Global recovery: Grand illusion or real recovery

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Key questions (*and answers*)

- How will the recovery look like?
  (Initially V-shaped, turning into a diminishing sine-wave)

- How will trend growth look like after the crisis?
  (Lower in all countries affected by the crisis)

- Will the “new normal” be a deflationary or inflationary environment?
  (We think inflationary)

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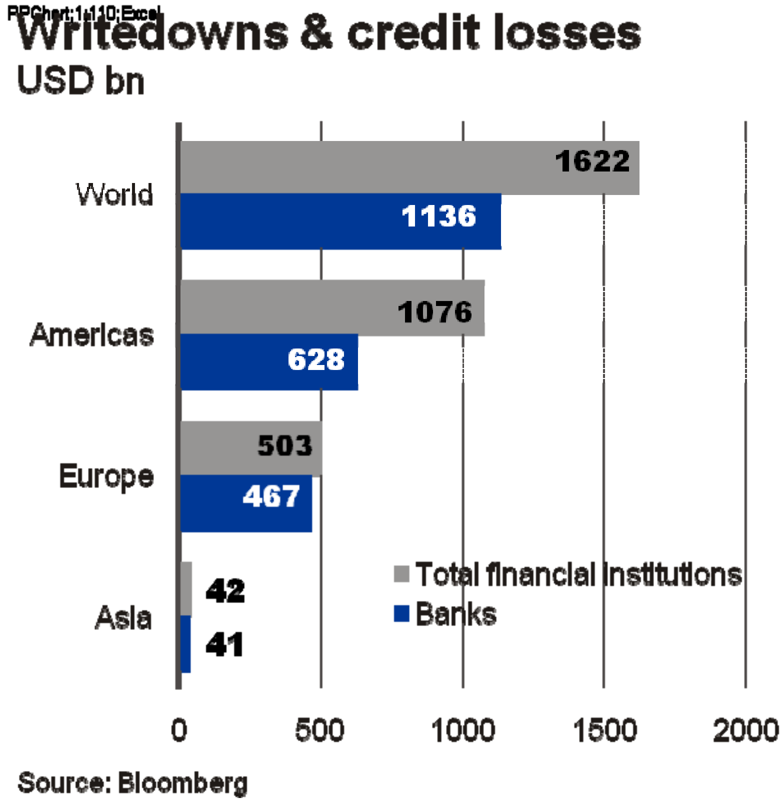
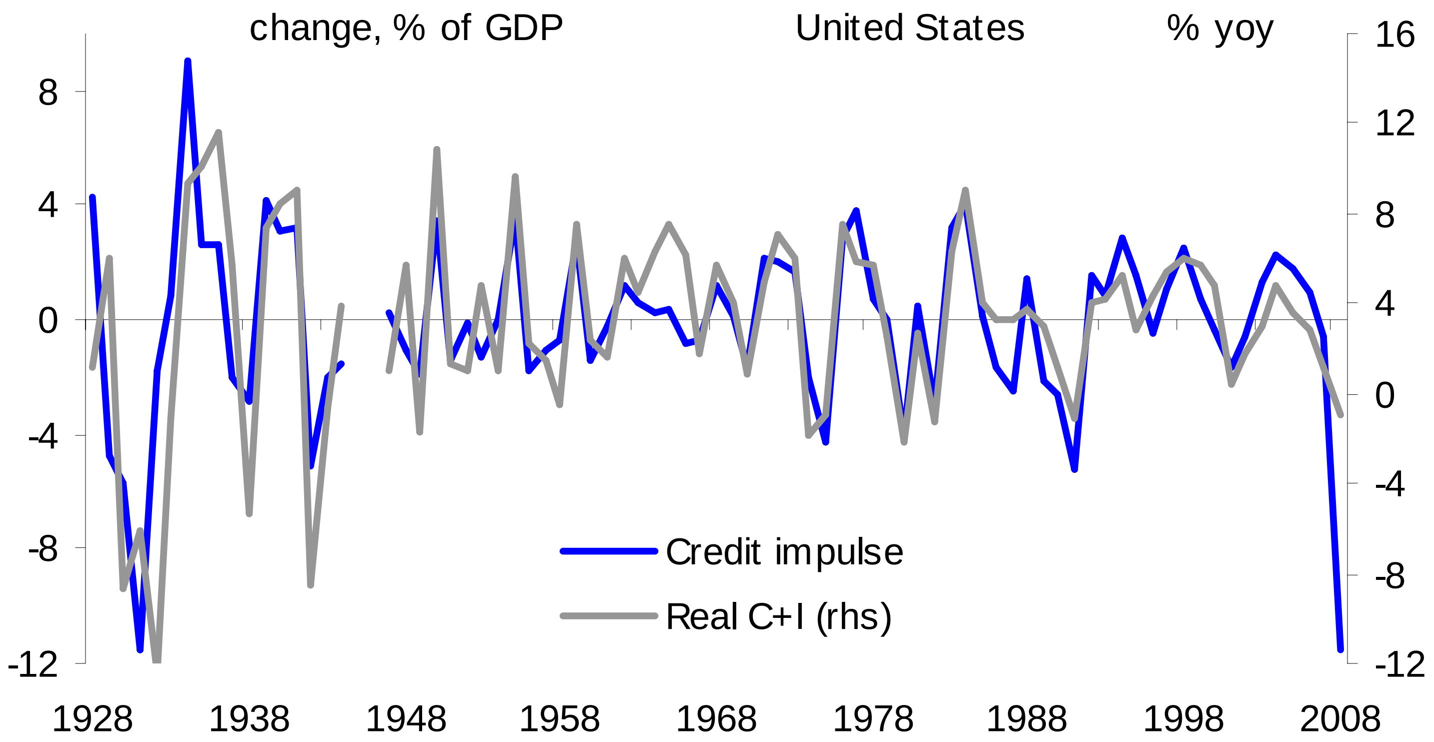
Financial institutions worldwide have so far written off USD 1 622 bn



US: The impact of credit on demand



Notes: Credit impulse := change in net lending flows from financial to private non-financial sector in % of GDP; Real C+I := real private consumption + investment

Source: US Federal Reserve, DB Global Markets Research

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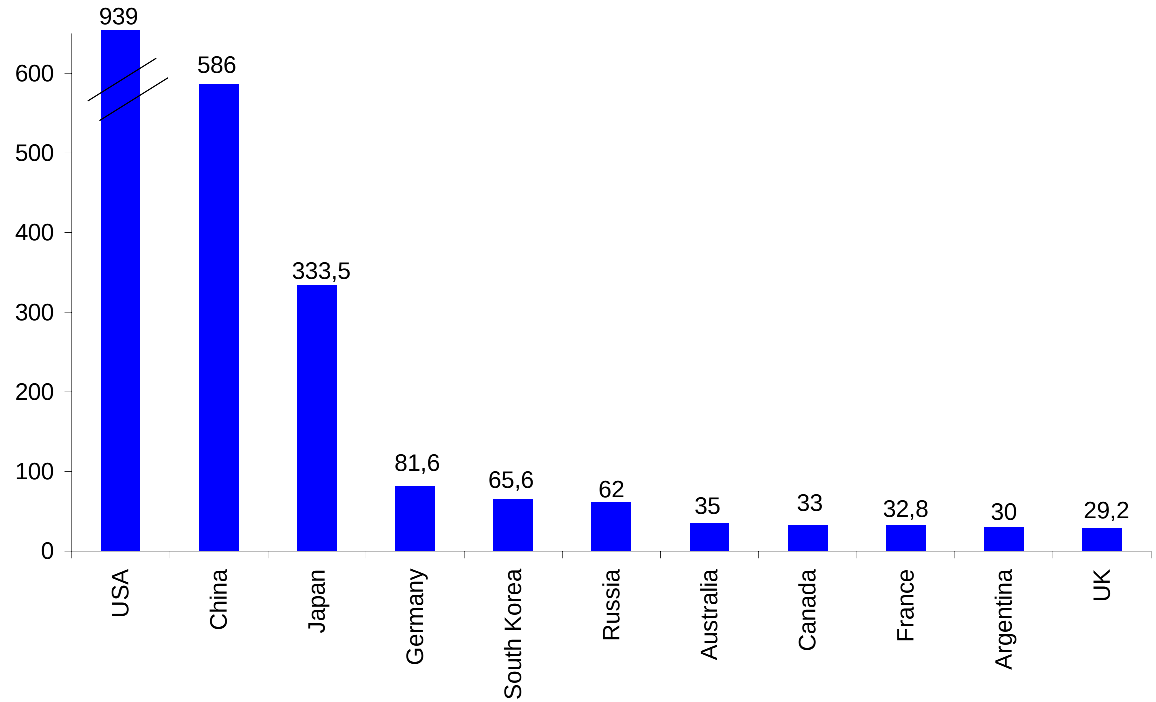
Absolute size of stimulus packages (US-$bn)



Sources: Factiva, National authorities, Deutsche Bank

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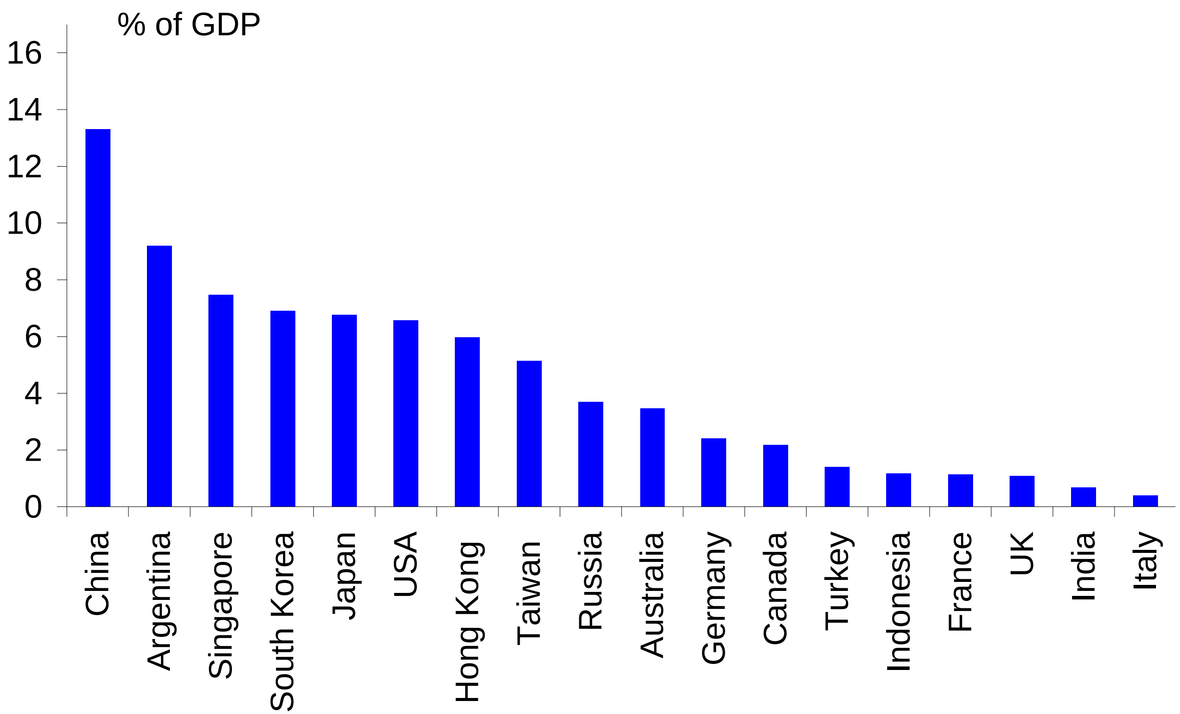
Relative size of stimulus packages as % of GDP



Sources: Factiva, National authorities, Deutsche Bank

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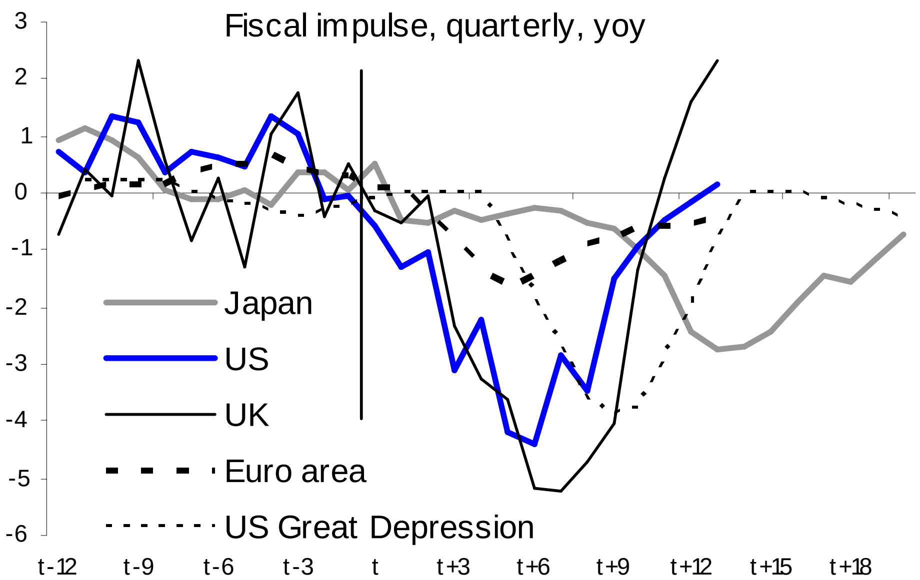
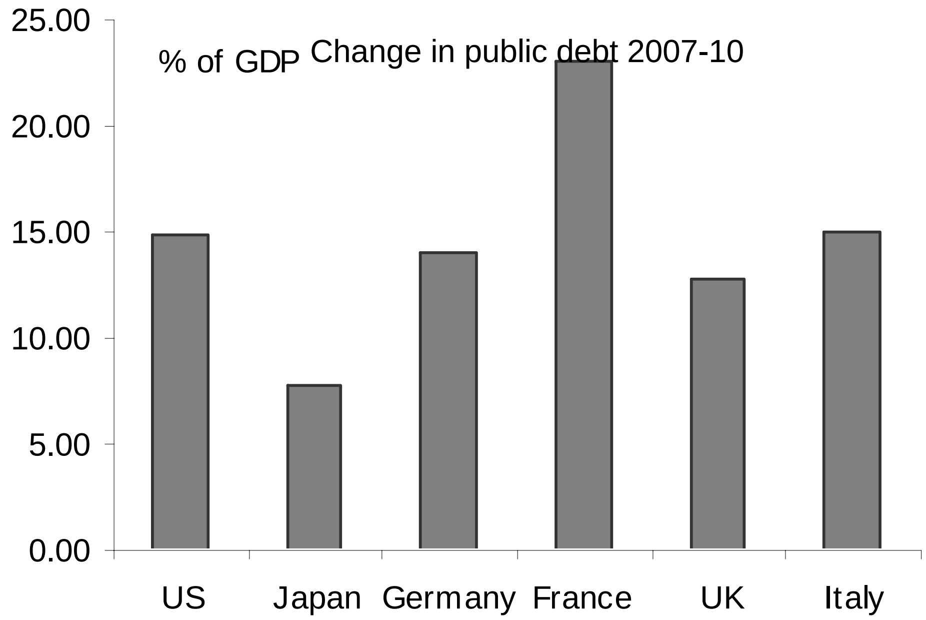
Fiscal stimulus



Notes: t marks quarter in which crisis started, t-x and t+x quarters before and after



Source: DB Global Markets Research

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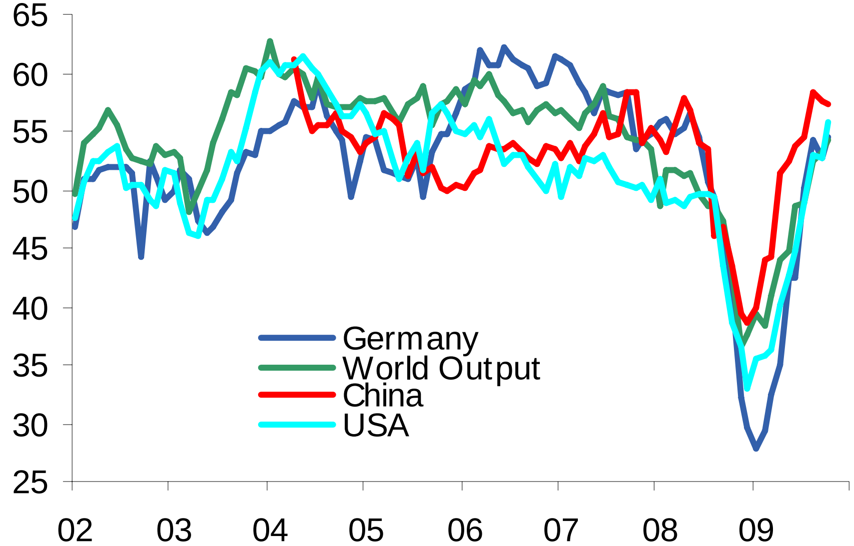
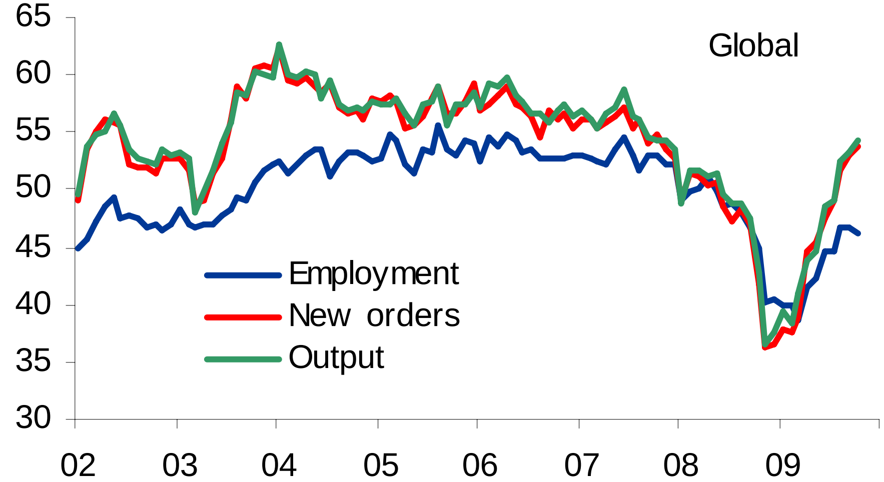
World leading indicators close to their peaks

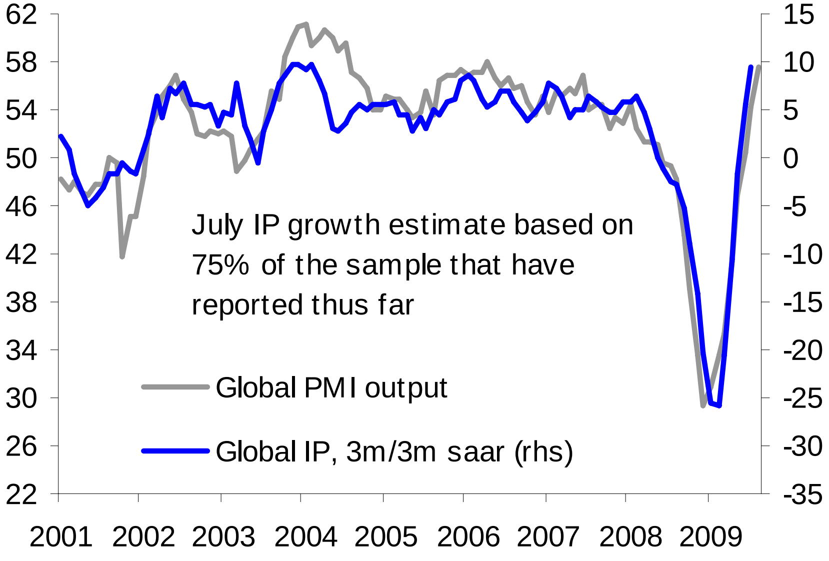
PMI

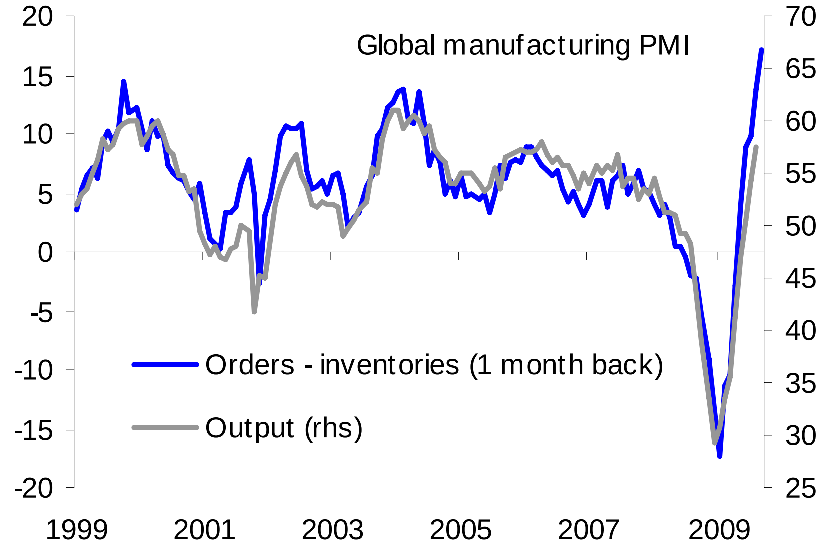




Sources: Markit, OECD, DB Global Markets Research

Consensus view of “sluggish recovery” likely to be challenged as inventory cycle…





Source: Haver, DB Global Markets Research

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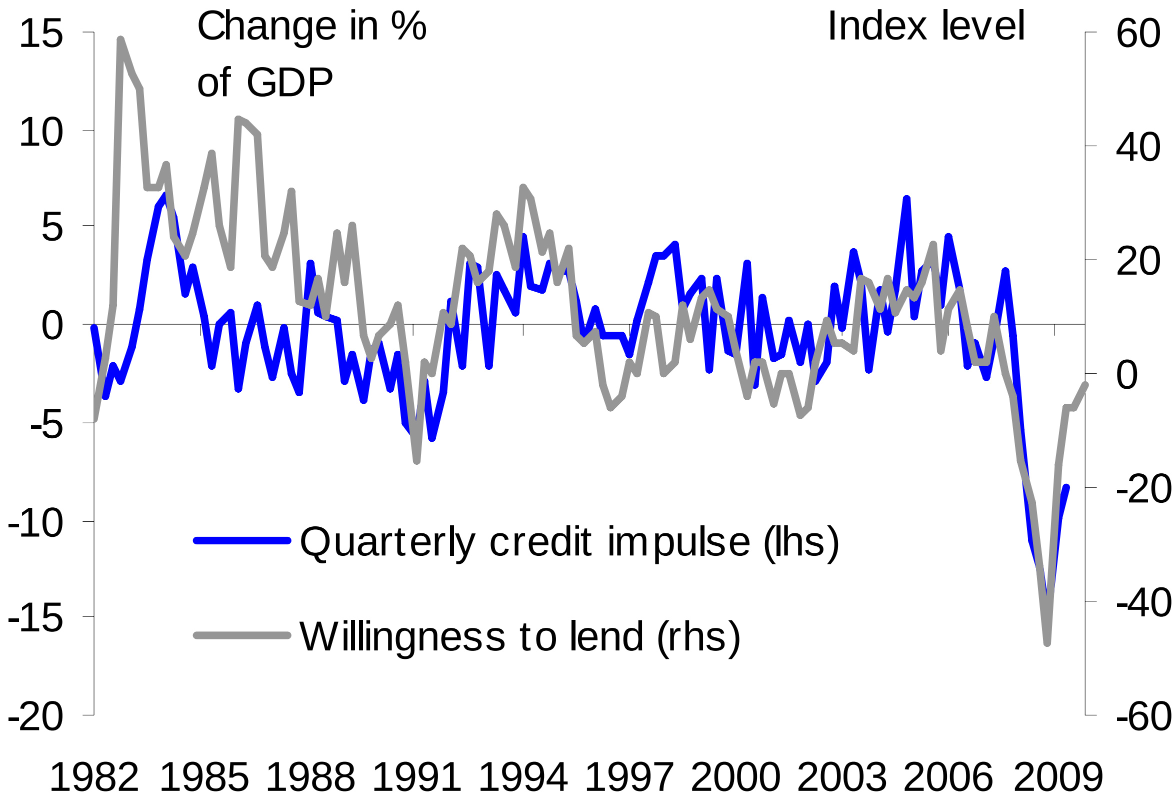
…and credit impulse are turning

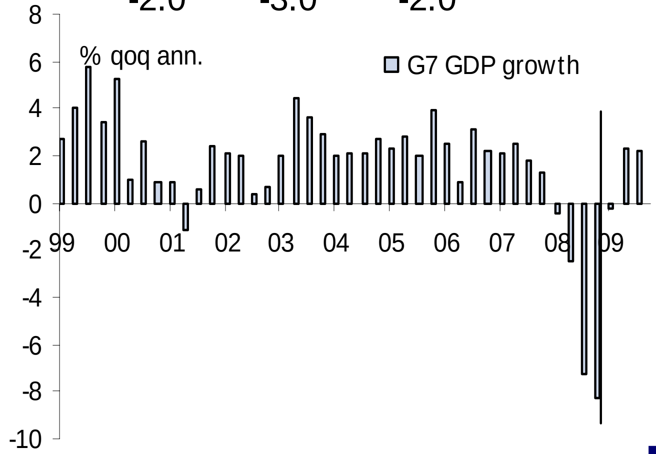
Q2 US credit impulse improving; bank lending survey suggesting further rise in Q3-Q4



Source: US Federal Reserve, DB Global Markets Research

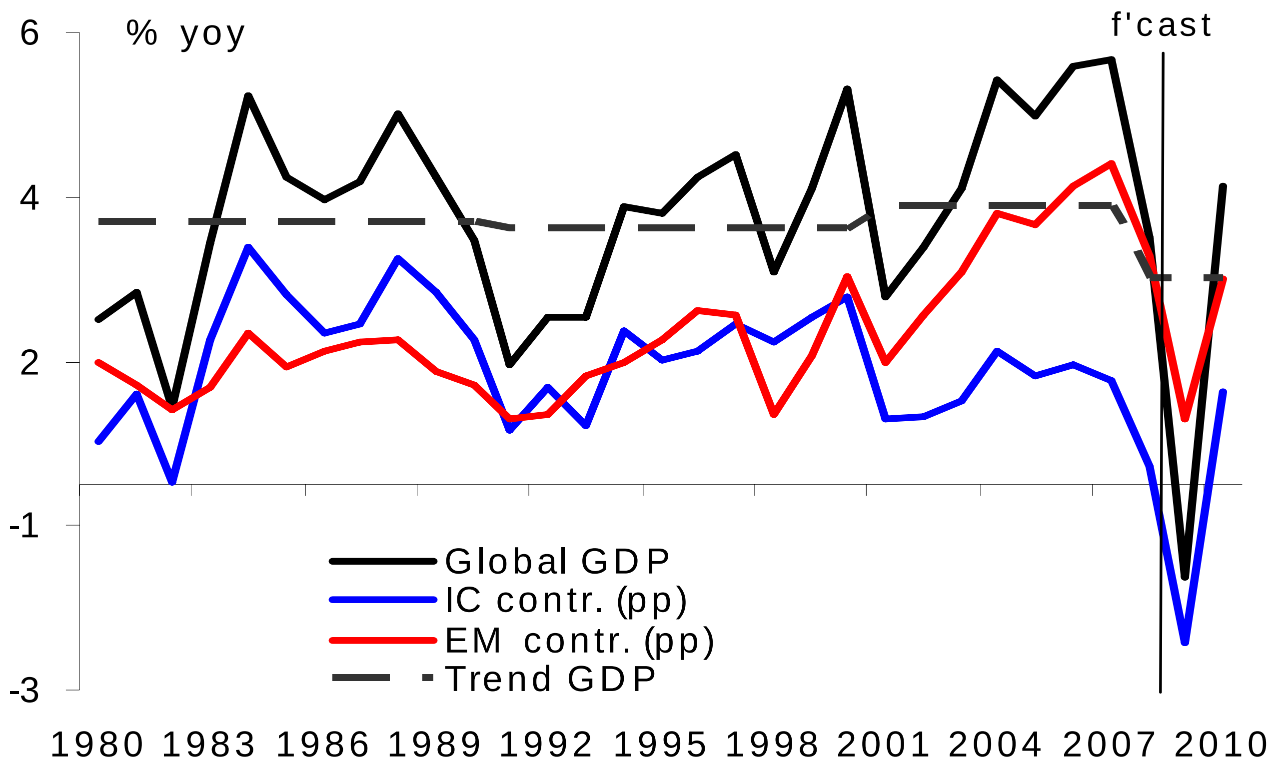
Global recession in 2009 but recovery in 2010

	Real GDP, % growth			CPI, % yoy			Fiscal balance, % of GDP		
	2008	2009F	2010F	2008	2009F	2010F	2008	2009F	2010F
US	0.4	-2.4	3.6	3.8	-0.4	1.3	-3.1	-13.3	-7.3
Japan	-0.7	-6.1	1.0	1.4	-1.3	-1.6	-4.2	-6.5	-7.6
Euroland	0.6	-3.8	1.6	3.3	0.3	1.1	-1.9	-6.3	-6.9
Germany	1.4	-5.0	1.8	2.8	0.3	0.7	-0.1	-4.5	-6.5
Asia (ex Japan)	6.8	5.3	7.2	6.6	0.6	4.0	-1.7	-4.2	-3.9
China	9.0	8.7	9.0	5.9	-0.5	3.4	-0.4	-3.0	-3.0
EMEA	4.3	-5.4	3.8	12.7	8.9	8.1	0.2	-6.3	-5.4
Russia	5.6	-7.4	3.8	13.3	10.1	9.8	3.4	-6.1	-3.5
Latin Ameri	4.0	-2.4	3.5	10.0	6.6	7.5	-0.8	-0.8	-0.6
Brazil	5.1	0.3	5.2	5.9	4.3	4.5	-2.0	-3.0	-2.0
G7	0.3	-3.5	2.6	3.2	-0.1	0.9			
Global	2.7	-1.1	3.9	5.3	1.3	2.8			



Source: DB Global Markets Research

Lower global trend growth and different growth drivers in the future



Source: DB Global Markets Research

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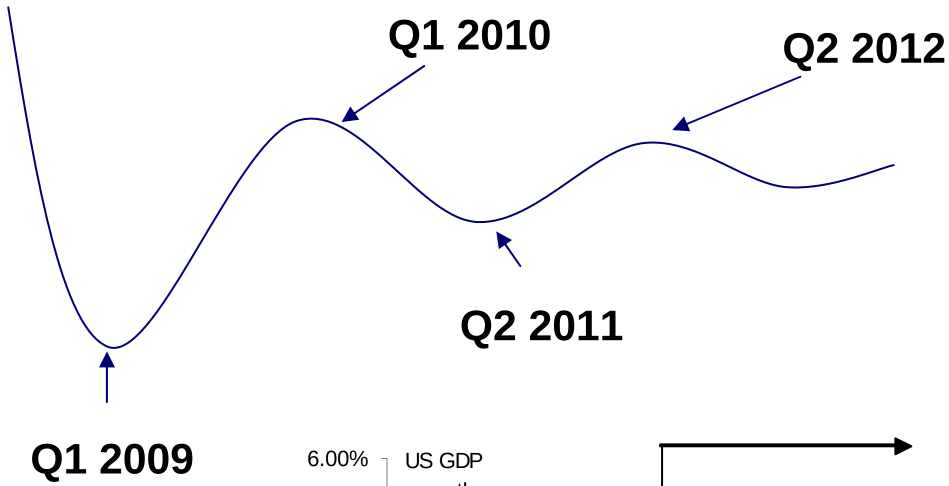
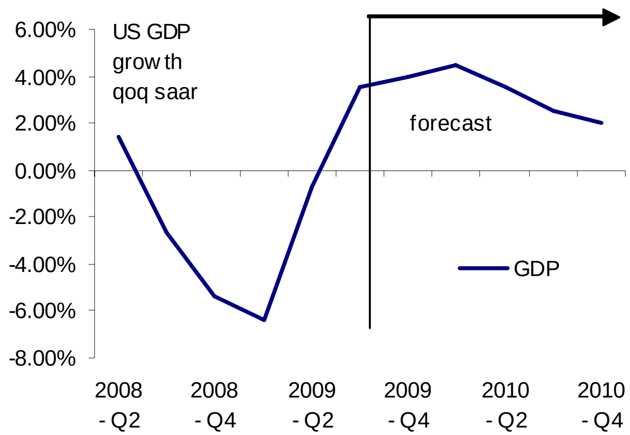
How to think about recovery

- No "V"
- No "U"
- No "L"
- But: Diminishing sine wave





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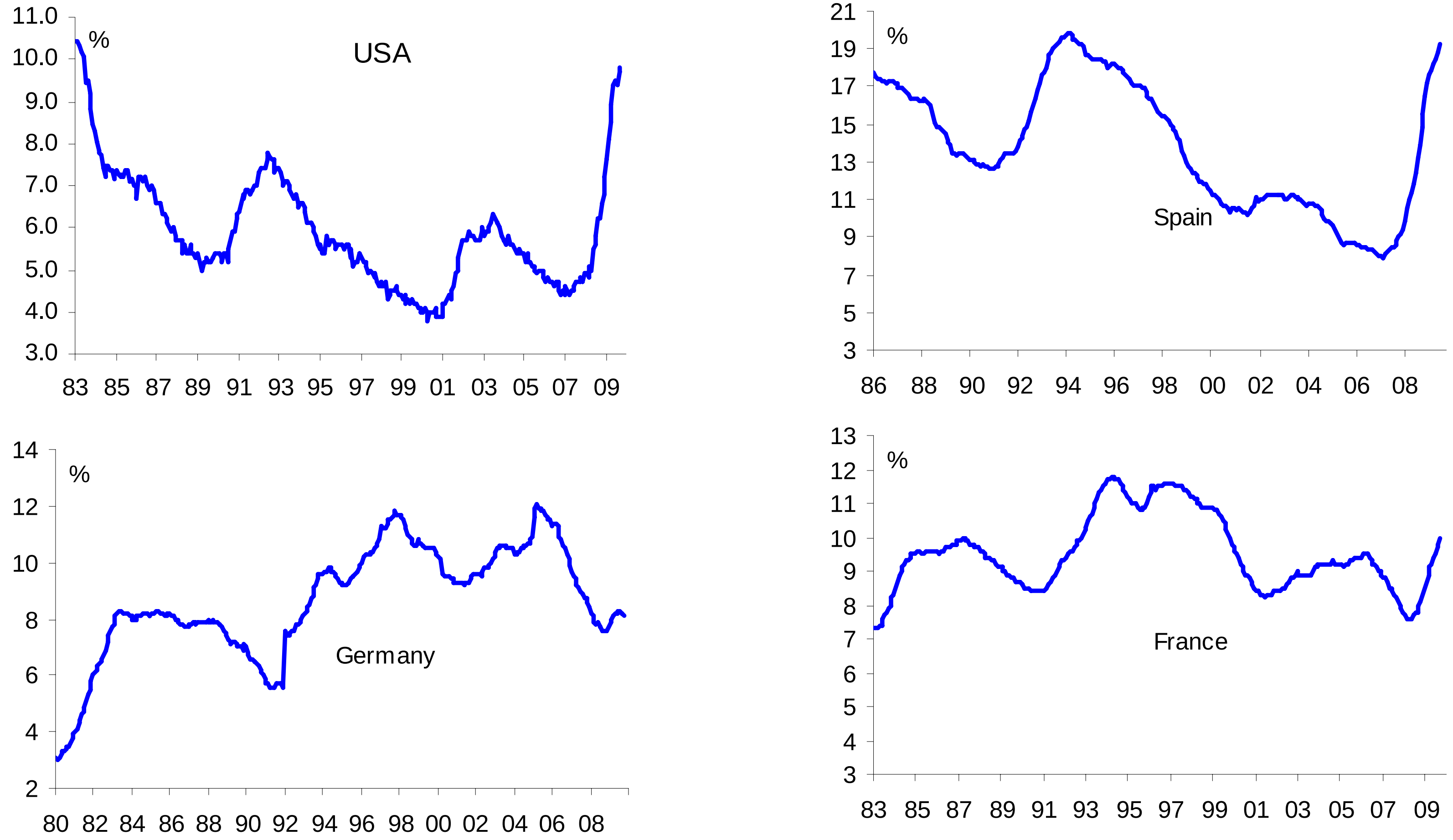
Unemployment: a rising problem

Unemployment rates



Sources: Global Insight, DB Global Markets Research

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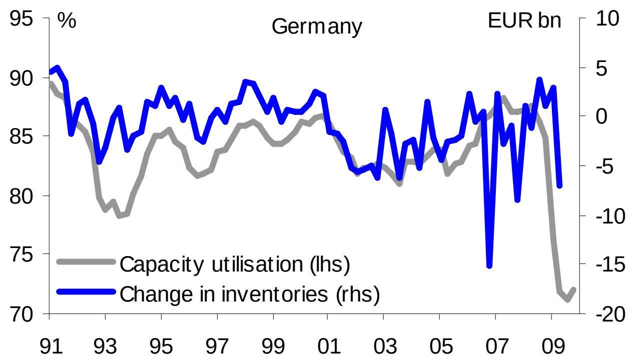
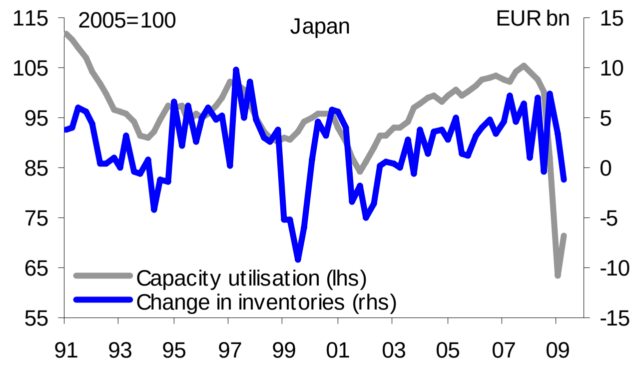
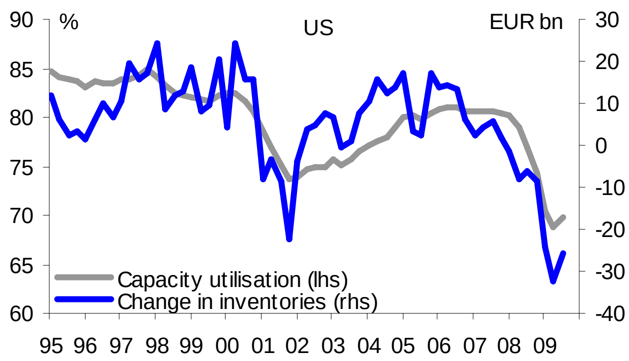
Capacity utilisation should limit pricing power

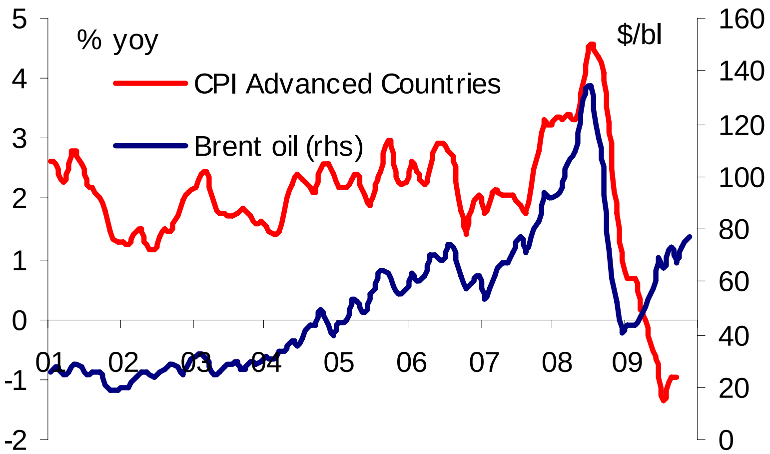




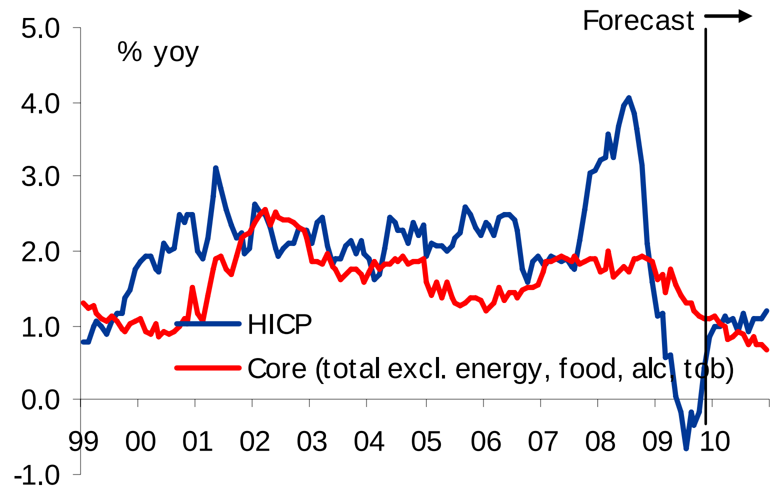


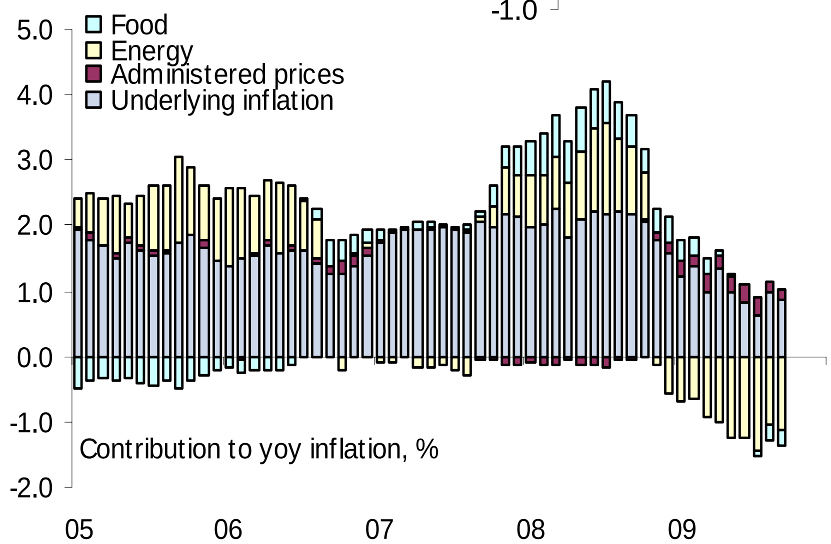
Sources: Global Insight, DB Global Markets Research

Deflation is the risk, not inflation



Euroland inflation





Sources: ECB, Bloomberg, DB Global Markets Research

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But inflation is the more likely medium-term outcome

- Massive central bank money creation and a surge in public debt have created a significant inflation potential
- Output gaps are likely to be smaller than generally assumed and relationship between output gaps and inflation is uncertain
- Exit from easy policies will be very cautious as in the “new normal” central banks need to secure financial stability and fiscal solvency
- In contrast to the Great Depression and Japan’s deflationary decade we had massive front-loaded monetary and fiscal stimulus

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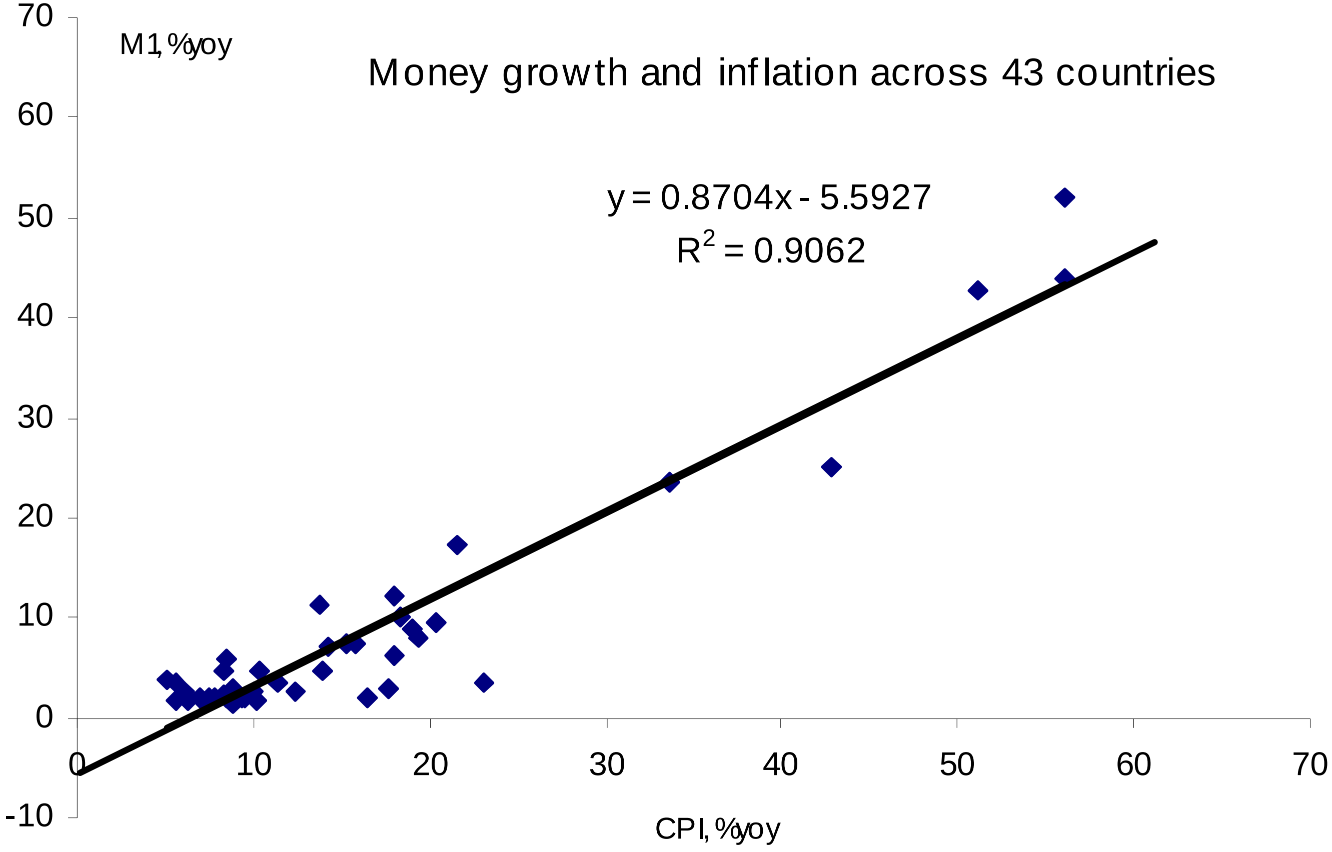
In the long-run inflation is a monetary phenomenon



Source: IFS, DB Global Markets Research

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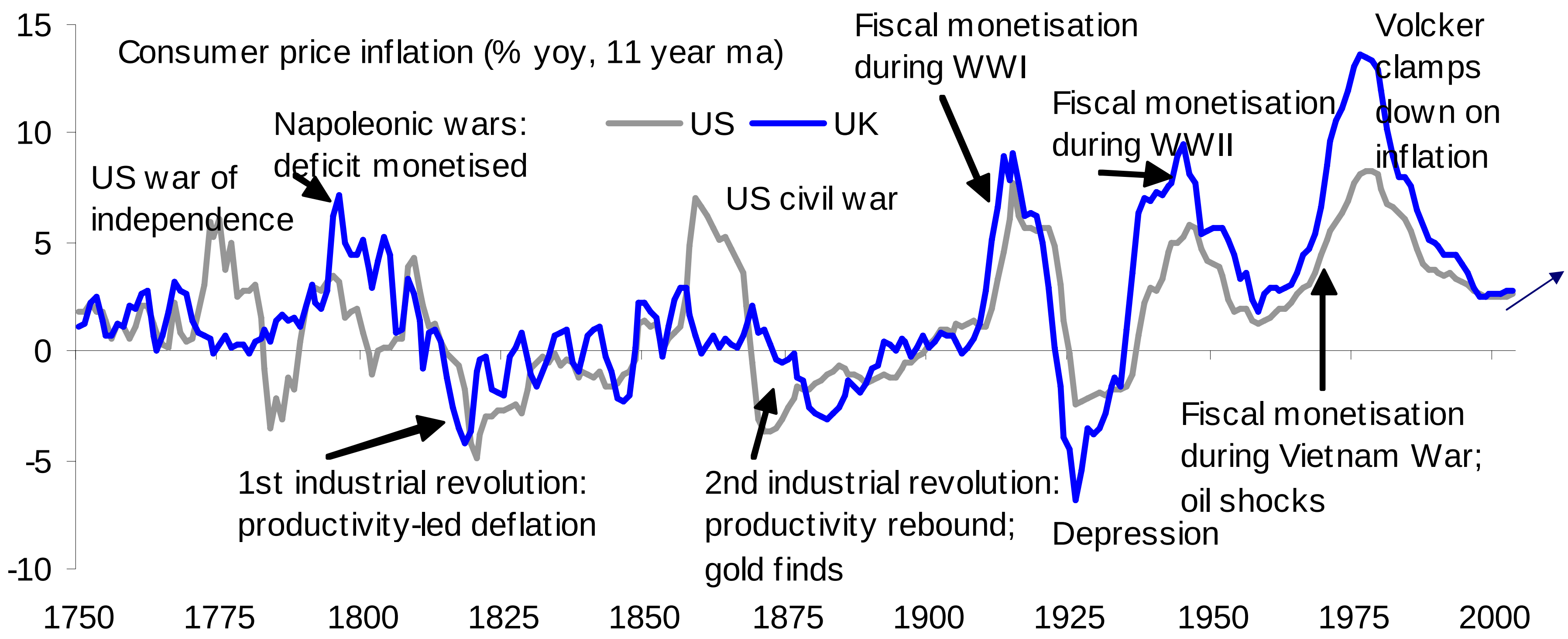
History points to monetisation of public debt and inflation



Source: DB Global Markets Research, Economic History Service

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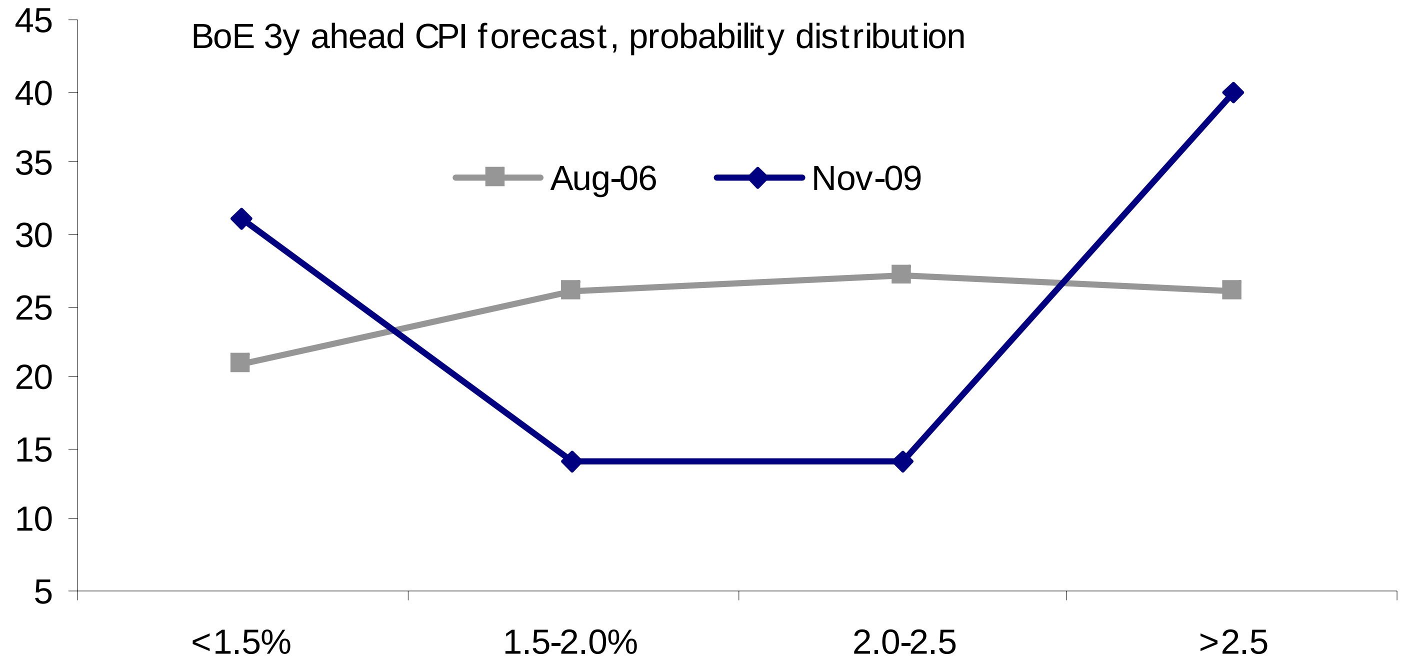
A bi-modal distribution of outcomes…

…according to the Bank of England. We agree.



Source: Bank of England, Inflation Reports

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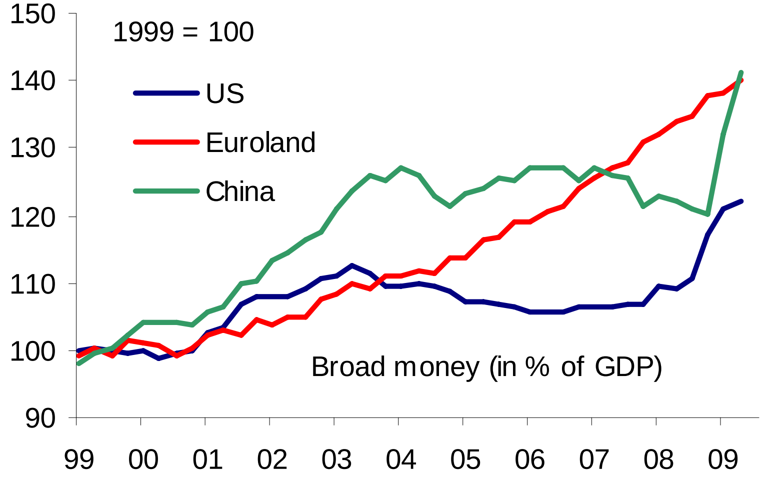
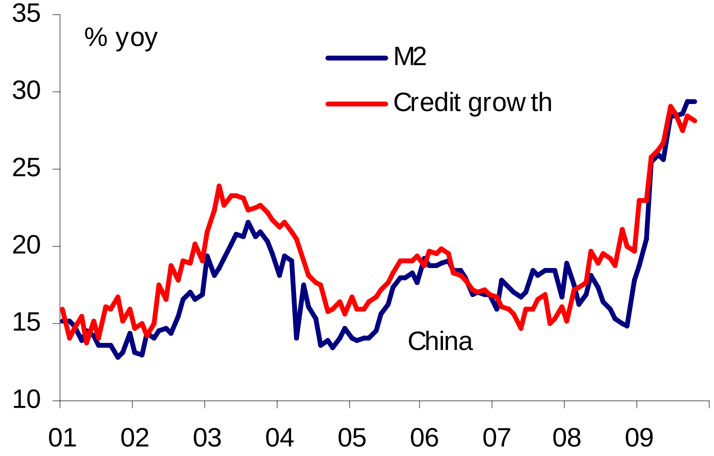
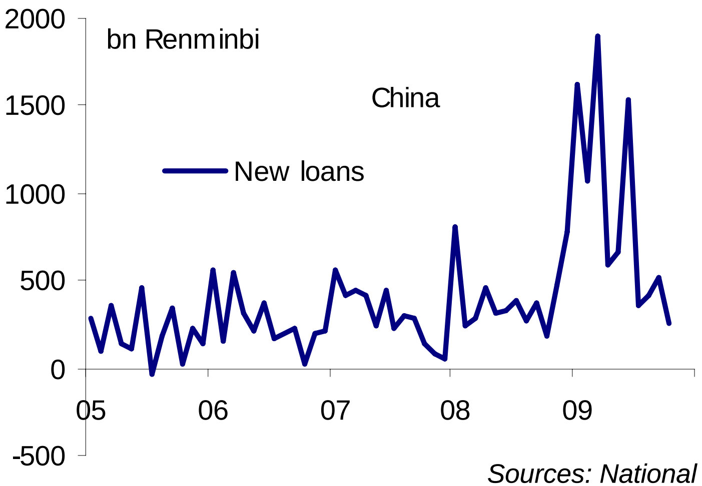
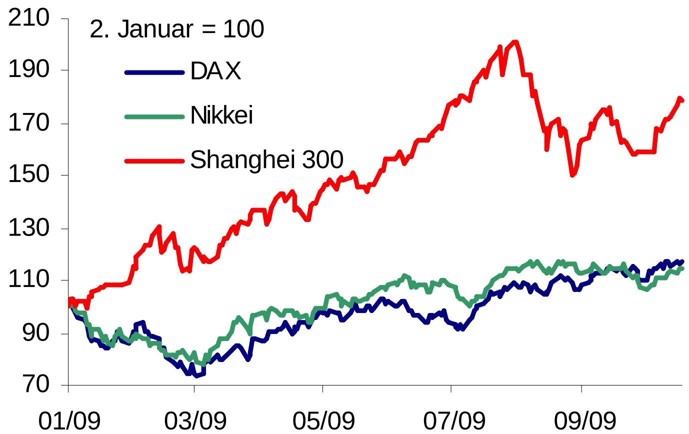
Central banks have provided strong stimulus









Sources: National central banks, DB Global Markets Research

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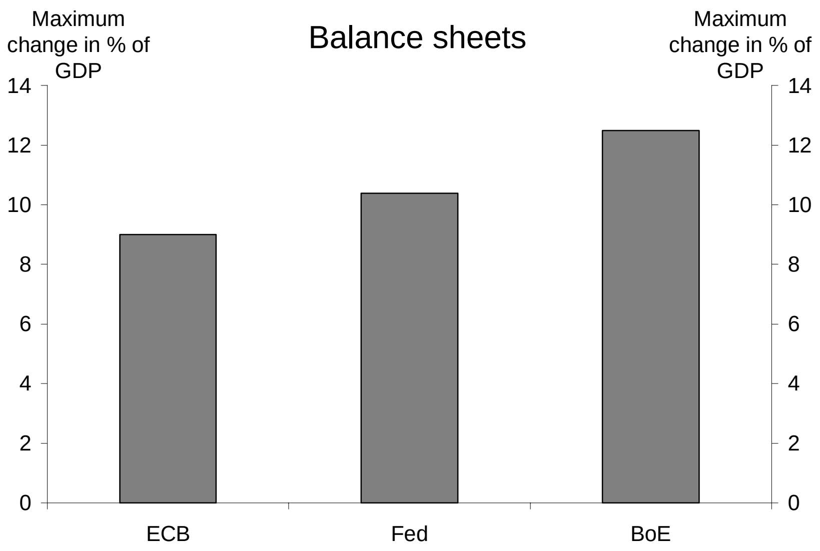
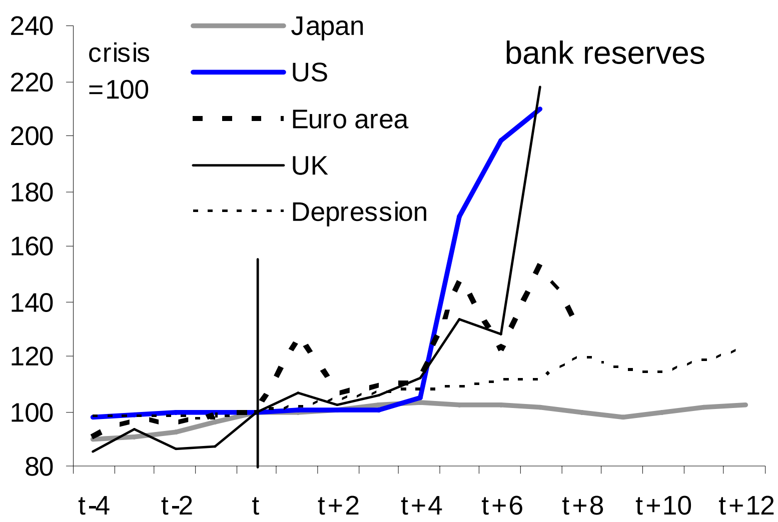
Massive monetary stimulus…

…including big balance sheet expansion leading to surge in reserves





Notes: t marks quarter in which crisis started, t-x and t+x quarters before and after

Source: DB Global Markets Research

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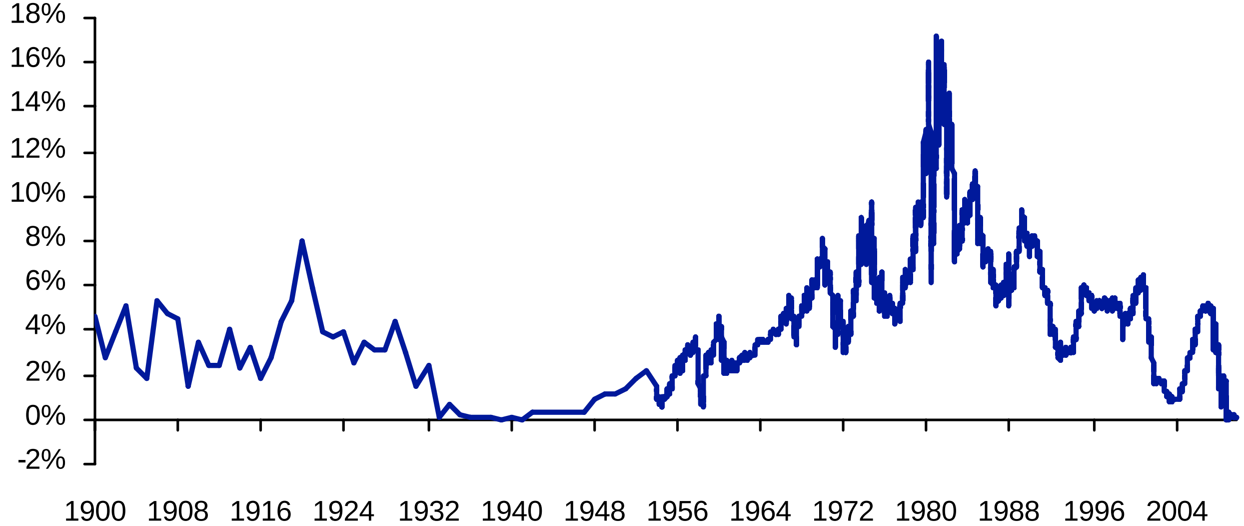
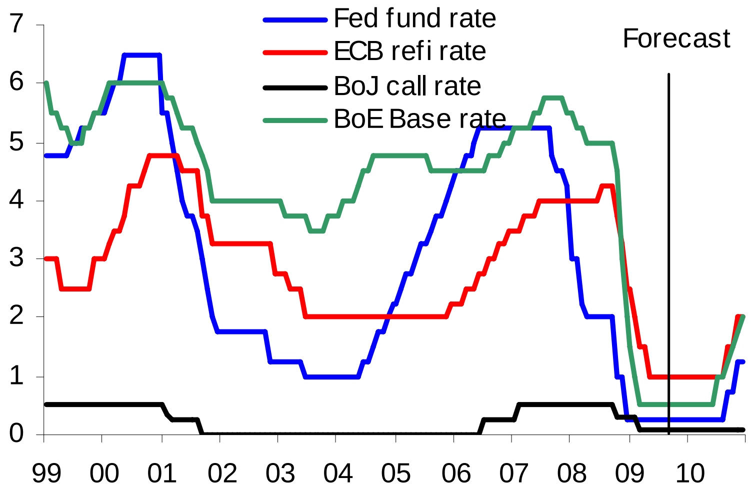
US 3-month Government Yield – ZIRP a rare and troubling event?



Source: Bloomberg, GFD, NBER

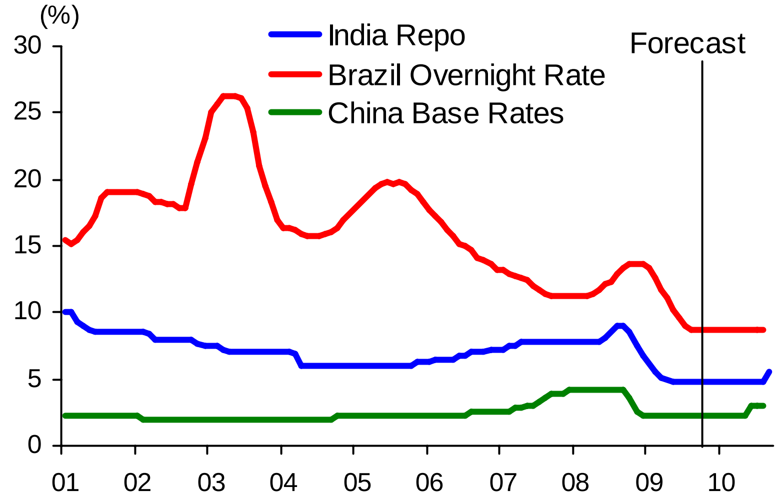
Central bank policy should remain accommodative

Central bank rates



Sources: Eurostat, Global Insight, DB Global Markets Research

Key rates in major emerging markets



Sources: DB Global Markets Research

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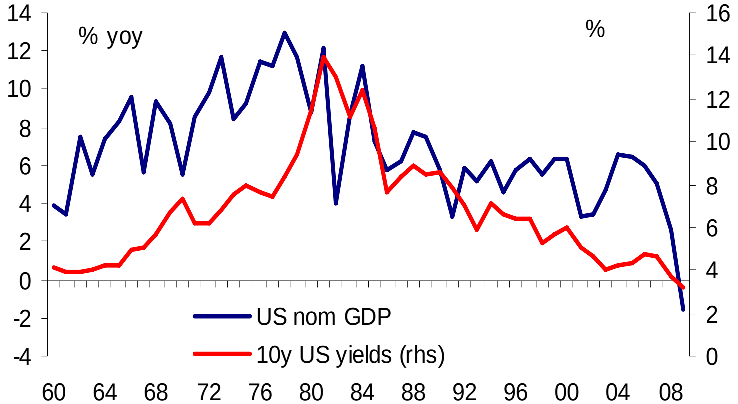
Financial markets in a sweet spot

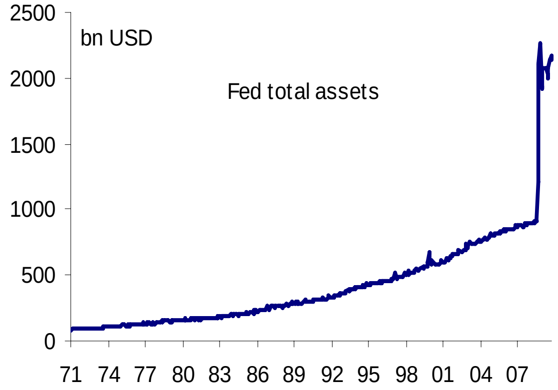
- Recovery to surprise to the upside over the next quarters
- Inflation to remain very low near-term
- Key central banks keeping emergency regime in place for now

⇒ Default risk free assets are overvalued; risky assets will follow suit, a mini-financial bubble likely to emerge

- But concerns about growth in the second half of 2010 plus fears of eventual “reflation” could induce renewed weakness of risky assets as of next spring

US bond market – really the next bubble?

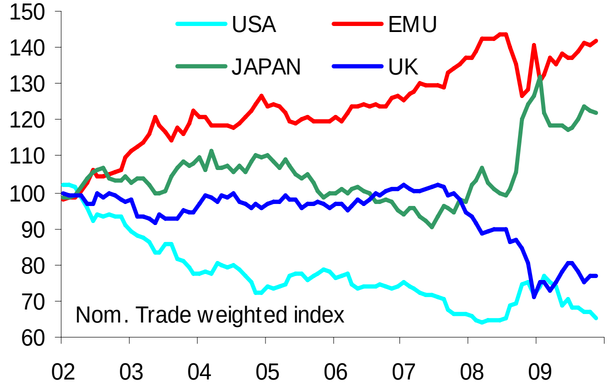




Fundamentally, US bond market does not seem to be too expensive

Strong supply should be counterbalanced by Fed and international investors.

However, Fed could be stopped out by a rise in inflation and foreign investors could be stopped out by a depreciation of the US dollar



Source: DB Global Markets Research

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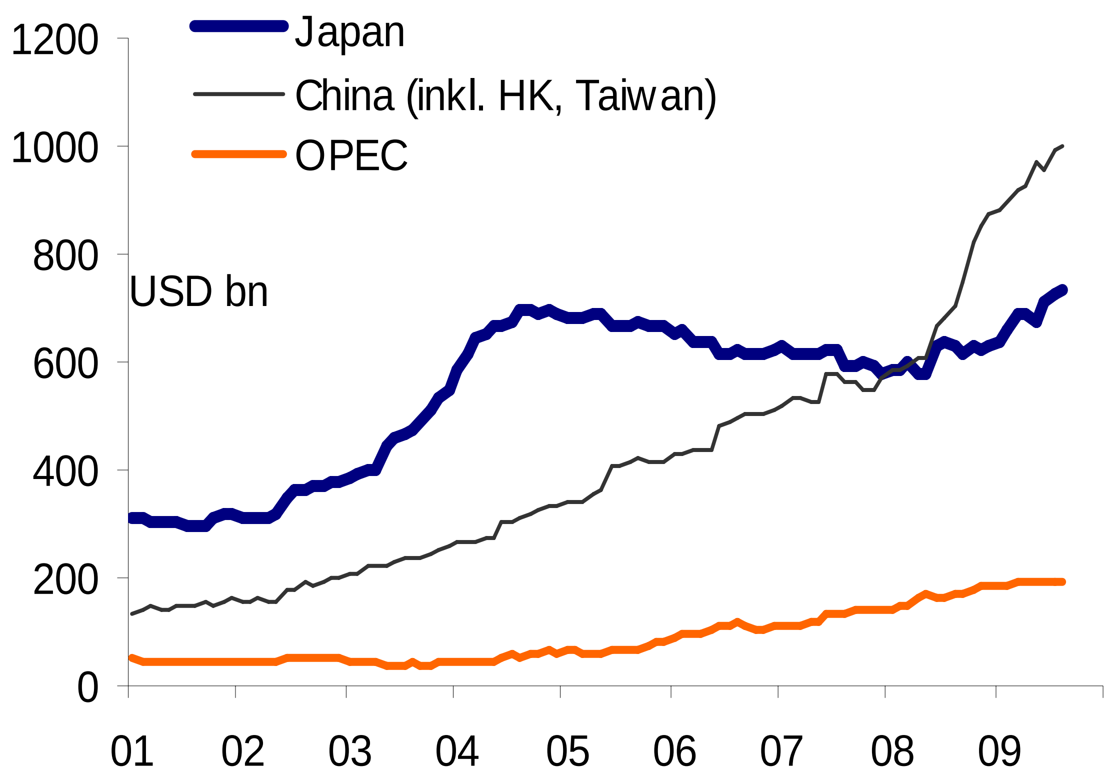
Foreign US bond holding



Sources: DB Global Markets Research

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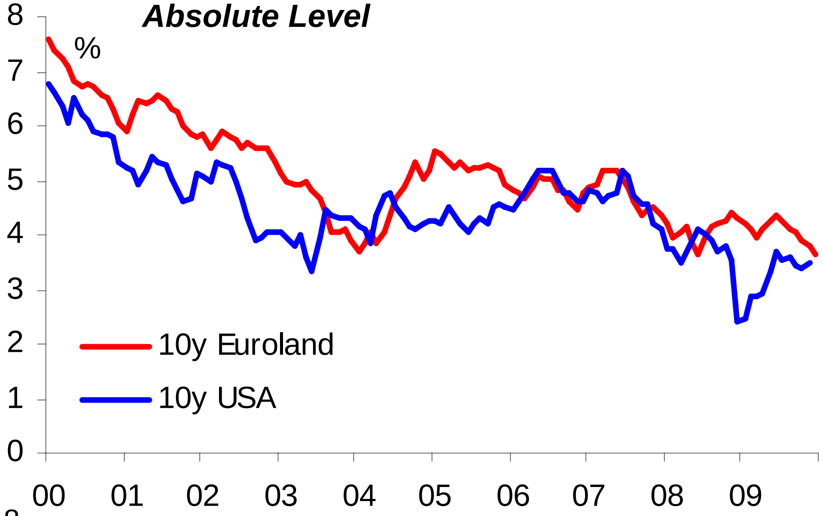
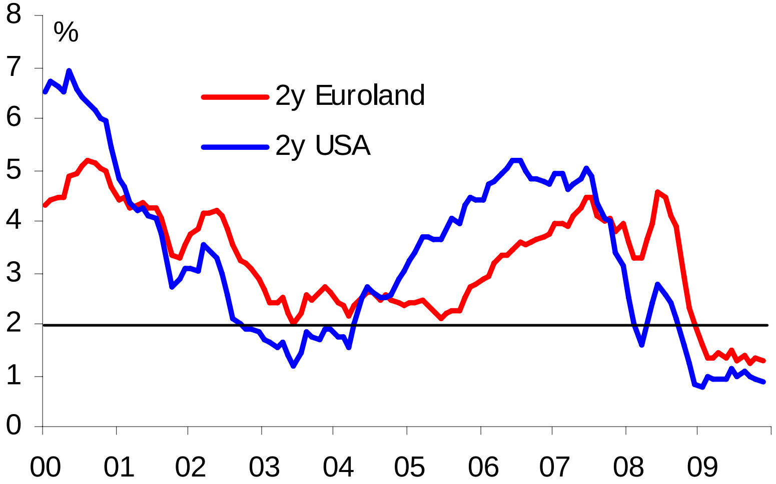
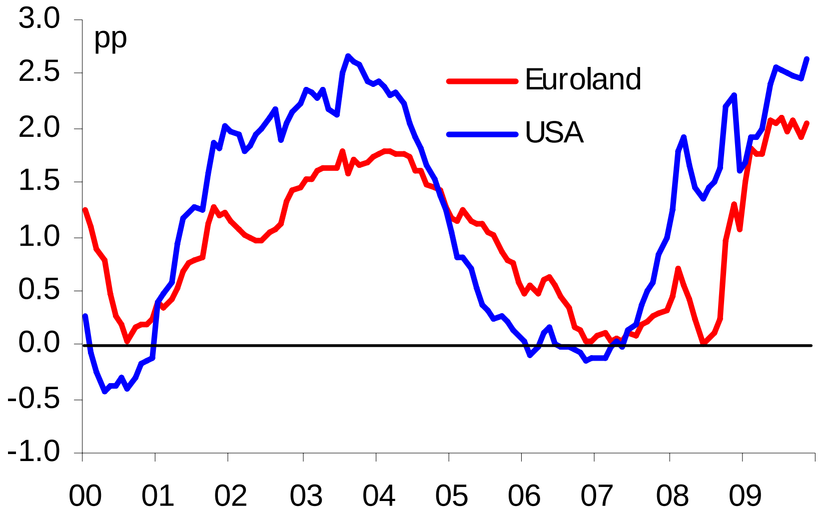
Bond markets – yield curves indicate pressure in government bond markets

Absolute Level





Spread 2y vs. 10y



Source: DB Global Markets Research

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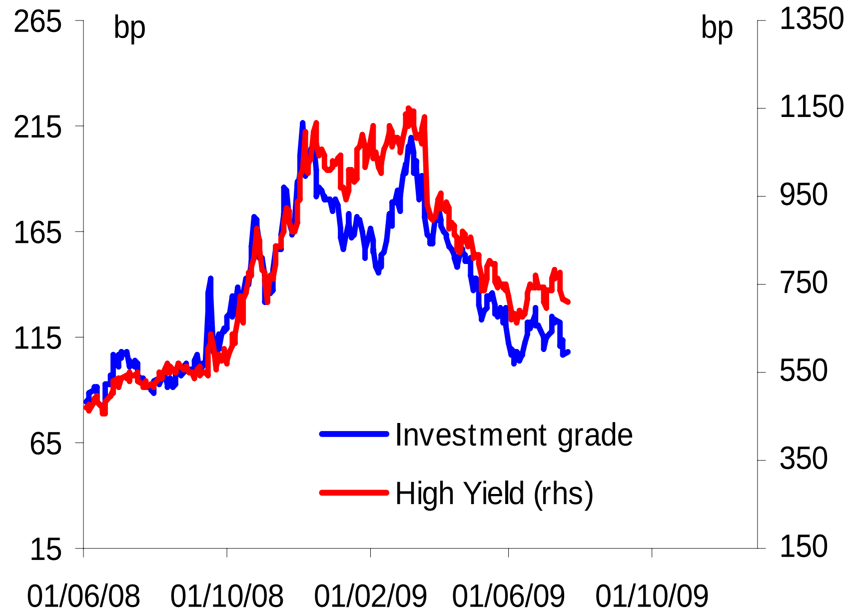
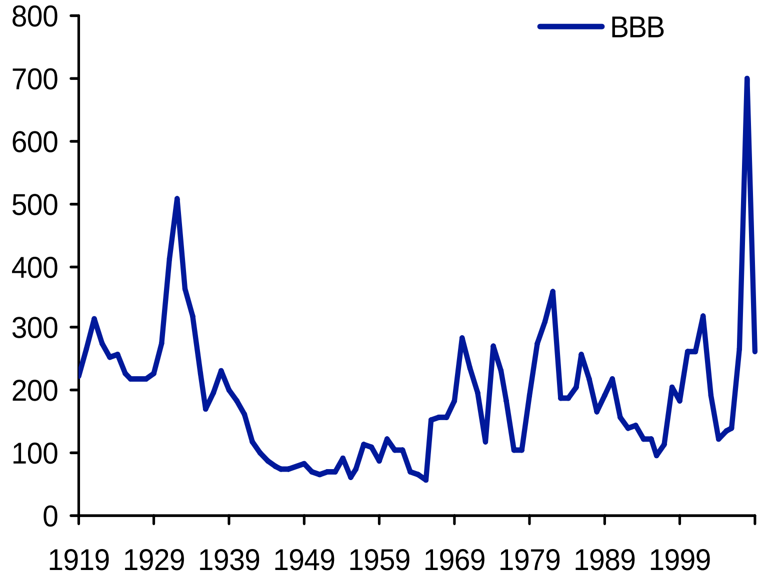
Spreads have tightened

Credit default swaps on European iTraxx



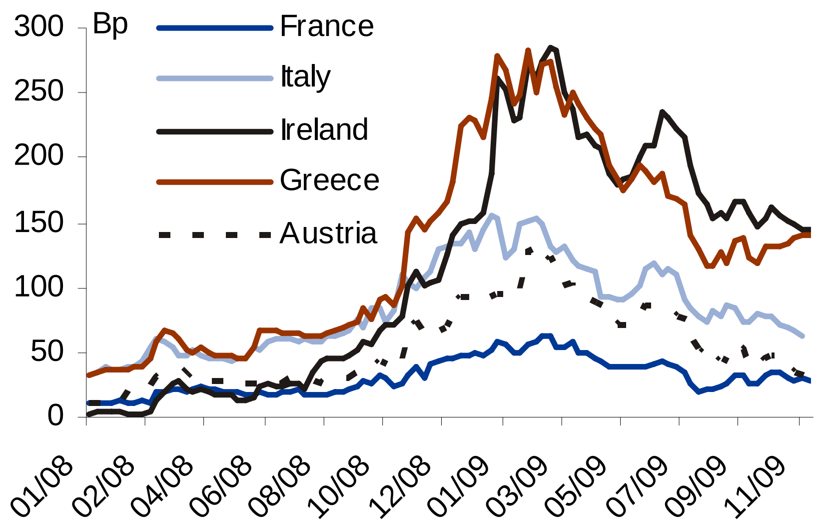
Long-term US BBB spreads vs Treasuries (bp)



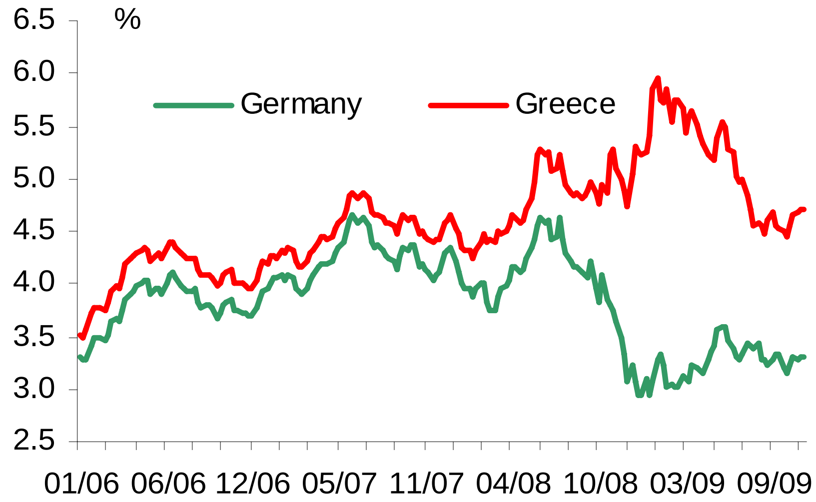
Sources: Bloomberg, DB Global Markets Research

Tensions have eased within the Eurozone

Spread vs. Bund (10y)



Government bond yields (10y)



Sources: DB Global Markets Research

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