



Berenberg Capital Markets Economic Research

Global outlook: Resilient recovery

Quarterly macro update: April 2011

Holger Schmieding

Chief Economist

+44 20 3207 7889

holger.schmieding@berenberg.com

08 April 2011

Economics

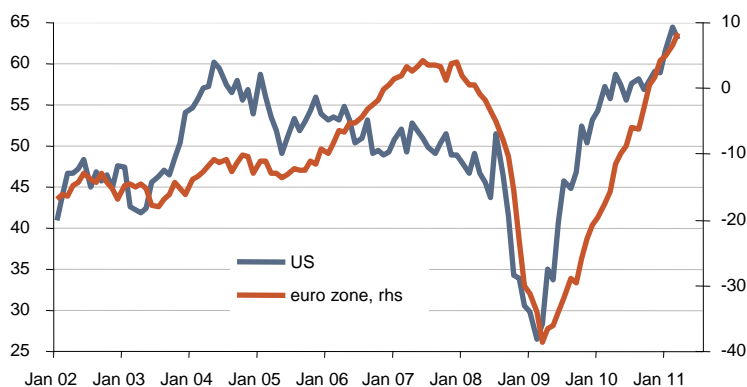
Table of contents

Summary: the rocky recovery keeps on rolling	1
Forecasts at a glance	2
A decent start into 2011	3
New risks	4
Reasons to expect resilient growth	5
Key regions	7
US: a recovery with jobs	7
China: on course for a soft landing	8
Euro zone: a core story	9
The UK: intelligent austerity	11
Inflation: edging up	12
Central banks: ECB first, Fed to follow	14
Market outlook: no news is good news	15
Sovereign bond markets: a rocky ride	16
Equity markets: still constructive	17
Foreign exchange markets	18
Key market forecasts	19
Disclaimer	20
Contacts: Investment Banking	21

Summary: the rocky recovery keeps on rolling

- The global economy is still enjoying the **'rock'n'roll recovery'** which we projected in our year-ahead outlook some three months ago: while occasional shocks are rocking markets, the recovery keeps on rolling.
- The first three months of 2011 have sprung **two major surprises**: leading economic indicators and oil prices have surged more than we had expected. On balance, these two surprises roughly offset each other. We have made no major change to our **global GDP forecasts**. But we now project less subdued inflation and earlier rate hikes.
- Higher oil prices and the triple catastrophe in Japan have added **new risks** to the mix. But a lot has also gone right so far this year: China seems to be on course for a soft rather than a hard landing; no currency war has erupted between major regions of the world; and the euro debt crisis has not escalated much further, with Spain pulling away from the brink recently.
- Contrary to the usual concerns about a 'jobless recovery', the **US labour market** has turned around quite impressively. Even the euro zone labour market has turned the corner. Industry is eager to hire (see Chart 1).
- **Monetary policy is working**. One major reason for our optimistic cyclical outlook is that monetary policy in the Western world is still extremely relaxed. As the healing process in the financial system continues, banks are able to pass more of that stimulus on to households and consumers. We need some obstacles – such as higher oil prices and a tightening of monetary and fiscal policy – to prevent an acceleration of growth, as the monetary stimulus is becoming more effective over time.
- By and large, **markets** have moved in the direction we projected at the end of 2010, with a rocky and uneven rise in equity prices and bond yields. We look for more of the same for the remainder of 2011.
- **Risks** abound, markets are nervous and the European debt crisis could still become much worse. But if Europe manages to control the risk, and other calamities do not materialise either, the extremely relaxed monetary policy across the West could possibly boost demand even more than we project.

Chart 1: Employment expectations in manufacturing



Source: ISM; EU Commission

Forecasts at a glance

Global economic forecasts

	Weight	GDP				Inflation				Unemployment				Fiscal balance			
		2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
World*	100	-1.6	4.1	3.4	3.6												
US	27.4	-2.6	2.9	2.9	2.9	-0.4	1.7	2.2	2.0	9.3	9.7	9.5	9.0	-11.0	-10.5	-9.0	-7.0
Japan	9.8	-5.2	4.0	0.6	2.6	-1.4	-0.9	0.6	0.5	5.1	5.1	4.9	4.6	-7.2	-7.6	-9.0	-8.5
China	9.9	8.8	10.3	9.4	8.7	-0.7	3.3	4.5	3.2	4.3	4.1	4.1	4.0	-2.8	-2.2	-1.8	-1.6
India	2.4	7.7	8.5	8.3	8.0	11.5	9.4	7.5	6.0					-6.4	-5.8	-5.3	-4.8
Latin America	6.8	-2.0	6.2	4.3	4.2		6.3	6.9	6.6					-3.5	-2.8	-2.4	-2.1
Europe	37.1	-4.4	2.2	2.1	2.4												
euro zone	24.3	-4.0	1.7	1.7	2.1	0.3	1.6	2.5	2.2	9.5	10.0	9.9	9.4	-6.3	-6.5	-4.4	-2.1
Germany	6.6	-4.7	3.5	2.8	2.4	0.3	1.1	2.4	2.4	7.5	6.9	6.3	5.8	-3.0	-3.5	-1.9	-0.9
France	5.2	-2.6	1.5	1.7	2.1	0.1	1.6	2.3	2.2	9.5	9.9	9.8	9.3	-7.5	-7.5	-6.0	-4.2
Italy	4.1	-5.0	1.2	1.2	1.6	0.8	1.4	2.2	2.1	7.8	8.4	8.1	7.6	-5.3	-5.2	-4.7	-3.0
Spain	2.8	-3.6	-0.1	0.7	1.8	-0.2	1.7	2.7	2.2	18.0	20.2	20.8	20.2	-11.1	-8.8	-5.9	-2.9
Other Western Europe																	
UK	4.6	-4.9	1.3	1.5	2.4	2.2	3.3	4.4	2.9	7.6	7.8	8.0	7.7	-11.4	-10.0	-8.0	-5.0
Switzerland	1.1	-1.9	2.6	2.5	2.3	-0.7	0.8	1.0	1.4	3.7	3.8	3.2	2.8	0.7	0.3	0.7	1.0
Sweden	0.9	-5.1	5.3	4.1	2.5	1.9	2.0	2.5	2.4	8.3	8.4	7.7	6.9	-0.9	-2.4	-0.8	0.4
Other Europe																	
Russia	2.4	-7.9	4.0	4.5	4.2	11.6	7.2	8.9	8.0	8.5	8.5	7.5	6.8	-5.9	-4.5	-3.3	-3.0
Turkey	1.3	-4.9	8.9	5.5	4.3	6.3	7.6	7.0	6.5	14.0	12.0	11.0	11.3	-5.5	-3.7	-3.4	-3.0

Unemployment rate: Harmonised definition (ILO/Eurostat); fiscal balance: general government deficit in % of GDP

*At current exchange rates, not purchasing power parity. PPP estimates give more weight to fast-growing emerging markets and inflate global GDP.

Source: FactSet; Bloomberg; ECB; Berenberg estimates from Q1 2011 onwards

Forecast changes

Since our last global economic update on 6 January 2011, we have made no major change to our global growth outlook, except to account for the obvious impact of a severe natural disaster on Japan (setback now, rebound later). Good news from global leading indicators and the burden from higher oil prices have roughly offset each other. However, due to oil prices, we have raised our 2011 inflation calls for:

- the US from 1.6% to 2.2%;
- the euro zone from 1.9% to 2.5%;
- the UK from 3.4% to 4.4%.

Central banks will likely react to less subdued inflation amid resilient growth by raising rates earlier than we had projected at the turn of the year. We now expect the ECB to raise rates three times instead of twice by 25bps this year, starting in April. The Bank of England (BoE) may bring its first 25bps rate hike forward to May from August 2011 and the US Federal Reserve (Fed) will probably deliver a first rate increase in December 2011 instead of in February 2012 after letting its asset purchase programme (QE2) expire in June. However, the Bank of Japan will likely stay on hold until early 2012.

Resilient growth...

...but oil prices push up inflation

Central banks to raise rates even earlier than expected

A decent start into 2011

So far, the **'rock'n'roll recovery'** which we predicted in our year-ahead outlook seems to be unfolding. Although global markets have been rocked by occasional shocks, the economic recovery keeps on rolling. The available data suggest that the US and core Europe enjoyed a reasonably strong start into 2011, with even the UK returning to modest growth after a setback in late 2010.

The rocky recovery keeps on rolling

As usual, the surprises came more from unexpected quarters (rebellion in Arab countries, disaster in Japan). But before we dwell on the new risks, let us highlight the risks that did not materialise in the first three months of 2011.

Surprises galore...

- Although **China** and other emerging markets continued to step gently on the monetary brakes after strong growth in 2010, their economies seem to be on course for a soft rather than a hard landing.
- No **currency war** has erupted between major economies of the world.
- The **euro debt crisis** escalated less than we had feared. The European approach to buy time is still working. Although Portugal finally had to ask for help from Europe and the IMF on 6 April, Spain has made some strides to regain market confidence (Chart 2). Spain (11.6% of euro zone GDP) matters much more than Greece, Ireland and Portugal combined (6.1% of euro zone GDP).
- Contrary to the concerns about a **'jobless recovery'**, which always seem to haunt markets at the early stages of a US economic upswing, the US labour market has started to turn around quite impressively. While private-sector employment rose by 1.5% year-on-year in March, the unemployment rate fell to a two-year low of 8.8% (Chart 3).
- Even the euro zone **labour market** started to turn the corner, with the number of unemployed declining for the fourth month in a row in February. We find much more evidence for our optimistic view that the strength of Germany will spread to its neighbours than for the pessimists' case that the trouble at the euro periphery will derail growth in the core.

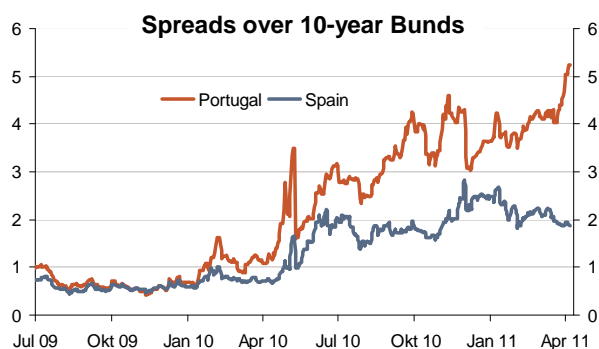
..but the key risks have not materialised so far

Containing the contagion risks in Europe

More jobs in the US...

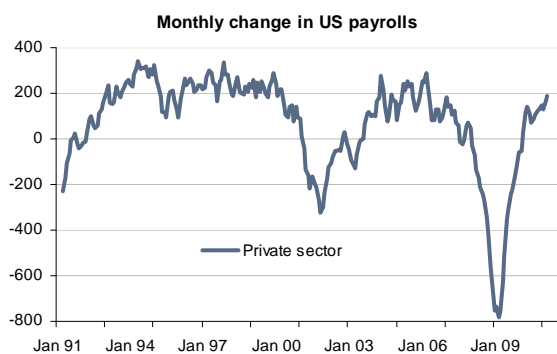
...and the euro zone

Chart 2: Euro crisis – Spain stabilises, Portugal suffers



In % points. Source: Bloomberg

Chart 3: Not too bad – US job creation



In 1000s. Source: BLS

New risks

The first three months of the year have sprung two major negative surprises.

- **Oil prices** have surged much more than we had expected. Instead of a very gradual further rise from \$92 to \$95 per barrel of Brent crude over the course of the year, the price has soared to just above \$120 at the start of April. Initially, higher oil prices reflected unexpectedly buoyant global demand. Since late February, however, fears have gripped markets that the rebellion in Arab countries against autocratic rulers may lead to a prolonged civil war in key oil-producing countries and thus disrupt oil supplies.
- The **triple catastrophe** in Japan is a severe shock for that country. By disrupting some supply chains, for instance in the automobile and information technology sectors, it could also be a brief hit to industrial production in other parts of the world. More importantly, the gory TV pictures from Japan and concerns about nuclear risks in general could hurt consumer confidence and consumer spending in places far beyond Japan.

A new oil shock

A lament for Japan

Higher oil prices reduce the purchasing power of consumers and raise costs for producers in oil-importing countries. On its own, the surge in oil prices by \$25 (equivalent to €17) per barrel relative to our end-2010 baseline scenario can raise the price level in major Western countries by 1% within three months and reduce the rate of GDP growth by slightly less than 1% over the four quarters after the shock. It is a serious challenge to our global growth optimism.

Oil could be a drag on growth worth 1% of GDP

Fortunately, the unexpected strength of leading indicators in early 2011 largely offsets the risk. Taken at face value, strong leading indicators point to economic growth that could be almost 1% point faster in 2011 than we envisaged at the end of last year. However, higher oil prices will probably cause the upswing in the major Western economies to moderate to the pace that we had projected anyway. But reflecting the balance of news (dearer oil, encouraging global lead indicators), we have lowered our forecasts for consumer spending in key Western economies while raising our calls for net exports, partly because Western economies will import less and partly because oil producers will buy more in real terms than we had initially thought.

However, strong leading indicators suggest that the global economy can stomach the shock

Of course, the risks from oil are significant. We expect oil prices to hover around current levels near-term and recede slightly to no more than \$115 per barrel in late 2011 as the situation in the Arab world becomes clearer. If oil prices were to surge further, we would probably have to make significant changes to our growth and inflation calls.

Significant risks

As to the risks from Japan, experience with previous disasters such as the Kobe earthquake in 1995, the US hurricane Katrina in 2005 and even the negligible impact of the Chernobyl nuclear catastrophe of 1986 in Western Europe suggests that regional catastrophes do not change the underlying cyclical trends in advanced economies. They merely distort the monthly pattern of some high frequency data such as industrial production. Unless the situation in Japan were to escalate dramatically (i.e. requiring the evacuation of Greater Tokyo, which accounts for 4% of global GDP, and/or a huge nuclear cloud frightening people across the Western world), Japan's impact on global economic growth will likely remain minimal, apart from such short-term volatility in the data.

Natural disasters usually do not derail well organised advanced economies

Reasons to expect resilient growth

Despite these challenges, we see compelling reasons to expect the economic recovery to continue for the remainder of 2011 and for 2012, probably with a near-term loss in momentum followed by a return to growth rates around trend by the end of 2011.

Compelling reasons to expect a further recovery

Monetary policy across the Western world is still extremely expansionary. Central bank rates are at or very close to the record lows which they reached in the wake of the post-Lehman recession. The huge gap between a US Fed funds rate of 0.25% and the 4.2% pace of nominal US GDP growth in late 2010 is just one of many ways to visualise the unusual size of the monetary stimulus (Chart 5).

Remember: monetary policy works

In 2009, **central banks** had to steer their rates to rock-bottom levels as a major part of the monetary stimulus became stuck in impaired banks and a weak financial system, leaving only a much smaller stimulus to actually reach the real economy. But as banks and markets have continued their gradual healing process, a greater share of the stimulus is now finding its way to households and non-financial companies. For example, the German Ifo credit indicator shows that corporate complaints about access to credit are close to a record low. As the transmission mechanism gradually returns to normal, the impact of the monetary stimulus on the real economy is becoming stronger over time even if central bank rates (or asset purchase programmes) do not change.

Rising inflation expectations and a less impaired transmission mechanism make the monetary stimulus even more powerful over time

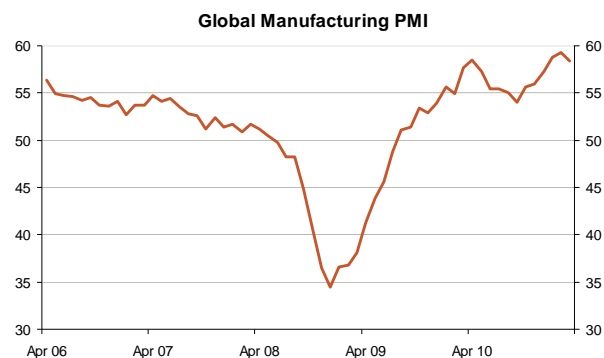
Money market rates have started to rebound as the markets are pricing future rate hikes. Also, the ECB has phased out its six-month and 12-month liquidity injections. However, as inflation expectations have risen at the same time, even real short rates are still at – or close to – their recent lows.

Money market rates on the way up already

In the absence of external shocks, the current extreme stance of monetary policy would probably propel the Western economies over time into an accelerating economic boom. Put differently, we need some external shocks and a tighter fiscal policy to prevent economic growth from soaring well beyond the rates reached last year. As monetary policy works with a lag and usually needs at least three quarters before its full effects on growth become visible, some tightening of monetary policy in Europe now will probably make only a modest difference to the immediate growth outlook anyway.

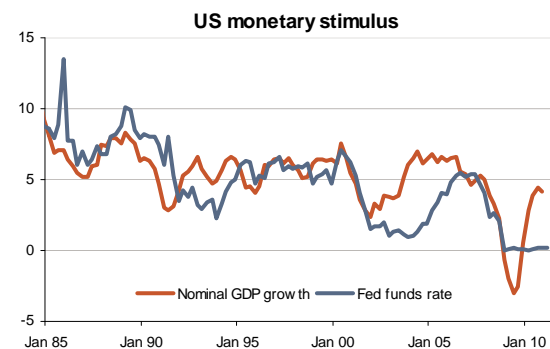
If left unchanged, rock-bottom rates could propel the Western economies into an ever-stronger upswing

Chart 4: Solid manufacturing recovery



Combined manufacturing PMI for the US, euro zone, UK and China, weighted by share in global GDP. Source: Markit; Berenberg calculations

Chart 5: Nominal GDP versus Fed funds rate



Year change in nominal GDP. Source: BLS, Fed

For 2012, further healing in the financial sector, more jobs and the likely absence of a new oil shock will probably underpin economic growth close to trend in the US and the major European economies, even if interest rates rise gradually and fiscal policy is tightened modestly further, as we expect.

Further healing

The more households and companies can put the havoc wrought by the financial crisis and the post-Lehman recession behind them, the greater are the prospects for resilient growth. In this respect, the situation is quite encouraging.

Encouraging progress

- Consumers have raised their savings rates from 2.1% in 2007 to 5.8% in 2010 in the US, from 2.0% in 2008 to 5.5% in late 2010 in the UK and from 10.3% in 2007 to 16% in mid-2010 in Spain. The shift from a rising to a stable or slightly falling savings rate of consumers in 2011 can allow the government sector to raise its own savings rate (well, to reduce its deficit, that is) without hurting aggregate demand much.
- Helped by more stable house prices and a rebound in equity markets, the **net worth of US households** has rebounded from a post-Lehman trough of \$48.8trn in Q1 2009 to \$56.8trn at the end of 2010. With a higher savings rate and a recovery in household net worth, the balance sheet repair of US households seems to be well advanced. Of course, it is not over yet. Net worth remains well below the peak of \$65.7trn in mid-2007. Adjusted for consumer price inflation, real net worth is still some 18% below its level at the top of the real estate boom.
- Although financial markets and banking systems are far from normal, we can find **little evidence of a crippling credit crunch**. We can largely explain the tepid rates of credit growth around much of the world by a dearth of credit demand, rather than an unusual restriction in credit supply. By and large, the massive monetary policy response to the post-Lehman recession and specific support mechanisms for various banking systems seem to have achieved their major purpose. With financing costs unusually low, banks can rebuild their balance sheets by asking for risk-adequate margins, without having to reduce credit to the real economy. In the euro zone, for instance, bank lending to households turned positive again in the spring of 2009, followed by lending to non-financial companies in the spring of 2010.
- Most importantly, companies and many households in the Western world have amassed **major reserves of liquidity** in the post-Lehman scramble for cash. This has reduced their dependence on bank credit. For example, the holdings of cash and overnight deposits of euro zone non-financial companies and households have surged by almost 25% since August 2008.

Consumers are saving more

Americans are becoming richer again

No credit crunch

Ample liquidity

For **fast-growing emerging markets** with a modest inflation problem, the obvious solution is to let their currencies appreciate. Since early June 2010, China has raised the exchange rate of the renminbi by 4.3% to the US dollar. We expect a further 5% gain in 2011. A stronger exchange rate would allow emerging markets to import more cheaply. This would dampen domestic inflation. It would also help producers from other countries to gain market shares. If so, the growth of US and European exports to these emerging markets may not lose much momentum, even if they have to constrain the growth of domestic demand somewhat.

Expect many emerging market currencies to drift up further

Key regions

US: a recovery with jobs

After a brief breather in mid-2010, the US economy accelerated again to a 3% pace in late 2010. Taken at face value, the surge in leading indicators in early 2011 points to a 4% gain in GDP in 2011. The impressive rebound in the US labour market with a 1.5% yoy rise in private payrolls in March will support consumer incomes.

Impressive rebound in employment

The **policy mix** favours further gains in GDP. US monetary policy remains very relaxed. As core inflation has edged up from 0.7% in late 2010 to 1.1% in February, monetary policy has become even more stimulative than before in real terms. However, the recent surge in oil prices is restraining the gains in real disposable income. It has started to weigh on consumer confidence. In addition, we expect President Obama and Congress to agree to a fiscal tightening for 2012 that will be slightly more ambitious than the net tightening of roughly 0.5% of GDP in 2011.

Favourable policy mix

The surge in leading indicators such as the ISM and the drag from higher oil prices roughly offset each other. We thus maintain our forecasts for 2.9% growth in 2011 and 2012, similar to the pace in 2010. By US standards, this is a muted upswing. Nevertheless, it is strong enough to underpin a gradual repair of private balance sheets. The risk of renewed US recession remains low.

But oil and balance sheet repair keeps the upswing muted by US standards

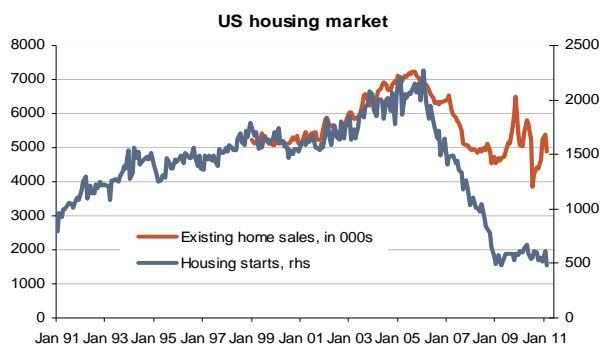
- Outside the strained **government finances**, there is no serious excess left in the US economy which might require a cleansing recession.
- **Residential construction** has fallen by 59% from its peak in late 2005 to a mere 2.4% of GDP in H2 2010. Even if the housing market, currently bouncing around at the bottom (Chart 6), were to turn south again, there is not much downside left to be a major drag on aggregate demand.
- **Inventories**, usually a key swing factor in the cycle, remain lean. So far, businesses have rebuilt only half of their inventory cuts in 2008 and 2009. There is little scope for a serious inventory correction.
- Households have saved raised their **savings rate** from 2.1% in 2007 to roughly 5.9% in early 2011 (Chart 7). Following the stabilisation of the labour and housing markets, they need to be less afraid of losing their job and their home than before. The shift from a rising to a largely stable savings rate is offsetting a major part of the fiscal stimulus removal.

Residential construction at rock bottom

No inventory overhang

Households are already saving more

Chart 6: US housing: the big fall is over



Monthly housing starts in 000s. Source: US Census

Chart 7: US savings rate



In % of disposable income. Source: BLS

China: on course for a soft landing

Judging by the results visible from afar, China has managed its economy rather well in the past 10 years. We look for more of the same in the foreseeable future. So far this year, China has continued to step gently on the brakes, cautiously raising interest rates and reserve requirements for banks. While some data (including retail sales) show that the economy is indeed losing momentum, there is no sign yet that Chinese growth could falter dramatically.

China is managing its economy well

We expect China to restrain its officially recorded rate of GDP growth from 10.3% in 2010 to 9.4% in 2011 and 8.7% in 2012. The annual rate of expansion has already moderated from 11.9% yoy in early 2010 to 9.8% in Q4. The key risk in any attempt to cool down demand growth is to not trigger a downward spiral that could lead to a hard instead of a soft landing. The rebound in the Chinese manufacturing PMI from a six-month low of 52.2 in February to 53.4 in March suggests that China is not stepping on the brakes too harshly.

Hard landing unlikely

China is often the focus of scare stories. Whether or not China may fall victim to a real estate boom-bust in some of its coastal cities, and whether a significant part of the state-directed credit expansion of the post-Lehman years may have been wasted, is difficult for outsiders to judge. But we take comfort from a number of facts.

A number of facts to ease the fears

- With **foreign exchange reserves** of \$2.8trn, the Chinese authorities could throw huge amounts of cash at any problem that may arise. As China has shown with its almost instant reaction to the Lehman crisis, it would not hesitate to do so if need be. We thus see little risk that any potential real estate or financial crisis could spiral out of control and cause a major and lasting downturn.
- Construction and **real estate prices** may – or may not – have gone up too fast and too far in parts of China. But with a population that is rapidly becoming richer and still flocking into the major cities, much of that extra real estate is likely to be needed within some years anyway.
- The bulk of the additional **credit-financed investment** seems to have gone into infrastructure projects. In China, most of the roads and railways will likely be needed in due course. This differs very much from Japan's state-directed construction spending in the 1990s, with the proverbial 'bridges to nowhere' that are unlikely ever to see much traffic.

China could afford a blunder if need be

The flats may well be needed in the future

Bridges to nowhere? Probably not

China itself is changing. As ever more Chinese escape abject poverty and join the urban middle classes, consumption is likely to gradually complement investment and exports as a driver of demand growth. Adjusted for inflation, Chinese retail sales have expanded at rates of 15% or more since 2007 (although the numbers are distorted by some state purchases). The stronger domestic dynamic has contributed to China's resilience during the post-Lehman recession. **China's expanding domestic market** looks set to offer excellent prospects for Western exporters for years to come, even if the overall pace of Chinese GDP growth moderates slightly.

The mega-trend: the rise of the Chinese consumer

Euro zone: a core story

Although the sovereign debt crisis continues to haunt the fiscally-challenged euro zone periphery, European policy makers have managed to contain the crisis rather well. 15 months after the Greek crisis triggered a near-panic in global markets, core Europe continues to enjoy a remarkable economic recovery. Thanks to some further policy initiatives, notably the agreement on broad outlines of a permanent European support mechanism for repentant fiscal sinners at the two EU summits in March 2011, tensions have eased somewhat. Whereas Portugal finally had to ask for help on 6 April, the fact that it managed to postpone this day of reckoning can count as an achievement. More importantly, the combination of European initiatives and domestic reforms has allowed Spain to move away from the brink, at least for now.

Gaining momentum during the peripheral debt crisis

The fact that the euro zone has defied widespread market expectations of an escalating crisis in early 2011 has supported a 6% gain in the euro against the US dollar so far this year.

Stronger euro

In the wake of the **Great Debt Crisis**, the euro zone enjoys a number of fundamental advantages over the US and the UK. While much of the US and the UK had gone through a **credit-fuelled real estate boom** that ended in a bad bust, only small parts of the euro zone (notably Spain and Ireland) had suffered the same fate. The major economy of the euro zone, **Germany**, has successfully emerged from its own austerity and reform drive that lasted from 2003 to 2007.

Solid fundamentals

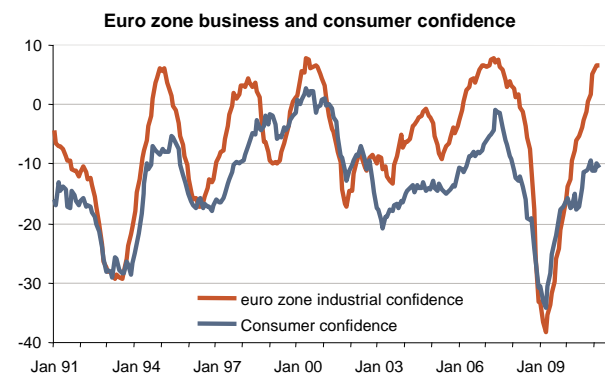
As a result, the euro zone has less need for private and public austerity than the US and the UK. Due to the region's better starting position, euro zone consumers have to be less afraid of fiscal tightening than consumers in the US and the UK.

Less need for austerity

After a further surge in January and February, leading indicators for the euro zone have started to recede slightly in March. However, they still point to growth significantly above the 1.8% trend rate of the euro zone (Chart 8). While industrial confidence is holding up very well, the 'double whammy' of high oil prices and concerns about the nuclear accident in Japan is weighing on consumer sentiment. The readiness to make major purchases fell back from a comparatively healthy -10.7 in February to a seven-month low of -15.7 in March, according to the EU Commission's monthly sentiment survey.

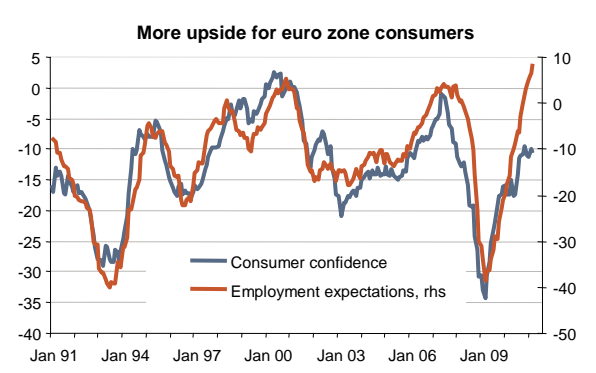
Leading indicators are starting to recede

Chart 8: Industrial confidence is at a peak



Source: EU Commission survey

Chart 9: Consumer confidence lags behind



Data are for euro zone. Source: EU Commission survey

Despite significant austerity in parts of the euro zone (Spain, Greece, Ireland, and Portugal, which account for 18% of euro zone GDP), the gains in Germany (26% of euro zone GDP) and some of its immediate neighbours, such as Austria, will likely underpin some increase in **euro zone consumer spending**.

Buoyant employment expectations versus a drag from high oil prices

As a result of the spike in oil prices, we have downgraded our forecast for euro zone consumption growth this year from 1.0% to 0.8%. While we do acknowledge some further downside risks, we see no reason to become very pessimistic. Most importantly, the labour market in the euro zone has started to turn the corner. Helped by strong gains in Germany and France and a lessening crisis in Spain, the number of unemployed fell for a fourth month in a row in February. **Employment expectations** have also soared in the euro zone as a whole (see Chart 9).

Less consumption growth, more exports

In line with the pattern we project for the world at large, euro zone growth looks set to lose momentum in spring 2011. As the effects of higher oil prices wane and the problem regions of the euro zone – notably Spain, Ireland, Greece and Portugal – hit bottom in early 2011 and return to at least some tepid growth later in 2011, the overall euro zone will probably pick up speed thereafter towards a growth rate of roughly 2% in late 2011 and in 2012.

Expect growth to lose some momentum this spring

Table 2: Euro zone economic forecasts

		2009	2010	2011	2012	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
GDP	% q/q	-4.0	1.7	1.7	2.1	0.4	1.0	0.3	0.3	0.6	0.3	0.3	0.5	0.6	0.5	0.5	0.5
	%q/q ann.					1.6	4.0	1.4	1.1	2.3	1.2	1.3	2.1	2.4	2.2	2.2	2.2
Private Consumption	% y/y	-4.0	1.7	1.7	2.1	0.8	2.0	1.9	2.0	2.2	1.5	1.5	1.7	1.8	2.0	2.2	2.2
	% q/q					0.4	0.2	0.1	0.4	0.2	0.1	0.1	0.3	0.4	0.4	0.4	0.4
Government Consumption	% y/y	-1.1	0.7	0.8	1.3	0.4	0.6	0.9	1.1	0.9	0.9	0.8	0.7	0.9	1.2	1.5	1.6
	% q/q					0.0	0.2	0.4	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Investment	% y/y	2.5	0.7	0.9	1.1	1.1	0.6	0.6	0.7	0.9	0.9	0.7	0.9	1.0	1.1	1.2	1.2
	% q/q					-0.2	2.1	-0.1	-0.6	1.4	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Final Dom Dd ¹	% q/q	-11.3	-0.8	2.8	3.3	-4.6	-0.3	0.7	1.2	2.7	1.6	2.6	4.1	3.4	3.2	3.2	3.2
	% y/y					0.2	0.5	0.1	0.1	0.4	0.3	0.3	0.4	0.5	0.5	0.5	0.5
Net exports ¹	% q/q	-2.6	0.4	1.2	1.7	-0.5	0.4	0.8	1.0	1.3	1.0	1.2	1.4	1.4	1.6	1.8	1.9
	% y/y					1.3	0.8	0.8	0.7	0.9	0.7	0.4	0.1	0.1	0.2	0.2	0.1
Stockbuilding ¹	% q/q	-0.8	0.9	0.5	0.2	0.4	0.3	-0.2	-0.2	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1
	% y/y					0.0	0.8	0.3	0.3	0.0	-0.3	-0.1	0.2	0.2	0.3	0.3	0.3
Current Account Balance	EUR bn	-51.4	-56.4	-61.4	-61.4	-1.9	-6.7	-14.4	-33.4	-5.9	-7.7	-14.4	-33.4	-5.9	-7.7	-14.4	-33.4
	% of GDP	-0.6	-0.6	-0.6	-0.6												
Industrial production ²	% q/q					2.3	2.4	0.8	0.6	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.7
	% y/y	-14.8	7.1	5.0	3.3	4.6	9.0	7.1	7.6	6.4	4.9	4.7	4.0	3.6	3.4	3.2	3.1
Unemployment rate ³	%	9.5	10.0	9.9	9.4	9.9	10.0	10.0	10.1	10.0	9.9	9.8	9.7	9.6	9.5	9.3	9.2
CPI ⁴	% y/y	0.3	1.6	2.5	2.2	1.1	1.6	1.7	2.0	2.4	2.6	2.4	2.4	2.3	2.2	2.2	2.2
General govt balance	% of GDP	-6.3	-6.5	-4.4	-2.1												
General govt debt	% of GDP	79.2	83.5	87.0	85.8												
Refinancing rate ⁵	%	1.00	1.00	1.50	2.50	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.25	2.50

¹ Contribution to GDP growth ² Ex construction, s.a., quarterly averages ³ ILO measure, period averages, s.a. ⁴ Period averages, (5) end of period m/m changes are quarterly averages;

Source: Eurostat; ECB; Berenberg estimates from Q1 2011 onwards

The UK: intelligent austerity

The UK economy contracted by 0.5% in Q4 2010. Although the drop itself can be largely blamed on unusually harsh weather, growth apparently stalled late last year even if we exclude the winter effect. First data for early 2011 suggest that the economy recovered some of the weather-related losses: for example, retail sales in January rose by 1.1% in real terms despite higher sales taxes. However, the underlying growth trajectory stayed sluggish. In February, retail sales fell back by 1% to just a tad above their dismal December level.

The UK is facing two inter-related economic challenges this year.

1. The government is tightening fiscal policy aggressively. The VAT rate already went up from 17.5% to 20.0% in January 2011, followed by some further tax hikes in early April. In addition, the government is largely sticking to its plan to slash the spending of most government departments by almost 20% over four years. For 2011, the fiscal hit will be close to 1.5% of UK GDP. This will weigh on demand.
2. As higher taxes and spending cuts hit households, the housing market may temporarily weaken again. A modest drop in house prices in early 2011 could – in turn – weigh on consumer spending.

However, the outlook is far from bleak. The UK has chosen intelligent austerity. It is combining major cuts in government spending with some pro-growth structural reforms, notably with a small cut in corporate taxes and a major clampdown on unwarranted incapacity benefits for able-bodied workers. This could raise the labour supply. Such smart austerity tends to promote business confidence, business investment and job creation over time. Also, the return of fiscal policy to prudence after 12 years of excessive growth in government spending is hardly a surprise. Instead, the turn to prudent fiscal policies may well have a positive confidence effect over time. At least consumers now know what pain lies ahead – and that fiscal policy has finally returned to a more sustainable path.

In addition, the BoE is doing its utmost to cushion the fiscal hit by maintaining an extremely relaxed monetary policy. Although headline inflation is running at rates above 4%, with higher sales taxes contributing about 1% point to that, the BoE has so far kept its main policy rate at a mere 0.5%.

With good governance, a flexible economy and London's global draw, the UK remains a magnet for wealthy foreigners and their capital. Inflows of foreign capital into London are likely to support the housing market once again.

The UK also benefits from an exchange rate that remains modestly undervalued. Although its manufacturing sector is small, contributing around 13% to GDP, a strong bounce in this highly cyclical sector can make a difference for the economy as a whole. In line with a robust outlook for global industry, the Purchasing Managers' Index for UK manufacturing rose to an average of 59.8 in Q1 2011, well above the 57.2 registered in Q4 2010, despite some slippage in February and March after a record reading for January.

We still expect the UK economy to expand by 1.5% in 2011, slightly below the 1.6% forecast we made at the end of last year. Exports and business investment are likely to turn into major drivers of growth, with household consumption staying muted in the wake of the 'double whammy' from higher oil prices and higher taxes. For 2012, we continue to look for solid growth of 2.4%.

The UK managed to maintain the confidence of debt markets in 2011

A major fiscal hit...

...and a wobbly housing market

Intelligent austerity can contain the pain

BoE tolerates major inflation overshoot

A magnet for money

A modestly undervalued exchange rate helps

1.5% growth in 2011 still achievable

Inflation: edging up

The further surge in oil prices so far this year has fuelled concerns about more general inflation risks. Headline rates of inflation have risen sharply, for instance from 1.1% last November to 2.1% this February in the US (Chart 10) and from 3.3% to 4.4% in the UK. The euro zone recorded an increase from 1.9% to 2.6% between November and March (Chart 11).

Oil pushes up the price level

Core rates of inflation excluding energy and food have not moved much yet, either stabilising around 1% in the euro zone or moving up slightly from 0.8% to 1.1% in the US between November 2010 and February 2011.

But core inflation is still well-behaved

Inflation will likely advance modestly further in coming months. For instance, higher energy costs will make transport services more expensive. This will show up in a stronger core CPI. In addition, the surge in producer prices (up 5.6% year-on-year in the US and 6.6% in the euro zone) points to additional pipeline pressure, even if the rise largely reflects higher raw material costs. In a global economic recovery, producers will be able to pass some of their cost increases on to final consumers.

Inflation likely to rise further in coming months

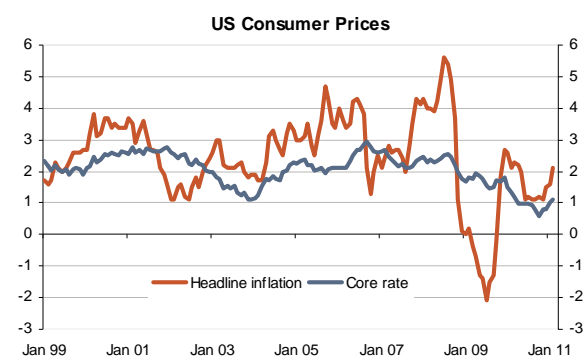
Nonetheless, inflation is unlikely to turn into a sustained problem for the Western world. Contrary to an overly simplistic version of monetarism, injections of central bank liquidity into banks and the financial system do not always cause inflation. They only become inflationary if and when the banks pass the liquidity on to households and companies – that is, if and when the ample liquidity in the banking system spills over into rapid growth in the supply of money circulating in the real economy. So far, this is not the case. Of course, if the financial healing process continues and central banks do not scale back their liquidity injections in time, it may possibly happen in 2012 or 2013.

No monetary overhang

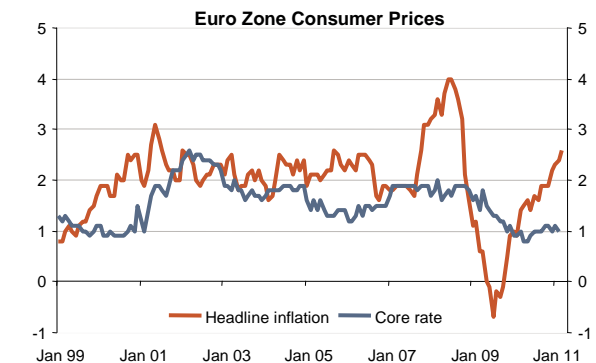
It takes a major sustained surge in final demand, a huge increase in domestic production costs and/or a massive jump in inflation expectations to raise core inflation rates to 3% or more. As US and UK households still reel under the impact of the real estate and debt crisis, they are unlikely to embark on any inflationary spending spree any time soon. Taken together, US and UK consumers account for almost half of all private consumption in the Western world. Anglo-American balance sheet repair makes it very unlikely that overall consumer demand in the Western world could really take off.

In the age of prudence, inflation risks remain limited

Chart 10: Headline versus core inflation in the US... Chart 11 ...and the euro zone



Yoy change in %. Source: BEA



Yoy change in %. Source: Eurostat

Wage growth also poses no serious threat. In the US, compensation growth in the private sector slowed to 1.9% yoy in 2010, down from 3.4% in 2007. Although unemployment has fallen from a peak of 10% to 8.8%, it is still high enough to prevent a major acceleration in wage inflation to rates beyond 3% within the next 12 months.

Wage inflation under control

In the euro zone, labour costs rose at a 1.25% rate in H2 2010, also well below the last cyclical peak of 3.3% in 2008. While wage inflation has started to pick up towards 2.5% in Germany in response to the major decline in unemployment, it will probably stay subdued almost everywhere else in the region.

German wage inflation is rising – but from a low basis

German core inflation (0.8% yoy in February) will probably rise to the rate prevailing in the euro zone outside Germany (1.0%) soon and edge up modestly further thereafter. But the growth outlook for Germany, or the euro zone as a whole, is not so extraordinarily strong as to project a disruptive surge in core inflation. Instead, we expect a modest rise in euro zone core inflation, to 1.7% by the end of 2011.

A modest increase in core inflation

Some further rise in raw material prices could keep headline inflation well above the core rate. However, raw materials are already expensive. Further increases in raw material prices are likely to remain more modest than they were from early 2007 to mid-2008 when oil prices had risen by almost 150%. The resulting surge in euro zone headline inflation to a 4% peak in mid-2008 is unlikely to be repeated in the foreseeable future.

Oil prices may rise, but hardly by 150%

Of the major Western countries, only the UK has a noticeable inflation problem. Except for a brief period in late 2009, UK inflation has exceeded the BoE's 2% target since late 2007. While UK headline inflation accelerated to 4.4% in February 2011, the core rate excluding food and energy of 2.8% also exceeded the euro zone rate by almost 2% points.

The UK problem...

We see three reasons why prices are rising much faster in the UK than on the Continent.

1. The increases in UK VAT in early 2010 and early 2011 are adding about 1% point to the UK rate.
2. The UK is importing some inflation. Whereas sterling is still modestly undervalued, the euro is slightly overvalued.
3. Wage inflation in the euro zone is still more subdued than in the UK, largely because labour markets in core Europe (notably Germany) react only with a lag to the economic upturn.

...has three major dimensions...

The inflation gap across the Channel could stay high throughout 2011. But once the UK's January 2011 VAT hike drops out of the annual inflation rate – and in line with a gradual pick-up in German wage inflation – the gap between the UK and the euro zone looks set to narrow substantially in 2012, probably with inflation rates of 2.2% for the euro zone and 2.9% for the UK.

...but may ease in 2012

Central banks: ECB first, Fed to follow

In the wake of the Great Debt Crisis, central banks in the Western world are still running an exceptionally loose monetary policy. In those countries where households and governments have serious balance sheet repair to do, central banks are inclined to generously offset the resulting drag on aggregate demand by staying loose for longer. However, the ongoing economic recovery and the oil-driven surge in headline inflation have raised concerns that inflation expectations could become unhinged. We expect the **US Fed to terminate** its bond purchase programme (QE2) in June and to start raising rates in December, two months earlier than we had projected at the end of 2010. In the wake of the recent natural disaster, the **Bank of Japan (BoJ)** will probably delay any rate increase until early 2012.

The end of exceptionally loose monetary policy...

For the **ECB**, we now expect three instead of two 25bps moves this year (see Chart 11). Whereas the ECB will probably reform its emergency lending programme to struggling banks in the euro zone periphery and terminate the full allocation of its three-month liquidity operations in mid-2011, the ECB may continue the full allocation of funds for its one-week tenders well into H2 2011. The ECB is drawing a clear distinction between its overall rate policy geared towards the needs of the euro zone economy as a whole and specific policies to prevent a series of regional banking crises.

...is drawing closer

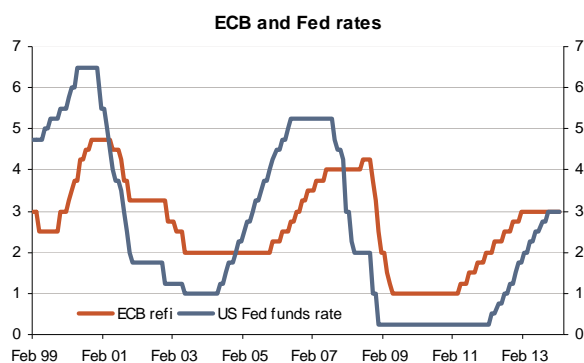
The **BoE** is facing a tough choice. Due to an undervalued currency and a VAT hike, UK inflation has exceeded the Bank's tolerance threshold of 3% since the beginning of 2010. However, the desire to offset the fiscal drag and the fragility of the housing market argue against rate hikes now. We expect the BoE rate-setters to wait for a bit more evidence that the economy is coping with the fiscal hit before they back away from their ultra-accommodative stance. If leading economic indicators hold up in the wake of the recent oil price surge, the first rate hike could come as early as May 2011. This is our main scenario. Otherwise, the BoE may wait until August.

A tough choice for the BoE

Some of the smaller, fast-growing economies of Europe, notably **Switzerland**, **Sweden** and oil-rich **Norway**, will probably normalise their monetary policy stance (further) over the remainder of this year, with the SNB likely to move in June if the exchange rate to the euro recedes somewhat further, as we project.

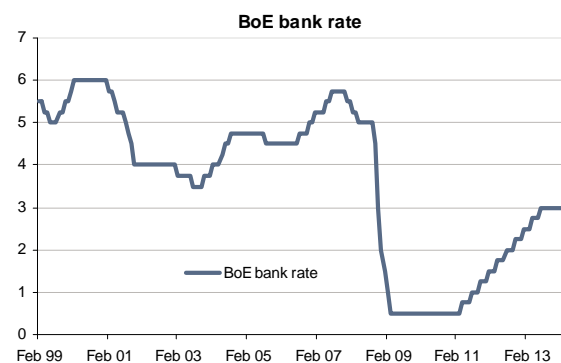
SNB to hike in June if CHF normalises further

Chart 12: Headline versus core inflation in the US...



Source: Fed, ECB, Berenberg forecasts from April 2011 onwards

Chart 13 ...and the euro zone



Source: BoE, Berenberg forecasts from April 2011 onwards

Market outlook: no news is good news

In our year-ahead outlook (*The rock'n'roll recovery*, 6 January 2011), we argued that a lack of truly bad macro news would be good news for markets. We have had no reason to change that view. By and large, markets have lived up to our expectations. Amid considerable volatility, equity markets and bond yields have drifted up.

The fear factor...

Markets are still prone to major bouts of volatility. The Lehman disaster has struck fear into them. Whenever problems arise, such as the fiscal travails of Greece or some renewed wobbling in the US housing market, investors seem to worry that a new Lehman-style catastrophe is on the cards. The surge in oil prices and the triple catastrophe that hit Japan in March have once again accentuated the concerns. As a result, risk aversion still seems to be elevated in Western markets, with low yields for top-quality government bonds and modest equity market valuations.

..should weigh less on markets over the course of this year

Our main economic forecast for 2011 and 2012 remains that none of the great calamities that markets are worrying about will in fact materialise: the US will not fall into a double dip; the euro will not break up; China will not be brought down by a real estate bust; the world will not revert to the disruptive trade or currency wars of the 1930s. Hopefully, Japan's nuclear crisis will not escalate and the rebellion in Arab countries against autocratic rulers will not turn into such a protracted civil war in major oil-producing countries that the flow of oil could be seriously disrupted.

Keeping our fingers crossed that none of the great calamities will materialise

If the global healing process continues and the worst fears of investors do not come true, risk aversion and the preference for safe havens should gradually recede over the remainder of 2011. Amid considerable volatility, we project a continuing rebound in global equity markets and some increase in government bond yields. In short, we expect more of the same trends that we already observed in the first three months of the year.

But markets may still be volatile

Sovereign bond markets: a rocky ride

As expected, sovereign bond markets had a rocky start in 2011. Amid considerable volatility, bond yields have rebounded further. With the ECB pre-announcing a first rate hike for April, the increase has been more pronounced for Germany than for the US and the UK (see table with key market forecasts on page 19).

A rocky year for government bonds

Relative to the pace of nominal GDP growth in major economies, benchmark bond yields are far too low. In Q4 2010, nominal GDP rose at annual rates of 4.2% in the US and the UK and 3.0% in the euro zone. Still, 10-year benchmark bonds yielded merely 3.5% in the US, 3.4% in Germany and 3.8% in the UK on 5 April 2011. Normally, 10-year bond yields should be somewhat above the pace of nominal GDP growth, especially at a time of rapidly rising supply of sovereign bonds.

The reasons for low yields...

A number of factors have limited the rebound in sovereign bond yields for the major Western countries.

...are going away

- Scarred by the post-Lehman crisis, global investors remain somewhat risk-averse, preferring safe havens over more risky investments.
- The European debt crisis has shifted bond demand towards the major markets deemed to be less risky.
- The US Fed is still purchasing US Treasury bonds.
- As China and the oil countries continue to run major external surpluses, their need to put these reserves to some use adds to global demand for sovereign bonds.

If our economic scenario unfolds, bond yields should rise significantly further over the course of the year. If none of the major calamities that markets are concerned about really materialise, risk aversion and the preference for safe havens should recede somewhat over time. In addition, the Fed will have no need to extend its programme to buy government bonds. Resilient Chinese consumer demand and some rise in the Chinese exchange rate will eventually dent into the Chinese current account surplus. Over time, China may have less reserve inflow and thus less need to buy ever more bonds.

Expect higher bond yields

As a result, we project a rise in 10-year bond yields to 3.9% in the US, 3.7% in the euro zone and 4.1% in the UK by the end of 2011. Our targets are now slightly above those which we published three months ago.

As before, there are at least two 'wild cards' in play this year. If Europe were to let its peripheral debt crisis spiral out of control, global investors could flock into safe havens in droves. This would raise demand for US Treasuries and (probably to a much smaller extent) for German Bunds as well. However, there is also a small risk that global bond vigilantes may focus on the US, the one major economy which has not even started to tackle its post-Lehman blow-out in budget deficits in earnest. If so, US bond yields could rise much faster than we project. Higher financing costs and pressure on the US authorities to react with forceful fiscal tightening one year ahead of the US presidential election in 2012 could make for noisy market turbulence and a significant hit to US growth and global equity markets.

Two 'wild cards': European debt crisis and US bond vigilantes

Equity markets: still constructive

With the obvious exception of Japan, the major equity markets in the Western world have managed to eke out a nice gain over the course of Q1, despite a sharp, Japan-induced setback in late March. Relative to the targets we published at the start of the year, US markets have performed better than Europe in absolute terms. But if we adjust the 7.4% gain in the Dow Jones for the 6.3% drop in the US dollar (as of 5 April 2011), the 1.1% rise in the US market in euro terms looks puny relative to the 5.7% advance in the Eurostoxx 50.

Who is ahead, US or Europe?

Within Europe, the absence of a new wave of the European debt crisis has allowed some of the euro zone peripheral markets such as Spain (+8.3% year-to-date on 5 April 2011) to outperform Germany (+3.8%). The major change to the scenario we laid out at the beginning of the year is that the unexpectedly high oil prices look set to restrain the upside for core European consumption and thus for domestically oriented providers of consumer goods and services by more than we had originally expected.

Lucky Spain

Our overall economic outlook remains constructive for equity markets. While earnings growth in Western countries and in many emerging markets could slow down significantly over the remainder of 2011, receding risk aversion should underpin further flows of funds into global equities. In many cases, multiples could expand.

Earnings and multiples

Last year, US and German equities and many emerging markets (except China) performed rather well, often with a bias on cyclical sectors. The fundamental arguments for these regions and cyclicals remains strong. We expect the global cyclical recovery to continue. We look for decent growth of 2.9% in the US and 2.8% in Germany. Although some emerging markets (led by China) will need to step on the brakes further, they will likely do so gently enough not to derail their economic recoveries. More importantly, the long-term case for stronger emerging markets is fully intact.

Emerging markets: short-term caution, long-term upside

However, the cyclical upswing is maturing over time: the prospect of higher bond yields and central bank rate hikes to come could be a drag on the performance of cyclicals. We would thus gradually shift the investment focus to regions and sectors that have not yet been very popular in 2010 and early 2011.

A maturing cycle

In Europe, Germany remains a good bet. But the story of the German rebound, which played out nicely in late 2010, is no longer new. Other European countries, which are following the German example of prudence and reform, may have more potential to spring positive surprises. For instance, this is an argument for increased exposure to the UK .

The German rebound is no longer a new story

If Europe keeps its debt crisis under control – still a quite significant ‘if’ – selected financials and selected peripheral countries may continue to perform rather well in the remainder of 2011.

Watch financials

But we are still living in the wake of the worst financial crisis in almost eight decades. Investors remain very nervous. Small disturbances can suffice to cause major market moves. All in all, equity investors probably have to brace themselves for a rocky ride in the months to come – although we expect markets to end up well above their current level at the end of the year.

Bouts of volatility

Foreign exchange markets

Despite some disturbing rhetoric in late 2010, no genuine ‘**currency war**’ has erupted in early 2011. Instead, China has steered its exchange rate to the US dollar up by a further 1% so far this year, slightly below the quarterly gains of 1.5% that we had projected for each quarter of 2011. We look for more of the same for the remainder of this year, possibly with a slightly faster pace of yuan appreciation over time.

No genuine currency war

Euro: In our year-ahead outlook, we had expected the euro to oscillate around the \$1.30-1.35 per euro range over the course of 2011, with pronounced swings but no clear trend and a year-end target of \$1.35. However, fading concerns about the Euro debt crisis and the prospect of an ECB rate hike in April have pushed the euro to \$1.42 instead. For the remainder of the year, we see no clear trend. As we expect the US Fed to terminate its bond purchase programme (QE2) in mid-2011 and to start raising rates in December, the interest rate differential should not drive down the Greenback much beyond the current level. We have adjusted our end-2011 target for the exchange rate between the two dominant economic regions of the world from \$1.35 to \$1.42 per euro.

Euro volatility around the current level

Sterling: Concerns about the impact of the UK’s harsh austerity measures on its economy could drag down sterling in early 2011. But the fiscal tightening is hardly a surprise. Unless the economy were to nosedive unexpectedly, the market reaction should be very limited. Over time, we expect the UK economy to pick up speed again, leading to a first BoE rate hike possibly as early as May 2011. If the UK indeed weathers austerity well, helped by stronger exports and more business investment, sterling could appreciate modestly against the euro and the US dollar in 2011.

Sterling can strengthen later in 2011

Yen: Japan’s currency is often driven by the swings in Japanese risk preference. Japanese households are big savers and the country is running a major current account surplus, earning investible resources in the process. If Japanese investors are eager to hunt for extra returns abroad, the yen weakens. But if Japanese savers are risk-averse and prefer to invest in their low-yielding home market instead, the yen strengthens. In the wake of the triple disaster that hit Japan in mid-March, the yen briefly surged until a G7 intervention put an end to this. We expect the preference for safe havens to lessen over the course of 2011. This could more than offset the possible repatriation of some assets into Japan to fund the post-disaster reconstruction efforts. If so, the yen should become less overvalued. We still predict a depreciation of the yen from 84 to 90 yen per US dollar by the end of 2011.

Less risk aversion = less overvalued yen

Swiss Franc: Even more so than the yen, the currency of small Switzerland reflects global demand for safe havens. If the euro zone manages once again to contain its debt crisis and if global risk aversion recedes, the CHF should weaken to the 1.40-1.45 range to the euro over the course of 2011.

CHF to return to more normal levels – if the euro zone contains its debt crisis

Key market forecasts

	End-2010	5 April 2011	Forecast for End-2011*
Central bank rates			
US Fed	0.0%-0.25%	0.0%-0.25%	0.5% (0.25%)
ECB	1.0%	1.0%	1.75% (1.5%)
BoJ	0.1%	0.1%	0.1%
BoE	0.5%	0.5%	1.25% (1.0%)
SNB	0.25%	0.25%	1.0% (0.75%)
10-year bond yields			
US	3.29%	3.46%	3.9%
Germany	2.85%	3.39%	3.7% (3.6%)
UK	3.42%	3.77%	4.1% (4.0%)
Currencies			
USD-EUR	1,32	1.42	1.42 (1.35)
USD-GBP	1,56	1.62	1,70 (1.65)
USD-JPY	82,2	84.4	90.0
EUR-CHF	1,26	1.31	1.42
Equities			
S&P 500	1270	1336	1370 (1330)
Eurostoxx 50	2797	2951	3100 (3000)
DAX	6860	7175	7500
Raw materials			
Oil (Brent)	92	122	115 (95)
Gold	1381	1449	1450

*In brackets: forecast made at the end of 2010, if different. Source: Bloomberg; Berenberg forecasts

Disclaimer

This document was compiled by the above mentioned authors of the economics department of Joh. Berenberg, Gossler & Co. KG, Berenberg Bank. Berenberg has made any effort to carefully research and process all information. The information has been obtained from sources which we believe to be reliable such as, for example, Thomson Reuters, Bloomberg and the relevant specialised press. However, we do not assume liability for the correctness and completeness of all information given. The provided information has not been checked by a third party, especially an independent auditing firm. We explicitly point to the stated date of preparation. The information given can become incorrect due to passage of time and/or as a result of legal, political, economic or other changes. We do not assume responsibility to indicate such changes and/or to publish an updated document. The forecasts contained in this document or other statements on rates of return, capital gains or other accession are the personal opinion of the author and we do not assume liability for the realisation of these.

This document is only for information purposes. It does not constitute a financial analysis within the meaning of § 34b or § 31 Subs. 2 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. It does not replace consulting regarding legal, tax or financial matters.

© Joh. Berenberg, Gossler & Co. KG, January 2011

Reprinting, reproduction – also partly – as well as the circulation of this document are subject to our explicit, written permit.

Remarks regarding foreign investors

The preparation of this document is subject to regulation by German law. The distribution of this document in other jurisdictions may be restricted by law, and persons, into whose possession this document comes, should inform themselves about, and observe, any such restrictions.

United Kingdom

This document is meant exclusively for institutional investors and market professionals, but not for private customers. It is not for distribution to or the use of private investors or private customers.

Contacts: Investment Banking

Equity Research

AUTOMOTIVE

David Cramer	+44 (0) 20 3207 7887
Mark Mackenzie	+44 (0) 20 3207 7861
Alay Patel	+44 (0) 20 3207 7821

BANKS

Nick Anderson	+44 (0) 20 3207 7838
Pedro Fonseca	+44 (0) 20 3207 7930
Thomas Faeh	+44 (0) 20 3207 7915
Alex Potter	+44 (0) 20 3207 7919

BUSINESS SERVICES

William Foggon	+44 (0) 20 3207 7882
Konrad Zomer	+44 (0) 20 3207 7920

CAPITAL GOODS

Simon Goetschmann	+44 (0) 20 3207 7856
Stephan Klepp	+44 (0) 20 3207 7884
William Mackie	+44 (0) 20 3207 7837
Margaret Paxton	+44 (0) 20 3207 7934
Dominik Podewils-Duerniz	+44 (0) 20 3207 7854

CHEMICALS

Jaideep Pandya	+44 (0) 20 3207 7890
----------------	----------------------

CHIEF ECONOMIST

Dr. Holger Schmieding	+44 (0) 20 3207 7889
-----------------------	----------------------

CONSTRUCTION

Robert Muir	+44 (0) 20 3207 7860
-------------	----------------------

DIVERSIFIED FINANCIALS

Richard Perrott	+44 (0) 20 3207 7925
-----------------	----------------------

Sales

Specialist Sales

CONSUMER GOODS

Alix Turner	+44 (0) 20 3207 7817
-------------	----------------------

FINANCIALS

Philip Pickard	+44 (0) 20 3207 7828
----------------	----------------------

HEALTHCARE

Frazer Hall	+44 (0) 20 3207 7875
Andrew Holder	+44 (0) 20 3207 7815

Sales

LONDON

John von Berenberg-Consbruch	+44 (0) 20 3207 7805
Matt Chawner	+44 (0) 20 3207 7847
Simon Chisholm	+44 (0) 20 3207 7801
Jeremy Gardiner	+44 (0) 20 3207 7808
Ben Hutton	+44 (0) 20 3207 7804
Andrew McNally	+44 (0) 20 3207 7802
David Mortlock	+44 (0) 20 3207 7850
Peter Nichols	+44 (0) 20 3207 7810
Kieran O'Sullivan (US)	+44 (0) 20 3207 7803
Max von Doetinchem	+44 (0) 20 3207 7826

ZURICH

Stephan Hofer	+41 (0) 44 283 2029
Carsten Kinder	+41 (0) 44 283 2024
Gianni Lavigna	+41 (0) 44 283 2038
Benjamin Stillfried	+41 (0) 44 283 2033

FOOD & BEVERAGE

Jafar Alam	+44 (0) 20 3207 7827
Philip Morrissey	+44 (0) 20 3207 7892
Anna Patrice	+44 (0) 20 3207 7863
James Targett	+44 (0) 20 3207 7873

FOOD RETAIL

Arnaud Cavigioli	+44 (0) 20 3207 7848
Niamh McSherry	+44 (0) 20 3207 7836

HEALTHCARE

Scott Bardo	+44 (0) 20 3207 7869
Alistair Campbell	+44 (0) 20 3207 7876
James Harvey	+44 (0) 20 3207 7885
Adrian Howd	+44 (0) 20 3207 7874
Tom Jones	+44 (0) 20 3207 7877

INSURANCE

Michael Broom	+44 (0) 20 3207 7872
Tom Carstairs	+44 (0) 20 3207 7823
Peter Eliot	+44 (0) 20 3207 7880
Trevor Moss	+44 (0) 20 3207 7893
Sami Taipalus	+44 (0) 20 3207 7866

LUXURY GOODS

Seth Peterson	+44 (0) 20 3207 7891
---------------	----------------------

MEDIA

Jonathan Helliwell	+44 (0) 20 3207 7865
Sarah Simon	+44 (0) 20 3207 7830

MID-CAP CONSUMER

Anna Patrice	+44 (0) 20 3207 7863
Trion Reid	+44 (0) 20 3207 7881

INDUSTRIALS

Chris Armstrong	+44 (0) 20 3207 7809
-----------------	----------------------

INSURANCE

Matthew Wright	+44 (0) 20 3207 7807
----------------	----------------------

TECHNOLOGY & MEDIA

Daegal Tsang	+44 (0) 20 3207 7822
--------------	----------------------

HAMBURG / FRANKFURT

André Grosskurth	+49 (0) 40 350 60 584
Susette Mantzel	+49 (0) 40 350 60 694
Marco Weiss	+49 (0) 40 350 60 719

PARIS

Christophe Choquart	+33 (0) 1 5844 9508
Arnaud Doré	+33 (0) 1 5844 9511
Dalila Farigoule	+33 (0) 1 5844 9510
Edouard Landau	+33 (0) 1 5844 9513
Olivier Thibert	+33 (0) 1 5844 9512

CRM

LONDON

Greg Swallow	+44 (0) 20 3207 7833
Sophy Mills	+44 (0) 20 3207 7834
Sandra Bode	+49 (0) 40 350 60 459

MID-CAP GENERAL

Gunnar Cohrs	+44 (0) 20 3207 7894
Benjamin Glaeser	+44 (0) 20 3207 7918
Bjoern Lippe	+44 (0) 20 3207 7845
Alexandra Roche	+44 (0) 20 3207 7879
Alexandra Schlegel	+44 (0) 20 3207 7896

OIL & GAS

Neill Morton	+44 (0) 20 3207 7812
--------------	----------------------

REAL ESTATE

Kai Klose	+44 (0) 20 3207 7888
Estelle Weingrod	+44 (0) 20 3207 7931

STEEL

John Philipp Klein	+44 (0) 20 3207 7895
--------------------	----------------------

SUSTAINABLES

Lars Dannenberg	+44 (0) 20 3207 7855
-----------------	----------------------

TECHNOLOGY

Adnaan Ahmad	+44 (0) 20 3207 7851
Jean Beaubois	+44 (0) 20 3207 7835
Ali Khwaja	+44 (0) 20 3207 7852
Zhancheng Li	+44 (0) 20 3207 7853

TELECOMMUNICATIONS

Wassil El Hebil	+44 (0) 20 3207 7862
Usman Ghazi	+44 (0) 20 3207 7824
Stuart Gordon	+44 (0) 20 3207 7858
Paul Marsch	+44 (0) 20 3207 7857
Barry Zeitoune	+44 (0) 20 3207 7859

TOBACCO & HPC

Erik Bloomquist	+44 (0) 20 3207 7870
-----------------	----------------------

UTILITIES

Benita Barretto	+44 (0) 20 3207 7829
Ana Gaspar	+44 (0) 20 3207 7814

TELECOMMUNICATIONS

Mandeep Singh	+44 (0) 20 3207 7816
---------------	----------------------

UTILITIES

Kader Hydra	+44 (0) 20 3207 7818
-------------	----------------------

Sales Trading

HAMBURG

Nils Carstens	+49 (0) 40 350 60 563
Oliver Garbe	+49 (0) 40 350 60 358
Fin Schaffer	+49 (0) 40 350 60 596
Hanns-Christian von Schuler	+49 (0) 40 350 60 761
Lars Schwartzau	+49 (0) 40 350 60 450
Tim Storm	+49 (0) 40 350 60 415
Philipp Wiechmann	+49 (0) 40 350 60 346

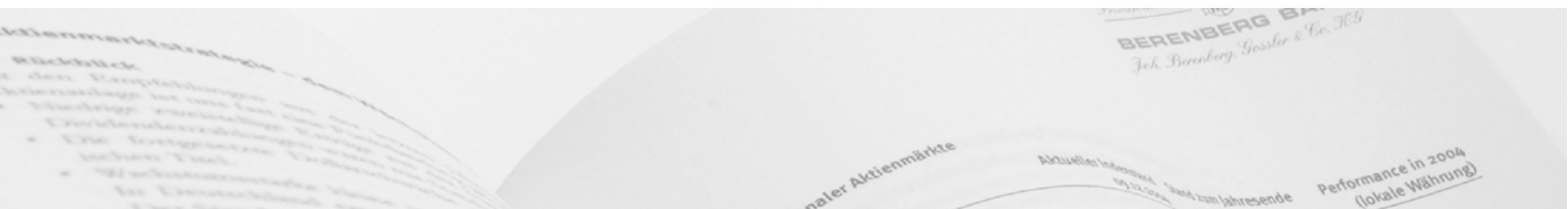
EVENTS

LONDON

Natalie Meech	+44 (0) 20 3207 7831
---------------	----------------------

E-mail: firstname.lastname@berenberg.com *** Internet: www.berenberg.de

HAMBURG BIELEFELD BRAUNSCHWEIG BREMEN DÜSSELDORF FRANKFURT MUNICH STUTTGART WIESBADEN LONDON LUXEMBOURG PARIS SALZBURG SHANGHAI VIENNA ZURICH



BERENBERG BANK
JOH. BERENBERG, GOSSLER & CO. KG
NEUER JUNGFERNSTIEG 20
20354 HAMBURG
GERMANY

400 YEARS – EXPERIENCE BUILDS THE FUTURE