Global and European setting

World economic activity

Mounting signs of global economic revival but global growth still dampened in Q4

There have been growing signs over the past few months that the global economy has been gradually picking up momentum. The revival is particularly evident in the manufacturing sector of the Asian emerging economies, but the leading indicators suggest that things are gradually improving in the industrial countries as well. However, the figures on global industrial output, available up until November, appear to show only a slight uptick in growth. This is a sign that global gross domestic product (GDP) in the fourth quarter was not yet able to perceptibly break free from the flat growth path of Q2-Q3. According to the IMF's current estimate, aggregate output growth in 2012, at 3¼%, is likely to have been significantly weaker than in the two preceding years and also more sluggish than its average of the past decade. In regional terms, the emerging markets appear to have stepped up a gear in the fourth quarter, while the previously meagre growth in the industrial countries has given way to a perceptible decline in output.

GDP down in industrial countries in autumn

The acceleration of the euro area's contraction contributed to the industrial countries' sluggish performance. In addition, real GDP in the UK in the fourth quarter was unable to match the significantly elevated level seen in the prior quarter. In Japan, aggregate output contracted once again, albeit only slightly. In the United States, although private domestic final demand remained on a sound upward trajectory, temporary negative influences on other expenditure aggregates meant that real GDP in the fourth quarter hovered at the level of the previous quarter, in which it had risen quite strongly. The fiscal policy debate at the end of the year did not appear to have had any negative impact on economic activity. Real GDP in the United States, Japan, the United Kingdom and the euro area taken together, for which initial provisional data are available, was ¼% below its level of the preceding period, in which it had still seen slight growth. Year-on-year growth was a mere ½%. Average GDP growth for 2012 as a whole stood at 1%, as against 1¼% a year earlier.

Key indicators pointing back upwards in past few months

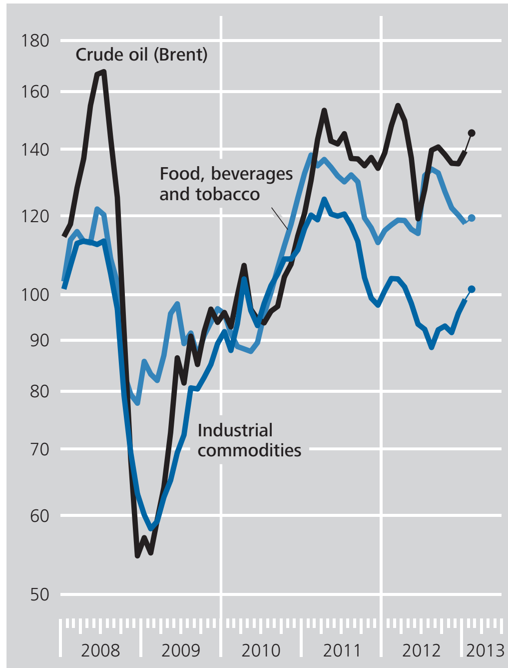
One indication that, as mentioned earlier, the economic outlook has been gradually brightening up in the past few months is that the global Purchasing Managers' Index (PMI) for the manufacturing industry went back across the expansion threshold in December for the first time since May 2012 and that its upward trend continued in January, while the index for the services sector continued to show robust growth. The other is that the business climate has recently improved, especially in the industrial countries, and the favourable price trend in the equity markets is likewise a sign of increasing optimism.

IMF autumn forecast largely confirmed

All in all, the global economy currently appears to be on a moderate recovery path, as predicted by international institutions' autumn forecasts. In its January update, the International Monetary Fund (IMF) virtually confirmed its October global growth forecast. The IMF staff expect growth of 3.5% in 2013 and 4.1% in 2014. Within the group of advanced economies, however, the forecasts for the newly industrialised countries in Asia and the euro area in 2013 were, respectively, lowered somewhat more strongly to +3.2% and to -0.2%. The revised forecast for the euro area, however, implies an increase in aggregate output over the year of 0.5%. Growth in the USA is projected to remain relatively unchanged at 2.0%. This forecast continues to assume that a constructive solution will be found to the negotiations in Congress on the path of fiscal consolidation and that the fiscal damper effect will not exceed 1¼% of GDP in the current year. Of the emerging market economies, the estimate for China (+8.2%) was retained, yet the forecast for Brazil was reduced distinctly to

World market prices for crude oil, industrial commodities and food, beverages and tobacco

US dollar basis, 2010 = 100, monthly averages, log scale



Sources: Thomson Reuters and HWWI. • Average of 1 to 8 February or 1 to 13 February 2013 (crude oil).
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+3.5%. The outlook for real world trade was once again given a markedly cautious assessment; its expected growth rate for 2013 and 2014 was reduced by 0.7 and 0.3 percentage points, respectively, to 3.8% and 5.5%.

Tendencies in international commodity market prices reverse course

The price tendencies previously observed in the international commodity markets reversed themselves in autumn. Measured in terms of the HWWI index for industrial countries, food, beverages and tobacco became considerably cheaper because weather-related crop failures, which in summer had given rise to sharp price hikes, did not materialise to the extent feared. On the other hand, given the pick-up in activity in the global manufacturing sector, the quoted prices for industrial commodities recouped part of the substantial losses they had sustained previously. By contrast, the price for a barrel of Brent crude oil fluctuated around a level of roughly US$110 in the autumn months; its average level for the year of US$111½ represented a new all-time high. The fact that Saudi Arabia cut back its production in the past few months is probably one of the main reasons for the oil price moving sideways at quite a high level. Moreover, demand-side developments and geopolitical factors seem to have largely cancelled each other out. Prices picked up markedly in the last few weeks again, however, owing to a resurgence of tensions in the Middle East and North Africa and to increased demand from China. As this report went to press, therefore, the price of a barrel of Brent was US$118; futures were trading at significant discounts, as before.

Moderate consumer price inflation in industrial countries

The basket of consumer goods in the industrial countries became considerably more expensive in the final quarter of 2012 compared with the previous period (+0.6%) after elimination of seasonal factors. However, this is the purely imputed outcome of a high overhang at the end of the third quarter caused by preceding oil price surges. By contrast, upward price pressure obtained only modest support over the course of the autumn quarter, not least because fuels tended to become cheaper. In the final quarter, year-on-year inflation was just as moderate as in the preceding three-month period (+1.8%). Core inflation, which excludes energy and food prices, came out somewhat lower still (+1.4%).

Selected emerging market economies

Slightly stronger growth in China

Officially reported real GDP growth in China in the fourth quarter of 2012 stood at 8% year-on-year following a pick-up of 7½% in the third quarter of the year. The pace of aggregate growth therefore increased again for the first time after six consecutive quarters of decline. One of the reasons for the acceleration appears to be that during the summer months the Chinese authorities launched a series of economic stimulus measures which seem to have begun to have an impact in the past quarter. Chief among these stimulus measures is additional expenditure on investment in rail transport and

other areas of infrastructure. The acceleration in Chinese economic activity was additionally boosted by housing construction, which revived following a marked recovery in real estate purchases. In the past quarter, however, foreign demand still is likely to have provided only meagre stimulus. Consumer price inflation picked up towards the end of the year. Food price increases and higher accommodation costs are the particular factors behind the rise in year-on-year inflation from 1.9% in September to 2.5% in December.

India still on flat expansion path

Real year-on-year GDP growth in India slowed down distinctly once again in the third quarter, up to which national accounts data are available, from 4% to 2¾%. At +5¼%, the growth rate of real gross value added, the measure of aggregate output preferred by the Indian Ministry of Statistics and the Reserve Bank of India, was somewhat lower than before. According to the indicators currently available, growth in India is not likely to have accelerated substantially in the autumn, either. On the bright side, however, sentiment has brightened perceptibly in some sectors of the economy. One contributory factor may be that, in September, the Indian government opened the retail trade sector to foreign investors, the largest reform step to have been taken in years. In order to stimulate the economy, the Reserve Bank of India cut interest rates at the end of January. All the same, inflation as measured by the national consumer price index remained very high in January, at 10.8%.

Economic activity in Brazil lacking momentum

Brazil's economic output, which had risen in the third quarter by ½% after elimination of seasonal influences, is likely to have seen only muted growth in the final quarter as well. The pronounced sluggishness of gross fixed capital formation, which had fallen in the summer for the fifth consecutive period, seems to have persisted according to the available data on capital goods production. Not even the sharp cuts in policy rates over the past one-and-a-half years were able to overcome enterprises' entrenched reluctance to invest, which is associated with, among other factors, uncertainty about the government's fiscal and economic policy course. Given that inflation has recently gone back up – at year's end, consumer price inflation rose to 5.8% – the central bank recently signalled that it would discontinue further monetary policy loosening.

Economic upturn in Russia is faltering

According to an initial estimate by the Russian Federal State Statistics Service, Russian economic output increased by an average of 3½% in 2012. These results suggest that the economic upturn in the final quarter of 2012 – for which no published data are yet available – is faltering. Another indication of this is that industrial output stagnated at the previous quarter's level. Over the year as a whole, industrial output was increased by only 2½%. Many services sectors, however, saw considerably stronger growth, particularly financial services (+15%). This is a reflection of, in particular, the strong expansion of lending by Russian banks. Inflation showed sideways tendencies in the autumn months and stood at 6.6% at year's end.

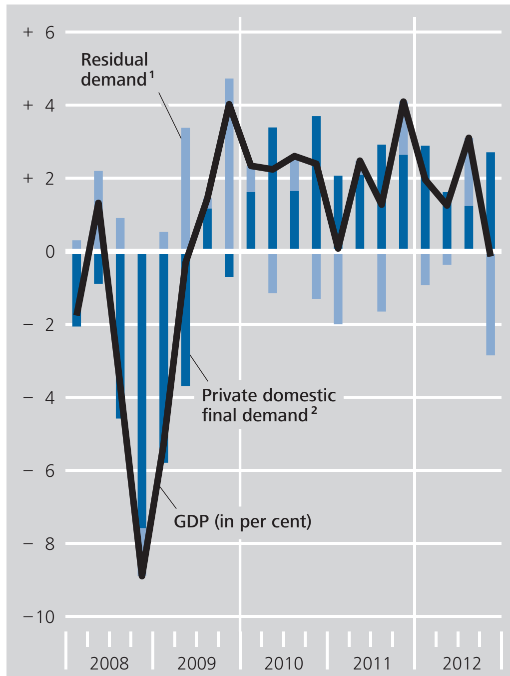
USA

Moderate aggregate recovery tendency obscured

In the United States, the stagnation of seasonally adjusted real GDP in the final quarter of 2012 has to be seen against the background of the good result in the summer quarter, in which aggregate output had risen by ¾%. The key factors at the time were temporary stimuli in restocking and in government demand, especially defence spending, the expiry of which put a brake on growth in the fourth quarter. In addition, the global economic slump weighed on macroeconomic developments by means of a decline in exports. On average over the second half of the year, GDP rose by ½% per quarter, thus continuing to follow a path of moderate expansion. Private domestic final demand – the actual engine of growth – even accelerated significantly in autumn. The fiscal policy debate thus did not leave any visible "brake marks" as had been feared previously.

Contributions to quarter-on-quarter growth in real US GDP

In percentage points, seasonally adjusted, in annualised terms



Source: Global Insight. **1** Public demand, inventory changes and net exports. **2** Private consumption and private fixed investment.

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Instead, firms overcame their caution of the summer and stepped up their gross fixed capital formation strongly, while the upswing in residential construction continued apace. Lastly, household consumption gained some strength as the effects of higher oil prices expired and real incomes accelerated. Although the seasonally adjusted consumer price index still rose considerably quarter-on-quarter, in December it was still lower than three months previously. The entire consumer goods basket was 1.9% more expensive in the final quarter than in the same period a year earlier. In addition, the continuing recovery of the labour market is likely to have supported household spending. The unemployment rate stood at 7.8%, nearly one percentage point lower than in the last three months of the preceding year. Nonetheless, in December, the US Federal Open Market Committee voiced its assumption that the unemployment rate would not fall below the 6.5% threshold for an interest rate move, announced as part of a shift in its communication strategy, until the second half of 2015.

Japan

Stabilisation following cyclical setback

After adjustment for seasonal influences, Japan's real GDP in autumn was marginally down from the previous quarter, in which it had dropped by 1%. One of the factors mitigating the downturn was that foreign trade weighed less on aggregate economic developments than previously. Although exports of goods and services fell sharply once again in terms of volume, real imports were reduced to a similar extent. This was a reflection not only of an increase in the energy import tax, which had led to frontloading effects in the summer, but also of the persistent slump in business investment. Another factor was that household consumption largely recouped its losses of the previous quarter, even though its growth was held back by a sharp decline in new car sales following the expiry of government incentives. Such temporary public sector measures have contributed repeatedly to cyclical ups and downs in the past few years. At last report, however, there was a tendency towards an increase in new car registrations. The latest decline in real GDP is, in purely imputed terms from a monthly perspective, due most likely to the negative carry-over from the end of the third quarter. By contrast, the economy seems to have stabilised over the course of the final quarter. This is consistent with an unchanged unemployment rate. Nonetheless, the new government announced additional spending to stimulate the economy. In addition, after already having expanded its ongoing bond purchase programme multiple times last year, the Bank of Japan announced that it would move to open-ended purchases in 2014 and, under severe political pressure, postulated a concrete inflation target of 2%. The consumer price index fell in the fourth quarter by 0.2% year-on-year; the Bank of Japan is therefore quite far removed from this aim. Excluding energy and food, the basket of consumer goods was as much as 0.5% cheaper.

United Kingdom

Economy still mired in slump

Aggregate output in the United Kingdom in the fourth quarter was unable to maintain its elevated level of the summer period. According to a provisional estimate, real GDP fell by ¼% from the previous period after seasonal adjustment. On the output side, the fall was attributable solely to the production sector (excluding construction). One crucial factor was the interruption of oil and gas production owing to maintenance work. In addition, real gross value added in the manufacturing industry was curbed sharply, and in the services sector – the backbone of the UK economy – it stagnated. By contrast, the steep slide in production in the construction industry came to an end. To be sure, an overall setback of sorts in real GDP could have been expected owing to the expiry of special factors which had raised the level of activity in the third quarter. However, the monthly indicators seem to suggest that the UK economy was treading water over the course of the autumn quarter as well. The labour market, though, continues to appear relatively favourable. In October, the standardised unemployment rate held steady at its level of July (7.8%), and the number of recipients of unemployment benefits fell perceptibly in November and again in December. Inflation according to the Harmonised Index of Consumer Prices (HICP) averaged 2.7% over the autumn months – still in excess of the Bank of England's inflation target. It is not least with this in mind that the central bank refrained from applying additional monetary policy stimuli in the past few months.

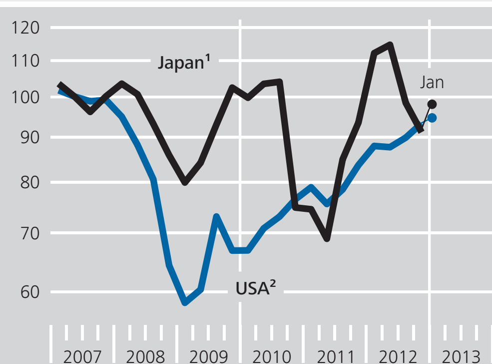
New EU member states

Distinct cyclical weakening

Economic output in the new EU member states (EU-7)[1] as a whole is likely to have fallen again in the last quarter of 2012 for the first time since spring 2009. Whereas real GDP fell in Hungary (-1%) and the Czech Republic (-¼%), it stagnated in Bulgaria and grew in Romania (+¼%), Lithuania (+1%) and Latvia (+1¼%). In

Sales of new cars in Japan and the United States

2007 = 100, quarterly, seasonally adjusted, log scale



Sources: Haver Analytics and Bundesbank calculations. **1** Number of first-time car registrations. **2** Unit sales of light motor vehicles.

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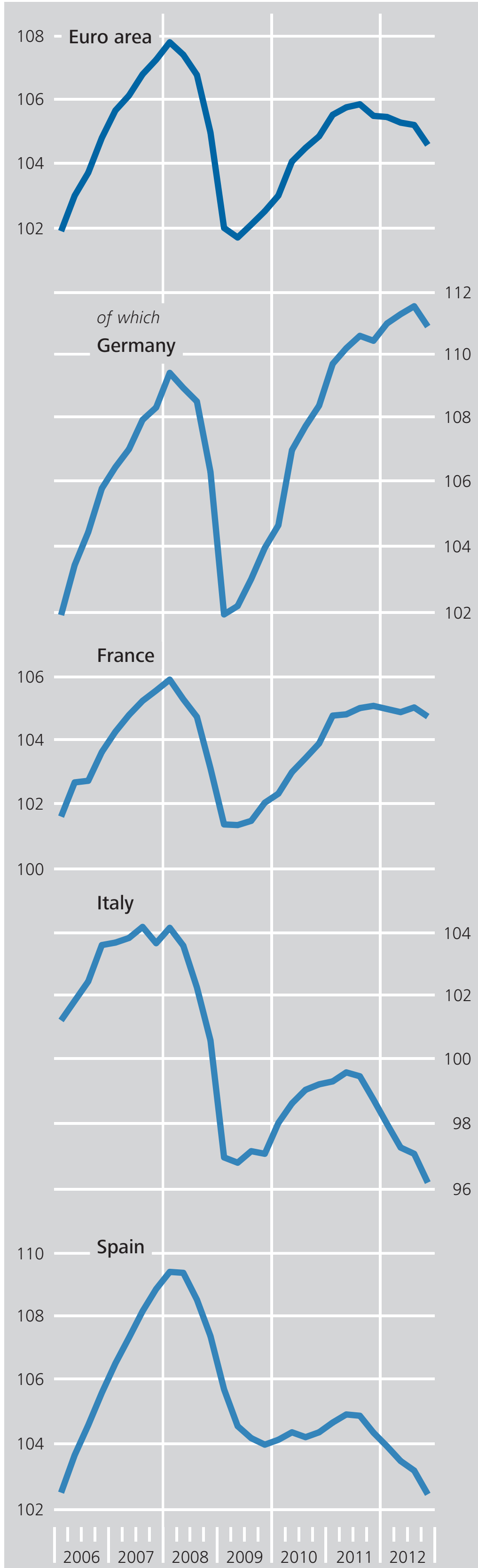
Poland, for which no national accounts data for the final quarter of the year are available, the indicators are likewise pointing to a contraction of aggregate output. As a result of the rather distinct cyclical weakening, the situation in the national labour markets has deteriorated for the most part. The aggregate unemployment rate, at a seasonally adjusted 9.5%, was only slightly below its cyclical high of the 2010 winter quarter. In many places, consumer price inflation has fallen perceptibly; headline HICP inflation in the fourth quarter stood at 3.3%. Some central banks in the region used the monetary policy latitude gained as a result to reduce their policy rates.

Macroeconomic trends in the euro area

Cyclical downward movement accelerated at year's end

The euro-area recession, which has been ongoing since autumn 2011, intensified significantly in the last quarter of 2012. Real GDP fell by a seasonally adjusted ½% from the preceding quarter, in which its decline had been minimal. Aggregate output in autumn contracted by 1% year-on-year. According to provisional data for 13 of the 17 member states, the un-

1 This group comprises the non-euro-area countries that joined the EU in 2004 and 2007.



favourable economic developments in the euro area continued to expand in many regions. Alongside the southern peripheral countries, in which the economic slump even accelerated further in most cases, Germany and Finland were forced to cope with perceptible output losses, whereas France, the Netherlands and Austria saw only moderate declines in production, and in Belgium output remained virtually unchanged. Only in Slovakia and Estonia did output actually grow. The poor fourth-quarter result is due, for one thing, to the euro-area's home-grown problems, with the intensification of the crisis in the summer most likely having caused a further significant decline in consumer and investor confidence. For another, non-euro-area countries provided less expansionary stimuli than before. Euro-area real GDP fell by ½% on average for 2012 as a whole. Around one-third of the 13 member states for which annual results can already be calculated reported positive growth rates; however, these rates were mostly quite low and unable to offset the, in some cases, powerful contractions in the other member states. GDP growth rates in the euro area in 2012 ranged from approximately -6½% in Greece to +3½% in Estonia.

Retarding effects waning but still no recovery in sight

According to survey-based indicators, the euro area as a whole is expected to be slightly calmer in the winter months of 2013, but no dramatic economic upswing is on the cards yet. Although the Purchasing Managers' Index for manufacturing has been tending slightly upwards again since August, in January it was still well below the expansion threshold. According to surveys conducted on behalf of the European Commission, industrial confidence has likewise improved markedly in the past three months yet was still quite far removed from its long-term average. A positive development in this context is that the indicator has recently gone back up in some crisis countries as well. Increased output expectations deserve a large portion of credit for the strengthening of sentiment in the euro area. In addition, assessments of inventory pressure are no longer as unfavourable as previously. The positive de-

velopment of export orders received according to the PMI also invites the conclusion that export business could be heading for a revival in the coming months. Consumer confidence has likewise improved. According to current forecasts, the euro area will return to a moderate growth path as the year progresses.

All parts of production sector affected by downswing

The contraction in aggregate output in the last quarter of 2012 is due predominantly to a decline in activity in the production sector. Seasonally adjusted construction output in the October-November period shrank by 1% from the third quarter, in which it had still managed slight growth. It was down by 4% on the year. Not only cutbacks in residential construction in the peripheral countries but also reductions in public and commercial construction investment in large swathes of the euro area are behind these developments. Output in the production sector (excluding construction) fell in the fourth quarter by a seasonally adjusted 2½% from the summer months and by 3¼% on the year. Manufacturers of consumer durables and capital goods were forced to scale back their output (by -4¾% and -3¾% respectively) particularly sharply from the previous period. Output of intermediate goods was down by 2½% and of non-durable goods by ¼%. Energy output was cut back by 1½%. The surveyed increase in capacity utilisation in the manufacturing industry in the October-January period could be a sign that industrial output recovered somewhat at the turn of 2012-13 following its slump in October-November.

Domestic demand persistently weak

With regard to the demand side, the decline in GDP is attributable first and foremost to weak domestic demand. According to the indicators for construction output and the production of capital goods, gross fixed capital formation is likely to have declined sharply once again. In addition, households' propensity to purchase remained restrained in the light of rising tax and levy burdens, shrinking real wages, rapidly rising unemployment and a generally pronounced feeling of uncertainty. Real retail sales (excluding motor vehicles and fuel) accordingly

Labour market in the euro area

Seasonally adjusted

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fell in the last quarter by 1½% on the period. Moreover, the propensity to purchase automobiles sagged as well. Motor vehicle sales, measured by new registrations, were likewise down by 1½% from their level in the summer months after seasonal adjustment. On average for 2012, they were down by 11¼% from 2011 to levels last seen in 1990. In the public discussion in the euro area, for some time now there have been calls for a significant acceleration of wage growth in Germany; by strengthening domestic growth forces, this would then also ripple over to Germany's partner countries in Europe. However, simulations using the NiGEM model show that such a change of direction in wage policy would not hold much promise of success for either Germany or its partner countries (see box on pages 18 to 20).

Exports to non-euro-area countries in autumn 2012 are not likely to have provided any further growth stimuli, unlike in the summer; in any event, nominal exports of goods and services in

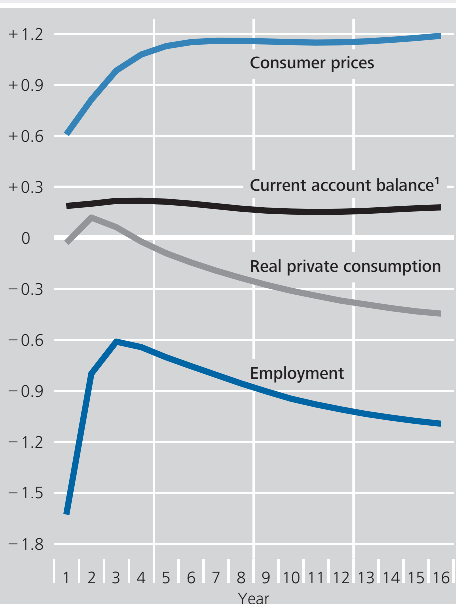
The macroeconomic impact of an increase in wages in NiGEM simulations

There have recently been growing calls for a significant increase in wages in Germany in the public debate. Its proponents believe that such a measure will strengthen private consumption and therefore domestic growth forces, which, by accelerating growth in imports, could also impact positively on Germany's partner countries, especially those in Europe. They suggest that this would also help to reduce imbalances in the euro area because an increase in domestic demand for foreign goods would decrease the trade surplus in Germany and deficits elsewhere.

Although this line of argument appears plausible on the surface, it is not certain whether this limited perspective takes account of important mechanisms and feedback effects both inside and outside such a complex and internationally interlinked economy. We investigate this using the global economic model NiGEM developed by the National Institute of Economic and Social Research (NIESR).[1] In the short to medium term, the model has Keynesian characteristics. In particular, aggregate output is determined by demand, which means that the cause-and-effect mechanism put forward by the proponents of a wage increase is incorporated in any case. In the long term, however, output is determined by the underlying production function. Furthermore, the trade relationships between 40 economies and six regions are modelled explicitly. As a specific experiment, we assume an exogenous and permanent increase of 2% in the average nominal hourly wage in Germany compared to the baseline, with key interest rates initially held fixed.

Responses of important macroeconomic variables in Germany to a wage shock*

Percentage or percentage point deviation from the baseline



* Exogenous and permanent increase of 2% in the nominal average hourly wage compared to the baseline at fixed key interest rates. **1** As a percentage of GDP (percentage point deviation).

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An exogenous wage increase of this kind, which is not caused by an increase in productivity, for example, represents a rise in the cost of labour as a factor of production. The firms in the model react directly to this pure cost shock by using less labour. This means cutting jobs, which leads to a decrease in potential output. In addition, firms adjust their capital stock to the lower levels of employment, giving rise to an immediate and considerable cutback in commercial investment. In the short term, reduced expenditure by firms also prevents a potential pick-up in household demand. However, even this expansionary effect is by no means clear-cut. Higher wages for households in employment are counterbalanced by reductions in income for those who have lost their jobs. Overall real disposable income and household consumption therefore only increase temporarily compared to the baseline. In the long term, they even sink markedly under the weight of job losses. Domestic demand and GDP, on the

1 The key interdependencies have already been explained in an earlier issue of the Monthly Report. See Deutsche Bundesbank, On the problems of macroeconomic imbalances in the euro area, Monthly Report, July 2010, pp 17-38.

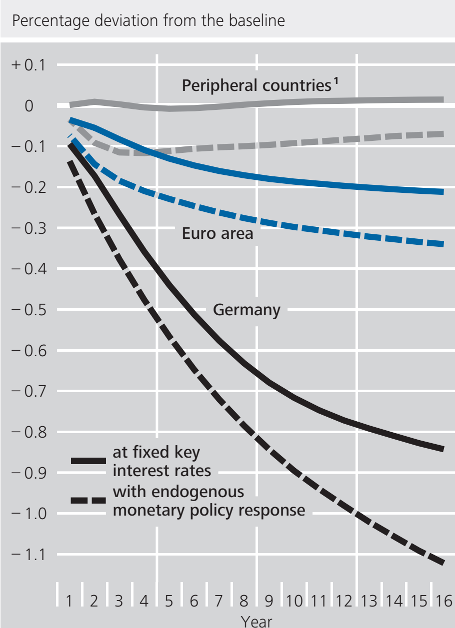
other hand, decrease in comparison to the baseline from the outset.[2]

Due to the contractionary effect on the domestic economy, the hoped-for expansionary effects on the partner countries also fail to materialise. In the simulation, real GDP, especially for the peripheral countries of Spain, Greece, Portugal and Ireland, remains practically on the baseline, while the decrease for the euro area on average mainly reflects the contraction in German output. Weaker domestic demand causes the German economy's real imports to fall in the short term. However, as costs rise, so do the prices of domestic products. As a result, domestic demand for goods shifts towards imported products and foreign demand is redirected towards suppliers outside Germany. This substitution effect ultimately compensates for the impact of the reduced domestic demand on the German volume of imports, causing real imports to return to the baseline in the long term.[3] By contrast, the volume of exports contracts slightly due to the deterioration in the German economy's price competitiveness. However, the desired decrease in the (nominal) current account surplus does not take place. The marked increase in export prices more than compensates for the limited losses in volume with regard to the value of the exports overall; the current account balance therefore even improves further.

Finally, the role of monetary policy should be examined. Until now, nominal key interest rates have been fixed at the baseline. However, in a second scenario, central banks are permitted to respond to the wage shock. Due to the additional upward pressure on costs and prices in Germany, monetary policy needs to be tightened slightly according to the rule implemented in the model. This causes both short-term and long-term interest rates to rise throughout the euro area in comparison to the baseline. As a result, output losses are somewhat higher than in the previous simulation. This is not confined to Germany; real GDP also slips slightly below the baseline in the euro-area partner countries.[4] Further-

Response of real GDP in selected economic areas to a wage shock* in Germany

Percentage deviation from the baseline



* Exogenous and permanent increase of 2% in the nominal average hourly wage compared to the baseline. **1** Spain, Greece, Portugal and Ireland.

Deutsche Bundesbank

2 Because private consumption does not fall as sharply as domestic demand or GDP overall, its share of these figures rises. The wage increase is therefore successful inasmuch as the "pile of goods" produced by the economy has been shifted to households. Nonetheless, in absolute terms, households are also in a less favourable position.
3 It should be noted that even a marked increase in the German volume of imports would not lead to a correspondingly large improvement in the external positions of the peripheral countries because an economy's trade activities are divided into numerous smaller flows to many different countries. Each measure taken by a surplus country with the aim of triggering an external impact therefore only has a relatively small impact on individual deficit countries. Furthermore, higher demand for imports in Germany would also benefit those economies that have a trade surplus themselves, as well as economies outside the euro area. The problem of large current account deficits can therefore only be solved by the affected countries themselves.
4 Within the framework of the model, the economic agents expect higher nominal key interest rates in the event of a positive wage shock. However, if these rates are fixed, as in the first simulation, the entities are surprised. The result is therefore actually a combination of a positive wage shock and an expansionary monetary policy shock, and it is this monetary policy shock that leads to the comparatively favourable changes in output if key interest rates are fixed.

more, an appreciating euro transmits the shock to the rest of the world. Central banks in non-euro-area countries also react to the depreciation of their own currencies and the resulting increase in consumer prices by raising interest rates slightly, which causes overall output to suffer there, too.

All in all, the conclusion of the NiGEM simulations is that an exogenous increase in wages represents a rise in the cost of labour as a factor of production, which primarily leads to a fall in employment. As a result, domestic growth forces are not strengthened but weakened, the current account surplus continues to rise and the central banks' task of safeguarding price stability is made more difficult.

Of course, the results of such model calculations should be treated with the necessary caution, not least because other models may generate different results. However, they at least highlight the possibility that higher wages may not necessarily be linked to the macroeconomic effects hoped for by their proponents, but may even be counterproductive to their proponents' aims. Experience in recent years in Germany has also underlined the importance of moderate wage increases for employment. It should be emphasised that this type of wage moderation primarily has an impact on the domestic economy, especially the labour market, and not on foreign trade. For this reason, wage moderation is also an important part of the adjustment process in the peripheral countries; it is less about securing a competitive edge in terms of prices on the international markets and much more about lowering the employment threshold of macroeconomic growth and bringing rampant unemployment under control.

Positive contribution to growth by net exports due only to sharp drop in imports

October-November were 1% down from their third-quarter level. Since, however, imports fell even more sharply, this could result in a purely imputed positive contribution to growth by net exports.

Situation in labour market deteriorated further

The recession in the euro area continued to weigh heavily on the labour market in autumn. Employment, for which no fourth-quarter data are available, will probably have fallen perceptibly once again after having previously contracted by ¼%. In the September-December period, the jobless numbers climbed by 280,000 to 18.7 million. This meant that, at end-2012, 1.9 million more people were out of work than a year previously and 7.4 million more than when unemployment hit its cyclical low in March 2008. In December 2012, the standardised unemployment rate in the euro area, at a seasonally adjusted 11.7%, remained at its all-time high.

Decelerating rise in consumer prices

Consumer price inflation in the euro area continued to diminish in the fourth quarter of 2012. It stood at a seasonally adjusted 0.4% period-on-period following 0.5% in the third quarter and 0.6% in the second. This was due in large part to subsiding upward pressure on energy prices, whereas the unfavourable price tendency for foods persisted. Year-on-year HICP inflation fell from 2.5% to 2.3%, but was still perceptibly higher than the seasonally adjusted annualised quarterly rate of 1.6%. This rather large gap and the muted economic outlook make a further decline in annual HICP inflation in the euro area likely. It averaged 2.5% for 2012 following 2.7% in 2011.

Differences between euro-area member states

In 2012, inflation in Germany was 2.1%; despite relatively favourable economic developments, this rate was still somewhat further behind the euro-area average than a year earlier. However, in several countries consumer prices were driven upward mainly by increases in indirect taxes and other administrative measures,

thereby overstating the price tendency that would be suggested by economic activity alone. Of the major economies, this is particularly the case for Italy, with an inflation rate of 3.3%, and Spain, at 2.4%. At 2.2%, average annual inflation in France was close to Germany's level. Greece, where HICP inflation stood at a mere 1.0%, was a downward outlier. Without government measures, consumer prices there would probably have declined amidst the severe economic crisis.