The euro zone's international environment

GDP growth was moderate in the United States and the United Kingdom in Q1 2003. The weakness of activity in these two trading partners of the euro zone mainly reflects the wait-and-see attitude adopted by economic agents faced with the crisis in Iraq. Despite the ending of the military intervention and the dissipation of international political uncertainties, activity is likely to accelerate, albeit only gradually, starting in Q3 2003. By the end of the year, the euro zone's international environment should therefore be slightly more supportive than at the beginning of the year. However, this upturn would be modest and growth in the American and British economies would remain below potential.

Activity in the United States is expected to accelerate slightly from Q3 on, but remain below the economy's potential

Activity in the United States grew by 0.5% in Q1 2003 *(cf. Table)*. This modest growth mainly reflects the wait-and-see attitude adopted by economic agents faced with rising uncertainty over the Middle East conflict. In the household sector, the confidence index fell steeply and consumption was only moderate in Q1 2003; in the corporate sector, the wait-and-see attitude was evident in the ISM industrial business climate index, which fell continuously during Q1. The uncertainty led firms to prefer to

GDP IN LEADING INDUSTRIALISED COUNTRIES OUTSIDE THE EURO ZONE
(share of countries in oecd total)

	Quarterly % change						Annual % change		
	2002		2003				2001	2002	2003
	Q3	Q4	Q1	Q2	Q3	Q4			
UNITED STATES (34.0%)									
GDP	**1.0**	**0.3**	**0.5**	**0.3**	**0.7**	**0.6**	**0.2**	**2.4**	**2.0**
Consumption	1.0	0.4	0.5	0.7	0.6	0.6	2.5	3.1	2.3
Fixed investment (1)	-0.1	1.1	0.0	0.3	0.8	0.8	-3.9	-3.1	1.6
Nonresidential investment	*-0.2*	*0.6*	*-1.2*	*0.0*	*0.9*	*0.9*	*-5.3*	*-5.8*	*-0.2*
Residential investment	*0.3*	*2.2*	*2.6*	*0.9*	*0.4*	*0.4*	*0.2*	*3.9*	*5.9*
Government expenditures(2)	0.7	1.1	0.1	0.5	0.5	0.5	3.6	4.4	2.3
Exports	1.1	-1.5	-0.4	0.0	1.0	1.0	-5.5	-1.8	0.2
Imports	0.8	1.8	-1.8	1.5	1.5	1.5	-3.0	3.5	3.1
Contributions:									
Domestic demand excluding stocks	*0.8*	*0.7*	*0.4*	*0.6*	*0.6*	*0.6*	*1.7*	*2.4*	*2.3*
Change in private inventories	*0.1*	*0.1*	*-0.1*	*-0.1*	*0.2*	*0.1*	*-1.4*	*0.7*	*0.1*
Net exports	*0.0*	*-0.4*	*0.2*	*-0.2*	*-0.1*	*-0.1*	*-0.2*	*-0.6*	*-0.4*
UNITED KINGDOM (5.6%)									
GDP	**1.1**	**0.4**	**0.2**	**0.3**	**0.4**	**0.4**	**2.1**	**1.8**	**1.7**
Consumption	0.7	1.1	0.4	0.4	0.5	0.5	4.1	3.9	2.5
Total investment (3)	-0.3	0.5	-0.1	0.7	1.0	1.0	2.3	-3.2	1.6
Government consumption	0.4	1.0	1.4	1.0	0.5	0.5	2.5	3.8	3.2
Exports	-1.1	-3.6	0.0	0.8	0.8	0.8	0.9	2.5	3.2
Imports	0.2	0.2	0.7	1.0	1.0	1.0	2.3	1.5	2.9
Contributions:									
Domestic demand excluding stocks	*0.5*	*1.0*	*0.5*	*0.6*	*0.6*	*0.6*	*3.2*	*2.7*	*2.6*
Change in private inventories	*0.8*	*0.8*	*0.0*	*-0.1*	*0.0*	*0.0*	*-0.7*	*-0.1*	*0.7*
Net exports	*-0.4*	*-1.3*	*-0.3*	*-0.1*	*-0.1*	*-0.1*	*-0.6*	*-0.9*	*-1.5*

Forecast
(1) Investment of firms and households
(2) Government consumption and investment
(3) Investment of firms, households and government

limit the level of their output, postpone their investment projects and slow down their rate of stocking, although not to the point of becoming negative *(cf. Graph 1)*. Because of this attitude on the part of households and firms, imports were down on Q4 2002.

GDP growth in Q2 2003 is likely to be weak (0.3%), despite an appreciable revival in demand following the end of the military intervention in Iraq. The lifting of international political uncertainties in fact led to a recovery in household confidence as of April. As at the time of the Gulf War in 1991 [(1)], consumption, after falling in response to the rise in uncertainty, is likely to return to its pre-crisis tendency in Q2 2003. This would lead to a temporary acceleration in consumption that would be further aided as of Q2 by the fall in the oil price [(2)] and the gradual fading of the impact of the higher oil price on household purchasing power. Corporate investment, the second main driving-force for United States domestic demand, is likely to level out following the fall seen in Q1. The upturn in investment that began in Q4 2002 following the sharp falls seen in 2001 and 2002 was interrupted in Q1 2003 by the rise in international political uncertainties. Investment growth is likely to turn positive again as of Q2 following the lifting of these uncertainties and the improvement in company profits resulting from the fall in the oil price. Nevertheless, the recovery in investment would be only gradual, given the depressed state of companies' demand expectations. The balance of opinion in the ISM surveys regarding new orders has remained weak, not reaching the 50 watershed on average over the past three months [(3)]. The recovery in investment is likely to follow only after a certain time lag the upturn in new orders for capital goods seen in Q1 2003 *(cf. Graph 2)*.

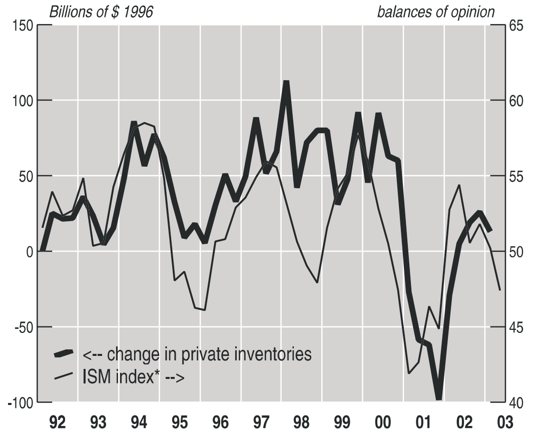
The fact that business leaders' expectations are still depressed is also leading them to limit production levels and slow down their rate of stocking in Q2 despite the upturn in demand. Consequently, GDP growth is likely to be moderate in Q2 2003, as is suggested by the first available quantitative indicators. The number of hours worked fell in April and May compared with the Q1 average *(cf. Graph 3)* and applications for unemployment benefit in April and May, have increased considerably.

As of Q3 2003, activity is expected to accelerate slightly. Average GDP growth for the quarter would be 0.6%, slightly below the American economy's potential. The acceleration in production during 2003 would in the first place be linked to the im-

(1) Cf. box on the impact of the first Gulf War in the overview section of the March 2003 note in this series.
(2) Cf. special report on oil and raw materials (available in French only).
(3) An ISM balance of opinion above / below 50 indicates that opinion is favourable / unfavourable.

1

UNITED STATES : INVENTORY CHANGES AND ISM INDEX OF INDUSTRIALS BUSINESS CLIMATE

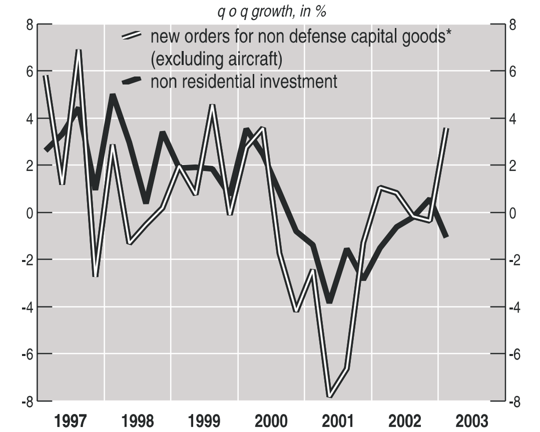


source: BEA, ISM

*Monthly data; last observed point: May 2003.

2

UNITED STATES : PRIVATE INVESTMENT AND ORDERS IN CAPITAL GOODS

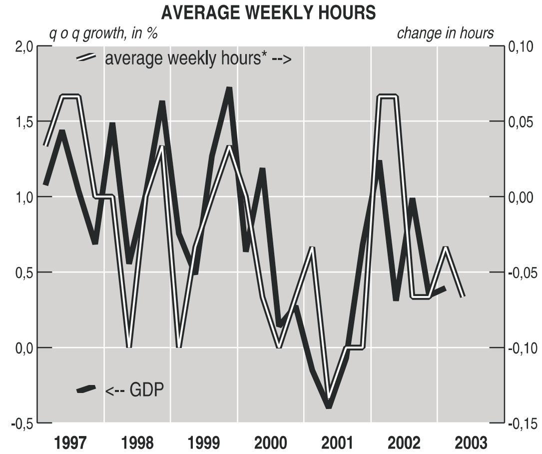


source: BEA, Census

*Monthly data; last observed point: March 2003.

3

UNITED STATES : GDP AND AVERAGE WEEKLY HOURS



source: BEA, BLS

*Monthly data; last observed point: April 2003.

provement in companies' demand expectations in response to a firming of consumption growth starting in Q2 2003. In addition, the upturn in production would be encouraged by the ending of the decline in exports as of Q2 2003. The balance of opinion in the ISM industrial survey regarding export orders, which remained above the 50 level in Q1 2003 and in April and May, is an advanced sign of this *(cf. Graph 4)*. On the assumption that the euro/dollar exchange rate stabilises at 1.15, American firms would benefit until the end of the year from the past depreciation of the dollar versus the euro, which has made their exports more competitive. However, the recovery in exports would be damped down by an unsupportive external environment. In particular, the flabby growth being forecast for the euro zone would not be favourable to exports. Lastly the low inventory/sales ratio recorded in Q1 would also lead firms to produce more in order to accelerate the stock build-up.

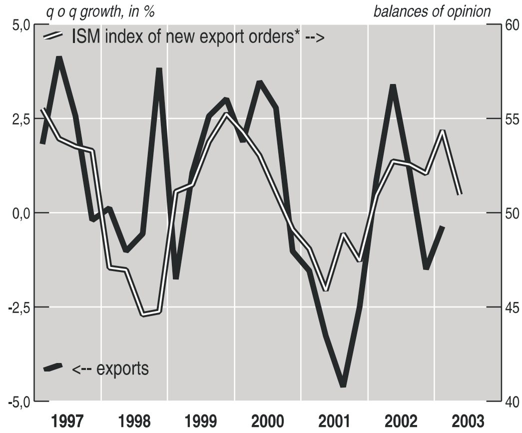
Firms are likely gradually to re-launch their investment projects as of Q3 2003, partly in response to the easing of financing conditions. There are several indicators suggesting that this easing, which has been at work since the end of 2002, is set to continue. Interest-rate spreads have continued to fall from their high point reached in October 2002; equity prices have stabilised; and, finally, the number of banks reporting a tightening of lending conditions in the Fed's loan officer survey has declined. With financing conditions becoming more flexible, companies can be expected to resume their productivity investment, especially in computers and the new technologies in view of the rapid obsolescence of these types of equipment. Overall, however, the upturn in investment would be limited by the fact that capacity investment would continue to be on a small scale, given the low capacity utilisation rates *(cf. Graph 5)*.

In the household sector, consumption growth is expected to be maintained at a fairly high level, of the order of 0.6% per quarter for the two final quarters of the year. In particular, it would be encouraged by the decline in inflation following the fall in the oil price and by the tax cuts proposed by the Bush Administration. These cuts, which have been voted by Congress, would have a retroactive effect and be applied as of Q3 thanks to the utilisation of "rebate cheques". Consumption growth would nevertheless be held back by the persistent negative wealth effects related to past stock-market falls. The saving ratio has remained low in Q1 2003 in relation to the wealth/income ratio. Moreover, mortgage loan conditions are no longer improving now that long rates have reached historically low levels [4]. In these circumstances, households can be expected to slow down both their recourse to mortgage refinancing and their

(4) On these two points, cf. the report on the euro zone's international environment in the March 2003 note in this series.

4

UNITED STATES : EXPORTS AND OPINION ON FOREIGN ORDERS

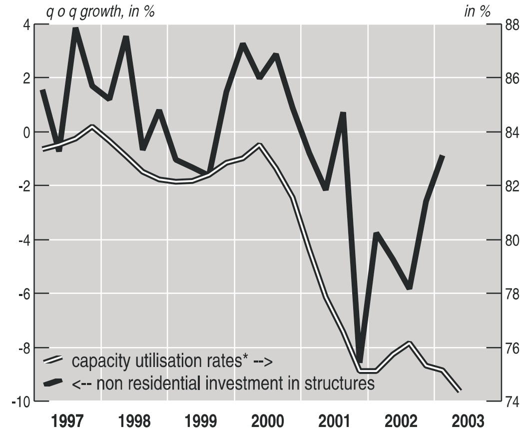


source: BEA, ISM

*Monthly data; last observed point: May 2003.

5

UNITED STATES : CORPORATE INVESTMENT IN STRUCTURES AND CAPACITY UTILISATION RATES

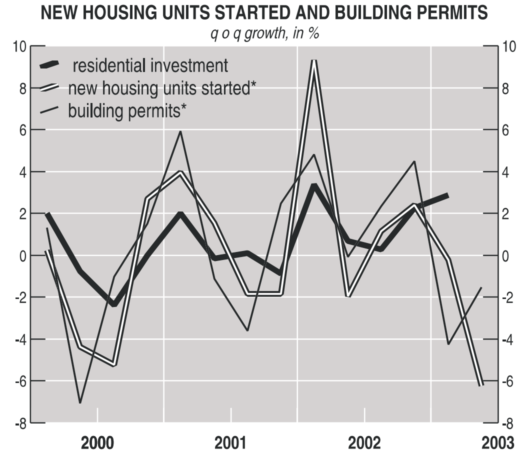


source: BEA, FRB

*Monthly data; last observed point: April 2003.

6

UNITED STATES : RESIDENTIAL INVESTMENT, NEW HOUSING UNITS STARTED AND BUILDING PERMITS



source: BEA, Census

*Monthly data; last observed point: April 2003.

housing investment starting in Q2 2003. The slowdowns in housing starts and building permits in Q1 2003 are advanced signals of this tendency *(cf. Graph 6)*.

The upturn in activity in the United Kingdom likely to be less pronounced than in the United States, with growth remaining below that of 2002

In the United Kingdom, the slowdown in growth seen in Q1 2003 (to 0.2% from 0.4% in Q4 2002) reflects the weakening of domestic demand. Growth in private consumption is slower than in 2002 and investment has declined. Without showing a significant upturn, activity is likely to accelerate slightly within the time-horizon of the forecast and come out at 0.4% at the end of the year. Household consumption, which has hitherto been the principal driving-force for UK growth, will probably make a substantially smaller contribution throughout 2003.

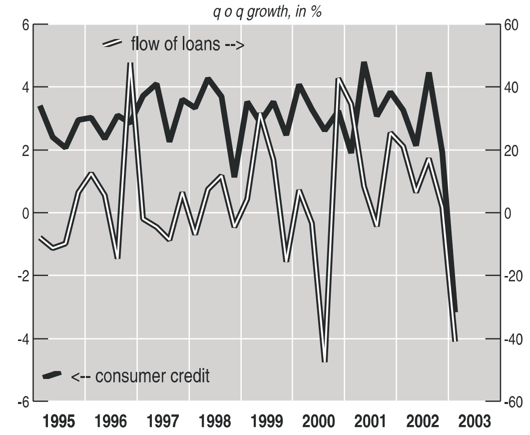
On the lines of the 0.4% rise in Q1, private consumption is likely in 2003 to post a slower growth rate than in 2001 and 2002, being affected throughout the year by the slower growth in borrowing and in the resources derived from mortgage refinancing mechanisms. As illustration, the volume of consumer credit slowed down in Q1 for the first time since 1994 and the slower rise in house prices held back the supply of loans backed by property assets *(cf. Graph 7)*. This mechanism is likely to continue to hold back growth in household resources in 2003, especially in view of the rise in social insurance contributions that came into effect in April. This means that, despite the lifting of the international political uncertainties linked to the Iraqi conflict, growth in private consumption in Q2 2003 would be held down to the modest level seen in the early part of the year (0.4%).

It would nevertheless become slightly firmer in H2 2003, coming out at 0.5% in both the third and fourth quarters. This is because, although private consumption would still be affected by the decline in the resources provided by borrowing and mortgage refinancing, the negative wealth effect would gradually weaken with the ending of the fall in stock-market prices. Along these lines, consumers' opinions in Q2 2003 regarding their future financial situation have picked up substantially *(cf. Graph 8)*.

In contrast to households, for whom 2003 is likely to be marked by a slowdown in consumption, firms are expected gradually to enter a new upswing in the investment cycle. Following a first quarter in which international political uncertainties and the slowdown in industrial activity have held back invest-

7

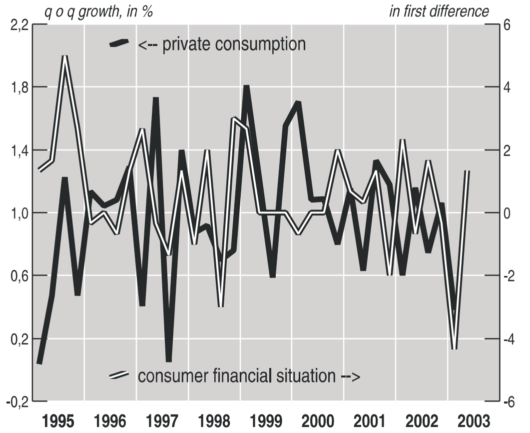
UNITED KINGDOM : CONSUMER CREDIT AND LOANS SECURED ON DWELLINGS



source: UK national statistics

8

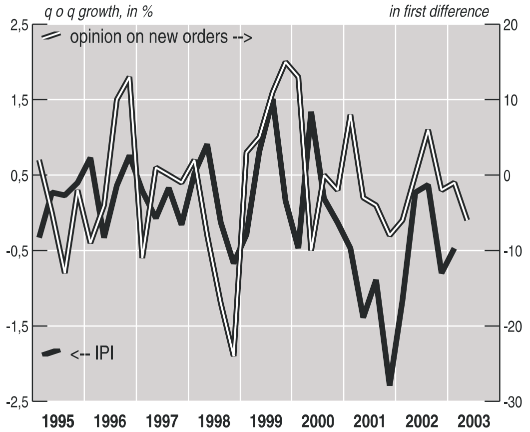
UNITED KINGDOM : PRIVATE CONSUMPTION AND CONSUMER CONFIDENCE ON THEIR FINANCIAL SITUATION



source: UK national statistics, european commission

9

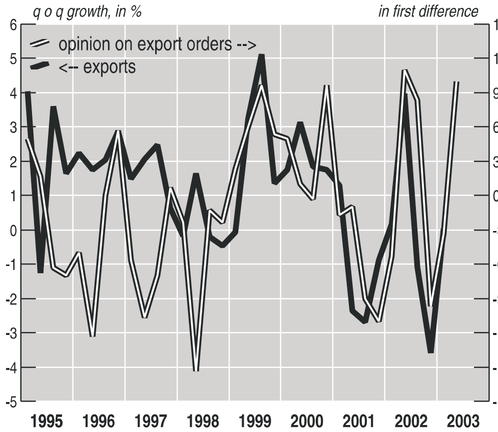
UNITED KINGDOM : INDUSTRIAL PRODUCTION INDEX AND OPINION ON NEW ORDERS IN RECENT MONTH



source: UK national statistics, european commission

10

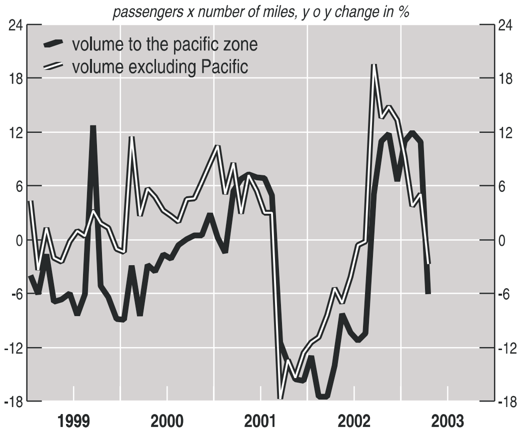
UNITED KINGDOM : EXPORTS AND OPINION ON EXPORT ORDERS



source: UK national statistics, european commission

11

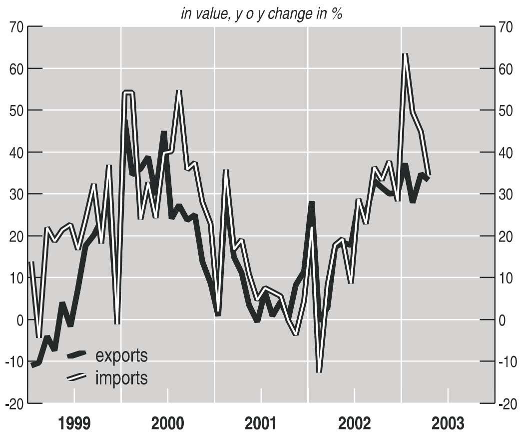
AIR TRAFFIC VOLUME FROM THE UNITED STATES TO THE PACIFIC ZONE AND TO THE REST OF THE WORLD



source: ATAA

12

CHINESE EXPORTS AND IMPORTS



source: China Statistics Monthly

ment, growth in the latter would return to a positive rate during the rest of the year. In Q2, it is mainly public investment that is liable to be lively as part of the restructuring of the healthcare and education systems. Companies, meanwhile, would remain wary. Indeed the decline in the capacity utilisation rate in the early part of the year has tended to confirm the deterioration in expectations regarding the state of demand for industrial goods. At the same time, confidence indicators for industry in Q2 remained relatively pessimistic regarding new orders *(cf. Graph 9)*. This climate remains unpropitious to a substantial upturn in private investment. Total investment in the second half is likely to continue to grow but with a modification in its structure. While public investment would be less dynamic in order to limit the rise in the public deficit, it is private investment that would accelerate, boosted by the improvement in financing conditions and by the calmer world political climate, factors that would encourage the resumption of the investment upswing.

The evolution in public spending would be similar to that of public investment: brisk in H1 but slowing down in H2 because of worries regarding the rise in the public deficit. At the time of the presentation of the Budget in April, the government in fact announced a forecast deficit of 2.5% of GDP for 2003, up from 2.1% in 2002.

In contrast to domestic demand, the contribution from foreign trade is expected to show a revival during 2003. The pattern over time of export growth would show a rise in 2003 following declines in the final two quarters of 2002 (of 1.1% in Q3 and 3.6% in Q4). After stagnating in Q1, exports would return to quarterly growth of 0.8% as of Q2, being largely stimulated by the depreciation of sterling, which has fallen by almost 12% versus the euro between October 2002 and end-May 2003 (exports to euro-zone countries account for more than 55% of total UK exports). The very gradual upturn in world activity would also help to underpin UK exports towards the end of 2003. Survey data regarding export prospects have improved, after falling steeply in Q4 2002 *(cf. Graph 10)*.

United Kingdom imports are also likely to accelerate during the year, the extent of the acceleration being largely conditional on that of exports, but also on that of domestic demand. The upturn in imports would nevertheless be on a smaller scale than for exports. The external contribution, while remaining negative, would be less of a handicap for growth than at the end of 2002.

Assuming it remains confined to particular areas, the SARS epidemic should have little impact on the American and European economies

The first cases of Severe Acute Respiratory Syndrome (SARS) appeared in November 2002 and the World Health Organisation launched a world-wide alert on 12 March 2003. The epidemic is unlikely to have a significant impact on the western economies (apart from Canada), being mainly localised in Asia. China is by far the most affected country with more than 300 SARS-related deaths recorded out of a world total of 700 according to the WHO communiqué issued on 26 May 2003. Among the western economies, Canada is virtually the only country to be affected, with some 30 deaths.

Because its development has been confined to Asia, the SARS epidemic is likely to discourage Western tourists from visiting the regions affected. It is therefore liable to affect in particular two sectors of western economies: tourism and air transport. In the case of the United States, the volume of air passenger traffic to the Pacific region has in fact fallen more than to the rest of the world in April 2003 *(cf. Graph 11)*.

However, the importance of the tourism and air transport sectors in relation to total production is very small. In United States, the two sectors together accounted for 1.1% of GDP in 2001. The impact on GDP through these channels is therefore likely to be limited.

However, the SARS epidemic is also liable to affect firms that import goods from the countries affected or export goods to these countries. Chinese exports do not seem to have been strongly affected in April *(cf. Graph 12)*. American and European imports from Asia would therefore seem to have been relatively unaffected and there have apparently been no supply problems for firms. As for Chinese imports, their growth rate has fallen very sharply. However, given the small proportion of these imports in American and European exports, the latter are not likely to be substantially affected. This means that, if the epidemic remains localised, its impact on the western economies will probably remain modest. ■

The economic situation in the euro zone

Against a background of high uncertainty and an unsupportive external environment, the euro zone's gross domestic product stagnated in Q1 2003 and is unlikely to accelerate significantly in Q2 (+0.1%).

Activity is likely to remain slack until the end of the year, with GDP rising by 0.2% in both Q3 and Q4. Private consumption, boosted in Q1 by exceptional spending on energy in Germany and France, seems set to slow down appreciably starting in Q2, with the worsening employment situation continuing to hold back income growth and household confidence. Exports, hit by the marked appreciation of the euro versus the dollar, would meanwhile be providing only limited support to growth. Lastly, the lifting of the international political uncertainties and the easing of financial conditions would permit only a very gradual recovery in investment starting in Q2 2003, this tendency being curbed by the weak demand prospects.

Gross domestic product stagnated in Q1 2003

The weakness of industrial output in Q1 2003 illustrates the slackness of activity in the euro zone. Following the contraction seen in Q4 2002, the industrial production index rose by 0.1% in Q1 2003 *(cf. Graph 1)*.

The stagnation of euro-zone GDP in Q1 2003 masks disparities between countries *(cf. Graph 2)*. Whereas Germany and the Netherlands went into recession, GDP growth turned out to be positive in France and Spain. In Italy, GDP contracted slightly in Q1 after being boosted in Q4 2002 by exceptional measures stimulating corporate investment and private consumption.

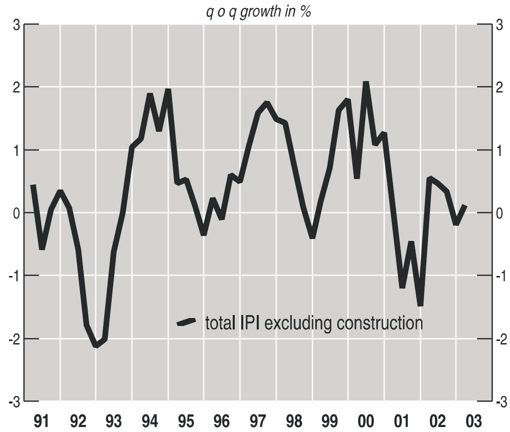
The weakness of euro-zone corporate demand held back activity in Q1 2003. In particular, investment contracted by 1.4%. The deterioration in the outlook for activity reported in the business surveys and the uncertainties linked to the conflict in Iraq led firms to postpone their investment projects. In Germany and Italy, it is likely that the decline was amplified by certain exceptional phenomena. In the case of Germany, following the one-off rise in activity linked to repairing the flood damage, but also because of unfavourable weather conditions in January and February, investment in construction fell by 3.3% in Q1 2003. In Italy, investment felt the backlash of the ending of the incentive tax measures applied in the framework of the "Tremonti-bis" Law and fell by 5%.

In the household sector, private consumption rose by 0.3% in the euro zone in Q1 2003, underpinned by exceptional demand for energy in Germany and France. However, the determinants of private consumption remained weak in the euro zone. The employment situation has continued to deteriorate, with the unemployment rate reaching 8.8% in April,

1

INDUSTRIAL PRODUCTION INDEX

q o q growth in %

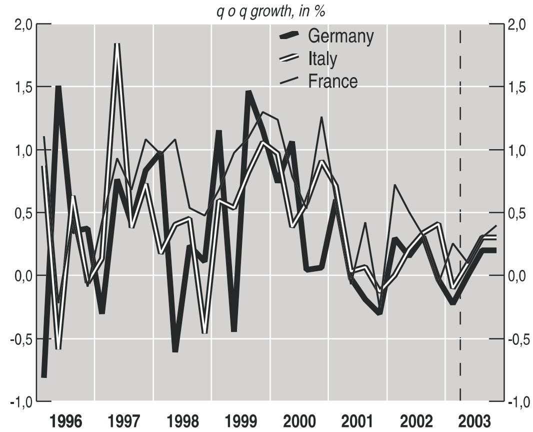


source: Eurostat

2

GDP GROWTH IN THE EURO ZONE COUNTRIES

q o q growth, in %



source: Eurostat

forecasts after the dotted line

GDP FOR THE EURO ZONE AND FOR THE MAIN MEMBER COUNTRIES

(% change)

	Half-yearly % change								Annual changes		
	2002				2003				2001	2002	2003
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GERMANY											
GDP	**0.3**	**0.2**	**0.3**	**0.0**	**-0.2**	**0.0**	**0.2**	**0.2**	**0.7**	**0.2**	**0.1**
Household consumption	-0.7	0.2	0.4	0.1	0.6	0.0	0.1	0.1	1.6	-0.6	1.0
Total GFCF	-1.9	-3.5	-0.2	0.8	-1.7	0.0	0.4	0.4	-4.9	-6.5	-1.8
Public consumption	0.7	0.6	0.2	-0.5	0.1	0.1	0.1	0.1	0.8	1.5	0.2
Exports	0.6	1.2	2.9	0.3	0.7	0.4	1.0	1.3	5.4	2.7	3.9
Imports	-3.6	1.7	2.1	1.9	1.9	0.7	0.9	1.0	1.3	-2.1	6.3
Contributions:											
Domestic demand ex. stocks	*-0.7*	*-0.5*	*0.2*	*0.1*	*0.0*	*0.0*	*0.1*	*0.2*	*0.0*	*-1.4*	*0.2*
Inventory change	*-0.4*	*0.7*	*-0.3*	*0.4*	*0.1*	*0.1*	*0.0*	*-0.1*	*-0.6*	*0.1*	*0.4*
Foreign trade	*1.4*	*-0.1*	*0.4*	*-0.5*	*-0.4*	*-0.1*	*0.1*	*0.2*	*1.4*	*1.6*	*-0.6*
FRANCE											
GDP	**0.7**	**0.5**	**0.3**	**-0.1**	**0.3**	**0.1**	**0.3**	**0.4**	**2.1**	**1.2**	**0.8**
Household consumption	0.2	0.4	0.4	0.4	0.6	0.1	0.3	0.3	2.7	1.4	1.5
Total GFCF	0.0	-0.4	-0.7	-1.1	0.4	0.2	0.3	0.6	2.1	-1.4	-0.4
Public consumption	1.4	1.1	0.7	0.7	0.1	0.6	0.6	0.6	3.2	4.1	2.2
Export	1.6	1.8	0.8	-0.5	-0.7	0.0	0.2	0.8	1.8	1.2	0.1
Imports	1.6	0.8	0.9	-0.6	0.7	0.8	1.0	1.2	1.4	0.7	2.3
Contributions:											
Domestic demand ex. stocks	*0.4*	*0.4*	*0.3*	*0.2*	*0.4*	*0.2*	*0.4*	*0.4*	*2.6*	*1.4*	*1.3*
Inventory change	*0.3*	*-0.2*	*0.1*	*-0.2*	*0.2*	*0.0*	*0.1*	*0.0*	*-0.7*	*-0.4*	*0.1*
Foreign trade	*0.0*	*0.3*	*0.0*	*0.0*	*-0.4*	*-0.2*	*-0.2*	*-0.1*	*0.1*	*0.2*	*-0.6*
ITALY											
GDP	**0.0**	**0.3**	**0.1**	**0.4**	**-0.1**	**0.1**	**0.3**	**0.3**	**1.7**	**0.4**	**0.7**
Household consumption	-0.2	0.7	0.5	0.8	0.0	0.0	0.3	0.3	1.1	0.4	1.2
Total GFCF	-0.8	-0.4	2.3	3.7	-5.0	0.0	0.6	1.3	2.4	0.7	-0.8
Public consumption	0.2	0.4	0.2	0.2	0.6	0.3	0.3	0.3	3.5	1.7	1.4
Exports	-3.2	5.7	3.0	-1.7	-3.5	-1.0	0.0	0.0	1.1	-1.0	-2.8
Imports	0.1	3.0	2.5	1.5	-1.4	0.0	0.4	0.7	1.0	1.5	1.9
Contributions:											
Domestic demand ex. stocks	*-0.2*	*0.4*	*0.8*	*1.3*	*-1.0*	*0.1*	*0.4*	*0.5*	*1.7*	*0.7*	*0.8*
Inventory change	*1.2*	*-0.8*	*-0.9*	*0.1*	*1.5*	*0.3*	*0.0*	*0.0*	*-0.1*	*0.4*	*1.2*
Foreign trade	*-0.9*	*0.8*	*0.2*	*-1.0*	*-0.6*	*-0.3*	*-0.1*	*-0.2*	*0.1*	*-0.7*	*-1.4*
SPAIN											
GDP	**0.5**	**0.5**	**0.7**	**0.3**	**0.5**	**0.3**	**0.4**	**0.5**	**2.7**	**2.0**	**1.8**
Household consumption	0.3	0.5	0.1	1.0	0.5	0.3	0.5	0.6	2.5	1.9	2.1
Total GFCF	0.6	0.9	1.4	-0.5	1.1	0.4	0.6	0.6	3.2	1.4	2.4
Public consumption	1.0	0.5	1.4	1.3	1.0	0.8	0.8	0.8	3.1	3.8	4.1
Exports	-2.2	1.3	5.8	1.0	-2.6	0.2	0.2	0.2	3.4	1.4	1.5
Imports	-0.8	0.0	4.3	4.1	-0.5	0.4	0.6	0.7	3.5	2.2	5.4
Contributions:											
Domestic demand ex. stocks	*0.5*	*0.6*	*0.7*	*0.7*	*0.7*	*0.4*	*0.6*	*0.7*	*2.8*	*2.1*	*2.5*
Inventory change	*0.5*	*-0.5*	*-0.3*	*0.6*	*0.4*	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*0.6*
Foreign trade	*-0.4*	*0.4*	*0.4*	*-1.0*	*-0.6*	*-0.1*	*-0.1*	*-0.1*	*-0.1*	*-0.3*	*-1.3*
ZONE EURO											
GDP	**0.4**	**0.4**	**0.3**	**0.1**	**0.0**	**0.1**	**0.2**	**0.2**	**1.5**	**0.8**	**0.5**
Household consumption	-0.1	0.3	0.5	0.4	0.3	0.1	0.3	0.3	1.8	0.7	1.0
Total GFCF	-0.7	-1.3	0.2	0.0	-1.4	0.0	0.2	0.5	-0.6	-2.6	-0.2
Public consumption	0.9	0.7	0.4	0.2	0.2	0.4	0.4	0.4	2.1	2.6	1.5
Exports	-0.2	2.1	2.0	-0.2	-0.6	0.0	0.4	0.6	3.0	1.3	1.2
Imports	-1.3	1.5	1.9	0.7	0.6	0.2	0.4	0.7	1.7	-0.4	1.5
Contributions:											
Domestic demand ex. stocks	*0.0*	*0.0*	*0.4*	*0.3*	*0.0*	*0.1*	*0.3*	*0.3*	*1.3*	*0.3*	*0.8*
Inventory change	*0.1*	*0.1*	*-0.1*	*0.1*	*0.5*	*0.0*	*0.0*	*0.0*	*-0.3*	*-0.1*	*-0.2*
Foreign trade	*0.4*	*0.3*	*0.1*	*-0.3*	*-0.5*	*0.0*	*0.0*	*0.0*	*0.5*	*0.6*	*-0.1*

Forecast
Last update: June 10th 2003.

compared with 8.5% in December *(cf. Graph 3)*. Total employment stagnated in France in Q1 and fell back in Germany for the sixth consecutive quarter (down by 0.4%). In Italy, the labour market, which had hitherto been lively, is starting to show signs of weakness, with the unemployment rate rising in Q1 2003 for the first time since the end of 1998, while the rise in employment is continuing but at a slower rate (+ 0.1%). At a time of moderate wage growth, this weakness of employment is holding back growth in the earned income of households in the euro zone. In addition, the 20% rise in the price of Brent in Q1 2003 has eroded household purchasing power.

Exports fell in Q1 2003 and are likely to rise only very gradually in the rest of the year

The slackness of domestic demand in the euro zone held back the evolution of intra-zone exports in Q1. Meanwhile, exports to other countries are being handicapped by the past appreciation of the euro versus the dollar (amounting to 12% for the year 2002 as a whole) and by the moderate growth posted in Q4 2002 and Q1 2003 in the United States and the United Kingdom. All in all, exports fell by 0.6% in Q1 2003.

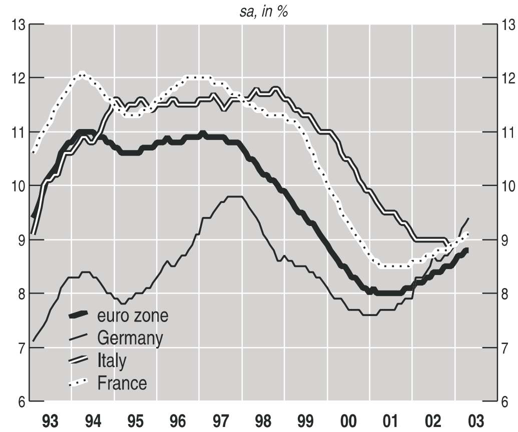
Looking beyond Q1 2003, exports are likely to continue to offer little support to activity. In the first place, they will be handicapped by the delayed effects of the 7% appreciation of the euro versus the dollar in Q1 2003 *(cf. Graph 4)*. In addition, the euro zone's external environment can be expected to remain unsupportive, as illustrated by the depressed outlook for export demand reported in the business surveys for Q2. All things considered, exports can be expected to stagnate in Q2 2003 before picking up slightly starting in Q3, thanks to a slight upturn in American imports. This would mean that exports would rise by 0.4% in Q3 and by 0.7% in Q4.

Household consumption set to slow down in Q2 2003 before gradually picking up again

Starting in Q2, household consumption is expected to rise by 0.1%, no longer providing more than very weak support for growth. It would then remain moderate for the rest of the year, rising by 0.3% in Q3 and Q4 2003.

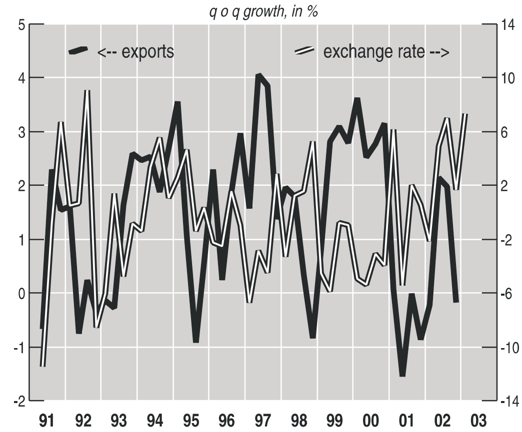
Household income will probably continue to be handicapped by the past slowdown in employment seen in most of the euro-zone countries. In addition, in certain countries like Italy, income growth would be held back by the wage restraint observed in Q1 2003. Finally, the deterioration in household confidence in the first months of 2003 in many euro-zone countries would continue to affect consumer spending in Q2 *(cf. Graph 5)*. In Italy, for example, the household confidence indicator for May was at its lowest since 1997 despite the resolution of the international political uncertainties over Iraq.

3



source: Eurostat

4



source: Eurostat, BCE

Household spending can be expected to be more depressed in Germany than in the other euro-zone countries. Consumption in Germany would in fact stagnate in Q2 2003, hit by a distinct deterioration on the labour market. The 2.6% fall in domestic orders for consumer goods in Q1 2003 probably constitutes an advanced sign of particularly weak consumption in Q2. In addition, the announcement of the reform of the labour market and the introduction of a tight fiscal policy can be expected to impair household confidence for the rest of the year, so that precautionary motivations would keep the saving ratio high.

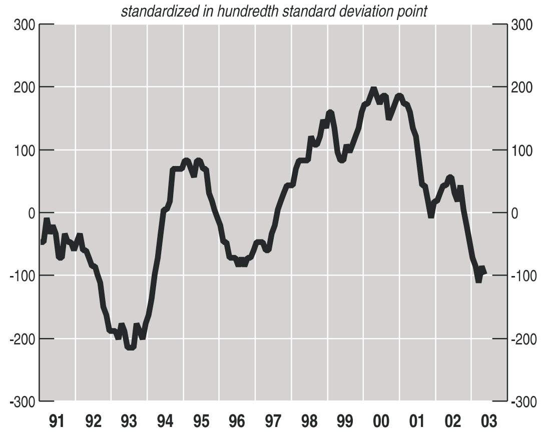
Consumption in Italy is likely to stagnate in Q2 2003, mainly because of the ending of the support measures for the automobile sector. New car registrations in April had already slumped by 16% compared with March. In addition, the high inflation recorded in April and May (2.7%, year on year, in both months) despite the fall in the oil price, would help to trim purchasing power a little more than in the other euro-zone countries.

In Spain, in contrast to the rest of the zone, private consumption is likely to remain brisk, being underpinned by the fall in income tax that has been in effect since the beginning of 2003 (0.4 of a point of GDP).

5

HOUSEHOLD CONFIDENCE IN THE EURO ZONE

standardized in hundredth standard deviation point



source: european commission

Despite the weakness of domestic demand, which is liable to continue to damage firms' expectations, investment is likely to pick up gradually during 2003

GDP growth in the euro zone is likely to come out at 0.1% in Q2 2003. This lacklustre performance is expected to last until the end of the year, with GDP rising by 0.2% in both Q3 and Q4.

In the absence of external support and given the slackness of household demand, activity in industry is expected to remain at a low level in Q2 2003. Leading indicators so far available confirm this diagnosis. Orders received by manufacturing industry were depressed in Q1 2003, falling by 1.4% in Italy and 0.1% in Germany. In addition, the statistical carryover for growth in the industrial production index for Q2 was negative in March (by 0.7% compared with the average for Q1 2003).

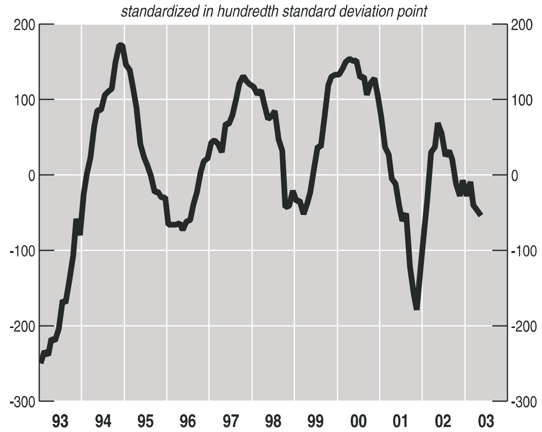
In manufacturing industry, the results of business surveys showed a substantial deterioration in March, April and May in all the euro-zone countries. In particular, industrial firms remain pessimistic regarding the tendency for their own production *(cf. Graph 6)* and an increasing number of them regard their productive capacity as adequate in relation to demand *(cf. Graph 7)*.

Despite these depressed expectations, which will continue to have an adverse effect until the end of the year, investment is expected to pick up gradually starting in Q2 2003 and to return to a positive growth rate. The fall in monetary interest rates and the ending of the stock-market declines should help to bring about a gradual easing of financial conditions. This easing would then be the main explanatory factor for a stabilisation in investment. In addition, since Feb-

6

PRODUCTION OUTLOOK IN THE EURO ZONE MANUFACTURING INDUSTRY

standardized in hundredth standard deviation point

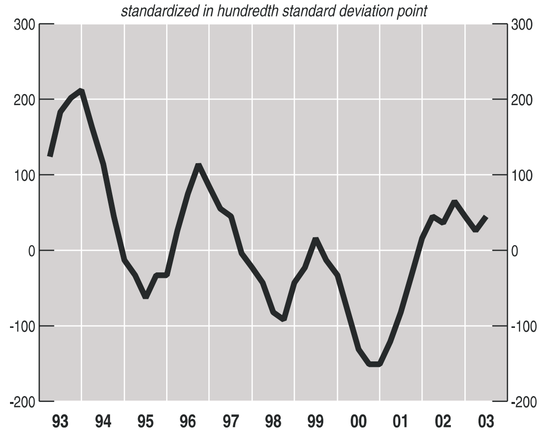


source: european commission

7

OPINIONS REGARDING PRODUCTIVE CAPACITY IN THE EURO ZONE

standardized in hundredth standard deviation point



source: european commission

ruary 2003 surveys in the construction industry have reported an improvement in the business climate that may be heralding an end to the deterioration in investment in construction. Finally, the dissipation of uncertainties linked to the war in Iraq is likely to provide an appreciable fillip to investment projects previously held back because businessmen were sitting on the sidelines.

Investment is expected to be more dynamic in Italy than in the other euro-zone countries, with corporate investment having the benefit of tax measures: a two-point cut in the rate of taxation of corporate profits. In addition, public investment would be boosted by the implementation of electoral promises concerning the modernisation of state infrastructure. ■

Consumer prices in the euro zone

The sharp rise in the prices of petroleum products during the winter, leading to an upturn in inflation in the euro zone to as much as 2.4% in February and March 2003, turned out to be merely temporary. The rapid ebb seen in the spring brought inflation back down to 2.1% in April. This movement also partly reflected the fall in core inflation in Q1 2003, previously masked by the rise in energy prices.

This decline in core inflation will probably come to an end during Q2 2003, with the prices of manufactured products no longer decelerating. For the rest of the year core inflation is expected to stabilise at just under 2.0%.

On the assumption of a Brent price close to 25 $/barrel until Q4, before weakening to 22 $/barrel at the end of the year, and a stable exchange rate of 1.15 dollars to the euro, inflation in the euro zone is expected to stabilise at around 2.0%, having been 2.1% in June and 2.0% in December.

The fall in the oil price has helped prices to slow down in Q2

With the dissipation of the inflationary pressures linked to the price of energy, inflation in the euro zone in Q2 2003 resumed the downward tendency that had been interrupted during the winter. The year-on-year rise in the HICP fell to 2.1% in April 2003 from 2.3% in December 2002.

This easing of 0.2 of a point in euro-zone inflation is partly the result of the continuing decline in core inflation [(1)], which fell back from 2.1% in December 2002 to 2.0% in April 2003. Consumer prices of manufactured products continued to pass on the effects of the slowdown in industry, contributing to that in the overall price index (negative contribution of 0.1 of a point). Alongside this movement, there was a one-off slowdown in prices of services because of the exit from the year-on-year calculation of

(1) Measured as the HICP excluding food, alcohol, tobacco and energy.

EURO ZONE INFLATION

(year on year % growth of HICP)*

Sectors (weight in the index)	April 2002	December 2002	April 2003	June 2003	December 2003
Food (15.5%)	3.5	1.5	1.6	2.2	2.2
Beverage and Tobacco (3.8%)	3.9	4.3	5.9	6.9	7.1
Clothing and footwear (7.6%)	2.5	1.8	1.3	1.3	1.5
Housing. water. electricity and gas (14.9%)	1.3	2.0	2.4	2.8	2.5
Furnishings and household equipment (7.9%)	1.7	1.5	1.3	1.2	1.6
Health (3.9%)	2.6	3.1	2.0	2.4	2.4
Transports (15.3%)	1.5	3.3	2.0	1.4	1.2
Communications (2.9%)	-0.1	-0.6	-0.6	-1.5	-0.9
Leisure and culture (9.7%)	1.0	0.7	0.9	0.1	0.2
Education (0.9%)	3.9	3.9	3.8	3.8	3.8
Hotels-cafés-restaurants (9.5%)	4.5	4.6	3.4	3.1	2.8
Miscellaneous goods and services (8.1%)	2.8	2.7	2.8	3.2	3.3
Total (100.0%)	**2.3**	**2.3**	**2.1**	**2.1**	**2.0**
Food (Beverage and Tobacco) (19.3%)	**3.7**	**2.3**	**2.5**	**3.2**	**3.2**
Energy (8.2%)	**-0.6**	**3.8**	**2.2**	**1.4**	**0.3**
Core inflation (72.5%)	**2.3**	**2.2**	**2.0**	**1.8**	**1.9**
of which: Manufactured products(31.6%)	*1.6*	*1.1*	*0.8*	*0.6*	*0.7*
Services (40.9%)	*2.9*	*3.0*	*2.9*	*2.7*	*2.8*

Forecast
* Harmonized Index of Consumer Prices
Source: Eurostat

the unaccustomed rises recorded a year earlier, notably at the time of euro changeover (a negative contribution of 0.1 of a point).

This tendency was concealed in Q1 2003 by the rise in energy prices. The rapid disappearance of this phenomenon in Q2, with the price of Brent falling from 34 $ to 23 $/barrel between the beginning of March and mid-April, intensified the easing of inflation in the euro zone (negative contribution of 0.1 of a point).

This tendency for inflation to ease has nevertheless been countered by the gradual acceleration in food prices (positive contribution of 0.1 of a point). The first effects of the late frosts, which potentially constitute a factor tending to push up prices of seasonal food until the summer, were in fact to be observed as of April.

Core inflation unlikely to exceed 2.0% during the rest of 2003

Core inflation is expected to bottom out at 1.8% in May 2003. Later, driven by prices of manufactured products, it will probably pick up in H2, reaching 1.9% in December.

The evolution in producer prices of manufactured products is in fact an indicator, with a lead-time of four to five quarters, of that of consumer prices of manufactured products *(cf. Graph 1)*. Given the upturn in producer prices of manufactured products that began in H2 2002 following the upturn in activity in Q1 of that year, the year-on-year rise in the HICP for manufactured products is expected to accelerate slightly in H2 2003. This phenomenon on its own will probably be the major factor in the slight and probably short lived (2) upturn in core inflation in H2 2003, with the rise in the price of services weakening only very marginally. Although there were wide contrasts between individual national situations, wage costs generally continued to rise strongly at the end of 2002 for the whole of the euro zone, thus tending to increase inflation in services *(cf. Box 2)*.

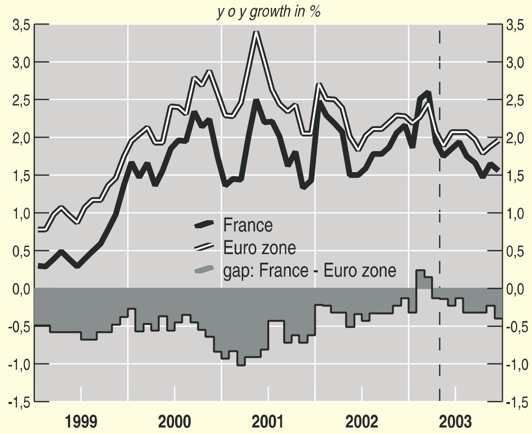
Inflation likely to remain stable at around 2.0% in H2 2003

On the assumption of a Brent price close to 25 $ /barrel until Q4, before weakening to 22 $, and a steady exchange rate of 1.15 dollars to the euro, inflation should be stable for the rest of 2003, fluctuating around 2.0% and having been 2.1% in June and 2.0% in December 2003.

BOX 1: THE INVERSION OF THE INFLATION DIFFERENTIAL BETWEEN FRANCE AND THE EURO ZONE WAS ONLY TEMPORARY

In February and March 2003, the inflation differential between France and the euro zone, as measured by the difference between the year-on-year changes in the respective HICPs, changed sign. This is an exceptional phenomenon and has to be directly related to the shift in the official period for bargain sales in France (this year concentrated on the single month of January). As of April, the differential turned negative again. During the summer it is likely to return to its historic average level, of close to 0.4 of a point. ■

HARMONIZED INDEX OF CONSUMER PRICES
France and the Euro zone
y o y growth in %

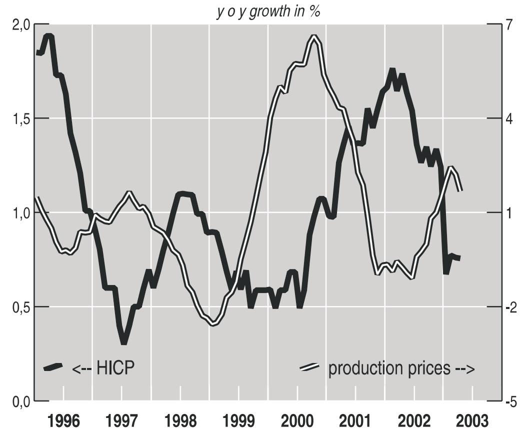


source: Eurostat, Insee

forecasts after the dotted line

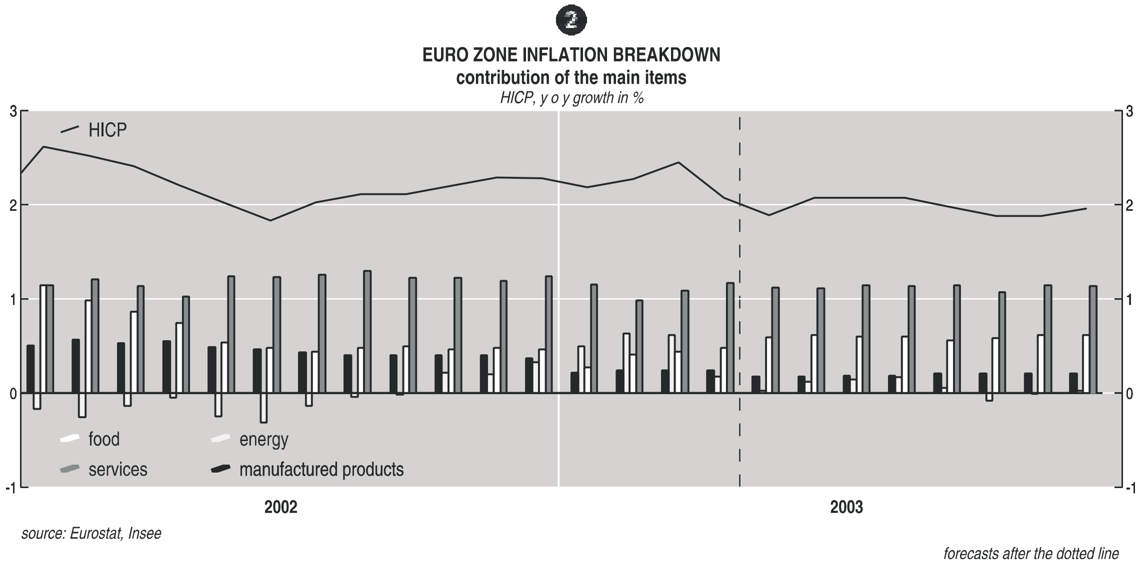
1

PRICES OF MANUFACTURED PRODUCTS
y o y growth in %



source: Eurostat

(2) As of March, the year-on-year change in industrial producer prices turned downwards, which would indicate a slowdown in consumer prices for manufactures at the beginning of 2004.



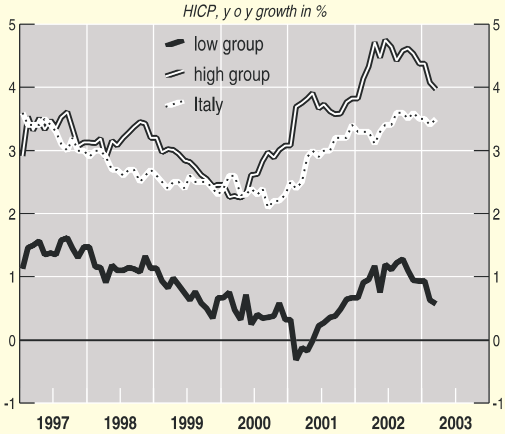
This decline of 0.1 of a point in inflation in the euro zone between April and December 2003 is the resultant of opposing movements in the principal components of the HICP. In addition to the slight decline in core inflation that would help to moderate inflation between now and December (by 0.1 of a point), the stabilisation and subsequent decline in the oil price would make a negative contribution of 0.2 of a point to the change in inflation between April and December. In the opposite direction, food prices are likely to display firmer evolutions until Q4 than in the corresponding period of 2002, notably because of the impact of the late frosts on the prices of seasonal food (contribution of +0.2 of a point) *(cf. Graph 2)*. ■

BOX 2: THE WIDE DIFFERENCES BETWEEN PRICE MOVEMENTS IN SERVICES ARE EXPLAINED BY DIFFERENT RATES OF LABOUR COST GROWTH

While core inflation eased in all the euro-zone countries with the exception of Italy and Greece (cf. Table) between April 2002 and April 2003, there remain marked disparities in the pattern of inflation. These are mainly the result of differing evolutions in the prices of services, with the prices of manufactured products showing more homogeneous evolutions.

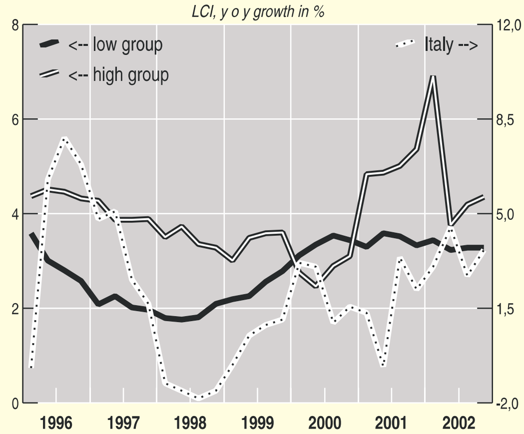
The HICPs for services reveal two sub-groups of countries with quite distinct inflation patterns. A gap of more than two points in the year-on-year change separates the "low" and "high" groups. This has risen steadily to reach 3.4 points at the beginning of 2003 (cf. Graph A). When one goes back to the source of this divergence, two different patterns for the evolution in labour costs become apparent (cf. Graph B). In the case of the "high" group, these have risen at a firmer rate and have in fact accelerated sharply (from 2.5%, year on year, at the beginning of 2000 to 6.9% at the beginning of 2002), thus fuelling the rise in the prices of services in 2002. By contrast, growth in labour costs in the "low" group followed a flatter tendency of close to 3.0%, and this helped to moderate inflation in services. These divergent tendencies explain the widening of the gap between the two groups in 2002.

A



source: Eurostat, Insee

B



source: Eurostat, Insee

Interpretation of the graphs:
"Low" group (58.4%): Austria, Belgium, Finland, France and Germany. "High" group (22.2%): Greece, Ireland, Netherlands, Portugal and Spain. Reminder: Italy has a weighting of 19.2%. Luxembourg (0.2%) has been omitted.

Euro zone inflation by countries

(year on year % growth of HICP*)

	Inflation		Core inflation		Services	
	April 2002	April 2003	April 2002	April 2003	April 2002	April 2003
France	2.1	1.9	1.9	1.7	2.7	2.6
Germany	1.5	1.0	1.3	0.9	1.7	2.0
Italy	2.5	3.0	2.8	2.8	3.1	3.4
Spain	3.7	3.2	3.7	3.4	4.5	3.9
Netherlands	4.2	2.5	4.5	2.2	5.4	3.8
Belgium	1.7	1.4	2.3	1.8	2.5	2.6
Austria	1.7	1.2	1.9	1.4	2.8	2.1
Finland	2.6	1.3	2.6	1.3	3.6	2.2
Portugal	3.5	3.7	4.5	3.8	5.4	5.1
Ireland	5.0	4.6	5.8	4.2	8.2	6.4
Luxembourg	1.9	3.0	2.4	2.0	3.4	2.8
Greece	4.1	3.3	3.2	3.2	3.7	4.5
Euro Zone	**2.3**	**2.1**	**2.4**	**2.0**	**2.9**	**2.9**
United Kingdom	1.3	1.5	1.4	1.4	4.1	3.8
Sweden	2.2	2.3	1.9	1.6	2.6	2.4
Denmark	2.3	2.5	2.6	2.9	3.8	3.9
E.U.	**2.1**	**1.9**	**2.2**	**2.0**	**3.1**	**3.1**

* Harmonized Index of Consumer Prices.
source: Eurostat

BOX 2: THE WIDE DIFFERENCES BETWEEN PRICE MOVEMENTS IN SERVICES ARE EXPLAINED BY DIFFERENT RATES OF LABOUR COST GROWTH

Italy has to be treated as a special case. After initially being close to the "high" group, Italy's services prices diverged as of Q2 2000 as the initial result of the decline in the growth of labour costs seen from 1998 on. At the end of 2002, the rise in Italian services prices again converged with that of the "high" group, because of the accelerated rise in labour costs since Q4 2001.

Given the support provided to inflation in 2003 by the performance of wage costs in 2002, the prices of services at the level of the euro zone as a whole cannot be expected to show any marked slowdown between now and the end of the year. ■

BOX 3: GERMAN CORE INFLATION UNLIKELY TO SLOW DOWN ANY FURTHER BETWEEN NOW AND THE END OF THE YEAR

Given the low level of inflation currently being experienced in Germany (+0.6% in May), the question has to be asked whether core inflation could turn negative in the short term. The evolution of core inflation is essentially determined by that of its two components: prices of manufactured products and prices of services. In both cases, the recent evolution in their respective determinants makes a continuation of the slowdown in prices between now and the end of the year unlikely.

First, producer prices in the manufacturing sector accelerated between June 2002 and February 2003 by 3 points of year-on-year growth. The time-lag for diffusion being of the order of one year, consumer prices could therefore accelerate at least until the end of the year.

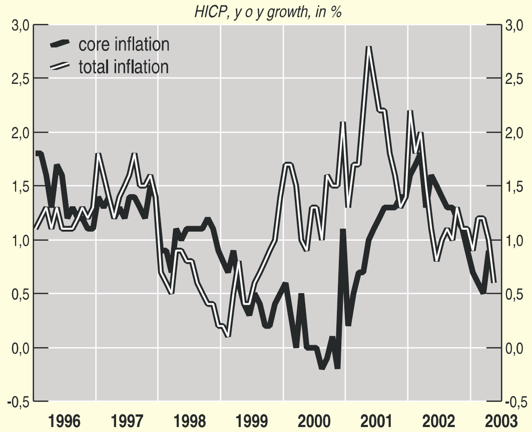
Second, labour costs were also accelerating throughout 2002. The current state of wage growth is therefore such as to fuel core inflation, via the prices of services, which remain dynamic.

All in all, the recent evolutions in producer prices and in labour costs tend rather to suggest a slight upturn in consumer prices in the short term. Core inflation in Germany in fact put on 0.4 of a point in April 2003, bringing to an end nine consecutive months of falls. ■

A

INFLATION IN GERMANY

HICP, y o y growth, in %

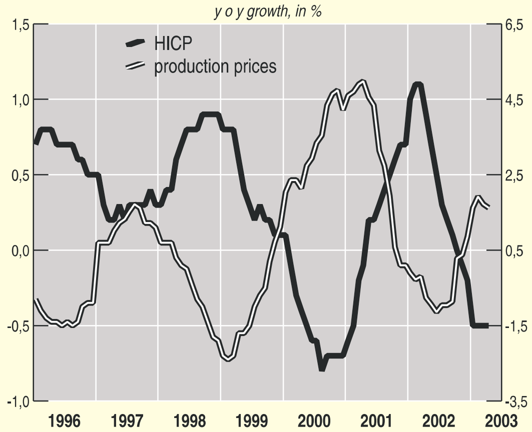


source: Eurostat

B

GERMANY : PRICES OF MANUFACTURED PRODUCTS

y o y growth, in %

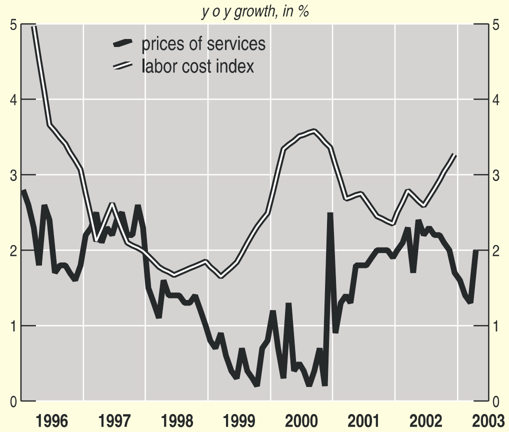


source: Eurostat

C

GERMANY : PRICES OF SERVICES AND LABOR COST

y o y growth, in %



source: Eurostat