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AIECE General Report

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PART I



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The authors would like to thank all colleagues at the AIECE institutes for providing their answers to the questionnaire.

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Section I. - GENERAL ENVIRONMENT.

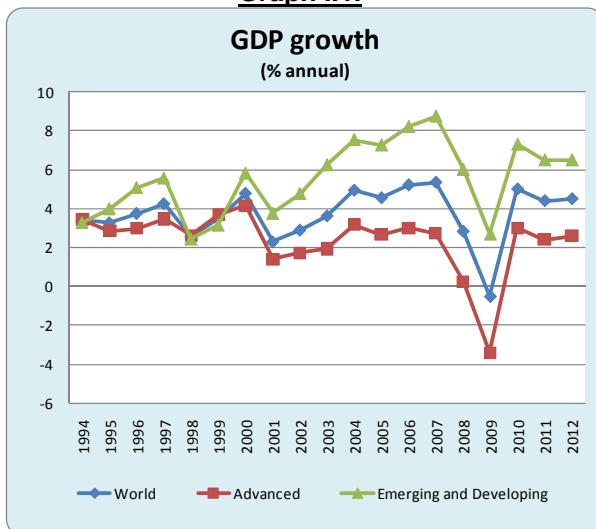
I.1. - RECENT TRENDS

a) World GDP growth.

As stated in the report of the previous meeting, it seems that the worst of the so called “Great Recession” is coming to an end.

According to the World Economic Outlook (WEO) of April, published by the International Monetary Fund (IMF), global output is projected to expand by 4½ percent in 2011, an upward revision of about ¼ percentage point relative to that of October 2010, with the growth rate for 2010 virtually unchanged from the previous year’s forecast (Graph 1). These figures allow the IMF to headline “The recovery has solidified”.

Graph I.1.



Source: IMF. WEO Database April 2011.

Graph I.2.



Source: IMF. WEO Database April 2011.

Yet the end is not happening in the same way for all the countries, as the recovery is taking place at two different speeds; faster for the emerging economies.

In many emerging economies activity remains strong, though inflation pressures are up-and-coming and there are some signs of overheating, driven in part by strong capital inflows. Most developing countries, particularly in sub-Saharan Africa, are also growing strongly and China and India continue to grow at high rates (Graph 2). Nevertheless, downside risks to the recovery in these countries remain elevated.

In Table 1 we have broken down the growth of the main world countries and areas into two big areas, the first includes the USA, the Euro area and Japan which we have called “The triad” and the second includes China, India and the Latin American area, which we have called “The non-triad”. It can be seen that in 2009 only China and India grew, and in 2010 all the countries and areas show positive rates of growth, though the growth of the non-triad is greater than in the triad, highlighting the Euro area for its low rate of growth and the USA for its strong contribution to world growth.

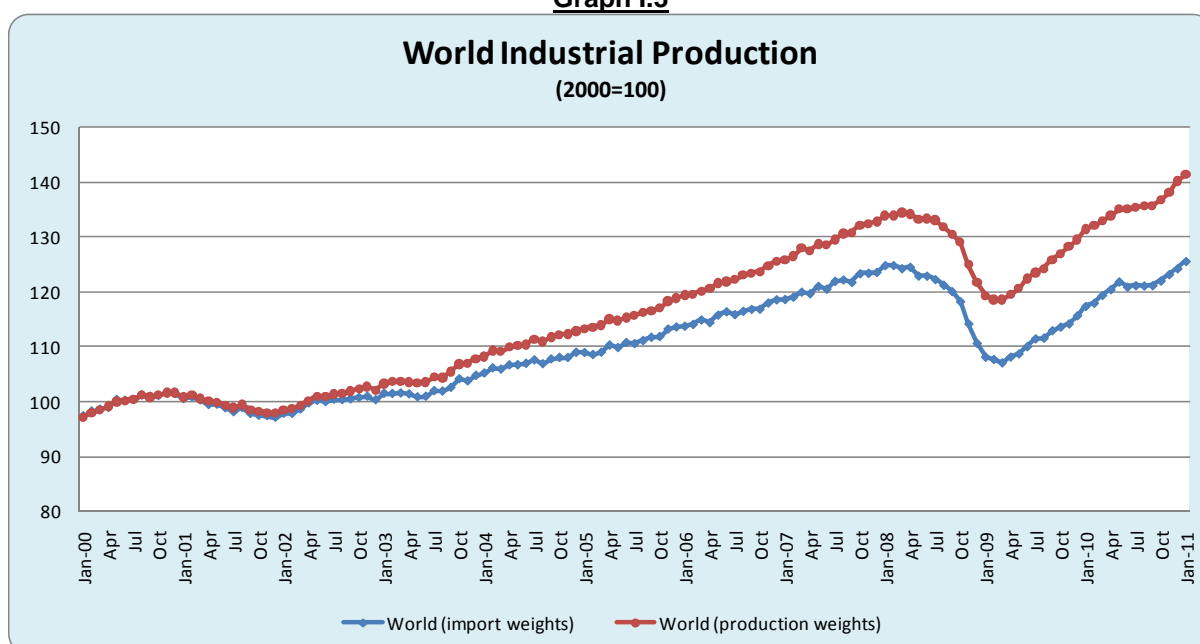
Table I.1

Contribution to growth of major countries and areas					
Area / Country	Weight in world GDP (%)	GDP growth (%)		Contribution to growth (percentage points)	
		2009	2010	2009	2010
USA	24,1	-2,6	2,8	-0,63	0,67
Euro area	21,5	-4,1	1,8	-0,88	0,39
Japan	8,2	-6,3	4,3	-0,52	0,35
Triad	53,8	-3,8	2,6	-2,02	1,41
China	8,2	9,2	10,3	0,75	0,84
India	2,3	5,7	9,7	0,13	0,22
Latin-America	6,8	-1,8	5,9	-0,12	0,40
Non-Triad	46,2	-0,2	5,4	-0,08	2,49
TOTAL s/Exch. Rates	100,0	-2,1	3,9	-2,1	3,9
TOTAL s/PPC	--	-0,6	5,0	--	--

Source: CEPREDE, April 2011, based on IMF forecasts.

The fall in global output in 2008, as measured by the Netherlands Bureau for Economic Policy Analysis (CPB) world industrial production index (Graph 3), started the recovery by mid 2009, and since then the index has recovered the growth path interrupted in early 2008.

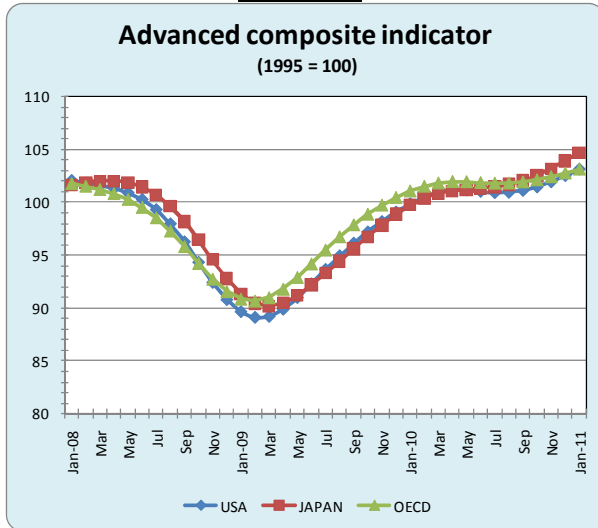
b) World Short term indicators.

Graph I.3

Source: CPD database world monitor, March 2011.

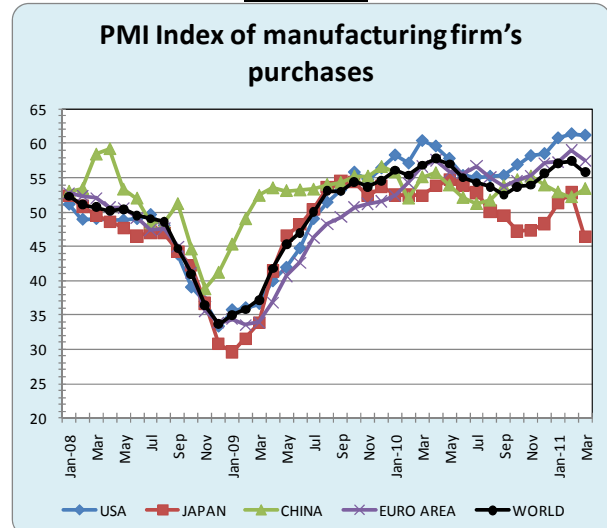
The OECD composite indicator of activity shows that for the OECD area the recovery started in December 2009, when the index reached the 100 value mark again, while for the USA and Japan the recovery started two months later, gaining momentum in both cases by the middle of the year, after it stood at pre-crisis levels (Graph 4).

Graph I.4.



Source: OECD April 2011.

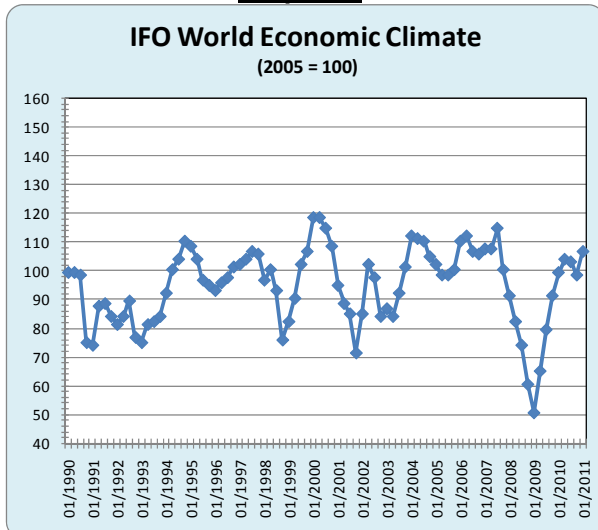
Graph I.5.



Source: NTC RESEARCH LTD. April 2011

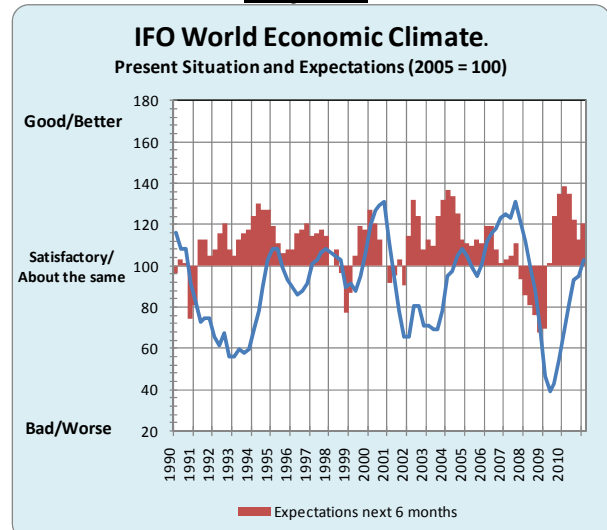
The index of manufacturing firm's purchases surpassed those levels in the first quarter of 2010; however, after appearing to be at a turning point in the second quarter of 2010, it has recovered momentum, with the exception of Japan, strongly affected by the tsunami provoked by the earthquake (Graph 5).

Graph I.6.



Source: IFO World Economic Survey (WES) 1st quarter 2011

Graph I.7.



Source: IFO World Economic Survey (WES) 1st quarter 2011

The IFO World Economic Climate indicator shows that the recovery started in the second quarter of 2009, surpassing the 100 level one year later.

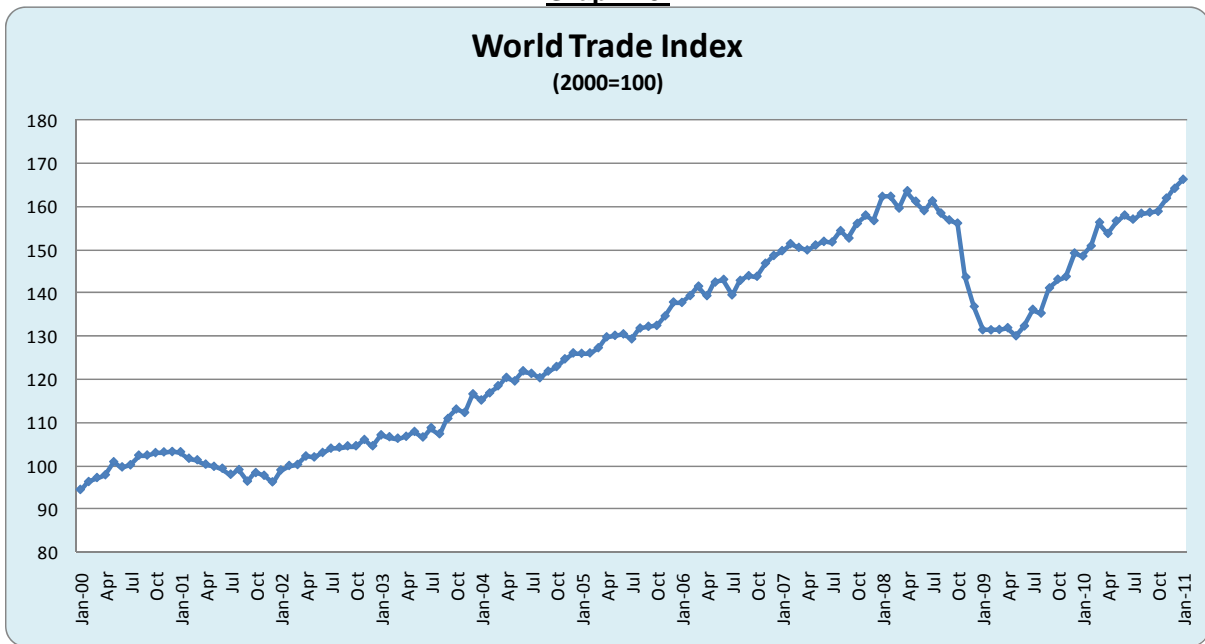
After a slight decline in the fourth quarter of 2010, the first quarter of 2011 has seen a noticeable rise, reaching its highest level since the end of 2007 (Graph 6). For the first time since the first quarter of 2008, the opinions of the experts surveyed about the present situation were good in the first quarter of

2010, and the expectations for the next six months continue to be positive for the seventh consecutive quarter (Graph 7).

c) World Trade.

After the strong fall in world trade that started in the second quarter of 2008, as measured by the CPB world trade index, the recovery started only one year later, reaching the index of pre-crisis levels by the end of 2010 (Graph 8).

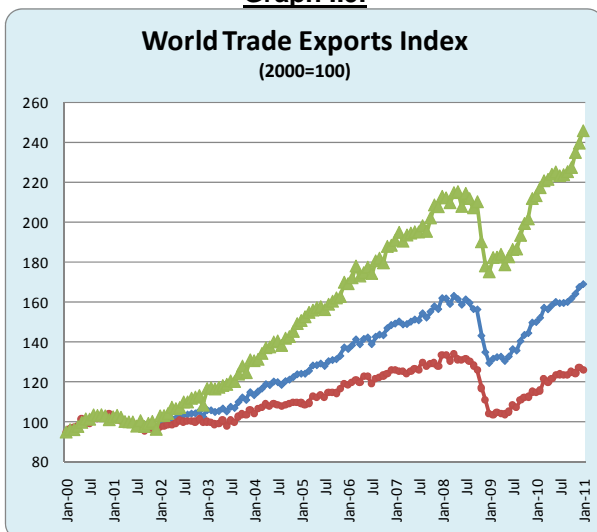
Graph I.8.



Source: CPB database. World Trade Monitor, January 2011

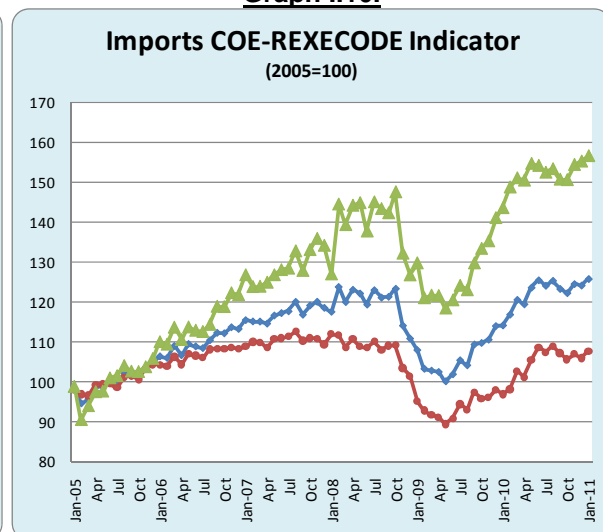
World trade exports followed a parallel path, with an increase of 16.2% in 2010 according to CPB figures, which is higher than the forecasts by the World Trade Organization (WTO) and the IMF made in September 2010, quoted in the previous AIECE report, with a stronger recovery in the emerging economies (Graph 9). According to the COE-REXECODE indicator, world imports are also recovering with greater strength in developing countries than in the OECD members, where they have stalled since the second quarter of 2010 (Graph 10).

Graph I.9.



Source: CPB database. World Trade Monitor, April 2011

Graph I.10.



Source: COE-REXECODE, April 2011

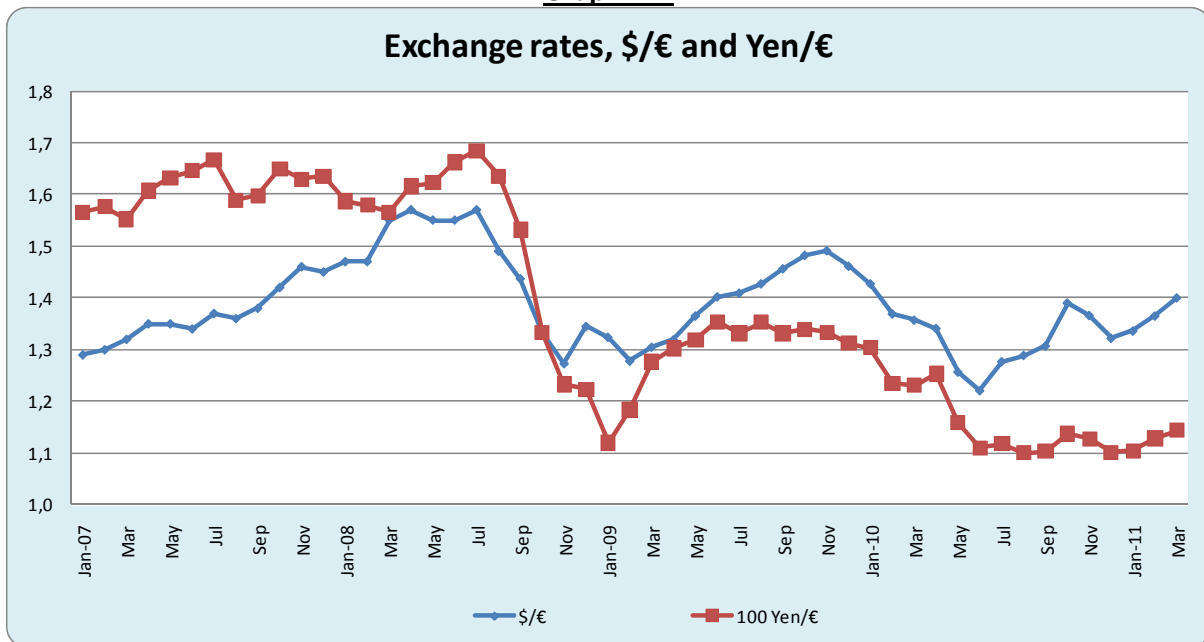
To sum up, the IFO World Economic survey, released in February, states “The results indicate that world economic activity, after a slight dampening at the end of last year, is picking up again.” Nevertheless, the road to recovery looks to be harder than anticipated in the advanced economies, as the USA continues its expansionary policy, the so-called fiscal consolidation in the European Union is imposing restrictions on economic policy that will take a toll on short and medium term growth. Within this context of a still weak global economy, where financial stability is not assured, significant policy challenges have to be addressed and room to manoeuvre is largely exhausted. On top of this, two major shocks have arisen in recent months, introducing additional problems: the escalating social unrest in North Africa and Middle East, particularly the war in Libya and the devastating earthquakes and tsunamis in Japan.

d) Exchange rates.

Differences in growth paths and macroeconomic policies around the globe are affecting exchange rates significantly and the volatility remains, due to the absence of clear signals.

Since the second half of 2010 the Dollar has resumed its depreciation against the Euro, with over-reaction movements around an equilibrium value of 1.35 that looks to be comfortable for the main world economies, though at the end of the first half of April the Euro is closing around 1.45 with an increase of 8.6% since January. The picture is quite different for the exchange rate of the Yen against the Euro, as it has remained quite stable in the second half of 2010, showing a moderate appreciation in the first quarter of 2011. Exchange rates of emerging economies have appreciated since 2007, in particular those with large external deficits.

Graph I.11



Source: CEPREDE database. April 2011.

According to the IMF World Economic Outlook of April, the appreciation of the Yen and the depreciation of Sterling by more than 20 percent in real effective terms are most noteworthy. Among the emerging market currencies of those countries with surplus in their current account, the Renminbi and the currencies of other Asian economies (for example, Malaysia, Singapore, Thailand) have appreciated by 5 to 10 percent. Nonetheless, the IMF considers that Asian currencies are weak relative to medium-term fundamentals.

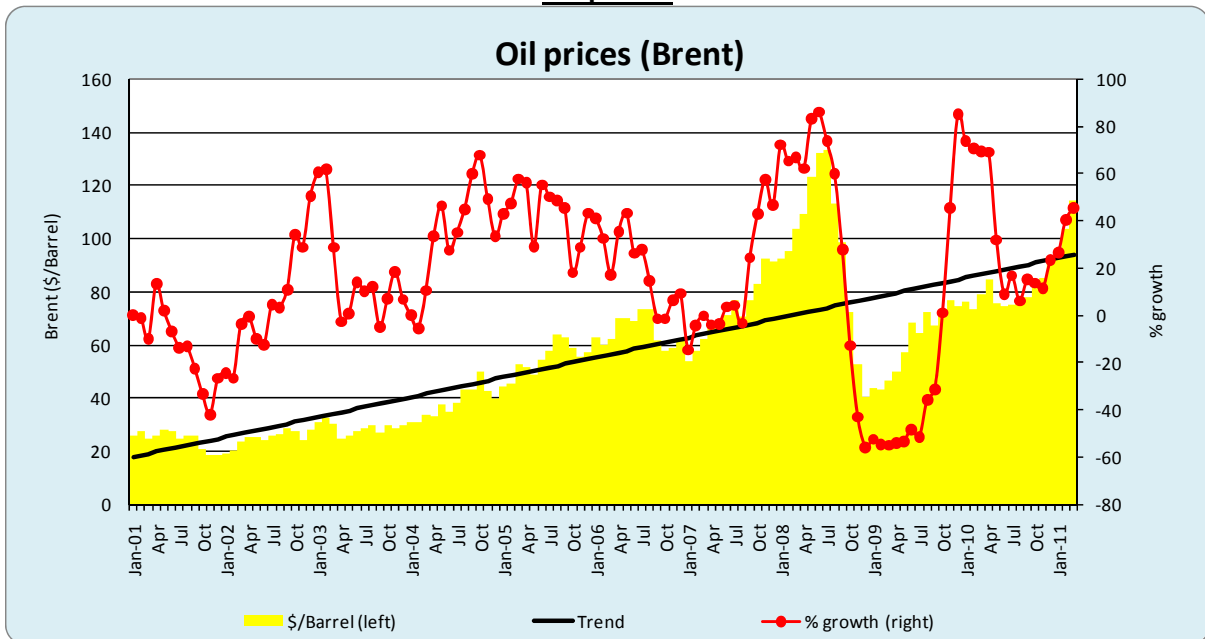
e) Commodity prices.

Oil prices have been growing since the end of 2009 but still keeps under June 2008 record.

The price of oil, which remained relatively stable over the last decade of the last century, has been growing since the start of this century, reaching a historical maximum in June 2008. At that time, it was clear that the economic crisis had reached the developed countries. Nevertheless, in the following six months the price dropped to the levels of mid 2004, till mid 2010 when it exhibited ups and downs, with an extremely large increase in December 2009, and since then it has grown continuously, till reaching the Brent price of 114.5 \$/barrel in March 2011 (Graph 12).

After the recuperation of the demand during 2010 in both developed countries and emerging and developing economies, particularly in China, the price increase in the first quarter of 2011 can be partly explained by the increases in inventories, but also for the rapid recovery of energy in advanced economies.

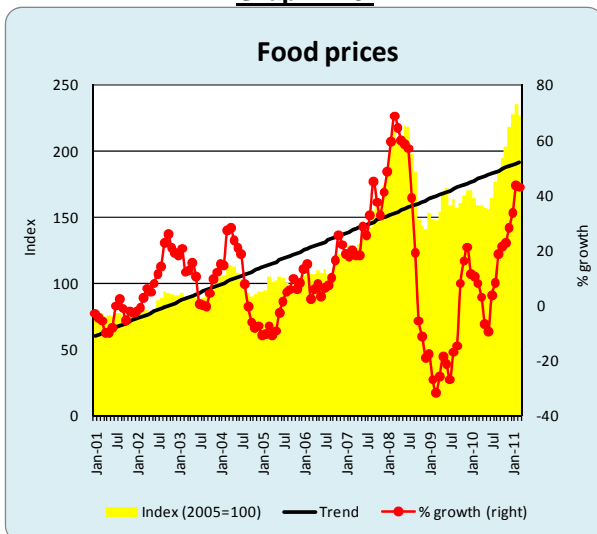
Graph I.12



Source: Financial Times. April 2011

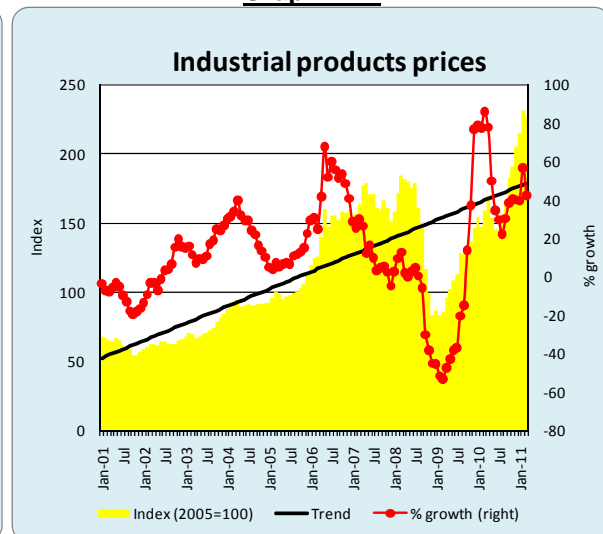
Price for industrial products, as well as food ones, have already surpassed the highest levels registered in 2008.

Graph I.13.



Source: The Economist, April 2011

Graph I.14.



Source: The Economist, April 2011

The price of food products started to grow at the onset of the new century, reaching a maximum in 2008, followed by a fall in 2009 and a new increase in 2010, particularly in the second half, reaching the pre-crisis level in January 2011 (Graph 13). These recent developments can be explained by the adverse weather conditions during 2010 that led to harvest shortfalls, with supply shocks in the second half of 2010, by restrictions to trade in some countries (i.e. Russia) and by a robust demand, in particular, from emerging countries including China.

Finally, the price of industrial products shows quite a similar path to those of oil and food products (Graph 14).

f) Interest rates.

We started this report commenting that the world has left behind the global recession, however, contrary to what was expected, the international financial stability is far from being assured.

The financial sector has to be remembered as the cause, jointly with the housing bubble, of the current financial crisis. In the developed countries, this volatility has extended to public debt markets, particularly to the euro area countries, where institutional investors have cast doubts on the health of the financial systems and public finances.

In the second quarter of 2010, financial speculators, led by rating agencies, also worthy of being remembered for their responsibility for what is happening, focused their attention on attacking those countries with higher perceived vulnerabilities, particularly Greece, Ireland and Portugal and, to a lesser extent, Spain. One may wonder why Italy and Belgium, with a high political instability and much higher ratios of public debt and interest payments than Spain, are not being attacked by financial markets¹.

There is a broad consensus that three factors seem to have been crucial to amplifying the consequences of the crisis for these countries: a) the degree of spread of toxic assets bought by domestic financial systems and the ability that these systems had to debug the corresponding balances of the institutions involved, with some governments using truly exceptional measures in their eagerness to support the banking system; b) the extent to which the dynamics of the economy had settled on the expansion of the housing bubble, as the leading sector for generating growth and employment in several countries; and c) the degree to which countries relied on international funding to wipe out previous imbalances.

The limited knowledge about the degree of involvement of financial institutions with bad assets fuelled the distrust of markets and produced a very severe credit crunch. The authorities responded with exceptional measures to avert what was considered as a possible financial meltdown. As it is well known, a wide range of measures were implemented from injections of liquidity into the system to offering guarantees to deposits, and from the active support of balance sheets to the acquisition, supposedly temporary, of those bank assets when the institution was seriously affected.

In addition, these countries had dismantled their direct taxation systems lowering tax rates and allowing generous tax expenditures so, as the crisis came to the worst, they adopted policies to boost demand, incurring in heavy public deficits. Hence, in the end, the financial crisis developed into a government debt crisis. As the crisis entered a new drift in the second half of 2010, the authorities focused on so-called structural adjustment measures, in addition to other severe measures aimed at reforming public finances: fiscal consolidation. Yet, these policy actions will not only take their toll on growth, reducing it in the short-run, but will also bear obvious social, political and institutional costs².

¹ According to the OECD Economic Outlook forecasts, in 2010 (all figures in % of GDP) Gross Financial Liabilities of Belgium, Italy and Spain were 102.5, 131.3 and 72.2; Net Debt Interest Payments were 3.3, 4.3 and 1.6; and General Government Financial Balances were -4.9, -5.0 and -9.2. See also the vulnerability indicators in Table 1.3 of IMF-WEO April 2011 (Pg. 16).

² "The measures taken seem to transcend mere occasional cost containment, to become an operation that affects the size of the respective welfare states and the scope of social rights that were granted before the crisis. In this framework, it is questioned not only the politics of social integration (which affects, among others, the immigrants), but also how far should be the public funding of previously services (such as health), the conditions of unemployment insurance, pension benefits and the age of retirement. It seems that they want to take advantage of the emergency imposed by the crisis and its relentless pressure on the budget balance to undertake, with less resistance, reforms in the social model that until now has characterized Europe."

If in Europe it was decided that the fiscal consolidation shall be finished in three years time, that is, in 2013, after four G-20 summits there has been little reform in the bank system or tax havens, and the new financial system regulation has been left to a new Basel agreement, Basel III, that will become fully in force in 2019! However, financial institutions are warning that a stricter regulation will lead to a "vicious circle", reducing their profitability. And almost nothing has been done regarding practices relating to fraud, malfeasance, abuse of privileged information, bonuses, spoliation, bad faith, unfair enrichment, etc. Conversely, it can be observed the speed with which those responsible for rating agencies or banks that have been rescued with public funds have gone on to develop the same type of risk behaviour or pay practices that led to the crisis and bankruptcy.

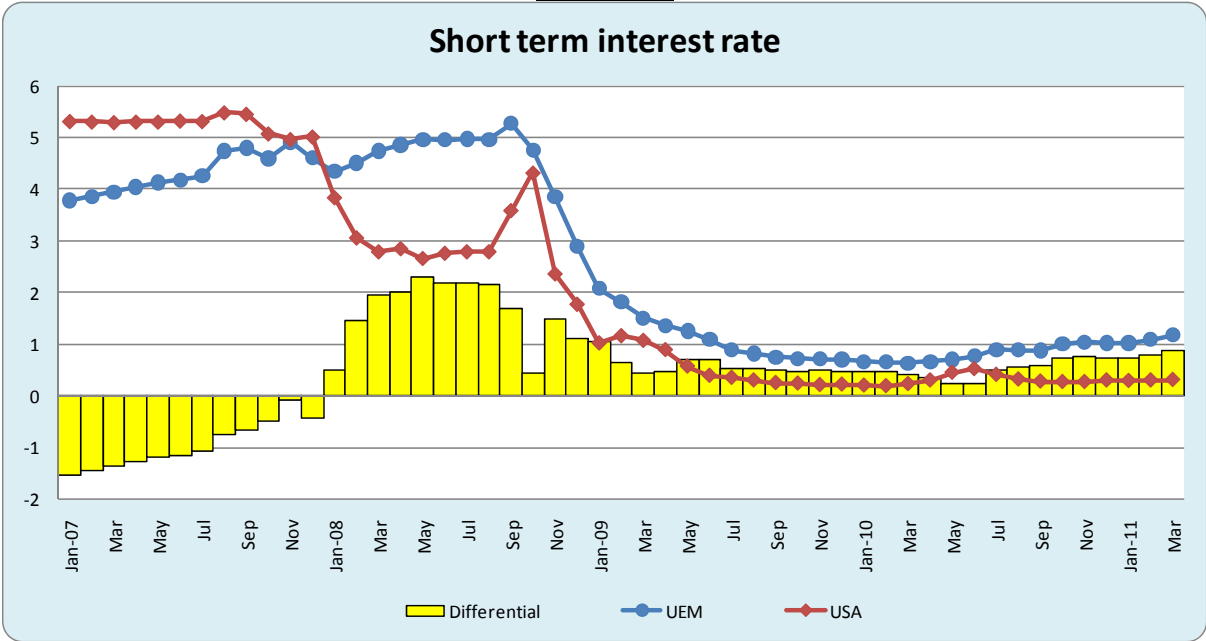
On the way out of the great recession in Europe, we can identify two groups of countries. On the one hand, Central European economies led by Germany, with relatively good fundamentals and boosted by global trade and on the other hand, those countries immersed in several adjustment processes accelerated by financial market pressure. For the latter, the doubts regarding the banking system, and the lack of a convincing strategy for repairing the financial system, ironically could undermine the confidence in fiscal sustainability.

Regarding the role of central banks, while the Federal Reserve, the Bank of Japan and the Bank of England have very clear ideas on monetary policy, the European Central Bank's (ECB) decision to raise the intervention rate 0.25 p.p. to 1.25% may be considered inappropriate, primarily because financial turmoil has not yet finished (the Lisbon call for help provides proof of this) and some countries still experiencing difficulties to grow, particularly as the situation complicates peripheral countries: rendering a more expensive debt refinancing in the midst of fiscal crisis and making their recovery harder.

In our opinion, the political framework is very clear to the Chairman of the ECB: France and Germany have rediscovered the path to growth and monetary policy can be adjusted (though liquidity facilities are maintained) without endangering the activity of these two countries. Yet this is a new mistake, similar to that of 2008, when it raised the intervention rate for fear of inflation driven by energy and food prices that quickly evaporated. Nothing else seems to matter to the ECB. It is indeed a problem related to the design of the institution, made at a time following the requirements of the economic orthodoxy that Krugman and Stiglitz called "market fundamentalism", which has brought us to where we are now and from where it seems so hard to leave, except for France and Germany. Nonetheless, it is also a problem of people, with a board of Directors which represents a faithful follower of the aforementioned economic orthodoxy. Moreover, amongst other reasons pointed out by some financial analysts, with the difficulties that businesses and individuals are experiencing to obtain credits, it is almost impossible to accelerate inflation; in fact, the Euro zone money supply is growing at a rate of 2%, well below what would be considered to be adequate.

The differential in short term interest rates between the EU monetary area and the US have increased in the first quarter of 2011, after a long period of rapprochement that started in the last quarter of 2008 (Graph 15).

Graph II.15

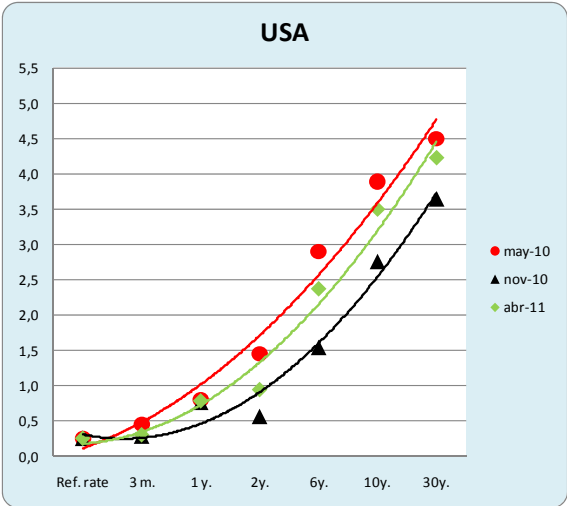


Source: CEPREDE Database. April 2011

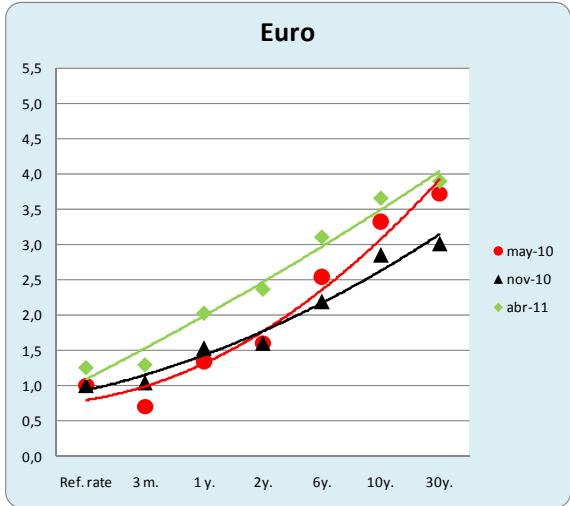
In Figure 16 we have drawn the evolution of US dollar and Euro spot curves of the interest rates in the last twelve months. In April 2011 the spot curve of the dollar interest rate is in between the forecast of one year ago and the forecast of six months ago. The picture is different for the Euro, because the April spot curve is above the forecasts of May and November 2010.

Graph II.16

Yield curves in the last twelve months



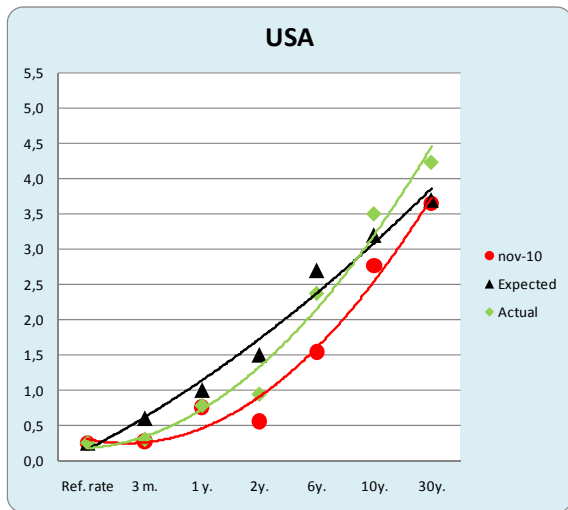
Source: CEPREDE, April 2011



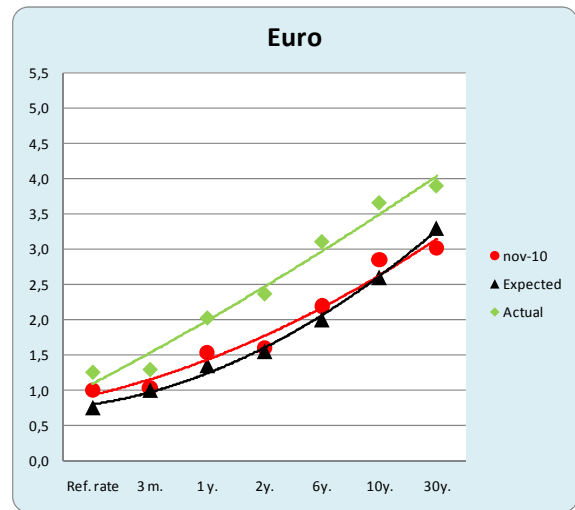
Source: CEPREDE, April 2011

The short term interest rates for the US dollar, current and forecasted (Graph 17 left), show an increase in the second semester, though slower than the rates expected six months ago. For the Euro, short term values are above what was expected six months ago, due to the fact that the ECB brought forward the decision of raising the intervention rate. Besides that, the financial markets believe that ECB intervention rates will keep rising (Graph 17 right).

Graph II.17
Yield curves: now and six months ago



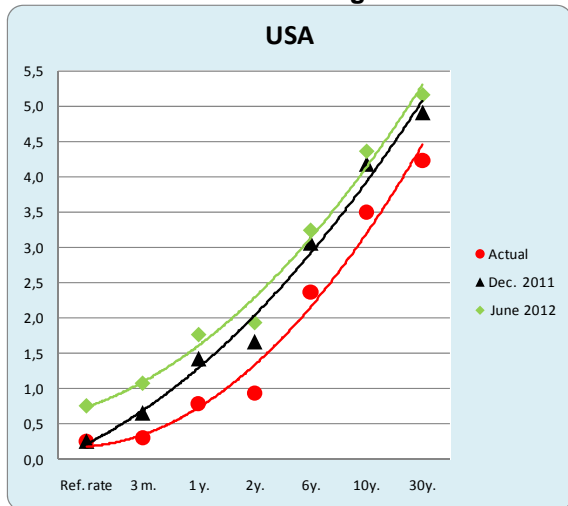
Source: CEPREDE, April 2011



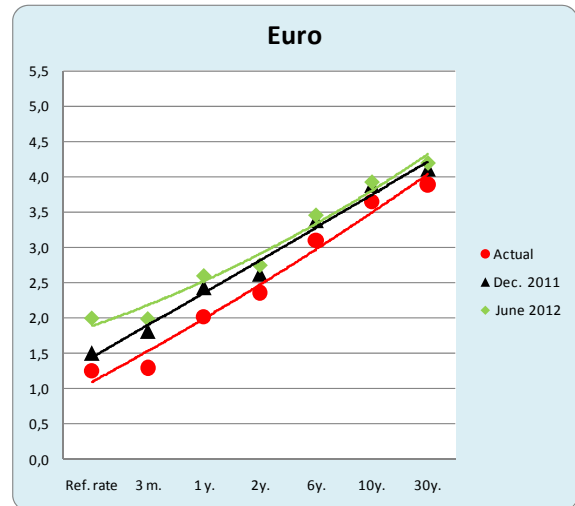
Source: CEPREDE, April 2011

The long term interest rates for the US dollar, current and forecasted (Graph 18 left), show a higher confidence in the US economy for the next twelve months, against the uncertainty of six months ago. For the Euro (Graph 18 right), current levels also show a higher confidence, but unlike the USA, the slope of the curve is very small, casting doubts on future sustainability.

Graph II.18
Long term interest rates: current and forecasted



Source: CEPREDE, April 2011



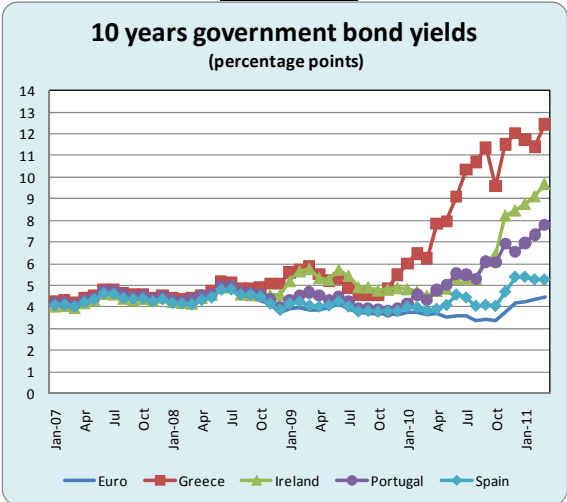
Source: CEPREDE, April 2011

Nevertheless, the differentials between long term interest rates in the Euro area have continued to grow during the first quarter of this year (Graph 19), and after the Portuguese crisis this month are even worsening (Graph 20) with rating agencies continuing to publish unscientific analyses³ threatening even the US debt.

³ We have been told that the “analysts” of these agencies are registered as financial journalists! Actually, in the documentary movie “Inside Job” (2010), the spokesperson of each of the three companies says that the ratings “are only opinions” and the spokesperson of Standard & Poors add: “They do not speak to the market value of the security, the volatility of its price or its suitability as an investment”.

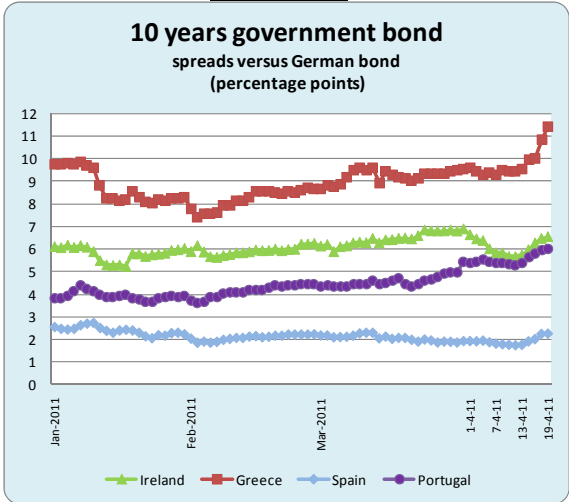
At the time of writing this chapter, the Portuguese government is negotiating the bail-out, expected to total 80 billion Euros, with the European Commission, the ECB and the IMF, after the main banks decided to strangle the financial support to the State. As usual, the EU and the IMF have each warned that Lisbon will have to implement more public spending cuts, tax rises and far-reaching privatisation, as the conditions of a medium term programme that has to be more severe than the one rejected by the Portuguese Parliament⁴. While a few days before the IMF was praising Spain for its labour market and pension reforms⁵ and for “accelerating bank restructuring and putting in place a new bank recapitalisation programme”. In presenting the Global Financial Stability Report, the International Monetary Fund said that Spain is a “completely different” case from the rest of the troubled Euro zone “periphery” and is successfully persuading investors that it has addressed its financial fragility.

Graph I.19.



Source: EUROSTAT, April 2011

Graph I.20.



Source: EUROSTAT, April 2011

⁴ What we know is that in most of the bail-outs that followed the same so called “liberal” recipes of the IMF, as in Latin America in the 80’s, they finished with less economic activity, less employment and more poverty.

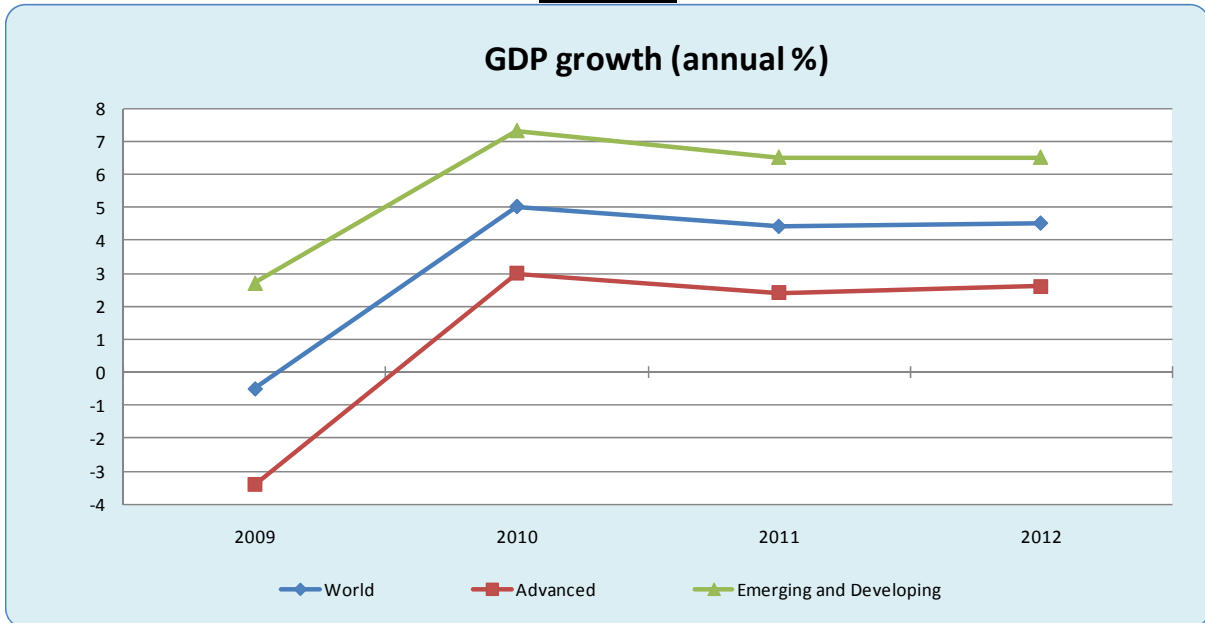
⁵ Though we don’t know what the relationship is between these reforms and the causes of the financial and economic crisis.

I.2.-THE OUTLOOK

In this section we would like to gather together the forecasts for some macro magnitudes made by the AIECE members, in addition to those made by international institutions.

The IMF projections for the world real GDP in 2011 and 2012 (Graph 21) show that growth is forecasted to reaccelerate, though with a modest slow down in relation to 2010 rates, and will continue at two different speeds, faster for the emerging (in particular China and India) and developing economies, for which is expected to expand by about 6.5%, while for advanced economies a 2.5% rate is expected. Unemployment will be greatly reduced; though it will remain lower in emerging and developed economies.

Graph I.21.



Source: IMF. WEO, April 2011.

a) World trade volume.

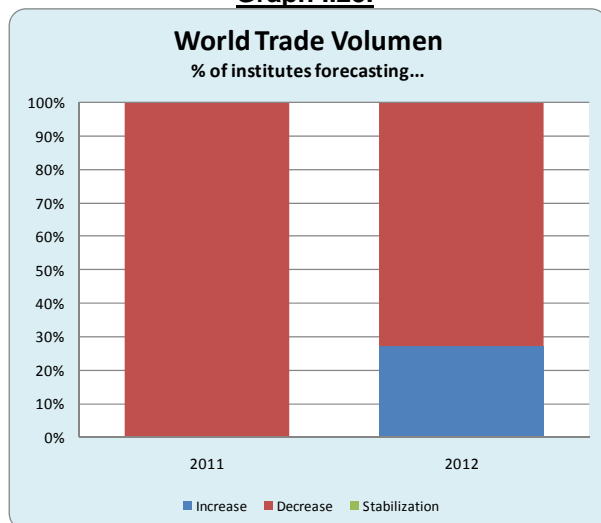
World trade volume of goods will decrease in 2011, and there's unanimity in this forecast and for the majority of Institutes and the IMF, this will also decrease in 2012 (Graph 22).

Graph I.22.



Source:AIECE, April 2011

Graph I.23.

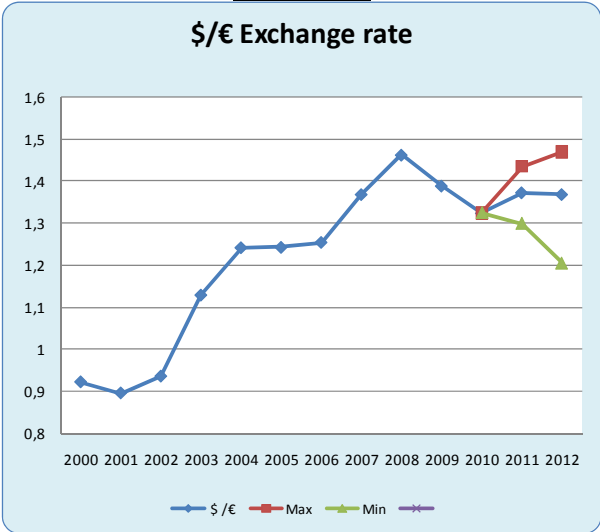


Source: AIECE, April 2011

b) Exchange rates.

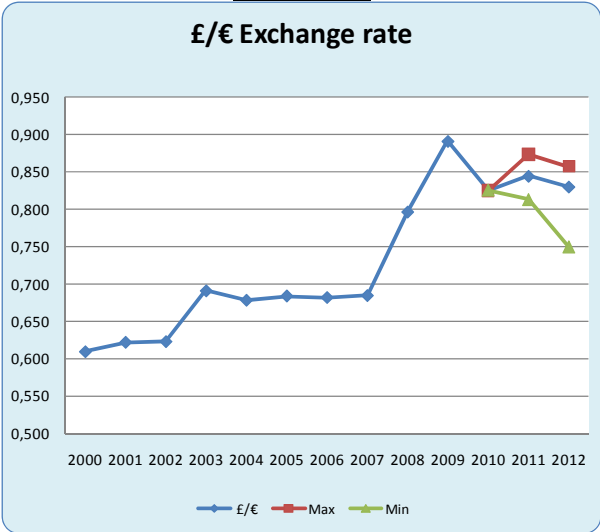
There is significant disagreement on the Dollar/Euro exchange rate as the opinions are closely split between those Institutes that forecast an appreciation and those which forecast depreciation, with a disagreement which is smaller for 2012 than for 2011.

Graph I.24.



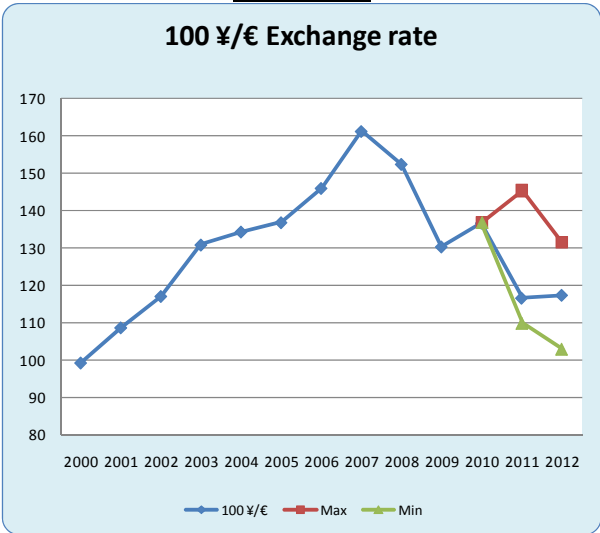
Source:AIECE, April 2011

Graph I.25.



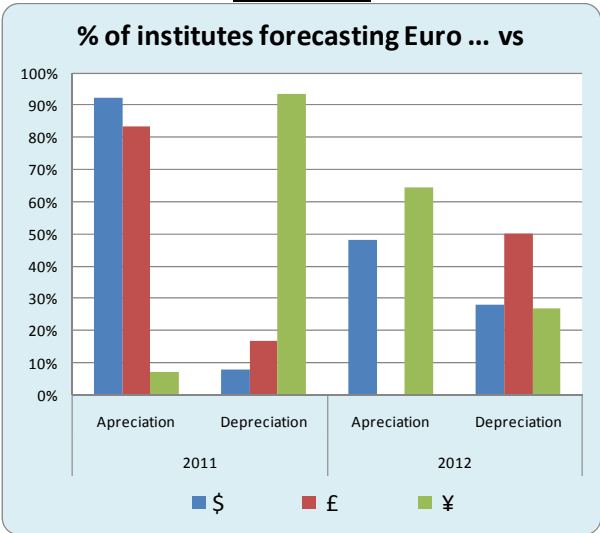
Source: AIECE, April 2011

Graph I.26.



Source:AIECE, April 2011

Graph I.27.



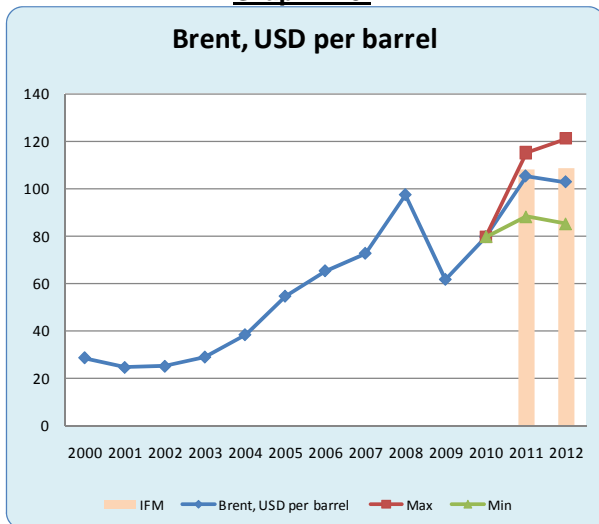
Source: AIECE, April 2011

Furthermore, there is disagreement on the Pound/Euro exchange rate for 2011, though the majority of Institutes forecast an appreciation and for 2012 most consider depreciation. Finally, for the Yen/Euro exchange rate, the majority forecast depreciation in 2011, with an opinion split for 2012.

c) Oil Prices.

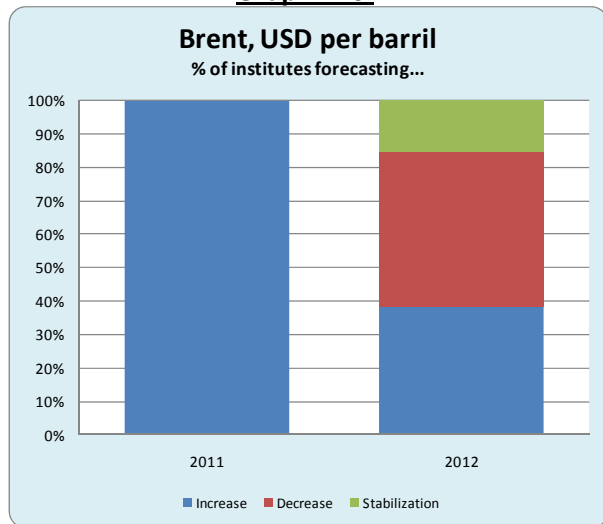
All the Institutes forecast an increase in the price of Brent in 2011, with divided opinions for 2012, with a minority forecasting stabilization and a remaining split between an increase and a decrease.

Graph I.28.



Source:AIECE, April 2011

Graph I.29.

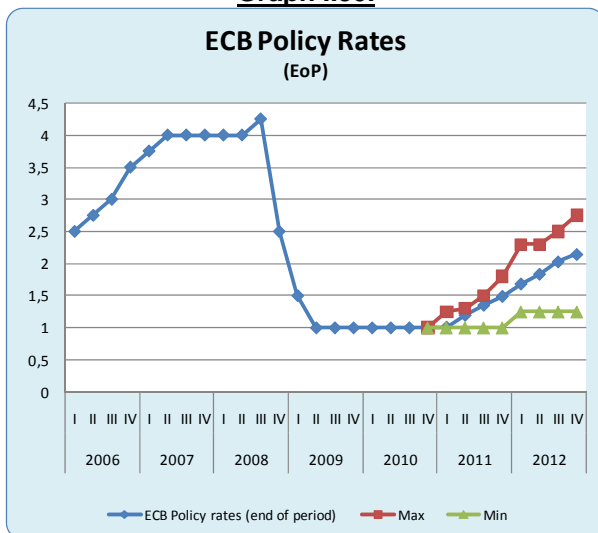


Source: AIECE, April 2011

d) Interest rates.

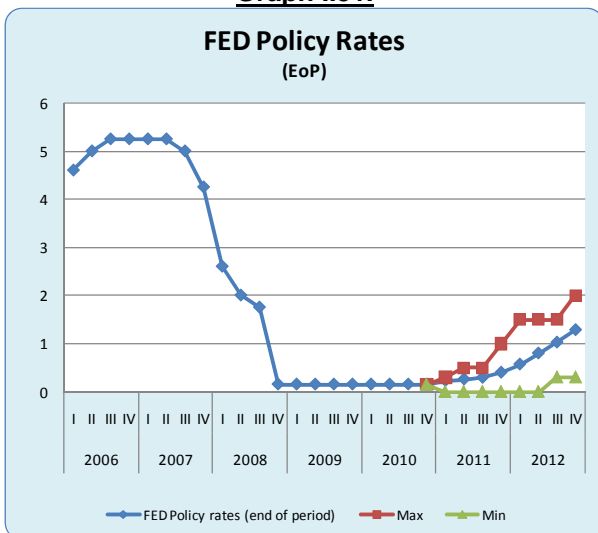
Regarding interest rates, the majority of Institutes consider that both the ECB and the FED will increase their rates of intervention, moderately in 2011 and more intensely in 2012, yet the FED rate will be below that of the ECB.

Graph I.30.



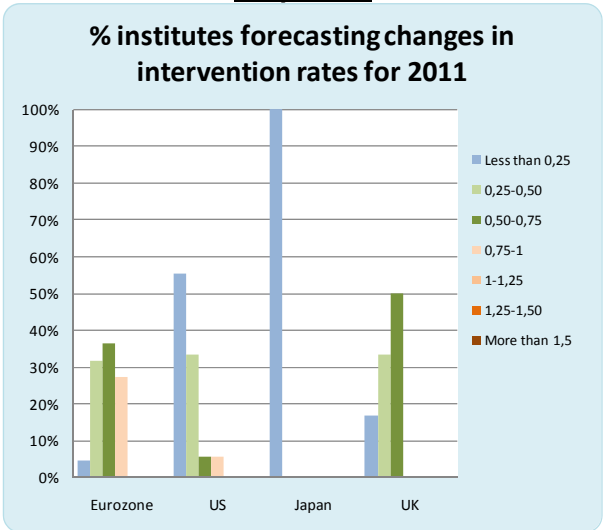
Source:AIECE, April 2011

Graph I.31.



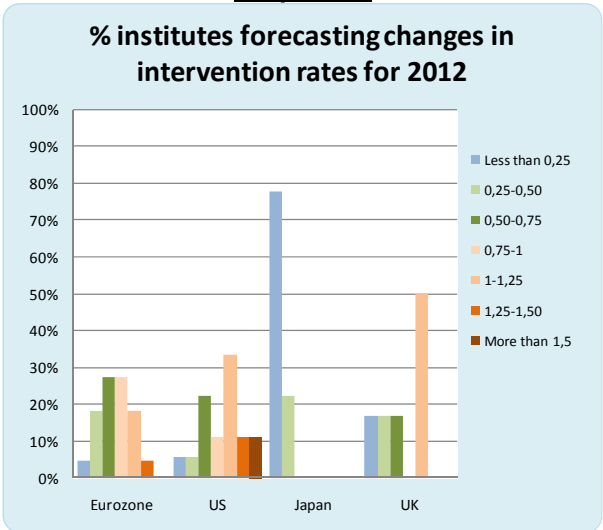
Source: AIECE, April 2011

Graph I.32.



Source:AIECE, April 2011

Graph I.33.



Source: AIECE, April 2011

I.3.- RISKS AND UNCERTAINTIES

To conclude this chapter, we will have a look at the main risks and uncertainties, as perceived by the international institutions and the Institutes surveyed.

a) The effects of Japan's disasters.

Some consider that the political consequences of potential nuclear disaster in Japan are unknown (CPB Netherlands Bureau for Economic Policy Analysis; DIW Berlin, Germany), or that the risk which stems from the disaster in Japan is difficult to quantify (WIFO, Austria). Again, the IMF analyses the implications for financial stability (IMF-Global Financial Stability Report, April 2011, Box 1.2) reaching the conclusion that financial stability risks seem manageable and limited to the area most affected by the natural disaster. Nothing is said about the impact of the failures of the Fukushima Daiichi nuclear plant on the energy policy of those countries with a high dependence on nuclear energy.

As an approach to the quantitative impact of the Japan disasters, the JPMorgan Global All-Industry Output Index (JPMorgan Global Manufacturing & Services PMI. 5 April 2011) fell sharply to a six-month low of 54.7 in March, but if the Japanese output index had stayed at its February level, the Global Output Index reading would have been 57.3 in March.

The OCDE in its latest Economic Survey of Japan (April 2011) says: "While it is still too early to assess the full extent of the damage, the immediate impact will be to reduce output, although this will later be reversed by reconstruction efforts. Deflationary pressures are likely to remain a headwind to growth." It quotes the Japanese government's first estimate, according to which it caused between 16 trillion yen and 25trillion yen of damage, substantially larger than the 9.6 trillion yen (2% of GDP) in the 1995 Hanshin-Awaji (Kobe) earthquake. "However, one unusual feature of the 2011 disaster is the reduced capacity of electricity generation, which creates uncertainty about the depth and length of the decline in output."

The open questions at this point could be the following:

- What is the explanation for the strong rise of the Yen during times of crisis?
- What will be the effects of the Japanese earthquake, tsunami and nuclear accident on the global economy particularly in terms of external demand, energy policy and energy prices?

b) Raw materials, in particular oil prices.

That political instability is a major risk of disruption of oil supply as mentioned by the following Institutes: CPB Netherlands Bureau for Economic Policy Analysis; National Institute of Economic Research, Sweden; Kopint-Tárki, Hungary; DIW Berlin, Germany; CSE, Sweden; WIFO, Austria; IBRKK, Poland; Institut für Weltwirtschaft Kiel, Germany. And the Institut für Weltwirtschaft Kiel states: a persistent increase of \$10 in the price of oil would reduce growth in the G7 by 0.3-0.7 percentage points, depending on the model used to estimate the impact.

The IMF considers that the degree of uncertainty has decreased since October 2010, yet downside risks have increased mainly due to the geo-political uncertainty caused by the current events of social unrest and war in the North Africa and Middle East (MENA) region. While inflation is expected to be higher, the key risk to growth is related to an increase in oil prices due to supply disruptions. The IMF devotes a full chapter of the WEO April 2011 to foreseeing the impact of an oil scarcity, suggesting that gradual and moderate increases in oil scarcity may not present a major constraint on global growth in the medium to long term. As for the effects on the global economy, "a sizeable downshift in oil supply trend growth of 1 percentage point appears to slow annual global growth by less than 0.25 percent in the medium and long term" (Pg. 90).

CEMEX Economics (March 2011) has also made an evaluation of the impact on oil prices of the social unrest in the MENA region, setting some potential risk scenarios, according to which "moving from North Africa to the Gulf makes a significant difference" (Pg. 13), the worst-case scenario being when

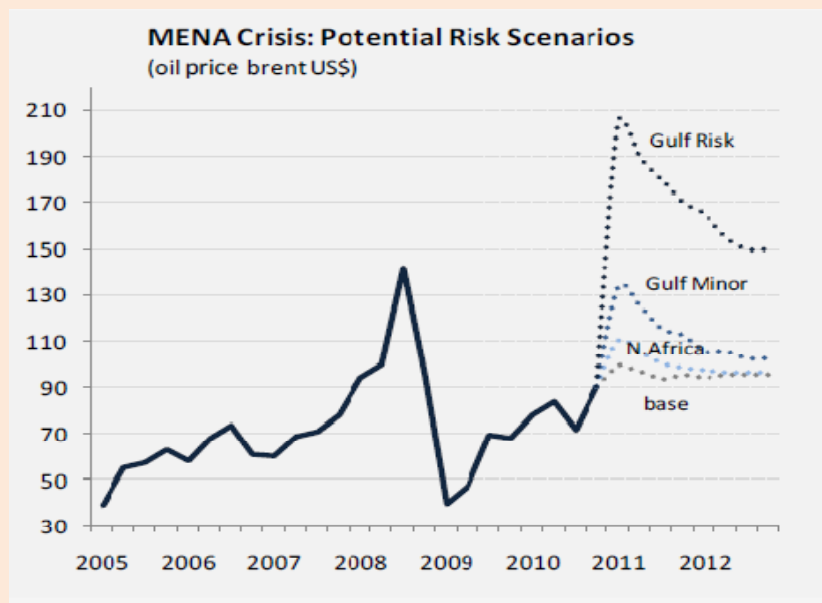
the disruption affects Saudi Arabia and Iran (the Gulf Risk) with the barrel price of oil moving to \$200 and the effect becoming more permanent (Box 1).

Finally, some Institutes mention the risk of increases in raw materials and food being triggered off by the strong expansion in Asia, and soaring inflation driven by strong demand for raw materials from developing countries is another risk to the baseline scenario (CSE, Sweden).

Regarding this issue, some opened questions have been proposed:

- If oil prices remain at current levels for the foreseeable future (until the end of 2012), to what extent could advanced countries face stagflation problems? How should economic policy makers react to these?
- What are the connections between monetary policy and oil (as well as other commodities)?
- Impact of the inflationary shocks in advanced economies.

Box 1. CEMEX Analysis of MENA Crisis



Source: CX Economics, March 2011.

To evaluate the impact on GDP, Cemex Economics uses the multi-country Oxford Economic Model, introducing oil price scenarios and an amplifier mechanism to take in account the chances of contamination due to other underlying problems in the world economy (a food prices crisis, the sovereign debt crisis and still weak banks' balance sheets being among the most important). In Table 2 we merely reproduce the impact on world GDP and the developed and emerging countries large world areas. In the worst-case scenario, a Gulf Risk, the impact on world GDP is 1.4 p.p. in 2011 and 1.8 p.p. in 2012, being higher for the emerging economies.

MENA Crisis - GDP Alternative Scenarios (%yoy)

	Baseline		North Africa		Gulf Minor		Gulf Risk	
	2011	2012	2011	2012	2011	2012	2011	2012
World IMF	4.4	4.8	4.3	4.8	4.0	4.4	3.3	3.0
Developed	2.5	2.8	2.4	2.8	2.1	2.4	1.4	1.2
Emerging	6.8	7.0	6.5	7.1	6.4	6.6	5.6	5.1

Source: CX Economics, March 2011.

c) Macroeconomic issues.

It is important to mention that in spite of the positive evolution of the activity since mid 2009, in the USA and the Euro zone there still exists a high negative differential between the effective and the potential level of GDP (IRES, Belgium).

While the recovery of the world economy has been stronger than expected, the risks have remained or even increased in recent months, triggered off by the strong expansion in Asia (WIFO, Austria).

Positive risks include a better than expected outcome in the US (DIW Berlin, Germany).

Open questions mentioned by institutes could be summarized as:

- Future trends in investments in the core EU countries, and expected trends in credits to companies, mainly SMEs.
- The trend in structural unemployment in high-unemployment countries such as Spain and Portugal.
- What could be the consequences if there are supply shortages and increases of raw materials and food prices for the global economic prospects and the European economy?
- Would the exchange rate movements contribute to reaching a new global economic balance or would they be rather used as a tool in "the war of currencies" aimed at temporarily fostering national economic growth and competitiveness?

d) Monetary policy.

Ultra expansive monetary policy in countries like the US and the UK also provides an upward risk to inflation (Statistics Norway).

The recovery currently depends on extremely loose monetary policy and, in the US, on renewed expansionary fiscal policy. The expected gradual tightening of monetary and fiscal policy is a risk (Federal Planning Bureau, Belgium).

Open questions:

- The path of monetary tightening in the Euro zone.
- When do we think that the BoE will hike rates?
- Will there even be another round of Quantitative Easing (QE1)?
- The impact of the end of Qualitative Easing (QE2) on funding rates in the US and on exchange rate.

e) Financial stability.

Regarding financial risks, the IMF considers that these have declined since October 2010, yet in the IMF- Global Financial Stability Report, April 2011, seven risks and challenges are identified:

- 1) The legacy in advanced economies of high debt burdens and excessive leverage, notably in the financial sector.
- 2) Not enough has been done in the reform of the banking system, as (financial) "markets" remain concerned that some banks are too highly leveraged and have insufficient capital given the uncertainty about the quality of their assets.
- 3) Sovereign funding, related to concerns about the sustainability of public debt, though the IMF doesn't pay attention to the lack of rational foundations of the vulnerability indicators.
- 4) The pressure on households and firms, as more structural policies are needed to reduce the debt burden of households (though the IMF only makes reference to the U.S.), and "weakness persists in parts of the corporate sector of advanced economies, especially among small and medium sized firms and in the commercial real estate sector" (Pg. 22).
- 5) The macro and stability implications of capital inflows into emerging markets, "at a time when their output gaps are closing and their inflation rates are rising." (pg. 27).
- 6) Accommodative monetary and financial conditions helped ease balance sheets strains and support an increase in risk appetite.
- 7) The agenda of regulatory reforms has unfinished business: "real progress is needed in areas where much has been said but less has been accomplished" (Pg. 53), though nearly nothing

is said about the regulation of the rating agencies, a fully unregulated oligopoly of which the only concern for the IMF is that produces “procyclicality”.

Amongst the concerns expressed by the Institutes, the continued vulnerability of banks and the possibility of sovereign default(s) in Europe have been mentioned (CPB Netherlands Bureau for Economic Policy Analysis). The unsustainable sovereign debt situation in some countries, notably in some peripheral euro zone countries (which taken to the limit could cause a banking crisis in Europe) is also mentioned (National Institute of Economic Research, Sweden). In the same vein, some mention that the main risks for the outlook pertain to the developments in the context of the Euro area debt crisis (DIW Berlin, Germany), as the debt crisis in Europe continues to be a threat to the ongoing recovery (CSE, Sweden). Public finances are over-stretched and housing markets in the US and some European countries appear to be still fragile (WIFO, Austria).

The situation of the banking sector across the EU, and perceptions of the likely impact of the Basel 3 regulations, has been marked as an open question by some institutes.

f) Open questions.

Taken in account the suggestions by the Institutes, we will set a group of questions that will allow us to employ our question device. We have also included the main results of the answers obtained during the meeting.

Will rising global imbalances lead to real protectionism?

- Yes.
- Yes, but only in emerging and developing countries.
- No.
- Other (please, comment).

Nº of answers: 29

1 - Yes



2 - Yes, but only in emerging and developing countries.



3 - No



4 - Other (please, comment).

0%

Is the volatility of exchange rates going to persist over the forecast period?

- Yes.
- No.
- Don't know.
- Other (please, comment).

Nº of answers: 28

1 – Yes.  86%

2 – No. 0%


3 – Don't know.  14%


4 – Other (please, comment). 0%

What are the prospects for restraining the rise in world prices of energy and foodstuffs in the medium term?


- Prices will continue rising due to the Asia growth.
- Prices will stabilize next year (2012).
- Prospects are uncertain.
- Prices will decrease as soon as inventories are rebuilt.
- Other (please, comment).

Nº of answers: 29

1 - Prices will continue rising due to the Asia growth.  41%

2 - Prices will stabilize next year (2012).  24%

3 - Prospects are uncertain  24%

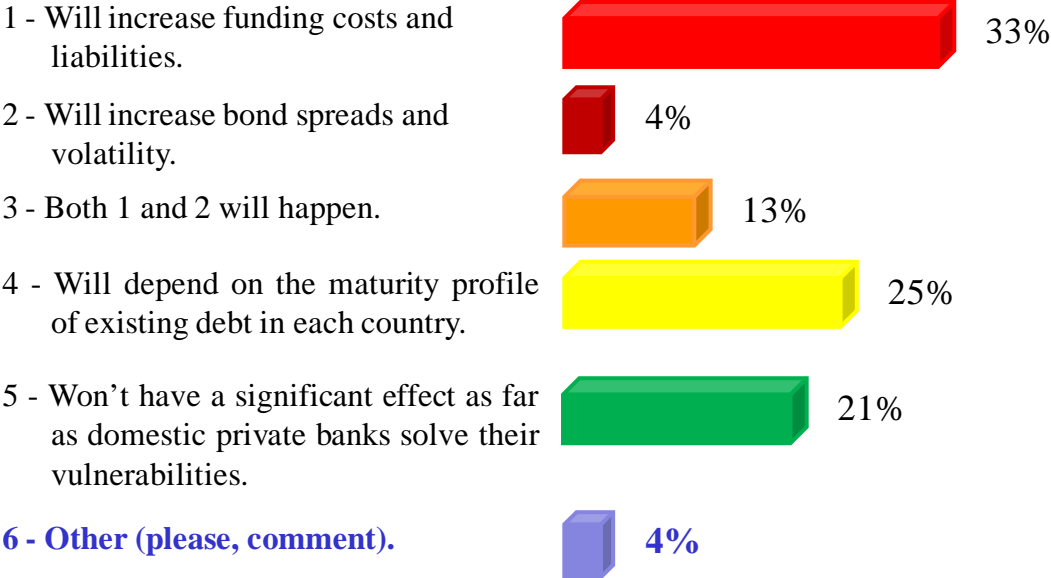
4 - Prices will decrease as soon as inventories are rebuilt.  7%

5 - Other (please, comment).  3%

How would rate rises by central banks affect government securities markets?

- Will increase funding costs and liabilities.
- Will increase bond spreads and volatility.
- Both A and B will happen.
- Will depend on the maturity profile of existing debt in each country.
- Won't have a significant effect as far as domestic private banks solve their vulnerabilities.
- Other (please, comment).

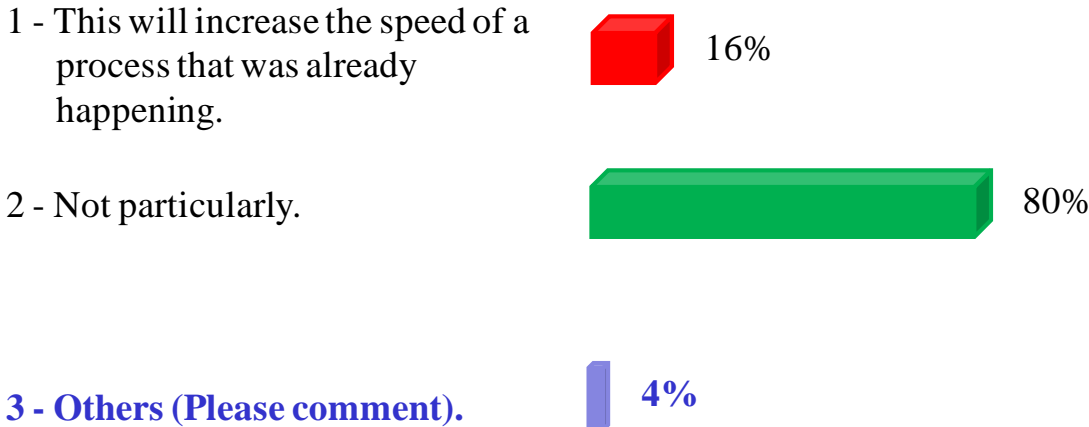
Nº of answers: 24



What are the long-term effects of the earthquake and its consequences on "globalisation"; will companies decide to keep more stocks to prevent the kinds of disruptions they have experienced as a result of the earthquake, and will they modify their sourcing strategies?

- This will increase the speed of a process that was already happening.
- Not particularly.
- Others (Please comment).

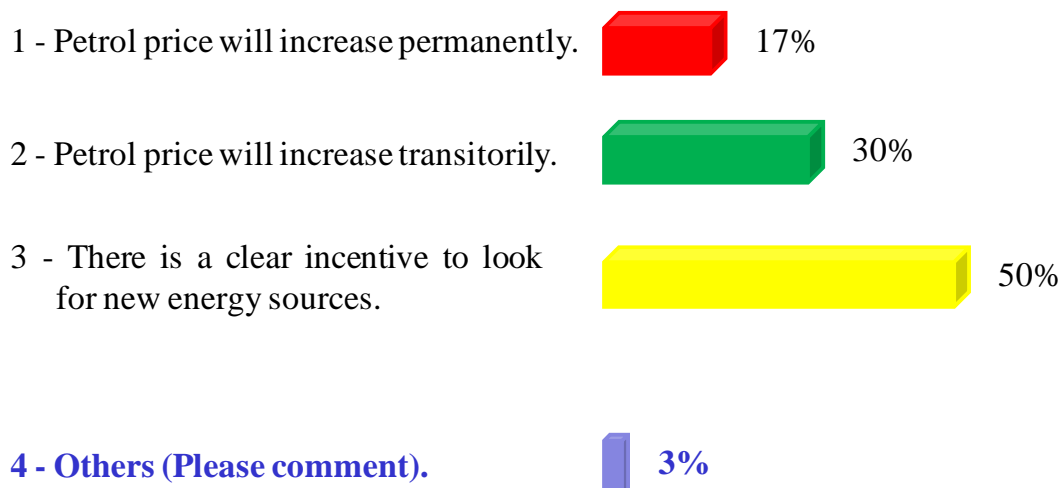
Nº of answers: 25



What will the impact be on energy markets in the long run, notably in oil-dependent emerging economies?

- **Petrol price will increase permanently.**
- **Petrol price will increase transitorily.**
- **There is a clear incentive to look for new energy sources.**
- **Others (Please comment).**

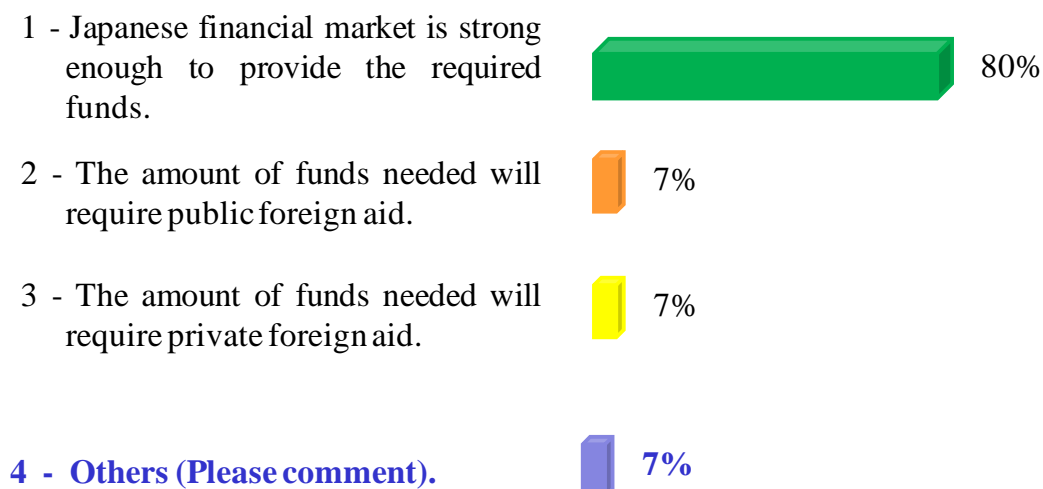
N° of answers: 30



To what extent will the financing needs of the Japanese reconstruction efforts require the injection of additional liquidity from the international financial markets?

- **Japanese financial market is strong enough to provide the required funds.**
- **The amount of funds needed will require private foreign aid.**
- **The amount of funds needed will require private foreign aid.**
- **Others (Please comment).**

N° of answers: 30



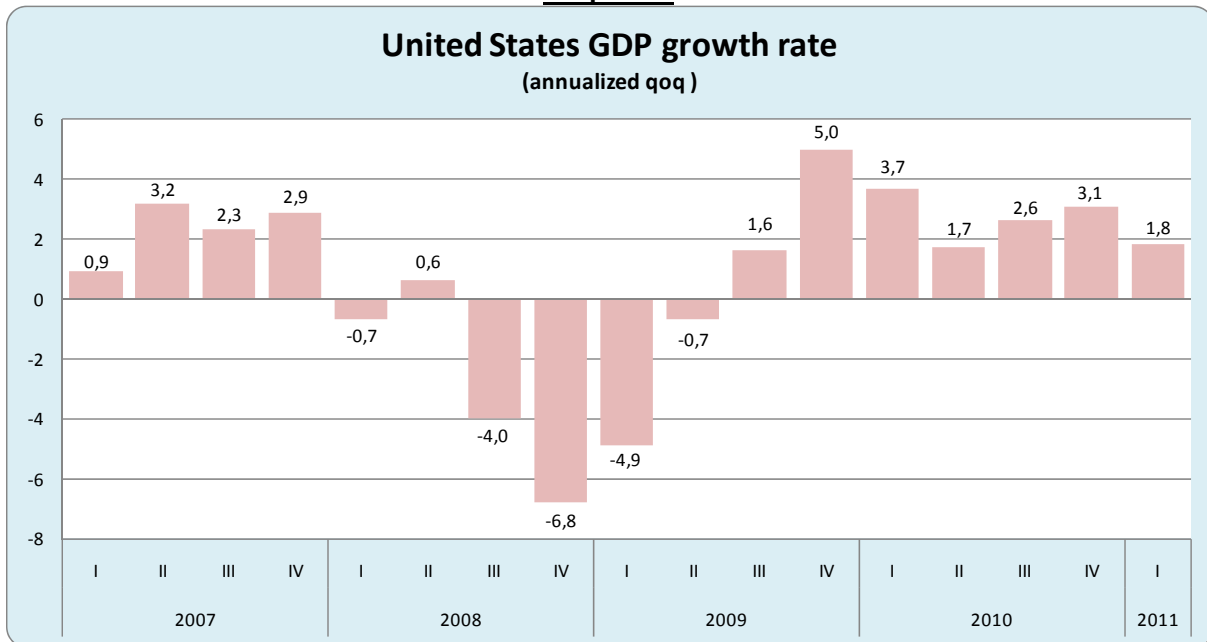
Section II.- INTERNATIONAL SITUATION .

II.1.- RECENT TRENDS

a) United States.

The economic activity of the United States stabilized half way through 2009. After that, the American economy has been growing continuously over the last six quarters. In the last quarter, accumulated GDP growth has exceeded the levels prior to the crisis. However, employment growth continues to be weak and the unemployment rate is still relatively high.

Graph II.1.



Source: US Bureau of Economic Analysis. April 2011.

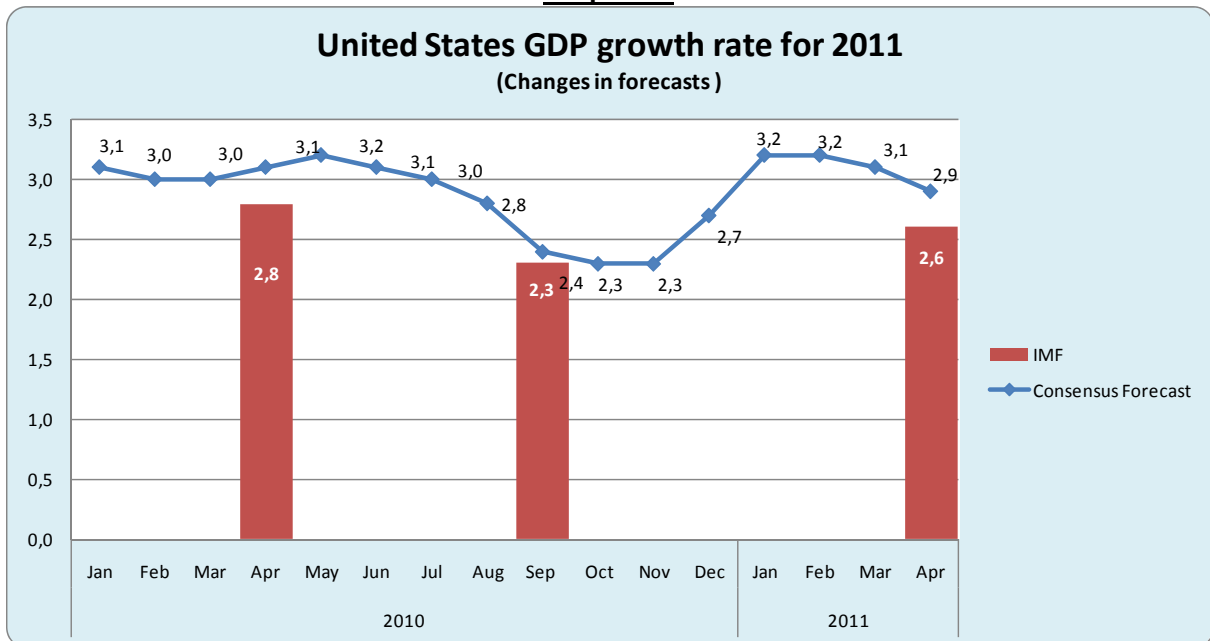
Public income was reduced substantially as a result of the deep recession in 2008 and 2009 and the weak initial recovery. Both local and federal public income was reduced. An increase in public deficit took place. As a result of this, both state and local government had to reduce expense programmes and public sector employment. The effect of the recession in 2009 was a drop in income of around 12%. However, during the first nine months of 2010, fiscal income of the states increased by 3% in the United States. This relatively modest growth, albeit positive, reflects the start of the economic recovery.

The recovery of the economy in 2010 was a result of the stabilisation of the financial system, the effects of monetary and fiscal policy and the strong boost in investment in enterprises, which allowed them to recover their pre-crisis inventory levels.

Economic growth slowed down in the first half of 2010 and recovered in the second half of the year. In the first half of the year, fiscal stimulus and investment in residential construction lost steam, at the same time as the debt problems in Europe was shaking world financial markets. During the second half of 2010 consumer expenditure and business investment in capital goods has grown at a sustained pace in the United States. Robust foreign and domestic demands have enabled a constant growth rate for manufacturing production in the United States.

The rhythm of growth for 2011 is better than expected. According to the Chairman of the Federal Reserve Bank, Ben Bernanke, the more recent forecasts include a growth rate of 4% GDP, increasing by half a point his previous forecasts, made in November 2010.

Graph II.2.

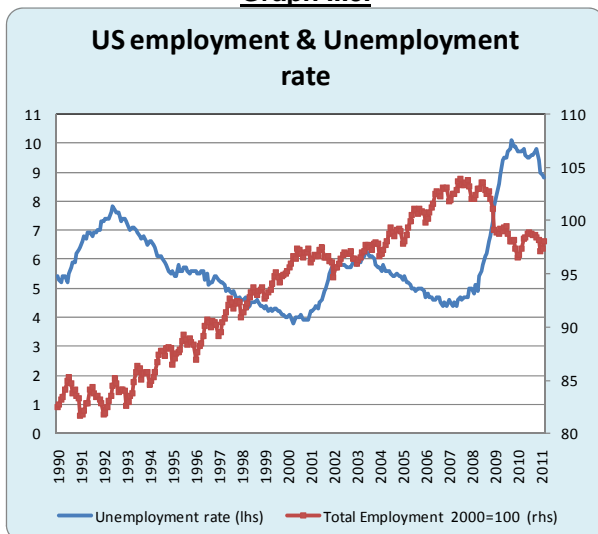


Source: Consensus Forecast and IMF WEO.

The reasons for the improvement in forecasts are firstly, an improvement in prospects for households and enterprises. Secondly, a monetary policy of low interest rates focused on growth and thirdly, an improvement in the conditions of banking credit, as a consequence of the improvement in prospects and the monetary stimuli measures of the Federal Reserve Bank.

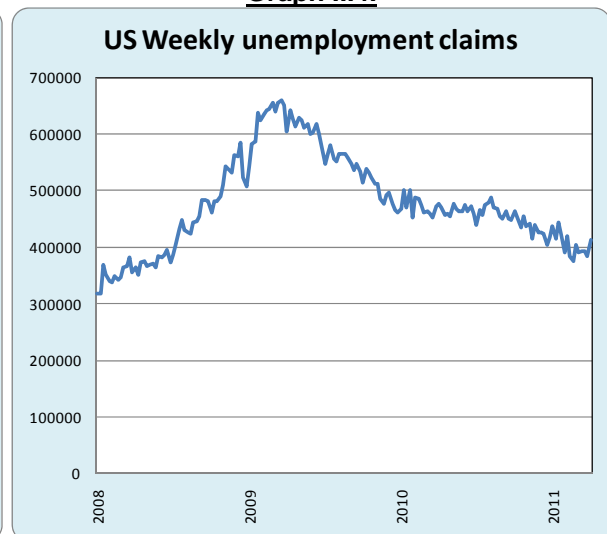
The labour market is the most outstanding problem of the American economy. Between the start of 2008 and 2009, 8.75 million jobs were lost. Moreover, since the start of the economic recovery only one million jobs have been recovered. In March, 2011, the unemployment rate was 13.5 million persons and the unemployment rate dropped to 8.8%. The year-on-year reduction in unemployment is 1.4 million persons, reinforcing an unemployment rate for 2011 below 9%.

Graph II.3.



Source: OECD. April 2011

Graph II.4.

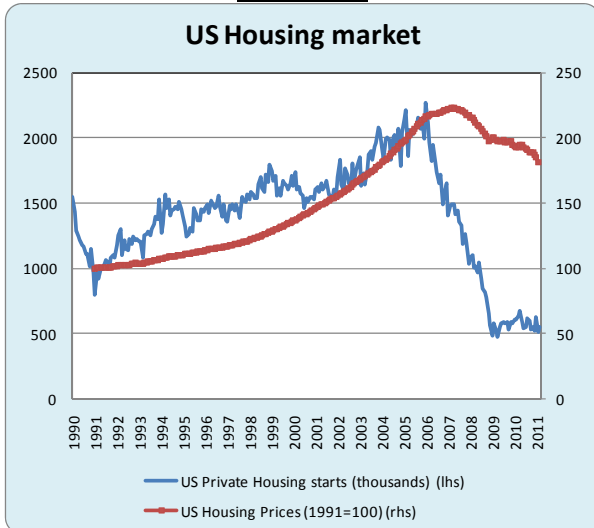


Source: US Department of Labor, April 2011

Unemployment grew significantly when the financial crisis started and the loss of employment intensified when the financial crisis affected the real economy. Unemployment is one of the objectives of the American governments, and the voters penalize the political parties whose policies give rise to higher unemployment rates. The Obama Administration immediately adopted expansive fiscal policies in order to diminish the rate of job destruction. This policy was accompanied by monetary expansive policy.

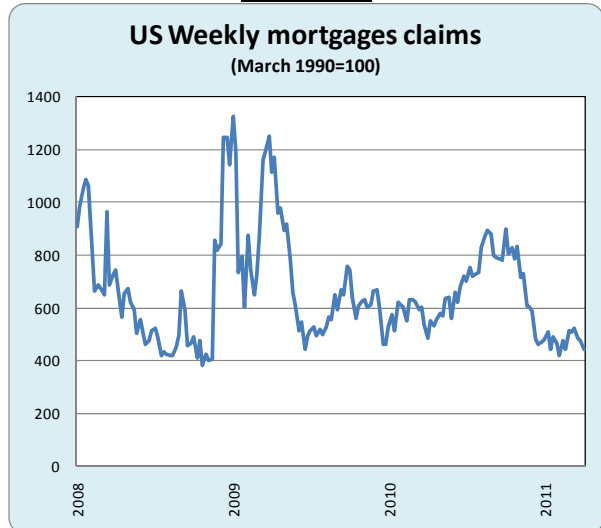
With the same ease as the American economy has to destroy employment, the labour market is able to create employment. For that reason, unemployment rates are expected to be consistently one figure rates.

Graph II.5.



Source: US Department of commerce. April 2011

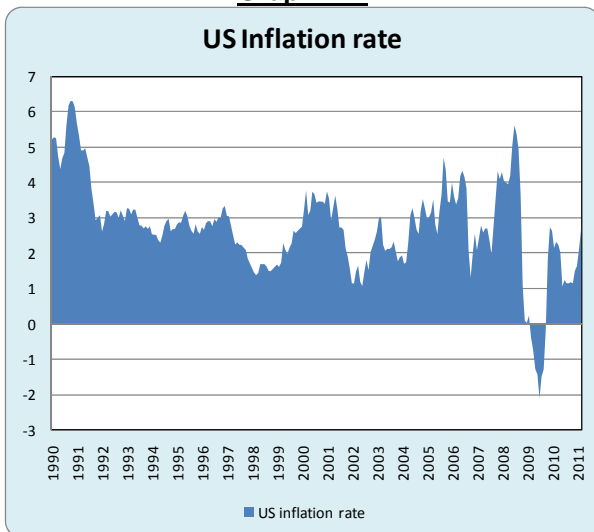
Graph II.6.



Source: MBA – Mortgage Bankers Ass. April 2011

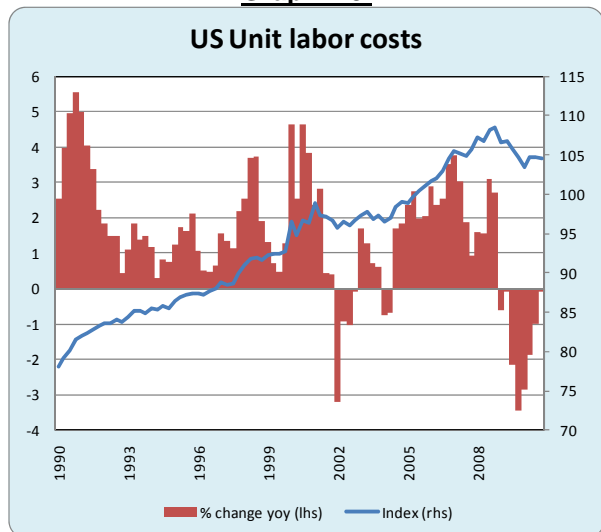
The residential construction sector continues to be particularly weak and the prices of new housing remain low. Despite low interest rates and other monetary measures, it is still difficult to obtain mortgages for the general public.

Graph II.7.



Source: US Bureau of labor statistics. April 2011

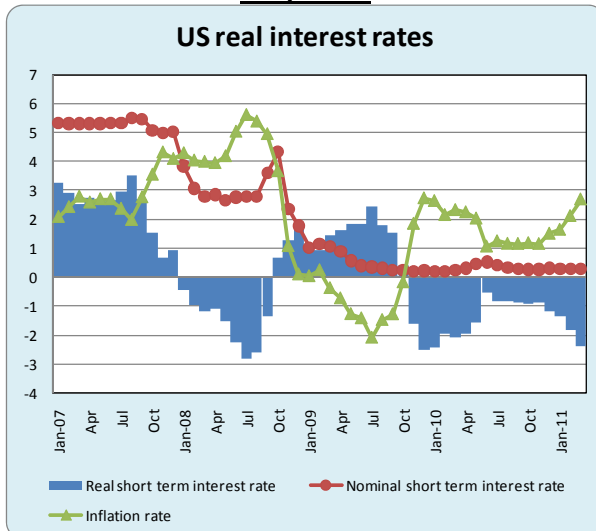
Graph II.8.



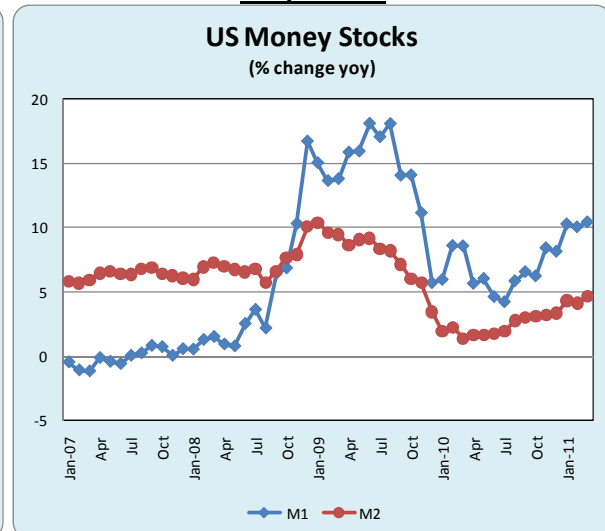
Source: US Bureau of labor statistics. April 2011

On the whole, Inflation has decreased since the onset of the financial crisis. This reflects the low levels of utilisation of production capacity and also the prospects of low inflation in the long term. The prices of household consumption increased to 1.2% in 2010, in contrast to the 2.5% drop in the previous year.

Unit product labour costs have remained stable because the low growth of salaries per hour by 1.9% has been balanced by the increase in productivity. The main forecasts for inflation are between 1.25% and 1.75% for the current year and the range widens for the upcoming year of between 1% and 2%.

Graph II.9.

Source: OECD and US Bureau of labor statistics. April 2011

Graph II.10.

Source: US FED April 2011

The Monetary policy adopted by the Federal Reserve Bank over the past two years has been very accommodative and lax, injecting liquidity in the system via the purchase on the open market of longer-term Treasury securities, agency debt, and agency mortgage-backed securities (MBS). The most important purchasing programme, lasting from December 2008 to March 2010, has clearly contributed to an improvement of financial conditions and a strengthening of the economic recovery. The extension of the programme announced in March 2009 increased financial and economic stability, allowing a significant growth in economic activity at the end of 2009.

Given the concerns regarding the possibility of a double dip in economic recovery, in August, 2010, the Fed authorised a policy of reinvesting principal payments in its holdings of agency debt and agency MBS into longer-term Treasury securities, which has increased liquidity in the system.

In November 2010, the Fed announced its intentions to repurchase a further \$600 billion in longer-term Treasury securities throughout 2010.

In order to judge the monetary policy followed by the Federal Reserve Bank, we have to consider that it has been using not only a reduction in interest rates but also large purchasing operations in long-term securities. This has the same effect of quantitative monetary easing as a conventional monetary policy. On the whole, it seems that the Fed has achieved the objective of encouraging economic recovery.

The official forecasts of the US Congressional Budget Office⁶ situate growth of the American economy at 2.7% for 2011 and 3.1% for 2012.

Table II.1.
CBO's Economic Projections for Calendar Years 2010 to 2021

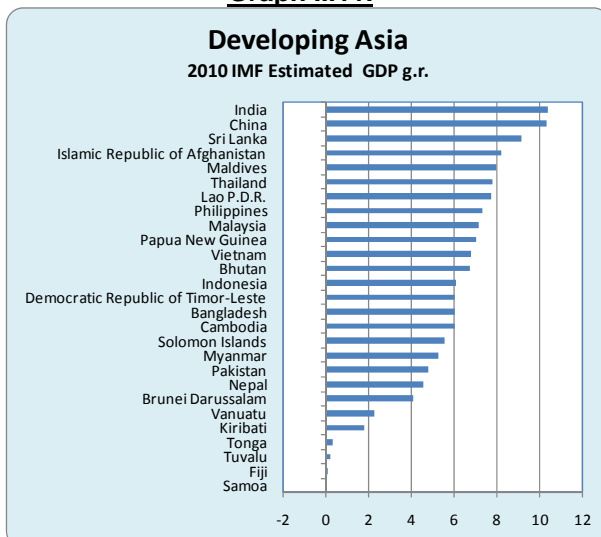
	Estimated,	Forecast		Projected annual average
	2010	2011	2012	2013-2016
Unemployment rate	9,6	9,2	8,2	5,3
	Year on Year (Percentage change)			
Real GDP	2,8	2,7	3,1	3,4
PCE Price Index	1,8	1,3	1,2	1,7
Core PCE Price Index	1,4	1,0	1,1	1,6
Consumer Price Index	1,6	1,6	1,3	1,9
Core Consumer Price Index	1,0	0,9	1,0	1,8
GDP Price Index	0,9	0,9	1,3	1,7
Nominal GDP	3,8	3,7	4,4	5,1

Independent analysts are more optimistic⁷, situating growth rates for the American economy at 3.1% for the current year and 3.3% for the next year.

b) Asia.

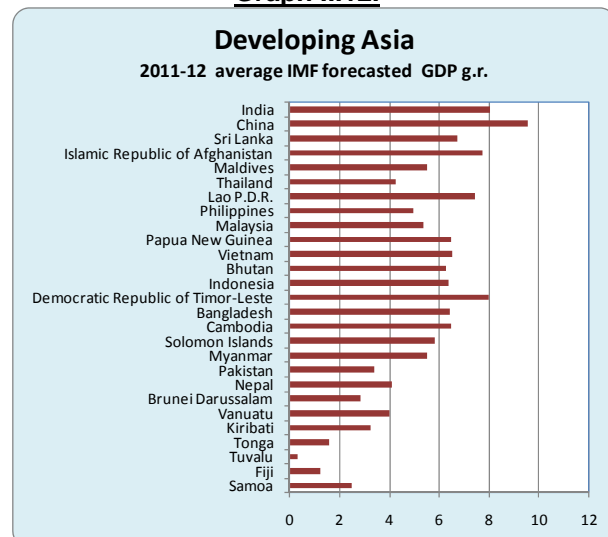
In 2010, the growth of this region was surprisingly strong, with a real GDP growth of 9.6%. A wide range of countries participated in this growth: six developing countries in Eastern Asia grew at a rate of 7% or above during 2010. This was due to the expansive fiscal and monetary policies which were undertaken in 2009 and 2010. Growth in exports to developed countries also contributed to this growth. For the upcoming years, real growth of GDP is expected to remain strong; around 8% for both 2011 and 2012.

Graph II.11.



Source: IMF WEO April 2011

Graph II.12.



Source: IMF WEO April 2011

⁶ Outlook for the Economy and the Budget. February 24. CBO Director Doug Elmendorf's presentation to the National Economists Club.

⁷ Consensus Forecast. March 14, 2011.

The greatest challenge for 2011 will be the inflationary upturn. This is of particular concern for the countries with medium incomes of Eastern Asia, where expansive monetary policy has led to price increases in food and basic goods. Furthermore, the increase in energy and commodities prices has consolidated inflation figures.

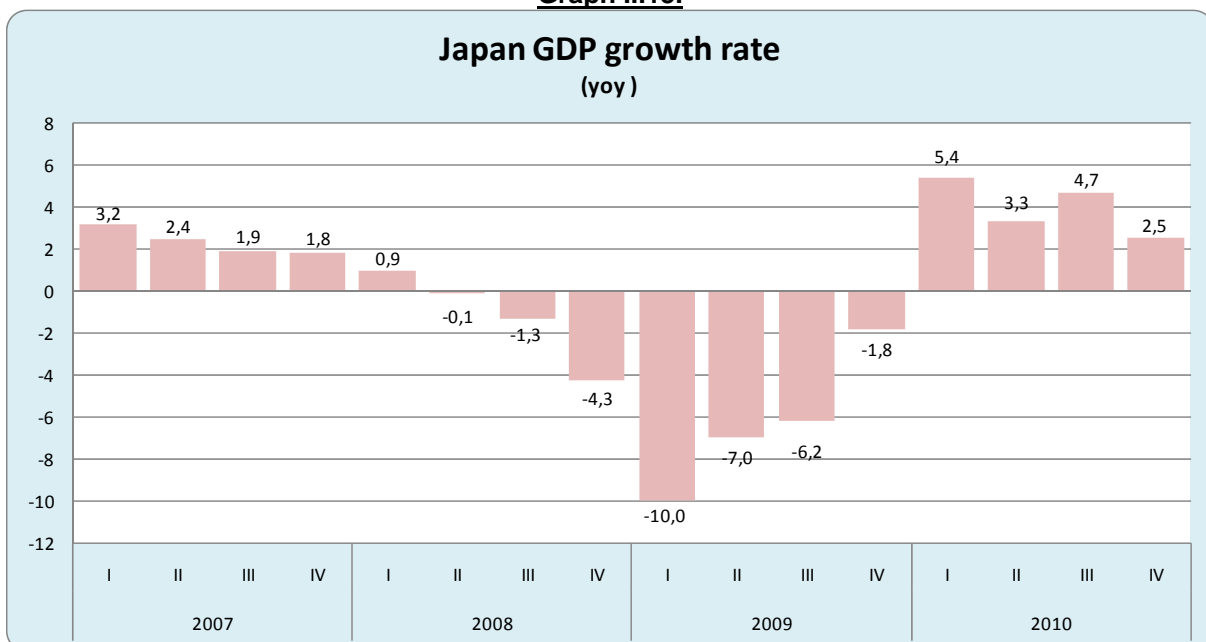
The region has to face important challenges in the mid-term. These involve the improvement of regional economic integration, the reduction of economic inequalities, and environmentally friendly production and consumption targets.

The earthquake and the following tsunami in Japan on the 11th of March 2011 will serve as a reminder that one of the greatest challenges facing Asia is its vulnerability for coping with natural disasters. Asia covers half of the world's surface, housing 59% of the world population and it suffers more than 70% of the world's natural disasters. The urban centres of Eastern Asia, where increasing amounts of production and population are concentrated, live under the threat of extreme weather conditions and rising sea-levels as a consequence of climate change. Moreover they risk human pandemics due to the poor standard of living in these areas. These countries should work towards building resistant cities with innovative technologies in order to face natural disasters. They also have to ensure environmental sustainability, to avoid climate change as far as possible and, in the meantime, to adapt to the consequences of this climate change. Moreover, it is important to improve the hygienic and sanitary standards for the poorest segments of the population.

A major concern in the short-medium term in this region is the possible appreciation of the Yen following the 11th of March. Approximately a quarter of the long-term debt in Eastern Asia is nominated in Yens. The aforementioned debt in Yens ranges from 8% in China to 60% in Thailand. Therefore, each time the Yen appreciates by 1%, debt servicing increases by \$250 million in the nominal debt in Yens of these countries.

For the last twenty years, Japan has been immersed in a period of reduced growth, the smallest rate of accumulated growth in the OECD countries. The average accumulated growth of its GDP has been 1.5% during this period. The explanation for this low level of growth has been weak domestic demand in Japan.

Graph II.13.

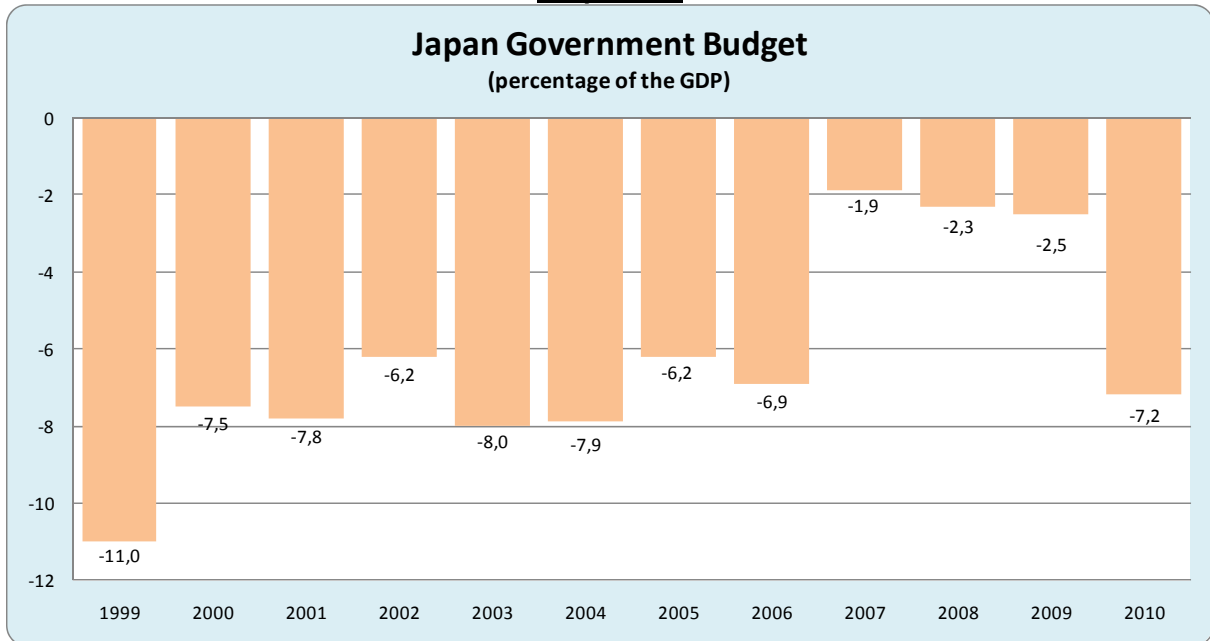


Source: OECD April 2011

The effects of the international financial crisis of 2008 and 2009 became apparent in Japan at the beginning of 2008. However, the Japanese economy showed an outstanding strength, exiting the recession in 2010 with the largest growth rate of the G7 group, obtaining a noteworthy growth rate of 3.9%, the highest level since 1991. Indeed, domestic demand was the growth engine last year, with a growth of private consumption of 1.9%, the strongest rate that Japan had seen in recent years. In spite of this, unemployment is still high at a rate of 5.1%.

An important inconvenience for the Japanese economy in this period has been its notable public deficit. The public debt in Japan, as a percentage of GDP, almost doubles it (196.4%), a record for developed countries in 2010.

Graph II.14.



Source: Japan Ministry of finance.

Japan suffered a huge disaster on the 11th of March with an earthquake followed by a tsunami. The effects of these provoked a nuclear disaster, the consequences of which remain unknown. To date, Fukushima rivals Chernobyl in the ranking for the worst nuclear accident in history. The figures, which are still provisional, talk of 13,000 dead and 15,000 missing persons. Moreover, the economic costs are estimated to be around 220 billion Euros, the equivalent of 5.7% of Japan's GDP. These estimates may worsen when economic damages are completely quantified.

It seems apparent that the impact on the logistic capacity of the country will be very serious and will cause a problem of electricity supply, which in turn will negatively affect economic activity. The negative consequences will be present throughout 2011. The automobile and electronic industries are currently experiencing severe difficulties, which affect the figures for March and April. What remains to be seen is the situation in the upcoming years.

Despite the difficulty of being able to make a complete evaluation of the natural and nuclear disaster, what is clear is that **historically Japan has been able to overcome** the effects of natural and artificial disasters. Without having to go back to the period reconstruction after the Second World War, the experience of the earthquake in Kobe in 1995 allows us to be optimistic.

The **earthquake of Kobe** suffered in 1995 reached the level of 7 on the Richter scale (less than the recent earthquake) and led to damages which amounted to more than 2% of the Japanese GDP. Some of the behaviour that took place in Kobe may occur today. Firstly, we can expect a strong

decline in production for two reasons; the first and inevitable one is the damages suffered by the infrastructures and the productive system. The second one, that the Government is trying to avoid today, in the light of the experienced obtained in Kobe, refers to the increase in value of the Yen due to the massive repatriation of foreign capital needed to initiate the reconstruction as soon as possible.

The current declarations of the Government expressing that they will face the costs of reconstruction try to maintain Japanese capital abroad instead of encouraging the repatriation given the negative effects it would have on the currency and the trade balance. After the earthquake in Kobe, Japanese trade decreased for less than a year. A year later, imports were the same as before the earthquake and exports reached 85% of levels prior to the earthquake.

The bill of the expansive fiscal policy in order to recover the previous level of activity was estimated around 5 trillion Yen (which represented 1 percentage point of the Japanese GDP in 1995). Today's bill has yet to be fully known, however, we could foresee an important programme for the reconstruction of the infrastructure after Japan's Tsunami disaster. On the monetary front, the Bank of Japan doubled the asset purchasing programme that forms part of its comprehensive easing strategy from ¥5 trillion to ¥10 trillion at the monetary policy meeting immediately after the earthquake on March 11.

A remaining doubt on a global level is how to face an energy programme after having experienced a nuclear catastrophe such as the one which has taken place in Japan. On the one hand, those in favour of nuclear energy uphold that it is very difficult to find such a reliable test for the complete security of a nuclear power station. On the other hand, those who are against nuclear energy maintain the idea that not even a sophisticated and technologically developed country such as Japan has been able to defy successfully the natural challenges that the earth presents it with.

We expect that the real GDP growth in 2011 will slow down. The endeavours for reconstruction, a lax monetary policy and the sustainability of foreign market clients will make this slow down a temporary one.

There are two important concerns on the horizon. The Japanese fiscal policy will continue to increase Japanese debt and nuclear energy has to be reconsidered in terms of security and collateral effects.

The first analyses undertaken⁸ estimate an impact on GDP growth for Japan in 2011 between -3 and -5 percentage points. Given that these analysts expect a growth of the Japanese economy of around 2%, this means that the Japanese economy will drop to between -1% and -3% by the end of 2011. These forecasts implicitly consider that the nuclear problem will be controlled in a short space of time. On the other hand, these forecasts do not assume any increase in activity due to the reconstruction programme to be undertaken.

Other analysts are less pessimistic and reduce the economic effects to the first part of 2011, reducing the growth for the first quarter of 2011 by between 0.2 and 0.6 points and between 0.5 and 1.4 percentage points for the second quarter of the current year⁹.

As a reference point which allows us to stand back from the consequences of Japan's tsunami, it could be convenient to remember the economic forecast made prior to the earthquake of the 11th of March. The average forecast of GDP growth for 2011 was around 1.5% and around 2.1% GDP growth for 2012¹⁰.

According to data from the National Bureau of Statistics of China, the Chinese economy grew by 10.3% in 2010; with growth of added value of the industrial sector at 15.7%, more than triple the growth of the previous year (4.7%). China's GDP was 39.8 trillion Yuan (5,879 billion US dollars). Therefore, China's

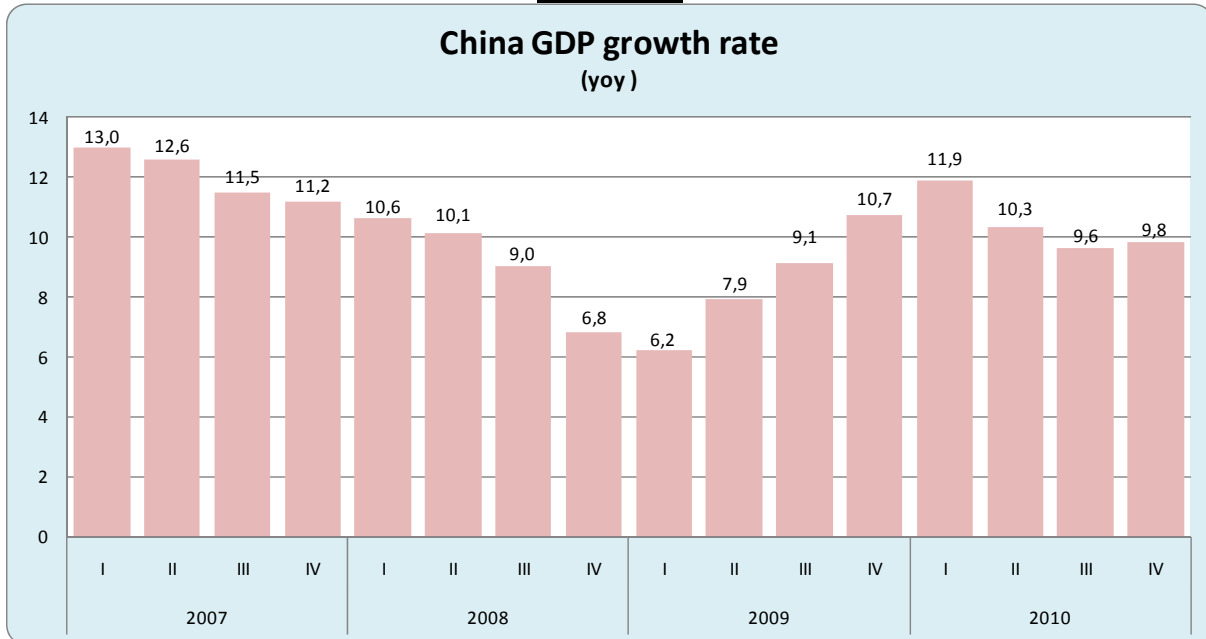
⁸ **Assessing Post-Quake Economic Path & Policy Responses: Tankan Preview.** March 18, 2011 . By Takehiro Sato, Tokyo. Morgan Stanley Global Economic Forum.

⁹ The Tohoku Pacific earthquake: Economic consequences. OECD. Paris, 15 March 2011.

¹⁰ Consensus Forecast. March 14, 2011.

economy undoubtedly occupies the second place in the world economy. The Chinese economy has clearly recovered from the international financial crisis, partly due to its successful fiscal stimuli programme of 4 trillion Yuan, initiated in 2009.

Graph II.15.



Source: TradingEconomics.com National Bureau of Statistics.

The IMF foresees that the Chinese economy will grow by 9.6% in 2011 whilst the OECD forecasts a growth of 9.7%, more than double world economic growth estimates for the same year.

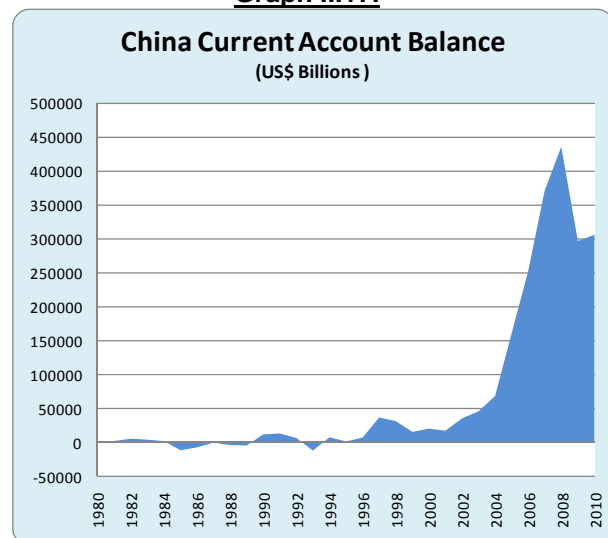
In December 2010 Chinese inflation was at 4.6%, 0.5 percentage points below the level in November. Concerned about price increases, the Chinese government will probably apply a tighter monetary policy, with obvious negative consequences on growth. It would seem that the Chinese authorities choose to control price levels in the unemployment-inflation trade-off, due to the dependence of the Chinese economy on foreign trade.

Graph II.16.



Source: China Bureau of Statistics. April 2011

Graph II.17.



Source: IMF WEO April 2011

The official objective of the Chinese government is to control inflation levels at 4% for 2011. However, this appears to be a difficult task; in February, inflation was already at 4.9%. Other analysts, such as JP Morgan Chase & Co. and Morgan Stanley, foresee an inflation level above 5% at the end of the year. This economic outlook does not take into account the effects on the price of petrol caused by the accident in Japan and the North African unrest.

The growth of the Chinese economy during the past 30 years has been absolutely spectacular. Chinese growth has been based fundamentally on the huge export capacity of its economy. The Chinese trade surplus has been sustained since the start of the nineties, of the last century.

The key question is whether these growth rates are sustainable in the medium term. It is clear that growth sustainability in the long run in China is related to the balance between growth in the export sector and the domestic economy; in how to develop from growth based on investment to one based on private consumption; in how to pass the development drive from enterprise to households; and geographically speaking, how to pass growth from the developed areas in the coastal provinces to growth in the central and eastern provinces of this country. In short, for being sustainable, Chinese growth has to be balanced.

In order to reach these objectives, China needs to implement a series of economic policy steps, together with institutional and environmental reform, whilst maintaining the efficiency of its economic sectors. It has indeed many reforms to carry out, but in particular it should focus its attention on implementing structural reforms to make it easier for the private sector to access financial services (especially SMEs and enterprises in rural areas). It also needs to eliminate subsidies for industry and for the exchange rate or to lift the restrictions in the service sector access, which urgently needs to open up to the private sector.

A large problem in the analysis of the Chinese economy is the quality of the official statistics of China. One always wonders if they really reflect the economic situation or the desires of the Chinese authorities.

“During a May 2001 conversation with several Chinese economists in Beijing, I expressed doubt that China’s recent GDP statistics reflect actual economic performance. Without missing a beat, a Chinese colleague said, “Nobody believes recent GDP statistics.” What’s going on? I believe that, beginning with 1998, standard GDP data contain exaggerations focuses on three matters: quantitative inconsistencies, qualitative information from Chinese commentaries, and suggestions about the possible magnitude of overstatement”

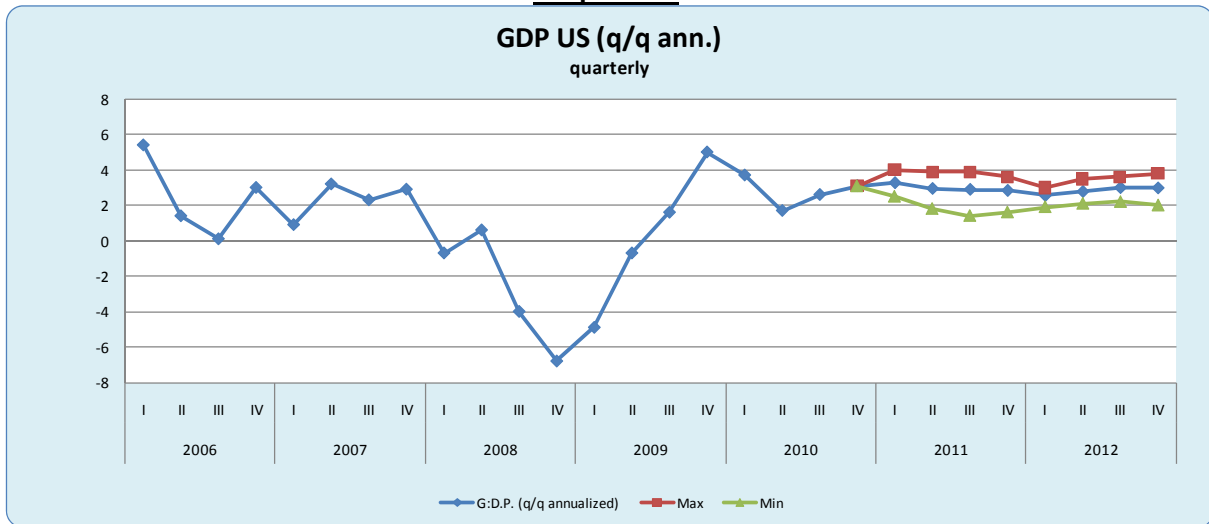
What is happening to China's GDP statistics? *Thomas G. Rawski*. [China Economic Review](#), 2001, vol. 12, issue 4, pages 347-354

II.2.- THE OUTLOOK

a) United States.

The forecasts regarding GDP growth in the United States for the next two years could be considered to be optimistic, to the extent that they foresee a sustained growth in activity of around 3%.

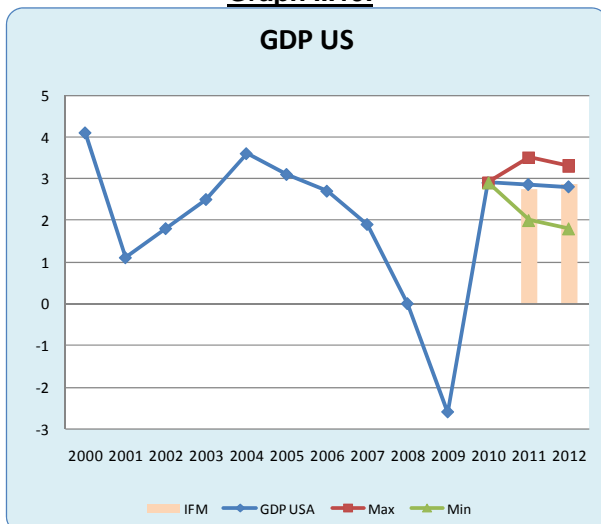
Graph II.18.



Source: AIECE. April 2011.

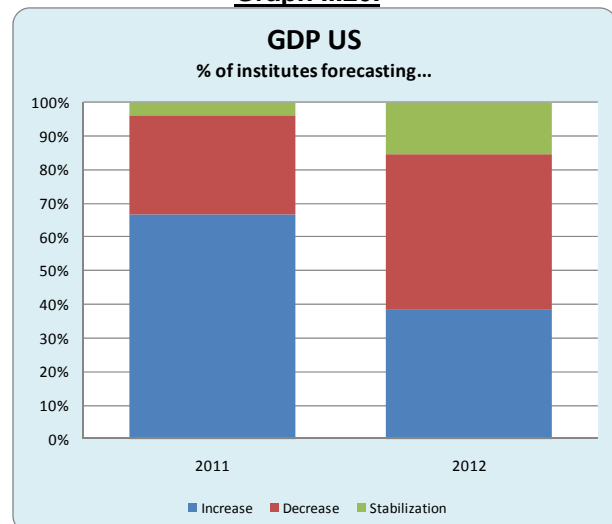
The GDP quarter on quarter annualised growth rate maintains its path at around 3%, with a maximum for some institutes around 4%, whilst the minimum level foreseen by other institutes is closer to 2%. As far as the temporary path is concerned, the majority of the predictions expect a slight drop at the end of this year and for the start of next year, converging in the second part of 2012 with a GDP growth of around 3% GDP growth.

Graph II.19.



Source: AIECE. April 2011.

Graph II.20.



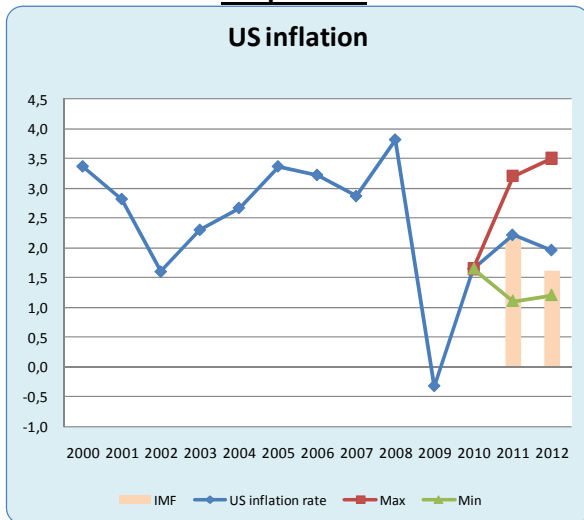
Source: AIECE. April 2011.

The IMF figures are aligned with the mean average of the predictions from the institutes, indicating a growth of around 3%, for this year and 2012. For 2011 the majority of the institutes foresee that the American economy will increase its growth rate. However, the institutes are slightly more pessimistic in

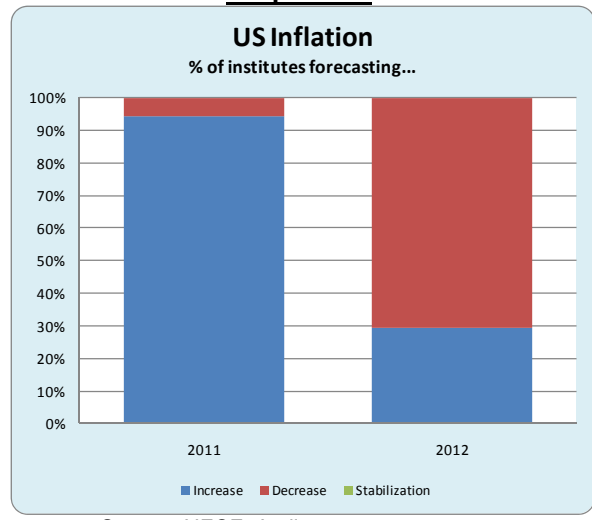
their predictions for 2012. Nevertheless, an average growth of around 3% is maintained for 2012, widening the range of predictions from 3.5% to below 2%.

The forecasts for inflation clearly distinguish between the current year and the following year.

Graph II.21.

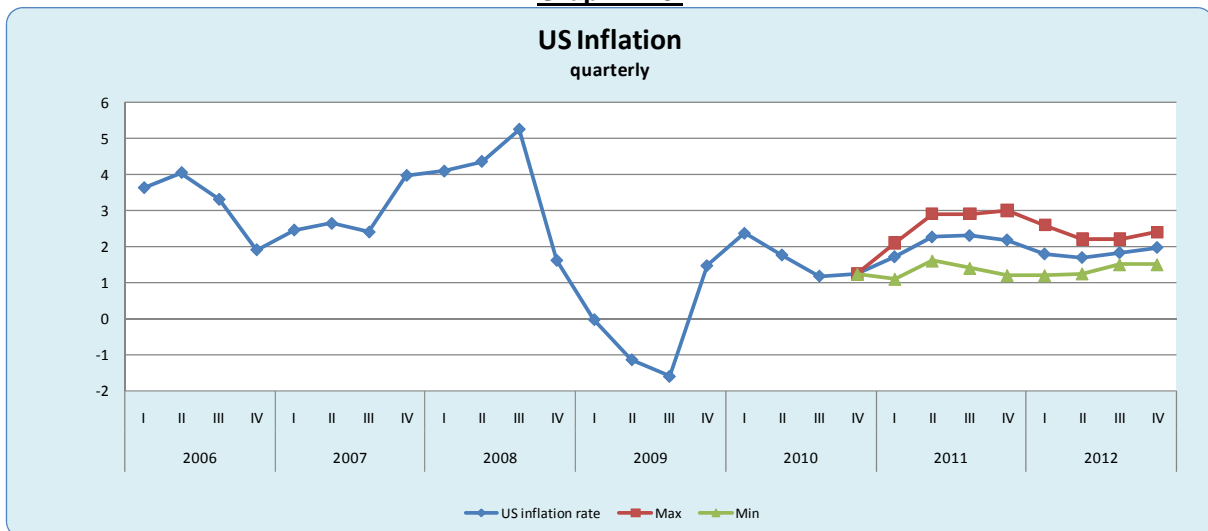


Graph II.22.



The IMF foresees that the United States will end the year with inflation levels slightly above 2% and 2012 with inflation levels around 1.5%. This opinion is shared by the institutes which remark a growth in inflation for 2011, almost unanimously, and forecast, in the main, a reduction in inflation in 2012. The range of predictions widens significantly, in particular for 2012, where there are predictions of inflation rates at almost 3.5% and other predictions fail to reach 1.5%. The average of institutes is around 2%.

Graph II.23.

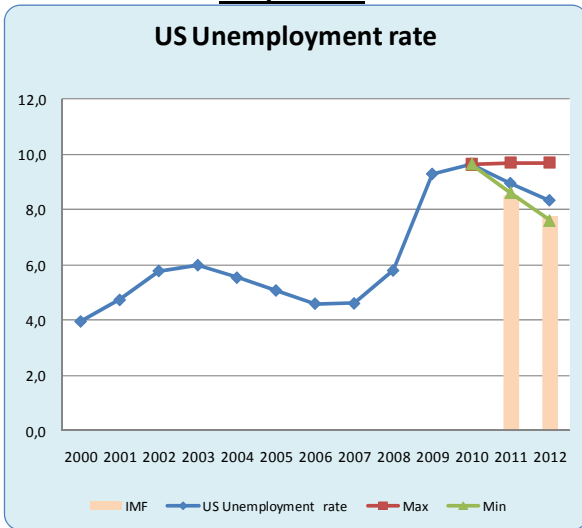


Quarterly US inflation gives us abundant information. Although the quarterly inflation rates from the different institutes do not coincide in the level of inflation, they do coincide in the pattern with which they expect to take place. That is to say, all the institutes foresee that the drop in prices that the American economy experienced in 2010 has finished for the time being and that the effects of the price crisis, both energy prices and food prices, will be passed onto consumer prices in the United States during the current year. Notwithstanding, inflation is not expected to be a great problem for 2012.

We have to bear in mind that the Federal Reserve takes underlying inflation as a reference point which excludes energy and food prices. Underlying inflation has grown slightly in February 2011 to 1.1 percentage points, being very close to the historical minimum level of underlying inflation, reached in October 2010.

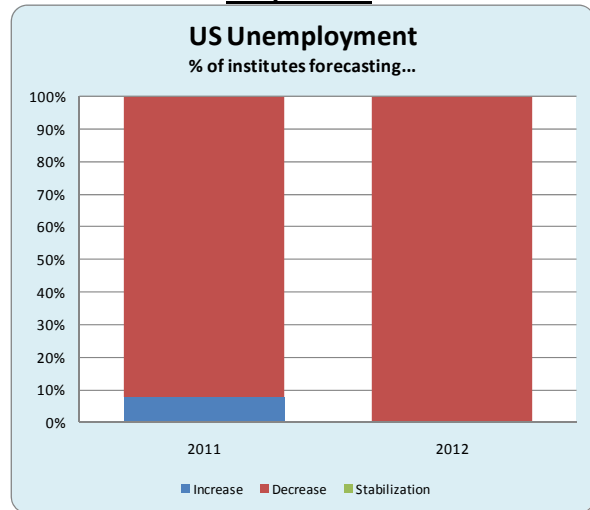
In accordance with previous predictions for prices and activity growth, the majority of institutes forecast a reduction in US unemployment for this year, and all the institutes unanimously expect a lower figure in the unemployment rate for 2012.

Graph II.24.



Source: AIECE. April 2011.

Graph II.25.



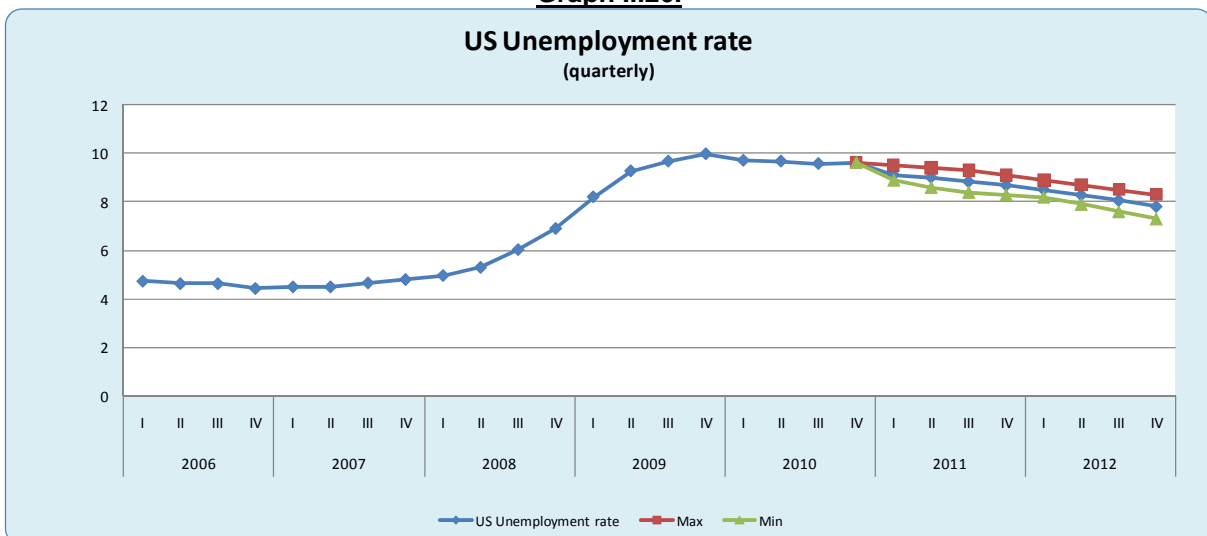
Source: AIECE. April 2011.

The unanimity of the institutes regarding the sign of the evolution of unemployment is transferred to the figure that this will reach in the upcoming three months. A consistent drop in the US unemployment rate is expected, to the extent that it will reach around 8% at the end of 2012.

One of the problems of the American economy is the speed at which it destroys employment, as can be seen from the graph; the unemployment rate has doubled in practically one year, highlighting all the effects of the economic and financial crisis. Nevertheless, in the same way that employment is destroyed, it is also created, as can be seen from the graph of predictions for the next year.

However, during the crisis 8,750,000 employment posts have been destroyed. During the recent period of recovery only 1,300,000 employment posts have been created. The American economy would probably still need a couple more years to recover its normal unemployment rate.

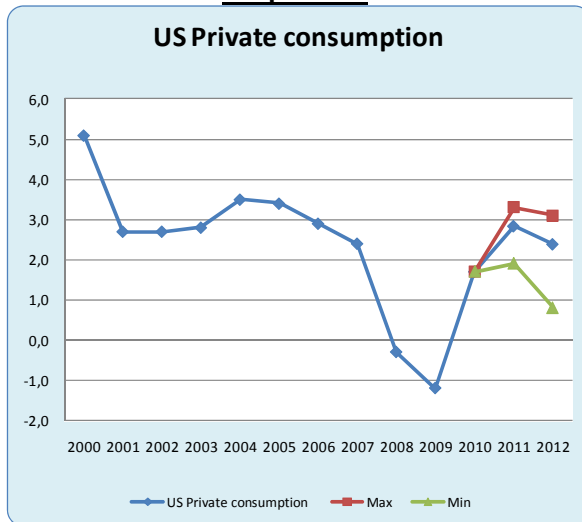
Graph II.26.



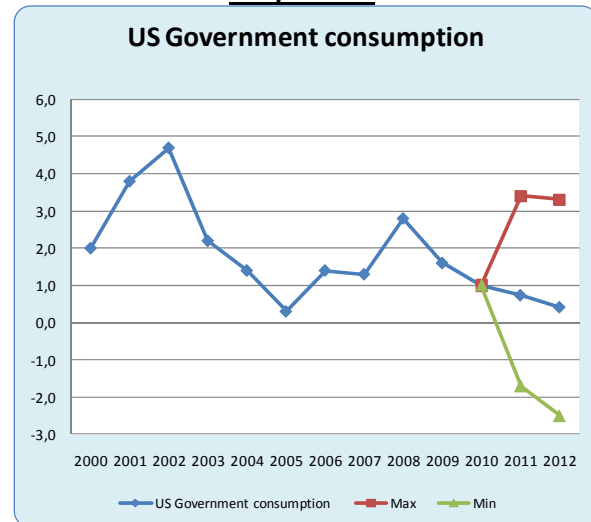
Source: AIECE. April 2011.

The anti-cyclical fiscal policy of the US Governments is forecasted to come to an end at the same time as household consumption takes the lead. The recovery in household income is enabling simultaneously increasingly strong consumption, together with a more sensible rate of household savings. Nevertheless, it is important to remember that Public debt is creeping towards 100% of GDP and household debt is around 115% of disposable income.

Graph II.27.



Graph II.28.

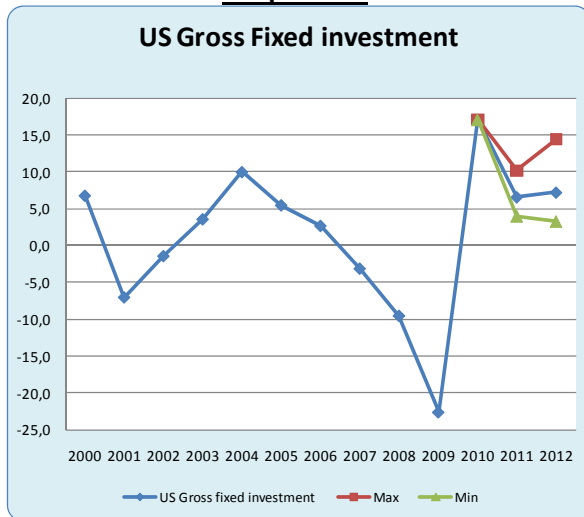


All the institutes forecast an increase of the US private consumption for this year. For the next year, it is not yet clear the exact forecast range which will span from less than 1% increase in private consumption to more than 3%. That is, there are serious doubts for 2012 as to whether household consumption could be qualified as being weak or strong.

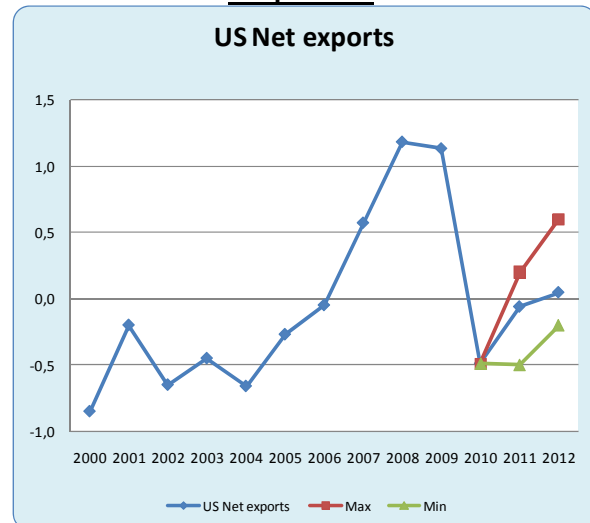
The institutes face the same dilemma regarding US Government consumption, which ranges from -3% to 2%, that is to say, shifting from restrictive fiscal policy to still strong anti-cyclical policy.

To find a clear outlook, we have to use the average from all the institutes and in that case we could agree that the increase in GDP that was previously forecasted will be based on private consumption in the future while Government starts to consolidate its fiscal account. Discussions in the US congress for next year's budget seem to reinforce the idea of the end of expansive fiscal policy, particularly considering the level of public debt.

To balance the books of National Accounting the institutes have been asked about US gross fixed investment and US net exports. The answers to the surveys coincide relatively, demonstrating strong confidence in the future evolution of these two magnitudes.

Graph II.29.

Source: AIECE. April 2011.

Graph II.30.

Source: AIECE. April 2011.

Investment in an economy is known to be one of the most difficult variables to predict, being as it is subject to immaterial factors such as the animal spirits of the entrepreneur. However, after the strong reduction in investment that the US has experienced since the beginning of the crisis, it is feasible to assume that the recovery in investment that the US has been experiencing over the past quarters will continue. The issue at stake is to determine how strong investment will be in the near future. Both maximum and minimum prospects are positive, with the increased average around 7%. In any case, enterprise confidence is strong.

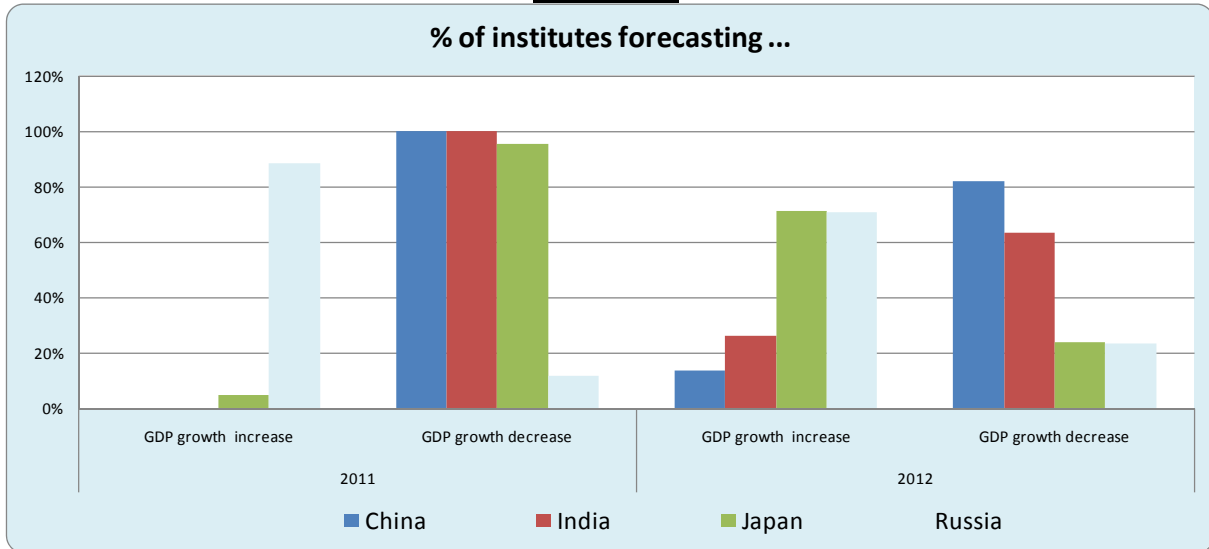
US foreign trade is consistent with the outlook of a stronger domestic consumption. In this sense, the mean average of the institutes considers that the foreign sector will neither add to nor subtract from economic growth. On the one hand, we have to consider that world growth will increase American exports. On the other hand, solid household consumption and the increase in the prices in energy could help imports to subtract American growth. The institutes' forecasts reflect this situation with a limited range of plus 0.5 and minus 0.5.

To sum up, strong growth for the United States based on domestic demand with strong investment and good perspectives for employment.

b) Japan and main emerging economies.

For 2011, 100% of institutes are forecasting a decrease in the growth of GDP for India and China. Nevertheless, for 2012, 20% of institutes are forecasting an increase in the growth of GDP for China and 40% foresee an increase for India. 80% of institutes envisage larger growth for Russia in 2011, 60% for 2012. Japan is forecasted, almost unanimously, to moderate its growth this year but 70% of us believe that it will recover its growth rate next year.

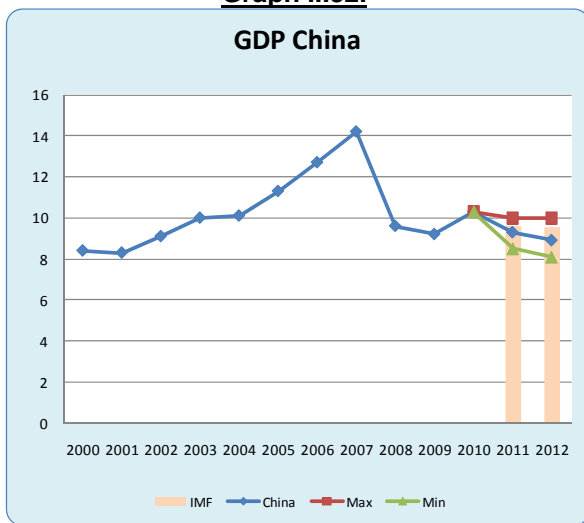
Graph II.31.



Source: AIECE. April 2011.

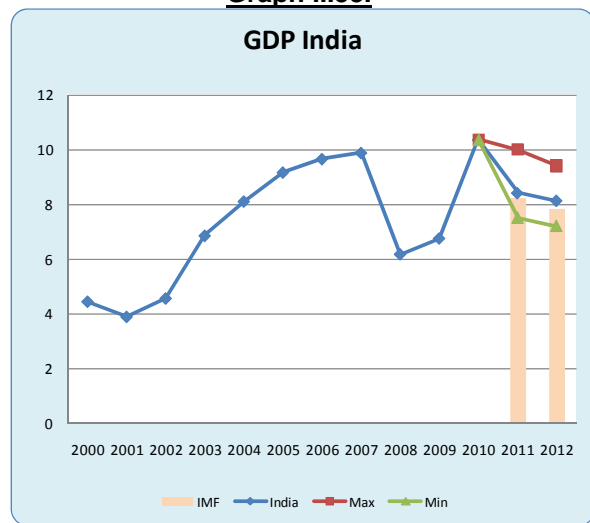
The risk of an overheating of the Chinese economy is likely. Therefore, the IMF believes that it will maintain its growth under 10%. Slightly more intensive moderation of its rate of growth is forecasted by nearly all the institutes. Albeit that moderation in growth in China means passing from 10% growth to 9% growth.

Graph II.32.



Source: AIECE. April 2011.

Graph II.33.



Source: AIECE. April 2011.

It is difficult to measure the enormity of a country like China where the statistics system works in a different way than the European one and it is difficult to interpret the figures on a yearly basis, bearing in mind that the date of the Chinese New Year doesn't always coincide.

Having said that, it seems quite clear that the monetary authorities tend to cool down the economy whose inflation reached 4.9% in February. An international increase in prices of energy and food will not help to reduce prices in the future. The Chinese central bank has increased its cash reserve ratio (CRR) up to 20% for the largest banks. Surprisingly, fiscal policy is still expansive, probably because the public deficit is about 1-2% and public debt could be about 15-20%.

As a result, it is feasible to foresee that China will keep its growth at slower pace. Quite a different issue is how the Chinese society is going to face this social, political and cultural responsibility of being the first economy in the world and indeed if that happens in 10 or 20 years' time, or maybe more or even never. This could be one of the discussion subjects in future meetings.

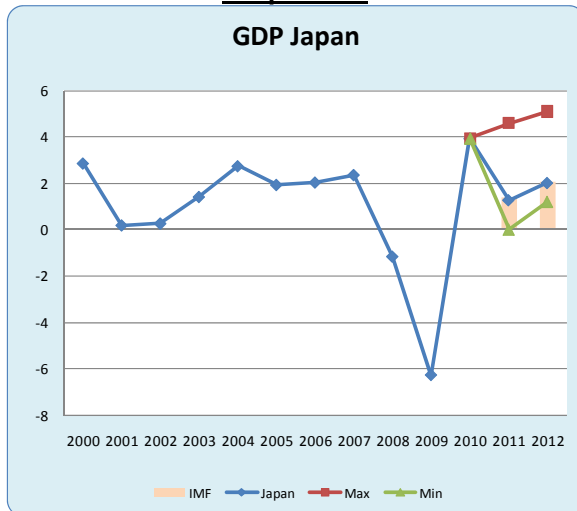
GDP in India is unanimously considered to moderate its growth rate for the current year, with more doubts surrounding its growth for 2012.

India has been growing consistently over the last decade with a stronger household consumption and higher added value products and services than China. Nevertheless, its growth rates have not been as spectacular as its Asian neighbour.

It seems that 2010 growth of 10% has reached a clear peak or glass ceiling for Indian growth, a rate of around 8% is expected for 2011, and even slightly less for 2012.

Most institutes consider that Japanese growth rate will slowdown this year and will recover its rhythm in 2012.

Graph II.34.



Graph II.35.



The Fukushima tragedy is being considered as a slowdown within an already not very exciting growth in Japan. Maybe we are not considering the Japanese Phoenix bird behaviour that has been demonstrated in other critical situations. We have to remember that GDP is the value of goods and services produced in a country over the period of a year and not its capital stock. Without a doubt, Japanese capital stock has been reduced as a result of the disaster, but not much more than around 5%, and its capacity to produce goods and services has been affected much less than that. The reconstruction plans will involve a reactivation of the Japanese economy and maybe its society. On the other hand, we still do not know how long the nuclear problem will last and how serious its

consequences will be. This is why it is so difficult to make predictions about Japan in the short term. The consensus seems to be that a small dip its economy will recover its past path.

Apart from the nuclear problem, other uncertainties regarding Japan refer to its strong debt level, both public and private. Even so, borrowers are basically Japanese and are, therefore, less affected by international turbulence. On the other hand, the Japanese growth engine is basically driven by exports which have very good prospects for the next 18 months.

Russia's GDP is mainly considered to moderate its rate of growth slightly for the current year and for the upcoming year.

The IMF foresees a growth which is slightly above 4% for the upcoming 18 months, that is to say, 2011 and 2012. The same appreciation is given by the mean average of the institutes' forecasts. Notwithstanding, what is apparent is that Russia has exited the international financial crisis and recovering growth rates similar to those of the past decade.

II.3.- RISKS AND UNCERTAINTIES

In 2010, Russia drastically bolstered its activities in the area of integration processes. This primarily affected the creation of the Customs Union (including Russia, Belarus, and Kazakhstan) and shaped on this basis a Single Economic Space, as well as Russia's initiative for the creation of a free trade zone in the CIS. In addition to its steps towards intensification of centripetal trends in the post-Soviet zone, the country announced its intent to launch negotiations on concluding free trade agreements (FTAs) with Far-Abroad countries, too. What is your opinion on the impact of free trade zones shaped by Russia on global trade in up-coming years?

The institutes which make up the AIECE show consensus regarding the general future trend of the macro magnitudes for the principal countries on the world stage. However, this should not prevent us from scrutinising the important details and evaluations that well deserve to be pointed out.

The conjuncture economic situation in the long term is economic structure and current economic situation tendencies turn into patterns if they continue in time.

It seems that there is where the debate lies.

Have we just suffered a specific crisis, from which we will recover and follow our original path? Or are there major changes to be made on our way that lead us to believe that things will not be the same as they were before?

The structural consequences of the crisis together with those topics which the participants of this meeting have shown particular interest in, will constitute the third part of this session.

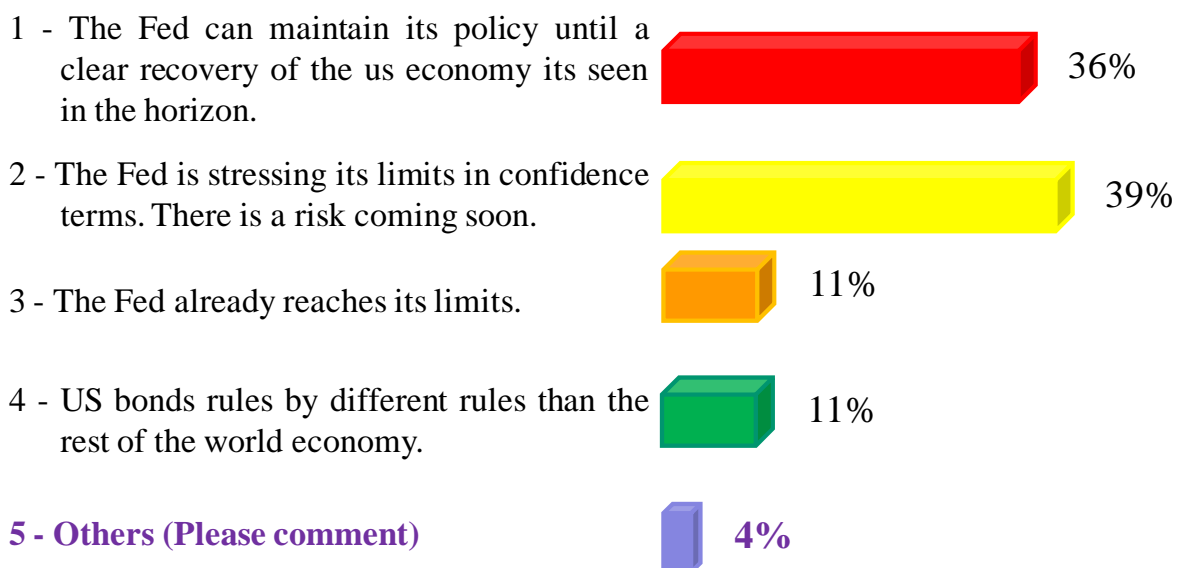
Let's start with the United States

a) Open questions: US.

The impact of the end of QE2 in June. What are the limits to the Fed's support of the economy, if they are? Is there a ceiling above which its holding of US government bonds becomes overly risky? (at present, the share is close to 40%).

- **The Fed can maintain its policy until a clear recovery of the US economy is seen in the horizon.**
- **The Fed is stressing its limits in confidence terms. There is a risk coming soon.**
- **The Fed already reaches its limits.**
- **US bonds rules by different rules than the rest of the world economy.**
- **Others (Please comment).**

Nº of answers: 28



What assumptions can we make about US fiscal policy?

- **Obama government will maintain an aggressive fiscal policy to tackle unemployment both with public expenses and fiscal tax cuts.**
- **Government, Congress and Fed will arrange the agreement of let fiscal policy neutral.**
- **Others (Please comment).**

Nº of answers: 28

1 - Obama government will maintain an aggressive fiscal policy to tackle unemployment both with public expenses and fiscal tax cuts.



2 - Government, Congress and Fed will arrange the agreement of let fiscal policy neutral.



3 - Others (Please comment).



The recovery in the labour market in US.

- **Will continues slowly but firm until it reaches the levels previous to the financial crises.**
- **Will continues but never reaches the previous levels of low unemployment. There is a structural change in US labour market.**
- **Too soon to say.**
- **Others (Please comment).**

Nº of answers: 30

1 - Will continues slowly but firm until it reaches the levels previous to the financial crises.



2 - Will continues but never reaches the previous levels of low unemployment. There is a structural change in US labour market.



3 - Too soon to say.



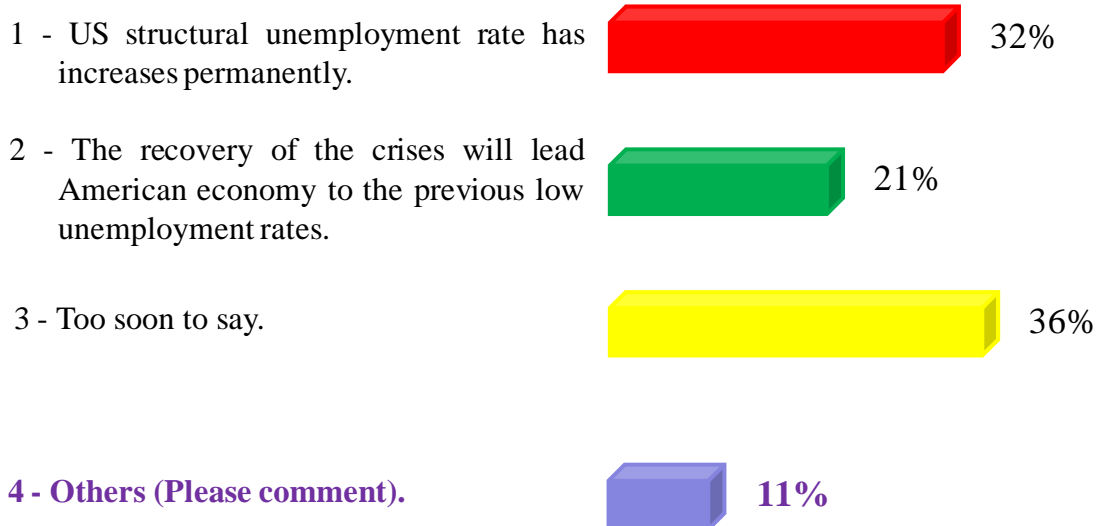
4 - Others (Please comment).



The current cycle is one of the worst in the US history in terms of growth and employment. The previous two cycle's recoveries were also very weak. Is this a permanent change?

- **US structural unemployment rate has increases permanently.**
- **The recovery of the crises will lead American economy to the previous low unemployment rates.**
- **Too soon to say.**
- **Others (Please comment).**

Nº of answers: 28



b) Open questions: Japan

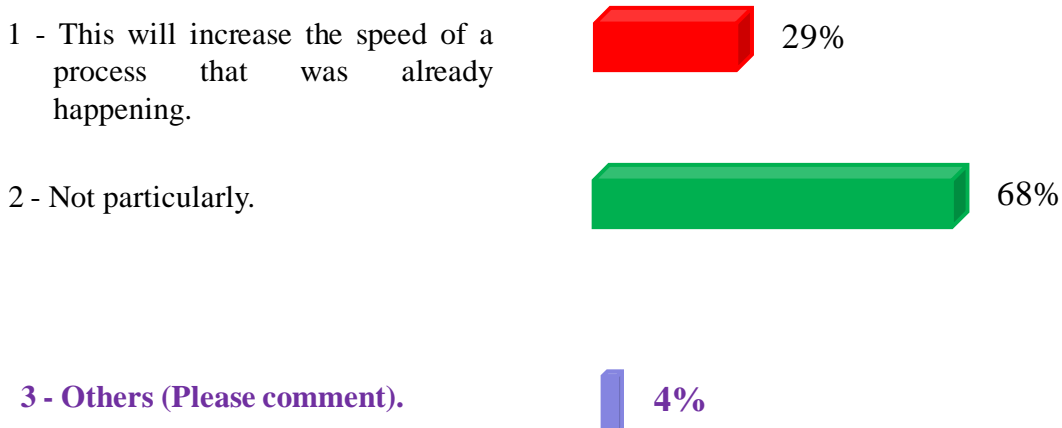
It is premature to estimate the influence of the tsunami on GDP growth of Japan. Nevertheless, we should discuss its implications - also with regard to the strong dispersal of Japanese corporate networks in other regions of the world economy.

What are the consequences of the natural and nuclear disaster in Japan?

Will the manufacturing industry in Japan be outsourced more in the future as a result of the disaster?

- **This will increase the speed of a process that was already happening.**
- **Not particularly.**
- **Others (Please comment).**


Nº of answers: 28




Impact of the catastrophes in Japan (on Japan and on the rest of the world, especially Asia). What is the role of splitting up the supply chains? Does it make the world economy more vulnerable?

- **Yes, it increases interdependence.**
- **No, one should not put all one's eggs in the same basket.**
- **Others (Please comment).**

N° of answers: 20

1 - Yes, it increases interdependence.  45%


2 - No, one should not put all one's eggs in the same basket.  45%


3 - Others (Please comment).  10%


To what extent are the events in Japan having an impact on the German, Italian and other European economies? Can they substitute failing output in Japan?

- **It is 'now or never'. It is a clear opportunity to overtake Japanese industrial production.**
- **The output substitution will only be a temporary one.**
- **There is no clear substitution relation.**
- **Others (Please comment).**

N° of answers: 29

1 - It is 'now or never'. It is a clear opportunity to overtake Japanese industrial production.  3%

2 - The output substitution will only be a temporary one.  62%

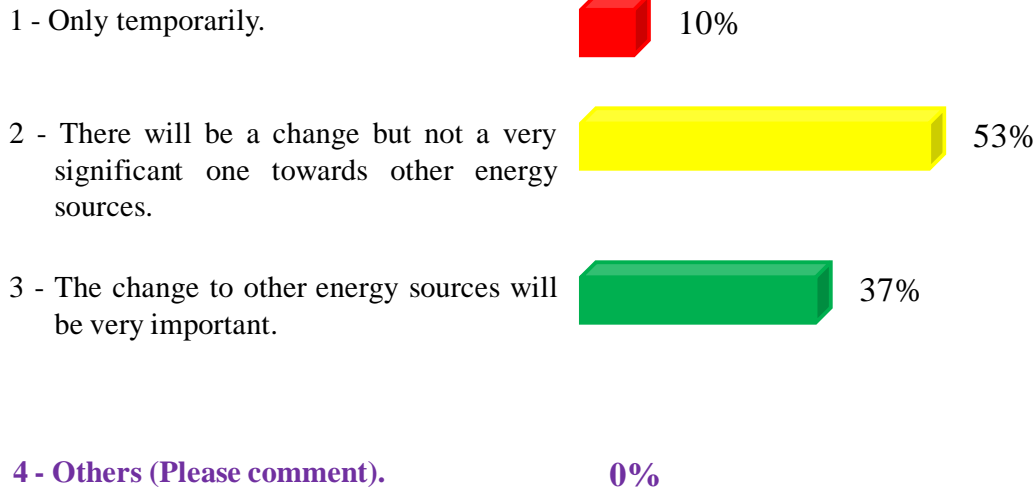
3 - There is no clear substitution relation.  34%

4 - Others (Please comment). 0%

Will the Japanese nuclear catastrophe bring about a substantial change in the energy portfolio of major countries?

- Only temporarily.
- There will be a change but not a very significant one towards other energy sources.
- The change to other energy sources will be very important.
- Others (Please comment).

N° of answers: 30



To sum up. The consequences of the natural and nuclear disaster in Japan will imply...

- Changes in the way enterprises organise production, particularly outsourcing processes.
- Changes in energy sources.
- Additional stress for international financial markets.
- Permanent lack of confidence in the Japanese economy.
- Others (Please comment).
- We are overreacting.

N° of answers: 30

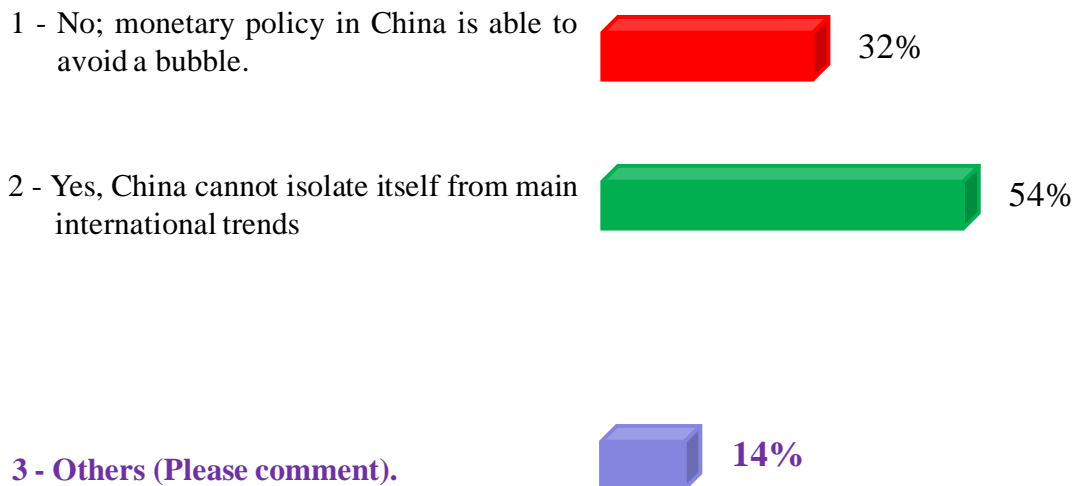


c) Open questions: China and India

Is loose monetary policy leading to a bubble in emerging markets (especially in China)?

- **No; monetary policy in China is able to avoid a bubble.**
- **Yes, China cannot isolate itself from main international trends.**
- **Others (Please comment).**

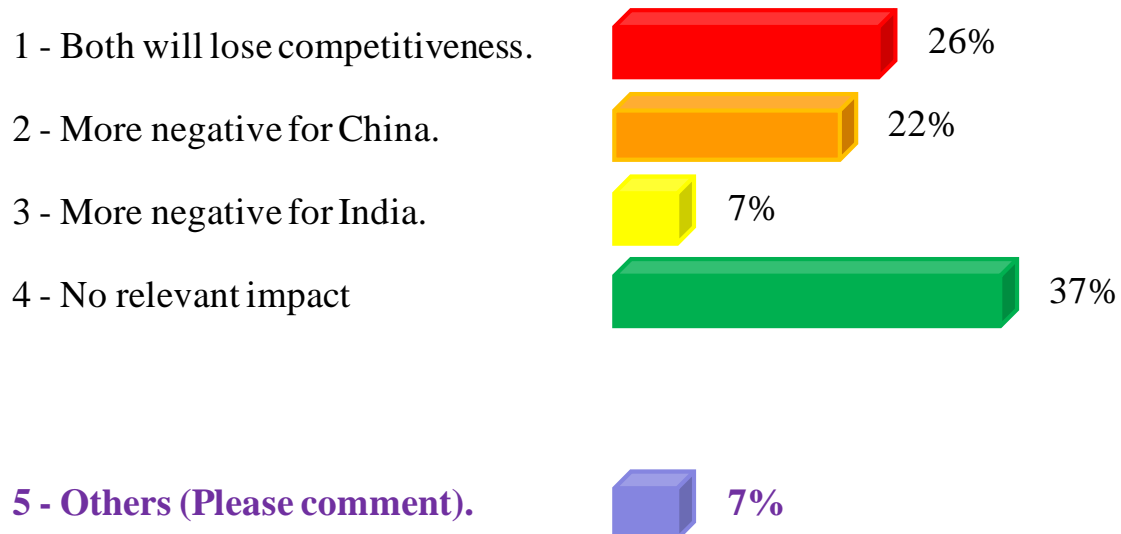
Nº of answers: 28



What is the impact of high/rising inflation in China and India?

- **Both will lose competitiveness.**
- **More negative for China.**
- **More negative for India.**
- **No relevant impact.**
- **Others (Please comment).**

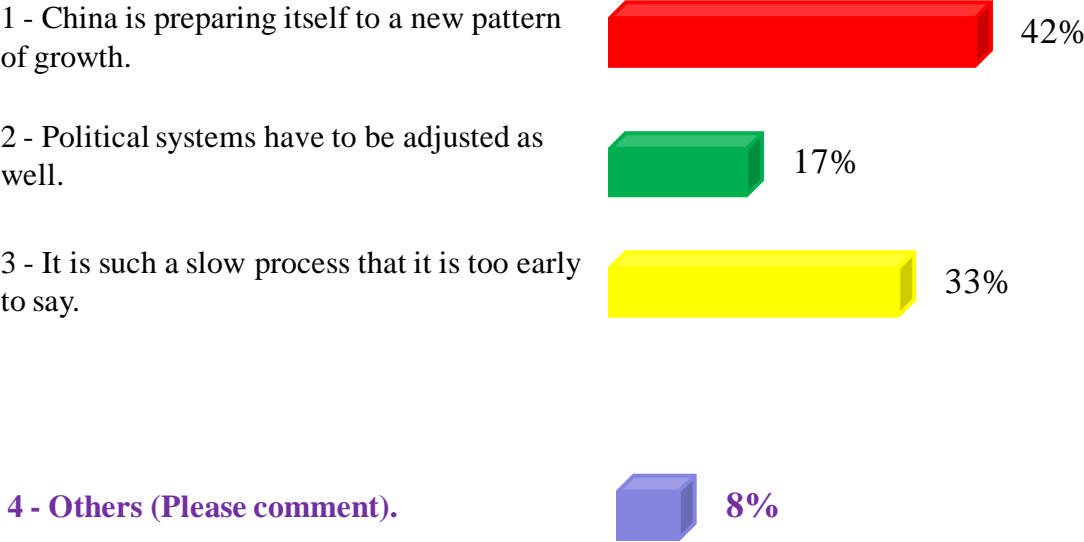
Nº of answers: 27



What are the global repercussions of China's growth rebalancing plan (moving away from exports & investments towards consumption)?

- **China is preparing itself to a new pattern of growth.**
- **Political systems have to be adjusted as well.**
- **It is such a slow process that it is too early to say.**
- **Others (Please comment).**

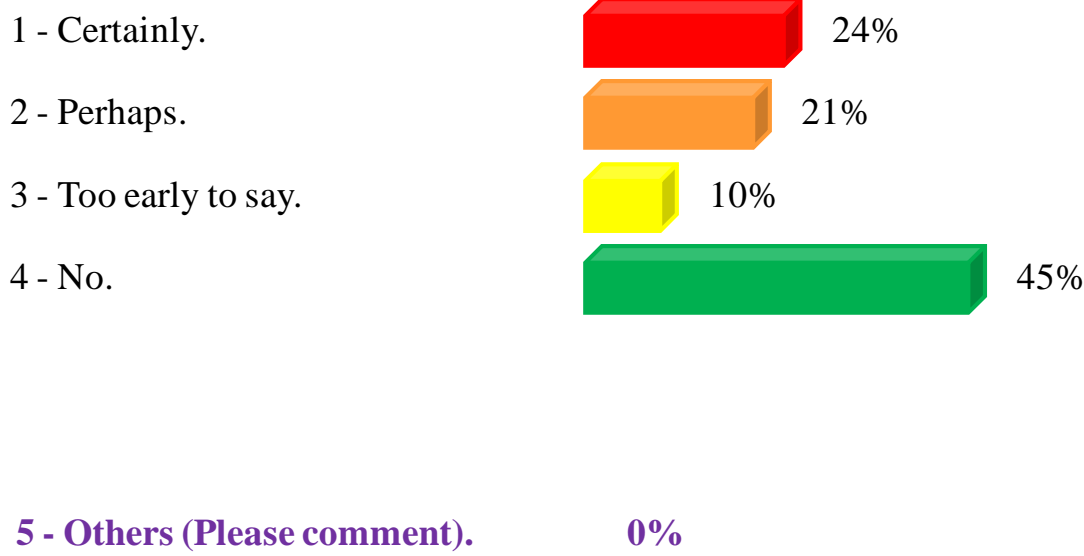
Nº of answers: 24



Has the risk of a severe setback in the Chinese economy further increased?

- **Certainly.**
- **Perhaps.**
- **Too early to say.**
- **No.**
- **Others (Please comment).**

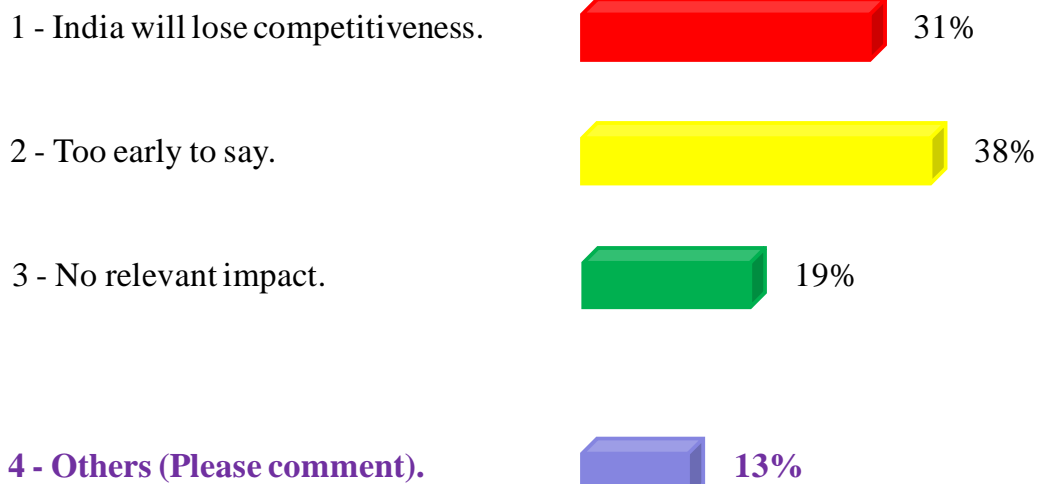
Nº of answers: 29



How severe is the risk of accelerating credit growth in India?

- **India will lose competitiveness.**
- **Too early to say.**
- **No relevant impact.**
- **Others (Please comment).**

Nº of answers: 16

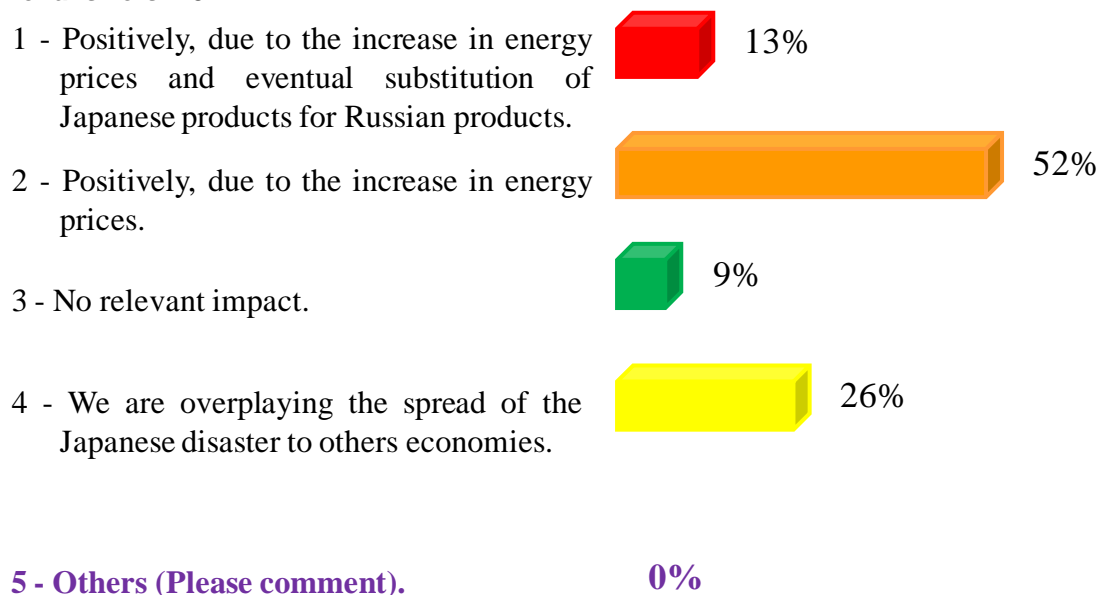


d) Open questions: Russia

How does the Japanese disaster affect the Russian economy? Will the effects be confined to the energy sector?

- **Positively, due to the increase in energy prices and eventual substitution of Japanese products for Russian products.**
- **Positively, due to the increase in energy prices.**
- **No relevant impact.**
- **We are overplaying the spread of the Japanese disaster to others economies.**
- **Others (Please comment).**

Nº of answers: 28

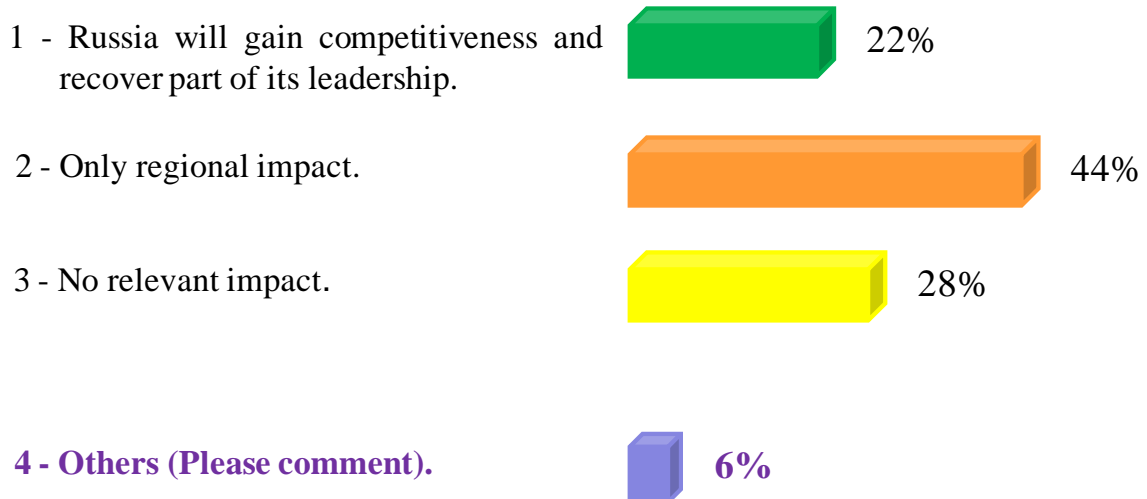


In 2010, Russia drastically bolstered its activities in the area of integration processes. This primarily affected the creation of the Customs Union (including Russia, Belarus, and Kazakhstan) and shaped on this basis a Single Economic Space, as well as Russia's initiative for the creation of a free trade zone in the CIS. In addition to its steps towards intensification of centripetal trends in the post-Soviet zone, the country announced its intention to launch negotiations on concluding free trade agreements (FTAs) with Far-Aboard countries, too.

What is your opinion regarding the impact on global trade of free trade zones shaped by Russia in up-coming years?

- Russia will gain competitiveness and recover part of its leadership.
- Only regional impact.
- No relevant impact.
- Others (Please comment).

Nº of answers: 18



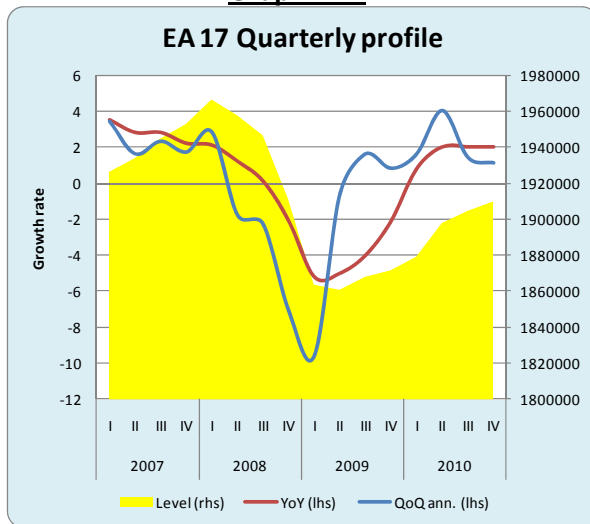
Section III.- EUROPE.

III.1.- RECENT TRENDS

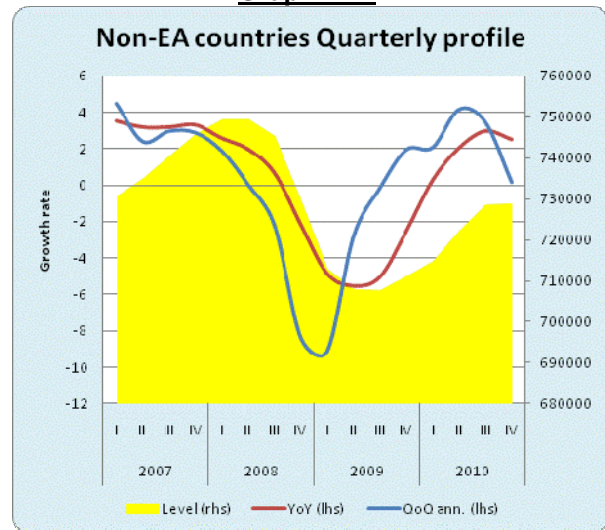
a) GDP growth.

By late 2010, European GDP growth had already returned to rates similar to those recorded before the crisis. However, production levels are still considerably lower than the 2008 average.

Graph III.1.



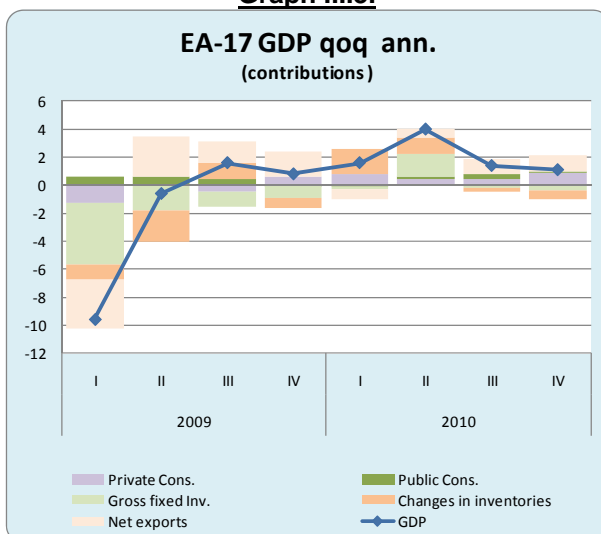
Graph III.2.



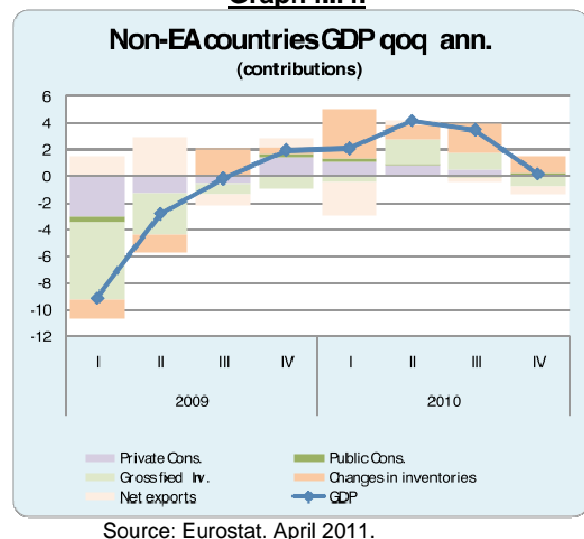
Indeed, both the group of 17 countries which make up the single currency area, with rates close to 2%, and the 10 other European Union countries, with slightly higher numbers, have already returned to the pace of growth experienced prior to the crisis. However, the significant drop in production in 2009 has caused real GDP levels to remain 2–3% lower than the levels achieved in 2008.

The recovery process has been based primarily on the net contribution of foreign trade, together with a significant contribution from the build-up of stock during the first half of 2010.

Graph III.3.



Graph III.4.



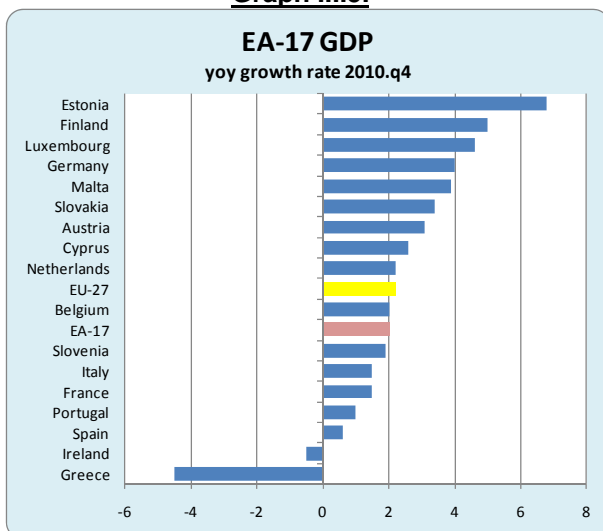
Analysing the make-up of quarterly European GDP growth, we find that, after the support provided by public expenditure during the early stages of the crisis, especially in the eurozone, foreign trade played a key role in the process of returning to positive growth rates during the second half of 2009 and early 2010, again most significantly in the euro area.

Subsequently, in early 2010, it was the build-up of inventory, supported by gross fixed capital formation, which raised growth rates to approximately 2% halfway through the financial year. However, the progressively diminishing effect of inventories slowed the recovery process slightly.

Late last year, there was a real change in growth patterns for the eurozone and the rest of the European Union. While in the former area, private consumption began to play an important role in GDP growth, supported by a positive contribution from foreign trade, in the remaining countries, the build-up of inventory and some support from public expenditure remained the main foundations for this growth.

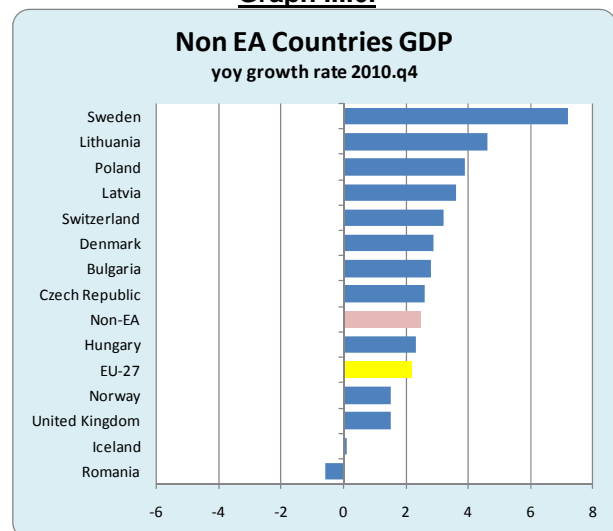
Economic growth among the members of the European Union was quite uneven at the end of last year, ranging from the 6% reported for Sweden and Estonia to appreciably negative numbers in Greece and virtually nil in Ireland, Spain and Iceland.

Graph III.5.



Source: Eurostat. April 2011.

Graph III.6.

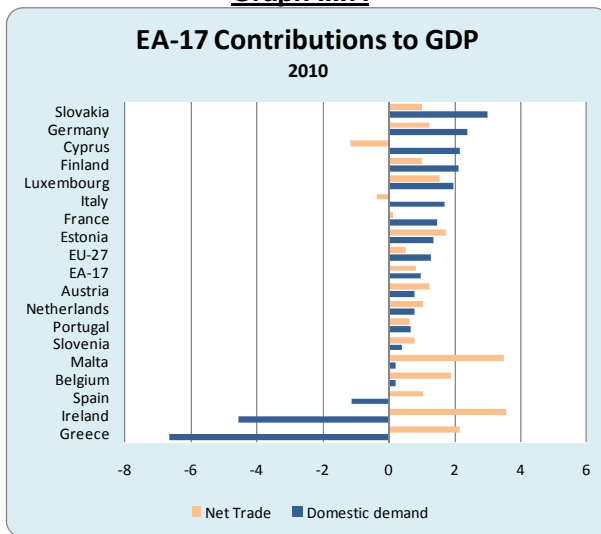


Source: Eurostat. April 2011.

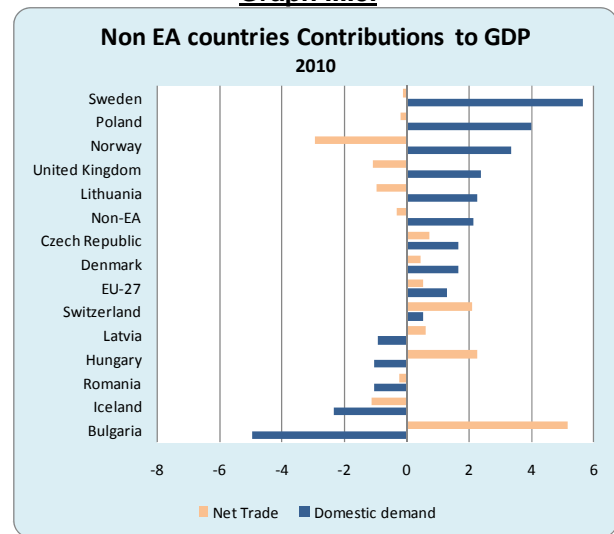
Analysing the growth rates reported in late 2010 we find three different rates of recovery. The first group of countries has annualised quarter-on-quarter growth rates of around 4% or higher. This includes Estonia, Finland, Luxembourg and Germany in the eurozone, and Sweden, Lithuania and Poland in the rest of the European Union.

The second group is made up economies with average growth rates around the average potential level of 2%, while the third group includes economies which are lagging behind and have not achieved this rate of potential growth. It is made up of the countries most affected by the so-called debt crisis: Greece, Ireland, Portugal and Spain, which are joined by Romania and Iceland outside the single currency area.

Domestic demand is most likely the source of the significant differences in rates of recovery in the different economies.

Graph III.7.

Source: Eurostat. April 2011.

Graph III.8.

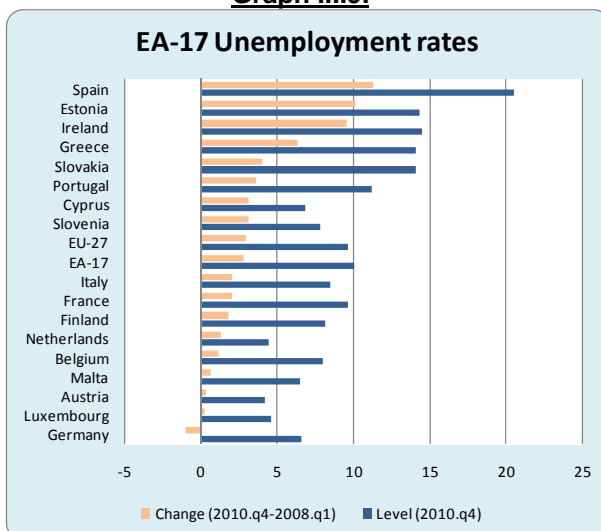
Source: Eurostat. April 2011.

Indeed, if we analyse the relative contribution of both domestic demand and foreign trade to GDP growth during 2010, it is easy to see that the relative dispersion of domestic demand contributions is much greater than what is observed for foreign trade as a whole. Therefore, while the contribution of domestic demand has a range of some ten points, just five points separate the most dynamic contribution of foreign trade from the most limited.

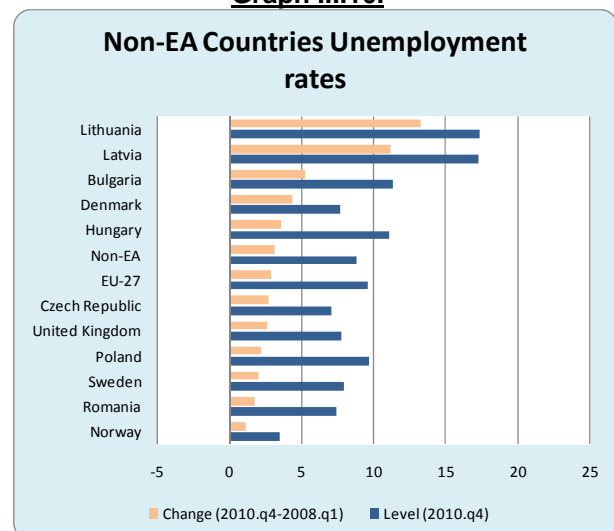
Logically, these differences in the performance of domestic demand are closely linked to the ultimate effects of the past economic crisis on both public budgets and unemployment.

b) Unemployment.

Generally speaking, the economies that have seen their unemployment rates increase the most during the crisis have lower rates of recovery for domestic demand, although there are some exceptions.

Graph III.9.

Source: Eurostat. April 2011.

Graph III.10.

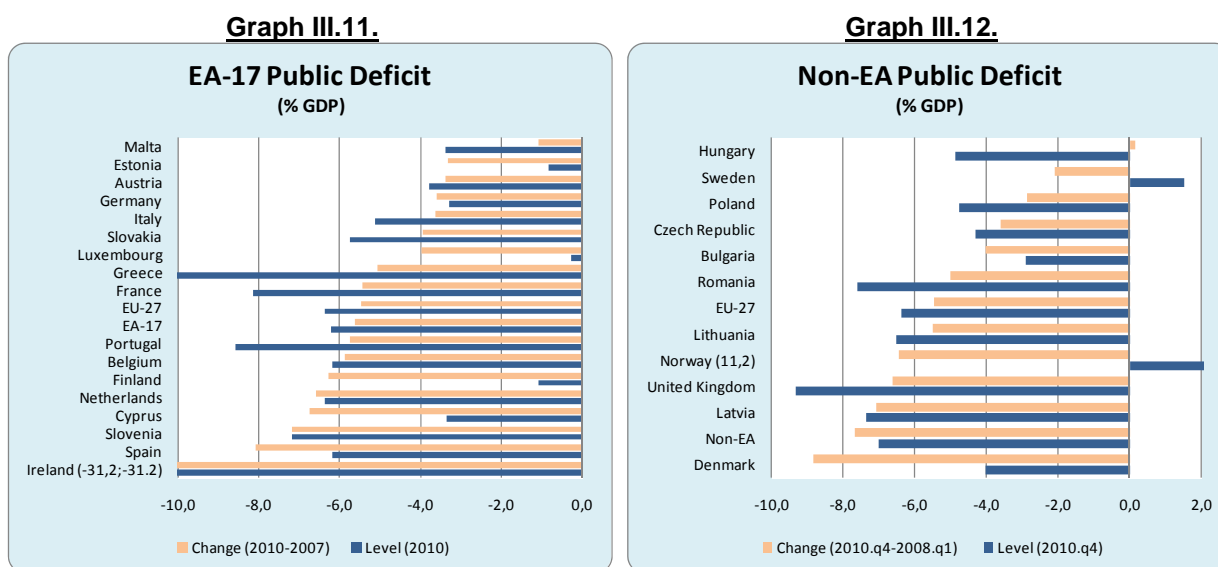
Source: Eurostat. April 2011.

Comparing the results of graphs 9 and 10 with those shown in 7 and 8, we can see that the countries with less growth in domestic demand are also those whose labour markets have declined the most, both in the euro area and the rest of the European Union.

However, there are some obvious exceptions to this general rule, as shown by Estonia and Slovakia. Although their labour markets declined significantly during the crisis, they have achieved positive results in terms of domestic demand growth.

c) Public deficit and debt.

The accumulation of public debt and the need to correct it appear to be more of a determining factor for the different trends in domestic demand among European countries.



Once again, if we compare the results of public deficit trends in the different countries (graphs 11 and 12) with the results in terms of relative contribution of domestic demand to growth (graphs 7 and 8), we find a marked symmetry between the figures, with countries which have accumulated higher levels of debt also being those with lower results in terms of domestic demand growth.

In fact, if we perform a qualitative analysis of the relationship between this relative contribution of domestic demand and the levels and changes observed in the data for unemployment and public deficit for European countries as a whole, we will find that the highest levels of correlation appear when we analyse the contribution of domestic demand in comparison with estimated deficit levels for 2010.

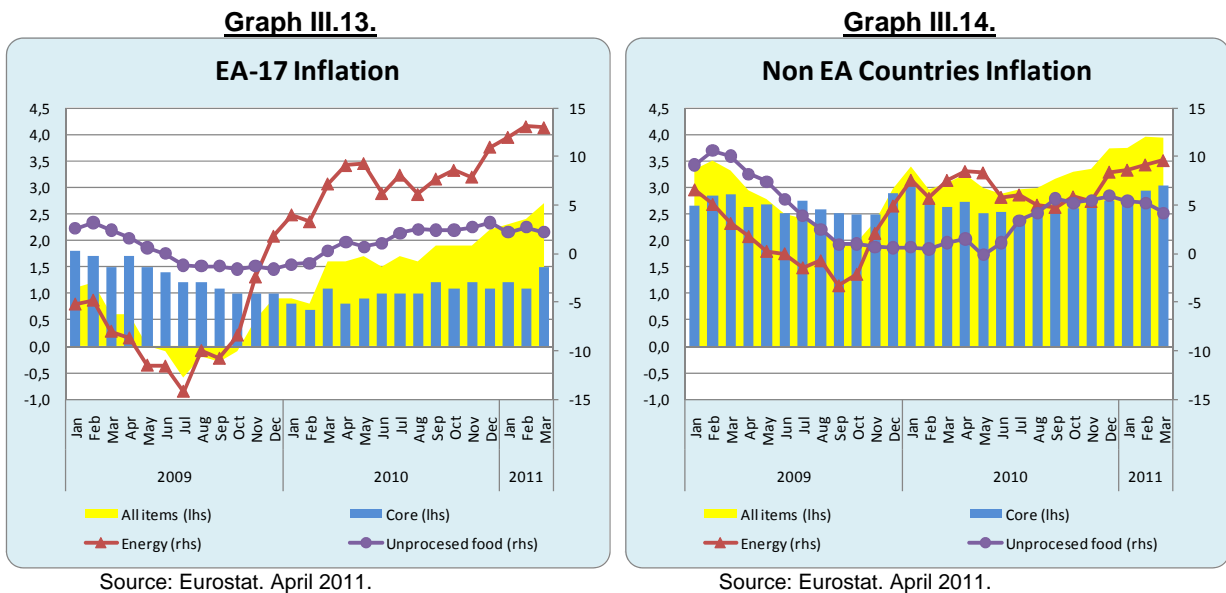
Furthermore, this quantitative relationship between the two sets of data is much more obvious when we analyse only the 17 countries which make up the single currency area, where the commitment to containing public debt is greater, as shown in the table below.

Table III.1
Determination coefficients R^2
(Domestic demand versus ...)

	Unemployment		Public Deficit	
	Level	Change	Level	Change
Total	0.15	0.14	0.31	0.14
EA-17	0.20	0.27	0.48	0.28
Non-EA countries	0.11	0.06	0.10	0.00

d) Inflation.

The economic recovery has been accompanied by a definite upturn in inflation caused by energy prices and to a lesser extent, unprocessed food.



Average inflation for European countries as a whole, which reached its lowest levels in mid-2009, is on an upward path, approaching 2.5% for the euro zone countries and very close to 4% for the other economies in the early months of 2011.

However, if we analyse the trend for this inflation, it is easy to see that it has been reactivated by the most volatile price components, energy and unprocessed food. Underlying inflation has remained at virtually the same levels recorded during the worst parts of the crisis. Therefore, we should not associate this upturn in inflation with a recovery of demand. In short, what we are experiencing is an episode of cost inflation, rather than a monetary expansion process caused by increased demand.

As shown in the graphs above, the impact of rising energy and unprocessed food costs has been slightly different in the euro zone to the other members of the European Union. Energy costs have affected the former more, while the effect of unprocessed food has been different for the latter.

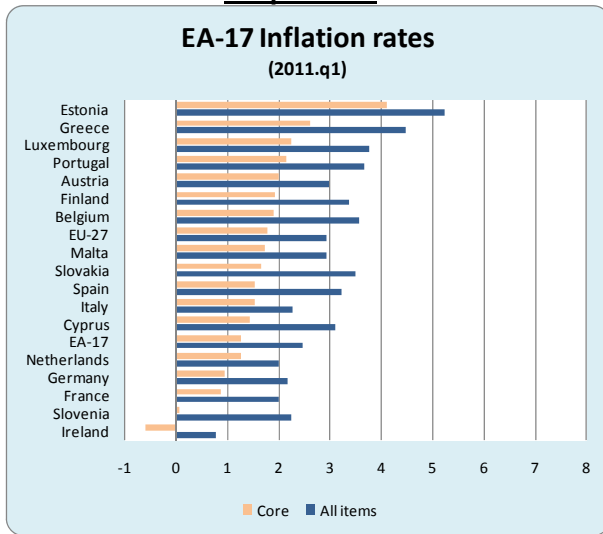
If we analyse price levels in the different economies, we find that they are quite heterogeneous, not only between eurozone member countries and the others, but also within the European Union itself.

Therefore, as shown in graph 15, the range of dispersion for average inflation levels within the eurozone is more than four and a half points, not only on the general index, but also for underlying inflation. As a result, the common monetary policy will have significant slants in both directions.

Logically, these differences are significantly more marked between the countries which are not part of the single currency, with a range of more than six points on the general index and five on underlying inflation.

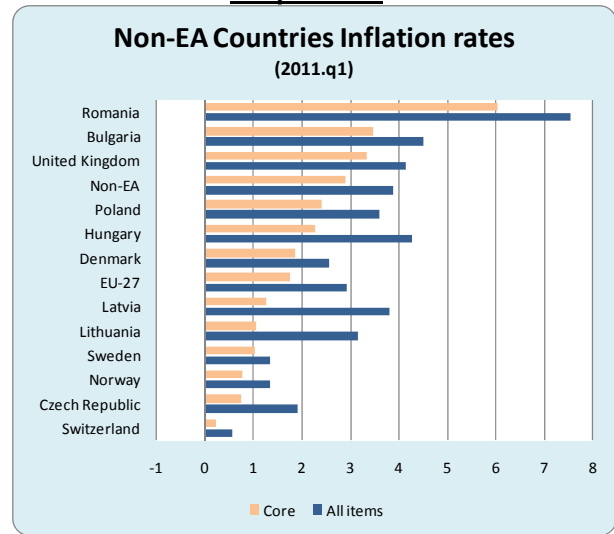
The inflation differential between countries is quite marked in the eurozone as a whole, even for underlying inflation.

Graph III.15.



Source: Eurostat. April 2011.

Graph III.16.



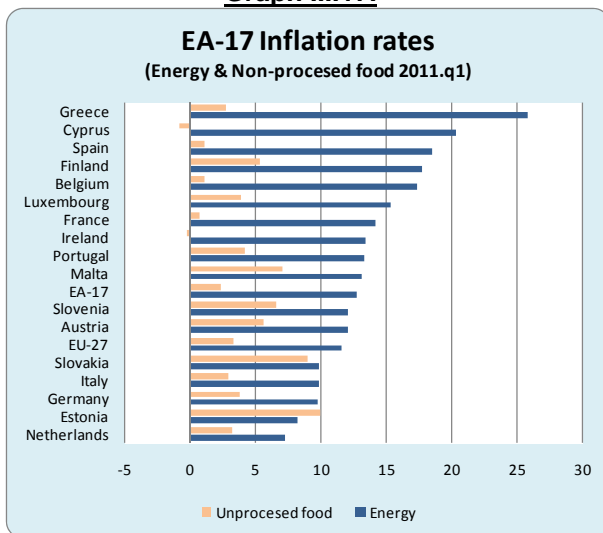
Source: Eurostat. April 2011

Returning to the data for the eurozone and analysing the data shown in graph 15, it is possible to see that only four countries exceed the 2% target for underlying inflation. Therefore, for the moment, there does not appear to be significant risk of rising inflation.

In any event, as we have said, it is, however, possible to see a significant difference in effect among the different economies, reinforcing the idea of asymmetric shocks within the European Union as a whole, and the eurozone in particular.

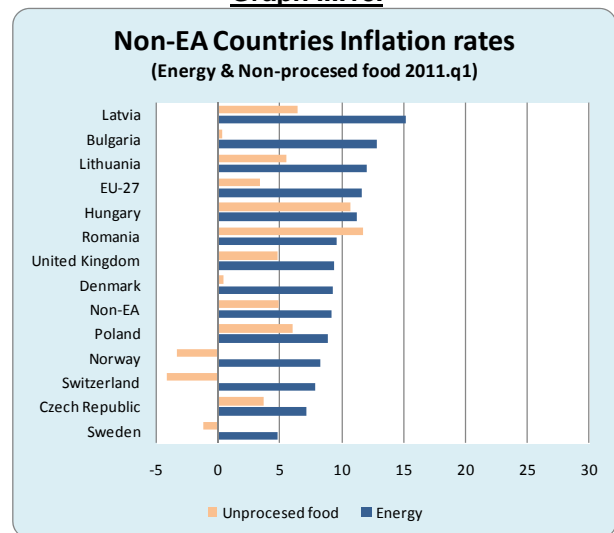
The inflation differentials for the most volatile components are especially marked, confirming the hypothesis of asymmetric shocks.

Graph III.17.



Source: Eurostat. April 2011.

Graph III.18.



Source: Eurostat. April 2011

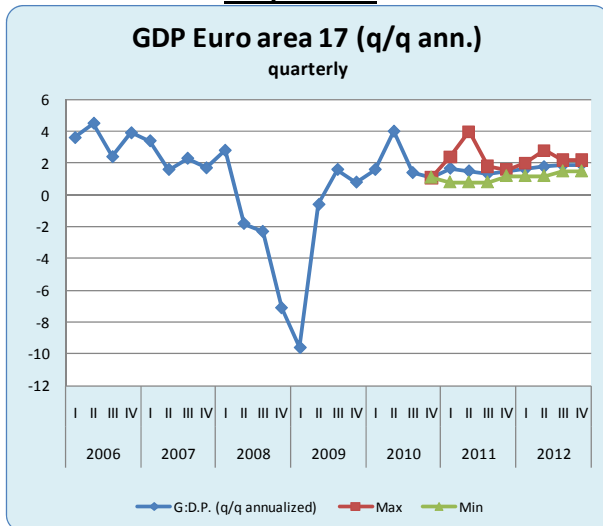
Indeed, the range of dispersion for the most volatile components of inflation is higher in the case of energy prices for the eurozone, as a whole, than the rest of the economies, while the price differentials for unprocessed food are higher for the countries which are not part of the single currency.

III.2.-THE OUTLOOK

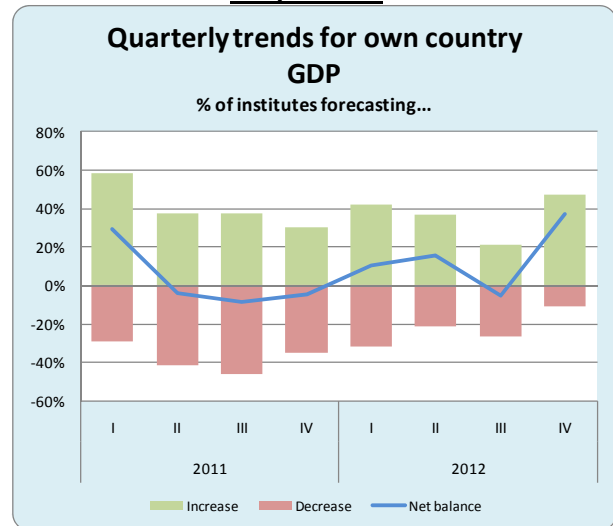
a) GDP Growth.

All of the AIECE member forecast institutes and centres predict relatively stable quarterly GDP growth for the eurozone, although with a certain trend towards acceleration following the two middle quarters of 2011, which are expected to report restrained growth.

Graph III.19.



Graph III.20.

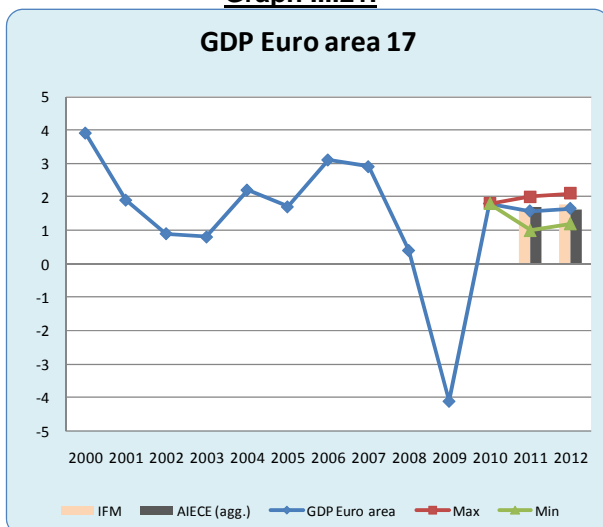


The quarterly profile expected by AIECE members, as a whole, indicates that growth will be restrained in the third quarter of the year, around 1.3% for the eurozone, after an additional expansion, close to 1.7%, during the first quarter.

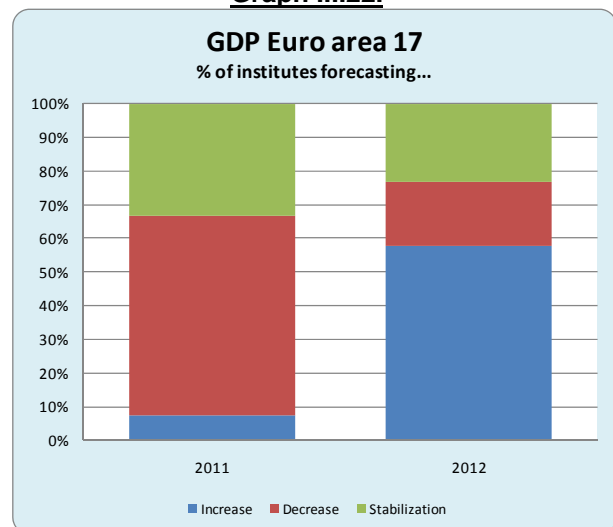
This will be followed by a recovery which will bring year-on-year GDP growth to around 2% in late 2012.

This profile of slightly restrained growth during 2011 is also reflected in the individual estimates of the different countries. During the second, third and fourth quarters of the current year, the percentage of institutes predicting a reduction in GDP growth rates is greater than those which forecast a certain acceleration. However, the net balance of these percentages becomes positive for virtually all of 2012, indicating that expectations of an accelerated rate of growth exceed those predicting more restraint.

Graph III.21.



Graph III.22.



In terms of annual aggregates, as shown in graph 21, the average of predictions for the eurozone, as a whole, anticipate 1.6% GDP growth for 2011 and 1.7% for 2012, figures very similar to those presented by the International Monetary Fund in its report from April of this year.

There is a significant degree of agreement between the different institutions regarding the trend profile, as the majority predict restrained growth for 2011 and a certain acceleration in 2012, as shown in graph 22.

Although the differences are very few and virtually imperceptible on the graphs, if we calculate average annual growth using the aggregate individual estimates of the different member countries, weighted according to their respective weight within total GDP for the eurozone, we obtain average figures very similar to the previous ones. However, the trend profile indicates a certain degree of restrained growth in 2012 in comparison with the values estimated for the current year, as shown in the table below.

The average annual estimates are quite close to those prepared by the IMF, although the aggregate of individual predictions points to sluggishness or a slight reduction in growth rates in 2012, in comparison with estimates for the current year.

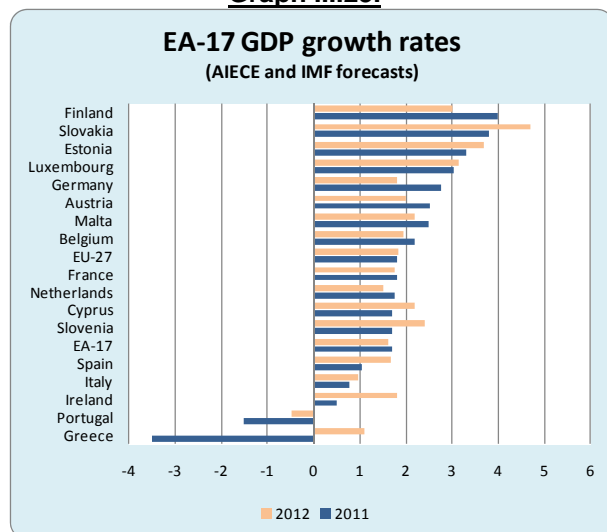
Table III.2
AIECE estimates for EA-17 GDP growth rates

Estimate	2010	2011	2012
AIECE average	1.8	1.6	1.7
AIECE maximum		2.0	2.1
AIECE minimum		1.0	1.2
AIECE country aggregation		1.7	1.6
IMF		1.6	1.8

NB: The estimate was obtained from the aggregate individual estimates by using a simple mean of the alternative estimates from the different institutions in a given country and the IMF's estimates for countries not represented in the AIECE (Estonia, Cyprus, Luxembourg, Malta and Portugal).

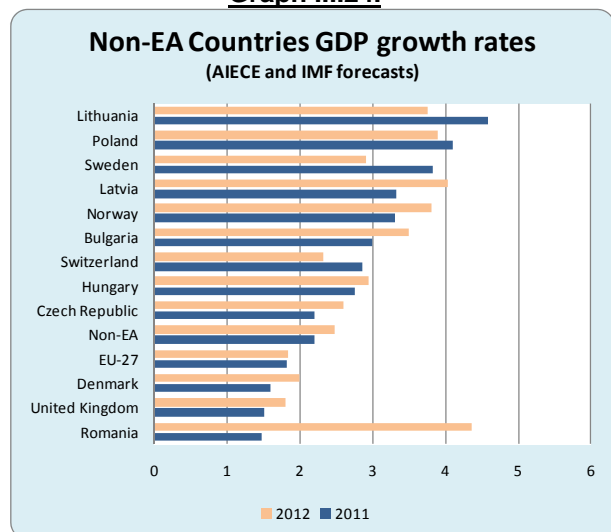
The short-term outlook for recovery continues to indicate a two-speed process, with some economies clearly expanding and others not yet having achieved their average potential growth.

Graph III.23.



Source: AIECE Institutes. April 2011.

Graph III.24.



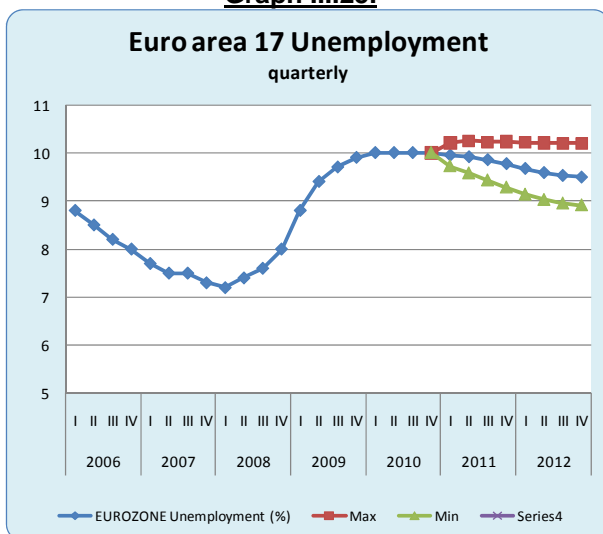
Source: AIECE Institutes. April 2011.

In the individual estimates by country, shown in graphs 23 and 24, it is still possible to see different behaviour within the eurozone, with some economies clearly undergoing expansion, such as Finland, Slovakia and Estonia, and others which have not achieved their average potential growth, such as Italy, Spain, Portugal and Greece.

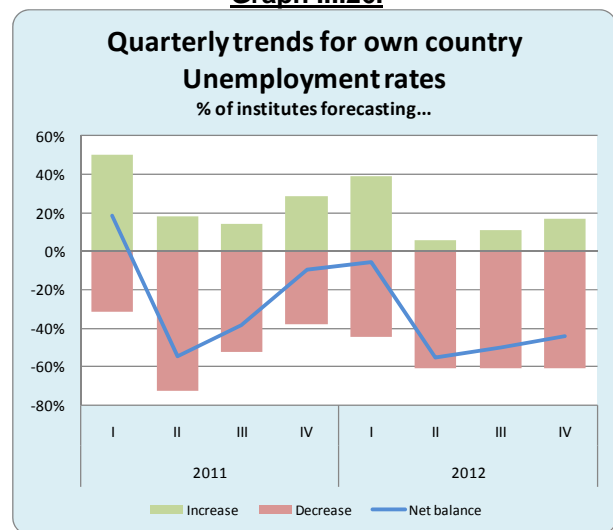
b) Unemployment.

Average predictions point to a slow, yet steady, reversal in the levels of unemployment accumulated during the crisis.

Graph III.25.

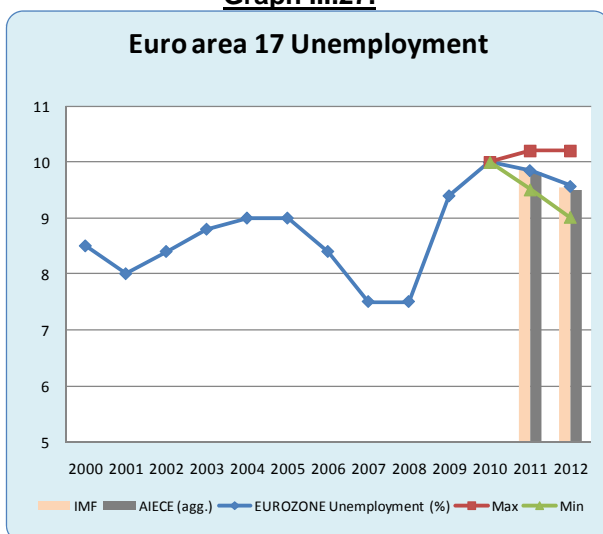


Graph III.26.

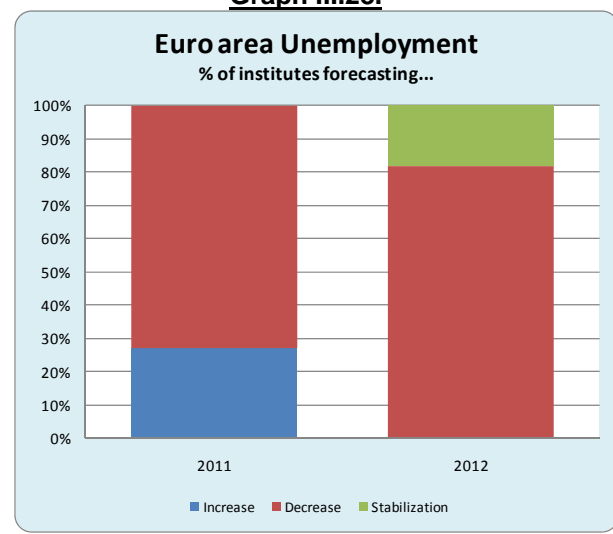


As the previous graphs show, the trend profile for unemployment in the eurozone as a whole shows it being curbed to a progressively greater extent in upcoming quarters. In fact, except for the first quarter of the current year, the net balance of individual estimates for curbing unemployment in the different countries is clearly positive, with reduced unemployment in the majority of the economies.

Graph III.27.



Graph III.28.



For annual values, AIECE member institutes, as a whole, predict that in 2011 unemployment rates will be held to around 9.8%, compared to the 10% reached in 2010, and up to 9.5% in 2012, figures which are still quite far from the low of 7.5% in 2007.

On this occasion, there is almost universal agreement, both in terms of assessing unemployment rate trends and the size of this reduction. As shown in table 3, the values are very similar to the mean estimate and that obtained by aggregating individual estimates from the different countries.

The annual mean estimates are relatively consistent and similar to those released by the IMF. They confirm that curbing unemployment will be a slow process.

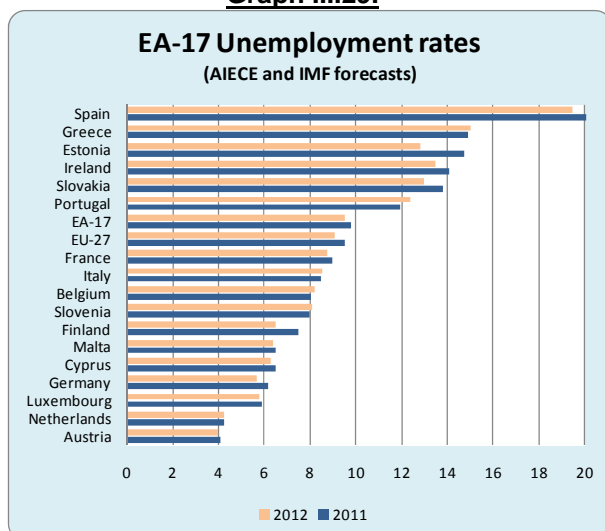
Table III.3
AIECE estimates for EA-17 unemployment rate

Estimate	2010	2011	2012
AIECE average	10.0	9.9	9.6
AIECE maximum		10.2	10.2
AIECE minimum		9.5	9.0
AIECE country aggregation		9.8	9.5
IMF		9.9	9.6

NB: The estimate was obtained from the aggregate individual estimates by using a simple mean of the alternative estimates from the different institutions in a given country and the IMF's estimates for countries not represented in the AIECE (Estonia, Cyprus, Luxembourg, Malta and Portugal), with the different rates weighted according to the working population of each country.

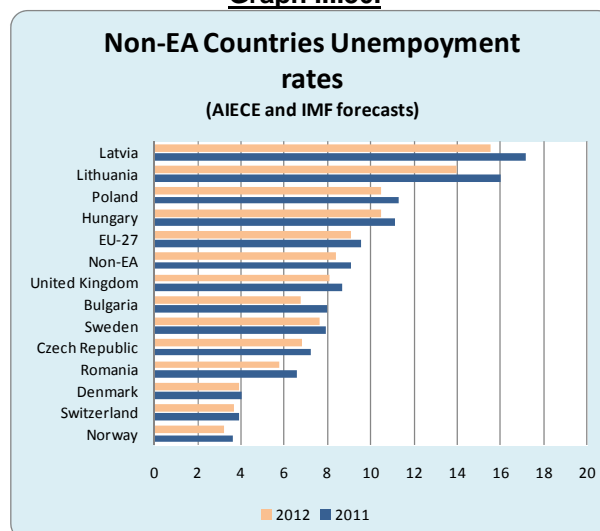
Different rates of growth, together with a variety of situations at the start of the crisis, lead to a wide range of dispersion for estimated 2011 and 2012 unemployment rates.

Graph III.29.



Source: AIECE Institutes. April 2011.

Graph III.30.



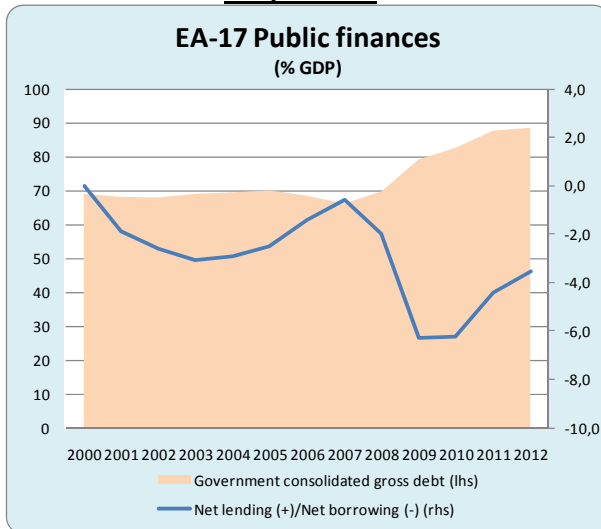
Source: AIECE Institutes. April 2011.

c) Public deficit and debt.

As with unemployment rates, average predictions for short-term trends in public finances are not very optimistic. Even when a progressive correction in imbalances is expected, it does not seem that it will be easy to get back to pre-crisis levels in the next few years. This results in an accumulation of debt, which will reach considerably higher levels than in previous years.

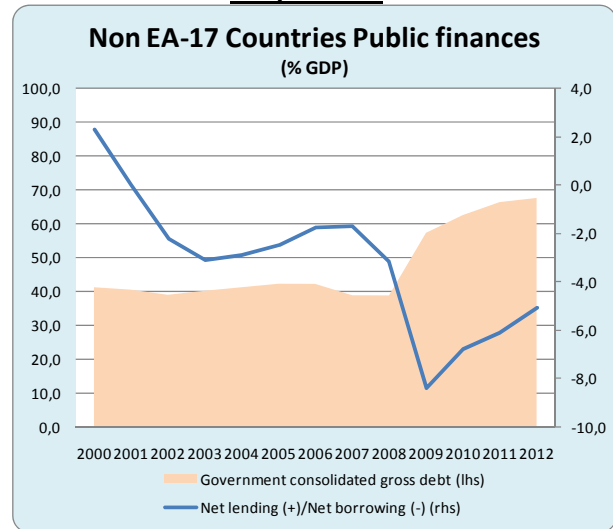
The public deficit will gradually correct itself over the next two years, although it will not reach pre-crisis levels and the total volume of national debt will increase.

Graph III.31.



Source: AIECE Institutes. April 2011.

Graph III.32.

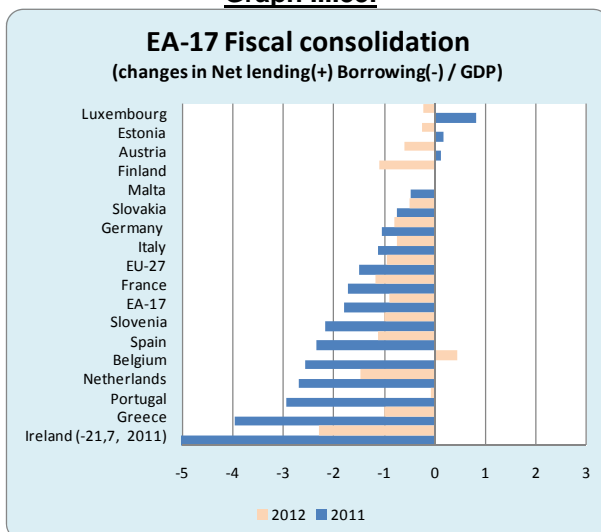


Source: AIECE Institutes. April 2011.

If we look at the average values forecast for public deficit by aggregating the individual estimates from the different countries, the convergence criteria established in the Stability and Growth Pact will not be fulfilled in the next two years, involving an additional effort in the area of fiscal restraint.

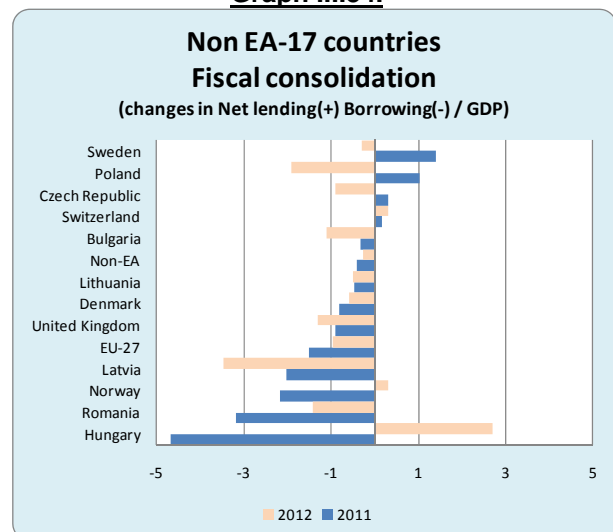
According to the estimates made by AIECE member institutes, the pace of fiscal consolidation, understood as the expected reduction of the public deficit, will be quite intense during 2011, averaging around 2%, and extend into 2012, albeit at a slower pace.

Graph III.33.



Source: AIECE Institutes. April 2011.

Graph III.34.

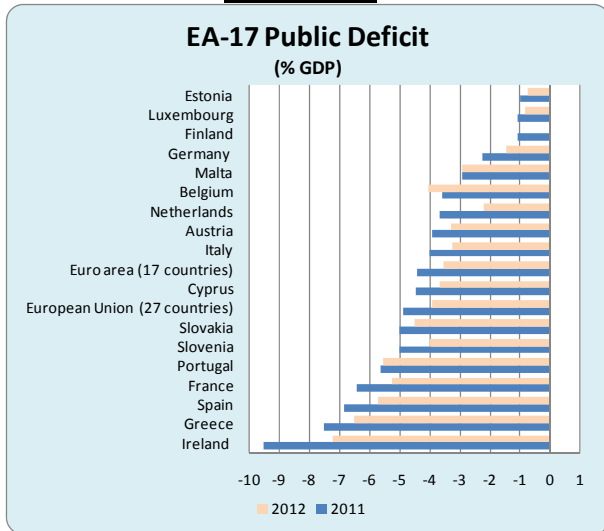


Source: AIECE Institutes. April 2011.

Observing the data for the different countries, we find that the expected reduction in the deficit will be especially intense in the economies most affected by the sovereign debt crisis

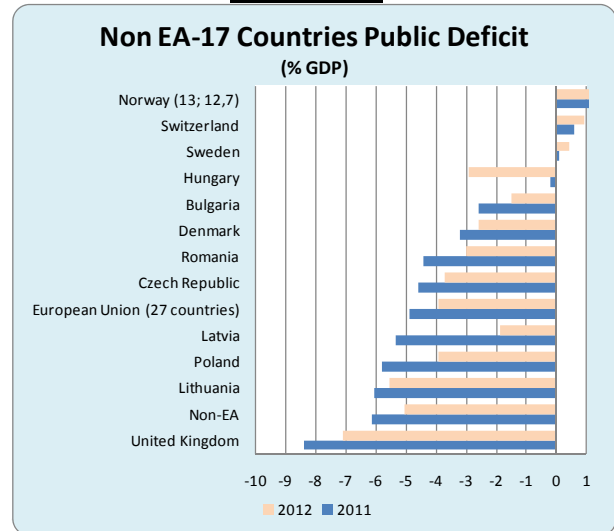
With regard to the countries which are not part of the single currency, the average level of fiscal consolidation will be rather more restrained. In fact, in 2011 we are already seeing some economies with a rather expansionary fiscal policy (increased debt).

Graph III.35.



Source: AIECE Institutes. April 2011.

Graph III.36.



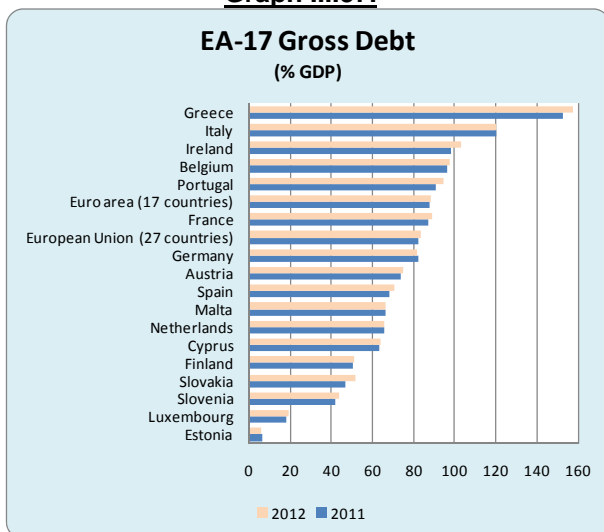
Source: AIECE Institutes. April 2011.

In any event, as indicated above, this fiscal effort will not be enough to reach stability and growth targets. In 2012, just six of the seventeen member states will have deficit levels below 3%.

Likewise, debt levels as a percentage of GDP will clearly exceed established targets and just five of the seventeen members will have debt ratios under 60% of GDP.

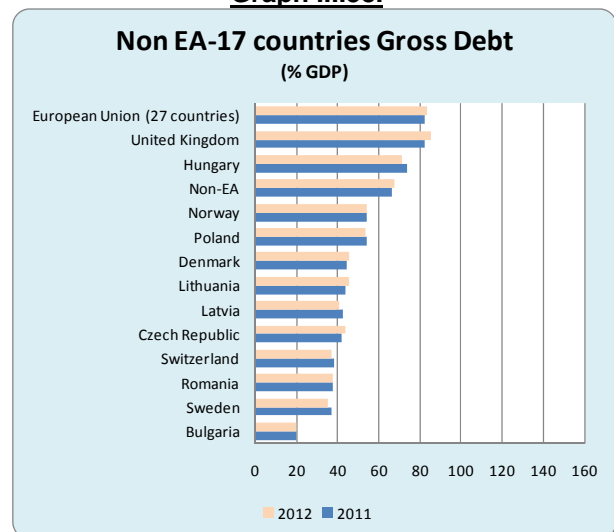
Despite efforts in the area of fiscal consolidation, Stability and Growth Pact targets will be far from being reached in the short term for the majority of the eurozone economies.

Graph III.37.



Source: AIECE Institutes. April 2011.

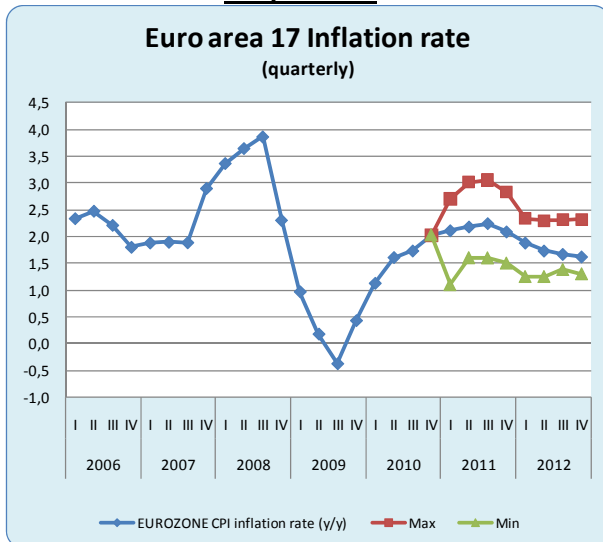
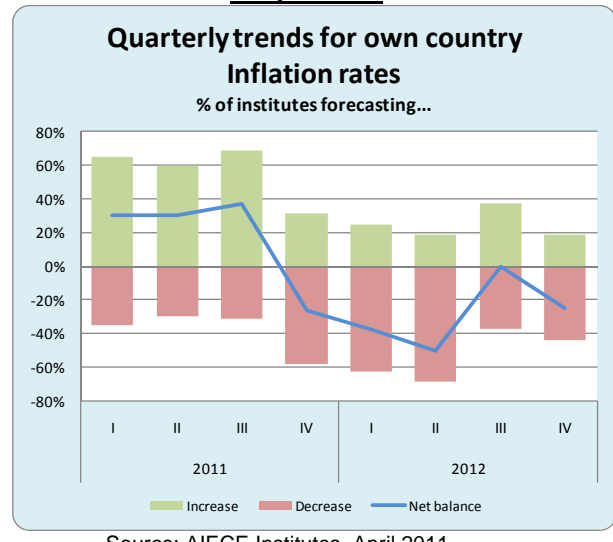
Graph III.38.



Source: AIECE Institutes. April 2011.

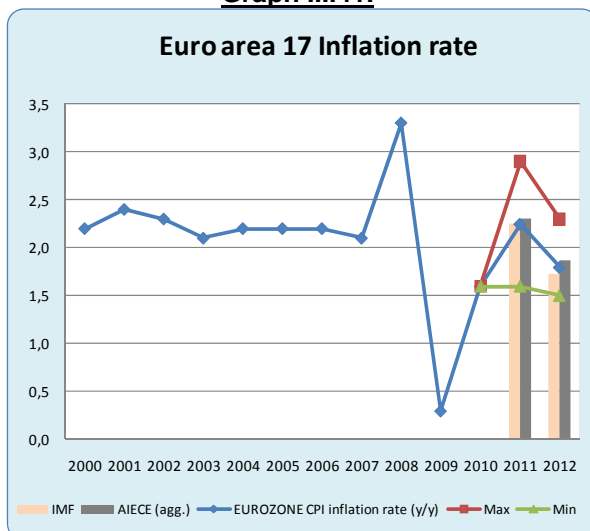
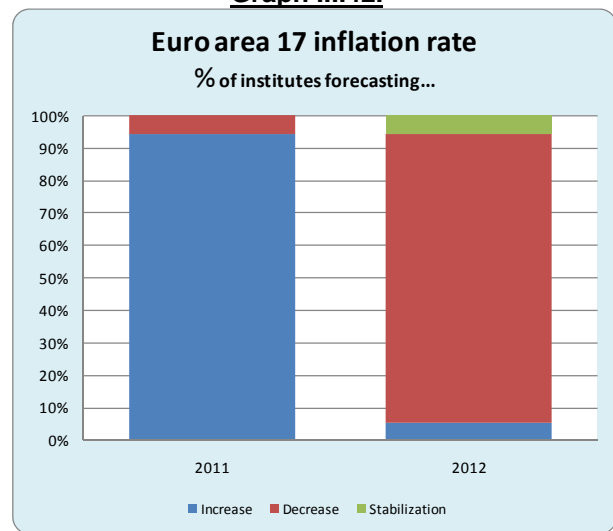
d) Inflation.

Average inflation estimates for the eurozone confirm the upturn in prices during the first two quarters of the current year, which will later be corrected, with average levels returning to below the 2% target in 2012.

Graph III.39.**Graph III.40.**

Although maximum values may be slightly above 3% during the middle two quarters of 2011, the average prediction does not even reach 2.5%, despite the fact that a large number of the institutions are anticipating ongoing increases in inflation for their own economies over the first three quarters of the year.

In contrast, the majority of estimates also indicate that these inflation rates will be checked starting in the fourth quarter of the current year, a process that will continue throughout 2012.

Graph III.41.**Graph III.42.**

In the annual aggregates, average estimates indicate that inflation will reappear in 2011, climbing to 2.2% from the 1.6% recorded 2010, and will later drop to 1.8% in 2012.

This trend profile is clearly reflected in the average percentages from institutions, which predict inflation increases in 2011 and subsequent adjustment in 2012.

If we calculate average inflation for the eurozone by aggregating the individual estimates of each one of the 17 members, we get a figure quite similar to the average estimate, although the final values will be somewhat higher for both 2011 and 2012.

Both average estimates and the aggregate of individual predictions confirm that inflation will accelerate in 2011 and abate in 2012.

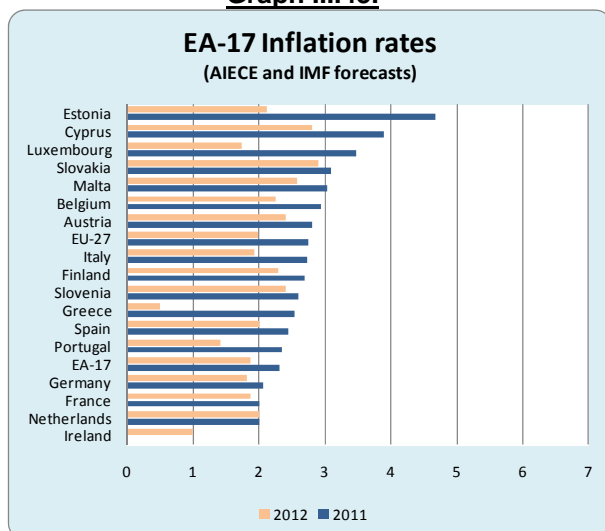
Table III.4
AIECE estimates for EA-17 inflation rates

Estimate	2010	2011	2012
AIECE average	1.6	2.2	1.8
AIECE maximum		2.9	2.3
AIECE minimum		1.6	1.5
AIECE country aggregation		2.3	1.9
IMF		2.3	1.7

NB: The estimate was obtained from the aggregate individual estimates by using a simple mean of the alternative estimates from the different institutions in a given country and the IMF's estimates for countries not represented in the AIECE (Estonia, Cyprus, Luxembourg, Malta and Portugal), with the different rates weighted according to the weights published by Eurostat.

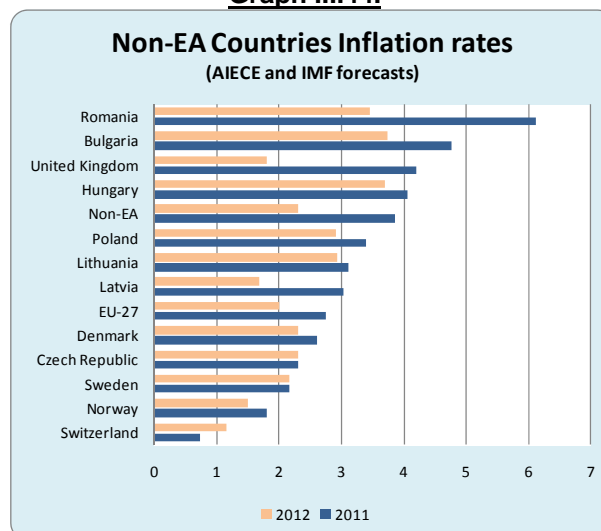
Inflation differentials between countries will tend to ease after overcoming the asymmetric shocks in 2011

Graph III.43.



Source: AIECE Institutes. April 2011.

Graph III.44.



Source: AIECE Institutes. April 2011.

Having overcome the asymmetric effects of the rising cost of raw materials in 2011, the relative dispersion of inflation estimated for the different economies will decrease significantly and the range of

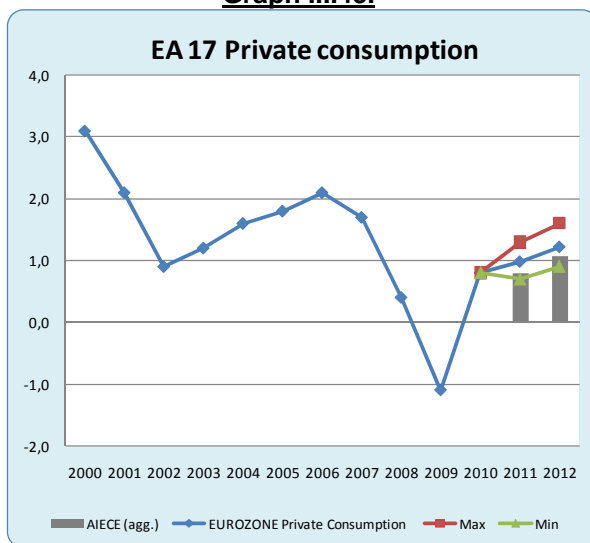
dispersion for the eurozone will drop from 4.7 points in 2011 to 2.4 in 2012; whereas for the rest of the economies, this level of variation will drop from 5.4 points in the current year to 2.6 in 2012.

e) Growth components.

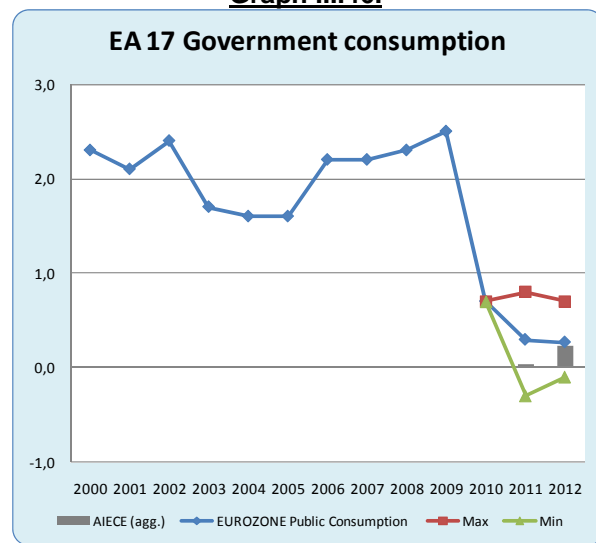
Having presented the overall estimates for the key data derived from the forecasts prepared by the AIECE institutes, we will now turn to the specific details of the predictions made for the different components of aggregate demand in the eurozone as a whole, comparing them with the results which would be obtained from the aggregate individual estimates for each country.

Here, in the absence of IMF forecasts, the values not available for the countries not represented in the AIECE have been replaced by European Commission forecasts compiled by Eurostat.

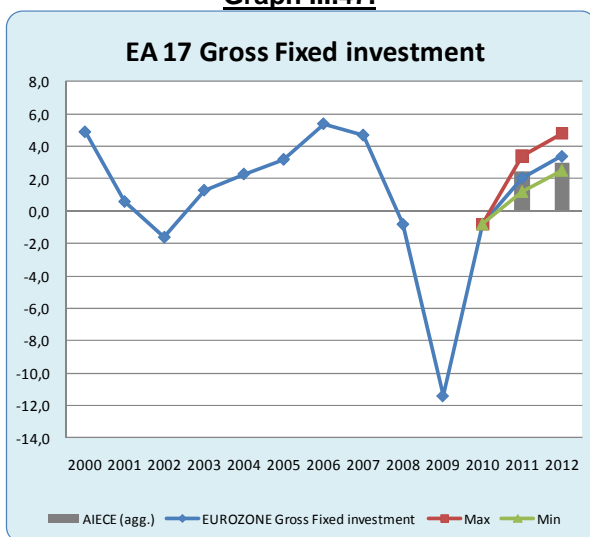
Graph III.45.



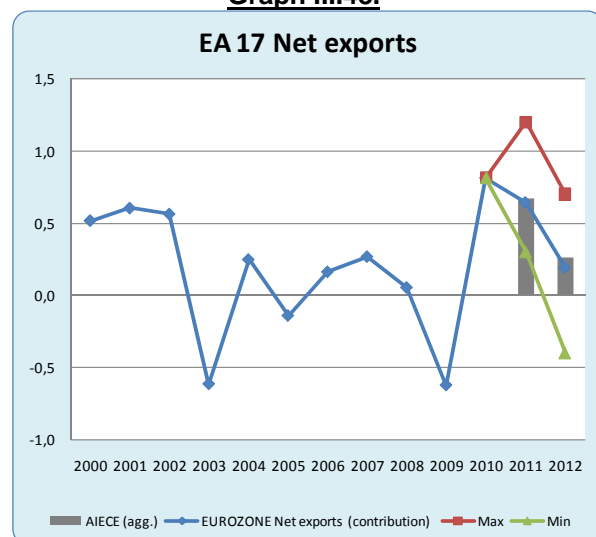
Graph III.46.



Graph III.47.



Graph III.48.



As shown in the previous graphs, average estimates are quite close to those obtained through aggregation for both gross fixed capital formation and the net contribution of foreign trade, confirming the acceleration of the former and a certain degree of restraint for the latter.

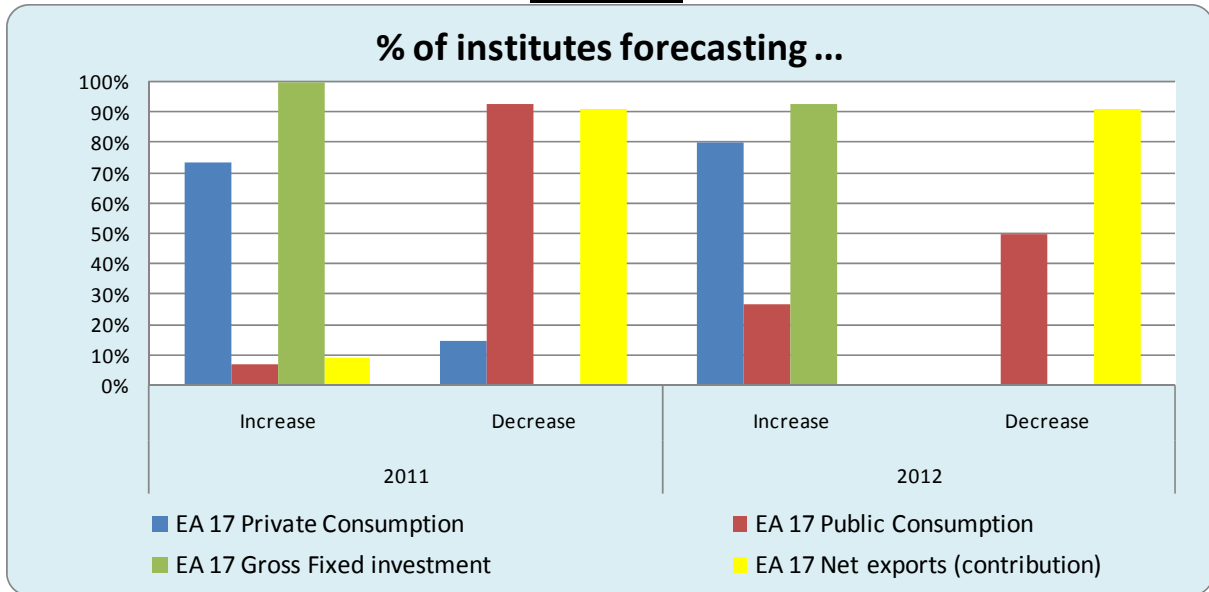
However, for private consumption, the aggregate results are closer to the estimated minimums than the average forecast, whereas for public expenditure, at least during 2011, the aggregate individual

estimates indicate considerably lower growth than the average assessment made by the different institutes.

The AIECE institutes, as a whole, point to a gradual recovery of both private consumption and investment, whereas public expenditure and the net contribution of foreign trade will tend towards more a moderate pace of growth.

These trend profiles are confirmed by the relative percentages of the forecasting institutions, expansions and contractions in the pace of growth in the different data, as shown in the graph below.

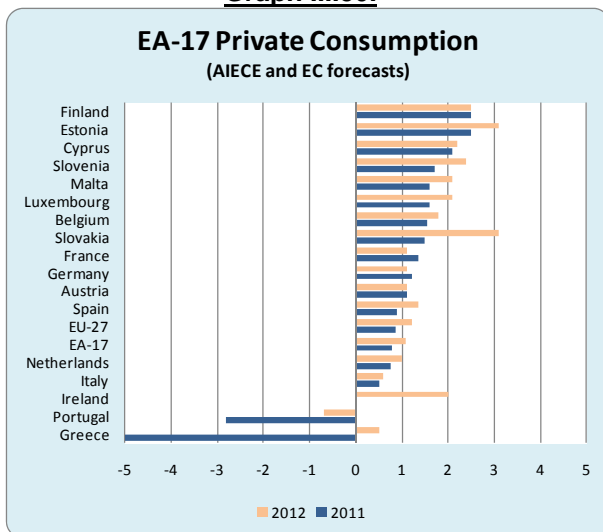
Graph III.49.



Source: AIECE Institutes. April 2011.

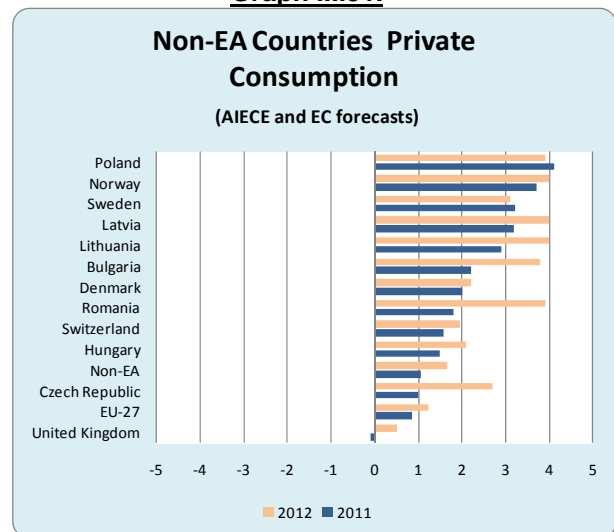
The graphs presented below contain individual estimates for each one of the countries for the different data analysed.

Graph III.50.



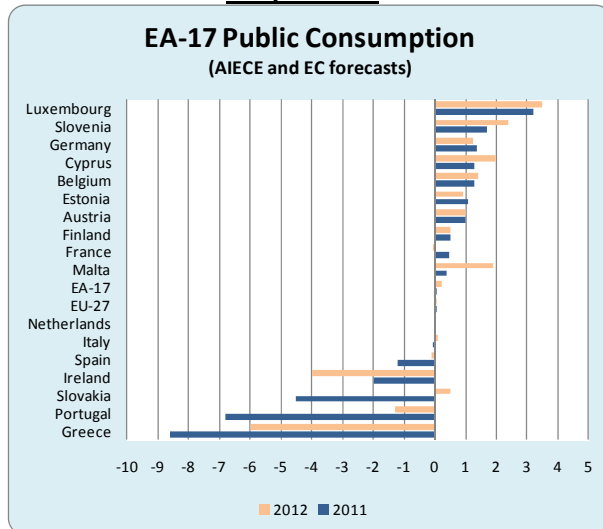
Source: AIECE Institutes. April 2011.

Graph III.51.

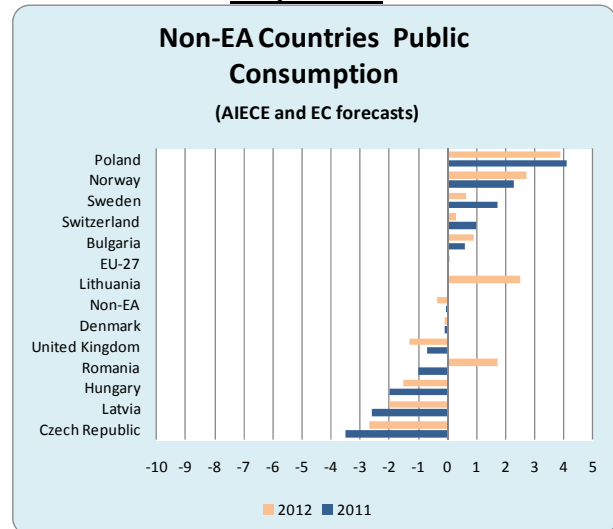


Source: AIECE Institutes. April 2011.

Private consumption is considerably more expansionary outside the euro area, where certain economies, such as Portugal and Greece, will experience additional contractions in consumption during the current year.

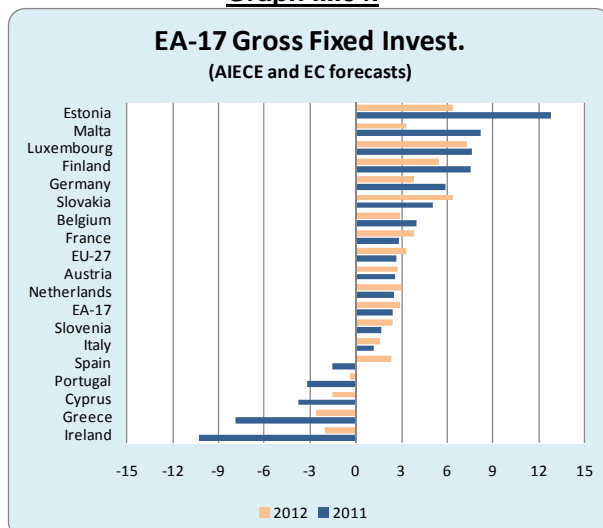
Graph III.52.

Source: AIECE Institutes. April 2011.

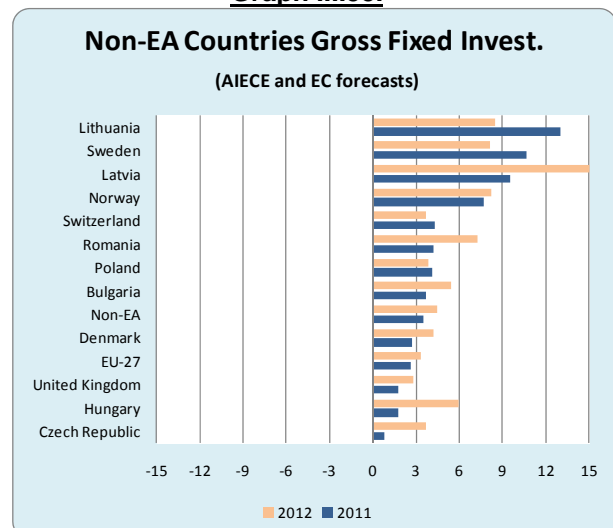
Graph III.53.

Source: AIECE Institutes. April 2011.

Public consumption clearly reflects the need for fiscal consolidation in the economies most affected by the debt crisis.

Graph III.54.

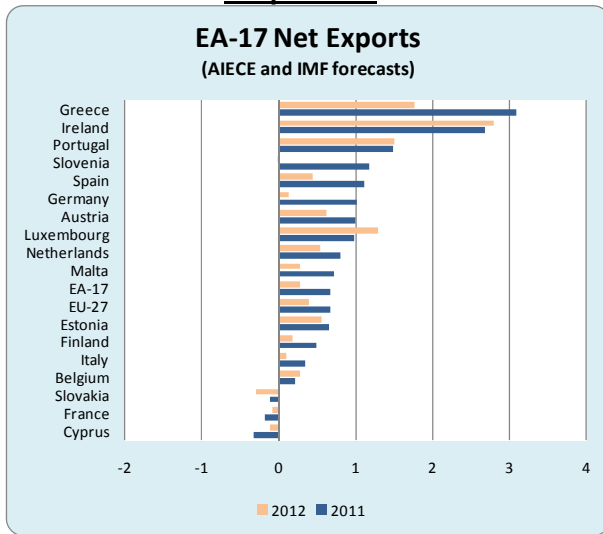
Source: AIECE Institutes. April 2011.

Graph III.55.

Source: AIECE Institutes. April 2011.

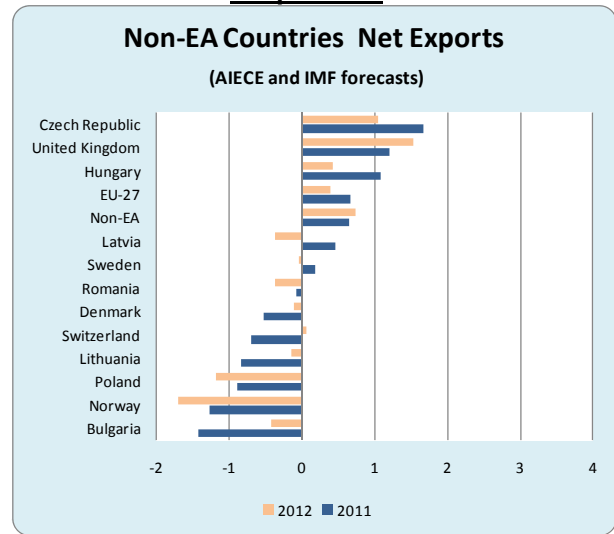
Like public consumption, investment reflects the problems of the economies on the periphery, whereas it is quite dynamic in the central and northern European economies.

Graph III.56.



Source: AIECE Institutes. April 2011.

Graph III.57.



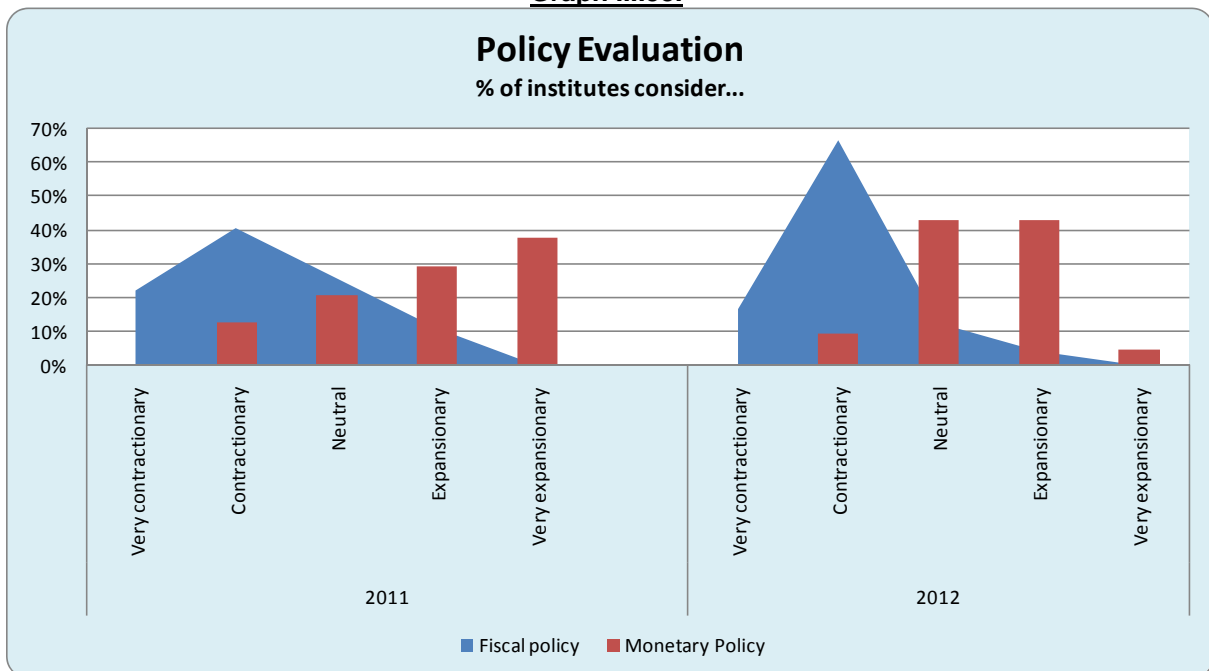
Source: AIECE Institutes. April 2011.

The net contribution of foreign trade will be especially significant in those economies with less expansion in domestic demand and where the pace of growth for imports will be quite slow. In any event, the majority of the economies in the euro zone can expect to see positive contributions.

f) Policy evaluation and credit conditions.

We conclude this section by presenting the forecasts produced by summarising how the different institutes assess fiscal and monetary policy, as well as credit conditions. Without a doubt, these will determine the growth prospects presented above.

Graph III.58.



Source: AIECE Institutes. April 2011.

Beginning with the assessment of monetary and fiscal policy, as shown in graph 58, the majority of AIECE institutes believe that for the current year, fiscal policy will tend towards contraction, even to a significant extent, for those economies affected by the debt crisis.

Far from slackening, apparently this contractionary bias in fiscal policy will tend to intensify during the upcoming financial year. Almost 90% of the institutions consider the fiscal policy assessed contractionary or very contractionary.

With regard to monetary policy, the assessment is somewhat more varied, as might be expected in a single currency area with different cyclical positions and a wide range of dispersion for rhythms of inflation.

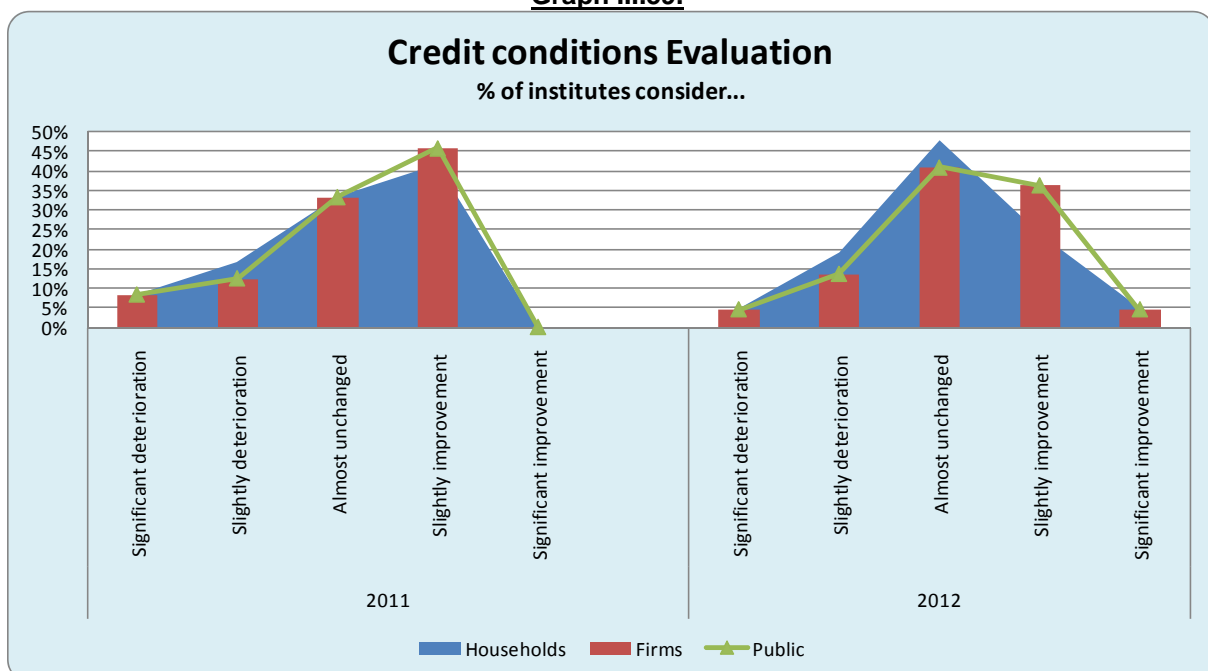
However, it seems that for the current year, the majority of institutions consider this monetary policy expansionary or very expansionary, with 70% of the responses offering this assessment.

For 2012, this expansionary bias in monetary policy shows a certain tendency towards correction, with more than 80% of responses positioned between neutral and expansionary.

If we combine this reduced expansionary bias of monetary policy with the increase in the restrictive nature of fiscal policy, it does not seem that the policy mix will especially favour the growth of domestic demand during the upcoming financial year.

2012 can be expected to bring some reduction in the expansionary bias of monetary policy, while the restrictive nature of fiscal policy will increase with regard to assessments for 2011.

Graph III.59.



With regard to credit conditions for companies, households and the public sector, a clear improvement is expected for the current financial year, while for 2012, most assessments expect the situation of the previous year to continue.

It is worth noting a certain improvement in credit conditions for companies and the public sector in 2012. For that year, the percentage of answers that indicate a considerable improvement is higher than for households.

II.4.- RISKS AND UNCERTAINTIES

In the previous section, we have shown that there is a considerable degree of agreement when it comes to assessing trends in the European economy over the next two years.

However, this level of agreement does not in the least mean that there are no risks and uncertainties which would affect the development of this economy in the short, medium and long term, as the majority of AIECE member institutes have stated.

In this third section, we intend to summarise the risks and uncertainties put forward by the different institutes with the aim not so much of clarifying these uncertainties, but rather in order to open up the debate and try to evaluate the possible alternative situations put forward.

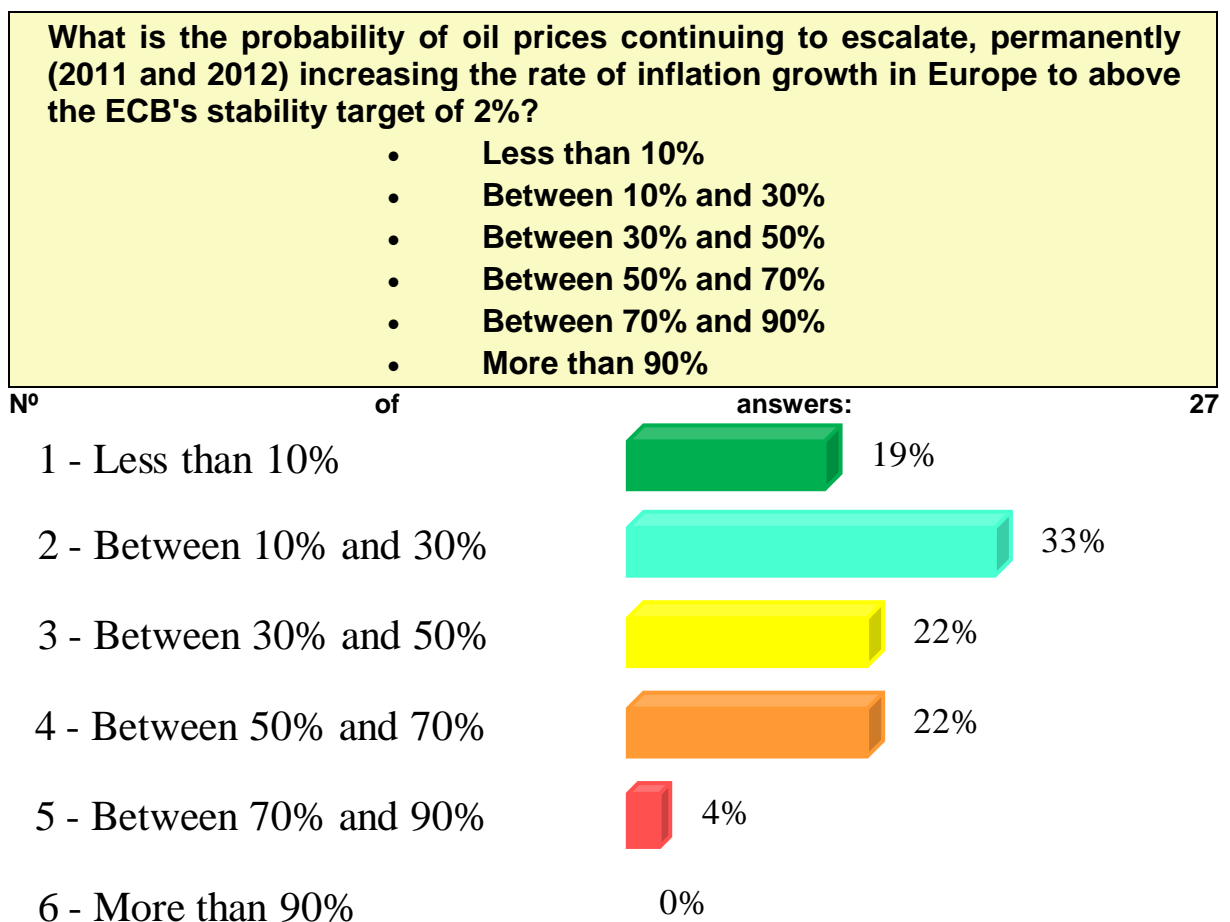
Although several issues have been put forward by AIECE members in their assessments of future scenarios, they clearly highlight three aspects related to relatively recent events in the global economy in general and the European economy in particular.

- The reappearance of high energy prices and the possible effects of geopolitical instability in North Africa and the Middle East on these.
- The consequences of the earthquake and subsequent tsunami in Japan.
- The sovereign debt crisis in the euro zone.

In addition, other aspects of risk linked to the sustainability of growth have been put forward, primarily related to the role which domestic demand must play in maintaining growth rates for real GDP and adapting the policy mix to the different situations experienced by European countries.

Given that the general aspects of the international situation have already been included in the previous sections, here we will focus on the possible effects of these events on the European economy as a whole, seeking to evaluate and quantify possible risks.

a) Open questions: Energy prices.

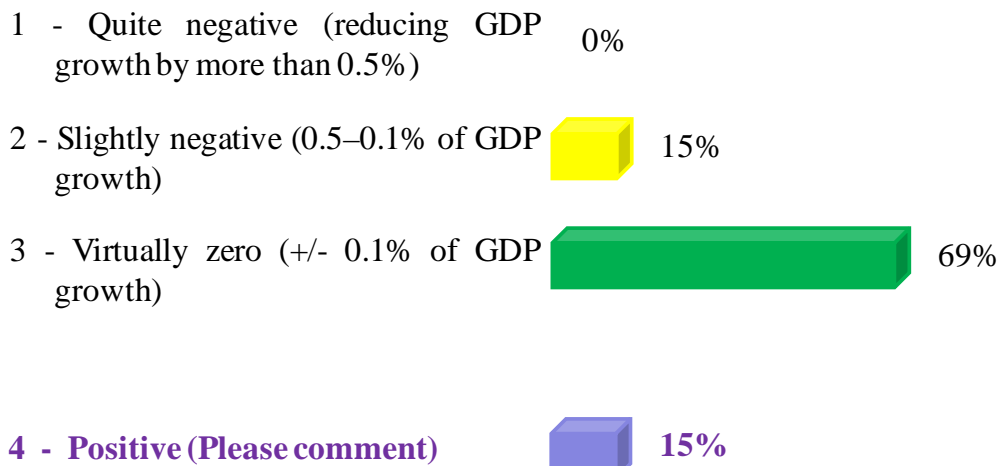


b) Open questions: Effects of the earthquake and Tsunami in Japan.

What kind of effect do you think the natural disasters in Japan will have on the growth of the European economy over the next two years?

- Quite negative (reducing GDP growth by more than 0.5%)
- Slightly negative (0.5–0.1% of GDP growth)
- Virtually zero (+/- 0.1% of GDP growth)
- Positive (Please comment)

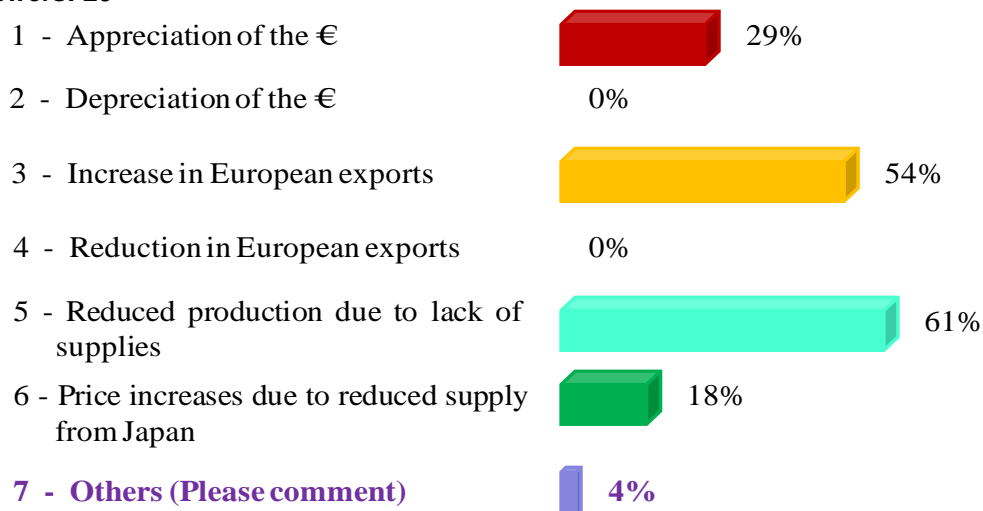
Nº of answers: 26



What are the main ways these natural disasters in Japan will have an effect on the European economy in the short term, 2011–2012?

- Appreciation of the €
- Depreciation of the €
- Increase in European exports
- Reduction in European exports
- Reduced production due to lack of supplies
- Price increases due to reduced supply from Japan
- Others (Please comment)

Nº of answers: 20

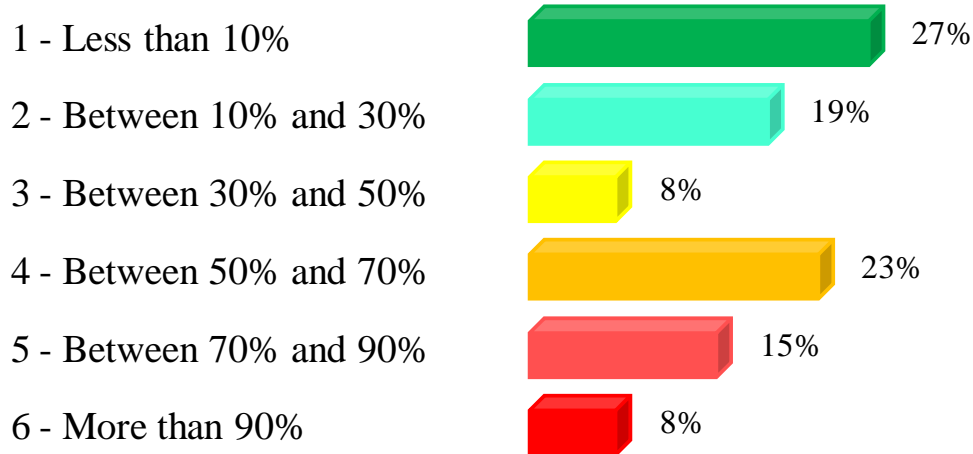


c) Open questions: Sovereign debt crisis.

What do you think is the probability of a scenario with partial non-payment (release) of sovereign debt in some of the euro zone countries is?

- **Less than 10%**
- **Between 10% and 30%**
- **Between 30% and 50%**
- **Between 50% and 70%**
- **Between 70% and 90%**
- **More than 90%**

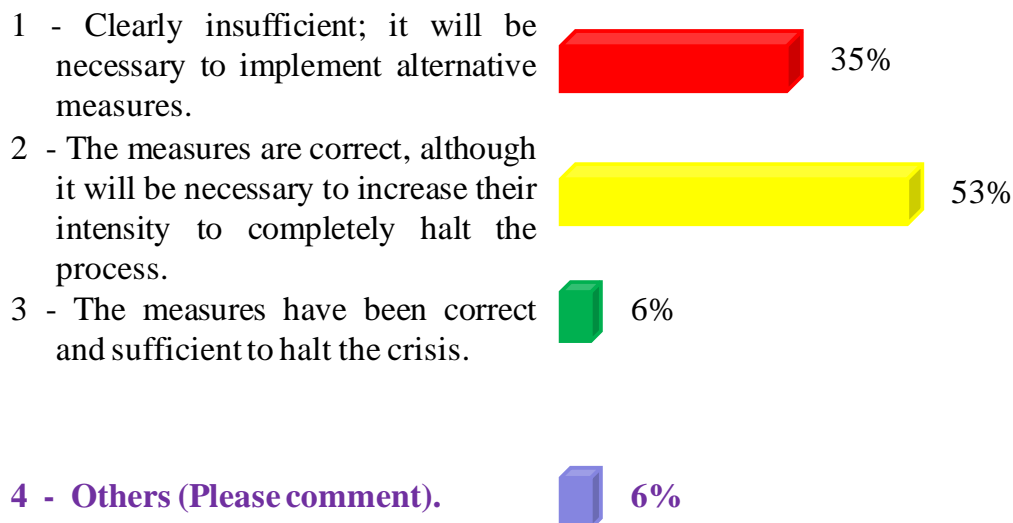
N° of answers: 26



What is your assessment of measures taken to date to halt the debt crisis?

- **Clearly insufficient; it will be necessary to implement alternative measures.**
- **The measures are correct, although it will be necessary to increase their intensity to completely halt the process.**
- **The measures have been correct and sufficient to halt the crisis.**
- **Others (Please comment).**

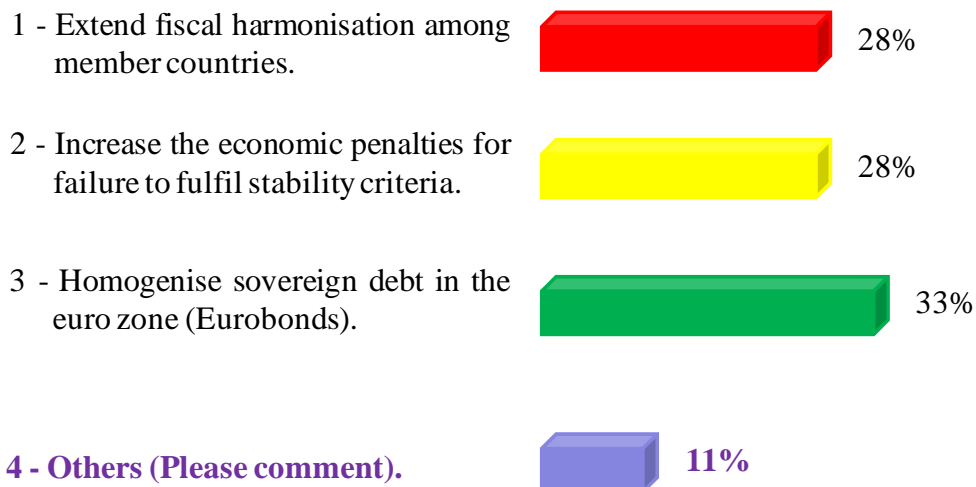
N° of answers: 17



In your opinion, what would be the most suitable measure to prevent new episodes of debt crisis in the euro zone?

- **Extend fiscal harmonisation among member countries.**
- **Increase the economic penalties for failure to fulfil stability criteria.**
- **Homogenise sovereign debt in the euro zone (Eurobonds).**
- **Others (Please comment).**

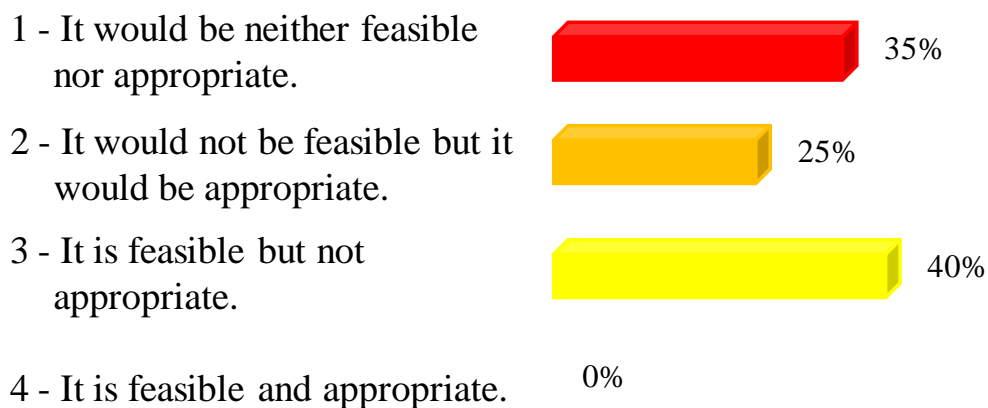
Nº of answers: 18



Do you think it is feasible or appropriate for any of the current members of the single currency to withdraw?

- **It would be neither feasible nor appropriate.**
- **It would not be feasible but it would be appropriate.**
- **It is feasible but not appropriate.**
- **It is feasible and appropriate.**

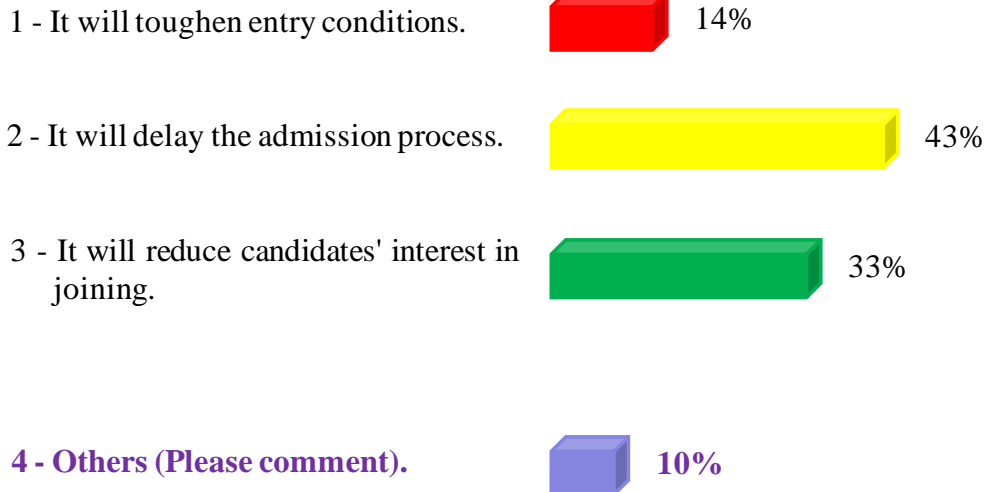
Nº of answers: 20



How do you evaluate the effect of this crisis on possible candidates to join the single currency?

- It will toughen entry conditions.
- It will delay the admission process.
- It will reduce candidates' interest in joining.
- Others (Please comment).

Nº of answers: 21



d) Open questions: Sustainability of growth.

What factors do you think will be the most important for private consumption levels in the European economy during 2011 and 2012?

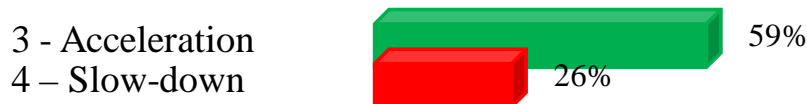
- Consumer confidence (increase / reduction)
- Employment (acceleration / slow-down)
- Saving rates (increase / reduction)
- Others (Please comment)

Nº of answers: 27

Consumer confidence:



Employment:



Saving rates:



7 – Others (Please comment) 11%

What factors do you think will be the most important for private investment levels in Europe during 2011 and 2012?

- **Prospects of business owners (increase / reduction)**
- **Cost of capital (increase / reduction)**
- **Ease of access to credit (improved / worse)**
- **Others (Please comment)**

N° of answers: 28

Prospects of business owners:



Cost of capital:



Ease of access to credit:



Do you think that domestic demand will be capable of offsetting the expected drop in the net contribution of foreign trade in 2011 and 2012?

- **Only partially (2011/2012)**
- **Completely (2011/2012)**
- **It will exceed it (2011/2012)**

N° of answers: 23

Only partially:



Completely:



It will exceed it:



What do you think will be the strengths and weaknesses of European exports in 2012?

- **The exchange rate (appreciation / depreciation)**
- **The volume of global trade (acceleration / slow-down)**
- **Market presence (improved / worse)**
- **The distinguishing quality of European products (improved / worse)**
- **Others (discuss during the debate)**

Nº of answers: 26

The exchange rate:



The volume of global trade:



Market presence:



The distinguishing quality of European products:



9 – Others (please comment)

