

# The economic situation in the euro zone

*The euro-zone economies have continued the slowdown that began to take shape at the beginning of the year. In H2 2001, growth is expected to come out virtually flat, bringing the annual average for the year to 1.5%, compared with 3.4% in 2000. After remaining close to stagnation at the beginning of 2002, activity is expected to recover somewhat in Q2.*

*The 2001 slowdown was triggered off by a decline in export flows, combined with much tighter investment behaviour and substantial de-stocking on the part of firms. In H1 2002, the international environment is likely to continue to give little support. Domestic demand is expected to continue to suffer from the weakness of investment, but the de-stocking that had adversely affected growth in 2001 should come to an end.*

*Private consumption, meanwhile, is likely to grow in the early part of 2002 at an annualised rate close to 1½%, slightly down on 2001. Despite the deteriora-*

*tion on the labour market, the tax cuts implemented in several countries in the zone have in fact permitted an appreciable increase in household purchasing power in 2001. Admittedly, purchasing power growth can be expected to slow down in H1 2002 because of the slowdown in the total wage bill, but this movement would be cushioned by disinflation.*

## Steep and rapid adjustment of corporate expectations from the beginning of 2001

European industry went into recession at the beginning of 2001. The industrial output index fell in Q3 by 0.3%, making the third consecutive quarterly fall.

Although the situation in industry seemed to be on the road to stabilisation in Q3, it then deteriorated in a much more marked manner after September, extinguishing hopes of a rapid stabilisation of the industrial situation in the euro zone. INSEE's composite

## FORECASTS FOR THE EURO ZONE

	Annual changes			Quarterly changes									
	1999	2000	2001	2000				2001				2002	
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
<b>GDP</b>													
Growth rate	1.6	3.4	1.5	0.9	0.9	0.5	0.6	0.5	0.1	0.1	-0.1	0.1	0.3
year on year growth	-	-	-	3.6	3.9	3.2	2.8	2.5	1.7	1.3	0.6	0.2	0.4
<b>IMPORTS</b>													
Growth rate	4.2	10.7	1.5	2.1	3.2	2.8	2.1	-1.4	0.3	-1.9	-0.2	-0.2	0.4
year on year growth	-	-	-	9.5	10.9	11.5	10.6	6.8	3.9	-0.9	-3.1	-2.0	-1.9
<b>HOUSEHOLD CONSUMPTION</b>													
Growth rate	1.5	2.6	1.9	0.8	0.8	0.2	0.2	0.8	0.5	0.2	0.4	0.4	0.3
Contribution	0.9	1.5	1.1	0.4	0.4	0.1	0.1	0.5	0.3	0.1	0.2	0.2	0.2
year on year growth	-	-	-	2.6	3.3	2.5	1.9	2.0	1.7	1.8	2.0	1.6	1.4
<b>GFCF</b>													
Growth rate	2.9	4.4	-0.6	1.5	0.7	1.0	-0.4	-0.3	-0.5	-0.3	-0.6	-0.5	-0.2
Contribution	0.6	0.9	-0.1	0.3	0.2	0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
year on year growth	-	-	-	5.5	4.9	4.2	2.9	1.0	-0.2	-1.4	-1.7	-1.9	-1.6
<b>EXPORTS</b>													
Growth rate	4.0	11.9	3.3	2.8	2.8	3.5	2.4	-0.2	-0.2	-0.6	-1.2	-0.3	0.3
year on year growth	-	-	-	11.6	11.7	12.3	12.0	8.8	5.6	1.4	-2.1	-2.3	-1.8
<b>DOMESTIC DEMAND EXCL. STOCKS</b>													
Growth rate	1.8	2.8	1.3	0.9	0.7	0.3	0.2	0.5	0.3	0.1	0.2	0.2	0.2
Contribution	1.7	2.8	1.3	0.8	0.7	0.3	0.2	0.5	0.3	0.1	0.2	0.2	0.2
year on year growth	-	-	-	3.1	3.5	2.7	2.1	1.8	1.3	1.1	1.1	0.8	0.8
<b>FOREIGN TRADE</b>													
Contribution	0.0	0.6	0.7	0.3	-0.1	0.3	0.1	0.4	-0.2	0.5	-0.4	0.0	0.0
<b>STOCKS</b>													
Contribution	-0.2	0.1	-0.5	-0.2	0.2	-0.2	0.3	-0.4	0.0	-0.5	0.1	-0.1	0.1

Forecast

## The economic situation in the euro zone

indicator for the zone, which seemed to be on the point of ceasing to deteriorate at the end of Q3, then fell sharply following the events of 11 September. In the space of three months, it fell back below the level reached in the trough of 1996.

The deterioration in the international environment in H1 2001 brought export growth to a sudden halt. From a rapid annual rate of 12%, annualised, throughout 2000, export growth dropped to below zero in H1 2001. In H2, the ongoing recession in the United States, Japan and several emerging countries is likely to have accentuated still further the decline in demand for euro-zone exports. In most EMU countries, business leaders' views recorded in Q4 2001 regarding foreign demand were at their lowest since 1993.

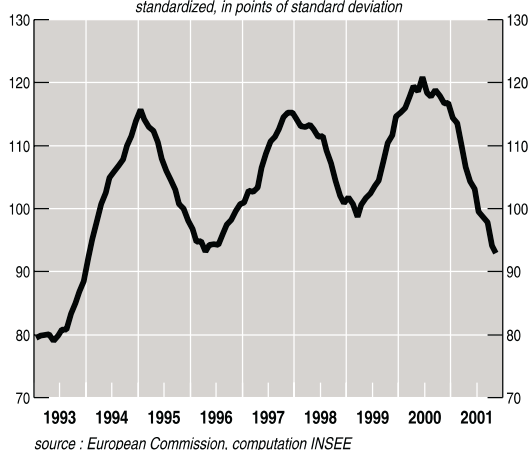
Even before exports began their decline, corporate investment had weakened substantially in H2 2000, affected by the downward revision of the profits expected from the surge in new technologies and the slowdown in household demand brought about by

the impact of the higher oil price. However, this tendency was accentuated in H1 2001, just when consumption was tending to pick up again.

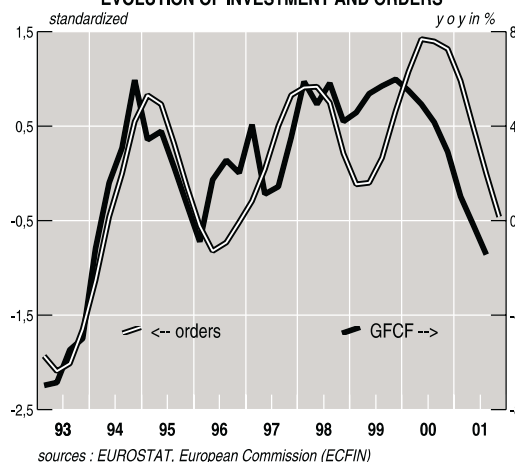
In fact, European corporate investment reacted in 2001 in a way that was both very rapid and strongly influenced by the deterioration in the international climate. The downturn in the world economic situation had an impact on business leaders' expectations, despite the consolidation recorded at the same time in European consumption, as the impact of the higher oil price began to fade.

In Germany, in particular, investment began to fall in Q4 2000, at a time when exports were still lively. Having risen by almost 10% on an annual average basis in 2000, it then began to post a sharp fall, the year-on-year figure for Q3 2001 being close to -6%. The recent evolution in domestic orders for capital goods, with the statistical carry-over in October 2001 for Q4 coming out at -4.5%, is not pointing to any upturn.

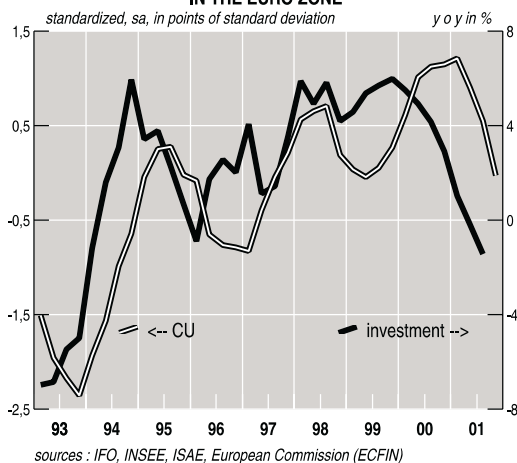
**COMPOSITE INDICATOR FOR MANUFACTURING  
INDUSTRY IN THE EURO ZONE**  
standardized, in points of standard deviation



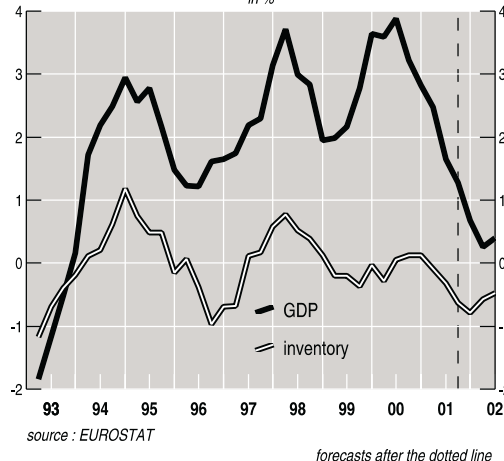
**EVOLUTION OF INVESTMENT AND ORDERS**



**INVESTMENT GROWTH AND CAPACITY UTILISATION  
IN THE EURO ZONE**



**INVENTORY CONTRIBUTIONS TO Y-O-Y GDP**  
in %



In H2 2001, the decline in investment seems to have gathered pace, giving a negative annualised growth rate of around 2%. It seems to have been particularly hard hit by the climate of uncertainty that followed the events of 11 September.

The sudden deterioration in business sentiment was also accompanied by a major de-stocking movement, which began as early as Q1 but seemed to be still strong in Q4. Taking the average for the whole of 2001, it is estimated to have cut euro-zone GDP growth by 0.5 of a point.

Reflecting this sharp decline in corporate demand, import flows (including intra-zone trade) fell sharply from the beginning of 2001, with the year-on-year change put at around -3% at the end of the year, as against +10.6% a year earlier.

### First half of 2002: no recovery in investment, end of de-stocking

At the present time, there is nothing to indicate any real upturn in the economic situation before Q2 2002. Euro-zone business leaders' expectations are worsening rapidly, as regards both demand and production. Exports seem to have fallen sharply again in Q4. From now on, the tendency could be somewhat less unfavourable, inasmuch as world trade seems likely to bottom out during the winter, although without actually picking up again.

The pessimism expressed by business leaders in the surveys suggests a persistent weakness of investment during H1, for an annualised decline of 1½%. The interest-rate cuts consented by the ECB are not likely to have had much impact on companies' investment plans, but they could intensify the upturn once expectations start to improve.

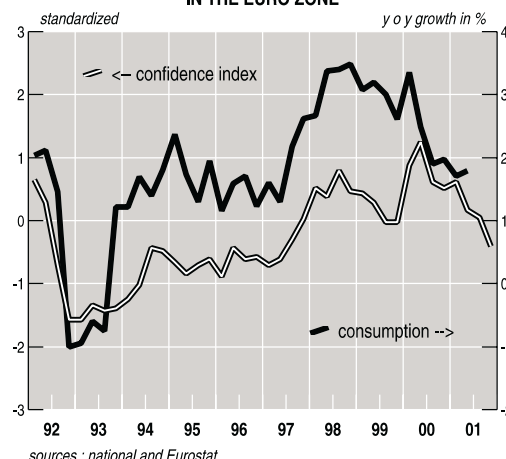
Conversely, the end of de-stocking could cushion to some extent the weakness of corporate demand in H1 2002, as inventory cycles are generally concen-

trated on periods of just a few quarters. It is already likely that the sharp de-stocking movement seen in H1 2001 would have been followed by a slight improvement in H2, had the events of 11 September not arrived to postpone it.

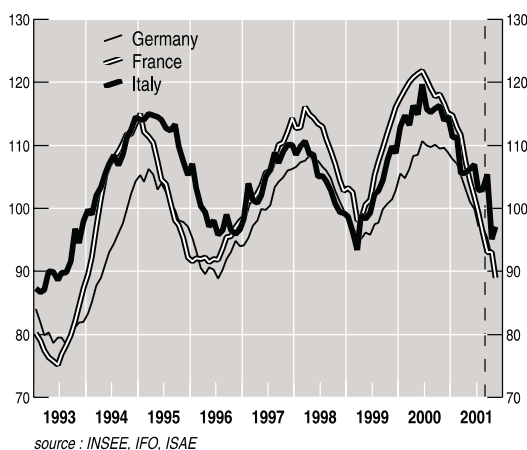
### Private consumption holding up relatively well

Private consumption is likely to continue its annual growth of 2% until the end of 2001, before falling back to a rate of around 1.5% during the time-horizon of the forecast. In fact, conforming to the productivity cycle, the labour market began to adjust to the slowdown in activity during the past year and this tendency is likely to continue in H1 2002. In addition, the tax cuts that underpinned the strength of household income in 2001 will be less substantial in 2002 (0.2 of a point for income in Germany and 0.6 of a point in Italy in 2002, as against around 1 point in 2001 in both countries). However, disinflation should cushion the impact of the slowdown in nominal incomes.

HOUSEHOLD CONSUMPTION AND CONFIDENCE INDEX IN THE EURO ZONE

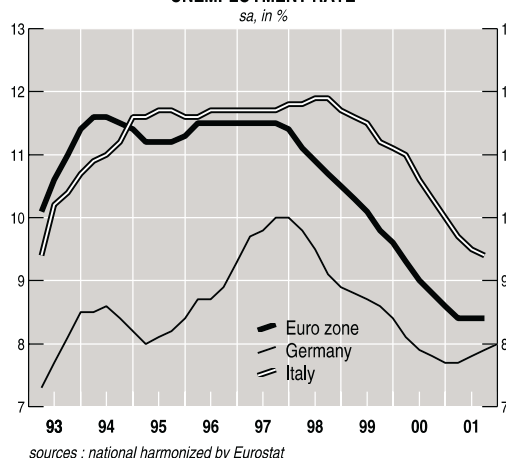


NATIONAL COMPOSITE INDICATORS



dotted line : Septembre 11, 2001

UNEMPLOYMENT RATE



## ARE ECONOMIC AGENTS' EXPECTATIONS IN DIFFERENT EURO-ZONE COUNTRIES DETERIORATING AT DIFFERENT RATES?

After more than a year during which the results of business surveys in the euro-zone economies rose to levels that were in many cases historic highs, they began to deteriorate in mid-2000, moderately for a period of slightly more than six months and then more markedly since the beginning of Q2 2001. Do these respective evolutions indicate that certain country economic situations in the euro zone have been more affected than others since the start of the slowdown?

A further question is whether individual national economic situations have reacted differently since the events of 11 September.

As regards the situation in industry, surveys carried out in the main economies of the euro zone have moved to large extent in phase since the beginning of the slowdown. There are nevertheless certain differences to be observed. Surveys in France seem to have recorded a relatively greater deterioration than those for the other leading economies in the zone, especially for the balance of opinion regarding «outlook for own-firm output». However, this difference stems mainly from the fact that the balances of opinion in the French case started from a high level. The relative dispersion of national surveys that had prevailed between mid-1999 and early 2001 has tended rather to diminish.

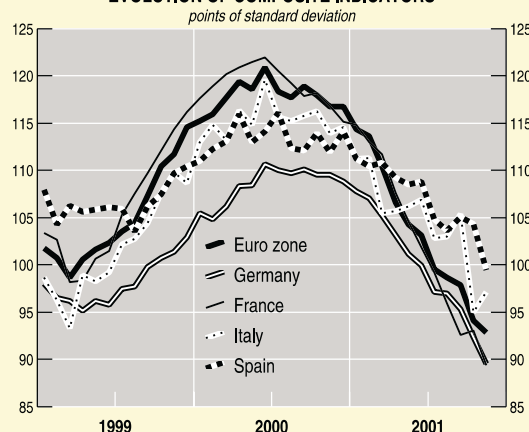
The only notable exception remains Spain, where the surveys have stood up to the general slowdown somewhat better than elsewhere. Since growth has been more dynamic there than in the whole of the euro zone since mid-1994, notably through a structural «catch-up» effect, the relatively good performance of the Spanish surveys seems only natural.

Are the surveys pointing to different reactions in different countries following the shock constituted by the events of 11 September?

The deteriorations recorded in the surveys since then turn out to have been extremely similar. The only notable exception is the relative firmness of the French household

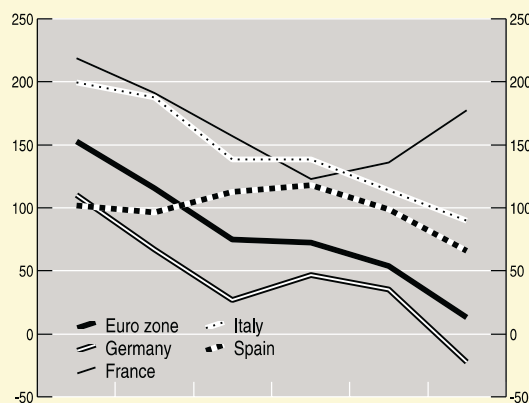
confidence indicator, which, despite declining since the beginning of the year, has continued to stand out markedly from household sentiment in the other euro-zone countries. ■

EVOLUTION OF COMPOSITE INDICATORS



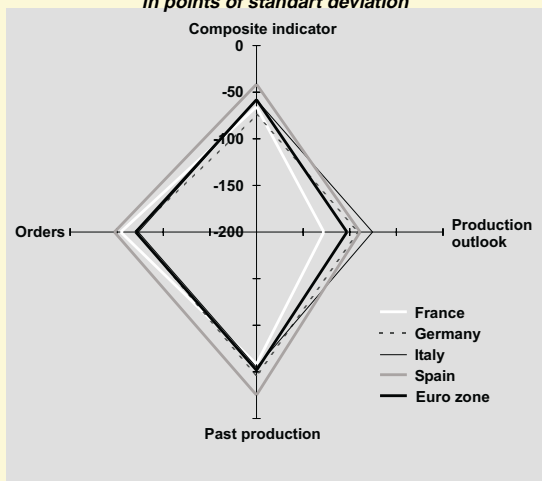
source : European Commission, computation INSEE

HOUSEHOLD CONFIDENCE INDEX

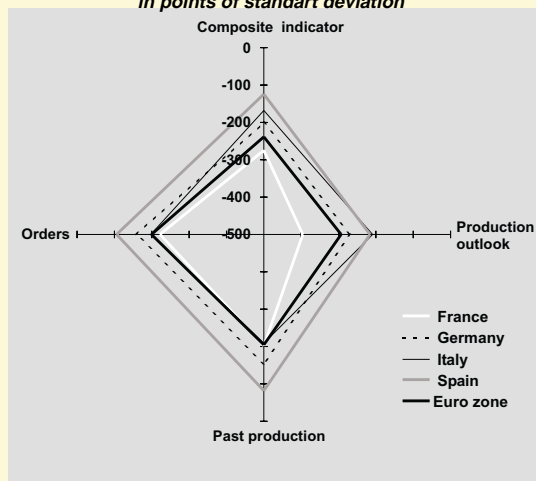


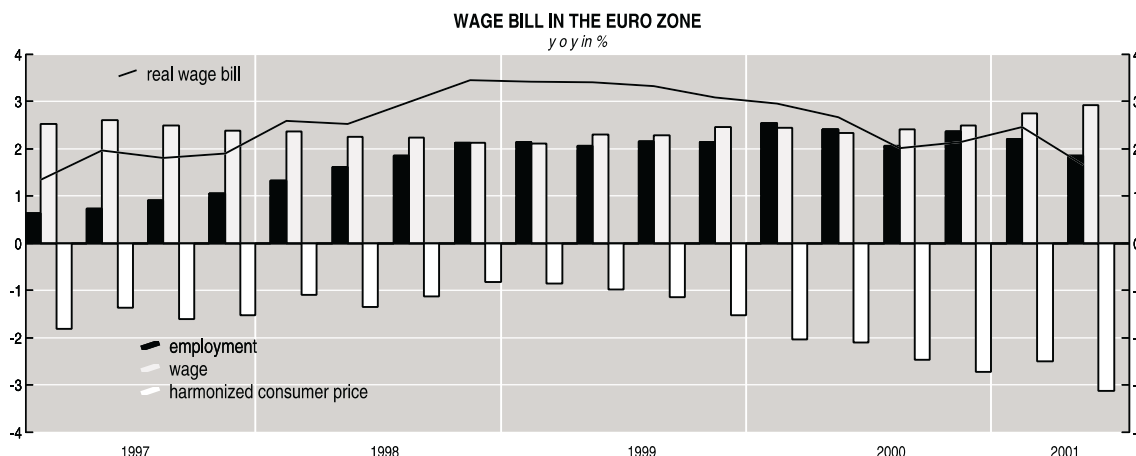
from June to November 2001

CHANGE IN VARIOUS BALANCES OF OPINION SINCE AUGUST 2001  
in points of standard deviation



CHANGE IN VARIOUS BALANCES OF OPINION SINCE NOVEMBER 2000  
in points of standard deviation





The slowdown in GDP growth has started to erode the strength of the labour market. Even so, employment was still growing at a rate of 2% in mid-2001. However, this overall situation masks wide differences between countries. In Germany, in particular, the labour market is noticeably more depressed than in the other economies in the zone. As a result, growth in total employment turned down in Q3 2000 and has declined slowly but steadily since last February (at an annualised rate of ¼%). Employment in France and in Italy has stood up better, slowing down more moderately and only from June on. In Spain, it is slowing down considerably, although still remaining more dynamic, falling below a year-on-year growth rate of 2.5% for the first time since 1996.

The unemployment rate for the euro zone has continued to decline at the slow rate seen since Q4 2000, the figure for Q3 2001 being 8.3%. However, in France and Germany this tendency was reversed in July. In Spain, the rate seems to have continued to decline in H2. The continuing slowdown in employment growth means that the euro-zone unemployment rate could rise slightly in H1 2002, to reach around 8.5% by June.

Growth in the total wage bill in real terms was close to 2% in H1 2001 and is likely to remain at this level, with the disinflation practically making up for the slowdown in employment.

In addition, the tax cuts implemented in most of the leading economies of the zone in 2001 (Germany, France, Italy) have boosted income and private consumption. The first wave of tax cuts took place in Q4 2000 in France, so that consumption re-bounded as from the beginning of 2001. In Germany and Italy, the cuts came into effect in Q1 and the effects were probably felt rather in Q2<sup>(1)</sup>.

All in all, private consumption at the end of the year seems to be maintaining a year-on-year growth rate close to 2%. In H1 2002, against the background of slower growth in nominal incomes, it should maintain a certain robustness thanks to disinflation (1.6% in June 2002 as against 2.0% in December 2001) and would be on a growth path of 1½%. ■

(1) Admittedly, the latest national accounts for the euro zone show a marked upturn in household consumption right from the start of the year (0.8%). However, 0.3 of a point of this figure is the result of revisions made to the German national accounts, with estimated German consumption growth in Q1 2001 raised from 0.1% to 1.2%. This upward revision in the growth rate for Q1 stems in large part from a downward revision in the level of consumption in 2000. It would seem that the acceleration in German consumption therefore dates rather from Q2 2001.

# Consumer prices in the euro zone

*After peaking at 3.4% in May 2001, inflation in the euro zone then fell back rapidly to 2.4% in October. Meanwhile, underlying inflation, after standing at 1.7% at the beginning of 2001, continued to rise, reaching 2.3% in October.*

*With the ending of the acceleration in food prices, inflation fell back in H2 2001 thanks to the fall in the year-on-year change in energy prices, a tendency that can be expected to continue until next summer. The downturn in growth in euro-zone wage costs seen in the latter part of this year and the weakening of the industrial situation should contribute to a stabilisation of underlying inflation during the winter and to an actual fall as of spring 2002.*

*Looking beyond certain irregular movements in the early part of the year- due to the exit from year-on-year calculation of the falls in energy prices in Q1 2001 -, inflation in the euro zone should continue to decline in H1 2002, especially as the impact of the rise in food prices seen in spring 2001 will gradually fade out of the picture. On the assumption of a stabilisation of the oil price at around USD 20/barrel and an exchange rate of USD 0.90 to the euro, inflation in the zone would come out at 1.6% in June 2002.*

## Prices of foodstuffs and services still lively in H2 2001

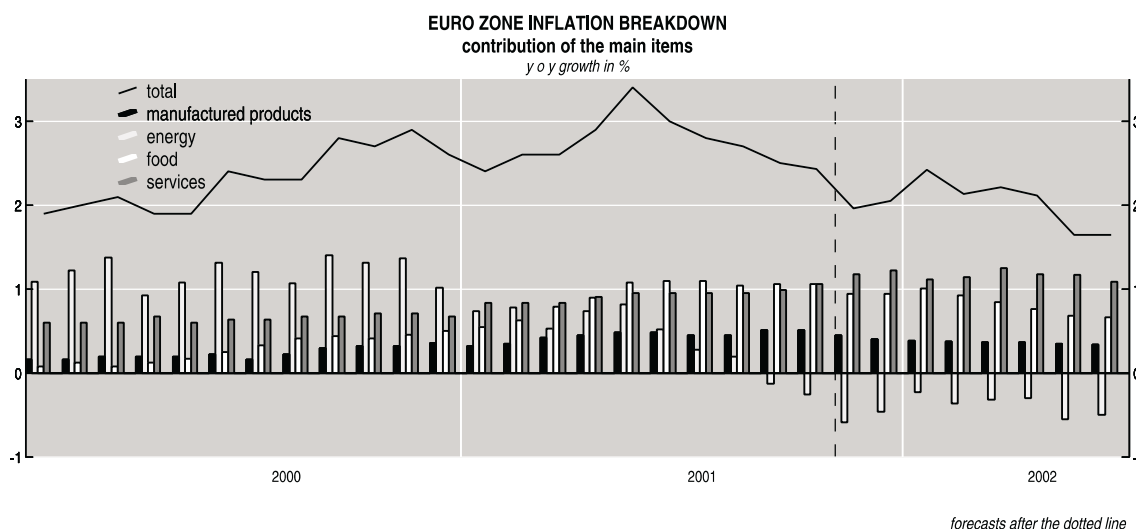
Under the impact of the strength of food prices and further rises in the oil price, inflation rose in the spring of this year, peaking at 3.4% in May before

slowly easing during the summer. The year-on-year rise in the price index was 2.4% in October 2001, compared with 2.7% a year earlier, giving a decline of 0.3 of a point in 12 months.

The stabilisation of the oil price and the subsequent decline in Q4 have produced a marked deceleration in energy prices. The exit from the year-on-year calculation of the sharp rises recorded in Q3 2000 contributed to a reduction of 1.6 of a point in overall inflation over a one-year period. This base effect was particularly pronounced for fuel prices, for which the year-on-year change dropped from +20.3% in October 2000 to -10.1% a year later.

The liveliness of food prices has constituted the principal obstacle to a more rapid easing of inflation in H2 2001. The combined consequences of the BSE crisis and the foot-and-mouth outbreak<sup>(1)</sup> and poor weather conditions in the spring pushed the year-on-year rise in food prices to historic high levels (5.4% in June 2001). Although the rise in food prices levelled off at the end of Q3, it has remained high for H2 2001 as a whole (above 4.5% on a year-on-year basis), so that the «food, alcohol and tobacco» item contributed 0.7 of a point to the change in year-on-year inflation between October 2000 and October 2001.

*(1) Meat prices accelerated sharply following these two successive crises, because of a switch to meat other than beef, combined with higher production costs and the emergence of a «quality» effect pushing beef prices up.*





## Consumer prices in the euro zone

The second obstacle to the slowdown in the overall index was underlying inflation<sup>(2)</sup> which rose steadily since Q3 2000 to reach 2.3% in October 2001, as against 1.5% a year earlier. This mainly reflected a deceleration in prices of services (2.8% in October 2001, as against 1.9% a year earlier), fuelled by a more rapid rise in wage costs since the beginning of 2000, but also by the recovery in the year-on-year change in telecommunication prices (from - 5.5% in October 2000 to - 2.2% in October 2001 as a result of less aggressive price-cutting). In manufacturing, the year-on-year price change rose less substantially, stabilising in Q4 under the impact of the slowdown in industrial producer prices that had begun at the end of 2000. All in all, underlying inflation contributed 0.6 of a point to the evolution in the year-on-year change in the overall index between October 2000 and October 2001.

### Narrowing of the inflation differential between France and the euro zone

Inflation fell back in all the euro-zone countries in Q3 2001 because of the universally negative contribution from energy prices. In October 2001, the maximum inflation spread was 3.3 points, as against 3.9 points a year earlier. Year-on-year price rises were 2.0% or less in four countries: Luxembourg (1.7%), France (1.8%), Belgium (1.9%) and Germany (2.0%).

The inflation differential between the euro zone and France, which had widened in Q4 2000, has since narrowed considerably, from 1.2 of a point in Janu-

ary 2001 to 0.6 of a point in October. This tendency is explained by evolutions in the energy item. On the one hand, the decline in German inflation was particularly rapid (to 2.0% in October from 3.6% in May), being more sensitive to the decline in prices of petroleum products. On the other, the narrowing of the differential was helped on in October 2001 by the exit from the year-on-year calculation of the specific indirect taxation measures taken in France (the introduction of the «floating» duty on petroleum products on 1 October 2000).

Between October 2000 and October 2001, prices accelerated in three countries: Austria (by 0.3 of a point for the year-on-year change), Portugal (0.5 of a point) and the Netherlands (1.8 of a point). In fact, underlying inflation in these countries rose more sharply than in the rest of the euro zone. On top of this phenomenon, in the case of the Netherlands there was the additional inflation resulting from the VAT rise on 1 January 2001, meaning that this country's inflation was the highest in the zone throughout the year and will automatically fall back in January 2002. In Portugal, energy prices are still largely set by the administration, so that the contribution from the energy item is not negative to the same extent as in the rest of the euro zone

(2) Measured as the year-on-year change in the index ex energy, food, alcohol and tobacco.

### EURO ZONE INFLATION

Sectors (weigh in the index)	(year on year % growth of HCPI*)			
	Oct. 2000	Oct. 2001	Dec. 2001	June 2002
<b>Total (100.0%)</b>	<b>2.7</b>	<b>2.4</b>	<b>2.0</b>	<b>1.6</b>
Food (16.4%)	2.1	5.8	4.7	2.6
Beverage and Tobacco (4.0%)	1.6	3.1	3.9	5.1
Clothing and footwear (7.8%)	1.1	1.9	2.6	1.4
Housing, water, electricity and gas (15.6%)	5.7	1.7	1.1	0.7
Furnishings and household equipment (7.9%)	1.2	2.1	2.2	1.8
Health (3.9%)	2.0	1.3	1.2	1.2
Transports (15.6%)	4.9	-0.3	-1.3	-1.5
Communications (2.3%)	-4.8	-1.8	-1.6	-0.4
Leisure and culture (9.4%)	0.8	2.1	1.7	1.9
Education (0.9%)	4.0	3.7	3.8	4.4
Hotels-café-restaurants (8.8%)	2.9	3.5	3.6	3.6
Miscellaneous goods and services (7.4%)	2.2	3.3	3.5	2.8
<b>Food (Beverage and Tobacco) (20.4%)</b>	<b>2.0</b>	<b>5.2</b>	<b>4.6</b>	<b>3.2</b>
<b>Energy (9.5%)</b>	<b>14.6</b>	<b>-2.7</b>	<b>-4.8</b>	<b>-5.2</b>
<b>Core inflation (70.1%)</b>	<b>1.5</b>	<b>2.3</b>	<b>2.3</b>	<b>2.0</b>
of which manufactured products(32.1%)	1.0	1.6	1.3	1.1
services (38.0%)	1.9	2.8	3.2	2.9

Forecast  
\* Harmonized Consumer Price Index  
Source: Eurostat

### EURO ZONE INFLATION BY COUNTRIES

	(year on year % growth of HCPI*)	
	October 2000	October 2001
France	2.1	1.8
Germany	2.4	2.0
Italy	2.7	2.5
Spain	4.0	3.2
Netherlands	3.2	5.0
Belgium	3.7	1.9
Austria	2.2	2.5
Finland	3.4	2.4
Portugal	3.7	4.2
Ireland	6.0	3.8
Luxembourg	4.3	1.7
Greece	3.8	3.2
<b>Euro Zone</b>	<b>2.7</b>	<b>2.4</b>
United Kingdom	1.0	1.2
Sweden	1.3	2.9
Denmark	2.8	2.0
<b>E.U.</b>	<b>2.4</b>	<b>2.2</b>

\* Harmonized Consumer Price Index.  
Source: Eurostat

### Easing of underlying inflation between now and next spring

Prices of services are likely to continue to rise briskly this winter, fuelled by the past growth in wage costs, which peaked in Q4 2000 (3.7%). Since the beginning of 2001, however, the rate of increase has weakened (only 3.3% in Q2 2001) and this could lead to a stabilisation in the year-on-year rise in the prices of services as of Q2 2002.

Under the impact of the decline in the oil price and the slowdown in activity, industrial producer prices have fallen substantially since the end of 2000, a tendency highlighted by the deterioration in firms' expectations regarding selling prices. Consumer prices of manufactures, for which the year-on-year change has stabilised this autumn, should therefore begin to slow down and continue to do so throughout H1 2002.

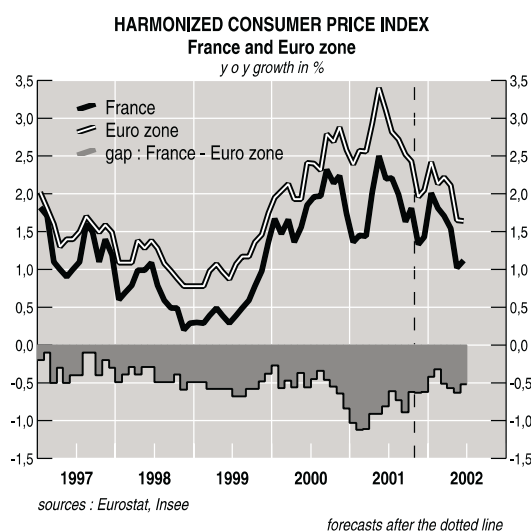
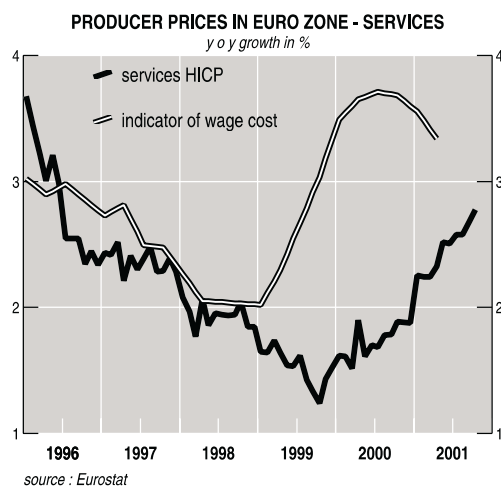
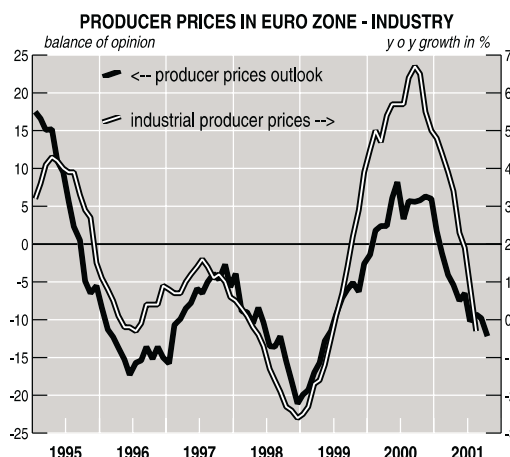
All in all, underlying inflation is likely to level off in Q1 2002 at 2.3%, before gradually easing back. The year-on-year price change ex energy and foodstuffs would then be 2.0% next June.

### Inflation below 2.0% next spring

On the assumption of a Brent price of around USD 20/barrel and an exchange rate of USD 0.90 to the euro next spring, inflation in the euro zone should continue to decline in H1 2002. Admittedly, it is likely to rise by a few tenths of a point in the early part of next year but this temporary phenomenon is due simply to the exit from year-on-year calculation of the falls in energy prices in Q1 2001. Inflation should reach 1.6% in June, compared with 2.0% in December 2001.

The half-point decline in inflation between December 2001 and June 2002 would be mainly attributable to the slowdown in food prices. The exit from the year-on-year calculation of the food price rises recorded in H1 2001 would in fact lead to a negative contribution amounting to 0.3 of a point from the «food, alcohol and tobacco» item to the evolution in inflation. The decline in the year-on-year rise in the overall index would also be helped on by underlying inflation (a reduction of 0.2 of a point).

These forecasts take into account the indirect tax measures<sup>(3)</sup> (increases in taxes on tobacco amounting to 30.0% in Germany and 9.0% in France) that come into effect on 1 January 2002. The inflationary potential of these measures will nevertheless be offset by the ending of the inclusion in the calculation of inflation in the euro zone of the sharp rise in VAT introduced in the Netherlands in January 2001. ■



(3) On the other hand, the forecast makes no assumption regarding the specific impact on inflation of the changeover to the euro.