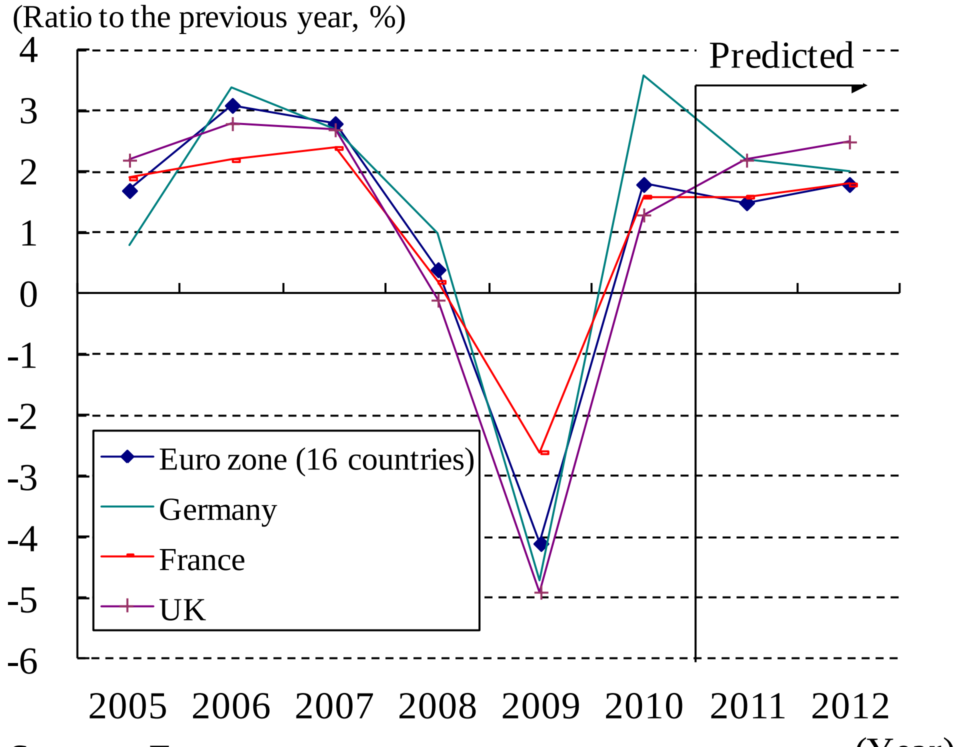
4. Current situation and problem of the economy of Europe

The economy of Europe as a whole recovered from the economic recession caused by the world financial crisis in 2010, but there was a large variation in economic recovery process, which was different from country to country. The real GDP growth rate of the euro zone[85] recovered to 1.8% compared with the previous year in 2010, years after large decrease of -4.1% in 2009. Germany, a major European country, achieved a high growth rates of 3.6% in 2010, but France and the UK also achieved the recovery of 1.6% and 1.3% respectively (Figure 1-1-4-1). On the other hand, Ireland and some of the Southern European countries which were shaken by the European financial crisis, continued to be in the severe situation of minus economic growth in 2010 (Figure 1-1-4-2).

After having observed economic trends in the whole euro zone, an overview of German economic trend, which accomplished high growth among countries in Europe, is given in the section below.

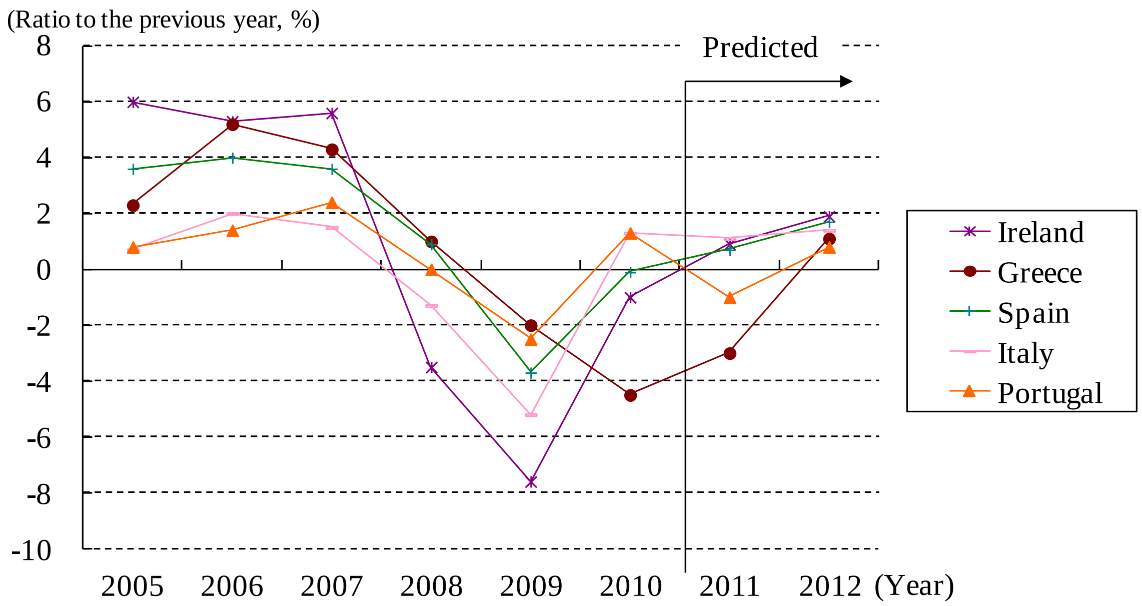
Figure 1-1-4-1 Transition of the real GDP growth rates of major countries in Euro zone and Europe



Sources: Eurostat

[85] In this Section, "euro zone" refers to 16 nations which introduced euro as of 2010 among EU member nations (Belgium, Germany, Greece, Spain, France, Ireland, Italy, Cyprus, Luxemburg, Malta, Holland, Austria, Portugal, Slovenia, Finland, Slovakia).

Figure 1-1-4-2 Transition of the real GDP growth rates of countries in South Europe



Sources: Eurostat

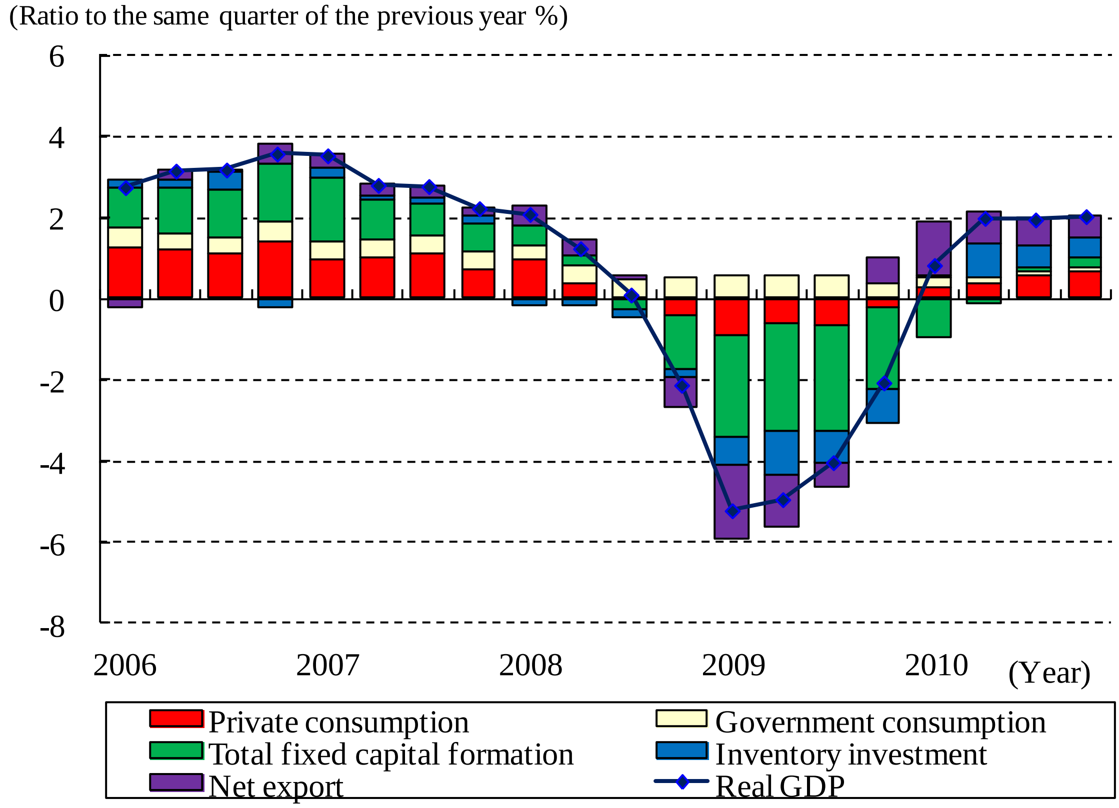
(1) Economic trends in the euro zone

(A) Economy, driven by foreign demand improved

After having been suddenly depressed under the influence of the world financial crisis, the euro zone economy was restored in 2010. Examining the transition of the real GDP growth rates, after having been depressed greatly from the previous year with a negative growth of -5.2% in the first-quarter of 2009, the size of the minus growth rate gradually reduced and it turned to plus growth with 0.8% in the first quarter of 2010 and afterward it maintained 2.0% growth over the same period of the previous year.

Examining trends of the euro zone economy according to demand of items, the degree o contribution of the foreign demand was 1.4% points in the first-quarter of 2010. The foreign demand pushed up the growth rate backed by recovery of the world economy. With recovery of the export, the production activity accelerated, and movement of the stock reconstruction expanded and the inventory investment, whose degree of contribution had so far been negative, pushed up the growth rate. The individual consumption also propped up the economic recovery (Figure 1-1-4-3).

Figure 1-1-4-3 Transition of the real GDP growth rates of countries in Euro zone by expenditure components



Sources: Eurostat

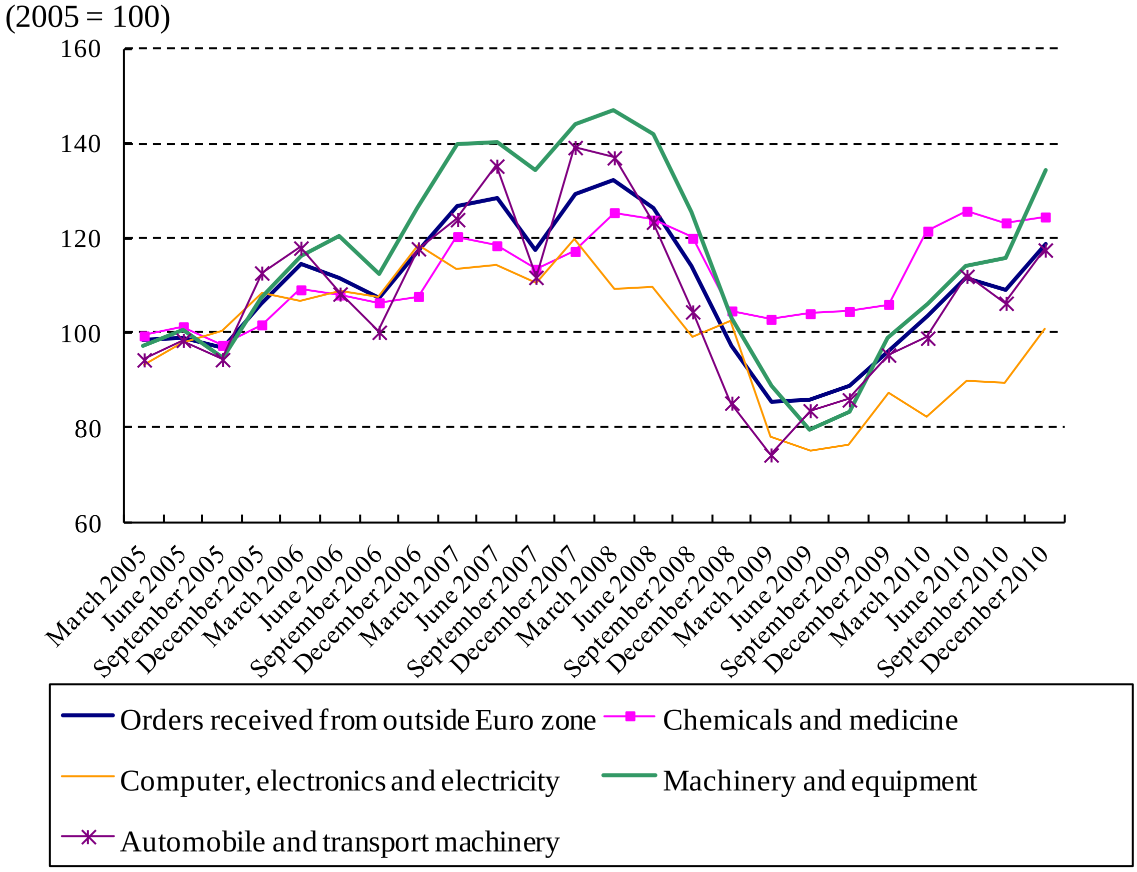
(B) The enterprises sector recovered the export driven productions

As for the order for the export of manufacturing industry to destinations outside the euro zone, the recovery became remarkable in the first-quarter of 2010 and afterward. Orders to export chemicals in the first half of 2010, and orders for machine/ equipment and automobile/ transport machine in latter half of 2010 were remarkably recovered to the previous level and even rose higher.

It was so supposed that the export orders of such articles increased due to recovery of exports to United States of America and emerging economies in Asia, particularly to China (Figure 1-1-4-4).

The production activities were restored with increase of the export orders. As for the industrial production of the euro zone, minus growth remained unchanged compared with the same month of the previous year in 2009, but it turned to the desired expansion level in January 2010 and the growth rate rose to around 8 to 9% over the same month of the previous year after March (Figure 1-1-4-5).

Figure 1-1-4-4 Export orders to manufacturing industry in Euro zone received from outside the region



Sources: Eurostat

(C) Private consumption recovered moderately

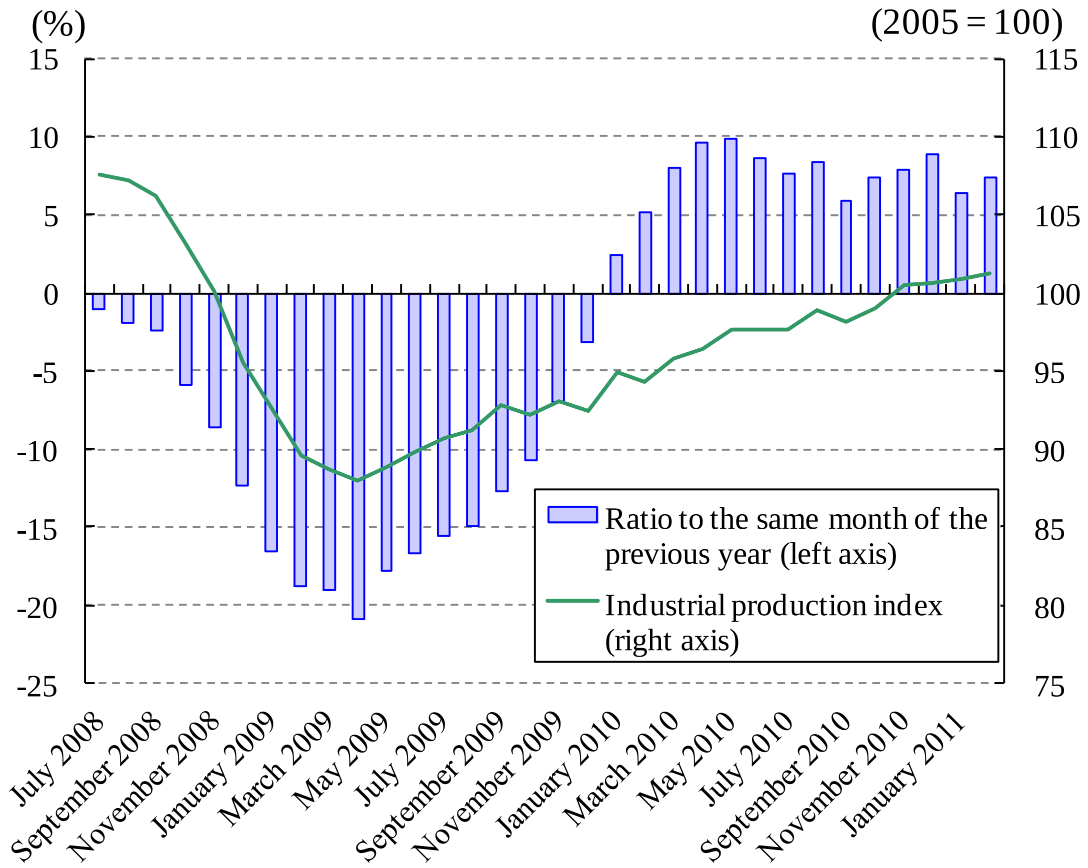
In the household sector, individual consumption continued to recover at a moderate pace. The retail sales amount in the euro zone turned to decrease in November, 2008, by -0.6% compared with the same month of the previous year, and continued to decrease towards middle of 2009 with a decline rate of -5 to -6%, but it became plus growth after February 2010 (Figure 1-1-4-6).

It is thought that the moderate recovery of the individual consumption was backed by the moderate improvement of the employment/ income circumstance. As of the employment situation, the unemployment rate was in transition at the high level of approximately 10%, but a sign to stop the increase of the unemployment could be seen. Number of unemployment continued to increase 400,000 to 500,000 in January through March 2009 compared with the same month of the previous year, but the width of increase reduced afterwards. The number decreased to 128,000 compared to same month of the previous year in November 2010, and afterwards it continued to decrease for consecutive 5 months until March 2011. The employees pay was improved gently[86] during these periods, and it supposed to contribute to the recovery of private consumption (Figure 1-1-4-7: Number and rate of

[86] In the euro zone, the employees' salary continued to rise on quarterly basis at an average of 2.1% compared with the previous years from 2009 through 2010.

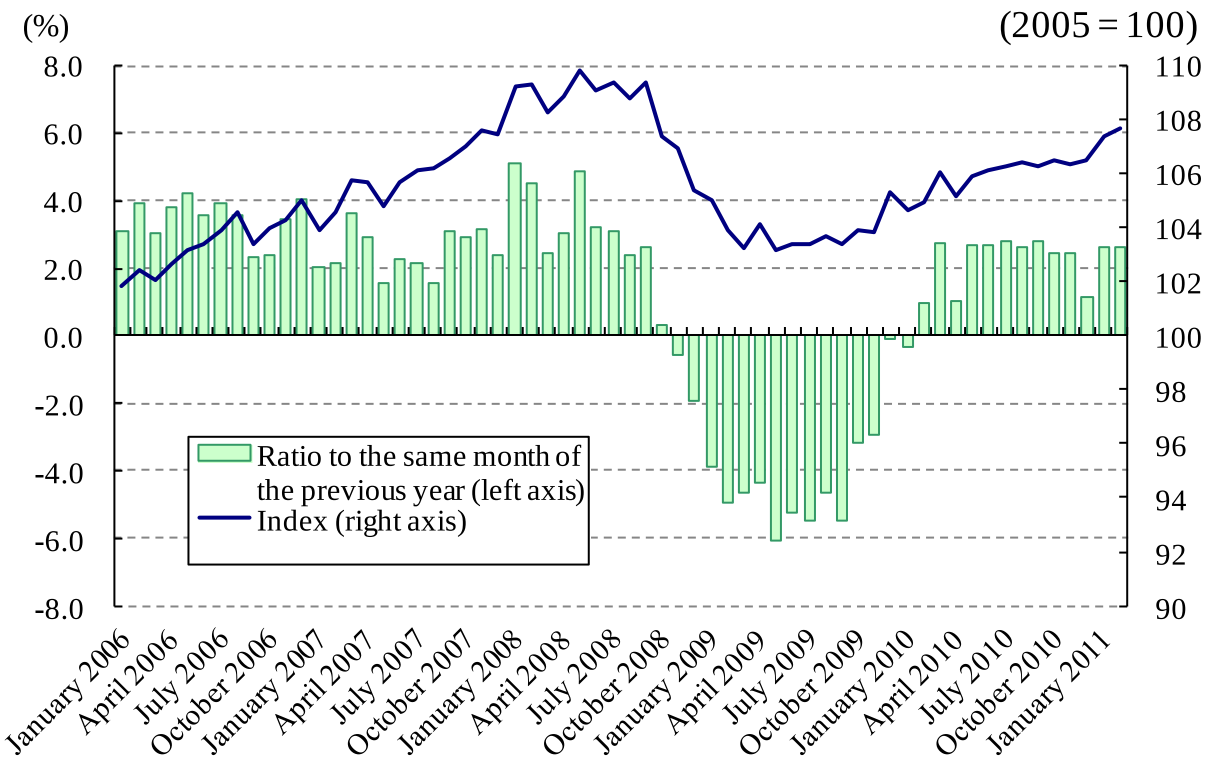
unemployment).

Figure 1-1-4-5 Transition of industrial production in Euro zone



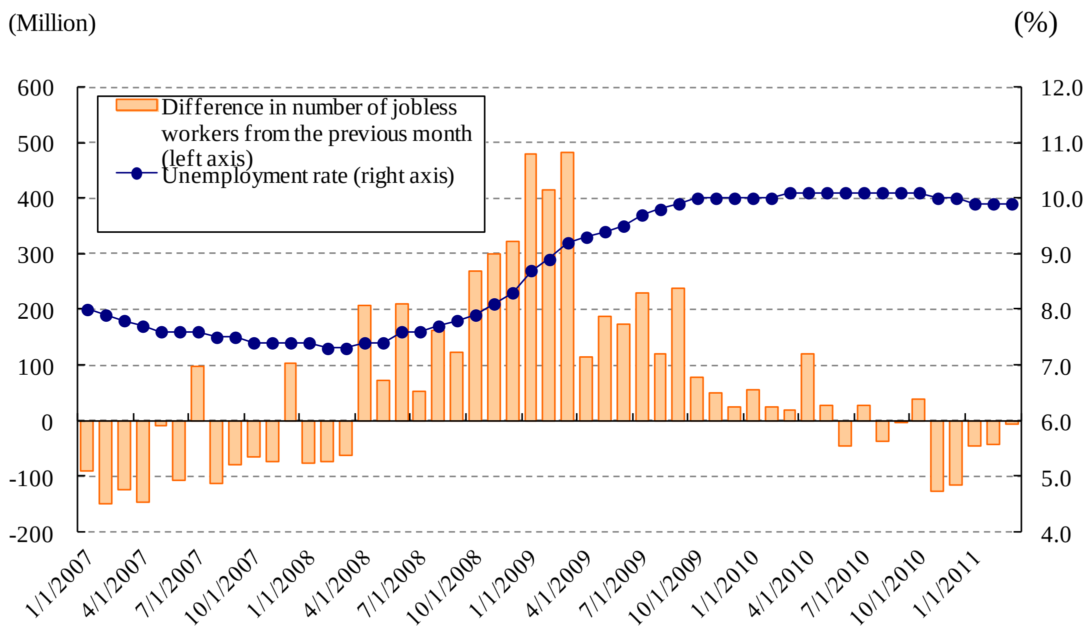
Sources: Eurostat

Figure 1-1-4-6 Transition of retail sales in Euro zone



Sources: Eurostat

Figure 1-1-4-7 Transition of number of jobless workers and unemployment rate



Sources: Eurostat

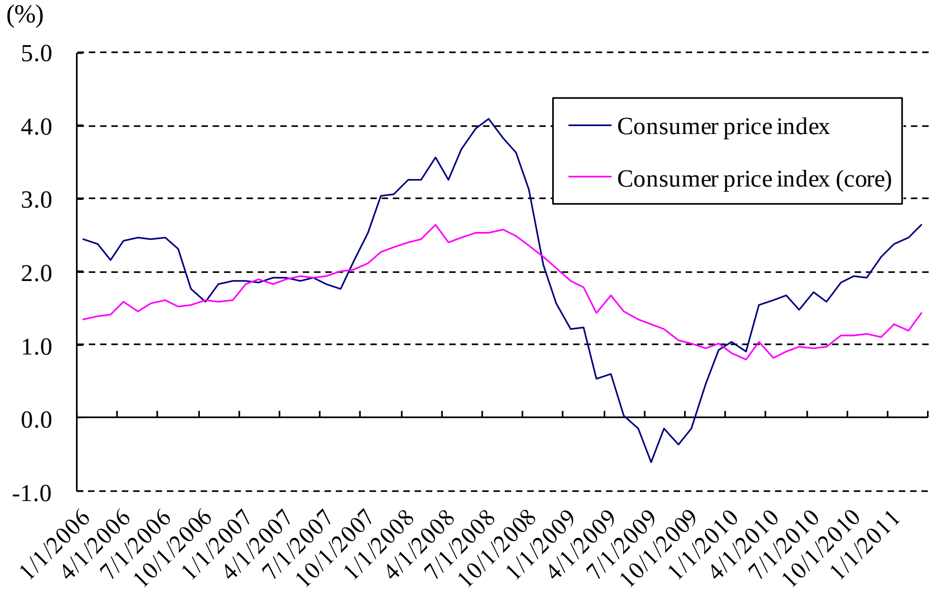
(D) Inflation concerns and European Central Bank (ECB)'s monetary policy

As the euro zone economy achieved moderate recovery in 2010, the commodity prices trends were changing stably, but price hike pressure gradually rose after the end of 2010. Observing changes in the climbing rate of Harmonized Index of Consumer Prices (HICP), in December, 2010, it became 2.2% compared with the previous year, and this was over 2.0% which was an inflation target of ECB, and the climbing rate was still accelerated and it was 2.6% in March, 2011. Background to these rises was the surge in prices of food and resources. Prices of food and crude oil were rising backed by situations such as tight supply-and-demand conditions caused by the high economic growth of the emerging economies Including China, funds inflow from the monetary market, political uneasiness in Middle East and North Africa (refer to Chapter 1, Section 2.1 The factors and influence of the remarkable rises in prices of food and resources). These factors combined with advancing decrease of euro value caused pressure to raise prices of upstream sectors such as import prices and producer prices. Therefore, the core inflation excluding food and energy became the 1% level (1.1% compared with the previous year) in September, 2010, and increased to 1.4% in March 2011(Figure 1-1-4-8).

In these situations, the ECB, which was cautious on inflation, determined to raise the main policy rate by 0.25% and make it 1.25% on April 7, 2011. Although the euro zone economy as a whole was moderately recovering, as mentioned above, economic trends in the said zone had a large gap between countries. Some of the South European countries including Ireland and Greece continued to register minus growth and the deflation concern was emerging. If interest rates increase, the home loan[87] mainly on the variable rate may lead to the intensification of the bad-loan problem of financial institutions. If it becomes overhasty to exit, it may cause the economic recovery to stall and a new confusion in the monetary market might arise. ECB is pressed to steer the difficult monetary policy for recovery.

[87] As for the home loan, the variable rate is main stream in countries such as, Spain, Greece and Ireland (European Mortgage Federation (2006) "Study on Interest Rate Variability in Europe, July 2006").

Figure 1-1-4-8 Transition of consumer prices in Euro zone



Sources: Eurostat

(2) Trends of German economy

Germany accomplished remarkable economic growth among countries in the euro zone with its real GDP growth rate of 3.6%, an increase over that of the previous year of 2010. Examining the Germany's real GDP according to demand of items, such as, the foreign demand, inventory investment and capital spending which led the economic recovery. And individual consumption was found to prop up the economy in late 2010. Regarding the business sector, when the significant economic recession occurred in 2009, production and capital spending were contracted. It was supposed that, as a reaction, the stock buildup and increase of capital spending were implemented in 2010, especially in the first half of the year (Figure 1-1-4-9).

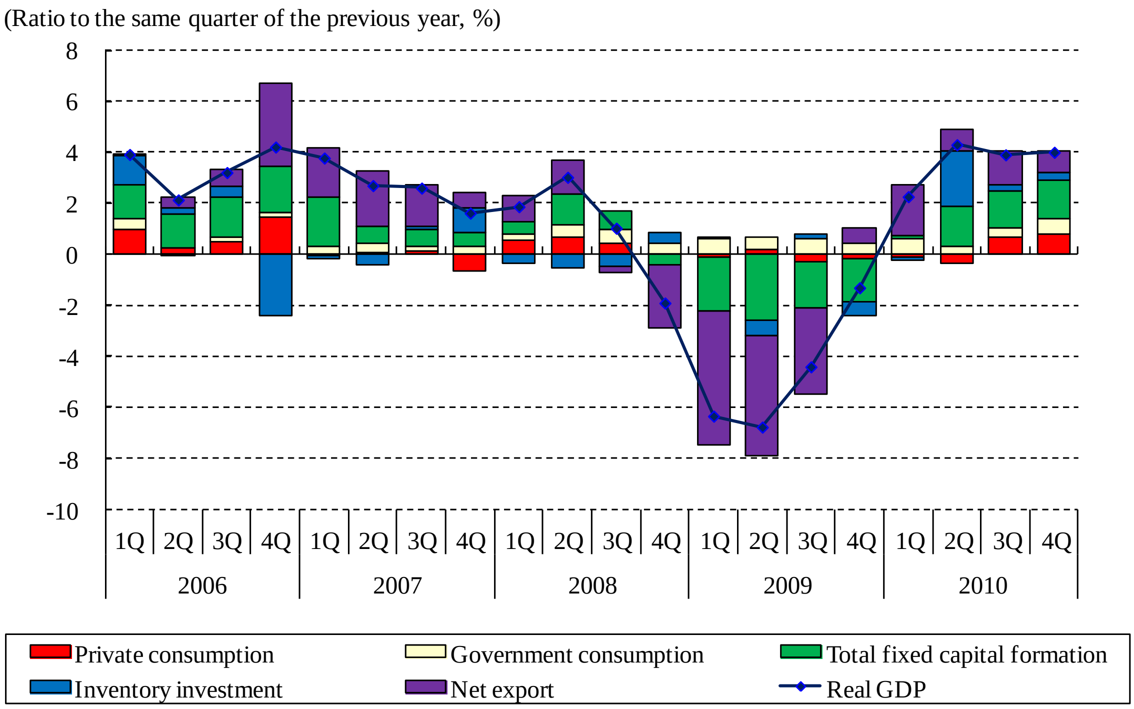
In addition, as Germany had a relatively high degree[88] of dependence on exports among major European countries, expansion of the export market greatly contributed to Germany's economic recovery (Figure 1-1-4-10). Particularly, the expansion of exports to China is supposed to have significant influence over Germany's economic recovery. The growth rate of all German exports registered 13.2% increase in 2010 over that of the previous year, but the exports to China reached higher growth rate of 35.7%. In 2009, Germany's overseas exports including exports to advanced economies registered a minus growth, but the export to China was positive with 4.3% growth over the previous year[89]. Approximately 60% of Germany's exports was to countries in the EU zone. But Germany's export to China grew steadily in the past several years. Germany's export to China accounted for 7.3% growth in 2005, which then grew to 13.9% in 2010. This is quite high among Germany's exports to countries outside the EU zone, and it increased almost to the same level of

[88] Degree of Germany's export-dependence in 2009 was 40.9%, which exceeded the national average of EC member countries (35.6%).
[89] World Trade Atlas.

Germany's exports to United States of America (16.8%) (Figures 1-1-4-11 and 1-1-4-12). Capital goods such as, machinery/ and transportation equipment account for approximately 70% of the overall export from Germany to China[90]. It is thought that such increase of export[91] contributed to recovery of German manufacturing industry.

The expansion in the production sector had a profound influence on the family budget, generating higher income. It should be specially mentioned that large labor adjustment was not made in Germany during the economic recession in 2009. When companies shortened the working hours of workers depending on business fluctuations, the government compensated each worker for the decreased wages subject to the certain conditions[92]. And this enabled Germans to avoid any labor adjustment requirements. When production was restored afterward, the employment level in companies rose, and the unemployment rate in Germany was improved to a historic low level of the first half of 7% level (Figure 1-1-4-13). It is said that improvement in employment and income environment led to increase in individual consumption later in 2010.

Figure 1-1-4-9 Transition of real GDP growth rate in Germany



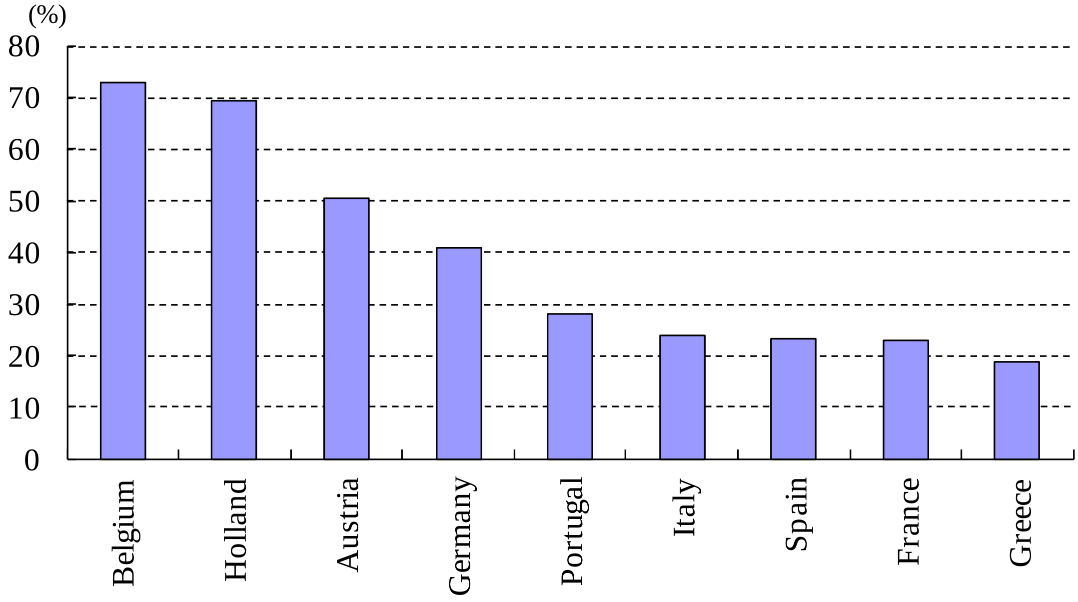
Sources: Federal Statistical Office

90 Deutsch Bank Research paper, "German growth remains robust" February 14, 2011

91 For example, automobile/ auto parts, which account for approximately 16% (in 2010) of Germany's export to China, recorded a 97.2% increase over the previous year in 2010.

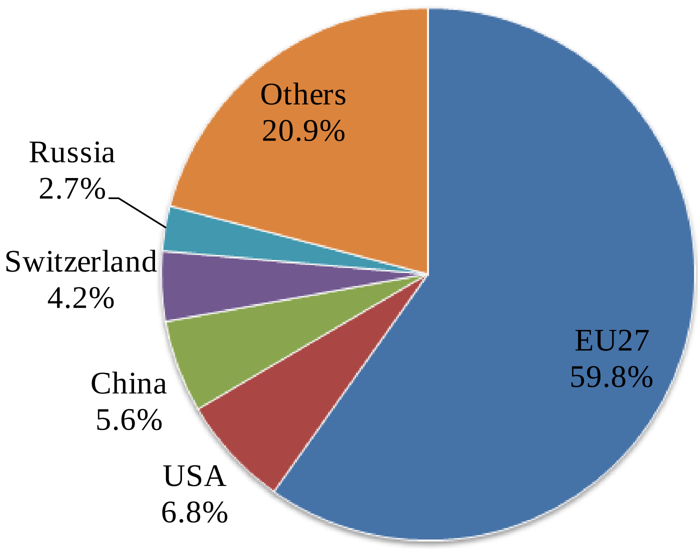
92 Cabinet Office, "This week's Index" No. 936 Germany: "Labor market and operation cut allowance" http//www5.cao.go.jp/keizai3/shihyo/2009/1019/936.html

Figure 1-1-4-10 Dependency on export of major country in Euro zone (2009)



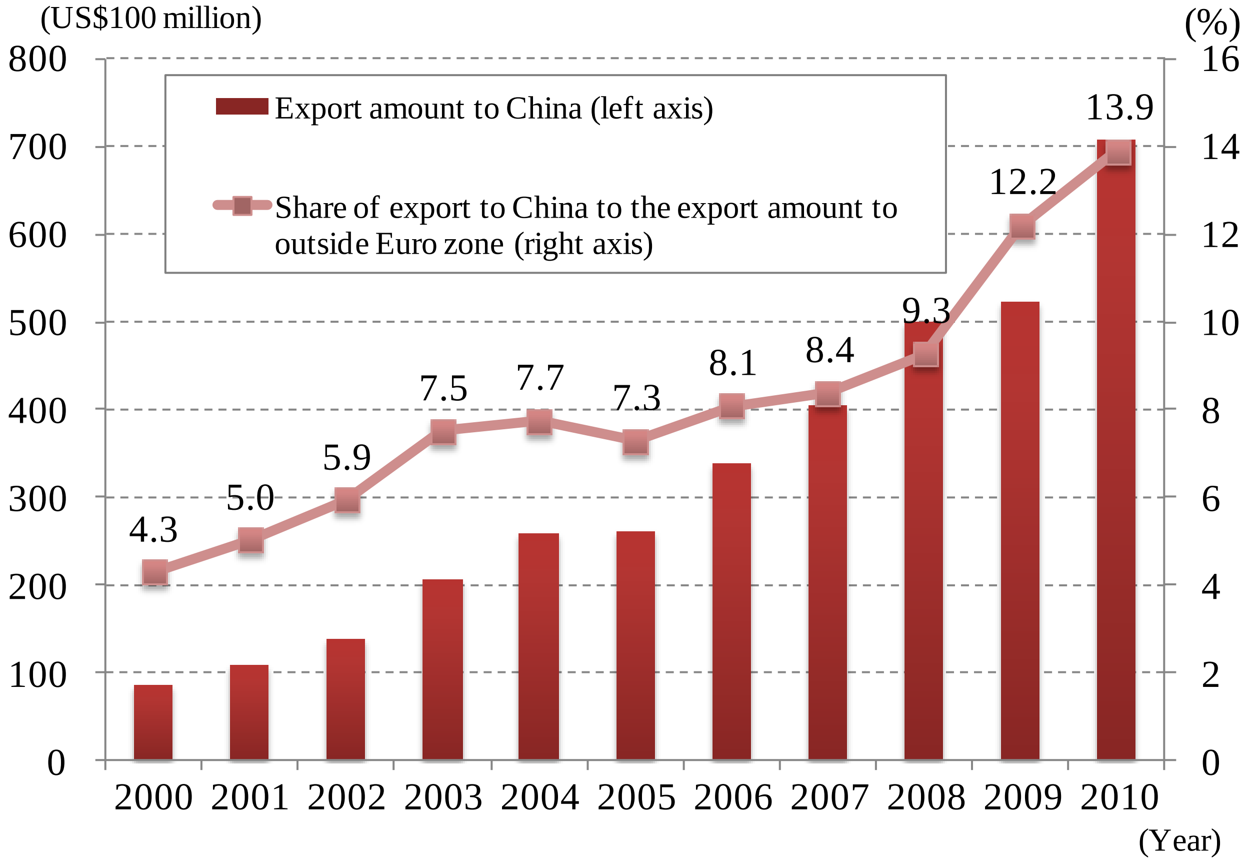
Notes: Ratio of total export amount to GDP
Sources: World Bank

Figure 1-1-4-11 Germany's export destination (2010)



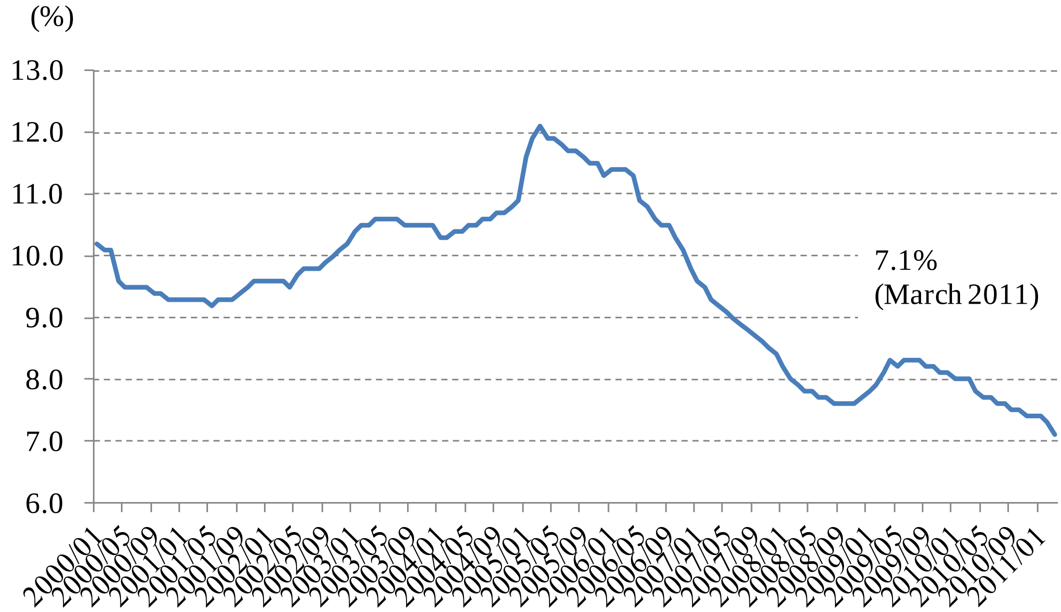
Sources: World Trade Atlas

Figure 1-1-4-12 Transition of export amount and share from Germany to China



Sources: World Trade Atlas

Figure 1-1-4-13 Transition of unemployment rate in Germany



Sources: Deutsche Bundesbank; CEIC Database