

GLOBAL ECONOMY IN 2006

Global economic activity remained in line with general trends in 2006. According to the International Monetary Fund, the gross domestic product of advanced economies grew by 3.1% in 2006 (2.5% in 2005, see Table 1)¹. By 2007, economic growth is expected to slow down to 2.7% and growth is likely to continue similarly also in 2008.

By regions, growth varied relatively much in 2006. It remained the highest in developing Asian industrial countries. China's economic growth amounted to 10.7%. The total US economic growth was brisk (3.4%), being much higher in the first half-year compared to the second one. The euro area economic growth stood at 2.8% and that of Japan at 2.2%. Compared to forecasts at the beginning of the year², the actual economic growth remained precisely at the anticipated level in the US, being 1.0 percentage points higher than expected in the euro area and 0.1 percentage points higher in Japan.

In 2006, global economic growth was supported by the relatively stable geopolitical environment and the small number of natural disasters. In the second half-year, the US real estate sector's situation started deteriorating rapidly, but the oil price decrease that began in August slightly offset the sector's negative impact on other economic sectors. The oil price rise in the first half-year temporarily boosted global inflationary pressures, but these abated in the second half. Labour market statistics revealed that unemployment remained close to its record low level in all major economic areas.

UNITED STATES AND JAPAN

In the first half of 2006, the **United States** maintained its role as the driving force of global economic growth but in the second half economic activity in the US started waning. The trend-setter was the real estate sector with growth dropping fast after the record levels of end-2005. The real estate sec-

Table 1. Economic indicators of advanced economies

	GDP growth (%)		Annual average CPI growth (%)		Annual average unemployment rate (%)		State budget surplus or deficit (% of GDP)		Current account balance (% of GDP)	
	2005	2006*	2005	2006*	2005	2006*	2005	2006*	2005	2006*
World	4,8	5,3								
Advanced economies	2,5	3,1	2,3	2,3	6	5,6	-2,5	-1,9	-1,4	-1,7
United States	3,2	3,4	3,4	3,2	5,1	4,7	-3,7	-2,6	-6,4	-6,4
Japan	1,9	2,2	-0,6	0,2	4,4	4,1	-4,8	-4,3	3,6	3,9
Euro area	1,4	2,8	2,2	2,2	8,6	7,8	-2,4	-1,8	-0,1	-0,5
Germany	0,9	2,7	1,9	1,8	9,1	8,1	-3,2	-1,9	4,0	3,9
France	1,2	2,0	1,9	1,9	9,9	9,3	-2,9	-2,6	-1,6	-2,3
Finland	2,9	5,8	0,8	1,3	8,4	7,7	2,5	2,9	4,9	5,7
Other EU Member States										
United Kingdom	1,9	2,7	2,0	2,3	4,8	5,4	-2,9	-2,6	-2,4	-2,9
Sweden	2,9	4,8	0,8	1,6	5,8	5,5	2,8	2,8	7,1	6,0

* Data for 2006 are preliminary.

Source: IMF World Economic Outlook, February 2007

¹ IMF World Economic Outlook, April 2007.

² Consensus Forecasts, January 2006



tor's adverse impact on other sectors was somewhat alleviated by the slight decrease in oil prices, which in turn enhanced private consumption. The US external balance remained poor and the current account deficit exceeded 6% of GDP. The budget balance improved during the year and the budget deficit decreased below 2% of GDP by the end of the year. The current account and budget deficits were covered by the continuously great capital net inflow into US securities throughout the whole year.

As economic growth continued to follow the trend and inflationary threats arose as a result of the oil price increase, the US Federal Reserve carried on with normalising the expansionary monetary policy during the first half-year: the key interest rate was raised four times by 25 basis points from 4.25% to 5.25%. In the second half-year the key interest rate remained unchanged owing to the deceleration of economic growth and the oil price drop which alleviated inflationary pressures.

By the end of the first half-year, inflation in the United States rose to 4.3% owing to the oil price rise, but decreased back to the range of 2.0–2.5% by the end of the year. Unemployment decreased from 4.7% in January to 4.4–4.5% by the end of 2006 (the lowest in five years). The employment increase remained moderate throughout the whole year, dropping slightly in manufacturing.

Japan's economic growth followed the trend in 2006. The industrial sector continued to grow the most vigorously: the year-on-year growth of industrial production ranged within 3–6% and the year-on-year growth of exports remained steady over 10%. Private consumption posted weaker results: the year-on-year growth of retail sales was negative at the end of the year. The annual economic growth stood at 2.2%. The growth of Japanese consumer

prices became positive in the middle of the year, rising to 0.9% in August. In the final months of the year price growth slowed down again. Unemployment decelerated from 4.4% at the beginning of the year to 4.0% at year-end (the lowest level in eight years). Owing to the positive economic growth and inflation, the Japanese central bank also ended its zero interest rate policy that had lasted for several years, raising the key interest rate to 0.25%.

EURO AREA

The economic growth of the euro area countries accelerated throughout 2006 and the year-on-year GDP growth (2.8%) significantly exceeded the forecasts made at the beginning of the year. By components, the economic growth was balanced: positive contributions were made by private consumption, private investment, the general government as well as net exports.

The inflation dynamics were similar to that of the US: the price pressures resulting from the oil price rise boosted the year-on-year growth of consumer prices to 2.5% in July, whereas by the end of the year inflation dropped to 1.9%. The core inflation of consumer prices rose from 1.2% in January to 1.5% in December. Unemployment in the euro area kept decreasing throughout the year, declining from 8.3% in January to 7.5% in December.

As economic growth remained close to trend and the growth of core inflation and money supply picked up, the European Central Bank continued to normalise the level of the key interest rate, raising it in each quarter by 25 basis points from 2.25% to 3.25%.

The economic outlook of the euro area for 2007 is positive, but growth is nevertheless expected to decelerate slightly to 2.0%³.

³ Consensus Forecasts, January 2007.

INTERNATIONAL FINANCIAL AND COMMODITY MARKETS

Major **stock markets** continued the upward trend in 2006, supported primarily by the upward phase of the global economic cycle and high corporate profits. Although in May and June a rather abrupt and extensive price fall occurred, it did not influence the generally favourable economic environment and the upward trend picked up again in the second half-year. From among major economic areas the euro area stock index FTSE Eurobloc 300 experienced the strongest growth (19.1%). Also the US stock market was more successful than last year with the SP 500 index rising by 13.6%. The Japanese stock index Nikkei 225 increased by 6.9%.

In the **bond markets** short-term interest rates were mostly influenced by the monetary policy of major central banks, which was oriented on avoiding overheating of the economy and decelerating inflation. The US Federal Reserve continued to raise the key interest rate as expected, raising it from 4.25% to 5.25% in the first half-year. In the second half the rate remained unchanged, as economic growth started to decelerate mainly because of the cooling housing market. The European Central Bank increased the key interest rate five times by a total of 1.25 percentage points. In Japan, the key interest rate was raised to 0.25%, confirming the revival of the Japanese economy and recovery from the deflation period. In the conditions of high economic activity and stricter monetary policy, long-term interest rates increased as well. In the US, the interest rate of the ten-year government bonds increased by 0.31, in the euro area by 0.64 and in Japan by 0.21 percentage points.

The **currency exchange markets** faced another turn in the US dollar trend. While in 2005 the dollar strengthened, in 2006 it started depreciating again against other major currencies, as economic growth began to show signs of deceleration. Thus, the euro exchange rate against the dollar rose to

1.32, i.e. by 11.4%. The dollar changed little compared to the Japanese yen, however, because the yen largely retained its status as a lending currency. The weakening yen could not be sufficiently supported by the raising of the key interest rate by the Japanese central bank either, as other banks raised their key interest rates even more. The yen depreciated by 1.1% against the US dollar and 12.7% against the euro.

As one of the most significant trends, the price increase of crude oil, continued in the **commodity markets**, being boosted by strong demand-side pressures. The price level peaked at the beginning of August, when a barrel of crude oil cost 77 dollars in the US. Later, the oil price decreased to the level reached at the beginning of the year (61 dollars) and remained virtually unchanged year-on-year. The price of gold also fluctuated within a rather wide range, rising to 636.7 dollars per ounce (23.2%) year-on-year. Due to the brisk global economic activity and the resulting increase in demand, the CRB index reflecting the general price level of major commodities rose by 21.5%, which is considerably more than in the previous year.