

Euro-Insider

Inside track analysis of the European Central Bank, the euro area economic zone and its politics

January 23, 2006

Incorporating Eurozone Monetary Strategist

Volume 13: Issue 1

IG Metall 5% claim sparks ECB fears of inflation and contagion

Michael Clauss

IG Metall, the German industry union, pre-announced a claim of "up to 5%" for the 2006 wage round, at the top end of expectation on December 10 last year.

Despite containing bonus payments worth 1% of the total, the claim reflects traditional IG Metall bargaining strategies and politics.

Although the wage round will only heat up in February/March 2006 the claim sends a negative signal to other unions in the euro area and to the ECB. It will exacerbate dismissal pressure rather than inflation pressure if it coincides with a recovery of the euro.

Our working hypothesis for the coming benchmark wage agreement in the metal and electrical engineering industry starting in March 2006 was reasonable wage growth, similar to the last one, amounting to a 1.9% rise in effective wages.

But the IG Metall wage commission's claim, aiming for a 5% wage increase instead of 2004's 4%, brings this into question.

On top of its wage claim the union aims for additional leverage, emphasising its target of a one year contract instead of the two year one asked for by employers, indicating that it would aim for a VAT offset in 2007.

Although the pre-announcement of the wage claim is part of the negotiating ritual, with the actual settlement usually coming in at 50% to 60%, even this would seem in stark contrast to the current situation in the manufacturing industry. Instead it reveals a traditional pattern of IG Metall wage bargaining, a sort of crisis driven progress which could be characterised as follows.

- The principle of benchmark agreements with particularly profitable large firms in the region of North-

Continued on page 14

ECB holds interest rates for now but hints at spring hike

John Arrowsmith

ECB president Jean-Claude Trichet announced the governing council's decision to leave the ECB's key interest rates unchanged in his prepared statement to the monthly press conference on January 12.

Trichet said that the information that had become available since the December decision to raise rates by 25 basis points supported the view taken then — that an adjustment of the very accommodative monetary policy stance had been warranted.

He said the policy stance was still accommodative, with interest rates still historically low in both nominal and real terms.

He said too that the governing council would continue to monitor closely all developments with respect to risks to price stability over the medium term.

In response to a direct question in the subsequent Q&A session, Trichet implied that the possibility of a further

In this month's issue:

European Central Bank:

January 12 governing council meeting, rates back on hold till spring 1,6,7

No more surprises expected just yet. December data analysed 2,3,4,5

New year, new faces on governing council 8, 9

Euro area outlook

German and French data point to sustained euro area recovery 10,11,12,13

Germany:

IG Metall wage claim fears 1,14

Forecasting:

Eurozone Barometer 6,15

November EuroCoin Indicator 15

increase in interest rates had been discussed this time.

Trichet said that the wisdom of a
Continued on pages 6,7

German, French GDP numbers presage euro area recovery

Michael Clauss

Following four quarters of weakness, growth in the euro area and in Germany recovered to 0.6% q/q in Q3 2005, clearly above potential. This could mark the beginning of a sustained recovery.

The European Commission, in its bi-annual forecast, expects GDP growth to dip only slightly in Q4 2005 (to 0.4%) and then resume 0.5% growth — broadly in line with potential. Germany is likely to be the main risk factor in this equation, on both the upside and downside.

Germany's growth trajectory is seen as more patchy — falling back to 0.2% in Q4 and 0.4% in the first three quar-

ters of 2006. This would repeat the seesaw pattern, which has been symptomatic of the current recovery (since 2003), reflecting dependence on exports and, to a lesser extent, machinery investment.

The economic environment could accentuate growth divergence both within Germany and between Germany and the rest of the euro area: the German economic research institutes estimate the sharp rise in energy prices to subtract 0.5% from GDP growth, most of which will be borne by private consumption, while the weakening of the euro removes a drag on export growth.

Continued on pages 10, 11, 12,13

No rate increase expected until spring

- December economic data not pointing to further rate rise in January.
- Indications of weaker activity in Q4 2005 and some easing of monetary growth.
- Upside risks to inflation remain but still no signs of significant pass-through from energy prices to other prices. Labour costs remain restrained and inflation expectations subside.
- 25bp rate rise likely in March or April on the back of GDP growth estimate for Q4 2005 and ECB staff macro forecast update.
- 50bp possible if inflation/expectations appreciably above 2%.
- Further rate rise, to 3%, expected by end 2006.

John Arrowsmith

At December's monetary policy meeting the ECB governing council was divided over whether an increase in interest rates was warranted. The decision to announce a 25bp rise was a compromise between those members who saw no immediate need to tighten policy and those arguing for a 50bp increase.

ECB president Jean-Claude Trichet said the main factors underlying this decision were recent data and survey evidence that economic activity had strengthened in the second half of

2005, headline inflation continuing significantly above 2%, evidence of increased upside risks to price stability coming from the monetary analysis and the need to maintain inflation expectations anchored firmly.

Information which has become available since the decision will do little to persuade those who had resisted a rate increase that they had been wrong to do so, and may even give those who were urging a 50bp rise some pause for thought.

The headline inflation rate has continued to subside but remains above that which the ECB regards as

feared pass-through from high energy prices. Inflation expectations, as measured by break-even inflation rates on indexed bonds, have edged back down.

There is also little evidence of second-round effects on industrial producer prices or on labour costs.

Despite the strengthening of GDP growth and domestic demand in the middle two quarters of 2005, there is little concrete evidence yet that this was sustained in the final quarter of the year. Industrial production and new orders fell back in October, and the volume of retail trade was virtually flat in October and November, while the fall in unemployment came to a halt.

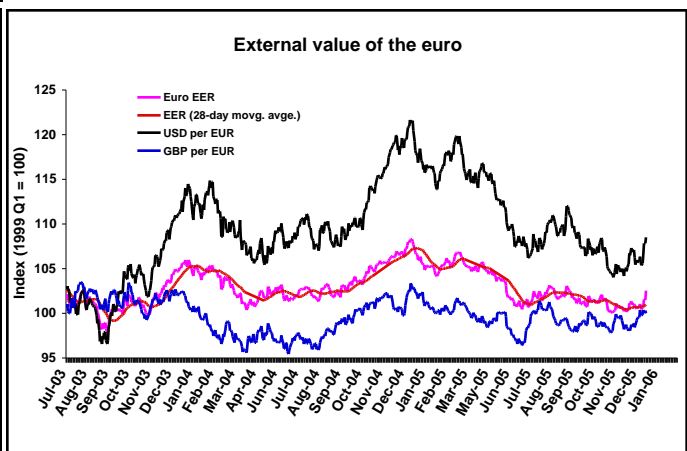
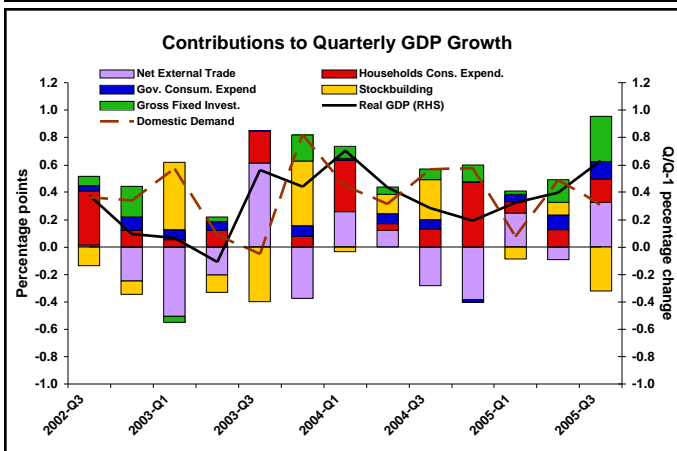
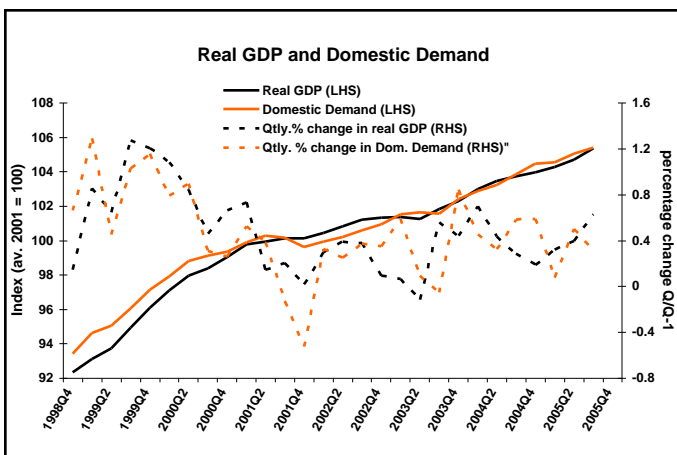
Only the evidence from survey-based indicators suggests that the eurozone economy remained buoyant through to the end of 2005.

On the monetary front, there are tentative signs that the tide may have turned, although the evidence is ambivalent.

M3 growth, although still uncomfortably high, has slowed. So has the growth of its most liquid components, and the liquidity overhang has contracted a little. But bank lending to companies and households remains strong.

Overall there is not the evidence to build a consensus on within the governing council for a further rise in interest rates — even if monetary policy remains accommodative and short-term rates are barely positive in real terms after last month's hike.

So we do not expect a further tightening until March at the earliest. Then the governing council will have seen Eurostat's flash estimate of GDP growth in Q4 2005 and the ECB staff's March update of the macroeconomic projections produced by the



Eurosystem/ECB staff in December.

If these indicate continuing robust growth, we would expect the governing council to raise rates by 25bp even if inflation appears to be coming down, and possibly by 50bp if inflation remains stubbornly above 2%. Consensus-building in the governing council might delay a decision until April however.

Looking further ahead, if GDP growth remains entrenched at an annual rate close to or above its potential rate of around 1.75%, we would expect the ECB to raise rates further in the course of the year to perhaps 3% by the end of 2006.

This view is broadly in line with the 22 market economists polled in FT Deutschland's latest monthly interest rate survey.

All but one are expecting a 25bp increase in the ECB's main refinancing rate to 2.5% by March, with a further rise to 2.75% or 3% by the end of the year.

Costs and prices

The MUICP headline rate of inflation, which had edged down from 2.6% in September to 2.5% in October, eased further in November to 2.3%, slightly lower than Eurostat's earlier flash estimate of 2.4%.

According to the latest flash estimate, the downward trend in headline inflation continued, to 2.2% in December, although this will have been more than accounted for by a quite strongly favourable year-ago base effect of 0.4 percentage points.

This would imply a month-on-month increase in prices in December 2005 of 0.3%, compared with a fall of the same order in November, and could herald an up-tick in the headline rate in January 2006, when the year-ago base effect will be strongly positive.

Analysis of the underlying compo-

Upside risks to inflation remain, but there is still no sign yet of serious oil price pass through beyond the energy sector

nents of the headline inflation figures however, provides some reassurance that there is no serious oil price pass-through beyond the energy sector yet.

Core inflation on the ECB's preferred measure (excluding energy and unprocessed food), which had risen fractionally from 1.3% to 1.4% (revised from 5%) in September and again to 1.5% in October, was unchanged at 1.5% in November. On the narrower definition (excluding energy, food, alcohol and tobacco) preferred by some outside commentators, core inflation was also unchanged at 1.4% in November.

But the ECB has recently downplayed the significance of core inflation concepts, saying they have tended to be lagging behind rather than leading indicators of headline inflation.

Latest data on industrial producer prices suggest a very limited feed-through from high energy prices so far. The aggregate figures show the monthly rise in producers' prices accelerating slightly from 0.4% in August to 0.6% in October but going into reverse in November

falling by 0.2% to a level 4.2% higher than a year ago.

Although this was largely attributable to a 1.6% fall in energy prices, the rise in producer prices excluding energy slowed from 0.3% to 0.1% in November to register, as in October, a 12-month rate of increase of 1.4%.

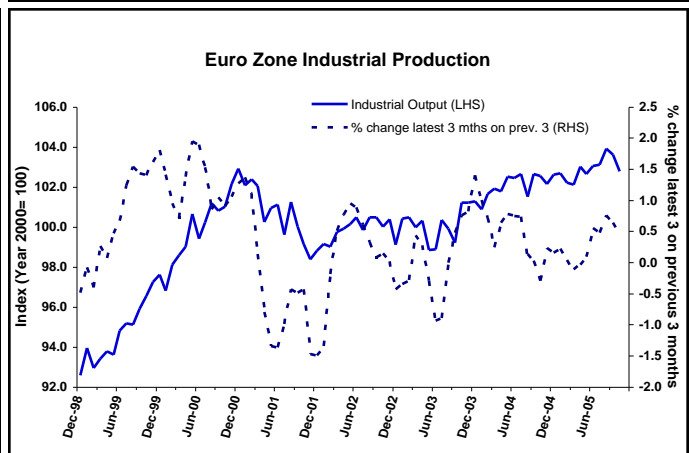
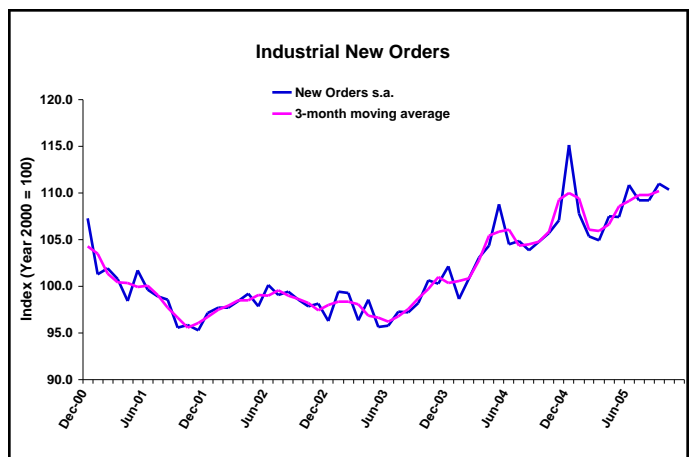
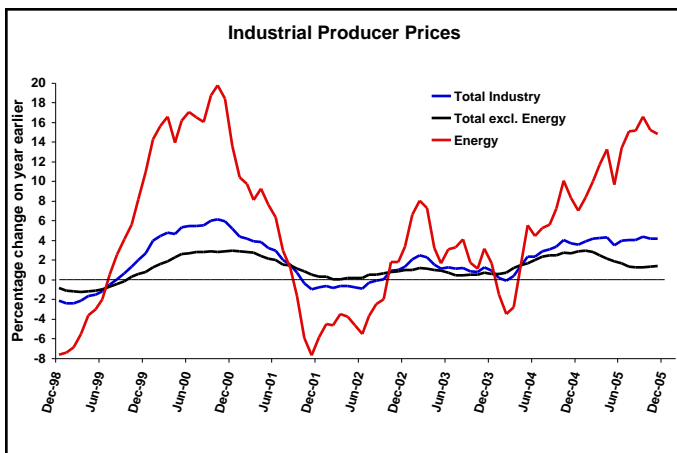
Newly released labour cost data show that the annual rate of increase in total hourly labour costs in the euro-zone economy as a whole, which had slowed from 3.2% in Q1 2005 to 2.5% in Q2, slowed further, to 2.2% in Q3, the lowest rate of increase since Q4 1999.

Taking industry on its own, the slowdown was less pronounced, from 3.3% in Q1 to 2.5% in Q3, whereas in construction it was much more marked, from 3.1% to 1.5%, while the rise in labour costs in the services industries slowed from 3.1% to 2.1% over the same period.

The moderate tightening of labour market conditions which took place during the spring and summer of 2005 has come to an end, helping to alleviate ECB fears that labour cost pressures might re-emerge with high levels of structural unemployment.

The seasonally adjusted unemployment rate, which had fallen from 8.8%

Continued overleaf



Further rate rises from ECB likely from March, April

Continued from page 3

in March to 8.3% in September, remained at 8.3% in both October and November.

Fears that inflation expectations were drifting upwards, voiced by the ECB and cited as one consideration behind the December 2005 interest rate rise, now appear to have been overdone.

Between June and October, breakeven inflation rates on indexed medium- to longer-term euro area government bonds, which had fallen below 2%, rose by about 20 basis points, but in the following two months they have subsided and are now at or even slightly below 2%.

The slight weakening tendency displayed by the euro since the summer of 2005, bringing with it fears of additional external cost pressures, has been halted and even slightly reversed in the past few weeks.

The euro's effective exchange rate, having eased 1.6% between August and November, was on average 0.2% higher in December, at a level 6.0% lower than a year earlier and 3.4% lower than two years ago.

Demand, output, confidence

Detailed data released the day before the governing council's December meeting confirmed Eurostat's earlier flash estimate that real GDP growth picked up sharply to 0.6% in Q3, from 0.3% (revised down from 0.4) in Q1 and 0.4% (revised up from 0.3%) in Q2, to a level 1.6% higher than in Q3 2004.

The data also showed that the recovery and broadening of domestic demand seen in Q2 was sustained in Q3, contributing 0.3 percentage points to GDP growth in both quarters.

This was undoubtedly an important consideration underlying the

If GDP growth remains entrenched at or near potential, rates may rise in the course of the year, to 3% by the end of 2006

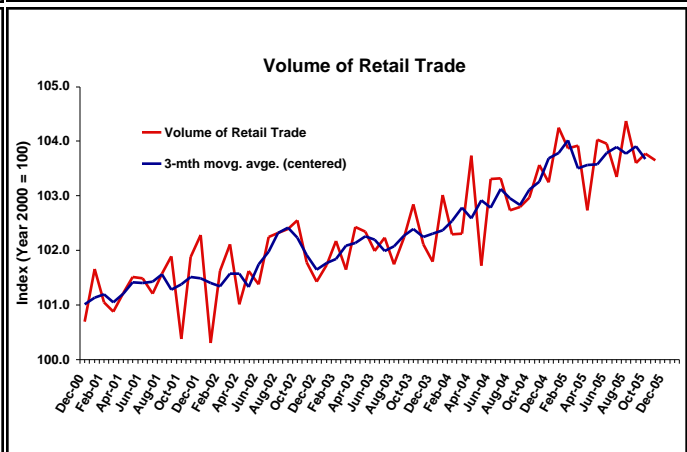
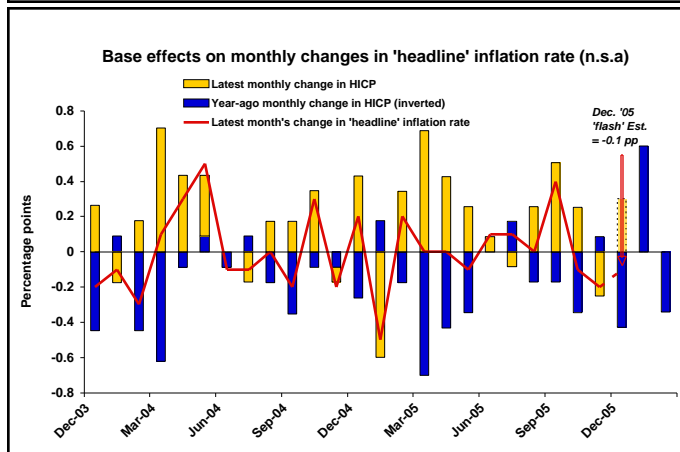
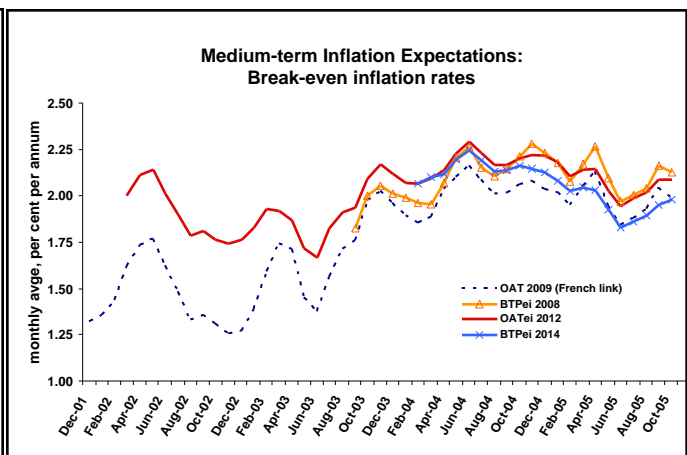
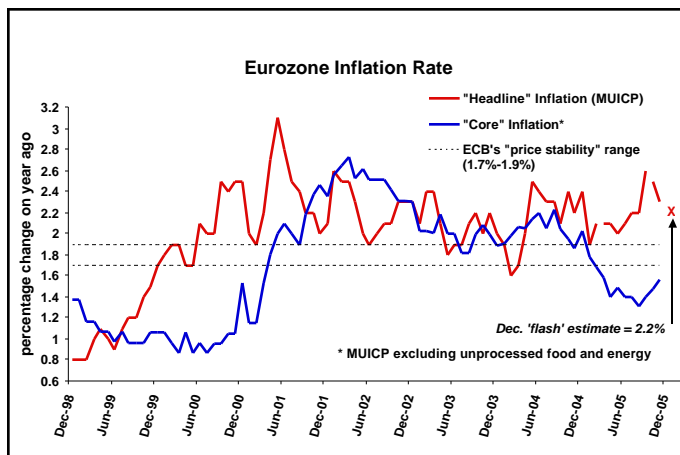
December 2005 rate rise.

Of the main components of domestic demand, household consumption contributed 0.2pp to GDP growth in Q3, compared to 0.1pp in Q2, fixed investment contributed 0.3pp, up from 0.2pp, and the contribution from government consumption was unchanged at 0.1pp, but a net run-down of stocks made a negative contribution of 0.3pp.

A sharp acceleration in export growth in conjunction with a modest acceleration of imports resulted in a positive 0.3pp contribution from net trade in Q3 compared with a 0.1pp negative contribution the previous quarter.

Indicators of economic activity so far in Q4 present a less buoyant and more fragile picture. Industrial production, which had fallen by 0.3% in September, fell a further 0.8% in October, to a level only 0.1% higher than a year ago. Output was on average only 0.3% higher than in the previous three months.

The latest month's data for industrial new orders are also somewhat disappointing, although the underlying picture remains reasonably buoyant.



The monetary analysis

Latest data for the monetary aggregates suggests that the growth of liquidity, although still very rapid, has started to slow.

The annual rate of M3 growth has declined for two months in a row, from 8.5% in September to 8.0% in October and 7.6% in November. The three month average of the annual growth rates of M3 has also turned down, from a peak of 8.2% in August-October to 8.0% in September/November.

The six-month growth rate (annu-

alised), having peaked at 10.6% in September, fell back to 9.3% in October and 8.4% in November. The annual growth rate of M1, having edged back up slightly from 11.1% to 11.2% in October, dropped to 10.6% in November.

Among the asset counterparts of M3, however, the annual rate of growth of loans to the non-bank private sector, has continued to accelerate, from 8.7% in September to 8.9% in October and 9.0% in November.

Seasonally unadjusted data show the rise in lending for house purchase and in consumer credit to have accelerated in November as did the growth of consumer credit and of loans to non-financial corporations. The annual growth rate of credit extended to general government picked up sharply in November, from 1.9% to 3.5%.

The recent slowing of monetary growth has helped curb the expansion of the liquidity overhang. The M3 Money Gap narrowed in October and November in nominal terms although in real terms, having narrowed in October, it widened slightly in November as the consumer price index fell that month. n

Having increased by 1.6% (revised up from 1.1%) in September, new orders dropped back 0.5% in October but were still 4.4% higher than a year earlier. On average over the three months August-October they were 0.9% up on the previous three months.

The volume of retail trade, a series which also fluctuates quite widely from month to month, had shown signs of resuming an upward trend since the spring but, having fallen by 0.7% in September, is now seen as having recovered only slightly in October by 0.2% (revised down from

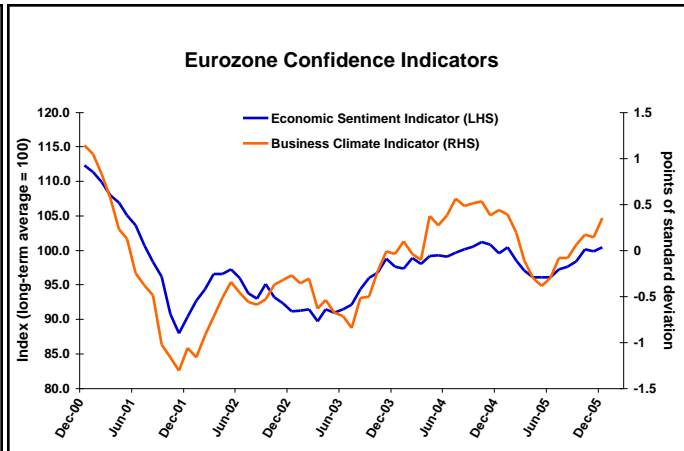
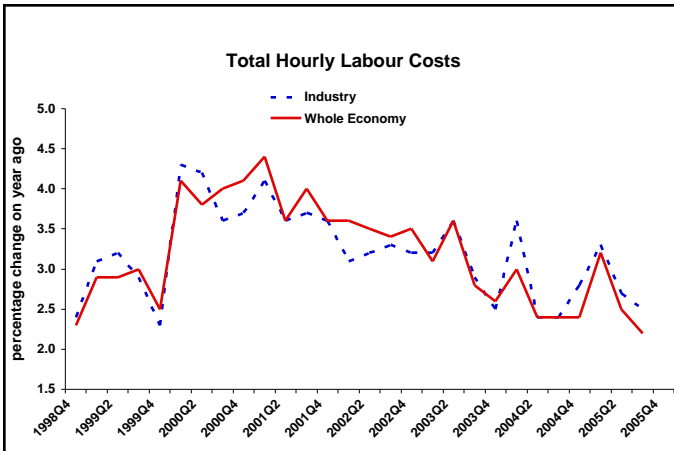
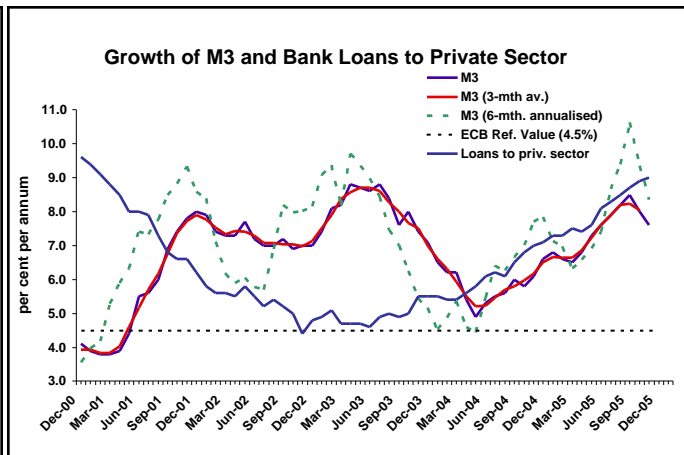
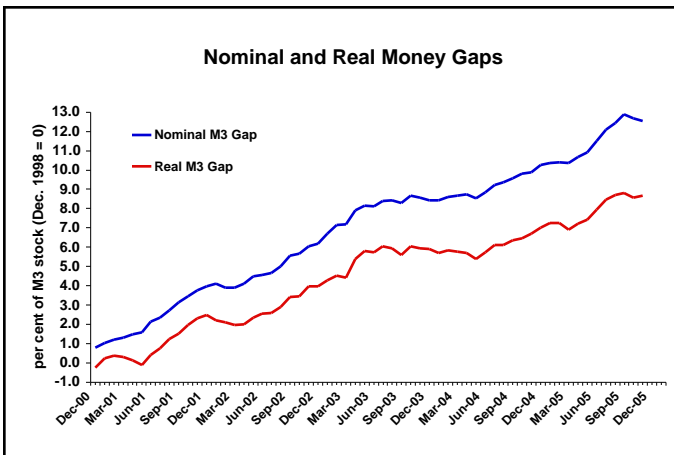
0.4%) and to have edged down 0.1% in November to a level only 0.3% higher than a year earlier. Over the three months to November, retail sales volumes were 0.2% down on the three-month period to August.

In contrast, information from the European Commission's survey-based confidence indicators suggests that economic confidence continues on an upward trend.

The Business Climate Indicator, which had been climbing fairly steadily since May 2005 and from September had been above its long-

term average, dipped slightly in November but recovered strongly in December, with an improvement in all underlying components, to a level close to that registered around the turn of 2004/2005.

The Economic Sentiment Indicator has followed much the same pattern, rising back above its long term average in December following a slight dip in November, as confidence recovered in the industrial, consumer and retail sectors, although it deteriorated slightly in the construction and services sectors. n



ECB hints at further rate rise in March, 25bp likely, 50bp storm signal possible

The main points from the January 12 meeting of the ECB governing council:

- ECB president Jean-Claude Trichet hinted at further rate rise in March.
- Monetary policy was still accommodative, rates were historically low and what was in the market "pretty well captured" the governing council's December 1 message.
- The governing council would continue to monitor all developments with respect to price stability risks very closely and would act and do what was necessary when it was necessary.
- GDP growth momentum seen as maintained in Q4 2005 and through into 2006, progressively reaching a rate close to, at, or around, potential.
- Inflation expected to remain elevated in the short term, with risks remaining on the upside beyond that.

Continued from page 1

"college" was not achieved by coming with a particular view and leaving with the same view after voting, but by exchanging views and reflecting on them, deepening one's understanding.

He went on to say that the decision to leave rates unchanged was unanimous.

Trichet was invited to comment on the market expectation that there would be a further rate increase in March.

He said that investors and savers had pretty well captured and interpreted the message communicated at the December 1 press conference, including what was in the market for possible future decisions.

He stressed several times that the governing council would act and do what was necessary, when it was necessary.

Comment: The fact that the prepared statement, which will have been agreed by the governing council, again describes the policy stance as accommodative and interest rates as historically low, suggests that governing council members see a need for a further rate rise before long.

Trichet's reply to the question about market expectations is a clear indication that he believes a consensus to act on this can be reached at the March 2 meeting.

The economic analysis

The prepared statement asserted that GDP growth had improved in the sec-

Jean-Claude Trichet's statement describing the governing council's policy stance as accommodative, and current interest rates as historically low, suggests that the ECB sees the need for a further rate rise before long.

ond half of 2005 as the ECB had expected.

In support of this it cited Eurostat's first full estimate of 0.6% GDP growth in the third quarter, up from 0.4% in the second, and the stronger contribution from domestic demand

In addition, recent economic indicators and survey data supported the view

Conclusion: Trichet gave a clear indication that he feels a consensus can be reached to raise rates again on March 2, on the back of further healthy GDP growth numbers, inflation persisting above 2% and continuing strong money and credit growth.

We would expect this to be a 25bp rise in the refi rate, unless the feared pass-through and second round effects from energy prices start materialising and inflation expectations start to turn upwards again, in which case the ECB could hoist a 50bp "storm signal".

In either eventuality, we expect the rate to be lifted further, to 3%, by the end of the year.

n

that the momentum was "broadly maintained" in the fourth quarter and that this would continue in the first months of 2006.

Repeating the mantra of past statements, it also asserted that the conditions remained in place for sustained growth, in line with the ECB staff's projections and other forecasts, but conceded that risks to the growth outlook remained on the downside because of volatile oil prices, global imbalances and consumer confidence.

Questioned about the ECB's confidence about the outlook for growth, Trichet said that all the information available since the governing council's decision at the beginning of December confirmed their working assumption that the euro area was progressively reaching a rate of growth that was close to, at, or around, potential.

To a further question he replied that if the economy were to develop and continue at a level of growth which was significant, this would augment the risks to price stability.

Trichet downplayed the slowing of the headline inflation rate to 2.2% in December from 2.5% in October and 2.3% in November, attributing the decline to some relaxation of earlier tensions in oil and petrol markets.

He added that inflation was expected to remain elevated in the short term because of recent oil price increases and announced increases in administered prices and indirect taxes as well as adverse base effects.

Beyond the short term he saw the possibility that indirect effects of past oil price increases on other components of the price index might materialise.

All this was consistent, he said, with

Eurozone Barometer Consensus forecasting: euro area 2005 to 2010

	2005e	2006f	2007f	2008f	2009f	2010f
Gross domestic product	1.8	1.9	1.7	1.9	1.9	1.8
Private consumption	1.4	1.5	1.5	1.8	1.8	1.8
Gross fixed investment	1.7	3.1	2.6	2.4	2.4	2.2
Industrial production (ex construction)	1.9	2.3	2.1	2.2	2.1	1.8
Unemployment rate, % of labour force	8.9	8.3	8.2	7.9	7.7	7.6
Harmonised index of consumer prices (HICP)	2.1	2.0	2.0	1.9	1.9	1.9
Current account, annual total, Eu bn	46.7	8.7	8.2	29.3	31.8	34.1
Current account, annual total, % of GDP	0.6	0.1	0.1	0.3	0.4	0.4
Financial indicators (end period)						
3 month interest rate, % per annum	2.16	2.9	3.04	3.25	3.28	3.25
10 year bond yield, % per annum	3.68	3.69	3.76	4.02	4.22	4.19
10 year — 3 month yield differential	1.52	0.79	0.72	0.77	0.94	0.93
USD/EUR rate	1.359	1.263	1.282	1.321	1.298	1.286

% change year-on-year, unless otherwise stated. Forecasts for 2008 to 2010 are taken from the January 2006 long term forecast survey.

Source: Eurozone Barometer, MJ Economics, www.mjeconomics.com

the December staff projections but risks — including further oil price rises and additional increases in administered prices and indirect taxes, as well as potential second-round effects in wage- and price-setting — remained on the upside.

Comment: Although we had interpreted recent monthly data as pointing to somewhat weaker GDP growth in the fourth quarter, the ECB appears confident that the stronger growth seen in the third quarter has been maintained

The ECB believes that this growth will be sustained in 2006, thus vindicating the staff projections of growth at, or even slightly above, potential, this year and next.

This implies that the governing council foresees a gradual emergence of demand pressures and hence a need to raise rates before this translates into a price and wage spiral.

Trichet's remarks about the inflation outlook seem to point to a heightened concern about the possibility of pass-through and second-round effects.

The monetary analysis

According to Trichet, monetary developments were also pointing to upside risks to price stability over the medium

to longer term.

Although moderating somewhat in November, the annual growth rate of M3 remained very robust, driven by its most liquid components and stimulated by the low level of interest rates.

Liquidity remained ample on all plausible measures and the already rapid growth of loans to the private sector — and mortgage borrowing in particular — had strengthened further.

Euro-Insider

Editor

Michael Halls,
michaelshalls@mac.com
Tel +44 (0) 1769 560 034

Production editor

Con Mansell
conmansell@mac.com

Publisher

Richard Betts
rbetts@ezadvisors.com
Tel +44 (0) 208 340 4328

ISSN: 1473-3196

No part of this publication may be reproduced or used in any form of advertising without prior permission in writing to the editor. No responsibility or loss occasioned to any person acting or refraining from acting as a result or material in this publication can be accepted. On any specific matter, reference should be made to an appropriate adviser. (c) 2005. Printed by Patersons, Tunbridge Wells, UK.

Editorial advisory board

John Arrowsmith
Michael Clauss
Allan Saunderson
Jacques Lafitte
Graham Bishop
Robin Marshall
Dieter Wermuth
Miranda Xafa
Eric Barande
Marc de Scitivaux
David Clark

New faces on ECB governing council as Issing's term ends, Fazio pressured out

John Arrowsmith

Two fresh faces will soon appear at the European Central Bank governing council. Out goes board member Antonio Fazio, and executive board member and chief economist Otmar Issing's eight-year term ends in May. In comes Mario Draghi to replace Fazio, and Jürgen Stark looks set to replace Issing, but may not get the job of chief economist.

Otmar Issing's eight-year term as ECB executive board member and chief economist runs out on May 31. Presuming there is tacit agreement that the four largest euro area members have direct representation at the ECB, it is widely assumed that his successor will be German, although there is no such presumption in the ECB statute or the EU treaty.

It is possible that one of the six euro-zone countries not represented on the six-member board will seek to challenge a German nomination, if only to uphold the principle that no country has a right to a seat in perpetuity. The likelihood is, however, that Issing will be succeeded by another German nominee.

Jürgen Stark

The German government considers Bundesbank vice-president and former finance ministry official Jürgen Stark the most suitable candidate, but his nomination could still be subject to some negotiation between the Christian Democrat and Social Democrat members of the governing coalition.

If Stark is nominated his appointment to the executive board — with a seat on the governing council — requires the unanimous agreement of the 12 euro area heads of government following a recommendation from the 12 euro area members of the ECOFIN council after it has consulted the European Parliament and the ECB's governing council.

Stark studied economics at the Universities of Hohenheim and Tübingen in Germany, graduated in 1973 and obtained his doctorate in 1975.

In 1978 he joined the economic pol-

So far, a Frenchman has been replaced by a Frenchman, a Spaniard by a Spaniard, and an Italian by an Italian. So it is almost inevitable that Otmar Issing will be replaced by another German when he steps down in May 2006

icy department at the Federal Ministry of Economics, moving to the Federal Chancellor's Office under chancellor Helmut Kohl in 1988 to head the unit covering trade and payments, money, foreign currency and financial markets.

He joined the Federal Finance Ministry in 1992, first as section head covering national monetary and capital market policies and then as head of the international monetary and financial relations department.

In 1995 he was promoted to state secretary, a quasi-political position at the finance ministry. In 1998 he was appointed vice-president of the Bundesbank as the Christian Democrat government's intended successor to president Hans Tietmeyer, who was due to retire the following year. But the CDU was defeated in the federal election and Gerhard Schröder's incoming Social Democrat government appointed SDP politician



Stark is favoured to replace Issing

Ernst Welteke over Stark's head.

In 2004 Stark was passed over a second time when president Welteke resigned. The non-partisan academic Axel Weber was appointed in his place.

Some constitutional purists may see Stark's candidacy for Issing's position — if it transpires — as politically motivated, but that would be oversimplistic.

While the CDU-led coalition might be seeking to reward a loyal and patient sympathiser, Stark has all the personal qualities and career background to make him a highly suitable candidate for membership of the executive board.

As a qualified economist with extensive finance ministry and central bank grounding, and considerable international experience, he would fit well into the culture of the ECB. With a relaxed and approachable manner he would adopt a pragmatic approach in monetary policy discussions rather than that of a doctrinaire monetary Spartan.

Whether Stark is the best candidate to take on Issing's job as chief economist however is questionable. His career has drifted away from his academic roots over the past 25 years as his reputation has grown in the field of international monetary and financial relations, for which he is responsible at the Bundesbank.

Stark will be 58 in May, the same age as Draghi, while Issing, at 69, is the same age as Fazio.

Lucas Papademos

Of the mainstream economists on the executive board, vice-president Lucas Papademos looks best qualified to take over Issing's job as chief economist. But the demands of the job are so exacting that combining this function with the administrative and representational responsibilities of vice-president is unlikely to be satisfactory.

Lorenzo Bini-Smaghi

Currently covering international relations on the executive board is Lorenzo Bini-Smaghi. A former cen-

Mario Draghi: banker and economist not rooted in central bank dogma

Mario Draghi replaces Antonio Fazio as governor of Banca d'Italia, the central bank of Italy.

Nominated on December 29, he takes up office on February 1. Under new legislation his term will be limited to six years, renewable once.

As a central bank governor he is automatically entitled to a seat on the ECB governing council.

Draghi has been a managing director and vice-chairman of Goldman Sachs International and based in London since January 2002.

He is a graduate of Rome's Sapienza University, with a PhD in economics from MIT in the US.

While professor of economics at the University of Florence from 1981 to 1991, he was an adviser to Banca d'Italia in 1990, and an executive director of the World Bank from 1984 to 1990.

In 1991 he was appointed director general of the Italian treasury, working there until 2001

As director general he was a member of the G7 Deputies and the EU Monetary Committee.

He became chairman of its successor, the Economic and Financial



Mario Draghi: Fazio's successor

Committee, which came into being with the start of monetary union in 1999.

Draghi is widely respected at home and abroad. He has an easy, urbane charm, in contrast to Fazio's austere and aloof character.

His nomination was welcomed by Italian politicians of centre-left and centre-right alike.

As an outside appointee with no political ties, he will be well placed to restore the reputation of the Banca



The writing was on the wall for Fazio

d'Italia.

With a more varied career than Fazio's, he will be less rooted in orthodox central bank dogma, and likely to adopt a more pragmatic approach in the ECB governing council's monetary policy deliberations.

While it would be wrong to characterise him as a dove, he will be inclined to look for sufficient hard evidence to justify any change in interest rates. n

tral banker turned civil servant — the opposite of Stark — his past career had been more closely oriented than Stark's towards economic research and analysis.

He was director-general for international financial relations at the Italian Ministry of the Economy and Finance (1998-2005), deputy director-general for research at the ECB (1998), head of policy division at the European Monetary Institute in Frankfurt (1994-98), head of the exchange rate and international trade division at the research department of Banca d'Italia (1988-94), and economist in the international section of the research department of Banca d'Italia (1983-88).

Responsibility for allocating the portfolios of executive board members rests with ECB president Jean-Claude Trichet. He could give Bini-Smaghi the role of chief economist and Stark the international relations function.

But that could be seen, at least in Germany, as according less political weight to economic analysis in the executive board's deliberations. n

Fazio: end of a career central banker

On December 19, amid a swelling tide of accusations of competition rigging and insider trading, Antonio Fazio, succumbed to months of intense pressure and resigned as governor of Italy's central bank.

His resignation automatically resulted in the loss of his *ex officio* membership of the board of the European Central Bank, and seat on its policy-making governing council.

Fazio's departure, after serving 12 years of his lifetime term of office, simultaneously resolved a quandary for the Italian government and a dilemma for the ECB.

Fazio's alleged involvement in sabotaging the Banca Antonveneta takeover by Dutch bank ABN AMRO, favouring an Italian bid by Fiorani, had threatened to undermine the ECB governing council's reputation.

Fazio has been under criminal investigation in Milan for allegations of insider trading relating to the

takeover, and in Rome, for allegedly having pressured the apparatus of the Banca d'Italia into giving a green light to the Fiorani takeover bid.

But action by the Italian government to remove Fazio could have compromised the governing council's political independence, which is, enshrined in the EU treaty.

The Italian government lacked the legal means to remove from office an over-powerful and high-handed incumbent whose interference in banking mergers was damaging the reputation of Banca d'Italia, and the regulatory functions which it exercised.

In September 2005 economy minister Domenico Siniscalco resigned in protest at Silvio Berlusconi's government's lack of action

Fazio was a career central banker promoted to governor in 1993 when his predecessor, Carlo Ciampi, stood down to become Italian prime minister. n

Sustained recovery signs in euro area, Germany falters but France accelerates

- The growth rate in Q3 2005 of 0.6% q/q in Germany and the euro area, and 0.7% q/q in France, may mark the beginning of a sustained recovery.
- It could be seen as a healthy signal after previous downward convergence of European growth towards the low rate seen in Germany. In 2006/2007 Germany is likely to trail the euro area by 0.5% in the annual GDP growth rate, while France is set to modestly out perform.
- Investment spending in equipment was the biggest positive surprise both for Germany and France (up 3.8% q/q. in Germany); we expect it to clearly exceed current forecasts.
- Current euro weakness and higher energy prices accentuate the imbalance in German growth favouring exports over consumption; fiscal policy will sustain this until the end of 2007.
- Surging energy prices have been an exogenous shock, leading to inflation convergence between Germany and the euro area. But next year's re-widening will only be temporary, until the German VAT hike in 2007 brings its inflation back in line with the euro area average.

Asset conclusions: a continuing non-inflationary recovery supplies a positive background for stocks, and will contain any rise in bond yields. The country factor is likely to be present in various sectors like industrials, construction and banking.

Continued from front page

France, by contrast, can be seen as more representative of the euro area as a whole, with growth more balanced between domestic demand and exports. In fact euro strength and higher energy prices promise to smooth the growth trajectory, keeping exports on board, while domestic demand — in France and in the euro area — is being taken care of by fiscal policy.

In fact France might be seen as the mirror image of Germany within the euro area, with stable consumption, but patchy exports. These may disproportionately benefit from euro weakening, leading to a consistent acceleration throughout 2006.

France

Reforms: the jury is still out as regards the willingness and ability of French prime minister Dominique de Villepin to push his modest reform agenda, with positive and negative signals in equal measure.

The most positive news is probably the signs of a cultural change. There is a subtle but undisputable evolution in

the way French media cover strikes.

Journalists are less supportive of irresponsible unions today than even a year ago, and public transport strikes attract much less sympathy in the mainstream media.

Whether this evolution results from the debate imposed by Sarkozy, it changes the rules of the game, and effects can already be felt on the ground.

The Marseilles mayor successfully resisted a tough 45 day strike of the bus and metro administration with the support of the majority of his electors — this would have been inconceivable a couple years ago.

The least positive news is the recent state railway strike. The strike was poorly followed, the media were not especially supportive of the strikers, and yet De Villepin ordered SNCF to accede to the demands of the unions — basically money and new hires. With 18 months to go until the presidential election, one can only hope that this is neither the beginning of election-related generosity nor hidden panic in the aftermath of the riots (Sarkozy's popularity soared whereas de Villepin's

remained unchanged).

Riot effects: one area which we did not cover in our analysis paper of the riots is the effect on tourism. Hotel bookings in Paris are down around 40% yoy in November. In the most visited city in the world (40m tourists a year), the economic effect is not entirely negligible, though authorities have decided to react swiftly with strong advertising campaigns in the countries where the damage is greatest (US, Japan, Russia and China). But it is more the psychological effect which needs careful attention: the last thing France needs at this crucial stage is more of its traditional “no one loves us” paranoia.

Germany will remain the main risk factor to the growth scenario, both on the upside and the downside. If the world economy remains buoyant, Germany would be the main beneficiary — given its 40% export share — with export strength possibly spilling over into the domestic sector.

Under a negative scenario by contrast, weakening world growth would exert additional job pressure in Germany, exacerbating weakness in the domestic sector, notably consumption. France by contrast seems the main stabiliser of euro area growth.

Exports, private consumption

Offsetting forces for the German economy in 2007: The two key forces which distinguish the German economy from the rest of the euro area — the cost of German unification on the supply side, and the construction sector's long term decline on the demand side — provide little positive news for Germany in the near term.

Recent labour market reforms might boost participation in East Germany, hence lower unification costs, but this is more a long term rather than immediate effect whilst residential construction will face a significant drag next year from the phasing out of home owner allowances.

Another structural feature of the German economy — its relative export strength /domestic demand weakness — explains the different effect of cyclical forces. Germany's export reliance can be seen as a result of corporate

restructuring, which boosts its international competitiveness, while reducing domestic demand.

This shifts German export focus to high value added goods — in order to protect margins — which are naturally found in the capital goods sector, a sector which is highly sensitive to growth (in the target markets) but not to price competitiveness. In this respect lower interest rates help the German economy less than a strong world economy.

Hence in an environment of strong world growth and moderately rising rates, German exports may perform particularly well, offsetting the fiscal drag on domestic demand (this will kick-in in full only in 2006 in advance of the 2007 VAT hike).

France seems more aligned with the rest of the euro area in all demand aggregates, construction (particularly residential), private consumption and exports. Exports have not been as buoyant as in Germany, but have outperformed the rest of the euro area (ex Germany), as did domestic demand.

Key demand aggregates

Exports remain driving force for Germany, stage recovery in France: Although net exports are likely to remain the key driver for German growth, their GDP

contribution has started to fade. However the benign international environment — key export markets like eastern Europe and China face an economic re-acceleration — coupled with the weakening of the euro are likely to make this decline a rather gradual event.

We agree with the forecast of the German institutes implying a decline in net exports from 1.0% of GDP in 2004 to 0.9% in 2005 and 0.8% in 2006 — in line with the trend of the current account balance.

Also we support the assessment that imports are likely to catch up with export momentum with goods exports having risen by double digit y/y rates in Q3 2005. The heavy boost German exports are getting from world demand is reflected in the sector composition of new orders.

In Q3 2005 high margin products of electrical equipment and machinery recorded double digit annual growth in orders — electrical goods orders surged by 20% — while price-sensitive intermediate goods were up 8% y/y and consumer goods only 4.5% y/y. The current distribution of global growth towards Asia and eastern Europe

(economies which are heavily geared towards capital spending) is likely to sustain this sector pattern into 2006.

French export orders by contrast were in a trough in Q3 2005 — annual growth slowed to a 2.5% in nominal terms after three quarters of double digit growth. French export goods felt the squeeze from previous euro strength with a longer time lag but more vigour than those of Germany.

The “country factor” is likely to be present in various sectors like industrials, construction and banking

However, the relief France gets from a weaker euro will be modest, both relative to Germany and the euro area, as seen in the comparatively small decline of its real euro TWI.

Import volumes, however, held up better than in Germany this year, but are likely to fade in 2006. This will help arrest the widening of the export gap in the course of next year — the same trend would apply to Germany resulting in stabilisation of the high trade surplus. Germany and France in this respect could be seen as antipodal but balancing each other and ensuring euro area trade remains almost in balance this year and next.

Domestic demand

Private consumption expenditure resilient in Germany, out-performing in France: The weakening in German private consumption spending since Q2 2005 cannot be seen as a surprise, given various headwinds such as the cut in regular jobs, high oil prices, fiscal tightening — tobacco tax, means testing in unemployment benefits etc.

The institutes expect net savings to remain stable this year and next, as both gross saving and private

borrowing are seen edging up. However, we are less pessimistic on German consumption, as we expect a stronger impact from labour market reforms on low paid jobs and profit incomes.

Based on consumer surveys, notably an increased buying propensity, we expect the current dent in consumer spending to be more short lived than forecast by the institutes, and hence would not rule out some growth in consumer spending next year.

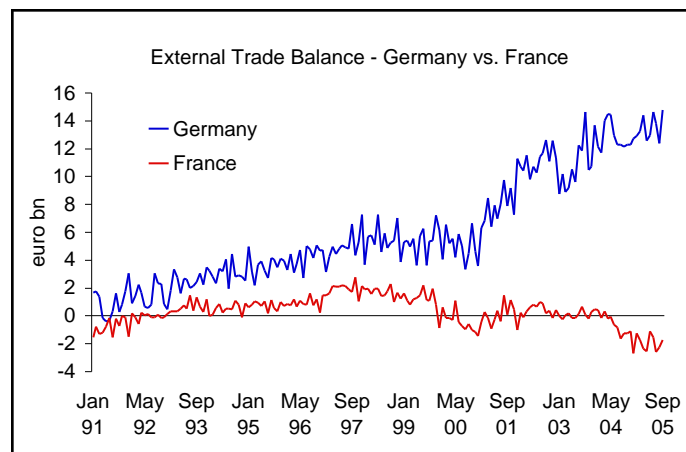
On top of this underlying trend fiscal policy is likely to lend an indirect boost to German private consumption through the phasing-out of tax allowances and a VAT hike in 2007. While the phasing-out of home owner subsidies in January 2006 might redirect spending from housing to consumption spending, the 2007 VAT hike is likely to bring spending forward into H2 2006 (notably for consumer durables) causing a spending trough in H1 2007.

Evidence in Germany has been mixed regarding previous VAT hikes (the last two in Q1 1993 and Q2 1998). In Q1 1993 a 1% VAT hike from 14% to 15% coincided with a 1% decline in consumer spending, but no prior increase whilst the Q2 1998 hike was preceded by a 1% rise in spending, but only a 0.5% retrenchment.

The different economic environments (recession in 1993, recovery in 1998) imply that the effect of the 3% VAT hike scheduled for 2007 will be difficult to gauge. Under normal circumstances, however, we would expect it to be substantial, with a swing in demand by 1.5% from Q4 2006 to Q1 2007 probably being a fair estimate.

Much will also depend on the behaviour of the trade unions — like the service sector union Ver.di, which announced its demand for “offsetting” wage hikes. This might smooth the

Continued overleaf



France, Germany presage euro area recovery

continued from page 11

immediate negative impact on demand but would lead to a negative effect on competitiveness.

Consumption in France, while still being the main driver of growth, has been much patchier during the last two years than before, with quarters of strength alternating with weakness — the last ones seen in Q3 2004 and Q2 2005.

This pattern reflects conflicting forces, ie the boost to wage incomes from a change of the law regarding the 35-hour work week, allowing a conversion of extra time to income payments but also the rise in unemployment.

This was only halted by the emergency employment plan, enacted in July 2005, setting incentives to small companies for new hires and encouraging a return to work.

We are more optimistic than the consensus in terms of French unemployment for a series of some excellent and other less inspiring reasons — successful “*nouvelle embauche*” job contract giving employers the option to terminate employment at any time during the first two years without justification, the improvement in the performance of public employment agency ANPE under pressure of private competitors, the more serious fight against false unemployment, heavily subsidised and often public job schemes for low-skilled workers.

Even with a modest growth of 1.8% it could decrease to around 9.0% from the current 9.8% by the end of 2006.

But given the deterioration of competitiveness in terms of unit labour costs, relative to Germany and the euro area, job creation in the private sector is bound to continue the under perform-

ance seen since 2003 relative to the euro area.

Therefore strength of consumer spending, which guaranteed France's superior growth during the last years, will depend next year also on a lower savings rate and low inflation. Part of this stems from further deregulation of retail trade, ie modification of the so-called “Galland law”.

In terms of private consumption Germany and France can also be seen as antipodal within the euro area — but with reversed relative strengths/weakness.

Consumer growth in the euro area will be almost identical to that of France, in stark deviation from that of Germany

While German consumer weakness is restrained by a combination of insufficient demand (subsidised production in the east) and supply rigidities regarding job creation, consumption in France only faces the latter, with the high minimum wage being the biggest obstacle to new hires. In addition demographics are also working in France's favour, given its 40% higher birth rate.

Against this background it seems only natural that consumer growth in the rest of the euro area will be almost identical to that of France and in stark deviation from that of Germany.

Business investment

Germany disappoints, France surprises: The different gearing of the

German economy on the one hand and of the French/euro area economy on the other towards exports and domestic demand has traditionally also been reflected in the two key categories of investment spending: equipment spending and construction.

Historically over the last 30 years equipment spending has undergone distinct cyclical swings.

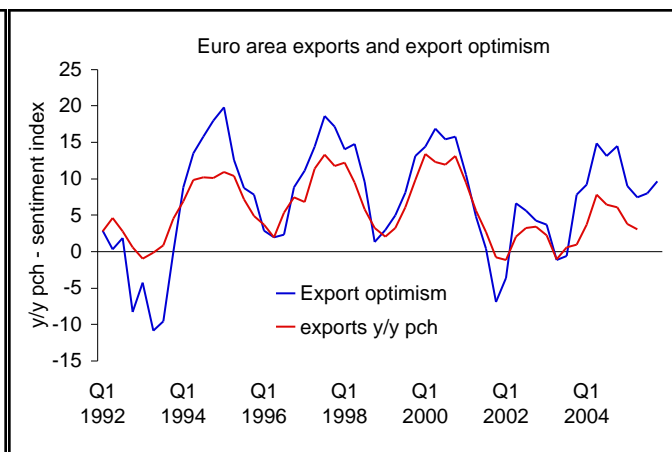
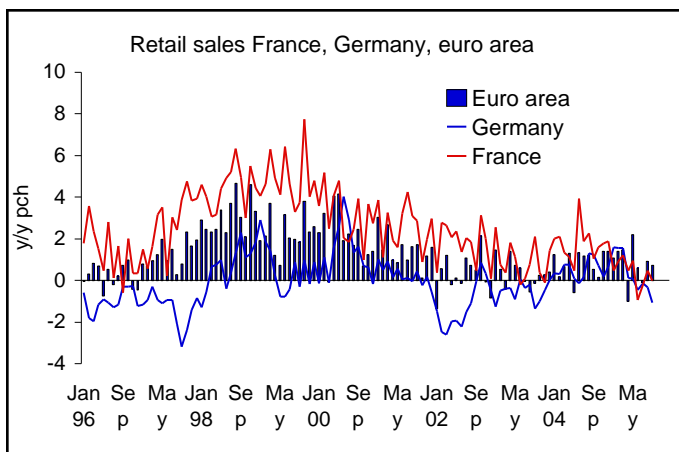
In terms of equipment growth while Germany usually trailed the euro area by a substantial margin (-1.6% from 1970 to 1990), during recoveries in the eighties and the nineties it had several episodes of double digit growth.

But during the current — two year old — recovery, equipment has been the weak link. This year the EU commission had nudged down its forecast for equipment growth by 1.5% and for next year by 3.5% to bring them almost in line with the German research institutes.

The equipment growth forecast of only 4.1% this year and 4.5% next year makes this recovery the shallowest for over 20 years. But this might now understate actual growth prospects, given the sharp acceleration in domestic capital goods orders, higher capacity use and positive feedback from direct investment in eastern Europe.

Also, business surveys like the one from the DIHK and the industry research institute IW in Cologne imply that investment might provide a positive surprise next year.

In France, equipment investment (slightly) surprised on the upside, but the quarterly investment outlook by INSEE sees no change in investment activity for next year. Still the EU commission forecast of 3.8% growth in equipment spending can be seen as rather cautious, given recent price and



profit trends.

Equipment spending is the only aggregate where both leading economies are forecast to outperform the rest of the euro area this year and pull it along in 2006.

Construction spending

Bottoming in Germany in 2006/7, persistent strength in France: Construction is the sector in which Germany has been most clearly out of sync with the euro area trend — for the obvious reason of unification spending — while France over the last decade has been well aligned.

However, weak construction spending has been a long term feature of the German economy, even during the two decades prior to unification. Much of this was due to political interference, including excessive planning requirements, in the residential sector.

The phasing out of home-owner subsidies is one of the last remaining major aspects in this area. A further deregulation in the construction sector — wage setting being a significant exception — might pave the way for a fast bottoming-out, setting the stage for a sustainable recovery from 2007 onwards.

In France, by contrast, the construction sector has shown brisk activity. After last year's recovery pause, growth in construction spending this year has been revised up to 2.4% by the European Commission, which now expects a growth rate of almost 3% in 2006 with growth is likely to be evenly spread between construction sectors.

Business investment may be helped by falling vacancy rates and public spending/civil engineering by pre-election infrastructure spending.

We are less optimistic than the European Commission on the performance of the housing sector.

Although the housing bubble appears less dramatic in France than in other

The 3% VAT hike in 2007 is likely to artificially boost German inflation but French inflation is likely to be held down

countries and French banks continue to resist lending against house-related capital gains, price rises have started to decelerate. The trend is likely to be reinforced by the imminent ECB rate hike.

Given relatively scarce supply linked to stringent environment laws and persistent bottlenecks in the construction sector, it is unlikely that prices will end up decreasing.

However the bonanza-like wealth effect of recent price increases of up to 20% y/y across the country is most likely over.

Many remember the last crisis, where prices decreased in nominal terms for seven long years from 1990 to 1997, so the consumption effect of any price correction could be felt relatively quickly, possibly as soon as H2 2006.

In the construction sector, France and Germany have again been antipodal within the euro area with German construction suffering painful downsizing, while France — together with Italy, Spain and the Netherlands — has been in the fast lane.

There are however some signs for potential convergence with the surge in house prices (in 2Q nationwide house prices were up 16% y/y, exceeding Spain and Ireland) perhaps having reached a peak and decelerating, while the drag for Germany may fade.

Inflation

Boost from higher VAT in 2007, retail competition in France: The surge in

energy prices has been regarded as an exogenous shock, affecting the euro area in a symmetric way. The comparison of France and Germany, however, confirms a marked difference in the way the energy price shock has been absorbed:

In Germany the energy price hike boosted CPI by at least 0.4% adding to the boost from the third stage of tobacco tax in September 2005 whereas in France the rise in energy prices was offset by downward pressure on goods prices.

The French consumption deflator was revised down to 1.3% (from 2%) by the EU commission, while Germany faced an upward revision to 1.7%. For 2006 CPI inflation is expected at 1.6% in Germany, at 2.1% in France — re-establishing the former pecking order — in line with the distinctly more favourable labour cost trend in Germany.

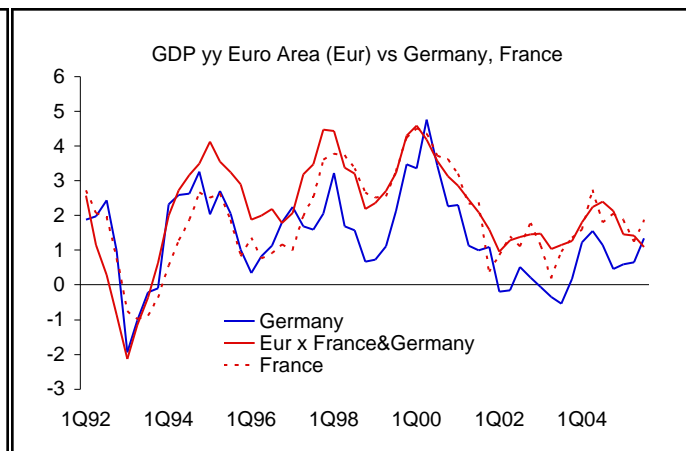
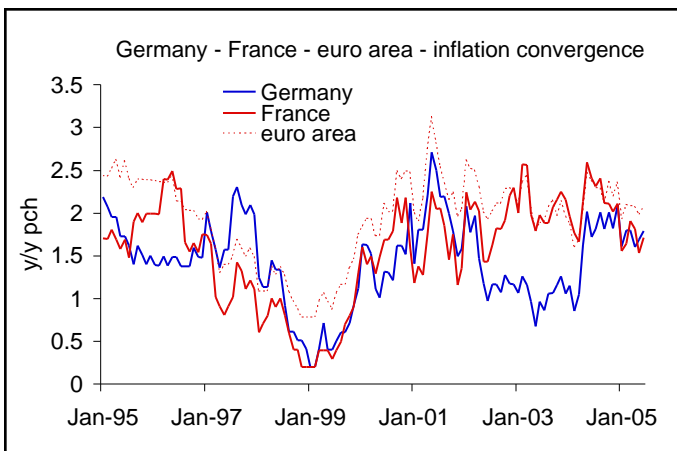
This year and next the gap in unit labour costs will widen to 2% between the two economies: -0.5% in Germany, 1.5% in France.

The favourable cost trend in Germany results from a combination of job cutting (particularly in flagship manufacturing sector companies), low wage rises (the January 2006 wage round is unlikely to alter this) and longer working hours. Persistent labour market pressure is likely to sustain the favourable cost trend.

In 2007, however, the 3% rise in VAT (and insurance tax) is likely to artificially boost German inflation.

French inflation is likely to be held down from the front end, ie final sales, through deregulating retail business — while regulation of petrol prices will prevent price spikes as seen this year.

All in all France can be seen as representative for euro area inflation trends, as regards both the level and profile, while Germany's underlying inflation remains distinctly lower. Any boost to



IG Metall demands 5% rise

Continued from front page

Württemberg resulting in wage rises, which are too high for the national average.

- The acceptance of persistent job losses in the manufacturing sector in contrast to other countries. The union's equation for wage rises includes inflation and productivity — in a stagnant economy mainly a result of high layoff rates. Since the beginning of 1994 — when the unification effect had been widely digested — manufacturing employment has declined by 15%, while the number of overall jobs has increased by 5% over the same period.

- Two-year wage rounds of modest increases (such as the one in 2004, when wages effectively rose less than 2%) alternate with substantial wage gains.

- A high headline wage increase, whose cost-effect is attenuated by pay rises coming into effect a few months late, and by including parts which are simply an extension of previous packages, as last time. IG Metall aims at extending previous bonus arrangements worth more than 1% of current pay this way, specifically aiming for a right to convert these payments to corporate pension schemes.

Conflicting forces

On the economic side, arguments for wage restraint have become more convincing over the last few years.

Former flagship firms like the car manufacturer Daimler Chrysler or the electrical firm Bosch have moved from hiring to firing during the last few years. Notably Dieter Zetsche, the new boss of Daimler Chrysler, has indicated layoffs in contrast to last year's agreement, when the union traded wage restraint for job guarantees. Similar agreements are

now called into question at German mega-employers like Volkswagen and Siemens;

Competition has shifted from product competition to labour competition. The big firms' outsourcing efforts to low cost countries are now being followed by the bulk of small and medium sized firms (to eastern Europe). According to official statistics the import content of German exports — export strength being the key argument for the IG Metall in justifying its wage claim — rose from 29% in 1995 to almost 40% in 2004.

Longer working hours agreed at key

The IG Metall wage rise in 1995 helped suffocate a recovery in job growth and private consumption

manufacturing firms like Siemens and in the public service sector seemed to highlight a trend change, allowing for an increase in per capita productivity without shedding jobs.

These economic arguments have obviously been outweighed by politics, both within IG Metall and at the national level.

IG Metall will undergo a leadership change at the end of 2007, with current head Jürgen Peters, handing over to Berthold Huber. While Peters is regarded as a hardliner, Huber is known for a more conciliatory line, aiming for better training agreements to enhance workers' scope for employment.

In the current wage round Huber, regarded as too ready to compromise in the last wage round, will be under pressure to reach a

“decent” wage increase in Württemberg, his home region, to underpin his position as the IG Metall leader-designate.

In terms of broader politics, the current government is regarded as heaven-sent by the trade unions, with the

SPD thwarting CDU plans for enhanced bargaining on a company level. This would have put the trade unions (and the employers' association) under pressure to reach agreements, preventing an opt-out of firms with low unionisation.

These political arguments were obviously strong enough to allow a comeback for the hardliners — humiliated in 2003 by a failed strike — and the prioritisation of short term gains over longer term interests.

Bad precedent

It is still early to predict the outcome of the current wage round — the wage claim has to be confirmed on January 20 before negotiations start. No strike action will be possible before April 2006.

But IG Metall has raised the stakes with its claim, defying the economic prerogative to come to more flexible arrangements. Instead it is following the traditional practice of going for a headline number in the “high twos” — possibly even eyeing the 3.5% wage rise agreed by the steel workers early this year — including company pension schemes.

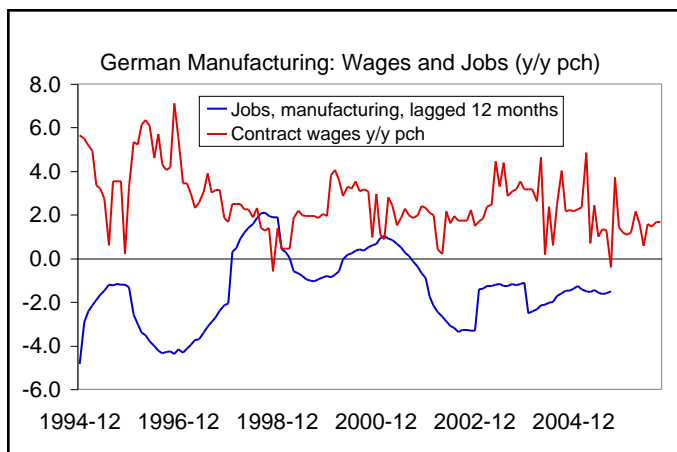
Even such an arrangement would be out of sync with current economic and job trends. Paradoxically it might even add to deflationary — not inflationary — pressures, given companies' usual reaction of increasing the speed of outsourcing. This particularly applies in the current situation, with outsourcing opportunities on the doorstep.

The main victim would be domestic demand — in sharp contrast to the trade unions' stated aim of securing spending power.

The negative effect of high wage rises have been particularly visible in the past, when manufacturing job growth reacted inversely to wage increases with a twelve month time lag.

Anticipating a response by the ECB, the effect might be exacerbated if it boosts the euro, a situation which resembles that of eleven years ago when IG Metall pushed through wage rises of 5% pa in March 1995. This contributed to the suffocation of a nascent recovery in job growth and private consumption, and the DM-dollar rate went through the roof, adding to German domestic headwinds.

Asset conclusions: bad for consumer related stocks (as wage claim will heighten uncertainty for jobs and consumption); potentially positive for the euro.



November EuroCOIN: negative signal from survey data

CEPR's November 2005 reading confirms the positive tendency recorded in previous months, but not the acceleration of October.

The cyclical component of quarterly euro area GDP growth remains stable between October and November at 0.553. The figures for August, September and October have been revised upward.

A negative signal comes from survey data and labour market variables. Industrial activity remained neutral, while a positive signal comes from interest rates.

The 25bp increase in key ECB interest rates was officially decided on December 1.

EuroCOIN figures from August 2005 are based on provisional data and may be subject to revision.

The signals from different sectors of the economy move in opposite directions with industrial production, interest rates and financial sector variables pointing to a slowdown while surveys and labour market variables indicate increasing growth.

EuroCOIN provides an estimate of the monthly growth of euro area GDP — after the removal of measurement errors, seasonal and other short-run fluctuations. To see the underlying direction in which economy is moving, one needs a monthly indicator free from seasonal and other short run fluctuations, from local and sector-specific shocks and from errors in the measurement of GDP

Month	Value
October 2003	0.713
November 2003	0.730
December 2003	0.648
January 2004	0.571
February 2004	0.508
March 2004	0.530
April 2004	0.546
May 2004	0.588
June 2004	0.593
July 2004	0.518
August 2004	0.457
September 2004	0.470
October 2004	0.402
November 2004	0.412
December 2004	0.367
January 2005	0.357
February 2005	0.340
March 2005	0.369
April 2005	0.362
May 2005	0.347
June 2005	0.348
July 2005	0.416
August 2005	0.476*
September 2005	0.52*
October 2005	0.553*
November 2005	0.553*

*provisional



If the graph of the indicator has a positive slope, the rate of growth is increasing, ie the cyclical component of GDP is accelerating. A negative slope indicates that the rate of growth is decreasing, ie the cyclical component of GDP is decelerating. If the value of the indicator is negative, this indicates that the level of economic activity is falling.

GDP is measured with error and is subject to large revisions. For example, between 1988 to 1997 estimates of GDP growth in Germany based on the final revised data were on average 0.2 percentage points higher than the rate estimates based on preliminary data.

EuroCOIN is produced monthly by CEPR and constructed by academic researchers. The members of the team

are: Filippo Altissimo (Banca d'Italia & CEPR), Antonio Bassanetti, Riccardo Christadoro (Banca d'Italia), Mario Forni (Università di Modena & CEPR), Marc Hallin (ECARES, Université Libre de Bruxelles), Marco Lippi (Università di Roma), Lucrezia Reichlin (ECARES, Université Libre de Bruxelles & CEPR), Giovanni Veronese (Banca d'Italia). n

Eurozone Barometer estimates for January 2006, France and Germany

	France: 2006			Germany: 2006		
	Cons	Last mth	2 mth	Cons	Last mth	2 mth
GDP	1.9	1.9	1.7	1.6	1.6	1.3
Household consumption	2.0	1.9	1.9	0.8	0.7	1.6
Gross fixed investment	3.0	3.0	2.7	2.9	2.7	2.1
Industrial production	2.1	1.9	1.9	2.9	2.8	2.6
Unemployment (% of labour force)	9.5	9.6	9.7	9.1	9.1	9.2
Consumer prices (HICP)	1.7	1.7	1.7	1.7	1.7	1.8
Current account balance (annual Eu bn)	-16.1	-12.9	-13.1	86.2	86.1	85.7
Current account balance (% of GDP)	-0.1	-0.8	-0.8	3.8	3.8	3.8
General govt budget balance (% of GDP)	-3.3	-3.4	-3.3	-3.5	-3.4	-3.4

Average % change from previous year, unless otherwise noted.

Source: Eurozone Barometer, MJ Economics www.mjeconomics.com

Data is provided by a panel of up to 31 institutions that include ABN Amro, Banca IntesaBCI, Bank of America, BBVA, BNP Paribas, Citigroup, Commerzbank, Dresdner Bank, Dun and Bradstreet, DZ Bank, Economist Intelligence Unit, Economy.com, ETLA, FAZ Institute, Global Insight, Goldman Sachs Handelsbanken, HSBC, HVB Group, ING Financial Markets, JP Morgan Chase, Lehman Brothers, Lloyds TSB Bank, Morgan Stanley, Nomura International, Nordea, Oxford Econ Forecasting, Raiffeisen Zentralbank, Santander Central Hispano, SEB and UBS.

Members of the editorial board of *Euro-Insider*

Robin Marshall

Robin Marshall is a former Managing Director of Economic Research at J P Morgan Chase. Since 1985 he has been one of Chase Manhattan's and later J P Morgan Chase's most senior economist analysts, becoming Chief Economist, Europe, Africa and Middle East at Chase Manhattan Bank in 1990. Robin, now an independent consultant, is one of the city of London's most respected economists.

Allan Saunderson

A Briton based in Frankfurt, Allan Saunderson is the leading non-German European Central Bank 'watcher'. Over the last two decades he has successfully tracked Bundesbank monetary policy from close up, plus the transition to EMU led by the European Monetary Institute and now the ECB.

Graham Bishop

The leading European Monetary Union specialist for Salomon Smith Barney during the 1990s, Graham Bishop is a member of the European Commission's Consultative Group on the euro impact on capital markets and is a specialist advisor to the UK Treasury parliamentary committee. Now an independent advisor he specialises on sterling euro entry and financial market regulation.

Michael Clauss

Michael Clauss is an adviser and former chief economist to Münchner Kapitalanlage. Before that he was director of economics at CSFB where he specialised in European research. He spent 11 years at CSFB after receiving his doctorate in 1988.

Marc de Scitivaux

Based in Paris, Marc de Scitivaux, is former head of mission for Industry Minister Alain Madelin during the mid-1980s and now leads a highly-respected financial and asset management advisory boutique. His monthly publication *Les Cahiers Verts de l'Economie* is widely read by French treasurers and asset managers

John Arrowsmith

Formerly Senior Advisor on West European & EU Affairs at the Bank of England, John Arrowsmith has spent the last 4-1/2 years in Frankfurt as the representative of the UK government with remit to advise government departments, the Bank of England and the Financial Services Authority on the policies of the European Central Bank. John is a visiting fellow at the prestigious NIESR.

Jacques Lafitte

Jacques Lafitte, CEO of JHLConseil, an independent consultancy focused on competition, EU financing and financial services is based in Paris and Brussels. From 1992 he was deputy head of the French Treasury. In 1995, he joined the cabinet of Yves-Thibault de Silguy, EU Commissioner for economic and monetary affairs.

Miranda Xafa

Miranda Xafa who started her career at the International Monetary Fund was an advisor to former Greek Prime Minister Mitsokakis in the early 1990s. A Greek national she has worked most recently as a senior economist for Salomon Brothers/Citibank in London. Based in Athens, she specialises in euro area economics.

Eric Barande

Based in Paris, Eric Barande has been an independent strategist on economics and financial markets since 1995. After starting his career at the French Ministry of Economics & Finance he worked as a senior economist-strategist at Citibank (Paris, Frankfurt), BIP Dresdner Bank (Paris) and Indosuez Carr Futures.

David Clark

David Clark is an independent political analyst based in London. From June 1997 to May 2001 he was Special Advisor to Robin Cook and the UK Foreign and Commonwealth Office specialising in European Affairs. Before that he worked for the Labour Party covering foreign and defence policy.

I would like to subscribe to *Euro-Insider*, a year's subscription for £585/Eu945

Name

Job title

Address

Company

Phone/fax:

Post/Zip code

E-mail:

1 year £585/Eu945

2 years £995/Eu1.605 (15% discount)

Signature

Date

Cheque attached

Please invoice me

Return to: Subscriptions, *Euro-Insider*,
POBox 33874, London N8 7XN, UK.

Or ring +44 (0) 20 8340 4328