



# Economics Weekly

15 June 2009

## Recession cannot disguise ongoing shift in global economy

Whilst the focus in global financial markets is, rightly, on when the recession will end, and on speculating on whether the proliferating signs of economic recovery are sustainable or not, there is another less observable trend that has not been changed by the recession: this is the higher share of global economic output taken by the emerging markets. Chart a highlights this trend. We have calculated the share of world economic output accounted for by the top ten developed economies (ranked according to their share of gdp) over the last 28 years and compared that group with the top ten emerging economies, also ranked by gdp. The results are clear: the share of the developed economies has fallen sharply, whilst the share of the emerging economies has, not surprisingly, risen equally sharply.

**Table 1: Global growth shifts to emerging markets**

G 10*	Averages			Forecast	
	10yr	5yr	2yr	2009f	2010f
GDP (%)	2.3	2.2	1.5	-2.8	1.6
Inflation (%)	2.0	2.4	2.6	-0.1	1.4
Current a/c (% of gdp)	-1.5	-1.7	-1.5	-1.0	-1.0
Fiscal balance (% of gdp)	-2.6	-3.2	-3.2	-7.1	-7.6
<b>Emerging markets*</b>	<b>10yr</b>	<b>5yr</b>	<b>2yr</b>	<b>2009f</b>	<b>2010f</b>
GDP (%)	8.2	10.1	10.3	1.4	5.6
Inflation (%)	8.2	5.4	6.3	4.4	3.6
Current a/c (% of gdp)	2.2	2.9	2.7	1.1	1.3
Fiscal balance (% of gdp)	-1.7	-0.4	0.1	-3.2	-2.8

\*weighted gdp average of the top 10 in each category

Looking at chart a, it can be seen that the output shares were pretty stable in the early 1980s but from about 1988 onwards the shares shifted at an accelerating pace in favour of the emerging country top ten (E10). These shifts will increasingly have implications for trade flows, for wealth creation, for the demand for raw materials and hence for commodity prices and trends, the future direction of financial markets and for a range of global institutions. It also clearly has implications for inflation, current account positions and fiscal trends. It is the latter that we look at more closely in the following analysis.

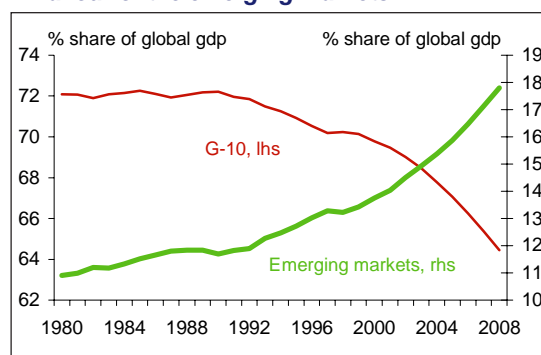
### Faster growth in the emerging economies has driven up their share of global gdp...

The rising share of global gdp accounted for by the top ten emerging economies is not down to slowing growth in the developed economies but to much faster growth in the emerging economies themselves. Chart b illustrates how rapid the rate of growth of the top ten emerging economies has been in the last decade and also how stable it has been at a high rate. Although emerging market growth has slowed markedly as the world economy has entered recession, it is also clear that, as a group, the top ten emerging market economies have avoided recession, though only because of China and India. Chart b highlights the fact that the top ten developed economies (G10) also had a stable growth rate in the last decade but that on average their annual average economic growth was some 4 to 5 times slower than in the developing economies. It is this that explains the outperformance of the emerging economies in taking a rising share of total global gdp.

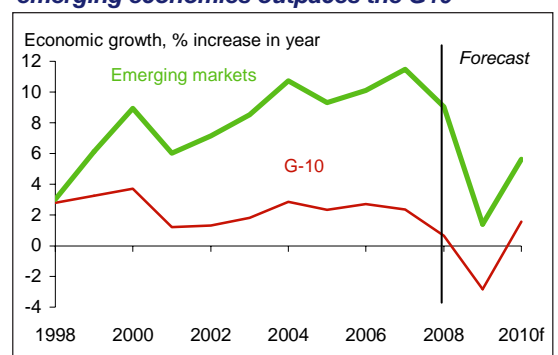
### ...but an improving trend shows up in other areas of economic performance as well

Table 1 compares the trend of the last 10, 5 and 2 years, in terms of gdp, inflation, current account and fiscal balances for the G10 and the E10. It highlights the better performance of the emerging top ten economies. In terms of gdp, the average annual growth average rate has been 2.3% for the G10 and 8.2% for the E10; in the

**Chart a: Share of world economic output shifts in favour of the emerging markets**



**Chart b: The rate of growth of the top 10 emerging economies outpaces the G10**



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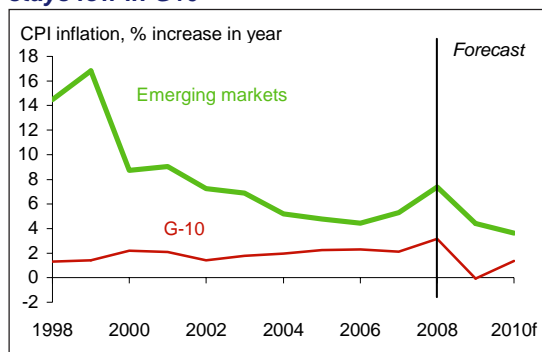
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## 2009 calendar of central bank meetings

<b>European ECB</b> (1.00%)
2 July, 6 August, 3 September, 8 October
<b>US FOMC</b> (0-0.25%)
24 June, 12 August, 23 September, 4 November
<b>UK MPC</b> (0.50%)
9 July, 6 August, 10 September, 8 October

**Chart c: Inflation falls sharply in E10 and stays low in G10**



last 5 years it been 2.2% for the G10 and 10.1% for the E10; in the last 2 years (to 2008) the average was 1.5% for the G10 but 10.3% for the E10. What about this year and next? The consensus forecast is that G10 gdp falls by 2.8% in 2009 and expands by 1.6% in 2010. For the E10, economic growth rises by 1.4% this year and accelerates to 5.6% in 2010. This means that there has been hardly any change in the trend observed in chart a and in table 1: the E10 share of global gdp continues to rise sharply, hardly slowed by the global recession.

But there are some other economic features of the relative performance of the G10 and E10 economies over the last 10 years worth focusing on as well. One

is that inflation has fallen globally, driven by the decline of inflation in the emerging market economies and its stability in the G10, see chart c. Price inflation averaged 8.2% in the E10 over the ten years to 2008, but this slowed to 5.4% in the last five years, with a modest acceleration to 6.3% in the last 2 years. For the G10, price inflation was remarkably stable at between 2% to 2.6% in the last 10, 5 and 2 years.

## Rolling calendar of UK data releases and events

Consumer credit (29/6)
Mortgage approvals (29/6)
GfK consumer conf (30/6)
Q1 GDP (30/6)
Manufacturing PMI (1/7)
Services PMI (3/7)
Industrial production (7/7)

Strong and stable economic growth and inflation were accompanied by a persistent trade deficit amongst the G10 and a growing but stable trade surplus for the E10, see chart d. Was this position ever sustainable? Probably not, as it implies that the G10 accumulated an internal financial deficit, as shown by chart e. To some extent, the recession has helped to reduce global trade imbalances as it has reduced the surplus of the E10 exporters and reduced the deficits of the G10 importers. But the problem is that it has been done at the expense of a worsening fiscal deficit in the G10. As chart e shows, the fiscal deficit of the G10 countries will, on average be around 8% in 2010, more than double its 2007 position.

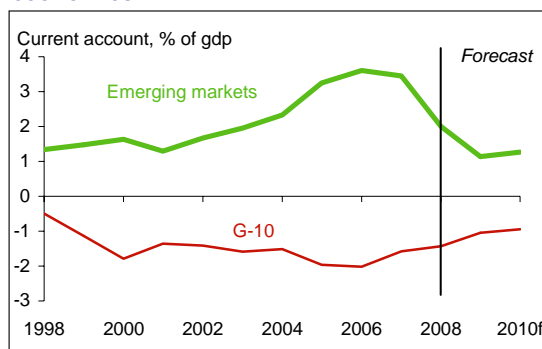
### What does this mean for financial markets?

Fast growth has led to a steady improvement in the finances of the emerging economies, with the last 2 years seeing a net positive position. This was of course related to rising exports and to increasing foreign currency reserves, so accumulating a net saving or creditor position with the rest of the world. Although both the G10 and the E10 will be in fiscal deficit over the next two years, the position of the E10 is clearly much better than that of the G10. This in itself is a remarkable fact of the last decade, that despite recession, the internal and external balances are better in the emerging market economies, as a group, than in the G10. This is just one reason why the trends analysed in this Weekly should interest all observers. There is a big pool of savings and capital sitting in the E10 area. Their fast growth and stable prices should mean a big and expanding market for goods from G10 economies but it also means a shift in the relationships between the G10 and the E10 in a number of other areas. From global banking trends and savings flows, to trading in commodities and the price of energy and the flow of capital and investment. These trends, therefore, have huge future implications for financial markets. This is why, despite the recession, we should not lose sight of what is happening in the global economy.

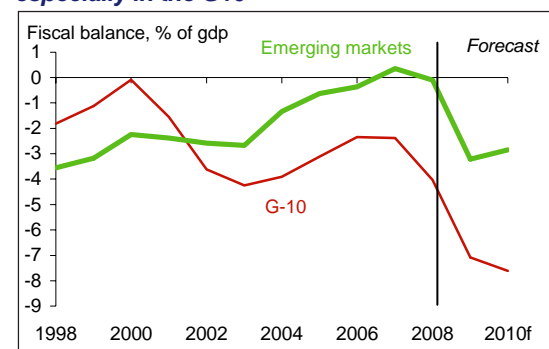
## Rolling calendar of US data releases and events

Existing home sales (23/6)
Durable goods (24/6)
New home sales (24/6)
Q1 GDP (25/6)
Core PCE deflator (26/6)
Chicago PMI (30/6)
Consumer confidence (30/6)

**Chart d: Global trade balances favours the E10 economies**



**Chart e: Fiscal deficits widen sharply, but especially in the G10**



Trevor Williams, Chief Economist, Corporate Markets

\* All charts are sourced to Lloyds TSB Corporate Markets Economic Research and Datastream

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# Weekly economic data preview

15 June 2009

## Data to show inflation falling markedly

*The sharp fall in energy prices since last year will be reflected in a marked improvement in inflation data in the UK, US and euro zone this week. Although crude oil prices have surged above \$70 recently, they still remain well below last year's heady levels. We forecast the UK headline consumer price measure eased below the 2% official target in May for the first time since September 2007, while its US counterpart dropped further into negative territory. The risk of inflation undershooting its official target in the medium-term will have remained the focus at the Bank of England's interest rate meeting earlier this month, the minutes of which are published on Wednesday. We expect to hear that the decision to maintain Bank rate at 0.5% and to keep the APF at £125bn was unanimous. The latest UK labour market, retail sales and public finances data are also published this week. In the US, the ongoing travails of the housing market will be evident from the latest housing starts and building permits data for May. US industrial production data, also due on Tuesday, are expected to show further broad weakness. However, confirmation of a sharp improvement in the US current account deficit in the first quarter of 2009 could provide a fillip for the dollar. It is a quiet week for euro zone data, headed by the German ZEW survey and EU-16 CPI for May on Tuesday. No changes to interest rates are expected at central bank meetings in Japan, Switzerland and Norway this week.*

- UK inflation data for May, due tomorrow, are expected to show year-on-year CPI inflation declined for the third consecutive month, to 1.9%, from 2.3% in April. Falling housing costs, reflecting the sharp drop in energy prices, and rising slack in the economy are likely to lead to further sharp falls in the remainder of the year, potentially briefly leading to outright falls on an annual basis. The annual retail price measure of inflation, which turned negative in March for the first time since records began in 1948, is forecast to show a further decline to -1.5% in May from -1.2% in April. The Bank of England's latest inflation forecast, as detailed in its May Inflation Report, showed CPI inflation at below the 2% target at the end of the two-year forecast horizon based on Bank rate remaining constant at 0.5% and £125bn of asset purchases. The minutes of the June MPC meeting, due on Wednesday, may therefore dampen speculation of a potential rise in interest rates early next year, while the prospect of further asset purchases could be enhanced depending on how the committee assess the recent sharp rise in gilt yields and the more positive economic data of late. However, risks to the outlook will also be highlighted by official data this week. UK unemployment data, also due on Wednesday, will show another substantial rise in the jobless total as the recession continues to bite. The claimant count measure of unemployment is expected to exceed April's rise of 57,100, with an increase of 70,000 in May. The ILO unemployment rate is forecast to rise from 7.1% to 7.4% in the three months to April, the highest since July 1997. Rising unemployment will keep downward pressure on earnings growth, with a further drop in headline average earnings growth possible and continuing subdued underlying earnings growth likely in April. The negative implications of rising unemployment for consumer spending and the public finances are likely to be reflected in data for retail sales and public sector net borrowing on Thursday. We forecast the volume of retail sales declined by 0.3% in the year to May, from a rise of 2.6% to April, while public sector net borrowing was £15.5bn in May, up from £12.2bn last year. Preliminary UK M4 money supply data, also due on Thursday, are likely to show that the impact of Q/E remains modest so far.
- In the US this week, further signs that the recession is abating should be provided by the latest initial jobless claims and housing market data. However, although modest improvements are expected, it should be remembered that prevailing levels are still well below those associated with recovery. US industrial production, due tomorrow, is forecast to show a further decline of 0.8% in May, equivalent to 13% lower on the year. Solid rises in the headline indices of producer and consumer prices in May may not prevent further declines in their respective annual rates, with annual CPI inflation forecast to fall to -0.9%, from -0.7% in April. The dollar could find support this week from confirmation that the US current account deficit narrowed to below \$100bn for the first time since Q4 2001, while net purchases of US long-term securities rose to \$60bn in April. Bernanke and Geithner head the list of speakers

Jeavon Lolay, Senior Economist

Chart 1: Annual inflation rates have fallen rapidly

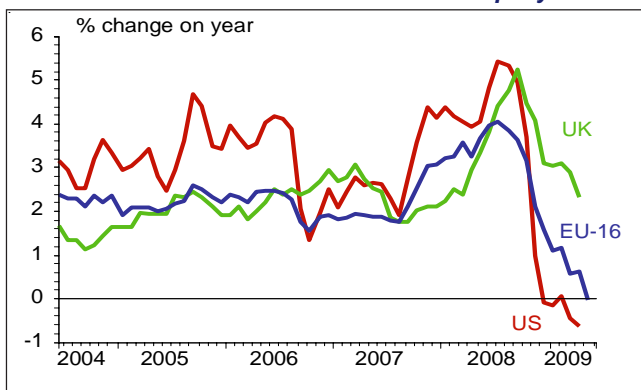
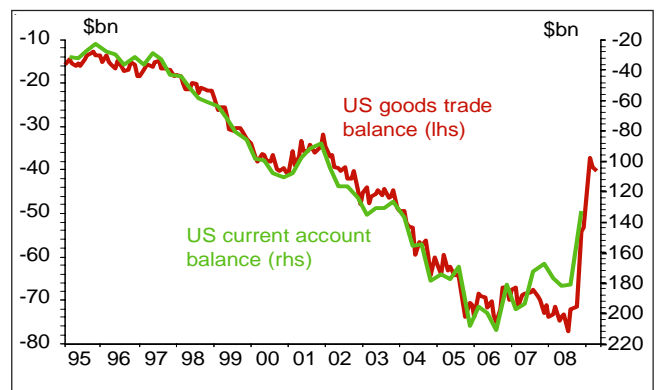


Chart 2: US current account deficit set to narrow further



Date	United Kingdom	United States	EU-16
Mon 15		<b>Empire manu. survey (13:30)</b> May -4.6% Jun (f'cast) -6.0% Median -5.2% Range -10.0%:+5.0% <b>Treasury Internat. Capital Data (14:00)</b> Mar +\$55.8bn Apr (f'cast) +\$60.0bn Median +\$52.9bn Range +\$30bn:+\$65bn	
Tue 16	<b>Consumer prices index (nsa)</b> Apr +0.2% Y-O-Y +2.3% May (f'cast) +0.3% Y-O-Y +1.9% Median +0.3% Range -0.1%:+0.5% <b>Core consumer prices index (nsa)</b> Apr Y-O-Y +1.5% May (f'cast) Y-O-Y +1.5% Median +1.5% Range +1.4%:+1.6% <b>Retail prices index (nsa)</b> Apr +0.1% Y-O-Y -1.2% May (f'cast) +0.2% Y-O-Y -1.5% Median +0.2% Range -0.2%:+0.6% <b>RPI ex-mortgage interest payments (nsa)</b> Apr +0.4% Y-O-Y +1.7% May (f'cast) +0.2% Y-O-Y +1.2% Median +0.3% Range +0.2%:+0.5%	<b>Producer prices (sa, prov) (13:30)</b> Apr +0.3% Y-O-Y -3.7% May (f'cast) +0.5% Y-O-Y -4.5% Median +0.6% Range +0.3%:+1.5% <b>PPI core (sa, prov) (13:30)</b> Apr +0.1% Y-O-Y +3.4% May (f'cast) +0.1% Y-O-Y +3.2% Median +0.1% Range -0.2%:+0.2% <b>Housing starts (sa) (13:30)</b> Apr 458k May (f'cast) 480k Median 480k Range 450k:550k <b>Building permits (13:30)</b> Apr 498k May (f'cast) 500k Median 500k Range 479k:530k <b>Industrial production (sa) (14:15)</b> Apr -0.5% Y-O-Y -12.5% May (f'cast) -0.8% Y-O-Y -13.0% Median -0.8% Range -1.5%:+0.3% <b>Capacity use (14:15)</b> Apr 69.1% May (f'cast) 68.5% Median 68.4% Range 64.8%:69.0%	<b>German ZEW survey (10:00)</b> Apr +31.1 May (f'cast) +34.0 Median +35.0 Range +25.0:+45.0 <b>EU-16 CPI (10:00) (final)</b> Apr +0.4% Y-O-Y +0.6% May (f'cast) zero Y-O-Y zero Median zero Range zero:+0.2%
Wed 17	<b>Unemployment (sa, claimant count)</b> Apr +57.1k Rate 4.7% May (f'cast) +70.0k Rate 4.9% Median +60.0k Range +47.0k:+85.0k <b>ILO Unemployment rate</b> Mar 7.1% Apr (f'cast) 7.4% Median 7.3% Range 7.2%:7.5% <b>Average earnings (3m avg, headline, sa)</b> Mar -0.4% Apr (f'cast) +0.2% Median +0.1% Range -0.7%:+0.7% <b>Unit wage costs (3m avg, annual, sa) (Apr)</b> Mar +9.8%	<b>Consumer prices (13:30)</b> Apr zero Y-O-Y -0.7% May (f'cast) +0.3% Y-O-Y -0.9% Median +0.3% Range -0.1%:+0.6% <b>Consumer prices ex-food, energy (13:30)</b> Apr +0.3% Y-O-Y +1.9% May (f'cast) +0.1% Y-O-Y +1.8% Median +0.1% Range -0.2%:+0.2% <b>Current account (13:30)</b> Q4 -\$132.8bn Q1 (f'cast) -\$85.0bn Median -\$85.0bn Range -\$130bn:-\$62.8bn	<b>EU-16 trade balance (nsa) (10:00) (Apr)</b> Mar +€0.4bn Median -€1.3bn Range -€2.5bn:+€1.0bn
Thu 18	<b>Retail sales volume (sa)</b> Apr +0.9% Y-O-Y +2.6% May (f'cast) +0.3% Y-O-Y -0.3% Median +0.4% Range -1.2%:+1.6% <b>Public finances - PSNCR</b> Apr +£5.2bn Cumulative +£5.2bn May (f'cast) +£18.8bn Cumulative +£24.0bn Median +£16.0bn Range +£14.0bn:+£18.8bn <b>Public finances - PSNB</b> Apr +£8.5bn Cumulative +£8.5bn May (f'cast) +£15.5bn Cumulative +£24.0bn Median +£19.3bn Range +£15.5bn:+£21.0bn <b>Money supply, M4 (prel, sa)</b> Apr +0.2% Y-O-Y +17.4% May (f'cast) +0.2% Y-O-Y +15.8% <b>CBI industrial trends survey (11:00)</b> May -56 Jun (f'cast) -30 Median -45 Range -54:-35	<b>Initial claims (w/e 13/6) (13:30)</b> Previous 601k Forecast 597k Median 610k Range 590k:625k <b>Philadelphia Fed Survey (15:00)</b> Apr -22.6 May (f'cast) -16.0 Median -18.0 Range -22.0:-10.0	
Fri 19			<b>German producer prices (07:00)</b> Apr -1.4% Y-O-Y -2.7% May (f'cast) -0.2% Y-O-Y -3.7% Median -0.1% Range -1.0%:+0.7%
Mon 22	<b>Rightmove house prices (00:01) (Jun)</b> May +2.4% Y-O-Y -6.2%		<b>German IFO business survey (09:00) (Jun)</b> May 84.2

NB: UK data released at 9.30 a.m., unless otherwise stated. Market medians are as of preceding Friday. Release times of US data are stated in brackets after the description of the indicator. Events are listed in the events column on the next page.

Date	Japan	Other Countries	Main events
Mon 15		<b>Canada manu. shipments (13:30)</b> Mar -2.7% Apr (f'cast) -1.5% Median -1.0% Range -1.8%:+1.5%	<ul style="list-style-type: none"> <li>• ECB member Tumpel-Gugerell speaks in Rome (08:15)</li> <li>• US Fed member Tarullo speaks in North Carolina (13:45)</li> <li>• ECB presents the "Financial Stability Review 2009", press briefing presented by ECB member Papademos (14:00)</li> <li>• US Fed member Evans speaks in Chicago (14:30)</li> <li>• ECB member Constancio speaks in Portugal (16:00)</li> <li>• ECB members Tumpel-Gugerell and Nowotny speak in Vienna (18:00)</li> <li>• US Fed member Duke speaks in Washington (23:00)</li> <li>• Bank of England to purchase £3.5bn of gilts at a reverse auction</li> </ul>
Tue 16	<b>Japan interest rate decision (05:00)</b> Current: 0.10% Forecast: 0.10%		<ul style="list-style-type: none"> <li>• Bank of Japan monetary policy meeting, rates expected to stay on hold at 0.10% (05:00)</li> <li>• ECB member Mersch speaks in Luxembourg</li> <li>• ECB member Weber speaks in Cologne (16:30)</li> <li>• US Fed member Warsh speaks in New York (18:15)</li> </ul>
Wed 17		<b>Canada wholesale sales (13:30)</b> Mar -0.6% Apr (f'cast) -0.2% Median -0.5% Range -0.5%:+0.3%	<ul style="list-style-type: none"> <li>• Bank of Japan publishes its monthly report (06:00)</li> <li>• ECB member Constancio speaks in Portugal (09:00)</li> <li>• Bank of England releases its minutes of the 3/4 June MPC meeting (09:30)</li> <li>• Germany to sell €7bn of 2yr notes (10:15)</li> <li>• Norwegian central bank interest rate decision, rates expected to stay on hold at 1.50% (13:00), followed by press conference (13:45)</li> <li>• US Fed Chairman Bernanke speaks in Washington (14:00)</li> <li>• Bank of England to purchase £3bn of gilts at a reverse auction</li> <li>• Bank of England Governor King speaks at Mansion House in London (time tbc)</li> </ul>
Thu 18		<b>Canada consumer prices (12:00)</b> Apr -0.1% Y-O-Y +0.4% May (f'cast) +0.3% Y-O-Y -0.3% Median +0.3% Range -0.1%:+0.6% <b>Canada consumer prices, core (12:00)</b> Apr +0.1% Y-O-Y +1.8% May (f'cast) +0.1% Y-O-Y +1.6% Median +0.1% Range -0.2%:+0.2%	<ul style="list-style-type: none"> <li>• Swiss central bank interest rate decision, interest rates expected to stay on hold at 0.25% (08:30)</li> <li>• French auction of BTAN notes (10:00)</li> </ul>
Fri 19		<b>Canada retail sales (13:30)</b> Mar +0.3% Apr (f'cast) +0.2% Median zero Range -0.4%:+0.2%	<ul style="list-style-type: none"> <li>• Bank of Japan publishes its minutes of 21/22 May monetary policy meeting (00:50)</li> <li>• ECB member Bini Smaghi speaks in Milan (08:00)</li> <li>• ECB member Gonzalez-Paramo speaks in Spain (10:30)</li> </ul>
Mon 22		<b>Canada int'l secs transactions (13:30) (Apr)</b> Mar +C\$6.8bn	