The international and European setting

Developments in the world economy

Terrorist attacks pose serious problems

The world economy, which was passing through a tricky period anyway around the middle of the year, has been additionally handicapped by the terrorist attacks on the United States. The global slowdown in business activity intensified in the autumn. Immediately after the events of September 11, there was substantial disruption of intra-US and international air traffic, which spread to other sectors as well. In some firms in the United States, production had to be curbed or even halted altogether at times owing to the shortage of intermediate inputs. To date, such production losses have apparently been made good only in part. Moreover, the tourism sector has likewise sustained severe losses since then – not just in the United States, but worldwide.

But more severe than these direct economic effects are the adverse psychological implications, even if they cannot at present be quantified reliably. US consumers, in particular, appear to be profoundly unsettled. Private consumption, which had previously been the primary buttress of US economic activity, showed distinct signs of weakness after September 11. In the equity markets, by contrast, the pronounced downturn in prices was followed by a rally, accompanied by high volatility. In the major foreign exchange markets, the swings remained within relatively narrow bounds, whereas prices in the international commodity markets dropped sharply. That led, on the one hand, to losses of revenue in the supplier countries, while, on the other, it contributed to an improvement in price movements in the industrialised nations.

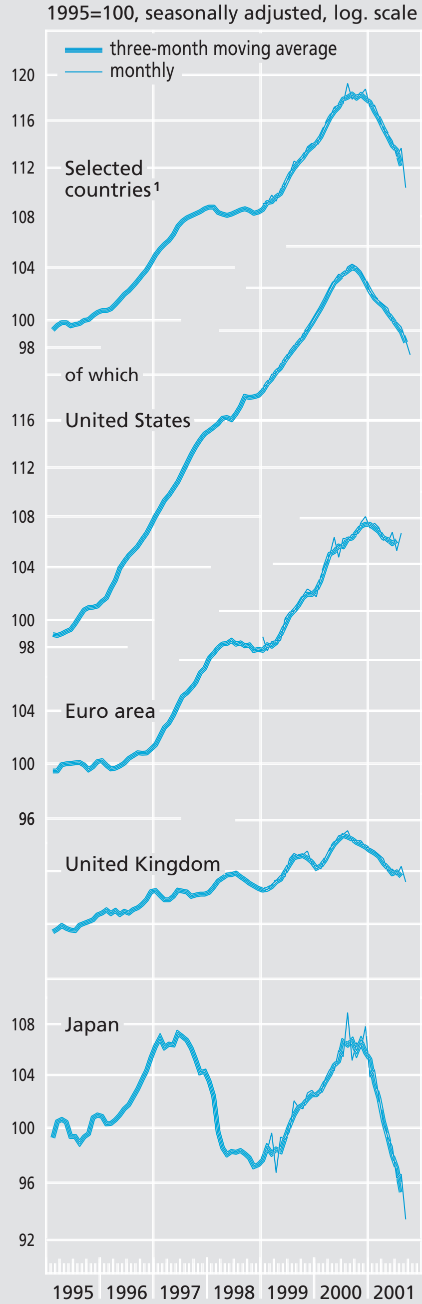
United States in a "technical recession"

Not least on account of the adverse economic consequences of the terrorist assaults, the expansionary stimuli expected in the United States from the marked easing of monetary policy since the beginning of this year, and from bringing forward tax-relief measures (as decided in the spring), have not materialised up to now. In the third quarter, seasonally adjusted aggregate output fell below the level of the previous quarter, for the first time since early 1991. Since most leading indicators are pointing downwards, that tendency might well persist for the time being, with the result that a "technical recession" (i.e. a decline in real GDP in two successive quarters) can no longer be ruled out. In specific economic sectors, moreover, a need for adjustment had built up which is becoming evident now, during the period of sluggish activity. Notably in the areas of information technology and communications technology, the over-investment of the past few years is exerting a greater impact than had originally been supposed.

Sluggish business activity in the rest of the world

In western Europe, real GDP probably rose only a little after mid-year. Japan once again slid into recession during the summer half. In the emerging economies of eastern Asia (other than China), the pace of the cyclical slowdown has intensified in recent months, especially in view of the waning of US and Japanese demand for electronic products. Latin American nations were likewise adversely affected by the slackening of the growth of world trade; that applies particularly to Mexico, which dispatches about nine-

Industrial output*
in selected countries



Source: National statistics, Eurostat and the Bundesbank's own calculations. — * Including mining and energy, excluding construction. — 1 Besides euro-area countries and the countries specified, the list includes Denmark, Norway, Sweden, Switzerland and Canada; weighted with the respective share in the gross value added by industry in those countries in 1995.

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tenths of its exports to the United States and Canada. In addition, the financial crisis in Argentina, which is spreading to neighbouring countries to some extent, worsened further in the summer months, and energy bottlenecks in Brazil hampered aggregate output again. Only a few countries have been able to record brisk economic growth in the current year. Besides China, they include the oil-exporting nations of the Near East and the Commonwealth of Independent States (CIS), above all Russia.

Revised forecast by the IMF

In November, the staff of the IMF once again revised its GDP forecast for the world economy downwards, viz. to 2.4 % in the whole of 2001; that represents the lowest growth rate since 1993. That rate also reflects the economic consequences of the terrorist attacks in the United States. The expansion of the volume of world trade, which apparently came to a halt, or even gave way to a contraction, in the second half of this year, will slow down, according to the IMF's forecast, to an annual average of 1 ½ % (compared with 12 ½ % in 2000). The IMF's staff lowered its forecast for global GDP growth in 2002, compared with the World Economic Outlook of October 2001, by a good percentage point to 2.4 %.

The chances of a worldwide recovery in 2002

Even so, there are prospects of a global change for the better in the course of next year. For one thing, purchasing power in the oil-consuming countries has strengthened of late owing to the fall in the market prices of crude oil. For another, US economic policy makers have set the signals at "expansion" more unmistakably than before. In western Europe, too, central banks have perceptibly lowered official interest rates. Fiscal policy is likely to buttress business activity (mainly because of tax cuts in major countries). In Japan, monetary and fiscal policy makers have tried – within the narrow leeway available to them – to counteract the contractionary process under way in the economy. Furthermore, adjustments of inventories have already made considerable headway in most industrialised countries, so that output will not be impeded so much from that angle in 2002 as it has been in the current year. However, this forecast is subject to distinctly greater uncertainty than other predictions have been in recent years. At present, for instance, it is hardly possible to foresee how much longer the uncertainty of investors and consumers, especially in the United States, will last.

US economic activity in the third quarter

As is being demonstrated again at the moment, the development of the world economy depends crucially on business activity in the United States. In earlier years, the United States made a massive contribution to strengthening global growth; in the course of the present year, however, and especially since mid-year, strong retarding effects have been emanating from that country. After adjustment for seasonal and working-day variations, aggregate output in the United States in the summer quarter was marginally (– 0.1 %) lower than in the spring. The level of the previous year was overshot by ¾ %. This poor outturn is only partly due to the events of September 11.[1] US business activity had already slackened perceptibly in the months before the attacks. That applies especially to industry, where capacity utilisation has gone down continuously since October 2000, and was lower in September than at any time since the spring of 1983. The loss of jobs in that sector has been offset ever less as the year has progressed by additional jobs created in the services sector. Hence the number of wage and salary earners in the economy as a whole has declined sharply since the early spring, and the seasonally adjusted unemployment rate rose by 0.9 percentage point during the period from August to October, to 5.4 %. Since its nadir in October 2000, it has gone up by 1 ½ percentage points.

In the summer months, the deterioration in labour-market conditions noticeably depressed consumer sentiment, which had picked up somewhat in the spring. The undermining of US residents' sense of security by the terrorist attacks of September 11 resulted in a further, in part dramatic, erosion of consumer confidence. In that inauspicious environment, the tax reform which came into effect on July 1 was unable to generate the hoped-for upturn in demand. After adjustment for price and seasonal variations, private consumption grew in the summer quarter by only ¼ %, compared with over ½ % in each of the two preceding quarters. At the same time, however, households' seasonally adjusted disposable income expanded by 3 % against the spring as a result of tax refunds. This increase in income accrued primarily to saving, so that households' saving ratio shot up from a seasonally adjusted 1.1 % in the second quarter to 3.8 % in the third; in September, it actually reached 4.7 %. Real investment by trade and industry again dropped sharply in the summer, and was just over 6 ½ % below its level a year before. Although housing investment still rose somewhat, it increased far less steeply than it had done earlier. The reduction in inventories that started at the beginning of 2001 continued at a faster pace; that curbed aggregate growth in the summer quarter, but at the same time improved the conditions for an economic turnaround. Exports and imports both tended to decline significantly; the deficit on real external trade diminished somewhat.

Price pressures at the consumer stage have eased perceptibly in the past few months, primarily on account of the relaxation of tensions on the energy markets. The year-on-year inflation rate, which had stood at 3.6 % in May, fell to 2.1 % in October. The statistical core inflation rate (excluding energy and

1 The Bureau of Economic Analysis (BEA), which is responsible for compiling the US national accounts, refrained from quantifying the adverse effects of the terrorist attacks on aggregate output in the third quarter since – as the Bureau states – they cannot be separated out of the primary statistics underlying the computation of GDP and its components. In certain items, however (including some of the most recent, which are not yet corroborated by primary statistics, and hence are estimated), adjustments have been made affecting, above all, the nominal account and movements in the implied deflators, but hardly impinging on real GDP. On the expenditure side, the September 11 attacks are reflected mainly in nominal consumption and imports of insurance services. Moreover, aggregate fixed assets were adjusted downwards, and the income account was modified. For instance, depreciation was raised, the figures for the wages and salaries of employees in trade and industry were reduced because of the production hold-ups and dismissals immediately after the terrorist assaults, and those of public sector employees were raised on account of the many hours of overtime worked by the rescue teams.

food), which is less volatile, remained virtually unchanged, at 2.6 %.

Turnaround in economic activity not likely until 2002

According to the available indicators (most of which are pointing downwards), a steeper decline in real GDP is to be expected in the fourth quarter of 2001 than in the summer. Hence a recovery of US business activity is not likely until some time next year. Hopes are being pinned, firstly, on the underlying optimism of US consumers and investors gradually regaining the upper hand. Secondly, substantial monetary and fiscal stimuli have been imparted. At the beginning of November, the US central bank lowered its interest rates, for the tenth time this year, to 2.0 % – a level such as has not been seen since the early sixties. Since September 11, fiscal policy has likewise taken a number of measures that may help to buttress aggregate demand. For instance, immediately after the terrorist assaults, US$ 40 billion of additional expenditure on immediate assistance and security measures and US$ 15 billion of spending on credit guarantees and subsidies to airlines were approved. For fiscal 2002, which began on October 1, the Administration has also proposed an economic package which has been increased by the House of Representatives to a magnitude of US$ 100 billion. It comprises both accelerated tax cuts and increases in spending. If it remains unchanged (the deliberations in Congress are still in progress), the fiscal measures, including a number of extra increases in spending, will amount to some 1 ½ % of nominal GDP.

Japan

In the Japanese economy, the recessionary tendencies have strengthened since the spring of 2001, after distinct signs of weakness had been discernible as early as the preceding quarters. In the second quarter, seasonally adjusted real GDP fell by ¾ % against the previous year. The adverse economic trends persisted after mid-year (although national accounts data are not yet available). Industrial output declined once more in the summer quarter, namely by 4 %, seasonally adjusted, against the preceding quarter. Thus it was one-tenth down on the year. That outcome owed something to weak domestic final demand, the consistently sizeable excessive inventories and the decline in exports, especially of IT products. The shedding of jobs has continued, and the seasonally adjusted unemployment rate reached a new all-time peak in September, at 5.3 %. The sustained fall in consumer prices fits into this picture; in October, they were almost 1 % lower than a year before. At present, there is little evidence that the Japanese economy will be able to bring about a cyclical turnaround in the near future by its own efforts. Hence the country is heavily dependent on expansionary external stimuli deriving from a recovery of the world economy in general, and the US economy in particular. According to the latest IMF forecast, Japanese real GDP will contract by 1 % in 2001 and 1 ¼ % in 2002.

United Kingdom

According to preliminary calculations, aggregate output in the United Kingdom in the summer, after adjustment for seasonal and working-day variations, was just over ½ % higher than in the spring, and a good 2 % up on the year. The growth was fuelled by the services sector and the construction industry, whereas industrial output once again decreased. However, the provisional GDP data for the third quarter may have to be adjusted downwards, since industrial output in September, which was not known when the annual accounts data were computed, turned out to be distinctly worse than had been expected. The recessionary pressures in industry are mainly attributable to the sluggishness of exports, which has been evident for some time now, and which might be reinforced by any further economic slowdown in major customer countries, especially the United States. By contrast, retail turnover once again increased strongly in the summer months. Sectoral differences in business activity were reflected in prices as well. The comparatively steep rise in the costs of services has been accompanied of late by falling import prices, which have favourably affected the prices of domestic industrial products. The inflation rate at the consumer level (excluding mortgage rates) decelerated to 2.3 % in September-October (compared with 2.6 % in August, when a baseline effect made itself felt).

Overall economic trends in the euro area

Marked slowdown in economic activity in the summer half

Seasonally adjusted economic growth in the euro area came to a halt during the spring months. That was primarily because real gross fixed capital formation and exports contracted noticeably. In particular, intra-euro-area exports appear to have gone down; at any rate, according to the balance-of-payments statistics, seasonally adjusted merchandise exports to non-euro-area countries remained at the level of late 2000 in the first half of this year. By contrast, households' real consumption tended to continue rising. In purely arithmetical terms, GDP growth was buttressed by the fact that real imports decreased again. (National accounts data for the third quarter are not yet available.)

After mid-year, the cyclical slowdown continued (according to the data at hand). During the period from July to August, seasonally adjusted industrial output was ¼ % lower than in the second quarter, and was thus also lower than a year before, for the first time since spring 1996. The decline compared with the previous year focused on intermediate products and consumer durables, while the production of capital goods stagnated and there was a distinct increase in the output of consumer goods. In September, industrial output in the euro area probably went down again, judging by the – already available – national figures for France, Germany, Italy, the Netherlands and Spain.

EU survey

The increasing sluggishness of industrial activity is likewise reflected in the faster decline in capacity utilisation since mid-year. Since the last peak (early in 2001), the degree of utilisation of production facilities in the manufacturing sector of the euro area has dropped by 2 ½ percentage points; even so, in October it was still slightly above the long-term average. Judging by the outcome of the latest EU survey, sentiment in industry in the euro area has continued to deteriorate in the past few months, especially in September-October. In particular, production expectations have been adjusted downwards. However, sentiment in industry has been less depressed than it was in the recession year 1993. Consumer confi-

Capacity utilisation in the euro-area manufacturing sector *

Seasonally-adjusted data in %

Country	Annual average (AA) 1990-2000	2001 Total	January	April	July	October	October 2001 against AA 1990-2000; in % points
Euro area	81.7	83.2	84.4	83.6	83.0	81.9	+ 0.2
of which:							
Belgium	79.9	82.3	84.8	82.7	81.4	80.2	+ 0.3
France	84.4	87.6	88.8	86.9	87.7	87.0	+ 2.6
Germany	84.2	85.1	86.9	85.7	84.3	83.3	– 0.9
Italy	77.0	78.9	79.5	79.4	78.7	77.9	+ 0.9
Netherlands	84.0	84.6	85.2	84.8	84.6	83.8	– 0.2
Spain	77.8	79.6	80.1	79.7	80.1	78.3	+ 0.5
Memo item:							
EU	81.8	82.7	84.0	83.1	82.3	81.4	– 0.4

* Source: EU economic survey; weighted overall outcome of the country data.

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dence has deteriorated, too, since mid-year. Although households have continued to rate their own financial situation (and that for next year) as rather favourable, they have turned out to be more and more concerned about general economic trends. Even though the overall findings of the survey point downwards, they do not warrant the conclusion that the euro area is currently in recession.

Labour market and prices

The economic slowdown in the euro area has hardly been mirrored as yet in the labour market. In September the (seasonally adjusted) standardised unemployment rate remained at 8.3 %, a level which has been unchanged since July. At any rate, the period of decreasing unemployment, during which the unemployment rate in the euro area has fallen no fewer than three percentage points since mid-1997, has come to an end, at least for the time being. In the period from July to October, seasonally adjusted consumer prices, as measured by the harmonised consumer price index (HCPI), rose at an annual rate of little more than 1 ½ %. In October, admittedly, the year-on-year rise still came to 2.4 %, but that was primarily due to the price surges emanating from food and energy prices during the first half of the year. Of late, energy prices have gone down slightly, and food prices have stabilised at a high level. Hence the chances of the inflation rate soon returning to the fold of price stability (i. e. rates of under 2 %) have distinctly improved.

Euro-area current account and exchange-rate trends

Foreign trade

During the summer months, the foreign trade of the euro area remained under the impact of the worldwide slowdown in growth. In the last three months for which figures are available (June to August), the export turnover of the euro-area countries with nations outside the eurozone remained unchanged compared with the preceding three-month period. At the same time, the markedly slower pace of business activity in the euro area curbed the growth of merchandise imports. In the three months under review, such imports (after seasonal adjustment) were only ½ % higher than in the preceding three months (March-May). That represented a continuation of the sideways movement discernible since the spring, after there had been a perceptible decline in import turnover at the beginning of the year, mainly on price grounds.

Current account

In the summer months (June to August), the seasonally adjusted trade surplus, at almost € 13½ billion, was again rather substantial, and fell only a little (about € 1 billion) short of the outturn of the previous period. The "invisible" current transactions of the euro area with non-euro-area nations were likewise virtually unchanged during the period under review; on balance, the seasonally adjusted deficit came to € 24½ billion, as in the previous period. Overall, the euro area ran a current account deficit of € 11½ billion in the three months from June to August, compared with € 10½ billion during the period from March to May. Thanks to the higher trade surpluses since the beginning of this year, the cumulative (seasonally adjusted) current account deficit in the first eight months of 2001, at € 24½ billion, has halved compared with the same period of last year.

Exchange-rate trends

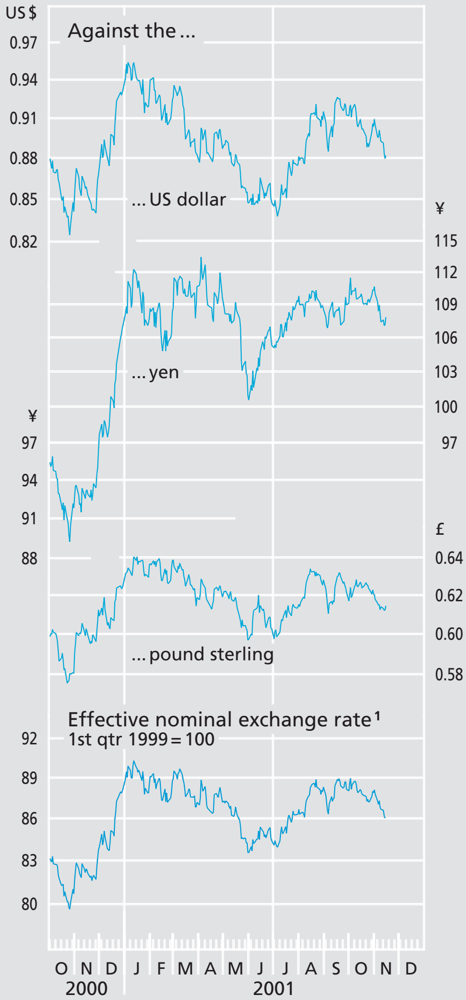
In the foreign exchange markets, the euro had initially strengthened noticeably against all major currencies in the late summer of this year. However, in the ensuing period, a sustained and radical revaluation of exchange-rate relationships among the major world currencies failed to materialise, after the growth prospects of the world economy and the euro-area countries had deteriorated more strongly than had been expected. The further revaluations of the single European currency were only short-lived. That was the case when the European markets were faced with stronger demand following the terrorist attacks on the United States and the associated disruption of the major US financial centres. On balance, however, the undermining of market players' sense of security as to the further development of the world economy in the wake of the events of September 11 was reflected primarily in the frequently changing signs of the movements of the US dollar.

US dollar

After the euro had fallen below the level of US$ 0.84 at the beginning of July, it rose again to over US$ 0.91 at the end of August. This adjustment was sparked off by a reference by the US central bank to the ongoing risks besetting US business activity. The already burgeoning doubts about any rapid recovery of US economic activity were additionally fostered when the figures on US economic growth in the second quarter were adjusted downwards and the International Monetary Fund questioned

Exchange rate of the euro

Daily data, log. scale



1 According to ECB calculations, against the currencies of 13 countries (12 countries from 2001).

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the sustainability of the high US current account deficit. But as early as the beginning of September, sentiment in the market started to swing in favour of the dollar again after new figures had presented US business activity in a somewhat more favourable light.

But that development was interrupted once more a short time later by the terrorist attacks in the United States on September 11, when the US dollar temporarily depreciated against all currencies. Against the background of the changed security situation, however, the US currency, in its traditional role of a "safe haven", had made good the preceding losses by the end of September. Besides, the ever more gloomy outlook for growth in Europe handicapped the further development of the euro in September and October. Following the publication, at the end of October, of data on the downturn in consumer confidence in the United States, and in the light of other bad news on conditions in the US economy, market sentiment shifted for a while in favour of the euro; most recently, however, the euro has again been perceptibly losing ground again. When this Report went to press, the euro was standing at US$ 0.88, and was thus back at the level of early August.

Yen

Against the yen, in August and September the euro moved in a comparatively narrow band between ¥ 107 and ¥ 110, with the Japanese currency remaining conspicuously firm despite the highly critical state of the Japanese economy. This may have owed something to the repatriation of sizeable amounts from abroad by Japanese financial institutions (shortly before the end of the Japanese financial half-year on September 30). During that period, the Bank of Japan tried to mitigate the upward pressure on the yen by means of foreign-exchange-market interventions, because of the associated loss of price competitiveness by Japanese exporters. But the yen did not weaken until the publication of the Bank of Japan's "Tankan" report (which is heeded all over the world) had drawn market players' attention more clearly to the deterioration in economic conditions in Japan. Towards the end of the period under review, however, the euro depreciated against the yen as well, being quoted only a little above ¥ 107.

Pound sterling

The movement of the euro against the pound sterling was rather more stable, even if the virtual synchronism of the movements of the pound sterling and the US dollar observed in the past persisted. The single currency initially appreciated distinctly against sterling at the beginning of August, although it had to relinquish a large part of those gains before the end of the month. In September, the UK currency was adversely affected by the temporary weakness of the dollar, following the terrorist assaults of September 11. More recently, however, the pound sterling has strengthened again in line with the US dollar.

Effective exchange rate of the euro

On balance, the euro, expressed as a weighted average against the currencies of the twelve most important trading partners of the euro area, has changed but little during the period under review despite repeated swings in either direction. Latterly, it has been about 3 % below its value at the beginning of the year, and just under 17 % below the rate ruling at the launch of monetary union at the beginning of 1999. In other words, economic growth in the euro area is not being handicapped by exchange-rate movements.

Monetary policy and the financial markets in the euro area

Interest-rate cuts by the Eurosystem from August to November

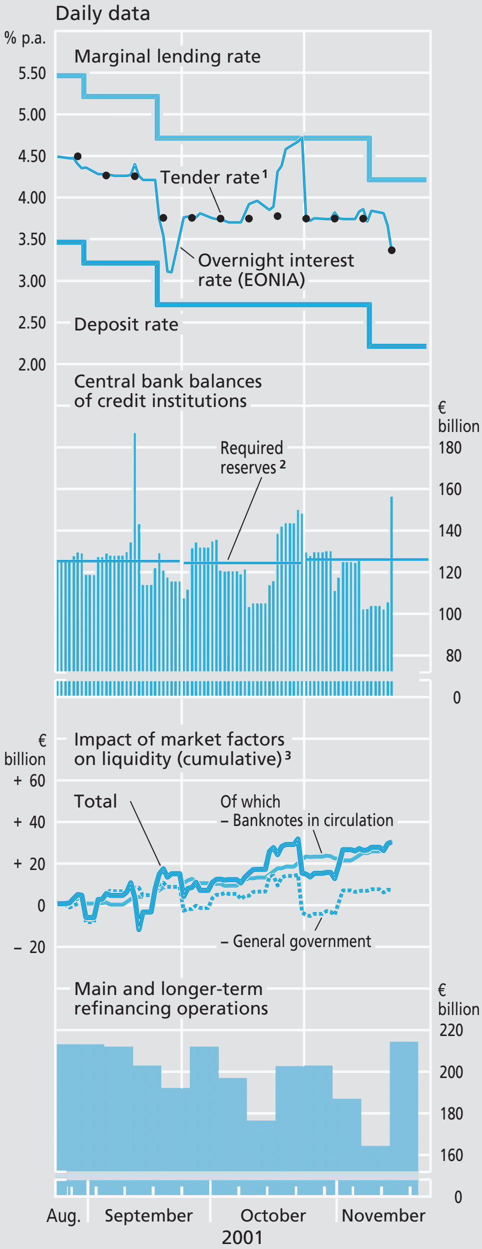
After the Eurosystem had left its interest rates unchanged during the summer months, at the level to which they had been lowered in May, the ECB Governing Council reduced official interest rates in three steps, by a total of 1 ¼ percentage points, between late August and early November. Since November 9, the interest rates for the marginal lending facility and the deposit facility have stood at 4.25 % and 2.25 %, respectively; since November 14, main refinancing operations have been conducted in the form of variable-rate tenders with a minimum bid rate of 3.25 %. Already during the summer, the analysis of monetary and macroeconomic data compiled with the aid of the two pillars of the Eurosystem's monetary policy strategy implied a slackening of inflationary pressures in the euro area and warranted the lowering of official interest rates by ¼ percentage point on August 30. That assessment was reinforced after the terrorist attacks in the United States on September 11. On September 17, the ECB Governing Council, as part of a concerted operation along with other central banks, lowered the official interest rates of the Eurosystem by ½ percentage point. Thereafter, the price prospects brightened up some more in the light of the ongoing deterioration in economic conditions in the euro area. Hence the ECB Governing Council further relaxed its monetary policy at the beginning of November, and lowered official interest rates by another ½ percentage point. The latterly strong monetary growth was not incompatible with an interest-rate cut since, on account of portfolio effects, it is hardly likely to pose any risk of inflation (see page 17 f.).

Decline in money-market rates

The interest-rate cuts by the ECB Governing Council had been expected by the market. Accordingly, forward quotations in the

Interest-rate movements and liquidity management in the Eurosystem

Daily data



1 Interest rate for main refinancing operations, single allotment rate (for fixed-rate tenders) or marginal allotment rate (for variable-rate tenders) — 2 Maintenance periods: 24 Aug. to 23 Sep., 24 Sep. to 23 Oct., and 24 Oct. to 23 Nov. 2001. — 3 Banknotes in circulation, government deposits with the Eurosystem, net foreign currency reserves of the Eurosystem and other factors; provision (+) or absorption (–) of central bank balances.

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money market went down ahead of those decisions, although the interest-rate reductions in mid-September and early November exceeded the expectations of some market players. The term structure of interest rates in the money market, which had been inverse since last December, levelled off distinctly after the September key-rate reduction, but then widened again (partly under the impact of falling capital-market yields). In mid-November, forward quotations in the money market were some 90 to 100 basis points below their level of mid-August.

Safeguarding orderly market conditions after the terrorist attacks

Developments in the overnight money market and credit institutions' compliance with the reserve requirements were both rather unsettled in the autumn months. The Eurosystem responded to the rise in EONIA after the terrorist attacks in the United States by conducting fixed-rate quick tenders with one-day maturities to boost liquidity on September 12 and 13. The ECB accepted all bids, amounting to totals of € 69.3 billion and € 40.5 billion, respectively. That operation enhanced the functionality of the financial markets. The same thing applies to the swap agreement between the US Federal Reserve System and the ECB, which served to meet the dollar liquidity needs of banks in the euro area. Thanks to the abundant supply of liquidity, the overnight money rate dropped distinctly below the main tender rate towards the end of the September maintenance period, resulting briefly in heavier recourse to the deposit facility. Because of the prevailing expectations of interest-rate cuts, credit institutions' participation in main tenders dwindled early in October. In the main refinancing operation conducted on October 10, the volume of bids fell substantially short of credit institutions' short-term liquidity requirements, and the overnight money rate rose. Since the ECB failed to meet all the remaining requirements with the final tender of the maintenance period, the overnight money rate went up to the level of the marginal refinancing rate, and the banks temporarily drew heavily on that facility. Early in November the main tender was again underbid, and the ECB responded, following the latest reduction in official interest rates, by massively increasing the volume of tenders.

Decrease in liquidity requirements

Between August and October funds totalling € 23.5 billion accrued to credit institutions owing to autonomous factors determining liquidity (see the adjacent table). That was mainly due to the exceptionally sharp fall in banknotes in circulation, which decreased significantly with the approach of the issuance of euro banknotes after the turn of the year. Another expansionary factor was the reduction in public sector deposits with the Eurosystem. Finally, the required minimum reserves dropped by € 2.8 billion. The Eurosystem reduced the volume of open market operations accordingly during the period under review, viz. by € 27.3 billion, to an average of € 136.7 billion.

Monetary growth reinforced by the events of September 11

The pace of monetary growth in the euro area continued to quicken in the third quarter of this year, after the money stock M3 had increased distinctly in the first half of the year. Especially in September, the money stock rose strongly. That seems to have owed a good deal to portfolio-shift operations in the wake

Factors determining bank liquidity *

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

Item	2001 24 Aug. to 23 Sep.	2001 24 Sep. to 23 Oct.	2001 24 Aug. to 23 Oct.
I. Provision (+) or absorption (–) of central bank balances by			
1. Change in banknotes in circulation (increase: –)	+ 12.2	+ 10.2	+ 22.4
2. Change in general government deposits with the Eurosystem (increase: –)	+ 3.6	+ 1.6	+ 5.2
3. Change in net foreign exchange reserves 1	– 0.8	– 11.4	– 12.2
4. Other factors 2	– 3.6	+ 11.8	+ 8.2
Total	+ 11.4	+ 12.1	+ 23.5
II. Monetary policy operations of the Eurosystem			
1. Open market operations			
a) Main refinancing operations	– 16.9	– 10.4	– 27.3
b) Longer-term refinancing operations	± 0.0	+ 0.0	+ 0.0
c) Other operations	+ 3.5	– 3.5	± 0.0
2. Standing facilities			
a) Marginal lending facility	+ 0.4	+ 0.6	+ 1.0
b) Deposit facility (increase: –)	– 0.2	+ 0.3	+ 0.1
Total	– 13.2	– 13.0	– 26.2
III. Change in credit institutions' current accounts (I. + II.)	– 1.7	– 1.0	– 2.7
IV. Change in the minimum reserve requirement (increase: –)	+ 1.9	+ 0.9	+ 2.8
Memo items 3			
Main refinancing operations	147.1	136.7	136.7
Longer-term refinancing operations	60.0	60.0	60.0
Other operations	3.5	–	–
Marginal lending facility	0.5	1.1	1.1
Deposit facility	0.4	0.1	0.1

* For longer-term trends and the contribution of the Deutsche Bundesbank, see pages 14* and 15* of 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 in Stage Three (outright transactions and the issuance of debt certificates). — 3 Levels as an average of the maintenance period under review or the last maintenance period.

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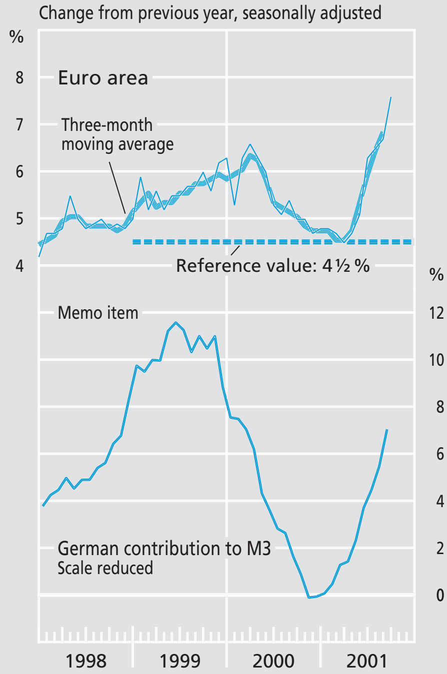
Growth of the money stock M3 in the euro area



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of the terrorist attacks of September 11. The long-standing uncertainties in the international equity markets suddenly multiplied, with the result that many investors apparently preferred to hold their funds in liquid and short-term asset forms. At the end of September, M3 throughout the euro area was 7.6 % up on the year, compared with 6.3 % at the end of June; the moving 3-month average of the year-on-year rates amounted to 6.9 % between July and September, against 5.4 % between April and June. Despite these high growth rates, monetary expansion is presumably posing little risk of inflation at the present time. Besides the above-mentioned portfolio shifts, it must be borne in mind, when interpreting the statistical growth of the money stock in the euro area, that such growth overstates the expansion of liquidity in the eurozone because purchases of money-market paper and short-term debt securities by non-residents of the euro area have not yet been eliminated from the figures. At present, such purchases are probably contributing three-quarters of a percentage point to the annual growth rate of M3.[2]

Components of the money stock

Among the individual components of the money stock M3, it was particularly overnight deposits that grew noticeably in the third quarter; they were increased massively, especially in September. On balance, the seasonally adjusted money stock M1 expanded more than in the previous quarter, despite the faster decline in currency in circulation in view of the imminent introduction of euro currency. At the end of September, it was 5.2 % higher than a year before. The other short-term bank deposits, viewed as a whole, likewise benefited from investors' marked propensity to place funds at short term. While time deposits with an agreed maturity of up to two years rose only moderately, deposits at an agreed notice of up to three months increased strongly between July and September. The simultaneous reduction in longer-term savings deposits, the interest-rate advantage of which has diminished significantly since the spring, suggests that shifts in such assets have occurred. Marketable instruments earning interest at market-related rates increased steeply again in the third quarter, al-

2 See the ECB Press Release, Monetary developments in the euro area – September 2001, 26 October 2001. Moreover, the ECB has announced that it will publish, towards the end of November, an M3 time-series that is adjusted for distortions due to all marketable financial instruments held by EU non-residents. See ECB, Monthly Bulletin, November 2001, page 5.

though the pace of their growth has recently slackened somewhat.

Balance-sheet counterparts

Lending to the private sector slackened perceptibly in the third quarter. At the end of September, loans by MFIs to the private sector were 6.9 % higher than a year before, compared with 8.4 % at the end of June. Seasonally adjusted loans by MFIs to enterprises and individuals went up at an annual rate of 5 % between July and September, compared with 6 % between April and June. At the end of September, they were 6.6 % higher than a year earlier, against 7.9 % at the end of June. Direct lending by MFIs to the public sector decreased again in the third quarter. Monetary capital formation, which had slowed down in the previous quarter, continued to lose momentum during the period under review. Monetary expansion was fostered in the third quarter by resident non-MFIs' payments to euro-area nonresidents; according to the available data, there were inflows in securities transactions in this sphere, especially in September, presumably in connection with the terrorist attacks on New York and Washington.

The German contribution

The German contribution to the money stock M3 in the euro area, which, after seasonal adjustment, had increased faster than the aggregate as a whole in the first half of the year, again expanded somewhat more strongly than the euro-area money stock M3 in the third quarter. At the end of September, it was 7.1 % up on the year, against 3.7 % at the end of June. Rather as at EMU level, the growth of the German contribution to M3 was marked by a steep rise in overnight deposits in September (see page 27 f.). In addition, debt securities issued with maturities of up to two years and money-market-fund certificates issued by German MFIs rose relatively strongly.

Capital-market rates continue to fall

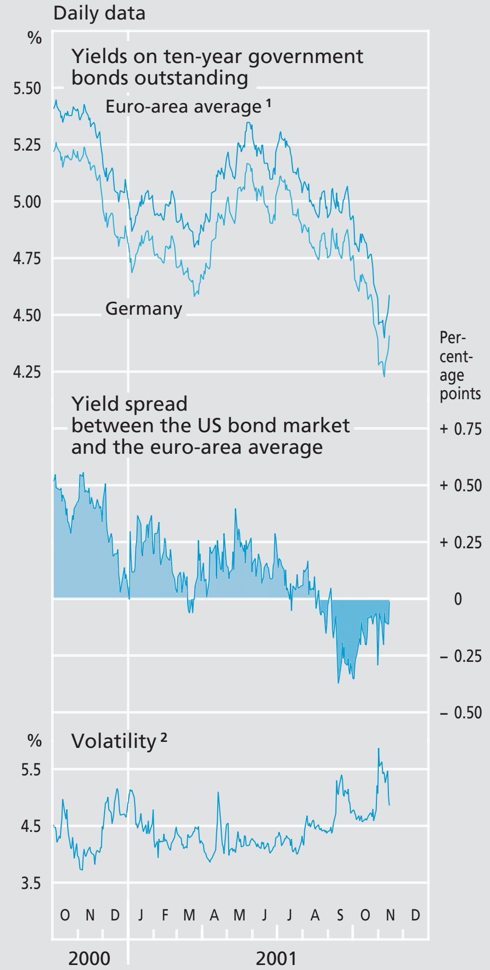
On balance, long-term capital-market rates in the euro area dropped further in the autumn months. Taking the average of the euro-area countries, the yields on ten-year government bonds stood at just under 4 ¾ % in mid-November. Hence they were ¼ percentage point lower than in mid-August. The terrorist attacks in the United States on September 11 exerted no direct impact on the level of long-term yields. Up to the end of September, the rates remained relatively constant, at around 5 %. But, as concern about further economic developments in the euro area increased, a downward trend set in and was fostered by the slightly declining inflation expectations of market participants (manifest from surveys by experts and from inflation-indexed bonds). Most recently, however, yields have gone up again in the light of rising equity prices and diminishing expectations of interest-rate cuts.

Wider gap between money-market and capital-market rates

The interest-rate differential between the capital market and the money market widened abruptly to over 140 basis points after the interest-rate reduction by the Eurosystem on September 17, but then narrowed distinctly again because of falling capital-market rates. After the latest interest-rate cut on November 8, the gap between long-term and short-term rates widened again. At the time of writing, at just over 1 ¼ percentage points, it was perceptibly above the level of mid-August (some 60 basis points). The uncer-

Bond-market yields in the euro area

Daily data



1 Weighted average yield on ten-year government bonds issued by all euro-area countries; weighted by GDP. — **2** Implied volatility of Bund futures.

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tainty of market players about future movements in bond prices, which is reflected in the implicit volatility of options on futures contracts in long-term Federal bonds, increased noticeably in the short run after the events of September 11. Not least on account of the swift and confidence-building liquidity and interest-rate measures taken by the Eurosystem, however, conditions largely calmed down again there as early as the end of September.

Long-term interest rates in the euro area and the United States converge

Against the backdrop of the distinct slowdown in economic activity expected in the United States, the yields on 10-year US Treasuries have dropped faster in recent months than those on similar bonds issued in euro-area countries. As a result, the yield advantage of US government bonds that has invariably been discernible in the past few years changed in September into an interest-rate gap in favour of euro-area bonds amounting at times to ⅓ percentage point. After the interest-rate cut by the US central bank at the beginning of October, that gap narrowed slightly because the yields on US government securities rose somewhat in hopes of an early recovery of US business activity. But when those hopes had been largely dashed, and signs of a more pronounced slowdown in growth had emerged in the euro area, too, the interest-rate advantage of euro-area bonds diminished again, to latterly 12 basis points.

Higher risk premiums for corporate bonds of low credit standing

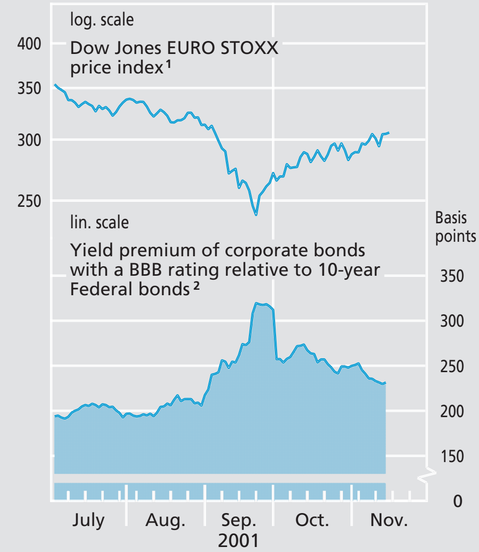
Risk premiums for corporate bonds of low credit standing shot up (dramatically in some cases) after the uncertainties caused by the events of September 11 – not only in the United States, but also in the euro area. Up to now, such premiums have declined only in part, in view of the generally poorer earnings prospects of enterprises, especially those in cyclically more vulnerable segments of the market.

Rally after equity-market downturn

In the euro-area equity markets, the persistent price erosion since the spring of 2000 continued during the summer months of 2001, and right into the autumn. Between mid-August and the time of writing in November, the Dow Jones EURO STOXX index fell altogether by a further 6%. Since their all-time peaks in March 2000, the valuations of listed European enterprises have thus declined by more than one-third. During the period under review, quotations came under marked pressure, especially towards the end of August. After the announcement of terrorist attacks on New York and Washington on September 11, they downright plummeted. When equity trading resumed in Wall Street on September 17, after an interruption due to the assaults, prices plunged further in the United States and Europe alike. At the same time, uncertainty about price movements (as measured by the implied volatility of options on the Dow Jones EURO STOXX 50 index) assumed proportions such as had not been recorded since the financial market crisis of September 1998. As early as the end of September, however, conditions in the equity markets calmed down appreciably. By mid-October, prices in almost all major stock-market centres were on average above their levels prior to September 11.

Valuations of firms in the euro-area equity and bond markets

Daily data



1 End-1991 = 100; Source: Deutsche Börse AG. — 2 Source: Bloomberg; rating as per Standard & Poor's.

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But diverse price movements in different sectors

Thus, the terrorist attacks directly affected general market trends only temporarily. But price movements since then in the individual economic sectors have been rather diverse. Whereas, previously, it was securities from the high-tech and telecommunications sectors that were under particular pressure, subsequently it was more equities from the consumer-goods and capital-goods fields and the transportation sector (and from banking) that fared worse than the average. Despite the generally somewhat more moderate level of valuations, it is now primarily the inauspicious economic outlook that is depressing equities in fundamental terms, and has already led in some cases to noticeable reductions in expected entrepreneurial earnings.