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Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

European Economic and Investment Outlook

Economic, social and political events are having a profound effect on the investment environment in Europe. The equity markets in Europe now offer many attractive opportunities for global investors. Our survey of the European investment scene identifies Germany, France and the United Kingdom as the most promising opportunities for global investors, particularly in the energy, financial, healthcare and telecommunications sectors.

The European Union will expand its membership next year to 25 nations with the admission of Poland, Czech Republic, Slovakia, Hungary, Slovenia, Estonia, Latvia, Lithuania, Cyprus and Malta. The European Central Bank experiences a change in leadership as Jean-Claude Trichet of France takes over as President from Wim Duisenberg of The Netherlands. History is in the making as a formal European Constitution has been drafted under the guidance of Valery Giscard d'Estaing. The Constitution will formalize many of the aspirations of Europe's leaders that have been expressed over the last sixty years. The European Union is now moving toward its goal of closer political and economic ties among the nations of Europe and is ready to assume a leadership role in the global economic system as a supra-national multi-cultural entity.

The Euro has gained strength against the US dollar, moving from a low of around 85 cents to almost $1.20 over the last two years. France is running budget deficits above 3% of GDP (the permissible limit under the Eurozone stability and growth pact) and is planning to modify its restrictive 35-hour workweek as part of a strategy for stimulating its economy. Germany is undertaking reform of its welfare state, including changes to pensions and other benefits. The United Kingdom is likely to adopt the Euro as its currency within the next few years. Ireland and Portugal are experiencing the benefits of their strategic locations and low-cost manufacturing facilities.

Russia has succeeded in strengthening its economy. Russian government debt now merits investment grade status. Russia will ultimately join the European Union when conditions are right for its entry. It will become a major player in the top tier of European leadership together with France, Germany and the United Kingdom. Turkey will also seek to join the European Union.

The European Central Bank has an inflation target of 2 per cent. France and Germany have announced plans to stimulate their economies through capital spending on infrastructure products. President Jacques Chirac of France and Chancellor Gerhard Schroder of Germany have agreed on specific spending initiatives to help achieve economic growth. The plan includes developing digital television and radio networks and broadband networks, linkage of German and French high-speed rail networks, and investment in the European satellite navigation system. Germany has announced tax cuts and a structural reform plan known as Agenda 2010. The European Investment Bank will spend 50 billion euros on infrastructure projects by 2010. For the ten accession countries, economic growth is forecast at 4.3 per cent in 2004, which is twice the growth rate for the fifteen existing member nations. Second quarter GDP figures for the Eurozone were generally weak, but third quarter figures show signs of improvement. It is now widely believed that the Eurozone economy is at a turning point and about to enter a cyclical upturn. The outlook for the German economy has improved as signs of a nascent recovery appear and fears of recession and deflation dissipate. Surveys of purchasing managers and the general business climate have shown steady improvements in recent months. The French Statistical Institute forecasts a 2 per cent increase in business investment in contrast to a double-digit decrease a year ago. Compared to the United States, European companies have been slower to cut costs and reduce debt levels. However, the impact of cost cutting, debt reduction and balance sheet restructuring is now emerging. European companies are taking positive action to overcome the excesses of the 1990's when Eurozone business investment soared to 23.6 per cent of GDP, financed mainly through debt issuance.

With Jean-Claude Trichet as the new President of the European Central Bank, it is anticipated that he will implement interest rate cuts as a major factor in monetary policy. The key European rate is currently at 2 per cent in contrast to the US Federal Funds rate of 1 per cent. The Eurozone growth and stability pact effectively constrains the European nations from running excessive budget deficits. It also opposes large tax cuts as stimulative measures. The strong-euro/weak-dollar relationship presents a challenge for Europe's export industries. The weak dollar and the US current account deficit of around 5 per cent of GDP are matters of grave concern in Europe. European economists perceive a risk of a serious dollar crash as a result of current US capital inflows that finance the current account deficit and artificially support the dollar.

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