

PART 1

MAIN DEVELOPMENTS

Methodological note

Since the issue for the second quarter of 2004, nominal and real effective exchange rates presented in this report are calculated based on a reference group of 41 countries. By extending the group of reference countries from 24 countries to 41 countries, over 80 percent of extra-EU12 exports instead of 58 percent are covered. The effective exchange rate calculations consequently better reflect trade patterns, including those with the new Member States.

The new reference group has been constructed by extending the former IC24 group (which includes the initial 15 EU countries, Norway, Switzerland, Australia, the United States, Canada, Japan, Mexico, New Zealand and Turkey) with the ten recently acceded Member States, Bulgaria, Romania, Russia, China, Brazil, Korea and Hong Kong. Due to data constraints, real effective exchange rates based on unit labour costs cannot be calculated for this group. Therefore, for the time being, only real effective exchange rates calculated to measure *price competitiveness* are based on this new reference group (“broad group”). Real effective exchange rates calculated to measure *cost competitiveness* are based on a smaller reference group of 34 countries (the former IC24 group plus the ten new Member States).

The “broad group” is included in the tables and charts where appropriate. In the tables and charts on pages 1 to 70 of part 2, each country’s relative position is assessed with respect to the rest of 34 countries (the EU25 countries, Norway, Australia, Canada, Japan, the United States, Mexico, New Zealand, Turkey and Switzerland), with the European Union and with the euro area.

DEVELOPMENTS OF PRICE AND COST COMPETITIVENESS IN THE EUROPEAN UNION, THE UNITED STATES AND JAPAN

MAIN FEATURES

The euro against major international currencies

- The euro appreciation continued in the second quarter of 2006. Between the first and the second quarter of 2006, the euro exchange rate gained 4.5 percent against the US dollar and 2.3 percent against the Japanese yen. The appreciation against other major currencies was smaller (0.3 percent against both the Swiss franc and the British pound sterling). While the euro exchange rate stood about 12 percent above its 1995 to 2005 average against the US dollar and the Japanese yen in the second quarter of 2006, it was still below its medium-term average against the British pound sterling and the Swiss franc.
- All in all, the euro appreciated by 2.5 percent in nominal terms against the currencies of 29 countries between the first and the second quarter of 2006. Despite this appreciation, the euro stood still slightly below its level in the second quarter one year ago. In a medium-term perspective, the euro was almost 14 percent above its 1995 to 2005 average.

Relative cost and price indicators: international developments

- Mainly driven by the nominal appreciation of the exchange rate, the international price and cost competitiveness of euro area producers deteriorated further in the second quarter of 2006. As a result, the real effective exchange rate was between one and 2.6 percent above its 1995 to 2005 average, depending on the applied deflator.
- In the US, a nominal effective depreciation of the US dollar by 1.7 percent led to a further improvement of price and cost competitiveness indicators in the second quarter of 2006. While relative price developments dampened the price competitiveness improvement, favourable relative cost developments added to the improvement of the cost competitiveness position. Price and cost competitiveness positions also improved in Japan between the first and second quarter of 2006 but worsened in the UK.

Relative cost and price indicators: intra-euro area developments

- Compared to the first quarter of 2006, cost competitiveness positions relative to the other euro area Member States continued to improve in Germany, Finland and the Netherlands. Of all other Member States, Greece, Spain and Ireland recorded the strongest losses in cost competitiveness, continuing the trend of previous quarters. As regards price competitiveness, all three measures indicated an improvement in Germany, Finland and Portugal. Italy, Spain and Ireland, on the other hand, saw a deterioration of all their relative price competitiveness indicators. For all other Member States, the different deflators pointed into opposite directions.
- In a medium-term perspective, the intra-euro area cost competitiveness positions of Germany and Austria were more favourable than their 1995 to 2005 averages. On the other hand, Ireland, Portugal, Greece, Italy and Spain continued to face cost competitiveness positions that were considerably worse than their 1995 to 2005 averages. Price competitiveness positions were more favourable than their 1995 to 2005 in Germany, Finland, France and Austria, while they were considerably worse in Spain, Italy, Greece and Ireland, with the exception that the Irish price competitiveness position based on export prices was somewhat better than its medium-term trend.

Relative cost and price indicators: non-euro area Member States

- In non-euro area Member States, cost competitiveness improved in Hungary, Poland, Cyprus and the UK between the first and second quarter of 2006. Of all other non-euro area Member States, Latvia recorded the strongest loss of cost competitiveness. The same trend was broadly reflected in price competitiveness indicators.
- Except for Sweden, cost competitiveness positions were worse than their 1995 to 2005 averages for all non-euro area Member States, with the cost indicators showing deviations ranging between 1.8 percent (Malta) and 32.4 percent (Czech Republic).

DATA ON PRICE AND COST COMPETITIVENESS

QUARTERLY REPORT - SECOND QUARTER 2006

I. INTERNATIONAL DEVELOPMENTS

1. BILATERAL EXCHANGE RATES OF THE EURO

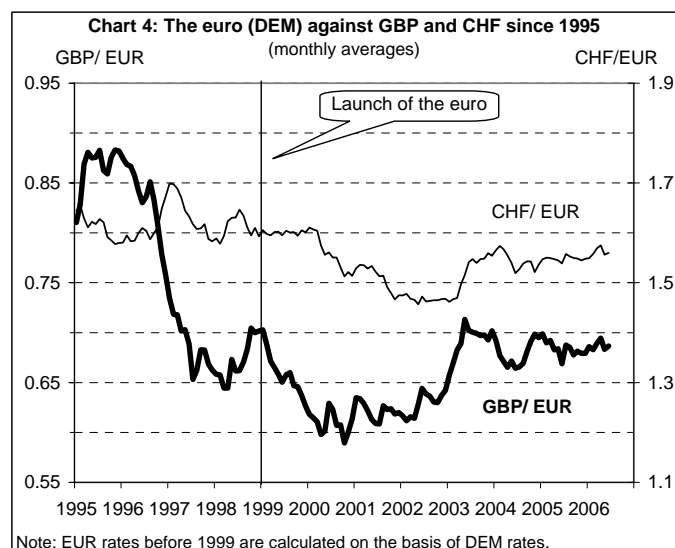
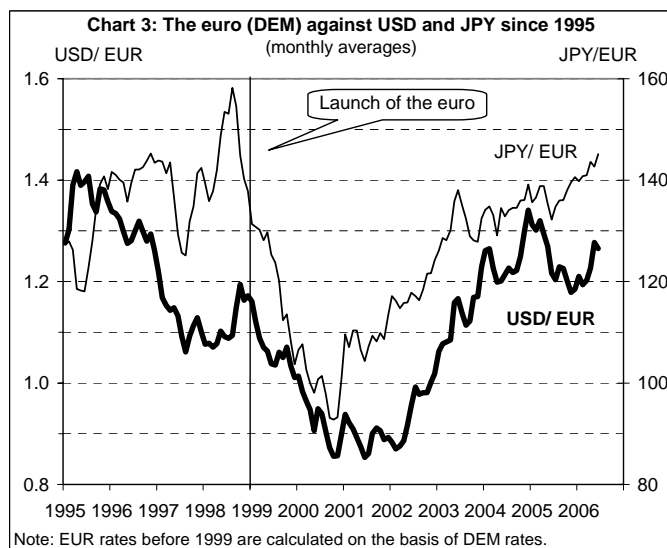
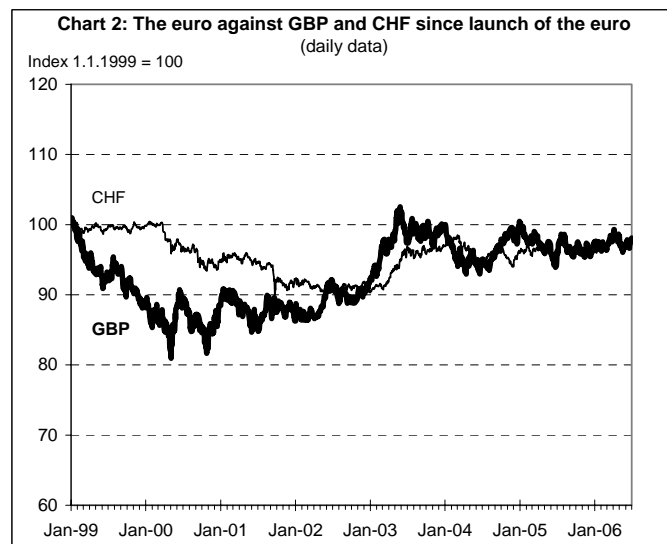
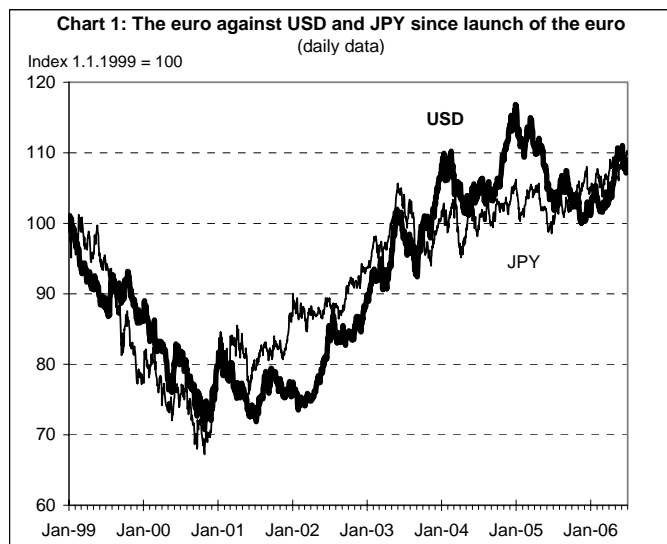


Table 1: Evolution of the main bilateral exchange rates

	Second quarter of 2006 (monthly averages)			Change relative to previous periods (quarterly averages)		
	Apr-06	May-06	Jun-06	previous quarter Q2-06/Q1-06	previous year Q2-06/Q2-05	medium-term avg Q2-06/avg 95-05
USD/EUR	1.227	1.277	1.265	4.5%	-0.3%	11.8%
JPY/EUR	143.6	142.7	145.1	2.3%	6.1%	12.8%
GBP/EUR	0.6946	0.6833	0.6867	0.3%	1.4%	-0.8%
CHF/EUR	1.575	1.556	1.569	0.3%	1.3%	-0.1%

2. NOMINAL EFFECTIVE EXCHANGE RATES

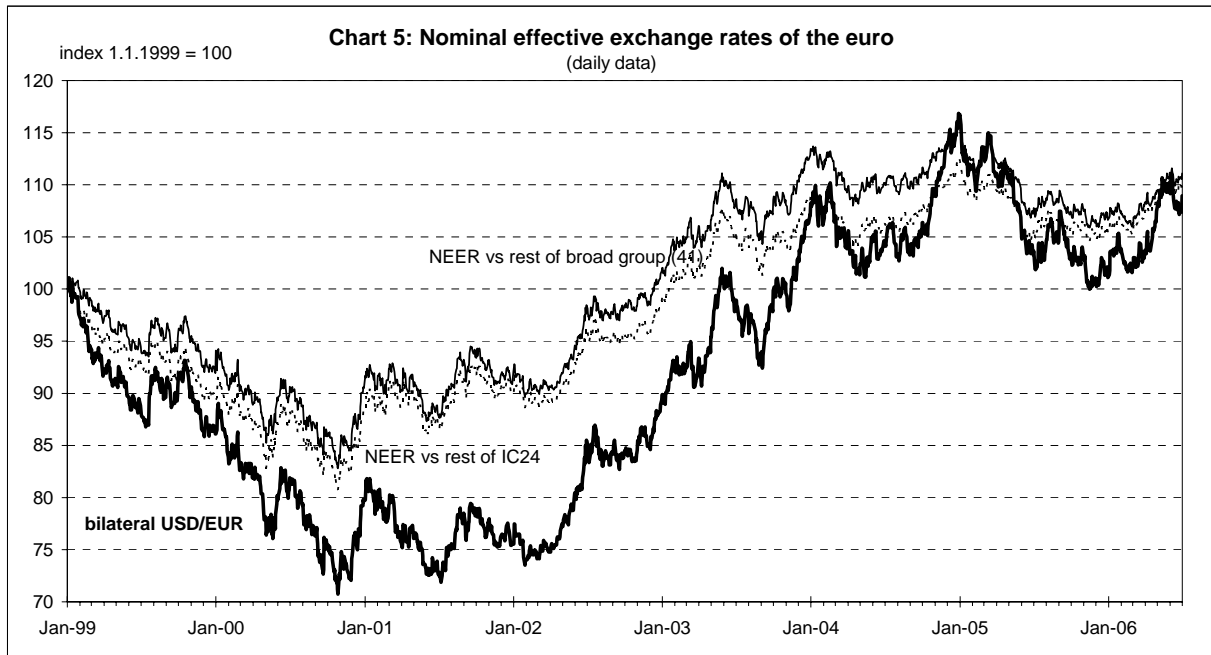
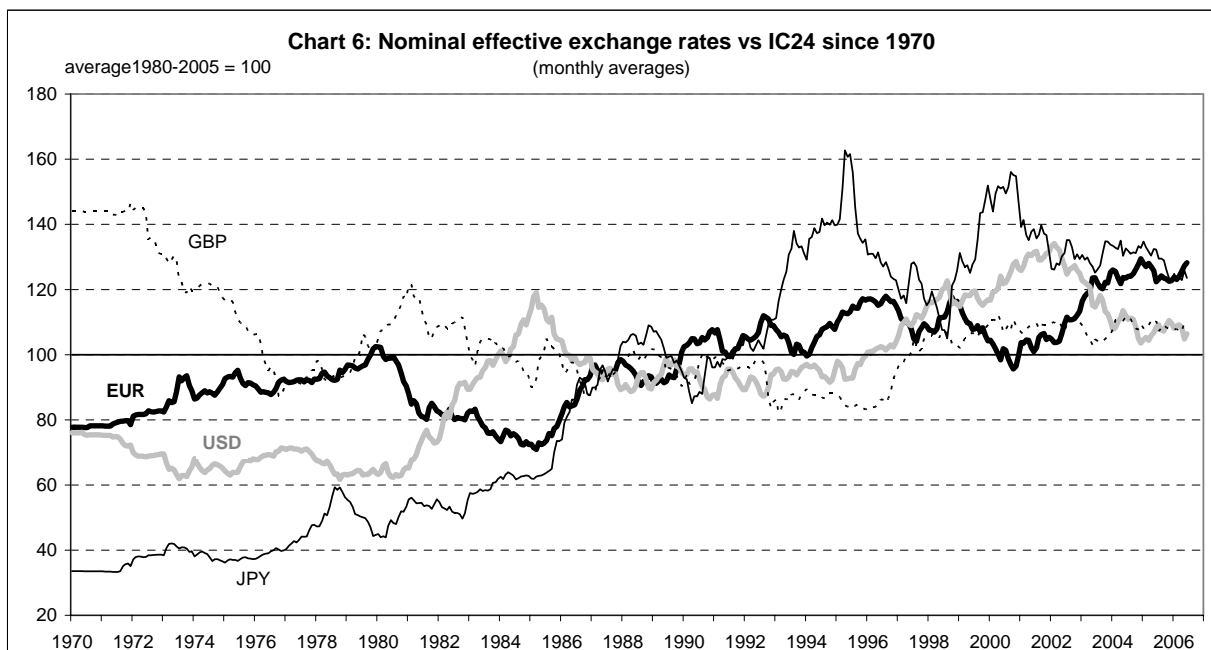


Table 2: Nominal effective exchange rates
(vs. broad group (41), index average 1999 = 100)

	Second quarter of 2006 (monthly averages)			Change relative to previous periods (quarterly averages)		
	Apr-06	May-06	Jun-06	previous quarter Q2-06/Q1-06	previous year Q2-06/Q2-05	medium-term avg Q2-06/avg 95-05
EUR12	112.8	114.5	115.2	2.5%	-0.3%	13.8%
USA	92.9	90.5	91.8	-1.7%	-1.9%	-5.5%
Japan	91.3	94.2	92.4	0.5%	-7.2%	-5.1%
UK	101.0	104.0	103.6	1.3%	-1.7%	6.5%



3. PRICE COMPETITIVENESS BASED ON CPI (HICP WHEN AVAILABLE)

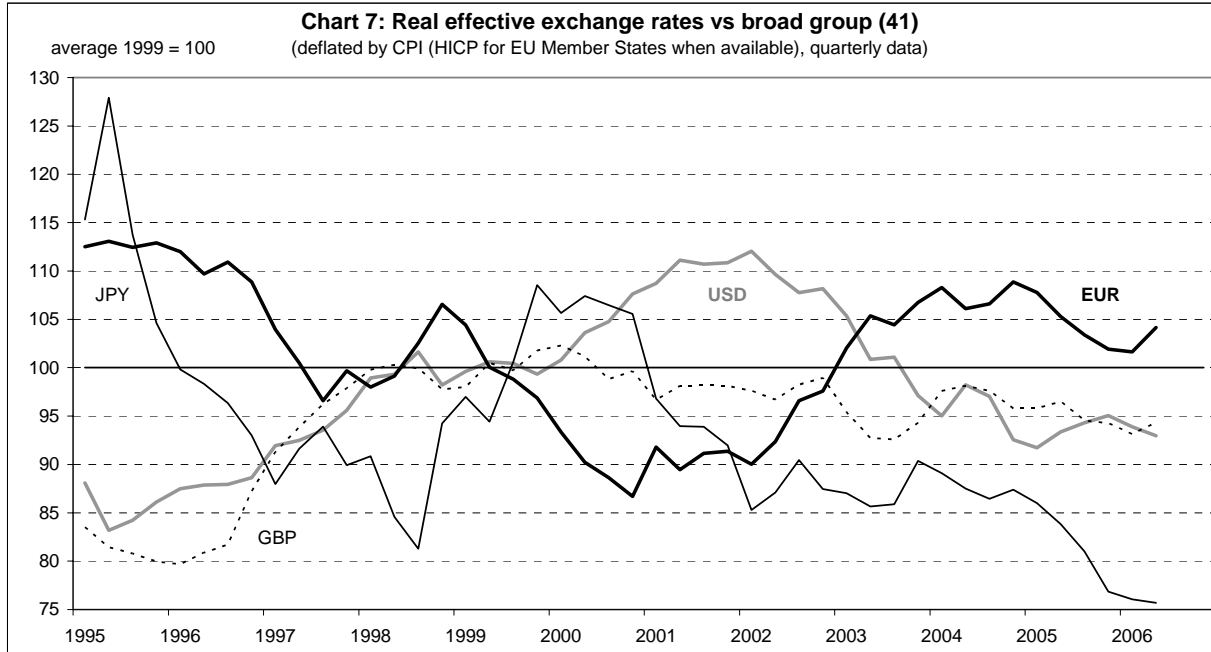
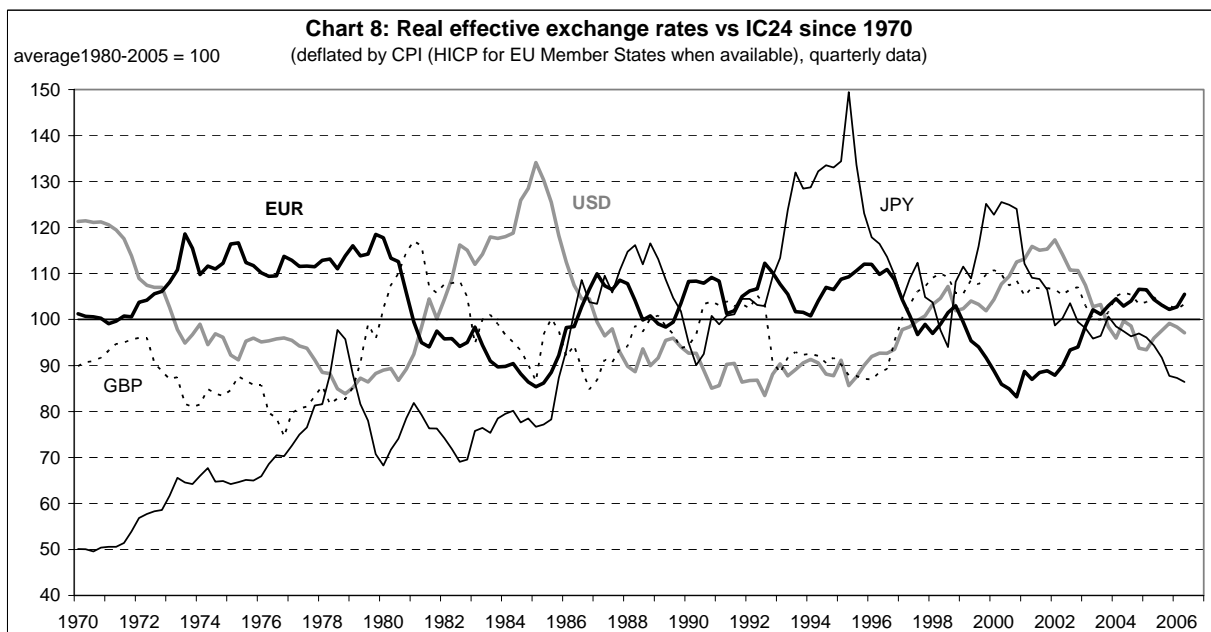


Table 3: Real effective exchange rates (CPI / HICP)
(vs. broad group (41), index average 1999 = 100)

	Most recent four quarters (quarterly averages)				Change relative to previous periods (quarterly averages)		
	Q3-05	Q4-05	Q1-06	Q2-06	previous quarter Q2-06/Q1-06	previous year Q2-06/Q2-05	medium-term avg Q2-06/avg 95-05
EUR12	103.4	101.9	101.6	104.2	2.5%	-1.1%	2.6%
USA	94.3	95.0	93.9	93.0	-1.0%	-0.4%	-5.4%
Japan	81.0	76.9	76.1	75.7	-0.5%	-9.7%	-19.6%
UK	94.5	94.3	93.1	94.3	1.3%	-2.2%	-0.3%



4. COST COMPETITIVENESS BASED ON UNIT LABOUR COSTS IN TOTAL ECONOMY

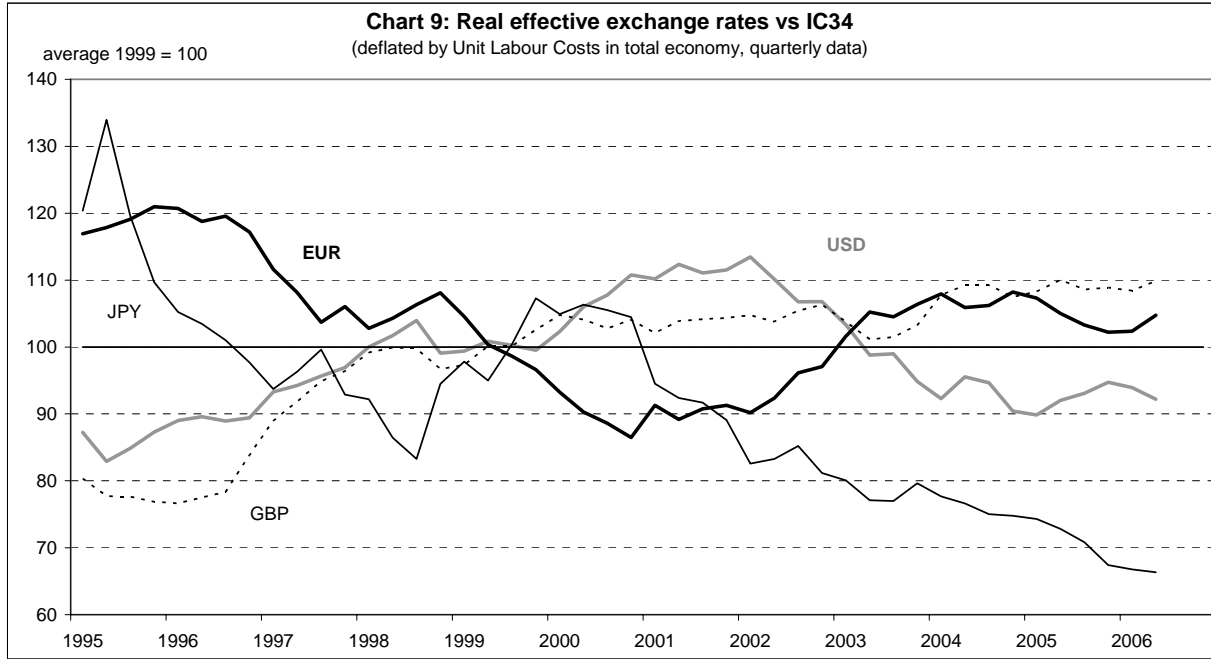
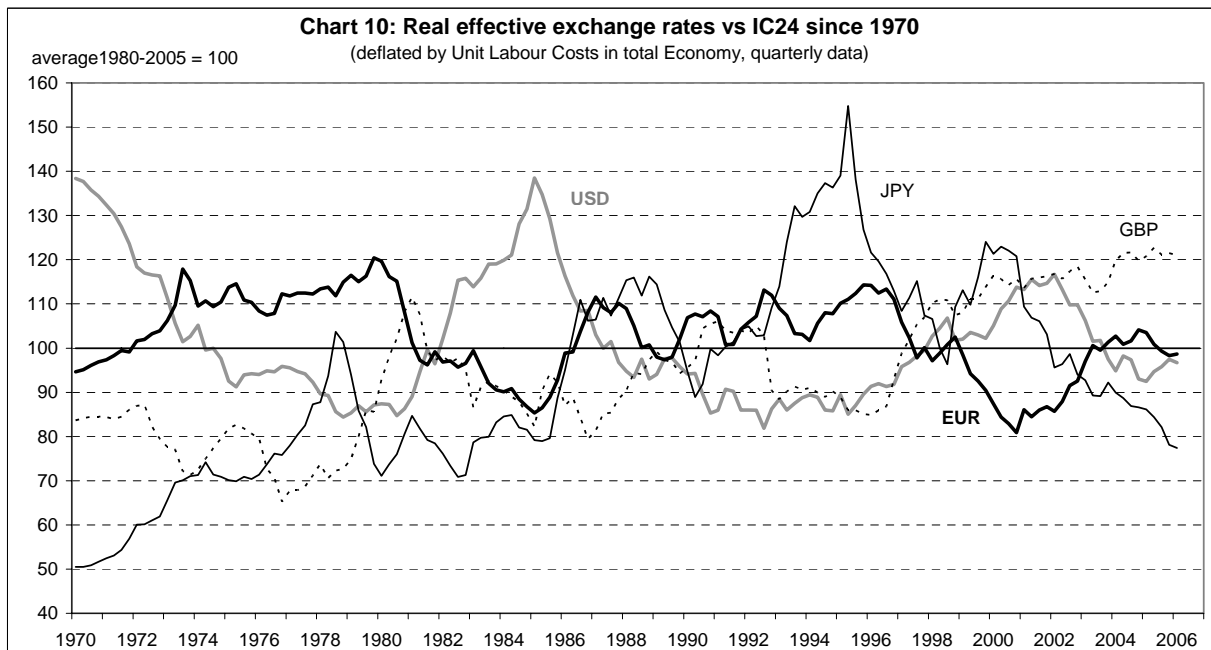


Table 4: Real effective exchange rates (ULCE)
(vs. 34 countries, index average 1999 = 100)

	Most recent four quarters (quarterly averages)				Change relative to previous periods (quarterly averages)		
	Q3-05	Q4-05	Q1-06	Q2-06	previous quarter Q2-06/Q1-06	previous year Q2-06/Q2-05	medium-term avg Q2-06/avg 95-05
EUR12	103.3	102.2	102.4	104.8	2.3%	-0.3%	1.0%
USA	93.1	94.7	93.9	92.2	-1.9%	0.2%	-6.4%
Japan	70.8	67.4	66.8	66.3	-0.6%	-8.9%	-28.0%
UK	108.6	108.9	108.4	109.8	1.3%	-0.2%	11.7%



5. COMPETITIVENESS OF THE USA AND JAPAN RELATIVE TO THE EURO AREA

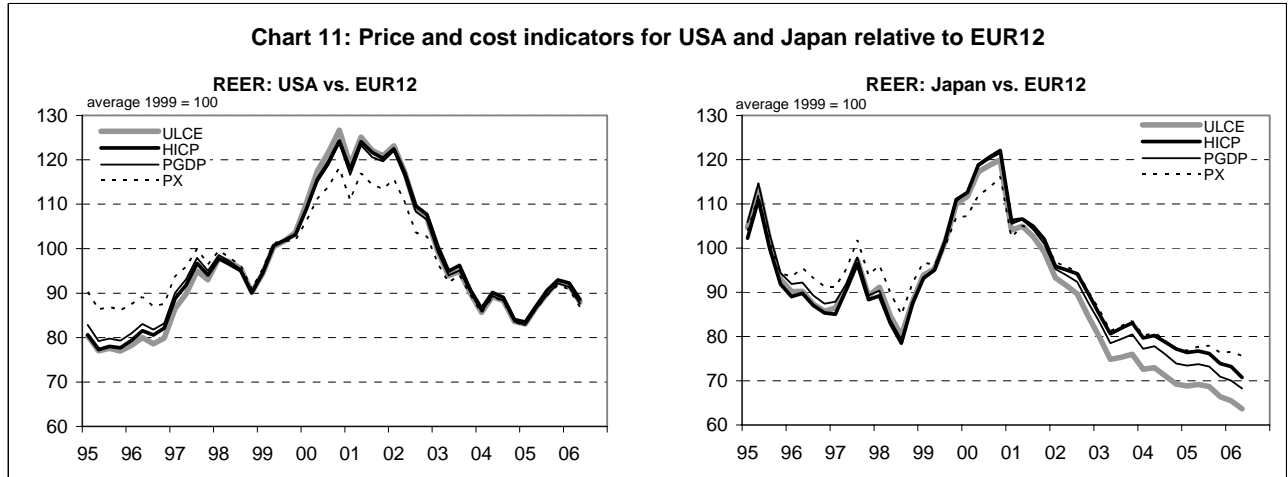
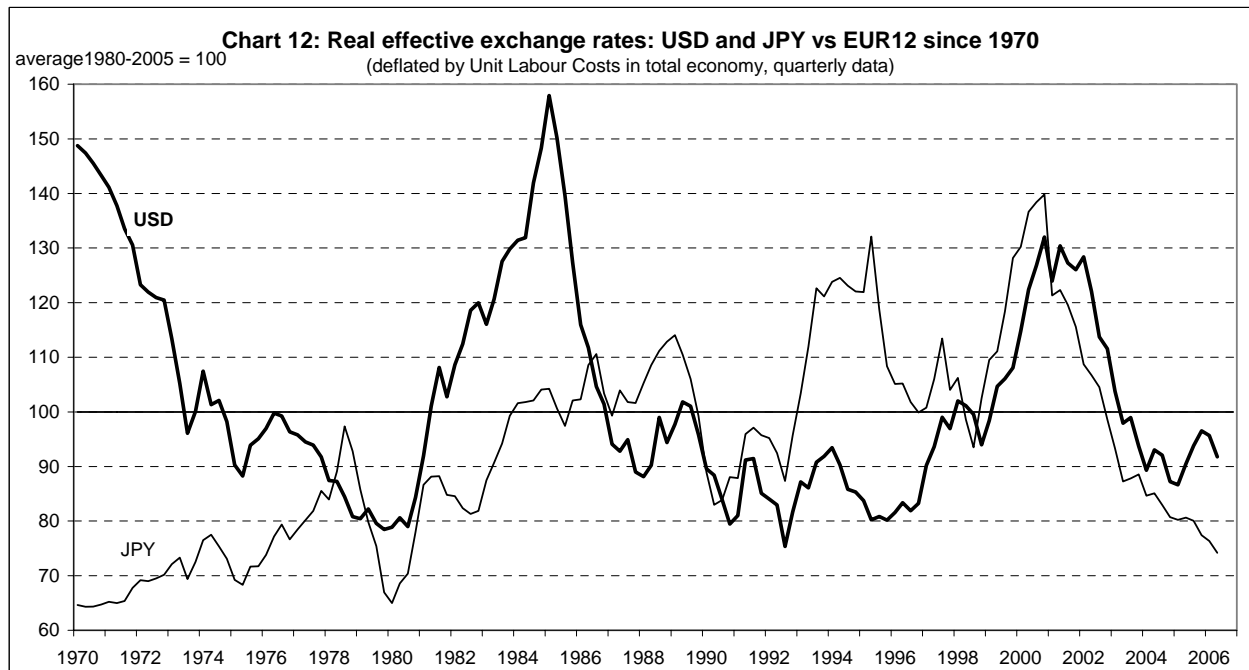


Table 5: Relative price and cost indicators of USA and Japan relative to EUR12

% change	over last quarter Q2-06/Q1-06				over last year Q2-06/Q2-05				compared to MT average (95-05) Q2-06/avg. 95-05			
	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP
USA	-4.1%	-4.1%	-4.4%	-4.0%	1.4%	1.3%	0.5%	1.7%	-9.2%	-9.9%	-10.6%	-8.9%
Japan	-2.8%	-2.6%	-1.2%	-3.3%	-8.0%	-7.5%	-2.7%	-7.8%	-29.2%	-25.7%	-19.1%	-23.2%



II. DEVELOPMENTS WITHIN THE EUROPEAN UNION

Diverging movements in costs and prices may change the relative cost competitiveness positions of Member States. With respect to the euro area, table 6 and Chart 13 show four measures of the real effective exchange rate of individual Member States against EUR12 (abbreviations for the deflators are explained in the Annex). The different measures do not always give a uniform picture of the movement over time in the real effective exchange rate of a given country against its partners and, as such, the indicators of cost and price competitiveness need to be interpreted carefully.

In some cases, deviating price and cost trends among euro area Member States could lead to a build-up of competitive imbalances which might ultimately hamper economic growth and cause unemployment in individual Member States. In other cases, however, longer-term changes in relative prices and costs may be justified by changes in economic fundamentals related e.g. to a catching-up in the level of economic development, changes in non-price competitiveness factors, or changes in underlying savings and investment patterns. Moreover, differences in cyclical positions may cause movements in relative costs and prices in the short term. This report merely provides a descriptive overview of movements in intra-euro area cost and price competitiveness indicators.

Table 6: Relative price and cost price indicators of the EU Member States vs. EUR12												
	over last quarter Q2-06/Q1-06				over last year Q2-06/Q2-05				compared to MT average (95-05) Q2-06/avg. 95-05			
Euro area Member States												
% change	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP
BLEU	-0.1%	0.2%	-0.1%	0.4%	0.3%	0.7%	0.8%	0.3%	0.1%	0.8%	6.9%	-0.1%
Germany	-0.5%	-0.4%	-0.6%	-0.7%	-2.2%	-1.6%	-2.4%	-0.2%	-10.6%	-9.0%	-9.1%	-4.6%
Greece	0.8%	0.3%	-0.2%	1.1%	2.8%	1.7%	0.0%	1.1%	8.8%	8.0%	7.7%	5.7%
Spain	0.6%	0.7%	0.1%	1.0%	1.7%	2.9%	1.2%	1.7%	6.9%	12.8%	7.3%	6.7%
France	0.3%	0.0%	0.0%	-0.1%	1.1%	-0.1%	-1.1%	-0.2%	0.9%	-2.4%	-6.3%	-1.2%
Ireland	0.4%	0.3%	0.3%	0.3%	2.4%	1.4%	0.5%	0.6%	11.6%	11.7%	-1.3%	7.0%
Italy	0.1%	0.2%	0.8%	0.7%	0.6%	0.6%	3.7%	-0.1%	8.1%	6.7%	20.7%	3.7%
Netherlands	-0.1%	-0.1%	0.7%	-0.2%	-0.4%	0.0%	2.6%	-0.6%	5.0%	4.1%	2.8%	1.9%
Austria	0.2%	0.1%	-0.2%	-0.3%	1.0%	0.6%	-0.9%	-0.3%	-2.2%	-0.2%	-1.3%	-1.5%
Portugal	0.1%	-0.1%	-0.1%	-0.1%	0.8%	-0.2%	-0.6%	0.2%	9.6%	5.4%	-0.6%	3.8%
Finland	-0.2%	-0.3%	-0.2%	-0.2%	0.0%	-0.6%	-2.0%	-0.7%	0.4%	-2.8%	-13.8%	-3.7%
Non-euro area Member States												
% change	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP
Czech Rep	0.7%	1.0%	0.1%	0.2%	5.7%	6.0%	2.0%	6.4%	32.4%	27.5%	10.0%	23.6%
Denmark	0.1%	0.6%	0.4%	0.1%	0.1%	1.8%	2.1%	-0.4%	3.1%	4.6%	6.8%	-0.3%
Estonia	0.7%	0.4%	0.2%	0.4%	2.8%	2.8%	1.6%	2.3%	16.6%	20.0%	15.9%	13.5%
Cyprus	-0.3%	-0.1%	0.5%	0.5%	0.6%	1.2%	2.5%	0.6%	5.0%	7.2%	7.6%	4.1%
Latvia	1.8%	1.3%	0.9%	0.8%	6.4%	6.2%	4.4%	4.2%	5.7%	14.4%	21.6%	6.8%
Lithuania	0.3%	0.7%	1.0%	0.1%	2.8%	3.6%	6.0%	1.3%	18.8%	22.2%	33.0%	15.4%
Hungary	-4.9%	-4.4%	-4.7%	-3.7%	-5.8%	-5.4%	-7.0%	-6.0%	18.3%	14.6%	-7.8%	13.8%
Malta	0.3%	0.5%	0.1%	4.3%	0.5%	2.2%	1.1%	1.1%	1.8%	4.6%	-1.6%	5.2%
Poland	-2.5%	-3.1%	-2.3%	-2.9%	6.6%	3.7%	3.1%	3.8%	5.4%	10.3%	14.1%	11.8%
Slovenia	0.2%	0.3%	-0.4%	0.8%	0.6%	0.7%	-0.7%	0.8%	3.0%	2.0%	0.2%	3.5%
Slovakia	0.2%	0.3%	-0.2%	-0.8%	5.2%	6.2%	4.2%	5.7%	25.5%	28.0%	12.3%	36.6%
Sweden	0.9%	0.6%	0.2%	0.6%	0.1%	-0.9%	-1.2%	-1.4%	-1.6%	-4.9%	-6.4%	-5.9%
UK	-0.1%	-0.2%	0.1%	-0.3%	-0.1%	-0.8%	0.0%	-1.6%	7.4%	2.4%	-2.5%	-3.3%

Note: relative ULCE for Italy relative to any period before 1998 are distorted by the 1998 tax reform which shifted taxation from labour costs to value added but did not significantly change competitiveness

Chart 13: Price and cost indicators for EU Member States relative to EUR12
(average 1999 = 100)

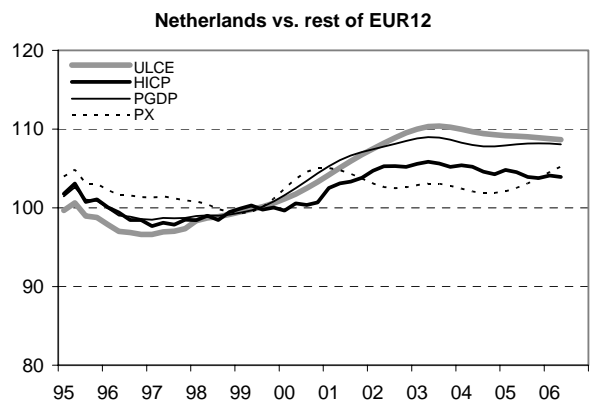
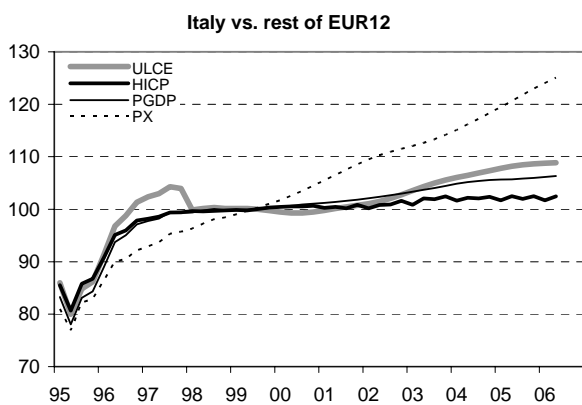
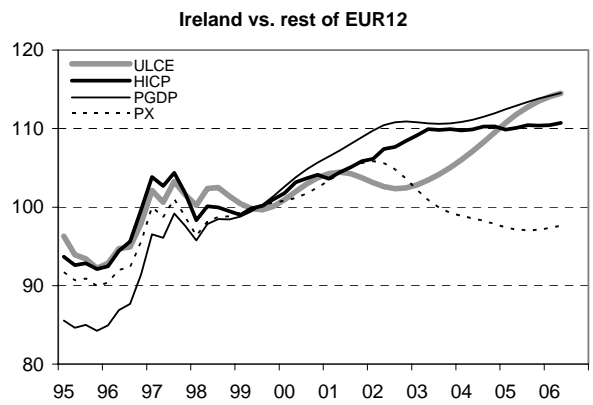
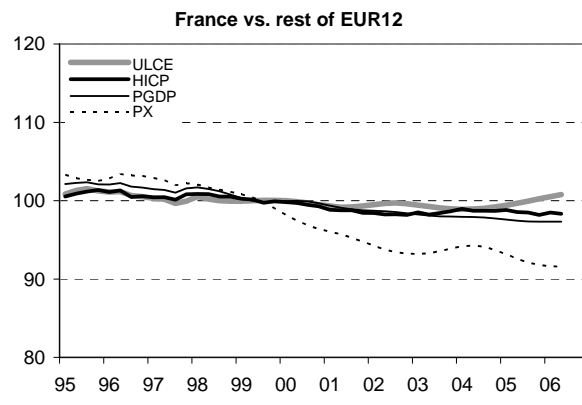
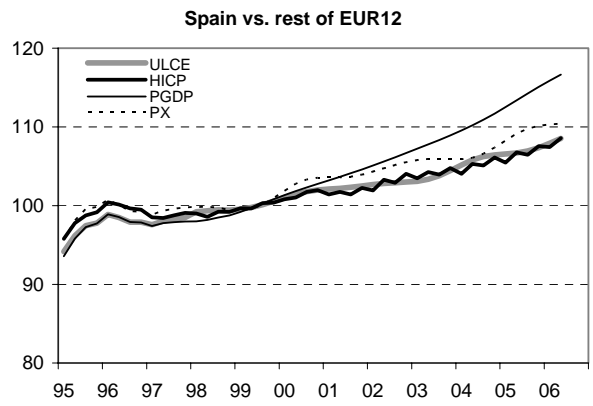
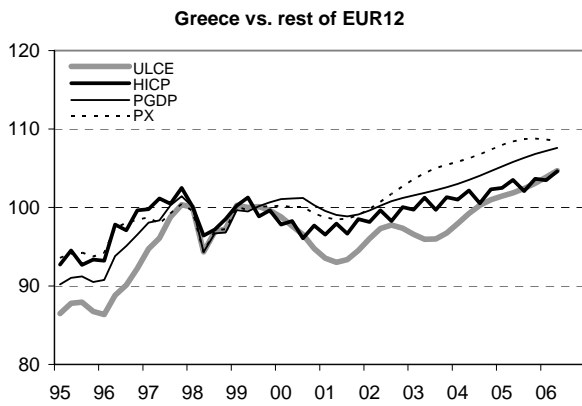
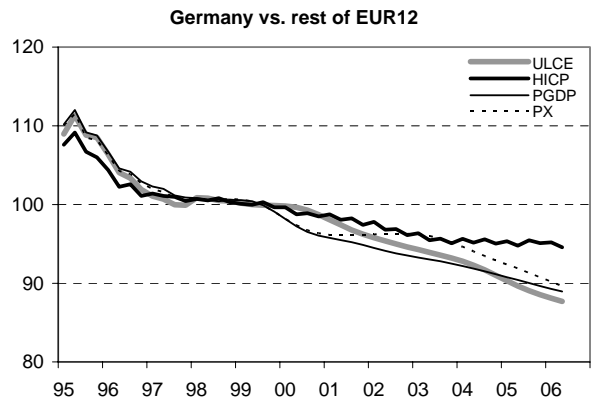
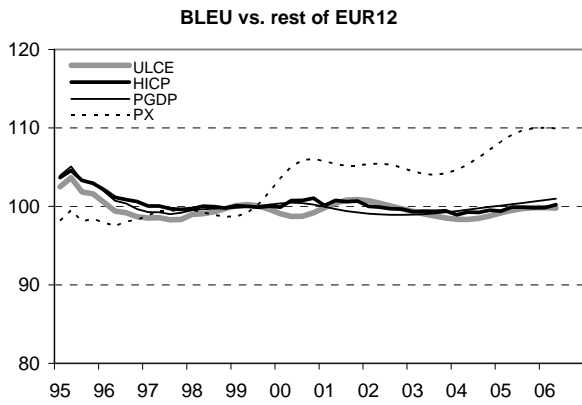
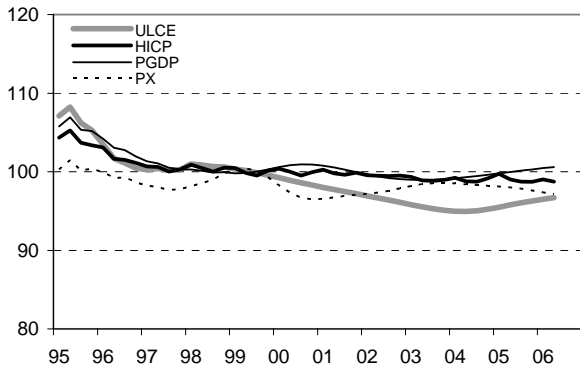
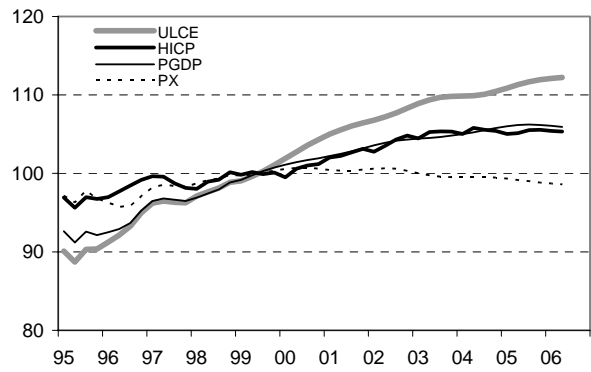


Chart 13 cont'd: Price and cost indicators for EU Member States relative to EUR12
(average 1999 = 100)

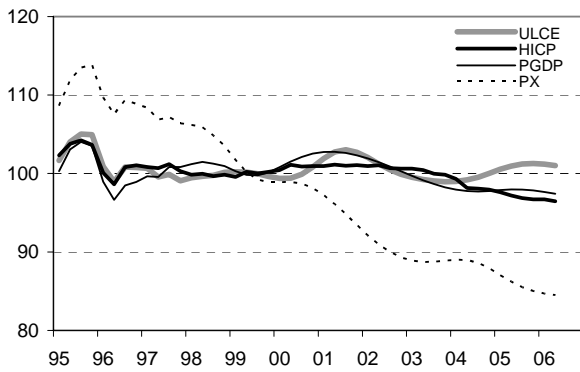
Austria vs. rest of EUR12



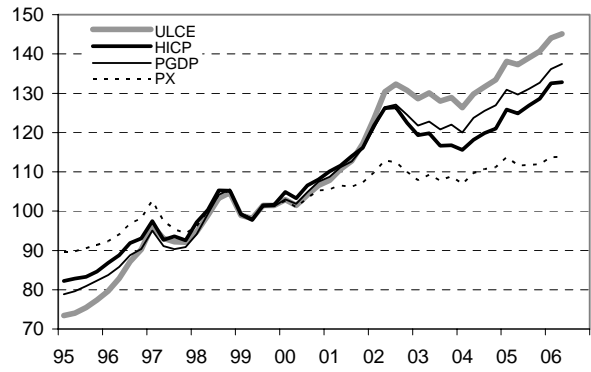
Portugal vs. rest of EUR12



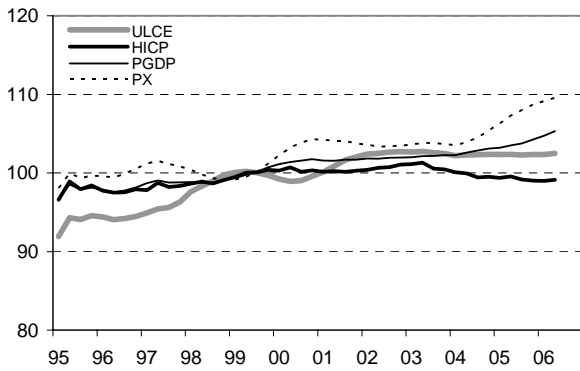
Finland vs. rest of EUR12



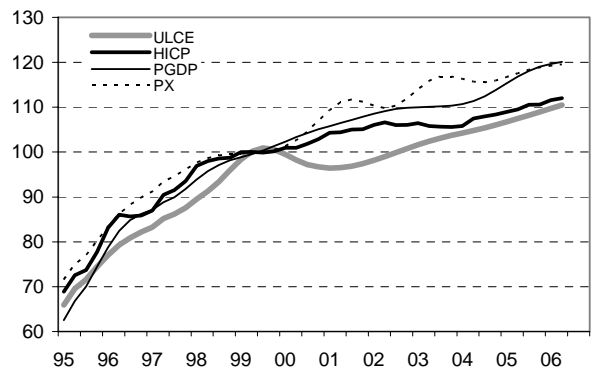
Czech Republic vs. EUR12



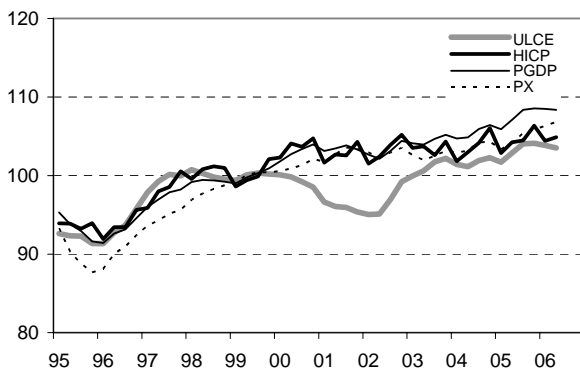
Denmark vs. EUR12



Estonia vs. EUR12



Cyprus vs. EUR12



Latvia vs. EUR12

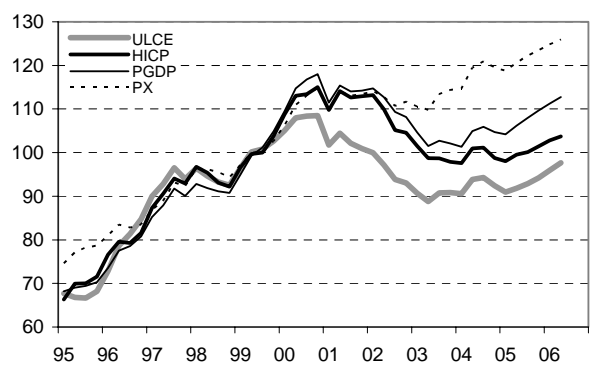
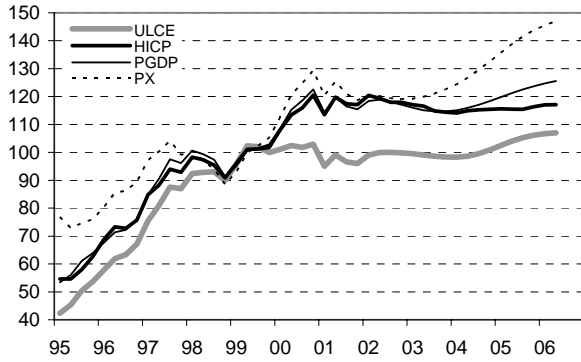
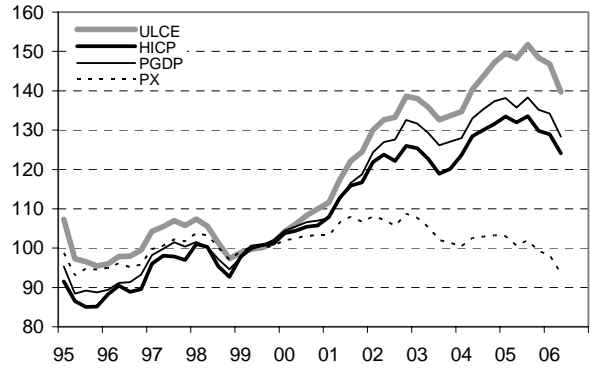


Chart 13 cont'd: Price and cost indicators for EU Member States relative to EUR12
(average 1999 = 100)

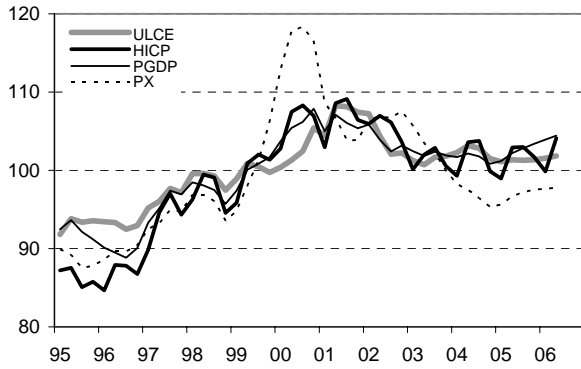
Lithuania vs. EUR12



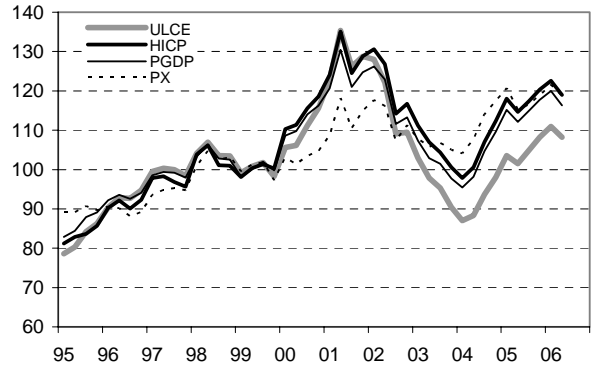
Hungary vs. EUR12



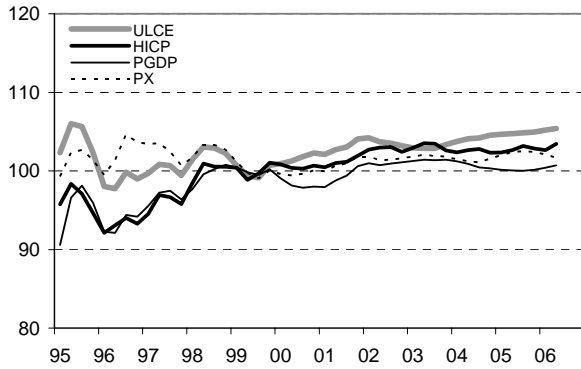
Malta vs. EUR12



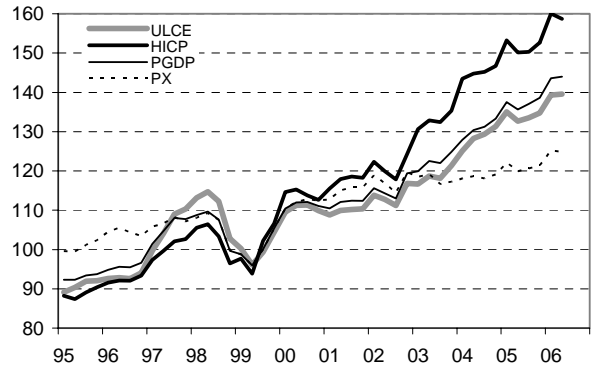
Poland vs. EUR12



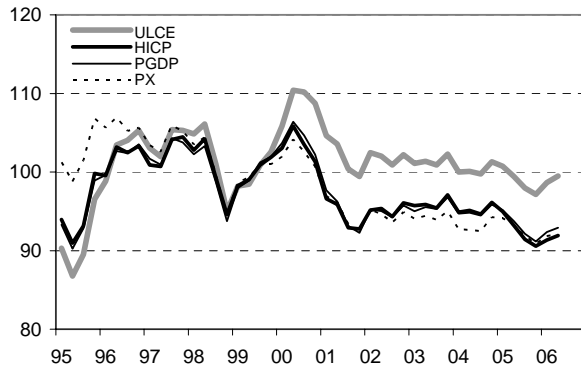
Slovenia vs. EUR12



Slovak Republic vs. EUR12



Sweden vs. EUR12



UK vs. EUR12

