THE WORLD ECONOMIC OUTLOOK IN 2007:
soft landing or hard landing?

Conferences BNP PARIBAS,
Tuesday 24th October, 2006
I - INTRODUCTION

charts 1 to 7
Chart 1

Real GDP growth, %

- **World**
- **USA**
- **Japan**
- **Eurozone**
- **France**

sources: IMF, BNPParibas
Real GDP annual growth, %

source: IMF (WEO, September 2006)
Chart 3

Brent oil price and world growth

Brent oil price, USD/barrel

Real world growth, %

source: IMF
Total OECD: output gap & inflation

Source: OECD

Output gap, %

Inflation, y/y %
Current-account balance, billions $

-1000 -800 -600 -400 -200 0 200 400 600 800 1000

USA

-1000 -800 -600 -400 -200 0 200 400 600 800 1000

Japan

China

Asia excl. China et India

Russia

Middle-East

Eastern Europe

Western hemisp.

Euro zone

India

source: IMF (WEO, September 2006)
Chart 6

Foreign exchange reserves, billions $

source: IMF (WEO, September 2006)
World reserves & US current-account balance

US current-account balance, annual rate, % of GDP

World reserves, billion $

sources: BEA, IMF
II - UNITED STATES
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STRONG SLOWDOWN IN ECONOMIC ACTIVITY

- Consequences of the retrenchment in the residential sector.
- Job creations weaken.
- The room of manoeuvre for the fiscal policy is limited.
LOW PROBABILITY OF RECESSION

- The financial situation of the corporate sector is healthy (profits, equity valuation).

- Resilience in world growth.

- Very reactive monetary policy.
EXTERNAL IMBALANCES LIKELY TO LAST.
USA : economic growth and ISM index

Real GDP, y/y % change
ISM new-orders index
ISM total index
Real GDP, y/y % change

sources: ISM, BEA
Chart 9

USA: yield curve & GDP growth

- T. Notes 10year - Libor 3month
- Real GDP growth, y/y %

Recession periods

Sources: Federal Reserve, BEA
USA: household consumption and saving

Household consumption,
volume, y/y %

Household saving rate, %

sources: BEA, Federal Reserve
United States: compensation and employment

- Real civilian compensation (ECI) (y/y % change)
- Monthly change in employment, 3-month moving average, thousand

Source: BLS
Chart 12

United States: home sales & homes for sale

(y/y %)  

Available existing homes for sale

Existing home sales

source: Bureau of Census
USA: housing starts, permits, investment & NAHB

source: BEA, Bureau of Census, NAHB
Chart 14

USA: employment in the construction sector

in thousands
as % of total employment

source: BLS
Chart 15

USA: flows of household debt and investment

Mortgage debt, billion $

Residential investment, billion $

source: Flow of Funds (Federal Reserve)
USA: breakdown of the nonresidential private fixed investment

(volume, y/y %)

source: BEA
USA: corporate profits & investment as % of GDP

Corporate profits

Nonresidential private investment

source: BEA
USA: corporate financing gap and investment as % of GDP

sources: BEA, Federal Reserve

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USA : unit labour cost & GDP deflator, y/y %

sources: BEA, BLS

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USA: budget balance

Chart 20

Structural balance, % of GDP

Fiscal balance, % of GDP

sources: OECD, BNP Paribas
Chart 21

USA: public receipts and expenditures as % of GDP

source: BEA
United States: interest rates and inflation

(* monthly average)

10-year interest rate*

Fed Funds interest rate*

Inflation, y/y %

source: Federal Reserve
United States: core CPI

(y/y %)

sources: BEA, BNPParibas
Expected inflation, %:
T.Note 10year - Inflation indexed T.Note

Consumer sentiment*:
expected change in prices, %
for next 5-10 years

Consumer sentiment*:
expected change in prices, %
for next year

sources: * University of Michigan, Federal Reserve
USA: exports & imports growth, & external contribution

- Exports of G&S, volume, y/y %
- Imports of G&S, volume, y/y %
- External contribution to real GDP growth (q/q annualized growth, %)

source: BEA
USA: current-account and budget balances, and savings

Fiscal balance* (federal, states & local)

Current-account balance*

Household savings rate

(* as % of GDP)

soures: BEA, Federal Reserve
United States: external position

(amounts outstanding end of period, billion USD)

Financial external position

Financial liabilities

Financial assets

source: Federal Reserve (FoF)
III - EUROZONE
charts 28 to 44
ECONOMIC ACTIVITY

- Growth above potential in 2006.
- Financial conditions support investments.
- Household consumption:
  - Job creations are back
  - Low increase in real wages
  - VAT hike in Germany: weakening demand in 2007
- External demand:
  - Resilient as of today
  - Stronger euro is a risk
- No room of maneuver for fiscal policy
- Monetary policy: normalization still in the pipe line.
STRUCTURAL ISSUES

- **Challenges:**
  - low potential growth
  - the cost of aging

- **A lot remains to be done:**
  - fiscal consolidation
  - goods market reform (privatization, competition, barriers to entry etc…)
  - labor market reform (disincentives to work, disincentives to create jobs have to be addressed…)

- **The political impediments**
Real GDP, y/y % change

United States

Japan

Euro zone

sources: BEA, Cabinet Office of Japan, Eurostat
Euro zone: PMI manufacturing

Chart 29

source: NTC
Euro zone: PMI and real GDP growth

Composite PMI

Real GDP, q/q, %

sources: Reuters, Eurostat
Euro zone: household confidence and unemployment rate

sources: Eurostat, European Commission
Euro zone: private consumption, GDP & household debt

Real private consumption, y/y %
Real GDP, y/y %
Household debt, % of disposable income

sources: Eurostat, ECB

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Euro zone, consumer surveys: economic situation & purchases

Economic situation over next 12 months

Major purchases over next 12 months

source: European Commission
Euro zone: employment, wages & GDP (y/y %)

sources: Eurostat, ECB
Unemployment rate, %

Euro zone

United States

sources: Eurostat, BLS
Euro zone: nonresidential investment growth and profit mark-up, %

Real nonresidential investment, y/y %

Profit mark-up:
GDP deflator (y/y %) - Unit labor cost (y/y %)

Sources: Eurostat, ECB, OECD
Euro zone: trade weighted EUR and exports

-20 -15 -10 -5 0 5 10 15 20 25

94 95 96 97 98 99 00 01 02 03 04 05 06

Exports of goods, volume, 3-month moving avg, y/y %

Nominal effective EUR, y/y % (inverted scale)

source: ECB, Eurostat
World trade of goods & services: real annual growth, %

Source: IMF (World Economic Outlook, September 2006)
Fiscal balance as % of GDP / country

sources: OECD, BNPParibas
Euro zone: ECB repo rate and inflation

sources: Eurostat, ECB
Euro zone: M3 and credit growth

(amount outstanding, y/y %)

Source: ECB

Household credit

Non financial corporate credit

M3

M3 target: 4.5 %
Euro zone: inflation & consumer surveys

Total inflation, y/y %

Prices: last 12 months*

Prices: next 12 months*

sources: Eurostat, * European Commission (Consumer surveys)
USA/Euro zone: interest rate & exchange rate

(monthly averages)

USA-Germany:
3-month interest spread, %

EUR/USD exchange rate

sources: Bundesbank, Federal Reserve, Reuters
IV - JAPAN
charts 45 to 57
ONGOING ECONOMIC RECOVERY TO SOFTEN

- GDP growth close to 2.5% in 2006, has headed to potential.
- Private capital expenditure and household consumption have backed the domestic recovery up until recently.
- The current industrial cycle has already peaked last quarter.
- Both business and investment of large exporting firms are likely to soften.
WHAT CHANGES IN MONETARY POLICY?

- The rebasing of the consumer price index has deferred the end of deflation.
- A very moderate increase in prices is expected to show up.
- Following a first rate hike last July, Bank of Japan should adopt a prolonged monetary status quo.
- The yen should gradually strengthen versus the dollar.
ACHIEVING FISCAL SUSTAINABILITY CAN NOT BE AVOIDED

- The public deficit represented around 5% of GDP and the public debt more than 170% last year.
- Primary fiscal deficit is about 4%; a stabilization of the debt ratio requires 1.5% of primary surplus
- A complete reshuffle of Japan’s tax system as well as a continuation of structural reforms are key to raise Japan growth potential and help the country cope with the challenge of its ageing population. Nonetheless no significant improvement is expected before next summer elections (1997 experience is in every mind...).
Chart 45

Japan: real GDP and domestic demand growth, y/y %

source: Cabinet Office
Japan: real consumption, investment & exports growth, %

(y/y % change)

Exports of goods & services

Household consumption

Public investment

source: Cabinet Office

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Japan: profits and business climate

Current profits, all industries, y/y % change

Tankan surveys: business condition, forecasts, all enterprises, %

sources: MoF, Tankan (Bank of Japan)
Japan: nonresidential investment & business climate

Tankan surveys: production capacity, actual, all enterprises, %

Nonresidential investment, volume, y/y %

Sources: Cabinet Office, Tankan (Bank of Japan)
Japan: orders and leading indicator

Orders for machines, y/y % change

EPA leading indicator

(source: Cabinet Office)
Japan: Tankan surveys

Bank lending attitude, actual, all enterprises, %

Financial position, actual, all enterprises, %

source: Tankan (Bank of Japan)
Japan: unemployment & Tankan surveys

Unemployment rate, %

Tankan surveys: employment, all enterprises, actual, %

sources: Ministry of Labour, Tankan
Chart 52

Japan: employment growth and job offers to applicants ratio

- Full-time employees, y/y %
- Job offers to applicants ratio

Source: Ministry of Labour
Chart 53

Japan: wages & inflation, y/y %

Inflation

Average earnings (6-month moving average)

Sources: Ministry of Labour, Ministry of Public Management
Japan: land prices and Nikkei

Land prices index: 6 big cities

sources: Japan Real Estate Institute, Tokyo Stock Exchange
Japan: bank reserves, trillion JPY

source: BoJ
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Japan: interest & exchange rates

- 3-month interest rate
- 10-year interest rate
- USD/JPY exchange rate

(monthly average)

Sources: BoJ, Reuters
Japan: fiscal balance and public debt as % of GDP

- Primary budget balance
- Public debt
- Fiscal balance

Sources: OECD, BNP Paribas
V - CHINA / INDIA
charts 58 to 64
IN A MEDIUM TERM PERSPECTIVE, THE GROWTH POTENTIAL REMAINS VERY STRONG.
IN THE LONG TERM, THE DEMOGRAPHIC EVOLUTION WILL BE ADVERSE.

- Strong economic growth, above 10%
- Inflation is subdued
- Low impact of the change from the dollar peg to a currencies basket
- External financial position: 1st in the world for forex reserves
WHAT RISKS?

- External trade tensions and pressures to reevaluate the yuan
- Recent acceleration in credit growth to be monitored
- Increasing social tensions
- Impact of high commodities price on corporate margins and increasing vulnerability to an economic downturn especially for sectors experiencing excess supply.
MEDIUM TERM OUTLOOK VERY FAVOURABLE. ECONOMIC GROWTH CAN KEEP IN A 8 % PATH.

- Global demand is strong and broadly based
- Inflation is subdued
- Comfortable external liquidity and solvency position (large stock of foreign exchange reserves, low external debt / GDP)
- India is still relatively insulated from global financial market fluctuations
SOME WEAKNESSES:

- Persistently strong credit growth
- Public finances: fiscal deficit
- The current account deficit is mainly financed by equity & corporate bonds purchases
- Adverse impact of coalition politics on the reform momentum (shelved privatization process, debate on SEZs)
Real GDP per capita

in USD

annual average growth rate

Source: Institute of International Finance
Gross domestic investment as % of GDP

source: IIF
Chart 60

Nominal GDP

in USD

per head in USD

Source: Goldman Sachs
Openness rate*

(\% of GDP)

* exports + imports of G&S / 2 x GDP (volume)

Source: national accounts
World market shares (country’s exports / world’s exports)

Source: IMF
Current-account balance + net foreign direct investments flows

billion USD

% of GDP

Source: Institute of International Finance
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