Germany

Robust growth

German activity slowed down in Q3 2016 (+0.2% after +0,4%), held back by a downturn in exports. However, private consumption accelerated, investment in construction bounced back and government consumption remained strong. Through to mid-2017, purchasing power gains should not weaken despite an anticipated upturn in inflation, and consumption should increase steadily, with a positive effect on all economic activity. All in all, growth is expected to rise to +0.5% per quarter between now and mid-2017. As an annual average, gross domestic product is set to rise by 1.8% in 2016 after +1.5% in 2015. The growth overhang for 2017 at the end of H1 is expected to be +1.6%.

Household expenditure looks set to rise significantly once more

In Q3 2016, German household consumption picked up (+0.4%) after a disappointing quarter in view of household purchasing power (+0.2%). Government consumption remained vigorous (+1.0% after +1.2%). Through to mid-2017, purchasing power gains are likely to be robust, in the order of +2.0% year on year, despite an expected rise in inflation. The employment situation should indeed remain very favourable with a low unemployment rate, wages boosted by the pay negotiations in the summer of 2016 and a rise in the minimum wage in January 2017. In addition, social benefits are likely to pick up in 2017 due to the increase in pensions and allowances paid to migrants. All in all, activity should accelerate, driven by consumption: +0.5% per quarter through to mid-2017. It should increase by 1.8% throughout 2016 as a whole, i.e. more than in 2015 (+1.5%). For 2017, the growth overhang is expected to be as high as +1.6% by mid-year.

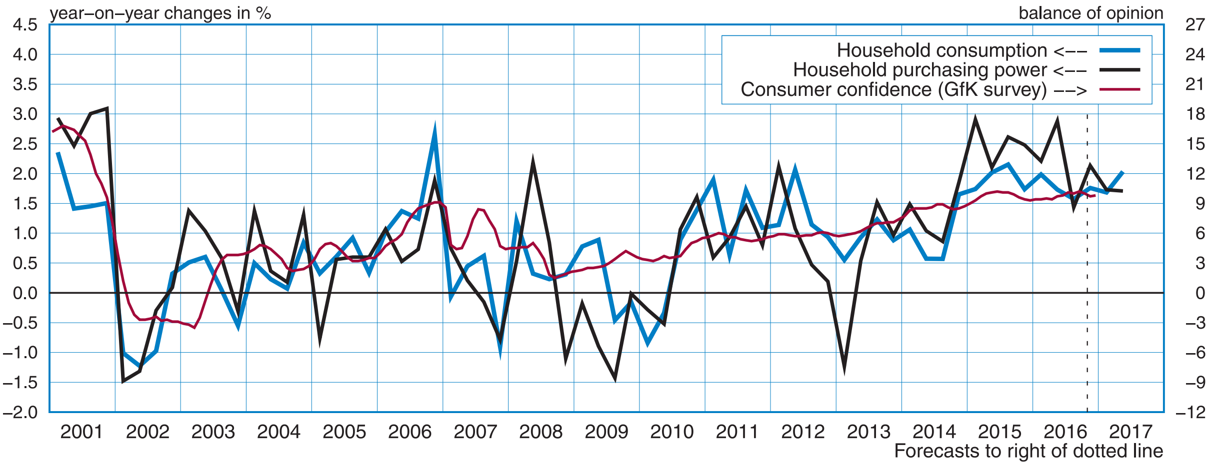
Investment should regain some vitality

After faltering in Q2 and Q3 2016 (–2.3% then –0.6%), equipment investment is expected to receive a boost between now and mid-2017 (+0.9% on average per quarter). Indeed, the business climate stabilised at a high level in November, especially business prospects, with the industrial capacity utilisation rate at its highest level since 2011. In addition, investment in construction should remain buoyant (approximately +1.0% per quarter through to mid-2017), as suggested by the recent rise in the number of building permits.

Foreign trade is expected to hamper growth slightly

Foreign trade hampered growth in Q3 (–0.3 points), as imports rose slightly (+0.2%) whereas exports slipped back (–0.4%). In Q4 2016 and in H1 2017, exports are unlikely to rise quite as quickly as imports, reflecting a more favourable economic outlook for Germany than that of its main partners. The contribution of foreign trade should therefore be slightly negative by mid-2017. ■

Strong consumption expenditure



Sources: Destatis, GfK survey, INSEE forecasts

Italy

The recovery is confirmed but should remain tentative

In Q3 2016, Italian activity picked up again (+0.3% after +0.1%). Activity in Q4 is likely to slow down slightly (0.1%) with investors playing a waiting game before the constitutional referendum on 4 December. All in all, GDP is expected to increase by 0.9% in 2016, i.e. slightly up on 2015 (+0.6%). In H1 2017, domestic demand is likely to give a moderate boost to activity (+0.2% per quarter).

Investment in construction picks up after a decade of crisis

In 2016, investment in construction should increase for the first time in ten years (+1.0% after –0.8%). It should continue to rise significantly between now and mid-2017: the business climate in the sector is improving (*Graph*) and real estate transactions are picking up. The growth overhang for 2017 should therefore already be +0.9% by mid-year.

Equipment investment should remain very buoyant

Equipment investment was very dynamic in Q4 2016: +3.0% after nine consecutive quarters of vigorous rises (+1.0% on average). Conditions remain favourable: demand is rising, enterprises have restored their self-financing capacities, credit terms have eased and the additional depreciation scheme (in force until the end of 2017) should be strengthened in January for investments in new technologies. However, this investment is likely suffer temporarily from the wait-and-see attitude prevailing prior to the constitutional referendum on 4 December (+0.1% in Q4). It should then pick up again (+1.0% on average per quarter) if the business climate does not suffer on account of the political uncertainties generated by the winning "No" vote. All in all over the year, it should remain very vigorous in 2016 (+4.7% after +4.3%) and its mid-year overhang in 2017 should still be strong (+3.5%).

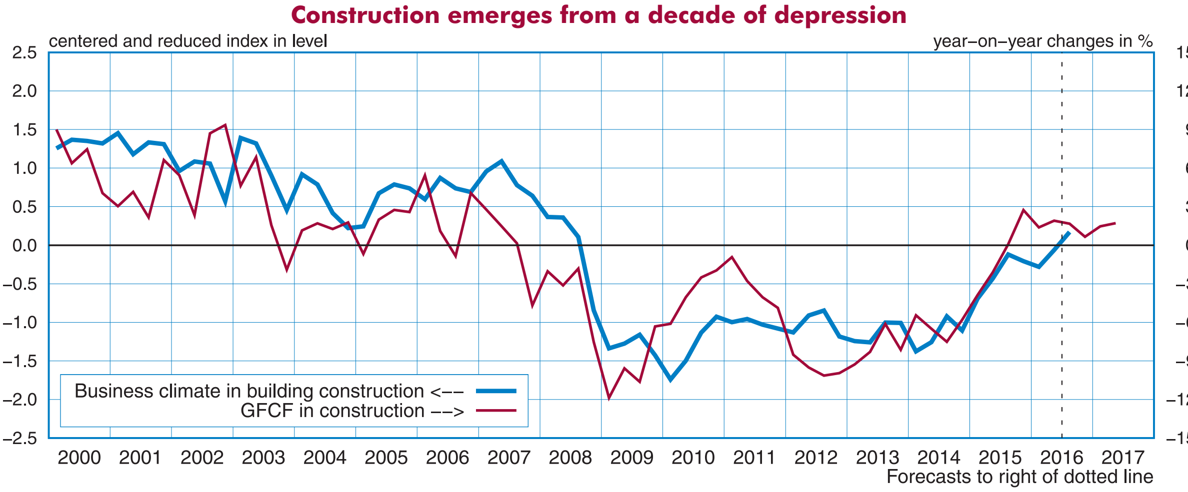
Consumption should grow slightly

In Q3 2016, household consumption remained sluggish (+0.1%), despite the previous decline in unemployment and net gains in household purchasing power over the last year. Very little improvement is expected between now and mid-2017 (+0.2% on average per quarter), as the nominal wage rise is likely to be offset by a slight upswing in inflation. However, a drop in property tax in late 2016, followed by a raise in pensions in 2017, should help to boost purchasing power.

Three earthquakes rocked Italy between August and October 2016 and new public spending will be required to repair the significant damage to property. Similarly, increased spending is required for rescuing and accommodating the growing number of refugees. All in all, government consumption should increase in 2016 (+0.6%), for the first time since 2011. It should rise again moderately in early 2017.

All in all, growth is likely to be weak in Q4 2016 (+0.1%) and then pick up only slightly in early 2017 (+0.2% per quarter), driven by domestic demand. Trade should make hardly any contribution. The growth overhang for 2017 is expected to reach +0.6% at the end of Q2, after +0.9% throughout the whole of 2016. ■

Construction emerges from a decade of depression



Sources: Istat, INSEE forecasts

Spain

GDP on the road back to its pre-crisis level

In Q3 2016, Spanish gross domestic product slowed slightly (+0.7%, after +0.8%). Over the coming quarters, activity should remain dynamic but is likely to be hampered by domestic demand. Growth should hold firm at +0.7% in Q4 before reaching +0.6% in Q1 2017 and +0.5% in Q2. In this way GDP should return to its level of early 2008 by next spring.

Consumption is set to slow in early 2017

Household consumption looks likely to remain buoyant in 2016 (+3.1% as an annual average, after +2.9%), driven by vigorous employment, low inflation and a slight recovery in wages. It should remain dynamic at the end of 2016 (+0.7%) and then slow down in early 2017 (+0.6% in Q1 then +0.5%), particularly consumption of motor vehicles, penalised by the end of the scrappage bonus in the summer. Indeed, purchasing power is expected to slow down slightly (Graph), undermined by an upturn in inflation (+1.5% over one year to mid-2017 compared to –1.0% in mid-2016) due to its energy component and an increase in taxes on alcohol and tobacco. In addition, employment should decelerate slightly. Its previous rapid rise originated partly from the tourism sector, the expansion potential of which is becoming more limited. The unemployment rate, while still high, should continue to fall, down to 18.0% in mid-2017: 2 points below its mid-2016 level and 8 points below its peak in early 2013. However, wages are likely to be boosted by a sharp rise in the minimum wage in January 2017 (+8%).

Government consumption bounced back in summer after shrinking in spring. It should subsequently slow down significantly, as the scale of the budget deficit (5.2% of GDP in 2015) should prompt the new government, appointed after ten months of political deadlock, to limit spending.

Productive investment is set to run out of steam

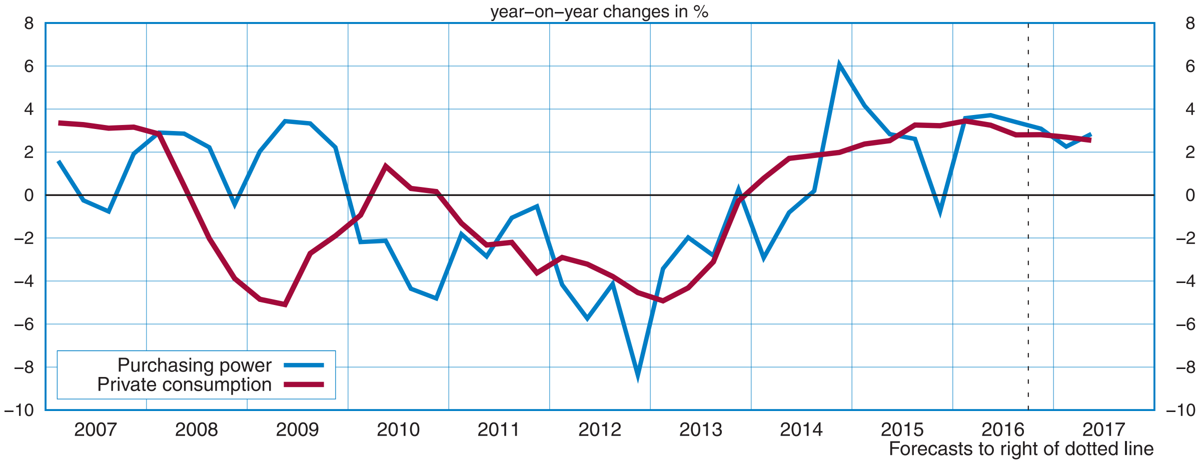
Benefiting from favourable financing terms, investment in capital goods is set to remain dynamic over the forecasting period, after stalling during the summer. However, it is likely to grow less quickly than in H1 2016: the investment rate is nearing its 2008 level and the catch-up process is running out of steam. On the other hand, the sharp upswing in building permits suggests a sharp rise in investment in construction.

Foreign trade is expected to stop driving growth

Despite Spanish growth being stronger than that of its main trading partners, foreign trade fostered growth in the first three quarters of 2016 due to weak imports. These imports should bounce back in late 2016 and foreign trade is likely to hamper growth slightly before becoming neutral in H1 2017.

All in all, with domestic demand slowing, activity should be held back slightly while remaining robust: from +0.7% in Q4 2016 to +0.5% in Q2 2017. On average over the year, gross domestic product should grow by 3.2% in 2016, as in 2015. In the spring of 2017, it is expected to return to the same quarterly level recorded in early 2008 and its growth overhang for the year should already stand at +2.1%. ■

Consumption should slow slightly in the wake of purchasing power



Sources: INE, INSEE forecasts

United Kingdom

Awaiting Brexit

In Q3 2016 the British economy remained buoyant (+0.5% after +0.7%), despite fears aroused by the Brexit referendum result. However, activity is expected to slow at the end of 2016 (+0.3%) and in early 2017 (+0.3% in Q1 followed by +0.2% in Q2), in the wake of domestic demand. Indeed, inflation should rise, driven by the strong depreciation of the pound; this is likely to handicap household purchasing power and with it consumption. In addition, investment is expected to weaken due to the wait-and-see attitude of the business community before the clarification of the Brexit procedures. The mid-year growth overhang for 2017 is expected to stand at +1.1%, after +2.0% over 2016 as a whole.

Households are suffering from a sharp surge of inflation

After the Brexit vote on 23 June, the pound depreciated significantly: the real effective exchange rate fell back by 14% on average between May and November. Fuelled by this depreciation and the upturn in energy prices, another rise in inflation is expected, up to +2.2% over one year to mid-2017 compared to +0.1% one year earlier. In addition, employment is likely to slow down considerably, as suggested by the drop in hiring prospects reported in the business tendency surveys. All in all, the purchasing power of British households is expected to slow significantly between now and mid-2017, and their confidence has been waning since the pro-Brexit vote (*Focus*). Household consumption should slow after being surprisingly vigorous in the summer (+0.7%): +0.3% in Q4, followed by +0.1% per quarter on average until mid-2017.

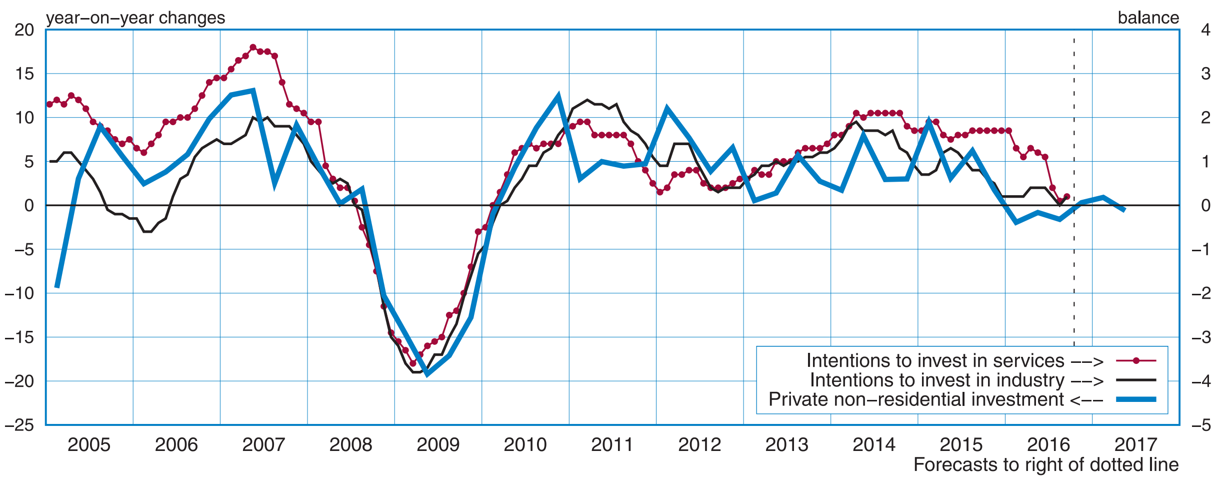
Private investment is likely to edge down

Since the spring, residential investment by households has been falling due to the impact of a new tax on purchases of second homes introduced in April, compounded by the post-referendum wait-and-see attitude. It should fall again between now and mid-2017. Enterprises, for their part, are revising their investment intentions downwards in both services and industry (*Graph*), and corporate investment should drop through to mid-2017 after holding firm in the summer of 2016 (+0.9%). Only government investment is likely to increase over this timeframe, boosted by a budgetary stimulus. The mid-year growth overhang for total investment is expected to be +0.3% for 2017, a marked slowdown compared with 2016 (+1.2%) and 2015 (+3.4%).

Foreign trade is likely to be the main driver of fast-slowing activity

British exports rebounded slightly in Q3 (+0.7% after –1.0%). They should remain vigorous through to mid-2017 (+0.9% on average per quarter), boosted by price competitiveness gains resulting from the depreciation of the pound, and by the buoyancy of foreign demand. Imports, on the other hand, are likely to remain almost unchanged over the period. Foreign trade should therefore be the main driver of British activity which is clearly losing momentum: it should contribute +0.2.points on average per quarter to GDP growth of +0.3% in late 2016 and early 2017, followed by +0.2% in Q2. The mid-year growth overhang for 2017 is expected to be +1.1%, after +1.7% one year earlier. ■

Business leaders have been revising their investment intentions significantly downwards since the Brexit referendum result



Sources: ONS, Bank of England, INSEE forecasts

What are the short-term consequences of the Brexit referendum?

Following the pro-Brexit vote, several risks and as many channels for transmitting this political shock to the real economy could be envisaged in the short term: an exchange rate shock with the depreciation of the pound; negative wealth effects through the fall in prices of real estate or financial assets; a financial shock in the form of a rise in interest rates or a tightening of financing conditions for private agents if confidence in British banks were lost; an uncertainty shock if companies were to delay purchases.
In the longer term, the impact of Brexit is expected to spread through other channels, trade-related in particular, if the nature of the new relationship between the United Kingdom and the rest of Europe were to be substantially altered, in particular if customs tariffs were increased or if the European financial passport were withdrawn from banks.

In the short term, more fear than actual harm in the financial sphere

Among the risks, some have not come to pass in the short term. In particular, in the financial sphere share prices, after a brief dip, soon returned to their pre-vote level, in the United Kingdom as elsewhere in Europe. Similarly, the volatility of the stock market indices only rose temporarily and then only to a limited extent. Concerning financing conditions, the reaction of the British monetary authorities led to a slight drop in sovereign yields and private interest rates before they rose again as part of the general upward trend in November. Finally, in surveys the banks are not reporting any more restrictions in supply conditions.

The pound has depreciated substantially

The pound depreciated in the run-up to the vote, in particular against the Euro, which went from £0.75 to in January to £0.79 in June 2016. It plummeted in the aftermath of the referendum due to massive sales of currency-denominated assets, with £0.90 to €1 in October, before appreciating again in November. All in all, the real effective exchange rate (REER), measured as the weighted sum of exchange rates with the main trading partners, fell by 16% between January and November 2016 (*Graph 1*).

Prices of imported goods, expressed in sterling, therefore increased whilst export prices, expressed in foreign currencies, fell. In the medium term, this development is favourable to the British economy as it boosts exporters' price competitiveness: the long-term REER elasticity of British exports is in the order of –0.5 (Borey & Quille, 2013): thus on average a 16% drop in the REER is expected to induce an 8% increase in exports. However, the wait-and-see attitude caused by the prospect of trade negotiations is expected to moderate exports, which are only expected to grow a little faster (+0.9% per quarter on average from now until mid-2017) than foreign demand (+0.7%).

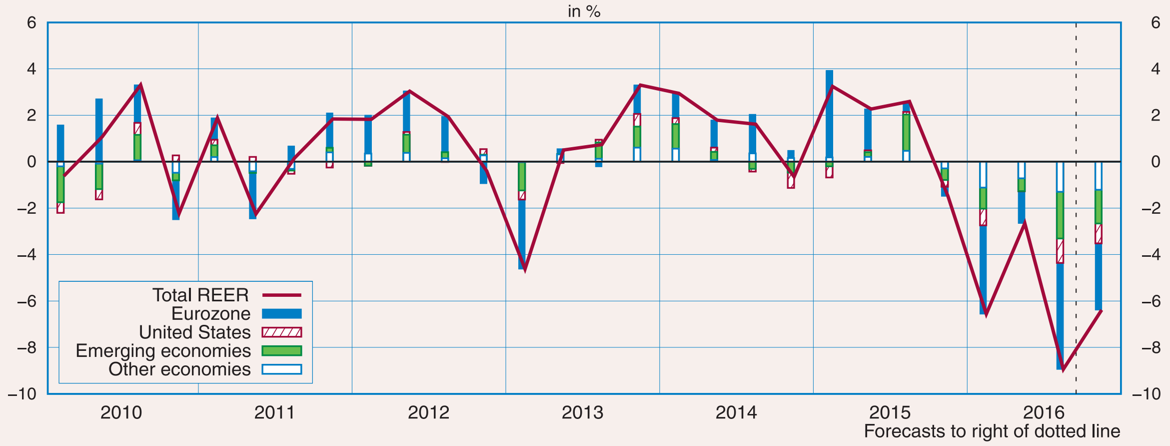
The rise in inflation is eroding households' purchasing power

On the other hand, the fall in the value of the pound has made imports more expensive, petroleum products in particular. Energy prices therefore rose by 2.5% in Q2 and then 1.3% in Q3. The depreciation of the pound accounts for almost three quarters of this increase. In addition, as 41% of manufactured goods consumed in the United Kingdom are imported, the depreciation is also causing an acceleration in core inflation. Overall, inflation rose from 0.2% in January 2016 to +0.9% in October and is expected to reach +2.2% in June 2017. In comparison, inflation in the Eurozone increased from +0.3% in January 2016 to +0.5% in October, and is expected to rise to +1.0% by mid-2017 (*Graph.2*).

The depreciation of the pound increases production costs, which will eventually compound its impact on inflation

In the short term, the depreciation of the pound has above all handicapped manufacturers, by making their intermediate consumptions more expensive. According to the Office for National Statistics, of the 7.2% year-on-year increase in producer prices in September, 4.7 points can be explained by the increase in the prices of their imported components.

1 - Quarterly variations in the real effective exchange rate of the pound and contribution of currencies



Source: INSEE

Initially, the increase in intermediate consumption prices is expected to adversely affect companies' margins, before being passed on to consumer prices. The impact on consumer prices will ultimately depend on the speed with which companies pass on the increase in their production costs to their sale prices.

Households are "over-consuming" a little due to expected price rises

Economic outlook surveys on households indicate that many more British people than usual expect prices to rise in the coming months (*Graph 3*). Faced with the prospect of an upsurge in inflation that will reduce their purchasing power, households have little inclination to save and more of them deem it an appropriate time to make major purchases. Indeed, retail sales surged in July (+2.0%), stabilised over the next two months and then increased strongly again in October (+1.9%). This vigour mainly stems from purchases of computers (+25.6% in October year on year) and music and video equipment (+7.4%), products that are virtually all imported. National accounts data confirm the buoyancy of household consumption in Q3 (+0.7%). This rush to beat the currency effects is expected to be only temporary and consumption is expected to slip back quickly to a level more in line with purchasing power by mid-2017, as the inflation shock makes itself felt.

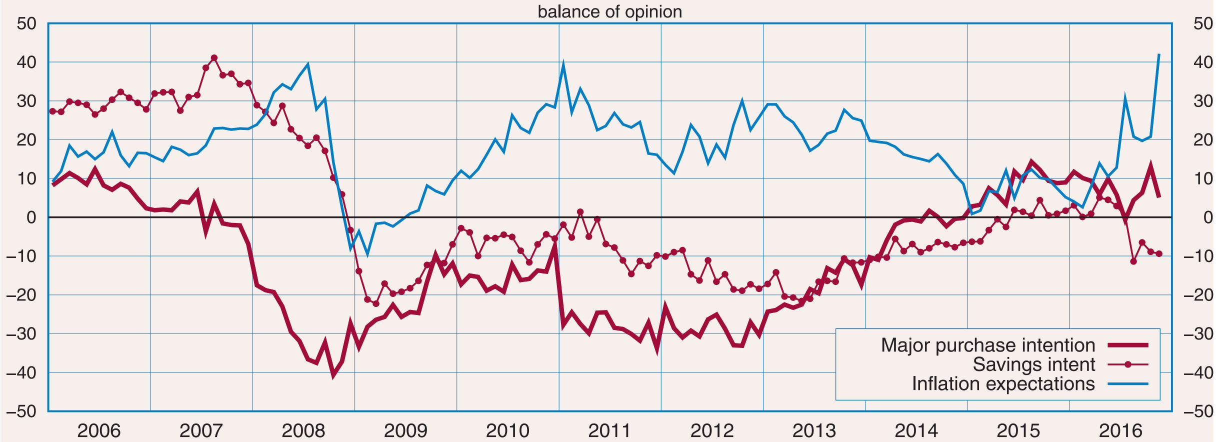
The uncertainty shock is expected to adversely affect investment

The first estimate of the quarterly accounts for Q3 show that corporate investment has held up (+0.9% after +1.0%). But uncertainties surrounding the conditions of Brexit are expected to lead investors to play a waiting game which will have a negative effect on their purchases through to mid-2017, and this is expected to last for as long as the exit conditions are not clarified. According to the Bank of England's surveys, investment intentions are at their lowest level, in particular in the service industries. Thus several business federations (for example the British Bankers' Association in the United Kingdom, the Verband der Automobilindustrie in Germany) have announced their wish to relocate a part of their productive activity to the rest of the European Union if the Brexit negotiations lead to the introduction of trade barriers that are too high (increases in customs tariffs or withdrawal of the European financial passport). In addition, according to an estimate produced by the CEBR Institute in November, based on a survey of 1,015 leaders of companies representative of the British economy, a third of firms have decided to postpone or abandon investment projects for reasons connected to Brexit.

2 - Year-on-year growth in consumer prices

Sources: ONS, Eurostat, INSEE forecasts

3 - Household behaviour surveys



Source: European Commission (DG ECFIN)

Nevertheless, other determinants also play a role in investments and are expected to mitigate this effect; in particular, order books remain full, financing conditions are largely favourable and the production capacity utilisation rate remains high in industry.

Property prices have held up so far

The buoyancy of the British property market kept the British economy extremely vigorous from mid-2013 to mid-2016, directly via the contribution of household investment, and indirectly via the wealth effects generated by the increase in property prices (*Cornuet et al.*, 2016). In April the application of Stamp Duty (equivalent to notary's fees in France) to ownership transfers involving second homes caused a substantial increase in transactions, followed by a collapse, which has contributed to a reversal in the home investment trend over the last two months. Apart from this effect, the outlook for prices and volumes on the property market does not seem to have seen a downturn since the referendum, according to economic outlook surveys (*Graph 4*).

Property prices have slowed slightly since the referendum, according to the Nationwide index, but do not seem to be going towards a clear turning point (*Graph 5*). Through to mid-2017, prices will likely tend to stabilise, which would remove any prospect of a slump in household expenditure via "wealth effects". ■

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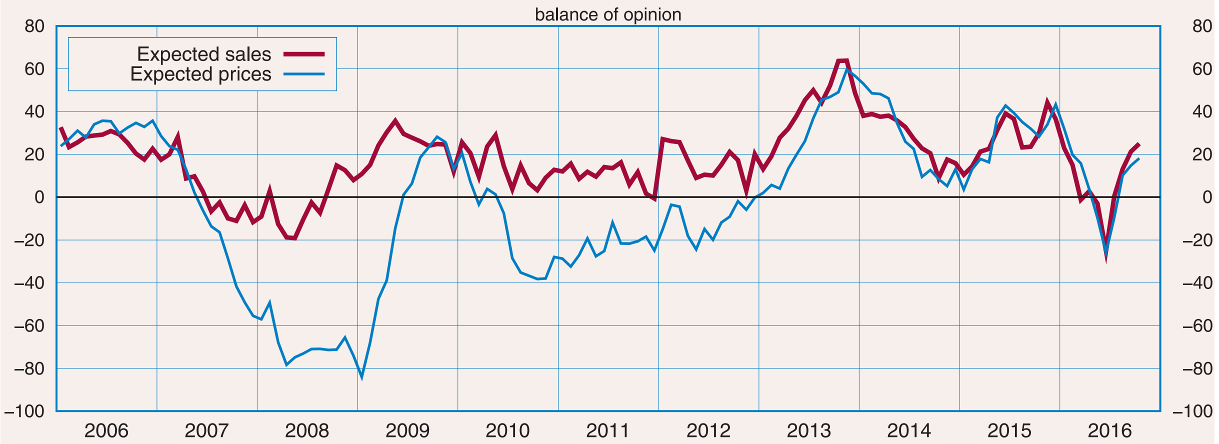
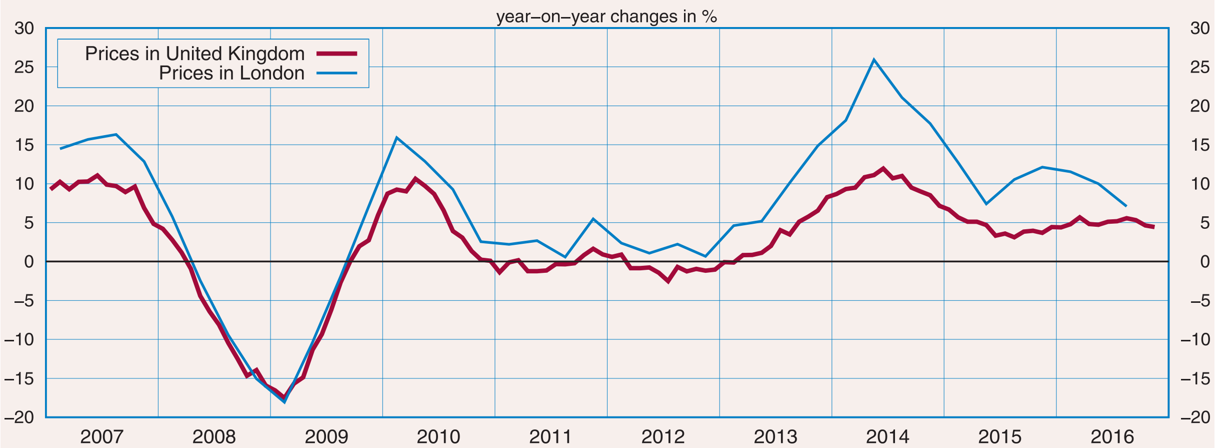
Cornuet F., **Hauseux Y.** and **Pramil J.** (2016), "Les raisons d'une croissance plus forte au Royaume-Uni qu'en France de mi-2013 à mi-2016", *INSEE Analyses* n° 27.

4 - Survey of estate agents



Source: RICS

5 - Changes in property transaction prices



Source: Nationwide

United States

Growth enjoying momentum

In Q3 2016, activity picked up (+0.8% after +0.4%) despite a slight slowdown in domestic demand: exports accelerated sharply and changes in inventories positively affected growth (+0.1 points after five consecutive quarters of destocking. In Q4 growth should remain strong (+0.6%), driven by revitalised domestic demand. Nevertheless, on average over the year, activity should slow (+1.6% after +2.6%), handicapped by the decline in corporate investment, especially in the oil sector.

Growth is expected to slacken again slightly in H1 2017 (+0.5% per quarter): with household purchasing power undermined by an upturn in inflation, household consumption is likely to slow down slightly while corporate investment should continue to increase moderately. The changes in economic policy announced after the presidential election may only have a limited impact on the economy before mid-2017.

Activity is back on track

In Q3 2016, industrial output picked up after three quarters of decline. The business climate this autumn is positive in both industry and services and the production capacity utilisation rate has been rising slightly since June. New rig counts have been increasing since the summer after slumping between late 2014 and mid-2016. Hence activity gathered momentum in Q3 (+0.8% after +0.4%), after being adversely affected since mid-2015 by a destocking cycle and the contraction of private investment, particularly in mining and oil structures (*Focus* and *Graph*). Changes in inventories are expected to be neutral through to mid-2017. Corporate investment should rise moderately again, with an expected mid-year growth overhang for 2017 of +1.4% compared to –0.6% in 2016. American growth is therefore expected to remain robust: +0.6% at end 2016 and then +0.5% per quarter in H1 2017, taking annual growth up to +1.6% in 2016 (after +2.6% in 2015) and the mid-year growth overhang to +1.8% for 2017.

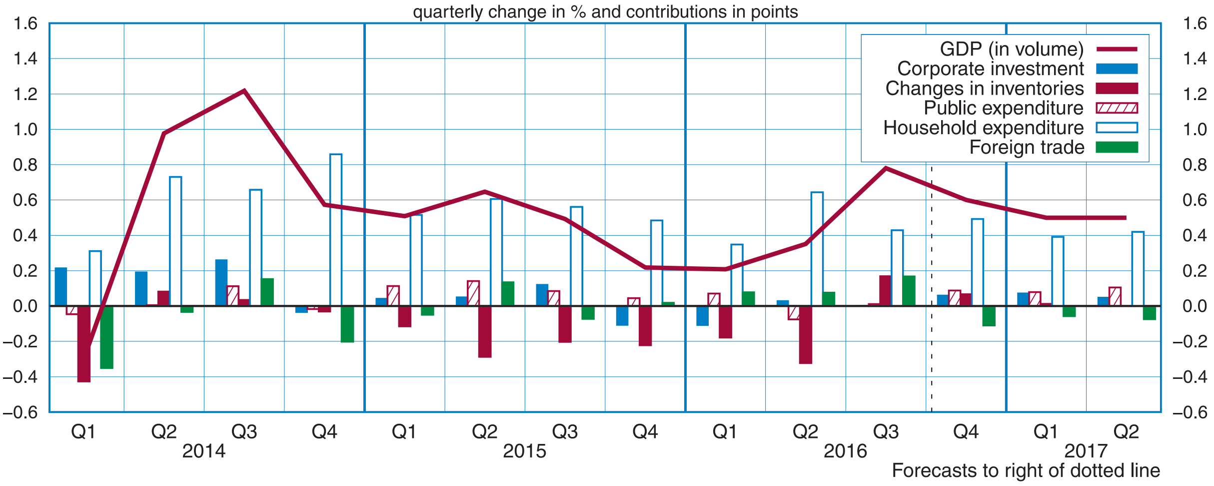
Household purchasing power should slacken slightly, along with household consumption

Due to the past decline in growth, employment is expected to slacken slightly but should remain sufficiently vigorous for the unemployment rate to stabilise below 5.0% over the forecasting period. In addition, inflation is likely to rise gradually, to +2.1% over a year to mid-2017, due to its energy component. All in all, household purchasing power is expected to slacken slightly. Household consumption should decelerate as a consequence, while remaining strong (+0.7% in Q4 and then +0.5% per quarter in early 2017).

Foreign trade should have an almost neutral effect on growth through to mid-2017

Exports picked up sharply in Q3 2016 (+2.4%, after +0.4%), driven by exceptional agricultural exports to South America in particular. They should stagnate at the end of 2016 and then grow at almost the same rate as world demand for American products between now and mid-2017 (+0.6% per quarter), despite the past appreciation of the dollar. After remaining almost stable for a year, imports picked up slightly in Q3 (+0.5%) and should steadily accelerate to reach +0.9% in Q2 2017. All in all, foreign trade should have an almost neutral effect on growth. ■

Corporate expenditure should once again encourage American growth



Sources: BEA, INSEE forecasts

The downturn in the mining industry explains a large part of the slowdown in American activity since 2015

Between 2005 and 2014, mining activity grew significantly in the United States

In terms of value added, mining in the United States accounts for approximately 2.0% of gross domestic product (GDP). A little more than half of the production is oil and gas, about 20% is other mineral ores, a quarter is support services for these extraction activities, the rest consisting of chemicals, plastics and other petroleum derivatives.

From 2005 to 2014, in spite of a few jolts mining grew strongly in the United States, with the deployment of the innovative techniques for extracting oil and gas known as fracking. These techniques are used to exploit at a reduced cost deposits that lie underneath hard rock, which were previously difficult to access. The quantities of crude oil and natural gas extracted have therefore surged in ten years (*Graph 1*), following a leap in the horizontal rig count, i.e. mainly the sites where fracking techniques are used (*Graph 2*)[1].

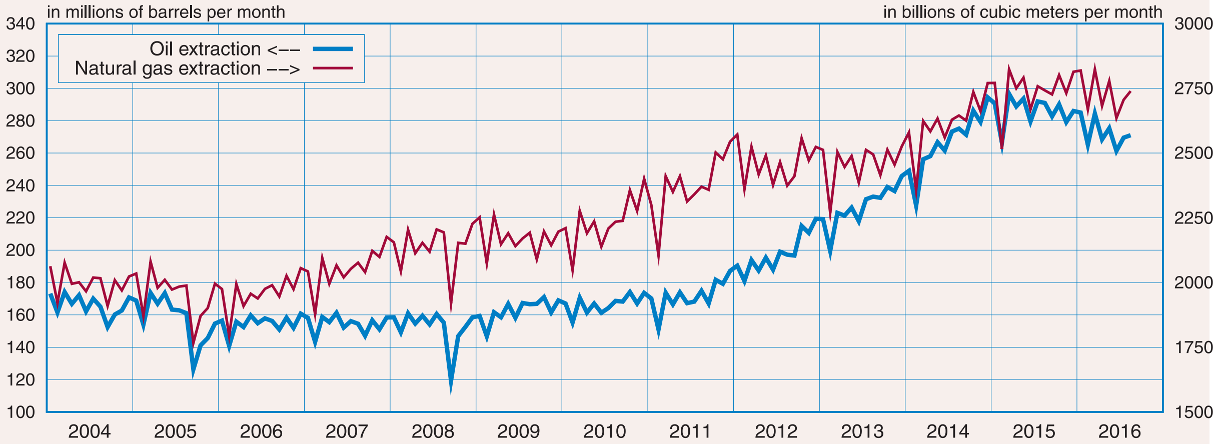
As a result, since 2005 the value added of the mining industry has increased by 56% in volume terms, that is, more than three times faster than economic activity overall: it increased sharply until 2014, before slipping back in 2015. In addition, the United States' trade deficit in mining products fell considerably, from 1.7% of GDP in 2005 to 0.7% in 2015; only 5% of this fall is a result of the decline in oil prices over this period.

Mining activity contributed strongly to American growth between 2005 and 2014

Between 2005 and 2014, on average mining contributed +0.2 points to GDP growth each year, mainly via the direct effect of the increase in the value added of the industry (*Graph 3*). Since 2011 the spread of technical innovations has led to an acceleration in investments in the mining industry.

1. cf. focus « A sharp downturn in American oil production expected by the end of 2016 », Conjoncture in France, june 2016.

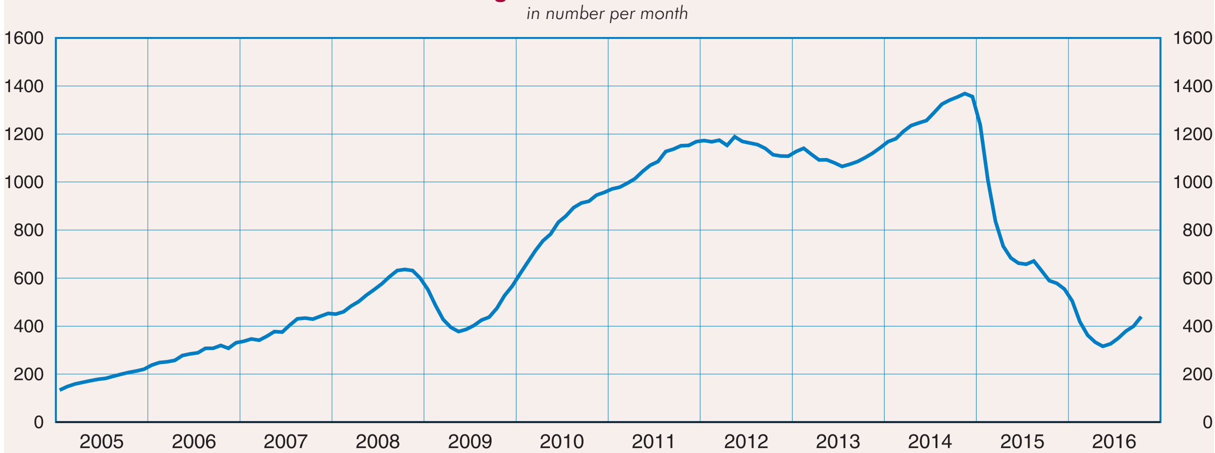
1 - Oil and gas outputs in the United States



Source: AIE

2 - Horizontal rigs commissioned in the United States

in number per month



Source: Backer-Hugs

Thus between 2011 and 2014, the mining industry's contribution to GDP growth rose to reach an average of +0.4 points each year.

Since 2015, mining has caused a loss of 0.7 points of cumulative growth

From mid-2014 to the beginning of 2016, oil prices fell by almost 70%; the price of a barrel of Brent crude fell on average from $109.7 to $33.7, although it has recovered a little to stabilise at around $50.

Against this backdrop, numerous rigs commissioned in the previous years found themselves producing at a higher cost than the price of the hydrocarbons extracted. Mining activity has therefore decreased sharply, falling by 12.3% in 2015 and 5.3% in 2016 (carry-over effect at mid-year). Likewise, mining industry investment has collapsed, plummeting by 27.8% in 2015 and 35.8% in 2016 (carry-over effect at mid-year).

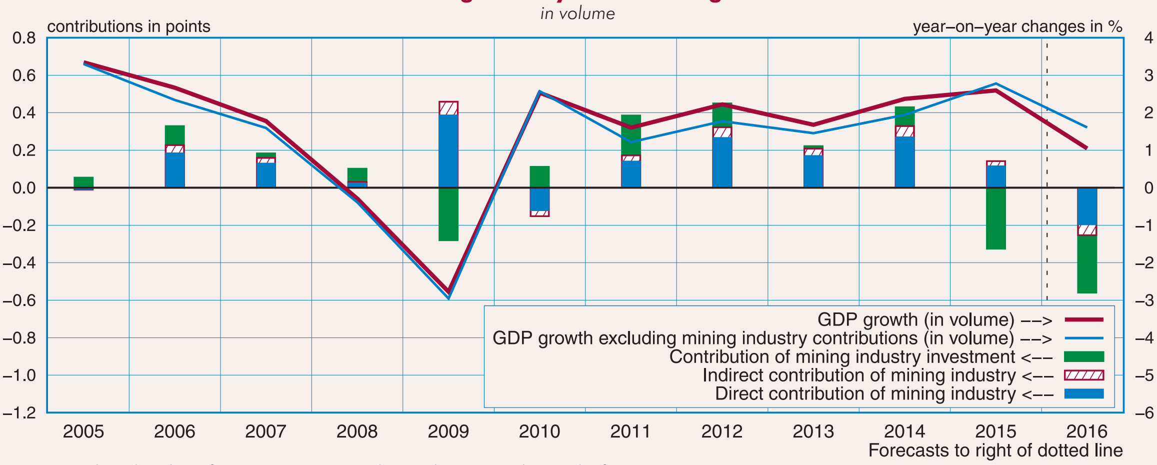
However, the fall in mining sector investments is expected to ease in H2 2016: with the stabilisation of oil prices, the new rig count is actually increasing again slightly. This is expected to limit the extent of the decline in mining activity over the next few quarters.

All in all, the mining industry caused a loss of 0.2 GDP points in 2015 out of a total growth rate of 2.6% and is expected to have taken its toll in 2016: assuming that it does not weigh any more heavily in H2, it is likely to have led to the loss of 0.6 points of growth in 2016 (+1.6%). It is therefore an important factor of the slowdown seen in the American economy in 2016.

Cumulatively over the different periods, mining activity is thought to have contributed 2.3 points of growth between 2005 and 2014 and then removed 0.7 points of growth since 2015. ■

3 - Contribution of the mining industry to economic growth in the United States

in volume



How to read it: the data for 2016 are growth overhangs at the end of Q2.
NB: for investment, the last point observed was in 2014, and the data presented after that date are the result of INSEE estimates.
Sources: Bureau of Economic Analysis, INSEE calculations

The method

Variations in mining activity have a knock-on effect on economic growth via the industry's value added, its intermediate consumption and its investments

Variations in the value added of the mining industry first of all have a direct effect on GDP, defined as the sum of values added of all branches of the economy.

In addition, in order to produce, the mining industry uses intermediate consumptions purchased from other branches, which in turn use other intermediate consumptions. This indirect effect is measured based on intermediate input tables (IITs) produced by the Bureau of Economic Analysis, which list the intermediate consumption content of each major branch of activity: they allow the calculation, for one dollar produced by the mining industry, of the volume of intermediate consumption mobilised at each production stage, and therefore the indirect contribution of that branch to GDP growth. The calculation consists of normalising the IIT so that, for each branch, the volume of intermediate consumption necessary is expressed as a percentage of total production, then of considering it as a square matrix and inverting it. In practice, for the United States this type of inverse IIT is provided directly by the Bureau of Economic Analysis. The calculations for this Focus were made using the IITs for 2013.

Finally, mining industry investment in various assets has a direct effect on GDP, which in the "expenditure approach" is the sum of the final uses of products. The sum of these three contributions serves to identify the way in which fluctuations in mining activity have contributed to economic growth in the United States. ■

Japan

Inflation remains low as the yen appreciates

Japanese activity slowed in the summer (+0.3% after +0.5%). Moderate rises are forecast: +0.2% to +0.3% per quarter until mid-2017. It should be driven by the upturn in household consumption (+0.4% per quarter) in the wake of household purchasing power which should be boosted by a favourable labour market. Government investment should be galvanised by a new fiscal stimulus plan. However, the appreciation of the yen is likely to put an end to export expansion. In addition, it has led to a general drop in prices: inflation was negative for six months before lifting slightly above positive in October 2016.

The appreciation of the yen has caused prices to fall and is likely to slow down exports

In November, the yen had appreciated by 11% since the start of 2016, bringing down the prices of imported products. In October, prices had risen by 0.2% year on year after six consecutive months of decline due to the drop in the prices of manufactured products (*Graph*). Consequently, inflation remains low. In addition, the continuous rise of the yen against the dollar is adversely affecting exports as it has made Japanese products less competitive: after rebounding in the summer, they are set to stagnate in late 2016 and early 2017 before recovering slightly in Q2 2017.

Consumption should pick up slightly thanks to purchasing power gains

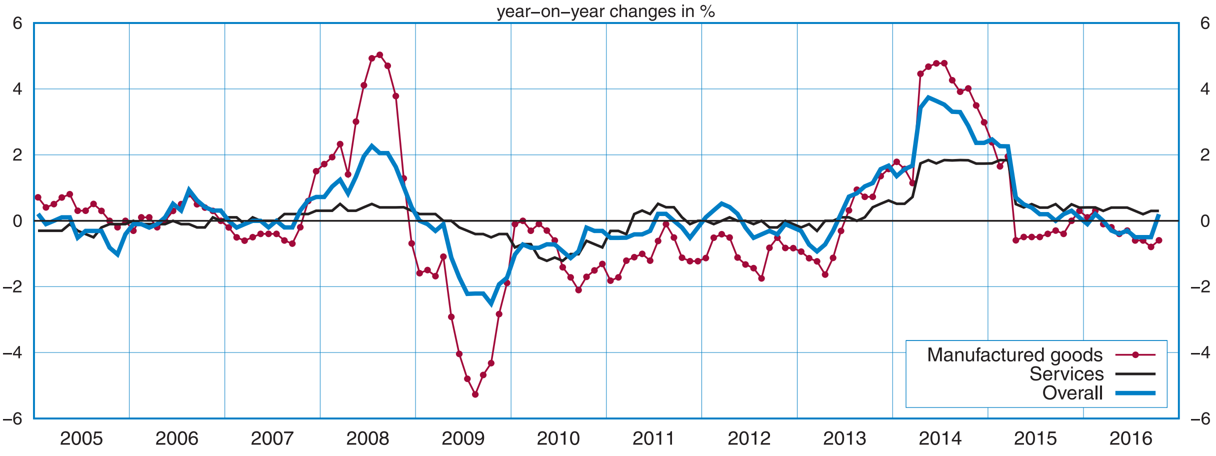
Private consumption has recovered moderately since the start of the year (+0.3% in Q3 after +0.2%). A slight acceleration is expected to follow over the forecasting period (+0.4% per quarter until mid-2017). Indeed, Japanese households have benefited from an upturn in their purchasing power for the past year, much of which has been saved, and low inflation has fostered new purchasing power gains. In addition, payroll should increase further, driven by vigorous employment and a slight rise in basic wages. However, household investment is likely to continue to decline, as reflected by the previous drop in new housing starts.

Government investment is set to increase strongly

The Abe government has announced a 28,100-billion-yen stimulus plan including 7,500 billion (1.5% of GDP) in new spending. This is likely to boost government investment, which should see a revival in its momentum (forecast of +1.0% to +1.5% per quarter).

All in all, activity should slacken slightly in late 2016 (+0.2% after +0.3%) due to exports, and gross domestic product should grow by 1.0% over the year as a whole (after +1.2% in 2015). In early 2017 activity is expected to grow moderately (+0.2% then +0.3%), so that the growth overhang should rise to +0.9% by mid-year. ■

In October, inflation picks up but remains low



Source: Macrobond, Japanese Statistics Bureau

Emerging economies

The short-term outlook is slowly improving

In the emerging economies, the short-term outlook has been improving since the summer of 2016, peaking at its highest level for two years in the autumn while remaining well below its average over the last fifteen years. Overall, growth in these countries is expected to rise gradually between now and mid-2017 and their imports should pick up.

In China, activity slowed slightly in Q3 2016, with exports slumping in particular. Growth is likely to start rising from Q4, with domestic demand boosted by substantial government support. On average over the year, the Chinese economy is expected to grow by +6.6% in 2016, once again lower than the previous year (+6.8%). In early 2017 China's foreign trade is expected to return to a pace more in line with its activity.

In Brazil the recession should ease. Consumption is still falling but less sharply than previously. However, exports edged down once again in the summer. In 2016 the downturn in activity is expected to be similar in scale to that of 2015 (–3.6% after –3.8%), but it should ease significantly in early 2017. The Russian recession should be much less severe than in 2016 (–0.5% after –3.7%) and a tentative return to growth is expected for activity in early 2017, boosted by the recovery of foreign trade. In Turkey, political tensions have continued to damage the business climate and are prompting investors to adopt a wait-and-see attitude. However, these tensions should ease and the Turkish economy is expected to return to more sustained growth in early 2017. Lastly, growth should remain dynamic in Eastern European countries and India.

In China domestic demand remains buoyant

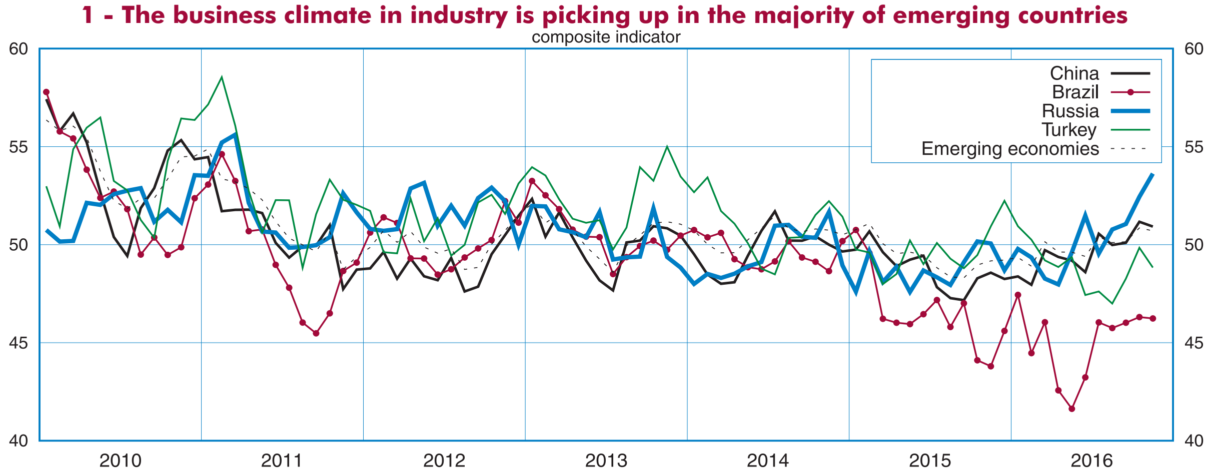
In China, activity slowed slightly in Q3 2016 (+1.5% after +1.7%). Most importantly, Chinese exports plummeted (–1.9% after +1.3%), especially those of assembled products made from components imported for processing, with the result that imports also slowed down sharply (–0.1% after +2.3%), which limited the negative contribution of foreign trade to growth.

Domestic demand is likely to remain buoyant: the business climate is picking up in the manufacturing sector (*Graph.1*), car registrations are accelerating sharply and investment in construction is picking up strongly. However, corporate investment in equipment should continue to slow despite a favourable monetary policy, largely due to the fact that many sectors are suffering from unutilised production capacity. All in all, the Chinese economy is expected to return to a growth rate of +1.7% per quarter through to mid-2017. As an annual average, growth is expected to weaken slightly again in 2016 (+6.6% after +6.8%) and the mid-year growth overhang for 2017 should stand at +5.1%. Both exports and imports are expected to increase again at a pace more in line with activity in early 2017, and their mid-year growth overhang should be positive.

In Brazil, the recession should ease

In Brazil industrial output and exports shrank again in Q3 2016, after bouncing back in Q2. However, the decline in household consumption

1 - The business climate in industry is picking up in the majority of emerging countries



Source: Markit

is easing, as inflation has fallen sharply since the start of 2016 (*Graph 2*) and household purchasing power has stopped declining. As a result, and in line with domestic demand, activity should continue to fall but at an increasingly diminishing rate. In 2016 gross domestic product (GDP) is expected to decrease by 3.6% (after –3.8% in 2015), and the growth overhang at the end of H1 2017 should be –1.4%.

Russia should see the return of tentative growth driven by foreign trade

Russian activity stabilised in the summer of 2016 and is likely to stagnate again in Q4. Retail trade in particular has been picking up slowly since the spring because lower inflation has eased the pressure on household purchasing power, and the upturn in commodity prices has been breathing new life into the Russian economy since the start of the year. On average over the year, the recession is expected to be much less severe in 2016 (–0.5% after –3.7%).

Driven by the slow recovery of external trade, GDP should return to tentative growth in H1 2017.

Central and Eastern European countries and Turkey: temporary weakening of otherwise sustained growth

After faltering in Q2, Turkish growth should remain weak in Q3, hit by political uncertainty. Industrial output fell again in Q3. However, in line with a business climate that has picked up slightly, growth should then regain its previous momentum. Over 2016 as a whole, activity is expected to slow significantly (+2.6% after +4.0% in 2015).

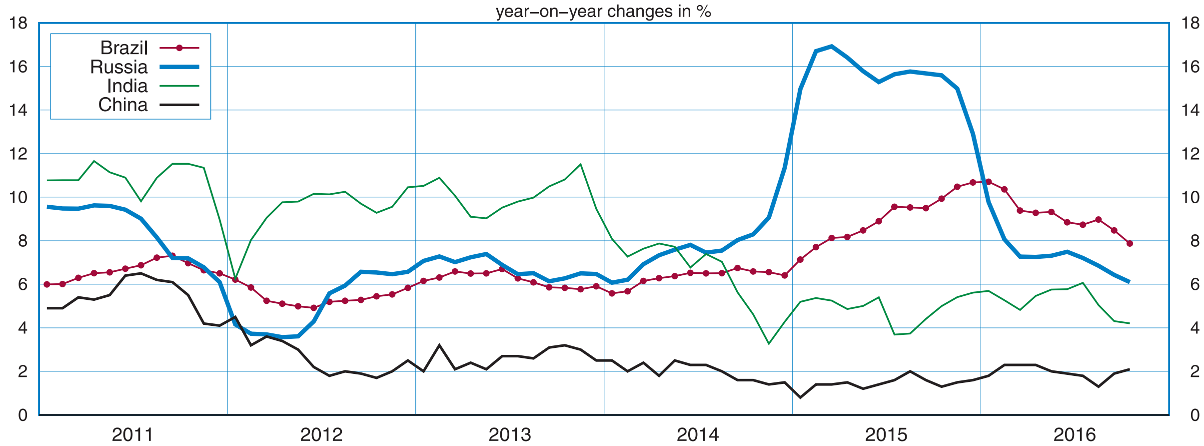
In Eastern Europe economic activity is likely to remain buoyant, boosted by demand from the Eurozone. However, it slackened slightly in the summer due to a downturn in industrial output. In reaction to this, activity is expected to accelerate in Q4 and growth should remain robust in early 2017. All in all, activity in 2016 should grow by 3.1%, i.e. not quite as quickly as in 2015 (+3.7%).

India should suffer briefly from the "banknote crisis"

India continues to enjoy sustained growth: +7.3% year on year in Q3. The unexpected withdrawal of 500- and 1,000-rupee banknotes from circulation, as part of the government's measures to combat money laundering from the black economy, led to major industrial action in an economy in which the vast majority of transactions are still carried out in cash. Consequently, the business climate deteriorated significantly in November, especially in the service sector. However, domestic demand should be buoyed by strong government consumption, the drop in food prices and the promised wage rise for civil servants. Therefore, the "banknote crisis" should only lead to a temporary slowdown in activity. ■

2 - Inflation has eased in Brazil, Russia and India

year–on–year changes in %



Sources: national statistical institutes