



## *Is The Euro Next?*

Earlier this year, the euro zone's \$12.2 trillion economy, second largest economy to America was looking fairly solid. Exports to emerging markets and business investment were strong, especially in Germany, the Euro zone's largest single member economy. French household spending, a longtime source of growth, did not falter and Spain's housing market was cooling off only gradually. The European Central Bank remained relatively optimistic about the regions prospects and Europe's main stock markets began recovering, supported by hopes that the Continent would be able to weather the global storm.

However, since mid-May 2008, the European stock markets have declined substantially and the region's major economies are all showing signs of slowing. Thoughts of escaping the worst of the global slowdown are quickly diminishing. It now looks like the euro zone; the world's second-largest economy is headed for a hard landing and perhaps recession.

Recently, Spain suffered its largest-ever business failure as construction group Martinsa-Fadesa SA, a company with assets of €10.8 billion, or about US \$17.17 billion, filed for bankruptcy protection, making it the biggest victim thus far of the bursting of Europe's real-estate bubble. The firm's failure is expected to have a serious impact on the real-estate sector compounded by the tumbling home sales and tighter bank lending. At the same time, the euro, advanced by the central bank's inflation-fighting efforts and fears of financial-sector vulnerability in the U.S., briefly reached a record high of over \$1.59. This posed a further threat to Europe's export sector which dropped the most in almost four years and an index of investor sentiment in Germany; fell to its lowest level since the recession of the early 1990s.

The rising risk of recession in Europe shows that despite the strength of emerging markets such as Russia and China, the economic downturn that began in the U.S. last year is spreading to other regions. This is battering hopes that the global economy might have "decoupled" just enough from the US, allowing the world to emerge from a U.S. slump relatively unscathed.

Europe's banking and property sectors are increasingly feeling the consequence from the housing-market and financial-sector turmoil across the Atlantic. Although Europe had little subprime lending of its own, many European banks lost money on U.S. mortgage-related securities, causing bank funding costs to rise and forcing banks to restrict the level of domestic property.

Due to the strong euro and rising costs, Germany's previously booming manufacturers have suffered declining new orders for the past six months. Blue-chip companies including engineering giant Siemens AG, consumer-goods maker Henkel AG and printing-machine maker Heidelberger Druck AG have all announced large-scale job cuts blaming the problem on the high euro, raw-material prices, slower global growth and the credit-market that has shaken confidence on both sides of the

Atlantic.

French consumer spending, once a pillar of the euro zone's domestic demand, is also stalling on rising inflation and a weakening housing market. In June, French consumer confidence hit its lowest point since the national statistics office INSEE began tracking the measure in January 1987.

Some economists believe the ECB's emphasis on fighting inflation could worsen the downturn. While the U.S. Federal Reserve has cut its key rate by 2.75% since September, the ECB has focused on the inflationary threat of rising commodity prices, and raised its key rate by 25 basis points to 4.25% earlier this month a seven-year high. The risk is that higher borrowing costs will exacerbate the economic slowdown. Europe's manufacturing and service industries are contracting and confidence in the economic outlook this month plunged the most since the Sept. 11 terrorist attacks.

In 2001, Germany and the Euro region's core economies suffered the most during last downturn. Spain, Ireland and other booming smaller economies helped the region. The United Kingdom was the biggest European economy outside the euro zone which increased its imports. As a result, the euro zone avoided recession and began a recovery that lasted until now.

However, this time the U.K. performance is faltering with its housing market falling sharply and inflation increasing. Recent data showed U.K. inflation at 3.8% in June from 3.3% and well above expectations. The Spanish housing sector is in a deep slump, and the country's construction-dependent economy is expected to enter a recession this year, ending a decade of strong growth. In 2006, Spain built more than 700,000 houses which were more than Germany, France and the U.K. combined and investment in housing made up nearly 10% of gross domestic product. However, the boom peaked last year, and Spanish home-sales transactions fell by 32% in the first quarter, compared with a year earlier. In May, Spain's unemployment rate stood at 9.9%, the highest in the euro zone from 8.6% at the end of 2007.

A short while ago, Europe was not expected to be affected by the faltering economic situation of the US. Things have changed since then and now all eyes are on the world's second-largest economy and the possibility of a hard landing compounding growth troubles around the world.

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### ***Current Happenings in Local and International Markets:***

- GraceKennedy Limited grew revenues by 20% to \$27 billion in its first six months
  - Indices fall as Neal and Massy declines
  - Republic Bank: Group profit \$937m
  - Prime lending rate increased from 12.25% to 12.75% in Trinidad
  - Duprey replaces Ashenheim as Lascelles chairman - Company set for another record year of profits
  - NCB positioning for investment schemes fallout, say some analysts
  - Inflation batters corporate Jamaica profits
  - Harnarine, Hindu Credit Union to pay \$1m for libel
  - Citigroup returning billions to investors, paying fine in deals over auction securities
  - AIG shares sink as 2Q results augur further losses
  - BOE Keeps Rate at 5% as Economy Slumps, Prices Rise
  - Freddie Mac Posts Fourth Straight Loss, Cuts Dividend
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- Fed Shift Indicates Main Rate Will Stay at 2% to Revive Economy

**Table 1: Regional Market Performance (as at 7 August 2008)**

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	1,160.49	-0.92	0.17	17.88	27.94
All Trinidad	1,555.75	0.74	2.04	28.94	36.32
JSE Index	108,827.61	-0.98	-0.07	1.22	18.09
JSE Select	2,957.16	-1.97	-1.65	1.72	15.77
All Jamaica	107,405.36	-1.82	-2.11	1.46	14.60
BSE Composite	1,067.44	-0.11	-0.77	3.76	12.45

**Table 2: International Market Performance (as at 7 August 2008)**

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	1,266.06	-0.10	1.10	-12.51	-14.26
Nasdaq Composite	2,355.73	1.30	5.01	-9.73	-8.04
Dow Jones Industrial	11,431.43	0.47	1.78	-12.36	-15.35
German Dax	6,543.49	0.99	2.31	-17.68	-12.91
FTSE 100	5,477.50	1.21	-0.64	-14.64	-13.18
Nikkei 225	13,124.99	-1.88	-1.76	-14.26	-22.44
Hang Seng	22,104.20	-2.76	0.87	-19.80	0.90
Eurostoxx	3,397.25	0.87	1.94	-21.71	-20.57

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