Global and European setting

World economic activity

Global economy much less dynamic in spring

In the second quarter of the year, global growth dynamics diminished noticeably. However, this was due in part to temporary factors which are clearly visible in the quarterly figures but have since lost influence. Although the disruptions to Japanese production, and carmakers in particular, following the natural disaster of mid-March have now largely been eliminated, efforts to return to normal in some Japanese car plants located abroad will probably also continue throughout summer. The considerable erosion of purchasing power as a result of rising energy and food prices in the latter part of 2010 and early part of 2011 also weighed noticeably on the global economy. Both effects were also a key factor in the reduced economic momentum in the United States.

After adjustment for general price movements, the price per barrel of Brent crude oil reached a level last seen in 2008 Q2-Q3 and in autumn 1979. Subsequently, commodity markets eased slightly; prices then fell considerably in the first half of August, making a decline in consumer price inflation likely for the second half of the year. The renewed turmoil in the financial markets caused prices to slide in the past few weeks. Market participants have been held in suspense by the increased uncertainty about the future outlook for the economy and about the state of public budgets in some advanced economies.

In addition to these temporary constraints on the global upturn, longer-term braking effects also played a role, however. These include the perceptible interest rate hikes and other restrictive measures taken by central banks which had become necessary, above all, in the emerging market economies in order to counter the danger of second-round effects with regard to price developments. In some advanced economies, ongoing consolidation efforts continued to dampen the pace of recovery. The renewed decline in the global Purchasing Managers' Index for the manufacturing industry in July indicates that at least industrial activity was able to maintain its slower pace at the start of the summer months (see box on page 14).

Virtual standstill in industrial countries' aggregate output

Seasonally adjusted global industrial output fell in April and May compared with the first quarter of 2011, and international goods trade likewise trended downwards slightly (-¼%). Weak industrial activity was broadly based across regions, with production in the emerging market economies stagnating yet declining by ¾% in the advanced economies. However, this was attributable to the considerable slump in Japanese output. Excluding this slump, industrial output of the advanced economies in the April-May period was even up somewhat compared with the first quarter. Similarly, aggregate economic growth in the United States and the United Kingdom proceeded at a tepid pace in the second quarter, while euro-area momentum slowed perceptibly after the strong surge in the winter months. At the same time, the contraction of the Japanese economy subsided distinctly. On the whole, according to initial estimates based on interim figures for the United States, Japan, the United Kingdom and the euro area, real gross domestic product (GDP) in the industrial nations rose once again by ¼% after seasonal adjustment.

June IMF forecast for 2011 revised downwards slightly

Given unexpectedly weak growth, in June the IMF reduced its growth forecast for the global economy published in the April edition of the World Economic Outlook slightly to a rate of 4.3%. However, it maintained its projection for 2012 unchanged at 4.5%. The revisions for the current year are focused on the industrial countries. The downward revisions for growth in Japan, the United States and the United Kingdom contrasted with a perceptible increase in the forecast for the euro area, which primarily reflects Germany and France's brisk growth in the winter months. The forecast for developing and emerging countries was increased slightly to 6.6% for 2011 and reduced a bit to 6.4% for 2012. The relatively strong upward revision in real world trade by 0.8 percentage point to 8.2% in the current year is noteworthy. This is founded on a more favourable outlook for foreign trade in developing and emerging countries. On balance, the IMF sees the mid-year risks to the forecasts as being more on the downside than in early spring, owing to the worsening of the euro-area debt crisis and the rise of concerns regarding the future economic outlook in the United States.

Calming in commodity markets following sharp price rises

After rallying noticeably in the 2010 Q4-2011 Q1 period, the price for a barrel of Brent crude peaked in April at slightly over US$126, its highest level since July 2008. After taking some distinct hits in May, it stabilised at an average level of US$114 in June. However, on average over the spring months, the price of Brent crude was still up by 11% on the quarter and 47% on the year. One of the main reasons for the slight easing in the crude oil market was that the political unrest in the oil-

Is the global Purchasing Managers' Index pointing to a further slowdown in industrial activity?

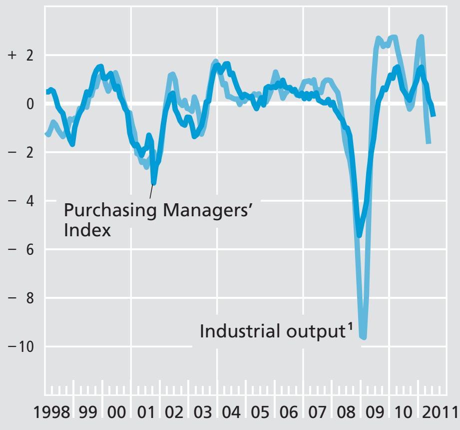
July's decline in the global Purchasing Managers' Index (PMI) for the manufacturing sector to just above the expansion threshold of 50 has been taken by many as a signal that output growth in this sector is grinding to a halt. Of course, such an interpretation of this indicator would only be valid if it were closely aligned with manufacturing output growth. According to the survey design, the PMI should actually reflect the monthly change in activity and thus, on account of its relatively rapid publication, give a timely indication of where the economy is heading. However, global industrial output growth, on which data are published on a monthly basis by the Centraal Planbureau is rather volatile. Consequently, the PMI tends to mainly show the underlying trend of output growth. The correlation is therefore closer if the increase in production is considered over a longer period, thus reducing the volatility in the reference series.[1] This, however, diminishes the informative value of this indicator with regard to industrial production growth at the current end, since it largely reflects changes in output that occurred in previous months.

In order to be able to directly compare the PMI with industrial output growth that has been smoothed in this way, they both still need to be adjusted for differences in their averages and volatilities.[2] Up to 2007, the time series that have been standardised in this way are actually largely identical. During the recession that followed, however, the PMI did not fall as much as the change in output, and by the same token, it has not yet risen as much during the subsequent recovery. This could be due to the survey design, as the focus is only on the direction, and not the size, of the change in activity. Furthermore, the picture is no different in qualitative terms if, instead of the overall index, the output or new orders component is compared with production growth.

In addition, the PMI does not appear to fully reflect the latest cyclical fluctuations in the global industrial sector. Its slide towards stagnation point in July is therefore to be viewed against the fact that already during April and May, average global industrial output was even down slightly from the first quarter. Of course, the main driving force behind this decline was the direct and indirect effects of the slump in activity in Japan. For example, production suspensions at Japanese car plants also had an impact on the foreign branches of the companies concerned, owing to bottlenecks in the supply of intermediate goods. As a result, industrial output also suffered in the United States and United Kingdom, as well as other countries where Japanese car firms operate production plants. The return to normal in the automobile industry is likely to give fresh impetus to global production growth in the summer months. It is unclear, however, whether the deterioration in the PMI over the past few months is not just simply an indication of these temporary burdens, but rather a weakening underlying trend in the manufacturing sector (excluding vehicle construction).

Global Purchasing Managers' Index for the manufacturing sector and the change in global industrial output

Seasonally adjusted and standardised,[2] monthly



1 Measured as the percentage change between the average of the last three months and that of the previous three-month period. — **2** In order to highlight any potential change in the correlation over time, the averages and standard deviations over the period from 1998 to 2007 were used for the standardisation.

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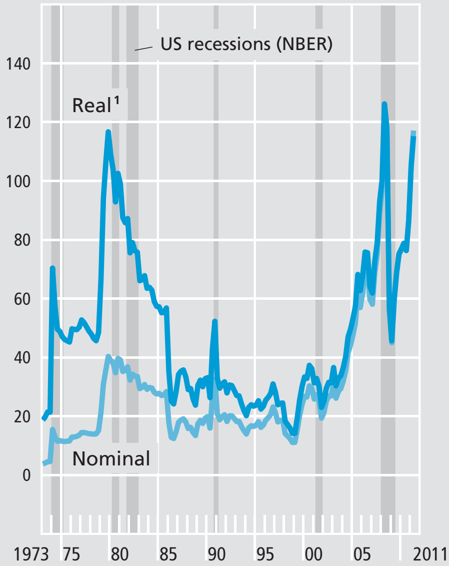
producing countries of North Africa and the Middle East did not expand any further or even subsided. Another was that growing signs of a global economic slowdown, the continued tightening of monetary policy in key emerging market economies and the general rise in uncertainty on the financial markets put pressure on prices. The announcement of the coordinated release of strategic crude oil reserves by the International Energy Agency caused only a temporary sharp drop in the spot price. In the first half of August, however, the escalating turbulence in the financial markets led to a considerable decline in crude oil prices to US$109 by mid-month. The prices of other commodities, after already sagging slightly from a high level in response to economic activity cooling off in the past few months, fell noticeably in the past few weeks. Global market prices for food, beverages and tobacco in the first half of August were 5% lower than in the spring quarter. Industrial raw materials were 2½% cheaper.

Consumer price inflation up once again in the industrial countries

The sharp increase in energy commodity prices pushed consumer prices in the industrial countries upwards anew in spring. Year-on-year headline inflation increased from +2.1% in the first quarter to +2.9%. However, inflation in the second quarter of the year, compared with the previous three-month period and adjusted for seasonal influences, dropped by nearly one-half to ½%. The considerable decline in pressure from energy and food contrasted with rising core inflation which, at just over ½%, showed the strongest quarterly increase since summer 2008. Annual inflation under this definition remained moderate at 1.7% year-on-year. Its strong increase in the past

Price of Brent crude oil

US$ per barrel, quarterly averages



Sources: Global Insight, International Monetary Fund and Bundesbank calculations. — 1 Deflated with the US CPI excluding energy (seasonally adjusted, reference year: 2010).

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few months shows clearly, however, that the underutilisation of aggregate capacity that still afflicts some industrial countries leaves open room for upside risks to price developments. The IMF once again revised its 2011 inflation forecast for the advanced economies upwards in June, from 2.2% to 2.6%, while holding its forecast for the other countries unchanged at 6.9%. With regard to 2012, both groups of countries are still expected to see declining inflation, however.

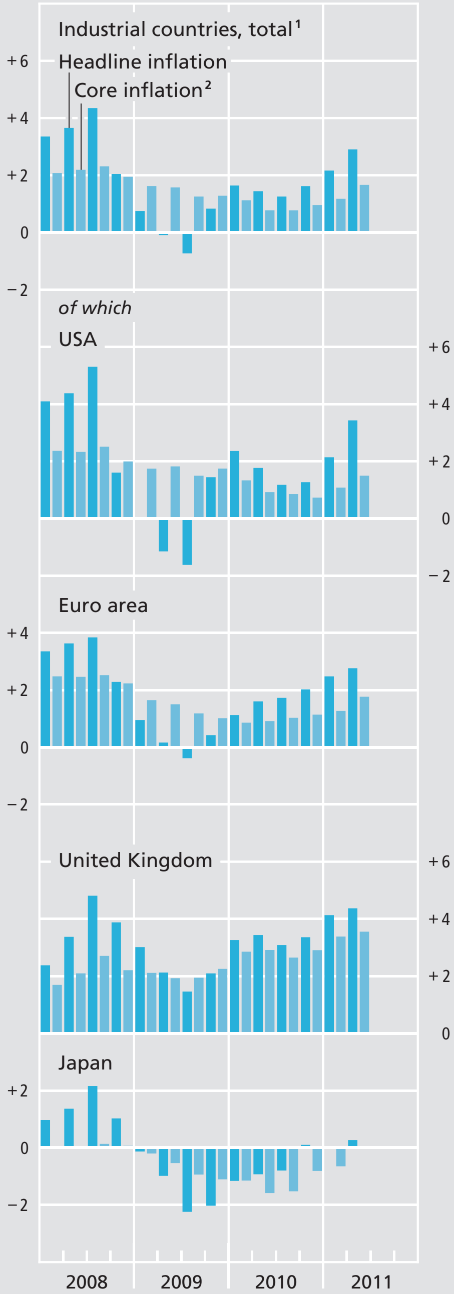
Selected emerging market economies

Chinese growth still strong despite unfavourable special effects

Year-on-year real GDP growth in China fell from 9¾% in the first quarter to 9½% in the second. The fact that the pace of growth declined to such a slight extent is remarkable given the strains the Chinese economy was ex-

Consumer prices in the industrial countries

Quarterly, year-on-year percentage change



Sources: national statistics, Eurostat and Bundesbank calculations. — **1** USA, EU-27, Japan, Canada, Norway and Switzerland. — **2** Excluding energy and food; euro area and United Kingdom: HICP excluding energy and unprocessed food; Japan: including alcoholic beverages.

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posed to during the reporting quarter. Power supply ran low in some provinces, while car manufacturing is likely to have taken a hit due to a lack of intermediate goods from Japan. In addition, the minimum reserve rates for banks were raised three times, and in July the People's Bank of China raised its policy rate for the fifth time in succession. However, consumer price inflation once again accelerated significantly, from 5.4% in March to 6.5% in July. This was due primarily to a more rapid increase in the price of food, which accounts for one-third of the goods basket. However, inflation has also continued to accelerate in the non-food sector; at 2.9% as this report went to press, it has reached a level which is exceptionally high by Chinese standards.

India's economy growing at slower pace

India's economy, which increased its output by 7¾% on the year in the first quarter, is likely to have slowed down in the past few months. One sign is that growth of industrial output has weakened perceptibly. This moderation was due primarily to slower domestic demand growth, whereas India's export activity continued to run full steam ahead. The strong inflationary pressure to which India has been subjected since 2008 continued throughout the reporting period. In the second quarter, the consumer price index rose 8.9% year-on-year, down only minimally from the beginning of the year.

Brazilian industrial sector hit by strong appreciation

The macroeconomic upswing in Brazil continued at a fast pace in the spring months. According to the available indicators, growth was supported mainly by services. By contrast, the Brazilian industrial sector was hit hard by the strong appreciation of the currency; in July, the real reached its highest value against the US dollar since early 1999. In addition, strong wage increases have been eroding Brazil's price competitiveness for quite a while. Whereas the country's real goods exports virtually stagnated in the past few years, imports have nearly doubled from their 2006 level. However, as the terms of trade have improved considerably owing to sharply rising commodity prices, Brazil is continuing to run a clear trade surplus. Consumer price inflation has accelerated slightly once again in the past few months, reaching 6.9% in July. This was still above the central bank's tolerance limit of 6.5%.

Recovery in Russia less buoyant

The Russian economy's pace of growth slowed down in the second quarter. According to a provisional estimate by Russia's Federal State Statistics Service, year-on-year growth of real GDP fell from 4% in the first quarter to 3½%. However, the seasonally adjusted quarter-on-quarter growth of economic output – in the absence of current official data – is likely to have been weak at best. This GDP result stands in a certain contrast to the picture painted by the monthly indicators of economic activity in Russia, which showed seasonally adjusted industrial output picking up in the second quarter by 1½% from its average over the winter months. Real retail sales, too, rose distinctly as a result of wage increases and a persistently favourable employment situation. Consumer price inflation was 9.0% in July. Whereas food price inflation continued to decelerate, inflation accelerated slightly once again for all other goods.

United States

Sluggish GDP growth in spring

Economic activity in the United States remained subdued in the second quarter of 2011. According to the extensive revisions to the national accounts, the initially rapid pace of cyclical growth diminished in the second half of 2010, reaching a near-standstill in winter 2011 (see box on pp 18-19). Seasonally adjusted quarter-on-quarter growth of real GDP in spring, at ¼%, was only somewhat higher than in the preceding three-month period.

Losses in purchasing power straining household consumption

This disappointing result was due mainly to households' reluctance to purchase, though this is probably largely the result of temporary factors. Real consumer spending stagnated at the previous quarter's level. Although this includes a sharp drop in car sales owing to problems Japanese car manufacturers had been facing with regard to production and deliveries, the more likely culprit, in the light of a general sluggishness in consumption activity, is that continued nominal increases in households' disposable income were eroded by inflation. The basket of goods on which the consumer price index is based increased in price, after eliminating seasonal influences, by 1% compared to the first quarter of the year; the corresponding year-on-year increase even accelerated from +2.1% to +3.4%. Core inflation (which excludes energy and food), at +1.5%, was double its level of half a year earlier. In addition, households were probably no longer willing to compensate for the inflation-related tightening of their income scope by curtailing their saving. At just over 5%, their saving ratio was even slightly higher than in the winter months. In this context,

The latest revision of the US national accounts

The latest revision of the US national accounts entailed a significant downward revision to real GDP growth in the first quarter of 2011. Taking this together with the advance estimate for the second quarter, a picture now emerges of an economy whose output increased only marginally in the first half of this year. In order to deduce the implications this may have for both the analysis of economic driving forces and the future outlook, this box takes a closer look at the statistical revisions.

Every year in the summer, the Bureau of Economic Analysis (BEA) revises the national accounts estimates for the last three years and the first quarter of the current year, in particular to take into account newly available data. Previously, corrections to earlier periods were carried out only as part of the BEA's comprehensive revisions which took place every five years. In the meantime, however, the BEA has adopted a more flexible approach.[1] It has now carried out a "flexible" revision in which the corrections to some expenditure components of GDP cover the period from 2003 onwards. That said, only a few changes have been made to the period prior to 2008.

Upon closer inspection of the latest revision, two results in particular stand out: the lower level of real GDP at the current end and the modified quarterly profile of its growth rates. Specifically, economic output in the first quarter of 2011 was revised downwards from its previous level by a total of 1½%. This now means that, in spring 2011 too, it remained below its pre-crisis level to which, according to previous estimates, it had already returned in autumn 2010.

Based on the business cycle dates published by the National Bureau of Economic Research (NBER), the main contributor to this downward revision over time was the unexpected severity of the recession (-1 percentage point), with approximately only ¼ percentage point being deducted each for the period prior to the downturn and the current recovery phase. In terms of the expenditure breakdown of GDP, around half of the downward revision was attributable to private consumption, in particular real spending on services, which was adjusted to reflect the results of more recent statistical surveys. The other half of the reduction stemmed more or less equally from lower investment in equipment and software on the part of enterprises, a drop in government spending and higher imports.

In terms of the temporal perspective and the breakdown of expenditure components together, the sharper-than-expected decline in private consumption during the recession contributed almost ¾ percentage point to the downward revision of GDP and its weaker growth prior to the recession a further ¼ percentage point. By contrast, the rise in real household spending during the current upturn has even been somewhat stronger than previously estimated. For example, a year ago it was still assumed that private consumption had contributed, on average, only one percentage point (in annualised terms) to GDP growth over the first four quarters of the recovery. In the meantime, its contribution has been revised upwards to 1½ percentage points, the upshot being that the pattern of private consumption during that period now resembles that of the two preceding recoveries.[2] The revision notwithstanding, real consumer spending has still exceeded its pre-crisis level since autumn 2010.

As was the case with private consumption, the latest national accounts data show that enterprises' investment in equipment and software slumped much further during the latest recession than had been previously estimated. By contrast, government spending growth was not weaker until during the recovery. The cyclical pattern in changes in inventories was even more pronounced than previously published. The temporal pattern of quarterly growth rates of real GDP was also revised considerably. Ignoring the direction of the change, the average annualised growth rate over the 13-quarter period from the first quarter of 2008 to the first quarter of 2011 was corrected by almost one percentage point. In terms of the expenditure components, primarily movements in inventories and imports leap to the eye, with their contributions to the annualised growth rate being adjusted by an average of ¾ and one percentage point respectively. Of course, if the direction of the changes is factored in, the revisions to these components largely cancel each other out over time. In the case of imports, the change stemmed from a modification of the seasonal adjustment method specifically for oil imports. As a result, the national accounts data now far better reflect the seasonally adjusted real imports of goods data that are published by the BEA and the US Census Bureau on a monthly basis.

Consequently, the pattern of real GDP growth over time has become much smoother. In particular, the data no longer include the marked deceleration in aggregate growth reported for spring 2010, which was due primarily to an increase in imports, but nevertheless fuelled last year's debate

1 See Bureau of Economic Analysis, Improving BEA's Accounts Through Flexible Annual Revisions, Survey of Current Business, June 2008, pp 29-32. — **2** See Deutsche Bundesbank, The current economic upturn in the United States in comparison with earlier phases of recovery, Monthly Report, August 2010, pp 18-19. — **3** See Deutsche Bundesbank, Global and European setting, Monthly Report, November 2010,

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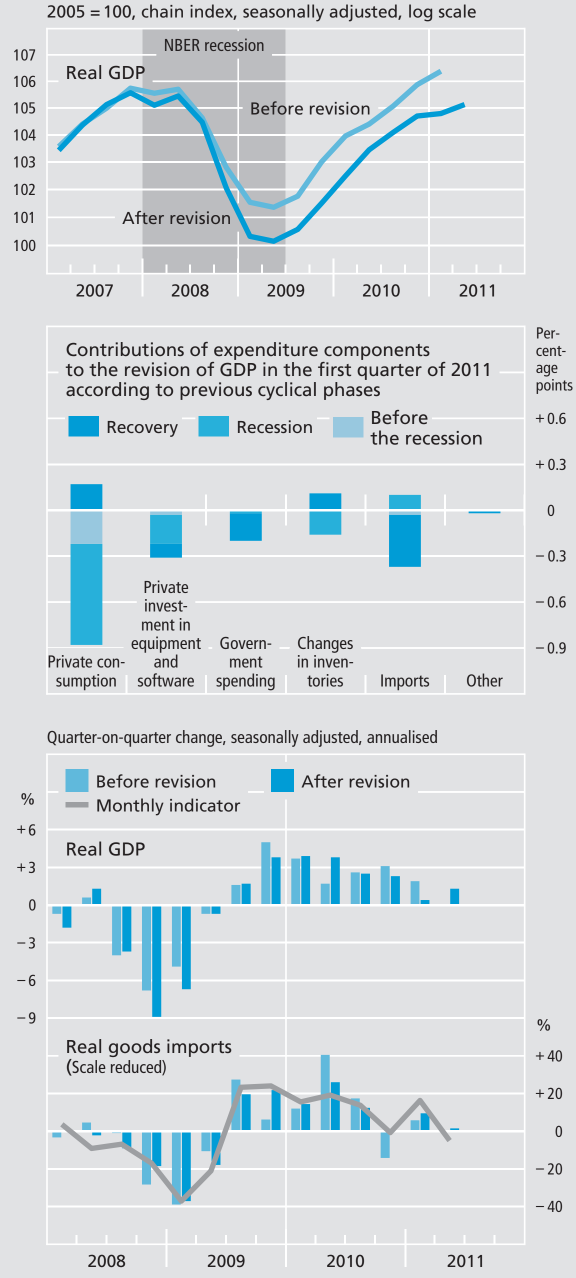
over the possibility of another recession.[3] That said, the annualised GDP growth rate for the first quarter of 2011 was revised downwards by no less than 1½ percentage points. This revision, however, was almost exclusively attributable to the adjusted contributions from inventory changes (-1 percentage point) and imports (-½ percentage point) and is therefore simply likely to be the reversal of revisions made in previous quarters.[4] According to the latest national accounts data, the episode of virtual stagnation at the beginning of the year was the result of a sharp decline in government spending, which was due to one-off effects stemming from military expenditure and to a large extent sapped growth in private domestic final demand. The more moderate pace of growth of the latter is to be viewed against the backdrop of its robust expansion at the end of 2010. Furthermore, the sharp hike in oil prices may have already curbed consumption at the beginning of 2011.

These factors are likely to soften the contrast between the sluggish overall economic momentum and the strong employment growth in the private sector at the beginning of this year. Furthermore, it seems plausible that employers briefly swallowed lower productivity from their staff on the back of temporary supply-side shocks such as the oil price hikes and subsequent delivery problems in the automobile industry. The sharper decline in real GDP during the latest recession is now more in line with the slump in employment at the time.[5]

Overall, the latest revision has not affected the basic economic picture. Now that the bolstering effect of the inventory cycle has waned, the upturn continues to be driven mainly by private consumption and enterprises' investment in equipment and software. As things stand at the moment, the weakness in consumption growth in the first quarter is likely to be largely temporary. The pick-up in motor vehicle sales in July from the depressed level a month earlier and the recent return to more favourable labour market developments are an indication that these strains will disappear. Against this background, it appears unlikely that the US economy will edge back into recession in the near future. However, given that the construction industry has yet to generate discernible positive stimuli and that government demand will have a dampening impact in the future, too, owing to the need for consolidation, the underlying momentum of economic activity over the next few quarters may lag behind that recorded in similar expansion periods.

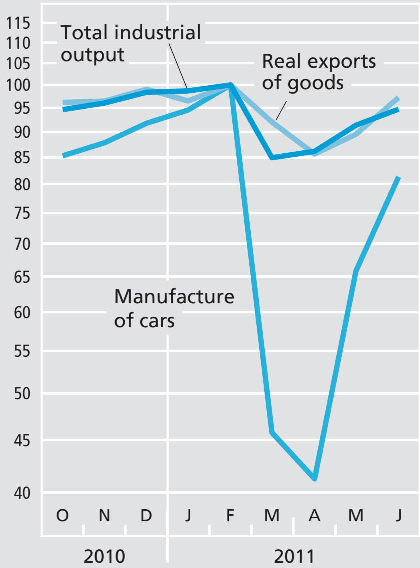
Main results of the latest revision to the national accounts data



pp 16-17. — **4** Accordingly, the contribution from imports to the downward revision to GDP growth in the first quarter of 2011 is also simply likely to be the result of changes in the seasonal pattern. — **5** See Deutsche Bundesbank, The US labour market in the current cycle, Monthly Report, April 2011, pp 35-51.

Selected economic indicators for Japan

February 2011 = 100, seasonally adjusted, log scale



Sources: Global Insight and Ministry of Economy, Trade and Industry.

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rising uncertainty about the development of public finances could have made households more cautious. Moreover, the slackening of economic activity also impacted on the labour market. Employment growth made little headway in May and June and only picked up steam in July. At 9.1% on average over the April to July period, the unemployment rate was one-quarter percentage point higher than in the first quarter of the year.

Robust commercial investment but falling government expenditure

As is to be expected in an economy that is being forced to shoulder temporary burdens, firms continued to perceptibly increase their investment in equipment and software in the second quarter, despite households' reluctance to consume. Budgetary consolidation at the federal, state and local government level, which is now looming and has already made itself felt in a renewed decline in government spending in the spring months, will involve short-term growth losses yet is indispensable over the medium and long term in order to ensure the macroeconomic upturn.

Japan

Renewed GDP contraction but recovery already under way

In spring, seasonally adjusted real GDP in Japan, according to an initial estimate, fell from the previous quarter for the third consecutive quarter (-¼%). On the expenditure side, the only factor pushing towards macroeconomic contraction was foreign trade, whereas domestic final demand once again expanded perceptibly and inventory movements provided positive stimuli. The time structure of key monthly indicators of economic activity makes it clear, moreover, that the quarter-on-quarter reduction in activity was still an outcome of the severe slump in March and April. In the following months, Japan's economy already returned to a path of steep growth. In June, industrial production went up to nearly 95% of February's output level after having fallen to 85% in March. Delivery bottlenecks had brought, in particular, the manufacture of motor vehicles to a temporary halt. Automotive manufacturing output was increased from 41% of February's levels in April to over 81% in June. Demand indicators, too, including the number of new registrations of cars as well as goods export volumes, are clearly pointing upwards. Outside the disaster area, unemployment in June, at 4.6%, was just as high as in February. In May and June the price of the basket of goods on which the consumer price index is based, excluding energy and food, increased slightly year-on-year (+0.1%) for the first time since 2008.

United Kingdom

Aggregate growth curbed by special factors

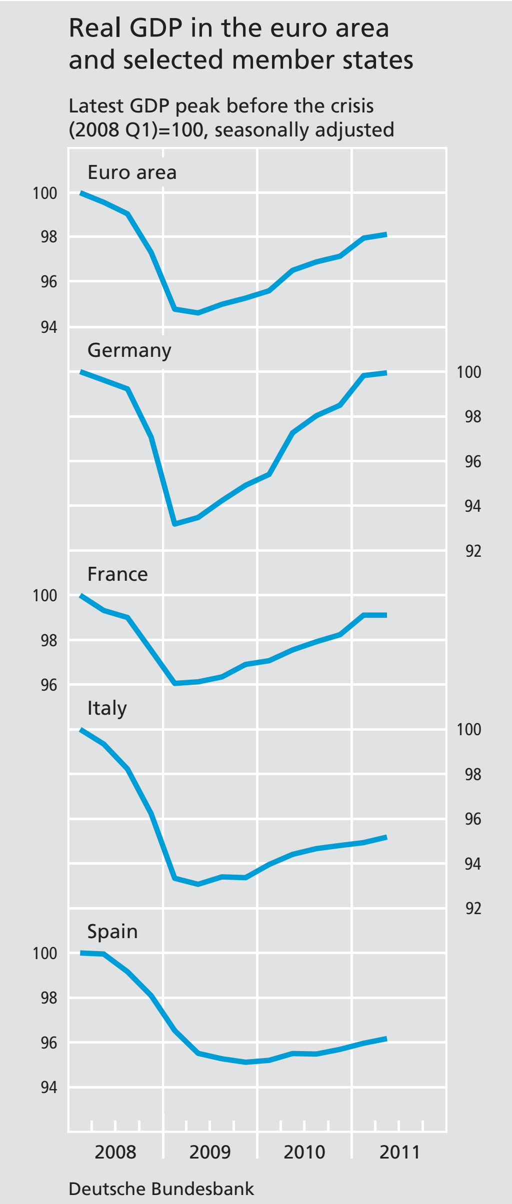
In the spring, UK economic recovery remained flat. UK output, according to a first estimate, grew by only ¼% on the quarter after seasonal adjustment and was thus barely above its summer 2010 level. However, it is necessary to take into consideration several special factors which probably, on balance, considerably depressed aggregate output in the past quarter and the elimination of which will probably cause GDP to rise accordingly in the coming quarters.[1] An *ad hoc* holiday to celebrate the royal wedding is likely to have had the greatest dampening impact.[2] However, it could have had a positive effect on real gross value added in hotels and catering. On the whole, output in the services sector was still up by ½% from the winter months. On the other hand, value added in manufacturing (excluding construction) contracted by 1½%. This was due mainly to a slump in oil and gas production following maintenance work, a sharp slowdown in energy production in April owing to exceptionally warm weather and disruptions in the production of motor vehicles caused by Japanese firms' problems with deliveries. Construction output recovered only slightly from its severe contraction in the 2010 Q4-2011 Q1 period (+½). The muted pace of aggregate growth is also making itself felt in the labour market, where the situation has not improved any further. The number of applications for unemployment benefits was somewhat higher on average for the second quarter than in the preceding three-month period. Year-on-year consumer price inflation receded again in June after surging at the beginning of the spring period. According to the Harmonised Index of Consumer Prices (HICP), average inflation over the quarter still rose from 4.2% in the winter period to 4.4%.

New EU member states

Recovery less buoyant

In the new EU countries (EU 7),[3] the pace of economic activity largely diminished in the second quarter of 2011. In the Czech Republic, seasonally adjusted real GDP was up by ¼% from the previous period, in which it had grown by 1%. Hungary's economic output remained unchanged following growth of ¼%. On the other hand, in Poland, for which no data on GDP are available yet, economic output is likely to have once again picked up distinctly. One sign is that second-quarter industrial output grew by 2% on the quarter. In most other countries in the region, industrial activity was less brisk than in the previous period. Consumer price inflation in the EU 7 overall has receded in the past few months, reaching 3.7% in July. It ranged from 1.9% in the Czech Republic to 4.9% in Rumania.

1 According to an estimate by the UK Office for National Statistics, which can only serve as a rough guideline, the special factors could have reduced real GDP by ½% in the second quarter.
2 Although the seasonal adjustment procedures used by the Office for National Statistics also includes the elimination of calendar effects, it only eliminates those that recur regularly.
3 This group comprises the non-euro-area countries that joined the European Union in 2004 and 2007.



Macroeconomic trends in the euro area

Distinct slowdown in growth rate following brisk beginning to the year

Euro-area growth diminished noticeably in the second quarter. Seasonally adjusted real GDP rose by only ¼% from a period earlier, in which it had grown by as much as ¾%. It was up by 1¾% on the year. The reduced pace of aggregate growth was due, for one thing, to an overstatement of the underlying economic trend by the buoyant growth at the beginning of the year, which had been affected by catching-up effects following weather-related cutbacks in production in the final quarter of 2010. Another factor was that euro-area consumers' pocketbooks were hit by accelerating inflation caused by the sharp rise in crude oil prices. Moreover, demand for exports from non-euro-area countries also decelerated.[4]

Visible reduction in euro-area growth differentials in spring

The elimination of the catching-up effects which, in the winter quarter, had particularly affected the more northerly euro-area member states also led to a visible reduction in euro-area growth differentials in the spring. Of the 12 euro-area countries that have already released data on GDP growth in the second quarter, Estonia (+1¾%) and Finland (+1¼%) recorded the best results after seasonal adjustment, followed by Austria and Slovakia, which posted growth of 1%. Of the large euro-area member states, only Italy, at +¼%, performed somewhat better than in the two preceding periods. However, following strong growth in the winter months, real GDP in Germany and France held more or less steady at its previous levels. Of those peripheral countries for which data are available thus far, Spain's second-quarter growth once again came in at ¼%, whereas Portugal's output, after falling considerably in the 2010 Q4-2011 Q1 period, maintained its level of a quarter earlier. No seasonally adjusted second-quarter data have been reported yet for Ireland and Greece. Overall,

4 The events in Japan and the associated disruptions to the supply chains did not cause any major production delays in the euro area since only a few Japanese manufacturers of cars and electronic appliances, which are generally heavily dependent on intra-group deliveries, have plants and factories located in the euro area.

real euro-area GDP stood at 2% below its pre-crisis level as this report went to press.

Slower pace of growth in industrial and construction sector

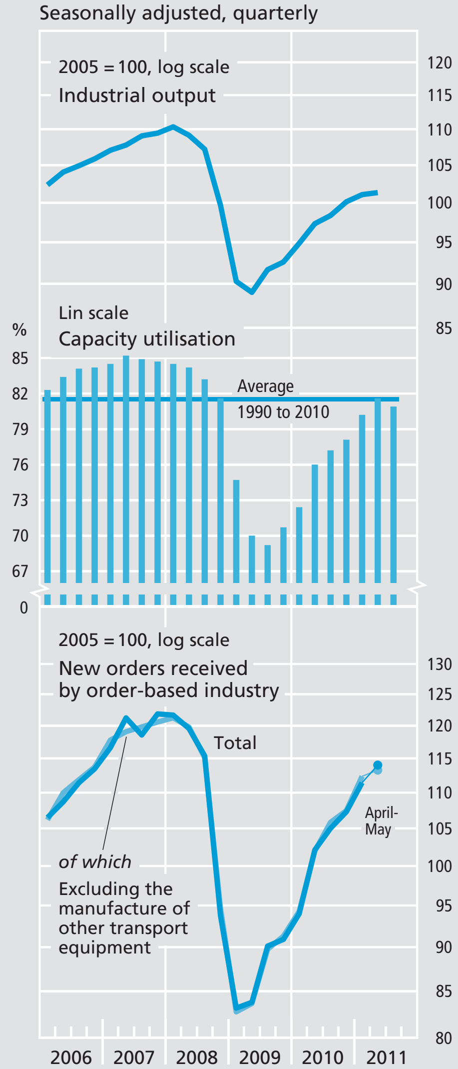
The main supply-side reasons for the slower pace of aggregate economic growth in the euro area are flatter industrial activity and a noticeable slowdown in the construction sector. Output in manufacturing (excluding construction) grew in the second quarter by a seasonally adjusted ¼%, which was well off its pace of a quarter earlier. Fittingly, capacity utilisation, which in April had pretty much returned to its multi-year average, fell off somewhat in July. The slower growth of industrial output is masking highly uneven trends in the various sectors. While the production of energy and consumer durables declined by 4% and ¼% respectively over the reporting period, intermediate goods production stagnated following very high growth rates at the beginning of the year. The manufacture of non-durables and capital goods, however, rose by 1% each. Construction output in the spring was only ¼% higher than in the first quarter, in which it had grown by 1½% owing to favourable weather conditions.

Uneven economic signals for second half of year

The indicators are not consistent with regard to developments in industrial activity following the middle of the year. The Purchasing Managers' Index for the manufacturing sector was down in July for the third consecutive time and stood only marginally above the expansion threshold. The industrial confidence indicator, too, was perceptibly pointed downwards and declined significantly in July once more, yet remained above its multi-year average throughout the reporting period. The assessment of new orders, in particular, was no longer as fa-vourable as in the winter months. This stands in a contrast of sorts to the considerable increase in new orders received by order-based industry; the April-May average, after seasonal adjustment, was 2¼% higher than in the first quarter. Even excluding the manufacture of other transport equipment, in which large orders often have a marked impact, new orders were still up perceptibly (+¾).

Selected indicators of euro-area industrial activity

Seasonally adjusted, quarterly



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Weaker growth of domestic and foreign demand

The spring slowdown of economic growth was broadly based across the demand side. In the second quarter of the year, the seasonally adjusted quarter-on-quarter rise in goods exports in terms of value, at ½%, was no longer as buoyant. Imports slowed down even further, remaining unchanged from the level of the first quarter, in which they had accelerated by 6½%. Gross fixed capital formation is also likely to have grown more moderately than in the winter quarter. The primary indicator of this being the case is that construction output, as mentioned earlier, exhibited much more muted growth, whereas the index for the production of capital goods, which is a rough indicator of investment in new equipment, maintained its growth rate of the winter period. Consumption by households, who had been hit in their pocketbooks by the considerable rise in energy prices, has probably provided no further boost to growth whatsoever. Real retail sales in spring were down both quarter-on-quarter and year-on-year. In addition, the number of new car registrations in the euro area was 4% below the level of the winter months after seasonal adjustment and down 1¾% on the year.

Labour market recovery stalled

Over the course of the spring quarter, the labour market recovery, which was proceeding at a snail's pace to begin with, once again started to stall. The seasonally adjusted number of unemployed persons in June was hardly any lower than in March. However, on a quarterly average, it still fell by 57,000 after a decline of 189,000 a period earlier. Unemployment was reduced by 349,000 on the year, with Germany being the main pillar of this improvement; the overall figure for the other euro-area countries, by contrast, remained virtually unchanged. Second-quarter unemployment, at a seasonally adjusted 9.9%, was only marginally lower than a quarter earlier. The number of employed persons in the first quarter (the latest period for which data are available) remained at the level of autumn 2010 after seasonal adjustment and was also just minimally higher than a year earlier, thereby also encapsulating the overall unsatisfactory labour market trend in the euro area.

Inflation still clearly above 2%

Consumer price inflation in the euro area has flattened over the course of the past few months. This reflects, in particular, the ups and downs of the crude oil markets. Consumer prices, following a seasonally adjusted surge in April caused by a further sharp rise in crude oil prices, remained unchanged in the following two months as crude oil prices were trending downwards. Year-on-year HICP inflation, however, still rose from 2.5% in the winter quarter to 2.8% in the second quarter of 2011. Specifically, price movements in spring were also influenced by the preceding sharp increase in prices in the international food markets. Prices of services were probably somewhat higher following the economic recovery, whereas the prices of industrial goods barely budged. Euro-area consumer prices are unlikely to have changed a great deal in July, whereas year-on-year HICP inflation fell from 2.7% in June to 2.5% in July. However, this decline is attributable to a change in the statistical treatment of seasonal goods. For the near future, annual HICP inflation of well over 2% can still be expected.