Germany

A solid upturn

Economic activity continued to progress in Germany in Q4 2013, (+0.4%, up from +0.3%). Exports saw a strong increase (+2.6%). Investment in construction remained highly dynamic (+1.4%), while investment in equipment picked up in pace (+1.4%, up from +0.1%). Nonetheless, household consumption fell slightly (-0.1%), slowing total activity.
The business tendency surveys suggest that activity should pick up in Q1 2014 (+0.8%), bolstered by the rebound of household consumption and the dynamism of investment in construction. Growth should remain solid in Q2 (+0.5%), despite a slowdown in the construction sector.

Morale is high among business leaders and consumers

According to the business tendency surveys, business leaders remain optimistic in early 2014: in February, the Ifo business climate index reached its highest level since 2011. Activity should thus accelerate in Q1 2014 (+0.8%). Similarly, the GfK consumer confidence barometer is at its highest level since 2007 (*see Graph*). However, household consumption dropped off slightly in Q4 2013 (-0.1%). This decline should only be temporary, and households should increase their consumption expenditure in H1 2014 (+0.6% and +0.4% respectively for the first two quarters).

A winter conducive to construction

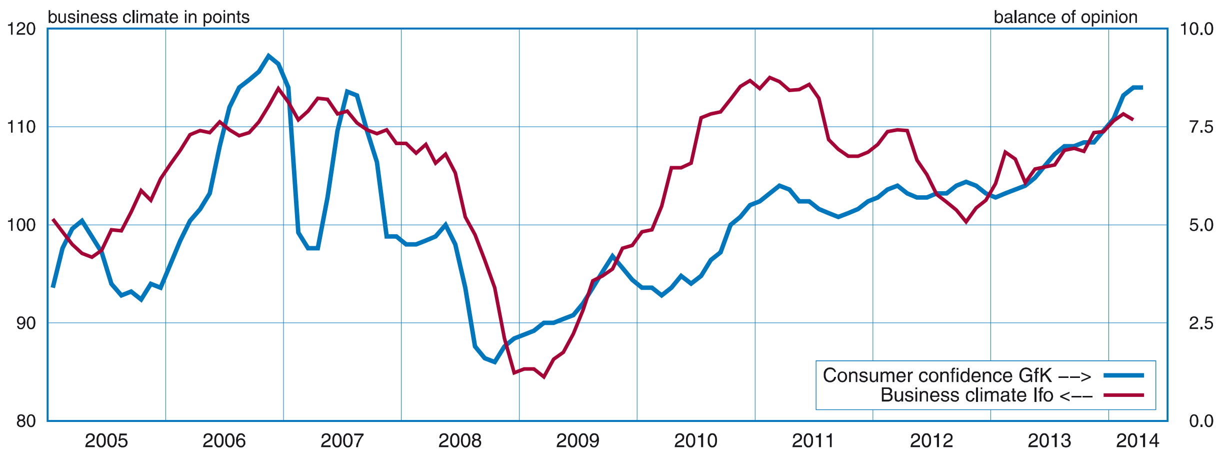
In December and January temperatures were almost two degrees above the seasonal average, allowing for more dynamic production in the construction sector (data corrected for seasonal variation). Investment in construction should therefore increase significantly in Q1 2014 (+2.0%), before stabilising in Q2 in reaction.

Investment in equipment increased again in Q4 2013 (+1.4%). This rebound should persist (+1.6% per quarter in H1 2014), as indicated by equipement orders already on the books, and as is to be expected given the increase in the production capacity utilisation rate.

Exports remain dynamic

Exports progressed much more rapidly than imports in Q4 2013 (+2.6% and +0.6% respectively). In light of the strong results from the export order surveys, exports should remain dynamic (+2.0% in Q1 and +1.5% in Q2 2014). Imports should become more dynamic in H1 2014, in line with the acceleration of private consumption and the rebound in investment in equipment.■

Business leaders and consumers confidence



Sources: Ifo, GfK

Italy

A tentative recovery

Economic activity in Italy increased by 0.1% in Q4, ending nine consecutive quarters of contraction. Between now and mid-2014, activity should grow by 0.2% per quarter, bolstered by the gradual recovery of household consumption and investment in equipment.

A clear improvement in the business climate

The business tendency surveys have continued to improve since the start of the year, and activity should show a moderate upturn in H1 2014 (+0.2% per quarter). The national surveys are at their highest level for two years in the manufacturing industry and service sector, but remain lacklustre in the construction sector. The composite Purchasing Managers Index (PMI) indicates that this trend broadly holds true, with the manufacturing industry continuing to expand and the service sector seeing its biggest increase in almost three years this February. Furthermore, various surveys indicate that an improvement in domestic and overseas order books is imminent.

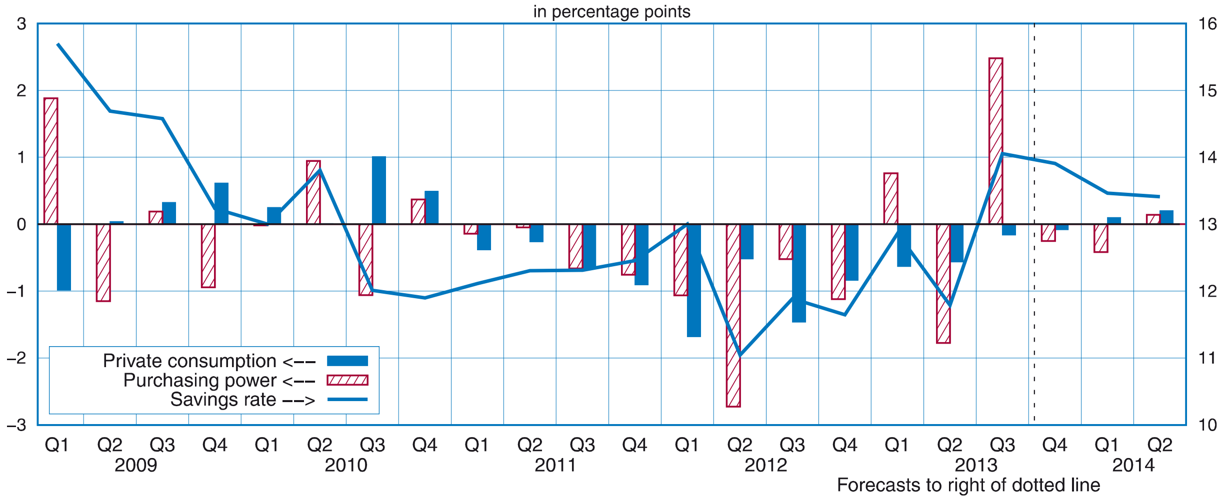
Investment in equipment should pick up

The improvement seen in the conditions of access to bank loans for business should help stimulate an upturn in investment rendered necessary by the need to renew production capacities. Investment in equipment should show a marked increase (+1.4% per quarter over the forecasting period, up from -0.2%), while investment in construction should continue to decline (-1.0% in Q1 and -0.5% in Q2). Furthermore, exports should remain dynamic (+1.0% per quarter in H1 2014), bolstered by the rise in global demand for Italian products.

Household consumption should pick up slightly

The new government led by Matteo Renzi has set itself a goal of "restoring hope" to the Italian people, whose purchasing power has been decreasing since 2011 due to an increased tax burden and poor conditions on the labour market. The government has therefore vowed to lighten the fiscal burden on households and companies, a move which will be only partially offset by a reduction in government spending. The purchasing power of households should therefore shrink less rapidly than before. The household saving ratio, which hit a very high level in Q3 2013, should have decreased in the early months of this year, and consumption should rebound slightly in H1 2014 (+0.1% in Q1 and +0.2% in Q2, *see Graph*).■

Purchasing power, household consumption and savings



Sources: ISTAT, INSEE calculations

Spain

Growth slowly starting to consolidate

The Spanish economy confirmed its move out of recession in Q4 2013 (+0.2% after +0.1%), supported by increased foreign trade (a contribution of +0.4 points) and dynamic private sector consumption. On the other hand, government consumption expenditure dropped off substantially. According to the business tendency surveys, economic activity in Spain should continue to grow at a moderate pace in H1 2014 (0.3% per quarter). This economic rebound should be primarily attributable to the dynamism of domestic demand. On the one hand, household consumption should increase thanks to the decline in precautionary saving. On the other hand, the dynamic increase in investment in equipment seen since mid-2013 should continue into mid-2014. However, foreign trade should make only a slight contribution to this growth, with imports strengthened by the upturn in domestic demand.

Consumption should remain dynamic

In 2013, the purchasing power of Spanish households seems likely to have declined for the fourth consecutive year. It should increase slightly by mid-2014, with the increase in nominal income being only slightly offset by inflation, which should stabilise at a very low rate. In reaction to the reduction in the household tax burden and the stabilisation of the labour market, Spanish households should reduce their precautionary saving. Consumption should thus increase in the first two quarters of 2014, as indicated by the recent developments in consumer credit.

Investment in equipment should pick up again

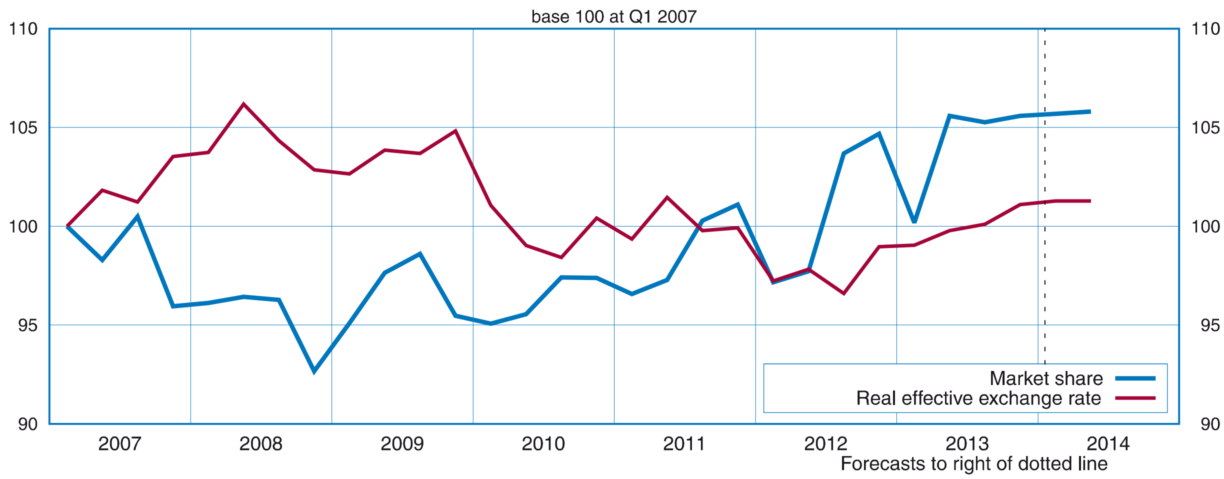
In early 2014, the construction sector should continue to contract but only at a greatly reduced rate, as suggested by the recent stabilisation of the short-term indicators. The period of adjustment experienced by the property market (started in 2008) should now be reaching its conclusion, while the decline in public investment should diminish.

Investment in equipment should continue to grow rapidly, bolstered by the recovery of the profit margins of Spanish businesses and the high production capacity utilisation rate ushered in by the period of adjustment that started in 2009 (-24%).

Spanish exporters continue to expand their market share

Since mid-2009, Spanish exports have been very dynamic. In 2013, they progressed by 4.9%. Exports should continue to progress in H1 2014 (+1.2% per quarter), at a rate slightly higher than that of global demand for Spanish goods, as Spain continues to gain market share at the same rate seen in recent years (*see Graph*). Meanwhile imports should see a marked increase, galvanised by the recovery of domestic demand. All in all, for the first two quarters of 2014, the contribution of foreign trade to Spanish growth should be positive, but only slightly.■

Market share and Real effective exchange rate



Sources: INE, DG Trésor

United Kingdom

United Kingdom on a roll

Economic activity in the United Kingdom saw a clear surge in 2013 (+1.8% after +0.3% in 2012). In early 2014, the business climate remains favourable and the recovery is not expected to run out of steam in the first six months of the year. By late June, British GDP should have returned to its level of Q1 2008. The construction industry should perform dynamically, particularly the residential property sector, supported by the government's "Help to Buy" scheme. Furthermore, consumption should pick up pace thanks to a rebound in wages, a reduction in unemployment and the wealth generated by rising house prices. The resulting short-term disparity between the United Kingdom and its principal trading partners, coupled with the recent increase in the strength of the pound, should be reflected in a negative contribution of foreign trade to overall activity growth in H1 2014.

Business tendency surveys at their highest levels for years

Activity remained dynamic in the United Kingdom in Q4 2013: +0.7% after +0.8% in Q3. Growth should remain strong across the forecasting period (+0.7% in Q1 2014 and +0.6% in Q2). Indeed in February the composite indicator compiled from the European business surveys was at its highest level since 1989 (116.9), and the PMI surveys also remain high. Activity should be dynamic across all sectors, particularly in the construction sector due to the improvement in lending conditions and the effects of the government's "Help to Buy" programme and the upturn in public sector investment. By late June, the growth overhang for the year 2014 should be +2.3%.

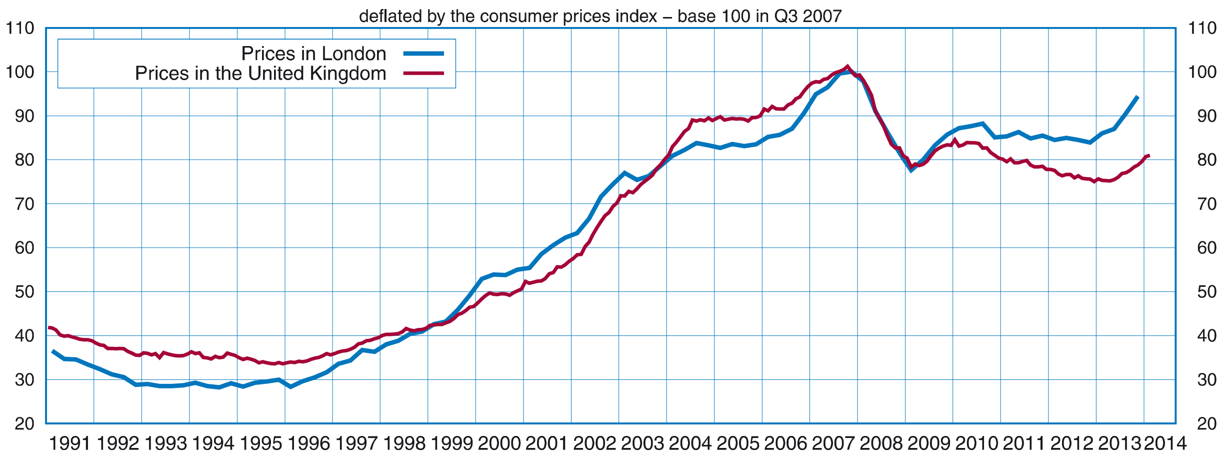
Consumption and investment remain solid

In 2013, household consumption increased by 2.4%. It should accelerate substantially in Q1 2014 (+0.9% after +0.4% in Q4). On the one hand, household purchasing power should benefit from the moderate rate of inflation and the increase in wages. On the other hand, the saving ratio should continue to fall thanks to the fall in unemployment (from 7.2% in Q4 2013 to 6.8% in Q2 2014) and the wealth generated by the dynamism of property prices, particularly in London (*see Graph*). As for business, the rise in production capacity constraints and the very high level of the industry order book surveys suggest that investment should remain dynamic. However, after two years of very modest improvement in the structural budget deficit (around 0.3 points per year), budgetary consolidation efforts should be stepped up and public sector consumption should see only a slight increase.

Negative contribution from foreign trade

Over the past two years the increase in exports has been modest, and the UK's market share continues to shrink. The strong pound should continue to hinder competitiveness. Exports should therefore progress much more slowly than international trade in general in H1 2014. Bolstered by the dynamism of domestic demand, imports should increase significantly and the contribution of foreign trade should thus be negative.■

Real property prices, in the United Kingdom and in London



Sources: ONS, Nation Wide

United States

Despite the cold, the engine keeps on running

Activity slowed in the USA in Q4 2013 (+0.7% after +1.0%), a result of the Federal "shutdown" in early October and the decline in property investment. Despite extreme weather conditions in early 2014, GDP should continue to grow slightly in H1 2014 (+0.5% then +0.6%), sustained by a rebound in the residential property sector and robust household consumption. Furthermore, thanks to the budget voted through Congress at the start of the year, budgetary pressure will be much less restrictive in 2014 than it was in 2013.

More clement budget conditions, but production feels the cold in January

Fiscal policy was highly restrictive in 2013, and the deficit shrank from 9.3% in 2012 to 6.4% in 2013. However the 2014 budget, approved by Congress in January, has significantly reduced the automatic cuts: all in all, federal spending, which declined sharply in Q4 2013, should bounce back in H1 2014.

Activity should nonetheless be mitigated in Q1. After making considerable progress in H2 2013, manufacturing output fell by 0.9% in January as a result of the extreme weather conditions (see Graph). Nonetheless, output bounced back in February (+0.8%) and the business tendency surveys suggest that the industrial expansion is set to continue.

Unemployment should continue to fall

Employment should remain dynamic, with the unemployment rate (6.7% in February) declining further between now and mid-2014. The reduction in unemployment should see wages waver, while profit margins, which have reached a very high level, should stabilise. Finally, inflation should remain low in Q2, at a year-on-year rate of 1.7%. All in all, household purchasing power should see a clear improvement. Nonetheless, household consumption should slow down slightly: the saving ratio, which dropped off markedly in late 2013 as a result of the rise in asset prices, should stabilise by mid-2014.

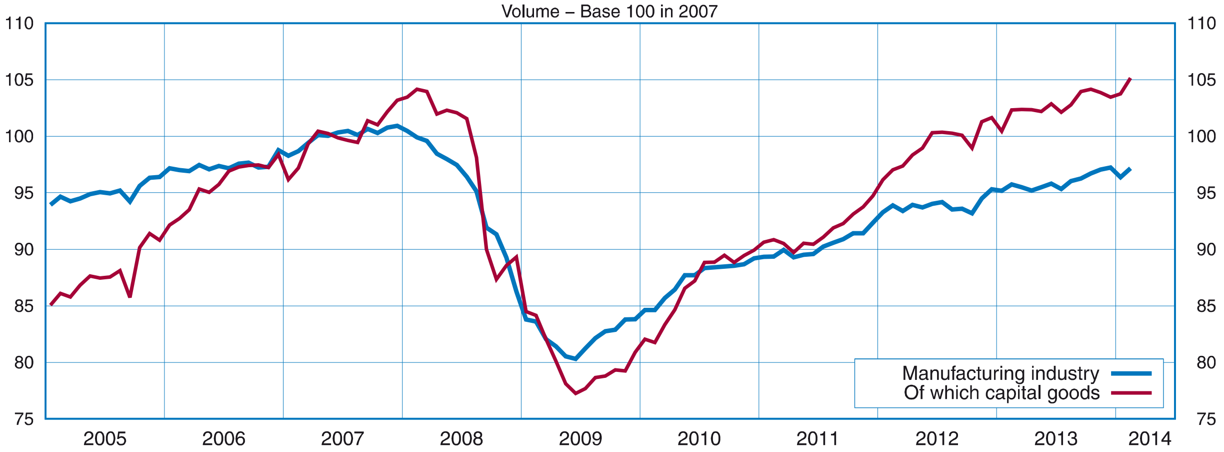
The residential property sector should see a rebound

In Q4 2013, investment in the residential sector fell for the first time in three years. The increase in interest rates in spring 2013, following the announcement of the reduction of the Fed's stimulus efforts, applied the brakes to the ongoing recovery. Nonetheless, unsold housing stocks are low and the number of new projects breaking ground increased towards the end of the year: investment in the residential property market should rebound in H1 2014. As for businesses, investment should slow down under the influence of new fiscal legislation: since 1st January, businesses no longer have the option of claiming a bonus depreciation deduction on new equipment purchases.

Exports picked up in Q4 2013, and should slow in line with the general global trend. Imports, which have been less than dynamic for the past year, should increase again in line with domestic demand, with foreign trade no longer propping up activity.■

Output blocked by the weather conditions in January

Volume – Base 100 in 2007



Source: Federal System Reserve

Japan

Fiscal consolidation

Economic activity in Japan grew more slowly than predicted in H2 2013 (+0.2% per quarter). While domestic demand was very dynamic, exports stagnated to the extent that the contribution of foreign trade to total activity was strongly negative. Over the forecasting period, Japanese fiscal policy should become restrictive: the stimulus plans should become less intensive, and VAT is set to rise from 5% to 8% on 1st April 2014. Due to the effect of advance purchasing of durables, activity should accelerate in Q1 2014 (+0.8%), before contracting in Q2 (-0.8%).

VAT increase on 1st April 2014

The macroeconomic stimulus policy launched by Shinzo Abe's government has been providing substantial support to activity and prices for the past year. In January inflation hit 1.4%, a rate rarely seen in recent years, while unemployment stood at 3.7%, its lowest level since 2007. The business tendency surveys available for Q1 2014 go as far as February, and remain positive, particularly in the industrial sector. On the other hand household confidence is shrinking, most likely in anticipation of the increase of VAT from 5% to 8% on 1st April, which has prompted households to bring forward their purchases of durables goods (*see Graph*) and investments in property. Furthermore, the government stimulus based on public spending should begin to wane.

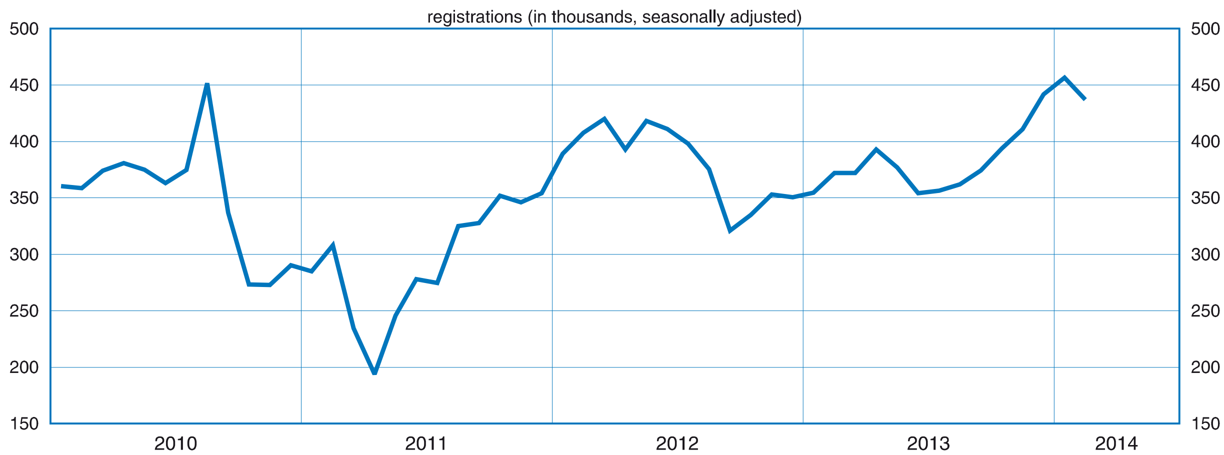
Upturn in corporate investment

Corporate investment picked up in Q4 2013 (+0.8% after +0.1%). This rebound in investment was later in coming than the rebound in activity, as companies first turned to their unused production capacities. However, in December the production capacity utilisation rate returned to its early-2012 level. Investment in production should remain dynamic in H1 2014, supported by the improvement in the business outlook and the reduction in corporation tax which comes into effect on 1st April.

Modest increase in exports

In 2013 exports grew by 1.6%, a modest increase given that the yen was devalued by almost 25% against the dollar at the start of the year. Exports should pick up steam in 2014, but not enough to offset the losses sustained in relations with China following the territorial dispute over the Senkaku-Diaoyu islands. At the same time, imports should reflect the fluctuations in domestic demand and, as an average over H1 2014, the trade deficit should stabilise at around 2% of GDP, its highest level for forty years.■

At the end of 2013, household brought forward their purchases of automobile



Source: Japonese association for automobile constructors

Emerging economies

Experiencing turbulence

After a disappointing H1, activity seems to have picked up in the emerging countries in H2 2013. This dynamism has been reflected in a vigorous rebound of imports, which grew by an average of 2.0% per quarter.
Activity looks likely to slow slightly over the forecasting period, partly as a result of the observed tightening of monetary policy. After a first shock last summer, the majority of emerging-market currencies lost value again in January, as the policy of quantitative easing comes to an end in the USA and the central banks tighten their monetary policies accordingly. In this context, the business climate remains below its pre-crisis level in the majority of emerging economies. Only the economies of the European Union's easternmost members, boosted by the European rebound, look likely to remain strongly dynamic between now and mid-2014.

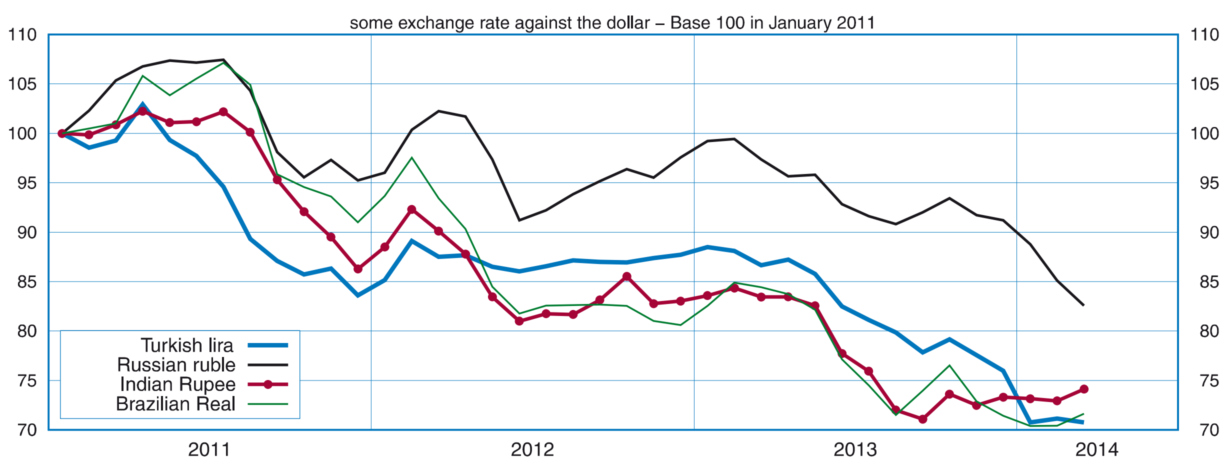
Uncertainties in China

Activity slowed down in China in Q4 2013 (+1.8% after +2.2% in Q3), and year-on-year GDP growth reached +7.7%. In Q1 2014, according to the business tendency survey and the energy consumption survey, activity should continue to slow. The Chinese central bank was forced to intervene and inject liquidity into the interbank market twice in December (300 billion Yuan - approximately €35 billion) and January (255 billion Yuan) in order to soothe tensions stoked by fears of a default by an investment fund managed by China's largest bank. Since mid-2010 the authorities have adopted a stricter monetary policy in order to restrict the rise in outstanding loans, which in the short term is stimulating the upturn in the property market and particularly the rise in house prices. As a result, according to the most recent data available, lending is slowing down. In February the rise in house prices hit 15.9% in Beijing and 12.1% in Shanghai for the year, but prices have been stagnating for the past two months after slowing considerably in December.

Second exchange rate crisis in a year for the largest emerging economies...

Last summer the perspective of a slowdown in money creation in the USA led to a first wave of withdrawal of capital invested by private investors in emerging economies, and a sudden depreciation of their currencies, particularly in those countries with a high current deficit (Brazil, India, Indonesia, Turkey). After a period of calm in H2 2013, capital withdrawal picked up again in December, leading to another slump of both the markets and the currencies, particularly in Russia, Turkey and Argentina (see Graph 1). The central banks have intervened on the foreign exchange market and further tightened their monetary policies (Turkey, Indonesia, Russia, Brazil, India), against a backdrop of inflationary tensions.

1 - Emerging-market currencies plunging against the dollar



Sources: IMF

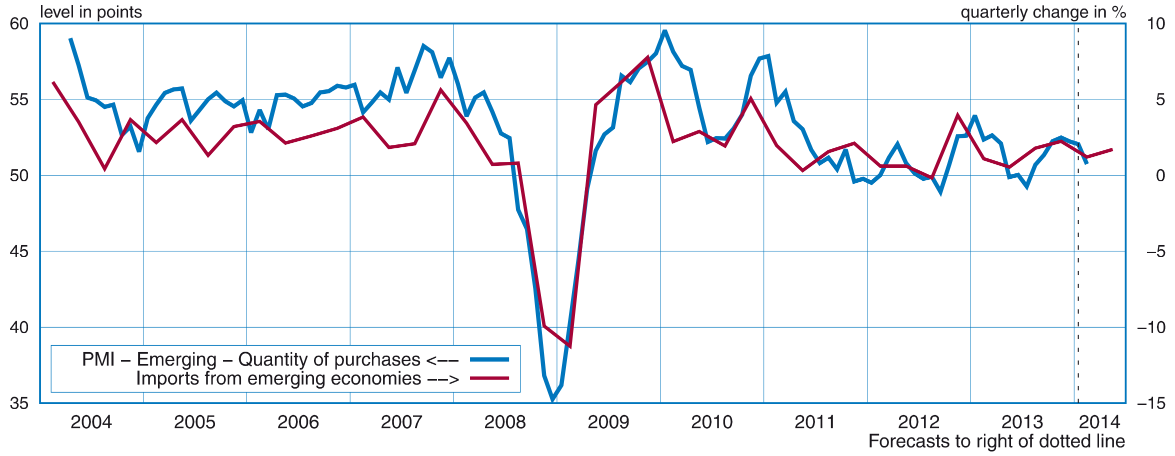
… and a slowdown in imports

Despite an acceleration towards the end of the year, activity in the emerging economies slowed over 2013 as a whole: growth fell to 4.6% after 4.9% in 2012. However an increase in imports (+6.1% after +4.5%) was sustained by robust domestic demand and the contribution of foreign trade was generally negative. In early 2014 the business climate took another turn for the worse (see Graph 2), despite already being well below the average seen in the last decade. Imports are not expected to maintain their late-2013 rate and should slow (+1.2% then +1.7% in the first two quarters of 2014). Exports, however, should be stimulated by the depreciation of the currencies and the acceleration of demand in the most advanced economies: the contribution of foreign trade should thus edge into the positive over this forecasting period, particularly in those countries with a high current deficit. For example, in India this January, imports were down by 18.1% over the year, with exports rising by 3.8%.

Acceleration in CEE

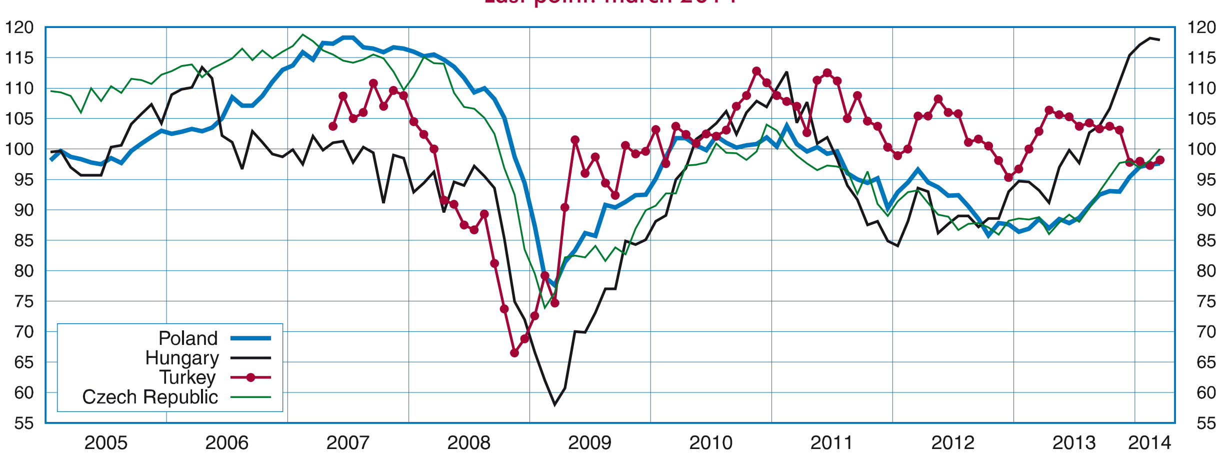
In Russia, GDP grew at a rate of +1.3% in 2013, its lowest level since 2009. For Q1 2014, industrial production overhang at the end of February is clearly negative (-0.9%) and the business climate has worsened: the PMI indicator for industry stood at 48.5 in February, up from 48 in January, its lowest level since 2009. In late February the Ukrainian crisis caused the rouble to fall again, while also stimulating an increase in Russia's base interest rates from 5.5% to 7.0%. Eastern Europe, on the other hand, should see a rebound bolstered by the pick-up in activity in the Eurozone. According to studies published by the European Commission, the composite business climate indicator is at its highest level since 2002 in Hungary, and is close to getting back to its long-term average in Poland and the Czech Republic (*see Graph 3*). Finally, the business climate in Turkey clearly indicates a slowdown in activity following the rebound of 2013. The depreciation of the Turkish lira has made commodities more expensive, while the severe increase in base rates (550 base points in January) should limit the increase in lending. ■

2 - Imports for emerging countries should slow



Source: Markit, Centraal PlanBureau, calculations and forecasts INSEE

3 - Synthetic index of business climate : Central and Eastern Europe and Turkey
Last point: march 2014



Source: DG ECFIN