

Global and European setting

World economic activity

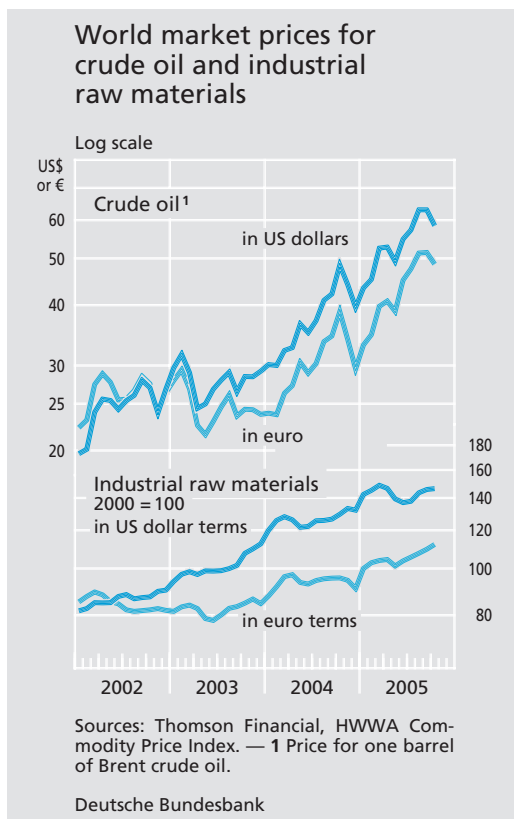
The world economy remained on a growth path after mid-year despite considerable additional strains. The renewed surge in oil prices in August once again visibly reduced real disposable income in the oil-consuming countries. In addition, since the end of August, the US economy has had to cope with considerable output losses owing to damage caused by severe hurricanes in the Gulf of Mexico. This did not leave a distinct mark on the third-quarter output figures, which were exceptionally favourable, particularly because the US economy was running at an extremely rapid pace at the beginning of the third quarter. In Japan, growth slowed distinctly after the middle of the year. By contrast, the euro area saw stronger growth.

Dynamic global economy despite renewed surge in oil prices

In the major industrial nations and economic regions (the United States, Japan, the United Kingdom and the euro area), aggregate real Q3 gross domestic product (GDP) – according to figures that are still provisional – was therefore $\frac{3}{4}\%$ higher in seasonally and working-day adjusted terms than in the second quarter, in which it had risen at the same rate. It rose by $2\frac{3}{4}\%$ on the year. According to the available leading indicators, the fourth quarter is likely to see a continuation of brisk economic activity in the industrial countries, although the pace is expected to slow down somewhat in the USA.

International crude oil prices (Brent) rose by US\$15 to around US\$65 from early May to mid-August. Following reports of the hurricane damage along the Gulf Coast of the

Oil markets calmer since early September



United States, prices rose further to US\$67½ in late August/early September. They then showed a noticeable downward trend. In mid-November, oil spot prices stood at US\$55½. Key factors in the calming on the oil markets since early September were the announcement by various industrial nations that they would release part of their strategic oil reserves and OPEC's decision to increase production once again. In addition, high oil prices in consumer countries have apparently triggered increased energy saving. In euro terms, the price of Brent crude oil – owing to the depreciation of the euro against the US dollar – rose somewhat more sharply; as this report went to press, the price of a barrel of oil, at €47½, was just over one-fifth higher than in early May. Given the continuing increase in the worldwide demand for oil and

the fact that the production losses in the Gulf of Mexico are likely to persist for some time, a sustained decline in crude oil prices is not to be expected for the time being. The (US\$) prices of industrial raw materials, having fallen slightly during the second quarter, picked up once again after mid-year and have, since early September, been holding firm at the level already reached in March-April. Denominated in euro, however, they were one-tenth higher as this report went to press.

The renewed surge in oil prices in the summer months put a visible damper on the price climate in the consumer countries. A prominent case in point was the United States, where considerable supply bottlenecks for oil products owing to the hurricane damage to refineries drove prices up particularly sharply. Between June and September, consumer price inflation in industrial nations rose by 1.2 percentage points to 3.0%. Excluding Japan, which dragged down the average considerably, consumer prices were 3.6% higher in September than a year before. Core inflation (ie excluding energy and food), however, at 1.7%, was virtually unchanged in comparison with Q2 figures. The larger discrepancy between the inflation rates indicates that indirect and second-round effects have so far remained limited in industrial nations.

In its September 2005 World Economic Outlook, the IMF continues to assume that the world economy – despite the renewed surge in oil prices in the third quarter – will grow by 4¼% both this year and next. The growth rate would thus remain well above the long-term average of 3½%. The spring estimate

Stronger oil price-related inflation in industrial countries

IMF forecast

was maintained without changes for 2005 and revised downwards only slightly for 2006, although the oil price assumptions, now at US\$54¼ for 2005 and US\$61¾ for 2006, are respectively around US\$8 and US\$18 higher than before. The IMF forecast is based on the expectation that the growth-dampening effects of higher oil prices will be offset by a continued accommodative monetary policy, favourable financial market conditions, especially low long-term interest rates, and a sustained improvement in corporate balance sheet structures.

According to the IMF's latest forecast, however, strong global GDP growth will be accompanied by somewhat weaker growth in real world trade. Growth rates were revised downwards by one-half and one-quarter percentage point to 7% and 7½% respectively. By contrast, price forecasts were revised upwards. For developing countries and emerging markets, in particular, a much stronger increase in consumer prices than as late as April 2005 is now expected (6% this year and 5¾% in 2006). The estimate for the industrial countries as a whole was revised upwards only slightly for 2005 and 2006 (each by ¼ percentage point) to 2¼% and 2% respectively. From today's perspective, however, this is likely to be the lower limit. In addition, it should be noted that the low Japanese rate is having a strong dampening impact on the average value.

Considerable risks to the world economy remain

The IMF's risk assessment has likewise changed little relative to earlier forecasts. The dangers arising from high and volatile oil prices remain at the top of the list. Increasing

IMF forecast for 2005 and 2006 *

Item	2003	2004	2005	2006
Real gross domestic product	Annual percentage change			
Advanced economies 1	+ 1.9	+ 3.3	+ 2.5	+ 2.7
of which				
United States	+ 2.7	+ 4.2	+ 3.5	+ 3.3
Japan	+ 1.4	+ 2.7	+ 2.0	+ 2.0
Euro area	+ 0.7	+ 2.0	+ 1.2	+ 1.8
Consumer prices 2				
Advanced economies 1	+ 1.8	+ 2.0	+ 2.2	+ 2.0
of which				
United States	+ 2.3	+ 2.7	+ 3.1	+ 2.8
Japan	- 0.2	0.0	- 0.4	- 0.1
Euro area	+ 2.1	+ 2.1	+ 2.1	+ 1.8
Unemployment	Number of unemployed persons as a percentage of the labour force			
Advanced economies 1	6.6	6.3	6.1	5.9
of which				
United States	6.0	5.5	5.2	5.2
Japan	5.3	4.7	4.3	4.1
Euro area	8.7	8.9	8.7	8.4

* Source: IMF, World Economic Outlook, September 2005. — 1 Including Taiwan, Hong Kong, South Korea and Singapore. — 2 Consumer price index; for the euro area, HICP.

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protectionism and a distinct deterioration in financial market conditions as a result of a sudden rise in inflation expectations are also regarded as risks. Over the medium term, macroeconomic imbalances, which are still on the rise, and the unsustainable fiscal policies pursued by some industrial nations are still considered to be potential sources of risk. The IMF forecasts that the US current account deficit will stabilise at just over 6% of GDP in 2006, although this will mean – relative to 2004 figures – a further rise by one-fifth to what will then be well over US\$800 billion.

In this context, it must be taken into account that the current account surpluses of the South and East Asian emerging market economies, owing to their higher national oil bills, will probably see only slight growth during

the forecasting period, whereas those of the oil-exporting countries will probably rise sharply. Although little is known about how those countries invest their "surplus" oil revenues, the US dollar as an asset may possibly play a less important role than in past investment decisions taken by East Asian emerging market economies, which were motivated by exchange rate management objectives. Higher interest rates in the USA and a steeper international yield curve have acted as a counterpart.

*South and East
Asian emerging
market
economies*

In some South and East Asian emerging market economies, the oil price-related depletion of private-sector purchasing power has, in the past few months, been amplified by the fact that the governments have, in some cases, made significant cuts in their previous petroleum products subsidies, especially for fiscal reasons. In the light of the still relatively high energy intensity of production in the countries concerned, this could lead, at least temporarily, to shortfalls in growth and increased vulnerability to shocks. The energy price-related macroeconomic strains in the region, however, were cushioned throughout the reporting period by the persistent expansionary stimuli being emitted by the USA and China. Chinese Q3 GDP – as in Q2 already – grew by 9½% on the year. For 2005 as a whole, a 9½% growth rate is once again to be expected. In the coming year, the growth rate in China and the other South and East Asian emerging economies could slow down somewhat, however.

Latin America

The majority of Latin American economies – especially Brazil, Mexico and Venezuela –

are still benefiting from the high prices of crude oil and industrial raw materials. For example, despite a distinct appreciation of the real in the first eight months of the year, Brazilian exports rose nominally by one-quarter on the year. Domestic activity has likewise picked up in the past few months, not least thanks to a decline in the inflation rate which led the central bank to reduce its lending rate once again (from 19½% to 19%). Average annual GDP growth looks likely to be 3½% after 5% in 2004. Mexico's economic growth is expected to be on a similar scale. The Argentine government is expecting GDP growth of 7¼% for this year following 9% in 2004. Fast growth, however, is coming more and more at the expense of price stability; in 2005, the inflation rate is expected to exceed the 9% mark.

A sharp rise in revenue from exports of raw materials is also boosting economic activity in the Commonwealth of Independent States (CIS). With overall capacity utilisation now at a higher level, however, price pressures have risen sharply over the course of this year. For 2005, the Russian government is expecting an inflation rate of 12% with probable GDP growth of 5¾%. Over the medium term, the large share of consumption in the economic growth of the CIS, in particular, will create problems. According to IMF calculations, gross fixed capital formation, averaging 21% of GDP for the 2000-2004 period, was five percentage points lower than the corresponding figure for the central and east European transition countries. This is undoubtedly partly attributable to the – at times – shaky

*Common-
wealth of
Independent
States*

framework conditions in which domestic and foreign investors have to operate.

USA

According to initial calculations, real GDP in the USA rose by nearly 1% after seasonal and working-day adjustment in the third quarter, a somewhat stronger rise than in the second quarter. For 2005 as a whole, growth of just over 3½% is expected. Without the adverse effects on overall output caused by the hurricane damage in late August and September, third-quarter growth would have been even stronger. Private consumption, gross fixed capital formation and government consumption were the main drivers. Although inventory changes once again had an adverse impact, it was much less pronounced than in the second quarter. With real exports showing little growth and imports at a standstill, the deficit in real net exports remained virtually unchanged after seasonal adjustment.

Households' disposable income was particularly strongly affected by the economic consequences of the late summer hurricanes. Non-insured household losses reduced net income from leasing and rents and from entrepreneurial activity by US\$20 billion. At the same time, revenues from transfer payments were just over US\$10 billion higher owing to insurance payments for insured losses. On the whole, third-quarter disposable income rose by a seasonally adjusted ¾% on the period. However, nominal consumption expenditure rose by a perceptibly larger margin, which caused the saving ratio to fall from +0.1% in the second quarter to -1.1% in the third.

US household expenditure was driven upwards, in particular, by the strong rise in energy prices which, in the July-October period, were one-quarter up on the year. This caused overall inflation to rise from 3.0% in the second quarter to 3.9%. Excluding energy and food, however, inflation slowed down slightly to 2.1% after mid-year. The core consumer price deflator, the US Federal Reserve's preferred instrument of price analysis, likewise fell slightly to 1.9% in the third quarter.

After expanding strongly in the first half of 2005, the Japanese economy grew much more slowly in the third quarter. Real GDP was initially estimated to have grown at just under ½% in seasonally adjusted terms, compared with 1½% and ¾% in the two preceding periods. Its year-on-year growth was 3%. Thus, for 2005, total output growth of between 2% and 2½% may be expected. Growth in the summer months was driven in large part by domestic demand. Commercial investment once again grew strongly at a seasonally adjusted ¾%. For the first time in six years, government investment also rose. After a sluggish first half of the year, housing construction likewise showed a visible rising trend. Private consumption was up by ¼% on the period. The strong rise in real exports (2¾% after seasonal adjustment) was offset, however, by an even stronger increase in imports, which meant that cross-border goods trade nominally reduced GDP growth somewhat. In addition, the current account surplus has tended to decrease since mid-2004, a development attributable above all to higher energy prices.

Japan

The available leading indicators point to a continuation of vibrant economic activity in the third quarter. The sharp rise in new orders received in the third quarter deserves primary mention here. The renewed surge in crude oil prices after mid-year, along with the depreciation of the yen, substantially increased the energy prices paid by Japanese households; however, this was offset by reductions in food prices, causing overall consumer prices in the third quarter to fall slightly once again after seasonal adjustment (-0.3% on the year).

According to initial estimates, total UK output rose by just under ½% in the third quarter after adjustment for seasonal and working-day variations; it was thus somewhat down on the preceding period. The year-on-year rise was 1½%. Growth for the entire year is likely to be somewhere in that range, too. The increase in production in the third quarter was driven once again by the services sector and construction, whereas manufacturers produced a seasonally adjusted ½% less than in the preceding period. With regard to demand, for which the available information is only sketchy, household consumption continued to sustain economic activity; retail purchases were up by ½% in the third quarter after adjustment for price and seasonal variations. It should be noted here that UK consumers' purchasing power was visibly reduced in the late summer owing to the sharp rise in energy prices. Hence inflation – as measured by the Consumer Price Index (CPI) – ran at 2.4% over the July-October period and was thus well above the UK government's medium-term inflation target of

2.0%. From mid-year onwards, house prices tended to go back up after having fallen somewhat in the second quarter.

Economic activity in the new EU member states – measured in terms of industrial output – accelerated noticeably during the first half of 2005. This means that the slump in the second half of 2004 appears to have been overcome. The upward movement continued in the third quarter. Seasonally adjusted industrial production surpassed its second-quarter level by 1¾% and was up by 6¼% on the year. Quarter-on-quarter growth was particularly pronounced in the Czech Republic, Estonia, Lithuania and Slovakia. Buoyant manufacturing activity has meant that employment has also continued to rise in the new EU member states. At the same time, the seasonally adjusted standardised unemployment rate fell slightly and stood at 13.3% as this report went to press.

*New EU
member states*

The price climate deteriorated after mid-year. In this case, too, higher market prices for crude oil were the main culprit, although their influence on domestic energy prices was softened in some countries by an appreciation of their currency. Consumer price inflation stood at 2.5% in October compared with 2.0% in June-July. At the beginning of the year, however, inflation had still been in excess of 3% and had averaged 4% in 2004. In the meantime, however, the price effects of the – at times – sharp tax increases which took effect in some of these countries upon accession to the EU on 1 May 2004 have been eliminated from the calculation of year-on-year inflation.

*United
Kingdom*

Macroeconomic trends in the euro area

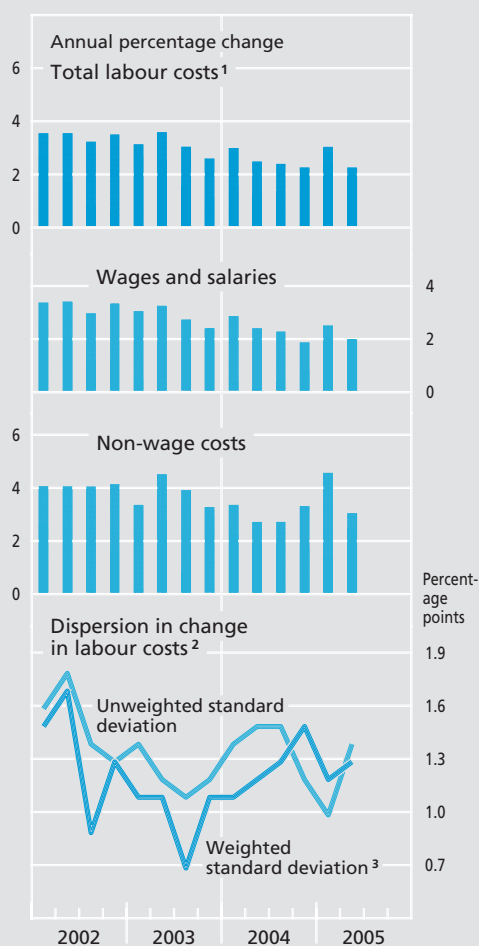
Third-quarter GDP

Euro-area growth accelerated noticeably after mid-year. According to an initial estimate (Flash Estimate), real GDP in the third quarter was up by just over ½% – after adjustment for seasonal and working-day variations – on the previous quarter, in which it had gone up by only ¼%. Year-on-year growth stood at 1½%. According to the European Commission's autumn forecast, total output will rise in the last quarter of the year by just under ½% after seasonal adjustment. Growth for 2005 as a whole is likely to be 1¼%.

Developments in key economic indicators

The slight increase in total output is due, above all, to the faster pace of growth in manufacturing. In the July-September period, manufacturing output was a seasonally adjusted ¾% higher than in the second quarter and 1¼% higher than a year earlier. Correspondingly, capacity utilisation increased in the July-October period – for the first time since the fourth quarter of 2004. Owing to the sharp decline in the first quarter of 2005, however, it was still below the level it reached at the beginning of the year. The continued improvement in confidence in the manufacturing industry is consistent with more lively industrial output. The key stimuli to manufacturing once again came from outside the euro area. In July-August, after elimination of seasonal influences, goods exports were 5% higher in terms of value than in the second quarter. By contrast, in the third quarter, private consumer demand – measured in terms of real retail sales – held firm at the previous quarter's low levels. As consumer confidence was still very low even in October, private

Labour costs in the euro area



Source: Eurostat and Bundesbank calculations. — 1 Gross hourly wages and salaries plus non-wage costs; excluding agriculture and public services. — 2 For eight euro-area countries. — 3 Weighted by euro-area countries' GDP shares.

Deutsche Bundesbank

consumption is not expected to recover in the next few months.

The number of unemployed persons in the euro area fell slightly after the middle of 2005. According to provisional Eurostat figures, the average number of persons without work in the third quarter stood at a seasonally adjusted 12.39 million. This represented a 4.1% year-on-year decline, following a 1.5% fall in the

Labour market

Euro-area consumer prices

Annual percentage change

Item	2005		
	Q1	Q2	Q3
HICP, total	2.0	2.0	2.3
<i>of which</i>			
Unprocessed food	0.5	0.8	0.8
Energy	7.6	8.8	12.9
HICP excluding energy and unprocessed food	1.6	1.5	1.4
<i>of which</i>			
Processed food	2.4	1.6	1.9
Industrial goods	0.3	0.3	0.1
Services	2.4	2.3	2.3

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preceding period. The standardised unemployment rate fell to 8.5%, having been 8.8% a year earlier.

New Labour Cost Index

In June, the Statistical Office of the European Communities (Eurostat) published its first quarterly Labour Cost Index (LCI) for the euro area. It measures the hourly nominal labour costs (ie gross wages and non-wage costs) adjusted for working-day variations. The indicator is calculated for the whole economy (excluding agriculture and public services) and for industry. The euro-area LCI is aggregated by Eurostat from the member states' relevant indices, which, except for the Italian index, are also published. New results are presented nearly three months after the end of the reporting quarter; this means that, at present, information is available up to the

second quarter. According to this information, labour costs in the overall economy and in industry in the second quarter of 2005 were, in each case, 2¼% up on the year. Even if the rates of change are sometimes quite volatile, this still clearly shows that the rise in labour costs has tapered off visibly in the past few years owing, above all, to more moderate growth in gross wages and salaries. In addition, the rise in non-wage costs has slowed down. This development has been relatively balanced from one member state to another; whatever the case, the (weighted and unweighted) dispersion of the rates of change in total labour costs around the euro-area average did not see any major change during this period.

In the third quarter of 2005, too, euro-area consumer prices – driven by oil prices – rose sharply. After seasonal adjustment, the increase was no less than 0.8%, following 0.7% in the second-quarter months. The year-on-year increase widened from 2.0% to 2.3%. The October inflation rate was 2.5%.

Consumer prices

Excluding energy and unprocessed food, quarter-on-quarter inflation, at +0.4% in the third quarter – which corresponds to a projected annual rate of 1½% – was much more moderate than in the preceding period. The year-on-year core inflation rate was 1½%, as in the second quarter already. The current underlying momentum of the Harmonised Index of Consumer Prices (HICP), however, is probably understated by core inflation, since the overall level of energy prices is in the midst of an upward movement that cannot be regarded merely as a reflection of higher

volatility. In addition, wages are still more or less strictly indexed in various member countries. Furthermore, it should be noted that the HICP inflation rate does not capture the price for the use of owner-occupied accommodation.

Energy prices rose by nearly 13% on the year. The strongest rise was recorded by heating oil

(+35%), followed by petrol (+14%). Gas prices (+11%) and, above all, electricity prices (+3%) have so far risen less sharply. However, these energy sources may also be expected to become much more expensive in the coming months as a consequence, for instance, of higher crude oil prices.