



Federal
Planning Bureau

Economic analyses and forecasts

International economic environment
Preparatory Meeting Economic Budget
January 14, 2009
Bart De Ketelbutter



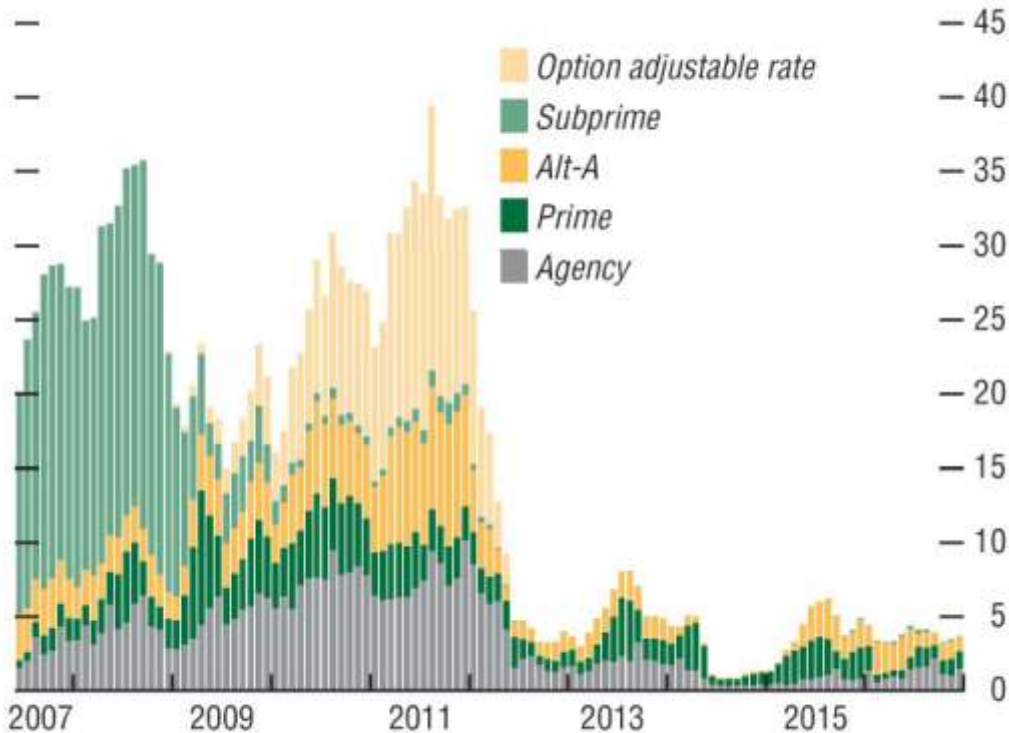
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Overview economic & financial situation

New wave of mortgage rate resets

Figure 1.7. Monthly Mortgage Rate Resets
(First reset in billions of U.S. dollars)



Source: Credit Suisse.

Source: IMF, Global Financial Stability Report, October 2007

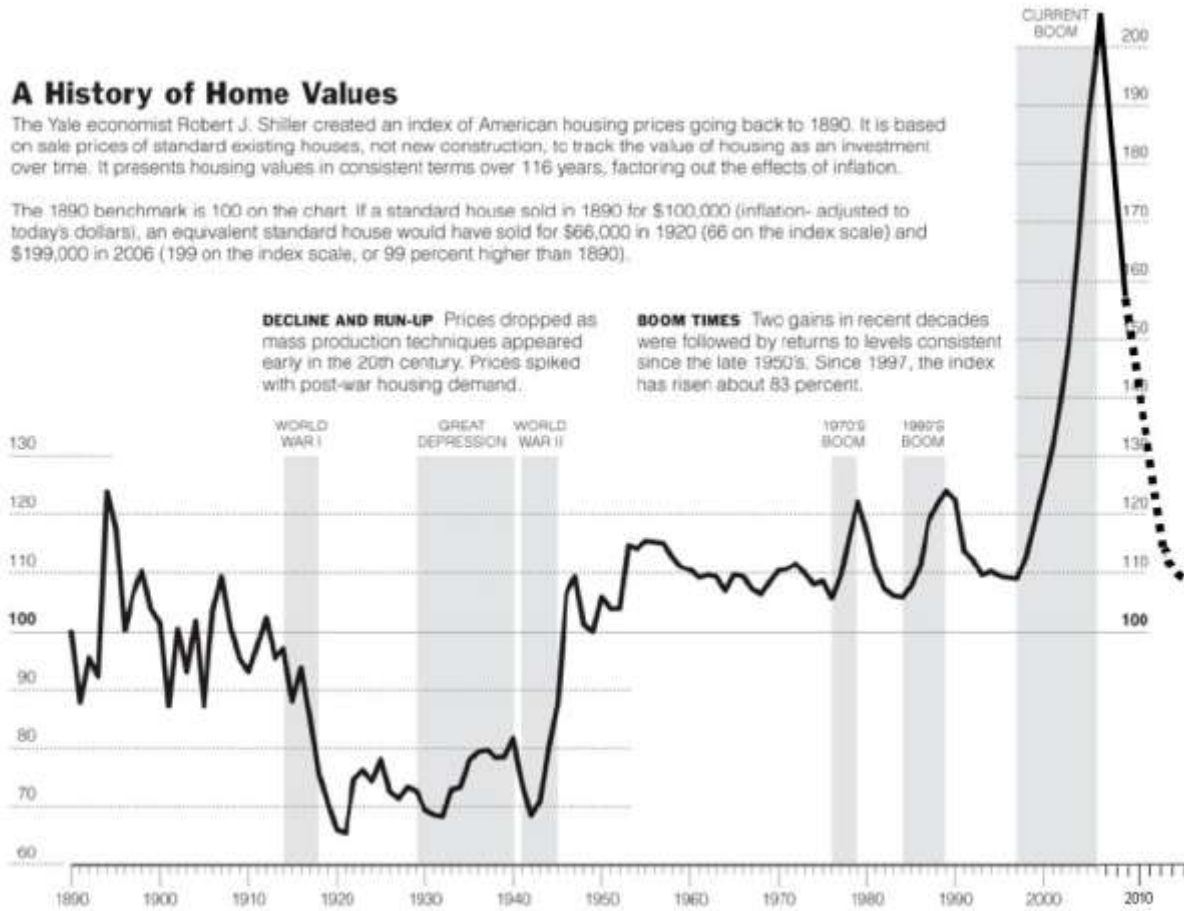
- A host of mortgages (Alt-A & Option ARM) will be reset to higher rates in 2009-2011 after low initial rates
- Implying more defaults, more homes fore auction, continuing home price declines
- Potential damage is large: Alt-A (1trn), Option ARM (0.5 trn) vs. subprime (1trn)
- Even prime default rate rising
- Also securitized and sold all over the world

House price correction to deepen

A History of Home Values

The Yale economist Robert J. Shiller created an index of American housing prices going back to 1890. It is based on sale prices of standard existing houses, not new construction; to track the value of housing as an investment over time. It presents housing values in consistent terms over 116 years, factoring out the effects of inflation.

The 1890 benchmark is 100 on the chart. If a standard house sold in 1890 for \$100,000 (inflation-adjusted to today's dollars), an equivalent standard house would have sold for \$66,000 in 1920 (66 on the index scale) and \$199,000 in 2006 (199 on the index scale, or 99 percent higher than 1890).



Source: New York Times

Total US mortgage related losses might reach 2000bn USD (1000bn written down so far)

- Nominal house prices have fallen by 20-25% since peak mid-2006
- Considering reset rate danger & huge inventory of unsold homes, prices are expected to decline by another 15-25%
- Would bring them in line with historical real values again
- Losses in mortgage related products (MBS, ABS, CDO) will mount



More credit losses in the offing as economic recession deepens

- Commercial real estate
- Car loans
- Credit card debt
- Corporate credit

Amount ?

Also securitized

This implies that a new wave of recapitalisations of banks will be needed and that financial markets will remain tense

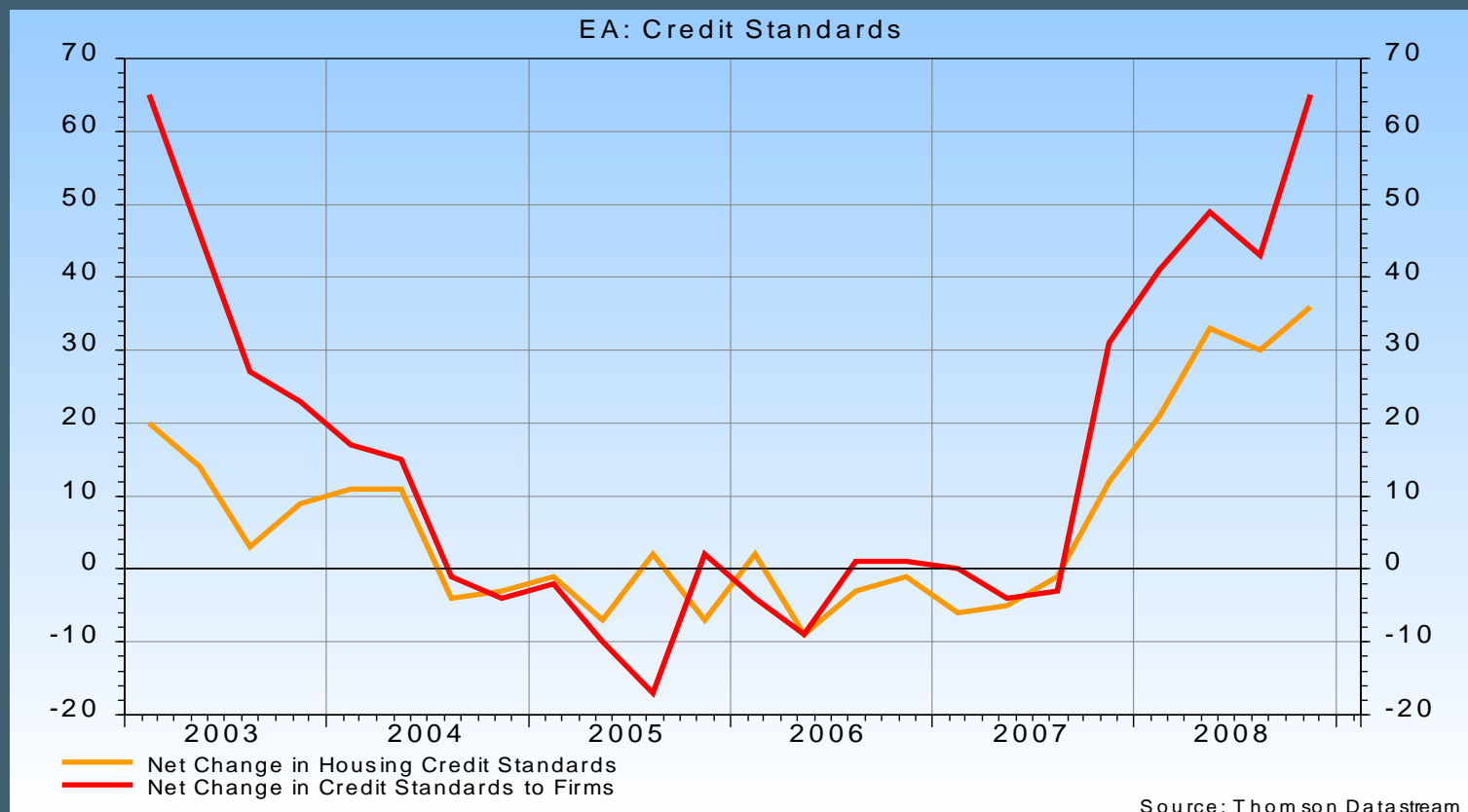
Credit Suisse, BNP Paribas, Deutsche Bank have already signalled huge writedowns due to market turmoil in Q4 08

Yet tensions have eased in the interbank market, thanks to government interventions



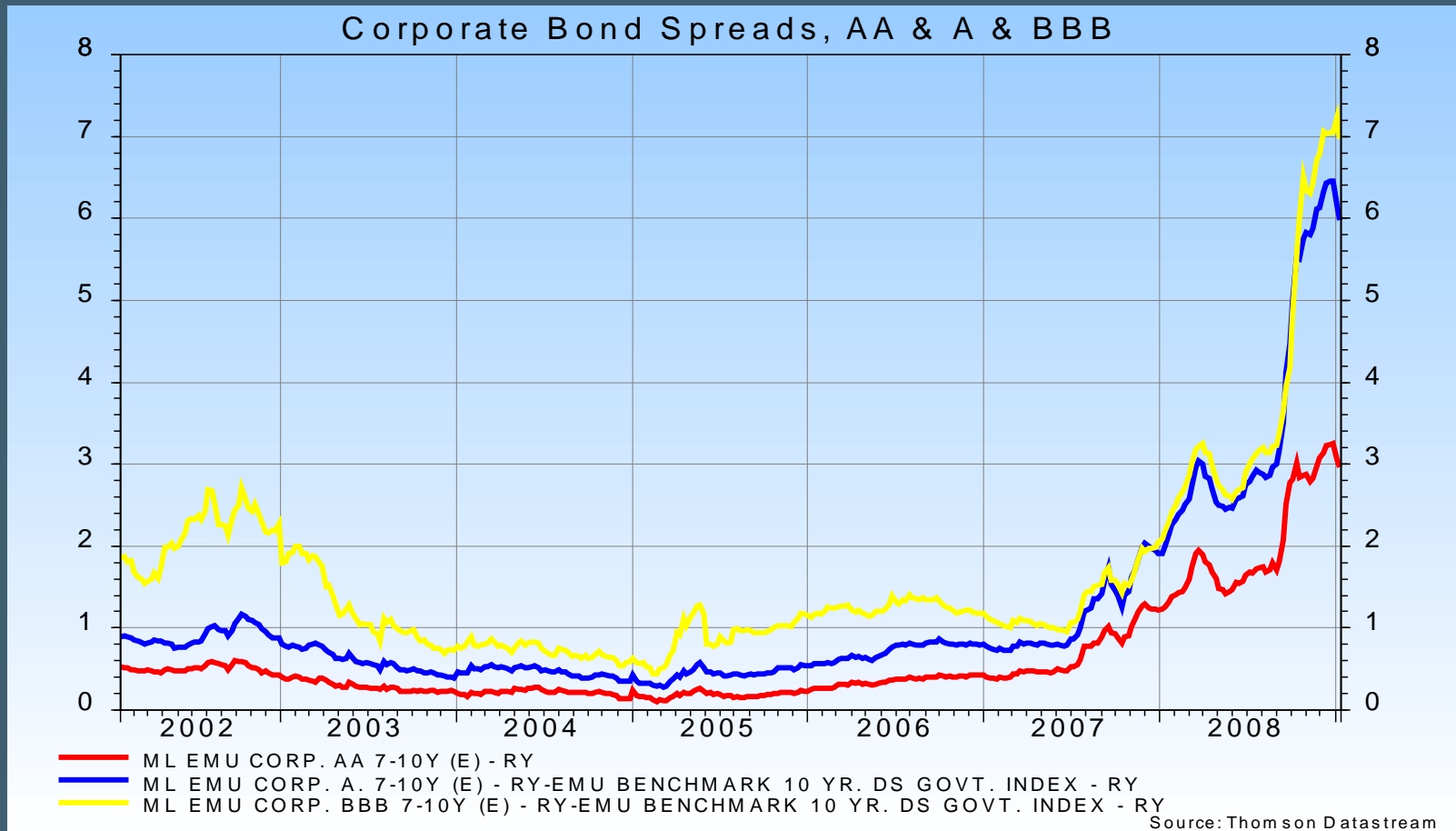
- Credit market stress has eased in those markets where public authorities intervened: interbank, top-rated commercial paper, agency MBS
- In the interbank market support provided by recapitalisations and funding guarantees
- Volumes remain low however

Credit standards tightened, credit growth slowing

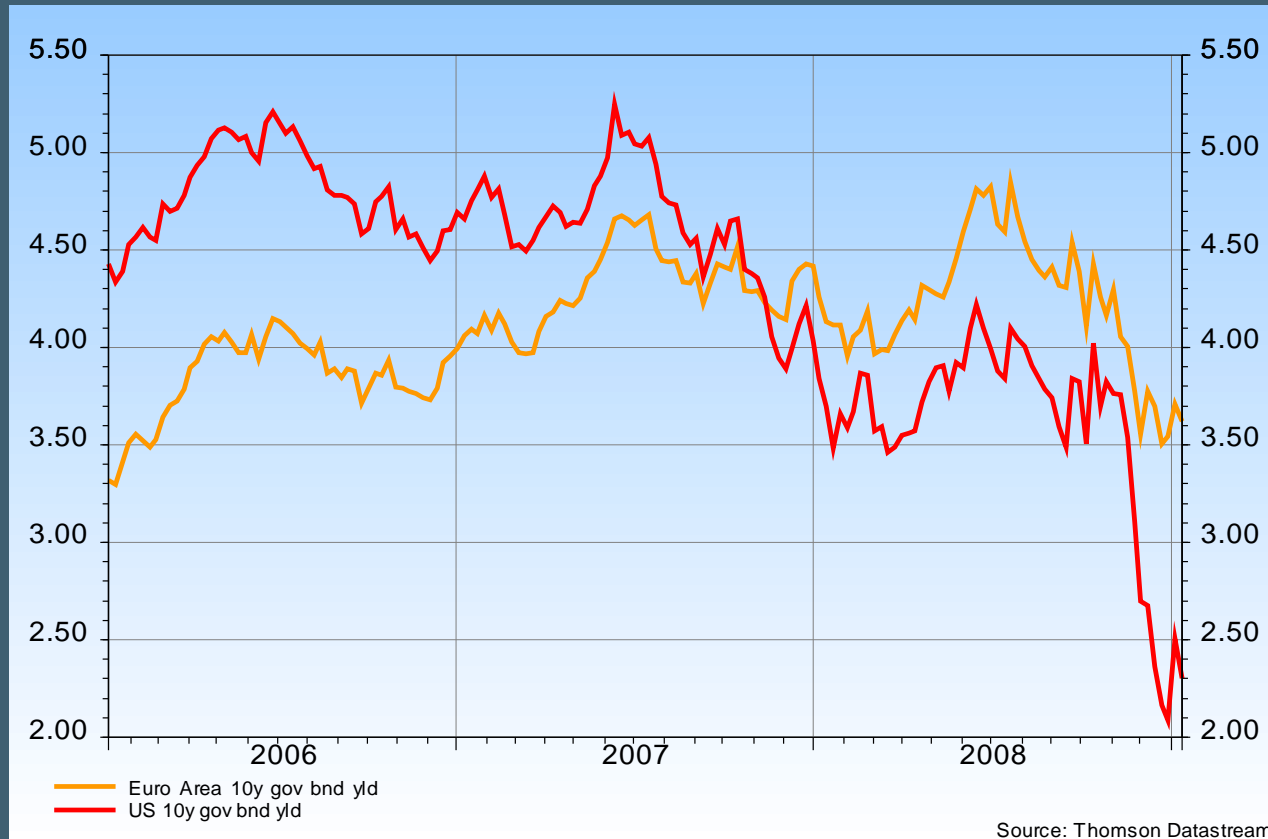


- Unclear whether reduced demand for or reduced supply of credit is responsible

Corporate bond spreads remain at record highs



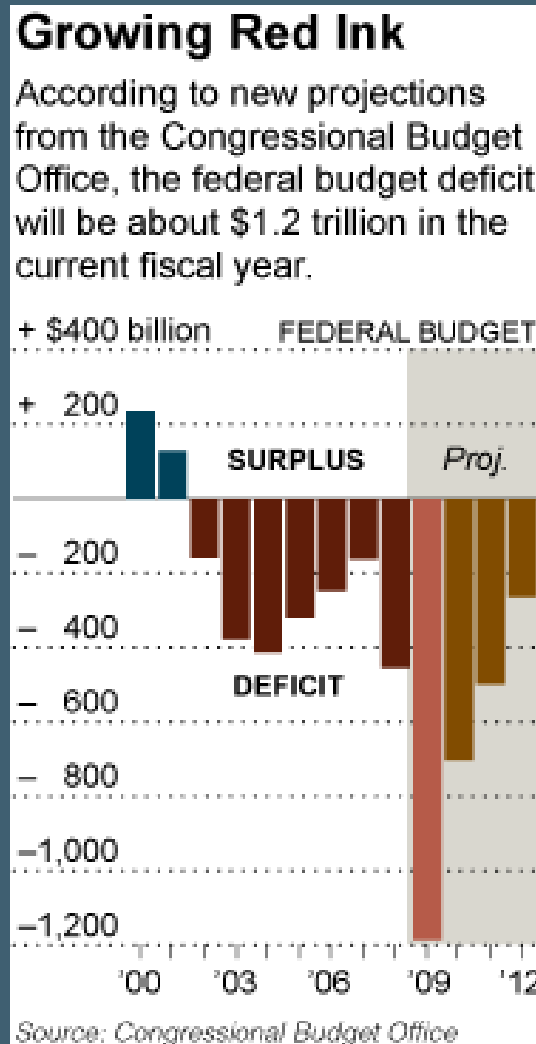
Government bond rates have plunged, especially in the US



- Economic recession and plunging inflation
- Risk aversion and flight to quality
- In the US also the possible buying of treasuries by the Fed to keep rates as low as possible

Problems for gov.bonds might loom ahead

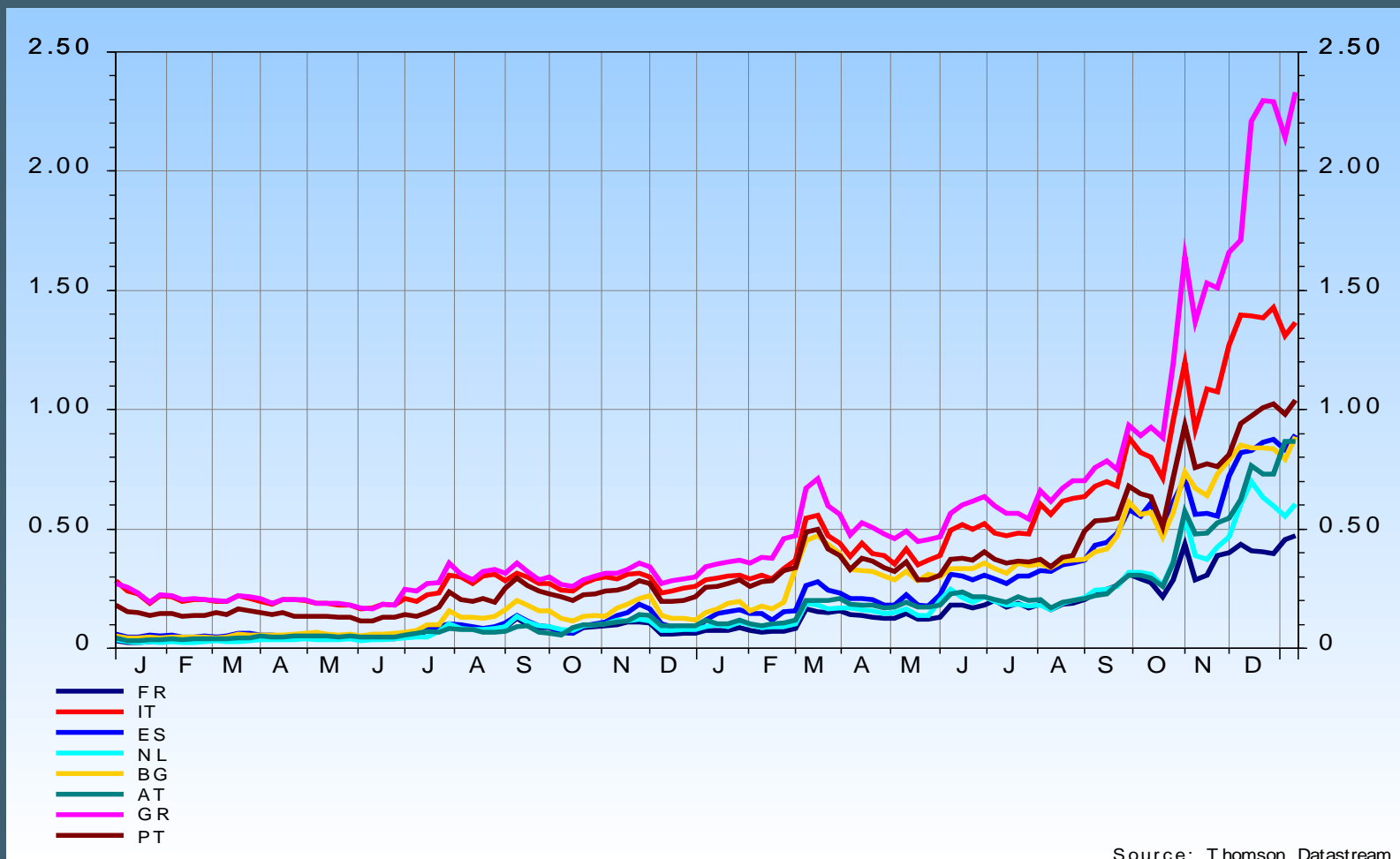
- Deficits in all countries are expected to rise sharply (to 10% of GDP in 2009 in the US)
- Implies a huge extra supply of government bonds this year
- Crowding out private and emerging market lending
- And could eventually lead to higher interest rates
- Especially with slackening demand for US bonds by China
- Failed bond auctions in several EA countries, even in Germany
- Rating agencies could downgrade rating ES, GR, IR soon



Source: New York Times, CBO



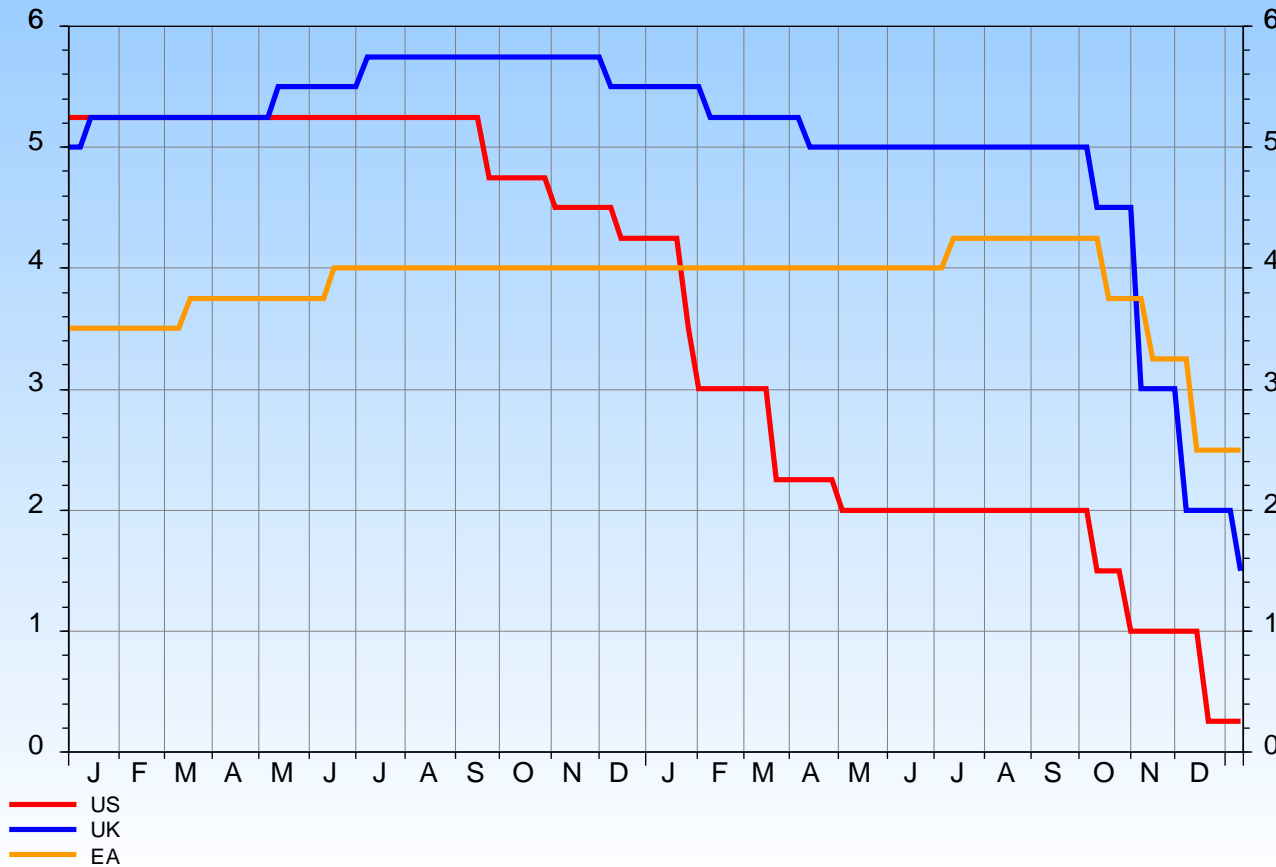
In the Euro Area spreads have continued to widen against German Bunds



Widening of spreads to do with concerns over consequences of bank rescues and fiscal packages on state budgets



Monetary Policy: towards ZIRP for everyone?



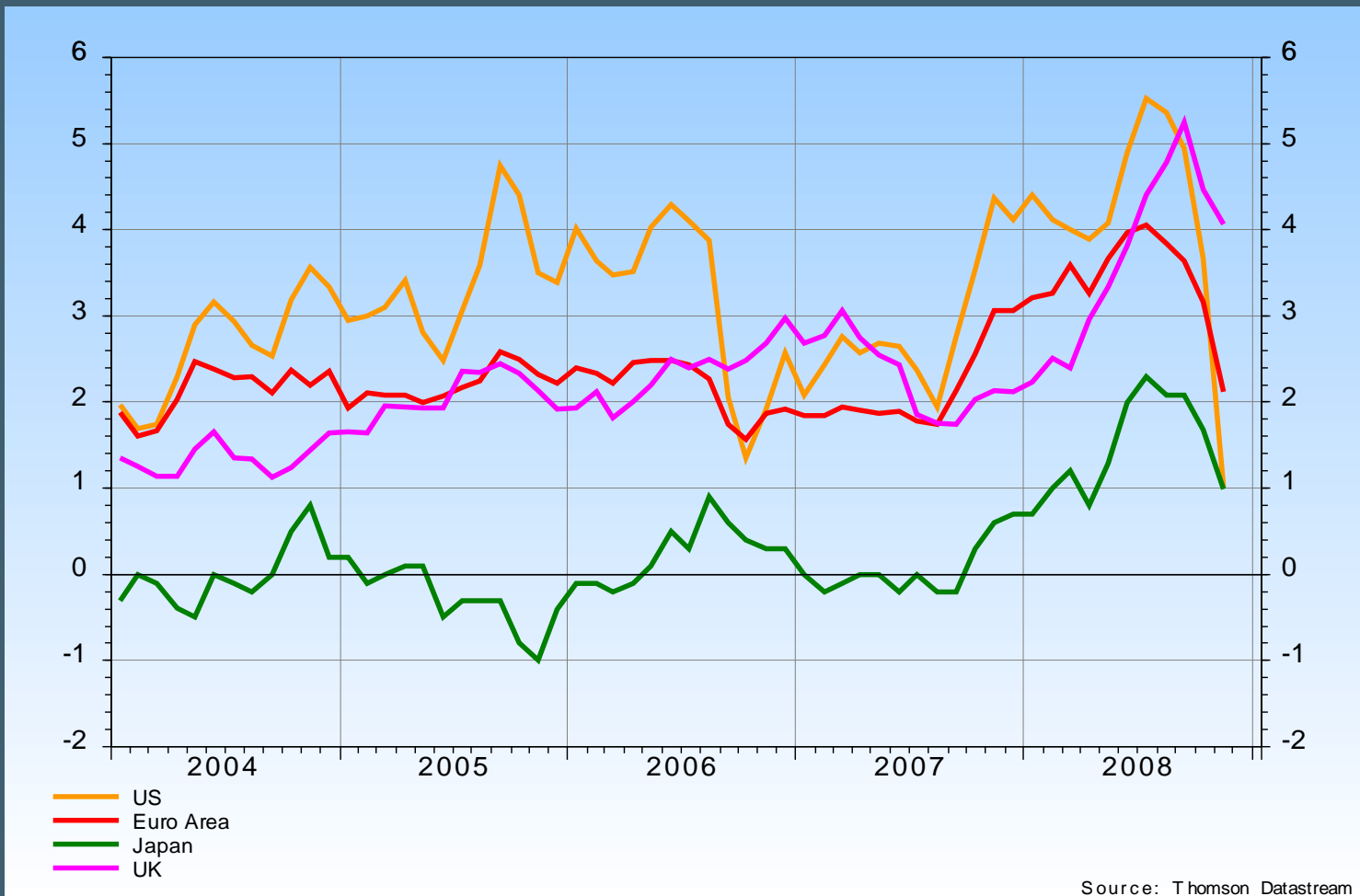
Source: Thomson Datastream

- Fedfunds: 0-0.25%
- BoE Base Rate: 1.5% (lowest in 315y history)
- ECB Refi Rate: 2.5%. Cut of 0.5 pp expected this thursday

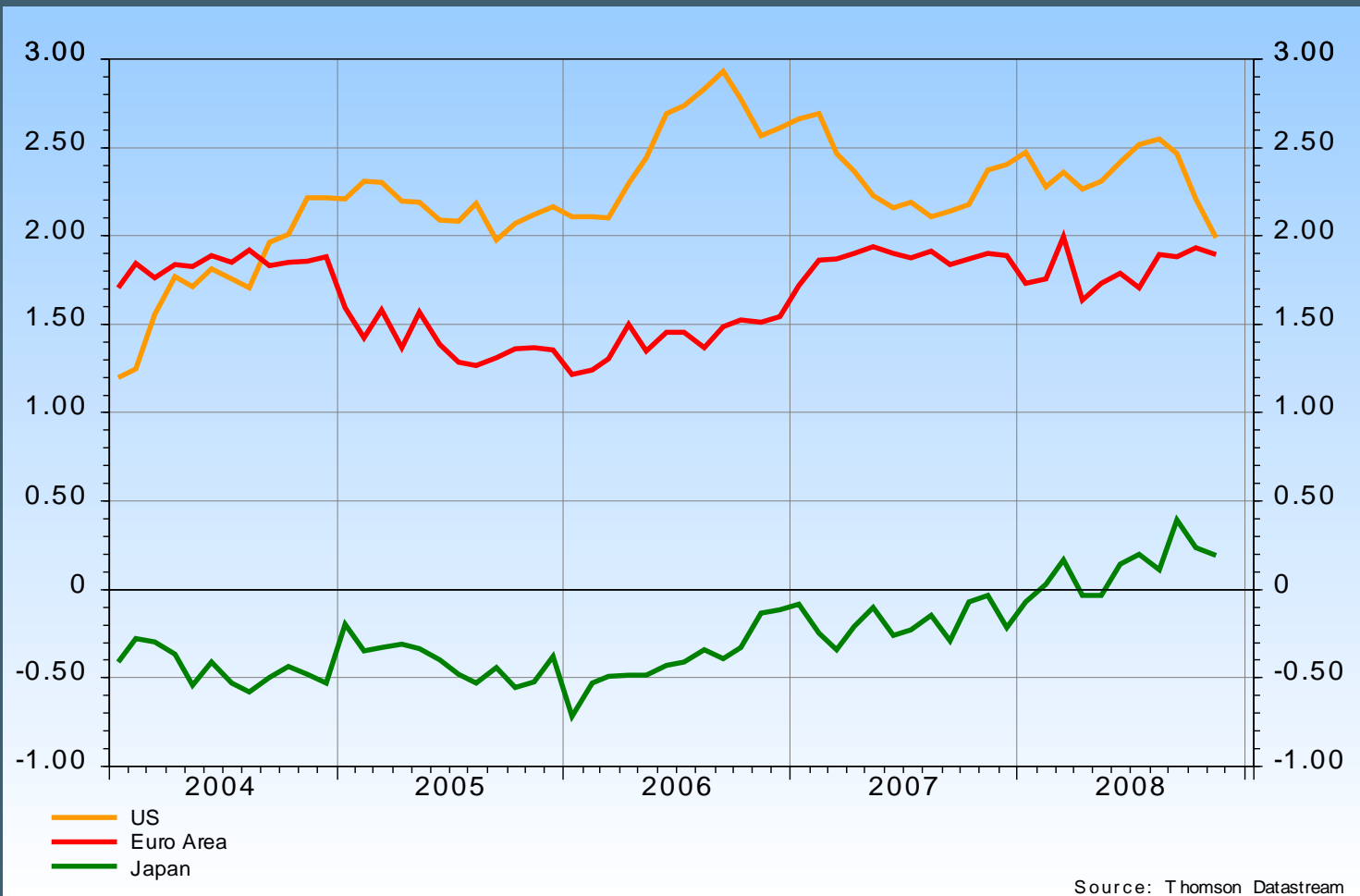
Fed: Buying agency securities (100bn), MBS (500bn) and possibly treasuries → financed by expanding reserves = money supply



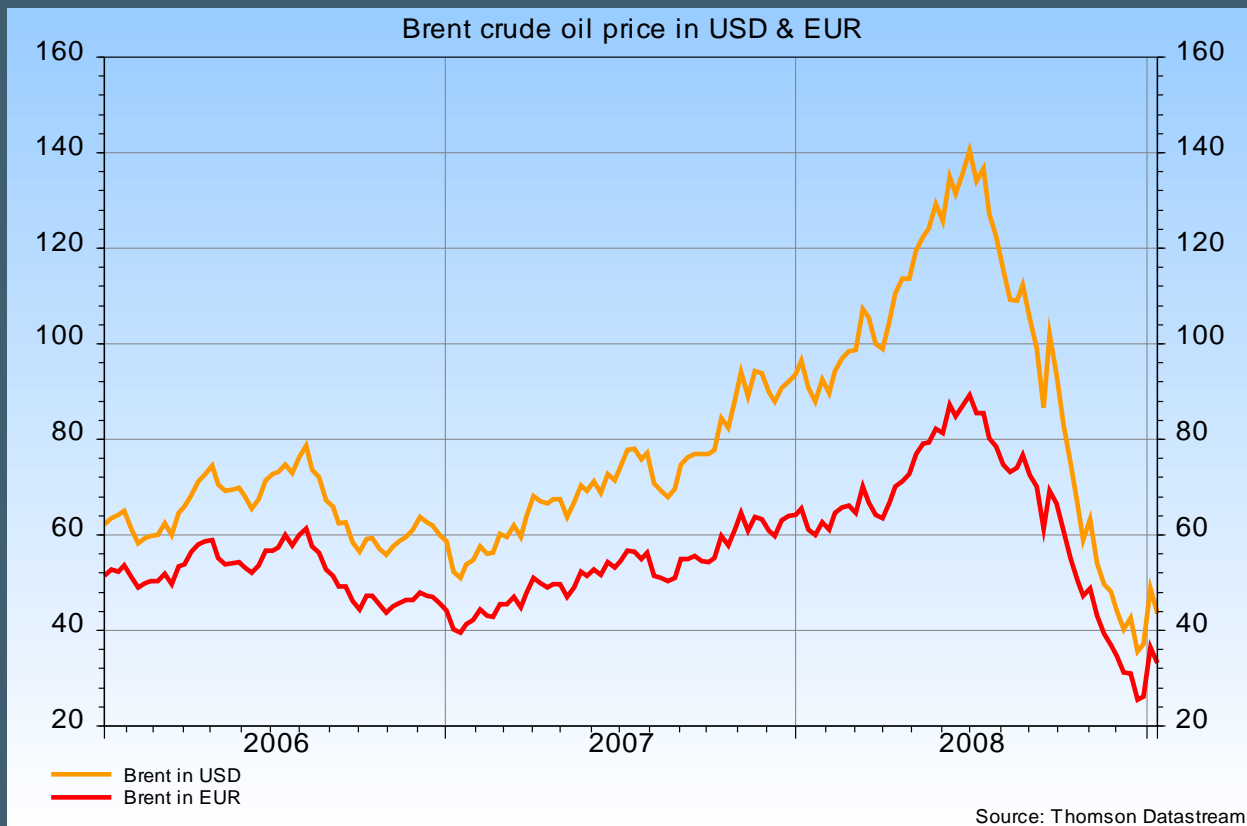
Headline inflation plunges



While core inflation remains fairly stable

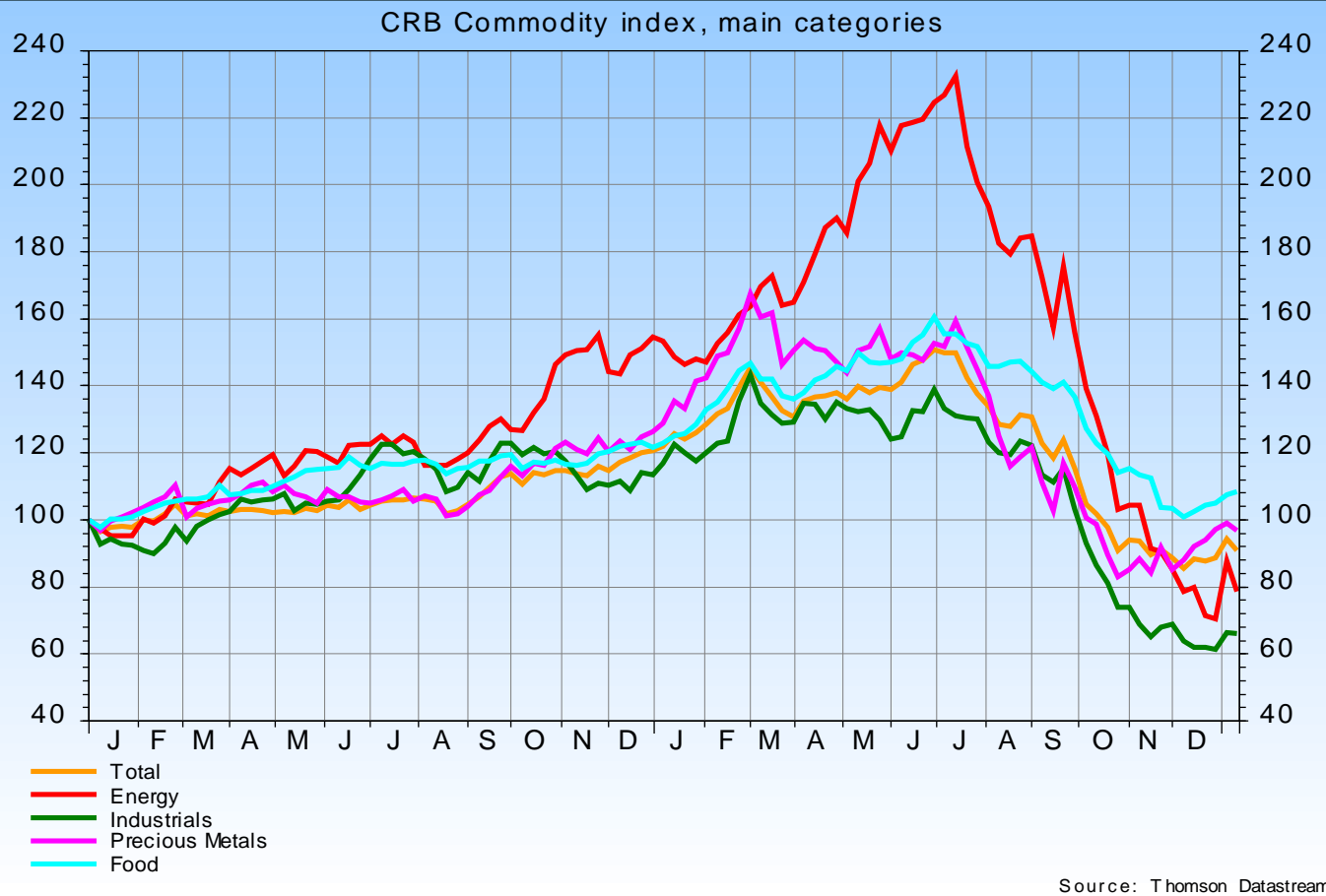


Brent oil price



- From a high of 144.5USD mid July to a low of 33USD end of December
- OPEC output cut of 4.2 mio barrels & turmoil in Middle East has arrested the decline in oil prices for now

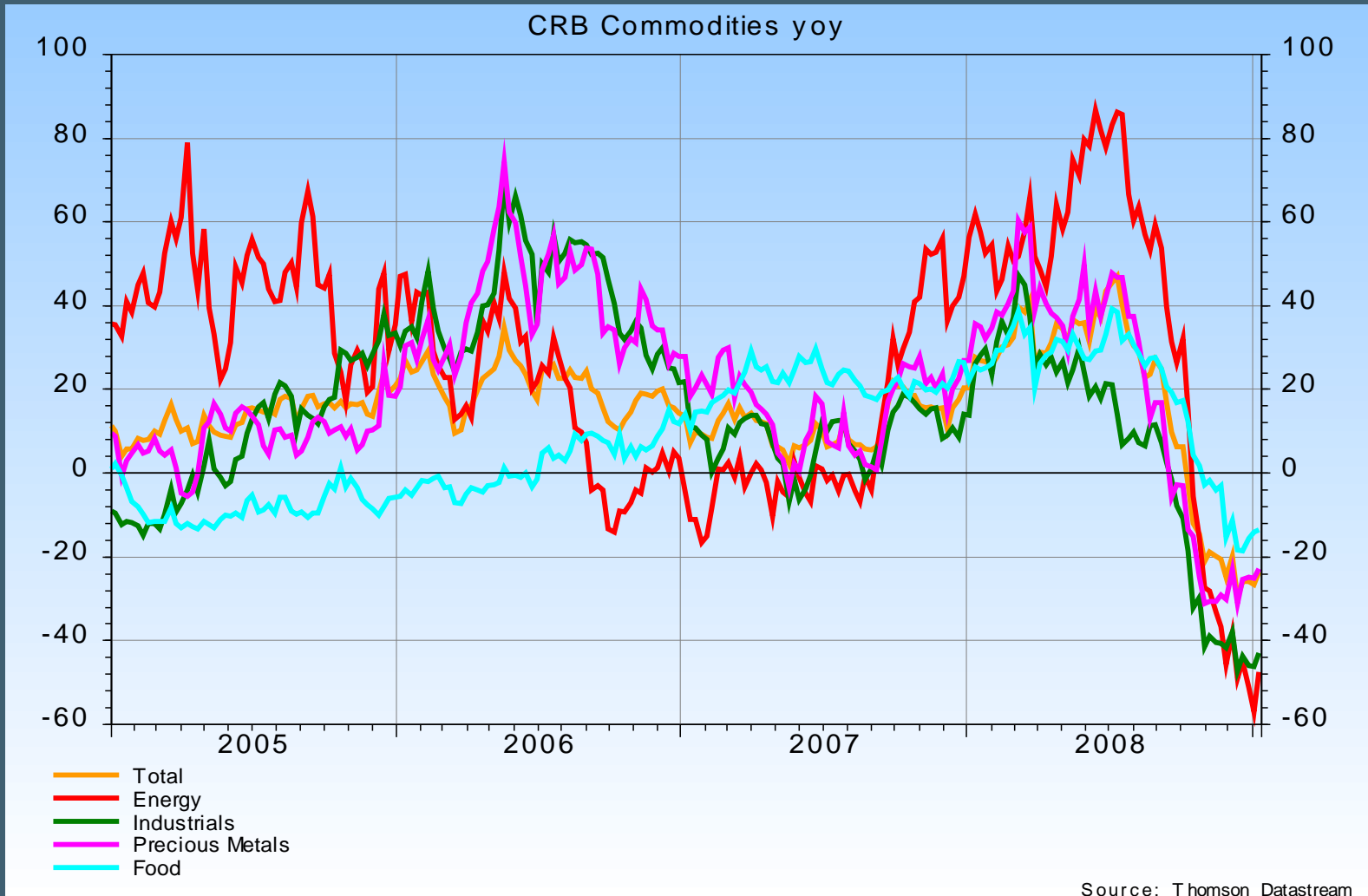
Commodity price index, main categories



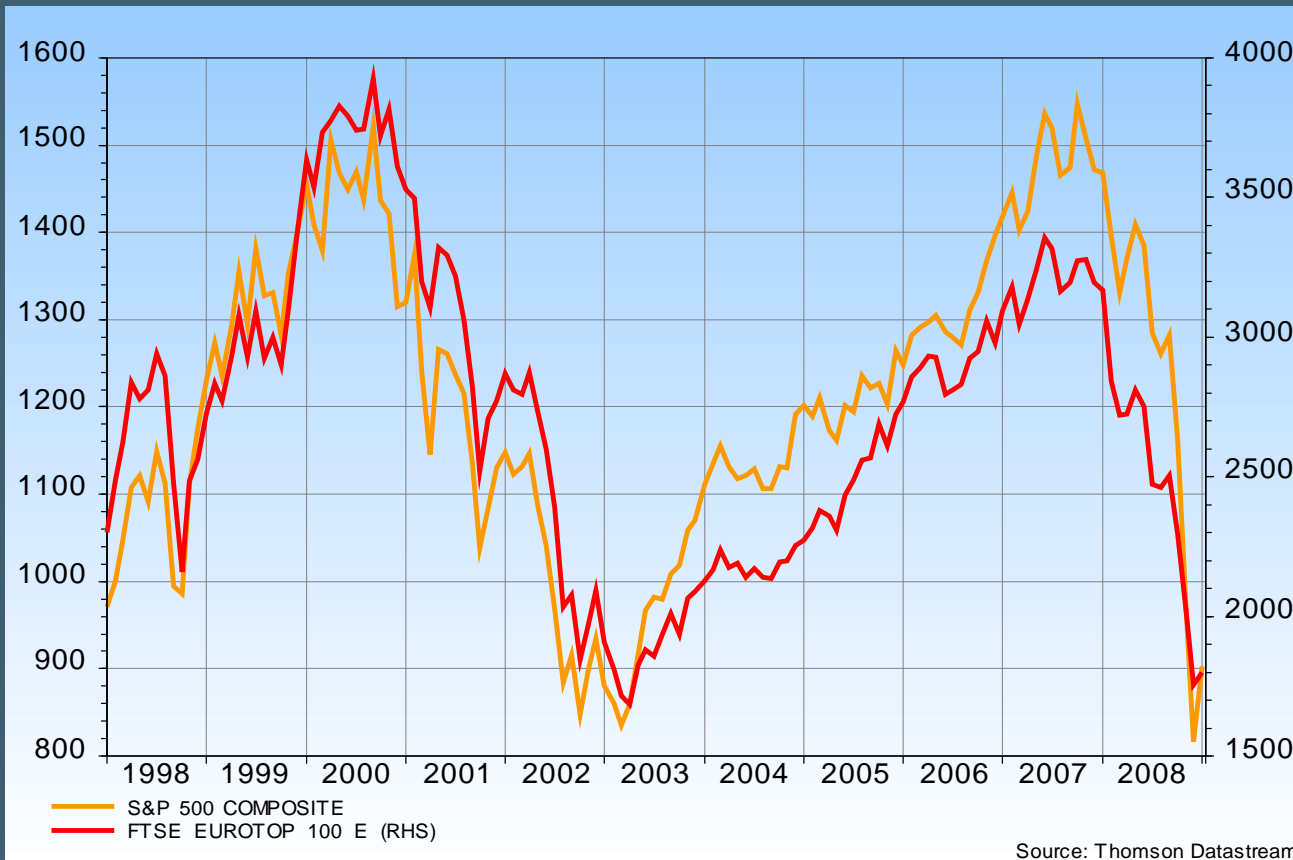
- Plunging world demand
- Attractiveness as asset class diminished
- Forced deleveraging hedge funds



Commodity price index, yoy

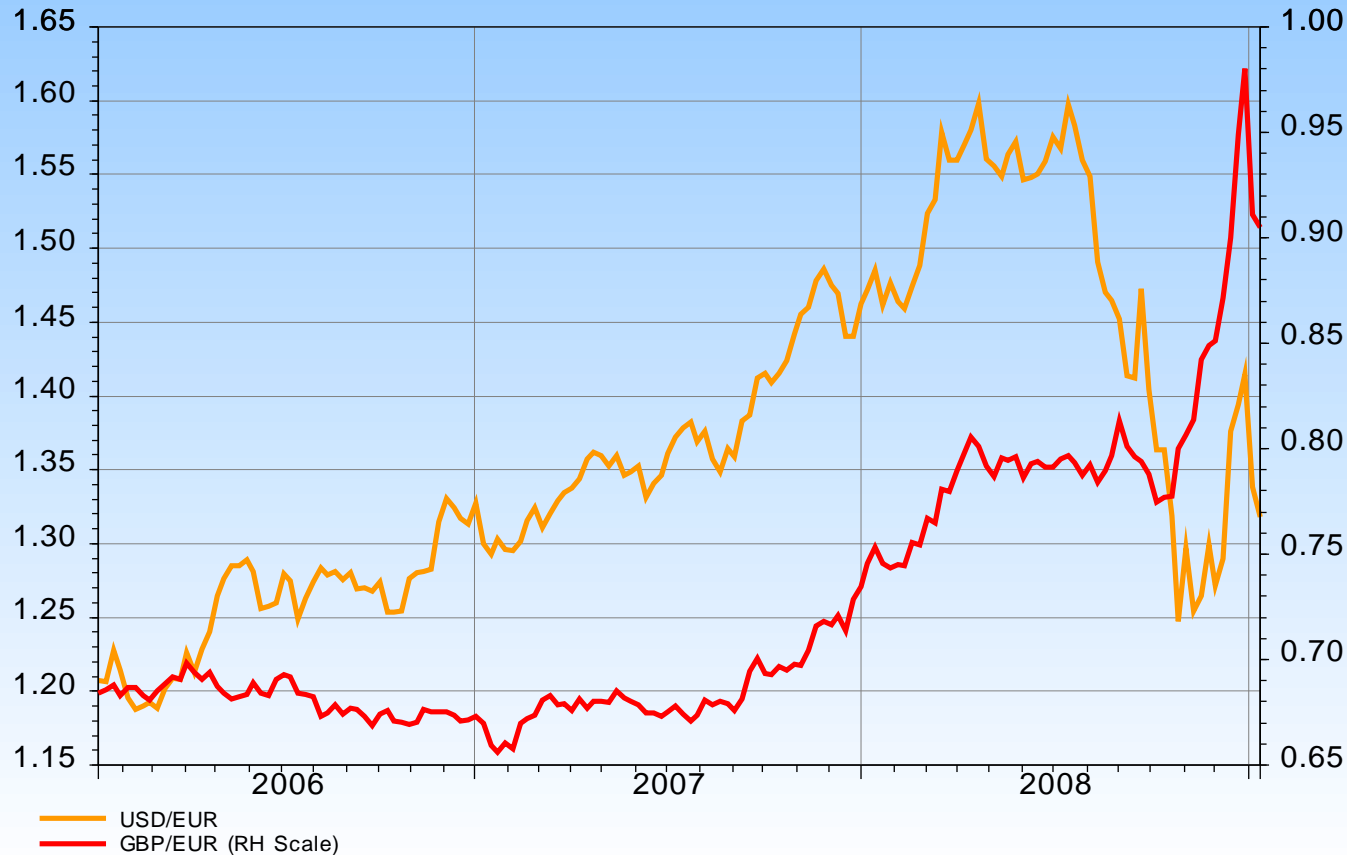


Equity markets



- Worldwide loss in market value in 2008 amounts to 30.000 bn USD
- A tremendous drain on wealth

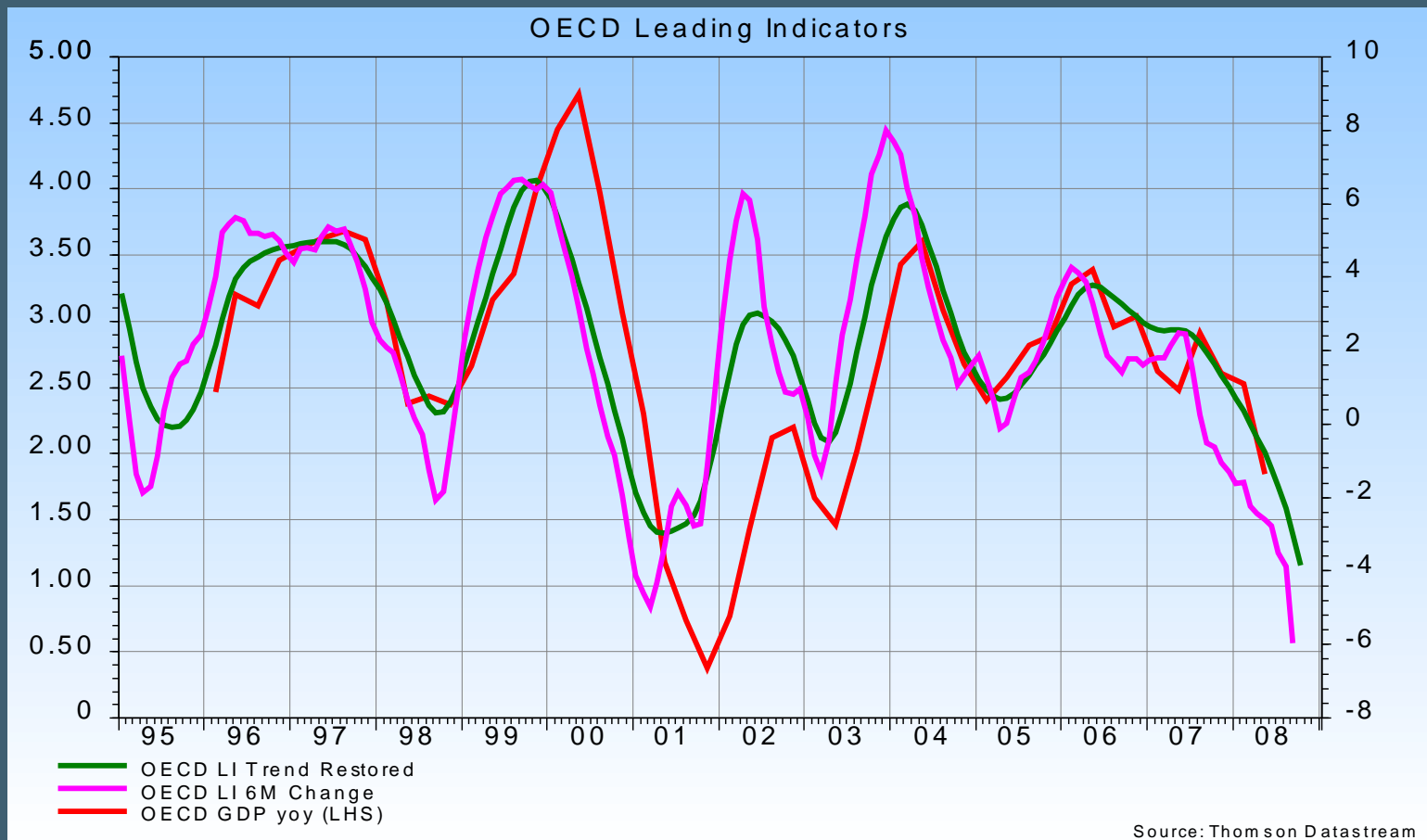
Exchange Rates



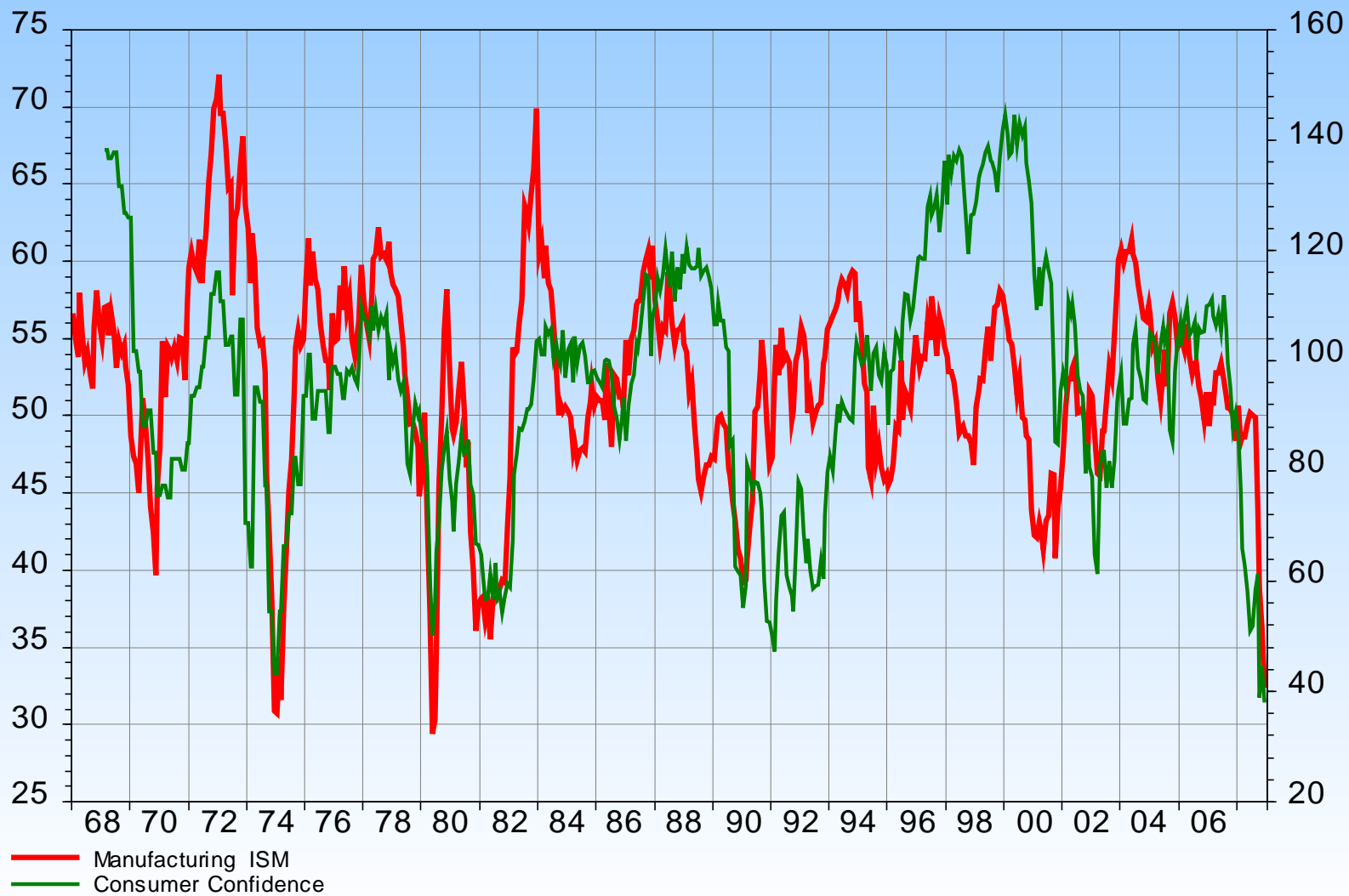
Source: Thomson Datastream

- USD has risen against the EUR lately as ECB expected to cut rates
- GBP has plunged because of very negative economic outlook & slashing of base rate by Bank of England

OECD leading indicators



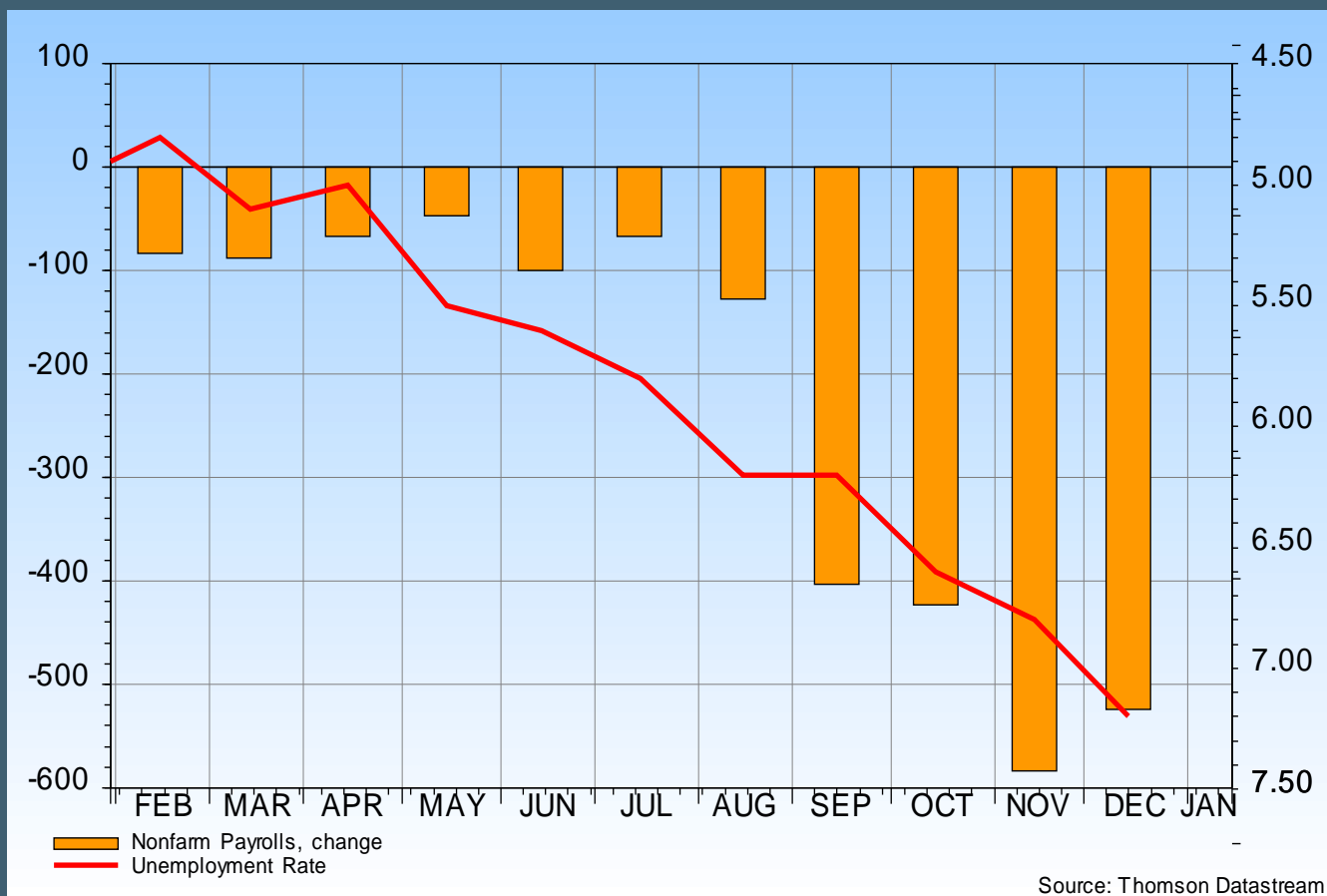
US leading indicators



Source: Thomson Datastream



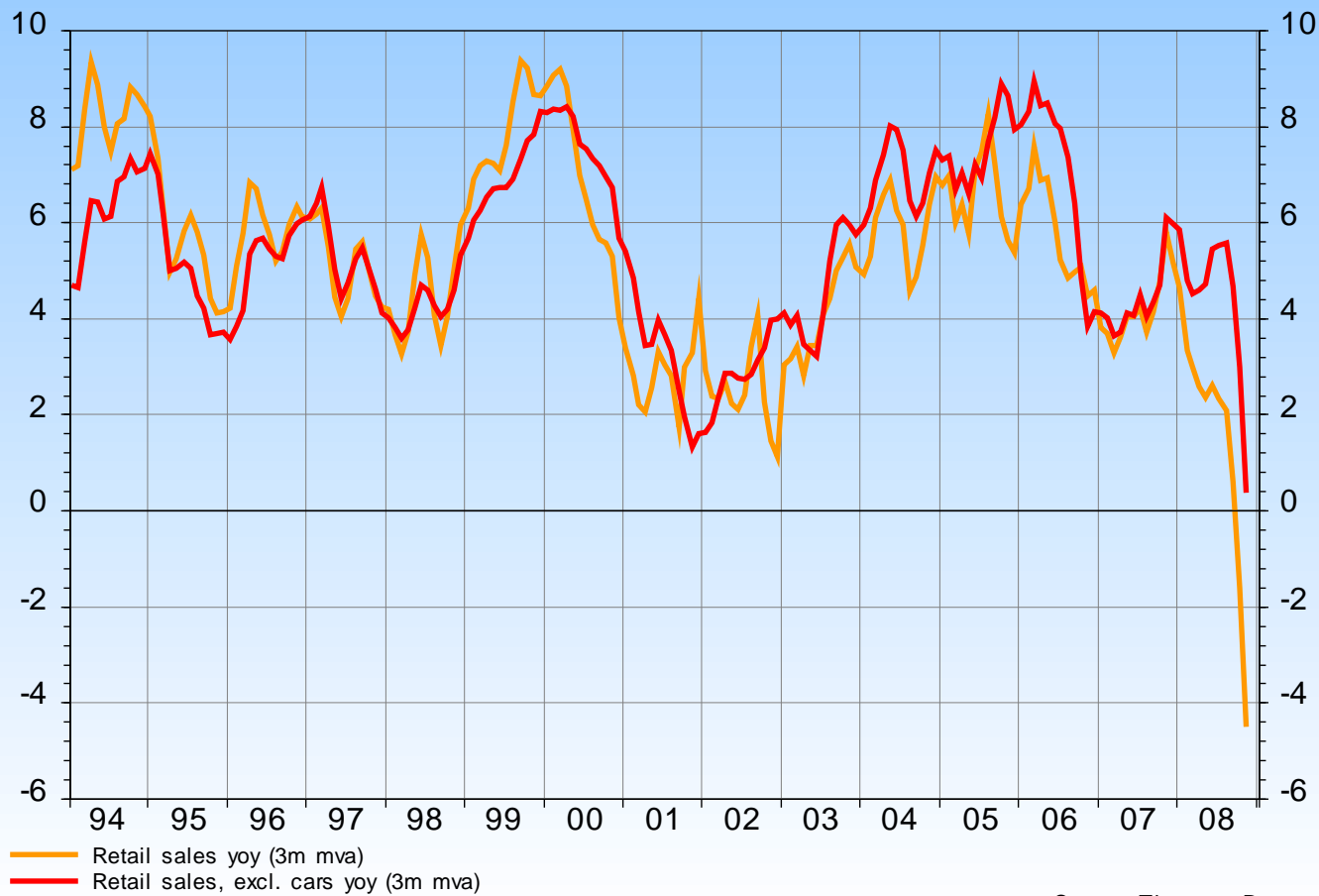
US labour market



- Hundreds of thousands sought full-time work but could only get part-time job
- Number of hours worked lowest since start of series in 1964

- Last four months:
 - Net loss of two million jobs
 - Unemployment rate up by 1 pp

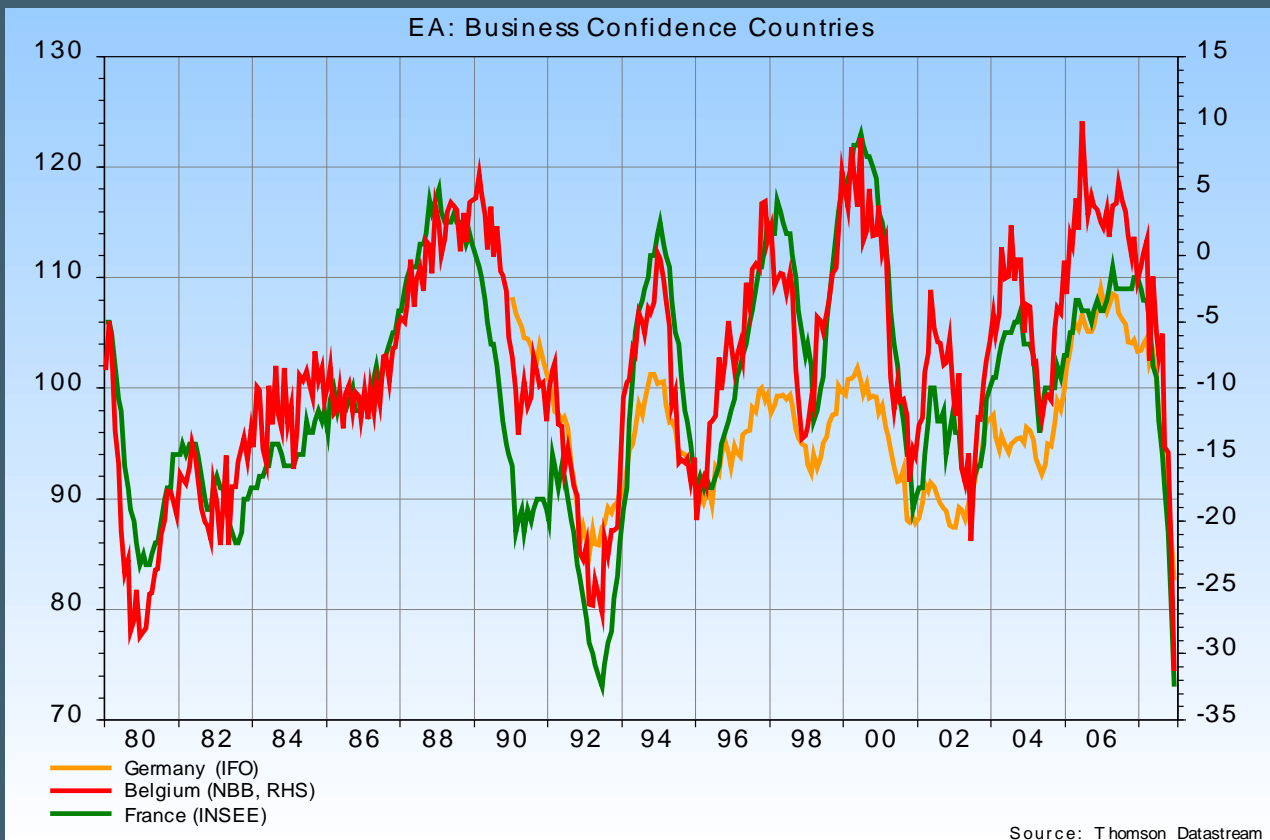
US retail sales



Source: Thomson Datastream

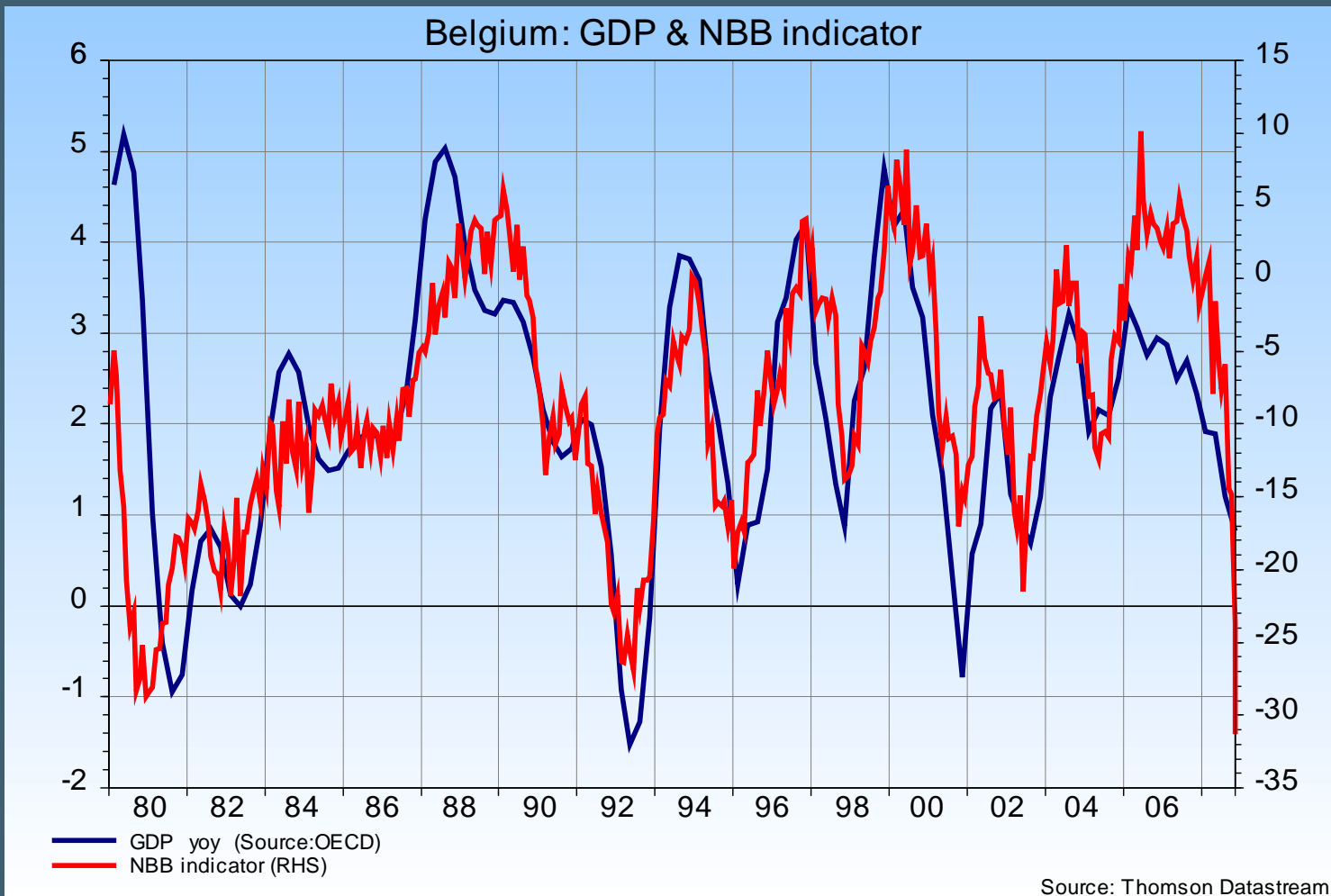


Euro Area leading indicators

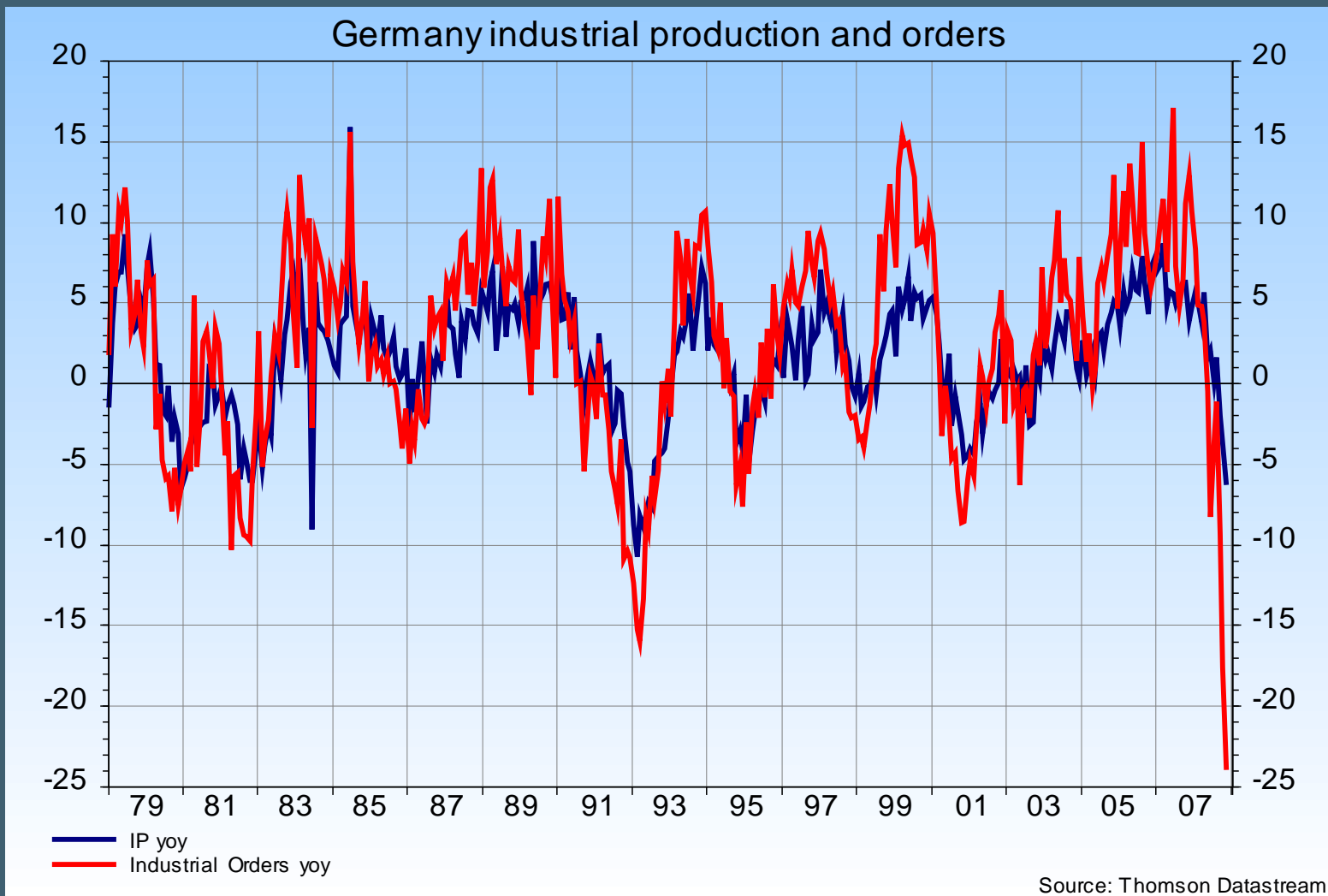


- Economic sentiment has plunged to lowest level since start series (1985)
- Other indicators (IFO, NBB, ...) have fallen to levels last seen during oil crises
- GDP drop in both Q4 08 & Q1 09 expected to be large (1% qoq?)

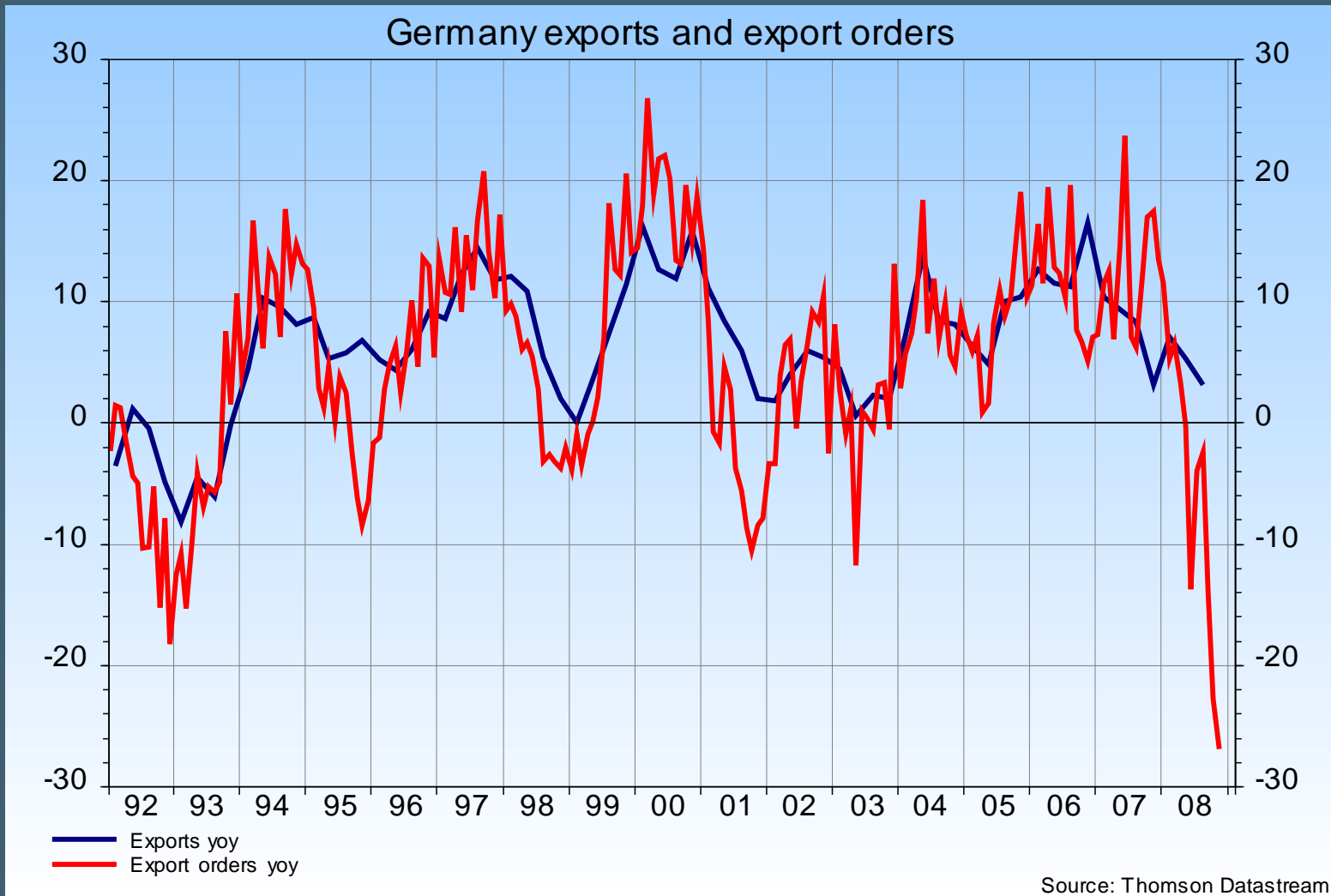
Belgium GDP & NBB indicator



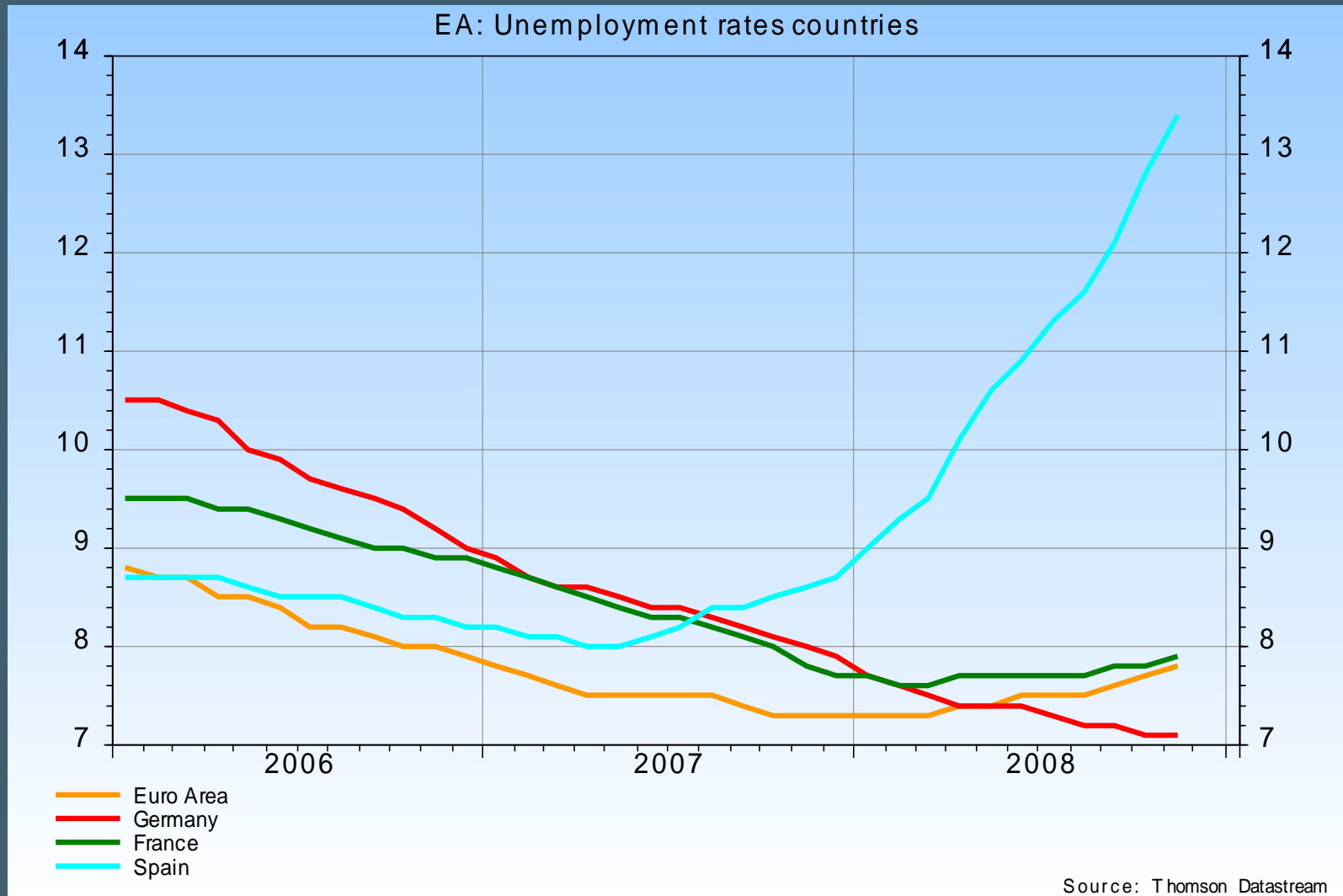
Germany industrial production & orders



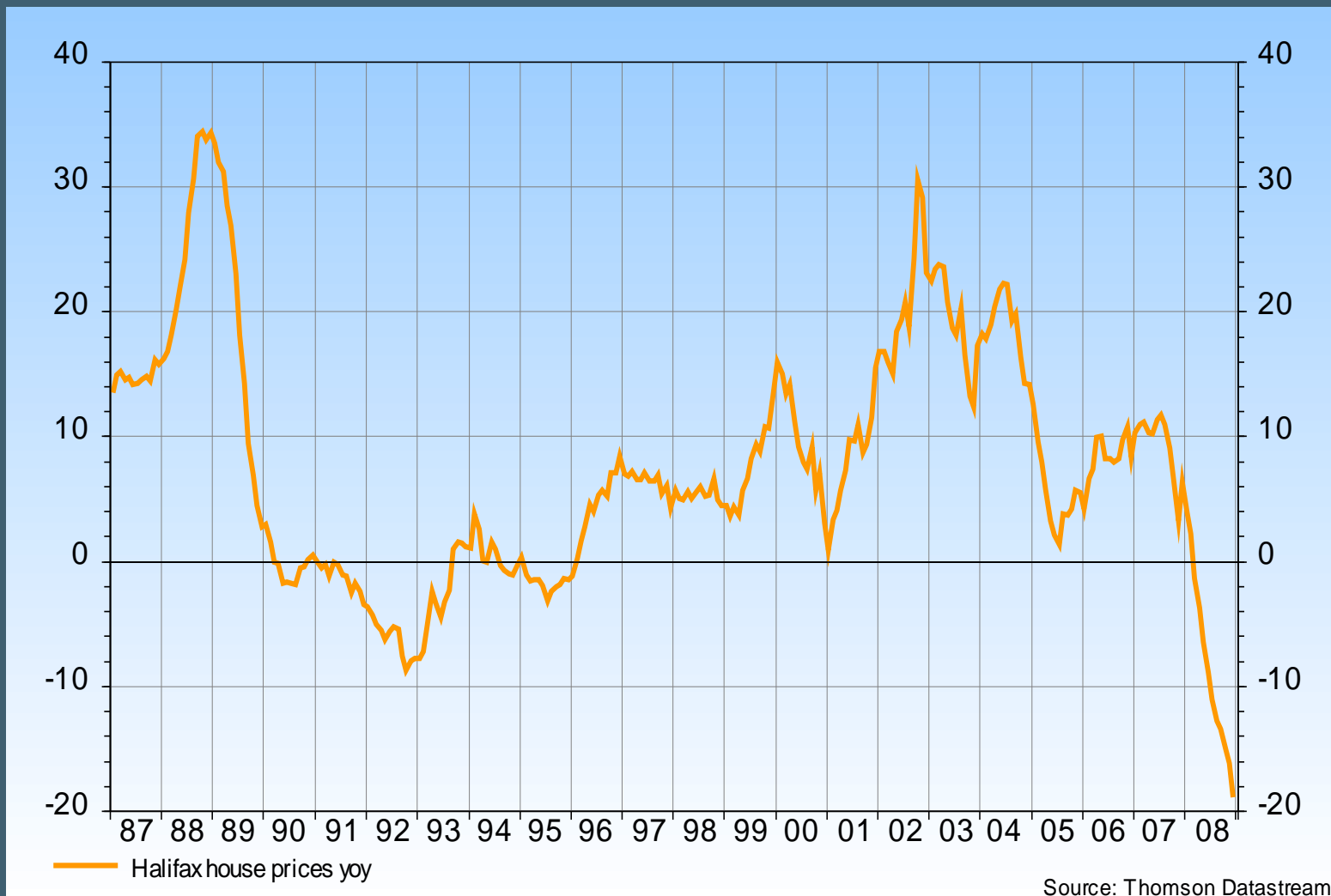
Germany Exports and export orders



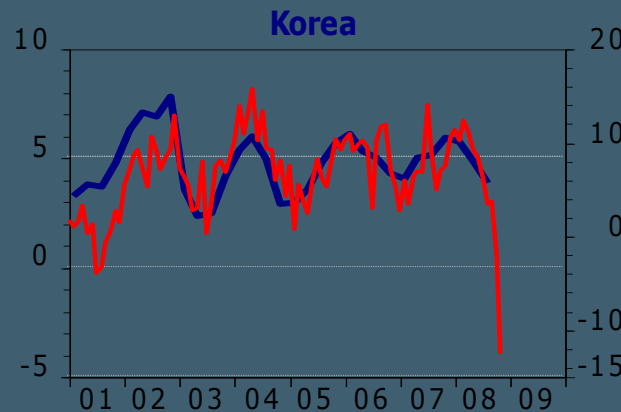
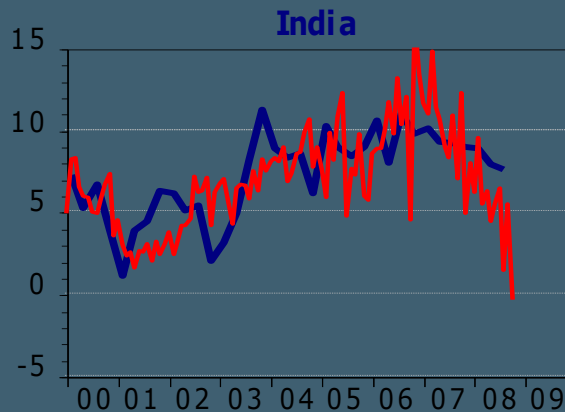
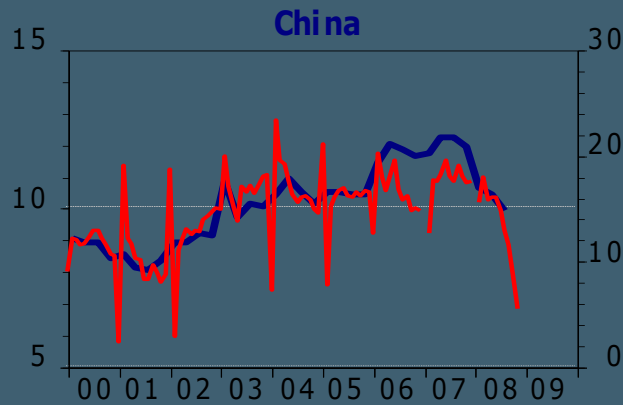
EA unemployment rates



UK house prices yoy



Emerging economies



(%, year on year)

— GDP — Industrial production [R.H.S.]

- IP & X plunged in November
- Hit by recession in developed world, drop in commodity prices and more difficult & more expensive access to credit
- Severity downturn in function of dependability of foreign capital

Source: Dexia Asset Management, Economic Outlook December 2008

