

Global and European setting

Global economic developments

Global economic upturn strengthened

The global economic recovery gained momentum in the second quarter of 2021. However, developments were quite heterogeneous across countries. Growth picked up mainly in the advanced economies, which made progress in combating the coronavirus pandemic. In Europe, the measures to contain the pandemic, which had been tightened in the fourth quarter of 2020 and first quarter of 2021, were rolled back in light of the progress made in vaccination programmes. Economic activity accelerated accordingly, growing especially sharply in the United Kingdom but also quite considerably in the euro area and the other EU countries. In the United States, the restrictions imposed on businesses and consumers had already been less stringent, so there was also less scope for opening up the economy any further. Nevertheless, US real gross domestic product (GDP), additionally boosted by the stimulus package approved in March, saw fairly strong growth and exceeded its pre-crisis level for the first time. The Chinese economy continued to pick up, despite a slowdown in its exceptional export boom. Meanwhile, the pandemic maintained its grip on other regions of the world in light of their low vaccination rates. For example, GDP growth in Japan was subdued particularly due to the fact that many pandemic containment measures remained in effect. Fresh outbreaks even led to economic declines in a number of emerging market economies. This was the case, for instance, in India.

Recovery in high-contact services a major factor

Economic developments in the second quarter were uneven across sectors as well. Providers of high-contact services benefited greatly from the steps taken towards opening up the economy. In particular, there was brisk demand for reopened food and beverage services. By the end of the second quarter, the number of restaurant visits around the world had almost re-

attained its pre-crisis level for the first time. In the travel sector, which had been hit hard by the pandemic, signs pointed to a recovery as well. Capacity utilisation in passenger air travel and the hotel and accommodation sector went back up in both Europe and North America. Industry took a blow, however. The reason for this seems to have been twofold: first, demand for certain goods, which had risen sharply during the pandemic, began to normalise. Second, supply-side bottlenecks intensified further. Throughout the reporting period, enterprises in the manufacturing sector were complaining of sharp rises in delivery times for intermediate inputs. Alongside logistical problems resulting from limited transport capacity, especially for maritime transport, production was throttled by global shortages of various intermediate goods. This had a particular impact on the motor vehicle industry, in which production de-

Global economic indicators

Seasonally adjusted

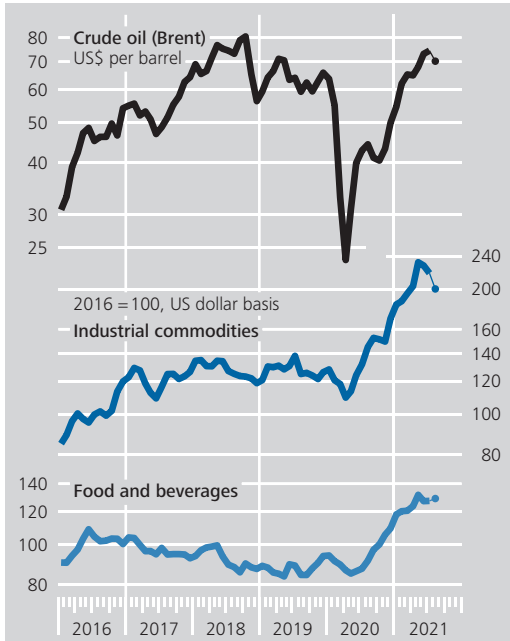


Sources: IATA Passenger Traffic Report, national figures, Haver Analytics, and Bundesbank calculations. **1** Ratio of revenue passenger-kilometres to available seat-kilometres. **2** Bundesbank aggregate of national data, unadjusted figures in thousands of units, most recent data points partially estimated.

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

Monthly averages, log scale



Sources: Bloomberg Finance L.P., HWWI and Bundesbank calculations. • Latest figures: Average of 1 to 13 August 2021, or 1 to 19 August 2021 for crude oil.

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Consumer prices in industrial countries

Year-on-year percentage change



Sources: IHS Markit and Bundesbank calculations. **1** Consumer prices excluding energy and food, additionally excluding alcoholic beverages and tobacco products for the EU27, Norway, Switzerland and the United Kingdom. **2** EU27, Canada, Japan, Norway, Switzerland, the United Kingdom and the United States.

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clined considerably due to a lack of semiconductor products.

Industrial producer prices continued to rise sharply in many places given the bottlenecks in a number of industrial and supply sectors. This was partly down to the dramatic increase in transport costs, which continued apace throughout the reporting period in container shipping at least. The situation likewise remained strained in the commodity markets. Crude oil prices increased perceptibly again in May and June. This rise was dampened only by the agreement among the OPEC countries and their partners to markedly expand supply, the slight growth in oil production in the United States, and the concerns surrounding future demand due to the spread of the Delta variant of the coronavirus. As this report went to press, the price of a barrel of Brent crude oil stood at US\$66. The prices of many industrial commodities also continued to rise strongly over the course of the second quarter. As this report went to press, however, there were considerable drops in the prices of iron ore and scrap steel as well as of some agricultural products, such as construction timber.

Strong rise in producer prices, partly due to high transport and commodity prices

The rise in consumer prices accelerated considerably in many parts of the world. In the advanced economies, the key factors here were the reopening of services sector that had previously been closed due to the pandemic as well as shortages of individual goods.¹ These shortages caused prices to rise not only as a result of higher production costs being passed through to consumers, but also because they had knock-on effects on related products. For example, in light of the delivery problems in the passenger car markets in many areas, the prices of used vehicles and rental cars also rose to an unusually large extent alongside those of new vehicles. Particularly in the United States, the prices of air travel and hotel accommodation also increased considerably. There, the stand-

Rise in consumer prices accelerates considerably ...

¹ In a number of emerging market economies, strong rises in food prices additionally played a major role.

ard year-on-year comparison shows that significant rebates were being provided for these services during the first wave of the pandemic. Base effects of this kind were even more pronounced for energy products. By contrast, the prices of most of the other products that make up the majority of the basket of consumer goods did not exhibit any noteworthy behaviour. However, the year-on-year rate of change in consumer prices in the advanced economies as a whole increased from 2% in March to 3.6% in July.² The core rate excluding energy and food also picked up by 1.6 percentage points over the same period to 3.0%, thus hitting a 20-year high. However, in July, it declined slightly to 2.8%.

... but probably largely due to temporary effects

There are some signs that consumer price inflation will soon abate again. Following the far-reaching rollback of pandemic-related restrictions on economic life, the price effects resulting from reopening the economy should also peter out. In addition, the production losses in the motor vehicle industry are likely to be gradually overcome and prices will probably fall again as the supply of new vehicles rises. The base effects will also gradually become less significant over the coming months.³ However, the extent to which the strong rise in producer prices over the past few months will be passed through to consumers is still unclear.⁴ In this regard, a key factor will be how much added pressure is put on corporate margins by broad-based increases in costs and wages.

IMF has favourable growth outlook ...

Looking ahead, in the regular July update to its World Economic Outlook, the International Monetary Fund (IMF) is also projecting that the advanced economies will return to moderate rates of inflation.⁵ In fact, the IMF's outlook for real economic developments among this group of countries is now more favourable than it was in April. In anticipation of further fiscal stimulus measures, the IMF revised its growth forecast for the United States significantly upwards for this and next year. By contrast, its 2021 projections for some emerging market economies were revised downwards – to a

considerable degree in some cases – in light of new waves of coronavirus infections. Overall, the IMF is still expecting global GDP growth of 6.0% this year. For 2022, it revised its projection upwards to 4.9%.

However, these forecasts may prove to be too optimistic, not only due to the possibility that the IMF may have overly high expectations of the fiscal package in the United States – which has not yet been approved – but also primarily because many emerging market economies have only made limited progress in their vaccination programmes thus far. Even in countries with relatively successful vaccination campaigns, there are risks to normalising social life, as the past few weeks have shown. Given the rapid spread of new variants of the coronavirus, renewed restrictions and setbacks in the recovery process cannot be ruled out for advanced economies either. These will probably be less extensive, however, in view of the progress made in administering vaccines. It is therefore important to push ahead with vaccination programmes in order to contain new waves of infection and limit their economic fallout.

... but risks tilted to the downside

China

The Chinese economy regained distinct momentum over the past quarter. According to official estimates, real GDP grew by 1.3% in seasonally adjusted terms over the previous quar-

Overall economic expansion regains distinct momentum ...

² When calculating the consumer price index for the aggregate of advanced economies, the consumer price index determined on the basis of weights from 2015 was used for Japan.

³ This development had already been anticipated on the market for crude oil. As the strong recovery in oil prices already began in the second quarter of 2020, the year-on-year change in crude oil prices has fallen by almost two-thirds since April, standing most recently at around 60%.

⁴ Estimates for the United States and the euro area suggest that the rise in freight rates could still be reflected in consumer prices next year. This will hold especially true if the strains on the maritime shipping sector persist for a longer period of time. For more information on the underlying relationship between these factors, see Herriford et al. (2016).

⁵ See International Monetary Fund (2021).

Real GDP in selected major emerging market economies

Q4 2019 = 100, seasonally adjusted, log scale



Sources: National Bureau of Statistics of China, Central Statistics Office of India, Brazilian Institute of Geography and Statistics, Rosstat – Federal State Statistics Service, and Bundesbank calculations.

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ter, which had seen growth of just 0.4%.⁶ The main reason for this was that there was an upturn in some consumer-related services sectors that had suffered setbacks at the start of the year due to a regional outbreak of coronavirus. Most recently, however, concerns of a resurgence of the pandemic in China have been mounting again. Several parts of the country reported rising numbers of new infections with the Delta variant. The Chinese authorities responded by imposing stringent containment measures. This could put a marked damper on services sector activity in the current quarter. In the meantime, major progress has been made in China's vaccination programme. According to official figures, more than 1.8 billion vaccine doses had been administered by mid-August.

Unlike the services sector, Chinese industry lost momentum over the past quarter. This was chiefly attributable to a slowdown in export activity, which had previously received a large boost from a global shift in demand towards

... but noticeable slowdown in industry

certain goods. Although export revenue increased again on a US dollar basis compared with the previous quarter – with higher prices likely playing a key role here, however – the Chinese producer price index suggested that the prices of industrial products rose by just over 8% on the year, which was the highest rate since 2008. By contrast, annual consumer price inflation remained moderate at 1.2%.

Other selected emerging market economies

India was hit by a second severe wave of the pandemic in April and May. Regional authorities imposed extensive containment measures in response to the rapidly escalating health crisis. As a result, the situation eased and many restrictions were rolled back. Mobility data suggest that economic activity has since largely normalised. Nevertheless, a considerable drop in real GDP is expected for the second quarter overall. This decline is likely to be significantly milder than that seen in the first wave of the pandemic, during which economic output fell by one-quarter. In light of the rather sluggish progress in India's vaccination programme, there is still the danger that the pandemic could see a resurgence. The risks to the economic outlook are likely to have been a factor that motivated the Reserve Bank of India to maintain its accommodative monetary policy stance despite the acceleration of the rise in consumer prices in the second quarter to 5.6% on the year.

Economic setback in India due to new and severe wave of infections

Despite persistently high numbers of infections, economic output in Brazil had already climbed back to its pre-crisis level during the first quarter. In the second quarter, however, the recovery may have come to a standstill. In any case, industrial output fell by 2.5% in seasonally ad-

Sputtering recovery in Brazil

⁶ During the past quarter, Chinese GDP grew by 7.9% on the year. In the first quarter, year-on-year growth had amounted to 18.3% as a result of the highly depressed level of economic activity at the time of the outbreak of the pandemic.

justed terms compared with the previous quarter. In Brazil, too, the passenger car sector specifically appears to have been impacted by shortages of intermediate goods. By contrast, commodity exports, particularly of iron ore and soy, continued at record levels. The increase in consumer prices accelerated considerably in recent months. In July, the year-on-year rate of the consumer price index (CPI) stood at 9.0%. Against this background, the Central Bank of Brazil sharply increased its policy rate multiple times, most recently to 5.25%.

Recovery in Russia continues through end of reporting period

In Russia, the economic recovery continued in the second quarter. According to Rosstat figures, real GDP exceeded the previous year's level – which was down significantly due to the coronavirus pandemic – by 10.3% and, in seasonally adjusted terms, it was probably also slightly above its pre-crisis level. Manufacturing output continued to rise in the second quarter. Oil production also saw further growth, which was based on an agreement with OPEC to gradually roll back part of its earlier production cuts. At the end of the quarter, Russia was hit by a third wave of coronavirus infections. As a result, restrictions were reimposed in some parts of the country, meaning that high-contact services are likely to have suffered a renewed setback. Consumer price inflation rose in the second quarter to 6.0% on the year. Not least for this reason, the Bank of Russia has increased its policy rate by a total of 200 basis points to 6.5% since the beginning of April.

United States

Continued buoyant economic growth ...

In the United States, the strong economic upturn continued virtually unabated in the second quarter. According to the initial official estimate, GDP expanded by 1.6% on the quarter after seasonal and price adjustment and thereby exceeded its pre-pandemic level for the first time. Growth was driven by the large-scale reopening of economic life. This allowed US consumers to utilise their spending options, which were much expanded mainly by the

March economic stimulus package.⁷ Alongside private consumption, industrial investment also continued to rise sharply in the second quarter. At the same time, exports picked up noticeably as the global economic situation brightened. In the wake of lively demand, growth of US imports slightly outpaced growth of exports, however. Meanwhile, government demand was somewhat weaker after the support programme for small and medium-sized enterprises was phased out.

As the buoyant recovery has unfolded, bottlenecks have emerged in various areas in recent months. Domestic economic activity again failed to keep up with demand, causing destocking to continue. In the real estate market, shortages and rising property prices dampened activity.⁸ Finally, many firms appear to be having problems filling the numerous vacancies. As this report went to press, labour force participation and employment remained subdued relative to their pre-crisis levels, while wages were picking up.

Against the backdrop of these developments, the increase in consumer prices strengthened further. In the period up to June, the year-on-year rate of the CPI climbed to 5.4%, and the core inflation rate excluding energy and food prices rose to 4.5%. However, the slight drop in the core rate to 4.3% in July is likely to confirm the US Federal Reserve in its view that the surge in inflation has, to date, mainly been due to temporary factors such as base effects and price normalisations. At the end of July, the Federal Open Market Committee reaffirmed its accommodative stance of monetary policy.

... meets supply-side bottlenecks

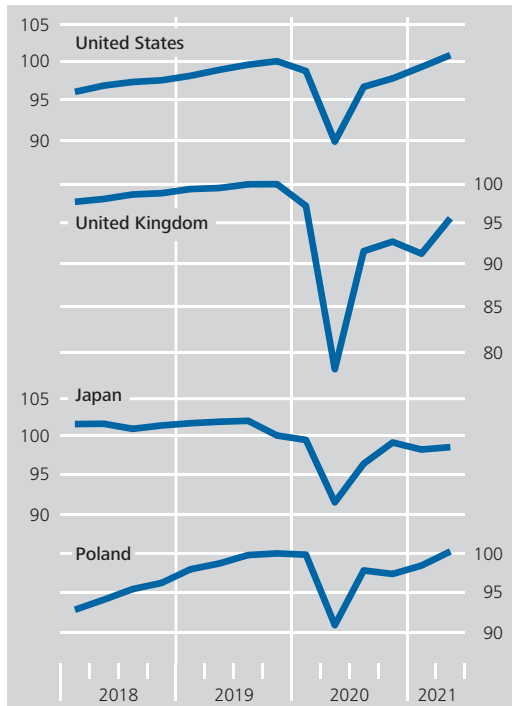
Strong upward pressure on consumer prices

⁷ For more on the macroeconomic implications of the American Rescue Plan, see also Deutsche Bundesbank (2021a). Fiscal policy is likely to continue to support economic activity going forward. The US Senate recently passed a public infrastructure programme with a bipartisan majority, and the governing party has been pursuing further legislative initiatives.

⁸ The weaker sales figures in the real estate market were also reflected in estate agent revenues in the second quarter and consequently had a significant influence on the drop in investment in private housing construction.

Real GDP in selected industrial countries

Q4 2019 = 100, seasonally adjusted, log scale



Sources: Bureau of Economic Analysis, Office for National Statistics, Cabinet Office of Japan, Statistics Poland and Bundesbank calculations.

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United Kingdom

Strong GDP growth given large-scale re-opening of the economy

As most of the measures to contain the pandemic were eased following a successful vaccination campaign, the UK economy entered onto a lively recovery path in the second quarter. According to the initial official estimate, real GDP after seasonal adjustment was up by 4.8% from the first quarter, in which economic output had fallen noticeably. The sharp rise in GDP was mainly the result of the strong expansion in private consumption, while gross fixed capital formation fell slightly. Food and beverage service activities and other providers of high-contact services, in particular, benefited from the large-scale easing of restrictions. Manufacturing expanded its output perceptibly despite production losses in the automotive industry. The fact that lessons have been learned on how to deal with the new frictions in trade with the EU is likely to have played an important role in this.⁹ In any case, exports of goods

to the EU recovered from their slump at the beginning of the year. Overall, gross value added in June was down by only just around 2% on its pre-pandemic level of February 2020. The situation in the labour market also improved. The seasonally adjusted unemployment rate fell slightly to 4.7%. In addition, the number of furloughed staff receiving continued wage payments from the government fell significantly. In recent weeks, firms have, however, increasingly been complaining of high levels of absences due to a renewed surge in infections. The UK government has, however, refrained from imposing new restrictions, pointing to progress on vaccinations and the fact that the health system is under little strain. The Purchasing Managers' Indices for the services sector and manufacturing consequently only fell slightly and continued to signal ongoing growth at the end of the quarter. Against the backdrop of the economic improvement and the higher prices of important intermediate inputs, the increase in consumer prices strengthened considerably. The year-on-year rate of the CPI rose to 2.4% by June, and then fell to 2.1% in July as a result of base effects. The Bank of England said at the beginning of August that it expected a further temporary strengthening of the rise in consumer prices over the next few months, but maintained its accommodative monetary policy stance.

Japan

As the vaccination campaign got off to a slow start and with the increasing spread of the Delta variant of the coronavirus, many containment measures remained in place or were actually tightened again in Japan as this report went to press. This was one reason why economic growth in the second quarter was muted. According to the initial official estimate, real GDP after seasonal adjustment was up by just 0.3% from the first quarter, in which it had fallen by 0.9%. Despite the state of emergency,

Measures to contain the pandemic weighing on economic growth

⁹ See Deutsche Bundesbank (2021b).

households upped their consumption expenditure and enterprises increased their investment spending. Foreign business, meanwhile, benefited from the upswing of the global economy. Imports expanded significantly more sharply still, however. Weak overall economic development had little impact on the labour market. The seasonally adjusted unemployment rate rose only slightly to 2.9% in the second quarter. A sharp reduction in mobile phone charges¹⁰ was one reason why the significant rise in producer prices has, to date, hardly been reflected in developments in consumer prices, which fell by 0.3% on the year in July.¹¹ Against this backdrop, the Bank of Japan maintained its accommodative monetary policy stance.

Poland

Strong recovery amid clearly strengthened rise in consumer prices

In Poland, the economic recovery gained momentum after restrictions to contain the pandemic were eased at the end of April. As a consequence, real GDP expanded sharply by 1.9% in the second quarter after seasonal adjustment, bringing it back up to its pre-crisis level. In this regard, Poland – like some other central and eastern European EU Member States – weathered the crisis better than the remainder of the EU (see also the box on pp.19 ff.). One key factor here was that industrial production remained buoyant. Construction output likewise rose sharply in the second quarter. However, retail sales remained virtually unchanged on the quarter after seasonal and price adjustment. The labour market benefited from the economic recovery. The standardised unemployment rate fell slightly again to 3.6% at the end of the period under review, a mere 0.6 percentage point above its level before the crisis. The rise in consumer prices accelerated to 5.0% on the year in July, and the rate excluding energy and food picked up slightly, to 3.7%. The rise in consumer prices consequently distinctly exceeded the National Bank of Poland's inflation target, which rated the overshooting as temporary, however, and left the policy rate at its all-time low of 0.1%.

Macroeconomic trends in the euro area

In the euro area, economic activity picked up noticeably in the second quarter of 2021. According to Eurostat's flash estimate, seasonally adjusted real GDP rose by 2.0% on the quarter, reducing the gap versus the pre-crisis level to 3.0%. Here, too, the surge in growth was mainly the result of the easing of pandemic-related restrictions in the course of the quarter, made possible by success in containing infections and progress in the vaccination campaign. In particular, high-contact services, which were particularly hard hit by the restrictions, picked up again. In addition, construction activity remained lively. In manufacturing, by contrast, ongoing supply bottlenecks for some intermediate goods prevented an expansion of production.

Lively economic recovery

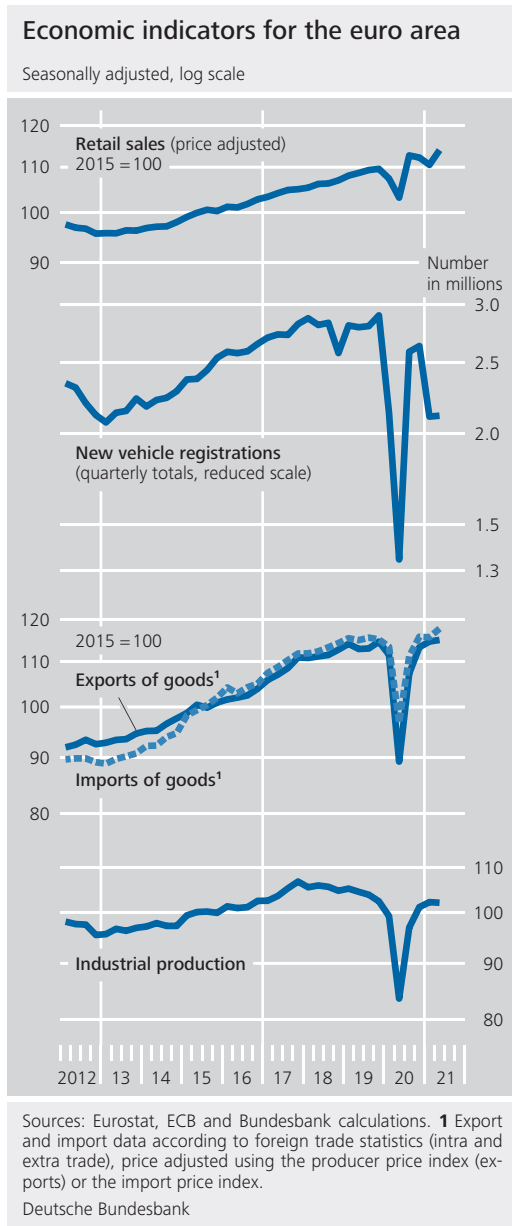
At the beginning of the quarter, several Member States had tightened containment measures in response to the fraught pandemic situation. Infections did not ease off, nor was there much progress in the vaccination campaign, until the course of the second quarter.¹² From May onwards, the restrictions were then loosened distinctly. Initially, retailers were the main beneficiaries. In June, restrictions for hotels and restaurants were eased considerably. As travel restrictions were relaxed, tourism picked up again. At the end of the quarter, the spread of new virus variants sent new infections up

Pandemic situation improves significantly over the quarter, measures eased considerably

¹⁰ Following a reform, mobile phone charges in Japan fell by 38% on the year in April, according to revised data from the Japanese Ministry of Internal Affairs and Communications. In July, this one-off effect lowered the year-on-year rate of the CPI by 1.1 percentage points.

¹¹ One novelty when consumer prices for July were published was a switch in the weighting scheme to the new base year 2020.

¹² By the end of June, more than 50% of the euro area population had received at least one dose of the vaccine, with differences in vaccination progress between Member States low, unlike in the EU as a whole. As this report went to press, it was becoming evident that the speed of vaccinations was tailing off significantly in many places despite a sufficient supply of vaccine and although large parts of the population are not fully vaccinated yet. Several Member States have therefore upped their efforts to increase the willingness of the population to be vaccinated.



again, in some cases sharply, and measures were tightened in some regions. As before, the main aim of these measures was to reduce social interaction in the private sphere and in leisure activities.

Private consumption main driver of the recovery

The most important driver of the economic recovery was private consumption. Demand for high-contact services, in accommodation and food service activities and arts, entertainment and recreation rose noticeably after many containment measures were lifted. However, as not all restrictions were lifted and customers remained somewhat cautious, the recovery was likely not complete, even at the end of the

quarter. Retailers, too, benefited from the relaxation of restrictions. Although many sales outlets were closed at the beginning of the quarter in some countries, and retail sales consequently dropped again perceptibly in April, there was strong growth thereafter, and retail sales significantly exceeded their pre-crisis levels again. However, new vehicle registrations fell considerably short of their pre-crisis level, not least because of the supply shortages in the automotive industry. Households' income situation remained favourable, and their savings rate probably normalised somewhat in the second quarter.

Gross fixed capital formation likely rose again in the euro area in the second quarter.¹³ This was probably mainly due to a perceptible expansion in construction investment. In any case, construction output once again grew perceptibly. Investment in intellectual property also likely rose further. Meanwhile, expenditure on machinery and equipment does not appear to have been expanded and remained considerably short of its pre-crisis levels despite good capacity utilisation in industry and favourable financing conditions. However, surveys show that firms view their growth prospects slightly more unfavourably again of late.

Investment remains on an upward trajectory

Foreign trade continued to expand in the second quarter. Trade among euro area Member States rose distinctly again, especially in intermediate goods. This was also true when taking into account sharply higher prices. Exports of goods to non-euro area countries also continued to rise in value terms, though growth was less strong than in the preceding quarter, and the gain was probably small in price-adjusted terms. Exports of intermediate goods, in particular, proved weak, while exports of consumer and capital goods likely expanded somewhat again. In regional terms, a signifi-

Slower growth in trade in goods with non-euro area countries

¹³ Excluding Ireland. For several years now, the statistical recording of investment as a whole, and of investment in intellectual property in particular, has been strongly influenced by the strategic planning of multinational enterprises there (see Deutsche Bundesbank (2018)).

The central and eastern European EU Member States during the coronavirus crisis

The economies of the central and eastern European EU Member States¹ fared better than widely expected during the coronavirus crisis. The real gross domestic product (GDP) of this group of countries fell by just 4% in 2020, a decline that was considerably less sharp than the 6% drop recorded for the EU as a whole. However, economic growth in these countries, averaging just over 4% in the five preceding years, was also noticeably stronger than growth in the EU, which came in at just under 2%. All the same, it was striking that the central and eastern European EU Member States were able to retain their lead despite potentially greater vulnerabilities.

The comparatively good performance of the central and eastern European EU Member States was probably down to factors such as differences in the way the pandemic developed and how the countries responded to it. These countries were less severely affected by the first wave of the pandemic in the second quarter of 2020, probably helped by fairly strict preventive measures to contain its spread. Nonetheless, the final quarter of 2020 and the first quarter of 2021 saw more severe outbreaks with high infection rates, which over-

whelmed the healthcare systems in some cases. Even so, the containment measures remained largely limited to the services sector, whereas in the second quarter of 2020 – owing also to measures in other EU countries – cross-border transportation had been disrupted and plants had been closed. Overall, the infection protection measures do not seem to have been any stricter than in Germany, say; in fact, they have tended to be somewhat less strict than the average in other EU countries. Some countries also benefited from the depreciation of their national currency against the euro.²

Another reason for this relatively good performance was the rapid recovery of the industrial sector, which plays a more significant role in most central and eastern European EU countries than in the EU as a whole, not least owing to capacity increases over the last few years and closer integration into cross-border value-added chains.³ In addition, Poland benefited from a strongly diversified economic structure. In Lithuania, sharp growth in pharmaceutical production as a result of the pandemic helped to ensure that GDP fell only slightly.

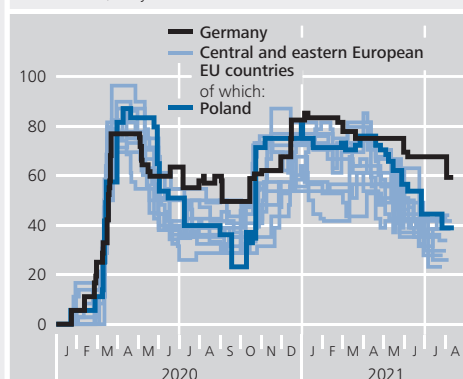
1 This group of countries includes five EU Member States belonging to the euro area (Estonia, Latvia, Lithuania, Slovakia, Slovenia), and six other EU Member States (Bulgaria, Croatia, Czech Republic, Hungary, Poland and Romania).

2 For instance, currencies that depreciated against the euro in 2020 were the Hungarian forint (by 8%), the Polish zloty (by 3.4%), and the Czech koruna (by 3.1%). The Croatian kuna and the Romanian leu depreciated by just 1.6% and 1.9% respectively. The Bulgarian lev remained unchanged owing to the country's currency board arrangement. The Croatian kuna and the Bulgarian lev have been included in the European Monetary System's exchange rate mechanism II (ERM II) since 13 July 2020.

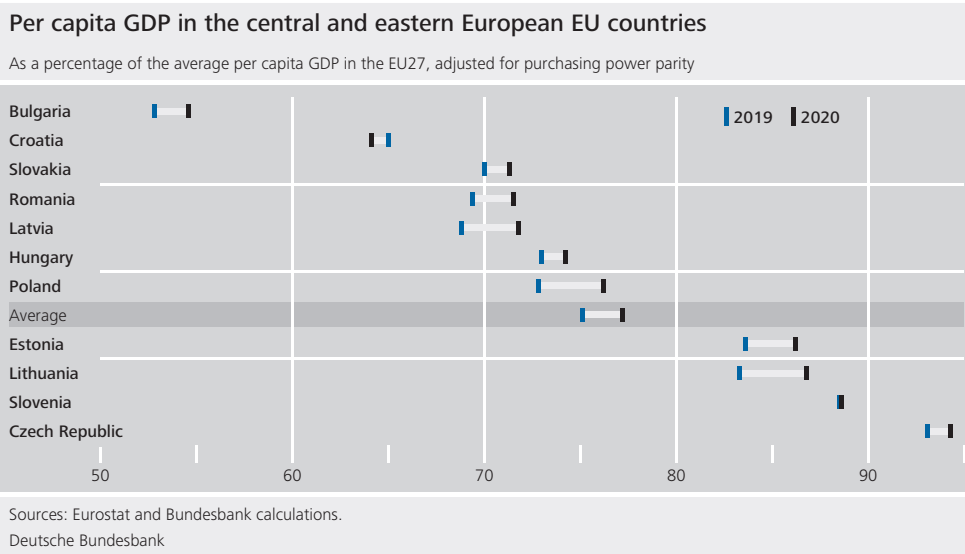
3 See Oesterreichische Nationalbank (2020, 2021). In 2019, industry accounted for one-quarter of aggregate gross value added in the central and eastern European EU countries and for one-fifth in the rest of the EU.

Stringency of government containment measures

Index values, daily



Source: Oxford COVID-19 Government Response Tracker.
 Deutsche Bundesbank



In Estonia, the main factor limiting the decline in GDP was the positive performance of the IT sector. By contrast, the automotive industry, which was hit especially hard by the crisis, held back developments in Slovakia, the Czech Republic and Hungary, where it plays a key role, while Croatia's heavy dependence on tourism had a negative impact. This was also true of Bulgaria, Hungary and Slovenia, albeit to a slightly lesser extent.⁴

Because the central and eastern European EU economies held up comparatively well during the coronavirus crisis, the gap compared to the EU average (which has now decreased, however), measured in terms of per capita GDP adjusted for purchasing power parity (PPP), narrowed further from 24.9% in 2019 to 22.8% in 2020.⁵ The Czech Republic remained in the lead in terms of convergence, with 94.3% of the average GDP per capita figure for the EU. It was followed by Slovenia with 88.6%, Lithuania with 86.8% and Estonia with 86.2%. Poland (76.2%), Hungary (74.2%), Latvia (71.8%), Slovakia (71.3%),⁶ and in the meantime also Romania (71.5%), reported GDP levels exceeding 70% of the EU average, followed by Croatia with 64.1% and Bulgaria with 54.6%.

The European Commission is expecting the central and eastern European EU Member States to recover rapidly this year.⁷ Economic growth in this group of countries is likely to be significantly stronger than in the rest of the EU in 2021, which should help to limit any longer-lasting economic damage. Another encouraging sign is that the unemployment rate in these countries, which was 4.6% in June 2021, was not a great deal higher than just before the coronavirus crisis in February 2020, when it stood at 3.7%. One reason for this will undoubtedly have been the various national short-time work schemes, supported by the EU loan

⁴ See European Commission (2021a, 2021b).

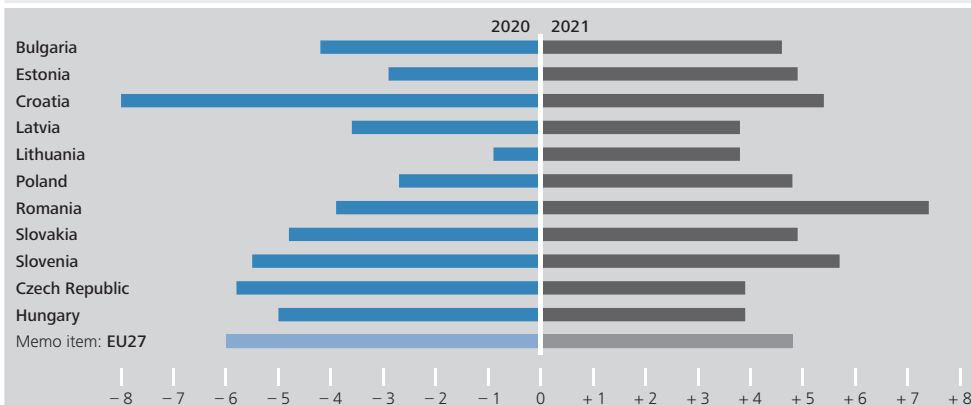
⁵ Because per capita income in the United Kingdom was higher than average, the EU average fell slightly after the UK left the European Union, thus narrowing the gap to this average for countries with lower economic output. As a result, the ratios that appear in this box are not directly comparable to those from last year's report (Deutsche Bundesbank (2020)). The recalculations also take into account new statistical information.

⁶ In the wake of the general revisions to the national accounts in 2019, the percentage of the costs of housing in Slovakia's GDP went up. Because the price level for this component was above average, PPP-adjusted per capita GDP in Slovakia was significantly lower than before. This also affects the convergence ranking list. It is worth noting here that, in 2020, nominal per capita GDP in Slovakia, at €16,800, was considerably higher than in Romania, for example, where it stood at €11,300.

⁷ See European Commission (2021a, 2021b).

GDP in the central and eastern European EU Member States

Year-on-year percentage change



Sources: Eurostat and European Commission – European Economic Forecast Summer 2021 (Interim), July 2021.
 Deutsche Bundesbank

programme SURE.⁸ At the same time, wages have continued to grow, albeit at a distinctly more moderate pace, which should benefit private consumption.

Higher energy prices and increased wage costs saw consumer price inflation in the central and eastern European EU countries rise to 3.9% in July 2021. The inflation rate exceeded the upper limit of the monetary policy target range in April in Poland and Hungary, in May in Romania, and in July in the Czech Republic.⁹ Policy rates were raised by a total of 40 basis points to 0.75% in the Czech Republic in June and August, and by 60 basis points altogether to 1.2% in Hungary in June and July. The central banks in Poland and Romania, on the other hand, have thus far taken a wait-and-see approach as they assume that the surge in inflation will be temporary and that the inflation rate will soon return to the target range.

The sustainability of the economic upswing in the central and eastern European countries will depend on whether the spread of the coronavirus can be kept under control. A key factor here will be the success of the vaccination campaigns. While considerable progress has already been made in a few countries such as Hungary, Poland and the

Czech Republic, vaccination rates in Bulgaria and Romania are still low and are rising only slowly.¹⁰

Over the next two years, the central and eastern European EU economies are likely to benefit particularly strongly from the EU's debt-financed recovery fund.¹¹ To date, the European Commission has approved the national implementation plans submitted by Croatia, Latvia, Lithuania, Slovakia and the Czech Republic,¹² and the Economic and Financial Affairs Council has approved the implementing decisions for the plans submitted by Latvia and Slovakia.¹³ This means that these countries can now start drawing on the funds. Measures to promote climate action and digitalisation are a focal point in particular. This should pave the way for sus-

⁸ SURE: Support to mitigate Unemployment Risks in an Emergency. So far, loans amounting to €18.5 billion (just over one-fifth of the total funds available) have been channelled to the central and eastern European EU Member States under this programme.

⁹ The various inflation targets are based on national consumer price indices whose rates of change can vary slightly from the rates calculated according to the Harmonised Index of Consumer Prices (HICP).

¹⁰ See European Centre for Disease Prevention and Control (2021).

¹¹ Recovery and Resilience Facility (RRF) as part of the Next Generation EU (NGEU) instrument.

¹² See European Commission (2021c).

¹³ See Council of the European Union (2021).

tainable economic development in the period after the pandemic. Central and eastern European EU countries will benefit from this in the long term because the financial assistance paid out to them will probably significantly exceed their future repayment shares.

Just as important as these measures will be ongoing efforts to develop institutional quality in the central and eastern European EU countries.¹⁴ According to the World Bank's governance indicators, this has deteriorated over the last five years owing, in particular, to setbacks in a number of large countries.¹⁵ In most cases, there were considerable gaps compared to the average of the other EU countries, especially in comparison to the top-ranking countries. Given these developments, the recovery fund should also be used to improve institutional quality.¹⁶ Moreover, the EU has introduced procedures to strengthen the rule of law in the Member States.¹⁷

14 The link between institutional quality and economic prosperity has already been the subject of a large body of research. See, for example, Góes (2016).

15 In the majority of the smaller countries, by contrast, it improved over the same period. See World Bank (2021). The World Bank's worldwide governance indicators encompass six individual indicators which are used to compute a simple average. Cross-country averages were calculated based on population shares.

16 See Regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility, especially Recital 15 – European Parliament and EU Council (2021). The rule of law, enshrined in Article 2 of the TEU as a shared value of the EU Member States, is the cornerstone of a properly functioning community and the confidence of citizens and enterprises in public institutions. Because the efficiency, quality and independence of justice systems therefore play a key role in the economic recovery of the Member States, the European Commission is supporting the implementation of appropriate reforms suggested as part of the European Semester's country-specific recommendations through the Recovery and Resilience Facility and through technical and financial assistance for structural reform.

17 The EU Justice Scoreboard and the Rule of Law Report, which are both published annually, form part of a comprehensive, preventive "European Rule of Law Mechanism", which has been added to the EU's existing toolkit. See European Commission (2021d, 2021e).

cant factor was that exports to the United Kingdom continued to recover, having fallen sharply as trade relations were reorganised at the beginning of the year.¹⁴ Exports of goods to China and the United States, as well as to Switzerland and Russia, also expanded in value terms. Meanwhile, exports of services from the euro area to non-euro area countries hardly rose at all according to balance of payments data and fell far short of their pre-crisis level, in part because of the continued restrictions on travel. Imports to the euro area from third countries rose sharply despite the very strong rise in prices, especially of intermediate inputs.

The recovery of the manufacturing sector stalled in recent months. Industrial production did not increase any further compared with the first quarter and remained just under its pre-crisis level. This was primarily due to the difficulties experienced by automobile manufacturers, who were affected by shortages of intermediate goods, chiefly semiconductor com-

ponents. The situation was more favourable in many other industrial sectors. Consumer goods production recorded another significant increase in the second quarter. In the light of strong demand, production of intermediate goods also continued to rise, especially in the wood processing, metal processing and chemical industries. The considerable climbs in prices for raw materials and intermediate inputs were a growing cause of concern. Nevertheless, capacity utilisation has remained above its long-term average since the start of the year and even went up further between April and July.

There was a sharp uptick in service providers' economic activity in the second quarter. This was particularly true of those sectors which had previously been severely hit by the measures introduced to contain the pandemic. That said, restrictions still in place and consumer caution inhibited the rebound, meaning that

Easing of measures provides boost for service providers

Recovery in manufacturing checked by automotive sector

14 See Deutsche Bundesbank (2021b).

these areas are still likely to fall short of their pre-crisis level come the end of the quarter. In the sectors less heavily affected by the containment measures, such as transport and business-related services, economic activity continued to recover in the second quarter, albeit at a markedly slower pace. The upswing in information and communication services, which has persisted over a number of quarters, continued unabated.

Upwards trend in all Member States

Economic conditions improved markedly in all Member States in the second quarter, although the range of GDP growth rates recorded was broad. Differences between the countries in terms of how the pandemic evolved, when and for how long containment measures were enforced and the way their national economies are structured were a crucial factor here.

Moderate rise in economic output in France

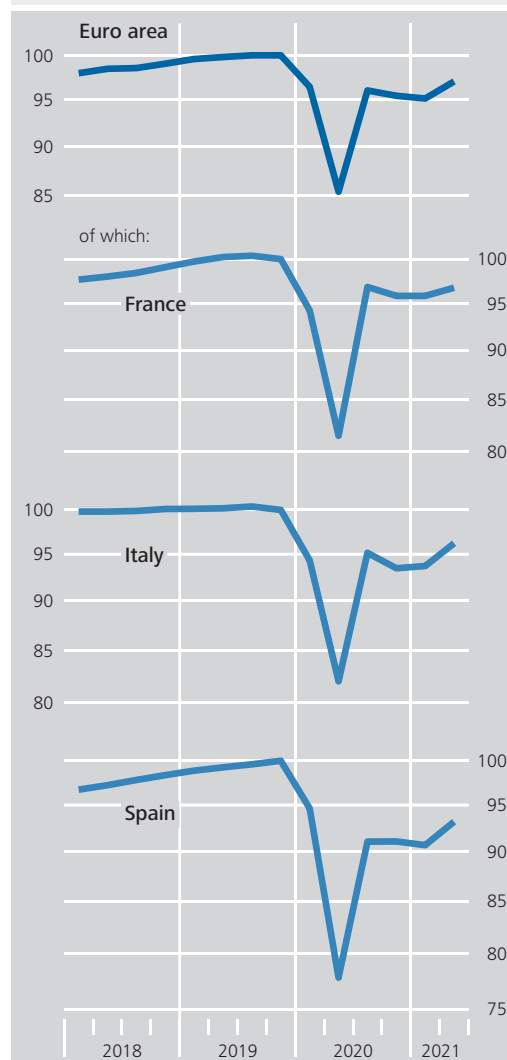
At 0.9%, France recorded below-average GDP growth in the second quarter. That followed a first quarter in which the country's economic output had not fallen, however. In addition, stringent containment measures hampered the economy's recovery into May. As the second quarter progressed, economic activity strengthened distinctly, primarily on the back of the revival in private consumption. Construction investment also rose considerably. On a quarterly average, GDP was only slightly more than 3% short of its pre-crisis level, with the shortfall likely to be yet smaller at quarter-end.

Steep rise in Italy's real GDP

According to preliminary data from Italy's statistical office, the second quarter saw the country's real GDP grow very steeply, by 2.7%. Despite this, average economic output for the quarter still fell just under 4% short of its pre-crisis level, partly because of the renewed substantial contraction it had undergone at the end of 2020 due to the pandemic. The recovery in the second quarter was broadly based. The services sectors in particular, including tourism, benefited considerably from the easing of the containment measures. Growth in construction remained brisk, with output exceeding its pre-crisis level by 13% in the first

Aggregate output in the euro area

Real GDP, Q4 2019 = 100, seasonally adjusted, log scale



Sources: Eurostat and Bundesbank calculations.
 Deutsche Bundesbank

two months of the quarter. Major impetus came in the form of public infrastructure projects and the tax bonus applying to renovation work with a view to improving the energy efficiency and earthquake-proofing of buildings. Moreover, manufacturing continued to rebound in spite of impediments on the supply side in automotive manufacturing.

In Spain, aggregate output rose strongly in the second quarter by 2.8% on the quarter, but economic output still trailed its pre-crisis level by around 7%. In no other euro area country was GDP in the second quarter so far behind its pre-crisis level, a situation caused not by an

Spanish economy strongly recovered of late, though still far below pre-crisis level

additional setback in the fourth quarter of 2020 and first quarter of 2021 but rather by the magnitude of the initial slump and the comparatively lacklustre recovery seen in the third quarter of 2020. Both factors were related to the country's particularly high dependence on tourism. The increase in economic output in the second quarter was primarily due to the revival in private consumption. Economic activity in consumption-related services increased steeply as restrictions were eased. Manufacturing output also saw a slight increase. The persistently weak investment activity was striking. Construction investment once again fell markedly, staying well below its pre-crisis level.

Recovery in the smaller Member States too, but at varying paces

Economic output also rose in the other Member States in the second quarter. In countries where the containment measures had still been very tight in the first quarter, including Austria and Portugal, aggregate output rose very strongly following the easing of those measures. Elsewhere – in the Netherlands, Belgium and Finland, for example – expansion was more moderate. In some of the smaller euro area countries, where a favourable economic structure and robust trend growth had already pushed figures beyond pre-crisis levels, such as in Lithuania, the margin by which they were exceeded widened further. Most euro area countries had not yet returned to their pre-crisis levels, however, with countries heavily dependent on tourism tending to lag the furthest behind.

Improved labour market situation

The situation in the labour market also improved in the second quarter. The number of persons in employment rose considerably in seasonally adjusted terms, by 0.5% compared with the first quarter, in which it had still fallen. It still undershot its pre-crisis level distinctly, by 1.6%, however. Measured in terms of hours worked, there is likely to have been a more pronounced recovery. At any rate, there was a marked drop-off in short-time work in several euro area countries in the second quarter. The standardised unemployment rate fell to 7.7% in the period to June, leaving it just 0.3 percent-

age point higher than before the crisis began. Given that government support measures are still being widely deployed, the labour market may look somewhat more favourable than it is in reality, however. In the second quarter, gross wages and salaries per employee probably climbed sharply compared with the same period last year, when they took a tumble as a result of coronavirus restrictions. The nascent rebound experienced by service providers is likely to have had a slightly negative impact on wage growth via compositional effects, however.

Consumer prices once again increased strongly in the second quarter of 2021. As measured by the Harmonised Index of Consumer Prices (HICP), their increase on the previous quarter – a seasonally adjusted 0.5% – was less strong than it had been in the first quarter as a number of one-off effects expired. Energy prices continued to track upwards. Food prices rose moderately and those for services slightly, while prices for non-energy industrial goods even went down somewhat. The year-on-year rate of the HICP rose further from 1.1% in the first quarter to 1.8% in the second quarter. The pandemic-induced slump in crude oil prices in the second quarter of 2020 was a significant factor behind this considerable increase. The rate excluding energy and food fell from 1.2% to 0.9%, however. Developments in the services sector had a particular bearing here: in Germany, the one-off statistical effect applying to travel services did not serve to push the HICP any higher.¹⁵ In other countries, most notably Spain, prices for travel-related services actually even fell further. Price trends in housing, recreation and other services (which include health, education and financial services) have remained unremarkable. In the case of non-energy industrial goods, the year-on-year rate persisted at the high level of the previous quarter. Strong rises in the prices for consumer durables, which were likely due to rising costs for intermediate goods and transport services, were the key fac-

Consumer prices increase strongly again in Q2

¹⁵ See p. 64 of this report.

tor here. Overall, core inflation excluding energy and food has hovered roughly around its pre-crisis level since the beginning of the year, however.

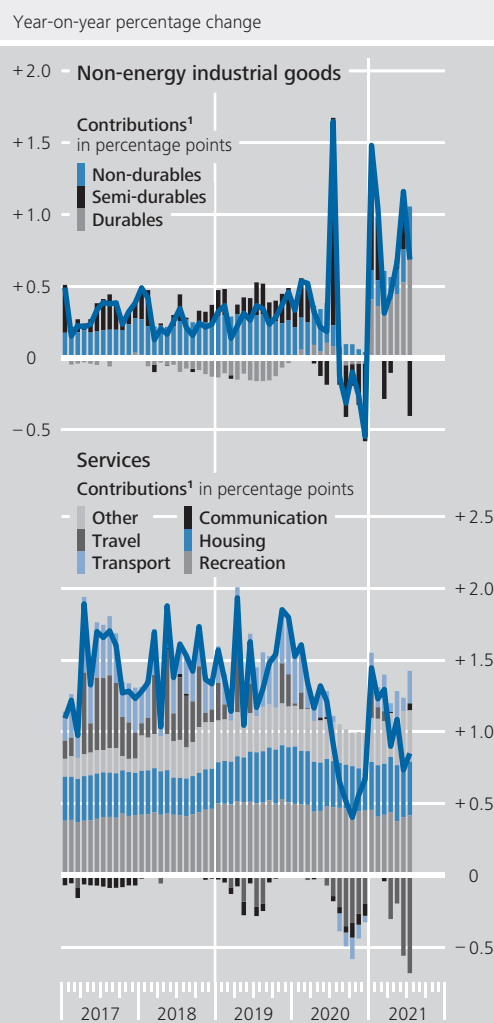
Inflation rate increases further in July

In July, the year-on-year rate of the HICP rose to 2.2%. The rate excluding energy and food recorded a slight decrease on June, however, dropping to 0.7%. While the rise in prices of services increased slightly in year-on-year terms, it slackened distinctly in the case of non-energy industrial goods. The fact that the rate in July 2020 had been especially high because seasonal summer sales had been postponed due to the pandemic played a part here.

Strong GDP growth in Q3, but indications that rebound is slowing

GDP in the euro area is likely to post strong growth in the third quarter, too. This is probable in part even just on the back of carry-over effects; economic activity picked up considerably as pandemic containment measures were eased over the course of the second quarter. Since then, rising infection numbers have prompted a degree of tightening in such measures on a localised basis and the postponement of further easing in some cases. Overall, though, the measures in the current quarter will be milder than they were on average in the second quarter, and consumers are also actually using the additional consumption opportunities now open to them. There have been some indications pointing towards a slowdown in the recovery of late, however. Consumer confidence dimmed slightly in July for the first time since the start of the year, mainly because of less favourable assessments of the future financial situation and of labour market developments. Expectations among service providers with regard to the future development of activity and employment also cooled slightly from their previously high level. This could be partly because more contagious virus variants and incomplete protection via vaccination mean that containment measures are likely to remain in

Composition of selected HICP components in the euro area



Sources: Eurostat and Bundesbank calculations. ¹ The sum of the contributions may differ from the year-on-year rate due to rounding.
 Deutsche Bundesbank

place to a certain extent and may even be partially re-tightened. In industry, production expectations remained well above their longer-term average but have still dimmed somewhat since June. Hindrances caused by materials shortages and climbing prices for raw materials and other intermediate inputs were probably key factors behind the somewhat gloomier outlook in spite of full order books. Whilst all of this is unlikely to jeopardise the recovery, it could be a drag on growth.

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