Global and European setting

World economic activity

World economy still buoyant but with somewhat less momentum in industrial countries

The world economy remained on a growth path after the turn of 2006-07. However, the pace of growth seems to have slowed somewhat. While the emerging market economies were in full swing throughout the reporting period, momentum in the industrial countries weakened perceptibly. After seasonal adjustment, their real gross domestic product (GDP) in the first quarter of 2007 was up by only ½% on the preceding period, in which it had grown by ¾%. This nevertheless constituted a year-on-year increase of 3%. Growth in Japan, which had been very strong in autumn 2006, decreased particularly significantly. Following a substantial increase in the previous quarter, growth in overall economic output in the euro area was also somewhat weaker. The economic slowdown in the United States continued.

Based on the average growth rate of the three major economic areas in the winter semester 2006-07, which allows short-term volatility and special factors to be abstracted, the euro-area and Japanese economies grew at around the same rate (+1½%) compared with the second and third quarters of 2006. In the United States, which is the most cyclically advanced of the triad, GDP growth was significantly lower (+1%). As far as can be seen, however, the dampening effects that this had on the global economy were limited. At the same time, the now more balanced growth constellation is tending to help to reduce the large external imbalances.

A number of special factors have contributed to the currently somewhat slower pace in the industrial countries. For instance, government investment in Japan declined slightly following the previous strong increase. In the euro area, the anticipatory effects of the VAT increase in Germany, which had boosted economic growth at the end of 2006 but dampened it at the beginning of 2007, played a role. This consequently obscured the positive effects which the mild winter weather had on construction activity in parts of western Europe at the beginning of 2007. In the United States, GDP growth was hampered by the continuing corrections on the housing market, which were fuelled by the worsening crisis in the subprime segment of the mortgage market in mid-March, and the unexpected decline in exports.

Stock market correction without significant effects on the world economy

However, the underlying cyclical trend in the world economy has remained on a clear upward course over the past few months. This is attested by dynamic employment growth throughout the reporting period and the continuing favourable developments in corporate profits. The quite sharp slump in share prices in the international stock markets at the end of February and beginning of March proved to be a temporary phenomenon. Against a backdrop of extensive company mergers and acquisitions, prices in the major markets have now even significantly exceeded their previous levels.

Phase of low oil prices has run its course

Oil prices initially continued to generate positive stimuli for the global economy – at US$58¾, the average price of Brent crude oil in the first quarter of 2007 was 3¾% lower than in the fourth quarter of 2006. However, these stimuli weakened perceptibly over the course of the first quarter, as prices increased significantly again from mid-January onwards. In mid-May, the price was 31% higher than the previous low recorded at the beginning of 2007 and only 13% lower than the peak recorded in early August 2006. In euro terms, the price of Brent crude oil rose somewhat more moderately owing to the appreciation of the euro against the US dollar; at €51, the price at the end of the reporting period was only 16% lower than at the beginning of August 2006. The rise in oil prices was driven mainly by greater geopolitical uncertainties owing, in particular, to the unresolved conflicts in the Middle East and the unrest in Nigeria. In addition, OPEC further cut production at the beginning of February even though the global demand for oil continued to grow significantly. Quotations on the futures markets, which exceeded spot prices throughout the reporting period, indicate that oil prices will tend to rise over the medium and long term.

Sustained rise in prices of other raw materials

Upward pressure on the prices of industrial raw materials remained undiminished after the turn of 2006-07. At the beginning of May, quotations exceeded the corresponding level in 2006 by 18% in US dollar terms. The main driving force was again the sharp price movements in agricultural raw materials and non-ferrous metals. By contrast, following a strong increase in the first two months, the world market prices for food, beverages and tobacco did not rise any further. However, in early May, they were still 13% up on the year.

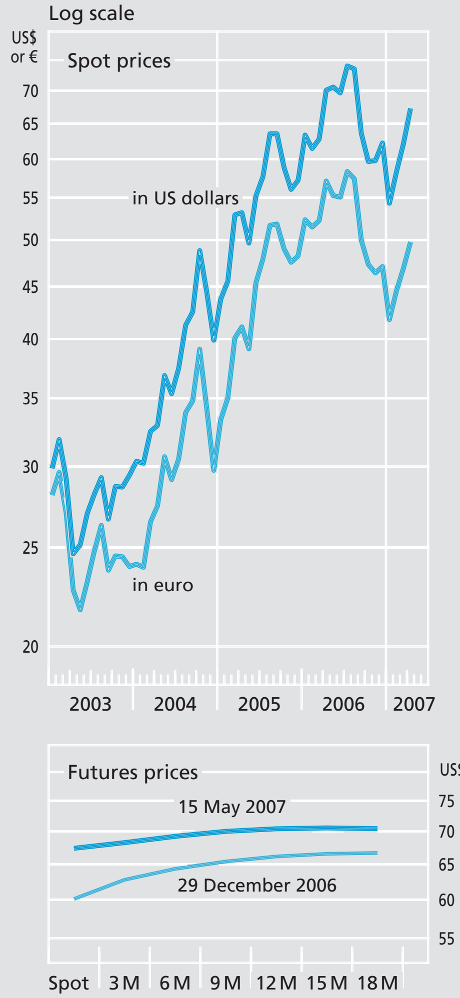
Price developments in industrial countries influenced by rising oil prices

The rate of consumer price inflation in industrial countries was again influenced by fluctuations in energy prices in the first months of 2007. Following a calm period in January, upward pressure began to increase again noticeably from February onwards. The year-on-year rate of growth increased accordingly from 1.8% in January to 2.3% in March. Excluding Japan, where prices were practically stable year-on-year towards the end of the reporting period, the inflation rate was 2.6%. On an average of the first three months of 2007, consumer prices in the industrial countries rose by 2.1% compared with 1.8% in the fourth quarter of 2006 and 2.6% in the second and third quarters. However, at 1.9%, core inflation (excluding energy and food) was no higher in the first quarter of 2007 than in the second half of the previous year.

OECD's composite leading indicators and new IMF forecast

According to the OECD's composite leading indicators, economic activity in the OECD area will flatten out somewhat over the next few months but will remain robust. In the case of China, the composite leading indicators have shown a renewed clear upward trend over the past few months. To a lesser extent, this is also true of Brazil. On the whole, this picture fits with the International Monetary Fund's (IMF) rather optimistic spring forecast, which expects global GDP growth of just under 5% for both 2007 and 2008 compared with almost 5½% in 2006. According to this forecast, growth in real world trade will decline from 9¼% in 2006 to 7% in 2007 and 7½% in 2008. The growth differential between the major industrial countries and regions will probably be smaller this year than it has been for quite some time. For 2008, the IMF predicts that the US economy will again be able to put a clear upward distance between itself and the euro area and Japan, but that it will continue to expand at a rate below potential. Growth in the emerging market economies will remain strong, although the expansion rates in 2007 and 2008 will decline somewhat, primarily in Latin America and the Commonwealth of Independent States (CIS) and, to a lesser ex-

World market prices for crude oil *



Sources: Thomson Financial Datastream and Global Insight. — * Price for a barrel of Brent crude oil.

Deutsche Bundesbank

IMF forecast for 2007 and 2008

Item	2005	2006	2007	2008
Real gross domestic product	Annual percentage change			
Advanced economies 1	+ 2.5	+ 3.1	+ 2.5	+ 2.7
of which:				
United States	+ 3.2	+ 3.3	+ 2.2	+ 2.8
Japan	+ 1.9	+ 2.2	+ 2.3	+ 1.9
Euro area	+ 1.4	+ 2.6	+ 2.3	+ 2.3
Consumer prices 2				
Advanced economies 1	+ 2.3	+ 2.3	+ 1.8	+ 2.1
of which:				
United States	+ 3.4	+ 3.2	+ 1.9	+ 2.5
Japan	– 0.6	+ 0.2	+ 0.3	+ 0.8
Euro area	+ 2.2	+ 2.2	+ 2.0	+ 2.0
Unemployment	Number of unemployed persons as a percentage of the labour force			
Advanced economies 1	6.0	5.5	5.4	5.4
of which:				
United States	5.1	4.6	4.8	5.0
Japan	4.4	4.1	4.0	4.0
Euro area	8.6	7.7	7.3	7.1

Source: IMF, World Economic Outlook, April 2007. — 1 Including Slovenia, Taiwan, Hong Kong, South Korea and Singapore. — 2 Consumer price index; for the euro area, HICP.

Deutsche Bundesbank

tent, in Asia and the central and eastern European transition countries. Overall, the IMF continues to view the downside risk to its prediction as significantly greater than the possibility that there will be a further improvement in developments.

Continued vigorous growth in the Asian and Latin American emerging market economies...

The partial information on hand suggests that the South and East Asian emerging market economies continued to expand significantly in the first few months of 2007. Following a somewhat slower rate of expansion in the second and third quarters of 2006, the Chinese economy even picked up speed to 11% – measured as the annual percentage change in GDP. At the same time, consumer price inflation increased to just over 3% in the March-April period. Against this backdrop, it is to be expected that the government and the central bank will take further measures to curb growth and reduce the current risk of overheating. Overall, the Latin American economies grew by 5½% in 2006, which was considerably more than had generally been forecast. At the same time, inflation fell by one percentage point to 5¼%. The Brazilian economy in particular regained momentum in the fourth quarter of 2006 and the first quarter of 2007, boosted by substantial cuts in central bank rates.

... and in the CIS and the Middle East

With a GDP increase of 7¾% and a fall in inflation of 2 percentage points to 9½%, 2006 was a successful year for the members of the CIS. It was noteworthy that the energy-importing countries in this group, such as Ukraine, grew at the same pace as the energy-exporting countries. The Russian economy, with a real GDP increase of 6¾% in 2006, continued on an expansionary course in the first quarter of 2007. Industrial output expanded by just over 8% year-on-year. In the oil-exporting countries of the Middle East, the boom continued. The temporary decline in oil prices has – as generally expected – not yet led to a visible slowdown in activity.

USA

According to the preliminary national account figures, after adjustment for seasonal and calendar effects, the US economy grew by ¼% in the first three months of 2007 and thus more slowly than at any time since the beginning of 2003. There was a 2% rise on the year. Residential construction, which contracted by a seasonally adjusted 4½% and was thus 17% below the peak of the summer of 2005, had significant retarding effects. In addition, government spending increased only slightly. By contrast, following a decline in the preceding period, business investment rebounded by a seasonally adjusted ½%. The key pillar of economic activity was again private consumption, which expanded by just under 1%. At ½% after seasonal adjustment, final domestic demand rose at the same rate as in the preceding period. Furthermore, the depletion of inventories slowed down. The main reason for the decline in GDP growth in the first quarter was that, in purely mathematical terms, real foreign trade made a slightly negative contribution to growth following a reduction in the deficit of just under ½% of GDP in the fourth quarter of 2006. This was due to a fall in exports of ¼%, which is to be viewed predominantly as a reaction to the sharp increase (+2½%) in the previous period. Despite the weaker growth in output which has been perceptible in the United States since spring 2006, the unemployment rate remained at a very low level (4½%) throughout the reporting period.

Consumer price inflation in the United States rose significantly over the first quarter owing mainly to the renewed surge in oil prices. The year-on-year rate of increase grew from 2.1% in January, when it had been additionally dampened by a baseline effect, to 2.8% in March. In April, it fell again to 2.6%. Core inflation (excluding energy and food) sank to 2.3% at the end of the reporting period after having moved within a band of between 2.5% and 2.9% since mid-2006. The corresponding personal consumption expenditure deflator stood at 2.1% in March.

Japan

In the first quarter, GDP growth in Japan flattened out considerably to just over ½% after seasonal adjustment compared with the preceding period, in which it had stood at 1¼%. Year-on-year growth was up by 2% in the winter months. The slower pace was primarily related to the strong GDP growth in autumn 2006. In the first quarter, the rise in overall output was driven by foreign trade, which, in seasonally adjusted terms, contributed just under ½ percentage point to growth. At 3¼%, the increase in real exports on the preceding period was noticeably greater than that in imports (+1%). Domestic demand rose relatively little (+¼%). The main reason for this was that the marked expansion in private consumption (+1%) was offset by a decline in business investment and residential construction. In addition, government spending decreased slightly. Inventory investment also had a dampening effect.

Under the impact of lower oil prices and reduced telecommunications prices, the annual rate of consumer price inflation sank from +0.3% in the last quarter of 2006 to -0.1% in the first quarter of 2007. Core inflation (excluding energy and food) remained unchanged at -0.3%. In spite of the slight decline in consumer prices at the end of the reporting period, it is not generally feared that the country will slide into a further deflationary phase. With an unemployment rate of 4.0%, the Japanese labour market now has hardly any reserves left, which is likely to gradually lead to a somewhat stronger rise in wages. Furthermore, the resurge in oil prices over the past few months combined with the weakness of the yen will probably increase imported price pressures. The fact that, on a national average, real estate prices in 2006 rose for the first time since 1991 also does not indicate a relapse into deflation.

United Kingdom

According to provisional calculations, in the first quarter of 2007, the UK economy maintained its high rate of expansion of a seasonally and calendar adjusted ¾% on the period. Year-on-year real GDP growth stood at 2¾%. In the winter months, growth in the United Kingdom was again supported by the services sector and the construction industry. In both areas, real gross value added was a seasonally adjusted ¾% higher than in the autumn. By contrast, the production sector (excluding construction) stagnated, although lower industrial production was offset by greater utilities output. The decline in industrial production is likely to be related to the appreciation of the pound sterling and the economic slowdown in the United States. In addition, private consumer demand, up by a seasonally adjusted ½% – according to real retail sales figures – was no longer on such a clear upward course in the winter as in the previous three quarters. The increased loss in purchasing power in the United Kingdom towards the end of the period under review could also have played a role in this respect.

Consumer price inflation increased from 2.7% in autumn 2006 to 2.9% on an average of the first three months of 2007. At 3.1%, inflation was higher in March than it had been at any time since the end of 1995 and stood at just over 1 percentage point above the government's inflation target; in the previous year it had been 1.8%. This was partly due to significant price increases for food products and fuel. In April, consumer price inflation fell again to 2.8%. Core inflation (excluding energy and unprocessed food) stood at 2.1% compared with 1.3% a year earlier.

New EU member states

The economies of the new EU member states (including Bulgaria and Romania but excluding Slovenia) had an exceptionally good start to the year. In the first quarter of 2007, industrial production was up by a seasonally adjusted 4½% on the already high fourth-quarter level. It was up by 12% on the year. The larger economies (Poland, the Czech Republic, Hungary and Slovakia) consistently achieved double-digit rates of growth. Against this backdrop, the slowdown in growth in the new EU member states which was forecast for 2007 is likely to be rather moderate. However, this quite dramatic economic growth led to a higher price rise in the winter months. For instance, the average rate of inflation increased from 3.3% in December to 3.7% in March. Around the turn of 2006-07, the dampening effects of the fall in energy prices were obscured by greater home-grown price pressures; oil prices contributed to the rise in inflationary pressure in March. In April, inflation remained at 3.7%. The increase in inflation was particularly pronounced in Poland, where the year-on-year consumer price inflation rate rose by 1 percentage point to 2.2% from December to April. By contrast, inflation in the two countries of the 2007 enlargement round (Bulgaria and Romania) declined further to 4.4% and 3.8%, respectively.

Macroeconomic trends in the euro area

Further strong growth in the euro area but more moderate than before

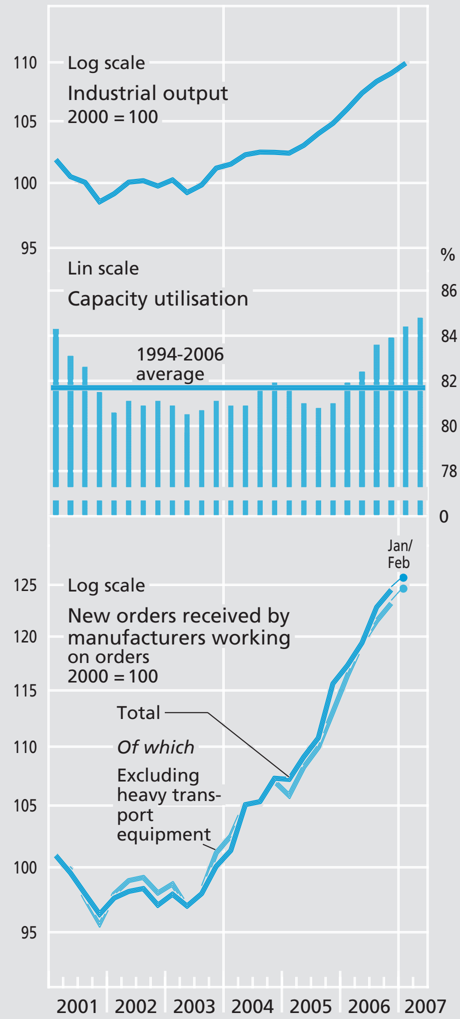
After adjustment for seasonal and calendar effects, real GDP in the euro area increased by just over ½% in the first quarter of 2007 compared with just under 1% in autumn 2006. The slowdown in growth is related to the anticipatory effects of the VAT increase in Germany on private consumption and construction, which led to a slump in demand after the turn of 2006-07. Furthermore, the previously vigorous growth momentum in Italy slowed considerably. By contrast, the French economy remained on the expansionary course on which it had embarked in autumn 2006. Overall economic output in the euro area increased by just over 3% on the year.

Industrial activity still buoyant

The production sector was again one of the sectoral driving forces. In the January-February period, activities in the construction industry were up by a seasonally adjusted 1½% on the final quarter of 2006, in which they had already expanded by 2¼%. The year-on-year increase stood at 9½%. The strong upward trend in the two winter months can be attributed both to the persistently buoyant construction demand in the euro area and to increased production as a result of the mild weather. In the first quarter, industrial output (excluding construction) was up by a seasonally adjusted ¾% on the quarter and 3½% on the year. Capacity utilisation continued to rise in the January-April period, exceeding the previous high reached in 2000; this is consistent with the image of continued brisk industrial activity. In addition, excluding the manufacture of other transport equipment, where large orders have a considerable impact, new industrial orders were up again in the January-February period by a seasonally adjusted 1% on the final quarter of 2006. The year-on-year increase stood at 8¾%.

Selected indicators of industrial activity in the euro area

Seasonally adjusted, quarterly



Deutsche Bundesbank

Results of EU industrial survey remain positive

The general sentiment in industry improved from the beginning of 2007 onwards following a somewhat more subdued period. The highest level to date was even achieved in

Fiscal developments in the euro area

Favourable development in 2006 amid positive cyclical influences and strong growth in revenue from profit-related taxes

At the end of April, Eurostat confirmed the reports made by member states as part of the European excessive deficit procedure. According to these reports, the general government deficit ratio in the euro area decreased from 2.5% to 1.6% last year and the **debt ratio** fell from 70.5% to 69.0%. Government revenue grew primarily owing to a surge in revenue from profit-related taxes (+6.1%), causing the revenue ratio to rise by 0.6 percentage point to 45.7%. Growth in expenditure (including one-off effects in Italy)[1] amounted to +4.0%. In spite of this, the expenditure ratio still fell by 0.3 percentage point to 47.3% owing to the favourable development in nominal GDP.

According to European Commission calculations, the cyclically adjusted deficit ratio fell by 0.6 percentage point to 1.2%; adjusted for additional temporary factors, this resulted in a decline of 0.9 percentage point. The sharp increase in the generally very volatile revenue from profit-related taxes is also reflected here since this was mainly registered as structural in the cyclical adjustment method. Thus, the recorded structural improvement overstates the basic stance of fiscal policy.

Only slight decreasing deficit and debt ratios expected in 2007 and 2008 amid continuing improvement in the economic condition

In its latest forecast, the European Commission expects no more than minor progress in euro-area consolidation for the current and the coming year. The halving of the deficit ratio to 0.8% is mainly a result of the continuing dynamic economic growth and the absence of the one-off effect which increased expenditure in Italy. While the structural deficit ratio will decline further by 0.3 percentage point in 2007, not least on account of the VAT increase in Germany, virtually no further progress in consolidation is expected in 2008 given tax cuts in some countries. It is assumed that expenditure (excluding one-off effects in Italy) will grow at a faster pace than in previous years. General government debt in the euro area is expected to fall to 65.0% of GDP in 2008, not least owing to strong economic growth. Even so, the debt ratio would then still be well above the reference value of 60%.

Rather positive development in countries with excessive deficit but European budgetary rules call for much more ambitious fiscal policy goals in good times

The development of euro-area public finances, which was relatively favourable on the whole, should, however, not conceal the fact that there is still a considerable need for consolidation in several countries. Last year, with the exception of Italy, all euro-area countries that had recorded fiscal deficits improved their fiscal balance. Italy and Portugal still have deficit ratios of more than 3%. While the EU Commission expects Portugal to continue to overshoot this level in the coming year if no additional measures are taken, an undershooting of the reference value is projected for Italy in 2007. The 2008 deficit ratios for Greece, Italy and France are estimated to be approximately 2% or above. Notable deficits of 1.5% and 0.8% of GDP are also expected for Slovenia and Austria respectively, while Belgium and Germany are predicted to achieve an almost balanced budget, and budgets which are close to balance or in surplus are likely in the Netherlands, Ireland, Spain, Luxembourg and Finland.

According to the forecast by the Commission, the debt ratios are expected to decline in all euro-area countries, with the exception of Portugal, between 2006 and 2008. However, the reference value for the debt level of 60% of GDP is likely to be exceeded by Belgium, Germany, Greece, France, Italy and Portugal in 2008. Austria is the only country that may be able to bring its debt ratio, which was above the reference value in 2006, down below the reference value by 2008.

Currently, there are four euro-area countries in the **excessive deficit procedure:** Greece, Germany, Italy and Portugal. The correction period granted to Portugal extends up to 2008. The correction period for Italy and Germany expires in 2007, and expired in 2006 for Greece. On

1 As a result of a ruling by the European Court of Justice of September 2006, Italy had to pay back VAT revenue that was declared contrary to European law. In addition, the Italian government decided to cancel the debt of the Italian railway company. Collectively, these one-off effects increased euro-area expenditure and the expenditure ratio in 2006 by ¾% and 0.4 percentage point respectively. —

Deutsche Bundesbank

16 May 2007, the Commission recommended abrogating the procedure for Germany and Greece. Greece reported a deficit ratio of below 3% for 2006. However, this was achieved by making extensive use of temporary measures to reduce the deficit by 0.6% of GDP. Nevertheless, the Commission identified an improvement in the structural deficit ratio of 2 percentage points for both 2005 and 2006, which exceeded requirements. In Germany, the fiscal deficit was already clearly below the 3% level one year before the correction period was due to expire, and the recommendation to reduce the cumulative structural deficit for 2006 and 2007 by at least 1% of GDP is likely to be met. Given deficit ratios that are forecast to be below the 3% level for the next few years and declining debt ratios, the Commission considers the undershooting of the 3% limit for both countries to be sustainable.

Nevertheless, beyond compliance with the reference values, the Stability and Growth Pact provides for significantly more ambitious **medium-term budgetary objectives**. These country-specific objectives are set by the member states themselves. After adjustment for cyclical effects and net of one-off and other temporary measures, surpluses or, at most, a deficit ratio of 1% are to be achieved depending on potential growth and the debt ratio. This is also intended to ensure that in downturns the 3% level is not exceeded if the automatic stabilisers are operating freely. The pact also sets distinct requirements for the adjustment path: if the structural deficit exceeds the target value, it has to be reduced annually by 0.5% of GDP, whereby greater progress in consolidation is to be achieved during good times. Last year, Austria, Belgium, Germany, Greece, France, Italy, Portugal and Slovenia, ie over half of the current euro-area member states, failed to meet their medium-term budgetary objectives and, according to a forecast by the Commission, among this group only Belgium will meet this objective by 2008. The forecast shows that Germany, Italy and France will achieve the required regular reduction in the structural deficit only in one of the two years, and that Portugal, Greece, Austria and Slovenia will not meet this consolidation requirement in either of the two years. The reformed pact's explicit goal of pressing ahead with consolidation precisely in good times is therefore in danger of not being attained. Experience has shown that during an economic downturn associated with a slump in revenue from profit-related taxes, in particular, excessive deficits can quickly emerge if the underlying position is not sufficiently sound.

	Budget balance (as % of GDP) 2				Structural budget balance (as % of GDP) 3				Debt (as % of GDP) 2			
Country	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
Austria	– 1.6	– 1.1	– 0.9	– 0.8	– 1.1	– 1.0	– 1.1	– 1.2	63.5	62.2	60.6	59.2
Belgium	– 2.3	0.2	– 0.1	– 0.2	0.2	– 0.4	– 0.1	0.1	93.2	89.1	85.6	82.6
Germany	– 3.2	– 1.7	– 0.6	– 0.3	– 2.4	– 1.5	– 0.8	– 0.7	67.9	67.9	65.4	63.6
Spain	1.1	1.8	1.4	1.2	1.6	2.3	1.8	1.7	43.2	39.9	37.0	34.6
Greece	– 5.5	– 2.6	– 2.4	– 2.7	– 6.1	– 3.9	– 3.6	– 3.4	107.5	104.6	100.9	97.6
France	– 3.0	– 2.5	– 2.4	– 1.9	– 3.2	– 2.3	– 2.1	– 1.5	66.2	63.9	62.9	61.9
Finland	2.7	3.9	3.7	3.6	3.6	3.7	3.5	3.6	41.4	39.1	37.0	35.2
Italy	– 4.2	– 4.4	– 2.1	– 2.2	– 3.9	– 2.6	– 1.6	– 1.8	106.2	106.8	105.0	103.1
Ireland	1.0	2.9	1.5	1.0	0.8	3.0	1.8	1.6	27.4	24.9	23.0	21.7
Luxembourg	– 0.3	0.1	0.4	0.6	1.0	0.5	0.6	0.8	6.1	6.8	6.7	6.0
Netherlands	– 0.3	0.6	– 0.7	0.0	0.7	1.1	– 0.4	0.1	52.7	48.7	47.7	45.9
Portugal	– 6.1	– 3.9	– 3.5	– 3.2	– 5.0	– 2.9	– 2.7	– 2.6	63.6	64.7	65.4	65.8
Slovenia	– 1.5	– 1.4	– 1.5	– 1.5	– 1.1	– 1.5	– 1.7	– 1.7	28.4	27.8	27.5	27.2
EU 13	– 2.5	– 1.6	– 1.0	– 0.8	– 2.0	– 1.1	– 0.8	– 0.7	70.5	69.0	66.9	65.0

2 Source: For 2005 and 2006 – Eurostat; for 2007 and 2008 – Economic Forecast Spring 2007, European Commission. — **3** Source: Economic Forecast Spring 2007, European Commission.

Euro-area consumer prices

Annual percentage change

Item	2006 Q2	2006 Q3	2006 Q4	2007 Q1
HICP, total	2.5	2.1	1.8	1.9
of which				
Energy	11.6	6.3	1.5	1.1
Unprocessed food	1.6	3.9	4.1	3.1
HICP excluding energy and unprocessed food	1.5	1.5	1.6	1.9
of which				
Processed food	2.2	2.1	2.2	2.1
Industrial goods	0.7	0.7	0.8	1.1
Services	2.0	2.0	2.1	2.4

Deutsche Bundesbank

April. This was due to more favourable production expectations as well as to an improved assessment of the orders situation. The main reason for this is likely to have been the increase in domestic orders as, according to the quarterly survey, export expectations have fallen twice in a row since the high in October. The assessment of warehouse stocks, the third subcomponent of industrial sentiment surveyed on a monthly basis, has remained practically unchanged since the latter part of the summer of 2006.

Mixed picture for demand indicators

The slower GDP growth in the first quarter is reflected on the demand side in a more subdued development in private consumption activity. Although information on the demand components in the national accounts is not yet available, first-quarter real purchases in the retail trade sector (excluding motor vehicles), which, after seasonal adjustment, stagnated at the same level as in autumn 2006, indicate that this was the case. Furthermore, the number of new car registrations fell by 3½%. Consumers' general reluctance to purchase and, in particular, to buy durable goods was significantly influenced by the anticipatory effects of the VAT increase in Germany. Leaving aside such special effects, consumption in the euro area remained on a clear upward path. This is also suggested by the fact that consumer confidence has tended to improve since the beginning of the year. Nominal exports of goods from the euro area to non-euro-area countries declined in the January-February period, down by a seasonally adjusted ¼% on the fourth quarter of 2006. However, imports from non-euro-area countries increased by 1½% on an average of January and February, which is likely to have been only partly price-related. Against this backdrop, foreign trade is unlikely to have made any positive contribution to real GDP growth in the first quarter. By contrast, inventories and fixed asset investment appear to have increased, whereby investment in new buildings was also fuelled by the mild weather conditions.

Further pick-up in the labour market

The decline in euro-area unemployment continued following the turn of 2006-07. According to provisional Eurostat figures, on an average of the first three months, a seasonally adjusted 10.90 million people were unemployed. This was 0.43 million fewer than in autumn 2006 and 1.49 million fewer than in the same period of last year. The unemployment rate fell from 7.6% at the end of 2006 to 7.3%, aided by persistently strong growth in employment. In the final quarter of 2006 – more recent information is not yet available – the number of employed persons rose by a seasonally adjusted 0.3%. Year-on-year growth stood at 1.6%. Almost all euro-area countries had a share in the favourable employment trend. Germany, France and Portugal experienced a particularly strong decline in unemployment in the winter months of 2007. Despite the improved labour market conditions, wage growth remained moderate until the end of 2006, which continues to appear warranted given the fact that unemployment in the euro area is still too high. At a seasonally adjusted 0.6%, growth in labour costs was only slightly stronger in the final quarter of 2006 than it had been in the preceding period. Year-on-year growth decelerated slightly to 2.4%.

Moderate rise in consumer prises

In winter 2007, consumer prices in the euro area increased by just over 0.5% in seasonally adjusted terms, after having remained stable on a three-month average of the October-December period. This corresponds to an annualised rate of 2.1%. The key factor in this development was the renewed increase in energy prices, which had fallen noticeably in the final quarter of 2006. However, the unfavourable trend in unprocessed food prices experienced over the preceding months did not continue. Excluding these two comparatively volatile components, prices increased at the same rate in the reporting period as in autumn 2006 – by a seasonally adjusted 0.5%. For goods (excluding energy) and services, upward price pressures increased – owing in part to the increase in VAT in Germany. By contrast, the rate of price increase for processed food decelerated. Compared with the previous year, the Harmonised Index of Consumer Prices (HICP), excluding energy and unprocessed food, rose by 1.9% in the first three months as against 1.6% in autumn 2006. The overall year-on-year rate of increase in the HICP rose slightly from 1.8% to 1.9%. In April 2007, for which results from individual countries are already available, there was a further significant rise in prices compared with the preceding month owing to higher oil prices. However, year-on-year HICP inflation remained at 1.9% owing to a baseline effect.