The euro zone's international environment

There has been a slight recovery in world economic activity. International trade seems once again to be gathering momentum, centred on the circuit linking Southeast Asia and the United States and accompanying the upturn in activity in one part of the new-technology sector. Production of electronic goods in Asia and the demand for new technologies in the United States have been gradually building up during the winter. However, the telecoms sector remains more depressed and this is hampering the revival of these sectors in Europe.

Consumption is holding up well in the United States, whereas investment continues to be held back by the excess capacity built up during the previous upswing. In manufacturing industry, the recovery is likely to manifest itself in H1 through stock rebuilding and a recovery in exports. Activity in the United Kingdom is being underpinned by the liveliness of domestic demand, boosted by a highly expansionary policy mix.

The economic situation in the emerging regions is in conformity with the geography of international trade and the location of production of new technologies. Asia is benefiting from the recovery in United States demand and seems to have recovered around the turn of the year. On the other hand, no economic upturn in Central Europe has as yet materialised in the output statistics and Latin America is still caught up in the fallout from the Argentina crisis.

Having declined throughout 2001, demand in the euro-zone's overseas markets can therefore be expected to recover gradually, with relatively low growth of around 2% at annual rate in H1 2002.

GDP IN LEADING INDUSTRIALISED COUNTRIES OUTSIDE THE EURO ZONE (SHARE OF COUNTRIES IN OECD TOTAL)

(Annual and half-yearly % change)

Annual average				Half-yearly % change		
2000	2001	2002		2001 H1	2001 H2	2002 H1
			UNITED STATES (34.0%)			
4.1	1.2	1.5	GDP	0.4	0.0	0.8
13.4	-2.7	-1.0	Imports (16%)	-3.4	-5.2	1.6
4.8	3.1	1.8	Private consumption (68%)	1.4	1.7	0.2
2.7	3.6	5.5	Public consumption (17%)	2.5	2.5	2.8
7.6	-1.9	-3.6	Total private GFCF (17%)	-2.0	-4.3	-0.7
9.5	-4.6	-4.8	Exports (13%)	-3.4	-8.3	0.3
5.1	2.3	1.5	*Contributions(2): Domestic demand excluding stocks*	1.0	0.8	0.5
-0.1	-1.2	0.2	*Stock change*	-0.9	-0.9	0.6
-0.9	-0.1	-0.4	*Foreign trade*	0.2	-0.1	-0.2
			JAPAN (17.2%)			
2.2	-0.4	-1.6	GDP	-0.2	-1.7	-0.3
9.6	-0.4	-6.0	Imports (11%)	-3.0	-6.3	-2.1
0.3	0.5	-0.2	Private consumption (59%)	0.8	0.2	-0.7
4.6	3.1	1.6	Public consumption (9%)	2.7	0.4	0.7
3.2	-1.7	-6.1	Total private GFCF (29%)	-2.1	-6.1	-0.2
12.4	-6.5	-4.3	Exports (14%)	-6.7	-5.7	-0.4
1.8	0.3	-1.5	*Contributions(2): Domestic demand excluding stocks*	0.3	-1.5	-0.3
0.0	0.0	-0.1	*Stock change*	0.0	-0.1	-0.1
0.5	-0.7	0.1	*Foreign trade*	-0.5	0.0	0.1
			UNITED KINGDOM (5.6%)			
3.0	2.4	1.3	PIB	1.2	0.5	0.5
10.9	2.8	-0.9	Importations (34%)	-0.1	-2.6	0.4
4.1	4.2	2.9	Private consumption (63%)	2.3	2.2	0.9
1.9	2.4	3.4	Public consumption (19%)	2.2	0.5	2.0
4.9	1.1	-2.3	Total private GFCF (18%)	-1.3	-3.3	-1.1
10.3	0.8	-3.4	Exports (31%)	-0.8	-4.6	-0.3
4.0	3.4	2.1	*Contributions(2): Domestic demand excluding stocks*	1.6	1.0	0.8
-0.3	-0.1	-0.1	*Stock change*	0.0	0.0	0.0
-0.7	-0.8	-0.8	*Foreign trade*	-0.2	-0.5	-0.2

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

Upturn in the new-technology sectors, stagnation in telecommunications

Since Q4 2001, encouraging signs have been coming from the world market for the new technologies. In the United States manufacturing sector, demand for IT has been improving since its low point last September. Sales of computers, deliveries of high-tech equipment and orders from industry for IT bottomed out in November. Since December, the upturn in demand in this sector has been more than just a case of stabilisation, with IT orders from industry rising by more than 15% between August and December *(Graph 1)*.

It is still too early to state with confidence that the recovery in investment in IT is here to stay, as the volatility of the data makes it impossible to extrapolate the figures for just two months. However, the upturn in United States demand could well already be breathing new life into trade between the United States and Southeast Asia[(1)]. In several Asian countries, the year-on-year change in electronics output has picked up in Q4, although still showing a levelling off in activity compared with the previous year *(Graph 2)*.

This encouraging diagnosis nevertheless has to be qualified in the light of the indicators coming out of the telecommunications industry. In this sector, the other industry spearheading the previous upswing, activity remains slack. On the back of the favourable conditions offered by the financial markets, substantial production capacity had been built up during the two previous years, in the form of equipment (routers, switching equipment) and underground optical fibre cables.

In the United States, civil engineering works built by the telecoms firms had risen at an annual rate of close to 20% in 1999 and 2000 *(Graph 3)*. Today, the sector is having to work off its past excesses. Much of the substantial surplus transmission capacity built up over recent years is unusable at present market prices. This surplus has led to a spectacular slump in the stock-market capitalisation of the whole of the sector and meant actual failure for some of the most heavily-indebted companies. The situation in Europe is little better. The IFO index of German

GDP IN OTHER REGIONS OF THE WORLD

(Annual % changes)

	Annual averages		
	2000	**2001**	**2002**
Countries in transition	6.7	4.1	3.3
Russia	8.2	5.2	4.0
Central Europe	4.0	2.2	2.0
Emerging Asia[(1)]	6.9	5.0	5.6
Latin America[(2)]	4.2	0.0	-1.6

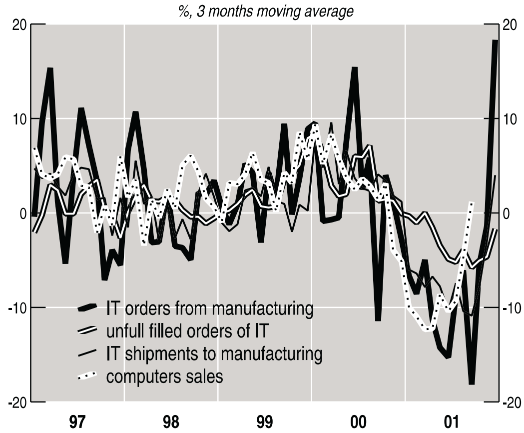
Forecast

(1) Korea. Hong Kong. Indonesia. Malaya. Philippines. Singapore. Taiwan. Thailand.
(2) Argentina. Brazil. Chile. Mexico. Venezuela.
Source: Direction de la Prévision

1

DEMAND FOR INFORMATION TECHNOLOGIES - UNITED STATES

%, 3 months moving average

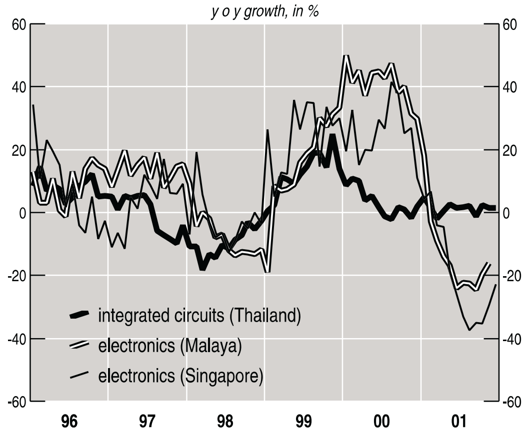


source : WEFA

2

PRODUCTION OF ELECTRONIC GOODS IN ASIA

y o y growth, in %



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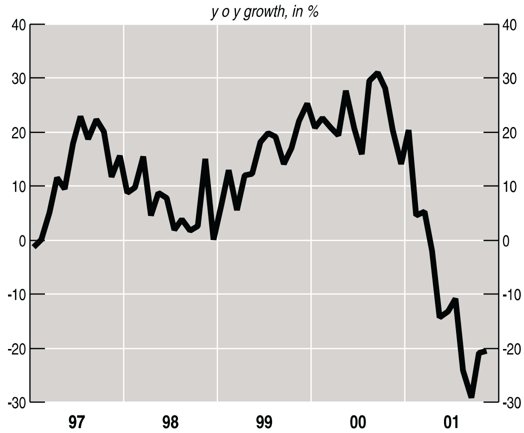
3

CIVIL ENGINEERING CONSTRUCTION IN THE TELECOM SECTOR UNITED STATES

y o y growth, in %



source : WEFA

(1) 20% of United States exports go to Southeast Asia, whereas 40% of Southeast Asia's exports go to the United States.

telecoms activity remains very low, while in the United Kingdom the production of equipment continues to decline *(Graph 4)*. The European equipment-makers have been hit particularly badly by the past excess accumulation, as well as by the bankruptcy of some of their customers to whom they had extended credit. As a result, past overinvestment, on the one hand, and the poor financial health of firms on the other are suggesting that investment in this sector can be expected to remain depressed for some time to come.

Overall, world trade in new technologies seems to have gathered a certain amount of momentum since 2001. However, the weakening of the telecoms sector is heralding more mediocre prospects in the short term for the European economy, which is more specialised in this sector. For the time being, it is the trade circuit linking Asia and the United States that seems to be deriving most benefit from the upturn appearing in the IT sector.

Recovery taking shape in the emerging regions

The return to growth now taking shape in the new technologies is setting the stage for economic upturn in some emerging regions. Southeast Asia, with its substantial exports of electronic goods, has experienced a genuine upturn in its industrial sector at the turn of the year, partly fuelled by United States demand. The January 2002 figures for the year-on-year change in industrial output were distinctly positive in Korea (+6%) and Taiwan (15%). The upturn therefore seems to have taken root in the final quarter of 2001 in this region of the world.

Possibly as a result of a different specialisation in the production of new technologies (more telecoms, less computers), the economic situation in Western Europe seems to be lagging slightly behind that of the United States. Moreover, the Russian economy, after several years of steady expansion fuelled by the additional income generated by the rising oil prices until 2000, went into recession in Q4 2001, slightly

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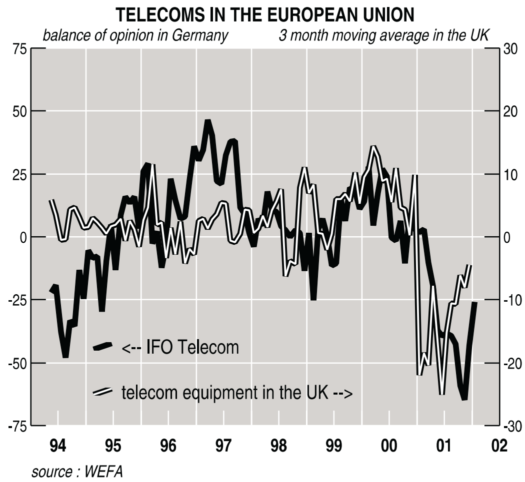

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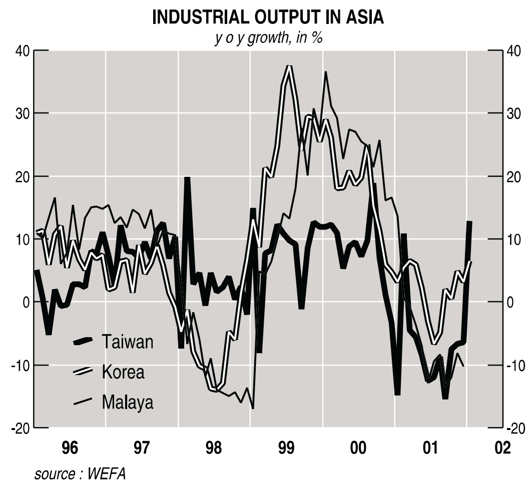

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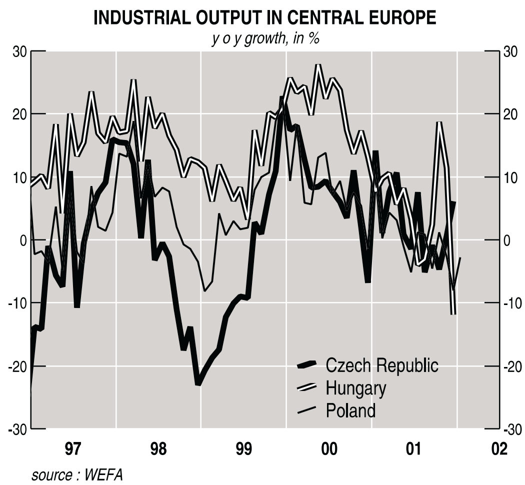

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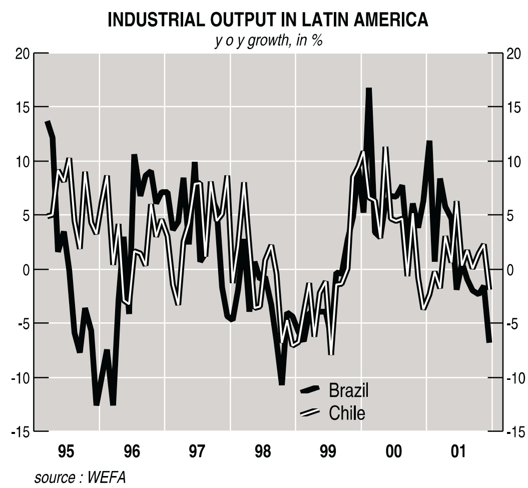

later than the rest of the world economy. These two factors explain why the upturn is hanging fire in the Central European countries, where activity has been less dynamic than in Asia around the turn of the year. In Poland and in Hungary, industrial output is still down on a year earlier. However, economic activity in these countries can hardly remain immune to the upturn elsewhere, as is suggested by the stabilisation of business leaders' opinion in these countries reported in the latest surveys.

Latin America is feeling the shock waves from the Argentinian crisis. Although Argentina's economy is not particularly open to international trade, the recession there is on such a scale that Brazil and Chile have not been left unscathed. The end of 2001 found industrial output continuing to decline in these countries.

Early recovery in the United States

The United States economy showed signs of bottoming out in Q4 2001. GDP rose by 0.3%, on the back of particularly lively consumption by both households and general government. Fuelled by the spending on repairs following the 11 September atrocities and by defence expenditure, general government consumption surged by 2.2% compared with the previous quarter, a growth rate not seen since the summer of 1986. Meanwhile, the strength of private consumption is mainly explained by the cut-throat competition between the carmakers in Q4 (price wars, zero-interest loans for the purchase of new vehicles). This demand was therefore in many cases met by de-stocking rather than by fresh production — reducing GDP growth by 0.5 of a point in Q4.

The astonishing dynamism of United States private consumption in Q4 is therefore mainly due to exceptional factors. Even so, the retail sales figures excluding automobiles for January and February illustrate the capacity of American households to maintain their consumption levels, with a rise of 1.5% compared with December, hence marking a distinct rally following the decline in Q4 2001, marked by the events of 11 September.

However, the robustness currently being shown by consumption is bound to be only relative, in view of the underlying economic determinants. For one thing, United States household income can be expected to remain lacklustre in the short term. Employment has been badly hit by the downturn in activity, with almost one million jobs lost in the private sector during the fall (just under 1% of total employment).

As a result, despite the firmness of real wages and salaries, which have benefited from the disinflation, the total real wage bill rose at an annual rate of around 1% in H2 2001. In H1 2002, even though manufacturing activity is showing signs of picking up somewhat, the situation on the labour market is unlikely to improve significantly. Furthermore, the tendency for unemployment to rise in the past year can be expected to lead to a gradual increase in household saving, with the result that consumption will probably rise only very faintly. All things con-

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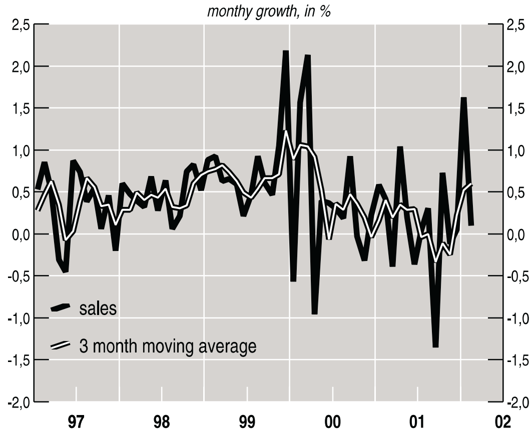
RETAIL SALES EX AUTOMOBILES - UNITED STATES

monthy growth, in %

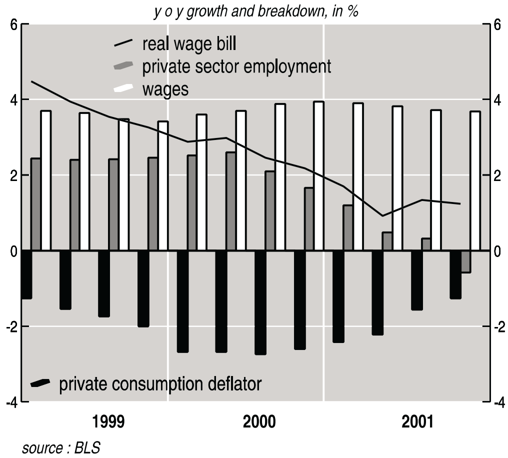


source : Census Bureau

9

REAL WAGE BILL IN THE UNITED STATES

y o y growth and breakdown, in %



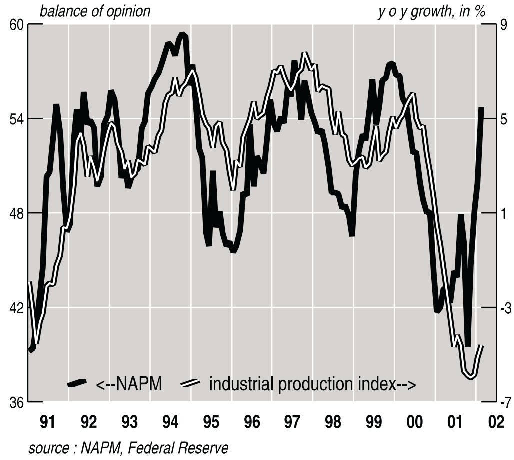
source : BLS

10

BUSINESS CONFIDENCE IN THE UNITED STATES

balance of opinion

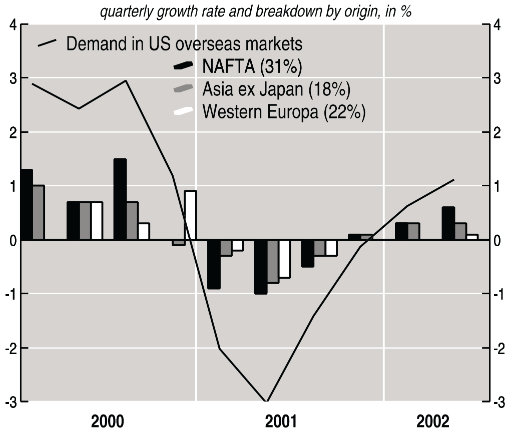
y o y growth, in %



source : NAPM, Federal Reserve

11

DEMAND IN UNITED STATES OVERSEAS MARKETS
quarterly growth rate and breakdown by origin, in %



source : Direction de la prévision

sidered, private consumption in 2002 is likely to remain handicapped by the deterioration on the labour market.

Meanwhile, a recovery is taking shape in industry. Industrial output has stabilised in January and business leaders' opinions have improved very considerably. The fact is that after six consecutive quarters of heavy de-stocking (lopping 2 points off United States growth between mid-2000 and end-2001), output could well now benefit from the ending of this tendency.

This ending of de-stocking would be motivated by the relative firmness of household consumption and the recovery in world trade, the latter being demonstrated by the latest surveys, with the opinions of American businessmen concerning their export order books showing a distinct recovery over the past three months. This upturn in exports could well be stemming from the revival of trade with Asia linked to the upturn in world production of new technologies. In these circumstances, world demand for United States exports would return to positive, if slow, growth in H1 2002. The improvement in United States activity would also stimulate trade with Canada and Mexico, which together account for almost 30% of United States exports.

However, this upturn in United States industry is unlikely to be accompanied by an upturn in investment in the short term. For one thing, despite the slump recorded in 2001, the excess capacity resulting from the remarkably strong increase in investment in the past five years (corporate investment in equipment maintained an annual growth rate of roughly 15% throughout the period 1995-2000) has yet to be absorbed. For another, household demand is likely to be moderate. And, finally, the financing of any investment is becoming more difficult. Corporate profits have for the present been badly hit by the slowdown and this has reduced companies' capacity for financing investment out of their own resources. At the same time, the correction on the stock market has meant a drying-up of the sources of external financing — the financial markets provide the channel for a large part of the financing of United States investment[2].

All things considered, the American economy is likely to post positive growth in the first half of the year, with an annual rate close to 2%. Most of this improvement would stem from more favourable inventory behaviour, as well as from an upturn in exports to NAFTA and Asia. General government consumption is likely to remain brisk, while private consumption will probably continue to hold up, underpinned by the further tax cuts contained in the fiscal package voted last March — without, however, leading to a clear-cut recovery.

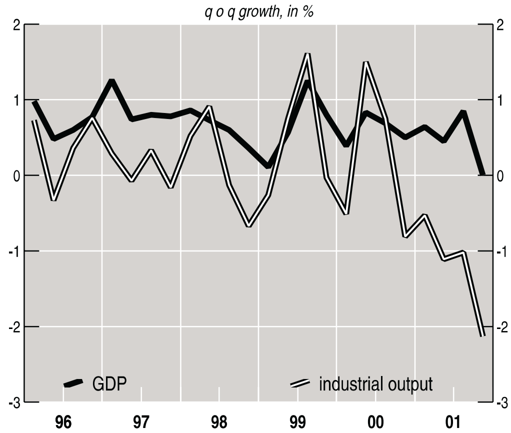
United Kingdom: activity underpinned by an expansionary policy mix

The UK economy stagnated in Q4 2001. Given the extremely marked deterioration in the international climate and the continuing high sterling exchange rate, the situation in manufacturing has continued to weaken, with industrial output at the end of the year showing its largest decline since 1984. In these circumstances, corporate investment remains depressed. More than ever, it is private consumption that is enabling the UK economy to remain buoyant, with household spending rising by 1.2% in Q4, compared with 1.1% in Q3.

However, the driving-force for UK activity provided by private consumption can be expected to slacken in H1 2002. Household incomes have already begun to suffer from the slowdown in growth and the sharp rise in the value of households' wealth in property form, which had made up for the slowdown in income in H1 2001, cannot be expected to provide as

12

NATIONAL PRODUCT AND INDUSTRIAL OUTPUT
IN THE UNITED KINGDOM
q o q growth, in %



source : WEFA

(2) However, despite their present low level, profits made by american firms could pick up rapidly as the recovery continues, in view of the severity of the workforce adjustments.

much support for consumption. Even so, the expansionary turn taken by fiscal policy could provide support for activity

The growth in UK household incomes is already slowing down. The recession in manufacturing, followed by the related slowdown in the rest of the economy, has finally begun to erode total employment. In November, the unemployment rate rose to 5.1%, 0.2 of a point above the April figure. In these circumstances wage growth has slowed down significantly, particularly via the variable portion of remuneration. Moreover, the stabilisation of inflation during the 2000 oil shock means that it is not possible to expect disinflation on a scale comparable to that about to be experienced by the United States and the continental European countries. All things considered, the purchasing power of the total wage bill was showing a distinct slowdown at the end of 2001, with the year-on-year rise falling back to around 1.5% from 3.5% at the beginning of 2001.

In these circumstances, the fact that consumption remained lively in H2 2001 (annual growth of roughly 4.5%) is explained by the monetary easing applied by the Bank of England (base rate having been cut by 200 basis points in the space of ten months).

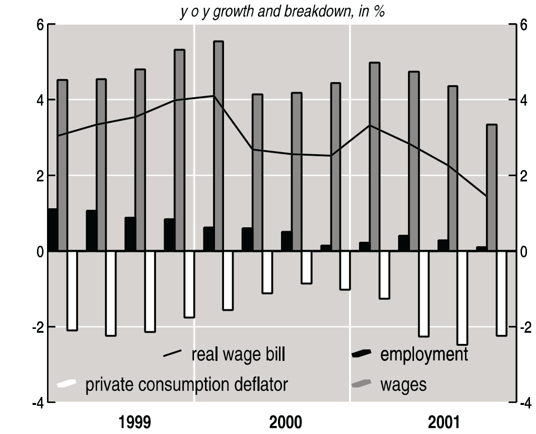
The second feature supporting monetary policy is more indirect and is based on the "wealth effect". In 2001, the decline in interest rates boosted the property market, facilitating transactions and reducing purchasers' debt. The Nationwide house price index therefore rose strongly in the summer. The impact of the cuts in interest rates was all the more noticeable in that the housing market had been relatively calm all the year, following the very sharp rise posted in the winter of 1999-2000. Not only did property owners receive a substantial addition to their capital but the UK financial system enables them to pledge the capital gains recorded on their principal dwellings to obtain consumer credits at preferential rates. Despite their ostensibly "unrealisable" nature, these gains are therefore easily transformed into new cash ("equity withdrawal"). And in fact, recourse to this type of financial product rose considerably towards the end of 2001, as it had in the winter of 1999-2000 (graph 11). This mechanism explains why, in contrast to the United States where the wealth effect is channelled also by financial assets, UK consumption is fairly responsive to a rise in house prices. In this respect, the stock-market correction seen at much the same time on the London market in 2001 turned out to be painless for households.

All in all, the expansionary turn taken by monetary policy in 2001 explains the sharp drop in the saving ratio recorded towards the end of the year, by increasing household wealth. However, this effect is bound to be only temporary. For one thing, rising uncertainty over job prospects can be expected to induce households to rebuild their saving, currently at a very low level (roughly 4% of income). For another, the loans taken out in the form of equity withdrawal will have to be repaid and the amount of these repayments will exceed new borrowing once house prices start to stabilise. Just when this stabilisation will take place is difficult to predict, but the marked slowdown in the economy and the increasing uncertainty regarding the labour market are bound at some stage to have their effect.

13

REAL WAGE BILL IN THE UNITED KINGDOM

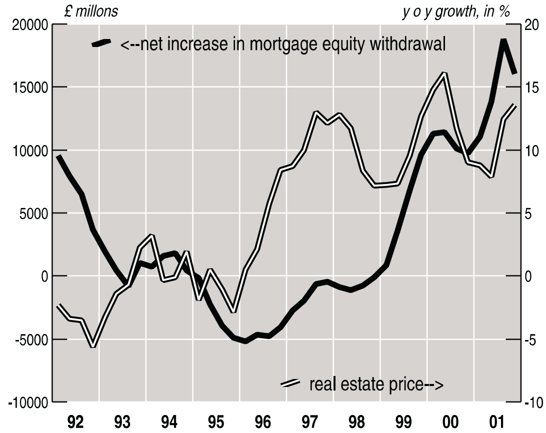
y o y growth and breakdown, in %



source : WEFA

14

REAL ESTATE INFLATION AND BRTISH HOUSEHOLDS INDEBTEDNESS



source : Nationwide et BOE

Taking all the determinants of household consumption together suggests that it can be expected to turn down during H1. This levelling off would nevertheless be compensated by the opportunely expansionary turn taken by fiscal policy for the tax year 2001-2002.

The Finance Act in fact provides for a surplus of around GBP 5 billion, compared with an outturn of GBP 18.4 billion the previous year, meaning a decline equivalent to around 1.5 of a point of GDP and perhaps even more if revenue (corporation tax) were to fall more than expected.

All things considered, the UK economy is likely to return to growth of the order of 1.5% in H1 2002, with the weakening of private consumption partly offset by the rise in public consumption. ■

The economic situation in the euro zone

Growth in the euro zone came to 1.5% in 2001. The deterioration in activity was due to the decline in external demand and, above all, to the sharp reaction this induced in corporate demand, both in terms of investment and stocks. This phenomenon was then intensified towards the end of the year by the events of 11 September. Meanwhile, private consumption was brisk in H1, before levelling off in H2. The tax cuts introduced in several leading European countries contributed to this relative firmness of household demand, while the slowdown in job creation explains why its buoyancy was somewhat eroded as the year went on.

Growth in Q2 2002 is expected to return to an annual rate of the order of 2%. Since last December, surveys of European business leaders have been showing an upturn in production prospects. The improvement in activity would be based on a return to normal stocking behaviour on the part of firms, with inter-industry flows benefiting from this tendency. On the other hand, the improvement in the outlook would be both too small and too recent for it to be possible to expect a clear-cut recovery in investment spending between now and the middle of the year.

An improved outlook for activity

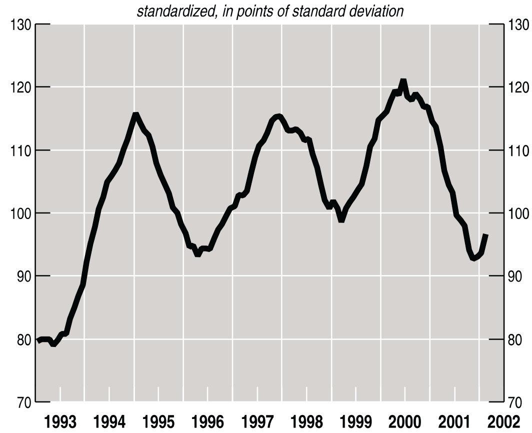
INSEE's composite indicator of the business climate, encapsulating the mood of surveys in manufacturing industry in the euro zone, steadily declined in 2001, falling towards the end of the year below the level reached in the cyclical trough of 1996. Indeed, manufacturing activity declined throughout the euro zone during the whole of 2001. This decline further intensified and became generalised to all the economies in the zone in Q4, during which industrial output fell by 6% at annualised rate.

Since last December, however, the surveys have been pointing to an improvement. The composite indicator has levelled out, before recovering strongly in February. In particular, industrialists' views regarding the production outlook have recovered strongly. Furthermore, despite a further deterioration in Q4 in industrial output and in order books, data for the month of December showed increases in Germany and in Italy, as was also the case for France in January.

It has to be said, however, that this upturn in the production outlook may merely be an overreaction to the spectacular drop in the wake of the 11 September

COMPOSITE INDICATOR FOR MANUFACTURING INDUSTRY IN THE EURO ZONE

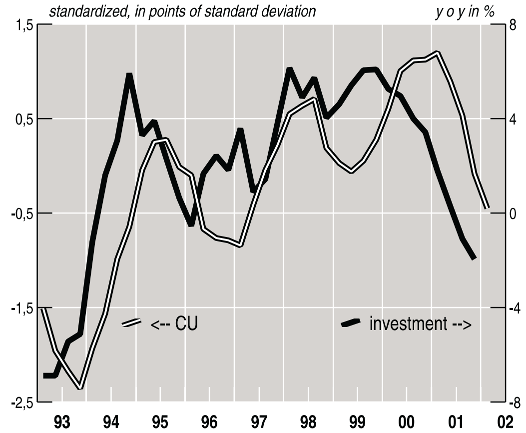
standardized, in points of standard deviation



source : European Commission, computation INSEE

INVESTMENT GROWTH AND CAPACITY UTILISATION IN THE EURO ZONE

standardized, in points of standard deviation *y o y in %*



sources : IFO, INSEE, ISAE, European Commission (ECFIN)

terrorist attacks. The strength and durability of the industrial upturn are still difficult to quantify with any precision.

Corporate demand becoming less restrictive

As far back as H1 2001, despite the fact that household demand initially remained robust, the deterioration in expectations led firms to adopt highly restrictive demand behaviour. In particular, a de-stocking cycle was launched, which then lasted throughout the year. In the final analysis, this de-stocking cost the euro zone 0.5 of a point of growth in 2001. This unfavourable stocking behaviour is likely to be reversed in H1 2002, in response to the improvement in expectations.

The external shock prompted European firms to bring numerous investment projects to a rapid halt. Throughout last year investment declined at a rate of 2%. However, the annual average for 2001 (-0.8%, compared with +4.3% in 2000) masks substantial national disparities. In particular, whereas in France, Italy and Spain productive investment maintained a slightly positive growth rate for the year, Germany stood out with a sharp decline (-4%).

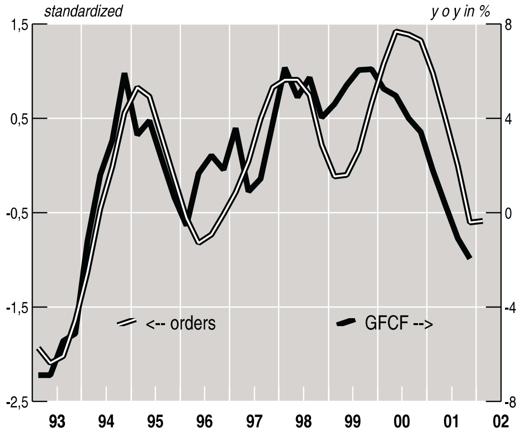
The decline in capacity utilisation rates suggests that investment is likely to continue to fall back in the euro zone in Q1 2002. The decline in domestic orders for capital goods in Q4 in Germany and Italy (by 1.2% and 2.7% respectively) supports this view.

Even so, the improvement in business leaders' demand expectations is likely to lead to a stabilisation of investment by next June.

A slowdown in private consumption

Household consumption was the mainstay for growth in the euro zone in 2001, contributing roughly 1 point to the evolution in GDP. In the early part of the year it was boosted by the tax cuts introduced simultaneously in Germany, France and Italy (representing between 0.5 and 1 percentage point of income). However, starting in Q2, following the lags normally seen in the productivity cycle, the labour market began to adjust to the slowdown in activity.

EVOLUTION OF INVESTMENT AND ORDERS



sources : EUROSTAT, European Commission (ECFIN)

Despite the disinflation seen in H2, private consumption then eased back. Among all the leading euro-zone economies, French household spending stood out last year as being particularly strong, with growth on an annual average basis at the same rate as in 2000 (2.9%). In Italy and Spain, by contrast, consumer spending slowed down appreciably. The slowdown was less marked in Germany, but growth had already been weak there in 2000.

European household consumption is expected to remain moderate in H1 2002. However, the disinflation can be expected to attenuate somewhat the

FORECASTS FOR THE EURO ZONE

(annual and quarterly % change)

	Annual changes			Quarterly changes									
	1999	2000	2001	2000				2001				2002	
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
GDP													
Growth rate	2.6	3.4	1.5	0.9	0.9	0.4	0.6	0.5	0.1	0.2	-0.2	0.2	0.5
year on year growth	-	-	-	3.6	3.9	3.2	2.8	2.4	1.6	1.4	0.6	0.3	0.7
IMPORTS													
Growth rate	7.2	10.9	1.8	2.3	2.5	2.8	3.0	-1.6	0.1	-1.3	-1.1	0.1	0.8
year on year growth	-	-	-	10.4	10.8	11.3	11.1	6.9	4.4	0.2	-3.7	-2.1	-1.3
HOUSEHOLD CONSUMPTION													
Growth rate	3.2	2.5	1.8	0.8	0.7	0.1	0.2	1.0	0.4	0.1	0.1	0.4	0.5
Contribution	1.8	1.4	1.0	0.5	0.4	0.0	0.1	0.6	0.2	0.0	0.1	0.2	0.3
year on year growth	-	-	-	2.6	3.3	2.4	1.8	2.0	1.7	1.7	1.6	1.0	1.1
GFCF													
Growth rate	5.5	4.4	-0.2	1.4	0.9	1.1	0.0	-0.2	-0.6	-0.3	-0.8	-0.4	0.4
Contribution	1.2	0.9	-0.1	0.3	0.2	0.2	0.0	0.0	-0.1	-0.1	-0.2	-0.1	0.1
year on year growth	-	-	-	5.2	5.0	4.0	3.4	1.8	0.3	-1.1	-1.9	-2.1	-1.1
EXPORTS													
Growth rate	5.3	12.2	3.4	3.3	2.4	3.2	2.8	0.0	-0.5	-0.4	-0.9	-0.1	0.5
year on year growth	-	-	-	12.6	11.9	12.2	12.2	8.6	5.6	1.8	-1.8	-1.8	-0.9
DOMESTIC DEMAND EXCL. STOCKS													
Growth rate	3.5	2.8	1.4	0.9	0.7	0.3	0.3	0.7	0.2	0.0	0.0	0.2	0.5
Contribution	3.4	2.8	1.3	0.8	0.7	0.3	0.3	0.6	0.2	0.0	0.0	0.2	0.5
year on year growth	-	-	-	3.0	3.4	2.6	2.1	1.9	1.4	1.2	0.9	0.5	0.8
FOREIGN TRADE													
Contribution	-0.5	0.6	0.6	0.4	0.0	0.2	0.0	0.6	-0.2	0.3	0.0	-0.1	-0.1
STOCKS													
Contribution	-0.2	0.0	-0.5	-0.4	0.2	-0.1	0.4	-0.7	0.1	-0.1	-0.2	0.0	0.2

Forecast

effects of the slowdown in nominal income, enabling private consumption to follow an annualised growth path of between 1.5% and 2%.

The rapid fall in the unemployment rate that has been characteristic of the European economic landscape for almost three years was interrupted at the beginning of 2001. It then remained virtually stable, standing at 8.4% in December, as against 8.5% a year earlier.

The levelling off in the unemployment rate took place earlier in Germany, Belgium and Austria (Q4 2000). Unemployment began to rise again at the beginning of Q3 in these countries, as well as in France and the Netherlands. Italy and Spain stand out, inasmuch as the decline in unemployment continued throughout 2001, although more slowly than previously.

The rise in the unemployment rate is explained by the marked slowdown in non-farm competitive-sector employment. This slowdown began in Q2 2001, following the normal lag inherent in the productivity cycle. The year-on-year change in job creation fell back to roughly 1.5% from more than 2%. The deterioration was particularly marked in Germany, where private employment declined in H2 2000 after stagnating in H1. In France and to a smaller extent in Italy, employment continued to rise in Q4, but at a slower rate. Spain was the country where the slowdown in employment was least marked.

All things considered, the real wage bill paid out by the private sector, which was still rising at annualised rates of more than 2% at the beginning of 2002, slowed down appreciably from Q2 2001 on, under the combined effects of the slowdown in employment and the price pressures seen in Q2. In H1 2002, the further slowdown in employment is likely to continue to hold back the rise in the real wage bill(1), with the year-on-year change likely to be of the order of 1.5% at the end of June.

Foreign trade set to improve in H1 2002

Against a background of worsening international economic conditions, a tendency that intensified during the year, exports (including intra-zone trade) fell back considerably, from year-on-year growth of the order of 12% throughout 2000 to -2% at the end of 2001.

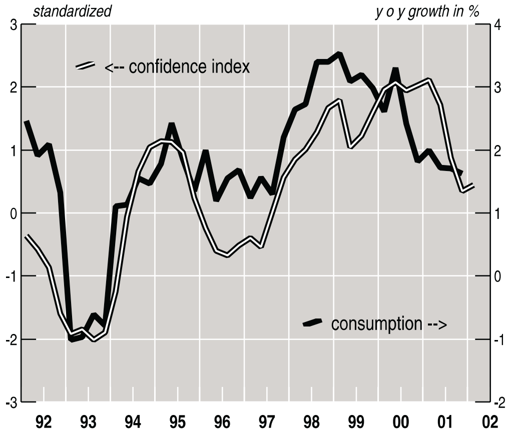
Reflecting the sharp drop in corporate demand, the slump in imports (including intra-zone trade) was even greater. At the end of the year, the year-on-year change came out at roughly -4%, compared with +10% a year earlier.

All things considered, despite the fact that the initial shock was external, foreign trade made a positive contribution of 0.6 of a point to GDP growth in 2001.

In H1 2002, foreign trade flows should probably return to positive growth, with intra-zone inter-industry trade benefiting from the reversal in corporate stocking behaviour. ■

(1) *Taking the HCPI as deflator in this case.*

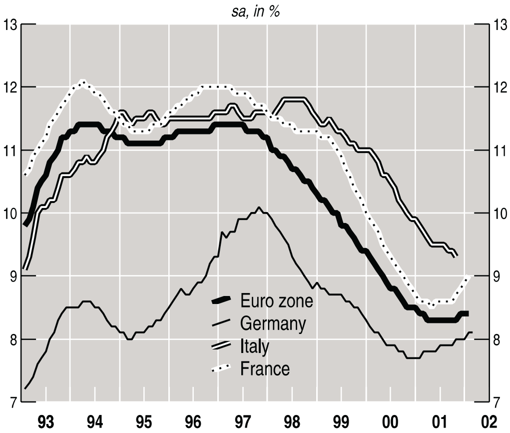
HOUSEHOLD CONSUMPTION AND CONFIDENCE INDEX IN THE EURO ZONE



sources : national and Eurostat

HARMONIZED UNEMPLOYMENT RATE

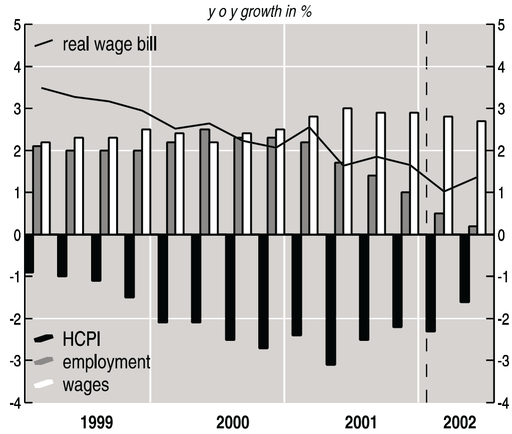
sa, in %



sources : national harmonized by Eurostat

WAGE BILL AND CONTRIBUTIONS IN EURO ZONE

y o y growth in %



forecasts after the dotted line

Consumer prices in the euro zone

After a temporary "spike" in January 2002 at 2.7%, inflation in the euro zone resumed the downward tendency that began in H2 2001, to stand at 2.4% in February 2002. Meanwhile, underlying inflation reached 2.5%.

The surge in prices of fresh produce during the winter is the main explanation for the unexpectedly large increase in inflation in the early part of the year. The changeover to the euro seems not to have been entirely neutral in its effect on prices, but the additional impact is not thought to have exceeded 0.2 of a point.

The economic slowdown and the downturn in wage costs can be expected from now on to contribute to the fall in underlying inflation. With the disappearance of the impact of the higher food prices, the year-on-year change in the overall index is therefore likely to continue to decline in H1 2002. Assuming a stable Brent price of USD 22/barrel and a USD/EUR exchange rate of 0.88, inflation in the euro zone can therefore be expected to be 1.7% in June 2002.

A tough winter for prices of fresh produce

The stabilisation of oil prices continued to contribute to the gradual decline in inflation in the euro zone in the run-up to winter, a tendency hampered by the strength of prices of services. From its May 2001 peak (3.4%), the year-on-year change in the price index therefore fell back to 2.4% in February 2002. This gives a decline of 0.2 of a point over 12 months, since inflation stood at 2.6% in February 2001 according to the previous measure *(see box on methodology)*.

As expected, there is a major scissors effect to be observed between energy prices and underlying inflation[(1)]. The exit from the year-on-year calculation of the sharp rises in the oil price recorded in Q3 2000 contributed -1.0 point to the change in inflation over 12 months. In the other direction, prices of services and manufactures have continued to accelerate during the winter, pushed up by the delayed effects of

(1) Measured by the HICP excluding energy, food, alcohol and tobacco.

EURO ZONE INFLATION BY COUNTRIES

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

	February 2001	February 2002
France	1.4	2.2
Germany	2.5	1.8
Italy	2.7	2.7
Spain	4.0	3.2
Netherlands	5.0	4.5
Belgium	2.5	2.5
Austria	1.8	1.7
Finland	2.7	2.5
Portugal	4.9	3.3
Ireland	3.9	4.9
Luxembourg	2.9	2.2
Greece	3.5	3.8
Euro Zone	**2.6**	**2.4**
United Kingdom	0.8	n.d.
Sweden	1.5	2.7
Denmark	2.3	2.4
E.U.	**2.3**	**2.3**

* Harmonized Consumer Price Index
Source: Eurostat

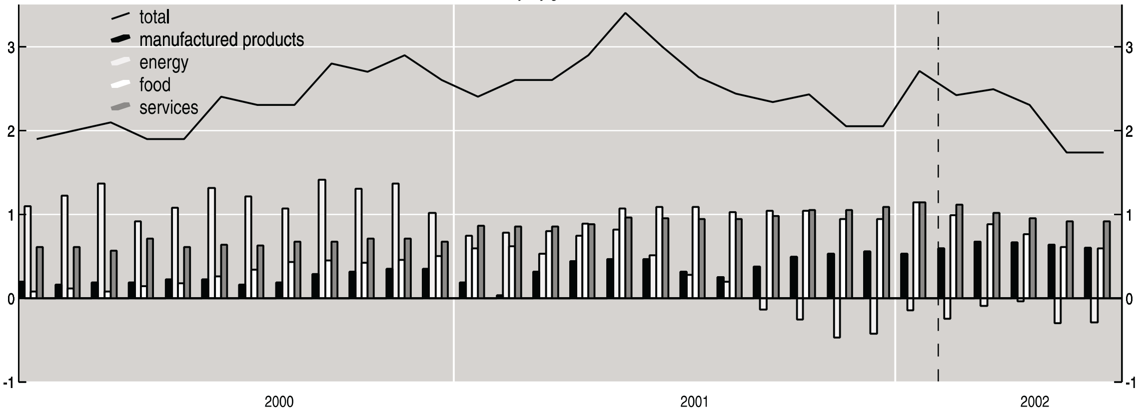
CHANGES IN METHODOLOGY AND SERIES REVISIONS

In January 2002, the Spanish and Italian statistical institutes began to take into account in their calculation of the HICP the impact of bargain sales on prices, in conformity with Eurostat's recommendation. This has led to sharp one-off falls in the price level for the months in which these sales are held. To prevent this modification from having too disturbing an effect on the comprehension of this year's inflation figures, the series of price indices for these two countries, and hence for the euro zone, have been revised going back to January 2001. However, since the indices have not been revised before that date, the figures for the year-on-year price changes during 2001 have been artificially modified.

For example, at the beginning and in the middle of last year, there was a sharp downward correction in the year-on-year change in the HICP for Italy and Spain, and hence, to a smaller extent, for the euro zone, merely reflecting the taking into account, for the first time, of a "sales" effect that had not been measured in 2000.

In practice, in order to analyse the evolution of inflation between 2001 and 2002, it is better to use year-on-year changes calculated on indices that are methodologically homogeneous, i.e. to persist with the old inflation series for 2001 and shift to a new series starting in January 2002. ■

EURO ZONE INFLATION BREAKDOWN
contribution of the main items
y o y growth in %



forecasts after the dotted line

the rise in wage costs and in industrial producer prices during the year 2000. All in all, underlying inflation has contributed 0.5 of a point to the evolution in the year-on-year change in the overall index between February 2001 and February 2002.

Food prices have risen more than expected. The bad weather conditions in November and December (a cold spell affecting all the Mediterranean countries) triggered off a further acceleration in the prices of fresh produce, which in January 2002 recorded unprecedentedly high growth rates (a monthly rise of 13.6% in the case of fresh vegetables). As a result of this climatic quirk, food prices contributed 0.3 of a point to the evolution in inflation between February 2001 and February 2002

The small impact on prices of the changeover to the euro

Throughout H2 2001, the imminent changeover to the euro as legal tender had inspired fears of inflation, but these seem to have been exaggerated, to judge by the initial figures available. Much more than the changeover, it was the surge in the prices of fresh produce that was at the origin of the spike in inflation recorded in the early part of the year in the euro zone. The overall impact of the changeover to the euro on inflation is not thought to have exceeded 0.2 of a point for the year-on-year change *(see box)* and seems to have been concentrated mainly on the "recreation and culture" and "restaurants and hotels" groupings.

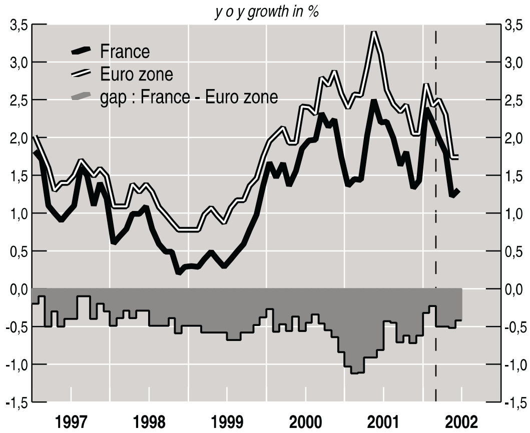
However, inflation has evolved differently in different countries. Between February 2001 and February 2002, it declined in six countries of the zone. On the other hand, it rose in Ireland (1.0), in France (0.9) and in Greece (0.3). There is a persistent gap between countries where inflation remains high — Netherlands (4.5%), Ireland (4.9%), Greece (3.8%) — and those where inflation is below 2.0% — Germany (1.8%), Austria (1.7%). However, the maximum difference has narrowed from 3.5 points in February 2001 to 3.2 points in February 2002

The sources of inflation drying up

Growth in wage costs in the euro zone peaked in Q4 2000. The downturn seen since the beginning of 2001 is likely to mean that this will no longer be a factor fuelling inflation in the services sector, where the year-on-year price change is expected to start to decline in Q2 2002. In parallel, industrial producer prices have slowed down sharply throughout 2001, under the impact of the levelling off in activity. This should assist in a decline in the year-on-year price change in prices of manufactures in Q2.

All in all, given the weakening of the sources of inflationary pressures, underlying inflation in the euro zone, after levelling off at 2.5% in the early part of year, seems set to fall to 2.2% in June 2002.

HARMONIZED CONSUMER PRICE INDEX
France and Euro zone
y o y growth in %



sources : Eurostat, Insee

forecasts after the dotted line

JANUARY 2002: HAS THE EURO ADDED TO INFLATION?

In January 2002, prices in the euro zone rose by 0.5% and year-on-year inflation increased to 2.7% from 2.0% in December 2001. This acceleration in the overall index coincided with the changeover to the euro as legal tender. A detailed analysis of the components of the HICP can throw light on the impact of the shift to pricing in euros on the observed progress of inflation.

The "shift to the euro" effect: +0.2 of a point at most

In January 2002, Italy and Spain revised their HICP series back to January 2001 in order to take account of periodical bargain sales. In order to obtain the best possible assessment of the acceleration in prices, it is therefore preferable to compare inflation in December 2001, as measured by the previous method, with observed inflation in January 2002 (see box on the methodology). On this basis, the upturn in inflation in the euro zone in January 2002 would therefore amount to 0.6 of a point, roughly broken down as follows:

- ab·0.05 of a point from the rise in prices of alcoholic beverages and tobacco, linked to the increase in indirect taxes on tobacco in France and in Germany;
- ab·0.25 of a point as a result of the energy base effect, spread over the transport and housing-water-gas-electricity items, due to the exit from the year-on-year calculation of the sharp rises in energy prices in January 2001;
- ab·0.1 of a point due to the acceleration in prices of fresh produce as the result of adverse weather conditions.

This leaves an "unexplained" residual of 0.2 of a point of inflation as the order of magnitude of the impact on price movements imputable to the shift to the euro.

The gap between the forecasts made in December and the January 2002 out-turn (+0.3 of a point for the year-on-year change in the HICP) is also, in principle, a way of evaluating the effect, since the forecasts made in the December issue in this series were made on the assumption of overall neutrality of the shift to the euro as regards prices. In this case it is necessary to identify a posteriori the sources of the difference in order to arrive again, but by a different route, at an "unexplained" residual.

The main difference between forecast and out-turn was recorded in food prices. This is explained, not by unjustified price rises profiting from the shift to pricing in euros, but to the sharp rises in prices of fresh produce related to this winter's bad weather conditions (+0.2 of a point). A second identifiable source of error, but in the opposite direction (-0.1 of a point), is that the one-off rises in indirect taxation on tobacco implemented in January 2002 were smaller than initially announced in the case of Germany.

After adjustment for these two phenomena, the forecasting error again leaves a residual effect of the shift to the euro on inflation of at most 0.2 of a point in terms of year-on-year change. It seems to have been particularly pronounced in the "recreation and culture" and "restaurants and hotels" sectors, where a significant forecasting error is to be found that could be due among other things to the drawing up of new psychological pricing schedules in euros[(1)].

The order of magnitude obtained is compatible with the estimate put forward by Eurostat, which estimates the impact in January of the shift to the euro to be +0.16 of a point of inflation. ■

(1) Regarding the impact of the shift to psychological pricing schedules in euros, see the special article in the December 2001 note in this serie.

EURO ZONE INFLATION

(year on year % growth of HCPI)*

Sectors (weigh in the index)	December 2001		January 2002		
	New series	Previous series	Forecasts (1)	Out-turn	Contribution (2)
Total (100.0%)	**2.0**	**2.1**	**2.4**	**2.7**	**0.56**
Food (16.4%)	5.1	5.1	4.0	5.8	0.12
Beverage and Tobacco (4.0%)	3.0	3.0	6.2	4.4	0.06
Clothing and footwear (7.8%)	2.3	2.1	2.5	2.2	0.01
Housing. water. electricity and gas (15.6%)	1.0	1.0	1.4	1.3	0.05
Furnishings and household equipment (7.9%)	2.2	2.2	2.1	2.0	-0.02
Health (3.9%)	1.0	1.0	1.4	1.8	0.03
Transports (15.6%)	-0.5	-0.5	0.4	0.8	0.21
Communications (2.3%)	-1.6	-1.7	-1.8	-1.4	0.01
Leisure and culture (9.4%)	1.8	1.8	0.8	1.7	-0.01
Education (0.9%)	3.7	3.7	3.7	4.0	0.00
Hotels-cafés-restaurants (8.8%)	3.6	3.7	3.9	4.2	0.05
Miscellaneous goods and services (7.4%)	3.4	3.4	3.3	3.4	0.01

(1) Forecasts made in December 2001 with previous series (that is without bargain sales in Italy and Spain).
(2) Contribution to the inflation variation between December 2001 (previous series) and January 2002 (new series).
Source: Eurostat

Consumer prices in the euro zone

EURO ZONE INFLATION

(year on year % growth of HCPI)*

Sectors (weigh in the index)	February 2001		February 2002	March 2002	June 2002
	Previous series	New series			
Total (100.0%)	**2.6**	**2.3**	**2.4**	**2.5**	**1.7**
Food (16.4%)	3.2	3.2	5.2	4.3	2.5
Beverage and Tobacco (4.0%)	2.3	2.3	3.7	4.5	4.2
Clothing and footwear (7.8%)	0.7	-3.1	2.7	2.6	2.4
Housing. water. electricity and gas (15.6%)	4.8	4.8	1.2	1.7	1.3
Furnishings and household equipment (7.9%)	1.5	1.5	1.9	1.8	1.5
Health (3.9%)	1.2	1.2	2.0	2.1	1.9
Transports (15.6%)	2.7	2.8	0.5	0.8	-0.6
Communications (2.3%)	-4.3	-4.3	-1.3	-1.3	-1.0
Leisure and culture (9.4%)	1.8	1.8	1.7	1.7	1.9
Education (0.9%)	3.0	3.1	3.9	3.9	3.9
Hotels-cafés-restaurants (8.8%)	2.8	2.9	4.3	4.5	4.3
Miscellaneous goods and services (7.4%)	2.5	2.4	3.3	2.9	2.4
Food (Beverage and Tobacco) (20.4%)	**3.1**	**3.1**	**4.8**	**4.3**	**2.9**
Energy (9.5%)	**8.2**	**8.2**	**-2.8**	**-1.0**	**-3.3**
Core inflation (70.1%)	**1.7**	**1.2**	**2.5**	**2.4**	**2.2**
of which manufactured products(32.1%)	1.1	0.1	1.9	2.1	1.9
services (38.0%)	2.2	2.2	2.9	2.6	2.4

Forecast
* Harmonized Consumer Price Index
Source: Eurostat

Inflation below 2.0% in Q2

On the assumption of a Brent price close to USD 22/barrel and a USD/EUR exchange rate of 0.88, inflation in the euro zone can be expected to continue to decline in H1 2002, reaching 1.7% in June compared with 2.0% in December 2001. The one-off rise (to 2.7%) recorded in January, due to a base effect in the case of energy prices and to the surge in prices of fresh produce, would therefore be rapidly wiped out.

The evolution in food prices seems likely to continue to determine the month-to month pattern over time of inflation in the euro zone. On the assumption of a return to a normal growth rate for food prices in Q2, the decline of 0.3 of a point in inflation between December 2001 and June 2002 would be explained mainly by the contribution of the “food, alcohol and tobacco” component (of the order of -0.3 of a point). The slowdown in the prices for this grouping reflects the exit from the year-on-year calculation of the food price rises recorded in Q2 2001. The downturn in underlying inflation, for its part, would contribute 0.1 of a point to the slowdown in the overall index. Finally, because of the higher assumption regarding the oil price, the year-on-year rise in energy prices is likely to stand in June 2002 at a level appreciably higher than in December 2001, and its contribution would hence be 0.1 of a point. ■