Global and European setting

World economic activity

Global economic activity rebounded

The global economy regained momentum in the fourth quarter of 2010 after slowing perceptibly in the preceding two quarters. Industrial output in October-November saw quite strong growth, of 1% after seasonal adjustment, compared with the summer quarter. According to the global purchasing manager indices, services have recently also been providing a stronger boost. The acceleration of growth in some emerging market economies is the primary reason for the increased dynamism of expansion. According to estimates based on preliminary figures for the major economies and the euro area, growth in real gross domestic product (GDP) among the advanced economies, at just under +½% after seasonal adjustment, was somewhat slower in the last quarter of 2010 than in the summer. The total output of this group of countries rose by 2½% on average for 2010 as a whole. Among the industrial countries, the United States has recently reassumed its status as the spearhead of economic growth. US real GDP grew much more dynamically than in the two preceding quarters, also surpassing, for the first time, its cyclical peak of end-2007. Canada was the only G7 country that returned to its pre-crisis level more quickly. Euro-area growth remained moderate in the autumn. By contrast, aggregate output in the United Kingdom and Japan was down on the previous period.

Brisk growth of economic activity early in the year

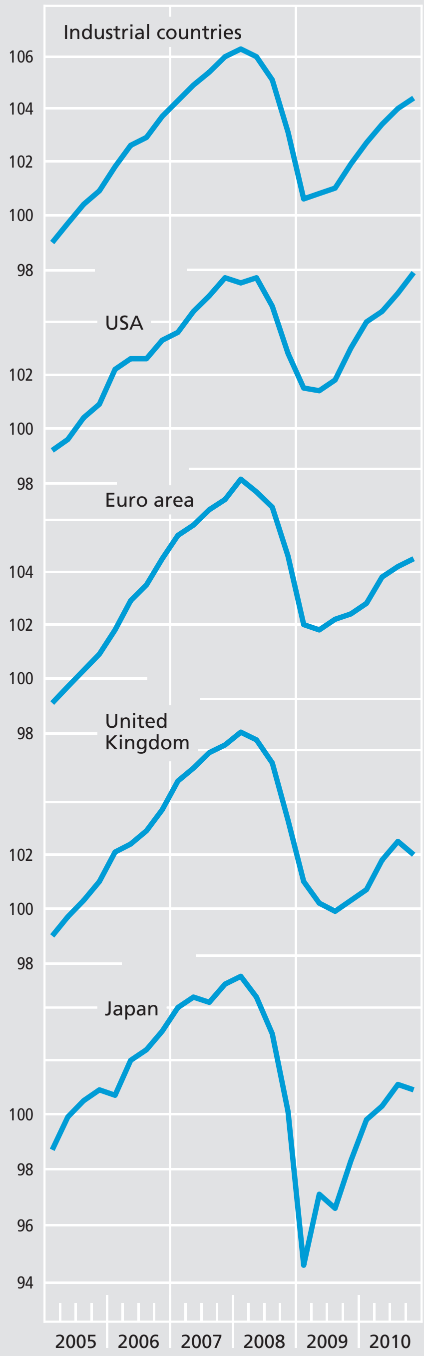
After the turn of 2010-11, the pace of global economic growth seems to have remained elevated or even accelerated slightly. For instance, the global purchasing manager indices rose perceptibly again in January. The Bundesbank's leading indicator for the global economy is likewise clearly pointing upwards again after dipping noticeably in the 2010 Q2-Q3 period.

Prices of crude oil and other commodities up considerably

The favourable global economic developments are, however, currently being accompanied by higher energy and food inflation. The price per barrel of Brent crude oil picked up from US\$80 in the last week of September to US\$92½ at the end of December. This was attributable not only to the perceptible increase in demand from the emerging market economies but also to the extremely inclement winter weather in Europe and North America, which caused inventories to shrink perceptibly. On average over the final quarter of 2010, crude oil prices were up 15½% on the year; denominated in euro, they increased by as much as one-quarter owing to the euro's depreciation. Crude oil prices maintained their steep ascent after the turn of 2010-11 and, at the end of January, surpassed the US\$100 mark for the first time since September 2008. This was due mainly to political unrest in Egypt, which, for one thing, caused concern on the markets that oil transportation via the Suez Canal might be interrupted. For another, there are fears that the crisis could spill over to the oil-producing countries in the Middle East. Not only spot prices but also forward prices rose sharply. World market prices for food, beverages and tobacco went up by 29% from the end of September to mid-February, especially owing to the impact of inclement weather. In the past few weeks, however, increased inventory purchases by North African countries

Aggregate output in industrial countries*

2005 = 100, seasonally adjusted, quarterly, log scale



Sources: national statistics, Eurostat and Bundesbank calculations. — * The United States, the euro area, the United Kingdom and Japan.

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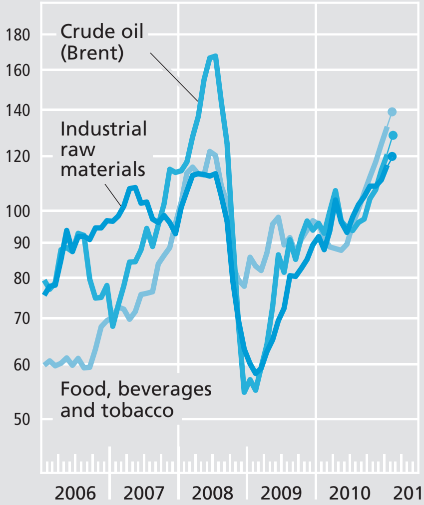
World market prices for crude oil and industrial raw materials as well as food, beverages and tobacco

US dollar basis, 2010 = 100, log scale



Sources: Thomson Reuters and HWWI. — • = 11 February 2011; 16 February for crude oil.

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have also been playing a role. Industrial raw materials prices likewise trended upwards, albeit not quite as sharply (+9¼%). Overall, in mid-February the HWWI non-energy commodity price index, in US dollar terms, was well above its July 2008 peak.

Deterioration in price climate

In the advanced economies, it was particularly energy price hikes which impacted on the consumer price index, whereas consumers in the emerging market economies (EMEs) were hit chiefly by higher food prices. In the light of these developments, monetary policymakers in countries such as China and India have tightened the reins in the past few months, with further moves likely to follow. In the major industrial countries, however, where inflation expectations – with the exception of the United Kingdom – remained quite low throughout the reporting period, policymakers continued to pursue a very expansionary policy. In this group of countries, after the elimination of seasonal effects, consumer prices were up in the autumn by 1.1% on the period; year-on-year inflation grew from +1.3% in September to +1.8% in December. Excluding energy and food, the rate of inflation in December, at 1.0%, was a mere 0.2 percentage point above its September level. The industrial countries as a whole are not currently facing any immediate threat of inflation on the domestic front.

Renewed upward revision of IMF price and growth forecast

The recent rise in inflation has led the IMF to increase its 2011 inflation forecast by 0.3 percentage point to 1.6% for the advanced economies and by 0.8 percentage point to 6.0% for the developing and emerging world. Corrections have been made for 2012 as well, albeit to a lesser extent. In addition, the October GDP forecast was once again revised upward; the current assessment now shows last year's world economic growth to have been one-quarter percentage point stronger, at 5.0%. The forecast for 2011 has been increased to a similar degree, to 4.4%; the picture remains largely unchanged for 2012. The revision for the past year is, above all, a reflection of unexpectedly strong second-half growth in the United States, Japan and Germany. For 2011, the IMF has revised its projection upward for the United States by no less than ¾ percentage point to 3.0%, with the forecast for Germany increasing slightly to 2.2%. Moreover, the projections for Central and Eastern Europe and for Latin America have been adjusted upwards.

Real world trade grew by 12.0% in 2010 according to the current estimate, and thus by more than ½ percentage point more strongly than had been expected in autumn. The projections for 2011 and 2012 have been increased slightly to 7.1% and 6.8% respectively. The IMF continues to see the downside forecast risks as prevailing, particularly emphasising the threat of financial contagion from euro-area peripheral countries to the core countries in the event of a renewed intensification of the sovereign debt crisis.

Selected emerging market economies

In south and east Asia, particularly China growing strongly, ...

Many south and east Asian EMEs have seen economic activity rebound perceptibly after a more subdued phase in the summer months. As a case in point, real GDP in China, according to seasonal adjustment by the Bundesbank, grew much more strongly than in the summer quarter. The faster pace is probably attributable, in particular, to a significant revival of exports, with domestic demand remaining brisk. China's average economic output for 2010 as a whole was up by 10¼% from 2009. As in previous years, gross capital formation made the greatest contribution to growth. Nominal GDP increased to nearly RMB 40 trillion (which translates to just under US$6 trillion), surpassing Japan's level at market exchange rates for the first time.[1] The trade surplus shrank by 6½% to US$183 billion, particularly on account of higher import prices caused by sharply rising commodity prices. India's economy, which in the summer months saw real GDP grow by 10½% on the year, seems to have slowed down perceptibly in the fourth quarter of the year, with year-on-year growth of industrial output falling from 9% in the third quarter to 5¼%. Surveys show, though, that manufacturing enterprises remain very optimistic about the future.

... but price pressure in this region also higher

In most of the EMEs in the region, the considerable hike in food prices has led to a significant increase in consumer price inflation. China's annual inflation rate rose from 3.6% in September to 4.9% in January. In India, however, it was, at 9.5%, visibly lower at the end of the year than on average over the summer months owing to a base effect.

Solid growth in Latin America

In the major Latin American countries, the economic upturn progressed very quickly in autumn. One contributory factor in Brazil was the robust growth in domestic demand, driven mainly by a continued strong rise in labour income. Whereas the services sector apparently grew perceptibly throughout the reporting period, industrial output has trended downwards slightly since the spring. This is probably connected with the strong appreciation of the Brazilian real. In the final quarter of 2010, the Mexican economy is likely to have registered solid growth as well. However, it received stimuli particularly from manufacturing, in which output increased by 1% over the summer quarter's level. On average for 2010, output in this sector was up by as much as 10%. One of the main contributors was the motor vehicle industry, which increased the number of cars manufactured by

1 Measured on the basis of purchasing power parities, China had already surpassed Japan in 2001 and has since been in second place in the country rankings behind the United States.

50%. In Latin America, too, food prices have picked up sharply in the past few months. However, because the weight of food prices in the Latin American price indices is lower than in the indices of the Asian EMEs, it had a somewhat less pronounced impact on headline inflation rates. In Brazil, year-on-year consumer price inflation escalated from 4.7% in September 2010 to 6.0% in January 2011; over the same period, it grew in Mexico from 3.7% to 3.8%.

Russian economy once again on recovery path after weather-related problems

Real GDP in Russia grew by 4% on average for 2010 according to an initial estimate from Russia's Federal State Statistics Service. This appears to indicate that, in the final quarter of the year, the Russian economy more than made up for the summer output losses caused by the exceptionally hot wealther and the wave of large forest and peat bog fires. The main factor behind this improvement was a perceptible resurgence of investment activity, whereas household consumption, measured in terms of real retail sales, still had barely any positive impact. The noticeable clouding-over of the price climate may have played a major role; accelerating prices for food, owing particularly to the summer's weather-related crop losses, caused inflation to surge to 9.6% in January.

USA

US economy much more buoyant…

In the final quarter of 2010, the US economy's growth rate accelerated perceptibly, leaving behind the Q2-Q3 dip. Seasonally adjusted real GDP rose by ¾% on the quarter according to a preliminary estimate after having risen by ½% a period earlier. Overall economic output thus returned to its cyclical peak of autumn 2007. GDP growth averaged 3% for 2010 as a whole.

… thanks to increased purchases by US consumers

The acceleration of aggregate growth was underpinned by a perceptible increase in purchasing by households. They increased their spending in the fourth quarter by a seasonally adjusted 1%, the highest rise since autumn 2006. Car sales were up by as much as 6½% from the preceding three-month period. The brisk consumption activity has not been reflected by the indicators of consumer confidence because, in the past few years, non-economic factors have been becoming increasingly important even though they do not appear to be having any effect on spending (see box on page 17). The strong household consumption growth in autumn 2010 was due not only to favourable trends in disposable income but also the ½ percentage point decline in the household saving ratio. The reduction in savings should probably be seen against the background of improvements in household wealth. In addition, the continued job market recovery is likely to have allayed US consumers' concerns about the future. Over the course of autumn, non-farm employment grew by 385,000, or an average of 128,000 jobs per month. In January, job growth, at 36,000, was disappointing, not least owing to inclement weather during the survey week. However, the unemployment rate fell by 0.4 percentage point for the second consecutive month, reaching 9.0%, its lowest level since April 2009.

Consumer purchasing power was affected somewhat more severely than before by price

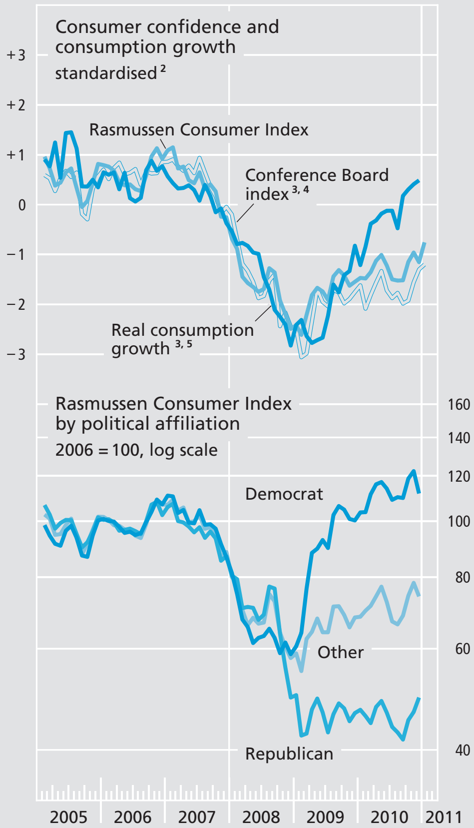
Why private consumption in the United States is growing robustly despite weak confidence

For decades, the Conference Board and the University of Michigan have provided the most commonly used indicators of US consumer sentiment. Until recently, movements in these indices were in close synchrony with growth in households' real consumer spending. Since 2009, however, this has no longer been the case; while private consumption has seen robust growth in the wake of the economic recovery and has recently gathered significant additional momentum, measures of consumer sentiment have remained relatively low.

One possible explanation for this recent divergence is provided by surveys that record certain characteristics of consumers along with their level of confidence. For example, in recent years Rasmussen Reports, an independent media company and public opinion polling firm, has published a consumer index that appears to capture consumer confidence in a similar way to the Conference Board's index but also provides a wealth of additional information. One particularly interesting element is the breakdown of consumer confidence according to respondents' political affiliation. If the indices are based uniformly on one year at the beginning of the reference period, eg 2006, there is little difference in confidence among Democrats, Republicans and those of other political affiliations up to the autumn of 2008. The subsequent escalation of the financial market crisis may have had a comparatively strong impact on Republicans – which might be related, among other things, to the fact that this group holds more financial wealth than other groups. However, what is most noticeable is the sharp divergence among the indices from the beginning of 2009 onwards; while Democrats swiftly and lastingly regained their confidence after President Obama's inauguration, consumer sentiment among Republicans remained subdued, dragging down the overall index. The same kind of effect may also be behind the continuing lack of confidence among small businesses. The movements in one index that is often used to illustrate the strains on small businesses have, at least in the past, been in close synchrony with consumer confidence.[1]

Although the rebasing of the Rasmussen indices according to political affiliation obscures differences in confidence levels which already existed in the preceding years, developments in these sub-indicators since the autumn of 2008 suggest that consumer sentiment can also reflect non-economic factors. Ultimately, however, these factors do not impact on real consumer spending, as the growth in private consumption since mid-2009 demonstrates.

Consumption indicators for the United States



Sources: US Bureau of Economic Analysis, Conference Board, Rasmussen Consumer Index (from 2005 onwards) and Bundesbank calculations.

1 The index referred to here is the "Small Business Optimism Index" of the National Federation of Independent Business (NFIB). — **2** Adjusted for the mean and standard deviation of the period from 2005 to 2008. — **3** Seasonally adjusted. — **4** Data already reflect revisions as a result of changes to the sample from November 2010 onwards. — **5** Year-on-year.

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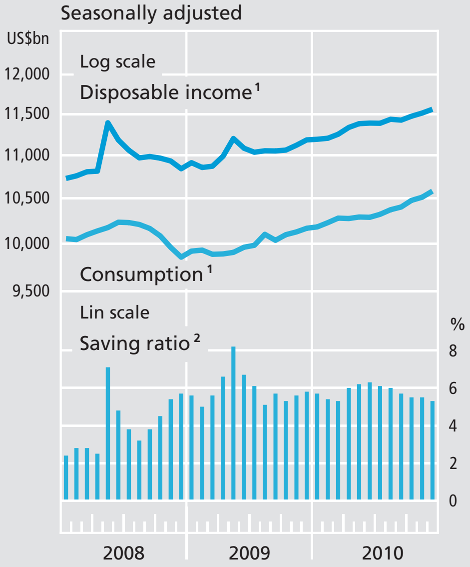
US households' disposable income, consumption and saving ratio

Seasonally adjusted



Source: US Bureau of Economic Analysis. — 1 Annualised. — 2 Saving as a percentage of disposable income.

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developments. The sharp rise in prices in the international commodity markets caused the consumer price index to increase in the final quarter of 2010 by just over ½%, seasonally adjusted, compared to the summer quarter's level. Excluding energy and food, however, inflation continued to fall. The year-on-year rates of the two indices, at 1.3% and 0.7%, were still relatively low in autumn; core inflation was even at its lowest level since the time series was launched in 1958.

Largely positive picture for remaining GDP components

Alongside household consumption, foreign trade provided a strong positive boost to GDP growth. The noticeable reduction in the trade deficit was caused not so much by exports but by a considerable decline in import demand, particularly as a countermovement to the steep rise in the Q2-Q3 period. Private investment in machinery and equipment was more subdued following strong growth in the previous quarters. Private residential investment continued its roller-coaster ride. After hitting a new cyclical low in the third quarter, household spending rebounded slightly in the autumn. At the same time, commercial construction, which lags the cycle, is also showing signs of stabilising. By contrast, inventory investment, following several quarters in which it significantly boosted real GDP, made a negative growth contribution of just under one percentage point. In addition, public sector demand had a slightly dampening impact.

Japan

Lull in growth following rapid recovery

In autumn 2010 the Japanese economy, after growing by a cumulative 5% over the previous four quarters and recouping most of the crisis-related overall output losses, paused to catch its breath. According to the initial estimate, real GDP contracted in the final quarter of 2010 by ¼% on the quarter. With average growth of 4% for 2010 as a whole, Japan tallied the strongest economic growth of all the G7 countries – including Germany. The main reason why growth tailed off towards the end of the year was that, as expected, household consumption fell into a demand hole once the government purchasing incentives expired. In addition, real exports, which had provided a key boost to GDP growth since the beginning of the recovery, trended downwards slightly. In keeping with the disappointing results for total output in the autumn months, the seasonally adjusted unemployment rate held firm at 5.0%, which is relatively high by Japanese standards. Despite strong GDP growth, the unemployment rate fell by a mere 0.2 percentage point on the year. The rate of consumer price inflation entered positive territory for the first time in two years. This was attributable not only to higher prices for energy and food but also to the tax hike on tobacco. The latter also left a dent in core inflation, which nearly halved from -1.5% in the summer to -0.8% in the last quarter of the year.

United Kingdom

UK GDP depressed by bad weather

The United Kingdom's aggregate output was perceptibly depressed in the autumn by bad weather. According to initial calculations, it fell by a seasonally adjusted ½% in the final quarter of the year following strong growth averaging 1% in the two preceding periods. The UK economy grew by 1½% in 2010 as a whole. The severe onset of winter with exceptionally heavy snowfall constrained construction output in December. Moreover, by considerably impairing the transport sector, the weather wrought havoc on much of public life, eating into value added throughout the services sector. According to an estimate by the UK's Office for National Statistics, the poor weather reduced aggregate economic output by ½ percentage point. This means that growth would have ground to a halt even under normal circumstances. Remarkably, the labour market was unaffected by the weather. At all events, the number of applicants for unemployment benefits continued to decline slightly in December. At 7.8% in October and November, the standardised unemployment rate was somewhat higher than in the two preceding months. Inflation picked up perceptibly at the turn of the year, not least as a result of the VAT hike that took effect on 1 January 2011. Consumer prices as measured by the Harmonised Index of Consumer Prices (HICP) were 2.2% higher in January, after seasonal adjustment, than in September 2010. The year-on-year inflation rate expanded to 4.0% as this report went to press.

New EU member states

Continuation of cyclical recovery in the new EU member states

Taken as a whole, the new EU member states (EU-8) maintained their upturn in the fourth quarter of 2010. Whereas growth accelerated significantly in Bulgaria and the Baltic states, seasonally adjusted GDP growth in the Czech Republic and Hungary slowed down. Economic growth in Poland, for which only an estimate of the GDP results for the year is available so far, also appears to have slackened considerably. Cyclical recovery has not yet begun in Romania. Consumer price inflation in the EU-8 as measured by the HICP was, at 3.9%, perceptibly higher in the closing quarter than in the summer (+3.3%). This was due largely to higher prices for energy and unprocessed food. Excluding these components, year-on-year inflation went up by a mere 0.2 percentage point to 2.7%.

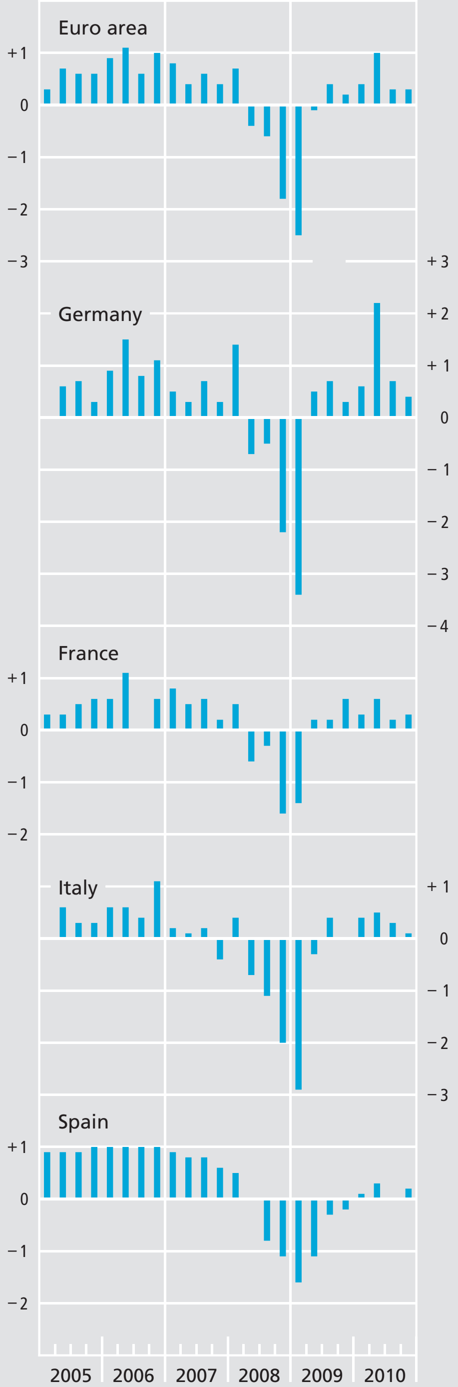
Macroeconomic trends in the euro area

Growth rate unchanged in Q4

Aggregate output in the euro area continued its moderate growth in autumn. According to the Eurostat flash estimate, it was up by a seasonally adjusted ¼% on the period, as in

Growth trends in the euro area

Real GDP, seasonally adjusted, quarter-on-quarter percentage change



Sources: national statistics, Eurostat and the ECB.

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the summer quarter, and was thus 2% higher than in autumn 2009. It grew by 1¾% on average for the year. Since the spring of 2009, when the cycle bottomed out, real euro-area GDP has grown by 2½%, yet has remained markedly below its pre-crisis peak. It is not likely to return to this level until sometime in 2012. Although growth differentials in the euro-area no longer grew in autumn among the 11 countries for which initial GDP estimates are available, they remained very large. Germany continued to grow somewhat faster than the rest of the euro area as a group, the result for which was once again dragged down by the weak performance of Greece, Portugal and Italy. Finland, the Netherlands, Austria and Slovakia fared better.

Industrial activity more buoyant

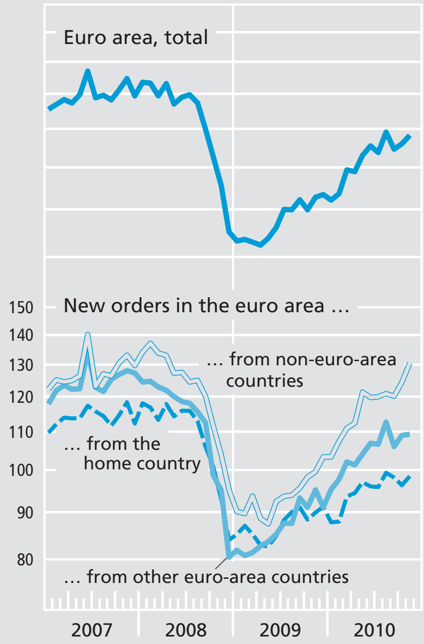
The resurgence of industrial activity, in particular, gave wings to aggregate economic growth in the euro area, whereas construction and transport were a drag on growth owing to the onset of severe winter weather in the more northerly member states. Industrial production picked up in the autumn quarter by 1¾% on the quarter after seasonal adjustment and thus by 7¾% on the year. This was due to a strong increase of 3¼% in the industrial production of capital goods and a perceptible expansion in the manufacture of intermediate goods (+1%) and energy (+2¼%). By contrast, output of non-durable goods was up only slightly (+¼%) compared with the summer months and durables production went down by ¾%. Capacity utilisation in the euro area rose markedly from October to January and was just slightly below its long-run average. Moreover, several leading indicators seem to show that the cyclical recovery continued after the turn of the year. New orders in October-November were up by 1¼% after seasonal adjustment from the summer, with orders from non-euro-area countries even picking up by 5¾%. In addition, the results of the European Commission survey indicate that sentiment in industry has continued to improve in the past few months, especially because the outlook for orders has once again been given a more favourable assessment amidst persistently high output expectations and low pressure on inventories.

Exports and investment in machinery and equipment quite brisk

GDP growth is likely to have received demand-side support in autumn particularly from exports and enterprises' spending on new machinery and equipment. Exports to non-euro-area countries picked up by a seasonally adjusted 2¾%, falling just short of their peak of the winter quarter of 2008. However, imports in the last quarter of the year grew even more strongly, by 5¾% on the period, although admittedly the sharp increases in the prices of energy and other commodities played a role. The euro area is therefore running a trade deficit for the first time since the end of 2008. The strong increase in the manufacture of machinery and equipment is indicative of lively industrial investment activity. Construction output, by contrast, was down by a seasonally adjusted 2¼% from the third quarter, though it was particularly impaired by the onset of winter weather in December. Private consumption, however, is likely to have had a minimal positive impact, if any, on GDP in the fourth quarter. Real retail sales were reported as being

New orders in the euro area

2005 = 100, log scale



Quelle: Eurostat.

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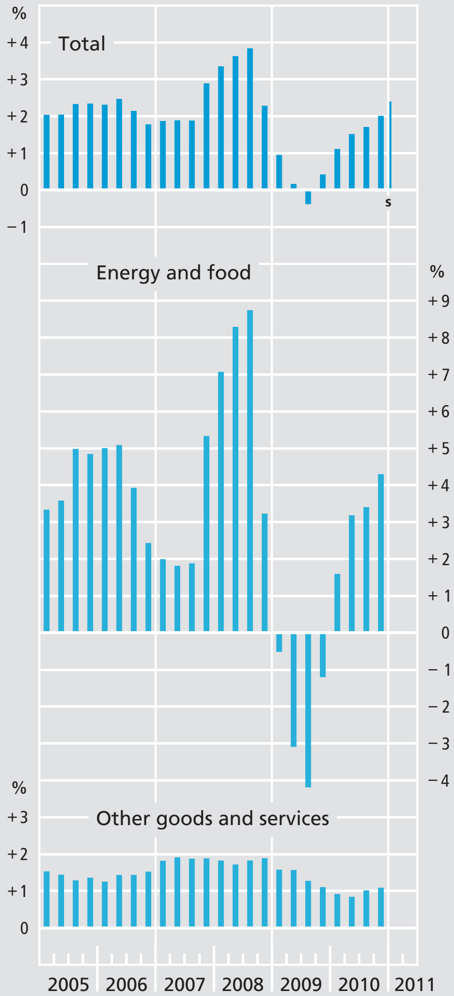
down slightly (-½%) from their average over the summer months. It must be borne in mind, however, that the relevant data for Germany are not very robust. New car registrations during the reporting period were up by 5% from a quarter earlier.

Further slowdown in job losses in summer; unemployment unchanged at high level in Q4

The situation in the euro-area labour market has stabilised further since mid-2010 but not yet improved. In the third quarter – more recent data are not available – employment fell by just a small margin both on the period and also on the year. The number of employed persons was up perceptibly in Germany and slightly in France but continued to trend downwards in the euro-area peripheral countries. The regional development of unemployment shows a similar pattern in reverse. The unemployment rate for the euro area as a

Euro-area consumer prices*

Quarterly, year-on-year change



Source: Eurostat and Bundesbank calculations. — * Harmonised Index of Consumer Prices.

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whole, at a seasonally adjusted 10.0% in the last quarter of the year, remained unchanged at the level of the Q2-Q3 period. Compared to the same period a year earlier, the number of unemployed persons increased by 0.3 million to 15.85 million.

Perceptible pick-up in consumer price inflation

Consumer price inflation in the euro area has accelerated significantly of late. Year-on-year HICP inflation went up from 1.7% in the third quarter of 2010 to 2.0% in the fourth and 2.4% in January. There is much to suggest that HICP will run at 2% or somewhat higher in most of the subsequent months of 2011 as well. The unusually high increases in the prices of energy and food, which themselves are mainly the product of the rise in commodity prices in the global markets caused by the global economic recovery, are a major reason for this. In the final quarter of 2010, these components combined increased by 4.3% year-on-year and, with a weight of just under one-third, contributed 1¼ percentage points to headline HICP inflation. In the years 1999 to 2007, energy and food, given an average annual rate of increase of 3.6%, had contributed an average of just under one percentage point. Core inflation, calculated as HICP less energy and food, and which is quite closely correlated with the change in the GDP deflator (the price component of domestic value added), trended only slightly upwards over the course of 2010. Its year-on-year increase was 1.1% as this report went to press, corresponding to a ¾ percentage point contribution to annual HICP inflation. In the meantime, initial signs have emerged that, particularly in those euro-area countries that are leading the cycle, wage growth and consequently also inflation in services and industrial goods could once again accelerate over the course of the year.