Mare Forum Ship-finance 2009

The economic recovery has arrived
But will it last?

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Fortis Bank Nederland

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Fear rules after the bankruptcy of Lehman Brothers…

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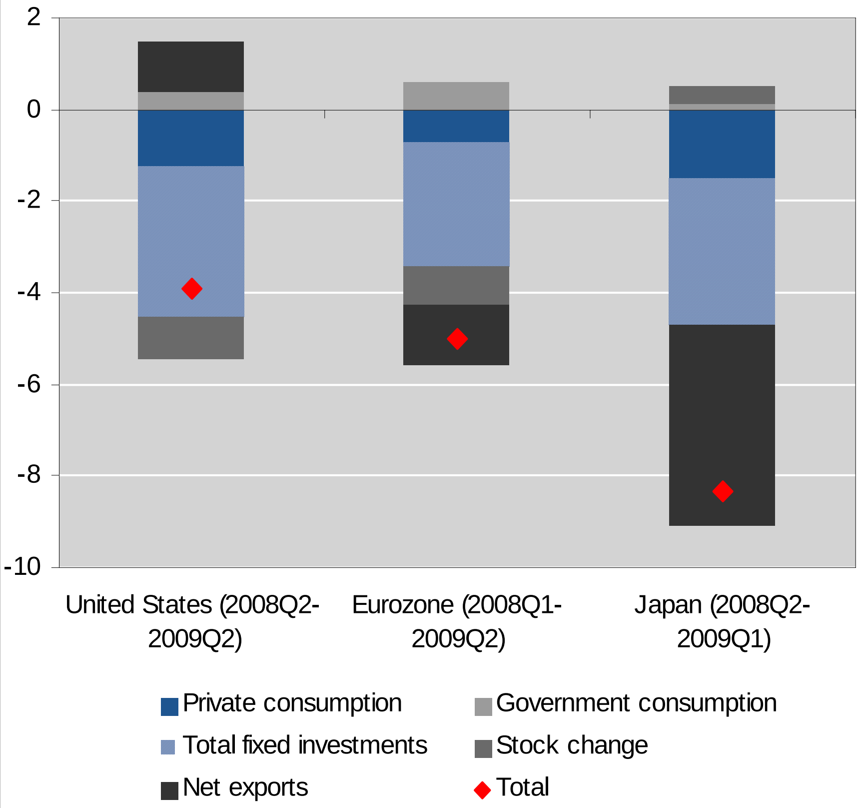
Anatomy of the Great Recession

Composition of the economic contraction



Source: Fortis Bank NL

The story

- The bankruptcy of Lehman Brothers in mid-September 2008 constituted a global 'fear shock'
- All of a sudden the financial system froze up completely, while businesses and households cut spending agressively, and simultaneously
- Final domestic demand fell sharply and roughly equally in the US and Japan; net exports were extremely negative to growth in Japan, and to a lesser extent the eurozone (both have relatively large manufacturing sectors/unfavourable geographic and or product specialisation)

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Comparing post-war US recessions

Key facts of past US recessions

	cumulative contraction of:		
NBER recession	GDP	priv. cons.	priv. inv. mach. & equipm.
Nov. 1948 - Oct. 1949	-1.7	no contr.	-20.6
Jul. 1953 - May 1954	-2.7	-0.9	-6.4
Aug. 1957 - Apr. 1958	-3.7	-1.3	-19.3
Apr. 1960 - Feb. 1961	-1.6	-0.4	-10.5
Dec. 1969 - Nov. 1970	-0.6	no contr.	-5.9
Nov. 1973 - Mar. 1975	-3.1	-1.8	-11.9
Jan. 1980 - Jul. 1980	-2.2	-2.4	-7.2
Jul. 1981 - Nov. 1982	-2.7	-0.8	-10.0
Jul. 1990 - Mar. 1991	-1.3	-1.1	-5.7
Mar. 2001 - Nov. 2001	-0.4	no contr.	-12.3
Dec. 2007 -	-3.9**	-2.0**	-22.5**

* Periods of contraction in GDP and its components don't necessarily correspond to NBER-defined recession period

** Fortis Bank NL estimates

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The V-shaped recovery that couldn’t happen…

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Two reasons for pessimism: recessions following financial meltdown tend to be long and deep (1)

Reinhart and Rogoff: The Aftermath of Financial Crises

	Average % drop	Avg. duration of downturn (years)	current US % drop	Duration of current US downturn (years)
real house prices	-35.5	6	-26	3
real equity prices	-55.9	3.4	-55	1.3
unemployment rate	-7	4.8	-5*	2.3*
real per capita GDP	-9.3	1.9	-4	1.5

* to-date

Source: Reinhart and Rogoff, Fortis Bank NL

- We have doubts about the wisdom of averaging past crises
- Clearly, every crisis is different, and this time the policy response was particularly aggressive, and well-coordinated
- The current recession seems to be equally deep as past ‘financial’ recessions, but duration is significantly less

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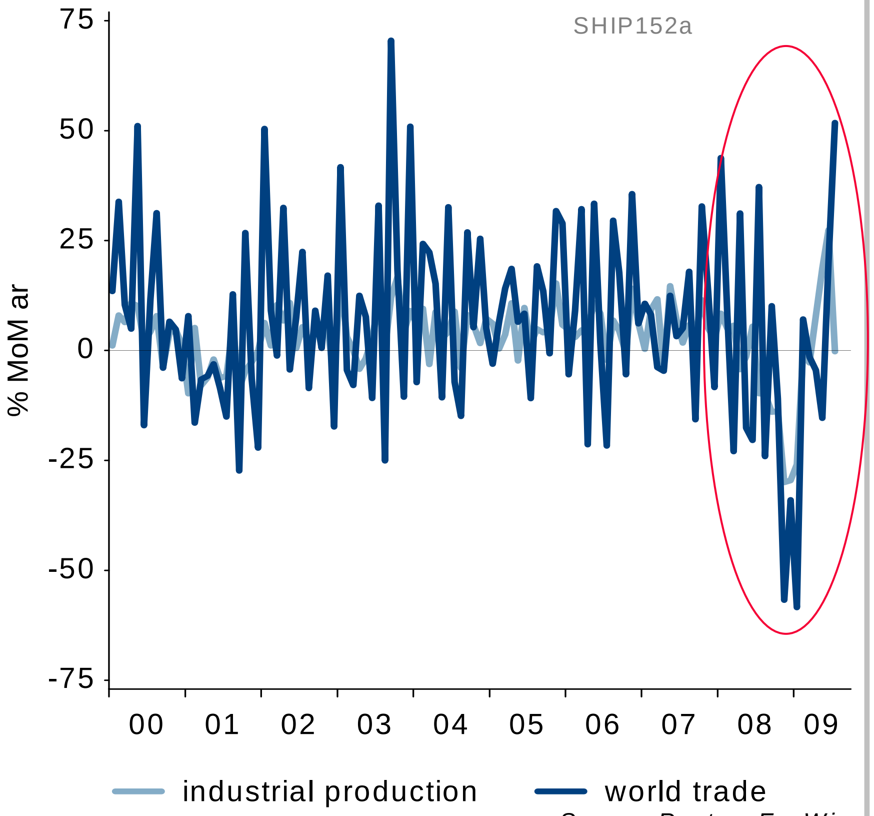
Two reasons for pessimism: recessions hit in simultaneously, so exports cannot act as safety valve (2)

World trade and industrial production



Source: Reuters EcoWin

The pessimists were wrong!

- Why couldn't a simultaneous slump be followed by a simultaneous rebound?
- If the slump resulted from a sudden injection of 'fear' into the economy, surely the rebound would follow more or less automatically if fear dissipated
- The recovery in world trade and world industrial production has resulted from
  - Less aggressive de-stocking
  - A bottoming out in final domestic demand in response to:
    - Aggressive and co-ordinated fiscal and monetary stimulus
    - Stabilisation of financial markets/ disappearing 'fear'

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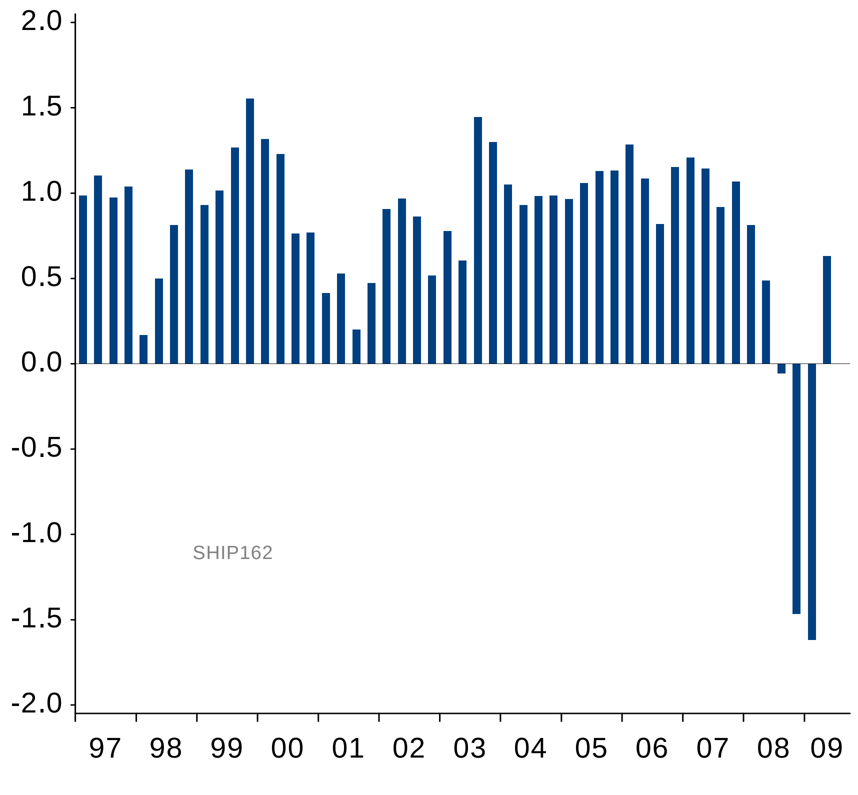
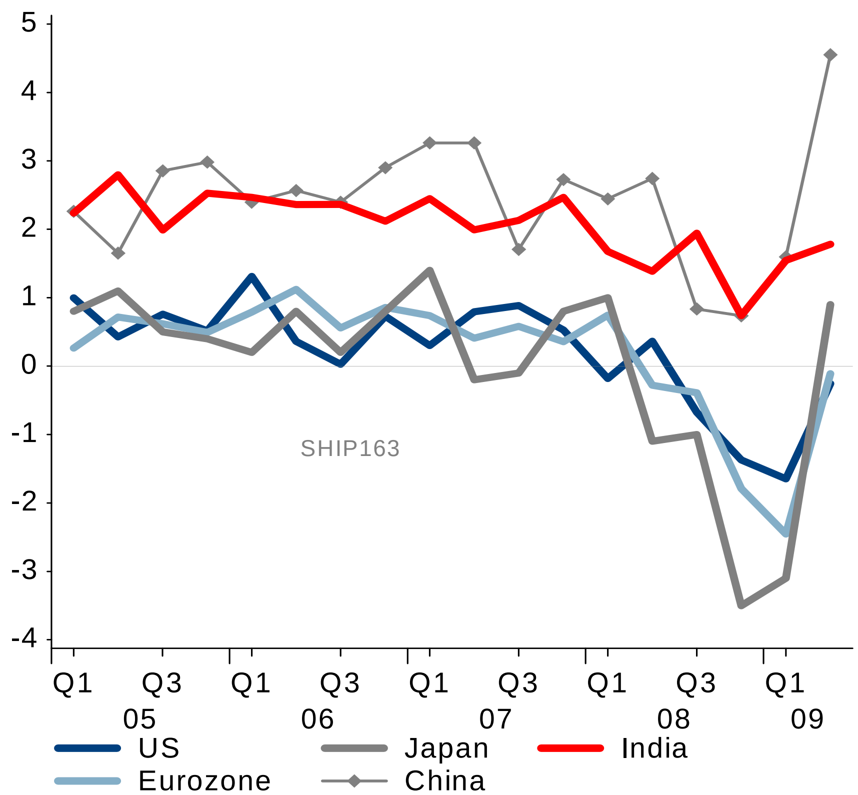
The world economy is growing again, and it looks like a V-shaped recovery!

World GDP growth (% QoQ)



Source: Reuters EcoWin, Fortis Bank NL

Quarterly growth in some major economies



Source: Reuters EcoWin, Fortis Bank NL

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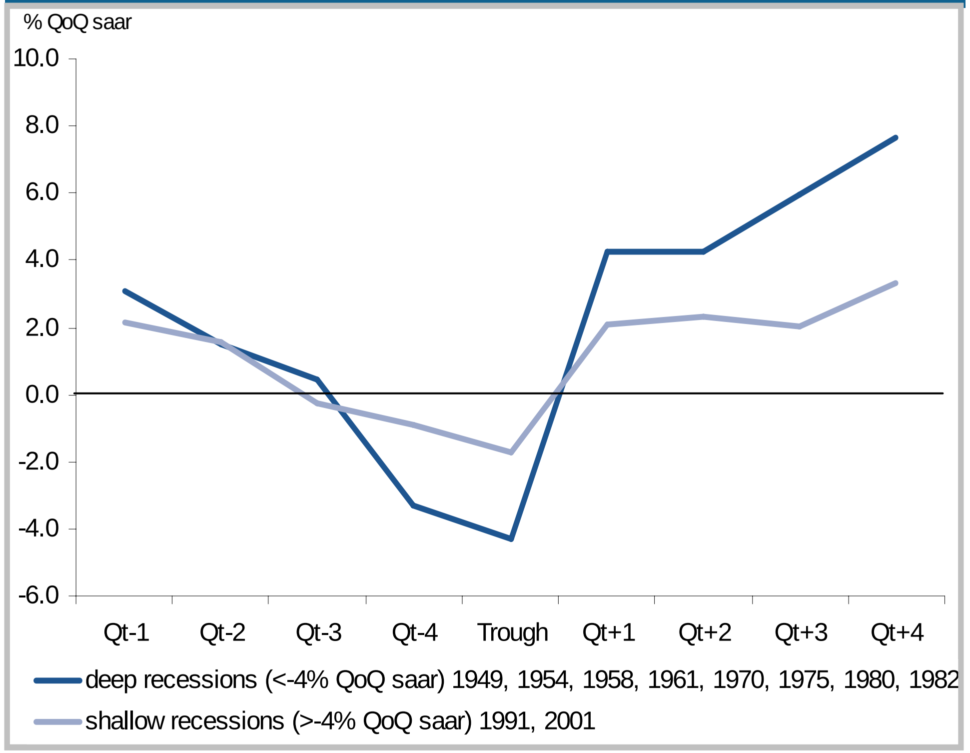
This continues a tradition: in post-WWII, deep recessions were always followed by steep recoveries

US quarterly annualised growth in real GDP



Source: Fortis Bank NL

average GDP growth over four quarters after trough	%QoQ saar
1948	7.61
1954	6.26
1958	7.34
1961	6.31
1970	4.55
1975	6.14
1980	4.46
1982	1.51

‘V’-shaped recovery could yet turn into a ‘W’-shaped recovery: Let’s give the floor to the ‘Double Dippers’

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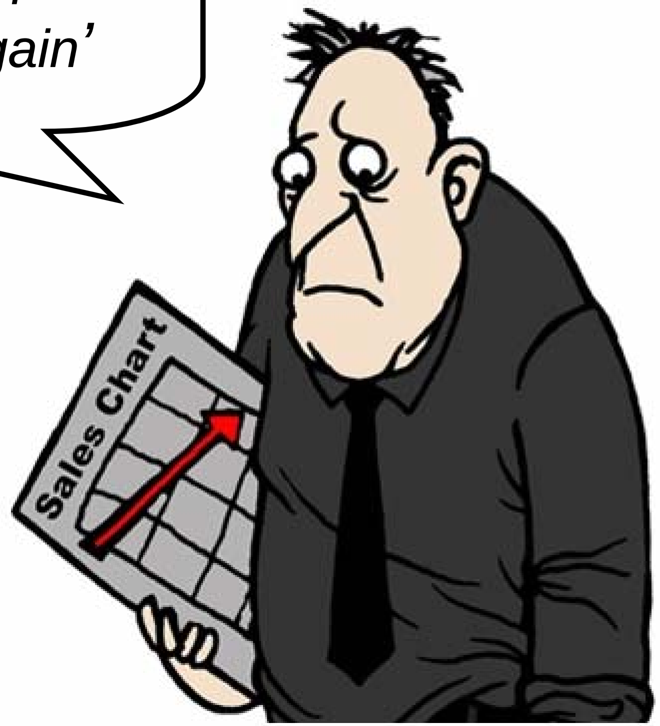
‘The recovery results from re-stocking/weaker de-stocking; once that process is complete, growth will fall back again’



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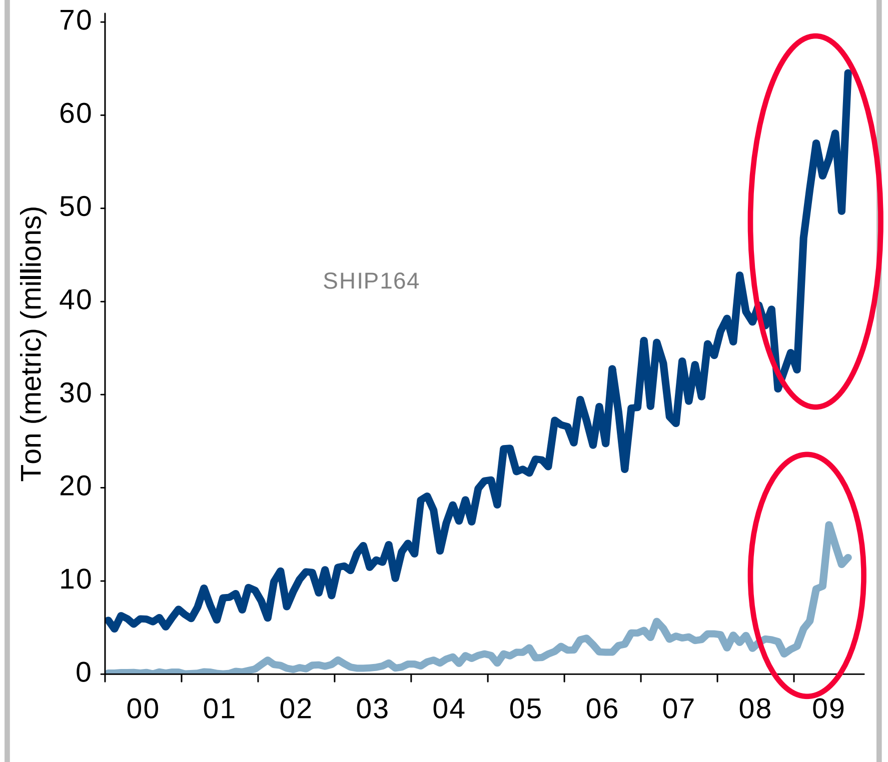
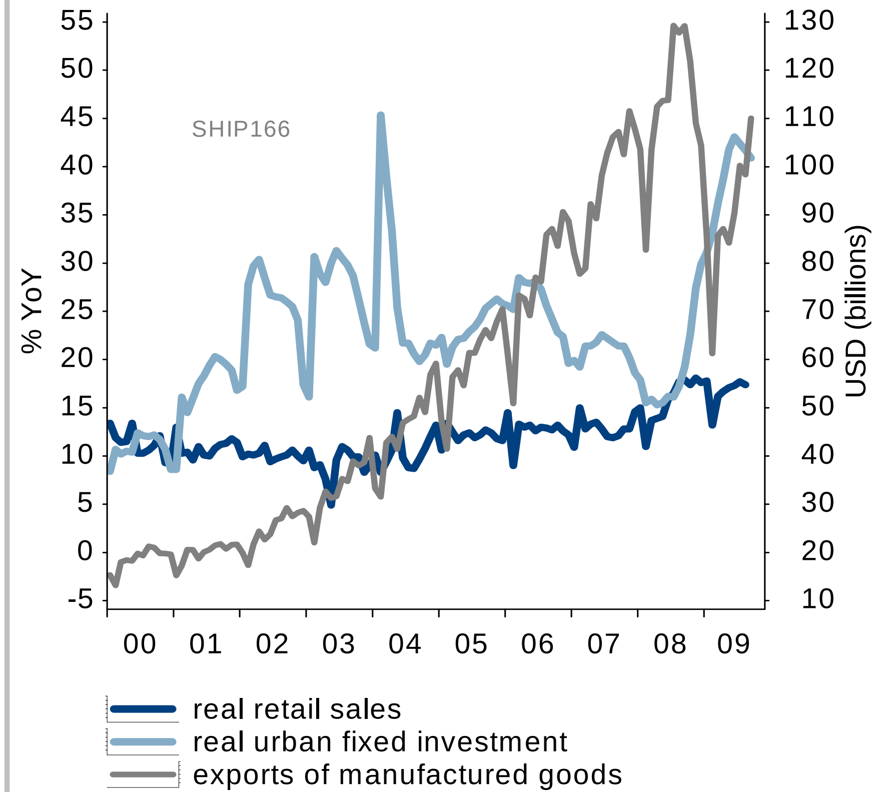
Stockbuilding has been a major force behind the Chinese and Indian upswings, but it hasn't been the only force…

Chinese comm. import growth unsust. high



Source: Reuters EcoWin

Chinese recovery is more than re-stocking



Source: Reuters EcoWin

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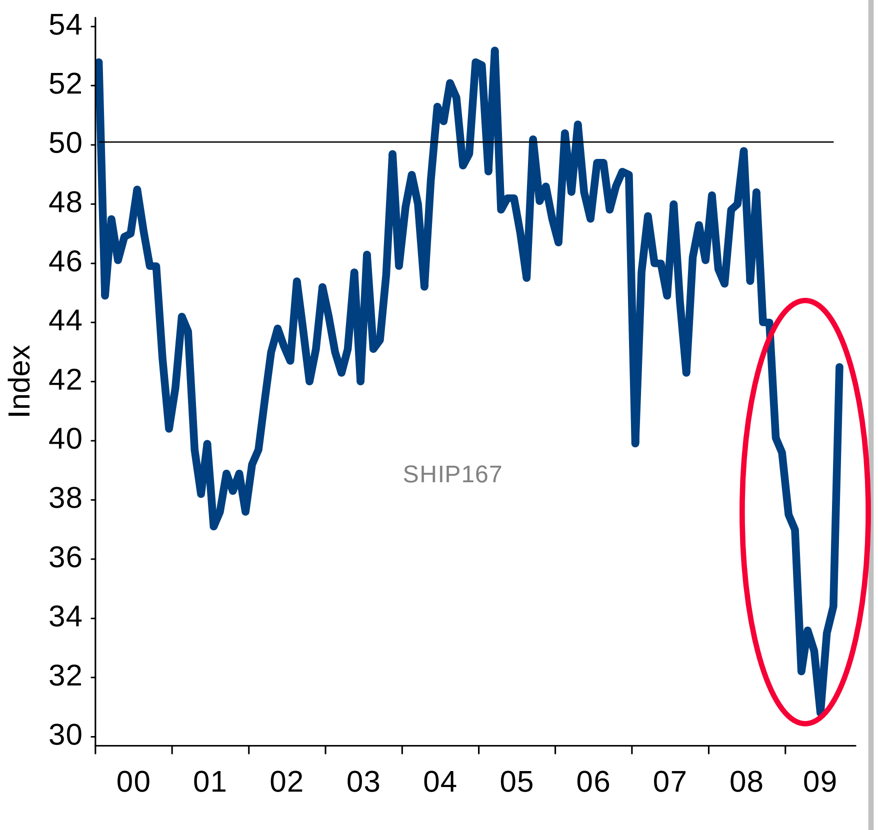
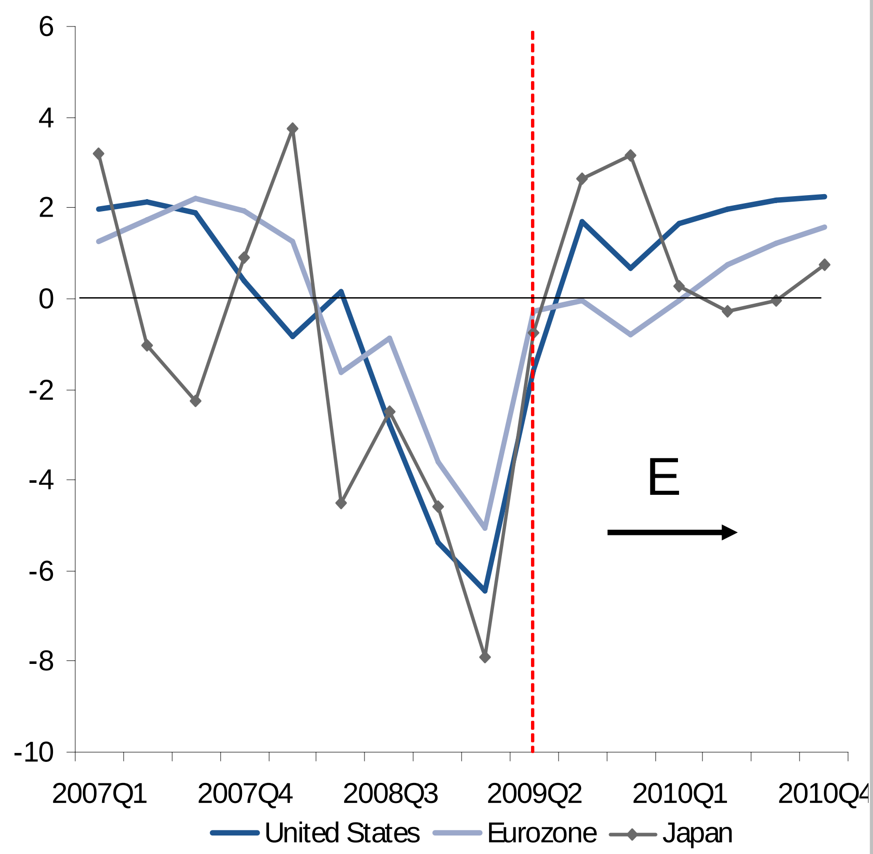
In developed countries the phase of aggressive de-stocking has only just ended; inventories could actually start rising once final domestic demand picks up

ISM manufacturing index: inventories



Source: Reuters EcoWin

Final domestic demand in recovery mode



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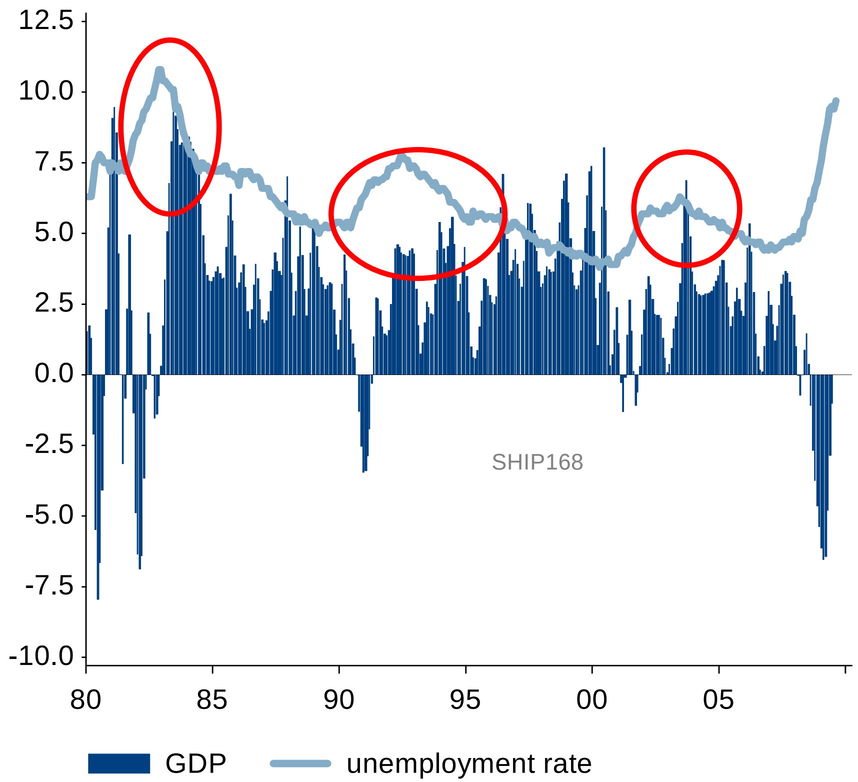
High unemployment is often named as a threat to recovery but it has never been in the past

US GDP and unemployment rate



Source: Reuters EcoWin

Recovery by def. coincides wit high unemp.

- One of the weakest arguments used to be pessimistic about the outlook is that unemployment is high
- Recovery by definition happens when the unemployment rate is close to or at its cyclical peak
- Economic growth drives unemployment rather than the other way around

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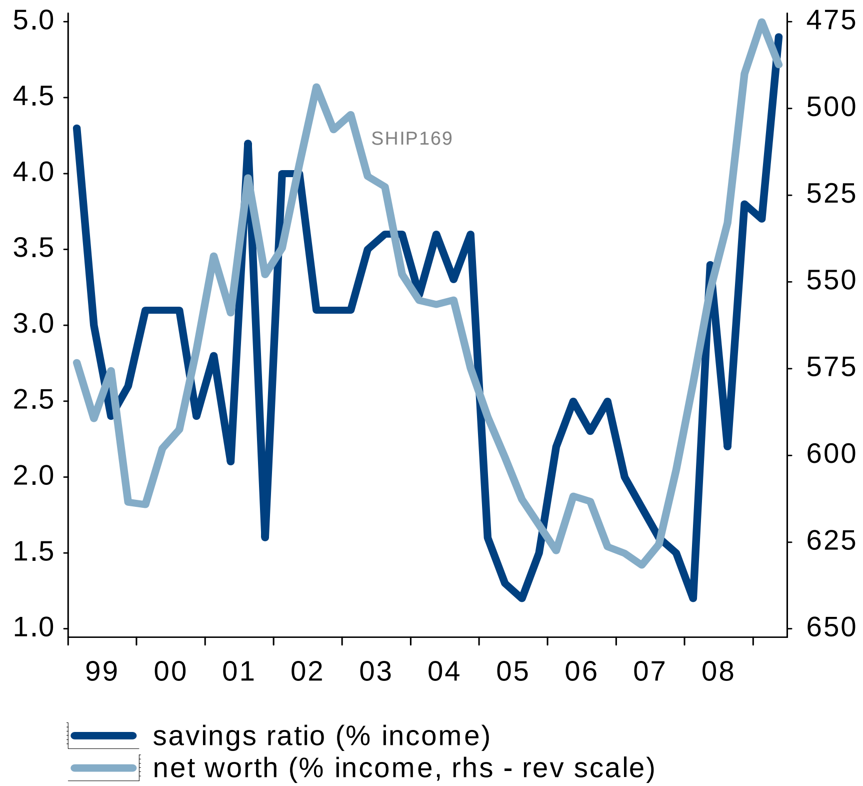
Adjustment for US households looks well advanced

US saving ratio has adjusted to lower wealth



Source: Reuters EcoWin

Labour market adjustment quicker in US

- Falls in net worth tend to lead households to save a bigger portion of their income, leading to lower consumer spending
- However, household savings ratio has already risen sharply enough to compensate for fall in wealth according to our econometric models (you can also see this with the naked eye in the chart on the left)
- With equity markets rebounding, and house prices bottoming out, household net worth is more likely to move higher than lower in the future

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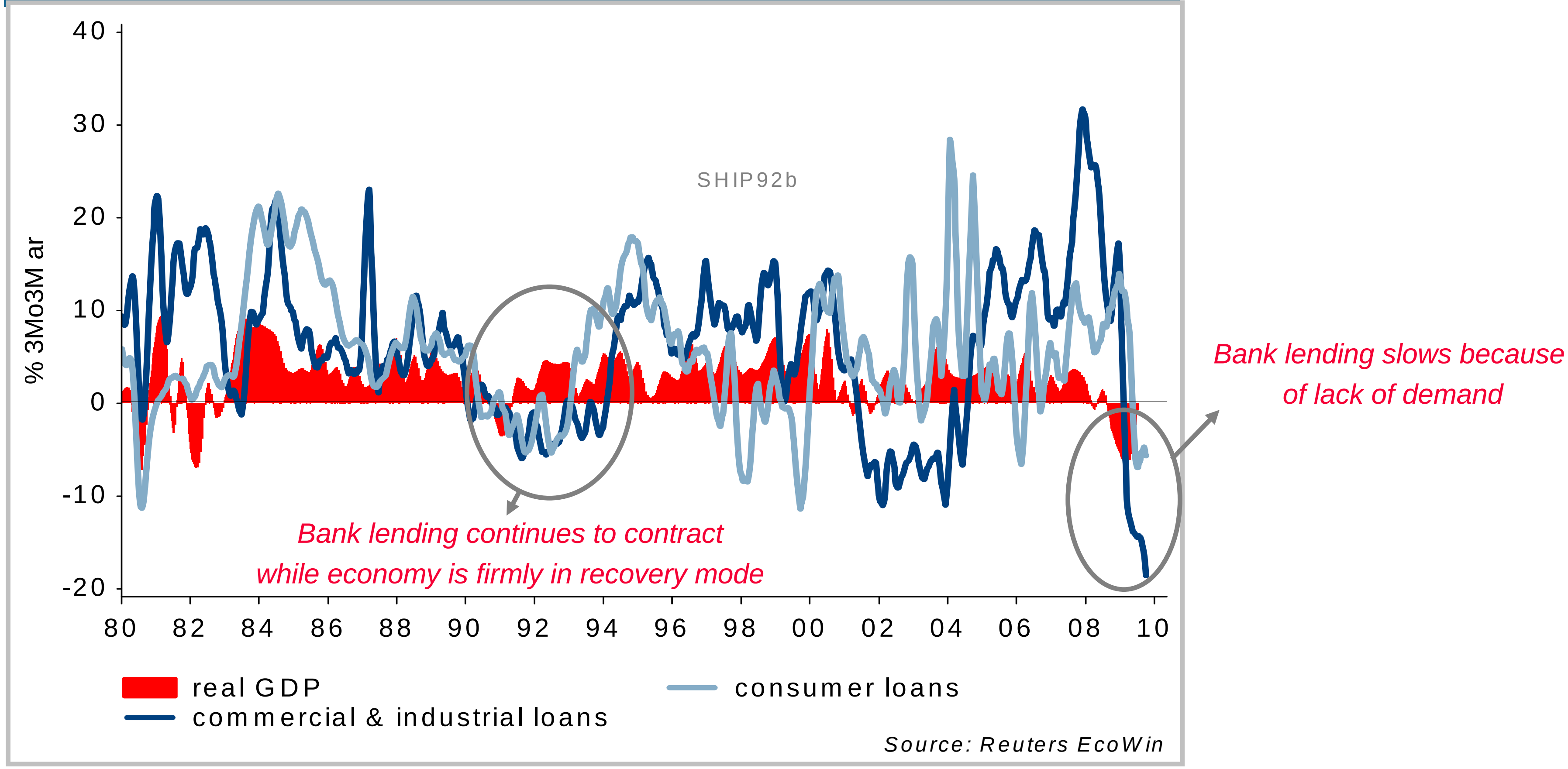
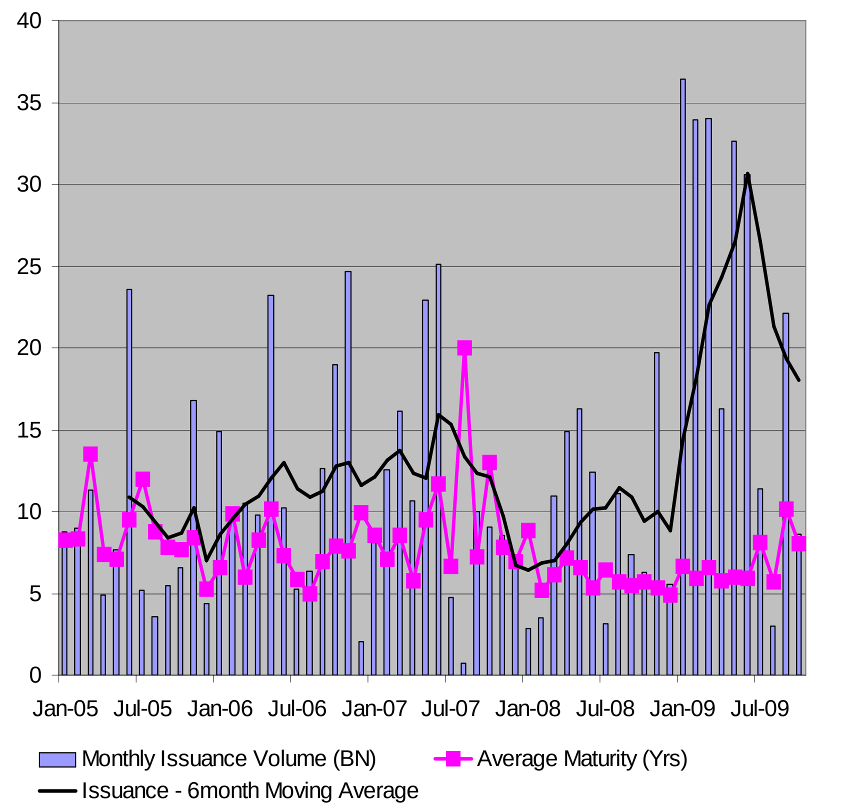
We don't think the banking sector will be a bottleneck during the upswing

US bank lending and real quarterly GDP growth



Eurozone companies have discovered corporate bond market

EUR non-financial corporate issuance



Source: Bloomberg, Dealogic, Fortis Bank NL

Things may not be as bad as they seem

- True, Eurozone banks still have some way to go in recapitalizing their balance sheet (American banks are largely finished)
- True, recapitalisation need will further increase if capital requirements are increased (but this will be done in a gradual fashion)
- But, companies are creative in finding alternative sources of funding, such as the corporate bond market; this will create space for bank lending to SME's
- Remember: a lot of bank lending in the past was actually financing bubbles! If we can avoid this, there's a more left for financing real econ.

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‘Fiscal and monetary retrenchment will throw the economy back into recession’

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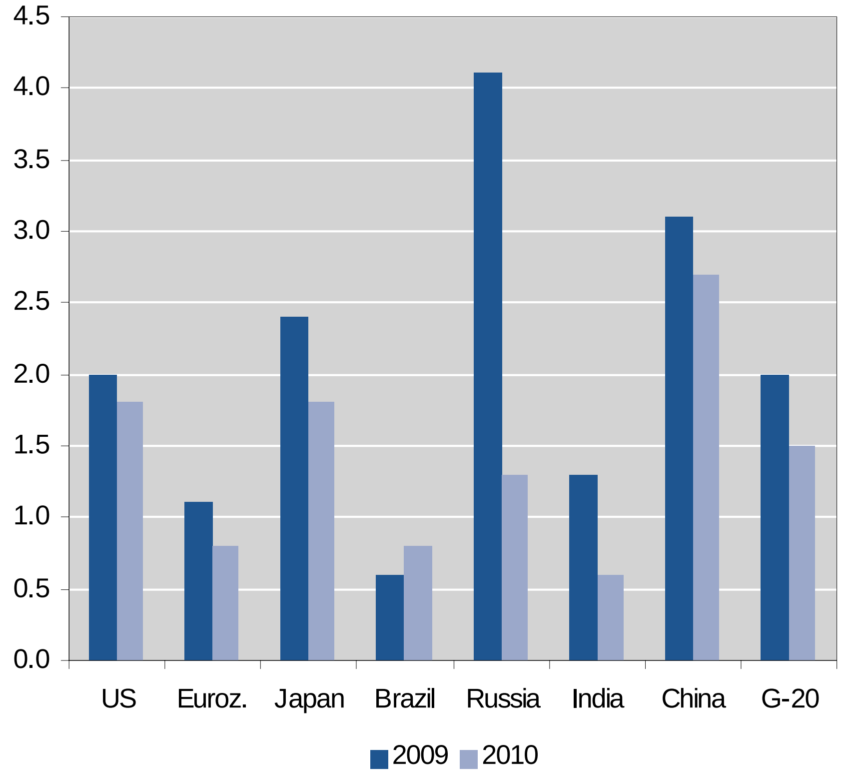
Macroeconomic policy looks set to remain accommodative in 2010

Stimulus packages 2009-2010 (% GDP)



Source: OECD

What central bankers say:

- Fed statement (12 August):

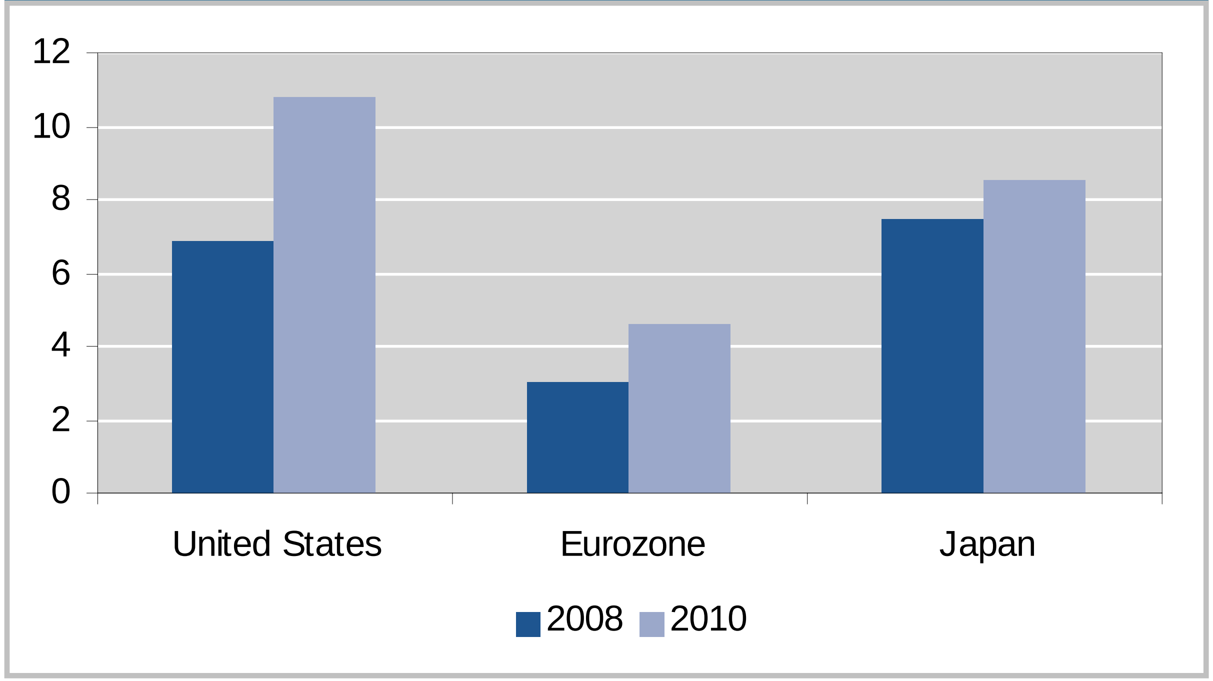
"economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period"

- ECB President Trichet (21 August):

"we see some signs confirming that the real economy is starting to get out of the period of "free fall" – which does not mean at all that we do not have a very bumpy road ahead of us – the largest mistake we could make would be to forget the importance and the urgency of this task".

To return the budget to a sustainable path, significant cut-backs are necessary

Fiscal gaps (to return debt in 2050 to 2008 level)



Source: IMF

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Cut-backs that come too soon or are too aggressive could throw the economy back into recession from 2011 onwards; this would continue a tradition of 'man-made' double-dips

Double-dip recessions

	1st recession	2nd recession	period in between (qrts)	trigger of double-dip
United States	1980Q1-1980Q3	1981Q3-1982Q4	4	- Aggressive monetary tightening under Volcker
Germany	1992Q2-1993Q1	1995Q4-1996-Q1	11	- Excessive wage increases - Solidaritätszuschlag
Japan	1991Q1-1993Q3	1997Q2-1999Q1	15	- Increase in VAT rate - Asian crisis
Japan	1997Q2-1999Q1	2000Q3-2002Q1	6	- Premature mon. tightening - Bursting of internet bubble

Source: Fortis Bank NL

Lessons well-learnt

- G20 finance ministers: '*We agreed the need for a transparant and credible process for withdrawing our extraordinary fiscal, monetary and financial sector support as recovery becomes more firmly secured. Working with the IMF and the FSB we will develop cooperative and coordinated exit strategies*'

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‘A lack of fiscal and monetary retrenchment will throw the economy back into recession’

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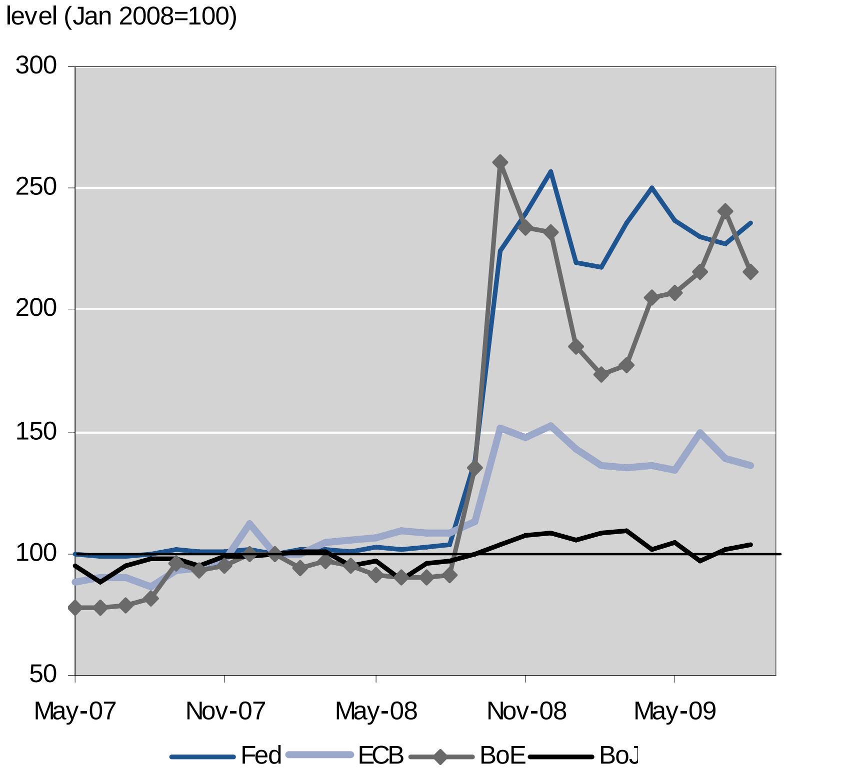
Damned if you do, damned if you don't (1)…

What if bank reserves begin to move?



Source: Fortis Bank NL

…and central banks are slow to react?

- Money supply would become hard to control, creating risk of new asset bubbles and/or goods inflation
- This could create a process such as in the 1970s, with inflation expectations moving higher
- In anticipation (real) interest rates could move significantly higher, driving trend growth lower
- Keeping the money supply under control, would also drive (real) interest rates significantly higher

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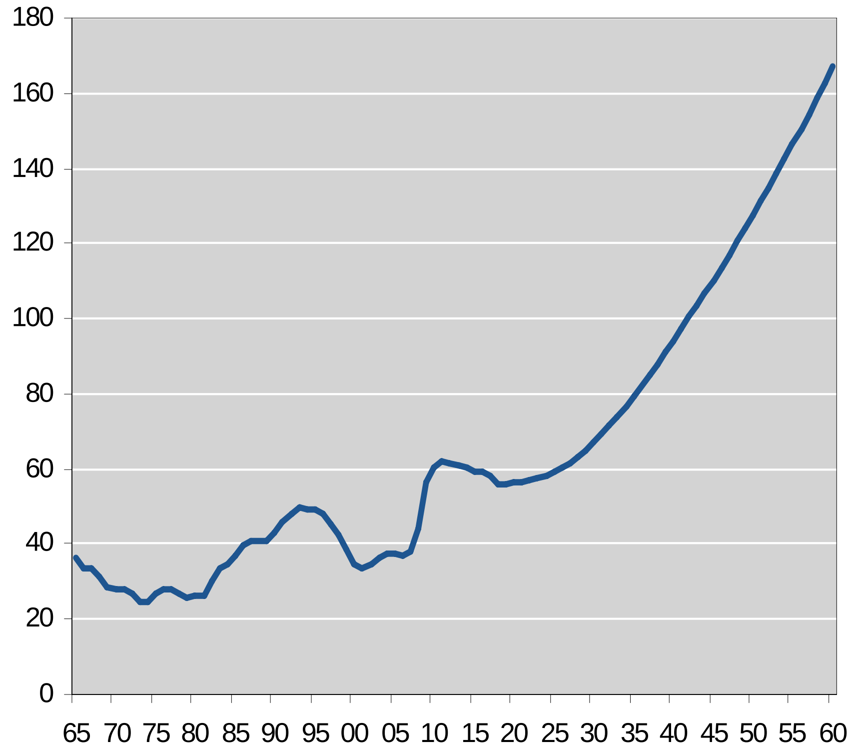
Damned if you do, damned if you don’t (2)…

What if we don’t close the fiscal gap?



Source: Congressional Budget Office

Government debt will explode

- Crowding-out of private sector debt, by driving interest rates much higher
- This would be increasingly negative for trend growth, although outright recession is unlikely
- Bad timing to try and implement $800bn health care reform…

Conclusions

- With financial markets stabilised, the post-Lehman fear-shock has unwound, and aggressive fiscal and monetary stimulus has begun to take effect, this should support growth well into 2010
- We are witnessing a reversal of the negative feedback effects dragging the world economy into a deep recession since mid-September '08
- Although the initial phase of the recovery is benefiting heavily from re-stocking and fiscal stimulus, positive feedback effects should soon make the economy stand on its own legs
- These positive feedback effects are likely to be quite forceful given the aggressiveness of cut-backs in investment spending, spending on consumer durables, inventory levels and staff levels (deep recessions tend to be followed by steep recoveries)
- The unwinding of fiscal and monetary stimulus should take place in a gradual and co-ordinated fashion or risk dragging the economy into a double-dip recession by 2011 (not FBN base scenario)
- Future trend growth could be lower as a result of structurally higher interest rates

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	2006	2007	2008E	2009E	2010E
GDP					
United States	2.7	2.1	0.4	-2.5	2.6
Eurozone	3.1	2.7	0.6	-3.9	1.0
Japan	2.0	2.3	-0.7	-5.4	1.9
United Kingdom	2.9	2.6	0.7	-4.2	1.8
China	11.6	13.0	9.0	8.5	9.0
India	9.8	9.3	7.5	6.3	7.0
Western Hemisphere	5.5	5.8	4.3	-1.5	2.0
Advanced economies	3.0	2.7	0.5	-3.2	1.9
Emerging economies	8.0	8.3	6.3	2.5	5.0
World	5.1	5.1	3.0	-0.8	3.2
World trade	*9.2*	*7.2*	*3.3*	*-9*	*6*

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