



## **Economic Review**

Europe

June, 2009

**Thomas White International, Ltd.**

## Thomas White Global Investing

It has never been more important for you to understand what is occurring in the world beyond your country's borders. Whether you realize it or not, we are now all fellow citizens...Global Citizens.

The Thomas White organization was founded 1992 with the goal of bringing the benefits of globalization to investors around the world. We believed that once investors understood that globalization was a positive force, they would also see the advantages of adding international equities to their portfolios. It only makes common sense that professional investors would begin searching the globe for the most attractive opportunities. Researching a wider universe of companies should improve long-term performance. Moreover, broad diversification typically lowers return volatility. Multinational corporations have been using this global strategy for years; why shouldn't investors do the same?

Now 15 years later, our firm growth and strong subsequent portfolio performance has confirmed our investment premise. Currently, Thomas White professionals are performing research and managing over one billion dollars in close to 50 countries. We believe one reason for our success is that the nationalities of these analysts are as globally diverse as our portfolios.

# Economic Review

## Europe: June 2009

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According to the European Central Bank (ECB), financial sector weakness in the European Union (EU) is likely to persist until the middle of the next year, followed by a gradual recovery. The **ECB left its key rate steady at a record low of 1%**, and going forward, will most likely concentrate on its €60 billion (\$84.07 billion) program to

buy low-risk bonds to unfreeze credit markets. The ECB has not ruled out the possibility of further rate cuts as well as an expansion of this bond-purchase program.

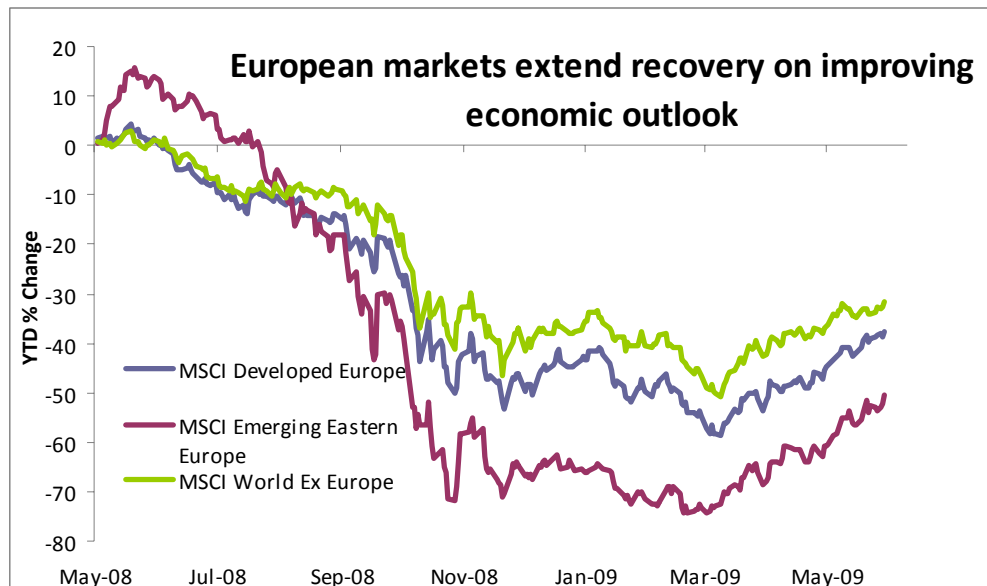
Held every five years, the **European Parliament Elections, the biggest trans-national elections ever, resulted in the election of 736 members. Representing a widespread disenchantment with the center-left, the results strongly favored the center-right** and increased support for the far-right, as well as other fringe groups. While there were 375 million eligible voters spanning 27 EU-member countries, a low turnout of less than 50% signaled a general apathy in a region that is dealing with its worst recession ever.

The European voters' disillusionment with existing policies was apparent, as governing parties in a dozen European countries were pummeled in the elections, including the ruling Labor party in the U.K. However, governing conservatives in France, Germany, Italy and Poland emerged victorious in the mandate.

**Meanwhile, unemployment remains a dominant concern in the 16-member Euro-zone, inching up to 9.2% in April compared to 8.9% in March. With consumer prices falling to 0% in May and producer prices declining by 1% in the Euro-zone in April, the risk of deflation has further**

clouded recovery hopes for the region. Reflecting grim consumer sentiment in the Euro-zone, retail trade continued to fall, tumbling 2.3% in April, compared to last year, despite near-zero inflation levels. Dashing any hopes of a quick economic recovery, **industrial production in the 16-member bloc declined 21.6% in April**, worse than the 19.3% drop in March. On a positive note, the overall Economic Sentiment Indicator for the Euro-zone rose to 69.3 in May from 67.2 in April, indicating a revival in business confidence. This reinforced the belief that economic growth in the recession-torn Euro-zone most likely reached a trough in the first quarter of 2009.

Positive global cues as well as hopes of an economic revival had a positive effect on stock markets as the MSCI Index for Developed Europe increased 12.41% through May, while that for Emerging Eastern Europe gained a healthy 26.04% in the same month.



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## AT A GLANCE

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**Germany:** The Euro-zone's growth driver encountered falling prices, while industrial production and exports toppled.

**U.K.:** The ruling Labor party lost ground in European Parliamentary elections, as the economy remained in the grip of a deepening slowdown.

**France:** A fall in industrial production offset the optimism of improved consumer and business sentiment.

**Italy and Spain:** While both the economies registered unexpected increases in industrial production, the overall economic outlook remained grim.

**Russia:** The erstwhile consumer-driven economy witnessed a retail sales collapse amid galloping inflation and a rising budget deficit.

**Hungary, Poland and Czech Republic:** Socialists were trounced in the European Parliamentary elections, as the political landscape in the region is set for an upheaval.

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## **Germany: Deflation fears haunt the economy while industrial output and exports tumble**

The Euro-zone's growth engine is still struggling with subdued export markets, resulting in a **massive 28.7% decline in exports** in April 2009 year-on-year. Not surprisingly, Germany also witnessed a **21.6% contraction in its industrial production** in the same period, an omen that economic activity may shrink even more than expected in the second quarter. Despite a deepening recession, the conservatives led by Chancellor Angela Merkel, still managed to garner wider voter support over the Social Democrats in the European Parliament elections. With national elections scheduled in September, this victory bodes well for the conservatives. Germany is currently governed by a grand coalition government comprised of the social democrats, and the conservatives.

Meanwhile, **the annual inflation rate in Germany as measured by the consumer price index, retracted 0.1% in May**, compared to a 0.8% increase in April, largely attributable to declining energy prices from their earlier peaks. Unemployment levels continued to climb to 7.7% in April, resulting in subdued consumer demand. Adding to this, the banking sector remains vulnerable to growing loan defaults. However, a silver lining was provided by the ZEW's economic expectations index in Germany, which improved to 31.1 points in May compared to 13 points in April. The Ifo business climate index also increased for the second straight month, to 84.2 in May from 83.7 in April.

The MSCI Index for Germany increased 10.26% through May.

## **U.K.: Labor Party fares dismally in the European Parliament Elections**

Lending a glimmer of hope, **industrial production in the U.K. posted its first monthly increase in 14 months in April**. Energy and manufacturing

output increased 0.3% in April over March, although remaining substantially lower than a year ago. Industrial production had dropped 0.3% in March on a month-on-month basis. Gordon Brown's Labor Party suffered a reversal of fortunes as the party captured just 15.7% of the national vote, its lowest share since 1910. Finishing third, behind the opposition Conservatives as well as the fringe U.K. Independence Party, the Labor Party has overseen a failing economy with a GDP contracting 1.9% in the first quarter of 2009.

Meanwhile, the **Bank of England (BoE) kept its key rate unchanged at the historic low of 0.5%**. The central bank also intends to leave the size of its £125 billion (\$204 billion) asset-purchase program unchanged as a part of a broader monetary easing program. **Consumer-price inflation in the U.K. slowed sharply in April, rising 2.3% compared to 2.9% a year earlier**, the lowest rate since January 2008. Moreover, retail prices dropped a larger than expected 1.2% in April compared to a 0.4% fall in March, the quickest drop in 60 years. This is due to a steep decline in mortgage-interest payments in response to the Bank of England's interest rate cuts.

**Encouragingly, U.K. consumer confidence increased in May to its highest level in six months.** The economic sentiment index gained 2 points to rise to 53, according to the Nationwide Building Society.

The MSCI Index for the U.K. rose 13.87% through May.

## **France: Economic sentiment improves marginally**

Following the broader pattern observed across the EU, President Nicolas Sarkozy and his UMP party trounced the Socialist party in France in the European Parliament elections. The defeat of the socialists came despite simmering social unrest and nationwide agitations against escalating unemployment levels. The **unemployment rate in France climbed to 8.9% in April compared to 7.6% a year earlier. Industrial production pulled back 1.4% in April month-on-month, falling a substantial 19.4% compared to a year earlier.**

While indicators for business and consumer sentiment advanced slightly in May, the outlook remained subdued. **Consumer confidence inched up to -40 in May from -41 in April, while business confidence rose to 72 in May from 71 in the previous month**, according to the French statistical agency INSEE. Inflation levels as measured by the consumer price index hovered at near-zero levels, with prices rising marginally by 0.1% in April year-on-year. These positive trends have sparked hopes that the recession has bottomed-out and recovery is in sight.

The MSCI Index for France climbed 12.73% through May.

## **Italy and Spain: Italian consumer confidence holds steady, while Spanish unemployment soars**

**Industrial production in both Italy and Spain posted surprise monthly increases in April.** While Italy registered a 1.1% rise in industrial output, Spain's industry expanded by 2% compared to the previous month. However, compared to a year earlier, industrial production remained substantially lower in both economies.

**Unemployment in Spain continued to accelerate unabated, rising to 18.1% in April**, the highest recorded level across the EU. Reflecting this, ruling socialists in Spain suffered losses, while the center-right party moved ahead in the European Parliamentary elections. **The Spanish economy also recorded the third consecutive month of decreasing prices**, with prices falling an estimated 0.8% from a year earlier. Highlighting the grim consumer sentiment, retail trade remained subdued, plunging 7.3% in April compared to the same month last year.

Meanwhile, according to the Rome-based research center Isee, **Italian consumer confidence remained unchanged at 104.9 in May, largely due to falling inflation levels.** Consumer price inflation in Italy remained subdued at 1.2% in April compared to a year earlier, reviving the purchasing power in the recession-hit economy. Italy's ruling center-right People of Freedom party led by Prime Minister Silvio Berlusconi emerged victorious in

the European Parliamentary elections with 35% of the vote, although the margin of victory was less than expected.

The MSCI Index in Italy increased 13.46%, while in Spain it rose 13.15% through May.

## **Russia: Unemployment escalates amid soaring inflation**

As the **unemployment rate in Russia rose to 10.2%** of the total labor force to 7.7 million in April, Russia's central bank **slashed its key rate by half a percentage point to 11.5%**. Russian unemployment is now at its highest level in a decade. The erstwhile rapidly expanding emerging economy saw retail sales plunge 5.3% in April on the year, the third consecutive decline after nine years of robust growth. **Industrial production in the economy plummeted 17% from a year earlier.**

Despite the recent strengthening of oil prices, the economic outlook remained bleak in this resource-rich country, with the economy expected to contract by over 6% this year. Economic growth in Russia has slowed down significantly to 5.6% in 2008 after a healthy growth of 8.1% in 2007. The surge in unemployment and the challenge posed by a banking sector riddled with bad debts has offset any positive gains from rising oil prices, a strengthening ruble, and the upsurge in the Russian stock market.

To make matters worse, inflation in Russia remains high, in double digit figures, while the fiscal deficit builds up. Russia will be registering its first budget deficit in over a decade, while **inflation is expected to hover around 14% in 2009**. While the government has been pressured to lend spending support to the weakening economy, the resulting rise in the fiscal deficit has caused inflation to spiral upwards.

The MSCI Index in Russia rose by 31.92% through May, as an increase in oil prices and the strengthening of the ruble positively impacted the stock market.

## **Hungary, Poland and Czech Republic: Economies dogged by upsurge in unemployment**

The economic crisis has led to significant political upheaval in Emerging Eastern Europe. While the Czech center-right government fell after losing a no-confidence vote, the Hungarian Prime Minister of the ruling Socialist Party resigned over accusations that his government mishandled the recession-afflicted economy. Reflecting dissatisfaction with the ruling Socialist Party in Hungary, angry voters reduced socialist support to a mere 17% of the national vote. The right-wing opposition garnered a handsome margin of victory, with a vote from 56% of the electorate.

The Czech Republic, which has had a caretaker government in office, witnessed former Prime Minister Mirek Topolanek's conservative Civil Democrats clinching 31.5% of the vote, with the left-wing Social Democrats trailing behind. In Poland, the ruling center-right Civic Platform secured a decisive vote, cornering around 45% of national support.

**All three economies have seen their unemployment rates rise**, as they remain mired in a deepening slowdown. The unemployment rate in the recession-hit Hungarian economy remains the highest at 9.6%, followed by Poland with a jobless rate of 7.8%, and the Czech Republic with 5.7% in April 2009.

**While the Hungarian as well as the Polish central banks decided to leave their interest rates unchanged at 9.5% and 3.75% respectively, the Czech National Bank has already brought down its key rate to a historic low of 1.5%.** The low interest rate in the Czech Republic is consistent with its inflation level, which at 1.3% is the lowest amongst the three economies. **However, inflationary pressures still remain a cause of concern in Hungary and Poland**, which have maintained higher interest rates than many of their peers. Consumer prices increased 3.2% in Hungary while inflation clocked 4.3% in Poland in April, much higher than the EU average of 1.2%.

The MSCI Index in Hungary recorded a 27.26% increase in May, while in Poland it advanced a moderate 3.68%. The MSCI Index for the Czech Republic gained 9.36% through the month.



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