

# Overall Economic Development.

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## Global Economy.

Despite occasional fears that there would be a repeat of the Great Depression of the 1930s, this did not occur last year. The economic stimulus programs initiated by the governments of major economies and the supply of liquidity from the most important central banks prevented the worst. Nevertheless, it was not possible to avert the most severe economic slump since the Second World War. This was reflected in a global state of shock that paralyzed the worldwide economy, particularly in the first half of the year: international trading in goods suffered a significant downturn, there was a dramatic drop in order intake and the utilization of capacity in major industrial nations at times fell to historic lows. The trend towards a recovery in the second half of the year was due above all to stimulation from fiscal and monetary policy.

Progress can be outlined effectively using the example of the United States. Although American GDP fell by 6.4% on an annualized basis in the first quarter of 2009, government measures such as the US scrapping premium provided a positive impetus, which led to growth of 2.2% again (on an annualized basis) in the third quarter of 2009. This positive development continued in the fourth quarter with growth of 5.7% (on an annualized basis) compared with the previous quarter. According to provisional estimates, the biggest economy may see a drop of 2.4% in real terms for 2009 as a whole. LBBW estimates that the global economy shrank by 0.6% in 2009 – the most severe downturn since the Second World War. Without the robust growth recorded in emerging countries, the result would have been much worse. Once again, China was the leading country here. The Chinese government provided the biggest economic stimulus package in relation to the gross domestic product. In both 2009 and 2010, government funds of around 7% of GDP have been available for investment measures. Against this backdrop, the Chinese economy grew by 8.7% in 2009, according to official provisional estimates.

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## Germany.

The severe slump in the worldwide economy shook the German economy to its core. Having been the most important growth drivers until the crisis, investment and exports now pushed GDP firmly into the red. The decline in investment was directly linked to the massive reduction in exports. On average for the first two quarters, exports fell by 18% in real terms year-on-year. Against this backdrop, the gross domestic product fell year-on-year by 6.7% and 5.8% in the first and second quarters of 2009 respectively. Without relatively robust private consumption and higher public spending, the economic downturn would have been even more severe. The spread of short-time working – between August 2008 and May 2009, the number of short-time workers rose from 39416 to 1.533 million – meant that the increase in the unemployment rate was not as sharp as had generally been feared. The job cuts avoided thanks to this (the unemployment rate rose only from 7.7% in December 2008 to 8.1% in December 2009), together with the high wage agreements of the previous year and the spending stimulus provided by the »scrappage bonus«, have ensured that consumers have remained willing to spend. The recovery that began in Germany in the second quarter continued in the third quarter with growth of 0.7% (with adjustments for seasonal and calendar effects) in a direct comparison of the two quarters. A positive impetus has been provided by investment in construction since the beginning of 2009 and by investment in machinery and equipment since the third quarter of 2009. Exports also showed growth of 3.4% in the third quarter of 2009, compared with the previous quarter. On balance, Germany's gross domestic product shrank by 5% in real terms in 2009 according to initial estimates of the Statistisches Bundesamt (German Federal Statistical Office), irrespective of the recovery from the second quarter onwards. This was due to the decline at the start of the year (-3.5% compared with the previous quarter).

## Central Bank Policy.

In view of the massive economic slump and the ongoing risks in the banking sector, major central banks found themselves forced to continue with the drastic measures they had commenced in 2008. In the period from March to May, the ECB cut its key rate by a total of 100 basis points to 1%, a historic low in the history of the central bank. The ECB also widened its room for maneuver with »unconventional measures«. Among other things, these included the announcement of the purchase of collateralized bank bonds from issuers in the euro zone. This program has a ceiling of EUR 60 billion. At the end of 2009, EUR 28.74 billion of this had been used. The central bank also introduced repo transactions with a term of one year. In a total of three annual tenders, the ECB allocated EUR 614 billion to commercial banks. The orders of individual institutions were met in full. On the money market, interest rates fell continuously for virtually the entire year, thanks to the expansive monetary policy.

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While the 3-month Euribor was 2.89% at the beginning of the year, an interest rate of 0.70% was quoted at the end of the year. The ample supply of liquidity from the ECB therefore achieved the desired success on the money market.

In the United States, the US central bank continued its policy of »quantitative easing«. After the Federal Reserve effectively lowered the Fed Funds Target Rate to zero in 2008, these instruments took on considerable importance beyond interest rate policy. As part of these programs, the US central bank was to buy up USD 300 billion in US government bonds and USD 1,250 billion in mortgage-backed securities (MBS) on the market, among other things. While the purchases of government bonds were completed in autumn 2009, the purchases of MBS are expected to continue until the end of the first quarter of 2010.

## Bond Market.

2009 is also expected to remain a record year for the bond market for a long time. In connection with a decline in yield markups for corporate bonds (measured against the Merrill Lynch Index EN00) from 350 basis points at the end of 2008 to 114 basis points over German federal government bonds at the end of 2009, corporate bonds with an investment grade rating achieved an annual performance of 16.4%. Corporate bonds from the high yield segment showed an even better annual performance of 74.8%. In contrast, the yield of 10-year German federal government bonds rose to 3.73% in May, starting from a record low of 2.89% in January 2009. During the rest of the year, this figure fluctuated between 3.10% and 3.40%, without any clear direction. 2009 will also be remembered as the year in which the market for government bonds in the euro zone was subjected to its first performance test. As a result of the financial market crisis and not least because of the associated drastic increase in state debt, the differences in yields between government bonds of euro member states rose again significantly for the first time since the introduction of the euro. Greek 10-year government bonds, for example, were yielding almost 300 basis points over German federal government bonds at the beginning of 2009. After the situation calmed down in the summer months, emerging fears about Greece's credit rating have led to another significant increase in risk premiums since the beginning of this year.

## Foreign Currency Market.

Throughout most of 2009, the euro gained ground against the US dollar. Both lower yields and the flood of US dollars into the markets as a result of the various aid programs of the Fed were factors that worked against the greenback. The euro reached its high against the US dollar of USD 1.51 to EUR 1 at the beginning of December. However, US yields are now higher again, at least in the medium-to long-term segment, which means that this argument is no longer applicable. When concerns then arose on the capital markets about Greece's solvency, the value of the euro against the US dollar dropped to USD 1.42/EUR 1 at the end of 2009.

## Stock Market.

The stock markets were subject to severe fluctuations in 2009. In the first quarter, the behavior of investors was dominated by the financial crisis and fears about the economy, along with a resulting extreme risk aversion. In a final sell-out, the DAX plunged in mid-March to a five-year low of around 3 600 index points. The subsequent countermovement, which was normal in view of the oversold chart situation, then moved directly into an impressive comeback. If the bull market was initially founded only on vague hopes of an end to the economic downturn, support was provided from the summer by the gradual stabilization of the macro-economic environment. Bit by bit, companies abandoned the distinct pessimism they had shown in the first half of the year. The upwards revision of profit forecasts for companies provided fundamental support for higher prices. One important catalyst was certainly the liquidity that was looking for a higher investment return. In the absence of attractive alternatives, institutional investors in particular turned once again to asset classes that carry greater risk, such as the stock market.