ABN·AMRO

Press Release

London, 1 December 2004

Global economy to slow and US Dollar to fall further in 2005, but outlook favourable for European equity and fixed income markets, says ABN AMRO

ABN AMRO predicts global GDP growth will fall from 5% to 4% in 2005, as continued US Dollar (USD) weakness fuels European and Japanese currency strength, damaging export demand and exposing chronically low domestic spending levels in these regions.

Despite the bleak macro economic environment, European equity markets are set to outperform relatively on stable interest rates, above average earnings growth and increased fund flows in Q1- the life assurance, telecom, utilities and energy sectors offering the most upside.

European credit is also predicted to outperform on a carry basis, with demand again outstripping only a slight increase in year on year supply in Euro (EUR) new issuance. Euro area fixed income as a whole will benefit from an expected end to further rate increases.

"Dollar weakness will be a dominant influence on the world economy in 2005," said Robert Lind, ABN AMRO's Global Head of Economics & Strategy*. "US policymakers see dollar weakness as central to a rebalancing of the US economy."

ABN AMRO's Global Head of FX Strategy, Tony Norfield, added:
"Reluctance by Asian central banks to provide continued support for USD, combined with a lack of private sector willingness to fund the US current account deficit, will drive the dollar lower."

US GDP growth should fall from 4½% in 2004 to 3¼% in 2005, with US domestic demand likely to weaken as the effects of monetary and fiscal policy stimulus fade. A slowdown in productivity and a recovery in wage growth will push up inflation. The US Federal Reserve is expected to increase its funds rate to 3% in the first half of 2005.

Currency strength in Europe and Japan will erode competitiveness, undermining export demand and exposing the weakness of domestic activity. Euro-area GDP growth should drop to 1½% in 2005 from 1¾% in 2004. The ECB will hold its refinancing rate at 2% throughout the year.

The UK economy is set for a sharp slowdown as house prices fall, sparking weaker consumer spending and a rise in unemployment. GDP growth is expected to fall from 3¼% in 2004 to 2% in 2005. Interest rates will remain unchanged at 4¾%, as rising import prices push inflation towards the Bank of England's target.

**ABN AMRO's pan-European economic research was ranked no.1 by Extel in 2004 and 2003*

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Tony Norfield expects demand from Asian central banks for USD assets to fade in 2005, in line with a weaker USD versus Asian currencies.

“The US current account deficit is mostly funded by official FX reserve accumulation, especially by Asian central banks. This totalled 83% in 2003 (BIS). A drop in official demand will have real implications for dollar valuation,” he added.

The unwinding of imbalances in the fixed income market will drive more divergence between USD and EUR bond yields in 2005, according to Global Head of Fixed Income Research, Graham McDevitt.

Treasury yields will rise as the US Federal Reserve pushes real Fed funds into positive territory, with reduced Asian central bank Treasury purchases exacerbating the rise in yields. In contrast, European yields will be supported by a European Central Bank that sits tight.

ABN AMRO estimates that if the share of Asian US Treasury holdings are reduced by just 1% in 2005, the net impact could push US Treasury rates 40 basis points higher. Correlation analysis also suggests an increase in the real Fed funds rate of +0.5% would increase nominal yields by 35-40 basis points.

“The risks are heavily weighed against US Treasuries, although more neutral for European bonds,” McDevitt said.

European equities are poised for a satisfactory performance in 2005 on the back of a predicted 9% growth in earnings for the year, according to Chief European Equity Strategist, Rolf Elgeti. Q1 will see significant fund flows into equities, with increased appetite for equity risk from insurance companies and excess liquidity in the form of carry and risk-carry trades.

“The biggest risk to equities is the high amount of leverage in the financial system. But current valuations are modest and the expectation of static interest rates in the euro area will not cause private sector debt levels to be a factor,” Elgeti said.

Germany will be the surprise performer in the euro area next year, largely supported by reforms in the labour market that will drive down costs for German corporates. Elgeti believes German equities are cheap compared to historical levels and European peers. The UK market will experience only modest progress, capped by weakness in the consumer sector and a generally weak economic environment.

Global Head of Credit Strategy, Alison Miller, expects a low risk of spread widening in European credit markets, with prices underpinned by sustained demand, redemptions and a continued limited supply of new bonds: ABN AMRO expects 2005 issuance of between EUR 90-115 bln, up on EUR 91-96 bln this year – but still down from EUR 152 bln in 2003.

Derivatives and structured products are expected to receive increased interest as a lack of new issuance will encourage investors to seek alternative investment opportunities. This will also help to underpin the credit market as a whole.

Head of EMEA Economics, Zsolt Papp, sees Central and Eastern European economies continuing to benefit from increased consumer demand driven by real wages growth, while EU funding and export opportunities are expected to support fixed capital investment.

Inflationary pressures should ease in emerging Europe on the back of lower food prices and relatively stable exchange rates. The stable outlook for currencies is also expected to ease pressure for rate hikes in the Czech Republic and Poland, with scope for a decrease in Hungary.

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About ABN AMRO

Netherlands-based ABN AMRO is a leading international bank with total assets of EUR 637.5 bln (as at 30 September 2004). It has over 3,000 branches in more than 60 countries and territories, and has a staff of about 104,000 full-time equivalents worldwide. ABN AMRO is listed on the Euronext and New York stock exchanges.

ABN AMRO operates through three Strategic Business Units, each responsible for managing a distinct client segment. Wholesale Clients provides integrated corporate and investment banking services to corporate, institutional and public sector clients worldwide. Consumer & Commercial Clients focuses on retail and SME clients in three home markets – the Netherlands, the US Midwest and Brazil and in a number of selected growth markets. Private Clients & Asset Management provides private banking services to wealthy clients and investment products to financial intermediaries and institutional clients.

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