Swap.*10Y Euro Benchmark bond yield.*

However, the yield on the 10 year German bond has been slowly decreasing since the end of 2009 and now shows yields between 3% and 3.4%. The yield on the 10 year American obligation was 70 basispoints lower as compared to the German equivalent at the beginning of 2009, but is currently 70 basispoints higher.

The Bank of England has also kept the refinancing rate, as expected, at the current level of 0.5%. This rate is the lowest since the existence of the central bank in 1694.

United States of America

The minutes of the Federal Reserve Bank (FED) meeting on the 16th of March have been released and clearly show that the central bank will keep the refinancing rate at its current low level for the upcoming months.

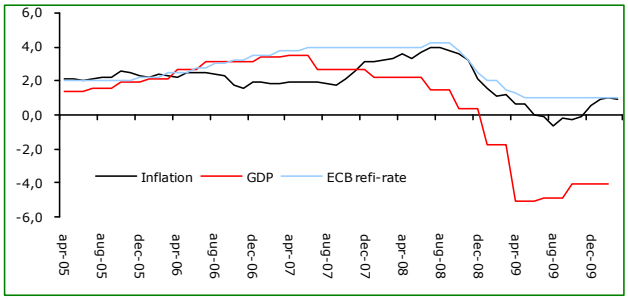

Figure 3: Inflation (YoY), GDP (YoY) + ECB refi-rate (%). Source: Bloomberg (see Appendix for definitions).

The FED expects a moderate inflation and does not see any signs that the situation on the housing market will improve or that unemployment will diminish any time soon. Therefore, it will not increase the interest rate.

Date		Inflation	M3	ECB refi-rate
2008	Nov	2,10	7,70	3,75
	Dec	1,60	7,60	3,25
2009	Jan	1,10	6,00	2,50
	Feb	1,20	5,90	2,00
	Mar	0,60	5,20	2,00
	Apr	0,60	4,90	1,50
	May	0,00	3,90	1,25
	Jun	-0,10	3,70	1,00
	Jul	-0,70	2,90	1,00
	Aug	-0,20	2,40	1,00
	Sep	-0,30	1,80	1,00
	Oct	-0,10	0,30	1,00
	Nov	0,50	-0,30	1,00
	Dec	0,90	-0,30	1,00
2010	Jan	1,00	0,10	1,00
	Feb	0,90	-0,40	1,00
	Mar	*	*	1,00

Table 4: Inflation (YoY), M3 (%) + ECB refi-rate (%).Source: Bloomberg (see Appendix for definitions)

The Bank of Japan did decide earlier this year to keep the Japanese refinancing rate at the current level of 0,1%. The last time the Bank changed its interest rate was in December 2008.

Appendix

Figure 2

The slope of interest rate curves (i.e. yield differential) is related to economic growth and should increase when long-term interest trend upwards that may point to an extra motivation for capital investments. The short-term interest rates largely reflect inflation expectations.

Figure 3 and table 4

Nominal interest rates are mainly driven by (expected) inflation; and therefore indirectly by economic growth, monetary policy and energy prices. Inflation and money supply are measured on a year to year basis.

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Foreign Exchange Rates

EUR/USD

The uncertainty with respect to the rescue plan for the Greek monetary problems and the fear that Portugal is also facing similar problems has put a tremendous pressure on the value of the euro. The European currency has depreciated in value to $1.33. This is the lowest notation in more than ten months. By the end of November 2009 the currency was valued at $1.50, but has decreased ever since. This makes the euro, next to the British pound, the worst performing currency as compared to the US dollar.

According to several analysts the euro has been decreasing due to the fact that the Euro member states cannot come up with an adequate solution for the problems in Greece. The market perceives this as a signal of weakness, whereby the EU apparently is not capable of resolving these kind of issues.

EUR/USD	Q2 10	Q3 10	Q4 10	Q1 11	2011
BNP Paribas (Mar/30/10)	1,36	1,32	1,27	1,22	1,21
UBS (Mar/15/10)	1,30	-	1,50	-	1,60
JP Morgan (Mar/26/10)	1,42	1,45	1,40	1,35	-
Commerzbank (Mar/15/10)	1,38	1,35	1,33	1,32	-
Forward curve (Apr/07/10)	1,34	1,34	1,34	1,34	1,34

Table 5: EUR/USD forecasts

Since Greece cannot devaluate its currency to resolve the problems, it will probably face strict budget cuts that are combined with any rescue plan. This will most probably automatically result in deteriorating economic growth potential for the Greek economy. It is expected that the euro will remain under pressure for the short term, as long as the European member states do not come up with an adequate solution for the Greek problem.

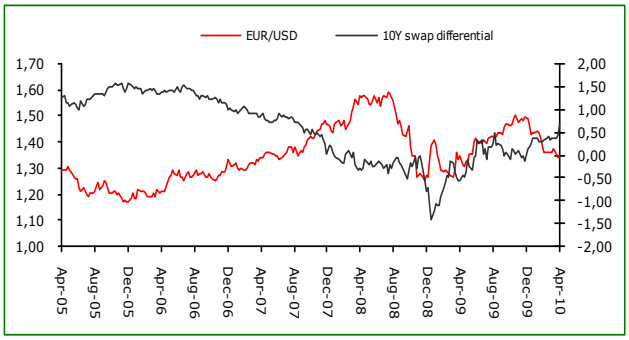

Figure 4: EUR/USD + 10y swap differential (%)

The British pound was also affected in March and devaluated strongly compared to the US dollar. This was mainly caused by Andrew Sentence, member of the Monetary Policy Committee of the British Central Bank, when he mentioned that there exists a possibility that the United Kingdom is facing a W-shaped recession

Asia

The Japanese currency also profited from the ongoing uncertainty with respect to Greece. The euro depreciated as compared to the yen to a quote of 125.4 yen.

Multiple Chinese government officials have mentioned that China is considering a revaluation of the national currency, the Yuan. For multiple years, the Chinese government has artificially kept the currency at a low level by connecting it to the US dollar. Between July 2005 and July 2008 China has intentionally appreciated the Yuan with 21% as compared to the US dollar. As of then, the currency has been locked to the US dollar again. This has protected the Chinese exporters against the negative consequences of the credit crisis.

According to American economists the yuan is approximately 25% to 40% undervalued. The United States of America has declared that China hereby creates an unfair competitive position that harms employment in America. Naturally, a liberal currency exchange rate policy would help America to strengthen its trade balance.

EUR/JPY	Q2 10	Q3 10	Q4 10	Q1 11	2011
BNP Paribas (Mar/30/10)	129	129	131	131	143
UBS (Mar/15/10)	124	-	135	-	136
JP Morgan (Mar/26/10)	124	131	130	130	-
Commerzbank (Mar/15/10)	132	132	140	145	-
Forward curve (Apr/07/10)	126	126	126	125	124

Table 6: EUR/JPY Forecasts

Asian governments have not responded with respect to the currency exchange rate policy of China. They are aware that their own economies have restored quickly from the global recession due to the economic growth in China. Furthermore, any comments on the Chinese policy could lead to economic and political repercussions by the Chinese government.

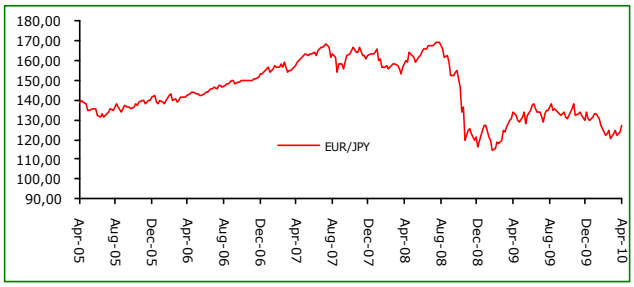

Figure 5: EUR/JPY exchange rate

Also European member states have not expressed significant concerns with respect to the exchange rate policy of the Chinese government. Only European Central Bank chairman Jean-Claude Trichet mentioned the issue when he was in Beijing last year. This is probably the result of the time and effort that goes to the Greek problems. What also should be mentioned is that the effects of a cheap yuan are less severe in Europe as compared to America. Furthermore, since November 2009 the Euro has depreciated in value with 11% as compared to the US dollar, which thus automatically is reflected in the value compared to the yuan.

Appendix

Figure 4 and 5

Foreign exchange rates are mainly driven by (expected) yield differential and differences in trade balances.

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