

# Press release



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## ***KBC's outlook for the international economy and financial markets in 2010***

### **Basic scenario: economic recovery to continue in 2010, but growth to remain weak and vulnerable in traditional industrialised countries**

- A year ago, the world economy was on the verge of collapse. Spectacular measures taken by monetary and budgetary authorities virtually everywhere in the world prevented the worst doomsday scenarios from materialising. In tandem with the turnaround in the stock cycle, these measures have ensured that there has been a clear economic recovery in recent quarters. The emerging economies in Asia had already come out of recession in the spring, with most traditional industrialised countries following suit in the summer. This economic turnaround has also been a source of optimism for the financial markets in recent quarters.
- The initial phase of the recovery has been quite stunning, but has been driven primarily in the industrialised countries by temporary factors, such as new stockpiling. Household spending is providing hardly any support at all to growth in these countries and, as a result of unemployment continuing to increase, will remain weak in 2010 as well. Companies are having to contend with historically low utilisation rates, which will put the brakes on business investment and also restrict inflation. As 2010 advances, the labour market will gradually bottom out and household and company spending could pick up again. However, that is unlikely to be enough to prompt the central banks in the US and the EMU to raise interest rates.

### **No double-dip recession**

- Given the ongoing low rates of interest, the continuing stimulatory budgetary policy in most countries and the gradual recovery of confidence in the financial sector, the economies of industrialised countries are unlikely to slip back into recession. What's more, exports from these countries are supported by the robust increase in demand from emerging markets. Despite the sharp appreciation of the euro, EMU countries have also benefited from the growth of these export markets in the past few months. The recent trend in foreign orders indicates that this trend could continue in 2010. It is unlikely that the euro will appreciate sharply again in 2010 (something that is not desirable in any way at all), given that it would ultimately have an adverse impact on the outlook for Europe's export.

### **Upside growth and inflation risks in emerging markets**

- It is, therefore, unlikely that the doomsday scenario of a new recession and of deflation in industrialised countries will materialise. However, the flexible interest-rate and budgetary policies will probably only be reversed sometime after 2010. Generally speaking, all these factors are conducive to a sustainable uptrend on the bond and stock markets in 2010. A reversal of the flexible interest-rate and lending policies might well be desirable in such emerging markets as China (specifically through an appreciation of the renminbi) and Brazil. If they procrastinate for too long, inflationary pressures could increase and bubbles might develop on the local equity and real estate markets. In addition to this risk, a positive surprise in terms of short-term growth in industrialised countries would not necessarily be good news for investors in 2010 either, in that the central banks would raise rates earlier than expected and budgetary policy would be tightened. At present, however, this is not yet totally on the cards.

## **Equities offer the best outlook for return**

- The spectacular economic recovery of recent months has served to increase investor appetite for risk. Equities in particular, but also commodities, corporate bonds and other higher yield bonds, have been much in demand and have been generating returns of between 15% and 75% since the start of March (for an investor in euros).
- Despite the sharp increase in share prices, stock markets can hardly be considered expensive, whether when compared to a realistic assessment of company earnings or to other asset classes. If a double-dip scenario can be avoided in the traditional industrialised countries, they offer the best outlook for return, certainly now that yields on corporate bonds have fallen sharply.
- The main risk for equity markets is the pace of growth in the US and Europe. Primarily the cyclical sectors are highly vulnerable to the inevitable slowdown of the current, vigorous rate of growth. Therefore, opting for emerging markets, which continue to expand at a fairly stable rate, and for somewhat more defensive sectors in traditional markets would seem advisable. The increase in commodity prices of recent months likewise looks vulnerable against the backdrop of a more realistic estimate of world economic growth. An exception to this is the oil market, where the fundamentals better justify the current level of prices.
- Equity markets aside, we still prefer corporate bonds and emerging market bonds to government bonds. Mainly Central-European bonds offer potential for narrowing spreads and for a further improvement in exchange rates.