

# The euro zone's international environment

*The euro zone's international environment is expected to remain relatively supportive between now and mid-2006, with the world economy continuing to demonstrate considerable resistance to the high oil prices. Even the Asian zone, despite consisting of countries with a large manufacturing component, is unlikely to show any clear signs of weakness.*

*In the euro zone's main industrialised partners (the United States, the United Kingdom and Japan) the consequences of the surge in oil prices for core inflation and for the principal growth motors have been particularly confined in the past year. The current oil-price shock, more evenly spread over time than its predecessors in the 1970s and occurring in very different monetary circumstances and in a competitive climate exerting strong downward pressure on prices, has generally been absorbed without difficulty.*

*This situation can be expected to last in H1 2006, with these industrial partner countries posting growth rates very similar to the ones seen in the second part of 2005 or perhaps even faster, given that domestic demand in these countries seems set to maintain its momentum. In the United States, the United Kingdom and Japan, households are likely to benefit from an improvement on the labour market. In the first two countries, households would also be benefiting from a slowdown in inflation as the direct consequence of the easing of the energy component of price indices. These positive tendencies are likely to induce firms to launch new investment projects.*

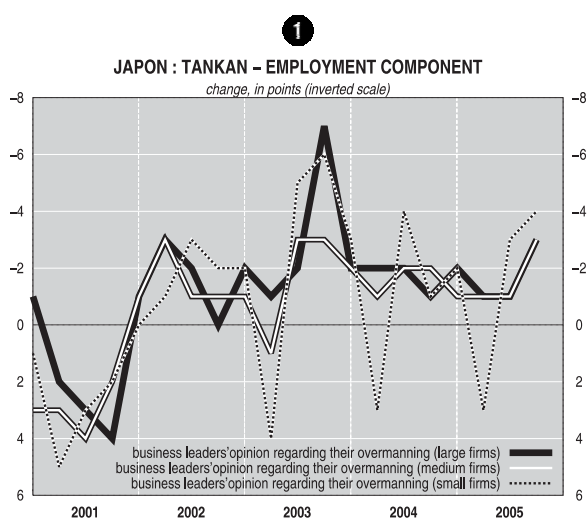
*All things considered, annualised growth rates in H1 2006 are likely to be of the order of 3.5% for the United States, 2.2% for the United Kingdom and 2.4% for Japan.*

**In the United Kingdom and United States, the improvement on the labour market, combined with an easing of inflation, can be expected to stimulate household demand**

Following a deterioration on the employment front during 2005, labour markets in the euro zone's principal industrialised partners seem set to show greater firmness in H1 2006. In the United States, the weakening of employment growth in September and October (net job creations of 17,000 and 44,000, re-

spectively, compared with an average of 195,000 in the first eight months of the year — a deterioration largely due to the effects of hurricanes Katrina and Rita) is likely to drag down the figures for Q4 2005. In the early part of 2006, however, job creations can be expected to pick up in line with the fresh acceleration in activity (see Table 1). In the United Kingdom, employment has regained strength (an increase of 0.4% in Q3, following stagnation in Q2). Meanwhile, the latest Tankan survey has reported quite positive signals from Japanese business leaders regarding hiring prospects for the early part of 2006 (see Graph 1).

In parallel, an easing of inflation is taking shape in the United Kingdom and the United States (see box). After peaking in September, the year-on-year rise in consumer prices declined in October in both the United States (from 4.7% to 4.3%) and the United Kingdom (from 2.5% to 2.3%). The easing already seen in the energy component of the price indices can be expected to continue, on the assumption that the Brent price stabilises in the region of \$55/barrel (see note on «oil and raw materials» available in the French version only). This downward tendency would in large part determine the time-pattern of inflation in coming months and, in the case of the United States, cushion the very gradual rise in the



*How to read the graph:  
Balances of opinion for the current period, extrapolated using expected evolutions for the last point*

**TABLE 1 : UNITED STATES, UNITED KINGDOM AND JAPAN : RESOURCE-USE BALANCE IN VOLUME**

	Quarterly % change								Annual % change		
	2004		2005				2006		2004	2005	2006 (c.o.)
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
<b>UNITED STATES (37.2%)<sup>(1)</sup></b>											
<b>GDP</b>	<b>1.0</b>	<b>0.8</b>	<b>0.9</b>	<b>0.8</b>	<b>1.1</b>	<b>0.8</b>	<b>1.0</b>	<b>0.8</b>	<b>4.2</b>	<b>3.6</b>	<b>2.8</b>
Consumption	1.1	1.1	0.9	0.8	1.0	0.6	0.8	0.7	3.9	3.7	2.6
Private investment <sup>(2)</sup>	2.0	1.7	1.7	2.3	2.1	1.8	2.1	1.6	9.7	8.4	6.3
<i>Nonresidential investment</i>	<i>2.8</i>	<i>2.5</i>	<i>1.4</i>	<i>2.1</i>	<i>2.1</i>	<i>1.8</i>	<i>2.1</i>	<i>1.6</i>	<i>9.4</i>	<i>8.9</i>	<i>6.4</i>
<i>Residential investment</i>	<i>0.7</i>	<i>0.4</i>	<i>2.3</i>	<i>2.6</i>	<i>2.0</i>	<i>1.7</i>	<i>2.0</i>	<i>1.5</i>	<i>10.3</i>	<i>7.5</i>	<i>6.2</i>
Government expenditures <sup>(3)</sup>	0.5	0.2	0.5	0.6	0.8	0.6	0.5	0.4	2.2	2.0	1.9
Exports	1.3	1.7	1.8	2.6	0.2	1.0	1.4	1.4	8.4	6.7	4.1
Imports	1.1	2.7	1.8	-0.1	0.5	1.6	1.8	1.8	10.7	6.0	4.6
<b>Contributions:</b>											
<i>Domestic demand excluding stocks</i>	<i>1.2</i>	<i>1.1</i>	<i>1.0</i>	<i>1.1</i>	<i>1.2</i>	<i>0.9</i>	<i>1.0</i>	<i>0.9</i>	<i>4.6</i>	<i>4.3</i>	<i>3.2</i>
<i>Change in private inventories</i>	<i>-0.1</i>	<i>0.0</i>	<i>0.1</i>	<i>-0.5</i>	<i>-0.1</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.3</i>	<i>-0.4</i>	<i>-0.1</i>
<i>Net exports</i>	<i>0.0</i>	<i>-0.2</i>	<i>-0.1</i>	<i>0.3</i>	<i>-0.1</i>	<i>-0.1</i>	<i>-0.1</i>	<i>-0.1</i>	<i>-0.7</i>	<i>-0.3</i>	<i>-0.3</i>
<b>UNITED KINGDOM (5.6%)<sup>(1)</sup></b>											
<b>GDP</b>	<b>0.3</b>	<b>0.5</b>	<b>0.3</b>	<b>0.5</b>	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>	<b>0.6</b>	<b>3.2</b>	<b>1.6</b>	<b>1.6</b>
Consumption	0.4	0.6	0.1	0.4	0.5	0.5	0.6	0.7	3.7	1.8	1.8
Total investment	0.5	0.8	0.0	1.0	1.0	1.0	1.0	0.9	4.9	2.8	3.2
<i>Enterprise investment</i>	<i>2.5</i>	<i>-0.2</i>	<i>0.4</i>	<i>1.5</i>	<i>0.3</i>	<i>1.0</i>	<i>1.0</i>	<i>1.0</i>	<i>3.4</i>	<i>3.0</i>	<i>3.1</i>
<i>Household investment</i> <sup>(4)</sup>	<i>-0.6</i>	<i>1.0</i>	<i>-5.3</i>	<i>5.2</i>	<i>3.5</i>	<i>1.0</i>	<i>0.5</i>	<i>0.5</i>	<i>6.1</i>	<i>1.4</i>	<i>4.6</i>
<i>Public investment</i> <sup>(4)</sup>	<i>-7.0</i>	<i>4.8</i>	<i>10.9</i>	<i>-10.3</i>	<i>-2.0</i>	<i>1.0</i>	<i>2.0</i>	<i>1.0</i>	<i>10.9</i>	<i>4.7</i>	<i>-0.4</i>
Public consumption <sup>(5)</sup>	0.2	0.3	0.6	0.5	0.4	0.5	0.5	0.5	2.5	1.6	1.5
Exports	1.0	1.1	-0.7	4.4	0.7	1.2	1.2	1.2	3.9	4.9	4.5
Imports	1.5	1.8	-0.8	1.9	2.1	1.4	1.5	1.6	5.9	4.9	5.4
<b>Contributions:</b>											
<i>Domestic demand excluding stocks</i>	<i>0.4</i>	<i>0.6</i>	<i>0.2</i>	<i>0.5</i>	<i>0.6</i>	<i>0.6</i>	<i>0.6</i>	<i>0.7</i>	<i>3.7</i>	<i>2.0</i>	<i>2.0</i>
<i>Change in private inventories</i>	<i>0.0</i>	<i>0.1</i>	<i>0.1</i>	<i>-0.7</i>	<i>0.4</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.1</i>	<i>-0.1</i>	<i>0.0</i>
<i>Net exports</i>	<i>-0.2</i>	<i>-0.2</i>	<i>0.0</i>	<i>0.5</i>	<i>-0.4</i>	<i>-0.1</i>	<i>-0.1</i>	<i>-0.2</i>	<i>-0.7</i>	<i>-0.1</i>	<i>-0.4</i>
<b>JAPAN (14.8%)<sup>(1)</sup></b>											
<b>GDP</b>	<b>-0.1</b>	<b>0.1</b>	<b>1.5</b>	<b>0.8</b>	<b>0.4</b>	<b>0.4</b>	<b>0.6</b>	<b>0.6</b>	<b>2.6</b>	<b>2.4</b>	<b>1.8</b>
Consumption	-0.1	-0.3	1.2	0.7	0.3	0.3	0.5	0.5	1.5	1.7	1.4
Total investment	0.0	0.2	1.7	1.6	0.9	0.6	0.8	0.8	1.3	3.1	2.8
<i>Private investment</i>	<i>0.7</i>	<i>0.3</i>	<i>2.3</i>	<i>2.4</i>	<i>0.9</i>	<i>0.5</i>	<i>0.8</i>	<i>0.8</i>	<i>5.0</i>	<i>5.8</i>	<i>2.8</i>
<i>Nonresidential investment</i>	<i>0.8</i>	<i>0.3</i>	<i>3.0</i>	<i>3.4</i>	<i>0.7</i>	<i>0.5</i>	<i>1.0</i>	<i>1.0</i>	<i>5.6</i>	<i>7.3</i>	<i>3.4</i>
<i>Residential investment</i>	<i>0.5</i>	<i>0.3</i>	<i>-1.0</i>	<i>-2.1</i>	<i>1.5</i>	<i>0.8</i>	<i>1.0</i>	<i>1.0</i>	<i>2.2</i>	<i>-0.8</i>	<i>2.6</i>
<i>Public investment</i>	<i>-2.9</i>	<i>-0.3</i>	<i>-0.3</i>	<i>-1.9</i>	<i>1.0</i>	<i>1.0</i>	<i>0.0</i>	<i>0.0</i>	<i>-10.8</i>	<i>-7.3</i>	<i>0.8</i>
Public consumption	0.3	0.6	0.7	0.3	0.3	0.3	0.3	0.3	2.7	2.0	1.0
Exports	0.5	1.6	0.0	3.1	2.7	2.5	2.2	2.0	14.5	6.7	7.8
Imports	1.7	2.5	0.1	2.3	3.9	2.0	2.0	2.0	8.9	7.8	7.7
<b>Contributions:</b>											
<i>Domestic demand excluding stocks</i>	<i>0.0</i>	<i>0.0</i>	<i>1.2</i>	<i>0.8</i>	<i>0.5</i>	<i>0.3</i>	<i>0.5</i>	<i>0.5</i>	<i>1.6</i>	<i>2.1</i>	<i>1.6</i>
<i>Change in private inventories</i>	<i>0.0</i>	<i>0.2</i>	<i>0.3</i>	<i>-0.2</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.2</i>	<i>0.3</i>	<i>0.0</i>
<i>Net exports</i>	<i>-0.1</i>	<i>-0.1</i>	<i>0.0</i>	<i>0.1</i>	<i>-0.1</i>	<i>0.1</i>	<i>0.0</i>	<i>0.0</i>	<i>0.8</i>	<i>0.0</i>	<i>0.1</i>

Forecast

(1) Country's share of OECD GDP (1995 PPP, 2003 volume)

(2) Investment of firms and households

(3) Government consumption and investment

(4) Items on which there is no information in the provisional accounts

(5) Consumption of unprofitable institutions included

Sources: BEA, ONS, Economic and Social Research Institute, Insee

core component of the consumer price index (*see Graph 2*). Also in the United States, a slight acceleration in wage growth is likely to come into play, encouraged both by the past rise in core inflation (an additional 0.7 of a point on the year-on-year rise between October 2003 and October 2005) and by rising inflationary expectations (the household survey carried out by the University of Michigan reports a rise in average inflationary expectations of 0.7 of a point during this period). Japan, for its part, is likely to experience a situation resembling the ending of deflation.

In all three countries, the dynamism shown by real incomes can be expected to stimulate household demand. Consumption by United States households, for example, after weakening temporarily towards the end of 2005, is likely to rally in the early part of next year, to the point that the saving ratio would be practically nil in mid-2006. In United Kingdom, two additional factors are likely to favour a recovery in consumption. First, the 25-basis-point cut in the leading rate in August should permit an easing of the debt burden on households, most of whose borrowing is at variable rate. Second, the ending of the downward tendency on the housing market (rises in

**TABLE 2 : UNITED-STATES, UNITED KINGDOM AND JAPAN : HOUSEHOLDS ACCOUNTS**

(in %)

	Annual changes		
	2003	2004	2005 (*)
<b>United-States</b>			
Non-farm dependent employment	-0.3	1.1	1.6
Average wage per head	2.9	4.3	4.3
Nominal gross disposable income	4.3	6.1	4.2
Private consumption deflator	2.0	2.7	2.8
Saving ratio (absolute level)	2.1	1.8	-0.6
<b>United Kingdom</b>			
Dependent employment	0.4	0.7	0.5
Average wage per head	3.5	4.3	3.9
Nominal gross disposable income	4.8	3.5	3.2
Private consumption deflator	1.9	1.2	1.9
Saving ratio	5.4	4.4	4.9
<b>Japan</b>			
Total employment	-0.2	0.2	0.6
Average wage per head	-0.3	-0.7	0.2
Nominal gross disposable income (dependent household)	0.5	-	-
Private consumption deflator	-0.7	-0.5	-0.6
Saving ratio	7.5	-	-

(\*) For the United States, annual average including forecast for Q4-2005.

For the United Kingdom, statistical carryover at end-Q2 2005 for employment, income and saving, and at end-Q3 2005 for the rest.

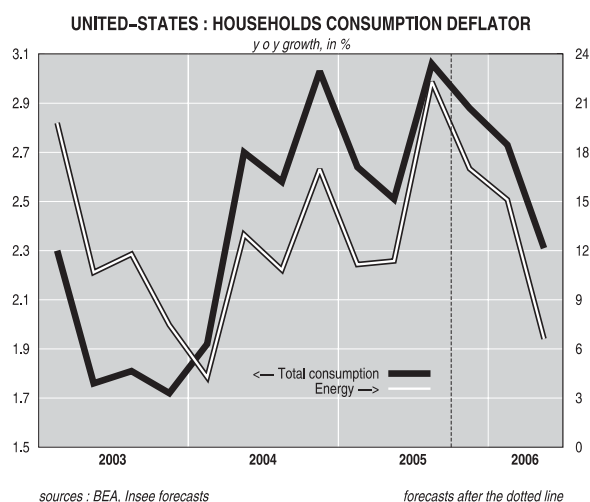
For Japan, statistical carryover at end October for employment and average wage per head, at end-Q3 2005 for private consumption deflator

Source : BEA, BLS, Central Statistical Office, Department of Employment, ONS, Economic and Social Research Institute, Ministry of Public Management, Ministry of Labour

the Nationwide and Halifax indices since October and June, respectively — see Graph 3) should ensure the return of more positive wealth effects.

Investment in housing, for its part, should also be positively headed in the euro zone's partners in general, subject to certain differences between countries. For example, after the boom seen in the United Kingdom in mid-2005 as the result of particularly favourable financing conditions, a certain moderation is likely to be seen in coming quarters. In Japan, by contrast, the upturn already seen in Q3 following the stagnation in the early part of year is set to continue.

2



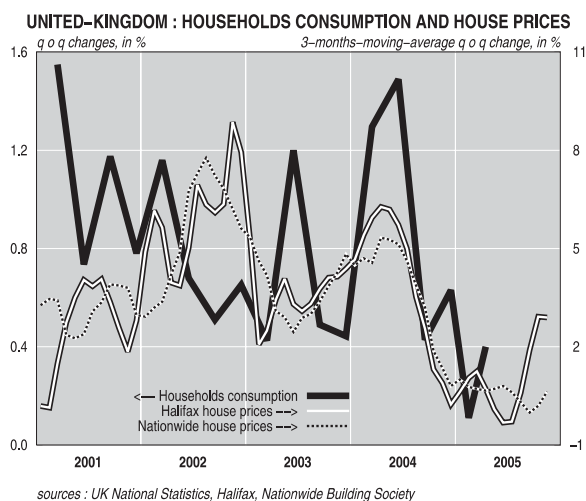
Finally, the very recent moderation in housing investment in the United States is likely to be only temporary, post-hurricane reconstruction needs tending to fuel the rise in housing starts in the early part of next year.

### Investment set to benefit from industrial recovery and improved financing capacity

The positive tendency in household demand expected between now and mid-2006 in the euro zone's principal partners can be expected to create a climate favourable to investment. The outlook reported by firms has also brightened in recent months.

In industry, first of all, the latest business surveys testify to renewed optimism, heralding an upturn in activity. This upturn actually materialised in October in the United States, with the industrial production index putting on 0.9% in the month. In the United Kingdom, the purchasing managers' confidence index returned above the 50-point level (indicating an expansionary phase) in Q3. In the emerging Asian countries, the prospects are particularly encouraging, as demonstrated by the uninterrupted rise since Q2 in South Korea's leading indicator of activity. Concomitantly, Japanese machinery orders rose in Q3 2005, pointing to an acceleration in investment next year.

3



Expectations in the various services sectors are also pointing to an expansion of activity in coming months. The United States ISM index of new orders for the non-manufacturing branches showed a further rise in November (to 59.5 points). The United Kingdom PMI for services remains positively headed, having been close to 55 points since the beginning of the year. Finally the Japanese index of tertiary activity, although showing great volatility, is signalling an improvement in the situation from the 2004 low point.

At the same time, financing conditions are likely to remain generally favourable. Admittedly, they are tending to tighten in the United States, in response to the Federal Reserve's interest-rate hike (*see note «financing of the economy» available in the French version only*). Even so, the percentage of banks reporting a hardening of their lending conditions to firms began to rise only in Q3 2005. Above all, the profits made recently — boosted by the Homeland Investment Act, which provides tax incentives for partial repatriation of the profits made by foreign subsidiaries — are likely to facilitate the financing of investment projects. In the case of the United Kingdom, the gradual return of inflation to below the 2% target in coming months should lead the Bank of England to leave its rates unchanged between now and mid-2006. This would make it possible to maintain the current favourable financing conditions, with the rate for loans to firms kept very stable at a relatively low level (of around 5%). In Japan, finally, the zero-interest-rate policy seems likely to be maintained between now and mid-2006. Above all, Japanese profit expectations, which showed a very marked increase in the latest Tankan survey for the end of 2005 and the beginning of 2006, should provide additional support for investment.

### Forces making for domestic growth leading in turn to growth in world trade

The domestic momentum in the American, British and Japanese economies can be expected to underpin imports and thus exert a positive influence on demand in the euro zone's export markets. Exports from these three countries, on the other hand, are likely to follow more divergent paths, remaining relatively strong in Japan, because of the strength of demand from the rest of Asia and because of the depreciation of the yen. By contrast, exports are likely to be less brisk for the United States and the United Kingdom, handicapped, in particular, by the recent appreciation in the dollar and in the sterling. In the final analysis, foreign trade is likely to make a negative contribution to growth in the United Kingdom and the United States in Q4 2005 and in H1 2006. ■

## BOX: THE LIMITED IMPACT OF THE OIL SHOCK ON INFLATION IN THE EURO ZONE'S PARTNERS

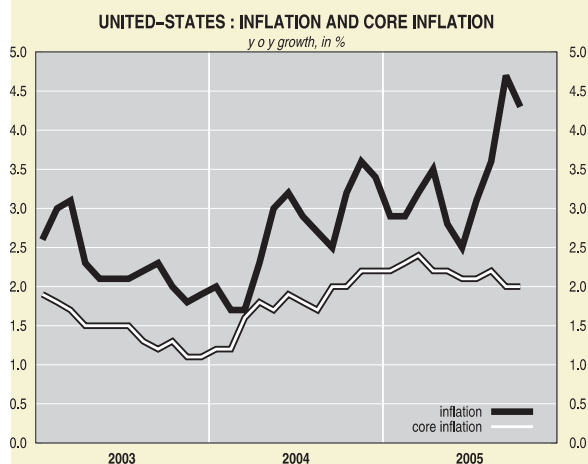
In most of the euro zone's partner countries, inflationary pressures have remained contained since the beginning of 2005, despite the rise in oil prices. In the United States and the United Kingdom, but also in Japan and even South Korea and Taiwan, core inflation has remained very stable and only the «energy» components of the price indices have tended to rise. It was practically only in Thailand and Indonesia, two countries already weakened by the end-2004 tsunami, that the gradual ending of the fiscal measures aimed at cushioning the oil shock has led very recently to a sharp upturn in inflation.

### A rise in inflation in the United Kingdom and the United States stemming essentially from the energy component

June 2005 saw United States inflation standing at 2.5%. By September, it had peaked at 4.7%, under the impact of the increase in the contribution from energy (adding 2.2 points to the year-on-year price rise in the space of 4 months), with the surge in gasoline prices following hurricanes Katrina and Rita playing a particularly important role. In October, the easing of the energy component permitted inflation to start to ebb, bringing it to 4.3%. Meanwhile, the year-on-year rise in prices excluding food and energy has remained very stable, standing at around 2% in Q3 2005 (see Graph A). This can be attributed in part to the moderation shown by unit wage costs throughout the private non-farm sector, following a slowdown between Q2 and Q3 2005, notably under the impact of the acceleration in productivity.

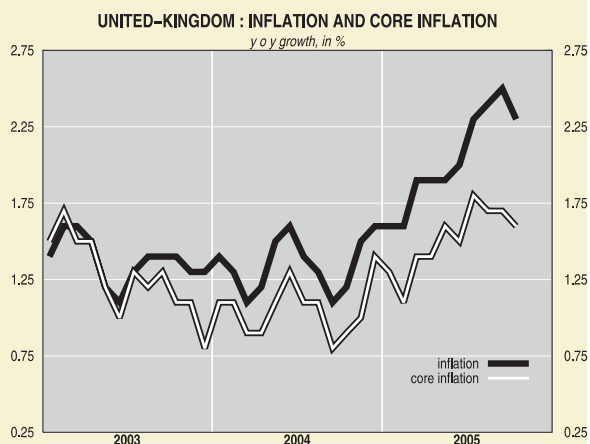
It should be noted, however, that the tightening of monetary policy implemented by the US Federal Reserve (the «Fed») began long before this recent rise in inflation. At the time, its motivation was more to restrain the rise in asset prices, particularly of real estate, than to limited inflation. The two objectives are now being tackled in parallel. The Fed has in fact raised the Fed Funds rate yet again, bringing it to 4% in November, and it is likely that

**A**



source : BLS

**B**



source : UK National Statistics

this policy will be continued in coming months, in as much as United States growth is showing no signs of running out of steam.

In the United Kingdom, core inflation (measured by the household consumption deflator excluding energy and food) has risen considerably in the past two years (see Graph B). This was partly due to the rise in unit wage costs seen since mid-2004, notably under the impact of the slowdown in manufacturing productivity. Since July 2005, however, core inflation has begun to ease again. The overall index, for its part, has continued its upward tendency, largely on the back of the energy component. The beginnings of an easing of inflation nevertheless appeared in October, with the year-on-year rise in the consumer price index showing its first fall in a year, down to 2.3% from 2.5% in September. In these circumstances, the average inflationary expectations reported in the European Commission's household survey, which had risen sharply during the past summer, eased back in October.

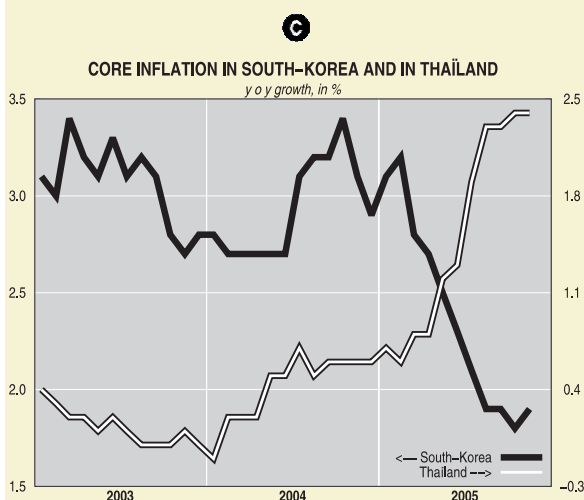
Even so, inflation remains above the Bank of England's target, which has been set at 2% (+/- 1 point) since September 2003. This means that the cut in the base rate made last August in order to provide support for activity is unlikely to be repeated and the most probable scenario is a maintenance of rates at 4.50%. The kicking-in of the traditional productivity cycle as a result of the expected upturn in activity should permit a slowdown in unit wage costs in coming quarters. Core inflation would remain contained, as a result, and lead to a continuing easing in overall inflation, on the assumption that oil prices fall back again.

### Differences in Asian countries' exposure to the oil shock

In Japan, the year-on-year rise in consumer prices continues to oscillate around 0%, with the rise in oil prices compensated by falls in the prices of rice and electricity. As a result, even though an end to inflation seems to be taking shape, monetary policy is likely to remain unchanged in the short term. In the Southeast Asian countries, however, the sharp rise in oil prices seen since the beginning of the year has been felt to differing extents. While the impact on the consumer price index has remained very moderate in South Korea and Taiwan, other countries such as Thailand or Indonesia have seen their inflation rates accelerate considerably in the course of 2005.

South Korea and Taiwan seem for the moment to have remained sheltered from any inflationary slippage due to the maintenance of a high oil price. The year-on-year rise in consumer prices fell from 3.1% to 2.5% in South Korea between January and October 2005 and rose from 0.5% to 2.6% over the same period in Taiwan. In both countries it was only the energy component of the price index that showed a rise. The core inflation indices have shown no signs acceleration in recent months (see Graph C), pointing to an absence of diffusion effects and, *a fortiori*, of second-run effects through any pressures that might be exerted on wages. In both countries, also, firms seem to have room to cope with higher production costs by reducing profit margins. Intervention by the monetary authorities has in fact remained very measured in both South Korea and Taiwan. The Bank of Korea has raised its key rate on two occasions (from 3.25% to 3.75%) since the start of the oil crisis, partly as a precautionary measure but also in order to limit the differential vis-à-vis United States leading rates. In Taiwan, the central bank has gradually adjusted its position during 2005 by making several small increases in its key rate, bringing it up from 1.75% to 2.125% between January and October.

On the other hand, inflationary pressure turned out to be much stronger in countries with higher energy intensities <sup>(1)</sup> like Thailand and Indonesia. In each of these countries the consumer price index has risen strongly, from 2.7% to 6.2% between January and October in the case of Thailand and from 7.3% to 17.9% over the same period in Indonesia. This tendency is explained by the gradual withdrawal of the State from management of the oil crisis. In fact, measures involving subsidies and price regulation for energy products had at one time been set in place in order to cushion the impact of the rise in oil prices, but these arrangements threatened sooner or later to bring about a deterioration in public finances and they are therefore on the point of being substantially trimmed back or even abandoned in both Thailand and Indonesia. These two countries are now heading more in the direction of social management of the crisis through targeted aids or salary increases, notably in favour of the most disadvantaged households. In order to stem the increase in inflation, central bankers have reacted by steadily tightening monetary conditions. ■



sources : Bank of Korea, Bank of Thailand

(1) Energy intensity, measured here as the ratio between oil consumption (in tons) and gross domestic product (in million dollars), was 267 in Thailand and 212 in Indonesia, compared with 154 for South Korea and 136 for Taiwan in 2004.

# The economic situation in the euro zone

GDP growth in the euro zone in Q3 2005 was surprisingly strong (0.6%). This was mainly the result of the rebound in activity seen in France and Germany after a slow second quarter. At a more general level, the acceleration in activity in the euro zone is explained by dynamic industrial production driven by all components of demand (see Graph 1).

As of Q4, GDP growth is expected to return to a quarterly rate of 0.4%. Despite the improvement in the business climate, the growth in corporate investment and the firmness of world demand are not likely to compensate for the weakness of private consumption. Moderate levels of job creation and the stagnation of wages are liable to continue to hold back household income, which would then continue to weaken the domestic driving forces for European growth. GDP growth for 2005 as a whole is expected to come out at 1.4%, with the statistical carry-over amounting to +1.5% in the middle of 2006.

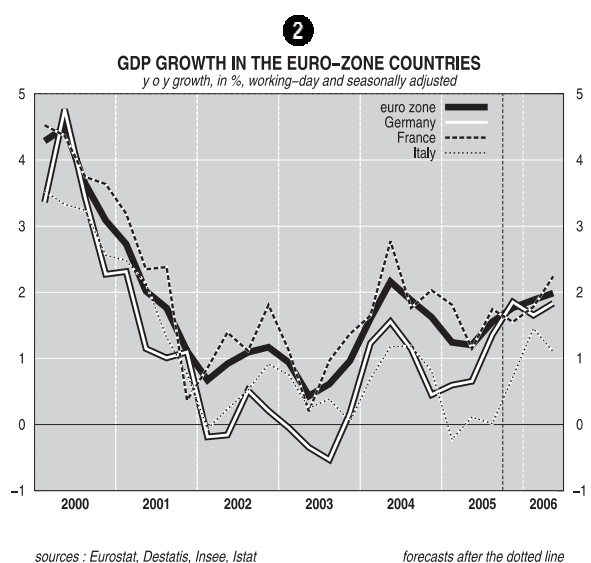
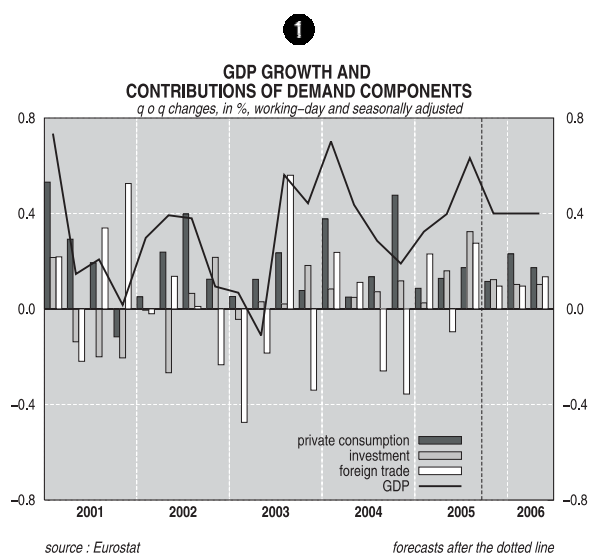
## Driven by the rally in domestic demand, GDP posted a one-off acceleration in Q3

Following four consecutive lacklustre quarters, GDP growth in the euro zone rose to 0.6% in Q3 (see table «GDP in the Euro-zone»). Industrial production in the zone was particularly dynamic (up 0.8% in Q3), underpinned by the improvement in all components of demand. This rise was observed in the whole of the zone (see Graph 2).

Total investment rose strongly in Q3 (+1.6% after +0.8% in Q2). In particular, productive investment picked up again in the major countries, with firms responding to the additional external demand in the case of Germany and the additional domestic demand in France. Investment in construction was temporarily dynamic, as this was the quarter in which the construction time lost in Germany because of the bad weather earlier in the year was made up.

Household consumption accelerated slightly throughout the zone (to +0.3% from +0.2% in Q2), against a background of wage restraint. It benefited from growth in unearned income, due notably to the increase in dividend payments (see table «detailed forecasts for the euro zone»). Germany was alone in posting a contraction in household expenditure.

The strength of demand from the zone's partner economies boosted exports during the quarter (see Graph 3). Exceptional Airbus deliveries (20 more aircrafts than in Q3 2004, 15 of them assembled in Germany) explained much of the growth in exports. In addition, following the damage caused by hurricane Katrina, European countries true on their stocks of refined or petroleum products for delivery to the United States, thus making out temporary addition to exports to that country. Matching the strength of overseas demand and as well as the relative consolidation of investment, imports rose strongly in Q3.



## The economic situation in the euro zone

### GDP IN THE EURO ZONE AND IN THE PRINCIPAL MEMBER COUNTRIES

(% change)

	Quarterly changes										Annual changes			
	2004				2005				2006		2003	2004	2005	2006
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2				c.o.
<b>GERMANY (29.4%)<sup>(1)</sup></b>														
<b>GDP</b>	<b>0.5</b>	<b>0.2</b>	<b>-0.1</b>	<b>-0.1</b>	<b>0.6</b>	<b>0.2</b>	<b>0.6</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	<b>-0.2</b>	<b>1.1</b>	<b>1.1</b>	<b>1.4</b>
Household consumption	0.5	-0.2	0.0	0.8	-0.4	-0.1	-0.2	0.0	0.1	0.1	0.1	0.2	-0.1	0.1
Total GFCF	-1.9	-0.3	0.9	-0.4	-1.2	0.2	2.2	0.4	0.2	0.2	-0.7	-1.5	0.4	1.9
Public consumption	-1.0	-0.5	0.4	-1.9	0.2	1.2	0.4	0.0	-0.2	-0.2	0.1	-1.6	0.0	0.1
Exports	3.3	3.2	-0.5	0.5	2.1	1.2	4.7	2.0	2.0	2.0	2.3	8.3	6.9	7.7
Imports	1.6	2.0	2.4	0.5	-1.1	2.3	4.4	1.4	1.3	1.3	5.0	6.1	5.3	6.2
<b>Contributions :</b>														
<i>Domestic demand ex. stocks</i>	-0.2	-0.2	0.2	0.0	-0.4	0.1	0.4	0.1	0.1	0.1	0.0	-0.4	-0.2	0.4
<i>Inventory change</i>	0.0	-0.1	0.6	-0.1	-0.2	0.4	-0.1	0.0	0.0	0.0	0.6	0.5	0.2	0.1
<i>Foreign trade</i>	0.7	0.6	-1.0	0.0	1.2	-0.3	0.3	0.3	0.3	0.3	-0.9	1.0	1.1	0.9
<b>ITALY (17.9%)<sup>(1)</sup></b>														
<b>GDP</b>	<b>0.5</b>	<b>0.3</b>	<b>0.4</b>	<b>-0.4</b>	<b>-0.5</b>	<b>0.7</b>	<b>0.3</b>	<b>0.3</b>	<b>0.2</b>	<b>0.3</b>	<b>0.4</b>	<b>1.0</b>	<b>0.2</b>	<b>1.0</b>
Household consumption	1.1	-0.5	0.0	0.5	0.1	0.6	0.4	0.3	0.3	0.3	1.4	1.0	1.0	0.9
Total GFCF	3.4	0.5	-1.5	-1.3	-0.8	1.5	1.0	0.5	0.3	0.3	-1.8	1.9	-0.7	1.7
Public consumption	-0.3	0.2	0.2	0.3	0.1	0.3	0.2	0.2	0.2	0.1	2.3	0.7	0.9	0.5
Exports	-1.5	3.7	4.5	-4.5	-4.7	5.5	1.5	1.3	1.2	1.2	-1.9	3.2	0.0	4.9
Imports	-0.3	1.9	1.1	0.1	-2.9	4.8	1.6	1.2	1.0	1.0	1.3	2.5	2.9	4.5
<b>Contributions :</b>														
<i>Domestic demand ex. stocks</i>	1.3	-0.1	-0.3	0.1	-0.1	0.8	0.4	0.3	0.2	0.2	0.9	1.1	0.7	1.0
<i>Inventory change</i>	-0.4	0.0	-0.3	0.9	0.1	-0.3	0.0	0.0	0.0	0.0	0.4	-0.3	0.4	0.0
<i>Foreign trade</i>	-0.3	0.5	1.0	-1.4	-0.5	0.2	-0.1	0.0	0.0	0.1	-0.9	0.2	-0.8	0.0
<b>SPAIN (10.2%)<sup>(1)</sup></b>														
<b>GDP</b>	<b>0.8</b>	<b>0.8</b>	<b>0.6</b>	<b>1.0</b>	<b>0.9</b>	<b>0.9</b>	<b>0.8</b>	<b>0.7</b>	<b>0.6</b>	<b>0.6</b>	<b>2.9</b>	<b>3.1</b>	<b>3.4</b>	<b>2.2</b>
Household consumption	0.8	0.8	1.3	1.8	0.6	0.8	1.1	0.6	0.5	0.4	2.6	4.4	4.2	2.0
Total GFCF	0.1	0.7	1.8	3.5	1.0	1.1	1.6	1.1	1.0	1.0	5.6	4.9	6.8	3.7
Public consumption	3.1	2.3	0.8	0.1	2.1	1.3	1.0	0.6	1.5	1.5	4.8	6.0	4.8	3.9
Exports	1.9	0.1	1.2	-1.1	-2.4	3.4	1.4	1.4	1.4	1.4	3.6	3.3	1.0	5.1
Imports	2.8	1.5	3.7	2.0	-1.6	4.2	3.0	1.8	1.8	1.8	6.0	9.3	7.3	7.1
<b>Contributions :</b>														
<i>Domestic demand ex. stocks</i>	1.0	1.1	1.4	2.0	1.0	1.0	1.3	0.8	0.8	0.8	4.2	5.0	5.2	2.9
<i>Inventory change</i>	0.1	0.1	0.0	-0.2	0.0	0.2	0.1	0.0	0.0	0.0	-0.6	-0.1	0.1	0.1
<i>Foreign trade</i>	-0.3	-0.4	-0.8	-0.9	-0.1	-0.4	-0.5	-0.2	-0.2	-0.2	-0.7	-1.8	-2.0	-0.8
<b>EURO ZONE (27.8%)<sup>(2)</sup></b>														
<b>GDP</b>	<b>0.7</b>	<b>0.4</b>	<b>0.3</b>	<b>0.2</b>	<b>0.3</b>	<b>0.4</b>	<b>0.6</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	<b>0.7</b>	<b>1.8</b>	<b>1.4</b>	<b>1.5</b>
Household consumption	0.7	0.1	0.2	0.8	0.1	0.2	0.3	0.2	0.4	0.3	1.1	1.4	1.3	1.0
Total GFCF	0.4	0.2	0.4	0.6	0.1	0.8	1.6	0.6	0.5	0.5	0.8	1.7	2.4	2.3
Public consumption	0.1	0.4	0.3	-0.1	0.3	0.6	0.6	0.2	0.3	0.3	1.6	1.1	1.2	1.1
Exports	1.8	2.5	1.2	0.3	-0.8	2.2	3.4	1.6	1.6	1.7	1.3	5.9	4.4	6.4
Imports	1.2	2.3	2.0	1.3	-1.5	2.6	2.8	1.4	1.4	1.4	3.1	6.1	4.8	5.6
<b>Contributions :</b>														
<i>Domestic demand ex. stocks</i>	0.5	0.2	0.3	0.6	0.2	0.4	0.6	0.3	0.4	0.3	1.1	1.4	1.5	1.3
<i>Inventory change</i>	0.0	0.1	0.3	0.0	-0.1	0.1	-0.3	0.0	0.0	0.0	0.2	0.4	0.0	-0.1
<i>Foreign trade</i>	0.2	0.1	-0.3	-0.4	0.2	-0.1	0.3	0.1	0.1	0.1	-0.6	0.0	-0.1	0.4

Forecast

1) Share of euro-zone GDP

2) Share of OECD GDP

### Household consumption expected to become modest again as result of the slow wage growth

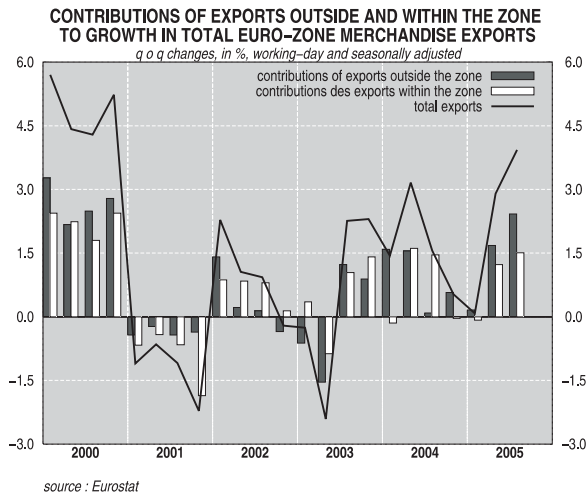
The fundamentals remain unfavourable to an upturn in private consumption in the euro zone. Despite the rise in employment (by 0.6% in 2005 — see Graph 4), household income remains handicapped by the stagnation of real wages. As indicated by the zero carryover from retail sales in October to Q4, house-

hold consumption is likely to mark time towards the end of 2005, before picking up slightly (quarterly growth of 0.3% in 2006).

In Germany, household consumption seems set to remain slack. The index of nominal wages, negotiated branch by branch, slowed down distinctly from a year-on-year rate of 1.5% in January to 1.0% in July. Wage restraint is likely to continue in 2006. This tendency is hampering consumption but is paying off in foreign markets, with German exporters



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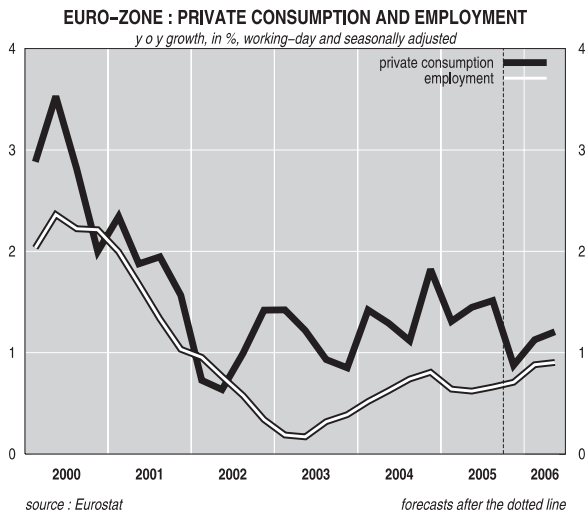


continuing to gain market share (see below). In Italy, now that the impact of tax cuts on income is over, low wage growth will do nothing to prevent the slowdown in private consumption.

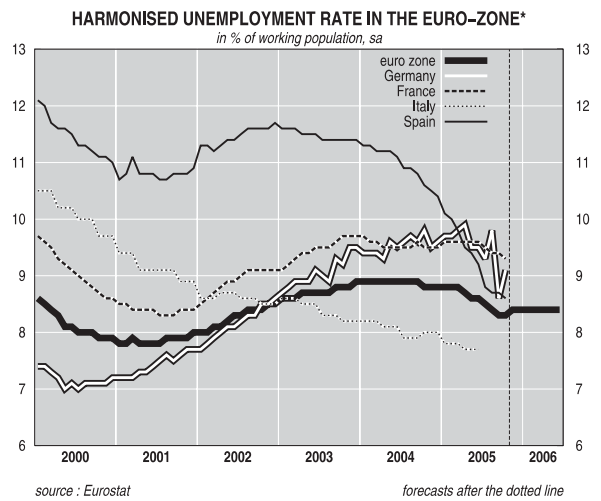
By contrast, Spain is likely to continue to stand out from the other countries in the zone through very brisk consumption, stimulated by the continuous decline in the unemployment rate, which is now below those of France and Germany (see Graph 5) and by massive consumer borrowing.

In the major countries of the zone, governments have little room for manoeuvre in fiscal policy if they wish to give support to household consumption. Public consumption cannot be expected to make up for the slackness of private consumption, growing by only around 0.3% per quarter, barely faster than in 2004. In the framework of the Stability and Growth Pact, control over public spending is in fact likely to be maintained.

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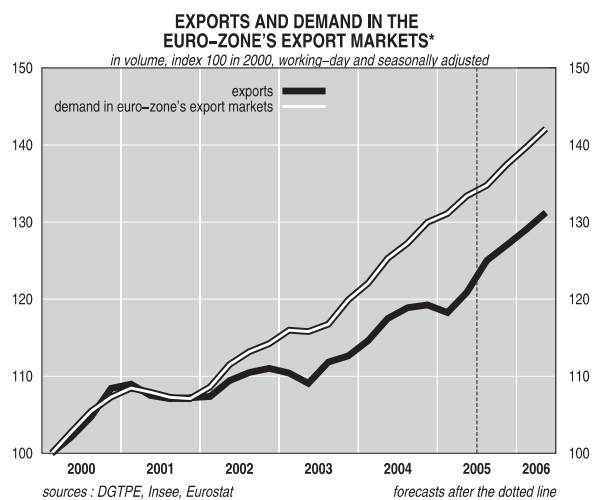
**How to read the graph**  
\*In Germany, the drop in the unemployment rate as defined by the ILO seen in September (by 0.8 of a point) and its subsequent rise in October (by 0.5 of a point) are thought to be mainly the consequence of the labour market reforms, which have affected the figures for the total labour force.

## The euro zone likely to benefit globally from strong world demand

Euro-zone exports benefited from the exceptional deliveries of Airbus aircraft and of refined petroleum products to the United States in Q3. They are from now on likely to grow more modestly, by around 1.6% per quarter, up to the middle of 2006.

Exports are likely to be driven by the demand from the zone's export markets (see Graph 6) and notably by the strength of the United States and Japanese economies. In addition, the past depreciation in the euro's effective exchange rate (by 7.8% in nominal terms between December 2004 and November

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**How to read the graph**  
\*the sum of imports by its partner countries weighted by its shares of the respective markets

## DETAILED FORECASTS FOR THE EURO ZONE

	Quarterly changes							Annual changes	
	2005				2006		2004	2005	
	Q1	Q2	Q3	Q4	Q1	Q2			
(% change)									
<b>Prices</b>									
Value added deflator	0.6	0.5	0.0	0.2	0.1	0.1	1.6	1.5	
Consumption deflator	0.4	0.6	0.8	0.6	0.3	0.2	1.8	2.0	
Investment deflator	0.3	1.0	0.9	0.2	0.2	0.1	2.7	2.9	
Exports of goods deflator	0.6	1.0	1.0	0.8	0.4	0.2	0.1	2.3	
Imports of goods deflator	-0.6	3.5	4.7	0.5	0.6	0.4	2.5	7.0	
Wages	0.9	0.3	0.4	0.6	0.4	0.4	1.9	2.0	
<b>Employment and unemployment</b>									
Unemployment rate (percentage points)	8.8	8.7	8.5	8.4	8.4	8.4	8.9	8.6	
Employment	0.0	0.2	0.3	0.2	0.2	0.2	0.7	0.6	
Active population	0.0	0.0	0.0	0.2	0.2	0.2	0.8	0.3	
Labour cost per unit	0.5	0.1	0.1	0.4	0.2	0.1	0.7	1.1	
Productivity of work	0.4	0.2	0.3	0.2	0.2	0.3	1.2	0.9	
<b>Others</b>									
Global demand	0.4	1.5	2.0	2.0	1.7	1.7	10.3	6.0	
Balance of trade (points of GDP)	1.8	1.5	1.4	1.4	1.3	1.4	2.1	1.5	
Level of capacity utilization (%)	81.9	81.1	80.9	80.9	81.0	81.0	81.5	81.2	
Gross disposable income (value)	1.1	0.9	1.1	0.6	0.6	0.6	3.2	3.5	
Contribution of gross operating surplus	0.4	0.4	0.7	0.1	0.1	0.2	1.2	1.2	
Contribution of wages	0.7	0.4	0.5	0.6	0.5	0.4	1.9	1.9	
Others contributions	0.0	0.2	-0.1	-0.1	0.0	0.0	0.1	0.4	
Saving ratio	12.7	12.8	12.9	12.7	12.5	12.6	12.6	12.8	

Forecasts obtained using the MZE model (see "Conjoncture in France" dated March 2003)

2005) can be expected to generate price-competitiveness gains on foreign markets. In most countries of the zone, business leaders regard their export order books as being well-filled and are expecting an increase in foreign demand. In Germany, for example, export orders leapt in September (the carryover to Q4 amounts to 1.3%).

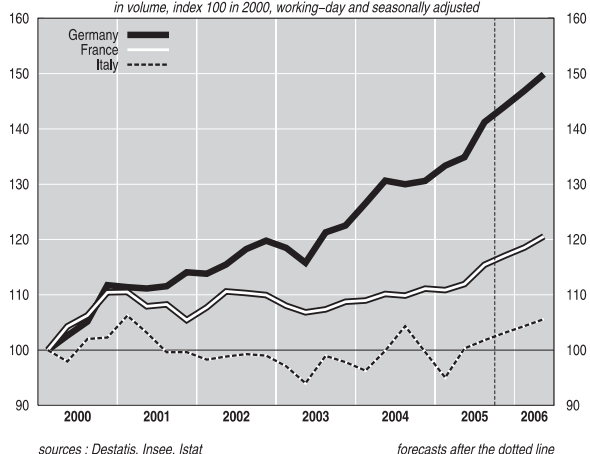
German export growth seems to be outstripping growth in demand from its export markets, thanks to cost-competitiveness gains generated by wage restraint. Germany's sectoral and geographic specialisation is also paying off, as shown by the fact that it is managing to export more than its European partners to the fast-growing emerging countries (China, Central and Eastern Europe).

On the other hand, Italian exports are expected to be still lagging behind world demand, signalling a loss of market share, especially in the car and textile sectors (see Graph 7). Even so, Italian exports in current euros have moved at the same rate as those of France, suggesting that the deterioration in Italian price-competitiveness has not in the end harmed its exports in value (see Graph 8). In the case of Spain, the unit-wage-cost differential vis-a-vis the euro zone (of the order of one percentage point) is likely to widen because of the 5% rise in the minimum wage on 1 January 2006. The deterioration in cost-competitiveness can therefore be expected to have an adverse effect on the Spanish trade balance, which is structurally in deficit.

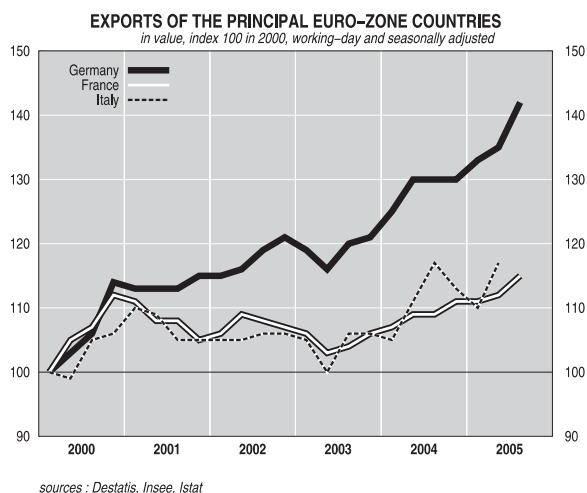
Euro-zone imports will probably slow down from Q4 2005 on, although still rising more strongly than domestic demand, thanks to the strength of exports, which have an indirect influence through their high import content. All things considered, foreign trade is likely to make a very small positive contribution to growth over the whole of the forecast period.

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EXPORTS OF THE PRINCIPAL EURO-ZONE COUNTRIES  
in volume, index 100 in 2000, working-day and seasonally adjusted



8



## Corporate investment unlikely to accelerate in coming quarters

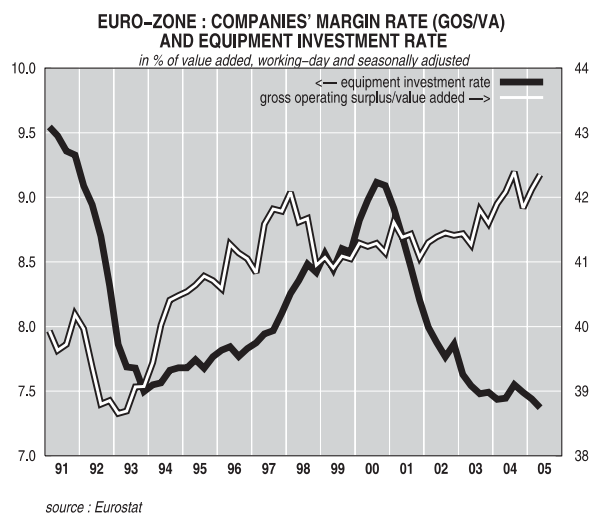
Conditions for the financing of investment remain favourable by historic standards, despite the rise in the ECB's leading rates. Moreover, firms have returned to substantial profit since 2001. The markup rate at the beginning of 2005 was even greater than the level seen in 1998 (see Graph 9).

Moreover, the business climate in the euro zone as being steadily improving since Q2 2005. This revival of confidence is to be seen simultaneously in industry, services and construction. This buoyant situation is confirmed by the distinct improvement in the outlook for production and therefore seems propitious for a consolidation of investment both in plant and machinery and in construction.

However, the productive capacity utilisation rate continues to stagnate. With firms still not observing pressures on productive capacity, they are unlikely to increase it. Moreover, they are likely to start to feel the costs generated by the diffusion of the oil shock and this is liable to erode their profitability. All things considered, they can be expected to moderate their investment spending in H1 2006.

Throughout the euro zone, the situation in the construction sector is still highly varied. Following the catch-up seen in Q3, investment and construction seems set to grow only slowly. In Germany and Italy, the structural difficulties of the sector are unlikely to be resolved, whereas in France and especially in Spain, growth in the sector is likely to remain firm, on the back of the favourable situation for housing loans.

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As a result, total investment is expected to grow by 0.6% in Q4 2005 and then by 0.5% in the first two quarters of 2006. ■

# Consumer prices in the euro zone

Pushed up by the rise in the oil price, inflation in the euro zone rose from 2.1% in June 2005 to 2.5% in October. Inflation differentials within the zone widened because evolutions in energy prices following the oil price rise turned out to be different from country to country. On the assumptions of an oil price of \$56.5/barrel and an exchange rate of \$1.19 to the euro in Q4, inflation is expected to stand at 2.4% in December.

In H1 2006, on the assumption of a Brent price stabilised at \$55/barrel and a euro exchange rate of \$1.18, core inflation<sup>(1)</sup> is expected to oscillate around 1.4%, while the year-on-year rise in energy prices would ease. All things considered, inflation is expected to ebb gradually to 2.0% in June.

## Euro-zone inflation set to ease distinctly in line with energy prices, returning to around 2.0% in Q2 2006

The tendency for inflation to ease seen in January 2005 (a year-on-year rise of 1.9%)<sup>(2)</sup> turned out to be short lived. In the wake of the oil price, euro-zone inflation then began to move up again, reaching 2.6% in September after the Brent price had broken through the \$60/barrel level.

(1) Measured as the HICP excluding food, alcoholic beverages, tobacco and energy.

(2) This phenomenon was explained at the time by the exit from the year-on-year calculations of the declines in reimbursement rates in 2004 following the reform of the German healthcare system.

(3) See note on «oil and raw materials» available in the French version only.

On the assumption of an average Brent price of \$56.5/barrel in Q4 and an exchange rate of \$1.19 to the euro until the end of the year, inflation can be expected to ease slightly to 2.4% in December 2005.

In H1 2006, inflation is expected to show a more marked decline, reaching 2.0% in June helped by a stable Brent price of \$55 and an exchange rate of \$1.18 to the euro.

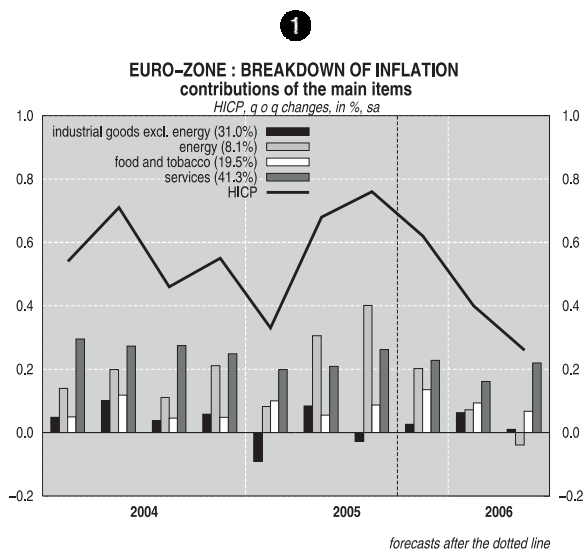
Driven by the rise in the oil price from \$45/barrel in January 2005 to over \$60/barrel in September<sup>(3)</sup>, inflation in the energy sector has increased sharply, standing at 12.2% in October compared with 9.4% in June. The forecast now is that energy prices will slow down thanks to the stabilisation of the oil price (see Graph 1). The year-on-year rise in energy prices is expected to decline to 7.3% in June 2006 from 14.4% in December 2005.

Food prices, which have risen steadily since Q2 2005, are expected to continue at the same rate before slowing down slightly in Q2 2006. This would bring the year-on-year rise back to levels that are more traditional for this sector, posting 0.7% in June 2006 (see Table 1). Moreover, the rise in tobacco prices that took place on 1 September 2005 in Germany contributed to the increase from 4.3% in August to 5.6% in September in the year-on-year rise in the «Alcoholic beverages and tobacco» item in the euro zone index. This measure would be partly responsible for the expected increase in the year-on-year rise in the «Food» item from 1.2% in June 2005 to 2.0% in June 2006.

TABLE 1: EURO ZONE INFLATION

Sectors (weight in the index in 2005)	Year on year changes at end					(year on year % growth of HICP) Annual changes		
	Dec. 2004	June 2005	Oct. 2005	Dec. 2005	June 2006	2003	2004	2005
	<b>Total (100.0%)</b>	2.4	2.1	2.5	2.4	2.0	2.1	2.1
<b>Food (Beverage and Tobacco included) (19.5%)</b>	2.0	1.2	1.9	1.5	2.0	2.8	2.3	1.6
of which Food (15.6%)	0.3	0.4	1.0	0.2	0.7	2.1	1.0	0.5
Beverage and Tobacco (3.9%)	8.4	4.0	5.7	6.4	7.0	5.9	7.5	5.6
<b>Energy (8.1%)</b>	7.0	9.4	12.2	14.4	7.3	3.0	4.5	10.6
<b>Core inflation (72.3%)</b>	1.9	1.3	1.4	1.2	1.4	1.8	1.8	1.4
of which: Manufactured products (31.0%)	0.7	0.3	0.4	-0.2	0.3	0.8	0.8	0.2
Services (41.3%)	2.7	2.3	2.2	2.3	2.1	2.5	2.6	2.3

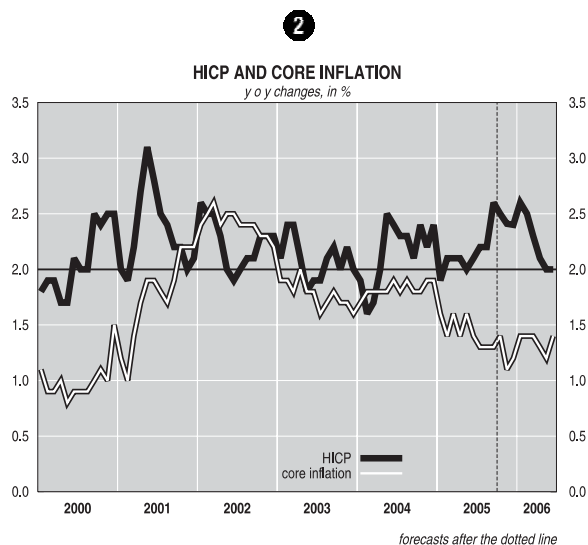
Forecast  
Source: Eurostat



## Core inflation likely to stabilise at around 1.4% until June 2006

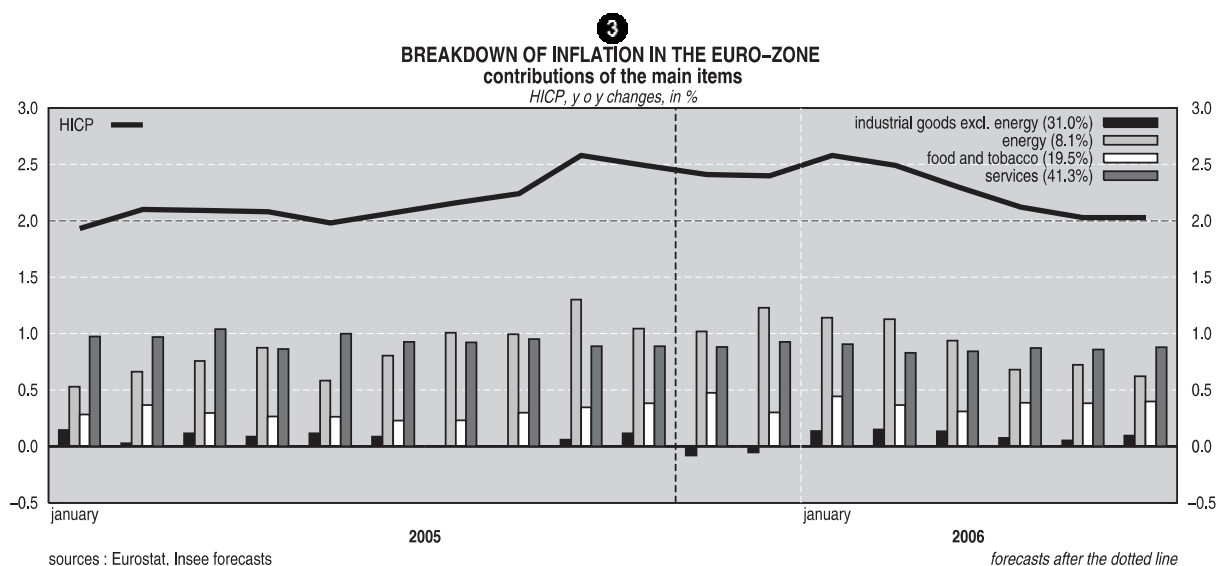
Core inflation has fallen appreciably since the beginning of 2005, from 1.6% in January to 1.3% in September. It is now forecast to oscillate around this level, posting 1.4% in June 2006 compared with 1.2% in December 2005 (see Graph 2). The diffusion of past rises in the oil price via producer prices is likely in the end to turn out to be very limited. In addition wage restraint is expected to continue, in Germany in particular.

The rise in the price of services, the largest single component of this index, was stable in the first half of 2005. Assuming that no account is taken of the impact of the reform of the Dutch healthcare system (see box), prices of services are expected to slow down in Q1 2006 and then stabilise (see Graph 3). The price falls expected in the telecommunications sector and the slackness of wage growth in the zone would be major contributors to this downward ten-



den- The principal unknown that might affect this forecast regarding prices of services would be a hardening of transport prices following past rises in the oil price. However, price evolutions should remain very moderate, with the year-on-year rise in prices in the services sector standing at 2.1% in June 2006.

Price rises in the manufacturing sector, the second largest single component of core inflation, are expected to be fairly marked in Q1 2006 following past rises in commodity prices. However, this diffusion is likely to be rapidly circumscribed if the assumption of a stabilization of the oil price is borne out. In addition, the weakness of growth in euro-zone consumption is likely to lead firms to maintain aggressive pricing policies, achieved through slight reductions in their markups. Year-on-year growth in prices of manufactures would then amount to 0.3% in June 2006.



**TABLE 2 : EURO ZONE INFLATION BY COUNTRIES**

	(year on year % growth of HICP)					
	HICP		Core inflation		Energy	
	October 2004	October 2005	October 2004	October 2005	October 2004	October 2005
Austria	2.3	2.0	1.8	1.0	12.1	11.8 (1.0)
Belgium	2.7	2.2	1.2	1.5	16.0	9.0 (0.9)
Finland	0.6	0.8	0.9	0.1	11.7	8.9 (0.7)
France	2.3	2.0	1.6	1.3	10.1	11.6 (1.0)
Germany	2.2	2.4	1.5	0.7	9.4	12.6 (1.2)
Greece	3.3	3.7	3.3	2.9	13.3	13.6 (0.9)
Ireland	2.5	2.7	2.0	1.7	12.5	19.9 (1.6)
Italy	2.1	2.6	2.2	1.8	5.8	12.3 (0.8)
Luxembourg	4.1	5.0	1.5	1.7	22.2	23.9 (2.8)
Netherlands	1.5	1.5	1.5	0.6	8.1	12.5 (1.1)
Portugal	2.4	2.6	2.3	2.0	9.2	13.2 (1.1)
Spain	3.6	3.5	2.6	2.8	11.6	12.8 (1.1)
<b>Euro zone</b>	2.4	2.5	1.8	1.4	9.8	12.2 (1.0)

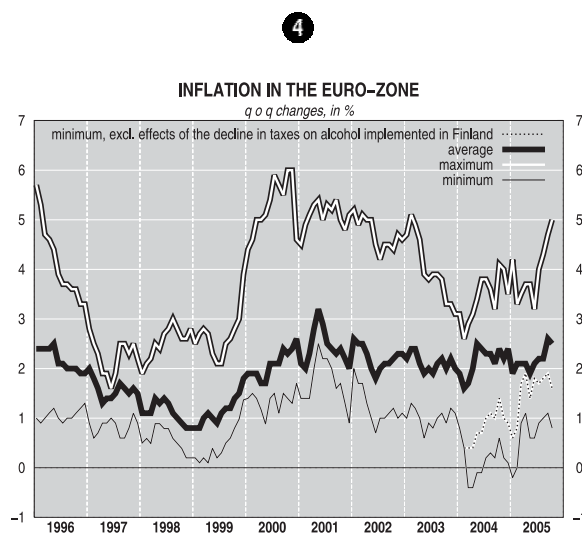
Source : Eurostat, calculations Insee

In the final column, the contribution of the energy component to overall inflation is shown in brackets

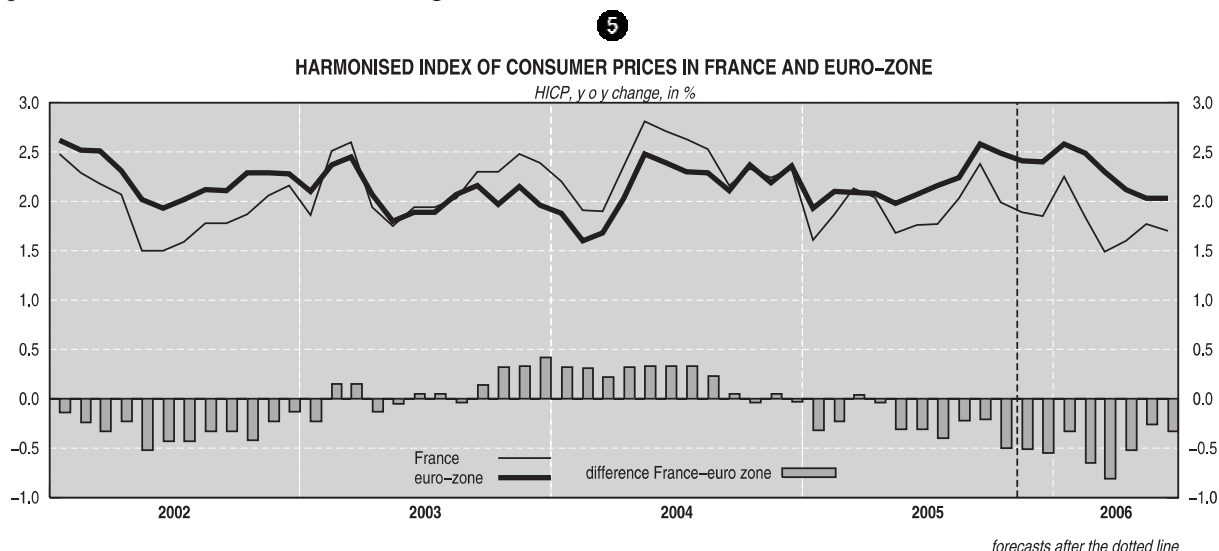
## Inflation differentials within the euro zone have widened substantially under the impact of the energy inflation

Between June and October 2005, inflation differentials within the euro zone widened substantially. The maximum gap increased from 2.6 points to 4.2 points (see Graph 4). Then, as a consequence of the widely differing reactions of individual countries' energy prices to the rise in the oil price, the maximum gap in the case of energy inflation reached 15 points in October. The contributions of the energy component range from 0.7 of a point in Finland to 2.8 points in Luxembourg. On the other hand, core inflation differentials have remained relatively stable, with the maximum gap standing at 2.8 points in October 2005.

The inflation differential between the French «harmonised index of consumer prices» (HICP) (see note «consumer prices» available in the French version only) and the euro-zone index stood at 0.5 of a point in October 2005. With the ending of the diffu-



sion effects of the energy inflation, it is now expected to narrow to 0.3 of a point in June 2006 (see Graph 5). ■



## BOX: THE REFORM OF THE NETHERLANDS HEALTH INSURANCE SYSTEM

**TABLE A : IMPACT OF THE REFORM OF THE DUTCH HEALTHCARE SYSTEM ON THE NATIONAL HICP AND THE MUICP**

	Impact on the quarterly variation in the Dutch HICP	MUICP: year-on-year change at end of Q1 2006 (INSEE forecast)	Core inflation : year-on-year change at end of Q1 2006 (INSEE forecast)
With the methodological change <sup>(1)</sup>	0.0	+2.3	+1.4
Without the methodological change	-4.0	+2.1	+1.2

Data from ECB, calculations by Insee

(1) This change could consist, for example, of allocating the weighting of the "healthcare" item among all the headings in the index.

On 1 January 2006 a far-reaching reform of the healthcare system in the Netherlands will come into force (privatisation of the sickness insurance system). The government will nevertheless remain in charge of levying contributions, which it will then redistribute to the mutual organisations and insurance companies previously chosen by individuals.

Prior to this reform, roughly two thirds of the Dutch population was affiliated to a public sickness insurance regime (Ziekenfondswet) that was part of the Social Security system. Affiliation to this regime was compulsory for all dependent and independent workers below a certain level of income. The regime was financed by employers' and employees' contributions that were withheld at source, together with a nominal personal contribution. These insurance premiums were not included in the calculation of the HICP. The remaining third of the population was insured by private companies and the contributions of this group were included in the calculation of the HICP and treated as household consumption expenditure in the national accounts.

The reform of the Dutch sickness insurance system involves the abolition of this public system. All citizens will be obliged to select a private sickness insurance scheme. However, the payment for this basic cover will take place through contributions withheld at source on wages and by a nominal premium levied in the form of a tax. As a result, healthcare spending for all Dutch citizens, including those who previously contributed only to the Ziekenfondswet to obtain basic cover, will be recorded as consumption by general government in the national accounts. The healthcare expenditure previously ensured by private companies will now be recorded as zero.

The introduction of the new sickness insurance system is unlikely to affect the evolutions in Dutch inflation, since the insurance premiums of the sickness schemes and the insurance companies are excluded from the basket of the national consumer price index (CPI). On the other hand, the impact on the HICP is likely to be substantial, as this does include private insurance premiums. With the reform, sickness insurance premiums will in fact fall by 100%. According to the ECB, the Dutch HICP is estimated to drop by 4 points as of January 2006. Given that the Netherlands has a weight of 5.2% in the Monetary Union Index of Consumer Prices (MUICP) euro-zone overall inflation and core inflation would both be reduced by 0.2 of a point (see Table A).

At the same time, the European Commission has evaluated the amount concerned in this transfer of private consumption to public consumption at €7.8 billion. This can be expected to result in Q1 2006 in a decline of 0.2% in the growth of household consumption in the euro zone and a rise of 0.5% in growth in the consumption of general government (see Table B).

However, there is uncertainty hanging over the way these changes will be taken into account in Dutch economic indicators. As regards the HICP, the methodological changes are currently being discussed between Eurostat and the Dutch statistical Institute CBS (Centraal Bureau voor de Statistiek). As regards the national accounts, no adjustment is planned. The accounts for the euro zone for Q1 2006 are expected to show growth rates as indicated in Table B, taking account of the reform. ■

**TABLE B : IMPACT OF THE REFORM OF THE DUTCH HEALTHCARE SYSTEM ON THE EURO ZONE'S QUARTERLY ACCOUNTS**

	Households' consumption expenditures	General government's consumption expenditures	GDP
Size of the transfer in 2006	-7.8 bn/euros	+7.8 bn/euros	0 bn/euros
Contribution to Dutch aggregates growth in Q1 2006	-3.5%	+7.5%	0,0%
Weighting in the calculation of the aggregate for the euro zone	0.054	0.075	0,062
Contribution to euro-zone aggregates growth in Q1 2006	-0.2%	+0.5%	0,0%
Euro-zone accounts in Q1 2006 (Insee forecasts, q o q changes)			
- Without taking the reform into account	+0.3%	+0.3%	+0,4%
- Taking the reform into account	+0.1%	+0.8%	+0,4%

Data from European Commission, calculations by Insee