Germany

Investment picks up

Economic activity in Germany picked up substantially in Q1 2014 (+0.8%, up from +0.4%) despite weak exports. Winter temperatures were particularly mild, producing an increase in construction expenditure (+3.6% after +0.2%).Household consumption also rebounded (+0.7% after -0.3%) and investment in equipment accelerated (+3.3%, up from +1.4%).
Economic activity should slow in Q2 (+0.4%), due to a backlash in the construction sector. It should then pick up slightly in H2 (+0.5% per quarter), strengthened by investment and household consumption. As an annual average, economic activity should grow by 2.1% in 2014.

Exports recover

World trade fell back in Q1 2014 and German exports grew only slightly (+0.2%). However, export order indices in the business tendency surveys remain at a high level, which bodes well for a rebound in exports in Q2 (+1.6%). They should then increase at the same pace as world trade (+1.1% per quarter).

In contrast, imports were very dynamic in early 2014 (+2.2% in Q1). They should slow in Q2 before growing at a sustained pace in H2, galvanised by strong domestic demand. All in all, the contribution of foreign trade to growth is likely to be null in H2 after a negative contribution in Q1 (-0.9 points) and after a rebound in Q2 (+0.6 points).

Dynamic investment expenditure

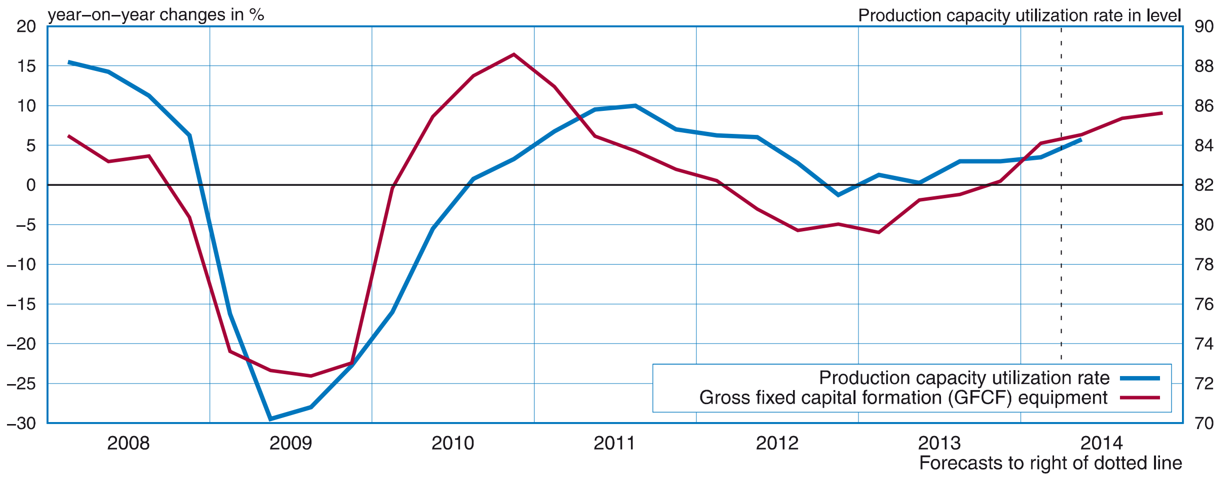
Investment in construction saw a strong increase this winter (+3.6%), as the number of days of frost was particularly low for the season. It is likely to shrink in reaction in Q2 (-2.3%) and should then increase at a sustained rate in H2 (+1.2% per quarter), due partly to low interest rates and partly to government expenditure to rebuild infrastructure damaged by floods in spring 2013.

Investment in capital goods increased sharply in Q1 (+3.3%). This dynamism should persist: the capacity utilisation rate is increasing (see Graph), as are domestic orders for capital goods. Overall, the investment rate should pick up, although it will not return to its 2011 level and investment in capital goods should grow by 7.3% in 2014, after -2.2% in 2013.

Consumption on the rise

In Q1 2014, the unemployment rate reached its lowest level since reunification (5.1%). The labour market situation should continue to improve for the rest of the year and employment is likely to increase by 1.1% in 2014, after +0.9% in 2013. While wages per head should remain at a moderate level (see Focus), the purchasing power of household income should improve in 2014 (+1.0% after +0.6%), bolstered by the drop in inflation. As a result, household consumption is also likely to pick up: +1.3% in 2014, after +1.0% in 2013. ■

Recovery of the investment in capital goods



Sources: Ifo, Destatis

German wages remain moderate before the introduction of the minimum wage

German wages slowed down in 2013

Germany has a substantial trade surplus: in 2013, Germany's current balance reached 7 GDP points. For a decade now, German growth has been driven more by exports than by domestic demand. The reduction of macroeconomic imbalances within the Eurozone therefore requires a rebalancing of German growth. This more specifically involves a perceptible acceleration of wages in Germany, both to support German domestic demand and to facilitate competitiveness adjustments within the Eurozone (see, *for example, IMF - September 2013 - or European Commission - March 2014*). However, German wages slowed down in 2013 (*see Graph 1* and *Destatis*, 2014).

This slowdown in wages may have a short-term cause...

This slowdown may have a short-term cause: at the time when branch agreements were being renegotiated (around Q2 2013[1]), activity in Germany had just gone through two very gloomy quarters (-0.5% then 0.0%), and the national-concept unemployment rate - the one that is most closely tracked in Germany - had increased in Q4 2012. In construction in particular, a sector in which nominal wages fell in 2013 (*see Graph 2*), activity shrank sharply during the winter due to unseasonably low temperatures.

... but the early signals for 2014 do not indicate any acceleration

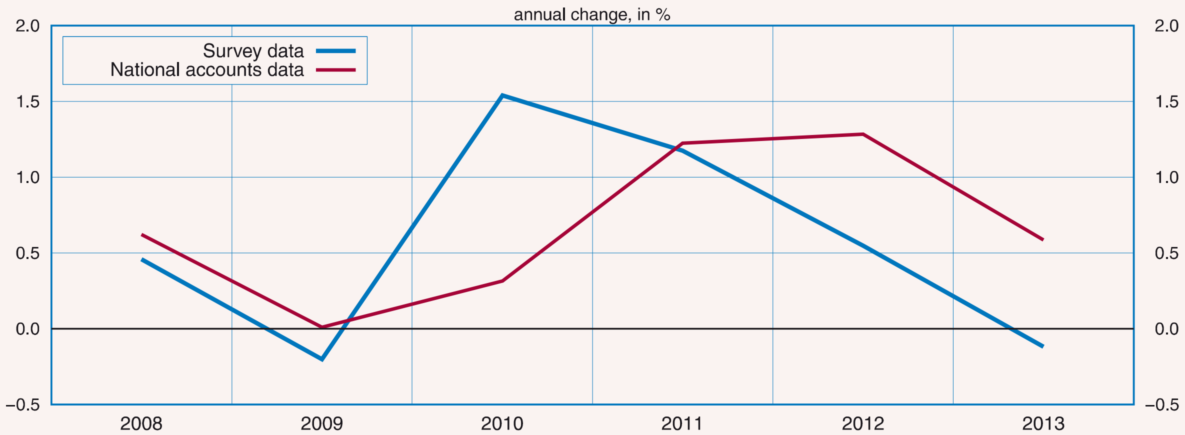
In 2014, the economic signals are far more positive (GDP up by 0.8% in Q1 2014, unemployment rate falling continuously for more than a year) and offer a favourable context for wage demands. However, the first indications regarding the opening of wage negotiations suggest only moderate growth in German wages (in particular, an increase of 3.1% in construction, after +3.2% in 2013). So our forecast scenario assumes a relatively stable situation for nominal wage rises (+2.3% forecast in 2014, against +2.2% in 2013).

The implementation of a minimum wage should, however, lead to wage rises in 2015

Wages, however, could accelerate in 2015, with the implementation of a minimum wage in Germany. According to Germany's main economic institutions, the introduction of this minimum wage will increase the average nominal wage per head by about 0.7%. This rise should lead to an acceleration in German wages[2]. Moreover, the downward trend in the unemployment rate should end up causing growing tensions in the labour market and lead to a wage rise. ■

(1) Wage negotiations go on all year, but the main agreements are concluded in the first half of the year.
(2) See Projektgruppe Gemeinschaftdiagnose, 2014, page 35 which details the scenarios for 2015 with and without the introduction of the minimum wage.

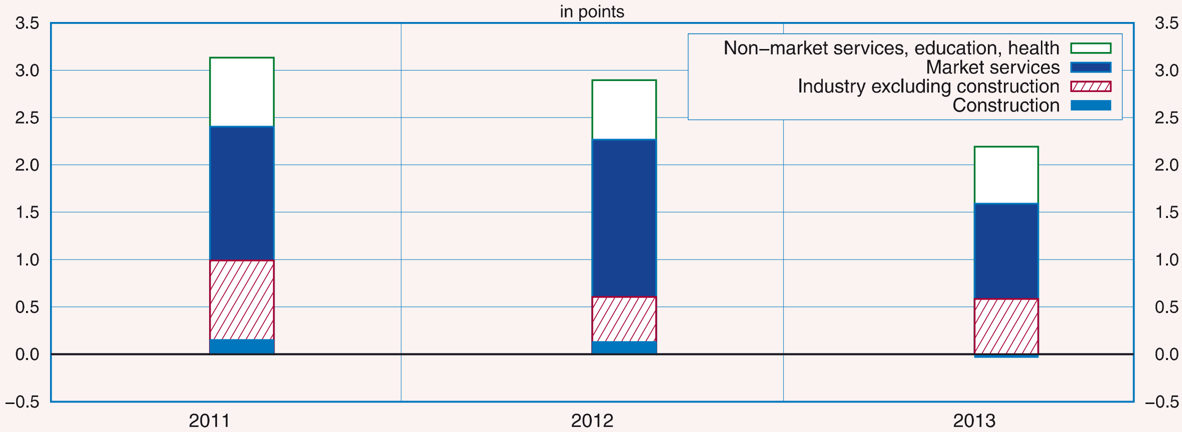
1 - Real wages



How to read it: There are two main sources on wages in Germany. The first to be published, the quarterly wages survey, receives major press coverage; it indicates a fall in real wages of 0.1% in 2013 (after +0.5% in 2012). The second, the national accounts data, states that real wages increased by 0.6% over the year (after +1.3% in 2012). Beyond the difference in the deflator (consumer price index or consumption deflator), the differential stems principally from the nominal wages series, and hence partially from a different scope: the national accounts cover the whole of the economy (including the non-market sector), whereas the wages survey covers only companies with more than five employees. So data from the national accounts should be preferred when considering wages in Germany.

Sources: Destatis, INSEE calculations

2 - Contribution to the growth in nominal wages



Sources: Destatis, national accounts, INSEE calculations

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Projektgruppe Gemeinschaftsdiagnose, *Deutsche Konjunktur im Aufschwung - aber Gegenwind von der Wirtschaftspolitik*, Frühjahr 2014. ■

Italy

Slow recovery

Economic activity declined by 0.1% in Q1 2014, while growth had only turned positive in Q4 2013 (+0.1%), after nine quarters of recession. This decline was unexpected (+0.2% forecast in the March Conjoncture in France and according to the April consensus). However, it should be only temporary: activity should pick up in Q2 (+0.1%), before accelerating slightly in H2 (+0.2% per quarter).

Business tendency surveys still showing a positive trend

Despite the decline in activity in Italy in Q1 (-0.1%), the recent upturn in the business tendency surveys suggests a slight acceleration in activity (*see Graph*). In the manufacturing sector in particular, the PMI surveys are up to 53.2 in May, indicating that the sector is in an expansionary phase. The improvement in services is less dramatic, but available indicators in May do not suggest anyfurther contraction in activity. Lastly, the contraction in the construction sector should ease off by the end of the year, according to the slight improvement seen in recent surveys. All in all, activity should grow in Q2 (+0.1%), before accelerating slightly in H2 (+0.2% per quarter).

Consumption slightly more dynamic in H2

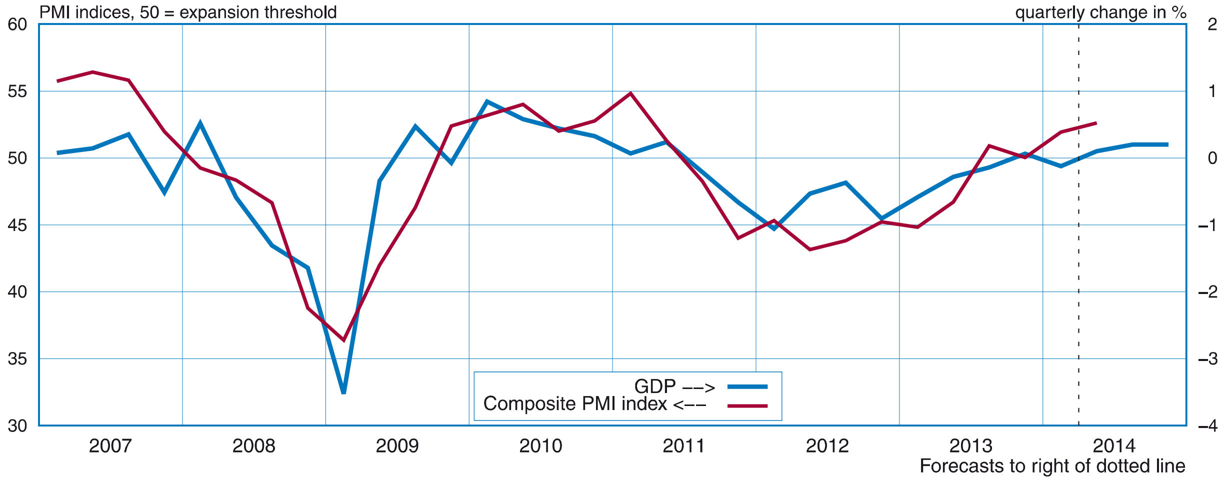
This acceleration in activity in H2 should be driven by the implementation of a stimulus package (especially tax reductions for modest households) announced by the Renzi government. Household purchasing power should therefore increase significantly in Q3 (+0.9%), despite the decline in employment (-0.1% per quarter) and sluggish real wages. After growing slightly in Q1 (+0.1%), consumption should increase again in Q2 (+0.1%) before becoming even more dynamic in Q3 (+0.3%) and Q4 2014 (+0.2%, *see Focus*).

Investment in equipment set to pick up, contribution of foreign trade to growth remaining virtually at a standstill

Investment should follow two different trends in 2014. On the one hand, investment in capital goods should grow (+0.5% in Q2 then +1.2% per quarter in H2), stimulated by low interest rates and the gradual recovery of companies operating margins. On the other hand, spending on construction is likely to decline further over the forecasting period (-0.5% per quarter in H2).

Exports should pick up again by the end of 2014 (around +0.5% per quarter), while imports should accelerate slightly (+0.4% per quarter) in line with domestic demand. The contribution of foreign trade to growth should be virtually nil. After two years of recession, economic activity should increase by 0.1% in 2014, but with a strong acceleration throughout the year: year-on-year GDP growth should increase from -0.9% at the end of 2013 to +0.4% at year's end in 2014. ■

GDP and composite PMI index of activity



Sources: Markit, Eurostat

How to account for the sharp drop in the savings ratio of Italian households throughout the Great Recession?

Italian households have stood out since the beginning of the crisis by the continuous fall in their savings ratio

Since the start of the financial crisis in 2008, household savings ratios in the Eurozone (and more generally in the major developed countries) have followed a path that matched economic intuition very closely: a raise during the peak of the crisis (2009), linked with the rise in unemployment (which encourages households to increase precautionary savings) and with the fall in asset prices (which reduces household wealth), then the gradual return to the pre-crisis level. Although the scale of these trends varied substantially in the different countries (very steep rise then fall in Spain, virtual stability in Germany and France), this phenomenon was widely broadcast.

The behaviour of Italian households was unusual (*see Graph 1*): the savings ratio dropped continuously from 2007 (15.5%) until 2012 (11.9%), even during the peak of the Great Recession, and did not pick up until 2013. While an international comparison of savings ratios may be fragile, savings of Italian households were far below the average in the Eurozone, despite the rise in the unemployment rate (from 6.1% in 2007 to 12.2% in 2013).

This unusual development in the savings ratio could be linked to the very strong purchasing power decline of Italian households since 2008

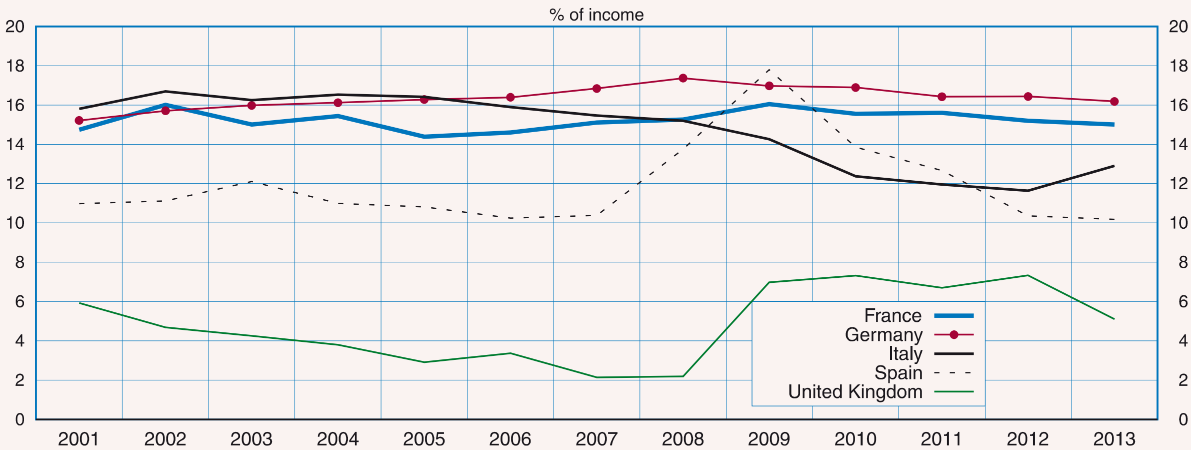
In an analysis of household behaviour, the hypothesis generally put forward is that households have a target savings ratio (which depends mainly on unemployment, inflation or on household wealth) which suggests that households are able to adjust their consumption to any variation in their income in order to keep their savings ratio close to their target value.

While this assumption is usually verified, in Italy this did not seem to be the case when the purchasing power of disposable income dropped sharply between 2008 and 2012 (-8.2%). Facing a major drop in their income (due to a rise in taxation[1] and a reduction in their wages), households should have drawn on their savings, over and above what their theoretical target suggests, in order to guarantee a given level of consumption. This seems to be confirmed by the Eurostat survey on "the inability of households to make ends meet" which suggests that Italian households are those who meet the most difficulty in balancing their budget (17.2% experienced difficulties in 2012, compared with 14.7% in Spain and 4.4% in France).

In order to model this specific behaviour, we use a traditional econometric equation, but in which consumption reacts, in the short term, only to income increases. In this specific equation, there is no effect on consumption in the short term if there is a drop in disposable income. This model is therefore unusual because variations in disposable income have an asymmetrical impact on consumption, depending on whether they are positive or negative.

(1) One of the most symbolic programmes ("*Salva Italia*") introduced by the Monti government at the end of 2011, included a €20 billion reduction in government deficit and €10 billion stimulus package, funded in part by huge tax rises.

1 - Change in household savings ratio



Sources: Eurostat

The equation is written as follows:

$$d(1\_conso) = \underset{(-3,1)}{-0{,}58} - \underset{(-3,0)}{0{,}08}{}^{*}[1\_conso(-1) - 1\_rdbr(-1)]$$
$$+ \underset{(2,5)}{0{,}16}{}^{*}d(1\_rdbr\_plus) - \underset{(-4,1)}{0{,}01}{}^{*}d(taux\_long\_plus)$$
$$\underset{(-3,4)}{-0{,}61}{}^{*}d(lag(1\_def\_conso(-1)))$$
$$\underset{(-4,2)}{-0{,}01}{}^{*}(chomage - lag(chomage(-2)))$$

where:

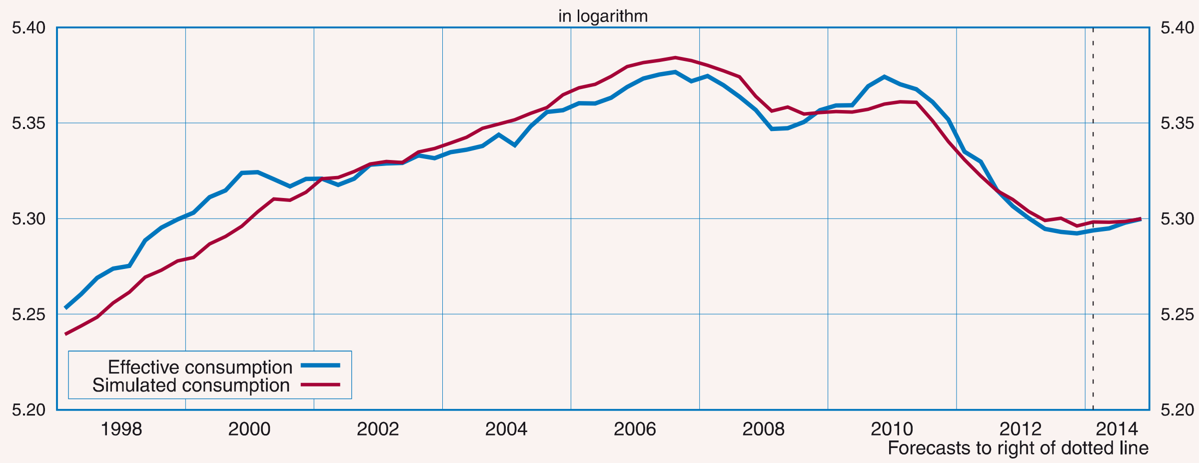
- d: first difference;
- l: logarithm;
- figures in parentheses are the Student's T test.

The variables are:

- conso: effective consumption;
- rdbr: real GDI;
- d(l_rdbr_plus) growth of GDI when this is positive;
- def_conso: consumption deflator;
- taux_long_plus: variation in interest rates when this is positive

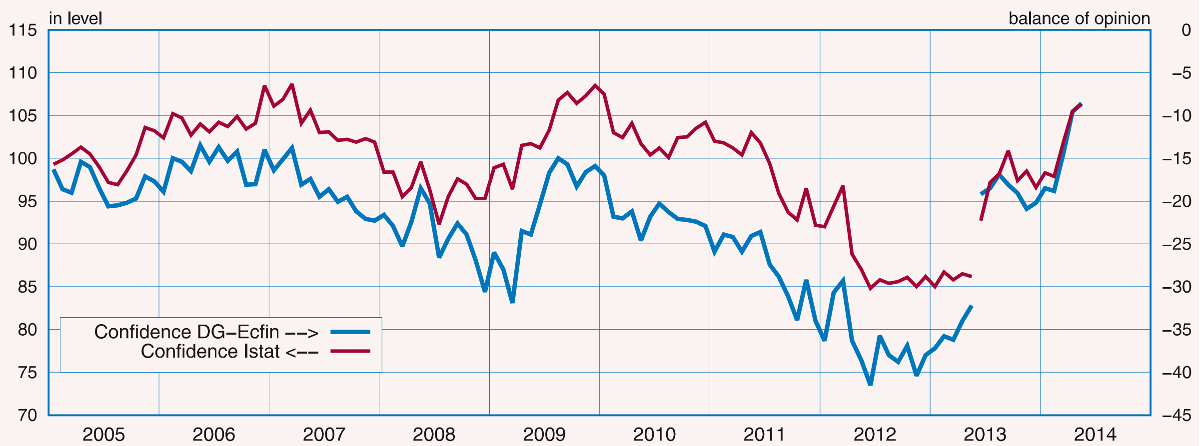
This econometric model provides a good understanding of household consumption behaviour (see Graph 2).

2 - Econometric estimation of the equation for private consumption in Italy: simulated consumption versus effective consumption



Sources: Istat, INSEE calculations

3 -Confidence of Italian households



How to read it: Istat has made a change in methodology from June 2013, resulting in a discontinuity in the series
Sources: Istat, DG Ecfin

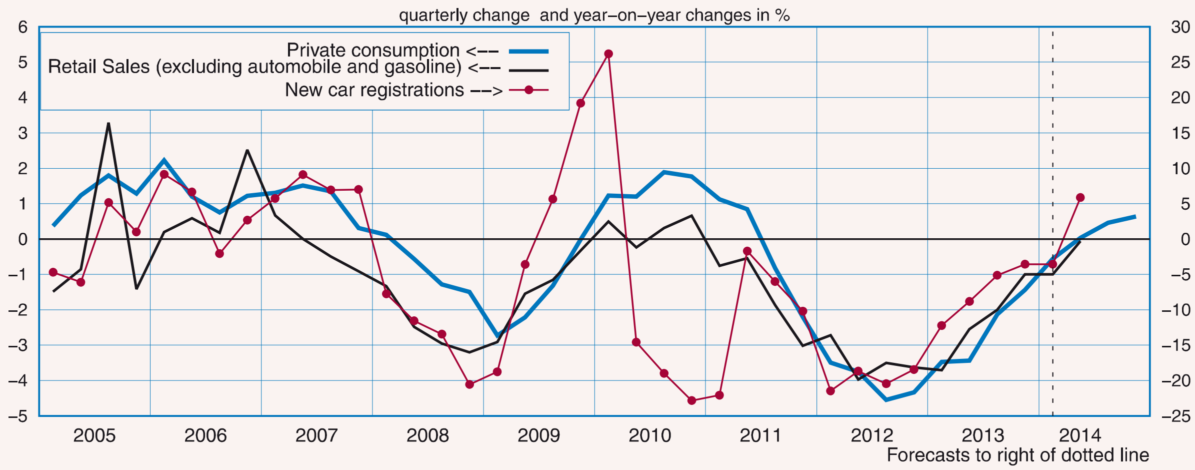
After three years of uninterrupted decline, Italian household consumption should increase in 2014

From 2010 to 2012, consumption in Italy declined, but less than the steep fall in disposable income would suggest. Since 2013 however, the situation of households has gradually improved, with a rise in purchasing power in the second half of the year. In the model selected here, we find a more standard relationship between consumption and income: in the short term, wage rises contribute in part to building up their savings. Indeed, the household savings ratio was once again moving upwards throughout 2013, even though confidence was gradually returning (*see Graph 3*). At the same time, consumption seemed better oriented over the quarters (*see Graph 4*).

Recent short-term indicators (retail sales, new car registrations; *see Graph 4*) suggest that consumption is likely to rise again in spring 2014 (after +0.1% in Q1). Then in H2 2014, household consumption should pick up (+0.3% mainly in Q3), as a result of a stimulus package[2] which should increase gross disposable income by 0.9%. However, as suggested by the model, Italian households should use this income rise to increase their precautionary savings: the savings ratio would then rise by 0.6 points in 2014. ■

(2) In accordance with the announcements made by Mr Renzi when he took office in March 2014, the budget presented by P.C. Padoan in April 2014 included a €100 reduction in income tax for households earning less than €25,000 per year, in other words an increase in income of around €1,000 net per year for monthly wages of less than €1,500 per month. The total cost of this measure is estimated by the government at €10 billion, and it could affect almost 10 million people.

4 - Private consumption, retail sales and new car registrations



Sources: Association of car makers, Istat

Spain

A strong recovery

Economic activity in Spain has found its way back to growth since mid-2013, and should maintain this Q1 momentum until the end of 2014 (+0.5% per quarter). Foreign trade shouldn't contribute to Spanish growth, only sustained by domestic demand. Investment in capital goods should keep the rapid growth rate of 2013 (+2.4% per quarter). Private sector consumption should also increase throughout the year, supported by small purchasing power gains generated by the improvement in the labour market. Finally, the rate at which construction investment is shrinking should slow, with the end of the fallout from the real estate bubble in prospect.

Activity set to increase sharply in 2014

The Spanish economy accelerated in early 2014 (+0.4% after +0.2%) and should continue this momentum over the forecasting period (+0.5% per quarter). Purchasing Managers Index (PMI) surveys and the national surveys are again announcing significant growth in activity in services and in manufacturing. In construction, however, they are still at a very low level. This sector is likely to continue to suffer from the period of adjustment in the property market and the slow recovery of the Spanish economy.

Private sector consumption should once again be the main contributor to economic activity

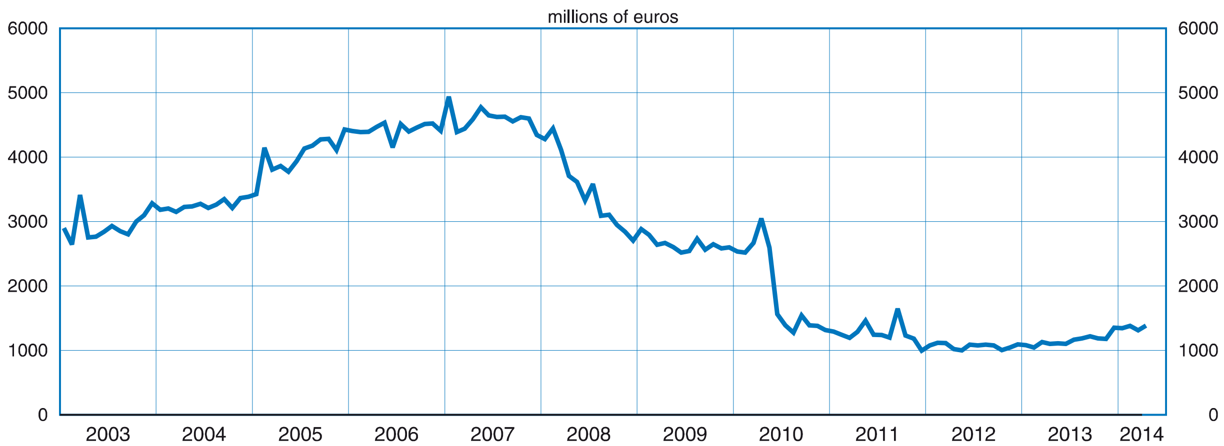
At the start of the year, consumer confidence reached a higher level than the average for the 2000s. Spanish households are indeed much less worried about future rises in unemployment. Their opinion of their financial situation is also improving.

Employment should stabilise in H1 before increasing in H2. Household purchasing power should benefit in particular from the rebound in wages, while inflation is likely to be very low. In addition, tax rises should slow, they should rise by an average of 1.0% per quarter in 2014 (compared with +2.0% on average per quarter in 2013). Thus purchasing power should increase slightly between Q2 and Q4 2014, after four years of sharp decline. After falling from 2010 to 2013, the savings ratio of Spanish households should decline slightly in 2014 to settle at a lower level than its long-term average. All in all, consumption should increase sharply, as the recent rise in consumer credit would suggest (*see Graph 1*).

Investment in equipment showing strong progress

There was a sharp increase in investment in equipment throughout 2013, sustained on the one hand by the need to reinvest after a marked phase of adjustment, and on the other hand by the high level of business margins. It should continue to grow over the forecasting period, at an annual rate of around 10%. ■

Household consumer credit*



** including non-profit institutions serving households (NPISHs)*
Sources: Bank of Spain, INSEE calculations

United Kingdom

Still dynamic

The upturn in the United Kingdom economy has been vigorous since the beginning of 2013 with activity growing by 0.8% in Q1 2014. This recovery should continue at more or less the same pace in Q2, as suggested by the very high levels in the business tendency surveys, especially for services, and the dynamism of domestic demand supported by a well oriented household confidence which remains high. Activity should slow slightly in H2, linked with the current levelling off of the property market.

Business tendency surveys at their highest levels since 1989

Economic activity in the United Kingdom increased substantially once again in Q1 2014 (+0.8% after +0.7% in Q4 2013 and +0.8% in Q3). In Q2 2014, growth in the United Kingdom should remain dynamic (+0.7%). The Markit business tendency surveys and the CBI surveys maintained their high levels in April (the highest since 1989 for the CBI). Growth should be particularly dynamic in the service sector and in manufacturing. In H2 2014, activity should increase at a more moderate pace (+0.5% per quarter) because of the slowdown in both domestic and foreign demand. All in all, United Kingdom growth should reach +2.8% in 2014, after +1.7% in 2013. GDP should regain its pre-crisis level in mid-2014, i.e. three years after France and Germany.

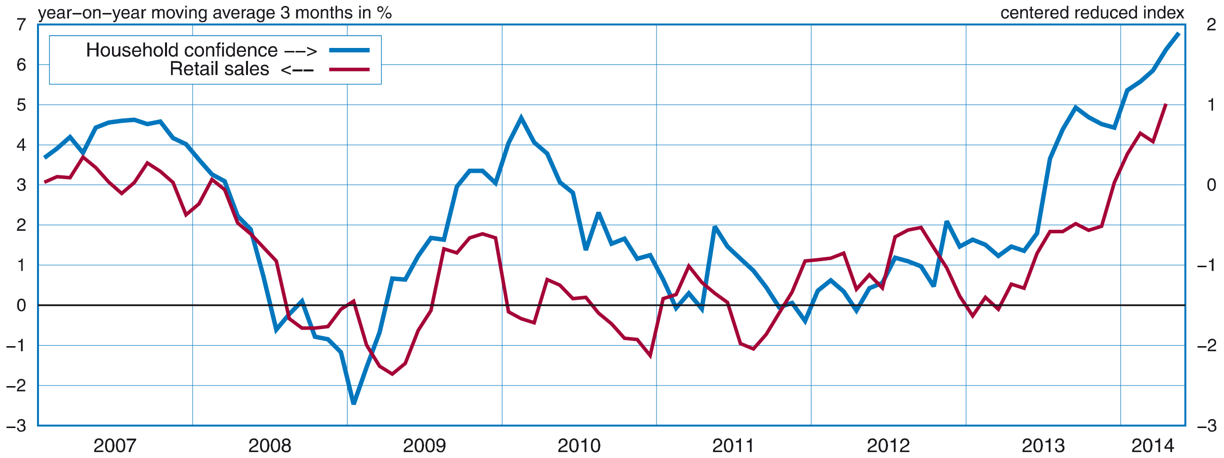
Domestic demand likely to slow in H2

Household consumption and investment once again drove growth in Q1 2014. Consumer confidence has picked up substantially (*see Graph*), in line with the improvement in the labour market and the wealth effects generated by the rise in property prices. Households should therefore continue their upsurge in consumption expenditure in Q2 (+0.7% after +0.8%). In H2, household expenditure should slow slightly. On the one hand, the amounts of mortgage credit available have decreased over the last few months, probably as a result of the tightening of the Funding for Lending Scheme. On the other hand, the increase in real wages should remain weak and the dynamism of employment is likely to run out of steam, which will tend to reduce household purchasing power. As for businesses, increased production constraints and the high level reported in investment intentions surveys suggest that investment should maintain its dynamism.

Contribution of foreign trade should be negative in H2

In the last two years, the increase in exports has remained modest and the United Kingdom's market share has continued to shrink. In addition, the strong pound is likely to hinder competitiveness. Exports should therefore increase more slowly than world trade over the forecasting period. Bolstered by the dynamism of domestic demand, imports should increase significantly; as a result, the contribution of foreign trade should be negative until the end of the year. ■

Household consumption and confidence: strong recovery since 2013



Sources: ONS, DG Ecfin, INSEE calculations

United States

Growth holds firm, but without taking off

Activity dropped in Q1 (-0.2% after +0.7%), as a result of extreme weather conditions and the decline in exports, but it should rebound in Q2 in reaction to the previous quarter (+0.8%). In H2, the catch-up effects should disperse with activity slowing slightly (+0.6% per quarter). Overall, growth is unlikely to take off in 2014 (+2.0% after +1.9%) despite the boost to purchasing power (+2.1% after +0.7%) and consumption (+2.7% after +2.0%). Indeed, after a vigorous upswing lasting two years, residential property should be at a standstill (+1.4% after +12.2%).

A clear improvement in the labour market

The American economy created 924,000 jobs between February and May and the unemployment rate fell once again to settle at 6.3%. This drop should continue until the end of the year and should be matched by a slight upturn in wages. Overall, despite a slight increase in prices, purchasing power gains from income should remain solid in 2014 (+2.1% after +0.7%).

In Q1, despite the cold which curbed purchases of goods, household consumption of both goods and services was sustained (+0.8%), due to soaring expenditure on healthcare with the introduction of the Affordable Care Act. Consumption should remain dynamic until the end of 2014, sustained by the increase in the purchasing power of income, the drop in unemployment and the continuing rise in health expenditure, even though this may be at a more moderate rate.

Government spending no longer slowing activity

Fiscal policy was restrictive in 2013: the budget deficit fell from 9.3% in 2012 to 6.4% in 2013 as an annual average, and federal spending has declined sharply in the last six months as a result of the shutdown at the end of 2013 then the cold weather in early 2014. However, the 2014 budget approved by Congress in January has significantly reduced automatic cuts: all in all, federal spending should increase at a moderate rate between now and the end of the year.

Investment ready to recover

Corporate investment declined in Q1, for the first time in a year (-0.4%), the harsh winter having delayed deliveries of materials. Investment should bounce back as a reaction to this decrease in Q2 (+1.7%, *see Graph*). Household investment has been declining for six months due to the rise in interest rates in summer 2013 and the cold winter of 2014. These two effects should fade and investment in the residential sector should pick up once again before the end of the year, as suggested by the increase in the number of new housing starts and planning permits registered since January.

Exports fell in Q1 (-1.5%) as a result of the decline in world trade and the reduction in sales of hydrocarbons. They should take off again in Q2 (+1.8%), in line with world trade (*see Focus*). Imports too should recover some of their momentum, backed by the dynamism of domestic demand. ■

Rebound in investment expected in Q2

Source: EA, Census

The United States has been increasing market share since 2005, a fact which is fully explained by the fall of the dollar.

American market share has decreased by three points in value since 2000 but has not fallen back since 2008...

Since 2002, the United States is no longer the world's first exporter. American exports, which represented about 11% of world trade in goods between 1974 and 2000 (12.5% for all goods and services) fell abruptly between 2001 and 2007, under the dual effect of the appreciation of the dollar and increased competition from emerging countries, particularly China (*see Graph 1*). Then, since 2008, the American share of exports stabilised at around 8.0% and has even slightly increased since 2011.

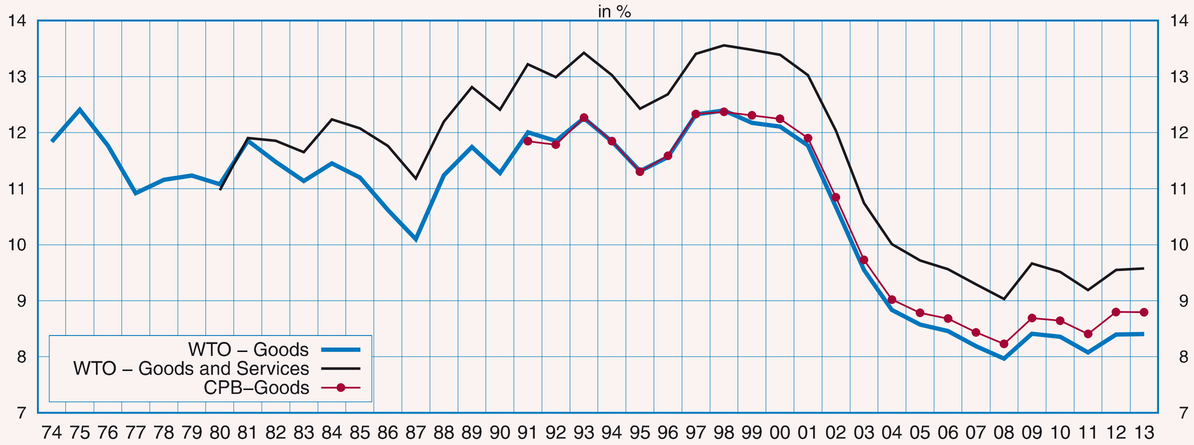
... in volume, it has even picked up a little since 2005

Market share in volume also fell between the end of the 1990s and the middle of the 2000s, in relatively identical proportions (between -16.9% and -23.9%) depending on the sources used1 (*see graph 2*). Since 2005, market share has risen again (between +2.7% and +8.4%). For goods alone, the IMF, the CPB and the WTO value it around +6% to 8%; for goods and services, the estimates of the IMF and the OECD are both around +5.5% (*see Table 1*).

How can this upturn in market share since 2005 be explained? Did the United States increase its competitiveness beyond fluctuations in the dollar's exchange rate?

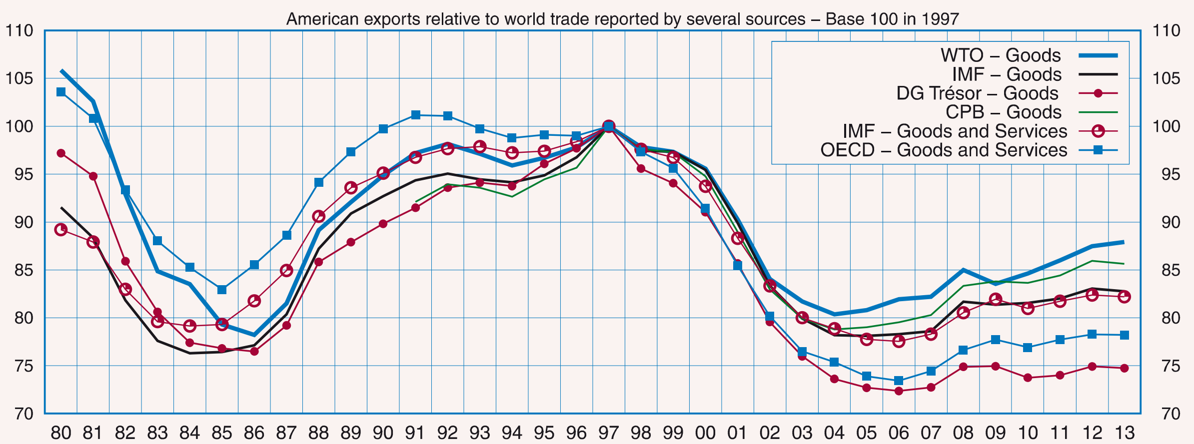
(1) The difference is due partly to the number of countries included in the calculations by different institutions, and partly to the primary sources used (national accounts or customs). The WTO and the CPB use customs data, whereas the IMF, the OECD and the Treasury Department use national accounting data. Moreover, the WTO uses customs unit prices to deflate the data in value and therefore ignores the quality effects. However, with the exception of the WTO, which reprocesses the series, all the other institutions use the series of American exports in volume calculated by the US Department of Trade.

1 - American exports' share of world exports in value



Source: OMC, Centraal PlanBureau (CPB)

2 - American market share in volume



Source: WTO, FMI, OECD, CPB, BEA, DG Trésor

This positive development results in part from geographical orientation

The geographical orientation of American exports explains about three points of the fall in market share between the end of the 1990s and the middle of the 2000s, and an equivalent rise since then. The United States is profiting from its proximity to the countries of Latin America, whose imports have been much more dynamic than the rest of the world's since 2009, whereas the opposite was true between 1999 and 2007.

A development in line with the development of cost competitiveness

We used used a similar method than in *Borey and Quille (2013)*[2] to estimate United States' exports as a function of its principal standard determinants (world demand for American products and cost competitiveness index) in one step from Q1 1991 to Q4 2007. Several models were developed, according to different world trade sources and by testing four cost competitiveness indicators: unit labour costs, American exports of manufactured products prices (relative to world prices), the real effective exchange rates calculated by the Fed and those calculated by the Treasury Department (*see Graph 3*).

According to the world trade series used, the estimated loss in the level of market share from 2001 was between 14% and 30% (*see Table 2*). The estimated elasticity of exports to cost competitiveness is even more sensitive to the series used: it varies between 0.0 and 1.0. At all events, it is low when compared with estimated elasticity in the European case reported by *Borey and Quille (2013)*.

All in all, in spite of the wide divergences in level depending on the sources used, American exports are globally in line with the dynamic simulation of the model, which indicates that geographical orientation (world demand for American products) and the dollar's past depreciation suffice to explain the increase in market share (*see Graph 4*): hence there is no increase in competitiveness in the American export, beyond fluctuations in cost competitiveness, and perhaps even the dollar's exchange rate. ■

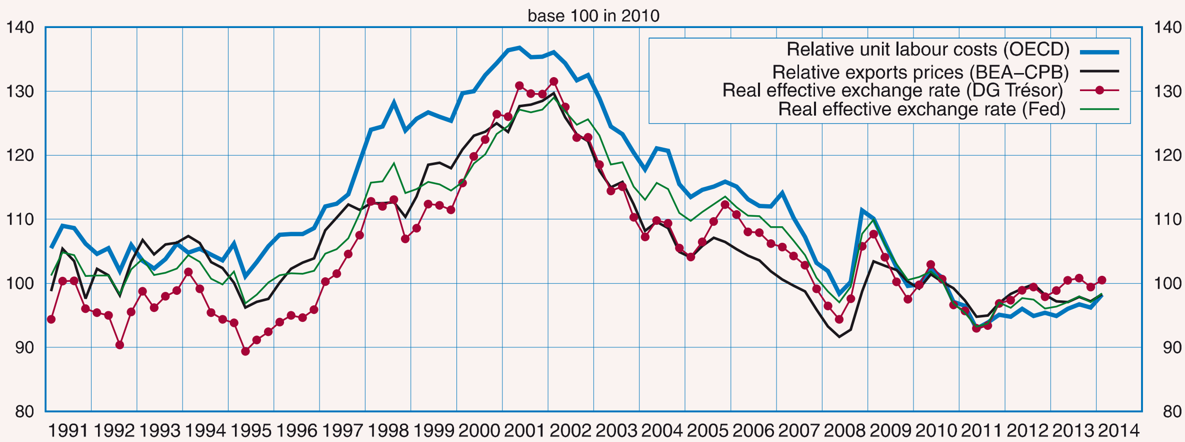
(2) See Borey G. et Quille B., "How to explain the recent shift in balance-of-trade trends in Europe", *Conjoncture in* France of June 2013.

Table 1

The development of the United States' exports share (in %)

Source	Champ	2004-2006 / 1995-2000	2012-2013 / 2004 -2006
WTO	Goods	-16.9	8.2
IMF	Goods	-19.4	6.0
DG Trésor	Goods	-23.9	2.7
CPB	Goods	-18.1	8.4
IMF	Goods and services	-19.8	5.4
OECD	Goods and services	-23.5	5.4

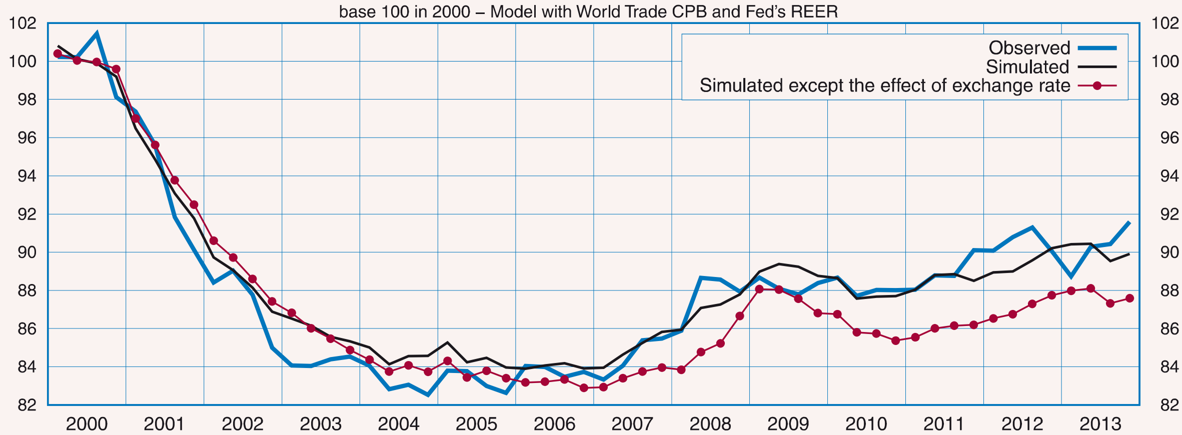
3 - Indicators of cost competitiveness in the United States



Source: WTO, IMF, OECD, CPB, BEA, DG Trésor

4 - American exports relative to world trade

base 100 in 2000 – Model with World Trade CPB and Fed's REER



Source: INSEE calculations

Table 2

Explained variable	world trade		Estimate of loss of market share from 2001 (in %)				Estimate of long term elasticity of exports to the real effective exchange rate				Exports differential from the simulated dynamic as a % in Q4 2013			
	Source	Scope	ULC	REER DGT	REER Fed	Relative exports price	ULC	REER DGT	REER Fed	Relative exports price	ULC	REER DGT	REER Fed	Relative exports price
Exported qantities - WTO	WTO	Goods	-14	-15	-15	-15	0,1	0,1	0,1	0,2	2,6	3,8	2,6	3,1
Exports of goods - BEA	IMF	Goods	-18	-19	-19	-20	0,1	0,2	0,2	0,3	-0,4	0,4	-0,8	1,2
Exports of goods - BEA	DG Trésor	Goods	-24	-24	-24	-30	0,5	0,7	0,9	1,0	-9,7	-5,1	-9,9	-5,7
Exports of goods - BEA	CPB	Goods	-16	-16	-16	-18	0,0	0,2	0,1	0,4	3,9	3,9	3,4	2,8
Exports of goods and services - BEA	IMF	Goods and services	-18	-18	-18	-21	0,3	0,3	0,4	0,5	-2,0	0,3	-2,1	-0,3
Exports of goods and services - BEA	OECD	Goods and services	-22	-21	-21	-25	0,5	0,5	0,6	0,8	-5,5	-1,4	-5,3	-1,8

How to read it: The quarterly series consistent with world trade calculated by the WTO and the IMF are rebuilt by calibration-adjustment, with the aid of three world trade series available on a quarterly basis (DG Trésor, CPB and OECD). Likewise, the WTO's quarterly series of American exports is estimated by calibration-adjustment with the aid of the Department of Commerce's series of goods exports. The series of real effective exchange rates are calculated monthly by the Fed and DG Trésor. The relative ULC are published quarterly by the OECD. The relationship between prices and exports is constructed with the aid of the monthly series of American export prices by the BEA and world export prices of manufactured products by the CPB. This is where we made the choice of modelling the loss of market share from 2001, the date when China entered the WTO, with a break in the constant of long-term relations: we thus estimate that it was an irreversible loss linked to the appearance of a new competitor in world trade, but not a linear trend for loss of market share. Lastly, the series on geographical orientation is the relationship between world demand for US products and world trade estimated by the Treasury Department to obtain an approximation of series of world demand for US products

Japan

The VAT increase puts pressure on activity in the spring

Activity in Japan increased sharply in Q1 2014 (+1.6% after +0.1%) boosted by advance purchasing not only by households but also by businesses before the VAT increase came into force on 1st April 2014 (from 5% to 8%). In Q2 2014, activity should fall as a reaction to this (-1.0%) before reviving with a modest increase in H2 2014 (+0.3% per quarter).

According to the business tendency surveys, activity in Q2 should decline significantly

In April, the business tendency surveys reached a turning point and activity is now set to decline in the spring. The PMI indicator for the manufacturing sector lost more than 4 percentage points (49.4 after 53.9 in March) due to the drop in production and orders, and stabilised in May. The decline in activity in Japan is also visible in the deterioration in the business climate for SMEs, as reported by the survey carried out by the Shoko Chukin Bank. However, the feeling about future activity in the national surveys (Economic Watchers Survey) is picking up (53.8 in May compared with 34.7 in March, see Graph) paving the way for an upturn in activity in H2, after the negative shock caused by the VAT increase.

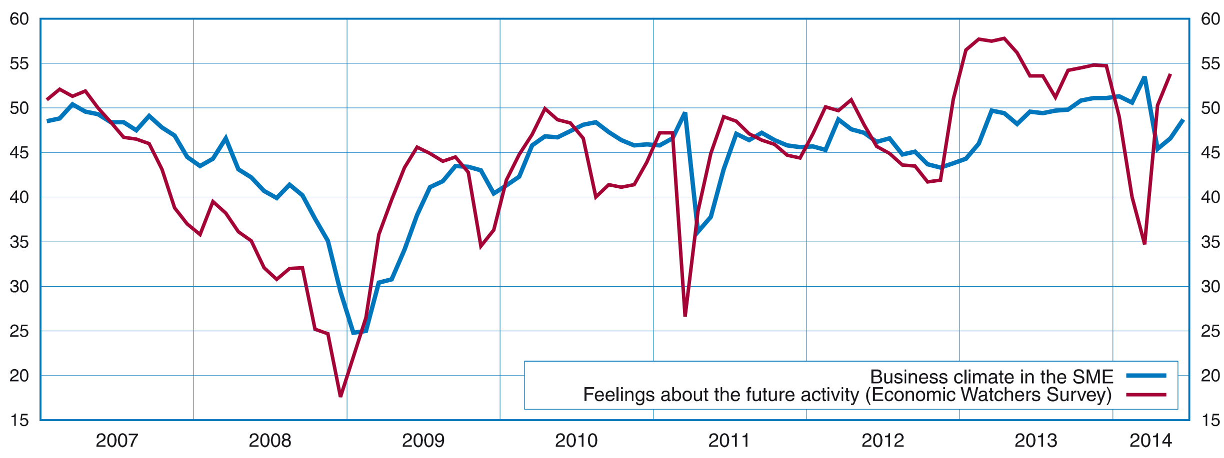
Domestic demand should decline

In reaction to the purchases made in Q1 in anticipation of the rise in VAT, household consumption should fall steeply in Q2 (-2.0% after +2.2%). In addition, inflation is likely to exceed 3% before the end of the year, for the first time in twenty years, while the rebound in wages, although real should nevertheless remain modest: the purchasing power of wages is therefore likely to decline and consumption to be lacklustre in H2. Households will probably also cut back drastically on their investment spending between now and the end of the year: deeds of sale signed before 1st October 2013 were still charged VAT at 5%, and so housing starts took off towards the end of 2013, before collapsing at the start of 2014. Finally, productive investment is also set to decline in Q2 (-1.4%) after a very dynamic Q1 (+7.6%). However, it should return to modest growth in H2 (+0.5% per quarter) as hinted at by the rebound in orders recorded in March.

The trade deficit should remain high

The business tendency surveys suggest a clear slowdown in exports after the lively progress in Q1 2014, and exports should slow markedly in Q2 in a backlash effect (+0.5%). Then, in line with world trade, exports should grow in H2 (+0.6% per quarter). Imports should fall in Q2 (-1.5%) in the wake of domestic demand, to bounce back somewhat in H2 (+0.5% per quarter). Overall, the balance of goods and services deficit should climb to almost 4% of GDP in 2014, after 2.8% in 2013, its highest level for forty years. ■

Business tendency surveys



Sources: Shoko Chukin Bank, Cabinet office

Emerging economies

Concerns about China, Russia falling behind

In Q1 2014, economic activity in the major emerging economies continued to grow much slower than its trend: +1.1% after +1.2%, compared with an average of +1.7% from 2000 to 2010. Imports in the emerging countries were at a standstill (-0.1%) while exports shrank significantly (-2.5%), especially in Asia.

It appears likely that activity will just be ticking over through to the end of the year. After Q1 was disrupted by the New Year, activity in China should pick up in spring; but this upturn will probably be limited because of the downturn in the construction sector recorded since January. The crisis in Ukraine has caused a collapse in investment in Russia and is harming prospects in Eastern Europe. In Brazil, the business climate in industry and construction is deteriorating just as the country is hosting the football World Cup.

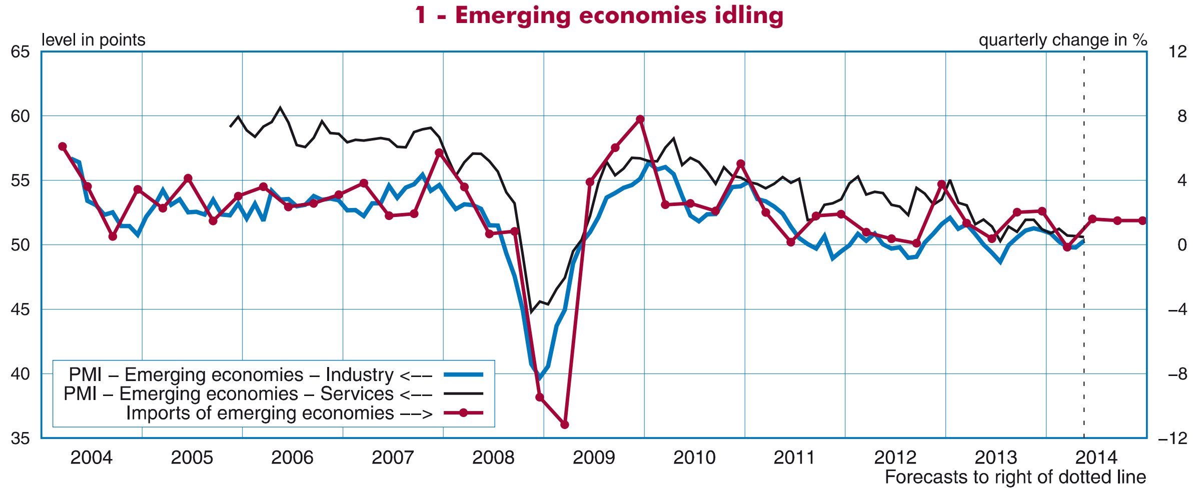
No improvement in sight despite a period of financial calm

The prospect of a slowdown in money creation in the United States led to a first wave of withdrawal of capital invested in the emerging countries and a sudden depreciation of their currencies in summer 2013, particularly in those countries with a high current deficit. After a period of calm in autumn, capital withdrawals picked up again in December, giving rise to a new fall in both markets and currencies, especially in Russia, Turkey and Argentina. The central banks intervened on the foreign exchange market and once again tightened their monetary policies (Brazil, India, Indonesia, Russia, Turkey). Since March, tensions over the financial markets have cooled and both share prices and currencies have picked up. However, it is likely that this monetary tightening in the past will continue to affect activity which is likely once again to just tick over. Indeed, the business climate has slumped since November 2013 and was still at a very low level in May 2014, compared with the average for the 2000s (see Graph 1). Imports should pick up slightly after marking time in Q1, but overall they should slow to +4.9% in 2014 after +6.2% in 2013, a long way below the average annual rate between 2000 and 2010 (+9.6%).

Property slipping back in China

Activity once again slowed in Q1 2014 in China (+1.4% after +1.7%). Although the temporary shocks that affected activity in Q1 have faded away (shrinking world trade, Chinese New Year) giving a slight boost in spring, it should still be limited according to the first indicators available. In May, industrial production had picked up by only 8.8% in a year, one of the lowest increases since 2009. The business climate in the industrial sector is still relatively lacklustre. As for demand, investment clearly seems to be slowing (see "*Slowdown in China: what risks for the world economy?*"): the increase in the acquisition of fixed assets reached +17.2% in May, its lowest since 2001. As a result of the tightening of credit conditions, the property market has reached a turning point: housing starts have collapsed (-20% year-on-year for the first four months of the year), as have sales of commercial properties (-7%) and land (-8%). Property prices have also settled down after a surge in 2013.

1 - Emerging economies idling



Sources: Markit,Centraal PlanBureau, INSEE forecasts

A struggling Brazilian economy welcomes the World Cup

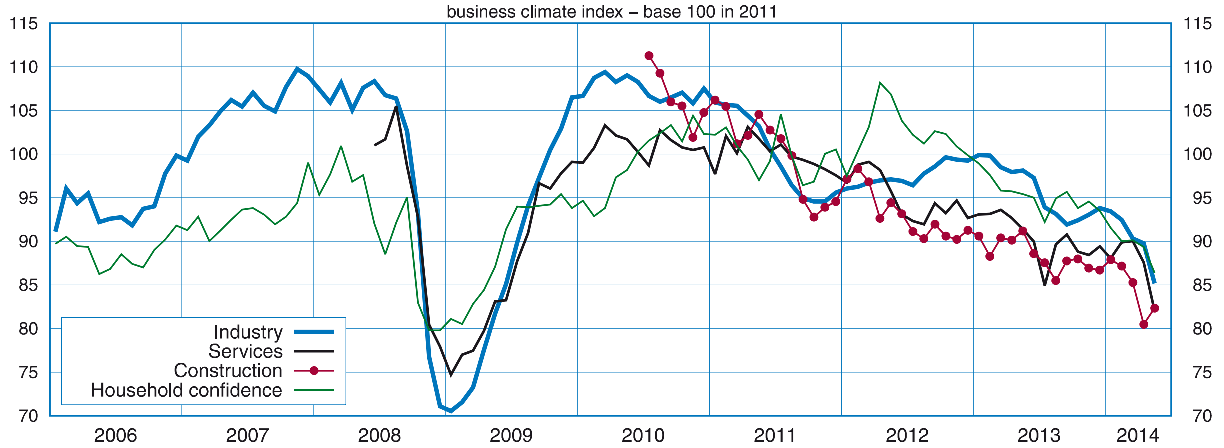
In Brazil, monetary easing and fiscal stimulus measures enabled activity to rebound as from Q2 2012. This stimulation in demand has caused a serious deterioration in the country's trade balance: it barely reached equilibrium in 2013 whereas it had a major surplus until 2012. However, a succession of monetary tightening policies in the last year along with social movements have contributed to a reversal of the business climate. In May 2014, household confidence was at its lowest since 2009 (*see Graph 2*) and the confidence of business leaders was deteriorating, especially in industry and construction. Support from this sector is likely to moderate considerably when projects linked with hosting the World Cup are completed.

The Ukrainian crisis has shaken Russia and weakened Eastern Europe

Activity in Russia had been showing signs of picking up for the last six months, but it shrank in Q1 2014 (-0.5%). Since the beginning of the year the Ukrainian crisis has led to a massive withdrawal of capital and caused the rouble to decline: investment has dropped (-4.9% in volume year-on-year in Q1), as have imports of goods (-7.5% in value over one year, *see Graph 3*). The business tendency surveys have deteriorated sharply since January, against a background of successive monetary tightening (increase in base interest rates from 5.5% to 7.5% between February and April). As a result, the Russian economy could be entering recession in Q2 2014. Probably as a repercussion of the crisis in Ukraine, the business climate in Poland and the Czech Republic has also been reversed, signalling a slowdown in activity. ■

2 - A struggling Brazilian economy welcomes the World Cup

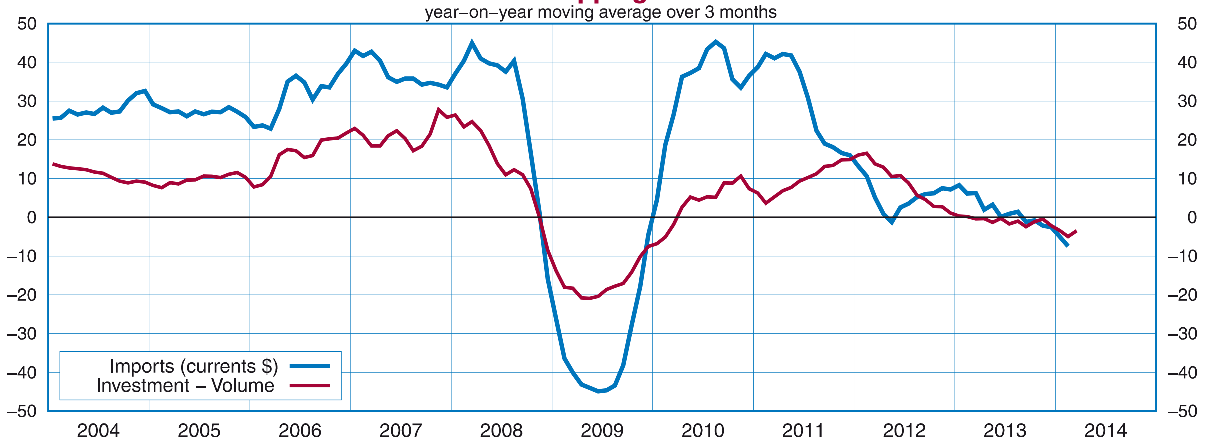
business climate index – base 100 in 2011



Source : Fondation Getulio Vargas

3 - Investment slipping back in Russia

year–on–year moving average over 3 months



Source: Russian Central Bank