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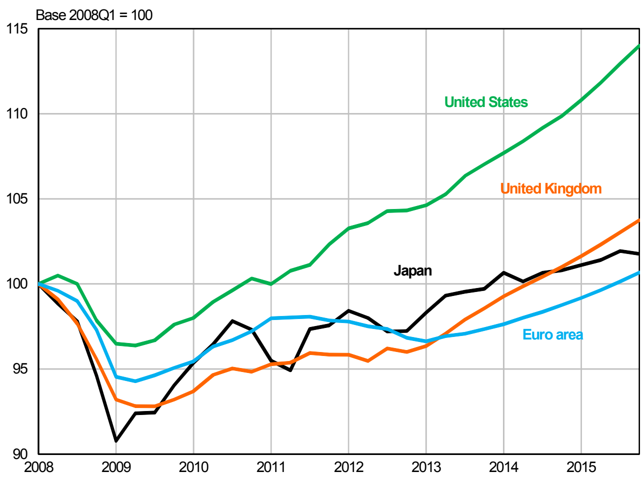
The global economy in the spring of 2014: stronger growth, but new risks

- In 2013 global economic growth gradually picked up, but divergences between major economic zones persisted. The growth differential between advanced countries was still stark, with the Anglo-Saxon countries and Japan on one side, and the euro area countries on the other. Growth remained fairly firm in the United States and recovered substantially in the United Kingdom and Japan, on the strength of an accommodative policy mix. Meanwhile, the euro area emerged from one and a half years of recession in the second quarter with a modest recovery that was unequally shared by the different countries, meaning that the euro area failed to post a positive growth figure for the year. This growth gap stems largely from past divergences, such as the overall less accommodative policy mix in the euro area since 2008 and strains on sovereign debt that have been specific to the euro area since 2010. Finally, the growth of emerging economies continued to slow as they were affected by exchange rate fluctuations, capital outflows following the Fed's tapering announcement and their own structural challenges.
- At the start of 2014, the earliest available economic indicators pointed to continued global economic growth. Global growth should become firmer in 2014 and 2015, however local growth rates will continue to vary. In the euro area, the recovery that started in 2013 should gain strength and post growth of 1.2% in 2014 and 1.8% in 2015, with the easing of financial tension and less intensive fiscal consolidation. However, growth will still be moderate, featuring persistent wide disparities between Germany, where growth will pick up, and Italy and Spain, which are just emerging from two further years of recession. Growth rates outside the euro area will differ. The Anglo-Saxon countries will continue to enjoy strong economic growth, but Japan's growth will slow as fiscal policy is tightened up. Finally, the growth of emerging economies should continue to be fairly strong, but it will be lower in the longer run than it was before the crisis, particularly in China, Brazil and Russia.
- Consequently, the growth of world trade should pick up again, reaching 4.7% in 2014 and 6.1% in 2015. However, it will not match the average growth rate seen between 2000 and 2008. This rebound will boost demand for French exports, particularly the renewed growth in the euro area, which is France's leading trading partner.
- This scenario of a gradual improvement in the global economic situation, driven by the developed countries, still faces major risks. In the euro area, as the ECB conducts a comprehensive assessment of bank balance sheets in 2014, the strength of the recovery could exceed expectations if uncertainty is dissipated, but renewed financial tension cannot be ruled out if the assessment goes the other way. The risk of deflation, which is still present in Japan and could threaten certain countries in the euro area, needs to be monitored and underlines the fragility of the current recovery. Finally, the return to more standard monetary policy in the United States is still likely to cause turmoil, not so much in the United States itself as in the emerging countries that are most vulnerable to external shocks.

GDP growth in the leading global economies



Sources: National data, DG Trésor forecasts.

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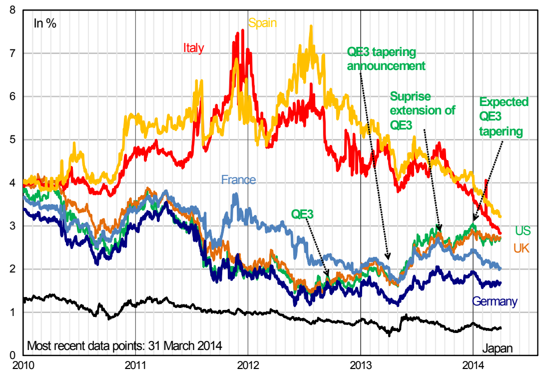
1. Growth gathered strength in the advanced economies at the end of 2013, while emerging economies continued to slow down

1.1 Financial conditions in advanced economies return to normal…

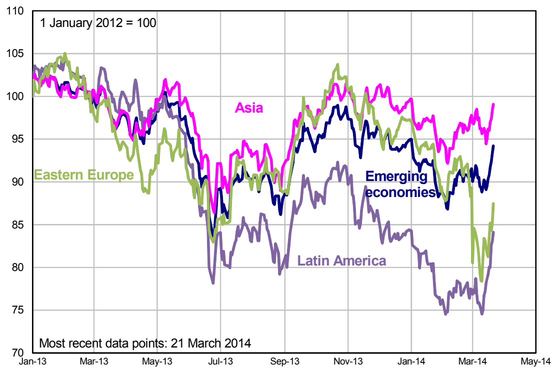
Financial condition gradually returned to normal in the advanced economies during the second half of 2013 (see Chart 1). Sovereign spreads narrowed in the euro area, following determined action by the Member States and by the European Central Bank to stabilise vulnerable countries, defer fiscal targets, advance banking union and ease monetary policy. This extended the improvement seen starting in the third quarter of 2012, in part because of the ECB's announcement of its OMT programme. At the end of 2013, spreads had returned to a level very close to the one seen in January 2011. At the same time, sovereign yields in the Anglo-Saxon countries, which had been very low because of their risk-free status and continuing securities purchases by central banks, started to rise to levels more consistent with economic fundamentals. The Fed's announcement in the third quarter of 2013 about tapering its securities purchases (QE3) led to a resurgence of tension on financial markets in the advanced economies. This tension turned out to be modest and short-lived, and did not reoccur when the amount of the Fed's purchases was cut in January and again in February 2014. On the other hand, the Fed's announcements led to asset reallocations that had a major impact on the emerging economies starting in January 2014 (see Chart 2).

Chart 1: Sovereign yields around the world



Source: IHS Global Insight.

Chart 2: MSCI Emerging Markets Index



Source: Morgan Stanley.

1.2 … underpinning stronger growth, but disrupting activity in emerging economies

The recovery continued in developed countries in the second half of 2013, but at this stage, it is stronger in the Anglo-Saxon countries than elsewhere (see Table 1). This growth differential stems largely from past divergences, such as the less accommodative overall policy mix in the euro area since 2008 and strains on sovereign debt that have been specific to the euro area since 2010. Furthermore, the recovery is still vulnerable, with persistently high unemployment levels and very low inflation in most of the advanced economies, particularly in the euro area (see Box 1).

The recession in the euro area ended in the second quarter of 2013 and all of the leading countries in the euro area are now posting positive growth. Growth in the euro area picked up in the fourth quarter, after remaining flat in the third quarter. The pattern was the same in France, where domestic demand got a boost from investment, and in Germany, where soft domestic demand was offset by strong export growth. In Spain, Belgium, Portugal and the Netherlands, the pace of growth increased steadily throughout the second half of the year. Finally, In Italy, the economy posted positive growth in the fourth quarter for the first time since the second quarter of 2011. On the other hand, the Greek economy fared very poorly, shrinking by 2.6%, following a year-on-year contraction of 3%, with no seasonal adjustment. Despite these favourable developments, the growth rate for 2013 was still negative for the euro area as a whole, standing at –0.4%, compared to –0.7% in 2012. There were major disparities between countries, with France, Belgium and Germany posting positive growth, while Spain, Italy, Portugal and the Netherlands saw their economies contract for the second year in a row.

Outside the euro area, the advanced economies posted sustained growth. The United States and the United Kingdom enjoyed strong growth in the second half of the year, driven by vigorous household consumption. Growth was especially resilient in these countries in 2013. The United States economy grew by 1.9%, despite the tax shock, as did the economy of the United Kingdom. However, British GDP has yet to return to its pre-crisis level. In Japan, Economic growth has slowed down since the third quarter as the positive confidence shock following the introduction of Abenomics wears off. Nevertheless, the growth rate for 2013 was sustained at 1.5%.

Finally, the growth of the emerging economies continued to slow down. Emerging economies were affected by exchange rate fluctuations and tighter monetary conditions following the Fed's tapering announcement (see Box 3). While slower year-on-year growth rates were less noticeable at the end of the year in China (7.7% in the fourth quarter, compared to 7.8% in the third quarter), in Russia (2.0% in the fourth quarter) and in India (4.7% in the fourth quarter, compared to 4.8% in the third quarter), year-on-year growth rates were disappointing in Brazil (1.9% in the fourth quarter) and in South Africa (2.0% in the fourth quarter).

Table 1: Quarterly growth of real GDP (seasonally and working-day adjusted, in%)

	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2012	2013*
United States	0.3	0.6	1.0	0.7	*2.8*	*1.9*
Japan	1.1	1.0	0.2	0.2	*1.4*	*1.6*
United Kingdom	0.4	0.8	0.8	0.7	*0.3*	*1.7*
Euro area	**–0.2**	**0.3**	**0.1**	**0.3**	***–0.7***	***–0.4***
Germany	0.0	0.7	0.3	0.4	*0.9*	*0.5*
France	**0.0**	**0.6**	**–0.1**	**0.3**	***0.0***	***0.3***
Italy	–0.6	–0.3	–0.1	0.1	*–2.4*	*–1.9*
Spain	–0.3	–0.1	0.1	0.2	*–1.6*	*–1.2*
Belgium	0.0	0.2	0.3	0.5	*–0.1*	*0.2*
Netherlands	–0.3	0.1	0.3	0.9	*–1.2*	*–0.8*
Portugal	–0.3	1.1	0.3	0.6	*–3.2*	*–1.4*
South Africa**	1.6	2.3	1.7	2.0	*2.5*	*1.9*
Brazil**	1.8	3.3	2.2	1.9	*1.0*	*2.3*
China**	7.7	7.5	7.8	7.7	*7.7*	*7.7*
India***	4.8	4.4	4.8	4.7	*3.2*	*4.4*
Russia**	0.8	1.0	1.3	2.0	*3.4*	*1.3*
Turkey**	2.9	4.5	4.3	4.4	*2.2*	4.0

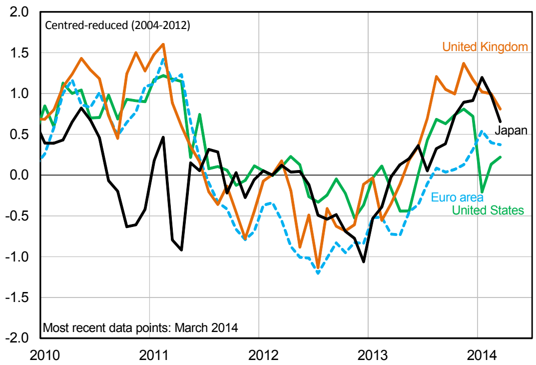
* Estimated following publication of 2013Q4 growth, except for India (forecast).
** For these countries, year-on-year data not adjusted for seasonal variations or working days.
*** These year-on-year data relate to the fiscal year (April 2013 to March 2014).

Sources : DataInsight and Eurostat; slight discrepancies with the annual accounts are possible because of the working day adjustment.

1.3 At the start of 2014, the economic outlook points to a continuation of the trends seen at the end of 2013

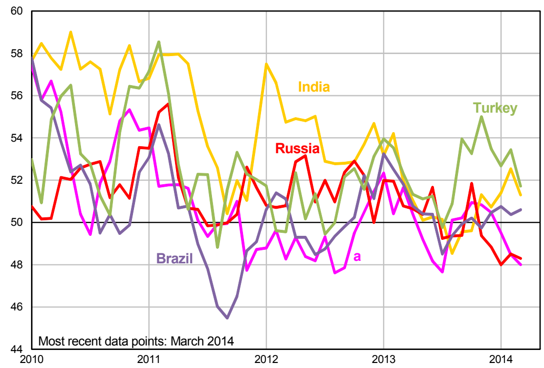
Economic indicators available at the start of 2014 point to continuing growth in the leading advanced economies, but possibly at a lower rate. This is what surveys of manufacturing purchasing managers indicate. Even though they mostly cover areas enjoying growth, the Purchasing Managers Index (PMI) surveys show a dip (see Chart 3). This dip appears to be modest in the euro area, but it is noticeable in its leading economies. In Germany in particular, the outlooks from the national surveys of entrepreneurs (IFO) and financial analysts (ZEW) show a dip. In the United States, the dip in business surveys is more pronounced, but most of it can be attributed to a particularly harsh winter that dampened activity at the end of 2013 and the start of 2014. On the other hand, the slower growth of emerging economies should continue, as shown by the January PMIs, which were down in the BRIC countries (except India) and in Turkey.

Chart 3: Manufacturing PMI surveys in the advanced economies



Source: ISM, Markit.

Chart 4: Manufacturing PMI surveys in the emerging economies



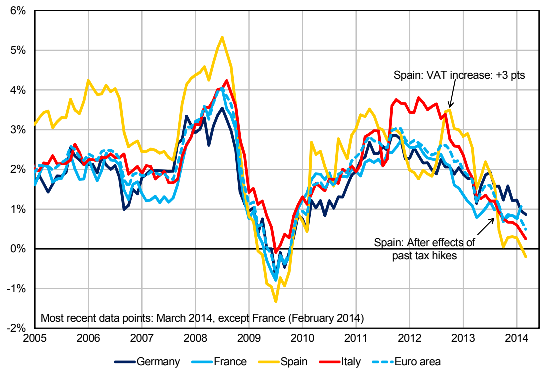
Source: Markit.

Box 1: **Lower euro area inflation**

The disinflation seen in the euro area since the third quarter of 2012 stems largely from lower commodity prices and the strengthening of the euro. However, stripping out the volatile price index components, inflation is still low because of a persistent demand deficit.

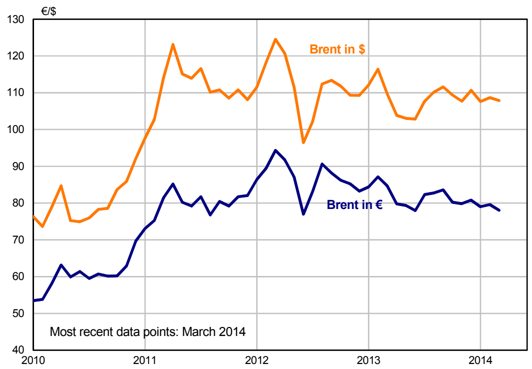
Inflation has fallen off sharply in the euro area since the third quarter of 2012 (see Chart 5). Between August 2012 and March 2014, inflation in the euro area (HICP) dropped by some two points to 0.5%, its lowest point since November 2009. Over the same period, energy inflation and imported inflation excluding energy both dropped significantly because of the stronger euro and lower industrial commodity prices (see Chart 6). Some temporary domestic factors added to the impact of these external factors in the second half of 2013. For example, the drop in Spain's inflation rate stems in part from strongly negative base effects between July and October 2013 as an after-effect of the VAT hike on 1 September 2012 and changes in prices set by the administration, such as university tuition fees.

Chart 5: Total euro area inflation by country - year-on-year change in the HICP in %



Source: Eurostat.

Chart 6: Oil prices (Brent spot) in € and in $



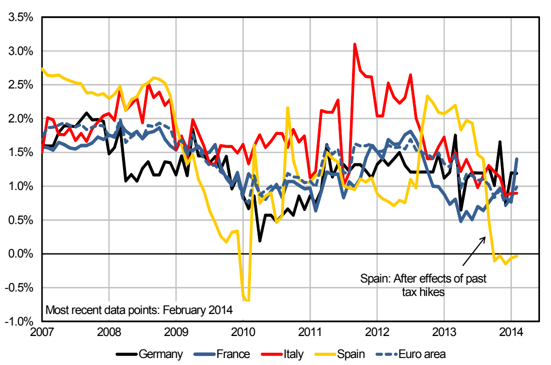
Source: IHS Global Insight.

Domestic inflationary pressures remained very weak in the context of a modest recovery. This can be attributed to low capacity utilization rates and persistently high unemployment rates. Even though cyclical factors seem to have less impact on inflation[a], the underlying inflation rates are still consistent on the whole with where economies are in the business cycle (see Chart 7). Even though inflation is down everywhere in the euro area, **inflation rates still vary widely within the zone** (see Chart 8). Total inflation is negative or near zero in countries that still have large demand deficits, such as Spain, while inflation in northern countries is higher, but nowhere more than 2%.

Nevertheless, deflation risk seems low as growth gradually resumes.

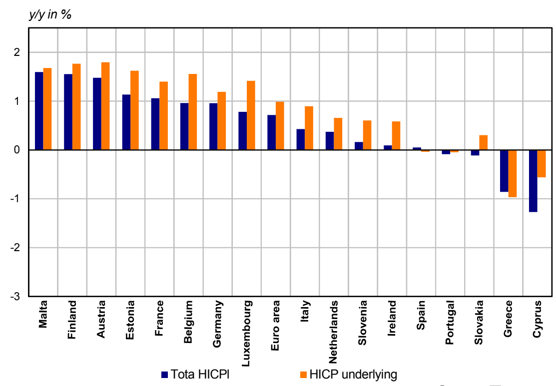
The risk of deflation seems small in the euro area in aggregate, but it cannot be ruled out in countries where the economy is still vulnerable. If our gradual recovery scenario plays out, inflation should remain low, as purchasing power is weakened by sluggish wage growth, which is a corollary of the persistence of historically high unemployment at a rate of about 12%. However, the risk of deflation, defined as a general and lasting drop in prices that impacts economic agents' expectations, seems low. Yet, there is still some risk in certain countries in the south of the euro area. More specifically, Greece and Cyprus have negative inflation rates, while in other Member States, such as Spain, Ireland, Portugal and Slovakia, the inflation rate is near zero.

Chart 7: Underlying euro area inflation by country - year-on-year change in the underlying HICP in %



Source: Eurostat.

Chart 8: Inflation by country in the euro area in February 2014



Source: Eurostat.

a. See for example: IMF (2013) "The Dog That Didn't Bark: Has Inflation Been Muzzled or Was It Just Sleeping?", World Economic Outlook, April, Chapter 3.

2. Global growth will gather strength in 2014 and 2015, especially in the euro area, which will leave the recession behind, but disparate growth rates will persist between the major economic zones

The expected rebound in global growth, driven by the developed economies, with the Anglo-Saxon countries at the forefront, will be underpinned by an easing of fiscal efforts and the continuation of accommodative monetary policy (see Box 2). Against the backdrop of easing financial tensions that have helped reduce uncertainty, the private sector engines of growth could take back their full role. Yet, the different economic zones should continue to post varying growth rates (see Table 2) as a result of persistent structural impediments in some countries stemming from the level of financing for the economy, progress on debt reduction and the recovery of real-estate markets.

Box 2: **Central banks in the spotlight**

The leading central banks should continue to apply accommodative monetary policies overall, but their policies will diverge gradually.

In the United States, stronger growth and a rapid drop in unemployment led the Fed to start adjusting its monetary policy. The tapering of its asset purchases announced in December was accentuated in January and March. The Fed is now buying USD 55 billion in assets per month, compared to USD 85 billion previously. At this pace, the central bank's balance sheet should stabilise at the end of the year. However, the Fed offset this announcement with enhanced forward guidance to underpin expectations of Fed funds rates remaining at their floor level for a long time after the securities purchases programme ends. **The Bank of England has made only minor changes to its policy since last August,** maintaining its stock of assets at GBP 375 billion and its policy rate at 0.5%, while trimming its program to support the property market. The Bank of England, like the Fed, adjusted its forward guidance in the February Inflation Report to convince financial markets that it is not about to raise its interest rates, despite the clear improvement in the economy in the second half of 2013 and, more particularly, the drop in the unemployment rate.

The European Central Bank (ECB) has not implemented an asset-purchasing programme like those of the other leading central banks. It is expected to maintain its monetary policy stance, aiming for policy rates that are very close to zero, combined with forward guidance and unlimited refinancing operations. It could even reinforce its stance with further measures. The Bank of Japan (BoJ) is also expected to continue its policy of Quantitative and Qualitative Monetary Easing (QQME) announced on 4 April 2014, which is aimed at doubling the monetary base in two years to achieve and maintain a 2% inflation rate.

Under the circumstances, short-term rates are bound to remain low but they will diverge slightly towards the end of the forecast period

Long-term sovereign yields should continue to converge in the euro area as financial tensions ease, whereas the divergence recently seen between the Anglo-Saxon countries and the core euro area countries should remain because of their diverging growth paths.

The announced tapering has not yet led to a big jump in sovereign yields, but as tapering intensifies and the date for the first hike in policy rates approaches, long-term American rates could overreact. Even though this is not the most likely scenario, it does constitute a downside risk for growth into 2015. It is primarily a risk for the American economy. Even though the recovery may be strong overall, certain segments of the banking and financial markets are particularly vulnerable to an increase in sovereign yields. Furthermore, the real estate market is improving, but it is still fragile and sensitive to changes in mortgage rates. The health of this market determines growth in the construction sector, as well as the growth of household consumption and investment. Finally, a sudden jump in American long-term interest rates, which is unlikely at this point, would have a major contagion effect on other sovereign yields, exchange rates and capital flows more generally. The potential impact could destabilise certain economies, particularly in the emerging countries.

2.1 The recovery in the euro area that started in 2013 should gather strength and boost growth

Economic growth in the euro area should accelerate over the next two years, but major disparities are likely to persist within the zone. The easing of fiscal efforts in the southern countries of the euro area should help the recovery, as financial fragmentation is reduced and uncertainties are allayed within the zone. However, the recovery will be fragile. Sluggish wage growth will weaken purchasing power, which is a corollary to persistent historically high unemployment, standing at about 12%.

Germany's economy should grow faster in 2014 and 2015, driven by domestic demand. Germany's economy should become more balanced over the next two years. The easing of uncertainties in the euro area will enable German companies to use their comfortable financial situation for a full resumption of their capital expenditure. Household consumption should be sustained by an increase in purchasing power, stemming from strong wage growth against a backdrop of low unemployment. Strong domestic demand should boost imports, leading to a slightly negative contribution to growth from foreign trade.

Italy's recovery should continue, but it will remain weak, particularly in 2014. The unemployment rate is not expected to ease until the end of 2014 and household purchasing power should remain weak, despite the support measures that the Renzi government has announced. Therefore, private consumption is bound to remain depressed. Financing terms for businesses should improve, but they will still be unfavourable, and business investment should have a hard time taking off again. The sole source of growth for the Italian economy should be foreign trade, as strong export growth is sustained by the rebound in global demand. In 2015, the growth rate should rise and domestic demand should gradually play a larger role.

The Spanish economy should see a modest recovery in 2014 and stronger growth in 2015. Fiscal efforts should ease and be less of a drain on the economy. More specifically, households should no longer be affected and see their purchasing power increase, as unemployment continues the downward trend seen at the end of 2013 and inflation remains moderate. Financing conditions for Spanish businesses should improve and their stronger financial situation should mean their capital expenditure takes off again. Foreign trade should continue to sustain growth with strong export performances.

2.2 The rest of the world should see more contrasted developments

The economies of the Anglo-Saxon countries should continue to enjoy strong growth, as a return to standard monetary policy underpins the recovery without impeding it. On the other hand, Japan's growth should slow as its fiscal policy becomes tighter. Finally, the growth of emerging economies should continue to be fairly strong, but the future trend should show weaker growth in the long run.

In the United States, growth should continue to gather strength, unimpeded by a return to more standard monetary policy. The American growth model should rely primarily on the strength of the private sector, led by households, as their consumption rises and their debt levels gradually increase again. Companies have improved their financial situation substantially since the crisis. This should lead to an increase in their capital expenditure, as the outlook for demand improves and uncertainty fades, particularly with regard to the policy mix. Residential investment should also continue to increase, driven by real estate price trends and population pressure.

Growth should also pick up in the United Kingdom. It should be driven by private consumption, with a strong labour market and low inflation. Several government measures to support the real estate market should also help boost growth. Furthermore, for the first time since 2010, investment should contribute to growth as the prospects for domestic and export demand improve. But considerable fiscal consolidation efforts that focus mainly on cutting public expenditure should continue to depress growth. Overall, the British economy should see a relatively strong recovery, even though there could be questions about it sustainability, when several supporting factors continue to surprise, such as a strong performance of the labour market, or are potentially fragile, such as the real estate market.

Japan's growth should remain relatively strong, but with ups and downs stemming from the VAT increases slated for the second quarter of 2014 and the fourth quarter of 2015. Japan's policy mix should produce a partial success, but it could gradually run out of steam as fiscal policy is tightened. This leaves the question of how inflation, including imported inflation, will be transmitted to wages, enabling households to preserve their purchasing power and consumption levels. This will also sustain inflation through the wage-price spiral and constitute a risk under this scenario.

In emerging economies, growth could be slightly stronger in 2014, particularly in India and Brazil, although it will be much slower than the average rates seen in the first decade of the new millennium. Some of this slower growth seems to be structural, as emerging economies catch up to the advanced economies and their market shares stabilise, and it reflects long-term economic issues (changing growth models, inflation, infrastructure investment deficits, competitiveness and governance). Each emerging economy also faces its own specific challenges, such as India's twin deficits, China's ageing population and the rebalancing of its growth model in favour of consumption, social unrest and weak investment in Brazil and diversification of Russia's economy.

Table 2: Growth forecasts

GDP (annual average, %)	2011	2012	2013*	2014	2015
	(not adjusted for working days)		*(forecast, adjusted for working days)*		
Global growth	**4.0**	**3.1**	**2.9**	**3.7**	**4.0**
Advanced economies	**1.8**	**1.4**	**1.3**	**2.3**	**2.5**
United States	1.8	2.8	1.9	2.9	3.3
Japan	–0.4	1.4	1.6	1.4	1.0
United Kingdom	1.1	0.3	1.7	2.7	2.5
Euro area	1.7	–0.7	–0.4	1.2	1.7
Germany	*3.3*	*0.7*	*0.5*	*1.8*	*2.1*
Italy	*0.4*	*–2.4*	*–1.9*	*0.6*	*1.2*
Spain	*0.1*	*–1.6*	*–1.2*	*1.0*	*1.6*
Emerging economies	**6.2**	**4.9**	**4.6**	**5.0**	**5.4**
Brazl	*2.7*	*1.0*	*2.3*	*2.3*	*2.8*
China	*9.3*	*7.7*	*7.7*	*7.5*	*7.3*
*India***	*6.3*	*3.2*	*4.4*	*5.4*	*6.4*
Russia	*4.3*	*3.4*	*1.3*	*2.0*	*2.5*
Turkey	*8.8*	*2.2*	*4.0*	*2.2*	*3.6*
World trade	*6.1*	*2.7*	*2.6*	*4.7*	*6.1*
Demande for Frech exports	*5.8*	*0.9*	*1.8*	*4.8*	*6.5*

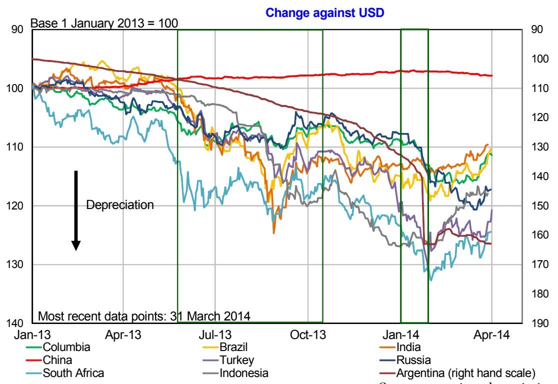
* Estimated following the publication of 2013Q4 GDP.
** CData for the fiscal year (March 2013 - April 2014).

Box 3: Tighter monetary policy and persistently acute financial tensions should continue to weigh on the growth of the emerging economies

Several major emerging economies had to cope with severe financial turmoil in the second and third quarters of 2013. Their currencies slid against the dollar and the euro. The hardest hit currencies were those of India, which lost 26% of its value against the dollar between early May and the end of August 2013, Brazil (–16%), Indonesia (–13%), Turkey (–13%) and South Africa (–15%). The timing of these movements should be compared to that of the Fed announcements, particularly B. Bernanke's announcement on 22 May 2013 of possible tapering of the Fed's securities purchasing programme (Quantitative Easing). Yet, the most severely affected countries were those that had shown the greatest vulnerability, with large current account deficits, high inflation and sharply slower growth.

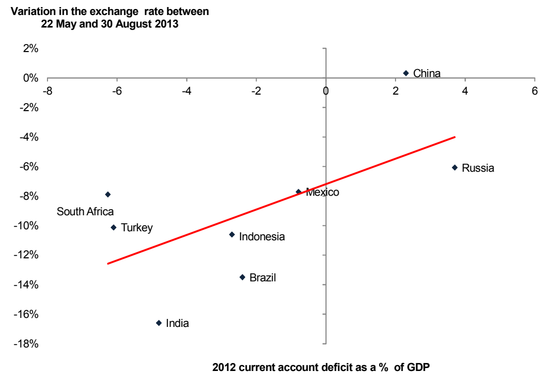
After a brief calm spell at the end of last year, tensions re-emerged at the start of 2014. As international financial tensions persist, with tighter financing terms and slower growth in the emerging economies, markets have strong reactions to any bad news coming from the emerging economies. Some of the economies most severely affected by renewed tensions are Argentina, which saw its currency slide by 16% against the dollar in January, and the Ukraine (–15% in February). These countries suffered from capital flight and dwindling foreign exchange reserves in 2013 and were forced to devalue their currencies. The Turkish pound slid by 6.5% in January in the wake of a political and economic scandal that rocked the country starting in mid-December. Finally, Russia ended its programme of automatic intervention on foreign exchange markets, after seeing its currency slide by 7% in January, against a background of more flexible exchange rates and inflation targeting by the central bank announced back in 2009.

Chart 9: deprecation of the main emerging countries' currencies...



Sources: national statistics.

Chart 10: ... in highly vulnerable countries

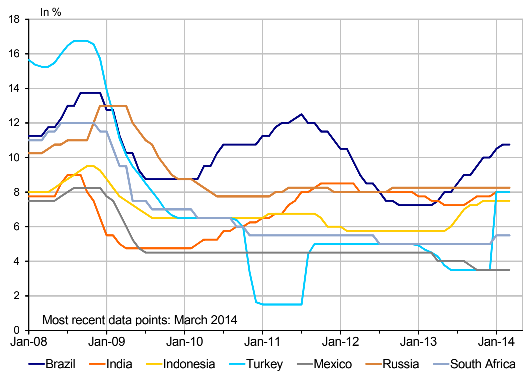


Source: DataInsight.

Several emerging economies tightened up their monetary policies in 2013 to cope with pressures on their currencies, with a fresh round of tightening at the start of 2014. Following an extraordinary meeting of its monetary policy committee, Turkey' central bank raised its three main policy rates by nearly 500 basis points in a single increment. Brazil's central bank has raised its rates by 350 basis points since the second quarter of 2013 and Indonesia's central bank raised its rates by 175 basis points. The central banks of India and South Africa make more moderate increases of 75 basis points and 50 basis points respectively. In Russia, the central bank responded to the depreciation of the rouble stemming from tension in the Ukraine by raising its policy rate by 150 basis points at the beginning of March.

The aim of these monetary policy decisions is to curb capital outflows and the inflationary impact of downwards pressure on exchange rates, but they are also likely to further depress the already disappointing economic growth rates in several countries. Higher interest rates are bound to lead to slower lending growth, particularly in Russia, Turkey and Indonesia, and as has already been seen in Brazil. This will mean more sluggish domestic demand and, more specifically, softer consumption. The impact on growth will be even stronger, since private consumption was the main driver of growth in emerging economies in 2013.

Chart 11: Rising central bank rates in the emerging economies

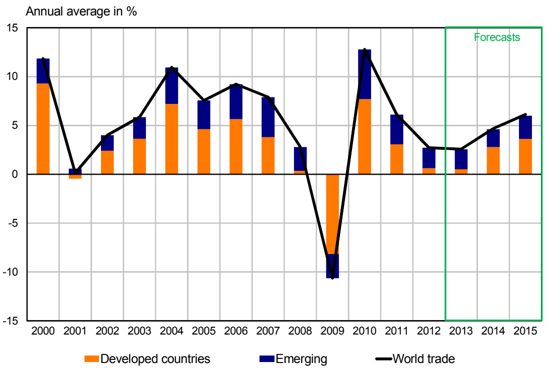


Source: DataInsight.

3. Consequently, world trade should rebound from its recent doldrums, along with demand in France's export markets

Against the background of modest global economic growth, world trade posted a moderate gain of 2.8% in 2013. However, it picked up at the end of the year and is expected to gather strength in the coming years as global economic growth accelerates, driven by the developed countries (see Chart 12). Towards 2015, world trade should grow at a rate of 6.1%, which is a much higher rate than in 2012 and 2013 and comparable to its historical average of 6 ¼% over the period from 1982 to 2007.

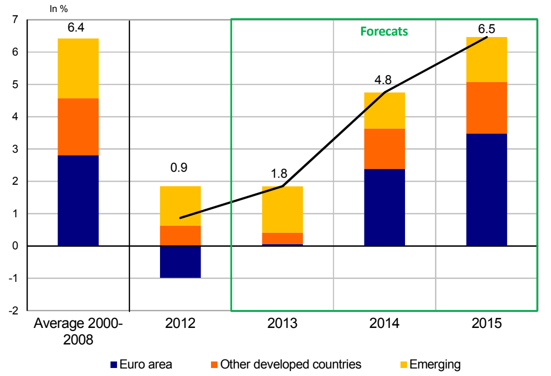
Chart 12: World trade (growth and contributions by zone, %)



Sources: IMF, World Economic Outlook, October 2013, DG Trésor forecasts.

Demand for French exports should show a similar pattern, growing by 4.8% in 2014 and by 6.5% in 2015. It should return to the average growth rate seen between 2000 and 2008 (See Chart 13). Most of the improvement will stem from the stronger economies of France's European trading partners, which account for more than half of its foreign trade.

Chart 13: Demand for French exports (growth and contributions by zone, %))



Source: DG Trésor.

4. There are still many risks surrounding this scenario of gradual and moderate improvement in the global economy driven by the developed countries

There are various downside risks. In the euro area, the primary downside risk is a resurgence of financial tension, for example, stemming from the comprehensive assessment of bank balance sheets by the ECB or recent geopolitical tensions. The risk of deflation, in the full meaning of the term, where falling prices disanchor expectations, is unlikely to be a problem for the euro area as a whole, but it should be monitored in the case of certain major countries, such as Spain. One of the downside risks outside of the euro area is a return to more standard monetary policy in the United States, which could disrupt the recovery of real estate markets and stock markets and increase the instability of emerging economies. Some of the factors driving growth in United Kingdom are still fragile, such as the real estate market, which is underpinned by government measures, and the surprisingly strong labour market. These factors constitute an additional source of uncertainty. The situation in Japan hinges on the success of Prime Minister Abe's policy mix, as VAT increases should start affecting growth. Finally, some of the emerging economies are particularly dependent on export demand from the advanced economies and commodity prices, as in the case of Russia and Brazil. Furthermore, renewed financial tensions linked to the external vulnerability of such countries as Ukraine, Argentina, Turkey, South Africa, Brazil, India, and Indonesia cannot be ruled out. Political tension could undermine investors' confidence and further weaken economies that are already slowing down.

But, **the recovery could be more rapid than expected if the uncertainties holding back global growth are eliminated**, especially in the euro area and the emerging countries, where output gaps are still wide, pointing to more room for growth to rebound if the outlook brightens.

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