Germany

Consumption not weakening and residential investment taking off

There was a significant acceleration in German economic activity in Q1 2016 (+0.7% after +0.3%), buoyed by domestic demand. Activity should slow down in Q2 due to a backlash effect (+0,3%), before regaining momentum in H2 (+0.4% then +0.5%). As an annual average, growth should rise in 2016 (+1.7% after +1.4% in 2015) because investment should pick up sharply in construction, while public and private consumption should remain almost as dynamic as in 2015. However, foreign trade should hamper activity growth by 0.5 points.

Investment in construction should take off

In Germany, activity accelerated markedly in Q1 2016 (+0.7% after +0.3%), driven by domestic demand, both private investment and consumption. In Q2, there should be a slowdown in activity (+0.3%) because investment should come to a standstill. There is likely to be a slight increase in growth in H2, returning to the average rate seen in 2014 and 2015 (+0.4% and then +0.5%), taking average growth over the year to +1.7% (after +1.4% in 2015).

This acceleration could be largely driven by investment in construction, which should rise sharply (+4.2% in 2016 after –0.2% in 2015). After two quarters in which it was boosted by the mild weather, investment in construction should level off in spring before picking up again strongly in H2, as suggested by the sharp rise in building permits in early 2016 (*Graph*). Investment in capital goods is also likely to slow down in Q2 (+0.2%), after a very dynamic first quarter (+1.9%), before resuming in H2 at a rate more in line with growth in activity (+0.6% per quarter).

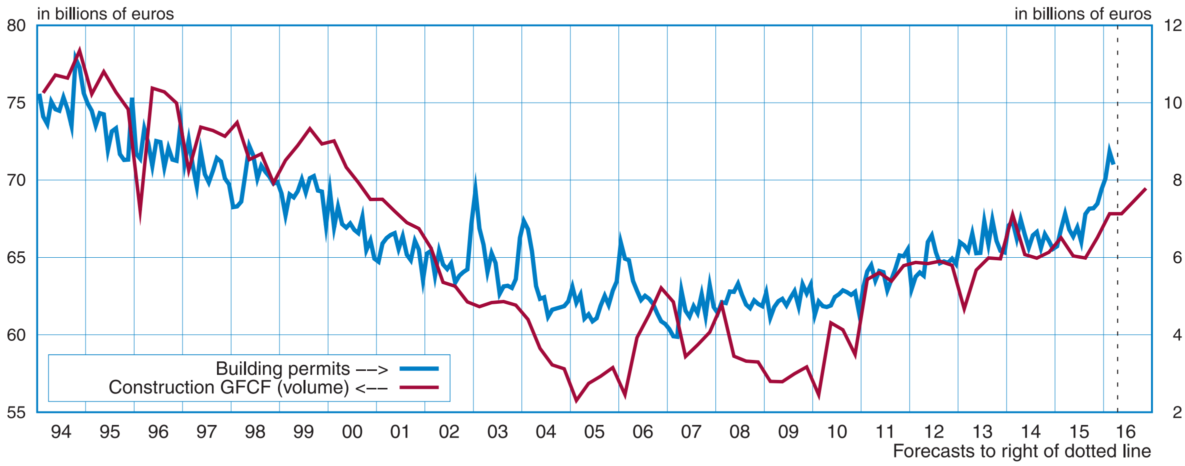
Consumption is set to remain strong

In Q1, household consumption rose as it did in late 2015 (+0.4%). It should continue to increase at a similar pace through to the end of the year (+0.4% to +0.5% per quarter), in step with household purchasing power gains. Employment shows barely any signs of weakening and should absorb the rise in the labour force due to the influx of migrants: the unemployment rate is likely to remain low (4.0% through to the end of the year). Wages should remain buoyant, as indicated by the increases agreed in the sector-specific wage negotiations. Public consumption looks set to remain dynamic throughout the year to finance the reception of migrants. Overall in 2016, public and private consumption (+2.5% and +1.8% respectively) should increase at almost the same rate as in 2015.

Foreign trade is expected to hamper growth in 2016

After accelerating markedly in early 2016, imports are likely to slow sharply in Q2, allowing foreign trade to make a positive contribution to growth. In H2, however, imports – driven by dynamic domestic demand – are likely to increase at a faster rate than exports, still adversely affected by weak demand from emerging countries. All in all, imports in 2016 should slow significantly less (+3.6% after +5.4%) than exports (+2.1% after +4.8%), with the result that foreign trade should hold back growth by 0.5 points (after +0.1 points in 2015). ■

Investment in construction should take off in 2016



Sources: Destatis, GfK, INSEE

Italy

Allegro ma non troppo

In Q1 2016, Italian activity picked up slightly (+0.3% after 0.2%), buoyed by dynamic industrial production. It should maintain almost the same pace through to the end of the year, taking growth to an average of +0.9% in 2016 after +0.6% in 2015. Consumption and investment should jointly contribute to ramping up activity, whereas foreign trade should hamper it once again.

Household consumption remains the mainspring of growth

In Q1 2016, household consumption in Italy held firm (+0.3%, after +0.3%), due to purchases of new vehicles in particular. Through to the end of the year, there is likely to be a further increase in household purchasing power (Graph). Admittedly, the curbs on wages should remain and employment should improve little: it slowed significantly in Q1, with the measures to cut the cost of labour in the framework of the Jobs Act having been reduced at the beginning of the year. However, Italian households should benefit from tax incentives, notably the scrapping of a property tax that brought in €3.5 billion in 2016, corresponding to 0.3 points of purchasing power. In addition, the decline in unemployment and the high level of confidence should encourage Italian households to reduce their savings ratio. Household consumption is likely to rise by 0.3% to 0.4% per quarter. Gathering pace, on average, throughout the year (+1.4% after +0.9%), it should remain the mainspring of Italian growth (+0.9% in 2016 after +0.6%).

Investment in construction set to increase for the first time since 2006

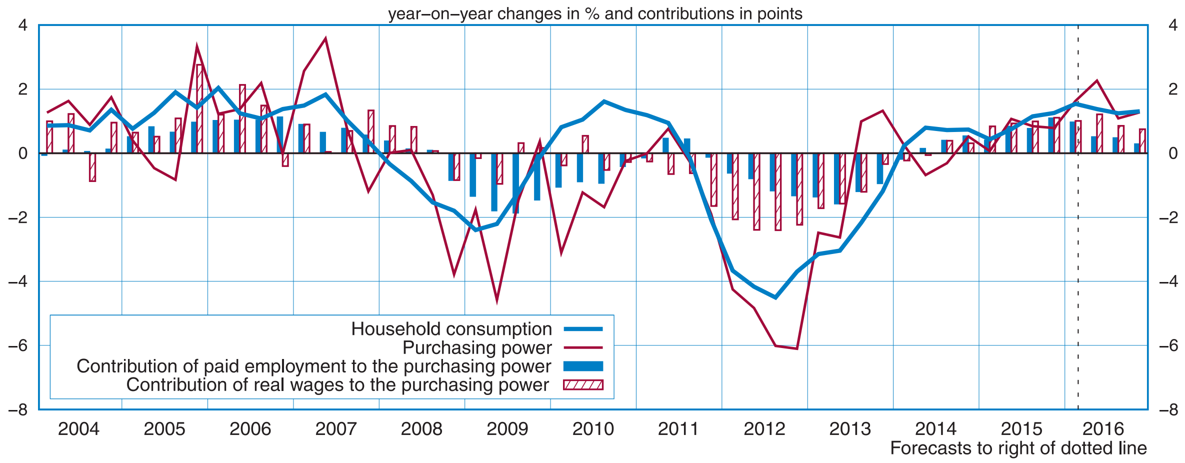
Investment in construction slipped back in Q1 (–0.5%). The business climate in the sector and the upswing in housing loans suggest that it should stabilise in Q2 before increasing modestly. Over 2016 as a whole, it should grow slightly (+0.5%), for the first time since 2006.

After a strong recovery in 2015 (+3.5%), investment in capital goods increased sharply in Q1 2016 (+1.3%). Favourable conditions have returned due to sustained demand, the renewed self-financing capacity of companies, the additional depreciation allowance incentive scheme, fewer doubts over the financial robustness of banks and the easing of credit terms. Investment in capital goods should therefore remain dynamic from now through to the end of 2016 (+0.6% in Q2, followed by +0.8% per quarter in H2) and over the year as a whole (+3.8%).

In 2016, foreign trade should once again hinder growth

In Q1 2016, exports (–1.5%) and imports (–0.9%) declined sharply. In Q2, international sales are likely to bounce back in reaction to this (+1.0%), and should then increase in line with global demand in H2 (+0.6% per quarter). On average in 2016, they should slow significantly (+0.3% after +4.1%). Imports are also likely to slow over the year (+1.4% after +5.8%), but should rise again more quickly: foreign trade should therefore continue to contribute negatively to growth (–0.3 points in 2016, as in 2015). ■

Purchasing power is sustaining consumption



Source: Istat, INSEE forecasts

Spain

Little sign of the catch-up dynamic fading

In Spain, activity grew fast in Q1 2016 (+0.8%, as in Q4 2015), still driven by vigorous domestic demand. Between now and the end of 2016, the catch-up dynamic should lose a little momentum but there is unlikely to be a significant drop-off in growth: +0.7% in Q2 followed by +0.6% per quarter in H2. Therefore, on average over the year, activity should slow slightly (+3.0% in 2016, after +3.2% in 2015) because investment looks likely to increase at a slower rate than in 2015, while consumption should remain strong.

The business climate remains favourable

In Q1 2016, Spanish gross domestic product (GDP) continued to grow at a fast pace (+0.8% after +0.8%). For the second quarter, the business climate remains favourable in both the manufacturing and service sectors, despite a slight drop since its peak in mid-2015. Therefore, there should be hardly any slowdown in activity: +0.7% in Q2 followed by +0.6% per quarter in H2, bringing annual growth to +3.0% in 2016 after +3.2% in 2015.

Household consumption should remain buoyant in the wake of purchasing power

Private consumption should remain buoyant in 2016, and should even accelerate slightly on an average annual basis (+3.4% after +3.1%). Spanish households should once again benefit from significant purchasing power gains (*Graph*). Employment looks set to increase at the same rate as activity, as has been the case since mid-2013, and unemployment should drop further: down to 18.9% at the end of 2016, seven points below its peak level at the beginning of 2013. Furthermore, wages are likely to pick up momentum, particularly for civil servants, who should receive the remainder of the bonus withheld in 2012. Finally, the drop in unemployment and a high level of confidence should encourage Spanish households to reduce their precautionary savings.

A slight slowdown in investment looks likely

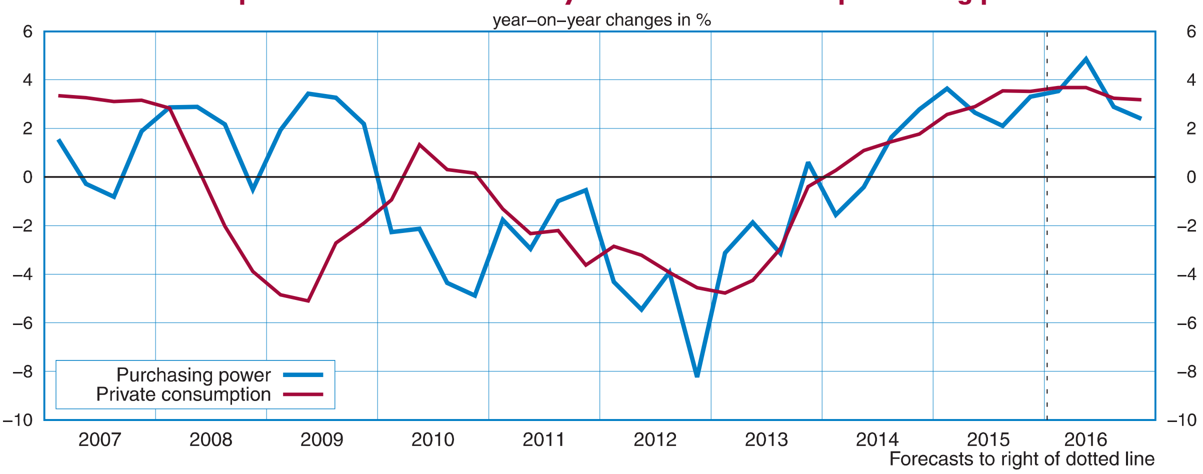
Investment in capital goods should increase less sharply in 2016 (+7.1%) than in 2015 (+10.2%). Production capacities are being used more intensively and corporate margins are very high. However, the corporate investment rate is approaching its 2008 level and the catch-up dynamic should lose a little momentum.

In construction, the business climate has been deteriorating for several months. As a consequence, and despite the high numbers of building permits granted recently, investment in construction should slow in 2016 (+2.0% after +5.3% in 2015), after the local and national elections in 2015.

Foreign trade should continue to hinder growth

With Spanish activity clearly outstripping that of its main trading partners, imports into the country should remain more dynamic than exports. In this way, foreign trade should once again hamper GDP growth in 2016 (–0.4 points after –0.5 points in 2015). ■

Consumption looks set to remain dynamic in the wake of purchasing power



Sources: INE, Markit

United Kingdom

To be or not to be (a member of the European Union), that is the question

In Q1 2016, activity in the United Kingdom slowed (+0.4% after +0.6%), especially in services. Uncertainties surrounding the outcome of the referendum on leaving the European Union are again likely to hold back growth in Q2 due to the wait-and-see attitude that has developed among economic agents. Even if the UK decides to remain in the Union, growth in 2016 would probably be impacted by a weakening of the factors that sustained domestic demand from mid-2013 to mid-2015. As an annual average, growth in gross domestic product should once again lose momentum in 2016: +1.7% after +2.3% in 2015 and +2.9% in 2014.

Uncertainties surrounding the referendum are likely to have an adverse effect on growth in the spring

In Q1 2016, British gross domestic product (GDP) slowed (+0.4% after +0.6%). Activity slowed down in the service sector, and contracted in construction and industry. In Q2, activity is likely to slow further (+0.3%) in the wake of domestic demand. Indeed, there has been a marked deterioration in the business climate over the past few months (Graph). Demand appears to have slackened, firstly because the favourable factors present since mid-2013 have been weakening (drop in unemployment, wealth effects and fiscal stimuli[1]), and secondly because the uncertainties surrounding the result of the referendum on leaving the European Union could be encouraging economic agents to adopt a wait-and-see approach. Consequently, consumption should slow (+0.3% after +0.7%) and firms could be more likely to postpone their investment decisions until after H1.

In H2, consumption and investment should regain a little momentum

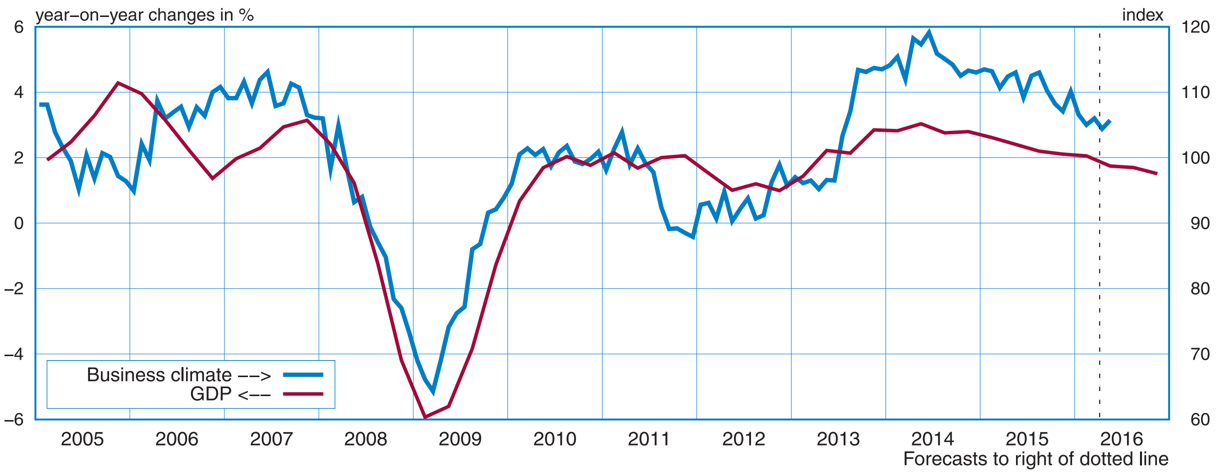
In H2, assuming that the UK remains in the European Union, activity should accelerate slightly (+0.4% per quarter) but should still be less dynamic than in the period from mid-2013 to mid-2015 (+0.7% per quarter on average). Once the uncertainties are over, corporate investment should pick up (+0.8% per quarter), despite a drop in the use of production capacities. In addition, household purchasing power is likely to be boosted by the sharp rise in the minimum wage on 1st April (+7.5%, Box). Household consumption should therefore regain a little momentum in H2 (+0.4% per quarter). All in all, British growth should decline in 2016: +1.7%, after +2.3% in 2015 and +2.9% in 2014. Despite the recent depreciation of the pound, foreign trade should continue to have a significant negative effect (–0.6 GDP points).

Risk: the "Brexit" could usher in a new period of uncertainty

Although the opinion polls favour neither outcome, the adopted forecast is based on the assumption of the United Kingdom remaining in the European Union, with the alternative assumption being a downside risk. In the short term, a "Brexit" would indeed be likely to increase the uncertainties of economic agents, until the form of a new trade partnership between the United Kingdom and the European Union were decided. ■

1. Hauseux Y. and Pramil J. (2016), "Why the United Kingdom has seen stronger growth than France since mid-2013", *Conjoncture in France*, March.

The business climate continues to weaken



Sources: ONS, CBI, European Commission, INSEE calculations

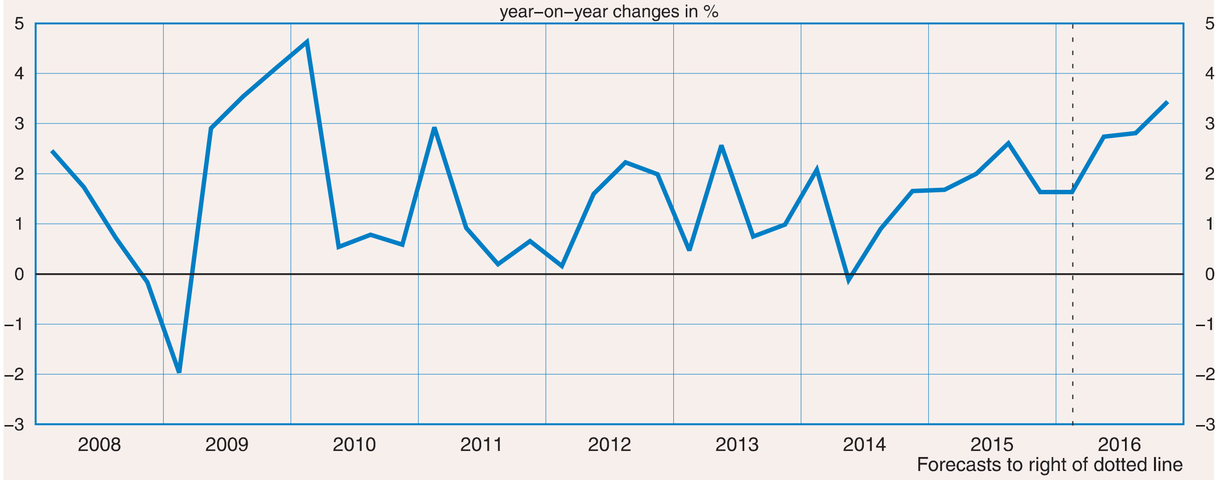
The raising of the minimum wage is expected to add 1 percentage point of growth to wages in Q2 2016

On 6 April, the British minimum wage (National Living Wage - NLW) was increased by 7.5%, from £6.70 to £7.20 an hour. This increase applies to all workers over the age of 25. According to a British institute, the Resolution Foundation, about 4.5 million British employees are expected to see their pay increase: 1.9 million people currently paid the minimum wage who will benefit from a direct 7.5% rise and another 2.6 million due to the knock-on effect on the salary scale.

These 4.5.million people, representing approximately 17% of salaried workers, will benefit on average from a wage increase lower than the increase in the NLW. The overall effect of raising the minimum wage on wage growth is expected to be in the order of 1 extra point in the second quarter of 2016. Over one year, wages are likely to rise faster in the last three quarters of 2016 (+3.0% on average) than has recently been the trend (+1.4% on average since 2010, *Graph*). ■

Average wage per capita in nominal terms

year–on–year changes in %



Sources: ONS, INSEE forecasts

United States

Acceleration expected after a setback in early 2016

American activity slowed again in Q1 2016 (+0.2% after +0.3%) due to the downturn in exports and productive investment, while household consumption continued to grow strongly. Between now and the end of 2016, employment looks likely to slow and with it consumption. However, investment should bounce back, especially given that no further spending cuts are likely in the oil sector. All in all, activity should accelerate in Q2 (+0.7%) and return to a moderate pace in H2 (+0.5% per quarter). Over 2016 as a whole, it is set to slow significantly (+1.9% after +2.4% in 2015).

The business climate is improving

After slumping in 2015, the business climate has improved since March, in both industry and services. After two quarters of weak growth (+0.3% in late 2015 followed by +0.2% in early 2016), activity should perk up: +0.7% in Q2 followed by +0.5% per quarter in H2. On average over the year, growth in 2016 (+1.9%) is likely to be weaker than in 2015 (+2.4%).

Employment should slow with consumption losing a little momentum

Due to the slowdown in activity and growing tensions in the labour market, employment is likely to slow between now and the end of 2016 (+0.2% per quarter against an average of +0.4% per quarter since 2011). The unemployment rate should stabilise at a low level (just under 5%) and households could be less inclined to dip into their precautionary savings than in the past. Household consumption could therefore slow in H2 (+0.4% per quarter) after solid growth in H1 (+0.5% followed by +0.6%). On an annual average basis, it should slow down significantly in 2016 (+2.3% after +3.1%).

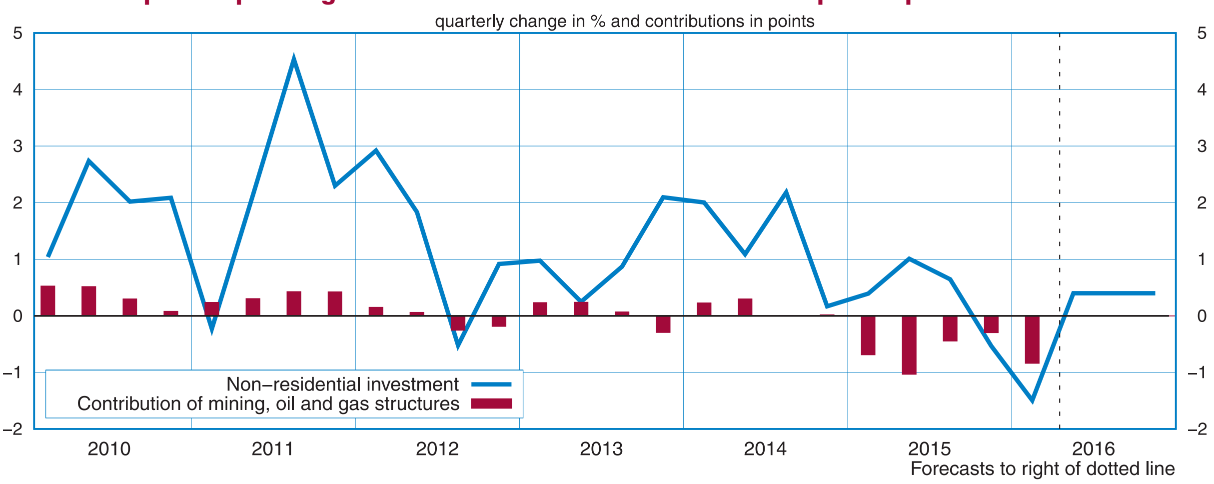
Corporate investment is set to recover but foreign trade could still make a negative impact

Corporate investment has slipped back over the last two quarters, due to the collapse in spending on new oil infrastructures (Graph). However, the rig count appears to have bottomed out and the associated expenditure should no longer hinder overall investment between now and the end of 2016. Consequently, productive investment is likely to bounce back, although only slightly (+0.4% per quarter), with the production capacity utilisation rate remaining low.

On the other hand, residential investment should remain dynamic (+9.2% in 2016 after +8.9% in 2015), due to the low level of interest rates for new housing loans and the healthy state of the property market.

Still penalised by the past appreciation of the dollar, exports declined again in Q1 2016, by 0.5%, as in Q4 2015. They are set to pick up in Q2 and should then increase in line with world demand in H2. Imports virtually stagnated in Q1 due to relatively sluggish domestic demand, and should accelerate along with this demand between now and the end of 2016. On average over the year, exports and imports are likely to slow but imports should remain more dynamic (+2.1% compared to +0.7%): the external balance should once again contribute negatively to growth in 2016 (–0.2 points), for the third consecutive year.■

The collapse in spending on oil infrastructures has held back corporate productive investment



Sources: BEA, INSEE forecasts

Japan

Activity to resume modest growth

In Q1 2016, Japanese activity picked up (+0.5% after –0.4%) thanks to exports and household consumption. Activity should subsequently return to its growth trend (+0.2% to +0.3% per quarter), driven by consumption. On the other hand, exports are likely to become sluggish again, penalised by the past appreciation of the yen in particular. In 2016, gross domestic product should grow by 0.6%, as in 2015.

Industrial production is set to bounce back moderately in Q2

In Q1 2016, gross domestic product (GDP) bounced back (+0.5% after –0.4%), driven by private consumption (+0.6% after –0.8%) and exports (+0.6% after –0.8%). This rebound was amplified by a calendar effect, as the Japanese quarterly accounts are not corrected for the extra day in leap years. However, industrial production dropped (–1.1%), penalised by factory stoppages, especially in the automobile sector due to steel shortages. In Q2, industrial production should rebound moderately when production in these plants resumes, despite the backlash expected in response to the "leap year effect" and the production stoppages caused by the earthquake on the island of Kyushu in April. Consequently, activity should return to its moderate trend in Q2 (+0.2%) and also in H2 (+0.3% per quarter), bringing average growth over the year to +0.6%.

Consumption should finally return to growth in 2016

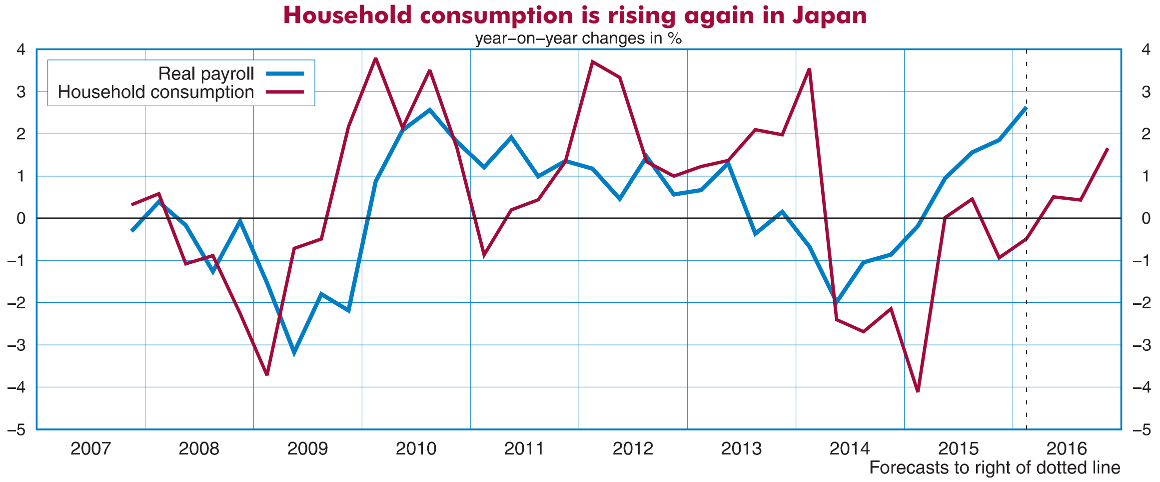
Households have been benefiting from an upturn in purchasing power for the past year, much of which has been put aside as savings so far (*Graph*). Between now and the end of 2016, the unemployment rate should remain low (3.2% in April), encouraging new wage rises. After picking up in Q1 (+0.6%), consumption is likely to rise more moderately in Q2 2016 (+0.2%), before accelerating in H2 (+0.4% per quarter). As an annual average, growth (+0.5%) should finally return after two years of decline. Household investment should bounce back (+3.1% in 2016 after –2.7%), as suggested by the clear recovery in housing starts since the start of 2016.

However, corporate investment looks likely to remain sluggish: the capacity utilisation rate has slipped back significantly over the past year and order books are becoming thinner, particularly on the export market. It should decelerate on average over the year (+0.7% after +1.6%).

The appreciation of the yen is likely to penalise exports

After picking up in Q1 (+0.6% after –0.8%), exports are likely to rise only slightly between now and the end of 2016 (+0.2% per quarter) due to the past appreciation of the yen, which is eating away at price competitiveness, and the persistent sluggishness of demand from emerging countries. At the same time, imports should start rising again (+0.5% per quarter), boosted by the upswing in consumption. On average, foreign trade is expected to make almost no further contribution to growth in 2016 (+0.1 points, after +0.4 points in 2015). ■

Household consumption is rising again in Japan



Source: Japan Cabinet Office

Emerging economies

Modest growth but the end of the slowdown in sight

In 2015, activity in the emerging economies continued to grow at a slower rate than at any time during the past twenty years. Divergences grew between countries that export commodities, which have been penalised by declining prices, and those that import these commodities and benefit from this decline.
In China, after a slowdown in Q1 2016 (+1.1% after +1.6%), growth looks set to rise again, by approximately +1.7% per quarter through to the end of 2016. This improvement should stem from major efforts to cut taxes and ease credit conditions, but it is unlikely to be sufficient to prevent another slowdown on average over the year (+6.3% after +6.8% in 2015). Nevertheless, the growth of imports should return to a rate more in line with activity, after an exceptional decline in 2015.
In Brazil, activity continues to weaken in a context of political crisis that heightens the uncertainties. Only exports, buoyed by the devaluation of the Brazilian currency – the real – and the slight recovery of commodity prices, may limit the extent of a new recession. The Russian economy, on the other hand, should stabilise in 2016 after a major decline in 2015, thanks to the recent appreciation of the rouble, which should hold back prices and support household consumption.
India and Turkey should maintain sustained growth and Central and Eastern European countries should also regain some dynamism after the slowdown at the beginning of 2016.
In terms of world trade, imports to the emerging economies, which again declined at the beginning of 2016, should bounce back slightly during the year, particularly imports into Russia and China.

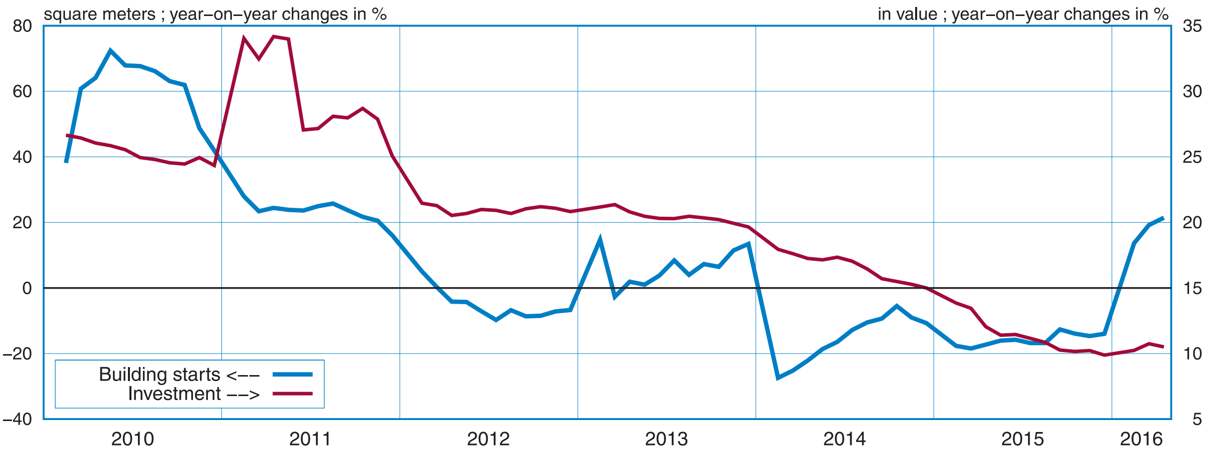
In China, growth is set to resume on the strength of new economic policy measures

China was hit by a new economic slowdown in Q1 2016 (+1.1% after +1.6% in Q4 2015). Nevertheless, growth should subsequently gain momentum and is likely to reach +1.7% per quarter through to the end of 2016. In particular, industrial production accelerated slightly at the end of winter, driven by an upturn in the activity of steelworks and cement works in particular, pointing towards a general improvement starting in the spring. However, on average over the year, growth looks likely to weaken again in 2016 (+6.3% after +6.8% in 2015 and +7.4% in 2014).

Much of the improvement over the course of the year is likely to be triggered by the new economic policy measures – tax cuts and incentives to develop credit – that should bolster domestic demand. There are signs of an upturn in consumption with car registrations returning to their trend growth level after sharp rises at the end of 2015 due to targeted tax measures. There was also an upturn in retail sales in March and household confidence, although remaining below its long-term average, has bounced back slightly in recent months.

The slowdown in investment should be over, due to the sharp credit recovery on the back of the new measures. There should be a rebound in

1 - Investment should stop slowing in China



Sources:

residential investment in particular, as there has been a turnaround in housing starts since the beginning of the year (+21.4% over the year to April; *Graph 1*).

Chinese exports slipped back in Q1 2016, dragged down by the new decline in exports of goods after processing. Imports also shrank in Q1 but much less than last year; they should subsequently recover and rise at a rate that corresponds more closely to domestic demand.

In Brazil, exports should limit the scale of another year of recession

The political crisis affecting Brazil has worsened and uncertainty remains high, adversely affecting activity. The recession looks set to continue in 2016. In Q1, there was indeed a decline in industrial production for the eighth consecutive quarter (–2.3%), and the business climate remains very poor in May. There has been a further drop in retail sales (–2.5% in Q1), while household confidence has fallen to a historic low, in a context of sharply declining purchasing power and a deteriorating job market.

Only exports are holding out, buoyed by the upturn in price competitiveness brought by the past depreciation of the real, and by the slight rise in commodity prices. Between now and the end of 2016, the further appreciation of the real and the drop in inflation (*Graph 2*) should limit the losses of household purchasing power, and consequently the decline in domestic demand. Nonetheless, as an annual average, another strong contraction of the economy looks likely: –3.3% in 2016, following on from –3.9% in 2015.

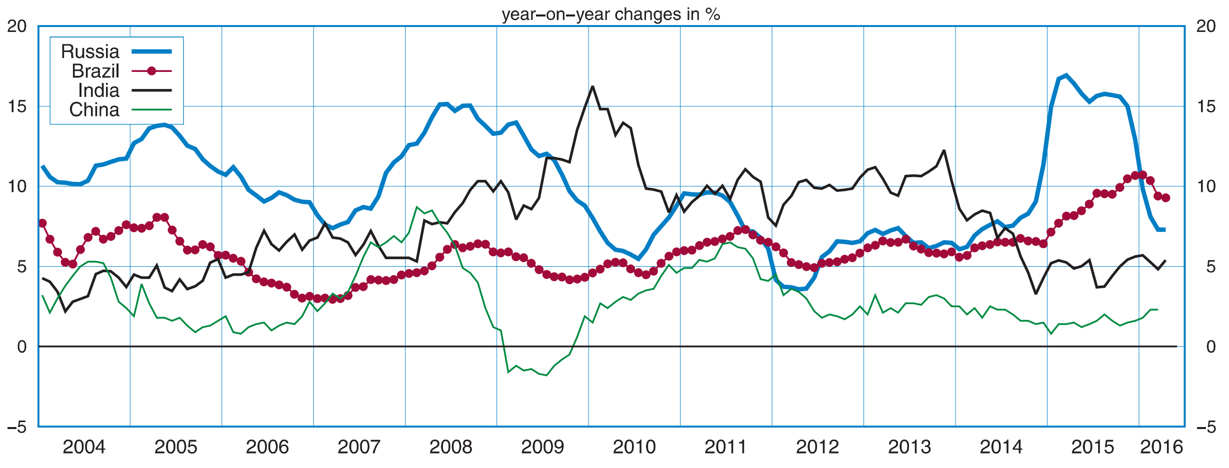
Pressures ease in Russia

In Q1 2016, industrial production and retail sales bounced back in Russia, and gross domestic product stabilised (0.0% after –0.3%). In May, the business climate remains above its expansion threshold. The rouble, although heavily depreciated, is rising again against the dollar, helping to ease inflation. This is limiting the pressure on household purchasing power and should help to stabilise domestic demand, which remains very poor. Considering the growth overhang at the start of the year, activity looks likely to contract again in 2016 (–0.6%), but to a significantly lesser extent than in 2015 (–3.7%).

Growth remains buoyant in India, Turkey and the CEEC

Supply and demand continue to grow vigorously in India, despite a downturn in the business climate. Growth in India should once again outstrip Chinese growth (+7.5% after +7.3% in 2015), bolstered by a previous drop in the prices of commodities, of which India is a net importer. For the same reasons, the Turkish economy should continue to grow strongly (+3.7% after +3.9%), despite the geopolitical tensions and a somewhat gloomy business climate. In Central and Eastern European Countries (CEEC), activity slowed down at the beginning of 2016 (+0.3%), as a backlash against the strong growth at the end of 2015 (+1.0%), but it should return to a more sustained pace in Q2. As an annual average, growth in the CEEC looks likely to ease off in 2016 (+2.9% after +3.6% in 2015). ■

2 - Prices are slowing in Russia and Brazil



Sources: national statistical offices