



## Press Release

12 November 2001

### **Euroframe: Prospects for the European Economies 2001/2002**

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#### **The World Environment**

- The September 11th attacks on the United States and the consequent combat against international terrorism have clouded the short-term outlook for the world economy.
- World economic growth had already slowed considerably from the final quarter of last year. Monetary tightening in reaction to persistent high growth rates in the US was partly responsible.
- A further deepening of the international cycle in the remaining part of the year seems unavoidable, while the previously expected recovery of the international economy will be delayed by at least one to two quarters to early 2002.
- Uncertainties surrounding this outlook are high. Our projection starts from the assumption that possible further attacks will not have major negative effects on sentiment, and that the oil supply from the Middle East will not be disrupted.

### ***Growth Prospects***

- The US economy is obviously in recession now. Japan is in an even more serious situation. Output as well as prices are falling, public deficits are extremely high and the financial sector is burdened by bad loans.
- After having peaked in the second quarter of 2000, economic growth in the Euro Area continued to slow in the course of 2001 and almost came to a halt in the summer. Signs of stabilization emerged in August in some components of the industrial surveys and industrial production did not fall further on average in July and August.
- With the events of September 11 and beyond, the picture has obviously changed to the worse. As a consequence the anticipated recovery of European growth will be delayed into next year.
- We do not expect the Euro Area to fall into outright recession, although that remains a risk to be faced. Euro Area GDP is forecasted to grow by 1.6 percent in 2001 as well as in 2002, almost 2 percentage points less than in 2000.

### **The Policy Response**

- Economic policy in the industrial world responded rapidly to the terrorist attacks, in particular in the United States. In a co-ordinated action, central banks in the major industrial countries reduced their lending rates, and injected large amounts of liquidity in the economy.
- Since early this year the US Federal Reserve System had already reduced its official rates repeatedly in reaction to slowing activity and better inflation prospects.
- Overall monetary conditions the Euro area have now moved to be expansionary. We do not see any danger of a sustained rise in underlying inflation while headline inflation is expected to decrease in the coming months.

### ***Policy prospects***

- Clearly the ECB should act rapidly and cut rates once again if the Euro Area economy were to slow down more than we forecast or the euro were to appreciate by more than we anticipate.
- Fiscal Deficits in the EU will significantly rise in 2001. The current economic situation shows that it was unrealistic to plan last year to undertake three-year public finance programmes, without taking account of the business cycle.
- Consequently governments now face the difficult task of achieving the budgetary targets set out in the Stability programmes, without implementing pro-cyclical fiscal policies that would add to the deceleration of activity.
- In the current cyclical context, it would therefore be wise to let automatic stabilisers play fully and use structural deficits as targets since they are independent of the state of the business cycle.

**Table 1. Forecast Summary****GDP**

	<b>World</b>	<b>OECD</b>	<b>EU</b>	<b>Euro Area 12</b>	<b>USA</b>	<b>Japan</b>	<b>World Trade (Goods)</b>
<b>1999</b>	<b>3.6</b>	<b>3.1</b>	<b>2.6</b>	<b>2.6</b>	<b>4.1</b>	<b>0.8</b>	<b>6.2</b>
<b>2000</b>	<b>4.7</b>	<b>4.1</b>	<b>3.4</b>	<b>3.4</b>	<b>4.1</b>	<b>1.5</b>	<b>12.9</b>
<b>2001</b>	<b>2.0</b>	<b>1.0</b>	<b>1.7</b>	<b>1.6</b>	<b>1.0</b>	<b>-0.7</b>	<b>0.3</b>
<b>2002</b>	<b>2.2</b>	<b>1.2</b>	<b>1.8</b>	<b>1.6</b>	<b>1.0</b>	<b>-0.5</b>	<b>2.3</b>

**Private Consumption Deflator****World Prices**

	<b>OECD</b>	<b>EU</b>	<b>Euro Area</b>	<b>USA</b>	<b>Japan</b>	<b>Manu- fac- tures (\$)</b>	<b>Oil (\$ Per Barrel)</b>
<b>1999</b>	<b>1.3</b>	<b>1.4</b>	<b>1.2</b>	<b>1.6</b>	<b>-0.7</b>	<b>-1.7</b>	<b>17.3</b>
<b>2000</b>	<b>2.1</b>	<b>1.9</b>	<b>2.2</b>	<b>2.7</b>	<b>-1.1</b>	<b>-5.4</b>	<b>27.1</b>
<b>2001</b>	<b>2.0</b>	<b>2.3</b>	<b>2.5</b>	<b>1.9</b>	<b>-1.3</b>	<b>-1.4</b>	<b>23.7</b>
<b>2002</b>	<b>1.3</b>	<b>1.6</b>	<b>1.6</b>	<b>0.9</b>	<b>-0.5</b>	<b>2.4</b>	<b>21.0</b>