CURRENT SITUATION • Recovery still on track

Global growth is consolidating thanks to good performances by the USA and China, the world’s two largest economies. The US recovery is getting stronger and the country is facing fewer downside risks than a few months ago. China is keeping up a robust rate of growth free from inflationary tensions. The threats to this positive scenario come from Japan, whose growth weakened in spite of its recent exit from deflation, but especially from some large emerging economies such as India and Brazil with insufficient growth, worrying inflationary tensions and large structural imbalances.

UNITED STATES

The recovery will consolidate in 2014, for which we predict 2.9% growth in GDP, higher than the 1.8% forecast for 2013. This acceleration will be helped by improvements in household wealth, whose net figure stood at 457% of GDP in 2013 Q3 after increasing by 31 percentage points compared with the same period the previous year. Another factor to take into account is that fiscal adjustment will be gentler than in 2013 and surrounded by less political uncertainty, especially after the recent agreement between Democrats and Republicans to modulate the effects of the sequester. We also expect investment to perform well, which should rise, boosted by corporate earnings that are close to an all-time high (12.6% of GDP in Q3) and business sentiment (for example, the ISM index) also at high levels.

Recent indicators point to a relatively strong 2013 Q4 and lead us to believe that the effect of the partial federal shutdown in October on consumers was less than initially estimated. Retail sales were strong in October and November, auguring healthy consumer spending figures in the National Accounts system. October’s good trade balance and the latest consumer confidence survey also suggest an upswing in activity. In fact, this pattern had already been observed with the upward revision of GDP for Q3 (from the figure of 2.8% initially announced to 4.1%), although most was due to a larger accumulation of stocks.

The gradual recovery in the housing market is another exponent of the strength of the US economy. Many indicators point to this: the oversupply of property is decreasing, the time required to sell a house has fallen to pre-crisis levels, the Case-Shiller index for second-hand homes accumulated an appreciation of 13.3% between January 2012 and September 2013 and, in December, the index for construction sector sentiment reached its highest level since November 2005.

Employment provided yet another pleasant surprise in November, albeit with some provisos. The 203,000 jobs created and the drop in the unemployment rate from 7.3%
to 7.0% point to the recovery in the labour market picking up steam. However, there are two ways of interpreting these employment figures. In the short term, the upswing is positive and is in addition to other indicators which suggest that activity grew in the final part of 2013. However, with a view to 2014 and 2015, the expected recovery in the labour market is too slow if we take into account the participation rate (proportion of employees in relation to the population aged 16 and over) which, in November, stood at a meagre 58.6%, zero improvement since January 2013. In other words, a large part of the decrease in the unemployment rate is due to an increase in the number of discouraged people leaving the labour market (who are not working or looking for work) and are therefore no longer counted as unemployed. With the current level of discouraged workers, only 814,000 new jobs need to be created to reach the unemployment target of 6.5% set by the Federal Reserve, in four months' time at the rate achieved last November. But if we include in this target the fall in the share of discouraged workers to pre-crisis levels, and even taking the ageing population into account, 4.6 million jobs would be required, delaying the achievement of this target level by almost two years.

The Fed will start tapering in January 2014 but will keep interest rates low until mid-2015. The Fed decided to start reducing its asset purchases as from January, lowering its monthly level of bond purchases from 85 to 75 billion dollars. Its monetary policy will be adjusted in line with macroeconomic conditions, taking into account the aforementioned slow recovery in employment as well as the absence of inflationary tensions. In November, the CPI stood at 1.2% year-on-year, a little higher than September's figure due to the effect of oil, while the core CPI, which excludes energy and foods, rose by 1.7% year-on-year, also a moderate increase.

JAPAN

Growth is losing steam. Japan’s growth in Q3 was revised downwards, going from an annualized quarter-on-quarter figure of 1.9% to 1.1% and leaving our growth forecast for the whole of 2013 at 1.6%. The breakdown by component is not encouraging. The drivers of growth over the last few years, namely capital goods investment and exports, both deteriorated and the decline in exports shown by November’s trade balance added to this weakness. Once the initial effect of the yen’s depreciation had been overcome, the boost provided by the foreign sector seems to have disappeared. Also of note is the slowdown in private consumption throughout the year, with annualized quarter-on-quarter growth falling from 4.0% in Q1 to 0.8% in Q3. This slowdown will force the authorities to take fiscal measures to offset the VAT hike planned for April 2014. In this respect, the Tankan business sentiment index improved in Q4, albeit with a drop in expectations for 2014 Q1.

The exit from deflation provides a positive note. November’s CPI rose by 1.6% year-on-year and, more significantly, the core CPI (without energy or food) rose by 0.5%, the highest figure
since August 1998. This provides backing for Abenomics, the series of expansionary policies adopted by the Prime Minister Shinzo Abe.

**CHINA**

China’s business indicators are still robust, undergoing a slow transition towards a model of growth with consumption playing a larger role. Demand looks healthy, as testified by the 13.7% increase in retail and consumer goods in November. Supply indicators such as the PMI and industrial production appeared somewhat more subdued although they still performed solidly. The foreign sector also helped to boost activity with a notable rise in exports. Urban fixed capital investment slowed down but the rate of growth in the cumulative figure from January to November was a respectable 19.9% year-on-year. Inflationary tensions remain contained with the CPI rising by a moderate 3.0% in November; excluding foods and energy, this figure falls to 1.8%. Similarly, the new Prime Minister Xi Jinping seems to be more committed to carrying out structural reforms than his predecessor, Hu Jintao.

**OTHER LARGE EMERGING ECONOMIES**

India and Brazil fail to dominate inflationary tensions. In India, wholesale prices rose by 7.5% year-on-year in November while Brazil’s CPI grew by 5.8%. The need to control inflation within a context of slow growth leaves their central banks little room to manoeuvre. In this respect, India’s GDP figures for Q3 came as no surprise, with a 4.8% increase year-on-year that leaves our forecast for 2013 at 4.7%, a much lower figure than the ones recorded in the non-too distant past. On the other hand, Brazil disappointed with a GDP that was down on Q2 and a poor cumulative figure of 1.8% year-on-year. In the final part of 2013, Brazil’s economy should benefit from its expansionary fiscal policies and achieve growth of 2.4% for the year as a whole. In both cases macroeconomic imbalances, both internal and external, are extensive within a context of slowness in carrying out reforms.

Turkey was surprisingly robust, with its GDP rising 4.4% year-on-year thanks to an upswing in investment and to consumption maintaining its good performance. The activity figures, added to October’s CPI of 7.3% which, although within a general situation of deceleration is still too high, will require fiscal adjustments to be implemented. For its part, Russia is going through a slowdown with its GDP rising by just 1.2% year-on-year in Q3 (for more details, see the Focus «Russia at the crossroads»).