Global and European setting

World economic activity

World economy at cyclical trough

The world economy is likely to have bottomed out in the second quarter of 2009. One sign of this is that some emerging market economies, particularly China, have either visibly stepped up their growth rate or have returned to growth. In addition, contractionary pressure has diminished considerably in the industrial world. In the second quarter, gross domestic product (GDP), according to initial estimates based on data for most major economies and the euro area, was down only minimally on the quarter after seasonal adjustment, compared with a slide of 1¾% and 2¼% in the two preceding quarters. Total output was down by 4¾% on the year. The main reason for the slower pace of decline in economic activity was that manufacturing output, which was at the heart of the recession, rebounded somewhat in the advanced economies over the course of the second quarter after having represented a major drag on overall economic growth in 2008 Q4-2009 Q1. A key role was played by both the revival of export orders and the growing demand-side impact of the government economic stabilisation programmes. In addition, the calm price environment had a stabilising effect.

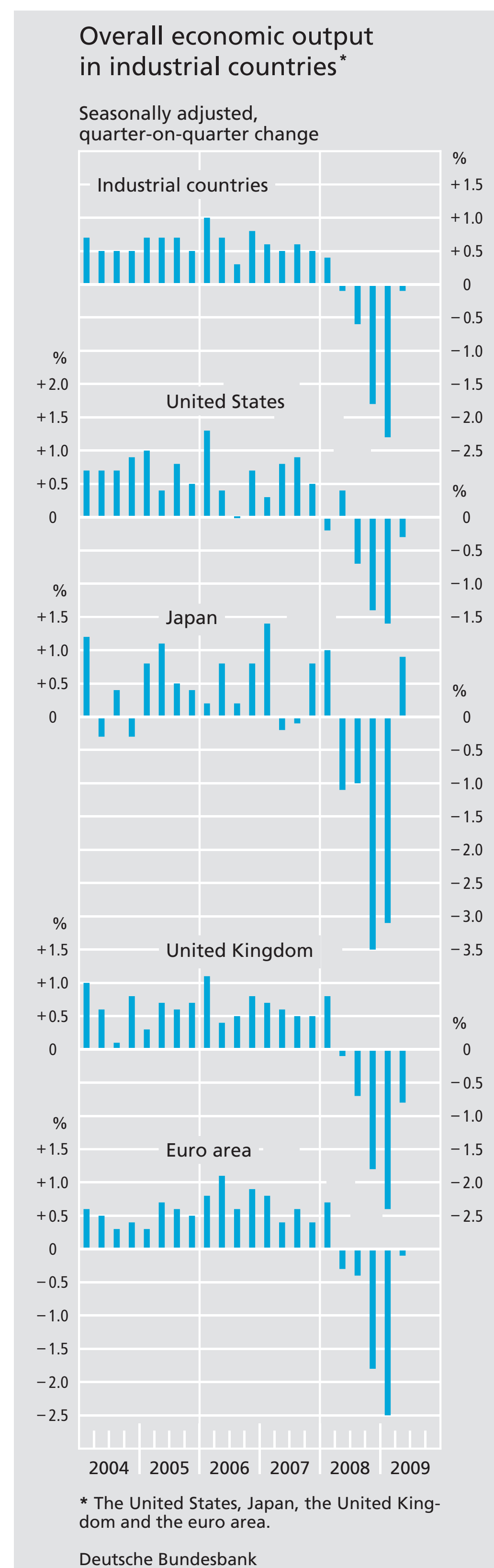
Signs of moderate second-half upturn

The trend toward a cyclical recovery could grow even stronger in the second half of the year, as is indicated by the perceptible worldwide improvement in, above all, the expectations component in surveys of firms and households. As a case in point, the ifo climate indicator for the world economy rose in the second quarter of 2009 for the first time

since the fourth quarter of 2007. However, the more favourable six-month-ahead expectations contrasted once again with a poorer assessment of the current situation. The Global Purchasing Manager's Index has likewise trended upwards in the past few months, with the manufacturing industry indicator, in particular, seeing an improvement. The increasingly noticeable positive effects of the economic stimulus packages, the very expansionary monetary policy and the extensive financial market stabilisation measures are all factors contributing to the brighter mood. However, one reason why the second half of 2009 might not see an exceptionally strong recovery is that, although the global shock to confidence has lost some of its sting, it has by no means been overcome altogether. In addition, the banks in the industrial nations, which already sustained, in some cases, severe capital losses on account of the financial crisis, could come under increasing strain caused by the recession-induced deterioration of credit quality; this would tend to dampen their enthusiasm to engage in commercial lending.

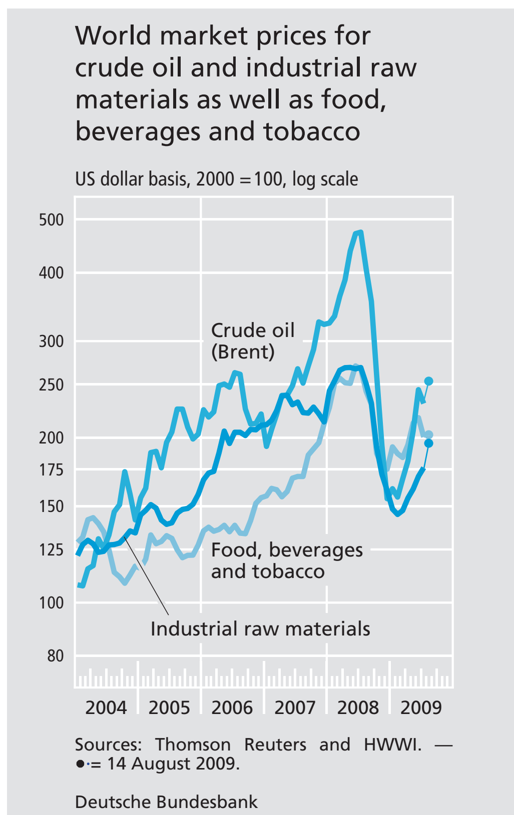
IMF forecasts favourable trends for 2009 and 2010

Given recent mounting positive signals from business indicators, in early July the International Monetary Fund (IMF) revised its April 2009 forecast for world GDP. It was owing to the very poor first-quarter result that the 2009 forecast was still revised slightly downward to -1.4%. The trend rate for the period from the fourth quarter of 2008 to the end of 2009, however, has been raised visibly from -0.6% to 0.0%, implying a perceptible end-2009 growth overhang. In addition, the trend rate for 2010 was increased from +2.6%



World market prices for crude oil and industrial raw materials as well as food, beverages and tobacco

US dollar basis, 2000 = 100, log scale



Sources: Thomson Reuters and HWWI. — •= 14 August 2009.

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to +2.9%, resulting in an annual average growth rate of 2.5%, compared with +1.9% in the April forecast. The 2009 projections for the industrial economies and for the emerging market economies were, at -3.8% and +1.5% respectively, virtually confirmed, and the 2010 projections were increased roughly in sync to +0.6% and +4.7% respectively. Among the industrial countries, Japan and the USA, in particular, are seen by the IMF to have a better outlook for growth in 2010 than estimated early in the second quarter. For the emerging market economies, the upward corrections were focused on the south and east Asian countries, Russia, and a few isolated Latin American nations, including Mexico. In the wake of the strong first-quarter contraction, the forecast for global trade growth in 2009 was revised downwards once again, by 1.2 percentage points, to -12.2%; however, for 2010 it was revised upward by 0.4 percentage point to +1.0%. The IMF still sees risks as being tilted towards the downside, although the tail risks have diminished. For the July update, the assumed price for key oil blends was revised upwards perceptibly to US$60½ (2009) and US$74½ (2010).

Crude oil prices tending towards stabilisation after rising sharply

Spot prices for crude oil, which had already rebounded noticeably from their last low point (US$40 for a barrel of Brent) in the period from the second half of February to the end of March, continued their sharp rise in the second quarter, fluctuating around the US$70 mark in mid-June. On an average of the second quarter, the price was 30% higher than in the first quarter, yet it was still down by about one-half on the year. One key reason was that the OPEC production cutbacks were being implemented more rigorously than in earlier periods of weak business activity. Another was that signs of a speedy Chinese recovery and positive business activity signals from the United States fuelled expectations that global demand for oil would soon rebound strongly. Following a July setback, Brent quotations returned to somewhat over the US$70 mark in the first two weeks of August. The yield curve remained sharply pointed upwards, indicating a visible rise in oil prices over the medium and longer term.

Prices for other commodities diverging since mid-year

Industrial raw materials prices, denominated in US dollars, likewise rose considerably in the second quarter. Their average over the April to June period was up by 10½% on the quarter but still down 39½% on the year.

Sharply increasing prices for non-ferrous metals, caused for their part by the spike in demand from China, were the main reason. The relatively low prices at the beginning of the second quarter had apparently been used for a considerable replenishment of inventories in China. After mid-year, industrial raw materials prices continued their climb at a more moderate pace. Over the course of the April-May period, prices for food, beverages and tobacco rose by 16¼%. In mid-June a correction set in, amounting to -10¾% by the end of the period. This was mainly caused by falling prices of grain and oilseeds due, above all, to forecasts of improved harvests. For the coming ten years, the OECD and the FAO expect the agricultural commodity prices to tend to level off below the peak reached in 2008.

Negative inflation in industrial countries

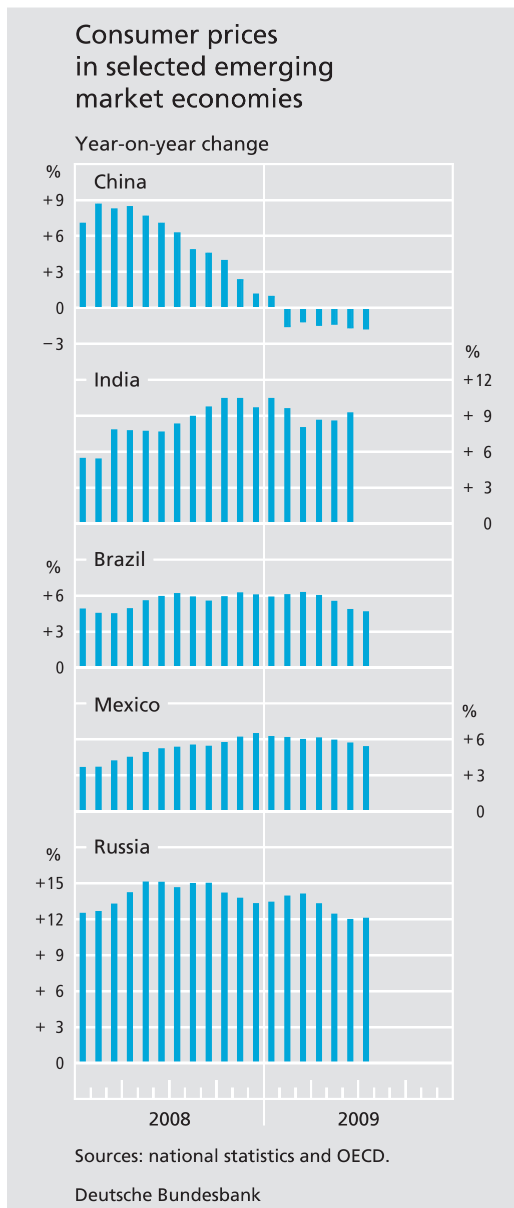
The increases in the price of crude oil and other commodities impacted distinctly on consumer price inflation in June in the industrial countries, with headline consumer price inflation, having remained virtually unchanged in April and May, rising in June by a seasonally adjusted 0.5%, owing mainly to higher fuel prices. Average inflation for the quarter was up by 0.2% on the preceding period, which had still seen prices fall by 0.5%. Year-on-year inflation, however, fell from +0.7% in the first quarter to -0.2% in the second. This figure contains base effects caused by energy and food prices, which rose sharply up until the beginning of the third quarter of 2008. For this reason, as well as because of the dropping off of fuel prices, year-on-year inflation is likely to have been negative in July, too. On average for 2009, consumer prices in the industrial world are forecast by the IMF in its July update to remain virtually stable (+0.1%) and to pick up by 0.9% in 2010.

Strong contraction in Russia, ...

Economic activity in the major emerging market economies was once again highly uneven in the second quarter. Recessionary pressure remained strong in Russia where, according to official information, second-quarter real GDP was down by 11% on the period after having already fallen by 9¾% in the first quarter. This even outdid the sharp decline recorded during the Russian crisis of 1998. The protracted slump in total output is likely to be due mainly to the considerable contraction in investment, including inventories. Private consumption likewise tended to slump, with a continued high inflation rate of 12.6% in the past quarter having played its part. Moderate cyclical relief is in sight for the second half of the year, not least owing to expectations of higher revenue from energy and commodity exports. For 2009 the IMF expects a 6½% decline in real GDP followed by growth of 1½% in 2010.

... mixed picture in the large Latin American countries, ...

In Brazil, by contrast, the upswing in the manufacturing sector that had already been emerging at the beginning of the year continued. In the second quarter, output was up by 3½% on the quarter but down by 12¼% on the year. Government financial incentives to purchase new cars were one of the factors contributing to the revival. By contrast, Mexico's economy is likely to have continued to shrink in the second quarter. One reason is Mexico's tight economic links with the US manufacturing sector, especially car makers.



Another is that the outbreak of influenza A (H1N1) temporarily paralysed economic activity. Argentina is likewise in a period of weak economic activity, though the slump does not appear to be very pronounced. Consumer price inflation in all three countries, however, has receded only slightly from its peak in the fourth quarter of 2008, to 5.4% in Mexico, 5.5% in Argentina and 4.7% in Brazil.

... but significant recovery in China

Cyclical recovery has made the strongest progress in China and some other Asian emerging market economies. After having already expanded perceptibly in the first quarter after seasonal adjustment (according to official Chinese figures), China's economy picked up the pace of growth in the second quarter. Year-on-year GDP growth therefore accelerated from 6% in the first quarter to 8% in the second. A strong increase in public infrastructure and housing investment made a key contribution, whereas exports have not yet regained their footing. Private consumption was supported not only by government incentives but also by a steady decline in consumer prices, which in July were down by 1.8% on the year. Since economic growth is currently being fuelled mainly by fiscal policy measures and by a strongly expansionary monetary and lending policy, the sustainability of the upswing is by no means assured.

United States

The slide of the US economy diminished distinctly in the second quarter, with real GDP falling in the second quarter, according to preliminary calculations, by only ¼% (after seasonal adjustment) on the first quarter, in which it had dropped by 1½%. Following a slight rise in the first quarter, real private consumption in the second quarter was down by ¼% quarter-on-quarter. This is attributable to diverging influences. Although the recession-induced decline in labour income has been slightly overcompensated by increased transfer payments and a reduction in the direct tax burden, households' saving ratio was up by 1¼ percentage points in the second quarter to 5¼%, a rate last seen in

the third quarter of 1998.[1] An additional factor that adversely affected consumer demand was the perceptible rise in energy prices in the second quarter, which contributed in key measure to the seasonally adjusted 0.3% increase in the consumer price index from its level in the first quarter, in which it had fallen by 0.6%. However, owing to the aforementioned base effect, annual inflation slid clearly into the negative zone (-1.2%). It is noteworthy that the considerable deterioration in the labour market situation has led neither to great uncertainty among consumers nor to major income losses. Non-farm payroll employment in the United States continued its rapid descent, and from March to July the unemployment rate rose by one percentage point to 9.4%.

The growth-dampening effects projected by investment diminished perceptibly in the second quarter, with the decline in commercial investment decelerating significantly from 11¾% to 2¼%. The decline in residential construction investment did not decelerate quite as sharply, with only a three-percentage-point change to -8¼%. Inventory destocking subtracted ¼ percentage point from overall economic output, as against just over ½ percentage point in the first quarter. Government expenditure and external trade projected expansionary stimuli. Real exports, at a seasonally adjusted 1¾%, once again shrank more moderately than imports (-4%); therefore, foreign trade – looking only at the numbers – added ¼ percentage point to growth, following a contribution of +¾ a period earlier.

The current leading indicators are pointing to a stabilisation of private final demand in the third quarter and a slight uptick at year's end. Against this background, in June the Federal Reserve revised its forecasts, particularly for 2009, upward. It now expects real GDP to shrink by 1½% to 1% from the fourth quarter of 2008 to the end of 2009 but then to rise by 2% to 3¼% in 2010 and by 3¾% to 4½% in 2011. The longer-term outlook for growth is still estimated to be in the range of 2½% to 2¾%. The Federal Reserve perceptibly raised its personal consumption expenditure (PCE) projection for 2009 to a range of 1.0% to 1.4%. The revisions are not significant for the two following periods, and the longer-run projection remains unchanged at a range of 1.7% to 2.0%.

Japan

The Japanese economy seemed to regain its footing as the second quarter progressed. Real GDP in the second quarter rebounded, going up by just under 1% after having declined by a total of 8¼% since its cyclical peak at the beginning of 2008. It still grew negatively on the year, by -6½%. Foreign trade was one of the pillars supporting macroeconomic recovery. Real exports accelerated nearly in sync with manufacturing output. At the same time, the drag from imports diminished significantly. The extensive economic

1 In the revised national accounts, which were published at the beginning of August along with preliminary results for the second quarter of 2009, households' disposable income was revised upwards much more sharply for the past few years than private consumption expenditure. As a consequence, the saving ratio rose significantly – for instance, by one to two percentage points between 2006 and 2008 – and no longer posts any negative values for either this year or the years previously. Real GDP growth was reduced noticeably, especially for 2008, when it was lowered from 1% to just under ½%.

stimulus packages boosted domestic demand, thus serving as another pillar of the recovery. Government incentives encouraged households to increase their consumption perceptibly, and public investment was expanded sharply. By contrast, private investment activity continued its decline. Over the course of the second quarter, the standardised unemployment rate rose by 1.6 percentage points to 5.4% in June. In the second quarter, consumer prices were down by a seasonally adjusted 0.4% on the quarter. The year-on-year decline was 1%. Both the energy price-related base effect and the protracted slide in the prices of consumer durables contributed to this development.

United Kingdom

In the second quarter, overall economic activity in the United Kingdom, according to preliminary information, was down by a seasonally adjusted ¾% from its level a quarter earlier, in which it had decreased by 2½%. The year-on-year output loss amounted to 5½% The contraction in real gross output decelerated significantly in all major sectors compared with the first quarter, with the exception of agriculture, forestry and fishing. In construction, negative GDP growth decelerated from -7% to -2¼% and in manufacturing from -5½% to -¼%. Value added in the services sector declined in the second quarter by ¾% after falling by 1½% a period earlier. Given the severe turmoil in the financial markets, which dealt a particularly strong blow to the City of London, it is remarkable to note that the year-on-year decline in the economic output of the financial sector and business-related services sector, at 4½%, has remained below the fall in GDP. The UK recession is clearly leaving its mark on the labour market. The standardised unemployment rate has continued its sharp rise; at 7.7% in May, it was higher than at any time since the fourth quarter of 1996. In July, consumer prices were 1.8% higher than a year earlier. This means that, of the G7 nations, the United Kingdom has by far the highest rate of inflation, a development attributable *inter alia* to the sharp depreciation of the pound sterling since early 2007.

New EU member states

In some of the EU member states, economic activity seems to have stabilised in the second quarter. On average for the April-June period, industrial output recorded at times very strong gains in Poland, Romania and Latvia, whereas in other countries it at least contracted at a much slower pace, in some cases. In this entire group of countries (excluding Malta, Cyprus, Slovenia and Slovakia, which all belong to the euro area), second-quarter industrial output, after seasonal adjustment, was up by 3% from the first quarter, in which it had shrunk by 5½%. The year-on-year decline weakened from 15¼% to 11½%. The deep recession in the new EU member states has, in the meantime, left a deep mark on the labour market. The number of unemployed persons went up from its cyclical low in September 2008 by around 850,000 to 3.68 million in June 2009; over this period, the standardised unemployment rate rose by 1.7 percentage points to 8.2%. Against this background, it comes as no surprise that retail sales (excluding cars) fell perceptibly in the second quarter, by just over 2% on the period (after seasonal adjustment) and by 2¼% on the year. In real terms, the fall is significantly

greater still, as consumer price inflation stood at 3.9% in the second quarter. However, in mid-2008 it was nearly double that figure.

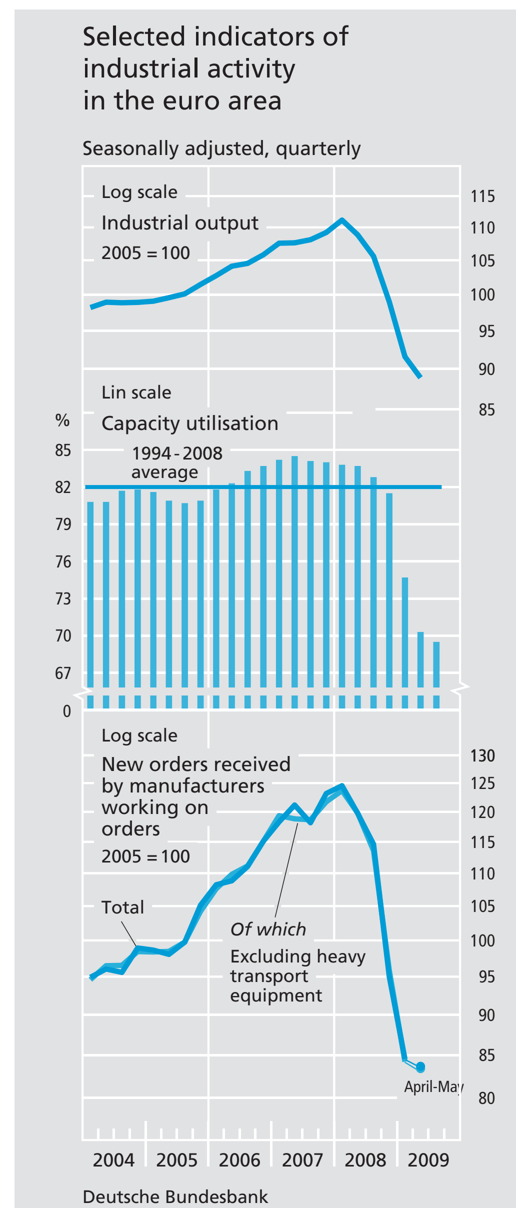
Macroeconomic trends in the euro area

Contractionary pressure ebbing

The euro-area cyclical downswing let up significantly in the second quarter. According to Eurostat's Flash Estimate, real GDP fell only minimally in the second quarter after having shrunk by 2½% in the first. The year-on-year decline amounted to 4½%. The trend was by no means the same in all countries, however. Of the 11 euro-area member states that have already published GDP figures for the second quarter, four countries, including Germany and France, reported a slight rise. Slovakia even recorded a significant increase in its economic activity, albeit on the back of a sharp slump a quarter earlier. In the other countries, especially Italy and Spain, overall output slumped once again. Euro-area business activity is generally expected to continue to stabilise in the second half of the year. Owing to the poor first-quarter result, the IMF, in its July WEO update, revised its projection for annual GDP growth for 2009 downward by 0.6 percentage point to -4.8% and is still expecting a slight decline of 0.3% for 2010.

Signs of bottoming-out in manufacturing industry

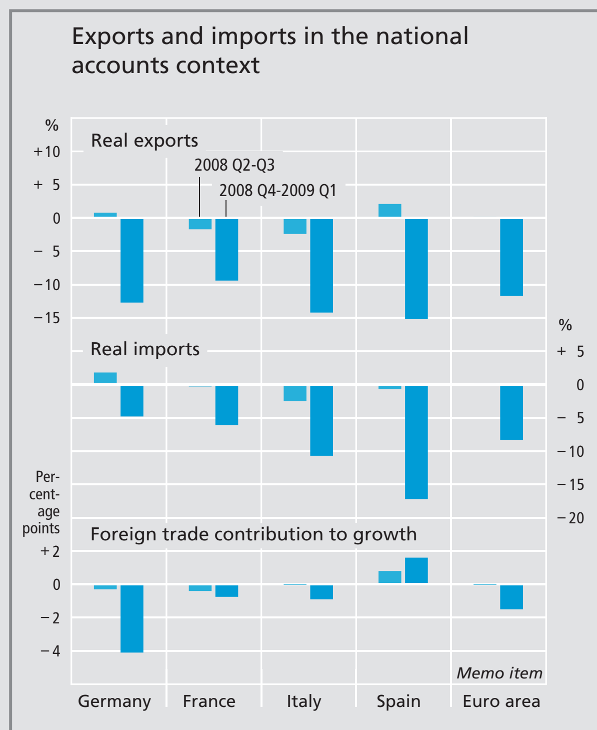
In the second quarter, one of the main factors that helped to rein in the slide in overall economic activity was the stabilisation of industrial output in the May-June period. A substantial share of this may be attributed to the sharp rise in car manufacturing owing to the environmental premiums being granted by several euro-area governments for scrapping old cars. On average over the second quarter, however, overall industrial output still fell by a seasonally adjusted 3%, and its year-on-year negative growth, at 18½%, remained very high. The decline in capacity utilisation in manufacturing over the April-July period was no longer as precipitous as previously. New orders, too, contracted at a less severe pace. In April-May, orders were down by a seasonally adjusted 1% from their level in the first



Foreign trade in the four major euro-area countries in the wake of the global recession

Of the four major euro-area countries, Germany's economy has been hit the hardest by the global recession. According to the IMF interim projection issued in July this year, Germany's total output will contract more substantially in 2009 (–6.2%) than that of France (–3.0%), Italy (–5.1%) and Spain (–4.0%). With the exception of Japan (–6.0%), the IMF has not predicted such a pronounced contraction for any other major industrial country. Characterised by economies with a large manufacturing share which are simultaneously extremely export-oriented, Japan and Germany have both been severely affected by the collapse of global manufacturing activity and the sharp decline in global demand. This is consistent with the fact that German net exports, after adjustment for seasonal and calendar variations, made a considerably greater contribution to negative growth in the fourth quarter of 2008 and the first quarter of 2009 than those of the other three major euro-area countries. It stood at 4 percentage points of the rate of change in real gross domestic product (GDP) on the preceding period – the second and third quarters of 2008 – compared with –¾ percentage point in France, –1 percentage point in Italy and a positive contribution of 1½ percentage points in Spain.

Exports and imports in the national accounts context



A closer examination reveals that these marked differences are only partly the result of sharper percentage declines in exports. For instance, with respect to the seasonally-adjusted fall in real exports (goods and services) during 2008 Q4 and 2009 Q1, Germany's weak performance (–12¾%) was bettered only by France (–9½%), while in Italy (–14¼%) and Spain (–15¼%) the decrease was even more pronounced. Instead, a crucial factor was that real imports contracted to a much lesser degree in Germany than in the other three countries, by 4¾% as against 10¾% in Italy, 17¼% in Spain and 6% in France. This comparatively moderate downward trend in German imports was largely attributable to the fact that domestic demand in the fourth quarter of 2008 and the first quarter of 2009 hardly fell below its previous level for the same period (–¼%), whereas in France it dropped by ¾%, in Italy by 2¾% and in Spain by 3¼%. Given the high import content (45%) of Germany's exports, it would have been reasonable to expect the considerable slump in exports to have caused an even larger decline in imports. Seen in this light, there is some evidence to suggest that imports as a share of domestic demand have increased. This is clearly borne out by developments in the automobile market, where the environment bonus payment triggered a boost in demand for smaller vehicles, which predominantly come from abroad. This resulted in an increase in the share of foreign cars among new registrations from 35½% in 2008 Q2 and Q3 to 38¾% in 2008 Q4 and 2009 Q1.[1]

Another factor is that, in Germany, the export share in GDP is much larger than in any of the other three countries. In 2008 Q4 and 2009 Q1, exports accounted for 48% of German GDP, roughly 20 percentage points higher than the respective levels for the other three countries. This has resulted in a markedly higher (6 percentage points) negative growth contribution from exports compared with 4 percentage points each in Italy and Spain and 2 percentage points in the case of France. Moreover, at 42%, German imports as a share of GDP are well below the domestic export share and much closer to the import ratios of Germany's partner countries, which stood at 29% (France), 33% (Italy) and 32% (Spain). Applying growth accounting to demand-side components, the resulting positive contribution of falling imports to GDP growth was the largest in Spain (5¾ percentage points), with Italy in second place (3¼ percentage

1 The foreign-trade-related effect is likely to have been even more significant, as a larger percentage of the small domestic models sold in Germany are manufactured abroad than is the case in the larger vehicle segments. — **2** It should be noted that, under this approach, various effects cancel each other out. Considered in isolation, the imputed increase in the export-to-GDP ratio of Germany's partners reduces the difference in growth contribution made by foreign trade while a similar increase in imports has the opposite effect. As the difference between export ratios is larger, the first effect dominates on balance. — **3** The volumes are calculated by multiplying the volume

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points), followed by Germany at 2 percentage points and France at 1¾ percentage points.

Hence, the relatively strong retarding effect on external activity in Germany is also attributable to the high surplus recorded for cross-border trade in goods before the start of the recession. In such a situation, foreign trade still makes a negative contribution to growth even if the percentage decline in exports and in imports is evenly balanced. The exact opposite holds true for countries with a pre-recession external trade deficit, as was the case in France and, above all, Spain. Under such circumstances, if real imports decrease by a larger margin than exports, as happened in Spain, the positive growth contribution made by net exports will be correspondingly higher.

There are two steps to gauging the impact of differences in the degree of openness and the level of net exports on the pre-recession situation. First, all four countries are assumed to have had a stable trade balance prior to the recession, with the respective export and import levels then declining in line with the observed rates. Second, it is assumed that imports and exports as a share of GDP were the same in all four countries. In concrete terms, a 45% ratio, which represents the mean of the actual German export and import ratios, was assumed. Under these conditions, the difference between net exports' contribution to economic growth in Germany and that in Spain, Italy and France would have been discernibly smaller – by around 1¼ percentage points for each of these partner countries.[2] The remaining difference vis-à-vis Spain and Italy can be explained, in net terms, by the smaller decline in imports in Germany. Only when compared with France was the more pronounced fall in exports in Germany a key factor.

External trade statistics show that, in the 2008 Q4–2009 Q1 period, real exports of goods in all four countries were down on the 2008 Q2–Q3 period by smaller margins, in seasonally adjusted terms, than price-adjusted exports of goods and services as recorded in the national accounts. These declines range from –14¾% in Spain, –15% in France and –16¼% in Italy to –16½% in Germany. One of the most likely reasons why French exports according to the national accounts declined considerably more weakly than goods exports as reported in the foreign trade statistics is that the external trade flows in the national accounts are deflated using the corresponding price indices, whereas the series contained in the foreign trade statistics are compiled on the basis of unit values.[3]

Viewed in regional terms it is striking that, according to the foreign trade statistics, real exports of goods to the European Union ex euro area slumped the sharpest, although France's exports contracted to a somewhat lesser extent than those of the other three countries. The largest period-on-period changes were recorded for exports to the rest of the world; while Germany's exports suffered a drop of 15¾%, French exports fell by a much smaller margin (9¾%). This is due, firstly, to the fact that, in France, car exports, which are included in consumer goods, do not play as great a role as they do in Germany.[4] In addition, imports of machinery and equipment fell by a surprisingly narrower margin.

All in all, the country comparison of external trade flows in 2008 Q4–2009 Q1 shows that, viewed in isolation, the recession-induced percentage decline in Germany's real exports, as recorded in the national accounts, was of much greater magnitude than that in France but still somewhat lower than the figures for Italy and Spain. According to the foreign trade statistics, these declines were even confined to a relatively narrow range of just under two percentage points. For exports, their diverging weight in GDP was the key factor, whereas for imports the reverse is true. Indeed, most of the divergent trends in the external trade growth contributions can be attributed to the comparatively moderate decline in German imports. This evidence is of great economic policy relevance inasmuch as it tempers to some degree the criticism under which the German growth model had come in the past few months for its strong focus on industry and exports.

Real exports of goods by region [5]

Seasonally adjusted percentage change in 2008 Q4-2009 Q1 from 2008 Q2-Q3

Destination region	Germany	France	Italy	Spain	*Memo item* Euro area
Euro area	– 15.3	– 17.9	– 17.5	– 14.4	[6] – 14.7
EU ex euro area	– 20.5	– 18.2	– 20.9	– 20.2	– 17.6
Rest of the world	– 15.8	– 9.7	– 13.2	– 13.3	– 15.0
Total	– 16.6	– 15.0	– 16.2	– 14.7	– 15.3

of the reporting month by the average value for the base year. The base averages are calculated by dividing the actual values for the base year by the underlying volumes. — **4** Unlike the indicators of industrial activity, which list automobiles under capital goods manufacturing in line with the NACE concept, in the EU foreign trade statistics motor vehicles are recorded alongside consumer goods. — **5** Source: Eurostat. — **6** Exports between euro-area countries.

quarter of the year, in which they had collapsed by 11%. The industrial confidence indicator has been trending back up slightly since April, owing mainly to less unfavourable output expectations and a distinct easing in the assessment of inventories; however, assessments of order books remained extremely poor.

Stimulus programmes having clearly recognisable impact

One of the demand-side reasons why the manufacturing industry is close to turning the corner is the sharp rise in new car purchases, with new car registrations in the second quarter up by a seasonally adjusted 12¼% following +¾% in the first-quarter months. They were also up year-on-year for the first time since the third quarter of 2007. However, in some cases the revival of car purchases may well have led to a redirection of purchasing power. Real retail sales (excluding cars), after factoring out seasonal influences, were not able to maintain their first-quarter level. Gross fixed capital formation is likely to have been muted once again in the second quarter. The continuing contraction of capital goods production, excluding the increased output of cars (most of which were purchased by households), indicates that investment in new machinery and equipment has continued to shrink significantly. In addition, construction investment is likely to have declined somewhat in April-May (seasonally adjusted); at all events, construction output went down slightly. Exports to non-euro-area countries fell once again in April and May; over this combined period, they were down by 2¾% on the quarter and 25% on the year. Since imports fell even further in those two months (after seasonal adjustment), the balance of trade over this period was positive. The euro-area aggregate, however, conceals considerable differences between the large member states in their foreign trade growth, especially on the import side (see also the box on pages 20-21).

Further-deterioration in labour market situation

The labour market situation experienced a further significant deterioration in the second quarter. The number of unemployed persons rose by 640,000 in the March-June period to 14.9 million. Since hitting its cyclical low in March 2008, the figure has risen by 3.6 million, with Spain by itself accounting for more than one-half of the increase. The unemployment rate in Spain rose similarly sharply, by 8.7 percentage points to 18.1% by mid-year. This puts Spain, by a large margin, at the top of the euro area, where the unemployment rate was 9.4% as this report went to press. The Netherlands recorded the lowest unemployment, at 3.3%. Euro-area employment fell in the first quarter of the year – after which no data are available – by just under 1% on the quarter and by 1¼% on the year. Labour costs, according to preliminary estimates, are likely to have grown at a somewhat slower pace in the first quarter of 2009.[2] On the year, hourly labour costs rose by 3.7%, following +4% at the end of 2008.

Consumer prices driven by the volatile components

Consumer prices in the euro area went up by an average of 0.3% (after seasonal adjustment) in the second quarter. This was due mainly to the sharp rise in international crude oil prices, which were passed through to

2 Owing to statistical changes, currently only incomplete, preliminary, and solely working-day adjusted data are available.

domestic consumer prices without any long time-lags. This more than cancelled out the favourable price movements for unprocessed food. Despite the perceptible quarter-on-quarter increase, year-on-year Harmonised Consumer Price Index (HICP) inflation fell from 1.0% to 0.2%. This decline was due mainly to the corrections that followed the sharp rise in the prices of energy and unprocessed food up until the beginning of the third quarter of 2008. In the meantime, annual HICP inflation has fallen below 1% in all euro-area countries (except for Finland) and is even negative in 12 of these countries. Excluding food and energy, by contrast, only three of these countries have inflation rates below 1%, whereas in nine of these countries inflation is at least 1.5%. In July, euro-area consumer prices fell by 0.2% (after seasonal adjustment), also owing to a temporary drop in crude oil prices. Year-on-year HICP fell to -0.7%. It is particularly base effects – but not deflationary risks – that show up in this figure. A return to positive inflation rates is in the offing for the fourth quarter.