Global and European setting

World economic activity

World economic activity still improving

The world economic recovery, which had been set in motion in the second quarter, strengthened further in the third quarter. Not only the increased risk appetite in the financial markets but also the extensive economic stimulus programmes, the expansionary monetary policy and the inventory cycle all played a role. Global industrial output growth accelerated significantly after mid-year and, in July-August, stood at a seasonally adjusted 2½% compared with the average of the second quarter, in which output had already risen by 2%.[1] Output was still down by 6¾% on the year, however. The recovery of industrial activity coincided with a perceptible expansion of global trade, the volume of which was up 3% in July-August from its second-quarter figure. In this two-month summer period, its year-on-year deficit already fell perceptibly to 15¾%. One of the important factors here was the increase in the demand for cars fuelled in many countries by car scrappage schemes or other fiscal incentives, which in many cases triggered sharp increases in imports of new cars and parts.

Global recovery regionally quite broadly based

Looking at individual regions, global economic activity was once again given a considerable expansionary boost by the emerging market economies, especially China. In addition, the industrial countries contributed positively to global growth. The main factor

1 These and the following figures on current patterns of real global trade are from the Netherlands Bureau for Economic Policy Analysis (Centraal Planbureau, or CPB), which for a long time has been calculating monthly indicators of the volume of world trade and global trade prices and, in August 2009, began calculating a global industrial output series.

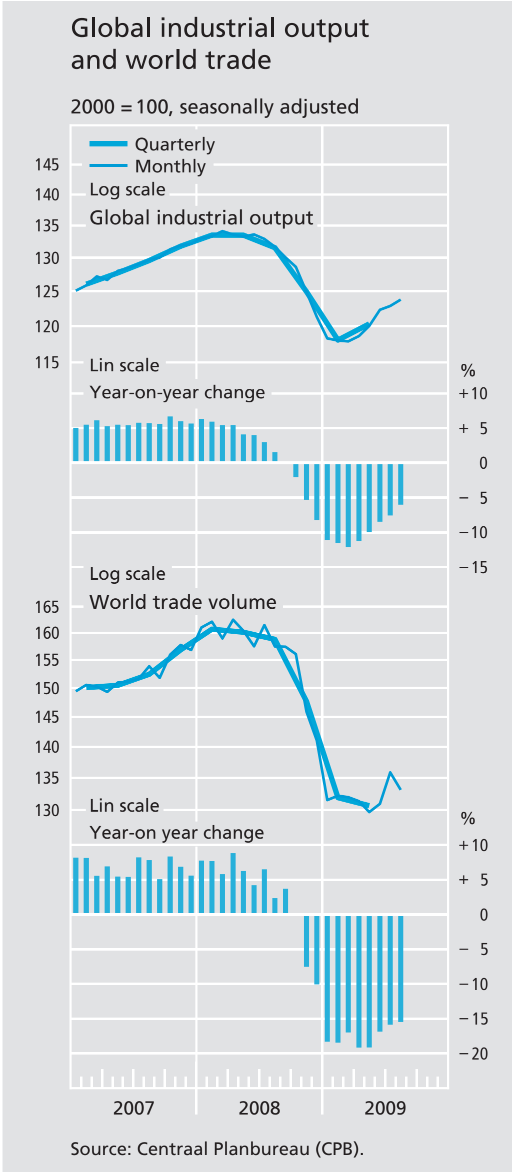
was that the precipitous drop in real gross domestic product (GDP) in the United States and the euro area was followed by growth in the third quarter. In addition, Japan's economy improved on its considerable pace of growth in the second quarter. According to initial estimates based on data for several major economies and the euro area, aggregate output in the industrial countries returned to growth in the third quarter, after seasonal adjustment, for the first time since early 2008, increasing by ½%. However, it was still down by 4¾% on the year.

Favourable signals for the 2009 Q4-2010 Q1 period

According to the available information, the cyclical upturn in the world economy will continue in the current quarter and the following months. Illustratively, the expectation component of the ifo World Economic Climate Indicator has reached a relatively high level. The OECD's composite leading indicator for the world economy (the OECD members and some major emerging market economies) has been on the rise since early 2009 and surpassed the previous year's level for the first time again in August. All in all, a broadly based global recovery therefore appears to be taking shape, with the indicators for the major emerging market economies trending upwards more strongly than those for industrial countries as this report went to press.

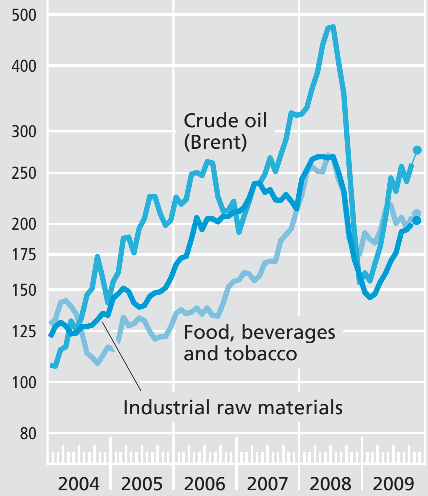
Upward revision of IMF forecast

Given the perceptible revival of global economic activity in the period spanning the second and third quarters of 2009, the strength of which had not been expected in the preceding forecasts, the IMF revised its growth forecast upwards in October, especially for 2010. For the current year, the IMF now expects global GDP to decline by 1.1%, compared with -1.4% in the July interim forecast. The projection for 2010 was increased by 0.6 percentage point to +3.1%; however, the global pace of expansion will still remain well below the average for the previous cycle (+4%). The ground for higher GDP growth next year has, to some extent, already been laid by the quite considerable growth overhang that appears to be in store for the end



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. — • = 13 November or 16 November 2009 (crude oil).

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of 2009. At the same time, the predicted decline in the world trade volume for this year was reduced slightly to 11.9%. For 2010, the IMF is expecting world trade to grow by 2.5%, as against 1.0% forecast in July. However, given the distinctly resurging growth in foreign trade flows, this appears to be a relatively conservative forecast. The IMF predicts that macroeconomic output in the industrial countries – following a 3.4% decline in the current year – will rise by 1.3% in 2010, with relatively sharp GDP growth expected for the United States (+1.5%) and Japan (+1.7%). For the euro area, the IMF is expecting a rise of only 0.3%, which, however, is at the lower end of the current forecast spectrum. Growth of developing countries and emerging market economies is expected to accelerate from 1.7% this year to 5.1% next year. The IMF continues to see the downside risks as prevailing and especially to see a danger that renewed turbulence in the financial markets could mar the global recovery or that the supply of bank credit might not suffice to finance global output growth.

Commodity price movements calm

The commodity markets are widely expected not to have an appreciable adverse impact on global economic growth next year. During the third quarter, crude oil prices fluctuated within a rather narrow band of between US\$65 and US\$75 per barrel. One factor at play here was that the hurricane season, which in earlier years had often disrupted production in the Gulf of Mexico, was very mild in 2009. In October, however, prices went back up amidst a further brightening of the global economic outlook. In mid-November a barrel of Brent crude oil was selling for US\$78½ and €52½. The base effect on the year-on-year oil price movement reversed itself in July because oil prices had begun their rapid descent at the same time a year earlier. Forward quotations suggest that oil prices will continue to rise moderately in the months to come. As regards the other commodities, the sharp price increases in the March to August period were followed by much flatter growth. In the case of industrial raw materials, this was because inventory build-up activity subsided, particularly in China, and because of lingering uncertainty about the strength of the global cyclical recovery. The sideways movement of the index for food, beverages and tobacco since mid-year has been influenced by countervailing movements between, on the one hand, grain and oilseeds, which tended to become cheaper as a result of good harvests, and, on the other, beverages, tobacco and sugar, which saw prices rise significantly owing mainly to weather-related output losses.

Inflation rates in industrial countries marked by reversal of base effect

The renewed increase in energy prices was a key reason for the perceptible resurgence, after seasonal adjustment, of consumer prices in industrial countries – especially the United States – from June onwards. Since the third quarter, the aforementioned reversal of the base effect for energy prices has also been making its presence felt in the movement of the industrial countries' annual inflation rate; between July and September, negative year-on-year inflation already narrowed by ½ percentage point to -0.6%. During the fourth quarter, inflation rates will probably reenter positive territory. Excluding energy and food, inflation in the industrial countries ran at 1.2% in the third quarter, as against 1.5% a quarter earlier.

Continued cyclical improvement in south and east Asian emerging market economies

In many emerging market economies, the cyclical recovery, which in some cases had already set in at the beginning of the year, continued in the summer months. It was particularly the south and east Asian emerging market economies that once again expanded their output sharply, with China achieving real year-on-year GDP growth of 9% in the third quarter, as against +8% a quarter earlier. The Chinese economy is still receiving a strong boost from public infrastructure investment being made as part of a comprehensive government fiscal programme. Household consumption is also proving to be a key pillar of growth; car purchases were up in the third quarter by more than 80% on the year – owing primarily to government financial incentives. Recently, recovery has also been driven for the first time once again by a perceptible revival of export business. Consumer price inflation in China has remained discernibly below zero in the past few months and stood at -0.5% in October. India's economy, the output of which had risen by 6% on the year in the second quarter, is likely to have more or less maintained its pace of growth in the third quarter despite considerable weather-related output losses in agriculture. The rise in the price of foods caused by crop failure, however, was one of the main reasons why inflation rose from 8.9% in the second quarter to 11.7% in the third.

Largely positive picture in Latin America

In Brazil, real GDP is also likely to have risen sharply in the third quarter, with industrial output up 4% on the quarter after seasonal adjustment. However, industrial output was still down by 8½% on the year. According to available indicators, the cyclical upswing continued to be supported largely by private consumption, which was boosted by government incentives to purchase cars and other consumer durables. In Mexico, the middle of the year saw the beginning of a distinct cyclical recovery owing mainly to a considerable increase in car manufacturing. Argentina's economy appears to have stabilised in the third quarter; however, a perceptible cyclical improvement does not yet appear to have kicked in. In Brazil and Mexico, consumer price inflation has tended to diminish further in the past few months, reaching 4.5% in both countries in October. By contrast, the inflation rate in Argentina rose to 6.5% at last report.

Recovery beginning in Russia

Russia, the major emerging economy to be hit the hardest by the global economic and financial crisis, overcame its cyclical trough in the third quarter. Negative year-on-year growth of real GDP narrowed to 9% from 11% according to an interim official estimate. Manufacturing activity has gone back up distinctly over the past few months owing in part to the perceptible expansion of oil production that was made possible, above all, by the launch of a large new oil field in Siberia. Consumer price inflation in Russia continued to subside considerably; in October the annual inflation rate stood at 9.8%. This is likely to have been due not only to households' very subdued appetite for consumption throughout the reporting period but also to the sharp appreciation of the Russian rouble, which, after its low in February, rose by one-quarter against the US dollar.

US economy back on growth track thanks to revival of household consumer spending...

During the third quarter, the US economy returned to a growth track. After aggregate output had shrunk by a total of 3¾% in the preceding four quarters, it rose in the third quarter of 2009 by just under 1% on the period after seasonal adjustment. The main reason was that domestic household final demand grew for the first time in two years – owing, in particular, to targeted monetary and fiscal policy stimuli. Household consumption rose by ¾% on the period in real terms after shrinking by ¼% a quarter earlier. Government environment premiums and favourable conditions from manufacturers intermittently led to a strong revival of car purchases. However, consumer spending on other goods and services also rose perceptibly. This is consistent with the fact that households' saving ratio, after rising to 5% in the second quarter owing, not least, to income-increasing measures under the economic stimulus programme, went back down to 3¼%. Resurging asset prices will probably also have given private consumption a boost. The price climate remained calm, which is likely to have had a positive effect on consumer demand. Although the consumer price index rose in the third quarter by 0.9% on the quarter after seasonal adjustment, owing mainly to higher energy prices, excluding energy and food this figure was only 0.4%. Owing to a base effect for, among other things, foods, the annual rate of inflation for the overall basket of goods slid somewhat further into negative territory (to -1.6%). Continuing job losses put a strain on household consumption, even though their pace has grown noticeably slower. In the June to October period, the unemployment rate rose by ¾ percentage point to 10.2%.

... and gross investment

Aggregate growth was also supported by private gross fixed capital formation. Residential construction investment grew by 5½%, bringing to an end a 3½-year period of contraction during which the (nominal) share of this component in GDP had fallen by around four percentage points to 2½% in early 2009. Factors contributing to this turnaround include not only tax relief for first-time home buyers and the stabilisation of residential property prices but also targeted monetary policy intervention in the mortgage market to dampen lending rates. The commercial real estate markets, however, remained in a state of tension. Investment in commercial construction, which tends to lag the cycle, was cut by 2¼%. Surprisingly, however, firms slightly increased their investment in plant, equipment and software despite considerable capacity underutilisation. Firms reduced the pace of inventory depletion, which also boosted growth.

Slightly negative growth contribution from foreign trade

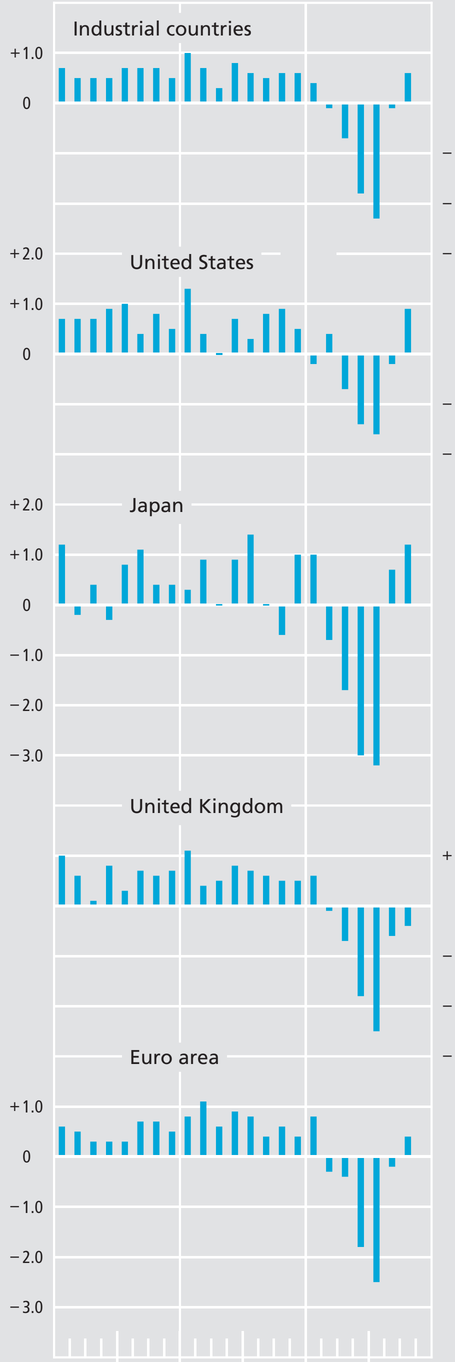
It was particularly the increase in cross-border deliveries of cars and car parts that caused real foreign trade flows to rise sharply. Since, owing to the revival of domestic demand, imports rose even faster than exports, on balance foreign trade put a slight damper on GDP growth – unlike in the preceding quarters.

Japan recovering at increased pace

According to a preliminary estimate, the Japanese economy increased the pace of its growth from its second-quarter rate of ¾% on the quarter (after seasonal adjustment) to 1¼% in the third quarter. Nonetheless, real GDP was still down by 4½% on the year. Much like in the United States, aggregate growth in Japan was broadly based on the demand side. It is attributable in virtually equal parts to foreign trade, inventory movements and private domestic final demand. The ¾% growth in households' consumer spending on the preceding three-month period, however, is particularly likely to have been induced by extensive fiscal stimuli. Households were also supported by initial signs of an improvement in the labour market. From its all-time high in July, the unemployment rate fell by 0.4 percentage point to 5.3% in September, while employee wages and salaries grew in real terms by ¾% on the quarter, owing largely to the continued perceptible year-on-year decline in

Overall economic output in industrial countries*

Seasonally adjusted, quarter-on-quarter percentage change



* The United States, Japan, the United Kingdom and the euro area.

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consumer prices – from -1.8% in June to -2.2% in September. Changes in firms' inventories also contributed substantially to GDP growth. In addition, commercial investment rebounded slightly, whereas the sharp slowdown in residential housing construction continued. The public sector was unable to fully maintain its high level of investment activity from the second quarter. Although exports of goods and services continued to grow at an unrelenting fast pace, a considerable increase in imports meant that foreign trade, on balance, did not shape overall economic growth to the same degree as a quarter earlier.

UK economic activity still weak

The UK economy did not yet bottom out in the third quarter. According to a provisional estimate, real GDP in the third quarter was down by just under ½% on the quarter after seasonal adjustment. All major economic sectors contributed to this contraction, which was, on the whole, only slightly weaker than in the preceding three-month period. In construction and the other non-energy manufacturing sectors, real gross value added, at -1% and -¾% respectively, fell even more sharply than in the second quarter. Although this result was affected adversely by maintenance-related disruptions to oil and gas production, value added in the more narrowly defined manufacturing industry continued its decline, too. Only in services did the slide slow down, from ½% in the second quarter to ¼% as this report went to press. No initial estimate for the movement of the expenditure components of GDP is yet available. However, there are indications that household consumption may have stabilised in the third quarter. As in other countries, car scrappage schemes meant that a significantly larger number of new cars were registered than in the preceding quarter. Moreover, retailers recorded a perceptible increase in the volume of sales. The labour market continued to have a retarding effect on consumption. However, the standardised unemployment rate rose only slightly, to 7.8% in the July-August period. The high level of consumer price inflation by international standards subsided distinctly over the summer months. Owing, in particular, to the base effect for energy, which has lasted longer in the United Kingdom, annual inflation fell by 0.7 percentage point between June and September to 1.1%.

Cyclical stabilisation in the new EU member states

Now that external sources of funds have dried up, an unavoidable adjustment process has begun in the new EU member states (EU-8), with major differences from one country to another. Nevertheless, economic activity in the EU-8 continued to stabilise in the third quarter. The recovery of the industrial sector gained a broader regional footing after mid-year following a second quarter in which output growth was carried almost exclusively by the upturn in Poland. On the whole, industrial output in the July-August period was ¾% higher than in the second quarter, with only Bulgaria posting a decline. However, since the improvement is associated with the revival of foreign demand for cars, the expiration of the environmental premiums in some European countries, including Germany, is likely to be followed, at least temporarily, by a decrease in external boosts. The third-quarter stabilisation of nominal retail sales (excluding cars) relative to the second quarter in the EU-8 reflects the strong sales growth experienced in Poland and the continuing contraction elsewhere. According to Bundesbank calculations, the region's standardised unemployment rate rose from 8.0% in June to 8.3% in September. Consumer price inflation continued to decrease; since mid-year, the Harmonised Index of Consumer Prices (HICP) has fallen by 1.0 percentage point to 2.7% in October.

Macroeconomic trends in the euro area

Economic slide ended in Q3

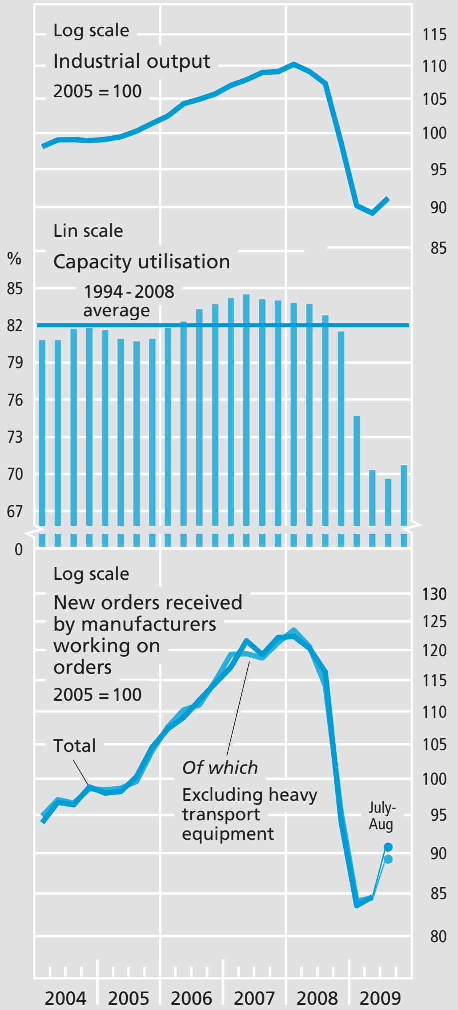
In the summer months, the euro area reverted to a moderate growth track after a second quarter in which the retarding forces had already diminished noticeably. Real GDP rose in the third quarter by ½% after seasonal adjustment compared with a decline of ¼% in the preceding three-month period. However, it was still down by 4% on the year. The cyclical upturn after mid-year was supported particularly by two major euro-area member states, Germany and Italy, with France's economy likewise making a positive contribution to euro-area growth. By contrast, Spain posted negative GDP growth. For the current quarter, the European Commission is expecting aggregate output in the euro area to rise by ¼%; however, this would mean an overall decline of 4% for 2009 as a whole.

Indicators of industrial activity clearly pointing upwards

It was particularly in production where mounting signs of a cyclical revival in the euro area became visible. Industrial output rose in the third quarter by 2¼% (after seasonal adjustment) from its low in the second quarter, yet was still down by 14½% from the third quarter of 2008. Whereas the manufacture

Selected indicators of industrial activity in the euro area

Seasonally adjusted, quarterly



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of consumer goods, which had been affected relatively little in the wake of the recession, stagnated in the third quarter, the production of intermediate and capital goods – including cars – and energy was pointing perceptibly upwards again. This is consistent with a slight rise in capacity utilisation in the manufacturing industry between July and October from a very low level, the first such increase since the first quarter of 2007. The improvement in in-

Labour markets in the global recession

The labour markets in industrial countries have responded to the sharp contraction in macroeconomic activity around the turn of 2008-09 to widely varying extents. A seasonally adjusted comparison of the relative decrease in employment with the percentage decline in GDP for the period between the first quarter of 2008 and the second quarter of 2009 reveals a rather mixed picture.[1] While there have been substantial job losses in Spain and Ireland, job cuts in a large number of other countries, including ones which have recorded very sharp production shortfalls, have been quite moderate so far. In Germany and Belgium, there were, on balance, actually more people in work in the second quarter of 2009 than there had been in the first quarter of 2008. If the developments in macroeconomic activity and employment are set in relation to one another, thus – so to speak – normalising the labour market response to the size of the underlying "shock", then very heterogeneous adjustment paths also become apparent. This also holds true if output per hour worked is examined for those countries for which corresponding data are available.

In some cases, a connection has been established between the international discrepancies in employment and productivity trends and government support measures, which enable enterprises experiencing a severe shortage of orders to reduce the working hours of their employees and partially offset the resulting loss of earnings through transfer payments.[2] The short-time working benefits provided in Germany are a well-known example of this. In contrast to the employment trend in Germany, however, the most recent expansion of short-time work is by no means unusual when compared with previous cycles. The strong decline in the number of hours worked per employee in Germany is attributable to a much greater extent to the more flexible provisions regarding negotiated working hours that have come into force over the past few years (see also the comments on page 52 et seq).

Reference is also often made to the significance of employment protection legislation. Countries such as the USA, Ireland and the United Kingdom, in which employers face relatively small obstacles in terms of laying off staff, have in point of fact recorded quite significant job losses; by contrast, the figures have been comparatively low in Germany, France and Italy; Spain, however, with its rather restrictive employment protection legislation, but a large share of its workforce employed on temporary contracts, is something of an exception. Even if – by way of comparison – the OECD's Employment Protection Index (EPI) is taken as a measure of the degree of employment protection, it is not possible to observe a close link here.

Indications of further possible reasons for the different labour market responses can be obtained by analysing particular sectoral features in individual countries. For example, there appears to have been a comparatively high number of job losses in those countries experiencing difficult adjustment processes on their real estate markets and, consequently, also in their construction sectors. The hefty job losses in Ireland and Spain can, to a large extent, be directly attributed to the construction sector. As a result of the previous misalignments on the real estate markets, a large number of jobs are likely to be lost permanently during the adjustment process.

Furthermore, it appears that other countries which have also recorded substantial job cuts in the construction sector have likewise suffered noticeable losses in other sectors. These changes in employment, which are broadly based across all sectors, may indicate that enterprises consider the underlying drop in aggregate demand to be a longer-term phenomenon. By contrast, those coun-

1 For European countries, the number of persons in work given in the national accounts is used as a measure of employment. For the USA, the number of employees on non-farm payrolls taken from the BLS' Establishment Survey is used, while for Japan data from the monthly

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tries which have recorded only a slight overall decline in the number of persons in work have experienced job cuts primarily in the industrial sector. This was due, first and foremost, to the fall in foreign demand for those countries' products. Given that this – in some instances, very strong – drop in demand may be largely deemed to be a temporary development, labour hoarding on the part of enterprises is understandable in view of the costs associated with laying off and hiring staff. It is certainly striking that, despite an extremely sharp contraction in industrial output, the two large industrial countries of Germany and Japan have, up to now, not recorded any or only moderate employment losses in their economies as a whole. Especially in Germany, the consensus among wage bargainers on the preservation of jobs is likely to have played a significant role. In addition to the costs assumed by enterprises and the government, employees themselves have borne some of the costs arising from labour hoarding by foregoing part of their wages.

The fact that economies which previously recorded a dramatic slump in industrial activity are now recovering at a comparatively rapid pace is likely to be a contributing factor in reclosing the international gap in the productivity trend. Moreover, it may be expected that countries experiencing relatively strong labour market responses will see employment recover again if the overall economic upturn continues. However, it remains questionable whether, in the majority of the countries affected, job losses that are broadly based across all sectors merely reflect a weakness in aggregate demand – which could be quickly surmounted when economic activity improves – or whether they indicate lasting structural changes. At all events, if underemployment continues, the human capital of the unemployed will depreciate in value, thus reducing the prospects of those affected of finding a new job when the economy picks up again.

Real GDP and employment

Labour Force Survey – which, in some cases, are subject to seasonal adjustment by the Bundesbank – are relevant. — **2** See European Central Bank, Links between output and unemployment in the euro area, Monthly Bulletin, October 2009, pp 52-54.

Euro-area consumer prices

Year-on-year percentage change

Item	2009 Q1	2009 Q2	2009 Q3
HICP, total	1.0	0.2	– 0.4
of which			
Energy	– 6.1	– 10.7	– 11.9
Unprocessed food	2.8	0.8	– 1.2
Processed food	2.1	1.1	0.6
Industrial goods	0.7	0.7	0.5
Services	2.2	2.2	1.8

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dustrial activity is expected to continue in the current quarter. Overall orders received rose in the July-August period by no less than 7¼% on the quarter. In addition, according to the EU economic survey the sentiment in industry in the euro area has improved considerably since its low in March 2009.

Demand indicators sending different signals

The picture being shown by demand-side indicators is still quite heterogeneous. Foreign trade is likely to have once again contributed positively to growth in the third quarter. Nominal exports to non-euro-area countries rose by 2½% in July-August, after seasonal adjustment, from their level in the second quarter, whereas imports fell by 2%. The trade surplus in this two-month period was higher than at any time since June-July 2004. Household consumption patterns continued to be shaped in the third quarter by the promotion of car sales through government purchasing incentives in various member states. New car registrations, which had already grown distinctly in the second quarter, were up by 1½% on the quarter and by 7¾% on the year. However, this coincided with a diversion of purchasing power away from traditional retail trade, where real sales increasingly trended downwards (-¾%). Although consumer confidence continued to improve throughout the reporting period, unfavourable assessments still hold the upper hand. Gross fixed capital formation is likely to have continued to fall in the third quarter. Euro-area construction output was down in the July-August 2009 period by a seasonally adjusted 2¼% on an already depressed second-quarter level. In addition, the increase in capital goods production was heavily characterised by greater household demand for new cars and less by orders of machinery and equipment by euro-area trade and industry.

Labour market showing distinct traces of recession

The euro-area recession, which lasted into the second and third quarters of 2009, left distinct traces in the labour market. Experience suggests that the labour market will still be fairly slow to bounce back even after the cyclical recovery has begun. Euro-area employment fell in the second quarter by 0.5% on the period, after adjustment for seasonal and working-day variations, and was down by 1.8% on the year (see box on pages 20-21). The heaviest year-on-year job losses were sustained by Spain and Ireland, at 7.1% and 8.2% respectively. By contrast, negative employment growth remained relatively limited in Germany (-0.1%), Italy (-0.9%) and the

Netherlands (-0.8%). In September 2009, the euro-area unemployment rate rose again slightly to 9.7% and was thus one percentage point higher than a year earlier. However, this obscures major differences among the various countries. Nominal labour costs per hour worked increased in the second quarter of 2009 by 1.0%, a rate similar to the preceding quarter. After adjustment for calendar-day variations, the year-on-year rate of change grew to +4.0%.

Despite moderate rise in prices…

On average for the third quarter of 2009, euro-area consumer prices rose by a seasonally adjusted 0.2% on the quarter and thus at a similar rate to the preceding quarter. While energy prices rose slightly for the second consecutive quarter following the sharp downward correction which expired in March and services also continued to grow more expensive, the prices of industrial goods stood still. Food prices were subject to countervailing developments: whereas unprocessed food was cheaper owing, not least, to favourable weather conditions, processed food became more expensive, on average.

… year-on-year HICP growth rates temporarily negative

Year-on-year HICP inflation turned around from 0.2% in the second quarter to -0.4% in the third, owing mainly to the sharp increase in the prices of energy and foods up until mid-2008 – when the year-on-year rate reached 3.8% – and the subsequent corrections. Excluding the particularly volatile components, energy and food, annual inflation averaged +1.3% in the third quarter, compared with +1.8% a year earlier. Current price trends indicate that such “core inflation” and overall inflation will quickly converge, with the annual rates having the greater distance to cover. In October, euro-area consumer prices rose by 0.1% after seasonal adjustment. Annual HICP inflation amounted to -0.1%, following -0.3% a month earlier, and core inflation held steady at 1.2%.