

Economic View

In Economic View, Zanders integrates the views of various large banks and economic institutions. The information and insights presented form a useful guide for mapping out interest rate and foreign exchange strategies as well as establishing realistic calculation levels to determine internal cost prices. From time to time, Economic View also provides short-term strategies and advice on how to reach well-founded hedging decisions, in which the ratio is predominant. Written by Zanders' consul-

tants, who can count on experiences gained in day-to-day practice, Economic View is a recurring item in Zanders Magazine.

In this issue, we provide an overview of the economic developments in the Eurozone and the US. Naturally, the consequences of the credit crisis are at the forefront.

Economic developments in the Eurozone and US

The most recent economic statistics from the Eurozone and the US are not entirely reassuring. The unemployment rates on both sides of the Atlantic stand at 9.4% (figures for June and July), and this is expected to rise further. Recent legislation, which allows shorter working hours and has a cushioning effect on unemployment, will not remain in force for ever and ultimately more people will be made redundant, unless the economy picks up again.

According to the US Commerce Department, the Gross Domestic Product (GDP) in the United States shrunk by 1% (annualized) between April and June. This would represent a stabilization of the fall in GDP. Consumer spending, which accounts for 70% of US GDP, decreased by 1%, however, whereas it had surprisingly risen by 0.6% in the previous period.

Return to growth

On a positive note, the first signs of the end of the recession are starting to appear. In Asia, the emerging economies, led by China, grew at annualized rates of 10% in the second quarter. The swift revival in Asia stems from the stronger Asian domestic markets. The fiscal package of stimulation measures was also bigger compared with those in the West. The return to high growth rates in Asia has a positive effect on the global economy, because Asian countries are increasingly becoming part of the consuming global population. Asian consumption will amply make good the falloff in American consumption. A shift in the ratio between consumer spending in America and in Asia is conducive to a balance in the global economy.

Although the growth rates are more modest than in the Asian countries, a few mature economies also got back to growth in the second quarter. In Europe, both Germany and France exhibited a moderate annualized growth of 1%. Japan actually grew by 3.7% on an annual basis. A majority of European countries, including the Netherlands, still faced shrinking economies over the past quarter. Countries with a large open economy, like the Nether-

lands and Belgium, saw their GDPs quickly fall due to the decline in global trade. Open economies are expected to benefit (more than others) once global trade picks up again.

	Eurozone		United States	
	Q1	Q2	Q1	Q2
GDP growth(%YoY)	-4.9	-4.6	-3.3	-3.9
Unemployment (%)	9.0	9.4	8.1	9.3
	8-Jul-09	6-Aug-09	8-Jul-09	6-Aug-09
Refi interest rate (%)	1.00	1.00	0.25	0.25
10-year swap interest rate (%)	3.54	3.58	4.03	3.54
EUR/USD	1.39	1.43		

Table 1: Economic developments in the Eurozone and the US.

Positive reports are coming out of the US on the back of a stabilizing property market. The S&P Case-Shiller Index (which tracks house prices in 20 US cities) increased for the first time in 24 months in May, and the increase was sustained through June. Many people now recognize that house prices can go down as well as up. According to some analysts, the recognition will lead to a growth in the derivatives market so as to hedge fluctuations in house prices. In the US it is already possible to invest in 'Macro Shares'. This gives individuals in the US a possibility to hedge the risk of falls in the price of their most valuable asset. The derivative increases or decreases in value depending on the regional house price index. It is an interesting development.

Future scenarios

As always the question is what will happen in the near future. The most optimistic scenario is that the economy will quickly and robustly return to growth. Reasons for believing that this scenario is likely include stimulation measures that are starting to work. Another argument is that the inventories can start to increase again. An important part of the negative growth in the past quarters was caused by companies scaling down production and selling off their inventories. This exacerbated the contraction. If

this process reverses, it may provide an extra stimulus for economic growth.

A second scenario is the biggest fear of some analysts, namely that the global economy will exhibit a double-dip. As stimulation measures and inventory measures are temporary by definition, there is a risk that the economy will slump again after a short period of growth. To avoid this scenario it is necessary to absorb the falloff of the positive growth driven by temporary effects by growth in the private sector and consumer spending.

The average European household has started to save more and American consumers will have to start paying off their debts, resulting in lower consumer spending. Cushioning measures like the 'Cash for clunkers' program in the US did result in higher consumer confidence in August, however. Here again, the temporary nature of the program means that consumer confidence remains fragile and that the double-dip scenario may as yet become reality. Q4 of 2009 and Q1 of 2010 are going to be important quarters, because by then the statistics are unlikely to reflect most of the temporary effects.

In the third scenario, there will be a longer period of contraction before any growth starts to occur. This scenario appears to be the least likely because a few European economies are already exhibiting a small growth.

Signals from central banks

Over the past months the European Central Bank has kept its most important rate historically low at 1%. The ECB does not see an economic recovery occurring until midway through next year. The market is interpreting this expectation as a sign that the ECB will leave its principal interest rate unchanged for the coming 12 months. For a long time now the Fed has stuck to its position of keeping the Target Funds Rate at a very low level. It is expected to stay at between 0% and 0.25% until mid-2010. However, Fed chairman Fred Bernanke has pointed out that these unconventional measures are easy to undo.

US interest rate forecast	Now	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10
10-years	3.48	3.69	3.83	3.97	4.10	4.29
2-year	1.06	1.16	1.34	1.51	1.78	2.17
3-month LIBOR	0.35	0.51	0.56	0.65	0.84	1.13
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.50	0.75
Spread (10Y / 2Y)	2.42	2.53	2.49	2.46	2.32	2.12

Table 2: Interest rate forecasts for US (%)

Interest rates: looking for a way to go

European medium-term interest rates are surrounded by doubts regarding the future state of the economy. This can be seen in the movements in returns on government bonds. After a lot of positive news about the state of the economy in a short space of time, the prices fell and the returns rose. Prices increased again when the Chinese premier said that the authorities should not be blindly optimistic about the economy. Due to the uncertainty concerning the sustainability of the current minimal recovery, the expectation is that the yield on government paper will remain low for a prolonged period of time.

10Y Swap	Q2 09	Q3 09	Q4 09	Q1 10
Rabobank (28 August 09)	3.68	3.84	3.99	4.10
Deutsche Bank (22 June 09)*	3.39	3.25	3.00	3.00
ING (15 July 09)*	3.36	3.50	3.50	3.60
Forward curve (28 August 09)	3.49	3.56	3.84	3.99

Table 3: forecasts for the 10Y Swap (%)

* Deutsche Bund

Liquidity mark-ups remain for the time being

A few banks, including Van Lanschot, have expressed their disquiet in the media about the effect of the support given by the Ministry of Finance to some banks. As a result of this support, savings interest rates remain high (too high) and funding for banks remains disproportionately expensive. This means that borrowing continues to be expensive, despite the low interest rates outlined above. There is also the ongoing complaint that banks are still reluctant when it comes to issuing loans. This obviously has an adverse effect on investments and thus on economic activity.

Derivatives for limiting your risks

Unfortunately for some home owners, the aforementioned derivative for local house prices is not yet available because of recent price drops in the real estate market. However, you can contact us about the valuation of all your existing derivatives and any issues regarding determination of the effectiveness of your hedges. Zanders can assist not only in the valuation of your hedges, but also in identifying any ineffective components, the outcome of an imperfect hedge and, ultimately, how these circumstances impact on your financial accounting.. <



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