Outlook 2010
How resilient is economic recovery?

10 December 2009

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Chief Economist KBC Group
Equity markets

Upward momentum stalling

Totale return in EUR (MSCI, March = 100)

EMU US Emerging Markets

EMU  US  Emerging Markets
Comparison with previous stock market crashes (S&P500)

- 1929-1932 (Depression)
- 1973-1976 (Oil crisis)
- 2007-2009 (Credit crisis)

World trade (volume)

- December 1929 = 100
- March 1974 = 100
- July 2008 = 100

Industrial production (world)

- June 1929 = 100
- January 1974 = 100
- March 2008 = 100

Equity markets

Depression fears have faded
Global economy
Recession ended in the Summer

GDP-growth (annualized, in %)

<table>
<thead>
<tr>
<th>Real GDP-growth (QoQ, ann., in %)</th>
<th>Q4 2008</th>
<th>Q1 2009</th>
<th>Q2 2009</th>
<th>Q3 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed countries</td>
<td>-7.2</td>
<td>-8.3</td>
<td>-0.3</td>
<td>2.3</td>
</tr>
<tr>
<td>US</td>
<td>-5.4</td>
<td>-6.4</td>
<td>-0.7</td>
<td>2.8</td>
</tr>
<tr>
<td>EMU</td>
<td>-6.9</td>
<td>-9.6</td>
<td>-0.7</td>
<td>1.5</td>
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<tr>
<td>Japan</td>
<td>-13.1</td>
<td>-12.4</td>
<td>2.7</td>
<td>4.8</td>
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<td>Emerging markets</td>
<td>-6.3</td>
<td>-3.9</td>
<td>7.6</td>
<td>7.3</td>
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<tr>
<td>Asia ex. Japan</td>
<td>-5.1</td>
<td>2.5</td>
<td>12.4</td>
<td>9.3</td>
</tr>
<tr>
<td>CEE</td>
<td>-7.7</td>
<td>-19.3</td>
<td>2.1</td>
<td>4.7</td>
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<tr>
<td>Latin-America</td>
<td>-8.8</td>
<td>-10.0</td>
<td>2.0</td>
<td>5.7</td>
</tr>
</tbody>
</table>
Global economy
Emerging markets pulling the recovery

Consumption (QoQ %-change, annualized)

Investment (QoQ %-change, annualized)
Global economy

Final demand remains weak in developed markets

Fiscal stimulus versus final domestic demand

Manufacturing supported by inventory cycle

Final domestic demand (expected YoY %-change 2009)
Discretionary fiscal stimulus for 2009 (% of GDP) (*)

(*) Change in cyclically-adjusted fiscal balances relative to 2008
Developed markets

Fiscal stimulus versus ‘deleveraging’ households

**Fiscal stimulus versus final domestic demand**

<table>
<thead>
<tr>
<th>Country</th>
<th>Fiscal Stimulus 2009 (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>-3</td>
</tr>
<tr>
<td>EMU</td>
<td>-2</td>
</tr>
<tr>
<td>Asia ex.</td>
<td>-1</td>
</tr>
<tr>
<td>China</td>
<td>0</td>
</tr>
</tbody>
</table>

(*) Change in cyclically-adjusted fiscal balances relative to 2008

**‘Deleveraging’ households (in % of disposable income)**

- **EMU**
  - Q1 2000: 70
  - Q1 2001: 75
  - Q1 2002: 80
  - Q1 2003: 85
  - Q1 2004: 90
  - Q1 2005: 95
  - Q1 2006: 100
  - Q1 2007: 105
  - Q1 2008: 110
  - Q1 2009: 115

- **US**
  - Q1 1980: 60
  - Q1 1983: 70
  - Q1 1986: 80
  - Q1 1989: 90
  - Q1 1992: 100
  - Q1 1995: 110
  - Q1 1998: 120
  - Q1 2001: 130
  - Q1 2004: 140
  - Q1 2007: 150
Developed markets

Fiscal stimulus versus ‘deleveraging’ households

Fiscal stimulus versus final domestic demand

[Graph showing fiscal stimulus versus final domestic demand for US, EMU, Asia ex. China, and China.]

‘Deleveraging’ households (in % of disposable income)

[Graph showing ‘deleveraging’ households for EMU countries with data for Household debt (lhs) and Savings quote (rhs).]

Change in household debt-to-GDP ratio in 2001-2008

[Graph showing change in household debt-to-GDP ratio for various countries from Germany to Ireland. (*) Data end in 2007]

Final domestic demand (expected YoY %-change 2009)

Discretionary fiscal stimulus for 2009 (% of GDP) (*)

(*) Change in cyclically-adjusted fiscal balances relative to 2008

(*) Data end in 2007
Labour market

Unemployment rate (in %)

US
EMU
Labour market

US - Another jobloss-recovery

Unemployment rate (in %)

Employment (index, last month recession = 100)

Recoveries 1970-1990 (average)

1991
2001
2009

Employment (YoY, in %)
Real GDP (YoY, in %)
Labour market

US – Green shoots indicate recovery next Spring...

Unemployment rate (in %)

Payrolls (change, '000, lhs)
Employment expectations (NFIB, rhs)
Labour market
… which should support US housing recovery

Mortgage defaults and
unemployment

Home sales

Home sales prices (YoY %-change)

Mortgage defaults and
unemployment

Existing
New

Default rate mortgage market (in %, lhs)
Unemployment rate (YoY %-change, rhs)

Labour market
… which should support US housing recovery

Home sales

Home sales prices (YoY %-change)

Mortgage defaults and
unemployment

Existing
New

Default rate mortgage market (in %, lhs)
Unemployment rate (YoY %-change, rhs)
Labour market

EMU – Less resilient than it looks

Unemployment rate (in %)

- US
- EMU
Labour market

EMU – Less resilient than it looks

Unemployment rate (in %)

German unemployment rate without shorter hours

EMU

Germany

Unemployment rate (in %)

Employment (YoY, in %)

Real GDP (YoY, in %)

'Kurzarbeit' (Germany)
Labour market

EMU – Less resilient than it looks

Unemployment rate (in %)

Increase unemployment rate from trough (mostly early 2008) to peak

Part-time employment for economic reason (YoY %-change)
Labour market

EMU – … some green shoots as well

Unemployment rate (in %)

Employment expectations EC-survey (st. dev. from long-term average)
Corporate spending
Two speed world

Capital expenditure
(YoY %-change)

Export orders EC-survey
(st. dev. from long-term average)
Corporate spending

Two speed world

Capital expenditure (YoY %-change)

Capacity utilization in manufacturing (in %)

- US Capital Goods Orders
- EMU Capital Goods Orders
- China Newly Started Investment Projects

- US
- EMU
- China

- Q1 2000
- Q1 2001
- Q1 2002
- Q1 2003
- Q1 2004
- Q1 2005
- Q1 2006
- Q1 2007
- Q1 2008
- Q1 2009
Corporate spending
Two speed world

Capital expenditure (YoY %-change)

Bank loans to the private sector (YoY %-change)

US Capital Goods orders
EMU Capital Goods Orders
China Newly started Investment Projects

US
EMU
China

US
EMU
China

jan/00
jan/01
jan/02
jan/03
jan/04
jan/05
jan/06
jan/07
jan/08
jan/09

jan/00
jan/01
jan/02
jan/03
jan/04
jan/05
jan/06
jan/07
jan/08
jan/09

22/12/2009
Corporate spending

Two speed world

Capital expenditure (YoY %-change)

Bank loans to the private sector (YoY %-change)

Credit crunch …?

US Capital Goods orders
EMU Capital Goods Orders

US
EMU
Corporate spending

Two speed world

Capital expenditure
(YoY %-change)

Bank loans to the private sector
(YoY %-change)

...or credit bubble?
Credit crunch?

Easing

Banks reporting tighter credit conditions (in %, central bank surveys)

US (Senior Loan Officer Survey Fed)

EMU (Survey ECB)

Households - mortgages
Households - consumer finance
Corporates
Credit spreads corporate bonds (iBoxx, in bps.)

Cumulative 5-year corporate default rate (US)

Discounted in investment grade corporate bonds at the peak of the crisis

Current discount (recovery rate = 20%)
Credit crunch?

Easing, also for SME’s

Producer confidence US (st.dev. from long-term average)

Large firms tighter credit
Small firms tighter credit

US

EMU
Banking system
Credit losses set to decline in 2010...

In 2010, credit losses are set to decline in both the US and EMU regions.

- **US**: IMF estimate for 2010 is 4.2%.
- **EMU**: EC sentiment, 2.9%.

**Graph Details**:
- **ISIM**: (+2 quarters, lhs, reversed scale)
- **Loan charge-off rate**: (in % total loans outstanding, rhs)

**Quarterly Data**:
- Q1 1985 to Q3 2009
- Q1 1990 to Q3 2009

**Notes**:
- The graphs show the ISM index and loan charge-off rate for the US and EMU regions over time.
- The graphs are annotated with the IMF estimate for 2010 and EC sentiment for the EMU region.
Banking system

… further restoring confidence…

Spread interbank loans versus policy rates
central banks (futures, in %)

Bank CDS spreads
(in basis points)
Central bank support
...and paving the way for central banks’ exit strategy

Money growth rates (YoY %-change)

US

EMU
Inflation

Will decline, but no deflation

YoY % change consumer prices
(forecast: oil price = stable at ca. 75 USD/barrel)
Cheap money
Monetary policy will remain loose

Fed does not tighten policy before unemployment starts to decline

ECB still in ‘wait-and-see’ mode
Cheap money
Monetary policy will remain loose

Fed does not tighten policy before unemployment starts to decline

ECB still in ‘wait-and-see’ mode
Cheap money

… too loose for emerging markets

Change Central Bank’s policy rates since August 2007 (in basis points)

Taylor rule error

Too tight

Too loose

Developed markets

Emerging markets

Countries already tightening monetary policy

Dev. markets

Em. markets

Emerging Europe

Latin America

Emerging Asia

Too loose for emerging markets
Corporate spending

Two speed world

Capital expenditure (YoY %-change)

Bank loans to the private sector (YoY %-change)

...or credit bubble?

China Newly started Investment Projects

China

...or credit bubble?

China Newly started Investment Projects

China
Cheap money

… too loose for emerging markets

Change Central Bank’s policy rates since August 2007 (in basis points)

Developed markets

Emerging markets

Countries already tightening monetary policy

Exchange rates to USD (USD per XXX)

Euro
Brazilian Real
Mexican Peso
Russian Rouble
Korean Won
Chinese Renminbi
Cheap money

...too loose for emerging markets

Pick-up of inflation in China should prompt return to RMB appreciation

Exchange rates to USD (USD per XXX)

Consumer price inflation (in %, lhs)
M2 money supply (YoY %-change, adv. +12M, rhs)

- Euro
- Brazilian Real
- Mexican Peso
- Russian Rouble
- Korean Won
- Chinese Renminbi

Pick-up of inflation in China should prompt return to RMB appreciation

Cheap money

...too loose for emerging markets
Heading for an (Asian) equity bubble?
Not yet, but beware…

Total return in EUR
(MSCI, March 2003 = 100)

Forward PE-ratio

Emerging Asia  China  Developed markets
Or another commodity bubble?

Gold price: concern for runaway inflation & USD collapse?

In USD, January 2000 = 100

Oil & metal prices: overly optimistic about the strength of the recovery?

YoY %-change

-10 -5 0 5 10 15 20

Jan/99 Jan/00 Jan/01 Jan/02 Jan/03 Jan/04 Jan/05 Jan/06 Jan/07 Jan/08 Jan/09

Jan/00 Jan/01 Jan/02 Jan/03 Jan/04 Jan/05 Jan/06 Jan/07 Jan/08 Jan/09

-100 -50 0 50 100 150

Leading indicator OECD (adv. +3 months)
Oil price (USD/barrel, lhs)
Industrial metal prices (lhs)
Gold

Oil
Industrial metals
Agriculture & food
Gold

-100
-50
0
50
100
150

Jan-00 Jan-01 Jan-02 Jan-03 Jan-04 Jan-05 Jan-06 Jan-07 Jan-08 Jan-09
China is gaining weight …..

…..but global demand remains cyclical

- Metals demand contracted by 9% in 2009 and is expected to reach 2008 levels not before 2011.
- Global growth of >2% is needed for metals demand to grow.
Inventories are high and still rising ..... but prices are already above marginal cost

### Western World stocks in weeks of consumption

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>5y AVG</th>
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</thead>
<tbody>
<tr>
<td>Aluminium</td>
<td>14.3</td>
<td>6.8</td>
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<tr>
<td>Copper</td>
<td>3.9</td>
<td>2.8</td>
</tr>
<tr>
<td>Nickel</td>
<td>13.2</td>
<td>5.7</td>
</tr>
<tr>
<td>Zinc</td>
<td>8</td>
<td>5.7</td>
</tr>
<tr>
<td>Oil</td>
<td>1.2</td>
<td>1.05</td>
</tr>
</tbody>
</table>

Source: Brook Hunt
Continued fiscal policy support

Damaging public finances

Public sector deficit (% of GDP)

Increase in public deficit across recessions (% points of GDP)

(*) Forecast EC
Continued fiscal policy support

Risk: too early removal of stimulus

Great Depression (US)

Lost decade (Japan)

Real GDP-growth, in %
How sustainable?

Need for credible medium-term consolidation

Public sector deficit (% of GDP)

Public debt (% of GDP)

(*) Forecast EC
How sustainable?

Need for credible medium-term consolidation

Belgium

EMU

% of GDP

Primary balance

Public debt
Bond markets not too worried yet
But higher intra-EMU spreads are here to stay

**Long-term interest rates**
(10-year gov. in %)

**Interest rate spread EMU**
(difference with 10-year gov. Germany)
Real GDP-growth (in %)

<table>
<thead>
<tr>
<th>Real GDP-growth (in %)</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2.0</td>
<td>1.1</td>
<td>-2.5</td>
<td>1.7</td>
</tr>
<tr>
<td>EMU</td>
<td>2.7</td>
<td>0.7</td>
<td>-3.7</td>
<td>1.5</td>
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<tr>
<td>- Belgium</td>
<td>2.6</td>
<td>1.1</td>
<td>-3.0</td>
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<td>Emerging Asia</td>
<td>10.6</td>
<td>6.7</td>
<td>5.4</td>
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<tr>
<td>- China</td>
<td>13.0</td>
<td>9.0</td>
<td>8.4</td>
<td>9.1</td>
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<td>Emerging Europe</td>
<td>7.2</td>
<td>4.9</td>
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<td>Latin America</td>
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<td>World</td>
<td>5.2</td>
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## Financial outlook KBC

<table>
<thead>
<tr>
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<th>December 7th 2009</th>
<th>+ 12 months</th>
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<tbody>
<tr>
<td>Central bank policy rates (in %)</td>
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<td>- Fed</td>
<td>0.25</td>
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<td>- ECB</td>
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<td>1.00</td>
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<td>10-year gov. bond yield (in %)</td>
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<tr>
<td>- US</td>
<td>3.45</td>
<td>3.15</td>
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<td>- EMU</td>
<td>3.20</td>
<td>3.05</td>
</tr>
<tr>
<td>EUR/USD</td>
<td>1.48</td>
<td>1.40</td>
</tr>
<tr>
<td>Oil price (USD/barrel)</td>
<td>78</td>
<td>80</td>
</tr>
</tbody>
</table>
Summary

- **Base scenario 2010:**
  - Global recovery continues (no double dip)
    - but weak and vulnerable in developed markets
    - much stronger in emerging markets (Asia)
  - Monetary and fiscal policy remain globally supportive
  - Resulting in a globally benign financial environment

- **Major threats:**
  - Surprisingly strong growth momentum in the short run
    - generating inflation and asset bubbles in emerging markets
    - and/or earlier than expected removal of monetary and fiscal stimulus in developed markets
  - Labour market recovery weaker than anticipated, reigniting deflation risks