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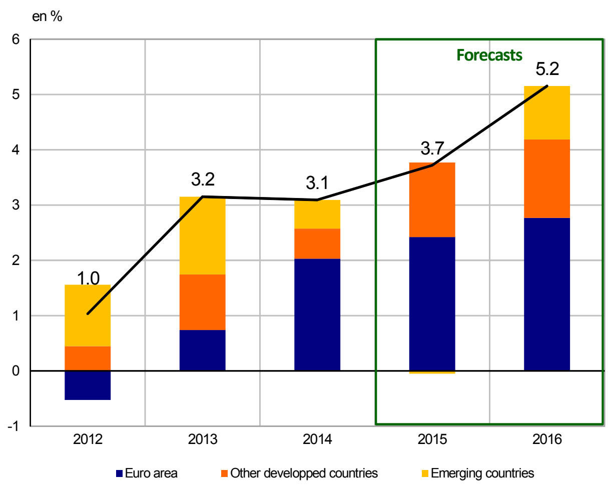
The world economy in the summer of 2015: emerging economies expected to slow global growth in 2015

- In early 2015, global economic growth slowed, with major disparities between economic areas. The advanced economies continued expanding, albeit at a slightly slower pace than at the end of 2014, but the outlook remains positive. In contrast, growth slowed more sharply in the emerging economies.
- In the United Kingdom and the United States, growth picked up again in the second quarter, after a temporary dip in the first quarter. This strong performance confirms the scenario in which surging domestic demand boosts these economies and they continue to outstrip their potential growth rate. In Japan, growth rebounded in the first half of the year, despite a tumble in the second quarter. Japan's growth rate should recover over the forecast period, after posting a negative rate in 2014.
- The recovery in the euro area is gathering strength, with growth rates varying from one country to the next. Growth was bolstered by a weaker euro, the big drop in interest rates stemming from the ECB's quantitative easing programme and a slower pace of fiscal consolidation. Germany's growth could be driven by sound domestic factors, even though it was disappointing in the first half of the year. Spain's economy continued to expand at a faster-than-expected pace in the first half of the year, and should be sustained by domestic factors and an improving labour market. After shrinking for three years in a row, Italy's economy started growing again in the first quarter, and is now driven by domestic demand.
- The emerging economies showed weak growth at the beginning of 2015. The slowdown was more marked than expected in China, while Brazil and Russia experienced major difficulties. India was the only BRIC country to post relatively resilient growth. Emerging economies should see a slight pick-up in growth in 2016, with brighter prospects in Brazil and Russia more than offsetting a continuing economic slowdown in China.
- World trade should post slower growth in 2015, as emerging economies imported less in the first half of the year. It should pick up again in 2016, driven by stronger activity in the advanced economies, as well as by import growth in emerging economies that is more in line with their economic growth, after lagging in 2015. World demand for French goods should be less affected by the emerging economies' flagging growth, given the structure of France's foreign trade. This demand should pick up in 2015 and 2016, bolstered by renewed growth in the euro area.
- The uncertainties surrounding the scenario balance each other out. There is great uncertainty about commodity prices, particularly oil prices, and exchange rates, which could potentially boost or hamper the growth of the advanced and emerging economies. As China's economy finds a new balance and stock market turmoil affects its growth, the slackening of domestic demand could be more severe than expected. This could be offset by a more assertive response from the Chinese authorities to sustain demand. Finally, a stronger-than-expected recovery in the euro area would greatly improve the prospects for global growth.

Growth in world demand for French goods by area



Source: DG Trésor.

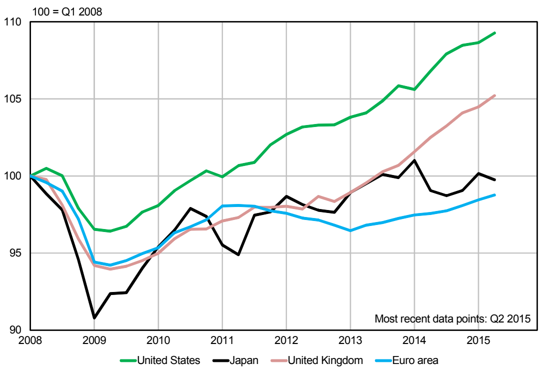
MINISTÈRE DES FINANCES ET DES COMPTES PUBLICS

MINISTÈRE DE L'ÉCONOMIE DE L'INDUSTRIE ET DU NUMÉRIQUE

1. Global economic growth dipped in the first half of 2015 as a result of emerging economies' difficulties and faltering growth of the advanced economies

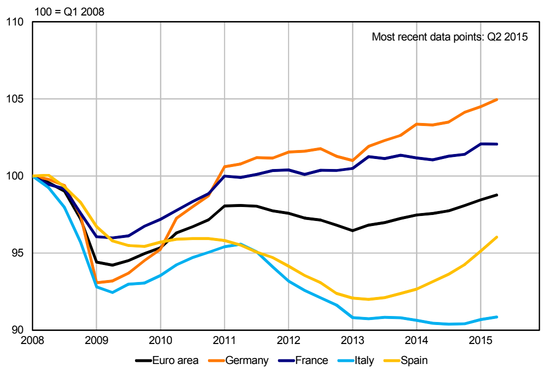
In early 2015, global economic growth slowed, with major disparities between economic areas. The United Kingdom and United States continued to post growth, but at a slightly slower rate than at the end of 2014, and the recovery gathered strength in the euro area (see Charts 1 and 2). Japan's economy made a halting recovery and the slowdown in the emerging economies continued to be sharper than expected.

Chart 1: GDP trends in the leading advanced economies



Sources: National statistics institutes and Eurostat.

Chart 2: GDP trends in the leading euro-area countries



Sources: National statistics institutes and Eurostat.

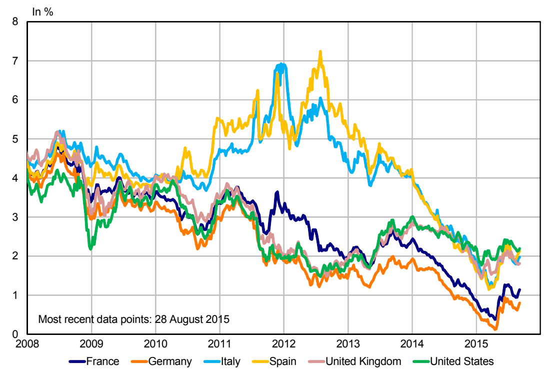
1.1 Despite great concern about the situation in Greece and China, the financial environment remained favourable for the advanced economies in the first half of 2015

The actions of the Federal Reserve, the Bank of England and the ECB continued to promote favourable financial conditions for the advanced economies. The ECB loosened its monetary policy at the beginning of 2015 by launching a new asset purchase programme[1]. Despite a move to start returning to normal monetary policy, the Fed and the Bank of England kept their benchmark rates very low. The Fed ended its quantitative easing programme in October 2014 and maintained its rates at their lower bounds (0 to 25 basis points) following the Monetary Policy Committee meeting in July. Meanwhile, the Bank of England made a commitment to maintain accommodative monetary policy until the economic recovery is firmly entrenched. It has kept its benchmark rate at 0.5% since March 2009 and halted its asset purchases in November 2012. The Bank of Japan has maintained its accommodative monetary policy since loosening it in October 2014 in response to the unexpected slump in the third quarter and falling commodity prices.

Nevertheless, concerns about Greece and China, along with the impact of lower oil prices on oil stocks, led to more volatile stock markets and sovereign yields. More specifically, European and American stock markets dipped slightly halfway through the year and the advanced economies' sovereign yields climbed steadily from April through July, before falling back again. Depending on the country, sovereign yields rose by 15 to 50 basis points between January and August (see Chart 3). Despite the rise, sovereign yields remained low and spreads showed limited increases.

The sudden drop in the price of Brent crude meant that lower energy prices helped improve households' purchasing power in the advanced economies. After falling by more than 50% between June 2014 and the end of January 2015, oil prices rose again until the middle of the year, but remained in the range of USD 50 to USD 65, despite marked volatility.

Chart 3: Sovereign yields around the world



Source: IHS Global Insight.

1.2 First-half activity was less dynamic in the advanced economies than at the end of 2014 and continued to slow in the emerging economies [2]

After a very strong second half in 2014, growth in the advanced economies slowed slightly in the first half of 2015, but was still positive (see Table 1). Despite a favourable environment, with good financing terms and rock-bottom oil prices, the strong surge in growth expected in the United States and the United Kingdom failed to materialise fully. However, growth rebounded in Japan and seemed to gather strength in the euro area. The carry-over growth for 2015 at the end of the second quarter remained positive in the advanced economies at 2.1% for the United Kingdom, 1.8% for the United States, 1.0% for the euro area and 0.4% for Japan.

(1) In addition to the previously announced purchases of ABS and covered bonds, the programme was expanded to include purchases of sovereign and European agency paper.

(2) The latest forecasts and data points date from 17 August 2015.

Table 1: Quarterly GDP trends (real GDP growth, adjusted for seasonal and working-day variations, in%)*

	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2013	2014	2015** carry-over
Developed economies (quarter-on-quarter, adjusted for seasonal and working-day variations)									
United States	−0.2	1.1	1.1	0.5	0.2	0.6	*1.5*	*2.4*	*1,8*
Japan	1.1	−1.9	−0.3	0.3	1.1	−0.4	*1.6*	−0.1	0,4
United Kingdom	0.9	0.9	0.7	0.8	0.4	0.7	*1.7*	*3.0*	*2.1*
Euro area	**0.2**	**0.1**	**0.2**	**0.4**	**0.4**	**0.3**	***−0.3***	***0.9***	***1,0***
Germany	0.7	−0.1	0.2	0.6	0.3	0.4	*0.4*	*1.6*	*1.2*
France	**−0.2**	**−0.1**	**0.2**	**0.1**	**0.7**	**0.0**	***0.7***	***0.2***	***0.8***
Italy	−0.2	−0.2	−0.1	0.0	0.3	0.2	*−1.7*	−0.4	0.4
Spain	0.3	0.5	0.5	0.7	0.9	1.0	*−1.2*	*1.4*	*2,6*
Belgium	0.4	0.1	0.3	0.2	0.4	0.4	*0.3*	*1.1*	*1.0*
Netherlands	−0.4	0.6	0.4	0.9	0.6	0.1	*−0.4*	*1.0*	*1,7*
Emerging economies (year-on-year, not adjusted for seasonal and working-day variations)									
Brazil	2.7	−1.2	−0.6	−0.2	−1.6	−2.6	*2.7*	*0.1*	*-1.9*
China	7,4	7.5	7.3	7.3	7.0	7.0	*7.7*	*7.4*	-
India	5.3	7.4	8.4	6.8	6.1	n.d.	*6.9*	*7.3*	-
Russia	0.6	0.7	0.9	0.4	−2,2	−4.6	*1.3*	*0.6*	*−4.2*
Turkey	4.9	2.3	1.9	2.6	2.3	n.d.	*4.1*	2.9	-

* Latest data points on 17 August 2015. **End of Q2 2015.

Sources: DataInsight and Eurostat; minor discrepancies with the annual accounts are possible because of the method used to compute working days.

Outside of the euro area, the United States, the United Kingdom and Japan posted economic growth in the first half, despite some quarterly stumbles. After finishing 2014 with very strong growth, the American economy slowed in the first quarter of 2015 due to severe winter weather, port strikes and a stronger dollar. Household consumption drove stronger growth in the second quarter. The United Kingdom's economy continued the strong growth seen in 2014 into the first half of 2015, driven by robust private consumption and investment. The VAT hike in Japan caused growth to dip in 2014, but it subsequently surged in the first quarter of 2015, as private investment rebounded. Overall, Japan's economy posted strong first-half growth, even though the stumble in the second quarter revealed the fragility of its recovery.

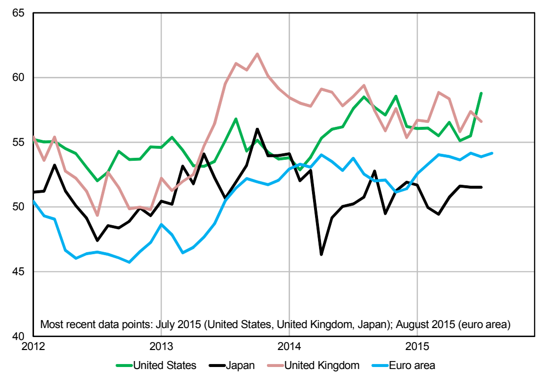
The euro area posted robust first-half growth. Second-quarter growth, at 0.3%, was in line with the 0.4% growth that the euro area posted in the first quarter of 2015. Spain continued to enjoy strong growth, at 1.0%, confirming that domestic demand, including construction investment, was once again driving expansion. Growth in Germany picked up as well, to 0.4%, boosted by private consumption and foreign trade, but the bounce was smaller than expected because the Greek crisis and slower growth in China acted as a drag on investment. Italy posted a positive growth rate for the second quarter in a row. The economy expanded by 0.2% as domestic demand recovered. Belgium and Portugal posted 0.4% growth, while the Netherlands saw growth of 0.1%.

Growth in the leading emerging economies continued to slow in the first half of 2015 as financial tensions worsened. China's year-on-year growth was stable at 7.0% in the first and second quarters, meeting the authorities' target of approximately 7.0%. Meanwhile, the real-estate correction continued and stock markets plunged during the summer, partially deflating the bubble that had been growing since 2014 (see Box 1). Russia's economy deteriorated very severely, shrinking by 4.6% in the second quarter, following a contraction of 2.2% in the first quarter, as a result of falling oil prices and geopolitical tensions. Brazil was also in recession, with a year-on-year contraction of 2.6% in the second quarter, as investment fell off in the wake of the Petrobras scandal, and consumption slumped as regulated prices were allowed to rise. Turkey saw soft growth at 2.3% as investors held off making decisions in the run-up to the general elections in June 2015. In addition, commodity-exporting countries were hit by falling prices. In contrast, India's growth was firmer as private consumption expanded and commodity prices fell.

1.3 The outlook for growth in the summer of 2015 suggest a gradual acceleration of activity in the advanced economies

Economic indicators pointed to faster growth in the United States and, to a lesser degree, in the euro area, along with continuing strong growth in the United Kingdom and a slight rebound in Japan. Surveys of purchasing managers in manufacturing and services showed positive outlooks in all three countries and the euro area (see Chart 4). In the United States, the ISM Composite Index soared to a ten-year high in July, driven by the service sector. Japan should see a modest rebound in growth, following a contraction in the second quarter. Its recovery is compromised by the VAT hike and the fading impact of Abenomics. PMIs in the United Kingdom fell back slightly after rebounding in June, but they remained very positive, pointing to continuing strong growth and a rapidly improving labour market. Finally, the economic outlook for the euro area remained favourable according to the business conditions surveys, pointing to a slight increase in activity.

Chart 4: Manufacturing and services PMI surveys in the advanced economies



Source: ISM, Markit.

In the emerging economies, economic indicators point to a sharper slowdown in China and more recession in Brazil, where economic policy has become very restrictive, and in Russia. Turkey's growth should still be hampered by a resurgence of political uncertainty in the run-up to early elections in November 2015[3]. In contrast, India is the only leading emerging economy where strong growth is expected to continue.

Box 1: China's economic situation

China has experienced a structural slowdown of its economy, stemming from the new balance of its growth model. After posting growth rates of approximately 10% in the 1990s and 2000s, expansion gradually slowed to 7.8% in 2013 and 7.4% in 2014. The Chinese authorities' growth target for 2015 is 7.0%. Slower growth reflects a gradual shift to an economy where growth relies more on household consumption and less on investment and exports, as well as a shift to a service economy.

But, since the end of the second quarter of 2015, fears of a sharper slowdown have been exacerbated by gloomy economic indicators for China and its palpable impact on world trade. The year-on-year growth rate for all goods and services stood at 7% in the first half of 2015, according to the Chinese National Accounts. China's imports of all goods plunged in the first half of the year, falling by 15.5% in nominal terms compared to the first half of 2014. The drop in imports other than energy stood at 11.5%. There have recently been some other troubling economic signals: (i) manufacturing output growth slowed from an average of 8.2% in 2014 to year-on-year growth of 6.0% in July, rail freight traffic was down and new vehicle registrations slipped, (ii) the Caixin/Markit China Manufacturing PMI dipped below 50 points to 47.8 points in July, (iii) nominal exports posted a year-on-year decline of 8.3% in July.

At the same time, China's stock markets tumbled in a partial correction of the bubble that had been growing since June 2014. The Chinese currency also weakened. A stock market bubble started growing in 2014 as investors borrowed more to buy market assets. The Shanghai index gained 150% between June 2014 and June 2015. The Shanghai stock market were then hit by a 38% correction between 12 June and 31 August 2015. Government measures to support the stock market helped to limit the correction at first.

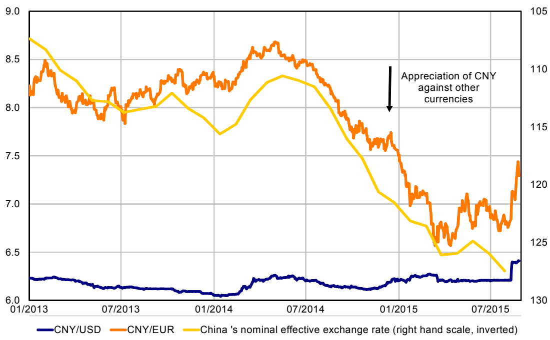
At the same time, with downwards pressure on the Chinese currency, the People's Bank of China changed the way it calculates the central parity rate of the yuan, resulting in a de facto devaluation. More specifically, the central bank changed the way it determines the mid-point of the +/- 2% range in which the yuan is allowed to fluctuate against the dollar. The central parity rate now includes the previous day's closing price. The change led to a depreciation of nearly 4% against the dollar over three days, followed by relative stability over the following days (CNY6.38 for USD1 on 31 August). Given its past rise against the euro, the yuan appreciated by 4.8% against the euro between 1 January and 31 August.

Under the circumstances, the People's Bank of China continued to loosen its monetary policy. On 25 August, the People's Bank of China announced a further cut in its benchmark rates, lowering its one-year lending rate to 4.6%, and relaxed reserve requirements. These moves marked the fifth cut in the benchmark rates and the fourth cut in reserve requirements since November 2014.

Slower growth in China has an impact on the global economy through trade channels and through commodity prices. The stock market correction and the depreciation of the yuan against the dollar should have a limited impact on the global economy at this point. The main effects that slower growth in China has on other countries, particularly in Asia, will be felt because of its impact on world trade. In addition, weaker Chinese demand is probably behind some of the further decline in commodity prices, which has dented the economies of commodity-exporting countries, but attenuated the impact on importing countries, like France.

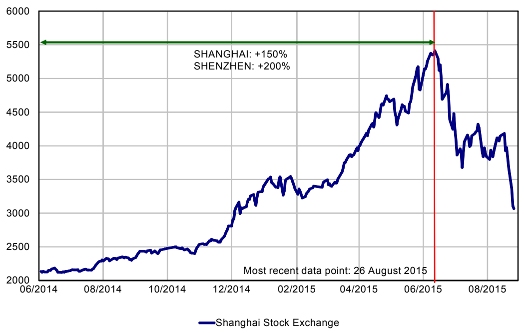
Our forecasts already incorporates a substantially slower growth in China in 2015, but the outlook for the Chinese economy is very uncertain. The international scenario presented here already incorporates the effect of sluggish growth of Chinese imports in the first half of 2015, with slower GDP growth of 6.5% in 2015 and a major downward revision of Chinese import growth in real terms to only 1.4% in 2015. The Chinese authorities have lots of room for manoeuvre when it comes to boosting their economy through fiscal and monetary policy if necessary. If the slowdown were to worsen, the impact on the euro area and the United States would still be limited. According to an IMF study[a], a 1-point decrease in Chinese growth would lead to a 0.15 point dip in euro-area growth and a 0.10-point decline in American growth.

Chart 5: CNY exchange rates since 2013



Source: DataInsight.

Chart 6: Chinese stock prices since June 2014



Source: DataInsight.

a. Spillover Report 2014, IMF.

2. After slightly slower growth in 2015, activity should pick up again in 2016 as emerging economies recover and advanced economies strengthen

Even though they are still the main contributors to global growth, emerging economies are slowing down, causing global growth to dip. The advanced countries should drive the global economy as the recovery gathers strength in the euro area in 2015 and the United States and the United Kingdom continue to enjoy brisk growth. In 2016, global economic growth should rebound as emerging economies recover, with the exception of China, and be driven by the good performance of advanced economies.

2.1 The euro area should see a surge in growth driven by domestic factors

The recovery in the euro area is gathering strength, but growth rates vary from one country to the next. Lower oil prices and the big drop in the euro against other currencies at the start of 2015 are expected to boost growth, which should be stronger in 2015 and 2016. Fiscal consolidation eased considerably in the euro area in 2014, and should be a neutral factor for the period covered by

(3) No coalition government following the June 2015 elections was constituted, so new elections were called for 1 November 2015.

this forecast. Exports should be sustained by stronger world demand and competitiveness gains. Private consumption should be boosted by households' improved purchasing power, as inflation remains weak. Meanwhile, business investment should be brisk as lending takes off again with the support of the ECB's massive quantitative easing programme. More specifically, financing terms have improved greatly in the peripheral countries as financial fragmentation in the euro area decreases. However, the euro area still has a high unemployment rate of more than 10% that is expected to decline very gradually.

Germany should see relatively sustained growth in 2015 and 2016, primarily as a result of stronger domestic demand. The continuing strength of the labour market means that private consumption should receive a boost from increasing purchasing power resulting from fairly strong wage growth (sustained by the gradual introduction of minimum wages since the start of 2015) and very weak inflation. Despite favourable financial terms and healthy profit margins, investment flagged in the first half of the year, as investors worried about *(i)* uncertainty in Greece, *(ii)* geopolitical tension in Ukraine and *(iii)* the severity of China's economic slowdown. If these uncertainties dissipate, investment growth should still be timid in 2015 and then more vigorous in 2016. Foreign trade should sustain growth, as global demand improves and competitiveness gains are achieved.

Italy should post positive growth in 2015 after three years of contraction. Growth will stem from the recovery of domestic demand, which should become the main driver of economic expansion. The economy should receive a major boost from a strong rebound of investment in capital goods, driven by the brighter outlook for demand and more business loans. On the other hand, the recovery of construction investment should take longer. Meanwhile, private consumption, sustained by households' greater purchasing power, should maintain the growth trend that started in 2014, despite the continuing gloom on the labour market. Italy's trade balance is expected to be penalised by strong import growth in 2015, but, in 2016, its contribution to growth should be positive as global demand picks up and Italian companies become more competitive (thanks in part to past depreciation of the euro).

Spain should see faster economic growth in 2015, followed by continuing strong growth in 2016, as domestic drivers remain strong and fiscal consolidation eases. Household consumption is expected to be the primary driver of growth in 2015 and 2016. It should be boosted by households' greater purchasing power, as wages grow against a backdrop of strong job growth and falling unemployment. Investment, excluding construction, should be particularly brisk as businesses continue to post healthy profit margins and business financing terms improve. The recovery of construction investment that started in 2014 should continue. Despite strong import growth, net exports are not expected to restrict growth in 2016, since exports will grow even faster as global demand strengthens and competitiveness improves.

2.2 The United Kingdom and the United States should continue to enjoy strong growth and the slowdown in emerging economies should be more severe than expected

The United Kingdom and the United States should still post the highest growth rates among advanced economies in both 2015 and 2016 (see Table 2). This points to a return to normal monetary policy in the medium term. Japan should see a gradual return to growth, as world trade recovers. The emerging economies, following a sharper-than-expected slowdown in 2015, should see slightly stronger growth in 2016.

The United States should see slower growth in 2015, followed by a higher rate in 2016. After being hit by severe winter weather and port strikes at the beginning of the year, growth should pick up again for the rest of 2015. Job creation and falling energy prices have boosted households' purchasing power and should drive consumption and thus growth. Purchasing power should stabilise in 2016, since the price-moderating effect of energy will no longer be a factor. Under the circumstances, private investment and consumption are expected to sustain activity in 2015 and 2016. After slowing down in 2015, as a result of the negative impact of falling oil prices on the oil industry, business investment should pick up again, as domestic demand strengthens. Housing investment should rebound, driven by rising real estate prices. Net exports are expected to be a modest drag on growth, largely as a result of the stronger dollar.

The United Kingdom should post sustained growth again in 2015 and 2016, based on domestic demand and exports boosted by the recovery in global demand. Consumption should remain firm, driven by the improvement in real wages and continuing weak inflation, which boost households' purchasing power. In view of the positive outlook for demand, business spending on capital goods should remain brisk. Net exports, however, should make another negative contribution to growth in 2015. Exports should be driven by stronger global demand, but imports should grow even faster, meaning that the large current account deficit should persist. The "productivity puzzle"[4] (strong employment growth that outstrips output growth) should be resolved over time. Job growth now appears to be slower than output growth, pointing to an improvement in productivity. Nevertheless, the unemployment rate should keep falling, nearing its structural level.

Japan should experience a gradual recovery in 2015 and 2016, as foreign trade picks up again. Exports should be sustained by the recovery in global trade and competitiveness improvements, as companies seem to be more willing to pass on more of the depreciation of the yen in their prices. The energy bill should hold down inflation, with falling oil prices, despite the weaker yen. Nominal wages should continue to rise, with favourable pay settlements and a rebound in corporate profits resulting from the new stimulus plan. All in all, households' purchasing power should rise faster, as inflation recedes, leading to a recovery in private consumption. Business investment should grow as profits increase and domestic and foreign demand pick up.

(4) See Bétry E., Chich M., Ennouchy P., Faure M-E., Gaudy L. (2015), "The productivity puzzle in the United Kingdom," *Trésor Economics* No. 146, April.

In the emerging economies, the decline in growth in 2015, compared to 2014, should be more severe than expected in China, Brazil, Russia and Turkey. India's strong growth, following a major upward revision, should attenuate this economic slowdown somewhat. All these economies should see higher growth in 2016, with the notable exception of China, where the widely expected slowdown should continue, but more sharply than originally foreseen. Despite the rebound, the main emerging economies should still fall far short of their average pre-crisis growth rate. Global factors account for some of the slowdown: the prospect of interest rate hikes in the United States has reversed capital flows and increased exchange rate volatility, and commodity-exporting countries have been weakened by falling prices. But the slowdown also stems from the specific structural features of these countries, such as weaker foreign demand and the diminishing impact of catching up to the advanced economies. This reveals the increasingly pressing problems of the different countries, including difficulty with changing growth models, chronic shortfalls in infrastructure investment for some, acute problems with competitiveness and governance for others.

Table 2: Growth forecasts

GDP (annual average, in %)	Average 2000-2007	2013	2014	2015 (Forecast, adjusted for working-day variations)	2016
Global growth[a]	**4.5**	**3.3**	**3.4**	**3.2**	**3.6**
Advanced economies	**2.7**	**1.1**	**1.8**	**2.0**	**2.4**
United States	2.7	1.5	2.4	2.3	2.8
Japan	1.5	1.6	–0.1	0.6	1.0
United Kingdom	3.0	1.7	3.0	2.6	2.2
Euro area	**2.2**	**–0.4**	**0.8**	**1.5**	**1.8**
Germany	*1.7*	*0.4*	*1.6*	*1.6*	*1.8*
Italy	*1.5*	*–1.7*	*–0.4*	*0.7*	*1.3*
Spain	*3.7*	*–1.2*	*1.4*	*3.1*	*2.9*
Emerging economies	**6.6**	**5.0**	**4.6**	**4.0**	**4.6**
Brazil	*3.6*	*2.7*	*0.1*	*–2.5*	*–0.5*
China	*10.5*	*7.7*	*7.4*	*6.5*	*6.3*
India	*7.1*	*6.9*	*7.3*	*7.3*	*7.4*
Russia	*7.2*	*1.3*	*0.6*	*–3.4*	0.2
Turkey	*5.2*	*4.1*	*2.9*	*3.0*	*3.4*
French export markets[b]		*3.2*	*3.1*	*3.7*	*5.2*
World trade[c]		*3.2*	*3.2*	*2.9*	*5.,2*

a. Global growth is estimated on the basis of IMF forecasts, adjusted for the DG Trésor forecasts for the countries in the table above, along with France, Belgium and the Netherlands.
b. French export markets covers 39 countries (Germany, Belgium, Italy, Spain, United States, United Kingdom, OPEC, Netherlands, China, Switzerland, Japan, Russia, Poland, Turkey, Brazil, Sweden, Korea, Hong Kong, Singapore, Canada, Morocco, Portugal, Austria, Czech Republic, Hungary, Australia, India, Malaysia, Mexico, Thailand, Ireland, Denmark, Greece, Slovakia, Norway, Taiwan, Finland, Philippines and Argentina), which account for 90% of French exports.
c. World trade covers 40 countries (the 39 listed above, plus France), which account for 85% of global exports.

Source: IMF, DG Trésor calculations and forecasts.

Box 2: Main revisions to the scenario compared to the 2015 Stability Programme

Compared to the 2015 Stability Programme, our world growth forecasts have been revised downward by 0.3 point for 2015 and by only 0.1 point for 2016.

The lower growth forecast for 2015 can mainly be explained by a start to the year that was more sluggish than expected. **The recovery was stronger than expected in the euro area (beating the forecast by 0.1 point in 2015), but weaker performance in the United Kingdom, and especially the United States, held back the advanced countries.** For the emerging economies, financial tension and poor results in China, along with a worsening political climate in Brazil and Turkey, took a heavier-than-expected toll on growth. In contrast, the growth forecasts for 2016 is largely unchanged.

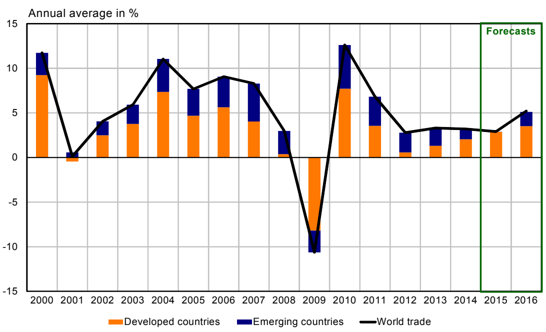
Growth forecasts for world trade were revised downward by 1.6 points in 2015 and 0.4 point in 2016. The major revision of the 2015 growth forecast stems primarily from the emerging economies' imports, which fell far short of our forecasts in the first half of the year, particularly in China and Russia. The revision to the 2016 forecast can be explained by a scenario of slightly slower growth of imports in Europe. **French export markets growth was also revised downward** by 0.8 point in 2015 and by 0.5 point in 2016. The revision for 2015 is smaller than the revision of world trade, since French exports are less reliant on emerging economies than global exports.

3. Demand in countries buying French exports should grow more rapidly, even though world trade growth is expected to slow down in 2015

World trade growth was steady at 3.2% in 2014, but it should slow to 2.9% as the emerging economies see falling growth rates. It should pick up in 2016, on the strength of emerging economies' imports that are more in line with activity growth, following a dip in 2015, and on the strength of faster growth in the advanced countries (see Chart 7 and Box 3).

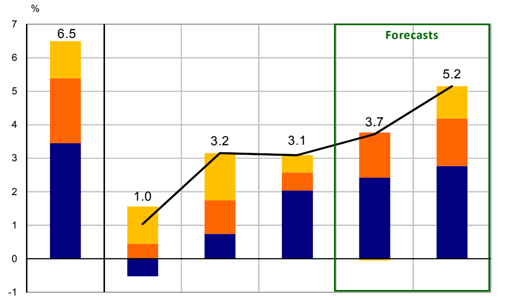
The structure of French exports means that world demand for French goods will be less affected in 2015, but the growth of this demand is not expected to surge either. It is expected to rise from 3.2% in 2014 to 3.7%. It should post a higher rate in 2016 (see Chart 8) as emerging countries' imports pick up again.

Chart 7: World trade



Source: IMF, World Economic Outlook, July 2015; DG Trésor forecasts.

Chart 8: World demand for French goods



Source: DG Trésor.

Box 3: **World trade has registered big swings following the plunge in emerging economies' imports at the beginning of the year**

The slower growth of emerging economies' trade in 2015 should lead to lower growth of world trade. This growth should pick up again in 2016, as China's imports track the growth of its economy more closely, Russia's imports rebound and growth rates recover in other emerging economies. The geographical structure of French exports means that world demand for French goods is less affected by changes in emerging economies' trade and should show higher growth in 2015 and 2016 .

A. Why is world trade growth going to be lower in 2015?

The growth of world trade declined from 3.2% in 2014 to 2.9% in 2015. There are two factors that offset each other: (i) faster growth in the advanced countries, particularly in the euro area, should make a bigger contribution to world trade growth, and (ii) slower trade growth in the emerging economies, whose contribution to world trade growth will diminish so sharply that it is expected to be zero.

The slower growth can be explained by the changes seen in the first half of the year, especially in China and Russia. Chinese imports fell in the first quarter, dampening all trade in Asia, including Japan, since the countries in the region are strongly integrated. At the same time, Russian imports plunged by more than 20% as international sanctions and retaliatory measures took effect. The decline continued in the second quarter, dampening trade in the Eastern and Central European countries. India and Turkey also saw declines in their imports. Despite the expected recovery in the second half of the year, imports in these four countries should shrink in 2015.

B. What factors could lead to much faster world trade growth in 2016?

World trade should grow much more quickly in 2016, at a rate of 5.2%. Faster growth will be the result of a combination of factors.

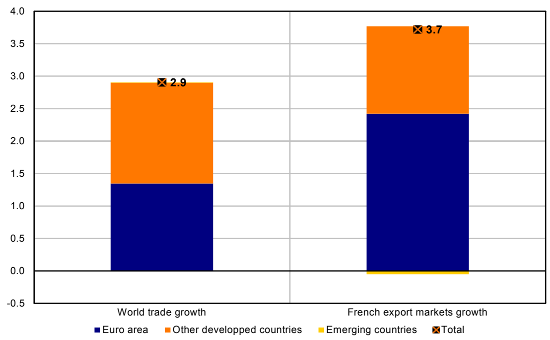
First, the advanced economies should continue to see rising growth rates, especially in the euro area, where imports are expected to increase briskly on the strength of firm domestic demand. Meanwhile, the emerging economies, except China, will see a recovery in their growth. Secondly, imports in China and its Asian neighbours (especially Japan and the Four Tigers) should post higher average annual growth following the poor foreign trade figures for the first quarter of 2015. China's imports should be more in line with its activity growth. The same pattern should apply to Russian imports, despite the extension of European sanctions until the end of January 2016. The stronger growth of world trade expected in 2016 needs to be seen in the context of the poor performance at the beginning of 2015 and the fact that world trade growth will remain below its pre-crisis average.

C. Why does world demand for French goods follow a different pattern than world trade in 2015?

Slower growth of emerging economies should affect French export markets less than it affects world trade. Even though French export markets growth remains relatively slow, it would still increase from 3.1% in 2014 to 3.7% in 2015, and it should match world trade growth in 2016.

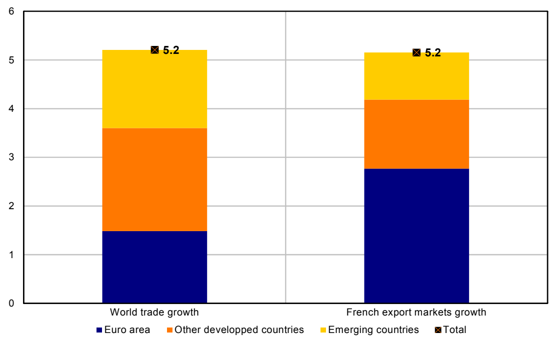
The difference in growth rates stems from the structure of French exports. France's trade within the euro area is massive; nearly half of French exports are bought by countries in the monetary union, whereas these countries account for only about a quarter of world exports. On the other hand, emerging markets account for one third of world trade, versus only 20% or so of France's foreign trade. This means that French export markets have been less affected by the major contraction of emerging countries imports, while benefitting more from stronger domestic demand in the euro-area countries.

Chart 9: World trade growth compared to French export markets growth in 2015



Source: DG Trésor

Chart 10: World trade growth compared to French export markets growth in 2016



Source: DG Trésor.

TRÉSOR DIRECTION GÉNÉRALE

4. Nevertheless, the scenario is still vulnerable to upside and downside risks

- **There is great uncertainty about oil prices.** An exacerbation of the conflict in Yemen and renewed tensions in Ukraine could lead to a sustained increase in oil prices. At the same time, prices could also rise if the next meeting of OPEC in December leads to a change in strategy and a decision to cut production quotas. On the other hand, slower growth of emerging economies, led by China, could drive down oil prices over the period covered by this forecast. There are also several factors that could sustain an abundant supply and prevent a rebalancing of the oil market, such as increasing oil production in Iran in 2016. All in all, falling commodity prices are a major risk for the net exporting countries, with a spillover effect on their trading partners' exports, but they are also a positive shock for the income of net importing countries.
- **Uncertainty still reigns about the scale of the slowdown in China's growth and its repercussions for the global economy.** There is also significant uncertainty about the spillover of Chinese stock market turmoil to other financial centres, the scale and speed of the rebound in international trade for the rest of 2015, and the impact of the depreciation of the yuan on China and its partners. Nevertheless, the Chinese authorities have lots of room for manoeuvre when it comes to stimulating their economy through fiscal and monetary policy if necessary.
- **Uncertainty also surrounds exchange rates.** A bigger slide in the value of the euro could give the euro area economy an added boost and lead to a stronger resurgence of inflation. The ECB has proclaimed that it stands ready to act if needed. On the other hand, a stronger euro would erode the competitiveness gains from past depreciation. Furthermore, a strong shift in capital flows, with the expected interest rate hike in the United States, could cause financial tension in certain countries. In contrast, the potential easing of monetary policy in emerging economies is an upside risk, even though high inflation and the prospect of tighter monetary policy in the United States restrict the room for manoeuvre.
- **The recovery in the euro area could be stronger than expected.** The recent performance of Spain's economy has been a good surprise and Germany can rely on its sound fundamentals. In the same vein, the deal that Greece and its creditors reached in August has reduced uncertainty and contributed to greater financial stability in the euro area.

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