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Outlook 2010:
Economic situation and capital market

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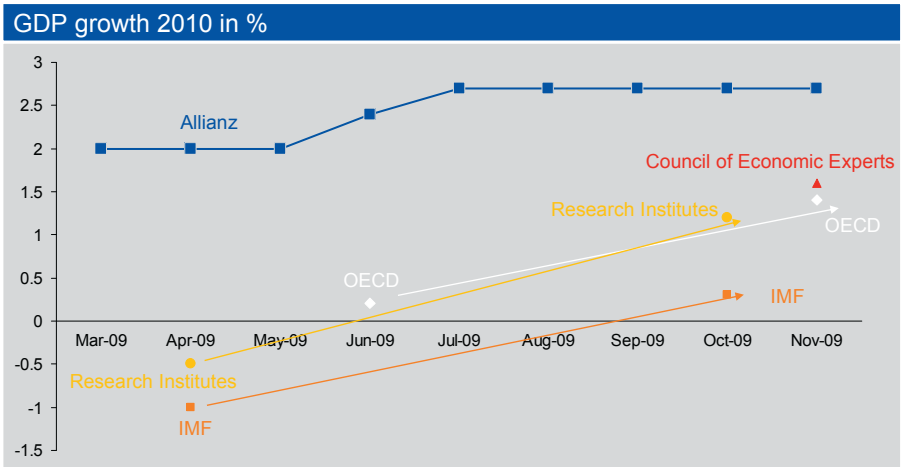
Outlook 2010

ECONOMIC SITUATION IN GERMANY

Business activity in 2010 will still bear the scars of the global economic crisis, although the economic outlook for Germany has brightened considerably. Not all that long ago it was still widely held that business would not rebound before mid-2010, with a severe downturn on the labor market causing a sharp drop in consumer spending. This view was shared, among others, by the economic research institutes in their joint April 2009 opinion paper, in which they calculated that for 2010 as a whole German gross domestic product would shrink by 0.5%. Even more skeptical at that time was the forecast by the International Monetary Fund, which saw the German economy shrinking by 1% in 2010.

Meanwhile, however, the German economy has already turned in growth again for two successive quarters, the second and third. Overall economic output will be much higher at the turn of the year 2009/2010 than on average for 2009. This alone has improved the starting position for 2010. So far, the anxiously anticipated jobs crisis predicted in many quarters has not materialized; indeed the German labor market has proved surprisingly resilient, with the number of people in work falling only moderately. This has kept a lid on the losses in purchasing power stemming from the economic crisis. Bolstered by almost complete price stability, real consumer demand has broadly held its level. In the wake of these developments most economic forecasts for 2010 have been upped significantly in recent months.

Economic forecast Germany



We estimate that the German economy will expand in 2010 by 2.8%, meaning that by the end of 2010 it would already have made good two-thirds of the production losses caused by the economic crisis. Although very positive, this still clearly shows that it is taking longer to recover from the financial market upheaval than from earlier recessions.

In the first half of 2010 powerful fiscal stimuli from hefty cuts in taxes and contributions at the beginning of the year and realization of investment in the infrastructure will lead to economic growth of 3% (at an annual rate). But in the second half-year the economy will already start to lose steam, growing by 2%

(annualized), partly as the public spending contained in the economic stimulus packages gradually peters out.

Exports

For 2010 as a whole exports will be the most powerful drivers of economic growth. We expect a strong resurgence (by 10 to 11%) in the volume of world trade. Shipments from Germany should climb by about 10% in 2010, although the strength of the euro is likely to slow their upward path as the year progresses. Having shed around EUR 60bn in 2009, the surplus on current account will presumably increase again by almost EUR 20bn to between EUR 120 and 125bn.

Private consumption

Despite the phasing out of the car scrappage incentive scheme, any drop in consumer demand should at the most be temporary. The marked tax cuts at the beginning of 2010 and the comparatively robust jobs market will be a key factor in preventing real household incomes from falling in 2010 either. For 2010 we are penciling in 1 to 1½% higher disposable incomes, which – with inflation running at 1% – will push up incomes slightly in real terms. Real consumption will probably edge up only marginally by 0.4%.

Labor market

At the beginning of 2010 jobless figures will rise sharply, much more so than usual for the season. In the opening months of the new year almost 3.8 million people will be out of work. But then in the course of 2010 the labor market will stabilize as the economy progresses on the road to recovery. We expect unemployment in 2010 to average 3.6 to 3.7 million, up from 3.4 million this year. Employment trends will vary considerably from one sector to another. Whereas manufacturing industry is likely to axe jobs rigorously by 5 to 6%, some services sectors (such as health and social services, education and teaching) should continue to build up their workforces.

Inflation

There will no longer be complete price stability in 2010, although low capacity utilization and modest pay increases will keep inflation down. A further gradual pick-up in commodity prices will probably create limited inflationary potential. On average for the year, we are looking for a roughly 1% increase in consumer prices.

Federal budget

Worth around EUR 50bn, the fiscal boost from Germany's economic stimulus packages in 2010 will be higher than in 2009 (EUR 35bn). Although this means that new public-sector borrowing next year will be stepped up sharply again (from EUR 70bn in 2009) to EUR 105bn, relative to GDP it will still be considerably more moderate, at 4.1%, than in other industrial countries. The prospect of being able to reduce new public borrowing again substantially with stringent spending cuts as from 2011 is therefore better than in most other countries.

Germany: Economic indicators and forecast*

		2008				2009				2010						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009f	2010f
GDP real		1.6	-0.6	-0.3	-2.4	-3.5	0.4	0.7	*0.8*	*0.8*	*0.6*	*0.5*	*0.4*	1.3	*-4.8*	*2.8*
Private consumption		0.4	-0.6	0.3	-0.4	0.9	0.6	-0.9	*0.0*	*0.2*	*0.3*	*0.2*	*0.2*	0.4	*0.6*	*0.3*
Government spending		1.0	0.7	0.1	0.6	1.2	0.6	0.1	*0.4*	*0.5*	*0.5*	*0.3*	*0.3*	2.0	*2.5*	*1.6*
Investment in machinery/equipment		-0.6	-0.8	1.5	-3.7	-18.5	-0.5	0.8	*2.0*	*3.0*	*2.0*	*2.0*	*2.0*	3.3	*-19.9*	*8.0*
Construction		5.9	-4.3	-0.4	-1.0	0.3	1.3	1.5	*0.5*	*0.0*	*0.5*	*0.5*	*0.5*	2.6	*0.0*	*2.2*
Domestic demand		2.3	-1.3	1.2	-0.4	-1.2	-1.4	1.3	*0.2*	*0.1*	*0.4*	*0.7*	*0.6*	1.7	*-1.6*	*1.3*
Exports		1.7	0.2	-0.1	-7.9	-10.5	-0.8	3.4	*3.0*	*4.0*	*1.5*	*0.5*	*0.5*	2.9	*-14.4*	*9.5*
Imports		3.3	-1.5	3.4	-4.2	-5.6	-5.4	5.0	*2.0*	*3.0*	*1.2*	*1.0*	*1.0*	4.3	*-8.5*	*7.3*
Industrial production (excl. construction)**		1.1	-0.8	-1.1	-7.1	-12.9	-0.6	3.7	*2.0*	*2.0*	*1.5*	*1.0*	*1.0*	0.3	*-16.7*	*7.2*
Unemployment rate (EU def.)	%	7.6	7.4	7.1	7.1	7.3	7.6	7.6	*7.6*	*7.8*	*8.1*	*8.3*	*8.3*	7.3	*7.5*	*8.1*
Unemployment rate (nat. def.)	%	8.1	7.8	7.6	7.6	8.0	8.2	8.2	*8.2*	*8.4*	*8.7*	*8.9*	*8.9*	7.8	*8.2*	*8.8*
Employed persons (national def.)	y-o-y	1.6	1.5	1.4	1.1	0.4	0.1	-0.2	*-0.4*	*-0.7*	*-0.7*	*-0.7*	*-0.5*	1.4	*0.0*	*-0.6*
Consumer prices	y-o-y	2.9	2.9	3.1	1.7	0.8	0.3	-0.2	*0.4*	*0.9*	*1.0*	*1.1*	*1.2*	2.6	*0.3*	*1.0*
Consumer prices (HICP)	y-o-y	3.1	3.0	3.3	1.7	0.8	0.3	-0.4	0.4	*0.9*	*1.0*	*1.1*	*1.2*	2.8	*0.3*	*1.0*
Producer prices	y-o-y	3.2	5.4	7.9	5.3	0.8	-3.6	-7.4	*-5.2*	*-1.8*	*0.8*	*2.6*	*2.0*	5.5	*-3.9*	*0.8*
Current account balance	EUR bn	45.6	45.5	40.3	33.8	17.4	27.7	31.0	*31.0*	*32.0*	*31.0*	*31.0*	*30.0*	166.3	*107.1*	*122.0*
	% of GDP													6.7	*4.4*	*4.9*
Budget balance	EUR bn													1.0	*-70.0*	*-105.0*
(Maastricht-definition)	% of GDP													0.0	*-2.9*	*-4.2*

*) quarterly figures: percentage change over previous period, seasonally and working day adjusted, except where noted, yearly figures: percentage change, not working day adjusted; **) annual average, working-day adjusted. f = forecast

ECONOMIC SITUATION IN THE EURO AREA

Emerging from a state of shock

With the help of unorthodox, comprehensive and partly coordinated monetary and fiscal measures, both the financial markets and the real economy gradually emerged from their state of shock in the course of 2009. Having contracted severely in the first quarter by 2.4%, euro area economic activity had already returned to virtual stagnation by the second three months, subsequently achieving what was for many economists surprising third-quarter growth of 0.4%. We take this as confirmation of our prediction that the European economy would recover in the second half of the year and continue down this positive path in 2010. Our growth forecast remains higher than the consensus outlook.

The growth drivers for 2010

For the euro area we expect overall economic growth in 2010 around the two percent mark, with gross investment in fixed assets and exports providing key evidence for this. Gross fixed capital formation suffered a massively negative shock, but meanwhile its steep downtrend has slowed significantly. Figures for the fourth quarter of 2009 will probably reveal a turn for the better.

The setbacks in exports were even more pronounced than in capital expenditure, but here too the outlook has improved. European companies' revenues from intra-European trade over the past ten years as a ratio of total revenues from global trade have remained broadly stable at 67%. With the emerging markets securing steadily expanding shares of world trade, it is essential, in terms of the outlook for European exporters, to pay attention to the dynamics in these regions. There is no doubt about the prognosis here: both Asia (in the main China) and Latin America (notably Brazil), two increasingly important regions for European banks and businesses, have escaped the crisis almost unscathed and offer excellent prospects for growing exports outside Europe.

Downside risks

Our forecast of two percent growth in the euro area is subject to various risks. Firstly, the worsening situation on the labor market next year could gather pace. Were the drop in employment to persist, it would have an extremely negative impact on consumer spending. Another downside is the pressure on European exports from the continued strength of the euro. Were the euro to see another steep rise, the outlook for exports would presumably cloud significantly.

Euro area: Economic indicators and forecasts*

		2008				2009				2010						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009f	2010f
GDP real		0.8	-0.3	-0.4	-1.9	-2.4	-0.2	0.4	*0.8*	*0.7*	*0.5*	*0.5*	*0.4*	0.5	*-3.9*	*2.0*
Private consumption		0.2	-0.4	0.0	-0.5	-0.5	0.0	-0.2	*0.4*	*0.3*	*0.3*	*0.3*	*0.2*	0.3	*-0.9*	*1.0*
Government spending		0.5	0.7	0.5	0.6	0.6	0.6	0.5	*0.7*	*0.6*	*0.6*	*0.5*	*0.5*	2.1	*2.5*	*2.5*
Investment		0.8	-1.2	-1.4	-3.8	-4.9	-1.7	-0.4	*0.9*	*0.5*	*0.6*	*0.5*	*0.5*	-0.5	*-9.7*	*1.4*
Exports		2.1	-0.5	-1.3	-7.2	-8.7	-1.3	2.9	*2.5*	*1.6*	*1.4*	*0.9*	*0.8*	0.8	*-13.4*	*6.5*
Imports		1.9	-1.1	-0.1	-4.8	-7.4	-2.9	2.6	*1.5*	*1.4*	*1.2*	*0.9*	*0.9*	0.8	*-11.5*	*4.6*
Industrial production (excl. construction)		1.0	-1.0	-1.7	-8.0	-8.6	-1.0	2.1	*2.2*	*1.1*	*0.8*	*0.5*	*0.5*	-1.8	*-15.5*	*4.6*
Unemployment rate	%	7.2	7.4	7.6	8.0	8.8	9.3	9.6	*9.9*	*10.3*	*10.5*	*10.6*	*10.6*	7.6	*9.4*	*10.5*
Consumer prices	y-o-y	3.4	3.6	3.8	2.3	1.0	0.2	-0.4	*0.5*	*1.2*	*1.4*	*1.7*	*1.7*	3.3	*0.3*	*1.5*
Producer prices	y-o-y	5.4	7.0	8.4	3.4	-2.0	-5.7	-7.8	*-4.6*	*-0.2*	*1.7*	*2.6*	*2.5*	6.0	*-5.0*	*1.7*
Current account balance	EUR bn, nsa	-31.4	-28.9	-37.5	-42.8	-37.4	-11.8	0.3	*0.0*	*-5.0*	*-10.0*	*-10.0*	*-10.0*	-143.3	*-54.0*	*-35.0*
	% of GDP													-1.5	*-0.6*	*-0.4*
Budget balance	% of GDP													-2.0	*-5.7*	*-5.7*
3m money market rate**)	%	4.7	4.9	5.3	2.9	1.5	1.1	0.8	*0.8*	*1.1*	*1.4*	*1.8*	*1.9*	4.6	*1.3*	*1.4*
10yr gov. bond yield***)	%	3.9	4.6	4.0	2.9	3.0	3.4	3.2	*3.4*	*3.7*	*4.1*	*4.2*	*4.1*	4.0	*3.3*	*3.9*
Trade-weighted euro **)	nominal	116.5	116.3	111.7	115.4	114.6	114.2	115.6	*115.4*	*117.9*	*119.9*	*120.4*	*121.3*	115.0	*115.0*	*119.9*
Exchange rate**)	USD per EUR	1.58	1.58	1.43	1.39	1.33	1.41	1.46	*1.50*	*1.55*	*1.60*	*1.57*	*1.55*	1.47	*1.40*	*1.56*

*) quarterly values: percentage change over previous period, seasonally adjusted, except where noted; annual GDP not adjusted; foreign trade incl.intra-trade.
) end of quarter, annual average. *) Germany as benchmark; end of quarter, annual average.

f = forecast.

US ECONOMY

Thanks to exceptional and sweeping economic policy measures, the US economy returned to growth in the third quarter of this year. Tax cuts, higher government transfers, record-low mortgage rates and perks for first-time home buyers all helped to stabilize private consumption and improve the situation on the housing market. In addition, public sector infrastructure investment is set to provide a boost into next year. The recently prolonged and expanded tax incentives for house buyers will resonate positively on housing sales into the coming year. Finally, with the pickup in world trade and the weak dollar, the outlook for US exports is also positive.

The economy is also increasingly getting back on its own two feet following the usual adjustments seen in a business cycle. Following drastic cost cutting and savage reductions in investment spending, the (non-financial) corporate sector now enjoys a financial surplus, rendering it less reliant on external funding.

The new-found investment leeway will probably be reflected initially in inventory investment. There are also growing signs that employment will turn the corner. In our view, employment reacted excessively to the decline in overall output up to the second quarter of 2009, in part due to the previous massive financial pressures. With goods demand heading up, it is therefore also likely that there is some catching up to do on the jobs front. The attendant rebound in wage and salary income will help

to underpin a sustained recovery in consumption. But the net wealth losses incurred in the crisis, which have been only partially recouped in the course of 2009, will limit the upside potential.

All in all, we expect the recovery in the US economy to continue in 2010. After a fall of 2.5% this year, overall output is likely to increase by 2¼% next year.

Monetary policy

Key interest rate, in %		
	12/11/2009	End-2010
USA	0 – 0.25	0.75
EMU	1.00	1.75

USA

Since December 2008 the US Federal Reserve has kept its benchmark interest rate close to zero and it has deployed substantial unconventional measures to stabilize the economy and get credit flows in the economy back to normal. The Federal Reserve Open Market Committee has signaled so far that the target rate could remain exceptionally low for an extended period. Although the Fed expects the upward trend in the economy to continue, it points to ongoing uncertainty about future developments. We consider it likely that, as the evidence for a stable recovery grows, the Fed will start adjusting its monetary policy stance in the course of next year. In conjunction with a mopping up of liquidity, the policy rate is likely to be raised moderately to 75 basis points. This would still leave monetary policy in very accommodative mode, with the real target rate remaining in negative territory.

EMU

Era of "quantitative easing" coming to an end

Unlike other central banks, the ECB made a distinction between liquidity measures seeking to combat systemic risk and use of the central bank refinancing rate as a crisis management tool. As late as July 2008 the ECB raised its main refinancing facility to 4.25%, before reverting to a policy of rapid rate cuts from September culminating in its setting a fixed rate of one percent as from May 2009 for its refinancing operations. In particular the non-standard open market operations in June (EUR 442bn) and September 2009 (EUR 75bn), both with a one-year maturity and a fixed interest rate of 1%, provided sufficient liquidity on the European financial market to make up for the liquidity constraints that had arisen on the interbank market.

With its announcement that the rate for the non-standard one-year refinancing operation in December 2009 would be fixed at the average minimum bid rate in the coming year and the six-month provision of liquidity scheduled for March 2010 was likely to be the last longer term refinancing operation, the ECB has ushered in the end of quantitative monetary easing.

First moves on interest rates in 2010 despite low inflation

We expect the European Central Bank to move on interest rates in the second, third and fourth quarters of 2010. The ECB's Executive Board will, we believe, be prompted by two factors:

Firstly, economic recovery will probably shape up faster than reflected in the ECB's projections. Whereas the central bank sees the economy expanding by between 0.1% and 1.5% in 2010, we are reckoning on growth of 2.0%.

Secondly, exuberant trends in some asset classes are raising the spectre of potential bubble tendencies. Given that Executive Board member Bini Smaghi and the President of the ECB, Jean-Claude Trichet, have both spoken of vigilance with regard to price trends for various asset classes – the former end-November 2009 and the latter during the December 4, 2009 press conference following the ECB Governing Council meeting – persistent increases in value on these markets would presumably argue in favor of a rate hike. With a minimum bid rate of 1% on refinancing operations and 1.75% on the marginal lending facility and the gradual onset of inflation (0.6% for November), the ECB is currently operating very close to a negative real interest rate. This will presumably have consequences for many asset classes.

Currencies

Exchange rates		
	12/11/2009	End-2010
EUR/USD	1.48	1.55
JPY/USD	88.9	93
CNY/USD	6.83	6.70

USD / EUR

We have identified three major factors impacting on the USD/EUR exchange rate and justifying a level of 1.55 at the end of 2010:

- The interest differential between the two currency areas: we see the ECB moving on interest rates sooner than the Fed. Mid-2010 quotations could even reach around 1.60 USD/EUR.

- Although the crisis has reduced global imbalances, the United States will continue to run up trade deficits for quite some time to come, with negative fallout on the US currency.

- Restructuring of global investments: ongoing uncertainty over the role of the USD as a reserve currency will continue to drive asset diversification into global currencies and asset classes. Most importantly, the economic dynamism and burgeoning growth in such major emerging markets as China, Brazil and India will increasingly redirect investment customarily channeled into the industrial nations towards the leading so-called "developing countries". This tendency, too, will have a negative effect on the US dollar.

JPY / USD

The Japanese yen has appreciated sharply against the greenback, even more so than the euro. For the first time since the mid-1990s one US dollar recently cost well below 90 yen. In the coming year we expect the exchange rate to edge up again slightly, because with consumer prices likely to continue on a clear downward path the Bank of Japan will hardly emulate interest rate hikes by the Fed and ECB. End-2010 we are looking for an exchange rate of 93 JPY/USD.

CNY / USD

With the Chinese authorities having initially put a stop, in the summer of 2008, to appreciation of the renminbi against the US dollar, we foresee a slight easing of exchange rate policy in the coming year. The second half of 2010 at the latest should bring an end to the strict currency peg and a return to the policy of slow but steady appreciation of the Chinese renminbi. The Chinese government presumably sees this as contingent on positive growth rates in exports, a prerequisite likely to be fulfilled already in the first quarter of 2010. On average for 2010 we are putting a price tag of 6.78 renminbi on the US dollar, as against 6.83 this year. We are penciling in a year-end level in 2010 of 6.70 renminbi.

Bond market

10yr government bond yield		
	12/11/2009	End-2010
Euro area	3.21	4.1
USA	3.55	4.4

Yields on the market for long-term government bonds in 2010 look set to stage a moderate rise. Given market expectations of inflation close to 2% (calculated on the basis of the spread on inflation-indexed and conventional bonds), yields are currently extremely low. We interpret this as a reflection of excessive liquidity in the banking sector and the belief that central banks will keep their benchmark interest rates very low for some time to come. As soon as the Fed and ECB start putting up money market rates again to normalize the provision of liquidity – which we expect to happen in the course of 2010 – rates at the long end are also likely to head north. But this is not to say that the rise in yields will be all that great, as the need for budget consolidation worldwide will put paid to a very vigorous economic upswing.

Spreads between corporate bonds and treasury bonds, which contracted very sharply in 2009 to hit a scant 50-60 basis points for AAA bonds in the euro area and a slightly higher level of 70-80 basis points in the US, are likely to ease only a tick more in 2010 – if, indeed, at all. We do not expect yield premiums to shrink to quite their pre-financial market crisis level as this would be indicative of an unhealthy appetite for risk.

Treasury bonds of EMU partner countries still exhibit comparatively high spreads relative to German bonds. In our estimation yield premiums will narrow in the course of 2010 – in the case of Austria and France they could even be halved – since they reflect exaggerated concerns over stability of the monetary union.

Following last year's steep ascent in risk premiums on foreign currency bonds issued by emerging markets, spreads this year have narrowed again significantly. Based on the EMBI+ Composite, at the beginning of December they totaled around 320 basis points. At the turn of the year 2008/2009 emerging markets were still having to pay an average markup of around 700 basis points on US Treasuries, which are considered risk-free. Next year will presumably see spreads on emerging markets bonds narrowing further in response to our predicted scenario of continuing global economic recovery and further stabilization of the situation on the international financial markets. At year's end we see the EMBI+ Composite in a range between 230 and 270 basis points.

Commodities and gold

in USD		
	12/11/2009	End-2010
Oil price , Brent grade per barrel	70.3	85-90
Gold	1114.5	1200

Oil

Although the price of oil (per barrel of Brent grade) has held fairly stable since mid-October at between USD 75 and 80, this is not to belie the fact that it has been prey to comparatively large swings for quite some time, having more than doubled since the beginning of the year.

Historically high and severely fluctuating prices in recent years, coupled with the economic crisis, have dented global demand for oil, driving it down by 1.7% in 2009. In many parts of the world the price factor has also encouraged the quest for and use of alternative energies. As economic activity rebounds, demand for oil will pick up again in 2010, especially with emerging countries such as China and India likely to continue scaling up their consumption.

On the supply side we need to take into account that output rose in the fourth quarter of 2009. This is partly due to the fact that production outages in the Gulf of Mexico were not as frequent nor as long as last year. We are assuming that the oil supply will stabilize at the current level. All told, we expect the oil price to climb as high as USD 90 by the end of 2010.

Gold

Driven by deep uncertainty about the economic outlook as well as the long-term consequences of super-loose monetary policy, many investors turned to gold in 2009. This resulted in volatility, but above all saw the gold price rocket. Whereas indices such as the DAX, S&P 500 and Dow Jones performed negatively in the crisis, gold underpinned its reputation as a safe haven.

In early December 2009 the cost of a fine ounce of gold topped USD 1,200 for the first time. In the course of next year further speculative spikes in the direction of USD 1,500 are possible. At the end of 2010, however, we see the gold price back down at around USD 1,200.

Other commodities

Prices on other commodity markets such as for nickel, copper and aluminum have largely moved up strongly in the course of this year from their lows in late 2008 / early 2009. The copper price, for instance, has doubled compared with December 2008. The price index for commodities (excluding energy) now stands some 60% higher than at the beginning of the year. In the course of 2010 we expect a further increase of 20 – 30% as industrial demand will continue to pick up.

Stock market

	12/11/2009	End-2010
Dax	5756	6400-6800
EuroStoxx50	2862	3200-3400
DowJones	10471	11000-11500

The stock markets, which have bounced back strongly since March of this year, have further upside potential in 2010. The rise in equities is in line with the improvement in expectations and in the situation in the corporate sector. Moreover, corporate earnings are set to rebound strongly in 2010 when existing capacities are better utilized. However, the stock market will not be a one-way street upwards. Indices will react very sensitively to all changes in the underlying backdrop. Above all, the economic policy switch from a very expansionary to less expansionary mode is unlikely to take place without rattling the markets. Temporary setbacks in the order of 10 to 15% cannot therefore be ruled out. But the underlying stock market trend is likely to be positive in 2010, with an overall gain in the region of 10% on the cards.

A FIRST LOOK AT 2011

Both Germany and the euro area face an awkward year on the economic front in 2011. Any boost feeding through from the stimulus packages into 2011 will be slight at best. In many European countries consolidation efforts are likely to be stepped up, partly via tax hikes and partly via spending cuts, in order to rein in yawning public sector deficits.

Stimulus packages: Overall volume of discretionary fiscal measures to date as % of GDP

Country	2009	2010	2011
Euro area	1.0	0.85	-
Germany	1.4	1.9	-
USA	2.0	1.8	0.8

Sources: IMF, Council of Economic Experts

In 2011, interest rates at both the short and the long end will no longer be as low as this year. Firstly, the ECB will remain on the road of monetary policy normalization. Following initial hikes in 2010, it will probably nudge key rates above the 2% mark.

Secondly, massive government bond issuance is likely to put mounting pressure on bond market prices, pushing up yields. In the face of towering debt ratios in many countries and the concomitant high long-term refinancing needs, investors will no longer tolerate paltry yields, particularly as alternative low-risk investment options will become increasingly attractive again on the back of rising short-term interest rates.

Furthermore, the probably high external value of the euro in 2010 will have negative economic repercussions in 2011. Following a strong recovery during much of 2010, towards late 2010 / early 2011 exports will lose a lot of their steam. As a result economic growth in the euro area and in Germany during the opening months of 2011 will be disappointing, temporarily raising concerns over economic stagnation.

We think it more likely, though, that the upward forces will maintain the upper hand even without government impetus. The corporate earnings picture will improve markedly by 2011 and, given a return to higher capacity utilization, underlying investment demand will continue to point up. In addition, the euro is likely to come back down to earth in 2011. With the moderate growth we have penciled in for the euro area, the European currency will be of only limited interest to investors, whereas the US economy is likely to become relatively more attractive amid enhanced price competitiveness and somewhat more vigorous business activity. We see the euro at USD 1.45 at the end of 2011, versus USD 1.55 at the end of 2010. The softer euro is likely to help rekindle export demand in the latter part of 2011 and bolster a gradual pickup in the economy. However, we expect average economic growth of only 1.5% for Germany and 1.4% for the euro area in 2011.

The emerging markets are once again likely to be the drivers of growth in 2011, expanding by 5.4%. Given moderate business activity in the industrial countries, which will probably record a GDP increase of only 1.7%, their growth edge will widen even further.

Growth rates in main economic regions

- GDP , real % change over previous year -

	2006	2007	2008	2009[1)]	2010[1)]	2011[1)]
Industrialized countries	**2.7**	**2.5**	**0.4**	**-3.3**	**2.0**	**1.8**
European Union	3.2	2.9	0.8	-3.9	1.7	1.6
Euro area	3.0	2.8	0.7	-3.9	2.0	1.4
Germany	3.2	2.5	1.3	-4.8	2.8	1.5
USA	2.7	2.1	0.4	-2.5	2.3	2.2
Japan	2.0	2.3	-0.7	-5.3	1.8	1.8
Emerging markets	**7.5**	**7.7**	**5.2**	**0.2**	**4.6**	**5.4**
Asia	9.1	9.8	6.4	4.8	6.7	7.3
Latin America	5.4	5.6	4.0	-2.6	2.9	3.4
Central and Eastern Europe	7.3	7.3	4.7	-6.3	2.1	3.3
World	**4.1**	**4.0**	**1.9**	**-2.2**	**2.8**	**3.0**

1) forecast.

These assessments are, as always, subject to the disclaimer provided below

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