News from the financial markets

The post-crisis world

Volume 2: Growth even in the face of weak consumption

October 2, 2009

VP BANK

The post-crisis world

Volume 2: Growth even in the face of weak consumption

Dr. Jörg Zeuner, Chief Economist, and Oliver Schlumpf, Junior Asset Allocation Strategist

At present, many signs are pointing toward growth. Strong base effects will ensure a positive dynamic through mid-2010. We expect to see ample growth rates despite several conservative assumptions – for example, our view of personal spending in the euro zone. As to the controversial prognoses for consumption in the USA, our expectation of a 0.5% increase can be considered moderate. Our scenario is based on the course of recovery that followed previous financial crises.

Signs point toward growth

Numerous leading indicators are suggesting that, by the end of this year, the sharpest economic slump since the Great Depression will draw to a close in most of the major economies. The purchasing managers indices for the large industrialized countries have improved by leaps and bounds in recent months and most have found their way back into the expansion zone (i.e. >50).
The Asian emerging nations returned to a recovery mode already in the first half of 2009. Brazil is also putting in a relatively robust performance: it started to recover already in first quarter.

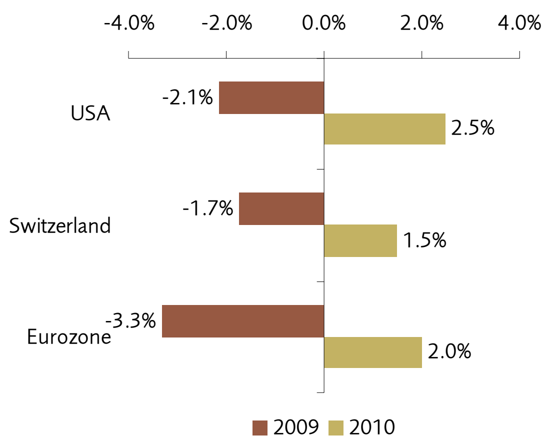
2009 setback less dramatic than expected

For the current year, we are forecasting a maximum 2% GDP decline in the USA and Switzerland – the consensus now appears to be coming around to our way of thinking.
The euro zone has been hit harder by the crisis, and its GDP is likely to shrink by more than 3%. The export sector has suffered the most from the global drop in demand. Despite the upbeat Q2 macro data from Germany and France, we expect to see two further difficult quarters for the euro zone as a whole. Above all the countries on the periphery – such as Ireland, Italy and Spain – will be unable to imitate Germany's speed of recovery.

VP Bank's forecast for 2010

We are going on the assumption that the US economy in 2010 will grow by roughly 2.5%. In terms of Switzerland, we expect to see GDP increase by around 1.5%. The euro zone should manage to record a growth rate of approximately 2%.
Despite the cautious underlying assumptions, our forecast comes in slightly above the consensus estimates, mainly with regard to the euro zone. Nevertheless, uncertainties remain high.

VP Bank growth forecasts



Source: VP Bank

Drivers of the economic upturn

The recovery is in the process of being kick-started by the restocking of inventories. In addition, capital spending and net exports will contribute significantly to the upswing:

- We are assuming that capital spending (before inventory changes) will increase by 1-2%. Due to the crisis, there is currently pent-up demand in this regard. The banks will gradually be more willing to finance postponed as well as new projects. And companies' reemerging willingness to accept risk will fuel that trend.
- Exports are likely to witness a significant upside correction already in the second half of 2009. Global trade is picking up, and for 2010 we expect to see exports grow by 2% (a slower pace than the IMF's projected global growth rate of roughly 3%).
- In our prognosis, imports will increase at roughly the same pace as private consumption (the largest component of GDP). Particularly in the USA, the price of oil (see box) will have an additional effect on import growth.
- Viewed collectively, exports from all three economies will grow faster than imports under these assumptions, thereby making a positive contribution to growth especially in Switzerland. A 1% increase in exports (ca. 50% of Swiss GDP) boosts GDP growth by 0.5% (all things being equal).
- Government spending was expanded during the crisis in effort to compensate partially for the decline in private demand. We are going on the assumption that those expenditures will no longer increase significantly in 2010 and thus make no notable contribution to economic growth.

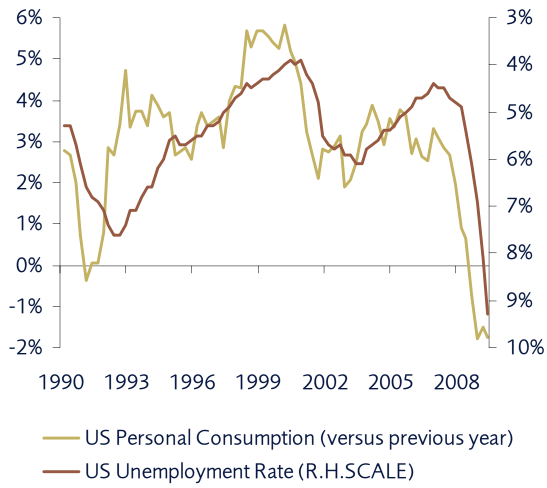
VP Bank oil price forecast

In response to the recovery, crude oil prices in our estimation should rise next year. Our forecast for the end of 2010 is USD 80-85/bbl. This estimate allows for an investment in crude oil by means of long-term futures, despite the slight contango at present. An appreciation in the value of the dollar poses the largest risk for crude oil, due to the pronounced negative correlation between USD and oil.

Consumption decline in the euro zone

We expect that private spending in the euro zone will decline again in the second half of 2010. The global recovery is progressing too slowly for employment to be maintained at its current level, thus unemployment is on the rise. What's more, the phase-out of buyer incentives (such as the "cash for clunkers" program) will depress consumers' spending proclivity.
In contrast to the euro zone, we expect that Switzerland will not experience a significant increase in unemployment. Accordingly, we are forecasting a stable rate of consumption in Switzerland.

Unemployment burdens personal spending

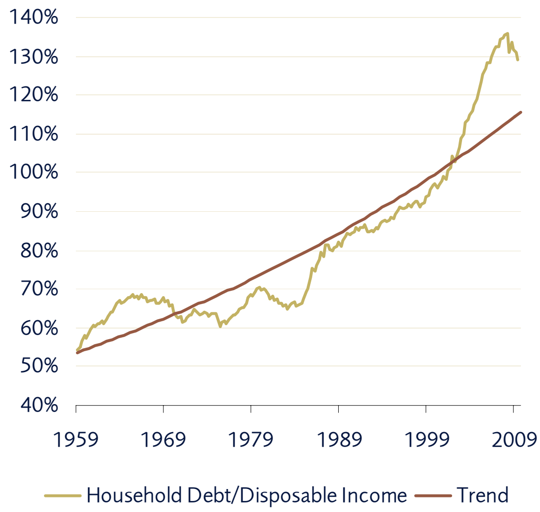


Sources: VP Bank, Datastream

Base effects ensure positive dynamic

Although the euro zone can expect little impetus from personal spending, a positive base effect will ensure that there is a high degree of dynamism next year. Provided that the quarterly GDP readings do not retreat to the levels recorded in the first half of 2009, the coming year on the whole should produce better GDP comparables than what we have seen this year. Thus even a slight upside bump in the individual components will be good for a handsome overall reading.

Debt reduction is underway



Sources: VP Bank, Datastream

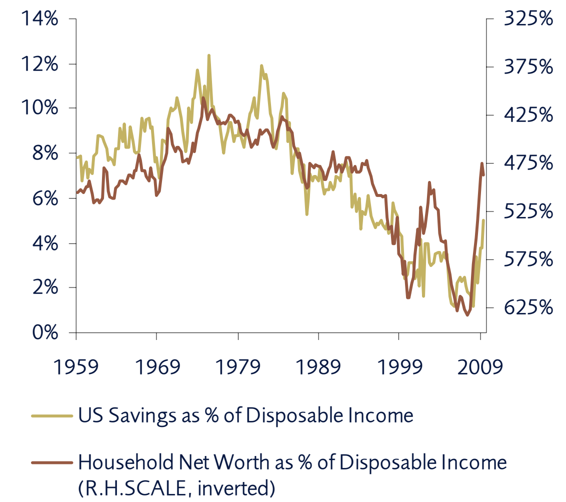
Controversial US consumption forecasts

We expect that the USA will experience a very modest 0.5% increase in personal spending:

- The reduction of personal household debt got underway already in 2008 and has made considerable progress in the meantime. The debt-to-disposable-income ratio declined from 136% to 129% within the shortest amount of time. Although it still lies above the long-term average, this reading ignores the asset side of the consumer's balance sheet.

- The ratio of net assets to disposable income has been recovering since the second quarter of this year and is now back at the levels seen in the early '90s. As a result of the impending upswing in real estate prices and the stronger equity markets, that ratio will improve even further.
- At its present level of 5-6%, the personal savings rate is essentially reasonable in light of the improved net asset situation. Accordingly, we are going on the assumption that private households will not commit a significantly greater portion of their disposable income to savings.

Personal savings rate



Sources: VP Bank, Datastream

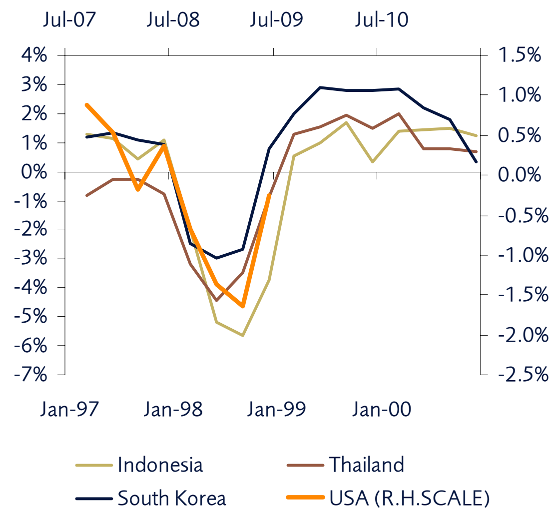
Given that the labor market cycle is already far advanced, a decline in personal spending is not very probable against the backdrop of a recovering economy. All things considered, the dynamic attributable to base effects is a key element of the upside correction also in the USA, where an increase in personal spending of 0.5% (as foreseen in our scenario) contributes a mere 0.2 percentage points to overall economic growth.

Previous crises offer a roadmap

Our assumption is that the USA and euro zone are experiencing the same type of cycle as was seen in the Asian countries during the aftermath of the 1998 banking and foreign exchange crisis: a sharp upside correction immediately after the crisis is followed by rather disappointing quarterly macro figures.

The repercussions of the crisis will also become evident in the long-term growth forecasts. The loss of capital, jobs and productivity will keep GDP levels below their pre-crisis potential growth rates for a number of years to come. The stabilization of government indebtedness will also have effects on the economy: declining deficits reduce overall demand and GDP growth. And ultimately, higher long-term bond yields resulting from the debt situation could weigh on the recovery.

Quarterly GDP growth rates at the time of the Asian crisis and today (USA)



Sources: VP Bank, Datastream

The bottom line:

We expect to see ample growth rates in 2010. A stronger dynamic will increasingly give way to waning GDP readings. On the whole, our forecasts lie slightly above the consensus estimates, even though we have based them on conservative assumptions. The upside correction from the crisis levels seen during the first six months of 2009 will provide at least optical fuel for the recovery.

US and Swiss personal spending is likely to rebound modestly in 2010. In the euro zone, unemployment can be expected to increase further, thereby putting a damper on consumer sentiment.

How does the post-crisis world size up? Your Economics and Investment team will attempt in the coming weeks and months to formulate initial responses to that question. We would be pleased to take your desired topics into account in our analysis and look forward to receiving your suggestions either directly at investment@vpbank.com or via your personal Client Advisor.

The VP Bank Group

Verwaltungs- und Privat-Bank Aktiengesellschaft is a bank domiciled in Liechtenstein and is subject to the Liechtenstein Financial Market Authority (FMA), Heiligkreuz 8, PO Box 684, LI-9490 Vaduz, www.fma-li.li.

Verwaltungs- und Privat-Bank Aktiengesellschaft
Aeulestrasse 6 - LI-9490 Vaduz - Liechtenstein
Tel +423 235 66 55 - Fax +423 235 65 00
info@vpbank.com - www.vpbank.com - VAT No. 51.263 - Reg. No. FL-0001.007.080

VP Bank (Schweiz) AG
Bahnhofstrasse 3
P.O. Box 2993
CH-8022 Zurich
Switzerland
Tel +41 44 226 24 24
Fax +41 44 226 25 24
info.ch@vpbank.com

IFOS Internationale Fonds Service Aktiengesellschaft
Aeulestrasse 6
LI-9490 Vaduz
Liechtenstein
Tel +423 235 67 67
Fax +423 235 67 77
ifos@vpbank.com

IGT Intergestions Trust reg.
Aeulestrasse 6
LI-9490 Vaduz
Liechtenstein
Tel +423 233 11 51
Fax +423 233 22 24
igt@vpbank.com

VP Bank (Luxembourg) S.A.
Avenue de la Liberté 26
LU-1930 Luxembourg
Luxembourg
Tel +352 404 770-1
Fax +352 481 117
info.lu@vpbank.com

VPB Finance S.A.
Avenue de la Liberté 26
LU-1930 Luxembourg
Luxembourg
Tel +352 404 777 383
Fax +352 404 777 389
info.lu@vpbank.com

VP Bank and Trust Company (BVI) Limited
3076 Sir Francis Drake's Highway
Road Town, Tortola
VG-British Virgin Islands
Tel +1 284 494 11 00
Fax +1 284 494 11 99
info.bvi@vpbank.com

VP Vermögensverwaltung GmbH
Theatinerstrasse 12
DE-80333 Munich
Germany
Tel +49 89 21 11 38-0
Fax +49 89 21 11 38-99
info@vpvv.de, www.vpvv.de

Verwaltungs- und Privat-Bank Aktiengesellschaft Hong Kong Representative Office
Suites 1002-1003
Two Exchange Square
8 Connaught Place
Central - Hong Kong
Tel +852 3628 99 99
Fax +852 3628 99 11
info.hk@vpbank.com

VP Wealth Management (Hong Kong) Ltd.
Suites 1002-1003
Two Exchange Square
8 Connaught Place
Central - Hong Kong
Tel +852 3628 99 00
Fax +852 3628 99 55
info.hkwm@vpbank.com

VP Bank (Singapore) Ltd.
9 Raffles Place
#42-01 Republic Plaza
Singapore 048619
Tel +65 6305 0050
Fax +65 6305 0051
info.sg@vpbank.com

VP Bank (Switzerland) Ltd. Moscow Representative Office
World Trade Center
Entrance 7, 5th Floor, Office 511
12 Krasnopresnenskaya Emb.
RU-123610 Moscow
Russian Federation
Tel +7 495 967 00 95
Fax +7 495 967 00 98
info.ru@vpbank.com

VP Wealth Management (Middle East) Ltd.
Dubai International Financial Centre
The Gate Village
Building no 5
4th Floor, Unit 8
Dubai
United Arab Emirates
Tel +971 4 425 9250
Fax +971 4 425 9240
info.ae@vpbank.com

Disclaimer

This publication was prepared by our employees using information sources, which we consider to be reliable. This publication is solely for your information. Although we exercise the greatest possible care in preparing this document, we cannot provide any guarantee or assurance regarding the completeness, topicality or accuracy of the presentation's contents.

In particular, the information and details contained herein shall neither constitute an offer nor represent an invitation to submit an offer or a public advertisement inviting transactions or other business activities with the products and/or services described.

With regard to the risks, which must be considered in connection with any investments in products and/or the use of services included in this publication, we would refer you to the respective risk declarations, such as the brochure entitled "Risks in Securities Trading" issued by the Liechtenstein Bankers' Association, and recommend that you seek advice from a specialist client adviser. We expressly disclaim any liability for damages or losses claimed on the basis of the product and/or service information contained in this publication.

The contents of this publication are protected by copyright. Any use of the publication, except for personal use, requires our prior consent.

FL-9490 Vaduz - Aeulestrasse 6 - Liechtenstein
info@vpbank.com - www.vpbank.com

VP BANK
Verwaltungs- und Privat-Bank Aktiengesellschaft