Germany

Germany consuming at long last

Despite the downturn in investment and the slowdown in exports, German economic activity remained resilient in Q3 2015 (+0.3% after +0.4%) thanks to the dynamism of household consumption and government consumption. In this forecast, activity is expected to pick up gradually (+0.4% in Q4 2015 and in Q1 2016 then +0.5% in Q2 2016), once more buoyed by consumption. Yearly average growth in GDP is expected to stand at +1.5% in 2015 after +1.6% in 2014. The carry-over effect for 2016 following the first half-year is expected to be +1.4%.

Consumption gathers pace

German activity, after having grown by 0.3% in Q3 2015, is expected to continue growing by + 0.4% in Q4 2015 and Q1 2016 and then to pick up slightly in Q2 2016 (+0.5%), once more buoyed by private and government consumption.

Household consumption picked up strongly in Q3 2015 (+0.6% after +0.1%), encouraged by the low unemployment rate (4.5%) and purchasing power gains boosted by the fall in energy prices and the introduction of the minimum wage (Focus). Government consumption also picked up in the summer (+1.3% after +0.7%).

In Q4, consumer confidence is still at a high level and car registrations and retail sales remain favourable. Household consumption is therefore likely to remain dynamic (+0.5%). It is expected to continue at this pace in H1 2016, stimulated by purchasing power gains, from wages in particular.

Government consumption is also expected to remain constant (Graph), as a result of the expenditure necessary for receiving numerous refugees onto German territory (900,000 people in 2015 and 600,000 in 2016 according to German economic research institutes).

An investment recovery on the horizon

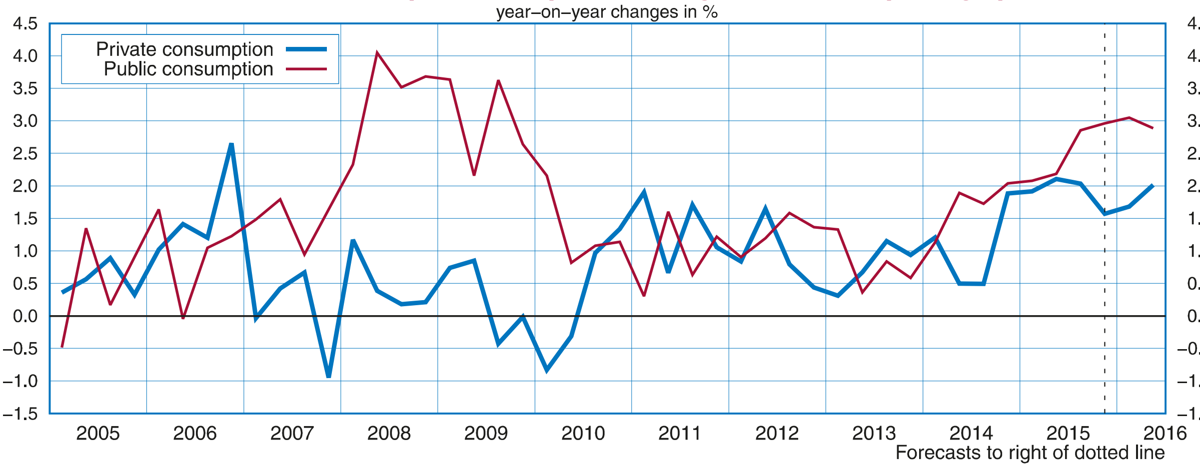
However, investment declined once more in Q3 (-0.3% after -0.4%), both in capital goods (-0.8% after +0.5%) and in construction (-0.3% after -1.3%). But with a high production capacity utilisation rate and relatively well filled order books, companies are expected to increase their expenditure once more between now and mid-2016 (+1.2% in Q4 then +0.7% per quarter). Investment in construction should be stable in Q4 2015 and then bounce back in H1 2016 (+0.6% per quarter).

Exports expected to regain momentum

In Q3 2015, while imports picked up (+1.1% after +0.5%), exports came to a standstill (+0.2% after +1.8%). Foreign trade thus contributed negatively to growth (-0.3 points).

In Q4, exports are likely to get back on track (+1.0%) in response to world demand for German products and should remain dynamic in H1 2016 (+1.1% per quarter). Imports are likely to grow at a comparable pace, and the contribution of foreign trade is expected to be neutral between now and mid-2016. ■

German consumption, both private and government, is picking up



Source: Destatis

The German minimum wage: a more diffuse effect than expected

In the December 2014 issue of *Conjoncture in France*[1], the effects of introducing a minimum wage of €8.50 per hour in Germany on 1st January 2015 were anticipated mainly on the basis of the assumptions made by the main German economic research institutes. The scenario selected showed a sharp increase in wages as early as Q1 2015, before a return to a trend growth rate from Q2 2015 onwards.

A more gradual rise in wages than predicted

The data published since then in the German quarterly accounts reveal per capita wage growth that was lower than expected in Q1, then higher in Q2. In Q1 2015, per capita wages accelerated only slightly (+0.8% after +0.7%) where an increase of 1.4% was expected, with +1.1 points of the forecast attributed to the introduction of the minimum wage. In Q2, on the other hand, wages accelerated, increasing distinctly more than their trend rate (+1.2% against +0.3% on average before 2015).

It therefore seems that the effect of the introduction of the minimum wage is more diffuse than expected. On the one hand, the sectors which until 2014 had lower negotiated minimum wages have two years to come into line and, in accordance with collective agreements, the entry into force of the minimum wage will be staggered from 1st January 2015 to 1st January 2017. Some sectors have therefore chosen to increase minimum wages gradually, thus smoothing the general increase in wages over the period. As an example, the minimum wage in temporary work agencies in East Germany rose to €8.20 per hour on 1st April 2015 and will not rise to €8.50 until 1st June 2016.

On the other hand, some companies appear to have anticipated the introduction of the minimum wage by increasing wages before 1st January 2015, as the estimate for Q4 2014 (+0.7%) proved to be much more dynamic than its trend.

The increase in low wages seems to have been partially offset by the slowdown in the highest wages in Q1

The survey on per capita wages published by Destatis offers another explanation: the pay of unqualified workers rose sharply in Q1 2015, in line with what was expected with the minimum wage (*Graph*). Similarly, the rise was marked for employees in the former East Germany and those in non-standard employment. But these upward effects seem to have been partially offset by a slowdown in wages in the other categories, which are theoretically less concerned by the minimum wage, in particular executives.

In Q2 2015, year-on-year wages accelerated for all categories but the same differential in dynamic was observed, with wages for the least qualified workers once more increasing more rapidly than those of executives. The same applied to the disparity in dynamic between employees in the East and the West, and between those in non-standard employment and in full-time employment; in particular the wages of "minijobbers" was 25% higher than one year earlier.

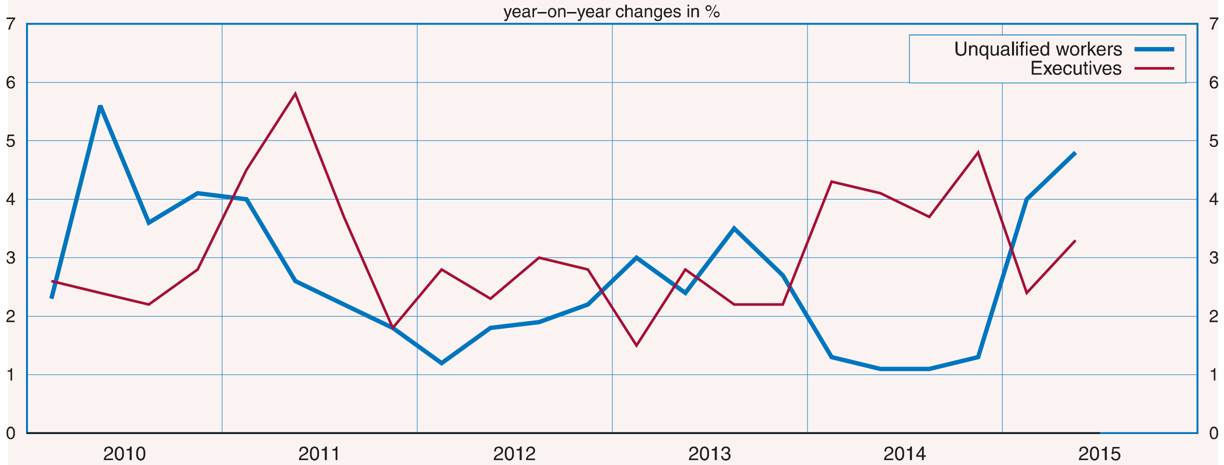
Wages should rise vigorously between now and mid-2016

In all, the effect of the introduction of the minimum wage seems to be spreading more gradually to German wages and companies have partly offset it in the other categories of employees. Bearing these factors in mind, wages are likely to remain dynamic over the forecasting period (+0.7% per quarter through to mid-2016). ■

[1] "Introduction of a minimum wage in Germany", *Conjoncture in France*, december 2014, p. 107.

Growth in wages by profession

year–on–year changes in %



Sources: Destatis, wages survey

Italy

The Jobs Act boosts employment

Italian activity grew again in Q3 2015 (+0.2% after +0.3%), confirming the recovery that began early in the year. Household consumption confirmed its renewed vigour, but investment in capital goods and exports stumbled. In Q4, activity should pick up slightly (+0.4%), driven by domestic demand. In 2015, growth in activity should reach +0.7%, after three years of recession. Employment should increase by 0.8%, fuelled by the tax incentive brought in by the Jobs Act. In H1 2016, activity is expected to slow down slightly (+0.3% per quarter).

Employment boosted by the Jobs Act

In 2015, Italian GDP is expected to grow by 0.7% after three years of recession. This recovery in activity also brings a pick-up in employment. Since the spring, payroll employment has been growing (+0.2% in Q3 after +0.5 %), driven by the effects of the Jobs Act (*Graph*). This scheme exempts employers from paying contributions for three years for any new hiring of employees on open-ended contracts in 2015, up to the limit of 8,060 euros per year (see *Conjoncture in France June 2015*, p. 103): therefore, in addition to net job creations, the proportion of open-ended contracts among hires rose sharply. Household purchasing power increased all the more since inflation was weak, particularly its energy component. As a result, household consumption increased: +0.4% in Q2 and Q3, after several years of near stagnation. All in all, activity should increase 0.4% in Q4 2015, then levelling off in early 2016 as the effects of the Jobs Act fade (+0.3% per quarter): the scheme is expected to be extended, but in a version that offers significantly less incentive.

Investment in capital goods declined, while investment in construction stabilised

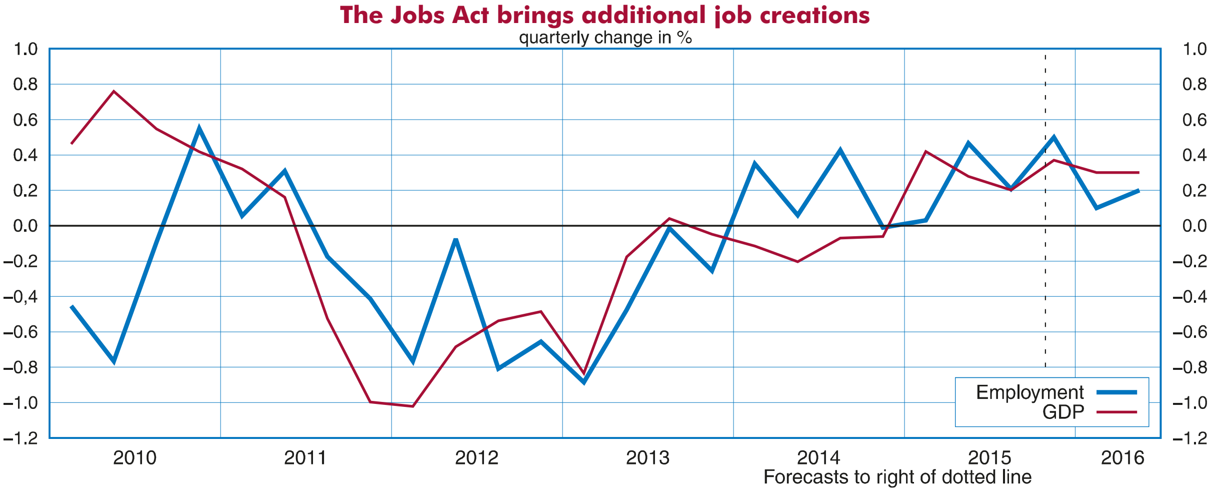
Investment in capital goods fell back (–0.6 % in Q3) after its strong recovery since autumn 2014. It should bounce back in Q4 (+0.9 %), stimulated by rising demand and better financing terms. As an annual average, it should grow 3.7% in 2015 (after –2.9% in 2014). In H1 2016, it should remain dynamic, driven by an additional depreciation allowance scheme similar to the one implemented in France.

In construction, the business climate is improving and the decline in investment is expected to ease off through to mid-2016. Investment in construction is therefore expected to decline significantly less in 2015 (–1.0%) than in 2014 (–4.8%), softening the fall that began in 2008. By mid-2016, its growth rate carried over should reach –0.3%.

Exports stumbled in Q3

Italian exports, affected by a setback in Eurozone foreign trade, dropped in Q3 (–0.8% after +1.3%). Imports increased for the seventh consecutive quarter (+0.5 %) and foreign trade adversely affected growth. In Q4, imports and exports are expected to increase at nearly the same pace (+1.0 %), and the same is expected for H1 2016 (+0.8% per quarter), a rate which is close to world demand for Italian products. All in all, foreign trade is expected to contribute negatively to growth in 2015 (–0.3 points), for the first time since 2009.■

The Jobs Act brings additional job creations



Source: Istat

Spain

Activity slows but remains robust

In Spain, GDP slowed down slightly in Q3 2015 (+0.8%), still driven by vigorous domestic demand, yet adversely affected by the negative contribution of foreign trade. The slowdown in activity is expected to continue in the upcoming quarters, this time due to domestic demand (+0.7% in Q4, then +0.6% per quarter in H1 2016). All in all, growth for 2015 as a whole should reach +3.1%, and the growth overhang for 2016 should be +2.2% at the end of June.

Industry stalling somewhat

In Q3 2015, Spanish activity slowed down slightly (+0.8% after +1.0%): domestic demand remained vigorous, but foreign trade contributed negatively to activity. National business tendency surveys still look promising, but the PMI declined, especially in industry, suggesting that industrial activity is stalling (*Graph*). Despite the recovery in construction, overall activity should slow down slightly through to mid-2016: +0.7% in Q4, then +0.6% per quarter in H1 2016.

Household purchasing power should remain vigorous

In Q4 2015, household consumption should continue to be sustained by purchasing power gains, driven by strong job creation, low inflation, and a slight acceleration in wages. Wages should be most notably stimulated in the civil service, with the back-payment in instalments of a bonus that was withheld in 2012. Government consumption was vigorous in 2015, a local and national election year, but is expected to slow down at the beginning of 2016 in a bid to curb the budget deficit. Through to mid-2016, the savings ratio should return to its average pre-crisis level, with the fall in unemployment making precautionary savings less necessary. The unemployment rate remains high, but is dropping rapidly: it should stand at 20.6% in mid-2016, six points lower than its peak at the beginning of 2013.

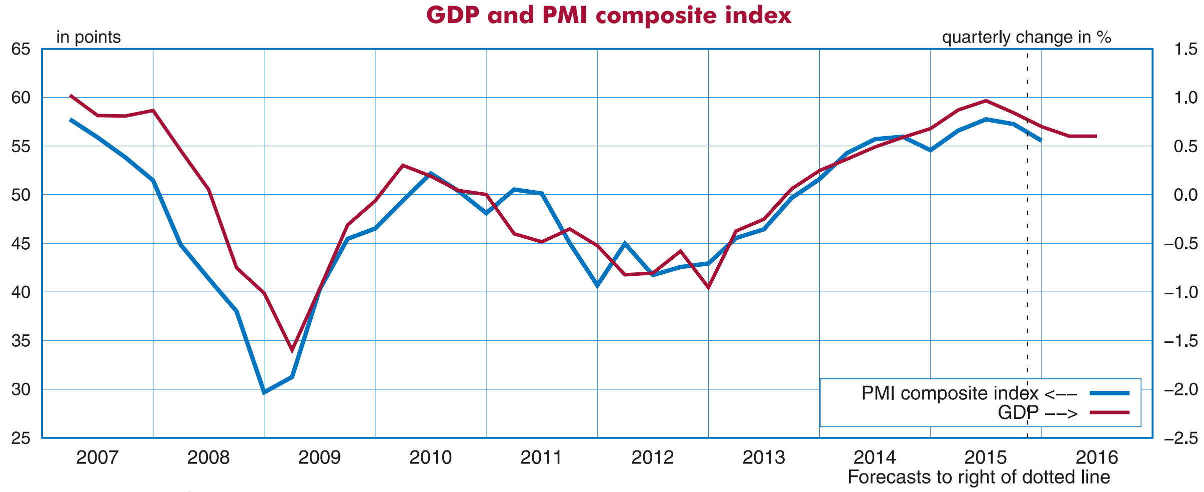
Investment should continue to grow vigorously

In Q4 2015, investment in capital goods is likely to continue to grow rapidly (+2.7%), against a backdrop of tensions on production capacities and corporate margins that are still very high (see the special report in this issue). It should slow down in early 2016 as the catch-up dynamic fades. Investment in construction should continue to rise: building permits have risen sharply since early 2015, though their volume remains well below the pre-crisis level. However, public investment in construction slowed down after the 2015 elections.

Imports expected to slow down

At the end of 2015, foreign trade should still hinder Spanish growth slightly, as imports are likely to remain sustained in order to meet domestic demand. In Q1 2016, the slowdown in domestic demand, particularly investment in capital goods, should check imports somewhat and the trade balance should again make a neutral contribution to growth.■

GDP and PMI composite index



Sources: INE, Markit

United Kingdom

Tensions on the labour market

In the United Kingdom, activity slowed down in Q3 2015 (+0.5% after +0.7%). Activity is likely to grow through to mid-2016, but at a slower pace than in early 2015 (+0.6% at end 2015 then +0.5% per quarter in H1 2016) due to the slowdown of domestic demand. Fewer jobs are expected to be created, checking the fall in unemployment; the savings ratio, which reached its lowest level early in 2015, is therefore expected to fall only very slightly over the forecasting period. In 2015, British growth should reach +2.4%, and the growth rate carried over for 2016 should stand at +1.7% at the end of June.

The business climate deteriorates yet remains favourable

British growth declined in Q3 2015 (+0.5% after +0.7% Q2), due to the decline in construction activity and the slowdown in the extractive industry. Based on Markit surveys on purchasing managers, the business climate improved in October and November, after significantly deteriorating in September. However, the Confederation of British Industry indices fell in November, while still remaining at high levels. These indicators suggest that GDP should grow 0.6% in Q4, bringing annual growth to +2.4% in 2015 after +2.9% in 2014. In H1 2016, activity should slow down slightly (+0.5% per quarter) due to the deceleration of household consumption, and the growth overhang for 2016 should reach +1.7% halfway through the year.

The smaller dip in unemployment expected to slow down consumption

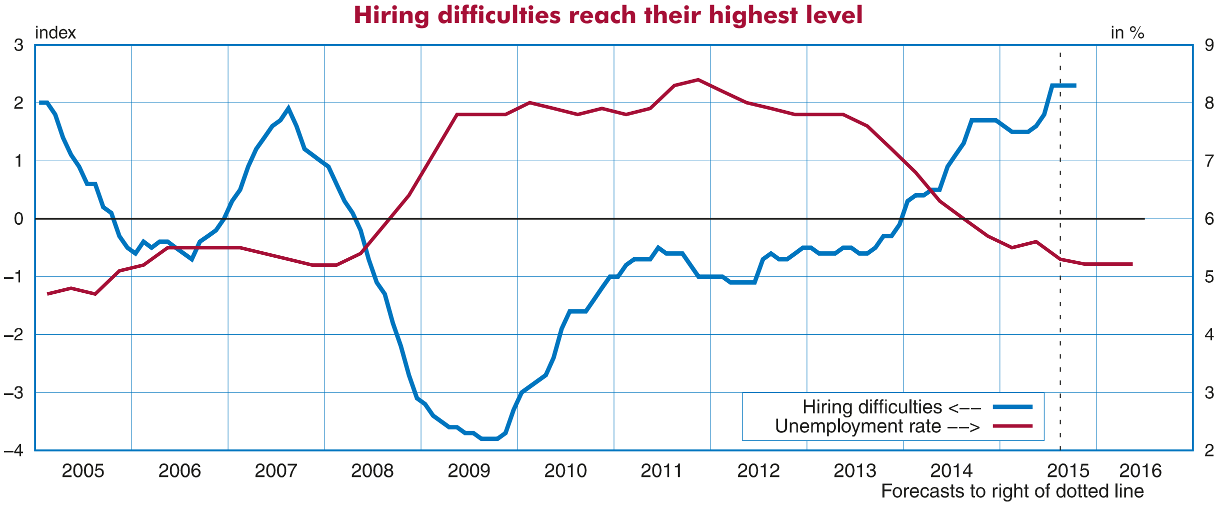
In Q4 2015, consumption should grow again vigorously (+0.7%, after +0.8% in Q3) thanks to the momentum of household purchasing power, driven by the rise in wages and low prices and by the wealth effects generated by rising housing prices. Furthemore, hosting the Rugby World Cup is expected to have led to a rise in household expenditures. In H1 2016, consumption is expected to slow down slightly (+0.6% per quarter). Indeed, although tensions on the labour market (*Graph*) are expected to cause a pick-up in wages, they should check job creation and the fall in unemployment; hence the savings ratio, which stood at 4.0% in early 2015, its lowest level since 1963, should barely fall at all through to mid-2016.

Over the forecasting period, investment should slow down in the wake of activity and companies' diminishing capacity constraints, especially in industry.

The contribution of foreign trade to activity expected to be slightly negative

Through to June 2016, exports should grow less quickly than world demand for British products (+0.6% per quarter), reflecting the trend losses in market shares and the past appreciation of the pound. Imports should increase slightly faster (+0.7% per quarter) in the wake of domestic demand. Assuming a stable exchange rate, the contribution of foreign trade to activity should be slightly negative through to mid-2016.■

Hiring difficulties reach their highest level



Sources: Bank of England, ONS

United States

Close to full employment

In the United States, activity slowed sharply in Q3 (+0.5% after +1.0%): it was again driven by household consumption and private investment, but checked by sluggish exports.
Starting in Q4, GDP is set to accelerate slightly alongside domestic demand (+0.6% per quarter), bringing average annual growth to +2.5% in 2015 and the mid-year growth overhang to +2.0% in 2016.

Industry suffering due to the strong dollar

After a rebound in spring 2015 (+1.0%), GDP slowed sharply in the summer (+0.5%). Domestic demand remained vigorous, particularly household consumption (+0.8%) and private investment (+0.8%), whereas exports continued to suffer from the appreciation of the dollar (+0.2%). The short-term outlook is significantly more promising in services than in industry, which is more exposed to the resulting decline in competitiveness (*Graph*).
Activity should pick up slightly through to mid-2016, at a pace close to its long-term average (+0.6% per quarter). It is expected to be affected by the same driving forces: the momentum of domestic demand, but the relative sluggishness of exports.

A labour market close to full employment

The pace of job creations fostered by growth remains strong. The labour market is on the verge of full employment: in October 2015, the unemployment rate reached 5.0%, almost at the equilibrium level estimated by the Fed (4.9%), after having dropped continuously since early 2010. This should boost wages, which are again expected to increase. Furthermore, inflation should be curbed, as the appreciation of the dollar and the decline in commodity prices continue to spread throughout the economy.
Therefore, household purchasing power should continue to grow at a rate of +0.8% in Q3, then 0.7% per quarter until Q2 2016, sustaining consumption which should increase at the same pace.

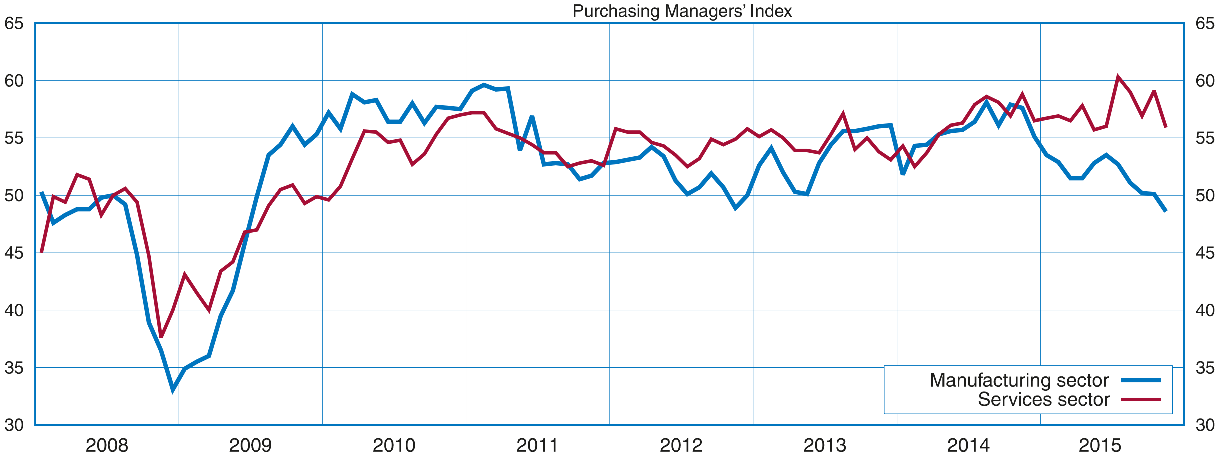
Investment in much better shape

After a setback at the end of 2014 and early 2015, corporate investment bounced back in spring (+1.0%) and in summer (+0.6%). It should continue to grow at a rate of +1.0% starting in Q4 2015. Over 2015 as a whole, investment should slow significantly (+3.2% after +6.2% in 2014), primarily due to a collapse in investment in the oil sector.
Residential investment should continue to accelerate under the effect of a rise in housing starts and a drop in interest rates for new home loans; on average over the year, it is expected to increase by 8.6% in 2015 (after +1.8% in 2014).

Foreign trade likely to continue taking its toll on growth

Despite the recovery of world trade, exports should continue to be adversely affected by the past appreciation of the dollar through to mid-2016, whereas imports should accelerate in the wake of domestic demand. All in all, the trade balance should again contribute negatively to growth in H1 2016, after cutting annual growth by 0.7 points in 2015.■

The business climate diverges between manufacturing and services



Source: ISM

Japan

Prices and wages recover slowly

In Q3 2015 Japanese activity rebounded (+0.3% after -0.1%), sustained by the momentum of domestic demand (excluding inventory changes). For the end of the year, business surveys remain promising, particularly in industry. Japanese activity is likely to grow at a moderate pace in Q4 2015 (+0.2%) then accelerate slightly in H1 2016 (+0.3% per quarter), driven by household consumption and renewed momentum in exports.

Industrial output expected to rebound

Industrial output fell back sharply in spring (-1.4%) and summer (-1.2%). However, short-term business indicators suggest that industrial output should rebound in Q4 2015. Sustained by domestic orders, the Purchasing Managers Index (PMI) of the manufacturing sector continued to rise (52.6 in November after 52.4 in October and 51.0 in September, Graph). In addition, the industrial production index increased by 1.4% in October and, as a result, the overhang for the fourth quarter is significantly positive (+1.8%); for November and December, the business managers in industry interviewed by the METI anticipate a stabilisation of their activity.

After rebounding in Q3 2015 (+0.6% after -1.3%), productive investment is expected to slow down in Q4 2015 (+0.3%) then grow in H1 2016 (+0.4% then +0.5% per quarter): this recovery is likely to be very gradual, as production capacities remain underused, and orders for machinery are at a lower level than that of early 2015, despite a slight rebound in September.

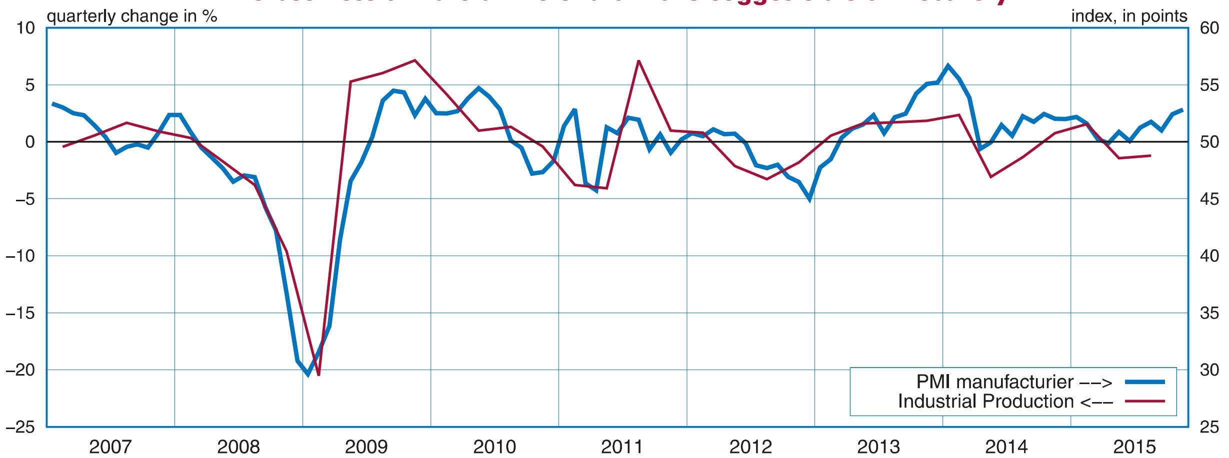
Prices and wages recover slowly

Inflation was weak in October 2015 (+0.3 %), due to the drop in oil prices. Core inflation, however, was +0.8%, a much higher level than that before the beginning of Abenomics. Employment remained relatively vigorous in Q3 (+0.4% after +0.2%) and the unemployment rate stabilised at a very low level (3.4%). The job supply-to-demand ratio is at its highest level since 1992. This tension on the labour market is stimulating wages: in Q3 2015, basic wages increased 0.2% compared with the previous quarter. Through to mid-2016, they should continue to rise slightly, encouraging household consumption: +0.3% in Q4, then +0.4% per quarter in H1 2016.

Exports and imports rally in tandem

Exports rebounded in Q3 after slipping back in H1. Through to mid-2016, they should grow again, driven by the slow recovery of Asian trade, particularly Chinese imports. Imports should increase in line with domestic demand, resulting in the contribution to foreign trade being neutral through to mid-2016.■

The business climate at the end of 2015 suggests a slow recovery



Source : Japan Cabinet Office, Markit

Emerging economies

General slowdown, widening divergences

In 2015, activity in the emerging economies continued to grow modestly, at a slower pace than that of the last two decades. Divergences are widening, particularly between exporting countries, adversely affected by the fall in commodity prices, and importing countries which benefit from it.

In China the economic slowdown continued in 2015. However, growth is expected to stabilise in H1 2016, buoyed by consumption. Imports are expected to return to a pace more in line with activity. In Brazil, the crisis has worsened sharply against a backdrop of political tension and the deterioration of public finances. Domestic demand and industrial production are falling and the Central Bank has not succeeded in curbing the continuous rise in prices. After a sharp decline in H1, the Russian economy stabilised in the summer. Nevertheless, domestic demand remains low and the road to recovery is likely to be long.

For their part, Central and Eastern Europe countries seem to have escaped the geopolitical crisis in Ukraine. They are expected to maintain particularly vigorous growth, benefiting most notably from the slow but steady recovery in the Eurozone.

All in all, the imports of the emerging economies, which had fallen back at the beginning of 2015, are expected to rebound slightly between now and mid-2016, as a result of the stabilisation in Rusia and the upturn in Chinese imports.

China: growth expected to stabilise

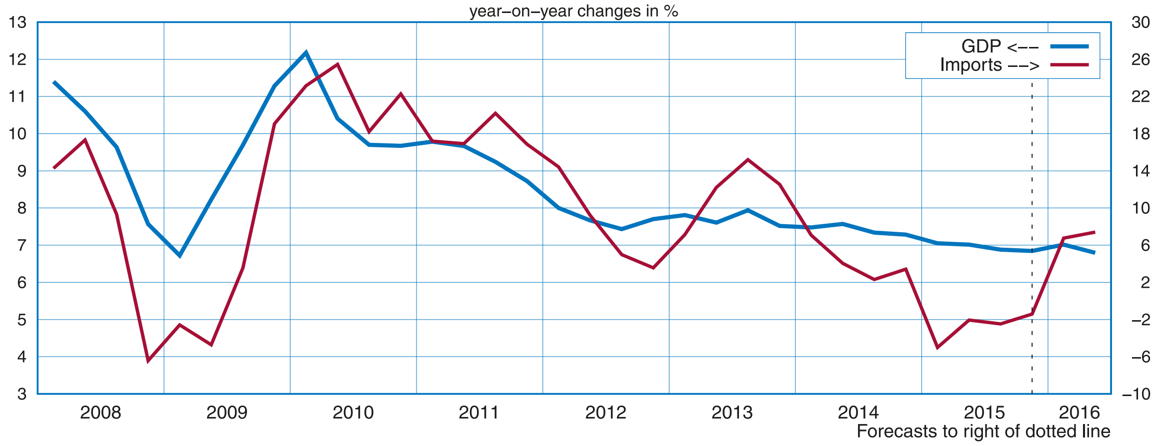
In China, total activity is likely to slow down slightly again in Q4 2015 before stabilising at a rate of +1.6% per quarter during the first half of 2016 (*Graph 1*). As an annual average, after +6.9% in 2015, the lowest growth since 1990, the carry-over effect at the end of Q2 for 2016 is expected to stand at +5.4%.

This stabilisation is likely to be largely driven by consumption. Indeed, renewed momentum seems to be gathering: after several months of downturn, car registrations have increased sharply since August; retail sales are picking up slightly and household confidence, while remaining below its long-term average, has ceased to deteriorate since June.

For its part, corporate investment has slowed since the beginning of 2015, in particular in corporate real estate. Nevertheless, the pick-up in property prices since the spring and the increase in the number of transactions should lead to a gradual return to normal of the market, in the context of a gradually more accommodating monetary policy.

Chinese exports are expected to pick up in Q3, as a result of the devaluation of the yuan in August 2015 and a slight recovery in world demand for Chinese products. After falling at the beginning of 2015, imports are expected to pick up between now and mid-2016 with domestic demand and exports, the import content of which remains significant.

1 - In China, growth is expected to stabilise and imports to pick up



Source: NBSC

Brazil sinking into crisis

The situation in Brazil continues to deteriorate rapidly and GDP contracted over the first three quarters. The real depreciated heavily during the summer and inflation has risen continually despite the increases in the base interest rate decided by the Central Bank. At the same time, public finances have deteriorated because revenues have dried up and the debt service has increased rapidly.
In this context, domestic demand is collapsing with the drop in real wages, the sharp increase in unemployment and the confidence crisis which is affecting both households and businesses.
On the supply side, industrial output fell by 11.4% in October year-on-year (*Graph 2*) and sectoral business climates remain far below their expansion threshold.
In Q4 2015, GDP is therefore expected to continue declining, although less quickly than in Q3 (-0. 7% after -1.7%). On average over the year, the recession is expected to reach -3.6% in 2015. Activity is likely to remain poor through tomid-2016.

Fragile stabilisation in Russia

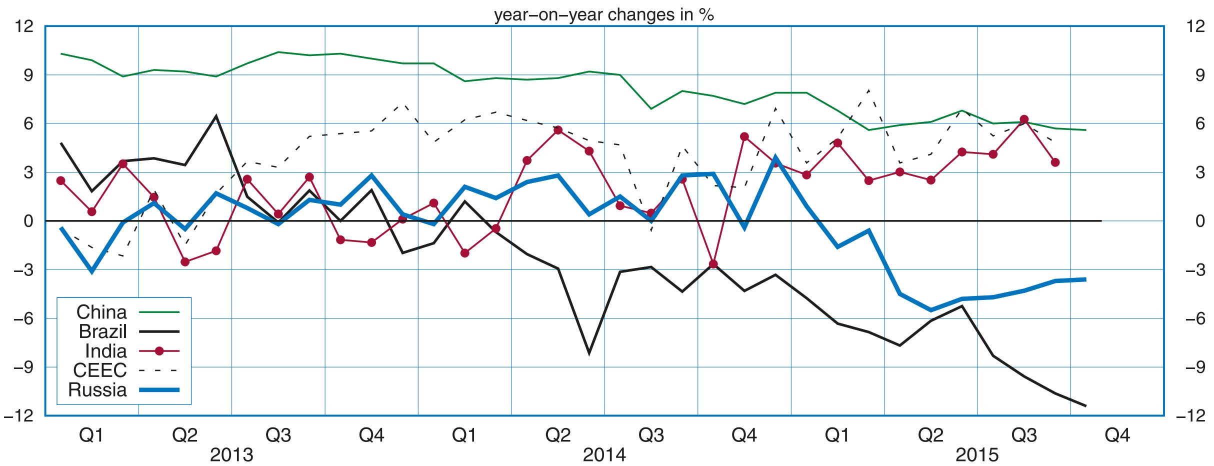
In Russia, activity declined sharply in Q1 2015 (–3.6% half-year on half-year) due to the sharp fall in the prices of commodities, the rouble crisis and reciprocal economic sanctions after the Ukrainian crisis. Nevertheless, GDP stopped falling in Q3 (+0.1%). In particular industrial production turned around after the sharp decline at the beginning of the year. The labour market confirmed its resilience: the unemployment rate stood at 5.5% in November. Moreover, the rouble has appreciated slightly since the end of August. However, the road to recovery is likely to be long. Prices have again increased rapidly (+15.0% in November) and the Central Bank has stopped lowering its base rate. Domestic demand remains depressed and the business climate has hovered around its expansion threshold since the summer.
In Q4 2015, growth therefore is expected to be virtually non-existent (+0.1%) completing a year of severe recession (-3.5% in 2015). Recovery is expected to remain sluggish at the beginning of 2016.

The CEEC and India confirm their vigour

For their part, Central and Eastern Europe countries are confirming their vigour and their resilience to the Ukrainian crisis (Focus). Business tendency surveys remain positive despite a slight slowdown in industrial output in Q3 2015. All in all, growth in the CEEC is likely to remain steady in Q4, although experiencing a slight slowdown (+0.7% after +0.9%), taking their average growth for the year to +3.6% in 2015.

In India, the dominance of the tertiary sector over the industrial sector should continue to limit the country's exposure to the slowdown in world trade and activity should remain dynamic, after year-on-year growth of 7.4% in Q3.■

2 - The pace of industrial output differs between the emerging countries



Sources: National Statistical Institutes

The economies of Central and Eastern Europe countries have proved to be resilient to the Ukrainian crisis

Despite their geographical proximity, historical ties and the size of the Russian domestic market, the value of exports from CEEC to the former USSR is low. Apart from trade between these two regions, second-round effects linked to the fragmentation of value chains exist but have only had a limited effect on CEEC exports. Lastly, the Ukrainian crisis has not caused any tension either on foreign direct investment (FDI) or on currencies and sovereign yields. All in all, these countries are today far more dependent on the European Union, and Germany in particular, than on Russia.

Since March 2014, the European Union (EU) and the United States have brought in economic and financial sanctions against Russia due to the geopolitical tensions in Ukraine. In August 2014, Russia decreed an embargo on imports of certain agricultural products. At the end of 2015, these economic reprisal measures are still in force. The ensuing flight of capital and the simultaneous fall in the prices of commodities caused a major crisis in the rouble, which lost one half of its value against the American dollar between the summer and the end of 2014. The purchasing power of Russian households dwindled with the acceleration in prices and activity contracted sharply between Q3 2014 and Q2 2015, leading to a collapse of imports accentuated by the restrictions linked to the embargo. In mid-2015, activity had fallen over one year by 4.5% in Russia and 14.7% in Ukraine; imports declined even more sharply, by almost one third of their volume over one year.

Despite the economic crisis affecting these two countries, activity in the geographically nearby Central and Eastern European countries (CEEC[1]) showed no sign of a downturn. GDP and industrial output remained buoyant in 2014 and through to Q3 2015 (*Graph 1*), once again driven by strong exports in 2014 (+7.1% over the year) and Q1 2015 (+ 3.0%), while imports from Russia slumped (–22.7% quarter-to-quarter change in Q1 2015). In Q2 2015, CEEC exports may have slowed down (+0.4%) but their dependence on the European Union, and on Germany in particular, helped to limit the extent of this shift.

Only 5% of CEEC exports are bound for the former countries of the USSR

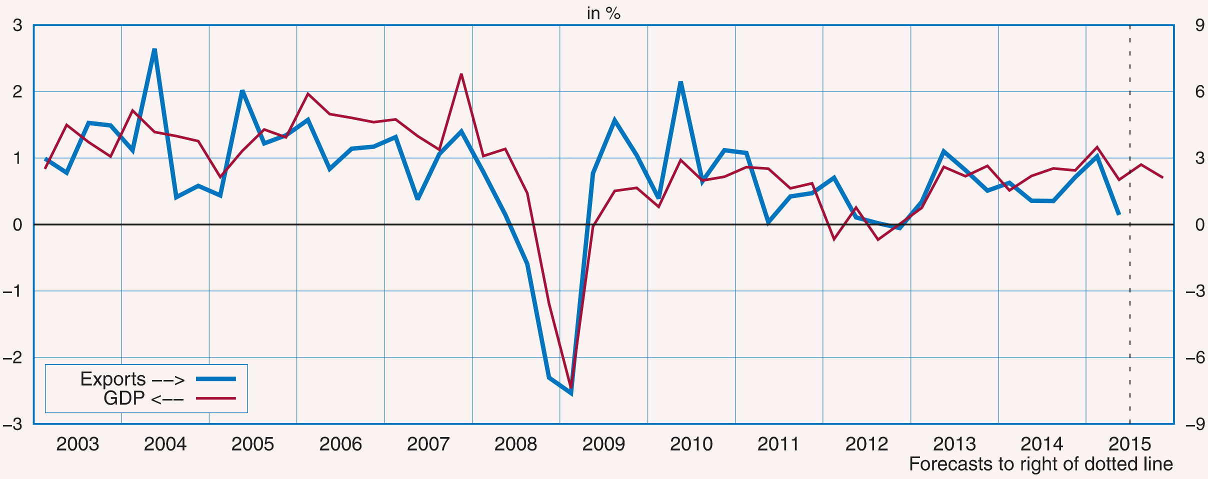
The percentage of the value of CEEC exports to countries of the former USSR is relatively low[2] and mainly concerns Russia and Ukraine. While it reached 10.3% before the Russian economic crisis of 1998, this percentage fell to less than 5% between 1999 and 2003 (*Table 1*). Between 2004 and the recession of 2008, a period of strong expansion in Russian demand, it increased to 8.6%. Since 2013, the percentage of exports to the former countries of the USSR has fallen once more and reached 5.2% in Q1 2015.

The CEEC send the majority of their exports to the European Union (outside of the CEEC) and North America: 80% of exports at the beginning 2015, 33% of which went to Germany alone. This percentage has been increasing since 2013, half of it thanks to Germany, after having declined between 2004 and 2013.

At the beginning of 2015 around 19% of CEEC exports took place within this group of countries. This percentage increased sharply between 2004 and 2013, rising from 13.5% to 18.8% of the total value of exports (2004 marking the entrance of Poland, the Czech Republic, Slovakia and Hungary into the EU), then stabilised in recent years.

1. Six countries are studied here (Poland, the Czech Republic, Slovakia, Hungary, Romania and Bulgaria), corresponding to the former Warsaw Pact countries, excluding the USSR and East Germany, and today members of the European Union.
2. The data used are exports of goods through customs, disseminated by the IMF.

1- GDP and exports of CEEC as a whole



Sources: National Statistical Institutes, INSEE calculations

By product, vehicles are the leading export from the CEEC and these sales are directed at Germany (19% against 15% to the world as a whole). The only sector of activity substantially more exposed to Russia (as the main importer of the former USSR) is the chemical industry: 8% of exports of chemical products go to Russia, against 5% of exports as a whole. For the other items, the sectoral composition of exports to Russia differs little from that of total sales.

World demand for CEEC products has withstood the Ukrainian crisis

Due to this orientation, world demand for CEEC products[3] has continued to grow since the beginning of the Ukrainian crisis (Graph 2). It grew in 2014 (+2.9% after +2.4% in 2013) and is likely to grow again in 2015 (+2.4%). So despite the collapse of Russian imports, world demand for CEEC products stabilised in Q1 2015: the negative contribution of Russian imports (–0.9 points) was offset by the dynamism of imports from the European Union (+1.2 points). They are likely to grow subsequently thanks to the buoyancy of European imports.

When trade within the CEEC is taken into account, the situation is more contrasting. On the one hand, in Poland, the Czech Republic, Hungary and Slovakia, world demand has continued to grow (+1.0% on average) as the Russian contraction in Q1 2015 was more than offset by the positive contribution of trade between the European Union and the CEEC. On the other hand, world demand slowed down sharply in Romania and shrank in Bulgaria due to their more unfavourable composition of exports, with a lower volume of trade with Germany and the rest of the CEEC and sales more oriented towards Turkey and the Middle East. However, their exposure to Russia is comparable to that of Central European Countries.

The second-round effect of the Russian recession on the CEEC appears low although not negligible

Despite relatively low direct exposure when only the composition of exports is taken into account, it is possible that the dependence of CEEC countries on Russia is greater when any second-round effects are considered. In particular, the cross-border breakdown of value chains and the processing trade may increase the extent of CEEC dependence on Russian domestic demand.

To approximate the share of CEEC exports intended to satisfy Russian demand via a trading partner (P), the share of CEEC exports to (P) is multiplied by the share of Russia in (P)'s exports. This product is finally multiplied by the share of the processing trade in (P)'s imports, which is approximated here by the openness rate. The sum of this operation for all of the CEECs' trading partners provides an estimation of the indirect share sought. This percentage also appears modest: in 2014, the indirect share of Russian demand reached around 3% of CEEC exports, against 4% for the direct share. Taking this effect into account, the contribution of Russian domestic demand to world demand for CEEC products in 2015 is expected to fall from –1.3 point to –2.3 points.

3. Intra-CEEC trade was neutralised in the calculation of world demand.

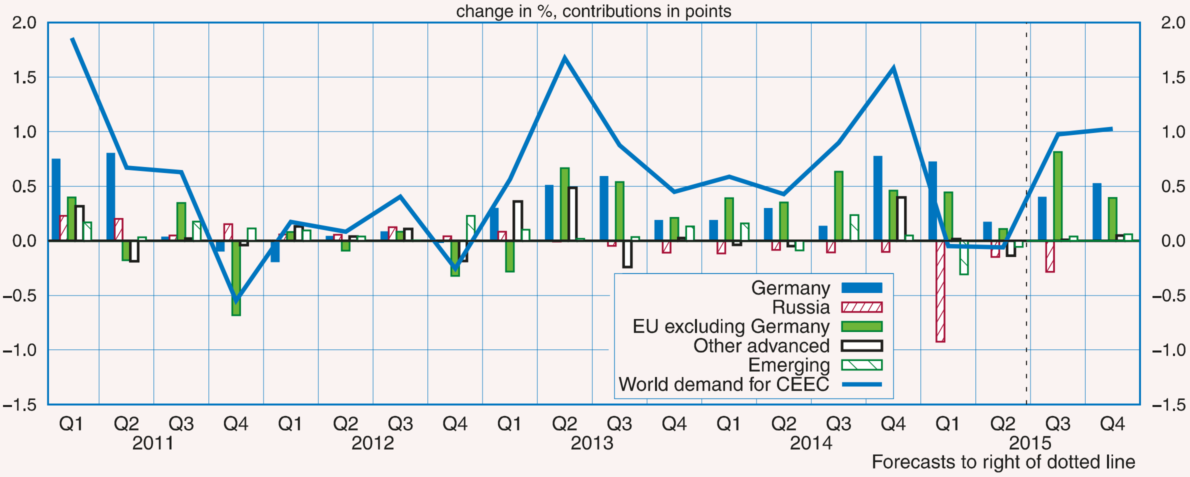
Share of CEEC exports (%)

	1996	2000	2004	2008	2013	2014	S1 2015
UE hors PECO et Amérique du Nord		**84.3**	**83.7**	**77.8**	**76.7**	**78.7**	**80.0**
Ex-URSS	**10.3**	**4.4**	**4.8**	**8.6**	**8.4**	**6.8**	**5.2**
- Dont Russie	*5.9*	*2.0*	*2.4*	*4.6*	*4.5*	*3.7*	*2.7*
- Dont Ukraine	*2.7*	*1.3*	*1.6*	*2.6*	*2.3*	*1.6*	*1.3*

Note : The CEEC are here taken as a whole and intra-CEEC trade is neutralised.

Source: FMI, INSEE calculations

2 - World demand for CEEC



Sources: National Statistical Institutes, INSEE calculations

Russia represents a tiny proportion of direct investment flows to the CEEC

Foreign direct investment (FDI) refers to investments whereby a non-resident entity acquires a long-term interest in a resident entity in a given economy. By convention, a direct investment relationship is established when a foreign investor acquires at least 10% of the share capital of the company being invested in. According to the bilateral data of UNCTAD,[4] the CEEC have a rather low share of foreign direct investment (2% of worldwide direct investment flows in 2014). UNCTAD'S bilateral data suggest a tenuous link between the CEEC and Russia, both for stock and flows: only 1% of incoming flows are from Russia. At the same time, flows from the European Union are the principal source of FDI to the CEEC (86% on average over the period 2001-2012, 21% of which was from Germany).

The currencies and sovereign yields of the CEEC do not seem to have been affected either

Apart from Slovakia (which has adopted the single currency) and Bulgaria (which has chosen a fixed exchange rate with the Euro) CEEC currencies have remained relatively stable in relation to the Euro since the beginning of 2014. De facto, in H2 2014, CEEC currencies depreciated sharply against the dollar in the wake of the depreciation of the Euro, and this sustained their exports.

Moreover, real sovereign yields as a whole fell from the beginning of 2014, confirming the absence of any particular tension on the CEEC's sovereign debts. ■

4. United Nations Conference on Trade and development, the latest bilateral data are for 2012