The euro zone's international environment

The revival in trade between the United States and the Asian countries began in Q4 2001. As a result, the Asian economies recovered earlier than elsewhere, benefiting from the upturn in demand for high-tech equipment and the acceleration in United States household consumption. In return, these same Asian exporting countries are for the moment ensuring, through the rise in their current-account surpluses, the financing of the fiscal stimulus and the further widening of the American current-account deficit that this is generating.

The Central and Eastern European countries in transition are experiencing a more modest recovery, since their main exposure is to the European economy. In the United Kingdom, manufacturing industry showed no recovery in Q1 2002; consumption seems to be slowing down and any upturn would be based more on the fiscal stimulus and the intensification of inter-industry trade within Europe.

Caught in the eddies of the Argentinian crisis, Latin America is having difficulty in entering the slipstream of the American recovery. The preservation of monetary stability in this region has obliged the monetary authorities to introduce major interest-rate hikes and these are limiting the capacity of domestic demand to put up resistance. Latin American countries are also suffering from low commodity prices.

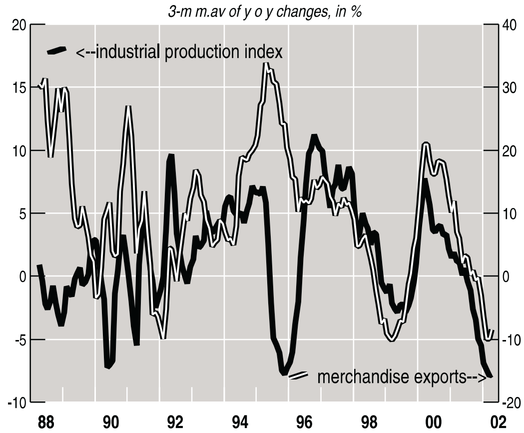
Demand in world markets for euro-zone exports was still stagnant at the end of 2001. With the incipient recovery in trade between the United States and Asia now spreading to the rest of the world and to all industries, this demand should return to an annual growth rate of 5% in H1 2002, followed by 8% in H2.

Recovery in Asia, hesitation in the other emerging regions

Recovery is starting to show itself in the Central and Eastern European countries. These countries, which do three-quarters of their foreign trade with European countries, including two-thirds with the euro zone, have suffered in the early part of the year from the absence of a clear-cut recovery in the zone and especially from the very lacklustre performance on the part of the German economy (which takes 30% of these countries' exports). Q2 finds industry in Poland and Hungary still in recession, but in the Polish case the situation seems to be stabilising. Although

LATIN AMERICA: INDUSTRIAL OUTPUT AND EXPORTS

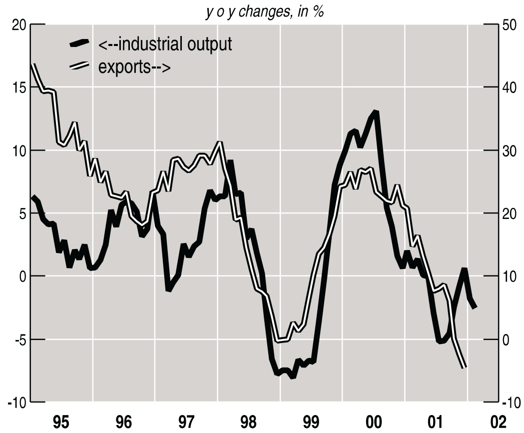
3-m m.av of y o y changes, in %



source : WEFA - Argentina, Brazil and Mexico

CENTRAL AND EASTERN EUROPE: INDUSTRIAL OUTPUT AND EXPORTS

y o y changes, in %



source : ONS

GDP IN OTHER REGIONS OF THE WORLD

(Annual % changes)

	Annual averages 2000	2001	2002
Countries in transition	6.7	3.4	3.9
Russia	8.3	4.5	4.0
Central Europe	4.0	2.0	2.1
Emerging Asia(1)	6.5	1.3	2.8
Latin America(2)	4.4	0.5	0.6

Forecast

(1) Korea. Hong Kong. Indonesia. Malaya. Philippines. Singapore. Taiwan. Thailand.

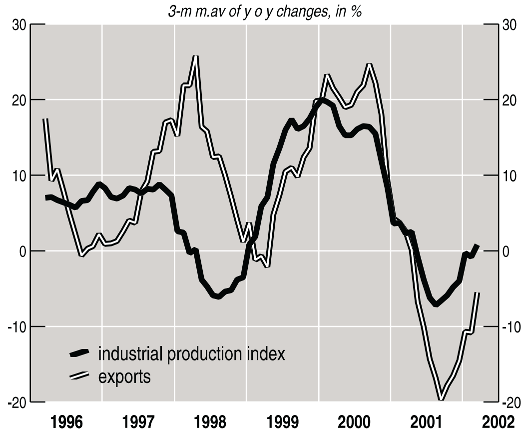
(2) Argentina. Brazil. Chile. Mexico. Venezuela.

Source: Direction de la Prévision

acceleration is expected for H2, growth in the Central European countries is unlikely to exceed 2% this year.

Latin America is without doubt the emerging zone experiencing the greatest difficulties at this time of world recovery, continuing to be hit by the fallout from the Argentinian crisis. Mexico is having difficulty in emerging from the recession into which it was plunged by the American economy at the beginning of 2001. In Brazil, recovery seems at last to be taking shape, but the Argentinian crisis has forced the central bank to adopt a highly restrictive monetary stance, in an attempt to avoid too steep a devaluation of the Real. The very high level of real interest rates is limiting the capacity of domestic demand — especially investment — to take up the running from exports when the time comes.

In contrast, recovery is being confirmed in Asia, triggered off by United States demand for semiconductors and the revival in American consumption. Even though the countries most affected by the revival in the Asia-United States trade circuit are those that are most specialised in high-tech materials (Singapore, Taiwan, Korea), the whole zone is benefiting from the recovery that began at the very beginning of the year. Growth in the Asian developing countries is therefore likely to be around 4% in 2002, as against 1.8% in 2001.



source : WEFA - Malaya, Taiwan, Korea

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

(Annual and half-yearly % change)

Annual average 2000	Annual average 2001	Annual average 2002		Half-yearly % change 2001 H1	2001 H2	2002 H1	2002 H2
			UNITED STATES (34.0%)				
4.1	1.2	2.7	GDP	0.4	0.1	2.2	1.4
13.4	-2.7	2.8	Imports (16%)	-3.4	-5.4	5.5	4.6
4.8	3.1	3.2	Private consumption (68%)	1.4	1.7	1.5	1.1
2.7	3.6	5.0	Public consumption (17%)	2.5	2.5	2.4	1.4
7.6	-2.0	-3.4	Total private GFCF (17%)	-2.0	-4.4	-0.4	1.9
9.5	-4.5	-1.4	Exports (13%)	-3.4	-7.9	3.2	4.0
5.1	*2.3*	*2.4*	*Contributions(2): Domestic demand excluding stocks*	*1.0*	*0.8*	*1.4*	*1.3*
-0.1	*-1.2*	*0.8*	*Stock change*	*-0.9*	*-0.9*	*1.4*	*0.3*
-0.9	*-0.1*	*-0.6*	*Foreign trade*	*0.2*	*-0.1*	*-0.5*	*-0.3*
			JAPAN (17.2%)				
2.2	-0.5	-0.9	GDP	-0.2	-1.8	0.6	-0.4
9.6	-0.5	-4.0	Imports (11%)	-3.0	-6.3	0.0	1.1
0.3	0.5	0.6	Private consumption (59%)	0.8	0.2	0.6	-1.0
4.6	3.1	2.2	Public consumption (9%)	2.7	0.1	1.5	0.7
3.2	-1.9	-9.4	Total private GFCF (29%)	-2.2	-6.3	-3.9	-1.2
12.4	-6.5	5.7	Exports (14%)	-6.7	-5.5	9.9	4.0
1.8	*0.3*	*-1.8*	*Contributions(2): Domestic demand excluding stocks*	*0.2*	*-1.7*	*-0.4*	*-0.7*
0.0	*0.0*	*0.0*	*Stock change*	*0.0*	*-0.1*	*0.0*	*0.0*
0.5	*-0.7*	*0.9*	*Foreign trade*	*-0.5*	*0.0*	*1.0*	*0.4*
			UNITED KINGDOM (5.6%)				
3.0	2.2	1.3	GDP	1.1	0.4	0.8	1.0
10.9	2.8	2.6	Imports (34%)	-0.4	-2.2	3.3	3.0
4.1	3.9	3.2	Private consumption (63%)	2.1	2.0	1.5	1.1
3.3	2.7	3.5	Public consumption (19%)	2.4	0.6	3.8	-0.8
3.9	0.1	-0.5	Total private GFCF (18%)	-3.5	-0.5	-1.4	2.4
10.3	1.0	-1.6	Exports (31%)	-1.3	-3.6	0.3	3.3
4.1	*3.1*	*2.8*	*Contributions(2): Domestic demand excluding stocks*	*1.1*	*1.3*	*1.5*	*1.0*
-0.3	*-0.2*	*0.1*	*Stock change*	*0.3*	*-0.6*	*0.5*	*0.1*
-0.7	*-0.8*	*-1.6*	*Foreign trade*	*-0.3*	*-0.3*	*-1.2*	*-0.1*

Forecast
(1) Variation between the last quarter of the current half-year and the last quarter of the previous half-year.
(2) It might happen, for statical reasons, that the sum of the contributions does not exactly match the GDP variation at a given date.
Source: Direction de la prévision

United States: more modest growth, following a distinct rally at the beginning of the year

Less than a year and a half after turning down, the American economy in Q1 2002 regained a momentum comparable to that of the late 1990s, growing at an annual rate of 5.6%. This dynamism is based for the most part on household consumption (contributing 2.5 points) and the reversal of inventory behaviour (4 points) on the part of firms that now have confidence in the recovery. Public consumption has continued to provide powerful support for activity.

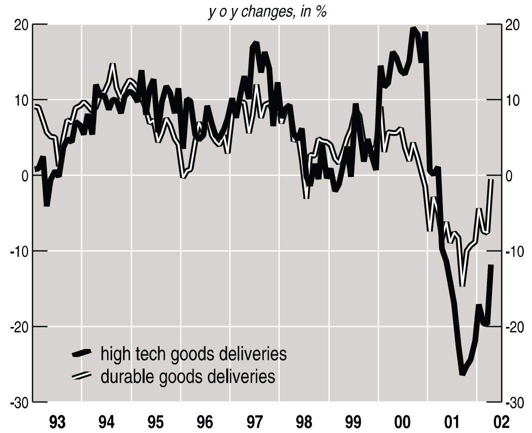
American GDP can nevertheless be expected to grow more moderately until the end of 2002. It has to be noted that a substantial proportion of the very rosy picture shown by recent published figures is due to the highly expansionary turn taken by fiscal policy since Q3 2001. By next December, corporate demand (stocks and investment) should admittedly show gradual recovery. At the same time, however, United States household consumption is likely to rise more slowly than in the early part of 2002 as a result of the weakening of the labour market and the temporary nature of the fiscal stimulus.

Productive investment fell again in Q1 2002 (down 2.3% at annual rate, as against 5.3% the previous quarter). It may level out in Q2 and the upturn in durable goods orders, which were in April back to the level of a year ago, is pointing to a recovery in H2

Any investment recovery would be helped by the improvement in companies’ financial situations. The gross operating surplus[2] of non-financial American companies returned to positive growth as of mid-2001. The drop in their earnings in Q4 2001 was due entirely to a sharp increase in depreciation (see graph). This build-up of depreciation in American corporate accounts is partly the result of a tax reform enabling firms to reduce the amortisation period of

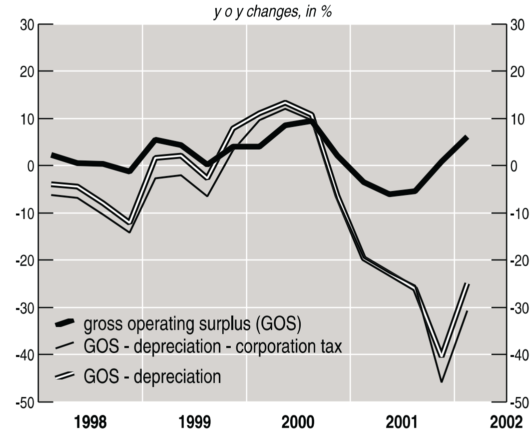
(2) In other words, value added less the total wage bill and interest charges — representing corporate profits before tax and depreciation.

UNITED STATES: INVESTMENT INDICATORS
y o y changes, in %



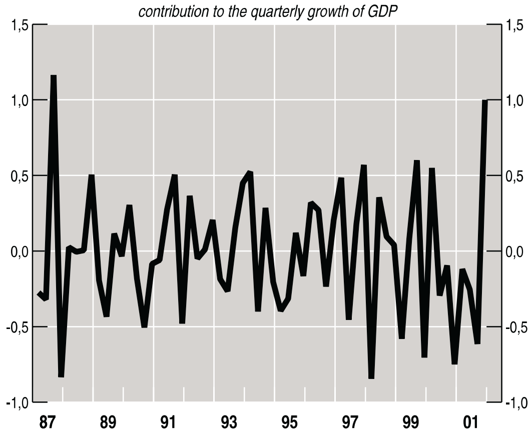
source : Bureau of Census

UNITED STATES
NON-FINANCIAL COMPANIES PROFIT GROWTH
y o y changes, in %



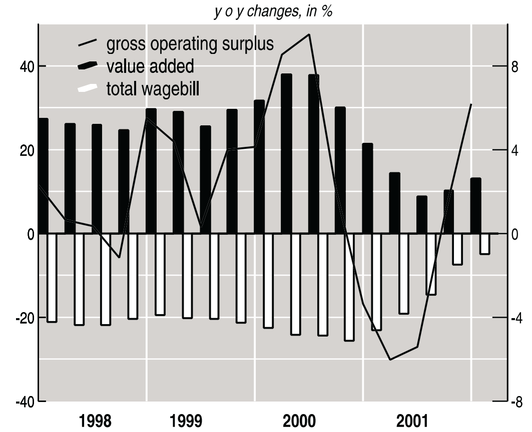
source : BEA

CONTRIBUTION OF INVENTORY CHANGES TO GROWTH
contribution to the quarterly growth of GDP



source : BEA

UNITED STATES NON FINANCIAL COMPANIES’ CONTRIBUTION TO PROFIT GROWTH
y o y changes, in %



source : BEA

the plant to 3 years for any investment made in or after September 2001. In addition, the amortisation of «goodwill» — meaning in practice the excessive prices paid for take-overs during the stock-market bubble of 1999-2000 — has also probably contributed to this deterioration in firms' net earnings.

Recent information regarding profits suggests that firms are again in a position to finance their investment projects out of their own resources — that is, if they have projects in mind. In the United States as in many other countries the principal determinant of investment remains the demand outlook (accelerator effect). Given the modest outlook and the continuing low level of capacity utilisation, the upturn in spending on equipment will no doubt be gradual.

At the same time, stock re-building may be incapable of making a lasting contribution to the recovery as this contribution was already very high in Q1 (around + 1 of a point).

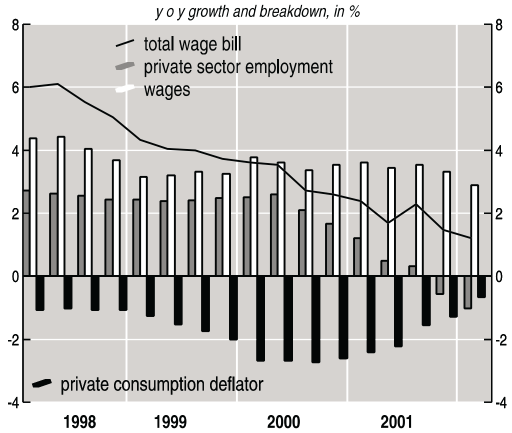
Even if corporate demand is on the road to recovery, it is on household demand that the strength of growth will depend. Unfortunately, this is likely to slow down, despite the tax cuts, because earned incomes are likely to be fairly flat for the rest of the year.

In the first place, there has been a very rapid deterioration on the labour market. Between August 2001 and March 2002, almost 1.2 million jobs were lost in American firms (1% of non farm private payrolls). The harshness of this reaction is explained by the need for companies to put their accounts back in order. As a result, in Q4 2001 the wage bill is no longer holding back profit growth (see graph), whereas it had reduced it by roughly 20 points up to the end of 2000. Growth in the total wage bill has therefore been very slight in the early part of 2002, posting year-on-year growth of 1.2% in real terms.

At the turn of the year, however, the weakness of earned income was compensated by the strength of the fiscal re-stimulus. In Q3 2001, total income was boosted by the checks sent out by the Treasury (ret-

UNITED STATES: TOTAL WAGE BILL

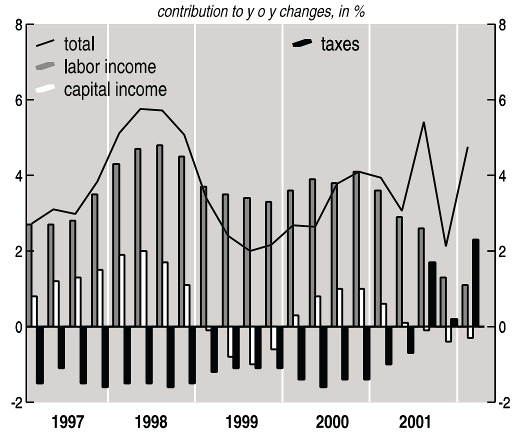
y o y growth and breakdown, in %



source : BEA et BLS

COMPOSITION OF US HOUSEHOLDS' INCOME

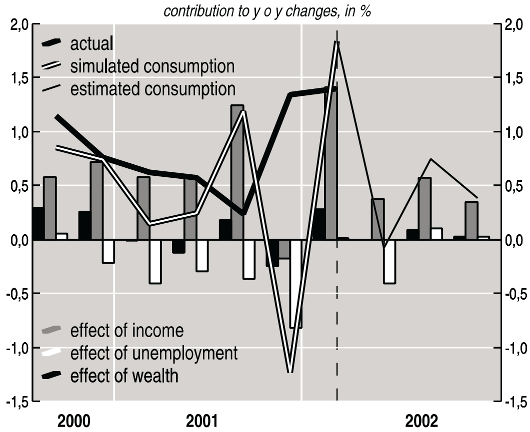
contribution to y o y changes, in %



source : BEA

PROJECTION OF US HOUSEHOLD' CONSUMPTION

contribution to y o y changes, in %

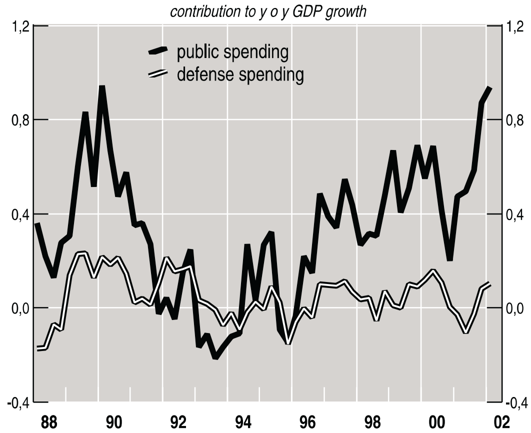


source : BEA - calculations by INSEE

prévision au-delà du pointillé

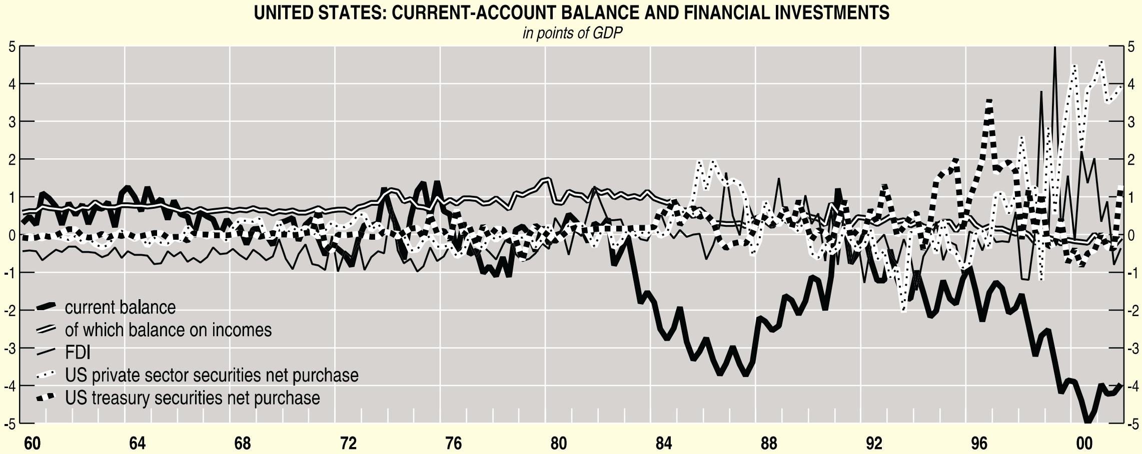
CONTRIBUTION OF PUBLIC SPENDING TO GROWTH

contribution to y o y GDP growth



source : BEA

THE FINANCING OF THE UNITED STATES CURRENT-ACCOUNT DEFICIT



source : BEA

After posting a surplus averaging 0.3% of GDP over the period 1960-1981, the United States current account has been in deficit since 1982. This deficit has widened in recent years, from an average of 1.9% of GDP in 1982-1991 to 2.3% of GDP in the following ten years. For the period 1998-2001, the deficit averaged 3.6% of GDP, with a high in 2000 of 4.5%.

A current-account deficit has to be financed by capital inflows. These can take the form of loans (bank loans, bonds) and in this case the country's indebtedness increases. They can also take the form of acquisition of property rights (foreign direct investment (FDI), portfolio investment in equities). In this case, the indebtedness is unchanged and the country's situation is more to be compared with a firm that disposes of assets or issues shares in order to invest(1).

Examination of the balance-of-payments statistics published by the Bureau of Economic Analysis gives the composition of the financing of the current-account deficit. Between the middle and end of the 1980s, most of the capital inflows consisted of purchases of private securities (equities, bonds) by non-residents. Then between 1992 and 1999 purchases of US Treasury bonds took up the running. In the period 1999-2000, direct investment was the main source of capital inflows, before purchases of private securities again became the dominant feature in 2000-2001.

The issue of financial claims and property rights in turn comes to have an adverse effect on the balance on current account via the remuneration of this capital (dividends, interest). Whereas the net income received from the rest of the world had amounted to roughly 1 point of GDP until the mid-1980s, since 1997 this item has shown a net outflow and hence been a burden on the American economy. It also holds back the recovery in the current-account balance.

Moreover, the interlude in 1999-2000 during which the financing of the deficit had benefited from high levels of FDI now seems to be definitely a thing of the past. Indeed, with the bulk of the capital now flowing into the United States being highly liquid in nature, it is liable, in the event of a rapid withdrawal, to amplify the tendency for the dollar to depreciate.

Examination of the «liabilities» (stock) of the United States economy vis-à-vis the rest of the world makes it possible to supplement the preceding analysis regarding the financing of the current-account balance (flow). A net worth account in relation to the rest of the world, calcu-

(1) It is, however, important to note that the payment of dividends will finally act as a burden on gross national income (GNI), since a substantial portion of national production (GDP) will have to be used to pay these dividends (this being a use of the current-account balance). For example, this is the case today for Ireland, which in terms of GDP per head ranked fourth in the European Union in 1999, but 11th for GNI.

Structure of the US net worth account vis-à-vis the rest of the world

(as % of GDP)

	1980-1981	2000-2001	Change
Assets held on the rest of the world	24	55	31
Equities and FDI	14	32	18
Portfoilio holdings of equities	1	17	17
Foreign direct investment	14	15	1
Debt	9	22	13
Bank loans and bank deposits	4	9	5
Credit instruments	4	7	3
Others	1	7	5
Liabilities with the rest of the world	16	75	58
Equities and FDI	7	30	24
Portfoilio holdings of equities	2	17	14
Foreign direct investment	4	14	10
Debt	10	44	34
Net interbank debt	-1	1	2
Bank loans and bank deposits	4	6	2
Credit instruments	6	30	23
Others	1	8	7

Source : Federal Reserve, Flow of Funds tables, calculations by INSEE

THE FINANCING OF THE UNITED STATES CURRENT-ACCOUNT DEFICIT (THE END)

lated quarterly by the Federal Reserve, makes it possible to differentiate between shares and debt instruments (bonds, bank debt). This information, which is not supplied by the balance-of-payments statistics, is useful in that debt interest is always payable, regardless of the economic situation, whereas dividends track more closely the fluctuations in the level of activity.

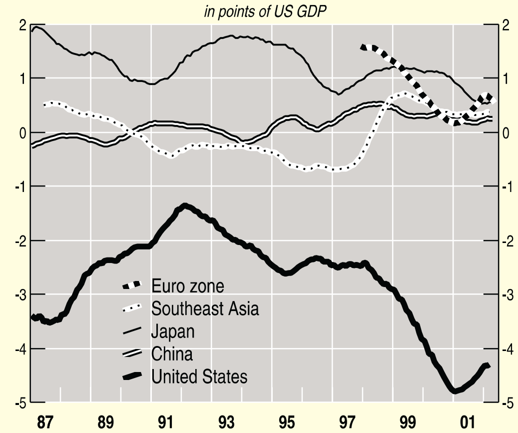
In terms of its evolution, the United States' net external position worsened by 27 points of GDP between the beginning of the 1980s and the years 2000-2001. More than three-quarters of this decline (21 GDP points) is explained by the decline in net claims held by the United States. Most of the nation's liabilities (net of claims on the rest of the world) therefore consists of debt. Examination of the table also confirms the marginal nature of direct long-term investment — despite the surge in 1999-2000. Liquid forms of capital, and especially debt, whose burden is not lightened when the economic situation deteriorates, therefore largely predominate.

This liquid capital has been coming mainly from Asia. The revival in trade between Asia and North America, at a time when the Asian currencies had depreciated against the dollar after the 1997 crisis, has led to a further widening of the commercial imbalance with the United States.

Southeast Asia, China and Japan have in fact posted current-account surpluses totalling 1.2 of a point of United States GDP since 1998. A substantial portion of these surpluses has gone into building up the exchange reserves. Indeed, in Q4 2001, China was the largest purchaser of US Treasury paper. This tendency is general throughout Asia and, in all cases, reflects the desire of central banks to maintain downward pressure on exchange rates in order to maintain export price-competitiveness.

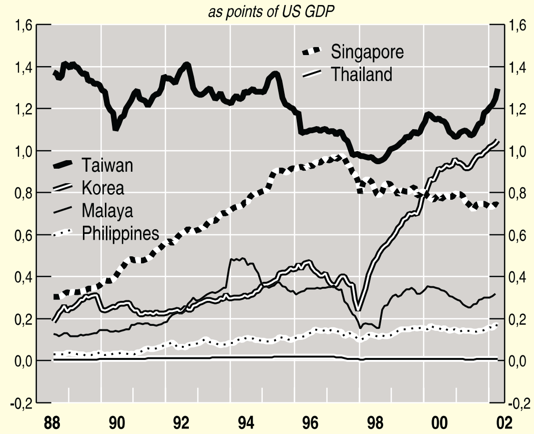
The result is that the financing of the United States current-account deficit is increasingly being performed by Asian central banks, whereas the direct investment in the years 1995-2000, which had come mainly from Europe, seems now to have largely dried up. In these circumstances, a depreciation of the dollar is liable to be more marked against the euro than against the Asian currencies (Chinese yuan, Japanese yen, Korean won). ■

TRADE BALANCES FOR THE MAJOR ECONOMIC ZONES
in points of US GDP



source : WEFA - ECB

FOREIGN EXCHANGES RESERVES OF CERTAIN ASIAN COUNTRIES
as points of US GDP



source : WEFA

rospective tax cuts for FY 2001). In H1 2002, the additional tax cuts voted in the fall performed a similar function. All things considered, the tax cuts are thought to be giving a boost to income and hence consumption of around 2 points of annual growth in FY 2002. In the absence of new measures, the quarterly progress in incomes would be more in phase with the evolution in the wage bill (1% at annual rate) between now and the end of the year.

The rise in incomes is likely to be mostly spent on additional consumption. However, the deterioration on the labour market, quite apart from its adverse impact on earned incomes, could also incite American households to step up their saving, for precautionary reasons. Leaving aside certain somewhat erratic month-to-month swings, the unemployment rate has in fact been continuing to rise, standing at around 6% in Q2, as against 4.4% a year earlier. To judge by the historical data, the impact of this increase on precautionary saving is probably far from negligible. If it is assumed that the unemployment rate stabilises at 6%, our estimates show that precautionary saving would trim 0.5 of a point off the growth rate in consumption in H2 2002.

After accelerating towards the end of last year and in the early part of this, consumption would return to a more moderate annualised growth rate of around 2% in the second half of the year. This would be in line with the expected growth in earned incomes, after allowing for certain timelags in the adjustment of consumption behaviour to tax cuts.

Quite apart from the tax cuts, United States fiscal policy has provided a direct stimulus for activity via public demand. In Q1 2002, this made a contribution to year-on-year growth of around 1 point, something that had not been seen since the end of the 1980s. The contribution from defence spending, although it has been rising since Q4 2001, does not fully explain this acceleration.

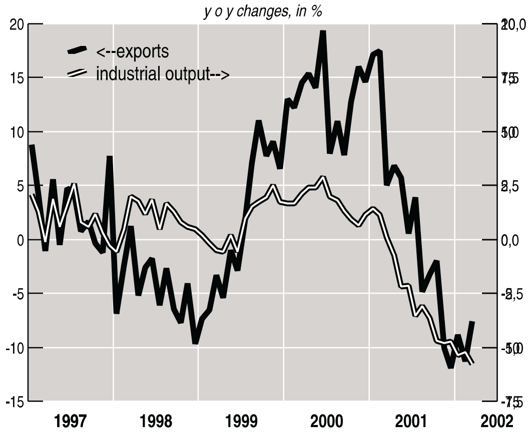
All things considered, United States economic growth should be on an annual growth path of 2.5%-3% in H2, compared with over 4% in H1. Even if recovery seems well established, the spectacular results posted at the turn of the year are explained by a reversal of inventory behaviour, with necessarily transitory effects, and by the impact of this winter's fiscal stimulus. Once these effects are no longer operating, consumption should again be more in phase with the tendency in earned income, while investment would pick up again gradually.

Recovery in the UK economy, thanks to the fiscal re-stimulus and the recovery in inter-industry trade

In the United Kingdom, GDP stagnated in Q4 2001 and Q1 2002. The recession in industry, which has now lasted more than a year, has finally brought the economy to a halt. Meanwhile, household consumption, hitherto the main platform for growth, has gradually slowed down, although remaining dynamic. Its year-on-year growth amounted to 3% at the beginning of the year, as against over 4% in mid-2001.

This slowdown is likely to continue, as the slowdown in UK wage growth is now affecting earned income. At the same time, UK industry is emerging very slowly from its deepest recession since 1984. Corporate demand, especially on the side of investment, is likely to recover only very gradually. As in the United States, the return to growth is based partly on the highly expansionary turn taken by fiscal policy.

UNITED KINGDOM
EXPORTS AND INDUSTRIAL OUTPUT
y o y changes, in %



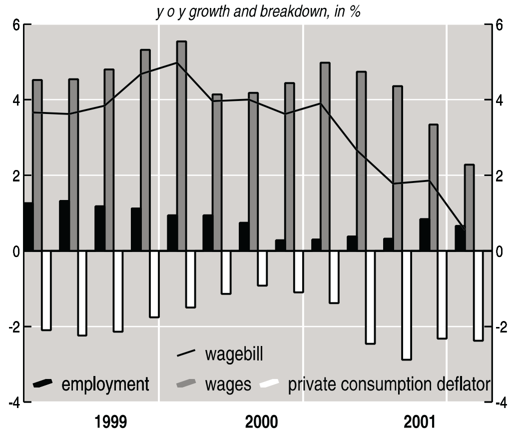
source : ONS

Although the world industrial recovery is already well launched, the British manufacturing sector is being slow to show signs of improvement. In particular, exports failed to pick up in Q1. However, UK business leaders' opinions regarding their order books have improved distinctly since the beginning of 2002. This improvement no doubt reflects the revival of inter-industry trade in Europe, which should benefit British exports in Q2 and favour an upturn in industrial activity.

Against this backdrop of recovery, the weakness of corporate investment should gradually cease to hold back growth. Even so, any revival is likely to be fairly weak. Orders for capital goods made by industrial firms for the coming months, although levelling off after last year's steady fall, are still at low levels.

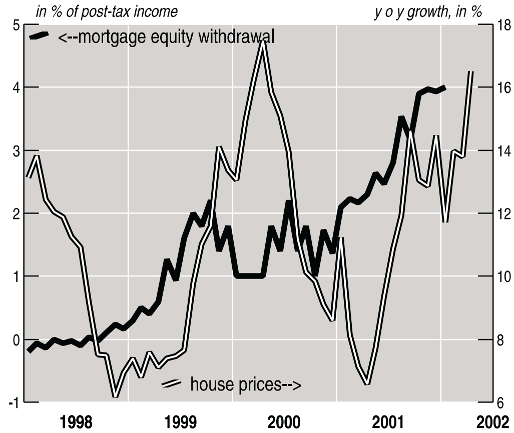
Meanwhile, household consumption is expected to slow down within the time-horizon of this forecast, in line with the evolution in incomes. Admittedly, the unemployment rate stabilised at 5.1% in Q1 and employment continues to grow slightly. At the same time, however, there has been a very marked slow-

TOTAL WAGEBILL IN THE UNITED KINGDOM
y o y growth and breakdown, in %



source : ONS

UNITED KINGDOM: MORTAGE BORROWING AND HOUSE PRICES



source : Nationwide et ONS

down in wage growth, which is now holding back progress in earned income. In Q1 2002, year-on-year growth in the wage bill in real terms amounted to 0.5%, as against 4% a year earlier.

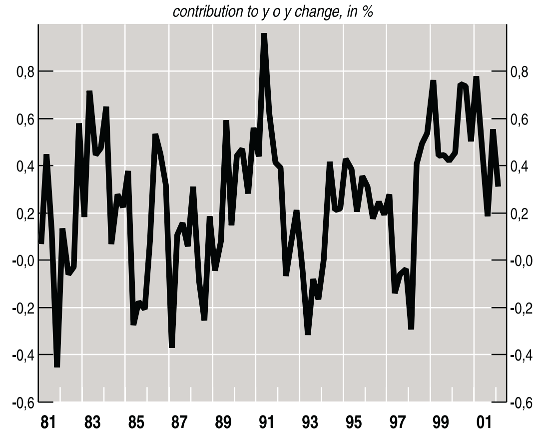
The dynamism of the housing market should nevertheless continue to bolster consumption. The rise in house prices enables British economic agents to increase the guarantees needed to back their consumer borrowing, through a process of «mortgage equity withdrawal» (MEW). Loans taken out between the end of 2000 and the end of 2001 have in fact totalled the equivalent of roughly four points of gross disposable income. House prices are expected to continue to rise. The low cost of borrowing should continue to help the market, especially as the prospect of monetary tightening has receded because of the slackness of growth in Q1.

All things considered, consumption should rise at an annual rate of 3% and then 2% in H1 2002, followed by 2% in H2, as against 4% throughout last year.

Slowing consumption and an industrial sector having difficulty in achieving recovery mean that the upturn in the British economy will also have to rely on fiscal stimulus. Indeed, public consumption is liable to remain brisk. The contribution from this item, which since the beginning of 1999 has been around 0.5 of a point, could rise at a time when the government is committed to improving public services, especially the National Health Service.

UNITED KINGDOM: CONTRIBUTION OF PUBLIC CONSUMPTION TO GROWTH

contribution to y o y change, in %



source : ONS

In the final analysis, after stagnating for two quarters, the UK economy should pull itself together within the time-horizon of this forecast. Its annual growth rate would be of the order of 1.5% in H1, followed by 2% in H2. Industrial output would be stimulated by the upturn in foreign trade, while public investment can be expected to increase throughout the year. Meanwhile, however, household consumption is likely to slow down. ■

The economic situation in the euro zone

Growth in the euro zone on an annual average basis was modest in 2001, at 1.5%, and this average figure in fact conceals a declining tendency. The slowdown in the economy finally led to an actual decline in GDP at the end of last year. This deceleration was due to the downturn in export demand and especially the sudden halt to inventory build-up and investment applied by European firms. In addition, as of the second half of the year, household consumption, which had hitherto been dynamic, also slowed down appreciably, under the impact of the deterioration on the labour market.

The early part of this year, however, has marked a turning point and activity is now accelerating. In a more buoyant international context, inventory behaviour has been reversed. Although still very weak in Q1, household consumption is expected to regain momentum as a result of the decline in inflation in Q2, and later through a stabilisation of the employment situation. This is probably the key to whether the recovery will last, as only stronger demand from the European households will make it possible to underpin the present tendency for business leaders' expectations to improve and to trigger off an upturn in investment in H2.

Growth of the order of 1.5% in the euro zone in H1

The first quarter of 2000 saw the euro zone return to modest growth (0.2%) following the decline recorded at the end of last year. This tendency should intensify as of Q2.

This is because the industrial cycle in the euro zone, which was at particularly low ebb in Q4 2001, has settled into an upswing phase since the beginning of 2002. Manufacturing output has levelled out this winter, putting an end to four consecutive quarterly falls.

FORECASTS FOR THE EURO ZONE

(annual and quarterly % change)

	Annual changes			Quarterly changes											
	2000	2001	2002	2000				2001				2002			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP															
Growth rate	3.5	1.5	1.0	0.9	0.9	0.4	0.7	0.5	0.0	0.1	-0.3	0.2	0.6	0.7	0.6
year on year growth	-	-	-	3.8	4.1	3.3	2.9	2.5	1.6	1.3	0.3	0.1	0.6	1.2	2.1
Imports															
Growth rate	10.9	0.8	1.2	2.4	2.5	2.7	2.7	-1.9	-0.3	-1.4	-1.3	-1.1	3.6	1.4	3.0
year on year growth	-	-	-	10.8	11.0	11.3	10.7	6.1	3.2	-1.0	-4.8	-4.1	-0.4	2.5	7.0
Household consumption															
Growth rate	2.5	1.7	0.8	0.9	0.6	0.1	0.2	1.0	0.4	0.1	-0.1	-0.2	0.7	0.5	0.5
Contribution	*1.4*	*1.0*	*0.5*	*0.5*	*0.4*	*0.0*	*0.1*	*0.6*	*0.2*	*0.1*	*0.0*	*-0.1*	*0.4*	*0.3*	*0.3*
year on year growth	-	-	-	2.7	3.3	2.4	1.8	1.9	1.7	1.8	1.5	0.3	0.6	0.9	1.5
GFCF															
Growth rate	4.7	-0.5	-1.6	1.5	0.7	1.2	0.0	-0.4	-0.7	-0.6	-0.5	-0.7	-0.4	0.2	0.6
Contribution	*1.0*	*-0.1*	*-0.3*	*0.3*	*0.2*	*0.3*	*0.0*	*-0.1*	*-0.2*	*-0.1*	*-0.1*	*-0.1*	*-0.1*	*0.0*	*0.1*
year on year growth	-	-	-	6.0	5.2	4.1	3.6	1.6	0.2	-1.7	-2.2	-2.4	-2.1	-1.3	-0.3
Exports															
Growth rate	12.2	2.5	2.8	3.4	2.4	3.0	2.4	-0.2	-0.8	-0.5	-1.3	0.9	2.1	2.4	2.2
year on year growth	-	-	-	12.9	12.2	12.2	11.7	7.7	4.5	0.9	-2.8	-1.7	1.2	4.1	7.8
Domestic demand ex. stocks															
Growth rate	2.9	1.3	0.5	0.9	0.6	0.4	0.3	0.7	0.2	0.0	-0.1	-0.2	0.5	0.4	0.5
Contribution	*2.8*	*1.3*	*0.5*	*0.9*	*0.6*	*0.4*	*0.3*	*0.6*	*0.2*	*0.0*	*-0.1*	*-0.2*	*0.5*	*0.4*	*0.5*
year on year growth	-	-	-	3.2	3.5	2.6	2.2	2.0	1.5	1.1	0.8	-0.1	0.2	0.6	1.2
Foreign trade															
Contribution	*0.6*	*0.7*	*0.6*	*0.4*	*0.0*	*0.2*	*0.0*	*0.6*	*-0.2*	*0.3*	*0.0*	*0.7*	*-0.4*	*0.4*	*-0.2*
Stocks															
Contribution	*0.1*	*-0.5*	*-0.1*	*-0.4*	*0.3*	*-0.1*	*0.4*	*-0.7*	*0.1*	*-0.2*	*-0.2*	*-0.3*	*0.5*	*-0.1*	*0.3*

Forecast

European industrial leaders' expectations have turned up again, as shown by the marked improvement since February in the composite indicator, which encapsulates the tone of business surveys in general. The most spectacular improvement relates to the production outlook. Opinions on order books have also been recovering. Admittedly the latest figures for domestic orders in Italy and Germany are slightly lagging behind these qualitative judgements, but they too started to improve at the beginning of Q2.

Exports recovering

The improvement in the industrial situation is due in the first place to the strengthening of world demand for euro-zone exports, shown by the distinct improvement in business leaders' opinions of the tendency in foreign demand. In Germany and Italy the recovery in the figures for orders from abroad is more marked than for domestic orders.

The upturn in exports from the euro zone is explained by the sharp rebound in United States activity. Not only is direct demand from the United States increasing but so is demand from Southeast Asian countries, which are also themselves benefiting from the North American recovery.

Finally, the improvement in European activity is being accompanied by a revival of intra-zone inter-industry trade, as shown, for example, by the marked improvement in Belgium and the Netherlands in the balance of opinion regarding foreign demand, these being countries much of whose foreign trade takes place within the euro zone itself.

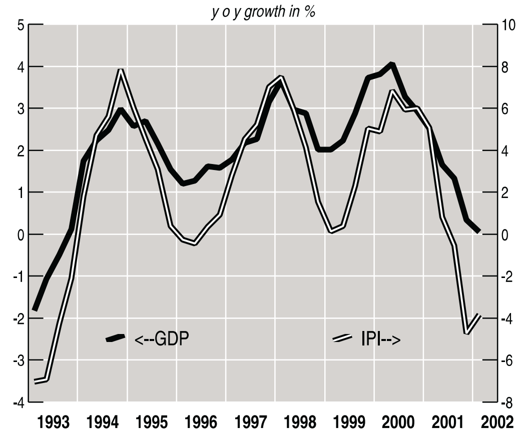
All in all, the acceleration in exports from the euro zone (including intra-zone trade) is likely to strengthen during the year, despite the recent appreciation in the euro. The annualised growth rate can be expected to rise from around 6% in H1 to 9% in H2.

Revival in demand from euro-zone firms

In addition to the revival in external demand, another factor triggering off the industrial upturn in the euro zone has been the termination of the de-stocking behaviour that had weighed heavily on activity last year. Business surveys now show that the level of stocks is judged to be on the low side. In April, this indicator even fell below its average level.

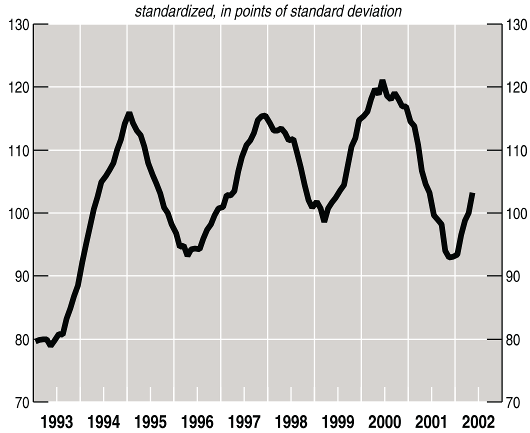
The return to inventory behaviour favourable to activity seems to have taken place already in Q2. This is explained by an improvement in demand expectations, but also by an upturn in expectations regarding prices. Comparison with last year shows a marked reversal in the tendency. The contribution of invento-

EURO ZONE: GROWTH AND INDUSTRIAL PRODUCTION INDEX CHANGES
y o y growth in %



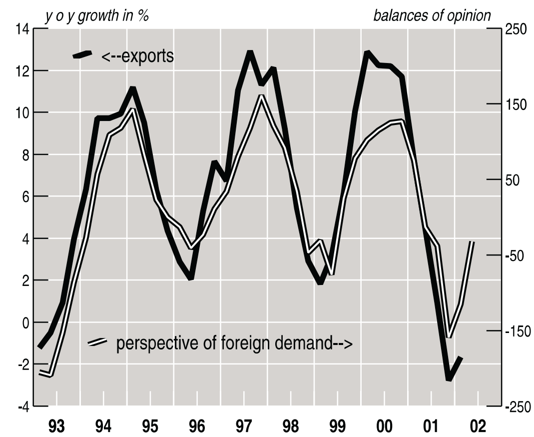
source : EUROSTAT

COMPOSITE INDICATOR FOR MANUFACTURING INDUSTRY IN THE EURO ZONE
standardized, in points of standard deviation



source : European Commission, computation INSEE

EURO ZONE: FOREIGN DEMAND



source: EUROSTAT

Exports include intra-zone. The foreign demand outlook is consistent with this definition, being a summation of national balances of opinion.

ries to euro-zone GDP growth is likely to be positive by around half a point in year-on-year terms at the end of 2002, whereas at the end of 2001 it had been negative by one point.

Productive investment, another major element in corporate demand, also turned down in 2001, following several years of strong growth. In Q1 2002 it declined for the fifth quarter in a row. However, the current improvement in the situation should enable it to take off again in H2. The easing in the past year of the capacity utilisation rate seems to have come to an end in the early part of Q2. Furthermore, monetary policy is currently on the accommodating side and is facilitating the financing of investment.

Even so, the upturn in productive investment is likely to very gradual, being conditional on the consolidation of household demand in the euro zone.

Moreover, the national disparities that had been a feature of investment in buildings in recent years are set to narrow to some extent. Whereas this sector has provided substantial support for growth in Spain, Italy and France since 1999, signs of a slowdown emerged in France last year and in Italy at the beginning of 2002. On the other hand, investment in buildings in Germany, after being woefully depressed for several years, showed signs of stabilisation in Q1. The buildings and public works sector is likely to be fairly lacklustre in the euro zone between now and next December.

All things considered, investment is likely to contract further in H1 2002 (an annualised decline of 2%, but should return to positive growth of the order of 1.5% in H2.

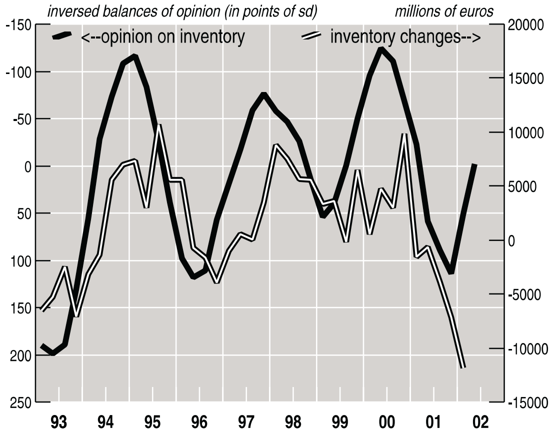
Stronger private consumption

In H2 2001, consumption by European households, which had stood up fairly well until then, went through a bad patch, which lasted until Q1 2002. This slowdown was above all the result of particularly depressed private consumption in Germany, but it also affected the other major European countries to a smaller extent. This phenomenon is explained mainly by the deterioration on the labour market, as well as by the fact that inflation remained relatively high. These two factors not only had an adverse effect on earned income, but also apparently led to a short-term build-up in precautionary saving, with consumption slowing down more than total earnings in real terms.

Household consumption can be expected to become firmer to some extent starting in Q2, stimulated in particular by the decline in inflation but also by the slight improvement that is expected on the employment front between now and the end of the year. This would mean that it would return to annualised growth of the order of 2% in H2.

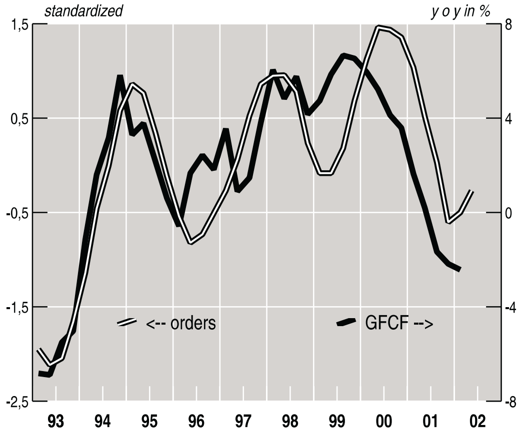
After being very strong since 1998, growth in employment in the euro zone eased in 2001, with the year-on-year rate falling to around 1% at the end of

INVENTORY CHANGES AND MANAGERS' OPINION ON INVENTORY



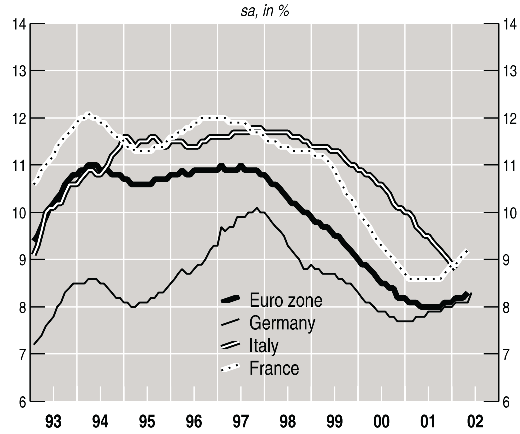
source : EUROSTAT, quarterly accounts and conjoncture survey

EVOLUTION OF INVESTMENT AND ORDERS



sources : EUROSTAT, European Commission (ECFIN)

HARMONIZED UNEMPLOYMENT RATE



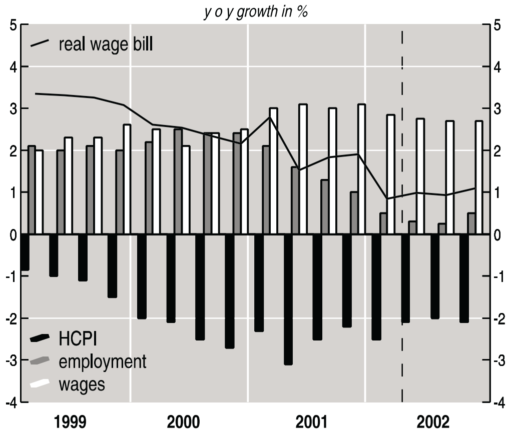
sources : national harmonized by Eurostat the year from 2¼% a year earlier. This slowdown is expected to continue in H1 2002 in view of the lags inherent in the productivity cycle, but a levelling out would take place in H2 as a result of the upturn in activity.

Individual country situations nevertheless remain heterogeneous. Employment has stood up relatively well in the Netherlands and especially in Italy during 2001, the slowdown being more appreciable in France. In particular, the German labour market remains much less buoyant than those of the other economies in the zone. There were net job losses in Q4 2001 and Q1 2002, giving an annualised decline of almost 1%. A gradual recovery is expected as of Q2, with the number of vacancies in the German economy recovering since the beginning of the year. Conversely, to judge by the replies to the Reuters PMI survey for May, the firmness of the Italian labour market, which had hitherto suffered very little from the slowdown in activity, could now start to fade.

Because of the slowdown in job creation, the euro-zone unemployment rate stopped falling in mid-2001 and has since been edging up slightly, from 8% in June 2001 to 8.3% in April 2002. It is in

WAGE BILL AND CONTRIBUTIONS IN EURO ZONE

y o y growth in %



forecasts after the dotted line

France and the Netherlands that the recent figures have been least encouraging. The rise in the unemployment rate in the German case took place as of the early part of 2001 but then proceeded at a more moderate pace, as the evolution in the labour force base is less dynamic there than in other countries. Finally unemployment in Italy continued to decline towards

FORECASTS FOR THE EURO ZONE'S LARGEST COUNTRIES (OTHER THAN FRANCE)

(annual and quarterly % change)

Annual changes 2001	Annual changes 2002		Quarterly 2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
		GERMANY								
0.7	0.7	GDP	0.4	0.0	-0.2	-0.3	0.2	0.5	0.6	0.6
0.5	2.2	Imports	-5.4	1.1	-1.7	0.0	-2.9	5.5	1.0	4.0
1.2	0.2	Household consumption	1.0	0.7	-0.3	-0.5	-0.3	0.7	0.4	0.4
1.7	1.3	Public consumption	1.1	0.1	-0.3	0.9	0.4	0.5	-0.3	0.5
-4.5	-3.2	Total GFCF	-2.2	-1.5	-1.5	-0.9	-0.7	-0.8	-0.3	0.5
5.2	5.5	Exports	0.1	0.3	0.6	-1.1	1.9	2.5	3.0	2.5
0.0	*-0.3*	*Contributions(1) : Domestic demand ex. stocks*	*0.3*	*0.1*	*-0.5*	*-0.3*	*-0.2*	*0.3*	*0.1*	*0.4*
-0.9	*-0.3*	*Inventory change*	*-1.8*	*0.2*	*-0.4*	*0.4*	*-1.2*	*1.0*	*-0.3*	*0.5*
1.6	*1.3*	*Foreign trade*	*1.8*	*-0.3*	*0.8*	*-0.4*	*1.6*	*-0.8*	*0.8*	*-0.4*
		ITALY								
1.8	1.1	GDP	0.7	0.1	0.0	-0.2	0.2	0.6	0.8	0.7
0.2	0.1	Imports	-1.1	2.0	-2.8	-1.9	-0.4	1.8	1.8	2.5
1.1	0.6	Household consumption	0.3	0.3	-0.4	0.1	-0.2	0.6	0.6	0.6
2.3	1.6	Public consumption	0.7	0.4	0.4	0.4	0.6	0.2	0.4	0.1
2.4	-0.6	Total GFCF	1.3	0.7	0.0	-0.2	-2.4	1.0	1.5	1.0
0.8	-0.2	Exports	0.3	-0.2	-2.4	-0.2	-2.1	2.5	2.0	2.0
1.6	*0.5*	*Contributions(1) : Domestic demand ex. stocks*	*0.6*	*0.4*	*-0.1*	*0.1*	*-0.5*	*0.6*	*0.7*	*0.6*
0.0	*0.6*	*Inventory change*	*-0.3*	*0.4*	*0.1*	*-0.8*	*1.2*	*-0.2*	*0.0*	*0.2*
0.2	*-0.1*	*Foreign trade*	*0.4*	*-0.6*	*0.1*	*0.5*	*-0.5*	*0.2*	*0.1*	*-0.1*
		SPAIN								
2.8	1.9	GDP	0.8	0.4	0.9	0.2	0.5	0.3	0.6	0.7
3.7	1.2	Imports	1.1	0.6	-2.0	0.3	-0.1	1.3	1.3	1.2
2.7	1.9	Household consumption	0.8	1.0	0.3	0.6	0.2	0.4	0.6	0.7
3.1	1.9	Public consumption	0.8	0.9	0.8	0.7	0.5	0.1	0.3	0.1
2.5	1.9	Total GFCF	0.8	0.4	0.9	-1.1	0.6	0.8	1.1	1.3
3.4	-0.2	Exports	-1.7	0.1	0.1	-0.4	-1.4	0.8	1.2	1.2
2.8	*1.9*	*Contributions(1) : Domestic demand ex. stocks*	*0.8*	*0.8*	*0.5*	*0.2*	*0.4*	*0.5*	*0.7*	*0.8*
0.1	*0.4*	*Inventory change*	*0.9*	*-0.2*	*-0.3*	*0.1*	*0.5*	*0.0*	*0.0*	*0.0*
-0.1	*-0.4*	*Foreign trade*	*-0.9*	*-0.2*	*0.7*	*-0.2*	*-0.4*	*-0.2*	*-0.1*	*0.0*

Forecast

(1) It might happen, for statical reasons, that the sum of the contributions does not exactly match the GDP variation at a given date.
Source: Direction de la prévision for Spain. Insee for Germany and Italy.

the end of last year. For the euro zone as a whole, the unemployment rate can be expected to stabilise between now and the end of the year, thanks to the slight improvement expected on the labour market in H2.

Meanwhile, the wage restraint that had prevailed in most countries of the zone in 2001 is likely to continue throughout 2002. In Italy and Spain contractual wages rose more firmly than in France and Germany.

In the final analysis, the slowdown in nominal earned incomes recorded in the euro zone since the beginning of 2001 could ease in H2 2002. In addition, purchasing power would benefit from the decline in inflation seen this spring. In these circumstances, household consumption should recover somewhat between now and the end of the year.

Brisk import growth

Firmer household consumption and especially the revival in inter-industry trade linked to the reversal of inventory behaviour and to the upturn in investment should lead to a distinct recovery in imports following five consecutive quarters of decline. Including intra-zone trade, they are likely to grow at an annualised rate of the order of 4% in H1, followed by 9% in H2. ■

Consumer prices in the euro zone

Inflation in the euro zone eased back in H1 2002, with the gradual exit from the year-on-year calculation of the sharp price rises recorded for foodstuffs and energy in 2001. Despite a brief rise to 2.7% in January, due to this winter's surge in prices of fresh produce, inflation returned to 2.0% in May 2002.

Core inflation stabilised in Q2 following more than two years' steady rise. After peaking at 2.6% in May, it is now expected to fall back slightly during the rest of the year, under the delayed impact of the slowdown in industrial producer prices, to stand at 2.4% in December 2002.

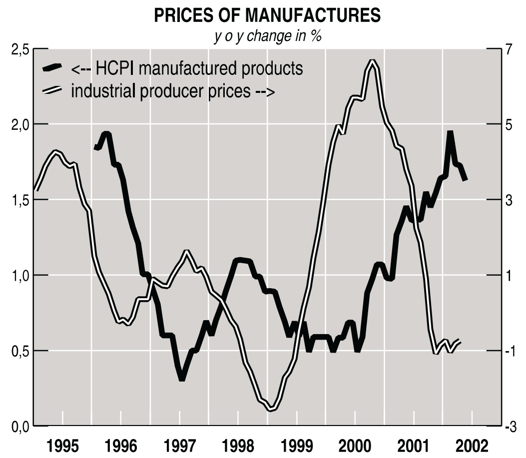
On the assumption of a stabilisation of the Brent price at USD 25/barrel and an EUR/USD exchange rate of 0.94, inflation is unlikely to change much this summer. Towards the end of the year, it is likely to rise temporarily because of the exit from the year-on-year calculation of the sharp rise in the oil price recorded in Q4 2001. This would mean inflation in the euro zone reaching 2.3% in December 2002.

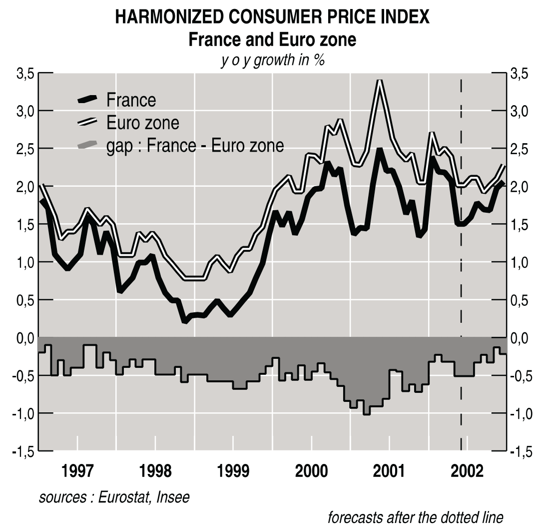
Relatively firm core inflation

The negative contribution of energy prices and the marked slowdown in food prices enabled inflation in the euro zone to ease back in H1 2002. In May 2002, the year-on-year rise was 2.0%, 1.4 of a point down from its May 2001 peak.

This easing of inflation is almost entirely the result of predictable base effects in the food and energy sectors. The exit from the year-on-year calculation of the sharp rises in food prices posted in H1 2001 (animal health crises and poor weather conditions) led to a slowdown in prices for this grouping, from 5.2% in May 2001 to 2.7% a year later, despite the surge in prices of fresh produce this winter. A similar mechanism meant that prices of energy slowed down even more, with the final disappearance of the effects of the oil price shock: -2.8% in May 2002, as against +8.7% a year earlier. In total, the contribution to the decline in inflation in the euro zone amounted to 0.6 of a point in the case of food and 1.1 point in the case of energy.

Core inflation[1], on the other hand, showed a less favourable evolution, stabilising only in Q2 2002 and then at a fairly high level: 2.6% in May. It was pushed up partly by the prices of manufactured goods. The steady slowdown in industrial producer prices between July 2000 and December 2001 only began to feed through into retail prices of manufactured products at the end of Q1, when it initiated a decline in the year-on-year price rise for this grouping. Over the previous 12 months, the prices of manufactured were neutral in relation to the decline in overall inflation.





Furthermore, the year-on-year rise in prices of services has increased to 3.3% in May 2002 from 2.5% a year earlier. This tendancy was fuelled by the appreciable acceleration in prices of hotels-cafes-restaurants (ending of the diffusion of past wage rises

(1) As measured by the HICP (Harmonised Index of Consumer Prices) ex energy, foodstuffs, alcohol and tobacco.

and the impact of the changeover to the euro) and healthcare prices (upward adjustment in consultation fees in France, in particular), but also by the ending of price cutting in the telephone sector. In the end, the prices of services have held back the decline of inflation over the last 12 months, making a postive contribution of 0.3 of a point.

Two groups of euro-zone countries

By May 2002, the year-on-year price rise had fallen back below 2.0% for half the countries in the euro zone: Austria, Belgium, Finland, France, Germany and Luxembourg. Between May 2001 and May 2002 the maximum inflation spread between euro-zone countries widened from 2.9 points to 3.4 points. This increase reflects a certain divergence in price tendencies between two groups of countries within the zone, a divergence that had been temporarily masked by the 2000 oil price shock and the strength of food prices in 2001.

Indeed, in Ireland (which has the highest inflation of the zone at 5.0%), the Netherlands and the countries in the south of the zone, inflation remains higher than 3.0%. Prices of services in these countries have risen substantially faster than the average for the zone. This situation is explained by the existence of structural inflationary forces, resulting not from any «overheating of the economy», but from economic «catch-up» phenomena (the Balassa-Samuelson effect) or from temporary cyclical lags[(2)]. Italy, with inflation ranging between 2.0% and 3.0% (2.4% in May 2002), is in an intermediate situation between the two groups of countries.

(2) See the box «Inflation differentials in the euro zone», in the March 2001 issue in this series, p. 26.

EURO ZONE INFLATION BY COUNTRIES

*(year on year % growth of HCPI *)*

	May 2001	May 2002
France	2.5	1.5
Germany	3.6	1.0
Italy[(1)]	2.9	2.4
Spain[(1)]	4.2	3.7
Netherlands	5.4	3.8
Belgium	3.1	1.4
Austria	2.9	1.6
Finland	3.3	1.8
Portugal	4.9	3.4
Ireland	4.1	5.0
Luxembourg	3.8	1.3
Greece	3.9	3.8
Euro Zone[(1)]	**3.4**	**2.0**
United Kingdom	1.7	n.d.
Sweden	3.1	1.7
Denmark	2.8	1.9
E.U. [(1)]	**3.1**	**1.8**

* Harmonized Consumer Price Index
(1) Indeed taking into account the impact of bargain sales on the Italian and Spanish price indices from January 2001 is disturbing the reading of new inflation series from January to December 2001.
Source: Eurostat

Prices of services liable to hold back the decline in core inflation

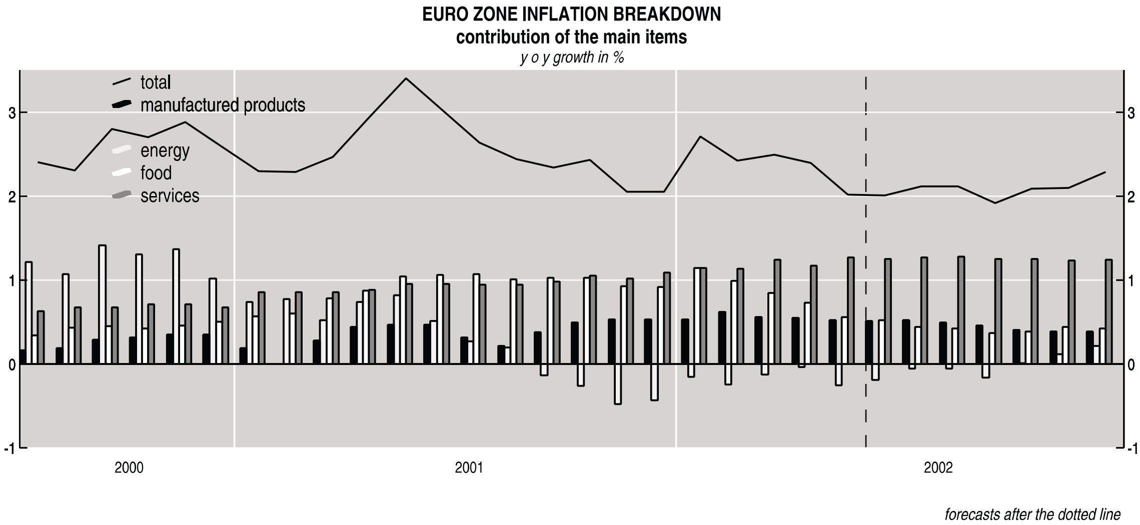
The year-on-year rise in the HICP for manufactured products reached a peak in February 2002. Helped on by the appreciation in the euro in Q2, the decline that began from then on is likely to continue and intensify until the end of 2002. This is because the levelling off in activity in 2001 produced a steady slowdown in industrial producer prices between October 2000 and November 2001 and the effects of this are now feeding through to the retail prices of manufactured products.

EURO ZONE INFLATION

(year on year % growth of HCPI)*

Sectors (weigh in the index)	May 2001	May 2002	June 2002	December 2002
Food (16.5%)	5.9	2.4	2.1	1.4
Beverage and Tobacco (4.0%)	2.9	3.9	4.6	4.6
Clothing and footwear (7.9%)	1.3	2.4	2.3	1.8
Housing. water. electricity and gas (15.0%)	4.1	1.1	0.9	1.1
Furnishings and household equipment (7.9%)	2.0	1.8	1.8	1.6
Health (3.9%)	1.1	2.4	2.8	3.8
Transports (15.2%)	3.9	0.5	1.2	3.9
Communications (2.5%)	-2.8	-0.9	-1.2	-1.2
Leisure and culture (9.5%)	2.2	1.9	1.3	0.7
Education (0.9%)	3.0	4.0	3.9	3.3
Hotels-cafés-restaurants (9.0%)	3.3	4.7	5.1	4.6
Miscellaneous goods and services (7.7%)	2.9	3.2	3.3	2.7
Total (100.0%)	**3.4**	**2.0**	**2.0**	**2.3**
Food (Beverage and Tobacco) (20.4%)	**5.2**	**2.7**	**2.5**	**2.1**
Energy (8.7%)	**8.7**	**-2.8**	**-2.2**	**2.4**
Core inflation (70.9%)	**2.0**	**2.6**	**2.6**	**2.4**
of which manufactured products(32.0%)	*1.5*	*1.6*	*1.6*	*1.2*
services (38.9%)	*2.5*	*3.3*	*3.2*	*3.2*

Forecast
* Harmonized Consumer Price Index
Source: Eurostat



The year-on-year rise in prices of services levelled off in Q2 and is not expected to diminish in H2, given that the expected slowdown in wage growth is likely to be very gradual.

In total, core inflation is expected to decline very slightly, to 2.4% in December 2002 from 2.6% in May.

An upturn towards the end of the year due to an unfavourable base effect in the case of energy prices

On the assumption of a Brent price of USD 25/barrel and an EUR/USD exchange rate of 0.94, inflation in the euro zone is likely to stabilise this summer before turning up again in Q4 2002. After remaining around 2% until October, it would rise to 2.3% in December.

This recorded rise in inflation of 0.3 of a point between May and December 2002 is explained entirely by an unfavourable base effect relating to energy prices. The exit from the year-on-year calculation of the steep rises in the oil price at the end of 2001 would lead to an acceleration in the figures for energy. Although cushioned by the appreciation in the euro, this factor would contribute 0.5 of a point to the rise in euro-zone inflation.

Meanwhile, food prices would be coming to the end of their slowdown. This would also cushion the upturn at the end of the year, with a negative contribution of 0.1 of a point to the evolution in inflation between May and December 2002. Over the same period, the modest decline in core inflation would have no notable impact on the overall figure (zero contribution).■