Germany

The growth would remain solid

In Germany, activity slowed in Q1 2015 (+0.3% after +0.7%), adversely affected by changes in inventories (contribution to growth of -0.3 points after +0.4 points). However, domestic demand excluding inventories remained strong. In Q2, activity should pick up slightly (+0.5%): the past depreciation of the Euro and the acceleration of world demand for German products should sustain exports. In H2, growth in activity is set to continue at the same pace (+0.5% per quarter). All in all, growth is expected to reach +1.6% in 2015, as in 2014.

Household consumption remains buoyant

Household consumption grew sharply again in Q1 2015 (+0.6% after +0.7%). Household confidence levels remain very high, and retail sales and car registrations are rapidly growing, suggesting that household consumption expenditure should again rise significantly in Q2 (+0.4%). Consumption is then likely to remain sustained in H2 2015 (+0.6% in Q3 and +0.7% in Q4), due to generally dynamic purchasing power, supported by the rise in the minimum wage at the beginning of the year and by continued job creations.

Jolts in construction

Since last autumn, temperatures above seasonal norms have stimulated construction activity. Investment in construction should fall back due to an expected backlash effect in Q2 2015 (-0.5% after +1.7% in Q1). In Q2, investment in the sector should only increase modestly (+0.3% per quarter): while orders picked up at the beginning of the year, building permits have been stagnant since the beginning of 2014 and the business climate in the sector has recently declined.

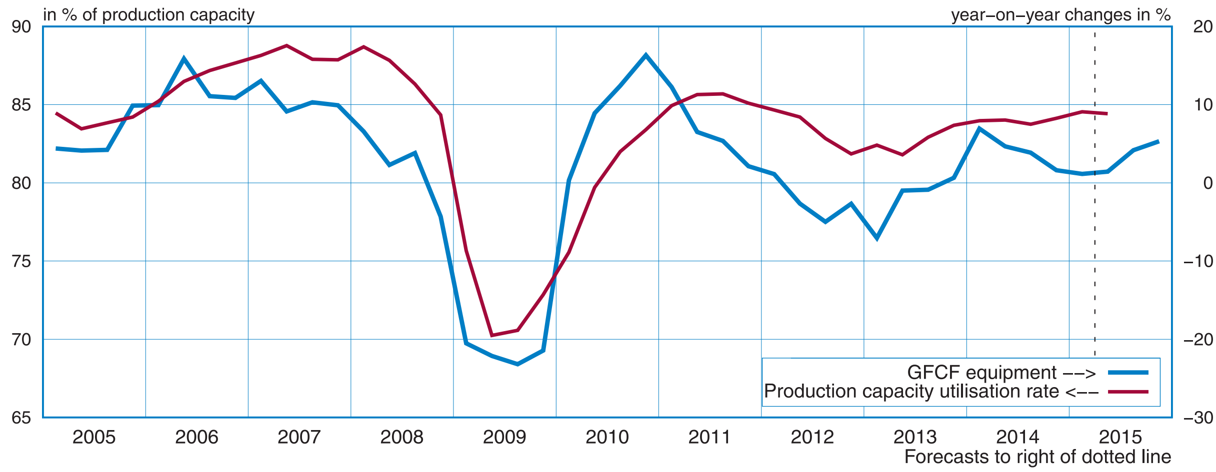
Investment in capital goods picks up

Investment in capital goods picked up in Q1 (+1.5% after +0.4%). Surveys point to renewed business confidence, and the production capacity utilisation rate has climbed over the past few quarters (*Graph*). The upswing in investment should consolidate through to the end of the year, and growth of 3.0% is expected overall in 2015 (after +4.2% in 2014).

Foreign trade not expected to contribute to growth in 2015

In Q1, exports remained less dynamic (+0.8% after +1.0%) than imports (+1.5% after +1.9%) despite the past depreciation of the Euro. In Q2, imports are expected to slow down, returning to a pace that is more in line with domestic demand, and exports should accelerate, sustained by world demand. In H2 the vigour of domestic demand is set to increase imports, so that foreign trade is expected to make a neutral contribution to growth. On average over the year, foreign trade is expected to make no contribution to growth in 2015 (after +0.3 points in 2014). ■

Investment in capital goods is set to restart



Source: Destatis, INSEE forecasts

Italy

Out of recession

In Q1 2015, Italy returned to growth (+0.3%). The following quarters are expected to confirm this modest recovery of momentum. On average over the year, growth should reach +0.6% in 2015 (after -0.4% in 2014 and -1.7% in 2013), stimulated primarily by private consumption and investment in capital goods, the latter being expected to bounce back significantly (+5.4%) after three years of decline. Foreign trade should again contribute positively to growth (+0.1 points in 2015 after +0.2 points in 2014).

Investment driving growth in 2015

In Q1 2015, Italian activity increased (+0.3%) after stagnating in Q4 2014. This growth was boosted by investment, up by 1.5%, the highest rise since late 2006.

On the one hand, investment in capital goods increased vigorously (+3.9% after +1.2%, see *Graph*), particularly transport equipment. This is the result of several favourable factors that should continue to contribute over the course of the coming quarters (0.0% in reaction in Q2, +0.7% in Q3, +1.5% in Q4): greater utilisation of production capacities, more buoyant domestic demand, improved credit conditions, and a self-financing ratio close to its long-term average should allow companies to emerge from a long period of underinvestment. All in all, investment in equipment should rebound in 2015 (+5.4%) after three years of contraction.

On the other hand, investment in construction rebounded in Q1 (+0.5% after -0.5%). The long crisis that started in 2008 (37% cumulative decline between early 2008 and late 2014) is expected to end, and this type of investment should continue to grow moderately over the course of the coming quarters. On average over the year, it should decrease in 2015 (-0.4%), but much less than in 2014 (-4.7%).

Change in inventories sustained growth in Q1 (by +0.5 points) after having an adverse affect in Q4 (-0.6 points). It should make a neutral contribution to growth through to the end of 2015.

Household consumption should increase as much as in 2014

In Q1 2015, household consumption fell back slightly (-0.1% after +0.1%). It is then expected to grow slightly faster (+0.1% in Q2 then +0.2% per quarter in H2). On average over the year, consumption should increase as in 2014 (+0.3%), in line with purchasing power which is expected to pick up for the first time since 2007 (+0.4%). After returning to growth in 2014, employment, supported by the 'Jobs Act' (see *Box*) should continue to progress in 2015.

Foreign trade once again contributing positively to growth

Exports should accelerate in Q2 (+1.2%), after stagnating in Q1. They should then continue to rise, albeit at a slightly slower pace (+1.0% per quarter in Q2), driven by the rise in world demand and the past depreciation of the Euro. Imports should also remain sustained (+0.6% after +1.4% in Q1, then +0.8% per quarter in H2), in the wake of growth in nearly all components of domestic demand. All in all, foreign trade should again contribute positively to growth in 2015 (+0.1 points, after +0.2 points in 2014). ■

Investment in capital goods recovers

Sources: Markit, Istat

The "Jobs Act", a law to reform the Italian labour market

The Italian labour market has certain specific weaknesses...

Unemployment has risen steeply in Italy since 2008, as it has in most European countries, increasing from around 7% at the start of 2008 to over 12% in mid-2013. But Italy also has its own specific problems to deal with: the rate of employment among young people is one of the lowest in Europe (it stood at 16.3% in 2013); Italy's long-term unemployment rate is also one of the highest in Europe: in 2013, 57% of the country's unemployed had been out of work for over a year; and the labour market is marked by a sharp duality (OECD, 2015): alongside employees on open-ended contracts there are a large number of workers in precarious employment, particularly young people, recruited on fixed-term contracts with little chance that they will be converted into open-ended contracts. The Italian labour market is also characterised by its broad array of atypical labour contracts, including 'collaborative', 'job on call' and 'job sharing' arrangements (Prouet, 2015).

... which the Jobs Act seeks to remedy

The reform known as the 'Jobs Act' thus has the dual objective of bringing down the unemployment rate and reducing the proportion of workers on precarious contracts, by boosting the number of open-ended contracts. This reform incorporates several measures staggered over a number of years, with some already in force.

Firstly, the 'Poletti decree' of May 2014 makes it easier for employers to offer fixed-term contracts, removing the requirement for companies to justify the use of such contracts; at the same time the decree limits the terms of fixed-term contracts (36 months) and the maximum proportion of a company's total employees permitted to be on such contracts (20% maximum). This easing of the regulations on fixed-term contracts is expected to be offset by a future decree aimed at restricting the use of other forms of precarious employment: the typology of atypical labour contracts available should thus be simplified. Furthermore, the introduction of a minimum hourly wage for employees not protected by a collective bargaining agreement (expected to be between €6.50 and €7 net/hour) is currently being discussed with employers' and employees' representatives.

The second measure, introduced in the budget act for 2015, comprises a full exemption from employer's social contributions for three years, up to a limit of €8060 per annum, for all employees hired on open-ended contracts in 2015 (on the condition that the person has not occupied a permanent position within the preceding six months, in order to limit windfall effects). The corresponding reduction in the cost of labour should average at around 20% for all new hires. According to the Italian government, a million new hires on open-ended contracts should be eligible for this incentive in 2015 (Ministero dell'Economia e della Finanza, 2014). This would be equivalent to a reduction of around 1.2% in the total cost of labour for all employees. The number of people benefiting from this incentive would not correspond to the net effect on employment: among the resulting hires, the following must be taken into account:

- hires on open-ended contracts which would have been made in 2015 without this incentive, a total of around 640,000 jobs if we consider the number of contracts signed in 2013 falling within the scope of this incentive;
- hires by substitution, i.e. hires on open-ended contracts of workers already on fixed-term contracts, or workers who would have been hired on fixed-term contracts without this incentive.

In order to estimate the net impact of this measure on employment, a conventional elasticity of employment to its cost can be set at 0.5; in this case, a 1.2% reduction in the cost of labour would lead to the creation of (or non destruction of) around 100,000 jobs.

The third measure of the 'Jobs Act', which came into force in March 2015, aims to make it easier to lay off employees recently employed on an open-ended contract: Article 18 of the Italian Labour Code, which allows employees whose economically-related redundancies are found to be unjustified by a court to get their jobs back, will not apply to new hires. This reform also fixes an upper limit on the amount of compensation it is possible to claim through legal action in cases of redundancy, defining this limit as two months' wages per year of seniority (with a minimum of 4 months and a maximum of 24 months). At the same time, the reform introduces a procedure allowing employees to receive a direct redundancy payment in return for waiving their right to pursue legal action. This compensation is less lucrative than that available via the previous one (one month's wages per year worked at the company, with a minimum of 2 months and a maximum of 18 months), but is tax exempted.

Finally, the labour market reform also extends to the unemployment benefit system. Entitlement to unemployment benefits has now been extended to 24 months (previously 12), their value will no longer depend on the jobseeker's age (but rather on the length of time they have been making contributions) and the number of workers eligible for these benefits has been significantly increased. The short-time working system is also being reformed. Lastly, the public system of regional employment agencies will be coordinated at national level and opened up to competition. ■

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Spain

Brisk growth

In Spain, activity once again grew strongly in Q1 2015 (+0.9%). Household and corporate demand both remained vigorous. The upswing in employment drove household confidence to its highest level since 2000. Activity should continue to grow at a sustained pace through to the end of 2015: +0.9% in Q2, then +0.8% per quarter in H2. For the year as a whole, GDP is expected to continue to grow sharply: +3.1% after +1.4% in 2014 and -1.2% in 2013.

Increasingly vigorous growth

In Q1 2015, activity again accelerated in Spain (+0.9% after +0.7%), driven by domestic demand. Household consumption remained buoyant despite a slight slowdown (+0.7% after +0.9%), as did corporate investment in capital goods (+1.3% after +1.8%). Government consumption rebounded in reaction to the previous quarter (+1.6% after -1.0%) and investment in construction continued to rebound (+1.5% after +1.4%). Moreover, foreign trade contributed to growth for the second consecutive quarter, as the rebound in imports (+0.8% after -0.6%) did not offset the good momentum of exports (+1.0% after 0.0%).

Optimistic households with growing purchasing power

As suggested by the business tendency surveys, growth should continue to be sustained in Q2 2015. Net job creations should remain significant and wages should pick up gradually, boosting household purchasing power once again. With confidence reaching its highest level since 2000, the pace of household consumption is again expected to increase: after a sharp rise in 2014 (+2.4%), its strongest growth since 2007, household consumption should continue to grow by 3.6 % as an annual average.

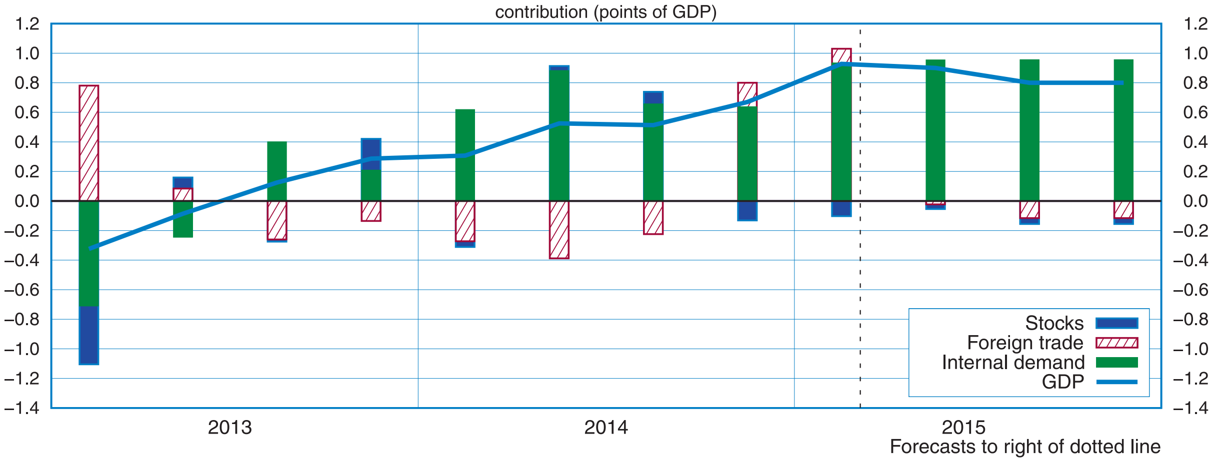
Investment in property and production expected to increase once more

At the same time, the recent rise in building permits and the renewed confidence among building entrepreneurs - albeit still below its long-term average - suggest that investment in construction should continue the recovery that started in spring 2014: +1.6% per quarter.

Corporate investment in capital goods should continue to grow at a rapid pace (around +10% per year), as it has since early 2013. This rise, made possible by very high corporate margins and improved external financing conditions, is the result of favourable demand perspectives and the need to boost production capacities which are being utilised on an intensive scale.

Lastly, in the wake of buoyant domestic demand, imports should increase more rapidly than exports, despite encouraging world demand and the past depreciation of the Euro. All in all, the contribution of foreign trade is expected to be slightly negative through to end-2015 and should reduce annual growth in 2015 by 0.1 points (after -0.9 points in 2014). ■

Contributions to GDP growth



Source: INE

United Kingdom

At cruising speed

In Q1 2015, British growth was disappointing (+0.3% against a forecast of +0.5% in the March Conjoncture in France report) due to a downturn in exports and despite the growth in domestic demand. Activity should return to sustained growth by the end of the year: +0.6% in Q2, then +0.5% per quarter in H2. It is likely to be driven by dynamic household consumption, in line with the expected progression of purchasing power. On average in 2015, British GDP should grow by 2.1%, after +2.8% in 2014.

The improved business climate is expected to herald an upturn in growth

In Q1 2015, the British economy slowed down (+0.3% after +0.6% per quarter in H2 2014) due to a negative reaction from foreign trade (contribution of -0.8 points after +0.8 points in Q4 2014), despite the recovery of domestic demand. In spite of a dip in May, the business climate remains well above the expansion threshold, suggesting that growth should increase in Q2 (+0.6%) and should maintain a sustained pace in H2 (+0.5% per quarter).

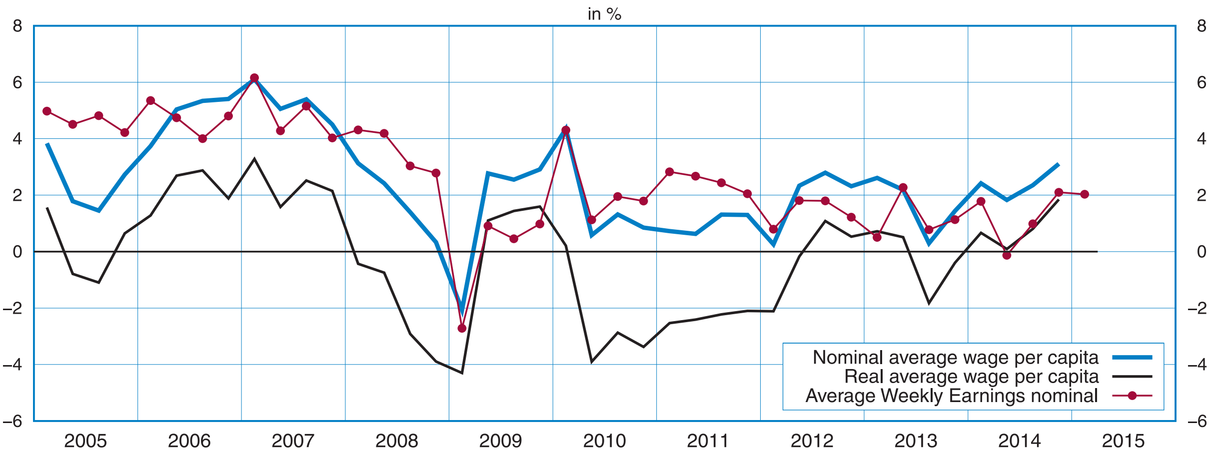
Real wages picking up and sustaining consumption British households continue to have a high level of confidence and their purchasing power is benefiting from the fall in energy prices. Household consumption expenditure should remain dynamic through to the end of 2015: +0.8% in Q2, then +0.7% and +0.6% in H2. All in all, household consumption should increase at a slightly faster pace in 2015 (+2.7%) than in 2014 (+2.5%). In addition to the effect of reduced inflation, household purchasing power should be sustained by an acceleration in wages, which in real terms recovered in 2014 after six years of contraction (*Graph*). However, there are likely to be fewer job creations than at the beginning of the year due to the past downturn in activity.

Household investment should also weaken as the property market calms down (prices slowing, decrease in the number of transactions and mortgages awarded). However, the rise in productive investment should remain vigorous, in line with the growth in activity. On average over the year, total investment should slow significantly (+2.9% in 2015 after +7.8% in 2014).

Foreign trade still taking its toll on activity

For the last two years, the United Kingdom has lost market share and its exports have grown modestly, partly due to the appreciation of the pound. Assuming that the pound stabilizes by the end of 2015, exports should grow moderately in H2 after a rebound in Q2 (+0.8%). In the wake of domestic demand, imports should increase more rapidly in Q2. All in all, the contribution of foreign trade to growth should again be negative: -0.4 points in 2015, after -0.5% in 2014. ■

After six years of decline, real wages returned to growth in 2014



Source: ONS,

United States

Fundamentals still robust

American activity contracted in Q1 2015 (-0.2%), affected in part by temporary factors. Activity should rebound in Q2 (+0.5%) thanks to the upturn in domestic demand, particularly corporate investment. Growth is expected to remain vigorous in H2 (+0.6% per quarter), driven by strong consumption and sustained private investment, despite the past appreciation of the dollar. Activity should grow by 2.0% on average over the year (after +2.4% in 2014).

Activity stalled in Q1

American activity contracted in Q1 2015 (-0.2% after +0.5%). Household consumption (+0.4% after +1.1%) suffered from particularly harsh winter temperatures. In addition, corporate investment fell back (-0.7% after +1.2%), as the fall in oil prices since summer 2014 led to significantly reduced expenditure on oil infrastructure. Furthermore, foreign trade was stifled by a dockers' strike at the major West Coast ports, which seems to have weighed down mainly on exports, resulting in a significantly negative contribution by the trade balance to growth (-0.5 points). Nevertheless, the weakness of activity can also be attributed to more lasting factors. The past appreciation of the dollar has placed a strain on American competitiveness, and surplus capacities on the labour market are diminishing.

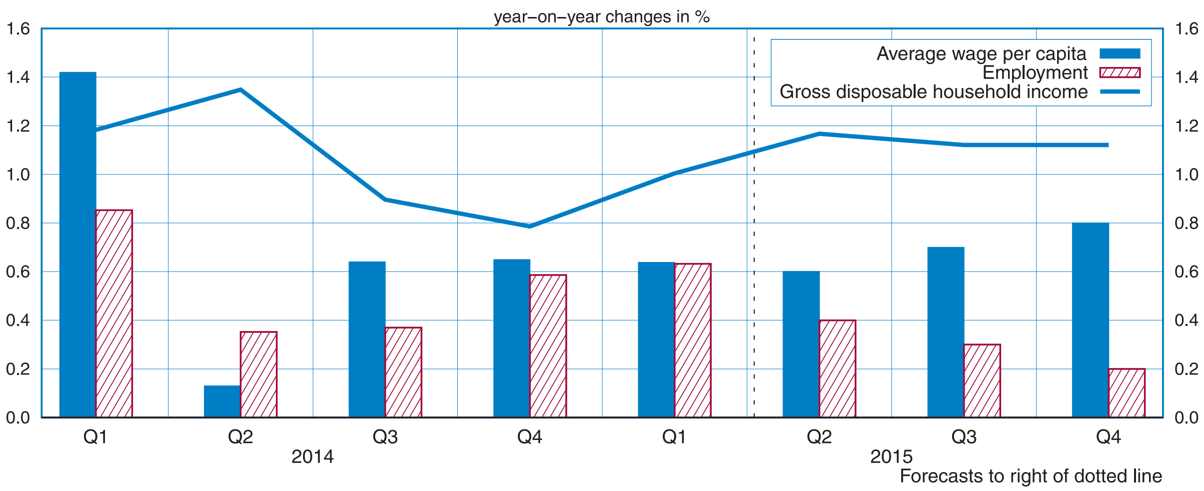
Employment slowing, but consumption still vigorous

Despite weak activity, employment was once again dynamic in Q1 (+0.6%). It should slow down slightly through to the end of 2015 (*Graph*), under the effect of a slight pick-up in productivity. All in all however, unemployment should fall once again: the unemployment rate should stand at 5.2% at the end of 2015 (against 5.5% in April), its lowest level since early 2008. The average wage per capita should increase through to the end of the year (+0.6% in Q2, then +0.7% and +0.8%), due to higher productivity gains, the fall in unemployment and a slight upturn in inflation. Purchasing power should therefore continue to grow steadily. As a result, private consumption should be vigorous: +0.5% in Q2 2015, then +0.7% per quarter in H2. All in all, consumption in 2015 should increase at a slightly faster pace (+2.8%) than in the two previous years (+2.4% then +2.5%).

Private investment should be sustained

After contracting in Q1 2015, corporate investment is expected to bounce back in Q2 (+1.6%), then progress at a brisk pace (+1.1% then +1.0%), in the wake of activity. After being adversely affected by poor weather conditions early in the year, household investment should again slow down slightly in Q2 (+0.2%), before picking up again in H2 (+0.5% then +0.9%). All in all, corporate investment should slow down significantly in 2015 (+3.8% after +6.3%), whereas household investment should accelerate (+3.5% after +1.6%).

Renewed momentum in wages should sustain household income



Source: BEA

The appreciation of the dollar likely to adversely affect foreign trade over the year as a whole

Over the course of Q1 2015, the Dollar continued to appreciate, particularly against the Euro. This rise has adversely affected US foreign trade, which should once again make a negative contribution to growth through to the end of the year, despite a marked increase in world demand. On average over the year, the external balance should cost -0.7 growth points, after -0.2 points in 2014. ■

How to account for the weakness of real wages in the USA and the UK, in spite of the substantial fall in unemployment?

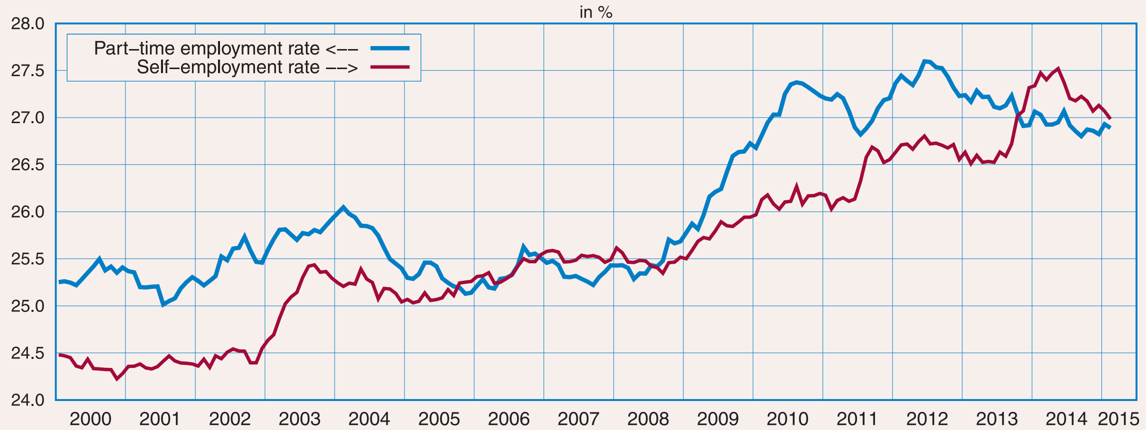
The weakness of wages has coincided with a sharp slowdown in productivity, particularly in the United Kingdom

The return to growth in the United States and the United Kingdom after the great recession of 2008-2009 has been characterised by a slowdown - very pronounced in the UK, less so in the USA - in apparent labour productivity. As such, job creations have been more vigorous since 2011 than the growth of economic activity would suggest. As a result the unemployment rate shrank very rapidly, reaching 5.4% in the USA in April 2015 and 5.5% in the UK in March, far below the peak levels seen in recent years (over 10% in the USA in 2009, and 8% in the UK in 2011) and close to the pre-crisis average.

Meanwhile, real wages per capita have remained sluggish since the crisis: average annual growth of +0.6% between 2010 and 2014 in the USA (compared with +1.5% between 2000 and 2007), and -0.9% in the UK (compared with +2.6% previously). From this point of view, the weakness of wages since 2010 would appear to be consistent with the slump in productivity.

In the UK, the sharp slowdown in productivity has been the subject of numerous analyses (see the analysis in the Conjoncture in France report for December 2013: 'In search of lost British productivity') and can be partly attributed to recent developments in the structure of employment. Since the crisis the rates of part-time employment and self-employment have increased substantially, and still remain well above their pre-crisis levels (*Graph 1*). At the same time, the creation of highly-qualified jobs has been sluggish since 2013: the dynamism seen in employment figures can be primarily ascribed to jobs demanding a low or medium level of qualifications, a workforce composition effect which has led to a slowdown in productivity and hindered the growth of wages. Furthermore, the tightening of access to unemployment benefits introduced in the Welfare Reform Act of 2012 and the more widespread use of so-called 'zero-hour contracts' may also have affected the nature of the increase in employment, confounding the usual pattern of wage rises. In the USA, the slowdown in productivity since the crisis has been less substantial than that seen in the UK.

1 - Development of part-time work and self-employment in the UK



Source: ONS

But, without this slowdown in productivity, the very rapid fall in unemployment should, according to the standard wage models (the 'Phillips curve'), have led to an increase in the bargaining power of employees, and hence an acceleration of wages. In reality the progress of real wages has remained far below that which we would have expected to see, given the sharp decline of unemployment: the Phillips curve has in fact flattened since the crisis, particularly in the USA (*Graphs 2* and *3*).

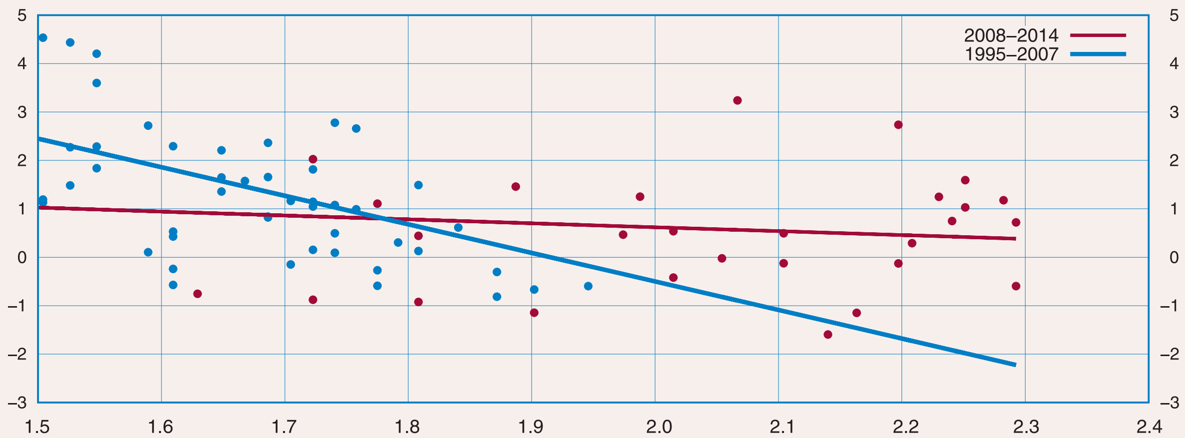
Surplus capacities on the labour market are more substantial than the level of unemployment would suggest

The unemployment rate alone is no longer a sufficient measurement of the surplus capacities on the British and American labour markets, for two main reasons.

On the one hand, the labour force participation rate is may decrease for cyclical and structural reasons. For example, in the United States a substantial proportion of the working-age population has ceased to participate in the labour market since 2008 (*Graph 4*). This decline in the labour force participation rate can be partly attributed to cyclical factors (the 'short-term activity reaction'): since the onset of the crisis, some unemployed people have given up hope and left the labour market; moreover, some young people have delayed their arrival on the labour market by extending their studies. This decrease is therefore reversible: one consequence of the decline in the labour force participation rate is the creation of a reserve of people capable of returning to the labour market, with a negative impact on wages for the period 1990-2012 (Blanchflower & Posen, 2014).

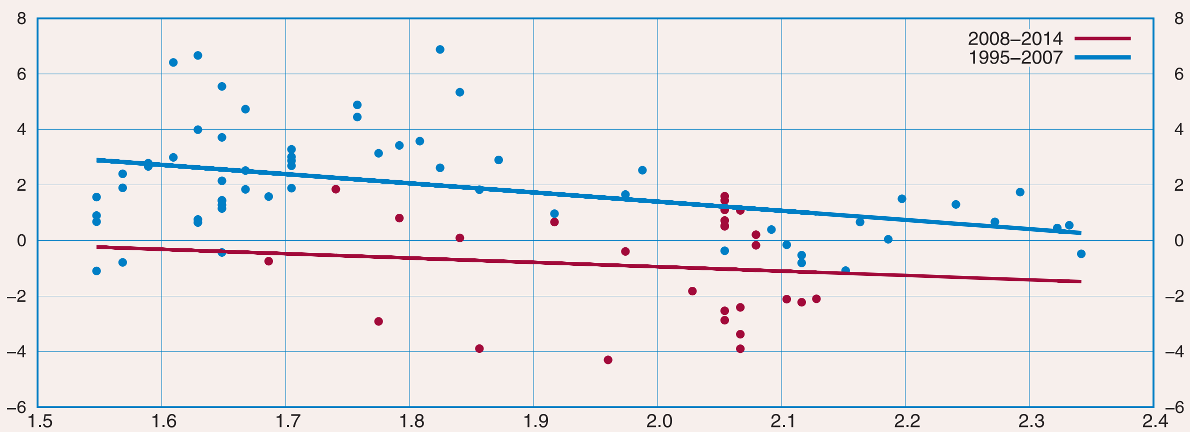
But the decline in the labour force participation rate may also be a result of structural factors. According to the Federal Reserve of Atlanta, to a certain extent (around 2 points between 2007 and 2014) the decline in the labour force participation rate in the USA may be a result of population ageing. In the UK, the labour force participation rate has followed a very different trajectory, much more in keeping with its usual cyclical behaviour: after falling during the crisis, it has rallied strongly since 2012 under the dual influence of improvements in the short-term outlook and structural reforms.

2 - Shift of the Phillips curve before and after the crisis in the US



Source: BLS

3 - Shift of the Phillips curve before and after the crisis in the UK



Reading note: *each quarter has its corresponding point on the graph, the X-axis of which is the unemployment rate (as a logarithm) and the Y-axis the variation in prices (year-on-year variation in real wages); the relation is clearly decreasing between 1995 and 2008, and much less so since 2009.*
Sources: ONS

On the other hand, unemployment rates present a binary view of the labour market which fails to reflect the intermediate states between employment and inactivity. In this respect, the American and British central banks make it clear that, in order to effectively steer their monetary policies, they base their analyses on a number of indicators measuring underemployment, which reveal the existence of considerable reserve capacities in the labour market for the period under consideration here.

In the USA, the 'U6' unemployment rate is often compared with the standard unemployment rate, because in the numerator it includes workers forced into part-time employment for economic reasons and inactive people who are nonetheless seeking employment. Although it has subsided since peaking in 2009, the underemployment rate has remained above its long-term average since then (Graph 5).

Underemployment has also increased in the British labour market: since the crisis, the number of hours worked per employee has been clearly inferior to the number of hours employees would like to work (involuntary part-time employment; Bank of England, 2015). ■

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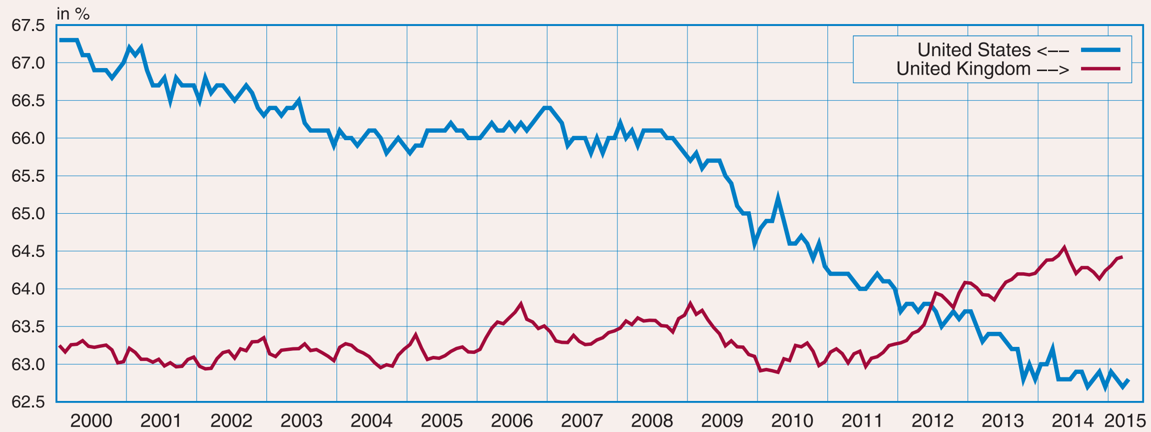
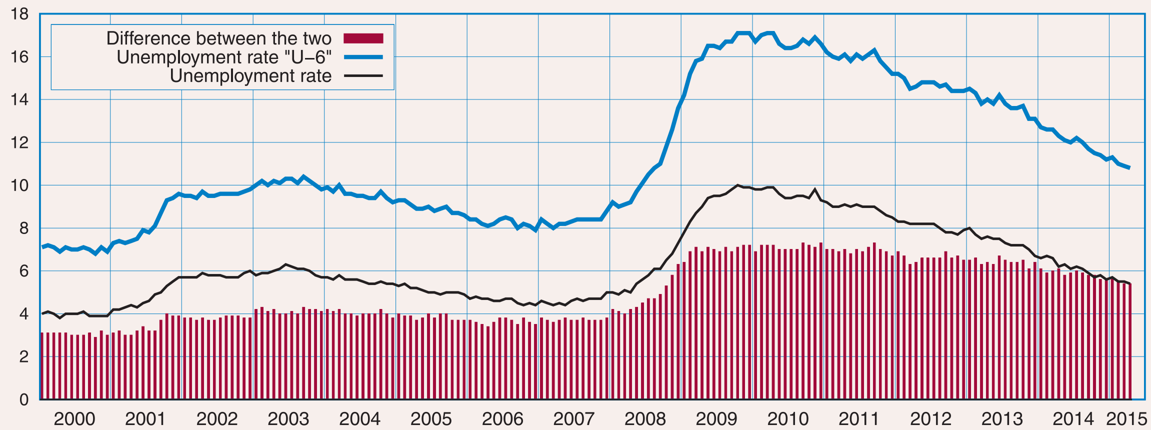
4 - Participation rate in the labor market



Sources:BLS, ONS

5 - Unemployment and underemployment in the US



Sources: BLS

Japan

Return to growth

As expected, activity in Japan picked up sharply in Q1 2015 (+1.0% after +0.3%), confirming that the country is out of the recession caused by the VAT rise in April 2014. Consumption nevertheless remains sluggish. Through to the end of 2015, activity should grow more moderately, in line with domestic demand.

The end of recession confirmed

Growth picked up sharply in Q1 2015 (+1.0% after +0.3%), driven by positive stockpiling (contribution to growth of +0.5 points) and the acceleration of private investment (+2.7% after +0.3%). However, due to the renewed momentum of imports, foreign trade adversely affected growth (-0.2 points) for the first time in a year.

In Q2, activity is expected to slow down (+0.5%). The business climate tracked in the surveys is favourable, yet remains at a low level. This sluggishness is expected to adversely affect stockpiling. In addition, consumption is expected to remain stuck at a significantly lower level than before the VAT spike. After a very dynamic Q1, corporate investment should return to a more moderate pace. All in all, domestic demand should slow down slightly.

Relative upturn in wages

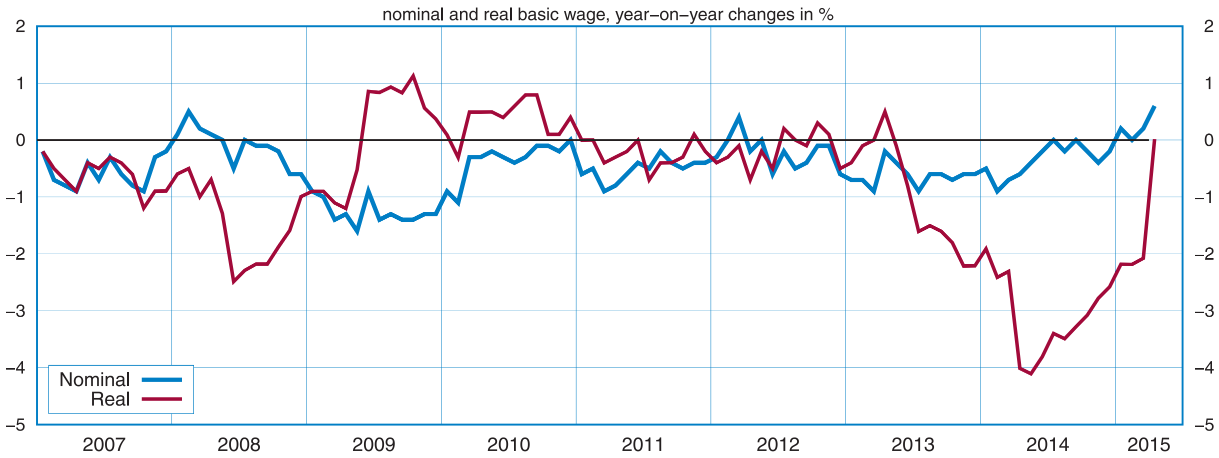
Employment remained dynamic in Q1, causing the unemployment rate to reach its lowest level in over 15 years in March (3.4%). The pace of job creations should decrease slightly over the forecasting period as excess capacities on the labour market diminish.

Nominal wages remained sluggish in Q1 (*Graph*), despite higher inflation due to the rise in VAT in April 2014. Real wages therefore contracted sharply once again. Nevertheless, in April real wages ceased to decline for the first time since April 2013. Falling unemployment is expected to cause a slight acceleration in wages through to the end of the year, which should benefit consumption (+0.4% then +0.5% per quarter in H2). All in all, over the year consumption should stabilise, after a 1.4% decrease in 2014.

Recovery expected to be difficult

In H2, the slight improvement in domestic demand, also sustained by the fiscal stimulus measures adopted in early 2015 and by private investment, should cause activity to pick up (+0.6% per quarter). However, though the Yen has stopped depreciating, foreign trade is expected to make a neutral contribution to activity. All in all, annual GDP growth is expected to reach +1.3% in 2015, after -0.1% in 2014. ■

Growth in wages remains very modest, the decline in real wages comes to an end



Source: Japan Cabinet Office

Emerging economies

No rebound in sight

At the beginning of 2015 the short-term outlook is still deteriorating in most of the larger emerging countries, notably China, where activity is still slowing. In Brazil, the crisis of confidence is deepening, industrial production is tumbling and the economy looked as if it would be in recession for the entire year. Russia is suffering from the earlier collapse of the ruble, following on from the fall in oil prices and the economic and financial sanctions imposed as a result of the Ukrainian crisis. However, the re-appreciation of the currency and the improvement in the business climate suggest that the country may be coming out of the crisis more quickly than had been anticipated. On the reverse side of this general gloom, the Indian economy has brightened and the countries of central Europe appear not have suffered from the geopolitical tensions caused by the crisis in Ukraine.

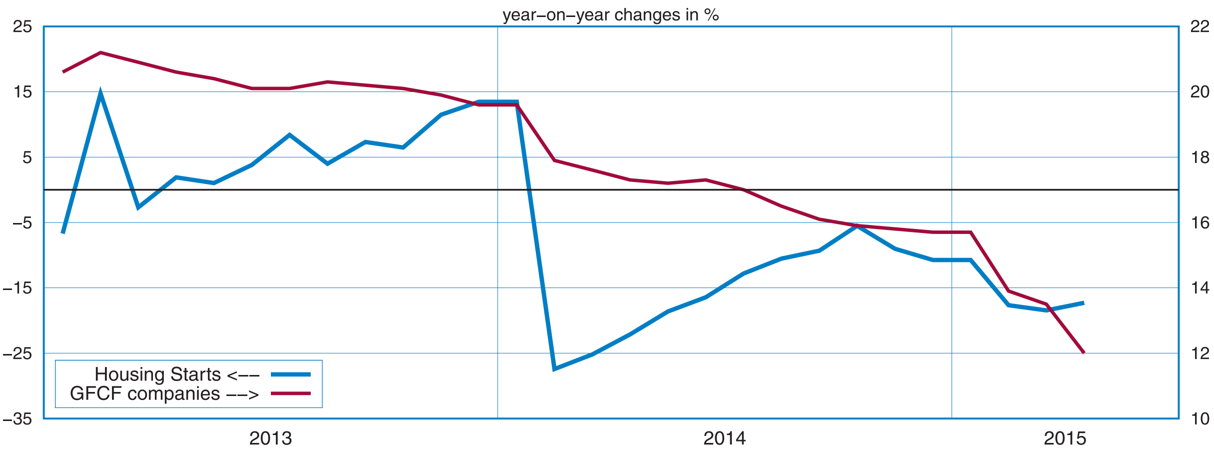
Across all the emerging countries, the business tendency surveys indicate no substantial improvement in the short term, the result being that they are likely to continue slowing in 2015. Their foreign trade in particular is unlikely to recover its pre-crisis vigour: their imports look set to increase by 1.2% in 2015, against 4.0% in 2014 and 15.3% on average per year between 2000 and 2007.

Growth likely to take a downturn once again in China

In Q1 2015 activity once again slowed in China, and in Q2 the short-term outlook remains bleak, especially in the manufacturing sector, where industrial output continues its downturn. Domestic demand also shows persistent signs of weakness. Investment, especially in real estate, continues to slow considerably, after several years of dynamic growth (*Graph 1*). By the end of the year, economic activity is likely to remain sluggish as domestic demand continues to slow, despite a more expansionist monetary policy.

Chinese foreign trade shrank sharply in Q1 2015. This jolt is partly due to a major strike by dock workers in the west coast ports of the United States, which hindered commercial trade with emerging Asia as a whole. In general, however, the slowdown in domestic demand is weighing down on imports and industrial output, and the trend in exports is reversing. In Q2, imports and exports should bounce back and should regain a little momentum in H2 2015, in the wake of the upturn in domestic activity and the turnaround of world trade. All in all, the Chinese economy is set to continue to slow for the rest of 2015, having already reached its lowest level of growth since 1990 (+7.4%) in 2014.

1 - China: private investment continues to slow



Source: NBSC

Brazil is sinking deeper into a crisis of confidence

Activity in Brazil stagnated in 2014 (+0.2% after +2.7%). Prices gathered pace, distorting household purchasing power and hence household confidence and consumption. Increases in the central bank's base interest rates did not manage to check the rise in inflation but they did take their toll on economic activity. Industrial output continued to tumble (-7.6% in April year-on-year, *Graph 2*), despite the revival of price-competitiveness as a result of the depreciation of the real. The corruption scandal surrounding the Petrobras oil company has further intensified the crisis of confidence that is running through the country, and the business climate is at its lowest since 1998. Finally, fiscal restrictions announced by the government are likely to depress domestic demand even further in 2015. The economic situation in Brazil is therefore likely to remain in a highly deteriorated state and the economy looks set to be in recession for the rest of the year.

In Russia, the situation is very poor but a way out of the crisis is emerging

The Russian economy has slowed considerably since 2012 and GDP increased by only 0.7% in 2014. Linked with economic and financial sanctions and the slump in oil prices, the depreciation of the ruble - which lost half its value against the dollar - has caused economic activity to deteriorate severely. It has led to an explosion in prices, and resulted in the central bank applying monetary tightening measures that are damaging domestic demand.

Despite the contraction of GDP in Q1 (-1.9% over one year), industrial output (-4.5% over one year in April) and retail sales (-9.8% over one year in April), there are several pointers towards a fairly quick exit from the crisis. The ruble has re-appreciated by about 40% against the dollar since February, inflation has fallen further and the central bank is rapidly lowering its base interest rate (from 17% to 12.5% between January and May). Financing terms are being relaxed and the Moscow stock exchange has been climbing once again since January. Finally, the business climate is improving rapidly and was back into its expansion zone in April. All in all, Russia is likely to be in recession in Q1 but come out of it before the end of the year, even though, as an average over the year, GDP is likely to decrease in 2015.

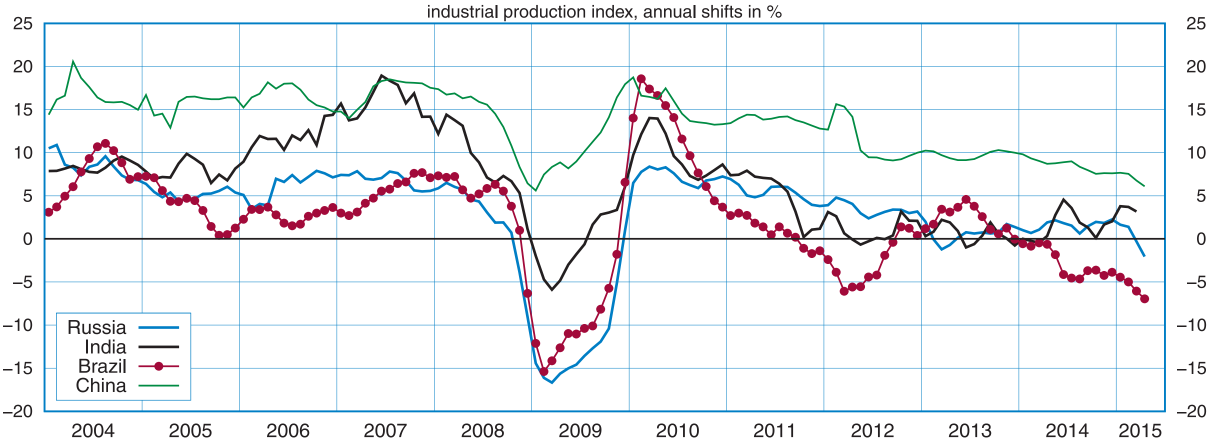
The situation remains favourable in India and the CEEC countries

India is the only large emerging country to maintain a positive momentum. The fall in energy prices has strengthened domestic demand while reducing the trade deficit. In addition, the central bank has been able to bring down its base interest rate. In 2015, economic growth in India is likely to strengthen slightly following on from activity that was already dynamic in 2014 (+7.2%).

In the Central and Eastern European Countries (CEEC), the business climate returned to a high level in 2014, and activity did not seem to be suffering from the geopolitical crisis in Ukraine. Growth should therefore continue to be sustained in the course of 2015. ■

2 - Brazilian production drops down

industrial production index, annual shifts in %



Sources: National Statistical Institutes