

Macroeconomic Outlook

Research Department

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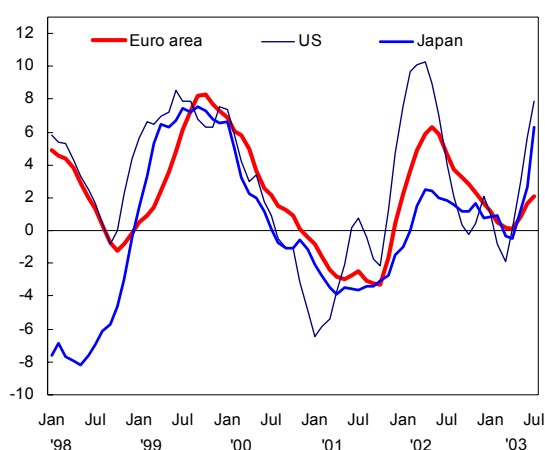
America looks east

The US balance of payments deficit has been keeping economists awake for over five years now, sparking unwarranted forecasts of a collapse in the dollar. After having spent so much time explaining why the current account deficit did *not* weaken the exchange rate, we are now finally seeing a correction. This year, the dollar began its slide in earnest, falling to levels that are starting to alarm some of its trading partners. In the run-up to the 2004 elections, the Bush administration—beset with problems on many fronts—has moreover decided to play the competitiveness card, and is now pressing some Asian countries accused of “stealing” jobs from the US to adopt a flexible exchange rate regime in a bid to weaken the dollar.

It would be naive to think that the realignment of exchange rates will be enough to close the trade gap without generating real costs at home. First, the realignment required could plunge Europe and Japan into recession (see page 11); second, imported inflation and interest rates have a strong effect on domestic demand (page 6). In the 1980s, when conditions were much more favourable, the cut in the US public deficit also made an important contribution. None of these factors will come into play in 2004, however: investment growth (which may well be fairly significant, although probably less so than consensus forecasts have it), a high budget deficit and low savings growth all point to a continuing large current account deficit. In other words, the US will continue to be the engine of the world economy, but growth will not be distributed as it has been in previous years. The US and Japan are in fact currently reporting the biggest improvements in leading indicators.

The dollar is weakening and will continue to do so for some time, even though the benefits and sustainability of this trend are somewhat doubtful. The average exchange rate will probably be lower in 2004 than in 2003. We have therefore cut our growth forecasts for the eurozone to 1.1%, and have also lowered our inflation estimates. Oil prices, currently on the rise, should fall again in 2004 but any drop will not be enough to offset imported inflation.

Leading economic indicators



Japan is the only country in Asia to agree to revalue its currency, but did so with some reluctance. However, the expected appreciation (up to 100 against the dollar, with stabilisation at 105) is unlikely to threaten the economic recovery in

progress (page 33). China seems to have completely ruled out the idea of immediate reforms in its exchange rate system, and this appears to be in keeping with the country's economic policy targets (see page 36). The issue may rear its head again if the US decides to take the politically risky step of introducing trade sanctions against China and using them as leverage in an attempt to get a significant revaluation of the yuan.

FX Rates – Quarterly Averages

	2002	2003	2004	2003				2004			
				1	2	3	4	1	2	3	4
USD/EUR	0.94	1.13	1.16	1.07	1.13	1.12	1.20	1.17	1.16	1.16	1.16
JPY/USD	125.2	115.0	103.5	119.0	118.5	117.5	105.0	105.0	104.0	103.0	102.0
GBP/USD	1.50	1.63	1.70	1.60	1.62	1.61	1.67	1.68	1.69	1.70	1.71
EUR/CHF	1.47	1.53	1.56	1.47	1.52	1.57	1.57	1.56	1.56	1.56	1.57
JPY/EUR	118.3	130.1	120.3	127.6	134.4	131.5	126.0	122.9	120.6	119.5	118.3
EUR/GBP	0.63	0.70	0.69	0.67	0.70	0.70	0.72	0.70	0.69	0.68	0.68
EUR/SEK	9.14	8.72	8.64	8.83	8.74	8.68	8.65	8.62	8.63	8.64	8.65
EUR/NOK	7.51	7.69	8.50	7.57	7.95	7.85	7.38	8.45	8.49	8.50	8.54
EUR/DEK	7.43	7.44	7.48	7.43	7.42	7.46	7.46	7.46	7.48	7.50	7.50
USD/CAD	1.57	1.42	1.45	1.51	1.40	1.38	1.40	1.42	1.45	1.47	1.47
USD/AUD	1.84	1.56	1.42	1.69	1.56	1.52	1.47	1.45	1.43	1.41	1.39

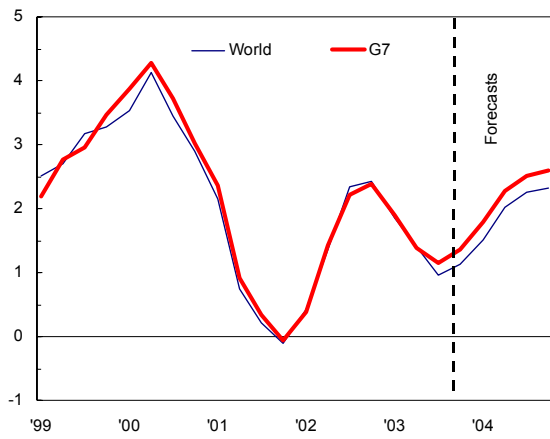
Against this backdrop, and with continued deflationary pressure in Europe and Asia (and also to a lesser extent in the US), expansive monetary policies are likely to continue to hold sway. We believe that official rates will be lower than those priced in by the market, and that we may not see any rate hikes in Europe before 2005. This does not mean however that bond yields will be stable. What with the prospect of bumpy yet rising growth coupled with doubts as to when this will lead to an upswing in employment, the fixed-income market is likely to remain volatile for now.

GDP Growth

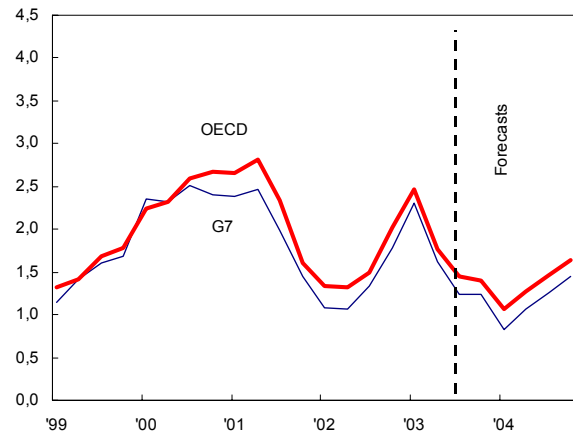
	2000	2001	2002	2003	2004	2005
USA	3.8	0.3	2.4	2.8	3.8	2.9
Japan	2.8	0.2	0.4	2.6	1.8	1.6
Eurozone	3.5	1.6	0.8	0.4	1.1	1.9
Eastern Europe	6.0	4.4	3.6	4.3	5.0	4.9
Latin America	3.8	0.2	-0.9	2.0	4.3	5.0
OPEC	4.3	8.4	1.8	0.0	7.1	5.0
East Asia	6.9	3.7	5.7	5.3	6.4	6.3
Africa	3.1	3.5	2.9	3.4	3.8	3.8
World growth	4.0	1.4	1.9	1.9	3.0	3.3

Average percentage changes over year ahead.

World GDP Growth



Inflation



(Luca Mezzomo)

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