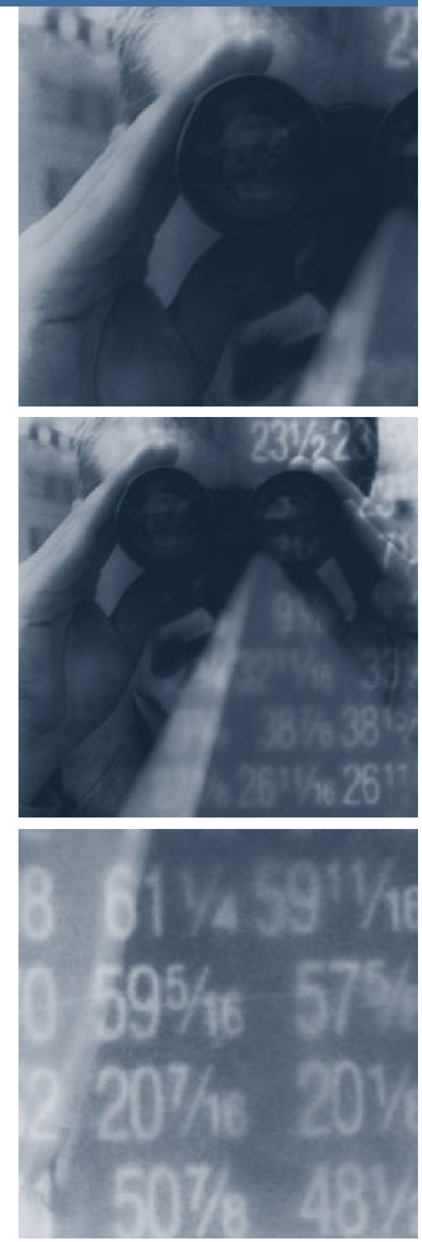
From Financial Risk to Economic Risk



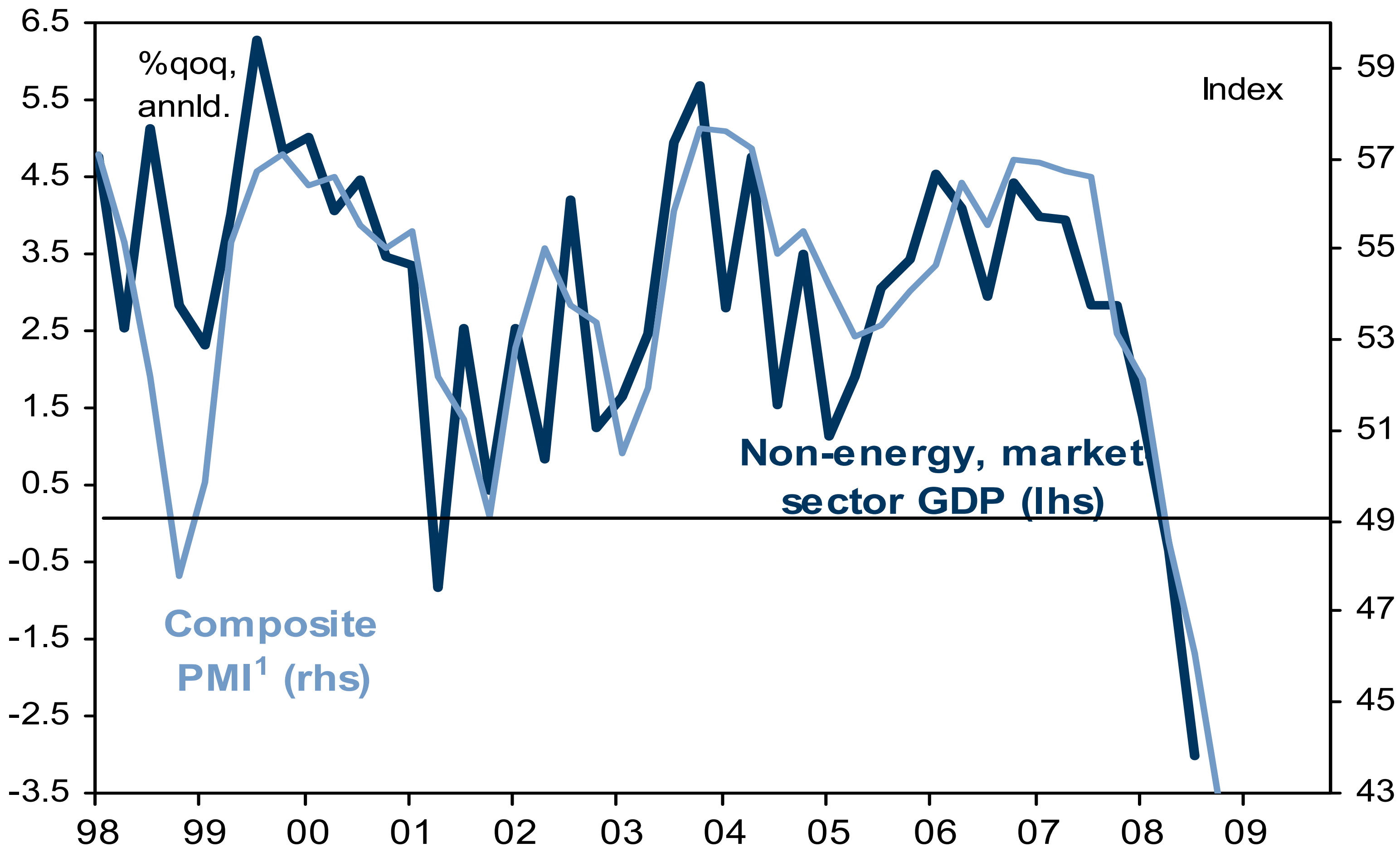
Kevin Daly
Executive Director
Goldman Sachs

17 November 2008

Summary

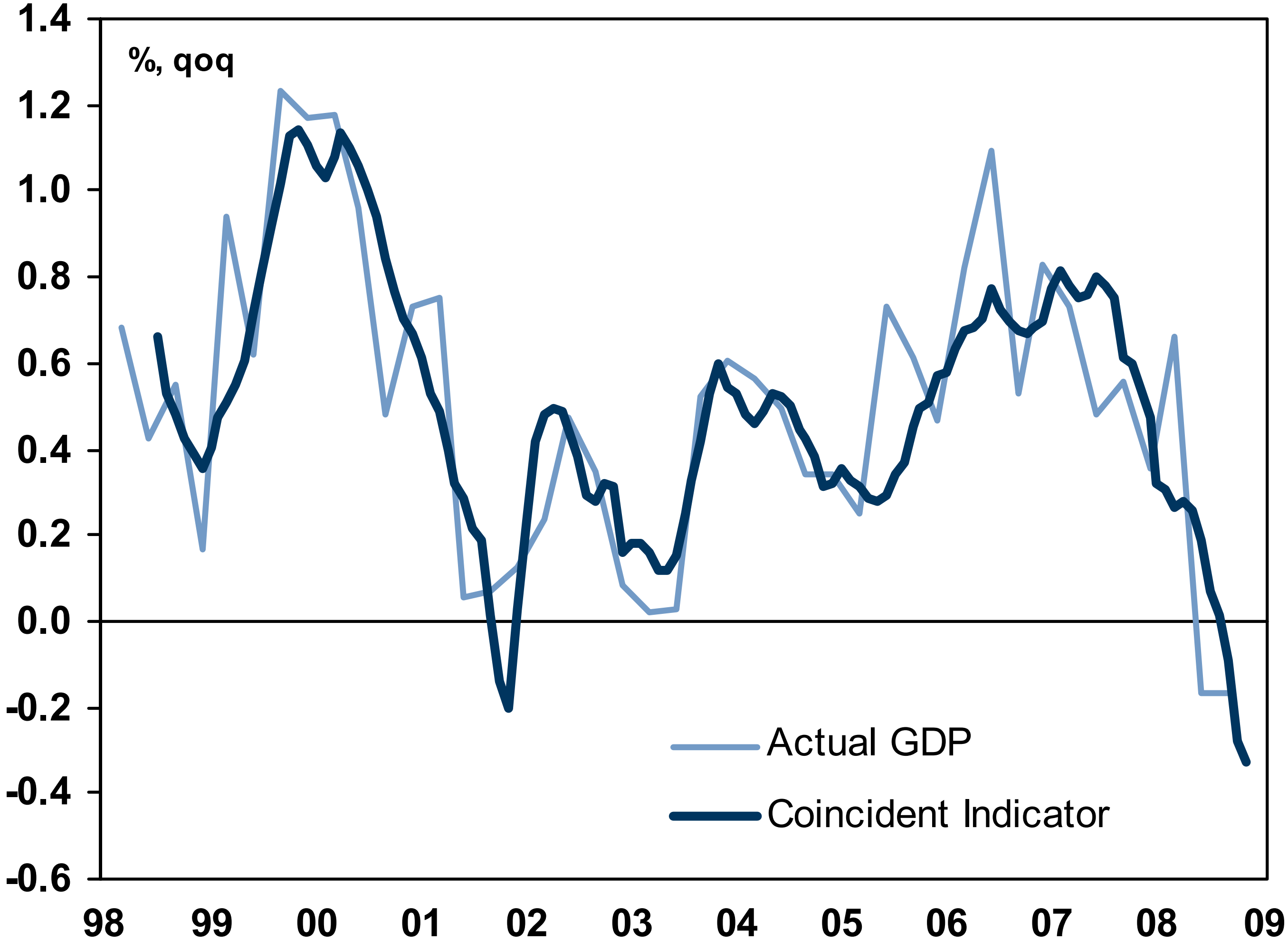
- **The near-term outlook is unambiguously bleak...**
- The UK and Eurozone economies have fallen sharply into recession. We expect a full-year contraction next year of 0.4% in the UK and 0.3% in the Eurozone.
- Monetary policy requires a sharp adjustment. We expect the MPC to cut rates to 1.5% and the ECB to cut rates to 2%.
- **Yet, amidst the gloom, there are some silver linings...**
- Monetary policy is responding and the trends in energy, food and mortgage costs are being reversed.

UK: Private sector contracted by 0.8% in Q3

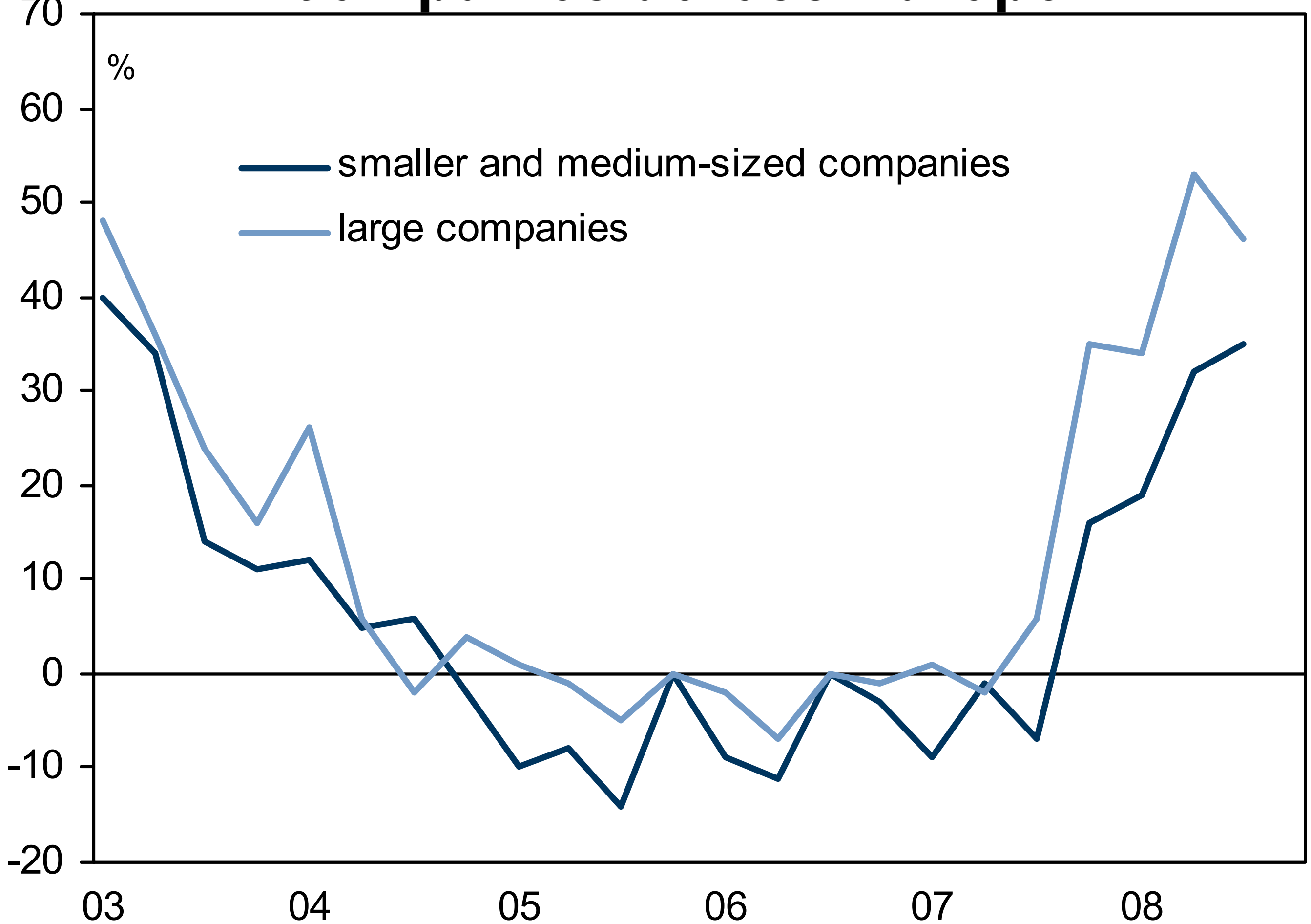


Source: ONS, NTL; [1]Includes rescaled CBI Distributive Trades Survey

Euro zone growth fell in Q2 & Q3.
A Further Decline is likely in Q4.

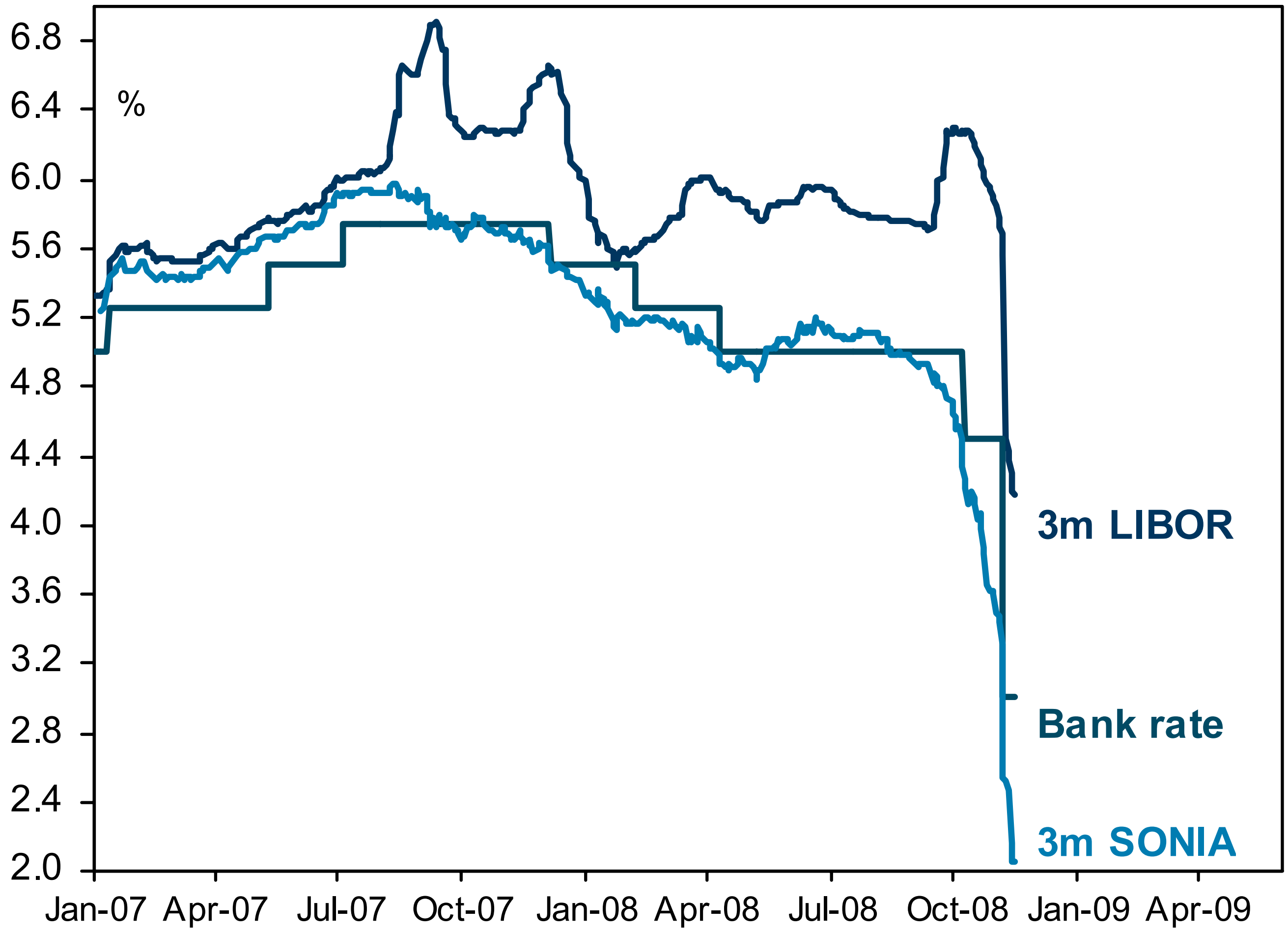


The Credit Crunch- Tighter lending standards to companies across Europe



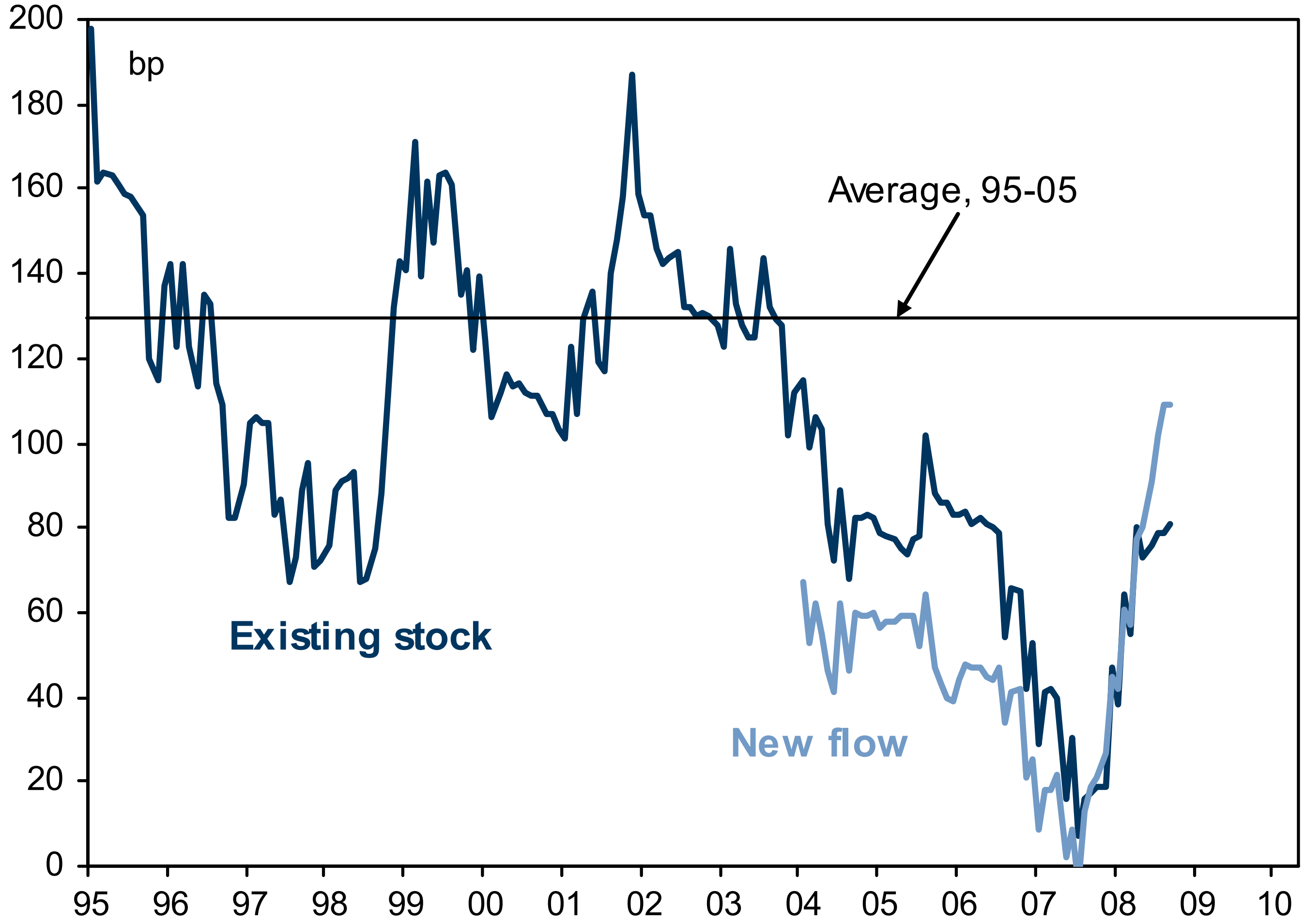
Source: ECB

UK: Divergence between official and "effective" interest rates



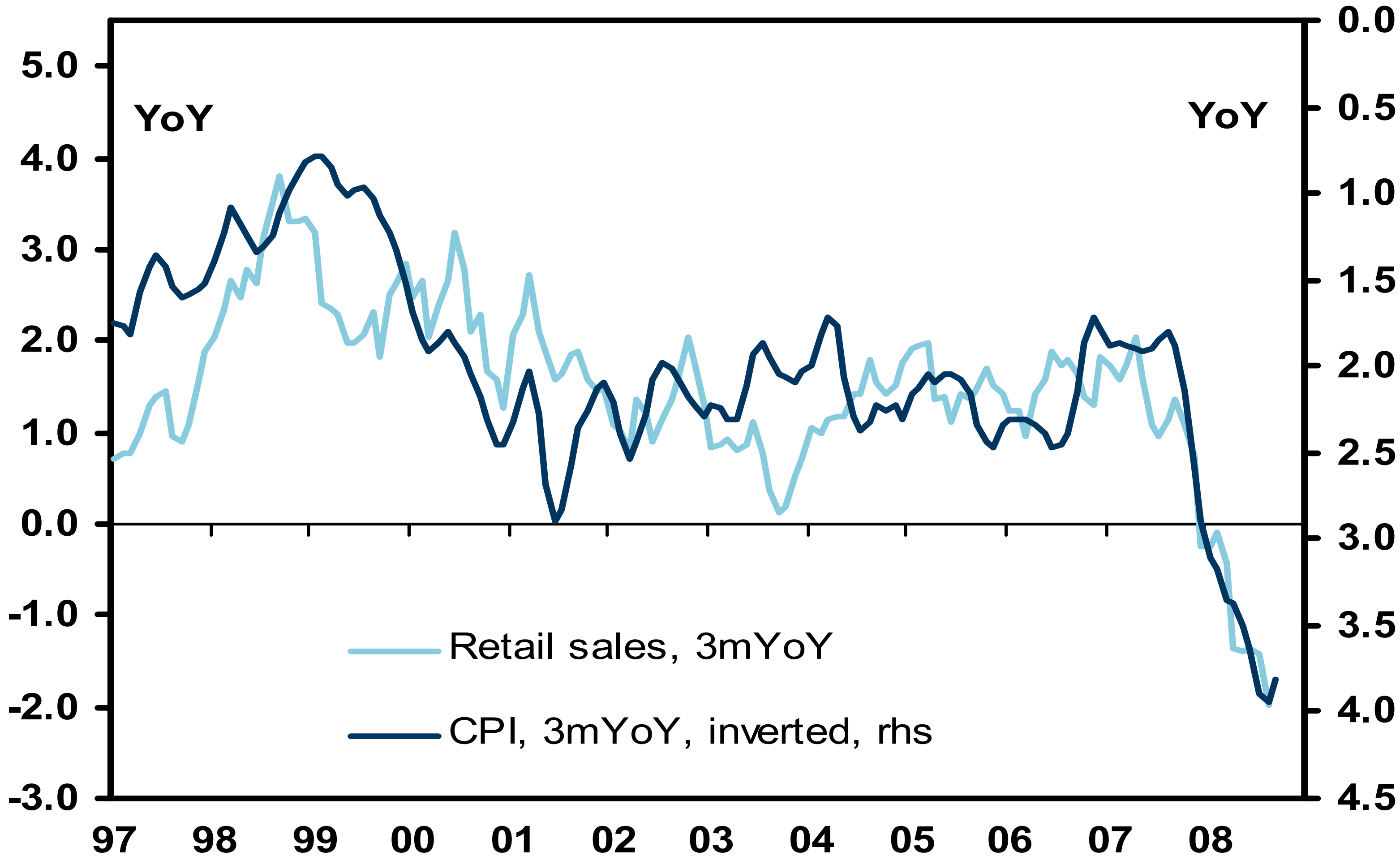
Source: Bank of England, Haver

UK: Spreads on mortgages will continue to rise



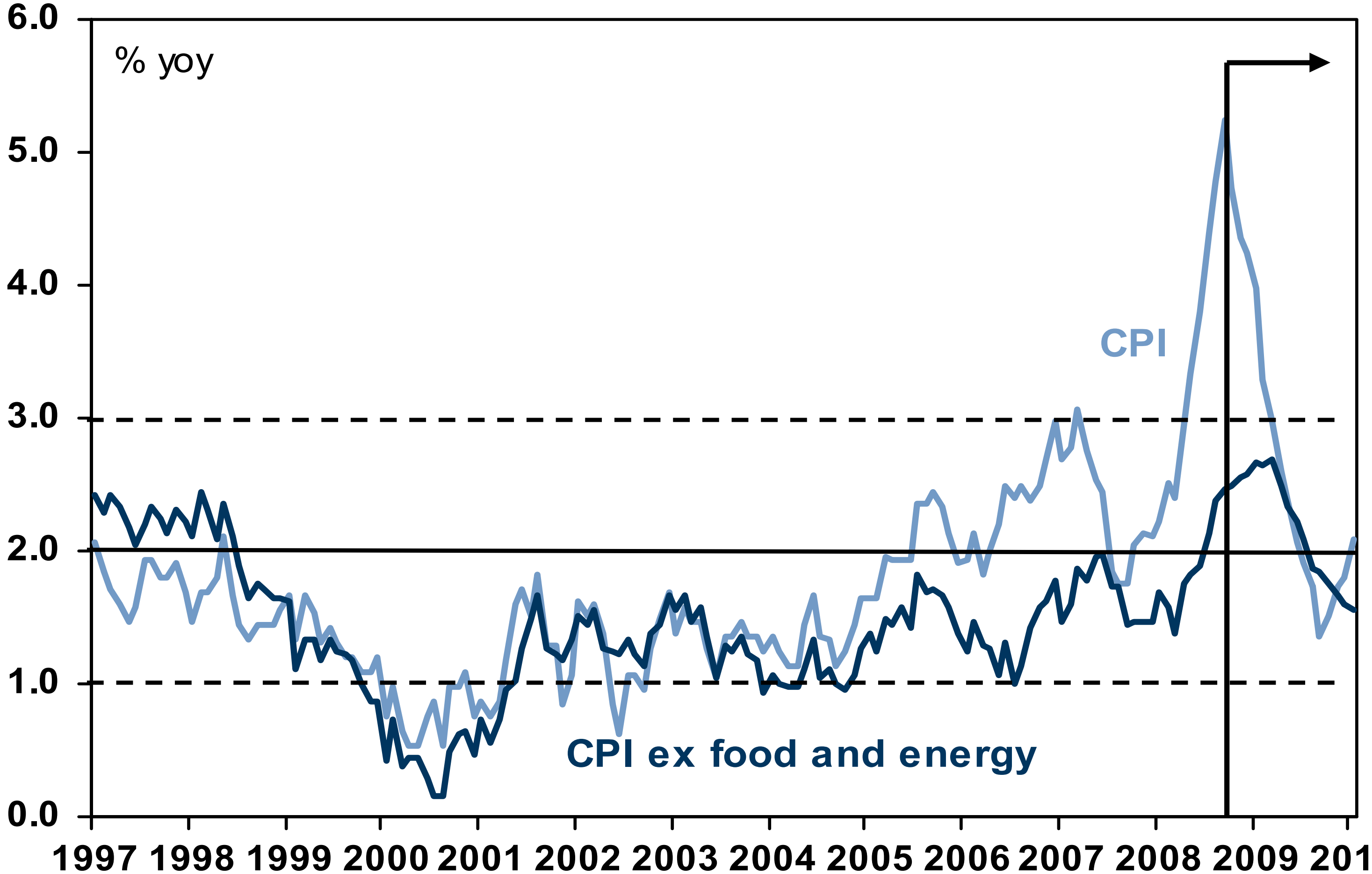
Source: BoE, GS

Eurozone: High costs have hurt consumption



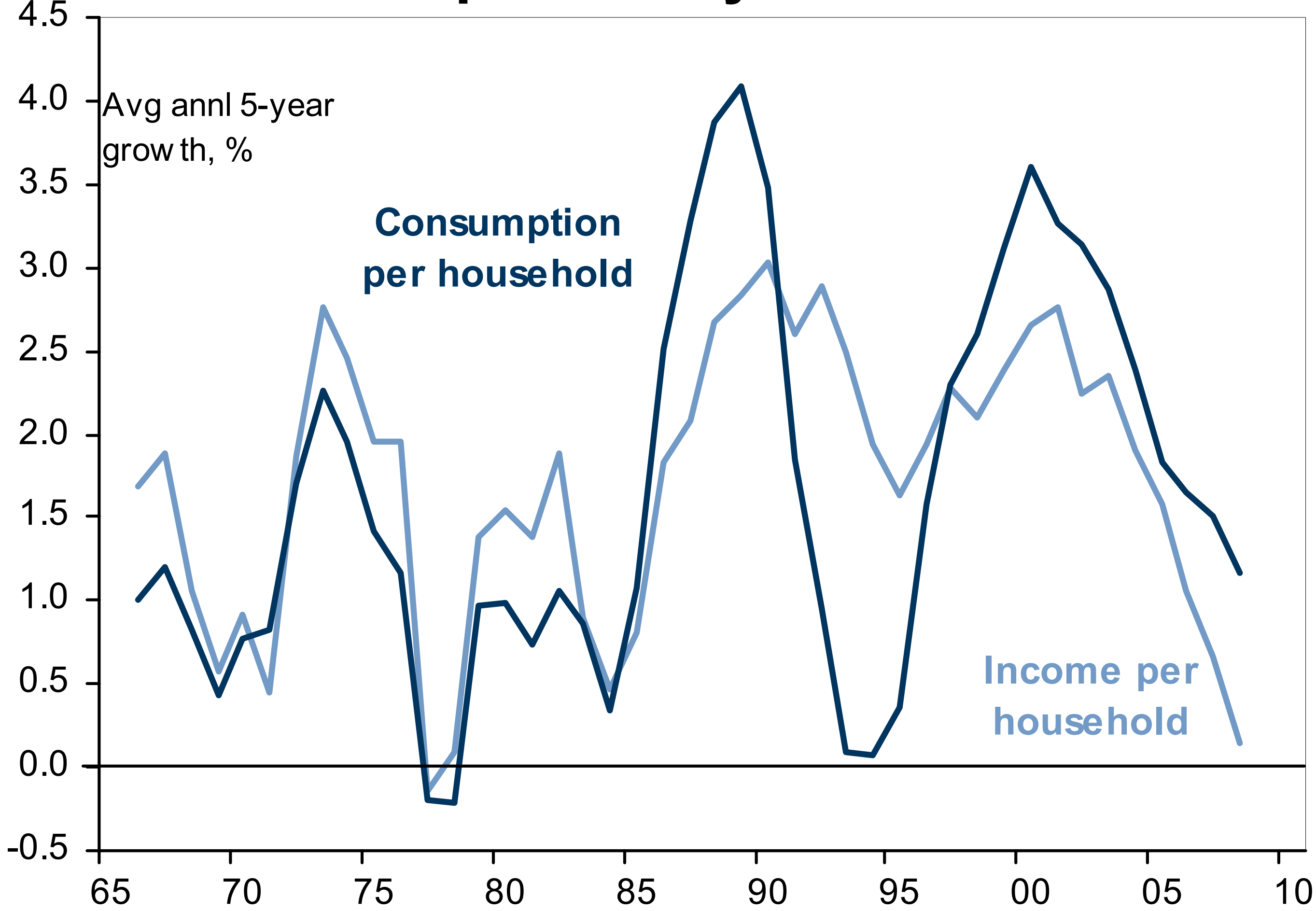
Source: Eurostat Eurostat

UK: Inflation will fall sharply from here



Source: ONS

UK: No growth in average household income over the past five years

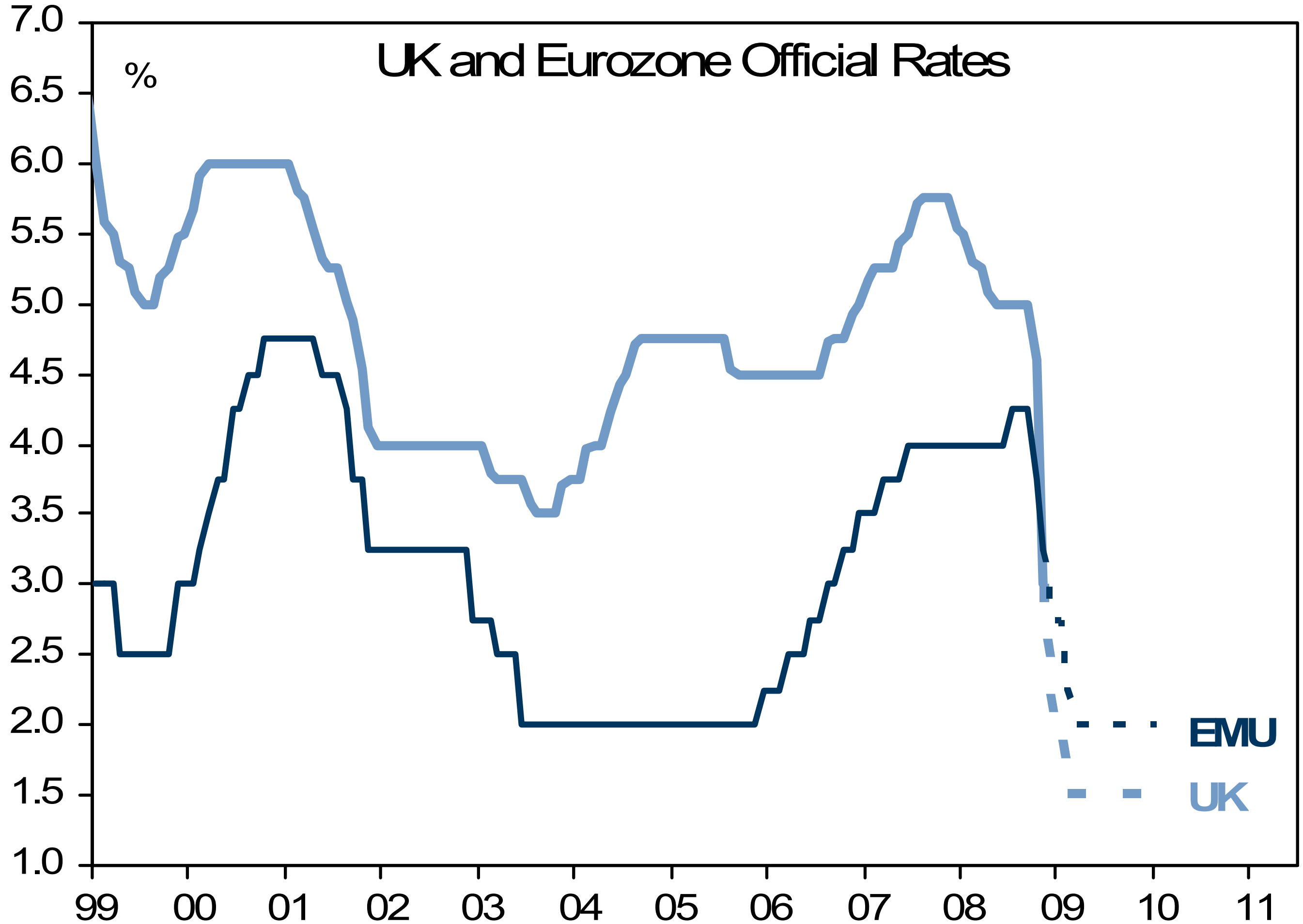


Source: ONS

Some silver linings amidst the gloom

1. Monetary policy is endogenous – interest rates can and are falling in response to the weakness.
2. A UK-specific positive: Financial conditions have already eased sharply on the back of a 25% fall in Sterling's trade-weighted exchange rate.
3. The reversal of the trends in energy, food and mortgage costs, together with a lower tax burden will add more than 3% to real household incomes in 2009.
4. The rate of European (even UK) mortgage write-offs is likely to rise by much less than the market is discounting.

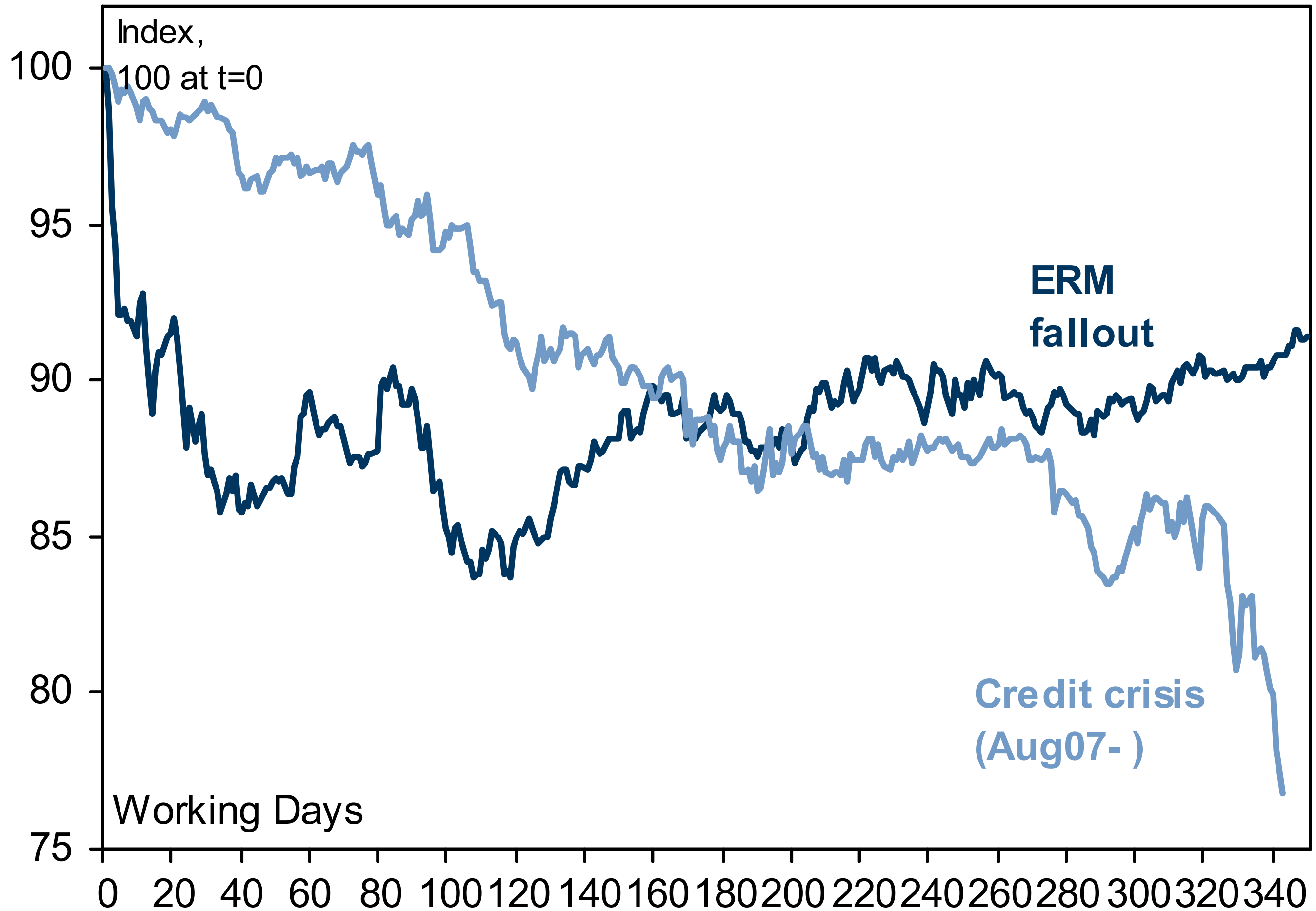
Official rates are adjusting sharply



Source: Bank of England, Goldman Sachs

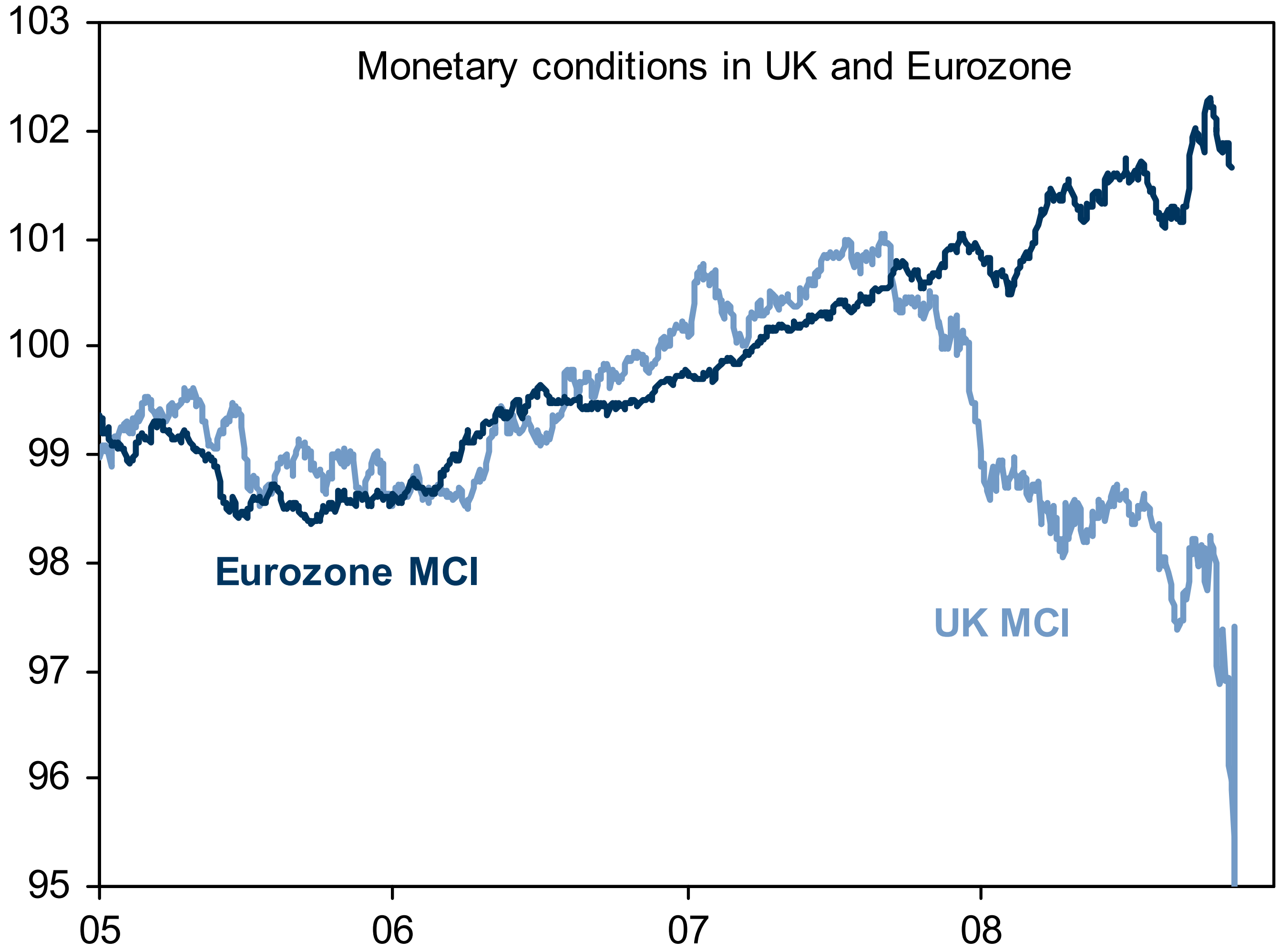
Sterling has fallen much more than in 1992/1993

Adding circa 5% to growth over 2 years

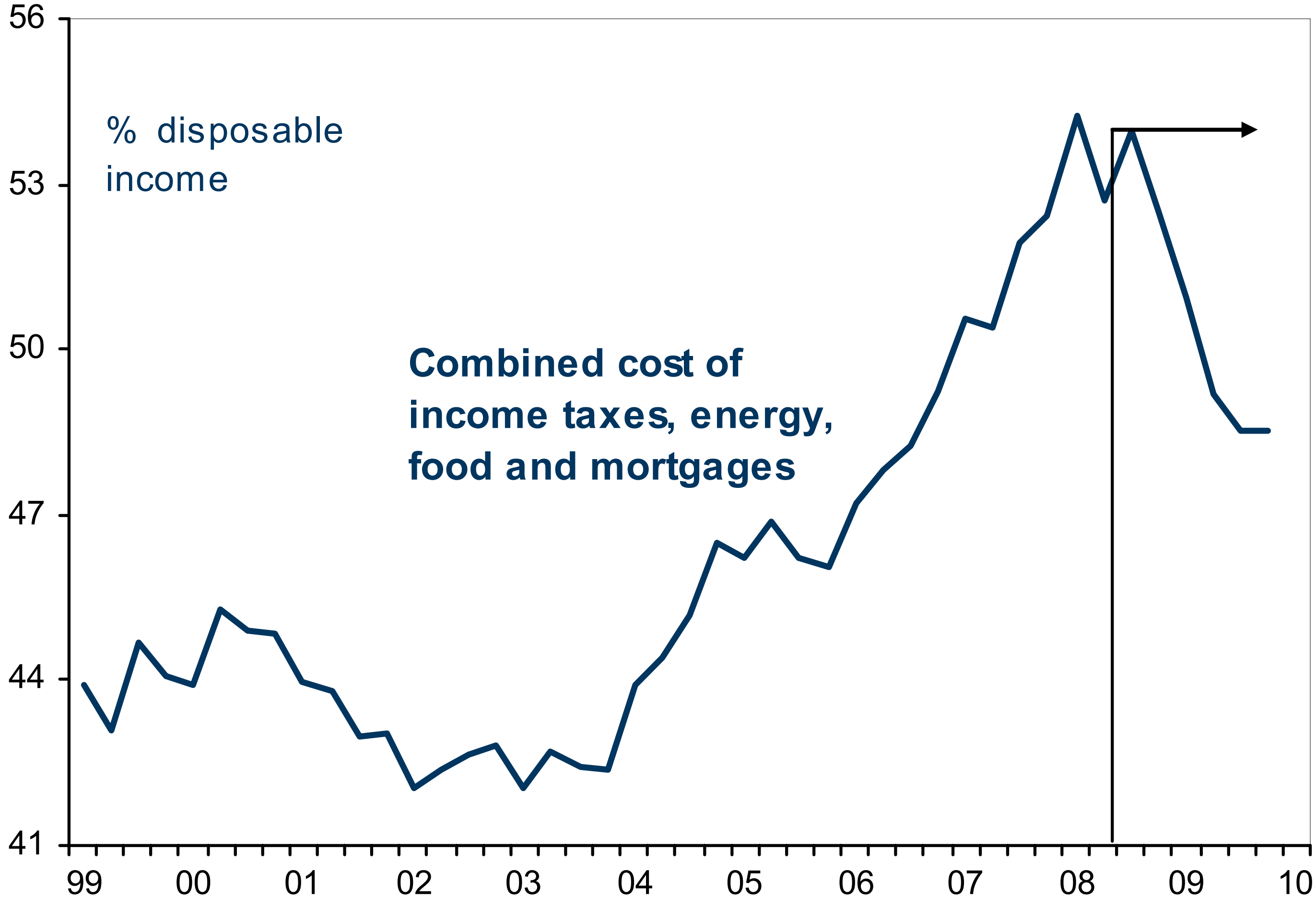


Source: Bank of England, GS

Sharply different policy stimuli in UK and Eurozone

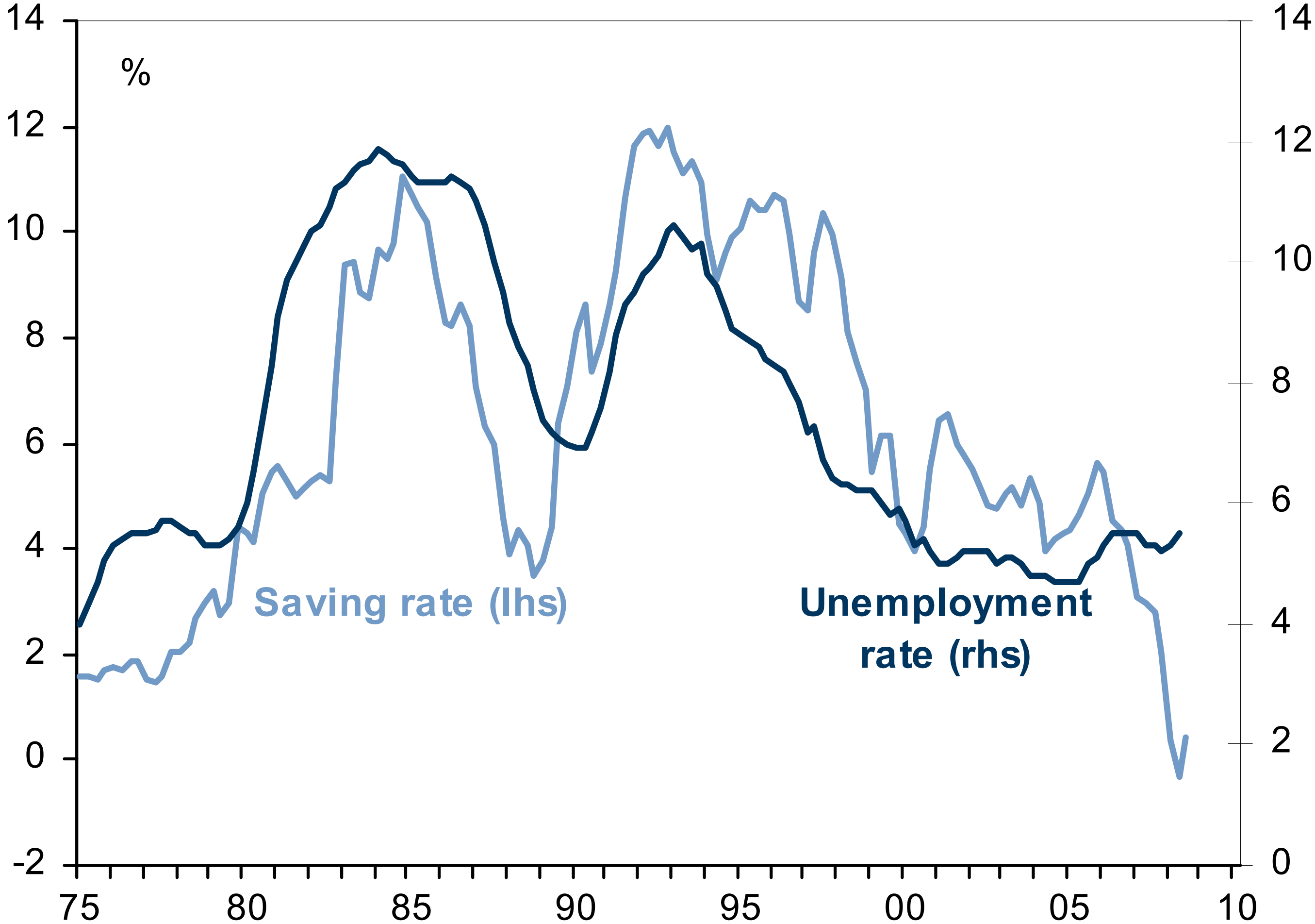


Better (i.e. some) household income growth next year



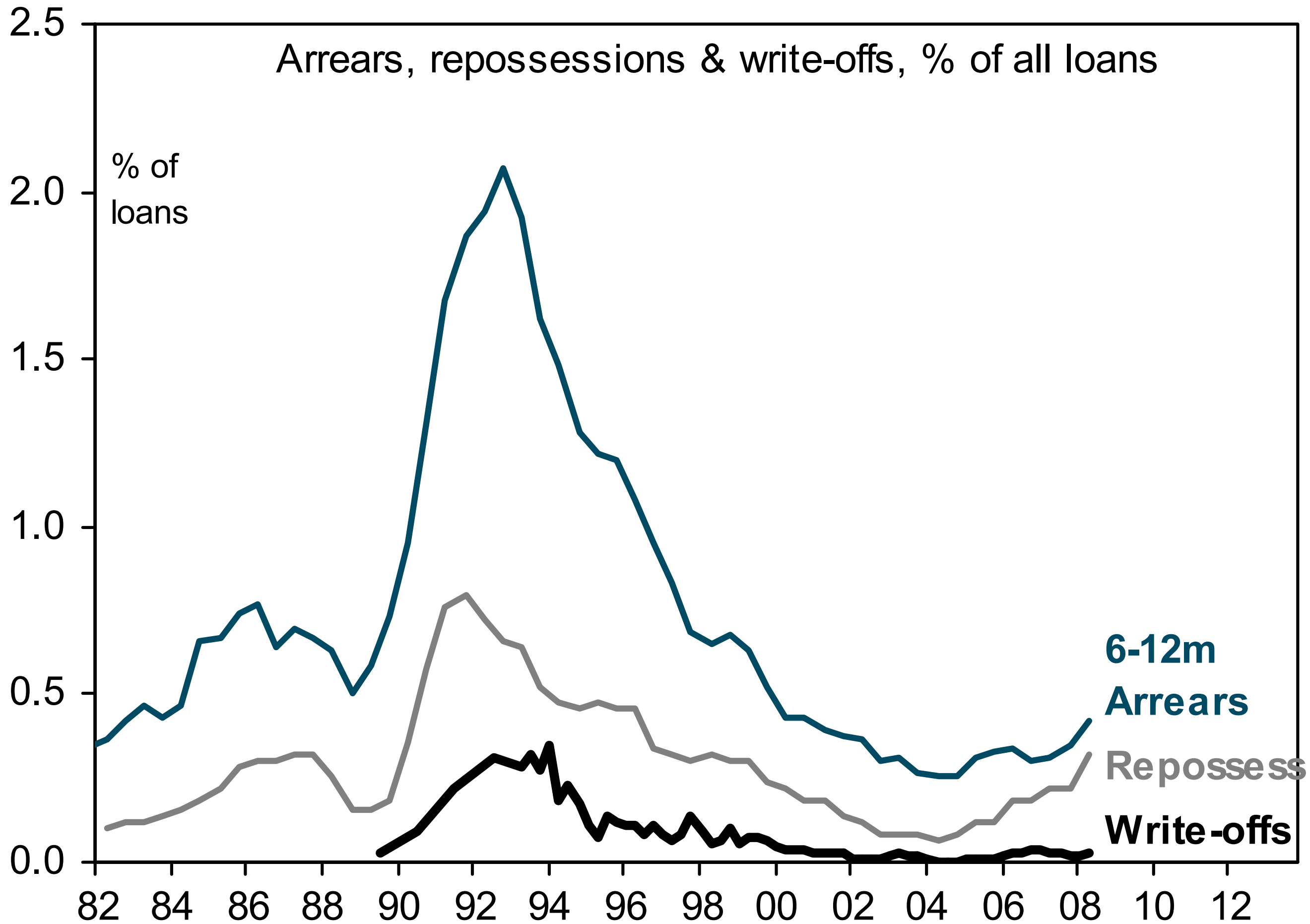
Source: ONS

Extra income will boost savings, not spending



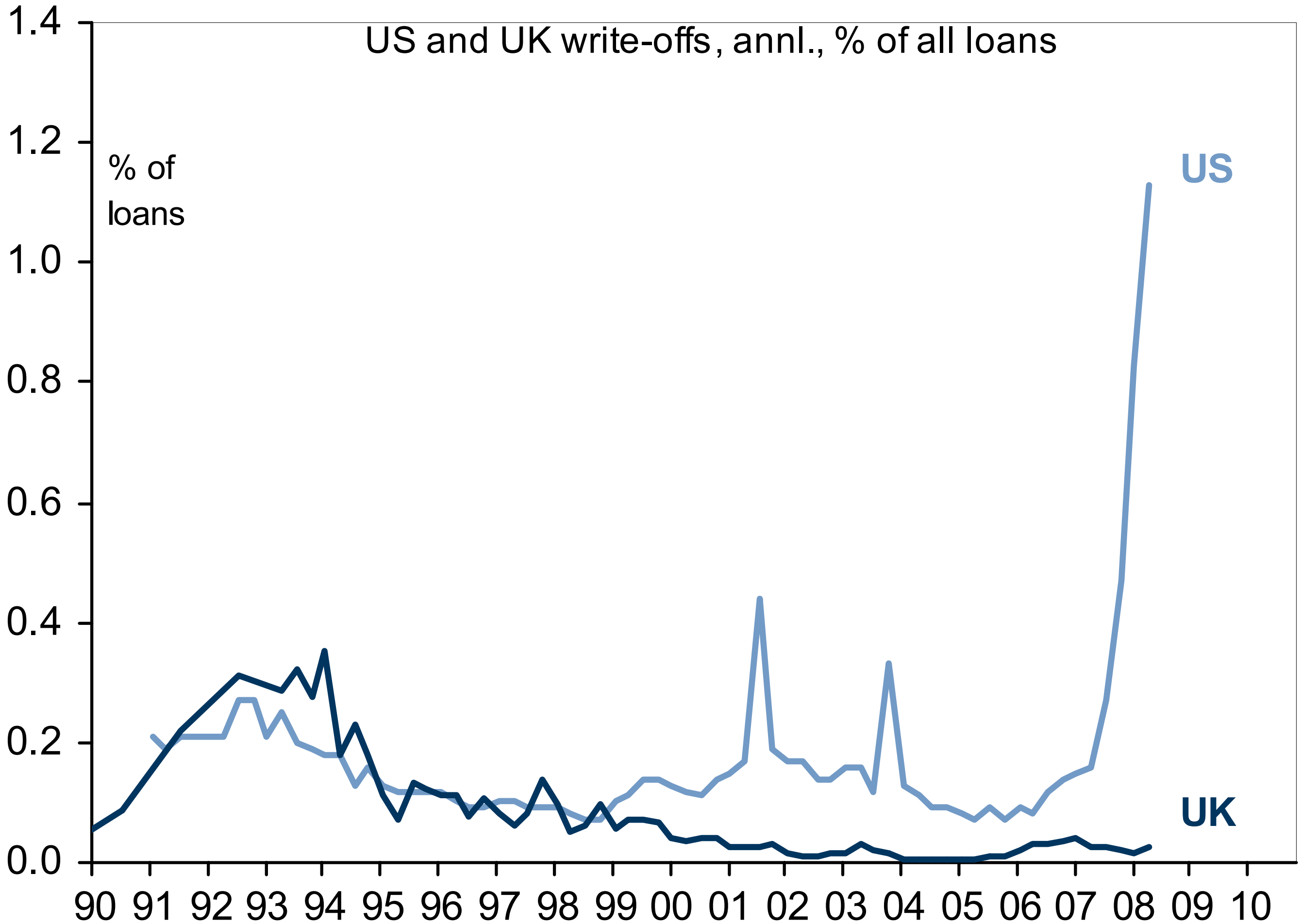
Source: ONS

Still some way from the early 1990s



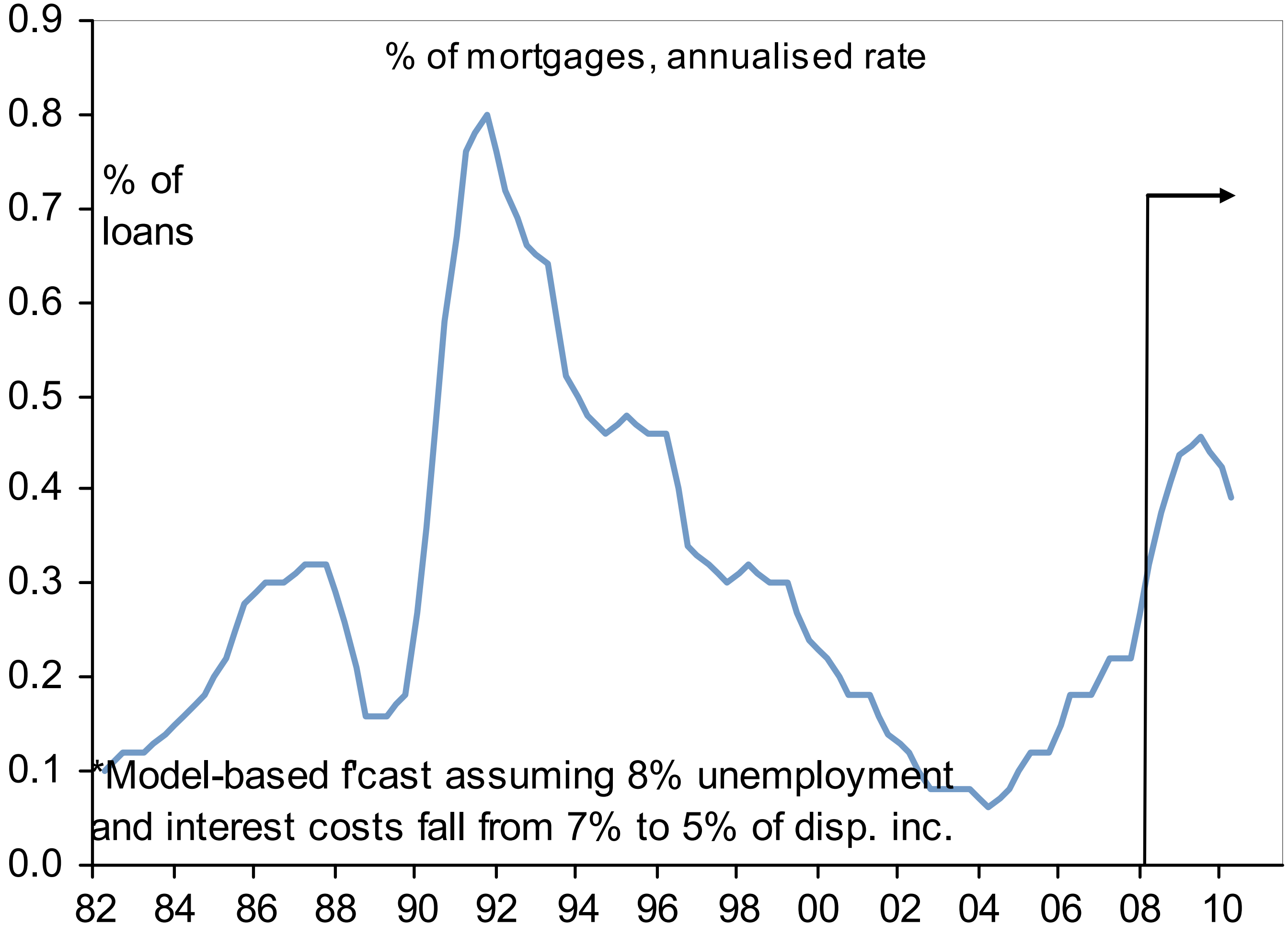
Source: Council of Mortgage Lenders, Bank of England, GS.

UK write-offs much lower than the US



Source: Bank of England, US Fed.

Repossessions likely to peak below 1990s level



Source: CML and GS calculations