International developments

Oil and raw materials

Since the start of 2013 tensions on the physical oil market have been limited, and this situation should persist throughout the forecasting period. On the one hand, despite the drop in production in the OPEC nations at the start of this year, global oil supply has remained steady thanks to oil production by non-conventional methods in North America. On the other hand, demand is still being restricted by the lack of dynamism in the international economy. Demand shrank in Q1 and should continue to shrink in Q2 2013, due to the seasonal drop in consumption in developed nations and the poor state of economic activity in Europe.

In H2 2013, demand should pick up again in developed nations, particularly with the effects of summer holiday travel. Nonetheless, the high level of additional production capacity in the OPEC countries, and the high level of reserve stocks in developed nations, will limit tensions on the physical market. As a result, the price of oil should fluctuate at around $104 per barrel of Brent crude for the duration of this forecasting period. It should thus remain well below the average price recorded for Q1 2013 ($112.60).

The decline of non-energy commodity prices observed in Q1 2013 continued into April. Most notably, fears over the slowdown in the Chinese economy and the appreciation of the dollar in Q1 led to a drop in industrial commodity prices. Grain prices are also down on Q1 2013, but seem to be stabilising, supported by uncertainties regarding the volume of the 2013 harvest.

In Q1 2013, tensions on the physical market remained weak despite the fall in OPEC output

As expected, global oil supply declined in Q1 2013, down 700,000 barrels per day (bpd) compared to Q4 2012, primarily as a result of a drop in output from the OPEC producers and the seasonal drop in global biofuel production. On the other hand, production stagnated in OECD countries: the fall in production seen in Australia as a result of stormy weather was offset by a rise in production by non-conventional methods in North America.

Global oil consumption (including stocks) also declined as expected in Q1 2013, particularly in Europe (-500,000 bpd) as a result of the weak state of economic activity in the Eurozone, in addition to the usual seasonal drop in consumption. In contrast, poor weather conditions and a more favourable economic context in the USA led to a slight increase in demand (+150,000 bpd), unusual for Q1. This increase was accompanied by a reduction in American

1 - Price of *Brent* in € and in $
last point: June 7, 2013

Source: Financial Times

reserve stocks. Demand rose in Japan in Q1, following the usual seasonal trend. China's consumption, on the other hand, declined as the economy slowed.

No increase in tensions on the physical market in Q2 2013

In Q2 2013, global oil supply should grow slightly (+100,000 bpd). At the same time, demand should continue to fall (-400,000 bpd). The dynamism of oil consumption in non-OECD countries (+800,000 bpd), particularly in the Middle East, should only partially offset the seasonal fall in demand from developed nations (-1.2 million bpd). Indeed as winter ends demand should drop sharply in Japan (-1 million bpd). In Europe, and especially in the US, the fall in demand should be less pronounced, with consumption already at a reduced level.

Tensions on the physical market should increase slightly by the end of 2013

In Q3 2013, global demand for oil should grow more rapidly than supply (+700,000 bpd). Supply should be bolstered by combined increases in the production of biofuels, American oil and liquefied natural gas from the OPEC nations. Global demand for oil should increase markedly (+1.9 million bpd) on account of the seasonal rise in consumption in developed nations caused by summer holiday travel. However, the high level of stocks in advanced countries should be sufficient to absorb this excess demand. Moreover, additional production capacities available for immediate deployment in the OPEC countries remain strong (in the order of 4 - 5 million bpd), making increased production an option.

In Q4 2013, with seasonal constraints out of the way, production should increase in Europe and remain dynamic in the United States thanks to oil output from non-conventional sources. Global demand should also rise, bolstered both by consumption in developed nations (particularly Japan) and non-OECD countries, primarily China.

Oil prices should stabilise

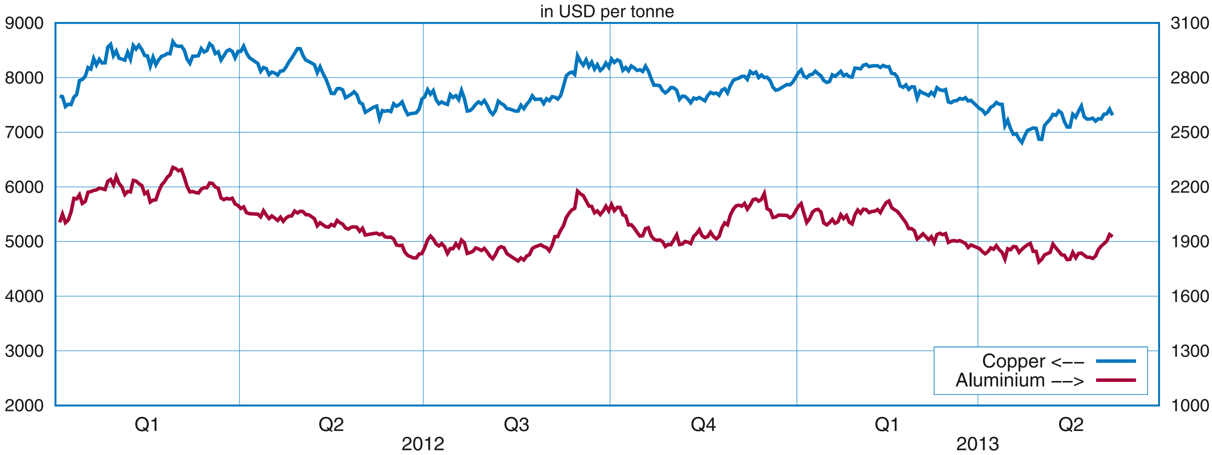
Oil prices rose significantly in Q1 2013, with supply and consumption both dropping off *(see Graph 1)*. In early April the easing of geopolitical tensions, reduced tensions on the physical market and enduring uncertainty over global economic activity combined to drive down the price of crude. The price of a barrel of Brent thus fell by $10 to reach $98.90 on 18th April, its lowest point since July 2011. The price thereafter rebounded slightly to reach $104. Over the forecasting period, as tensions on the physical market seem likely to remain under control, the price of oil should fluctuate around $104 per barrel of Brent crude.

Non-energy commodity prices no longer falling

While they had been falling since Q1 2013, essentially due to the effects of a slowdown in demand from China, industrial commodity prices stopped falling in Q2 *(see Graph 2)*. The price of copper stabilised in April, and the price of aluminium has almost stopped falling. Cereal prices have also halted their decline, the result of poor weather conditions in the USA and Europe, which pose a risk to the 2013 summer harvests *(see Graph 3)*. ■

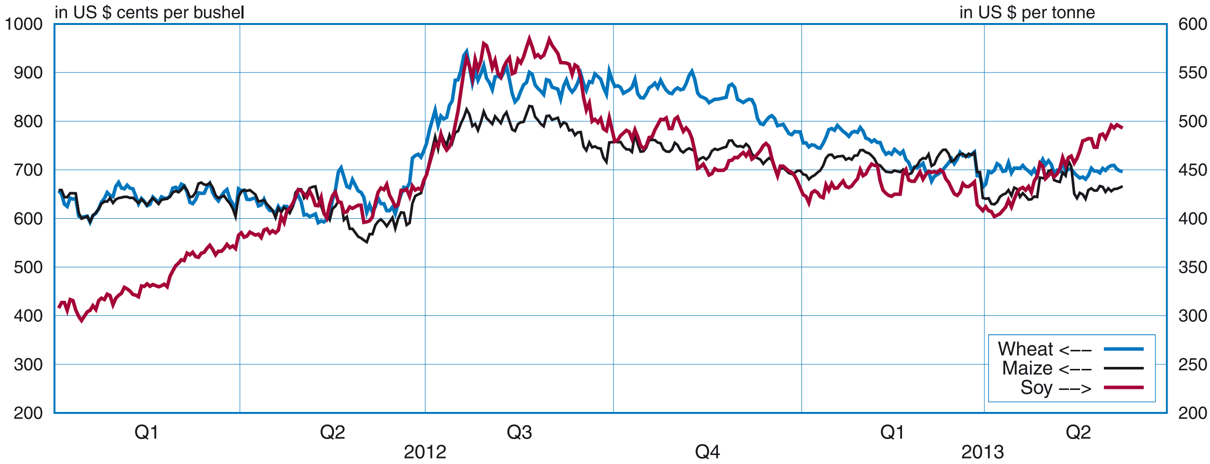
2 - Prices of industrial metals

in USD per tonne



Source: London Metal Market

3 - Prices of food commodities



Source: DataInsight

Financial markets

Tensions have eased, but credit conditions remain uneven in Europe

The monetary policies in place in the advanced economies remain very accommodating. Refinancing rates are very low and monetary authorities continue to apply unconventional policies, particularly in Japan and the USA.

At the same time, fears over the financing of European sovereign debt have continued to subside. Countries with strong credit ratings are enjoying extremely low long-term rates, and those countries with economic difficulties are beginning to obtain more favourable financing conditions.

The initiatives taken by central banks, and a general perception of reduced risk in the Eurozone, also stimulated a generalised rise in share prices which continued until mid-May.

In the Eurozone, where tensions on the sovereign debt markets have seen a long-term easing, the principal issue remains the transmission of monetary policy to the real economy. In spite of abundant liquidity, credit conditions are still tight in some Eurozone countries.

In March, weak economic forecasts for the Eurozone, political instability in Italy and the financial crisis in Cyprus put an end to the appreciation of the Euro against the dollar seen in Q1 2013. Over the forecasting period, the Euro exchange rate should stabilise at around 1.30 dollars, 126 yen and 0.85 pounds.

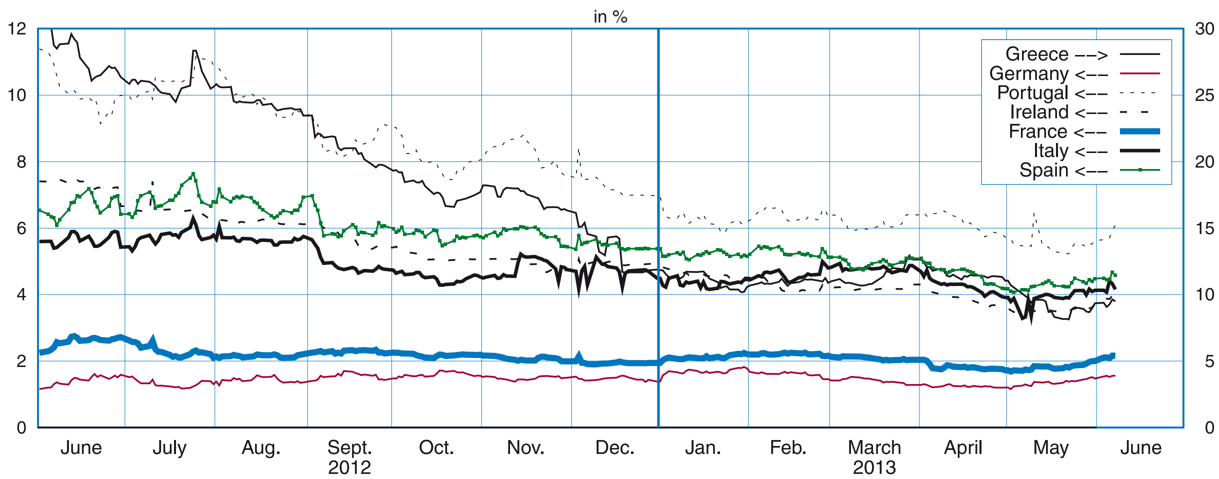
Non-standard monetary policies remain the tool of choice for central banks

The advanced economies continue to relax their monetary policies. At the start of May the European Central Bank reduced its base rate by 25 basis points. The base rate now stands at 0.5%, the lowest rate seen since the creation of the single currency. However the impact of this measure, with European banks already borrowing at very low rates and an abundance of liquidity, may be limited.

In the United States, the Federal Reserve continues to pursue its policy of quantitative easing.[1] The base rate has been fixed at 0.25% since December 2008. Moreover, the Fed continues to implement its programme of buying up long-term debt securities at a rate of 85 billion dollars per month (40 billion dollars of mortgage-backed securities and 45 billion dollars of American treasury bills). Economic forecasts remain positive in the US, increasing the probability that the Fed will scale back this programme, but the timeframe for this reduction is not known.

(1) Quantitative easing is a non-standard monetary policy that consists in the Central Bank expanding its balance sheet by buying more or less risky equities.

1 – 10-year sovereign interest rates of the main countries of the Eurozone



Source: DataInsight

In the United Kingdom, the Bank of England has also maintained a very low base rate, set at 0.5% since March 2009. Nonetheless the Bank has not, for the time being, resumed its policy of buying up British Treasury bonds, which it already holds in quantities equivalent to 25% of the country's GDP.

Finally, since the start of 2013, Japan has been pursuing a more robust policy of quantitative easing, with a view to halting deflation. The Bank of Japan's inflation target was revised upwards to 2% in January, and in order to achieve this target the Bank has announced plans to double the monetary base over the next two years, adding the equivalent of just under 30 points of additional GDP by the end of 2014.

On the sovereign debt markets, rates have returned to early-2011 levels

With the risk of sovereign default substantially reduced by the announcement of the launch of Outright Monetary Transactions (OMT) by the ECB in autumn 2012, the long-term financing conditions for European states have improved *(see Graph 1)*. Cyprus' financial crisis in March 2013 did not have knock-on effects for the sovereign yields of other European nations, further evidence of the reduced uncertainty on the sovereign markets. Furthermore, the announcement of Japan's new quantitative easing programme caused a drop in the sovereign yields of all European countries, between mid-April and early May.

Further proof of the easing of tensions on the sovereign debt markets comes from the fact that those countries whose financial situation was very poor in 2011, such as Ireland and Portugal, are gradually returning to the long-term debt market. Ten-year yields for Italian (averaging 3.9% in May, down from 5.7% in July 2012) and Spanish bonds (averaging 4.3% in May, down from 6.9% in July 2012), have fallen considerably since summer 2012. Finally, the average yield of French 10-year bonds in May 2013 was 1.81%, with German bonds at 1.35%, remarkably low rates. However from mid-May onwards the uncertainty surrounding the continuation of expansionist monetary policies, particularly in the US, has led to a moderate rise in all sovereign yields.

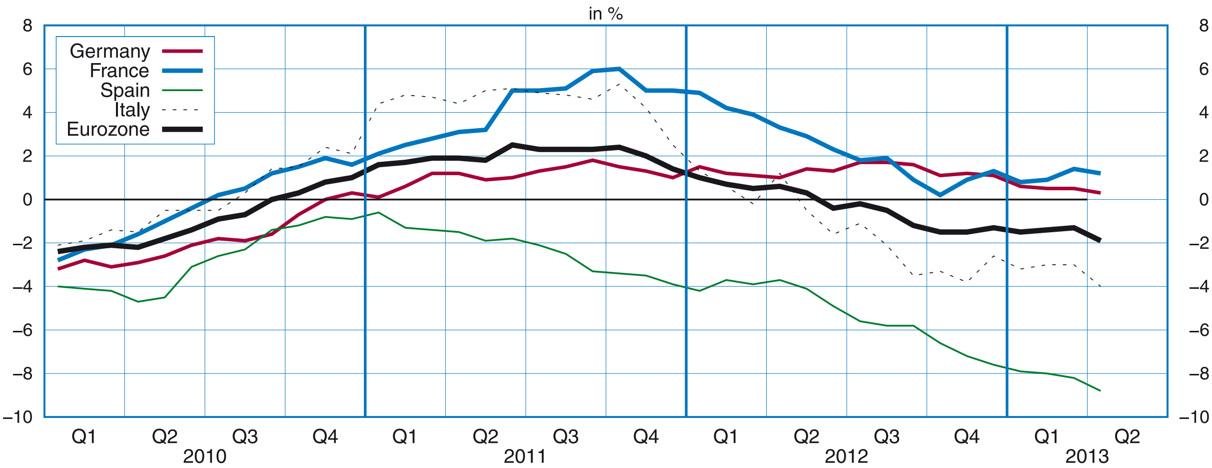
Still an abundance of liquidity on the European money markets

The European money market is still feeling the influence of the abundance of available liquidity, resulting largely from the very long-term refinancing operations undertaken by the ECB in late 2011 and early 2012. Interest rates have remained very low, though this does not necessarily indicate a return to normal functioning on the interbank market. Many European banks are indeed retaining large liquidity reserves and no longer conducting transactions on the interbank market.

Bank lending conditions remain uneven across the Eurozone

Bank lending in the Eurozone continued to shrink in Q1 2013 *(see Graph 2)*. On the one hand, demand remains sluggish due to the gloomy economic outlook. On the other hand, bank lending surveys indicate that their conditions for lending to businesses in Q1 2013 have still not been relaxed. Moreover, in Italy and Spain the interest rates charged to businesses are still affected by a higher risk premium, in comparison to the rates available in France and Germany. This fragmentation within the Eurozone is evidence of an uneven transmission of EU monetary policy, and remains a matter of concern for the ECB.

2 – Annual growth of the outstanding loans to non-financial corporations in the Eurozone



Source: European Central Bank (ECB)

International developments

In France, outstanding loans to non-financial companies saw year-on-year growth of 1.1% in March. Surveys indicate that although tensions affecting the supply of credit are subsiding, demand remains weak.

Household borrowing grew slightly in March. Property loans are displaying a certain dynamism, while consumer credit is down for the year. Surveys suggest that lending conditions were eased slightly for these types of loans in Q1 2013, but the demand for consumer credit continues to fall, while demand for property loans remains stable.

A halt to the recent growth seen on stock markets in advanced economies

The low yields offered by bonds, and the more positive global economic outlook, have prompted investors to turn to the stock markets. As a result, stock prices had been rising in all advanced countries since Q4 2012. By early May, the stock market indices in these countries had by and large exceeded their levels of 1st January 2011. This rise in stock prices was accompanied by a stabilisation of the volatility seen on stock markets, which remains low. But in mid-May this rise was interrupted. International economic perspectives remain indeed mediocre, and uncertainty over medium-term monetary policies has had an impact on stock prices.

Euro's appreciation against the dollar halted

Since February 2013, the combined effects of poor economic forecasts for the Eurozone and political instability in Italy have led to a depreciation of the single currency *(see Graph 3)*. For the forecasting period, the exchange rate should stabilise at around 1.30 dollars to the Euro.

In contrast, the acceleration of quantitative easing in Japan in April caused further depreciation of the yen, which reached its lowest rate against the Euro since 2010. ■

3 – Euro exchanges rates

Source: DataInsight

Eurozone

Tiny steps

Despite the improving business climate, activity in the Eurozone slipped back in Q1 2013 (-0.2% after -0.6% in Q4 2012). Exports were disappointing, especially in Germany, Italy and Spain. Consumption picked up slightly after the sharp decline in Q4 2012 but investment fell back once again.

Activity should stop shrinking in Q2 2013 (+0.1%) and grow slightly in H2: +0.1% in Q3, +0.2% in Q4. After two quarters of decline exports are likely to pick up momentum thanks to the vitality of demand outside the Eurozone and the recovery of trade within the Eurozone. Household consumption should decline less rapidly than in 2012 due to a smaller drop in purchasing power. Production capacities are therefore likely to be used more extensively and investment should slowly start to pick up at the end of the year.

All in all, growth in the Eurozone in 2013 should stand at -0.6% after -0.5% in 2012.

Sixth consecutive quarter of GDP decline

In Q1 2013, activity slipped back once again in the Eurozone (-0.2% after -0.6% in Q4 2012). Exports and imports both declined and the contribution of foreign trade to activity was virtually nil (+0.1 points). The recent appreciation of the euro doubtless played a role there. Investment also fell back again: weak business prospects restricted the need to renew production capacities and the harsh temperatures slowed activity in construction, particularly in Germany. However, consumption progressed slightly due to its dynamism in Germany and a lesser decline in Spain, after the sharp drop in Q4 linked to the VAT rise.

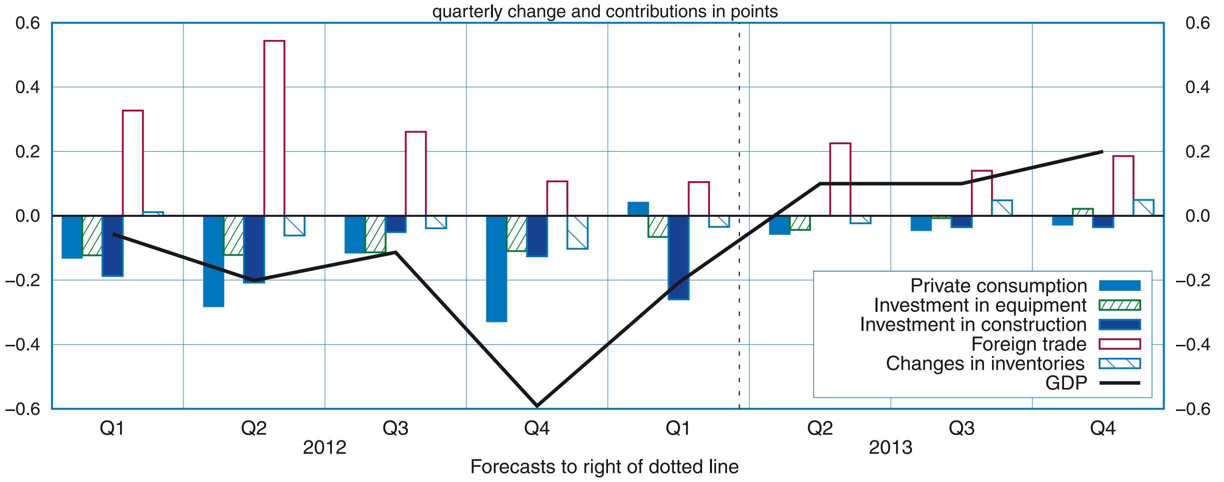
Slight upturn in activity from Q2

Activity in the Eurozone should grow slightly in Q2 2013 (+0.1%, *see Graph 1*) and continue to do so in H2: +0.1% in Q3 and +0.2% in Q4. Individual outlooks are likely to diverge within the Eurozone: activity should be dynamic in Germany and grow slightly in France, but shrink once again in Italy and Spain. At the end of 2013 activity should however stabilise in Italy and Spain.

The decline in consumption set to ease

In 2013 employment is likely to fall back again and the return to growth in H2 will come «without jobs», since productivity gains are set to pick up. The unemployment rate should therefore continue to rise, up to 12.7% in Q4 2013. This deterioration of the labour market is taking its toll on the bargaining

1 - Slow recovery in the Eurozone



Sources: Eurostat, INSEE calculations

power of employees. The private sector in Italy and Spain in particular is moderating wages. Nominal earned income should thus barely progress in 2013, and slow compared to 2012.

However, purchasing power is likely to decline at a slower pace than last year because the fiscal consolation effort is not quite so sustained in 2013 and inflation is set to moderate. The decline in household consumption should therefore be limited (-0.1% per quarter).

Tentative recovery in investment

The gradual recovery of output prospects *(see Graph 2)* and the need to renew production capacities after a marked adjustment phase should help investment pick up somewhat. Furthermore, although financing conditions for private agents remain difficult in certain Eurozone countries, they should improve gradually bearing in mind the easing of tensions on the sovereign debt market.

In construction, after a marked decline in Q1 investment should be stable in Q2 2013, as an after-effect. In H2 it is likely to decline again, in line with the low level of confidence in the sector reflected by the recent drop in building permits.

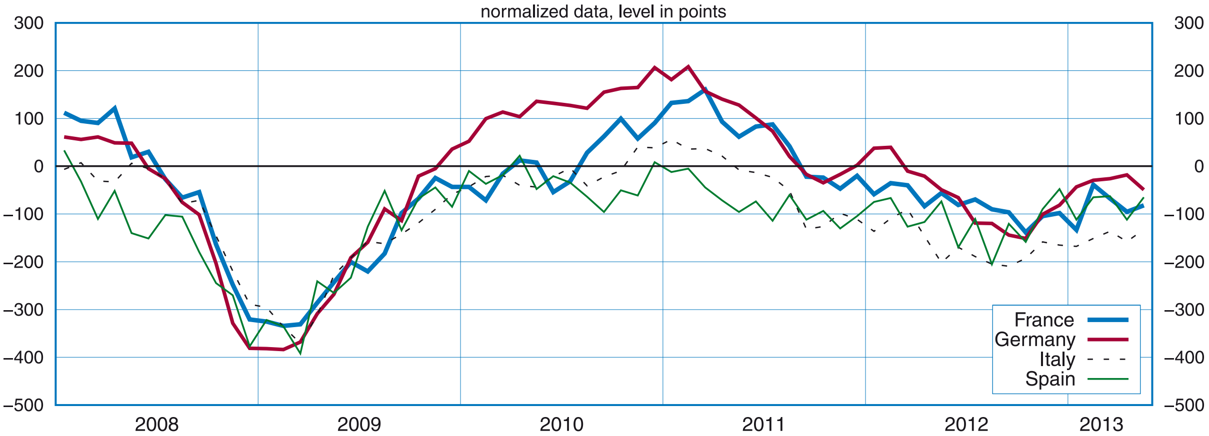
Rebound in exports

After slipping back in Q1 2013, exports are set to rebound in Q2 (+0.9%) and should then progress in Q3 (+0.9%) and Q4 (+1.1%). They are likely to be sustained by world demand for Eurozone products. However, the recent appreciation of the euro is still likely to weigh down on exports in Q2, most notably in Italy and Spain.

Inflation would remain stable

In May headline inflation stood at 1.5%. The sharp fall in headline inflation since the start of 2012 is likely to continue through to October 2013, rising thereafter to reach 1.1% year-on-year in December 2013, following the profile of energy inflation. With the worsening labour market, inflationary pressure should be limited and core inflation should remain stable (1.1% in December 2013). Furthermore, assuming that the Brent barrel remains stable at $104, year-on-year energy prices should fall to -2.6% in September 2013. They are likely to rise subsequently and should be nil in December 2013, with the exit of the energy price-cuts of October-December 2012 of the year-on-year figures. Lastly, the rise in food commodity prices since the start of 2012 should sustain year-on-year food prices. ■

2 - Production expectations in industry



Source: European Commission

Fiscal consolidation and its impact on economic activity in the Eurozone in 2013

Fiscal consolidation continues in the Eurozone

Confronted with tensions regarding the financing of their sovereign debt, since 2011 the majority of European countries have been implementing policies aimed at consolidating their public finances and thus re-establishing their financial sustainability. These European nations have therefore brought in consolidation measures which have had a major impact on economic activity. In 2013 the Spanish government continues to make considerable efforts to reduce its structural deficit, and efforts to reduce France's structural balance are intensifying. In contrast, Italy's budgetary consolidation efforts have eased off in 2013, after intensive fiscal consolidation efforts in 2012. Finally Germany, which is close to achieving a balanced budget, will see neutral fiscal development over the forecasting period.

Assessing the impact of fiscal consolidation on growth in the four largest Eurozone economies in 2013

This evaluation of the effects of fiscal consolidation on economic activity in the Eurozone in 2013 follows on from the assessments already published for the years 2011[1] and 2012.[2] It is based on the multi-national NiGEM model, which allows us to estimate the effects of consolidation measures on the major Eurozone economies, taking trade channels into account. In the short term, the budgetary reforms conducted in these countries have a negative impact on economic activity because they restrict domestic demand. This impact will vary depending on whether the measures affect households or businesses. A country's economic activity is also affected by the fiscal consolidation measures taken by its principal trading partners, through the trade chanel. However this external factor, related to strategies put in place in the other leading Eurozone economies, is of limited significance.[3]

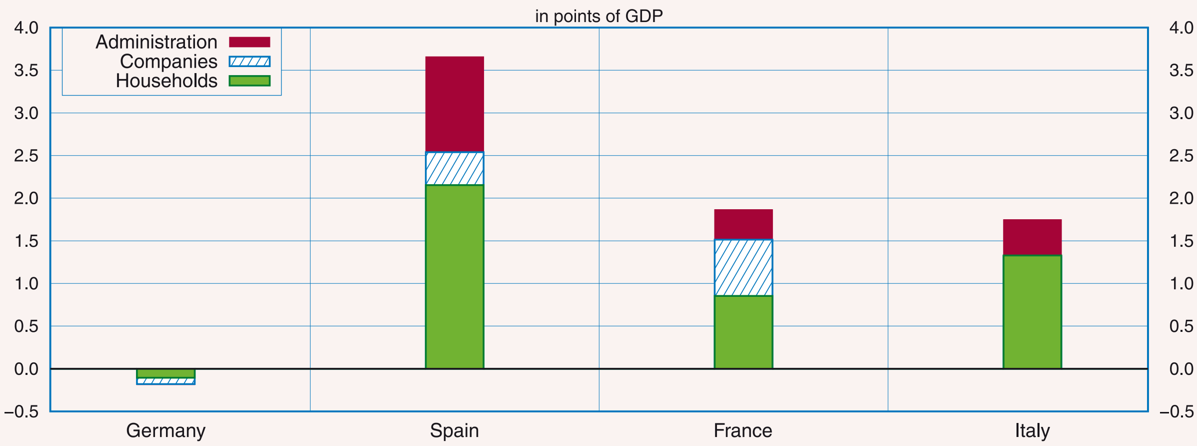
Like its predecessors, this assessment is merely indicative, as it does not take certain mechanisms into account. Most notably, in some countries fiscal consolidation measures may have the beneficial effect of halting or slowing down a rise in interest rates: their inhibitory impact would thus be reduced. Conversely, these models do not integrate some of the characteristics of the current situation, which tend to amplify the effects of fiscal consolidation measures: in particular, the capacity of monetary policy to offset a slowdown in activity is limited, since interest rates which are already close to zero cannot be significantly reduced.

The impact of fiscal consolidation measures in 2013 should be comparable to 2012

To conduct this assessment, we need to divide fiscal consolidation measures into different categories (expenditure, household taxes, business taxes etc.). This is achieved by analysing the fiscal legislation in force in each country. In Italy and Spain, households and public expenditure have been hardest hit by fiscal consolidation measures *(see Graph 1)*. In France in 2013, consolidation efforts should mostly affect households and businesses. Finally, Germany should apply a mildly expansionist fiscal policy in 2013, due to reductions in social security contributions. In Spain the impact of these adjustments in 2013 should be in the order of 1.8 points, slightly less than in 2012. The impact of consolidation measures should rise slightly in France, restricting growth by 0.8% compared with

(1) *Kerdrain C. et Lapègue V. (2011)* " Restrictive fiscal policies in Europe: *what are the likely effects ?", Note de Conjoncture* de l'Insee de mars 2011 et *Lequien M., Mauroux A. et Roucher D. (2012)* " Eurozone and United States in 2011: growth despite shoks ", *Note de Conjoncture* de l'Insee de juin 2012.
(2) *Lequien M. et Roucher D. (2012)* « Prix du pétrole et crise de la dette : quels effets sur la croissance en zone euro ? », *Insee Analyses* n°7, décembre 2012.
(3) The only Eurozone countries analysed here are Germany, France, Italy and Spain.

1 - Scale and composition of fiscal consolidation measures 2013



Sources: National Financial Laws , INSEE calculations

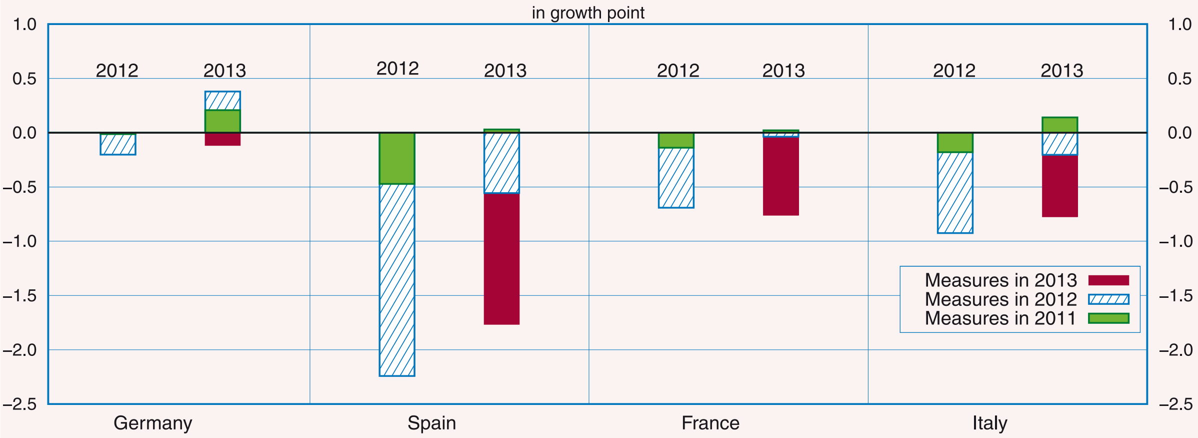
0.7% in 2012. In Italy the budget cuts for 2013 are much less severe than those seen in 2012, but the delayed effects of the measures implemented in 2012 should continue to affect economic activity in 2013. Growth in Italy should therefore be only slightly less restricted in 2013 than it was in 2012 (0.8 points, compared with 0.9). Finally, in Germany the effects of the budget on economic activity should be more or less neutral in 2013, as in 2012 *(see Graph 2)*.

(4) Elsewhere in the Eurozone, fiscal consolidation efforts are set to continue in Austria, Belgium, Ireland and Portugal.

Fiscal consolidation set to continue

Moreover, under the terms of the 2013-2017 stability programmes submitted to the European Commission in April 2013 by member states, this policy of fiscal consolidation looks set to continue. In France, the structural deficit should be reduced from -2.0% of GDP in 2013 to -0.2% in 2015. In Spain, fiscal consolidation should last until 2016, by which time the structural deficit should have reached -0.2% (it is estimated at -2.3% in 2013). In Italy and Germany, on the other hand, the structural deficit should be wiped out in 2013.[4] ■

2 - Effects of fiscal consolidation on GDP



How to read it: In France, the effort of measures passed weighs on growth up to 0.7 percent of GDP in 2012.

Sources: Economic Ministries of concerned countries, NiGEM, INSEE calculations

Germany

Germany moving forward

Although the climate as reported in the business tendency surveys improved sharply, activity did not rebound in Q1 2013 (+0.1%). In particular, exports slumped once again and investment in capital goods fell for the sixth consecutive quarter. Additionally, the harsh temperatures in winter slowed investment in construction. Only very dynamic household consumption sustained growth (+0.8%).

Activity should pick up in Q2 2013 (+0.6%), driven by the recovery of exports and the catch-up effect in construction. In H2 2013 it is likely to progress at a similar rate (+0.4% in Q3 and +0.5% in Q4) and should increase overall by 0.5% in 2013.

Rebound in exports

At the start of 2013 and for the second consecutive quarter, German exports fell back sharply (-1.8%). Exports should rise again, in line with the pace of world trade, as early as Q2 2013 (+1.4%), as suggested by the clear recovery of foreign orders in February and March. They are likely to remain dynamic in H2 2013 and the contribution of foreign trade to growth should remain positive.

In Q1 2013 investment in capital goods slipped back once more. The scale of the decline in investment since the start of 2012 is partly unexplained: activity is still showing an upward trend and credit award conditions are still very favourable in Germany. This decline in investment should come to an end during the forecasting period, as orders for capital goods indicate.

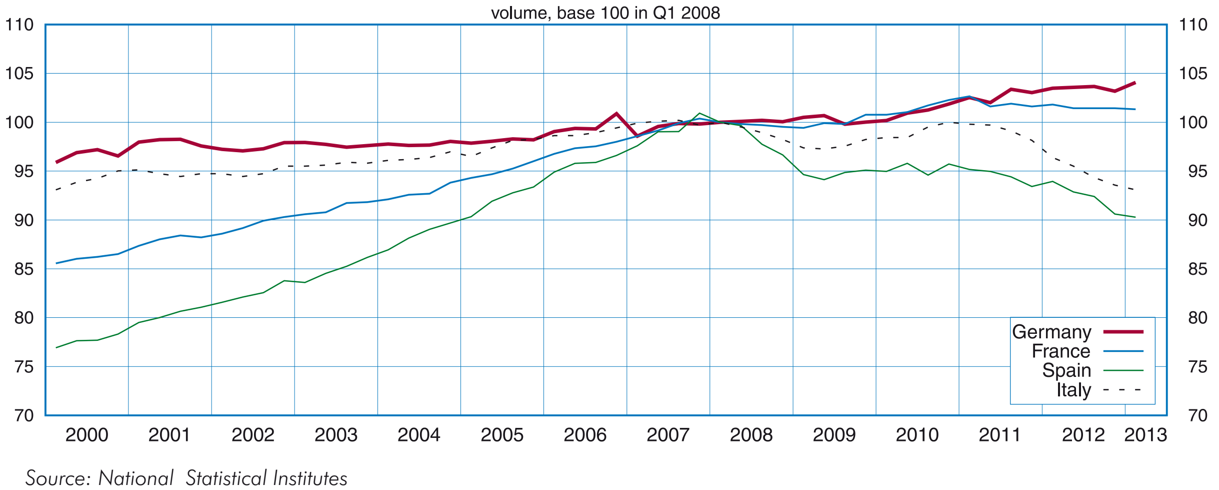
Construction set to pick up in spring

Construction suffered due to the very harsh winter in Germany. Investment in construction consequently fell back, although building permits and orders were globally on the rise. In spring the delays accumulated during winter should be made up for and investment in construction is likely to rebound (+3.5%), before progressing more moderately in H2.

Household consumption driving German growth

As in 2012, household consumption should largely sustain growth in 2013. Indeed the labour market situation is still sound: the unemployment rate is low (5.4% in Q1 2013) and employment has continued to progress despite weak activity. This works in favour of the bargaining power of employees in the conclusion of branch agreements, which this year concern a third of all employees. Real wages should thus remain dynamic in 2013. These positive income perspectives have contributed to maintaining consumer confidence at a high level and, while stabilising their savings ratio, households are likely to increase their consumption expenditure by 1.0% in 2013, after +0.7% in 2012 *(see Graph)*. ■

German household consumption picking up



Source: National Statistical Institutes

Italy

Investment picking up, consumption on hold

Italian activity continued to decline in Q1 2013 (-0.6%). The fall in activity should ease in Q2 (-0.3%) and in Q3 2013 (-0.1%) and stabilise at the end of the year (0.0%). Exports, which were penalised at the start of the year by the appreciation of the euro and weak trade in the Eurozone, should pick up, while investment in capital goods should start to recover after a very marked adjustment phase. Lastly, in 2013 households are likely to bring down their consumption less extensively than in 2012 due to the less pronounced decline in their purchasing power.

Financial and fiscal environment improving

After intense fiscal consolidation in 2012, the Italian fiscal effort should be reduced in 2013. Furthermore, the conditions for financing Italian debt have eased considerably since the end of summer 2012 and this trend has continued since the creation of a national union government in April 2013. Access to credit for private agents, which is still difficult, should therefore ease provided that the political situation stabilises.

Recovery of investment in capital goods

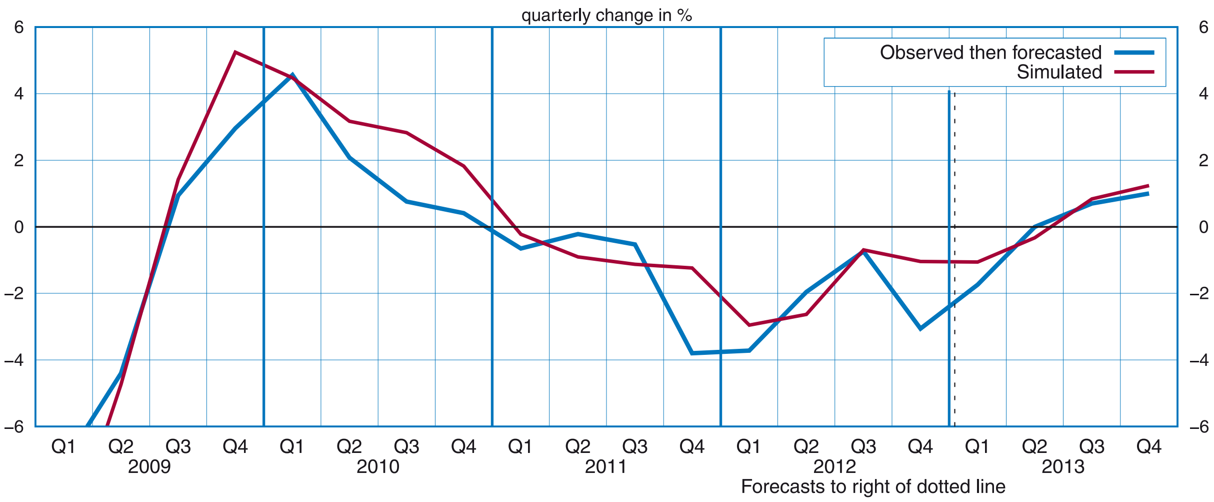
Investment in capital goods fell back sharply in 2012 (-9.2%), mainly due to the significant decline in activity. This adjustment is set to come to an end and investment should stabilise in Q2 2013 before picking up in H2 *(see Graph)*. Indeed, companies need to renew their production capacities. Additionally demand perspectives should improve, particularly exports which, sustained by world demand for Italian goods, are set to gradually accelerate over the forecasting period. Lastly, this upturn in investment should be helped by the improved credit conditions.

Consumption set to fall sharply once again

Weak activity has caused employment to slip back once again, all the more so as productivity appears to be picking up after falling significantly in 2012. The uninterrupted rise in unemployment should continue to weaken the bargaining power of employees and real wages are likely to come down. However, household purchasing power is set to decline less sharply in 2013, under the combined effect of the fall in inflation and the upturn in the income of sole proprietors.

Faced with the very sharp drop in their purchasing power in 2012 (-4.7%), Italian households only brought down their savings ratio slightly and thus greatly restricted their consumption expenditure (-4.3%). In 2013 the savings ratio should be virtually stable and consumption should thus fall back by 2.6%. ■

Investment in capital goods picking up in 2013



Sources: ISTAT, INSEE calculations

Spain

On the road to recovery

After falling by 0.5% in Q1 2013, Spanish activity should contract less sharply in 2013: -0.3% in Q2 then -0.2% and -0.1% in Q3 and Q4 2013. On the one hand Spanish exports, which have been dynamic since 2008, should benefit from the upswing in world trade. On the other hand, investment in capital goods should stop declining over the forecasting period, buoyed by the need to catch up after a marked adjustment phase and by the easing of financial tensions since summer 2012.

Consumption at half mast

The very high unemployment rate (26.7%), the stagnation of nominal wages and the fiscal consolidation measures (3.6 GDP points in 2013) are once again likely to slash household income. Bearing in mind the sharp drop in inflation, predicted to be virtually nil at the end of 2013, purchasing power through to the end of 2013 is likely to fall at a slower pace than in 2012. Households are thus likely to stabilise their savings ratio on average in 2013 after the sharp fall over the last four years. As a result, household consumption should once again shrink significantly in 2013.

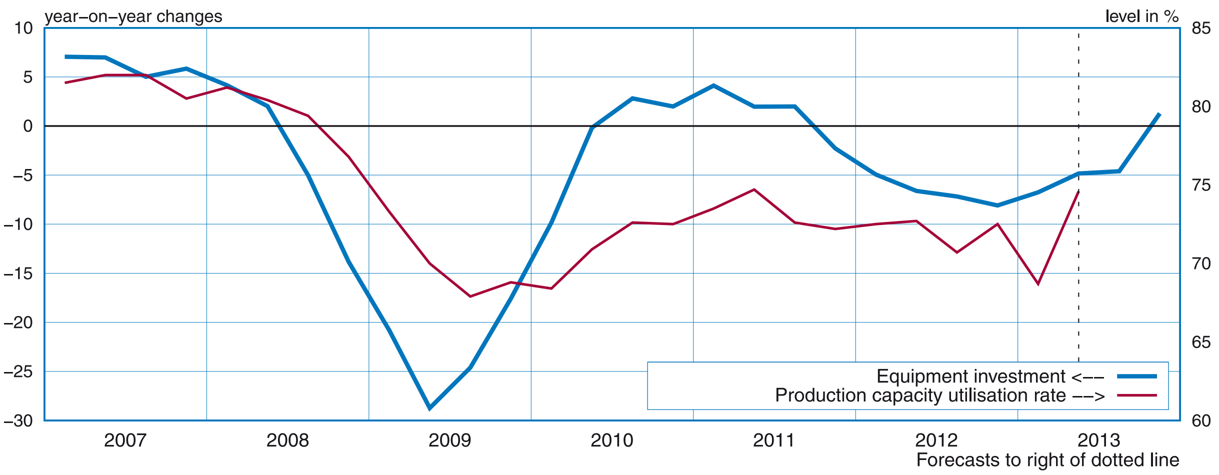
Spanish exports anew dynamic

However, activity in Spain should anew be sustained by the country's export performances, observed since 2008. After two quarters of decline (-1.3% in Q1 2013 after -0.9%), Spanish exports should rebound over the forecasting period (+0.9%, +1.2% and +1.1% for the last three quarters of 2013). In line with domestic demand which is still poor, imports should contract again in 2013 and the now-positive Spanish trade balance should continue to recover.

Investment in capital goods picking up

Dynamic exports should encourage investments to recover, despite weak domestic demand perspectives. Indeed several factors favour investment: the clear upturn in the margins of Spanish businesses since 2009, the easing - at least partially - of financial tensions, and the need to renew productive capital after a marked adjustment phase; the production capacity utilisation rate rose by 4 points in Q1 2013, returning to its level of early 2011 *(see Graph)*. Investment in capital goods should remain almost stable in Q2 2013 (+0.1% as in Q1) then rise slightly in H2 (+0.4% and +0.7% per quarter). Investment in construction, however, is still likely to be penalised by the debt left over from the property bubble and the drop in public investment, and should continue to decline at a sustained rate. ■

The adjustment of investment in capital goods coming to an end



Sources: INE, INSEE calculations

United Kingdom

Growth surge

In the United Kingdom, growth is likely to firm up through to the end of 2013 thanks to the improvement of the situation in the construction sector and on the property market, and to the recovery of exports. Favourable activity prospects are likely to sustain private investment. However, despite a fall in the savings ratio, household consumption is set to slow.

The current upturn set to continue

British growth rebounded in Q1 2013 (+0.3%), stimulated by progress in services and the slight pick-up in energy production after the prolonged maintenance work at the end of 2012. For Q2 2013, the April and May business tendency surveys *(see Graph)* suggest that activity should remain dynamic in services, while manufacturing output should pick up. Additionally energy output should benefit from the partial upturn in oil and gas production at the Elgin site, while construction, penalised by the cold and snowy conditions in early 2013, should rebound. All in all, British activity should accelerate in Q2 2013 (+0.4%), then grow by 0.3% per quarter in H2.

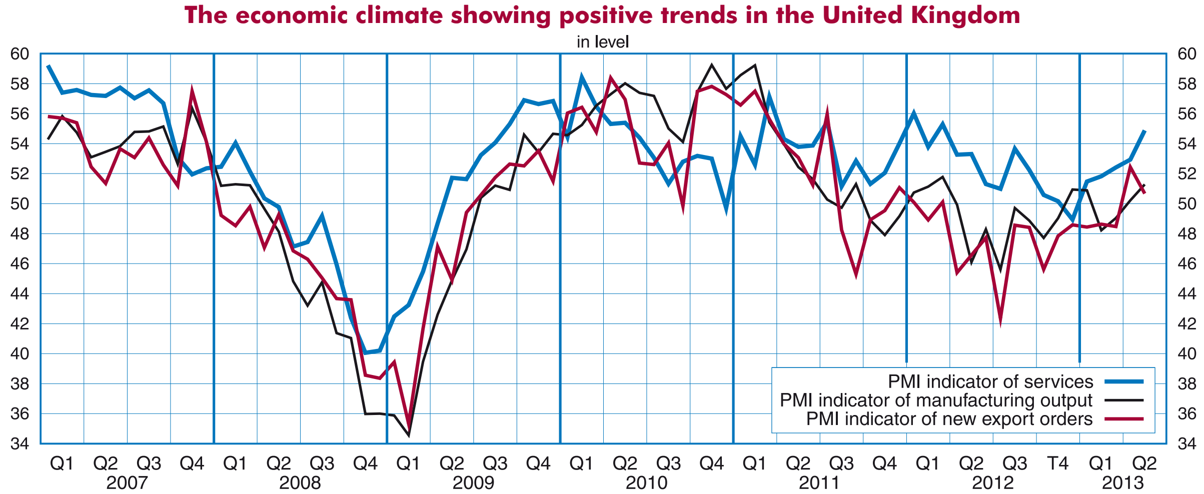
Fiscal consolidation, but support for credit and investment

For the financial year starting in 2013, the new fiscal consolidation measures should be similar in scale to those of last year, in the order of 1.1 GDP points. The vast majority of them are likely to be focused on spending cuts: ministry budget cuts, reduced index-linking of social benefits paid to households, abolition in January 2013 of family allowances for households in the upper income tax bracket. Conversely, the government is set to strengthen its stimulus measures for public investment (at a cost of 0.2 GDP points) as well as support for credit for households and businesses.

Rebound in exports and upturn in investment

All the items of demand are likely to progress over the forecasting period. Sustained by the governmental measures, public and housing investment expenditure should pick up gradually. In parallel, companies are likely to increase their production investments given the improved business prospects and favourable credit conditions. After falling at the start of 2013, British exports should rebound in Q2, driven by the acceleration in world demand and the recent depreciation of the pound. Lastly, household consumption expenditure will likely continue growing, although at a more moderate pace than in 2012 (+0.2% on average per quarter after +0.4%). Indeed, household purchasing power should slow sharply under the combined effect of fiscal consolidation, improved productivity and high inflation, a corollary of the depreciation of the pound. ■

The economic climate showing positive trends in the United Kingdom



Source: Markit

United States

Painless consolidation for America

The American economy accelerated in Q1 (+0.6% after +0.1%). More specifically, despite a sharp rise in the tax burden, household consumption was dynamic. In Q2 the effects of fiscal consolidation should nonetheless be felt: households are likely to bring down their expenditure and, with the «sequestration» measures, public expenditure will remain weak. However, the positive trend in financing conditions for private agents and household wealth should soften the blow. All in all, the slowdown in activity should only be modest in 2013 (+1.8% after +2.2% in 2012).

Fiscal consolidation cushioned

The annual structural effort represents almost 2 GDP points. On the expenditure side, the automatic cuts ("sequestration") have been in force since 1st March 2013. Public spending has already declined sharply and is now only likely to drop slightly through to the end of the year *(see Graph)*. Further to the agreement between Congress and the President in December 2012, households have also seen a sharp rise in their tax burden, which leaped by 8.2% in Q1 2013. And yet household consumption has accelerated, most notably because the improved labour market situation, the rise in equity prices and the recovery of credit have all led to a drop in the savings ratio.

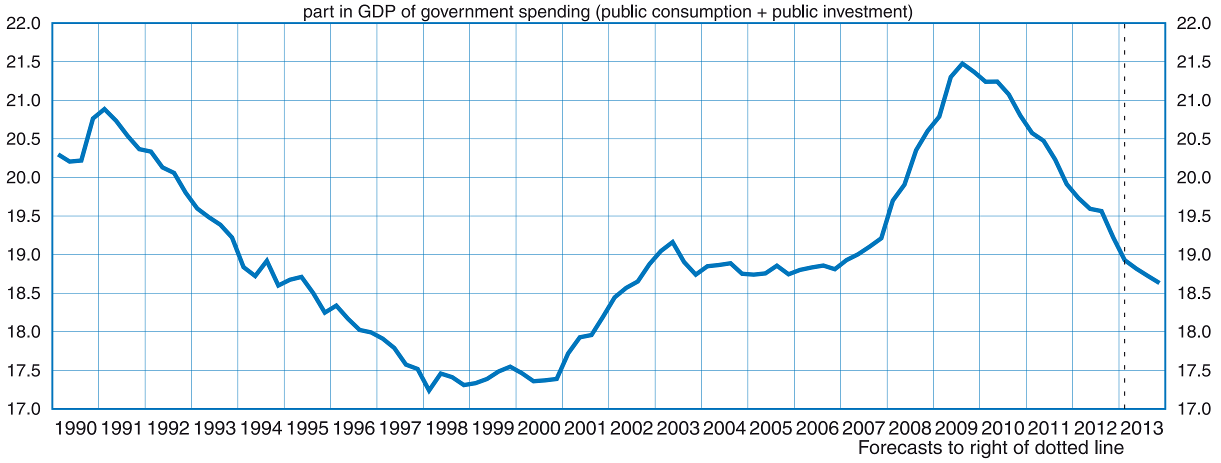
Wealth effects sustaining consumption

Under the effect of the fiscal shock, household purchasing power fell back in Q1 (-2.2%) and the savings ratio stood at 2.3%, well below its average level of 2012. Over the forecasting period, households are likely to increase their savings ratio gradually but modestly *(see Focus)*. The usual savings ratio determinants suggest that the drop observed in Q1 is likely to be long-term for the most part. In particular, the rise in equity and property prices has generated wealth effects, which are usually very marked in the United States. Further, inflation should slow once again, to +1.3% at the end of the year. All in all, consumption should slow down but remain sustained (+0.4% per quarter).

Investment on the rise

American exports stagnated in Q1 under the effect of the contraction of European demand. They are likely to gain in momentum thanks to the pick-up in world trade, especially in Asia, and should remain dynamic through to the end of 2013. Investment in capital goods, which has driven the recovery since 2010, should continue to progress over the forecasting period. Businesses are likely to make the most of their sustained activity prospects and high margins to develop their production capacities. In parallel the construction sector should continue to recover at a sustained pace, contributing almost 0.5 points to overall growth in 2013. ■

Sharp drop in public spending in the United States



Sources: Bureau of economic analysis, INSEE forecasts

Wealth effects and the fiscal shock explain the low savings ratio in the United States

The savings ratio of households at its lowest point for 5 years

The savings ratio of American households stood at 2.3% in Q1 2013, after 4% on average in 2012 *(see Graph 1)*. It has thus returned to its level of 2007. According to our forecasts it is likely to increase only very slightly over the rest of the year, reaching 2.9% in Q4.[1] This trend is in line with that forecast by the model presented in the December 2011 issue of Conjoncture in France (see *Redoules O. and Roucher D.* (2011), "Où en est-on de l'ajustement de l'épargne des ménages américains ?").

Modelling of the savings ratio shows that this trend is explained by wealth effects...

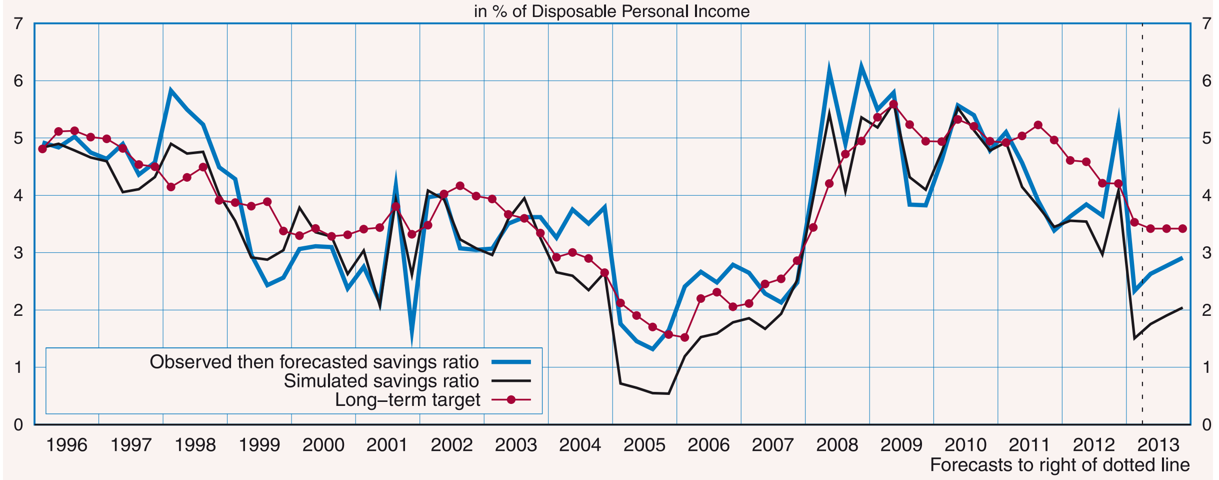
Over the long term, the savings ratio of American households depends on their financial wealth, their net housing wealth, the interest rates, access to credit, and demographic variables. The long-term target of the household savings ratio thus calculated has fallen by 1.5 points since 2011 (from 5% to 3.5%) *(see Graph 1)* under the effect of the rise in household wealth *(see Graph 2)*. American households are indeed making the most of both the dynamism of financial asset prices and the reduction in their mortgage debt in order to improve their net wealth.

...as well as by the absorption of short-term shocks

Nevertheless, the savings ratio is well below this long-term target. This gap is explained by trends in certain short-term determinants. On the one hand, the continuous fall in the unemployment rate since 2011 has contributed to a reduction in precautionary savings.2 Next, the savings ratio reacts positively to income shocks (rising adjustment period, falling ratchet effect) and inflation shocks (real money balance effect) due to the consumption expenditure

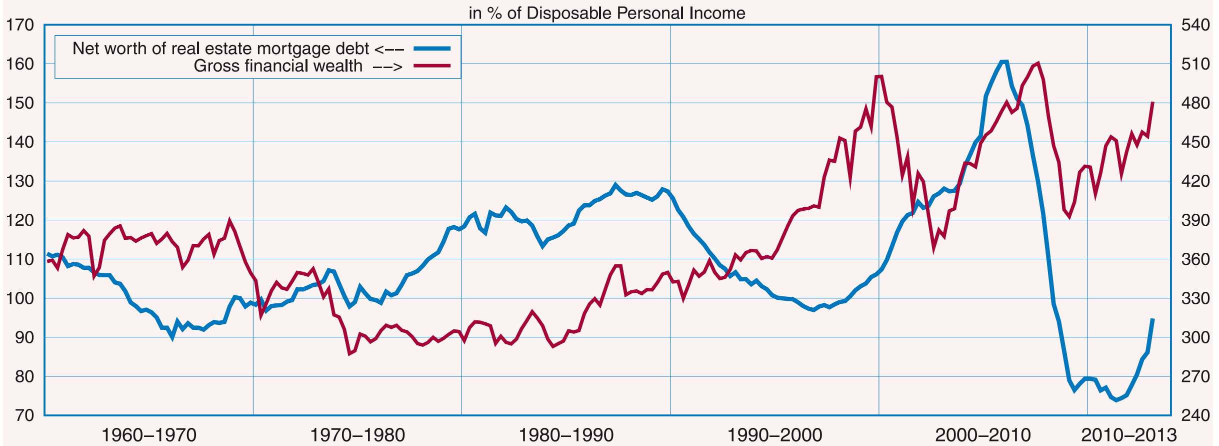
(1) For a discussion on comparisons of savings ratios between OECD countries, and notably the role of the measurement of capital depreciation and the inclusion of purchases of durables in the USA and Europe, see 'What is the savings ratio of French households?'; *L'économie française* 2002-2003, INSEE; 'Comparison of household savings ratios', OECD *Statistics Brief*, April 2005, n°8 .

1 - Savings ratio of households



Sources: Bureau of economic analysis, INSEE calculations and forecasts (see Note de conjoncture december 2011)

2 - U.S. household wealth



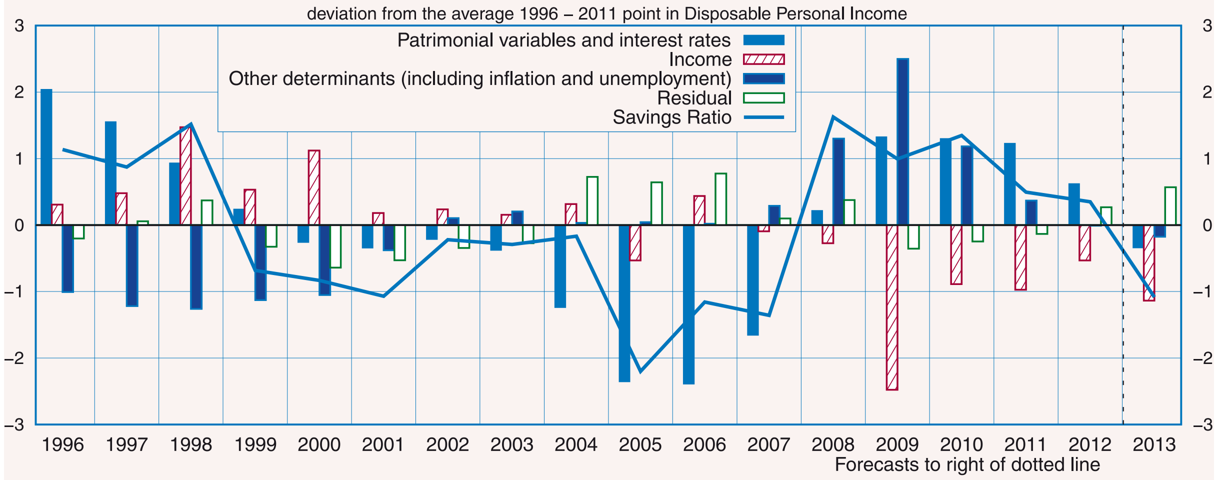
Sources: Bureau of economic analysis, US federal Reserve smoothing behaviour of households. Thus the positive income shock of Q4 2012 (advance payment of dividends and bonuses in order to escape the tighter forthcoming tax rules) did not lead to a rise in consumption but to a transitory increase in the savings ratio. Conversely, households absorbed the fiscal shock at the start of 2013 by moderating their saving effort. All in all, half of the drop in the savings ratio in 2013 could also be explained by the short-term smoothing of income shocks, which by definition is temporary. At the end of 2013, the savings ratio should remain below its long-term target, on the one hand because the income shock should only be half absorbed, and on the other hand because other short-term determinants (inflation and variation in unemployment) are bringing down the saving effort over the forecasting period *(see Graph 3)*.

(2) The American unemployment rate is stationary and does not feature in the long-term determinants of the savings ratio. However, point variations in the quarterly unemployment rate contribute very significantly to variations in the short-term savings ratio.

Interest rate levels also explain the fall in the long-term target

Over the longer term, even once the short-term effects contributing to the drop in the savings ratio have gradually faded, this ratio is unlikely to return to the level observed in 2008 or 2009. Although the majority of the wealth variables have returned to levels close to their long-term average (financial wealth is slightly higher than its long-term average but net housing wealth is still slightly below), the low level of the long-term target can mainly be ascribed to low interest rates, today around 2% for 10-year sovereign yields. The 10-year interest rates would have to rise by 300 basis points (bringing them up to 5%) for the savings ratio to rise by about 1 points. ■

3 - Evolution of savings ratio and contributions



Sources: Bureau of economic analysis, INSEE forecasts

Japan

Under full sail

Activity picked up sharply in Japan in Q1 2013 (+1.0% after +0.3%) and, sustained by the proactive macroeconomic policies of the Shinzo Abe government, it should continue to grow at a brisk pace through to the end of 2013. Exports in particular are set to benefit from the strong depreciation of the yen. In parallel corporate investment is likely to rebound, driven by good business prospects. The growth rate should stand at +1.6% in 2013 after +1.9% in 2012.

Sharp upswing in the business tendency surveys

Elected at the end of 2012, the Shinzo Abe government has engaged in a vigorous macroeconomic stimulus policy comprising a three-pronged attack: a very expansionist monetary policy including the doubling of the monetary base by the end of 2014 in order to bring deflation to an end, a new set of fiscal stimulus measures, and a set of structural reforms aiming to improve potential growth. The announcement of these measures led to a confidence spike and a sharp improvement in the business climate *(see Graph)*. Activity is thus likely to keep up a sustained pace through to the end of the year (+0.6% per quarter).

Household consumption still dynamic

In Q1 2013 private consumption accelerated (+0.9% after +0.4% in Q4 2012). The household confidence indicator has picked up significantly since the start of the year and has returned to its pre-earthquake level *(see Graph)*. Furthermore, the fall in unemployment (4.1% in April, the lowest level since 2008) should allow employees to negotiate real wage gains. Consumption expenditure should therefore continue to progress.

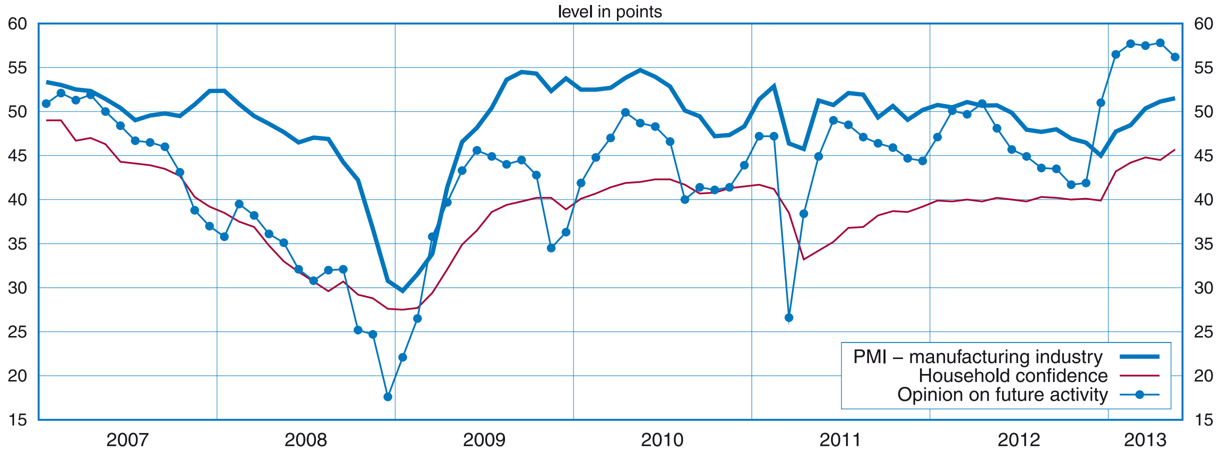
The strong depreciation of the yen should continue to sustain exports

After suffering greatly due to tensions with China in H2 2012 (-7.2% half-year on half-year), Japanese exports rebounded in Q1 2013 (+3.8%). They should continue to grow through to the end of 2013, buoyed by the strong depreciation of the yen since December 2012 (-20% against the dollar and -25% against the euro) and dynamic trade in Asia.

Private investment set to rebound

In Q1 2013, despite the improved economic situation, corporate investment declined once again in Japan - for the fifth consecutive quarter. Through to the end of the year, driven by improved business prospects and very favourable financing conditions, it should rebound sharply, as suggested by the strong growth in private orders for capital goods recorded in March (+22% against February). ■

Clear upswing in the business climate in Japan



Sources: Markit, Cabinet Office

Emerging economies

A subdued upturn

In Q1 2013 activity was not as dynamic in the emerging economies as the improved business tendency surveys had suggested. In China activity actually slowed (+1.6% after +2.0%), and overall imports from the emerging economies decelerated (+1.1% after +3.8%).

In May the surveys covering the main emerging economies pointed to a dip. Fiscal and monetary policies nevertheless remain very expansionist in orientation and should continue to sustain domestic demand through to the end of the year. Activity should therefore gain in momentum somewhat in these economies, but without returning to the growth levels of the 2000s.

A disappointing start to the year for the Chinese economy

In Q1 2013 activity slowed in China, according to the official data of the National Bureau of Statistics (+1.6% after +2.0%). Year-on-year, GDP grew by 7.7% in Q1 2013 after +7.9% at the end of 2012, and industrial output slowed (+9.3% after +10.0%) *(see Graph 1)*. However, according to the PMI surveys, purchasing managers were expecting a sharp acceleration in activity in Q1 2013: the index stood at 52.3 points in January for the manufacturing industry, i.e. its highest level for two years. Since then the business climate has deteriorated *(see Graph 2)* and the index stood at 49.2 in May. According to national surveys, activity levels are quite weak in the real-estate sector, notably.

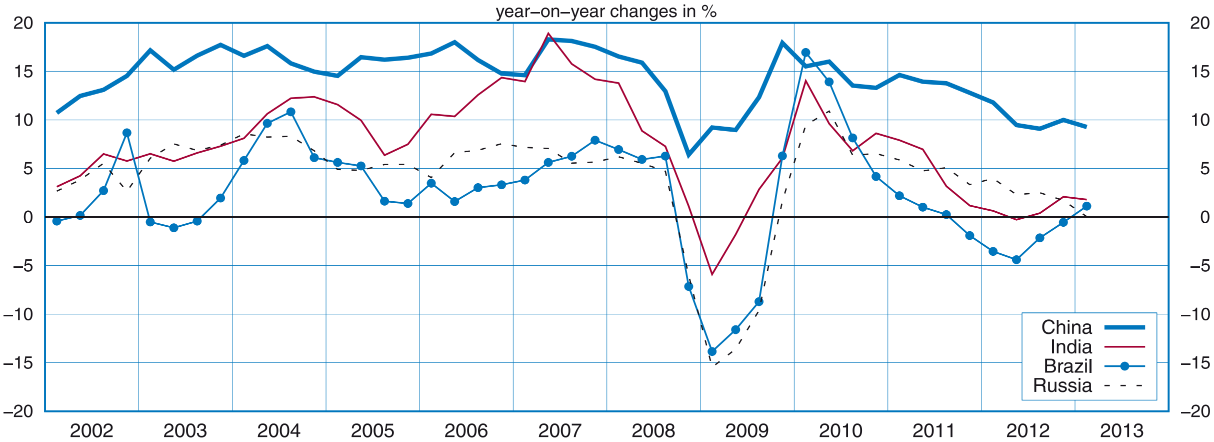
However, with the easing of monetary policy throughout 2012, credit enjoyed an upswing (in the year to April, outstanding loans rose by 14.9%) which should fuel investment over the short term. In September 2012 the government also announced the financing of several public infrastructures (subway lines, motorways) for an amount in the region of 1000 Bn Yuan, or around 2% of GDP. Chinese imports should therefore be dynamic over the forecasting period.

In India and Brazil activity is picking up and imbalances are reappearing

After stagnating from mid-2011 to mid-2012, Indian industrial output has progressed sharply over the last two quarters *(see Graph 1)*, boosted by monetary and fiscal measures to support activity. The main bank refinancing rate was brought down once again in May, and although the PMI and Indian Central Bank surveys indicate a slowdown, activity should remain dynamic. However, monetary easing has revived inflationary tensions (+10.2% in April 2013 against +5.3% in January 2012), thereby damaging the price-competitiveness of Indian goods. In 2012 exports in value shrank by 4.0% while imports rose by 5.3%, resulting in a new record trade deficit (almost 10% of GDP). The public deficit is also at a very high level (8% of GDP).

In Brazil monetary easing and fiscal stimulus policy led to a rebound in activity starting in Q2 2012. In Q1 2013 activity increased by 0.6%. But this stimulation of demand coupled with a real

1 - Industrial output of BRIC



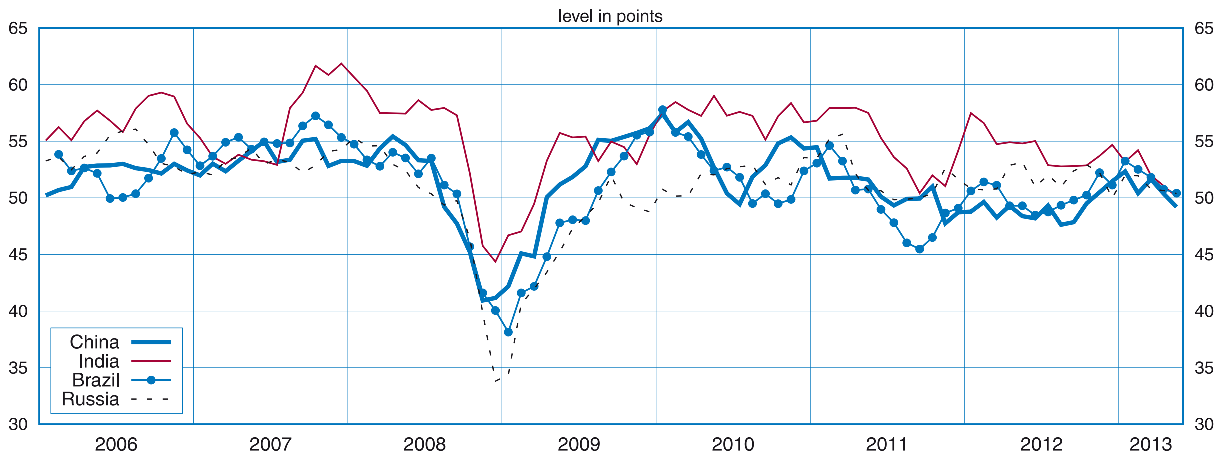
Sources: National Statistical Institutes appreciation of the Real caused a sharp deterioration of the country's trade balance: for the first time for twelve years, Brazil recorded a trade deficit in Q1 2013. In Q2 2013, according to surveys in the manufacturing sector, expansion is still forecast. Brazilian imports should thus continue to grow rapidly.

Little in the way of momentum east of the Eurozone

In Russia year-on-year GDP slowed in Q1 (+1.6%) to its lowest point for three years, and industrial output once again declined *(see Graph 1)*. Generally speaking activity has been sluggish for a year and, according to the PMI surveys, the climate in the manufacturing sector and in services does not point to any notable acceleration. Despite the fiscal stimulus measures announced, growth in the Russian economy through to the end of the year should remain well below its pre-crisis level.

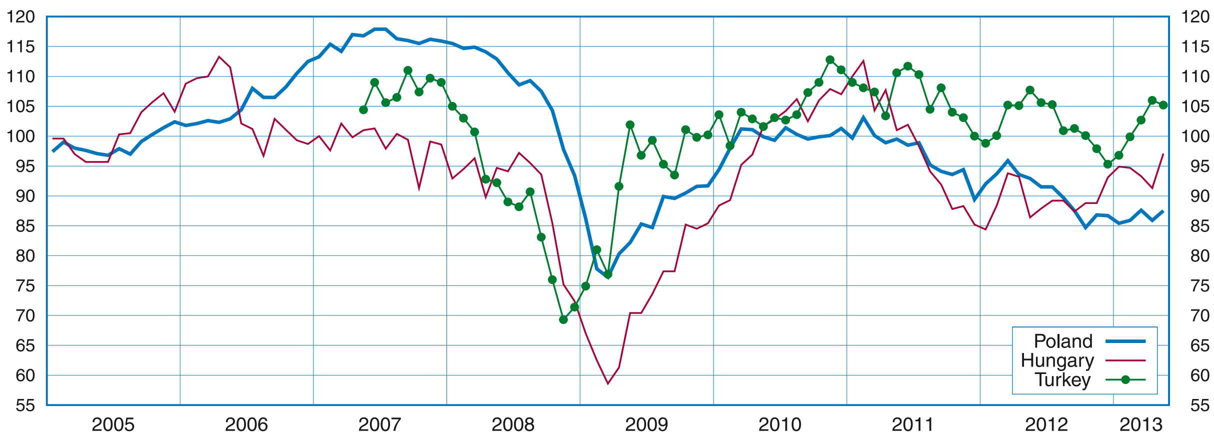
Eastern Europe is struggling to achieve any momentum, penalised by weak activity in the Eurozone. According to the European Commission surveys, the composite business climate indicator is well below its long-term average in Poland and is only picking up slightly in Hungary *(see Graph 3)*. Conversely, activity has picked up sharply over the last six months in Turkey after slowing significantly in mid-2012. Despite a decline in the manufacturing sector, the composite indicator of European surveys has continued to improve since January 2013. After growth fell to +2.2% in 2012, activity should accelerate in Turkey in 2013, provided that the current tensions do not put an end to this recovery. ■

2 - BRIC: PMI in the manufacturing industry



Source: Markit

3 - Poland, Hungary, Turkey: Economic Sentiment Indicator Composite Measure



Source: DG ECFIN