

## Box 5

### A comparison of the 1998 and 2001 slowdowns in the euro area

The latest euro area data suggest that economic activity returned to a positive growth path around the turn of the year. The pronounced slowdown in euro area growth in 2001 turned out to be rather different from the slowdown in 1998. This box briefly describes the features of the slowdown in 2001, and highlights the differences with the slowdown in 1998 by comparing the different patterns of the contributions to growth made by the main components on both the expenditure side and the value-added side of real GDP.

#### **The slowdown of 1998: weak foreign demand but resilient domestic demand**

The 1998 slowdown in euro area growth was more limited than the 2001 slowdown. The dynamics of the 1998 downturn were largely determined by weak foreign demand. The contribution of net exports to growth declined markedly while that of domestic demand remained broadly stable (see left-hand chart below). The crisis in the emerging market economies that underpinned weaker world economic growth had some adverse impact on euro area export growth in 1998. However, growth in imports was much less affected thanks to the resilience of growth in domestic demand, and did not therefore mirror the decline in export growth. Falling inflation in 1998, inter alia due to positive price shocks resulting from wage moderation, declining oil prices and deregulation, supported real disposable income growth and consumer confidence, more than offsetting the negative impact of external developments on industrial confidence. Thus the contribution of domestic demand to growth increased markedly in 1998 compared with 1997, whereas the contribution of net exports turned negative in 1998.

These developments were reflected in the robust contribution to growth of real value added in market-related services and the declining contribution to growth of real value added in industry, reflecting the high sensitivity of the latter sector to changes in the external environment (see the right-hand chart below).

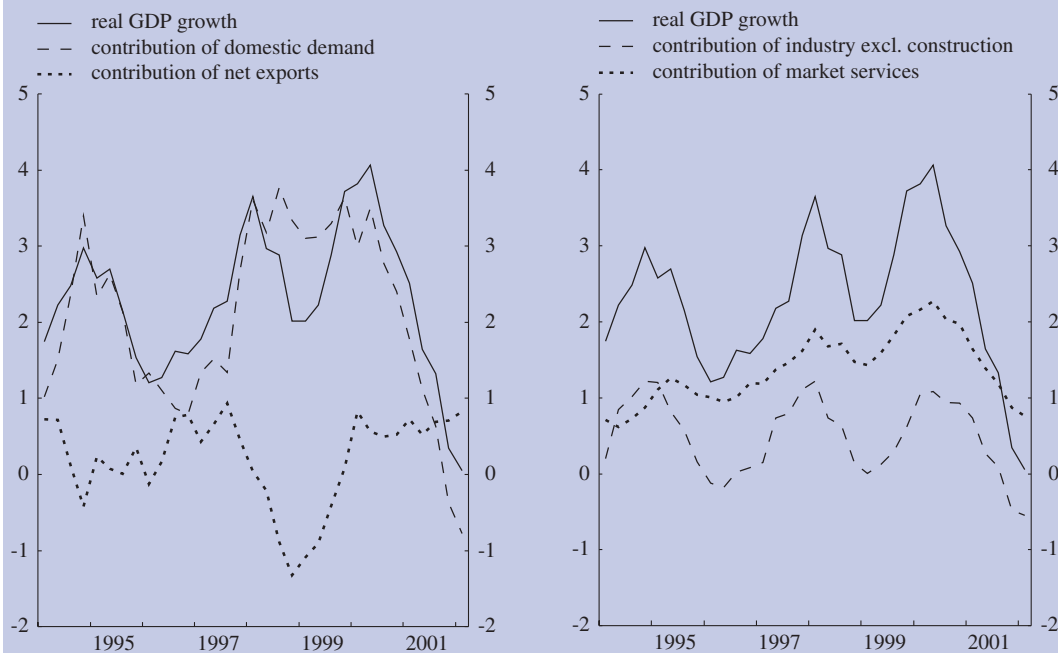
### The slowdown of 2001: the result of weak domestic demand and exports

In 2001, real GDP increased by 1.5%, less than half that recorded in the previous year. The slowdown was characterised by a marked decline in the contribution to growth of domestic demand. This was the result of several adverse developments. First, relatively high inflation, caused by surging energy and food prices, dampened growth in real disposable income, leading to lower consumption growth. Second, the deterioration in the external environment that began in the United States towards the end of 2000, and subsequently the terrorist attacks of 11 September 2001, saw a marked increase in uncertainty on the part of both consumers and investors. By contrast, the contribution of net exports remained broadly unchanged in 2001 compared with 2000. However, this was not due to continued export growth. Instead, the significant decline in export growth resulting from the weaker world economic situation was counterbalanced by a similar decline in import growth, due to the weak growth in domestic demand.

On the value-added side of real GDP these developments led to a significant decline in the contributions to growth from both industry and market-related services in 2001. The decline in domestic and foreign demand resulted in a lower contribution to growth from real value added in industry (excluding construction). Moreover, the contribution to growth made by real value added in market-related services fell sharply in 2001, largely as a result of weak domestic demand.

### Euro area real GDP growth and contribution to growth

(annual percentage changes, percentage point contributions)



Sources: Eurostat and ECB calculations.

Note: All data are seasonally adjusted.

Overall, three main differences can be identified between the two slowdowns of 1998 and 2001 explaining why the former was more limited than the latter. First, in 2001 growth in domestic demand declined significantly compared with the previous year, whereas in 1998 it had remained robust. Second, while weak external demand played a role in both slowdowns, the adverse impact was stronger in 2001 when the deterioration of the external environment originated in the United States and then spilled over to other areas, whereas in 1998 it had been confined to emerging market economies. As a result, the decline in the growth of foreign demand was much more pronounced in 2001 than it had been in 1998. Third, in contrast to 1998, the

2001 slowdown was also affected by a number of specific shocks, such as strong food and energy price rises, a sharp downturn in America's high-productivity information and communication technology sector (which had significant international spillovers due to the highly global nature of this industry), and the events of 11 September.

From a sectoral perspective these differences are mirrored in a different pattern in the contributions to growth made by industry (excluding construction) and market-related services. In both the 1998 and 2001 slowdowns the decrease in export growth led to a declining contribution to growth from real value added in industry, a sector more vulnerable to changes in the external environment. However, while in 1998 the contribution to growth from real value added in market-related services remained robust, this contribution declined significantly in 2001.