GLOBAL ECONOMIC OUTLOOK – MAY

2011

Monetary and Statistics Department
External Economic Relations Division

CZECH NATIONAL BANK

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The outlooks for the advanced economies point to a persisting, yet slow, recovery. **GDP** growth in the euro area is expected to stabilise at 1.7% at the two-year horizon. The German economy is expected to grow strongly again this year, by 2.6–2.8%, but slow to 1.9% next year. After slowing slightly to 2.6–2.7% this year, growth of the U.S. economy is expected to increase to 2.7–3.2% in 2012. In China, GDP growth of just over 9% is expected this year.

Despite a current slowdown, prices of energy commodities and food are an important source of inflationary pressure. **Inflation** will reach 2.2–2.5% in the euro area and Germany this year. It is expected to return below the 2% target next year in the euro area, while holding at 2% in Germany in 2012. The U.S. economy will record slightly higher inflation (2.5–3.0%) in 2011. The following year, inflation is expected to fall to 1.5–2.1%. Inflation in China will be just below 5% and then slow by about 1 percentage point.

The **leading indicators** in May are signalling continuing buoyant economic growth in the USA and a slight slowdown in the euro area, Germany and China. The increased confidence of American consumers is particularly significant.

3M and 1Y **EURIBOR rates** have been increasing since mid-January, although at slightly lower levels compared to the previous month's forecast. The non-fulfilment of market expectations regarding the speed of tightening of ECB monetary policy shifted the rates expected for end-2012 quite significantly downwards. The forecast for the 10-year German bond yield was unchanged from the previous month. The end-2012 outlook for dollar **LIBOR rates** moved downwards in response to a slight decline in market rates in April and early May.

As a result of the dollar's depreciation trend against other world currencies observed between January and April 2011, the May CF moved the paths of the forecasts towards a weaker dollar. The **exchange rate** was significantly affected by the Fed's low interest rate policy and a deterioration of the Standard & Poor's rating outlook. On the other hand, the uncertain outlook for the euro area persists: whereas the southern states and Ireland are looking for a solution to their debt crises, the North faces tighter monetary conditions and a stronger euro. The exchange rate of the dollar against the euro is expected to be around USD 1.43 at the three-month horizon. The dollar will appreciate by 5% at the two-year horizon; it is also expected to appreciate against the Japanese yen and the Swiss franc.

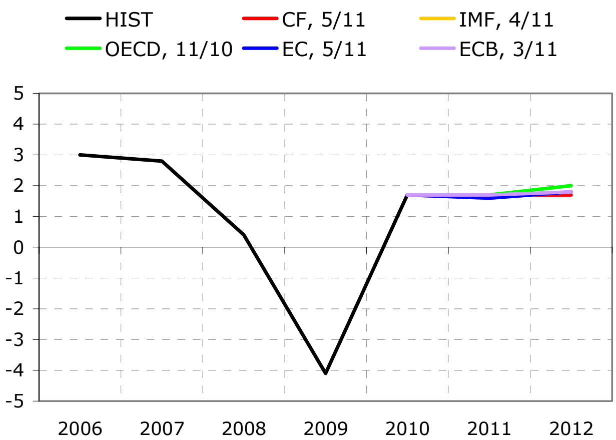
A sharp fall in the **price of oil** in the first week of May was linked with fast appreciation of the dollar in this period and with concerns that monetary policy tightening will adversely affect economic growth and demand for oil in most countries. Subsequently, the price of oil returned to its March levels and the new forecast declined over the entire horizon compared to the previous month. New outlooks based on market contracts now start at USD 117 per barrel and drop to USD 108 per barrel at the end of 2012. These developments will be reflected in the natural gas price with a lag of roughly six months.

A fall in prices was recorded by industrial metals and, to a lesser extent, by food commodities at the start of May. While **prices of industrial metals** should remain flat at their current levels, **food commodity prices** are expected to rise until mid-2012, owing mainly to a tight wheat market.

II.1 GDP

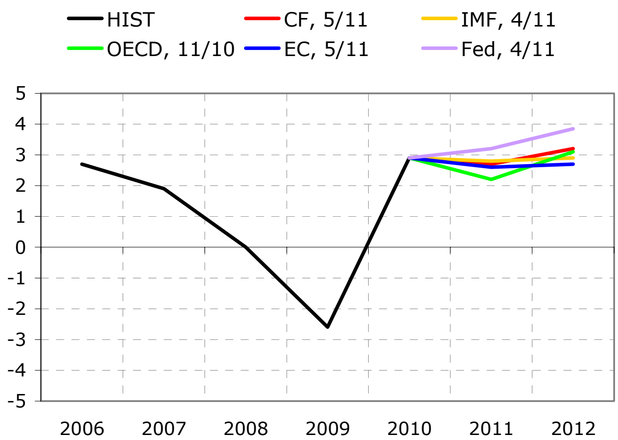
For a third period in a row, the May CF expects economic growth in the euro area to remain at the 2010 level (1.7%) in the next two years. On the other hand, the German economy will grow at 2.6–2.8% (CF and EC) thanks to continued recovery, low unemployment and stable domestic and external demand. In 2012, growth in German GDP will drop to 1.9%. The European Commission expects growth to be driven mainly by domestic consumption. By contrast, the effect of net exports will decline owing to rising imports. The budget deficit and government debt are also expected to decrease in the years ahead. After the expected slowdown to 2.6–2.7% this year, the U.S. economy is expected to increase by 2.7–3.2% (CF, EC). The forecast for economic growth published by the Fed remains at the upper end of the range of the forecasts of the monitored institutions: 3.2% for 2011 and 3.9% for 2012. Economic growth in China will slow slightly owing to discontinuation of fiscal stimuli, monetary policy tightening and inflationary pressures, but will remain around 9%. The 12th five-year plan published by the National People's Congress in March 2011 set the growth target for the next five years at 7%. This is 0.5 percentage point lower than the target of the previous five-year plan.

EURO AREA



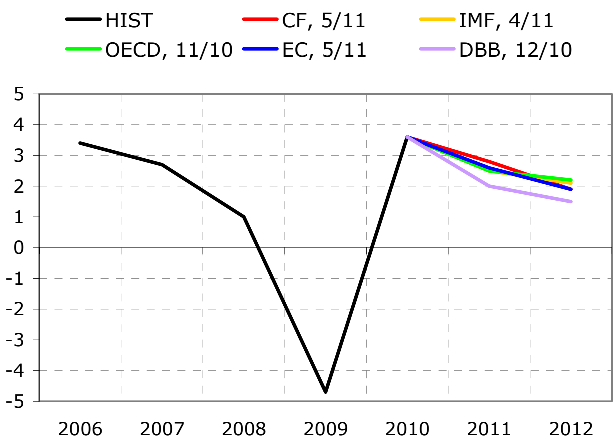
	HIST	CF	IMF	OECD	EC	ECB
2010	1.7					
2011		1.7	1.6	1.7	1.6	1.7
2012		1.7	1.8	2.0	1.8	1.8

USA



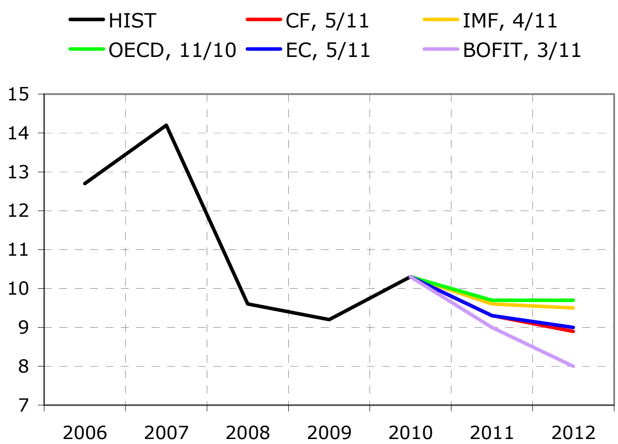
	HIST	CF	IMF	OECD	EC	Fed
2010	2.9					
2011		2.7	2.8	2.2	2.6	3.2
2012		3.2	2.9	3.1	2.7	3.9

GERMANY



	HIST	CF	IMF	OECD	EC	DBB
2010	3.6					
2011		2.8	2.5	2.5	2.6	2.0
2012		1.9	2.1	2.2	1.9	1.5

CHINA



	HIST	CF	IMF	OECD	EC	BOFIT
2010	10.3					
2011		9.3	9.6	9.7	9.3	9.0
2012		8.9	9.5	9.7	9.0	8.0

Note: Legend shows latest forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. [Cut-off date for data: 13 May 2011]

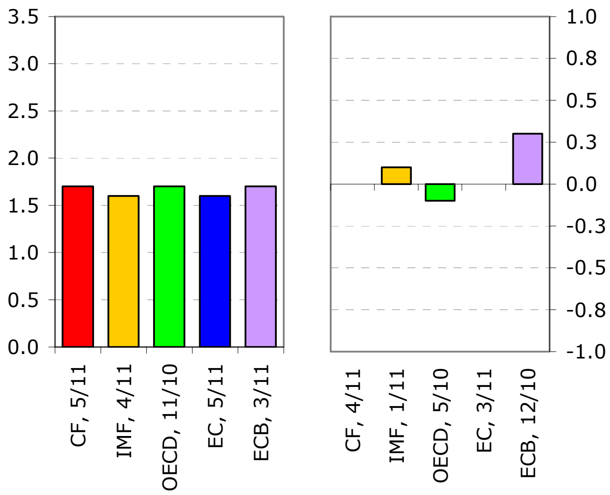
Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.2 GDP forecast comparison and change from the previous forecast

The new CF and EC outlooks left expected euro area economic growth unchanged. By contrast, both institutions expect stronger economic activity in Germany compared to the previous forecast. Since March, CF has gradually revised U.S. GDP growth downwards. Its forecast is based on slower economic growth in 2011 Q1 (preliminary estimate) owing to a continuing slowdown in the housing sector and high commodity prices. The European Commission increased U.S. GDP growth by 0.5 percentage point compared to its November forecast.

EURO AREA

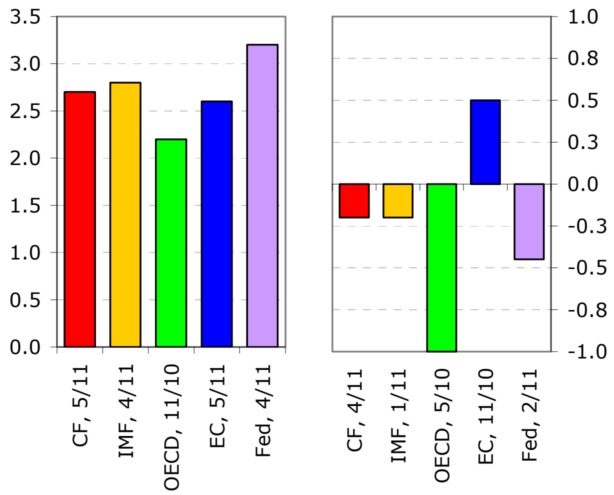
Forecast **Change**



	2010	CF	IMF	OECD	EC	ECB
Forecast	1.7	1.7	1.6	1.7	1.6	1.7
Change		0.0	0.1	-0.1	0.0	0.3

USA

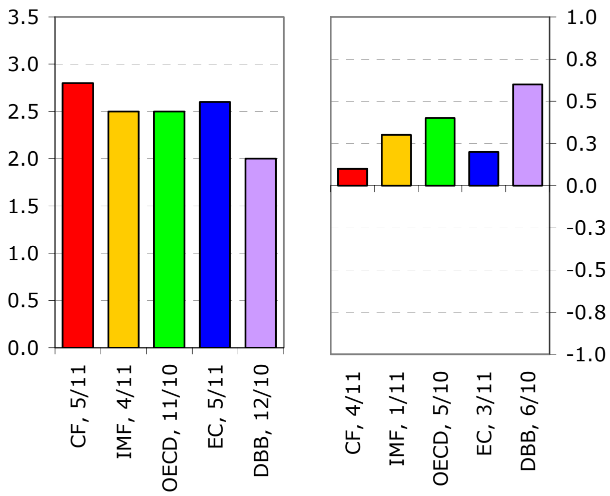
Forecast **Change**



	2010	CF	IMF	OECD	EC	Fed
Forecast	2.9	2.7	2.8	2.2	2.6	3.2
Change		-0.2	-0.2	-1.0	0.5	-0.5

GERMANY

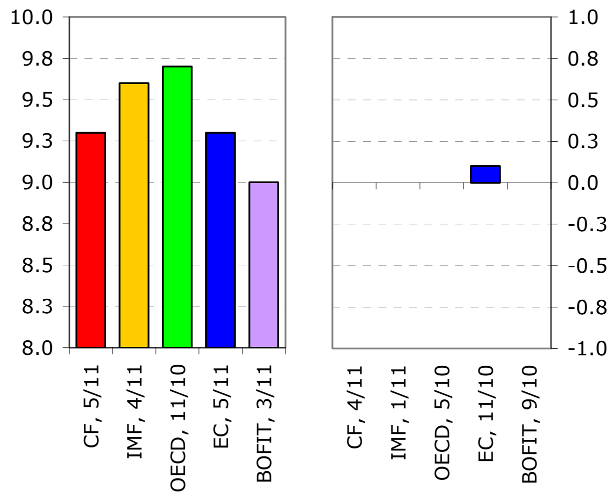
Forecast **Change**



	2010	CF	IMF	OECD	EC	DBB
Forecast	3.6	2.8	2.5	2.5	2.6	2.0
Change		0.1	0.3	0.4	0.2	0.6

CHINA

Forecast **Change**



	2010	CF	IMF	OECD	EC	BOFIT
Forecast	10.3	9.3	9.6	9.7	9.3	9.0
Change		0.0	0.0	0.0	0.1	0.0

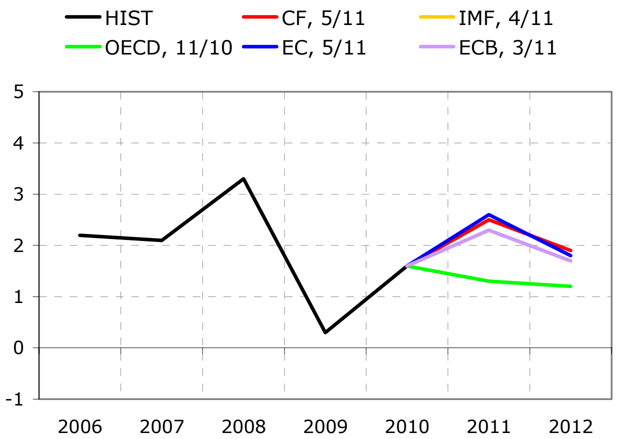
Note: Horizontal axis of left-hand (right-hand) chart shows latest (previous) forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. [Cut-off date for data: 13 May 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.3 Inflation

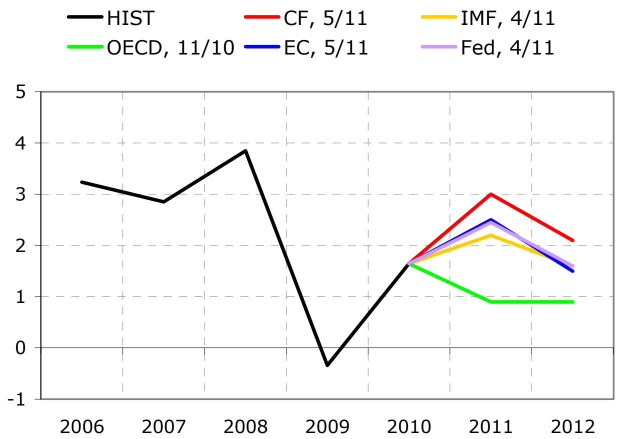
According to CF and the European Commission, prices in the euro area should rise by 2.5–2.6% in 2011, the highest level since the euro area came into existence. The inflation rate is expected to fall to 1.8-1.9% next year. German inflation will reach 2.2–2.3% this year. According to CF, the maintaining of a price level that is rather high for Germany is due partly to the limited room for increasing ECB interest rates (the risk of a worsening of the economic situation in "problem" economies on the periphery of the monetary union) and to a resulting excess of easy money. Inflation will start to return to the target level in 2012. Inflation in the United States will be 2.5–3% this year owing to high energy prices, but will slow to 1.5–2.1% in 2012 (CF, EC and Fed). Inflation in China will significantly exceed 4% in 2011. According to CF, inflation there will reach 4.7% this year but will slow to 3.8% in 2012.

EURO AREA



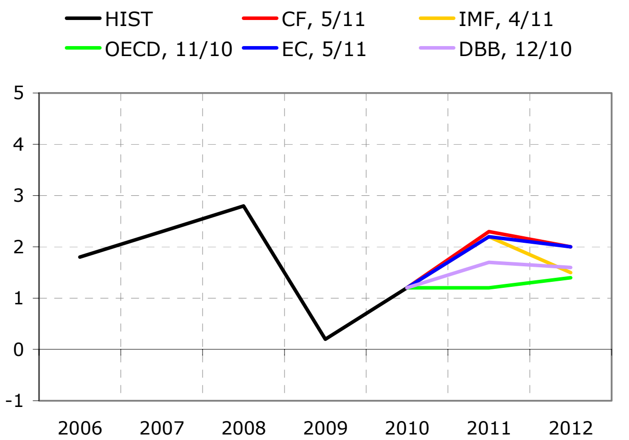
	HIST	CF	IMF	OECD	EC	ECB
2010	1.6					
2011		2.5	2.3	1.3	2.6	2.3
2012		1.9	1.7	1.2	1.8	1.7

USA



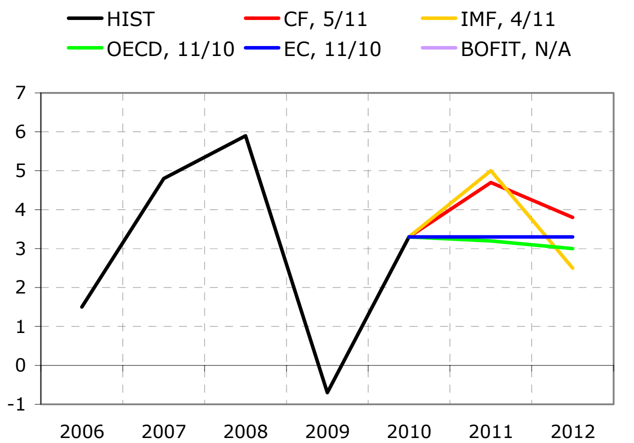
	HIST	CF	IMF	OECD	EC	Fed
2010	1.6					
2011		3.0	2.2	0.9	2.5	2.5
2012		2.1	1.6	0.9	1.5	1.6

GERMANY



	HIST	CF	IMF	OECD	EC	DBB
2010	1.2					
2011		2.3	2.2	1.2	2.2	1.7
2012		2.0	1.5	1.4	2.0	1.6

CHINA



	HIST	CF	IMF	OECD	EC	BOFIT
2010	3.3					
2011		4.7	5.0	3.2	3.3	
2012		3.8	2.5	3.0	3.3	

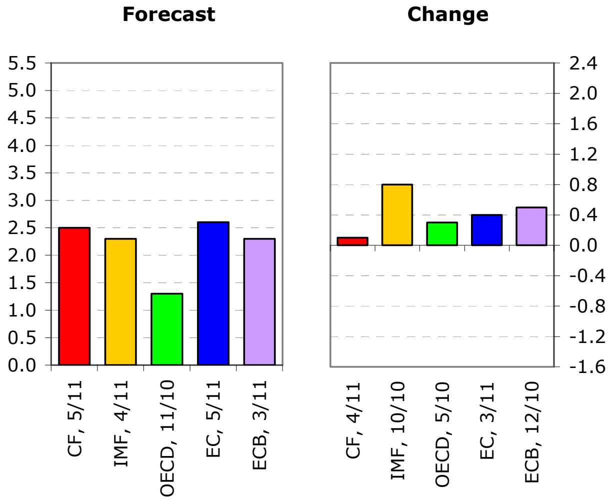
Note: Legend shows latest forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. [Cut-off date for data: 13 May 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

II.4 Inflation forecast comparison and change from the previous forecast

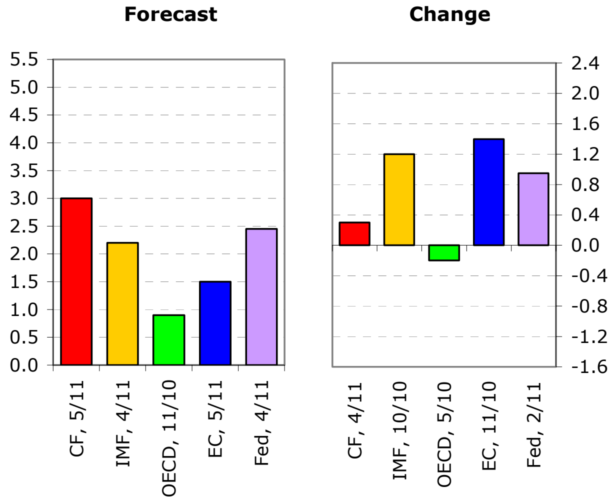
Higher inflation is expected for the euro area than in the previous forecast. CF slightly increased its outlook for inflation in Germany. The European Commission left its outlook unchanged. According to the new forecasts, prices in the United States will rise more than expected. CF slightly increased its forecast for China.

EURO AREA



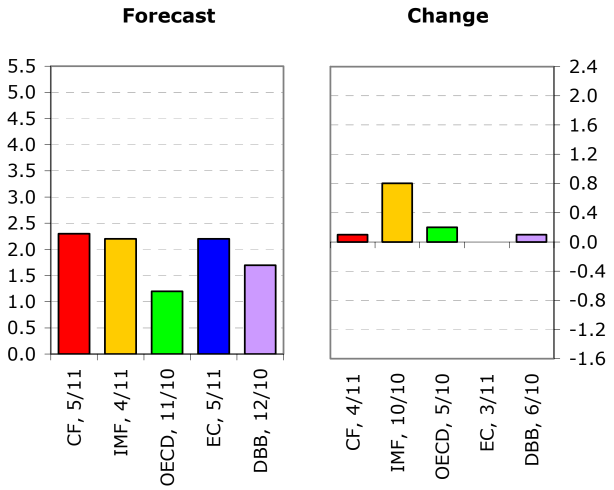
	2010	CF	IMF	OECD	EC	ECB
Forecast	1.6	2.5	2.3	1.3	2.6	2.3
Change		0.1	0.8	0.3	0.4	0.5

USA



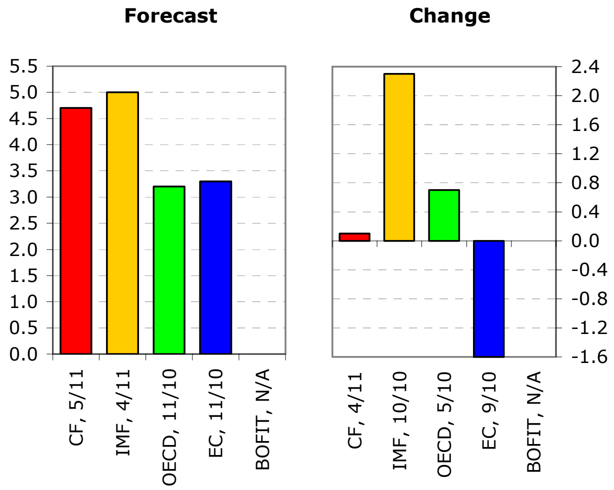
	2010	CF	IMF	OECD	EC	Fed
Forecast	1.6	3.0	2.2	0.9	1.5	2.5
Change		0.3	1.2	-0.2	1.4	1.0

GERMANY



	2010	CF	IMF	OECD	EC	DBB
Forecast	1.2	2.3	2.2	1.2	2.2	1.7
Change		0.1	0.8	0.2	0.0	0.1

CHINA



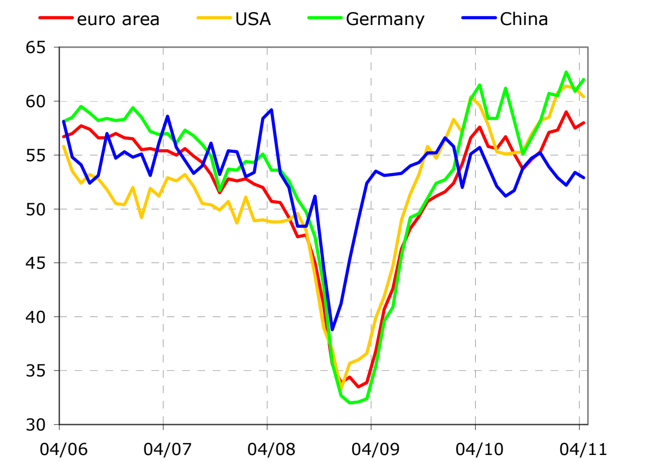
	2010	CF	IMF	OECD	EC	BOFIT
Forecast	3.3	4.7	5.0	3.2	3.3	
Change		0.1	2.3	0.7	-1.6	

Note: Horizontal axis of left-hand (right-hand) chart shows latest (previous) forecast data in format "Source, month/year of forecast publication". HIST: historical value. ECB and Fed: midpoint of range. [Cut-off date for data: 13 May 2011]

Source: CNB calculation using Eurostat, CF, IMF, OECD, EC, ECB, Fed, DBB and BOFIT databases.

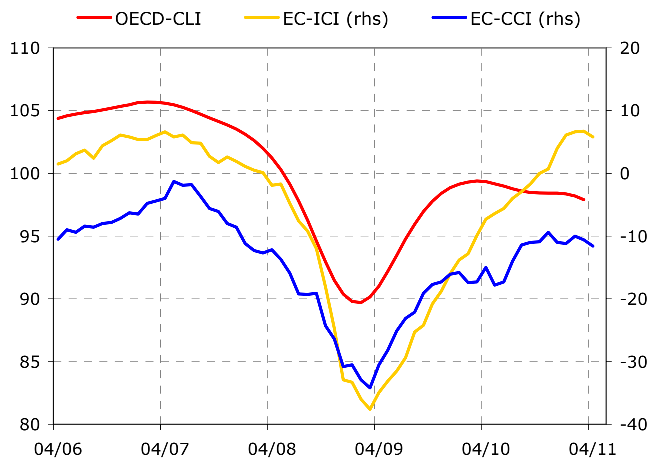
The PMI (Purchasing Managers' Index) leading indicators in industry declined slightly in May in the USA and China from their previously high levels, suggesting somewhat slower growth in this sector. By contrast, these indicators rose in the euro area, including Germany. In the USA, the other leading indicators (except the PMI) strengthened, signalling continuing buoyant economic growth. The increased consumer confidence is particularly significant. The situation is completely the opposite in the euro area and Germany: the leading indicators (except the PMI) declined, suggesting a lower rate of economic recovery despite a high growth rate of industrial production.

PMI IN MANUFACTURING



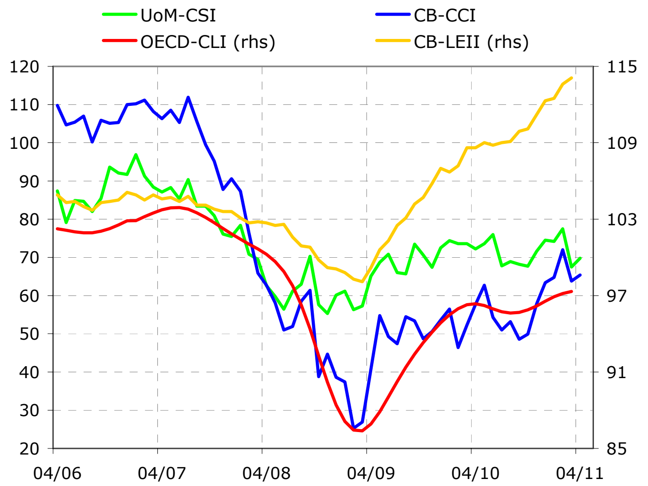
	EA	US	DE	CN
2/11	59.0	61.4	62.7	52.2
3/11	57.5	61.2	60.9	53.4
4/11	58.0	60.4	62.0	52.9

EURO AREA



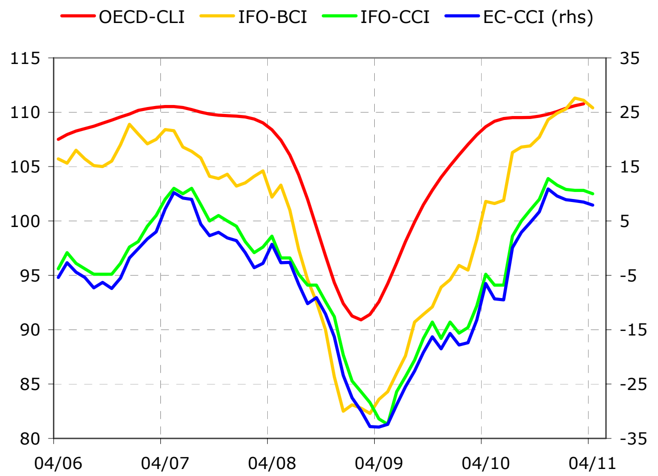
	OECD-CLI	EC-ICI	OECD-CCI
2/11	98.2	6.6	-10.0
3/11	97.9	6.7	-10.6
4/11		5.8	-11.6

USA



	OECD-CLI	CB-LEII	UoM-CSI	CB-CCI
2/11	97.2	113.6	77.5	72.0
3/11	97.3	114.1	67.5	63.8
4/11			69.8	65.4

GERMANY



	OECD-CLI	IFO-BCI	IFO-CCI	EC-CCI
2/11	110.6	111.3	102.8	8.7
3/11	110.8	111.1	102.8	8.5
4/11		110.4	102.5	7.9

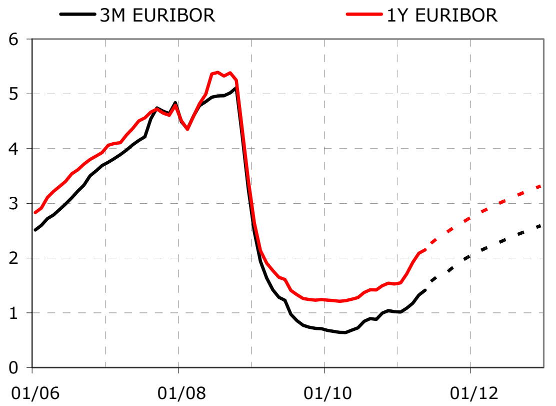
Note: OECD-CLI stands for OECD Composite Leading Indicator, EC-ICI (right-hand scale) for European Commission Industrial Confidence Indicator, EC-CCI (right-hand scale) for EC Consumer Confidence Indicator, CB-LEII for Conference Board Leading Economic Indicator Index, CB-CCI for CB Consumer Confidence Index, UoM-CSI for University of Michigan Consumer Sentiment Index, IFO-BCI for Institute for Economic Research – Business Climate Index, and IFO-CCI for IFO Consumer Confidence Index. [Cut-off date for data: 12 May 2011]

Source: CNB calculation using OECD, EC, IFO and UoM databases.

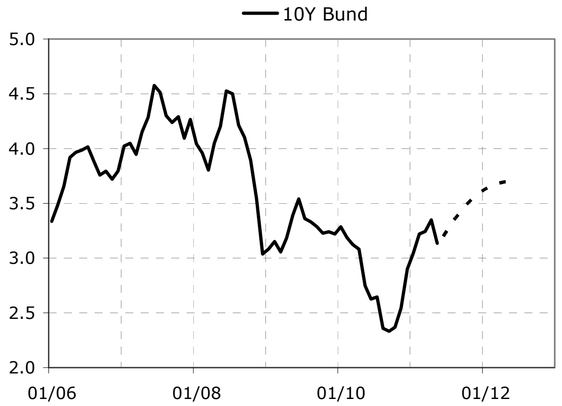
IV.1 Outlook for short-term and long-term interest rates: Euro area

3M and 1Y EURIBOR interest rates have been increasing since mid-January and continued to rise in April and early May. However, the growth was slightly lower than expected by the previous month's forecast. According to the ECB, its rates will not be increased as fast as expected by the markets after the previous meeting, so the rates expected for the end 2012 have been revised downwards fairly significantly. The 3M rate declined by almost 0.5 percentage point to 2.6%. The 1Y rate decreased by 0.4 percentage point to 3.3%. A downward tendency has been observed for the German 10Y government bond yield since roughly mid-April, but the CF forecast remained unchanged: 3.4% for 3M and 3.7% for 1Y horizon.

EURIBOR



GOVERNMENT BOND YIELD



	04/11	05/11	06/11	12/11	06/12	12/12
3M EURIBOR	1.32	1.41	1.58	2.02	2.33	2.59
1Y EURIBOR	2.09	2.15	2.27	2.71	3.04	3.31

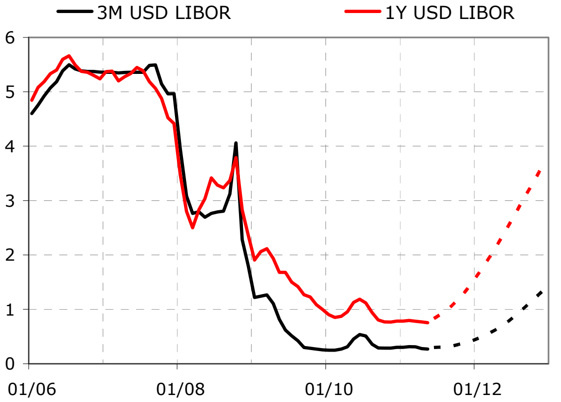
	04/11	05/11	06/11	12/11	06/12	12/12
10Y Bund	3.35	3.14	3.20	3.59		

Note: Forecast for EURIBOR rates is based on rates implied by interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizon). Forecast for German government bond yield (10Y Bund) is derived from CF forecast. Dashed line represents outlook. [Cut-off date for data: 9 May 2011]
Sources: Thomson Reuters (Datastream), Bloomberg, CNB calculations.

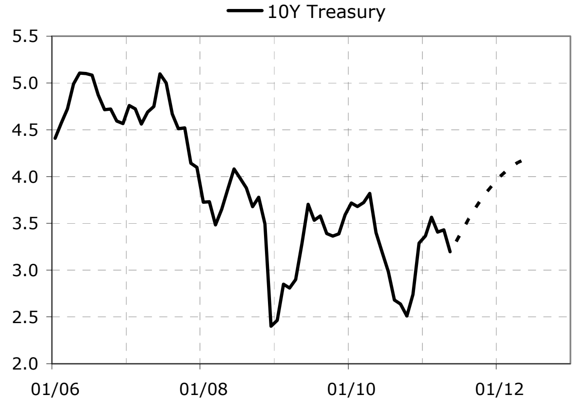
IV.2 Outlook for short-term and long-term interest rates: USA

Although markets have been expecting growth for some time, dollar LIBOR rates declined slightly in April and early May after a long period of stagnation. This was probably due mainly to bad data from the U.S. labour market. The end-2012 outlook thus shifted downwards by 0.7 percentage point for 3M and 0.8 percentage point for 1Y maturity. The ten-year government bond yield has been decreasing since mid-April. CF left its three-month forecast unchanged at 3.6% and slightly lowered its one-year forecast to 4.2%.

USD LIBOR



GOVERNMENT BOND YIELD



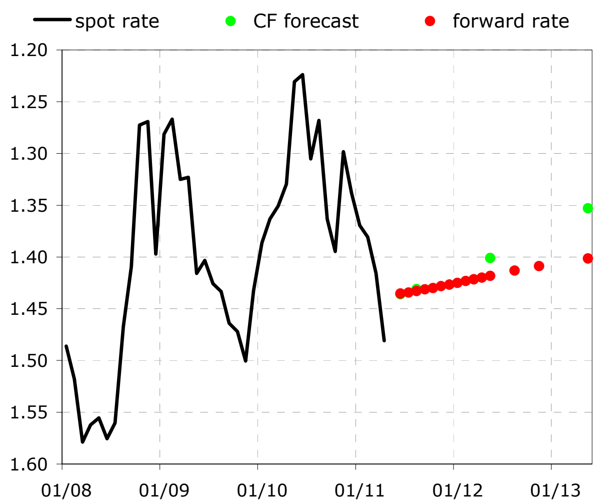
	04/11	05/11	06/11	12/11	06/12	12/12
3M USD LIBOR	0.28	0.27	0.30	0.42	0.78	1.38
1Y USD LIBOR	0.77	0.75	0.83	1.46	2.53	3.72

	04/11	05/11	06/11	12/11	06/12	12/12
10Y Treasury	3.43	3.20	3.31	3.92		

Note: Forecast for 3M and 1Y USD LIBOR rates is based on rates implied by London interbank market yield curve (USD LIBOR rates are used up to 3M, 3M FRA rates up to 15M, and adjusted IRS rates for longer horizon). Forecast for US government bond yield (10Y Treasury) is derived from CF forecast. Dashed line represents outlook. [Cut-off date for data: 9 May 2011]
Sources: Thomson Reuters (Datastream), Bloomberg, CNB calculations.

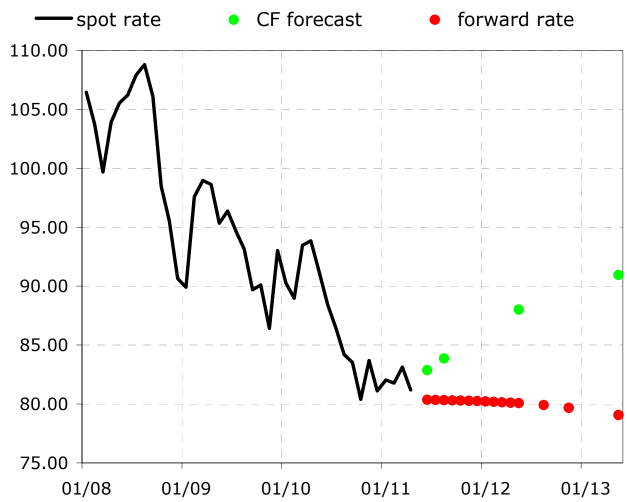
The exchange rate of the dollar against the euro was close to USD 1.5 in late April and early May; the new CF forecast also moved the path of the expected exchange rate downwards compared to the previous month. The dollar should appreciate to US 1.4 to the euro at the one-year horizon, with USD 1.35 to the euro being expected at the end of May 2013. CF also expects a weaker dollar against the British pound and the Swiss franc. By contrast, the forecast for the exchange rate of the dollar against the Japanese yen remained broadly unchanged in the short term. The dollar-pound exchange rate should remain broadly stable at the two-year horizon. The dollar is expected to appreciate against the Swiss franc by 13% and the Japanese yen by 10%.

US$ per Euro



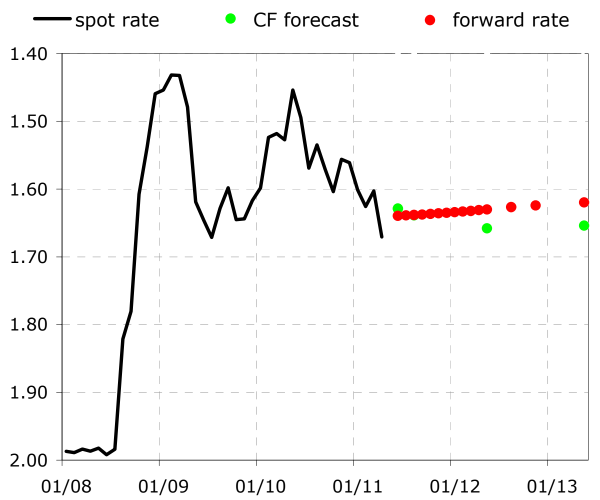
	9/5/11	06/11	08/11	05/12	05/13
spot rate	1.437				
CF forecast		1.436	1.431	1.401	1.353
forward rate		1.435	1.433	1.418	1.401

Yen per US$



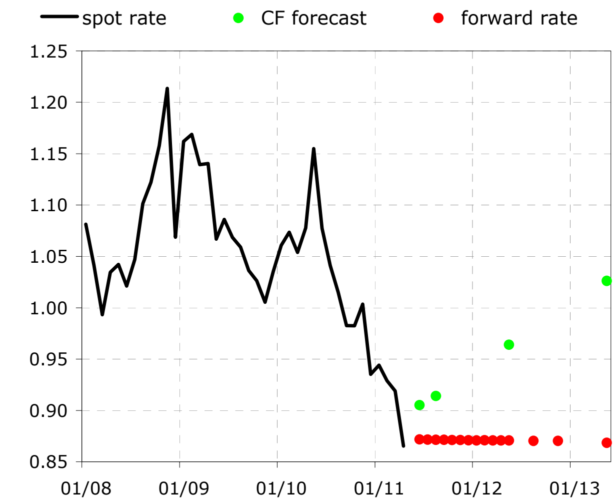
	9/5/11	06/11	08/11	05/12	05/13
spot rate	80.36				
CF forecast		82.87	83.85	88.01	90.94
forward rate		80.35	80.32	80.06	79.05

US$ per UK£



	9/5/11	06/11	08/11	05/12	05/13
spot rate	1.640				
CF forecast		1.629	1.639	1.658	1.654
forward rate		1.640	1.638	1.630	1.620

Swfr per US$



	9/5/11	06/11	08/11	05/12	05/13
spot rate	0.872				
CF forecast		0.905	0.914	0.964	1.026
forward rate		0.872	0.871	0.871	0.868

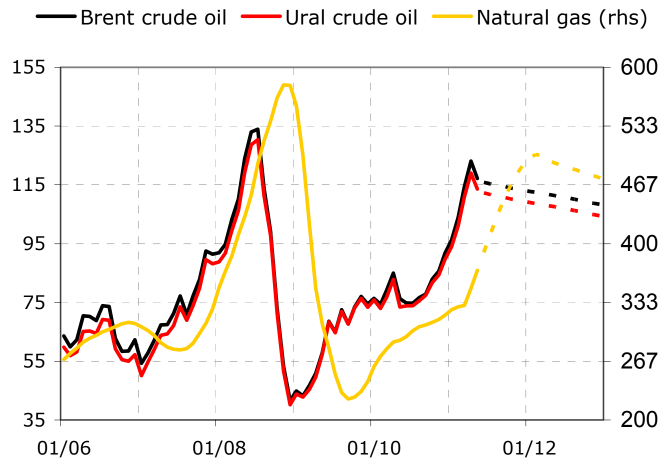
Note: Increase in currency pair represents appreciation of US dollar; data as of the last day of the month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibilities for securing future exchange rate. [Cut-off date for data: 12 May 2011]

Source: CNB calculation using Bloomberg and Consensus Forecasts databases.

VI.1 Oil and natural gas

The oil price fell sharply (by almost 13%) in the first week of May in connection with a fast appreciation of the dollar and concerns that monetary policy tightening (in China in particular, but also elsewhere around the world) will dampen economic growth and demand for oil. Although the price of oil subsequently corrected its fall, it is still well below its early-April levels. This was also reflected in the forecast based on market futures contracts. The new forecast starts at USD 117 per barrel and stands at about USD 108 per barrel at the end of 2012. Compared to the previous month, it moved downwards by around USD 7 per barrel over the entire horizon. The natural gas price reflects the oil market with a lag of roughly six months.

OUTLOOK FOR PRICES OF OIL AND NATURAL GAS



	05/11	06/11	12/11	06/12	12/12
Brent crude oil	117.2	115.9	113.2	111.0	108.3
Ural crude oil	113.6	112.3	109.4	107.1	104.4
Natural gas	369.6	390.3	488.6	488.9	474.4

Note: Oil prices in USD/barrel are taken from listings on London-based ICE Futures Europe international exchange. Prices of Russian natural gas at border with Germany in USD/1000 cubic m are calculated using IMF data. Future oil prices are derived from oil futures. Dashed line represents outlook. [Cut-off date for data: 9 May 2011].

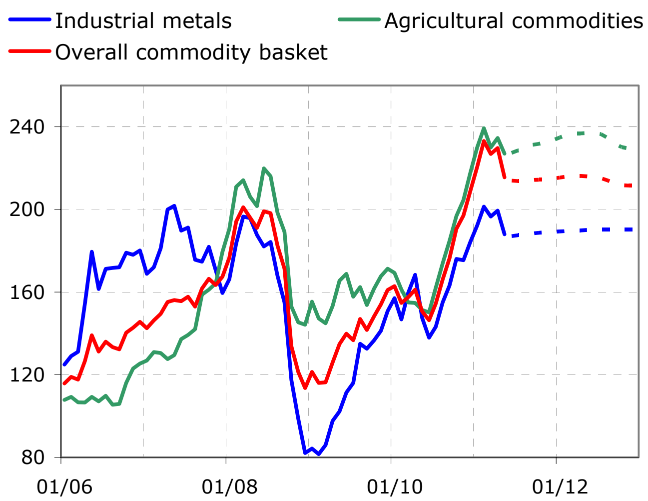
Source: Bloomberg, IMF, CNB calculations.

VI.2 Other commodities

A similar pattern as for the price of oil (i.e. a fall in early May) can also be observed for industrial metal prices and, to a lesser extent, for food commodity prices. While the metal price index declined over the entire forecast horizon (by about 9%), the fall in the food commodity price index was only one-half, but its price growth is picking up in the outlook (until mid-2012); food prices should thus gradually return to the previous month's forecast.

As regards individual commodities, the price of aluminium is expected to rise, while the price of copper is expected to decline. Prices of other industrial metals should be broadly flat. As for food, the most dramatic situation is expected for the price of wheat, which should rise considerably in the remainder of the year. On the other hand, prices of maize, rubber and cotton should decline further from their record highs; the price of soy is also expected to decrease.

OUTLOOK FOR OTHER COMMODITY PRICES



	05/11	06/11	12/11	06/12	12/12
Industrial metals	188.0	187.1	189.1	190.2	190.3
Agricultural commodities	227.0	227.3	233.4	237.0	229.6
Overall commodity basket	215.5	213.9	214.8	215.7	211.7

Note: Chart shows indices, year 2005 = 100. Dashed line represents outlook. [Cut-off date for data: 9 May 2011].

Source: Bloomberg, outlooks based on futures.

WINNERS AND LOSERS OF THE ECONOMIC CRISIS IN THE EYES OF EUROPEAN INVESTORS

The deep recession following the global financial crisis of 2007–2009 has led to shifts in the significance of individual countries and regions for the world economy. Some of these shifts, associated with economic globalisation, started long before the crisis and were merely speeded up by the recession. However, the overall figures on GDP growth and external imbalances mask mixed trends across sectors. The following article presents the findings of the CESifo think-tank's March conference "The Global Divide: Winners and Losers of the Crisis", which offered a disaggregated view of the post-crisis situation in key branches of European industry.[1] *The discussions at this event revealed that there are enough prospering exporters in Germany and elsewhere in Europe (such as in the Nordic countries) who are able – by leveraging their knowledge of the needs of individual markets and their comparative advantages – to mitigate the impact of the recession and lay the foundations for sustainable recovery in their home countries*.

Introduction

A rather simplified, but accurate, view of the global economy in the last 2–3 years is that the post-crisis recovery is a two-speed one, progressing faster in the major emerging economies and more sluggishly in most "old" industrial countries. At the same time there is an increasing belief that Germany is one of the few advanced countries (including euro area members) that is currently in the somehow "alien" high-speed group. Among other things, the investment strategies applied by German industry over the last decade have proved quite successful. This provides an interesting contrast to the – diplomatically speaking – unconvincing investment performance of German banks (particularly, but not solely, the public *Landesbanken*) in the same period. It is all the more interesting, then, to hear the opinions arising from debates among economists and investor representatives and their analytical advisers at one of Germany's foremost economic research institutes – the Munich-based Ifo – regarding the prospects of the world economy as a whole and of its individual sectors in particular. Such a debate took place at the March CESifo conference in Berlin. The presentations and discussions focused initially on macroeconomic issues, then on commodities as major import items and finally on the central topic of the conference – export industries.

1. Global and regional imbalances

Investors' mistakes and external imbalances

The "macroeconomic" part of the conference yielded mostly already well-known views about the post-crisis world economy. The most interesting presentation was CESifo Director Hans-Werner Sinn's detailed exposition on how to overcome Germany's unilateral trade surplus with the peripheral euro area members. This surplus mirrors the peripheral economies' deficits that have become so visible during the continuing fiscal crises in Greece, Ireland and Portugal. Professor Sinn pointed out the clear – from the accounting point of view – fact that a current account deficit always reflects a financial account surplus. He repeated that the key to remedying the problem lay in redirecting surplus German savings into reasonably risky domestic investment rather than

[1] The CESifo Group is a joint research group of the Ifo Institute (Information und Forschung, an economic research centre financed mainly from private sources in German industry) and the CES (Center for Economic Studies, which is part of the Faculty of Economics University of Munich, i.e. a public institution).

seemingly risk-free investment in the official debts of the uncompetitive euro area periphery. The markets' original conviction that the latter was risk-free had of course been shaken by the outbreak of the fiscal crisis in the PIGS countries, but in his opinion it could in no way be renewed by exaggerated guarantees and rescue projects such as the EFSF and ESM.[2] Specifically, Professor Sinn is pleading for bail-outs accompanied by more realistic (i.e. higher) market yields on indebted countries' bonds, reflecting the possibility of significant haircuts in the event of debt restructuring. Restructuring could in fact be declared for any coupon payment (if the indebted country has difficulties making that payment) and apply only to that payment. Sovereign debt that is either completely risk-free thanks to full guarantees from a rescue fund, or purely speculative if the rescue fund is not sufficient, should no longer exist. This means that the catastrophic vision of complete insolvency causing a country to default on its entire debt at once (a "Black Swan" event as popularised by economists analysing the recent global financial crisis[3]) would become an event of limited importance with a standard probability of occurrence which the markets can assess conventionally by setting an appropriate risk premium on the bond yield. In this way Professor Sinn hopes to "train" German and other investors to be fully aware of the risks of sovereign debt on the euro area periphery, to better understand the disadvantages of investing in such debt, and to focus on the core countries' domestic markets. Lower capital exports will also, in his view, automatically mean lower goods and services exports and a reduction of the imbalances that are causing many of Germany's partners in Europe to accuse it of mercantilist practices. To achieve this, however, the artificial convergence of market yields on individual member countries' bonds which prevailed in the euro area in 2001–2008 must vanish forever. In pursuit of this vision, Professor Sinn is clearly willing to accept limited losses in German banks' balance sheets. At the same time, he claims that these losses will eventually be much lower than the banks themselves have warned, as the losses on, say, the debt of the PIIGS[4] countries will be partly offset by book profits from the rising prices of the core countries' bonds, which are also owned by the banks in large quantities. To what extent this estimate is correct is difficult to say precisely, as complete data on banks' bond portfolios are not publicly available.

Professor Sinn's recipe has recently been getting empirical support. In the first decade after adopting the euro, Germany had been on the tail of the euro area and the entire EU in terms of both rate of investment and rate of growth. But after the worst effects of the global financial crisis eased in 2009 it started to move to the front in terms of both investment and growth. It seems that German investors are really starting to be "cured" of their exaggerated dependence on simple investment in foreign sovereign debt and are keeping more funds at home. Germany can be therefore be nominated as the first candidate for the role of winner of the global crisis, at least in Europe. The economies of the Nordic countries, Sweden in particular, have also withstood the crisis quite successfully. This success has been achieved thanks to the performance of firms operating in the most promising branches of industry (see section 2).

The different prospects of the regions

<u>Europe</u>: The debate then widened logically from individual countries to larger economic regions, including the euro area, which is the nearest to the Czech Republic. Post-crisis recovery is being promised everywhere, but the structural asymmetry in the EU (the

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[2] The European Financial Stabilisation Fund and the European Stability Mechanism.

[3] The term originates from Nassim Taleb's book *The Black Swan: The Impact of the Highly Improbable,* Penguin, 2007, 2010.

[4] Portugal, Ireland, Italy, Greece and Spain.

gap between the "North" and the "South", although the South also includes Ireland) suggests that the differing growth rates will last for years. The second part of this summary explains the role of exports to non-euro area economies as the main source of growth.

USA and Japan: Many parameters of the present post-crisis period in the USA are formally very similar to those seen at the start of the "lost decade" in Japan. They include not only the most visible indicators such as stock indices and property prices, but also data outside the main focus of attention, such as the ratio of the monetary base (rising due to monetary expansion) and the volume of loans (falling or, at best, flat). However, there is one major difference: Japan has always had trade surpluses.[5] This is linked with its industrial base, which survived even the proverbial lost decade after the banking crisis of the late 1980s and early 1990s, whereas the US industrial base has been contracting continuously and sources of growth have been created mainly in the limited areas of IT and bio-technology. Problems with the industrial base, and particularly with the human capital needed to develop it, are currently considered to be key to the USA's chances of reversing its unfavourable long-running "twin deficit" trend.

China: China is expected to switch over gradually to a consumer economy. This trend is due more to natural evolution than to political direction (although the latter is present as well). It is also being accelerated by the fact that some export industries (steel, shipbuilding, medium-technology equipment) have no chance of surviving the next few years without massive subsidies and there is a question whether such subsidies will be available in the future. Even if support continues to come from public funds, it will not necessarily be provided in the scale required to halt the contraction.

Brazil: Out of the other BRIC[6] countries, attention was focused on Brazil, as it is considered the most promising for foreign (including European) investment. The country's potential in terms of investment opportunities was described as the biggest in the entire emerging world. This is natural because the institutional (in the broad sense) "distance" between the advanced countries and Brazil seems insignificant when one considers the analogous criterion applied to Asia or Russia.

Commodities: a need to prepare for new sacrifices

Commodity investment fund managers and their sell-side analysts are foretelling further inevitable growth in prices due to rapid exhaustion of the currently cheapest and/or best-quality deposits. They are therefore predicting the possibility of irreversible price jumps to ensure that mining or farming in less accessible locations and maintenance of the required quality will remain profitable. However, even these players with vested interests have to admit that there is a contest between technological progress in prospecting and extraction, which decreases prices, and the exhaustion of cheap resources, which conversely pushes prices up. None of the experts questioned the fact that the supply-side inflexibility "responsible" for the rise in prices is a short-term factor (although the lead-managers of commodity investment instruments also need to sell their products to final investors in the short term).

Steel: Steel production is a "positive" example from sell-side managers' perspective, as demand, investment and revenues are going up despite pessimistic forecasts. Not surprisingly, demand is expected to be highest in emerging markets. Rather more surprising is the estimated absolute size of unsatisfied demand by 2050, which is giving

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[5] The prevailing opinion is that neither the natural disaster nor the subsequent accident at the Fukushima nuclear power station, which occurred one week before the conference, will significantly affect these long-term trends.

[6] Brazil, Russia, India and China.

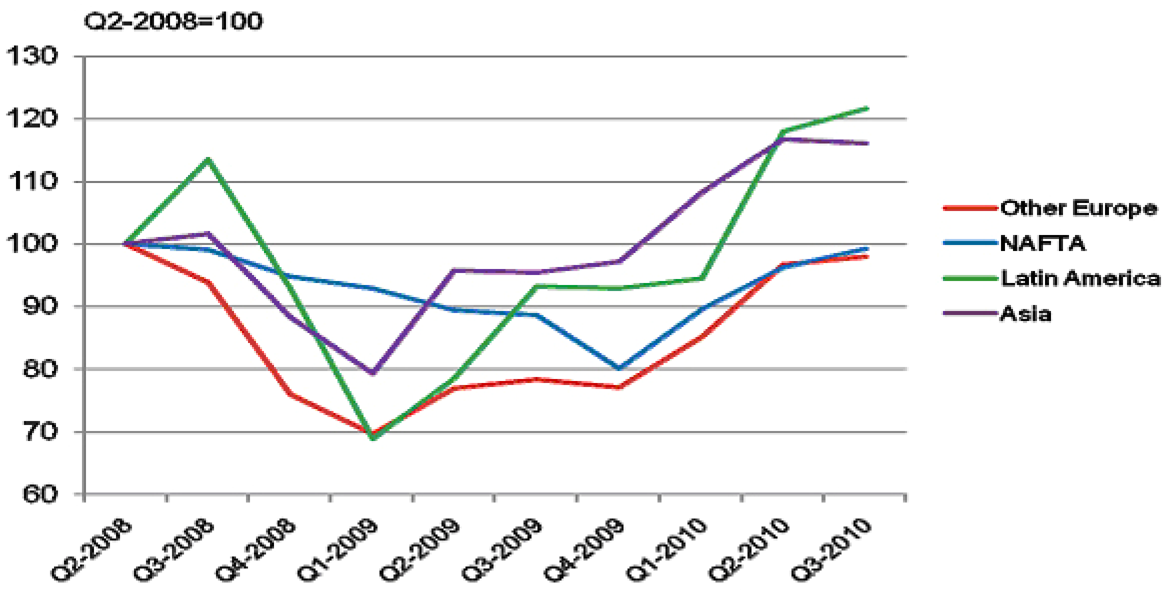
rise to strong expected price growth in advanced countries as well. True, this forecast is based on the extrapolation of future trends outside Europe and America in the 21st century based on the trends – and relevant per-capita steel consumption – recorded in these two regions during the Industrial Revolution of the 19th century, which is rather bold, but the prospects for steel demand in the developing world are very favourable even so. European steelmakers have a chance to share in this demand boom, although their share could have been many times higher had it not been for the contraction this sector experienced in Europe in the 1980s and 1990s.

2. Problems and prospects of key industries

The following were identified as key export sectors for German and European industry (in order of presentation, not necessarily of economic weight): chemicals, automotive, electronics and large industrial plant. Although none of them turns out to be a trouble-free area of unlimited possibilities, each of them offers chances for European exports for many years ahead.

Chemicals: Pharmaceuticals should be considered separately from other production here. The former – a typical "defensive" industry – was virtually unaffected by the crisis and has been growing in the past 3–4 years at a similar pace as before. A slowdown was visible at the end of 2010 (with the trend continuing into this year), when traditional "procyclical" branches started to recover. Moreover, pharmaceutical production is necessarily closely linked with research capacity, which in the advanced world (including the EU) is maintaining its lead over Asian competitors, so there is no danger of losing market share in world sales in the years ahead.

Figure 1: Extra-EU exports of the European chemical industry



Source: Cefic Chemdata International

Table 1: Regional export shares (extra-EU) of the European chemical industry

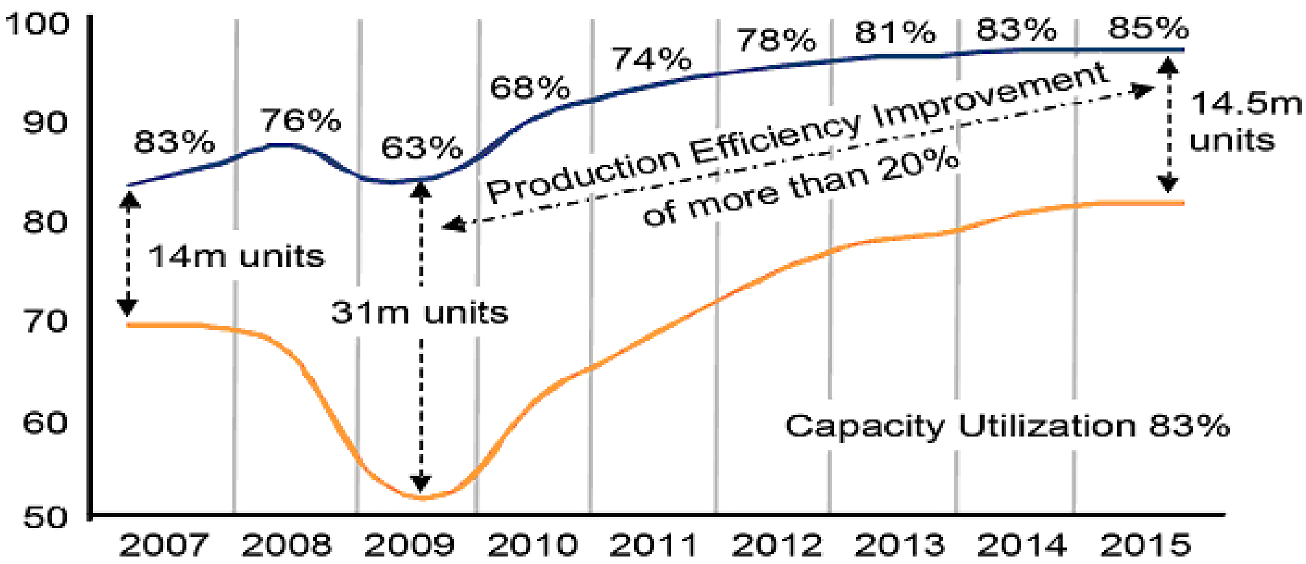
2008 Q2, in %

Region	Other Europe	Asia	NAFTA	Latin America	Rest of the world
Share of total exports	29	28	27	6	10

Source: Cefic Chemdata International

On the other hand, the impact of the crisis on non-pharma segments has been very painful. It has included a fall in production, a drop in employment and a loss of market positions. Of the "chemically important" countries, only Belgium and Poland have exceeded the previous production peak observed at the start of 2008, and the EU as a whole is not expected to do so before 2013. The currently positive growth in some countries is due to renewed and fast-growing demand from emerging markets (Figure 1 and Table 1 illustrate this sector's situation at the EU level). Some of these economies are also active as competitors. For instance, the BRIC group's global share of sales in the chemicals industry has been higher than that of the EU since 2008. Growth is expected to be below 5% for the EU in the years ahead, and even that figure may be in danger if, for example, commodity prices keep rising. Supply-side technological factors that can limit the pressure on input prices, such as the development of shale gas production in North America, will meanwhile increase the competitive advantages of chemical producers on that continent at the expense of Europe. Emission trading in the EU is seen as another drag on growth. This sector will be driven overall mainly by inorganic chemical products if cost-effective production chains involving, among others, the new Member States (e.g. Poland) and emerging markets are kept running.

Figure 2: Global overcapacity for the production of light vehicles – situation and outlook



Source: *CIBC Global Automotive Outlook*

Note: Blue line denotes production capacity and orange line actual production, both in millions of units

Automotive: Overcapacity is the biggest problem in this sector, including on the global scale (Figure 2). Not surprisingly, the largest growth in demand is expected in Asia. Interestingly, though, overcapacity is also expected to arise there, particularly in China and India, within the next five years. This is due to an estimate that leading producers are willingly operating in markets with overcapacity, or with an outlook for overcapacity, as their priority is to maintain market share. Therefore, progress and tougher competition is expected mainly in the area of diversification of car versions for customers, whereas no revolutionary technical innovations are expected in core areas (engines, combustion, steering, etc.). The existing technological crossroads in the advanced world is a growing investment uncertainty. In particular, the technological uncertainty regarding electric mobility is huge.

Electronics: Virtually all buyers of this sector's products, with the exception of (government-financed) defence, security and space programmes, experienced a downturn at the peak of the global recession in 2009. Europe's market share was declining systematically in favour of Asia, not only during the crisis, but also before it (for example, China's market share increased from 15% to more than 30% of global production between 2000 and 2010). In Europe, industry-supplying segments recovered best last year, while production for mass consumers was almost flat (home appliances) or kept falling (consumer electronics). In itself this is not bad news for European producers, as the base of the consumer electronics industry moved to the Far East with the onset of globalisation. Even so, the expected average growth in the sector is 2.5% for Europe, 2.9% for North America and 8.9% for China in 2009–2014 (the growth rates in previous years and the outlook are given in Table 2). Electronics production in Europe is not "dead" as is often mistakenly believed, but survives at the level of SMEs rather than large corporations (with the aforementioned exception of defence, security and space technology, supplies of which by large European companies have increased since the end of the crisis). This is due to the need to switch markets flexibly and to be satisfied with the role of sub-contractor in larger international projects. A particularly interesting observation was that while automotive industry analysts see electric mobility as an uncertain vision, electronic industry analysts are almost certain it will expand massively over the next 10 years and consider it to be the future driving force of growth in their sector. Only after the long-term trends in energy commodity markets become more apparent will it become clear whether this is a case of obligatory optimism spiced up by a conflict of interest (where the analysis is meant as an annex to an investment prospectus) or a well-informed estimate based on a sharp observation.

Table 2: Growth in electrical equipment production in major world regions – situation and outlook

	Sales volumes in EUR bn., 2008	Annual growth in %			Cumulative average annual growth in %, 2009-14
		2009	2010	2011	
Europe	217	-13.9	1.5	2.1	2.5
North America	204	-11	2.8	2.9	2.9
China	336	-0.3	8.5	9.5	8.9

Source: *DECISION*

Large industrial plant: This segment is specific in that it has an above-average production cycle length and requires a very wide range of technological know-how. Consequently, it has historically been more prominent in larger and more diverse economies, with Germany traditionally being the global leader. For years most projects have been exported to other advanced countries and increasingly to emerging markets (although not just the Far East; on the contrary, the geographical distribution is surprisingly even – see Table 3).

Table 3: Geographical distribution of German exports of large industrial plant (EUR bn)

Region	Industrial countries	Asia and Pacific	Near and Middle East	Eastern Europe and CIS	Rest of the world
2009	4.7	2.9	4.6	2.8	3.25
2010	4.85	3.25	2.96	2	4.6

Source: German Engineering Federation

The recent crisis primarily affected exports, while domestic orders remained stable. Since the crisis, as exports have recovered, lower prices and better positions of buyers can be observed, along with a gradual rise in Asian competition (South Korea as well as China). The chances for European products in smaller catching-up countries (outside the BRIC group, for example in Latin America) remain high. In addition, in response to South Korean competition, German suppliers are opting to invest more in R&D and to expand cooperation with sub-contractors in target countries (and thereby stay ahead of their Asian competitors used to sub-contractors from their home countries). Contracts in this sector are longer term in nature than in the case of other industrial supplies, so the crisis will be felt for several years yet. This means that while the number of contracts is likely to increase, sales may continue to a decline for some time after the drop in orders in 2009–2010. Growth in commodity prices is perceived as an interesting growth opportunity especially for European exporters, as this factor should foster higher demand for efficient technologies developed in Europe.

Conclusion

The above summary reveals that a number of European economies, having overcome the global recession, are in a better position than the United States. The countries concerned, led by Germany, have managed to maintain the core of their traditional industrial base and to invest sufficiently in innovation in the face of globalisation and the recent crisis. In the USA, by contrast, the last major broad innovative investment in production took place in the 1990s, so there is now a palpable lack of specific human capital in the form of experts who still remember this investment. This means that Germany and other economies with a similar structure have a chance of solid and sustainable growth over the next 5–10 years, thanks mainly to growing third-world markets. The main emerging economies undoubtedly represent increasingly serious competition for the EU economy and will continue to do so. However, the two sides are helping each other to create new sources of economic growth, thanks to the complementarity of the products made in Europe and Asia, which will continue for years to come. European producers' ultimate share in this global growth will depend very much on how successful they are in identifying economic needs outside Europe and finding unsaturated markets for their products. Overall, the message of the CESifo conference is that industry in Germany and in numerous Northern European countries is no longer a novice in the penetration of emerging markets. It is for this reason that industry representatives are cautiously optimistic about the future.

BOFIT	Bank of Finland Institute for Economies in Transition
CB-CCI	Conference Board Consumer Confidence Index
CB-LEII	Conference Board Leading Economic Indicator Index
CBOT	Chicago Board of Trade
CF	Consensus Forecasts
CN	China
CNB	Czech National Bank
DBB	Deutsche Bundesbank
DE	Germany
EA	euro area
EC	European Commission
ECB	European Central Bank
EC-CCI	European Commission Consumer Confidence Indicator
EC-ICI	European Commission Industrial Confidence Indicator
EIU	The Economist Intelligence Unit database
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
Fed	Federal Reserve System (the US central bank)
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
CHF	Swiss franc
IFO	Institute for Economic Research
IFO-BCI	IFO – Business Climate Index
IFO-CCI	IFO – Consumer Confidence Index
IMF	International Monetary Fund
IRS	Interest rate swap
JPY	Japanese yen
LIBOR	London Interbank Offered Rate
N/A	not available
OECD	Organisation for Economic Co-operation and Development
OECD-CLI	OECD Composite Leading Indicator
UoM	University of Michigan
UoM-CSI	University of Michigan Consumer Sentiment Index
US	United States
USD	US dollar