

think:act CONTENT

Fresh thinking for decision makers

Developments in
the world

SZENARIO-UPDATE 2010

economy

in 2010 | The effects of
the crisis so far | Seven
parameters determine
future outlook | Four
issues remain on
corporate agendas

HOW THE GLOBAL ECONOMY WILL DEVELOP DEPENDS ON 7 PARAMETERS

1

GROWTH DRIVERS
Are there any countries that will be able to drive the global economy?



2

PROTECTIONISM

Is there a threat to free global trade?

3

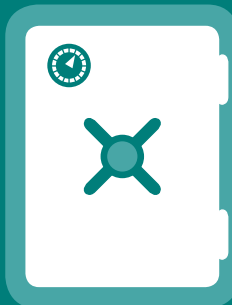
ECONOMIC STIMULUS PROGRAMS
Will governments be able to provide a soft landing?



4

MONETARY POLICY

Will the central banks be able to gently phase out the era of cheap money?



5

PRICES OF RAW MATERIALS/OIL
Will raw materials prices remain at a healthy level?



6

FINANCIAL MARKETS

Will strict(er) regulations go into effect as planned?



7

UNEMPLOYMENT
Are the labor markets stabilizing?



WHY PUBLISH ANOTHER THINK: ACT CONTENT ABOUT THE ECONOMY?

Many signs indicate that the global economy's V-shaped recovery will continue, and that the outlook for Germany and Europe is bright. The stock markets at least have already anticipated a sharp upturn: from the depths plumbed last year, the DAX and EuroStoxx have rebounded by 60%. Upbeat expectations are buoyed by the forecasts of leading research institutions and organizations, according to which Germany's economy will grow by 1.8% and the USA's by 2.9%. In the view of the OECD, China's output will jump by 10.2%. The IWF expects global growth of 3.9%, thereby adjusting its forecast upward by 0.8 points.

We could see all this as welcome confirmation. After all, the first two scenarios we posited for economic development in Europe and Germany saw the V-curve as the probable outcome – contrary to the majority of professional prophets. Yes, our November 2008 publication also underestimated the depth of the recession. On the other hand, our very first scenario got it right about what would fuel the recovery. In April 2009, we analyzed three possible scenarios in detail – the V-, U- and L-curves. Even then, we estimated that the V-curve was most likely with a probability of 70%. The U-curve had 25% probability and the L-curve just 2% – and we have nothing new to add to these predictions.

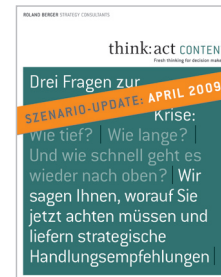
The problem, however, is that it is still hard to trust the indicators and forecasts. Cheap money from the central banks is at least as important as genuine confidence in business fundamentals for driving the relentless bull run on the world's stock exchanges, for example. And the IMF – leading the charge of today's optimists once again – was still predicting 3% growth for 2009 as late as October 2008. It corrected this view down to -0.5% in January 2009, just three months later; and took just another three months to end up at -1.3%. That is a spread of more than four percentage points in the space of just a few months. The conclusion is obvious: Complex economic models were unable to foresee the downturn. Why, then, should they now reliably forecast the upswing?

We have to accept that we can no longer trust numbers in general and forecasts in particular. Nor are there any reliable trends that might give us clearer orientation and relieve us of the responsibility to make our own decisions. What is needed, therefore, is sound judgment coupled with the ability to interpret the trends in those parameters that are most important to economic development, namely:

- Growth drivers
- Protectionism
- Economic stimulus programs
- Monetary policy
- Raw materials
- Financial markets
- Unemployment

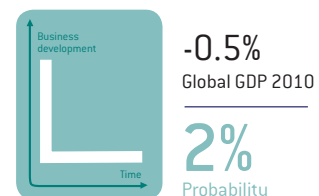
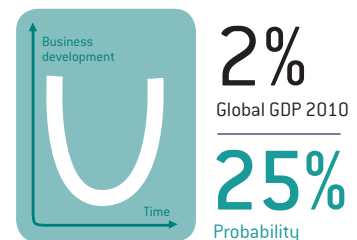
APRIL 2009: THREE POSSIBLE SCENARIOS

Turning points correctly identified



THE V-CURVE

After the deep plunge in 2009, the recovery is beginning



USA, CHINA, INDIA, RUSSIA...

...positive economic signs from all four regions

**1. GROWTH DRIVERS**

A handful of economies – the USA, India, China and Russia – have the potential to significantly accelerate or slow the world's economic recovery. They have this potential not just because together they account for nearly 40% of global GDP. A further reason is that what happens in these countries is instrumental in shaping economic pessimism or optimism around the planet. By no means the least factor, incidentally, is that all four regions are major export markets for Germany and Europe.

Fortunately, the signals from all four regions are positive right now:

- The USA is growing again. Extrapolated for the year as a whole, expansion was back up to 2.8% as early as the third quarter of 2009. Unemployment is rising much more slowly, order books are filling up, and in December 2009 the ISM Purchasing Manager Index for the manufacturing industry hit its highest point since April 2006. Having bottomed out in mid-year 2009, even the property market showed initial signs of expansion in some regions.
- China not only beat the forecasts for 2009 but can look forward to growth of over 10% in 2010, according to the OECD. The automobile market alone leaped by an incredible 46% last year, and is now – in absolute terms – the largest vehicle market in the world.
- India too outstripped the positive forecasts and was growing by a very impressive 7.9% at the end of 2009. Its prospects appear to remain sound. At year-end, industrial output, for example, posted the strongest gain in more than two years.
- Russia is benefiting from the steep increase in oil prices. The resultant revenue growth gives the government the leeway it needs to invest heavily and realize plans to modernize infrastructure and the corporate sector. What remains less clear, however, is whether the initiatives launched by President Medvedev will indeed deliver the goods.

All this good news translates into upbeat readings of the present situation. The Bloomberg Professional Global Confidence Index, for instance, has been providing reasons for fresh optimism since August 2009. Compare that with the Ifo Global Economic Climate Index, which reached its nadir at around 50 points in the first quarter of 2009. Just three quarters later, this index had rebounded to a good 90 points – within striking distance of its long-term average of 96.4 points.

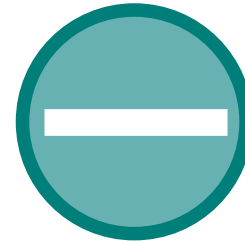
These figures at once testify to the depth of the crisis and to the dynamic pace of recovery, which – of this there is little doubt – will continue unhindered in India and China. It follows that two key factors will now determine the outcome of the V-curve scenario. One is the US labor market, which must begin to visibly recover in the first quarter. The other is that Russia too must see its economy turn the corner in the second quarter at the latest in order to strengthen the global upswing.

2. PROTECTIONISM

Sound growth prospects for China, India, the USA and Russia can materialize only if they are not choked off by another outbreak of protectionism. The controversial "Buy American" initiative and certain proposals by the French government early on in the crisis have faded away. Protectionism has not gained ground in Europe. Farther afield, putting up new trade barriers is the exception rather than the rule, even though the emerging economies have created a number of obstacles since October 2008. Brazil, for example, has significantly jacked up its import duties on 500 goods. Russia too has slapped an increase of up to 30% on vehicle import tariffs. By and large, economists nevertheless agree that, unlike in the 1930s, tightly meshed contractual relationships and robust institutional hurdles are likely to keep this trend from escalating. Moreover, a substantial proportion of world trade today takes place in free trade areas and is therefore, by definition, free from customs duties and other (non-monetary) barriers to trade. While the globalization of world trade could slow down, it is unlikely to grind to a halt. Take China, for example, which – unexpectedly – has imposed no import restrictions and is once again stepping up its inbound trade. The progress made by liberalization will thus be a good measure of whether or not this positive climate can be maintained. In other words, the fate of the Doha Round will be an important factor in determining what the future holds for the world's economy.

THE FATE OF THE DOHA ROUND WILL BE...

...a key milestone on the path toward more liberalization in global trade



3. ECONOMIC STIMULUS PROGRAMS

Governments' and economists' greatest fear is that the stimulus programs launched in 2009 may already have done all they can. We beg to differ. While some USD 2.8 trillion has been set aside worldwide to combat the effects of the economic crisis, much of this money has not yet actually been deployed. Of the USD 787 billion freed up by the US government's stimulus package, for example, only USD 260 billion has been disbursed. Calculations suggest that this program created or preserved between 1.6 million and 2.0 million jobs in 2009 alone; and considerable knock-on effects are projected for 2010, all of which should definitely support the V-curve scenario.

Volume issues aside, virtually all the programs launched to date target sustainability. The sizeable sum of USD 430 billion has, for example, been earmarked for infrastructure development projects and to promote new technologies.

4. MONETARY POLICY

Swift and coordinated action by central banks around the world prevented an even worse economic crisis. Fears that the policy of making money cheap might fuel rapid inflation have so far proved groundless. Prices rose by 0.4% in Germany and by 1.2% in the euro zone in 2009. As the money supply continues to shrink, we believe that inflationary pressure in the euro zone will remain moderate in the months ahead. The vast quantities of money transfused into the markets by the central banks have already largely been absorbed by the banking system.

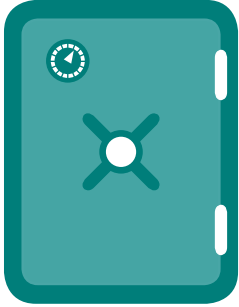
ECONOMIC STIMULUS PROGRAMS

Promise of significant knock-on effects in 2010



MONETARY POLICY

Will the central banks be able to gently phase out the era of cheap money?

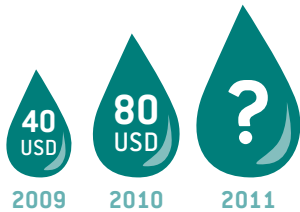


Nor is the deflation that was still feared as late as last year really likely, given rising raw materials prices. By mid-year at the latest, the ECB will nevertheless begin to stem the high tide of liquidity on the market and will rein in its monetary policy. The Fed too will tighten up what has been a very loose monetary policy in the USA. Since many banks are still dependent on liquidity from the central banks, however, that is not going to be easy.

The important thing is to keep a close eye on what the note-issuing banks do with their monetary policy. The trend in money supply, the inflation rate and the refinancing rate are key indicators. Carefully pruning today's exceptional liquidity while maintaining historically low refinancing rates will reduce the risk of nipping the economic upswing in the bud. Should a sharp increase in the price of oil, for example, trigger faster inflation, then higher interest rates will be unavoidable. This would cause the economy to recover much more slowly while worsening the credit squeeze. With that said, the central banks have in the past proven their ability to use the tools at their disposal both with discretion and very effectively. There is therefore nothing to suggest that they are about to do things differently.

PRICES OF RAW MATERIALS/OIL

The oil price could become a burden if and when it rises above USD 100



5. RAW MATERIALS

Since touching bottom in the darkest days of the crisis, the metal price index has surged by 110%. The oil price is up by 114%. Stronger demand from the emerging markets in particular, lower mining and production levels and a resurgence in speculative activity are the reasons. The oil price should turn out to be the most important factor on the road to economic recovery. At around USD 80 a barrel, oil is now once again more than twice as expensive as in spring 2009 and has found a healthy price level. Even in the nascent recovery, the corporate sector is coping well with this development. Meanwhile, the major raw materials producers – especially Russia – are using the resultant revenues for capital investment, thereby stimulating the global economy. But a burden on economic development could result at the latest if and when the USD 100-mark is exceeded again – at least a psychological one.

6. FINANCIAL MARKETS

The financial markets play a crucial role in determining the pace of economic recovery. We believe that companies defaulting on their loans will again weigh heavily on the banks. In our recent restructuring study, a majority of the experts assumed that the number of insolvencies – a typical downstream consequence of such crises – will rise by between 10% and 20%. Though the risk to the banks is accordingly high, we believe the danger of another existential crisis in the banking system to be slight. In the short term, the issue of the availability of credit for companies will probably play a more important role in shaping the hoped-for upturn. Banks are already handing out loans only if the risk of default is very clearly containable. It is only natural for banks to shift back to a conservative lending policy in a crisis. On the other hand, their current reluctance to lend is nourishing fears of a

genuine credit crunch. In our study, 53% of companies claimed their credit terms had deteriorated, while 46% said it was already becoming difficult to arrange loans at all. We are pleased to note that the German government has wasted no time in putting this problem on its agenda. Via the agency of the KfW (a government-owned banking group with a mandate to stimulate economic, social and ecological development), Germany has the tools it needs to expand lending practice directly if the need arises. In light of this fact, plus the intervention and action plans that many banks are drawing up, we believe the threat of a credit crisis is, at the very least, manageable. Another factor is that the banking sector has already effected huge write-offs and sharply ramped up its risk provisions. If a series of asset classes experience a rapid recovery, the banks could gain additional room to maneuver by reversing some of these provisions – a fact that would benefit borrowers too. The current extremely steep yield curve is likewise doing its bit to help the financial sector recover quickly. Whether or not this industry continues to recover will be reflected in large banks' next few quarterly reports.

In the long run, regulating the financial markets will probably be the most important issue. Very positive resolutions were prepared in record time for the international crisis summit. Implementation, however, is clearly not being treated as such an urgent priority. This is especially true of the USA and the UK, both of whose economies depend much more heavily than Europe on the financial markets. The key factor in this context must therefore be the extent to which the US government can push through its ideas on strict regulation on the home front.

7. UNEMPLOYMENT

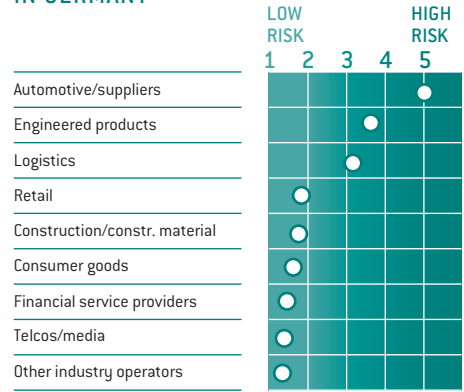
The rise in unemployment in the world's leading economies has, despite the collapse in corporate revenues, so far been comparatively modest. In Germany in particular, businesses have resorted to tools such as short-time work in order to keep their best people and stay prepared for the next upturn. The wholesale job losses predicted by many experts after Germany's last general election have failed to materialize. Furthermore, the chances are that the labor market will again remain relatively stable in 2010.

To briefly recap: As 2009 got underway, most experts expected the jobless figure to hit around four million by year-end and around five million in the course of 2010. In fact, unemployment stood at just under 3.3 million in December 2009 and is forecast to average four million during 2010. This, then, is another factor that will significantly affect the chances of a rapid upswing.

OUR PEEK INTO THE FUTURE

The crisis has shown that we need courage to form our own opinions. Ours is still that the V-shaped scenario remains the most likely form of economic recovery. We expect that the economy will pick up pace over the course of 2010.

INSOLVENCY RISKS IN GERMANY



Source: Roland Berger study

UNEMPLOYMENT



STRUCTURAL STRENGTHS

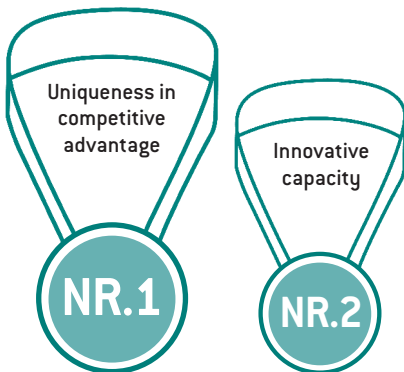
Industrial skills count for something once again!



We would indeed go further: If we learn the right lessons from the crisis, the decade ahead could bring genuine, sustainable prosperity for even broader areas of the world. This could mean that the way out of the crisis actually reinforces Germany's and Europe's inherent strengths. Why? Because industrial skills now count for something again; and Germany is excellently positioned on this score, with manufacturing accounting for 24% of its economy. The figure for continental Europe too is strong at around 18%, compared with just 14% for the USA and less than 10% for the UK. That will make the difference – and not just manufacturing's share of the economy. German industry is in an extremely strong position, as shown by the latest World Economic Forum (WEF) rankings, in which Germany is classed:

→ Top for the uniqueness of its competitive advantage. That is simply another way of saying that Germany's products set the country apart better than those of any other country.

ADVANTAGE: GERMANY!



→ Second for innovative capacity. Clearly, Germany's research and development landscape is in much better shape than many seem to believe. Germany is currently the second-largest host country for international research (after the USA), and German companies are constantly increasing their share of the nation's research effort.

→ Second for the standard of its production processes. To put that another way, high-end production in Germany is definitely competitive.

→ Top for its infrastructure.

A year and a half ago, speculation surrounded not just a deep recession but also a complete systemic collapse. With hindsight, we now know that the world's economy is relatively robust. The system did not go down after all. There are more than enough reasons to be optimistic, then.

WHAT ACTIONS MUST BE TAKEN NOW?

Restructuring still an issue

Rigorous restructuring remains an absolute imperative. Especially at the end of a protracted downturn, companies find themselves weakened. At such a time, it takes a concerted effort to stay the course over the last few yards of the downturn, to mobilize the resources needed to invest in the upturn, or indeed to do both. That is especially true of sectors in which the recovery is dragging its feet. Examples include retail, which is suffering from the decline in private consumption, and the automotive industry, which is still burdened by overcapacity.

Businesses therefore find themselves in desperate need of one thing in particular right now: capital. Capital to buffer the losses that continue to accumulate. Capital to dismantle overcapacity and make overdue structural adjustments. Capital to once again finance selective growth. In the resultant conflict of interests, cogent answers that satisfy all stakeholders are of the essence.

A holistic restructuring strategy delivers precisely these answers. It embraces the regular tools of operational restructuring: strict cost management and the rigorous reduction of working capital to boost cash flow and help companies pay their own way. The second aspect of any comprehensive corporate turnaround is restructuring the balance sheet.

In this context, it is important to systematically scale back debt. Selling off parts of a company can help to accelerate deleveraging. Those parts with a poor risk/return profile or that do not fit the strategy of the rest of the company are likely candidates. Creative financing is another vital element. Precisely when banks write off their receivables from a company, the company can discover room to negotiate. Receivables may even be waived to some extent. Let the manager beware, however. If the company is in a critical situation, there is always the risk that the bank may refuse to back a restructuring plan and, instead, simply accept the total loss of the loans it has already written off. This can improve the bank's risk position but leave the company with no alternative to insolvency.

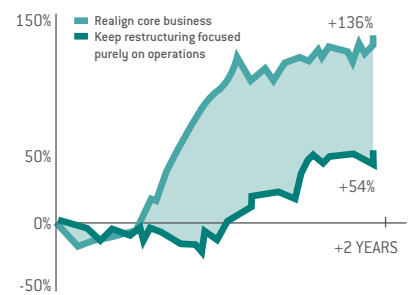
Besides running down its debts, companies must also systematically optimize their cost of capital, especially as interest rates are likely to rise. The balance sheet must be adjusted in light of cost of capital and risk considerations. Investment projects that do not recoup their cost of the capital must be terminated.

The final aspect of balance sheet restructuring is the need to place long-term financing on a sound footing. A recent Roland Berger study on corporate finance found that many CFOs still have trouble stumping up the funds they need, especially when they try to borrow money. This is especially true of medium-sized companies which, deprived of access to the capital markets, are essentially left with bank loans as their only option for sourcing debt. To make matters worse, many mezzanine financing programs are now expiring. As this happens, we are experiencing a return to covenants where the conditions attached to the granting of credit are stricter than ever. Dependencies can be minimized by assembling as broad a mix of financing as possible. At the same time, risk can be optimized by borrowing from a spread of creditors. The most critical issue when seeking to secure solid financing is nevertheless honest communication of a robust, long-term strategy for the company's future.

The third aspect of the restructuring plan is a reorientation of corporate strategy. Efforts to restructure both operations and the balance sheet must necessarily be intertwined with a clear strategy. Why? Because this alone calls legacy business models into question, clearing the way for strategic change that can lead the company to lasting success. And only in this way can we lay the foundation for future sales growth. The Anglo-American tradition – restructure first and grow later – is obsolete. Today's companies must fight simultaneously on both fronts over the long term. To do so, they need financial and operational room to maneuver. Intelligent restructuring creates precisely this room and, hence, the ability to seize attractive opportunities even before all difficulties have been dealt with.

FORMULA FOR SUCCESS: STRATEGY & RESTRUCTURING

Potential for generating value can be tapped with restructuring actions



Source: Roland Berger Strategy Consultants

GLOBALIZATION AS A GROWTH DRIVER

3.5%

GROSS DOMESTIC PRODUCT

8.7%

EXPORTS

12.4%

DIRECT INVESTMENTS^{*)}

^{*)} Net average annual growth rates between 1990 and 2008

A global footprint

What was true before the economic crisis is still true afterward: Globalization is driving the world's economic development. From 1990 through 2008, global GDP expanded at a compound annual growth rate (CAGR) of 3.5%. The CAGR for exports in the same period was 8.7%, however; and that for net direct investment was 12.4%. For a season, the crisis subdued these trends but did not halt them. Witness the rebound in China's – and Germany's – exports.

Companies can benefit from this resurgent economic dynamism if they strengthen and enlarge their global footprint with two aims in mind: further optimize their supply chain and establish a presence in fast-growing local markets. The advance of globalization will also add to cost pressure. That is why constantly screening the cost and quality aspects of supply chains at a global level is now a must. At the same time, emerging markets themselves are now spawning new trends – in mobile communications, for instance. The full import of these trends can be assessed quickly enough and profitably assimilated into a company's own products only if that company has a presence on the ground. Yet another reason for a sizeable global footprint is that growth markets such as China, India and Brazil are now approaching critical mass. When they do so, it will no longer be sufficient just to have a local sales outfit in place. Any firm that wants to fully exploit the revenue potential of these markets must fully commit to them early on. The fact that China has overtaken the USA as the world's largest auto market clearly shows the direction in which the global economy is heading – and where opportunities will continue to open up for corporate players.

Shoring up raw materials

The sharp increase in raw materials prices to which we referred in the first half of this publication shows that the same challenges we faced before the crisis continue to confront us in its wake. If they have not already done so, companies must now urgently examine how, in the next growth phase, they can ensure an affordable and, above all, reliable supply of the materials they need. Germany, for example, depends on imports for 97% of its oil and 82% of its gas. The three countries with the largest deposits of important industrial raw materials (such as chrome, platinum, lithium and tungsten) together control between 75% and 95% of the world's reserves. Germany, by contrast, has no significant reserves of any of them. In the thick of the recession, the issue of raw materials took a backseat for many. Now, however, businesses must work with their governments to actively do more to stake their claim in the foreseeable rush for materials. This includes, for example, internal activities to improve energy efficiency and reduce their own demand for these materials. Necessary external activities include cultivating deeper relationships in countries that are rich in raw materials. One example is the current energy dialog between the EU and Russia. Bearing in mind the more than 450 restrictions imposed on exports of over 400 raw materials worldwide, trading in these materials is clearly as much a political as an economic issue.

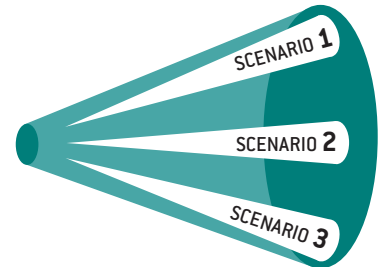
New tools of corporate management

Our experience of the crisis to date (and even the time before the crisis) shows that strategic planning – and hence corporate management – can no longer rely on trends or trend research. These days, we have to be prepared for trends to change rapidly and radically. We can therefore no longer quantify every strategic project or plan down to the last cent. As a result, we need new strategic tools to help us deal better with uncertainty and complexity. After all, managers, employees and investors alike still need some form of guidance and orientation. This guidance can be provided by scenario planning that paints alternative pictures of the future. Each scenario models one way in which the future could pan out. Comparing and contrasting a number of different scenarios thus allows companies to prepare themselves for whatever the future might hold.

At the same time, the practice of planning alternative scenarios must be dovetailed with the corporate planning process in a new way. Modern scenario planning requires intensive involvement on the part of the organization – primarily the board and operational management. In the past, involving operational managers was often the prime difficulty, as their day-to-day business was much further removed from scenario planning than the strategic considerations of top management. These days, however, the fact that scenarios are planned with shorter horizons and that outcomes can flow directly into operational planning have made managers at operating level more amenable to active participation. Scenario planning is a vital tool to help companies deal with the new climate of post-crisis uncertainty. It is so important, in fact, that we plan to devote an entire edition of think:act CONTENT to this issue alone.

THINKING IN SCENARIOS

Traditional linear planning doesn't work anymore



IF YOU HAVE ANY FURTHER QUESTIONS,
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