

## Global and European setting

### World economic activity

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The cyclical recovery of the world economy, which had begun in the second quarter of 2009, continued in the last quarter of the year. Numerous economic stimulus programmes, expansionary monetary policy, ongoing calming of the financial markets and the inventory cycle all combined to keep providing key stimuli. All the same, global industrial output in October-November was up by a more moderate 2%, after seasonal adjustment, from the previous quarter, in which – boosted in part by the increased demand for cars due to government stimulus measures – it had grown by 3%. The volume of global trade, by contrast, maintained its very buoyant growth in that two-month period.

*Global economy still on path to recovery...*

The south and east Asian emerging market economies, particularly China and India, remained on their steep expansionary path and also managed to increase their total economic output considerably on average for all of 2009. The rise in demand from this region for crude oil and other commodities, in particular, caused their prices in the international markets to rise sharply over the course of the past year. This benefited, in particular, the OPEC nations and some Latin American economies which have now largely returned to sound growth. Of the industrial countries, the United States was clearly at the forefront of economic developments in the fourth quarter, as the pace of growth increased perceptibly. By contrast, the euro-area recovery has made hardly any meaningful progress owing, above all, to the subsiding effects of the fiscal stimulus packages and to inventory adjust-

*... yet great differences with respect to dynamics remain between countries and between groups of countries*

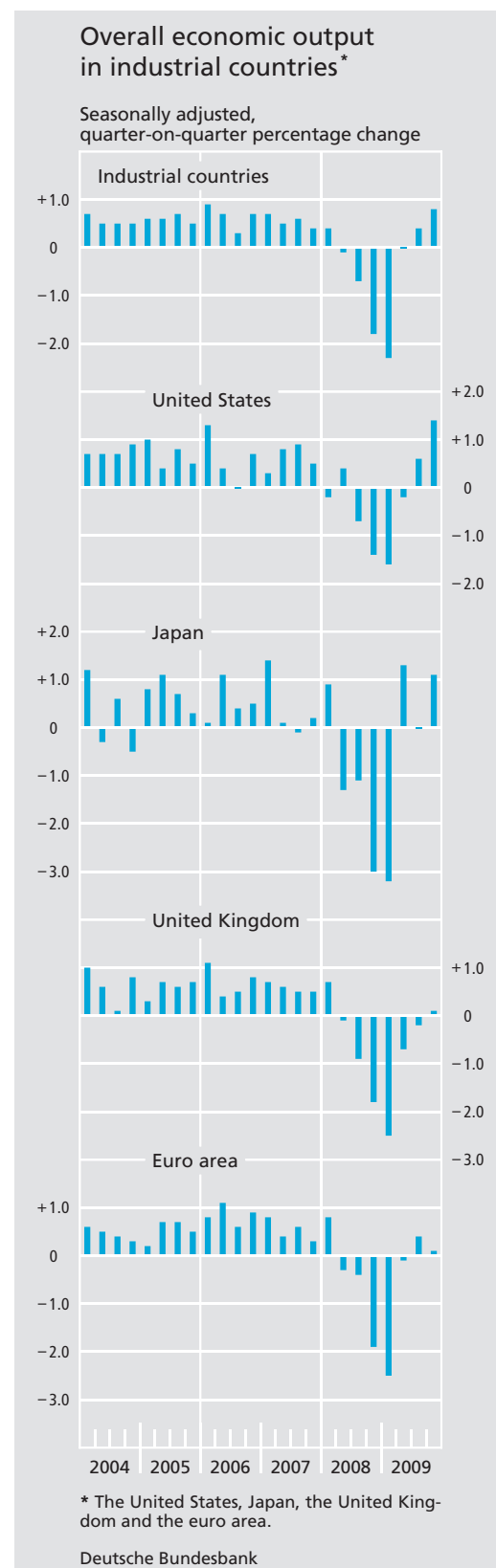
ments. The Japanese economy, however, emerged from a growth hiatus in the third quarter with renewed vigour. Total real gross domestic product (GDP) of the industrial countries as a group, at +3/4% (after seasonal adjustment) according to initial estimates based on provisional information for some major economies and the euro area, grew significantly faster than in the previous quarter. On average for all of 2009, however, growth was still down by 3 1/2%.

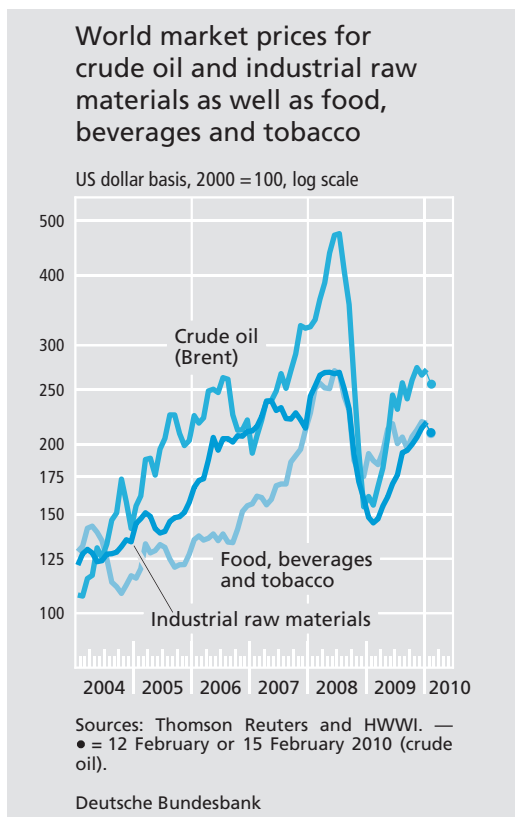
*Cyclical signs  
still clearly  
positive in early  
2010*

The global economy appears to have remained on its growth track following the turn of 2009-10, with the global Purchasing Managers' Index for the manufacturing sector up again noticeably in January. The OECD composite leading indicator also continued its rise towards the end of the previous year, signalling good future prospects for the south and east Asian and Latin American emerging market economies as well as for the industrial countries. Of the industrial countries, the US economic climate, in particular, has improved visibly of late.

*IMF forecast  
revised  
upwards*

At the end of January, the International Monetary Fund (IMF) revised its forecast of global growth for this year upwards, from 3.1% in its autumn forecast to a current level of 3.9%, to take account of sharp corrections for both the advanced economies (to 2.1%) and the developing and emerging economies (to 6.0%). Of the latter group, the growth rates were revised upwards by 2.1 percentage points for Russia to 3.6%, by one point for China to 10.0% and for India by 1.3 points to 7.7%. Real global trade is expected to grow by +5.8% as compared with +2.5% in early





October. For 2011, now included in the published forecast for the first time, the IMF now expects global GDP to grow by 4.3% and world trade to expand by 6.3%. This interim forecast for 2010 and 2011 rests on the assumption that average crude oil prices (based on a basket of the three most important blends of oil) will be at US\$76 and US\$82 a barrel respectively.

*Commodities more expensive since beginning of Q4*

The price of a barrel of Brent crude oil continued to rise sharply in the first half of October before then mostly holding steady within a relatively narrow band of US\$75 to US\$80 up until the end of the year. There was ultimately no major price volatility throughout the entire second half of 2009, which was also due to the near-absence of disruptions to production in the Gulf of Mexico owing to

the very mild hurricane season. On average for the quarter, though, the price of crude oil still rose by nearly one-tenth on the quarter and by nearly one-third on the year. In early January the price of crude oil very briefly broke the US\$80 mark before returning to US\$72¾ or €53½ per barrel by mid-February. In order to minimise speculation, in January the US Commodity Futures Trading Commission introduced upper position limits, though the effects of these limits cannot yet be reliably assessed. Non-oil commodity prices continued to rise sharply from October to mid-January before going back down noticeably. In the first half of February non-oil commodities were trading 29¾% higher on the year in US dollar terms. Higher prices for industrial raw materials, which rose by +42% year-on-year, played a greater role here than increases in the prices of food, beverages and tobacco (+8%).

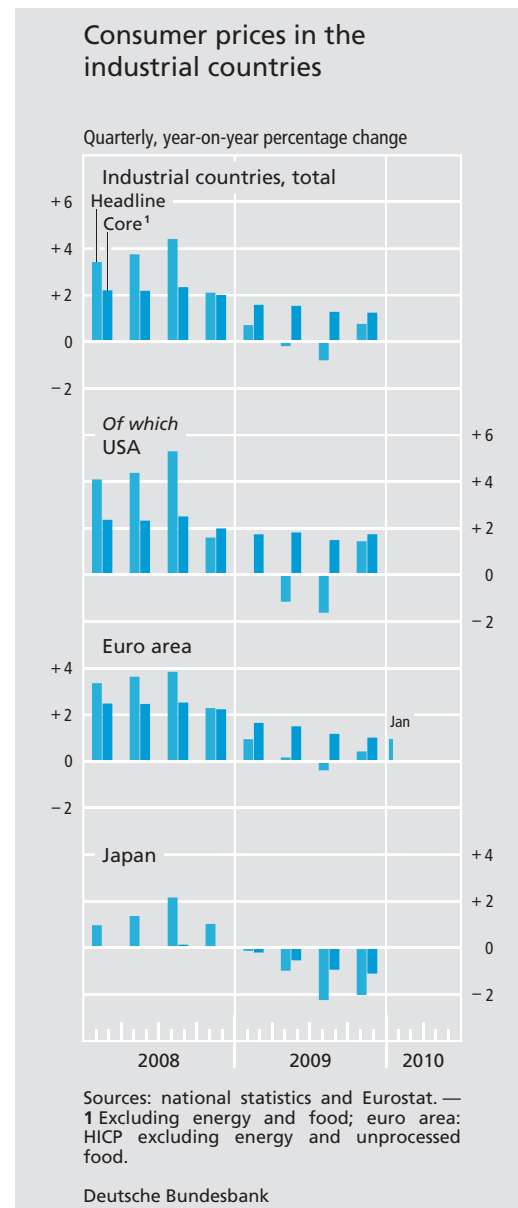
Rising prices for energy and food had a perceptible impact on consumer price trends in the industrial countries in the fourth quarter. Headline inflation was up by 0.6% (after seasonal adjustment) on the quarter. Year-on-year inflation, having been negative up until October, reversed itself and returned to positive territory in November owing, above all, to a base effect in the above-mentioned components. In December, headline inflation stood at 1.6%, or 1.9% excluding Japan. Core inflation (excluding energy and food), by contrast, has stood at around 1¼% since the middle of 2009.

*Year-on-year consumer price inflation once again positive*

### Selected emerging market economies

*Strong growth in south and east Asian emerging market economies*

Of the emerging market economies (EMEs), it was those in south and east Asia which, in the fourth quarter, remained at the forefront of the cyclical recovery, even though the exceptionally strong momentum of the period spanning the second and third quarters of 2009 has subsided somewhat in many places. In China, however, real year-on-year GDP growth accelerated from 9% in the third quarter to 10¾% in the fourth. Although the expansion of year-on-year growth was due in part to a base effect, the pace of overall growth remained high even in the final quarter of the year. Positive stimuli were generated by the extant fiscal policy stimuli, strong growth of household consumption and a distinct recovery in export demand. For 2009 as a whole, Chinese economic output rose by 8¾%. According to an official estimate, gross investment, which was expanded massively by the government economic stimulus programme, contributed no less than eight percentage points. Consumer price inflation in the past few months rose sharply again, particularly due to a base effect and a weather-related increase in food prices, and stood at 1.5% in January. On average for 2009, the consumer price index fell by 0.7%, owing mainly to lower energy prices. Since growth prospects have remained favourable, attention has been increasingly given to inflationary risks. Against this background, China's central bank tightened the reins of monetary policy somewhat at the beginning of the year. In addition, the authorities have announced a significant cutback in credit growth in 2010. In India, where real GDP (at



market prices) grew by 6¾% on the year in the third quarter, recovery continued apace in the fourth quarter. The sharp consumer price inflation, caused particularly by crop failures, persisted throughout the reporting period. Average inflation for the year totalled 10.9%, the highest rate since 1998.

In the Latin American countries, too, the cyclical upswing continued up until the end of

*Latin America  
on solid growth  
path*

the year. This was true especially of the Brazilian economy, where, according to the available indicators, household consumption, which is still being stimulated by government incentives, continued to expand sharply in the fourth quarter. In addition, increased investment activity and rising demand from overseas, not least from Asia, are likely to have boosted growth. In Mexico, it appears likely that real GDP rose significantly in the last quarter of 2009, according to the available information. However, the extremely strong pace of the previous quarter, during which the economy rebounded following a decrease in influenza A (H1N1) and the country's car industry benefited from the US "cash for clunkers" scheme, could not be maintained. In many Latin American countries, consumer price inflation picked up at the beginning of 2010 for the first time in a long time. In January, inflation stood at 4.6% in Brazil and 4.5% in Mexico.

*Positive tendencies  
in Russia*

Real GDP in Russia contracted by 8% on average for 2009 according to an initial estimate from the Federal State Statistics Service. This implies that macroeconomic output grew significantly in the fourth quarter after seasonal adjustment, to which fiscal stimuli probably made a major contribution. Given the massive collapse in 2009 as a whole, the rise in the unemployment rate by two percentage points from the previous year's average to 8.4% was still within reasonable bounds. The cyclical recovery is generally expected to continue in the current year as well. Consumer price inflation has abated in Russia throughout the reporting period, posting a rate of

8.1% in January compared with 13.4% a year earlier.

## USA

In the final quarter of 2009, the US economy accelerated considerably. After the elimination of seasonal variations, total economic output according to the initial estimate rose by 1½% from the preceding quarter, in which it had risen by ½%. At -2½%, however, the overall 2009 result was still perceptibly in negative territory. According to current indicators, the US economy got off to a positive start in the new year, and its outlook is more favourable than it has been for quite some time. The recovery of household final demand is likely to initially remain based on monetary and fiscal policy support measures.

*Economic  
activity picking  
up steam*

A considerable slowdown in inventory depletion was the primary reason why total economic output picked up speed towards the end of 2009. However, domestic household final demand likewise rose once again. Real household consumption even managed to surpass by ½% its elevated level of the third quarter, when car sales had been given a strong boost by the temporary government environmental premium granted in July and August. After dipping sharply in September, car sales rebounded strongly over the course of the fourth quarter. In addition, households rapidly increased their spending on other goods and services. This may have had several causes: not only did household wealth recover, but real disposable incomes also saw solid growth and the saving ratio held steady at 4½%. That the saving ratio remained

*Expansion of  
household  
consumption  
from elevated  
level ...*

## Saving and unemployment during the global financial and economic crisis

The impact of the global recession on the labour markets in industrial countries has varied quite considerably. Beginning with the third quarter of 2007, when the first major shockwave emanated from the international financial markets, unemployment in the USA doubled to 9.6% in the third quarter of 2009.<sup>1</sup> In Spain, the number of unemployed persons rose in this period by more than ten percentage points to 18.7%. By contrast, Germany even managed to post a slight decline in unemployment. What is noteworthy is that, in a pattern transcending national borders, there was no close connection between job losses and total output losses.<sup>2</sup>

Conversely, there seems to be a very close symmetric link between the increase in the level of underemployment and the growth pattern of the household saving ratio. In countries such as Germany, France or Japan, where the impact on labour markets has thus far been relatively limited, households increased their saving only modestly. By contrast, in the USA, the UK and particularly in Spain, a relatively sharp increase in saving and unemployment was observed.

This link suggests that, across the world, enterprises and households alike have assessed their economic outlook quite disparately. For instance, in export-oriented economies like Germany and Japan the downturn might have been interpreted first and foremost as a temporary decline in foreign demand, which households would not interpret as a threat of major adjustment in employment (redundancies) and which therefore did not result in a sharp fall in consumer spending. This argument is based on the theory of saving, which contends that households generally keep their spending constant if they suspect that the period of economic slowdown will be relatively short, whereas any anticipation of a protracted process of structural adjustment involving heavy job losses triggers an increase in precautionary saving. This appears to have been very much the case in Spain.

Naturally, there were numerous other factors which influenced households' spending in the course of 2008 and 2009. In particular, the extensive government programmes to stimulate purchases of durable goods, such as the environmental premium in Germany, are likely to

have at least intermittently depressed the saving ratio, taken in isolation. On the other hand, it appears that wealth losses in the wake of the international financial crisis have discernibly dampened private consumption in some countries in favour of stronger saving. Between the third quarter of 2007 and the first quarter of 2009 – the low point in the financial markets – mainly US and UK households saw their net financial wealth dwindle. The prime reason for this was that – unlike German and Japanese households – they had invested most of their financial assets in shares, which recorded particularly large losses. This was compounded by financial losses on real estate ownership. As a consequence, fewer options were available for taking up collateralised loans for consumption purposes, which had played a role in reducing the saving ratio in the years preceding the crisis, especially in the USA. In Spain, the home value to income ratio has by no means declined more sharply than in the USA and therefore does not explain the relatively strong increase in the saving ratio. Nonetheless, the perception of major turmoil in the real estate markets, coupled with signs of a long and arduous structural adjustment process, predominantly in the construction sector, and the adverse effects of this in the labour market are likely to have had a significant influence on Spanish households' saving.

### Saving and unemployment rates in selected industrial countries<sup>3</sup>

Seasonally adjusted figures, 2009 Q3 compared with 2007 Q3



<sup>1</sup> Although, for the USA, more up-to-date information is available, for various other countries considered here data are available only up to 2009 Q3. — <sup>2</sup> See Deutsche Bundesbank, Labour markets in the global recession, Monthly

Report, November 2009, pp 20–21. — <sup>3</sup> Sources: Eurostat, BIS, OECD, national data and Bundesbank calculations. — <sup>4</sup> 2009 Q2 compared with 2007 Q3.

unchanged is probably associated with the stabilisation in the labour market (see box on page 17). Although unemployment in the fourth quarter, at 10.0%, was higher than at any time since the second quarter of 1983, the shedding of jobs came to a near-standstill at the turn of 2009-10. By contrast, price trends did not provide any further relief to consumers. Higher energy prices, in particular, caused the consumer price index to rise by 0.9% in the fourth quarter from the preceding three-month period. A base effect as a result of the sharp drop in energy prices in the fourth quarter of 2008 was the primary reason why headline inflation underwent a turnaround from -1.3% to +2.7% between September and December. The annual inflation rate excluding food and energy rose by 0.3 percentage point to +1.8%.

*... yet other demand components likewise pointing upwards*

Improved profitability and a rise in capacity utilisation – albeit from a low level – enticed firms to step up their spending on machinery and equipment and on software. However, commercial construction investment continued its nosedive, which is attributable to its lagging the cycle and to the steep downturn in the relevant real-estate-market segment. Investment in residential construction continued to recover, albeit at a much slower pace than a quarter earlier. Given the real effective depreciation of the US dollar over the preceding months, exports were able to fully constitute part of the revival in world trade. As the growth of exports (4½%) outstripped that of imports (2½%), on balance foreign trade generated a slight increase in GDP in the final quarter of the year.

## Japan

After a hiatus in the third quarter, the recovery of the Japanese economy became reinvigorated in the last quarter of 2009, during which real growth, at 1% on the quarter after seasonal adjustment, was nearly as strong as in the second quarter, when the cyclical recovery had begun. Average GDP growth for the year as a whole was -5%. However, throughout the reporting period the Japanese economy remained dependent on strong external stimuli and on fiscal policy. Although household consumption in the fourth quarter did once again post a significant gain on the preceding three-month period (+¾%), this is likely to be due largely to government incentives, especially for purchasing consumer durables. The persistent difficulties in the labour market situation, in particular, have dented households' propensity to consume, even though unemployment remained quite low by international standards, ending the year at 5.1%. Whereas investment for residential construction continued to contract in the fourth quarter, commercial investment stabilised, most likely because the favourable trend in overseas business continued. Real exports continued to recover at a brisk pace, growing by 5% compared with the third quarter of the year. In the light of muted domestic demand, imports rose by only 1¼%. This calculates to foreign trade making up nearly one-half of total GDP growth in the final quarter. The negative year-on-year growth in the consumer price index narrowed, primarily owing to a base effect in the energy component, by one-half percentage point to 1.7% between September and December. Excluding the

*Reinvigoration of recovery path*



comparatively volatile prices for food and energy, the Japanese basket of consumer goods was 1.2% cheaper at the end of 2009 than a year earlier.

### United Kingdom

*Economic slump is over*

In the United Kingdom, the economic contraction that had begun in the second quarter of 2008 ended in the fourth quarter; however, no meaningful cyclical recovery has occurred yet. Real GDP in the fourth quarter was only minimally higher than the relatively low level of the preceding period and contracted by 4¾% on the year. This disappointing fourth-quarter result rested on a virtual stagnation of real gross value added in both the services sector and the manufacturing sector (excluding construction). With regard to manufacturing it should be noted that, following the completion of maintenance and repairs, the production of oil and gas picked up perceptibly again after seasonal adjustment and manufacturing output was pointed upwards for the first time since early 2008, whereas output in the utilities sector contracted considerably. Activity in the construction sector, which in the previous quarter had been boosted to a large extent by numerous public building projects, did not grow any further. In October, the standardised unemployment rate, at 7.8%, held steady at the level of the third-quarter months. Consumer price inflation, which had also been relatively high owing to the depreciation of the pound sterling in 2009, jumped toward the turn of the year. In January 2010, the 2.5-percentage-point increase in value-added tax caused inflation to climb to 3.5%.

### New EU member states

The economic picture for the new EU member states remains quite heterogeneous. Estonia and Lithuania, which – like Latvia – were forced to cope with a particularly sharp correction of their unsustainable growth paths once their external sources of finance had dried up, saw their economies resume economic growth in the fourth quarter. Poland, which had hardly any past imbalances to deal with, will probably have continued its recovery, which had already begun in the second quarter, thanks to robust domestic demand. In Bulgaria, Hungary, Latvia and Romania, however, the slump does not appear to have abated even in the fourth quarter. The increase in the standardised unemployment rate for this group of countries as a whole by 0.3% over the course of the fourth quarter to 9.2% at the end of the year, however, is much weaker in a quarter-on-quarter comparison. Over the same period, consumer price inflation, as measured by the Harmonised Index of Consumer Prices (HICP), rose by 0.1 percentage point to 3.2%.

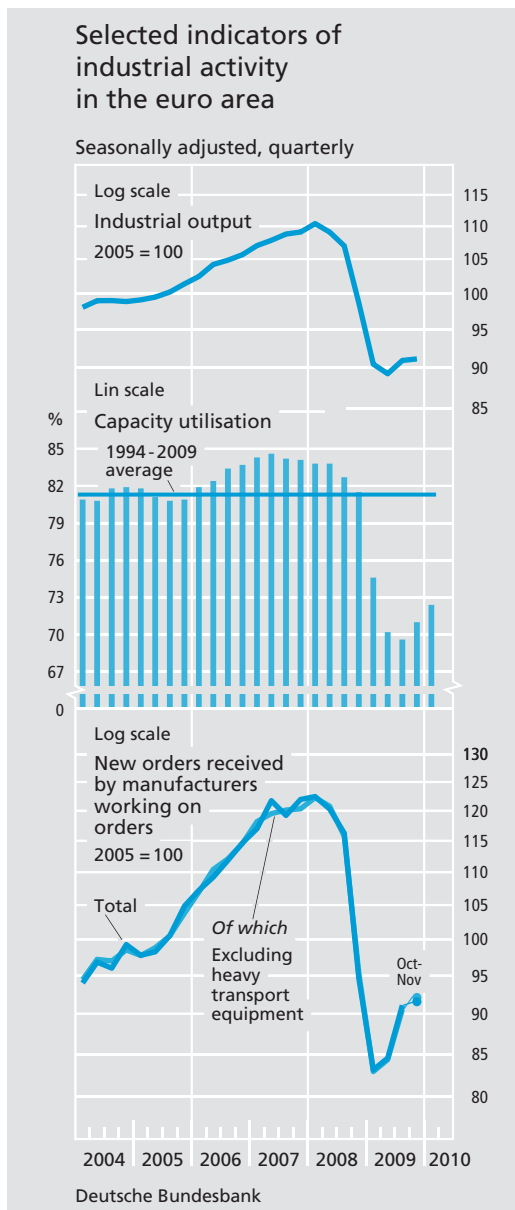
*Economic picture remains mixed*

### Macroeconomic trends in the euro area

The euro-area recovery made little progress in the last quarter of 2009. Real GDP was only marginally up, after seasonal adjustment, from the third quarter, in which it had grown by ½%. On account of the sharp decline in output in the first quarter, total economic output fell by 4% on average for the year. The main reasons for the stalled recovery in the euro area – broken down by country –

*Upward trend stalled*





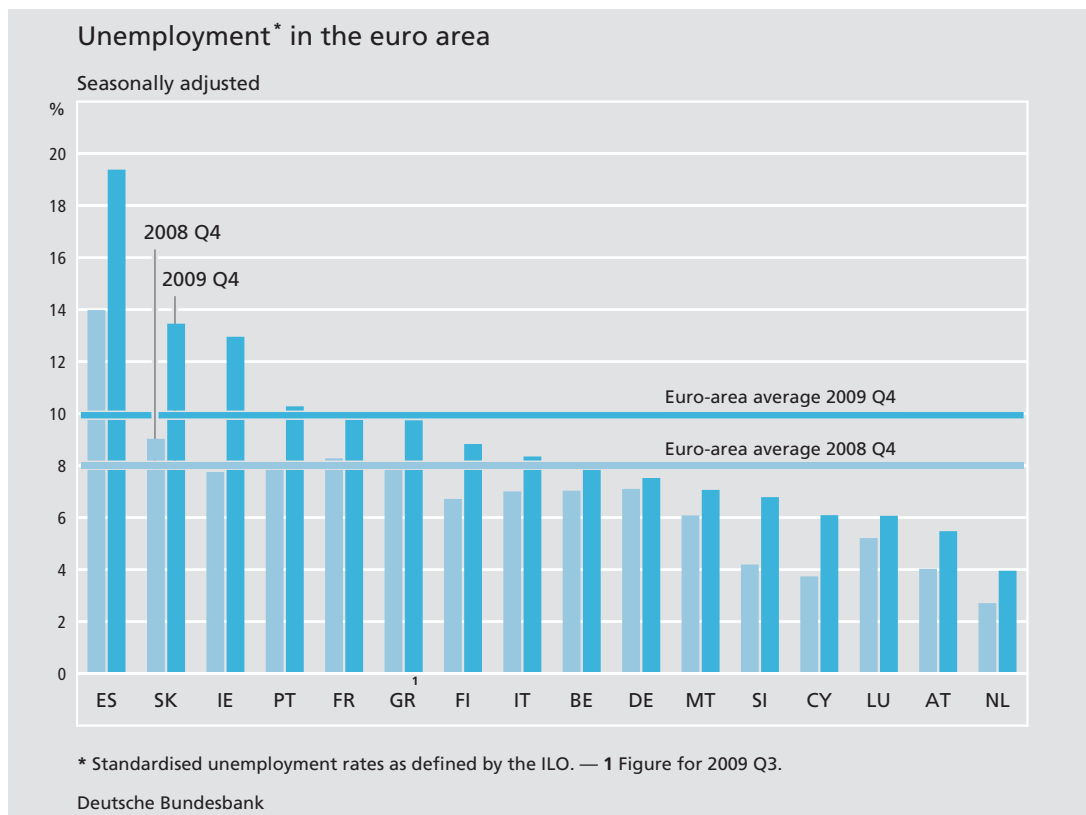
were faltering growth in Germany and a slight decline in Italy's GDP. By contrast, the French economy grew markedly more strongly because, among other things, the gradual reduction in the environmental premium for new cars that had begun in January 2010 continued to buoy car sales even into the fourth quarter.<sup>1</sup> In Spain, the cyclical tailspin that had continued since the third quarter of 2008 has come to a near-standstill. For the

current quarter, recovery in the euro area is likely to remain sluggish amidst subsiding stimuli from the government economic stimulus packages. The muted outlook is also manifesting itself in a January revision of the IMF's forecast: now growth in 2010 is predicted to be only 1.0%, thereby lagging far behind that of the industrial countries as a group and especially that of the United States.

On the supply side, the weaker GDP growth in the fourth quarter of 2009 is largely attributable to a more subdued pace of industrial output growth, which amounted to a mere ¼% after seasonal adjustment compared with +2% in the third quarter. Capacity utilisation in the manufacturing sector, however, rose just as sharply in the October-January period as in the three months previously. Whereas the manufacturers of capital goods and intermediate goods saw distinct growth compared with the third-quarter months (+1¼% and +1½% respectively), output of consumer goods (-¼%) and energy (-1%) continued to decline. In 2009 as a whole, industrial output fell by 15%. Growth of demand for industrial goods likewise weakened in the October-November two-month period, up to which information is available. Excluding the manufacture of other transport equipment, which is often characterised by large orders, new orders rose by a seasonally adjusted 1¾% from the third quarter, in

*Industrial activity expanding less dynamically of late*

<sup>1</sup> For orders up to 30 June 2010 with an invoice date not later than 30 September 2010, only one premium (prime à la casse) of €700 (previously €1,000) is paid. This premium will go down to €500 for orders up to 31 December 2010 with an invoice date not later than 31 March 2011.



which they had grown by 7½%. Sentiment in the industrial sector continued to brighten at the beginning of the year, even though survey results remained visibly below their long-term averages. One factor was that order books and inventory stocks were no longer assessed as unfavourably as before, while another was that the indicator for production expectations continued the steep ascent which had begun in the second quarter.

One of the key demand-based pillars of overall euro-area growth in the fourth quarter was exports, which in nominal terms and after adjustment for seasonal variation rose by not less than 4% in October-November compared with the third quarter. Imports grew somewhat more weakly, at 3½%, which meant that for the last quarter of the

year foreign trade with non-euro-area countries made a perceptible positive contribution to growth. Household consumption is likely to have provided next to no stimulus, however. New car registrations in the fourth quarter were up only slightly on the period (+1¼%); relatively strong growth in some countries, especially in France and Portugal, contrasted with sharp declines in, for instance, Germany. However, a more damaging impact was caused by the fact that seasonally adjusted real retail sales only treaded water in the fourth quarter after falling in the second and third. Nevertheless, consumer confidence has continued to improve since the beginning of the fourth quarter. The renewed decline in construction output in October-November must be seen particularly against the background of the low demand for new produc-

*Only weak growth stimuli from domestic household demand*

tion capacities and the housing glut in some member states. Firms' demand for new machinery and equipment – based on the output of capital goods excluding cars – is likely to have risen slightly.

*Labour market  
still reeling  
from the  
recession*

No improvement in the labour market situation is in sight. Employment in the euro area fell in the third quarter of 2009 once again by ½% after seasonal adjustment from the second quarter and was thus down 2% on the year. Since firms had short-time work arrangements which were, in many cases, quite favourable owing to government subsidies, and because of the options for more flexible working hours negotiated in wage contracts in many countries, the number of hours worked fell considerably more strongly – by 6¾% on the year. Implementing this method of adapting the volume of labour to output cutbacks, however, has in most cases not been cost-neutral. Rather, labour costs skyrocketed, going up in the third quarter by 3.2% on the year. They rose particularly strongly in Greece, at 11.2%. The trend decline in employment will have probably kept up in the fourth quarter as well. At all events, one sign of this happening is that the number of unemployed persons rose by around 450,000 on the period. The standardised unemployment rate rose by 0.3 percentage point to 9.9%, compared with 8.0% a year earlier and 7.2% in March 2008.

In the fourth quarter, consumer prices in the euro area rose by a modest 0.2% after seasonal adjustment, much as in the two preceding quarters. Specifically, the prices for energy and services picked up somewhat, whereas those for industrial goods and food virtually held steady. The downward trend in the prices of unprocessed food ground to a halt. Year-on-year HICP inflation reversed itself from -0.4% in the third quarter to +0.4% in the fourth. Along with the low rate of inflation at the current end, another contributory factor was the sharp drop in energy prices in the fourth quarter of 2008, which has now had the effect of increasing the year-on-year rate. Although energy prices in the final quarter of 2009 remained below the level at the end of 2008, their negative year-on-year growth has narrowed since the third quarter of 2009 by 8.7 percentage points to -3.2%. Excluding energy and food, which are very volatile, annual inflation in the fourth quarter stood at a mere +1.1%, compared with +1.3% in the third quarter and as much as +1.6% in the first quarter of 2009. This also reflects the impact of the cyclical slowdown. In January, euro-area consumer prices are likely to have risen slightly after seasonal adjustment. Annual total HICP inflation, according to the Eurostat flash estimate, stood at +1.0% following +0.9% a month earlier. The gap between headline and core inflation is therefore likely to have closed.

*Gap between  
headline and  
core inflation  
probably closed*