Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

MARCH 6, 2012

Euro Area Growth Watch

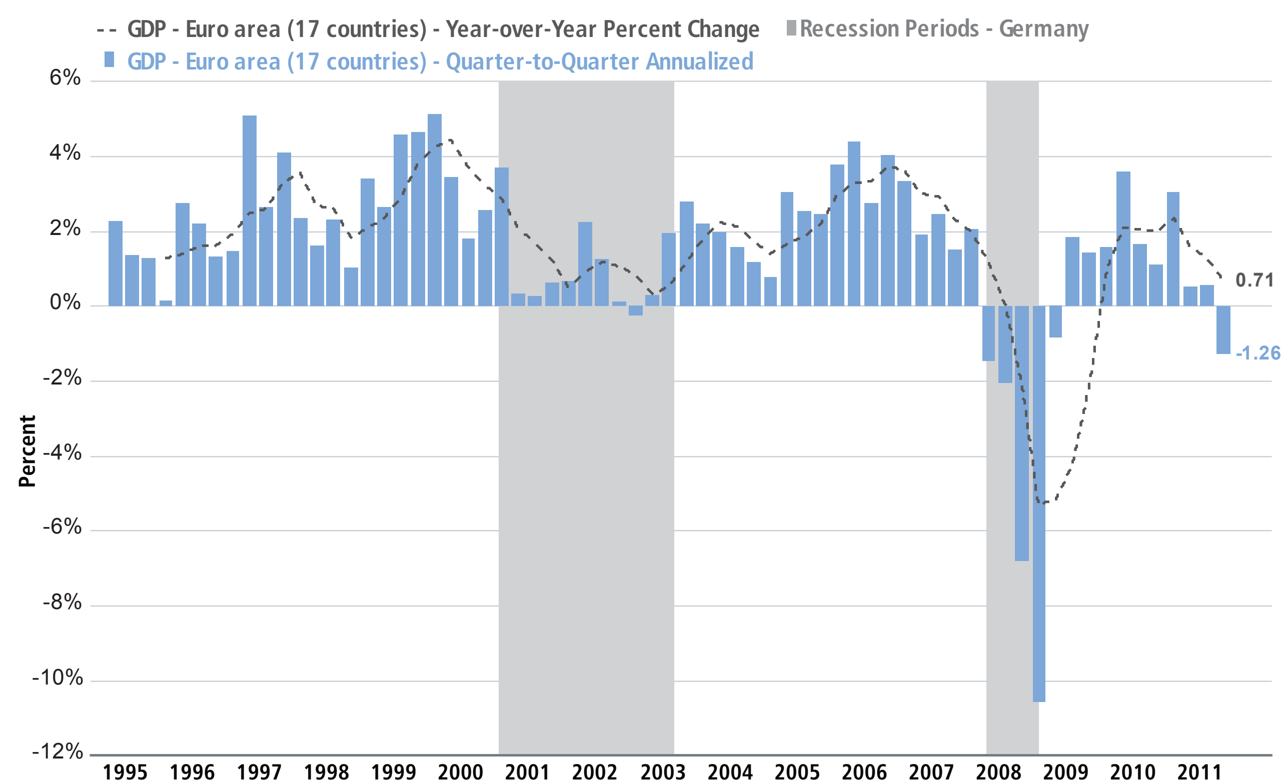
With a tornado of talk surrounding Greek debt restructuring, CDS triggers and Euro FinMins meeting, fact and fiction mix indiscriminately. Here, however, is one fact: no matter what happens in Greece over the next few weeks, economic growth (or lack thereof) over the next several quarters will have important implications for fiscal health measures, including debt/GDP ratios, in Greece and the rest of the euro area. So many assumptions about economic growth are "baked" into near-term policy decisions and the debt restructuring/bailout calculations that reality checks are important as ever.

On that front, this morning EuroStat issued its second estimate of real euro area gross domestic product (GDP) growth for Q42011. GDP contracted 0.3% in Q42011. At an annual rate, euro area GDP contracted by -1.3% during the quarter—its worst performance since 2009 and its sixth quarterly decline in the span of just 4 years (see chart below).

The details released with this version of the report are more worrisome. Both household consumption (-0.4%) and government spending (-0.2%) contracted during the quarter. Investment tumbled -0.7% in the quarter. Meanwhile, since imports shrank more than exports, net exports actually contributed positively (+0.3%!) to growth during the quarter. In short, it could have been worse. And it could get worse in 2012. Export activity – which boosted aggregate euro area growth over the last 3 years—has slowed along with the world economy. Couple this trade slowdown with a) a rising euro area unemployment rate, b) a contraction in lending to the private sector and c) continent-wide fiscal austerity and you have the recipe for further contraction ahead.

Further, while the euro area growth profile (+0.7% Q4/Q4) looks decent in aggregate, the peripheral subset is not so lucky. For example, while we still do not have full details, EuroStat reported that the Greek economy fell 7% year-over-year in the fourth quarter. Compare this with the original Troika forecast of a 2.7% contraction for calendar 2011. Debt/GDP calculations will be altered by this ongoing GDP contraction and this ultimately drives sovereign fiscal health over the long term.

EURO AREA GDP SLUMPS



Source: EuroStat

Note: The euro area (EA17) includes Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland.