

year, exports were up 14.6 per cent, partly reflecting a 22.1 per cent increase in sales to the rapidly growing Chinese import market.

In 2007, GDP is expected to grow at the same pace as in 2006 but near-term prospects depend critically on whether the rebound in consumer spending seen in the last quarter of 2006 can be sustained.

Euro Area

Despite headwinds from high oil prices, monetary tightening and a slowdown of the US economy in the second half of 2006, economic activity in the euro area accelerated in the fourth quarter of 2006. For the whole year, the euro area economy grew by 2.6%, the highest rate in six years and almost double the 1.4 per cent recorded in 2005.³ Domestic demand remained the main contributor to growth but net exports improved after a relatively lacklustre performance in 2005. The recovery of domestic demand was initially driven by a surge in investment spending. Other contributors include budgetary consolidation and a greater focus on the need to secure sustainable public finances in light of an ageing population. Although all the four largest economies – Germany, France, Italy and Spain – recorded solid real GDP growth in 2006, recovery in the German GDP growth led the euro area. Among factors underpinning the German expansion in economic activity are booming exports, a solid increase in capital formation, a better functioning of labour markets and an increase in private consumption, after several years of stagnation.

The outlook for the euro area is bright with real GDP growth forecast to grow 2.5 per cent for the next two years.⁴ The slight deceleration would reflect both the effect of some monetary and fiscal tightening, and a lower contribution of net exports to growth.

The UK

GDP growth of 2.7 per cent in 2006 confirms that the U.K. economy has rebounded from the

weak performance (1.9 per cent) in 2005. Growth was mainly driven by domestic consumption and business investment. Although trade volumes were strong during the first half of the year, net exports recorded a negative contribution to economic growth for the full year. Initial indications suggest that retail trade confidence will remain robust in 2007. GDP is expected to maintain its steady growth early in the year before decelerating, owing to the effects of higher interest rates.

The Emerging Economies

In 2006, economic expansion remained robust in emerging Asia, led by very strong growth in China and in India. Although still lagging growth in emerging Asia, 2004-2006 was the strongest three-year period of growth in Latin America since the late 1970s.

China

China's economy grew 10.7 per cent in 2006, up from 10.4 per cent in 2005. This was the fourth successive year with a growth rate exceeding 10 per cent. There was a modest slowing in the second half of 2006 following tightening measures that had been implemented since April, aimed at curbing excessive investment growth, which, together with exports and consumption, were the principal drivers of growth in 2006. The tightening measures included monetary policy operations to curb increases in liquidity, credit and monetary growth. Concerns have been raised that over heating could lead to over-investment and to speculative "bubbles" in real state and equities. However, the slight slowdown in investment in the second half of 2006 was partly offset by further increases in exports, which grew by about 20 per cent for the whole year in U.S. nominal dollar terms. As a result, the contribution of net trade to GDP growth increased to 3.3 percentage points in the second half of 2006, up from close to 2.0 percentage points in the first half. In addition, the trade surplus reached historical new highs,

³ European Commission (2007). Interim Forecast, February.

⁴ Ibid.