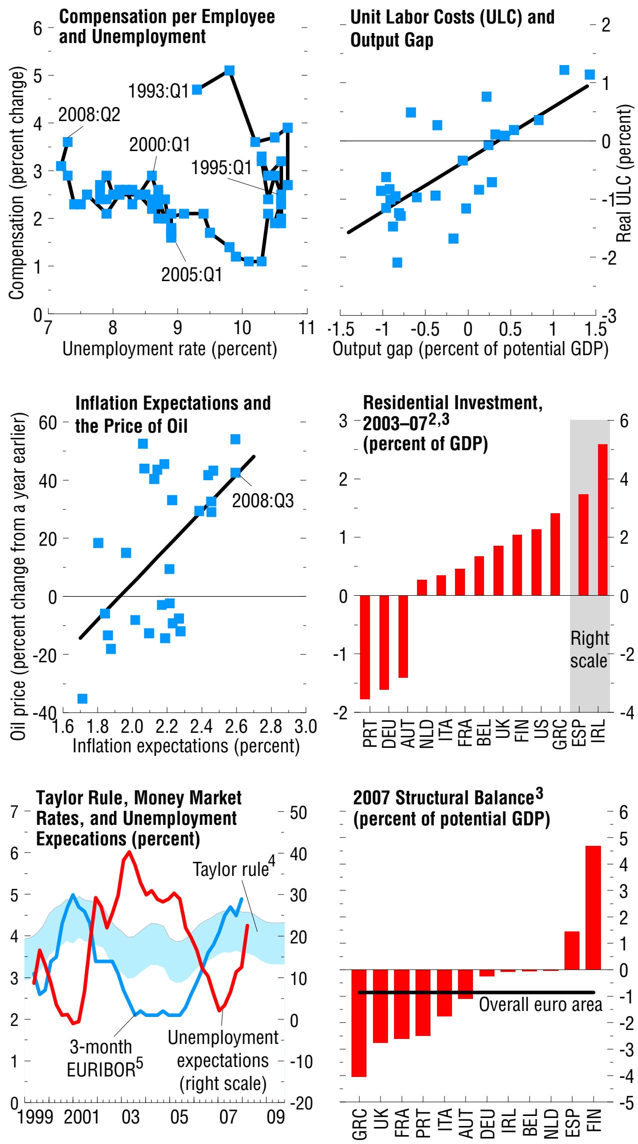
Figure 2.2. Western Europe: Slowing Demand and High Inflation[1]

Although headline inflation is high, wages have generally remained subdued, and slowing activity and rising unemployment fears should restrain demand for pay hikes. In the euro area, monetary conditions are on the tight side by the standards of recent history, and countries have little room for discretionary fiscal stimulus, lest they breach the Maastricht limit of 3 percent of GDP deficit.



Sources: European Central Bank; European Commission; Eurostat; Haver Analytics; Thomson Datastream; and IMF staff estimates.

[1]Data refer to the euro area unless otherwise noted.

[2]Deviation from 1993–2002 average.

[3]AUT: Austria; BEL: Belgium; FIN: Finland; FRA: France; DEU: Germany; GRC: Greece; IRL: Ireland; ITA: Italy; NLD: Netherlands; PRT: Portugal; ESP: Spain; UK: United Kingdom; US: United States.

[4]The formula gives equal weight (0.5) to the deviation of breakeven inflation from the inflation target and to the output gap; the lower band is based on a natural rate equal to 3.5 percent; the upper band is based on a natural rate equal to 4.5 percent.

[5]Euro interbank offered rate.