Germany

Is the German economy overheating?

In Germany, activity accelerated sharply in Q3 2017 (+0.8% after +0.6%), buoyed by foreign trade and inventory (+0.4 points for each), whereas domestic demand stalled. GDP is expected to slow somewhat but should remain very vigorous for the forecasting period (+0.7% in Q4, then +0.6% in Q1 2018 and +0.5% in Q2), driven once again by domestic demand but held back by growing production capacity tensions. Annual GDP should increase by 2.6% in 2017, after +1.9% in 2016.

Corporate equipment investment should remain very buoyant

For the last three quarters, corporate equipment investment has been particularly buoyant (+7.2% in 9 months). At the end of 2017, the business climate is still progressing and has reached its highest level since reunification, particularly in industry. In this sector, the production capacity utilisation rate is at its highest level since 2008 and equipment investment is expected to remain very vigorous through to mid-2018 (+1.2% to +2.0% per quarter), all the more so since the self-financing ratio is still well above 100%.

However, construction expenditure should progressively reflect the stabilisation of the number of building permits since the start of the year and it is expected to lose momentum between now and mid-2018.

Employment and wages should bolster consumption again

Private consumption stagnated in Q3 after rising very sharply for two quarters (–0.1% after +0.9% and +0.8%).

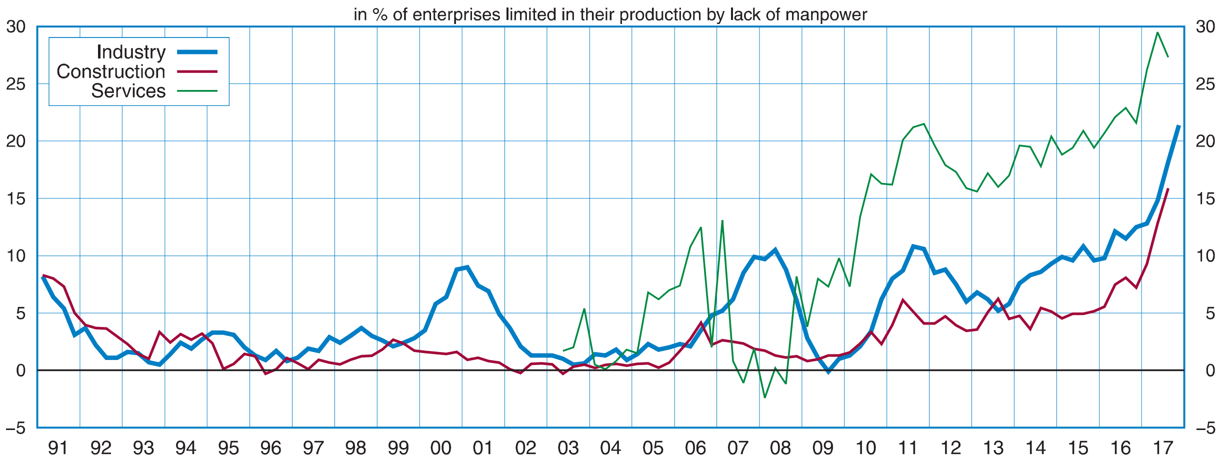
Through to mid-2018, despite unemployment rate being at its lowest level since reunification (3.4%), employment should rise strongly, with the gradual integration of refugees into the labour force (*Focus*). Recruitment difficulties have never been greater in all sectors (*Graph*) and wages are likely to gather pace. For all that, inflation has risen slightly but remains contained (1.8% year-on-year in November) thanks to productivity gains and the tightening of corporate margins. Consequently, through to mid-2018, purchasing power is expected to be lively and household expenditure should be vigorous (+0.6% per quarter).

Imports should benefit from the rise in domestic demand

Activity was strongly bolstered by foreign trade in Q3 2017 (+0.4 points). Exports are expected to remain very steady through to mid-2018 (+1.1% per quarter), in line with demand for German products, and should barely be affected by the recent appreciation of the euro. However, imports are likely to gather pace in response to domestic demand (+1.4% per quarter), with the result that the contribution of foreign trade is expected to be slightly negative.

All in all, activity is set to remain very buoyant (+0.7% in Q4 2017 after +0.8%, and then +0.6% in Q1 2018 and +0.5% in Q2) and growth is expected to rise to +2.6% in 2017 after +1.9% in 2016. The growth overhang for 2018 should already stand at +2.0% by mid-year.■

Recruitment difficulties have never been greater in all sectors of activity



Source: European Commission

Italy

A growth rate not seen since 2010

In Q3 2017, Italian activity picked up (+0.4% after +0.3% in Q2), thanks to investment. Growth should remain solid through to mid-2018, at +0.4% per quarter, driven by household consumption. As an annual average, GDP is expected to rise by 1.5% in 2017, a growth rate not seen since 2010.

Household consumption is set to remain solid, driven by the rise in employment

Household consumption picked up slightly in Q3 (+0.3% after +0.2%) and should remain lively at the end of 2017 (+0.5%), driven by still-high consumer confidence (*Graph*). In H1 2018, employment is likely to maintain its momentum (+0.4% per quarter). After stabilising at around 11.2% in Q3, the unemployment rate is expected to drop to 10.5% in mid-2018. It remains high, however, limiting employees' bargaining power: real wages should barely rise through to mid-2018. In a context of inflation stabilising at around 1%, purchasing power is likely to rise by 0.3% to 0.4% per quarter, driven solely by employment, with fiscal policy becoming neutral after fostering purchasing power in 2017. Households are expected to reduce their precautionary savings a little more, and consumption should remain solid in H1 2018 (+0.4% per quarter).

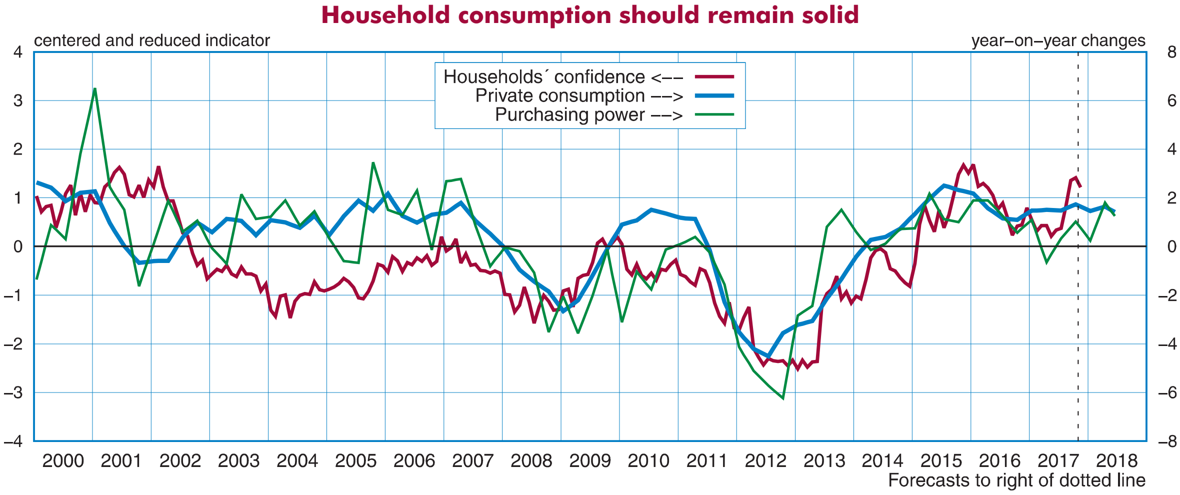
Construction investment is set to recover

After stumbling in Q2 2017 (–0.3%), construction investment bounced back in Q3 (+0.3%). It is likely to gather pace through to mid-2018 (+0.5% per quarter), as the business climate is at a high level.
Equipment investment was exceptionally vigorous over the summer of 2017 (+8.2%). In reaction, it is expected to slip back at the end of 2017 (–2.0%) before increasing steadily in early 2018 (+1.2% per quarter). The conditions are indeed very favourable: industrialists' investment intentions are at their highest level in ten years, and the corporate self-financing ratio, at well above 100%, is at a twenty-year high. In this way, the mid-year growth overhang for equipment investment in 2018 is expected to reach +5.4%.

Foreign trade should make a neutral contribution to activity

Through to mid-2018, exports are likely to benefit from the buoyancy of world demand but could be slightly held back by the recent appreciation of the euro. They should rise at a rate of approximately +0.8% per quarter and their growth overhang for 2018 is expected to be +2.8% by mid-year, after +5.1% in 2017. Imports should rise at a similar rate, boosted by domestic demand. Consequently, the contribution of foreign trade is likely to be neutral, but the trade surplus is expected to decline slightly due to the rise in oil prices; nevertheless, it is set to remain high, at around 2.6% of GDP. ■

Household consumption should remain solid



Sources: Istat, DG Ecfin, INSEE forecast

Spain

Growth should resist the Catalonian crisis

In Spain, activity remained vigorous in Q3 2017, although slightly down on the previous quarter (+0.8% after +0.9%). Activity should remain solid until June 2018, driven by the buoyancy of domestic demand. The contribution of foreign trade should weaken somewhat due to the appreciation of the euro. All in all, the mid-year growth overhang for 2018 is expected to stand at +2.5% after +3.1% in 2017.

The business climate remains positive despite the Catalonian political crisis

In November the business climate remained positive, in both services and the manufacturing industry, and even continued to pick up in construction (Graph). Growth should therefore remain high in Q4 (+0.8%) despite the political crisis in Catalonia. As an annual average, activity should slow only very slightly (+3.1% in 2017, after +3.3%). In H1 2018, activity is set to remain robust (+0.8% in Q1 and then +0.7%) and the growth overhang should climb to +2.5% by mid-2018.

Consumption is not expected to gather pace despite a drop in inflation

Household consumption continued to rise sharply in Q3 2017 (+0.7%). Consumer confidence indices suggest that it will remain virtually stable in Q4. However, inflation, which rose sharply in Spain in early 2017, has undermined purchasing power: since the start of the year, only the drop in the savings ratio has enabled households to maintain their consumption rate. Through to mid-2108, inflation should edge down slightly to +1.6% against +2.1% one year earlier, but households are likely to use this as an opportunity to partially rebuild their savings, and their expenditure is not expected to pick up.

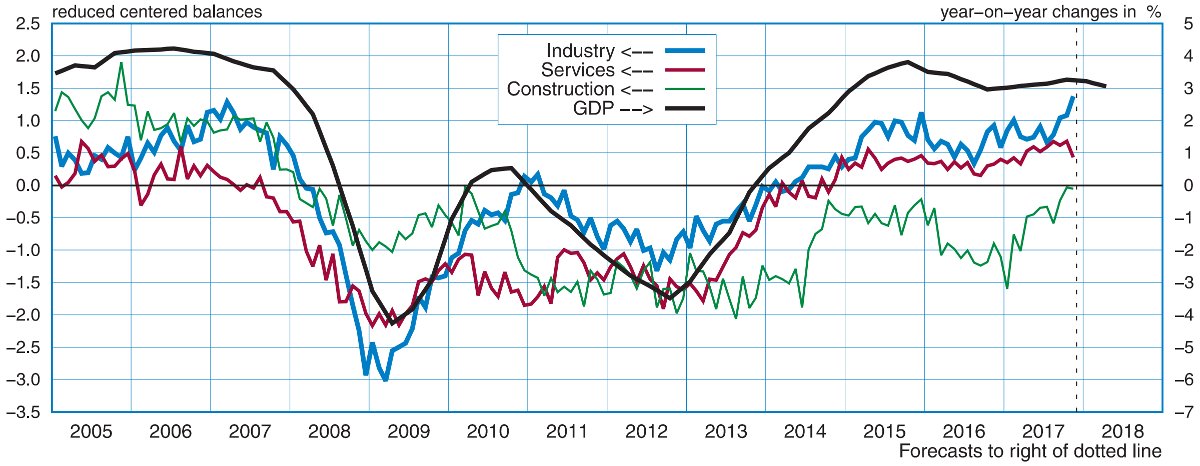
Investment is set to remain very vigorous

Investment in capital equipment bounced back in Q3 2017 (+2.5%) after declining in Q2 (–0.1%). With the investment rate nearing its 2008 level, the catch-up effect is expected to run out of steam, all the more so since the rise in corporate taxes announced in late 2016 (approximately +4 billion euros for 2017) is likely to affect their savings. In this way, investment should slow slightly in late 2017 and early 2018, while remaining very vigorous (+1.0% in each quarter). In construction, non-residential investment should remain brisk, reflecting the previous rise in building permits.

The contribution of foreign trade to growth should decline slightly

Thanks to the ramp-up of world demand and gains in market shares, foreign trade should continue to foster growth but to a lesser extent than in 2017 due to the appreciation of the euro. The contribution of foreign trade to the growth overhang for 2018 is expected to be +0.3 points, after +0.5 points throughout 2017 as a whole, and +0.7 points in 2016. ■

The business climate remains favourable despite the political crisis in Catalonia



Sources: MINETUR, SIMPLE LOGICA, INE, INSEE forecast

United Kingdom

Temporary acceleration in a wait-and-see climate

In the United Kingdom activity picked up slightly, to +0.4% in Q3 2017, after +0.3% in both Q1 and Q2. Household consumption received a temporary boost (+0.6% after +0.2%) from a rise in new vehicle registrations. Activity should continue to grow by 0.4% at the end of 2017, before slowing to +0.3% per quarter in H1 2018. Indeed, the past drop in purchasing power should continue to hold back household consumption, with households slowly building up their savings. On an annual average basis, growth is nonetheless expected to come to +1.5% in 2017, after +1.8% in 2016, and the mid-year growth overhang for 2018 is likely to be +1.1%.

Temporary rebound in consumption amid the slowdown

In Q3 2017, British activity would appear to have accelerated slightly (+0.4% after +0.3%), buoyed by private consumption (+0.6% after +0.2%). Indeed, new vehicle registrations bounced back (+4.2%) during the summer. They had plummeted by 12.4% in Q2 after an increase in the tax on new vehicles. Consumption is expected to slow again from Q4 2017. Purchasing power is likely to rise, however, bolstered by the buoyancy of employment and the gradual slowdown in prices. However, households are likely to gradually build up their savings ratio, which should reach 5.4% in mid-2018 after falling to 3.8% in early 2017 (*Graph*).

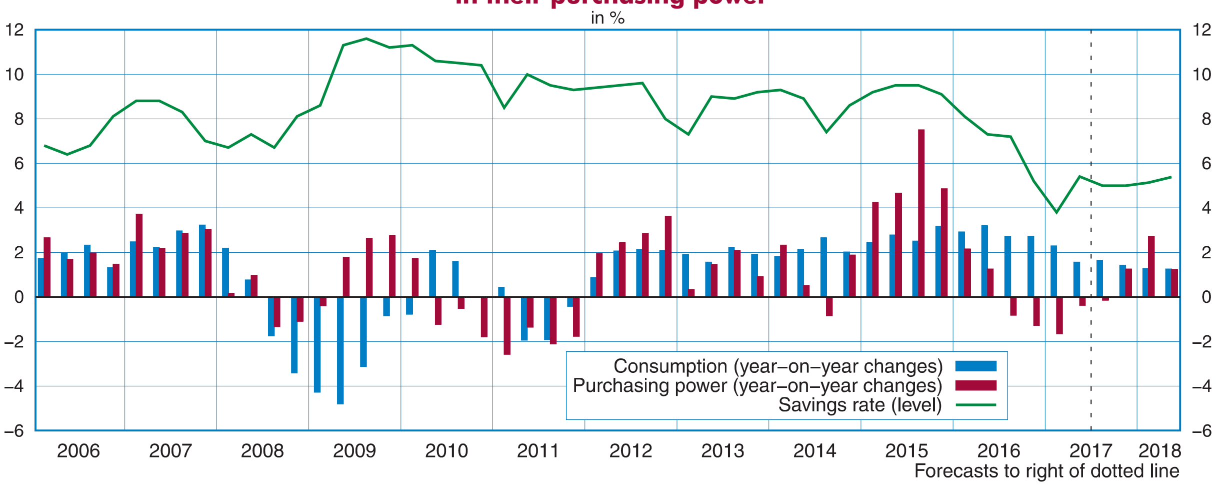
The wait-and-see attitude to Brexit should slow down private investment

For companies, meanwhile, investment slowed during the summer (+0.2% after +0.5%), but should remain resilient in late 2017 (+0.7%), as suggested by the improvement in order books and investment intentions, according to surveys conducted by the Bank of England. However, the uncertainties associated with the UK's exit from the European Union are expected to weigh down on corporate investment in H1 2018 (+0.5% per quarter). Meanwhile, household investment picked up slightly in the summer (+0.4% after –2.9%) but it is likely to slip back in this climate of uncertainty (–0.5% per quarter).

Foreign trade is out of step with the rest of the EU

Lastly, exports declined in Q3 (–0.7% after +1.7%), and imports gathered pace (+1.1% after +0.2%), cutting GDP growth by 0.5 points. In reaction, exports are likely to bounce back in late 2017 and imports should stabilise. In early 2018, exports should continue to rise strongly (+0.8% per quarter) in line with world demand, and imports should increase at a more moderate level (+0.6% per quarter). The contribution of foreign trade should therefore be slightly positive, reflecting the divergence with the rest of the European Union. On an annual average basis, British growth is likely to reach +1.5% in 2017 after +1.8% in 2016. In 2018, the mid-year growth overhang is expected to be only +1.1%. ■

Households are progressively adjusting their consumption to the past drop in their purchasing power



Source: ONS

United States

Purchasing power gets back on track

In Q3, activity remained very vigorous in the United States (+0.8%, as in Q2). Corporate consumption and investment remained solid. However, government expenditure stagnated once again and residential investment slipped back further.
Through to mid-2018, growth should remain strong (+0.8% and then +0.6% per quarter), driven by consumption, corporate investment and an upswing in government expenditure.
As an annual average, activity should accelerate in 2017, to +2.3% after +1.5% in 2016. The growth overhang for 2018 should climb to +2.2% by mid-year

Real wages and tax cuts should bolster consumption

In the United States, consumption slowed only very slightly in Q3, to +0.6% after +0.8%, despite the hurricanes in September. Employment is set to remain buoyant (+0.4% per quarter) and unemployment should stabilise at the level recorded in October (4.1%), the lowest since 2000. After two years of near-stagnation, real wages should gather a little momentum in 2018. Lastly, the tax reform adopted in December should lead to household tax cuts of around $35 billion (0.4 GDP points) in H1 2018. All in all, purchasing power is expected to gather pace in 2018: its mid-year growth overhang should stand at +1.8% after +1.2% in 2017. In its wake, household consumption should remain solid, at +0.7% in Q4 and then +0.5% but it is not expected to pick up further, with households gradually building up their savings (*Graph*).

After remaining slack during the summer, government expenditure is set to pick up through to mid-2018, all the more so since the federal government has released funds to assist the states hit hard by the hurricanes.

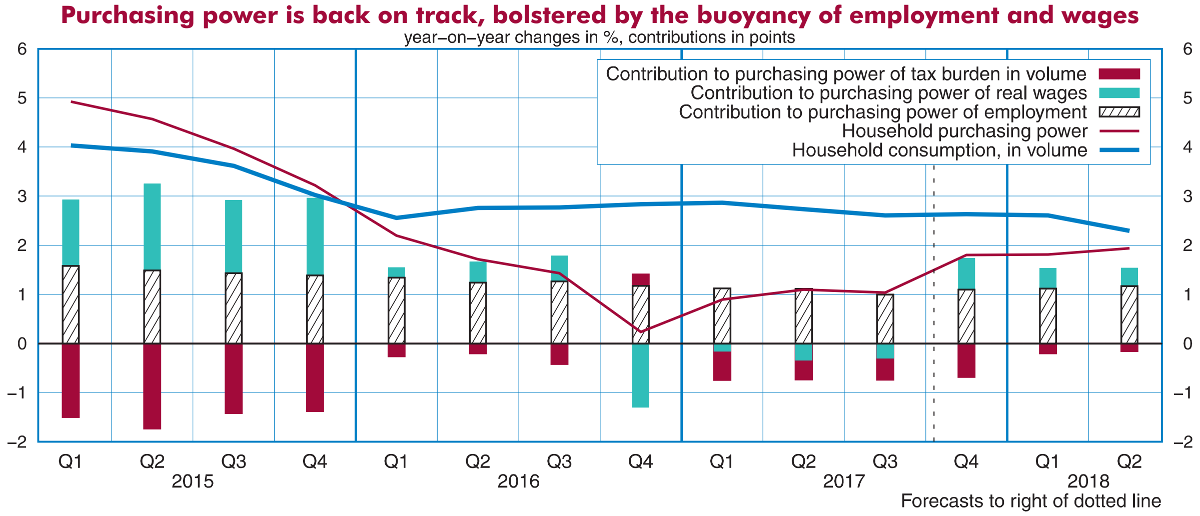
Corporate investment drives growth

Corporate investment remained solid in Q3 (+1.2% after +1.6%). The business climate remains very favourable, particularly in industry. Corporate expenditure should accelerate gradually through to mid-2018 (+1.1% at the end of 2017, then +1.2% and +1.3%), bolstered by the margin rate stabilising at a high level. In addition, the tax reform provides for a reduction in corporation tax combined with a temporary additional depreciation allowance measure equivalent to 0.2 GDP points. On an annual average basis, corporate investment is expected to bounce back in 2017 (+4.6% after –0.6%), and its growth overhang for 2018 should stand at +4.0% by mid-year.

Foreign trade should no longer hamper activity

Exports are set to remain vigorous, in line with world demand for American products. On average over the year, they are expected to gather pace sharply in 2017, to +3.2% after -0.3% in 2016. With a growth overhang for 2018 that should climb to +3.2% by mid-year, exports should gather pace throughout 2018 as a whole, as they will no longer by held back by the past appreciation of the dollar. As American imports should follow a similar pattern due to the momentum generated by domestic demand, foreign trade should no longer hold back American growth through to June 2018. ■

Purchasing power is back on track, bolstered by the buoyancy of employment and wages



Source: U.S. Bureau of Economic Analysis

Japan

Consumption taking off again

In Q3 2017, Japanese activity remained vigorous (+0.6%) after a sharp acceleration in Q2 (+0.7%). It was driven by foreign trade (contributing +0.5 points) whereas domestic demand remained at a standstill (+0.1% after +1.0%) along with household and government expenditure. In reaction, activity is expected to slow at the end of 2017 (+0.2%), before increasing moderately in early 2018 (+0.3% each quarter): foreign trade is likely to no longer sustain activity but domestic demand, and consumption in particular, should hold firm.

Activity is set to slow slightly

In Q3, activity remained vigorous after gathering pace in the spring (+0.6% after +0.7%). The business climate remains favourable in both industry and services. In reaction, activity is expected to slow at the end of the year (+0.2%) and should remain lively in H1 2018 (+0.3% per quarter). Over 2017 as a whole, it is expected to accelerate sharply, to +1.8% after +0.9%, driven by a rebound in domestic demand and exports (Graph). Its growth overhang for 2018 should stand at +1.2% by mid-year.

Domestic demand should be back on the rise

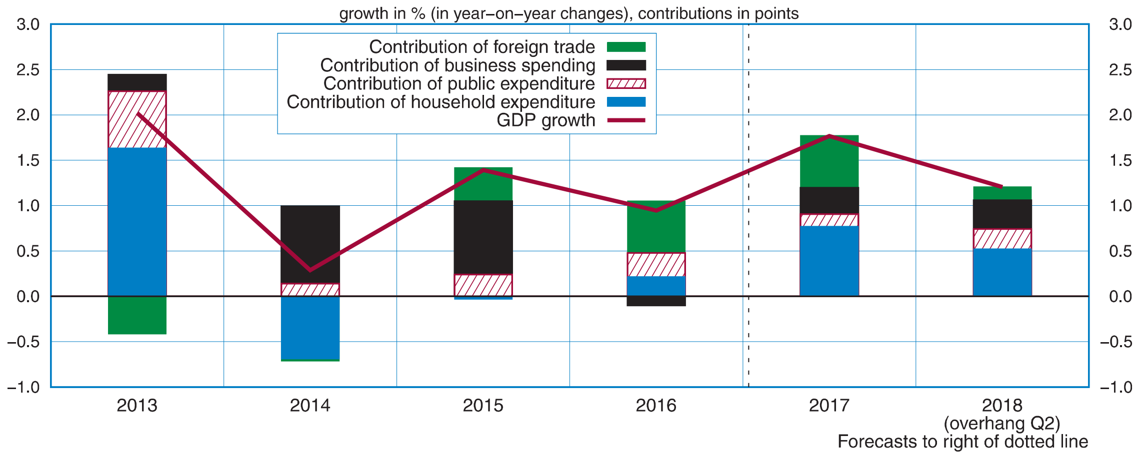
Employment should continue to rise (+0.1% at the end of the year and then +0.2% per quarter through to mid-2018) despite unemployment being at its lowest level since 1990, thanks to the rise in the labour force participation rate. With wages having picked up a little momentum in a context of near-zero inflation, household consumption is expected to rise steadily through to mid-2018 (+0.6% in Q4 after –0.5%, and then +0.4% per quarter). Over 2017 as a whole, it is expected to pick up quite substantially (+1.2% after +0.1%). Corporate investment is likely to be solid (+0.5% to +0.6% per quarter through to mid-2018), bolstered by an all-time high profit rate (12.0% of GDP). Lastly, government investment, after a sharp rise in the spring of 2017 under the impetus of the fiscal stimulus plan announced in late 2016, is expected to remain at a high level, despite dropping off in Q3. All in all, domestic demand should remain vigorous and continue to sustain Japanese activity.

Foreign trade is expected to stop bolstering activity at the start of 2018

Exports bounced back in Q3 (+1.5% after –0.1%) with the upswing in Chinese imports. They should then rise moderately (+0.9% at the end of 2017, followed by +0.8% per quarter through to mid-2018). As an annual average, they should accelerate markedly in 2017 (+6.0% after +1.3%), but their mid-year growth overhang for 2018 (+2.8%) could point towards a slowdown, in line with slackening Chinese imports.

Imports declined in Q3 (–1.6% after +1.5%) with the slowdown in domestic demand. They are expected to recover at the end of the year (+1.0%), and should then remain vigorous (+1.0% per quarter). On an annual average basis, imports are likely to be in a much healthier position in 2017 (+2.6% after –1.9%), and their growth overhang for 2018 should stand at +2.1% by mid-year. After two years of very positive contributions, foreign trade should almost entirely cease to sustain activity. ■

Domestic demand should take over from foreign trade in sustaining growth



Source: Cabinet Office of Japan

Emerging economies

China slows down but the other BRIC countries bounce back

In China, activity grew by 1.7% in Q3, at a constant pace since the start of the year. Imports are in much better shape after stalling in the spring, contributing to the upswing in world trade. Exports are at a standstill after accelerating strongly in Q2. Chinese activity is expected to slow down a little at the end of the year to +1.5%, in the wake of domestic demand, and should then grow by 1.6% per quarter through to mid-2018. On an annual average basis, growth is likely to be +6.8% in 2017, as in 2016, and the growth overhang for 2018 should stand at +5.3% by June.

In Brazil, Russia and India, the sharp drop in inflation brought about by the appreciation of the local currencies is facilitating the recovery of domestic demand, and consumption in particular. Nevertheless, the return of growth remains more tentative in Brazil than in Russia and, above all, in India. In Turkey, the business climate has picked up significantly after suffering from the consequences of the failed coup in mid-2016, and activity is likely to remain vigorous through to mid-2018. Lastly, the Eastern European countries are expected to maintain their buoyancy, driven by demand from the Eurozone.

China: domestic demand has been slowing since the spring

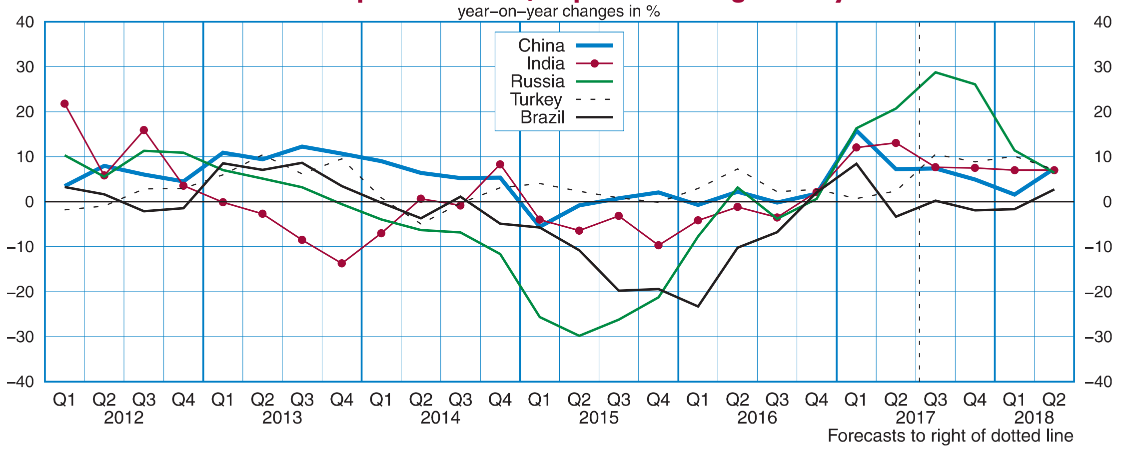
In China, activity was reported to have grown by 1.7% in Q3, as it has been since the start of 2017. It should slow down slightly to +1.5% between now and the end of the year, in the wake of domestic demand. On an annual average basis, it is set to increase by 6.8% – a very similar rate to the last two years. Its growth overhang for 2018 should stand at +5.3% by mid-year.

Domestic demand slackened again in the summer, coming to a standstill after three quarters of acceleration through to the start of 2017. Since the summer, the business climate indicators have been hovering barely above their expansion threshold in the manufacturing sector. Corporate profits, which bounced back dramatically in late 2016 and early 2017, after dropping in 2015 and growing only weakly in 2016, are generally in a slowdown phase, due to public-sector firms in particular. In real estate, sales continue to slow down sharply, as is the case for housing starts, and prices have been plummeting for several quarters. Retail sales are also slowing and consumer prices have been picking up over the last two quarters. They had significantly declined at the beginning of the year, due to their food component in particular.

Exports fell back in Q3 (–2.9%), in reaction to a strong acceleration in the spring. They should gradually recover, bolstered by world demand for Chinese products and by the stabilisation of the yuan after several months of appreciation; they should stabilise at the end of the year and then increase by 1.5% per quarter through to mid-2018. However, as has been the case overall for the last three years, China is not expected to gain any more market share.

Chinese imports gained momentum over the summer (+1.2%). They had slumped in the spring, to –3.5%, after rising strongly for four consecutive quarters. They should gather pace through to mid-2018, to +2.0% per quarter, as they will no longer be adversely affected by the drop in the

1 - After a sharp acceleration, imports should gradually slacken



Sources: NBSC, Rosstat, TurkStat, MOSPI, IBGE, INSEE calculations share of assembly trade. On an annual average basis, imports are set to bounce back in 2017, to +8.7% after +0.8%, making China one of the main drivers of the recovery of world trade this year. Their growth overhang for 2018 – expected to stand at +4.8% by mid-year – could indicate a gradual slowdown in Chinese imports, in the wake of domestic demand (*Graph 1*).

Russian imports are set to slacken after the rebound induced by the recovery

Growth picked up in Q3 (+0.7% after +0.1%). It should remain steady through to mid-2018: the business climate is favourable and the drop in inflation triggered by the appreciation of the ruble (*Graph 2*) is sustaining the rise in purchasing power. After a post-crisis rebound (+14.9% in Q1, Focus), imports slowed significantly in Q2 (+6.2%). This deceleration is expected to continue, settling at a rate more in line with activity. In 2017, activity is likely to pick up, to +1.6% as an annual average, and the growth overhang should stand at 1.8% by mid-2018.

In India, growth should rise after a slowdown in early 2017

In H1 2017 growth slowed in India, following the surprise demonetisation of 500- and 1,000-rupee banknotes in late 2016. In Q3, the implementation of a single VAT regime on 1st July prompted a wait-and-see attitude, and drove producers to sell off their stocks. Industrial output edged down in June and July, but bounced back in August, and purchasing managers surveys point to an improvement in activity to come. From the end of 2017 onwards, India is expected to regain a vigorous growth rate, driven mainly by substantial public stimuli. Indian growth is likely to pick up a little in early 2018.

Brazil: activity is set to rise again gradually

After two years of recession, Brazilian growth turned around in H1 2017. The drop in inflation continues to boost purchasing power and retail sales. The business climate improved significantly in both industry and services, and industrial production continued to progress over the summer. Activity is expected to accelerate at the end of 2017 and this should continue at a sustained pace through to mid-2018. In 2017, positive growth (+1.1%) should return to Brazil, and the growth overhang by mid-2018 is likely to be significantly higher (+1.6%).

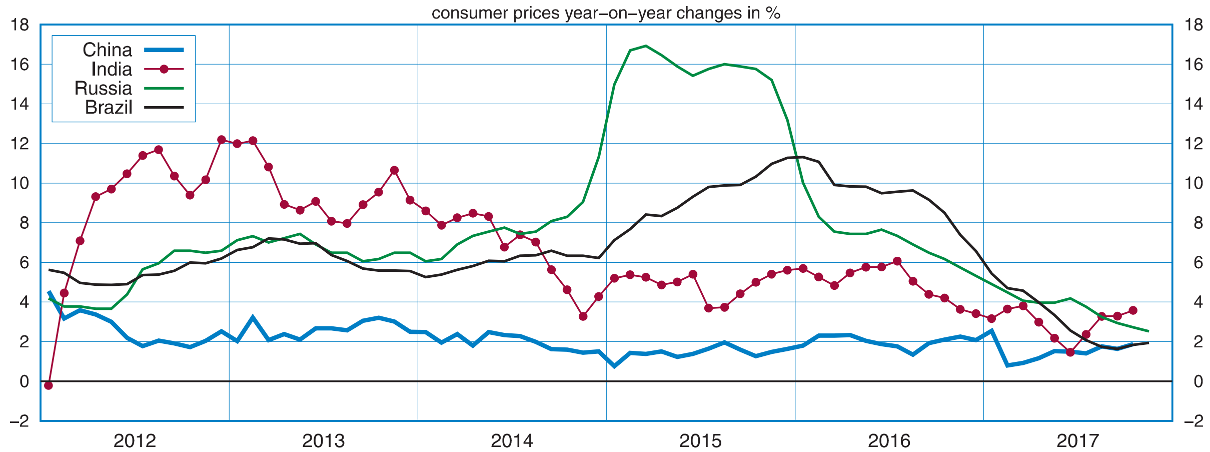
Investment should remain vigorous in Turkey

After the attempted coup in mid-2016 that brought production to a temporary halt, growth has returned. In H1 2017 growth remained buoyant thanks to government spending. The business climate remained positive in the summer, with industrial production continuing to rise. In the wake of domestic demand, imports are likely to remain vigorous but should slow down slightly in early 2018. From late 2017 through to mid-2018, activity is set to rise at a sustained rate. As annual average, growth is expected to reach +6.0% in 2017, and the growth overhang for 2018 should increase to +2.8% by mid-year.

CEEC: growth holds firm

In H1 2017, growth accelerated to +1.3% per quarter in the Central and Eastern European Countries (CEEC), in the wake of industrial production. Growth should continue at a vigorous rate, driven by demand from the Eurozone. As annual average in 2017, GDP is expected to accelerate to +4.6%, and the mid-year growth overhang for 2018 should rise to +3.5%. ■

2 - Inflation is falling in Russia and Brazil



Sources: NBSC, MOSPY, Rosstat, IBGE