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| The bank for a changing world

Economic Outlook. Uitdagingen voor Europa na de crisis.

Mechelen, 17/11/2010.

Freddy Van den Spiegel
Chief Economist

Intro: The crisis is over. Back to normal or regime switch?

- The extra ordinary environment of 1990 – 2007.



The extraordinary environment of 1990 – 2007.

Technological
Revolution

+

Worldwide
Deregulation



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The extraordinary environment of 1990 – 2007.

Technological
Revolution

+

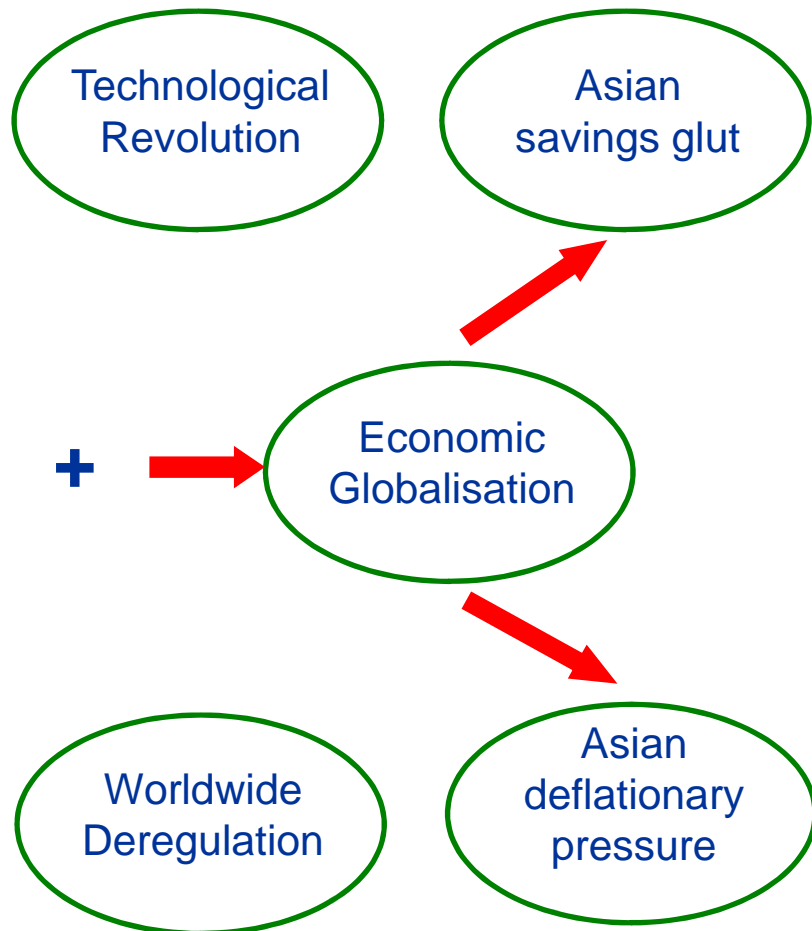


Economic
Globalisation

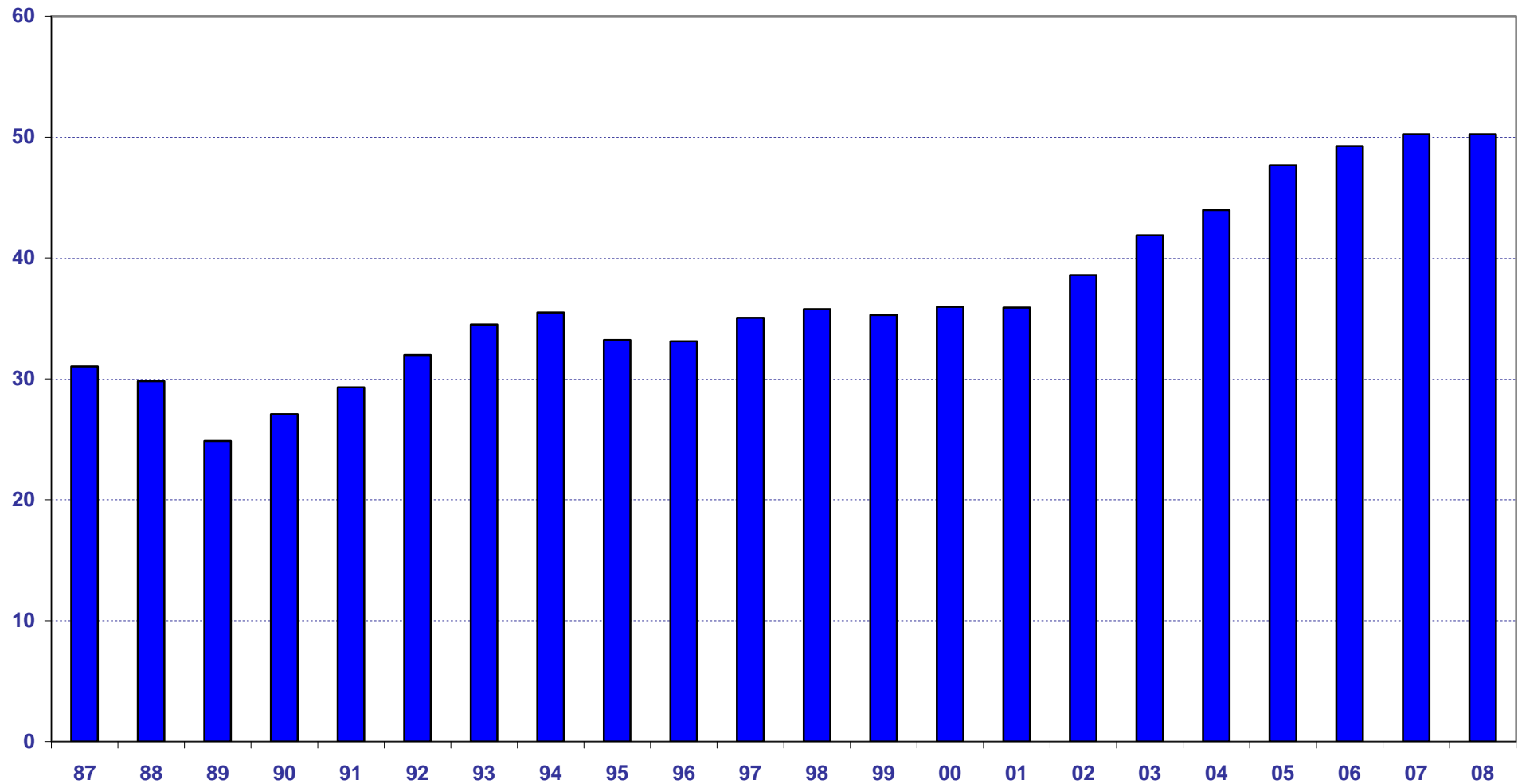
Worldwide
Deregulation



The extraordinary environment of 1990 – 2007.



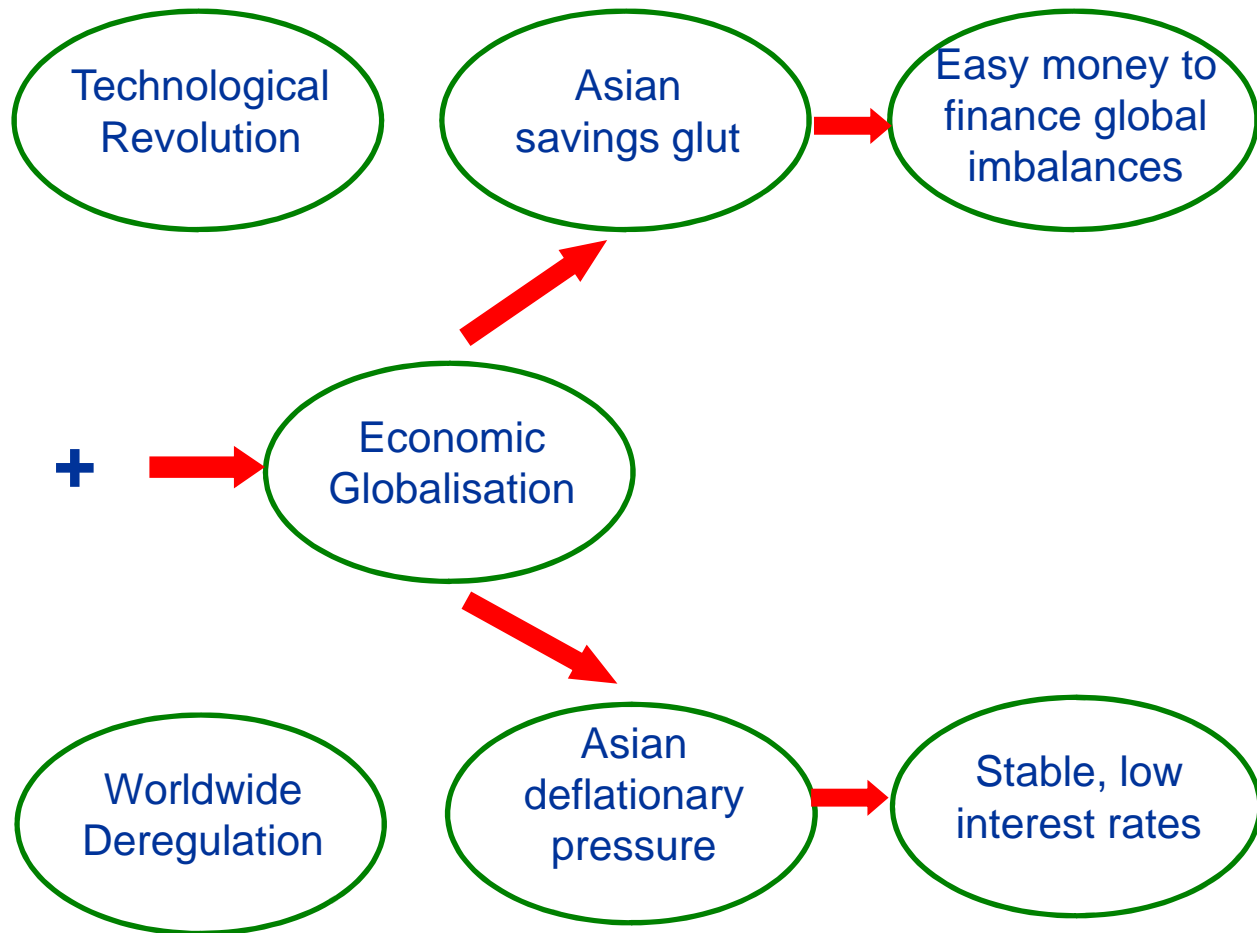
CHINA: GROSS NATIONAL SAVINGS AS % OF GDP



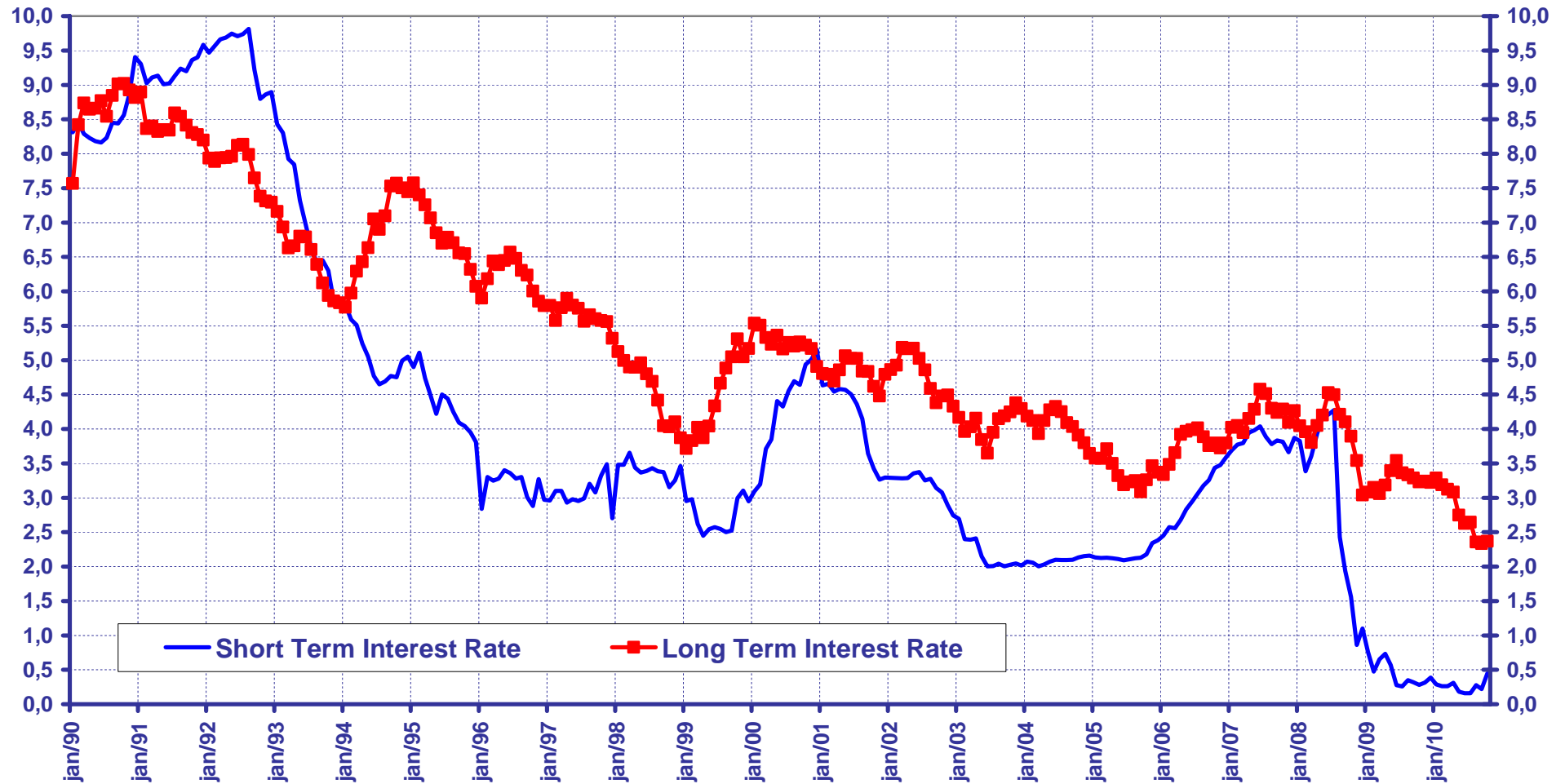
Source: Thomson Financial Datastream, own calculations



The extraordinary environment of 1990 – 2007.



EUROPE : Nominal Interest Rates (1990- Oct 2010)



Source : Thomson Financial Datastream

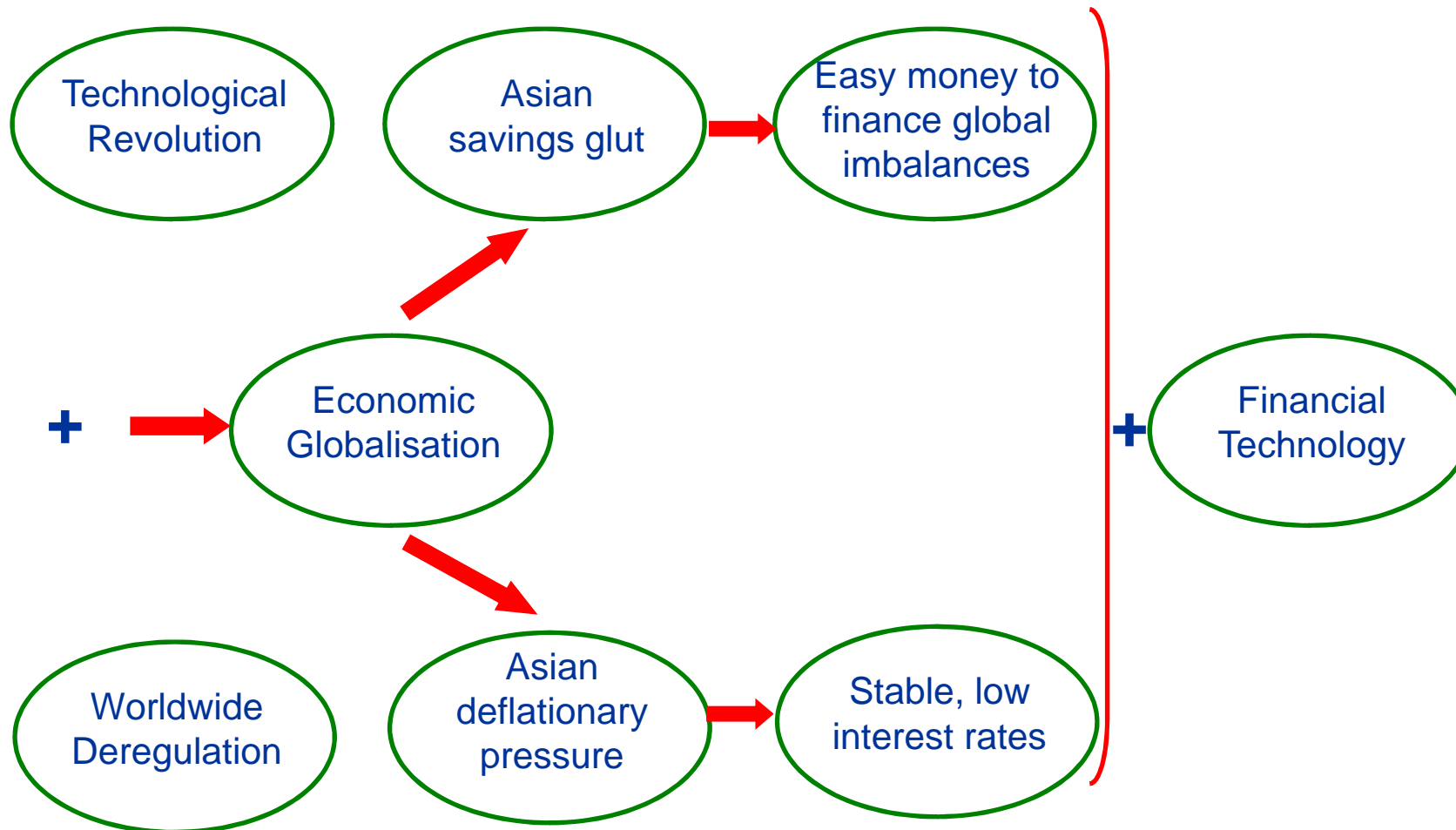


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The extraordinary environment of 1990 – 2007.



Overview of recent financial technology

CDS

CDO

CLO

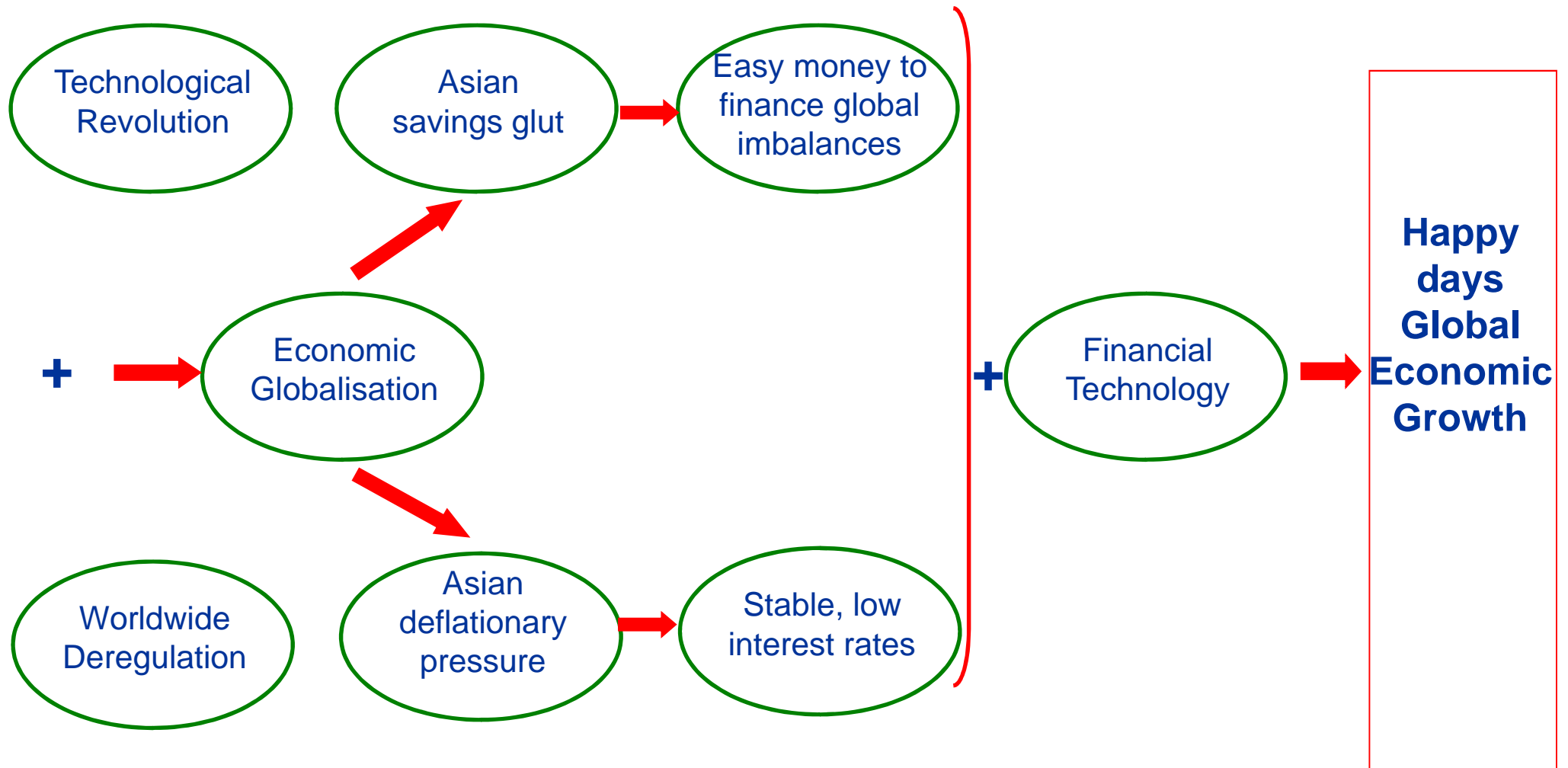
Hedge Funds

Private equity

ABRACADABRA, WHERE IS THE RISK?



The extraordinary environment of 1990 – 2007.



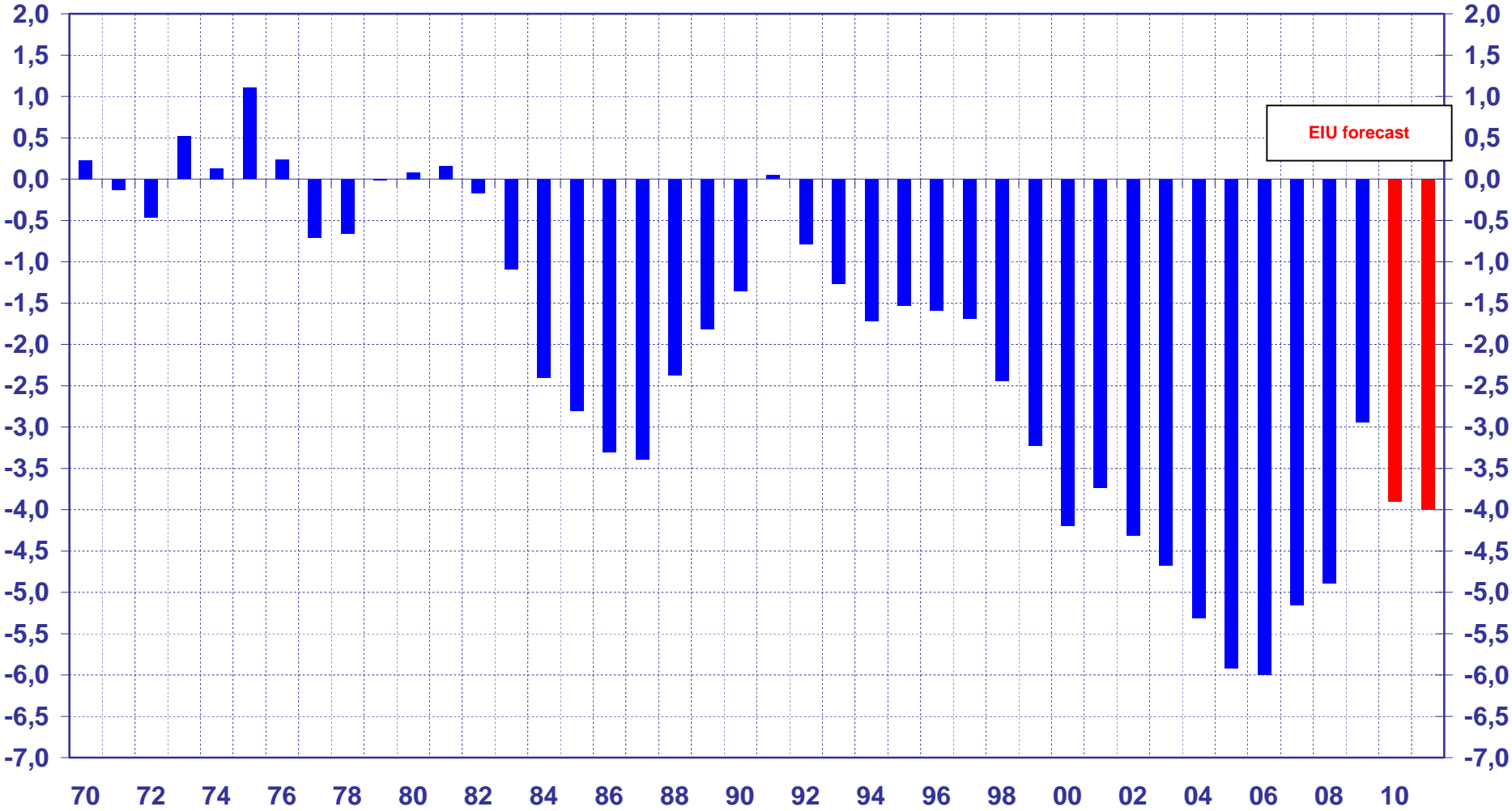
Intro: Back to normal or regime switch?

- The extra ordinary environment of 1990 – 2007.
- But underneath unsustainable bottle necks developed.
 - Imbalances of the US.



Intro: Back to normal or regime switch?

US: CURRENT ACCOUNT BALANCE (in % of GDP)
OECD figures



Source: Thomson Financial Datastream



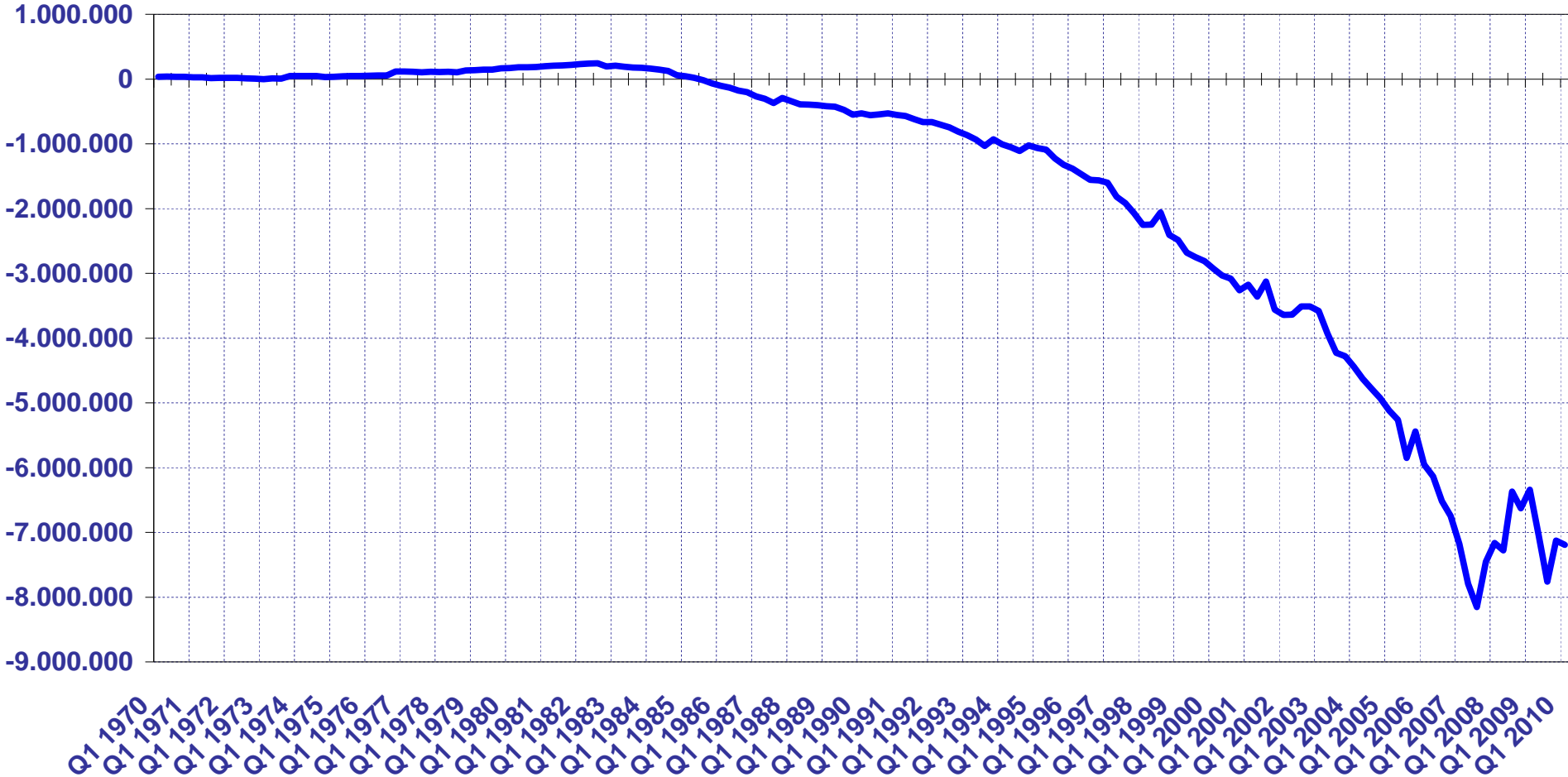
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Intro: Back to normal or regime switch?

US: NET FOREIGN ASSET POSITION OF THE US
(in mio USD)

(stock)



"-" indicates net debtor position of US w.r.t. rest of the World

Source: Federal Reserve



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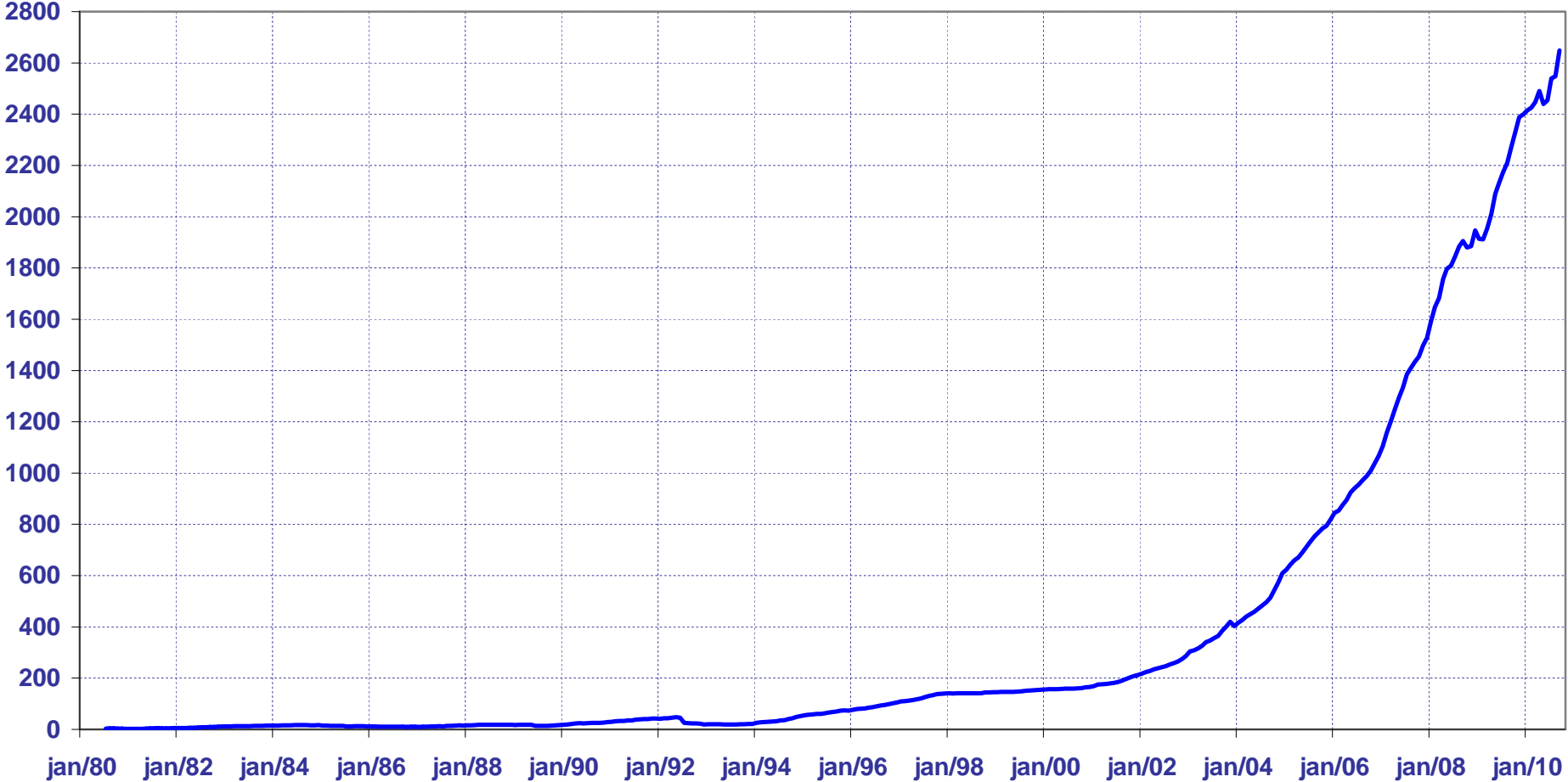
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- But underneath unsustainable bottle necks developed.
 - Imbalances of the US
 - Savings glut of Asia.



Intro: Back to normal or regime switch?

CHINA: GOLD AND FOREIGN RESERVES
Billion USD



Source: Thomson Financial Datastream



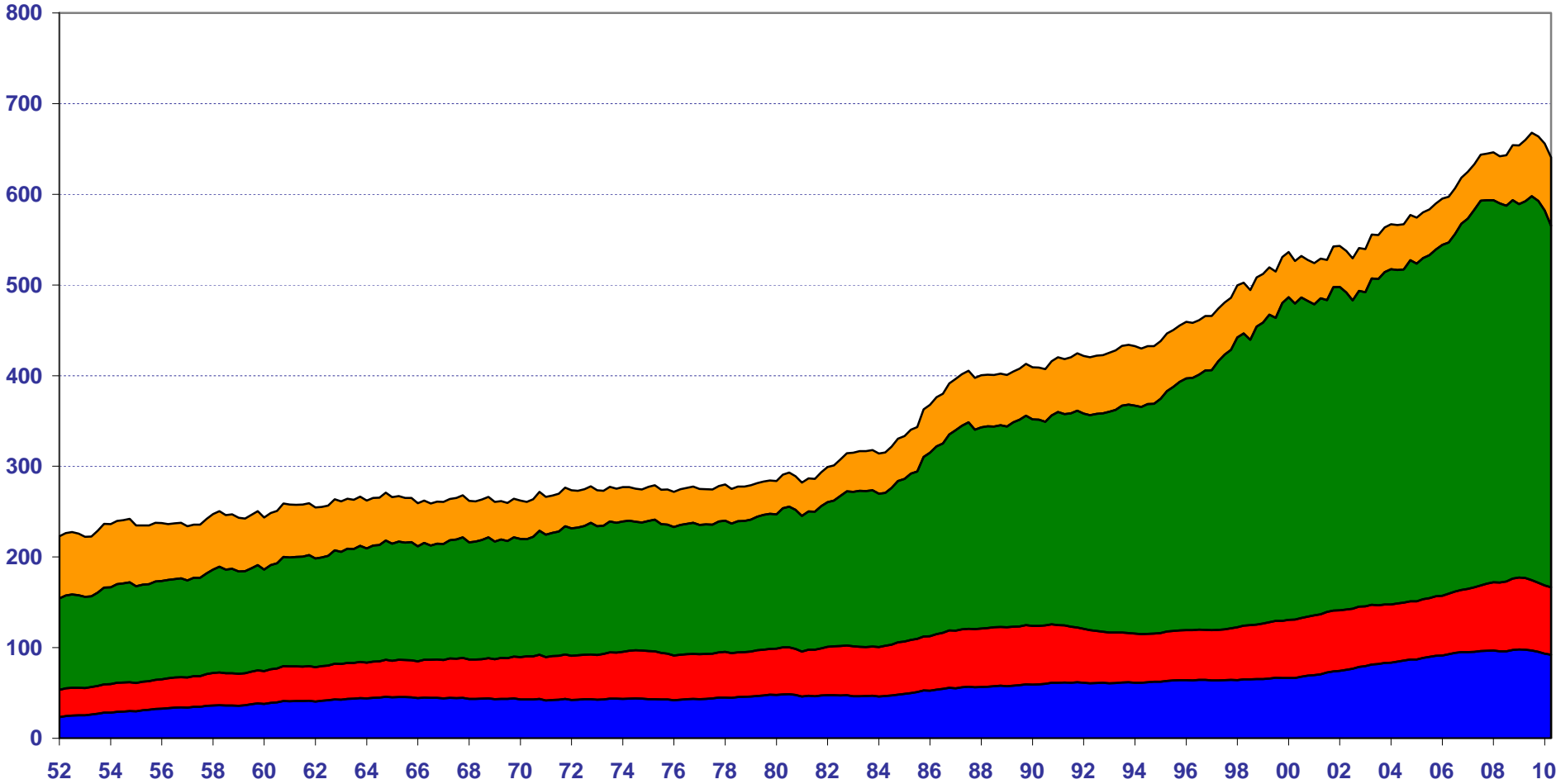
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- But underneath unsustainable bottle necks developed.
 - Imbalances of the US.
 - Savings glut of Asia.
 - Unsustainable financial leverage.



Intro: Back to normal or regime switch?

US: DEBT BY SECTORS (% of GDP)



■ Households ■ Businesses ■ Financial sector ■ Government

Source: Datastream, Federal Reserve



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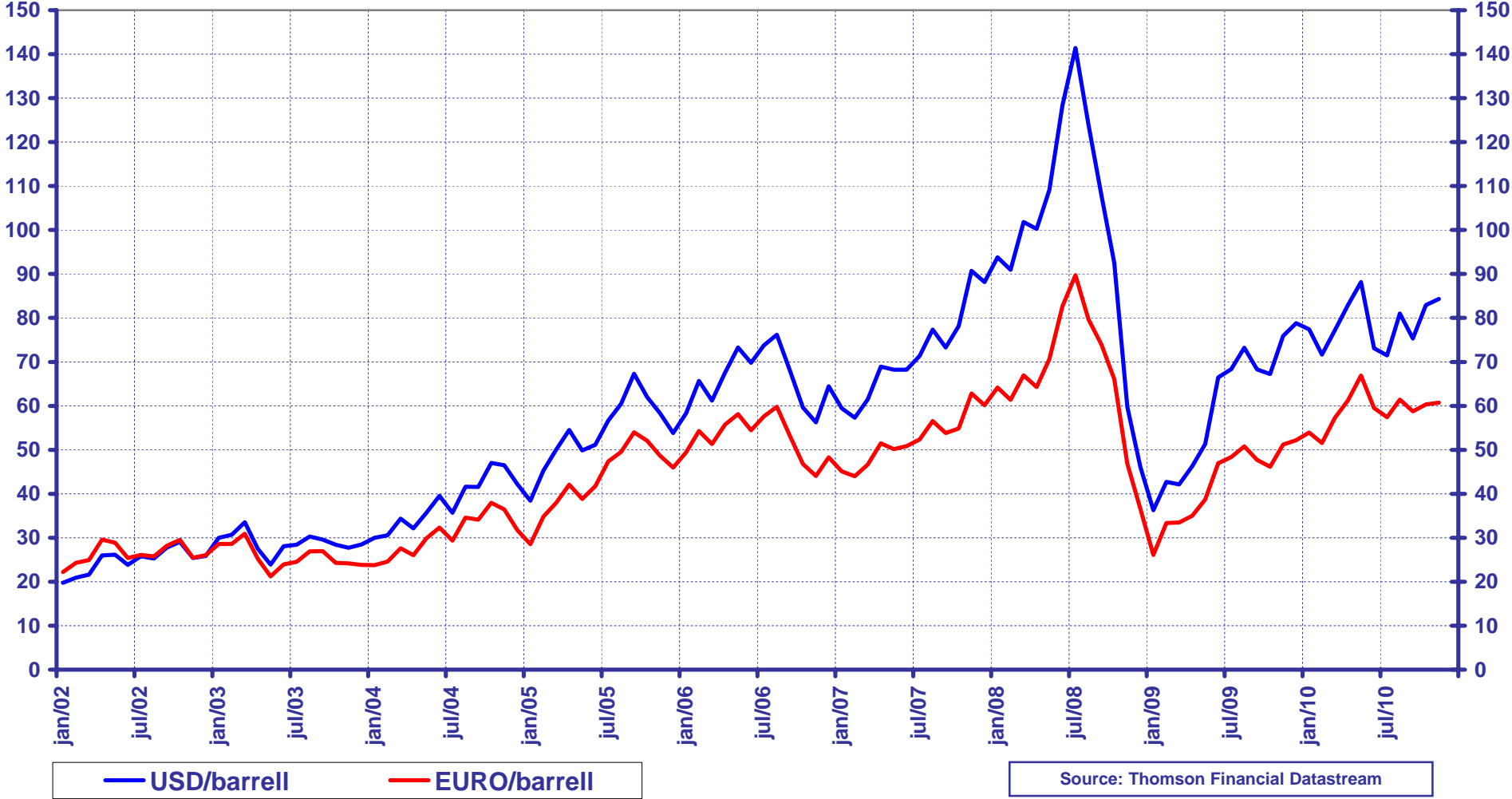
Intro: Back to normal or regime switch?

- The extra ordinary environment of 1990 – 2007.
- But underneath unsustainable bottle necks developed.
 - Imbalances of the US.
 - Savings glut of Asia.
 - Unsustainable financial leverage.
 - And natural limits of growth were reached: prices and environment



Intro: Back to normal or regime switch?

Commodities : Oil



Intro: Back to normal or regime switch?

- The extra ordinary environment of 1990 – 2007.
- But underneath unsustainable bottle necks developed.

“BACK TO NORMAL” SEEMS UNLIKELY AND EVEN UNDESIRABLE



History of the crisis

- Summer 2007: starting problems in US housing market and “toxic” financial products.
- September 2008: major banks fail in US and EU, global economy into recession.
- 2010 gradual recovery but major problems and risks remain.



Consequences of the crisis

**Loss in world market capitalization since end 2007: 15.3 trn USD
(+/- 25% of total)**

Loss in world output: 3.7trn USD (6% of total)

Global bank writedowns: 2.8trn USD

35 million new unemployed workers globally since June 2008

5.8trn USD increase in OECD public debt



AND WHAT NOW?

**Economic outlook: The official view.
Worried but improving**

**Economic outlook: the consensus view.
More cautious and confusing...and until now too
pessimistic.**



Scenario May 2010

	GDP Growth			Inflation			Budget Balance		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
US	-2,5	2,5	2,8	-0,4	1,7	1,3	-11,2	-10,7	-9,4
EMU	-4,0	0,9	1,7	0,2	0,9	0,7	-6,1	-6,7	-6,2
Belgium	-3,1	0,8	1,7	-0,1	1,0	0,9	-5,7	-5,6	-5,2
China	8,3	10,2	9,3	-1,1	0,1	1,0	-1,8	-0,9	-0,3

Source: OECD

Scenario October 2010, the official view:

	GDP Growth			Inflation			Budget Balance		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
US	-2,6	2,6	2,3	-0,3	1,4	1,0	-12,9	-11,1	-9,7
EMU	-4,1	1,7	1,5	0,3	1,6	1,5	-6,3	-6,5	-5,1
Belgium	-2,7	1,6	1,7	0,0	2,0	1,9	-5,9	-4,8	-5,1
China	9,1	10,5	9,6	-0,7	3,5	2,7	-3,0	-2,9	-1,9

Source: IMF



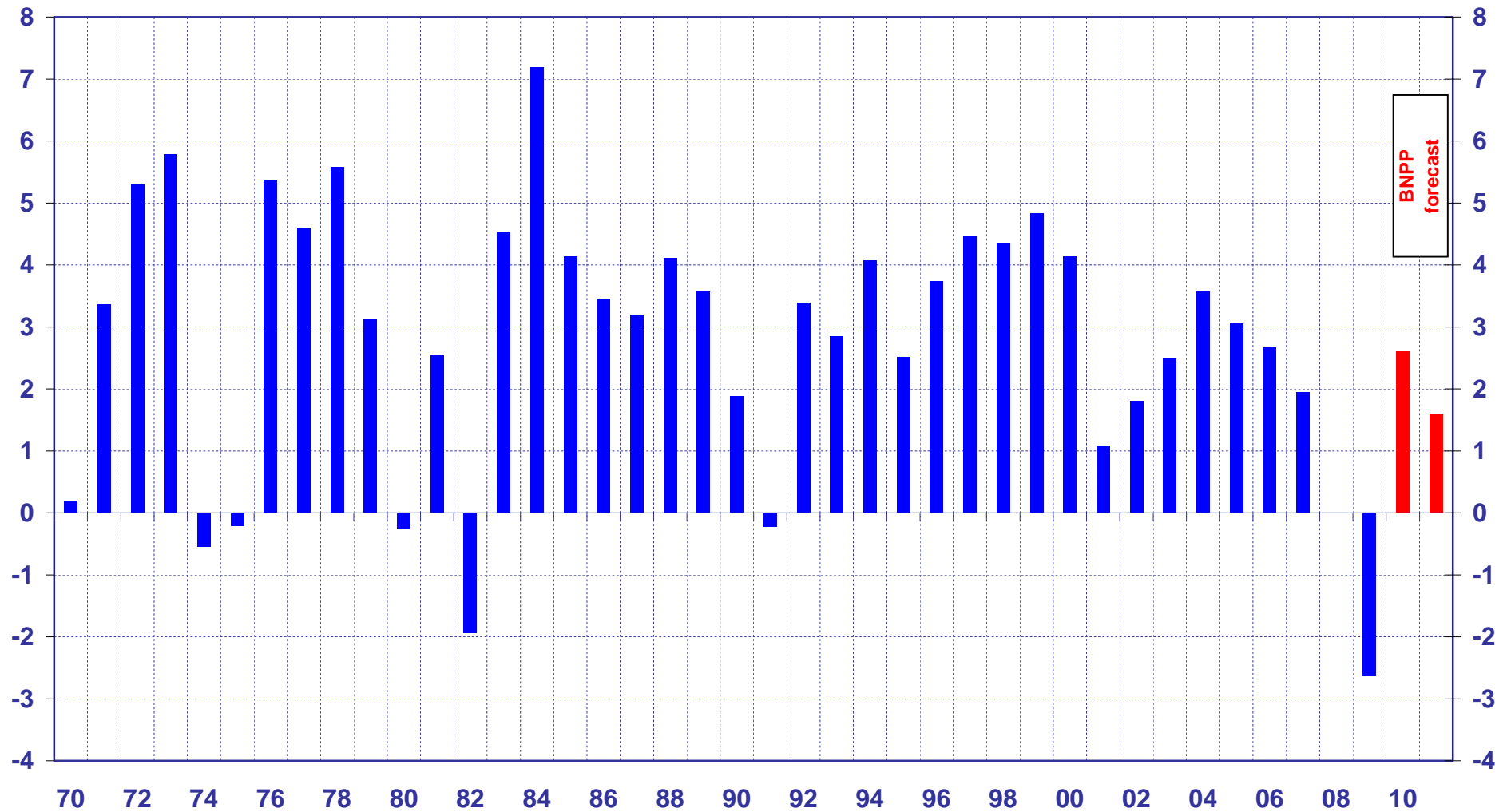
1. Economic outlook: focus on the consensus view.

US: Growth is back but slowdown after fast recovery end 2009.



1. Economic outlook: focus on the consensus view.

US: GDP GROWTH (yoy in %)
Department of Commerce figures



1. Economic outlook: focus on the consensus view.

US: Growth is back but slowdown after fast recovery end 2009.

- Corporate confidence fully recovered.
- Corporate profits recovered.
- Credit spreads normalised.

- But government debt reaches increasingly dangerous levels.
- But consumers remain worried: sticky unemployment, confidence and the need to restore sustainable financial balances.
- But need to reduce macro imbalances.

RECOVERY SEEMS SUSTAINABLE BUT VULNERABLE



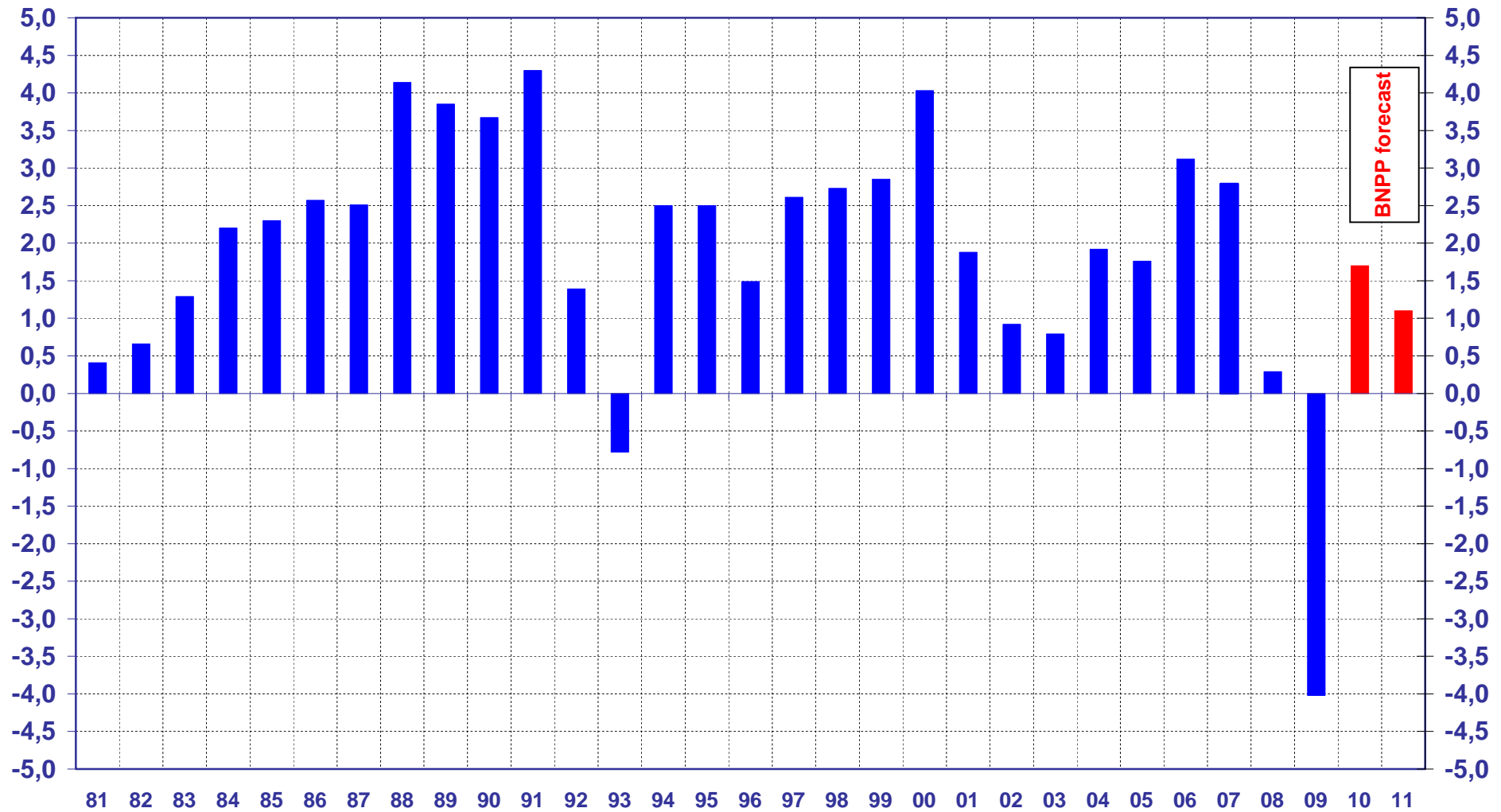
1. Economic outlook: focus on the consensus view.

EMU: Growth is back but slower than US.



1. Economic outlook: focus on the consensus view.

EMU: REAL GDP GROWTH (yoy in %)
Eurostat figures



Source: Thomson Financial Datastream



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1. Economic outlook: focus on the consensus view.

EMU: Growth is back but slower than US.

- Impressing second quarter 2010.
- Corporate confidence remarkably high (especially Germany).
- Investments recover.
- Credit spreads normalise gradually.
- Consumer confidence improves.
- Exports are booming.

- But government debt leaves no room for manoeuvre.
- But sticky unemployment.
- But increasingly diverging economic development of Member States creates confusion and chaos.

SUSTAINABLE GROWTH BUT UNDERMINED BY POLITICAL UNREST



1. Economic outlook: focus on the consensus view.

Asia: Continued growth and apparent stability.

- No fundamental problems with crisis (banks and government debt).
- But based on massive government support.
- But still focused on exports which is unsustainable.

Growth can continue at high speed, but increasing dangers of conflicts with major clients.



1. Economic outlook: focus on the consensus view.

The global picture

- Growth will continue at acceptable level, no double dip.
- Inflation should not be a problem for the next few quarters.
- Government debt is a problem but can be fixed.

In general a comfortable outlook, but lots of remaining structural problems that have to be resolved in order to create a more stable world.

Alternative scenario's

- A double dip.
- Complete financial chaos.

Where is the upside?



1. Economic outlook: the consensus view.
2. Are we getting out of the mess: overview of developments in risk areas.

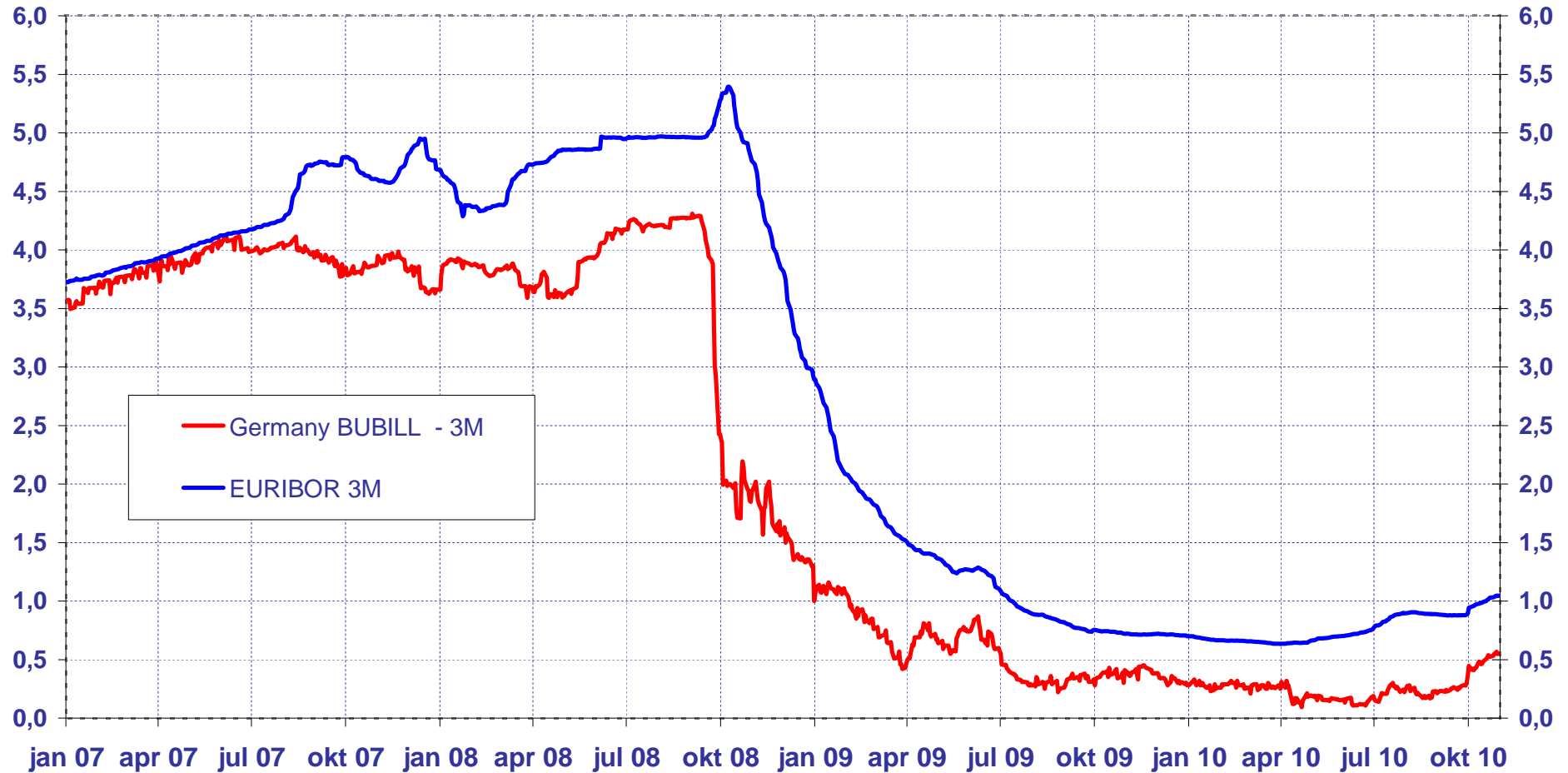


2. Are we getting out of the mess? Overview of risk areas.

- Banking health.
 - Confidence stable.



European Benchmark Rates (10/11/2010)



Source: Datastream Thomson Financial



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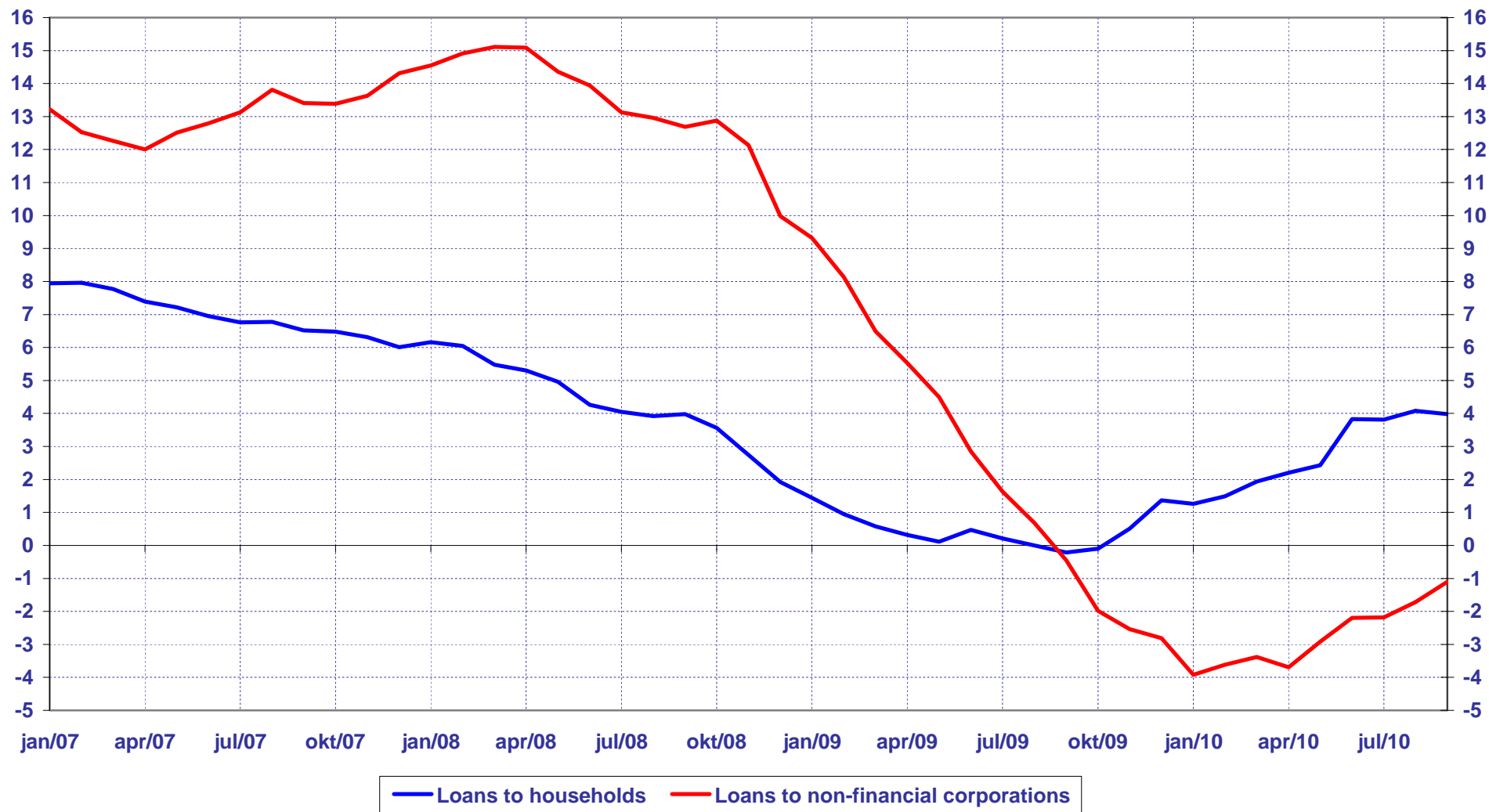
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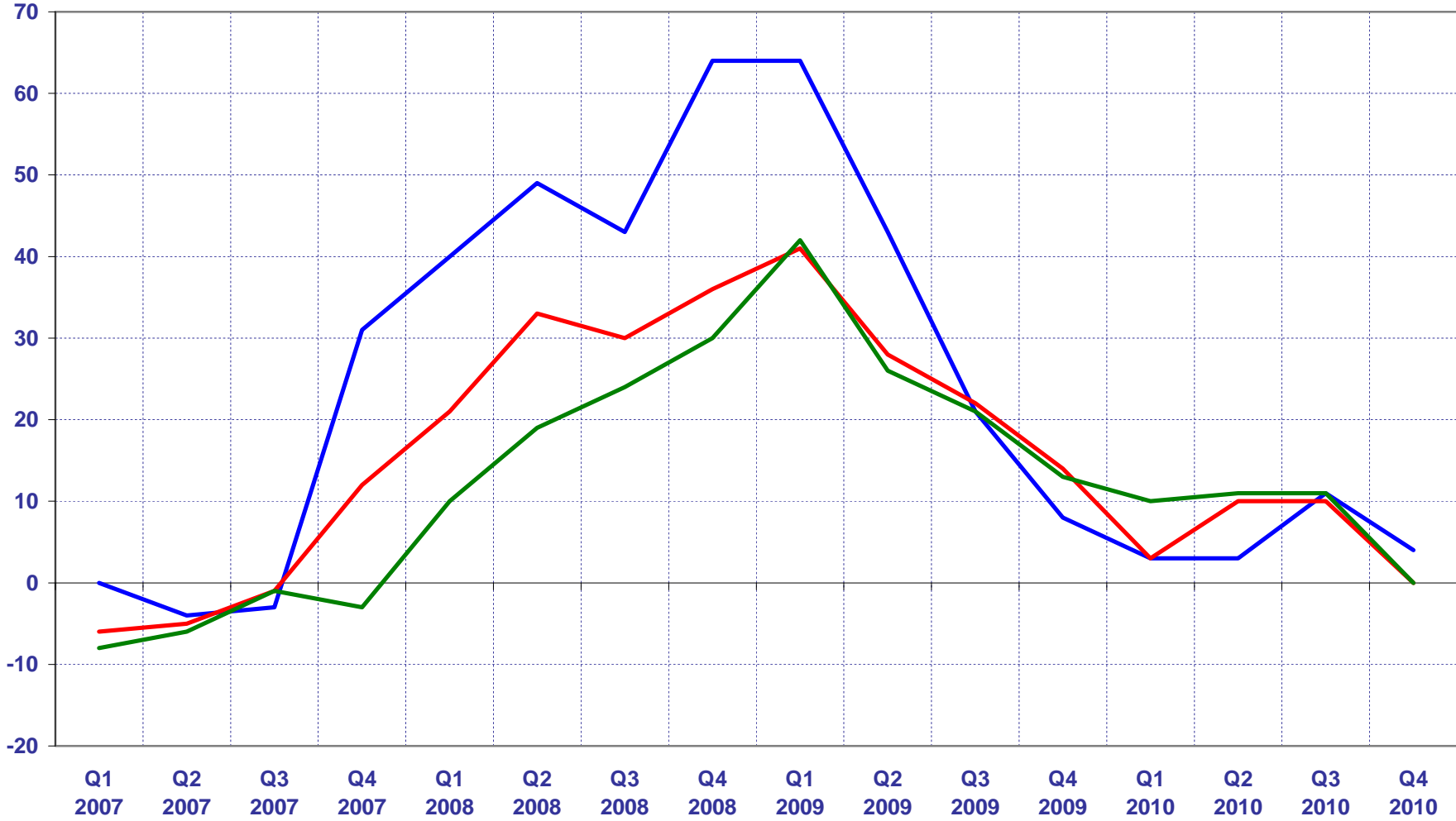
- Banking health.
 - Confidence stable.
 - Lending to private sector recovers.



EMU: Evolution of bank credit to private sector (% YoY)



EMU: NET % OF BANKS TIGHTENING CREDIT STANDARDS



— Enterprises — Consumer credit — Mortgage Lending

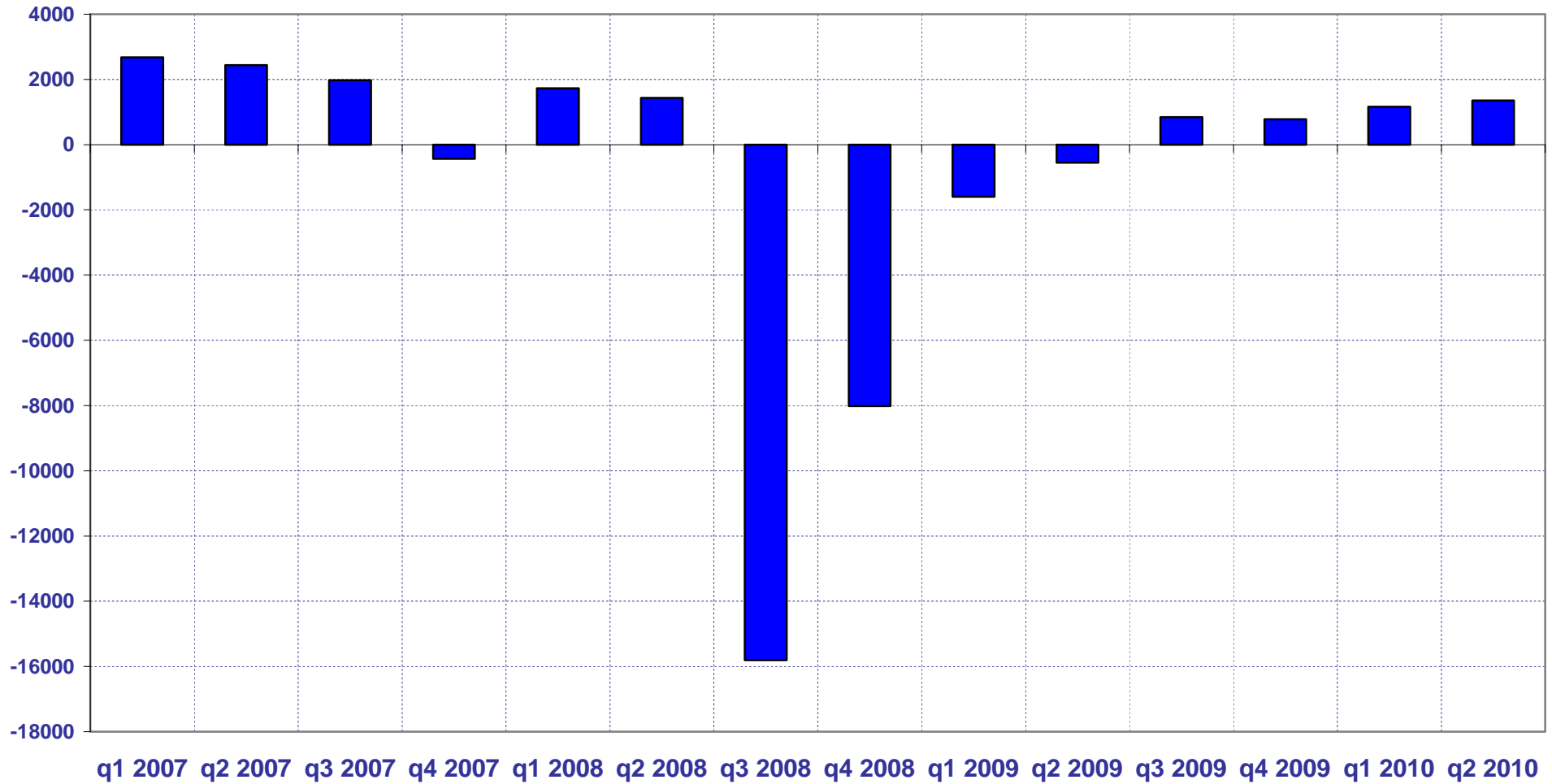


2. Are we getting out of the mess? Overview of risk areas.

- Banking health.
 - Confidence stable.
 - Lending to private sector recovers.
 - Profitability back but still vulnerable.



Belgian banking sector: net results (million EUR)



Source: Belgostat



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2. Are we getting out of the mess? Overview of risk areas.

- Banking health.
 - Confidence stable.
 - Lending to private sector recovers.
 - Profitability back but still vulnerable.
 - Stress tests reassuring but controversial.



Identified weak banks:

(Seven of the 91 banks tested fell short of the minimum Tier 1 capital ratio)

5 Spanish Cajas

Hypo Real Estate (Germany)

ATEbank (Greece)



But renewed uncertainty about the true extent of exposures:

“Lenders shunned on stress tests doubts” (FT, 02/09/2010)

Leading UK and continental European companies are increasingly shunning banks from Spain, Italy and even Germany because they do not believe the Europe-wide stress testing of banks gave a true picture of their financial health.



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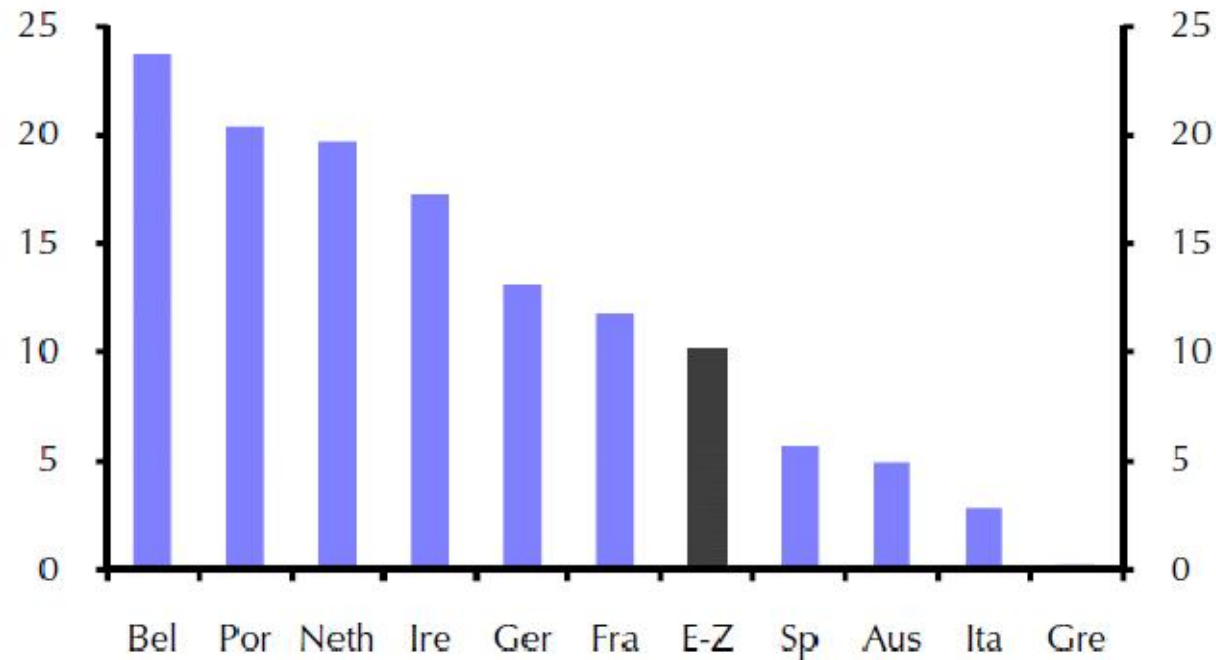
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- But exposure to risky assets remains significant.



Banking contagion channel: exposure to sovereign and private sector debt

Bank's exposure to non-domestic Eurozone periphery (Greece, Spain, Portugal, Italy), sovereign and private sector debt, in % of GDP



Source – BIS, Capital Economics



2. Are we getting out of the mess? Overview of risk areas.

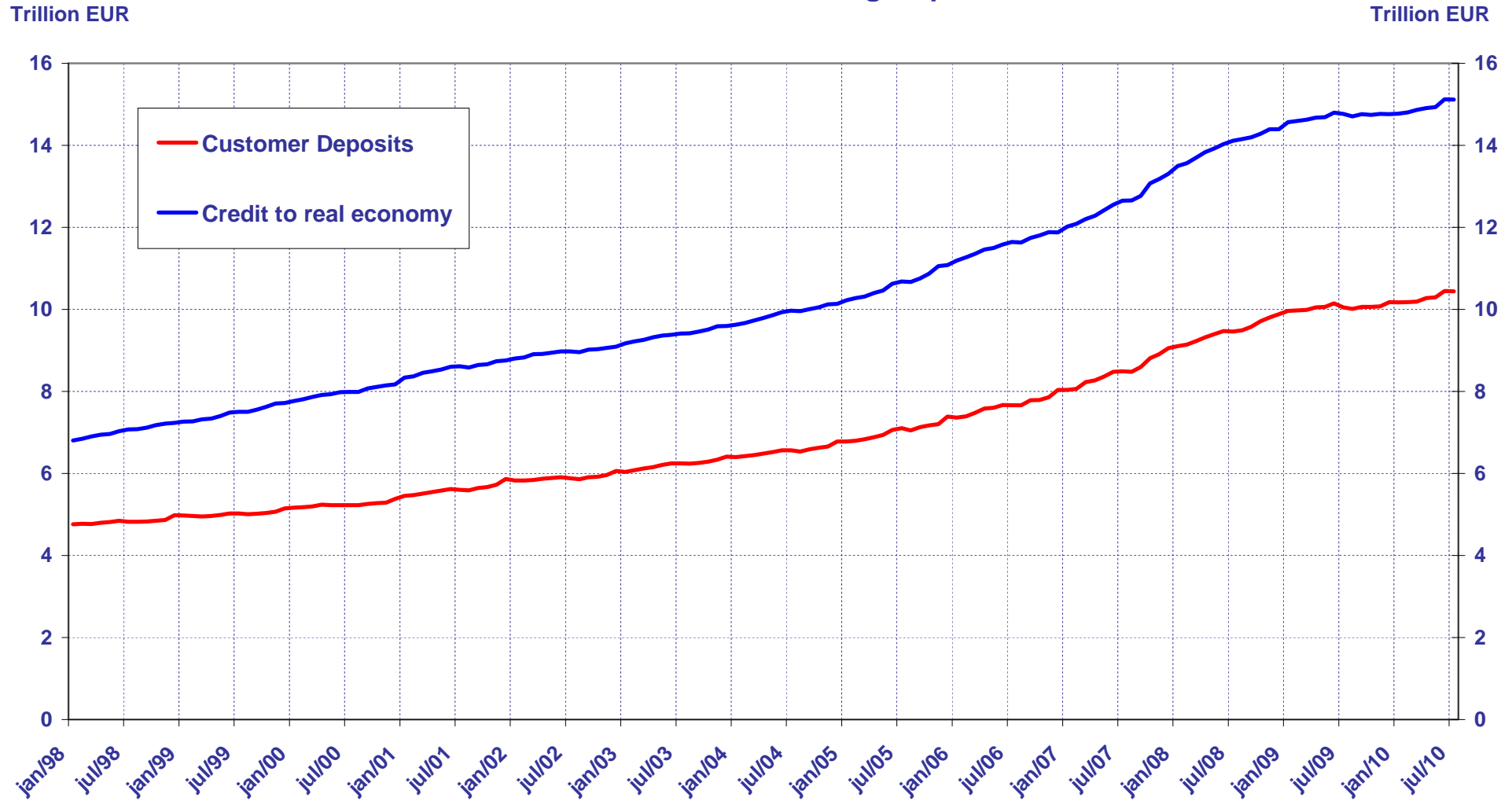
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- But exposure to risky assets remains significant.
- But funding gap remains wide.



Funding gap remains wide

Eurozone MFI Funding Gap



Source: Datastream Thomson Financial



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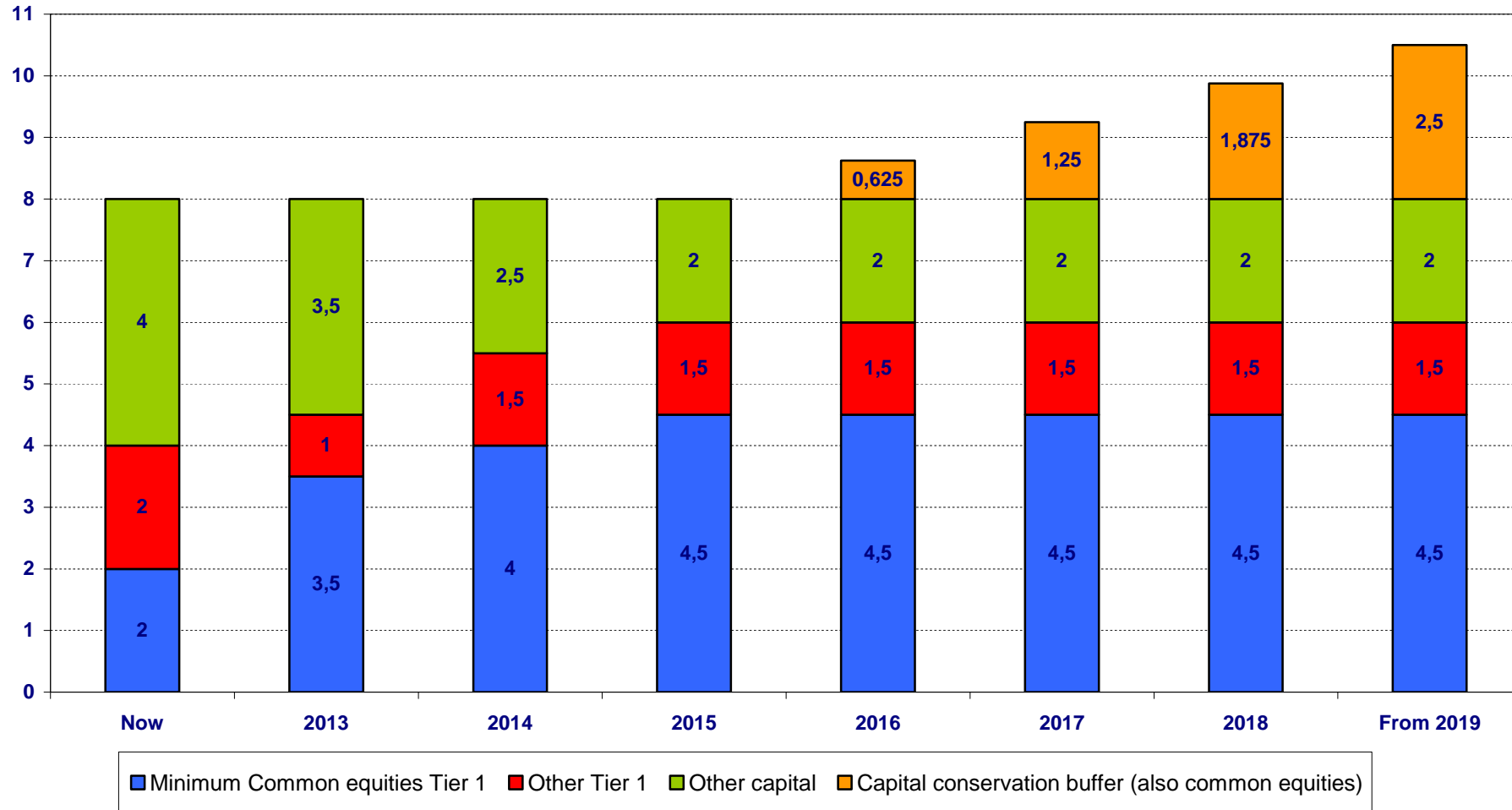
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- But funding gap remains wide.
- But new regulations create uncertainty.



Capital requirements: gradual increase until 2019



Uncertainty about impact of new Basel II rules:

Cumulative impact on GDP of bank regulatory requirement:

BIS: 0.4% of GDP

IIF: 3.1% of GDP



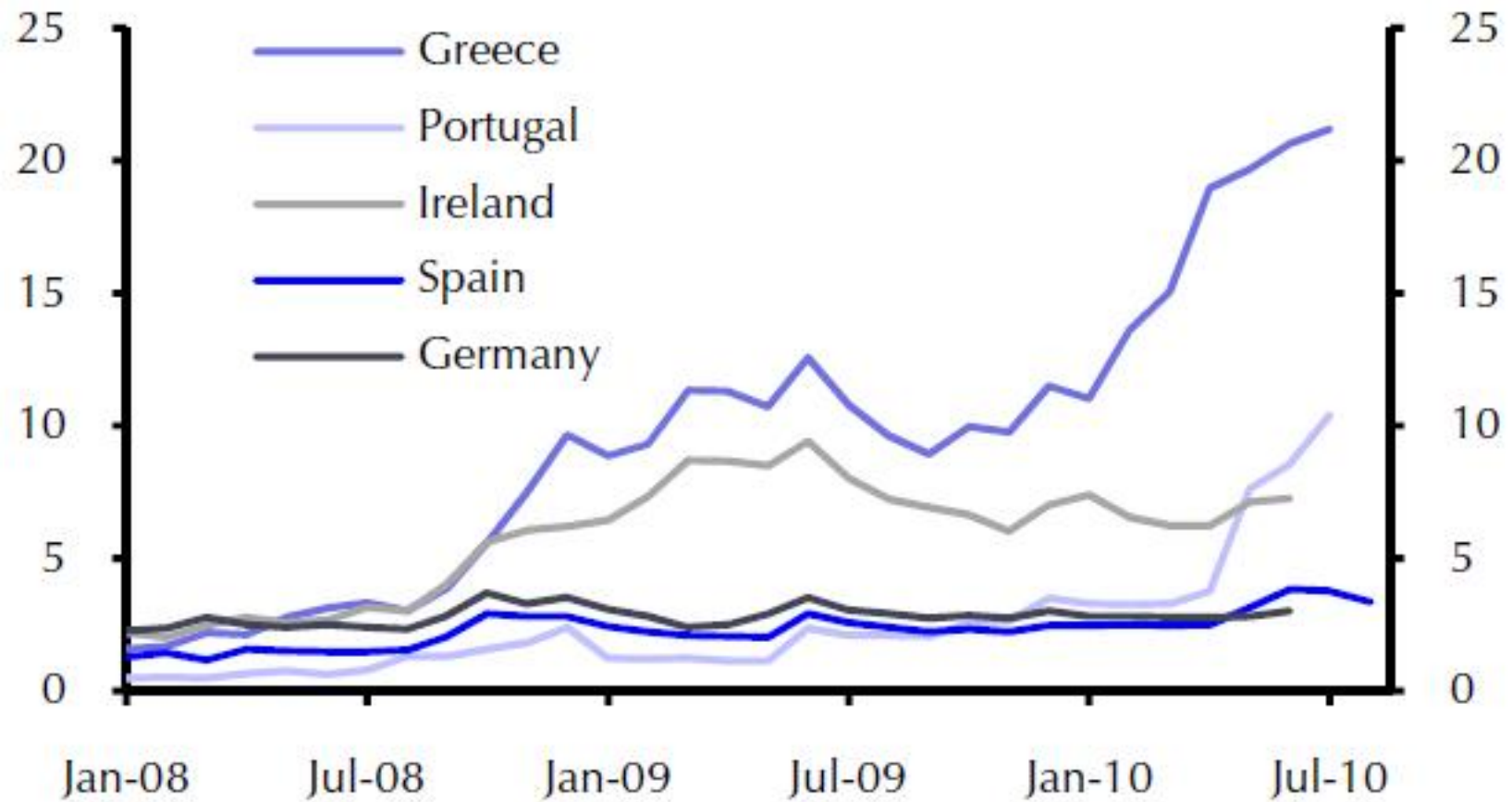
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- But exposure to risky assets remains significant.
- But funding gap remains wide.
- But new regulations create uncertainty.
- **But many weaker banks remain dependent on ECB in some countries.**



Central Bank Loans to Commercial Banks (% of assets)



Source: National Central Banks



2. Are we getting out of the mess? Overview of risk areas.

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BANKS ARE RECOVERING BUT STILL VERY VULNERABLE, A LONG WAY TO GO



2. Are we getting out of the mess? Overview of risk areas.

- Banking health.
- Central Banks balance sheets.



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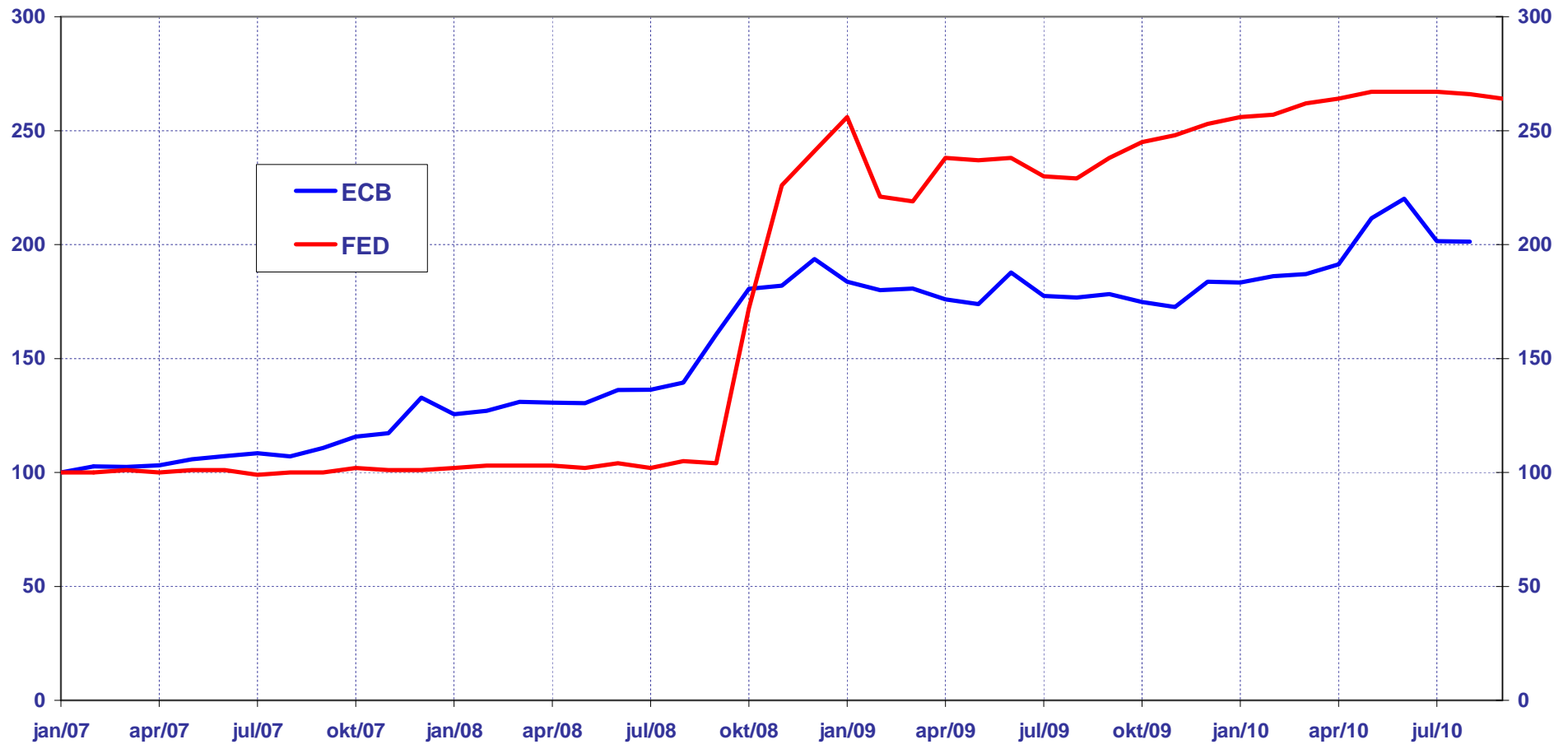
Central Banks balance sheets.

- Massive support during the crisis.



2. Are we getting out of the mess? Overview of risk areas.

CENTRAL BANK BALANCE SHEET EVOLUTION
(rebased jan 2007 = 100)



Source: Thomson Financial Datastream



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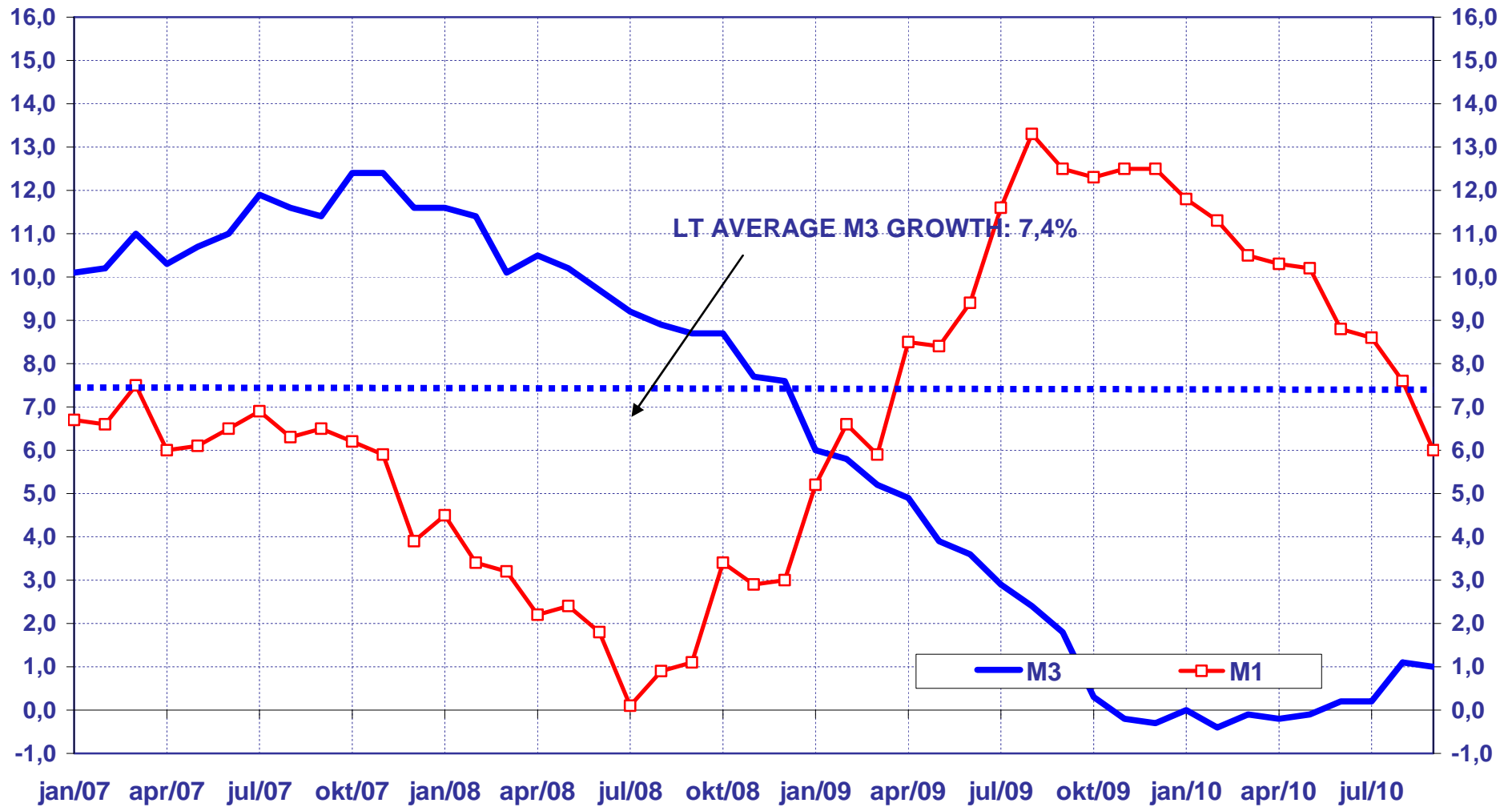
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Central Banks balance sheets.

- Massive support during the crisis.
- Leading to inflation? No worries yet.



EMU: MONEY SUPPLY (yoy growth in %)
European Central Bank figures



2. Are we getting out of the mess? Overview of risk areas.

Central Banks balance sheets.

- Massive support during the crisis.
- Leading to inflation? No worries yet.

Conclusion: no hurry to exit, but what when M3 wakes up?



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- Banking health.
- Central Banks balance sheets.
- Government finances.



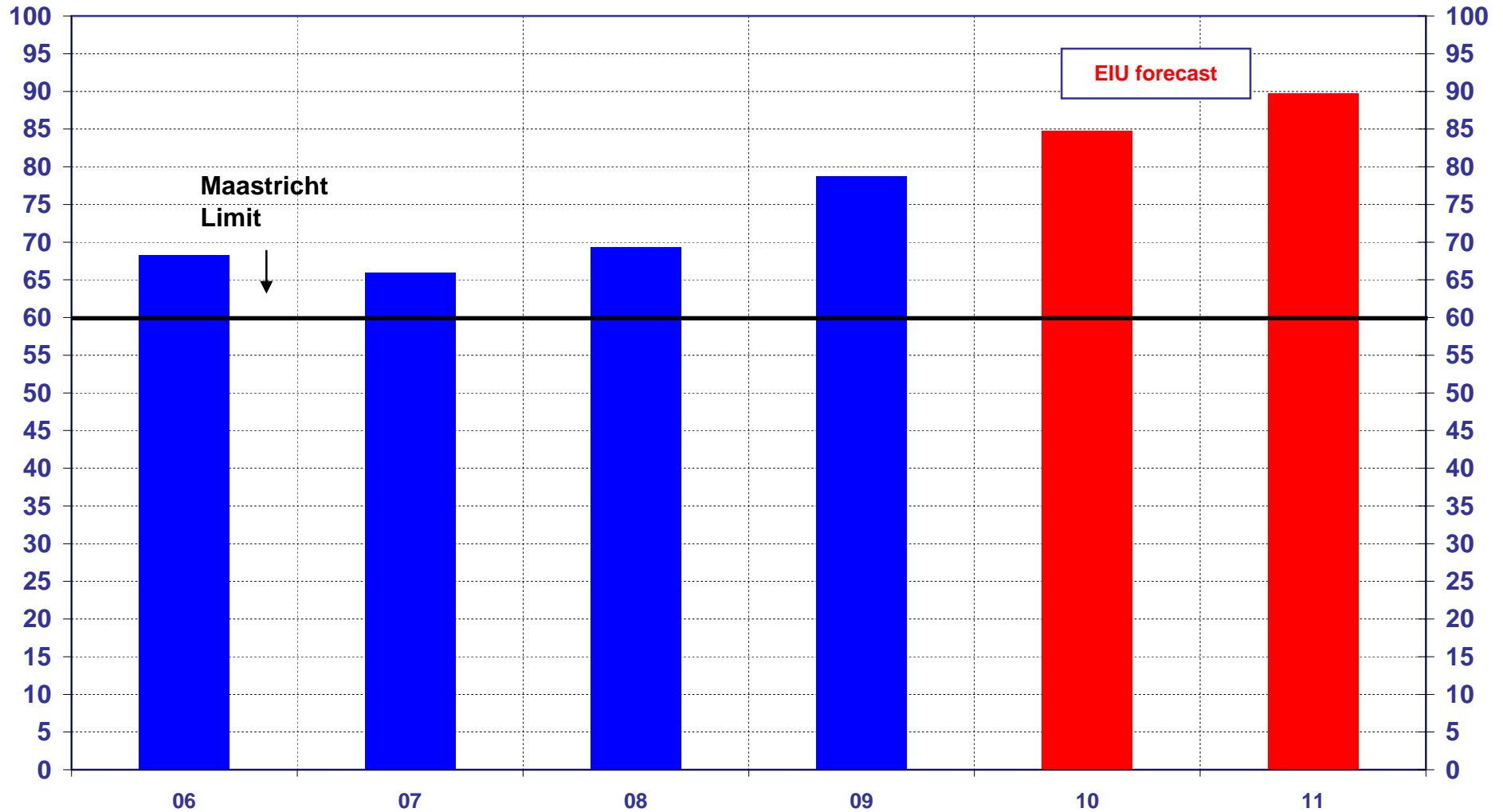
2. Are we getting out of the mess? Overview of risk areas.

Government finances.

- Deficits and unsustainable debt levels.



EMU: PUBLIC DEBT (in % of GDP)
European Central Bank figures



2. Are we getting out of the mess? Overview of risk areas.

Government finances.

- Deficits and unsustainable debt levels.
- Deficits are structural: no easy way out.



2. Are we getting out of the mess? Overview of risk areas.

Government finances.

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- Deficits are structural: no easy way out.

Conclusion:

Governments cannot continue to support the economy but have no other option in case of (unexpected) further slowdown. A dangerous potential dilemma.



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- Banking health.
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- Government finances.
- Divergence within EMU – future of EURO.



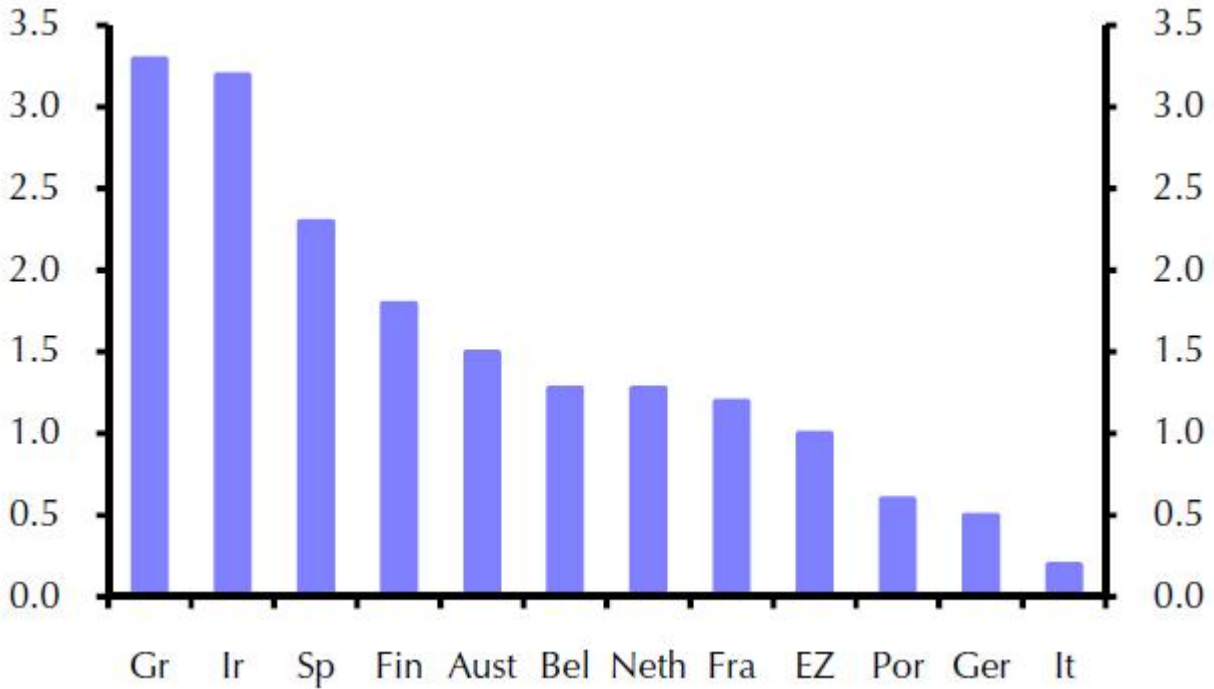
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Divergence within EMU – future of EURO.

- Diverging performance.
 - A story of unsustainable growth paths: from top performers to PIGS.



Eurozone GDP (%YoY, average 2001-09)



Source: Capital Economics



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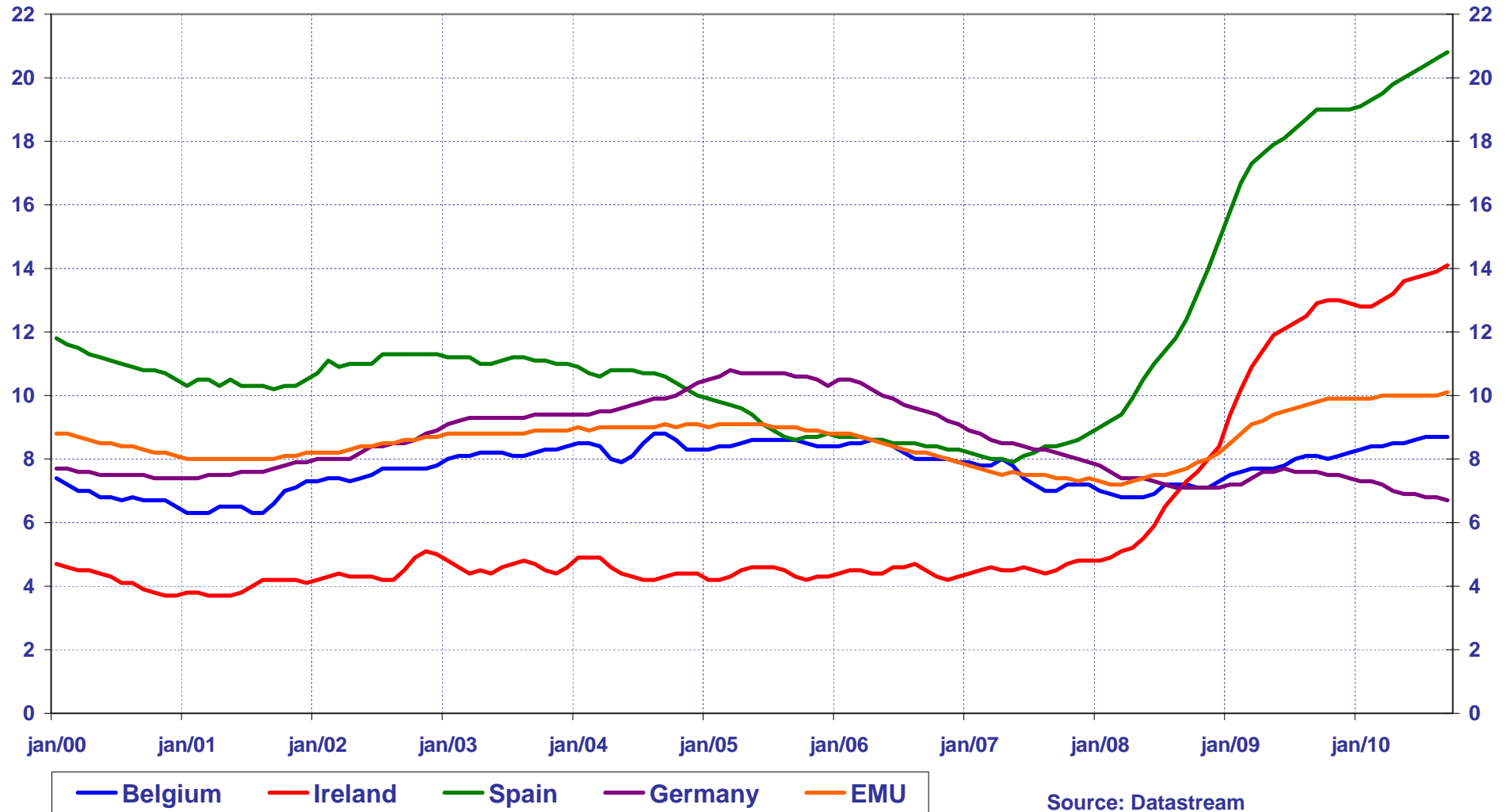
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 - Unemployment.



2. Are we getting out of the mess? Overview of risk areas.

Unemployment rates in the EMU



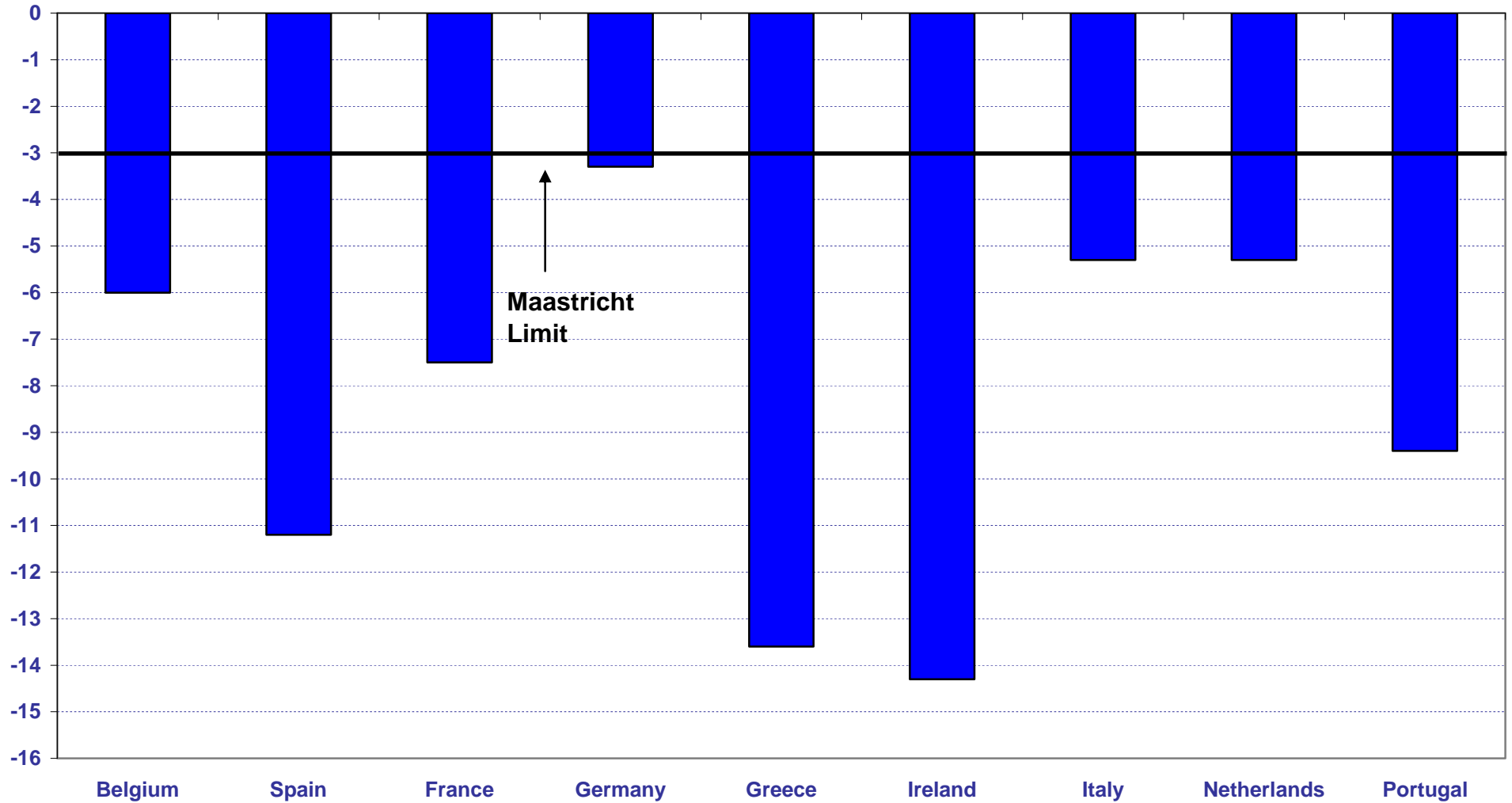
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 - Unemployment.
 - Government deficit.



EMU GOVERNMENT DEFICIT/SURPLUS IN 2009 (% of GDP)



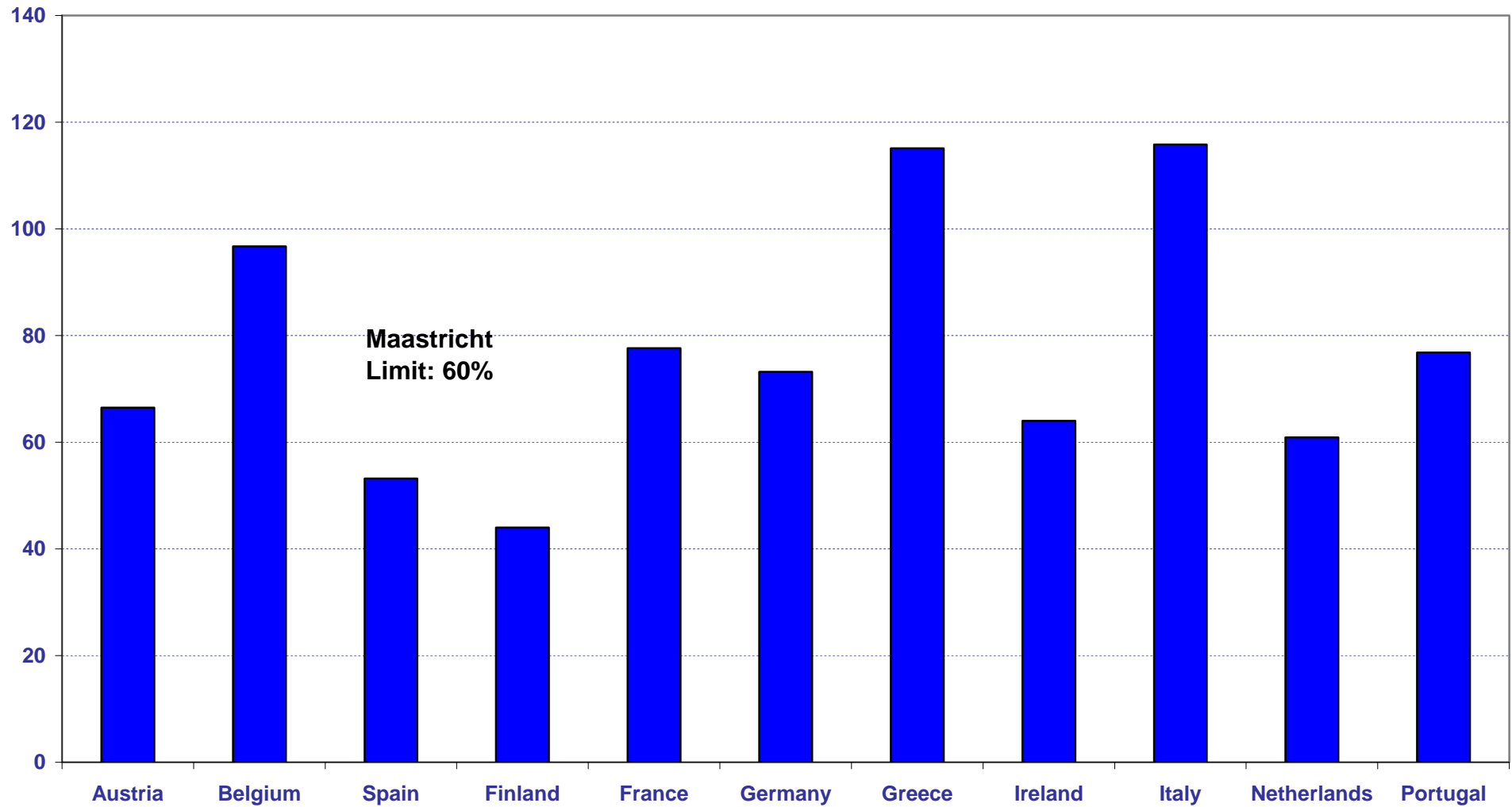
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EMU GOVERNMENT DEBT IN 2009 (% of GDP)



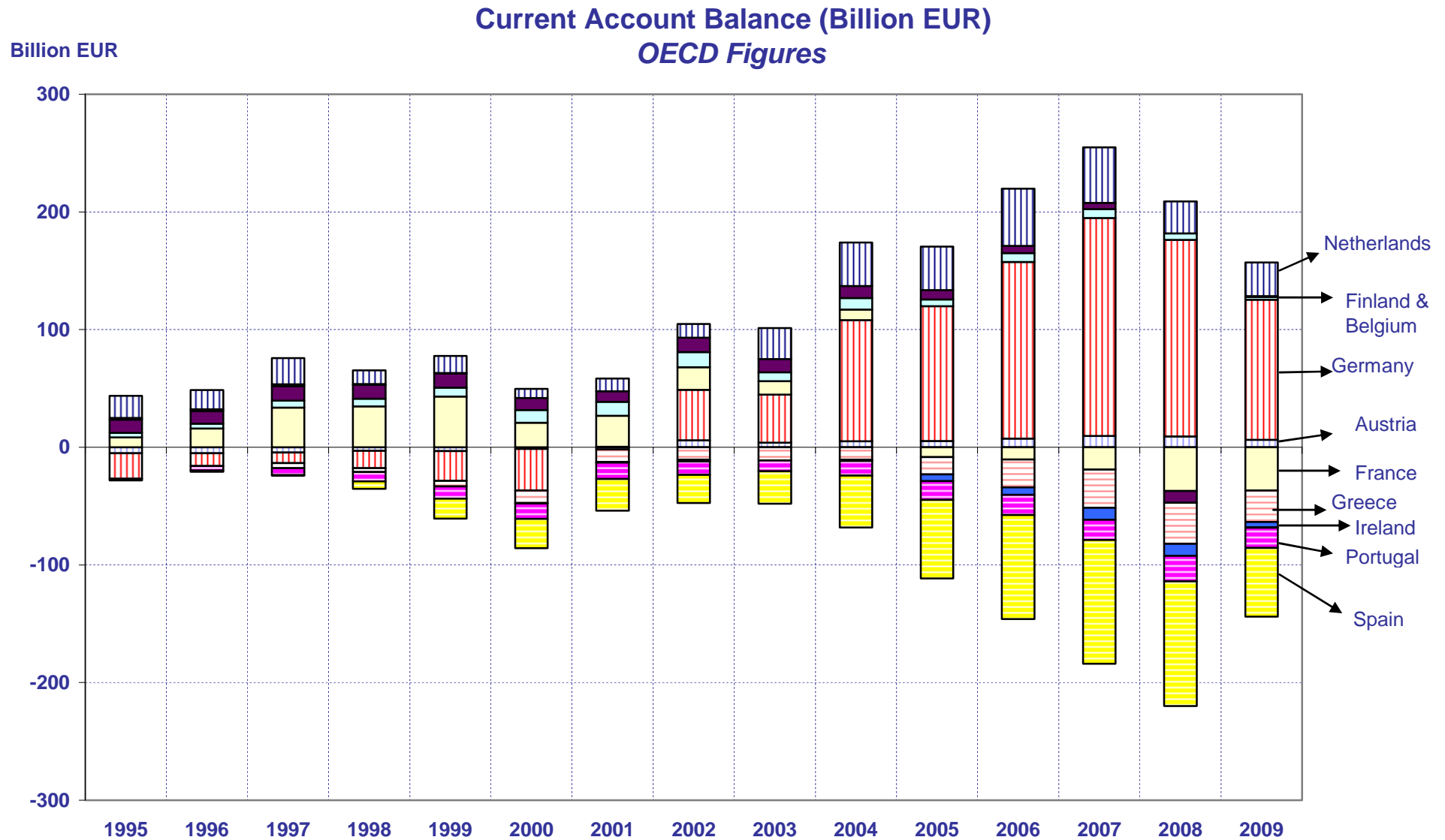
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 - Government debt.
 - Current account.



2. Are we getting out of the mess? Overview of risk areas.



Source: Thomson Financial Datastream



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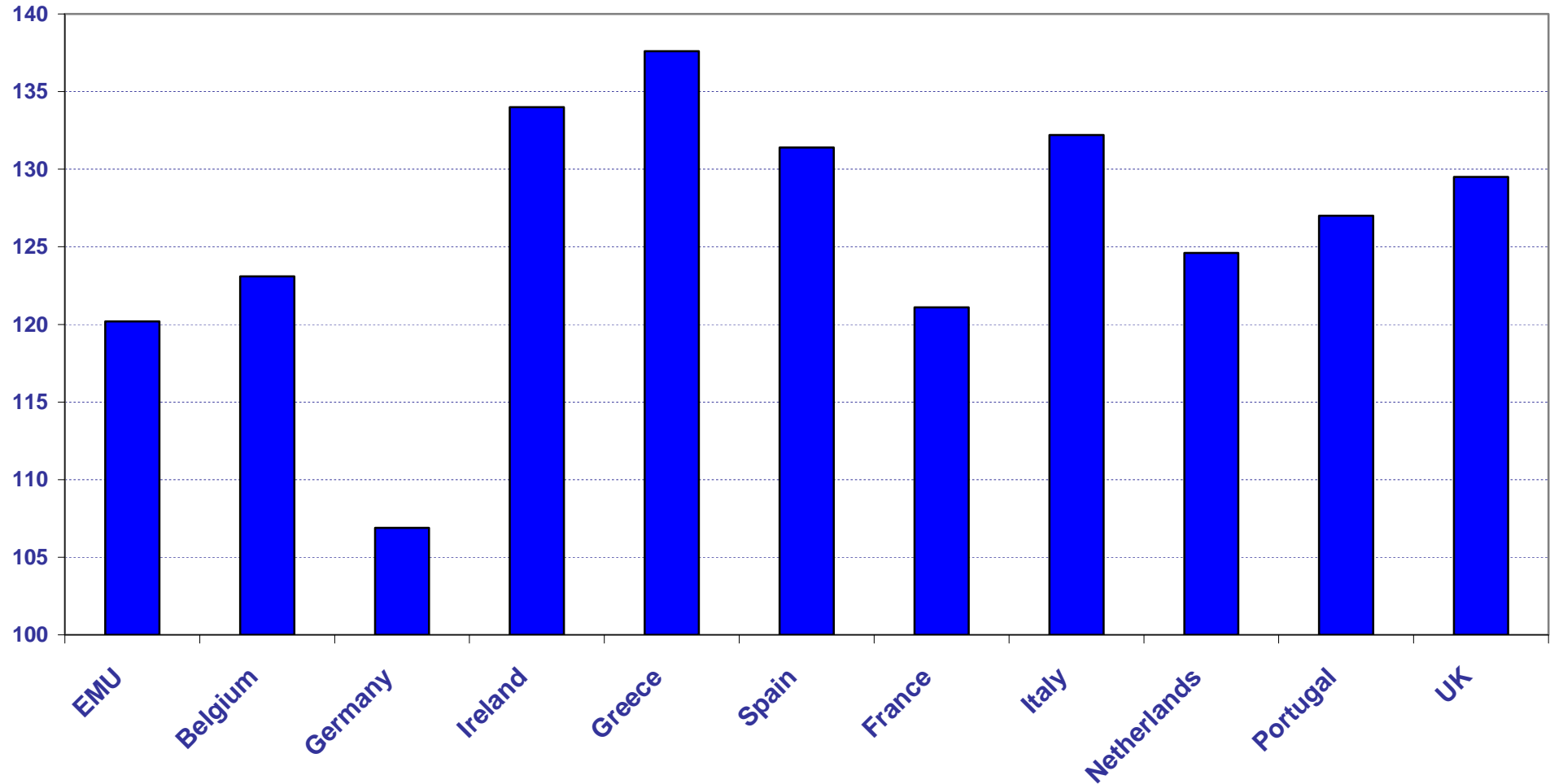
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 - Government deficit.
 - Government debt.
 - Current account.
 - Competitiveness.



Unit Labour Cost Index, 2000 = 100
Eurostat Figures



2. Are we getting out of the mess? Overview of risk areas.

Divergence within EMU – future of EURO.

- Diverging performance.
- Scorecard per country.



2. Are we getting out of the mess? Overview of risk areas.

Performance 1999-2009										
	EMU	Netherlands	Germany	Belgium	France	Ireland	Spain	Portugal	Italy	Greece
GDP	1,5	1,9	1,0	1,7	1,6	4,4	2,8	1,2	0,6	3,4
Government debt (end 2009)	78,9	60,9	73,2	96,7	77,6	64,0	53,2	76,8	115,8	115,1
Unemployment (end 2009)	9,4	3,4	7,5	7,9	9,4	11,9	18,0	9,6	7,8	9,5
Government deficit	-1,8	-0,8	-2,0	-1,0	-3,1	-0,6	-1,3	-4,0	-3,0	-5,9
Inflation	2,0	2,3	1,6	2,0	1,8	2,9	2,9	2,6	2,3	3,1
Current account	0,2	5,4	3,3	2,6	0,3	-2,1	-5,8	-9,2	-1,5	-9,0
ULC (2000 = 100)	120,2	124,6	106,9	123,1	121,1	134,0	131,4	127,0	132,2	137,6



2. Are we getting out of the mess? Overview of risk areas.

Divergence within EMU – future of EURO.

- Diverging performance.
- Scorecard per country.
 - The fatal combinations for Greece
 - Current account / ULC
 - Government deficit / debt
 - Consumption driven growth
 - “managed” statistics



2. Are we getting out of the mess? Overview of risk areas.

Divergence within EMU – future of EURO.

- Diverging performance.
- Scorecard per country.
 - The fatal combinations for Greece
 - The fatal combinations for Ireland
 - Importance of financial sector
 - Household debt
 - Current account / ULC



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Divergence within EMU – future of EURO.

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- Scorecard per country.
 - The fatal combinations for Greece
 - The fatal combinations for Ireland
 - The fatal combinations for Portugal
 - Current account / ULC
 - High household debt



2. Are we getting out of the mess? Overview of risk areas.

Divergence within EMU – future of EURO.

- Diverging performance.
- Scorecard per country.
 - The fatal combinations for Greece
 - The fatal combinations for Ireland
 - The fatal combinations for Portugal
 - The fatal combinations for Spain
 - Current account / ULC
 - Housing / construction bubble



2. Are we getting out of the mess? Overview of risk areas.

Divergence within EMU – future of EURO.

- Diverging performance.
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 - The fatal combinations for Greece
 - The fatal combinations for Ireland
 - The fatal combinations for Portugal
 - The fatal combinations for Spain

FOUR DIFFERENT STORIES BUT SOME COMMON ELEMENTS



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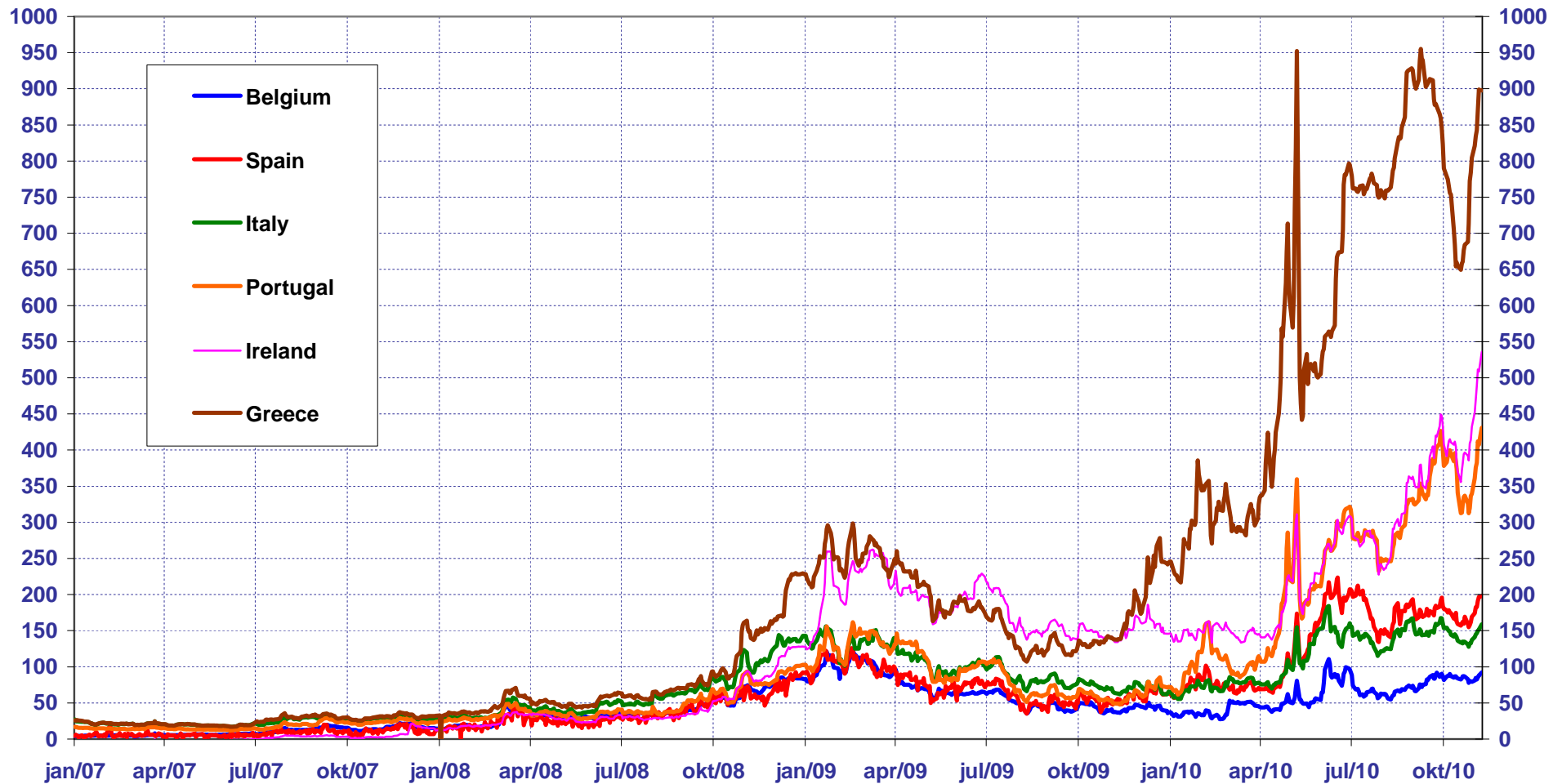
Divergence within EMU – future of EURO.

- Diverging performance.
- Scorecard per country.
- Crisis as a consequence.

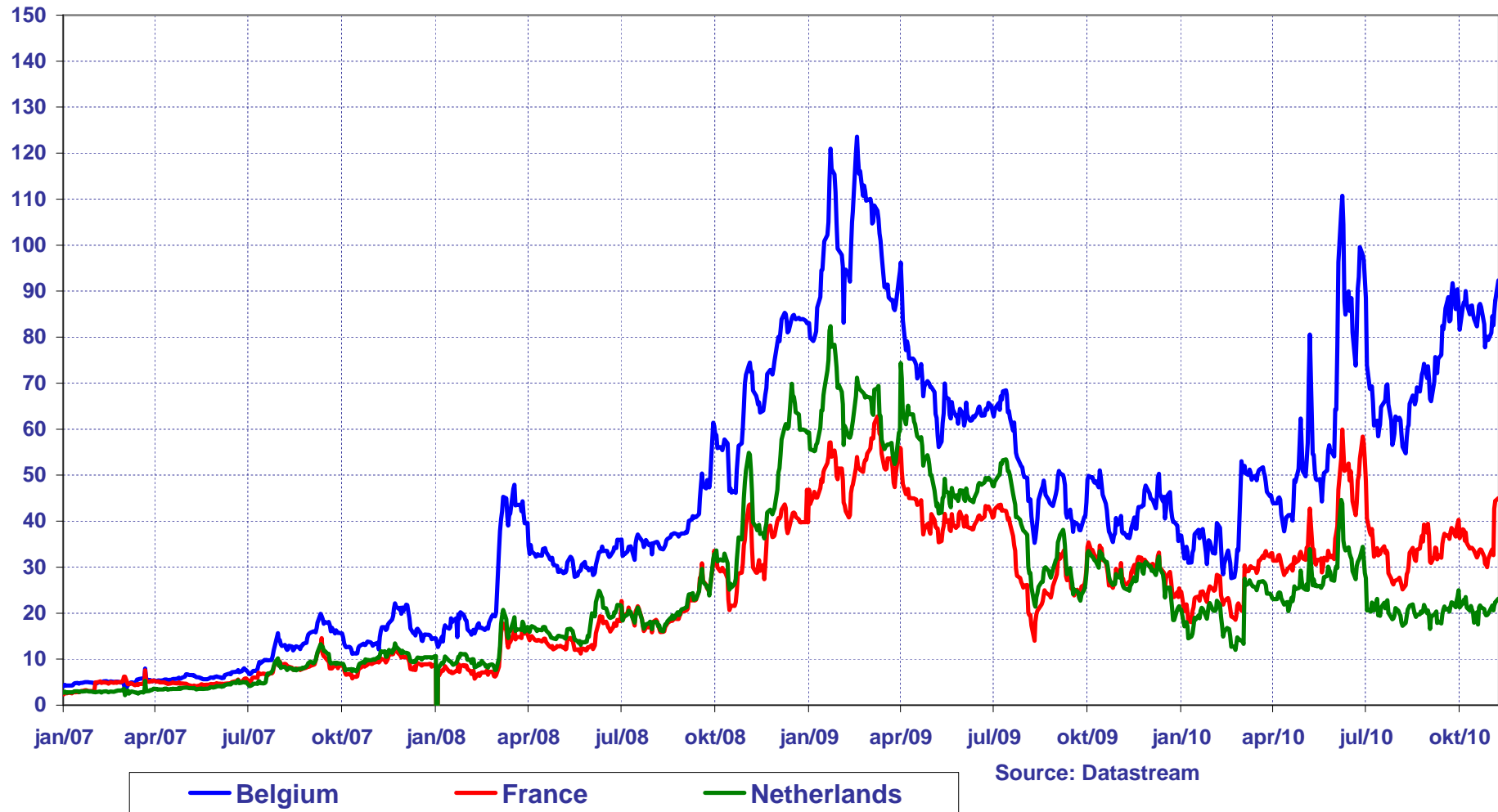


2. Are we getting out of the mess? Overview of risk areas.

YIELD ON EMU GOVERNMENT BONDS 10Y
Spread with German Bund 10y in bp
08/11/2010



European Government Bonds: Spread with German Bund 10y in bp 08/11/2010



2. Are we getting out of the mess? Overview of risk areas.

Government Finances / Sovereign Debt crisis in Europe

- Divergence within EU: the EURO crisis
- Crisis as a consequence
- Political reaction
 - Rescue package



Eurozone rescue package:

720 bn EUR emergency fund:

- 440bn bilateral loans and guarantees
- 60bn from the EU budget
- 220bn from the IMF

+ 110bn EUR loan to Greece

ECB intervention:

- liquidity extension to commercial banks (reintroduction of fixed rate, full amount for 3M and 6M loans)
- Purchase of government bonds
- Acceptance of Greek collateral, regardless of the rating



Eurozone rescue package: is it enough?

Sovereign Financing Needs 2010-2012				
	2010	2011	2012	Total 2010-2012
Portugal	37,0	22,6	14,9	74,5
Ireland	26,8	24,3	18,6	69,7
Italy	590,0		?	>590
Greece	46,0	39,1	45,4	130,5
Spain	223,8	129,1	110,8	463,7

Source: IIF; Capital economics, own calculations



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 - National Austerity Programs:
 - Focused on government budget.



The efforts to be made:

General Government Budget balance (% of GDP)					
	2009	2010	2011	2012	2013
Greece	-13,6	-8,0	-7,6	-6,5	-4,9
Ireland	-14,3	-32,0	-10,0	-7,2	-4,9
Portugal	-9,4	-8,3	-6,6	-4,6	-2,8
Spain	-11,2	-9,8	-7,5	-5,3	-3,0

Source: National Stability and Growth Programs.

Remark: Irish Government budget deficit will hit 32% of GDP because of rescuing its banking sector. This is a one-off measure.



2. Are we getting out of the mess? Overview of risk areas.

Government Finances / Sovereign Debt crisis in Europe

- Divergence within EU: the EURO crisis.
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 - Rescue package
 - National Austerity Programs:
 - Focused on government budget.
 - Expected impact on growth.



Fiscal Austerity: Impact on Growth					
		2010	2011	2012	2013
Greece	SGP	-4,0	-2,6	1,1	2,1
	BNPP	-4,0	-3,2	0,7	
Portugal	SGP	0,7	0,9	1,3	1,7
	BNPP	1,4	-0,5	0,8	
Spain	SGP	-0,3	1,8	2,9	3,1
	BNPP	-0,4	-0,6	1,2	
Ireland	SGP	-1,3	3,3	4,5	4,3
	BNPP	0,5	1,5	3,1	3,6
EMU	SGP	0,9	1,9	2,3	
	BNPP	1,7	1,1	1,4	2,0

Source: Ecofin, BNP Paribas

SGP = forecast as in Stability and Growth Pact

BNPP = forecast by BNP Paribas



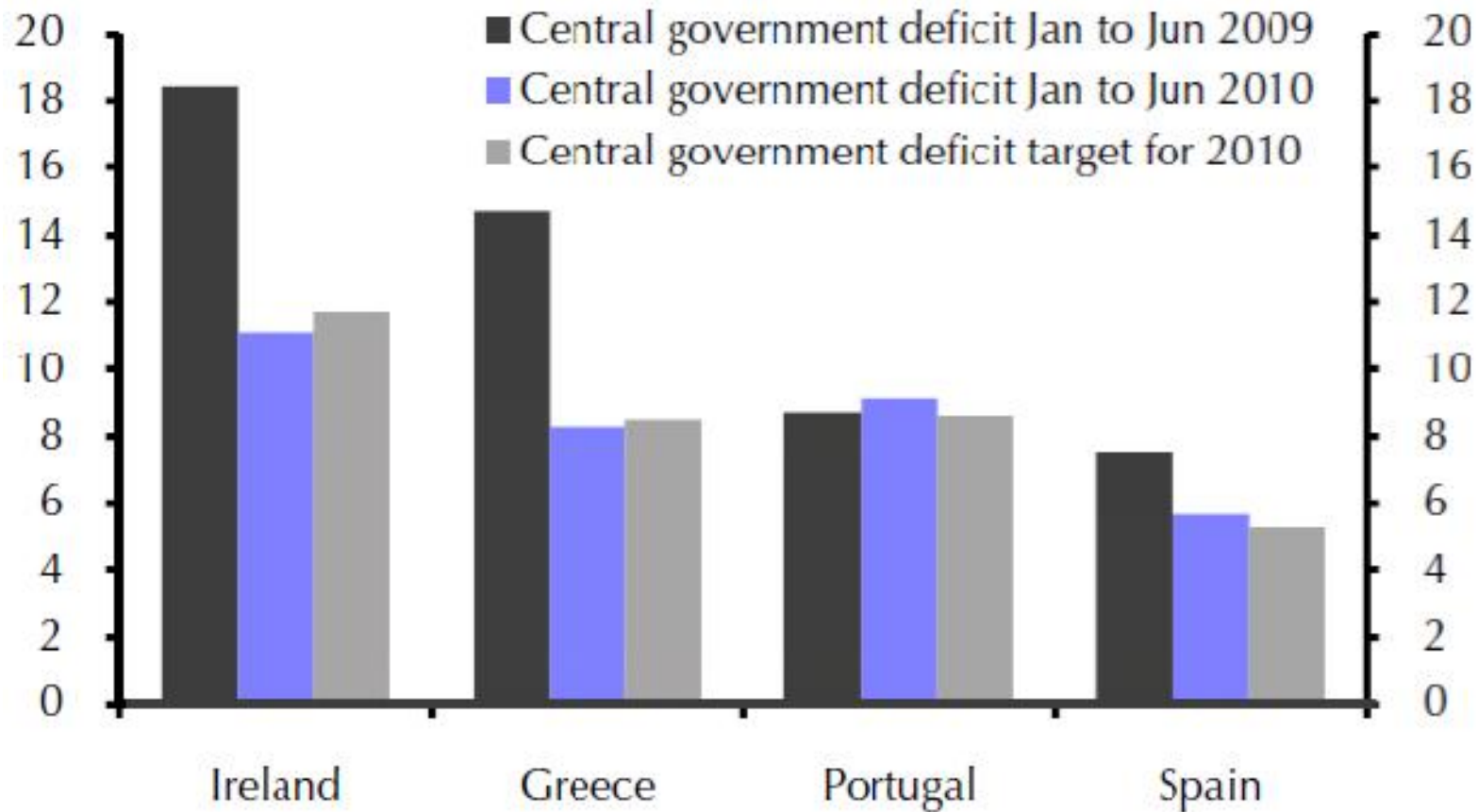
2. Are we getting out of the mess? Overview of risk areas.

Government Finances / Sovereign Debt crisis in Europe

- Divergence within EU: the EURO crisis.
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 - Rescue package
 - National Austerity Programs:
 - Focused on government budget.
 - Impact on growth.
 - Mixed results until now.
 - government deficit on target



Central government budget deficit (% of GDP)



Source: Capital Economics



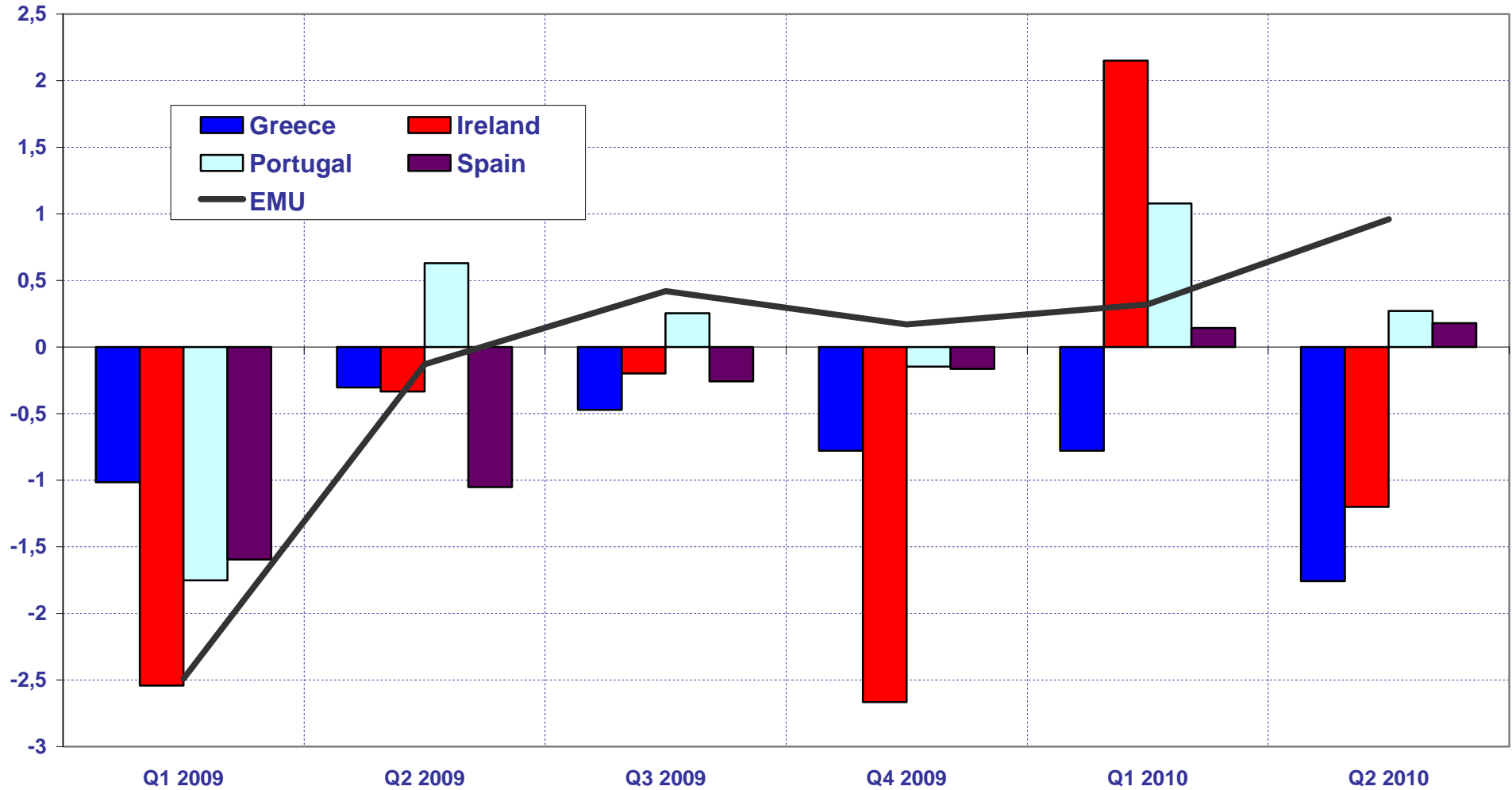
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 - government deficit on target
 - growth implosion as expected for Greece



Evolution of economic growth in PIGS (Real GDP % QoQ)



Source: Datastream



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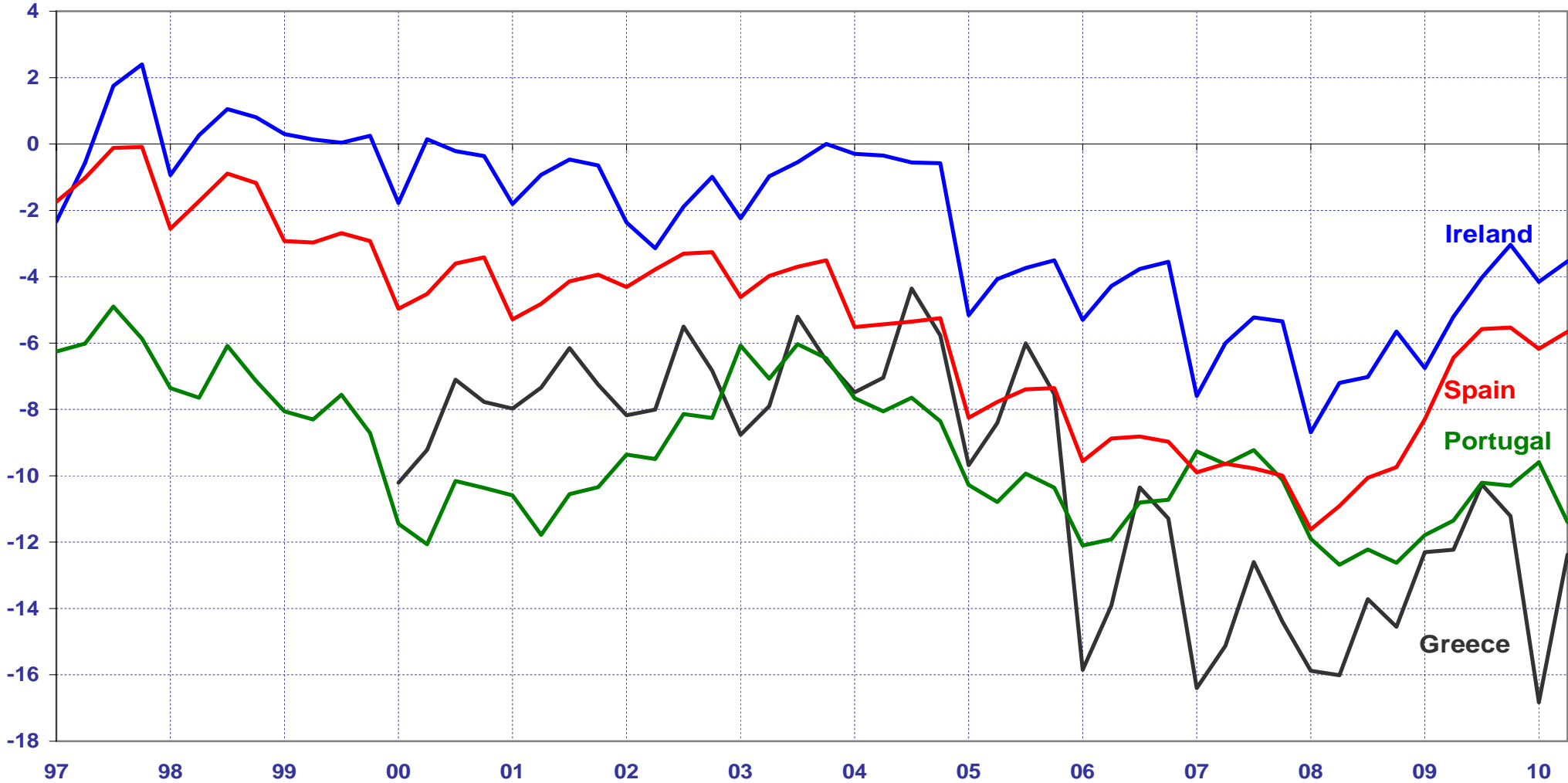
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Government Finances / Sovereign Debt crisis in Europe

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 - Mixed results until now.
 - government deficit on target
 - growth implosion as expected for Greece
 - current account problematic for all: the fundamental competitiveness challenge



CURRENT ACCOUNT BALANCES AS % OF GDP



2. Are we getting out of the mess? Overview of risk areas.

Government Finances / Sovereign Debt crisis in Europe

- Divergence within EU: the EURO crisis.
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 - Rescue package
 - National Austerity Programs.
 - New rules for the Eurozone: Task Force on Economic Governance



Task Force on economic governance.

Agreements of the European Council, October 29.

The creation of a new macro-economic surveillance framework.

- It will detect imbalances and risks, like housing bubbles.
- It will observe the competitiveness of Member States. If a country loses too much competitiveness, action will have to be undertaken, in particular within the Eurozone.

A stronger Stability and Growth Pact.

- Compared to the current situation, sanctions will kick in earlier and progressively: sanctions will be possible before the 3 percent annual deficit is reached (if not enough preventive action is taken). Moreover, sanctions can be decided more easily
- Public debt will be taken more into account, alongside the deficit criterion.

A permanent crisis mechanism

- It should be able to address financial distress and avoid contagion from one country to another. It should also avoid moral hazard.



Reaction of the ECB:

“The Governing Council considers that the proposals do not go as far as the quantum leap in economic governance of Monetary Union that it has been calling for. In particular, the Governing Council is concerned that there would be insufficient atomicity in the implementation of fiscal surveillance, that there is no specification of the rule to reduce government debt ratio, and that financial sanctions have not been explicitly retained under the macroeconomic surveillance procedure.

With regard to the macroeconomic surveillance procedure in particular, the new system of mutual surveillance would need to concentrate firmly on euro area countries experiencing sustained losses of competitiveness and current account deficits. It should be determined by transparent and effective trigger mechanisms. It would be essential that the assessments of macroeconomic imbalances and recommendations for corrective action be given broad publicity at all stages of the surveillance process ”



2. Are we getting out of the mess? Overview of risk areas.

Government Finances / Sovereign Debt crisis in Europe

- Divergence within EU: the EURO crisis
- Crisis as a consequence
- Political reaction.

CONCLUSION:

- PROBLEMS ARE UNDER CONTROL FOR THE TIME BEING BUT THE FUNDAMENTAL ISSUE OF COMPETITIVENESS IS FAR FROM RESOLVED;
- MARKETS DO NOT BELIEVE THIS IS A SOLUTION, ESPECIALLY FOR GREECE
- THIS ISSUE WILL CONTINUE TO WEIGHT ON EU ECONOMIES



2. Are we getting out of the mess? Overview of risk areas.

- Banking health.
- Central Banks balance sheets.
- Government finances.
- Divergence within EMU – future of EURO.
- Double Dip?



2. Are we getting out of the mess? Overview of risk areas.

Double Dip?

- Risks:
 - Aggressive fiscal tightening: postponed.



2. Are we getting out of the mess? Overview of risk areas.

Double Dip?

- Risks:
 - Aggressive fiscal tightening: postponed.
 - Exit central banks: postponed.



2. Are we getting out of the mess? Overview of risk areas.

Double Dip?

- Risks:
 - Aggressive fiscal tightening: postponed.
 - Exit central banks: postponed.
 - Growth in US, EU, Asia seems sustainable.



2. Are we getting out of the mess? Overview of risk areas.

Double Dip?

- Risks:
 - Aggressive fiscal tightening: postponed.
 - Exit central banks: postponed.
 - Growth in US, EU, Asia seems sustainable.
 - New shocks: possible, but unpredictable.



2. Are we getting out of the mess? Overview of risk areas.

Double Dip?

- Risks:
 - Aggressive fiscal tightening: postponed.
 - Exit central banks: postponed.
 - Growth in US, EU, Asia seems sustainable.
 - New shocks: possible, but unpredictable.

Conclusion: Possible but unlikely.



2. Are we getting out of the mess? Overview of risk areas.

- Banking health.
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- Inflation / deflation.



2. Are we getting out of the mess? Overview of risk areas.

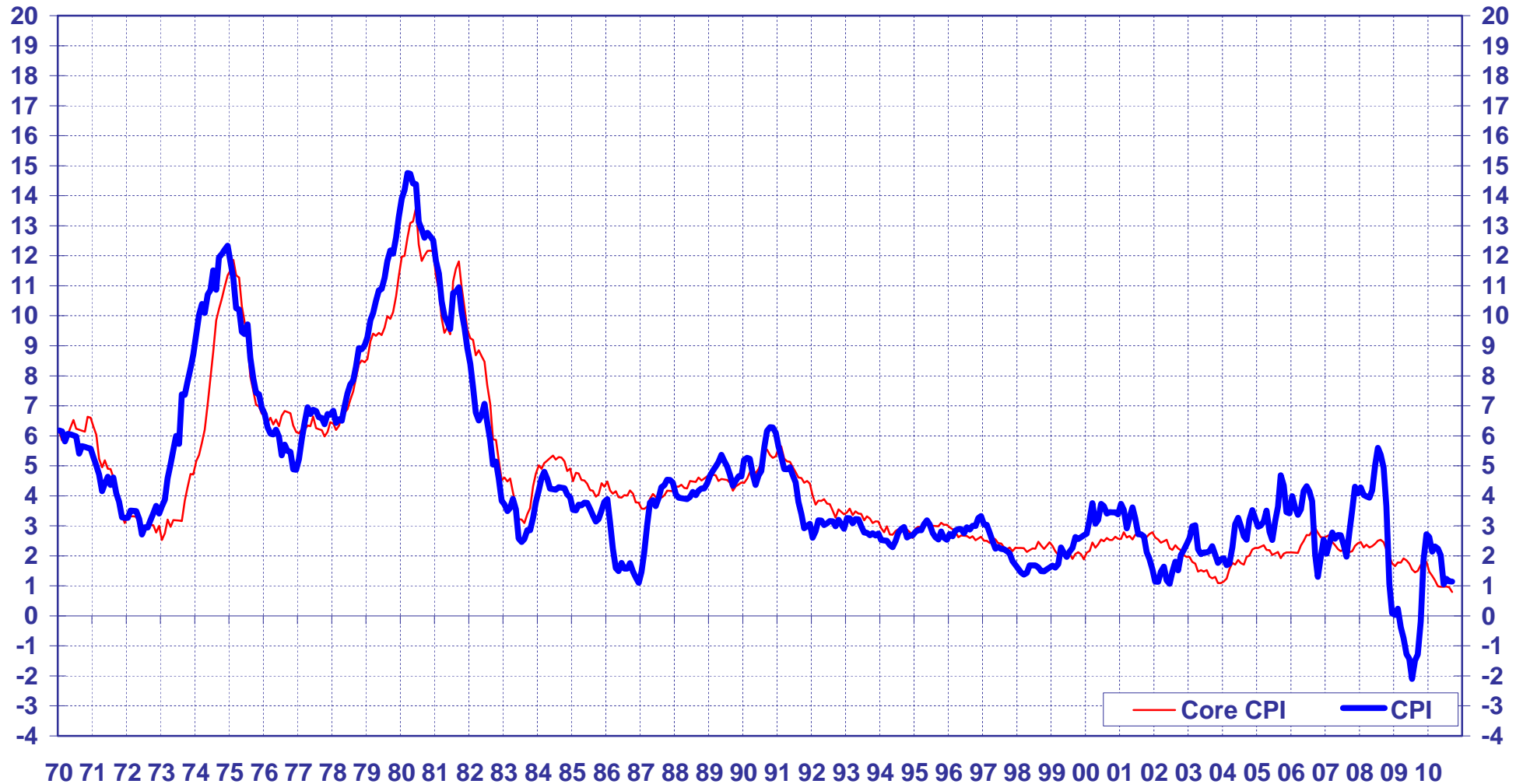
Inflation / deflation.

- Core inflation at record lows in both US and EMU.



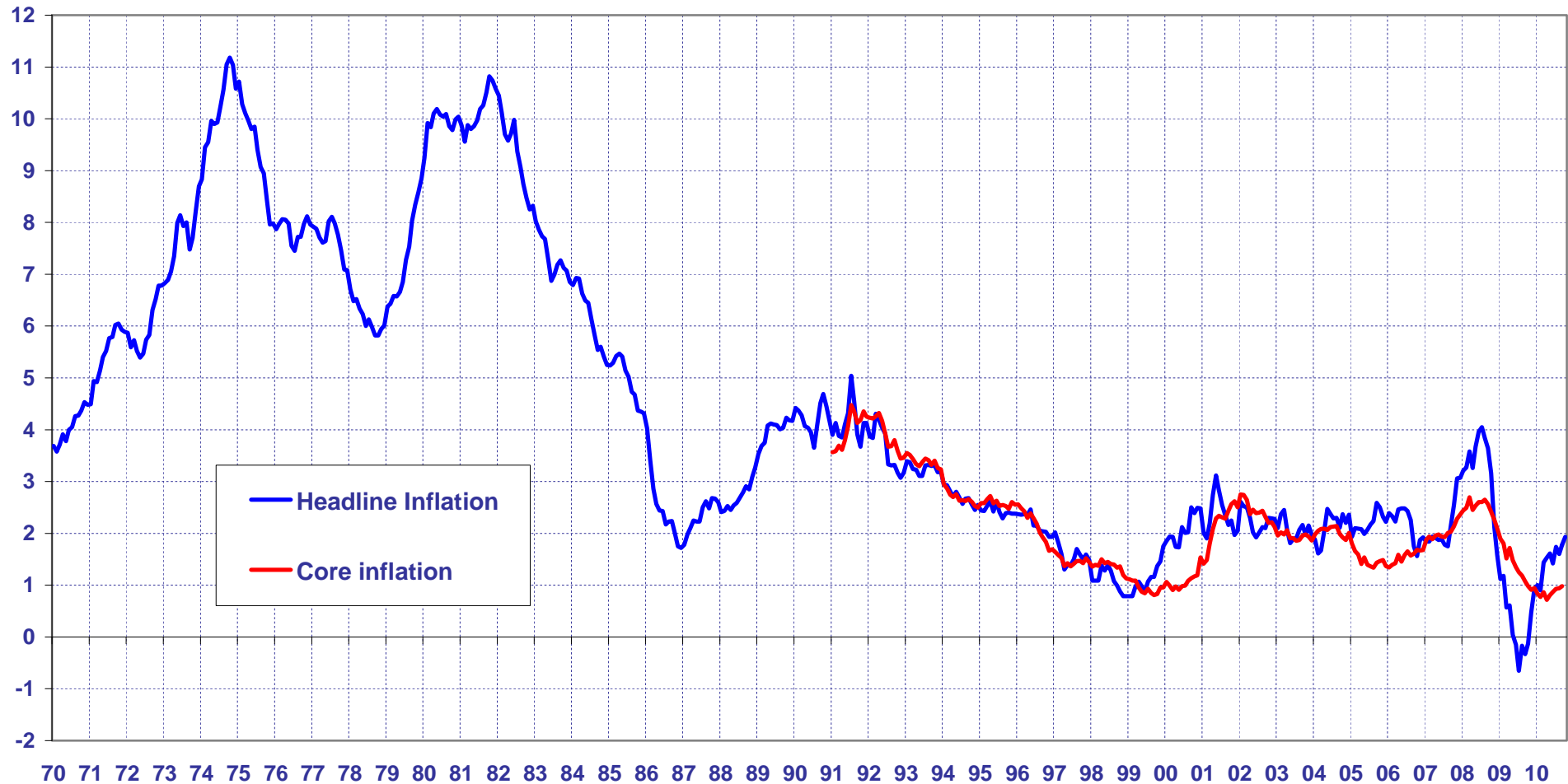
2. Are we getting out of the mess? Overview of risk areas.

US: CONSUMER PRICES (yoy change in %)
Department of Labour figures



2. Are we getting out of the mess? Overview of risk areas.

EMU: CONSUMER PRICES (yoy change in %)



2. Are we getting out of the mess? Overview of risk areas.

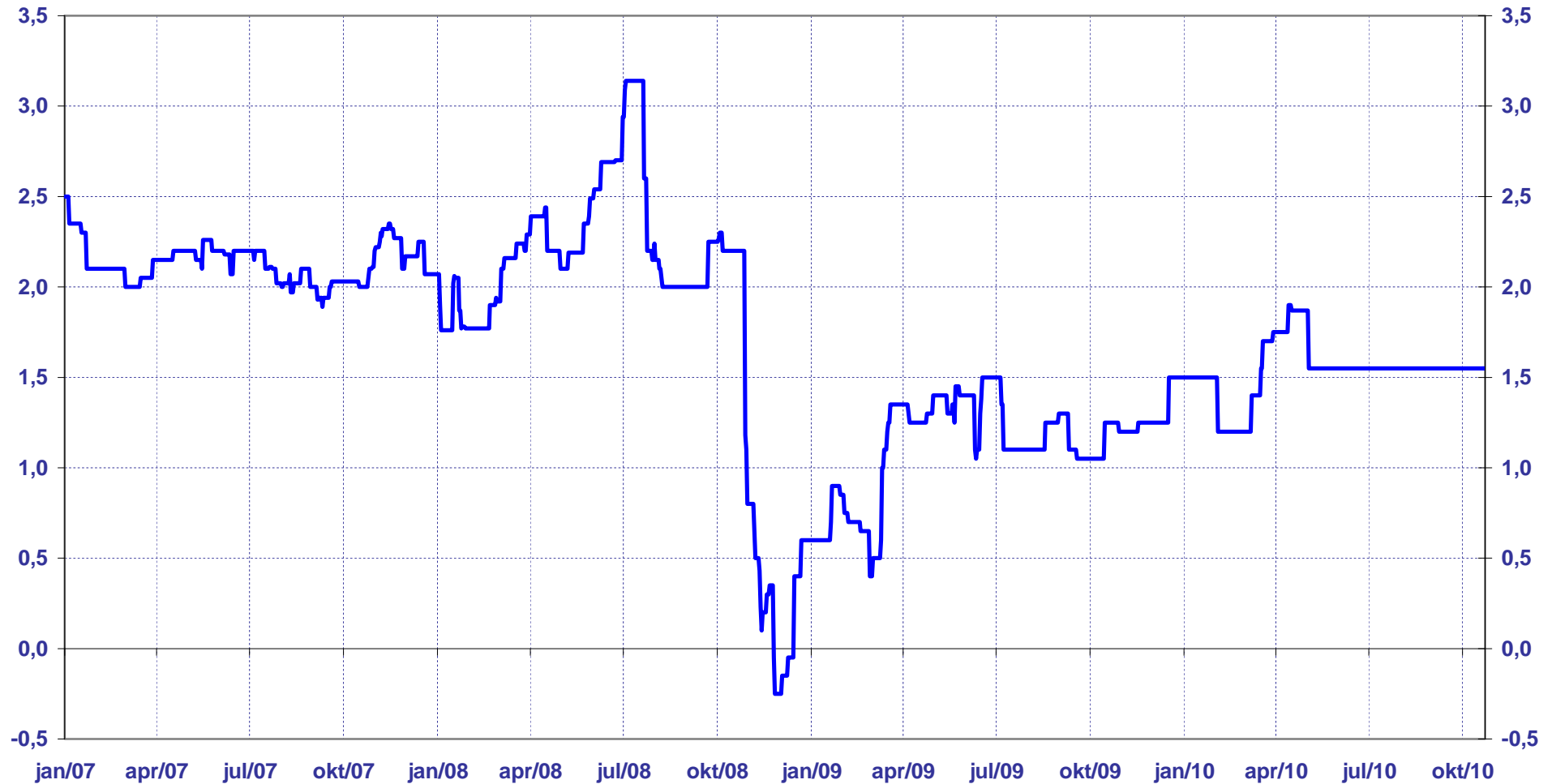
Inflation/deflation

- Core inflation at record lows in both US and EMU.
- Inflation expectations are trending downwards in the US, while they are sticky in the EMU.



2. Are we getting out of the mess? Overview of risk areas.

EMU INFLATION EXPECTATIONS (within 12 months)
Inflation derived from CEM future contracts



Source: Bloomberg



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2. Are we getting out of the mess? Overview of risk areas.

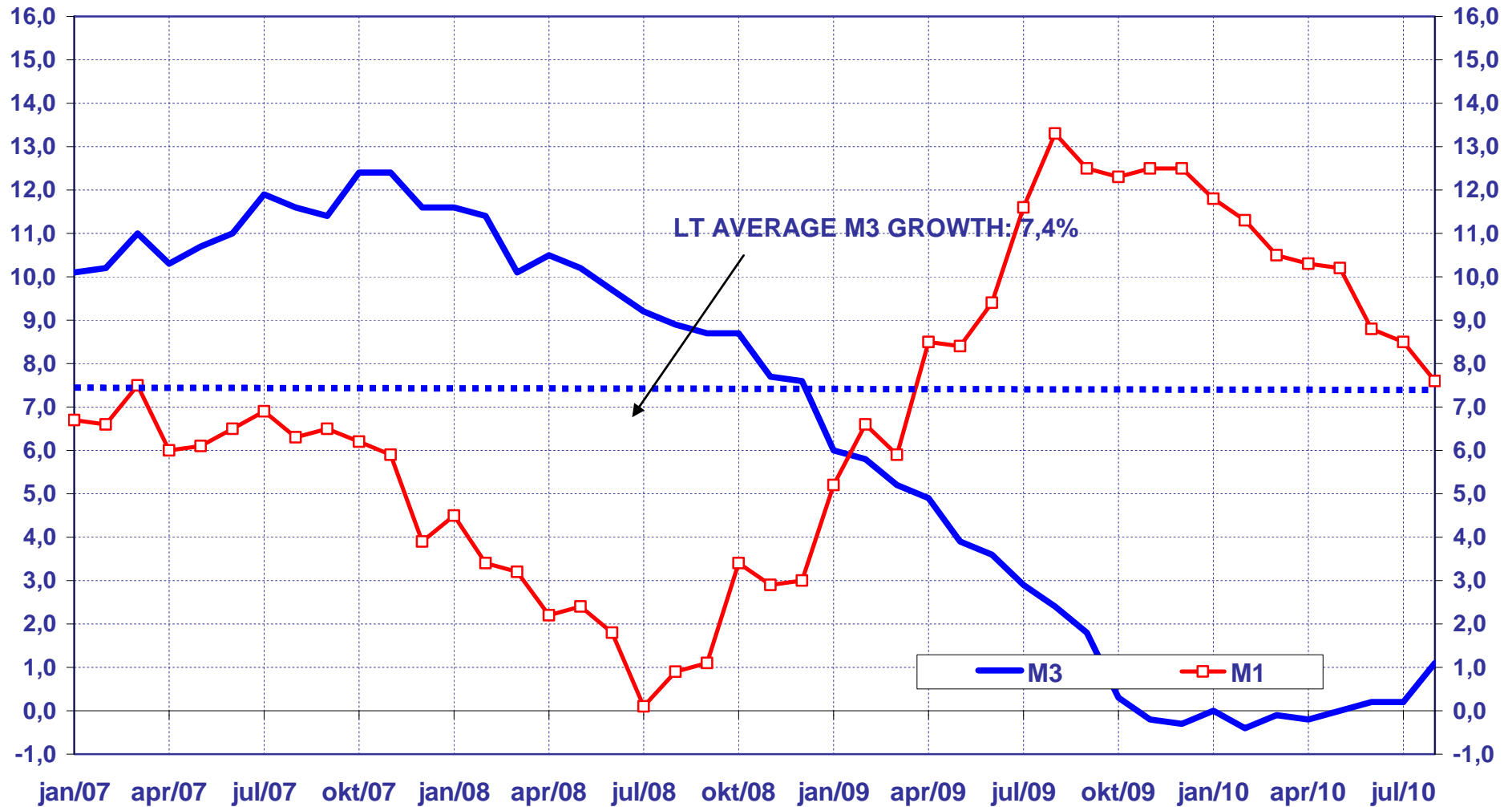
Inflation/deflation

- Core inflation at record lows in both US and EMU.
- Inflation expectations are trending downwards in the US, while they remain stable in the EMU.
- Inflationary pressures from monetary expansion not an issue for the time being.



2. Are we getting out of the mess? Overview of risk areas.

EMU: MONEY SUPPLY (yoy growth in %)
European Central Bank figures



2. Are we getting out of the mess? Overview of risk areas.

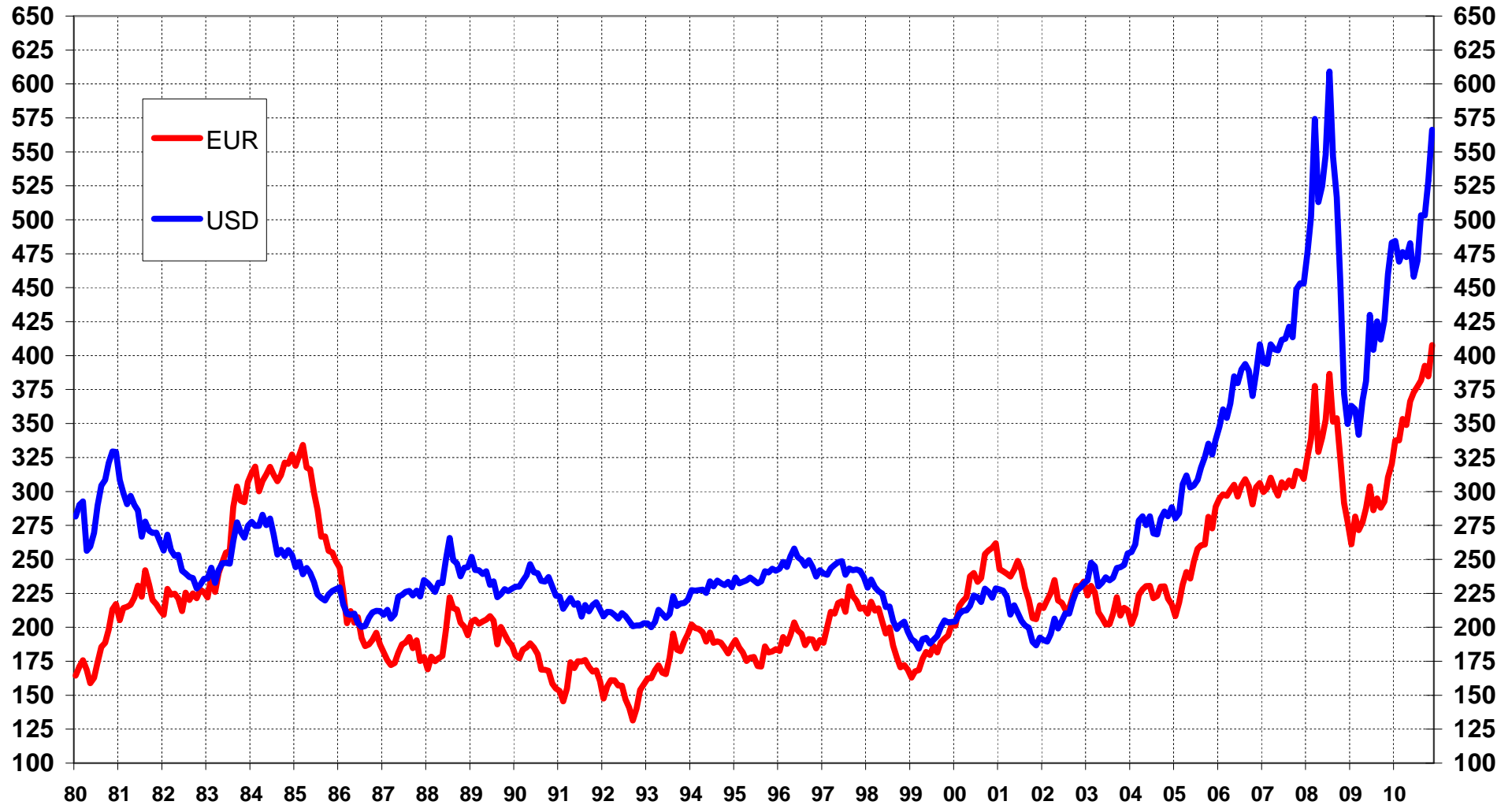
Inflation/deflation

- Core inflation at record lows in both US and EMU.
- Inflation expectations are trending downwards in the US, while they remain stable in the EMU.
- Inflationary pressures from monetary expansion not an issue for the time being.
- But commodity prices have to be watched.



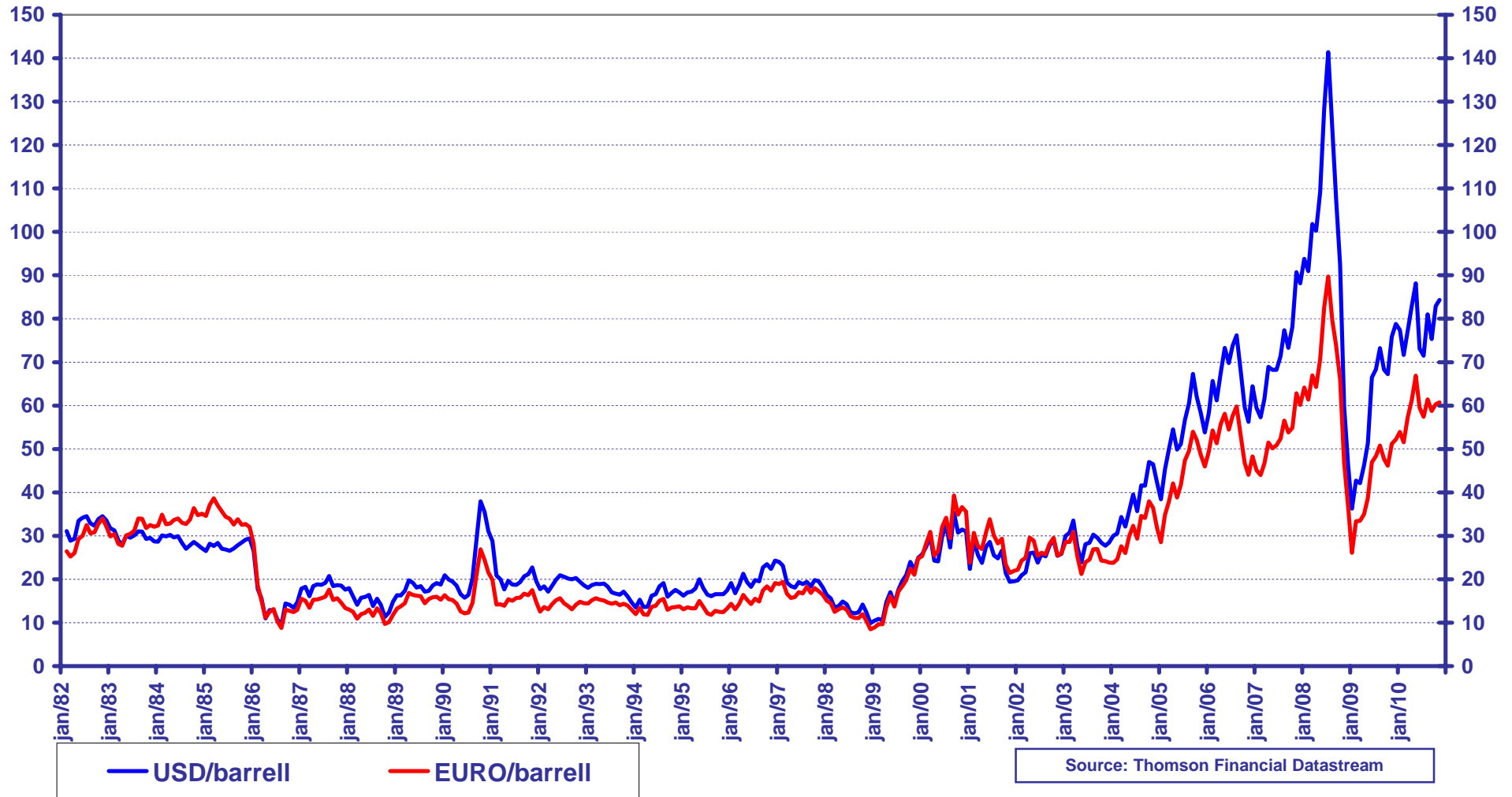
2. Are we getting out of the mess? Overview of risk areas.

COMMODITY PRICE INDEX
CRB



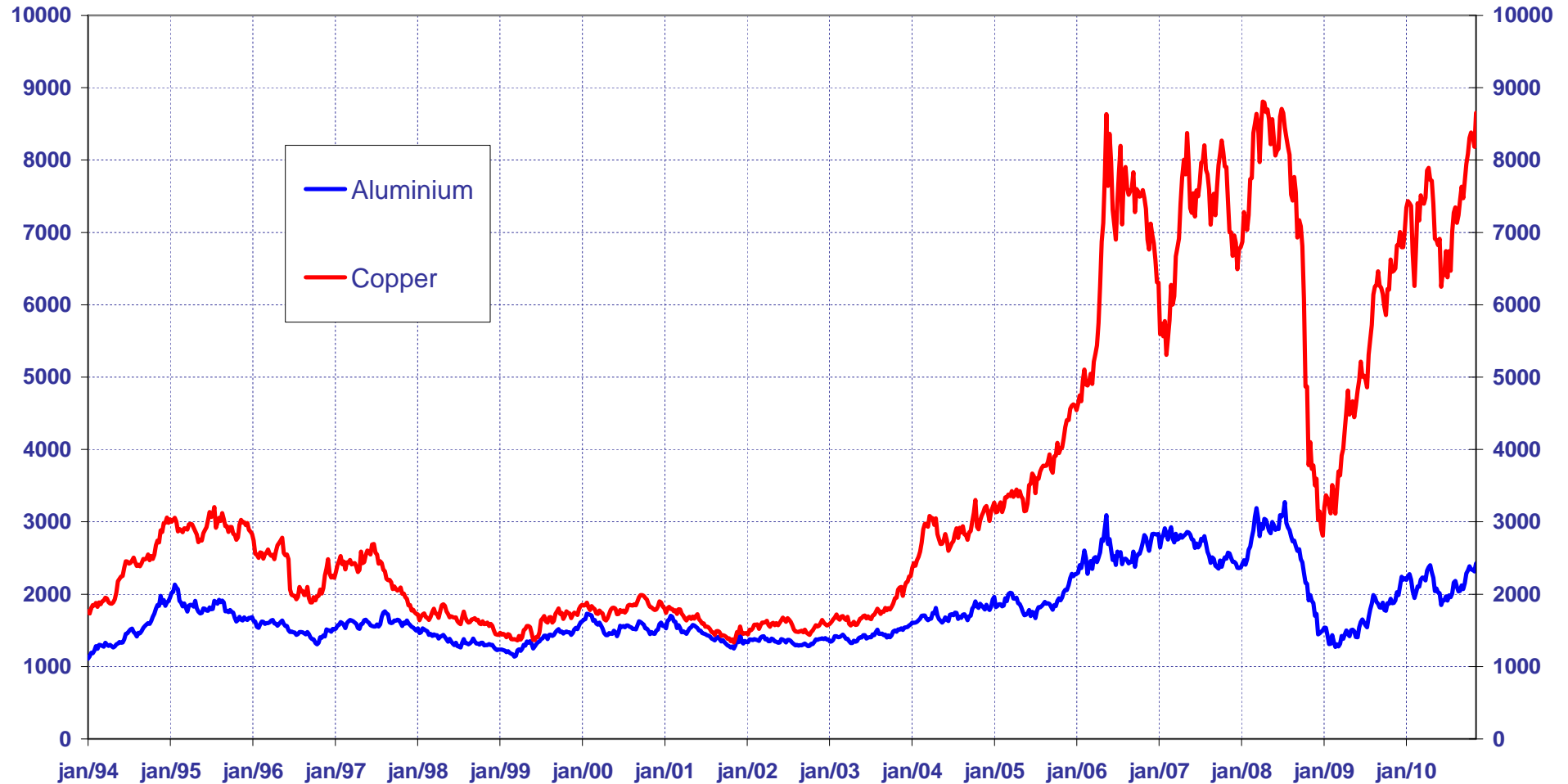
2. Are we getting out of the mess? Overview of risk areas.

Commodities : Oil



2. Are we getting out of the mess? Overview of risk areas.

Metal prices (USD/Metric Tonne)
Notation on London Metal exchange



2. Are we getting out of the mess? Overview of risk areas.

Inflation/deflation

- Core inflation at record lows in both US and EMU.
- Inflation expectations are trending downwards in the US, while they remain stable in the EMU.
- Inflationary pressures from commodities and monetary expansion.

Conclusion:

no immediate threat but inflation / deflation switch is thin line.



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- Inflation / deflation.
- Deleverage.



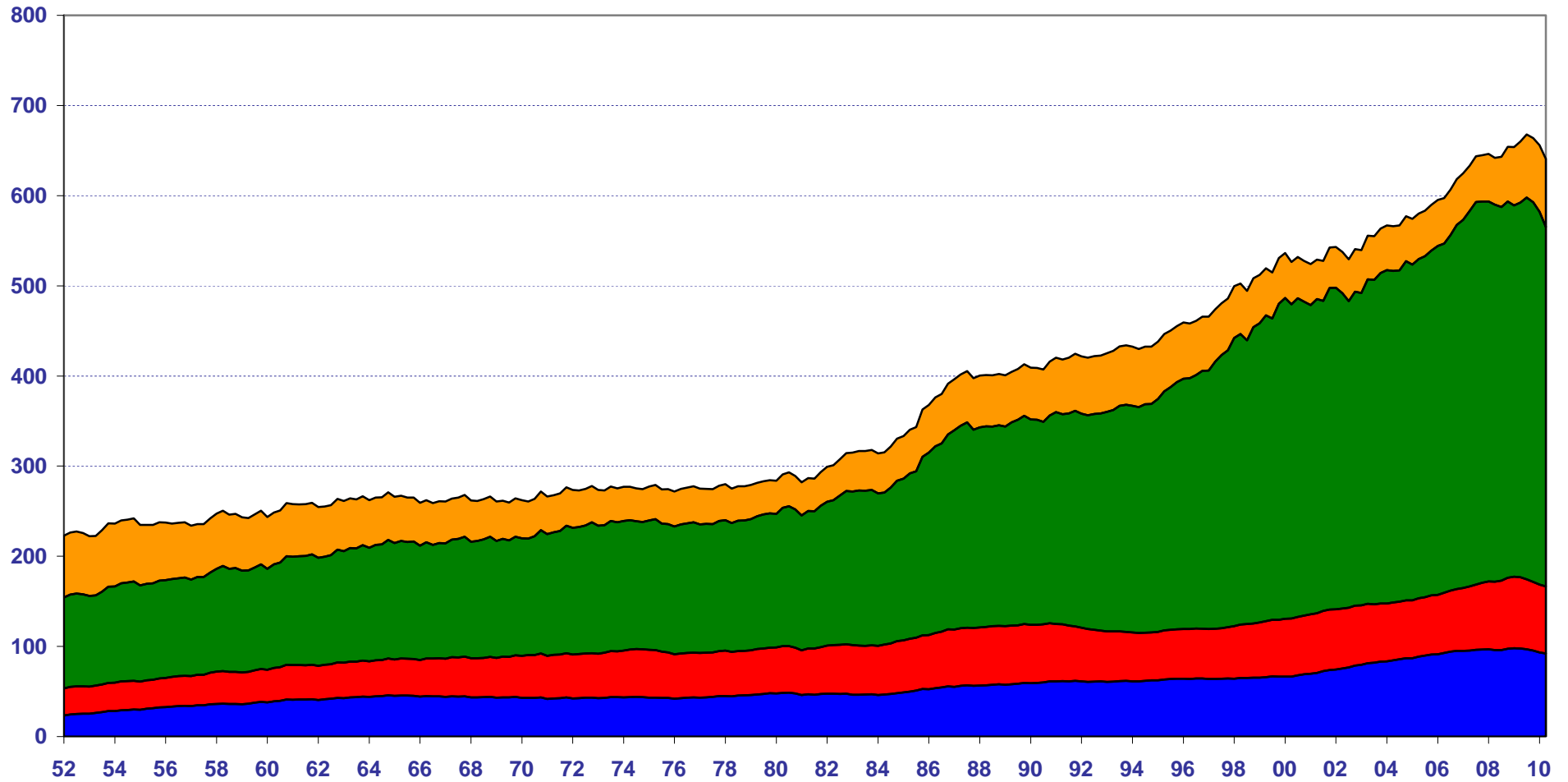
2. Are we getting out of the mess? Overview of risk areas.

Deleverage.

- Deleveraging is gradually going on everywhere (except governments), without bottle necks until now.
- Europe is slower than the US.



US: DEBT BY SECTORS (% of GDP)



■ Households ■ Businesses ■ Financial sector ■ Government

Source: Datastream, Federal Reserve

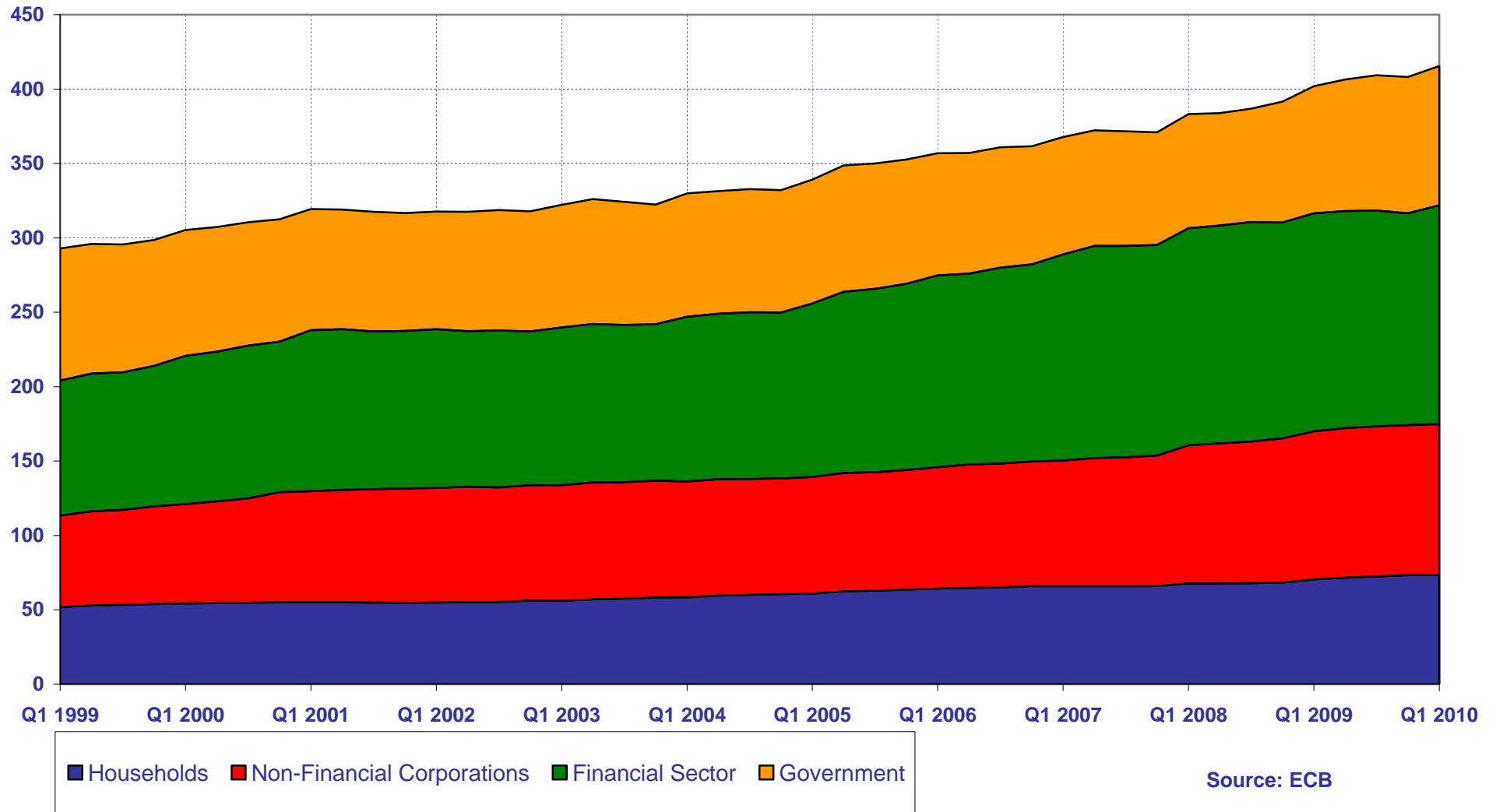


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Euroland sectoral debt, % of GDP



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- Deleverage.
- Global imbalances.



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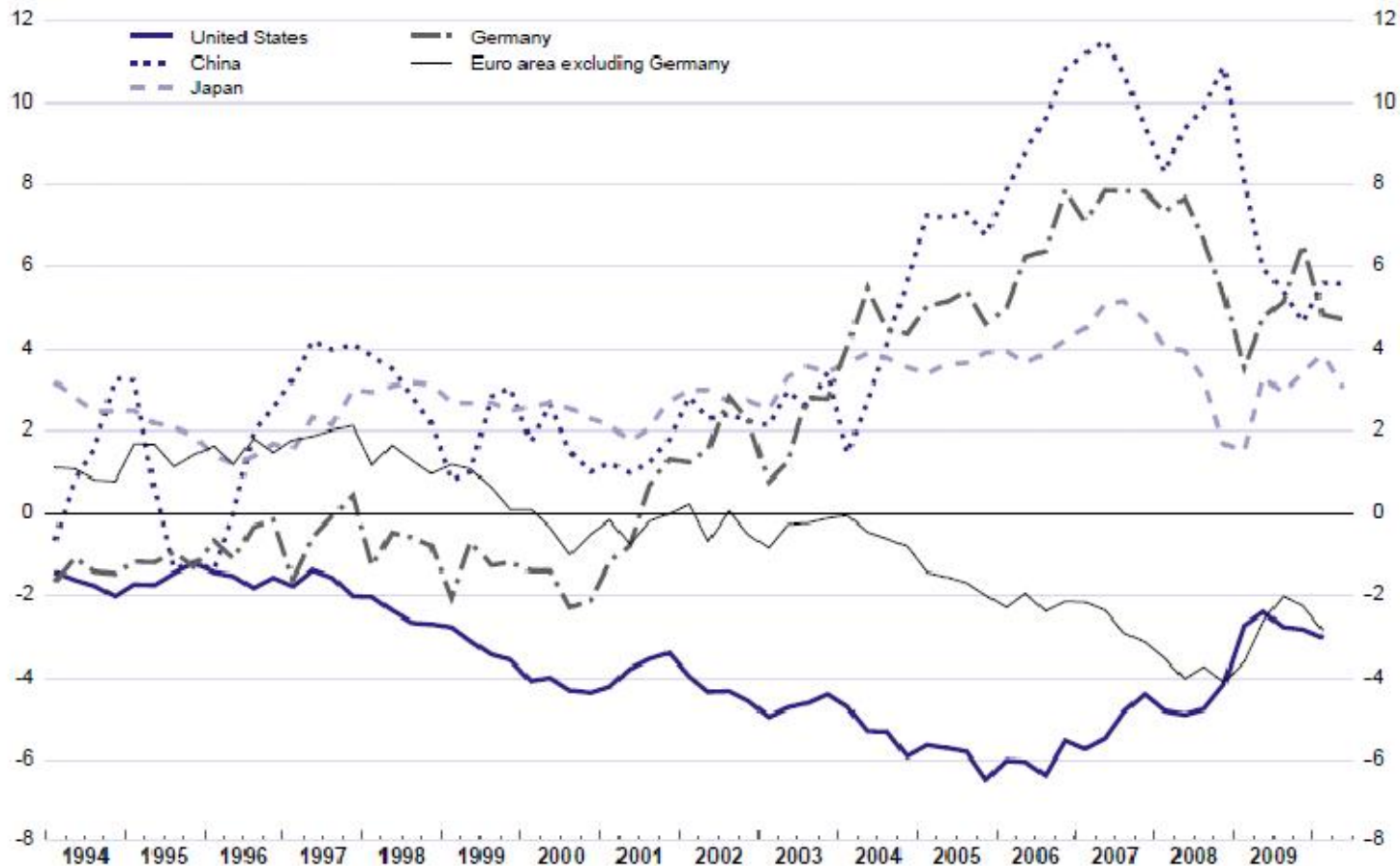
Global imbalances.

- Signs of improvement in trade flows.



Global imbalances are widening but remain well below pre-crisis levels.

Current account balance, in per cent of GDP

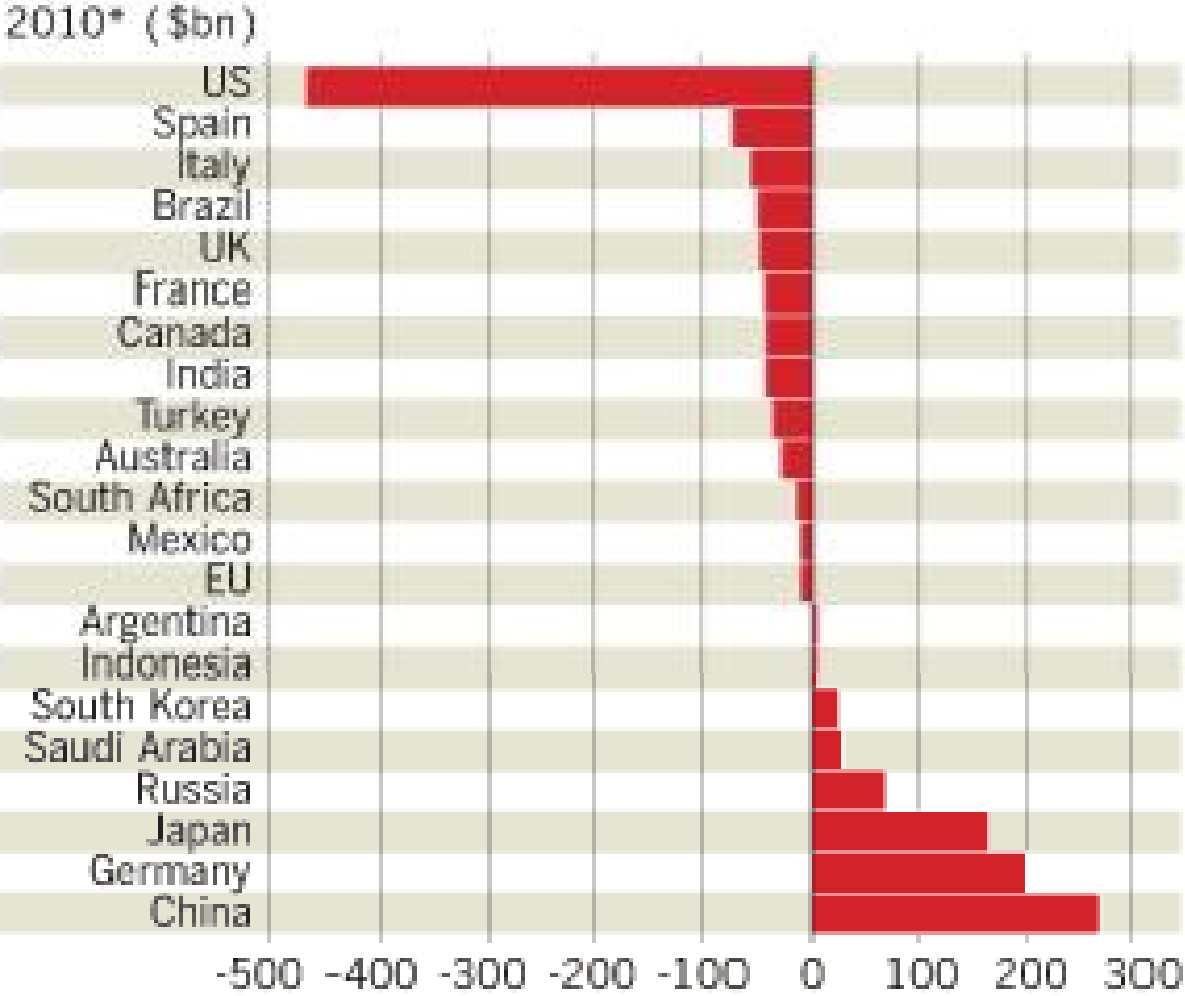


Current Account Balances

2010* (% of GDP)



Current Account Balances



2. Are we getting out of the mess? Overview of risk areas.

Global imbalances.

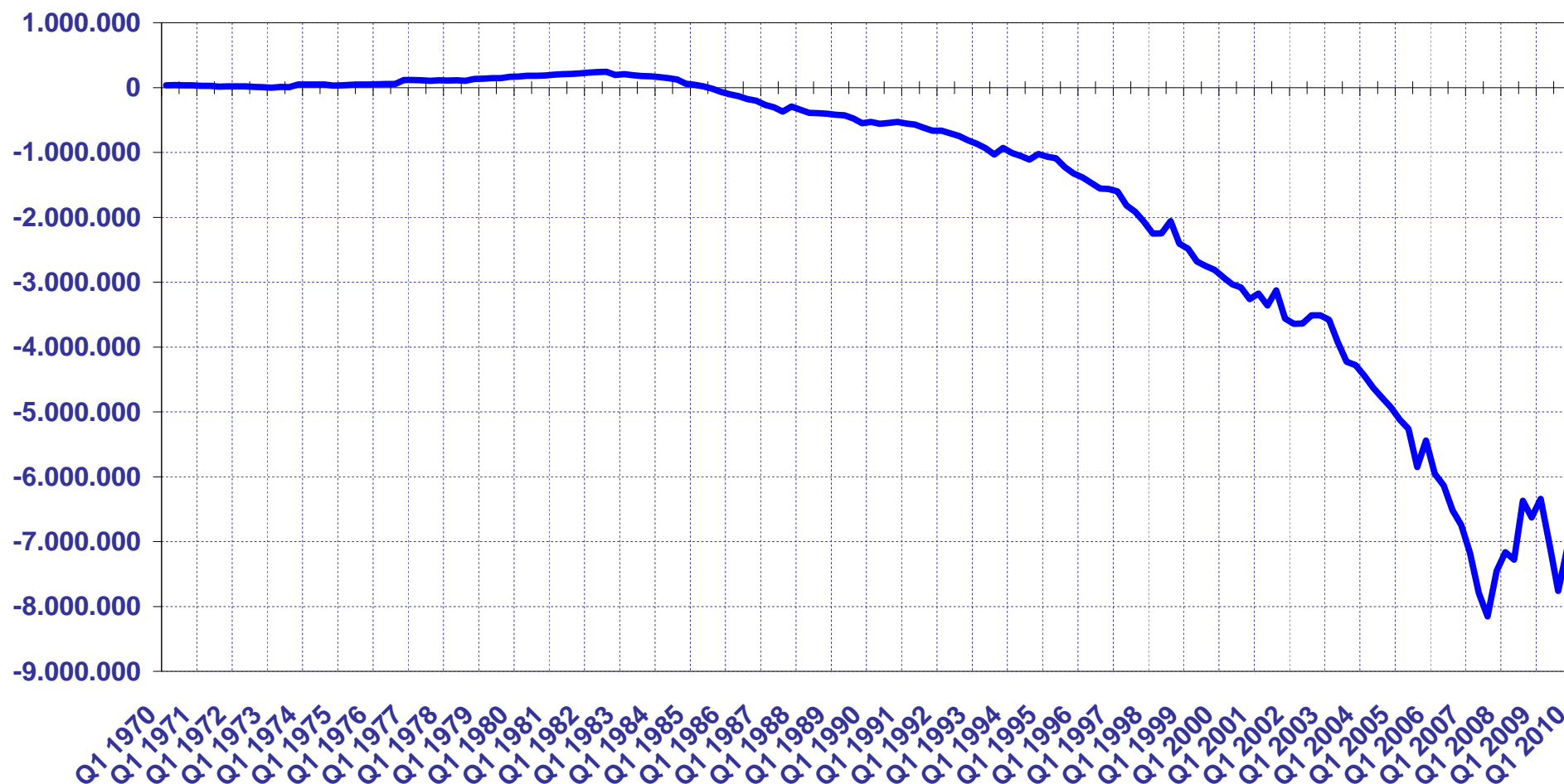
- Signs of improvement in trade flows.
- But stocks remain at dangerous levels: no improvement yet.



2. Are we getting out of the mess? Overview of risk areas.

US: NET FOREIGN ASSET POSITION OF THE US
(in mio USD)

(stock)



"-" indicates net debtor position of US w.r.t. rest of the World

Source: Federal Reserve



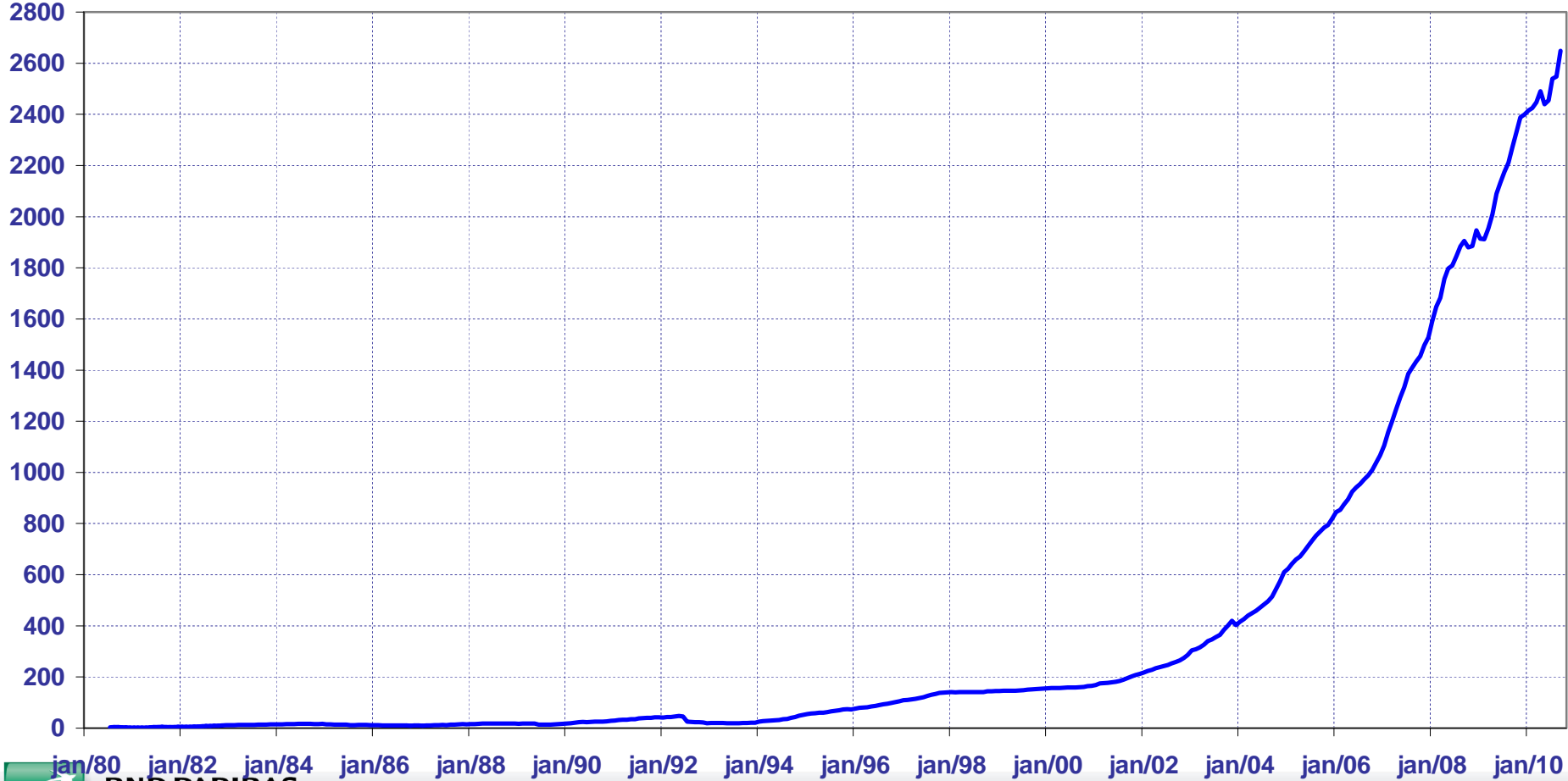
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2. Are we getting out of the mess? Overview of risk areas.

CHINA: GOLD AND FOREIGN RESERVES
Billion USD



2. Are we getting out of the mess? Overview of risk areas.

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- Inflation / deflation.
- Deleverage.
- Global imbalances.
- Geopolitical stress / protectionism.



2. Are we getting out of the mess? Overview of risk areas.

Geopolitical stress / protectionism.

US raises pressure for renminbi rise

(FT, 15/09/2010)

Washington took aim at China's "unfair" trade policy on Wednesday, with lawmakers threatening legislation against Chinese currency intervention and the administration filing two new cases against Beijing at the World Trade Organisation.

Fears of global currency war rise

(FT, 12/10/2010)

Thailand is introducing a tax on foreign holdings of bonds, the latest in a string of attempts by emerging economies to curb destabilising capital inflows amid fears of a global currency war. (...) Emerging markets have been caught in the middle of a seemingly intractable dispute over exchange rates and capital flows between the US and China .



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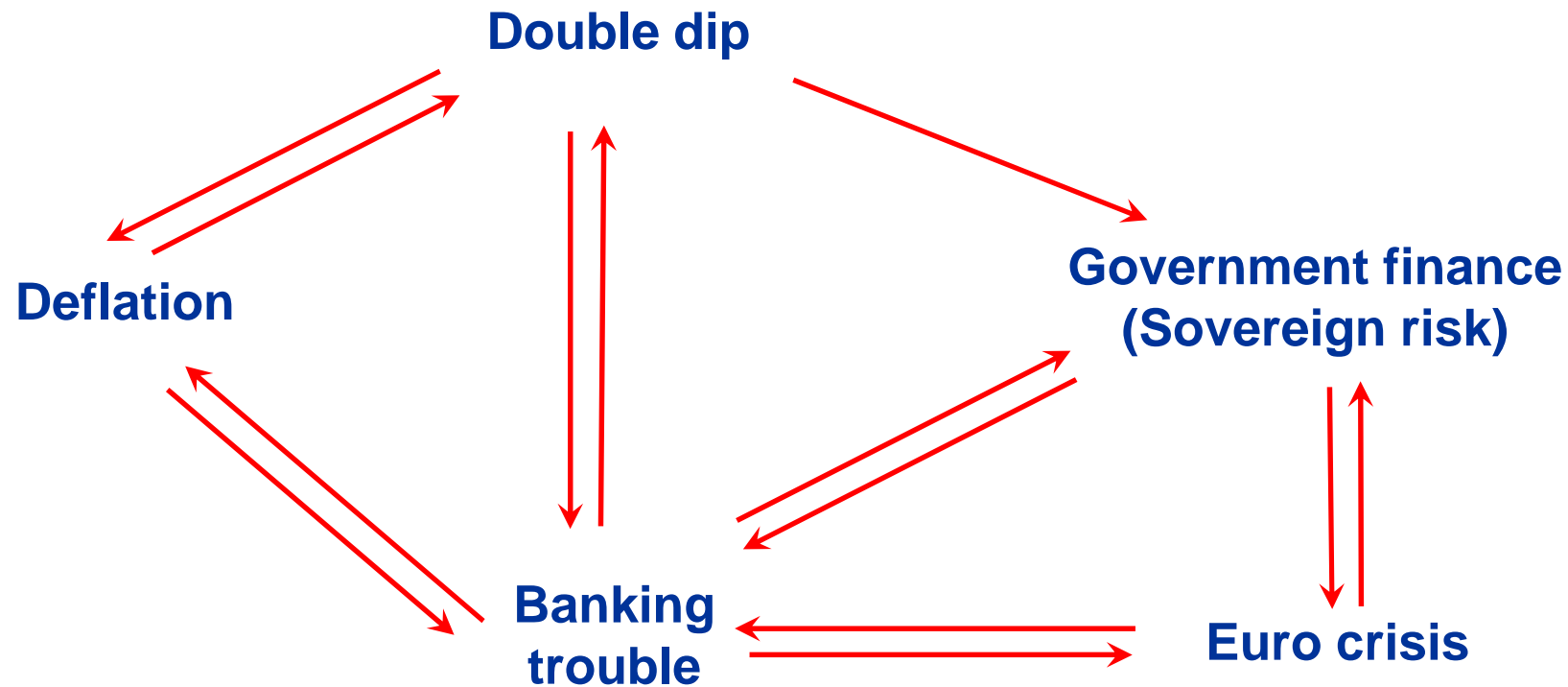
THE BIGGEST RISK: INTERCONNECTEDNESS AND POTENTIAL CHAIN REACTIONS.



2. Are we getting out of the mess? Overview of risk areas.

DRAMA

Example of chain reactions.



2. Are we getting out of the mess? Overview of risk areas.

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- Geopolitical stress / protectionism.

CONCLUSION: Situation remains vulnerable, but is under control.

Major risks have not been resolved.



3. Macro Movements.

- Politics are back.



3. Macro Movements.

Politics will dominate the agenda: a challenging balancing act

- Normalise banking system
- Deleverage the economy
- Normalise central bank policy and balance sheets
- Stabilise public debt levels
- Develop new regulatory framework for the financial industry.
- Revive international trade (or switch to protectionism?)
- Solve global environmental issues.
- Towards a new financial, economic and political world order
 - **WITHOUT KILLING THE RECOVERY**



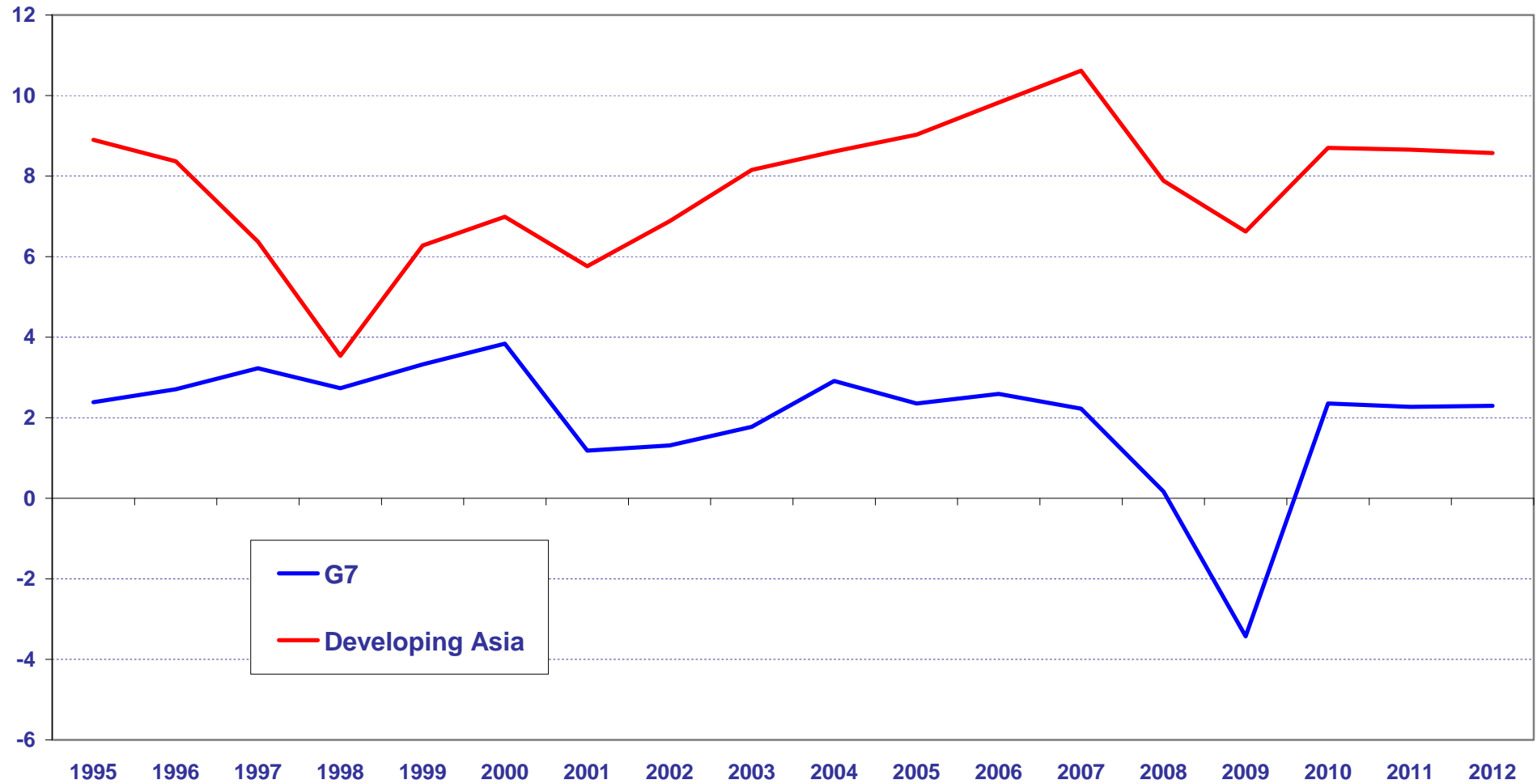
3. Macro Movements.

- Politics are back.
- From west to east as a gradual process.



3. Macro Movements.

G7 versus Developing Asia: Real GDP Growth (% YoY)
IMF Figures



3. Macro Movements.

Top 10 Banks in the World (2008 Ranking)		
	Country	Tier1 Capital (million USD)
1 HSBC Holdings	UK	104967
2 Citigroup	US	89226
3 Royal Bank of scotland	UK	88888
4 JP Morgan Chase & Co	US	88746
5 Bank of America Corp	US	83372
6 Mitsubishi UFJ Financial Group	Japan	82859
7 Crédit Agricole Group	France	68724
8 ICBC	China	66271
9 Banco santander	Spain	58479
10 Bank of China	China	56210

Source: The Banker



3. Macro Movements.

- Politics are back.
- From west to east as a gradual process
 - But now speeding up after three shocks of the western world:
 - Banking crisis
 - Economic crisis
 - Sovereign crisis



3. Macro Movements.

- Politics are back.
- From west to east.
- Europe's specific weaknesses/vulnerabilities:
 - Internal disputes and divergence, incomplete union
 - Uncertainty about the future of euro
 - Rigid monetary policy (or is it a strength?)
 - Huge banking sector





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Thank you.