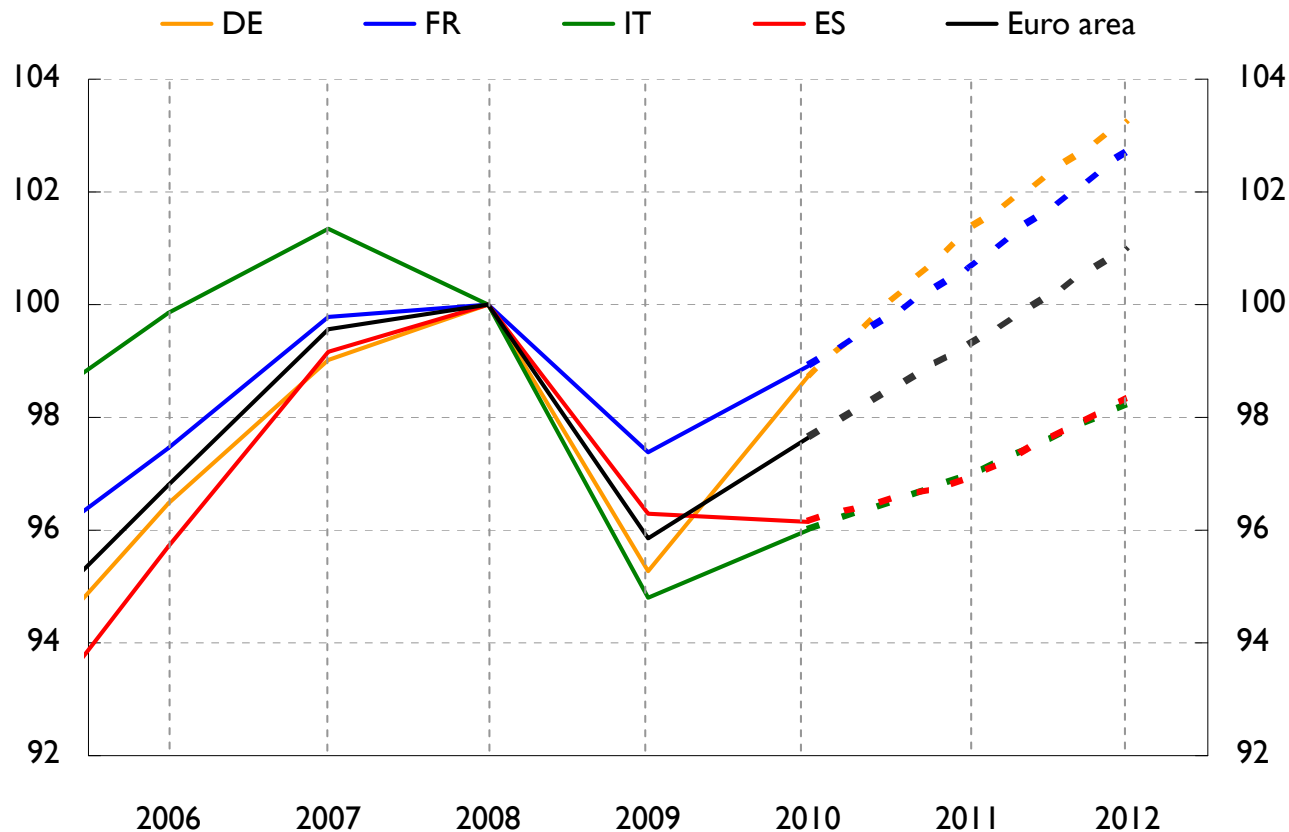# The Ruling Companies

Where is the economy heading?
The challenges ahead

Milan, 11 July 2011

Lorenzo Bini Smaghi
Member of the Executive Board
European Central Bank
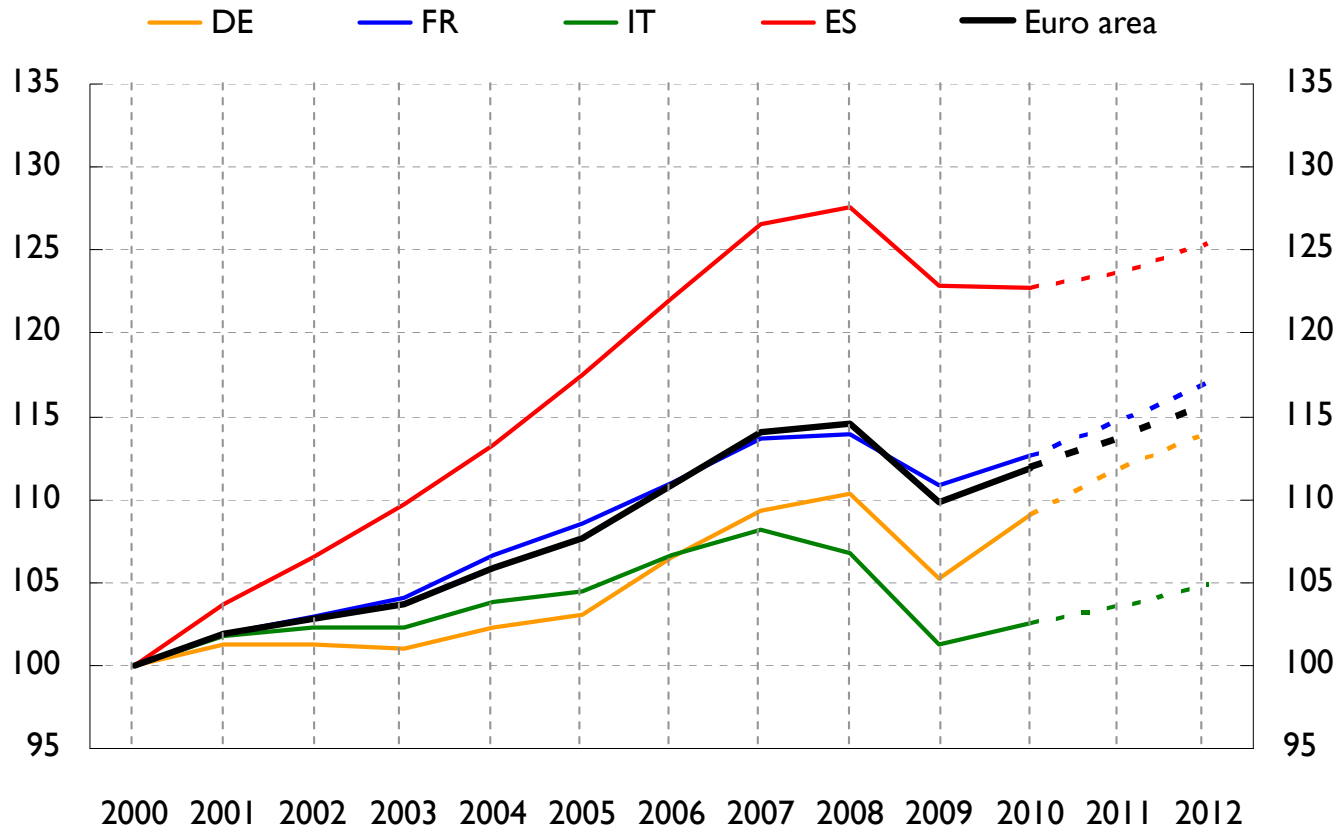
Growth is recovering at an uneven pace

(Real GDP, Index: 2008 =100)

Source: European Commission projections (Spring 2011).
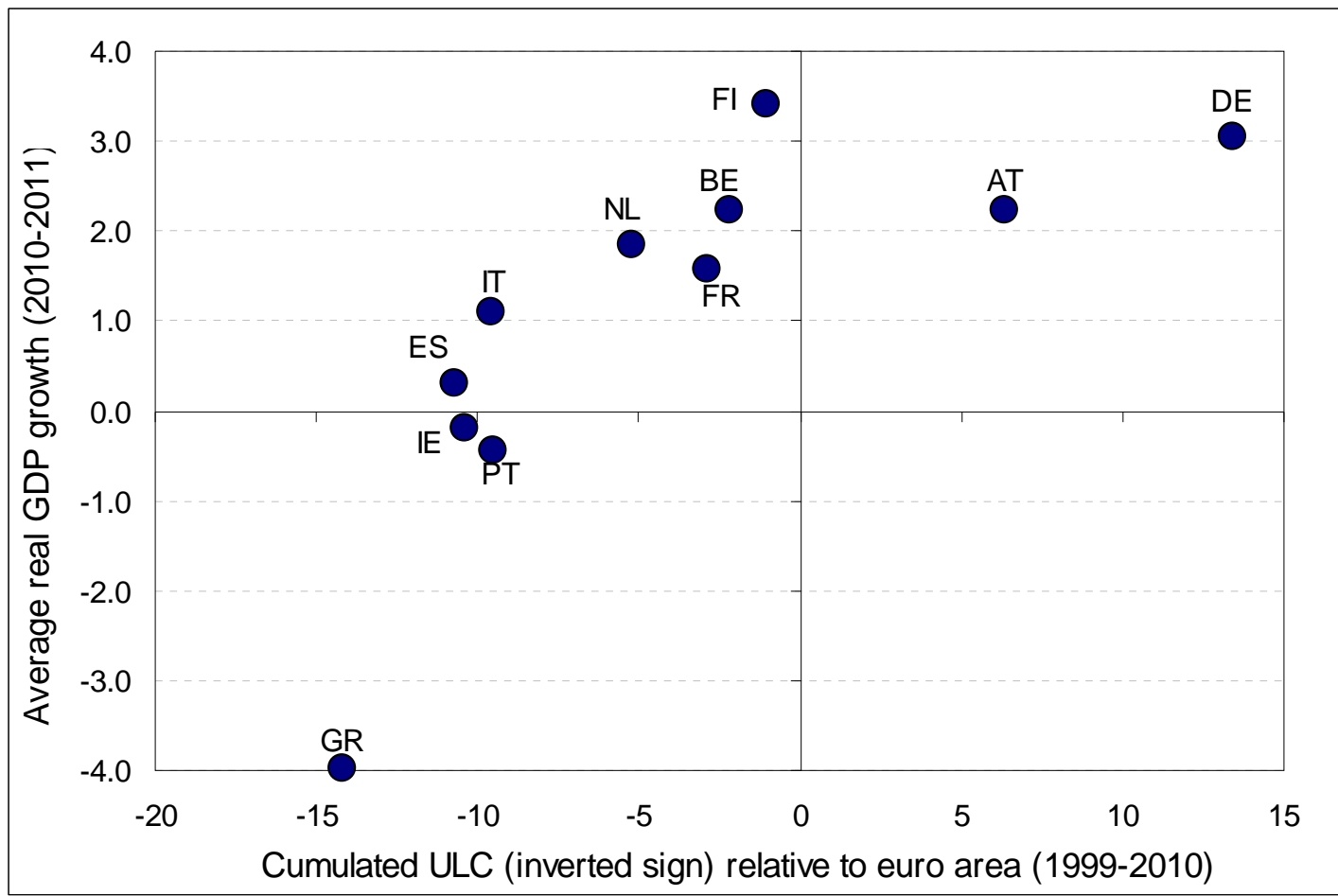*Latest actual data 2010. Dotted lines indicate projections.*

With different trends
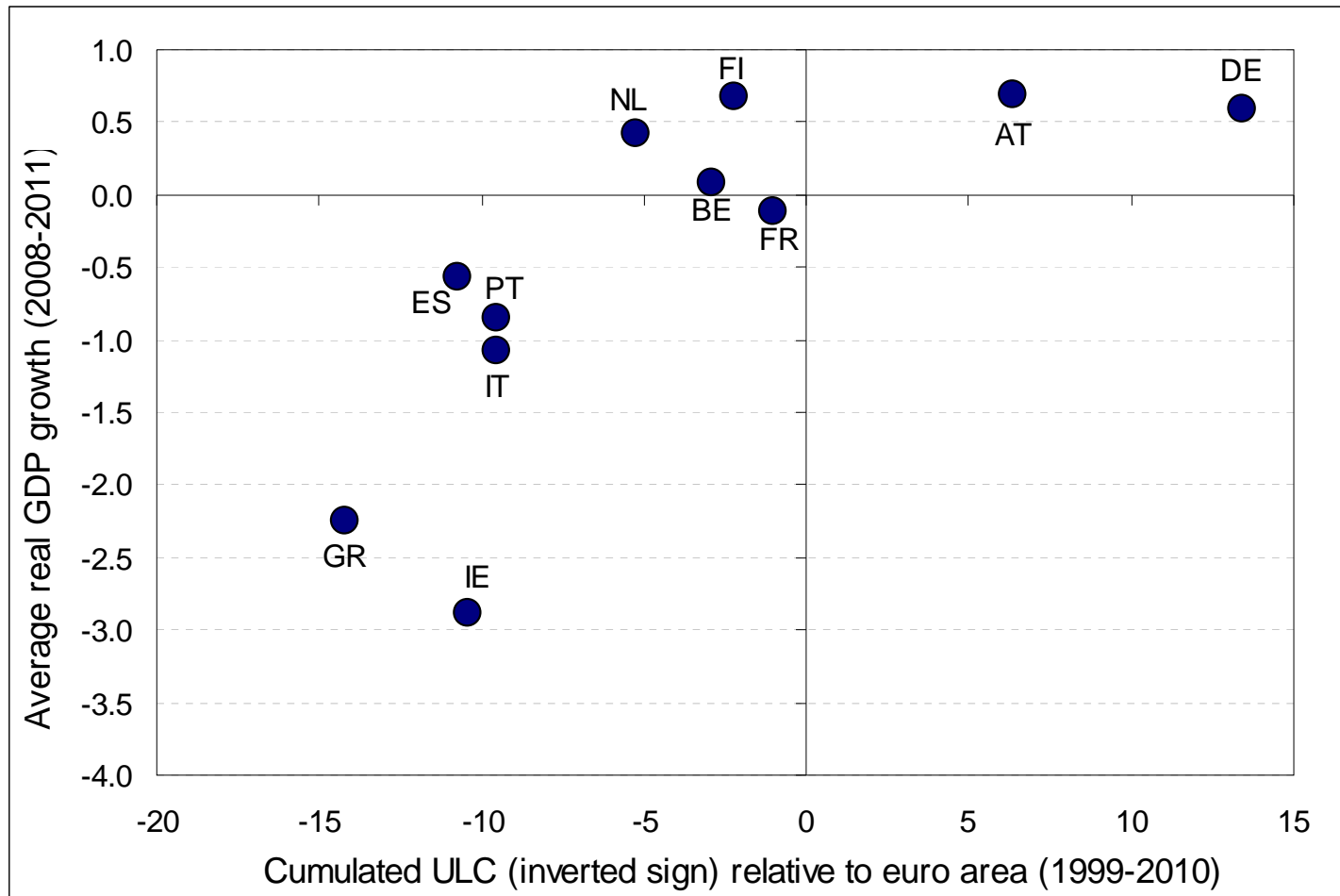
(Real GDP, Index: 2000 =100)

# The recipe for recovery is competitiveness

Sources: Eurostat and European Commission. For GR ULC growth starts in 2001
Note: Cumulated ULC growth relative to the euro area average (1999-2010) and average real GDP growth (2010-11) in %.

It has been true over the recent cycle

Past divergences have to be corrected

Unit labour costs in selected euro area countries, nominal
(index 1998 Q4 = 100, relative to Germany, based on sa data)
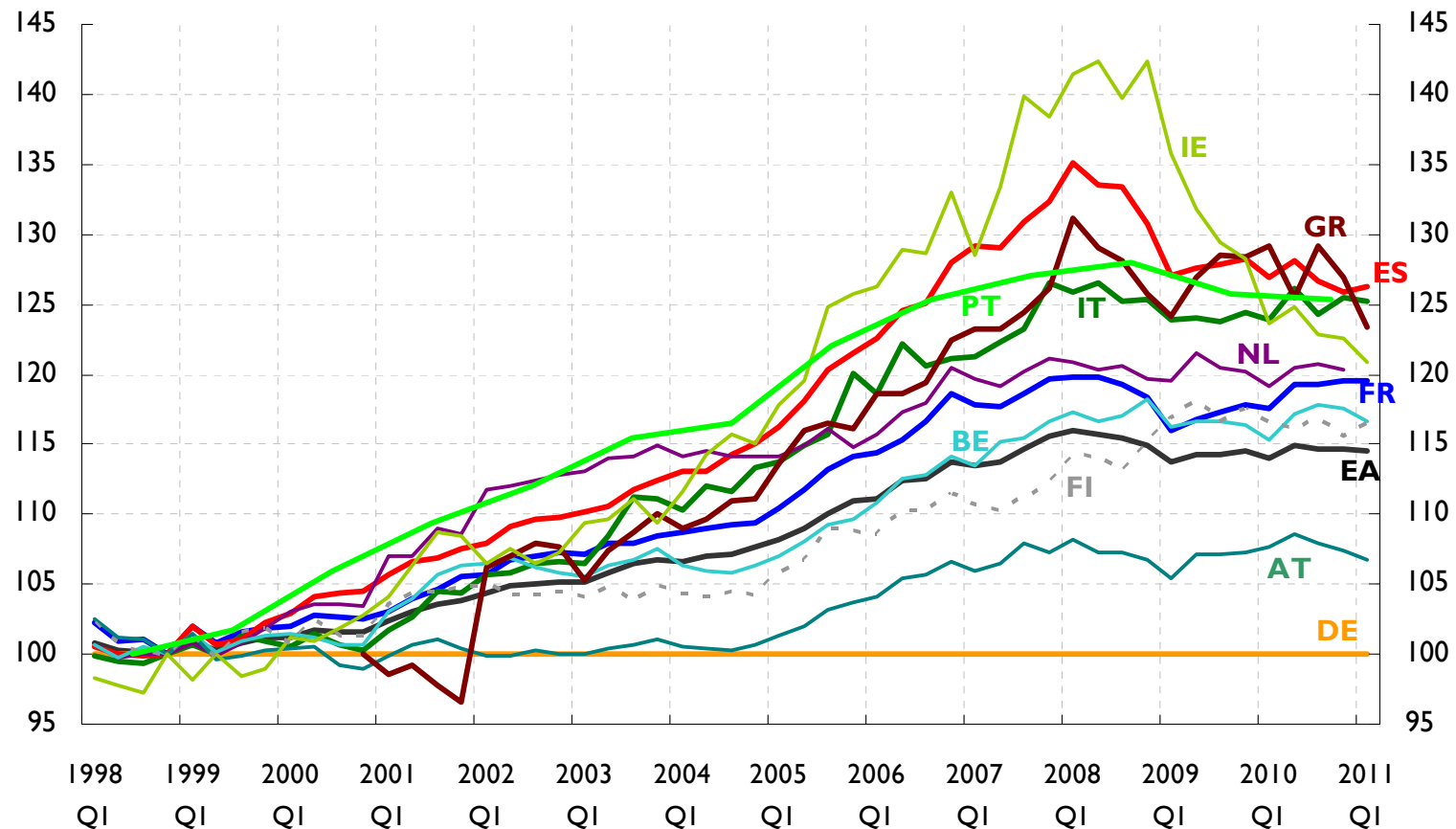
Source: Eurostat. Quarterly data up to 2011Q1 for all countries except for the Netherlands (2010Q4) and Portugal (annual data up to 2010).
Note: The ULC indices are set to 100 in the last quarter before the euro area accession of the respective country.
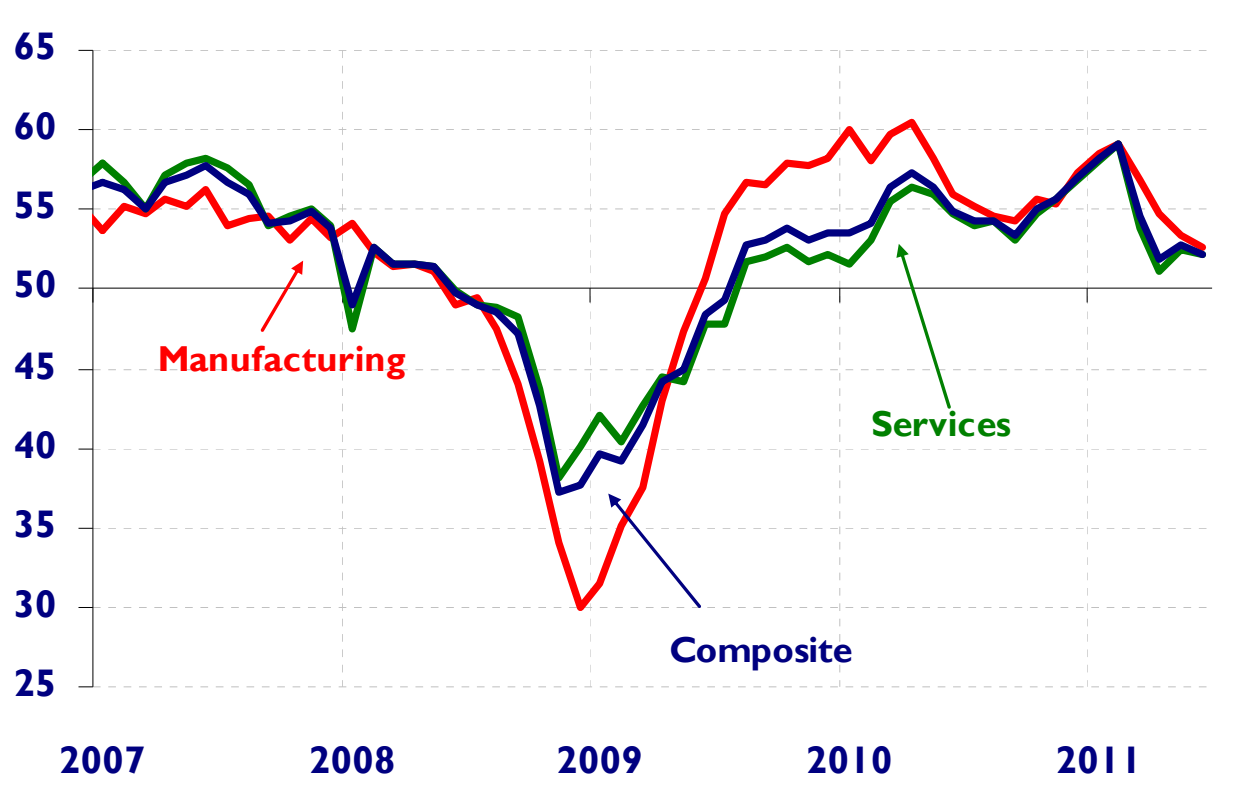The ULC developments presented for Greece and Portugal might differ from the calculations made by the National Central Banks.
The quarterly pattern in Greek ULC is affected by substantial volatility in quarterly compensation of employees figures.

Global PMI
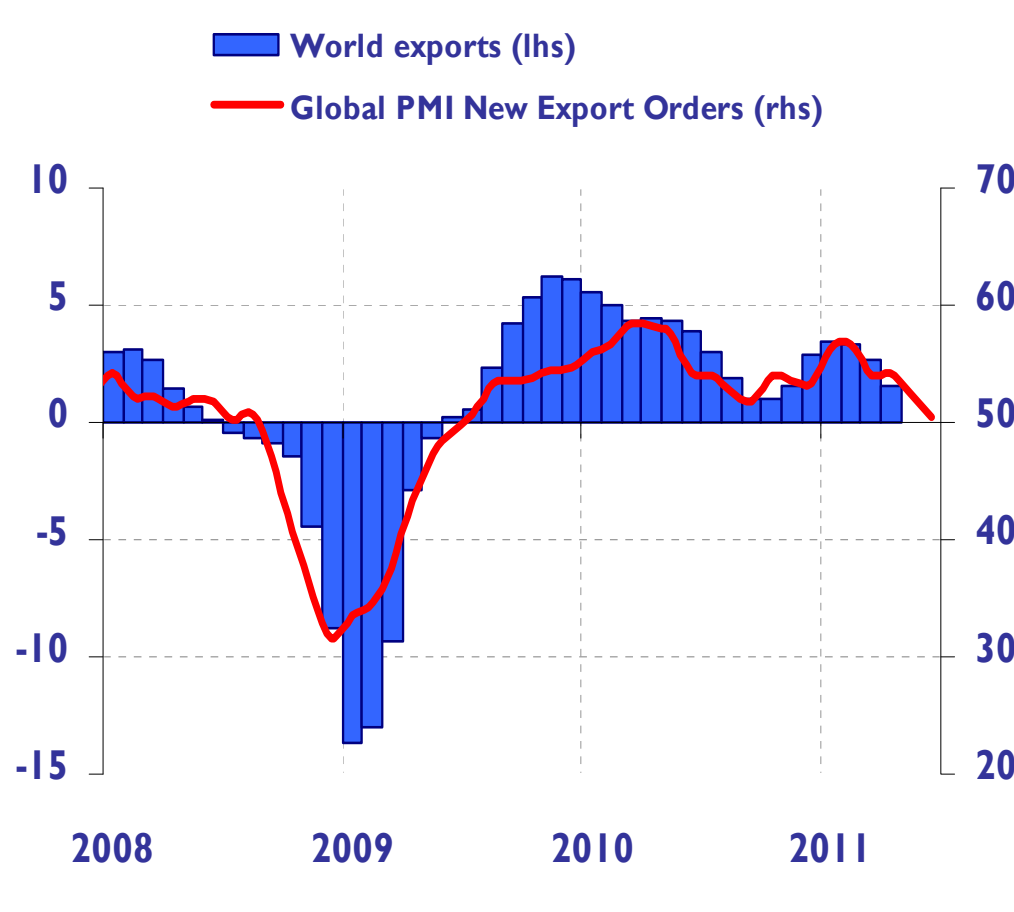*(Diffusion index; SA; monthly data)*

Source: Markit.
Note: Last observation refers to June 2011.

World trade growth momentum slows

World exports and World PMI new export orders
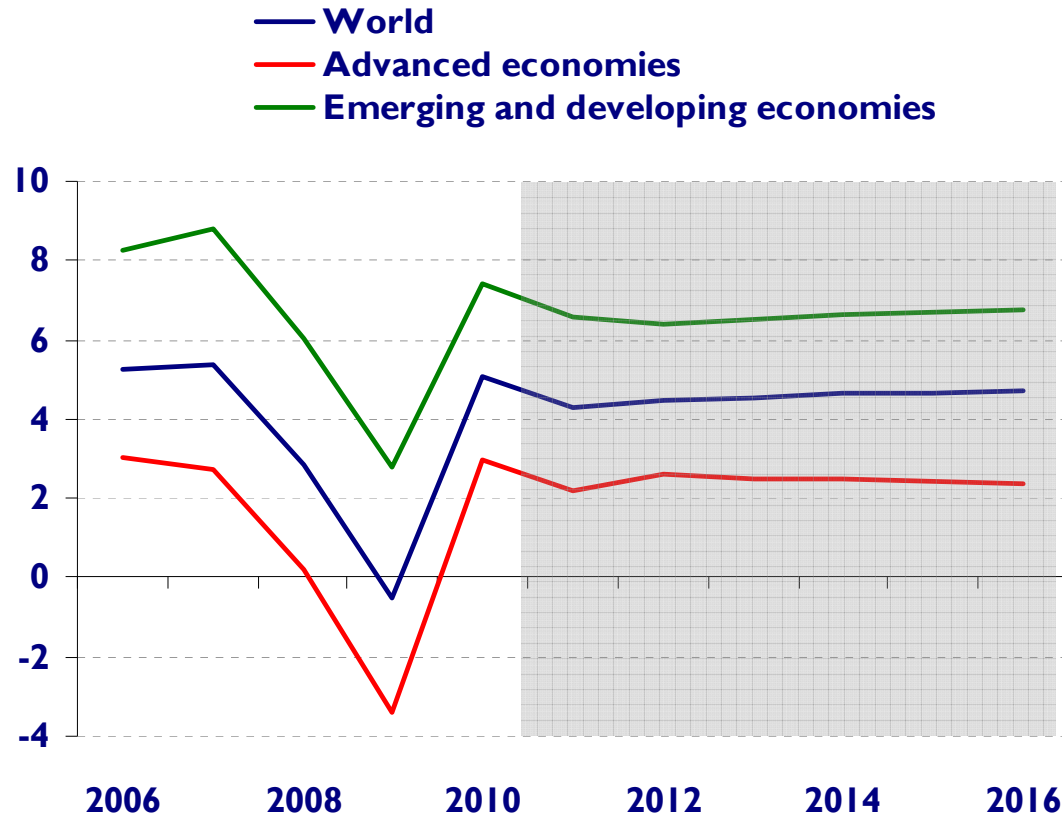*(lhs:3mma, 3m-3m % change, rhs: diffusion index)*

Source: CPB and Markit.
Note: Latest observation refers to June 2011 for the Global PMI and April 2011 for World exports.

But IMF expects recovery to remain on track

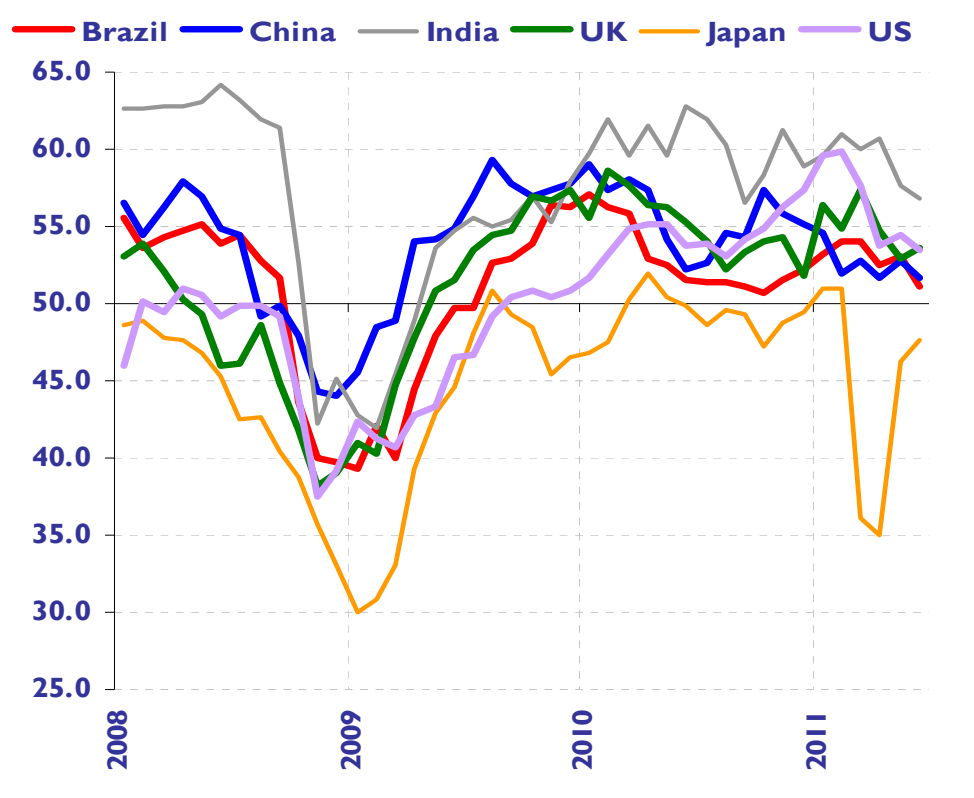**GDP growth in advanced and EMEs**
(y-o-y % change)

Source: IMF WEO (April 2011, June 2011 Update).
Note: Latest observation refers to 2010, projections up to 2016.

PMI indicators signal a slowdown in growth momentum

Composite PMI output
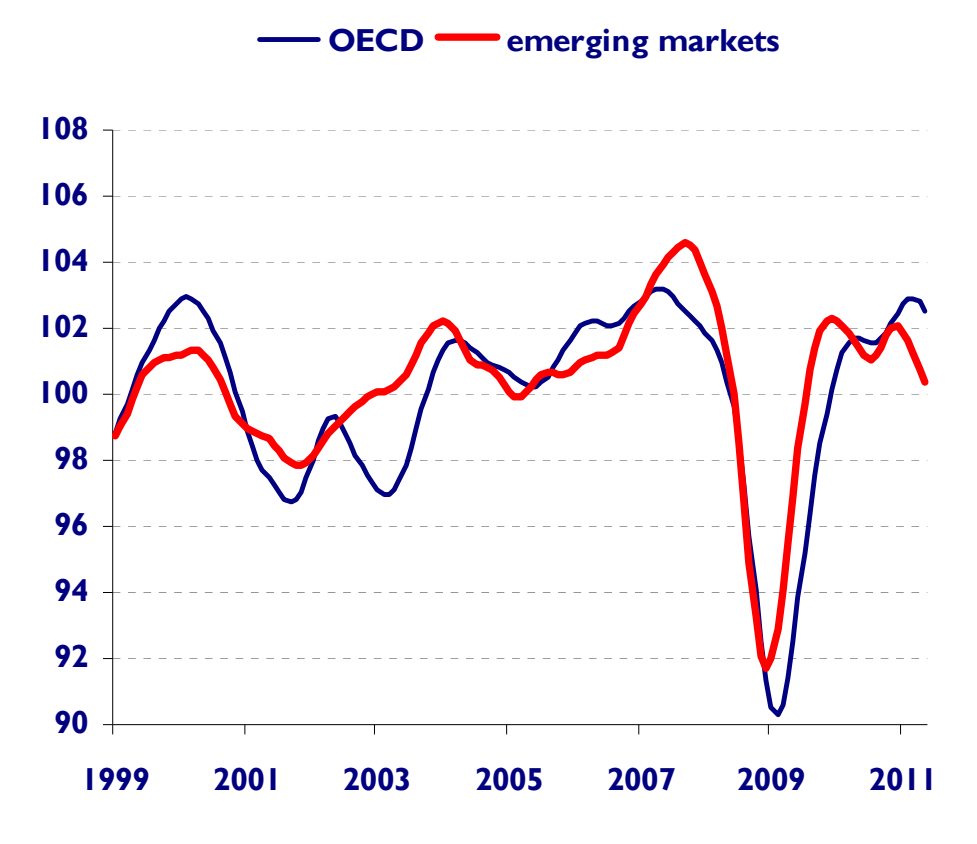*(Diffusion index; SA; monthly data)*

Brazil — China — India — UK — Japan — US

Source: Markit.
Note: Latest observation refers to June 2011.

OECD CLI suggest a mild loss of growth momentum

OECD composite leading indicators
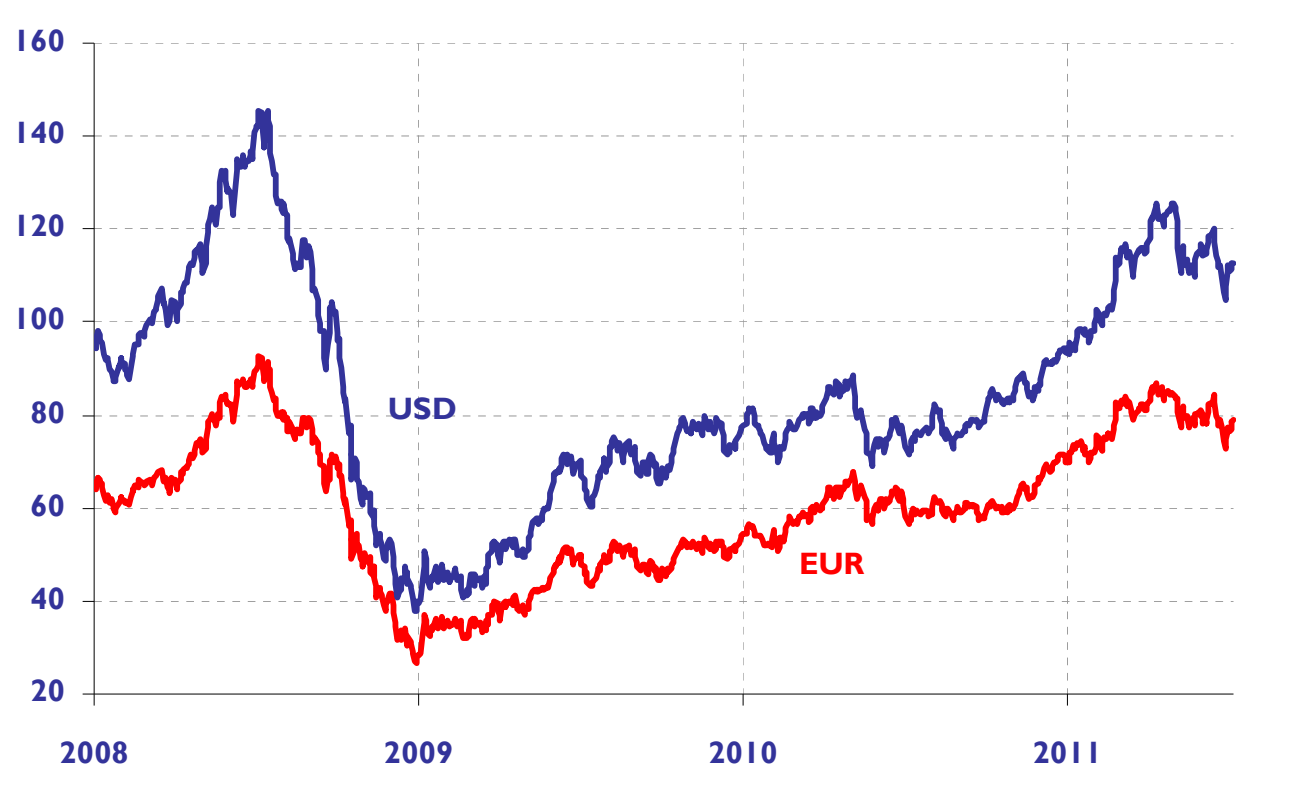*(monthly data; amplitude-adjusted)*

Source: OECD.
Note: Latest observation refers to May 2011. The emerging market indicator is a weighted average of the composite leading indicators for Brazil, Russia and China.

Oil prices increase has moderated ...
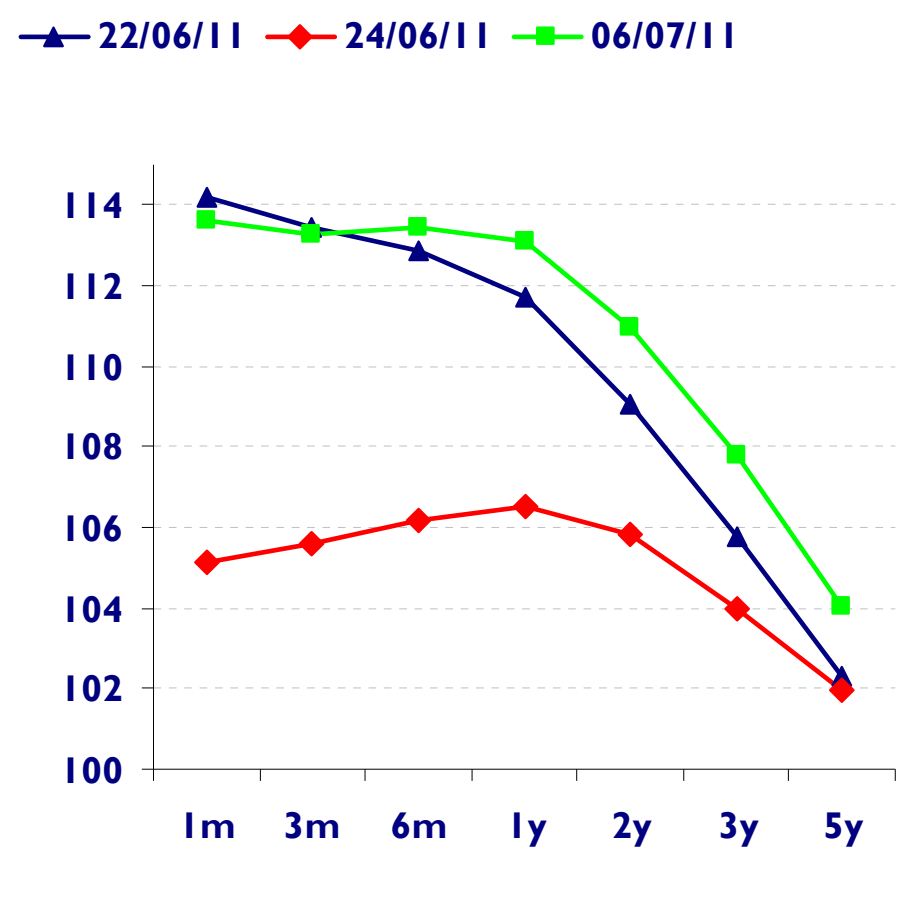
Brent crude oil
(in EUR, USD per barrel)

Source: Bloomberg.
Note: Last observation refers to 6 July 2011.
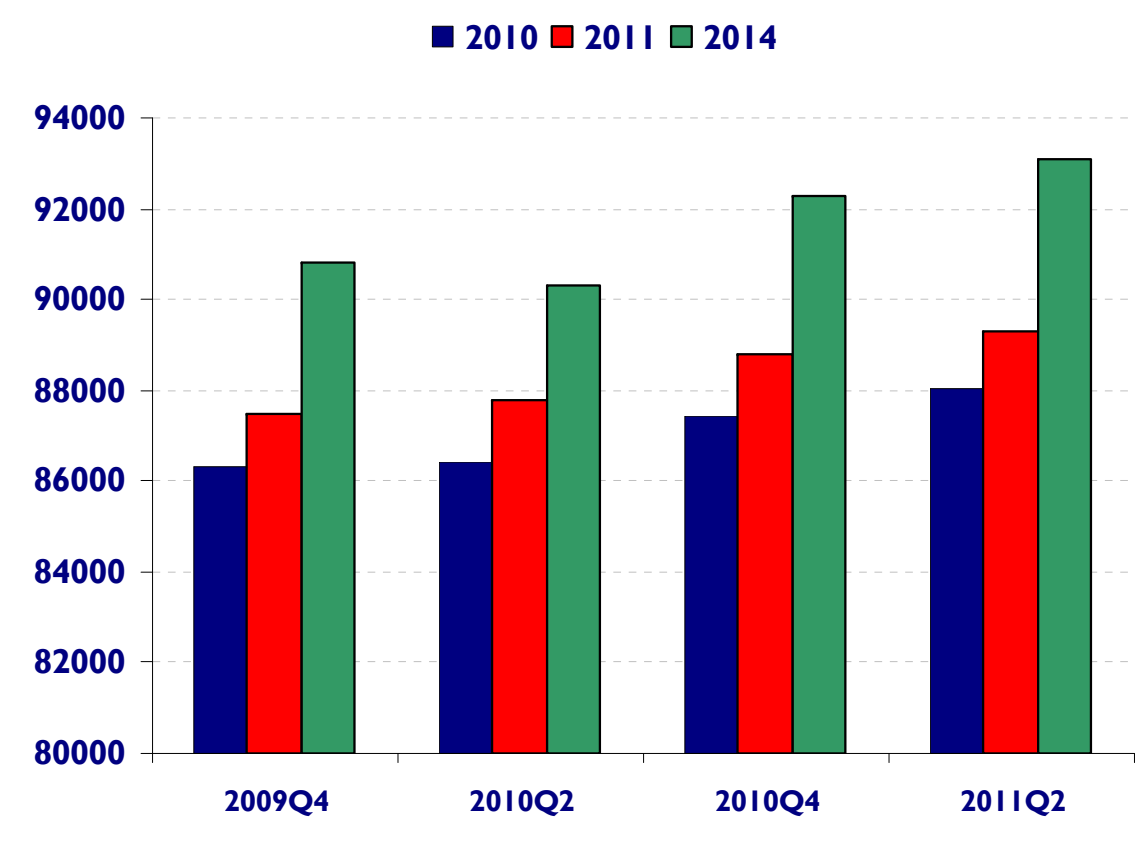
Oil futures

Oil futures curve
(USD/barrel)

But oil consumption is expected to rise

Total oil demand: OECD and non-OECD countries
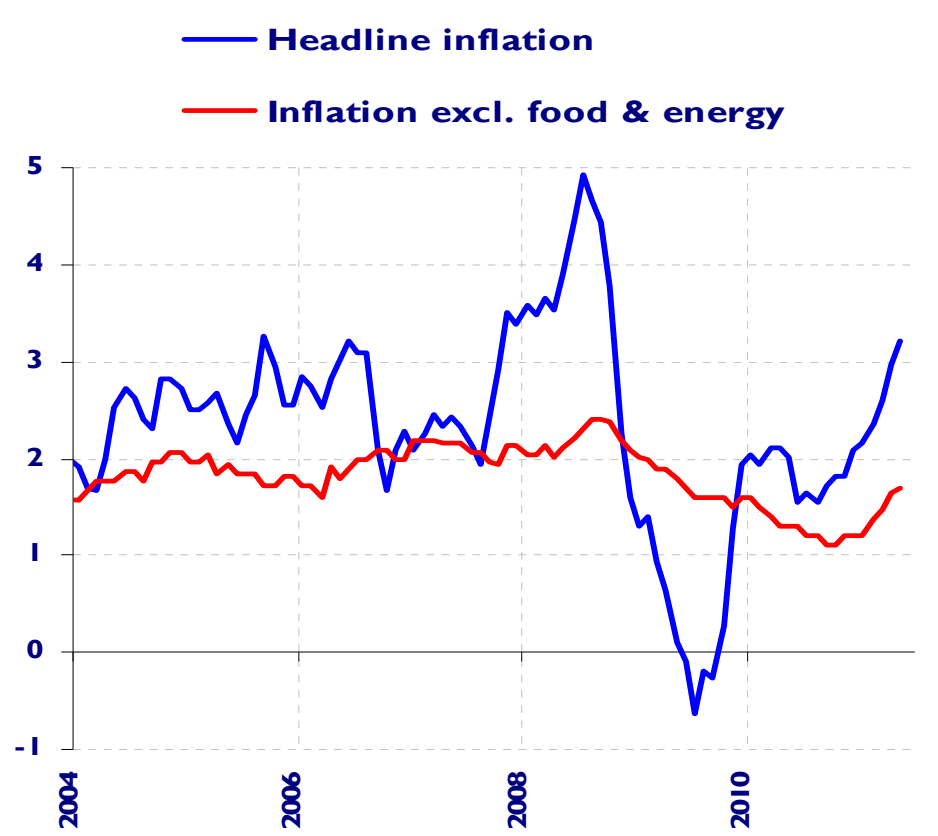*(in millions of barrels per day)*

Source: International Energy Agency.

Global inflation rates continue to increase
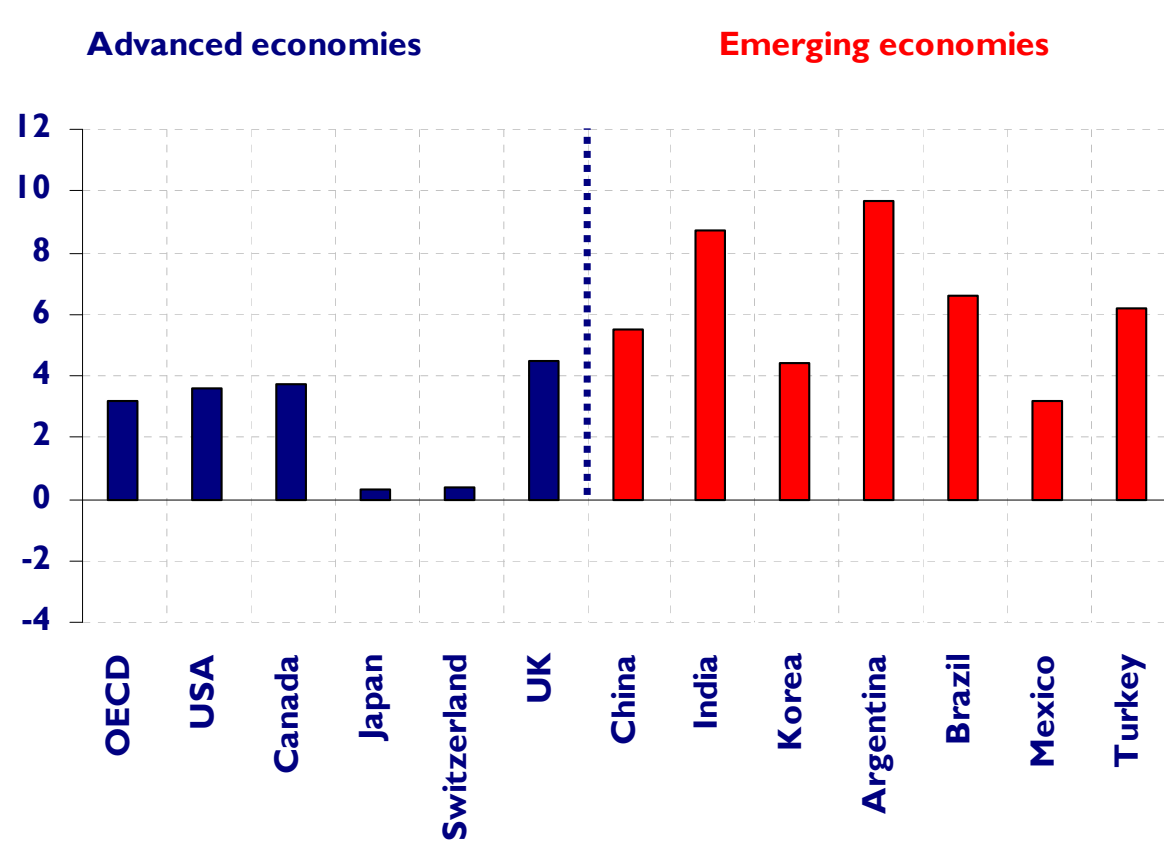
OECD inflation
(y-o-y % change)

Sources: OECD.
Latest observation: May 2011.

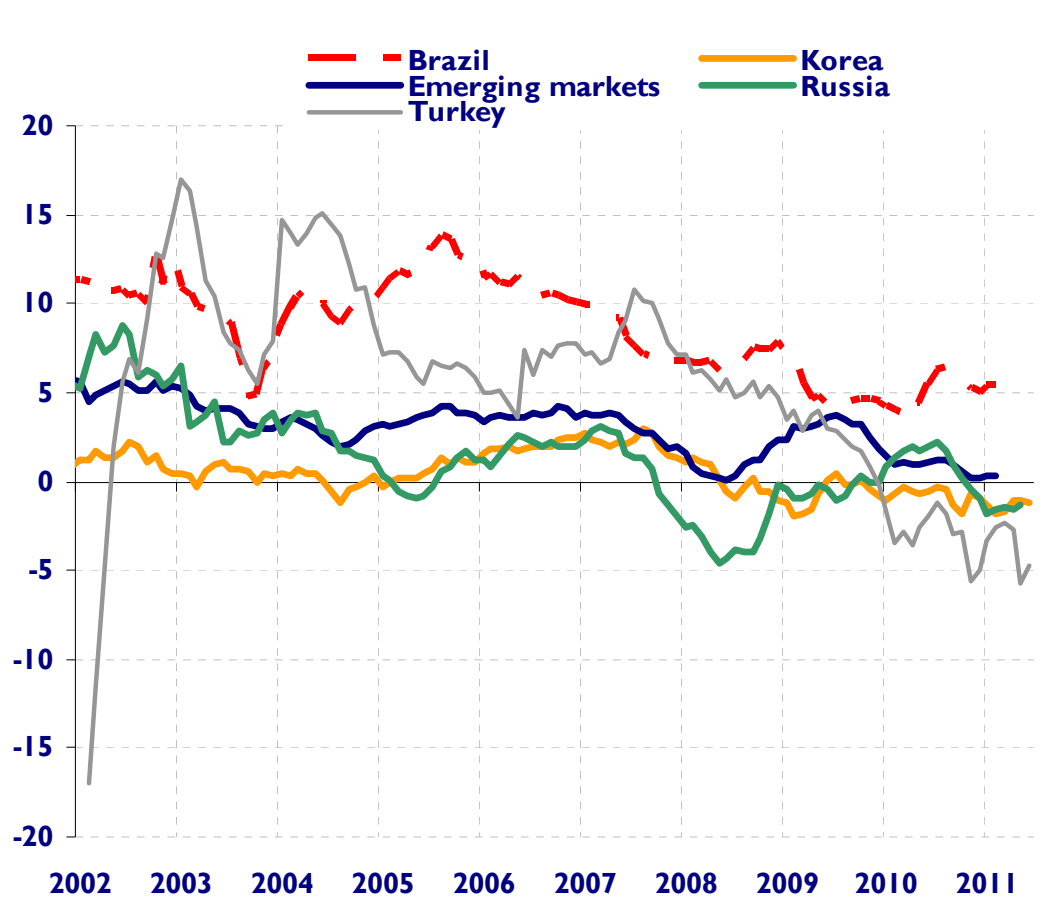# Global inflation rates

CPI inflation rates
(year-on-year % change)

Sources: OECD, Haver Analytics.
Note: Latest observation refers to May 2011 except for Korea and Turkey (June 2011).
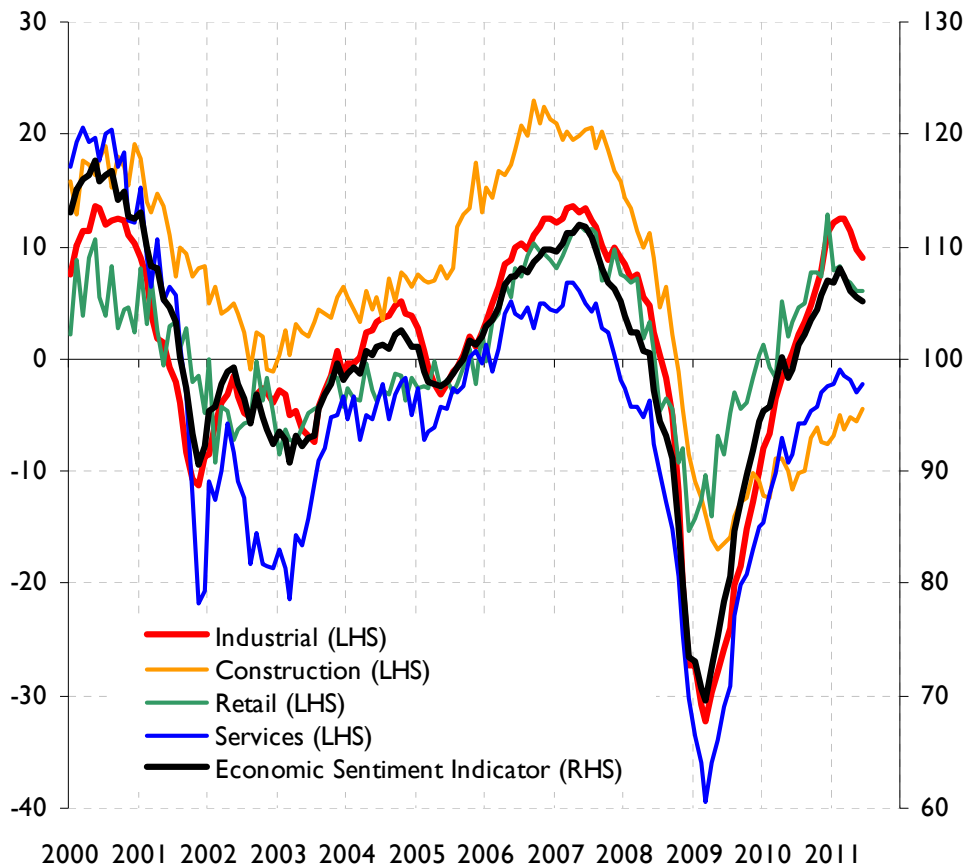
Real policy rates
(monthly, %, EOP)

Source: Haver Analytics.
Note: Last observation refers to June 2011 for Korea and Turkey, May for Russia and to February 2011 for the others.

Business confidence in the euro area
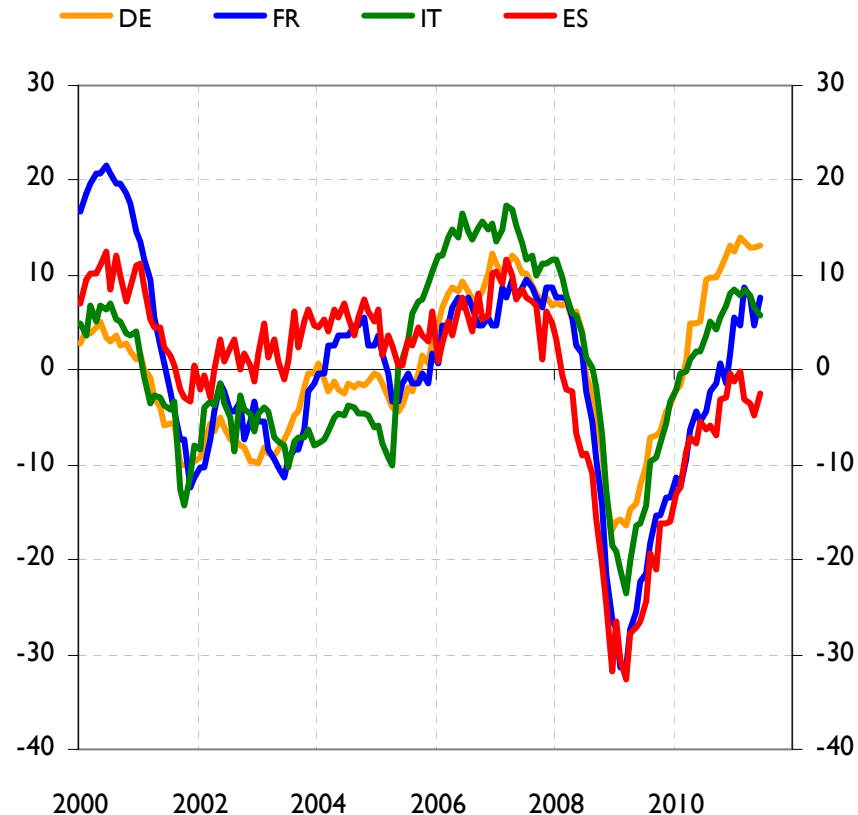
Business confidence in the euro area

(percentage balances, mean adjusted; index: deviation from long term average)

Legend:
- Industrial (LHS)
- Construction (LHS)
- Retail (LHS)
- Services (LHS)
- Economic Sentiment Indicator (RHS)

Source: European Commission. Monthly data up to June 2011.

National business confidence

(percentage balances, mean adjusted)

Legend: DE FR IT ES
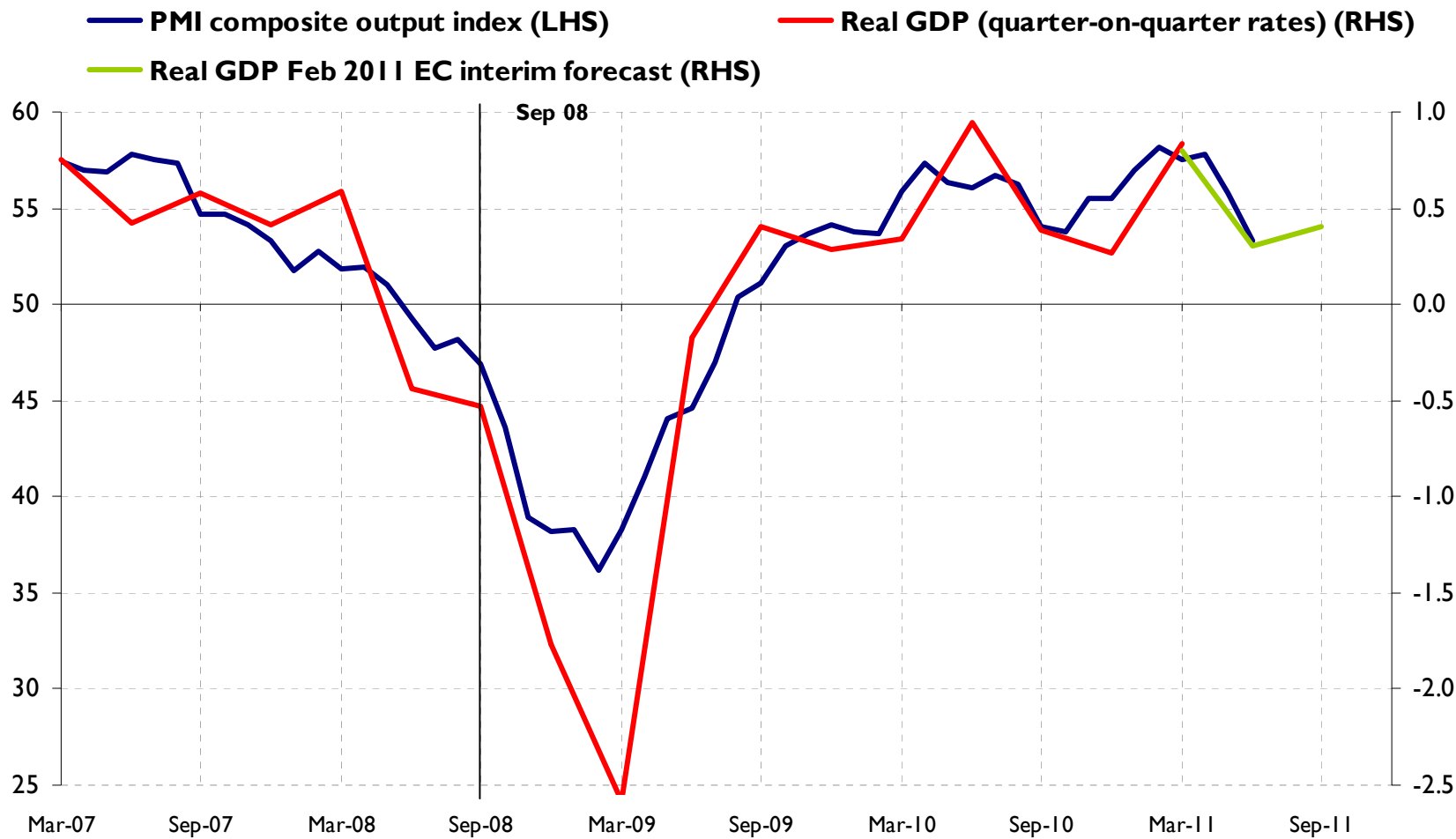
Sources: IFO, INSEE, ISTAT, European Commission.
Latest observation: June 2011.

PMI composite output and real GDP growth

(diffusion index – lhs, quarterly growth rates - rhs)

— PMI composite output index (LHS) — Real GDP (quarter-on-quarter rates) (RHS)
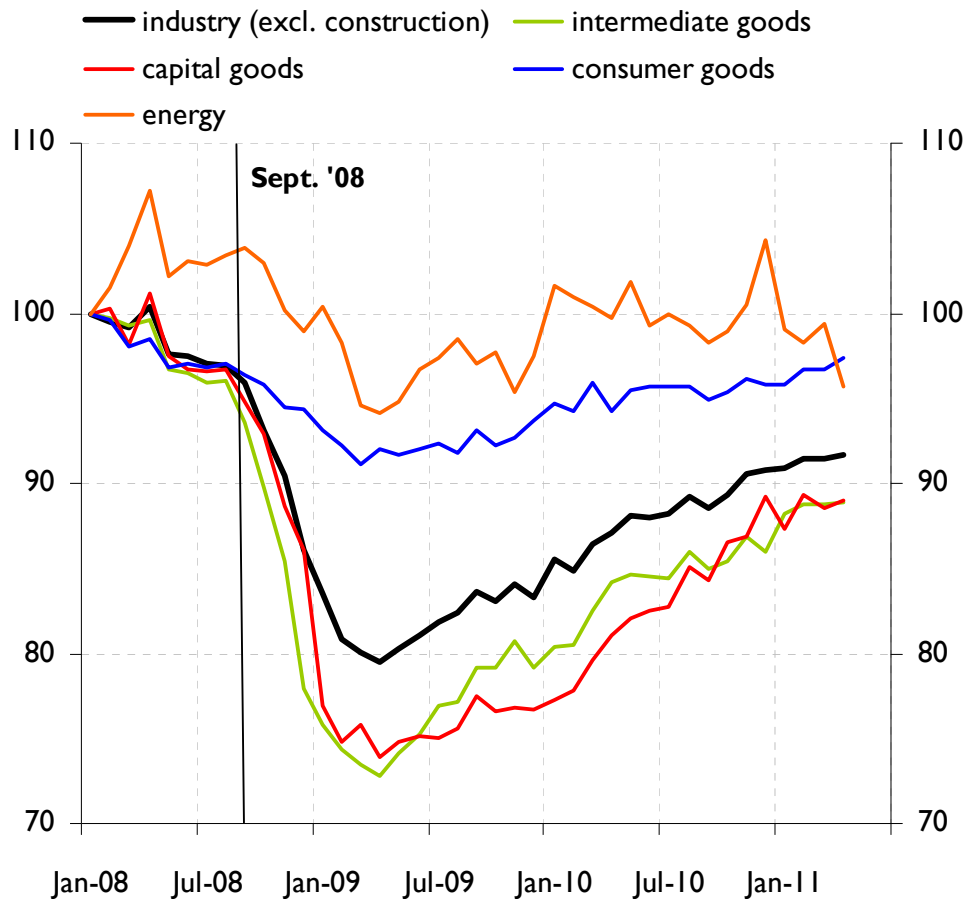— Real GDP Feb 2011 EC interim forecast (RHS)

Sep 08

Sources: Eurostat, European Commission, Markit.
Latest observations: Purchasing Managers' Index (PMI) June 2011, GDP Q1 2011.

Industrial production and orders

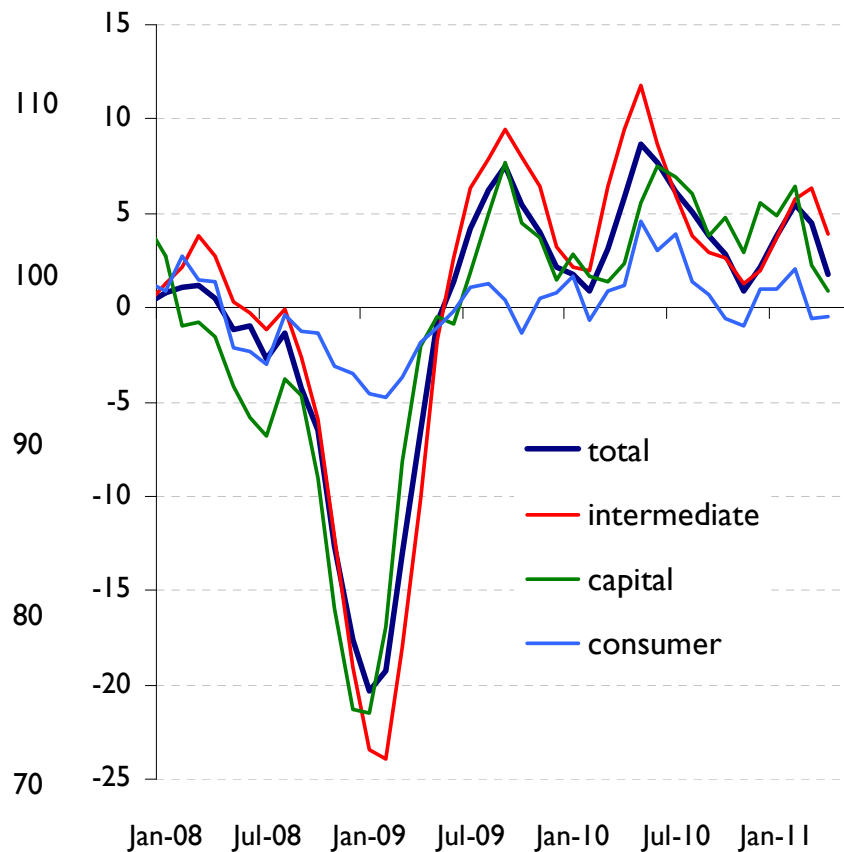## IP: Sectoral breakdown for the euro area

(WDA&SA indices; January 2008=100)

Source: Eurostat. Latest observation: April 2011.
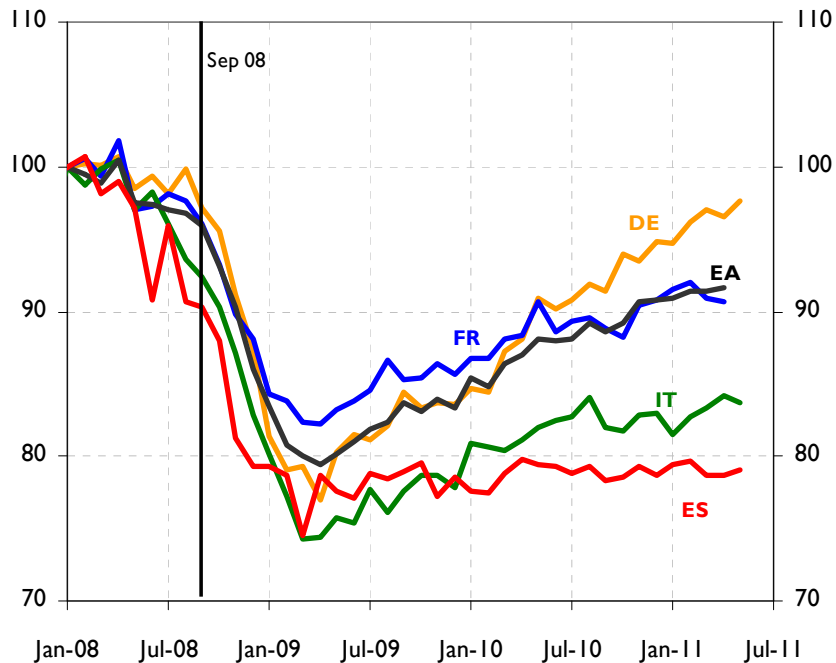
New orders in the euro area

(3-month-3-month ma growth rate; WDA&SA)

Source: Eurostat. Latest observation: April 2011. Note: Industrial new orders exclude heavy transportation equipment.

Industrial production excluding construction

(WDA&SA indices; January 2008=100)

(% change over previous period. WDA & SA)

Industrial production (excluding construction) in the largest euro area countries

% change over previous period. WDA & SA.

|	2010 Q4	2011 Q1	Feb-11	Mar-11	Apr-11	May-11	Percentage change Sep 08 - May 09	Percentage change May 09 - Apr 11
Germany	3.0	2.0	1.6	0.9	-0.5	1.2	-17.3	20.2
France	0.7	1.9	0.5	-1.2	-0.3	-	-13.4	9.0
Italy	-0.5	0.0	1.5	0.7	1.1	-0.6	-18.0	11.1
Spain	0.1	0.6	0.3	-1.2	0.0	0.4	-14.0	1.5
Euro area	1.8	1.2	0.5	0.1	0.2	-	-16.4	14.4
memo items								
Country aggregation (1)	1.5	1.2	1.0	0.2	-0.2	0.6	-15.5	12.5

Source: Eurostat.

(1) Aggregation of available country data. The aggregate covers 68.3 % of the euro area total for May 2011.

Source: Eurostat. Latest observation: May 2011 for Germany, Italy and Spain, April 2011 for France and euro area.
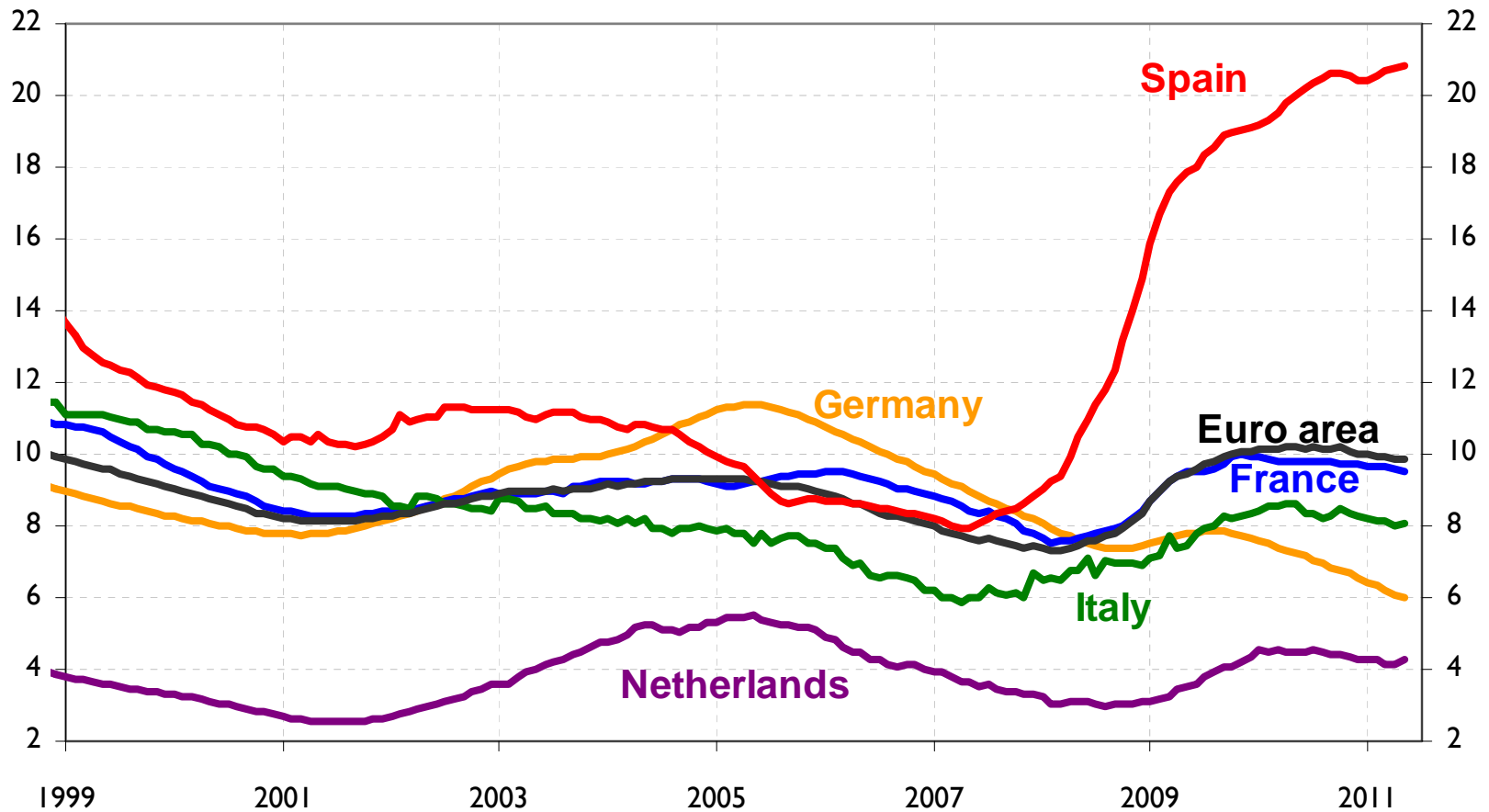
Unemployment in the euro area

(% of labour force; thousands)
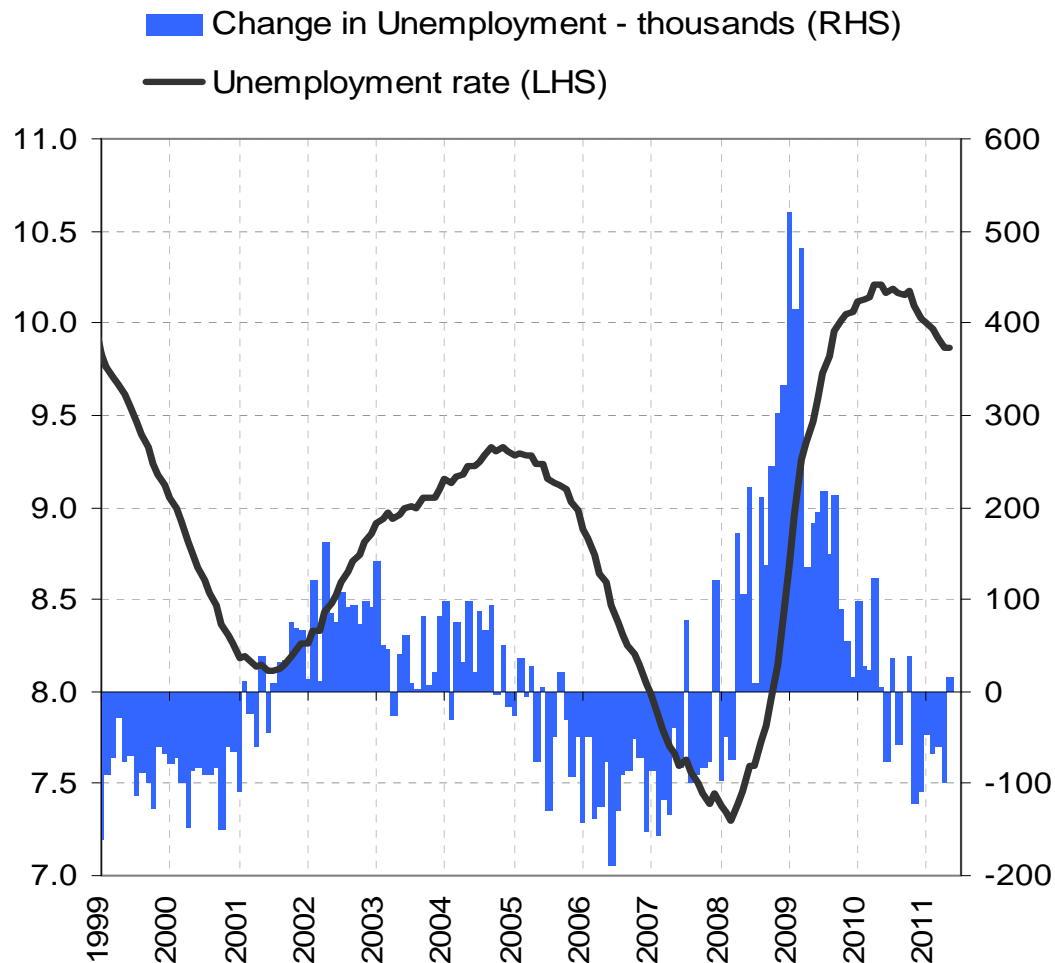
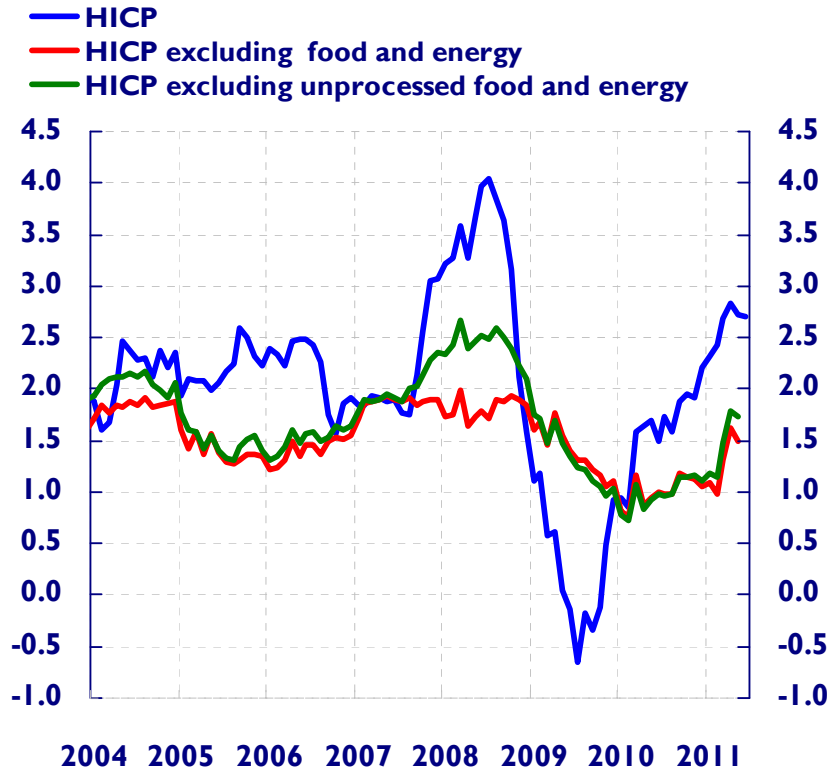Source: Eurostat. Latest data: May 2011.

Unemployment in euro area countries

(% of labour force)

Euro area HICP inflation

(annual percentage changes)

HICP
HICP excluding food and energy
HICP excluding unprocessed food and energy

	weights	HICP Apr 11	HICP May 11
HICP	100	**2.8**	**2.7**
Energy	9.6	12.5	11.1
Unprocessed food	7.3	1.4	2.4
Processed food	11.9	2.8	3.2
Services	42.0	2.0	1.8
NEIG [1]	29.3	1.0	1.0
HICPX [2]	71.3	1.6	1.5

Sources: Eurostat and ECB calculations.
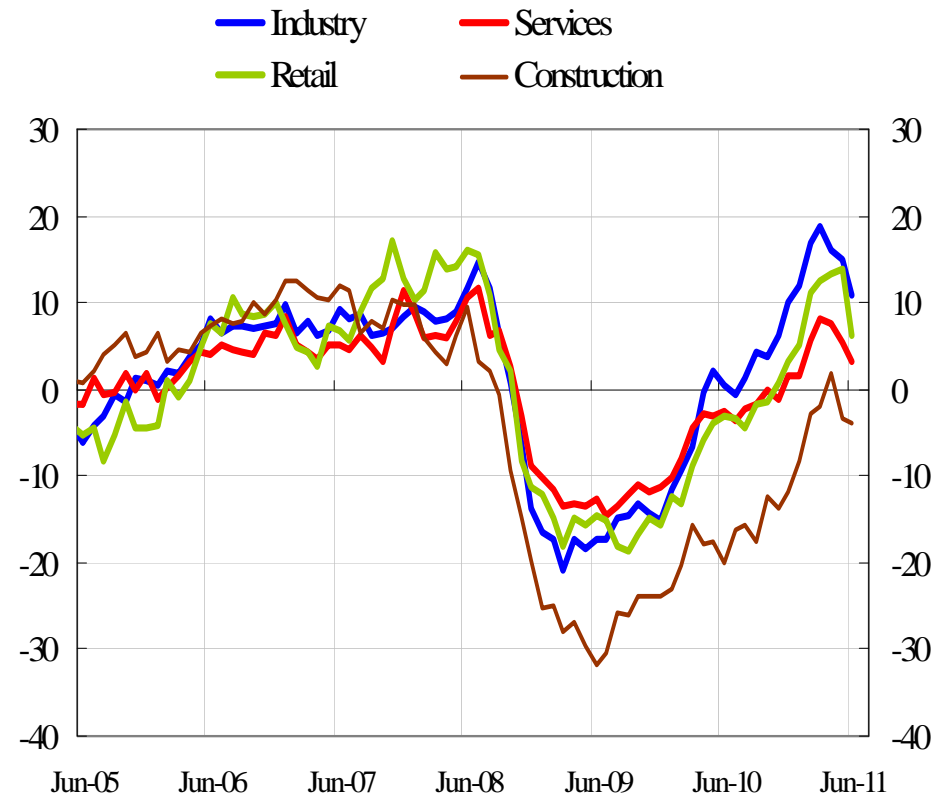*Latest observations: June 2011 for HICP, May 2011 for the rest.*
Notes: 1) non-energy industrial goods; 2) overall excluding food and energy.

Industrial producer prices and selling price expectations

Producer price developments
(annual growth rates)

- PPI excluding construction and energy (lhs)
- PPI consumer goods exc. food&tobacco (rhs)

Source: Eurostat.
Latest observation: May 2011.
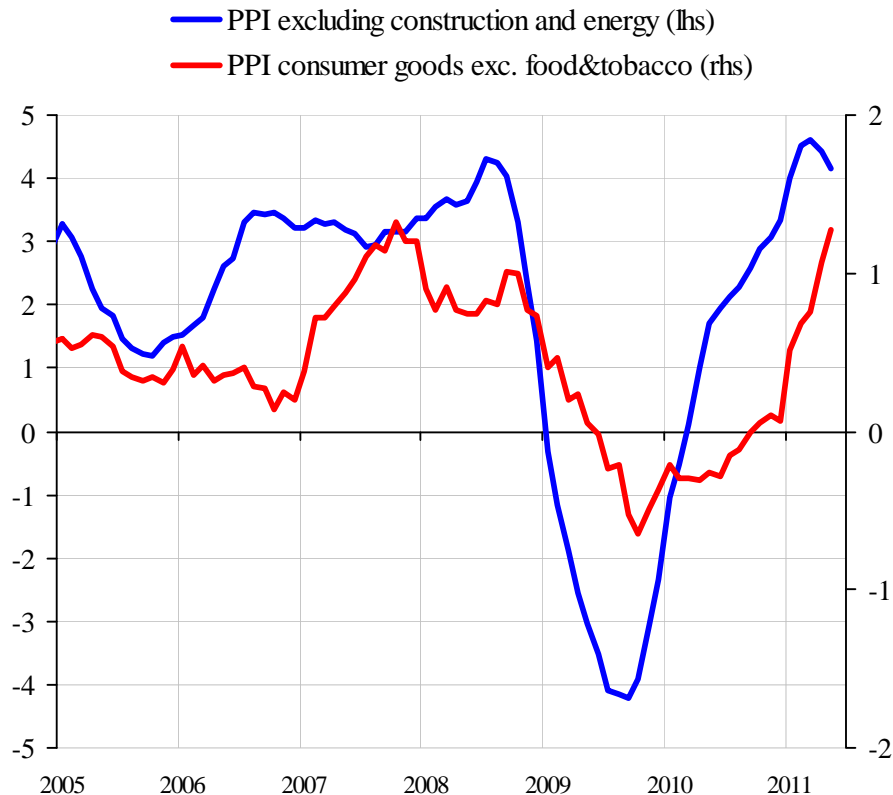
Selling price expectations
(percentage balances mean adjusted over the period since 1999)

- Industry
- Services
- Retail
- Construction

Source: European Commission Business Surveys
Latest observation: June 2011.

HICP inflation in the main euro area countries

(annual growth rates)
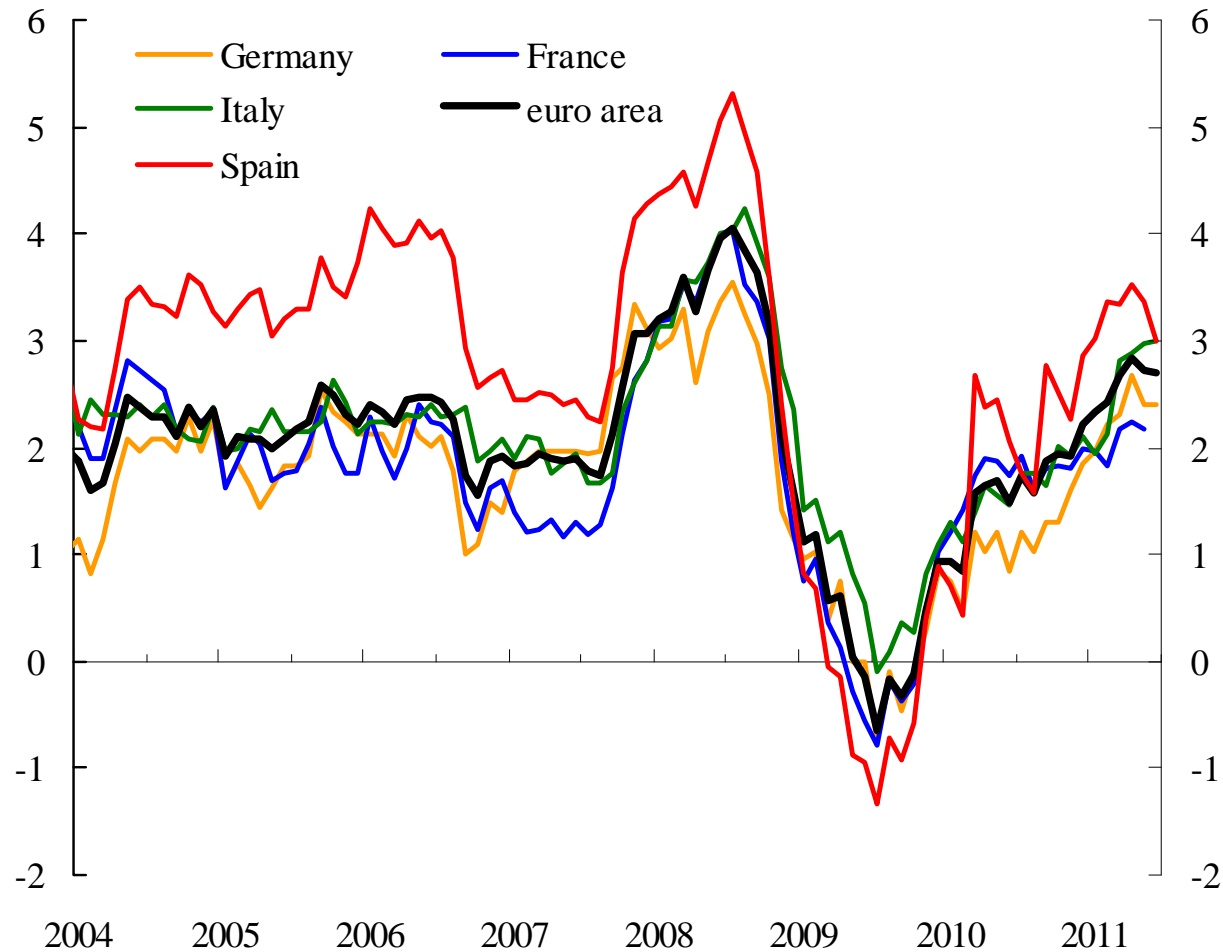
Source: Eurostat.
Latest observation: May 2011 for France, June 2011 for the rest.

Probability distribution for average longer-term (5 years ahead) inflation expectations in the latest SPF rounds.
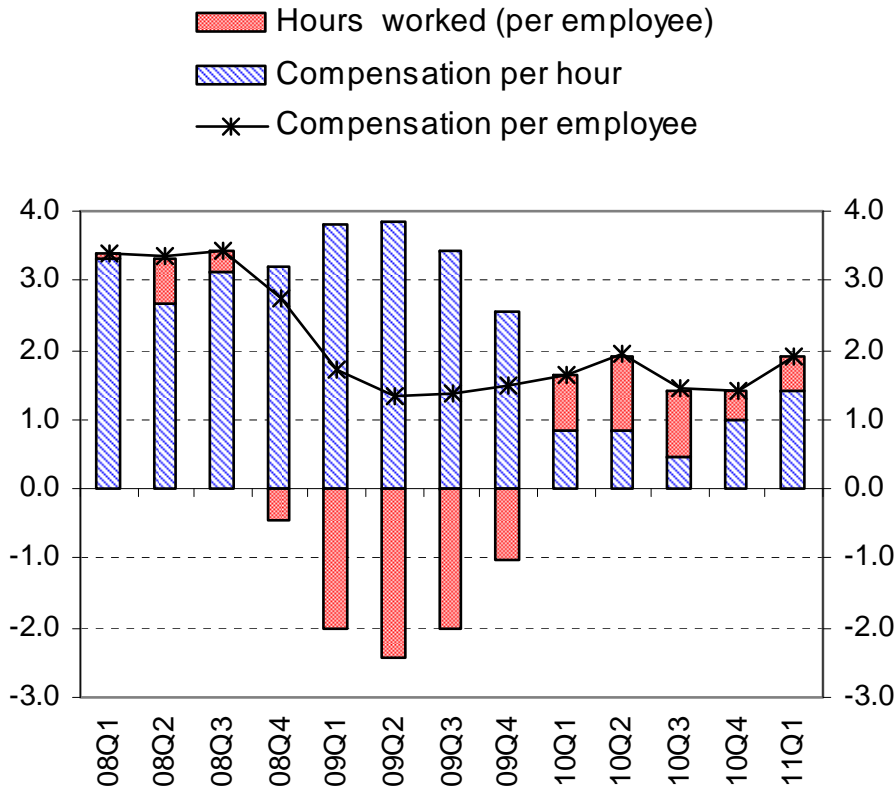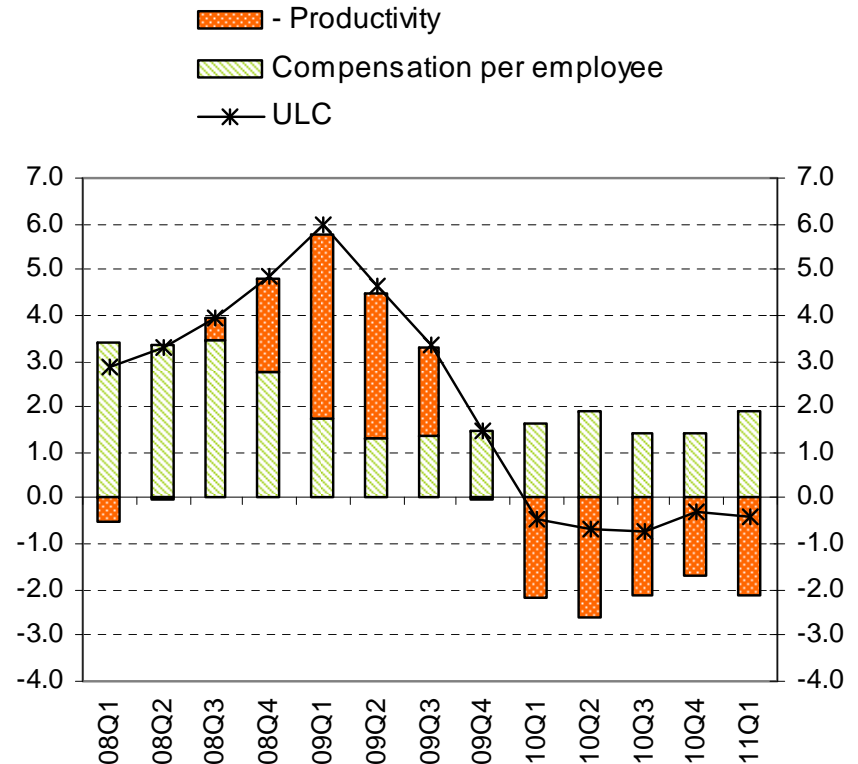*(probability in percentages)*
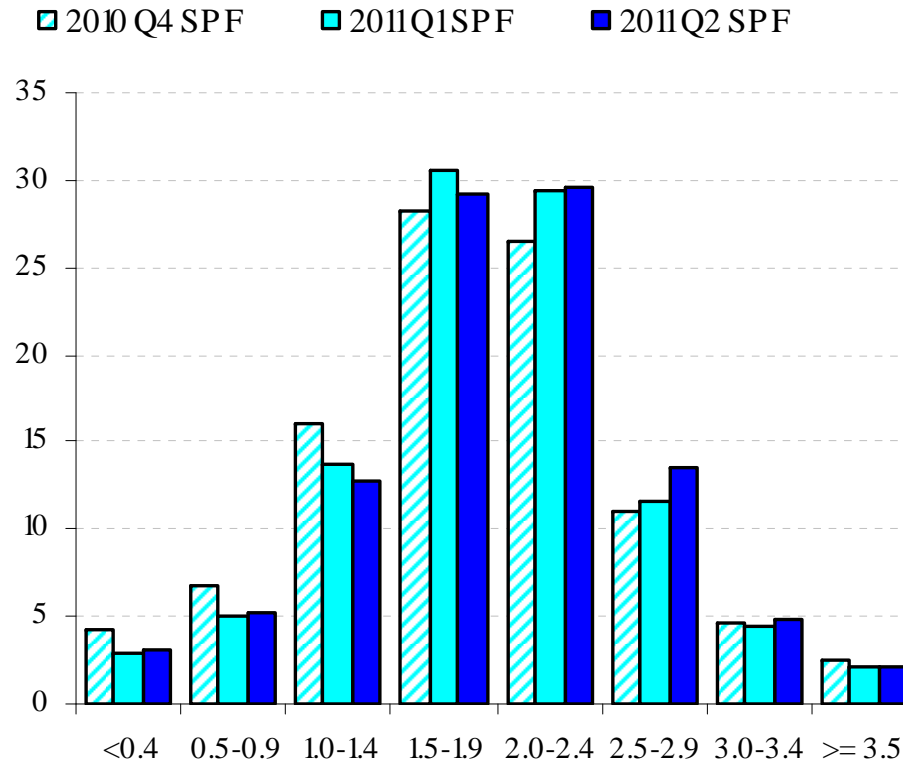
Source: ECB.
Note: Probability distribution correspondent to the average of individual distributions provided by SPF forecasters.

Labour and unit labour cost developments

Compensation per employee
(annual percentage change)
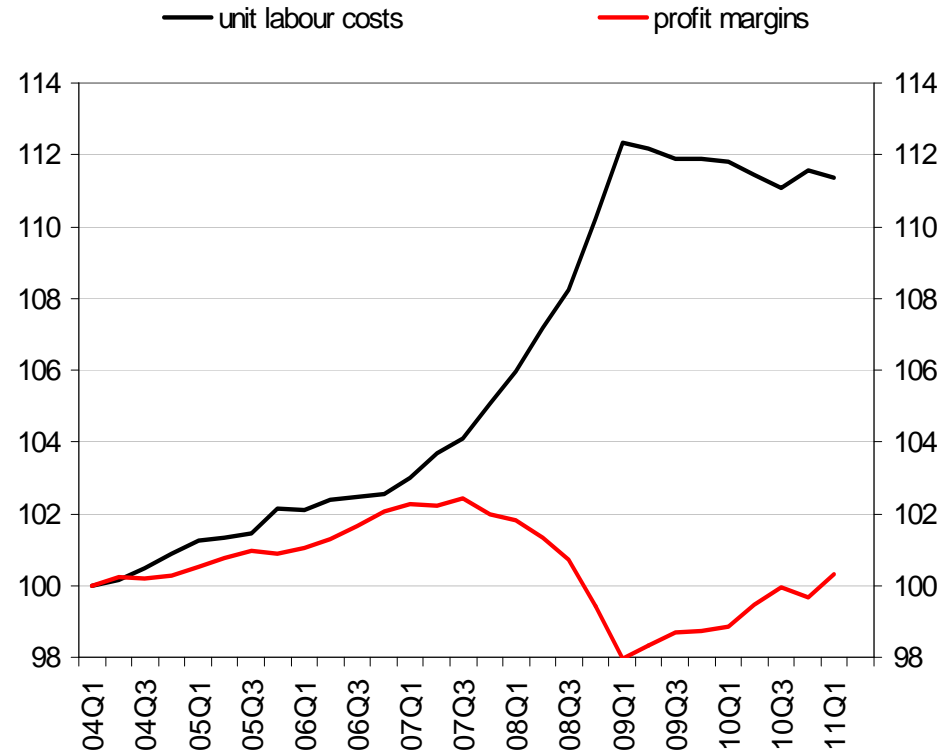

Unit labour cost
(annual percentage changes)

Sources: Eurostat and ECB calculations.
Latest observation: 2011 Q1.

Profit and unit labour cost developments

Decomposition of GDP deflator
(annual percentage changes)
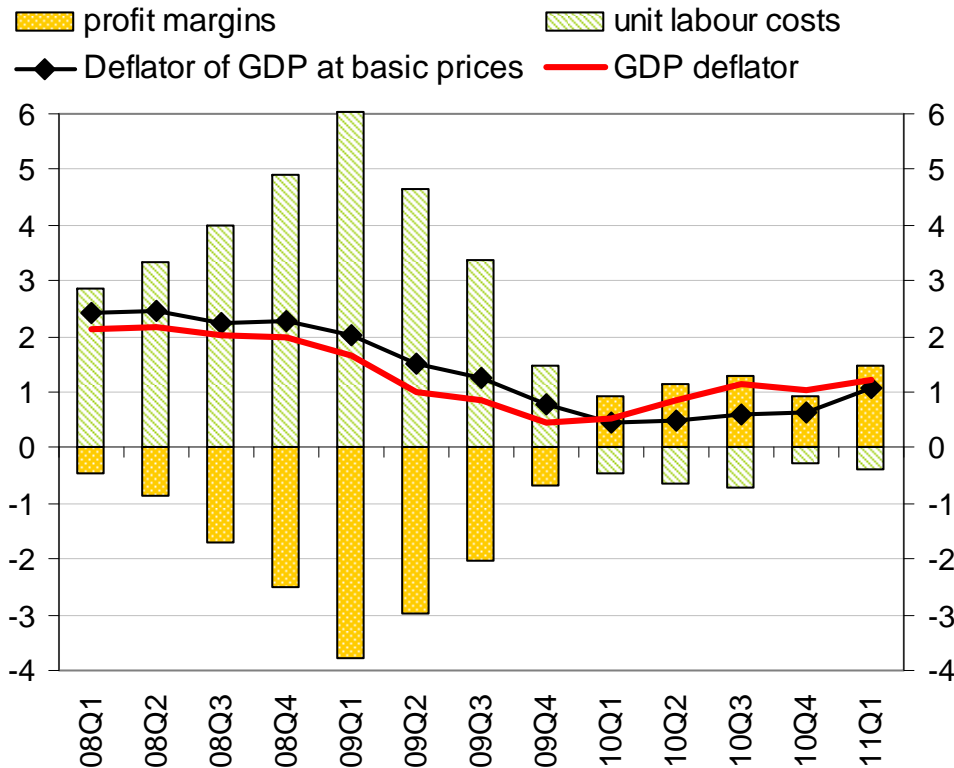
Legend: profit margins · unit labour costs · Deflator of GDP at basic prices · GDP deflator

Unit labour cost and profits
(level, index 2004Q1 = 100)

Legend: unit labour costs · profit margins

Sources: Eurostat and ECB calculations.
Latest observation: 2011 Q1.
Note: Growth in profit margins is defined as the growth rate of the GDP deflator at basic prices minus that of unit labour cost.

Profit and unit labour cost developments in Italy

Decomposition of GDP deflator
(annual percentage changes)

Legend: profit margins | unit labour costs | Deflator of GDP at basic prices | GDP deflator

Unit labour cost and profits
(level, index 2004Q1 = 100)

Legend: unit labour costs | profit margins

Sources: Eurostat and ECB calculations.
Latest observation: 2011 Q1.
Note: Growth in profit margins is defined as the growth rate of the GDP deflator at basic prices minus that of unit labour cost.

5-year forward 5 years ahead break-even inflation rates *(% p.a.)*
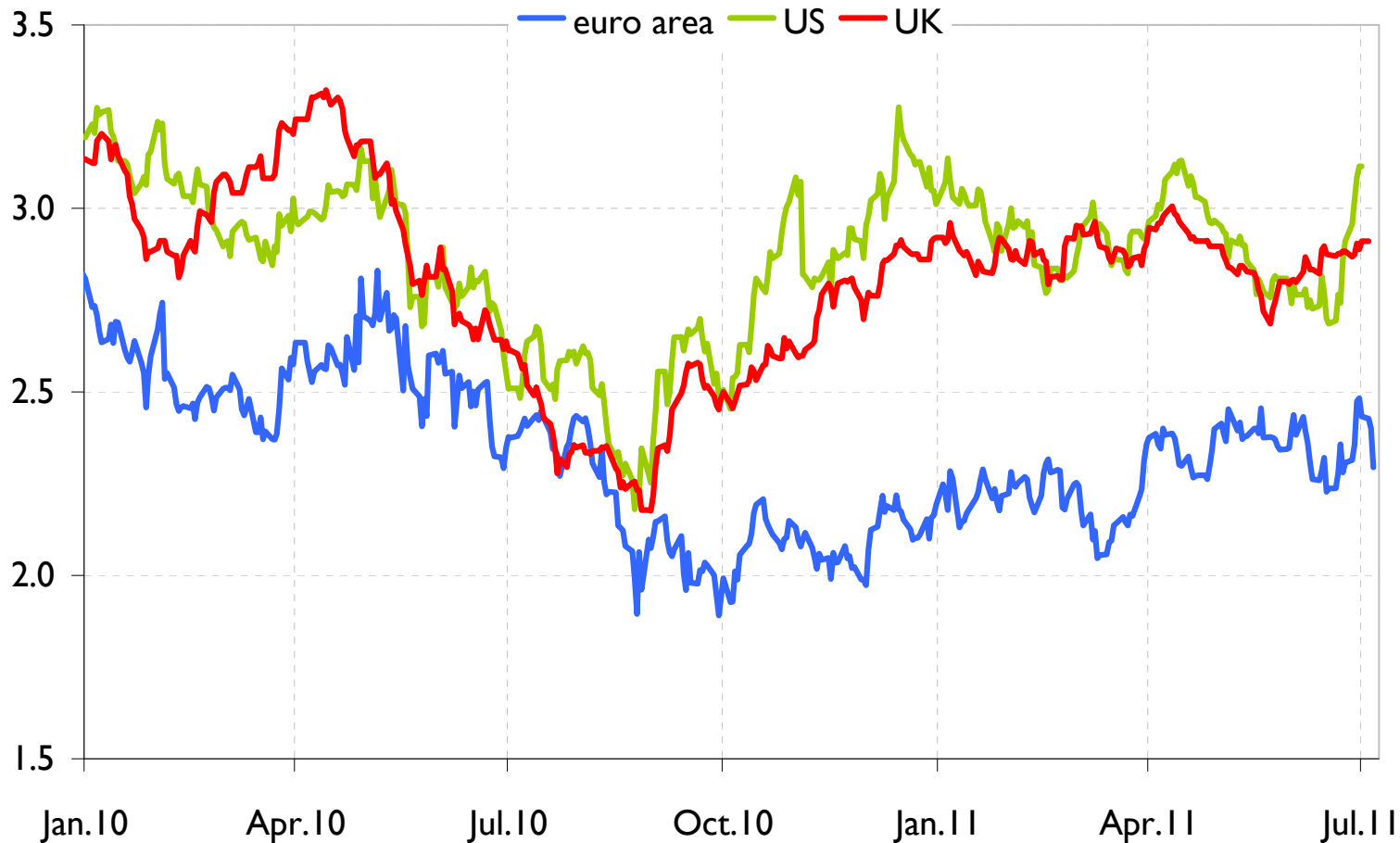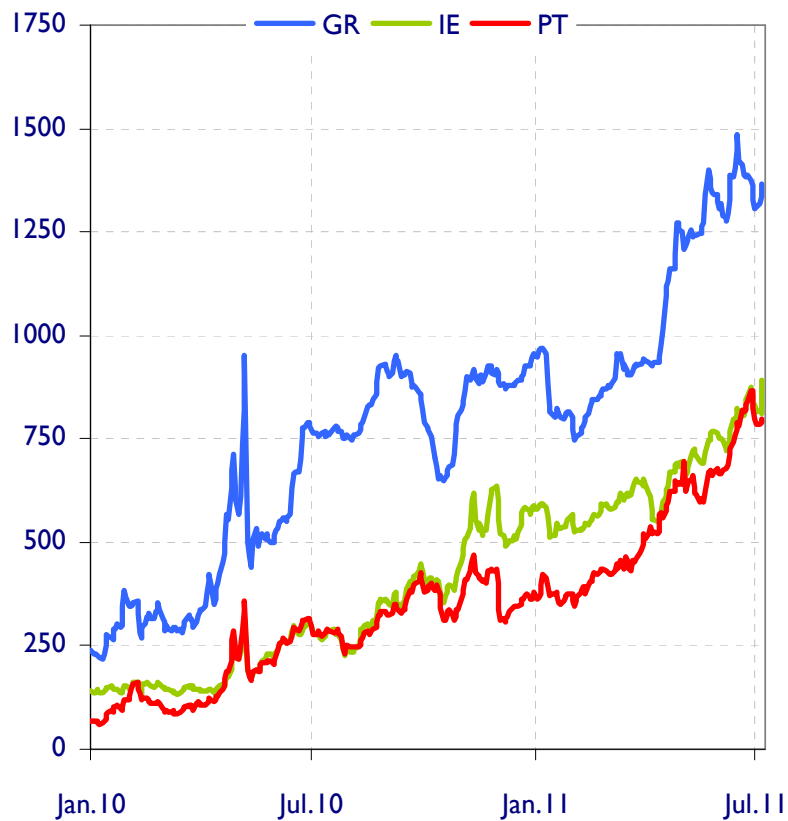

Latest observation: 6 July 11

Sources: Thomson Reuters, ECB, Federal Reserve board staff calculations, Bank of England
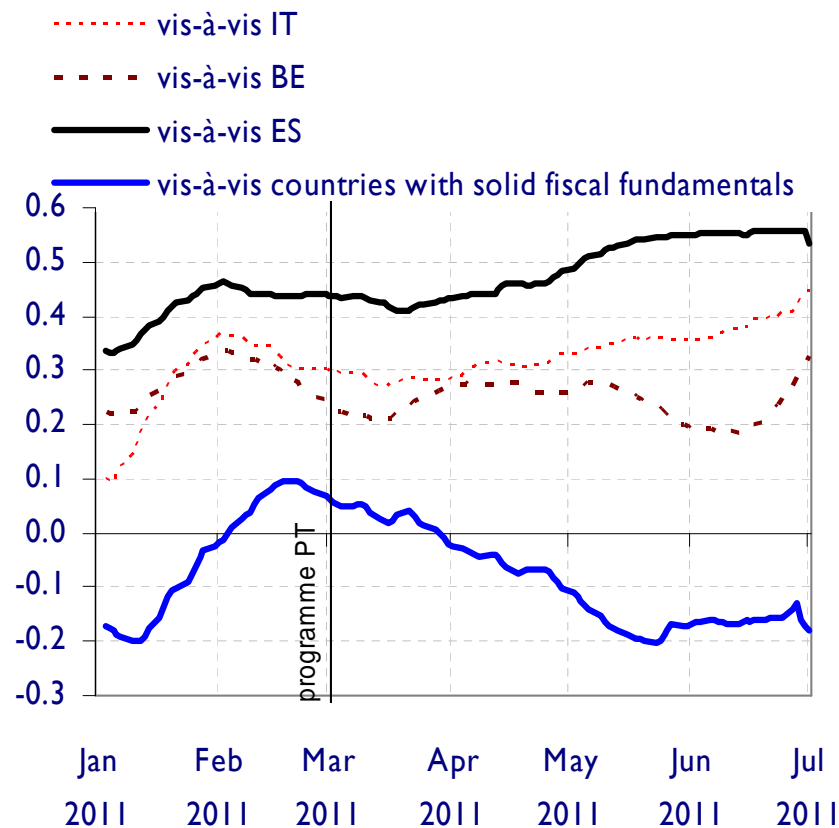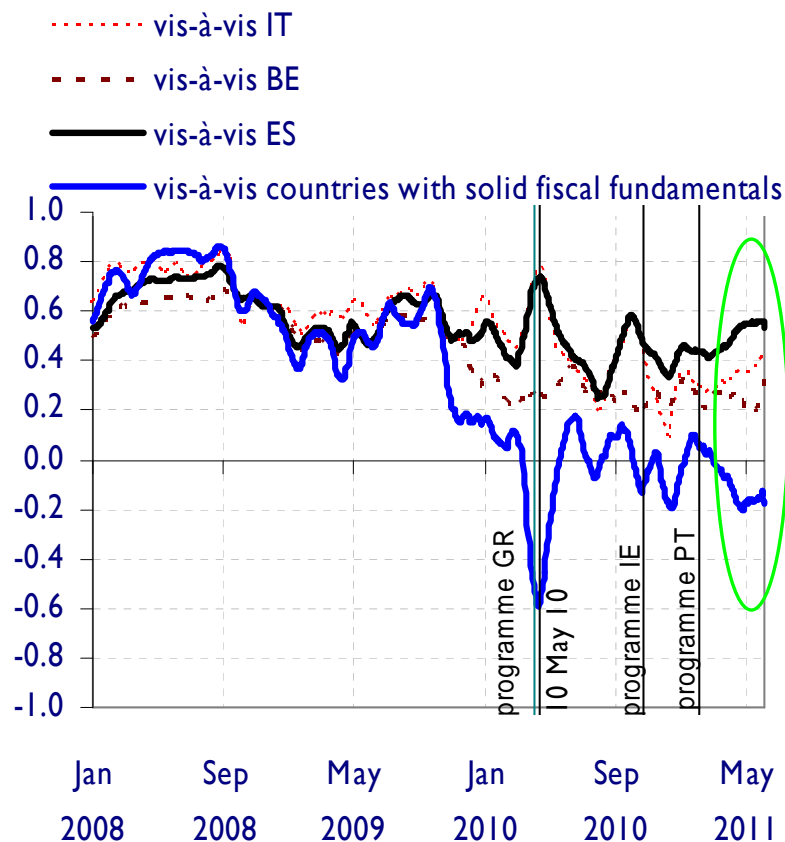
Government bond spreads vis-à-vis Germany

## Ten-year sovereign spreads *(basis points)*
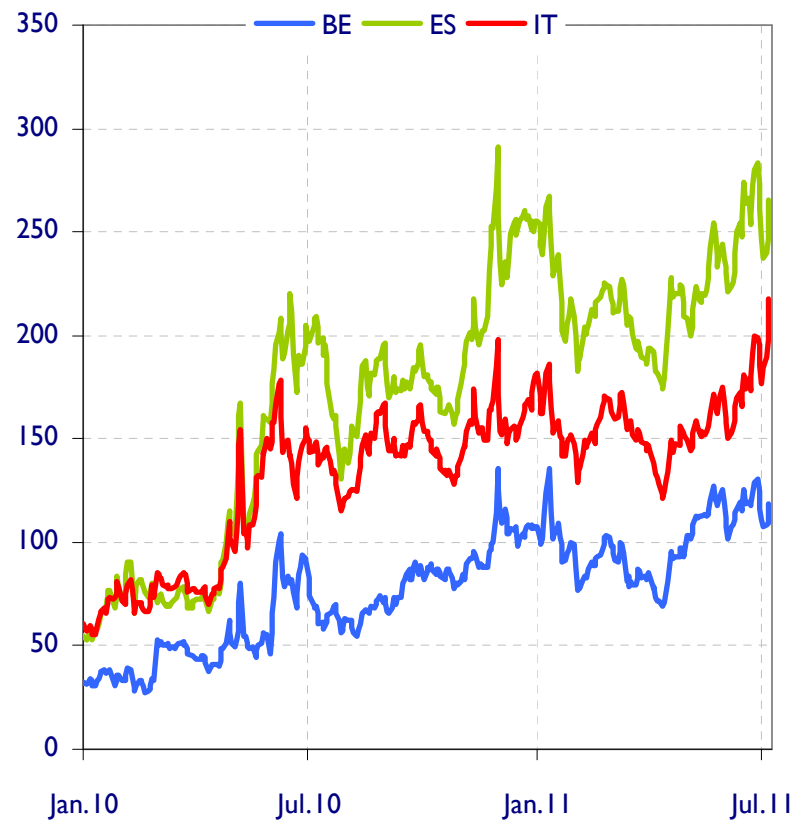
Source: ECB staff calculations based on GARCH methods. Latest observation: 1 July 2011, 20 days moving averages.
Notes: The charts show: (i) the average correlation of stressed countries (Greece, Ireland and Portugal) vis-à-vis Italy, Belgium and Spain; (ii) the average correlation of Greece, Ireland and Portugal vis-à-vis Austria, Finland, France, Germany and the Netherlands, which are labelled as "vis-à-vis countries with solid fiscal fundamentals".

Bank CDS

Banks 5-year CDS *(basis points)*
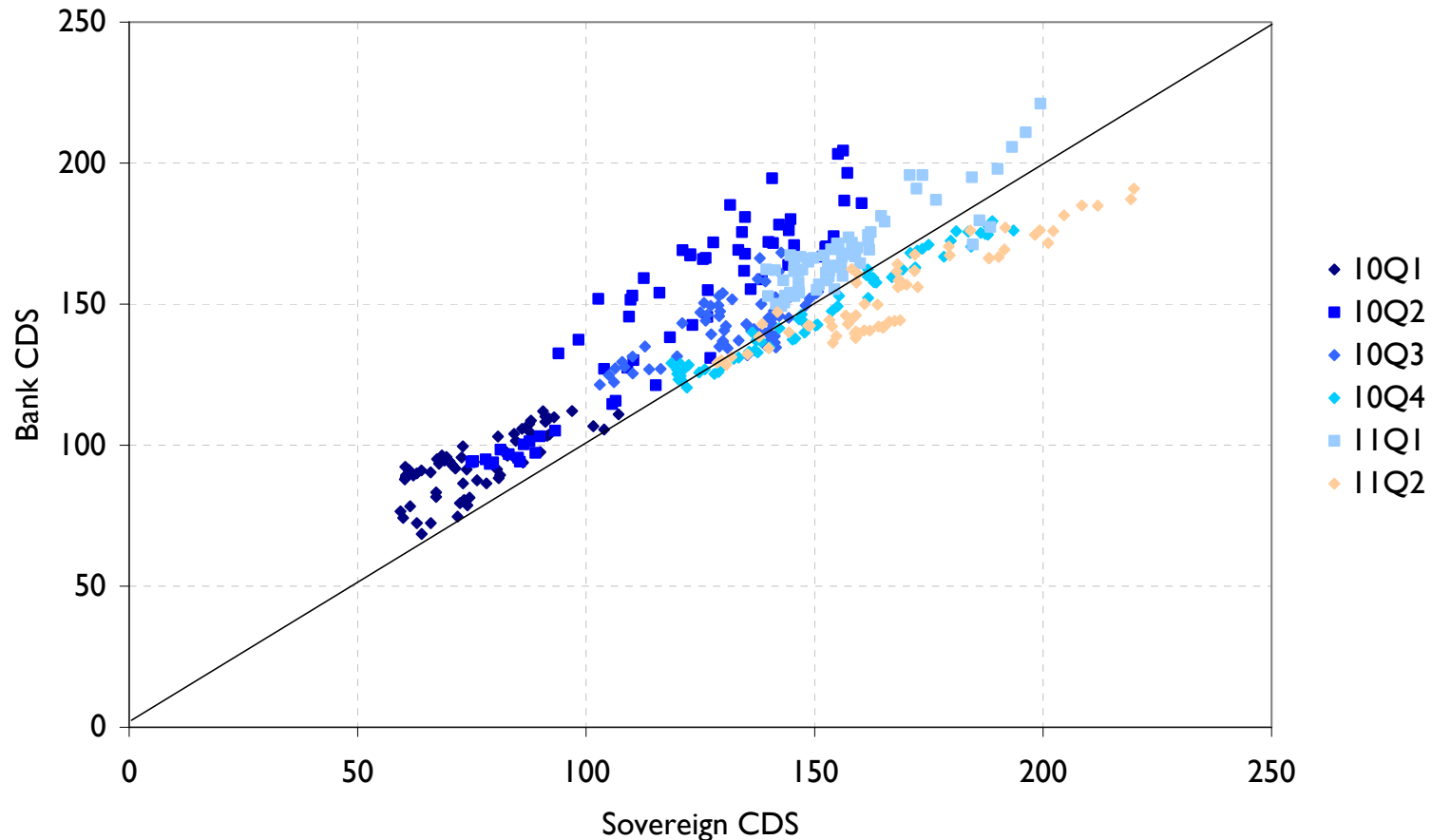

Legend: "non-stressed" — ES — GR — IE — PT
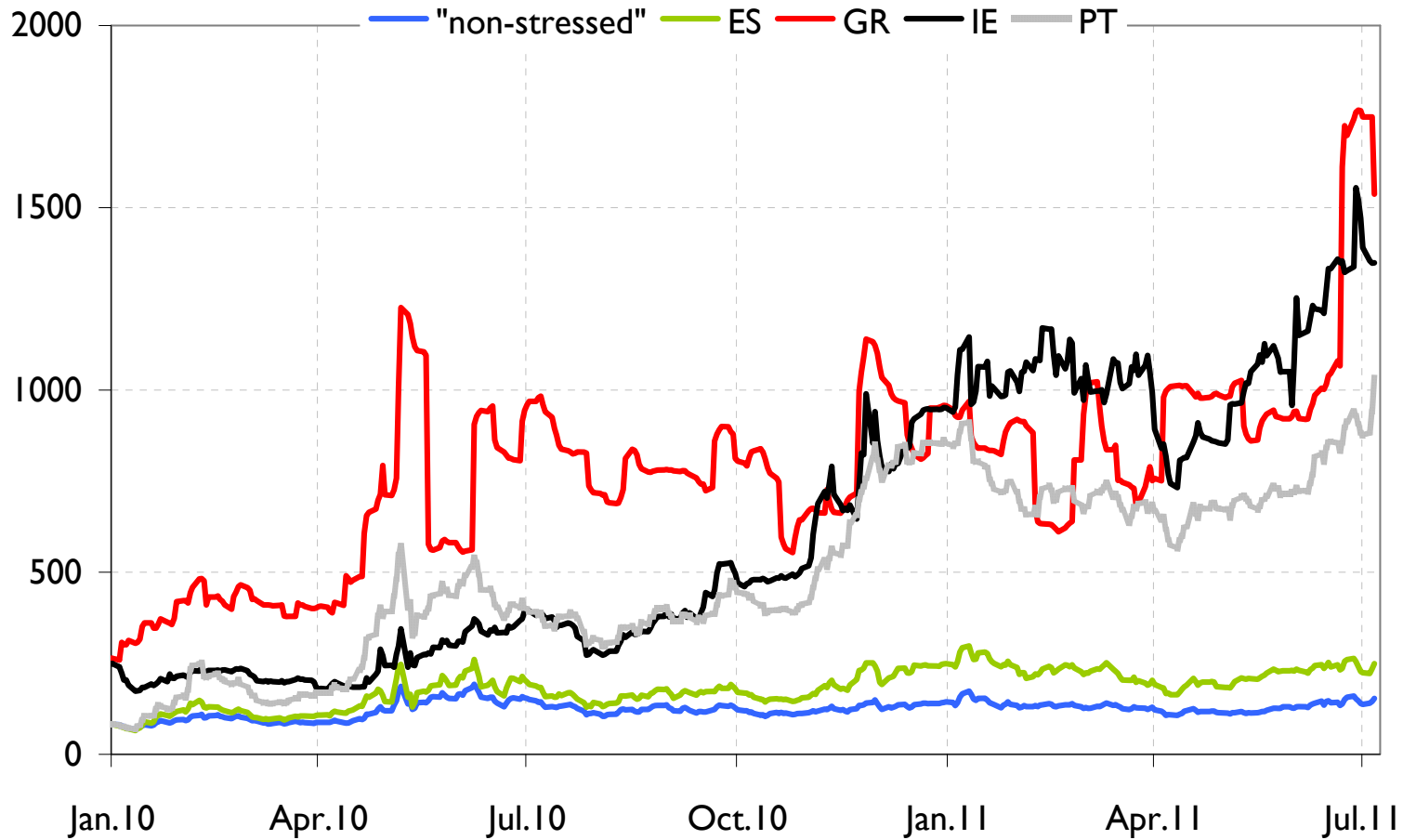
Latest observation: 6 July 11

Source: Thomson Reuters : CDS spread of the largest bank from each country. "Non-stressed" is calculated as weighted average based on ECB's capital key.
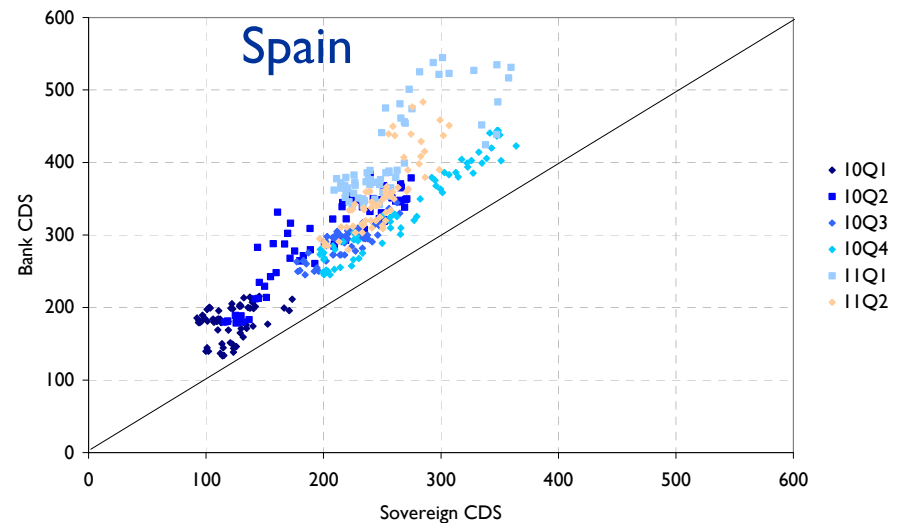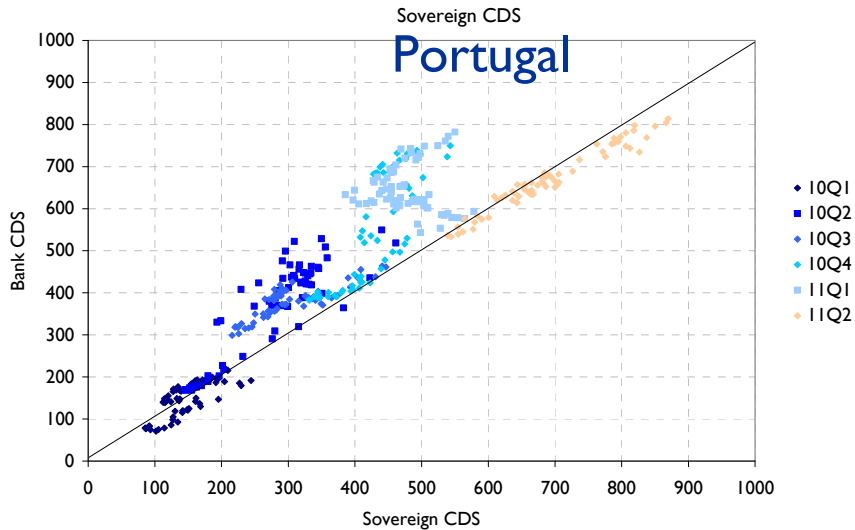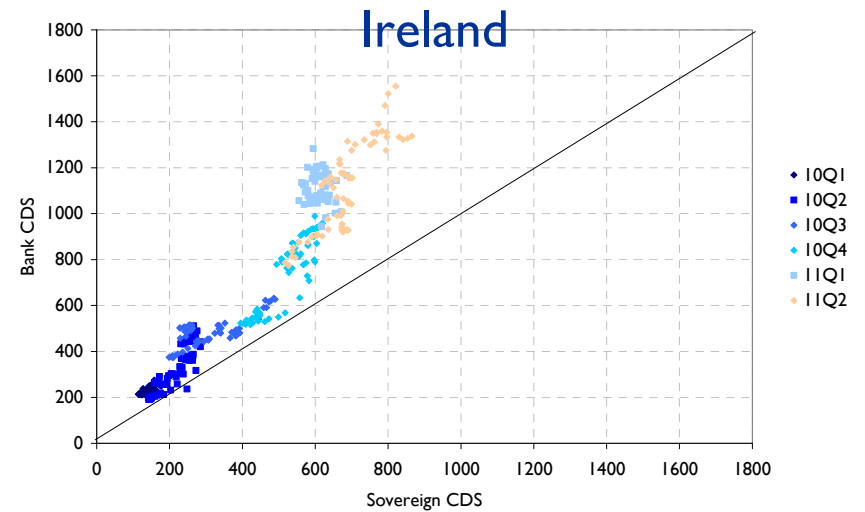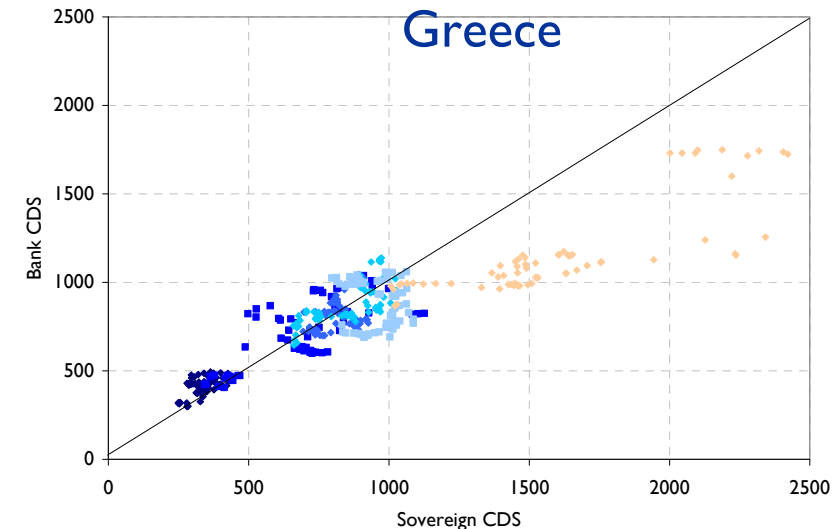
Correlation between sovereign and bank CDS – Euro area
(data in basis points)

Source: Datastream and ECB calculations.

Note: The chart presents average sovereign CDS (weighted with the capital key at the ECB) and bank CDS (simple average for 10 largest euro area banks) for daily observations in the period 1.1.2010 – 6.7.2011. Diagonal line at 45°. The first few July 2011 observations are added to 11Q2.
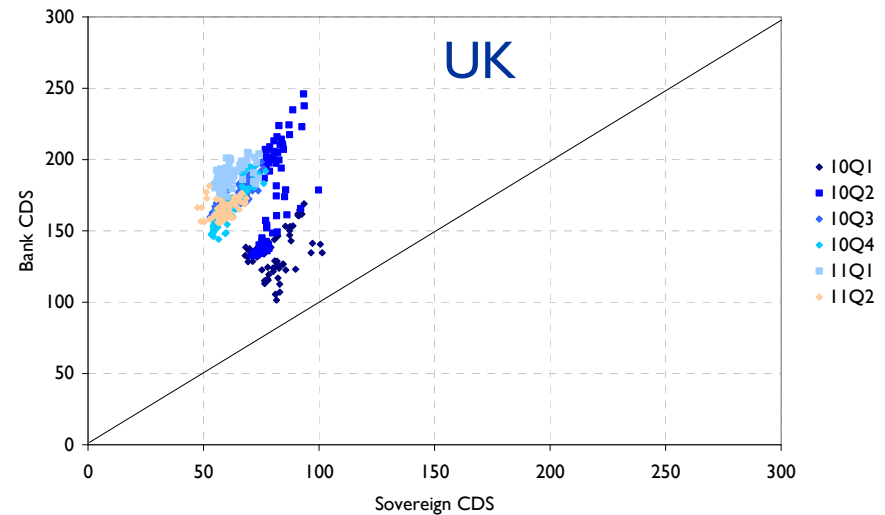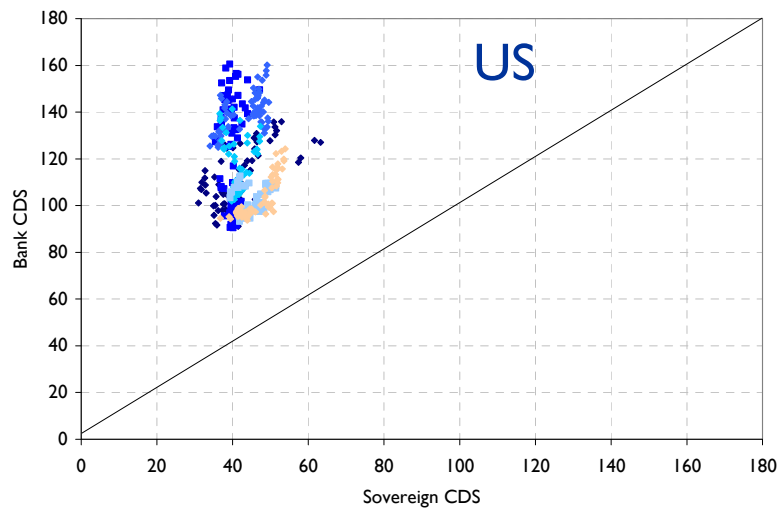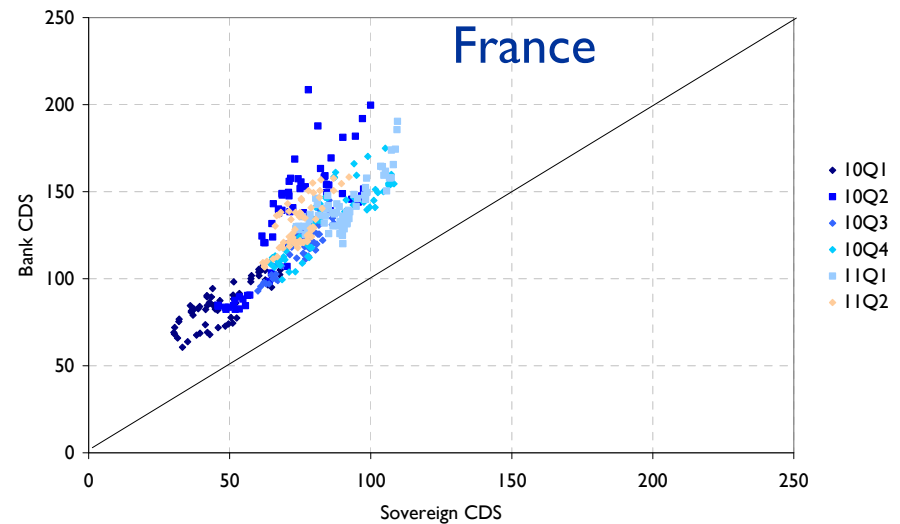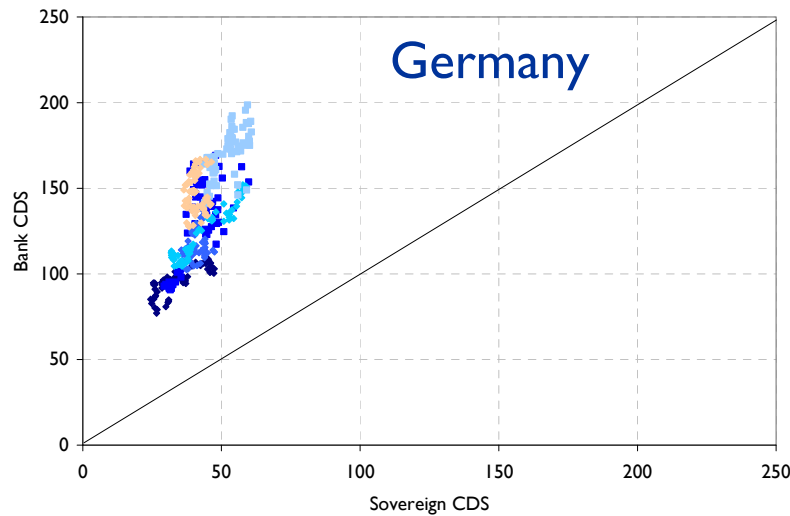
High correlation in all EA countries – although with different patterns

Source: Datastream and ECB calculations.
Note: The chart presents sovereign CDS and median bank CDS for daily observations in the period 1.1.2010 – 6.7.2011. Diagonal line at 45°. Data in basis points. The first few July 2011 observations are added to 11Q2.

Correlation between sovereign and bank credit risk for UK and US is virtually zero
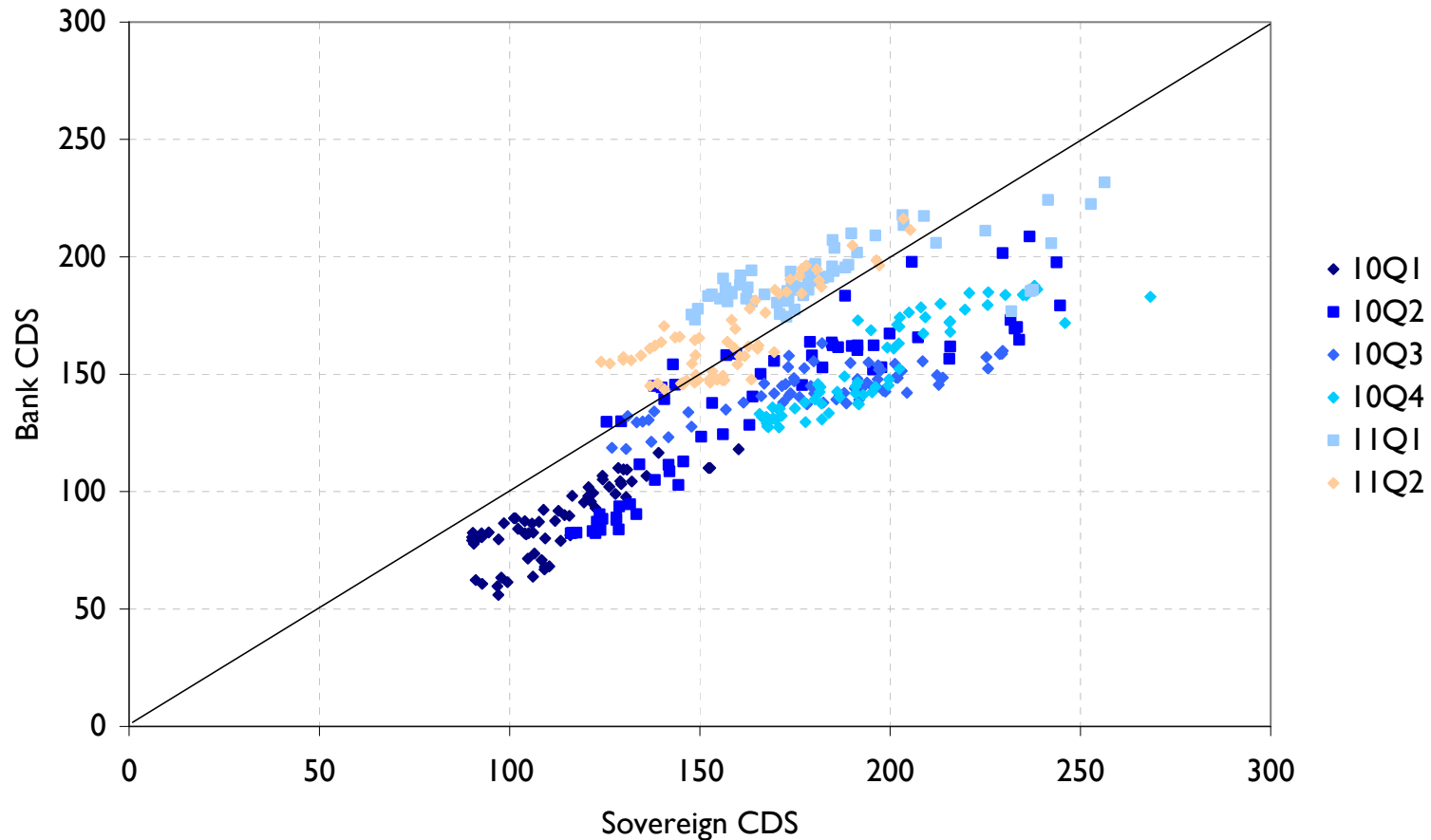

Source: Datastream and ECB calculations.
Note: The chart presents sovereign CDS and median bank CDS for daily observations in the period 1.1.2010 – 6.7.2011. Diagonal line at 45°. Data in basis points. The first few July 2011 observations are added to 11Q2.

High correlation between sovereign and bank CDS Italy

Correlation between sovereign and bank CDS *(data in basis points)*

Source: Datastream and ECB calculations.
Note: The chart presents sovereign CDS and median bank CDS for daily observations in the period 1.1.2010 – 6.7.2011. Diagonal line at 45°. Data in basis points. The first few July 2011 observations are added to 11Q2.

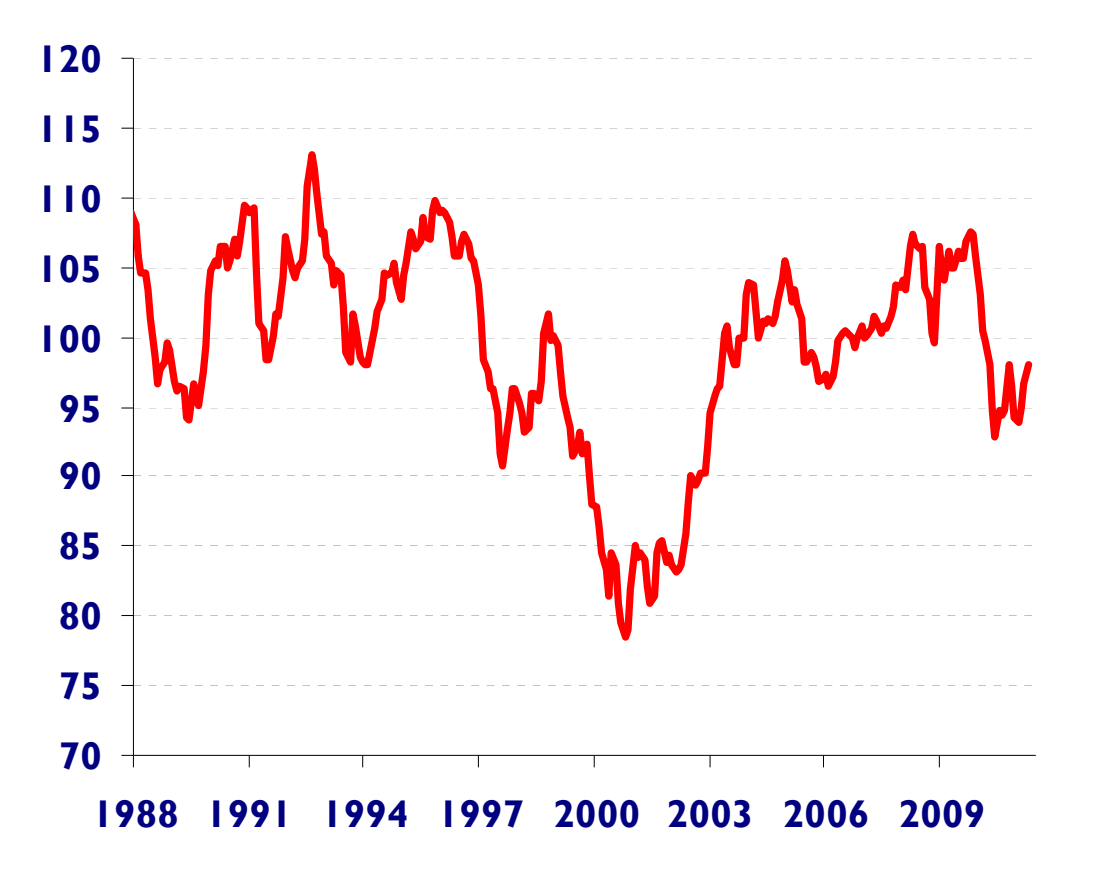# Real effective exchange rates – US dollar

(Index: 2005=100)

Real effective exchange rates – Euro
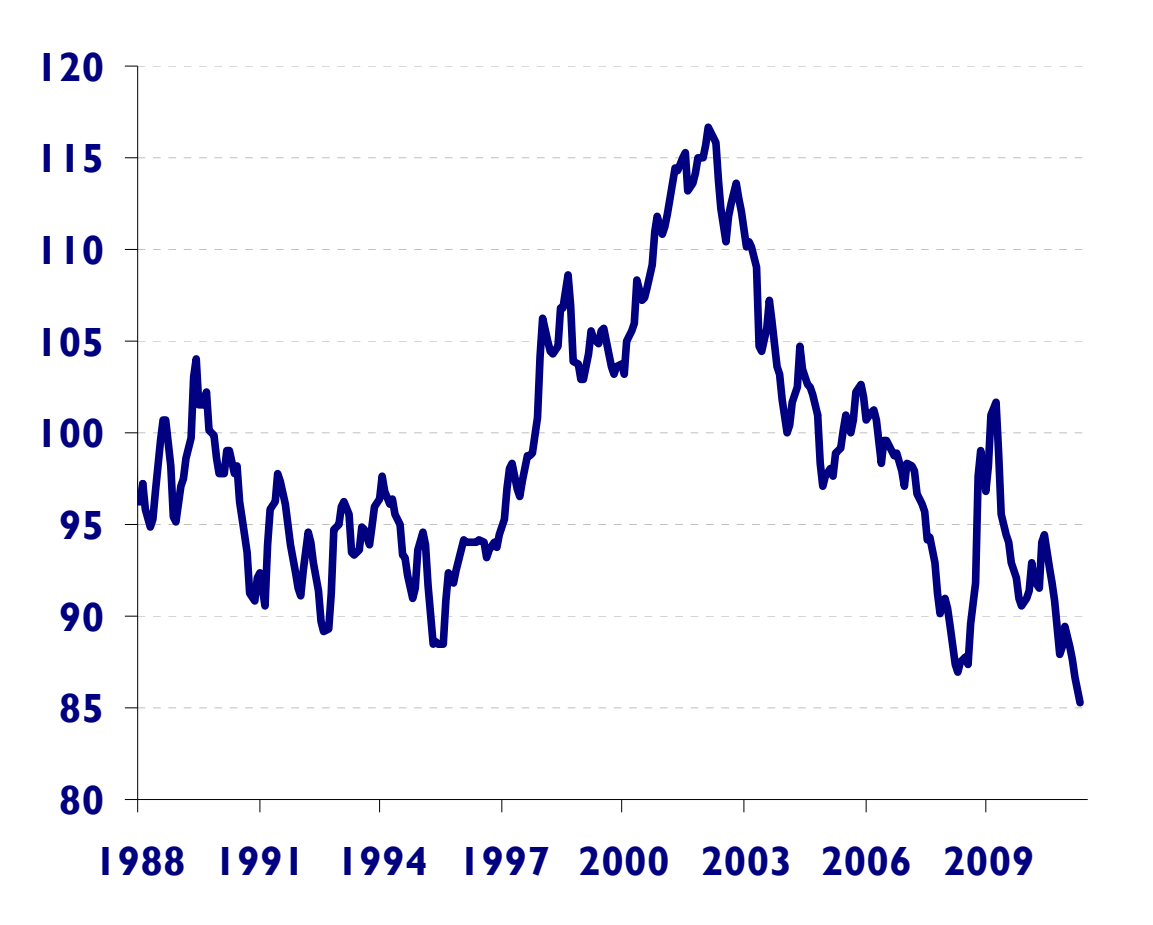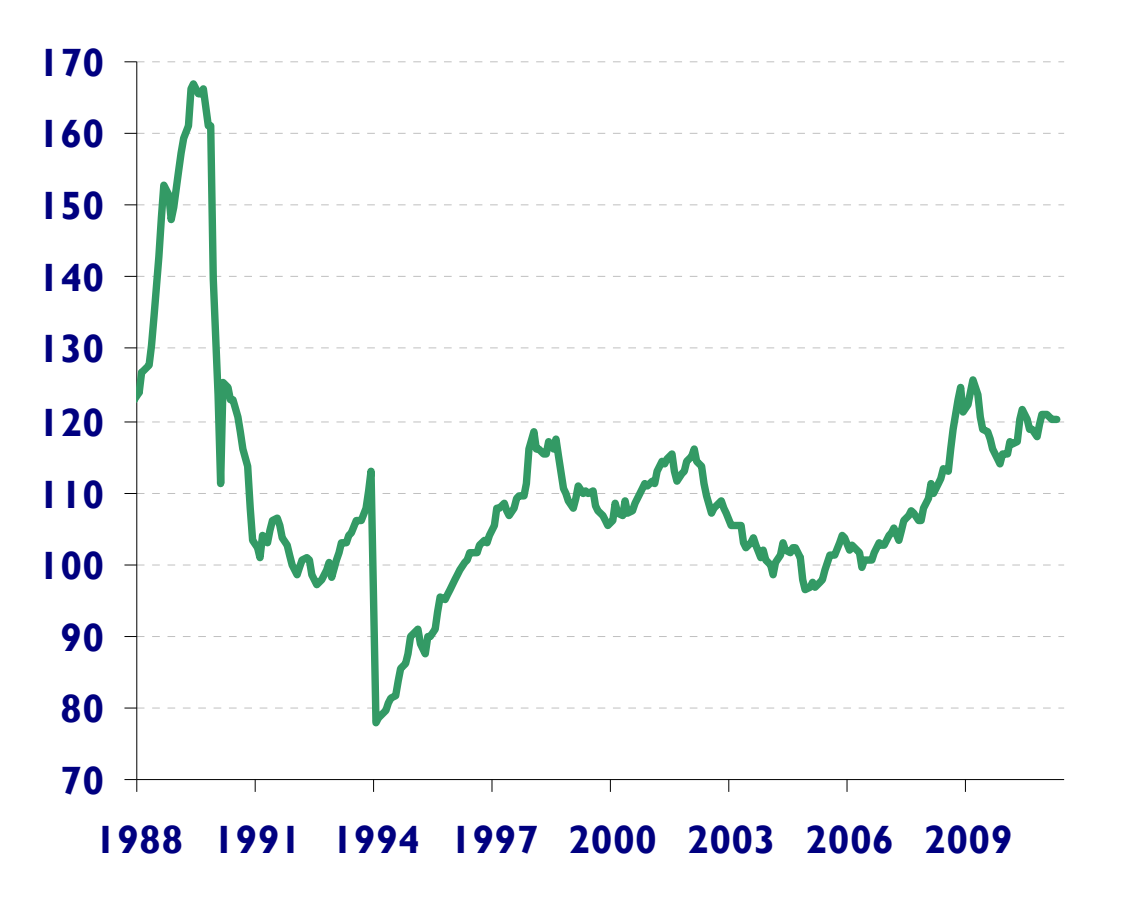
(Index: 2005=100)

Source: IMF.
Note: Last observation refers to April 2011.

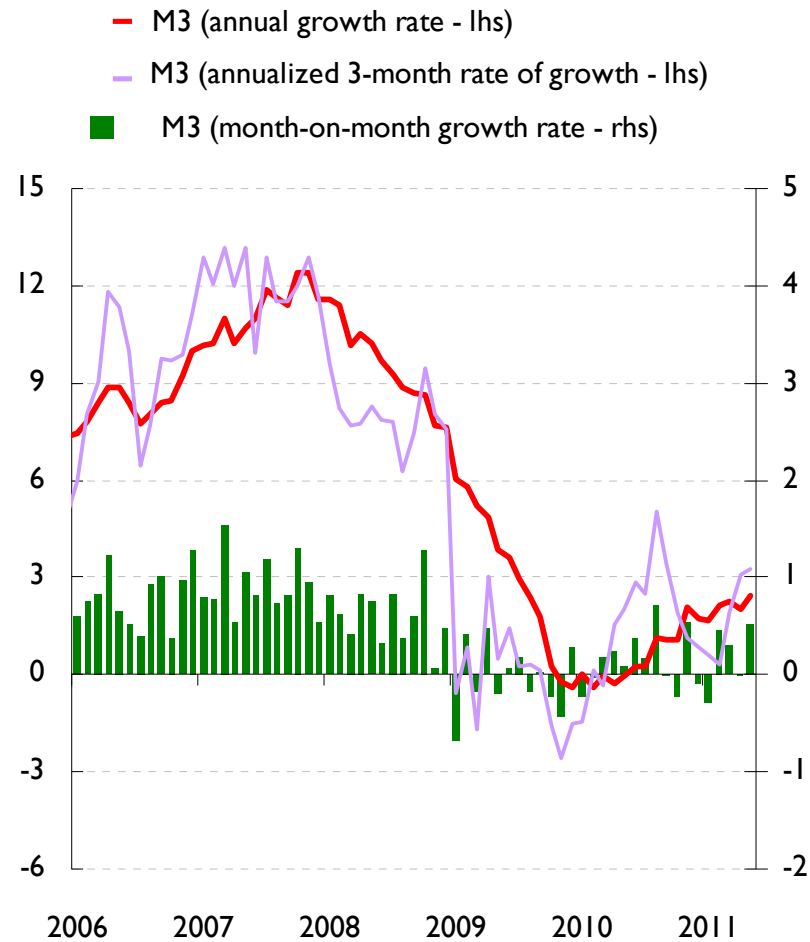# Real effective exchange rates – Chinese yuan

(Index: 2005=100)

Source: IMF.
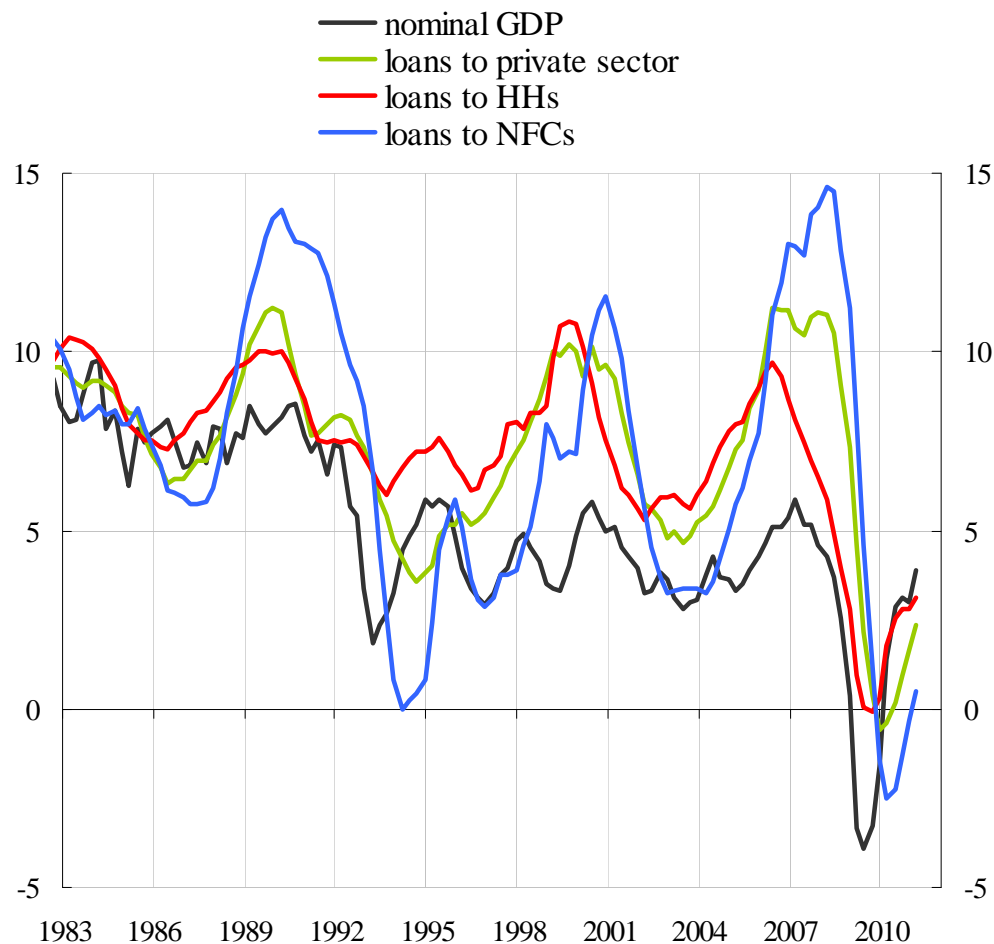Note: Last observation refers to April 2011.

Developments in M3

M3 *(growth rates in percent, sa)*

- M3 (annual growth rate - lhs)
- M3 (annualized 3-month rate of growth - lhs)
- ■ M3 (month-on-month growth rate - rhs)

Source: ECB. Latest observation: May 2011.

Private sector loans and economic nominal dynamics

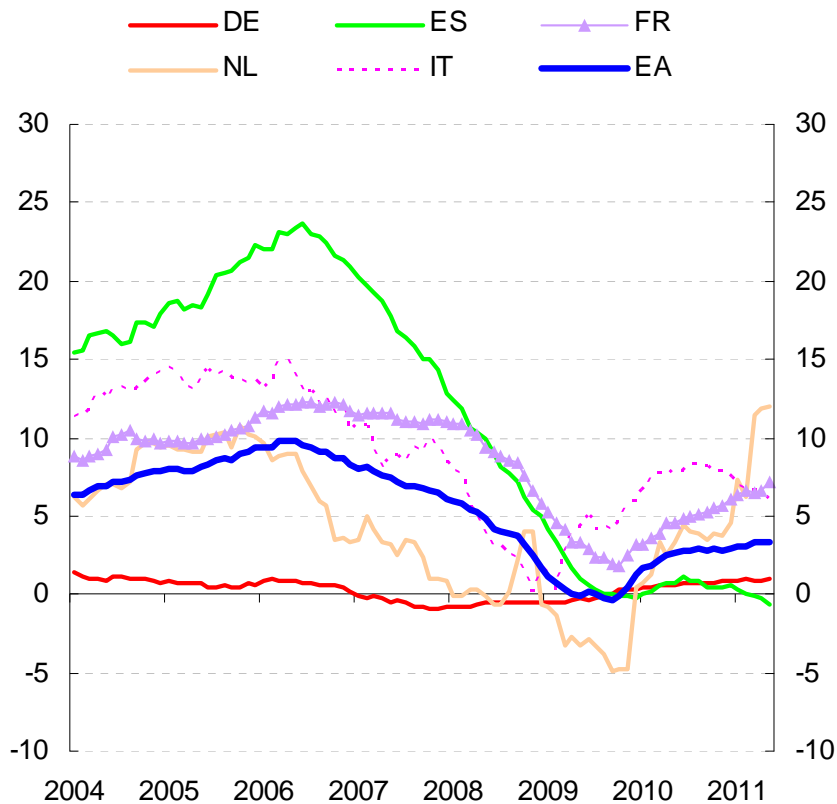**MFI loans to private sector and economic activity** *(annual percentage change)*

MFI loans to households and non-financial corporations

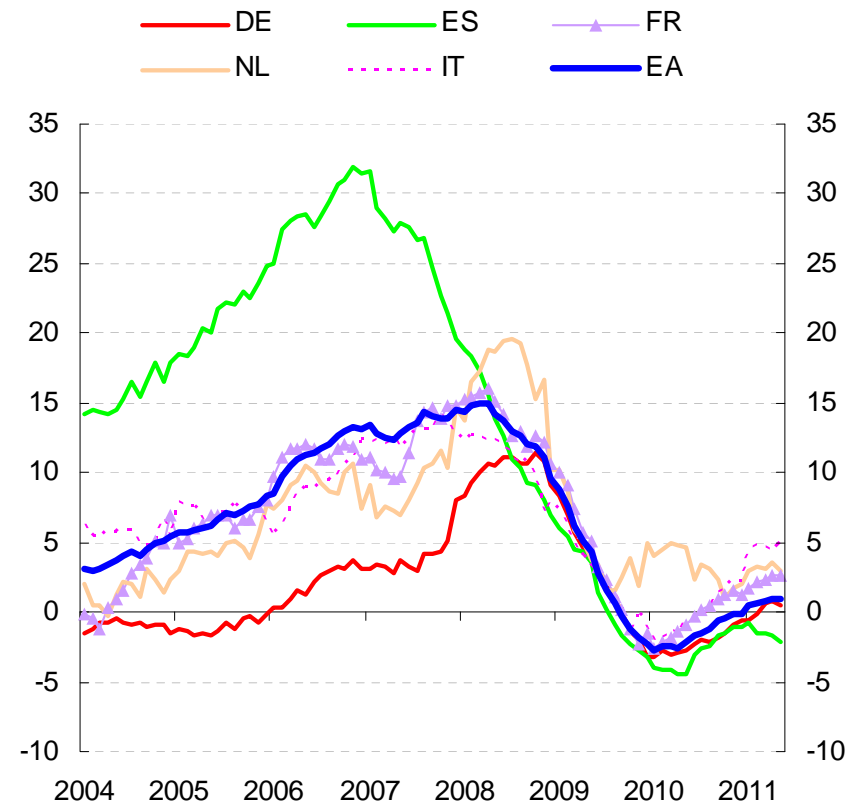**Household loan growth in "large countries"**
(annual percentage changes; sa)

Legend: DE, ES, FR, NL, IT, EA

Non-financial corporations loan growth in "large countries"
(annual percentage changes; sa)

Legend: DE, ES, FR, NL, IT, EA
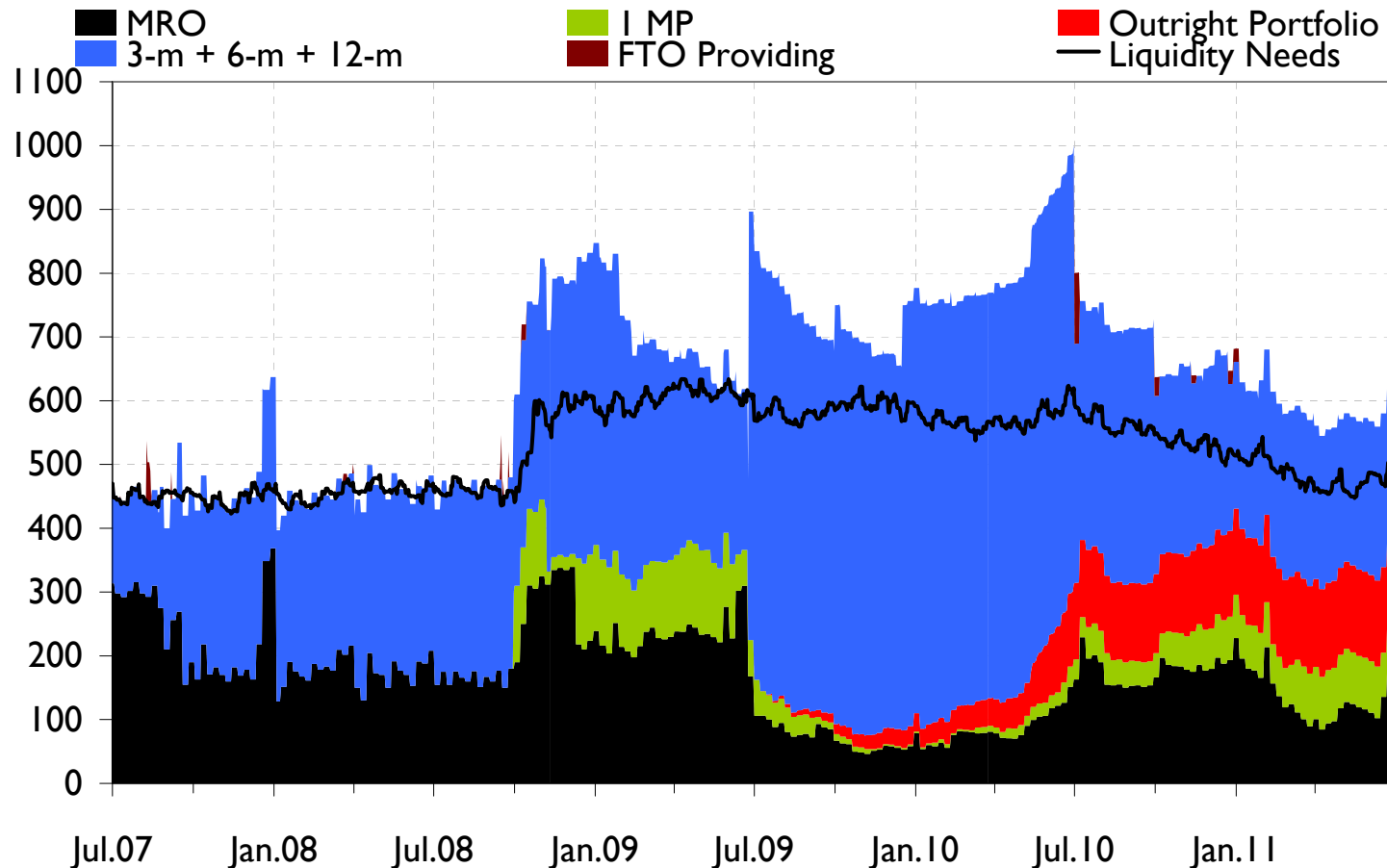

Source: ECB. Latest observation: May 2011.

Monetary policy operations and liquidity needs

(Mill. eur)
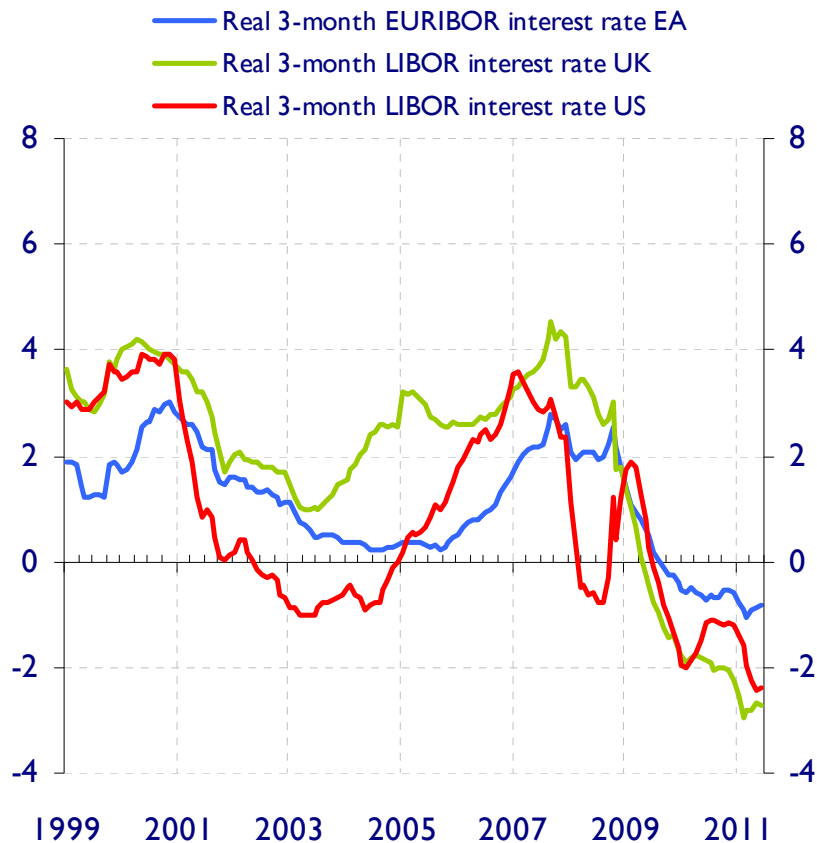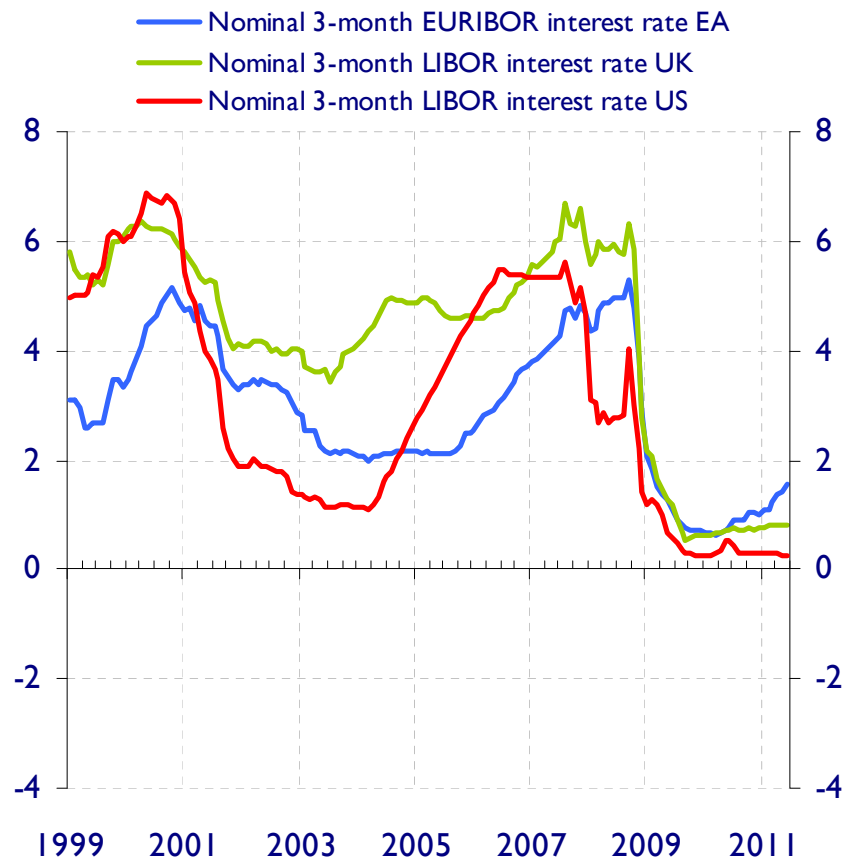

Sources: ECB.
Latest observation: 26 June 2011.

Federal Reserve Assets (Uses of Funds)
$ billions
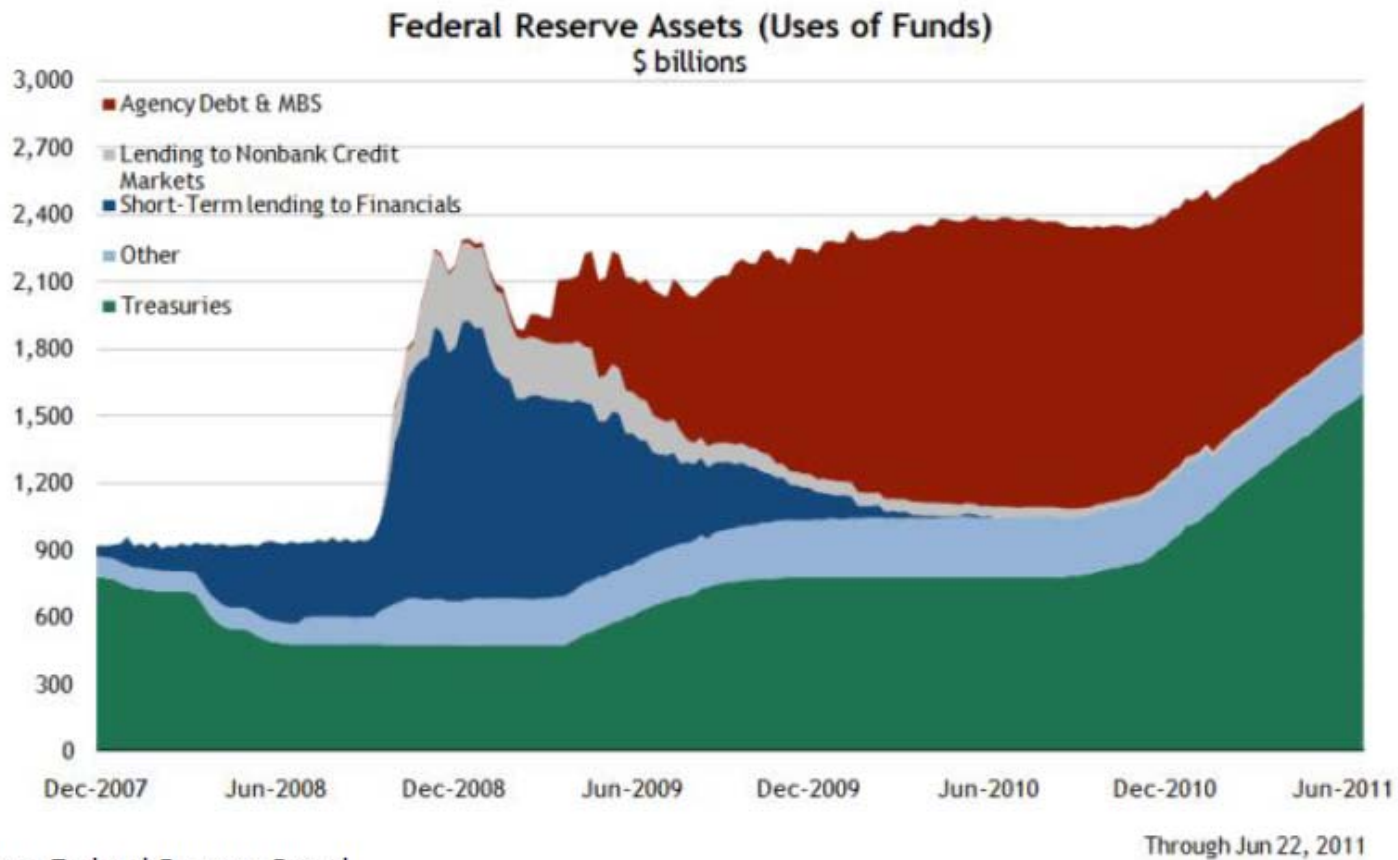
Source: Federal Reserve Board

Through Jun 22, 2011

Real and nominal three-month interest rates - EA, UK and US *(percentages per annum)*

Real interest rates

- Real 3-month EURIBOR interest rate EA
- Real 3-month LIBOR interest rate UK
- Real 3-month LIBOR interest rate US

Nominal interest rates

- Nominal 3-month EURIBOR interest rate EA
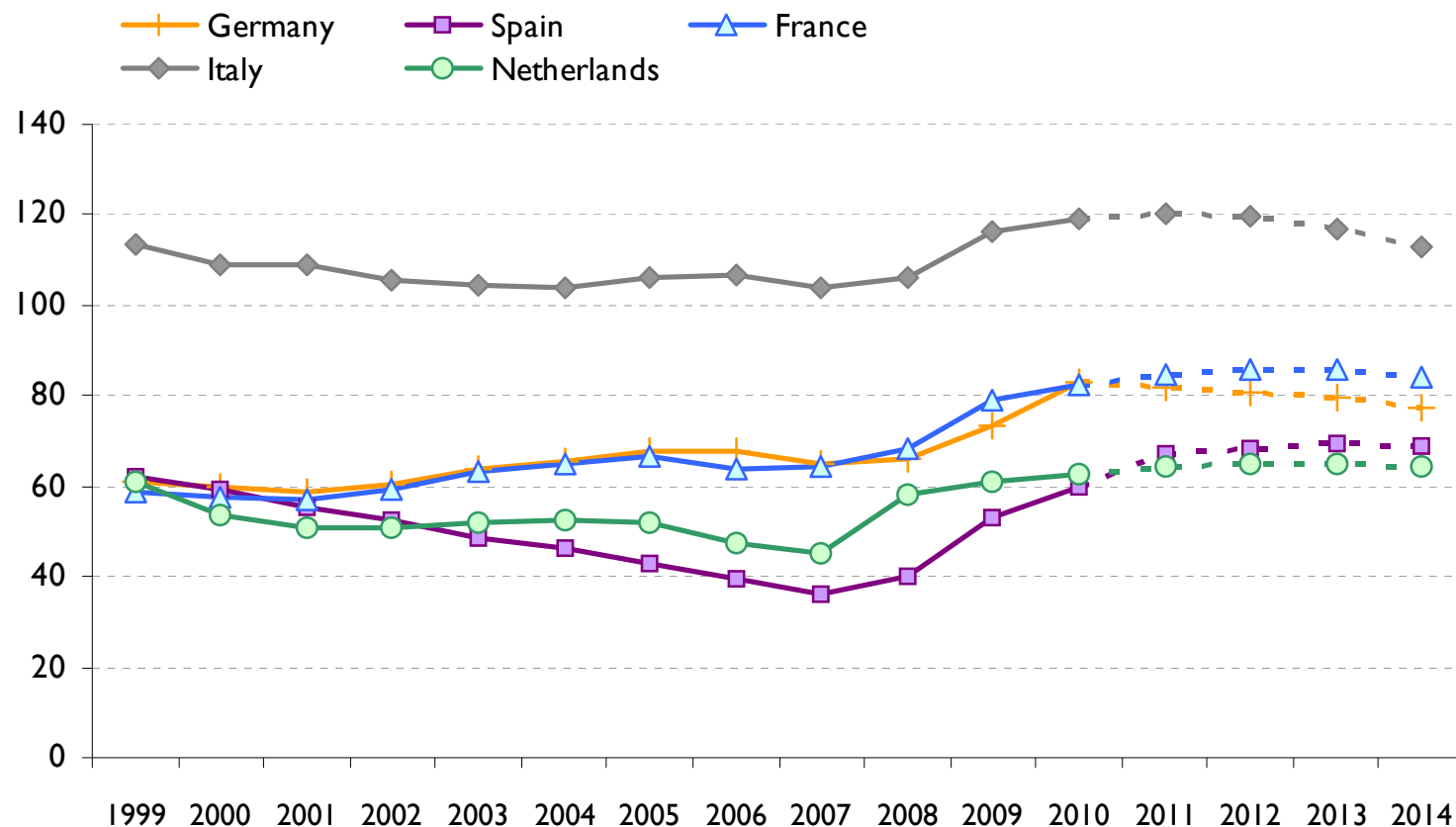- Nominal 3-month LIBOR interest rate UK
- Nominal 3-month LIBOR interest rate US

Sources: Reuters, Consensus Forecast and ECB calculations.
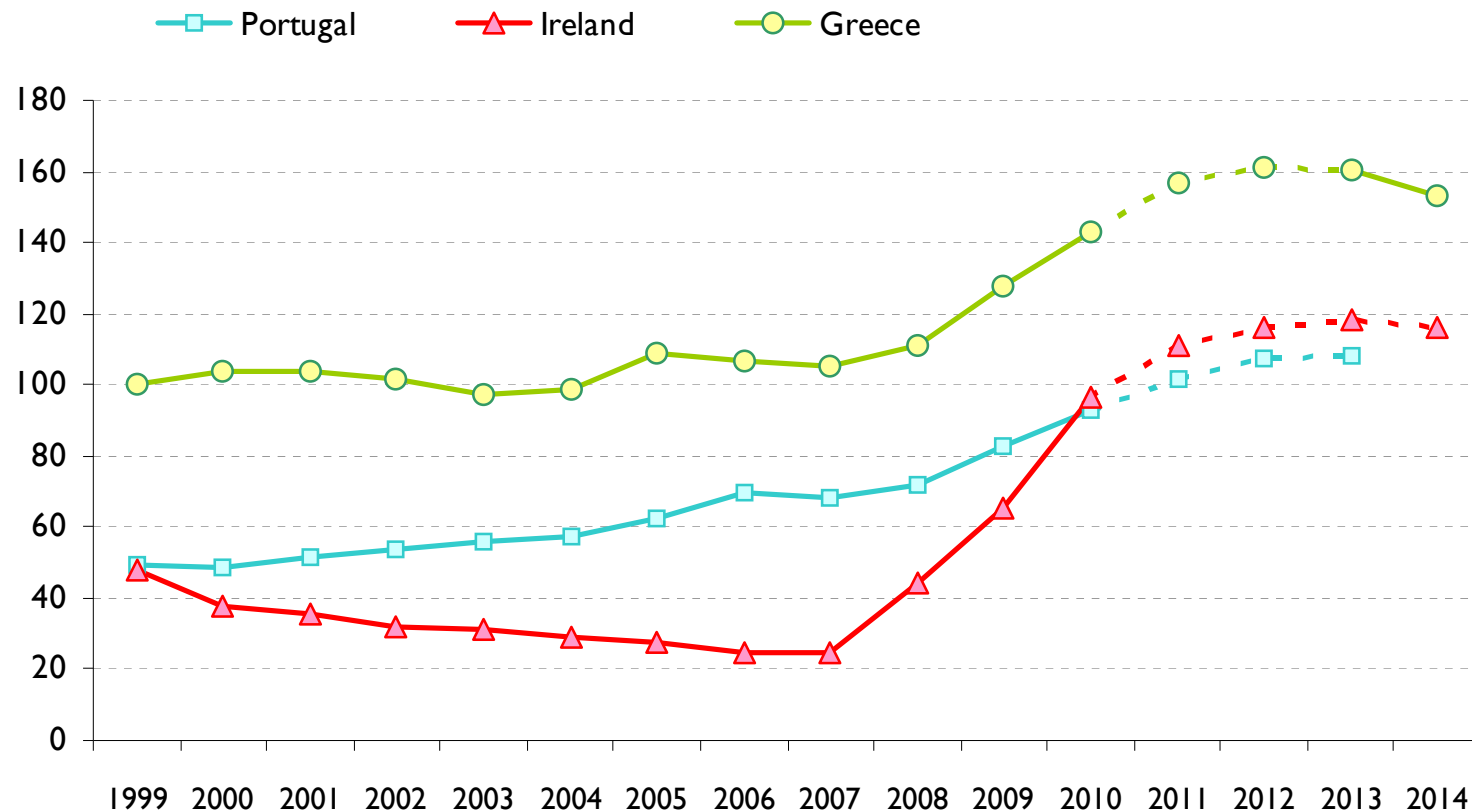*Latest observation: Average of daily rates in June 2011.*

Government gross debt in the biggest euro area economies (% of GDP)

Government gross debt in the programme countries (% of GDP)

Legend: Portugal, Ireland, Greece

Sources: Eurostat, 2011 updates of the stability programmes (Ireland) and the EU/IMF adjustment programmes (Greece and Portugal).

Thank you for your attention