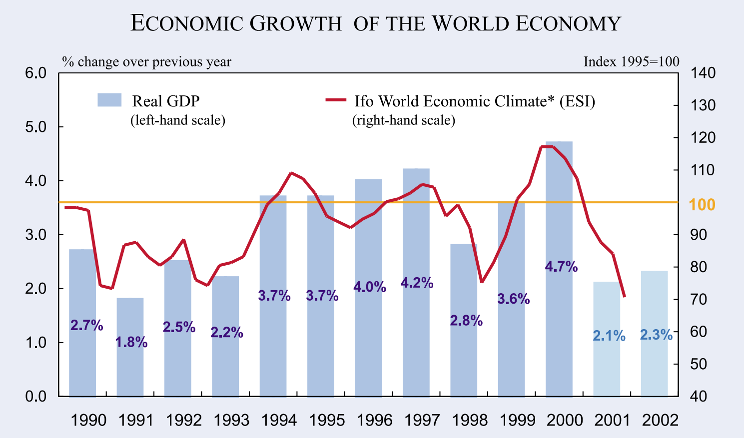
The European Economy: Current Situation and Economic Outlook

1. Current Situation

After a record growth of 3½ per cent in 2000 (see Figure 1.1), the highest level in the past ten years, economic expansion in the European economy[1] slowed significantly in 2001, and towards the end of the year growth came to a near standstill. This slowdown had started already in the second half of 2000 and it was affected, firstly, by the rapid price increase for oil and other energy sources. Secondly, the central banks in Western Europe had tightened monetary policy to stem the danger of inflation. Last but not least, the world economy weakened significantly as the boom in the United States came to a sudden end. The terrorist attacks on 11th September caused an additional shock to business and consumer confidence not only in the United States but also in the global economy including Europe. This event is expected to prolong the slowdown of the European economy.

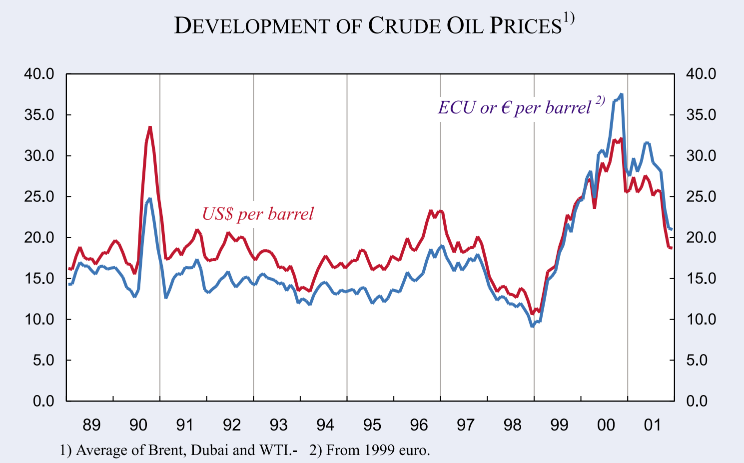
It is difficult to disentangle the impact of these different adverse factors on aggregate demand in Europe. But the beginning of the downturn in the second half of 2000 was associated with the drastic worsening in the terms of trade from the cumulative effects of the oil price explosion and the weak euro (see Figure 1.2). The higher prices for energy were followed by a price increase for foodstuffs – much of the latter due to animal epidemics – and led to a sharp rise in consumer prices absorbing purchasing power for other goods (see Figure 1.3). In 2000 the terms of trade of the Euro area deteriorated by 1.3 per cent of GDP. More recently prices of foodstuff and energy have declined again with oil prices falling back close to their level in 1999. The deterioration of the labour market and additional economic and political uncertainties emerging in the aftermath of the terrorist attacks of 11th September, have added to the dampening of consumer spending.

Fig. 1.1



*) Arithmetic mean of judgment about present and expected economic situation.
Source: IMF, Ifo Economic Survey International: calculations and forecast by the Ifo Institute.

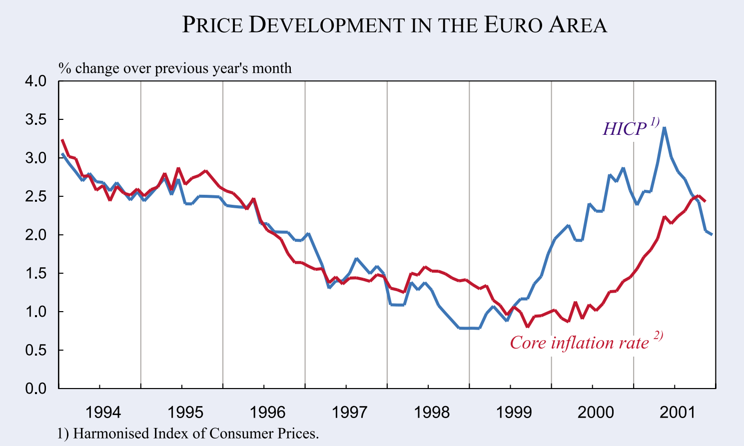
Fig. 1.2



1) Average of Brent, Dubai and WTI.- 2) From 1999 euro.
Sources: HWWA, calculations by the Ifo Institute.

[1] Real GDP increased by 3.5 per cent in the Euro area and by 3.3 per cent in the European Union.

Fig. 1.3



1) Harmonised Index of Consumer Prices.
2) HICP excluding energy and unprocessed food.
Sources: European Central Bank, Eurostat, calculations by the Ifo Institute.

Exports of the Euro area rose strongly up to the end of 2000, boosted by the high order backlog and improvements in competitiveness as a result of the weak euro. In early 2001, however, a decline in foreign demand became evident and exports stagnated during the course of the year. Investment activity also weakened, and in some countries the continued fall of building investment was a further drag on aggregate demand. With the sharp cyclical slowdown of production, seasonally adjusted unemployment stopped declining and began to rise.

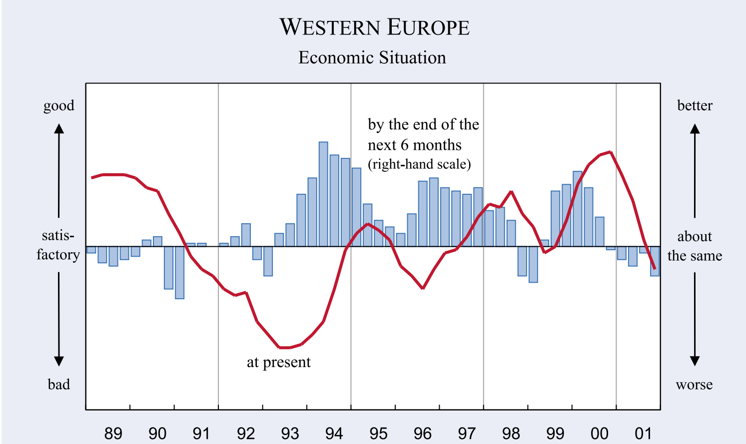
2. Economic Outlook

2.1 The Global Economy

In the current situation any projections for the European economy are highly uncertain. Given the closely synchronised sharp economic downturn in virtually all industrial countries and the low business and consumer confidence, there is a considerable risk of the global economy and the European economy falling into a recession. In fact, the United States and also Germany have already entered a recession with GDP declining in the third quarter and with a further decline expected for the fourth quarter. On the other hand, economic policies are now on a clearly expansionary course which should support aggregate demand. Furthermore, the oil price has declined to a low level and the associated increase in the terms of trade will stimulate domestic demand. Finally, business and consumer confidence are expected to recover again – and some leading indicators have started to improve as well as confidence in financial markets.

For the world economy the timing and strength of the US economic recovery are of crucial importance. The Federal Reserve had already lowered key interest rates significantly before the terrorist attacks and has reduced them further since this shock. Since January 2001 the Fed Funds target rate has been reduced by 4 3/4 percentage points from 6.5% to 1.75% of which 1 1/4 percentage points were cut after the 11th September. In addition, a large fiscal stimulus has been decided on or is in preparation. Apart from the tax cuts which were enacted in spring 2001, new measures were taken (or are in preparation) after 11th September, in particular the programme for emergency and military spending ($40 billion), the granting of subsidies to airlines ($15 billion) and another tax-cut package which could add up to $ 90 billion over the next two years. For 2002 the additional fiscal stimulus could amount to about 1 per cent of GDP. These expansionary policies should help the US economy to recover gradually. However, as a good part of the US slowdown is associated with the correction of the excessive expansion of the high-tech sector, continued weakness of this sector could be a drag on economic growth. We nevertheless

Fig. 1.4



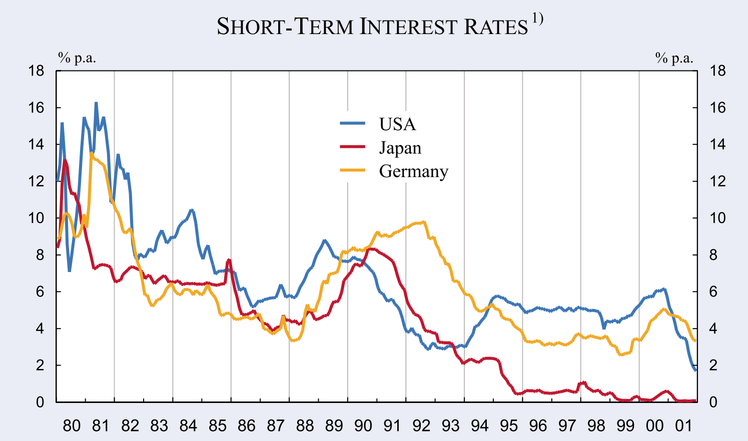
Source: Ifo Economic Survey International (ESI).

assume that expansionary policies will be strong enough to bring the downturn to a halt and achieve a moderate recovery. The cyclical improvement in the United States will in particular stimulate the economies in Southeast Asia. For the Japanese economy, however, the impetus may not be strong enough to lead to a robust and sustainable recovery. For all industrial countries, the economic expansion will amount to only about 1 per cent in 2001 and 2002, after growth of 3.3 per cent in 2000.

2.2 The European Economy

In the summer of 2001 the European economy appeared to be on the verge of recovery. The direct and indirect adverse effects of the terrorist attacks in the United States reinforced the downturn, however. Most of the leading indicators do not suggest any improvement in the near future (see the results of the Ifo Economic Survey International for Western Europe in Figure 1.4 and the results of this survey for individual countries in Annex 1) but the low point is likely to be reached at the turn of 2001/2002. It appears, however, that in some countries (in particular in Germany) the downturn is more pronounced than in other countries (e.g. France) (for further details see the section on individual countries in Annex 2). Nevertheless, the expected turnaround of the US economy and the expansionary stance of monetary conditions in Europe should contribute to a recovery of the European economy in the course of 2002. The lower oil price and the significantly lower prices of industrial and agricultural raw materials provide a further stimulus to real domestic demand. But there are still downside risks: the deterioration in the labour market may dampen private consumption further and, given the declining capacity utilisation, the propensity to invest may remain weak despite low interest rates. Most of all, the US recovery may come later or be too weak to lead the European economy out of the current slump. Overall, we expect only a relatively moderate recovery of the European economy during 2002; the growth rate year-over-year is likely to be somewhat lower than in 2001 (see also the statistical background tables in Annex 3).

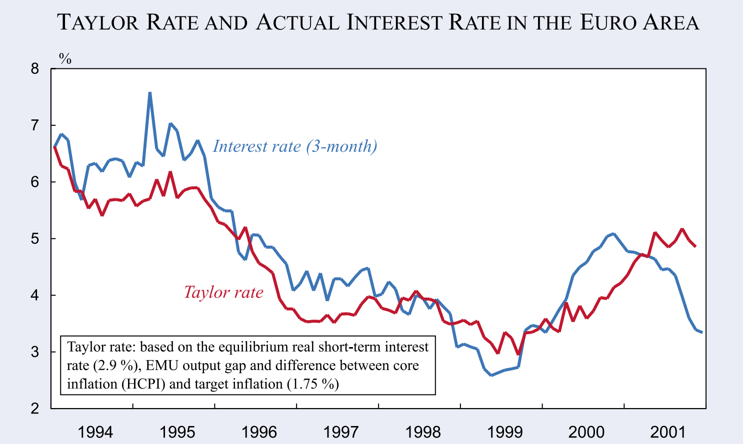
Fig. 1.5



1) 3-month interest rate.

Sources: Deutsche Bundesbank, European Central Bank, Federal Reserve Bank of St. Louis, OECD.

Fig. 1.6



Sources: European Central Bank, calculations by the Ifo Institute.

Monetary conditions

Since last May the European Central Bank has lowered key interest rates in four steps by altogether 1½ percentage points to 3.25% of which 1 percentage point was done (in two equal steps) after 11th September (see Figure 1.5). The easing of monetary policy was a response to the cyclical weakening of the economy and was facilitated by the decline in headline inflation. Interest rates were reduced despite money supply growth being continuously above its target rate. But this was not seen as posing a risk for inflation as it was mainly caused by portfolio shifts in favour of less risky liquid assets which are part of the M3 money supply. The actual short-term interest rate is now lower than the "optimal" rate as measured by the Taylor rate (see Figure 1.6 and Box). Taking into account the low real exchange rate of the euro as well, overall monetary conditions remain quite expansionary (see Figure 1.7). Moreover, a further moderate cut in interest rates is likely if the risk of recession increases. But this has not been assumed in this forecast.

Taylor rule

In 1993, John Taylor from the University of Stanford established a relationship between the optimal central bank interest rate and two indicators: the deviation of inflation from its target and the output gap. The Taylor rule interest rate is a kind of benchmark interest rate. The rule is based on the idea that the central bank interest rate is managed in order to ensure price stability and keep output at normal capacity utilisation (trend GDP). Any deviation of the inflation rate from its target and concerns about the level of output[1] will induce the Central Bank to adjust the interest rate. If the short-term interest rate is above the Taylor interest rate, it indicates that monetary policy is more restrictive than one would expect based on the prevailing inflation rate and output gap. If the actual interest rate is below the Taylor rate, it indicates that monetary policy is more expansionary than the inflation rate and the output gap would suggest.

The formula for the Taylor rate is as follows:

$I^t = i^{eq} + 0.5 \text{ x } (y\text{-}y^*) + 0.5 \text{ x } (\pi\text{-}\pi^*)$, where I^t: Taylor interest rate, i^{eq}: nominal equilibrium interest rate[2], (y -y*): output gap, $(\pi\text{-}\pi^*)$: inflation targeting deviation.

The more real output exceeds potential (or trend) output, the higher the Taylor interest rate will be. In the same way, the more inflation exceeds its target (1.75 per cent), the higher the Taylor interest rate will be. On the assumption that the Central Bank is equally concerned with price stability and real output, we use an equal weighting of 0.5 for each. While there is considerable uncertainty regarding the appropriate weighting scheme, the weights applied here bring the Taylor rate relatively close to the actual interest rate in most of the past years (see Fig. 1.6). Furthermore, the real equilibrium interest rate has to be determined. According to estimates by the Bundesbank, the real equilibrium interest rate in Germany was roughly 3% (2.9%) during the period 1979 to 1998. We assume that this rate also reflects the current real equilibrium interest rate in the Euro area as a whole. So we get:

$I^t = (2.9 + \pi + 0.5) \text{ x output gap} + 0.5 \text{ x } (\pi\text{–}1{,}75)$

We calculate two options for the Taylor rate, one based on the headline inflation rate and the other based on the core inflation rate. The headline inflation is measured by the overall consumer price index (in Europe, the Harmonised Consumer Price Index). By contrast, core inflation excludes the volatile energy and food prices. The Taylor rate based on the core inflation rate assumes that with a given output gap the Central Bank raises interest rates only if core inflation increases i.e. it does not react to temporary effects of energy prices on the inflation rate.

[1] The output gap is here defined as the percentage deviation of real GDP from its trend.

[2] Real equilibrium interest rate plus expected inflation rate. The expected inflation rate is set equal to the actual inflation rate in what flows.

Fiscal policy

Owing to tax cuts in many European countries, fiscal policy had an expansionary effect in 2001.The fiscal deficit of the Euro area increased from 0.8 per cent of GDP in 2000 to around 1½ per cent of GDP[2] and a similar deficit is expected for 2002 (see Figure 1.8). This fiscal projection is based on the assumption that governments allow, to a good extent, the so-called automatic stabilisers of the fiscal system to become effective. As the stability programmes set targets for actual deficits on the basis of a higher growth forecast, governments are assumed to tolerate some slippage from these targets. If, in contrast to our assumption, governments stick more firmly to the fiscal goals outlined in the stability programmes, they would have to take additional measures to cut spending or increase taxes which would dampen domestic demand further. The current situation highlights the risk of setting fiscal targets without considering possible changes in economic conditions. It would therefore be preferable if future stability programmes were to target cyclically adjusted (i.e. structural) deficits rather than actual deficits, notwithstanding the problems of estimating the cyclical effects on the budget.

[2] Excluding one-off revenues from the sale of UMTS licenses in 2000. As these receipts amounted to 1 per cent of GDP, a surplus of 0.2 per cent of GDP was achieved by including these receipts.

Fig. 1.7

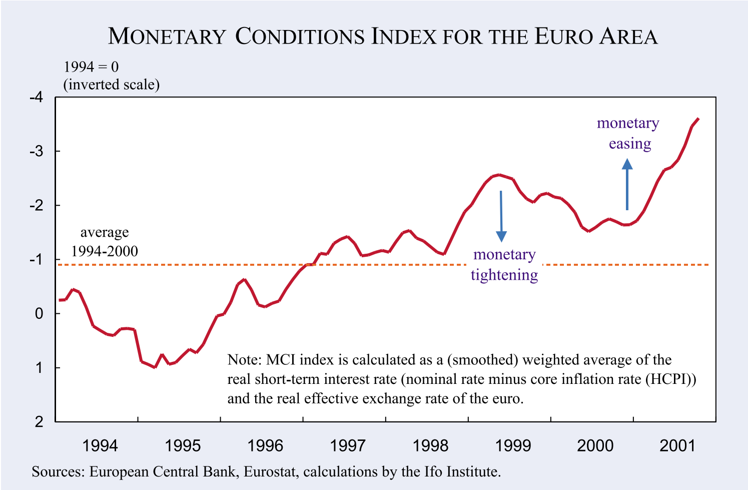
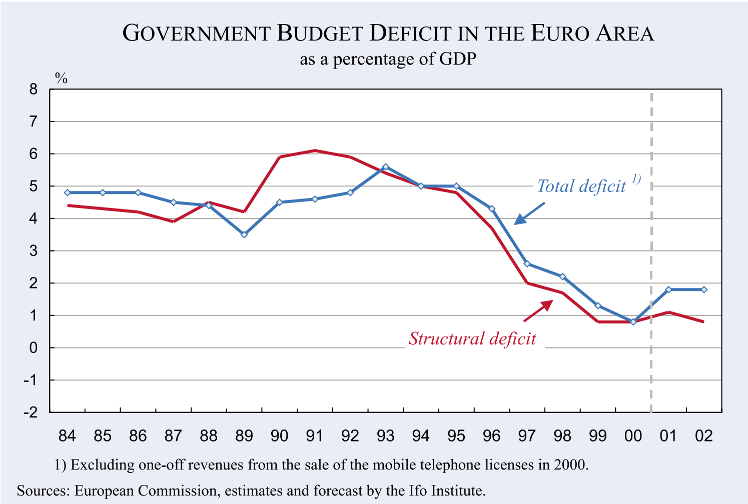


Fig. 1.8



Development of demand components

Along with the recovery of the world economy, the current slump in exports should gradually come to an end. Despite some acceleration in the course of the year, exports will expand by only 0.2 per cent in 2002, however, after 3½ per cent in 2001 and 12.1 per cent in 2000. Private consumption will increase on average by 1.5 per cent in 2002, which is somewhat less than in 2001. In 2001 tax cuts in some countries supported nominal disposable income but at the same time the surge in consumer prices and the weakening of the labour market dampened real consumer spending. As the labour market will remain weak in 2002, consumer spending will continue to rise only moderately despite the expected further decline in inflation. Investment will also remain sluggish; with the expected recovery of export demand in the second half of 2002 it may, however, increase by around 2 per cent after stagnation in 2001. In some countries the continuing weakness of construction – partly for structural reasons (as

Wage agreements

In the forecast it is assumed that wage developments in Europe will remain moderate. Given the fact that in 2001 a good part of the increase in net wages was absorbed by the higher inflation rate, there could actually be more wage pressure than assumed here. Trade unions in some countries have in fact announced higher wage demands. But as unemployment is increasing and as at the time of major wage negotiations in spring 2002 the inflation rate will be relatively low, it is likely that wage increases will remain moderate in Europe.

Fig. 1.9

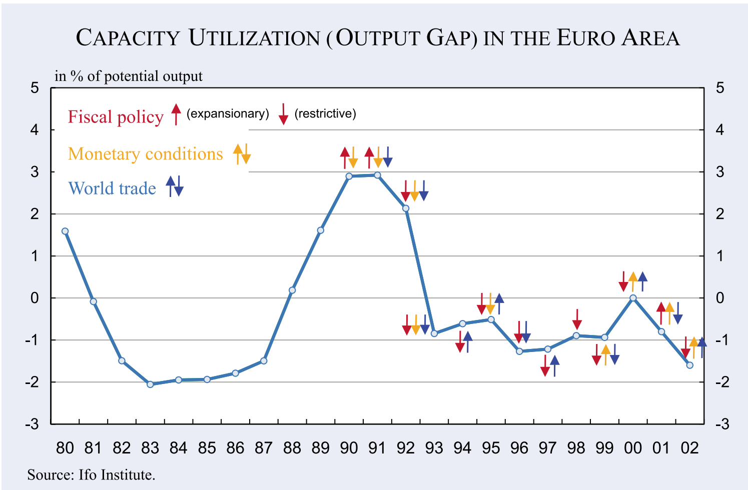
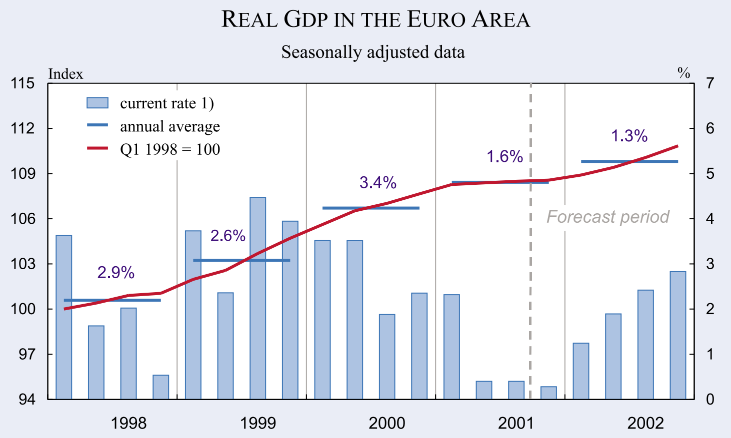


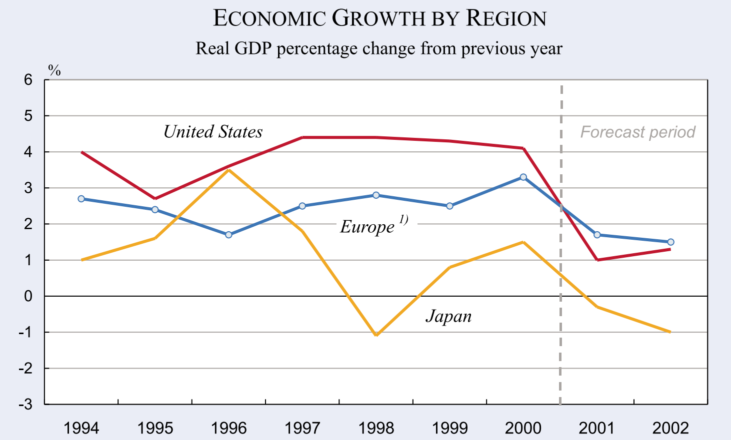
Fig. 1.10



1) Change on previous quarter, expressed as an annual rate, right-hand scale.

Sources: Eurostat; calculations and forecast by the Ifo Institute (January 2002).

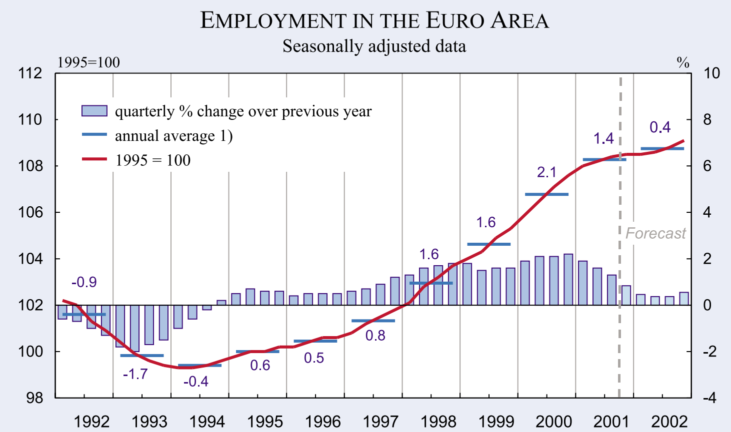
Fig. 1.11



1) Western and Central Europe.

Sources: OECD, calculations and forecast by the Ifo Institute (January 2002).

Fig. 1.12



1) Figures: annual % change against previous year.

Sources: Eurostat, calculations and forecast by the Ifo Institute (January 2002).

in eastern Germany) – will remain a drag on overall investment and growth.

Growth, employment and inflation

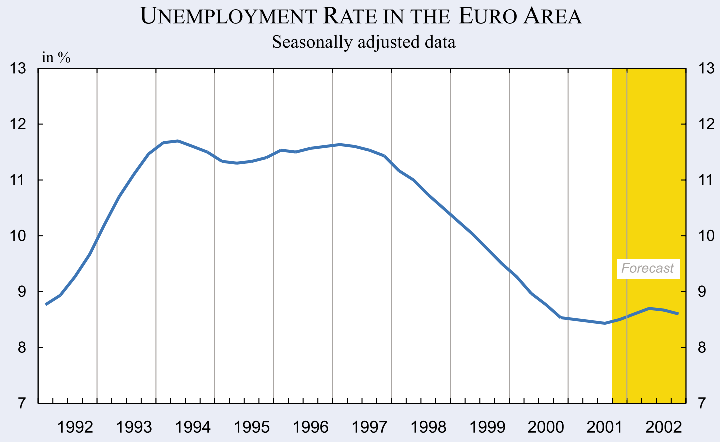
Altogether, in 2001 real GDP in Western and Central Europe can be expected to have grown by about 3/4 per cent and grow by 1 1/2 per cent in 2002. Given potential output growth of the Euro area of about 2 1/2 per cent, the output gap (which was around zero in 2000) will widen significantly in both years which implies a fall in overall capacity utilisation (see Figures 1.9, 1.10 and 1.11).

With output growth weaker than productivity growth, employment rose at a slow pace while unemployment increased in the course of 2001. This trend will continue in the first half of 2002.[3] On average, the unemployment rate in the Euro area is likely to rise from 8.5 per cent to 8.6 per cent (see Figures 1.12 and 1.13).

As the rise in energy and food prices came to an end and the oil price fell, the inflation rate declined in the second half of 2001. Assuming continued moderate wage increases and a drop of the oil price from about $25 per barrel in 2001 to around $20 per barrel on average in 2002, the inflation rate (consumer prices) in the Euro area will decline from 2 1/2 per cent in 2001 to 1 3/4 per cent in 2002 on average, and to even lower rates in the second half of

[3] Due to the higher level of employment and the low level of unemployment at the beginning of 2001, the average level of employment in 2001 was higher and the average level of unemployment was lower than in 2000.

Fig. 1.13

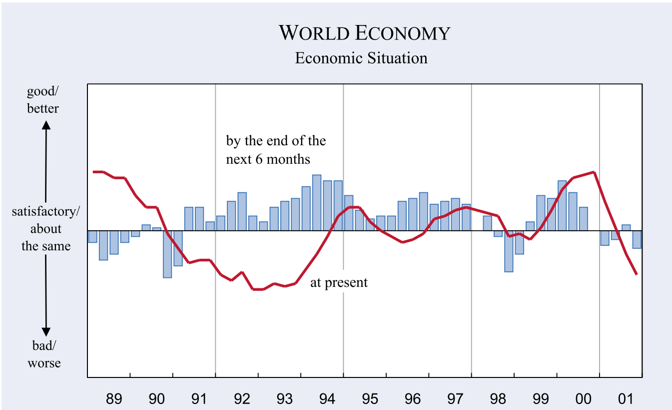


Sources: Eurostat, calculations and forecast by the Ifo Institute (January 2002).

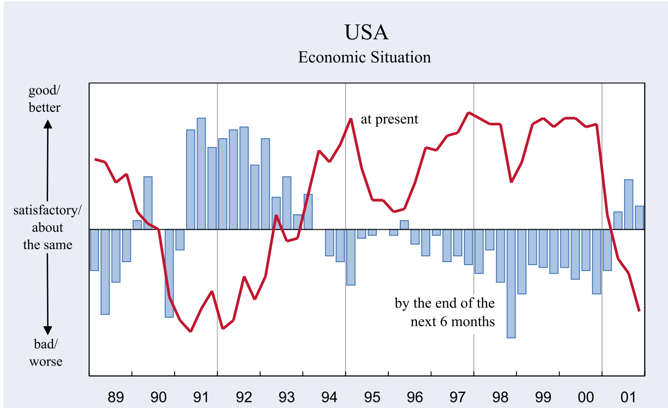
the year. The headline inflation rate would be in line again with the ECB target of "less than 2 per cent". (More details of the economic forecast are provided in Annex 3.)

Appendix 1
Ifo Economic Survey International (ESI)

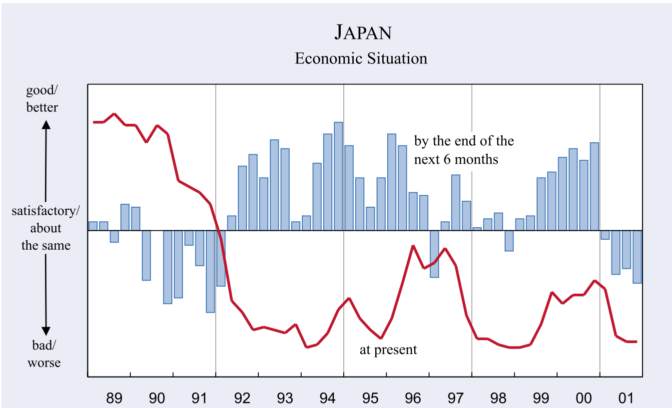
ESI is a world-wide survey of the Ifo Institute for Economic Research, questioning - on a quarterly basis - more than 800 economists of multinational corporations in 80 countries on the present economic situation of the country of residence and its economic prospects by the end of the next six months.



Source: Ifo Economic Survey International (ESI).



Source: Ifo Economic Survey International (ESI).



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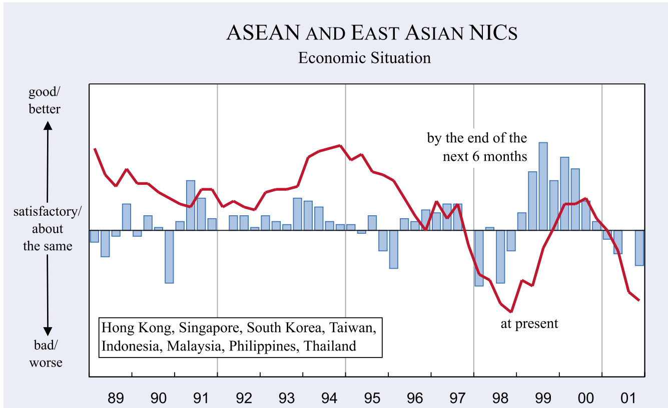
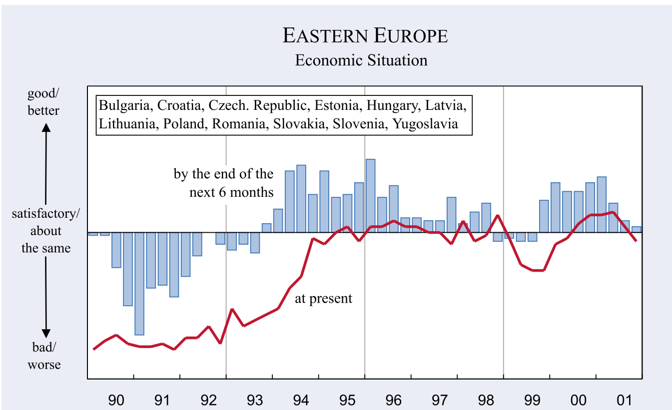


Source: Ifo Economic Survey International (ESI).



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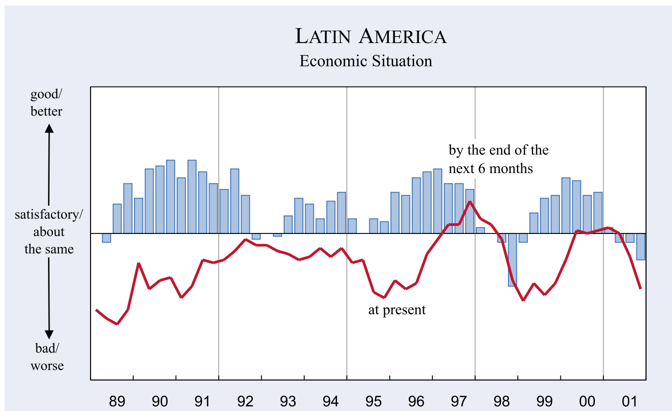
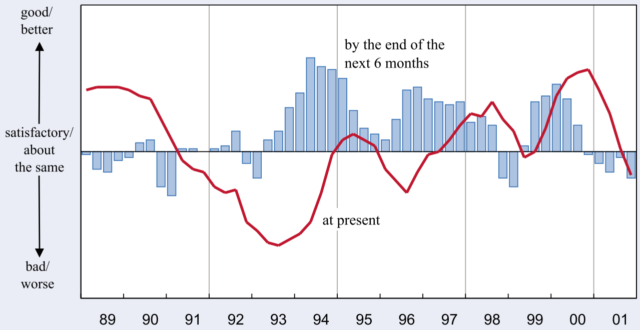


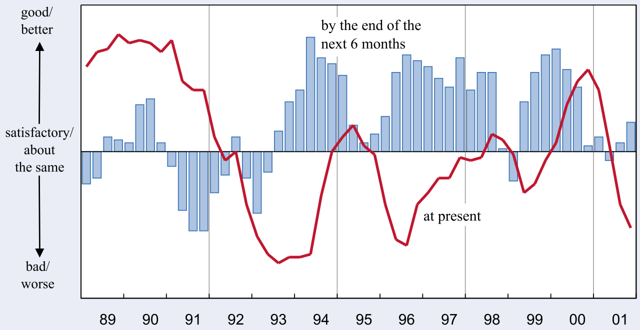
Source: Ifo Economic Survey International (ESI).

EUROPEAN UNION
Economic Situation



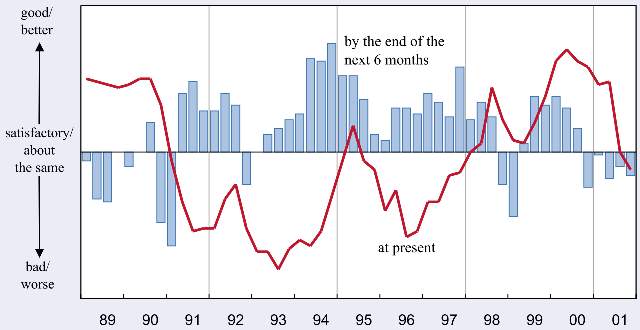
Source: Ifo Economic Survey International (ESI).

GERMANY
Economic Situation



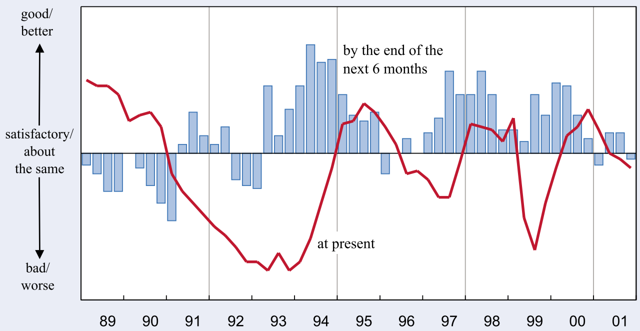
Source: Ifo Economic Survey International (ESI).

FRANCE
Economic Situation



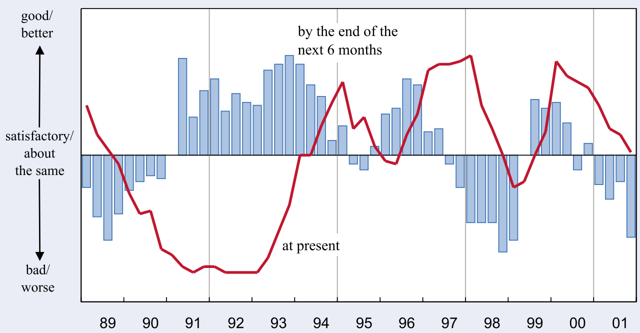
Source: Ifo Economic Survey International (ESI).

ITALY
Economic Situation



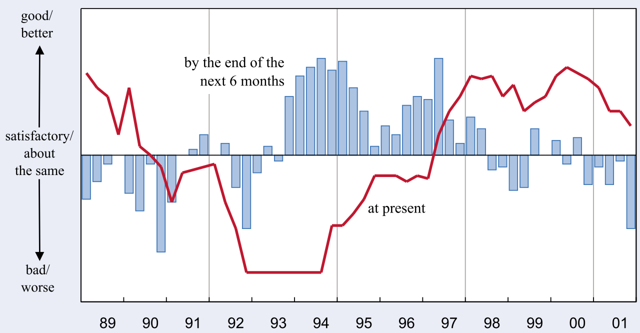
Source: Ifo Economic Survey International (ESI).

UNITED KINGDOM
Economic Situation



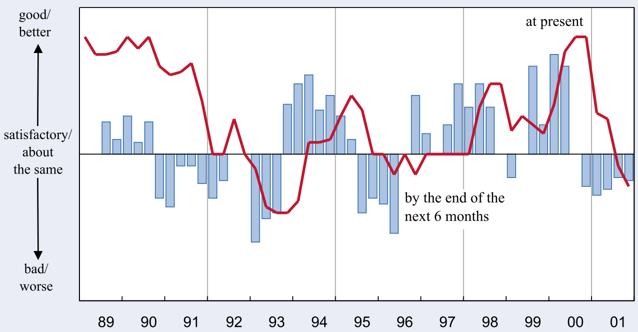
Source: Ifo Economic Survey International (ESI).

SPAIN
Economic Situation



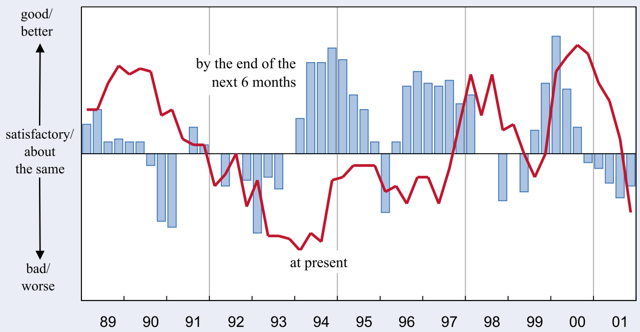
Source: Ifo Economic Survey International (ESI).

AUSTRIA
Economic Situation



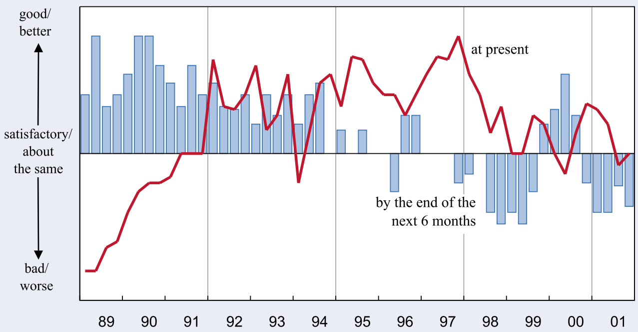
Source: Ifo Economic Survey International (ESI).

BELGIUM
Economic Situation



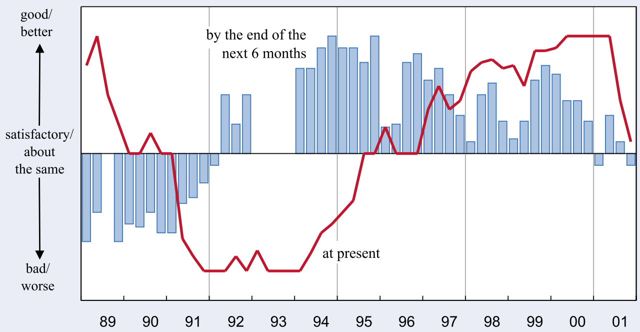
Source: Ifo Economic Survey International (ESI).

DENMARK
Economic Situation



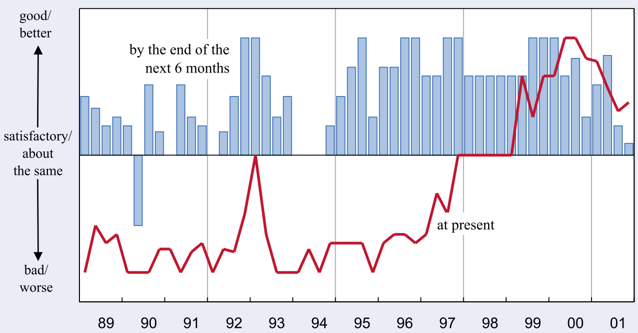
Source: Ifo Economic Survey International (ESI).

FINLAND
Economic Situation



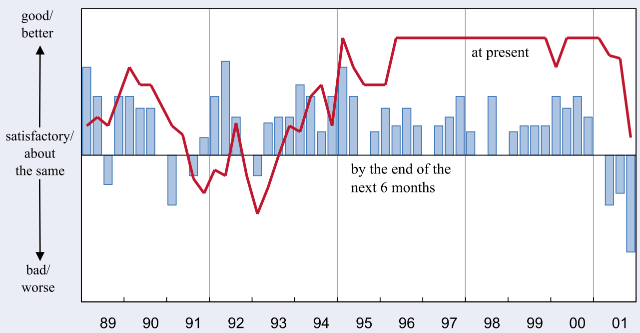
Source: Ifo Economic Survey International (ESI).

GREECE
Economic Situation

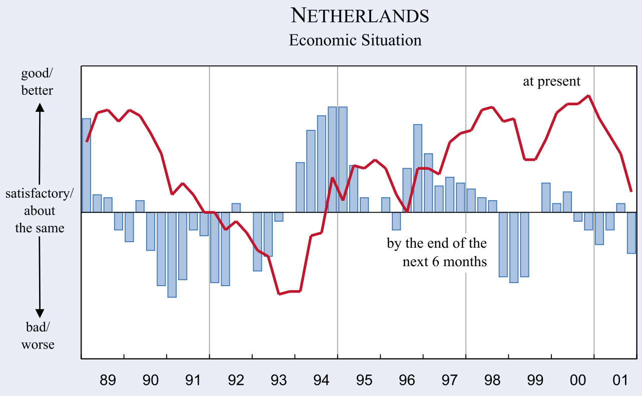


Source: Ifo Economic Survey International (ESI).

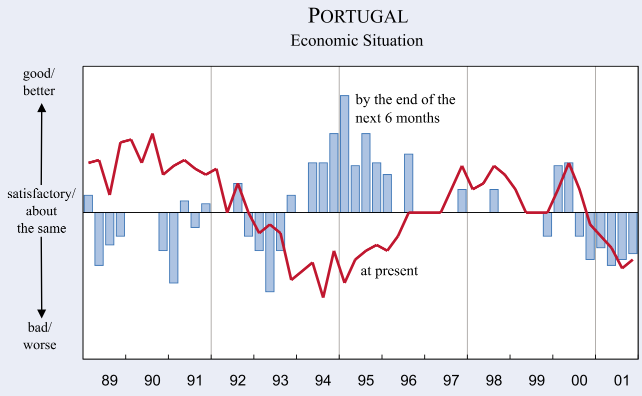
IRELAND
Economic Situation



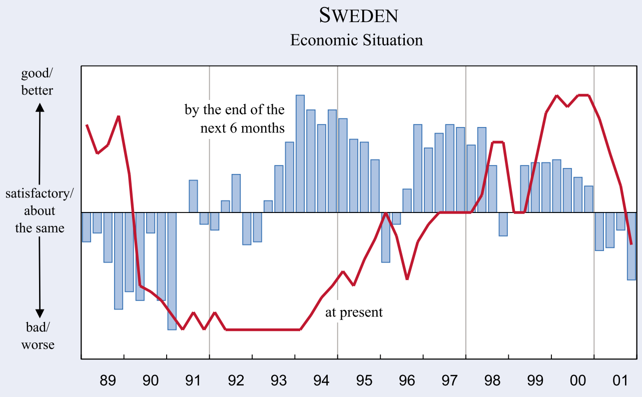
Source: Ifo Economic Survey International (ESI).



Source: Ifo Economic Survey International (ESI).



Source: Ifo Economic Survey International (ESI).



Source: Ifo Economic Survey International (ESI).

Appendix 2

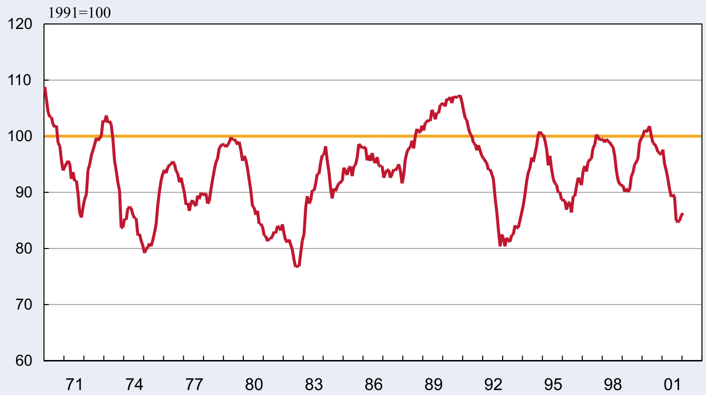
Country reports

Germany

The slowdown of economic activity has been more pronounced than in most other European countries. Economic growth fell from more than 4 per cent in the first half of 2000 to slightly negative growth in the third quarter of 2001 (seasonally adjusted annual rate – 0.6 per cent) and for the fourth quarter another small decline is expected. Various factors contributed to this downturn: (1) the price shock of higher energy and food prices which dampened domestic demand in the second half of 2000 and the first half of 2001; (2) the weakening of the US economy and the global economy which weakened export demand and business confidence; (3) as a result of weaker demand and (possibly) adverse effects of the tax reform[4], investment in machinery and equipment declined and stocks were reduced; (4) the ongoing recession in the construction sector deepened; (5) after the 11th September terrorist attacks in the United States, business confidence (as reflected in the Ifo Business Climate Indicator) plummeted further although business expectations (which is one component of the Business Climate Indicator) had turned around in preceding months. In recent months the level of this indicator has approached (although not reached) the low levels of previous recessions. Obviously the adverse effects on the German economy were much stronger than the fiscal stimulus of the tax cut (1 per cent of GDP), which was implemented at the beginning of 2001, and the easing of monetary conditions. The increase in unemployment reduced consumer confidence further.

Altogether, economic growth in Germany will only amounted to 0.6 per cent in 2001. This year,

IFO BUSINESS CLIMATE[1)]



1) Western Germany; manufacturing industry, construction, wholesale and retail trade.

Source: Ifo Business Survey.

Germany
Key Forecast Figures

	1999	2000	2001	2002[1)]
Percentage change over previous year[a)]				
Private consumption	3.1	1.4	1.4	0.8
Government consumption	1.6	1.2	1.3	1.1
Gross fixed capital formation	4.2	2.3	– 4.1	– 1.7
Machinery and equipment, other	8.0	8.7	– 2.2	0.8
Construction	1.5	– 2.5	– 5.7	– 3.9
Domestic expenditure	2.6	2.0	– 0.5	0.4
Exports	5.6	13.2	5.1	2.2
Imports	8.5	10.0	2.0	1.8
Gross domestic product	1.8	3.0	0.6	0.6
Unemployment rate[b)] (in %)	9.7	9.1	9.1	9.3
Consumer prices[c)] (% change on the previous year)	0.6	1.9	2.5	1.5
General government budget balance[d)] in % of GDP[e)]	– 1.6	– 1.3	– 2.6	– 2.5

[1)] Forecast of the Ifo Institute. – [a)] At 1995 prices. – [b)] Unemployment as a % of labour force (employed and unemployed). – [c)] Price index for the cost of living of all private households (1995 = 100). – [d)] On national accounts definition (ESA 1995). – [e)] In 2000 without revenues from the auction of UMTS licenses.

Source: National Statistical Office, calculations of the Ifo Institute.

[4] The corporate tax rate was reduced but depreciation allowances became unfavourable so that the effective marginal tax rate rose. This may have induced firms to bring forward some of their planned investment into 2000.

German Tax Reform

The income tax and business tax reform of 2001 aims at promoting economic growth and employment. The direct budgetary costs of tax reductions are estimated to amount to DEM 46 billion or 1.1 per cent of GDP in 2001 (see table below). About 60 per cent of this reduction increases the disposable income of private households and 40 per cent benefits the business sector. The income tax reduction of 2001 will reduce the tax bill of wage earners by 1½ to 1¾ per cent, depending on the size of income. The corporate tax rate has been reduced significantly in order to bring business tax rates more in line with those of other countries. The reduction of tax rates is accompanied by a broadening of the tax base, in particular the introduction of less favourable depreciation allowances. This leads to an increase in the marginal effective tax rate on new investment (capital costs). Furthermore, the full imputation system of the corporate tax was abolished. Distributed profits bear the full corporate tax paid by the firm. However, the recipient will pay income tax only on half of the amount received ("Halbeinkünfteverfahren"). On average, this should bring the effective tax rate on distributed profits close to that of income from other sources. For shareholders with a marginal income tax rate of 40 per cent the tax burden on distributed profits is similar to the old system while for those with a marginal tax rate below 40 per cent the tax burden is higher and for those with a marginal income tax rate of more than 40 per cent it is lower than with the old imputation system.

Changes in taxes and social security contributions from 2000 to 2003

–: lower revenues +: higher revenues

	2000	2001	2002	2003
	DEM Billion			
Taxes and social security contributions	– 1.0	– 46.4	– 36.0	– 45.1
Taxes	+ 3.0	– 39.3	– 25.7	– 31.5
Social security contributions	– 4.0	– 7.1	– 10.3	– 13.6

Reduction of social security contribution (for persons) from 20.3 to 19.5 per cent (1.4.1999), to 19.3 per cent (1.1.2000), to 19.1 per cent (1.1.2001), to 18.9 per cent (1.1.2002) and 18.7 per cent (1.1.2003)[a] and introduction of social security contribution for part-time-workers.

[a] Estimate for 2002 and 2003 based on information from the government.

Sources: Federal Ministry of Finance. Calculated by the six German economic research institutes.

with the expected recovery of the US economy and the global economy the retarding factors will lose their strength, the mild recession will be overcome and economic growth could accelerate to almost 3 per cent (annual rate) during the course of the year. But given the low starting position at the beginning of the year average growth will only be again 0,6 per cent. Continuing deterrents to expansion in Germany are the structural problems in the eastern German economy and the overall weak construction sector. Other growth-retarding factors are labour-market rigidities and the high marginal tax rates on labour input. The relatively weak increases in output in both 2001 and 2002 will be achieved entirely by improvements in productivity. The number of gainfully employed may not increase until 2002 as the economy recovers and average unemployment in 2002 is expected to amount to 9.3 per cent. The previous goal of the German government to reduce unemployment to below 3½ million by the autumn of next year will clearly not be reached; according to this forecast unemployment will rise to almost 4 million at that time.

The general government budget deficit is expected to amount to 2½ per cent in 2001 and in 2002 which is significantly higher than planned by the Government in its stability programme in the autumn of 2000 (1½ per cent for 2001 and 1 per cent for 2002). The fiscal slippage is to a large extent caused by lower tax revenues in response to weaker growth.

Tax reform measures

		Step 1	Step 2	Step 3
	2000	2001	2003	2005
Business sector				
Corporate sector				
Corporate tax rate[a)]	40.0	25.0	25.0	25.0
Corporate marginal tax rate				
Retained earnings[b)]	51.8	38.6	38.6	38.6
Distributions[c)]	61.5	54.3	53.9	52.2
Non-corporate sector[d)]				
Top marginal income tax	43.0	48.5	47.0	42,0
Total marginal tax rate[b)]	54.5	51.4	50.1	45.7
Household sector				
Marginal income tax rate				
at the bottom	22.9	19.9	17.0	15.0
at the top	51.0	48.5	47.0	42.0
incl. solidarity tax	53.8	51.2	49.6	44.3
Basic tax allowance (DEM)	13.500	14.000	14.500	15.000
Income bracket for top marginal tax rate (DEM)	115.000	107.500	102.000	102.000

[a)] Retained earnings. – [b)] Incl. solidarity tax and local business tax. – [c)] For shareholders with the top marginal income tax rate, incl. solidarity tax. – [d)] From 2001, firms can de facto deduct a good part of the local business tax from their income tax bills.

Furthermore, the recent corporate tax reform may have led to bigger revenue shortfalls than previously expected and it is suspected that, in the context of VAT, tax evasion is widespread.

German business tax rates in international comparison[a)]
in %

Germany (1998)	**56.0**
Germany (1999/2000)	**51.8**
United States (New York)	40.8
Germany (2001)	**38.6**
France	37.8
Portugal	35.2
Spain	35.0
Netherlands	35.0
Austria	34.0
Denmark	32.0
United Kingdom	30.0
Finland	29.0
Sweden	28.0
Norway	28.0
Switzerland (Zürich)	25.0
Ireland	24.0

[a)] Corporate taxes inc. local taxes.

Source: Federal Ministry of Finance.

France

Whereas real GDP increased by 3.4 per cent in 2000, economic growth slowed markedly during 2001. But the slowdown was less pronounced than in Germany; in the third quarter GDP growth even picked up a bit (to 0.5 per cent against the previous quarter). As elsewhere, the slowdown in the world economy reduced export growth. The consequence was a weakening of business investment. Furthermore, firms reduced stock-building. The government provided fiscal stimuli by cutting income taxes and social security charges which supported private consumption. Even more, the 35 hour-week will also be introduced in small firms at the beginning of 2002 and the job programme for the young will be continued which both will be supportive of employment in the short term. As we have seen in recent years, a favourable situation in the labour market is of upmost importance for private consumption – and it will be decisive for the general election and the presidential election held in May 2002. For that reason the government can be expected to stimulate employment directly and indirectly beyond the present programmes. These are costly for the government budget. Despite con-

Fiscal Policy in France

Between 1997 and 2000, France experienced a strong macroeconomic expansion. This pick-up followed a severe and protracted recession which had a substantial impact on public debt. The latter increased from 39.5 per cent of GDP in 1990 to 65.1 per cent in 1998, as a result of both automatic stabilisers and the introduction of various subsidies and tax cuts in order to stimulate activity. Therefore, during this period, France moved from a situation where it was quite virtuous, to a situation where its debt/GDP ratio is now similar to that of other countries. During the more recent expansion, the fiscal stance improved, and the budget deficit gradually fell from over 3 per cent of GDP to less than 2 per cent.

General government deficit (% of GDP)

1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
4.2	6.0	5.5	5.6	4.1	3.0	2.7	1.6	1.3	1.6	1.4

Most of this improvement, however, is due to automatic stabilisers. There has been no attempt to take advantage of the previous expansion to reverse the earlier trend of growing public debt, which was still equal to 64.5 per cent in 2000, lower than the average of the Euro area but larger than in Germany and the UK. Instead, the government implemented some tax cuts, most notably of VAT in 1997, and increased its spending commitments. In particular, there has been no pension reform, despite the fact that the current situation is financially unsustainable. For example, contrary to what happened in Germany, the retirement age has not been increased. As this is a politically sensitive issue, it is likely not to be tackled seriously before it actually occurs, i.e. in 2010, when baby-boomers come to retirement. This lack of reform is likely to generate strains on public finances in the future. The workweek has been reduced by more than 10 per cent as of January 2000, without any compensating fall in take-home pay although trade unions have accepted moderate wage increases. In order to offset the effect of the reduced workweek on this large increase in labour costs, the government has subsidised wages for firms that shift to the 35-hour week. The fiscal cost of these measures is about FF 100 billion a year. There has been no attempt to reduce the size of the public sector, although the fraction of the workforce employed in the public sector is one of the largest of the OECD, and despite a historical opportunity due to large numbers of retirements in the civil service in the coming year. Instead, recruitment has been slightly increased where needed (hospitals), but staff was not reduced where possible (the modernisation of some sectors like the tax administration was blocked by unions). Active labour market policies were increased despite their already high cost of about FF 200 billion a year, and most measures (in particular the emplois-jeunes) favoured employment in the public or non-business sector. Future pressure to transform these temporarily funded relief jobs into permanent positions in the public sector is likely to arise, thus contributing to an increase in government expenditures. As a result, the cyclically adjusted budget deficit (as measured by the OECD) remained between 1.8 and 2.2 per cent of GDP over this expansion period. The major consequence of this development is that if a new recession were to come, France would emerge from it in a financially fragile position, with a debt of perhaps 70 to 90 per cent of GDP, and the need for a painful adjustment like in Italy and Belgium. This would not be the case if France had accumulated a surplus during the recent period of very strong growth, as sound economics recommends. In the longer run, the trend toward an excessively large public sector continues. According to the OECD, in 2000 government outlays amounted to 51.4 per cent of GDP, ranking second in the OECD after Sweden. Similarly, France ranks among the top countries in terms of public employment, with a share of over 25 per cent.

Why is inflation so low in France?

Standard macroeconomic thinking holds that when tensions on product and labour markets are too high, wages and prices adjust upwards, thus generating inflationary pressure. Typically, this occurs when unemployment falls below the so-called "natural rate", which depends on regulation and frictions in product and labour markets. Therefore, if one has an idea of the level of the natural rate, one should be able to predict inflationary tensions by estimating the difference between this natural rate and actual unemployment (or, equivalently, the "output gap"). However, the natural rate itself moves, and macroeconometric analysis sheds little light on the structural causes of such moves. For example, in the early 1990s in the United States, many economists thought the natural rate to be about 6 per cent, and would have expected the strong expansion that was observed in the second half of this decade to increase inflation. In fact, inflation did not exceed 2 per cent and was actually lower than in the preceding period, despite unemployment falling continuously to 4 per cent in 2000. To critics of orthodox economics, such episodes suggest that the concept of a natural rate is simply useless. To us, it means that the natural rate has fallen for structural reasons that need to be investigated. In an interesting paper, Shimer (1998) argues that this can be entirely explained by changes in the composition of the workforce, due to a lower share of younger workers and an improvement in education. However, the growth pick-up of the period (see chapter on growth) has also played a role in disinflation, since faster productivity growth reduces price inflation for any given level of wage inflation. According to the US Bureau of Labor Statistics, wage inflation has been moderate at 3 per cent during this period, but increased to 4 per cent in 2000. An indicator of labour market tensions like the help wanted index went up, as is always the case in expansions, but by less than in previous cycles. Superficially, the strong expansion in France in 1997–2000 exhibits similarities. Unemployment fell rapidly from over 13 per cent to less than 9 per cent. A lot of unemployment at the beginning of this period was "Keynesian", i.e. in excess of the natural rate, due to the severe recession of the mid-1990s. On the other hand, the natural rate of unemployment was expected to be significantly higher than in the United States because of a rigid labour market and the absence of significant structural reforms. Indeed, in the expansion of the late 1980s, as unemployment fell to near 8 per cent, a sharp increase in labour supply bottlenecks was observed, suggesting a low search activity of many unemployed workers. This created wage pressure and inflationary tensions, which eventually brought the economic expansion to a halt. This episode suggested that the natural rate of unemployment was around 8 to 9 per cent at that time. Given that no institutional reform aimed at improving the labour market was implemented in the 1990s, it was reasonable to expect a similar scenario in the current boom, with unemployment stabilising at 8 to 9 per cent, and a sharp rise in labour market tightness indicators. Indeed, unemployment bottomed at 8.5 per cent in the spring of 2001 and has been going up again since then. And indicators of hiring difficulties went up sharply in early 2000, by virtually the same amount as in the previous expansion, and much more for the least skilled workers.[1] The emergence of labour market bottlenecks suggests that wage pressure should have picked up, thus putting upward pressure on inflation. But, in fact, this has not happened. Until recently, both price and wage inflation had been moderate. Therefore, this situation has been paradoxical, in that tension indicators suggested – at least until spring 2001 – a labour market tightness, while the behaviour of wages and prices suggested otherwise. How can we reconcile these two facts? Although this is the matter of much speculation, we can at least point out two factors. First, inflation has been suppressed as wage moderation agreements were signed in many firms as part of the transition to the 35-hour week. If tensions persist in the labour market, such moderation will probably be lost when these contracts are renegotiated. That is, these arrangements have delayed the inflationary impact of labour market tightness. Second, price adjustment has been delayed to some extent because of the transition to the euro in 2002. Since, at this date, all firms will have to change their prices anyway, it is not worth for a given firm to increase its price six months or one year ahead of the event, as competitors will typically not do so simultaneously, so that the firm runs the risk of losing customers. Indeed, in the summer of 2001, there were signs of substantial price hikes in the retail sector as firms set their euro prices, so much that the Ministry of Finance threatened to impose "sanctions". More generally, prices are only one tool of adjustment; firms can play on other margins such as delivery lags, product quality, etc. Different instruments will be used depending on circumstances. But given the most recent cyclical weakening of the economy, it is likely that inflation will remain moderate.

[1] See Pisani-Ferry (2000), fig. 19, p. 95.

strained government spending in some areas, transfers from the central budget to local budgets will show an increase of 8.4 per cent in 2002 as against 2001. Consequently the public deficit is on the rise. After a level of 1.4 per cent of GDP in 2000 and more than 1$^1/_2$ per cent in 2001, it might amount to about 2$^1/_4$ per cent in 2002, thus clearly missing the targets of the Stability and Convergence Programme. While public consumption will grow steadily by 2 per cent, private consumption will gain momentum in the course of 2002, but given the relatively low starting level at the end of next

France
Key Forecast Figures

	1999	2000	2001[1)]	2002[1)]
Percentage change over previous year[a)]				
Private consumption	2.8	2.5	2.7	1.9
Public consumption	2.0	2.2	2.0	2.2
Gross fixed capital formation	6.2	6.1	2.7	0.7
Domestic demand	3.0	3.6	1.7	1.8
Exports	4.0	12.6	3.0	1.7
Imports	4.7	14.2	2.3	1.8
Gross domestic product	2.9	3.1	2.0	1.7
Unemployment rate[b)] (in %)	11.2	9.6	8.6	8.8
Consumer prices[c)] (% change on the previous year)	0.6	1.8	1.8	1.3
General government financial balance[d)] in % of GDP[e)]	– 1.6	– 1.3	– 1.6	– 1.4

[1)] Forecast of the Ifo Institute. – [a)] At 1995 prices. – [b)] Unemployment as a % of labour force (employed and unemployed). – [c)] Price index for the cost of living of all private households. – [d)] On national accounts definition (ESA 1995). – [e)] In 2000 without revenues from the auction of UMTS licenses.

Source: Eurostat, National Statistical Office, calculations of the Ifo Institute.

year consumption growth will be lower than in 2001. Gross fixed investment will recover only slowly next year, since there is no indication that housing investment or investment in plant and machinery will pick up significantly before autumn.

Based on a recovery of the world economy, exports and overall economic growth will pick up in the course of 2002. Real GDP will increase by about 2 per cent in 2001 and 1¾ per cent in 2002. The unemployment rate, which declined from 9.6 per cent in 2000 to 8.6 per cent in 2001, is expected to rise again to 8¾ per cent in 2002. Inflation will remain modest and below the Western European average. Consumer prices are likely to rise by 1¼ per cent in 2002 after 1¾ per cent in 2001; retail trade is committed to keep prices stable in order to avoid irritations while euro coins and notes are introduced. The current account will continue to show surpluses in the order of 1½ per cent of GDP.

Italy

Italy
Key Forecast Figures

	1999	2000	2001[1)]	2002[1)]
Percentage change over previous year[a)]				
Private consumption	2.3	2.9	1.6	2.1
Public consumption	1.5	1.6	1.3	1.7
Gross fixed capital formation	4.6	6.1	1.5	2.5
Domestic demand	2.3	4.1	1.8	2.0
Exports	0.0	10.2	3.9	2.0
Imports	5.1	8.3	3.8	3.9
Gross domestic product	1.6	2.9	1.8	1.4
Unemployment rate[b)] (in %)	11.3	10.5	9.6	9.8
Consumer prices[c)] (% change on the previous year)	1.7	2.6	2.7	2.0
General government financial balance[d)] in % of GDP[e)]	– 1.8	– 1.5	– 1.3	– 1.2

[1)] Forecast of the Ifo Institute. – [a)] At 1995 prices. – [b)] Unemployment as a % of labour force (employed and unemployed). – [c)] Price index for the cost of living of all private households. – [d)] On national accounts definition (ESA 1995). – [e)] In 2000 without revenues from the auction of UMTS licenses.

Source: Eurostat, National Statistical Office, calculations of the Ifo Institute.

After an increase in GDP of 2.9 per cent in 2000, which was the highest rate since 1995, economic growth slowed in 2001. The world-wide slump of the IT-sector did not hurt very much since this industry does not play a role worth mentioning. The slowdown of growth was caused by a parallel weakening of domestic demand and exports. Industrial production and business confidence fell during the first half of 2001 and business investment weakened significantly; while the upswing in construction slowed only moderately, the investment boom in machinery and equipment came to an abrupt halt not only for cyclical reasons. There were clear signs of a recovery before the September terrorist attacks as business confidence had improved and order inflow had picked up. Despite a modest decline, the consumer confidence indicator remained on a high level. After the events of 11th September hopes for a recovery were dashed and business confidence declined sharply. But the consumer climate was still favourable.

Employment continued to rise at about the same pace as in 2000 (1.6 per cent). It appears that the measures to reduce labour market restrictions taken since 1998 (more flexible labour contracts) are having a positive impact on employment; the strong increase of part-time jobs is perhaps the most striking evidence. Private consumption, which had been supported in 2000 by the drop in the savings rate, decelerated to a rate similar to that of real disposable income, due to the oil and food price shocks (they have been petering out since midyear) which reduced the purchasing power of private households.

In the course of 2002 exports are expected to recover which will stimulate demand in addition to expansionary monetary policy. Real GDP can be expected to increase by about 1½ per cent after 1¾ per cent in 2001, implying a steady acceleration in the course of 2002. There will be a steady increase in public consumption, a slight acceleration of private consumption, but gross fixed investment is expected to grow significantly in the later course of the year due to new fiscal incentives (a second "Legge Tremonti"). Inflation is likely to fall from 2¾ per cent in 2001 to almost 2 per cent in 2002. The rate of unemployment which declined from 10.5 per cent in 2000 to 9½ per cent in 2001 is expected to remain almost unchanged in 2002.

As in Germany and in France the economic slowdown will cause an overshooting of the fiscal deficits of the targets of the stabilisation programme despite unorthodox operations like significant sales of public real estate etc. The deficit might amount to 1¼ per cent of GDP in 2001 and 2002 compared with the targets of 0.8 per cent and 0.5 per cent respectively.

United Kingdom

United Kingdom
Key Forecast Figures

	1999	2000	2001[1]	2002[1]
Percentage change over previous year[a]				
Private consumption	4.2	4.0	3.9	2.4
Public consumption	2.8	1.6	2.5	3.5
Gross fixed capital formation	0.9	4.9	1.9	1.0
Domestic demand	3.9	5.0	3.0	2.4
Exports	5.4	10.2	2.0	1.0
Imports	8.9	10.7	3.7	2.8
Gross domestic product	2.1	2.9	2.2	1.8
Unemployment rate[b] (in %)	6.1	5.5	5.1	5.4
Consumer prices[c] (% change on the previous year)	1.3	0.8	1.2	1.0
General government financial balance[d] in % of GDP[e]	1.2	4.3	1.0	– 0.1

[1] Forecast of the Ifo Institute. – [a] At 1995 prices. – [b] Unemployment as a % of labour force (employed and unemployed). – [c] Price index for the cost of living of all private households. – [d] On national accounts definition (ESA 1995). – [e] In 2000 without revenues from the auction of UMTS licenses.

Source: Eurostat, National Statistical Office, calculations of the Ifo Institute.

After an increase in real GDP of 2.9 per cent in 2000, growth decelerated albeit less than in most other countries. The slowdown was caused by significantly weaker export growth, which was affected by the global downturn, the sharp adjustment of high-tech industries and the overvalued pound Sterling. In addition, the international competitiveness of manufacturing continued to dwindle and production began to decline in late summer of 2000, albeit slowly. By contrast, the service sector and also the construction sector held up much better and the "split economy" continued. The unemployment rate continued to decline. Headline inflation increased as consumer demand remained strong. It came down somewhat in the second half of the year when the temporary effects on food prices of the poor weather conditions and the BSE and foot-and-mouth-epidemic waned.

Economic policies remain expansionary. Given a budgetary surplus, which provides room for manoeuvre, and pressures to improve the public infrastructure and public services, public spending – including investment in the public infrastructure which underpins further growth of construction – will continue to be increased significantly in 2002; between April and October 2001 spending grew by as much as 9.6 per cent (annual rate). Furthermore, tax credits for various purposes (e.g. R&D investment, work incentives and saving) have been introduced. Monetary policy has been eased in the light of deteriorating economic prospects, the high Sterling exchange rate and the low inflation rate. After the September terrorist attacks, interest rates were cut further, reaching a historically low level. A further cut seems likely in order to support demand in general and the manufacturing industry in particular.

Economic growth is expected to slow from 2.9 per cent in 2000 to 2$^{1}/_{4}$ per cent in 2001. An improving global economy and the strong expansionary stance of economic policies should support aggregate demand, and growth is expected to accelerate in the course of 2002. Average growth in 2002 will amount to 1$^{3}/_{4}$ per cent. This rate means an acceleration in the course of the year with public consumption and public construction picking up strongly. Private consumption will grow less, since increasing unemployment will cause an increase of the savings rate. Investment by the manufacturing industry is not expected to revive until the later course of 2002 and then only slowly. Consequently, it may not contribute appropriately to the coming upswing of the world economy. The unemployment rate might rise from around 5 per cent in 2001 to 5$^{1}/_{2}$ per cent in 2002. The inflation rate (CPI) will be. 1$^{1}/_{4}$ per cent in 2001 and about 1 per cent in 2002 (after 0.8 per cent in 2000).

Appendix 3

Forecasting Tables

Euro Area
Key Forecast Figures

	1999(*)	2000(*)	2001(s)	2002(s)
Percentage change over previous year[a]				
Private consumption	3.2	2.5	1.8	1.4
Public consumption	2.2	1.9	1.7	1.3
Gross fixed capital formation	5.4	4.3	– 0.5	0.7
Domestic demand	3.2	2.8	0.8	1.3
Exports	5.2	11.9	3.3	1.4
Imports	3.7	10.7	1.4	1.2
Gross domestic product	2.6	3.4	1.6	1.3
Employment[b] (% change on the previous year)	1.6	2.1	1.4	0.4
Unemployment rate[c] (in %)	9.9	8.8	8.5	8.6
Consumer prices[d] (% change on the previous year)	1.1	2.4	2.6	1.8
General government financial balance[e] in % of GDP	– 1.3	– 0.8	– 1.1	– 1.4
Memo item:				
Real GDP in USA (% change over previous year)	4.1	4.1	1.0	1.3
Real GDP in Japan (% change over previous year)	0.7	1.5	– 0.3	– 1,1

(*) Preliminary. – (s) Forecast of the Ifo Institute. – [a] At 1995 prices. – [b] Domestic employment. – [c] Unemployment as a % of labour force (employed and unemployed). – [d] Harmonize index of consumer prices. – [e] On national accounts definition (ESA 1995); in 2000 without UMTS revenues.

Source: Eurostat, calculations of the Ifo Institute.

Economic Growth by Country and Region
Real GDP, percentage change over previous year

	% weights as of 2000[a]	1994	1995	1996	1997	1998	1999	2000	2001[f]	2002[f]
Austria	0.82	2.6	1.6	2.0	1.6	3.5	2.8	3.0	1.1	1.3
Belgium	0.99	2.8	2.6	1.2	3.6	2.2	3.0	4.0	1.4	1.5
Czech Republic	0.22	2.6	5.9	4.3	– 0.8	– 1.2	– 0.4	2.9	3.4	3.5
Denmark	0.70	5.5	2.8	2.5	3.0	2.8	2.1	3.2	1.3	1.4
Finland	0.53	4.0	3.8	4.0	6.3	5.3	4.0	5.7	0.5	1.3
France	5.60	1.8	1.9	1.1	1.9	3.5	3.0	3.1	2.0	1.7
Germany	8.12	2.3	1.7	0.8	1.4	2.0	1.8	3.0	0.6	0.6
Greece	0.48	2.0	2.1	2.4	3.6	3.4	3.4	4.3	3.5	3.2
Hungary	0.20	2.9	1.5	1.3	4.6	4.9	4.2	5.2	3.8	3.7
Iceland	0.04	4.5	0.1	5.2	4.8	4.6	4.0	5.0	1.4	0.5
Ireland	0.41	5.8	10.0	7.8	10.8	8.6	10.8	11.5	6.3	3.5
Italy	4.66	2.2	2.9	1.1	2.0	1.8	1.6	2.9	1.8	1.4
Luxembourg	0.08	4.2	3.8	3.6	9.0	5.8	6.0	9.5	4.1	3.0
Netherlands	1.59	3.2	2.3	3.0	3.8	4.3	3.7	3.5	1.4	1.3
Norway	0.70	5.5	3.8	4.9	4.7	2.4	1.1	2.3	1.6	1.9
Poland	0.71	5.2	7.0	6.0	6.8	4.9	4.0	4.0	1.5	1.6
Portugal	0.45	2.2	2.9	3.7	3.8	3.8	3.3	3.4	1.9	1.6
Slovak Republic	0.08	4.9	6.7	6.2	6.2	4.1	1.9	2.2	3.0	2.9
Spain	2.41	2.4	2.8	2.4	4.0	4.3	4.1	4.1	2.7	2.2
Sweden	0.99	4.1	3.7	1.1	2.1	3.6	4.1	3.6	1.6	1.8
Switzerland	1.04	0.5	0.5	0.3	1.7	2.4	1.6	3.0	1.5	1.2
United Kingdom	6.14	4.7	2.9	2.6	3.4	3.0	2.1	2.9	2.2	1.8
Euro area[b]	25.65	2.3	2.2	1.4	2.3	2.9	2.6	3.4	1.6	1.3
European Union[c]	33.96	2.8	2.4	1.7	2.6	2.9	2.6	3.3	1.7	1.4
Western Europe[d]	35.75	2.7	2.3	1.6	2.5	2.7	2.5	3.3	1.7	1.4
Central Europe[e]	1.21	4.5	6.2	5.3	4.5	3.4	3.0	3.9	2.3	2.4
Western and Central Europe	36.95	2.7	2.4	1.7	2.5	2.8	2.5	3.3	1.7	1.5
Japan	20.00	1.0	1.6	3.5	1.8	– 1.1	0.8	1.5	– 0.3	– 1.1
United States	43.05	4.0	2.7	3.6	4.4	4.3	4.1	4.1	1.1	1.3
Total of the above countries	100	2.8	2.3	2.7	3.0	2.7	2.9	3.3	1.0	0.9

[a] Aggregates were computed using nominal GDP weights of the previous year. – [b] Excluding Greece until 2000. – [c] Euro area plus Denmark, Sweden, United Kingdom and Greece until 2000. – [d] European Union plus Iceland, Norway and Switzerland. – [e] Czech Republic, Hungary, Poland and Slovak Republic. – [f] Forecast of the Ifo Institute.

Source: OECD, OECD Economic Outlook.

Inflation Rates by Country and Region

Consumer Price Index, percentage change over previous year

	% weights as of 2000[a)]	1994	1995	1996	1997	1998	1999	2000	2001[f)]	2002[f)]
Austria	0.82	3.0	2.2	1.8	1.2	0.8	0.5	2.0	2.3	1.5
Belgium	0.99	2.4	1.5	1.8	1.5	1.3	1.1	2.7	2.4	1.4
Czech Republic	0.22	10.0	9.1	8.8	8.5	10.7	2.1	3.9	4.8	4.2
Denmark	0.70	2.0	2.1	2.1	1.9	0.9	2.1	2.7	2.3	1.6
Finland	0.53	1.1	0.8	1.1	1.2	1.4	1.3	3.0	2.7	1.6
France	5.60	1.7	1.8	2.1	1.3	0.7	0.6	1.8	1.8	1.3
Germany	8.12	2.8	1.7	1.2	1.5	0.6	0.6	2.1	2.4	1.5
Greece	0.48	10.9	8.9	7.9	5.4	4.5	2.1	2.9	3.7	3.0
Hungary	0.20	18.9	28.3	23.5	18.3	14.2	10.0	9.8	9.1	6.4
Iceland	0.04	1.5	1.7	2.2	1.8	1.3	2.1	4.4	6.6	5.5
Ireland	0.41	2.3	2.5	2.2	1.2	2.1	2.5	5.3	4.0	3.0
Italy	4.66	4.1	5.2	4.0	1.9	2.0	1.7	2.6	2.7	2.0
Luxembourg	0.08	2.2	1.9	1.2	1.4	1.0	1.0	3.8	2.4	1.2
Netherlands	1.59	2.8	1.9	1.4	1.9	1.8	2.0	2.3	5.1	2.7
Norway	0.70	1.4	2.4	0.7	2.6	2.0	2.1	3.0	2.7	1.9
Poland	0.71	32.2	27.8	19.9	14.9	11.6	7.3	10.1	5.6	3.8
Portugal	0.45	5.4	4.2	2.9	1.9	2.2	2.2	2.8	4.4	3.1
Slovak Republic	0.08	13.4	9.9	5.8	6.1	6.7	10.6	12.1	7.4	6.4
Spain	2.41	4.7	4.7	3.6	1.9	1.8	2.2	3.5	3.7	2.5
Sweden	0.99	2.4	2.9	0.8	1.8	1.0	0.6	1.3	2.7	1.6
Switzerland	1.04	0.9	1.8	0.8	0.5	0.0	0.8	1.6	1.0	0.7
United Kingdom	6.14	2.5	3.4	2.5	1.8	1.6	1.3	0.8	1.2	1.0
Euro area[b)]	25.65	3.0	2.7	2.2	1.6	1.2	1.1	2.4	2.6	1.8
European Union[c)]	33.96	3.0	2.9	2.3	1.7	1.3	1.2	2.1	2.4	1.6
Western Europe[d)]	35.75	2.9	2.9	2.2	1.7	1.3	1.2	2.1	2.4	1.6
Central Europe[e)]	1.21	24.7	23.3	17.5	13.7	11.5	7.0	9.1	6.2	4.5
Western and Central Europe	36.95	3.6	3.5	2.7	2.1	1.6	1.4	2.3	2.5	1.7
Japan	20.00	0.7	– 0.1	0.1	1.7	0.6	– 0.3	– 0.7	– 0.5	– 0.4
United States	43.05	2.6	2.8	2.9	2.3	1.6	2.2	3.4	2.9	1.9
Total of the above countries	100	2.6	2.5	2.3	2.1	1.4	1.4	2.2	2.1	1.4

[a)] Aggregates were computed using nominal GDP weights of the previous year. – [b)] Excluding Greece until 2000. – [c)] Euro area plus Denmark, Sweden, United Kingdom and Greece until 2000. – [d)] European Union plus Iceland, Norway and Switzerland. – [e)] Czech Republic, Hungary, Poland and Slovak Republic. – [f)] Forecast of the Ifo Institute.

Source: OECD, Main Economic Indicators; Eurostat, Eurostatistics.

Unemployment Rate by Country and Region

Standardised unemployment rates (per cent of civilian labour force)

	% weights as of 2000[a)]	1994	1995	1996	1997	1998	1999	2000	2001[f)]	2002[f)]
Austria	0.95	3.8	3.9	4.3	4.4	4.5	4.0	3.7	3.8	4.0
Belgium	1.06	10.0	9.9	9.7	9.4	9.5	8.8	7.0	6.9	7.2
Czech Republic	1.27	4.4	4.1	3.9	4.8	6.5	8.8	8.9	8.3	8.4
Denmark	0.70	8.2	7.2	6.8	5.6	5.2	5.2	4.7	4.5	4.7
Finland	0.63	16.7	15.2	14.5	12.6	11.4	10.2	9.7	9.1	9.1
France	6.37	12.4	11.7	12.4	12.3	11.8	11.2	9.6	8.6	8.8
Germany	9.76	8.4	8.2	8.9	9.9	9.3	8.6	7.9	7.8	8.2
Hungary	1.00	11.0	10.4	10.1	8.9	8.0	7.1	6.5	6.0	6.0
Ireland	0.41	14.4	12.3	11.7	9.9	7.5	5.6	4.2	3.8	3.9
Italy	5.74	11.2	11.6	11.7	11.7	11.8	11.4	10.5	9.6	9.8
Luxembourg	0.06	3.2	2.9	3.0	2.7	2.7	2.4	2.4	2.4	2.6
Netherlands	1.,94	7.1	6.,9	6.3	5.2	4.0	3.4	2.8	2.4	2.9
Norway	0.57	5.5	5.0	4.9	4.1	3.3	3.2	3.5	3.5	3.4
Poland	4.22	14.4	13.3	12.3	11.2	10.6	13.9	16.1	18.5	19.5
Portugal	1.22	7.0	7.3	7.3	6.8	5.2	4.5	4.1	4.3	4.8
Spain	4.05	24.1	22.9	22.2	20.8	18.8	15.9	14.1	13.2	13.3
Sweden	1.07	9.4	8.8	9.6	9.9	8.3	7.2	5.9	5.1	5.3
Switzerland	0.97	3.8	3.5	3.9	5.2	3.5	3.0	2.6	1.8	2.1
United Kingdom	7.12	9.6	8.7	8.2	7.0	6.3	6.1	5.5	5.1	5.4
Euro area[b)]	32.21	11.6	11.3	11.5	11.5	10.8	9.9	8.8	8.3	8.6
European Union[c)]	41.10	11.2	10.7	10.8	10.6	9.9	9.1	8.2	7.6	7.9
Western Europe[d)]	42.64	10.9	10.5	10.6	10.4	9.7	8.9	7.9	7.4	7.7
Central Europe[e)]	6.49	11.9	11.1	10.3	9.6	9.4	11.9	13.2	14.6	15.2
Western and Central Europe	49.14	11.1	10.6	10.6	10.3	9.6	9.3	8.6	8.4	8.7
Japan	16.56	2.9	3.1	3.4	3.4	4.1	4.7	4.7	5.0	5.7
United States	34.30	6.1	5.6	5.4	4.9	4.5	4.2	4.0	4.7	6.1
Total of the above countries	100	8.0	7.6	7.6	7.3	6.9	6.8	6.4	6.6	7.3

[a)] Aggregates were computed using nominal GDP weights of the previous year. – [b)] Euro area without Greece. – [c)] Euro area plus Denmark, Sweden, United Kingdom. – [d)] European Union plus Norway and Switzerland. – [e)] Czech Republic, Hungary, Poland. – [f)] Forecast of the Ifo Institute.

Source: OECD, Main Economic Indicators; Eurostat, Eurostatistics.