The euro zone's international environment

The American economy returned to positive growth in Q4 2001, thanks notably to the upturn in consumption. The revival in activity was nevertheless uneven. Following very strong growth in Q1 2002 (1.2%), activity slowed down temporarily in Q2 (0.3%) before picking up again in Q3 (1.0%). Being strongly affected by fluctuations in consumption, American growth is expected to have weakened again in Q4 2002, before returning to a more customary rate. Investment is expected to pick up again gradually starting in 2003, on the back of more accommodating financial conditions and continuing strong prospects for domestic demand. Growth in activity would then return to an average of 0.7% a quarter in H1 2003.

The firmness of American growth is likely to spread rapidly to the Asian countries, notably through the latter's exports of high-tech products.

Growth in the United Kingdom is expected to stay at an average of 0.6% a quarter until Q2 2003. So far, it has mainly been underpinned by the strength of household consumption, itself boosted by the rise in house prices. Consumption is expected to continue to underpin growth in coming quarters, but its growth rate would decrease. Investment and exports are likely to pick up again gradually in 2003.

The international context in which the euro zone operates can therefore be expected, in general, to return to normal in 2003.

The easing of financial conditions should enable the United States to return to firm growth from the start of 2003

Following the recession in 2001, the American economy returned to positive growth as of end-2001. However, the American recovery has been very uneven. After posting growth rates close to those of the 1990s at the end of 2001 (0.7%) and the beginning of 2002 (1.2%), there was a marked slowdown in Q2 2002 (0.3%), before a further acceleration in Q3 to 1.0%. This seesaw growth pattern is partly explained by the fluctuations in consumption — around a firm growth rate — since the end of 2001. Moreover, investment, after declining throughout 2001, failed to pick up again in 2002. Tougher financial conditions held back its recovery, meaning that it was unable to provide backing for consumption in underpinning growth. Corporate capital expenditure nevertheless stopped falling as of Q2 2002.

GDP IN LEADING INDUSTRIALISED COUNTRIES OUTSIDE THE EURO ZONE
(share of countries in oecd total)

(Annual and half-yearly % change)

	Half-yearly % change								Annual average		
	2001		2002				2003		2001	2002	2003 (c.o)
	H1	H2	H1	H2	H3	H4	H1	H2			
UNITED STATES (34.0%)											
GDP	-0.1	0.7	1.2	0.3	1.0	0.3	0.6	0.8	0.3	2.4	2.0
Imports	-3.1	-1.4	2.1	5.1	0.6	0.6	0.6	1.9	-2.9	3.3	4.1
Private consumption	0.4	1.5	0.8	0.4	1.0	0.4	0.7	0.7	2.5	3.1	2.2
Public expenditure *	-0.3	2.5	1.4	0.3	0.8	0.6	0.6	0.6	3.7	4.3	1.9
Total private GFCF	-1.1	-2.3	-0.1	-0.3	0.0	0.0	0.6	1.2	-3.8	-3.3	1.4
Exports	-4.6	-2.5	0.9	3.4	0.8	0.0	-0.9	1.8	-5.4	-1.4	1.7
Contributions : Domestic demand excluding stocks	*0.0*	*1.1*	*0.8*	*0.3*	*0.8*	*0.4*	*0.7*	*0.8*	*1.7*	*2.4*	*2.1*
Stock change	*0.0*	*-0.3*	*0.6*	*0.3*	*0.1*	*0.0*	*0.1*	*0.1*	*-1.2*	*0.7*	*0.4*
Foreign trade	*-0.1*	*-0.1*	*-0.2*	*-0.4*	*0.0*	*-0.1*	*-0.2*	*-0.1*	*-0.2*	*-0.7*	*-0.5*
UNITED KINGDOM (5.6%)											
GDP	0.3	0.2	0.1	0.6	0.8	0.5	0.6	0.6	2.0	1.6	2.0
Imports	-2.3	0.3	1.4	0.6	-0.7	1.0	0.7	0.5	2.8	0.3	1.6
Private consumption	1.0	1.1	0.5	1.4	0.8	0.7	0.6	0.3	4.1	3.7	2.1
Public consumption	2.7	1.8	2.9	-2.7	1.3	1.0	1.0	1.0	3.1	4.1	2.5
Total private GFCF	-0.9	-3.2	-1.6	-0.1	-2.0	0.0	0.5	0.5	0.3	-5.5	-0.2
Exports	-3.2	-1.6	-0.1	3.5	-1.7	0.0	0.4	0.6	1.2	-0.9	0.8
Contributions : Domestic demand excluding stocks	*1.1*	*0.5*	*0.6*	*0.4*	*0.5*	*0.7*	*0.7*	*0.5*	*3.3*	*2.2*	*1.9*
Stock change	*-0.5*	*0.3*	*0.1*	*-0.7*	*0.6*	*0.2*	*0.1*	*-0.1*	*-0.6*	*-0.2*	*0.5*
Foreign trade	*-0.2*	*-0.6*	*-0.6*	*0.9*	*-0.3*	*-0.4*	*-0.1*	*0.0*	*-0.7*	*-0.4*	*-0.3*

Forecast
* Public consumption and investment

American growth is thought to have slowed down again in the final part of the year, to 0.3%, but is then expected to return to firm growth in the first two quarters of 2003, of the order of 0.7% a quarter, thanks notably to the easing of financial conditions. For the whole of 2002, growth is put at 2.4%.

In Q4 2002, consumption is thought to have slowed down substantially, bringing its growth rate to levels more compatible with the evolution in households' financial wealth. This was severely affected in Q3 2002 by the steep fall in equity prices (21% between May and October 2002 — *see graph 1*). In addition, there are temporary factors explaining the high level of consumption growth in Q3 and these are not expected to have as favourable an impact in the final part of the year:

The impact of the tax cuts on consumption is tending to peter out. The sharp declines in the apparent income tax rate in Q3 2001 and Q1 2002 *(see graph 2)* have now been built into American households' behaviour, with the result that they can no longer be expected to bring about any notable increase in the consumption growth rate in Q4 2002.

There is no possibility for the three large American car firms (Ford, Chrysler and General Motors) to increase their sales. The financing rate offered to private buyers in Q3 was already down to 0% and prices are running up against the limits of the producers' mark-ups. In these circumstances, there is likely to have been a sharp fall in car purchases in Q4. The result would be to reduce growth in total consumption by almost 0.2 of a point in Q4 2002, after having raised it by 0.5 of a point in Q3 *(see box 1)*.

The 50-basis-point cut in interest rates carried out in November was less substantial than those made towards the end of 2001 (175 basis points). The additional liquidity generated by the refinancing of mortgage-backed loans can therefore not be expected to have as great an impact as at the beginning of 2002.

Companies, meanwhile, are likely to cope with difficult financing conditions as a result of the climate of mistrust generated by the numerous examples of fraudulent accounts. Their balance sheets have been severely weakened by the fall in equity prices, which has led all lenders to harden their terms. As a result, the interest-rate spread between corporate bonds and government bonds, representing the risk premium demanded by the lenders, has risen sharply in Q3 *(see graph 3)*. The interruption in the fall in stock-market prices in October and the rate cuts introduced by the Fed in November can be expected to ease financial conditions only after a certain timelag, not before 2003. Facing constraints on the credit markets, firms also find themselves short of the internal resources needed to finance their investment spending and re-stocking, as corporate profit growth remains depressed despite the improvement in Q3 *(see graph 4)*. The contribution of investment to growth is therefore likely to be zero in Q4, as in the three previous quarters. The same can probably be said of inventory changes, following a steady fall during the first three quarters of 2002.

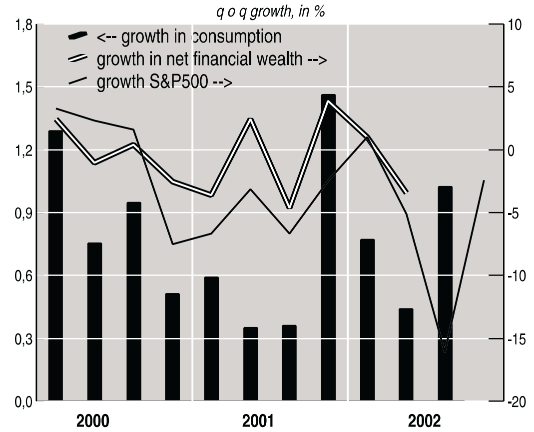
A major feature of foreign trade is likely to be a slowdown in exports, mainly because of the low growth expected in the euro zone until the end of Q1 2003. Exports would then pick up again in Q2, as growth in the euro zone recovers.

As of Q1 2003, the easing of financial conditions would reverse the cautious corporate behaviour as regards investment and inventories. Investment and inventories would accordingly make positive contributions to growth in the first two quarters of 2003.

1

CONSUMPTION, FINANCIAL WEALTH AND S&P 500

q o q growth, in %

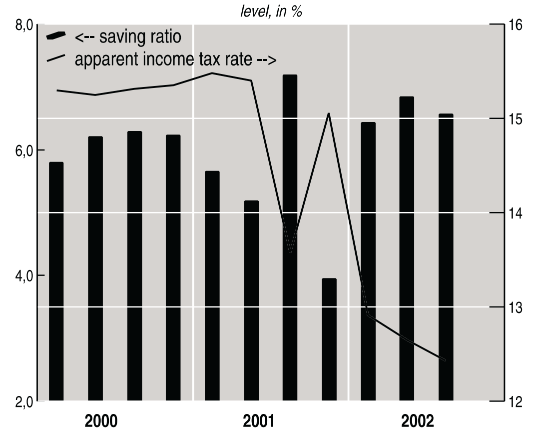


source : BEA, FRB et WEFA

2

SAVING RATIO AND APPARENT INCOME TAX RATE

level, in %



source : BEA

This less restrictive behaviour could also be encouraged by the introduction of new tax measures in favour of firms.

The interruption to the fall in equity prices starting in October can be expected to encourage consumption after a certain time lag, in Q1 and Q2 2003 *(see graph 1)*. This is because the fall in equity prices exerted a negative financial wealth effect on consumers in 2002, an effect which was then compensated by a positive real-estate wealth effect and by the above-mentioned temporary factors. The stabilisation of stock-market prices means that this negative financial wealth effect can be expected gradually to fade. The household confidence indicators relating to the general situation in fact stopped falling in November *(see graph 5)*. The rate cuts decided by the Fed in November also reduced the interest rates applied to consumer credit, and this should have a positive effect on consumption in 2003.

In the United Kingdom, the dynamism of private consumption likely to be replaced by that of investment, foreign trade and public expenditure

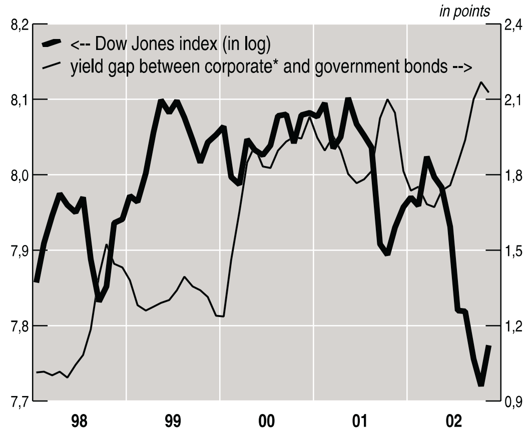
In the first three quarters of 2002, the mainstay of United Kingdom growth was household consumption *(see graph 6)*. The continuous rise in house prices (10.4%, semester on semester, in H1) made a major contribution to the increase in households' resources by stimulating the granting of loans, which rose by 13.1% during the first three quarters. The strength of the housing market provides a stimulus to the granting of loans in that housing assets are often used as collateral by British households (in what is known as "mortage equity withdrawal").

At the same time, investments were making a negative contribution to growth. The gloomy outlook for activity revealed by business surveys, the continuing

3

STOCK-MARKET INDEX AND SPREAD BETWEEN CORPORATE BONDS AND GOVERNMENT BONDS

in points

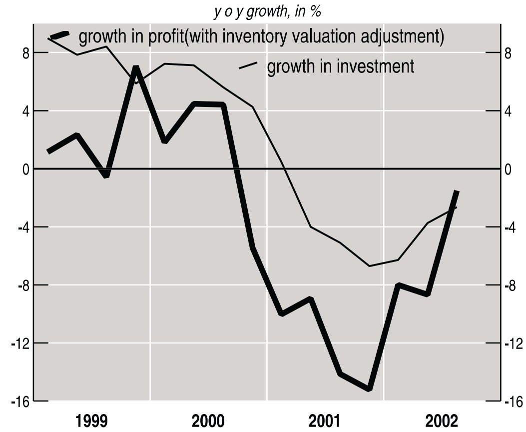


source : WEFA, FRB
** it is companies listed BBB*

4

INVESTMENT AND CORPORATE PROFITS

y o y growth, in %

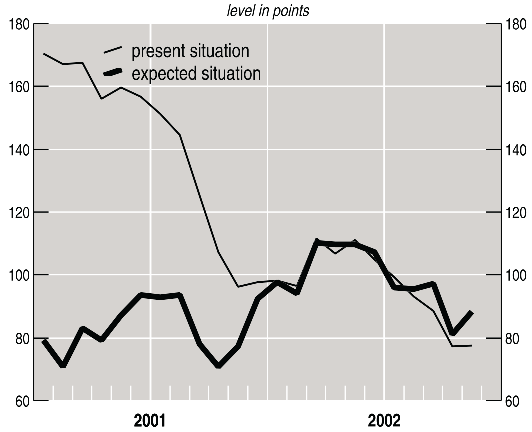


source : BEA

5

CONFERENCE BOARD INDICES OF CONSUMER CONFIDENCE

level in points

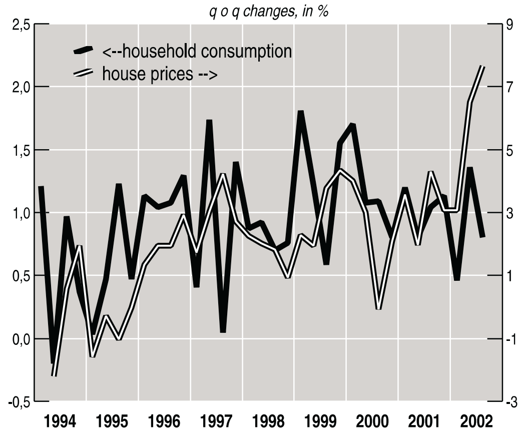


source : Conference Board

6

HOUSEHOLD CONSUMPTION AND HOUSE PRICES IN THE UNITED KINGDOM

q o q changes, in %



source : Nationwide Building Society et ONS

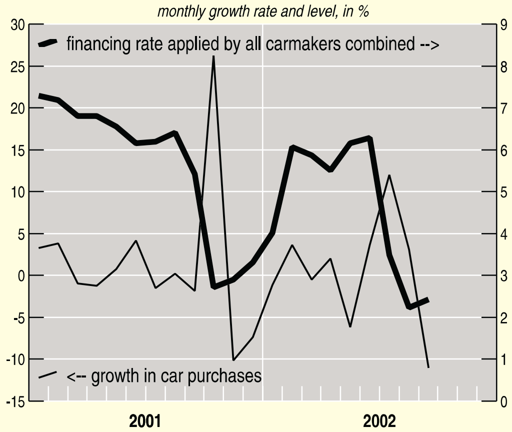
BOX 1 : SHARP FALL IN UNITED STATES CAR PURCHASES EXPECTED IN Q4 2002

In July 2002, the large American car-makers launched promotions based on financing at zero interest rate. Measures of this kind had already been offered in October 2001. These incentives substantially increased car sales during these two months *(see graph)*. Sales were then smaller in the following months, given that the promotions were of limited duration. In terms of quarterly growth rate, the impact was particularly marked in Q4 2001 (+13%), being followed by a steep decline in Q1 2002 (-8%). On the lines of the 2001 experience, car purchases are likely to show a similar steep decline in Q4 2002.

Despite the relatively small weighting of cars in total consumption (5%), these fluctuations, because of their amplitude, had a substantial impact. In Q4 2001 and Q1 2002, growth in car purchases accounted respectively for +0.6 of a point (= 5% x 13%) and -0.4 of a point (= 5% x -8%) of total consumption growth (1.4% and 0.8%, respectively). Similarly, growth in car purchases in Q3 2002 explained +0.5 of a point of growth in total consumption of 1.0%. It should continue to make a negative contribution to growth in total consumption in Q4 2002.

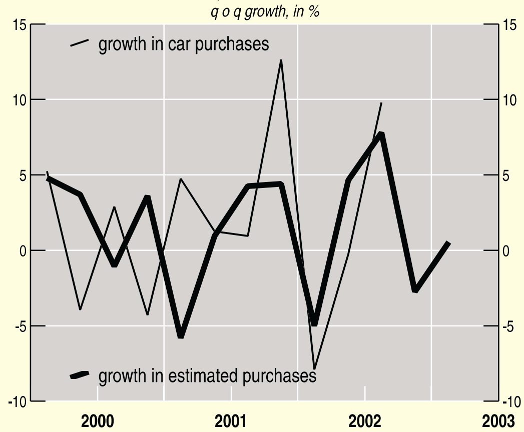
An econometric equation for car purchases has been estimated in order to assess the scale of this contraction. In this, purchases depend on disposable income and the financing rate proposed by the carmakers. An error-correction model is used for the relationship between the short term and the long term, meaning that the estimation brings in previous values of the variables in terms of level and difference.

CONSUMPTION AND FINANCING RATE OF CAR LENDING
monthly growth rate and level, in %



source : BEA, FRB

CAR PURCHASES, OBSERVED AND ESTIMATED
q o q growth, in %



source : BEA, calculations by Insee

As a forecasting model, this equation shows the peak in consumption at the end of 2001, the decline at the beginning of 2002 as well as the peak in Q3 2002 *(see graph)*. It forecasts a fall in growth of car purchases of the order of 3% in Q4 2002, making a negative contribution of 0.2 of a point to total consumption. ■

$$\underset{(0,1)}{DLCAUTO = -0{,}4} - \underset{(0,08)}{0{,}25} \times DLCAUTO\{-1\} + \underset{(0,5)}{2{,}0} \times DLRDB + \underset{(0,5)}{1{,}4} \times DLRDB\{-1\} - \underset{(0,005)}{0{,}026} \times DR$$

$$- \underset{(0,05)}{0{,}15} \times \left(LCAUTO\{-1\} - 0{,}97 \times LRDB\{-1\} + 0{,}02 \times R\{-1\}\right)$$

$R^2 = 0{,}40$

Figures in brackets show the standard deviations of the estimated coefficients.

Estimation carried out for the period Q4 1971- Q3 2002

DLCAUTO = growth rate of car purchases (in volume)
DLRDB = growth rate in the purchasing power of gross disposable income
DR = change in the financing rate applied by carmakers
LCAUTO = log car purchases (in volume)
LRDB = log purchasing power
R = financing rate applied by carmakers lagged by one quarter.

need to absorb the accumulation of surplus capital begun in 2001 and the deterioration in financing conditions had an adverse effect on private investment.

Up to the end of 2002, private consumption seems to have been the principal growth motor, with its strength still boosted by house prices, having risen by 23% for the year as a whole according to Nationwide Building Society figures.

At the same time, household consumption has not had to suffer the impact of a slowdown in income growth *(see graph 7)*. The slowdown seen in the industrial sector for more than a year has done little damage to the labour market. It was in fact mainly the structure of the market that changed, with the manufacturing and financial sectors losing jobs at a time when recruitment was being stepped up in the public sector and in building. Between July and October, the unemployment rate therefore remained stable, as did wage growth.

The present rate of the rise in house prices seems impossible to maintain, however, and a weakening has been seen since September. This slowdown should not affect the growth rate for private consumption before Q1 2003. This is because consumers' confidence regarding their financial positions is still at peak levels and the rapid growth in borrowing is foreshadowing continuing firm growth in spending until the end of 2002.

In the early part of 2003, the high household indebtedness ratio (currently 111% of disposable income), combined with a slowdown in house prices, can be expected to hold back consumer spending.

Investment, by contrast, both by firms and by general government, should gradually return to making a positive contribution. Business leaders' expectations have been more favourable since January 2002, following the gloom shown throughout 2001. Investment in the United Kingdom should also benefit from the relaxation of general financing conditions.

Export demand can be expected to recover as of the beginning of next year. The upturn in the American economy in Q1, compounded by that of the euro zone in Q2, can be expected to boost United Kingdom exports *(see graph 8)*.

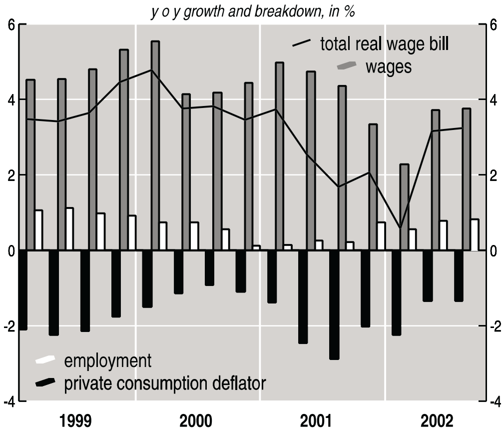
On the same lines as public investment, other government spending can be expected to have continued to rise until the end of 2002 and this growth should persist in 2003. This is because of the major programme launched by the government to restructure the healthcare system.

All in all, the United Kingdom economy should show quarterly growth of close to 0.6% until the end of H1 2003.

7

TOTAL REAL WAGE BILL IN THE UNITED KINGDOM

y o y growth and breakdown, in %

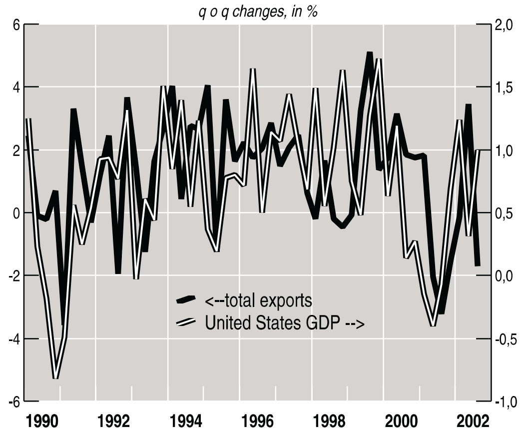


source : ONS

8

UNITED KINGDOM EXPORTS OF GOODS AND SERVICES AND UNITED STATES GDP

q o q changes, in %

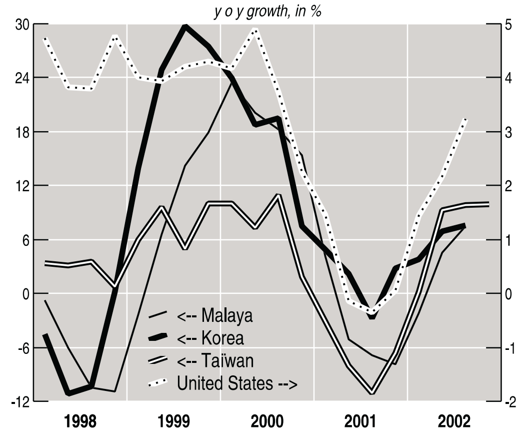


source : BEA ET ONS

9

INDUSTRIAL PRODUCTION INDEX IN ASIA AND UNITED STATES GDP

y o y growth, in %



source : WEFA

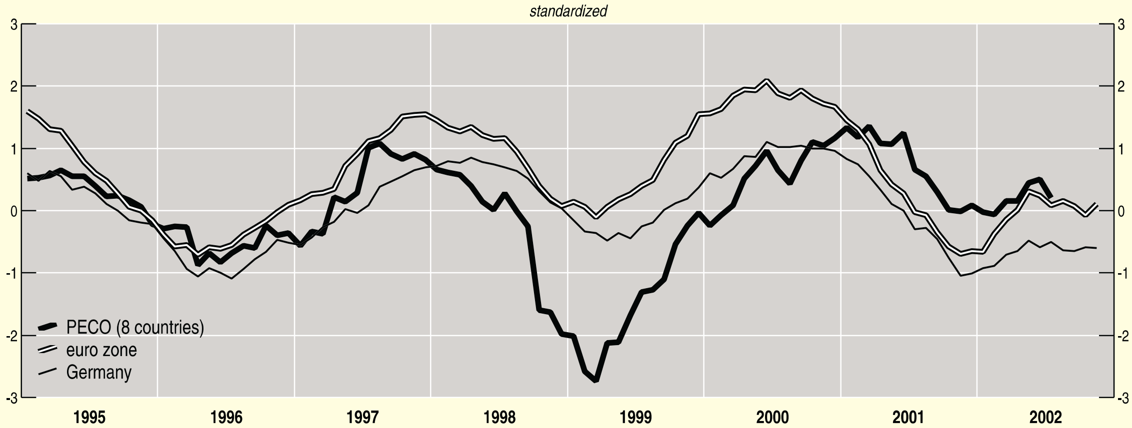
BOX 2: THE SYNCHRONISATION OF THE BUSINESS CLIMATES IN THE CEEC AND THE EURO ZONE

Ten countries, including eight Central and Eastern European countries (CEEC), are due to make their entry into the European Union at the beginning of 2004. In 1999, the GDP of these countries was equivalent to 4.2% of that of the euro zone. The use of business surveys that are harmonised at European level for the eight (Poland, Czech Republic, Hungary, Slovakia, Slovenia, Estonia, Lithuania and Latvia) makes it possible to construct a business climate indicator for this zone. The methodology is that governing the construction of an indicator for the euro zone, enabling a preliminary comparison to be made of the activity cycles in these two zones.

The business climates of the CEEC and the euro zone turn out to have been in phase with one another up to mid-1997. From Q3 1997 to Q3 1998, there was a first uncoupling of the CEEC business climate from that of the euro zone, corresponding to the impact of the Asian crisis. A second more marked uncoupling emerged in Q3 1998 with the crisis in Russia. From 2000 on, the business climate in the CEEC tracks the turning-points of that of the euro zone, with a lag that diminishes over time.

This cyclical synchronisation can be attributed to the substantial bilateral trade between the two zones. On average, the CEEC send 60% of their exports to the euro zone, with this trade transiting mainly through the three countries marking the inter-zonal frontier: Germany, Austria and Italy. Germany, in particular, absorbs a substantial proportion of CEEC output, and this may explain the slight time-lead in the evolutions in German imports in relation to the economic climate in the industry of the candidate countries. ■

COMPOSITE INDICATORS OF THE BUSINESS CLIMATE
standardized



source : European Commission, calculations by Insee

Asia and the CEEC countries likely to see their growth move in parallel with those of the United States and the euro zone respectively

Trend growth in most of the Asian countries (apart from Japan) is higher than in the Western economies. The economic situation in the Asian countries is likely to continue to track that of the United States *(see graph 9)*. They can therefore be expected to be affected by the slowdown in American growth towards the end of 2002 before picking up again in 2003. Meanwhile, the Central and Eastern European countries (CEEC) are in a catch-up phase vis-à-vis the economies of the European Union and their economic situation is similarly mainly dependent on that of the euro zone *(see box 2)*. ■

The economic situation in the euro zone

The first two quarters of 2002 saw activity in the euro zone grow at a modest rate (0.4% and 0.3% respectively). After again rising by 0.3% in Q3, activity then is likely to slow down to 0.1% in Q4 2002. This means a rise of 0.7% for the year 2002 as a whole. In Q1 2003, growth is expected to continue to remain slow, before picking up in Q2 (0.4%). This overall situation is likely to mask substantial disparities between countries. In particular, the situation would be more depressed in Germany than in France because of the relative slackness of private consumption.

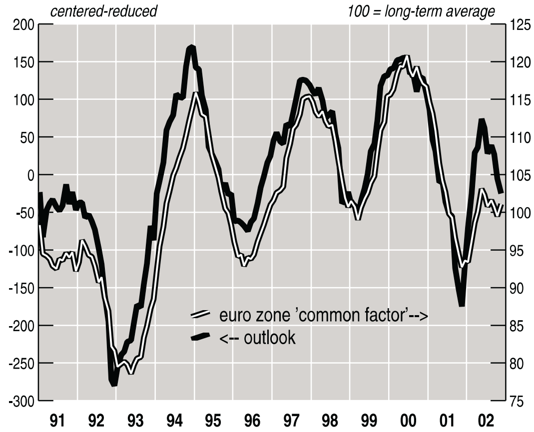
In H1 2002, business leaders' expectations temporarily picked up and inventory behaviour was reversed. However, financing conditions deteriorated sharply during the summer, notably as a result of the slide in stock-market prices. At the same time, business leaders' expectations turned down again before investment had had time to recover. Within the time-horizon of the forecast, the labour market is expected to remain very depressed and private consumption slack, with an average rise of 0.2% per quarter. Against a background of lacklustre domestic demand and despite positive signals towards the end of the year, investment is unlikely to revive before Q2.

Activity is expected to pick up again in Q2 2003. This recovery would be due to a revival of growth in the United States and the easing of financial conditions worldwide. These two factors would contribute to a turnaround in corporate demand, with inventory behaviour turning positive and investment slowly picking up again.

Following the recession seen during 2001, European industry picked up at the beginning of 2002. In the manufacturing sector, the business climate underwent an appreciable improvement until May. This revival in confidence was reflected in an upturn in output, with the industrial production index rising in H1 at an annualised rate of close to 2%. However, a deterioration in the economic climate took place in June, with a marked downturn in the outlook for production *(see graph 1)*. This deterioration was reflected in Q3 in a decline of 0.1% in the industrial production index. The worsening of the economic climate involved all sectors of the economy, but especially retailing and construction. In Spain, the outlook for industry went into reverse somewhat later than the other countries, i.e. in September.

1

BUSINESS LEADERS' EXPECTATIONS IN THE EURO ZONE
MANUFACTURING INDUSTRY



The gloomy assessments made by business leaders up to October mean that there is little prospect of any distinct recovery in activity before the end of the year. However, business surveys in November showed a halt to the deterioration in the climate, coinciding with an improved tendency in financial conditions and foreshadowing an upturn in growth. The low growth in domestic demand expected in H1 2003 nevertheless suggests that any growth will be merely moderate within this time-horizon.

Corporate demand set to remain depressed until Q1 2003

In H1 2002, the very distinct improvement in expectations in manufacturing industry, boosted by the encouraging signs regarding world demand in the early part of the year, prompted firms to adopt a less restrictive behaviour regarding their inventories. The contribution of inventory changes to GDP growth, after being temporarily positive in H1 2002, turned negative again in Q3. This behaviour is thought to have continued in Q4 2002 and is expected to do so in Q1 2003, with a small negative contribution to GDP growth (of 0.1 of a point each quarter).

In the case of investment, the early part of 2002 saw firms continue to hold back projects in view of the weakness of domestic demand. Investment in capital goods maintained a negative tendency close to that already seen at the end of 2001 (-5%). The phenomenon was particularly noticeable in Germany, Italy and the Netherlands.

The decline in business leaders' expectations during the summer again had a negative impact on investment in Q3. Productive investment in Germany and in France, in particular, continued to decrease during the summer. In Italy, on the other hand, anticipation of the ending of incentive tax measures led firms to invest on a massive scale, making it possible for total euro-zone investment not to show a fall. For the end of 2002 and the early part of 2003, the halt to the deterioration in industrial leaders' expectations in November and the improvement in financing conditions should permit a recovery in corporate spending, albeit only extremely gradual. The recent tendencies in business leaders' opinions regarding their productive capacity show that this is still sufficient to meet the demand *(see graph 2)*. The appreciation of the euro versus the dollar since June is likely to handicap European export competitiveness. In particular, domestic demand seems set to remain slack in euro-zone countries, and more particularly in Germany. Furthermore, in the German case the tightening of loan conditions has been particularly marked because of the difficulties experienced by the banking system and could have a further negative effect on firms' behaviour. Although investment seems to have recovered in Germany in Q4 2002 following the additional spending brought on by the floods *(see box)*, it is likely still to be on a negative

GDP FOR THE EURO ZONE AND FOR THE MAIN MEMBER COUNTRIES

(annuals and quarterly % change)

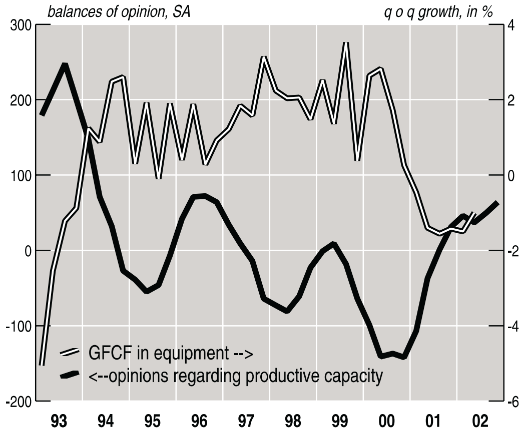
	Quarterly changes								Annual changes		
	2001		2002				2003		2001	2002	2003 (c.o)
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GERMANY											
GDP	**-0.2**	**-0.3**	**0.3**	**0.2**	**0.3**	**0.0**	**-0.1**	**0.2**	**0.7**	**0.2**	**0.2**
Imports	-2.0	-0.6	-3.0	1.4	2.8	0.7	0.0	0.7	1.3	-2.0	2.8
Household consumption	-0.2	-0.5	-0.6	0.1	0.5	0.1	-0.1	0.0	1.6	-0.5	0.2
Public consumption	-0.1	0.3	0.8	0.7	0.1	0.0	-0.1	-0.1	0.8	1.6	0.0
Total GFCF	-1.7	-1.3	-1.9	-3.0	-0.5	0.4	-0.7	0.1	-4.9	-6.5	-1.4
Exports	0.9	-1.0	0.5	1.1	2.7	0.5	0.5	1.0	5.4	2.4	3.2
Contributions:											
Domestic demand ex. stocks	*-0.5*	*-0.5*	*-0.6*	*-0.4*	*0.2*	*0.1*	*-0.2*	*0.0*	*0.0*	*-1.4*	*-0.1*
Inventory change	*-0.7*	*0.3*	*-0.2*	*0.6*	*0.0*	*-0.1*	*-0.1*	*0.1*	*-0.6*	*0.1*	*0.1*
Foreign trade	*1.0*	*-0.2*	*1.1*	*-0.1*	*0.1*	*0.0*	*0.2*	*0.1*	*1.4*	*1.5*	*0.3*
ITALY											
GDP	**0.0**	**-0.2**	**0.1**	**0.2**	**0.3**	**0.1**	**0.1**	**0.3**	**1.8**	**0.3**	**0.6**
Imports	-2.6	-1.3	-0.1	3.6	2.9	0.5	0.3	0.8	0.2	2.2	3.6
Household consumption	-0.4	0.1	-0.1	0.3	0.5	0.3	0.2	0.2	1.1	0.4	0.9
Public consumption	0.3	0.5	0.4	0.4	0.3	0.3	0.3	0.3	2.3	1.5	1.0
Total GFCF	-0.2	-0.1	-2.2	-0.1	2.8	-0.3	-0.3	0.1	2.4	-1.0	0.9
Exports	-2.5	-0.6	-2.0	3.7	3.2	0.5	0.5	1.0	0.8	0.5	4.1
Contributions:											
Domestic demand ex. stocks	*-0.2*	*0.1*	*-0.4*	*0.2*	*0.9*	*0.2*	*0.1*	*0.2*	*1.6*	*0.3*	*0.9*
Inventory change	*0.2*	*-0.5*	*1.2*	*-0.1*	*-0.8*	*-0.1*	*-0.1*	*0.0*	*0.0*	*0.5*	*-0.5*
Foreign trade	*0.1*	*0.3*	*-0.7*	*-0.2*	*0.0*	*0.0*	*0.1*	*0.1*	*0.2*	*-0.5*	*0.2*
SPAIN											
GDP	**1.0**	**0.0**	**0.5**	**0.5**	**0.8**	**0.3**	**0.3**	**0.8**	**2.7**	**2.0**	**1.6**
Imports	-2.0	0.6	-0.7	0.1	3.9	0.6	0.6	1.5	3.5	1.0	4.2
Household consumption	0.3	0.6	0.4	0.2	0.2	0.1	0.1	0.3	2.5	1.6	0.5
Public consumption	0.8	0.8	0.7	0.8	0.9	0.8	0.7	0.8	3.1	3.1	2.6
Total GFCF	0.9	-1.5	0.8	0.9	1.3	0.5	0.5	1.5	3.2	1.7	2.9
Exports	-0.1	-1.0	-1.9	1.8	5.1	1.0	1.0	2.0	3.4	1.5	6.3
Contributions:											
Domestic demand ex. stocks	*0.6*	*0.1*	*0.6*	*0.5*	*0.6*	*0.3*	*0.3*	*0.7*	*2.8*	*1.9*	*1.5*
Inventory change	*-0.2*	*0.4*	*0.3*	*-0.5*	*-0.1*	*-0.1*	*-0.1*	*0.0*	*0.0*	*-0.1*	*-0.4*
Foreign trade	*0.6*	*-0.5*	*-0.3*	*0.5*	*0.3*	*0.1*	*0.1*	*0.1*	*-0.1*	*0.1*	*0.6*
ZONE EURO											
GDP	**0.2**	**-0.3**	**0.4**	**0.3**	**0.3**	**0.1**	**0.1**	**0.4**	**1.4**	**0.7**	**0.7**
Imports	-1.4	-1.4	-0.9	1.4	2.2	0.5	0.4	0.9	1.4	-0.7	2.9
Household consumption	0.1	0.0	-0.2	0.2	0.5	0.2	0.2	0.2	1.8	0.5	0.8
Public consumption	0.4	0.4	0.9	0.8	0.3	0.4	0.4	0.4	1.9	2.4	1.3
Total GFCF	-0.7	-0.9	-1.0	-1.2	0.0	-0.1	-0.3	0.4	-0.7	-3.1	-0.4
Exports	-0.2	-1.3	0.0	1.6	2.2	0.5	0.5	1.0	2.8	1.0	3.1
Contributions:											
Domestic demand ex. stocks	*0.0*	*-0.1*	*-0.1*	*0.0*	*0.3*	*0.2*	*0.1*	*0.3*	*1.3*	*0.1*	*0.6*
Inventory change	*-0.3*	*-0.1*	*0.2*	*0.1*	*-0.1*	*-0.1*	*-0.1*	*0.1*	*-0.4*	*0.0*	*-0.1*
Foreign trade	*0.4*	*0.0*	*0.4*	*0.1*	*0.1*	*0.0*	*0.1*	*0.1*	*0.5*	*0.6*	*0.2*

Forecast

Last update : December 11th 2002.

2

GFCF IN EQUIPMENT AND OPINIONS REGARDING CAPACITY



sources : EUROSTAT, European Commission

path in the early part of next year. As a result, total investment in the euro zone is unlikely to return even to a slightly positive rate as of next spring.

Household demand likely to remain weakened by the deterioration on the labour markets

During H1 2002, household demand, via the employment situation and the rise in unemployment, has suffered from the weakness of corporate activity. However, in Q3 the growth in private consumption picked up appreciably to 0.5%, with household income boosted by exceptional measures in France and Germany: in France, the fall in the rate of income tax and in Germany the substantial payment of family benefits. In Q4 2002 and Q1 2003, the unfavourable tendencies on the labour market are likely to

CAN THE REPERCUSSIONS OF THE FLOODS ON GDP GROWTH BE QUANTIFIED?

The overflow of the Danube and the Elbe in the summer of 2002 caused substantial material damage, especially in East Germany. The net spending involved in the repair of the flood damage is put at 13.5 billion euros, according to the independent report by the six German institutes, this sum being spread over 2002 and 2003. The German government has announced that it would allocate 7.1 billion euros to repairing the flood damage. On top of this figure, there would be the compensation paid by the insurance companies to the victims, as well as private donations.

The German economy should therefore benefit from «additional activity» (in relation to an initial very depressed situation, meaning that it would be somewhat less so in the final analysis) via investment and consumption in the winter of 2002-2003. Investment would be increased, stimulated by the public construction investment needed to make good the many infrastructure works that have been destroyed (see table). This additional activity would be one-off in nature and mainly concentrated on the second half of 2002 and the first half of 2003. This would in fact still leave the construction sector in a state of overcapacity.

In relation to GDP *(see table)*, the total contribution made by this additional spending would be greatest in Q4 2002 (+0.6 of a point). The contributions to GDP growth would thereafter be negative in Q1 2003, since the expenditure would be lower than in Q4 2002.

The timetable[(1)] for the repercussions of this additional spending on the GDP growth rate is nevertheless difficult to establish. Previous contributions therefore have to be interpreted with caution.

(1) The floods having taken place in August, the assumption regarding the breakdown of spending in H2 2002 is one-third in Q3 and two-thirds in Q4. For the following half year, the spending is also broken down by quarter.

Moreover, while the additional expenditure will in the short term act as a re-stimulus, the final impact will be limited inasmuch as the public monies made available for aid to reconstruction will be largely financed out of taxes. The tax cuts in favour of households initially planned for 2003 have been adjourned and the government has announced substantial tax increases on firms (increase in the rate of corporation tax, flat-rate tax of 15% on capital gains from share disposals, on rented property, etc.). The positive effect on consumption and investment from the higher spending would first be partly offset by these tax adjustments. Moreover, the expenses linked to the floods can be expected in part to be a substitute for other household spending, with the result that the real repercussions on activity could turn out to be smaller than as calculated above. ■

Net expenditure linked to the repairs to the damage caused by the August 2002 floods

(billion euros)

	2002	2003		Total
	H2	H1	H2	
Private consumption	1,0	0,8	-	1,8
Construction	-	-	-	-
Housing	1,5	1,6	0,4	3,5
Firms	0,7	1,1	0,5	2,3
Public administration	1,4	2,2	0,8	4,4
Other investment	0,5	0,7	0,3	1,5
Total investment	4,1	5,6	2,0	**11,7**
Total	5,1	6,4	2,0	**13,5**

source: report by the six institutes dated 22 October 2002.

Contributions to the GDP growth rate

(in %)

	2002		2003	
	Q3	Q4	Q1	Q2
Private consumption	0,1	0,1	0,0	0,0
Total investment	0,2	0,5	-0,1	0,0
Total contribution	0,3	0,6	-0,1	0,0

handicap growth in private consumption (bringing it to 0.2% per quarter). In Germany, the rises in taxes and social insurance contributions anticipated by households are likely to mean that private consumption is more depressed than in the other European countries. All things considered, private consumption in the euro zone seems likely to have risen by 0.5% in 2002 on an annual average basis, a marked slowdown compared with 2001.

In September 2002, there were almost 11.5 million job seekers in the euro zone, 350,000 more than in December 2001. The number rose steadily throughout the year at a moderate rate. As a result, the euro-zone unemployment rate stood at 8.4% in October as against 8.1% in October 2001 *(see graph 3)*. Individual country situations, with the exception of Italy, have converged as regards the deterioration on the unemployment front. In Germany unemployment has been increasing since the winter of 2001, whereas in Spain, the Netherlands and Belgium, the process began only in Q4 2001. By contrast, the Italian unemployment rate has continued to decrease in the early part of 2002, to stand at 9.0% in July (latest available figure).

This phenomenon has had an adverse effect on household confidence, which has been in marked decline since June in the euro zone. The saving ratio could therefore rise for precautionary motives and hold back consumption in coming quarters.

The employment situation has been deteriorating in the euro zone for more than a year now. In H1 2002, an appreciable slowdown in job creation was to be seen in France and Spain, and total numbers employed actually declined in Belgium and Germany.

The continuation of the overall slowdown in the economy is likely to continue to restrict employment in H2 2002 as well as in the early part of 2003. This would mean that the total wage bill remains under pressure, restricting private consumption until Q2 2003. The tendency for prices to slow down in the early part of 2003 would be insufficient to compensate for this evolution.

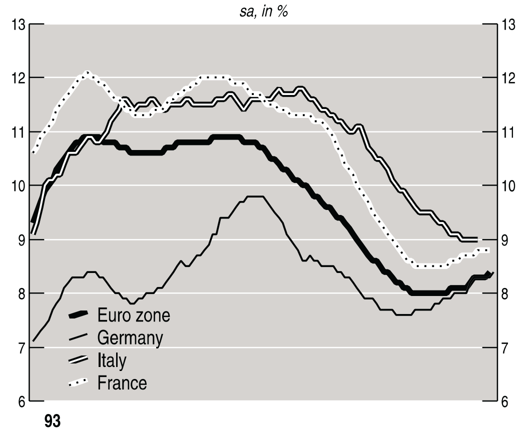
Until Q1 2003, foreign trade is likely to suffer from the past slowdown in the world economy.

In fact, exports are thought to have weakened in Q4 2002, in view of the past slowdown in world demand and the negative effects associated with the impact on competitiveness of the recent appreciation of the euro. Exports are likely to remain weakened for these reasons until Q1 2003.

3

UNEMPLOYMENT RATE

sa, in %



source: Eurostat

As a direct consequence of the slackness of domestic demand, euro-zone imports (including intra-zone trade) is likely to have declined on an annual average basis in 2002 that stance. They are thought to have stagnated in Q4 and are expected to do so in Q1 2003 as well.

All in all, foreign trade is likely to continue to make a positive contribution to GDP growth.

External demand and an easing of financing conditions likely to permit an upturn in activity in Q2

An upturn in activity could well take place in Q2 2003, with GDP growth putting on 0.4%. This upturn would be encouraged by a recovery in world demand, driven by more dynamic growth in the United States.

At the same time, more favourable financing conditions should permit a recovery in investment in Q2. The decline in monetary interest rates, combined with that of corporate risk premiums, should result in an easing of financing conditions.

Private consumption seems set to remain handicapped by the past erosion of growth in nominal incomes. Furthermore, with the acceleration in activity being transmitted to the labour market only after a certain timelag, these positive effects would not have immediate repercussions on private consumption, which would therefore continue to rise slowly, by 0.2% in Q2 2003, despite the general decline in inflation. ■

Consumer prices in the euro zone

Inflation in the euro zone reached a trough of 1.8% in June 2002, thanks to the marked slowdown in food prices in the spring and a continuing negative contribution from energy prices. The latter was cancelled out in the summer, contributing to a rise in inflation to 2.3% by October 2002

However, this phenomenon did nothing to call into question the decline in core inflation that had begun after the May 2002 peak of 2.6%. Core inflation stood at 2.4% in October 2002 and it should intensify its decline in Q1 2003, with the help of a slowdown in prices of services, to reach 1.8% in June 2003.

On the assumption that the price of Brent stabilises at around USD 25/barrel and that the euro remains at parity with the dollar, inflation in the euro zone would fall in parallel with core inflation, reaching 2.0% in June 2003, after peaking at 2.4% in December 2002.

Core inflation headed downwards again

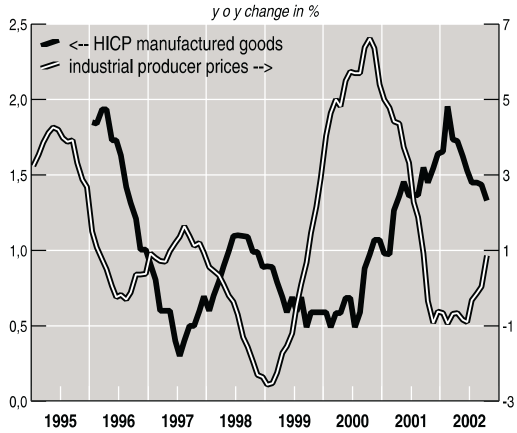
Inflation in the euro zone amounted to 2.3% in October 2002, compared with 1.8% in June 2002, meaning an addition of 0.5 of a point to the year-on-year change.

The temporary surge in oil prices in the summer led to an acceleration in energy prices and this is the main factor explaining the rise in inflation between June and October 2002 (a contribution of 0.5 of a point). Food prices, which had posted a year-on-year rise of 5.6% in January with the leap in prices of fresh produce, slowed down sharply in Q2 2002 (the June figure was 2.3%), reaching 2.2% in October, as the result of the exit from the year-on-year calculation of the sharp rises in 2001 (animal health crises and poor weather conditions). The contribution of food prices to the upturn in inflation since June 2002 is therefore nil.

The uninterrupted upswing in core inflation[1] since Q4 1999 seems to have come to an end after the high point reached in May 2002 (2.6%). Core inflation has fallen back slowly in the past summer, reaching 2.4% in October 2002. This as yet modest decline has not contributed to the evolution in the year-on-year change in the overall index over the same period. It masks countervailing effects as between the prices of services and the prices of manu-

1

PRICES OF MANUFACTURED GOODS IN THE EURO ZONE



factured goods. While prices of services have stopped accelerating in Q4, they are still rising briskly, making a contribution of 0.1 of a point to the evolution in inflation since June 2002. Prices of manufactured goods, by contrast, have continued to slow down (a year-on-year rise of 1.3% in October, compared with a February peak of 2.0%) and this is helping the reduction in inflation (a negative contribution of 0.1 of a point).

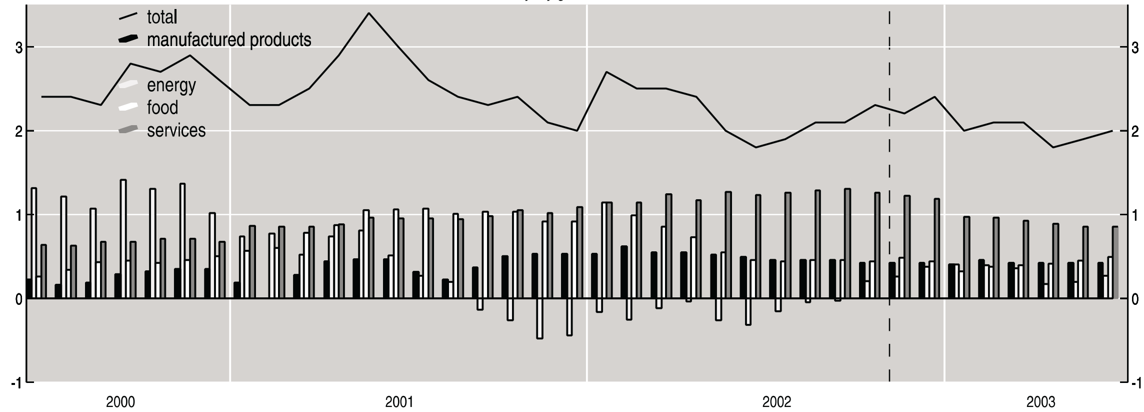
A two-speed euro zone from the inflation standpoint

In the summer of 2002, the disparities as regards inflation linked to the prices of services[2] have been confirmed more distinctly within the euro zone. They are to be seen more clearly with the gradual disappearance of the exogenous shocks affecting food and energy prices (food health crises, poor weather conditions, surge in the oil price) which were still in the early part of the year masking structural disparities.

(1) As measured by the HICP (Harmonised Index of Consumer Prices) excluding food, energy, alcohol and tobacco. It should be made clear that this definition is slightly different from that of the French IPC, which excludes, in addition, the impact of new tax measures.
(2) This could be to some extent the consequence of the Balassa-Samuelson effect. See on this subject the box “Inflation differential in the euro zone”, INSEE, conjoncture in France, March 2001, page 26.

❷

BREAKDOWN OF INFLATION IN THE EURO ZONE
contribution of major items
y o y growth in %



forecasts after the dotted line

Five countries (Spain, Portugal, Greece, Ireland and the Netherlands) are in fact recording core inflation rates of more than 3.5%, underpinned by a year-on-year change in the prices of services of above 4.5%. At the other extreme, the rest of the euro zone has in Q4 been experiencing a core inflation rate not exceeding 3.0%. Within this second group, only Luxembourg is still posting a core inflation rate above the threshold of 2.0% adopted by the European Central Bank (ECB).

The Italian situation remains more ambiguous. Prices of services are growing at a rate close to that of the zone as a whole (3.5%), but core inflation is above the average (3.0%), driven by the continuing liveliness of prices of manufactured goods, despite the slowdown in industrial producer prices.

A base effect on the price of services set to contribute to a decline in core inflation in January 2003

Inflation in the services sector is likely to come down abruptly in January 2003, by around 0.4 of a point. This is due to the exit from the year-on-year calculation of the sharp rises recorded in January 2002, especially for hotels and catering, which may in large part be attributable to the transition to the euro. However, with no appreciable weakening of wage growth in the euro zone in H1 2002, no further slowdown in services prices is expected between now and June 2003.

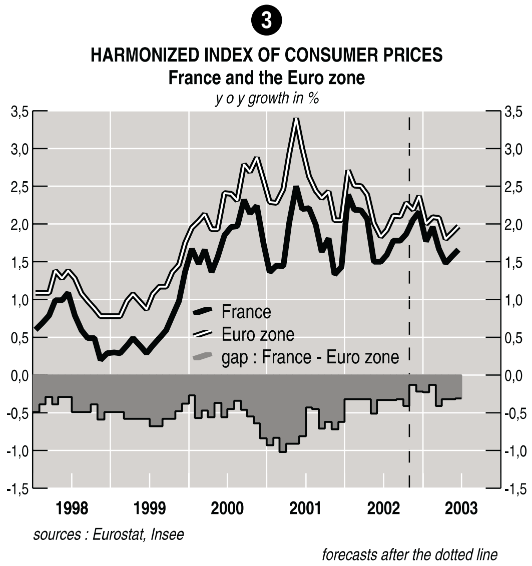
EURO ZONE INFLATION

(year on year % growth of HICP)*

Sectors (weigh in the index)	October2001	June 2002	October2002	December 2002	June 2003
Food (16.5%)	5.6	1.9	1.7	1.5	1.7
Beverage and Tobacco (4.0%)	3.1	4.1	4.0	4.6	5.1
Clothing and footwear (7.9%)	1.9	2.2	1.9	1.7	1.2
Housing, water, electricity and gas (15.0%)	1.7	0.6	1.4	1.9	2.2
Furnishings and household equipment (7.9%)	1.9	1.7	1.6	1.4	1.4
Health (3.9%)	1.2	2.2	2.3	3.8	2.7
Transports (15.2%)	-0.4	0.4	3.3	3.8	2.2
Communications (2.5%)	-1.8	-0.8	-0.6	-0.8	-0.1
Leisure and culture (9.5%)	2.0	1.7	1.4	1.1	0.9
Education (0.9%)	3.6	4.0	3.9	4.0	3.4
Hotels-cafés-restaurants (9.0%)	3.4	4.7	4.6	4.3	2.9
Miscellaneous goods and services (7.7%)	3.2	3.1	3.0	2.8	2.2
Total (100.0%)	**2.4**	**1.8**	**2.3**	**2.4**	**2.0**
Food (Beverage and Tobacco) (20.4%)	**5.0**	**2.3**	**2.2**	**2.2**	**2.4**
Energy (8.7%)	**-2.7**	**-3.7**	**2.4**	**4.3**	**3.1**
Core inflation (70.9%)	**2.2**	**2.4**	**2.4**	**2.3**	**1.8**
of which manufactured products(32.0%)	*1.5*	*1.5*	*1.3*	*1.3*	*1.3*
services (38.9%)	*2.8*	*3.2*	*3.2*	*3.0*	*2.2*

Forecast
* Harmonized Index of Consumer Prices
Source: Eurostat

Consumer prices in the euro zone



The slowdown in industrial producer prices triggered off by the cyclical downswing in 2001 came to an end in Q3 2002. Given the time lag observed in the transmission to the consumer prices of manufactured goods (roughly one year, *see graph 1*), the latter should cease to slow down at the beginning of 2003.

The slowdown in prices of services associated with the favourable base effect in January 2003 can therefore be expected to take over from the slowdown in prices of manufactured goods seen since Q2 2002. All things considered, core inflation would continue to ease, standing at 1.8% in June 2003 compared with 2.3% in December 2002.

Inflation expected to be down to 2.0% in Q2 2003

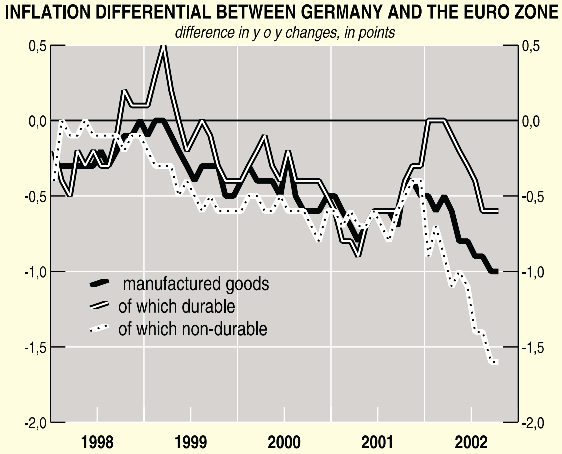
On the assumption of a Brent price close to USD 25/barrel and approximate parity between the euro and the dollar, inflation in the euro zone will probably fall back in Q1 2003. After rising to 2.4% in December 2002, it would stand at 2.0% in June 2003.

This easing of inflation by 0.4 of a point between December 2002 and June 2003 would be mainly due to the slowdown in core inflation induced by that of the prices of services (a contribution of 0.3 of a point). With the ending of the effects of the surge in oil prices in Q3 2002, energy prices would register a slowdown in H1 2003, thus slightly intensifying the slowdown in the overall index, with a contribution of 0.1 of a point to the decline in inflation between December 2002 and June 2003. Over the same period, the year-on-year price rise for food would remain stable and thus have a neutral impact on the evolution of inflation in the euro zone. ■

GERMAN INFLATION IN LOW GEAR

German core inflation has historically been lower than in the euro zone as a whole because prices of services there are structurally less dynamic than in countries like Spain or the Netherlands. However, 2002 saw a widening in the core inflation differential, from an average of 0.5 of a point in 2001 to 1 point in Q4 2002. The more depressed economic situation in Germany has in fact led to a more marked slowdown in the prices of manufactured goods in Germany than in the euro zone.

This phenomenon is particularly apparent for non-durable manufactured goods (pharmaceuticals, newspapers and periodicals, small electrical items). In Germany, the year-on-year change in prices for this grouping is tending towards zero (0.3% in October 2002) and shows a divergence of more than 1.5 of a point compared with the zone average. Industrial producer prices have remained headed downwards in Germany in Q3 2002 whereas they were starting to move upwards in the euro zone, the result being that no reduction in the inflation differential is expected in the short term. ■



EURO ZONE INFLATION BY COUNTRIES

(year on year % growth of HICP)*

	Inflation		Core inflation	Services
	Oct. 2001	Oct. 2002	Oct. 2002	Oct. 2002
France	1.8	1.9	1.9	2.9
Germany	2.0	1.3	1.4	2.3
Italy (1)	2.5	2.8	3.0	3.5
Spain (1)	3.2	4.0	3.8	4.8
Netherlands	5.0	3.6	3.6	4.6
Belgium	1.9	1.3	1.5	1.7
Austria	2.3	1.8	1.8	2.6
Finland	2.4	1.7	2.0	3.0
Portugal	4.2	4.1	5.1	6.7
Ireland	3.8	4.4	4.7	7.1
Luxembourg	1.7	2.5	2.0	3.0
Greece	3.2	3.9	3.5	4.6
Euro Zone (1)	**2.4**	**2.3**	**2.4**	**3.2**
United Kingdom	1.2	1.4	1.6	4.5
Sweden	2.9	1.7	1.4	1.4
Denmark	2.0	2.7	2.7	3.8
E.U. (1)	**2.2**	**2.1**	**2.2**	**3.4**

* Harmonized Index of Consumer Prices
(1) For Spain and Italy and the euro zone are presented figures corresponding to the old series, before taking account of the methodology revision.
Source: Eurostat