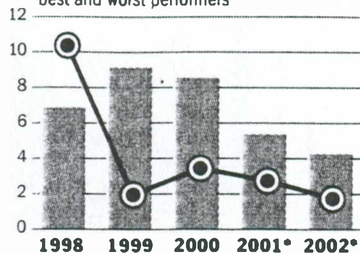
Converging

Growth and inflation rates narrow

- Difference in GDP growth between euro zone's best and worst performer, in percentage points
- Difference in annual inflation between euro zone's best and worst performers



*Forecast Source: WSJE calculations based on data supplied by Eurostat, consensus forecasts and CSFB

NOTE: All figures in percent, annual rates of change

Expected top 3 GDP performers for 2002	
Ireland	5.8
Greece	3.9
Finland	3.5
Expected worst 3 GDP performers for 2002	
Germany	1.5
Italy	1.6
France	1.9
Expected top 3 inflation performers for 2002	
France	1.5
Austria/Belgium	1.7
Italy	1.8
Expected worst inflation performers for 2002	
Ireland	3.5
Greece	2.9
Netherlands	2.8

Euro Zone's Economies Start to Move in Unison

Growth and Inflation Rates Synchronize

By G. THOMAS SIMS
STAFF REPORTER

FRANKURT — The economies of the euro zone are finally starting to move in step, though unfortunately they're all heading in the wrong direction.

Growth and inflation rates among the 12 countries that share the euro are more in sync than at any time since the birth of the single currency, making it easier to set interest rates in what remains an extremely diverse region.

In 1999, the year the euro was officially launched, the European Central Bank had to form a single monetary policy for a region where annual growth ranged from 10.8% in Ireland to 1.6% in Italy. But current economic forecasts suggest that 9.2-percentage-point difference will narrow by more than half by next year, to a level not seen since 1993.

Likewise with inflation. In 2000, rates ranged from 5.3% in Ireland to 1.8% in France. Next year, that 3.5 point difference could narrow to 1.8.

The bust in the technology sector brings growth and inflation rates of boomers such as Ireland and Finland closer to those of their much larger peers. But the phenomenon also is occurring within the core of the euro zone. The troubling growth gap between better performing France and weaker Germany is forecast to be a third next year of what it is this year, good news considering these two nations make up slightly more than half of the euro zone's economy.

The convergence makes it much easier for the ECB to operate a one-size-fits-all monetary policy. "If cyclical conditions are aligned, then the ECB can make decisions without worrying that what is good for one country can be bad for another," says David Naude, senior euro-area economist at Deutsche Bank in Paris.

That doesn't mean that the 18-member council that sets interest rates at the ECB has an easy job. Right now, the future course of the economy hinges on many unknowns — the length of the U.S. slowdown, the prospect for war, and the psychology of consumers. Uncertainty means the bank could easily go too far with cutting rates, at the risk of stoking inflation, or not far enough, to the detriment of growth. But at least this somewhat accidental convergence prompted by the slowdown gets rid of one complicating variable.

Of course, this synchronization won't last forever. In any large currency bloc — even in the U.S. — growth and inflation rates can vary. But the trend toward harmony comes at good time for Europe: National governments can't act in lockstep to stimulate the economy through extra spending, with many countries posting budget deficits and only a few surpluses.

And this doesn't change the fact that each nation has its own individual economic quirks that could keep them ticking differently in the future. Here's a look at the current economic situation in the major euro-zone countries:

AUSTRIA

Thanks to overzealous builders, Austria has a lot of empty office space, and spending for roads, bridges and railroads is slowing sharply as the government tries to reduce its budget deficit. That is bad news for construction, which makes up 7% of the economy of this Alpine region — a much larger portion than for its Western neighbors. The hope is that as the European Union expands eastward, construction in this crossroads country will pick up.

BELGIUM

Tightly knitted into the European economy through its heavy trade links, Belgium is keenly sensitive to decisions and conditions elsewhere. More than 20% of its nongovernment work force is employed by foreign multinationals such as **Ford Motor** and **Alcatel**, the French telecom company. Its large transport sector accounts for close to 20% of gross domestic product, which means the slowdown in trade could hurt it more than others. Belgium faces domestic problems as well: If troubled national airline Sabena goes under, that could put 12,000 out of work.

FINLAND

As **Nokia** goes, so goes Finland. And that's a problem. Finland, which grew 5.7% last year, may grow 0.5% this year, making it the euro-zone country hardest hit by the slowdown. Nokia makes up about 5% of Finnish economy, so the slowdown in demand for mobile phones has hit Finland hard. But the country's equally large reliance on the forestry sector means that a pickup in the economy abroad, and a resulting increase in demand for paper, could quickly rescue Finland from recession.

FRANCE

The recent introduction of a nationwide 35-hour workweek seemed to go fairly smoothly, but the added cost for businesses — at the expense of competitiveness — was concealed by the fact that the economy was relatively strong. As growth now slows, economists worry that the government subsidies to cover companies' added expense might not be enough. France is already testing the limits of euro-zone rules on government spending.

GERMANY

The major challenge for the euro zone's largest economy is to avoid recession at a time when its budget is strapped. More than any other country in the euro zone, Germany generates a third of its output through exports of cars, machine tools and other goods outside the euro zone. That makes Germany especially vulnerable when the U.S. and Japan are suffering. Even the German central bank president, Ernst Welteke, doesn't seem very optimistic about avoiding recession.

GREECE

Fortunately for Greece, the Olympic Games are headed to Athens in 2004, providing a healthy boost to infrastructure investment. Meanwhile, it's unlucky for Greece that tourism makes up 7% of the economy — more than any other country in the euro zone. The global slowdown and added scare of terrorism mean that visitors are canceling bookings for hotels and cruises, anecdotal evidence suggests. With the tourist season nearing an end, the bad news might not sink in until next year.

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Euro Zone's Economies Start to Move in Unison

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IRELAND

The Celtic tiger probably could do without the ECB's interest-rate easing of late. Though inflation has cooled in the past year, at 3.7% it is still well above the euro area rate of 2.7%. Ireland is arguably more sensitive to the downturn in the U.S. economy, and the American tech sector woes in particular, than any other euro-zone country. Technology exports accounted for more than one-third of its total economy last year, most of that from Irish subsidiaries of U.S. technology companies.

ITALY

Last year was a good one for the European economy, but Italy was the laggard, growing at the slowest rate in the euro zone. Companies have a hard time firing surplus workers, even when times are rough. And bureaucracy makes it difficult to start up a new business. These problems require changes in laws and won't disappear overnight. But even the presence of the Mafia deters prospective entrepreneurs from founding a business with the specter of paying protection money.

THE NETHERLANDS

Unemployment is just under 2%, the lowest level in the euro zone, thanks to deregulation of the labor market. But a labor shortage is making these workers expensive. Hourly labor costs rose 5.2% in the second quarter, faster than anywhere else in the euro zone. Construction workers are asking for 6% pay raises. Economists fear this will stifle corporate profits, investment, employment growth and investment. ECB President Wim Duisenberg even says he regrets the pay claims workers are making in his home country.

PORTUGAL

The tech-driven gains in living standards that other small euro-area countries, such as Ireland and Finland, have enjoyed in recent years have eluded Portugal. Next to Greece, it has the lowest gross domestic product per head, $17,478 (€19,411) last year, compared with the euro-area average of $23,678. The government has made major strides in getting its fiscal house in order, but its deficit is still well above the euro-area average, giving it even less wiggle room than others to cushion the economy from the downturn.

SPAIN

Flexibility also characterizes Spain's labor market, but some economists say it might be too flexible. A third of the work force has temporary contracts, most of which can be quickly terminated. The fear that employers will overreact during a slowdown by quickly cutting staff can just as quickly hurt confidence, consumption and growth. The Organization for Economic Development is happy to see Spain now making a push for more flexible long-term job contracts, something that could pay off for Spain down the road.

Christopher Rhoads in Berlin contributed to this article.