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European economic outlook: general report presented at  
the AIECE meeting in Paris, May 9 - 11, 2001

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376/377

# **European Economic Outlook**

**General Report Presented at the AIECE Meeting  
in Paris, May 9–11, 2001**

by Klaus-Jürgen Gern, Christophe Kamps and Joachim Scheide

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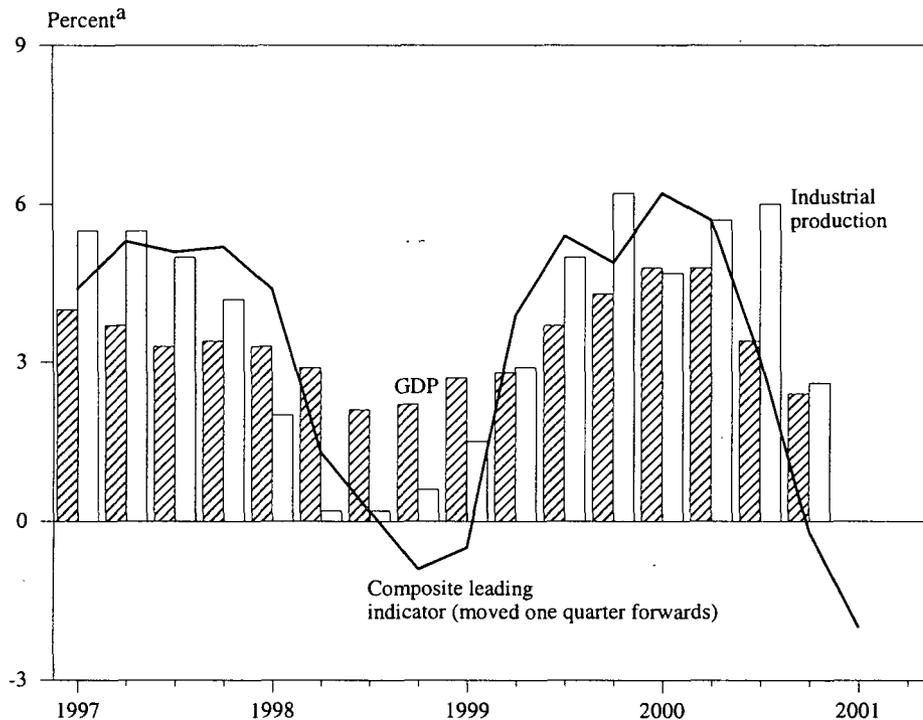
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*The General Report was prepared by the Kiel Institute of World Economics (IfW) for the AIECE General Meeting held in Paris, France, on May 9–11, 2001. The rapporteurs would like to thank all colleagues at the AIECE institutes for providing their answers to the questionnaire. In the Appendix, the forecast tables and country notes as provided by the individual AIECE institutes are reproduced.*

# 1 Introduction and Summary

In the spring 2001, the world economy is in a delicate situation. The vigorous growth momentum that prevailed in the recovery in 1999 and into 2000 is clearly gone. In the second half of 2000, global growth decelerated rapidly. In contrast to the last downturn of the world economy in 1997/98, the deceleration originated in the industrial countries, where growth rates were more or less cut in half compared to the first half of the year and the OECD leading indicator declined rapidly (Figure 1.1). Major factors behind the slowdown were lagged effects of monetary tightening and the pronounced and sustained rise in oil prices. It has to be noted, however, that the loss of momentum was substantially larger than expected by most forecasters, including the AIECE institutes in fall of last year, although oil prices behaved largely as expected. The deceleration of activity was particularly pronounced in the IT sector, and the substantial weakening of demand for electronics equipment and IT consumer goods went in tandem with a dramatic decline in the price of tech stocks on a global scale.

Figure 1.1: OECD-Area: Real GDP, Industrial Production and the OECD Composite Leading Indicator, 1997–2001



<sup>a</sup>Annualized 6-month percentage change.

Source: OECD (2001).

Indications that the global economy is at the brink of recession are, however, not conclusive. In most countries, business climate and consumer confidence indicators are still at relatively high levels despite the fact that they have fallen over recent months. This is true even in the United States, where the deterioration of indicators has been most pronounced, at least as consumer confidence is concerned.

The slowdown in economic activity was most pronounced in the United States, where growth nearly came to a halt towards the end of last year after growth rates of some 5 percent in the first half of the year. Real GDP growth picked up slightly in the first quarter of 2001 and came in somewhat stronger than expected, owing not least to weak imports. The Japanese growth performance also deteriorated substantially, despite a continued strong rise in corporate investment, as exports and private consumption weakened. By comparison, Western European growth held up relatively well, one reason being that monetary conditions have remained favorable mainly due to the weak euro. However, the deceleration of output growth was substantial in some Western European countries, too, most importantly in Germany, and leading indicators suggest that there is some significant deceleration of Western European growth under way.

Economic activity in the emerging market economies has not been unaffected by the deterioration of the economic environment, although some countries benefited from elevated oil prices. Towards the end of the year, it became obvious that growth in the regions outside the industrial countries had also lost momentum. Non-Japanese Asia had been particularly affected as a consequence of their economies being particularly exposed to the downturn in the global electronics cycle.

Against the background of a slowing global economy, world trade volumes rose at a grossly reduced pace in the second half of 2000 and in early 2001. The high annual rate of growth of world trade in 2000, which is estimated to have been at around 13 percent, was mainly due to an extremely rapid expansion at the end of 1999 and in the first half of 2000.

In view of recent developments, the AIECE institutes have revised their forecasts for growth in 2001 significantly downwards. The revision was largest for the United States to only 1.7 percent from 3.2 percent expected for this year in fall 2000, but the forecasts for Japan and the European Union have also been reduced, by 0.9 and 0.6 percent, respectively (Table 1.1).

Table 1.1: Summary of Forecasts<sup>a</sup>

|                           | Spring 2001 |      |      | Fall 2000 | Revision <sup>b</sup> |
|---------------------------|-------------|------|------|-----------|-----------------------|
|                           | 2000        | 2001 | 2002 | 2001      | 2001                  |
| Real GDP growth, %        |             |      |      |           |                       |
| United States             | 5.0         | 1.7  | 2.5  | 3.2       | -1.5                  |
| Japan                     | 1.7         | 1.0  | 1.5  | 1.9       | -0.9                  |
| European Union            | 3.3         | 2.6  | 2.7  | 3.2       | -0.6                  |
| Growth in world trade, %  | 11.8        | 6.4  | 6.7  | 8.4       | -2.0                  |
| Oil prices, US \$         | 28.4        | 24.7 | 24.0 | 25.3      | -0.6                  |
| US Fed funds rate, %      | 6.2         | 4.7  | 4.5  | 6.3       | -1.6                  |
| Dollar/euro exchange rate | 0.92        | 0.96 | 1.00 | 0.99      | -0.03                 |

<sup>a</sup>Average of AIECE forecasts. — <sup>b</sup>Difference between the average AIECE forecasts for 2001 made in spring 2001 and fall 2000.

Source: AIECE institutes; IRES (2000); own calculations.

As a reaction to the rapid deceleration of growth, the US central bank has aggressively lowered interest rates by 2 percentage points in only 4 months. This response is judged as being adequate for the time being and, in combination with the implementation of the first stage of a large-scale tax cut, expected to lead to a rebound of activity in the second half of the year. The majority of institutes, however, expects the recovery in the United States to be shallow, with growth in the 2–3 percent range. Inflation is generally forecast to decline swiftly, although some institutes argue that given a still high level of capacity utilization at the overall economy level there is risk that inflation will remain at current levels.

In Japan, the economy is forecast to deliver slow but positive growth this year and the next. The main challenge for economic policy is to break deflationary expectations. However, traditional demand side policies have proved to be largely ineffective, and with interest rates at zero and the fiscal situation critical there seems to be little room to maneuver except to accelerate structural reforms.

In Western Europe, growth is forecast by the AIECE institutes to continue at rates slightly above 2.5 percent, which may be around the sustainable rate of output growth.<sup>1</sup> In the euro area, monetary policy is currently faced with the fact that headline CPI inflation is stubbornly high and that core inflation is gradually accelerating towards the upper limit of the ECB target range. Notwithstanding, the majority of AIECE institutes feel that the ECB's policy stance is too tight and expect interest rate cuts in the near future ranging from 25 to 100 basis points. By contrast, there is more or less agreement with the monetary policy stance in the countries outside EMU. This year, demand in Western Europe will be supported by fiscal stimulus in a number of countries. In the euro area, tax cuts have been implemented that amount to around 1 percent of GDP. As there are no counter measures on the expenditure side, a consolidated budget deficit is expected by the AIECE institutes of 0.8 percent in relation to GDP. This follows a surplus of 0.3 percent last year, which was, however, heavily influenced by large one-off revenues. As concerns the medium-term fiscal strategy, many institutes note that governments will not be able to meet their deficit targets laid down in their latest stability programs, mainly due to overly optimistic growth assumptions.

Central and Eastern European accession countries are expected to continue robust growth this year and the next against the background of a relatively mild slowdown in Western Europe and the projected recovery of the world economy. While current account deficits continue to be high in a number of countries, an economic crisis like the one in South East Asia in 1997, triggered by massive outflows of short-term capital, is regarded as improbable given the fact that external deficits were to a very large degree financed by long-term foreign direct investment.

## 2 External Environment

### 2.1 United States

#### *On the Brink of Recession*

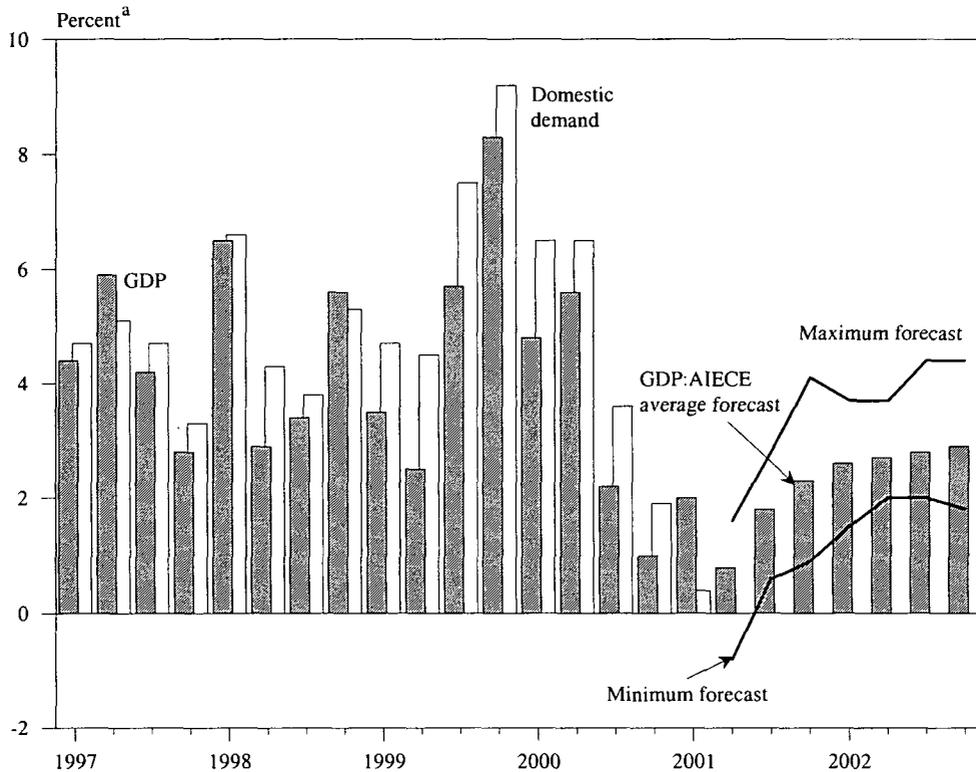
The downturn in the United States during the second half of 2000 has been much more pronounced than expected. Real GDP growth slowed down from a pace of more than 5 percent in the first half of the year to only 1 percent in the final quarter (Figure 2.1). The strong decline in business climate indicators and, more recently, consumer confidence has led the AIECE institutes to sharply revise downwards their growth expectations by 1.7 percentage points from 3.2 percent in the fall last year to 1.5 percent in the current survey. Although the majority of institutes puts the probability of the United States falling into recession at less than 50 percent, many point out that there is a substantial downward risk. It is also mentioned that the US economy is already in recession if recession is defined as a period of growth significantly below potential growth ("growth recession").

Recent data have, however, not been consistently on the downside. Most importantly, the first estimate of real GDP growth in the first quarter of the current year, which came in at a 2 percent annualized rate, was significantly higher than the average expectation of the AIECE institutes (0.8 percent). While much of the strength came from a positive contribution of foreign trade as imports declined strongly, some confidence may also be drawn from the fact that the inventory correction proceeded swiftly and the deterioration of investment growth came to a halt.

The latter fact may be especially important if sustained, as the turnaround of business investment, which basically stopped growing after several years of double-digit growth, is seen as the main driver of the slowdown in economic growth by the institutes. Private consumption growth has also moder-

<sup>1</sup> The detailed tables containing the forecasts of the AIECE institutes and comments on the economic situation and policies in the individual countries taken from the answers to the questionnaire are documented in the Annex.

Figure 2.1: United States: Real GDP and Domestic Demand, 1997–2002



<sup>a</sup>Percentage change over previous quarter at annual rate.

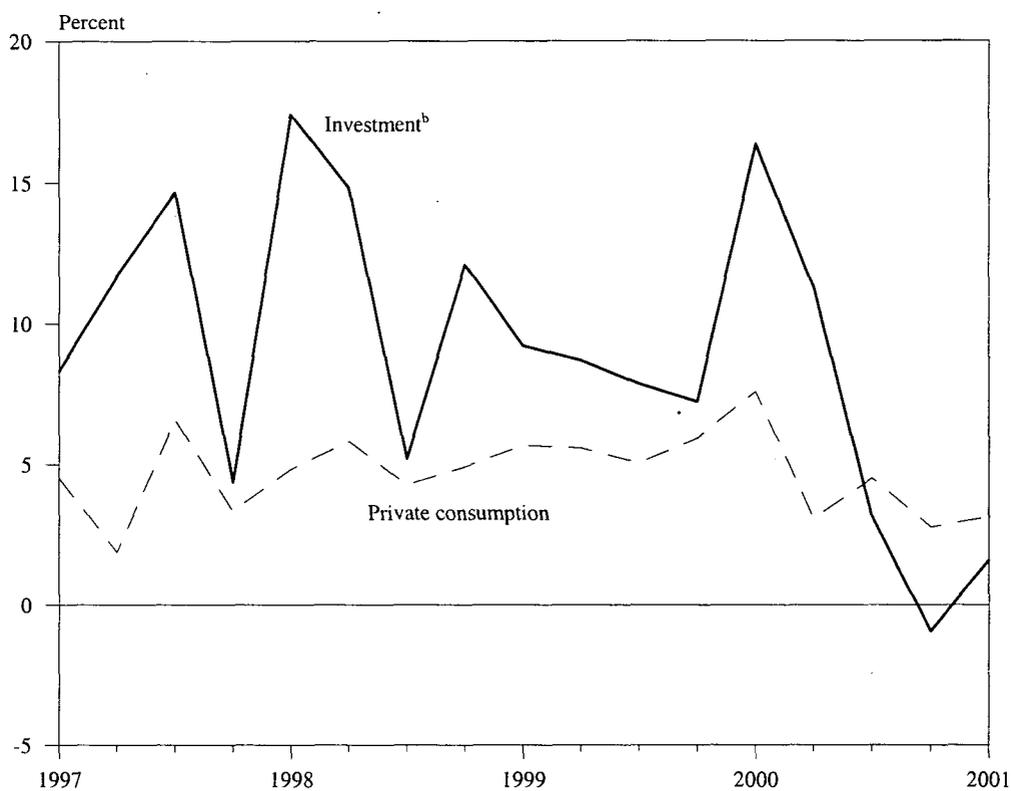
Source: OECD (2001); AIECE institutes; own calculations.

ated, although it remained relatively well on track given the decline in household wealth over the past 12 months (Figure 2.2). Major factors behind slower investment according to AIECE institutes are the lagged effects of monetary tightening, less favorable financing conditions due to the slump in equity prices and an increase in the interest rate spread between corporate debt of differing quality, an intensifying profit squeeze and a growing sentiment of overinvestment and excess capacities, particularly in IT-related industries, after an exceptionally long period of expansion. Other factors mentioned include the rise in oil prices and the appreciation of the dollar.

Given the host of factors putting a drag on capital spending, weak investment for the immediate future seems to be incorporated in most forecasts. Thus, in the event of an early stabilization of investment the cyclical downturn in the United States could prove to be shorter and less pronounced than generally forecast. The major downside risk is to be seen in a sudden adjustment of household spending, which has continued to outpace earnings growth at the start of the year, leading to a further decline in the savings ratio to around -1 percent. This risk seems not far fetched in the face of the reduced stock market valuation and reduced tightness in the labor market, although a correction of consumption behavior is likely to occur rather gradually than suddenly, according to the pattern observed in the past.

One reason to expect that the current slowdown will not cumulate into a major recession is monetary policy, which has been eased early and aggressively. According to the AIECE institutes expectations, short-term interest rates will be lowered further, if only slightly. Actually, the Fed has done a lot in recent months. The reduction by 2 percentage points is slightly more than a Taylor rule would suggest under these circumstances, and the level of interest rates is relatively low given the size of the output gap and the current level of inflation (Figure 2.3).

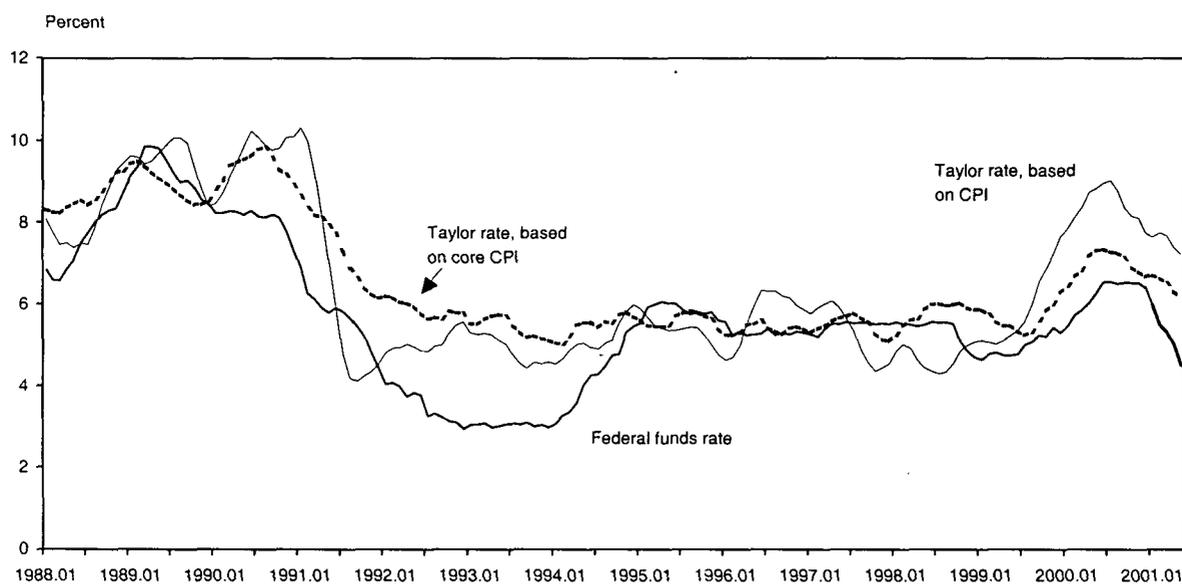
Figure 2.2: United States: Real Private Consumption and Investment, 1997–2001<sup>a</sup>



<sup>a</sup>Percentage change over previous quarter at annual rate. — <sup>b</sup>Real gross private fixed investment.

Source: OECD (2001).

Figure 2.3: United States: Fed Funds Rate and Interest Rate According to the Taylor Rule, 1988–2001



Note: The Taylor rate was calculated using CBO potential output estimates, an inflation target of 2.5 percent and an equilibrium real interest rate of 3 percent.

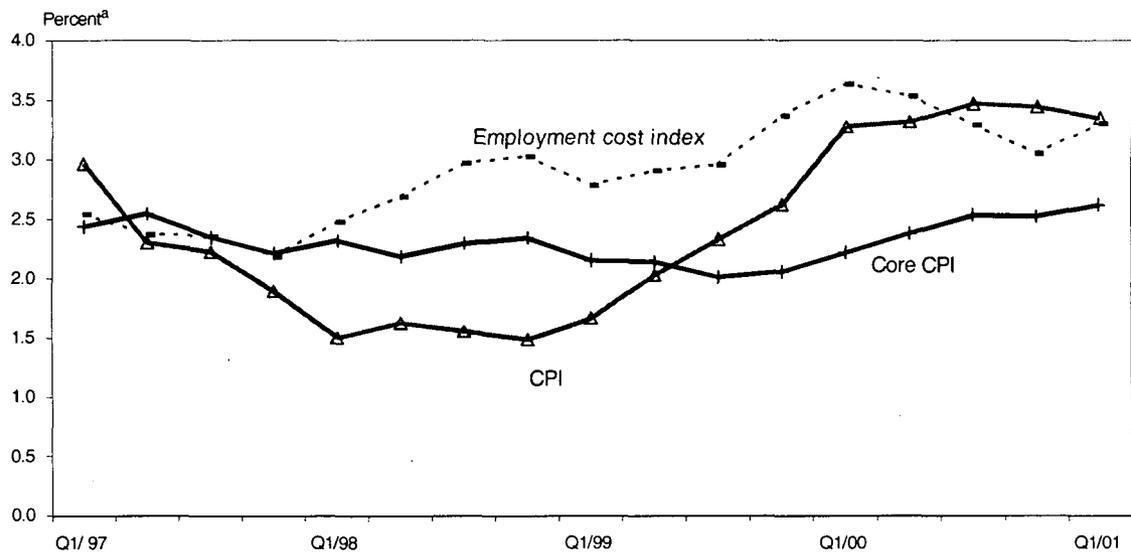
Source: Congressional Budget Office (2001); Federal Reserve Bank of St. Louis (2001a); US Department of Commerce (2001); own calculations.

On the fiscal policy side, the probability is high that a substantial part of the 10-year plan for tax reduction proposed by the Bush administration will be implemented. While fiscal stimulus will be small in the short term and moderate in the coming fiscal year — tax reductions may amount to some 0.5 percent of GDP — there is the possibility that already the announcement of a tax package will have a positive impact on consumer confidence and private consumption.

The combination of expansionary monetary and fiscal policies is deemed an appropriate policy response by the AIECE institutes in order to get the economy on track again. Inflation risks are mentioned by only a minority of institutes which point to the persistent tightness in the labor market and the still relatively high capacity utilization outside manufacturing. In this environment, a quick return to rates above potential growth rates could soon give rise to inflationary pressures, especially if the dollar should weaken as is expected by most institutes. Some institutes have also pointed to the risk that in a phase of downward adjustment of the targeted capital stock, rising liquidity could lead to another bubble in asset prices. The actual development of inflation since fall has not been particularly reassuring, with the year-on-year change in consumer prices remaining at slightly below 3.5 percent in the first months of the year despite the reduction in crude oil prices since fall. At the same time, the core rate has continued to creep upwards (Figure 2.4). Also, the rise in wage costs has more or less remained at its elevated level. Notwithstanding, the central forecast of the AIECE institutes is for inflation to slow down significantly over the coming quarters as a reaction to declining capacity utilization and lower oil prices. On average, CPI inflation is expected to fall to below 2.5 percent by the start of next year.

In general, a recovery is forecast starting in the second half of the current year, but the upturn is expected to be modest compared to growth in recent years. Real GDP growth in 2002 is forecast to amount to 2.5 percent. At the same time, many institutes remain confident about long-term growth and have generally not revised downwards their estimate of the growth rate of potential output, which is often estimated to be 3.5 percent or slightly less. The beneficial effects of the so-called New Economy, namely an increase in the underlying rate of productivity growth, are perceived to remain for the time being. There is, however, also the view that the boom in IT investment might have shifted the production possibility frontier outwards, but has left long-run technical progress and output growth unchanged.

Figure 2.4: United States: Consumer Price Inflation and Wage Inflation, 1997–2001



<sup>a</sup>Percentage change over previous year.

Source: Federal Reserve Bank of St. Louis (2001b).

*Box 2.1: Japanese Stagnation in the United States?*

At first glance there are disturbing similarities in the developments of the US economy in the period 1995–2000 and the Japanese economy in the second half of the eighties (Figure). In both countries, real GDP was exceptionally strong. It accelerated to rates beyond any reasonable estimate of potential output: 5–6 percent in the case of Japan in the late eighties and 4–5 percent in the United States in the recent past. Both economies experienced an exceptional investment boom. The share of gross private fixed investment in GDP increased from around 14.5 to some 19 percent in real terms in each country. The boom in the real economy was associated with a tripling of share prices in Japan as well as in the United States. Other indicators also went in tandem. The current account in both countries deteriorated by some 3 percent relative to GDP in the respective periods, although with the difference that Japan remained in surplus while the United States started in deficit already. And both countries experienced a significant improvement of the fiscal situation and registered a surplus in the general government financial balance of more than 2 percent in the final year of the expansion, although the swing in the United States from a deficit of 3.1 percent in 1995 to a surplus of 2.6 percent in 2000 has been somewhat more pronounced.

While the similarity of developments of some macroeconomic indicators does suggest that in both countries the economy experienced a pronounced boom in the respective periods under consideration, it does not allow conclusions on the extent and the nature of cyclical excesses and on the way such excesses will be corrected. This is because there are also important differences with respect to the economic developments and economic policies.

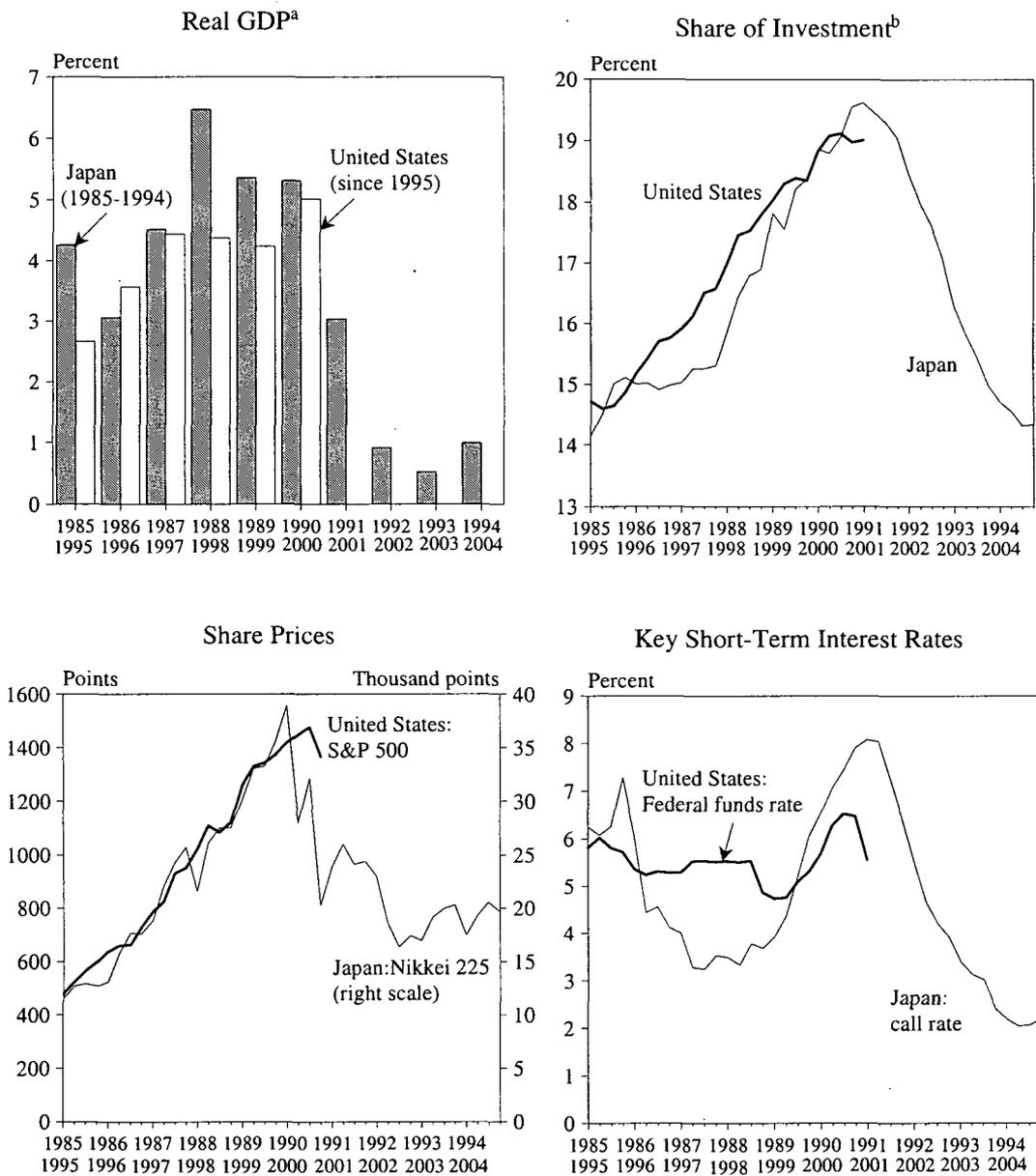
Most importantly, it can be argued that there is a difference in the foundations of the boom. While the Japanese upturn in the late eighties was largely the result of expansionary monetary policies, the acceleration of US growth in recent years had its foundations in the real economy. It was based on a pronounced increase in productivity growth which is believed to be at least partially structural in nature and is associated with the New Economy.

Another significant difference is monetary policy. In Japan the monetary restriction had been much more pronounced and over a longer period of time, and the Bank of Japan did not prevent deflationary expectations from coming about. By contrast, monetary tightening in the United States had been relatively moderate and the Fed started easing aggressively as soon as it was clear that the economy had weakened substantially. As financial sector instability is seen as one important factor behind the Japanese problems, it has to be noted that the Fed is obviously anxious to prevent disruptions in financial markets. In this context it is important that the banking sector in the United States seems to be in relatively better shape. The loss in asset valuation can be expected to be relatively modest in the United States, since the decline in asset prices is likely to be largely confined to share prices. In contrast to the Japanese case, there is no indication of a bubble in property prices in the United States. And even if banks were to get into trouble as a result of nonperforming loans, it could be expected that a clean-up will be organized swiftly.

The ultimate reason behind the Japanese malaise seems to be that the structures that prevailed in the economy and in society in general were not adequate to cope with the changed economic environment. As a result, structural problems have been recognized late, and response has been slow. A lack of openmindedness and flexibility is part of the explanation that structural change which is necessary to increase the growth rate of potential output in Japan is proceeding painfully slowly. By contrast, flexibility is one strength of the US economic system.

*Box 2.1 to be continued*

Figure: Japan 1985–1994 and United States since 1995: Comparison of Selected Macroeconomic Indicators



<sup>a</sup>Change over previous year. — <sup>b</sup>Real private gross fixed investment in percent of real GDP.

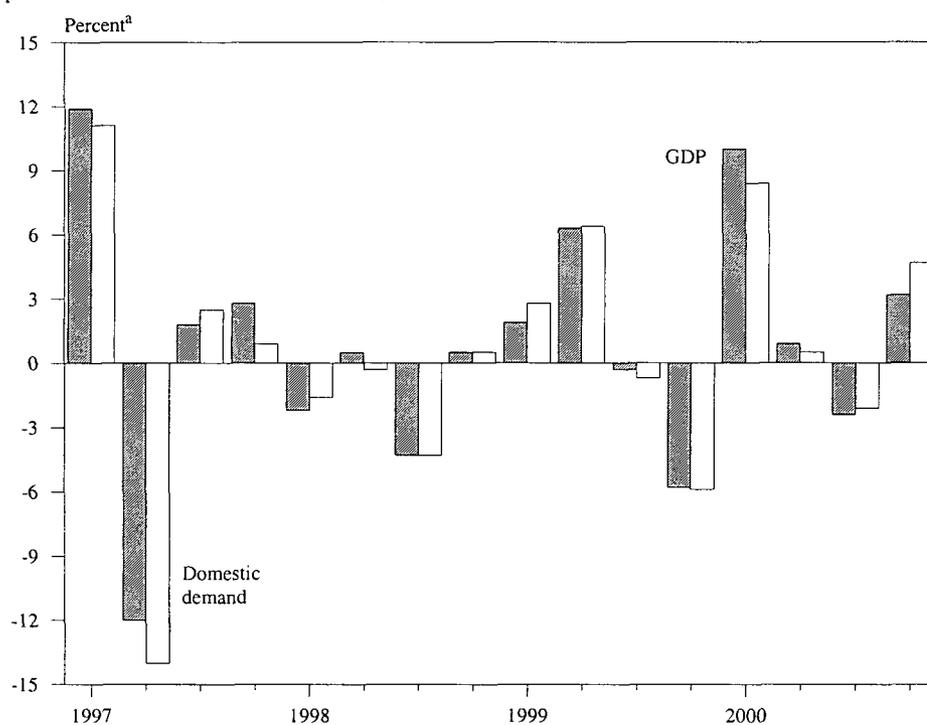
Source: OECD (2001); Bank of Japan (2001); Federal Reserve Bank of St. Louis (2001b); own calculations.

## 2.2 Japan

### Renewed Weakness

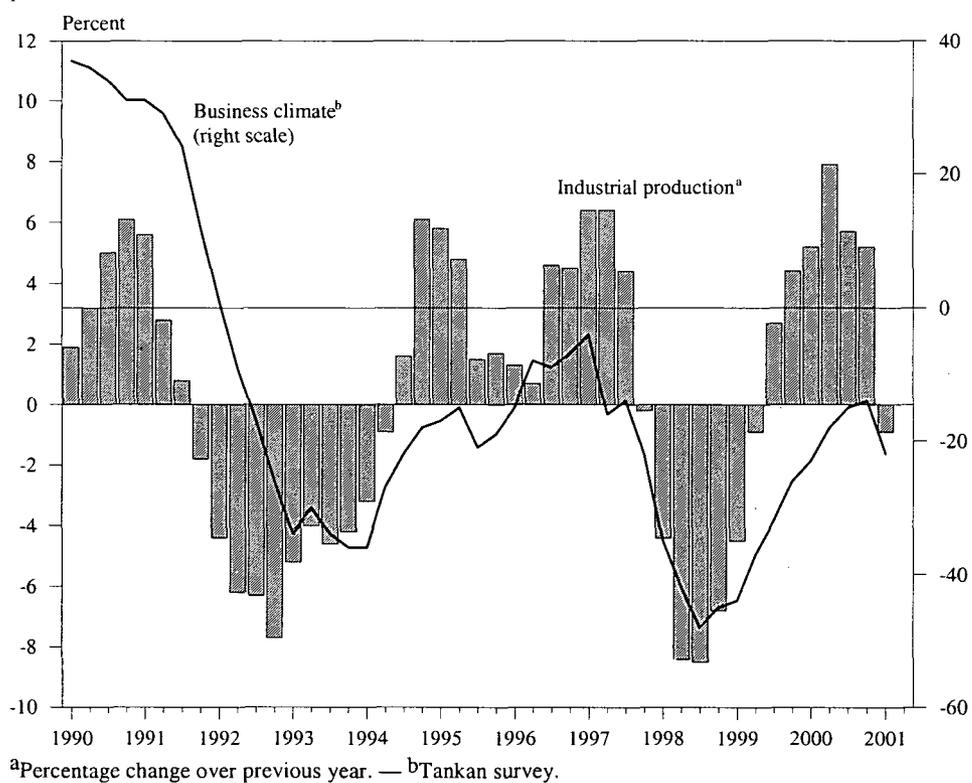
In Japan, the recovery from the 1998 recession seems to have stalled. GDP was basically flat in the second half of 2000 (Figure 2.5). The year-on-year growth rate of industrial production in combination with business confidence (Figure 2.6) gives a much clearer picture of the cyclical developments in Japan than quarterly GDP figures, which are notoriously volatile. Exports that had been a main engine of growth in the first half of 2000 stagnated, reflecting the downturn in the United States and the rest

Figure 2.5: Japan: Real GDP and Domestic Demand, 1997–2000



Source: OECD (2001).

Figure 2.6: Japan: Business Climate and Industrial Production, 1990–2001



Source: OECD (2001); Bank of Japan (2001).

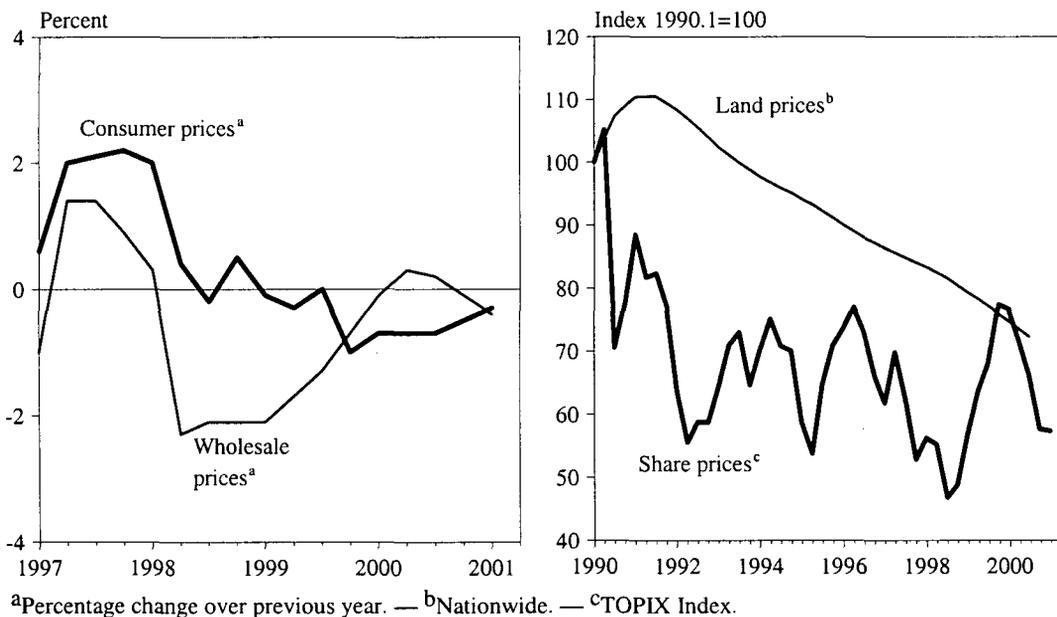
of Asia and a strong dependency on the dwindling global IT demand. Household expenditure did not support growth, as the labor market continued to soften and a growing sense of job insecurity dampened the propensity to consume. Business investment was the sole source of demand growth, with IT-related investment having been exceptionally strong.

Since the beginning of the year, signs of a renewed cyclical downturn have continued to occur, as weak external demand led to a decline in industrial production and corporate sentiment deteriorated. Declining orders for machinery and equipment suggest that investment has passed its peak. At the same time, deflationary tendencies have continued (Figure 2.7). Notwithstanding the rise in oil prices and more recently a devaluation of the yen, consumer price inflation remained in the negative territory throughout last year and in the first months of 2001. The deflationary forces have recently gained momentum, as can be seen at the wholesale level where price inflation fell below zero again after a short interval of positive numbers.

In order to get a more complete picture of the deflationary problem in Japan the development in asset prices has to be taken into account. The relentless fall of the value of land is still going on, and land prices on the national level are down by 25 percent since the peak in early 1992. Share prices are even down by 40 percent from their peak and, after a substantial recovery during 1999, have again reversed.

With deflation unabated and the stock market in renewed decline, a new sense of crisis seems to have emerged. As one result, the Bank of Japan first lowered interest rates again in February and subsequently changed its target and switched from the call money interest rate to a quantitative one for outstanding current account balances at the central bank. In order to achieve the target, which has been set at 20 percent above the average balance held at the central bank in the preceding months, the Bank of Japan will increase its purchases of long-term government bonds on the secondary market if necessary. Stimulus from the monetary side will nevertheless be limited as real interest rates will remain in the positive territory for the time being. The possibility of large-scale monetization of government debt is remote however, since the stock of government bonds held at the central bank is not allowed to rise above the outstanding issue of currency.

Figure 2.7: Japan: Inflation in Goods Prices and Asset Price Development

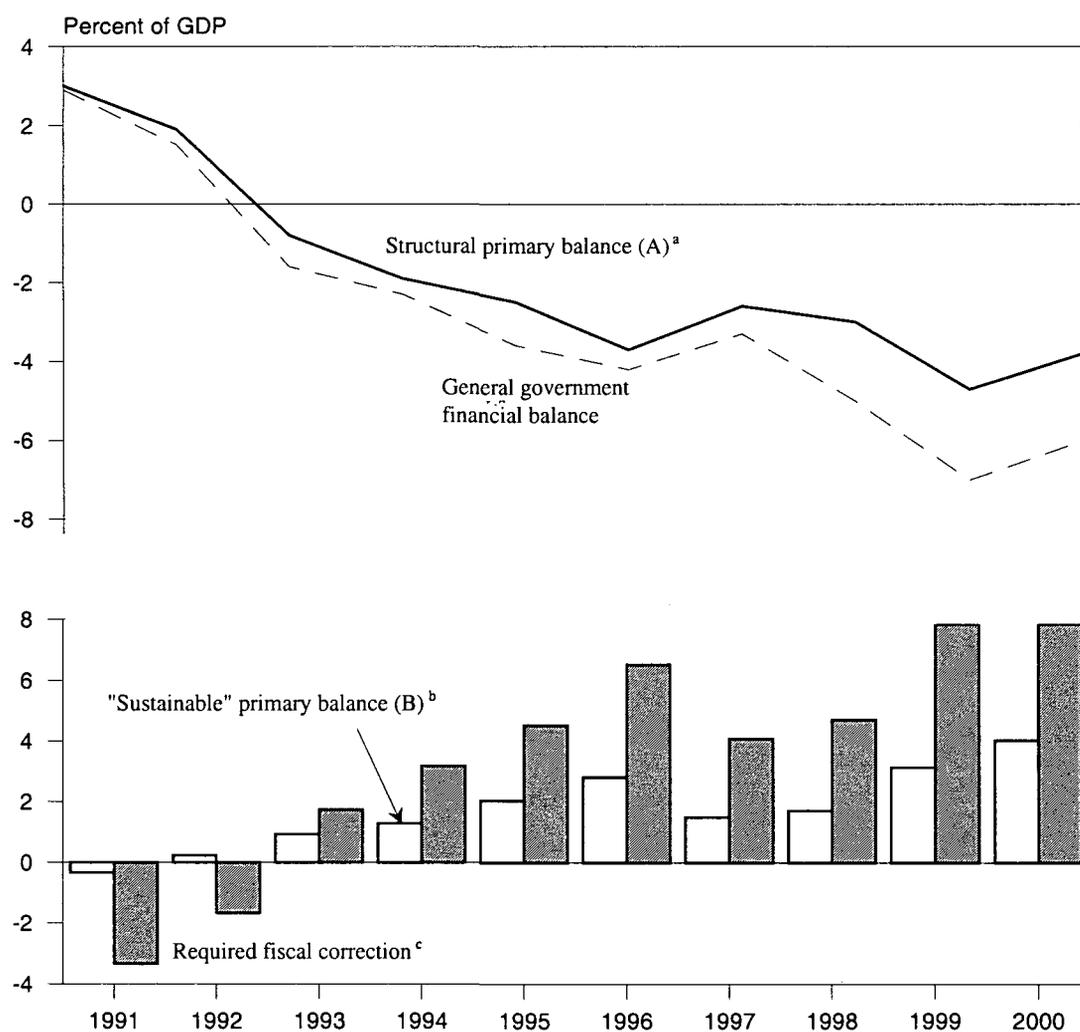


<sup>a</sup>Percentage change over previous year. — <sup>b</sup>Nationwide. — <sup>c</sup>TOPIX Index.

Source: Bank of Japan (2001).

While some stimulus from the fiscal side is likely, it will probably be moderate. Any additional supplementary budget is likely to be relatively small in size given the critical condition of public finances. Public debt has risen to around 120 percent of GDP during the nineties. The serious situation of the budget is illustrated in Figure 2.8. The improvement in the general government deficit from 1999 into 2000 to around 6 percent is mainly due to extraordinary tax revenues associated with the maturing of high-yielding fixed-term postal savings deposits. Comparing the actual structural primary balance, which stood at nearly 4 percent in 2000, with the sustainable balance, that means the structural primary balance that would have stabilized the debt-to-GDP ratio, yields the fiscal correction needed in the current situation to prevent a debt explosion. Calculations using OECD estimates of potential growth and imputed interest rates show that a fiscal tightening of as much as 7.5 percent of GDP is currently necessary in order to stabilize debt.

Figure 2.8: On the Fiscal Situation in Japan, 1991–2000



<sup>a</sup>Structural general government financial balance according to OECD minus interest payments (A). — <sup>b</sup>Structural primary balance that would have stabilized the debt-to-GDP ratio (B). — <sup>c</sup>(B)-(A).

Source: OECD (2000a); own calculations.

A need for fiscal consolidation and a reorientation of government policies in order to overcome the long-term stagnation is increasingly acknowledged in the political arena in Japan, and with a supposedly reform-oriented politician elected as new prime minister a conceptual renewal of policy might be in the offing. Structural reforms are viewed as being the key to a sustainable recovery by many AIECE institutes, as they would improve the growth potential of the economy and could potentially restore confidence, which is crucial in order to revive domestic demand. In this context the need for a sweeping reconstruction of the financial sector is stressed in particular. It is, however, noted that reforms could also weaken demand in the short term as a consequence of heavy restructuring and therefore should be combined with a continuation of expansionary macro policies. While it is unanimously suggested to have easy monetary policies in the current situation, the institutes' opinions about the adequate fiscal response are divided. While some argue in favor of additional public demand in order to prevent the economy from falling into recession, others doubt that fiscal expansion can be effective in an environment of spiralling government debt (Ricardian situation).

As concerns the short-term outlook, the AIECE institutes expect low, but positive growth of 1 percent this year. This represents a significant downward revision from 1.9 percent expected last fall. Next year, real GDP is forecast to rise by 1.9 percent.

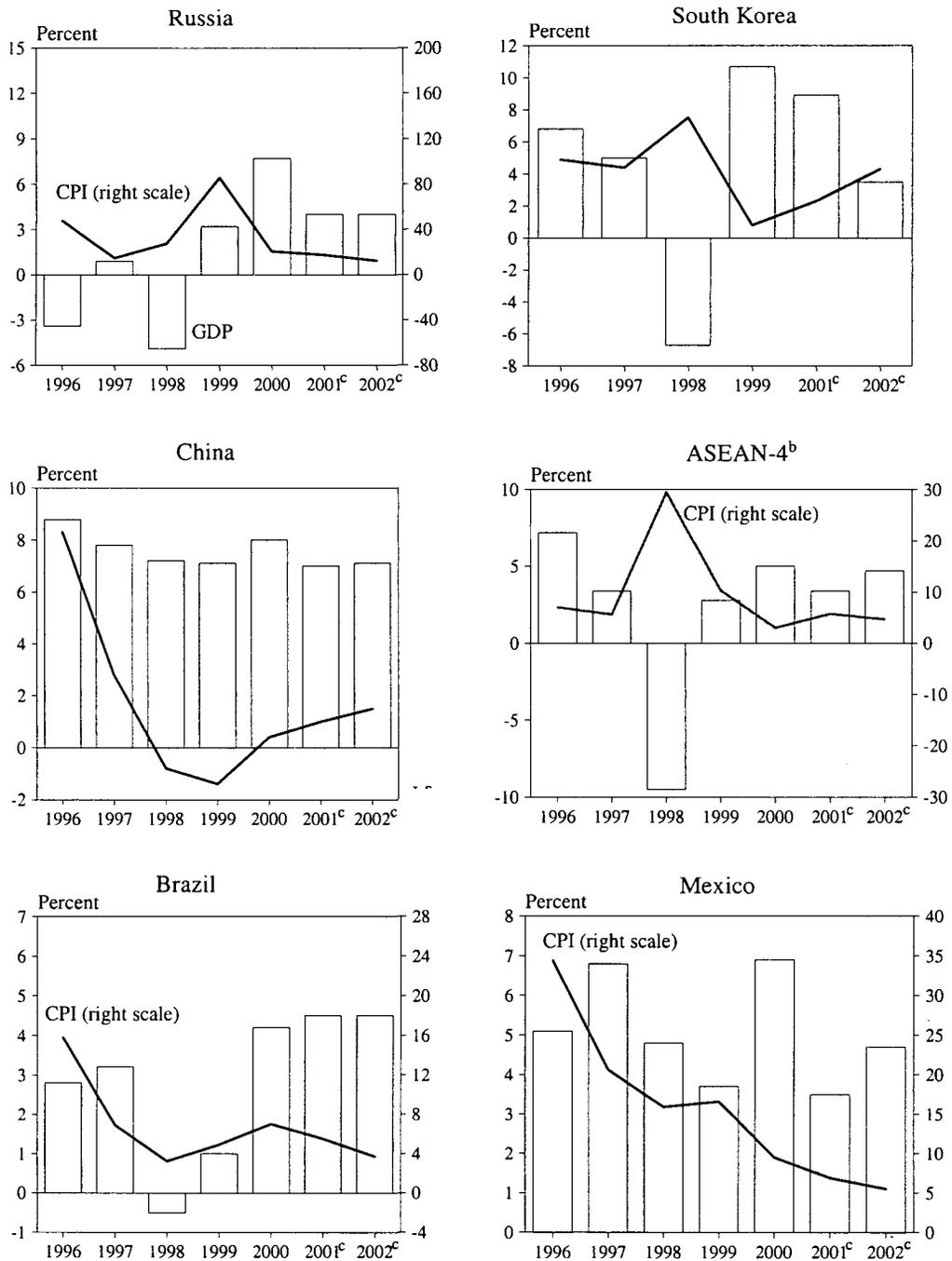
### **2.3 Emerging Market Economies**

In the Asian emerging market economies, growth in the year 2000 was strong. While domestic demand strengthened with the economic recovery progressing, exports remained the main engine of growth for the region. The slowdown in the industrial countries in the latter half of last year, however, has been clearly felt, as Asian countries—due to their specialization—are particularly affected by the end of the high-tech boom. Growth rates declined towards the end of the year, and data on exports and industrial production for the first months of 2001 suggest that economic activity has slowed further. The weakness in exports is unlikely to be countered by rising domestic demand. In a number of countries, the effectiveness of monetary policy to stimulate demand is still limited, due to the persistent weakness of banks and the ongoing process of de-leveraging in the corporate sector. At the same time, room for fiscal expansion has narrowed, with deficits in many countries still being high and the public debt having ballooned over the last years. Growth rates in non-Japanese Asia outside China can be expected to fall significantly—the IMF forecasts output growth in South Korea to fall from 8.8 percent last year to 3.5 percent this year and in the ASEAN-4 from 5.0 percent last year to around 3.4 percent this year (Figure 2.9). By contrast, the growth momentum in China seems to be much more robust. GDP data for the first quarter of 2001 suggest that economic activity has even accelerated over recent months despite the deteriorating external environment.

The picture in Latin America is mixed. While some countries like Brazil and Chile recovered in 2000 and Mexico continued to grow strongly, the Argentine economy remained in recession as a result of a weak competitive position of tradable-goods producers and high real interest rates that were necessary to defend the parity of the peso vis-à-vis the US dollar in the context of the currency board. The downturn of the US economy has already impacted on Latin America. Especially Mexico and Chile have been relatively hard hit due to their close ties with the US economy and, thus, economic activity in these countries has clearly slowed over the past couple of quarters. Other countries, including Brazil, have been less affected. The growth prospects here critically hinge on further progress on structural reform and fiscal consolidation, which seem to be a necessary condition for keeping the inflow of foreign capital at the level required to finance the deficit in the current account balance and allowing to hold interest rates at a reasonable level.

In Russia, the surprisingly strong recovery from the 1998 crisis was largely due to import substitution after the devaluation of the rubel and higher energy prices. During 2000, the rubel appreciated significantly in real terms. Strong rises in real incomes will also lead to stronger import growth. These

Figure 2.9: Real GDP and Consumer Prices in Selected Emerging Market Economies<sup>a</sup>



<sup>a</sup>Change over previous year in percent. — <sup>b</sup>Indonesia, Malaysia, Philippines, Thailand. — <sup>c</sup>IMF forecast of April 2001.

Source: IMF (2001).

developments can be expected to continue, and the resulting compression of corporate profits will dampen investment. At the same time, lower oil prices will reduce export earnings. Last but not least, the economic environment for a sustained strong growth seems to be still missing, as progress in structural reforms is still slow. Therefore, GDP growth is expected to slow down to 4 percent in 2001 and 2002.

### 3 European Economic Outlook

#### 3.1 Euro Area

##### *Cooling Down of Economic Activity*

Production in the euro area moved onto the path of potential output in the course of last year. Thus, a long period of underutilized capacities in the economy came to an end.<sup>2</sup> After a very strong expansion until summer 2000, economic activity has slowed down perceptibly (Figure 3.1). In the second half of last year, real GDP rose at an annual rate of 2.7 percent, a rate that is only slightly higher than potential output growth. The slower speed of expansion was above all due to a weaker increase in domestic demand following monetary tightening and the strong rise in oil prices. Private consumption was especially dampened in the third quarter of last year when the losses in real income resulting from the oil price surge culminated. In the last quarter of 2000, private consumption strongly recovered, not only because of falling oil prices but also in reaction to tax measures in some countries. Italy introduced income tax cuts in November, and in the Netherlands purchases were brought forward because indirect taxes were considerably increased at the beginning of 2001. Gross fixed capital formation decelerated only slightly in the course of last year. Admittedly, financing conditions deteriorated in the wake of monetary tightening, and, moreover, sales and profit expectations are less optimistic than in mid-2000. At the same time, however, according to surveys of the European Commission, capacity utilization in the manufacturing sector is still substantially above its long-term average.

The export sector of the euro area was able to expand its sales to third countries by a double-digit number in real terms last year. This performance can be partly attributed to the prosperous economic situation in the most important sales markets. Especially the deliveries to the United Kingdom, to Central and Eastern Europe and to Southeast Asia increased strongly. However, exports to the United States, which had expanded particularly lively until last spring, showed signs of deceleration in the second half of 2000. Notwithstanding, external demand remained strong until the end of last year due to continued impulses from the depreciation of the euro. Even though the real effective exchange rate of the euro has risen since October, it still was 5.6 percent lower at the end of 2000 than one year before.

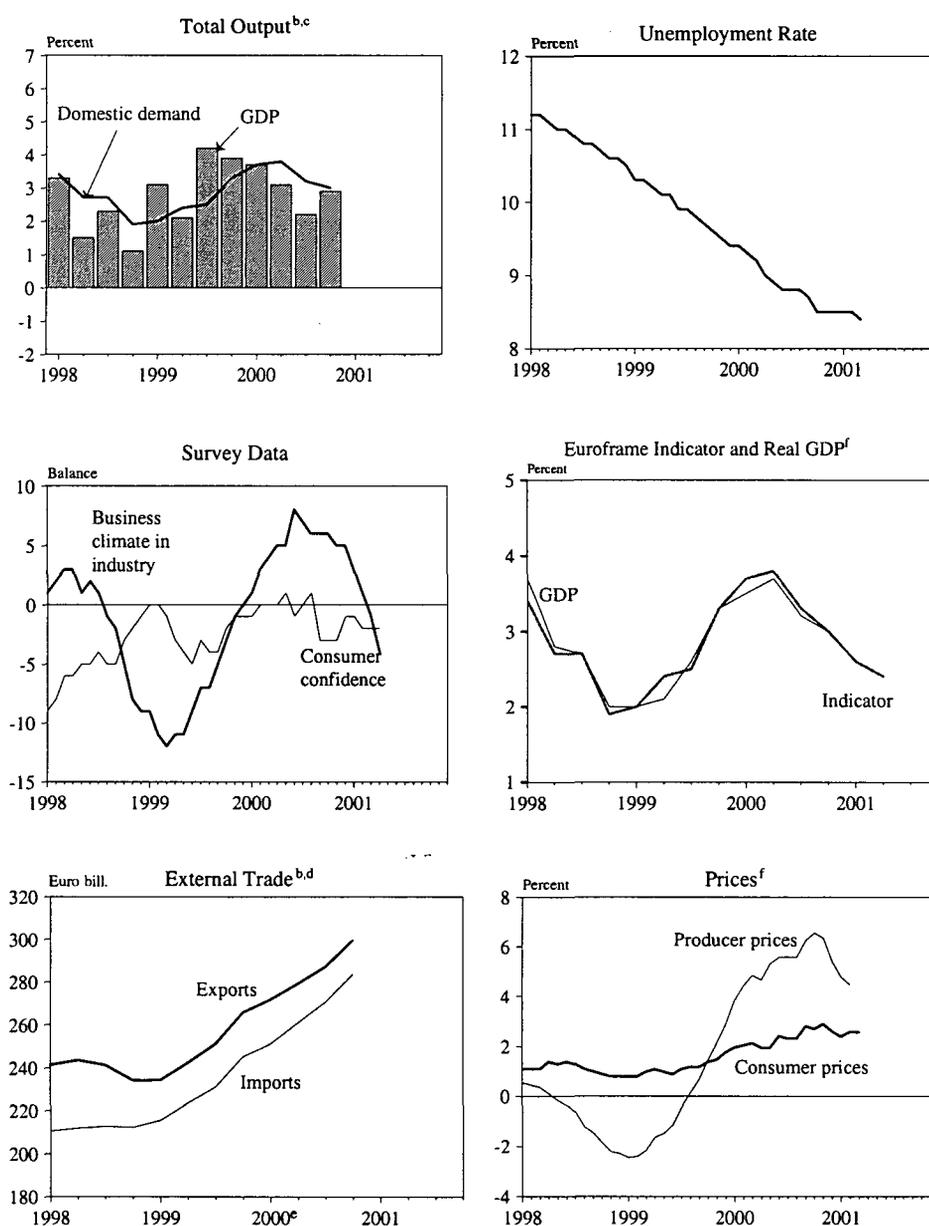
Consumer price inflation has remained high until recently. In March 2001, the Harmonized Index of Consumer Prices (HICP) was 2.6 percent higher than one year before. With that the inflation rate has exceeded the upper bound that the ECB is willing to tolerate in the medium run for more than a year. Admittedly, the largest part of the acceleration in inflation is due to the rapid rise in energy prices—a barrel of crude oil costs on a euro basis 40 percent more in 2000 than the year before. But in the meantime the underlying price trend (the so-called core inflation, i.e., HICP excluding energy, food, alcohol and tobacco prices) has also crept up. On the one hand, companies in the euro area have increasingly exhausted the scope for raising prices arising from the strong economic expansion. On the other hand, the rise in core inflation can be traced back to the indirect effects of the increase in energy prices. The past months witnessed a strong rise in the consumer goods component of the industrial price index. This component usually reacts with some delay to changes in the prices of imported intermediate goods. However, there is little evidence for second-round effects so far, as wage increases in the euro area have remained moderate.

The labor market evolved particularly favorably last year against the background of the strong upswing. The number of employed persons increased by more than 2 percent according to ECB estimates, and in March 2001 the unemployment rate (8.4 percent in ILO definition) reached its lowest level since fall 1991. Since the end of 1997 the unemployment rate has continuously declined by 3 percentage points. Wage moderation has decisively contributed to this positive development.

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<sup>2</sup> According to OECD estimates, the output gap, which had opened up in the course of the 1993 recession in the euro area, remained negative until about mid-2000.

Figure 3.1: Business Cycle Indicators<sup>a</sup> for the Euro Area



<sup>a</sup>Seasonally adjusted. — <sup>b</sup>At constant prices. — <sup>c</sup>Percentage change over previous quarter (annual rate). — <sup>d</sup>Estimation on the basis of the national accounts, excluding intra-Euroland trade. — <sup>e</sup>Partly estimated. — <sup>f</sup>Percentage change over previous year.

Source: Eurostat (2001); Euroframe (2001).

### Outlook: GDP Grows in Line with Potential Output

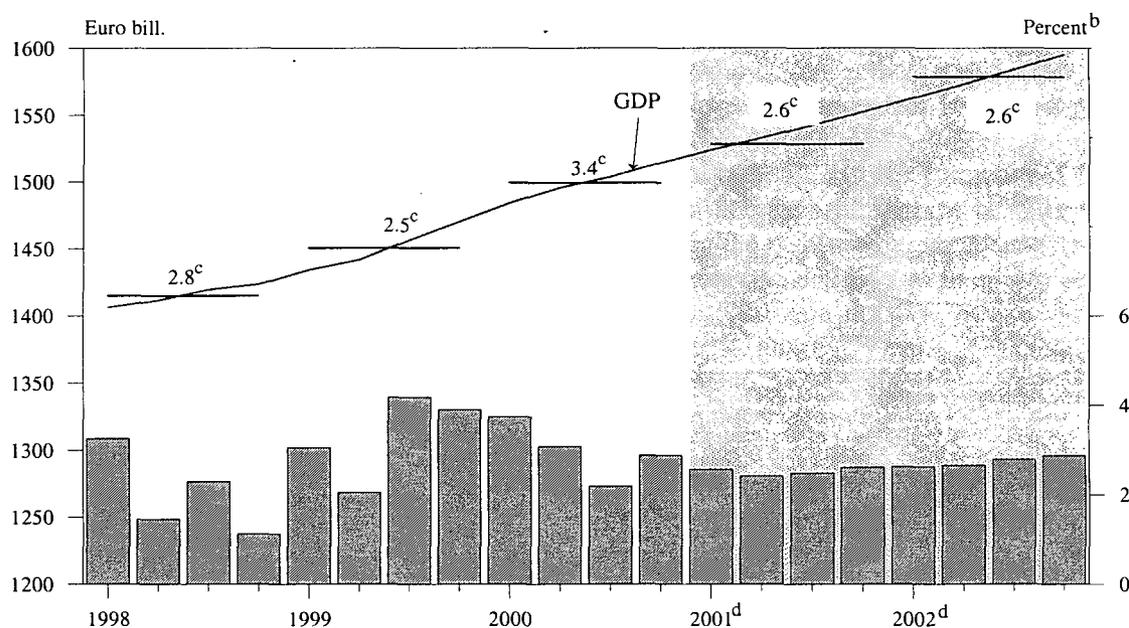
At present the leading indicators paint an ambiguous picture of the short-term perspectives of the European economy. The sentiment indicators compiled by the European Commission point to a continuation of economic expansion at a rapid pace. Consumer confidence has increased recently after having gone down markedly in the wake of the oil price surge. The recent embellishment is probably due to the tax relieves that have come into force in several countries at the beginning of the year. Moreover, confidence in the industrial sector is still high in comparison with its historical average, even though it has decreased considerably since last summer. However, a number of other leading

indicators signal an economic slowdown in the coming months. The European purchasing manager index has dropped significantly following the downturn in the United States. Also, the growth indicator calculated by Euroframe<sup>3</sup> shows that economic activity will lose some more momentum in the first half of 2001.

All in all, the leading indicators suggest that the basic trend of economic expansion will remain moderate (Figure 3.2). However, in the first quarter of 2001, GDP growth was relatively strong. In particular private households raised their expenditures considerably, since real disposable incomes increased more rapidly than before, following the tax cuts. In the course of this year, however, the fiscal stimulus will gradually fade. Then the weakening of economic activity implied by the less favorable external environment will get the upper hand. The cooling down of economic activity in the United States will dampen the demand for European products. Moreover, the deliveries to other regions will increase at a slower pace than before. Economic expansion will be especially dampened in Southeast Asia and in Latin America by the business trend in the United States.

How will the weakening of the world economy affect the euro area? The institutes on average forecast that real GDP in the United States will increase by 1.5 percent this year. This can be regarded more or less as a soft landing. A recession in the United States is not probable, yet it constitutes a risk for the forecast. Recently, Euroframe (2001), with the help of the NIGEM macro-econometric model, investigated how strongly the euro area would be affected by a stronger weakening in the United States in 2001. The growth rate of real GDP in the euro area would be 0.6 percentage points lower than in the baseline projection if real GDP in the United States turned out 1 percentage point lower than in the baseline projection. This would be accompanied by a strong depreciation of the US dollar. According to these estimates, even zero output growth in the United States this year would not entail a recession in the euro area.

Figure 3.2: Real GDP<sup>a</sup> in the Euro Area, 1998–2002



<sup>a</sup>Seasonally adjusted. — <sup>b</sup>Annualized quarterly rate of change in percent. — <sup>c</sup>Percentage change over previous year. — <sup>d</sup>AIECE institutes' average forecast starting in the first quarter of 2001.

Source: Eurostat (2001); AIECE institutes.

<sup>3</sup> Apart from the Kiel Institute of World Economics (Germany) the following European research institutes participate in the research network Euroframe: CPB (Netherlands), DIW (Germany), ETLA (Finland), NIESR (United Kingdom), OFCE (France), PROMETEIA (Italy) and WIFO (Austria). For information on this cooperation, see: <http://www.euroframe.org>.

Real GDP in the euro area will on average rise by 2.6 percent in 2001, after 3.4 percent the year before. The slowdown is due to weaker external demand as well as to a slightly slower increase in domestic demand. After an acceleration at the beginning of this year, resulting from tax cuts, private households will expand their consumption expenditure at a slower pace in the remainder of 2001. Gross fixed capital formation will increase by less than last year until late summer. The institutes expect a faster increase from this fall on when sales and profit expectations will improve in the wake of the recovery in the United States and of a gradual loosening of monetary policy in Europe. Exports will considerably lose momentum this year. This is not only due to the cooling down of the world economy, but also to an appreciation of the euro. The institutes on average assume that the euro will appreciate by 11 percent against the US dollar in the course of 2001 and reach parity in the fourth quarter.

In the course of next year economic activity will expand somewhat faster than potential output. Monetary policy will stimulate economic growth. Private investment will rise somewhat faster in the wake of the recovery in the world economy. Private consumption will remain robust next year. Admittedly, tax relief for private households will not reach the magnitude of this year's relief, but household spending will benefit from falling inflation and the further improvement in labor market conditions. There will be no impulse from foreign trade next year. The increase in exports will remain moderate, as the appreciation of the euro will unfold its full effect. All in all, the institutes expect that real GDP will increase by 2.6 percent in 2002 (Table 3.1).

The increase in the Harmonized Index of Consumer Prices (HICP) will gradually weaken over the forecast horizon. The institutes expect that the inflation rate will decelerate to below 2 percent in the fall of 2001 from around 2.5 percent at the beginning of the year. This is due to the decline in crude oil prices. It is assumed that the oil price will average approximately 25 US dollar per barrel this year and next year. The core inflation rate will continue to accelerate during the first half of 2001, but decrease slightly afterwards. This can be traced back to the fact that the monetary overhang that had arisen in the last two years has already been translated into higher consumer prices. Meanwhile, the tightening of monetary policy during last year has contributed to slower monetary growth. Thus, the risk of a permanent violation of the stability target has diminished. Due to its high level at the beginning of this year, the inflation rate will average 2.2 percent in 2001. Next year it will amount to 1.7 percent on average.

Table 3.1: Real GDP, Consumer Prices and Unemployment Rate in the Euro Area, 1999–2002

|             | Weights<br>in total <sup>a</sup> | Real GDP <sup>b</sup> |                   |                   |                   | Consumer prices <sup>b,c</sup> |                   |                   |                   | Unemployment rate <sup>d</sup> |                  |                   |                   |
|-------------|----------------------------------|-----------------------|-------------------|-------------------|-------------------|--------------------------------|-------------------|-------------------|-------------------|--------------------------------|------------------|-------------------|-------------------|
|             |                                  | 1999                  | 2000 <sup>e</sup> | 2001 <sup>f</sup> | 2002 <sup>f</sup> | 1999                           | 2000 <sup>e</sup> | 2001 <sup>f</sup> | 2002 <sup>f</sup> | 1999                           | 2000             | 2001 <sup>f</sup> | 2002 <sup>f</sup> |
| Germany     | 31.8                             | 1.6                   | 3.0               | 2.1               | 2.2               | 0.7                            | 2.0               | 2.1               | 1.5               | 8.8                            | 8.3              | 7.6               | 7.2               |
| France      | 21.5                             | 3.0                   | 3.2               | 2.8               | 2.9               | 0.6                            | 1.9               | 1.3               | 1.3               | 11.3                           | 9.5              | 8.8               | 8.2               |
| Italy       | 17.6                             | 1.4                   | 2.8               | 2.3               | 2.2               | 1.6                            | 2.7               | 2.5               | 1.7               | 11.4                           | 10.5             | 9.9               | 9.5               |
| Spain       | 9.0                              | 4.0                   | 4.1               | 3.2               | 3.1               | 2.2                            | 3.5               | 2.8               | 2.4               | 15.9                           | 14.2             | 12.7              | 12.4              |
| Netherlands | 5.9                              | 3.9                   | 3.9               | 3.3               | 2.8               | 2.0                            | 2.3               | 3.9               | 1.9               | 3.3                            | 2.8              | 3.4               | 3.5               |
| Belgium     | 3.7                              | 2.7                   | 4.1               | 2.9               | 3.0               | 1.2                            | 2.7               | 1.6               | 1.9               | 9.1                            | 8.5              | 8.9               | 8.4               |
| Austria     | 3.2                              | 2.1                   | 3.0               | 2.2               | 2.1               | 0.5                            | 2.0               | 1.7               | 1.3               | 3.8                            | 3.5              | 3.6               | 3.6               |
| Finland     | 2.0                              | 4.2                   | 5.7               | 4.5               | 4.1               | 1.3                            | 3.0               | 2.1               | 1.5               | 10.2                           | 9.8              | 9.1               | 8.4               |
| Greece      | 1.9                              | 3.4                   | 4.1               | 4.2               | 4.4               | 2.2                            | 2.8               | 2.8               | 2.5               | 11.7                           | 11.2             | 10.5              | 9.6               |
| Portugal    | 1.7                              | 3.0                   | 3.0               | 2.5               | 2.4               | 2.2                            | 2.8               | 3.6               | 4.6               | 4.5                            | 4.2              | 4.4               | 4.5               |
| Ireland     | 1.4                              | 9.8                   | 11.5              | 6.7               | 6.2               | 2.5                            | 5.2               | 4.2               | 3.6               | 5.7                            | 4.4              | 3.3               | 3.2               |
| Luxembourg  | 0.3                              | 7.6                   | 8.0               | 6.0               | 5.0               | 1.1                            | 3.8               | 3.9               | 5.7               | 2.3                            | 2.2              | 2.1               | 2.1               |
| Euro area   | 100.0                            | 2.5                   | 3.4               | 2.6               | 2.6               | 1.1                            | 2.3               | 2.2               | 1.7               | 10.0 <sup>g</sup>              | 9.0 <sup>g</sup> | 8.4 <sup>g</sup>  | 8.1 <sup>g</sup>  |

<sup>a</sup>Based on GDP in current prices and exchange rates of 1999. — <sup>b</sup>Percentage change over previous year. — <sup>c</sup>Harmonized Index of Consumer Prices (HICP). — <sup>d</sup>Standardized unemployment rates according to OECD. — <sup>e</sup>Partly estimated. — <sup>f</sup>Forecast. Where available the forecast figures are taken from the national institutes' questionnaires. Figures for Portugal and Luxembourg are IfW forecasts (see Kamps and Scheide 2001). — <sup>g</sup>Based on the number of employees in 1999.

Source: Eurostat (2001); OECD (2001); AIECE institutes; own calculations and forecasts.

The wage increase in the euro area will remain moderate in the course of this year and in the coming year, although the institutes expect that real wages will increase faster due to lower inflation. While they will not exceed the increase in productivity, there will be less stimulus for employment from this side. In conjunction with the slowdown in economic activity this will lead to a perceptibly slower employment growth. According to the AIECE institutes' forecasts the unemployment rate will average 8.4 percent this year. In the course of next year, unemployment will decrease only slightly; the unemployment rate will average 8.1 percent in 2002.

## 3.2 Economic Policies

### 3.2.1 Monetary Policy

In the questionnaire we sent out in preparation for this report, we asked whether the AIECE institutes approved the current stance of monetary policy either for their own country or for the euro area as a whole. As was to be expected, there were notable differences between the answers. Quite naturally, for rapidly growing economies the ECB's interest rates were viewed as too low, even if for the euro area they were considered appropriate. The majority of institutes, however, thought that the stance of monetary policy in Europe was too tight, and most also expected rate cuts by the ECB in the near future, ranging from 25 to 100 basis points from the current level (Figure 3.3). A small group thought that the ECB would not loosen its policy.

As far as the countries outside EMU are concerned, there was more or less agreement with the stance of monetary policy in the respective country, one exception being Poland where short-term interest rates are considered too high, amounting to about 10 percent in real terms.

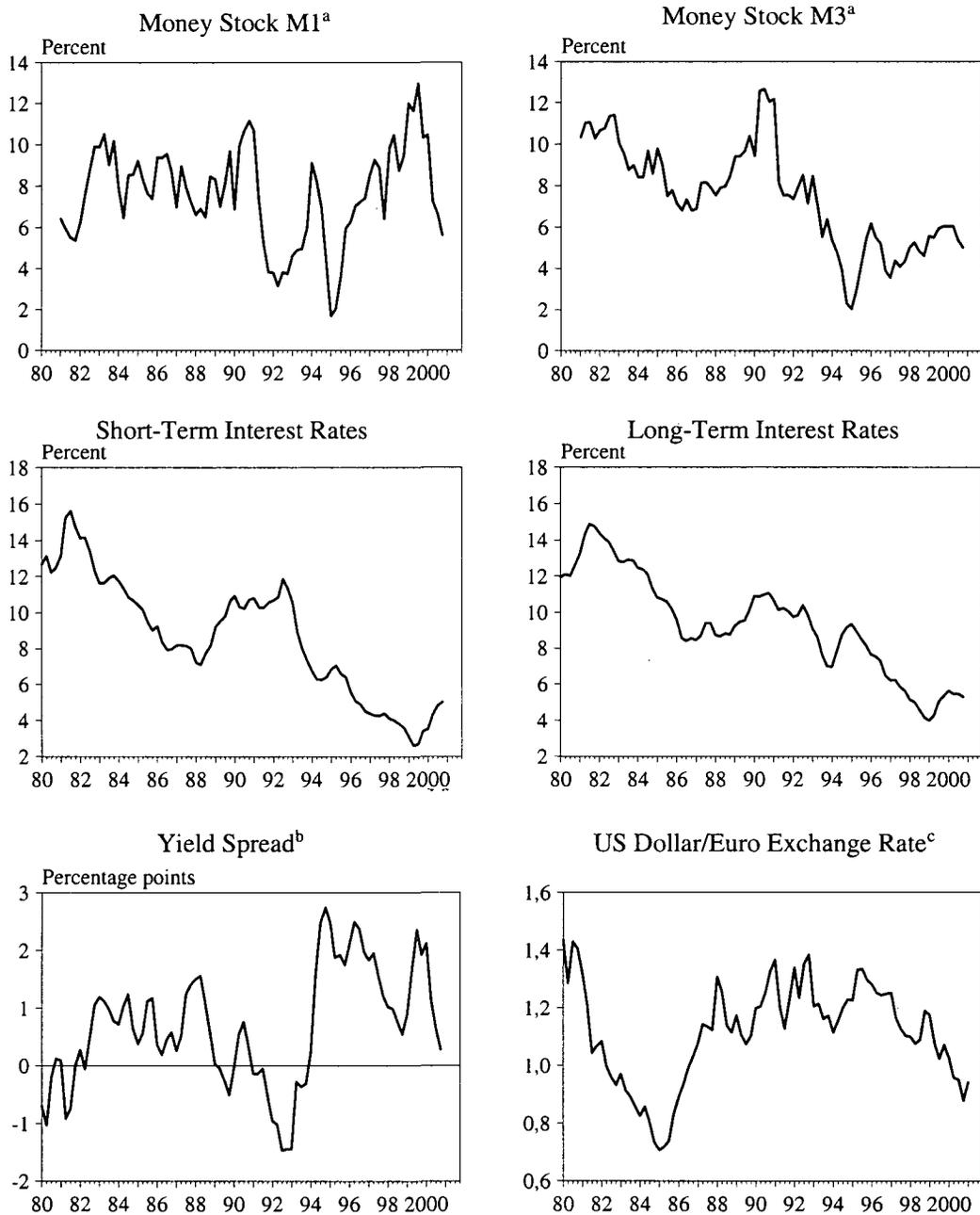
The answers concerning the appropriateness of the monetary policy strategy of the ECB were very mixed. Surprisingly or not, there was a slight majority in favor of the current two-pillar strategy, although some criticisms were made as far as, for example, the communication policy is concerned. Several institutes thought that a change in the strategy may be suitable in the future but should not be considered at this early stage. Many institutes favored a shift in the strategy towards the alternative of inflation targeting, and there were also proposals that the ECB should respond more to cyclical conditions and follow a policy similar to the Taylor rule.

There has always been a controversy about the stance of monetary policy. This has certainly also been true for the policy of the ECB. The main reason is that there is not a unique or well-accepted way to define whether monetary policy is too tight, too loose or just appropriate. This is mainly due to our lack of understanding how the economy works. There are many theoretical models which have a similar success in "explaining" reality. Apart from these possible differences, there has been a broad consensus in the literature that a central bank should keep inflation low and try to smooth fluctuations of economic activity. Also, most macroeconomists agree that central banks should follow a kind of pre-announced rule. This idea has also been more or less accepted by many central banks. However, there is no agreement about the type of rule that should be pursued: What is the appropriate indicator, what are important variables to be included, and should the rule be simple or complex?

While these questions are not solved—and they may never be—, there have been a few proposals which get a lot of attention. Most advocates of rules would certainly not say that their particular rule should be followed strictly and in a mechanistic way. Rules are usually understood as a rough guide, and if followed, they should prevent the central banks from making "big mistakes," i.e., high inflation or deflation should be avoided as well as booms or recessions.

Two such rules will be discussed here (Box 3.1). They define a course for the central banks which is compatible with the targets. For example, according to the Taylor rule there is a money market rate and according to the McCallum rule there is a growth rate for money which are compatible with the target for inflation (McCallum 2000). When calculating respective values, we assume that the ECB's target for the increase of the Harmonized Index of Consumer Prices (HICP) is 1.5 percent; this rate is implied in the reference value that the ECB has derived for M3.

Figure 3.3: Indicators of Monetary Policy in the Euro Area, 1980–2000



<sup>a</sup>Percentage change over previous year. — <sup>b</sup>Long-term interest rate minus short-term interest rate. — <sup>c</sup>Before 1999: exchange rate US dollar/ECU.

Source: ECB (2001).

What does the Taylor rule say about the “appropriate” level of interest rates? Based on the assumption that the output gap, estimated by the OECD, has recently closed, the Taylor interest rate depends only on the current inflation rate and the deviation of inflation from the target (which can be taken as 1.5 percent). According to the Taylor rule, the central bank should raise the real interest rate above the equilibrium level if inflation is above the target. This is the outcome of most macroeconomic models. With an inflation rate of 2.5 percent in the first quarter of this year and an equi-

## Box 3.1: Rules for Gauging the Stance of Monetary Policy

The rules used here vary according to the instrument applied: there is either an interest rate or a monetary aggregate. One can use the rules to analyze the course of monetary policy, that is, to assess whether the current policy is too expansionary or too restrictive with respect to the inflation target.

To determine the interest rate  $i$  according to the Taylor rule, the parameters of reaction have to be determined, i.e., the amount of the change in the interest rate in reaction to a deviation of inflation from its target ( $\pi - \pi^*$ ) or the output gap ( $y^* - y$ ). Commonly, the value of these parameters equals 0.5. Furthermore, one needs an estimate of the equilibrium real interest rate  $r$ , which is by no means trivial (Scheide 1998), as well as an estimate for potential output  $y^*$ , for which there are several methods leading to often quite different results.

The Taylor rule usually has the following form:

$$[1] \quad i = \pi + r + 0.5(\pi - \pi^*) - 0.5(y^* - y).$$

According to this equation, there is an excessively expansionary course of monetary policy if the actual interest rate is lower than the rate given by the Taylor rule, i.e., if the central bank lowers interest rates more than “necessary” in order to stimulate the economy. In this case, there is—given the underlying theory—the risk of an overshooting of the inflation target.

In the McCallum rule, the monetary aggregate  $m$  is used as an instrument where the precise definition of money is left open.<sup>a</sup> According to this rule (monetary targeting) the money growth rate  $\Delta m^*$  in the quarter  $t$  compatible with the inflation target  $\pi^*$  is as follows:

$$[2] \quad \Delta m_t^* = \pi^* - \frac{1}{16}(v_{t-1} - v_{t-17}) + \frac{1}{16}(y_{t-1} - y_{t-17}).$$

This rule, too, can be used as a gauge for the course of monetary policy: For example, if the actual growth rate of money is higher than the rate according to the rule, monetary policy is too expansionary and would lead to higher inflation in the medium term. It comes close to the concept of a potential-orientated policy which was pursued by the Deutsche Bundesbank and which is also the basis of the strategy of the European Central Bank.

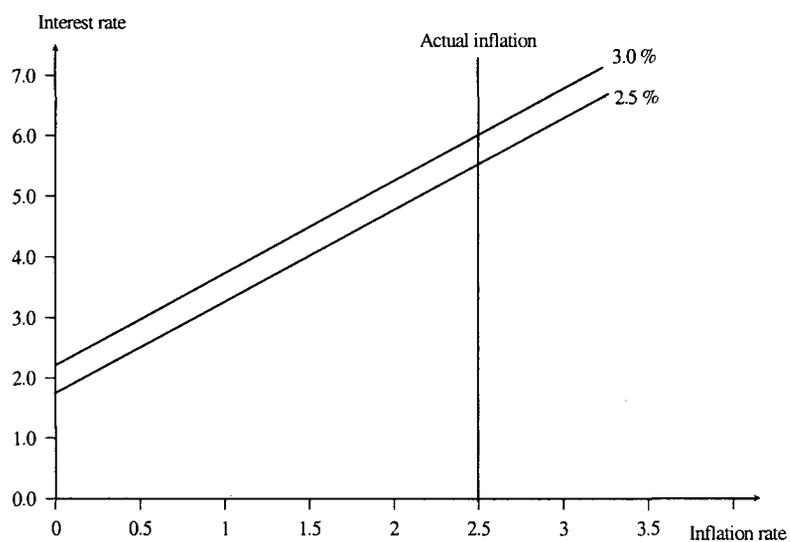
<sup>a</sup>An important requirement is that the monetary aggregate can be controlled with sufficient precision. For the purpose at hand it is important that the aggregate has a close relationship with the target variable.

librium real rate of 3 percent, the nominal interest rate which is compatible with macroeconomic stability amounts to 6 percent; if the real equilibrium rate is assumed to be only 2.5 percent, the rate is also half a percentage point lower (Figure 3.4). Assuming that inflation will decelerate somewhat in the near future, the Taylor interest rate would decline, too, but it would still be above the current nominal rate. The current interest rate could be considered appropriate only if the core rate of inflation, which is slightly lower than 2 percent, is used for the calculation.

If the alternative McCallum rule is considered as a guide, one can conclude that the stance of monetary policy is about correct in terms of the inflation target. This rule implies that M3 can increase by about 5 percent per year which is almost exactly the currently observed rate (Figure 3.5). So this rate is compatible with the ECB’s target of price stability, although the reference value is slightly lower, reflecting a different estimate of trend output and velocity. All in all, the first pillar of the strategy does not call for a loosening of monetary policy.

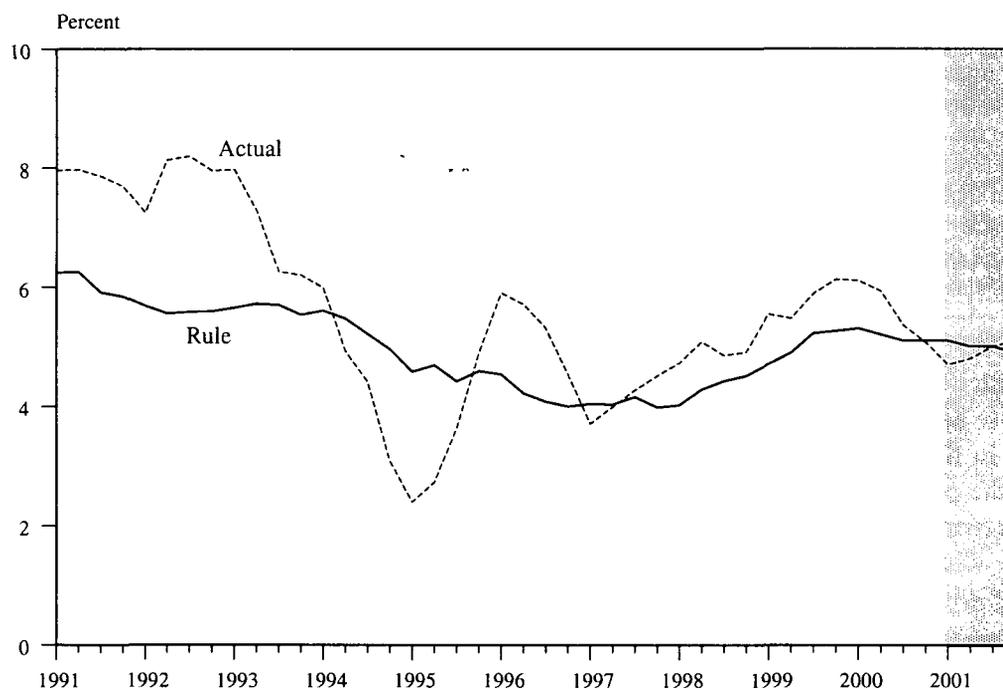
As far as the second pillar is concerned, the ECB published projections for inflation and other key variables in December 2000 (Box 3.2). At that time, the ECB expected real GDP to increase by about 3 percent per year until the end of 2002 if interest rates remained constant. As the ECB still assumes potential output to grow by 2–2.5 percent a year, this forecast implies a cumulated increase of the output gap by 1.5 percent; this would actually call for a rise of key rates for cyclical reasons. In addition, inflation is supposed to remain close to the upper limit of tolerated inflation. Recently, however, the ECB revised its forecast for GDP growth downwards, implying that the output gap will rise only a little until the end of 2002. But as there have recently been several negative surprises regarding inflation, the inflation forecast was not changed much. In short, on the basis of the second pillar, i.e., the projections by the ECB, interest rate cuts are not likely.

Figure 3.4: Interest Rate According to the Taylor Rule and Inflation Rate at Normal Capacity Utilization<sup>a</sup>



<sup>a</sup>Alternative assumptions on the equilibrium real interest rate (3% or 2.5%).

Figure 3.5: Expansion of M3 in Euroland:<sup>a</sup> Actual Values and Values According to the McCallum Rule



<sup>a</sup>Year-over-year increase of M3. Forecast starting in the first quarter of 2001.

Source: ECB (2001); own calculations.

Many AIECE institutes have criticized the ECB's strategy because of the use of M3. They pointed at possible instabilities of money demand and therefore proposed to abandon this orientation. This is certainly in line with the majority of economists as well as central banks. However, the ECB has stressed that the behavior of velocity in the euro area has been (maybe surprisingly?) relatively stable in the past, even after the introduction of the new currency.

Box 3.2: Publication of the Inflation Forecast

The European Central Bank published its inflation forecast for the first time in December 2000; this is a new step as far as communication with the public is concerned. With this the central bank has made the second pillar of its monetary policy strategy more precise, whereas previously the perspectives for inflation were only more or less vaguely described, but not put in concrete numbers. This had quite often led to irritations in the public, because the weights of the different factors affecting inflation was not always clear. Also it appeared that the importance of the various indicators seemed to change.

The projection on the basis of constant interest rates is in line with the procedure of those central banks that pursue a strategy of inflation targeting; among these is, for example, the Bank of England. The idea of the publication is that monetary policy becomes more transparent and is also better controlled by the public. This does not mean, however, that the central bank has to follow such forecasts in a mechanical way when deciding about key interest rates; this is also not true in the framework of inflation targeting. But the central bank is under pressure to explain its behavior if, for example, interest rates are not raised in spite of a forecast overshooting the inflation target. In this way, the publication leads to more discipline of monetary policy, which is desirable in the context of a rule-like policy. With such an instrument credibility may be enhanced, so that the risk premium and thus the real interest rate can decline. The publication of forecasts may also be helpful for those central banks that had allowed too much inflation in the past (which is true for most of the central banks now pursuing the strategy of inflation targeting and which was also the explicit reason for the shift to the new strategy), and also for a “young” central bank like the ECB which may not yet have the reputation it would like to have.

Whether this new instrument of the ECB will have the desired consequences remains to be seen when monetary policy decisions are made. At present, it is not quite clear what the role of the inflation forecast for interest rate policy is, i.e., if and how much the ECB will refer to these forecasts. So far the ECB has tried to play down the importance of the projections somewhat by stressing that these are the only pieces of information monetary policy will use. However, such a procedure of playing down does not seem appropriate, because the projections are nothing less but the second pillar of the monetary policy strategy. Every policy decision in the future will therefore have to refer to the projections, and the ECB will have to explain how the level of interest rates will help to achieve the inflation target. It may be useful for the ECB to avoid the impression that it is locked in for too long as a consequence of its published projection or that it will have to provide more explanations if it does not act according to the projection. As the forecasts may have to be revised quite quickly because conditions — as the present situation shows — may change rapidly, it would be desirable if the forecasts were published four times a year instead of only twice a year as it is planned now.

That said, it seems a little peculiar that the ECB assigns a prominent role to money growth, but it does not use M3 to, for example, forecast inflation. One way to do that would be the so-called P-star approach. In this model, inflation over time is explained by a liquidity overhang — defined in the model as the price gap<sup>4</sup> — and by cost factors. This approach implies that in the long run, the price level is determined by the level of the money stock alone, whereas in the short run, there is no immediate adjustment of prices to changes in money. The attractive feature of this model is that it is compatible with almost all macroeconomic theories: On the one hand, there is the assumption of a certain rigidity of prices, on the other hand, the long-run neutrality of money holds.

Estimating a P-star model only makes sense if both the trend of output and the trend of velocity can be estimated with some confidence. This seems to be the case for the euro area, as there is not much of a difference as far as potential output is concerned; and the velocity of money has behaved in a remarkably stable way in recent years as it followed closely the trend observed in the 1990s. The estimated model can explain the behavior of inflation in the past 20 years quite well (Box 3.3). This includes also the recent pickup of inflation which was in part due to the rise of the oil price and the fall

<sup>4</sup> The price gap is the difference between the equilibrium price level, which is determined by the money stock, and the actual price level. A positive price gap leads (*ceteris paribus*) to an acceleration of inflation.

## Box 3.3: A P-Star Model for Euroland

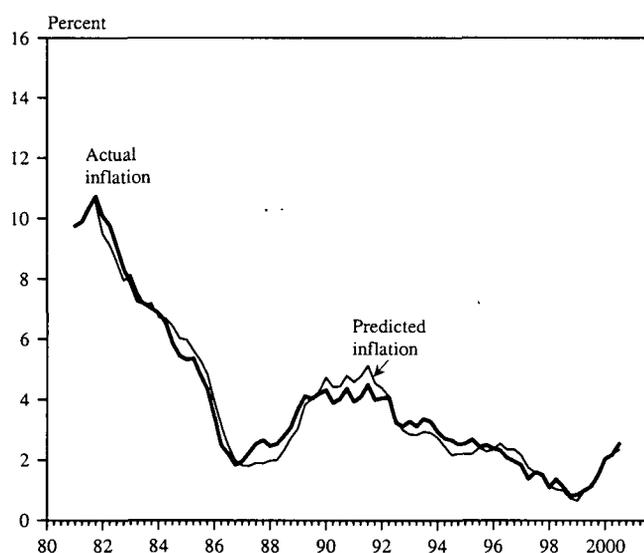
The quarterly inflation rate ( $\Delta p$ ) — defined as the current change in the HICP — is influenced by a number of factors. Apart from the lagged endogenous variable the estimate is based on the price gap ( $pgap$ ) and the quarterly rates of change in the oil price ( $petrolp$ ), other raw material prices ( $rawp$ ), unit labor costs ( $ulc$ ) and the effective exchange rate of the euro ( $exch$ ):<sup>a</sup>

$$[1] \quad \Delta p_t = 0.0014 + 0.54 \Delta p_{t-3} + 0.19 \Delta p_{t-5} + 0.18 pgap_{t-1} + 0.0043 \Delta petrolp_{t-1} + 0.016 \Delta rawp_{t-4} + 0.009 \Delta rawp_{t-6} \\ + 0.10 \Delta ulc_{t-1} - 0.031 \Delta exch_{t-1} - 0.026 D_{92:3-94:3}$$

(4.37) (8.14) (2.92) (5.85) (3.47) (4.19) (2.31)  
(2.59) (4.9) (-4.0)

The price gap which is determined by the trend of velocity, the growth rate of potential output and by the money stock, has a relatively large impact on the inflation rate in the following period: If M3 increases by 1 percent, the rate of inflation rises (*ceteris paribus*) by 0.2 percentage points. While the other variables only have a transitory impact on inflation — just as the quantity theory suggests —, a permanent change in the money stock leads to a permanent change in the price level; in other words: the neutrality of money holds according to the equation. A dynamic simulation shows that the movements of inflation can be described quite well by the equation (see Figure below).

Figure: Dynamic-in-Sample Forecast of Inflation, 1981.4–2000.3



<sup>a</sup>See Scheide and Trabandt (2000) for a detailed description.

of the euro. But it was also important that money growth accelerated in 1999 and 2000, which implied that the price gap became positive.

For the forecast of inflation it is important that the price gap has closed in the meantime: First of all, the price level rose considerably, and second, money growth has slowed down recently. The other factors (excluding unit labor costs) work in the direction of a slowdown of inflation in the future, too.

### 3.2.2 Fiscal Policy

The combined budget of euro area countries showed a surplus in 2000 for the first time since the 1960s; in relation to GDP it amounted to 0.3 percent after a deficit of 1.2 percent the year before (Table 3.2). The debt-to-GDP ratio fell to 68.5 percent last year and thus came closer to the reference

Table 3.2: Indicators of Fiscal Positions in the Euro Area, 1999–2002

|             | Gross public sector debt <sup>a</sup> |       |                   |                   | General government budget balance <sup>a</sup> |      |                   |                   |
|-------------|---------------------------------------|-------|-------------------|-------------------|------------------------------------------------|------|-------------------|-------------------|
|             | 1999                                  | 2000  | 2001 <sup>b</sup> | 2002 <sup>b</sup> | 1999                                           | 2000 | 2001 <sup>b</sup> | 2002 <sup>b</sup> |
| Germany     | 61.1                                  | 60.2  | 58.7              | 58.4              | -1.4                                           | 1.3  | -1.7              | -1.2              |
| France      | 58.7                                  | 58.0  | 57.0              | 55.6              | -1.6                                           | -1.3 | -1.0              | -0.7              |
| Italy       | 114.5                                 | 110.2 | 107.0             | 105.0             | -1.8                                           | -0.3 | -1.4              | -1.3              |
| Spain       | 63.4                                  | 60.6  | 57.7              | 55.5              | -1.2                                           | -0.3 | 0.0               | 0.3               |
| Netherlands | 63.2                                  | 56.3  | 51.8              | 48.1              | 1.0                                            | 2.0  | 1.1               | 1.5               |
| Belgium     | 116.4                                 | 110.9 | 107.0             | 101.7             | -0.7                                           | 0.0  | 0.5               | 0.6               |
| Austria     | 64.7                                  | 62.8  | 61.5              | 59.7              | -2.1                                           | -1.1 | -0.4              | 0.0               |
| Finland     | 46.9                                  | 44.0  | 40.4              | 38.1              | 1.8                                            | 6.7  | 6.2               | 5.6               |
| Greece      | 104.6                                 | 103.9 | 100.2             | 97.2              | -1.8                                           | -0.9 | 0.2               | 1.0               |
| Portugal    | 55.0                                  | 53.8  | 52.5              | 51.0              | -2.0                                           | -1.4 | -1.0              | -0.8              |
| Ireland     | 50.1                                  | 39.1  | 32.3              | 24.5              | 2.1                                            | 4.5  | 4.4               | 3.7               |
| Luxembourg  | 6.0                                   | 5.3   | 5.0               | 5.0               | 4.7                                            | 5.3  | 3.5               | 3.0               |
| Euro area   | 72.0                                  | 69.7  | 68.0              | 66.4              | -1.2                                           | 0.3  | -0.8              | -0.5              |

<sup>a</sup>In percent of nominal GDP. — <sup>b</sup>Forecast. Where available the forecast figures are taken from the AIECE institutes' questionnaires. Figures for Portugal and Luxembourg are IFW forecasts (see Kamps and Scheide 2001).

Source: Eurostat (2001); AIECE institutes; own calculations and forecasts.

value laid down in the Maastricht Treaty. However, the increase in the budget balance suggests a size of consolidation that was not really achieved. The improvement in public finances is above all due to one-off revenues. Some countries obtained receipts from the allocation of mobile phone licenses (UMTS), which amount to around 1 percent of GDP for the euro area as a whole. Moreover, the high speed of economic expansion brought about that additional tax revenues were pouring in and that expenditures related to unemployment could be reduced. If one corrects the budget balance for these effects, it can be shown that not all governments in the euro area continued their consolidation efforts last year.

As the concerned governments have not yet planned any consolidation measures it is to be expected that the euro area as a whole will once more record a considerable budget deficit this year and next year in spite of a continued increase in production. On the one hand, the receipts from the allocation of mobile phone licenses will be considerably lower this year and vanish in 2002. On the other hand, the budget position in the euro area deteriorates because several countries have — in some cases substantially — cut direct taxes at the beginning of this year. The institutes estimate that the tax cuts amount to around 1 percent in relation to GDP. This is not compensated by equivalent expenditure reductions or extra revenue due to economic trends. All in all, the consolidated budget of the euro area will exhibit a deficit of 0.8 percent in relation to GDP this year. In 2002 it will amount to 0.5 percent according to the AIECE institutes' projections.

In the year 2000, the majority of countries still did not meet the provisions of the Stability and Growth Pact. The Pact demands that euro area countries exhibit a balanced budget on average over the business cycle. Germany, France, Italy, Austria and Portugal will still be away from this target at the end of the forecast horizon. While the two last-mentioned countries will gradually reduce the deficit, the three largest economies of the euro area have cut taxes considerably without corresponding expenditure reductions. Admittedly, tax cuts are welcome under efficiency considerations in those countries with a high tax burden. But they should be accompanied by expenditure restraint in order not to endanger the medium-term goal of a balanced budget.

In their updated stability programs, governments in Germany, France and Italy seem to mainly rely on higher trend growth than in the past and expect that this will be sufficient to eliminate budget deficits (Table 3.3). The growth assumption is particularly optimistic in the case of Italy. The GDP

Table 3.3: Key Figures of the Stability Programs<sup>a</sup>

|                            | GDP growth <sup>b</sup> |           | General government budget balance <sup>c</sup> |      | Gross public debt <sup>c</sup> |      | Expenditure <sup>c,d</sup> |      | Receipts <sup>c,d</sup> |      |
|----------------------------|-------------------------|-----------|------------------------------------------------|------|--------------------------------|------|----------------------------|------|-------------------------|------|
|                            | 1996–2000               | 2000–2004 | 2000 <sup>e</sup>                              | 2004 | 2000 <sup>e</sup>              | 2004 | 2000 <sup>e</sup>          | 2004 | 2000 <sup>e</sup>       | 2004 |
| Germany                    | 2.0                     | 2.5       | -1.0                                           | 0.0  | 60.0                           | 54.5 | 48.0                       | 44.0 | 47.0                    | 44.0 |
| France                     | 2.8                     | 3.0       | -1.4                                           | 0.2  | 58.4                           | 52.9 | 53.0                       | 49.8 | 51.6                    | 50.0 |
| Italy                      | 1.9                     | 3.1       | -1.3                                           | 0.3  | 112.1                          | 94.9 | 48.1                       | 44.3 | 46.8                    | 44.7 |
| Spain                      | 4.1                     | 3.2       | -0.3                                           | 0.3  | 61.1                           | 49.6 | 40.7                       | 40.0 | 40.4                    | 40.3 |
| Netherlands <sup>f,g</sup> | 4.1                     | 2.0       | 1.0                                            | 0.6  | 56.6                           | 46.7 | 38.6                       | 36.4 | 39.4                    | 36.8 |
| Belgium                    | 3.1                     | 2.5       | -0.1                                           | 0.6  | 110.6                          | 92.9 | 49.7                       | .    | 49.6                    | .    |
| Austria                    | 2.5                     | 2.5       | -1.4                                           | 0.0  | 63.1                           | 55.3 | 51.8                       | 49.4 | 50.4                    | 49.4 |
| Finland                    | 5.3                     | 3.6       | 4.5                                            | 4.9  | 42.4                           | 32.2 | 44.7                       | 41.2 | 49.5                    | 46.3 |
| Greece                     | 3.5                     | 5.3       | -0.8                                           | 2.0  | 103.9                          | 84.0 | 46.4                       | 42.2 | 45.6                    | 44.2 |
| Portugal                   | 3.4                     | 3.2       | -1.5                                           | 0.0  | 55.6                           | 48.1 | 46.8                       | 46.0 | 45.3                    | 46.0 |
| Ireland <sup>f</sup>       | 10.0                    | 6.9       | 4.7                                            | 4.6  | 52.0                           | 36.0 | 31.0                       | 28.4 | 35.7                    | 33.8 |
| Luxembourg                 | 7.0                     | 5.5       | 3.0                                            | 2.5  | .                              | .    | 41.1                       | 38.8 | 44.1                    | 41.2 |
| Euro area <sup>h</sup>     | 2.8                     | 2.9       | -0.7                                           | 0.6  | 71.0                           | 61.6 | 47.7                       | 44.2 | 46.9                    | 44.8 |

<sup>a</sup>Some Stability Programs include alternative scenarios concerning GDP growth. This table reflects the basic scenario. —  
<sup>b</sup>Average annual growth rate. — <sup>c</sup>In percent of GDP. — <sup>d</sup>Based on figures from the Stability Programs, partly corrected for differences in definitions. — <sup>e</sup>Figures for 2000 are taken from the Stability Programs. Receipts from the allocation of UMTS licenses are not included. — <sup>f</sup>Projection until 2003 only. — <sup>g</sup>Central government. — <sup>h</sup>Average for the countries mentioned.

Source: OECD (2000b); Stability Programs; own calculations.

growth rate of 3.1 percent assumed for the years 2001–2004 has not been reached, let alone exceeded in a single year since the late 1980s. Government projections also seem to be too optimistic in the case of Germany and France. The institutes in these countries almost unanimously hold the view that governments will not be able to meet the deficit targets laid down in their latest stability programs against the background of a slowing economy.

Yet, there is considerable disagreement between the AIECE institutes on whether the Stability and Growth Pact is reasonable. While some critics argue that the Pact restrains the stabilization properties of fiscal policy, other observers praise that it is more flexible than the Maastricht deficit criterion. In fact, the Stability and Growth Pact — by being oriented towards the medium run — refers to the structural budget balance whereas the Maastricht Treaty aimed at the headline deficit. The Pact does not prevent the automatic stabilizers from unfolding their effects and by asking for a large safety margin with respect to the 3-percent-ceiling, it also gives some room for countercyclical action in the case of a severe downturn.

Another controversial point concerns the financing of government capital formation. Some institutes feel that the Pact should allow for deficit finance of public investment, as the benefits of the latter accrue not only to current but also to future generations. Others, however, argue that tax finance of public investment is still preferable, because it leads to a smaller reduction in private savings and thereby entails larger overall capital accumulation. One thing is for sure: The Stability and Growth Pact does not imply that government investment has to be curtailed in order to achieve the target of a balanced budget in the medium run. Rather the Stability and Growth Pact as well as the Broad Economic Policy Guidelines of the European Union intend that the expenditure structure in the member countries should be adjusted in favor of public investment.

In addition, some institutes point to the fiscal burden that will arise from population aging in the coming decades. According to their view the budgetary target of the Stability and Growth Pact should be even more ambitious, at least in the next twenty years. Their argument goes as follows: If it were

not possible for political reasons to move from a pay-as-you-go system to a system of privatized funded pensions, governments should build up assets by running large budget surpluses in the immediate future as a substitute for private prefunding.

The AIECE institutes were also asked to comment on the need for further fiscal coordination in the European Union. Two fields can be identified: First, most of the institutes agree that, as regards the coordination of macroeconomic stabilization policy, there should be no efforts going beyond deficit ceilings in order to avoid negative spillover effects from massive debt accumulation. As noted above, however, some controversy exists on whether deficit provisions should aim at a balanced budget or a deficit-to-GDP ratio equal to the output share of public investment. The majority of institutes argue that fiscal policy as a stabilization instrument should remain in national responsibility in order to counteract idiosyncratic shocks. Second, the institutes commented on the need for coordination concerning tax policy. As could be expected, the views differ most on this subject. While some institutes argue for harmonization as regards capital income and corporate taxation as well as sales taxes in order to “level the playing field” and in order to avoid a “race to the bottom,” others hold the view that tax competition is a useful device for the reduction of high fiscal burdens in most European countries in order to improve the resource allocation.

### *3.2.3 Wage Policies*

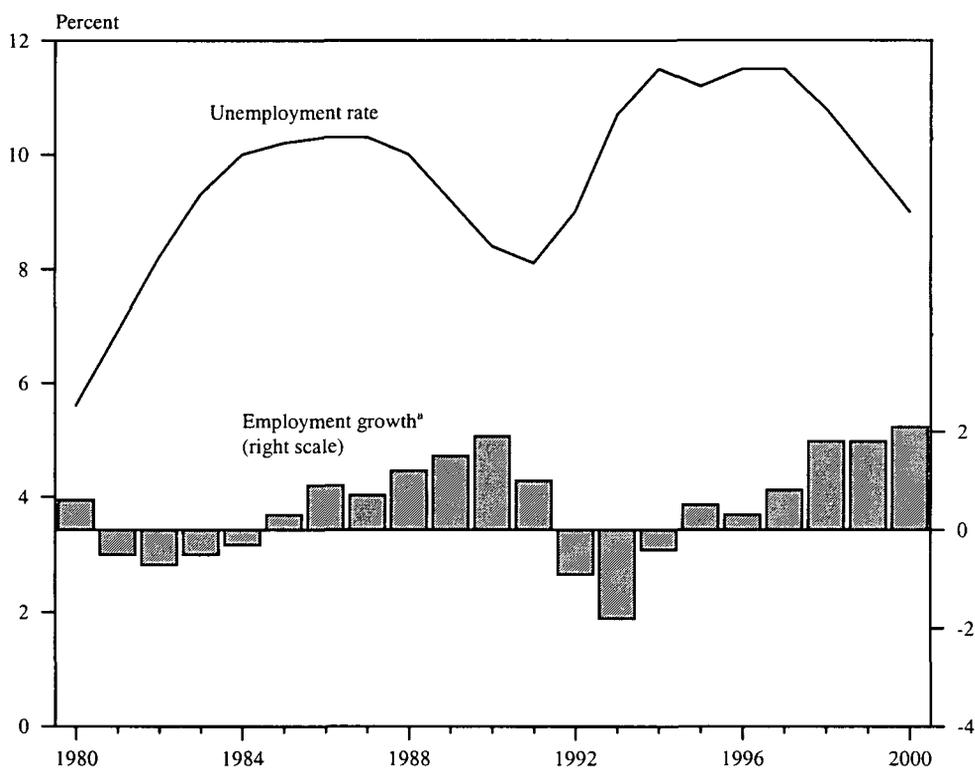
The labor market situation in the euro area improved significantly in 2000, with unemployment falling by nearly 1 percentage point to below 9 percent, down from 11.6 percent in 1997. The major factor behind this was employment which continued to expand briskly in 2000. The number of employees increased by 2 percent which is the highest rate of employment growth in more than 20 years (Figure 3.6). The high growth rate came on top of two already exceptionally strong years with increases of 1.8 percent in both 1998 and 1999. This strong development cannot be fully explained by the development of output.

One reason often cited as being a cause of the marked improvement on the labor market is labor market reforms carried out over recent years. In all countries of the euro area except Ireland labor market reforms of some significance have been carried out according to the judgement of the AIECE institutes, and also in most other European countries (Table 3.4). These reforms consisted of measures that reduced the reservation wage, improved incentives to work and increased the flexibility of the labor market, for example by increasing the possibilities of fixed-term work contracts or part-time work. In many countries there was also an increase in active labor market policies such as labor procurement programs or wage subsidies targeted at problem groups. While there is no clear correlation between the significance of labor market reforms as perceived by the institutes and the performance of the labor market across countries, most institutes report that the reforms had a positive impact on employment, partly through a dampening impact on wage growth.

Wage growth in the euro area has been moderate for a number of years. A noticeable wage restraint in the recent past has been diagnosed by the institutes for all euro area countries, except the Netherlands, and a number of other European countries (Table 3.5). While again the correlation between the degree of wage restraint and the reduction of unemployment is weak, most institutes see wage moderation as one major factor behind the sustained upturn in the labor market.

The final years of the nineties had been characterized by falling inflation which supported real income growth. By contrast, the last year saw a negative surprise in consumer price inflation. Wages have until now hardly reacted to the disappointing real wage growth, partly because wage contracts negotiated under the assumption of less inflation are still in effect. But the AIECE institutes generally do not expect significantly stronger wage growth in this year's wage round and in 2002. According to the institutes there is still no evidence in any country that the negative surprise in consumer price inflation will be translated into higher labor costs; there are no serious attempts reported to shift the

Figure 3.6: Labor Market Developments in the Euro Area, 1980–2000



<sup>a</sup>Percentage change over previous year.

Table 3.4: Countries According to Significance of Labor Market Reforms<sup>a</sup>

| Significant                                                                                         | Moderate                                                                                     | Negligible             |
|-----------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------|------------------------|
| Belgium<br>Denmark<br>France<br>Germany<br>Hungary<br>Italy<br>Poland<br>Slovenia<br>United Kingdom | Belgium<br>Czech Republic<br>Finland<br>Germany<br>Greece<br>Netherlands<br>Norway<br>Sweden | Ireland<br>Switzerland |

<sup>a</sup>As judged by the respective country's AIECE institutes.

Table 3.5: Countries According to Degree of Wage Restraint<sup>a</sup>

| Significant                                                            | Moderate                                                                                                                            | Negligible                                                                                   |
|------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------|
| Belgium<br>Denmark<br>Finland<br>France<br>Germany<br>Hungary<br>Italy | Austria<br>Belgium<br>Czech Republic (public sector)<br>France<br>Germany<br>Greece<br>Ireland<br>Italy<br>Poland<br>United Kingdom | Czech Republic (private sector)<br>Italy<br>Netherlands<br>Norway<br>Slovenia<br>Switzerland |

<sup>a</sup>As judged by the respective country's AIECE institutes.

burden of higher oil prices and more recently other negative supply shocks from the consumer to the producer. This represents a major change from wage-setting behavior in earlier decades and improves the outlook for growth and inflation. One factor supporting the continuation of wage moderation is fiscal policy which is increasing the disposable incomes by reducing taxes, but the structural reforms of the labor market might also be part of the explanation.

### 3.3 Other EU Countries

Economic activity is also expected to slow down in EU countries outside the euro area. In the *United Kingdom*, GDP growth is forecast to fall only moderately to 2.4 percent from 3 percent last year. A considerable loosening of fiscal and monetary policy helps to cushion the dampening effects stemming from the foot-and-mouth disease and the relatively large exposure to the cooling down in the United States. In *Denmark*, output expansion is expected to lose considerable momentum. Last year the Danish economy grew by 3 percent, mainly driven by buoyant gross fixed capital formation and a strong export performance. This year, output is projected by the DEC to increase by a mere 1–1 ½ percent, owing above all to stagnating private investment. The *Swedish* economy is expected to slow down from 3.6 percent to around 2 ½ percent this year, mainly due to weaker export growth and less vigorous private consumption. Sweden ranks among the countries for which the wealth effect stemming from the equity boom was estimated to be the largest. Thus, it is expected that the decline in the personal saving rate observed in recent years will be reversed in light of the marked decline in stock valuations.

Next year, economic activity is expected to pick up in Western Europe outside the euro area. The acceleration of growth will be sustained by the recovery of the world economy and the lagged effects of monetary loosening. As output expansion in these countries will be roughly the same on average as in the euro area, the European Union as a whole will record a growth rate of 2.6 percent in 2002. This growth rate is in line with potential output growth as estimated by most international organizations.

### 3.4 Central and Eastern Europe

In the year 2000, the Central and Eastern European accession countries recorded the highest rise in production since the beginning of the transformation process, with GDP growth of around 4 percent for this country group.<sup>5</sup> Growth is expected to remain robust in these countries this year and next year against the background of the relatively mild slowdown in Western Europe and the projected recovery of the world economy.

However, external shocks constitute the main risk to economic growth in Central and Eastern Europe. There appears to be little room for stimulating economic policies in the case of a larger downturn in the world economy and especially in Western Europe. Inflation rates remain at or near double-digit levels in many countries so that the priority of monetary policy continues to be to restrain inflation in order to proceed on the convergence process towards EU levels. So far, European institutions have insisted that the accession candidates will have to fulfill all Maastricht criteria before entrance into the euro area. Some observers have objected that the inflation criterion should not be applied to the Central and Eastern European countries. The AIECE institutes are divided on this question. Some institutes argue that the accession candidates will have to wait until full inflation convergence is achieved in order to facilitate the ECB task of maintaining price stability in the euro area, while other institutes hold the view that the candidates should be allowed early entry and the target inflation rate of the ECB should be adjusted accordingly. Both groups agree, however, that

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<sup>5</sup> The group consists of ten countries, including Poland, Czech Republic, Romania, Hungary, Slovak Republic, Bulgaria, Slovenia, Lithuania, Latvia and Estonia.

inflation rates in accession countries will be higher than in the euro area for a prolonged period of time for structural reasons. Thus, it would not be sensible for these countries to conduct an overly tight monetary policy in order to reach a low inflation rate in the short to medium run. An artificially low inflation rate could not be sustained after entry into the euro area as the common monetary policy would imply a significant loosening of monetary conditions. As a result, inflation would rapidly increase and remain far above the target level of the ECB.

Current account deficits of between 4 ½ percent of GDP in the Czech Republic to around 5 ½ percent of GDP in Poland are often mentioned as another potential risk for the economic development in Central and Eastern European countries. However, the vast majority of AIECE institutes do not consider the external positions to be especially vulnerable in the near future. In the past years the current account deficits in these countries were almost exclusively financed by long-term foreign direct investment. This trend is likely to continue in the coming years. Thus, a crisis like the one in South East Asia in 1997 triggered by massive outflows of short-term capital is improbable in Central and Eastern Europe.

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## Appendix: Forecast Tables and Country Notes by AIECE Institutes

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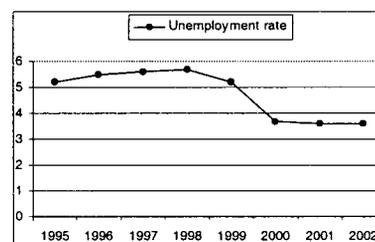
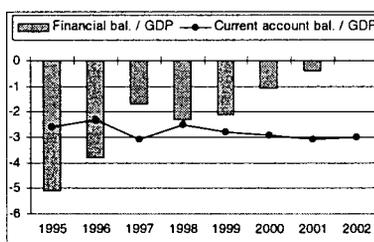
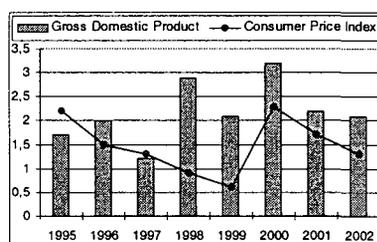
Institute: WIFO

Date of forecast: March 2001

|                                              | LEVEL      | Volumes, average growth |       |       |
|----------------------------------------------|------------|-------------------------|-------|-------|
|                                              | 2000       | 2000                    | 2001  | 2002  |
|                                              | euro bill. | %                       |       |       |
| GDP                                          | 205.9      | 3.2                     | 2.2   | 2.1   |
| Private consumption                          | 116.7      | 2.7                     | 2     | 2     |
| Public consumption                           | 40.7       | 2.3                     | 1.5   | 1.5   |
| Gross fixed capital formation                | 48.7       | 3.1                     | 2.5   | 2.1   |
| of which:                                    |            |                         |       |       |
| Equipment                                    | 20.1       |                         |       |       |
| Construction                                 | 25.1       |                         |       |       |
| Change in stocks (contrib. to growth) (*)    |            | 0.4                     | 0.4   | 0.4   |
| Total domestic demand                        | 208.5      | 2.9                     | 1.9   | 1.9   |
| Exports of goods and services                | 100.8      | 9.8                     | 5.4   | 4.3   |
| Imports of goods and services                | 103        | 9.2                     | 4.7   | 4     |
| GDP deflator                                 |            | 1.2                     | 1.6   | 1.5   |
| Consumer prices (consumer price index)       |            | 2.3                     | 1.7   | 1.3   |
| Hourly wages                                 |            |                         |       |       |
| Employment (1,000 persons)                   | 3,064.5    | 1                       | 0.6   | 0.5   |
| Unemployment rate (%)                        |            | 3.7                     | 3.6   | 3.6   |
| Saving rate, households (%)                  |            |                         |       |       |
| Public sector financial bal. (% of GDP) (**) |            | -1.1                    | -0.4  | 0     |
| Gross public debt (% of GDP) (**)            |            | 62.9                    | 61.5  | 59.7  |
| Current account balance (% of GDP)           |            | -2.9                    | -3.1  | -3    |
| Short-term interest rate (3 m.) (%)          |            | 4.4                     | 4.6   | 4     |
| Long-term interest rate (10 yr.) (%)         |            | 5.6                     | 4.7   | 4.7   |
| United States Federal Funds Rate (%)         |            |                         |       |       |
| GDP United States                            |            | 5                       | 1     | 2     |
| GDP Japan                                    |            | 1.7                     | 0     | 1     |
| GDP European Union                           |            | 3.3                     | 2.3   | 1.8   |
| World trade volume (goods)                   |            | 13                      | 4.5   | 5.5   |
| Oil price (US\$/b Brent) (***)               |            | 28                      | 24    | 25    |
| Exchange rate, 1 euro = \$                   |            | 0.92                    | 1     | 1.05  |
| Exchange rate, 1 euro = natl. currency       |            | 13.76                   | 13.76 | 13.76 |

(\*) In % of GDP of previous period. — (\*\*) EMU definition. — (\*\*\*) Average import price for OECD countries.

### AUSTRIAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

### COMMENT: WIFO

After a growth rate of 3.2% in 2000, spurred by vivid foreign demand, the weaker international performance (especially in the US) and a continued fiscal tightness will allow Austria's economy to

expand only moderately. We expect a growth of 2.2% this year and 2.1% next year. For the US we expect 1% in 2001 and 2% in 2002 and for the EU 2.4% and 1.8%, respectively. Whereas real exports expanded by around 11% in 2000, the weaker external development combined with an appreciation of the euro in 2001 as well as 2002 will only allow an export growth of 6% this year and 5% next year. Due to the above-mentioned fiscal stance, the use of government consumption expenditures will in both years be lower than 1%. In Austria, a large part of non-residential investment is done by the industrial sector which itself is very strongly linked to export performance. So also this category of investment products is projected to develop below the average of the last years. Investment in construction will suffer from weak public demand and too affluent stocks of residential objects. Private consumption growth will be lower due to tax hikes which reduce private disposable income.

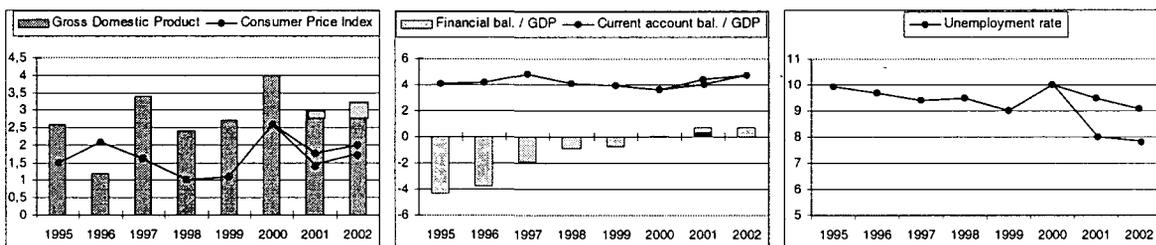
Due to the weaker overall performance, employment will rise only modestly and the unemployment rate will remain nearly unchanged. After rising inflation in 2000 we expect a decline to 1.7% in 2001 and 1.3% in 2002, respectively.

Country: **Belgium**

|                                        | LEVEL      | Volumes, average growth (%) |         |         |         |         |          |         |         |         |
|----------------------------------------|------------|-----------------------------|---------|---------|---------|---------|----------|---------|---------|---------|
|                                        | euro bill. | 2000                        | 2001    |         |         |         | 2002     |         |         |         |
|                                        |            |                             | DULBEA  | BUREAU  | IRES    | avg     | DULBEA   | BUREAU  | IRES    | avg     |
|                                        |            |                             |         | DU PLAN |         |         |          | DU PLAN |         |         |
| GDP                                    | 247        | 4                           | 3       | 2.8     | 2.9     | 2.9     | 2.75     | 2.9     | 3.2     | 3       |
| Private consumption                    | 132.3      | 2.9                         | 2.75    | 2.6     | 2.7     | 2.7     | 2.5      | 2.6     |         | 2.6     |
| Public consumption                     | 52.2       | 2                           | 1.5     | 1.6     | 1.4     | 1.5     | 1.25     | 1.3     |         | 1.3     |
| Gross fixed capital formation          | 52.35      | 4.2                         | 3.75    | 3.4     | 4.8     | 4       | 3.75     | 3.4     |         | 3.6     |
| of which:                              |            |                             |         |         |         |         |          |         |         |         |
| Equipment                              |            |                             |         |         |         |         |          |         |         |         |
| Construction                           |            |                             |         |         |         |         |          |         |         |         |
| Change in stocks (contrib. to growth)  | -8.65      | 0.1                         | 0       | 0       | 0.1     | 0       | 0        | 0       |         | 0       |
| Total domestic demand                  | 238        | 3.1                         | 2.5     | 2.5     | 2.6     | 2.5     | 2.25     | 2.6     |         | 2.4     |
| Exports of goods and services          | 214.5      | 10.7                        | 8       | 5.5     | 5.5     | 6.3     | 8.5      | 6.5     |         | 7.5     |
| Imports of goods and services          | 205.5      | 9.9                         | 7       | 5.3     | 5.3     | 5.9     | 7        | 6.4     |         | 6.7     |
| GDP deflator                           |            | 1.9                         | 2       | 2.3     | 1.5     | 1.9     | 1.75     | 2.1     |         | 1.9     |
| Consumer prices (consumer price index) |            | 2.6                         | 1.75    | 1.5     | 1.5     | 1.6     | 2        | 1.7     |         | 1.9     |
| Hourly wages                           |            | 3.3                         |         | 4       | 3.2     | 3.6     |          | 3.5     |         | 3.5     |
| Employment (1.000 persons)             | 3,914.3    | 1.7                         |         | 1.2     | 1.3     | 1.3     |          | 0.9     |         | 0.9     |
| Unemployment rate (%)                  |            | 10                          | 8(**)   | 9.5     | 9.3     | 9       | 7.75(**) | 9.1     |         | 8.4     |
| Saving rate, households (%)            |            | 15.7                        | 16.25   | 16.4    | 16.8    | 16.5    | 16.25    | 16.7    |         | 16.5    |
| Public sector deficit (% of GDP) (*)   |            | 0.1                         | 0.5     | 0.7     | 0.3     | 0.5     | 0.5      | 0.7     |         | 0.6     |
| Gross public debt (% of GDP) (*)       |            | 111.75                      |         | 107     |         | 107     |          | 101.7   |         | 101.7   |
| Current account balance (% of GDP)     |            | 3.6                         |         | 4.4     | 4       | 4.2     |          | 4.7     |         | 4.7     |
| Short-term interest rate (3 m.) (%)    |            | 4.35                        | 4.5     | 4.3     | 4.6     | 4.5     | 4.5      | 4.5     |         | 4.5     |
| Long-term interest rate (10 yr.) (%)   |            | 5.6                         | 4.75    | 5       | 4.81    | 4.9     | 4.75     | 5.2     |         | 5       |
| United States Federal Funds Rate (%)   |            | 6.5                         |         |         | 4.5     | 4.5     |          |         |         |         |
| GDP United States                      |            | 5                           | 2       |         | 1.6     | 1.8     | 3        |         |         | 3       |
| GDP Japan                              |            | 1.7                         |         |         | 1.3     | 1.3     |          |         |         |         |
| GDP European Union                     |            | 3.4                         | 3       |         | 2.7     | 2.9     | 3        |         |         | 3       |
| World trade volume (goods)             |            | 11.5                        | 6.5     | 6.2     | 6.3     | 6.3     | 7.5      | 7.2     |         | 7.4     |
| Oil price (US\$/b Brent)               |            | 28.6                        | 25      | 25      | 25      | 25      | 25       | 25.7    |         | 25.4    |
| Exchange rate, 1 euro = \$             |            | 0.92                        | 0.94    | 0.941   | 0.93    | 0.9     | 0.96     | 0.945   |         | 0.95    |
| Exchange rate, 1 euro = natl. currency |            | 40.3399                     | 40.3399 | 40.3399 | 40.3399 | 40.3399 | 40.3399  | 40.3399 | 40.3399 | 40.3399 |

(\*) EMU definition. — (\*\*) Eurostat definition.

### BELGIAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institutes; if forecasts differ, their maximum range is shown.

Source: OECD (2001); AIECE institutes.

#### COMMENTS: DULBEA (April 2001)

Après une croissance du PIB de 4 % en 2000, on s'attend à une décélération à 3 % en 2001, principalement à cause des exportations nettes, et à 2.75 % en 2002.

En effet, on s'attend à un ralentissement des exportations après la croissance vigoureuse de l'année passée suite au freinage de la demande mondiale. Ainsi, l'économie américaine est en train de se ralentir, les dernières estimations montrant une croissance du PIB d'uniquement 1.1 % au dernier trimestre 2000. Les indicateurs préliminaires indiquent une croissance du PIB presque nulle au premier trimestre 2001.

Néanmoins, on s'attend en général à une reprise de la croissance américaine en deuxième partie de l'année, les débats portant sur le fait de savoir si le rétablissement de l'activité économique va se manifester déjà dès le deuxième trimestre, ou s'il aura lieu uniquement à partir du deuxième semestre 2001.

Dans ce scénario il y a des incertitudes quant à la capacité de la FED d'intervenir par le biais de la politique monétaire afin d'éviter une récession. Outre l'évolution de l'économie américaine, on prévoit une faible croissance d'environ 1% pour l'économie japonaise, ce qui est susceptible d'engendrer un ralentissement de la demande dans les autres économies du Sud-Est asiatique. Cette combinaison d'éléments mènera à un ralentissement de l'économie mondiale. Une partie de cet effet pourrait être annulée par les bonnes perspectives de croissance qu'on continue de prévoir en Europe qui peuvent soutenir une partie de la demande pour les exportations belges. En même temps, il y a un deuxième élément qui peut peser sur les exportations belges et européennes en général : l'évolution du taux de change euro-dollar. En effet, le freinage de l'économie américaine réduira le différentiel de croissance entre l'Europe et les Etats-Unis donné comme la principale explication de la faiblesse continue de l'euro par rapport au dollar. On peut alors s'attendre à une appréciation de l'euro par rapport au dollar, ce qui va réduire la compétitivité des exportations en provenance de l'UEM.

Mais si la faiblesse de l'euro est plutôt due aux effets d'inertie qui font que le dollar garde sa position de monnaie internationale alors que l'euro n'a pas encore conquis la sienne, alors la réduction du différentiel de croissance Etats-Unis—Europe ne va pas nécessairement se traduire par une tendance de l'euro à la hausse.

En tout état de cause, l'effet de l'évolution du taux de change euro-dollar sur les exportations belges devrait être limité, vu que la plupart des exportations vont vers les autres pays de l'UEM. Il y aura en même temps un ralentissement des importations, vu le contexte mondial présenté plus haut et le ralentissement prévu de l'économie belge. Au niveau des composantes domestiques de la demande, la consommation privée devrait être stimulée en 2001 par la hausse du revenu disponible des ménages. Ce dernier serait influencé positivement par l'augmentation de l'emploi, des salaires, et par la baisse de l'impôt des personnes physiques.

La hausse de la consommation privée sera accompagnée d'une hausse du taux d'épargne des ménages après la baisse enregistrée en 2000. En effet, la hausse des prix pétroliers s'est traduite par une baisse du pouvoir d'achat des ménages alors que les dépenses de consommation se sont maintenues à des niveaux élevés sur le fond d'une bonne confiance des consommateurs. Pour financer ces dépenses les ménages ont dû rabaisser leurs épargne. Cette année on s'attend à un rétablissement du pouvoir d'achat des ménages suite à l'augmentation de leur revenu disponible et à la baisse des prix pétroliers. Les investissements des entreprises devraient connaître un rythme soutenu suite au degré élevé d'utilisation des capacités de production dans l'industrie manufacturière et au fait qu'on s'attend à une évolution très favorable de la rentabilité des entreprises.

Bureau Fédéral du Plan (February–April 2001)

Belgian exports will be hit this year by the deceleration in world economic growth. Even when taking into account the expected recovery in world trade from the second half of 2001 onwards, growth in Belgian export markets should significantly ease back (in 2001 as in 2002). Moreover the expected appreciation of the euro will reduce the price competitiveness of Belgian exports and would lead to loss of market share over the whole forecasting period. As a result, the positive contribution of external trade to real economic growth will decline in 2001 and 2002 in comparison to last year.

Nevertheless, domestic demand should remain robust over the 2001–2002 period. Business investment should benefit from a rise in firms' profitability due to the gain from the terms of trade. Private consumption will be sustained by substantial growth in household real disposable income as the expected deceleration in inflation will allow to regain, this year, part of the loss of purchasing

power in 2000. Furthermore, households' disposable income will also be supported by some personal tax cuts (mainly in 2002). Although the deterioration in the business cycle will lower the pace of employment growth, the higher labour intensity, which has been observed during the last three years, will give rise, both years, to a favorable employment outcome.

All in all, Belgian GDP is expected to decelerate from nearly 4% in 2000 to 2.8% this year and to 2.9% next year; and it will be less export-led than in 2000.

Taking into account these macro-economic forecasts, the 2001 budget, the 2002–2005 fiscal reform, and including the revenues from the UMTS licences, the general government budget balance is expected to move from equilibrium in 2000 to a small surplus in 2001 and 2002 (about 0.7% of GDP in both years).

IRES (March 30, 2001)

With a GDP increase of about 4 percent, the Belgian economy enjoyed very strong growth in 2000, well above the EU average. As a consequence of the deterioration in the international environment, economic growth in Belgium is expected, in 2001, to be weaker than it has been last year. However, GDP growth should remain strong, at about 3 percent, thanks mainly to robust consumption expenditures. In response to declining inflation, vigorous job creations, and reductions in income tax rates, household real disposable income is expected to increase very rapidly in 2001, by about 3.5 percent. The savings ratio is expected to increase slightly in 2001: whereas consumer confidence remains quite high, we anticipate that the decline recorded in 2000 will be reversed this year. Against this backdrop, consumer expenditures are expected to increase by 2.7 percent in 2001, compared to 2.9 percent in 2000. Despite a less favorable outlook for demand, the prospect for investment expenditures should remain good: the degree of production capacity utilization in industry is high, financial conditions are favorable, and investment in new technologies should be sustained. Accordingly, business investment should grow by 4.8 percent in 2001, compared to 4.1 percent last year. As a whole, domestic demand is expected to grow by 2.6 percent, compared to 3.1 percent in 2001. The contribution of net exports to GDP growth should be of about 0.4 percentage points, half its 2000 level. In 2001, total employment is expected to grow by about 1.3 percent, compared to 1.7 percent in 2001. Job creations will therefore remain vigorous, thanks mainly to continued economic strength, further reductions in payroll taxes and a reinforcement of active employment policies. Against this background, unemployment should continue to decline. By the end of 2001, the unemployment rate, expressed as a percentage of economic active population, should be close to 9 percent, compared to about 10 percent at the end of 2000. Inflation, as measured by the year-on-year increase in the consumer price index, should decline from 2.6 percent in 2000 to 1.5 percent in 2001. This inflation forecast reflects the decline in oil prices and the moderation of wage increases. It is also assumed that spillover effects from the past increase in energy prices to other prices will be very limited, as it has been the case so far.

Country: **Czech Republic**

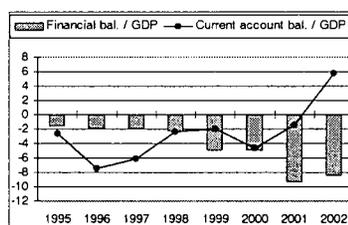
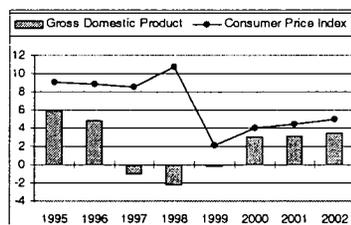
Institute: CCSF

Date of forecast: April 6th, 2001

|                                                | LEVEL         | Volumes, average growth |      |      |
|------------------------------------------------|---------------|-------------------------|------|------|
|                                                | 2000          | 2000                    | 2001 | 2002 |
|                                                | CSK bill. (*) | %                       |      |      |
| GDP                                            | 1,433.8       | 3.1                     | 3.2  | 3.5  |
| Private consumption                            | 758.1         | 1.4                     | 2.7  | 3    |
| Public consumption                             | 283.7         | -0.1                    | 1.6  | 1.2  |
| Gross fixed capital formation                  | 449           | 5.2                     | 5.5  | 5    |
| of which:                                      |               |                         |      |      |
| Equipment                                      |               |                         |      |      |
| Construction                                   |               |                         |      |      |
| Change in stocks (contrib. to growth)          | 54.5          | 2.1                     | 0    | 0    |
| Total domestic demand                          | 1,545.3       | 1.5                     | 3.2  | 3.2  |
| Exports of goods and services                  | 1,216.5       | 17.9                    | 9.3  | 8.7  |
| Imports of goods and services                  | 1,327.1       | 17.6                    | 8.8  | 8.2  |
| GDP deflator (**)                              | 133.2         | 1                       | 2.7  | 3.4  |
| Consumer prices (consumer price index) (**)    | 138.6         | 4                       | 4.4  | 4.9  |
| Hourly wages (***)                             | 78.36         | 6.4                     | 7.4  | 7.7  |
| Employment (1,000 persons)                     | 4,732.1       | -0.7                    | 0.3  | 0.3  |
| Unemployment rate (%) (ILO)                    |               | 8.8                     | 8.4  | 8.1  |
| Saving rate, households (%)                    |               | 9                       | 8.2  | 7.7  |
| Public sector financial bal. (% of GDP) (****) | -93.3         | -4.9                    | -9.3 | -8.4 |
| Gross public debt (% of GDP) (****)            | 356.9         | 18.8                    | 27.1 | 33.5 |
| Current account balance (% of GDP)             | -91.4         | -4.6                    | -1.4 | 5.8  |
| Short-term interest rate (3 m.) (%)            |               | 5.4                     | 5.6  | 6.5  |
| Long-term interest rate (10 yr.) (%)           |               | 6.8                     | 7.2  | 7.8  |
| United States Federal Funds Rate (%)           |               |                         |      |      |
| GDP United States                              |               |                         |      |      |
| GDP Japan                                      |               |                         |      |      |
| GDP European Union                             |               |                         |      |      |
| World trade volume (goods)                     |               |                         |      |      |
| Oil price (US\$/b Brent)                       |               |                         |      |      |
| Exchange rate, 1 euro = \$                     |               | 0.92                    | 0.95 | 0.99 |
| Exchange rate, 1 euro = natl. currency (*****) | 38.63         | 11.7                    | -5.5 | -8.3 |

(\*) In Czech korunas, average exchange rate in 2000 is 1 euro : 38,63 CSK. — (\*\*) Level 1995= 100, volume = average annual growth. — (\*\*\*) Computed on basis of monthly wage levels. — (\*\*\*\*) Estimate on basis of EMU definition. Official data are based on different methodology. — (\*\*\*\*\*) Positive value = depreciation, negative value = appreciation, in percent.

## CZECH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: CCSF*

The growth rate achieved by the Czech Republic in 2000 was much more robust than originally anticipated (even by our own forecast presented at last year's spring session of the AIECE). The increment of the GDP had reached 3.1% in this year, while industrial production increased by more than 5%. After a protracted slump, also construction experienced a pronounced boom (with a 5.3% growth rate). Though retail trade turnover increased less strongly, even its 4.6% growth achieved in the course of 2000 signals a pronounced upturn in the overall economic situation in the Czech Republic, mirroring not only an improvement in household incomes, but also in consumer confidence.

To this robust recovery had contributed (among others) mainly the strong conjunctural upswing in the EU, which had boosted demand not only for final products of Czech provenance, but to a still greater extent for semiproducts, originating mainly from its engineering and chemical industry. The fact that the Czech manufacturing industry has become increasingly involved in subcontracting to EU-based companies has thus proved to be an advantage. But it had also increased the vulnerability of these industries—and of the country as such—by an eventual deceleration of economic growth in the EU.

Nevertheless, in 2001 and the more so in 2002, a further acceleration of economic growth is anticipated in the Czech Republic (to 3.2% and 3.5% increment of its GDP, respectively), as the present recovery has not yet achieved the growth rates which may be regarded as sustainable in this country (due to its location and its other comparative advantages). But it is assumed that in the subsequent two years economic growth will probably be based much less on net exports than on a further increase in domestic demand. In this, foreign direct investment—whose inflow has already reached since 1999 nearly 10% of the GDP each year and which probably will be oscillating around this volume also in the next few years—is expected to play an important role, not only because it will supplement domestic expenditures on investments, but also because it will contribute to the creation of new work places and thus also to the increase in consumer demand. And should this inflow be targeted at greenfield investments, it will also result in further productivity gains. Thus most of the past ailments of the Czech economy will be left behind.

The soundness of its present recovery is showing up also in the steadiness of the exchange rate of the koruna (it has become one of the strongest currencies among transition countries) as well as in the maintenance of an inflation rate which belongs to the lowest reached in such countries. The so-called “net inflation” amounted merely to 3% in 2000 in spite of the strong increase of prices of imported energy. It is expected to be kept at this rate (possibly even at a somewhat lower one) in spite of the decrease in interest rates (which the Czech National Bank had introduced in February 2001 by lowering the discount rate by 1% , the Lombard rate by 150 bps and the repo-rate by 0.25 bps) and the continuing strong inflow of FDI and of bank deposits of foreign subjects (which are diluting the money supply).

On the other hand, this inflow will help to mitigate the impact of the recent increase in the deficits of the balance of current account and of the trade balance (which reached \$2.1 bill. and \$3.3 bill., respectively, in 2000 and are expected to increase slightly even in 2001) on the balance of payments of the country. Though the external public debt of the Czech Republic is expected also to increase somewhat in the coming years (less so because of repeating budgetary deficits, but mainly because of the need to cover losses the banking sector had incurred in the past), it will still remain far below the Maastricht limit. So even the overall financial position of the country may be regarded as sustainable. But this does not change the fact that rigorous measures will have to be introduced presently, not only in support of the strengthening of the “fiscal discipline” of the local business community, but also in order to curtail expenditures in several fields of public spending.

Country: **Denmark**

Institute: DEC

Date of forecast: Fall 2000 with revisions

|                                                   | LEVEL    | Volumes, average growth (%) |         |      |
|---------------------------------------------------|----------|-----------------------------|---------|------|
|                                                   | 2000(**) | 2000(**)                    | 2001    | 2002 |
| GDP (bill, 1990 dkr, %)                           | 1,312.2  | 2.9                         | 1-1.5   | 2    |
| Private consumption (bill, 1990 dkr, %)           | 627.4    | -0.2                        | 0.5-1.5 | 2.8  |
| Public consumption (bill 1990 dkr, %)             | 324.3    | 0.6                         | 2.2     | 1.2  |
| Gross fixed capital formation                     | 289.7    | 12.8                        | 0       | 0.3  |
| of which:                                         |          |                             |         |      |
| Equipment (bill, 1990 dkr, %)                     | 160.7    | 15.5                        | 5       | 1.4  |
| Construction (bill, 1990 dkr, %)                  | 126.8    | 5.8                         | -9      | -0.8 |
| Change in stocks (contrib. to growth)             | 2.2      | 0.3                         | 0       | 0    |
| Total domestic demand (bill, 1990 dkr, %)         | 1,241.3  | 2.8                         | 0.5     | 1.8  |
| Exports of goods and services (bill, 1990 dkr, %) | 556.9    | 9.8                         | 6       | 3.8  |
| Imports of goods and services (bill, 1990 dkr, %) | 486      | 10.2                        | 5       | 3.7  |
| GDP deflator (%)                                  |          | 3.7                         | 2.5     | 2.2  |
| Consumer prices (deflator) (%)                    |          | 3.1                         | 2.5     | 1.5  |
| Hourly wages (%)                                  |          | 3.5                         | 3.8     | 3.6  |
| Employment (1,000 persons)                        | 2,686.6  | 0.8                         | 0       | 0.5  |
| Unemployment rate (natl. def)                     |          | 5.3                         | 5       | 4.6  |
| Saving rate, households (%)                       |          |                             |         | -3.1 |
| Public sector financial bal. (% of GDP) (*)       |          | 2.4                         | 2.9     | 3.1  |
| Gross public debt (% of GDP) (*)                  |          | 47                          | 41.9    | 37.1 |
| Current account balance (% of GDP)                |          | 1.5                         | 1.6     | 2.3  |
| Short-term interest rate (3 m.) (%)               |          |                             |         | 6.4  |
| Long-term interest rate (all bonds) (%)           |          | 6.3                         | 6.3     | 6.4  |
| United States Federal Funds Rate (%)              |          |                             |         | 3    |
| GDP United States                                 |          | 5.3                         | 1.5-2   | 3    |
| GDP Japan                                         |          | 2                           | 0.5-1.5 | 2.3  |
| GDP European Union                                |          | 3.4                         | 1-1.5   | 2.6  |
| World trade volume (goods)                        |          |                             |         |      |
| Oil price (US\$/b Brent)                          |          | 29                          | 25      | 25   |
| Exchange rate, 1 euro = \$                        |          |                             | 0.95    | 0.98 |
| Exchange rate, 1 euro = natl. currency            |          | 1.96                        | 1.96    | 1.96 |

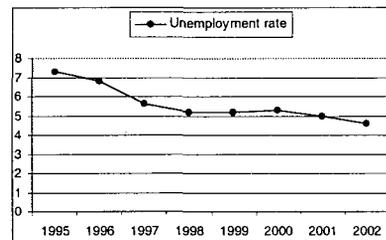
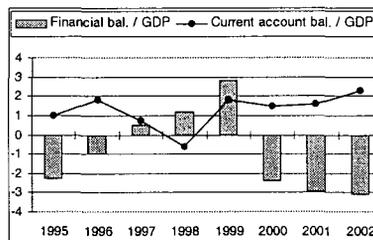
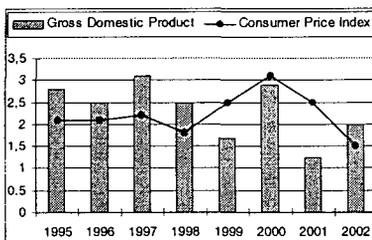
(\*) EMU definition. — (\*\*) Historical data from the National Account.

Please note that the enclosed forecast for 2001-02 is based on our forecast made in November 2000.

Some of the figures in 2001 are however updated as of 01.04.2001. The adjustments are made in order to reflect the newest information available.

The adjusted figures for 2001 are shown without decimals.

### DANISH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute; forecast for CPI refers to private consumption deflator.

Source: OECD (2001); AIECE institutes.

*COMMENT: DEC*

Danish economic growth in 2000 was 2.9 percent, which was moderately higher than projected in the fall of 2000. The increase was driven primarily by substantial increases in residential and business fixed investments. The hurricane that hit Denmark in December 1999 has been a contributory cause to this development. Export growth was also very high in 2000 but as growth in import was higher, net export contributed only modest to the growth in GDP. Development in private consumption has been very subdued in the last two years. Growth in private consumption was even negative in 2000. Several indicators point to a continued subdued growth in private consumption in the first months of 2001. The private consumption growth rate is expected to pick up in the second half of 2001. Our forecast on growth in private consumption is anyway likely to be very low in 2001. In 2002 and 2003 the burden of taxation is expected to decrease, and this will have a positive impact on the growth rate of private consumption. The growth rate in public consumption was modest in 2000 and lower than expected. In 2001 a larger growth in public spending is expected. This year, GDP growth will most probably be very modest due to the development in private consumption and a low growth rate in net exports and private investments. Last year, employment increased by 20,000 persons, primarily owing to rising employment in the private sector. The unemployment rate is therefore still very low at 5.3% on average. Nevertheless, wage increases have been modest and there seems generally to be no inflationary pressure. Employment is expected to rise slowly in the period 2001–03.

The surplus in the general government financial balance is expected to increase in the years to come. This will be caused by a continuing widening of the tax base and a limit to the growth in income transfers due to falling unemployment.

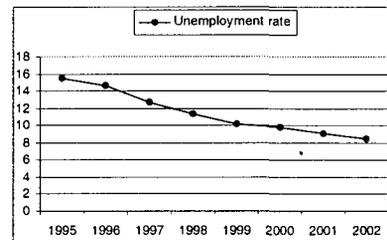
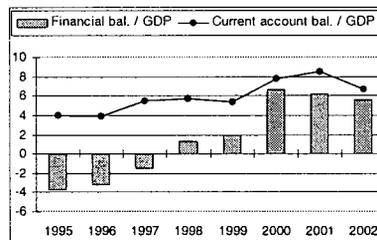
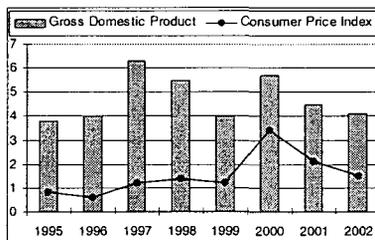
The domestic-market-determined inflation rate is moderate. In the projection period, it is assumed that the effective Danish exchange rate will strengthen with the euro against the dollar, and wage costs and fuel prices are expected to grow at a slower pace, causing the inflation rate to decline. However, a number of uncertainties are associated with the forecast for the inflation rate. In particular, it is assumed that the increase in hourly wage costs will be lower than historical experience might predict. This assumption is made on the basis of the structural reforms that have been implemented in the Danish labour market during the 1990s. If the labour market turns out to be less flexible than anticipated, the result could be a return to a path of relatively higher inflation.

Country: **Finland**Institute: ETLA  
Date of forecast: March 22, 2001

|                                             | LEVEL      | Volumes, average growth |         |         |
|---------------------------------------------|------------|-------------------------|---------|---------|
|                                             | 2000       | 2000                    | 2001    | 2002    |
|                                             | euro bill. | %                       |         |         |
| GDP                                         | 132        | 5.7                     | 4.5     | 4.1     |
| Private consumption                         | 65         | 3                       | 3.8     | 3       |
| Public consumption                          | 27.1       | 0.4                     | 1.5     | 1.5     |
| Gross fixed capital formation               | 25.1       | 4.8                     | 6.9     | 5.6     |
| of which:                                   |            |                         |         |         |
| Equipment                                   | 8.4        | 4.8                     | 13      | 7       |
| Construction                                | 14.1       | 4.9                     | 3       | 4       |
| Change in stocks (contrib. to growth)       | -0.2       | -0.2                    | -0.1    | 0.2     |
| Total domestic demand                       | 118.7      | 2.5                     | 3.7     | 3.7     |
| Exports of goods and services               | 56.1       | 17.7                    | 8       | 6.9     |
| Imports of goods and services               | 42.8       | 12.8                    | 7.4     | 6.8     |
| GDP deflator                                |            | 2.9                     | 2.2     | 1.2     |
| Consumer prices (consumer price index)      |            | 3.4                     | 2.1     | 1.5     |
| Hourly wages                                |            | 3.8                     | 4.2     | 3.2     |
| Employment (1,000 persons)                  | 2,335      | 1.7                     | 1.4     | 1.3     |
| Unemployment rate (%)                       |            | 9.8                     | 9.1     | 8.4     |
| Saving rate, households (%)                 |            | -2                      | -1.5    | -1.5    |
| Public sector financial bal. (% of GDP) (*) |            | 6.7                     | 6.2     | 5.6     |
| Gross public debt (% of GDP) (*)            |            | 44                      | 40.4    | 38.1    |
| Current account balance (% of GDP)          |            | 7.7                     | 8.5     | 8.7     |
| Short-term interest rate (3 m.) (%)         |            | 4.4                     | 4.6     | 4.1     |
| Long-term interest rate (10 yr.) (%)        |            |                         |         |         |
| United States Federal Funds Rate (%)        |            | 6.2                     | 5.1     | 4.8     |
| GDP United States                           |            | 5                       | 1.5     | 2.5     |
| GDP Japan                                   |            | 1.7                     | 1.3     | 1.9     |
| GDP European Union                          |            | 3.3                     | 2.7     | 2.9     |
| World trade volume (goods)                  |            | 13                      | 6.8     | 7.1     |
| Oil price (US\$/b Brent)                    |            | 28.6                    | 24.8    | 23.5    |
| Exchange rate, 1 euro = \$                  |            | 0.92                    | 0.94    | 1       |
| Exchange rate, 1 euro = natl. currency      |            | 5.94573                 | 5.94573 | 5.94573 |

(\*)EMU definition.

## FINNISH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: ETLA*

Finnish GDP increased by 5.7 percent last year, thanks to exceptionally strong export growth. GDP growth is forecast to slow to 4.5 percent this year, as external demand for Finnish exports weakens considerably. We expect both export and consumption growth to slow next year, leading to a moderation in GDP growth to 4.1 percent. Industrial production growth will slow to 7.5 percent this year, moderating further next year to 5.5 percent. The output of private services will increase by 4 percent both this year and next. The output of total services, private and public, typically increases at a one-percentage point slower pace, since the output of private services generally increases at a faster pace than that of public services.

The unemployment rate has declined slowly in recent years due to very rapid growth in labor supply. Last year, the unemployment rate fell by only 0.4 of a percentage point to 9.8 percent. We expect a faster decline in unemployment this year, with the jobless rate averaging 9.1 percent for the year as a whole. The unemployment rate will continue to decline next year to a level of 8.4 percent. The greatest increases in employment will be in the private service sector. The number of industrial jobs, however, will increase at a slow pace. Within industry, the biggest employment gains will be experienced in telecommunication equipment manufacturing. Measures aimed at improving working life and reducing long-term unemployment have reduced the rate of structural unemployment. Further steps should be taken to reduce structural unemployment. Such measures include various steps aimed at reducing the gap between labor demand and supply, such as easing income taxation, reducing hiring costs, increasing the efficacy of vocational training policy as well as improving the flexibility of the labor market.

Consumer prices rose by 3.4 percent last year. This year, consumer price inflation is forecast to decline to 2.1 percent. Slower inflation will result primarily from declines in the housing and transportation price indexes.

The general government fiscal surplus rose considerably last year, mostly due to the improvement in central government finances. The general government surplus rose to 6.7 percent of GDP, with one-off revenues accounting for two percentage points of the surplus.

Part of the fiscal surplus should be used to reduce the tax burden on earned income. High taxes mitigate the decline in unemployment by reducing both labor demand as well as job search. Part of the surplus could also be used to boost public expenditures, on the condition that careful consideration be given to the specific spending programs targeted. However, moderation in public expenditure growth is called for. This requires politicians to prioritize expenditures more clearly. Even after reducing taxes and increasing expenditures, there will still be room to cut the central government's debt.

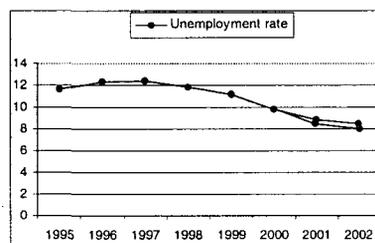
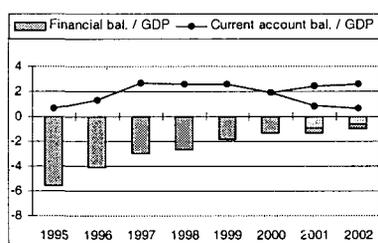
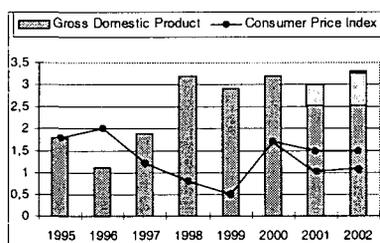
Country: **France**

Institutes: BIPE, COE, O.F.C.E., REXECODE

|                                             | LEVEL              | Volumes, average growth (%) |      |      |      |          |      |      |      |      |          |      |
|---------------------------------------------|--------------------|-----------------------------|------|------|------|----------|------|------|------|------|----------|------|
|                                             | 2000<br>euro bill. | 2000                        | 2001 |      |      |          |      | 2002 |      |      |          |      |
|                                             |                    |                             | BIPE | COE  | OFCE | REXECODE | avg  | BIPE | COE  | OFCE | REXECODE | avg  |
| GDP                                         | 1,395              | 3.2                         | 2.7  | 2.9  | 3    | 2.6      | 2.8  | 3    | 2.8  | 3.3  | 2.6      | 2.9  |
| Private consumption                         | 765                | 2.3                         | 2.7  | 2.8  | 2.8  | 2.6      | 2.7  | 3    | 2.6  | 3.5  | 2.8      | 3    |
| Public consumption                          | 328                | 1.5                         | 2.1  | 1.8  | 2    | 1.6      | 1.9  | 1    | 1.8  | 2    | 1.5      | 1.6  |
| Gross fixed capital formation               | 275                | 6.7                         | 5.8  | 6.9  | 5.6  | 5.3      | 5.9  | 5.1  | 5.6  | 4.6  | 3.6      | 4.7  |
| of which:                                   |                    |                             |      |      |      |          |      |      |      |      |          |      |
| Equipment                                   |                    |                             |      |      |      | 6.9      | 6.9  |      |      |      | 4.6      | 4.6  |
| Construction                                |                    |                             |      |      |      | 1.6      | 1.6  |      |      |      | 1.3      | 1.3  |
| Change in stocks (contrib. to growth)       | 8                  | 0.2                         | -0.2 | 0.1  | 0    | 0.1      | 0    | 0.1  | 0    | 0    | 0        | 0    |
| Total domestic demand                       | 1,376              | 3.6                         | 3.1  | 3.5  | 3.2  | 3        | 3.2  | 2.9  | 3    | 3.3  | 2.6      | 3    |
| Exports of goods and services               | 403                | 13.6                        | 7    | 6.4  | 9.1  | 6.1      | 7.2  | 5.3  | 6.7  | 7.4  | 5.5      | 6.2  |
| Imports of goods and services               | 384                | 14.7                        | 8.5  | 8.9  | 10.6 | 7.8      | 32.9 | 5.6  | 7.8  | 7.9  | 5.9      | 6.8  |
| GDP deflator                                |                    | 0.5                         | 1.9  | 1.2  | 1.3  | 0.8      | 1.3  | 1.8  | 1    | 1.6  | 1        | 1.4  |
| Consumer prices (consumer price index)      |                    | 1.7                         | 1.5  | 1.1  | 1.4  | 1.2      | 1.3  | 1.5  | 1.2  | 1.5  | 1.2      | 1.4  |
| Hourly wages                                |                    | 4.6                         | 3.7  | 2.2  | 3.7  | 3.6      | 3.3  | 2.5  | 2    | 4.1  | 4.2      | 3.2  |
| Employment (1,000 persons)                  | 23,941             | 2.5                         | 1.6  | 2.6  | 2    | 1.7      | 2    | 1.4  | 1.7  | 1.7  | 1.2      | 1.5  |
| Unemployment rate (%)                       | 6.8                | -1.4                        | 8.9  | 8.8  | 8.7  | 8.8      | 8.8  | 8.2  | 8.4  | 7.9  | 8.5      | 8.3  |
| Saving rate, households (%)                 | 16.2               | 0.4                         | 15.9 | 16.4 | 16.2 | 15.5     | 16   | 15.2 | 16.2 | 16   | 14.9     | 15.6 |
| Public sector financial bal. (% of GDP) (*) | 1.3                | -0.3                        | -0.8 | -1.1 | -1   | -1.3     | -1.1 | -0.3 | -0.9 | -0.5 | -1       | -0.7 |
| Gross public debt (% of GDP) (*)            | 58                 | -0.7                        |      | 56.8 | 57.1 | 57.1     | 57   |      | 55.6 | 55.4 | 55.7     | 55.6 |
| Current account balance (% of GDP)          | 1.9                | -0.7                        | 2.4  | 1.2  | 1.7  | 1.9      | 1.8  | 2.6  | 1    | 1.9  | 1.9      | 1.9  |
| Short-term interest rate (3 m.) (%)         |                    |                             | 4.53 | 4.4  | 4.6  | 4.6      | 4.5  | 4    | 5    | 4.5  | 4        | 4.4  |
| Long-term interest rate (10 yr.) (%)        |                    |                             | 4.91 | 5.5  | 4.9  | 4.9      | 5.1  | 5.07 | 5.4  | 5    | 5.1      | 5.1  |
| United States Federal Funds Rate (%)        |                    |                             | 4.06 | 6.2  | 5    | 5.1      | 5.1  | 3.75 | 5.9  | 4.5  | 5.2      | 4.8  |
| GDP United States                           | 5                  | 1.1                         | 1.7  | 1.3  | 1.7  | 1.7      | 1.5  | 2.5  | 3.2  | 2.2  | 2.5      | 2.6  |
| GDP Japan                                   | 1.7                | 1.3                         | 1.2  | 0.9  | 0.5  | 1        | 1.9  | 1.8  | 2.2  | 1.4  | 1.8      | 1.8  |
| GDP European Union                          | 3.4                | 2.5                         | 2.9  | 2.6  | 2.6  | 2.7      | 3    | 3.1  | 2.9  | 2.7  | 2.9      | 2.9  |
| World trade volume (goods)                  |                    |                             | 7.3  | 7    | 5.4  | 6.6      | 6.6  | 9.1  | 7.3  | 5.8  | 7.4      | 7.4  |
| Oil price (US\$/b Brent)                    | 28.4               | 25.3                        | 22.3 | 24.2 | 23.9 | 23.9     | 24.6 | 22   | 22.1 | 20.3 | 22.3     | 22.3 |
| Exchange rate, 1 euro = \$                  | 0.92               | 1.02                        | 0.98 | 0.97 | 0.96 | 1        | 1    | 1.09 | 0.98 | 1    | 1        | 1    |
| Exchange rate, 1 euro = natl. currency      | 6.56               | 6.56                        | 6.56 | 6.56 | 6.56 | 6.56     | 6.56 | 6.56 | 6.56 | 6.56 | 6.56     | 6.56 |

(\*) EMU definition.

## FRENCH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institutes; if forecasts differ, their maximum range is shown.

Source: OECD (2001); AIECE institutes.

## COMMENTS: BIPE (March 2001)

A positive European environment : Europe is now a closed economy, and the monetary union has brought exchange rate stability. In 1992 when the US dollar tumbled all European central banks (except the Bundesbank, of course) raised interest rates to defend parities. This is over. To the opposite, we are likely to see monetary easing this time around (75 bps by the end of 2001 in our view).

And this easing will occur in an environment of solid domestic demand in France, and very solid services sector growth. Consumer confidence is historically high, labour markets are well oriented and more flexible than in the past. Consumers benefit from tax cuts and also benefit from the ebb of inflation with the fall in oil prices. Credit conditions remain healthy thanks notably to solid financial positions from banks. Interest rates are still historically low. Finally, firms need to expand their capital

stock given the very high capacity utilization rates (back to late 80s levels) and a structural catch-up process with regard to new technologies.

#### COE (March 2001)

The French economy will register a growth rate of 2.9% in 2001 and 2.8% in 2002, a continuation of the pace seen over the past three years. Although it will not avoid the effects of the slowdown in the US economy during the first half of 2001, suffering in particular from the sharp reduction in export flows, the French economy should remain relatively robust despite the international slowdown.

Europe will be affected by the slowdown in global demand. However many countries (including Germany, France, Italy and the UK) have set out on the path of fiscal loosening, which should help to support domestic demand. The French economy will follow this European trend, with the rebound in consumer spending compensating for the deterioration in the international environment, while investment should remain robust as a result of pressures on productive capacity, and thanks to a recovery in IT spending. The dynamic path of household spending is essentially explained by fiscal loosening and by the reductions in inflation linked to falling oil prices. In addition, the maintenance of an impressive rate of new job creation, even if it turns out to be fractionally slower than the dramatic performance in 2000, should allow France to record a GDP growth rate significantly above Germany.

In 2002 the two main components of domestic demand, consumption and investment, will be a little less buoyant in France, while in contrast exports should benefit from an improvement in the international environment. The fizzling out of the effects linked to the reduction in employers' social security contributions and the move to a shorter working week will put a brake on employment creation, while companies will feel less of a need to use investment to bolster their productive capacity. However, after a quasi stagnation in the first half of 2001 (and indeed an industrial recession), a gradual recovery in activity levels should take place in the United States. French exports should thus accelerate significantly during the course of 2002, thereby compensating for the moderation in domestic demand.

#### INSEE (March 30, 2001)

The year 2000 witnessed the continuation of an upswing phase in France that has already lasted longer than that of the late 1980s and has been marked by a very steep rise in employment. However, the salient feature of the economic situation in 2000 was the slowdown in household consumption in response to the rise in imported inflation. This impact of the higher oil price now seems to be a thing of the past. At present, the brakes are on a different growth motor, with world demand slowing down under the impact of the sudden downturn in the American economy.

The year 2001 has begun in France with domestic demand showing signs of considerable strength. Investment remains brisk against a background of strained productive capacity and still favorable financing conditions. Household consumption rebounded in the first quarter, this tendency being facilitated by the recent disinflation. The upturn in consumption in France is likely to be more marked than in the euro zone as a whole, thanks to an acceleration in household income that is slightly more pronounced and has begun slightly earlier. This strength of domestic demand should enable French growth in the first half to be at a rate roughly half a point better than in the euro zone as a whole.

In France, job creation in the second half of 2000 remained at an exceptional level. Most of these new jobs were in the competitive sector (250,000 creations compared with 95,000 per half-year on average in 1994–1999), benefiting both from the strength of activity and the short-term impact of the reduction in working hours. The rise in employment is expected to remain very strong in the first half of 2001, although weakening somewhat, mainly because of a fading of the impact of the 35-hour week. The rise in private dependent employment is expected to be 1.4% in the half-year, compared

with 1.8% and 1.7% in the first half and second half of 2000, respectively. This strong job creation should enable unemployment to continue to fall. Having been 9.2% in December 2000, the rate is expected to be down to around 8 1/2% of the labour force at end-June, thus falling below its 1990 low and reaching a level not seen since 1983.

Against a background of steadily falling unemployment in the past 3 1/2 years, the nominal basic monthly wage can be expected to accelerate slightly, with the year-on-year rise moving up from 1.6% in mid-2000 to 2.2% in mid-2001. The implementation of the reduction in working hours, which is in most cases being accompanied by agreements at company level for wage restraint for a period of 1 to 2 years, no doubt partially explains the delayed nature of this acceleration.

All in all, households' earned income can be expected to remain dynamic in the first half of 2001, with the buoyancy of the total wage bill still boosted mainly by the employment tendency.

In addition, households are benefiting from the cuts in taxes and social contributions introduced towards the end of last year: a decline in rates for the lower income-tax brackets, cuts in local taxes, the elimination of personal vehicle tax. Other cuts are planned for 2001, mainly in the second half of the year (fall in unemployment insurance contributions as of 1 January, lowering of the income-tax schedule, so-called "employment bonus" in September).

Moreover, after rising steadily last year to peak at 2.4% in November, inflation fell back to 1.6% in December 2000, as a result of the lower oil price. In the first half of 2001, the year-on-year consumer price rise is expected to fluctuate around 1.4%. The stabilization of the oil price at roughly \$25/barrel and the gradual reappreciation of the euro should take some of the force out of imported inflation. Underlying inflation is expected to remain stable at around 1.3%. Food prices are likely to rise more strongly (year-on-year rise of close to 4%), driven upwards by the impact of the BSE and foot-and-mouth crises on meat prices.

The ebbing of inflation in the first half of 2001 should also help to bring about a marked acceleration in the growth of household purchasing power, likely to be around 3.5% in mid-year, ignoring quarterly fluctuations.

Although growth in household spending seems to have been modest towards the end of last year, the acceleration in income started to make itself felt on household consumption as early as in the fourth quarter of 2000. The overall figure in fact masks particularly weak tendencies regarding food and energy, these traditionally being the most volatile sectors, and at the same time a slight acceleration regarding manufactures and increased momentum for traded services as a whole.

The first half of 2001 is likely to be marked by an intensification of this tendency. Growth in household consumption of manufactures is liable to pick up to an annualized rate of the order of 6%. In particular, after declining in the second half of 2000 following the alterations to the rules regarding model years, car purchases are likely to return to much more rapid growth. Spending on services should continue to be very brisk, stimulated by the spread of telecommunications services and the continuous fall in prices in this sector.

The strength of consumption is likely to be accompanied by a continuing high saving ratio, as is normal at times of a sustained acceleration in income.

Against a background of continuing firm overall demand, productive investment should continue its strong progress. Housing investment, for its part, is likely to slow down, given the impact on purchases of the rise in house prices and the slight hardening of financing conditions. Moreover, part of the slowdown would be attributable to the completion of the repair work connected with the sales at the end of 1999. Finally, investment in public works can also be expected to slow down, following the great dynamism shown in the second half of 2000 (which was marked by the run-up to the municipal elections).

In contrast to the acceleration in domestic demand, the slowdown at world level is likely to hold back demand in French export markets. This would mean a marked slowdown in exports in the first half of 2001, despite continuing firm demand from certain European trading partners. The annual

growth rate for manufacturing exports is expected to be halved from one half-year to the next, i.e. from 12% to 7%. In addition, food exports can be expected to decline under the impact of the BSE and foot-and-mouth crises. As exports have a high import content, imports too can be expected to slow down, but to a smaller extent, given the strength of domestic demand. The external contribution to growth would be negative for the half-year, by slightly less than half a point in annualized terms.

All things considered, the marked slowdown in external demand would be offset by an acceleration in domestic demand, with French growth amounting to 3% in the first half of 2001.

However, this strength in activity would mask differing situations in the main sectors of activity. The building and public works sector, whose strength underpinned growth in 1999 and 2000, is expected to slow down. The manufacturing industry is likely to do so as well, but still maintaining a solid growth rate, of the order of 3.5%. Distribution and services are likely to be very buoyant.

#### O.F.C.E. (March 2001)

French GDP is expected to rise by 3.0 per cent this year and by 3.3 per cent in 2002. This is similar to the GDP growth rates in recent years, after a period of slow growth in the first half of the 1990s: output rose by 1.1 per cent a year between 1990 and 1996 and by 3.2 per cent between 1997 and 2000. The unemployment rate fell from 12.4 per cent in 1997 to 9.7 per cent in 2000. Job creation broke records in 2000 with a net increase of 580 000 in employment. Albeit slowing down, job creation will remain strong in 2001 and 2002 (between 400 000 and 500 000); the unemployment rate will drop to 7.6 per cent by the end of 2002, i.e. the level of the early 1980s.

In 2000, the rise in oil prices had some effect on French GDP and inflation. It cost 0.5 per cent of growth, and inflation did not accelerate as wage increases remained moderate and temporary cuts in oil taxes were introduced. As in 2000, the external environment will not threaten French growth in 2001 since the latter is mainly driven by domestic demand, especially consumer spending and private investment. High employment growth boosts disposable income and consumer confidence. Strong domestic demand also stimulates private investment, since capacity utilisation has reached historically high levels, with current rather low production capacities after years of poor investment in the 1990s. The level of corporate returns and investment opportunities in ICTs also contribute to the growth of private investment.

Falls in unemployment are partly the consequence of the measures implemented on the labour market. The youth employment scheme, offering 5-year jobs in the public sector to people under 25, has reduced the particularly high rate of unemployment among young employees. The introduction of the 35-hour working week has also had a positive effect on employment. It has been financed by productivity gains (through increased flexibility), wage moderation, and reductions in employers' social contributions. As a consequence, the strong upswing in hourly wages did not boost inflation. French inflation is among the lowest in the European Union. The unemployment rate is still high and keeps pressure on wages. In 2001 and 2002, wages are forecast to accelerate slightly, but inflation will remain under control thanks to productivity gains and tax cuts. The rise in households' real disposable income will keep on stimulating demand despite a stabilisation of the saving ratio.

The virtuous circle of self-fed strong domestic demand is expected to last in France in the two years to come. Fiscal policy will be neutral. Public spending will remain under control, but within the tax cuts decided, and largely introduced in 2000, some are to come into effect in 2001 or 2002 (they will amount to 0.9 per cent of GDP in 2001 and 0.5 per cent in 2002, after 1.1 per cent in 2000).

#### REXECODE (April 11, 2001)

Au cours de l'année 2000, la croissance du PIB en France s'est rapprochée de sa tendance de long terme en s'inscrivant sur un rythme compris entre 2,4 et 2,8 %. La croissance française ne diffère pas

de celle de la zone euro après l'avoir dépassée lors des deux années précédentes. Le résultat de l'année 2000 s'explique par une faiblesse de la consommation des ménages qui n'a été que partiellement compensée par un investissement toujours vigoureux. En raison d'une détérioration de l'environnement mondial, la croissance se modérerait à 2,6 % en 2001 et en 2002. En profil trimestriel toutefois, la croissance s'infléchirait au premier semestre 2001 avant d'accélérer progressivement pour ressortir à 3 % à la fin de l'année 2002.

Les exportations ont été particulièrement vigoureuses tout au long de l'année 2000 mais elles se modéreraient dès le premier trimestre 2001 en raison du ralentissement du commerce mondial et du redressement de l'euro. La progression des importations en volume serait à nouveau supérieure à celle des exportations en 2001 et 2002. En effet, en dépit du ralentissement de la croissance début 2001, le desserrement des contraintes pesant sur le niveau de l'offre ne s'opérerait que lentement. Les difficultés de recrutement risquent même de se tendre au cours des deux prochaines années avec le durcissement des règles d'application de la loi sur les 35 heures. Ces contraintes pourraient à nouveau peser sur le niveau de l'activité et nourrir ainsi les importations face à une demande intérieure encore vigoureuse.

La demande intérieure hors stocks s'inscrirait sur une tendance de l'ordre de 2,7 % en 2001 et 2002 après 3 % en 2000. A la faveur d'un ralentissement de l'inflation et des réductions d'impôts, la consommation des ménages accélérerait à 2,6 % en 2001 et 2,8 % en 2002 en rupture par rapport à la tendance qu'elle a connue en 2000. La consommation serait également soutenue par une accélération des salaires liée d'une part au durcissement des tensions sur le marché du travail et, d'autre part, à l'expiration des accords de modération salariale conclus dans le cadre du passage aux 35 heures dans les entreprises de plus de 20 salariés. Cette avance viendrait ainsi nourrir les gains de pouvoir d'achat du revenu des ménages et ce en dépit d'une moindre progression de l'emploi salarié marchand.

L'investissement des entreprises se modérerait en début d'année tout en conservant une progression très supérieure à sa moyenne de long terme. Les tensions sur les équipements demeurent vives dans l'industrie et la construction notamment et nourrissent une demande vigoureuse de biens d'équipement en grande partie satisfaite par des importations. Mais la détérioration de l'environnement mondial viendrait peser sur l'investissement. De même les déterminants financiers de l'investissement tendent à se noircir avec la faible progression de l'autofinancement, l'alourdissement de l'endettement et l'orientation à la hausse du coût réel du crédit.

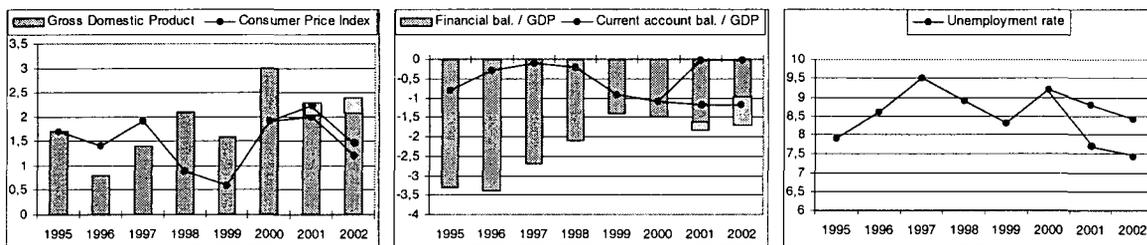
Le ralentissement de la croissance à 2,6 % en 2001 viendrait peser sur l'équilibre des comptes publics. De plus, de nombreuses incertitudes demeurent sur les conditions de financement des réductions de charges consécutives à la mise en œuvre des 35 heures alors que dans le même temps les dépenses de santé manifestent des signes de forte accélération. Dans ce contexte, l'objectif d'un déficit public équivalent à 1 % du PIB en 2001 et à 0,6 % en 2002 apparaît difficile à atteindre, ce qui contraint encore un peu plus l'objectif de réduction de la dette publique.

Country: Germany

|                                             | LEVEL      | Volumes, average growth (%) |         |         |         |         |         |      |         |         |         |         |         |      |
|---------------------------------------------|------------|-----------------------------|---------|---------|---------|---------|---------|------|---------|---------|---------|---------|---------|------|
|                                             | 2000       | 2000                        | 2001    |         |         |         |         |      | 2002    |         |         |         |         |      |
|                                             | euro bill. |                             | DIW     | RWI     | HWWA    | IwW     | IFO     | avg  | DIW     | RWI     | HWWA    | IwW     | IFO     | avg  |
| GDP                                         | 2,032.9    | 3                           | 2       | 2.1     | 2.3     | 2.1     | 2.1     | 2.1  | 2.1     | 2.2     | 2.4     | 2.2     | 2.2     | 2.2  |
| Private consumption                         | 1,180.6    | 1.6                         | 2.2     | 2.2     | 2.3     | 2.3     | 2.2     | 2.2  | 2.5     | 2.1     | 2.2     | 2.3     | 2.1     | 2.2  |
| Public consumption                          | 383.6      | 1.4                         | 0.7     | 0.8     | 0.8     | 0.6     | 0.8     | 0.7  | 0.9     | 0.9     | 0.9     | 0.8     | 0.9     | 0.9  |
| Gross fixed capital formation               | 435        | 2.4                         | 0.8     | 1.4     | 2.8     | 0.9     | 1.4     | 1.5  | 1.1     | 2.9     | 3.4     | 2.6     | 2.9     | 2.6  |
| of which:                                   |            |                             |         |         |         |         |         |      |         |         |         |         |         |      |
| Equipment                                   | 173.9      | 9                           | 4.2     | 5.9     | 8.3     | 4.7     | 5.9     | 5.8  | 5       | 6.5     | 7.3     | 6.1     | 6.5     | 6.3  |
| Construction                                | 238.4      | -2.5                        | -3.4    | -2.3    | -2      | -2.2    | -2.3    | -2.4 | -1.1    | -0.3    | -0.4    | -0.5    | -0.3    | -0.5 |
| Change in stocks (contrib. to growth)       | 25.9       | 0.2                         | 0.9     | 0.2     |         | 0.7     | 0.2     | 0.5  | 0.7     | -0.1    |         | 0.2     | -0.1    | 0.2  |
| Total domestic demand                       | 2,025.1    | 2                           | 1.6     | 1.9     | 2.1     | 2.3     | 1.9     | 2    | 1.9     | 1.9     | 2.2     | 2.3     | 1.9     | 2    |
| Exports of goods and services               | 678.1      | 13.2                        | 10.6    | 10.1    | 11.6    | 9.4     | 10.1    | 10.4 | 5.9     | 6.7     | 6.8     | 5.6     | 6.7     | 6.3  |
| Imports of goods and services               | 670.3      | 10.2                        | 9.9     | 10      | 11.4    | 10.7    | 10      | 10.4 | 5.7     | 6.3     | 6.3     | 6.1     | 6.3     | 6.1  |
| GDP deflator                                |            | -0.4                        | 1.1     | 1.1     | 1       | 0.7     | 1.1     | 1    | 1.1     | 1.1     | 1       | 1.3     | 1.1     | 1.1  |
| Consumer prices (consumer price index)      |            | 1.9                         | 2       | 2.1     | 2.1     | 2.2     | 2.1     | 2.1  | 1.2     | 1.5     | 1.5     | 1.5     | 1.5     | 1.4  |
| Hourly wages                                |            | 2                           | 2.4     | 2.25    | 2       | 2.1     | 2.2     | 2.2  | 2.3     | 2.5     | 2.5     | 2.5     | 2.5     | 2.5  |
| Employment (1,000 persons)                  | 38,533     | 1.6                         | 0.8     | 0.9     | 1       | 1       | 0.9     | 0.9  | 0.7     | 0.8     | 0.7     | 0.9     | 0.7     | 0.8  |
| Unemployment rate (%)                       |            | 9.2                         | 8.8     | 8.7     | 7.7     | 8.7     | 8.7     | 8.5  | 8.4     | 8.2     | 7.4     | 8.1     | 8.2     | 8.1  |
| Saving rate, households (%)                 |            | 9.8                         | 10      | 10      | 10      | 9.5     | 10      | 9.9  | 9.9     | 9.8     | 9.8     | 9.9     | 9.8     | 9.8  |
| Public sector financial bal. (% of GDP) (*) |            | -1.5                        | -1.8    | -1.7    | -1.6    | -1.8    | -1.8    | -1.7 | -1.2    | -1.2    | -0.9    | -1.7    | -1.2    | -1.2 |
| Gross public debt (% of GDP) (*)            |            | 60.3                        | 58.8    | 58.7    | 58.7    | 59      | 58.8    | 58.8 | 58.4    | 58.4    | 58.4    | 58.6    | 58.4    | 58.4 |
| Current account balance (% of GDP)          |            | -1.1                        | -0.9    | -1.2    | -1      | -0.02   | -1.2    | -0.9 | -1.2    | -0.9    | -0.75   | -0.02   | -0.7    | -0.7 |
| Short-term interest rate (3 m.) (%)         |            | 4.4                         | 4.6     | 4.5     | 6.63    | 4.8     | 4.5     | 5    | 4.2     | 4.3     | 4.5     | 4.8     | 4.3     | 4.4  |
| Long-term interest rate (10 yr.) (%)        |            | 5.4                         | 5       | 4.9     | 5       | 4.8     | 5.3     | 5    | 5.4     | 5.3     | 5.1     | 5.1     | 5.4     | 5.3  |
| United States Federal Funds Rate (%)        |            | 6.24                        |         |         | 5       | 4.5     |         | 4.8  |         |         | 5.3     | 5       |         | 5.2  |
| GDP United States                           |            | 5                           | 1.5     | 1.9     | 1.8     | 1.5     | 1.5     | 1.6  | 2.5     | 2.7     | 2.5     | 3       | 2.6     | 2.7  |
| GDP Japan                                   |            | 1.7                         | 0.8     | 1.1     | 0.8     | 0.8     | 0.9     | 0.9  | 1.4     | 1.4     | 1.5     | 1.5     | 1.4     | 1.4  |
| GDP European Union                          |            | 3.3                         | 2.5     | 2.7     | 2.6     | 2.4     | 2.4     | 2.5  | 2.6     | 2.6     | 2.6     | 2.5     | 2.6     | 2.6  |
| World trade volume (goods)                  |            | 13                          | 7       | 8.5     | 7       | 7       | 7       | 7.3  | 7       | 7       | 7.5     | 7       | 7.5     | 7.2  |
| Oil price (US\$/b Brent)                    |            | 28.8                        | 25      | 25      | 25.4    | 25      | 25      | 25.1 | 24      | 25      | 25      | 25      | 25.2    | 24.8 |
| Exchange rate, 1 euro = \$                  |            | 0.92                        | 0.93    | 0.93    | 0.95    | 0.96    | 0.93    | 0.94 | 0.96    | 1.01    | 1       | 1.04    | 0.98    | 1    |
| Exchange rate, 1 euro = natl. currency      |            | 1.95583                     | 1.95583 | 1.95583 | 1.95583 | 1.95583 | 1.95583 |      | 1.95583 | 1.95583 | 1.95583 | 1.95583 | 1.95583 |      |

(\*) EMU definition.

## GERMAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institutes; if forecasts differ, their maximum range is shown.

Source: OECD (2001); AIECE institutes.

## COMMENTS: DIW (March 2001)

The economic upswing in Germany lost momentum since mid-2000 and capacity utilization, still on a high level, was somewhat reduced. In the first months of this year, the number of unemployed persons was only slightly reduced. In spite of the considerable downward trend of oil prices, inflation in March was still 2.5%, i.e., still about at the same level as in late summer 2000, when the oil price was at its high. The direct and indirect effects of the oil price increase needed more time to work through than was supposed some months ago. But what was more important, administrative price increases and the consequences of BSE contributed much to the high level of inflation.

The slowing down of the world economy till now did not affect German exports to a large extent. But imports increased faster in the second half of 2000.

Most important was the slowing down of domestic demand. Especially private consumption grew only slowly, and the growth of investment in equipment came down, too. Construction activity was even negative. On the whole, there was no further progress in the process of adaptation of the east German economy to the west German economy.

In 2001, especially in the first half of the year, dampening effects on the German economy will come from the weak expansion of the world economy. Export dynamics will be reduced. With the recovery of the US economy in the second half of this year and higher imports of the oil-producing countries, export growth in Germany will recover to a certain extent.

Fiscal policy is supporting demand. The tax reform this year gives a stimulus in the order of 1% of GDP and reduces the tax burden of enterprises and private households. Next year fiscal policy will be slightly restrictive again.

Monetary policy is not stimulating. The probable reduction of the key interest rate by the ECB will come too late to compensate for the negative demand effects.

Wage policy is still moderate. Effective hourly wages in the year 2001 will increase by a little bit less than 2 ½% and a little bit more than 2 ½% in 2002. Unit wage costs will increase slightly more than this year. On the whole, there will be no pressure on prices from the wage side.

The growth trend in Germany will continue and the economy will recover in the later course of the year. Less export dynamics this year will—at least partly—be compensated by higher domestic demand. Monetary policy will become more expansive, having its main positive effects in 2002. Foreign demand will benefit from the recovery of the world economy. But there will be no further stimulus from fiscal policy. Thus in both years, GDP growth will only slightly exceed 2%. With lower growth in both years, unemployment will be reduced only slowly. Inflation will come down in the next quarters of the year as oil price effects are running out.

## RWI (March 2001)

In 2000, the recovery of the German economy continued. The upswing gained further momentum during the first half of the year, but slowed down afterwards, mainly due to the strong rise of the oil price. Demand for exports received strong impulses from the lively expansion of the world economy and was further supported by the continuous weakness of the euro. As a consequence, investment in equipment recovered strongly, also strengthened by some supply side factors (tax reform, decrease of unit labour costs and low real interest rates). Domestic demand as a whole, however, grew less than expected for two reasons: Private consumption suffered from the high oil price and investment in construction shrank further in view of the still high surplus built up after reunification. In addition, public expenditure remained weak. Employment increased strikingly; however, the expansion by nearly 600 000 is partly due to statistical revisions, now taking marginal part-time workers fully into account. At the same time, unemployment (ILO) decreased to an unemployment rate of 9.2%. Inflation remained moderate (1.9%), with half of the increase due to the rise of energy prices.

All in all, the international environment has worsened compared to last year. World trade will lose some of its momentum (2001: 8 ½%; 2002: 7 %) and the euro will revalue slightly against the US dollar. The crude oil price is expected to stay at about 25 \$/barrel.

## IFO (End of March 2001)

In Germany real GDP rose by 3% in 2000. This was the highest growth rate since the unification boom in the early nineties. Exports were the main driving force, propelled by very favourable world economic conditions and the significant devaluation of the euro vis-à-vis the US dollar. Falling unit labour costs also contributed to the strong export drive—exports of goods (and services) grew approximately in line with world trade (ca. 13%). Since imports rose by roughly 10%, the external balance contributed a full percentage point to output growth. Gross fixed capital formation continued to grow rather moderately (+ 2.4%), but the discrepancy between investment in plant and equipment (+ 9%) and investment in construction (−2.5%) remained considerable. The very weak performance of the construction sector—on-going since 1995—was mainly due to the continuing strong recession of this sector in east Germany; the development in the construction sector in west Germany was virtually stagnant. The expansion of private consumption came almost to a halt in the second semester due to the impact of much higher prices for energy. Consumer prices (HCPI) accelerated and rose by 2.1% on average. Employment picked up by 1.6%, while the unemployment rate (EUROSTAT) dropped by 0.5 percentage points against 1999 to 8.1%. The deficit of the current balance widened to 1.2% of GDP due to worse terms of trade.

The buoyant upswing, which started in mid-1999, came to an end in the course of the second semester 2000—as was indicated by the “Ifo Index” of the business climate, though order inflows and production in the industrial sector grew further. The main reasons were the oil price shock and the monetary tightening in the USA and the euro area.

Economic policy can be expected to stimulate the economy in 2001 but might be more or less neutral in 2002. The main contribution comes from fiscal policy thanks to the “tax reform 2000” which contains tax cuts for private households and enterprises in the order of 1.1% of GDP. In 2002 fiscal policy is likely to be somewhat restrictive. But, with the European Central Bank starting to lower its key rate in the summer half year 2001, this will be more than compensated by stimulating effects from monetary policy. In the course of 2001/2002 a moderate revaluation of the euro vis-à-vis the US dollar is expected.

The slowdown of economic growth will continue well into the current year, as is also indicated by the “Ifo business climate index”. Worsened world economic conditions and the dwindling effects of the euro devaluation are the main reasons. In addition the tightening of monetary policy until fall 2000

will be felt more and more. The beginning of the next upswing can be expected in late spring next year, triggered by an improving international environment, and led by the upswing in the USA. In the course of 2002 economic growth will gain further momentum.

In 2001 real GDP is expected to grow in the order of 2%. The expansion of exports in the first place, but also of gross fixed capital investment (the recession in the construction sector will continue) and of public consumption will slow down, while private consumption is likely to pick up somewhat due to the tax reform. The impact of slower growth will be felt on the labour market. Employment will grow only in the order of 0.9%, and the unemployment rate will drop less than the year before. Due to the persisting increase of prices for energy and food also in the second quarter (and a gradual slow-down during the second half-year) consumer prices will rise by more than 2% on average. The deficit of the current balance is likely to rise to ca. 1.5% of GDP.

In 2002 a general improvement of the economic situation is expected: Real GDP might grow by roughly 2.2%—which means an acceleration from the second quarter onwards—with exports and gross fixed capital formation gaining momentum and private consumption growing by slightly more than 2%. The improvement of the labour market will be about the same as in 2001. Consumer prices are likely to continue rising more slowly well into 2002; the level will be about 1.5% higher than 2001. The deficit of the current balance is likely to decline as well as the general government financial balance.

HWWA (March 21, 2001)

Economic expansion, unsustainably strong until last summer, slowed considerably in Germany since then, with dampening effects from monetary policy as well as—temporarily—faster rising prices being the main factors behind the slowdown. Weaker world demand meanwhile showed hardly up in exports yet. Nevertheless the external contribution to growth was slightly negative as imports soared (with the deflator of imports in national accounts having risen much less than that of unit values of goods, the increase of imports may be somewhat exaggerated, however).

Internal demand will rise significantly faster again in the first half of 2001 as a result of reductions in income tax at the beginning of this year; next year fiscal policy will be neutral again. The effects of fiscal impulses waning this summer will be partly offset by a deceleration in price increases. The strong rise in food prices is expected to be but temporary; further, with lower oil prices and some revaluation of the euro, the terms of trade are improving. The prospective return into the stability range as well the slow monetary expansion is expected to cause the ECB to lower the repo rate by half a percentage point shortly. Monetary policy then will be about neutral for Germany; the same applies to monetary conditions with the euro assumed to revalue slightly in the forecast period. In the later part of the year and in 2002 external demand will be stronger again partly due to a recovery in the US.

On the whole GDP will rise less this year and next than it did in 2000. But increases by about 2.3 to 2.4% will correspond roughly to potential growth. Comprehensive structural measures to foster potential growth aside from lowering taxes, e.g. in the labour market, are not projected. Employment will increase, though more moderately than last year, and unemployment will continue to fall, but moderately. The inflation rate (year on year) will sink below the mark of 2% in the later part of the year, as the temporary forces driving inflation will abate. Further we assume that wage moderation will continue. Uncertainty on this, however, has grown somewhat during recent weeks as the climate between the bargaining partners cooled off.

KIEL (March 2001)

In 2000, the German economy grew with the highest rate since reunification. The main reasons were the hitherto expansive orientation of monetary policy and the very favorable economic environment in

the world economy. Helped by the strong decline of the real exchange rate of the euro, German exports grew at record pace. However, while exports expanded strongly until the end of the year, domestic demand growth was dampened in the second half of 2000 by the increase in oil prices and the tightening of monetary policy. Real GDP increased only by an annual rate of 1 percent in the course of the second half of the year, following 4.4 percent in the first half. Private consumption was restrained by the adverse impact of higher consumer price inflation on real disposable income. The dynamics of investment in machinery and equipment also lost some of its momentum, but remained headed upwards supported by some frontloading of investment projects in order to escape the tightening of depreciation rules that went into effect at the start of the year.

In the first half of 2001, economic growth will benefit from the reduction in personal income tax rates that came into force in January. Tax cuts amount to 1.1 percent of GDP and are only partly offset by slower growth in expenditures and lower depreciation allowances. Moreover, there are positive impulses from falling capital market interest rates and lower energy costs. We therefore expect a temporary increase in the growth rate of aggregate production in the first quarter. Following this tax-related acceleration, the economy will slow down starting from the second quarter. As the world economy loses momentum and the euro appreciates, export growth will decline sharply. However, the economy will not move into recession since domestic demand will remain robust. As monetary policy is expansionary this year and neutral next year, investment will continue to grow. Private households will expand expenditures as real disposable income continues to increase as employment continues to grow, although at a slower pace than in 2000, wages rise at a slightly higher pace, and consumer price inflation is reduced. The gradual recovery of the world economy that we expect to start in the second half of 2001 will more and more support growth in the course of next year. All in all, we expect real GDP to expand by 2.1 percent in 2001 and by 2.2 percent in 2002. Consumer prices will rise by 2.2 percent and 1.5 percent this year and next year, respectively. The unemployment rate will fall from 9.2 percent in 2000 to 8.1 percent in 2002.

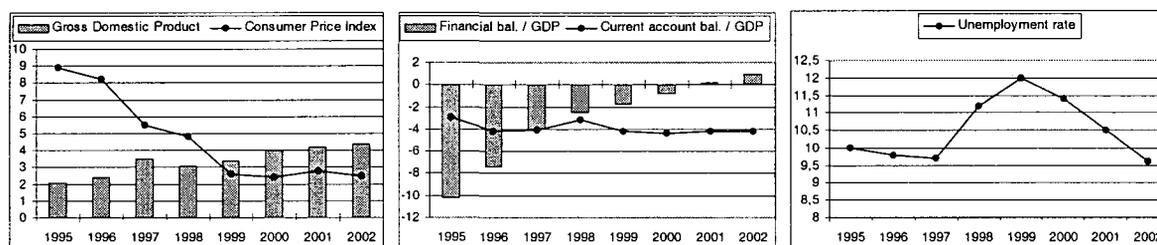
Country: Greece

Institute: KEPE  
Date of forecast: April 2001

|                                             | LEVEL          | Volumes, average growth |       |       |
|---------------------------------------------|----------------|-------------------------|-------|-------|
|                                             | 2000           | 2000                    | 2001  | 2002  |
|                                             | bill. drachmas | %                       |       |       |
| GDP                                         | 40,872         | 4                       | 4.2   | 4.4   |
| Private consumption                         | 28,780         | 3.1                     | 3.3   | 3.4   |
| Public consumption                          | 6,130          | 1                       | 0.9   | 0.9   |
| Gross fixed capital formation               | 9,686          | 9.2                     | 9.6   | 10.2  |
| of which:                                   |                |                         |       |       |
| Equipment                                   | 3,415          | 9.9                     | 10.2  | 11.2  |
| Construction                                | 5,131          | 8.1                     | 9.7   | 10.1  |
| Change in stocks (contrib. to growth)       |                | -0.1                    | 0.2   | -0.2  |
| Total domestic demand                       | 44,678         | 4.4                     | 4.4   | 4.7   |
| Exports of goods and services               | 8,655          | 6                       | 6.2   | 6.2   |
| Imports of goods and services               | 12,461         | 7.5                     | 7     | 7     |
| GDP deflator                                |                | 3                       | 3     | 2.7   |
| Consumer prices (consumer price index)      |                | 2.4                     | 2.8   | 2.5   |
| Hourly wages                                |                | 3.9                     | 4     | 3.6   |
| Employment (1,000 persons)                  | 3,940          | 1.2                     | 1.4   | 1.5   |
| Unemployment rate (%)                       |                | 11.4                    | 10.5  | 9.6   |
| Saving rate, households (%)                 |                | 10.7                    | 11.5  | 12    |
| Public sector financial bal. (% of GDP) (*) |                | -0.8                    | 0.2   | 1     |
| Gross public debt (% of GDP) (*)            |                | 103.9                   | 100.2 | 97.2  |
| Current account balance (% of GDP)          |                | -4.4                    | -4.2  | -4.2  |
| Short-term interest rate (3 m.) (%)         |                | 6.5                     | 5.2   | 5     |
| Long-term interest rate (10 yr.) (%)        |                | 6                       | 5.7   | 5.5   |
| United States Federal Funds Rate (%)        |                |                         |       |       |
| GDP United States                           |                | 5                       | 1.5   | 2.5   |
| GDP Japan                                   |                | 1.7                     | 0.8   | 1.1   |
| GDP European Union                          |                | 3.3                     | 2.7   | 2.9   |
| World trade volume (goods)                  |                | 10.4                    | 6.2   | 6.5   |
| Oil price (US\$/b Brent)                    |                | 29                      | 25    | 25    |
| Exchange rate, 1 euro = \$                  |                | 0.93                    | 0.93  | 0.98  |
| Exchange rate, 1 euro = natl. currency      |                | 336                     | 340.5 | 340.5 |

(\*) EMU definition.

## GREEK ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

## COMMENT: KEPE

Macroeconomic conditions have improved remarkably, in Greece, during recent years. Since 1997, the Greek economy has returned to a firm growth path with GDP growth rates above EU average. Economic growth, which averaged 3.1% during the 1996–99 period, accelerated in 2000, reaching 4.0 per cent. Activity was led by robust domestic demand with investment spending being the principal

contributing factor. The growth rate is expected to increase somewhat in the current year, reaching 4.2 per cent.

The average annual inflation rate, which was reduced by nearly 6 percentage points in the 1996–99 period to a rate of 2.5% in 1999, rose again in 2000 as a consequence of higher world oil prices, looser monetary conditions and exchange rate depreciation. The average increase in the private consumption deflator was 2.9% in 2000. The twelve-month average CPI is currently running at 3.2% and core inflation is also rising in part due to the unwinding of indirect tax cut effects, which were part of the anti-inflation policies of previous years.

Government efforts to contain inflation pressures are expected to be relatively successful, as wage settlements have remained moderate. Increased competition in goods and services markets should also play a role in strengthening anti-inflation policies. However, higher inflation remains the major risk, both in relation to the weakness of fiscal plans but also to the possible short-run effects of monetary easing. Also, a threat of cost inflation cannot be entirely ruled out given the combination of a wage drift in certain sectors and catch-up clauses in the present wage agreements.

Central bank intervention rates converted to Eurozone levels at the end of 2000. Long-term government bond rates have also declined accordingly, although, in comparison to German bonds, a difference of 0.5 percentage points persists. Commercial bank lending rates, on the other hand, are still 1–3 percentage points higher than those in the euro area, despite a decline of around 3.4 percentage points.

The fiscal consolidation effort, undertaken over recent years, resulted in gradually reducing the size of the general government's deficit from 7.4% of GDP in 1996 to an estimated 0.8% in 2000. Although the fiscal outlook for 2001 is favourable, the government is running into difficulties realizing the small surplus (0.5% of GDP) included in this year's budget.

At the public debt front the rate of decline has been slower. Despite the generation of large primary surpluses in the state sector since 1996, the debt ratio declined only by 7.4 percentage points, from 111.3% of GDP in 1996 to 103.9% in 2000. The target of a quick decline over the next four years to about 85% of GDP in 2004 appears presently rather optimistic but the downward trend in the debt ratio is expected to strengthen in the following years, if the privatization programme has a significant degree of success.

Output growth has not been accompanied by comparable employment growth. Employment has increased by an average of 0.8% over the 1996–2000 period, while at the same time the labour force increased by an average 1.3%. The combined result is a considerable increase in unemployment, which reached the record level of 11.8% in 1999 and, according to provisional data, 11.3% in 2000. Unemployment has become the major challenge for policy makers, and the immediate outlook is not particularly bright as a substantial part of unemployment is considered to be of a structural character. The recent labour market reform, introduced with a view to increase flexibility, has not produced any positive results as yet. On the other hand participation rate is expected to continue rising. In consequence, unemployment is forecast to decline very slowly in response to increased economic activity.

The current account deficit, which improved slightly in 1999 at 3.2% of GDP, has deteriorated in 2000, standing, according to the most recent estimates, at 4.4% of GDP on a national accounts basis. This deterioration is partly the result of increased oil prices but reflects also the considerable increase in the volume of non-oil imports (mainly capital equipment and non-durables) and has occurred despite the satisfactory export performance particularly to non-EU countries. The picture is not expected to change in the course of the current and next year.

The most serious risk to the forecasts is the weakness of euro area growth. A further risk concerns the longer-term sustainability of growth, which hinges as much on the success of structural reforms as on sound financial policies. From the long unfinished agenda one item stands out as requiring the most urgent attention, namely the social security system. The government is currently attempting to introduce a major social security reform amidst strong opposition of labour unions.

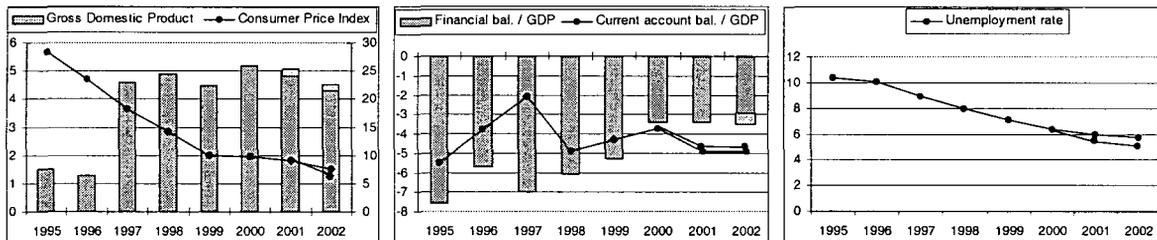
Country: Hungary

Institute: GKI Co.  
Date of forecast: April 2001

|                                             | LEVEL           |           | Volumes, average growth |        |       |         |        |        |          |        |       |
|---------------------------------------------|-----------------|-----------|-------------------------|--------|-------|---------|--------|--------|----------|--------|-------|
|                                             | 2000 euro bill. |           | 2000                    |        |       | 2001    |        |        | 2002     |        |       |
|                                             | GKI             | KOPINT    | GKI                     | KOPINT | avg   | GKI     | KOPINT | avg    | GKI      | KOPINT | avg   |
| GDP                                         | 49.6            | 49.43     | 5.3                     | 5.2    | 5.3   | 5       | 4.8    | 4.9    | 4.4      | 4.5    | 4.5   |
| Private consumption                         |                 | 30.91     | 3.8                     | 3.3    | 3.6   | 5       | 4.4    | 4.7    | 4.5      | 4.3    | 4.4   |
| Public consumption                          |                 | 4.79      | 2.5                     | 1.6    | 2.1   | 3       | 2.5    | 2.8    | 2.8      | 2.5    | 2.7   |
| Gross fixed capital formation               |                 | 11.94     | 6.5                     | 6.6    | 6.6   | 11      | 8      | 9.5    | 9        | 7.5    | 8.3   |
| of which:                                   |                 |           |                         |        |       |         |        |        |          |        |       |
| Equipment                                   |                 |           | 6                       | 7.6    | 6.8   | 9       | 8.8    | 8.9    | 8        | 8      | 8     |
| Construction                                |                 |           | 7                       | 5.8    | 6.4   | 13      | 7      | 10     | 10       | 7      | 8.5   |
| Change in stocks (contrib. to growth)       |                 | 30.3      |                         | 6.1    | 6.1   |         | 6.2    | 6.2    |          | 6      | 6     |
| Total domestic demand                       |                 | 50.67     | 5.1                     | 5      | 5.1   | 5.8     | 5.2    | 5.5    | 4.6      | 4.7    | 4.7   |
| Exports of goods and services               | 30.5            | 30.23     | 22                      | 21.8   | 21.9  | 13      | 13     | 13     | 11       | 11     | 11    |
| Imports of goods and services               | 34.8            | 31.46     | 21                      | 21.1   | 21.1  | 14      | 13.5   | 13.8   | 12       | 11     | 11.5  |
| GDP deflator                                |                 |           | 9.8                     | 8.9    | 9.4   | 9       | 8.4    | 8.7    | 7.5      | 5.8    | 6.7   |
| Consumer prices (consumer price index)      |                 |           | 9.8                     | 9.8    | 9.8   | 9       | 9      | 9      | 7.5      | 6.5    | 7     |
| Hourly wages                                |                 | HUF 55800 | 3.4(***)                | 11.4   | 7.4   | 5(***)  | 11.4   | 8.2    | 4.6(***) | 8.8    | 6.7   |
| Employment (1,000 persons)                  | 2,718           |           |                         | 1      |       | 0.9     | 1      | 1      | 0.7      | 1      | 0.9   |
| Unemployment rate (%)                       |                 |           | 6.4                     | 6.4    | 6.4   | 6       | 5.5    | 5.8    | 5.7      | 5.3    | 5.5   |
| Saving rate, households (%)                 |                 |           | 4.3                     | 9      | 6.7   | 4       | 9.3    | 6.7    | 4.2      | 9.4    | 6.8   |
| Public sector financial bal. (% of GDP) (*) |                 |           | -3.4                    | -3.5   | -3.5  | -3.4    | -3.4   | -3.4   | -3/-3.5  | -3.2   | -3.2  |
| Gross public debt (% of GDP) (*)            |                 |           | 56                      | 59     | 57.5  | 55      | 58     | 56.5   | 54       | 56     | 55    |
| Current account balance (% of GDP)          |                 | -1.9      | -3.7                    | -3.8   | -3.8  | -4.9    | -4.7   | -4.8   | -4.9     | -4.7   | -4.8  |
| Short-term interest rate (3 m.) (%)         |                 |           | 11.58(**)               | 11.8   | 11.7  | 10(**)  | 10.5   | 10.3   | 9(**)    | 8.2    | 8.6   |
| Long-term interest rate (10 yr.) (%)        |                 |           | 8(**)                   | 8      | 8     | 7.5(**) | 7.85   | 7.7    | 7(**)    | 5.7    | 6.4   |
| United States Federal Funds Rate (%)        |                 |           | 5.5                     | 5.5    | 5.5   | 5       | 5      | 5      | 5        | 5      | 5     |
| GDP United States                           |                 |           | 5.3                     | 5      | 5.2   | 2       | 1.8    | 1.9    | 1.5      |        | 1.5   |
| GDP Japan                                   |                 |           | 0.7                     | 1.7    | 1.2   | 1-2     | 1      | 1      | 1        |        | 1     |
| GDP European Union                          |                 |           | 3.2                     | 3.4    | 3.3   | 2.6     | 2.7    | 2.7    | 2.8      |        | 2.8   |
| World trade volume (goods)                  |                 |           | 4                       | 12     | 8     | 3       | 6.5    | 4.8    | 3        |        | 3     |
| Oil price (US\$/b Brent)                    |                 |           | 29                      | 28.5   | 28.8  | 25-27   | 25     | 25     | 23-25    |        |       |
| Exchange rate, 1 euro = \$                  |                 |           | 0.92                    | 284    |       | 0.95    | 0.92   | 0.935  | 0.95     | 0.93   | 0.94  |
| Exchange rate, 1 euro = natl. currency      |                 |           | 260.6                   | 261    | 260.8 | 268.5   | 269    | 268.75 | 279.6    | 275    | 277.3 |

(\*) EMU definition. — (\*\*) At end of year. — (\*\*\*) Yearly average gross wages.

## HUNGARIAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institutes; if forecasts differ, their maximum range is shown.

Source: OECD (2001); AIECE institutes.

## COMMENTS: GKI CO. (March 2001)

Tendencies that started in the second half of last year continue in early 2001. Economic growth slows down, the increase of demand accelerates, inflation does not decline, trade and current account balances deteriorate, and capital outflow continues. In the past years, the Hungarian economy managed to achieve a growth rate 2 percentage points higher than in the EU. This difference is expected to persist, and GDP growth will be probably close to 5% this year.

Imports expand faster than exports, although the latter increase dynamically, too. As a consequence, trade deficit will be also high. Foreign trade turnover of custom-free zones will increase somewhat faster than the average. A portion of the import increase serves investment purposes. The high trade

deficit can already be detected in the current account balance. In the whole year, the external equilibrium is expected to deteriorate, a current account deficit of 2.5 billion euro is expected.

Inflation in Hungary will decrease only to a small extent this year. Domestic energy prices—partly in connection with their artificial stop last year—are still heading toward higher levels (for example gas prices will rise by 12% this year but still remain below cost level). Agricultural and food prices will probably increase further. Prices of consumer durables and clothes will rise, however, moderately. The average price increase of the first half of the year will be around 9.8%, while that of the second half will be approximately 8.2%.

Domestic demand will be strong, the growth of investments will be higher than in 2000, appr. 11% in 2001. Real wages increase by about 4%, and household consumption by 5% due to a declining savings rate. Budget deficit will be around 3.4% of GDP.

We expect that exchange rate policy will be changed at the end of this year or somewhat later when the crawling peg will be abolished. Even if it were to serve anti-inflation policy, it would affect the competitiveness of the Hungarian economy negatively and therefore priorities of economic policy have to be changed in 2002 (election year) when the aspects of economic equilibrium would come to the front.

Kopint-Datorg (April 10, 2001)

In 2000, the Hungarian economy developed dynamically. The 5.2% growth of GDP was driven, first of all, by export-oriented industrial development. Gross industrial production increased by 18%, commodity exports in current euro terms by 30%. The driving force of this development was multinational companies that continue to invest strongly in the country (most of new investment are “greenfield”) in spite of the fact that large-scale privatization had come to an end. More important than inflow of new capital (FDI) into Hungary is the accumulation of assets of foreign-owned companies as a result of re-investment of their profits. Domestically owned firms develop more modestly. As a consequence of this development path, and the deterioration of the terms of trade by 2.7% in 2000 (GDI increased by 3.8% only), domestic incomes and domestic uses of GDP showed a more modest improvement than that suggested by the indicators of production growth. Real wages increased by 1.5%, real incomes per capita by 3%; and the growth rate of private consumption (about 3.5%) as well as that of investment (6.5%) are clearly below the rate which was usually expected on the basis of the data about GDP and industry (manufacturing). The inflation rate was unexpectedly high (9.8% measured as CPI) mostly (but not exclusively) because of exogenous reasons. Domestic and external balances remained at a satisfactory level. (Public sector deficit was smaller than planned.) The current economic situation still seems to be promising for further growth, although external conditions are less favourable than last year. Domestic demand has an increasing impact on GDP growth, partly because of the ‘expansionist’ cycle of the economic policy (in May 2002, there will be parliamentary elections in Hungary). Although external impacts do not increase the consumer price index as much as last year, inflation remains high in the forecast period, especially because of the decreasing level of trust in government inflation projections (i.e. stubbornly strong inflations expectations of households).

Country: **Ireland**

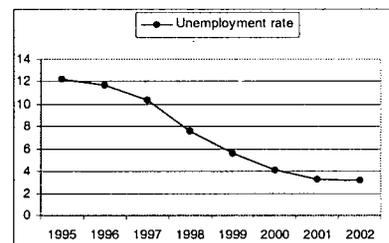
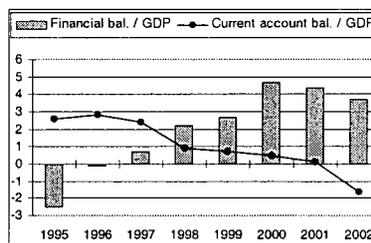
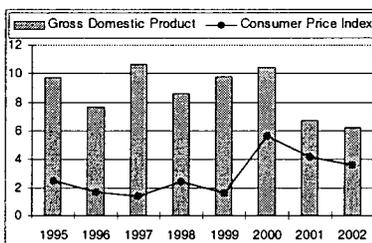
Institute: ESRI

Date of forecast: March 2001

|                                             | LEVEL      | Volumes, average growth |      |      |
|---------------------------------------------|------------|-------------------------|------|------|
|                                             | 2000       | 2000                    | 2001 | 2002 |
|                                             | euro bill. | %                       |      |      |
| GDP                                         |            | 10.5                    | 6.7  | 6.2  |
| Private consumption                         |            | 9.4                     | 7.6  | 6.8  |
| Public consumption                          |            | 5                       | 5.2  | 4.6  |
| Gross fixed capital formation               |            | 11.2                    | 7.1  | 6.9  |
| of which:                                   |            |                         |      |      |
| Equipment                                   |            | 14.6                    | 7.8  | 8    |
| Construction                                |            | 9.1                     | 6.8  | 6.3  |
| Change in stocks (contrib. to growth)       |            |                         |      |      |
| Total domestic demand                       |            | 9.5                     | 7.1  | 6.7  |
| Exports of goods and services               |            | 19                      | 8.6  | 8.5  |
| Imports of goods and services               |            | 18.4                    | 8.8  | 9.8  |
| GDP deflator                                |            | 6.2                     | 6.6  | 5    |
| Consumer prices (consumer price index)      |            | 5.6                     | 4.2  | 3.6  |
| Hourly wages                                |            | 7.8                     | 11.1 | 9.8  |
| Employment (1,000 persons)                  | 1,691      |                         | 3    | 1.9  |
| Unemployment rate (%)                       |            | 4.1                     | 3.3  | 3.2  |
| Saving rate, households (%)                 |            | 7                       | 7.6  | 7.2  |
| Public sector financial bal. (% of GDP) (*) |            | 4.7                     | 4.4  | 3.7  |
| Gross public debt (% of GDP) (*)            |            | 39                      | 32.3 | 24.5 |
| Current account balance (% of GDP)          |            | 0.5                     | 0.1  | -1.6 |
| Short-term interest rate (3 m.) (%)         |            |                         |      |      |
| Long-term interest rate (10 yr.) (%)        |            |                         |      |      |
| United States Federal Funds Rate (%)        |            |                         | 4.6  | 3.75 |
| GDP United States                           |            |                         | 1.8  | 2.5  |
| GDP Japan                                   |            |                         | 1    | 1.3  |
| GDP European Union                          |            |                         | 2.8  | 2.7  |
| World trade volume (goods)                  |            |                         |      |      |
| Oil price (US\$/b Brent)                    |            |                         |      |      |
| Exchange rate, 1 euro = \$                  |            | 1.17                    | 1.18 | 1.3  |
| Exchange rate, 1 euro = natl. currency      |            |                         |      |      |

(\*) EMU definition.

## IRISH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: ESRI*

Irish economic growth rates have defied most expectations by continuing to accelerate over the last two years. Output growth in 2000 is estimated to be 10.5 per cent in real GDP terms, driven, in part, by strong export growth and reinforced by buoyant domestic demand. The growth in output as measured by real GNP is estimated to have reached a historical high of 9.8 per cent in 2000. Inflation in consumer prices averaged 5.6 per cent in 2000, with the unemployment rate ending the year at 3.6 per cent. Against this exceptional performance, the prospects for output growth in 2001 and 2002 look more modest, but are also much more uncertain.

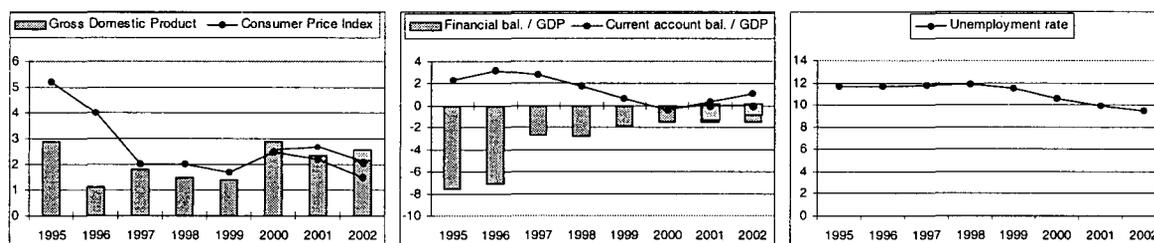
The uncertainties arise from the prospects for the external environment given the rapid slowdown in the United States and from the economic threat posed by the foot-and-mouth crises within Europe. Our forecasts are predicated on the balance of probabilities that the US will experience a "soft landing", with economic activity recovering in the latter part of 2001. We have taken a benign view on the impact of the foot-and-mouth outbreak, assuming that it will be regionally confined and the containment measures will have their greatest impact over a duration of one quarter. Growth in 2001 is forecast to be 6.7 per cent in real GDP and 6.1 per cent in real GNP terms. This revised forecast for 2001 reduces the growth rate by over half a percentage point. The growth prospects for 2002 are much more susceptible to the extent and duration of the US slowdown. We forecast that output growth in 2002 will be 6.2 and 5.2 per cent in real GDP and real GNP terms, respectively. Inflation as measured by the consumer price index is forecast to moderate to 4.2 per cent in 2001 and 3.6 per cent in 2002. The unemployment rate is forecast to continue to decline this year to average 3.3 per cent and levelling off to a 3.2 per cent average in 2002.

## Country: Italy

|                                             | LEVEL      | Volumes, average growth (%) |            |          |          |                |          |            |          |          |                |          |
|---------------------------------------------|------------|-----------------------------|------------|----------|----------|----------------|----------|------------|----------|----------|----------------|----------|
|                                             | 2000       | 2000                        | 2001       |          |          |                |          | 2002       |          |          |                |          |
|                                             | euro bill. |                             | PRO-METEIA | IRS      | ISAE     | CONFIN-DUSTRIA | avg      | PRO-METEIA | IRS      | ISAE     | CONFIN-DUSTRIA | avg      |
| GDP                                         | 921.37     | 2.9                         | 2.3        | 2.4      | 2.4      | 2.3            | 2.4      | 2.4        | 1.9      |          | 2.5            | 2.3      |
| Private consumption                         | 599.183    | 2.9                         | 2.2        | 2.4      | 2.3      | 2.4            | 2.3      | 2.4        | 2.1      |          | 2.6            | 2.4      |
| Public consumption                          | 156.821    | 1.7                         | 1.1        | 0.5      | 1.2      | 1.1            | 1        | 1          | 1.4      |          | 1              | 1.1      |
| Gross fixed capital formation               | 188.554    | 6.1                         | 3.5        | 5.9      | 5.1      | 4.3            | 4.7      | 4.3        | 4.9      |          | 5.3            | 4.8      |
| of which:                                   |            |                             |            |          |          |                |          |            |          |          |                |          |
| Equipment                                   | 134.44     | 7.8                         | 4.5        | 7.5      | 7        | 5.6            | 6.2      | 6.3        | 6.4      |          | 6.3            | 6.3      |
| Construction                                | 92.44      | 3.6                         | 1.9        | 3.5      | 2.4      | 2.4            | 2.6      | 1.3        | 2.5      |          | 3.8            | 2.5      |
| Change in stocks (contrib. to growth)       | -1         | -1                          | 0.4        | 0.1      | 0.2      | -0.2           | 0.1      | 0.3        | 0.1      |          | 0              | 0.1      |
| Total domestic demand                       | 906.193    | 2.3                         | 2.6        | 2.8      | 2.9      | 2.4            | 2.7      | 2.9        | 2.6      |          | 2.8            | 2.8      |
| Exports of goods and services               | 277.318    | 10.2                        | 5.6        | 5.7      | 6.4      | 6.6            | 6.1      | 5.8        | 3.5      |          | 5.6            | 5        |
| Imports of goods and services               | 262.141    | 8.3                         | 6.9        | 7.6      | 8.1      | 7              | 7.4      | 7.5        | 6.4      |          | 7              | 7        |
| GDP deflator                                | 115        | 2.2                         | 2.4        | 3        | 2.7      | 2.4            | 2.6      | 2.3        | 2.4      |          | 2.3            | 2.3      |
| Consumer prices (consumer price index)      | 112.8      | 2.5                         | 2.6        | 2.6      | 2.2      | 2.5            | 2.5      | 1.5        | 1.6      |          | 2              | 1.7      |
| Hourly wages                                |            | 2.5                         | 2.5        | 3.3      | 2.9      |                | 2.9      | 3.2        | 2.6      |          | 1.1            | 2.3      |
| Employment (1,000 persons)                  | 23,545.3   | 1.5                         | 1.2        | 1.1      | 1.3      | 1.2            | 1.2      | 1          | 0.7      |          | 1.1            | 0.9      |
| Unemployment rate (%)                       |            | 10.6                        | 9.9        | 9.8      | 9.8      | 9.9            | 9.9      | 9.5        | 9.4      |          | 9.5            | 9.5      |
| Saving rate, households (%)                 |            | 12.2                        | 11.2       | 12.5     | 12.1     |                | 11.9     | 11.2       | 12.3     |          | 1.3            | 8.3      |
| Public sector financial bal. (% of GDP) (*) |            | -1.5                        | -1.3       | -1.5     | -1.3     | -1.4           | -1.4     | -1.1       | -1.5     |          | -1.3           | -1.3     |
| Gross public debt (% of GDP) (*)            |            | 110.8                       | 107.6      | 105.8    | 106.9    | 107.6          | 107      | 105.4      | 103.7    |          | 105.7          | 104.9    |
| Current account balance (% of GDP)          |            | -0.4                        | 0.4        | 0.2      | -0.1     | -0.2           | 0.1      | 1.1        | 0.2      |          | -0.2           | 0.4      |
| Short-term interest rate (3 m.) (%)         |            | 4.3                         | 4          | 4.3      |          | 4.2            | 4.2      | 3.7        | 4        |          | 4.2            | 4        |
| Long-term interest rate (10 yr.) (%)        |            | 5.6                         | 4.8        | 4.9      |          | 4.8            | 4.8      | 4.5        | 4.7      |          | 5              | 4.7      |
| United States Federal Funds Rate (%)        |            | 6.25                        | 4.2        | 4.7      |          | 4.6            | 4.5      | 4          | 4        |          | 4              | 4        |
| GDP United States                           | 6,988.974  | 5                           | 1.2        | 1.3      | 2.2      | 1.4            | 1.5      | 2          | 1.5      |          | 2.5            | 2        |
| GDP Japan                                   | 4,272.65   | 1.7                         | 0.9        | 1.3      | 1.8      | 1              | 1.3      | 1.6        | 1.6      |          | 1.5            | 1.6      |
| GDP European Union                          | 7,559.883  | 3.4                         | 2.3        | 2.4      | 2.8      | 2.5            | 2.5      | 2.5        | 2.3      |          | 2.8            | 2.5      |
| World trade volume (goods)                  |            | 11.2                        | 5.5        | 5.9      | 7.7      | 5.9            | 6.3      | 5.6        | 5.3      |          | 7.3            | 6.1      |
| Oil price (US\$/b Brent)                    |            | 28.5                        | 25.5       | 25.4     | 25       | 26             | 25.5     | 24         | 24.3     |          | 26             | 24.8     |
| Exchange rate, 1 euro = \$                  |            | 0.92                        | 0.93       | 0.95     | 0.974    | 0.95           | 0.95     | 1.01       | 1        |          | 1              | 1        |
| Exchange rate, 1 euro = natl. currency      |            | 1,936.27                    | 1,936.27   | 1,936.27 | 1,936.27 | 1,936.27       | 1,936.27 | 1,936.27   | 1,936.27 | 1,936.27 | 1,936.27       | 1,936.27 |

(\*) EMU definition.

### ITALIAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institutes; if forecasts differ, their maximum range is shown.

Source: OECD (2001); AIECE institutes.

#### COMMENTS: PROMETEIA (April 2001)

In the second half of 2000 the Italian economy started to slow even if average figures for last year are very favourable. The slowdown was mainly due to exports growth deceleration and, to a lesser extent, to the deceleration of consumption and investment growth as a consequence of the oil shock and the early signs of the deceleration in the US economy. Many indicators suggest that the slowdown continues. The worsening of the international scene and the increased uncertainties, coming also from the financial markets instability, are the main causes. Assuming that the international economy will recover in the second half of the year, the economic growth is expected to improve also in Italy. However, the world recovery is expected to be slow and hence also 2002 figures will be affected: GDP is likely to increase by 2.3% this year and 2.4% next year (2.9% in 2000).

Domestic demand growth should remain relatively sustained, since the budget policy is slightly expansionary with its measures for households and firms, and labour market conditions should continue to improve. Moreover, interest rates are low by historical standards, both in nominal and real terms. On the contrary, net exports contribution to GDP growth will be negative in 2001 and 2002 due to the marked slowdown of exports growth caused by the more moderate pace of world trade growth.

In recent years employment increased at a relatively fast rate (for instance, in January 2001 it was 3.2% higher than in the same month of 2000). It is expected to increase at a more moderate rate reflecting the less favourable economic activity developments. However, the unemployment rate should continue to decrease. It should be noted that in the northern regions it is already very low: 2.8% for males and 6.3% for females.

The current account of the balance of payments registered a deficit in 2000 (the first since 1992) due to the terms of trade losses (the non-oil trade surplus was stable). It should improve in 2001, mainly as a result of the oil price developments (it is expected to average around \$25 per barrel).

In the first quarter inflation was higher than expected (it was 2.9%) because of marked increases in food and services prices. The expected deceleration is based on the above mentioned assumptions concerning the oil price and on the fact that the core inflation seems to have already reacted to the oil shock (it gradually accelerated and now is around 2.5%). In 2002 the deceleration is likely to be rapid mainly due to a statistical effect. It is worth noting that the inflation deceleration and the reduction of inflation differential would be more rapid through the liberalization of several markets, especially in the non-tradeable sectors.

In 2000 the public sector deficit / GDP ratio was 1.5% (excluding UMTS revenues) as indicated in the 1999 Stability Program but slightly higher than expected more recently by the government (1.3%). It is expected to decrease gradually in 2001 and 2002, but it seems unlikely to meet the Stability Program targets (-0.8% and -0.5%, respectively), mainly because of a less sustained economic growth (according to this document, GDP should increase by 2.9% in 2001 and 3.1% in 2002).

## IRS (April 2001)

The economy was growing at a good pace till the end of last year. Data for the first quarter still remain satisfactory. However, leading indicators are rapidly deteriorating. The prospect is that of a slowdown of the economy during the second half of the year, driven by the worsening export demand.

Specific factors are affecting the profile of the domestic demand. Private consumption is sustained by the stimulus of the tax reductions and by the employment recovery that took place until the beginning of this year. The expectations of further tax reduction are probably playing a role. However, our estimates suggest that the public deficit this year is higher than the government target, and there won't be any possibilities for further fiscal stimulus.

Firms at the beginning of the year seem to delay their investments, waiting for the fiscal reductions expected by the next government (a new "Tremonti law"). Then, we expect a recovery of the investment demand during the second half of the year after a slowdown during the first two quarters. This would be an exceptional behavior, as investments are supposed to move according to a counter-cyclical profile. However, the risk is that these delayed investments won't be realized if the business cycle worsens more than expected.

We expect that after the high growth rate of the fourth quarter 2000 (0.8 per cent according to preliminary estimates), the growth in the first quarter will be at almost the same rate. This implies that, despite a significant slowdown during the second half of this year, the average growth rate will remain near 2.5 per cent.

Inflation will be reduced during this year for the energy and food products. At the end of the year we are projecting an inflation rate at 2 per cent with a "core" inflation (excluding the food and energy products) near 2.4 per cent.

## ISAE (January 2001)

After the positive result of the fourth quarter of last year (when GDP accelerated and increased by 0.8% on a quarter-to-quarter basis), the Italian economy has registered a deceleration at the beginning of 2001. Industrial production fell both in January and February, and the ISAE survey indicator on business confidence, which has been diminishing since the last part of 2000, strongly deteriorated in the first two months of 2001. The fall of entrepreneurs' confidence reflected a worsening of current and future orders as well as less positive expectations on future trends of production. Some more positive signs come from the consumers' confidence indicator that has been improving, with some temporary interruptions, since last November: in March it achieved a value just below the favourable average level attained during last summer.

Notwithstanding the deceleration of industrial activity, still positive news come from the labour market: in January, employment kept on increasing and the seasonally adjusted unemployment rate fell below 10%. The improvement reflected better trends both in the North and in the South of Italy.

Inflation (measured on the basis of the national index of consumer prices) has been a bit higher than expected in the first months of 2001. This has been caused by the lagged impact of the past oil price increases and of the weak euro on final goods and services, compounded with the "mad-cow effect" on food prices. However, the figure of March has showed a deceleration; expectations of operators (both entrepreneurs and households) surveyed by ISAE point to a slowdown of inflation.

Given these trends, the Italian economy should register on average this year a deceleration of growth (GDP should rise by about 2.4%, after having increased by 2.9% last year). The slowdown basically reflects the deterioration of net exports, due to the world trade deceleration and the diminishing of the stimulating effect of the euro depreciation. The deterioration of the net external demand should only partly be compensated by a still positive domestic demand. The latter would be stimulated

by the reduction of fiscal pressure on households and firms and by an improvement in the terms of trade, coming from lower oil prices.

Employment is expected to continue to grow and the unemployment rate to further fall. As for inflation, after the peak of the first quarter consumer prices should register a deceleration favoured by the easing of external pressures. On average, the rate of increase of the national index could be 2.4% in 2001; the rate of increase in the Harmonised Index would be a little lower and stay at 2.2%.

#### CONFINDUSTRIA (April 2001)

According to ISTAT data for January and CSC survey for February and March, industrial production stabilized in the first quarter on roughly the same level as in the last quarter of 2000. Business confidence declined in the first months of the year, reflecting a slump of both domestic and foreign orders; manufacturing firms registered also an increase in the level of inventories, which returned in February above the level considered as "normal". On the other hand, consumers' confidence continued to increase, reflecting the rise in employment level and the fall in unemployment, and returned in the first quarter below the level of 10% (9.9% on a seasonally adjusted basis). Inflation reached 3% in January and February, given the exceptional rise in food prices (related to the so-called "mad-cow" disease) and the increase in public tariffs that concentrated at the beginning of the year. Inflation returned to 2.8% in March, and we expect it to decline further in the next months, returning to around 2% by the end of the year; on this hypothesis, on average inflation will be around 2.5% in 2001.

We expect GDP to grow on average around 2.3%, somewhat slower than the EMU average (that we estimate at 2.5%). External demand contribution to growth will be negligible or even slightly negative, internal demand will continue to grow even if at a much slower rate with respect to last year (whose rate of growth, net of a large negative inventories contribution, was equal to 3.1%); inventories will give a slightly negative contribution to growth.

Country: **The Netherlands**

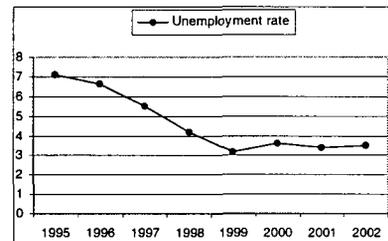
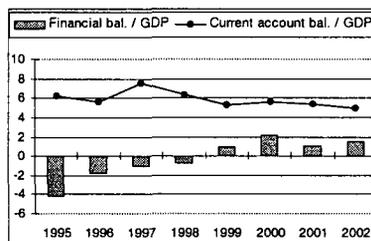
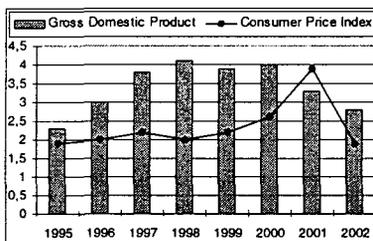
Institute: CPB

Date of forecast: April 10, 2001

|                                               | LEVEL      | Volumes, average growth |      |      |
|-----------------------------------------------|------------|-------------------------|------|------|
|                                               | 2000       | 2000                    | 2001 | 2002 |
|                                               | euro bill. | %                       |      |      |
| GDP                                           | 400.6      | 4                       | 3.3  | 2.8  |
| Private consumption                           | 199.1      | 3.7                     | 4.4  | 4.2  |
| Public consumption                            | 91.5       | 3.3                     | 2.2  | 1.9  |
| Gross fixed capital formation                 | 90.7       | 4.6                     | 3.3  | 2    |
| of which:                                     |            |                         |      |      |
| Equipment                                     |            | 4.9                     | 4.8  | 2    |
| Construction                                  | 12.5       | 6.2                     | 3.8  | 2.4  |
| Change in stocks (*)                          | 0.4        | 0                       | 0    | 0    |
| Total domestic demand (including stocks)      | 381.7      | 3.8                     | 3.6  | 3.2  |
| Exports of goods and services                 | 269        | 9.3                     | 5.5  | 5.8  |
| Imports of goods and services                 | 250.1      | 9.6                     | 6.1  | 6.6  |
| GDP deflator                                  |            | 3.1                     | 4.9  | 1.9  |
| Consumer prices (consumer price index)        |            | 2.6                     | 3.9  | 1.9  |
| Hourly wages                                  |            | 4                       | 4.7  | 4    |
| Employment (1,000 persons) (**)               | 7,236      | 2.3                     | 1.8  | 1.4  |
| Unemployment rate (%)                         | 267        | 3.6                     | 3.4  | 3.5  |
| Saving rate, households (%)                   |            | 9.6                     | 9.8  | 8.8  |
| Public sector financial bal. (% of GDP) (***) |            | 2.2                     | 1.1  | 1.5  |
| Gross public debt (% of GDP) (***)            |            | 56.5                    | 51.8 | 48.1 |
| Current account balance (% of GDP)            |            | 5.6                     | 5.4  | 5    |
| Short-term interest rate (3 m.) (%)           |            | 4.4                     | 4.5  | 4.3  |
| Long-term interest rate (10 yr.) (%)          |            | 5.4                     | 4.9  | 4.9  |
| United States Federal Funds Rate (%)          |            |                         |      |      |
| GDP United States                             |            | 5                       | 1.75 | 2.75 |
| GDP Japan                                     |            | 1.7                     | 1    | 1.5  |
| GDP European Union                            |            | 3.3                     | 2.5  | 2.5  |
| Relevant world trade, volume (****)           |            | 11                      | 6.3  | 7    |
| Oil price (US\$/b Brent)                      |            | 28.41                   | 25   | 23   |
| Exchange rate, 1 euro = \$                    |            | 0.92                    | 0.96 | 0.98 |
| Exchange rate, 1 euro = natl. currency        |            | 2.2                     | 2.2  | 2.2  |

(\*) In % of GDP of previous period (contribution to growth). — (\*\*)  $\geq 12$  hours/week. — (\*\*\*) EMU definition. — (\*\*\*\*) Weighted average of volume changes of non-energy imports of customers countries, with Dutch shares as weights.

### DUTCH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: CPB*

In 2000 economic growth came out around 4% for the fourth successive year. For this year and next the forecast for GDP growth is 3¼% in 2001 and 2¾% in 2002. This cyclical downswing is due primarily to a poorer export performance. Dutch non-energy merchandise export growth is expected to come out at 5½ %, this means a halving compared with last year. The main reason is the loss of momentum in the world economy. As a result of a slight improvement in external demand, the projection foresees some recovery in export growth next year. As they did last year, Dutch exporters will lose market share to their international competitors in 2001 and 2002. The reasons for this are an unfavourable export mix and production bottlenecks due to staff shortages. Next year the expected deterioration in price competitiveness will also play a role. This is due to the projected appreciation in the euro and the sharp rise in unit labour costs in Dutch manufacturing industry. Because of the deteriorating competitiveness, industry will barely be able to benefit from the improvement in export market growth. Re-exports will account for most of the acceleration in exports growth in 2002, and this conceals the underlying loss of competitiveness.

Private consumption, by contrast, is expected to increase by 4½% in 2001, and will thus accelerate compared to last year. Largely thanks to the considerable burden relief resulting from the recent tax reform, real disposable household income will actually increase by as much as 5¼% this year. But because this purchasing power impulse will take some time to be translated into expenditure, consumption growth will lag slightly behind income growth this year. Next year private consumption is expected to grow by 4¼%. The increase in household wealth is expected to make a considerably smaller contribution to private consumption growth this year and next compared to previous years.

The volume of business investment is expected to continue to expand in 2001 and 2002, but at a slower pace compared to previous years. The staff shortages, higher real earnings growth and the ongoing process of product innovation will avert a decline in investment in response to the economic slowdown. Consequently the investment ratio, i.e. the proportion of investment to output, should remain at the historically high level of last year.

Owing to a coincidence of circumstances, inflation is likely to accelerate from 2.6% last year to around 4% this year. This is caused, firstly, by a number of government measures, including increases in indirect taxes (especially value added tax and regulatory energy tax) from 1 January this year; and secondly, by the acceleration in labour costs and the delayed passing on of last year's hike in import prices. Many of the factors pushing up this year's inflation figure are of a temporary nature. Furthermore, the dollar's depreciation since late last year, which the projection assumes will continue to some extent, and the weakening of world economic growth will lead to lower import prices this year and next. The rise in the consumer price index is therefore expected to stay within 2% next year.

Not least as a result of the continuing tightness on the labour market, contractual pay rates are expected to increase by 4% this year and by 3¼% next year, in both years above the change in the consumer price index. Because of the lower growth rate, the projection shows an end to the long-standing fall in unemployment. The unemployment rate will be stable at 3.5%.

The public finances will continue to develop favourably. On the revenue side this is reflected in a big windfall, which will amount to more than 30 billion guilders next year. The public-sector EMU balance is currently projected to come out between 1–1½% of GDP in 2001 and 2002. It should be borne in mind here that the economic conditions during this period were highly favourable. The cyclical component in GDP is estimated at ½–1% in these years.

Country: Norway

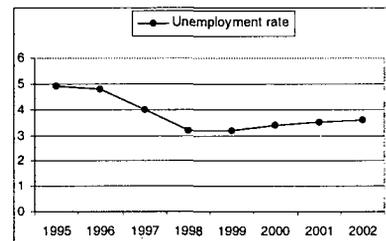
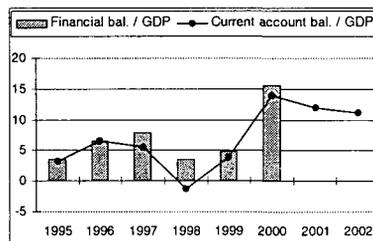
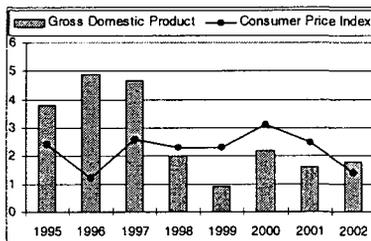
Institute: STATISTICS NORWAY

Date of forecast: February 6, 2001

|                                             | LEVEL          | Volumes, average growth |       |       |
|---------------------------------------------|----------------|-------------------------|-------|-------|
|                                             | 2000           | 2000                    | 2001  | 2002  |
|                                             | N. kroner, bn. | %                       |       |       |
| GDP                                         | 1,403          | 2.2                     | 1.6   | 1.8   |
| Private consumption                         | 581.1          | 2.1                     | 1.6   | 2.7   |
| Public consumption                          | 269.3          | 1.4                     | 2.3   | 1.9   |
| Gross fixed capital formation               | 271.5          | -2.7                    | -1.7  | 1.9   |
| of which:                                   |                |                         |       |       |
| Equipment                                   |                |                         |       |       |
| Construction                                |                |                         |       |       |
| Change in stocks (contrib. to growth)       | 30.3           | 0.4                     | 0     | 0     |
| Total domestic demand                       | 1,080.9        | 2.2                     | 1.3   | 2.1   |
| Exports of goods and services               | 650.4          | 2.8                     | 4     | 3.4   |
| Imports of goods and services               | 428.7          | 1.2                     | 2.6   | 5     |
| GDP deflator                                |                | 15.3                    | -0.6  | 0.3   |
| Consumer prices (consumer price index)      |                | 3.1                     | 2.5   | 1.4   |
| Hourly wages                                |                | 4.3                     | 4.3   | 3.8   |
| Employment                                  |                | 0.4                     | 0.6   | 0.4   |
| Unemployment rate (%)                       |                | 3.4                     | 3.5   | 3.6   |
| Saving rate, households (%)                 |                | 6.3                     | 7.6   | 8.3   |
| Public sector financial bal. (% of GDP) (*) |                | 15.7                    |       |       |
| Gross public debt (% of GDP) (*)            |                | 26.7                    |       |       |
| Current account balance (% of GDP)          |                | 13.9                    | 12    | 11.1  |
| Short-term interest rate (3 m.) (%)         |                | 6.6                     | 7.1   | 6.1   |
| Long-term interest rate (10 yr.) (%)        |                |                         |       |       |
| United States Federal Funds Rate (%)        |                |                         |       |       |
| GDP United States                           |                | 5.1                     | 2.6   | 3.5   |
| GDP Japan                                   |                | 1.9                     | 1.8   | 1.9   |
| GDP European Union                          |                | 3.3                     | 2.9   | 2.9   |
| World trade volume (goods)                  |                |                         |       |       |
| Oil price (US\$/b Brent)                    |                | 28.6                    | 24.5  | 24    |
| Exchange rate, 1 euro = \$                  |                | 0.923                   | 0.982 | 1.036 |
| Exchange rate, 1 euro = natl. currency      |                | 8.11                    | 8.2   | 8.2   |

(\*) EMU definition.

## NORWEGIAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: STATISTICS NORWAY*

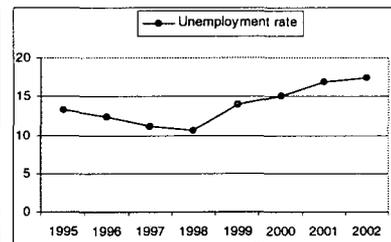
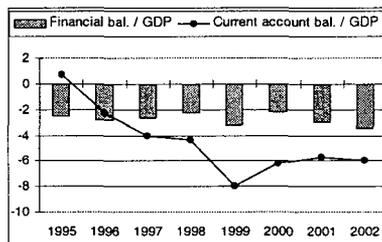
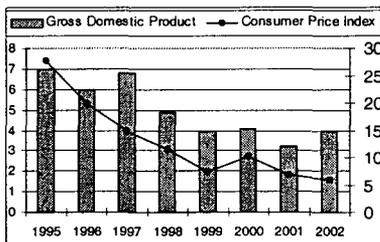
2000 was a year of consolidation for the Norwegian economy. Growth in production and employment was very moderate, and the economic boom of the last half of the 1990s ended. Cost inflation continued, but at a more moderate pace than in previous years even though unemployment was low and some labour market segments were tight. Despite sharp growth in oil revenues, fiscal policy was neutral while monetary policy shifted to a more contractionary stance. Surpluses in central government accounts and the balance of payments were record high. Excluding the rise in energy prices and the effect of exchange rate movements, price inflation remained moderate, partly because productivity growth in the mainland economy picked up following a sluggish trend in recent years. In 2001 and 2002 the economy is expected to expand approximately on a par with trend growth. In spite of slightly lower oil prices and a weaker dollar, the current account will show very high surpluses. Inflation will gradually subside to a level that does not deviate substantially from the inflation rate among trading partners. The same will be true for wage growth in 2002.

Country: **Poland**Institute : IKCHZ  
Date of forecast: April 10, 2001

|                                             | LEVEL     | Volumes, average growth |      |      |
|---------------------------------------------|-----------|-------------------------|------|------|
|                                             | 2000      | 2000                    | 2001 | 2002 |
|                                             | PLN bill. | %                       |      |      |
| GDP                                         | 690.4     | 4.1                     | 3.2  | 4    |
| Private consumption                         | 440.7     | 2.4                     | 2.4  | 3.2  |
| Public consumption                          |           | 0.8                     | 1.1  | 1.7  |
| Gross fixed capital formation               | 173.9     | 3.1                     | 4.2  | 6.5  |
| of which:                                   |           |                         |      |      |
| Equipment                                   |           | 8.7                     | 11   | 9.5  |
| Construction                                |           | -5                      | -6   | 2.5  |
| Change in stocks (contrib. to growth)       |           | 0.3                     | 0.1  | 0    |
| Total domestic demand                       |           | 2.7                     | 2.9  | 4    |
| Exports of goods                            | 137.9     | 24                      | 12.5 | 12   |
| Imports of goods                            | 213.1     | 9.7                     | 7.5  | 8.5  |
| GDP deflator                                |           | 7.7                     | 6.3  | 5.5  |
| Consumer prices (consumer price index)      |           | 10.1                    | 6.8  | 5.8  |
| Hourly wages                                |           | 12.9                    | 9    | 8.5  |
| Employment (1,000 persons)                  | 15,700    | -1.4                    | -1.7 | -0.7 |
| Unemployment rate (%)                       |           | 15                      | 16.9 | 17.5 |
| Saving rate, households (%)                 |           | 11.7                    | 12.5 | 12   |
| Public sector financial bal. (% of GDP) (*) |           | -2.2                    | -3   | -3.5 |
| Gross public debt (% of GDP) (*)            |           | 38.8                    | 37.2 | 38   |
| Current account balance (% of GDP)          |           | -6.2                    | -5.7 | -6   |
| Short-term interest rate (3 m.) (%)         |           | 20.5                    | 18.5 | 14.5 |
| Long-term interest rate (10 yr.) (%)        |           |                         |      |      |
| United States Federal Funds Rate (%)        |           | 6.2                     | 4.7  |      |
| GDP United States                           |           | 5.1                     | 2.5  | 3.5  |
| GDP Japan                                   |           | 1.7                     | 0.6  | 1    |
| GDP European Union                          |           | 3.3                     | 2.4  | 2.7  |
| World trade volume (goods)                  |           | 13                      | 7    | 8    |
| Oil price (US\$/b Brent)                    |           | 28.3                    | 25   | 24   |
| Exchange rate, 1 euro = \$                  |           | 0.92                    | 0.95 | 0.98 |
| Exchange rate, 1 euro = natl. currency      |           | 4.01                    | 4.02 | 4.36 |

(\*) EMU definition.

## POLISH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: IKCHZ*

The GDP growth in 2000 was lower than officially expected, but still more than 4 %. The economy has shown some signs of slowing down since the second quarter of 2000.

Given the strong cyclical upturn in Western Europe, the economic growth in Poland has been driven mainly by exports of manufactures. The rate of growth of industrial production more than doubled from 3.6% in 1999 to 7.6% in 2000. With stronger import demand from Western Europe, export growth has outpaced domestic demand which has remained subdued due to tight monetary policy. The tightening of monetary policy (in particular the significant increases in interest rates in late 1999 and twice in 2000) have had a negative impact on both fixed capital investment and private consumption expenditures.

The major cause of the higher than expected inflation rate was the soaring world market prices of crude oil and natural gas, which compounded by the strong appreciation of the dollar, led to frequent increases in domestic fuel and utility prices. Together with higher import prices, rising food prices had also contributed to inflationary pressures.

The labour market continued to worsen in 2000. The rise in unemployment was mainly due to a wave of mass lay-off caused by restructuring in the coal mining, steel and textile industries. Rising labour productivity has also reduced the demand for labour. The situation has been further aggravated by the fact that a generation of the baby boom of the first half of the 1980s is now beginning to enter the labour market. The tight monetary policy has also affected the demand for labour.

The foreign trade of Poland has recovered strongly after its slowdown in late 1998 and early 1999 in the wave of the Russian crisis and a period of slow economic growth in the EU. The main boost to export came from the EU. Strong import demand in Germany was particularly important.

During the last four years Poland has been running current account deficits on a scale which has caused concern, but since the second half of 2000 it has started to diminish.

In face of the expected slowdown of economic growth and coming parliamentary elections the short-term outlook for Poland is subject to many risks. The main external risk of the forecast is a transmission of a possible "not so soft landing" of the US economy to the EU and then from the EU to Poland. Main internal risks rise from unfavourable developments in the labour market and public finance position. The massive unemployment has become a central economic problem the solution of which requires a political consent and a wide spectrum of policy measures including a labour market deregulation and an active fiscal policy pro-employment action.

Despite these challenges we expect that a better macroeconomic policy mix and a stronger position of the government after the elections will make possible a smooth return to a sustainable and satisfactory medium-term growth rate during 2002.

Country: **Slovenia**

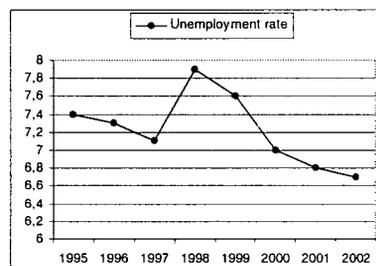
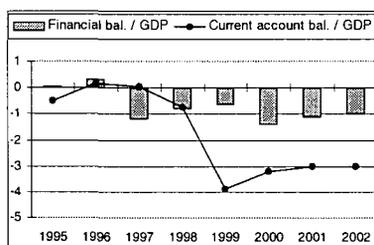
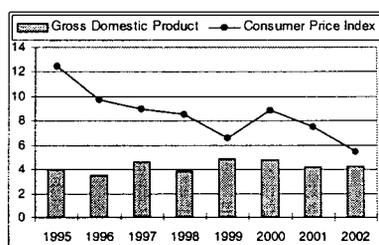
Institute: SKEP

Date of forecast: April 10, 2001

|                                             | LEVEL     | Volumes, average growth |      |      |
|---------------------------------------------|-----------|-------------------------|------|------|
|                                             | 2000      | 2000                    | 2001 | 2002 |
|                                             | SIT bill. | %                       |      |      |
| GDP                                         | 4,045.5   | 4.8(**)                 | 4.2  | 4.3  |
| Private consumption                         | 2,216.2   | 1.6                     | 3.1  | 3.5  |
| Public consumption                          | 841.1     | 3.1                     | 4.4  | 4.3  |
| Gross fixed capital formation               | 1,131.6   | 1.5                     | 4.2  | 5    |
| of which:                                   |           |                         |      |      |
| Equipment                                   |           | 2.2                     | 5    | 5.8  |
| Construction                                |           | 0.6                     | 3    | 4.7  |
| Change in stocks (contrib. to growth)       |           |                         |      |      |
| Total domestic demand                       |           | 1.9                     | 3.7  | 4.1  |
| Exports of goods and services               | 2,386     | 11                      | 6.5  | 6    |
| Imports of goods and services               | 2,529.4   | 6                       | 5.5  | 5.5  |
| GDP deflator                                |           | 5.5                     |      |      |
| Consumer prices (consumer price index)      |           | 8.9                     | 7.5  | 5.5  |
| Hourly wages                                |           | 1.6                     | 3.5  | 3.5  |
| Employment                                  |           | 1.2                     | 1    | 1    |
| Unemployment rate (%)                       |           | 7                       | 6.8  | 6.7  |
| Saving rate, households (%)                 |           | +                       | +    | ~    |
| Public sector financial bal. (% of GDP) (*) |           | -1.4                    | -1.1 | -1   |
| Gross public debt (% of GDP) (*)            |           | 35                      | 36   | 36   |
| Current account balance (% of GDP)          |           | -3.2                    | -3   | -3   |
| Short-term interest rate (3 m.) (%)         |           | 15.8                    | 13.8 | 12   |
| Long-term interest rate (10 yr.) (%)        |           | 17.7                    | 15.7 | 13.5 |
| United States Federal Funds Rate (%)        |           |                         |      |      |
| GDP United States                           |           | 5.2                     | 2    | 2.5  |
| GDP Japan                                   |           | 1.5                     | 1    | 1.5  |
| GDP European Union                          |           | 3.3                     | 2.5  | 2.5  |
| World trade volume (goods)                  |           | 13                      | 6    | 7    |
| Oil price (US\$/b Brent)                    |           | 28                      | 25   | 24   |
| Exchange rate, 1 euro = \$                  |           | 0.92                    | 0.94 | 0.96 |
| Exchange rate, 1 euro = natl. currency      |           | 205                     | 219  | 229  |

(\*) EMU definition. — (\*\*) First calculation of Statistical Office 30/03/01.

## SLOVENIAN ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: SKEP*

Very favourable international as well as domestic economic developments and promising business surveys towards the end of 2000 suggested for Slovenia the possibility of even over 6 per cent GDP growth for the year 2000, i.e. even higher than our previous forecasts. First calculations of the National Statistical Office from the end of March this year pointed out the 4.8 % official growth rate for 2000, so far. Strong export growth, above 11 % in real terms, assisted the fall of the current account deficit, despite the high increase in the world oil and commodity prices. The Slovenian economy is doing well, with the exports proceeding to be the main driving force in the first months of 2001 again. In the light of the trends in the global economy the export is forecast to grow by 6.5% on average in 2001. On the other hand, domestic demand will exceed the growth in 2000. After a quite moderate 1.6% real wage growth in the last year, this year some more relaxed wage policy could bring a 3–4 % wage increase, and other incomes are growing, too. Savings are also on the rise, especially since the introduction of the national housing saving scheme. Extremely high investment growth, very characteristic for Slovenia in past years, lost momentum in 2000. Nevertheless, it will come in line with GDP growth in 2001, mainly because of investments in equipment. We forecast a 4.2 per cent GDP growth in 2001. Our recent surveys from March 2001 on business expectations show that the companies still believe in not very deteriorating overall business possibilities for the second half of 2001 compared to the first half of the year. Business confidence remains more or less stable and short-term orders expectations have recently been still optimistic.

The inflation went up again during 2000, fed primarily by a rise in oil prices and some price increases in domestic services. The inflation trends proceed in the first quarter of 2001, accompanied by rising excise duties and prices in some sectors, where the state and local authorities still have the dominant influence (energy, post, agriculture, transport...). Consequently, our present estimation points out on at least 7.5 % of average inflation for the year 2001 and some 5.5 % for 2002. The change at the top of the Bank of Slovenia will probably bring some more restrictive monetary policy in coming months. The interest rates remain high and only a slight lowering in real rates is possible in 2001 and 2002. The reasons are still the relatively limited competition in the banking sector, the level of liberalization and specifics of the financial sector in the small-sized economy. Fiscal policy is somewhat relaxed in the present circumstances, and the budget for 2001 (delayed after the change in government, before and after the election in last autumn), passing the Parliament in April, counts on a 1% deficit again. The labour market is expected to keep the trend of modest growth in employment and to retain the level of the standardized unemployment rate at around 6.7%.

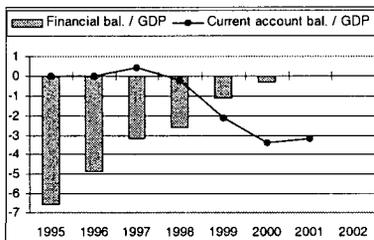
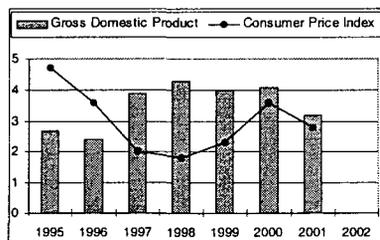
Country: **Spain**Institute : SGEI – M<sup>o</sup>. de Economía

Date of forecast: 24.04.2001

|                                             | LEVEL              | Volumes, average growth |         |         |
|---------------------------------------------|--------------------|-------------------------|---------|---------|
|                                             | 2000<br>euro bill. | 2000                    | 2001    | 2002    |
|                                             |                    | %                       |         |         |
| GDP                                         | 606.3              | 4.1                     | 3.2     |         |
| Private consumption                         | 359.9              | 4                       | 2.7     |         |
| Public consumption                          | 103.5              | 2.6                     | 2       |         |
| Gross fixed capital formation               | 154.4              | 5.9                     | 5.3     |         |
| of which:                                   |                    |                         |         |         |
| Equipment                                   | 45.2               | 5.3                     | 4.8     |         |
| Construction                                | 84.6               | 6.4                     | 5.7     |         |
| Change in stocks (contrib. to growth)       |                    | -0.1                    | 0       |         |
| Total domestic demand                       | 620.3              | 4.1                     | 3.3     |         |
| Exports of goods and services               | 181.4              | 10.8                    | 8.1     |         |
| Imports of goods and services               | 195.4              | 10.4                    | 7.9     |         |
| GDP deflator                                |                    | 3.5                     | 3.4     |         |
| Consumer prices (consumer price index)      |                    | 3.6                     | 2.8     |         |
| Hourly wages                                |                    | 2.4                     | 2.4     |         |
| Employment (increase in number of persons)  |                    | 480000                  | 324800  |         |
| Unemployment rate (%)                       |                    | 14.1                    | 12.7    |         |
| Saving rate, households (%)                 |                    | 11.2                    | 11.3    |         |
| Public sector financial bal. (% of GDP) (*) |                    | -0.3                    | 0       |         |
| Gross public debt (% of GDP) (*)            |                    | 60.6                    | 57.7    |         |
| Current account balance (% of GDP)          |                    | -3.4                    | -3.2    |         |
| Short-term interest rate (3 m.) (%)         |                    | 4.4                     | 4.6     |         |
| Long-term interest rate (10 yr.) (%)        |                    | 5.5                     | 5       |         |
| United States Federal Funds Rate (%)        |                    | 6.2                     | 4.5     |         |
| GDP United States                           |                    | 5                       | 1.5     |         |
| GDP Japan                                   |                    | 1.7                     | 1       |         |
| GDP European Union                          |                    | 3.3                     | 2.7     |         |
| World trade volume (goods)                  |                    | 12.5                    | 7.7     |         |
| Oil price (US\$/b Brent)                    |                    | 27.1                    | 22      |         |
| Exchange rate, 1 euro = \$                  |                    | 0.94                    | 0.92    |         |
| Exchange rate, 1 euro = natl. currency      |                    | 166.386                 | 166.386 | 166.386 |

(\*) EMU definition.

## SPANISH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: MINISTERIO DE ECONOMIA Y HACIENDA*

En 2000 l'économie espagnole atteint une croissance du PIB autour de 4,0% pour la quatrième année consécutive. En même temps, le profil trimestriel montre un plafonnement de cette croissance pendant le premier semestre aux alentours d'un maximum de 4,2% en glissement annuel, à partir duquel le taux de croissance va décélérer se situant à 3,8% au dernier trimestre.

C'est bien à la demande interne qu'il faut attribuer cette décélération de la croissance en cours d'année, autant à la consommation finale des ménages que, surtout, à l'investissement des entreprises en biens d'équipement; alors que l'investissement immobilier n'a subi qu'un léger ralentissement pendant l'année. Le secteur extérieur a pu bénéficier de la forte poussée du commerce mondial, mais beaucoup moins de la dépréciation de l'euro, car plus des deux tiers des exportations espagnoles sont destinées à l'Union Européenne.

C'est dans ce contexte qu'il faut situer la nouvelle prévision pour 2001 révisée encore hier, selon laquelle la croissance du PIB sera de 3,2%. La contribution du secteur extérieur étant identique à celle de l'année passée (c'est-à-dire légèrement négative), la décélération de la croissance de l'ordre d'un point pourcent sera le résultat d'un ralentissement prononcé de la consommation privée, son taux d'augmentation n'étant que de 2,7%, c'est-à-dire 1,3 points inférieur à celui de 2000; alors que la FBCF agrégée subira aussi une légère perte de vitesse, son taux d'expansion de 5,3% sera inférieur d'un peu plus d'un demi point à celui observé en 2000. Au total, la demande interne dans son ensemble atteindra un rythme annuel de 3,3%; 0,8 points pourcent inférieur à celui enregistré l'année passée.

Sur le ralentissement de la consommation des ménages (qui est le facteur principal de la révision à la baisse de la croissance du PIB en 2001), plusieurs facteurs auront une incidence décisive. D'abord, le rythme de création nette d'emploi se situera juste au-dessus de 2%, alors qu'il était de 3,3% en 2000. Mais, surtout on espère que les familles vont tâcher d'assainir leur position financière après leur comportement très dépensier les dernières années; en particulier, son taux d'épargne est descendu à un niveau très bas en 2000, puisque leur consommation atteint presque 90 pourcent de leur revenu disponible et qu'en même temps leur investissement en logement augmentait à un rythme de 6,4%, sans oublier la chute des valeurs boursières à partir du printemps de 2000.

Le fléchissement du rythme d'expansion de l'investissement sera moindre. L'investissement des entreprises en biens d'équipement plafonnait en 1998 avec un taux d'expansion de 13,4%; depuis lors ce taux décroît, il devrait se situer au-dessous de 5% en moyenne annuelle en 2001, étant donnée l'évolution escomptée de la demande interne et externe.

L'investissement dans le secteur du bâtiment devrait décélérer un peu seulement, puisque son rythme de croissance serait encore de 5,7% cette année. Car si le nombre de logements construits diminue à la suite de leurs hausse de prix de 15% l'année passée, la construction non-résidentielle viendrait le compenser.

La faible contribution du secteur extérieur à la croissance du PIB (-0,1 pourcent) cache une décélération des exportations et des importations autour de 2,5 points chacune, par rapport à 2000. Celle des exportations tiendrait à la moindre poussée du commerce mondiale (encore que les exportations espagnoles sont relativement abritées, étant donnée leurs destination majoritaire à l'UE). Celle des importations serait induite par le fléchissement du rythme d'expansion de la demande interne.

Country: Sweden

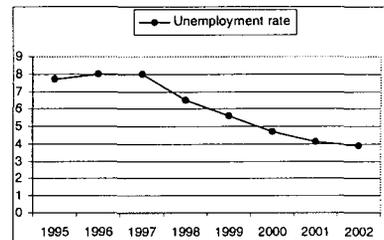
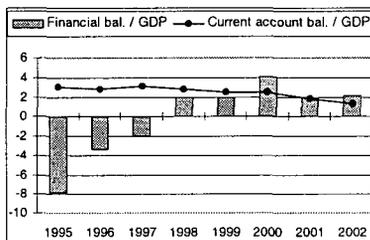
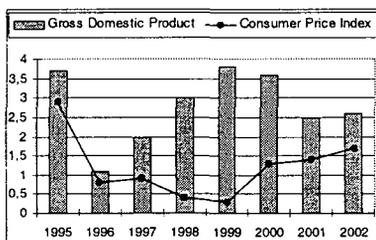
Institute: INDUSTRIFÖRBUNDET

Date of forecast: April 11, 2001

|                                             | LEVEL      | Volumes, average growth |      |      |
|---------------------------------------------|------------|-------------------------|------|------|
|                                             | 2000       | 2000                    | 2001 | 2002 |
|                                             | euro bill. | %                       |      |      |
| GDP                                         | 246.8      | 3.6                     | 2.5  | 2.6  |
| Private consumption                         | 124.5      | 4.1                     | 3    | 2.9  |
| Public consumption                          | 64.9       | -1.7                    | 1.2  | 1.2  |
| Gross fixed capital formation               | 42.1       | 4.5                     | 7.3  | 4.1  |
| of which:                                   |            |                         |      |      |
| Equipment                                   | 27.1       | 4                       | 7.6  | 2.6  |
| Construction                                | 15         | 4.5                     | 5.2  | 4.6  |
| Change in stocks (contrib. to growth)       | 2          | 0.6                     | -0.4 | 0    |
| Total domestic demand                       | 233.6      | 3.1                     | 2.8  | 2.6  |
| Exports of goods and services               | 122        | 9.8                     | 5.9  | 6.2  |
| Imports of goods and services               | 100.6      | 9.7                     | 7.2  | 6.6  |
| GDP deflator                                |            | 0.8                     | 1.3  | 1.6  |
| Consumer prices (consumer price index)      |            | 1.3                     | 1.4  | 1.7  |
| Hourly wages                                |            | 4.7                     | 4.1  | 4    |
| Employment (1,000 persons)                  | 4,156      |                         | 1.4  | 0.9  |
| Unemployment rate (%)                       |            | 4.7                     | 4.1  | 3.9  |
| Saving rate, households (%)                 |            | 2                       | 2.8  | 3.6  |
| Public sector financial bal. (% of GDP) (*) |            | 4.1                     | 2    | 2.2  |
| Gross public debt (% of GDP) (*)            |            | 55.6                    | 53   | 50   |
| Current account balance (% of GDP)          |            | 2.5                     | 1.8  | 1.3  |
| Short-term interest rate (3 m.) (%)         |            | 3.95                    | 4    | 4.2  |
| Long-term interest rate (10 yr.) (%)        |            | 5.37                    | 5    | 5.3  |
| United States Federal Funds Rate (%)        |            | 6.24                    | 4.7  | 4    |
| GDP United States                           | 10,829.5   | 5                       | 1.2  | 2.5  |
| GDP Japan                                   | 5,152.6    | 1.2                     | 0.8  | 1.1  |
| GDP European Union                          | 6,417.5    | 3.3                     | 2.6  | 2.6  |
| World trade volume (goods)                  |            | 13.5                    | 5.5  | 6.5  |
| Oil price (US\$/b Brent)                    |            | 28.5                    | 24   | 24   |
| Exchange rate, 1 euro = \$                  |            | 0.92                    | 1.02 | 1.02 |
| Exchange rate, 1 euro = natl. currency      |            | 8.44                    | 8.75 | 8.55 |

(\*) EMU definition.

## SWEDISH ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

## COMMENT: INDUSTRIFÖRBUNDET

Last year concluded in sharp contrast to the way it started. While the year opened with accelerating growth on global markets, its conclusion came to be dominated by fears that the global economy was weakening. In an economy such as the Swedish, with exports accounting for almost 50 per cent of the

aggregate volume of goods and services produced (GDP), it is inevitable that such a change in our external markets will have a major effect. However, it was no surprise that the global economy was about to cool off. A series of interest rate increases in the USA, the EU and elsewhere were, after all, intended to moderate economic growth in order to prevent inflation from rising.

The abruptness and speed of the economic downswing surprised many people, not least industrialists themselves. The gap between the expected order intake and the actual one in manufacturing industry in Sweden has been widening dramatically ever since last summer. This means that many companies have drawn up plans for their business on the basis of a stronger demand situation than what actually eventuated. The level of orders booked was a major disappointment, particularly during the fourth quarter of 2000, even though companies had already lowered their expectations. This resulted in rising stocks, largely involuntary.

Companies are now being compelled not only to adjust their production to the lower level of demand but also to reduce their stocks. Admittedly, it was not until quite recently that the many profit warnings and lowered expectations began to provide an unambiguous picture, but in actual fact, the slowdown in the industrial economy could have been observed as long ago as last summer in one set of statistics or another. The sectors of industry that are normally affected first in the classic industrial cycle—raw materials and intermediate goods—began to come up against steadily weakening growth in demand almost one year ago. Rates of production in these industries have also been successively lowered. Even though manufacturing industry now accounts for around 20 per cent of the aggregate value added in the Swedish economy, by virtue of its size as a buyer of corporate services and such like, it is a very important component of the economy.

In contrast to the recession caused by the crisis in Asia, this time there is no other strong growth factor driving the Swedish economy. During the Asia crisis, IT companies in particular expanded in the services sector to full effect, and successfully bridged over the weakness of the industrial economy. According to preliminary figures, mining and manufacturing output rose by 6.7 per cent in 2000. This year, we expect production to grow by a moderate 2.8 per cent. Around half of the increase can be contributed to a positive so-called overhang from 2000. The stabilization of the global economy during the autumn, followed by rising demand, will stimulate growth in 2002, and generate an increase of some 3.5 per cent in industrial output. Our preliminary estimates show that GDP expanded by 3.7 per cent last year. Almost 1 percentage point of this upswing can be explained by the strong contribution of stocks. Exports rose by almost 10 per cent. A return to an import demand that was more normal for the Swedish economy led to an increase of 11 per cent in imports. Consequently, a positive contribution of foreign trade of almost 1 percentage point in 1999 was converted into a small negative contribution last year. The negative trend is expected to continue this year. GDP growth will slacken to 2.5 per cent in 2001. Despite rising final domestic demand, destocking will lower the growth rate by almost 0.5 percentage points. One important factor behind the estimated increase in domestic demand is the rising level of capital formation. In manufacturing industry, for example, the substantial investments planned in the transport equipment industry and the pulp and paper industries will raise the level of capital investment for the year. In the business sector, excluding manufacturing, the installation of the UMTS network will get going in 2001. We estimate that around one-third of the investments that this project will require between now and 2003 will be made in 2001. The international recovery expected in 2002 will stimulate exports slightly, while the more moderate rate of capital formation will tend to hold down import demand slightly; GDP is expected to grow by 2.6 per cent.

Country: **Switzerland**

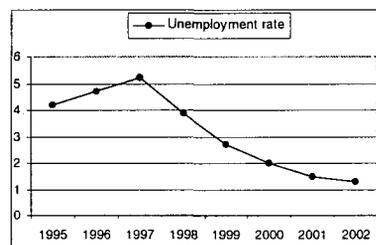
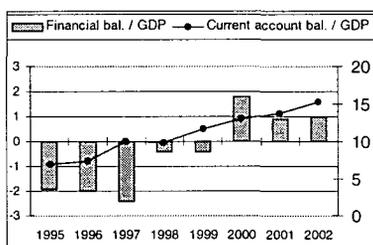
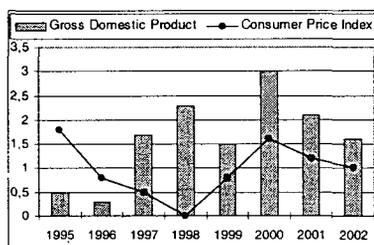
Institute: KOF

Date of forecast: April 2001

|                                             | LEVEL      | Volumes, average growth |      |      |
|---------------------------------------------|------------|-------------------------|------|------|
|                                             | 2000       | 2000                    | 2001 | 2002 |
|                                             | euro bill. | %                       |      |      |
| GDP                                         | 345.0181   | 3                       | 2.1  | 1.6  |
| Private consumption                         | 200.4308   | 2                       | 1.9  | 1.6  |
| Public consumption                          | 50.5442    | 0.2                     | 0.7  | 1    |
| Gross fixed capital formation               | 92.665     | 5.9                     | 4.3  | 2.8  |
| of which:                                   |            |                         |      |      |
| Equipment                                   | 50.8546    | 8.7                     | 6.6  | 3.8  |
| Construction                                | 41.8098    | 2.7                     | 1.6  | 1.5  |
| Change in stocks (contrib. to growth)       | 2.3        | -0.2                    | 0    | -0.2 |
| Total domestic demand                       | 345.94     | 2.5                     | 2.4  | 1.7  |
| Exports of goods and services               | 157.517    | 8                       | 4.1  | 3.4  |
| Imports of goods and services               | 158.439    | 6.6                     | 4.6  | 3.5  |
| GDP deflator                                | 0.1177     | 1.3                     | 1.6  | 1.4  |
| Consumer prices (consumer price index)      | 0.1003     | 1.6                     | 1.2  | 1    |
| Hourly wages                                | 0.114      | 3.3                     | 2.9  | 2.9  |
| Employment (1,000 persons)                  | 3,062      | 1.5                     | 1.4  | 0.7  |
| Unemployment rate (%)                       |            | 2                       | 1.5  | 1.3  |
| Saving rate, households (%)                 |            | 8.1                     | 8.1  | 8.8  |
| Public sector financial bal. (% of GDP) (*) |            | 1.8                     | 0.9  | 1    |
| Gross public debt (% of GDP) (*)            |            | 49.9                    | 47.2 | 44.9 |
| Current account balance (% of GDP)          |            | 13.1                    | 13.8 | 15.3 |
| Short-term interest rate (3 m.) (%)         |            | 3                       | 3.2  | 2.9  |
| Long-term interest rate (10 yr.) (%)        |            | 3.9                     | 3.4  | 3.6  |
| United States Federal Funds Rate (%)        |            | 6.4                     | 4.4  | 3.1  |
| GDP United States                           | 138.9      | 5                       | 1.3  | 1.6  |
| GDP Japan                                   | 114.4      | 1.7                     | 0.8  | 1.7  |
| GDP European Union                          | 122        | 3.3                     | 2.5  | 2.7  |
| World trade volume (goods)                  | 181.2      | 10.5                    | 5    | 5.1  |
| Oil price (US\$/b Brent)                    |            | 28.3                    | 23.5 | 21   |
| Exchange rate, 1 euro = \$                  |            | 0.92                    | 1    | 1.13 |
| Exchange rate, 1 euro = natl. currency      |            | 1.56                    | 1.55 | 1.55 |

(\*) EMU definition.

## SWISS ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: KOF*

The Swiss economy's performance in 2000 was unmistakably heartening. Gross domestic product registered its strongest growth since 1990. The main distinguishing features last year were the more vigorous aggregate domestic demand compared to 1999, strong growth in exports of goods, a tightening of monetary screws up to the mid-year point, only a gentle rise in inflation induced by cyclical economic effects despite the robust growth in the economy, and a further marked reduction in the labour market disequilibrium.

The combination of trends on individual GDP components resulted in GDP expanding by 3.0% year over year in 2000 (1999: +1.5%). Full-time-equivalent employment rose by 1.5%, compared to 0.7% in 1999. The increase in job vacancies on offer last year worked out considerably smaller than the expansion in employment itself, thereby further reducing the labour market disequilibrium. The unemployment rate dropped from 2.7% to 2.0%. The national consumer price index (CPI) showed annual inflation averaging 1.6% in 2000, which is more or less double the rate registered in 1999. Despite this acceleration, inflation in Switzerland remained below the ceiling of 2.0% set by the SNB for maintaining price stability. The underlying core rate of inflation as computed by KOF/ETH—which is better suited to assessing inflation trends prompted by cyclical economic effects<sup>9</sup> than the headline CPI—realized out at 0.7%. This noticeably lower underlying rate compared to the headline CPI indicates that Switzerland experienced only comparatively muted cyclical inflationary pressures last year, despite the robust growth registered by the economy.

The framework of economic policy underpinning the forecast for 2001/2002 is sketched out as follows: Last year, the SNB consistently tightened its monetary policy as it saw fit until the middle of the year, thereby giving it the latitude to switch to a watching brief from the second half of the year onwards. This year, the SNB decided to lower its target range slightly for the reference 3-month LIBOR in late March, based on its belief that inflationary risks in Switzerland were receding. Owing to Switzerland's close external economic ties with the EU, the SNB is only likely to allow the Swiss franc to edge up a fraction against the euro in the coming couple of years. We would expect that the SNB will make a further move to ease its current monetary restrictiveness in the second half of the year as the output gap begins to widen a little again.

The outlook for public sector finances (government and social security scheme) is favourable for the next two years. We would expect to see surpluses on the accounts for both the social welfare scheme and government authorities. Overall though, the combined surplus is unlikely to be as large as it was in 2000. For the 2001/2002 forecasting period, the income ratio is likely to fall whilst the policy on spending should be geared towards ongoing containment of expenditure. The public spending ratio will, therefore, decline a little. Given this scenario, the structural balance on government finances will be lower than the sizeable surplus booked in 2000. Nevertheless, public sector finances will still show a surplus.

On the domestic economy front, several factors will hamper growth. Rates of increase in all constituents of aggregate domestic demand, with the sole exception of public sector consumption, will decline over the forecasting period. The driving forces on the domestic economy front are set to lose power over the 2001–2002 forecasting period even though a growth rate of a just under 2% remains reasonably robust. The momentum from the foreign trade front will also fade quite noticeably. Growth rates for both total exports and total imports will be lower than last year. The net impact on GDP for the current year from foreign trade (excluding precious metals and gems) will be negative whereas it should be neutral in 2002. Overall, GDP growth is likely to slacken to 2.1% in 2001 and 1.6% in 2002. A look at how growth rates are likely to change during the course of the year reveals that they are likely to display a fairly consistent pattern this year. As from early next year, however, the annualized year-over-year growth rates will dip a little before levelling off at just under 1.4%. GDP growth will, therefore, be running at a solid tempo for the Swiss economy.

This year, employment (recalculated on a full-time-equivalent basis) will rise by 1.4% on the back of 2.1% GDP growth. In the coming year, with GDP growth forecast to rise by 1.6%, employment is likely to rise by just 0.7%. The projected expansion in employment for 2001 and 2002 will help to offset the rise in jobs being offered. The labour market disequilibrium will, therefore, diminish in both years. The rate of decline will, however, steadily ease as from mid-2002, leaving the labour market disequilibrium almost unchanged. The registered jobless rate can be expected to work out at an annual average of 1.5% in 2001 and 1.3% in 2002. Over the next couple of years, the anticipated fall in crude oil prices will help to bring down the rate of imported inflation. Over the forecasting period, the annual average increase in the national CPI is expected to reach 1.2% in 2001 and 1.0% in 2002, as opposed to 1.6% last year. This clearly shows that there are no immediate inflationary dangers lurking on our 2001/2002 forecasting horizon.

Country: **United Kingdom**

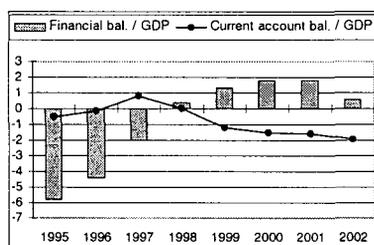
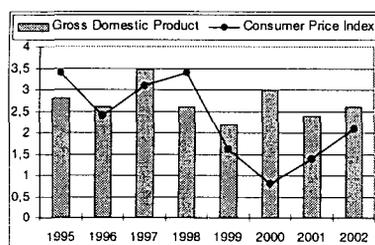
Institute: NIESR

Date of forecast: April 2001

|                                             | LEVEL   | Volumes, average growth |       |       |
|---------------------------------------------|---------|-------------------------|-------|-------|
|                                             | 2000    | 2000                    | 2001  | 2002  |
|                                             | £ bill. | %                       |       |       |
| GDP                                         | 819.9   | 3                       | 2.4   | 2.6   |
| Private consumption                         | 551.6   | 3.7                     | 2.7   | 2.5   |
| Public consumption                          | 152.7   | 2.7                     | 4.2   | 3.3   |
| Gross fixed capital formation               | 156.6   | 2.7                     | 3.7   | 4.5   |
| of which:                                   |         |                         |       |       |
| Equipment                                   |         |                         |       |       |
| Construction                                |         |                         |       |       |
| Change in stocks (contrib. to growth)       |         |                         |       |       |
| Total domestic demand                       | 862.9   | 3.7                     | 2.9   | 3.2   |
| Exports of goods and services               | 273.4   | 8.4                     | 5.6   | 3.6   |
| Imports of goods and services               | 315.4   | 9.6                     | 6.4   | 5     |
| GDP deflator                                | 114     | 1.8                     | 1.3   | 2.2   |
| Consumer prices (consumer price index)      | 110.9   | 0.8                     | 1.4   | 2.1   |
| Hourly wages                                |         |                         |       |       |
| Employment (1,000 persons)                  | 25,314  | 0.9                     | 0.4   | -0.1  |
| Unemployment rate (%)                       |         |                         |       |       |
| Saving rate, households (%)                 |         |                         |       |       |
| Public sector financial bal. (% of GDP) (*) |         | 1.8                     | 1.8   | 0.6   |
| Gross public debt (% of GDP) (*)            |         | 32.5                    | 30.1  | 28.2  |
| Current account balance (% of GDP)          |         | -1.5                    | -1.6  | -1.9  |
| Short-term interest rate (3 m.) (%)         |         | 6.1                     | 5.4   | 5.25  |
| Long-term interest rate (10 yr.) (%)        |         | 5.3                     | 5.1   | 5.1   |
| United States Federal Funds Rate (%)        |         | 6.5                     | 4.4   | 4.6   |
| GDP United States                           |         | 5                       | 1.6   | 2.3   |
| GDP Japan                                   |         | 1.7                     | 1     | 1.4   |
| GDP European Union                          |         | 3.3                     | 2.5   | 2.5   |
| World trade volume (goods)                  |         | 12.9                    | 7.3   | 7.1   |
| Oil price (US\$/b Brent)                    |         | 27.1                    | 25.4  | 24    |
| Exchange rate, 1 euro = \$                  |         | 0.925                   | 0.907 | 0.903 |
| Exchange rate, 1 euro = natl. currency      |         | 1.64                    | 1.58  | 1.57  |

(\*) EMU definition.

### UNITED KINGDOM ECONOMIC INDICATORS



Note: Figures for 2001 and 2002 are forecasts of the institute.

Source: OECD (2001); AIECE institutes.

*COMMENT: NIESR*

The economy over recent periods has been impacted by a number of short-term supply shocks, namely the disruption on the railways and the foot-and-mouth disease, along with a slowdown in world demand emanating from the US. This has served to lower forecasts of growth for this year relative to where they would have been 6 months ago. Over the medium term the slowdown in private demand is expected to be replaced to some degree by the announced increases in government demand, most noticeably government investment. The value of sterling has also impacted disproportionately on the traded sector of the economy over recent times. Sterling is forecast to weaken over the next few years, easing such pressures. The depreciation in sterling provides one of the main upward influences on inflation in the forecast.