

## EXECUTIVE SUMMARY

### THE EMERGING COUNTRIES, LEADING THE RECOVERY

**The foreign sector is the pillar of the recovery in developed countries.** High levels of indebtedness — in some countries of the public sector, in others of the private sector and of both in many countries — limit domestic demand's capacity to grow. The foreign sector has therefore become the driving force of the recovery. Given this situation, it comes as no surprise that, for many countries, improving competitiveness has gone from a priority to an urgent need.

**Emerging countries hold the key to the recovery.** In this respect, the first quarter growth figures, in general worse than expected, have raised certain fears of activity slowing down. Brazil is finding it difficult to return to the levels of growth displayed before the crisis. Moreover, high inflationary pressures have forced its central bank to raise the official interest rate by 50 basis points. Mexico's GDP figures for the first quarter were also disappointing and some countries in Eastern Asia, such as Korea and Taiwan, are losing competitiveness due to the appreciation of their currencies against the Japanese yen.

**The wide room for economic policy in emerging countries is cause for confidence.** The fact that international energy prices have remained contained means that, in most countries, inflationary pressures are relatively under control and that, consequently, there is even more room to implement expansionary monetary policies. In fact, in those countries with the lowest rate of activity, such as India, Turkey and Korea, the official interest rate has been cut in the last few weeks. Another encouraging sign is the drive with which some notable countries are undertaking their agenda of structural reforms. In this respect, Mexico is exemplary. After approving labour, education and telecommunications reforms, at the beginning of May the guidelines were presented for banking reforms whose main aim is to boost private credit.

**It is the euro area that is most dependent on exports.** That is why the EC has once again started to discuss the urgent need to carry out an ambitious agenda of structural reforms. Their implementation will help to speed up the adjustments still pending, especially in the periphery countries. For Spain, the list of recommendations is long and includes a review of labour reform, energy reform, tax system reform and public administration reform, accompanied by a strict schedule.

Italy's extensive black economy is still a source of concern, as well as its relatively inefficient judicial system. However, the EC has also set homework for the core countries.

Germany must start up measures to stimulate domestic demand as its current account surplus, standing at 6.9% of GDP, does not look like correcting itself, while the area of concern for France is its economy's long-term growth capacity. In this respect, making its labour market more flexible is seen as one of the key factors in turning this situation around.

**Japan is also being supported, for the time being, by its export industry.** The revolution carried out by Japan's new Prime Minister, Shinzo Abe, which is now known as Abenomics, is based on three pillars: monetary expansion, more public expenditure and structural reforms. The effects of the asset purchases carried out by the Bank of Japan are already being felt. The sharp devaluation of the yen has boosted exports which grew by 3.8% in quarter-on-quarter terms in the first quarter. However, growth in domestic demand is likely to consolidate as public spending increases and particularly as the agenda of structural reforms is implemented.

**The economy's growth is more balanced in the USA** although the adjustment in its public accounts has yet to consolidate. Nevertheless, this can be carried out while preserving a similar rate of growth to the last few quarters as the deleveraging of households and companies is now quite advanced, allowing consumption and investment to gradually take over. The solidity that seems to be offered by the US economy's growth prospects has revived debate regarding the direction monetary policy should take. Some members of the Fed have expressed their desire to speed up the process of withdrawing monetary stimuli. It is important not to reduce these too quickly as the pace of economic activity has yet to consolidate but, if the macroeconomic figures improve, it might be advisable to reduce the rate of asset purchases. Striking the balance will by no means be an easy task, so the debate that has been started is unlikely to end, leading to some volatility in the markets from time to time.