

III. INTERNATIONAL CAPITAL MARKETS

In a context characterised by fears of inflationary pressure in the beginning of the year and increasing aversion to risk ; along with slower world economic growth and publication of disappointing results by several major banks, the international capital markets were marked in 2008 by the following main developments :

1. Stock market indexes in industrialised and emerging countries began to fall in the first quarter of the year, becoming more acute in the second half of the year after Lehman Brothers declared bankruptcy and bad news about the ability of almost all major financial institutions to survive the effects of the sub prime crisis proliferated. For the year as a whole, the developed countries' main stock market indexes fell by more than 30%. The MSCI emerging market index lost more than 50% of its value.
2. Bond markets on the whole went up, influenced by uncertainty about slower economic growth (especially in industrialised countries), sizeable drops in interest rates, and falling values on stock markets. At the end of 2008, ten year yields for US Treasury bonds closed at 2.21%, a drop of 182 base points compared to the 2007 yearend figure. Yields on Japanese Government bonds closed at 1.17%, a drop of 33 base points, while yields for German Government bonds of the same maturity closed at 2.95%, a drop of 140 base points.
3. The money market was dysfunctional and loan conditions became more stringent, reflected in the difference between the LIBOR on various currencies and the key rates of various central banks, despite measures taken by monetary and governmental authorities to boost activity.
4. There was a drop in the volume of bonds issued by emerging countries, especially over the second half of the year under the influence of a generalised increase in margins on secondary markets. The EMBI+ index closed for the year at about 690 base points, gaining more than 400 base points compared to its level at the beginning of the year, while marking a peak of 860 base points toward the end of October as investor aversion to risk became more acute.

A. THE STOCK MARKET

2008 ended with a record drop in the major stock market indexes, after five straight years of growth. Practically all stock markets around the world (all categories of assets taken together) had a hard year. The financial crisis that began in 2007 with a crisis in indebtedness and credit, notably in the United States, spread to the rest of the world economy in 2008. Banking stocks, hard hit by the credit crisis, was the main vehicle for falling values throughout the year. All world stock markets posted record losses. In the United States, Wall Street experienced its worse year since 1931, with the Dow Jones down by 34%. European stock markets lost between 31% (London) and 50% (Amsterdam, Brussels, Milan) of their value. The crisis hit stock markets in emerging countries even harder, after good performance over the past few years. The MSCI index of emerging stocks fell by 54%. Overall, the MSCI world index lost more than 43% of its value. Risk premiums on stock market indexes hit record levels, in a context of fear of further defaults on payment. In 12 months, the major international stock markets lost almost half of their capitalisation, more

than 25 000 billion dollars. In Paris, more than 600 billion euros went up in smoke just for CAC 40 stocks.

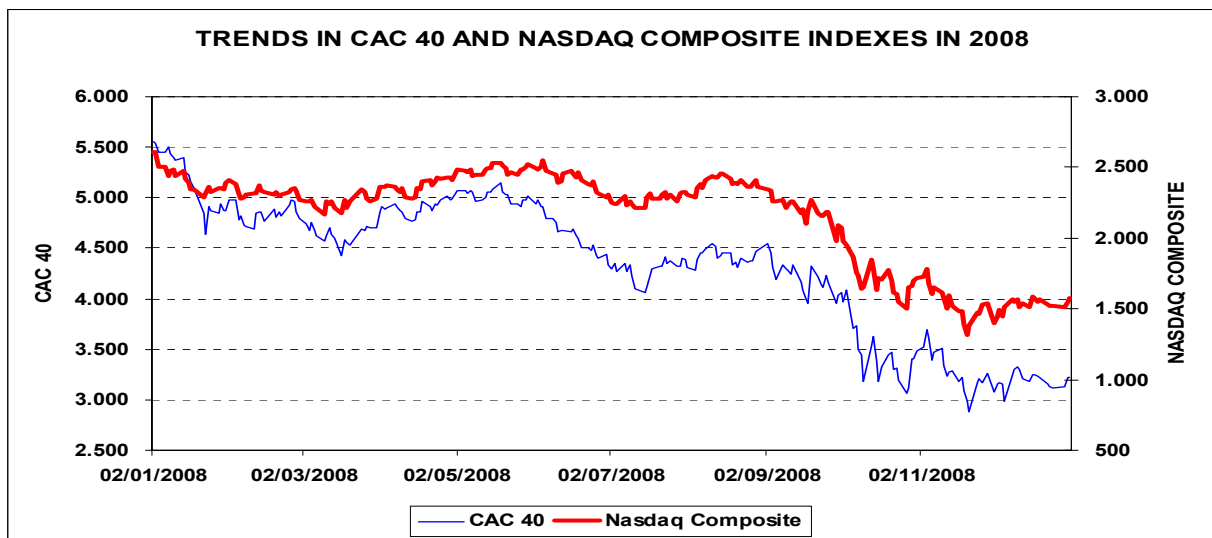
Realisation of the gravity of the US subprime mortgage crisis and of a possible recession in the western hemisphere caused the first sharp drop of the year on 21 January 2008 : (-6.83 % in Paris). Then the announcement by *Société Générale* of a 4.9 billion euro loss in the wake of fraudulent transactions by one of its traders also affected stock markets. In mid March, acquisition by JP Morgan Chase & Company of the American bank Bear Stearns caused new turbulence on the markets. Since then, stock markets have been relatively calm, as prices for raw materials soared, especially for oil, which listed 147 dollars a barrel in July.

But the situation changed suddenly in September, with the bankruptcy of Lehman Brothers and the emergency bail out of the insurance company AIG. These two events had profound financial, economic, political and social repercussions. A large number of US banks (such as Merrill Lynch) as well as European banks (Fortis, Dexia...) had to be saved from bankruptcy by their governments. Totally at sea, stock markets panicked and there were record drops and increases alternating at unprecedented volatility.

Faced with collapse of confidence in the main institutions of the international banking system, authorities in a number of countries launched an unprecedented wave of initiatives to stop the freefall in the value of assets. There was a series of official interventions at the end of September, notably suspension of short sales of financial stocks and prohibition of short positions, which helped to gain some short term recovery on equity markets.

But the announcement of more unfavourable macroeconomic results began to offset the initial impact of these official initiatives. Toward the end of October and in early November, equity markets were clearly reacting to fears of recession. Stock market indexes fell virtually everywhere in the world at a degree unknown since the 1930s, affected by negative news about profits, tougher loan conditions, and a rapid decrease in consumer confidence. By the end of November, despite new easing of monetary policy by several Central Banks, stock markets had lost a further 35% from end August levels.

In Europe, the Paris stock market's CAC 40 index finished the worst year in its history, down by 42.7%. This was almost as high as the drop in the Eurostoxx index of the 50 leading stocks in the euro zone (-44.3%), the highest annual loss ever recorded by the index since it was created in June 1988. The pan-European index FTSEurofirst 300 closed for the year down by a bit more than 44%, the worst performance in its history. The Dax index of the 30 leading German stocks plunged by 40.4%, after gains of 22% in 2007.



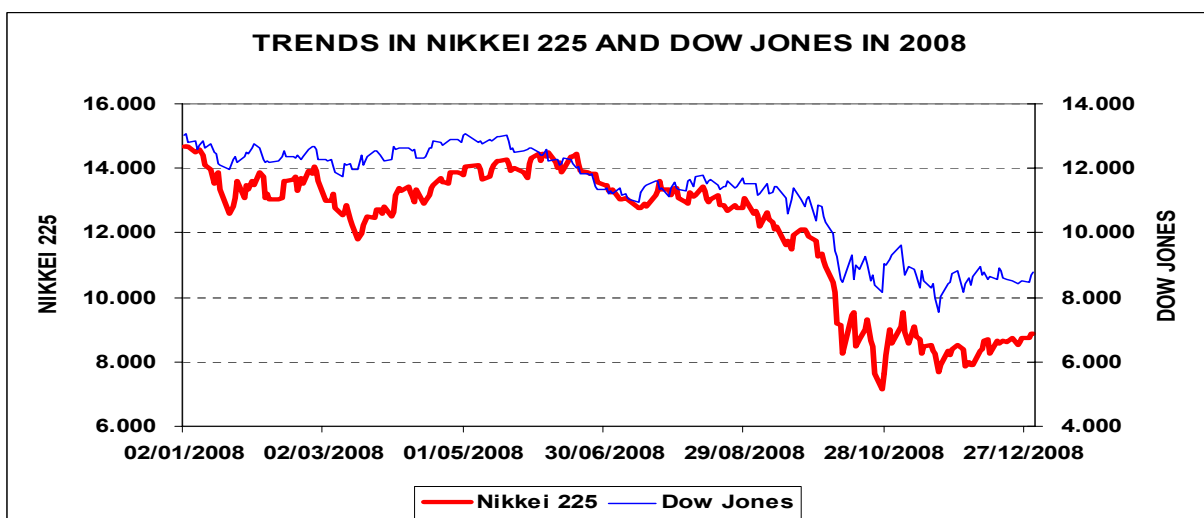
Although it managed to resist in the first half of 2008, the CAC 40 caved in starting in September, when the financial crisis took a dramatic turn for the worse, followed by signs of overall recession. It was the worst performance in the 20 years that the Parisian index has existed, victim of the economic and financial crisis that struck all categories of assets.

The London stock market's FTSE 100 index lost 31.3% of its value in 2008, the largest annual drop since it was created in 1984, another victim of the financial crisis and of the recession that weighed on corporate results.

In Iceland, the Reykjavik stock market was near bankruptcy, having lost 90% of its value.

On US markets, the three main New York indexes recorded spectacular losses. By yearend, the S&P 500 had gone down by 38.5%, the Nasdaq (with a high proportion of technology stocks) lost 40.5%, and the Dow Jones experienced its worst year since 1931 with a decrease of 34%.

US stock market indexes posted their lowest levels on 20 November 2008, in the wake of fears of severe world economic recession. When the worst unemployment figure in 16 years was announced, the S&P 500 fell to its lowest level since 1997.



A breathtaking drop of 42.1% was recorded at the end of 2008 on the Japanese stock market, the sharpest drop in 58 years.

Emerging stock markets were among those hardest hit by the crisis, with the Moscow stock market plummeting by 72%, the Shanghai market by more than 65% and the Bombay market by 52%. This situation was engendered by collapse of the world financial system and the worst world economic crisis since 1930. The Shanghai stock market's 65% loss of value in 2008 was the worst in its 18 year history, as slower economic growth burst the speculative bubble prevailing on this Chinese market, after several years of two-digit economic growth. The Shanghai stock market gained 130% in value in 2006 and 97% in 2007, with the dynamic Chinese economy attracting millions of new investors. But the overabundant supply of stocks compared to demand and uncertainty about prospects for world trade (the main motor for growth in China) caused a brutal crisis of confidence in the stock market's capitalisation. The Moscow stock market's RTS index fell by 72.4% in 2008, probably the most severe loss of all the leading world stock markets.

The main stock markets in Latin America encountered sharp drops after the crisis broke out in September. The Mexican stock market lost 24.1% in value throughout the year and the Merval index for Argentina's stock market fell by 49.9%.

TRENDS IN MAIN STOCK INDEXES

Financial centre	Index	31/12/07	31/12/08	Variation in %
Paris	CAC-40	5,614.1	3,218.0	-42.7
Frankfort	DAX-30	8,067.3	4,810.2	-40.4
London	FTSE-100	6,456.9	4,434.2	-31.3
New York	DOW JONES	13,264.8	8,776.4	-33.8
New York	Nasdaq composite	2,652.3	1,577.0	-40.5
Tokyo	NIKKEI-225	15,307.8	8,859.6	-42.1

B. BOND MARKETS

Taking advantage of its status as a safe haven as stock market prices fell (especially in the banking and automotive sectors), the climate of economic slowdown in industrialised countries and accommodating monetary policy, bond markets went up in 2008. Bond yields closed for the year (in line with high volatility on all market segments) at their lowest level.

On the US market, starting in January and under the influence of growing concern about economic prospects, US bond yields dropped sharply. The two year yield on UST bonds lost 99 base points, dropping to 2.15% on 30 January 2008, while ten year yield lost 38 base points, down to 3.65%.

Affected by market expectations of a drop in the federal fund rate to 2% by June 2008, two year US Treasury bonds began to drop in February, reaching a threshold of 1.34% mid March because of worsening conditions on the mortgage market in the wake of difficulties at Bear Stearns. Rates for 10 year US Treasury bonds, however, went up to 3.91% in February before falling to 3.30% on 17 March, losing more than 70 base points compared to the figure at the beginning of the year.

The exceptional measures taken by the Federal Reserve, notably assertive intervention in providing a bailout for Bear Stearns and a 75 base point drop in the key rate to 2.25% at its meeting of 18 March 2008 helped to achieve fragile recovery on markets and some gain in investor confidence. But publication of economic indicators that were better than expected brought about a return to risky assets. US bond yields thus began to edge up again in April, reaching their highest level for the year on 16 June 2008 at 3.04% for two year bonds and 4.28% for 10 year bonds.

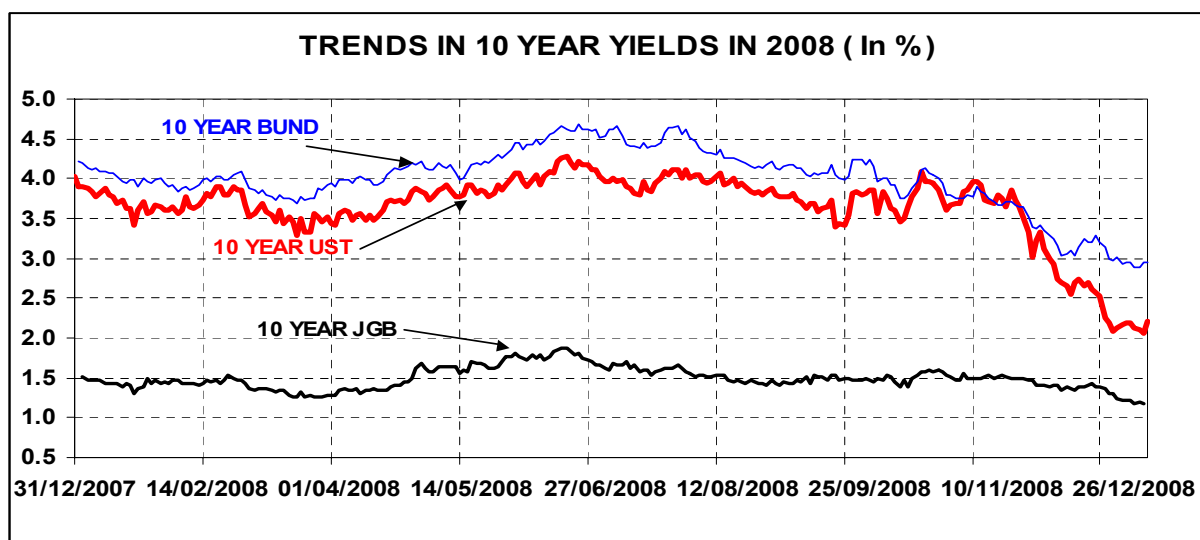
Such strong growth in yields ended in the second half of June, influenced by uncertainty about growth and expectations of higher inflation in the wake of soaring prices for oil and commodities. The Fed's decision at its meeting on 24-25 June to hold its main key rate to 2% did not have any notable effect on long term rates, which remained unchanged. But bond yields went up somewhat at mid July, affected by the various measures taken to save government-sponsored agencies, before falling anew starting on 20 August.

Deepening of the financial crisis in September and greater problems in bank refinancing (especially after US Government intervention to bail out two mortgage refinancing giants) caused greater concern in the real economy, with rate expectations diminishing and flight to quality increasing sharply. The US two year rate lost 41 base points, dropping to 1.98%, while the ten year rate slackened over the first half of the month to 3.40% before rising to 3.86% at the end of the month because of the impact on the US budget of the various support measures taken.

Energetic intervention by authorities in all developed countries starting in October in the form of bailout plans created a new phase for bond markets. In taking such action, governments shifted risk from the private sector to the banking sector by setting up a recapitalisation fund, thus putting an end to flight to quality by having long term sovereign bonds bear risk of additional credit. In effect, ten year US bonds went up by 15 base points over the end September figure to 4% per annum.

This sharp correction in stock market values in a generalised crisis of confidence and doubt about the soundness of financial institutions once again caused an investor rush to stocks considered to be the surest possible choice. The drop in yields was more marked in the US, where the 10 year UST bond lost some 100 base points, down from 3.92% to 2.92% between November 1st and November 28th, while very short term yields were near to zero. The US bond market closed for the year on an upturn, as the spectre of recession took hold in the leading industrialised economies. The 10 year rate sank in December to close at 2.21%.

On the European market, yield rates on the Bund also fell at the beginning of the year, influenced by a new wave of aversion to risk, despite lower monetary pressure in the region. Two and 10 year rates were down by 47 and 36 base points to 3.38% and 3.94% respectively. Long term yields eased off on 17 March by 62 base points compared to the figure at the beginning of the year, posting 3.68%, affected by anticipation of accommodating monetary policy by the European Central Bank. At the end of February, markets expected a drop of 25 base points in the key rate by May to 3.75%, along with a second drop of 25 base points to 3.50% by August.



Reacting to positive trends on stock markets, 10 year yields on the Bund rose by 90 base points between mid March and mid June. The trend reversed at the end of June as hopes for economic growth diminished in the wake of soaring prices for oil and commodities. Still, yields rose in mid July as bailout measures were taken by US officials.

Publication of indicators reflecting slowing of the economy in the euro zone that was more pronounced than expected in September (a drop in the manufacturing PMI index : purchasing manager's index to 45.3% instead of the expected figure of 47.3%), and spread of the liquidity crisis to European banks (bringing about the bailout or nationalisation of some) altered short term monetary expectations in favour of a quick drop in key rates and a sharp drop in short term rates.

Compared to end August, the two year Bund rate lost more than 60 base points, coming to 3.49% at the end of September. The ten year rate fell by 16 base points to 4%, then to 3.78% in October, influenced by lower expectations of inflationary pressure.

European bond markets continued on an upturn in November, in a context of negative information about the international banking sector, harsh economic prospects, and intensification of the liquidity crisis in the zone. For November, the 10 year yield on the Bund lost 54 base points, falling to 3.26%. Yields continued to fall in the final month of the year, closing for 2008 at 2.95% for 10 year bonds.

On the Japanese market, long term rates fell over the first three months of the year, losing 23 base points from the end 2007 figure, posting 1.28% for the ten year JGB. Trends reversed in the second quarter of the year, with the ten year bond reference yield coming to 1.86% in the first half of June, gaining more than 50 base points as fears about growth lessened.

Ten year yields remained stable at about 1.5% for the period July-November. They began to fall starting the end of November, influenced by flight to quality as the crisis worsened and spread, closing for the year at 1.17%. This drop in Japanese yields over the second half was however less severe than the drops in US and European yields.

Emerging markets experienced soaring margins on bond issues. With a relatively calm start to the year thanks to emerging countries being somewhat immune to the impact of the crisis, margins for international issues by these countries on secondary markets widened to reach over the first half of the year (according to the EMBI+ index) some 330 base points. This is a high 100 base points more than at the beginning of the year, influenced by high volatility on the main international stock markets and an increase in prices for raw materials (oil and agricultural products).

The bankruptcy of Lehman Brothers in mid September was the main factor affecting investor confidence and pushing up margins on international issues by emerging countries on secondary markets. In this climate, the EMBI+ index rose to 860 base points at the end of October (its highest level since 2002), an increase of more than 600 base points above the level of margins at the beginning of the year. Under the influence of falling yields for US bonds and revision by the FED on 16 December of its key rates (which somewhat encouraged investors to return to emerging stocks), margin levels fell slightly, closing for the year at some 690 base points.

To summarise, bond markets were marked in 2008 by greater volatility and by good performance especially for US bonds. 2008 was also marked by reorientation of demand from business, agency and emerging country securities to sovereign securities.

TREND IN 10 YEAR YIELDS FOR MAIN CURRENCIES

	Closure 2007	Closure 2008	Variation (bp)
Dollar	4.03	2.21	-182
Euro	4.35	2.95	-140
Yen	1.50	1.17	-33