

Global and European setting

World economic activity

In the summer quarter, global economic growth was somewhat stronger than in the preceding period, in which output growth had been restrained. The diminishing influence of the previously active temporary strains was one of the reasons for the pick-up in activity. Energy and food prices did not climb any further, and to a limited extent some prices even fell. This impacted to some degree on consumer prices. A phenomenon which has more of a short-term effect was the rectification of the disruptions to production processes in Japan caused by the natural disaster in March, which had affected, above all, car manufacturing. Consequently, industrial output in Japan and in countries with Japanese manufacturing plants, especially the United States, rose sharply.

Slight resurgence of global growth in summer months ...

In the July-August period, seasonally adjusted global industrial output was 1¼% higher than in the second quarter, in which it had stagnated. As this report went to press, the main drivers of growth were the industrial countries, which means here not only Japan and the United States, which had previously been hit hard by the disaster-related interruptions, but also the euro area, which was less affected by the events in Japan. By contrast, industrial output in the emerging market economies (EMEs) has barely budged since mid-year. One reason is that, in many regions, a restrictive economic policy has been maintained in order to minimise price pressure and the resultant threat of second-round effects. Of the major EMEs, to date only Brazil and Indonesia have loosened their mone-

... thanks to brisk industrial output

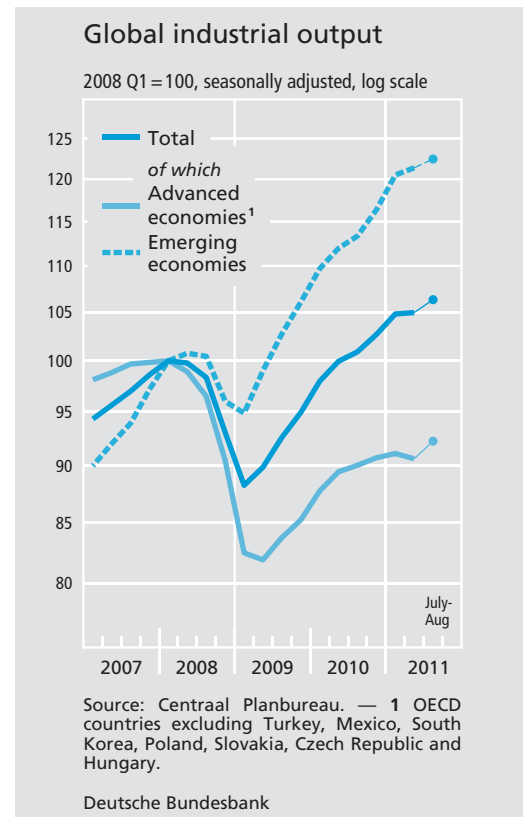
tary policy reins. Trade volume, unlike global industrial output, rose only sluggishly in the summer.

Perceptible increase in industrial countries' GDP

The livelier growth in the advanced economies' industrial sector is reflected in stronger aggregate output growth. In the third quarter, according to initial estimates based on provisional data for the United States, Japan, the United Kingdom and the euro area, real gross domestic product (GDP) grew by a seasonally adjusted ½% and was thus 1¼% higher year-on-year. Japan was in the lead, with seasonally adjusted growth of +1½% vis-à-vis the spring quarter, followed by the United States and the United Kingdom at +½% each. By comparison, the euro area was only able to achieve moderate growth (+¼%).

Contradictory signals make it difficult to assess short-term outlook

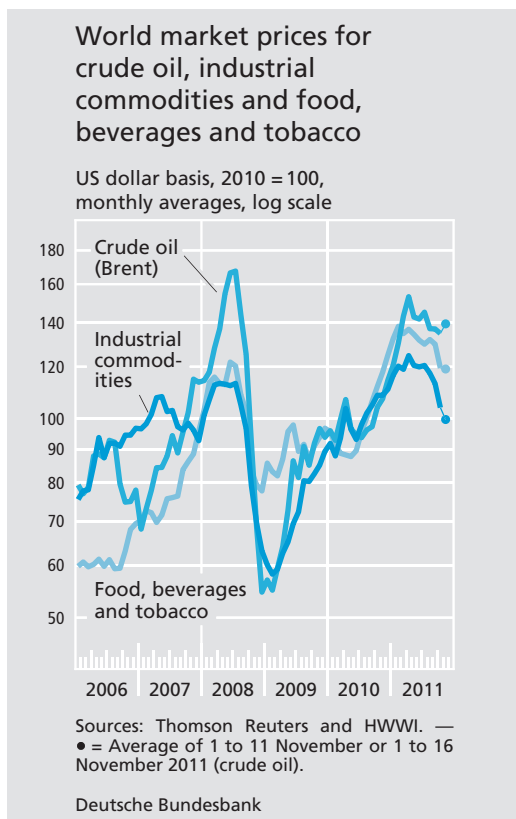
The outlook for the global economy in the 2011 Q4-2012 Q1 period has become considerably more pessimistic following the renewed escalation in the European sovereign debt crisis and the global stock market slump. This is also reflected in the fact that leading indicators based on surveys among businesses and households have for several months been pointing clearly downwards, signalling the risk of a recession. By contrast, hard business activity indicators, to date, draw a more favourable picture. The sovereign debt crisis in the euro area could weigh on the recovery in Europe especially, but could also have adverse implications for trading partners in other economic areas. However, extreme turmoil such as that following the Lehman Brothers insolvency three years ago is not likely. Assuming that the sovereign



debt crisis in Europe does not intensify dramatically, there is justified reason for hope, given falling inflation and a very expansionary monetary policy in the industrial nations as well as continued robust demand growth in the EMEs, that the global forces of growth will not run aground in the coming months. This would also mitigate the uncertainty prevailing among consumers and enterprises regarding the economy.

Against the background of stock market corrections, the renewed escalation of the sovereign debt crisis in the euro area and the resulting global deterioration in sentiment, the IMF revised downwards its forecast for global economic growth in September from its interim forecast in June. The growth forecasts for 2011 and 2012 were reduced by ¼ and

IMF forecast revised downwards



$\frac{1}{2}$ percentage point respectively to 4.0% for each of those years. However, this still represents above-average growth compared with the last economic cycle. The corrections are focused on the industrial countries, especially the United States and the euro area. The forecasts for the EMEs were reduced for each of those years by $\frac{1}{4}$ percentage point to 6.4% and 6.1% respectively. The revisions were larger than average for the central and east European countries (excluding the CIS) because of the relatively pronounced dependence of their economies on the euro area. The changes in the assessment of world trade growth were also quite extensive. Owing to the escalation of the euro-area sovereign debt crisis, the IMF's latest World Economic Outlook sees the downside risks as being even more predominant than earlier.

Following a bout of sharp price increases in the 2010 Q4-2011 Q1 period, the commodity markets calmed perceptibly in the summer months amidst more moderate global economic activity and increased uncertainty in the financial markets. The spot price of a barrel of Brent crude oil was $4\frac{1}{4}\%$ cheaper than in the spring. However, it was still more expensive year-on-year ($45\frac{3}{4}\%$). Oil futures were trading at considerable discounts, indicating that short-term supplies are still low despite the restoration of oil production in Libya. Prices for industrial commodities and food likewise fell perceptibly in the summer period. Unlike crude oil, however, their prices started to fall at an even faster pace as late as the beginning of autumn.

Perceptible calming in commodity markets

In the summer months, the effect of the easing in the commodity markets was to make a slight dent in consumer price inflation in the industrial countries. However, the consumer price index was still up by $\frac{1}{4}\%$ (seasonally adjusted) from the previous quarter, in which it had risen by $\frac{1}{2}\%$. The basket of goods excluding energy and food was once again up by $\frac{1}{2}\%$. Prices therefore afforded households no perceptible relief. Year-on-year headline inflation accelerated from 2.9% to 3.0%; core inflation (excluding energy and food prices) rose by 0.2 percentage point to 1.7%.

Consumer prices still under upward pressure in the industrial countries

Selected emerging market economies

The Chinese economy's slowdown, which had started at year's beginning, continued in the summer months. Year-on-year real GDP growth fell from $9\frac{1}{2}\%$ in the second quarter to 9%. One of the reasons for the decelera-

Chinese economy continuing to gradually cool off

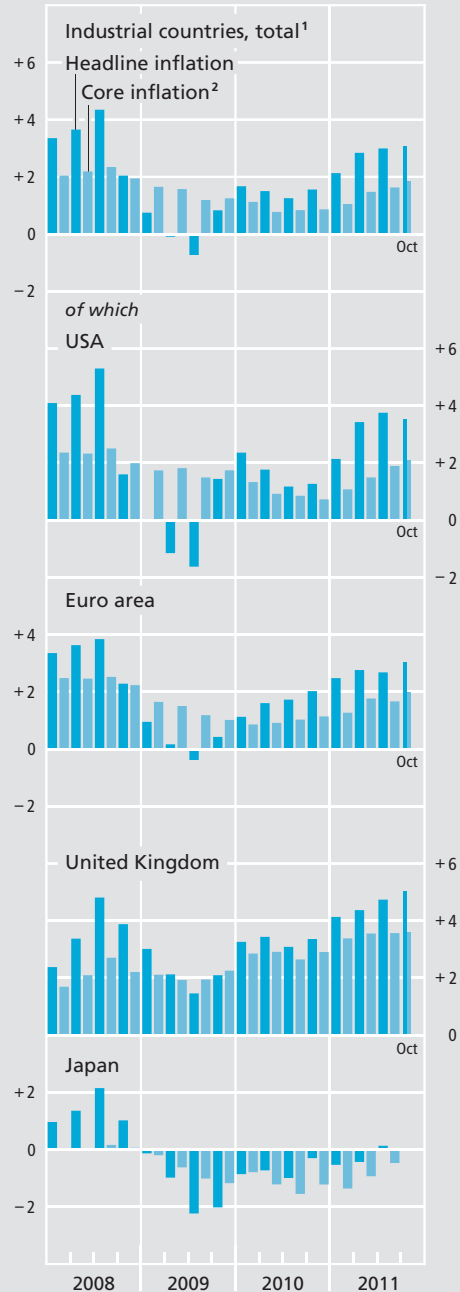
tion is that the People's Bank of China has maintained its restrictive monetary and lending policy. In particular, the central government's programme of strongly expanding public residential construction, designed to meet rising demand for affordable housing, has caused investment growth to weaken only moderately up to now. Another reason is that real retail sales grew somewhat more slowly in the past few months than previously. The loss of consumers' purchasing power as a result of the persistently high rate of inflation is likely to have played a major role. As this report went to press, consumer price inflation decelerated somewhat owing to a slight easing in food prices; however, at 5.5% in October, it was still well off the government's target level of 4%. Alongside the dampened domestic dynamics, a slowdown in exports also contributed to the recent moderation of growth in China. Year-on-year export growth – in US dollar terms – fell from 22% in the second quarter to 19% in the period from July to October.

India looking at prospect of economic slowdown

In India, for which no current GDP data are available yet, economic output growth is likely to have decelerated perceptibly in the third quarter from a high level. One particular sign of this is that manufacturing activity, after having already slowed down considerably, lost a perceptible amount of momentum again, with year-on-year industrial output growth falling from +6¾% in the second quarter to +3¼% in the third. Moreover, the very strong momentum in some services sectors up to that point appears to have recently also flagged considerably. Unlike the trend in many other EMEs, consumer price inflation in

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.

Deutsche Bundesbank

India rose over the course of the summer, from 8.6% in June to 10.1% in September. In order to counter the strong inflationary pressure, the Reserve Bank of India raised its key interest rate in September and again in October.

Brazilian economy treading water

Brazil's economic output growth has probably more or less come to a standstill in the past quarter after having grown by a considerable 3¼% in the spring quarter. Industrial output, which has become less competitive owing to a strong appreciation of the Brazilian real and high wage increases, continued to trend downwards in the past few months. In September, output was down by a seasonally adjusted 4% from its March cyclical peak. However, like in India, services seem to have entered calmer waters as this report went to press. The Brazilian central bank lowered its key interest rate in September and October by a total of 100 basis points owing to a less favourable assessment of the economic outlook. However, consumer price inflation in October stood at 7.0%, which was still above the central bank's upper tolerance threshold of 6.5%.

Increased growth rate in Russia

The Russian economy, unlike those of the other major emerging market economies, saw significant output growth in the past quarter. According to an initial estimate from the Russian Federal Statistics Service, real GDP was up by 4¾% on the year compared with +3½% in the second quarter. Even period-on-period – seasonally adjusted data are not yet available – output is likely to have grown much more strongly than in the spring quarter, in which GDP growth had been de-

pressed not least owing to inventory adjustments. On the whole, the Russian economy has been on more of a flat growth path since the beginning of the recovery; as before, aggregate economic output is still below its pre-crisis levels. This is due chiefly to weak investment growth. The declining trend in consumer price inflation since the beginning of the year has continued throughout the reporting period. Consumer price inflation was 7.2% in October, and thus 2.4 percentage points lower than in January.

United States

The US economy picked up the pace perceptibly in the third quarter. After seasonal adjustment, real GDP was up by ½% from the spring quarter, in which it had risen by only ¼%. This represented an exceeding of the growth level of 2007 Q4, the latest cyclical peak. Households were one of the key drivers of the acceleration. Following a quarter in which an undersupply of Japanese cars had put a considerable damper on real consumer spending (+¼%), the return to normal in the summer months led to a greater impetus (+½%). Virtually just as many new cars were sold in September as in April. However, labour market developments remained subdued. Although monthly employment growth, at 130,000 jobs, was much stronger in the July-September period than on average in the May-June period (+37,000 jobs), the first four months of 2011 had seen average monthly employment growth of 179,000. Whereas the tentative employment growth constrained nominal income growth, stubborn inflation eroded consumers' purchasing

Economic activity receiving renewed stronger boost from households ...

power. Consumer prices were up in the summer by a seasonally adjusted $\frac{3}{4}\%$ from the second quarter, in which they had risen by 1%. Year-on-year headline inflation thus increased from +3.4% to +3.8%. Even excluding energy and food prices, the rate of inflation rose, from 1.5% to 1.9%. All in all, real disposable incomes contracted slightly compared with the spring, which meant that households' increased consumption came at the expense of their savings. At 4%, the saving ratio was at its lowest level since the end of 2007. The role of real income trends and specifically that of inflation in explaining the flatter path of consumption in the past few years relative to previous upswings is also shown by an econometric study (see box on pages 18 and 19).

... and
enterprises

It was not only households that provided a stronger boost in the summer, but also enterprises. After price adjustment, their spending on equipment and software grew more buoyantly than at any time since spring 2010 (+4%). In addition, construction investment once again showed strong gains. By contrast, private residential investment growth was muted at best, public demand remained unchanged, and foreign trade had virtually no impact on GDP growth. The slowdown in stockbuilding continued to perceptibly inhibit the upward trend in aggregate economic activity. On the whole, real spending shows that households and enterprises, despite the increased uncertainty expressed in some measures of sentiment, assume that the upswing will continue.

Japan

Of the key industrial countries, Japan showed by far the strongest quarter-on-quarter growth in aggregate economic activity in the summer, at a seasonally adjusted $1\frac{1}{2}\%$. If upward revisions are taken into account, real GDP nearly returned to its level of a year earlier. This reflected a return of production to normality following the disaster-related stoppages in the winter and spring. With monthly indicators already showing much more moderate economic growth in Japan as the summer progressed, the sharp $6\frac{1}{4}\%$ rise in real exports of goods and services in the third quarter, in particular, needs to be seen in the context of the slump in the preceding quarter (-5%). The calming of global economic activity and appreciation of the yen are likely to put a considerable strain on the growth rate of Japanese exports in the months to come. The strong surge in imports in the summer months was driven by rising domestic demand. It was especially private-sector spending on residential construction which rose sharply in real terms, while government investment was scaled back. However, the recent third extra budget passed by the Diet of Japan is expected to further support the reconstruction process. The labour market proved to be a stabilising factor. In September, the national unemployment rate, at 4.1%, was even much lower than during the last nationwide survey in February (4.6%). Owing, above all, to higher energy prices, Japan's consumer price index underwent a U-turn from -0.5% in the spring to +0.1% in the third quarter. Excluding energy and food

Economic activity largely back to normal

Explaining growth in US private consumption during the current upturn

So far, the pace of economic recovery in the United States has been only moderate. The upswing has been rather flat not only in relation to the severe contraction in the latter part of 2008 and early part of 2009. The current expansion is even below average compared with the two previous phases of recovery in the early 1990s and 2000s, both of which followed considerably milder downturns.¹ Sluggish growth of private consumption is an important reason for the relatively weak current upward trend of the US economy. In order to illustrate this, a consumption function is estimated below. A comparison of earlier cycles with the individual influencing factors' contribution to growth calculated from this estimation enables the identification and classification of economic driving forces and growth-inhibiting factors.

It is assumed in the consumption function that the change in consumer spending (C) is a function of growth in households' disposable income (I). As the estimating equation is based on real variables, the higher rates of inflation caused by rising energy and food prices directly affect real disposable income. Particular attention is paid to households' balance sheets. Aside from net housing wealth (HW) and net financial wealth (FW) their debt (D) is also taken into account.² For this purpose, a cause-and-effect relationship is assumed between the growth of private net wealth and consumption expenditure. In this case, the wealth effect is assumed to be the key driver. Rising asset prices therefore discourage households from saving current income as they can achieve a similar increase in wealth with less saving and vice versa.³ With this in mind, the sharp decline in the saving ratio of American households up to the middle of the past decade is often attributed to the strong increase in their net assets. Conversely, falling real estate prices since the beginning of the most recent financial and economic crisis are likely to have pushed the saving ratio up markedly, thus leading to a dent in consumption. Households' increasing efforts to reduce their debt could be having a similar impact. The unemployment rate (U) is included in the function as an additional regressor since rising unemployment may lead to higher precautionary saving.

On the basis of the Johansen Test, a cointegrating relationship between real private consumption and real income can be confirmed. The error correction model below is initially estimated for the entire time period available, 1957 Q1 to spring 2011.⁴

¹ As only the first eight quarters of recovery could be observed, the reference periods at the beginning of the 1990s and 2000s were restricted to this horizon, too. — ² Net housing wealth is calculated by subtracting mortgage debt from housing wealth. Net financial wealth also includes stocks of durable consumer goods as well as equipment and software. The debt variable comprises overall outstanding household debt, including mortgages and consumer credit. The data are taken

$$\Delta \ln C_t = \beta_1 + \beta_2 \Delta \ln I_t + \beta_3 \Delta \ln FW_t + \beta_4 \Delta \ln HW_t + \beta_5 \Delta^2 \ln D_t + \beta_6 \Delta U_t + \gamma (\ln C_{t-1} - \ln I_{t-1}) + \varepsilon_t$$

However, structural adjustments within the US economy over the past 55 years are likely to have substantially altered the sensitivity of consumption to some of the factors considered in this context. Calculating the growth contributions at the current end and based on a regression covering the entire estimating period could lead to the picture being distorted. To gain an impression of the movement of the coefficients over time, rolling regressions are carried out over a period of 20 years. The results indicate that the importance of the wealth effect in the case of real estate did not manifest itself until the beginning of the boom in the early 1990s. The coefficient in the estimation over the last 20 years was considerably higher than with regard to the regression across the entire observation period. In contrast, the coefficient of net financial wealth mostly oscillated within a fairly narrow range, without giving an indication of a sustained upward or downward tendency. However, the sensitivity of consumption to increases in income has continually weakened over the past few decades. Similarly, US consumers have recently appeared to be perceptibly less sensitive to changes in the unemployment rate than was the case in the 1970s and 1980s. The dynamics of the time-varying coefficients underline the likelihood of a regression of the entire estimation period potentially leading to an incorrect specification at the current end. For this reason, the above regression function has been re-estimated for the 1990 to 2011 period; the resulting coefficients provide the basis for the following analysis.

The estimation results are in line with the literature.⁵ Aside from real disposable income, households' net assets also impact significantly on consumption growth in both statistical and economic terms. The considerably higher coefficient of the growth of housing wealth compared with that of financial wealth signals that households are a great deal more sensitive to movement in house prices than to fluctuations in the financial markets. A change in the unemployment rate impacts on consumption expenditure not only through the development of wage incomes, but also through adjustment of the saving ratio. As the debt dynamics appear to be insignificant, they will no longer be taken into account below.

from the Federal Reserve's Flow of Funds. All nominal variables were converted into real terms with the help of the personal consumption expenditure deflator. — ³ An additional impact on consumption could stem from liquidity constraints. Hence, households which have trouble obtaining credit could use the additional net equity "created" by higher asset prices to finance current consumption. — ⁴ As it is not the changes in the level of debt as such, but the change to the change of

The model does not explain the weakness of private consumption experienced in the most recent economic recovery compared with the expansionary phase at the beginning of the 1990s. The residual's negative contribution to growth reflects virtually the entire growth differential. A look at the beginning of the new millennium leads to a different result: during this period, the regressors studied in this context did considerably more to stimulate growth, on balance.

A closer look at the explanatory factors reveals that the moderate increase in real disposable income has throttled consumption growth since mid-2009 in comparison with 2002 and 2003 in particular, but also with the early 1990s. This, however, is probably not particularly attributable to the moderate increase in employment; the phases at the beginning of the last two decades were even referred to as "jobless recoveries". Moreover, on average over the past few quarters, nominal wage income, too, did not grow any less than in previous periods. Instead, the strong inflation, particularly in energy and food, appears to have dampened the growth of real disposable income a great deal more than in earlier phases of recovery. This finding accentuates the dampening real economic effects of the latest increase in oil prices. In view of the high consumption intensity, the repercussions for the US economy were particularly hard-felt. For instance, the share of energy expenditure in private consumption rose by $\frac{3}{4}$ percentage point in the four quarters up to spring 2011.

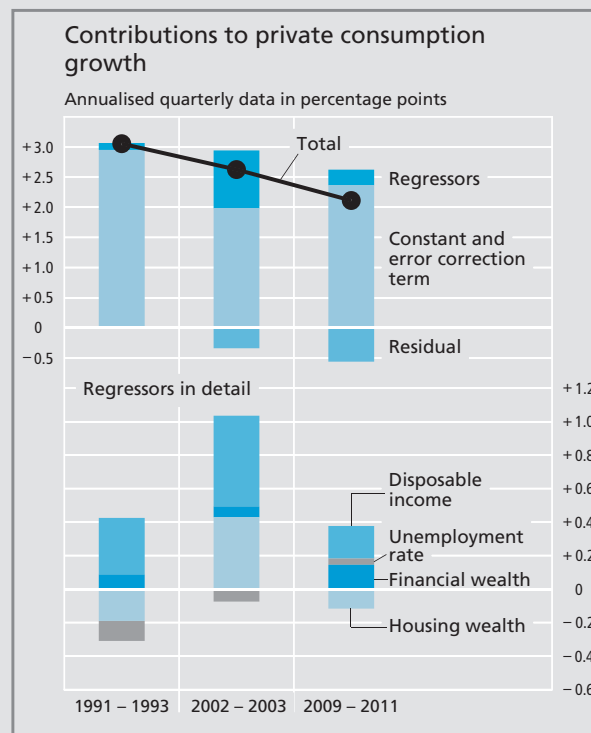
By contrast, the unemployment rate made a slight positive contribution to the latest upswing. Unlike in the periods at the beginning of the 1990s and 2000s, the unemployment rate – starting from a relatively high level – temporarily trended downwards somewhat. With regard to household wealth, the assumption is confirmed that the fall in real estate prices, which has continued beyond the recession to the present, has stifled consumption considerably. However, since at the same time the stock market recovery has improved household wealth substantially, wealth effects generated no negative growth contributions on balance. Compared with 2002 and 2003, during which the real estate boom was strongly expansive, an important stimulus was nevertheless missing.

this level that determines consumption growth, the variable is incorporated in the second difference. For financial wealth, an additional term lagged by one period was tested, but proved to be insignificant. The same applies to the lagged endogenous variable. — 5 See, for instance, K Case, J Quigley and R Shiller (2005), Comparing Wealth Effects: The Stock Market versus the Housing Market, *Advances in Macroeconom-*

Determinants of real private consumption growth ($\Delta \ln C$)

Coefficient, p-value in parentheses

Determinant	1957 Q1 to 2011 Q2	1990 Q1 to 2011 Q2
Change in income ($\Delta \ln I$)	0.215 (0.00)	0.156 (0.01)
Change in financial wealth ($\Delta \ln FW$)	0.032 (0.02)	0.027 (0.08)
Change in housing wealth ($\Delta \ln HW$)	0.036 (0.04)	0.081 (0.00)
Second change in private debt ($\Delta^2 \ln D$)	0.024 (0.33)	-0.040 (0.37)
Change in the unemployment rate (ΔU)	-0.008 (0.00)	-0.004 (0.01)
Error correction term ($\ln C_{(t-1)} - \ln I_{(t-1)}$)	-0.049 (0.00)	-0.058 (0.04)
Constant	0.001 (0.59)	0.001 (0.73)
<i>Memo item</i>		
R^2 (adjusted) in %	43.9	52.4
Number of observations	218	86



ics 5 (1) and J Benjamin, P Chinloy and D Jud (2004), Real Estate Versus Financial Wealth in Consumption, *Journal of Real Estate Finance and Economics*, 29 (3). For a meta-analysis of the effects of housing wealth on consumption growth, see: CBO Background Paper (2007), *Housing Wealth and Consumer Spending*.

prices, however, inflation remained negative (-0.4%).

United Kingdom

GDP growth overstates underlying dynamics

After virtually stagnating, UK economic output rose moderately in the summer compared with the preceding quarter. However, since special factors had previously constrained real GDP growth, its seasonally adjusted increase of ½% from the spring is probably more likely an overstatement of the underlying momentum of economic activity. Although gross value added in the manufacturing sector (excluding construction) once again grew considerably following a contraction in the previous quarter, this was due mainly to the recovery of power and gas production following a weather-related dent. By contrast, manufacturing output growth was once again anaemic; construction even saw a contraction. However, the services sector, which accounts for three-quarters of total gross value added, showed considerably stronger growth (¾%) than in the second quarter, in which an additional holiday had dampened the level of activity. Although no information on the expenditure side of GDP is available yet, households are likely to have remained in a tight spot, after already having curbed their real consumer spending in the spring for the fourth consecutive quarter. For one thing, unemployment climbed to 8.3% in August, its highest level since 1995. The number of applications for unemployment benefits continued to rise in September and October, although the pace decelerated. For another, households saw their purchasing power take yet another heavy hit. In the

summer, the Harmonised Index of Consumer Prices (HICP) rose nearly as sharply period-on-period as in the spring (+1%). Its year-on-year rise further increased somewhat to +4.7%, and even core inflation (excluding energy and unprocessed food), at 3.5%, was well above the official inflation target (regarding headline inflation) of 2%.

New EU member states

In the entire group of new EU member states (EU-7),¹ economic output is likely to have once again grown perceptibly in the summer quarter following a rise of ½% in the second quarter after seasonal adjustment. Real GDP was up by 2% in Romania and ½% in Hungary. In addition, the robust upward trend of Polish industrial output is indicative of a perceptible increase in aggregate output. The situation on the labour market has continued to improve slightly in most of these countries. In the region as a whole, unemployment fell from 9.4% in the second quarter to 9.2% in the third. Consumer price inflation averaged 3.5% in the July-October period, which was much lower than in the second quarter (4.5%). This was due in large part not only to the easing of food prices but also to the elimination of the mid-2010 rise in indirect taxes in Romania from the year-on-year comparison.

Upswing continues

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

Macroeconomic trends in the euro area

Moderate growth in the summer quarter

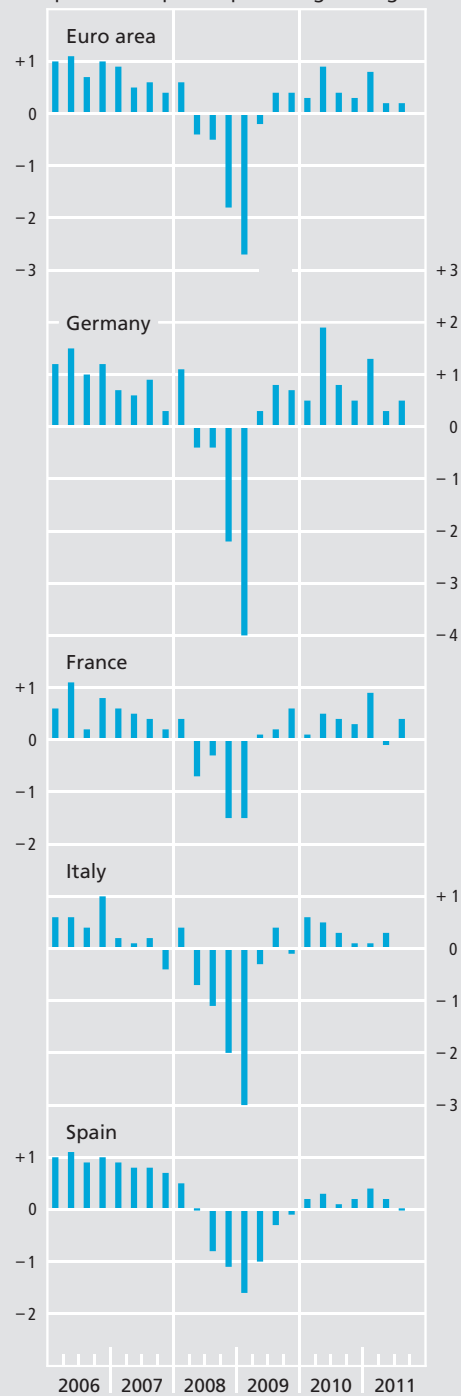
In the third quarter, the euro area remained on the flat growth path that it had embarked on in the second quarter. Real GDP grew once again by ¼% after seasonal adjustment. It was up by 1½% on the year but still 1¾% removed from its pre-crisis level. The German and French economies, which each expanded by a seasonally adjusted ½%, made the main contributions to growth. In Spain, real GDP remained stagnant at the previous period's level. The Netherlands, Portugal and Cyprus reported a decline in aggregate output. The contraction process seems to have continued unabated in Greece. Although Greece has no longer reported seasonally adjusted data on real GDP since the spring, negative year-on-year GDP growth in the third quarter (5¼%) is likely to have been smaller than a quarter earlier owing merely to a base effect. No such data are available for Italy and Ireland yet. Mounting uncertainty among consumers and investors caused by the renewed escalation of the sovereign debt crisis in the summer is likely to be one of the key reasons for sluggish euro-area growth. In addition, banks appear to be less willing to grant loans in the most afflicted countries.

Growth outlook more on gloomy side towards year's end

The deterioration of the sentiment indicators, which has already lasted for several months now, has failed to make itself felt in a corresponding distinct weakening of real economic activity, thus making it more difficult to assess macroeconomic trends in the euro area for the 2011 Q4-2012 Q1 period. There is currently no telling in which direction the gap between the extraordinarily bad survey-

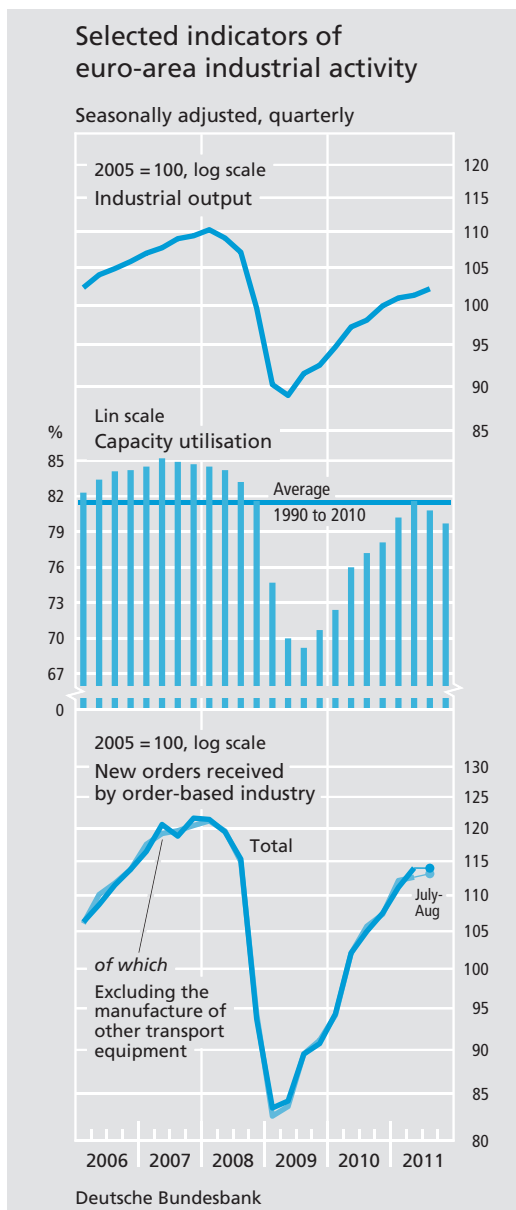
Growth trends in the euro area

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



Sources: national statistics, Eurostat and the ECB.

Deutsche Bundesbank



based indicators and the less unfavourable hard economic indicators will close. All in all, there are many indications that growth in the fourth quarter will more or less grind to a halt. Further macroeconomic developments are likely to depend, in particular, on how the sovereign debt crisis unfolds.

The increase in economic output in the third quarter was borne chiefly by the increased

buoyancy of activity in the production sector compared to the spring quarter. Industrial output was up by a seasonally adjusted 1% on the period. Capital goods (+2¾%) and energy production (+1¼%) were the main drivers. The production of intermediate goods and consumer durables rose by ½% each. By contrast, the output of non-durables went down perceptibly (-½%) in the period under review. Although output was brisk on the whole in the summer quarter, capacity utilisation in manufacturing fell once again in the July to October period, thus moving even further away from normal levels. Besides the industrial sector, construction activity rose noticeably in the summer quarter, by ¾% compared to the second quarter.

Industrial output is buoyant ...

With regard to the outlook for the euro-area industrial sector, at present the leading indicators – as is the case for other economic areas – are presenting a somewhat hazy picture. In the July-August period, orders received by manufacturing maintained their high level of the spring months. Excluding the manufacture of other transport equipment, in which numerous large orders were recorded in the second quarter, orders were still up by ½%. This represented a year-on-year increase of 6¾%. By contrast, according to the European Commission's economic survey, industry confidence continued to deteriorate, albeit at a slower pace, falling in October back to its multi-year average. A poorer assessment of order books and higher pressure on inventories are the main reasons for the deterioration of growth. In addition, the Purchasing Managers' Index for manufacturing (as well as for services) fell even further

... yet uncertain outlook

below the expansion threshold in October, thus signalling a contraction.

Corporate investment and exports boosting economic activity

From the demand side, investment and exports are likely to have boosted GDP growth in the third quarter. The perceptible growth in capital goods and construction output mentioned above indicate rather favourable development of investment expenditure. In the July-August period, nominal exports from the euro area to non-euro-area countries rose by a seasonally adjusted 1% from the second quarter. Since imports simultaneously stagnated, the euro-area balance of trade improved distinctly during the period under review. Foreign trade is thus likely to have once again made a positive contribution to growth. On the other hand, household consumption has probably put a renewed damper on aggregate growth. At all events, the number of new car registrations was down slightly after seasonal adjustment, whereas real retail sales stood pat at the depressed level of the previous period. This is consistent with a decline in consumer confidence that persisted throughout the reporting period, which was particularly pronounced in those member states that are under severe pressure to consolidate their public finances.

Situation in labour market persistently difficult

After mid-year, the recovery in the labour market began to sputter. Employment growth, which in the second quarter still managed to amount to ¼% compared to the winter months, is likely to have come to a virtual standstill given the renewed sluggishness of economic growth. This is also indicated by the renewed rise in the number of unemployed persons in August and Septem-



ber to a seasonally adjusted 560,000 above its low of April 2011. Since then, the standardised unemployment rate has gone up by 0.3 percentage point to 10.2%. After factoring out the favourable development in Germany, the picture presented by the labour market is even gloomier. In the euro area excluding Germany, employment did not reach its cyclical trough until the beginning of 2011 and has only inched upwards since then. In addition, the unemployment rate in that group of countries, at 11.9%, was perceptibly higher than in the euro area as a whole.

Year-on-year HICP inflation in the euro area rose to 3.0% in September 2011 and stayed at that level in October. This means that the wave of inflation which followed the global economic recovery with a time-lag is likely to

Peaking of inflation

have peaked. Year-on-year HICP inflation is expected to recede distinctly in the coming months. The impact on annual inflation of the surging energy prices in the 2010 Q4-2011 Q1 period, in particular, is likely to gradually wane. The same applies to the in some cases rather sharp increase in food prices. The price-driving effects of fiscal measures applied in some euro-area countries to consolidate public budgets in deficit in the second half of 2010 and beginning of 2011 will likewise probably diminish.

The extension of coverage to include seasonal products beginning in January 2011

without adjusting the index series for the past has increased the volatility of the monthly annualised HICP rates for the euro area, making them considerably more difficult to interpret at times. This is particularly true of non-energy durables and non-durables, in which the semi-annual end-of-season sales made themselves felt much more strongly than before. Because of these influences – the year-on-year rates in July and August were thus condensed – year-on-year consumer price inflation, at 2.7% on average over the third quarter, was even slightly less strong than in the second quarter, when it stood at 2.8%.