Overview

Remaining doubts on the strength of the American recovery have vanished during the 2nd half of last year. US activity is backed by historically low interest rates, as proved by the historically high level of applications for mortgage loan refinancing, and by the maintenance of the tax relief. Undoubtedly these elements of support are not likely to last for ever, a factor of consumption dynamism has already disappeared with the fall in mortgage refinancing. Nonetheless growth prospects remain well orientated. Leading indicators, such as the ISM index, and more particularly its new order component reached historical highs in December, allowing us to forecast GDP growth around 4.5% this year. The rise in consumption is probably likely to slow, as temporary supporting factors vanish away. However, the necessary consolidation of US households' financial position should not induce a collapse in their demand: their interest gearing is low, consumer confidence is consolidating, equities are up, partly offsetting past negative wealth effects. Disappointing figures as regards job creations should be short-lived, if one looks at the job component of leading indicators as well as the fall in initial jobless claims. Nonetheless the current employment figures remain difficult to interpret, owing to the discrepancy between business and household surveys (which include jobs hiring in new firms), the latter being on an upper trend. This does do not facilitate the diagnosis.
The low level of stocks, the rise in corporate earnings – non financial corporate have recorded a financial surplus since mid-2003 – and loose financing conditions back a further rise in capital expenditure. In addition, the fall in the dollar as well as the global recovery stimulate exports. As regards monetary policy, disinflation and the Fed's concerns about the long end of the yield curve should delay a progressive normalisation to mid-2004.

Monetary policy should remain very accommodative until the end of this year. If risks appear to be more balanced, they have not vanished. In particular, the drift in public finances aimed to back the once shivering economic recovery needs to be corrected following the elections. For now, official projections are very optimistic. They refer to a stabilisation in public expenditure as well as to a mostly temporary tax relief. To this extent, the Fed estimates that one point of GDP increase in the expected public deficit pushes up long-term interest rates by 25bp and that a 10 points rise in the debt-to-GDP ratio generates a 40 bp increase in long-term rates, all things being equal. In the zone euro, Q3 national accounts testify that the economic recovery has been spreading, as had already been announced by leading indicators (PMI, OECD...). The global recovery has boosted exports, offsetting the damage done by the euro's appreciation. However, continuous adjustments in corporate balance sheets, a neutral budgetary policy as well as the weakening of the labour market weigh on households' confidence and slow the rise in private consumption.

All in all, we assume GDP growth will remain below its potential (2.25%). In spite of weak activity recorded during the past three years and of the euro's appreciation, inflation has remained relatively sticky. This is due not only to exogenous shocks (such as food prices, indirect taxes) but also to disappointing productivity gains which triggered excessive growth in unit labour costs. Under these conditions, with the exception of a new fast rise of the euro above 1.30-1.35 level, the BCE should leave its rate refi unchanged for a long period of time. We do not assume any tightening before the 4^{th} quarter.

In Japan, following the 2002 recession, activity resumed in 2003. The economy should not gather speed this year, because of the strength of the yen and is likely to grow by around 3%. Japan has benefited from a dynamic external demand – in particular in Asia – and also from the financial recovery of the industrial sector whose fixed investment expenditure is rising again. Nonetheless, the stabilisation of the labour market is not sufficient to back household confidence. Disappointing figures for October and November consumption underline their cautious behaviour. In this context, monetary authorities have massively intervened on foreign exchange markets in order to safeguard the recovery and to temper deflationary pressures. A change in policy looks very unlikely, despite official pressures favouring more "flexibility" on foreign exchange markets.

In emerging countries, economic growth has continuously accelerated since the beginning of 2000. Below 3% in 2001, GDP growth reached 3.6% in 2002 and 4.5% last year. It should significantly exceed 5% in 2004. With the exception of Africa-Middle-East area, the acceleration in growth is widespread.

Economic growth should approach 3.5% in South America, 4.5% in central European countries and 6.5% in Asia. This acceleration is coupled with a marked rise in imports which leads to a contraction in current account surpluses. Following 1.5% of GDP last year, the current account surplus should narrow to 0.5% in 2004 on average, with a small deficit in South America and Eastern Europe.
Favourable prospects and loose financing conditions have boosted capital inflows, in particular investments in equities. Consequently, in a context of sustained current surpluses, official reserves increase in all areas. In parallel, narrower spreads have triggered bond issues, partly in order to take advantage from looser monetary conditions to refinance debt.

Philippe d'Arvisenet