



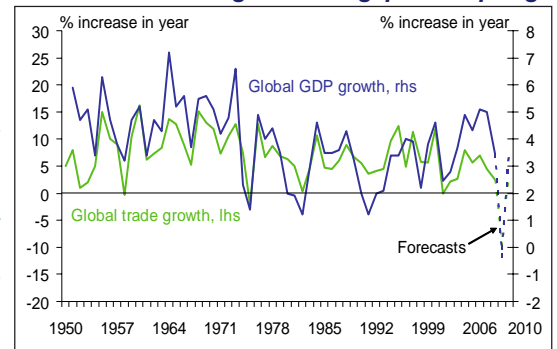
Economics Weekly

9 March 2009

Collapse in trade leads global downturn in production

For all of the focus there has been on the crisis in financial markets, the economic downturn has been led by the industrial sector. However, a substantial part of the reason for the decline in industrial output is a tightening of credit conditions – a direct result of the financial market crisis. But the key point is the downturn now underway is impacting countries which did not increase debt (leverage) excessively nor were involved directly in the credit markets that have now gone bad. Rather, they are being affected by the widespread collapse in global trade that is now underway. This means that the higher the share of foreign trade in a country's economy, the worse the impact on it from the current slowdown in world growth. The credit crisis is acting to worsen the global economic downturn as trade credit and invoicing dry up. Not surprisingly, companies are reducing inventories rapidly, business confidence has fallen sharply and unemployment is now rising quickly.

Chart a: World trade growth and gdp is collapsing...



World trade collapse is leading the economic downturn...

Of course, the facts show that an economic slowdown was underway before the credit crisis erupted in 2007, because of rising interest rates around the world to head off rising price inflation. Accelerating inflation was occurring because a long period of fast economic growth had reduced global spare capacity sufficiently to ramp up commodity prices and this was helping to cause a sharpening rise in global consumer prices. Further, it is worth bearing in mind that global growth was itself unbalanced, with the surplus of the exporting countries being used to fund growth in the countries with a trade deficit via a rise in their debt (as they borrowed from the rest of the world). This could not continue indefinitely, as it was creating bubbles in property and financial markets in the debtor countries that eventually burst and spawned the resultant credit crisis that still rumbles on, despite all the efforts to tackle it.

...hitting countries with large exporting shares, even though they are not highly indebted...

It is a collapse in economic growth in the debtor countries that is now leading to a sharp contraction in global economic growth. This is particularly hitting those countries that are big exporters (Germany, Japan etc). But the situation is more complicated than this, as the general slowdown in economic growth and trade volumes in a globalised economy is spreading the shock to all countries. It is also probably worth noting that growth in Germany and Japan has been led by exports in the last decade and that domestic demand is not sufficient to prevent recession. Indeed, both of these large economies would have barely grown in the last decade if not for the sharp rise in global trade. The same cannot be said of some of the countries with big trade surpluses, like China and India. Although economic growth has been led by exports in these countries, domestic demand growth has been strong as well. Nevertheless, there is now a vicious self-perpetuating downward cycle underway between trade and economic growth that will likely take a resolution of the credit crisis and a return of business confidence to help to break this pattern.

Chart b: ...as shown by the decline in export volumes

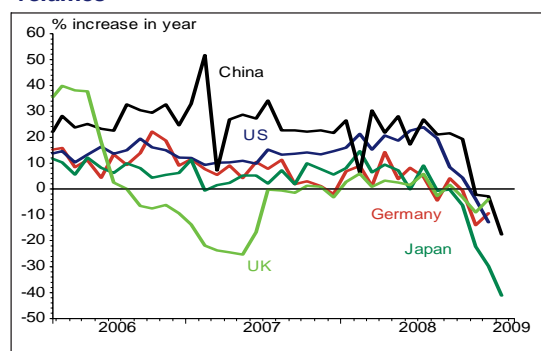
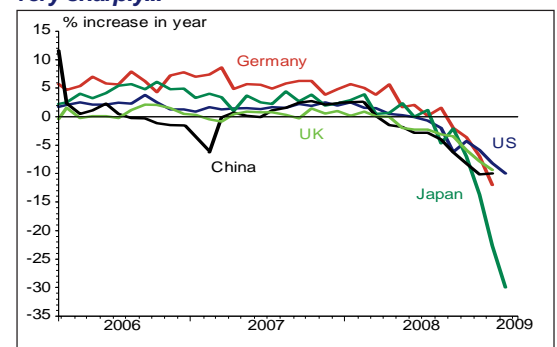


Chart c: Industrial production is therefore falling very sharply...



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2009 calendar of central bank meetings

European ECB (1.50%)
 2 April, 7 May, 4 June, 2 July,
 6 August, 3 September
US FOMC (0-0.25%)
 17 March, 29 April, 24 June,
 12 August, 23 September
UK MPC (0.50%)
 9 April, 7 May, 4 June, 9 July,
 6 August, 10 September

Rolling calendar of UK data releases and events

Official house prices (17/3)
 BoE MPC minutes (18/3)
 Labour market stats (18/3)
 Public finances (19/3)
 M4 money supply (19/3)
 CBI industrial trends (19/3)
 Consumer prices (24/3)

Rolling calendar of US data releases and events

TIC capital flows (16/3)
 Industrial production (16/3)
 Producer prices (17/3)
 Housing starts (17/3)
 Building permits (17/3)
 Consumer prices (18/3)
 Current account (18/3)

Chart d: ...leading to a collapse in business confidence...

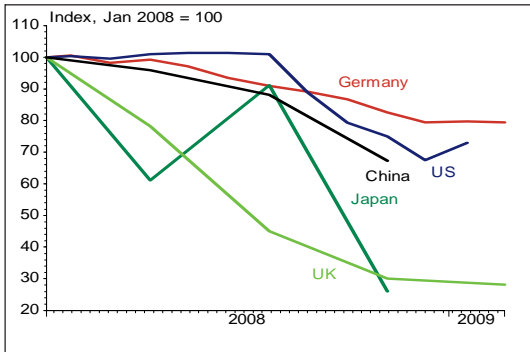
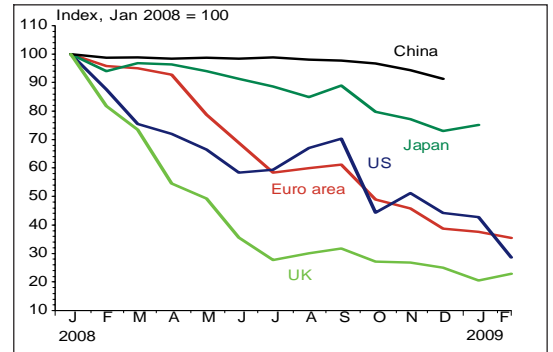


Chart e: ...as consumer confidence drops dramatically



This is the context for the general fall in global trade that is now underway, with chart a showing that this is likely to be easily the biggest decline in global trade since the 1950s. Since world trade growth and world gdp growth seem to be closely linked, a recovery in global trade will be necessary to sustain any recovery in economic growth and vice versa. Export volumes are falling very sharply, see chart b, with the decline in Japanese export volumes in January, for instance, running at nearly 50% lower than in the year before. Hence, trade linkages seem to lie at the heart of the collapse taking place in global industrial production. Chart c shows industrial production tracking the fall in export volumes downward almost in step. In practical terms, the response reflects a calculation being made by companies that are facing falling demand and a reduced access to external and internal finance. They are scaling back in order to survive the economic downturn now underway and so sharply reducing stocks, output and employment.

...as in a closely integrated global economy, recovery will take time and depend on the resolution of the credit crisis

The fall in industrial production is fed by a severe fall in business and consumer confidence. Chart d and e show that the falls in confidence have been dramatic since the third quarter of 2008. One of the key features of this is that it is happening almost simultaneously in a range of key economies around the world. With such a big synchronised, fall in global production and business confidence, it is not surprising that unemployment is beginning to show the kind of increase not seen in decades, see chart f. With these negative economic trends in place, it is only a matter of time before retail sales fall more sharply than seen so far in most countries, see chart g. It may seem obvious, but the pace of the eventual economic recovery will be limited by the extent of the rise in unemployment now underway. Unfortunately, this analysis also suggests that the global economic recovery may take some time, despite the massive fiscal and monetary loosening now underway and that it could get worse before it gets better.

Chart f: This is beginning to lead to rising unemployment...

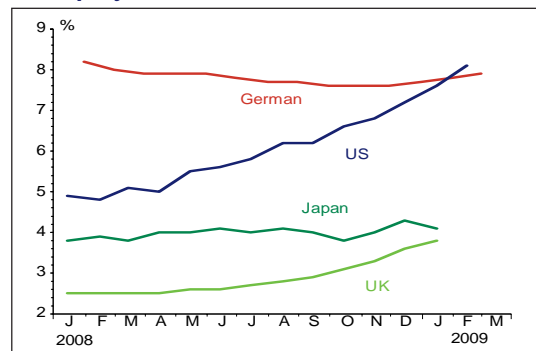
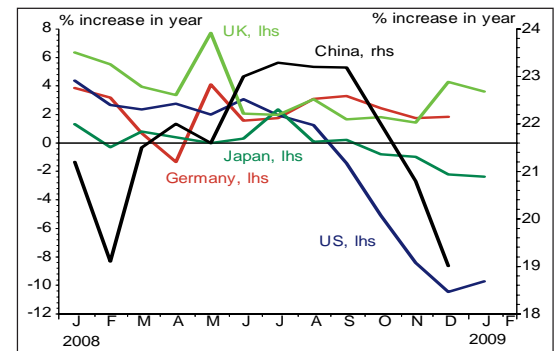


Chart g: ... and retail sales will fall sharply as well



Trevor Williams, Chief Economist, Corporate Markets

*** All charts are sourced to Lloyds TSB Corporate Markets Economic Research and Bank of England**

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Weekly economic data preview

9 March 2009

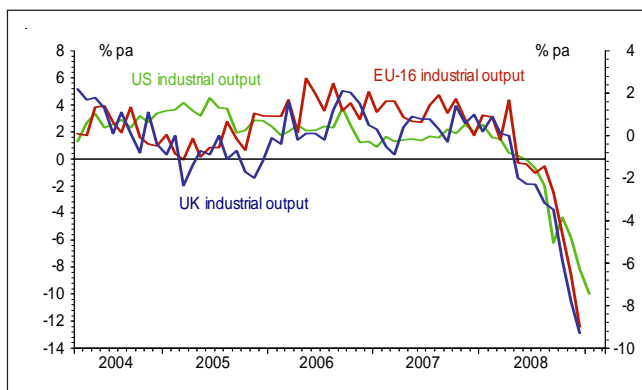
BoE Quarterly Inflation Attitudes Survey and a plethora of weak data

The Bank of England commences its £75bn asset purchase programme with £2bn of 2014-2018 gilt purchases on Wednesday. But we are likely to see little or no immediate positive impact from this or earlier measures to stimulate the UK economy, and perversely, incoming data this week will continue to point to deepening recession. But over coming months it may become clearer whether or not the twin policies of cutting the cost and directly increasing the supply of money will have the intended effect. For now, with many global governments going all out to avert severe global recession, financial market participants have heightened sensitivity to government speeches and communiqués. Today, we may hear more policy news from the Global Economic Meeting of leading central bankers held at the Bank for International Settlements in Basel and also from the Eurogroup of Finance ministers' meeting in Brussels. ECB members have a particularly heavy speech schedule, including ECB President Trichet's commentary on Thursday. Interest rate setting meetings are held by the New Zealand Central Bank, which is expected to deliver a 75bp cut to 2.75% and the Swiss National Bank, which may hold official interest rates at 0.5% as this is already effectively a zero rate policy stance.

- The UK BoE publishes its Quarterly Inflation Attitudes Survey on Thursday. The November survey showed the largest quarterly fall in consumer price expectations since the survey began in November 1999. We will be looking to see how much household perceptions have changed three months on. In particular, will 12-month price expectations be in line with the BoE's assessment derived from market interest rates of inflation hovering around 1% over the 2-yr forecast horizon (well below the 2% target). Inflation expectations are important for the BoE and have in the past been a key indicator informing monetary policy decisions. Should there be a sharp decline in household price expectations it will provide further justification of the need for the £75bn asset purchase programme. BoE member Barker's speech will also attract attention on Thursday, especially for any insight that she may offer on the depressed UK housing market. In terms of data, the UK statistical office publishes industrial production, which is likely to have undergone another sharp fall in January and external trade data which may position the trade deficit at around £7.8bn (£7.4bn in December) as world trade collapses. Other releases include the NIESR 3-month rolling GDP figure and the BRC retail sales monitor, both for February.
- February data published last week showing the US unemployment rate rising to a 25-year high of 8.1% and US NFP employment falling by 651,000 the worst outcome since 1949, set the stage for another gloomy array of US economic news this week. Wholesale and business inventories are both likely to have again significantly contracted in January, as firms attempt to tighten operating margins in response to falling orders. Retail sales for February will also register sharp falls of around 9% on an annual basis as consumer confidence is very weak. This will be highlighted by the March preliminary University of Michigan Survey due Friday, which will probably be only just above November's index low of 55.3, at 56.5. Finally, the US trade deficit may have narrowed further to \$37bn in January (\$39.9bn in December) as the recession imposes a sharp adjustment to the US external accounts.
- One or other ECB member presents speeches each day this week, all of which will be gleaned for follow on information from ECB President Trichet's press conference last Thursday. Questions such as, will the ECB cut its repo rate further back towards zero or will it rely on using the 1% deposit refinancing corridor and unlimited commercial banks' refinancing scheme to ultimately do the job of unfreezing financial markets and re-invigorating the economy? Other contentious issues include how the ECB would reach governmental agreement for quantitative easing, if considered necessary, given the sharp economic and fiscal deficit variation between its member states. EU-16 economic data include French & German industrial output, German factory orders (forecast to have contracted by 28% on an annual basis) and EU-16 producer prices & retail sales. With the Eurozone economy under growing strain from within and without there must be a high probability of the ECB having to do more - we project an interest rate cut to 1% as soon as April.

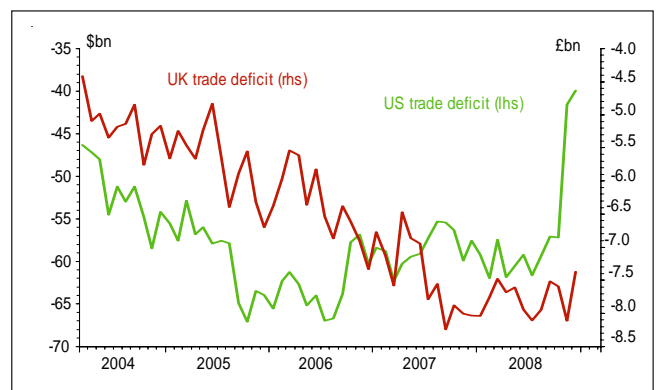
Nichola James, Senior Economist

Chart 1: Industrial output plunges in the major economies



Source: Thomson Datastream

Chart 2: The US is well ahead of the UK in narrowing its trade deficit as recession imposes adjustment



Source: Thomson Datastream

Date	United Kingdom	United States	EU-16
Mon 9			
Tue 10	BRC Retail sales monitor (00:01) (Feb) RICS house price survey (00:01) (Feb) Jan -76 Median -75 Range -80:-74 Industrial production (sa) Dec -1.7% Y-O-Y -9.4% Jan (f'cast) -1.2% Y-O-Y -10.2% Median -1.2% Range -1.8%:-0.4% Manufacturing output (sa) Dec -2.2% Y-O-Y -10.2% Jan (f'cast) -1.4% Y-O-Y -11.6% Median -1.4% Range -2.0%:-0.5%	Wholesale inventories (14:00) Dec -1.4% Jan (f'cast) -1.0% Median -1.0% Range -1.5%:-0.4%	German CPI (07:00) (final) Jan -0.6% Y-O-Y +0.9% Feb (f'cast) +0.7% Y-O-Y +1.0% Median +0.7% Range +0.7%:+0.7% French industrial production (07:45) Dec -1.8% Y-O-Y -11.1% Jan (f'cast) -1.0% Y-O-Y -13.2% Median -0.6% Range -2.0%:+2.7% French trade balance (07:45) (Jan) Dec -€2.5bn Median -€3.0bn Range -€4.7bn:-€2.3bn
Wed 11	NIESR GDP estimate (00:01) (Feb) Jan -1.7% Global visible trade balance (sa) Dec -£7.4bn Jan (f'cast) -£7.8bn Median -£7.5bn Range -£7.8bn:-£7.0bn Non-EU trade balance (sa) Dec -£4.2bn Jan (f'cast) -£4.4bn Median -£4.4bn Range -£4.5bn:-£4.1bn	Treasury statement (sa) (18:00) Jan -\$175.6bn Feb (f'cast) -\$205.0bn Median -\$205.3bn Range -\$265bn:-\$175bn	German factory orders (11:00) Dec -6.9% Y-O-Y -25.1% Jan (f'cast) -2.0% Y-O-Y -28.3% Median -2.0% Range -10.0%:+2.0%
Thu 12		Retail sales (advance) (12:30) Jan +1.0% Y-O-Y -9.0% Feb (f'cast) -0.6% Y-O-Y -8.7% Median -0.5% Range -1.5%:+1.0% Retail sales, ex-autos (12:30) Jan +0.9% Y-O-Y -5.8% Feb (f'cast) -0.3% Y-O-Y -5.3% Median -0.2% Range -1.0%:+0.9% Initial claims (w/e 7/3) (12:30) Previous 639K Forecast 610K Median 640K Range 610K:660K Business inventories (14:00) Dec -1.3% Jan (f'cast) -1.3% Median -1.1% Range -1.5%:-0.6%	French consumer prices (07:45) Jan -0.4% Y-O-Y +0.8% Feb (f'cast) +0.2% Y-O-Y +0.7% Median +0.3% Range -0.2%:+0.3% EU-16 producer prices (10:00) Dec -1.3% Y-O-Y +1.8% Jan (f'cast) -0.4% Y-O-Y +0.3% Median -0.2% Range -1.2%:+0.3% German industrial output (11:00) Dec -4.6% Y-O-Y -12.0% Jan (f'cast) -2.0% Y-O-Y -14.7% Median -3.0% Range -5.0%:-0.7%
Fri 13		Trade balance (sa) (12:30) Dec -\$39.9bn Jan (f'cast) -\$37.0bn Median -\$38.1bn Range -\$43.9bn:-\$31.0bn Import prices (12:30) Jan -1.1% Y-O-Y -12.5% Feb (f'cast) -0.8% Y-O-Y -13.4% Median -0.8% Range -2.2%:+0.8% Uni. of Michigan confidence (prel) (14:00) Feb 56.3 Mar (f'cast) 56.5 Median 55.5 Range 47.5:57.0	EU-16 retail sales (10:00) Dec zero Y-O-Y -1.6% Jan (f'cast) +0.2% Y-O-Y -2.1% Median +0.2% Range -0.5%:+0.7%
Mon 16	Rightmove house prices (00:01) (Mar) Feb +1.2% Y-O-Y -9.1%	Empire manu. survey (12:30) (Mar) Feb -34.7% Treasury Internat. Capital Data (13:00) (Jan) Dec +\$34.8bn Industrial production (sa) (13:15) (Feb) Jan -1.8% Y-O-Y -10.0% Capacity use (13:15) (Feb) Jan 72.0%	EU-16 CPI (10:00) (final) (Feb) Feb (flash) -0.8% Y-O-Y +1.1%

NB: UK data released at 9.30 a.m., unless otherwise stated. Market medians are as of preceding Friday. Release times of US data are stated in brackets after the description of the indicator. Events are listed in the events column on the next page.

Date	Japan	Other Countries	Main events
Mon 9		Canada housing starts (12:15) Jan 153.5k Feb (f'cast) 145.0k Median 148.5k Range 135.0k:158.8k	<ul style="list-style-type: none"> • ECB member Stark speaks in Luxembourg (09:00) • Global Economy Meeting (GEM) of central bank heads from leading economies held at the Bank for International Settlements (BIS) in Basel (final day) • Eurogroup finance ministers hold meeting in Brussels
Tue 10	Leading index (prel) (05:00) Dec 80.0% Jan (f'cast) 77.4% Median 77.4% Range 76.9%:77.9% Coincident index (prel) (05:00) Dec 92.4% Jan (f'cast) 89.8% Median 89.8% Range 89.4%:90.2% Machinery orders (23:50) Dec -1.7% Jan (f'cast) -5.0% Median -5.0% Range -11.0%:+2.0% Domestic CGPI (23:50) Jan Y-O-Y -0.2% Feb (f'cast) Y-O-Y -1.2% Median -0.6% Range -1.2%:-0.1%		<ul style="list-style-type: none"> • ECB member Weber speaks in Germany (09:00) • UK DMO to auction £3bn of 4.5% gilts due 2019 (10:30) • US Treasury to sell \$34bn of 3yr notes (17:00) • ECB member Mersch speaks in Luxembourg (17:05) • US Fed chairman Bernanke speaks in Washington (12:30)
Wed 11	Real GDP (23:50) (final) Q4 (prel) -3.3% Annualised -12.7% Q4 (f'cast) -3.5% Annualised -13.4% Median -3.5% Range -3.7%:-3.1% GDP deflator (23:50) (final) Q4 (prel) +0.9% Q4 (f'cast) +0.9% Median +0.8% Range +0.8%:+1.0%	Canada new housing index (12:30) Dec -0.1% Jan (f'cast) -0.2% Median -0.3% Range -0.3%:+0.3%	<ul style="list-style-type: none"> • Germany to auction €8bn of 2yr Schatz notes (10:15) • ECB member Liikanen speaks in Helsinki (11:00) • US Treasury to sell \$18bn of 10yr notes (17:00) • New Zealand interest rate decision (75bp cut to 2.75% expected) (20:00)
Thu 12		Australia unemployment rate (00:30) Jan 4.8% Feb (f'cast) 5.0% Median 5.0% Range 4.8%:5.2%	<ul style="list-style-type: none"> • ECB publishes its monthly economic report (09:00) • Bank of England releases its Quarterly Inflation Attitudes survey (09:30) • UK DMO to auction £1.1bn of 1.25% index linked gilts due 2032 (10:30) • Swiss National Bank interest rate decision (interest rates expected to stay on hold at 0.50%) (13:00) • ECB member Mersch speaks in Luxembourg (15:00) • US Treasury to sell \$11bn of 30yr notes (17:00) • ECB members Trichet and Nowotny speak in Vienna (time tbc) • BoE member Barker speaks in London (18:30)
Fri 13	Industrial output (23:50) (final) Jan (prel) -10.0% Y-O-Y -30.8% Jan (f'cast) -10.0% Y-O-Y -30.8%	Canada unemployment rate (11:00) Jan 7.2% Feb (f'cast) 7.4% Median 7.4% Range 7.1%:7.4% Canada employment change (11:00) Jan -129.0K Feb (f'cast) -50.0K Median -50.0K Range -65.0K:-30.0K Canada int'l merchandise trade (12:30) Dec -C\$0.5bn Jan (f'cast) -C\$0.8bn Median -C\$0.8bn Range -C\$1.5bn:-C\$0.5bn	<ul style="list-style-type: none"> • ECB member Stark speaks in Germany (time tbc)
Mon 16			<ul style="list-style-type: none"> • ECB President Trichet speaks in Frankfurt (16:30)