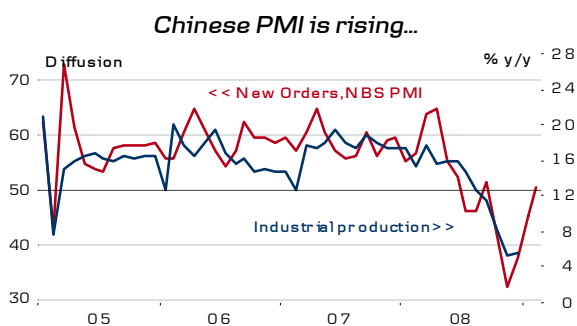


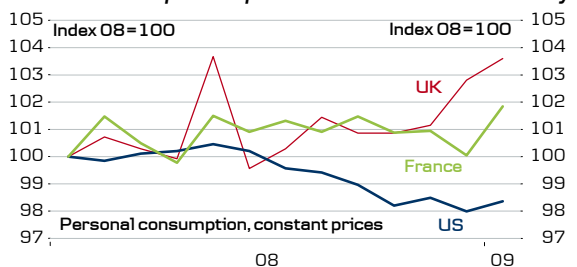
surprised to the upside but also US personal spending has flattened out after falling rapidly [see chart below]

- Car sales have improved recently in Asia and in February we have also seen monthly increases in both German and UK car sales. New incentives to buy cars may start to have an effect now.



Source: Reuters Ecowin

**... and consumption up in several countries lately**



Source: Reuters Ecowin

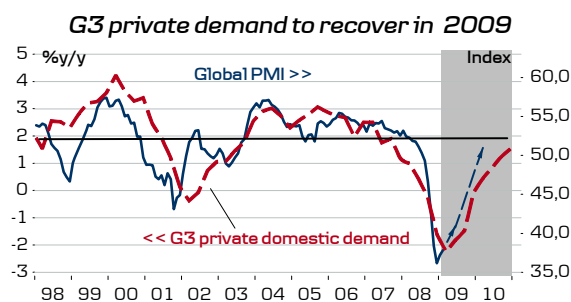
**The world recovers - but slowly**

The tentative signs of improvement run well in line with our forecast that Q4 and Q1 will mark the worst in the current recession in terms of negative growth. The world economy is progressing in absorbing the massive shock after the Lehman bankruptcy, and once the massive stimulus starts to kick in and inventories have been run down further, the base for a recovery will be in place.

Fiscal policy packages		
% of GDP	2009	2010
US	1.9	2.9
Euroland	0.9	0.8
Japan	1.4	0.4
Asia ex Japan	1.5	1.3
Total	1.4	1.3

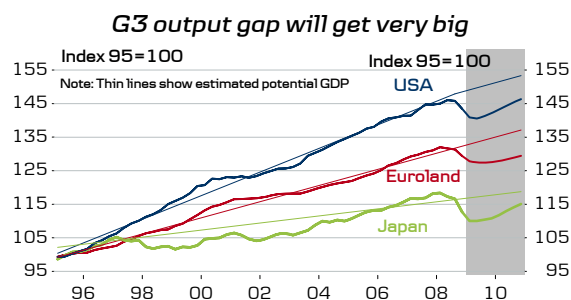
As announced per 17 Jan, 2009. Source: IMF

The stimulus given to the world economy is of a magnitude not seen previously in history. In the US the government is the biggest spender with outlays of close to 2% of GDP in 2009 and 2.9% in 2010. Euroland will provide a smaller boost of just below 1% of GDP in both 2009 and 2010. This is part of the reason why Euroland will lag getting out of this recession. On top of the fiscal stimulus, monetary policy is being eased substantially globally.



Source: Ecowin and Danske Bank calculations

We expect the financial crisis to continue for a long time but we believe the impact on growth rates will peak in Q4 08/Q1 09. Although the crisis will continue to dampen activity, this does not mean that production will continue to free fall. Instead it means the recovery from the current "shell-shock" levels will likely be slow. We don't expect global growth to be back at trend growth until the first quarter of 2010 (measured in % q/q). The global output gap will therefore continue to widen and reach very low levels. Unemployment should rise strongly for the rest of 2009.



Source: Reuters Ecowin

The key risk to our scenario is new negative events in the financial crisis that could initiate more global shocks. Developments in CEE are of particular concern at the moment and a further slump could lead to material losses for European banks [see

### [Research Euro area: Exposure to the crisis in Central and Eastern Europe\]](#)

#### **US and Asia to recover first, Euroland and CEE lag**

We expect the US and Asia to be the first to pull out of recession, whereas Euroland and CEE will lag.

In the US we expect the recession to continue until mid-year, but the pace of decline to get smaller from going forward. In the middle quarters of the year a range of stabilising factors will kick in. A slower rate of credit tightening, an income boost from stimulus rebates, lower commodity prices and lower mortgage rates will act to stabilise demand. In combination with a slower pace of business destocking, we estimate this will facilitate a recovery in the ISM index to the 45-50 range by June or July. The economy should return to trend growth by year-end.

China will likely be “last in – first out” of the crisis. As shown above there are already signs of improvement in PMI. Lending growth has also picked up recently pointing to a rise in investment spending. China is one of the few places in the world where credit standards are being eased instead of tightened as authorities have removed all quota restrictions on commercial banks. The fiscal stimulus is also massive and the improvement in production is a sign that this is already kicking in. We expect growth to bottom out below 7% in H1 2009 and to recover sharply in H2 as the aggressive easing measures start to pay off. Japan has seen the sharpest decline in GDP in 2008 but will benefit from the projected recovery in China in H2 2009 and 2010. Hence we see the Japanese economy returning to trend by end-2009.

Euroland and CEE are expected to be the laggards in the cycle. In Euroland the policy response has come later – and is smaller compared to US and China. Several countries are struggling with ailing housing markets and Germany is suffering from a strong exposure to CEE. Trend growth in Euroland is not expected to be reached until the end of 2010. CEE is in a very severe downturn, paying the price for highly leveraged growth in the past five years. At the same time the policy response is

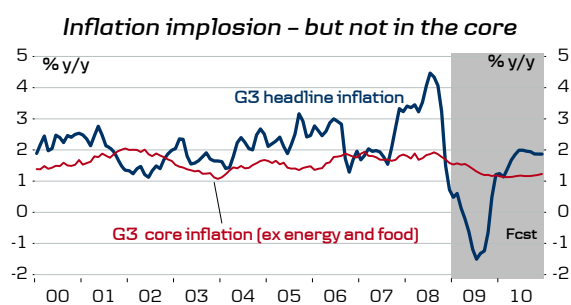
restricted as fiscal deficits are being punished by the financial markets through a flight of capital.

### Deflation risks rising, but still limited

#### **The ingredients for a deflationary spiral are present keeping central banks busy**

With the output gap becoming very negative, the deflationary forces will continue over the coming year. Second round effects from lower commodity prices will also pull down core inflation. Although strong, we don't expect the forces to be strong enough to push any of the major countries (except Japan) into outright deflation. Our models suggest that it would take an even stronger recession to push us into this territory. Sustained deflation in core prices historically requires a period of falling wages – as was seen during the Great Depression and in Japan in the past decades. Wage growth is still above 3% in both US and Euroland, and although it is expected to come down, we don't forecast negative wage growth at a macro level (however certain sectors will likely see lower wages). Moreover surveys of long-term consumer inflation expectations remain stable and close to the long term average.

We expect headline inflation in G3 to fall below zero during the coming quarter, but this is primarily due to the decline in commodity prices and it will be temporary as base effects will push up headline inflation again in H2 2009.



Source: Ecwin and Danske Bank calculations

However, the imminent threat of a negative deflation spiral is keeping monetary authorities on alert. With most central banks at or approaching the zero bound for rates, the focus is turning to further non-standard measures such as quantitative easing. The Fed will continue – and

possibly expand - its quantitative easing programme and the ECB could start on an asset

purchase programme during summer.

Danske Bank	USA			Euroland			Japan			China		
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008	2009	2010
GDP	1.1	-2.7	2.5	0.7	-2.7	0.8	-0.7	-5.0	2.8	9.1	7.2	9.2
Private consumption	0.2	-0.8	1.8	0.5	-0.5	0.4	0.7	-0.2	1.4	15.7	15.0	16.0
Investment	-3.9	-13.0	7.2	0.6	-6.0	0.6	-4.8	-6.4	2.1	12.8	10.3	14.3
Export	6.2	-14.1	0.5	1.7	-10.1	2.4	1.9	-27.2	18.2	14.4	-6.5	11.2
Import	-3.4	-9.5	5.4	1.7	-7.3	2.8	1.1	-12.6	1.1	20.4	-4.0	13.8
Industrial production	-1.8	-7.5	2.0	-2.1	-4.4	2.8	-3.4	-26.5	10.2	13.1	7.8	12.1
Inflation excl. food and energy	2.3	1.3	1.2	1.8	1.5	1.3	0.0	-0.3	-0.3	-	-	-
Inflation	3.8	-0.8	2.5	3.3	0.5	1.3	1.5	-0.9	-0.1	5.9	-0.4	1.4

Indicator	Comment	Measure	Latest		Jun-09
GDP	The Euroland economy is cooling fast at the moment.	%q/q, AR	-5.7%	↗	-4.7%
PMI	PMI set to increase from record low	Index	36.2	↗	40.0
Inflation	Commodity prices drags inflation down.	%y/y	1.1%	↘	0.4%
ECB	No inflation fear and slump in activity. The ECB is cutting rates aggressively	%p.a.	1.50%	↘	1.00%
Ifo	The German economy is feeling the pain from collapse on export markets	Index	82.6	↗	87.0
GDP	Q1 growth will be deeply negative but in Q2 we are past the worst contraction	%q/q, AR	-6.2%	↘	-7.0%
ISM	ISM has bottomed and will improve in the coming months	Index	35.8	↗	46.0
Employment	Businesses will continue to shed jobs but at a less rapid pace	3 mth. mavg.	-662K	↗	-316K
Core inflation	Core inflation will trend lower as labour cost pressures evaporate gradually	%y/y	1.7%	↘	1.2%
Federal Reserve	Fed will keep interest rates on hold and focus on further credit easing	% p.a.	0.13%	→	0.13%
GDP	GDP growth will remain dismal until Q2	%q/q, AR	-12.7%	↗	-9.6%
PMI	PMI will recover as manufacturing activity stabilise in coming months	Index	31.6	↗	41.0
Inflation	Inflation will decline on lower core inflation and lower commodity prices	%y/y	0.0%	↘	-1.3%
BoJ	BoJ on hold until late 2010, focus on non-conventional easing	%p.a.	0.10%	→	0.10%

### Box: Where and when to look for turnaround signs?

In order to track the road to recovery we highlight what indicators to look at and what to look for. As we believe the US and Asia will turn first, this is where we will mainly look for signals.

#### Macro signals:

- 1) **Global business surveys:** We expect global business surveys to rise gradually from here as growth rates become less negative. We expect improvements in especially the US and Asia. We will track this development in our monthly [Global Business Cycle Monitor](#).
- 2) **Commodity prices:** Metal and oil prices have found a base recently, indicating that global production is stabilising. If commodity prices start to increase this would indicate rising global demand.
- 3) **US retail sales:** The positive effect of lower gasoline prices and tax cuts should show up in consumption. We look for an imminent bottom in retail sales.
- 4) **Global car sales** have been hit very hard recently by the credit crunch (on top of all the other headwinds), falling to very low levels. We are seeing some indications that car sales are stabilising in several countries - not in the US, though. A stabilisation in US car sales would be a sign that the credit crunch is easing on the back of the Fed initiative to support the ABS market.
- 5) **Consumer confidence:** The boost from lower gasoline prices and tax cuts should show up in consumer confidence. We expect consumer confidence to rebound slightly around March/April.
- 6) **US Building permits:** So far the activity in the housing sector has continued to deteriorate. We expect a weaker pace of decline in building permits to materialise during Q2.
- 7) **NAHB:** The NAHB housing index has fallen to new lows recently. As with building permits, we expect a slight improvement in the NAHB index during Q2.
- 8) **Jobless claims:** Jobless claims posted new cycle highs recently. We expect claims to peak in early Q2.

#### Financial signals:

- 1) **Credit spreads:** A decline in credit spreads - including mortgage spreads - would help ease the pressure on investments and the housing market and support a faster turnaround. We only expect a very gradual improvement during the first half of 2009.
- 2) **Money market spreads:** Libor-ois spreads on 3 month maturities and longer give another indication of the state of the credit crisis. We would look for a further very gradual narrowing from the current levels.
- 3) **Equity markets:** A turn in equity markets would improve consumer sentiment, adding to the boost from lower gasoline prices. Equity markets are also often a leading indicator for the overall economy. We expect equity markets to bottom as soon as the recovery in business surveys unfreezes very negative market sentiment.

## Alternative 1: New fuel to the financial crisis

- The financial crisis intensifies as the European banking sector is faced with substantial losses in the wake of a severe meltdown in Central and Eastern Europe. A large part of the losses ends up as government debt causing funding costs for Euroland countries with a weak fiscal situation to explode.
- The rise in risk aversion and renewed uncertainty about the health of the global financial system causes renewed turmoil in money and credit markets leaving little room for monetary policy stimuli to reach the real economy.
- Despite the huge income boost from the collapse in energy prices and fiscal stimuli, consumers and businesses remain reluctant to spend. Japan, US and Euroland all remain in recession into 2010 and the outlook for a prolonged period of negative economic growth makes equity and commodity markets plunge anew. Pressure on emerging markets in general increases and the early signs of improvement in Asian economies are reversed as global demand slows.

### Credit crunch intensifies in Europe

#### *G3 in recession into 2010*

The crisis in Central and Eastern Europe turns out to be even more severe than feared with repercussions for the global financial sector. Euroland banks' losses on loans in CEE will be substantial due to a poisonous mix of collapsing property prices, economic downturn and exchange rate depreciation. In addition, part of the credit provided by Western European banks has been given on too loose lending conditions. Uncertainty about global banks' exposure to the CEE meltdown and the distribution of losses gives way to a renewed rise in general risk aversion and intensification in the financial crisis.

A substantial part of the losses end up as government debt, given the presence of government guarantees for banks in all Western European countries. This adds new fuel to the worries about the sustainability of government budgets and fears about a possible Euroland sovereign default lead to a surge in funding costs for Euro-member countries with a weak fiscal situation.

Against this background, policy measures from global authorities prove too vague to halt the credit crisis and heal the economy. In Europe, the implementation of fiscal stimuli at national levels falls short of what is needed to kick start the economy. In the US the Treasury Department's Financial Stability Plan fails to succeed in restoring

confidence in the balance sheets of the US banking sector.

Money and credit markets continue to struggle, leaving little room for monetary policy stimuli to reach the real economy. The deleveraging process in the financial sector continues at an equally rapid pace causing a de facto shutdown of credit availability for both consumers and businesses throughout 2009. In addition, worries about rising budget deficits in the US and Europe puts upward pressure on longer term interest rates.

Consumers, businesses and markets are trapped in a self-fulfilling spiral of negative sentiment. This means that, despite a boost to real incomes from the collapse in energy prices and fiscal stimuli, consumers and businesses remain reluctant to spend or invest, causing private savings rates to rise rapidly.

The outlook for a prolonged period of negative economic growth makes equity markets plunge anew and the correction in the housing sector continues, adding additional pressure to consumer net wealth and spending. Japan, US and Euroland all remain in recession into 2010. With falling raw material prices and rising risk aversion emerging markets will suffer. Countries with current account deficits and large external debt will underperform. In addition slower global demand will weigh hard on the export-dependent Asian economies.