

QIR-GRETA Monthly Macroeconomic Commentary

United States

The U.S. economy rebounded in the second quarter of 2007, growing at an annual rate of 3.4% Q/Q (+1.8% Y/Y), according to the **GDP** advance estimates released by the Bureau of Economic Analysis. It is the fastest pace of growth since the first quarter of 2006. GDP rose just 0.6% Q/Q (+1.5% Y/Y) in the first quarter, revised down from the previous 0.7% Q/Q estimate.

The rebound in the second quarter reflected improvements in trade deficit, increased government spending, the vitality of business investment, and a rebuilding of inventories after significant reductions in the past two quarters. These offset a sharp slowdown in consumer spending and a decline in investments in homes.

In more detail, government spending contributed 0.82 percentage points to the GDP growth in the second quarter, after subtracting 0.09 percent in the first quarter and partly offsetting the lower contribution stemming from personal consumption expenditures:

- **Government consumption expenditures and gross investment** increased by +4.2% Q/Q (+2.0% Y/Y) in the second quarter, in contrast to a decrease of -0.5% Q/Q (+1.2% Y/Y) in the first quarter. The increase recorded in the second quarter includes a 9.5% Q/Q rise in defence spending.

It is worthwhile stressing the decrease of domestic consumption in the contribution to the overall GDP growth, from 2.56 percent recorded in the first quarter to 0.89 percent in the following quarter:

- **Real personal consumption expenditures** increased by +1.3% Q/Q (+2.9% Y/Y) in the second quarter, following an increase of +3.7% Q/Q (3.2% Y/Y) in the first quarter.

Fixed investment increased by 2.2% Q/Q (-3.6% Y/Y) in the second quarter, compared to a decrease of -4.4% Q/Q (-4.5% Y/Y) in the first quarter:

- **Real non-residential fixed investment** increased by +8.1% Q/Q (+3.4% Y/Y) in the second quarter, compared with an increase of +2.1% Q/Q (+2.5% Y/Y) in the first quarter. Business investment contributed 0.83 percentage points to GDP growth.
- **Real residential fixed investment** decreased by -9.3% Q/Q (-15.9% Y/Y), compared with a decrease of -16.3% Q/Q (-16.5% Y/Y) in the previous quarter: it is the smallest decline since the first quarter of 2006. Investment in residences subtracted 0.49 percentage points from second quarter growth, compared with 0.93 percentage points from first quarter growth.

The real change in **private inventories** added 0.15 percentage points to the second quarter GDP growth, after subtracting 0.65% in the first quarter.

The trade deficit added 1.18 percentage points to the GDP growth in the second quarter, in contrast to a negative contribution of -0.51% in the first quarter. A weaker dollar against the euro and several other key currencies boosted exports and cut non-oil imports:

- **Real exports of goods and services** increased by +6.4% Q/Q (+6.8% Y/Y) in the second quarter, compared with an increase of +1.1% Q/Q (+6.6% Y/Y) in the first quarter.
- **Real imports of goods and services** decreased by -2.6% Q/Q (+2.0% Y/Y) in the second quarter, in contrast to an increase of +3.9% Q/Q (+2.9% Y/Y) in the first quarter.

With regard to labour market developments, both the number of unemployed persons (7.1 million) and the **unemployment rate** (4.6%) were about unchanged in July.

The **Consumer Price Index** rose +0.2% M/M (+2.7 Y/Y) in June, thanks in significant measure to rising food prices, according to the report issued by the US Labor Department. In May the CPI increased by +0.7% M/M (+2.7% Y/Y). In June the **core CPI** – consumer prices less energy and food – rose +0.2% M/M (+2.2% Y/Y), after rising +0.1% (+2.2% Y/Y) in May.

Japan

According to the second preliminary estimates released by the Cabinet Office, the Japanese **real GDP** increased +0.8% Q/Q (+2.7% Y/Y) in the first quarter of 2007, posting positive growth for the ninth consecutive quarter. GDP increased by +1.3 percentage points Q/Q in the fourth quarter of 2006.

The Japanese economy continued to recover steadily in the first quarter of 2007, while inflation remained subdued. GDP growth benefited from a surge of exports as well as from the renewed strength of consumer spending, which more than offset the slowdown of business capital investment that had driven economic expansion in the past few years:

- **Real private consumption expenditures** came out to be the largest factor of the economic growth during the first quarter, namely it increased by +0.8% Q/Q (+1.4% Y/Y) in the first quarter, compared with an increase of 1.1% Q/Q (+0.5% Y/Y) in the fourth quarter of 2006.

But another pillar of domestic demand - **business capital investment** - declined by -0.9% from the preceding quarter, the first drop in five quarterly periods, raising some concern about the continued robustness of the economic recovery.

As for trade balance, robust shipments to Asian countries, India and China among others, contributed to the growth, while those to the United States slowed down:

- **Real exports of goods and services** rose by +3.3% Q/Q (+7.4% Y/Y) in the first quarter, following an increase of +0.8% Q/Q (+6.3% Y/Y) in the fourth quarter of 2006.
- **Real imports of goods and services** increased by +0.4% Q/Q (+1.2% Y/Y), in contrast to a decrease of -0.1% Q/Q (+2.7% Y/Y) in the last quarter of 2006.

According to the monthly report on the state of Japan's labour force issued by the Ministry of Internal Affairs and Communications, **unemployment rate** decreased by -0.1% to reach 3.7% in June. This is the lowest level for the unemployment rate since February of 1998. According to the report, 2.41 million people were unemployed in June, which was 370,000, or 13.3% fewer than June of last year.

With regard to price developments, inflation has remained subdued. Japan's **core CPI** has fallen for the fifth straight month, showing a 0.1% decline in June. Japan's core CPI includes energy prices but not fresh food. According to the ministry, this month's figure was kept from sliding further by increases in gasoline prices.

Euro area

According to the Eurostat's second estimate, Euro area **real GDP** grew by +0.7% Q/Q (+3.1% Y/Y) in the first quarter of 2007 following a growth of +0.9% Q/Q (+3.3% Y/Y) in the previous quarter. Compared with the first estimate, real GDP growth has been revised upwards by +0.1 percentage point as a consequence of a revised estimate of private consumption growth (from -0.1% to 0.0%) and an upward revision to the contribution from net trade (from -0.5% to -0.4%).

The latest indicators of developments in Euro area activity suggest that the expansion seen in the first quarter of 2007 quarter is solidly based and driven by domestic demand:

- **Household final consumption expenditure** remained stable +0.0% Q/Q (+1.4% Y/Y) in the first quarter of 2007, after +0.4% Q/Q (+2.0% Y/Y) in the fourth quarter of 2006.
- **Government final consumption expenditure** increased by +0.8% Q/Q (+1.9% Y/Y) in the first quarter of 2007, compared to an increase of +0.4% Q/Q (+2.3% Y/Y) in the last quarter of 2006. This increase added 0.2 percentage point to the GDP growth in the first quarter of 2007.

The main contribution to the variation in GDP came from gross fixed capital formation, which expanded at the fastest pace in years, contributing 0.5 percentage point to overall GDP growth of 0.7%:

- **Gross fixed capital formation** increased by +2.4% Q/Q (+7.1% Y/Y), following the increase of +1.5% Q/Q (+5.9% Y/Y) in the previous quarter.

The real change in **private inventories** added 0.4 percentage point to the first quarter GDP growth, after subtracting 0.4 percentage point in the last quarter of 2006.

The trade deficit subtracted -0.4 percentage points to the GDP growth in the first quarter, in contrast to a positive contribution of +0.7% in the previous quarter:

- **Exports of goods and services** rose by +0.8% (+6.6% Y/Y) in the first quarter, compared to an increase of +3.3% Q/Q (+9.5% Y/Y) in the fourth quarter of 2006.
- **Imports of goods and services** increased by +1.7% Q/Q (+6.3% Y/Y) in the first quarter of 2007, following an increase of +1.6% Q/Q (+7.4% Y/Y) in the last quarter of 2006.

With regard to labour market developments, Euro area employment growth has been consistently strong. According to the data released by Eurostat, the Euro area **unemployment rate** stood at 7.0% in the second quarter of 2007 compared with 7.2% in the first quarter. This suggests that the trend improvements in the Euro area labour market that started in early 2005 continued in the second quarter of 2007.

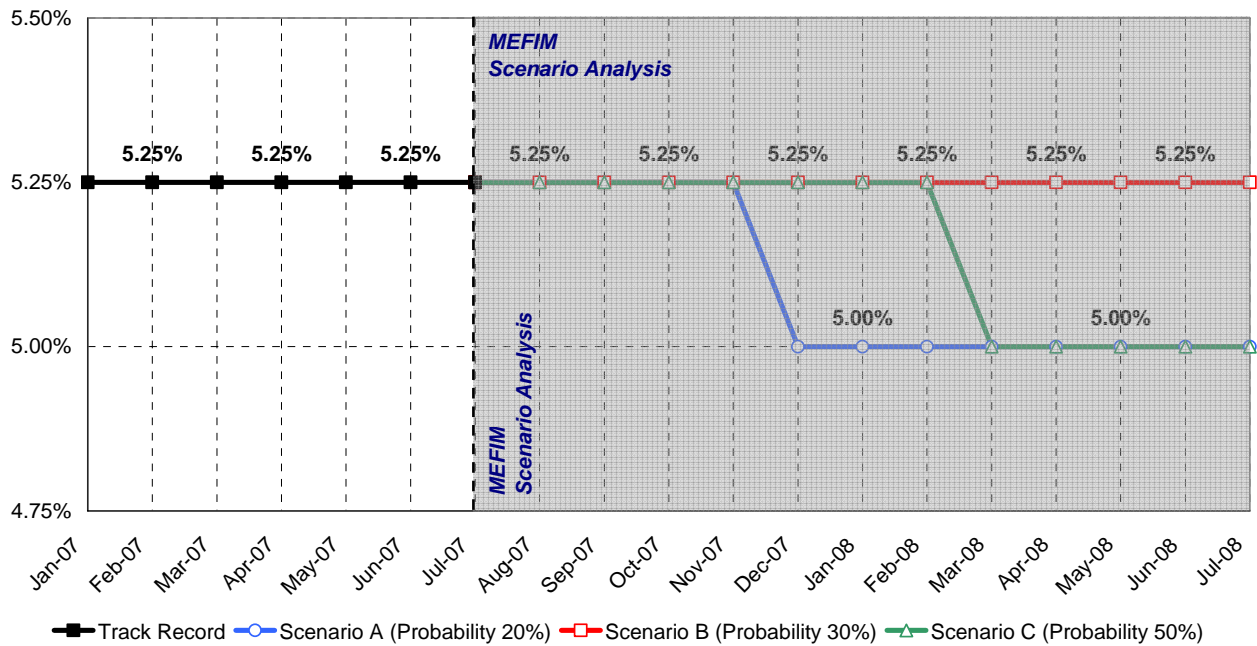
The latest available data on industrial production in the second quarter are consistent with the upbeat sentiment in industry, as reported in surveys. Namely, the seasonally adjusted **industrial production** increased by +0.9% M/M (+2.5% Y/Y) in May 2007, in contrast to a decrease of -0.7% M/M in April. Similarly, the Euro area **industrial new orders** index increased by 1.7% M/M (+9.1% Y/Y) in May, in contrast to a decrease of -0.6% M/M in April. The latest survey data released for August continue to provide a positive signal for economic activity in the third quarter of 2007 in both the industrial and the services sectors.

With regard to price developments, according to Eurostat's flash estimate, **HICP inflation** is expected to be 1.8% in July 2007, down from 1.9% in June. Available information suggests that the energy component contributed significantly to the estimated decline in inflation in July.

MEFIM Macroeconomic Scenario Analysis

United States		
Scenario A (Probability: 20%)	Scenario B (Probability: 30%)	Scenario C (Probability: 50%)
<i>Assumptions:</i>	<i>Assumptions:</i>	<i>Assumptions:</i>
<ul style="list-style-type: none"> Recovery in fixed investment Prolonged difficulties in the housing sector and sub-prime fallout determine negative spillover into the broader economy Muted inflationary pressures due to the weak economic cycle 	<ul style="list-style-type: none"> Strengthening in GDP growth, which narrows the gap with respect to the potential Rebound in consumer spending Recovery in fixed investment Uncertainties in the housing sector, though negative spillover into the broader economy are partly muted Inflationary threats fuelled by increasing energy prices 	<ul style="list-style-type: none"> Growth rate near its potential Moderate upturn in fixed investment Not very buoyant rebound in consumer spending Uncertainty in the housing sector with negative spillover into the broader economy Persistent Inflationary pressures
<i>FED's expected action:</i>	<i>FED's expected action:</i>	<i>FED's expected action:</i>
to cut the Federal funds interest rate by -25 pb in the December 2007 meeting	to leave unchanged the Federal funds interest rate	to cut the Federal fund interest rate by -25 bp in the March 2008 meeting

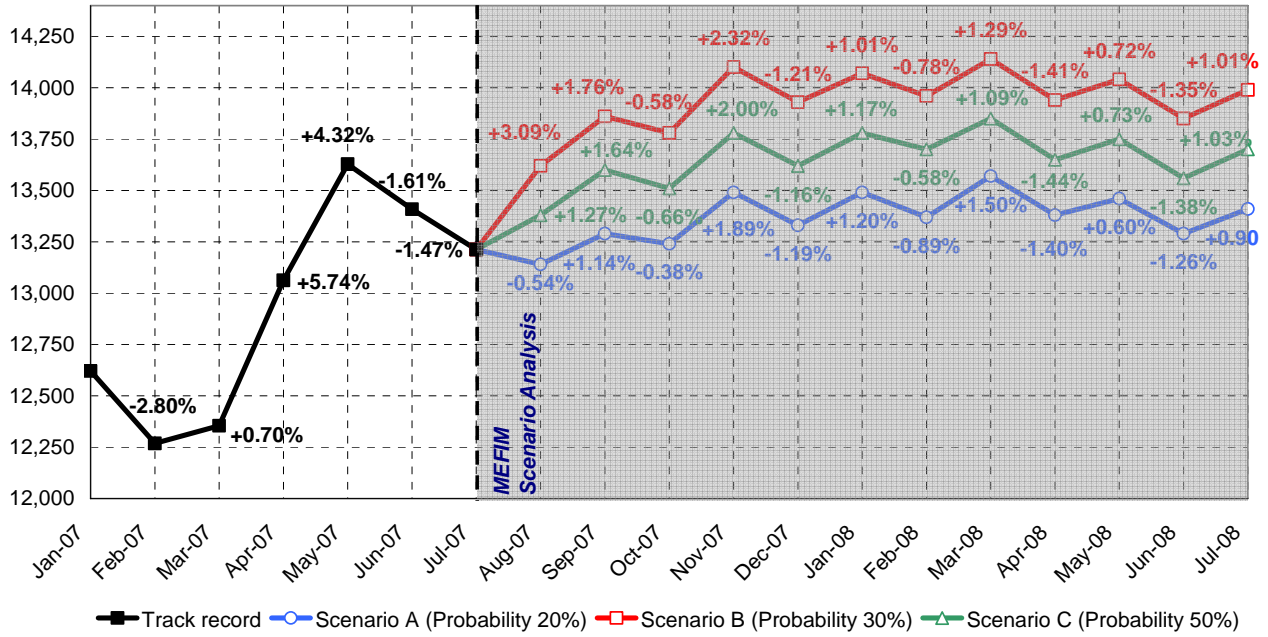
FED Funds Interest Rate
(Scenario analysis from January 2007 to July 2008)



FED Funds Interest Rate
(MEFIM Scenario Analysis from August 2007 to July 2008)

Scenario (Probability)		Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08
A (20%)	Interest Rate	5.25%	5.25%	5.25%	5.25%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
	Intervention	-	-	-	-	-0.25%	-	-	-	-	-	-	-
B (30%)	Interest Rate	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%
	Intervention	-	-	-	-	-	-	-	-	-	-	-	-
C (50%)	Interest Rate	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.00%	5.00%	5.00%	5.00%	5.00%
	Intervention	-	-	-	-	-	-	-	-0.25%	-	-	-	-

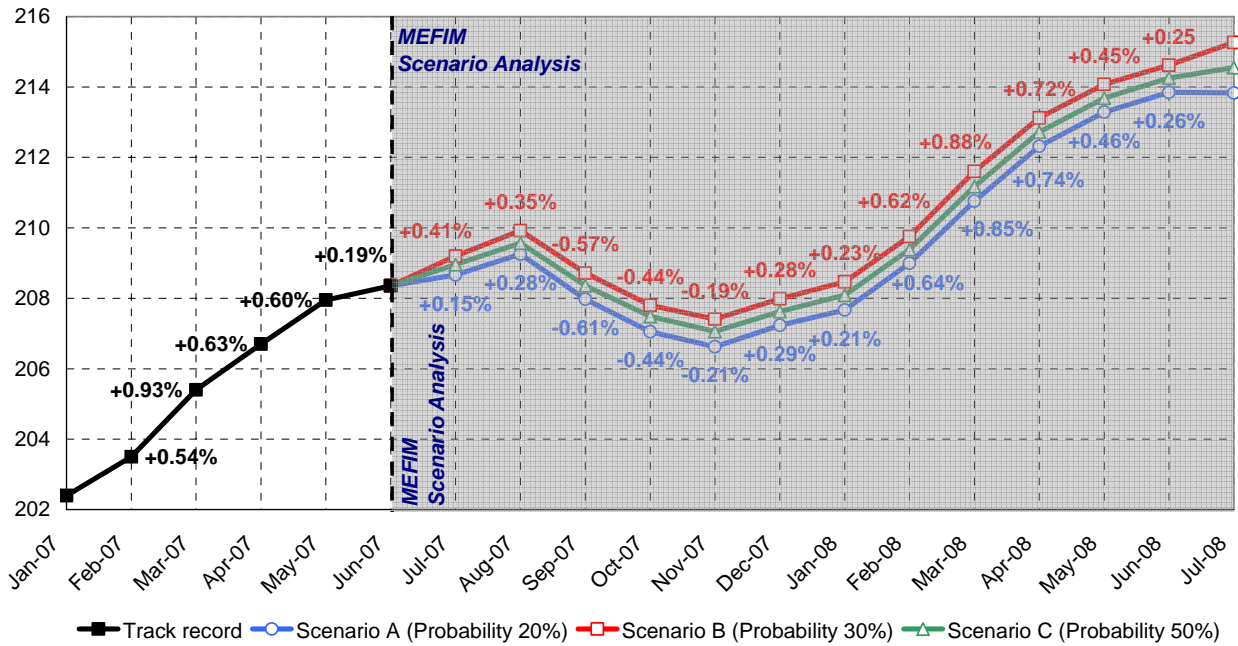
Dow Jones (Scenario Analysis from January 2007 to July 2008)



Dow Jones (MEFIM Scenario Analysis from August 2007 to July 2008)

Scenario (Probability)		Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08
A (20%)	DJ Price	13,140	13,290	13,240	13,490	13,330	13,490	13,370	13,570	13,380	13,460	13,290	13,410
	Change M/M	-0.54%	1.14%	-0.38%	1.89%	-1.19%	1.20%	-0.89%	1.50%	-1.40%	0.60%	-1.26%	0.90%
B (30%)	DJ Price	13,620	13,860	13,780	14,100	13,930	14,070	13,960	14,140	13,940	14,040	13,850	13,990
	Change M/M	3.09%	1.76%	-0.58%	2.32%	-1.21%	1.01%	-0.78%	1.29%	-1.41%	0.72%	-1.35%	1.01%
C (50%)	DJ Price	13,380	13,600	13,510	13,780	13,620	13,780	13,700	13,850	13,650	13,750	13,560	13,700
	Change M/M	1.27%	1.64%	-0.66%	2.00%	-1.16%	1.17%	-0.58%	1.09%	-1.44%	0.73%	-1.38%	1.03%

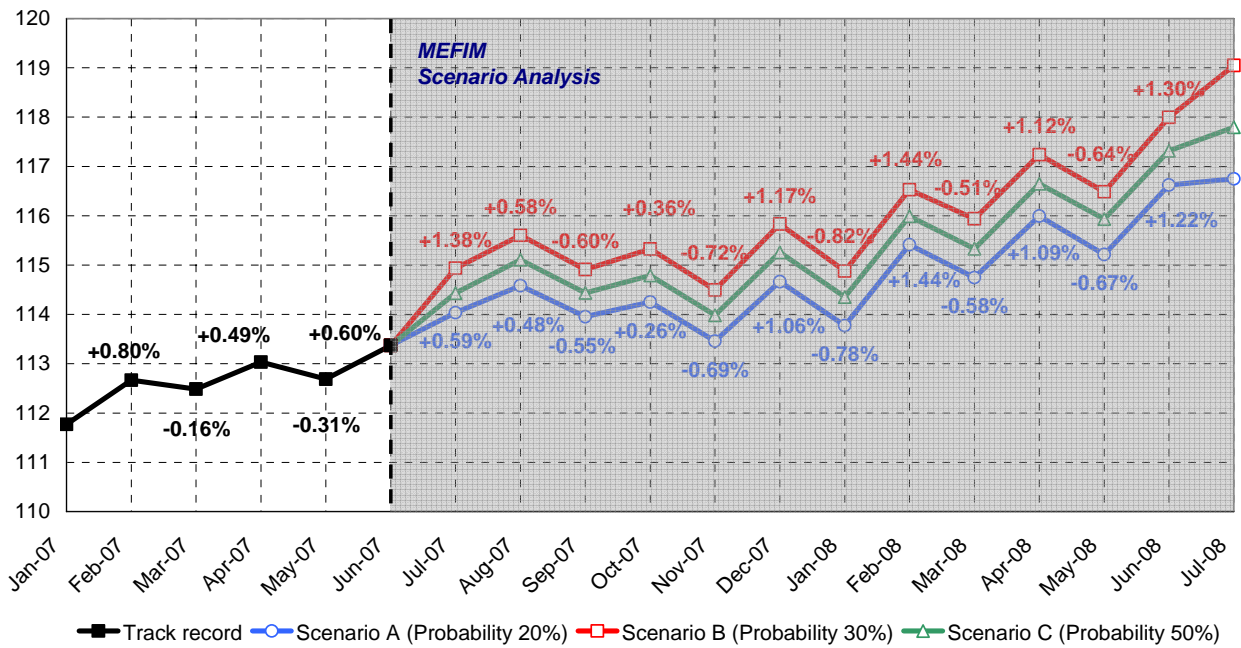
US Consumer Price Index (Scenario Analysis from January 2007 to July 2008)



US Consumer Price Index (MEFIM Scenario Analysis from July 2007 to July 2008)

Scenario (Probability)		Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08
A (20%)	US CPI	208.66	209.25	207.97	207.05	206.63	207.23	207.67	208.99	210.76	212.32	213.28	213.85	213.83
	Change M/M	0.15%	0.28%	-0.61%	-0.44%	-0.21%	0.29%	0.21%	0.64%	0.85%	0.74%	0.46%	0.26%	-0.01%
B (30%)	US CPI	209.20	209.92	208.72	207.80	207.41	207.99	208.47	209.76	211.60	213.12	214.08	214.62	215.26
	Change M/M	0.41%	0.35%	-0.57%	-0.44%	-0.19%	0.28%	0.23%	0.62%	0.88%	0.72%	0.45%	0.25%	0.30%
C (50%)	US CPI	208.96	209.57	208.36	207.49	207.06	207.62	208.09	209.39	211.18	212.72	213.68	214.25	214.56
	Change M/M	0.29%	0.29%	-0.58%	-0.42%	-0.21%	0.27%	0.23%	0.62%	0.85%	0.73%	0.45%	0.27%	0.14%

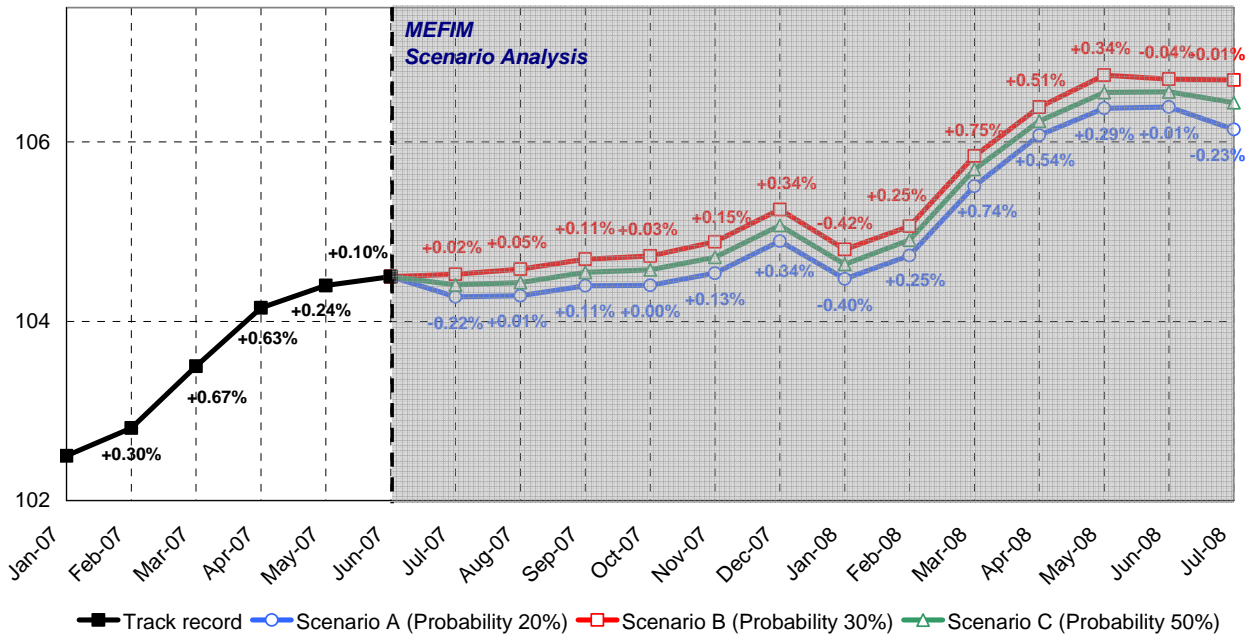
US Industrial Production Index (Scenario Analysis from January 2007 to July 2008)



US Industrial Production Index (MEFIM Scenario Analysis from July 2007 to July 2008)

Scenario (Probability)		Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08
A (20%)	US IPI	114.04	114.58	113.95	114.25	113.46	114.66	113.77	115.41	114.75	116.00	115.21	116.62	116.75
	Change M/M	0.59%	0.48%	-0.55%	0.26%	-0.69%	1.06%	-0.78%	1.44%	-0.58%	1.09%	-0.67%	1.22%	0.11%
B (30%)	US IPI	114.93	115.60	114.91	115.33	114.50	115.83	114.88	116.53	115.94	117.24	116.49	118.00	119.05
	Change M/M	1.38%	0.58%	-0.60%	0.36%	-0.72%	1.17%	-0.82%	1.44%	-0.51%	1.12%	-0.64%	1.30%	0.89%
C (50%)	US IPI	114.43	115.11	114.44	114.79	113.98	115.26	114.35	115.99	115.33	116.65	115.93	117.32	117.79
	Change M/M	0.93%	0.59%	-0.58%	0.31%	-0.70%	1.12%	-0.79%	1.43%	-0.57%	1.14%	-0.61%	1.19%	0.41%

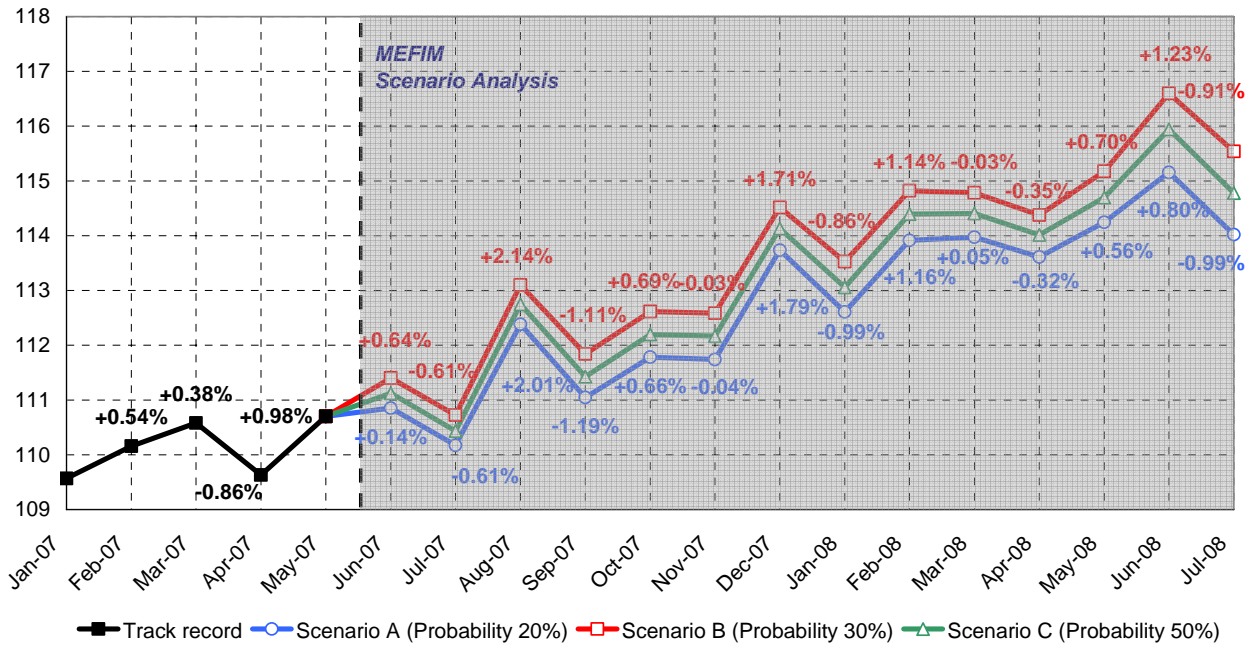
EU Consumer Price Index (Scenario Analysis from January 2007 to July 2008)



EU Consumer Price Index (MEFIM Scenario Analysis from July 2007 to July 2008)

Scenario (Probability)		Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08
A (20%)	EU CPI	104.27	104.29	104.40	104.40	104.54	104.89	104.47	104.73	105.51	106.08	106.38	106.39	106.14
	Change M/M	-0.22%	0.01%	0.11%	0.00%	0.13%	0.34%	-0.40%	0.25%	0.74%	0.54%	0.29%	0.01%	-0.23%
B (30%)	EU CPI	104.52	104.58	104.69	104.73	104.89	105.25	104.80	105.06	105.84	106.39	106.75	106.70	106.69
	Change M/M	0.02%	0.05%	0.11%	0.03%	0.15%	0.34%	-0.42%	0.25%	0.75%	0.51%	0.34%	-0.04%	-0.01%
C (50%)	EU CPI	104.41	104.43	104.55	104.57	104.72	105.07	104.64	104.91	105.69	106.23	106.55	106.56	106.44
	Change M/M	-0.09%	0.03%	0.11%	0.03%	0.14%	0.34%	-0.41%	0.26%	0.75%	0.51%	0.30%	0.01%	-0.11%

EU Industrial Production Index (Scenario Analysis from January 2007 to July 2008)



EU Industrial Production Index (MEFIM Scenario Analysis from June 2007 to July 2008)

Scenario (Probability)	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	
A (20%)	EU IPI	110.85	110.18	112.38	111.05	111.78	111.74	113.74	112.61	113.91	113.97	113.61	114.24	115.15	114.02
	Change M/M	0.14%	-0.61%	2.01%	-1.19%	0.66%	-0.04%	1.79%	-0.99%	1.16%	0.05%	-0.32%	0.56%	0.80%	-0.99%
B (30%)	EU IPI	111.40	110.73	113.10	111.84	112.62	112.59	114.52	113.53	114.82	114.78	114.38	115.18	116.60	115.54
	Change M/M	0.64%	-0.61%	2.14%	-1.11%	0.69%	-0.03%	1.71%	-0.86%	1.14%	-0.03%	-0.35%	0.70%	1.23%	-0.91%
C (50%)	EU IPI	111.12	110.44	112.75	111.42	112.20	112.17	114.13	113.06	114.40	114.41	114.02	114.70	115.94	114.78
	Change M/M	0.38%	-0.62%	2.09%	-1.17%	0.69%	-0.03%	1.75%	-0.94%	1.18%	0.01%	-0.34%	0.60%	1.08%	-1.00%