

The world economy after the credit-driven super-cycle

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Thomas Mayer

Co-head of Global Economics
& Chief European Economist
tom.mayer@db.com
(+44) 20 7547 2884

value Change
1,100.62 38.07 ▲ 1.37%
2,649.71 33.35 ▲ 1.27%
807.90 2.93 ▲ 0.36%
10,711.54 96.83 ▲ 0.90%
1,301.10 13.29 ▲ 0.90%



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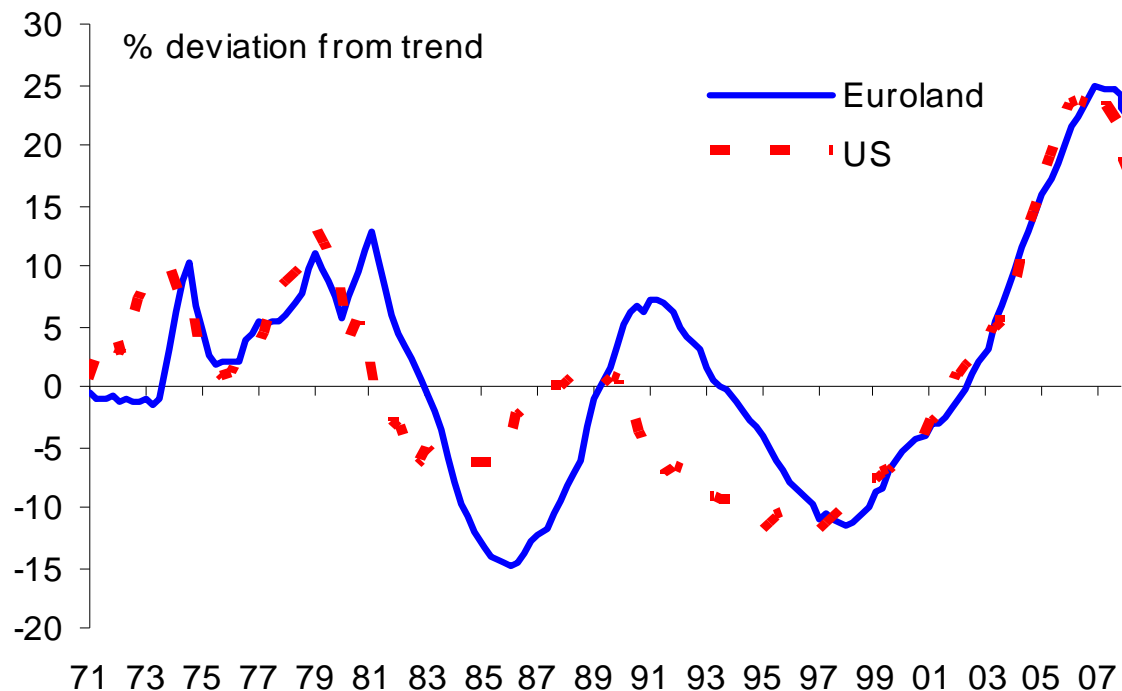


Overview

- The credit-driven growth of the last decade resulted in a big transatlantic housing market and global financial bust.
- The unprecedented policy measures taken by the big countries in recent weeks have successfully reduced systemic risk and are likely to stabilise the financial sector. But they cannot prevent a sizeable reduction of leverage in the financial sector, which is likely to reduce credit to the real economy and to depress economic activity.
- We expect the reduction in credit to induce the most severe global recession since the 1980s. In the wake of the downturn, inflation is likely to drop and monetary as well as fiscal policies are likely to be eased.
- Europe is likely to experience a somewhat sharper downturn than the US because of a smaller fiscal policy impulse, more rigid labour markets, and heavier government regulation in the financial sector.

Transatlantic shock 1: Deflation of housing bubble

Housing prices adjusted for inflation
(GDP weighted averages for Euroland)

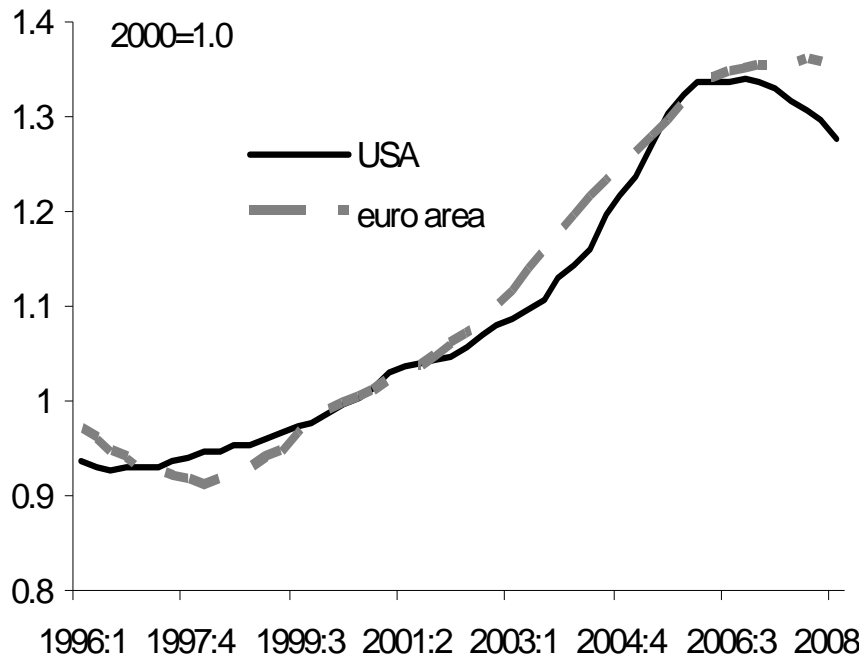


Source: OECD, DB Global Markets Research

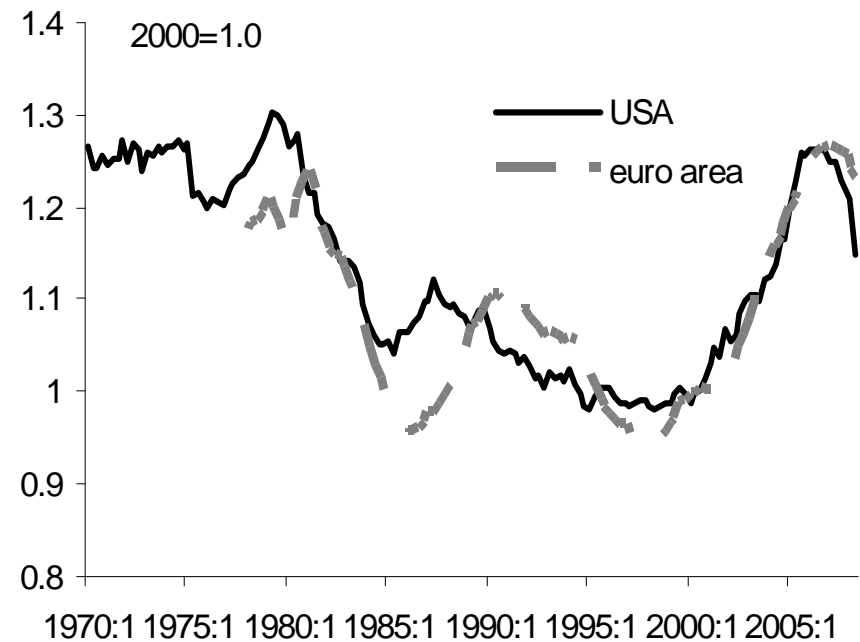


Housing markets in the US and Europe: some similarities in valuation developments

Price-to-rent ratio



Price-to-income ratio

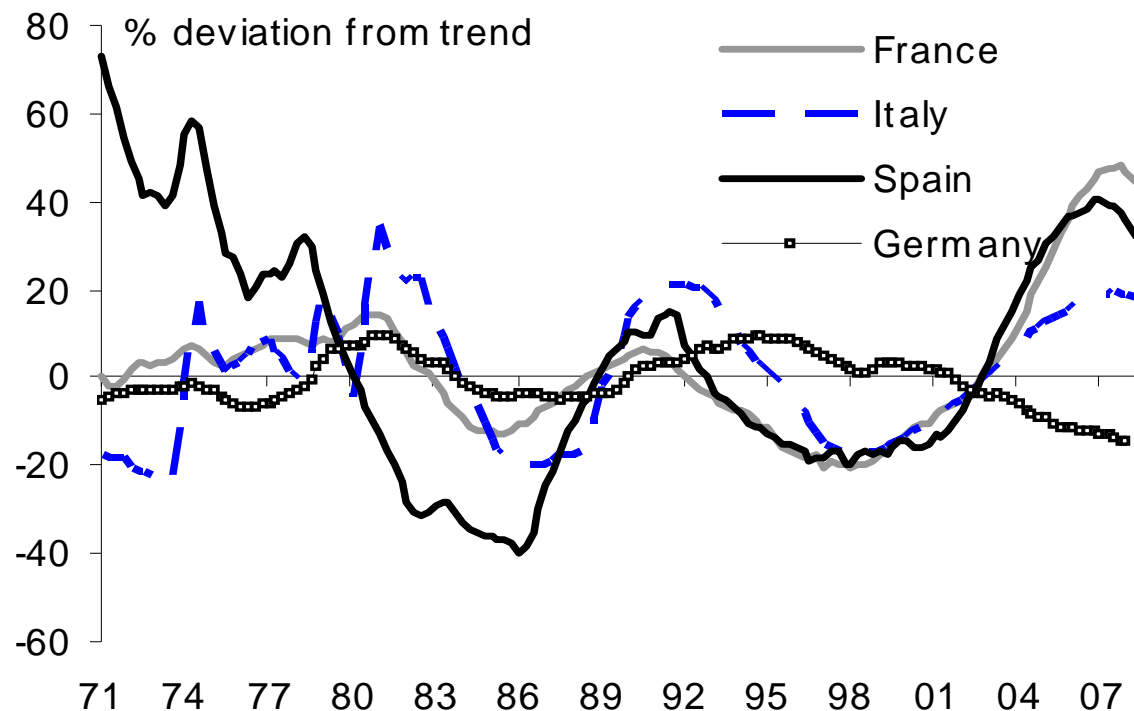


Source: OECD, DB Global Markets Research



Euroland's key housing markets: Hot, except in Germany

Housing prices adjusted for inflation

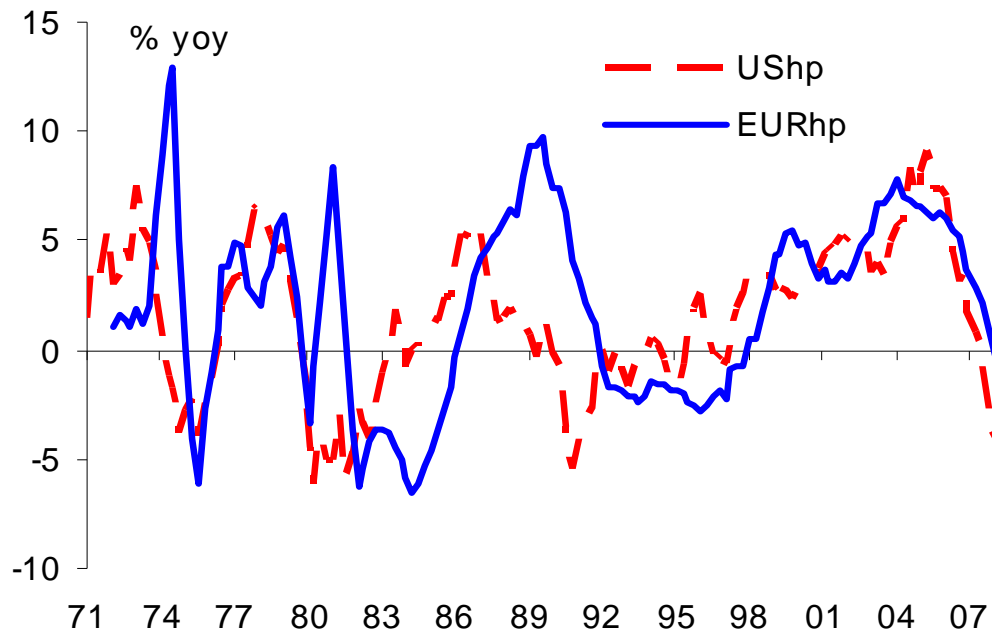


Source: OECD, DB Global Markets Research



Adjustment is under way

House prices adjusted for inflation



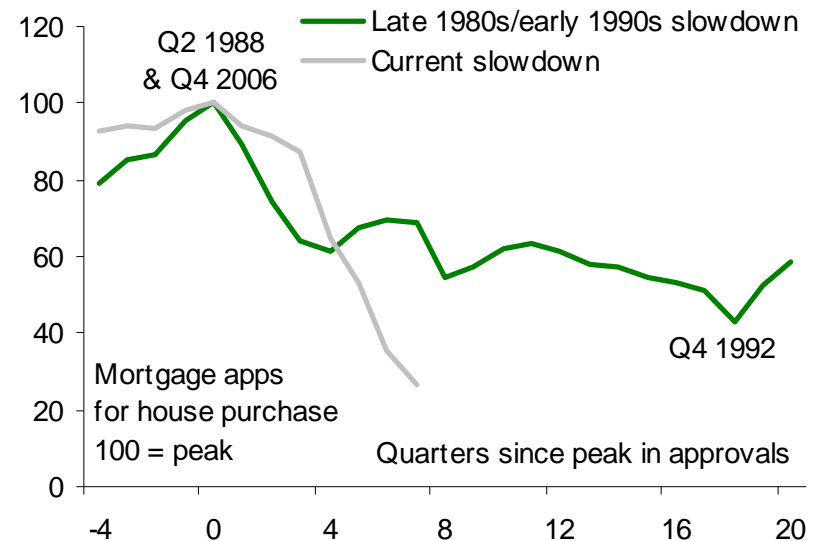
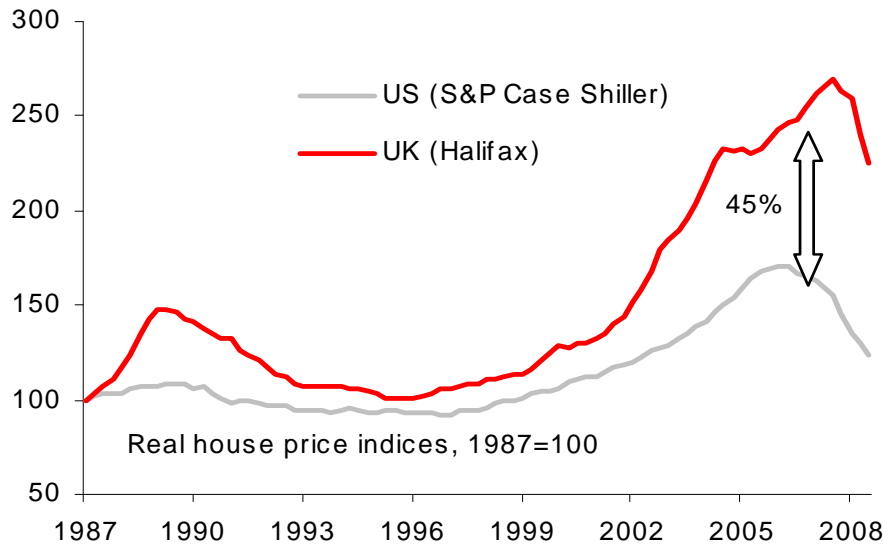
We expect US and euro area house prices to drop by about 17% from their peak to 2010 to correct for over-valuation. Further declines are possible before the cycle turns.

Source: OECD, DB Global Markets Research



UK ahead of deflation of a major housing bubble

UK house prices are about 40% overvalued and could fall about 30% over 6 years to go back to fair value (and more for a new upswing to start)



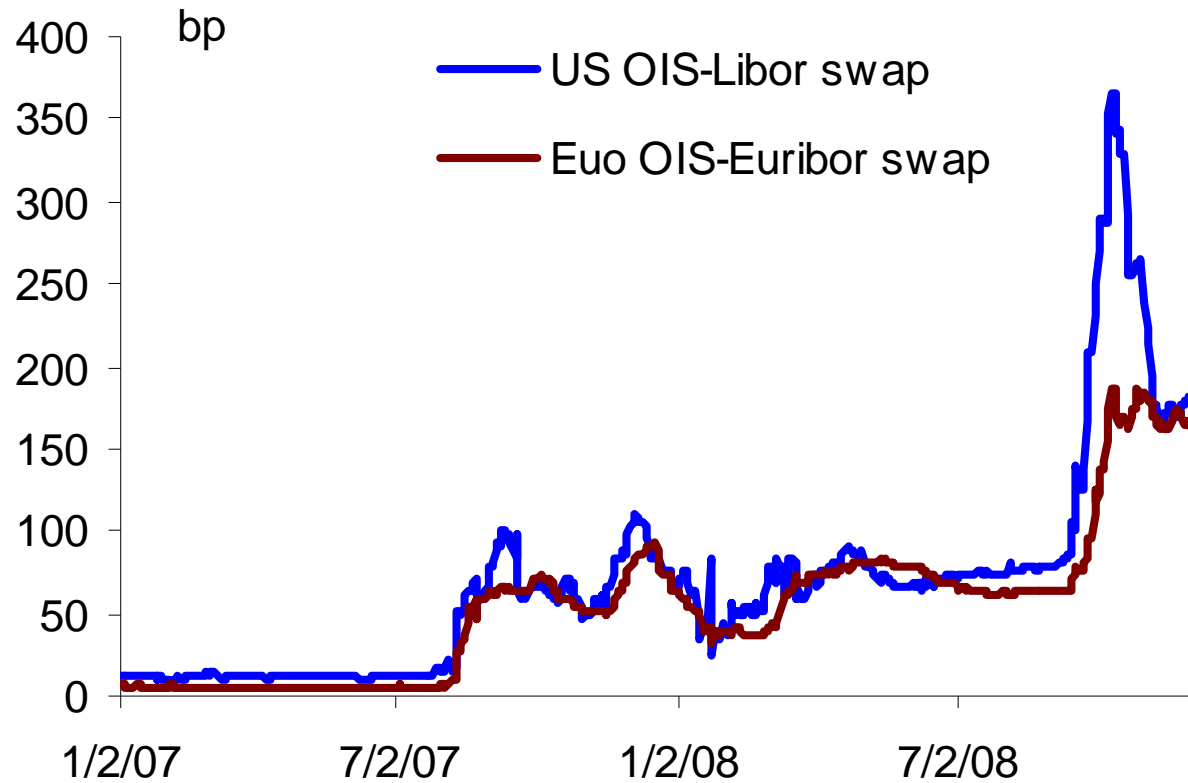
Sources: Halifax, S&P/Case Shiller, ONS, BEA





Transatlantic shock 2: Financial crisis

Money markets gummed up...



Source: Bloomberg, DB Global Markets Research

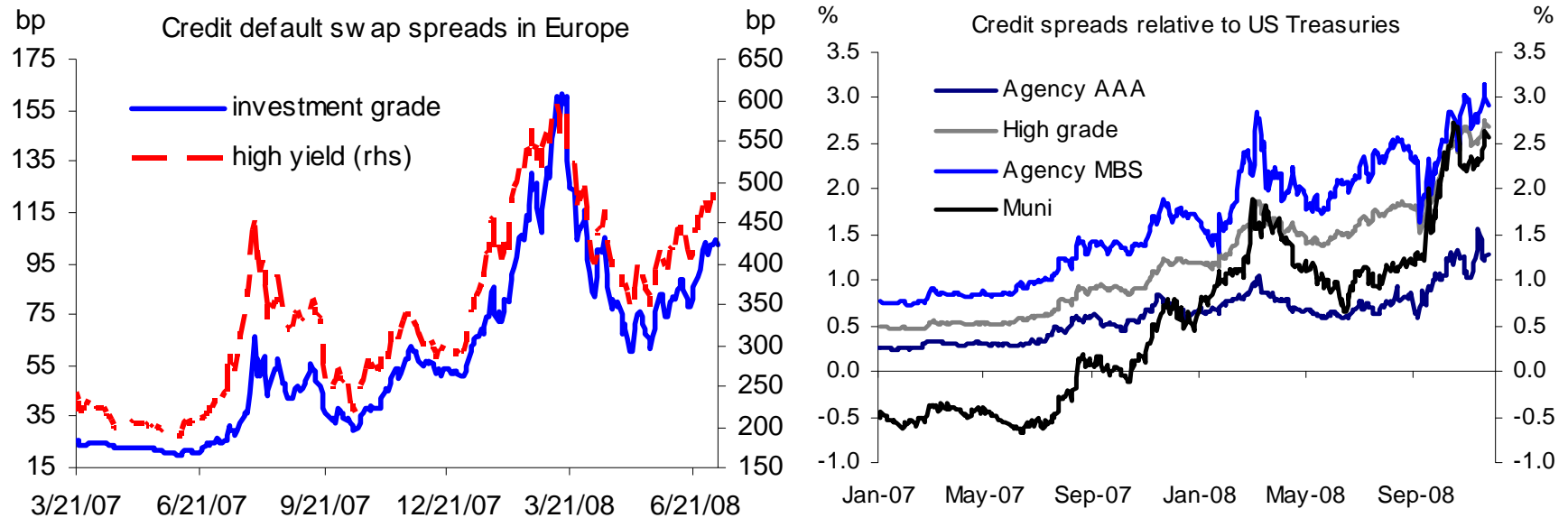
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Transatlantic shock 2: Financial crisis

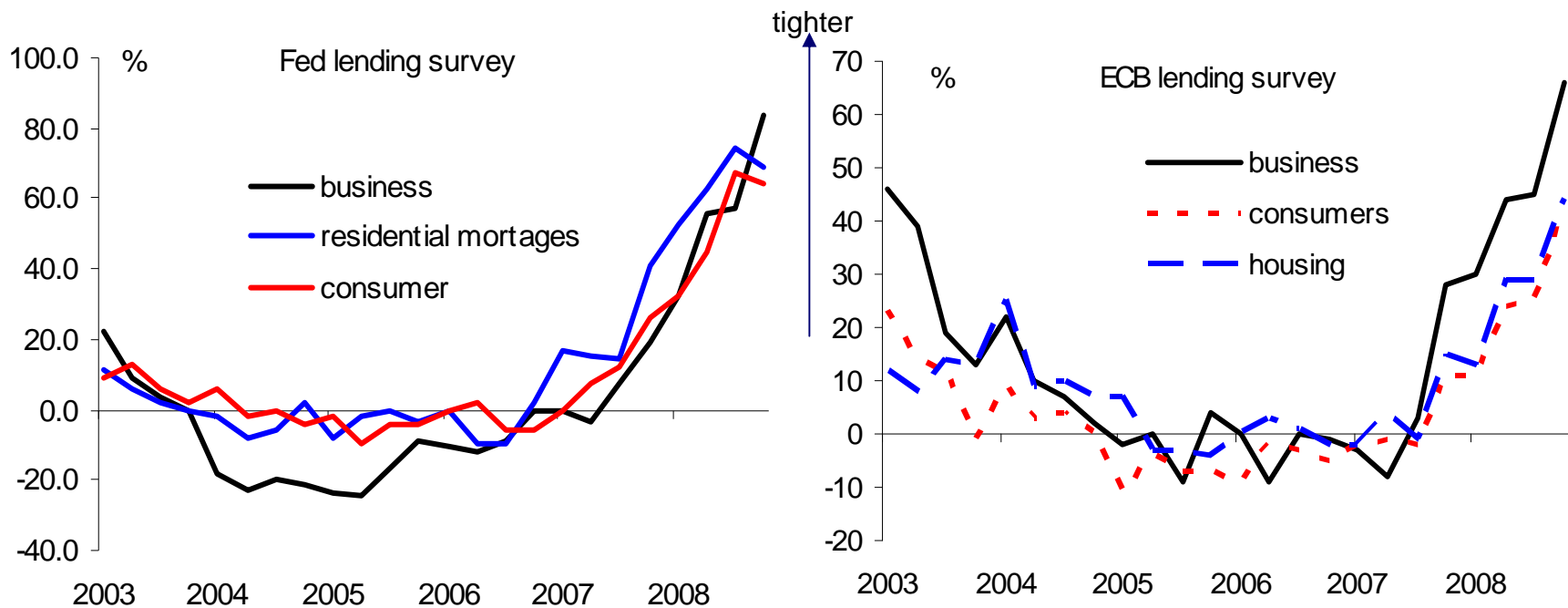
...tensions in credit markets ran high...





Transatlantic shock 2: Financial crisis

...and bank lending standards tightened

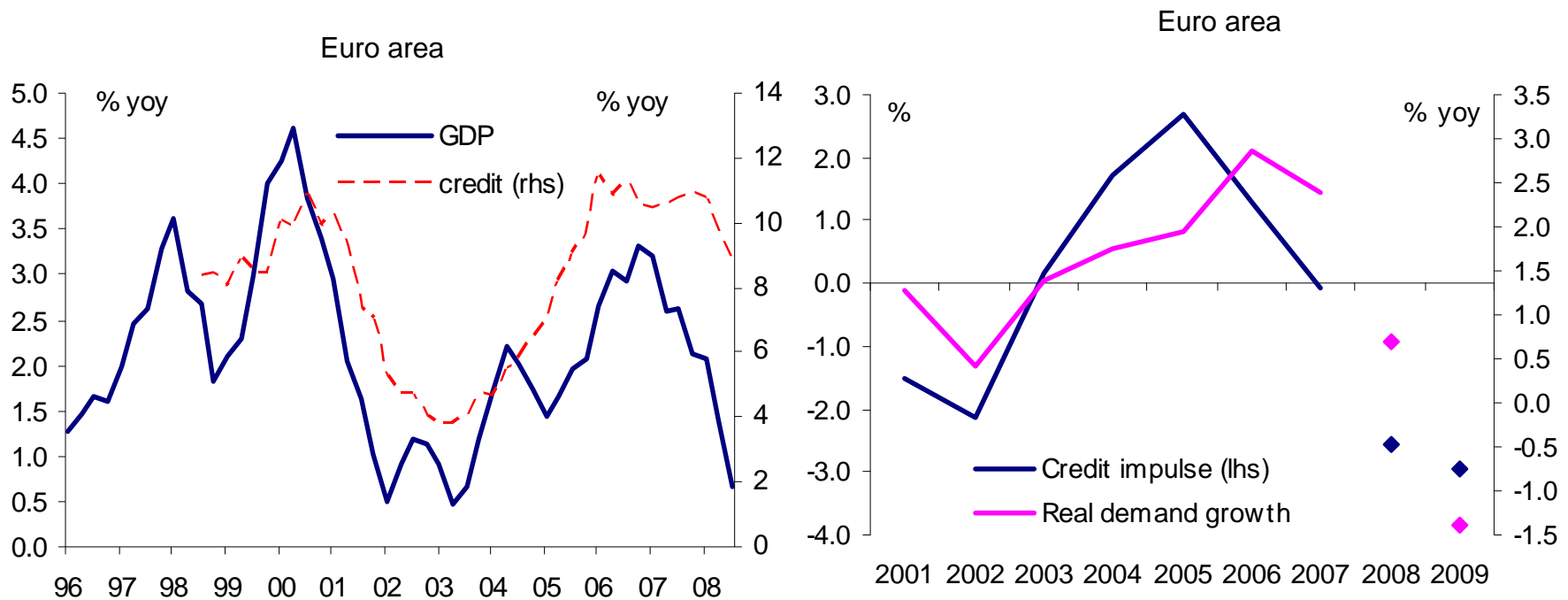


Sources: Fed, ECB, GM Research



Transatlantic shock 2: Financial crisis

Bank credit growth a lagging crisis indicator



Source: Haver, DB Global Markets Research



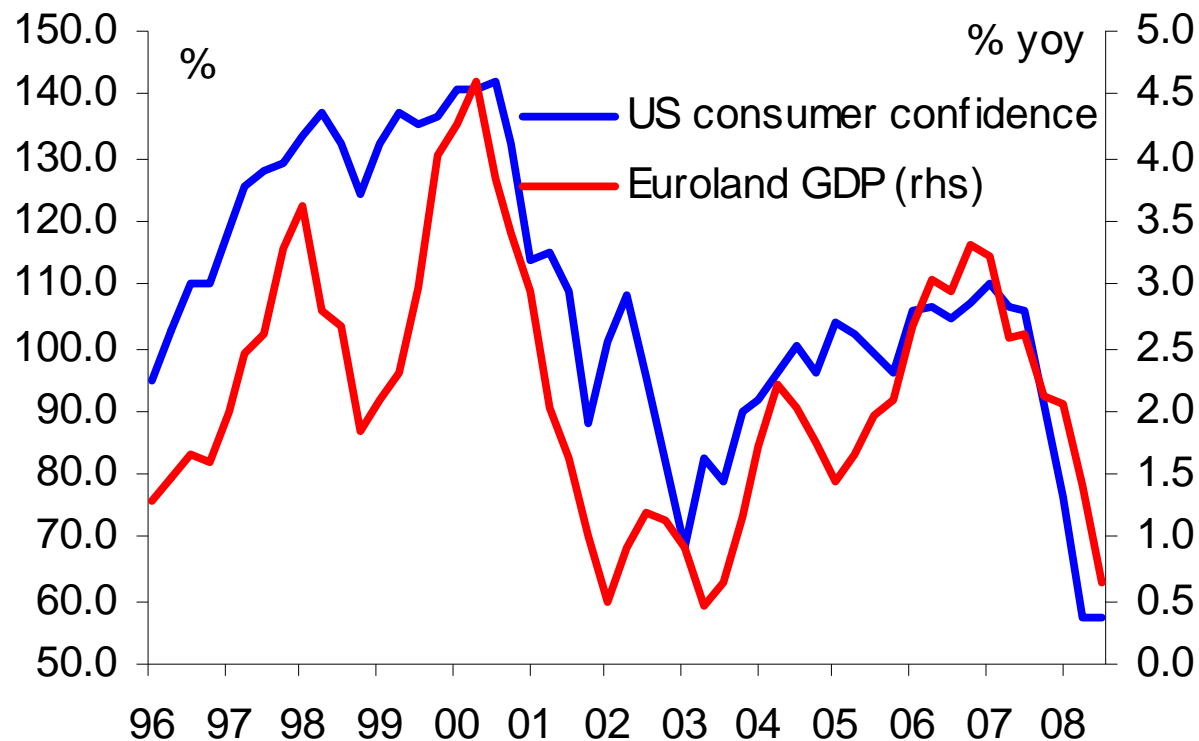


Will the policy measures make a difference?

- Measures have addressed the key risks in the banking sector: **(i)** lack of liquidity (central bank programmes, TARP(s)); **(ii)** institutional bank run (explicit or implicit guarantees of bank debt); and **(iii)** solvency (re-capitalisation of banks with public money).
- To support the real economy, central banks are cutting rates, but a big positive fiscal impulse is still needed.
- Even if everything falls into place, the example of the Scandinavian countries suggest that in the wake of a housing bust and banking crisis a severe recession is likely

Transatlantic spill-over effects: From US to Europe

US consumer was the locomotive of the global economy



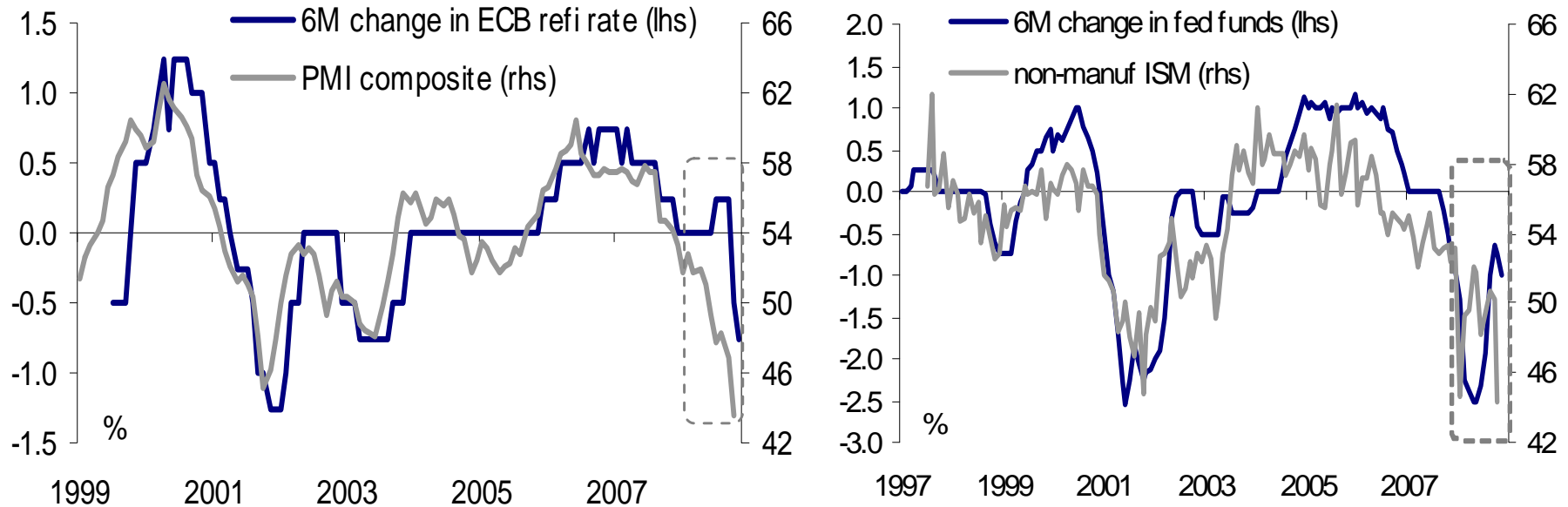
Source: Haver, DB Global Markets Research

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Differences in monetary policy: The ECB's late awakening

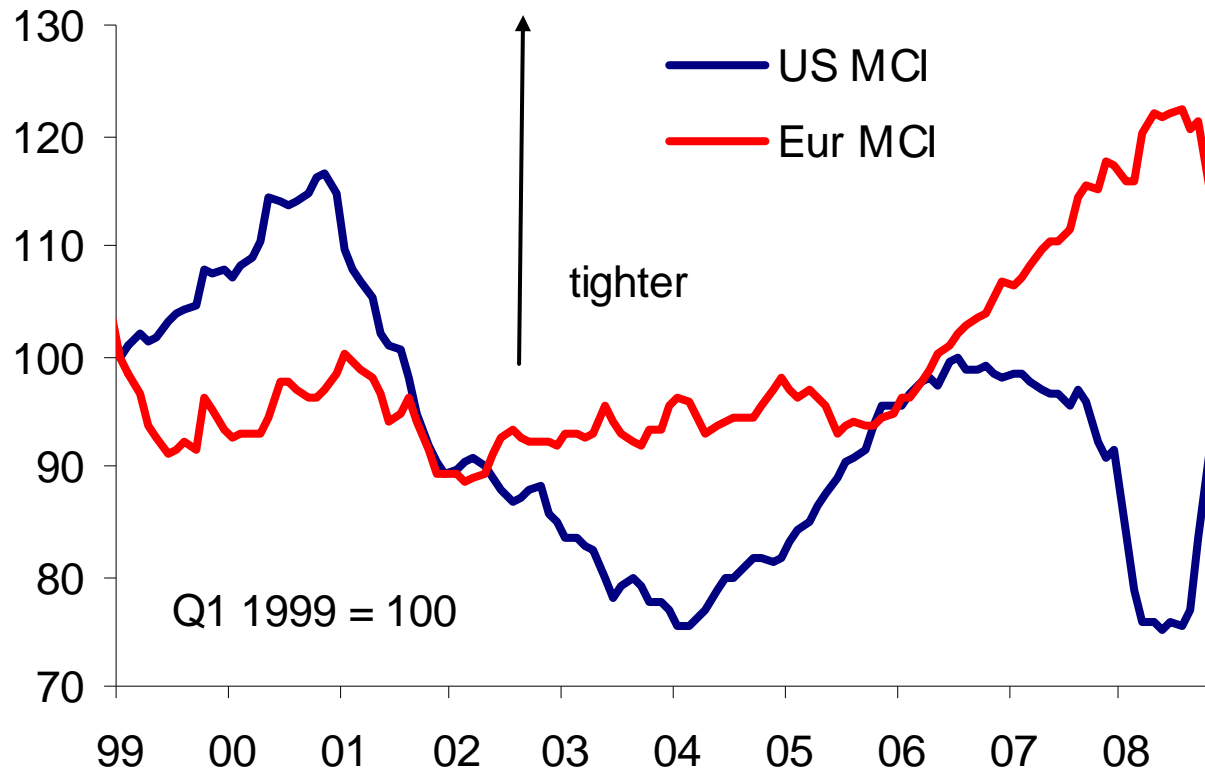


Source: ECB, Haver, DB Global Markets Research

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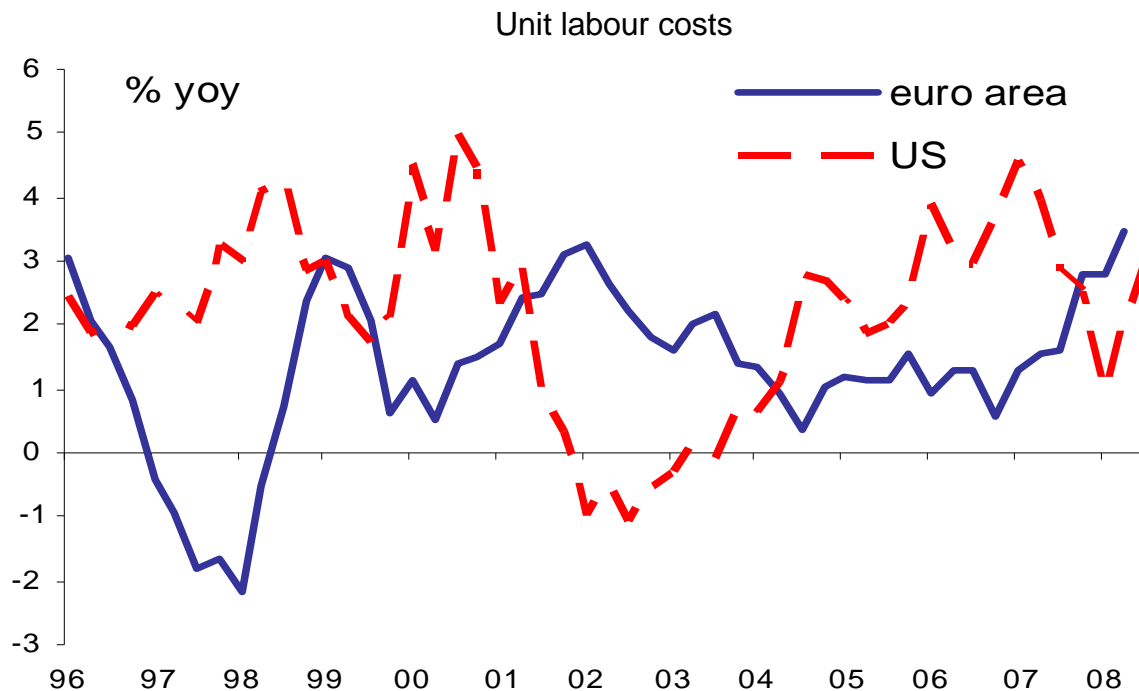


Differences in monetary policy: Easing in US, tightening in euro area into the downturn



Differences in monetary policy: Inflation worries dominated in Europe

Real wage rigidity and job protection lead to “2nd round effects” of oil price increases in Euroland



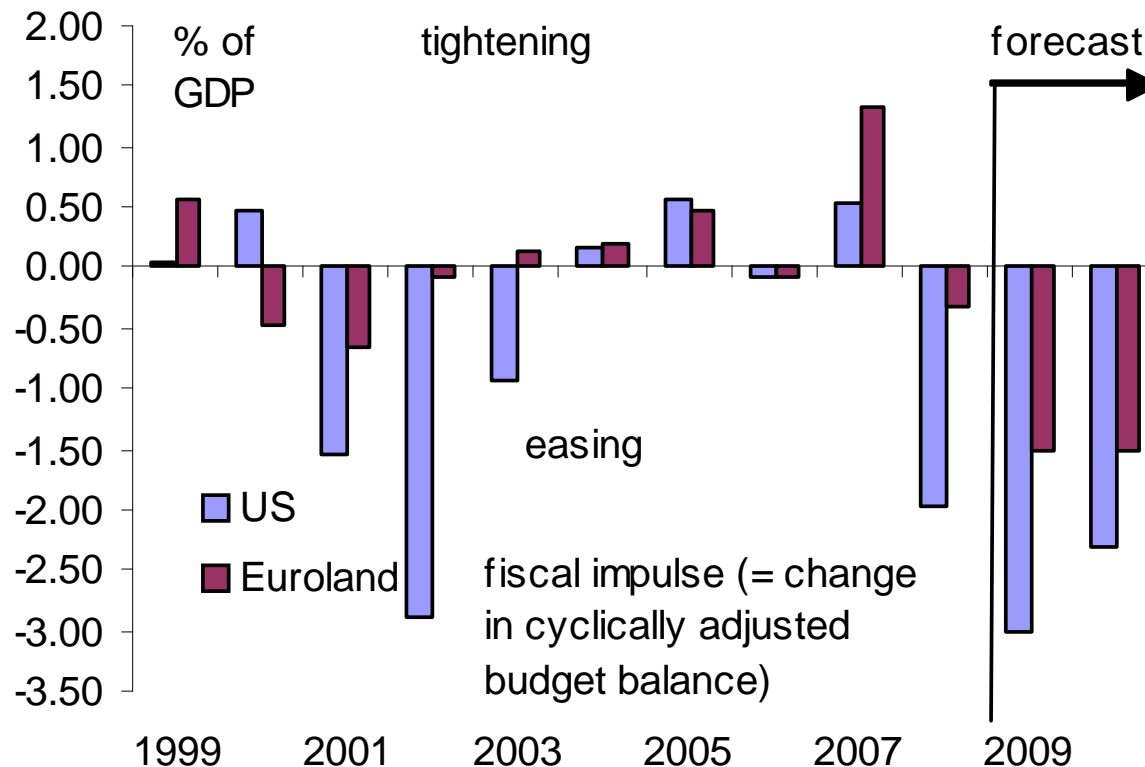
Source: Haver, DB Global Markets Research

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Differences in fiscal policy in 2008: Expansionary in US, neutral in euro area

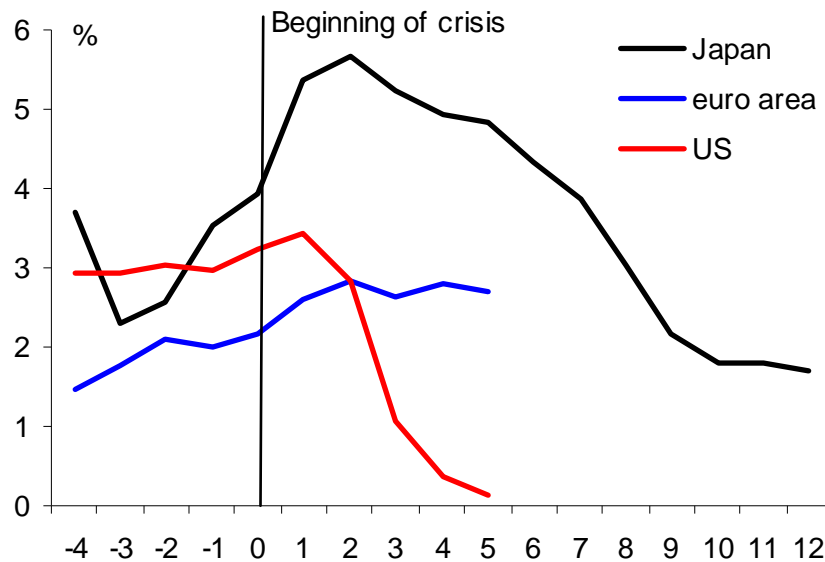
Differences likely to continue in 2009



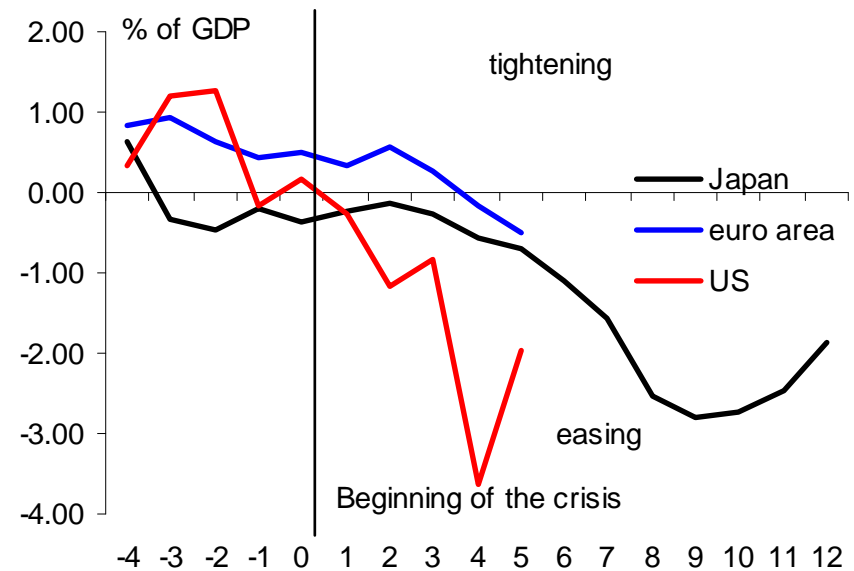


Similarities and differences to Japan

Real short-term interest rates

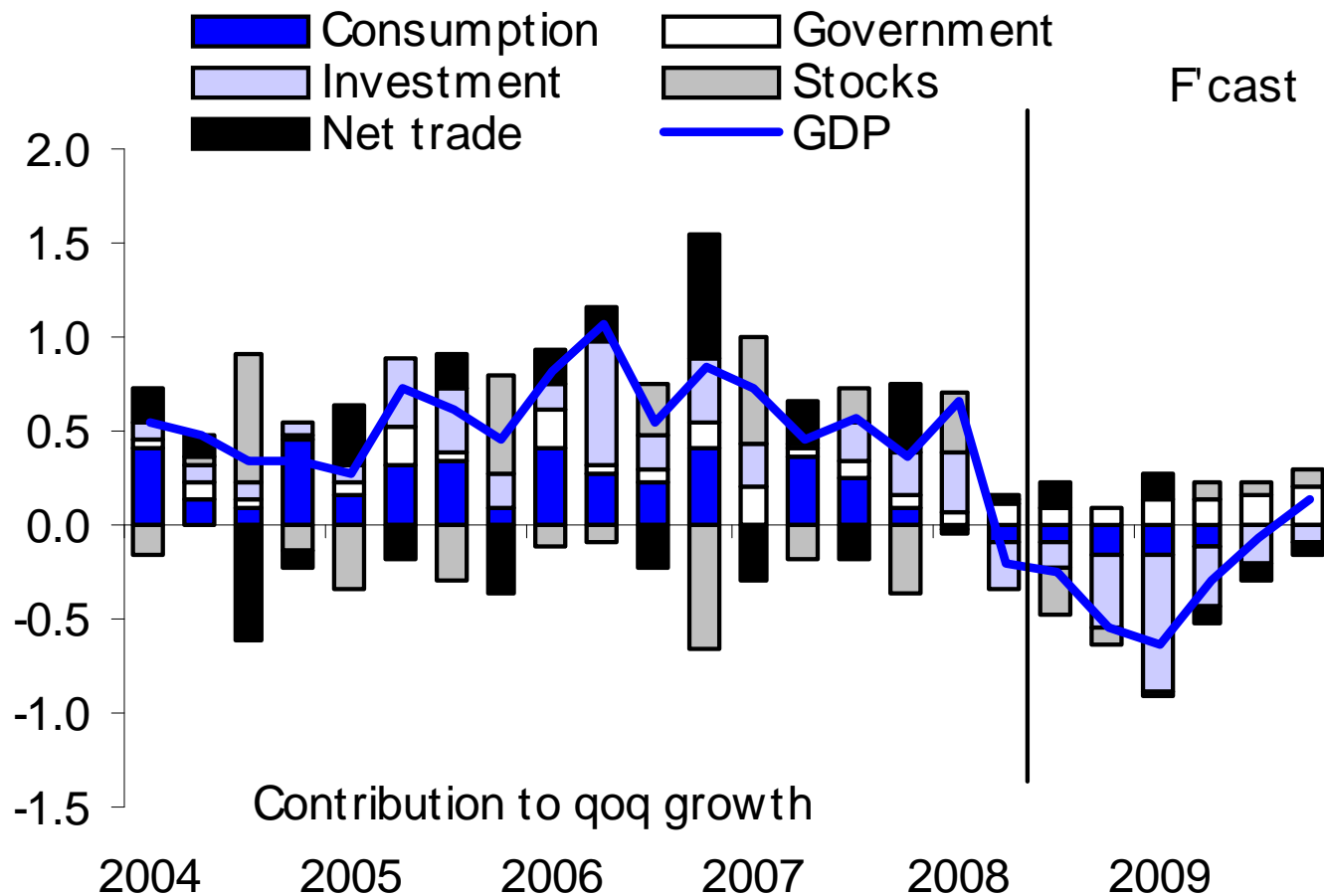


Fiscal impulses





Euroland coming down hard





A severe global recession...

World Economy in Deep Recession

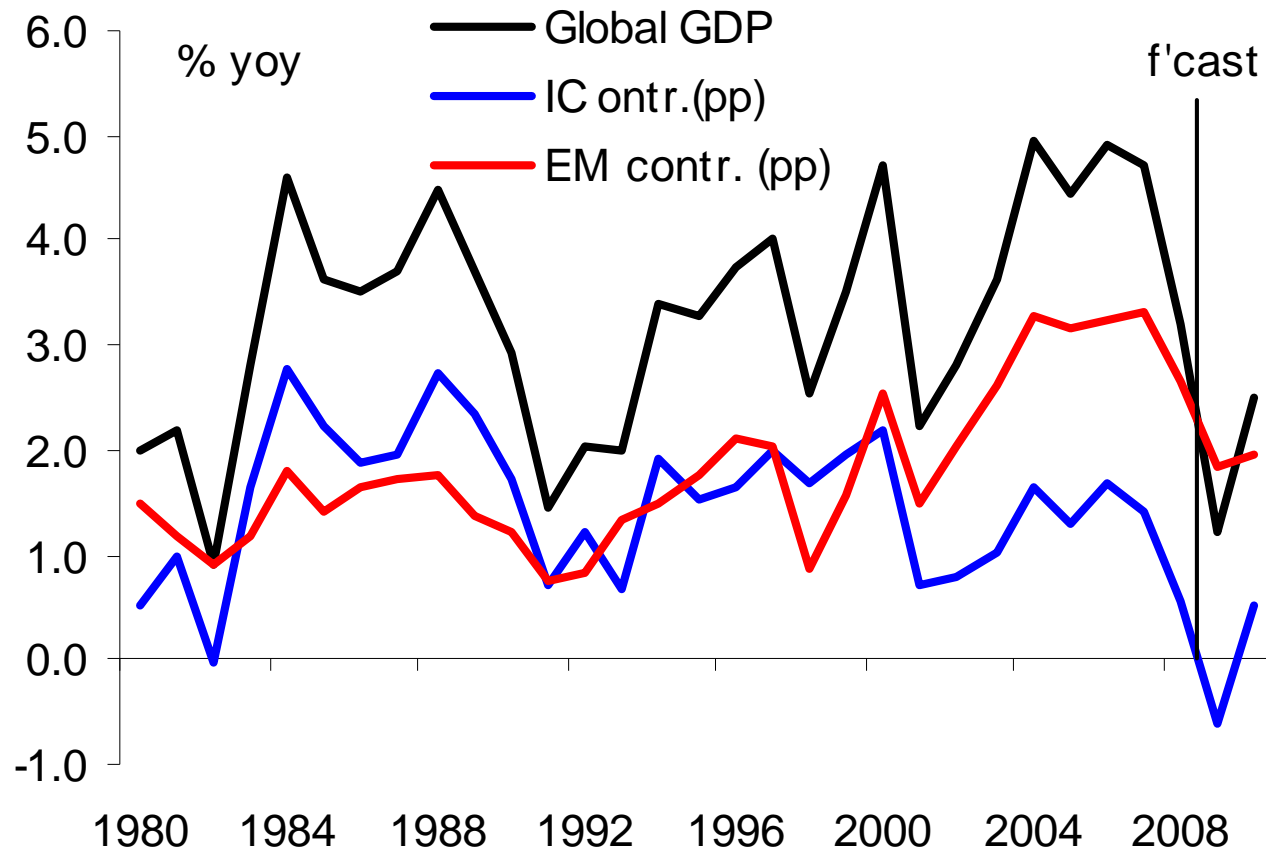
	GDP growth, %				CPI inflation, %			
	2007	2008F	2009F	2010F	2007	2008F	2009F	2010F
G7	2.2	0.9	-2.0	1.3	2.2	3.3	0.2	1.1
--US	2.0	1.2	-2.0	1.6	2.9	4.0	-0.4	1.5
--Japan	2.1	0.3	-1.7	0.7	0.0	1.5	0.0	-0.5
--Euroland	2.6	0.9	-2.5	1.0	2.1	3.3	1.2	1.4
EM Asia	9.4	7.1	4.6	5.7	4.4	7.2	3.0	2.6
--China	11.9	9.1	7.0	6.6	4.8	6.0	0.6	1.0
EMEA	6.8	5.2	1.1	3.5	10.5	13.0	7.7	6.0
Latam	5.5	4.3	1.8	3.0	7.0	9.2	7.4	5.9
Industrial countries	2.4	0.9	-2.0	1.2	2.2	3.4	0.5	1.2
EM countries	8.1	6.1	3.3	4.7	5.7	8.2	4.1	3.6
Global	4.7	3.1	0.2	2.6	3.6	5.3	1.9	2.2

Source: DB Global Markets Research



...and shifting sources of growth

Industrial countries experiencing worst recession since WWII, but EM faring better than in 1982



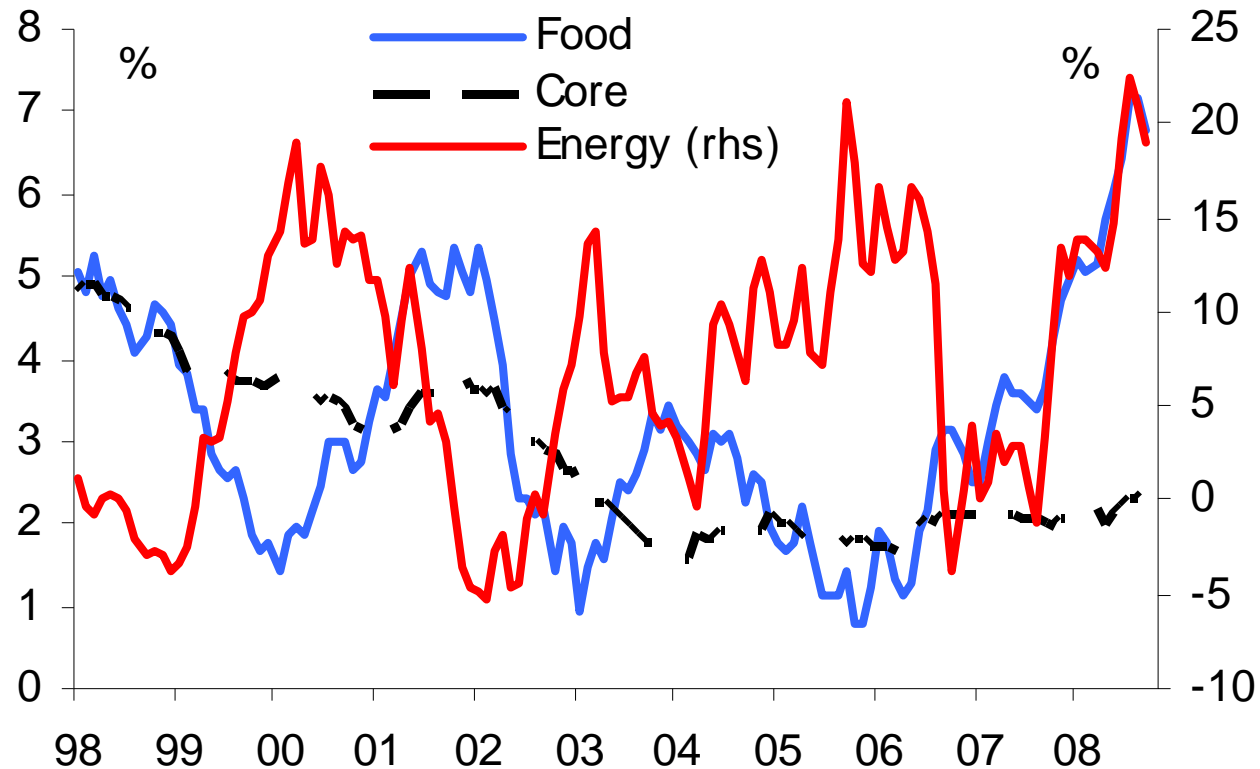
Source: DB Global Markets Research

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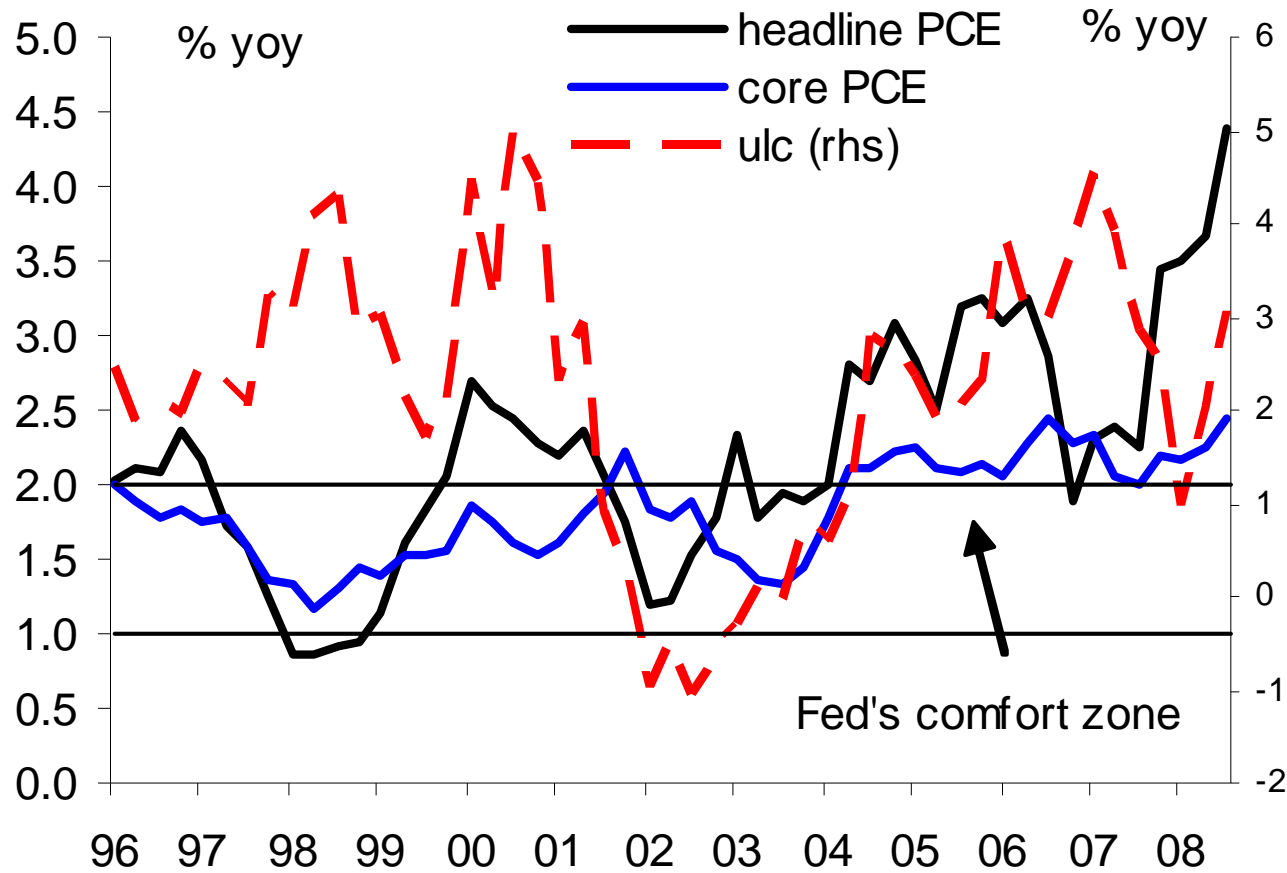




OECD core inflation has remained benign



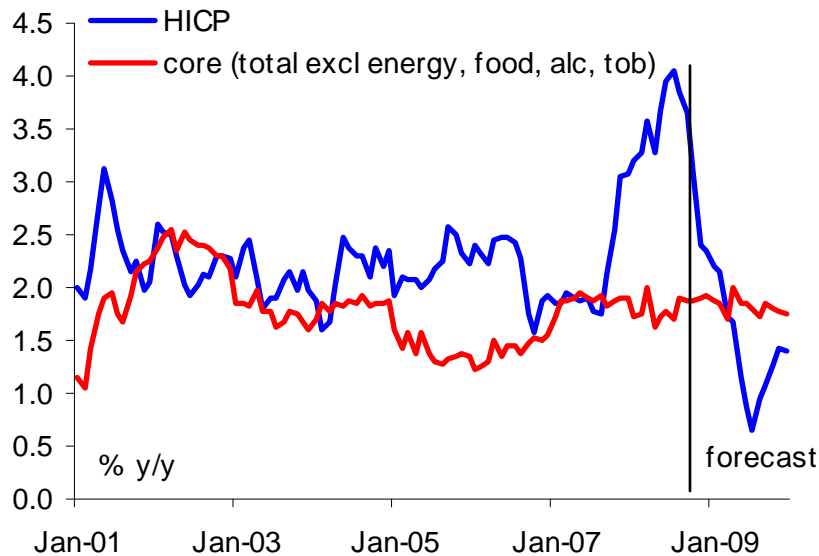
US inflation: Lower oil prices, lower unit labour cost growth likely to induce decline



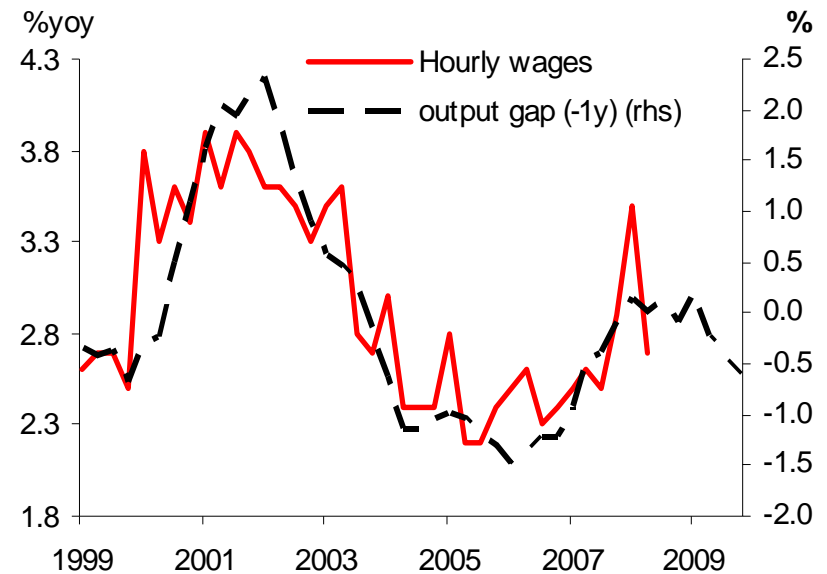


Euroland inflation : Slower growth likely to reduce cyclical inflationary pressures

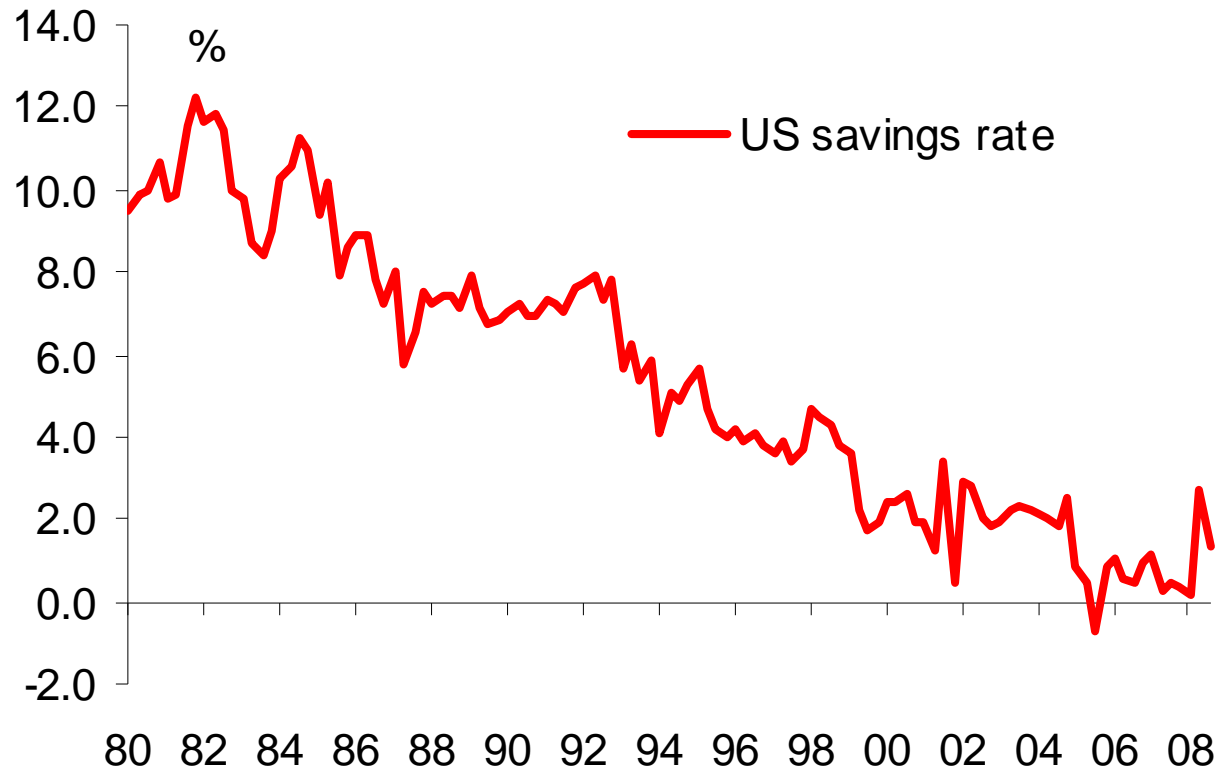
Headline inflation likely to plunge because of energy



Wage inflation up, then down



Need to raise savings rate likely to keep US consumption growth sluggish...





... and US growth low for years to come

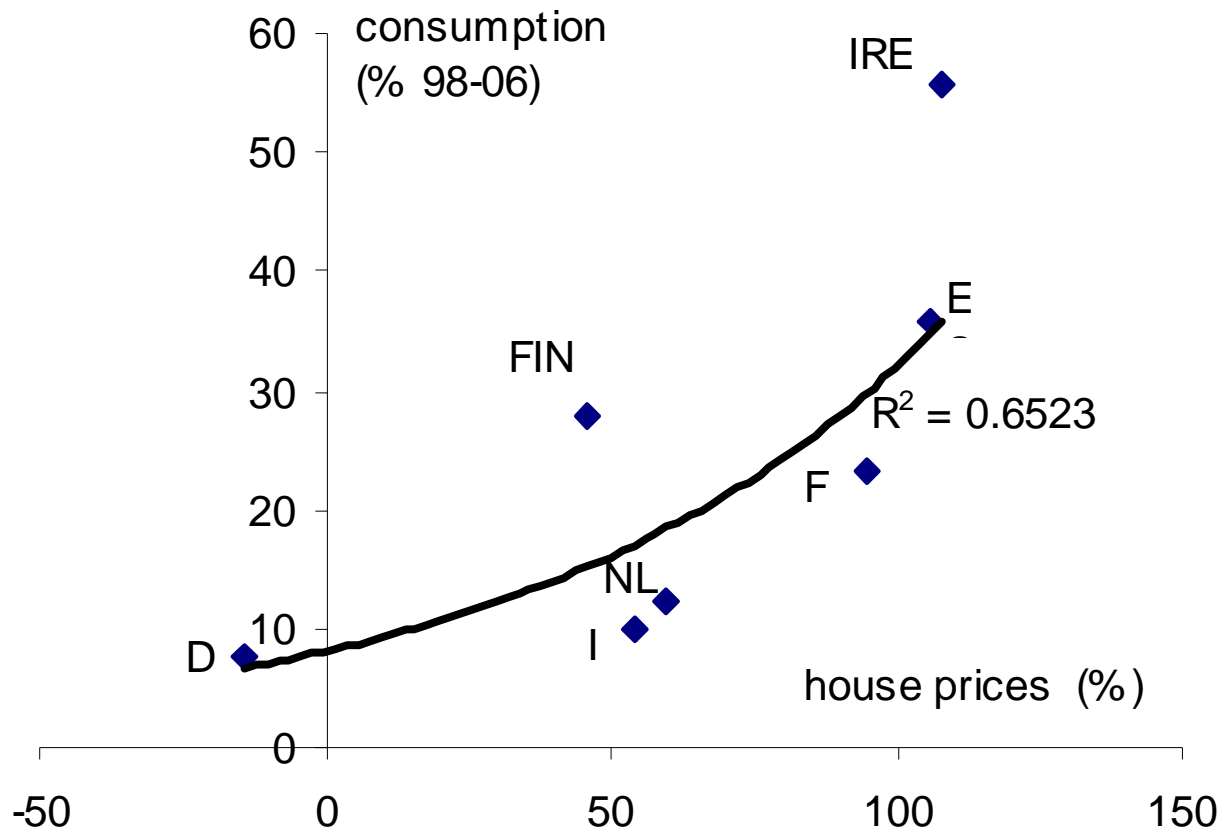
US medium-term projections assuming increase in the savings rate to levels of the mid-90s

	2008	2009	2010	2011
GDP	1.5	1.5	1.6	1.6
Private consumption	0.5	0.5	0.5	0.5
Public spending	1.7	1.7	1.7	1.7
Investment	3.0	3.0	3.0	3.0
Exports	7.0	7.0	7.0	7.0
Imports	3.0	3.0	3.0	3.0
Net exports (% of GDP)	-4.4	-4.0	-3.5	-3.0
Savings rate	1.4	2.4	3.4	4.5

Source: DB Global Markets Research

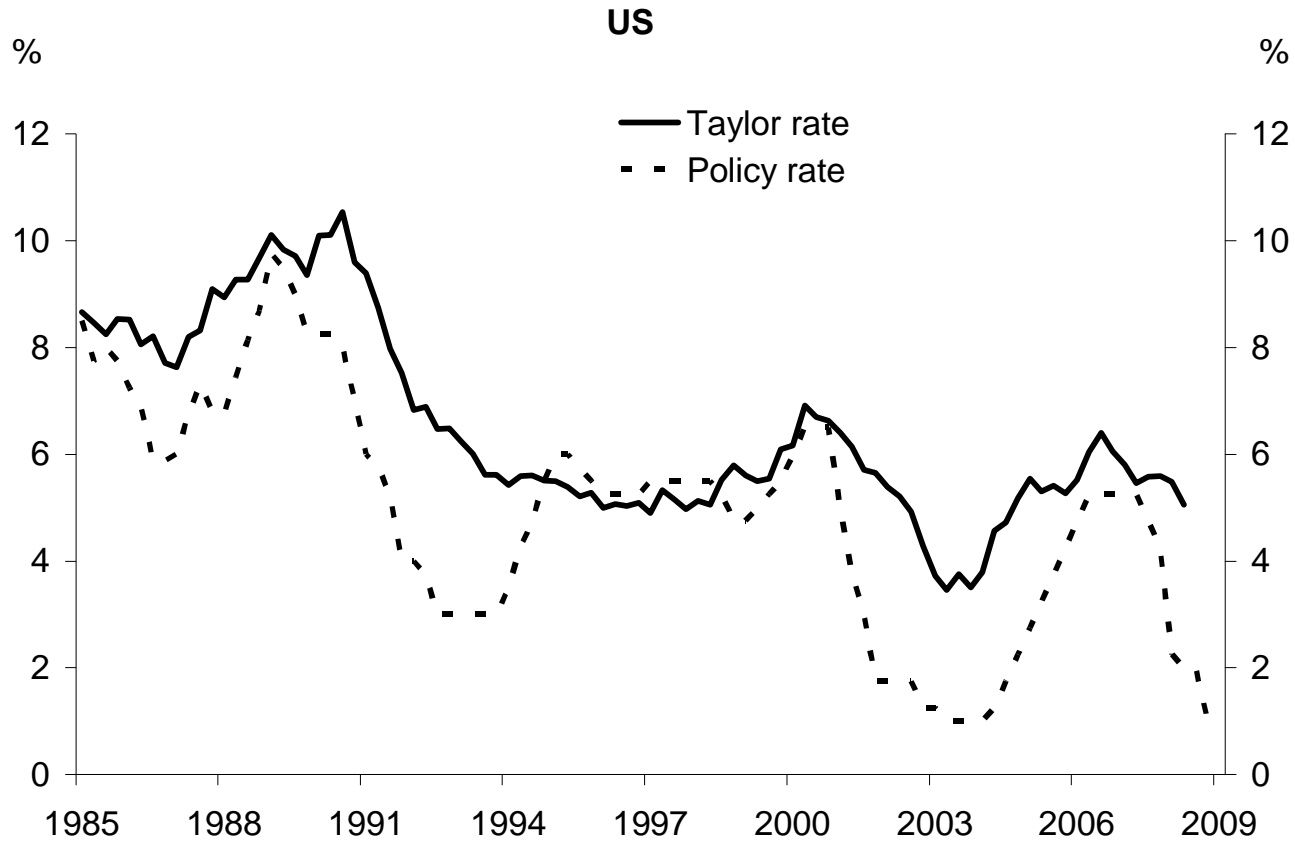


European house price-consumption dynamics going into reverse



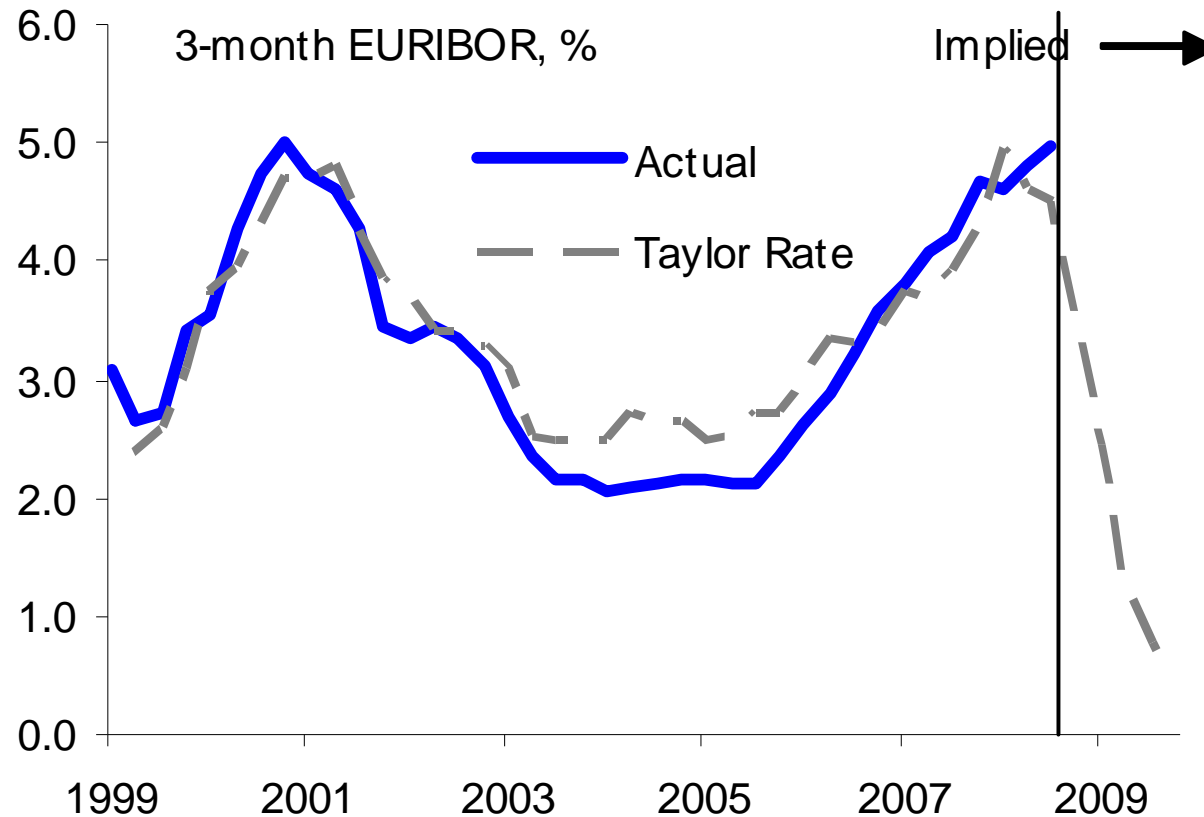


Fed has taken insurance against financial risks



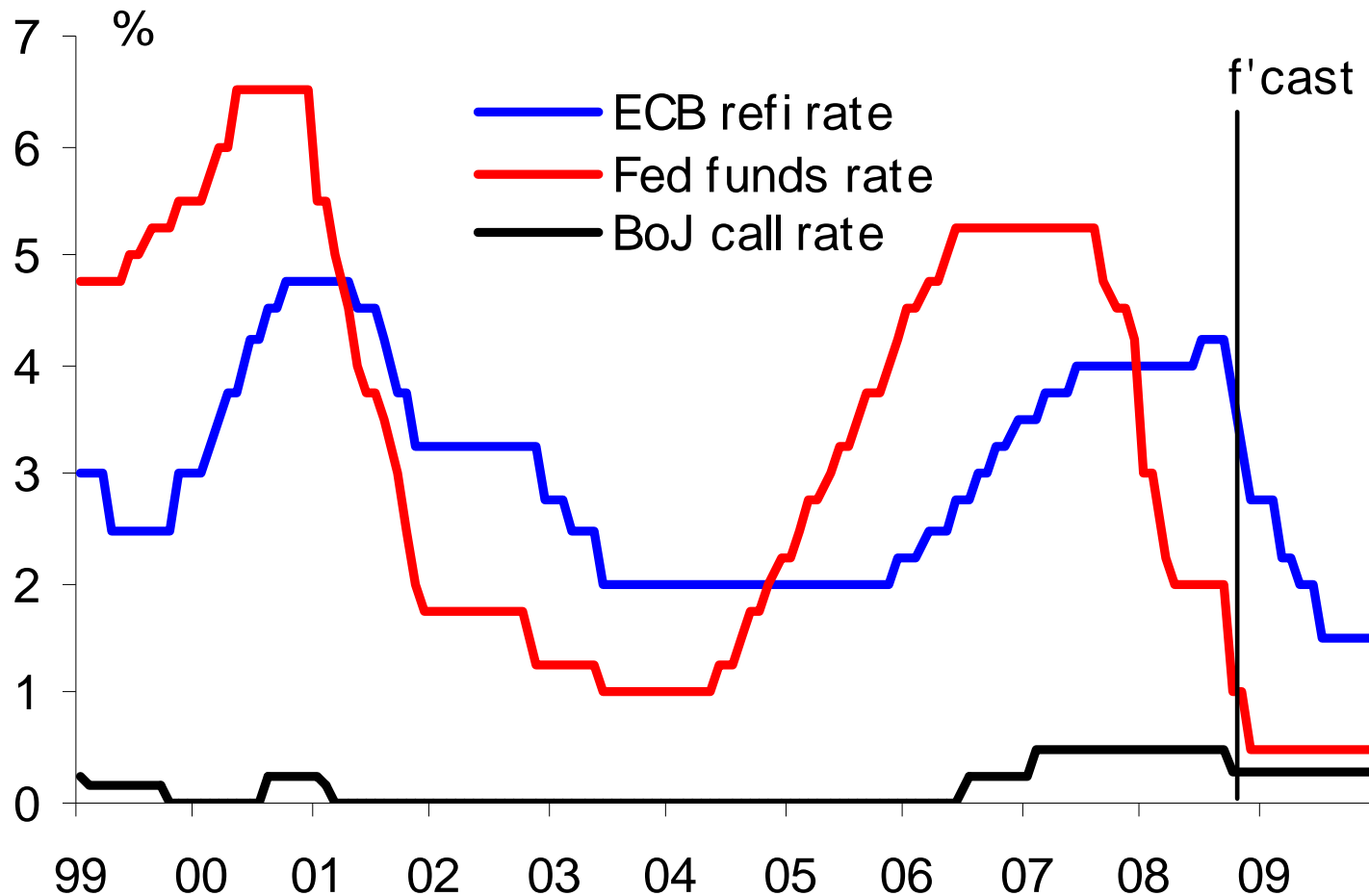


ECB will have to catch up with weaker economy





Further monetary easing coming up



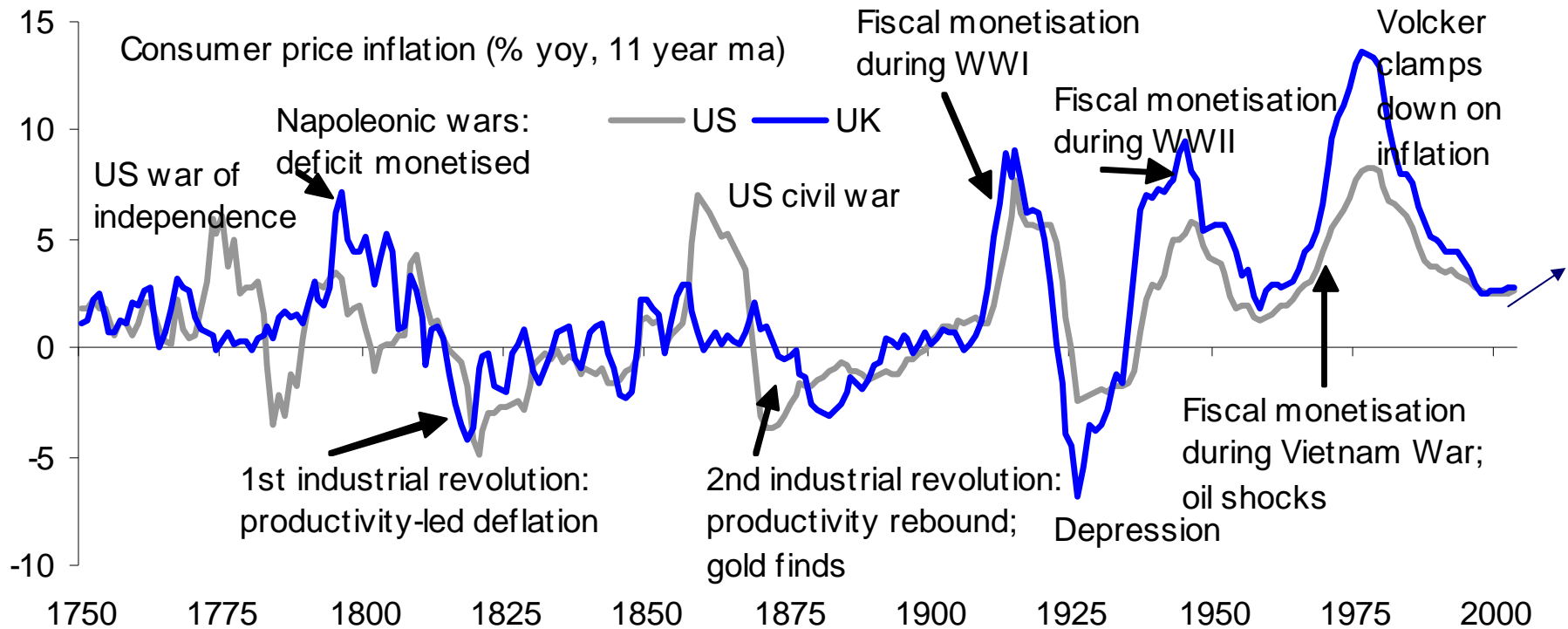
Source: Haver, DB Global Markets Research

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...and eventually a new long-term inflation cycle



Source: DB Global Markets Research, Economic History Service



Appendix

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