

MACROECONOMIC AGGREGATES

	GDP growth (by volume)			Inflation (annual growth rate as %)			Current account balances (as % of GDP)		
	2007	2008	2009 (f)	2007	2008	2009 (f)	2007	2008 (f)	2009 (f)
United States	2.0	1.1	-2.7	2.9	3.8	-1.2	-5.3	-4.7	-3.3
Japan	2.4	-0.6	-5.7	0.1	1.4	-1.0	4.8	3.2	2.6
United Kingdom	3.0	0.7	-3.0	2.3	3.6	1.4	-2.8	-1.7	-1.3
Euro area	2.6	0.8	-2.5	2.1	3.3	0.4	0.4	-0.4	-0.1
France	2.1	0.7	-2.2	1.5	2.8	0.3	-1.0	-2.0	-2.0
Germany	2.5	1.3	-3.0	2.4	2.6	0.5	7.9	6.9	5.9
Italy	1.4	-1.0	-2.7	2.0	3.5	0.6	-2.4	-3.1	-3.5
Spain	3.7	1.2	-2.7	2.8	4.1	0.6	-10.1	-9.8	-8.9

CENTRAL BANKS INTEREST RATES

	2008	11/03/2009	May 2009	August 2009
United States - Fed funds	2.08	0.25	0.25	0.25
Japan - Discount rate	0.46	0.10	0.10	0.10
United Kingdom - Bank rate	4.67	0.50	0.50	0.50
Euro area - Refinancing rate	3.90	1.50	1.00	1.00

INTEREST RATES

	2008		11/03/2009		May 2009		August 2009	
	3-month	10-year	3-month	10-year	3-month	10-year	3-month	10-year
United States	2.99	3.65	1.40	2.92	1.25	3.00	1.25	3.10
Japan	0.85	1.49	0.70	1.31	0.70	1.20	0.55	1.20
United Kingdom	5.49	4.48	1.88	3.09	1.30	2.90	1.10	3.20
Euro area	4.62		1.70		1.25		1.15	
France		4.19		3.66		3.60		3.55
Germany		3.99		3.07		3.05		3.15
Italy		4.61		4.51		4.40		4.40
Spain		4.35		3.86		4.10		4.10

EXCHANGE RATES

	2008	11/03/2009	May 2009	August 2009
EUR/USD	1.47	1.28	1.25	1.30
EUR/GBP	0.80	0.93	0.96	0.92
EUR/JPY	152	125	115	125
USD/JPY	103	97	92	96
GBP/USD	1.84	1.38	1.30	1.41

'WHO'LL STOP THE PAIN?'

- To this question, posed by Paul Krugman in the *New York Times* on 20 February, we can only answer either governments and central banks, or time, meaning a long period of anaemic growth following the severe adjustment we have been suffering since Lehman Brothers collapsed (an L-shaped or Japan-style recession).

- Either way, as Sweden demonstrated in the early 1990s (cf. *Focus*, pages 6-7) and in the light of Japan's experience during its 'lost decade', no durable recovery can take place before two conditions are met: excessive debt and its associated property bubbles have to be corrected; and banking systems have to be cleaned up.

- The Swedish example also shows that credit and property bubbles take a long time to deflate, during which time activity suffers even when the banking system is straightened out quickly and effectively. Real Swedish GDP contracted for three years in a row in 1991-93, and the strong recovery of 1994 was made possible only by a rebound in exports following a 20% depreciation of the krona and a related surge in productive investment. Similarly, Japan pulled out of a depression in 2003 that had persisted since the early 1990s because of vigorous exports to the rest of Asia (notably China) and the USA. Today's crisis is global, however, and only monetary and fiscal policies can keep the world economy out of a deflationary spiral and then trigger a rapid exit from this impasse.

- Since October 2008, and in an emergency situation, governments and central banks have managed to stabilise the financial system. Even so, and despite a slump in oil prices, they have not succeeded in preventing an extraordinarily sharp contraction in activity worldwide or depressive spirals involving job losses, idle productive capacity and a crash in asset prices, equities in particular. Fresh risks and constraints have emerged, including difficulties in several emerging countries and mounting risk premiums on government debt, notably within the euro zone. In the USA and the UK, plans to stabilise the banking system have proved insufficient to guarantee some institutions' solvency, and solvency is a necessary condition for the system's normalisation. This has given rise to yet more initiatives. At the same time, monetary policies have been eased again, with complementary quantitative and unconventional measures adopted in the USA, Japan and the UK.

- So what lies in store for the next few months? Quite clearly, the recession will deepen in the first quarter and continue until the summer at least. Positive factors will start to kick in from that point onwards: fiscal stimulus will be in place, widespread and significant rate cuts as well as unconventional monetary policies will start to have an effect, destocking (and its crippling effect on production) will be over, and residential construction will bottom out in countries like the USA. The end of the year and early 2010 will be a critical period for the resumption of growth. By their very nature, fiscal stimulus packages have only a temporary impact on activity. In order to ensure that they impart momentum to growth, rather than a brief show of fireworks that dies away next year, financial stability has to be restored in the meantime. In other words, bank lending has to resume, risk and liquidity premiums have to normalise and the securitisation jam has to be overcome.

- In short, government and central bank action will again decide what happens next. The authorities have to be pragmatic, aware that the risks mean excessive intervention is better than too little in the time left to them to head off deflation. Moreover, our extremely interdependent economies and financial markets require co-ordinated policies and forbid any form of protectionism.

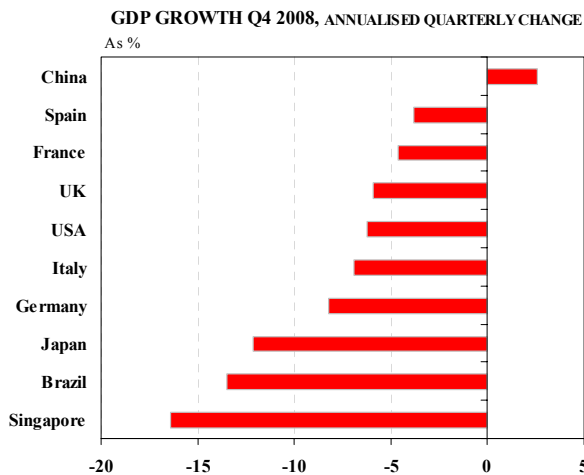
An exceptionally sharp, widespread and severe recession; economic indicators at their lows

Activity has contracted dramatically in the world's major economies since Lehman Brothers collapsed. The simultaneous nature of the downturn highlights the extent to which developed countries – where the crisis started – and emerging countries are financially and economically interdependent. Indeed, the shock is proving most violent in Asia, where trade links are particularly strong and which depends heavily on exports to the USA and European Union. Paradoxically, major exporters like Germany and Japan are suffering badly, even though they had no property or credit bubbles beforehand. China's deceleration has been severe, with sagging industrial production and exports.

Even so, the country's closed financial system and considerable budgetary leeway offer a degree of protection via government spending and credit growth¹. This reorientation of the components

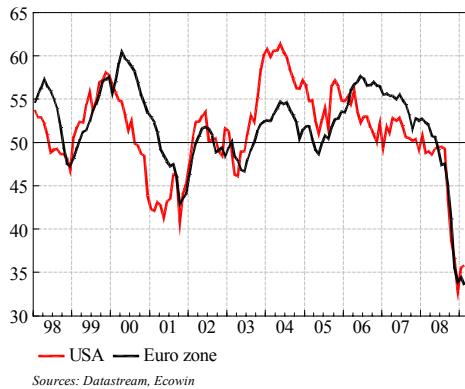
¹ Chinese exports fell 25.7% year-on-year in February but investment surged as a result of infrastructure spending included in a stimulus package. The PMI has also picked up, although it remains low in absolute terms.

of final demand will end up reducing the Chinese trade surplus, despite lower prices for oil and raw materials imports. In other words, it will help resolve international disequilibria, especially if it continues via more vigorous consumption.



Economic indicators remain depressed worldwide, pointing to continuing recession in the first quarter, and at least as severe as it was in the fourth quarter.

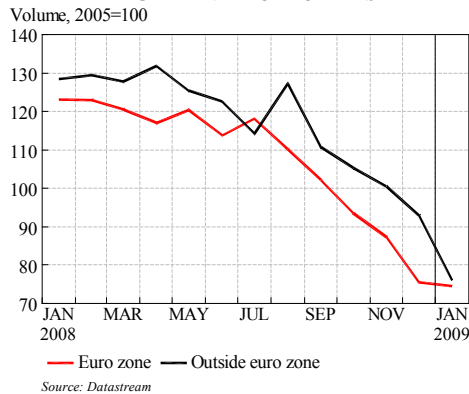
MANUFACTURING ISM AND PMI INDEX



Sources: Datastream, Ecowin

German export orders reflect the exceptional magnitude of the crisis for capital goods producers (including automobiles) and then manufacturers of intermediate goods. This phenomenon may be attributed to a lack of access to liquidity amid extreme uncertainty after Lehman Brothers collapsed. As the chart below shows, the crisis hit developed countries first then spread to emerging countries late last year.

GERMAN EXPORT ORDERS



Source: Datastream

For their part, companies have been aggressively cutting stocks. The problem is that demand has contracted unexpectedly quickly, so that even major adjustments to production have often not been enough to prevent stocks rising. Thus the contribution of stocks to GDP growth was strongly positive in the euro zone in the fourth quarter of 2008 (+0.6 point q/q) and close to zero in the USA (+0.16 point on an annual basis). From now on, however, destocking will trim growth rates significantly. The stocks/sales ratio in the USA has interrupted its downtrend with a sharp rise, confirming this outlook.

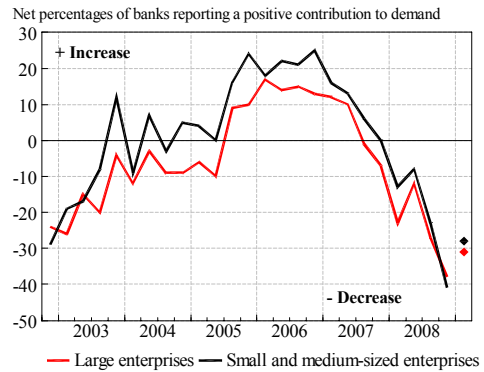
USA: STOCKS/SALES RATIO



Source: Datastream

Although banks are tightening their lending conditions in view of higher credit risk during recessions, corporate demand for credit is also fading, as recent commercial bank lending surveys show in the USA and the Euro zone.

EMU: CORPORATE CREDIT DEMAND

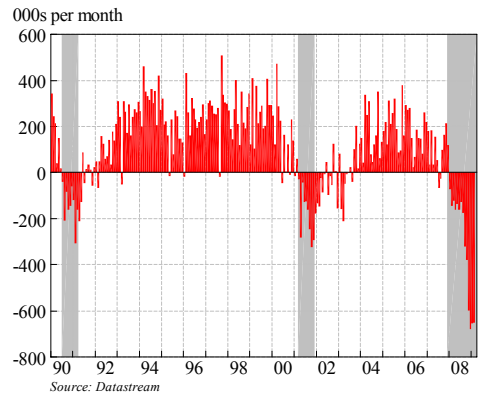


Source: ECB - The Euro area bank lending survey

Household demand is weakening in all countries, and the rebound in private consumption in France late last year was the exception rather than the rule.

In countries like the USA, UK and Spain, this component of demand contracted early on, reflecting the collapse of the credit and residential property bubbles; in others, such as Japan, Germany and, in 2009, France, the key factor has been rising unemployment and sliding confidence in the wake of falling corporate demand and investment. Balance of payments positions are improving for the first group of countries and worsening for the second group.

US JOB CREATION



Source: Datastream

In the USA, Spain and the UK, the constraints weighing on households are aggravated by unprecedented job destruction, tighter credit conditions and very negative wealth effects (lower house and share prices, with an impact on pension funding in the USA and UK)². As a result, confidence is at its lows.

Households are therefore rebuilding their savings (or reducing their debt) extremely quickly, producing impressive increases in savings rates and reduced consumption. This move has further to go, and we expect the US savings rate to be around 8% in 2010, compared with 5% in January.

² In 2008, US households net worth decreased, coming back from \$62.7tn to \$51.5tn.

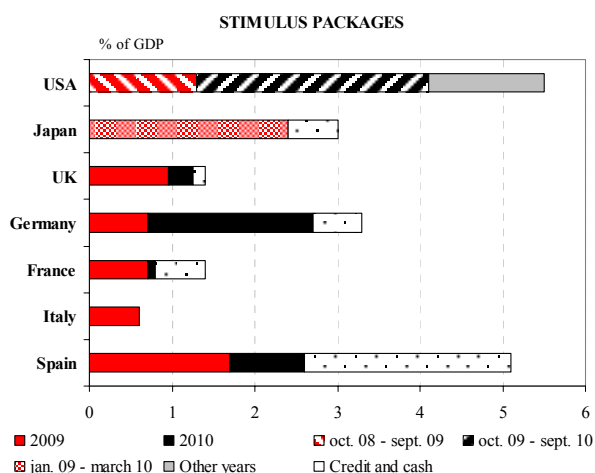
The Obama administration's initiatives

The Obama administration is implementing a range of initiatives (cf. pages 10-11) with three, complementary objectives:

- to bolster activity in the near term with a \$787bn stimulus package (5.5% of GDP) that will also help to strengthen productive potential in the medium term (infrastructure investment, energy saving, new sources of energy, health, education etc.);
- to stabilise the financial system so that households and businesses can obtain the finance they need, implying a clean-up of the banking system;
- to reduce the number of foreclosures and help stabilise the property market.

Several remarks may be made at this stage:

1. Two conditions are required (although they may not be sufficient) for the upturn in activity to become self-sustaining: the credit crunch affecting so many financing mechanisms (particularly securitisation) has to end; and the vicious circle linking property prices, negative equity and repossessions has to be interrupted. If the above three objectives are not met simultaneously, the chances of a return to durable growth next year will be slight.



2. The stimulus package mobilises \$185bn between now and September and another \$399bn between October and September 2010. It is front-loaded, with most of its positive impact concentrated between this spring and mid-2010, in 2009 H2 especially. The outlook for activity from that point on is open to question. Either private demand will be strong enough to take over, or growth will fall back again, or additional fiscal stimulus will be voted in the run-up to mid-term elections, creating even more government debt. While the existing package appears substantial, automatic stabilisers are far more powerful in Europe. Either way, more may have to be done on both sides of the Atlantic.

3. The financial stabilisation plan remains vague. Two questions remain open. What will happen to those institutions that do not pass the stress tests to which they are now subjected? And will the government remain a minority shareholder, will it take a majority stake, as in RBS and Lloyds Banking Group in the UK, or will it nationalise them?

The latter option has the merit of clarity, at least, and deals easily with the problem of valuing toxic assets as they can be parked in defeasance structures. It has drawbacks, too. Firstly, the markets could oblige the authorities to nationalise a great many banks, from one to another, in order of decreasing financial fragility. Secondly, managing international banks is not a simple matter and it is by no

means obvious that the public sector has the resources to do so, particularly if it owns several of them. It would also be desirable for lending policy to remain on a commercial basis rather than political in nature. Lastly, the subsequent privatisation of these big banks would be complicated and would take time.

It is also unclear how private investors are to be encouraged (cut-rate loans? loss sharing?) to participate in the \$500bn (and eventually \$1trn) public/private investment fund that is to offer banks the possibility of shuffling off their toxic assets at a price fixed by these same private investors. The sale of assets at a bearable – if difficult to determine – price has one precious advantage relative to the insurance system used for Citigroup, BoA, RBS and LBG: it completely eliminates the risk these assets generate for the banks.

4. The Term Asset-Backed Securities Loan Facility (TALF) is a joint Fed-Treasury programme intended to encourage the securitisation of consumer credit, student loans and loans to small businesses guaranteed by the Small Business Administration. Securitisation, once important financing mechanism for the US economy, virtually ceased to function (except for GSEs) in the fourth quarter. The financial stability plan multiplies the TALF's potential resources to \$1,000bn and incorporates CMBS as well. The chances of the programme's success are unclear, however, partly because it concerns AAA tranches only.

5. At this stage, the \$75bn earmarked for financing the shared effort to reduce mortgage loans monthly payments and a series of incentives to servicers and borrowers looks inadequate. And the plan does not really tackle the problems of over 10 million households with negative equity.

6. In a bid to obtain and keep public support, the Treasury and the Fed are trying to be as transparent as possible, and the Treasury will impose strict conditions on its aid to financial institutions. But public opinion can sometimes lead to counterproductive half-measures, particularly concerning banks and help for households with negative equity and/or struggling to meet their mortgage payments.

7. On the plus side, and despite occasional hiccups, the US authorities have been pragmatic and really have mobilised massive resources. The record budget deficit for the 2009 fiscal year (\$1.75trn, or 12.3% of GDP) includes an indicative \$250bn charge to cover losses linked to removing toxic assets from banks' balance sheets, within a \$750bn allocation to complement the TARP.

All in all, the Obama administration has come up with a series of consistent measures but that lack clarity on certain major points. Moreover, their chances of success are uncertain, given the rate at which the economic situation is deteriorating. The markets have therefore received these plans unenthusiastically, and a unique opportunity to reverse expectations has been lost. The positive point lies in the fact that the USA is the only country in the world with virtually unlimited leeway in terms of monetary and fiscal policy. Complementary measures would undoubtedly be taken if required.

Hervé MONET +33 1 42 14 88 16

All opinions and estimations included in the report represent the judgment of the sole Economics Department of Société Générale and do not necessarily reflect the opinion of the Société Générale itself or any of its subsidiaries and affiliates. These opinions are subject to change without notice. It does not constitute a commercial solicitation, a personal recommendation or take into account the particular investment objectives, financial situations.

Although the information in this report has been obtained from sources which are known to be reliable, we do not guarantee its accuracy or completeness. Neither Société Générale nor its subsidiaries/affiliates accept any responsibility for liability arising from the use of all or any part of this document.

Société Générale may both act as a market maker or a broker, and may trade securities issued by issuers mentioned in this report, as well as derivatives based thereon, for its own account. Société Générale, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any issuer mentioned in this report.

Additional note to readers outside France: The securities that may be discussed in this report, as well as the material itself, may not be available in every country or to every category of investors.