The economic scene in Germany in autumn 1999

The international and European environment

Developments in the global economy

Upturn in the global economy

In the summer half year of 1999, the global economy gathered pace again. The rapid rate of expansion is an indication that the contractionary impact of the shocks generated by the international financial and economic crises has increasingly receded, leading to a marked improvement in the global economic outlook for the coming year. The stabilisation of the Japanese economy and the, in some cases, very dynamic upswing in a number of East Asian emerging market economies played a substantial role in this. Furthermore, recessionary tendencies were halted comparatively quickly in the majority of Latin American countries. In the central European countries in transition, the economy has been picking up again since spring; in Russia, too, overall economic output has recently been edging upward again following the sharp downturn in production in 1998. Moreover, the recovery of the global economy continued to be boosted by the sustained strong expansion in the United States.

Most recent IMF forecast

In the light of global developments, which have been quite positive over the past few months, the IMF recently revised its spring 1999 forecast for global growth upward from 2¼% to 3%; this would imply a ½ percentage point increase in the rate of growth compared with 1998. According to the latest forecast, global output is to increase by 3½% next year, and the volume of world trade is to grow by more than 6%. The IMF predicts that differences in economic growth among the industrial countries could continue to narrow substantially, especially between Japan and the United States. The forecast for western Europe is that the pace of economic activity will pick up appreciably. Nevertheless, owing to the expected soft landing of the US economy next year, the increase in aggregate real GDP, which is likely to amount to 2½%, will virtually be no greater than in 1998 and 1999. The rate of growth in the developing countries, by contrast, is expected to go up from 3½% this year to almost 5% next year, and in the transitional countries it is expected to accelerate from less than 1% this year to almost 3%. For Russia, it is anticipated that overall economic output will expand by 2% next year after stagnating, on an annual average, in 1999. According to the IMF forecast, the global strengthening of growth in output is taking place in what is generally a comparatively favourable price climate, despite sharp rises in commodity prices since spring 1999 and signs of an increasing degree of capacity utilisation.

South-East Asia

The strong economic recovery in the South-East Asian emerging markets is especially notable since most of these countries suffered major slumps in output in 1998. The IMF forecasts that Taiwan, South Korea, Singapore and Hong Kong, taken together, will expand at a rate of more than 5% in both 1999 and 2000. Other countries in the region, such as Indonesia, Malaysia, the Philippines and Thailand, which were, in some cases, affected even more severely by the crises, have also pulled out of the cyclical trough and are back on the path of expansion. Even so, the current upswing in South-East Asia, which was given an additional boost in the past few months by the strength of the

IMF forecasts for 1999 and 2000 *

Item	1997	1998	1999	2000
Real gross domestic product	Change from previous year in %			
Advanced economies 1	+ 3.2	+ 2.2	+ 2.8	+ 2.7
of which				
United States 2	+ 3.9	+ 3.9	+ 3.7	+ 2.6
Japan	+ 1.4	– 2.8	+ 1.0	+ 1.5
Euro area	+ 2.4	+ 2.8	+ 2.1	+ 2.8
Inflation 3				
Advanced economies 1	+ 2.1	+ 1.5	+ 1.4	+ 1.8
of which				
United States	+ 2.3	+ 1.6	+ 2.2	+ 2.5
Japan	+ 1.7	+ 0.6	– 0.4	0.0
Euro area	+ 1.6	+ 1.2	+ 1.0	+ 1.3
Unemployment	Number of unemployed as % of the labour force			
Advanced economies 1	6.8	6.7	6.5	6.5
of which				
United States	4.9	4.5	4.3	4.5
Japan	3.4	4.1	5.0	5.8
Euro area	11.7	10.9	10.3	9.7

* Source: IMF, World Economic Outlook, October 1999. — **1** Industrial countries plus Israel, China (Taiwan), Hong Kong (Special Administrative Region), Republic of Korea and Singapore. — **2** Revised figures for 1997 and 1998 after the changeover to the new System of National Accounts (SNA 93): + 4.5% and + 4.3%, respectively. — **3** Measured by the consumer price index.

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Japanese yen and the very buoyant global demand for electronic intermediate and finished goods, does conceal structural problems that continue to exist. Therefore, the strong cyclical upswing must not lead to a relaxation of the pressure to continue the restructuring of the financial and corporate sectors.

United States

The US economy gathered pace again following a moderation of economic activity in the spring; initial estimates indicate that real GDP in the third quarter, after adjustment for seasonal and working-day variations, was just over 1% higher than in the second quarter and 4% up on the year. These data were published simultaneously with the revised figures calculated on the basis of the new System of National Accounts (SNA 93) for the years from 1959 onwards. According to these calculations, economic growth in the United States – especially in the nineties – was considerably stronger, at an annual rate of 3½%, than previously shown (3%). The changeover to the new system has also led to an upward revision of the saving ratio of households, which nevertheless remained relatively modest in summer 1999, amounting to 2.1% of disposable income (according to the former calculations, the figure had been as low as – 1.3% in the spring).

The strong economic growth in the third quarter may be attributed, firstly, to an increase in industrial investment. Secondly, real exports also rose quite perceptibly at a seasonally adjusted rate of 3%, probably already reflecting the economic recovery in major customer countries. Price-adjusted private consumption expenditure continued to expand at the same rapid pace as in the spring, with demand for durable goods remaining strong. By contrast, a downward trend emerged in housebuilding, not least as a reaction to the interest rate increases in the US capital market. The situation in the labour market remains tense; however, this has not yet been reflected in an acceleration of inflationary pressure. The rise in consumer price inflation from 2.3% in August to 2.6% in September may chiefly be attributed to the sharp increase in energy prices and a leap in tobacco prices.

Japan

In Japan, the cyclical revival initiated in the first quarter with the aid of massive government stimuli to demand continued into the second half of the year. In the summer, industrial output increased at a seasonally adjusted rate of just under 4% compared with the second quarter, and thus showed a year-on-year rise (2½%) for the first time in two years. However, special factors also played a part in this substantial increase; the upward trend is therefore likely to be noticeably flatter. According to the IMF forecast, real GDP will grow by around 1% and 1½%, respectively, in 1999 and 2000, compared with a decline of just under 3% in 1998.

The government's decidedly expansionary fiscal policy, which is to be continued, remains the main pillar of economic recovery. The government has, for example, announced a new stimulus package in the order of 3½% of GDP, which also comprises components that do not directly influence demand, such as official credit guarantees for small and medium-sized companies. In the final analysis, this programme chiefly replaces other stimulus measures that are now coming to an end; the budget deficit remains very high at an estimated 7½% of GDP. Although the public stimulus packages of the past two years have helped to improve business and consumer sentiment, they have not yet generated a self-sustaining upswing. Thus, given high levels of overcapacity, enterprises are planning further substantial cuts in their investment budgets in the current financial year. Moreover, restructuring in the corporate sector is affecting private consumption in terms of more jobs being shed, which is in itself clouding the outlook for employees' income. In addition, the development of exports, which had been buoyant in the spring, has been curbed increasingly over the past few months by the strength of the yen.

United Kingdom

According to the provisional calculations, overall economic output in the United Kingdom continued to accelerate in the summer, rising in seasonally and working-day adjusted terms by almost 1 % compared with spring, when it had been slightly higher than ½ %, and by just under 2 % on the year. The British economy has now been on a path of expansion since the summer of 1992; during this period, output has increased by more than 20 %. Growth was especially strong in the service sector, which expanded by almost 30 %. The sustained upswing has led to a marked reduction in unemployment. Since reaching its last peak at the beginning of 1993, the standardised unemployment rate fell by almost 5 percentage points to a seasonally adjusted 5.9 % in July 1999, and was thus substantially below the average in the euro area (10.0 %). The downside of this development is that wages have recently been subject to considerable upward pressure. In the three-month period from July to September, average earnings rose at an annual rate of 4 ¾ %, an increase which the Bank of England no longer considers to be consistent with its stability policy objectives. The sharp price increases in the real estate markets are likewise seen as an indication of growing inflationary pressure. However, consumer price inflation (excluding mortgage rates), which amounted to 2.2 % in October, remained clearly below the 2.5 % inflation target.

General economic trends in the euro area

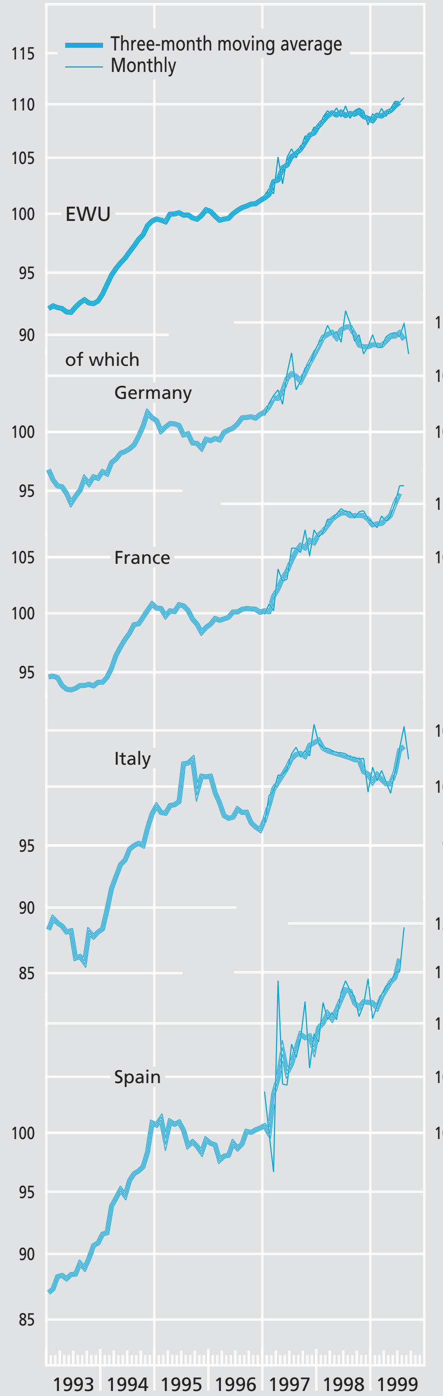
Positive economic development in the summer half year

According to the most recent estimates, real GDP in the euro area in spring rose by a seasonally adjusted ½ % compared with the first quarter, when it had grown at a somewhat slower rate. It thus exceeded the level recorded in the second quarter of 1998 by more than 1½ %. This growth was supported almost exclusively by domestic demand, which was 2 ½ % higher than a year before. After adjustment for seasonal variations, the development of private consumption and fixed capital formation was less dynamic than it had been in the winter months, but this was offset by the slight rise in inventory investment, which had previously been cut back sharply in view of the prevailing weakness of demand. Furthermore, real exports grew quite strongly at a seasonally adjusted rate of 1½ %. Since imports increased at a somewhat slower pace, the foreign balance rose slightly. In the seven countries on which the current GDP calculations for the euro area are based, overall economic output was following an upward trend throughout the first half of the year. However, the pace of expansion differed substantially among the individual countries, the lowest annual rate of growth being in Italy (less than ½ %) and the highest in Spain (3 ½ %).

Economic activity in the euro area appears to have picked up momentum in the second half of the year. Industrial output in the period from July to August rose by a seasonally adjusted ¾ % when compared with the second quarter – this increase was due chiefly to Italy, Spain and France – and by more than 1 % against the same period a year before. This is consistent with the fact that seasonally adjusted industrial capacity utilisation in the euro area went up again slightly following a decline in the spring. Moreover, the industrial

Industrial output *
in the euro area

1995 = 100, seasonally adjusted; log. scale



* Including mining and energy, excluding construction. — Sources: Eurostat, national statistics.

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confidence indicator, which is determined by means of surveys, was continuing its rising trend up to the end of the period under review, with the climate improving in almost all the member states. All in all, recent data indicate that the disparate growth patterns in the euro area are levelling out again.

Prospects for 2000

The recent IMF forecast points in the same direction, predicting that the current economic "stragglers", Germany and Italy, will make good progress in catching up with the euro area average next year, while the countries which are already expanding at a rapid pace will probably be able to maintain their high growth rates. Thus, economic growth in the euro area could accelerate from 2 % this year to 2 ¾ % in 2000. This would also lead to a perceptible rise in the degree of overall capacity utilisation, but would still not stretch production capacity to the full; this holds true especially for Germany and Italy.

Labour market

There has been hardly any further improvement in the labour market situation in the euro area over the past few months. In September, as in July and August, the standardised unemployment rate was a seasonally adjusted 10.0 % and thus only slightly below the level recorded in June (10.1 %). It was, however, 0.7 percentage point lower than a year before. It was only in Germany that unemployment rose somewhat in seasonally adjusted terms; the number of unemployed continued to decline in the Netherlands, Finland, France, Ireland and Spain.

Consumer prices

Consumer prices have risen at a moderate pace since the beginning of the year. In September, as in August, consumer prices were 1.2% higher than a year before. While energy prices continued to rise under the influence of the developments in the global commodities markets, prices for unprocessed food, in particular, declined. There were barely any further price rises for manufactured goods in the past few months. Price trends continue to differ widely across the individual countries. Whereas inflation remained below 1% in Austria, France and Germany, prices recently went up by 2.4% in Spain and 2.8% in Ireland compared with a year before. The Netherlands, Portugal and Italy were all near the 2% ceiling of the range determined by the ECB as being compatible with price stability. To keep inflationary pressure within bounds, the Italian government recently decided to cut mineral oil taxes for a limited period. Overall, inflationary pressure in the euro area is expected to increase slightly on average in 2000.

Euro area current account and exchange rate developments

Foreign trade of the euro area with third countries

The worldwide recovery in economic growth was a substantial boost to trade relations between the euro area and third countries in the summer months. In particular, exports of euro area suppliers became perceptibly more buoyant in the past few months after having reached their trough as early as at the turn of 1998-99 but subsequently regaining momentum only slowly. This is not immediately evident in a year-on-year comparison, but in the two-month period of July and August (the figures for September are not yet available), exports from the euro area were, for the first time, again higher than in the corresponding period of 1998 (by more than ½%); in the first half of 1999, by contrast, they had still been more than 3½% down on the year.

The cyclical revival in the euro area countries has also gone hand in hand with a rise in goods imported from third countries. In July and August of 1999, the value of imports was more than 4½% higher than in the same months last year, compared with a decline of 1½% in the first half of 1999. Nevertheless, real import growth was lower than these figures suggest at first glance because of the sharp rise in import prices, especially for crude oil and mineral oil products. As a result, the differing increases on the export and import sides also led to the euro area's export surplus in foreign trade with third countries being lower, at € 20½ billion, than the corresponding figure for 1998 (ECU 24 billion) – despite the fact that exports were much more buoyant in July/August.

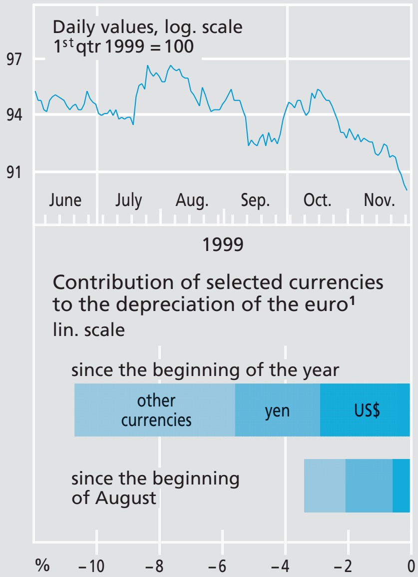
Current account

At the same time, the deficit in the area of "invisible" current account transactions was higher (€ 10½ billion) than in July/August 1998 (ECU 9 billion), chiefly owing to an increase in transfer payments to third countries. On balance, the current account for the euro area therefore showed a markedly lower surplus, at just over € 9½ billion, than a year earlier (ECU 15 billion).

Exchange rate developments

In the foreign exchange markets, the euro, after strengthening temporarily in the summer, had weakened again by the end of September. Following that, upward pressures

Development of the effective exchange rate of the euro *



* Against the currencies of 13 countries. — 1 Weighted change in the bilateral exchange rates.

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predominated for a time, but in the first weeks of November the euro depreciated again, reaching its lowest level so far this year.

The yen

The development of the euro in the autumn months was initially influenced by the high level of the Japanese yen, which appreciated sharply by just over 6 % against the euro in mid-September. At first, this reappraisal of the exchange-rate relations was probably mainly attributable to both the cyclical revival in Japan and the unexpectedly rapid recovery in a number of emerging markets in East Asia. However, the shift in market sentiment with respect to the future outlook for growth in the euro area then gave cause for a certain correction. The interest rate expectations that arose in the euro area in this connection fostered the recovery of the European currency for a time. The euro recently stood at 110 yen, exceeding its low in September by around 1½ % but nonetheless remaining almost 18 % below its value at the beginning of the year.

The dollar

The US dollar, on the other hand, was affected by contrasting factors, so that no clear pattern of development has been discernible over the past few months. Following a perceptible firming in July, the euro fluctuated within a range of between US$ 1.03 and US$ 1.09, reflecting the frequently alternating market assessments of the economic outlook in both regions. On the one hand, reports on the remarkably robust and relatively tension-free economic growth in the United States repeatedly boosted the US dollar; on the other hand, the outlook for the euro improved because the economic recovery in the euro area was continuing to take shape, so that, on balance, the differences in economic growth in the two regions should tend to diminish. As this report went to press, the euro stood at US$ 1.04.

Effective rate of the euro

As a weighted average, the euro has weakened by 3½ % since the beginning of August, coming to stand almost 11% below its rate at the beginning of the year. Against a background of quite similar inflation rates in the industrial countries, the exchange rate situation thus continues to support the positive competitive position of European suppliers in foreign markets. In the long run, however, competitiveness in the global markets will have to be "earned" by cost discipline at home.

Monetary policy and financial markets in the euro area

Interest rates raised in November

In the past several months, the ECB Governing Council initially continued its interest rate policy of holding a steady course, leaving the Eurosystem's official rates unchanged. Then, with effect from November 10, it raised the interest rate on the main refinancing operations, which will continue to be conducted as fixed rate tenders, from 2.5 % to 3.0 %. In addition, the interest rate on the marginal lending facility was raised from 3.5 % to 4.0 % and that on the deposit lending facility from 1.5 % to 2.0 %, both with effect from November 5, 1999. The aim of this interest rate increase is to maintain the price stability that has broadly been achieved and thus to contribute to sustained economic growth. In the light of the increased risks to price stability, the persistently strong monetary growth, and the cyclical upswing that has set in, marked expansionary impulses were no longer appropriate. On balance, the interest rate increase signifies a revocation of the interest rate cut in April 1999, which was intended as a precautionary measure against deflation. Even after the interest rate increase, monetary policy remains relaxed.

Rising money market rates

The ECB had been preparing the public for the interest rate increase since the summer months, so that expectations of rising central bank rates had already formed in advance in the financial markets. While interest rates on longer and medium-term futures contracts in the spot market (EURIBOR) had been rising continuously since the early summer, shorter-term rates have also been moving up sharply since the beginning of October. Apart from expectations of a decision on interest rates by the ECB Governing Council, this also reflects the premiums for the millennium date change (year 2000 problem), which are considerably higher – especially for unsecured contracts – than the typical end-of-year premiums. All in all, there was a clear upward shift in the money market yield curve.

Ample provision of funds through main refinancing operations

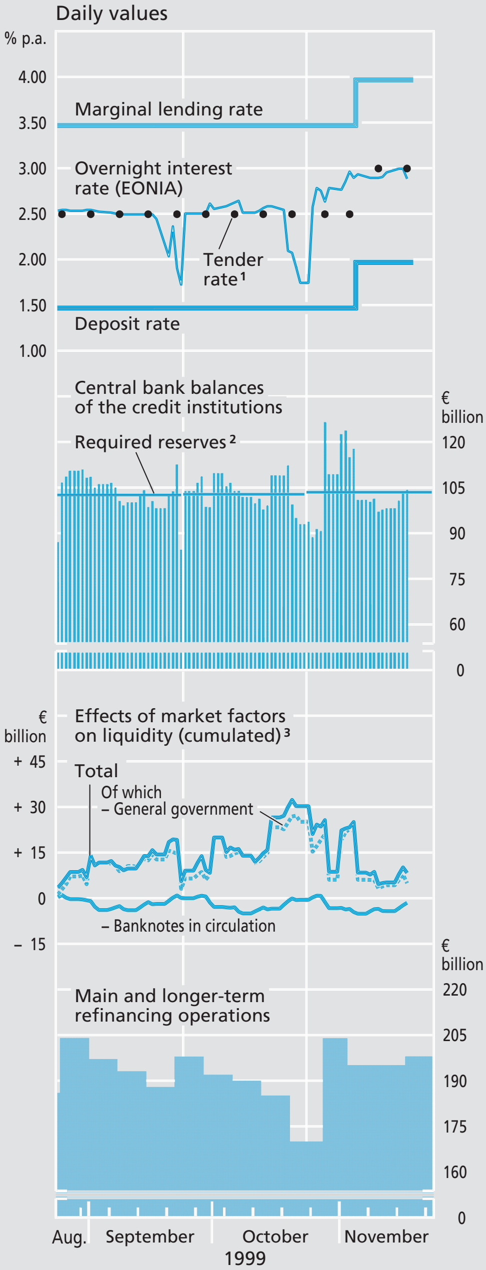
The Eurosystem's ongoing money market management continued to pursue the aim of steering the overnight interest rate (EONIA) as closely as possible to the main refinancing rate in order to counter the very high amount of bids in the fixed rate tenders. It has done so by tending to provide ample funds at the beginning of each reserve maintenance period, thus offsetting the effects of the factors determining market liquidity (mainly public sector cash transactions). Nevertheless, owing to the increased interest rate uncertainly, the overnight rate was, from the beginning of October, often markedly higher than the official money market rate. The amounts of bids in the main tenders reached new all-time highs, and the allotment rates remained low. Towards the end of each maintenance period, however, the EONIA rate fell substantially owing to the prospect of excess liquidity, and recourse to the deposit facility regularly increased for a time.

Longer-term refinancing operations

The longer-term refinancing operations which reached maturity by September, each with a volume of € 15 billion, were all completely replaced. In October, the ECB Governing Council decided to change the allotment volume of the three main tender operations

Interest rate movements and liquidity management in the Eurosystem

Daily values



1 Interest rate for main refinancing operations. — **2** Maintenance periods: August 24 to September 23, September 24 to October 23, October 24 to November 23, 1999. — **3** Banknotes in circulation, net general government position vis-à-vis the Eurosystem, net foreign currency reserves of the Eurosystem and other factors; provision (+) or absorption (–) of central bank balances.

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still to be conducted up to the end of the year to € 25 billion each. This increase is intended to help guarantee a smooth transition to the year 2000. At the end of October, the allotment rates in these transactions, which continue to be conducted as variable rate tenders, went up considerably, reflecting developments in the money markets.

On the whole, the Eurosystem's open market operations declined by € 7.1 billion to € 188.0 billion between August and October (see table on page 15). This offset market-related liquidity inflows amounting to € 6.8 billion. The minimum reserve requirement remained broadly unchanged. The Eurosystem continued to refrain from short-term fine-tuning operations. Recourse to the standing facilities declined slightly.

Money stock continued to move away from reference value

The growth of the money stock M3 in the euro area was somewhat sharper again in the third quarter of 1999 after its pace had slackened in the previous quarter. In September, M3 in the euro area as a whole was 6.1 % higher than a year before, compared with 5.7 % in August and 5.8 % in July. The three-month moving average of the 12-month growth rates from July to September was 5.9 %; in the past few months, this figure moved further away from the reference value of 4½ %. In July and September, in particular, the money stock M3 expanded strongly, whereas in August, the increase was only moderate. When interpreting monetary growth in the euro area as a whole, some caution is still warranted because the developments in the individual EMU member states remain very heterogeneous. Germany's contribution to monetary expansion in the euro area continues to increase at a markedly faster rate than the monetary aggregate as a whole (see page 16). Experience has shown that a sustained ample liquidity supply to the economy leads to increased risks for price stability in the future. With its recent interest rate decision, the ECB Governing Council showed its determination to counteract any such development.

Components of the money stock

Among the individual components of the money stock M3, the marketable instruments – in particular, money market fund certificates and money market paper as well as bank debt securities issued with an original maturity of up to two years – expanded at an especially fast pace. The growth of overnight deposits remained strong. The volatility in the financial markets is likely to have fostered investors' preference for liquidity and induced them to lodge funds in short-term forms of investment. Uncertainties in connection with the year 2000 problem might also have been a factor. Currency in circulation also increased quite sharply in the third quarter. On the whole, the money stock M1, which includes currency in circulation and sight deposits, expanded at a seasonally adjusted annual rate of 8 % between July and September; at the end of September, M1 was 13 % higher than a year before. The development of the other shorter-term deposits in the money stock M3 was moderate.

Counterparts of M3 in the balance sheet

In terms of the balance-sheet counterparts of M3, monetary growth in the euro area continued to be boosted by lending to the private sector, which has been very strong for some time now, although the growth rate slackened somewhat in the third quarter. Credit

Factors determining bank liquidity *

€ billion;
calculated on the basis of daily averages
of the maintenance periods

Item	1999 Aug. 24 to Sep. 23	1999 Sep. 24 to Oct. 23	1999 Aug. 24 to Oct. 23
I. Provision (+) or absorption (–) of central bank balances by			
1. Change in banknotes in circulation (increase: –)	+ 2.7	– 0.4	+ 2.3
2. Change in general government deposits with the Eurosystem	– 4.1	+ 6.0	+ 1.9
3. Change in net foreign exchange reserves 1	+ 0.3	+ 6.1	+ 6.4
4. Other factors	+ 0.5	– 4.3	– 3.8
Total	– 0.6	+ 7.4	+ 6.8
II. Monetary policy operations of the Eurosystem			
1. Open market operations			
a) Main refinancing operations	+ 0.3	– 7.4	– 7.1
b) Longer-term refinancing operations	– 0.0	± 0.0	– 0.0
c) Other operations 2	–	–	–
2. Standing facilities			
a) Marginal lending facility	– 0.3	+ 0.1	– 0.2
b) Deposit facility (increase: –)	+ 0.3	+ 0.1	+ 0.4
Total	+ 0.3	– 7.2	– 6.9
III. Change in credit institutions' current accounts (I. + II.)	– 0.3	+ 0.2	– 0.1
IV. Change in the minimum reserve requirement (increase: –)	+ 0.2	– 0.2	+ 0.0
Memo items 3			
Main refinancing operations	150.4	143.0	143.0
Longer-term refinancing operations	45.0	45.0	45.0
Other operations 2	–	–	–
Marginal lending facility	0.2	0.3	0.3
Deposit facility	0.7	0.6	0.6

* For longer-term trends and the contribution of the Deutsche Bundesbank see pages 14* and 15* in the Statistical Section of this Report. — 1 Including end-of-quarter valuation adjustments with no impact on liquidity. — 2 Including monetary policy operations concluded in stage two and still outstanding at the beginning of stage three; excluding outright transactions and the issue of debt certificates (included in item I.4.). — 3 Levels on an average of the maintenance period under review or the last maintenance period.

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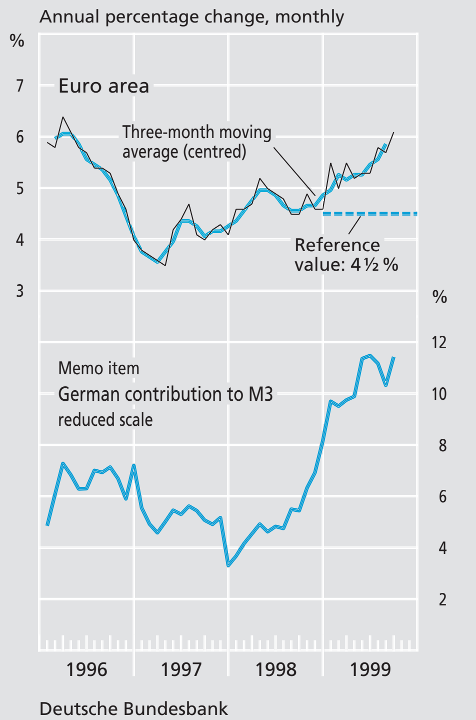
Growth of the money stock M3 in the euro area



granted by the MFIs to the private sector rose by € 73.6 billion between July and September, compared with an increase of € 88.2 billion in the same period last year. At the end of the period under review, the year-on-year rate was 10.5%. While the increase in MFIs' holdings of shares and other equities was only moderate in the third quarter, MFIs' loans to enterprises and households continued to expand quite strongly. The rising interest rates on bank advances may have induced borrowers to take up loans to secure the current lending terms, which are still favourable, in the longer term. The amount of credit granted by MFIs to the public sector grew by € 4.9 billion in the third quarter, compared with a decline of € 20.9 billion in the same period last year. On balance, however, this was attributable almost exclusively to an increase in MFIs' portfolio holdings of public securities. By contrast, MFIs' advances to the public sector continued to decline. The growth of monetary capital kept with the MFIs, which had increased somewhat in the previous quarter, continued at broadly the same pace throughout the third quarter of 1999, leading to a slight reduction in the pace of monetary growth. In the payments between resident non-MFIs and counterparties outside the euro area, the outflows of funds were markedly lower in the third quarter than in the two preceding quarters. The net external asset position of the euro area MFIs, in which such transactions are reflected, declined by € 9.0 billion, compared with a fall of € 60.0 billion in the second quarter and of € 70.4 billion in the first quarter.

German contribution

At a rate of 11.4%, the German contribution to M3 growth in the euro area expanded on the year at a distinctly faster pace than the euro area aggregate. However, this rate probably significantly overstates the current liquidity situation in Germany. One particular indication of this is that the acquisition of money market paper and shorter-term bank debt securities by investors from non-euro area countries has continued to rise recently.[1] By contrast, the high return flows of funds from the euro market that were observable in the first half of the year weakened perceptibly in the third quarter.

1 Since the outstanding volume of these instruments is shown less the holdings of the euro area MFIs and no additional distinction between euro area and non-euro area buyers has been introduced so far owing to statistical problems, such liabilities of MFIs vis-à-vis non-euro area creditors are included in the money stock M3.

Further increase in capital market rates up to the end of October ...

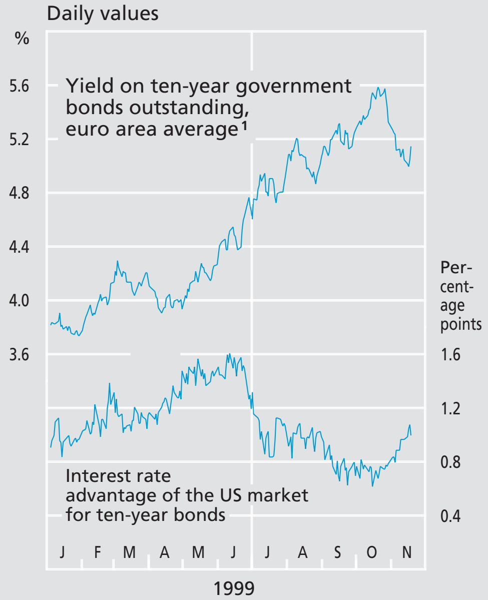
The increase in capital market interest rates that has been under way in the euro area since the spring continued into the autumn. The average yield of ten-year government bonds in the member states of the euro area increased by more than 1 percentage point between the end of June and the end of October, reaching a peak of over 5 ½ %. By international standards, long-term rates in the euro area rose at a comparatively rapid pace. As a result, the interest rate advantage of ten-year government bond yields in the United States over comparable euro area paper diminished to around ¾ percentage point by the end of October; this is only about half the level recorded in June. The closing of the gap in yields between capital market rates in the euro area and the United States, where economic growth remains strong, is an indication that the interest rate rise in Europe was motivated, above all, by a more optimistic appraisal of the economic outlook. With a view to the situation in the spring, which was marked by fears of a crisis, the higher level of capital market rates may thus be regarded as a kind of return to normal. However, the yield increase is also an indication that, in the summer months, stability risks again shifted more towards rising prices. Given that situation, the increase in interest rates in autumn was probably also influenced by speculation as to when and by how much the Eurosystem would raise its interest rates.

... and subsequent decline in connection with the Eurosystem's interest rate increase

At the end of October, interest rates began to decline, and ten-year yields fell back to below 5 ¼ % on an average of the euro area. This was probably chiefly due to the fact that uncertainty in the capital market receded as the signs of a raising of the Eurosystem's official interest rates became increasingly manifest. After the ECB Governing Council's interest rate decision, yields continued their downward trend; in mid-November, capital market rates in the euro area were at 5 %. On balance, the yield curve flattened out considerably in the autumn. At the end of the period under review, ten-year yields were about 1½ percentage points higher than the three-month EURIBOR, compared with a peak of 2 ½ percentage points in the late summer. It should, however, be taken into account that – like all money market rates that span beyond the end of the year – the three-month EURIBOR currently contains a premium due to banks' higher preference for liquidity for the period over the millennium date change.

Interest rate movements in the euro area bond market

Daily values



1 Weighted average yield on ten-year government bonds of the euro area countries; GDP-weighted.

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Volatile share prices

Share prices in the euro area were characterised by strong volatility in the summer and autumn months, with European stock markets – as usual – broadly following the developments on Wall Street. After reaching a new all-time high in the middle of July, European equity quotations fell by more than 10 % – measured by the Dow Jones Euro Stoxx index – up to the beginning of August. By mid-September, they had recovered almost completely from this cyclical trough, and then fell back again considerably into October. Finally, the recent upturn in prices brought quotations back up to new record highs. In mid-November, prices were almost 19 % higher than at the end of 1998. Overall, European equities gained considerable ground in the autumn compared with US shares, probably mainly on account of the fact that the economic outlook has now improved substantially in the larger countries of the euro area, too.