

TURNING THE CORNER

Positive GDP data and improving confidence have raised expectations of a modest recovery in 2004

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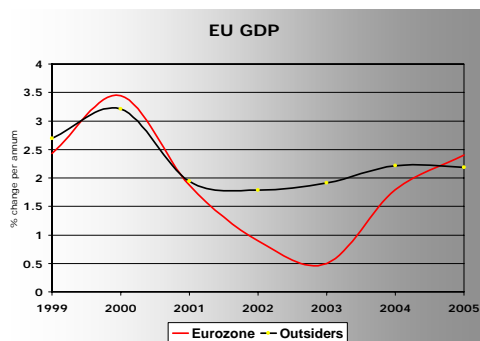
Third quarter data for Eurozone GDP indicate that economic growth accelerated fractionally to 0.3% in year on year terms compared with 0.2% in the second quarter.

Quarter on quarter the figure indicate that the corner may have been turned. GDP rose by 0.4% compared with the previous three month period, an improvement on the 0.1% fall seen in the second quarter.

Overall private consumption growth slowed to just under 1%, while fixed investment declined again, dropping by 1.9%

Set against this, there was a sharp improvement in the external balance in the third quarter. Exports were down only fractionally by comparison with a year earlier, while imports fell by 0.5%

Industrial production was weaker than expected in the third quarter, falling by 0.5%, while figures for the first half of the year were also revised downwards. In part at least this is due to the continuing strength of the euro against the dollar particularly.

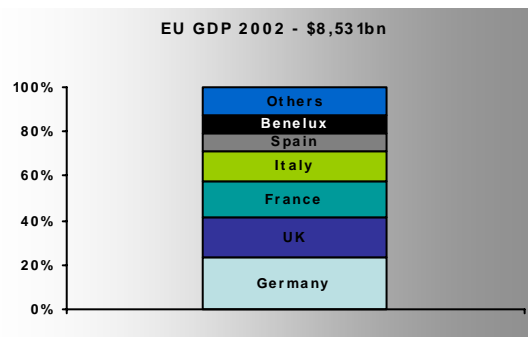


The EU economies outside the Eurozone have performed significantly better during the downturn with a trough in GDP growth of just under 2% in 2002.

As the whole EU improves however, growth in these economies is expected to be overtaken by the Eurozone in 2005.

It is worth reflecting upon the relative economic weights in play here since it helps to explain the dismal growth picture in the Eurozone.

The four largest economies – Germany, France, Italy and the UK account for around 72% of EU output. The first three of these are in the Eurozone and 2003 growth rates of



0%, 0.2% and 0.4% respectively go a long way towards explaining why performance has been so bad.

However, a Eurozone recovery in 2004 is by no means guaranteed and there remain a number of issues to derail that particular train. The main structural risk is that of the dollar:euro rate which will hit European manufacturers hard. There are also some country-specific risks.

Although Germany has begun to make some long-needed reforms there is still a long way to go to bring about the flexibility and transparency required of a modern economy.

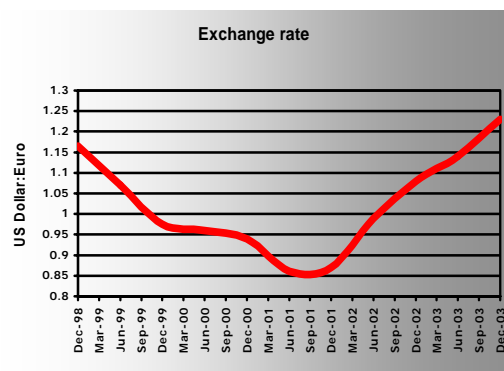
As the economic heart of Europe, its performance has far-reaching effects outside its borders, particularly in its immediate neighbours and in Central and Eastern Europe. Growth is expected to rise to 2.1% in 2004, followed by a fall to 1.8% in 2005.

France, the second-largest Eurozone economy, is likely to recover some momentum in 2004, albeit in the face of some traditional labour market protests. French GDP is expected to expand by only 0.2% in 2003, its weakest performance since 1993, increasing to 1.7% in 2004 and 2.1% in 2005.

Although the overall economic structure of Italy is comparable to that of most "northern European" economies, with a diminishing primary sector and services that contribute almost two-thirds of gross value added, its main strength has been in manufacturing. Particularly small and medium-sized firms specialising in products that require high-quality design and engineering.

Manufacturing accounts for about 25% of GDP and about 90% of total merchandise exports. This makes Italy especially vulnerable to the strength of the Euro. GDP growth is expected to pick up from an estimated 0.4% in 2003 to about 1.5% in 2004 and 2% in 2005.

The Spanish economy has taken something of a pause in the past couple of years. Economic growth, estimated at 2.1% in 2003, is half that of the late 1990's, but remains the highest among the large Eurozone economies. As the global economy recovers, the Spanish economy is expected to expand more robustly in 2004-05 with GDP growth around 3% in 2004.



Elsewhere in the EU most economies, with the exception of the Netherlands, have kept their heads above the waters of recession.

Greece has seen the best growth performance in 2003 – expected to be around 3.8%. Low interest rates and final preparations for the 2004 Olympic Games have boosted investment.

Consumer spending has provided further growth, on the back of expanding credit and gains in employment. By comparison, after two years of near-stagnation the Dutch economy contracted in the first half of 2003.

GDP is set to decline by ½ per cent for 2003, as consumers adjust to weak disposable income, the corporate sector struggles to restore competitiveness and the government tightens fiscal policy. Despite projected GDP growth in 2004/5 of 1% and 2%

	2002	2003	2004	2005
Netherlands	0.2	-0.3	0.9	1.9
Belgium	0.7	0.7	1.9	2.8
Luxembourg	1.3	1.2	2.0	2.9
Portugal	0.5	0.7	1.6	2.5
Austria	1.0	0.9	1.6	2.2
Greece	4.0	3.8	4.1	3.4
Finland	1.6	1.1	2.5	3.1
Sweden	1.9	1.5	2.3	2.5
Denmark	1.6	0.8	2.1	2.5

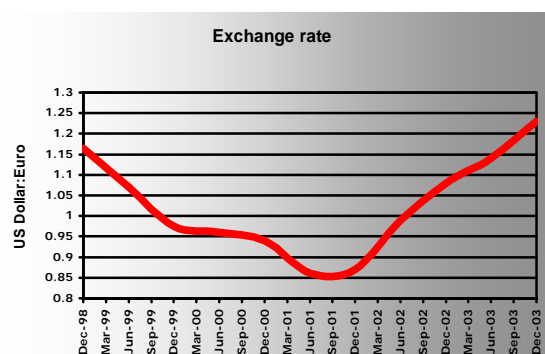
GDP Minor EU economies

respectively this is still way below economic capacity. As a result unemployment is expected to increase.

For all the EU economies 2004 is expected to be considerably better than 2003.

The appreciation of the euro against the dollar is the main downside risk for exporting industries. However, domestic demand is expected to begin to recover as employment picks up and consumer expenditure kicks in.

Concurrently business investment, stagnant over the last two years, will start to rise again purely as a function of the product cycle.



These assumptions may yet prove to be optimistic, especially given the currency risk implicit in a weak dollar, and, as we shall see, they could have big implications for property markets.

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