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Asset Management

The Future of Europe

Tokyo, April 2009

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The Future of Europe

Presentation

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The Future of Europe

- Europe after the Second World War
- The European Success Story
- Outlook for Europe

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The beginning of the European Union

Belgium, France, Italy, Luxembourg, Netherlands and West Germany



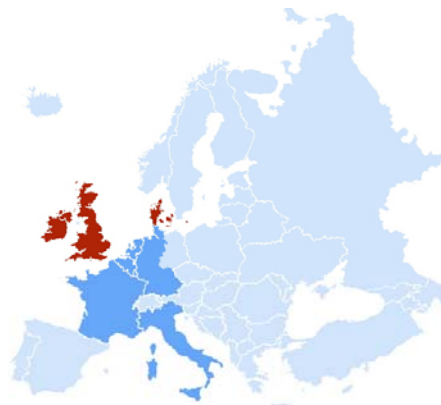
Source: European Union

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- 9th May 1950: "Birthday" of the European Union. French foreign minister Robert Schuman presents a plan for European Cooperation
- 1951: European Steel and Coal Community
- 1957: the European Economic Community (EEC)
- 1967: The European Community was created

First expansion wave of the European Community

New member states: Denmark, Ireland and United Kingdom



Source: European Union

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- 1973: Ireland, Denmark and United Kingdom joined the European Community
- 1977: The European Court was established
- 1979: First election for the European Parliament

Second expansion wave of the European Community

New member state: Greece



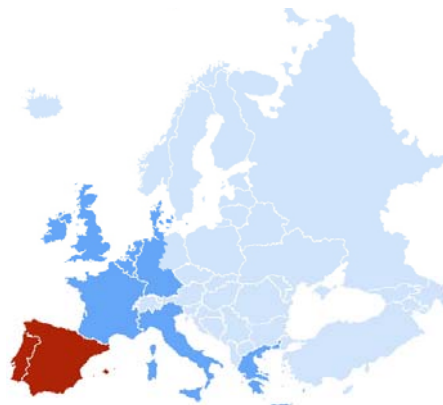
Source: European Union

- 1981: Greece becomes new member of the European Community
- 1985: The implementation of the Schengen Agreement results in removal of cross-boarder controls between the member countries of the European Community

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The European Community expands to 12 members in the 1980s

New member states: Portugal and Spain



Source: European Union

- 1986: Portugal und Spain became the 11th and 12th member of the European Community
- 9th November 1989: People in Eastern Germany demonstrate peacefully for freedom

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Reunion of the Federal Republic of Germany



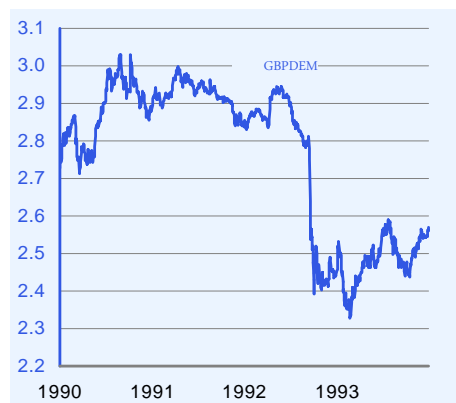
Source: European Union

- 3th October 1990: Reunion of Germany
- 1991: A deepening of the political and economic integration of Europe is negotiated in Maastricht
- 1993: The European Union is established as successor of the European Community
- 1993: A common market is established. Barriers to trade, capital and the movement of people inside the European Community are abolished in accordance with the Maastricht Treaty

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Europe experienced several setbacks on the way to integration

British Pound versus Deutsch Mark exchange rate (GBPDEM)



Sources: Thomson Financial Datastream, Metzler calculations

- The worst setback for European integration was devaluation of the British Pound in September 1992 after an currency attack by George Soros
- The Bundesbank hiked the key interest rate up to 10% to fight inflationary pressures due to the German unification
- The British economy could not withstand this high level of interest rates
- The devaluation of the British Pound was perceived as a "National Humiliation" by the British population

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The third wave of enlargement
and the introduction of the euro exchange rate

New member states: Austria, Finland and Sweden



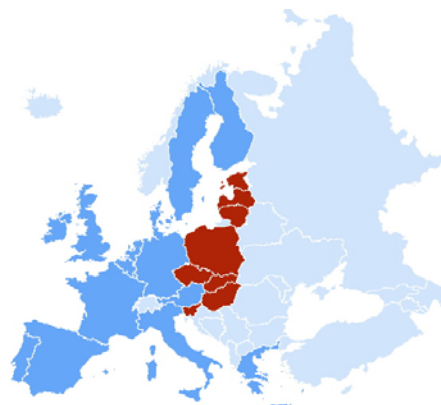
Source: European Union

- 1995: Austria, Finland and Sweden join the European Community
- 1999: Creation of the European Central Bank
- 1999: Introduction of the euro exchange rate in eleven European Community member countries
- 2001: Greece joins the monetary union
- 2002: Introduction of euro notes and coins

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Enlargement of the European Union to Eastern Europe

Ten new member states



Source: European Union

- 2004: The Mediterranean states Cyprus and Malta join the European Union
- 2004: Eight former Eastern European states join the European Union: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia

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European Union expands to 27 member states

New member states: Bulgaria and Romania



- 2007: Bulgaria und Romania join the European Union
- 2007: The European Union consists of 27 member states
- 2007: Several countries from the Balkan and Turkey are currently applying for membership

Source: European Union

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Europe has a long history of war. The peaceful integration after the Second World War is therefore all the more remarkable

Roman Empire in 117 AD



Europe in the 1600



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The European Macro Economy

2007	Unit	Euro area	EU	USA	Japan
Total Population	millions	320.5	496.0	301.7	127.7
GDP (PPP)	EUR trillions	8.9	12.6	11.7	3.6
GDP per capita (PPP)	EUR trillions	27.9	25.5	38.8	28.5
Savings Rate of Private HH	% of Income	14.0	11.0	3.4	10.3
Government Debt	% of GDP	66.3	58.7	49.3	156.1
Budget Balance	% of GDP	-0.6	-0.9	-2.9	-2.5
Current account balance	% of GDP	0.4	-0.3	-5.3	4.8

Source: European Central Bank

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Europe could successfully close the productivity gap with the United States

GDP per capita/hour; 1970 and 2000

	GDP per capita		GDP per hour		Hours per capita	
	1970	2000	1970	2000	1970	2000
US	100	100	100	100	100	100
EU 15	69	70	65	91	101	77
France	73	71	73	105	99	67
Spain	50	57	47	73	105	78
Italy	65	73	74	104	86	71

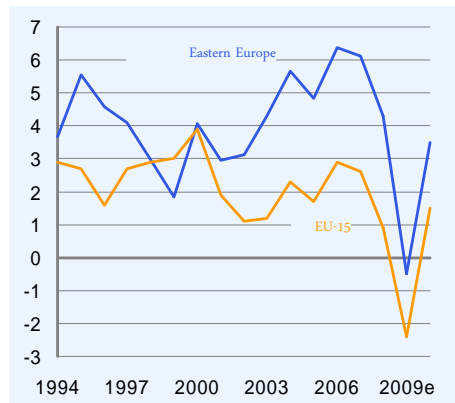
Sources: EU, Ameco data base

US = 100. Germany not included because of the reunification break. GDP per hour in Germany in 2000: 92

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The integration of the emerging Eastern European countries has brought substantial benefits for Europe

GDP in % y-o-y



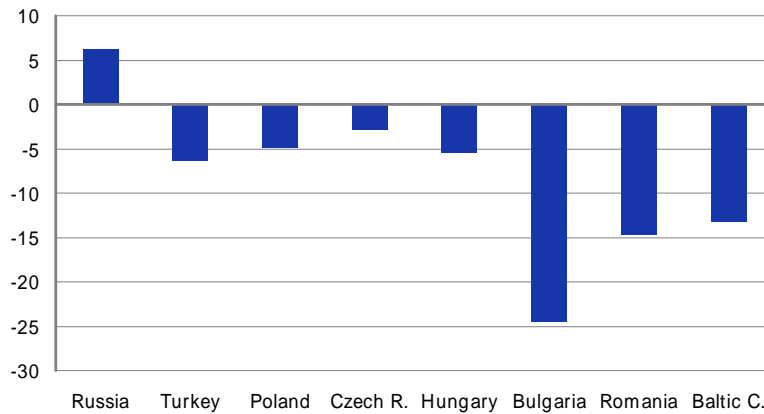
Sources: Thomson Financial Datastream, Metzler calculations

- The new EU member countries from Eastern Europe are on a structural convergence process and will continue to grow strongly over the medium-term
- The old EU member countries benefit from the increasing export demand from Eastern Europe
- The Western European countries are under pressure to restructure due to the increased competition from Eastern Europe

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Eastern Europe faces a normal balance of payments crisis which can be overcome with the help of the IMF

Current account balance in % of GDP in 2008

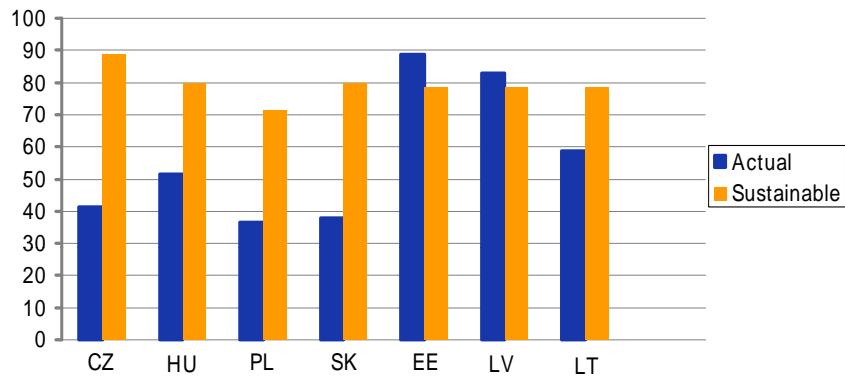


Sources: Bloomberg, Thomson Financial Datastream, Metzler calculations

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Medium-term convergence process still fully intact

Actual and sustainable levels of bank credit to private sector in % of GDP



Source: IMF

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Eastern Europe benefits from financial support from the EU for infrastructure expenditures

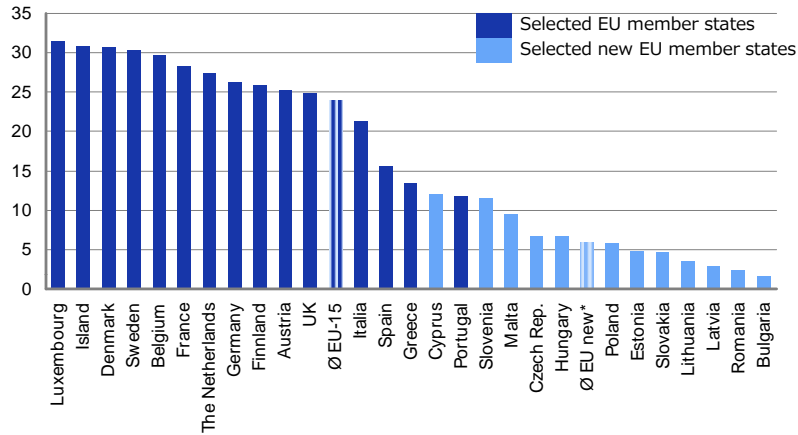
EU financial funds in EUR bn

Budget	2007–2013 total	Per capita	In % of GDP p.a.
Poland	59.7	1,573	3.2
Hungary	22.5	2,272	3.5
Czechia	23.7	2,332	3.2
Slovakia	10.3	1,875	3.4
Slovenia	3.7	1,898	1.8
Estonia	3.1	2,303	3.7
Latvia	4.1	1,790	4.0
Lithuania	6.1	1,837	3.8
Bulgaria	6.0	816	3.7
Romania	17.3	802	2.9
Pre-accession funds			
Croatia	1.2	266	0.5
Turkey	7.0	90	0.3

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Labour cost: the significantly lower wage level should easily compensate for productivity deficits

in EUR per hour (2006)

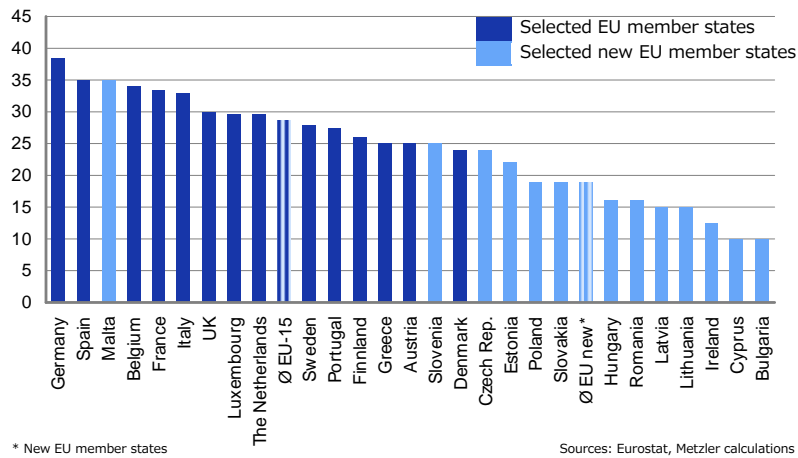


* New EU member states Sources: Eurostat, Metzler calculations

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Taxation: CEE countries have started a "race to the bottom" on corporate taxation to attract foreign investment

Top corporate tax rate in %

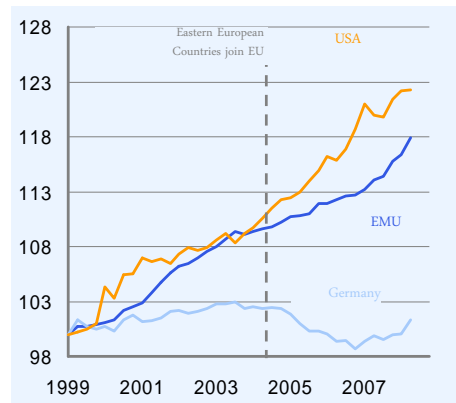


* New EU member states Sources: Eurostat, Metzler calculations

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The restructuring of Western European countries has accelerated after the accession of the Eastern European countries

Unit labor costs (1.1.1999 = 100)



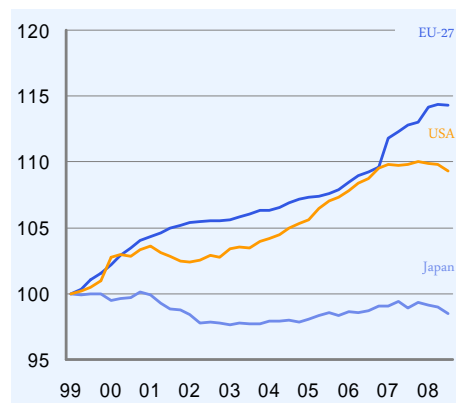
Sources: Thomson Financial Datastream, Metzler calculations

- Germany has the closest proximity to Eastern Europe and has felt the most intense pressure to restructure
- The Germany labor market has become much for flexible as a result
- Germany has introduced a corporate tax reform in 2008
- The European economies remain under strong pressure to restructure

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The European economy is slowly reaping the benefits of all the structural changes

Employment (31.1.1999 = 100)



Sources: Thomson Financial Datastream, Metzler calculations

- Employment growth has been accelerating in recent years
- Employment rose from 127 million in 1999 to more than 145 million in 2008
- The labor market continues to be very dynamic as a result of past structural reforms

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European Financial Markets

The introduction of the euro has been the main catalyst
of financial market development in Europe

The euro area



Sources: ECB

16 Member States of the European Union
use the euro as their currency:

- Belgium
- Germany
- Ireland
- Greece
- Spain
- France
- Italy
- Cyprus
- Luxembourg
- Malta
- The Netherlands
- Austria
- Portugal
- Slovenia
- Finland
- Slovakia

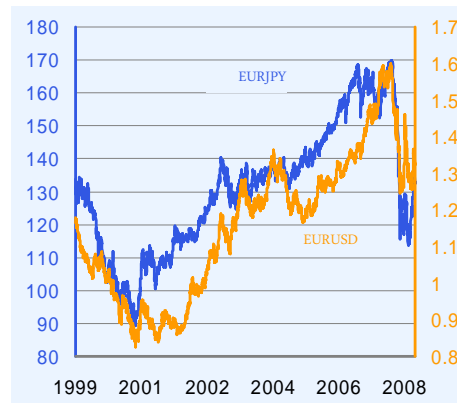
Non-participants:

Bulgaria, Czech Republic, Denmark,
Estonia,
Latvia, Lithuania, Hungary, Poland,
Romania,
Sweden and the United Kingdom are
EU Member States but do not currently
use

The single European currency.

The introduction of the Euro in 1999 was accompanied with a lot of skepticism

Euro exchange rate



- The euro lost considerable value in the first three years of existence as there was a lot of uncertainty inside and outside the Euro area about the sustainability of the European Monetary Union
- A stable economic environment, a hawkish European Central Bank and declining government budget deficits caused a turnaround in the assessment in the euro exchange rate

Sources: Thomson Financial Datastream, Metzler calculations

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The euro has become a serious challenger for the US dollar

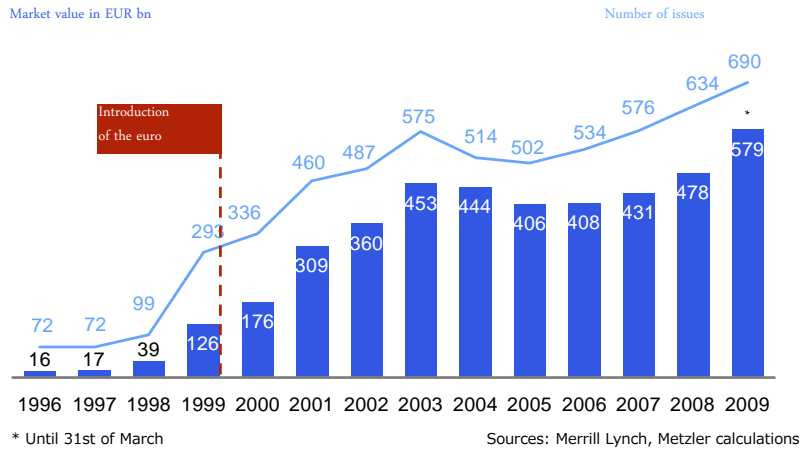
The weight of the euro in foreign exchange reserves

	1999	2001	2003	2005	2008
USD	71.0	71.4	65.9	66.5	63.4
JPY	6.4	5.1	3.9	3.6	3.3
EUR	17.9	19.3	25.3	24.4	26.4
GBP	2.9	2.7	2.8	3.7	4.5

Sources: IMF, Metzler calculations

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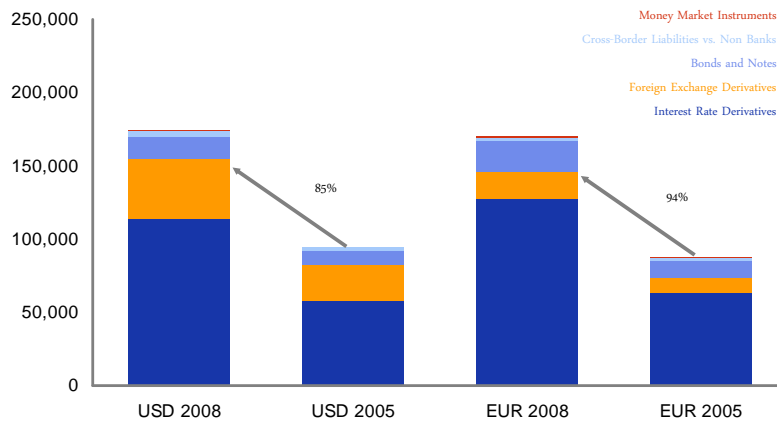
A deepening of financial markets due to the introduction of the euro – the corporate bond market came into existence



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European financial markets have become as liquid as financial markets in the United States

in USD bn, amounts outstanding



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Political integration is still an ongoing process

EU-27

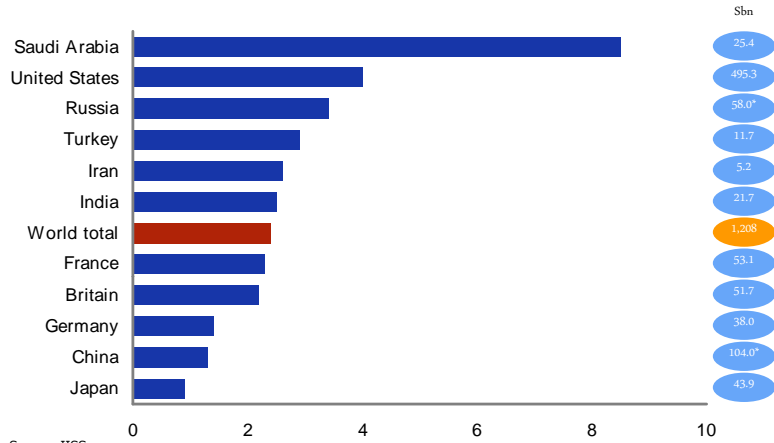


Source: European Union

- Europe needs a "Constitution"
- Political power has to shift further to the EU so that decision making remains efficient with 27 member countries
- European parliament has to become more powerful
- A common European foreign and defense policy is needed

Europe needs a common defense policy

As % of GDP, 2005

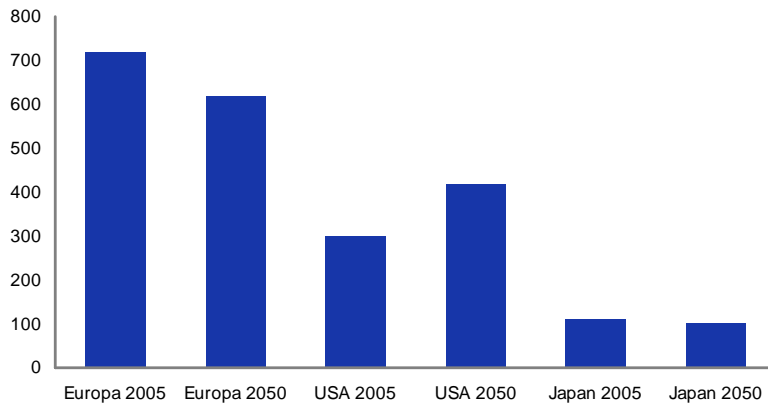


Source: IISS
* Dollar values are calculated using PPP exchange rates

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Demographics pose a challenge for government budgets in the future

Population Projections in m



Sources: Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: The 2002 Revision and World Urbanisation Prospects; <http://esa.un.org/unpp>, April 2003

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- European Integration since the Second World War has been a success story. The integration process has been peaceful and has brought a substantial increase of wealth for the European citizens
 - The enlargement of the European Union to Eastern Europe has been a catalyst for structural reforms. Economic growth in Europe will therefore become much more dynamic in the future
 - The euro exchange rate has become a major international currency. The euro is even starting to become a serious challenger for the US dollar
 - Financial markets have developed strongly in recent years in Europe and have become the most deep and liquid in the world
 - Many challenges remain for Europe. If the past is any guide to the future, Europe will capitalize on these challenges and will continue to move forward to a United States of Europe