

THE ECONOMIC DRIVERS OF EUROPEAN COMMERCIAL PROPERTY



Vol. 2 2009

Editors: Roger Bootle and Ed Stansfield

Lacklustre recovery will keep interest rates and bond yields low

The economic drivers of occupier markets

- The improvement in business and consumer confidence surveys has to date been less convincing in the **euro-zone** than elsewhere. Economic activity is unlikely to do better than stagnate in 2010 and will remain well below trend in 2011. France looks set to experience one of the smallest contractions in GDP this year. Germany could be one of the first to return to positive, but weak, growth.
- In the **rest of Western Europe**, GDP in both the UK and Norway will expand modestly next year. In Sweden and Denmark, however, we expect no growth, while Switzerland is likely to contract. The UK faces a severe fiscal squeeze, however, and we think that Norway is likely to be one of the first European economies to return to trend rates of growth.
- Fiscal austerity measures and tight domestic credit conditions will prolong the downturn in Hungary and Romania. Elsewhere in **Emerging Europe** there seems to be little scope for monetary stimulus in Russia. But GDP growth in Poland, the Czech Republic and Turkey could turn positive next year, although we think that growth will remain well below trend.

The economic drivers of investment markets

- Spare capacity is rife and credit markets remain impaired. Official interest rates have further to fall in Emerging Europe. In Developed Europe they will stay at record low levels until the end of 2010, perhaps longer. Bond yields everywhere could reach fresh lows in early 2010.
- Both sterling and the euro are likely to fall against the dollar in the second half of this year, while the recent stabilisation in Emerging European currencies could be undone by devaluation in Latvia. The Swedish, Swiss and Norwegian currencies look overvalued and could fall in the medium-term.

This document presents, from a property perspective, the economic forecasts that underpin our European commercial property forecasts. Those forecasts are presented in our Euro-zone Commercial Property Analyst Vol. 2, 2009 and our Non-euro European Commercial Property Analyst Vol. 2 2009.

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Global economic influences

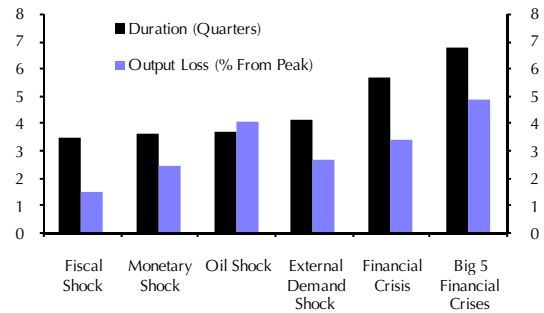
Global influences on occupier markets

- Analysis from the IMF suggests that historically recessions caused by financial crises tend to be deeper and longer lasting than those triggered by other types of shock. (See Chart 1.)
- Accordingly, while welcome, it is still far too early to interpret the recent upturn in business and consumer sentiment surveys across the world as clear evidence that a sustained economic recovery is imminent.
- To date, the upturn in the surveys has not been reflected in hard economic data for spending or production. The synchronised nature of the recession also means that the scope for exports to assist recovery in any one country is limited. And despite the recent run-down, global inventory levels are still too high. (See Chart 2.)
- Although, we now think that activity in the major economies is unlikely to contract further in 2010, GDP growth in 2010 and 2011 is likely to remain well below trend. (See Chart 3.)

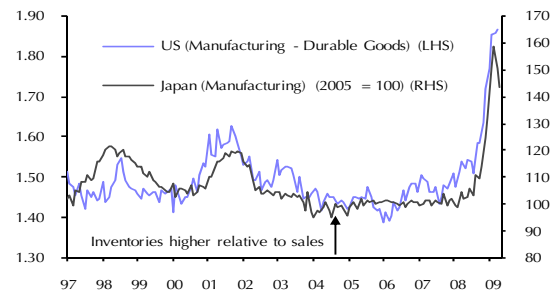
Global influences on investment markets

- Governments around the world have implemented huge fiscal stimuli. (See Chart 4.) Although, with the exception of the UK, fiscal tightening is not imminent, sooner or later this fiscal stimulus will need to be reversed.
- To us, the risks of resurgent inflation look low. Given this, and in order to offset the impact of tighter fiscal policy on economic growth, we think official interest rates will remain at current levels for the foreseeable future.
- With growth set to disappoint and official interest rates remaining low, we think that the recent rise in bond yields will be reversed in early 2010. Yet the availability of finance is likely to remain low, keeping the commercial property investment market activity subdued.

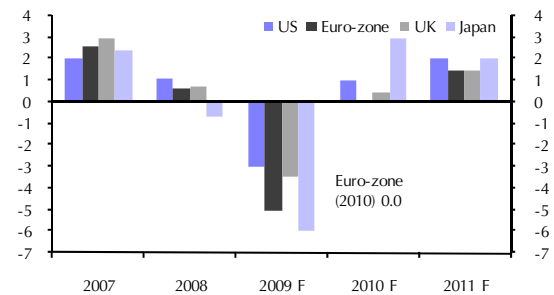
1: Average severity of recessions



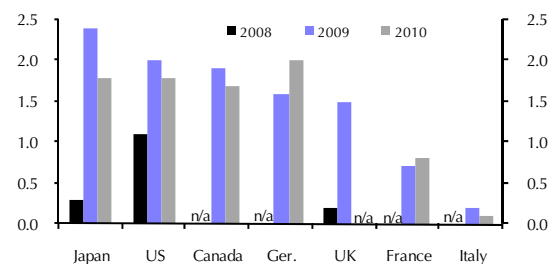
2: Inventory/sales ratios, 1997 - 2009



3: GDP growth, % y/y, 2007 - 2011



4: Discretionary fiscal stimulus (relative to 2007 baseline, % national GDP)



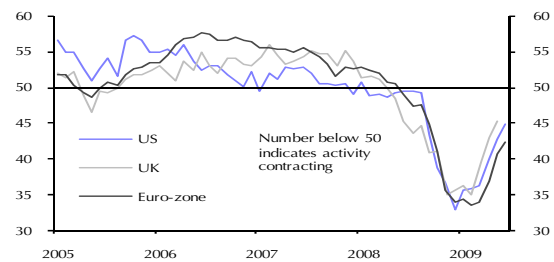
Sources – Thomson Datastream, IMF, Capital Economics

The euro-zone

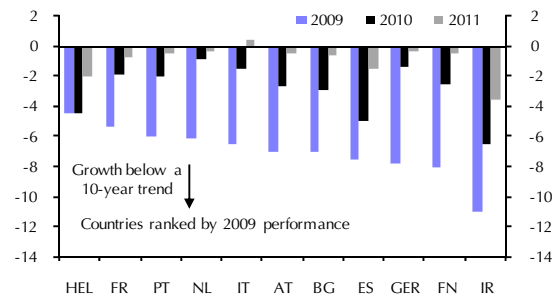
Economic drivers of occupier markets

- The euro-zone may be the last major region to emerge from recession. As in the UK and US, survey indicators have begun to point to an easing in the rate of economic contraction in the euro-zone. The improvement, however, has been somewhat less marked. (See Chart 1.) That seems consistent with the slower response from euro-zone policy makers and the fact that the euro's strength may be hindering exporters.
- GDP in much of the euro-zone will contract for a second consecutive year in 2010. However, Finland and France could stagnate, and in Germany and the Netherlands any improvement in global trade flows could be enough to deliver at least some growth. Relative to the growth rates seen in the past decade, we think France will fare comparatively well. Even in 2011, growth is likely to remain well below trend in Greece, Ireland and Spain. (See Chart 2.)
- Manufacturing output has slumped across the euro-zone, but consumer spending is holding up rather better, most notably in France and Germany. In general, the fact that euro-zone households have relatively low levels of household debt and thus less need to undergo a painful period of deleveraging than, say, in the UK, suggests that consumer spending growth may return to positive, albeit weak rates, in most economies next year. (See Chart 3.)
- Job insecurity will weigh heavily on consumer spending. That seems consistent with our views that most economies will still be shedding jobs next year. (See Chart 4.) Apart from Spain and Ireland, where the losses will be larger, taking 2009 and 2010 together, employment in most economies will fall by 3% to 4%.

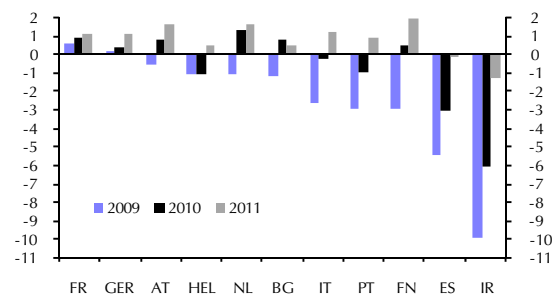
1: Euro-zone, UK and US manufacturing PMIs, diffusion indices, 2005 – 2009 June



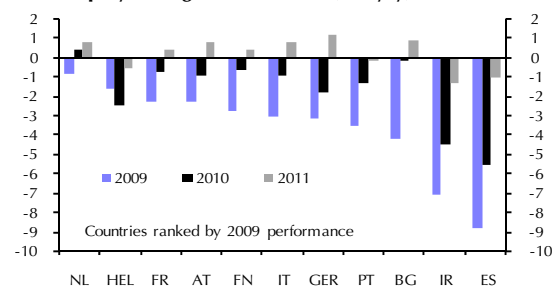
2: GDP growth forecasts relative to a 10-year average, % points, 2009 - 2011



3: Consumer spending growth forecasts, % y/y, 2009-2011



4: Employment growth forecasts, % y/y, 2009-2011



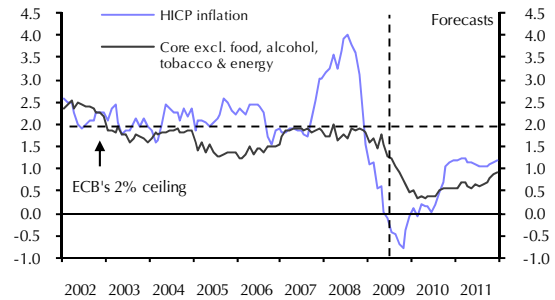
Sources – Thomson Datastream, CIPS/Markit, Capital Economics

The euro-zone

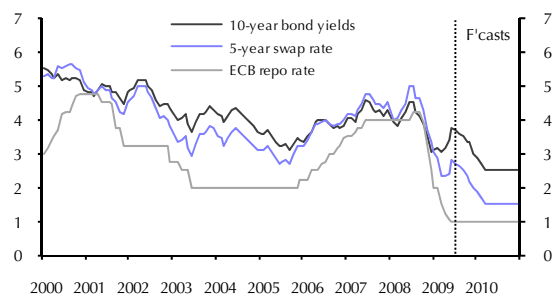
Economic drivers of investment markets

- With a return to trend growth still nowhere in sight, euro-zone inflation looks set to remain very subdued for at least the next two years. (See Chart 1.) Accordingly, although the ECB is unlikely to cut official interest rates below 1%, the combination of an economy struggling to gain traction and a well below target inflation environment suggests there is little need for monetary policy to be tightened either this year or next.
- Low official interest rates should provide an anchor for market interest rates. Accordingly, we doubt that the recent rise in bond yields and swap rates that have accompanied the tentative signs of an improvement in the world economy will be sustained once markets realise the recovery will be rather weaker than they had been expecting. We think that 10-year bond yields could drop to 2.5% by early to mid-2010. (See Chart 2.)
- Index-linked gilts have risen a little as CPI inflation in the euro-zone has turned negative. (See Chart 3.) If we are right in thinking that inflation is set to remain low for the foreseeable future but not transform into a broader based deflation, real yields are likely to remain close to current levels. This will help to deliver a modest convergence in real and nominal bond yields.
- As risk appetite has improved and equity markets have rallied a little, dividend yields have fallen from their recent record highs. (See Chart 4.) To our minds, the weak growth outlook, which points to further pressure on corporate profits, means that rapid further falls cannot be taken for granted.

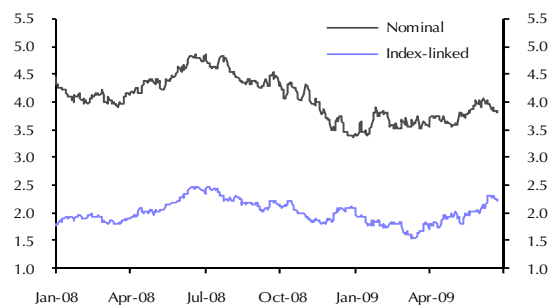
1: Euro-zone CPI inflation, % y/y, 2002 - 2011



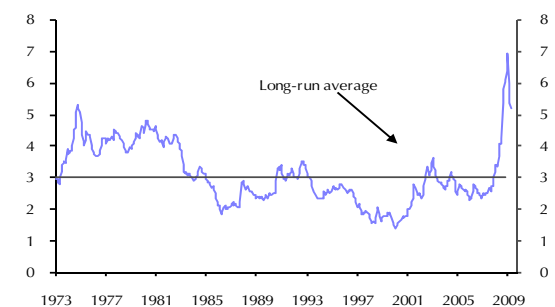
2: Euro-zone interest rates, swap rates and bond yields, %, 1999 - 2010



3: French nominal and index-linked bond yields, %, Jan 2008 – June 2009



4: Euro-zone equity dividend yields, %, 1973 – June 2009



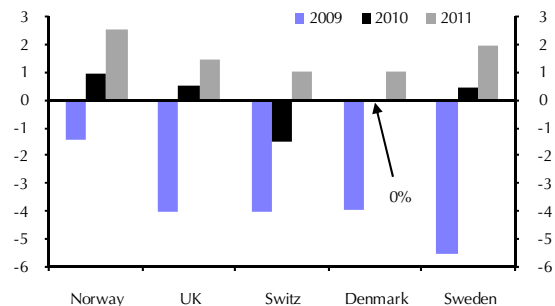
Source – Thomson Datastream, Bloomberg and Capital Economics

The rest of Western Europe

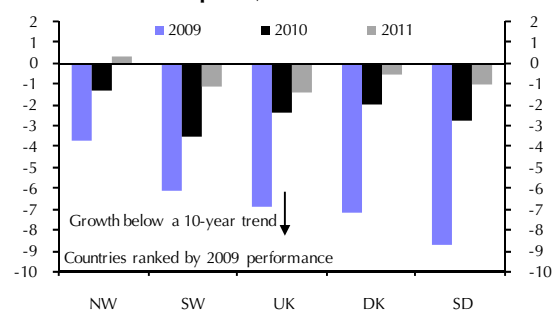
Economic drivers of occupier markets

- Norway looks set to weather the global downturn well. Economic growth should be weak, but positive, next year. (See Chart 1.) The same is true of the UK and Sweden, but the consumer debt overhang in the UK, and the impact of Swedish banks' losses from lending to the Baltic states, will mean that the recovery is more muted in both economies.
- Denmark will stagnate next year, thanks to the impact of falling house prices on activity. The Swiss economy's dependence on financial services and exports to the euro-zone suggests that a further year of contraction lies ahead.
- Yet even in 2011, when we envisage all five economies expanding once again, growth is likely to remain below the average levels of the past decade everywhere bar Norway. (See Chart 2.)
- Compared to the growth rates seen in the past decade, the outlook for consumer spending is weakest in the UK. Here, a depressed housing market, the need to rebuild savings and, perhaps, higher taxes will all curtail household purchases. (See Chart 3.) With no housing boom to unwind, Swiss consumption should prove a little more resilient. Healthier public finances and higher savings rates should also ensure that Scandinavia suffers a shallower consumer spending downturn than the UK.
- The weak domestic and external growth outlook, however, suggests that further job losses can be expected. Consistent with the stronger economic outlook, employment in Norway looks likely to be the first to begin to rise again, while Denmark and the UK look set for the longest and deepest labour market downturns. (See Chart 4.)

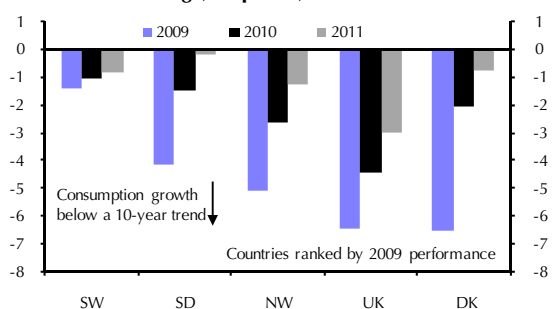
1: GDP growth forecasts, % y/y, 2009 -2011



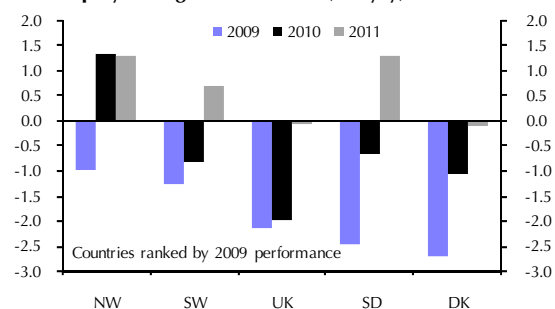
2: GDP growth forecasts relative to a 10-year average, % points, 2009 - 2011



3: Consumer spending growth forecasts relative to a 10-year average, % points, 2009 - 2011



4: Employment growth forecasts, % y/y, 2009 - 2011



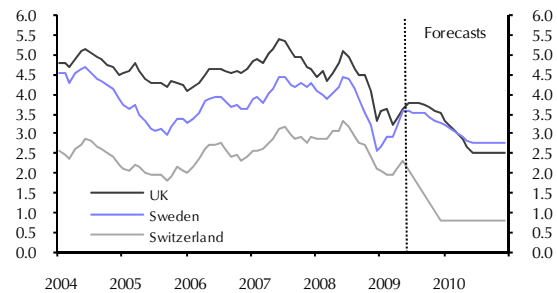
Sources – Thomson Datastream & Capital Economics

The rest of Western Europe

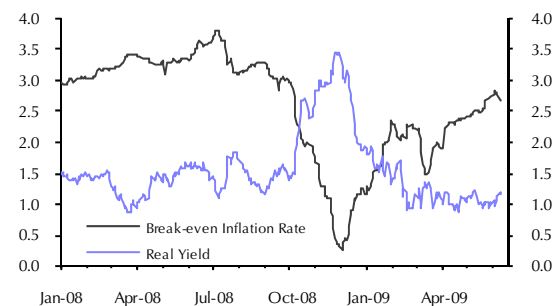
Economic drivers of investment markets

- The recent rise in bond yields is, in our view, likely to prove temporary. Towards the end of this year or early in 2010, we expect bond yields to fall back. We think they could drop to 1% or below in Switzerland. (See Chart 1.) Yields could drop to 2.5% or 2.75% in the UK and Sweden and to similar levels in Denmark and Norway.
- Several factors have contributed to the recent rise in yields. These include the prospect of higher bond issuance and rising hopes for recovery. Consistent with that, inflation expectations have risen. (See Chart 2.) This has led markets to begin pricing in tighter monetary policy. Yet, if we are right about the lacklustre pace of any recovery, policy rates will be held at their current low levels until at least the end of next year, if not longer.
- A recovery characterised by sub-trend growth also points to rising levels of spare capacity. Although inflation expectations are still low, there is scope for them to fall back. Our forecasts envisage very weak inflation in the UK over the next two years. (See Chart 3.) Elsewhere, inflation will remain below, or in line with, current targets.
- Dividend yields have dropped back thanks to rallies in global equity markets in recent weeks and the improved appetite for riskier assets. In Norway and Denmark, the rallies have left dividend yields below long-run average levels but they remain relatively high in Sweden, Switzerland and the UK. (See Chart 4.) As economic growth disappoints, we think that equity markets could give back some of their recent gains. If so, we would expect at least some of the recent fall in dividend yields to be reversed.

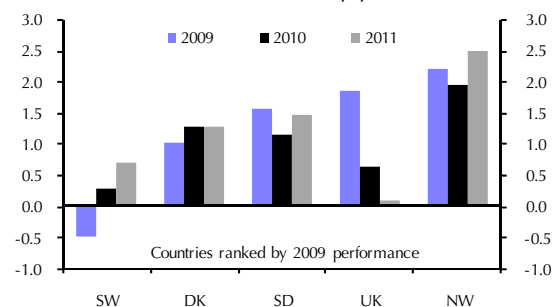
1: 10-year Government bond yields, %, 2004 - 2010



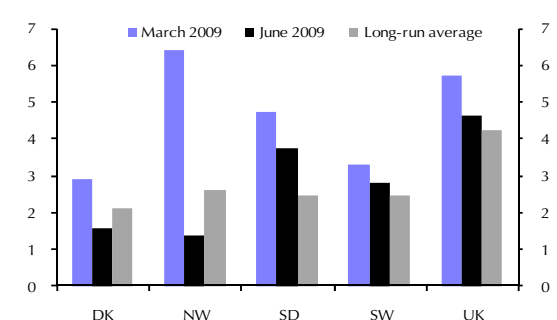
2: 10-year real yields and breakeven inflation rates, UK, %, Jan 2008 – June 2009



3: CPI inflation forecasts, % y/y, 2009-2011



4: Equity dividend yields, %, March and June 2009



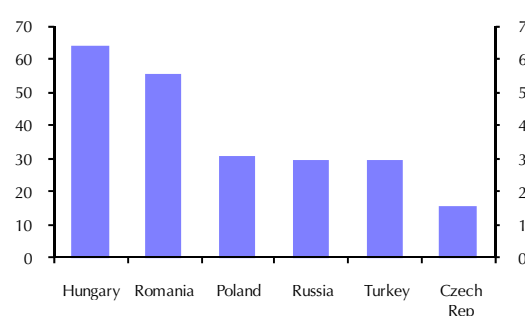
Source – Thomson Datastream, Bloomberg & Capital Economics

Emerging Europe

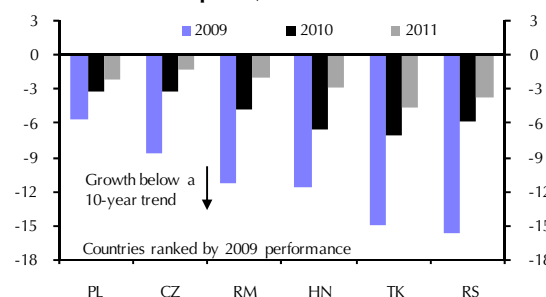
Economic drivers of occupier markets

- A euro-zone recovery is vital for Emerging Europe given the two regions' strong trade links. Our view that the euro-zone will only stagnate next year does not bode well. In addition, following the collapse in Emerging European currencies, the high level of foreign currency-denominated debt is likely to weigh on economic growth for some time, notably in Hungary and Romania. (See Chart 1.)
- Banking systems look least fragile in Poland, the Czech Republic and Turkey. Poland is less dependent on exports than other Emerging European economies. Meanwhile, interest rates have been cut sharply in Turkey, and the Czech Republic. The Czech government is also among the few to have unveiled a meaningful fiscal stimulus. These three economies look most likely to expand next year, but even here, economic growth will remain lacklustre by the standards of recent years. (See Chart 2.)
- Consumer spending is likely to remain very weak in 2010 across the region. (See Chart 3.) Unemployment is rising and interest rate cuts are not being passed on fully to consumers. Hungary has announced a fiscal consolidation equivalent to a total of 4.5% of GDP for 2009 and 2010. Romania too must look to reduce its structural deficit by 3% of GDP under the terms of its IMF/EU bailout. In Russia, the weakness of the ruble is limiting the scope for monetary stimulus to support looser fiscal policy.
- In short, even in Poland, where we are most optimistic, economic growth will not be strong enough to prevent substantial further job losses this year and next. While there should be a return to positive rates of job creation in 2011, the outlook is weak. (See Chart 4.)

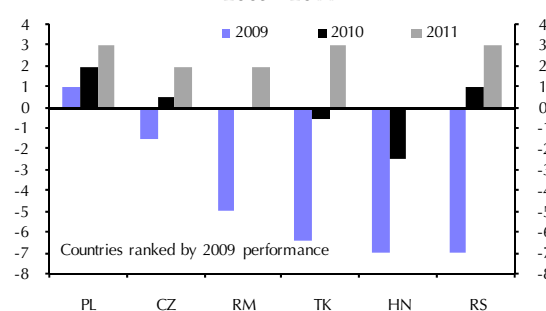
1: Foreign currency loans, in selected Emerging European economies, % of all loans outstanding, 2008Q4



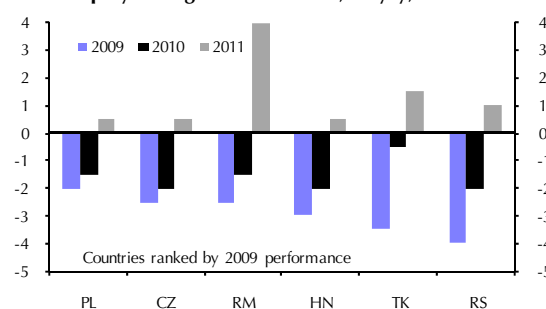
2: GDP growth forecasts relative to a 10-year average, % points, 2009 - 2011



3: Consumer spending growth forecasts, % y/y, 2009 - 2011



4: Employment growth forecasts, % y/y, 2009-2011



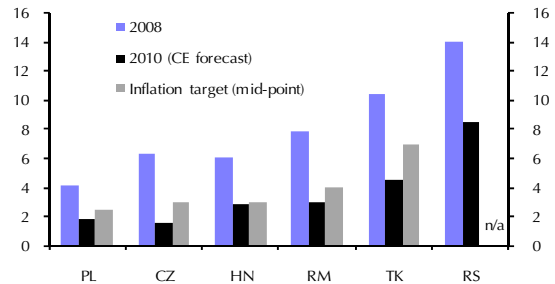
Source – Thomson Datastream, Capital Economics

Emerging Europe

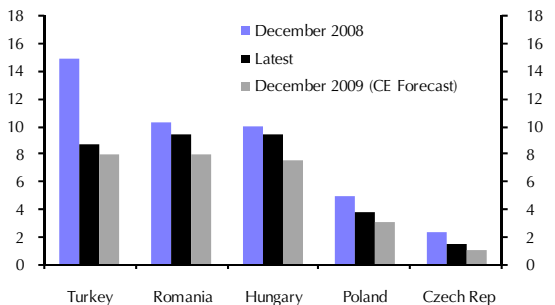
Economic drivers of investment markets

- Inflation in Emerging Europe has generally surprised on the upside over the past month or two, but with the recession set to generate huge amounts of spare capacity, it seems likely that inflation will drop back in line with or below current inflation targets by the end of next year. (See Chart 1.)
- That should create scope for official interest rates to drop further from current levels. The pace of further cuts is likely to be determined by the extent of short-term rises in inflation and the stability (or otherwise) of the region's currencies. In Turkey, a lack of progress towards fiscal consolidation could limit the scope for further cuts. But our central forecasts envisage official interest rates in Hungary, Romania and Turkey dropping to 8% or below by the end of the year and to 3% in Poland and 1% in the Czech Republic. (See Chart 2.)
- Lower official rates and moderating inflation would normally lead to lower bond yields, but in Emerging Europe global investor risk appetite is also crucial. Thus, with little prospect of a return to positive growth in most economies this year or next, we think the scope for bond yields to fall much further is limited. (See Chart 3.)
- Equity market rallies across the region over the past few weeks have helped to lower equity dividend yields and offer further evidence of an improvement in investor sentiment towards the region. (See Chart 4.) But the improvement in risk appetite has been limited and may not be reflected in less liquid assets such as property. Dividend yields remain above their long-run averages in all markets and at the time of writing there are signs that sentiment towards the region is beginning to fade again.

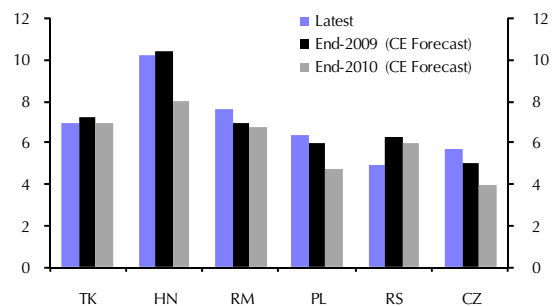
1: CPI inflation and current inflation targets, % y/y, 2008 & 2010



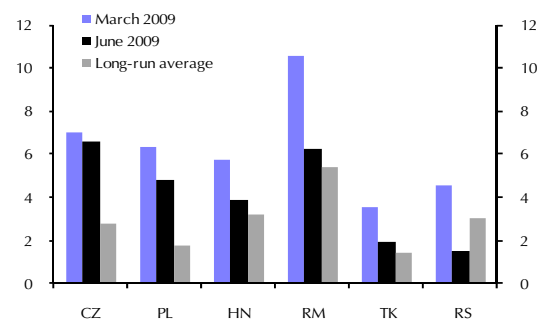
2: Official interest rates, %, Dec 2008 to Dec 2010



3: 10-year government bond yields, %, latest data and end-2009 and end-2010 forecasts



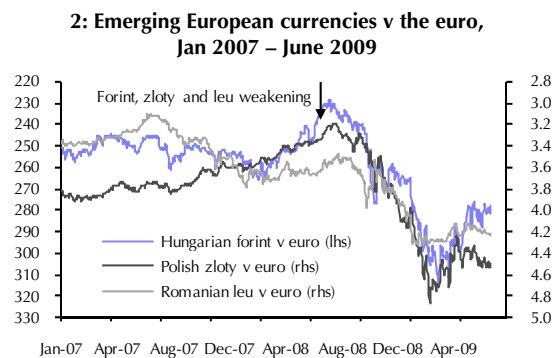
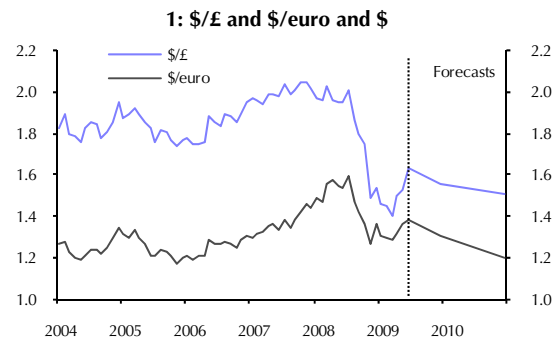
4: Equity dividend yields, %, March and June 2009



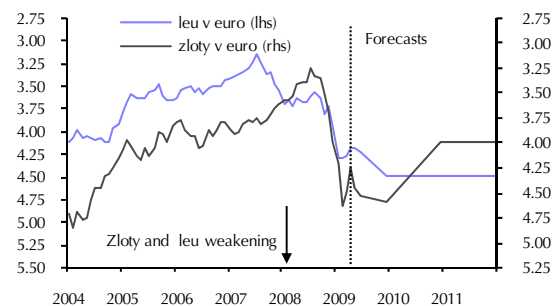
Source – Thomson Datastream, Bloomberg and Capital Economics

Currencies and risk

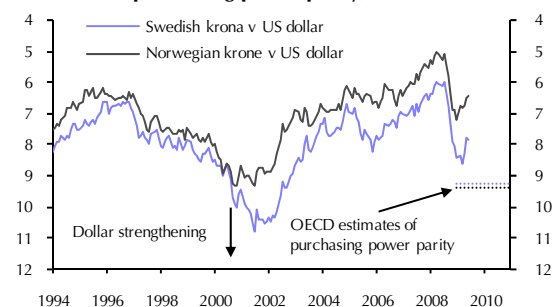
- As fears of a long-lasting depression for the world economy have faded, so too has the safe-haven appeal of the US dollar. But the recent weakness may be reversed if the pace of the recovery disappoints while, at the same time, growth in the US economy is the best of a bad lot. Accordingly, we think the US dollar could strengthen to 1.20 against the euro and 1.50 against the pound (See Chart 1.) That implies a euro/£ rate of 0.80.
- Following the slump last year, Emerging European currencies have stabilised or moved higher in recent months. (See Chart 2.) We would not rule out a period of renewed and widespread weakness in the second half of the year as hopes for a straight-line recovery in global growth fade. There must also be a risk that a Latvian devaluation could also turn any renewed weakness into a further indiscriminate rout.
- Over the medium term, however, the relative growth outlook suggests that the Polish zloty is most likely to appreciate and the Romanian leu to depreciate. (See Chart 3.) We see no strong case to expect the Russian ruble, Turkish lira, Czech koruna or Hungarian forint to move significantly against the euro from current levels.
- The recent rises in the Norwegian krone and Swedish krona have taken them further above estimates of purchasing power parity (PPP). (See Chart 4.) Although currencies often diverge from such fair value estimates for long periods, there must be a risk of a sharp depreciation in both currencies in the medium term. The Swiss franc also looks overvalued by perhaps 40% on this basis.



3: Forecasts for the Polish zloty and Romania leu v the euro, 2004 - 2011



4: Swedish krona and Norwegian krone v US dollar and estimates of purchasing power parity, 1994 – June 2009

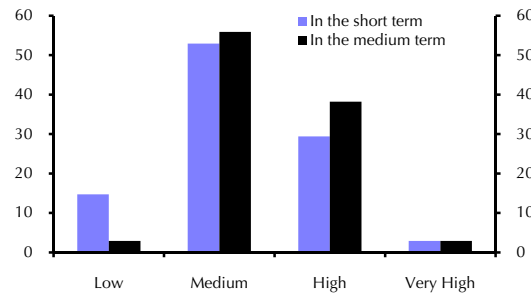


Source – Thomson Datastream, Bloomberg and Capital Economics

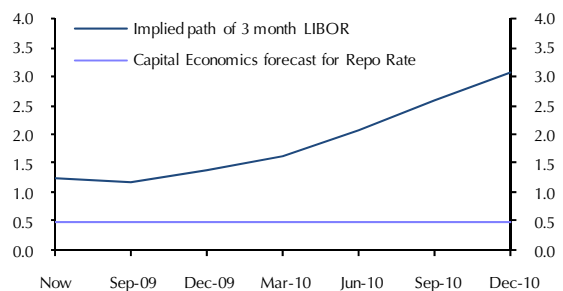
Currencies and risk (continued)

- The upturn in confidence seen in recent weeks appears very fragile. A Bank of England survey found that more than a third of respondents put the probability of a “high impact” event in financial markets as being “high” or “very high” in the short term. Over the medium term, those figures were more than 40%, with just 3% of respondents rating the probability as “low”. (See Chart 1.)
- Nevertheless, there must be a risk that we are overstating the both the weakness of the growth outlook and the lack of inflation pressures. Financial markets are pricing in a rise in official UK interest rates before the end of this year. (See Chart 2.) If this proved right, however, and was replicated in the US and Europe, our bond yield forecasts would need to be revised up sharply.
- On the other hand, we feel that too little attention is being paid to the very weak outlook for household incomes. The slump in activity we have already seen points to substantial increases in unemployment, which will depress wages growth and could very plausibly result in it falling. (See Chart 3.) To our minds, the risks of a damaging period of deflation have not yet fully evaporated.
- Are we underestimating the risk of resurgent inflation? Oil prices have almost doubled since the turn of the year. (See Chart 4.) Meanwhile, we already have ultra-low interest rates almost everywhere, huge injections of capital into banking systems and most major economies receiving some degree of fiscal stimulus. Yet such measures simply reflect the dreadful state of demand. Against this backdrop, we suspect that rising oil prices present a bigger threat to the growth outlook than to the inflation outlook.

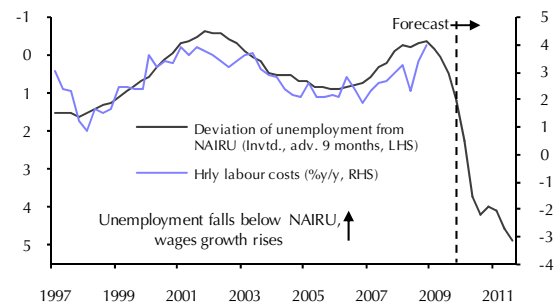
1: Probability of a “high-impact” event in the UK financial system, May 2009, % of survey respondents



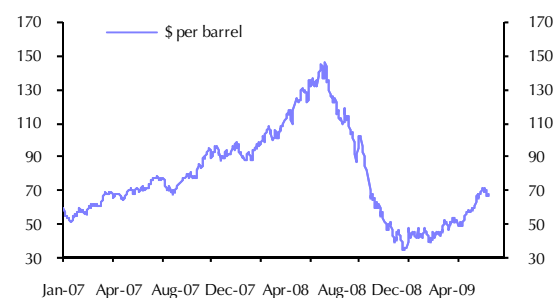
2: Capital Economics UK repo rate forecast and financial markets’ implied expectations, %, June 2009 – Dec 2010



3: Euro-zone unemployment and hourly labour costs, 1997 - 2011



4: Brent crude oil prices, Jan 2007 – June 2009

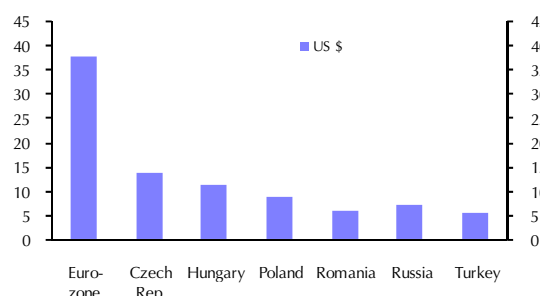


Sources – Thomson Datastream, Bloomberg, Bank of England & Capital Economics

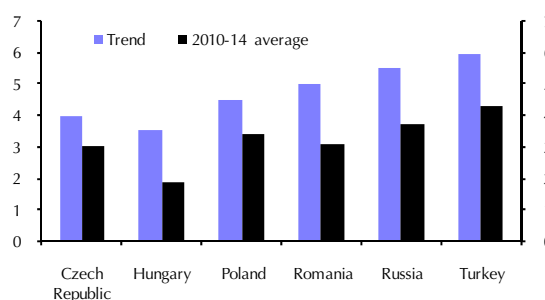
The medium-term economic outlook

- Our central economic forecasts envisage a prolonged period of sub-trend economic growth. But over the medium term, growth will be restored to trend levels or better.
- In Emerging Europe, despite the region's current travails, GDP per capita remains no better than 40% of the euro-zone average. (See Chart 1.) This suggests that there remains ample scope for higher productivity growth than in the West, which will help to offset the impact of generally poor demographics.
- However, the depth of the recession and the need for further structural reforms means that in all cases, taking the next five years as a whole, on average, growth is likely to underperform its trend by between one and two percentage points. (See Chart 2.)
- Similarly, if our forecasts for the next year or two prove correct, in order to deliver trend growth on average between 2010 and 2014 growth would need to average almost 6% in Ireland, nearly 4% in the UK, 2.8% in France and 2.3% in Germany. (See Chart 3.)
- That is not impossible, but the recession has resulted in a sharp deterioration in public finances almost everywhere. (See Chart 4.) Budget deficits will need to be reined in; in most cases that will require tighter fiscal policy over several years, which in turn will tend to dampen growth. From this perspective, the Scandinavian economies look well placed. High deficits could also derail Polish and Romanian ambitions to join the single currency.

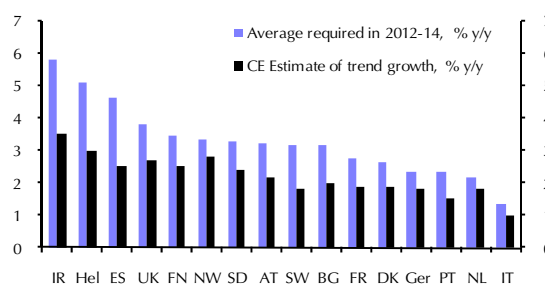
1: Nominal GDP per capita in the euro-zone and Emerging European economies



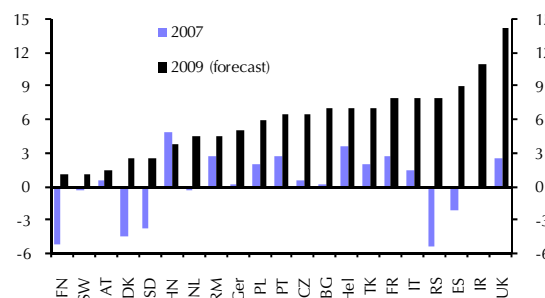
2: Average real GDP growth 2010- 2014, %/y



3: GDP growth required in 2012-14 to ensure average growth over the next five years is in line with trend.



4: Government Budget deficits, % GDP



Source – Thomson Datastream, Capital Economics

Detailed forecasts – GDP and consumer spending growth

TABLE 1: REAL GDP GROWTH

% y/y (year average)	1998-07					Sustainable rate
	avg	2008	2009	2010	2011	
Euro-zone						
Austria	2.2	1.7	-4.8	-0.5	1.7	2.2
Belgium	2.0	1.1	-5.0	-1.0	1.5	2.0
Finland	2.5	0.7	-5.5	0.0	2.0	2.5
France	1.9	0.3	-3.5	0.0	1.2	1.9
Germany	1.8	1.0	-6.0	0.5	1.5	1.8
Greece	3.0	2.9	-1.5	-1.5	1.0	3.0
Ireland	3.5	-3.0	-7.5	-3.0	0.0	3.5
Italy	1.0	-1.0	-5.5	-0.5	1.5	1.0
Netherlands	1.8	2.0	-4.3	0.9	1.5	1.8
Portugal	1.5	0.0	-4.5	-0.5	1.0	1.5
Spain	2.5	1.2	-5.0	-2.5	1.0	2.5
Eastern Europe						
Czech Republic	3.6	3.1	-5.0	0.5	2.5	4.0
Hungary	4.1	0.6	-7.5	-2.5	1.3	3.5
Poland	4.2	4.8	-1.5	1.0	2.0	4.5
Romania	3.9	7.1	-7.5	-1.0	2.0	5.0
Russia	5.7	5.5	-10.0	0.0	2.0	5.5
Turkey	7.5	0.8	-7.5	0.5	2.9	6.0
Other Europe						
Denmark	2.0	-1.1	-5.0	0.0	1.5	1.9
Norway	2.2	2.1	-1.5	1.0	2.5	2.8
Sweden	3.2	-0.4	-5.5	0.5	2.0	2.4
Switzerland	2.1	1.7	-4.0	-1.5	1.0	1.8
UK	2.9	0.7	-4.0	0.5	1.5	2.7

TABLE 2: REAL CONSUMER SPENDING GROWTH

% y/y (year average)	1998-07					Sustainable rate
	avg	2008	2009	2010	2011	
Euro-zone						
Austria	1.7	0.8	-0.5	0.8	1.7	2.2
Belgium	1.8	0.8	-1.2	0.9	0.6	2.0
Finland	2.8	1.6	-3.0	0.5	2.0	2.5
France	2.4	0.9	0.6	0.9	1.2	1.9
Germany	0.9	-0.1	0.3	0.4	1.2	1.8
Greece	5.1	2.3	-1.1	-1.0	0.5	3.0
Ireland	6.1	-0.9	-10.0	-6.0	-1.2	3.5
Italy	1.6	-0.9	-2.6	-0.2	1.3	1.0
Netherlands	2.4	1.3	-1.1	1.4	1.7	1.8
Portugal	2.5	1.7	-2.9	-1.0	1.0	1.5
Spain	4.2	0.1	-5.5	-3.0	0.0	2.5
Eastern Europe						
Czech Republic	2.7	2.7	-1.5	0.5	2.0	4.0
Hungary	4.0	0.1	-7.0	-2.5	0.0	3.5
Poland	3.7	5.4	1.0	2.0	3.0	4.5
Romania	9.8	9.1	-5.0	-0.5	2.0	5.0
Russia	8.6	11.3	-7.0	1.0	3.0	5.5
Turkey	6.9	0.3	-6.5	0.0	3.0	6.0
Other Europe						
Denmark	2.0	-0.1	-4.5	0.0	1.3	1.9
Norway	3.3	1.2	-1.8	0.7	2.0	2.8
Sweden	2.2	-0.4	-2.0	0.5	1.5	2.4
Switzerland	1.6	1.7	0.2	0.6	0.8	1.8
UK	3.4	1.4	-3.0	-1.0	1.0	2.7

Sources: Thomson Datastream and Capital Economics

Detailed forecasts – CPI inflation and employment growth

TABLE 3: CPI INFLATION

% y/y (year average)	1998-07					Sustainable rate
	avg	2008	2009	2010	2011	
Euro-zone						
Austria	1.7	2.7	1.7	1.7	2.0	1.8
Belgium	1.9	4.5	0.1	0.8	2.0	1.8
Finland	1.5	3.9	1.7	1.2	0.8	1.7
France	1.7	3.2	0.1	0.7	0.7	1.7
Germany	1.5	2.8	0.3	0.5	0.5	1.7
Greece	3.3	4.2	1.0	1.8	1.5	3.0
Ireland	3.3	3.1	-1.1	-0.5	-0.2	2.8
Italy	2.3	3.5	0.8	0.7	0.7	2.3
Netherlands	2.3	2.2	0.6	0.8	1.2	2.0
Portugal	2.9	2.7	-0.8	0.5	0.7	2.5
Spain	3.0	4.1	-0.5	0.0	0.2	2.5
Eastern Europe						
Czech Republic	3.0	6.3	1.2	1.5	2.0	2.0
Hungary	7.6	6.0	4.3	2.8	2.0	3.0
Poland	4.7	4.2	3.7	1.8	2.5	2.5
Romania	26.1	7.9	6.0	3.0	4.0	4.0
Russia	23.0	14.1	12.5	8.5	7.5	7.0
Turkey	36.7	10.4	6.5	4.5	5.0	7.0
Other Europe						
Denmark	1.9	3.6	1.0	1.2	1.0	2.0
Norway	1.8	3.4	2.3	2.0	2.5	2.5
Sweden	1.5	3.3	1.6	1.2	1.5	2.0
Switzerland	0.8	2.4	-0.5	0.3	0.7	0.8
UK	1.6	3.6	1.9	0.6	0.1	2.0

TABLE 4: EMPLOYMENT GROWTH

% y/y (year average)	1998-07					Sustainable rate
	avg	2008	2009	2010	2011	
Euro-zone						
Austria	0.9	1.8	-2.3	-0.9	0.8	0.5
Belgium	1.1	1.2	-4.2	-0.2	1.0	0.5
Finland	1.4	1.6	-2.8	-0.6	0.5	0.5
France	1.2	0.5	-2.3	-0.7	0.5	0.7
Germany	0.6	1.4	-3.1	-1.7	1.2	0.5
Greece	1.8	1.1	-1.6	-2.4	-0.5	1.0
Ireland	4.5	-0.6	-7.1	-4.5	-1.3	1.5
Italy	1.3	0.3	-3.0	-0.9	0.9	0.5
Netherlands	1.3	1.2	-0.8	0.4	0.9	0.3
Portugal	1.8	0.5	-3.5	-1.3	-0.2	0.5
Spain	4.3	-0.5	-8.8	-5.5	-1.0	1.2
Eastern Europe						
Czech Republic	0.2	1.6	-2.0	-1.5	1.0	0.0
Hungary	0.7	-1.2	-2.5	-2.0	0.5	0.0
Poland	0.1	3.7	-2.5	-1.5	1.5	0.0
Romania	-1.4	0.2	-3.0	-2.0	0.5	0.0
Russia	1.2	0.3	-4.0	-2.0	1.0	0.0
Turkey	0.7	1.7	-3.5	-0.5	1.5	1.5
Other Europe						
Denmark	0.4	1.7	-2.6	-1.1	-0.1	0.2
Norway	1.1	3.3	-1.0	1.4	1.7	0.5
Sweden	1.3	1.1	-2.5	-1.1	1.1	0.3
Switzerland	1.2	1.9	-1.3	-0.8	0.7	0.3
UK	0.9	0.9	-2.1	-2.0	0.0	0.5

Sources: Thomson Datastream and Capital Economics

Detailed forecasts – Interest rates and bond yields

TABLE 5: OFFICIAL INTEREST RATES

% end year	1998-07		2008	2009	2010	2011
	avg	Latest*				
Euro-zone	2.96	3.25	2.50	1.00	1.00	1.00
Eastern Europe						
Czech Republic	3.94	2.75	2.25	1.00	1.00	3.00
Hungary	10.75	11.00	10.00	7.50	6.00	5.50
Poland	10.00	5.75	5.00	3.00	3.00	4.50
Romania	11.77	10.25	10.25	8.00	6.00	6.00
Russia (3m interbank rate)	26.17	7.48	10.73	10.50	10.00	9.00
Turkey	46.21	16.25	15.00	8.00	8.00	10.50
Other Europe						
Denmark	3.11	4.00	3.50	1.00	1.00	1.00
Norway	4.69	4.75	3.00	1.25	1.25	2.00
Sweden	3.17	3.75	3.75	0.50	0.50	1.00
Switzerland	1.38	1.26	0.66	0.10	0.10	0.10
UK	5.05	3.00	2.00	0.50	0.50	0.50

TABLE 6: 10-YEAR GOVERNMENT BOND YIELD (LOCAL CURRENCY UNLESS STATED)

% end year	1998-07		2008	2009	2010	2011
	avg	Latest**				
Euro-zone	4.35	3.98	3.04	3.00	2.50	2.50
Eastern Europe						
Czech Republic	4.72	5.75	4.07	5.00	4.00	4.50
Hungary	7.71	10.39	9.07	10.50	8.00	6.50
Poland	7.48	6.35	5.39	6.00	4.70	5.25
Romania	6.85	9.31	8.35	6.30	6.00	6.00
Russia	8.04	5.01	8.35	6.30	6.00	6.00
Turkey (US\$ denominated)	n/a	n/a	11.00	7.30	7.00	7.50
Other Europe						
Denmark	4.56	3.95	3.47	3.10	2.60	2.60
Norway	5.16	4.25	3.81	3.25	2.75	3.25
Sweden	4.59	3.60	2.55	3.25	2.75	2.75
Switzerland	2.82	2.39	2.09	0.82	0.82	1.50
UK	4.88	3.81	3.34	3.50	2.50	2.50

TABLE 6: 5-YEAR SWAP RATES

% end year	1998-07		2008	2009	2010	2011
	avg	Latest**				
Euro-zone	4.11	2.98	3.33	2.00	2.00	2.00
Eastern Europe						
Czech Republic	5.52	3.51	2.91	4.50	3.70	4.20
Hungary***	7.58	8.68	7.89	9.00	7.80	6.50
Poland***	5.66	5.66	4.19	5.90	4.60	5.15
Romania	n/a	n/a	n/a	n/a	n/a	n/a
Russia	n/a	n/a	n/a	n/a	n/a	n/a
Turkey	n/a	14.29	16.1	14.0	12.0	10.0
Other Europe						
Denmark	4.42	3.46	3.79	3.50	3.00	3.00
Norway	5.48	3.94	3.84	3.50	3.00	3.00
Sweden	4.66	2.95	2.98	3.25	2.75	2.75
Switzerland	2.71	1.91	1.91	1.40	1.40	1.40
UK	5.48	3.65	3.36	3.00	2.50	2.50

* 30 June 2009, ** month ending 30 June 2009, *** 2004- 2007 average

Detailed forecasts – Currencies

TABLE 5: LOCAL CURRENCY PER EURO

% end year	Latest*	2007	2008	2009	2010	Purchasing power parity
Euro-zone	1.00	1.00	1.00	1.00	1.00	1.00
Eastern Europe						
Czech Republic	26.5	26.1	27.0	26.0	26.0	16.8
Hungary	280	267	290	260	250	164
Poland	4.51	3.99	4.60	4.00	4.00	2.28
Romania	4.22	3.94	4.50	4.50	4.50	n/a
Russia	43.5	37.8	42.9	39.0	37.2	n/a
Turkey	2.16	2.13	2.15	1.92	1.80	1.18
Other Europe						
Denmark	7.45	7.45	7.46	7.46	7.46	10.24
Norway	8.97	9.42	8.50	8.00	8.00	11.1
Sweden	10.92	11.00	11.00	11.00	10.00	10.9
Switzerland	1.51	1.58	1.50	1.60	1.60	1.96
UK	0.86	0.89	0.84	0.80	0.80	0.77

TABLE 6: LOCAL CURRENCY PER US DOLLAR

% end year	Latest*	2007	2008	2009	2010	Purchasing power parity
Euro-zone (\$ per Euro)	1.40	1.37	1.30	1.20	1.20	1.18
Eastern Europe						
Czech Republic	18.9	19.1	20.8	21.7	21.7	14.3
Hungary	200	195	223	217	208	140
Poland	3.23	2.92	3.54	3.33	3.33	1.94
Romania	3.01	2.88	3.46	3.75	3.75	n/a
Russia	31.1	27.6	33.0	32.5	31.0	n/a
Turkey	1.55	1.56	1.65	1.60	1.50	1.00
Other Europe						
Denmark	5.32	5.45	5.74	6.22	6.22	8.70
Norway	6.41	6.89	6.54	6.67	6.67	9.40
Sweden	7.80	8.04	8.46	9.17	8.33	9.27
Switzerland	1.08	1.16	1.15	1.33	1.33	1.67
UK (\$ per GBP)	1.64	1.54	1.55	1.50	1.50	1.53

TABLE 6: LOCAL CURRENCY PER £ STERLING

% end year	Latest*	2007	2008	2009	2010	Purchasing power parity
Euro-zone	1.17	1.37	1.30	1.20	1.20	1.3
Eastern Europe						
Czech Republic	31.0	29.4	32.2	32.5	32.5	21.8
Hungary	328	300	346	325	313	213.8
Poland	5.27	4.48	5.48	5.00	5.00	3.0
Romania	4.93	4.42	5.37	5.63	5.63	n/a
Russia	50.9	42.4	51.2	48.8	46.5	n/a
Turkey	2.53	2.40	2.56	2.40	2.25	1.5
Other Europe						
Denmark	8.70	8.37	8.89	9.33	9.33	13.3
Norway	10.5	10.59	10.13	10.00	10.00	14.4
Sweden	12.8	12.4	13.1	13.8	12.5	14.2
Switzerland	1.77	1.78	1.79	2.00	2.00	2.6
UK	1.00	1.00	1.00	1.00	2.00	1.0

* month ending 30 June 2009

Sources: Thomson Datastream and Capital Economics

Country abbreviations

Euro-zone ¹

Austria	AT
Belgium	BG
Finland	FN
France	FR
Germany	GER
Greece	HEL
Ireland	IR
Italy	IT
Netherlands	NL
Portugal	PT
Spain	ES

Non-euro Europe

Czech Republic	CZ
Denmark	DK
Hungary	HN
Norway	NW
Poland	PL
Romania	RM
Russia	RS
Sweden	SD
Switzerland	SW
Turkey	TK
United Kingdom	UK

¹: data limitations mean that we do not cover Luxembourg or Slovenia.