The euro zone's international environment

World economic activity turned down in the early part of the year under the combined impact of the American slowdown and the weakening in world demand for new-technology products. These two factors can be expected to continue to operate in coming quarters, meaning that any recovery in world activity is unlikely to manifest itself before next year. World demand for euro-zone goods can be expected to remain weak.

However, certain countries are holding up better than others. This diversity reflects differences in exposure to the two factors underlying the present downturn. The Asian economies, with their eyes turned mainly towards the United States and their large production of electronic equipment, are being particularly hit by this downswing, especially as their domestic demand remains fragile. Latin America apart from Mexico constitutes a more closed grouping but it is more heavily indebted to the outside world and would therefore suffer more from the effects of an increase in financial pressure.

In Europe, the United Kingdom is suffering from its exposure to the American economy, as well as from the consequences of the foot-and-mouth disease and its specialisation in financial services. However, the strength of domestic demand should enable it to cushion part of these negative factors. The Central and Eastern European countries seem to be less directly exposed to the world economic situation in general, but are liable to suffer from the distinct slowdown in activity in the euro zone.

United States: no upturn to be expected before the end of the year

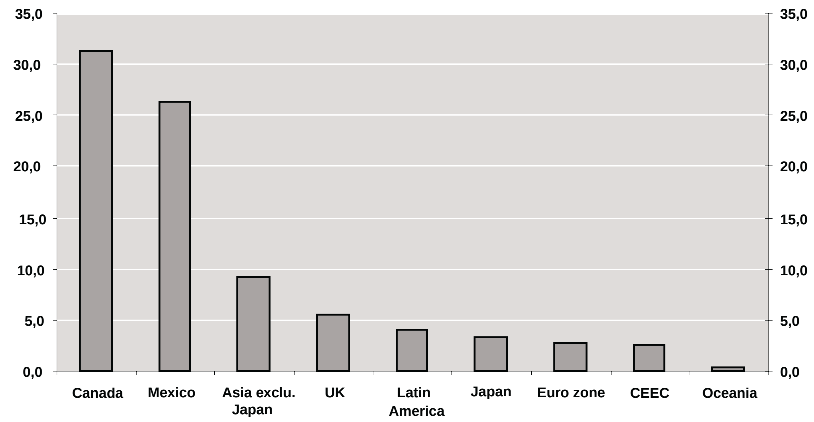
Q1 2001 saw the American economy continuing to grow at an annual rate of slightly more than 1%. This slowdown, which began in H2 2000, stems from the sudden downturn in US corporate investment in capital goods and a major de-stocking movement. In Q1, household consumption, although slowing down, has maintained a brisk annual growth rate of 3%. The levelling off in disposable income, as well as the very low level of household savings, indicates a more marked slowdown in consumption in coming quarters. Neither the major monetary easing launched by the Fed since last January nor the tax cuts expected in H2 are likely to have any influence before the very end of the year. In any event, the US economy cannot be expected to recover before next year.

The American industrial sector has been in recession since Q4 2000. US corporate investment in capital goods has slowed down considerably, from an annual growth rate of more than 15% until H1 2000 to an actual fall of 2.6% in Q1 2001 (graph 2).

Investment in capital goods is unlikely to pick up within the time-horizon of this forecast. The outlook for final demand remains sombre (there has been no recovery in the NAPM index) and corporate profits are in decline (by 4.6% in Q1), limiting the possibilities for firms to finance investment out of their own resources. The slowdown in the price falls seen in

EXPOSURE TO THE AMERICAN MARKET
Share of GDP exported to the US

1



sources: OECD and Direction de la Prévision the IT sector that began in 1999 (graph 3), has probably influenced the current downturn in demand for this type of equipment. At the same time, the gloom on the stock market and the sudden wave of investor mistrust towards the new technologies have adversely affected the supply of lending. With the bond market in the doldrums, firms needing finance have been obliged to turn to credit lines made available by their banks. In fact, since the end of 2000, lending to firms has been accelerating again, without this reflecting any desire on the part of the banks to act as a substitute for the market for the financing of long-term projects. The bursting of the speculative bubble has put them in a difficult situation and forced them to give priority to the consolidation of the asset side of their balance sheets by provisioning dubious loans. All in all, the current investment crisis stems from a combination of weak overall supply (disintermediated or otherwise) and of weak demand for lending.

The Federal Reserve will probably not be able on its own to kick-start investment in capital goods. For one thing, the normal credit channels are in a poor state, as more than half corporate borrowing is through the bond market. This high level of disintermediation makes the supply of lending more pro-cyclical by raising the risk premium more sharply in times of recession (graph 4). The increased uncertainty is reflected in the fact that the gap between the bond yields for firms graded BAA and AAA by Moody's is now around 90 basis points.

In theory, monetary policy can operate by a second transmission channel. By inducing interest rates to vary, the Fed can influence the price of assets and affect the value of economic agents' wealth, and this value then in turn has a significant effect on their borrowing capacity. This phenomenon is particularly important in the United States (and the United Kingdom), where households can provide security for

2

INDUSTRIAL PRODUCTION & INVESTMENT IN THE UNITED STATES

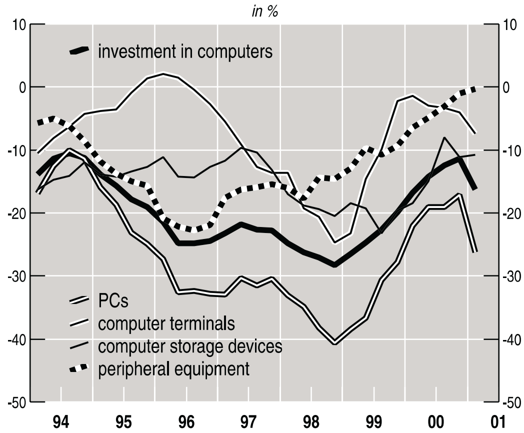
y o y growth in %

sources : FED et Census Bureau

3

PRICE OF IT INVESTMENT IN THE UNITED STATES

in %



source : Bureau of Economic Analysis

4

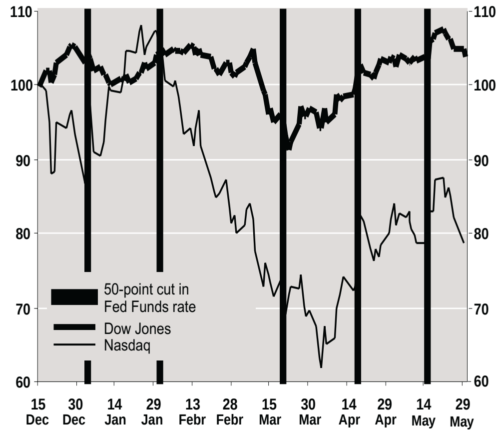
RISK PREMIUM IN THE UNITED STATES (Spread between AAA - corporate bonds and treasury bonds)

basis points

source : Federal Reserve

5

MONETARY POLICY AND THE STOCK MARKET



source: Federal Reserve Board

their personal borrowing using financial or real-estate assets. The five 50-bp cuts in the Fed Funds rate since the beginning of 2001 are probably in part the result of a desire to prop up stock-market prices. However, the use of this second lending channel carries greater risk, since it could possibly generate a speculative bubble. In addition, it would seem to be less efficient. In reality, the reactions of the NASDAQ to interest-rate cuts, although generally positive, have been small in relation to the weekly movements in the index (graph 5). The influence of changes in short rates on the Dow Jones is even less marked.

The capacity of the Fed to achieve any real easing of the conditions on which firms finance their investment is therefore still limited. There is likely to be bad news coming out of the housing investment sector, which posted a sudden upturn in Q1 2001, but this was explained by the delayed impact of the declines in long rates seen throughout 2000. The tensions on the bond market can be expected to put an end to this tendency. Moreover, the decline in employment and the slackness of the stock market are likely to hold back housing construction. After flirting with historic peaks, sales of new houses declined in April and starts have been weakening since February.

Household consumption is also liable to hold back activity. There were declines in non-farm private employment in both March and April, for the first time since early 1991. Its growth has fallen back to 0.6%, year on year, and it is no longer acting as a

GDP IN OTHER REGIONS OF THE WORLD

(Annual % changes)

	Annual averages		
	1999	2000	2001
Countries in transition	3.3	6.4	3.2
Russia	3.5	7.7	3.4
Central Europe	3.0	4.1	2.6
Emerging Asia[1]	5.3	6.5	3.2
Latin America[2]	0.4	4.4	3.8

Forecast

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

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

Source: Direction de la Prévision

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			
1999	2000	2001		2000		2001	
				H1	H2	H1	H2
			UNITED STATES (34.0%)				
4.2	5.0	1.6	GDP	2.6	0.8	0.6	0.7
10.7	13.5	2.3	Imports (16%)	7.2	3.7	-1.1	2.8
5.3	5.3	2.5	Private consumption (68%)	2.6	1.8	1.0	0.6
3.3	2.8	2.7	Public consumption (17%)	0.9	0.4	1.7	1.3
9.2	9.3	1.6	Total private GFCF (17%)	6.6	0.5	0.8	0.3
2.9	9.0	2.3	Exports (13%)	4.9	1.7	0.1	3.2
5.7	*5.7*	*2.4*	*Contributions[2]: Domestic demand excluding stocks*	*3.1*	*1.4*	*1.1*	*0.7*
-0.4	*0.2*	*-0.7*	*Stock change*	*0.0*	*-0.2*	*-0.7*	*0.1*
-1.2	*-1.0*	*-0.1*	*Foreign trade*	*-0.6*	*-0.4*	*0.2*	*-0.1*
			JAPAN (17.2%)				
0.8	1.5	0.0	GDP	2.5	0.0	-0.4	0.4
2.9	9.9	2.5	Imports (11%)	4.3	6.4	3.2	0.7
1.2	0.5	0.3	Private consumption (59%)	2.1	-0.6	0.0	0.5
4.0	3.6	1.7	Public consumption (9%)	2.2	1.4	0.3	0.7
-0.8	0.6	0.4	Total private GFCF (29%)	1.0	1.9	-0.3	-0.8
1.3	12.1	-0.4	Exports (14%)	8.4	1.1	-2.7	2.3
1.1	*1.0*	*0.2*	*Contributions[2]: Domestic demand excluding stocks*	*1.8*	*0.4*	*-0.3*	*0.2*
-0.2	*0.1*	*0.0*	*Stock change*	*0.2*	*0.0*	*0.0*	*0.0*
-0.1	*0.4*	*-0.3*	*Foreign trade*	*0.5*	*-0.4*	*0.0*	*0.2*
			UNITED KINGDOM (5.6%)				
2.3	3.0	2.1	PIB	1.3	1.3	0.9	1.1
8.1	9.6	7.1	Importations (34%)	5.4	3.2	3.3	2.5
4.5	3.7	3.0	Private consumption (63%)	1.5	1.8	1.3	1.5
4.0	2.7	3.0	Public consumption (19%)	1.2	1.7	1.1	2.0
5.4	2.6	4.7	Total private GFCF (18%)	-0.5	3.8	1.6	1.3
4.0	8.4	5.0	Exports (31%)	5.2	3.3	1.5	1.6
4.6	*3.5*	*3.4*	*Contributions[2]: Domestic demand excluding stocks*	*1.2*	*2.2*	*1.3*	*1.6*
-0.7	*0.4*	*-0.2*	*Stock change*	*0.5*	*-0.8*	*0.3*	*0.0*
-1.5	*-0.8*	*-1.1*	*Foreign trade*	*-0.3*	*-0.1*	*-0.8*	*-0.5*

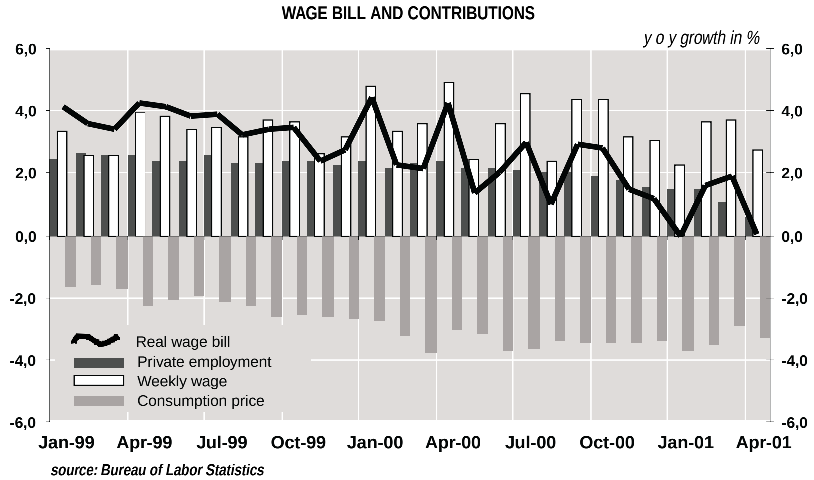
Forecast

(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

6



driving force for income growth. At the same time, the high level of inflation (3.3% in April), although falling slightly, is continuing to eat into real earnings. Total real earnings have been rising at a rate of no more than 1% in the early part of 2001 (graph 6). This means that private consumption can no longer sustain its present growth rate (roughly 3% in Q1 2001) without further weakening the saving ratio. And the upturn in unemployment, combined with a negative wealth effect, is now operating in favour of a slight rebuilding of household savings. In its May survey of managers of lending agencies, the Fed has in fact noted the tightening of consumer credit.

However, disposable income should benefit from the substantial income tax cuts adopted by the Bush administration and voted on 26 May by the Senate and the House of Representatives. The cut in the lowest tax band will be retroactive to 2001. Starting in Q3, the tax authorities will be sending out checks to taxpayers for a total sum equivalent to 0.4 of a point of GDP. However, in the present climate, these tax cuts are likely to be used not only for consumption but also to add to household savings, which would then become a substitute for public savings. The impact of these tax cuts on consumption in H2 2001 would therefore be slightly positive, but would be more than offset by the slowdown in employment.

All things considered, American economic growth should remain at around 1.5% until the end of the year. The de-stocking movement will be followed, as of Q2, by a levelling off in household consumption. Investment in capital goods is not likely to recover and housing investment will become less lively. Foreign trade cannot be expected to underpin activity, since domestic demand in the principal trading partners of United States is at least as depressed as its own.

Asia badly hit by the downturn in world trade

Asia is being particularly badly hit by the slowdown in demand for new-technology products at world level and by the American slowdown. Meanwhile, domestic demand remains rudderless, handicapped by the poor state of the banking sector. This diagnosis holds for most of the Asian economies. Japan represents an extreme case, with the economic slowdown set to persist and no recovery before 2002.

April saw the year-on-year growth rate for exports from most of the Asian countries close to 0% (graph 7). The slowdown is particularly marked for Korea and Singapore. The export growth rate for both these countries has fallen from 40% in Q3 2000 to around 0% in Q2 2001. The tendency is slightly less marked for Hong Kong and Thailand, where the new technologies are less important.

In Asia, manufacturing production had started to slow down as far back as the beginning of 2000, especially in Hong Kong and, to a smaller extent, in

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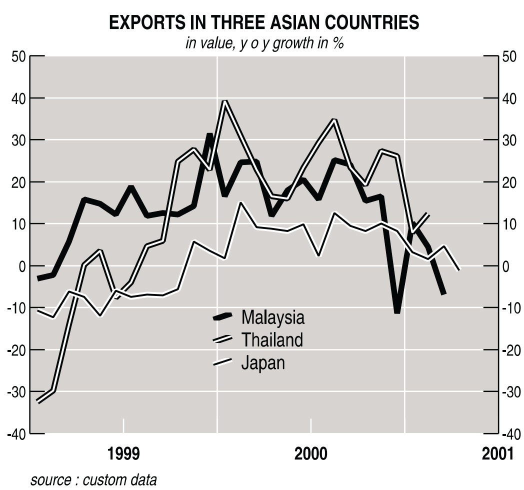


Singapore. In Q4 2000, world demand turned down more sharply, intensifying the levelling off of activity in the manufacturing sector. In Malaysia, Singapore and Taiwan, the year-on-year growth in manufacturing production fell from 20% in Q3 2000 to 0% around the turn of the year (graph 8).

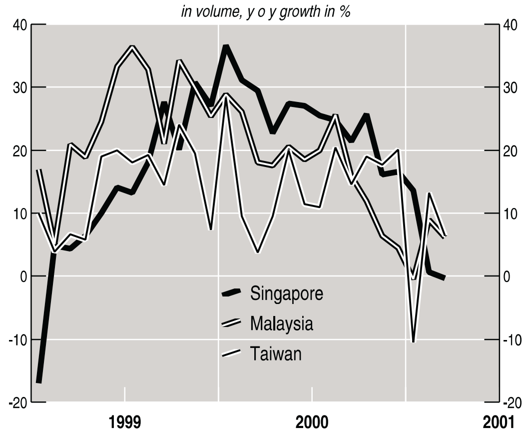
These three last-mentioned countries are, with Korea, the largest exporters of electronic components and new-technology products in Asia ex Japan. Generally speaking, emerging Asia and Japan specialise in the production of electronic equipment. In Malaysia and Singapore, added value in the electronic sector exceeds 10% of GDP. The importance of the technological factor in the final stages of the current cycle therefore has a particularly severe impact on activity in Asia. For example, the production of electronic equipment, which had been rising by almost 50% in Q2 2000 in Taiwan and Singapore, has stagnated in the early part of 2001 (graph 9).

The downturn in demand for Asian exports stems in large part from the slowdown in the American economy. The countries of emerging Asia are in fact particularly exposed to the American market, which takes almost 40% of their exports. Given the high degree of openness of these economies, this means that exports to the United States account for almost 10% of their GDP (1). Japan is in a slightly different case: while exports to United States account for 30% of the total, the low degree of openness reduces the share of the American market in the outlets for Japanese firms to only 3%. However, given the weakness of domestic demand in Japan, exports are now playing a more important role than this figure would indicate, especially as the other large element in Japanese exports consists of sales to Southeast Asia.

(1) In Singapore, the Philippines and Malaysia, exports to the United States account for 22%, 17% and 28% of GDP, respectively.

8

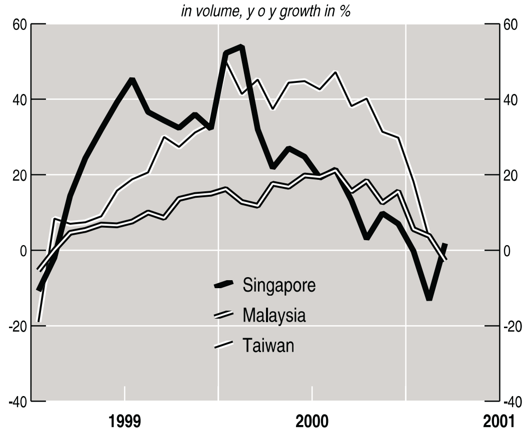
MANUFACTURING IN THREE ASIAN COUNTRIES
in volume, y o y growth in %



source : WEFA

9

HARDWARE & ELECTRONICS PRODUCTION IN SOUTH EAST ASIA
in volume, y o y growth in %



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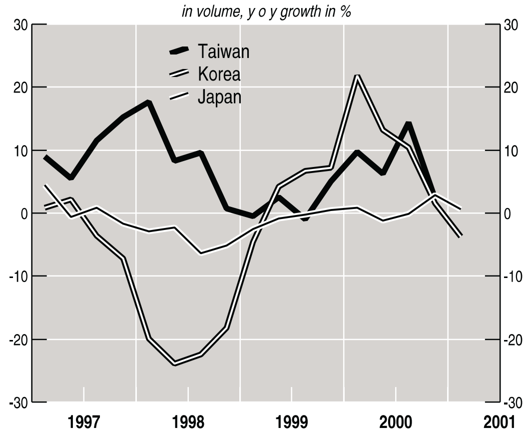
INVESTMENT IN THREE ASIAN COUNTRIES
in volume, y o y growth in %



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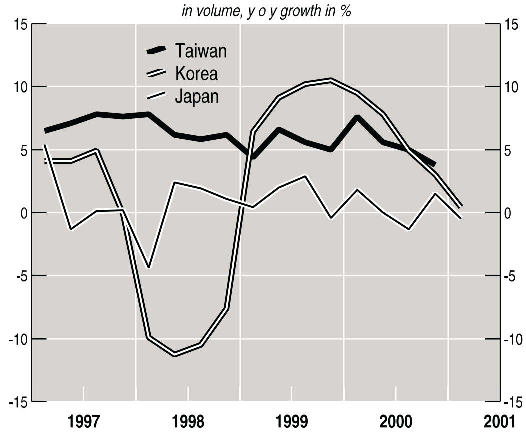
11

CONSUMPTION IN THREE ASIAN COUNTRIES
in volume, y o y growth in %



source : WEFA

In the face of this levelling-off in exports for the Asian countries as a group, domestic demand seems incapable of constituting a solid platform for growth. Investment continues to suffer from the repercussions of the 1997 Asian crisis (graph 10): the bank sector is concentrating on dealing with its dubious loans, especially in Thailand, Korea, Indonesia and Taiwan. This means that there is a shortage of liquidity to finance investment, especially as the assets that could be used as collateral (real estate, equities) have also lost much of their value since 1997. The situation is similar in Japan since the bursting of the financial and real-estate bubbles built up in the latter part of the 1980s. The net result is that loans to firms continue to be sluggish and this is holding back investment. Only Singapore and Hong Kong seem to have maintained a high level of investment in the early part of 2001. Firms in these two countries have maintained a certain room for manoeuvre in financial terms since their currencies have stood up well to the dollar during the crisis and this has limited the rise in their foreign-currency indebtedness.

The downturn in investment is being accompanied by a gradual decline in private consumption (graph 11). The most severe slowdown is being seen in Korea, where private consumption growth has dropped from almost 10% in the early part of 2000 to virtual stagnation in the early part of 2001. But downturns in consumption are already clearly visible in Hong Kong and Taiwan. In the case of Japan, the stagnation of household income makes it impossible to envisage any upturn in consumption.

Latin America: holding up relatively well against a background of financial uncertainty

The end of the cycle finds Latin America less exposed than the Asian economies. Leaving aside Mexico, the United States accounts for only a small part of these countries' outlets. Moreover, they are little involved in the production of new-technology items so that they are relatively shielded from the ups and downs of the current cycle. The main risk facing these economies is contagion from Argentina to the rest of the continent. A build-up of investor mistrust towards South American currencies and South American debt could lead to a toughening of monetary policy in order to consolidate the balance on capital account and thus hold down domestic demand.

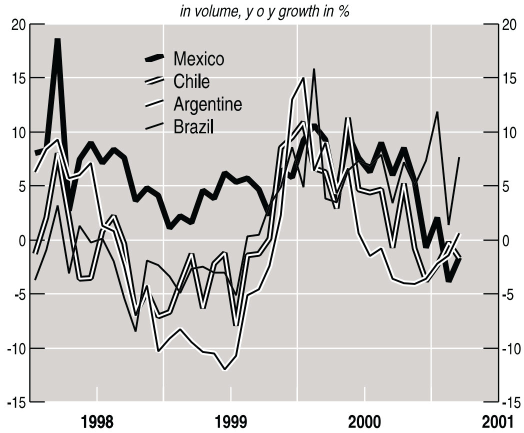
Although the United States accounts for almost 40% of the exports of Latin America ex Mexico, these countries represent a relatively more closed grouping than the emerging Asian countries, with American customers totalling only 4% of total outlets, meaning an exposure only half that of Asia's. Mexico is a special case, being much more integrated with the American economy. Since the creation of NAFTA, several American firms have relocated south of the Rio Grande that part of their production with the highest unskilled labour content. As a result, almost 26% of Mexico's GDP consists of intermediate goods and capital goods produced for the American market. Chile is another country highly open to international trade, with exports equivalent to 30% of GDP.

It is therefore in these two countries that industrial output has fallen most rapidly (graph 12). This occurred in Q4 2000 in the case of Mexico, in perfect synchronisation with the American economy. In this country, the situation is all the more worrying in that domestic demand, hitherto very lively, began to turn down in the first quarter.

12

INDUSTRIAL PRODUCTION IN LATIN AMERICA

in volume, y o y growth in %



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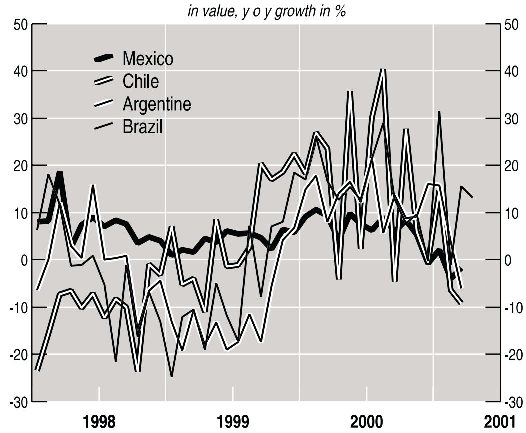
13

EXPORTS OF FOUR LEADING SOUTH AMERICAN COUNTRIES

in value, y o y growth in %



source : WEFA

Brazil, for its part, is a relatively closed country, with exports less than 8% of GDP. Given the strength of domestic demand, industrial output is continuing to rise at a rate of roughly 5% a year. In Argentina, another relatively closed economy, industrial output seems to be picking up slightly, after almost a year of recession.

The Argentinian economy, which was in recession last year (a fall of 0.5 of a point of GDP), could see a gradual upturn in domestic demand. Despite the intervention of the IMF and the cuts in American interest rates, monetary easing is still slow in coming. The anchorage of the peso to the dollar still lacks credibility, to judge by the capital flight. The deterioration of the balance of payments has automatically resulted, via the currency board system, in a continued decline in the monetary base.

In reality, the principal risk inherent in this scenario of "resistance except in Mexico" is financial. Latin America is the emerging zone with the highest external debt in relation to exports (table 1). Investor mistrust regarding the sustainability of the Argentine debt and exchange rate could spread to other countries on the South American continent. If such a risk were to take concrete form, exchange rates would slide (2) and risk premiums would increase, adding to firms' debt burdens in dollar terms. Adjusting the external accounts would then require a tightening of monetary policy and a reduction in domestic demand, already in a weak state in most of these countries.

United Kingdom: underpinned by private consumption

The British economy grew by 0.4% in Q1 2001, relying on continuing lively domestic demand. The downturn in household consumption has been partly compensated by a temporary pick-up in investment around the turn of the year. Given its international specialisation, the United Kingdom can be expected to suffer a particularly marked downturn in exports, a tendency that already began in Q1 2001. However, domestic demand continues to be buoyed up by strong income growth and a more expansionary fiscal policy. All things considered, activity in the country can be expected to show annual growth of roughly 2%.

Given its international specialisation, the UK economy is being particularly affected by the current downturn in the cycle. While its new-technology sector (2.3% of GDP) is no larger than in the euro zone (2.6%) or the United States (4.3%), the sector has made an appreciable contribution to United Kingdom growth in the past four years (of the order of 0.4 of a point of GDP on average). The major contribution of financial services to exports and to GDP (more than in the case of the United States) also seems likely to constitute a handicap in present circumstances. In 2000, the sector had contributed 0.2% of the country's growth. The downturn in M&A activity and the gloom on the financial markets is likely to weigh heavily on growth prospects in 2001.

EXTERNAL INDEBTEDNESS OF SELECTED EMERGING COUNTRIES

(in %)

	External indebtedness / exports
Argentine	547
Brazil	314
Chile	150
Mexico	84
Malaysia	36
Thailand	70
Korea	68
Czech Republic	33
Poland	87
Hungary	70

source : FMI

On top of these tendencies, there is the foot-and and-mouth crisis. Given the small scale of the contribution of livestock to the UK economy, the direct impact of this crisis is admittedly virtually negligible. But the knock-on effects on tourism are more important and could weaken the current-account balance.

Investment is likely to remain lacklustre. The uncertainties affecting the international environment, reflected in the sharp downturn in the results from UK business surveys, mean that firms have been led to postpone a substantial part of their investment plans. Moreover, weaker profits (a year-on-year decline of 3.3% in Q4 2000 according to the ONS) is reducing their capacity for financing investment out of their own resources.

The principal mainstay for UK growth remains household consumption, which in turn is based on substantial growth in real earnings. Admittedly, Q4 2000 saw total employment rising at a year-on-year rate of only 0.2%, the result of a near-full-employment situation (the unemployment rate as defined by the ILO stands at 5.3%). As a reflection of these pressures and the low level of inflation, real incomes are rising at an annual rate of around 2.5%. The low

(2) The Brazilian real has already lost more than 20% of its value versus the dollar since February 2001.

level of inflation (the recent strength of sterling has resulted in the import of disinflation), as well as the firmness of the housing market, which is an important indicator of household wealth, point to unchanged saving behaviour and hence to relatively brisk consumption (growth of around 0.6% a quarter) within the time-horizon of the forecast.

At the same time, fiscal policy is expected to become more expansionary for the tax year starting in April 2001. According to the fiscal rules the government has set itself, the GBP 3 billion of public investment that had not been spent in 2000/2001 is to be reallocated this year. In addition, tax revenue is turning out to be 1.6 billion pounds down on the forecast for 2000/2001, meaning that the basis for calculations regarding this tax year will have to be cut back. As a result, the public surplus could fall by around 0.5 of a point of GDP in 2001/2002 (excluding 3G licences).

Central and Eastern Europe: dependence on the euro zone

The CEEC are not directly exposed to the factors determining the downturn in the world economy. 75% of the exports go to Europe, with sales to the United States accounting for 2.6% of the zone's GDP. In addition, the countries produce relatively little in the way of new-technology goods. Finally, the external situation makes them less vulnerable to financial pressure and to the possibility of a currency crisis than certain Latin American countries (table 1).

Even so, under the impact of a slowdown in Western Europe, the situation in Central and Eastern Europe could worsen during 2001, especially as these countries are particularly exposed to the least dynamic euro-zone country, namely Germany. In the Czech Republic and Poland, industrial output was still rising at a rate of roughly 5% in Q2 2001, but exports had already begun to slow down at the beginning of the year (graph 15). However, private consumption remains brisk in both countries, with domestic demand cushioning to some extent the impact of the European slowdown.

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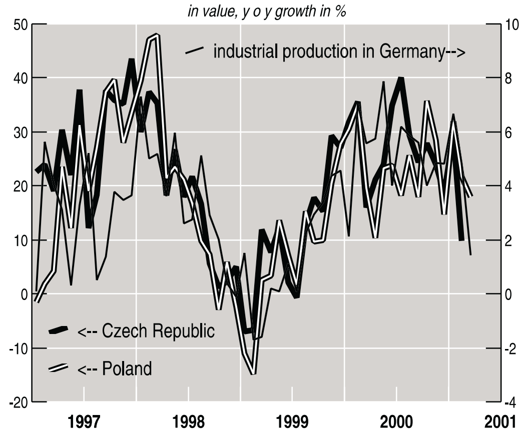


All things considered, growth in Eastern Europe can be expected to weaken in 2001, the result being growth of roughly 3%, compared with 4% last year. ■

The economic situation in the euro zone

Growth in the euro zone was almost 3 1/2% in H1 2000, before falling back to 2 1/2% in H2. This slowdown has intensified in 2001, bringing the growth rate down to 1% in the summer. For the year as a whole, annual average growth is likely to come out at slightly below 2%.

While the trigger for the maturing of the manufacturing cycle and for the slowdown in consumption last year was the leap in the oil price, it is now the downturn in the world demand for euro zone exports that is holding back growth. This slowdown in external demand has not been compensated from the household demand side. Despite the tax cuts launched in several countries, household demand remains weakened by higher-than-expected inflation, under the impact of a food price shock and continuing very high energy prices. This sombre environment is affecting European corporate behaviour, with de-stocking in H1, coupled with a cutback in investment, intensifying the slowdown in activity during the year. Even so, the ebbing of inflation in H2 should breathe some life into consumption. In the circumstances, although it is not possible to talk of genuine recovery, activity can be expected to pick up somewhat towards the end of the year.

The industrial cycle: the slowdown continues

The situation in industry has been gradually weakening since Q3 2000. At the end of Q1 2001 the decline in the INSEE composite indicator, which summarises the results of industrial business surveys in the euro zone, gathered pace.

FORECASTS FOR THE EURO ZONE

(annual and quarterly % change)

	Annual changes			Quarterly changes											
				1999				2000				2001			
	1999	2000	2001	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP															
Growth rate	2.5	3.4	1.9	0.8	0.5	1.0	1.0	0.9	0.7	0.6	0.6	0.5	0.2	0.3	0.4
year on year growth	-	-	-	1.9	2.2	2.6	3.4	3.5	3.7	3.3	2.9	2.5	2.0	1.7	1.5
IMPORTS															
Growth rate	6.8	10.6	3.7	1.7	2.1	2.6	2.9	2.4	2.6	2.4	2.7	-1.5	1.0	0.8	0.8
year on year growth	-	-	-	4.7	5.4	7.4	9.7	10.5	11.0	10.7	10.4	6.2	4.6	3.0	1.1
HOUSEHOLD CONSUMPTION															
Growth rate	3.0	2.6	1.7	1.0	0.3	0.9	0.7	0.7	0.9	0.2	0.2	0.3	0.5	0.6	0.6
Contribution	*1.7*	*1.5*	*1.0*	*0.6*	*0.1*	*0.5*	*0.4*	*0.4*	*0.5*	*0.1*	*0.1*	*0.2*	*0.3*	*0.3*	*0.3*
year on year growth	-	-	-	3.2	2.9	2.9	2.9	2.6	3.2	2.5	2.1	1.7	1.4	1.7	2.0
GFCF															
Growth rate	5.2	4.5	1.3	1.5	1.3	1.9	0.7	1.6	0.6	1.0	0.3	-0.9	1.2	0.5	0.7
Contribution	*1.1*	*1.0*	*0.3*	*0.3*	*0.3*	*0.4*	*0.2*	*0.4*	*0.1*	*0.2*	*0.1*	*-0.2*	*0.3*	*0.1*	*0.2*
year on year growth	-	-	-	4.3	5.3	5.5	5.5	5.6	4.9	4.0	3.6	1.0	1.6	1.1	1.5
EXPORTS															
Growth rate	4.8	11.9	4.5	0.7	2.9	3.1	3.1	2.8	2.4	2.9	3.0	0.1	-0.3	0.4	0.4
year on year growth	-	-	-	0.8	2.5	5.9	10.1	12.4	11.9	11.7	11.6	8.7	5.8	3.2	0.6
DOMESTIC DEMAND EXCL. STOCKS															
Growth rate	3.1	2.9	1.6	1.0	0.5	1.0	0.7	0.9	0.7	0.4	0.3	0.1	0.7	0.5	0.6
Contribution	*3.1*	*2.8*	*1.6*	*1.0*	*0.5*	*1.0*	*0.6*	*0.9*	*0.7*	*0.4*	*0.3*	*0.1*	*0.7*	*0.5*	*0.6*
year on year growth	-	-	-	3.1	3.1	3.2	3.2	3.1	3.4	2.7	2.4	1.5	1.5	1.6	1.8
FOREIGN TRADE															
Contribution	*-0.5*	*0.6*	*0.4*	*-0.3*	*0.3*	*0.2*	*0.1*	*0.2*	*0.0*	*0.3*	*0.2*	*0.6*	*-0.5*	*-0.1*	*-0.1*
STOCKS															
Contribution	*0.0*	*0.0*	*0.0*	*0.1*	*-0.2*	*-0.2*	*0.2*	*-0.1*	*0.1*	*0.0*	*0.1*	*-0.1*	*0.0*	*0.0*	*0.0*

Forecast

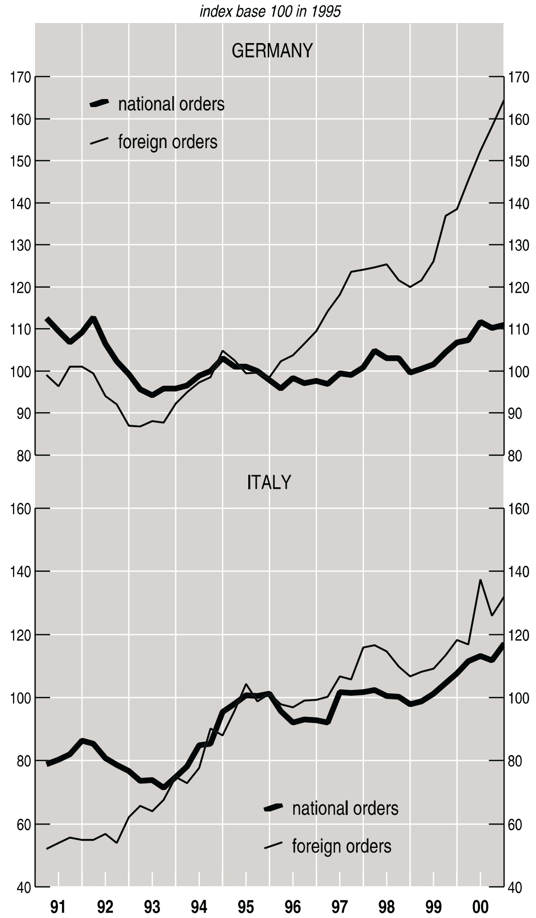
In fact, industrial output growth in the euro zone came out at less than 2% (compared with 6% in the previous half-year). Meanwhile, the decline in orders suggests that industrial activity will fall, starting in Q2.

However, the slight recovery in the production outlook as reported at the end of May in the majority of countries, if confirmed, raises hopes of stabilisation between now and the end of Q3.

Exports: little prospect of improvement before the end of the year

Euro-zone exports (including intra-zone trade) stagnated in Q1, bringing to a sudden halt the rapid growth seen since Q2 1999. This tendency stems above all from the downturn in world demand that began at the end of last year. On top of this, there was a diminution in the beneficial price-competitiveness effects of the past depreciation of the euro.

INDUSTRIAL ORDERS
index base 100 in 1995



sources : national

Against a background of persistent depression in world economic activity, external demand for euro-zone goods is expected to remain unsatisfactory for the rest of the year. However, the acceleration in household consumption could provide support for intra-zone exports in the second half.

All things considered, exports are likely to rise by 4 1/2% in 2001 (as against almost 12% in 2000), a figure that is still positive on an annual average basis, but masks stagnation during the year.

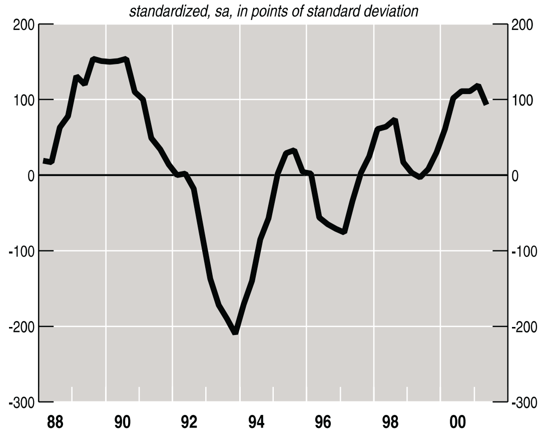
Private consumption: slight consolidation

After four years of uninterrupted decline, the euro-zone unemployment rate remained stable at 8.5% between October and February. March and April saw further declines (8 3% in April) but the rate of decline in unemployment, which had been rapid until Q4 2000, has slowed appreciably.

Under the impact of the slowdown in growth in H2 2000 the rate of job creation has weakened in the early part of this year. Q1 2001 witnessed major disparities between countries. While private dependent job creation has remained very brisk in France, it fell back in Germany. The current slowdown in activity is likely to continue to leave its mark on employment in coming quarters, although the structural changes that have taken place in recent years on a certain number of national labour markets (notably the development of fixed-term contracts in Spain and Italy), by enhancing the job-content of growth should cushion the shock.

In 2000, wage growth in the euro zone was not very strong. The end of the year saw it standing at 2.5 %, year on year, in nominal terms. While in Germany it

CAPACITY UTILISATION RATES IN THE EURO ZONE
standardized, sa, in points of standard deviation



sources : IFO, INSEE, ISAE, European Commission (ECFIN) was above the zone average, France, Italy and Spain saw their wages per head rise more moderately (by around 2% at the end of last year).

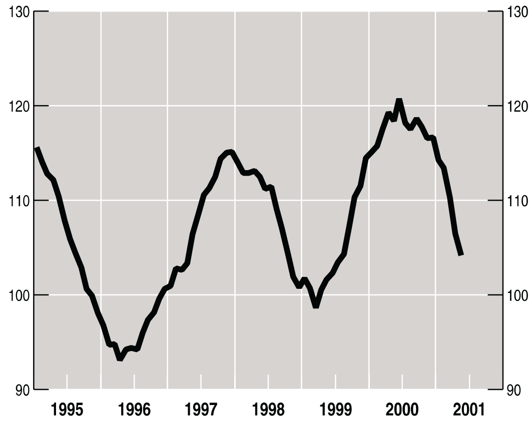
In 2001, some countries have already been experiencing wage rises emerging from the renegotiation of contracts subsequent to the price rises recorded in 2000. However, these remain moderate.

The easing of inflation expected in H1 2001 failed to materialise. For one thing, the fall in the oil price in the early part of the year was followed by an upturn in Q2. In addition, the euro zone found itself facing a fresh shock, this time in the food sector from the effects of the BSE and foot-and-mouth disease crises and a surge in prices of fresh produce due to the highly unfavourable weather conditions at the beginning of Q2. Germany was particularly affected: the usual "good boy of the class" as regards price performance found its inflation (HICP) reaching 3.6% in May.

In the circumstances, European consumption, after weakening substantially in H2 2000 under the impact of the higher oil price, has maintained a low growth rate (1.3%, annualised) in Q1, despite the tax cuts introduced in several of the major countries of the zone. Differences in consumption growth in the early part of the year seem in fact to have been directly linked to the scale of price changes. The overall result was adversely affected by the sharp decline in purchases recorded in the Netherlands (a fall of 1.7% in Q1), following the raising of the VAT rate (Dutch inflation rose above 5% following this move). Conversely, in France, where the year-on-year price rise lost one point between November and December 2000, consumption as distinctly accelerated.

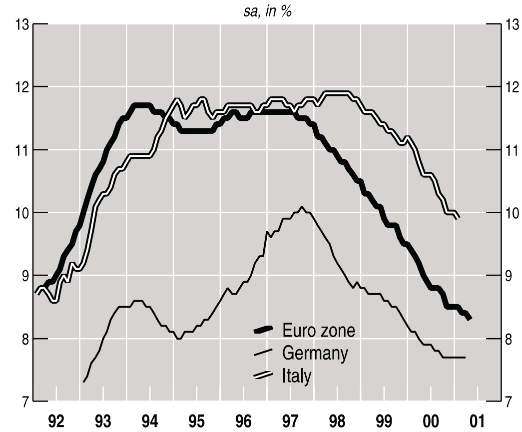
With the return to normal of food prices and the fall in prices of petroleum products in the second part of the year, European households' purchasing power should increase again. In the circumstances, the tax cuts could make themselves felt and lead to a revival of consumption, with its growth returning to around 2.5% in H2. However, this scenario assumes that European household confidence is not too badly impaired by the downturn seen on the employment front.

COMPOSITE INDICATOR FOR MANUFACTURING INDUSTRY IN THE EURO ZONE



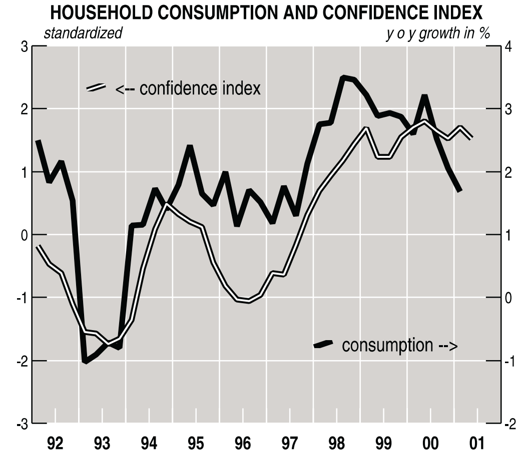
UNEMPLOYMENT RATE

sa, in %



sources : national harmonized by Eurostat

HOUSEHOLD CONSUMPTION AND CONFIDENCE INDEX



sources : national and Eurostat

THE EVOLUTION OF WAGE INCOME IN THE EURO ZONE IN 2000

Technical note concerning the data: the evolution of wages in the euro zone is approximated here by using the earnings index compiled by Eurostat, covering all sectors of the economy other than agriculture. This is a quarterly index, which becomes available roughly three months after the end of the period concerned. At individual national level, the methods used for compiling the indices are not harmonised. In particular, data can come either from surveys of businesses or from data collected for administrative purposes.

The evolutions as regards employment for the whole of the euro zone are calculated here as the weighted average of the observed evolutions for the six main countries. Employment is taken in its national accounts sense, covering the whole of the economy (including agriculture, civil service, education, health care and social activities).

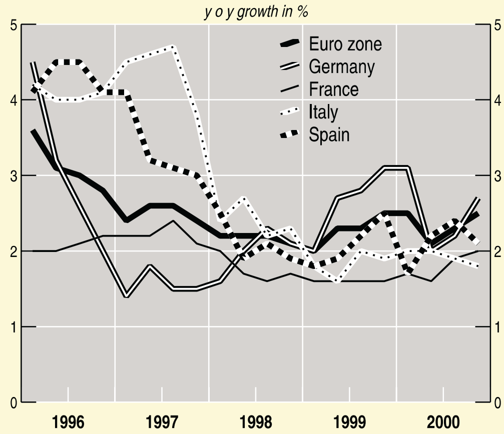
Growth in nominal monthly wages has been stable in France, Spain and Italy, from 1998 to 2000. The pattern over time turns out to be more uneven in Germany. For the euro zone as a whole, monthly wages rose during this period at a rate slightly above 2% a year. At the end of 2000, the year-on-year change was 2.5%. The dispersion of evolutions in wages in individual countries around the average for the zone is relatively unimportant. Following the rise in oil prices, the inflationary shock affected most of the major countries in the zone in very similar fashion until the end of 2000, with the harmonised indices of consumer prices rising in all countries by roughly 1.5 of a point between Q3 1999 and the end of 2000. In the early part of 2001, on the other hand, the ebbing of this form of inflation was slightly more marked in France than elsewhere.

Under the impact of the rise in inflation, gains in monthly wage purchasing power declined from mid-1999 on in all the major countries. Prior to the oil shock, the rise in real wages in France had been close to the average for the zone, distinctly higher in Germany and lower in Italy and Spain. The advent of the oil shock meant that the year-on-year change fell virtually to zero in Q4 2000 in France and Germany, and was distinctly negative in Italy and Spain.

In the final analysis, the oil shock took almost one and a half points off the purchasing power of wages in the euro zone in 2000. The shock was slightly greater in Germany, where wages had accelerated in1999, as well as in Spain, where inflation rose somewhat more strongly.

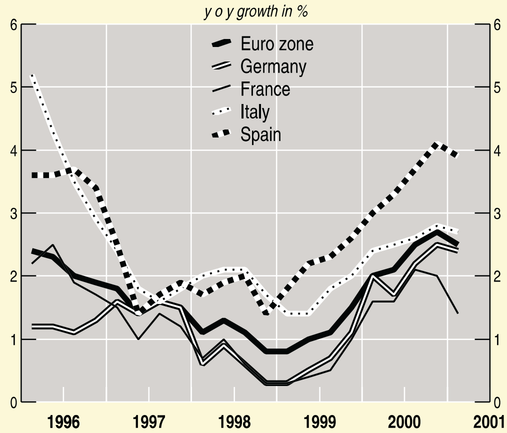
Dependent job creation, all sectors taken together, remained firm throughout 2000. It was slightly less brisk in Germany than in the rest of the euro zone, slightly above the average in France and persistently stronger in Spain. The rate in Italy rejoined that of the rest of the zone towards the end of the year.

MONTHLY WAGES
y o y growth in %



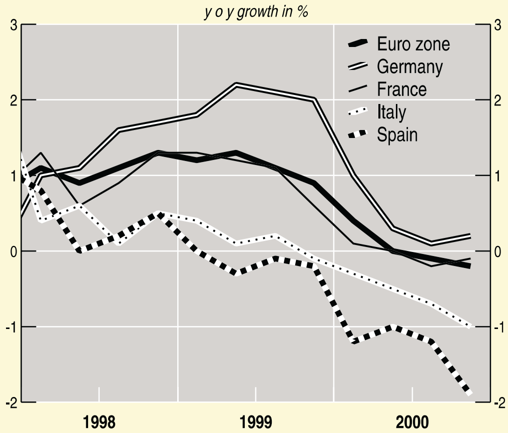
source : Eurostat

HARMONIZED CONSUMER PRICE INDEX
y o y growth in %



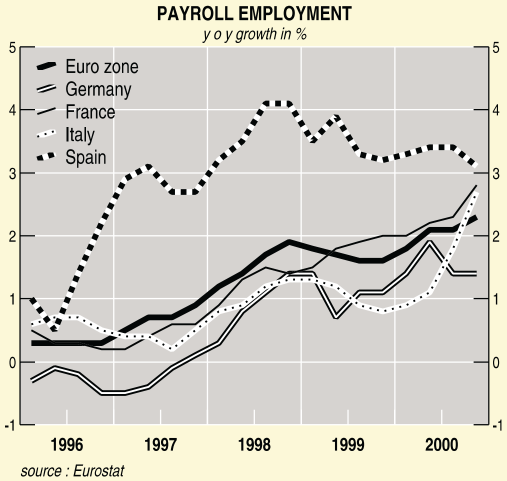
source : Eurostat

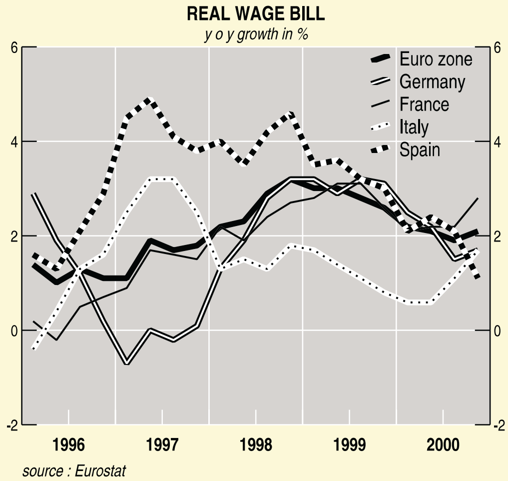
MONTHLY WAGE PURCHASING POWER
y o y growth in %



source : Eurostat

The evolution of wage income in the euro zone in 2000 (continuation)





In all, under the impact of the slowdown in real wage growth, total real wage income fell by just under one point in the euro zone between the beginning of 1999 and the end of 2000. The patterns over time in France and Germany were remarkably similar until Q3 2000, but have since diverged.

At the end of 2000, France was posting real year-on-year wage income growth of close to 3%, whereas in Germany, Italy and Spain it was slightly below the 2% average for the zone.

It is to be expected that the rise in inflation has produced a fresh slowdown in wage income in H1 2001. ■

Reduction in corporate demand

Facing a distinct deterioration in external demand and the delayed upturn in consumption, firms have been cutting back their demand since the beginning of the year, thus intensifying the slowdown. The de-stocking cycle has begun in the intermediate goods branch, one that is traditionally more dependent on the world industrial cycle. Investment has been subjected to a downward shock (a fall of 0.9% in Q1). The scale of this movement was accentuated by the decline recorded in the German construction sector, brought about by unfavourable weather conditions, suggesting that there may be a technical rally in Q2. Even so, the underlying tendency for productive investment is below what has been seen since 1998. In all countries of the zone, capacity utilisation rates eased appreciably in Q1 2001, having remained at historically high levels throughout 2000. Moreover, expectations in the capital goods sector, which had stood up fairly well until then, have turned down more markedly since March.

In the second part of the year, investment growth should revive somewhat as household demand improves again. This tendency would also be favoured by the need to replace equipment at the time of the shift to the euro.

All things considered, domestic demand, after slowing down appreciably in H1, should return to growth rates of the order of 2% in the second.

Imports slowing down

In the first quarter of the year, imports (including intra-zone trade) fell back sharply. This fall stems partly from the de-stocking that took place in the intermediate goods branch. It is also probably a reaction to the very sharp increases posted in H2 2000 (12% at annualised rate), at a time when domestic demand was nevertheless already slowing down.

With the ending of the de-stocking cycle and the modest strengthening of domestic demand, imports can be expected to return to growth of the order of 3 1/2% in the second half of the year.

At a time when exports remain very depressed, the external contribution would therefore tend to limit growth in the euro zone in H2, which, after bottoming out at around 1% in mid-year, would remain very weak, of the order of 1.5% at year-end. ■

Consumer prices in the euro zone

The end of the year 2000 saw inflation in the euro zone tracking the decline in oil prices and returning to 2.4% in January 2001. This easing was interrupted in February, when the rise in food prices, followed in the spring by those of energy, sent inflation up again, reaching 3.4% in May.

Underlying inflation (ex food and energy) has accelerated in H1 (1.5% in December 2000, 2.1% in May 2001). This gradual rise is related to specific tax measures in certain countries (the Netherlands) and to the residue of the 2000oil shock. In H2, despite a slight acceleration in wages, underlying inflation is expected to stabilise, in view of the weakening of the economic situation.

Inflation is unlikely to weaken during the summer, with the decline coming only in Q4. On the assumption of a euro/USD exchange rate of 0.88 and a return of the Brent price to USD 25/barrel in H2, inflation should stand at 2.3% in December 2001, under the impact of the now negative contribution from energy prices.

The unexpected nudge to inflation given by food prices.

The year-on-year price rise stood at 3.4% in May 2001 compared with 1.9% a year earlier. The fall in energy prices around the turn of the year had permitted a marked decline in inflation in January 2001, bringing it to 2.4% from 2.9% in November 2000. However, the overall index again accelerated in the spring, under pressure from the sharp rises in the prices of meat and fresh produce and further rises in energy prices.

The BSE and foot-and-mouth crises have been reflected every month since January 2001 in sharp increases in meat prices (the "quality" effect and the higher production costs). In addition, the repercussions of the bad weather conditions in the early part of the year on the production of fruit and vegetables have meant an acceleration in prices of fresh produce. These two factors have fuelled a steady addition to the year-on-year rise in food prices[1]. This in turn has added 0.8 of a point to the rise in inflation over the past twelve months.

The relative stabilisation of the crude oil price should have automatically produced a decline in energy prices. However, severe pressures on the productive capacity for refined products emerged in the spring and postponed this tendency. As a result, the year-on-year rise in energy prices increased slightly in the first half and this limited the contribution of energy to the decline in year-on-year inflation, which was no more than -0.1 of a point between May 2000 and May 2001.

The past acceleration in industrial producer prices, whose year-on-year rise peaked in autumn 2000, has led to an acceleration in the consumer prices of manufactures, although this remains modest (1.6%, year-on-year, in May 2001 as against 0.5% in January 2000). The strength of food prices has been passed on to those of hotels and catering, resulting in an increase of 0.5 of a point in the year-on-year rise in services prices in H1 2001. Tax measures specific to certain countries (the rise in the Dutch standard VAT rate in January 2001 and the exit from the year-on-year calculation of the impact of the cut in French VAT in April 2001) also contributed to the increase in the year-on-year price rise ex energy and food. This meant that underlying inflation[2] in the euro zone has gradually risen from 1.1% in May 2000 to 2.1% a year later, contributing 0.7 of point to the rise in inflation from the same period.

The maximum inflation differential has narrowed

Most euro-zone countries posted inflation rises in Q2 and the figure for May was everywhere above 2.5%. The Netherlands, where the standard VAT rate was raised in January 2001, has the highest inflation in the zone (5.4%). The maximum inflation differential between euro-zone countries narrowed by three points in May 2001, having been 3.6 points in May 2000 and 3.9 points in October 2000.

The addition to inflation posted between May 2000 and May 2001 was less than 1.4 of a point in all countries other than the Netherlands (3.3), Portugal and

(1)The scale of this movement was underestimated in the March 2001 note, when it was expected that the year-on-year rise in food prices would stand at 3.4% in June 2001. The current forecast is 5.8%.
(2) HICP ex energy and food, unadjusted for changes in indirect taxation.

Germany (2.5 and 2.1). While in Portugal and the Netherlands this can be explained by specific tax situations (government-controlled energy prices in the first case and the VAT rise in the second), Germany is experiencing a relatively novel situation. The first half saw the year-on-year rise in German food prices climb rapidly to over 4.0%, higher than at any time since the creation of the HICP in January 1995. On top of this there were the further rises in energy prices in the spring, more marked in Germany than in the rest of the euro zone. The result was a gradual widening of the inflation differential between Germany and France to a peak of 1.1 of a point in March 2001, having been zero in July 2000.

A decline in energy prices and a stabilisation of food prices expected during the summer

Pressures on refinery capacity were particularly great in April and May 2001. These supply-side problems are likely to ease during the summer, making it possible for energy prices to slow down considerably. The levelling off in activity will also probably hold down demand for crude oil, whose price should fall slightly in H2, thus intensifying the slowdown in energy prices. The year-on-year change for this group of products is expected to turn negative in September, contributing to a fall in overall inflation.

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

EURO ZONE INFLATION

(year on year % growth of HCPI)*

Sectors (weigh in the index)	May 2000	May 2001	June 2001	December 2001
Total (100.0%)	**1.9**	**3.4**	**3.1**	**2.3**
Food (16.3%)	0.4	5.9	6.4	5.7
Beverage and Tobacco (4.0%)	2.3	2.9	3.6	3.6
Clothing and footwear (7.8%)	0.8	1.4	1.3	1.7
Housing. water. electricity and gas (15.6%)	3.5	4.1	4.0	0.7
Furnishings and household equipment (7.9%)	0.9	2.0	2.2	2.0
Health (3.9%)	1.8	1.1	1.1	0.9
Transports (15.6%)	5.1	3.9	2.3	1.0
Communications (2.4%)	-4.9	-2.8	-3.3	-2.6
Leisure and culture (9.4%)	0.3	2.2	1.5	1.5
Education (0.9%)	2.5	3.0	3.0	2.2
Hotels-cafés-restaurants (8.8%)	2.5	3.3	3.3	3.6
Miscellaneous goods and services (7.4%)	2.0	2.9	2.9	2.4
Core inflation (70.2%)	**1.1**	**2.1**	**1.9**	**2.0**

Forecast
* Harmonized Consumer Price Index
Source: Eurostat

EURO ZONE INFLATION BY COUNTRIES

(year on year % growth of HCPI)*

	May 2000	April 2001	May 2001
France	1.6	2.0	2.5
Germany	1.5	2.9	3.6
Italy	2.5	3.0	2.9
Spain	3.2	4.0	4.2
Netherlands	2.1	5.3	5.4
Belgium	2.4	2.9	3.1
Austria	1.6	2.6	2.9
Finland	2.7	2.8	3.3
Portugal	2.4	4.6	4.9
Ireland	5.1	4.3	4.1
Luxembourg	2.9	2.7	3.8
Greece	2.6	3.7	3.9
Euro Zone	**1.9**	**2.9**	**3.4**
United Kingdom	0.5	1.1	1.7
Sweden	1.3	3.0	3.1
Denmark	2.8	2.6	2.8
E.U.	**1.7**	**2.6**	**3.1**

* Harmonized Consumer Price Index.
Source: Eurostat

THE EBB AND FLOW OF THE INFLATION DIFFERENTIAL BETWEEN THE EURO ZONE AND FRANCE

Since the creation of the HICP, the inflation differential between the euro zone and France, measured on this basis, has oscillated around 0.4 of a point in year-on-year terms. The gap widened considerably in Q4 2000 and reached a high of 1.2 of a point in February and March 2001. It has since narrowed slightly, standing at 0.9 of a point in May 2001.

A lasting inflation differential of the order of 0.4 of a point

Examination of the contributions of the principal constituent aggregates of the HICP makes it possible to identify the principal determinants of the inflation differential between the euro zone and France.

The diagnosis that emerges is the existence of a lasting inflation differential of the order of 0.4 of a point. The reasons can be sought in two dimensions, sectoral and geographic. At product level, it is due in equal parts to the prices of services and those of manufacturing goods ex-energy (core inflation); as regards countries, Spain and Italy share the contribution to the differential, given their weightings in the overall index.

In 2001, still taking this two-dimensional approach, specific factors emerge in the case of energy and Germany. In addition, there are divergences as regards indirect taxation.

CONTRIBUTIONS TO INFLATION GAP BETWEEN THE EURO ZONE AND FRANCE

Postes	1998	1999	2000	2001*
Inflation gap (annual growth rate)	**0.4**	**0.6**	**0.5**	**1.1**
Manufacturing excl. energy(1)	0.2	0.3	0.2	0.2
Energy	0.0	0.2	0.1	0.6
Food	0.0	0.0	-0.2	-0.1
Services (4)	0.2	0.1	0.4	0.4
Core-inflation(1+4)	0.4	0.4	0.6	0.6

* The 2001 figure is the average of y o y growth rate from January to April.
Source : Eurostat

The predominant factors in the evolution of the differential

The oil shock produced a widening of the inflation differential between France and the euro zone. This was initially modest in 1999 and 2000, but intensified at the time of the recent surge in energy prices in 2001 (adding something of the order of 0.5 of a point). The acceleration of food prices, which occurred earlier in France than in the rest of the zone, tended to mask this increase in the energy inflation differential in 2000. In 2001, the negative differential regarding food prices diminished as the various food crises spread to the whole of the zone. Conversely, the energy price differential widened because of divergent indirect tax changes. This second factor tending to widen the inflation differential between the euro zone and France also affects the differential for underlying inflation.

Energy prices and German particularities

Two factors explain the substantial contribution of German energy prices to the widening of the inflation differential between the euro zone and France :

- First, German inflation is more sensitive to energy prices than is the case for its principal trading partners. The weighting of energy in the German HICP is the highest in the zone — 11.3%, as against 9.2% for France, 8.8% for Spain and 7.6% for Italy — meaning that a rise in world oil prices brings about a greater increase in inflation in Germany than elsewhere.
- The dropping out of the inflation calculation of the impact of the deregulation of the German electricity market that took place starting in H2 1999 has since Q4 2000 led to a sharp rise in the year-on-year increase in electricity prices. This was intensified by price rises due to higher energy production costs in Q1. Between the low point in June 2000 and April 2001, the year-on-year rise in electricity prices rose from -8.8% to +4.1%, adding something of the order of 0.3 of a point to the year-on-year rise in Germany, whereas there was no acceleration in electricity prices in France.

COUNTRY CONTRIBUTIONS TO INFLATION GAP BETWEEN THE EURO ZONE AND FRANCE

annual growth rate in %

	HICP			Energy			Services			Manufacturing excl. energy		
	1999	**2000**	**2001***	**1999**	**2000**	**2001***	**1999**	**2000**	**2001***	**1999**	**2000**	**2001***
Total à expliquer	0.6	0.5	1.1	0.2	0.1	0.6	0.1	0.4	0.4	0.3	0.2	0.2
Belgium	0	0	0	0	0	0	0	0	0	0	0	0
Germany	0.1	0.1	0.3	0.2	0.1	0.4	-0.1	0.1	0.1	0.1	0	0
Greece	0	0	0	0	0	0	0	0	0	0	0	0
Spain	0.2	0.2	0.3	0	0	0	0.1	0.1	0.1	0.1	0.1	0.1
Ireland	0	0	0	0	0	0	0	0.1	0	0	0	0
Italy	0.2	0.2	0.2	0	0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Netherlands	0.1	0	0.2	0	0	0.1	0	0	0.1	0	0	0
Austria	0	0	0	0	0	0	0	0	0	0	0	0
Portugal	0	0	0.1	0	0	0	0	0	0	0	0	0
Finland	0	0	0	0	0	0	0	0	0	0	0	0

* The 2001 figure is the average from January to April.
Source : Eurostat

The ebb and flow of the inflation differential between the euro zone and France (continuation)

Divergent changes in indirect taxation

- While France was introducing indirect taxation measures to combat the rise in energy prices in H2 2000 (the "floating" tax on petroleum products), Germany did not reduce taxes on fuels and persisted with the planned rise in the "eco-tax". This helped to widen the existing inflation differential between France and Germany in the energy sector. Other major contributions came from Italy and the Netherlands in 2001. In Italy, the "rebates" decided by the government on the price of fuels applied only to the year 2000 and disappeared on 1 January 2001. At the same date, the Netherlands introduced a sharp rise in the standard VAT rate from 17.5% to 19%, bringing about, in particular, an acceleration in energy prices.
- In fact, in the services and manufactured goods sector, national indirect taxation measures explain the difference from the situation prevailing in 1998 and 1999. In addition to this rise in the Dutch VAT rate, there was a fall in French VAT on 1 April 2000, leading to a slowdown in the French price rise and hence a widening of the underlying inflation differential between the euro zone and France. The impact of this last move has gradually started to disappear as of April 2001.

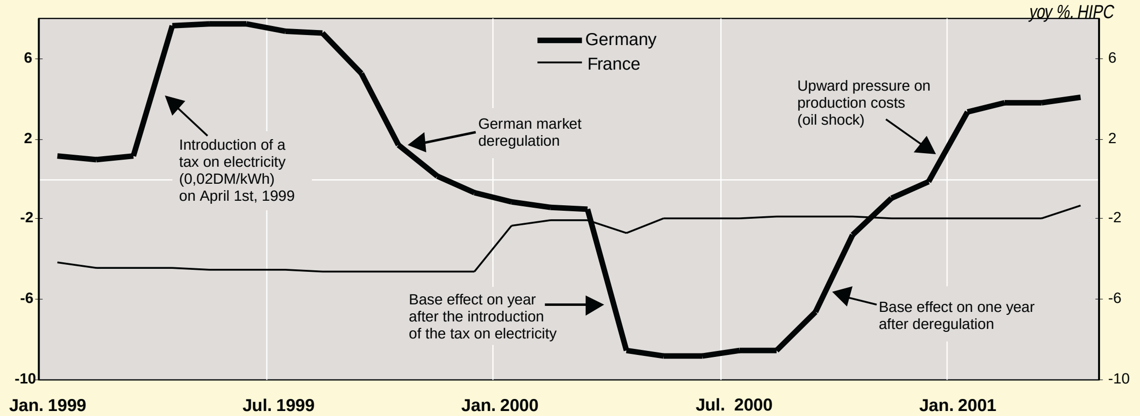
A return to the trend inflation differential

The inflation differential between the euro zone and France is expected to continue to narrow, mainly under the impact of the exit from the year-on-year calculations of the specific tax measures and also the slowdown in prices of petroleum products. The major stages in this tendency are likely to be:

- June 2001: exit from the year-on-year calculation of the energy price rises recorded a year earlier, which had been less pronounced in France than in the rest of the euro zone;
- October 2001: exit from the year-on-year calculations of the cut in the tax on petroleum products introduced in France on 1 October 2000;
- January 2002: exit from the year-on-year calculations of the VAT rise in the Netherlands.

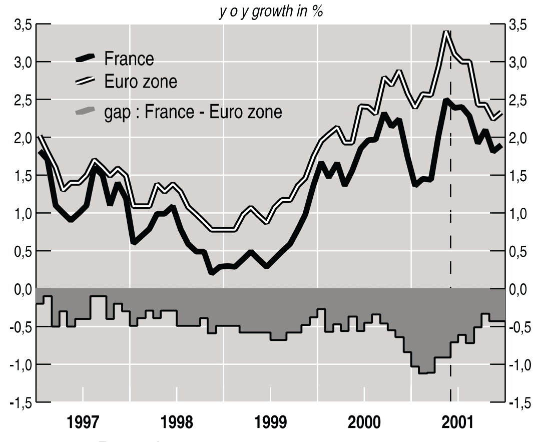
This would bring the inflation differential back towards its long-term trend level by the end of the year, with a subsequent stabilisation during Q1 2002. ■

ELECTRICITY PRICES IN GERMANY AND FRANCE



Recent statements by the British government indicate that the foot-and-mouth epidemic is being brought under control in the United Kingdom. This means that the surge in meat prices could calm down during the summer. Meanwhile, prices of fresh produce are expected to slow down with the gradual disappearance of the impact on production of the bad weather conditions in Q1. In all, prices of foodstuffs are expected to stop accelerating at the beginning of the second half, but the year-on-year rise would remain high at the end of the year (5.4% in December 2001, a rate unprecedented since the creation of the HICP in January 1995).

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



sources : Eurostat, Insee

forecasts after the dotted line

Inflation set to decline in the autumn

On the assumption of a return of the Brent price to USD 25/barrel and a euro/USD exchange rate of 0.88 by the end of the year, inflation in the euro zone will probably remain high throughout the summer before easing in the autumn. After reaching 3.4% in May, it would then fall back to 2.3% in December 2001, but without managing to fall below the 2.0% threshold.

This decline of 1.1 of a point in year-on-year inflation between May and December 2001 is mainly due to the very steep fall in the year-on-year price change for energy, expected to decline from 8.6% in May to -1.9% in December 2001, contributing 1.2 of a point to the decline in inflation over the same period. The liveliness of food prices would probably restrain this movement with a contribution of 0.1 of a point to the year-on-year change in the overall index. Pressures on the productive apparatus are now declining against a background of weaker activity in the euro zone. The fall in energy prices should maintain for some time to come the slowdown in industrial producer prices. Despite a slight acceleration in wages, underlying inflation can be expected to remain little changed between now and the end of the year. ■