

Global and European setting

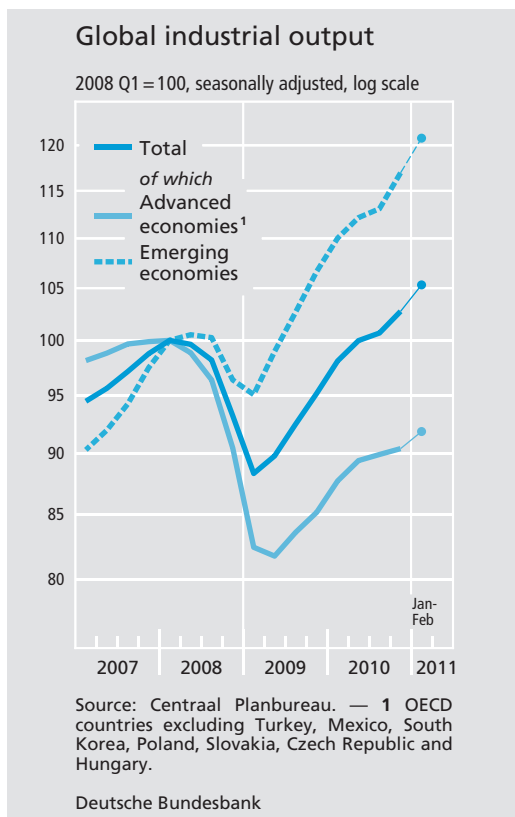
World economic activity

The world economy got off to a dynamic start in 2011, having already recovered from the dip of the second and third quarters of last year by the end of 2010. The emerging market economies remained the primary drivers of growth. Global industrial output saw an exceptionally sharp rise in January-February, increasing by a seasonally adjusted 2½% on the fourth quarter of 2010. The global purchasing managers index for services also rose significantly in the first two months of the year. The rapid pace of global growth at the beginning of 2011 is all the more remarkable given that, even before the natural disaster in Japan, several factors *per se* were weighing on worldwide growth. These notably include the political unrest in North Africa and the Middle East, which significantly aggravated already high demand-driven inflation in crude oil prices. Furthermore, the severe floods in Australia not only caused harvest losses, they also disrupted exports of metal ores and coal.

World economy off to buoyant start in 2011 ...

Global purchasing managers indices for manufacturing and services suggest, however, that the world economy shifted down a gear in March-April. This was probably due, first, to the perceptible loss of consumer purchasing power as a result of considerably higher energy and food prices. The threat of second-round effects led many central banks, particularly in the emerging economies, to raise interest rates. Second, the earthquake and tsunami in Japan and the major incidents they caused at nuclear power stations also played a role. The large number of fatalities

... but slower pace in early spring



and the long-term effects of releasing radioactive material into the environment make these events, first and foremost, a human tragedy, with the economic fallout piling in comparison. Nonetheless, the economic implications are considerable; alongside the destruction of real assets, reduced production – which is discussed in more detail below – is especially important in this regard. As things stand, however, the negative economic repercussions for the rest of the world are universally thought to be minor. This is chiefly because the Japanese economy is comparatively closed and because those Japanese enterprises that are involved in international supply chains are remarkably flexible. This flexibility is the main reason why the widely feared bottlenecks in intermediate electronic goods have not materialised to date. Further-

more, catch-up effects in production and the expansionary impact of reconstruction are likely to strengthen as early as the second half of the year.

Excluding Japan, which had not yet released current national accounts data when this report went to press, real gross domestic product (GDP) in the industrial countries grew at a seasonally adjusted quarter-on-quarter rate of ½% in the first quarter of 2011 – around the same pace as in the previous quarter. This is based on initial estimates made using provisional data for the United States, the United Kingdom and the euro area. While growth in the euro area and the United Kingdom picked up considerably after their fourth-quarter results had been dampened by severe winter weather, growth in the US economy was more subdued.

Still perceptible GDP growth in industrial countries excluding Japan

The strong momentum in the world economy was a key factor in the high inflation on the commodity markets. However, this inflation eased significantly towards the end of the period, first for non-energy commodities and later for crude oil, too. World market prices for food, beverages and tobacco rose again considerably in the course of January but stagnated in February and March. Prices for industrial raw materials were likewise only slightly higher at the close of the quarter than at the end of January. Owing to the political unrest in some oil-producing countries in North Africa and the Middle East, prices for crude oil rose incrementally from US\$93½ in the last week of December to US\$117 at the end of March, with the events in Japan having only a brief dampening effect. This

High inflation on commodity markets

increase continued in April. After falling sharply in early May, however, oil prices had returned to their end-March level at last report. Forward prices initially kept pace with rising spot prices at the beginning of the year. Nonetheless, when concerns about the crisis-stricken Arab countries amplified the rise in oil prices, futures market prices came down significantly, signalling a future decline in spot prices.

Ongoing deterioration in price climate

The sharp rise in energy and food prices at the turn of the year had a perceptible impact on consumer price indices. The emerging economies were particularly hard hit. In recent months, many central banks in Asia and Latin America, including China, India and Brazil, have further tightened their monetary policy to avert the threat of second-round effects. In the industrial countries, too, prices continued to rise significantly in the first quarter of 2011. After seasonal adjustment, they saw a renewed increase of 1% on the period, and the year-on-year rate rose from +1.7% to +2.1%. The core rate (excluding energy and food) reached 1.2%, having stood at 0.9% in the fourth quarter.

New IMF World Economic Outlook: inflation forecast raised again

In its April World Economic Outlook (WEO), the IMF responded to the substantial rise in global inflation with a further upward revision of its January inflation forecast – particularly for 2011. The figure was raised by 0.6 percentage point to 2.2% for the advanced economies and by 0.9 percentage point to 6.9% for the emerging and developing economies. However, the forecast for world GDP growth (+4.4%) was left unchanged; the moderate downward revisions for Japan and

the United States were offset by higher growth forecasts for several other countries, including Germany. The IMF's projection for growth in world trade (+7.4%) is now noticeably more favourable than at the beginning of the year.

Emerging economies

China's aggregate output was up by 9¾% on the year in the first quarter of 2011. According to the first seasonally adjusted figures ever to be released by China's National Bureau of Statistics, quarter-on-quarter real GDP growth stood at 2%, compared with +2½% previously. This continuing high pace was probably due, not least, to the ongoing buoyancy of exports; nominal exports (in US dollar terms) were up by no less than one-quarter on the year. In value terms, imports rose by as much as one-third. This reflects both the clear increase in import prices for commodities and strong domestic demand, which represents the second pillar of China's economic growth. The upward trend in car sales has levelled off considerably in recent months, however. This is because, first, a tax concession for the purchase of small cars expired at the beginning of the year. Second, the city authorities in Beijing have imposed a ceiling on the number of new registrations so as to alleviate traffic congestion and heavy smog.¹

Strong growth continuing in China ...

¹ Although motor vehicle imports, a large part of which come from Germany, have held up relatively well, it seems likely that they, too, will see a moderation in their previously exceptionally strong growth.

... but high price pressure indicates possible overheating of economy

Concerns that the Chinese economy could overheat despite the tightening of monetary and lending policy have been reinforced by strong growth and by recent inflation developments. Consumer price inflation rose from 4.6% in December 2010 to 5.3% in April 2011. This was attributable not only to higher food prices but also to non-food inflation, which had reached 2.7% – a high level for China – at last report.

Strong economic expansion in India last year

The Indian economy achieved average GDP growth of 10½% in 2010, thus slightly outpacing China. For the beginning of 2011, the still rather fragmentary picture provided by the indicators suggests that aggregate output has remained on a steep growth path. Nonetheless, the steep rise in consumer prices continued throughout the reporting period despite the Indian central bank's more restrictive monetary policy; the rate of inflation stood at 8.8% in March. Besides food prices, which are still rising substantially despite a good harvest, this was also attributable to higher prices for clothing and energy.

Continuing upturn in Brazil

After the turn of the year, the Brazilian economy remained on the more moderate growth path it had embarked upon in the second half of 2010. Real retail sales in the first quarter point to continuing brisk consumption. The strong growth in imports of consumer goods indicates that imported goods (including, increasingly, those from China) – which have become cheaper in comparison with domestically produced goods owing to the sharp appreciation of the Brazilian real – account for a growing share of household spending. The unemployment rate remained

at a historic low thanks to the favourable economic developments. Given the tightening of the labour market, nominal wages have been increasing at double-digit rates since mid-2010. Consumer price inflation has accelerated in recent months, reaching 6.5% in April. In particular, inflation in services rose significantly, partly because enterprises seem to have been largely able to pass higher wage costs on to consumers.

According to an initial estimate by the Russian Federal State Statistics Service, real GDP in Russia increased by 4% year on year in the first quarter of 2011; the pace of growth was thus marginally below that recorded in the fourth quarter of 2010. The macroeconomic recovery is being bolstered to a large extent by the high oil price, which caused export revenues (as measured in US dollars) to rise by 24% in the first quarter. In addition, the Russian car manufacturing industry, which more than halved its output in the crisis year of 2009, is currently experiencing a substantial boom; car sales climbed by just over 60% year on year in the first four months of 2011. The scrappage scheme for old cars introduced by the Russian government last year is likely to have played a particularly prominent role in this development. At 9.6%, the rate of inflation recorded in April was appreciably higher than at the end of 2010. Food inflation is still especially strong.

Russian economy on a solid growth path

United States

In the first quarter of 2011, the US economy was unable to match the previous quarter's strong growth owing, among other things, to

US economy unable to match pace of previous quarter in Q1

special factors. According to the initial estimate, real GDP rose by a seasonally adjusted ½% on the quarter, having increased by ¾% a period earlier. The weaker macroeconomic growth was partly attributable to a lull in households' previously brisk consumption. While US consumers had upped their expenditure by 1% in the fourth quarter of 2010, the first-quarter rate was more moderate, at +¾%. However, this was not caused by an unfavourable development in disposable income, which actually saw a nominal quarter-on-quarter increase of 1¾% in the first quarter as a result of the ongoing labour market recovery and lower social security contributions.² Instead, the slower pace of growth in real private consumption was probably largely due to the erosion of consumer purchasing power by sharply higher energy and food prices. After seasonal adjustment, the consumer price index was up by just over 1¼% on the period in the first quarter of 2011. Even excluding energy and food, however, seasonally adjusted inflation came to just under ½%. The corresponding year-on-year rates rose from 1.3% to 2.1% and from 0.7% to 1.1% respectively in the same period. Furthermore, the moderation in growth recorded in the winter was connected with the fall of just over 1¼% in public sector demand. Above all, it was spending on defence goods – which is generally fairly volatile – that fell. Moreover, the beginning of the year saw declining activity in both housing construction and industrial and commercial construction.

While households' strong appetite for consumption had caught enterprises off-guard

in the fourth quarter of 2010 and almost brought inventory building to a standstill, weaker-than-expected first-quarter private consumption could explain the significant rise in the level of inventories. This resulted in a contribution of ¼ percentage point to growth. By contrast, foreign trade no longer had any notable effect on GDP. Although the momentum of exports decelerated somewhat compared with the previous quarter, the rise in imports was even more moderate.

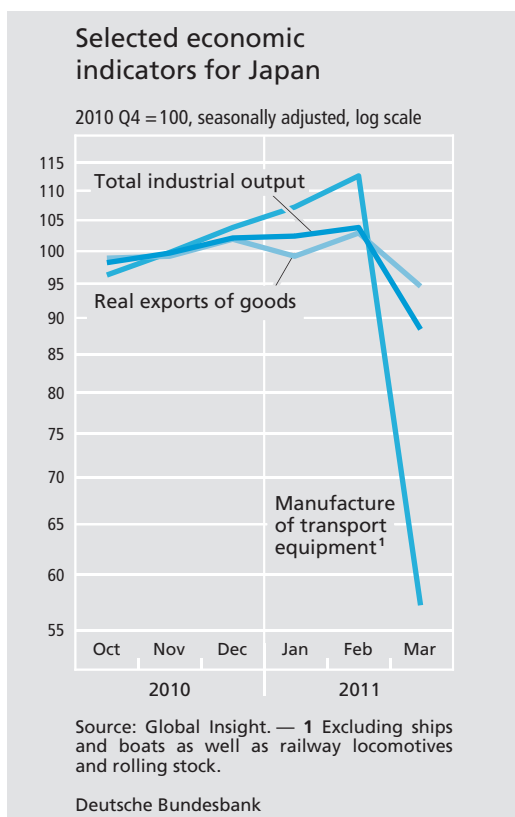
Japan

Following a brief pause in the fourth quarter of 2010, the economic recovery in Japan had been accelerating perceptibly in the first two months of 2011 when the country was hit by the Tohoku earthquake and the ensuing tsunami on 11 March. Industrial output and real exports of goods had gathered significant momentum at the beginning of the year, and the labour market recovery had strengthened markedly, too. The impact of the natural disaster on first-quarter GDP is therefore likely to have been relatively limited (no official data were yet available as this report went to press). On a quarterly average, both industrial output (-1¾%) and real exports (-1%) declined fairly moderately on the quarter. However, industrial output (-15%) and the volume of goods exports (-8%) slumped in March. All in all, the adverse effects of the earthquake and tsunami on economic output are likely to be much stronger in the second quarter.

Perceptible build-up of inventories but neutral contribution to growth from foreign trade

Tohoku earthquake hits the Japanese economy in a phase of recovery

² The December 2010 tax relief package introduced a one-year cut of 2 percentage points in employees' contributions to social security starting on 1 January 2011.



Slump in output due, among other things, to bottlenecks in electricity generation and intermediate goods

The substantial fall in output was attributable not only to the destruction wreaked upon infrastructure in the areas directly hit by the disaster but also to electricity outages and interrupted supply chains that also affected some parts of the country that had not directly suffered the devastation of the earthquake and tsunami. By the end of April, the energy company Tepco was able to restore around half of the capacity for electricity generation that had been temporarily shut down. Even so, Japan may face electricity shortages again in the summer months, when energy consumption reaches its seasonal peak. Nonetheless, the country may already see strong macroeconomic growth in the third quarter of 2011, as reconstruction activities increase.

United Kingdom

According to the first preliminary estimate, seasonally adjusted growth in real GDP, at ½%, just about offset the weather-related decline in the fourth quarter of 2010. The absence of a clearer expansion is primarily due to the fact that construction output did not experience a countermovement once weather conditions had returned to normal. In fact, the downward trend in construction output, at -4¾%, was more pronounced than in the previous quarter, which saw a decline of 2¼%. By contrast, the financial sector and business-related services posted an increase of 1% in their value added, the sharpest since the summer of 2007, and this substantially bolstered macroeconomic growth from the output side. While this, too, was probably partly due to catch-up effects after the severe winter weather in December brought much of public life to a standstill, it still more than offset the previous quarter's decrease. Manufacturing continued its steady recovery, although since the cyclical trough in the summer of 2009 it had still only recouped just under half of its decline in output. The labour market, too, is still a long way off its pre-crisis situation. The unemployment rate, which had increased by just under 3 percentage points to 8% between the beginning of 2008 and its cyclical peak in February 2010, stood at 7.7% in January 2011. Owing to the VAT hike at the beginning of the year and the sharp rise in energy and food prices, headline inflation in the winter months was up by just over 1½% on the quarter after seasonal adjustment. The annual rate increased from 3.4% to 4.2% – again clearly above the infla-

UK economy back on growth track

tion target of 2%. The rate excluding energy and food was 3.4%.

New EU member states

Recovery in EU 7 progressing well

In the new EU countries (EU 7)³ as a whole, the cyclical upturn continued to progress well in the first quarter of 2011. In the Czech Republic, real GDP expanded by a seasonally adjusted ½% on the previous period, when growth was only half as high. The Hungarian economy increased its output by ¾%, compared with ½% previously. In Poland, too, economic output is likely to have risen significantly (GDP figures are not yet available); the quarter-on-quarter rise in industrial output stood at 2% in the first quarter. In the EU 7, consumer price inflation, as measured by the Harmonised Index of Consumer Prices (HICP), was 4.3% on average for the first four months of the year – perceptibly above the fourth-quarter figure (3.9%). The rate of inflation is still being buoyed to a large extent by the considerable rise in food and energy prices. Nonetheless, the annual rate rose even without these goods, climbing from 2.7% to 3.0%.

Macroeconomic trends in the euro area

Brisk start to the year but still major growth disparities within euro area

The cyclical upturn in the euro area⁴ accelerated considerably in the first quarter, having been dampened, above all, by the onset of severe winter weather in the final quarter of 2010. After seasonal adjustment, quarter-on-quarter real GDP growth, at ¾%, was more than twice as strong as before; year-on-year growth stood at 2½%. The underlying cyclic-

al trend is likely to be somewhat more moderate, however, as the figure for the previous quarter was low and at least part of the output that was lost in the autumn was recouped in the first quarter of 2011. The perceptible widening of growth disparities among the euro-area countries must also be viewed in this light. The more northerly member states – which have, in any case, experienced significantly more positive economic developments than the south of the euro area since the recovery began in mid-2009 – accounted for the bulk of the weather-related increase in output.

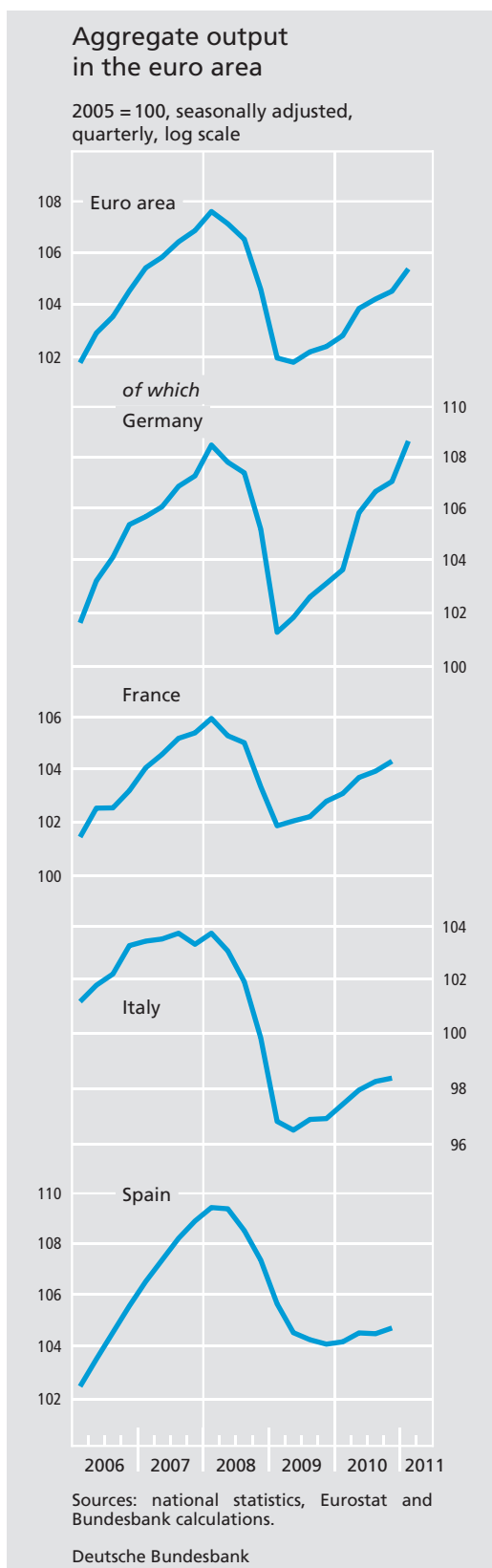
Of the 13 euro-area countries that have already released data on GDP growth in the first quarter, Estonia (+2%) and Germany (+1½%) recorded the best results after seasonal adjustment, followed by Belgium, France, the Netherlands and Austria, which all posted growth of 1%. Of the peripheral countries, Portugal again saw its real GDP decline, whereas Spain posted an increase. Although Greece also reported a rise in real GDP, this result is not very robust owing to changes in the statistical methodology used. No first-quarter data is yet available for Ireland.

In the first quarter of 2011, aggregate output in the euro area was still 2% below its pre-crisis level. This gap is unlikely to be closed until 2012. The latest forecasts from international institutions predict growth of 1½% to 2% for 2011. All of these forecasts assume

Pre-crisis level unlikely to be matched until 2012

³ This group comprises the non-euro-area countries that joined the European Union in 2004 and 2007.

⁴ Estonia joined the euro area on 1 January 2011.



that the events in Japan will have no noteworthy economic impact on the euro area, and this appears highly plausible as things stand. The negative impact of the military conflict in Libya on overall euro-area growth is also likely to be negligible even though the significant trade between some southern European countries and Libya has virtually come to a halt.

The livelier macroeconomic growth in the winter months is largely attributable to the production sector. In the first quarter, construction output was up by a seasonally adjusted 1% on the period owing to the aforementioned weather-related shifts. This was the first time that construction output had grown since the second quarter of 2010, when weather-related catch-up effects had likewise played a role. Construction activity in the euro area has fallen by around one-quarter since its cyclical peak at the end of 2006 because of the marked process of adjustment in some member states that had experienced extreme developments on their real estate markets in the run-up to the crisis. Industrial output rose by a seasonally adjusted 1% on the quarter in the first quarter of 2011. The production of intermediate goods rose particularly sharply in the reporting period (+3%). Output of capital goods and durable consumer goods climbed by 1½% and 1¼% respectively, whereas the figure for non-durable goods was virtually unchanged from the fourth quarter of 2010. Energy production fell significantly (-2%) owing primarily to the weather. Given the noticeable expansion in industrial output, capacity utilisation in the manufacturing sector in April

Strong stimuli from the production sector

almost returned to its long-term average for the first time since October 2008.

Leading indicators suggest that the upward trend in industry is likely to continue in the near future. After seasonal adjustment, new orders in January-February were 4% above the average of the previous three months. Excluding the manufacture of other transport equipment, for which orders tend to fluctuate widely month on month because of large orders, they increased by as much as 5%. However, euro-area industrial activity seems to have become somewhat more subdued towards the end of the period. The European Commission's industrial confidence indicator, for instance, fell slightly in April, although it remained fairly close to the cyclical peak recorded in 2007.

High export growth, lively investment activity but subdued consumer demand

In the first two months of the year, one of the main driving forces on the demand side were extra-euro-area exports of goods, which expanded by a seasonally adjusted 6¼% in value terms compared with the fourth quarter, thus rising back above the pre-crisis level for the first time. Growth in the value of imports, at 7¾%, was even stronger in the reporting period owing, not least, to the sharp increase in prices on the commodity markets. In real terms, exports are again likely to have outpaced imports. Final domestic demand probably also made a positive contribution to growth in the first few months of the year. Both the rise in the production of machinery and equipment and the strong growth in construction output indicate a perceptible increase in gross fixed capital formation. By contrast, real retail sales

remained at their fourth-quarter level in the first quarter of 2011. Moreover, the number of new motor vehicle registrations climbed much more moderately, which is consistent with the fact that, according to the European Commission's survey, consumer confidence has not improved since the end of 2010. This is likely to be due, first, to the appreciable loss of purchasing power resulting from the sharp rise in energy and food prices. Second, the events in Japan are likely to have depressed sentiment.

In the fourth quarter of 2010 and the first quarter of 2011, the economic recovery in the euro area spread to the labour market. In the final quarter of 2010 – the latest period for which data are available – there was a year-on-year increase (¼%) in the number of employed persons for the first time in two years. While employment increased sharply in the higher-growth countries, particularly Germany, most peripheral countries witnessed a sustained fall in employment. Euro-area unemployment appears to have passed its cyclical peak at the beginning of the fourth quarter of 2010; the seasonally adjusted figure fell by 350,000 to 15.6 million by March. The rate of unemployment has been slightly below the 10% mark (9.9%) again since February. However, the euro-area average still masks very large differences between individual countries, with rates ranging from 4.2% in the Netherlands to 20.7% in Spain. Youth unemployment rates vary even more widely; only the Netherlands and Germany have single-digit figures.

First signs of easing on labour market

Fiscal developments in the euro area

Despite lower general government deficits, debt ratio still expected to rise perceptibly

At the end of April 2011, Eurostat published the general government deficits and debt levels of the EU member states as part of the European budgetary surveillance procedure. Apparently, the euro-area deficit fell slightly last year, having previously reached the highest figure recorded since European monetary union was established (from 6.3% to 6.0% of gross domestic product (GDP)). Cyclical developments were a slight mitigating factor, and the phasing-out of measures to support the economy as well as the application of consolidation measures also reduced the deficit somewhat, while the transfer of capital in connection with financial market support measures increased. The debt ratio continued to rise sharply, from 79.3% to 85.1%. The high deficits and deficit-debt adjustments (processes that are neutral in terms of their impact on the deficit but increase debt levels), such as government recapitalisations of banks and the assumption of risky assets by government resolution agencies, were the key factors here.¹

In its spring forecast, the European Commission expects the euro-area deficit to drop clearly to 4.3% of GDP in 2011. This is only partially due to cyclical factors, instead largely reflecting a structural improvement, particularly on the expenditure side.² The Commission is forecasting a similar picture for the further reduction in the deficit to 3.5% of GDP for 2012. In this context, debt-servicing costs, which are rising sharply at the current end, predominantly due to rapidly growing government debt, will also be driven increasingly by the assumption of higher interest rates.

According to the Commission forecast, overall government debt in the euro area will rise by around 3 percentage points to 88½% of GDP between the end of 2010 and the end of 2012, largely as a result of stubbornly high deficits.

Most countries are still in breach – often considerably – of the reference values for deficit and debt ratios

Looking at the euro-area aggregate masks significant disparities between the individual countries. The Commission estimates that 5 of the 17 euro-area countries (Estonia, Luxembourg, Finland, Germany and Malta) will comply with the 3% deficit limit this year. Ireland will record the highest deficit ratio at 10½%, followed by Greece with just under 9½%. Figures of around 6% are forecast for Spain, Portugal, France and Slovenia. Moreover, the debt ratios in four countries that also have high deficits will exceed 100% (Greece, Italy, Ireland and Portugal). However, in Belgium, France and Germany, too, debt relative to GDP is a very long way off the reference value.

All of the euro-area member states apart from Estonia and Luxembourg are currently subject to an excessive deficit procedure. The Commission forecast highlights the danger that numerous countries will not meet the European agreements and requirements

¹ Guarantees and support measures similar to guarantees that were also deployed in the context of the financial crisis are generally not reflected in the figures if they have not (yet) been taken up. According to Eurostat, risky contingent liabilities, which in 2010 had no im-

posed on either the deficit or debt levels, equate to 6½% of GDP in the euro area. — ² Moreover, financial market support measures in Ireland, which had increased the Irish deficit ratio by 20 percentage points in 2010, will no longer be a factor. Looking at the euro area,

laid down as part of the deficit procedures. In order both to achieve the minimum budgetary adjustment requirement (defined as an average annual improvement in the structural balance) and to comply with the deficit correction deadline, additional consolidation efforts over and above the measures detailed to date are frequently required.

Without additional measures, the Commission expects the debt ratios in all of the euro-area countries except for Germany, Italy and Malta to rise by the end of 2012. Particularly sharp increases in the debt ratios compared with 2010 are projected for Ireland and Greece (more than 20 percentage points), and Portugal and Spain will also experience large increases (14 percentage points and 11 percentage points respectively). By far the highest debt ratio is reported for Greece, at 166%. The ratios are almost 120% in Italy and Ireland. In 2012, only Estonia, Luxembourg, Slovakia, Slovenia and Finland are likely to comply with the 60% reference value for the debt ratio.

Situation particularly difficult in Greece, Portugal and Ireland

Although Greece made considerable progress in achieving a deficit ratio of 10.5% in 2010 (4.9 percentage points), it still clearly missed the target of 8.1% agreed when the programme was established; the figure was also higher than expected at the end of 2010 (9.4%). The main reason for this is likely to have been a base effect from a renewed upwards revision of the budgetary deficit for 2009, but principally also the fact that the agreed consolidation targets were missed. By contrast, overall economic growth in nominal terms was no worse than projected when the programme was drawn up. For the current year, the Commission in its spring forecast expects a deficit ratio of 9.5% if no additional measures are taken, meaning that the 7.5% target agreed for 2011 would also be missed by a significant margin.

By granting loans and reducing the interest rate payable on them – which is itself problematic, not least given the moral hazard this entails – Greece's European partners have provided enormous *ex ante* assistance. The assistance commitments are therefore rightly subject to strict conditionality. The Greek government must therefore return to the deficit reduction path laid down in the adjustment programme this year, resorting – as agreed – to additional readjustment measures if need be. Any watering down of the targets would call into further doubt both the sustainability of Greece's debt and the credibility of future European agreements. It is now up to Greece to press ahead with comprehensive and timely consolidation as well as economic reforms. This will undoubtedly involve considerable difficulties and hardship. It is, however, ultimately unavoidable in order to restore sustainable public finances and as a precondition for assistance payments, without which the adjustment path would be considerably more daunting. In order to bolster confidence in sound public finances in the individual euro-area member states going forward, it is vital to strengthen the incentives for nations to solve their fiscal problems on their own responsibility and to

pact on either the deficit or debt levels, equate to 6½% of GDP in the euro area. — ² Moreover, financial market support measures in Ireland, which had increased the Irish deficit ratio by 20 percentage points in 2010, will no longer be a factor. Looking at the euro area,

ensure that shifting the burden onto third parties is not seen as a viable option.

Faced with an impending loss of confidence in the financial markets, Portugal had announced in May 2010 that it would accelerate the originally planned reduction of the deficit. Owing mainly to statistical revisions (in particular the reclassification of economic units to the general government sector) and capital transfers to support the financial sector, the country missed the budget target for 2010 by a significant margin – although it would only have been achieved with the help of a large-scale one-off measure anyway.³ After a consolidation programme that had been agreed in March 2011 as part of the European Council package to solve the debt crisis failed to pass parliament, elections had been called for June and it had become apparent that, without support measures, Portugal had no recourse to wholesale funding at conditions considered sustainable, Portugal applied for financial help in April 2011. On 16 May 2011, the euro-area finance ministers agreed a comprehensive assistance programme. Under this programme, Portugal will receive €78 billion worth of financial support for three years, funded in equal parts by the IMF, the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). This is intended, in particular, to cover funding requirements and ongoing deficits, while €12 billion are earmarked to stabilise the banking sector. The adjustment programme, which was

agreed jointly with the major Portuguese opposition parties, includes structural reforms to improve competitiveness, measures to stabilise the financial sector, plans to bring forward privatisations and numerous fiscal measures. However, it does not aim to return to the deficit reduction path announced in May 2010, and the reference value of 3% for the deficit ratio will not be met until 2013.⁴

The fiscal adjustment programme is largely based on the consolidation plan presented in March 2011. The fiscal objectives that have now been agreed are less ambitious than the previous deficit reduction path, also taking into account the statistical revisions for 2010 and the more muted macroeconomic outlook, and should be easier to achieve. Given the precarious budgetary situation, the failure to tackle structural issues in the past and the particular conditions of the support programme, strict compliance with the rules is imperative.

In Ireland, the new government is sticking to the agreed objective of bringing the deficit ratio back below the 3% ceiling by 2015. The necessary measures have, however, been fully approved only for the current year. Other areas still need to be detailed in the budget plans for the next few years. Weaker economic growth could jeopardise the fiscal plans. Further potential costs in connection with the restructuring of the Irish banking sector pose an even greater risk, however.

Forecast and plans for the public finances of the euro-area countries

Country	European Commission spring 2011 forecast								Stability programmes, ⁵ April 2011			Deadline to correct excessive deficit
	Budget balance as a percentage of GDP				Government debt as a percentage of GDP				Budget balance as a percentage of GDP			
	2009	2010	2011	2012	2009	2010	2011	2012	2011	2012	2013	
Austria	- 4.1	- 4.6	- 3.7	- 3.3	69.6	72.3	73.8	75.4	- 3.9	- 3.3	- 2.9	2013
Belgium	- 5.9	- 4.1	- 3.7	- 4.2	96.2	96.8	97.0	97.5	- 3.6	- 2.8	- 1.8	2012
Cyprus	- 6.0	- 5.3	- 5.1	- 4.9	58.0	60.8	62.3	64.3	- 4.0	- 2.6	- 2.0	2012
Estonia	- 1.7	0.1	- 0.6	- 2.4	7.2	6.6	6.1	6.9	- 0.4	- 2.1	0.1	-
Finland	- 2.6	- 2.5	- 1.0	- 0.7	43.8	48.4	50.6	52.2	- 0.9	- 0.7	- 0.9	2011
France	- 7.5	- 7.0	- 5.8	- 5.3	78.3	81.7	84.7	86.8	- 5.7	- 4.6	- 3.0	2013
Germany	- 3.0	- 3.3	- 2.0	- 1.2	73.5	83.2	82.4	81.1	- 2½	- 1½	- 1.0	2013
Greece	- 15.4	- 10.5	- 9.5	- 9.3	127.1	142.8	157.7	166.1	- 7.6	- 6.5	- 4.8	2014
Ireland	- 14.3	- 32.4	- 10.5	- 8.8	65.6	96.2	112.0	117.9	- 10.0	- 8.6	- 7.2	2015
Italy	- 5.4	- 4.6	- 4.0	- 3.2	116.1	119.0	120.3	119.8	- 3.9	- 2.7	- 1.5	2012
Luxembourg	- 0.9	- 1.7	- 1.0	- 1.1	14.6	18.4	17.2	19.0	- 1.0	- 1.5	- 1.2	-
Malta	- 3.7	- 3.6	- 3.0	- 3.0	67.6	68.0	68.0	67.9	- 2.8	- 2.1	- 1.6	2011
Netherlands	- 5.5	- 5.4	- 3.7	- 2.3	60.8	62.7	63.9	64.0	- 3.7	- 2.2	- 1.8	2013
Portugal	- 10.1	- 9.1	- 5.9	- 4.5	83.0	93.0	101.7	107.4	- 5.9	- 4.5	- 3.0	2013
Slovakia	- 8.0	- 7.9	- 5.1	- 4.6	35.4	41.0	44.8	46.8	- 4.9	- 3.8	- 2.9	2013
Slovenia	- 6.0	- 5.6	- 5.8	- 5.0	35.2	38.0	42.8	46.0	- 5.5	- 3.9	- 2.9	2013
Spain	- 11.1	- 9.2	- 6.3	- 5.3	53.3	60.1	68.1	71.0	- 6.0	- 4.4	- 3.0	2013
Euro area	- 6.3	- 6.0	- 4.3	- 3.5	79.3	85.4	87.7	88.5	.	.	.	-

Source: European Commission, spring 2011 forecast.

this equates to 0.3% of GDP. — 3 The effect of the reclassification is likely to continue to affect the deficit into the current year at around ½% of GDP. — 4 Based on a deficit of 9.1% of GDP last year, the following figures are now projected (budgetary targets of May 2010

in brackets): 5.9% (4.6%) in 2011, 4.5% (3.0%) in 2012 and 3.0% (2.0%) in 2013. Real GDP is expected to decline by around 2% in both 2011 and 2012 and to rise by 1.2% in 2013. — 5 For Greece and Portugal, adjustment programme targets.



Inflation clearly above 2%

Consumer price inflation in the euro area has accelerated considerably of late. In the first four months of 2011, consumer prices rose by no less than 1½% after seasonal adjustment, and year-on-year HICP inflation increased from 2.2% in December to 2.8% in April. This was mainly due to the steep rise in

crude oil prices on the world markets, which led to sharp appreciation in consumer prices for energy. Food prices have likewise climbed significantly in the past few months, driven by global developments. The rate of inflation for services broke away from its cyclical low but remained below the rates recorded immediately before the crisis despite some countries having substantially increased their VAT rates. This reflects, among other things, the impact of the wage moderation caused by high unemployment in the euro area. For goods excluding energy and food, sharp price rises in the upstream stages of the economy have not yet fed through to a discernible increase in price inflation. However, the change in the statistical treatment of seasonal goods introduced at the beginning of 2011 has increased the volatility of this time series and hampered year-on-year comparisons. This makes promptly estimating the price trend considerably more difficult. In view of the disruptive factors still affecting crude oil markets and the robust global economic activity, year-on-year HICP inflation is unlikely to fall below 2% in the near term.