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ECONOMIC RESEARCH DEPARTMENT

Eco PERSPECTIVES

Editorial

Stronger momentum

Economic indicators are picking up in most of the developed countries. Eurozone growth is more robust, at an annualised rate of nearly 2% in first-quarter 2017. The rebound is also better distributed, as the economic cycles of the 19 eurozone member countries are tending to move more in sync. The United States reported an upturn in oil and shale gas- related activities, and corporate investment in this sector probably rebounded at the beginning of the year. Inflation rebounds, approaching or overshooting the official 2% target. The central banks keep calm, however.

Eurozone cyclical data have been rather satisfactory in recent months. The purchasing managers index (PMI) averaged more than 55 points in January-March, which is compatible with economic expansion of 2% a year, or even higher. Moreover, the member countries are no longer split by widely contrasting performances, and there is even a certain degree of convergence, for the first time since the creation of the Economic and Monetary Union (EMU). Germany is no longer the economy's sole growth engine: Italy and Spain also contributed to the first-quarter rally. In France, the survey data in our Nowcast index coincides with GDP trends, signalling stronger growth.

Domestic - especially household - demand is the main support factor for European growth. Private consumption hasn't faltered despite rising energy bills, which can be explained by falling unemployment (less of a concern in European Commission surveys) and stronger lending activities. Here too, the improvements are widespread. In Spain, for example, which has long been insensitive to the improvement in Eurozone financing conditions, consumer loans have surged by 4% a year. As a result, it is gradually closing the demand shortfall.

Corporate investment is following the accelerator principle: bolstered by a flurry of new orders at the beginning of the year, investment should be more dynamic. This is also suggested by the upturn in capacity utilisation rates in industry.

In the United States, we can see the same trends, which are not only relying on a "Trump" effect. Based on the key ISM index, and the new orders component in particular, US companies also stepped up expenditure on capital goods in the first quarter. Yet they were not responding to an increase in private consumption (automobile sales are slowing), but rather to foreign demand. In the emerging countries, import volumes have be rising strongly in recent months, driven in part by China, which has returned to an expansionist policy. Looking beyond textbook gearing effects, this has triggered an upturn in oil prices, which is beneficial for the US. With crude oil prices currently at about USD 50 a barrel, US production of oil and shale gas has become profitable again, especially since breakeven points have fallen. Production and the number of wells have both increased strongly since the beginning of the year.

In the unconventional energy sector, given its heavy accumulation of debt, the rebound in prospects has squeezed corporate spreads (the yield spread with regard to government bonds), creating an additional support factor for investment.

Inflation rebounds… slightly. In the eurozone, it is approaching the central bank's 2% target (+1.8% year-on-year in Q1), while in the US, it has overshot the Fed's target (+2.5% year-on-year for the same period). For the most part, this movement is due to higher oil prices, and has not affected the core component of the price index (excluding energy and food). This is especially true in the eurozone, where core inflation has barely reached 1% and shows no signs of accelerating. For industrial goods, prices have been virtually flat, while service prices have held to the same sluggish slope of 1% for the past three years. This inertia brings to mind the sluggish pace of wage growth which, except in Germany, has held close to productivity gains and has progressed very little. As a result, unit labour costs are not exerting any pricing pressure, a reflection of the persistently high level of unemployment (9.5% in February).

Although unemployment is declining, it is still higher than the pre-2008 average and the equilibrium unemployment rate calculated by the OECD, which means it is still fluctuating in the non-accelerating inflation zone (see eurozone article on page 6). The situation is different in the United States, where the unemployment rate has fallen below 5% and unit labour costs are rising about three times faster than in the eurozone.

This dichotomy explains the divergence in monetary policies. The European Central Bank (ECB) gives little credit to price movements at the beginning of the year, considering that "underlying inflationary pressures remain very subdued".

This is clearly the case today. After setting its key rate at zero in March 2016, the ECB has little reason to raise it. We expect no change in the key rate, not only in 2017, but also in all or part of 2018. The central bank will continue its securities purchases at a monthly rate of EUR 60 billion net from April to December 2017, before scaling back the programme in 2018.

The US Federal Reserve, in contrast, has finished with quantitative easing, and since December 2015 it has been moving away from the zero lower bound. Lifted to 0.75-1% in March 2017, the Fed funds target rate is still lower than core inflation. In the end, it is comparable in real terms to the ECB's refinancing rate. Thus the normalisation of US monetary policy is bound to continue. We expect the Fed to make two or three additional key rate cuts in 2017, which would bring it within a range of 1.50% to 1.75% in December.

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United States

From one U-turn to the other

It seems increasingly clear that there will be no fiscal stimulus, at least not in 2017. Attention is now focused on intrinsic economic trends. Survey results and production statistics are looking rather upbeat, but household consumption is slowing. In March, employment slowed sharply. Although it is too early for this to be a real source of concern, when taken in conjunction with inflation, which is no longer accelerating, it could provide the Fed with reasons for a break in the normalisation process. Yet there is no doubt that the Fed will seize every possible opportunity to move away from the ZLB. If prices and employment were to regain some strength in June, then the Fed could increase rates again, with hopes for a third one by the end of the year.

The fiscal stimulus that many were certain would follow Donald Trump's election is looking increasingly like an empty promise. The president still has not published his recommendations for budget revenues for the next fiscal year: only his spending proposals are available. As we expected, there is no trace of an infrastructure investment plan. As to taxation, Mr. Trump seems to have become disinterested…

Fiscal policy

The financial markets have been exuberant over Donald Trump's election. This shows their faith in the promises of a fiscal stimulus – a mix of tax cuts and spending increases – that would boost the economy and widen the deficit, the perfect formula for increasing inflationary pressures, and that could only lead the Fed to adopt a more restrictive monetary policy. This has kept interest rates under pressure. Yet President Trump's first 100 days in office paint a very different picture.

In the United States, the budget process is particularly long and complex. To sum up, the president and the two chambers of Congress each make budget proposals, and then work to reconcile their differences. But the process does not stop there. Congress must then vote on appropriations bills to finance the Federal government. These bills do not always cover the entire fiscal year, and sometimes Congress must vote on short-term or very short-term stop-gap resolutions to keep the government running, as was the case in spring 2011. Congress must also authorise the Federal government to take on more debt, or to be more precise, to raise the debt ceiling, as it does more or less regularly, often to great trepidation as in summer 2011.

As we can see, it is Congress that holds the purse strings and that has real fiscal power. The president's proposals are just that: recommendations. With the same party dominating both chambers of Congress and the Presidency, it is easy to imagine that their points of view will converge. Yet the recent episode in the House of Representatives, which failed to vote on a text to repeal and replace the Affordable Care Act, better known as Obamacare, is a clear reminder of the limitations of presidential power in the US.

Following this setback, Mr. Trump declared that he would now turn his attention to fiscal matters. Whether he has run into new troubles or simply changed his mind, recent interventions have placed the repeal of Obamacare back into the limelight. The prospects of fiscal reform are thus fading, in terms of both household and corporate taxation. As to his proposals for Federal government revenues, we should not expect too much, and in any case, nothing for the current fiscal year (ending 30 September 2017). As to spending, we can jump to the same conclusion: over the past three legislatures, Republicans have shown an unwavering thirst for spending cuts, and Mr. Trump wants to reduce them as well. Since nothing needs to be done to reduce spending, Congress should be able to handle it.

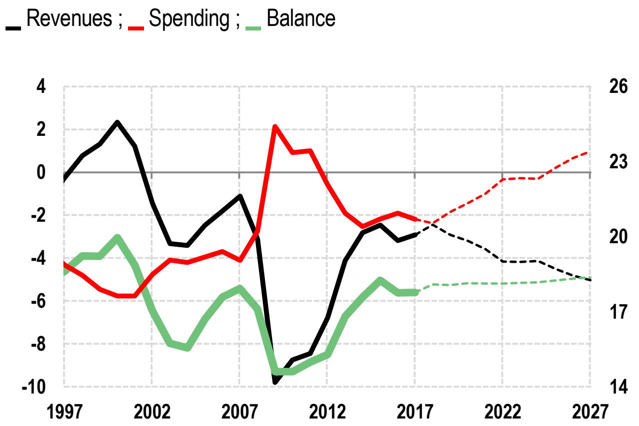
1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.6**	**2.2**	**2.7**
Private consumption	2.7	2.5	2.8
Gross Fixed Capital Formation	-0.4	3.7	5.8
Exports	0.4	2.4	3.0
Consumer Price Index (CPI)	1.3	2.4	2.6
Unemployment rate	4.9	4.6	4.2
Current account balance	-2.5	-2.4	-2.4
Fed. Govt. Budget Balance (% of GDP)	-3.4	-4.2	-5.0
Gross Fed. Govt. Debt (% GDP)	71.2	72.7	74.9

e: BNP Paribas Group Economic Research estimates and forecasts

2- Federal government finances

Percentage of GDP



Source : Congressional Budget Office

The economy

As a result, economic analysis has taken centre stage again, since fiscal policy will be neither more nor less buoyant than expected before the November 2016 elections. As is the case in other regions of the world, economic indicators are sending divergent signals. Survey results are very buoyant, with both ISM indexes above 55 points. The weighted sum of the two ISMs – a PMI index covering the entire US economy – averaged 56.5 in first-quarter of 2017, the highest level since Q3 2015. This is compatible with economic growth of about 2.5%, higher than the US economy's long-term growth potential, which the consensus rather consistently estimates at a little under 2%[1].

Activity data, in contrast, are much less encouraging. In January and February, real household spending contracted 0.2% and 0.1%, respectively, and retail sales were not particularly buoyant in March. We can thus expect a sharp slowdown in consumption in the first quarter of 2017. Demand and supply indicators seem to be following divergent trends. The manufacturing sector reported strong growth, notably in the capital goods sector. We can thus expect a rebound in corporate investment, while exports are also trending upwards.

The two main nowcasting models do not really help to settle the matter. Growth is estimated at 2.6% by the New York Fed's model, but only 0.5% by the Atlanta Fed. Based on the past performances of these two models, we are more inclined to give extra weight to the Atlanta Fed's model. Its relatively pessimistic tendency is supported by the relative weight of exports, corporate capital investment and household consumption as components of final demand: the sum of the first two account for only 28% of the third.

Monetary policy

In March, the Federal Open Policy Committee (FOMC) increased the Fed funds target rate by 25 basis points.

As soon as it began the process of normalising monetary policy, the Fed made it clear that it would seize every possible opportunity to increase its key rates, to move away from the uncomfortable area at the zero lower bound. With the job market still going strong and inflation slowly but surely rising towards the Fed's target, March could only bring another rate increase.

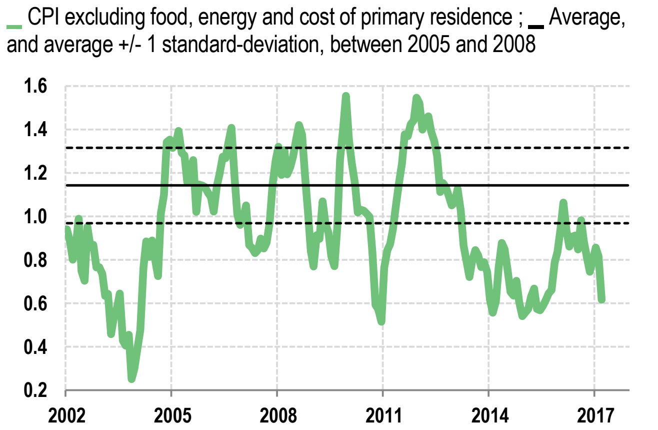
Yet the Fed also wanted to avoid raising expectations that the cycle would be steeper than previously expected. After waiting a full year before increasing its key rate a second time, the FOMC has now shortened the waiting period to three months. That's why March's rate increase came with an accommodative tone.

The main message was that the rate increase had nothing to do with a revaluation of its forecasts. In other words, the Fed was not surprised by the economy's strength, growth was no stronger than expected, and there was nothing surprising about the upturn in inflation.

During the press conference following the FOMC meeting, Janet Yellen also said that it would not take many rate increases to bring back to their estimated neutral level: although the effective Fed funds rate is still very low, its "supporting power" is not very high, because it is only slightly lower than the neutral rate.

3- Core inflation

Consumer price index, year-on-year, %



Source : Bureau of Labor Statistics

Lastly, the press release was amended to qualify the inflation target as "symmetric". Although there is nothing new about this symmetry, its introduction in the press release increases its credibility. In brief, the Fed increased its key rates and said that it would continue to do so at the pace already announced last December (i.e. a total of three rate increases in 2017, 2018, and 2019), and that the upside limit was much lower than in the past. This is another way of saying "lower for longer".

Since the FOMC meeting, the monthly jobs report for March was published, revealing a sharp slowdown in job creations. These statistics must be interpreted with caution: one point does not make a trend, and the weakness shown in the establishment survey data is not mirrored in the household survey, according to which employment increased by 472,000 jobs. Nonetheless, this would be an excellent reason for the Fed not to raise its key rates again in May. As to June, we must carefully analyse the job market data and various price indexes. Prices seem to suggest that the rebound in inflation is winding down. Excluding food, energy and the cost of primary residence, the consumer price index rose only 0.6% year-on-year in March, down from 0.9% in January and 0.8% in February. This is a key factor to watch.

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[1] The long-term growth rate is estimated between 1.8% and 2% based on the median estimates of the FOMC members; at 1.6% by the Congressional Budget Office, and at 1.5% by the OECD.

Eurozone

Patient optimism

The economic situation in the eurozone continues to improve: confidence surveys point to a very positive trend, although the latest "hard" economic data suggest that the prevailing optimism should be tempered somewhat. Our growth forecasts have been upgraded since the end of 2016. Yet, despite the economic improvement, labour market slack remains significant and results in very low inflation if we exclude the most volatile elements from the figures. With this in mind we continue to expect monetary policy to remain accommodating for some time, characterised by an extremely gradual withdrawal of non-conventional measures from January 2018.

The eurozone economic situation is improving. After growth of 0.5% q/q in Q4 2016, the various confidence surveys conducted since the beginning of the year have suggested that growth will continue at a similar or perhaps even stronger rate in the first quarter of 2017. It is nevertheless important to note the recent appearance of a gap between the very positive image created by surveys and the more mixed picture painted by "hard" economic data (see chart). In particular, the industrial production figures for February were disappointing, notably in France.

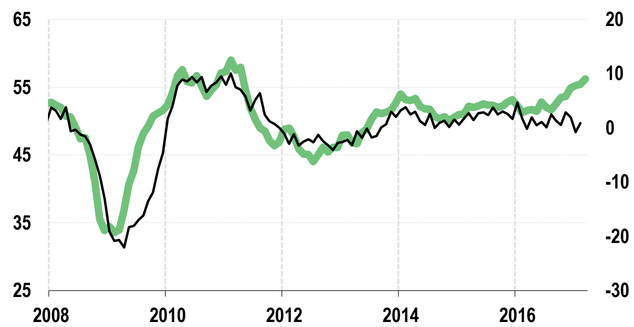
It therefore remains to be seen to what extent GDP figures, the first estimate of which will be published on 28 April, confirm the general mood of optimism. Even so, barring any accidents, eurozone growth is likely to continue to set a fairly strong pace, something that was far from assured just a few months ago: between the Brexit vote, rising energy prices and the European electoral calendar, the risks seemed to be clearly on the downside. This positive surprise should not, however, give rise to unbridled optimism. Despite the economic improvement, the lag in production accumulated since 2008 is significant and has resulted in very low inflation if we exclude the most volatile elements from the figures. With this in mind we continue to expect monetary policy to remain accommodating for some time.

1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.7**	**1.6**	**1.6**
Private consumption	1.8	1.3	1.5
Gross Fixed Capital Formation	2.5	2.1	2.4
Exports	2.4	3.9	4.2
Consumer Price Index (CPI)	0.2	1.8	1.4
Unemployment rate	10.0	9.4	9.1
Current account balance	3.4	3.0	3.1
Gen. Govt. Balance (% of GDP)	-1.7	-1.4	-1.2
Public Debt (% GDP)	89.4	88.5	87.3

e: BNP Paribas Group Economic Research estimates and forecasts

2- A growing gap



Sources: Eurostat, Markit

GDP growth and output gap

A common error when looking at the economic performance of a country (or in this case the whole eurozone) is to confuse GDP growth with economic output level. Of course, observers have an interest in GDP growth figures, but the fundamental issue for the 'health' of an economy is the gap between the actual level of output and the potential output. An overheating economy is one where actual output exceeds potential, resulting in inflationary pressures. In an underperforming economy, actual output is below potential and inflation tends to slow.

The difficulty in economic analysis is that, unlike GDP, potential GDP cannot be observed: it has to be estimated using approaches and assumptions that can vary widely. As a result, there is rarely a consensus on its level. For example, the OECD put the output gap for the eurozone at -1.9% of potential GDP at the end of 2016, whilst the IMF put the figure at -1.2% and the European Commission had it at -1%.

One of the main reasons for these differences is the estimated impact of the economic crisis on potential output. In concrete terms, the question is whether or not there has been a permanent, unrecoverable loss of output and employment. The European Commission, which has the most conservative estimate of the output gap, believes that the structural unemployment rate, estimated at 7.5% in 2008, is now 9%.

The structural unemployment rate is the level of unemployment recorded when the output gap is closed, that is to say when the economy is performing at potential. It is also the level of unemployment around which wage growth starts to accelerate. As a result, the estimate of structural unemployment has significant consequences for inflation expectations and hence for expectations of future monetary policy. Indeed, it is generally expected that as an economy approaches its potential, and the first signs of inflation appear, the central bank will tighten monetary policy.

In February the eurozone unemployment rate fell to 9.5%, its lowest level since 2009. If we take the European Commission's estimate of structural unemployment there are therefore 795,000 'missing' jobs in the eurozone: at unchanged participation rates this represents between two and three quarters of job creation at its current pace. On this view, the ECB would be nearing the point where it tightens financial and monetary conditions to head off overheating. On the other hand, if we use the OECD's estimates instead, the shortfall in jobs is 1.3 million, rising to 3.2 million on the basis of pre-crisis structural unemployment. On these figures, continued monetary support is required.

The eurozone is still convalescing

Current inflation dynamics in the eurozone suggest that substantial production capacity remains idle. The uptick in inflation seen since the beginning of 2017 is due primarily to increases in energy and food prices, which are subject to powerful base effects. Stripping out these volatile items reveals weak, or non-existent inflationary pressures. Underlying inflation remains below 1% and is showing no sign of rising (see chart). This situation stems primarily from the lack of vigour in wage growth: although the details vary from one country to the next, average wage growth has been on a downward trend since 2009 and recent developments have shown no sign of an upturn. This implies that the European Commission's estimates of the output gap and structural unemployment are probably too restrictive. In short, although it is recovering, the eurozone economy remains damaged and has not yet moved into its inflationary phase.

The experience of the US economy (whose cycle is significantly in advance of the eurozone) also argues for caution: the lesson is that after a major crisis the full recovery of the labour market can be extremely slow. Despite a very low unemployment rate – in reality already below the estimated structural level – US wage growth remains modest. One explanation is that underemployment goes beyond the unemployed: it is important to take account of part-time workers as well as "shadow unemployment" (those people who would take a job even though they are not actively looking for one). The unemployment rate only gives a partial picture of the economic situation. Thus in order to be complete, economic analysis must take account of a number of discontinuities which push back the horizon for monetary normalisation.

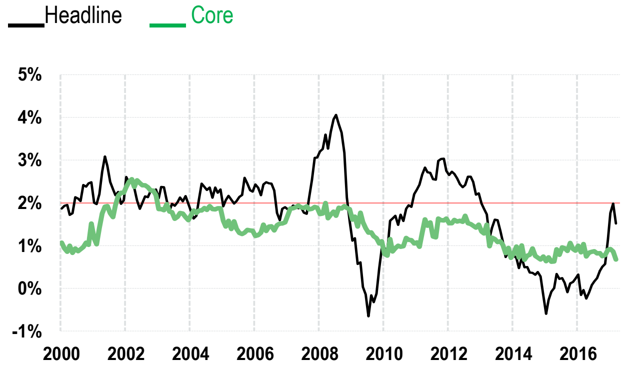
Prolonged monetary support

As part of its quantitative easing programme, the ECB has scaled back the monthly rate of asset purchases from EUR 80 bn to EUR 60 bn from April 2017 through to the end of the year. We expect a similar type of change to QE from January 2018: a reduction in monthly purchases but with no announcement of a pre-determined end date. Thus in September 2017 the ECB could announce that from January 2018 the monthly volume of purchases will be reduced (to say EUR 45 billion or EUR 40 billion) for a minimum 6-month period, before a new adjustment is made, and so forth. Monetary normalisation will be gradual, with the ECB making a series of re-evaluations, and thus retaining a significant degree of flexibility.

Due to the direct effect on excess liquidity of a significant prolongation of QE, even on a scaled-back basis, it can but feed into speculation on the possibility of an increase in the deposit facility rate from its current level of -0.40%. Indeed, the combination of QE and a negative deposit facility rate puts bank profits under pressure, which could over time disrupt the transmission of monetary policy. Clearly this issue will get increasingly acute the longer QE lasts, which is why we expect the ECB to narrow the corridor (raising the deposit rate by 10bp, whilst leaving the *refi* rate unchanged) before ending net purchases of assets, perhaps in the first half of 2018.

3- Inflation

Consumer price y/y



Source: Eurostat

Such a measure could also help satisfy the more hawkish members of the Governing Council, although it should be emphasised that QE itself is the main topic of debate at the central bank. More generally, the heterogeneity of EMU member states, which is being expressed increasingly openly in statements from different members of the Governing Council, could muddy the ECB's communication as we go forward. However, we would underline that such ambiguity over the direction of monetary policy does have the positive effect of avoiding too abrupt a transition from a resolutely accommodating ECB (as has been the case since mid-2014) and an ECB equally resolutely committed to the path to normalisation (which would seem premature). It is therefore probably the best type of communication at present, given the halfway position in which the monetary union finds itself at present.

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Germany

Inequality at centre of election campaign

The German economy is performing very well. Growth in 2017 and 2018 is likely to remain close to 1.8%. Germany's outperformance vis-à-vis the eurozone is often attributed to the reform programme Agenda 2010. However, the fall in unemployment has been accompanied by a rise of the working poor. The German Social Democratic Party has signalled that it wants to correct some of the reforms, as these have led to less secure and badly paid jobs. This could open an interesting debate on social justice and equity.

Early data indicate that the German economy grew very rapidly in first months of 2017, supported by robust domestic as well as foreign demand. Industrial production, seasonally adjusted, recovered strongly after a sharp fall in December. By contrast, orders weakened substantially, after their strong surge in Q4 2016, although remaining on a rising trend. Moreover, construction activity rebounded in February following a cold weather-related fall in January.

The industrial sector is profiting from gains in competitiveness related to the weakness of the euro, whereas construction activity is supported by the strong demand for housing against the backdrop of low interest rates and favourable labour market conditions. Moreover, the recent upswing in world trade has made companies more confident about the short-term business outlook. The IFO climate index reached 112.3 in March, its highest level since July 2011.

GDP growth - on a working-day adjusted basis - should remain robust, at around 1.8% both in 2017 and 2018. Exports are set to remain an important driver supported by strong world trade and euro weakness. By contrast, domestic demand could become more sluggish, as private consumption growth eases largely because of the rise in energy prices. Moreover, lack of skilled staff has made companies reluctant to expand their installations. Other factors that have been weighing on capital spending are the unpredictable course of the new US administration, the triggering of article 50 by the UK government and the uncertainties surrounding the upcoming elections in France and Germany. Lastly, government spending is unlikely to increase rapidly after the election, as the major parties are in favour of pursuing a balanced budget policy.

Against this backdrop, the current account surplus is likely to remain above 8% of GDP, one of the largest in the world. The surplus is mainly against the US, the UK and the emerging economies including China. The surplus vis-à-vis the eurozone may shrink as German unit labour costs are outpacing those in the rest of the eurozone.

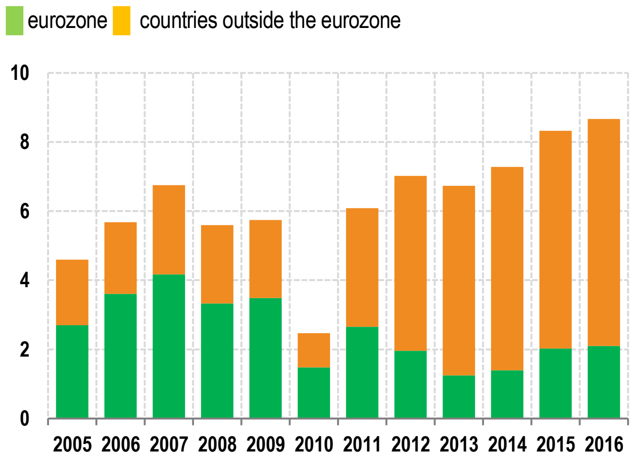
GDP growth is likely to remain well above the potential growth rate, estimated at 1.3%, resulting in a widening of the positive output gap. At the same time, unemployment is expected to inch up due to growing mismatches in the labour market. Even though the shortage of skilled workers might drive up the remunerations for them, trade unions might be willing to moderate their demands in order to remain competitive in European markets and avoid the delocalisation of plants. Hence, core inflation is expected to inch up only gradually, reaching 1.3% in 2018.

1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.8**	**1.8**	**2.0**
Private consumption	1.7	1.3	1.7
Gross Fixed Capital Formation	2.0	2.2	2.2
Exports	2.3	4.2	4.6
Consumer Price Index (CPI)	0.4	1.9	1.6
Unemployment rate	6.1	6.1	6.3
Current account balance	8.8	8.3	8.5
Gen. Govt. Balance (% of GDP)	0.6	0.7	0.6
Public Debt (% GDP)	68.4	65.3	62.4

e: BNP Paribas Group Economic Research estimates and forecasts

2- Germany: current account surplus
% of GDP



Sources: Deutsche Bundesbank and BNP Paribas

Less unemployment, more in-work poverty

Germany's outperformance vis-à-vis the eurozone is often attributed to the reform programme Agenda 2010, launched by SPD Chancellor Schröder. In particular, the labour market reforms, collectively known as the Hartz reforms, have been credited for turning the German labour market around. In particular, the Hartz IV reform, which became effective in 2005, reduced the generosity of the unemployment insurance by shortening the benefit period and replacing the unemployment assistance scheme for long-term unemployed by a less favourable social assistance scheme.

The dynamism of the labour market has been impressive. Between 2005 and 2015, total employment increased by 3.3 million persons. Most of them ended up in regular jobs. The number of precarious jobs (mini-jobs [1]) as sole source of income remained stable at around 5.2 million.[2] Over the same period, long-term unemployment declined from almost 6% of the labour force to only 2%.

Most policy makers would consider that the best way to get people out of poverty is by job creation. However, this is not immediately obvious in the case of Germany. In fact, the risk of in-work poverty, defined as employed persons receiving less than 60% of the overall equivalised median disposable income, has substantially increased, in particular following the great financial crisis, from 5.5% in 2006 to 9.7% in 2015 (EU-SILC). An increase in in-work poverty rates is also observed in other European countries, albeit to a lesser extent. Nevertheless, this does not rule out that people who transit from unemployment to a poorly paid job may be better off.

Income inequality has increased since the Hartz reforms, as the income quintile share (S20/S80 ratio) increased from 3.8 in 2005 to 4.8 in 2015. This is just below to the EU average (5.1), but much higher than in France (4.3). However, as the rise in inequality is also observed in other countries, other factors might have played a role, such as the growing demand for high-skilled workers.

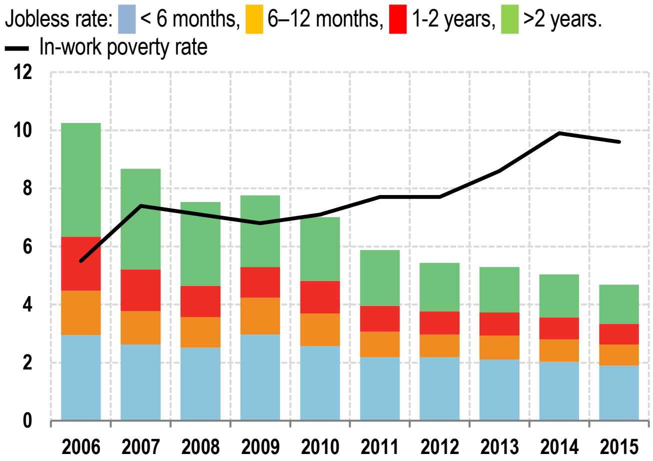
An interesting election campaign

The labour market reforms are not uncontested. In the upcoming election for the Bundestag, to be held on 24 September, discussions on labour market conditions might take centre stage. The newly elected leader of the German Social Democrats (SPD), Martin Schulz, recently called for the Hartz reforms to be corrected as they have led to less secure and badly paid jobs. Mr Schulz was in particular critical about the increase in the number of fixed term contracts. About 18% of people aged between 25 and 34 are on such contracts, against around 10% before 2005. Moreover, he took aim at the unpopular Hartz IV reforms and the shortening of unemployment benefits to a maximum of two years for those 58 or older. Before the reforms, the unemployment scheme functioned as a kind of early retirement scheme, as job seekers could receive a benefit until retirement.

The return to the pre-Hartz regulations is unlikely to happen. Nevertheless, the attack on the Hartz reforms may allow the SPD to regain part of the working class that felt betrayed by its adoption in the mid 2000s. According to the latest polls, Mr. Schulz has gained back support to the detriment of the left-wing party Die Linke and the populist right-wing party Alternative für Deutschland (AfD), and is now neck to neck with the Christian-Democrats (CDU/CSU) of Chancellor Angela Merkel at just over 30% of voting intentions.

A new element in the upcoming election is the rising support for the AfD on the back of dissatisfaction with government policies, such as the euro and the support to the southern European countries, domestic security, immigration, and labour market policies. The

3- Less unemployment, more in-work poverty



Source: Eurostat

party did quite well in regional elections, especially in the new Länder (former East Germany). In the latest regional elections in Saxony-Anhalt and Mecklenburg-Vorpommern the party obtained more than 20% of the vote. These are among Germany's poorest areas. In 2016, the unemployment rate (national definition) in these eastern Länder amounted to 8.5% compared with 5.6% in the Länder of former West Germany. According to the latest opinion polls, the AfD would gain just over 10% of the total vote.

A radical change in Germany's economic policy is unlikely to happen after the election, as both front runners, Mrs Merkel and Mr Schultz, are in favour of a balanced budget. Moreover, both also want to support the southern European countries conditional on the implementation of reforms there. However, on social policy, some cracks have appeared in the ruling coalition. Mr Schulz is expected to propose some corrections to the Hartz reforms. This could open an interesting debate on social justice and equity.

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[1] Mini-jobs are small jobs paying less than 450 euro a month tax free. These jobs are popular with students, pensioners and female second-earners, who are not dependent on their own earned income.

[2] In addition, mini-jobs as second job increased by around 1 million to 2.7 million. Many employees prefer these as second job to working more hours in their main job, as the former are exempt from taxes and social security contributions.

France

Heading for a slow acceleration

The expected acceleration in growth in 2016 failed to materialise, pushing hopes into 2017. 2016 nevertheless ended on a robust growth performance which, at least, allows 2017 to get off to a good start. Confidence surveys have also been on the right track over the first quarter, though this positive signal has been offset by mediocre monthly activity figures. The overall picture to emerge from our forecasts is of somewhat more solid growth in France, thanks in particular to an improvement in the labour market. However, growth in 2017 will not be much higher than in 2016 (1.3% in annual average terms from 1.1%), held back by the pick-up in inflation.

A good start to the year?

The assumption of a strong growth figure for the first quarter of 2017, in line with that for the final quarter of 2016 (0.4% q/q) is now under scrutiny: it continues to be supported by positive survey data, but not by mediocre monthly activity figures.

As far as the surveys are concerned (with data available to March), INSEE's composite business confidence index averaged 104 over the first quarter. It is thus significantly higher than the reference average of 100 (itself consistent with a quarterly growth rate of 0.3% to 0.4%). It is also slightly higher than its average of 103 over the fourth quarter of 2016, suggesting that growth could even accelerate somewhat. The signal from PMI figures is even more positive.

However, monthly activity data for January and February paint a less exciting picture. Household spending on goods (that is to say, energy plus manufactured goods) bears the traces of volatile energy bills caused by big changes in the weather, with 2017 bringing the coldest January since 2010, and the warmest February since 2007. The rise and then fall in the total consumption of goods hides however an inverse trend in purchases of manufactured goods. Weather conditions had matching effects on energy production (up in January, down in February) but industrial production fell in both months, pulled downwards by the decline in manufacturing output. Foreign trade monthly data were also mixed: exports reflected wide variations in Airbus deliveries, whilst imports saw the effect of exceptional purchasing of pharmaceutical products from Austria.

These mediocre activity figures outweigh the positive survey results, and create downside risk on our forecast of 0.4% q/q in the first quarter. On the basis of hard data, our nowcast model predicts 0.2% q/q growth in the first quarter, compared to 0.5% q/q based on the soft data. By way of comparison, INSEE is forecasting 0.3% q/q, as is Banque de France, which cut its forecast by 0.1 of a point in its March update.

As far as the components of growth are concerned, our forecast integrates less dynamic household consumption than in the previous quarter. But the monthly figures for consumption of goods make this forecast look optimistic, without undermining it altogether. There is a bigger risk of a negative surprise in exports, but this could be offset by imports also growing less than expected. On the investment side, there is downside risk on household residential investment (due to the cold January) but corporate investment could provide a positive surprise, with a final surge before the expiry in April of the over-amortization scheme. Lastly, our growth forecast is pulled downwards by a negative contribution of inventories, in line with poor production figures. This negative contribution of inventories will also weigh on the growth figure for the whole year.

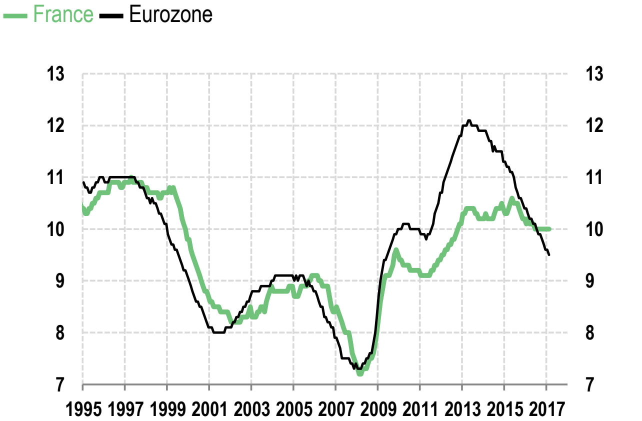
1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.1**	**1.3**	**1.5**
Private consumption	1.8	1.4	1.6
Gross Fixed Capital Formation	2.8	2.5	2.7
Exports	1.2	3.4	3.9
Consumer Price Index (HCPI)	0.3	1.6	1.0
Unemployment rate	10.0	9.7	9.4
Current account balance	-0.9	-0.9	-1.1
Gen. Govt. Balance (% of GDP)	-3.4	-3.0	-2.7
Public Debt (% GDP)	96.0	96.1	95.1

e: BNP Paribas Group Economic Research estimates and forecasts

2- Unemployment down, but still too high

Unemployment rate, % of labour force



Source: Eurostat

Somewhat more solid growth

The overall picture to emerge from our forecasts is of somewhat more solid, but not necessarily much higher, growth. The greater solidity comes in particular from the improvement in the labour market seen since mid-2015 on the employment side and since end-2015 in unemployment. This improvement may be gradual, but it is undoubtedly under way and is helping put the economy on track for self-sustaining growth.

What are the signs? In terms of job creation, the figures for 2016 were very positive: 167,000 additional non-farm payrolls on average over the year, with a 192,000 increase year-on-year. This is a significant improvement on 2015 job creation figures of 24,000 on average over the year and 99,000 year-on-year. The employment growth rate in 2016 hit its highest pace since 2007. It is driven by the service sector (159,000 in 2016, from 86,000 in 2015) and temporary work (53,000 and 29,000 respectively). If we draw a distinction in the service sector (including temporary posts) between segments which create relatively unskilled jobs and those creating more highly skilled jobs, it was the latter which accounted for the bulk of job creation in both 2016 and 2015[1]. Job losses in industry and construction continued but at a slower pace (-29,000 from -37,000 in industry, and -15,000 from -45,000 in construction).

Employment is rising and unemployment is falling: the number of Category A jobseekers registered with Pôle Emploi, the French unemployment body, was down 3.1% y/y in February and 29,000 lower over the whole of 2016 compared to 2015, its first fall since 2008. However, the trend is still up for Category B and C jobseekers, which cover reduced-activity jobseekers[2]. As for the unemployment rate as measured by INSEE under the ILO definition, this was 10% of the labour force in the fourth quarter of 2016 (9.7% for mainland France), a fall of 0.2 of a point over the year. It averaged 10.1% over 2016, a fall of 0.3 of a point relative to 2015, its biggest fall since 2008. However, this downtrend came later than in the eurozone as a whole (where it began in 2013) and has also been slower (half a point down from the peak in the third quarter of 2015, against a one-point drop in the eurozone). Thus the French unemployment rate has yet to drop below the 10% mark, something that has already been achieved in the eurozone (9.5% in February 2017, see chart).

A bit more solid? Yes. Much stronger? No.

Our growth forecasts are unchanged on those released in January. We continue to expect a modest acceleration: from average annual growth of 1.1% in 2016, we see the French economy growing by 1.3% in 2017 and then 1.5% in 2018. Our forecast for 2017 is right in line with the April consensus, whilst that for 2018 is 0.1 of a point higher. The gap to eurozone growth (a spread of 0.6 of a point on average since 2014[3]) will narrow to 0.3 of a point in 2017 and 0.1 of a point in 2018 (the eurozone is expected to grow by 1.6% in both years, from 1.7% in 2016). The risks to this baseline scenario are balanced or perhaps shaded to the upside.

The underperformance of the French economy in 2016 was due to a series of setbacks to activity and one-off negative shocks, which trimmed a few tenths of a percentage point off growth (notably through their impact on exports)[4], which could be made up for in 2017. With growth still expected to be fairly weak this year, the reasons lie in the divergent trends in the various components of growth. We expect a marked deceleration in household consumption in the wake of smaller gains in purchasing power which are squeezed by rising inflation, itself driven by higher oil prices. The slowing of business investment in annual average terms bears the brunt of the quarterly volatility created by the expiry of the fiscal incentive to invest, but hides an acceleration over the course of the year. The recovery in household investment should continue to gather strength, adding 0.2 of a point to growth. Lastly, after a poor year in 2016, exports are set to bounce back at a rate in line with growth in global demand addressed to France (estimated at 3.4%), which will be driven by better international conditions.

Under this scenario, the negative output gap, which the European Commission estimates at slightly over 1 point in 2016, would see very little narrowing over the forecast period. The unemployment rate has started to fall, but wage trends remain constrained by the sluggish nature of this decline and the still high level of the unemployment rate in absolute terms. Any increase in core inflation is therefore likely to be slow. This is true to such an extent that core inflation in France is expected to remain below 1% in annual average terms. It would therefore be lower than the eurozone average (where the determinants of inflation, on aggregate, are showing slightly more positive trends). France could thus derive a slight competitive advantage.

The outcome of the presidential election on 7 May is uncertain. The result is certain to change the overall picture, but we do not yet know in what direction or to what extent. Our scenario has therefore been prepared on unchanged politics, in all senses of the term, particularly in fiscal policy. Growth therefore continues to be held back by the on-going structural adjustment (which we estimate at 0.25 of a point, or around half of the government's own estimate). Our forecasts suggest that the budget deficit will just make it to the 3% of GDP level in 2017 (against the government's new estimate, updated for the April 2017 stability programme, of 2.8%, *i.e.* 0.1 point more than in the 2017 budget, with an unchanged growth forecast of 1.5%).

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[1] The "low skilled" group includes retail, transport & warehousing, hotels & restaurants and household services (73,000 new jobs in 2016, from 37,000 in 2015). The "skilled" group covers information & communication, financial services and insurance, real estate activities and business services (138,000 new jobs in 2016, from 77,000 in 2015).

[2] These statistics can be difficult to interpret: how can we distinguish the "good" sort of reduced activity/unemployment (a first stage before a durable return to the labour market) from the "bad" one (people locked into a 'job insecurity trap' or calculating their position to take advantage of benefit rules)?

[3] Note that French growth was on average 0.2 of a point higher than eurozone growth between 1995 and 2013.

[4] Mild winter in 2015-16, Euro 2016 football championship (10 June to 10 July), strikes and refinery blockades (May-June), grain sector impacted by bad spring weather, tourism hit by the November 2015 and July 2016 terrorist attacks, aerospace sector hit by supply problem, electricity exports reduced at the year end due to maintenance closures of sections of capacity.

Italy

More private investment

In 2016, activity grew by almost 1%, driven by domestic demand. Net exports kept on negatively contributing to the overall growth for the third year in a row. Gross fixed capital formation grew by about 3%, with spending on machinery and equipment increasing by almost 4%. Over the last three years, investment of non-financial corporations grew by EUR 11 bn, while the public component has further declined, from EUR 45 bn in 2011 to EUR 35 bn in 2016. Home prices increased in Q4 2016. Even if it was a limited increase, it is the first positive figure in five years. The news flow keeps on being positive. According to the Agenzia delle Entrate, more than 528,000 residential units were sold in 2016, almost 20% more than in 2015.

A domestic driven recovery

In 2016, real GDP rose by almost 1%, driven by the strengthening of domestic demand, which, excluding the inventory change, added 1.4 percentage points to the activity growth. For the third year in a row, net exports' contribution was negative (-0.1 points), as imports rose more than exports, respectively +2.9% and +2.4%. Despite the recovery, real GDP is still 7 percentage points below the pre-crisis level.

In 2016, the economy benefited from further improvement of conditions in the manufacturing sector, with production increasing by almost 2%, i.e. more rapidly than in France and Germany. While in 2015 the increase in the industrial activity had been extremely concentrated, with production of transport equipment rising by more than 15% and explaining most of the overall increase, in 2016 the positive momentum spread among several sectors. Production of metals and metal products increased by 3.3% and that of machinery and equipment by 3.6%, as fiscal incentives supported private investment, while the increase in the sector of food products and in that of pharmaceutical products mainly reflected the strength of exports, which rose by 4.2% and 6.8% respectively.

Still uncertain private consumption

During the recent months, labour market conditions have further improved. Despite the definitive discontinuation of social contribution relief, at the beginning of 2017, the number of employees has further increased, both in fixed-term and open-ended contracts. In the last two years, almost 480 thousands new jobs have been created. The unemployment rate is still above 11%, as the labour participation rate has risen. However, the positive effect on disposable income of this favourable evolution has been damped down by the slowdown of wages. Besides, since the beginning of the crisis, Italian households have experienced a strong decline in net interest income, from EUR 64 billion in 2008 to EUR 26 billion in 2016.

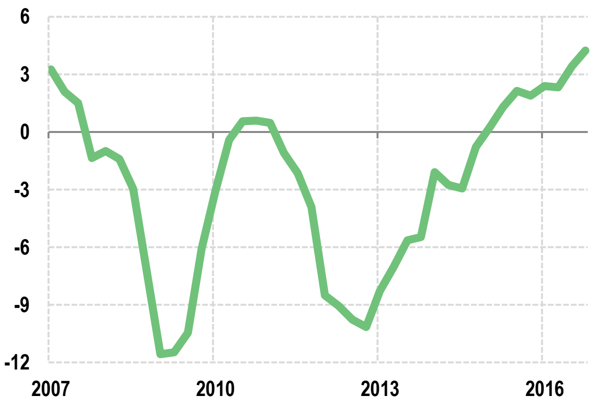
Despite some improvements, with purchasing power increasing by more than 1.5%, also as a consequence of a still moderate price evolution, Italian households remain extremely cautious. From the peak reached at the end of 2015, consumer confidence has declined, despite remaining at a high level by historical standards, leading households to slightly increase their propensity to save, which had fallen to a very low level in 2015. In 2016, private consumption rose by 1.3%, with signs of weakening during the year, due to a slowdown in private spending on durable goods and on services. Households consumption remains about 4.5% lower than in 2007, with a strong contraction on expenditure on foods, clothes and furniture.

1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.0**	**0.6**	**0.6**
Private consumption	1.4	0.5	0.8
Gross Fixed Capital Formation	2.0	0.9	1.3
Exports	1.2	2.4	2.4
Consumer Price Index (CPI)	-0.1	1.6	1.0
Unemployment rate	11.6	11.4	10.9
Current account balance	2.1	2.2	2.1
Gen. Govt. Balance (% of GDP)	-2.4	-2.4	-2.5
Public Debt (% GDP)	132.8	133.2	134.1

e: BNP Paribas Group Economic Research estimates and forecasts

2- Gross Fixed Capital Formation
Year-on-year, %



Source: Istat

The recovery of investment

In 2016, gross fixed capital formation rose by almost 3%, adding 0.5 percentage points to the GDP growth. Since 2014, investment on machinery and equipment has increased by more than 7% and that on means of transport by about 65%, while that on construction has continued to suffer. The investment recovery mainly reflects a better evolution of firms spending, while the public component has further declined, from EUR 45 billion in 2011 to EUR 35 billion in 2016.

In the last three years, Italian non-financial corporations increased the value of their investment by EUR 11 billion, from EUR 138 to

EUR 149 billion. Despite this improvement, the propensity to invest is still low. In 2016, the investment-to-value added ratio was 19.7%, about 4 percentage points below pre-crisis levels.

The overall picture for Italian firms remains mixed. During recent years, value added of non-financial corporations has recovered, reaching in 2016 the highest value in the last twenty years, while the profitability has been disappointing, remaining at a low level. In the coming months, private investment is expected to further increase, as confirmed by the Bank of Italy Survey on Inflation and Growth Expectations, conducted on a sample of firms with 50 or more employees.

Real estate in Italy

The long period of declining house prices could be coming to an end. In the fourth quarter of 2016, residential property prices recorded a year-on-year growth of +0.1%; albeit feeble, it is still the first positive change since the fourth quarter of 2011. Compared to the previous quarter, prices remained unchanged, due to a combination of a +0.5% growth of new dwellings and a -0.2% decline of the existing ones.

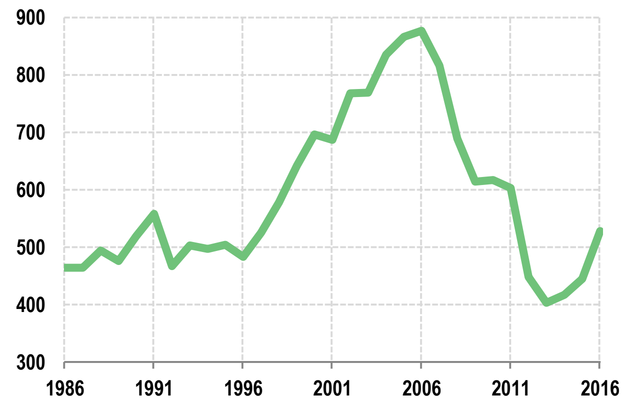
In 2016 house prices decreased by 0.7%, much less than in 2015 (-2.6% year-on-year) and in 2014 (-4.4% year-on-year). The slowdown of the fall is particularly evident in the case of existing dwellings, whose prices fell by -0.6% (year-on-year) after -3% in the 2015 and -5.2% in 2014. Overall, compared to 2010 (first year for which the Istat data are available), 2016 prices were 14.6% lower, largely due to existing dwelling prices' performance (-19.6%), while much smaller has been the decline of new dwellings prices (-2.3%).

According to some international institutions, the current level of the house prices-to-income ratio in Italy is still slightly below its long-run average. This may be seen as an indicator of undervaluation of the residential markets.

The residential real estate transactions keep showing double digit growth rates. In the fourth quarter of 2016 the sales of residential properties increased by 15.2% (year-on-year) leading to an annual increase of 18.9%. It is the fastest increase since the series is available (1986). Accordingly, the number of transactions in 2016 amounted to 528,800, approximately the same figure recorded in 1997 and about 350,000 units less than the peak reached in 2006 (877 thousands). Transactions grew in all the areas of the country, although the most significant increases (as in the other quarters of the year) took place in the Northern regions (+22.3% in 2016, against +16.2% in Central regions and +14.6% in the Southern ones). Among the major cities, the fastest growth in 2016 was recorded in Turin (+26.4%), Bologna (23.7%), Genoa (22.9%) and Milan (21.8%). In 2016 about 50% of transactions were carried out in the Northern regions.

Moreover, an interesting factor needs to be pointed out, namely the growing support of the banking system to the purchase of houses by households, both as dwellings or investment. According to the Agenzia delle Entrate, in 2016 246,182 properties have been bought using a mortgage loan (+27.3% with respect to 2015) for a total amount of EUR 29.45 billion (+27.8% year-on-year), equivalent to about EUR 120,000 on average per unit. The amount of bank loans increased in all the regions of the country. Overall, in 2016 the share of total houses purchased by households thanks to a mortgage loan rose to 48.5%, 3 percentage points more than in the previous year.

3- Home sales
Thousands of units



Source: Agenzia delle Entrate

Furthermore, the last wave of the survey carried out by the Bank of Italy among the professionals of the real estate sector shows a significant increase in the confidence over the consolidation of the recovery, both for price and transaction trends. Positive signals on the current and future performance of the residential market also came from other *ad hoc* surveys: according to Nomisma, the number of months needed to sell a house, after reaching a peak of 10 months on average in 2014, is slowly decreasing and it is now about 8 months. In the same period the time required for the lease of a house dropped from 3.9 to 2.8 months, while the average discount applied by sellers on the proposed price has steadily declined, and it is now 16.2% on average.

The prolonged period of crisis experienced by the country since 2008 has had a remarkable impact on the construction sector. According to the ANCE (the Italian association of construction firms), between 2008 and 2014 100,000 firms (16%) left the market. The crisis hit particularly the small ones (-40%), the medium and the large ones (-31%), while the micro firms (less than 10 employees) and especially the units employing just one person did much better (-20 and -5.7% respectively).

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Spain

Finding the right dose

After three years of recovery the Spanish economy will, over the next few months, finally return to the activity levels seen at the beginning of the financial crisis. This is not just a question of making up lost ground, given that the economy has seen profound transformations. The recovery will continue, but will be somewhat less vigorous than in the past. Now that the political situation has been clarified, the Spanish executive will step up its fiscal adjustment efforts. The tricky thing for Mariano Rajoy's minority government will be finding the right dose.

The peak has passed, but recovery will remain strong

Spain's strong economic recovery continued unabated at the end of 2016. Once again GDP grew by 0.7% q/q in the fourth quarter, a strong pace but one which represents the lowest level of quarterly performances in this economy since the winter of 2014. GDP growth for the year was thus 3.2% in 2016, matching the figure for 2015. This performance has returned Spain to its pre-crisis position in the leading pack of eurozone countries when it comes to economic growth.

With growth prospects improving, and now looking very solid in most eurozone countries, everything suggests that the positive trend that has taken hold in Spain will continue in 2017. Export growth in particular is likely to remain strong, fueled by past gains in competitiveness, the weakness of the euro and the strength of global demand. The country is also likely to remain a favoured destination for international tourism, against a still favourable geopolitical background.

Having grown by an average of more than 3% per year in 2015 and 2016, domestic demand is likely to see continued growth in 2017 and 2018, albeit at a more modest pace, in particular due to the increase in inflation and the tightening of fiscal policy, which will hold back private consumption somewhat. To date, domestic demand has been one of the main engines of economic growth, which as noted reached 3.2% in 2016, but could slow by nearly one point this year.

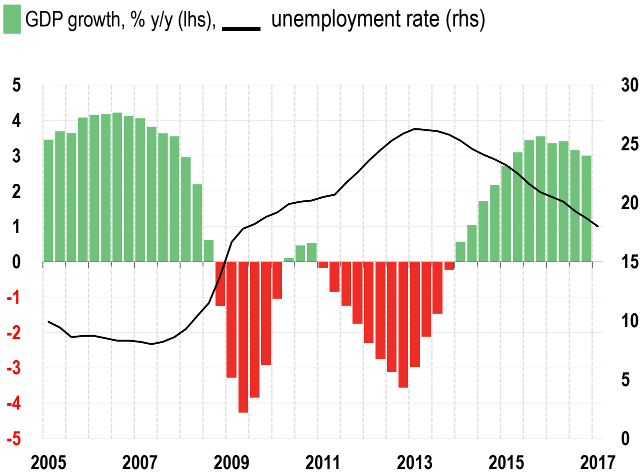
After three years of uninterrupted economic growth, the level of economic activity will regain its previous peak level, set in 2008, over the coming months. But this is not just a question of regaining lost ground, given the profound transformation of the economy during this period of time. Compared to 2008, investment in residential construction has nearly halved, taking its weight in GDP from 10% to 5% at end-2016. As far as international trade is concerned, the weight of exports has grown from 26% to 33% of GDP over this period, an increase of around 25% on 2008 both for goods (up 28%) and services (up 20%). The weight of imports, meanwhile, has moved in the opposite direction, from 31% of GDP in early 2008 to 28% now, the sign of a significant reduction in the import content of final demand. Faced with this beneficial rebalancing, investment spending other than in construction has returned to its pre-crisis level of around 10% of GDP, but the main weakness of the current regime of growth lies in the low level of private consumption, which remains 6% below its pre-crisis level and which, above all, reflects the still very high level of unemployment (18% of the active population in February 2017).

1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**3.3**	**2.6**	**2.0**
Private consumption	3.1	2.2	1.9
Gross Fixed Capital Formation	3.6	2.5	3.8
Exports	4.1	3.5	2.8
Consumer Price Index (CPI)	-0.3	2.2	1.5
Unemployment rate	19.8	19.1	18.8
Current account balance	1.8	2.1	2.1
Gen. Govt. Balance (% of GDP)	-4.6	-3.6	-3.0
Public Debt (% GDP)	99.4	99.9	99.6

e: BNP Paribas Group Economic Research estimates and forecasts

2- Growth and unemployment



Source: INE

Unemployment is falling; inflation beginning to rise

Unemployment has fallen rapidly since the recovery began, with the unemployment rate dropping by 7 points over the past three years. The rate of job creation is rapid (waged employment rose 2.5% in 2016) and, despite the weak performance of wages, is feeding into growth in disposable income and the recovery of consumption. Employment growth is likely to slow this year, in line with the overall economic trend. Even so, unemployment will continue to come down, and the main brake on accelerating domestic demand will come this year above all from rising inflation.

Still negative in August 2016, inflation has risen rapidly over the ensuing months. In January and February of this year, inflation jumped up to around 3.0% y/y according to harmonised Eurostat figures, before falling back a bit in March, to 2.1%. Over the next few months, and over and above a degree of volatility from basis effects and the timing of Easter, inflation will remain above 2%.

As in other eurozone countries, the recent increase in prices is due in large part to trends in food and energy prices. This said, underlying inflation in Spain is rising a bit more quickly than elsewhere in the eurozone. It climbed from 0.5% in mid-2016 to 1.3% in February, at a time when the eurozone aggregate has held steady at around 0.9%.

The public finances

The strength of the recovery augurs well for an improvement in Spain's public finances. To date, however, progress on the deficit has been slow and the ratio of government debt to GDP is struggling to stabilise at around 100%. For 2017, Spain has given an undertaking to European institutions to put the emphasis on the adjustment of the public finances. This adjustment is one of the main reasons for which the country is one of the few in the eurozone where growth is expected to slow this year.

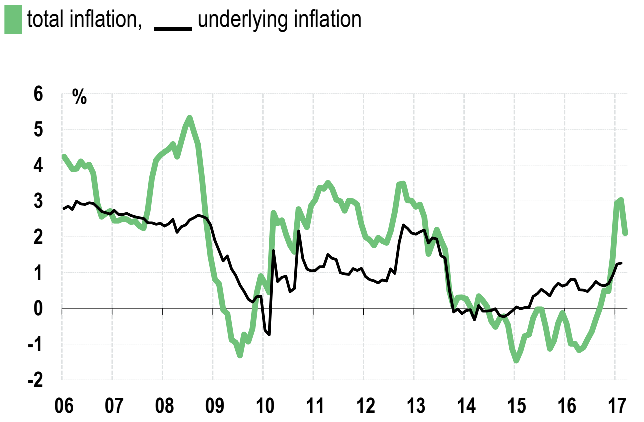
Over the past two years, the government has pushed fiscal adjustment to the back burner and concentrated instead on growth. The structural balance of the public finances, as estimated by the European Commission, having been brought back to -1.8% of GDP in 2014, widened significantly to -2.6% in 2015 and -3.8% in 2016. Probably a largely deliberate decision in 2015 in the run up to the elections at the end of the year, this trend gathered pace in 2016, when the economy was managed by the transitional government for much of the year.

In any event, it is clear that economic activity has benefited from a markedly expansionist stance in the public finances in 2015 and 2016. The slight improvement in the nominal deficit over this period, from 6.0% of GDP in 2014 to 4.6% in 2016, has only been made possible by economic growth[1] and the reduction in the interest paid on government debt, which fell from 3.5% to 2.8% of GDP over the period. This trend has not been the result of a reduction in the debt ratio, but rather a fall in the cost of borrowing made possible by the recovery in the country and the quantitative easing policy and purchasing of sovereign debt by the European Central Bank.

At the end of 2016, therefore, France and Spain were the last two eurozone member states to have a government deficit of more than 3% of GDP, and thus to remain subject to the excessive deficit procedure that was commenced in 2009[2]. Whilst France has undertaken to come back below this threshold in 2017, Spain has until 2018 to do so. Shortly after the formation of Mariano Rajoy's minority government, the country sent Brussels an updated version of its budget forecasts for 2017. Measures adopted at the end of last year will broaden the tax base for business taxes, and raise certain taxes (on alcohol, tobacco and sweetened drinks). In the final analysis, the effort expected at present is not particularly significant.

3- Recovery on the right track

Harmonised consumer price index (HCPI), % y/y



Source: Eurostat

The government is therefore estimating that the structural deficit will improve by half a point of GDP in 2017, the minimum required of a country still under the excessive deficit procedure, whilst the European Commission, taking a less optimistic view, puts the improvement at just 0.2 points of GDP. Compared to 2016, where fiscal policy added 1.2 points to GDP, the change of speed is nevertheless major, which explains the expected impact on the prospects for economic activity. Although nearly a point slower than in 2016, growth will still be sufficiently robust to contribute to a significant cyclical reduction in the deficit.

Overall, and given that the European and global economic environments remain favourable, the Spanish government looks well placed to win its bet: with growth estimates of just over 2% this year and in 2018 and a minimal fiscal adjustment effort, our estimates, like those of the European Commission and the IMF[3], suggest that Spain will meet its European commitments and bring its deficit to just under 3% of GDP in 2018.

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[1] And the positive cyclical effects of growth on trends in spending and tax receipts.

[2] Formally, the Commission is expected to recommend the closure of the procedure for Portugal within the next few weeks, once Eurostat has confirmed that the deficit dropped below 3% in 2016. The Greek deficit also fell below this threshold last year.

[3] *Winter 2017 Forecast* for the EC and *World Economic Outlook*, April 2017 for the IMF.

Brazil

A game of good cop, bad cop

Economic activity was disappointing again in late 2016, bringing the contraction in GDP to an average of 3.6% for the year. Yet there are increasing signs that the economy is pulling out of recession, lending credibility to the hypothesis of a very gradual upturn in economic activity in the quarters ahead. Restricted in recent years by inflationary pressures and budget overruns, the central bank now has free reign to ease monetary conditions (good cop). A stronger real, rapid disinflation and the highly awaited decline in real interest rates are all support factors for a recovery, unlike fiscal austerity (bad cop), which is nonetheless essential for the credibility of the policy mix.

The light at the end of the tunnel

Real GDP contracted for the eighth consecutive quarter in Q4 2016, at a seasonally-adjusted rate of 0.9% q/q. This brings the cumulative decline since year-end 2014 to 8.2%. The recession did not spare any of the components of GDP, neither in terms of supply or demand. With gross fixed capital formation down 1.5% in Q4, investment has declined by 22.8% in two years, to only 16% of GDP in 2016. Household consumption declined 0.6% in Q4, and 9.6% over the past two years, squeezed by a very depressed job market situation. Over the past two years, 3.6 million formal sector jobs were destroyed, bringing the jobless rate to 13% of the active population. Despite ongoing disinflation (see below), real wages continue to decline, and shed another 5.9% year-on-year in February. Given the sluggishness of domestic demand, imports naturally declined 10.4% in volume in 2016. At the same time, exports increased by a feeble 1.6%.

Our forecast of a gradual economic recovery starting in Q4 2016 proved to be too optimistic. Retail sales (bolstered by a recent change in methodology) and household consumption are not expected to swing back into positive territory in Q1 2017. Yet there have been more and more positive signals recently. Business and household confidence indicators continue to pick up. In February, net job destructions in the formal sector came to a halt for the first time since November 2014. Total industrial output, including manufacturing, mining and construction, has picked up (+1.5% y/y, 3-month moving average in February), for the first time since November 2013.

Extraction industries (mining and oil) should continue to benefit from the rebound in commodity prices. At 46.9 in February, the purchasing managers index (PMI) for the manufacturing sector was still lower than 50, the threshold that separates economic expansion from contraction. Yet production capacity utilisation rates in manufacturing increased slightly in January and February, even though they are still 5 points below the long-term average of 81%. The recently observed rebound in domestic automobile sales and especially exports (essentially to Argentina) should stimulate production in the months ahead. The construction sector's recovery is much less certain: the residential market has slumped after the boom years of 2006-2013, and certain projects and bids to tender have been halted or frozen in connection with the sprawling Petrobras corruption scandal, a legal quagmire that is unlikely to end anytime soon. Lastly, after a tough year for the agricultural sector in 2016, the national statistics institute (IBGE) expects harvests to increase by more than 20% in 2017, notably in the first part of the year. The recent "rotten meat" scandal is unlikely to have more than temporary impact on Brazil's cattle and poultry industries, in which the country is a world leader.

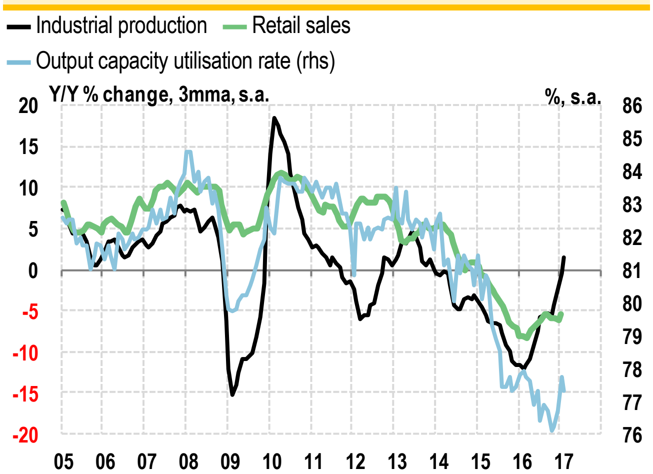
The March consensus of economists calls for average GDP growth of 0.5% in 2017 and 2.4% in 2018, in line with the government's forecast. The IMF is forecasting growth of 0.2% and 1.5%, respectively. In the midst of fiscal austerity, the easing of monetary policy should play a key role in lifting Brazil out of recession.

1- Summary of forecasts

	2015	2016e	2017e	2018e
Real GDP growth (%)	-3.8	-3.6	1.0	3.0
Inflation (CPI, year average, %)	9.0	8.8	4.1	4.3
Fiscal balance / GDP (%)	-10.3	-8.9	-9.6	-8.3
Gross public debt / GDP (%)	66.2	69.5	78.7	80.3
Current account balance / GDP (%)	-3.3	-1.2	-1.4	-2.1
External debt / GDP (%)	30.5	34.2	29.0	28.1
Forex reserves (USD bn)	349	354	360	365
Forex reserves, in months of imports	20.7	23.9	22.1	19.5
Exchange rate USD/BRL (year end)	3.9	3.3	3.0	3.3

e: BNP Paribas Group Economic Research estimates and forecasts

2- Economic indicators



Sources: IBGE, BCB, BNP Paribas

Monetary policy, the good cop

Even though Brazil is not very open to trade, macroeconomic adjustments have nonetheless helped consolidate the external accounts since 2014. For the past year, the improvement in the terms of trade, thanks to higher commodity prices, notably for metals, has supported this consolidation movement. As a result, Brazil reported a trade surplus of USD 45 bn last year, the highest level since 2006. The current account deficit (USD 23.5 bn) is largely covered by the net inflow of foreign direct investment (USD 71.1 bn), which remains very buoyant despite the economic and political crisis. At the same time, Brazil was hit by a net outflow of portfolio investment (-USD 19.2 bn in 2016), as non-resident investors pulled out of the local bond market (-USD 26.6 bn), but the equity market was still attractive (+USD 6.3 bn). Since late 2015, BRL has regained 24% against the US dollar (after dropping 33% in 2015), and the Sao Paulo stock exchange has gained 47%.

The disinflationary process at work over the past year has continued in this environment. The increase in the IPCA general price index slowed to 4.6% y/y in March 2017, from 10.7% y/y in January 2016. It is now in line with the BCB's target range (4.5%, +/- 2 pp). The BCB no longer considers that disinflation is due solely to the real's appreciation and the slowdown in food prices. It has now spread more broadly to factors and sectors more sensitive to the business cycle and monetary policy, such as the services sector. The Selic rate has been cut four times over the past six months, from 14.25% to 12.25%. It seems highly likely that monetary easing will continue, and could even be amplified, especially since inflation expectations are firmly anchored at 4.15% for year-end 2017, and 4.50% for 2018 and 2019.

In the midst of a deleveraging phase (the bank loan to GDP ratio dropped 4 points to 48.7% in just one year), the slight decline in borrowing rates has not stimulated lending yet, but it has helped ease the financial constraints on rather heavily indebted economic agents. In February, corporate loans outstanding contracted 9.6% y/y with commercial banks and 10.1% y/y with development banks. The non-performing loan ratio for commercial loans 90 days overdue has levelled off in recent months at about 3.5%, which is low considering the severe deterioration in balance sheets since 2011, and major needs for refinancing, notably in foreign currency (more than 50% of corporate debt, including Petrobras, is in foreign currency). As to households, loans outstanding have continued to increase very slightly, and the non-performing loan ratio as dipped in recent months.

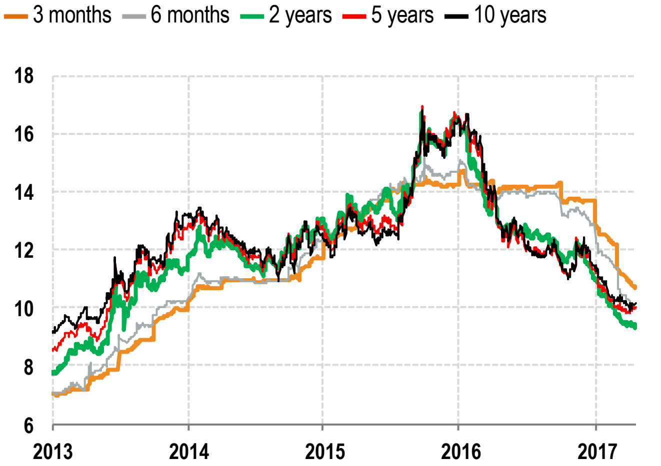
All in all, lowering real interest rates is the key to hopes for a gradual but lasting economic recovery, and to the easing of debt servicing charges on public debt.

Fiscal policy, the bad cop

Fiscal austerity is still necessary given the deterioration of public finances and the difficult process of consolidation. The primary and overall deficits have reached 2.3% and 8.5% of GDP, respectively, in the 12 months to February, and the public debt peaked at 70.6% of GDP. After adopting a law last December to freeze public spending in real terms, parliament was recently presented a pension reform project. Amendments will be made and the final text is not expected to be adopted before September.

3- Local bond yields

Annual, %



Source: Macrobond

Congress is still divided, and operation Car Wash (Lava Jato) is bound to weaken reform efforts in the run-up to general elections scheduled for October 2018. The corruption investigation hangs like a sword of Damocles over the entire political class. Former president Dilma Rousseff has been brought to trial in the October 2014 presidential campaign finance scandal. The new president, Michel Temer, will not be spared since he was Rousseff's running mate and former vice president, but he nonetheless benefits from immunity.

Justifying its actions based on the downward revision of growth prospects for 2017, the government announced a new series of austerity measures in late March that aims to generate BRL 58.2 bn in additional savings (about 0.9 points of GDP) to comply with its primary deficit target (BRL 139 bn). The programme includes BRL 42 bn in new budget cuts (half from operating expenses and a quarter from the Growth Acceleration Programme), BRL 10 bn in one-off revenues from concessions (notably electrical power), and BRL 6 bn in additional tax revenues (elimination of certain tax loopholes and an adjustment in the financial transactions tax).

All in all, the positive momentum that has been unleashed in recent months remains fragile. An outbreak of social-political risks, the failure of reforms or a real and/or external financial shock could trigger a new bout of weakness in BRL and a reversal in monetary policy, all of which would drive up sovereign risk.

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Russia

The recovery is taking shape

Russia's macroeconomic situation has consolidated. After a 2-year recession, the Russian economy swung back into growth in fourth-quarter 2016, inflationary pressures dropped sharply allowing the central bank to ease monetary policy, the rouble has appreciated significantly over the past twelve months, and the government launched a major programme to consolidate public finances. In the light of this new environment, the rating agency Standard & Poor's attached a positive outlook to Russia's sovereign rating, suggesting that it could soon be upgraded to "investment grade" if the country's macroeconomic situation continues to strengthen.

Exit from recession is confirmed

In fourth-quarter 2016, the Russian economy pulled out of recession as GDP rebounded by 0.3% year-on-year. For the full year, the economy contracted only 0.2%, after a 2.8% decline in 2015 (after revisions). Yet net exports were the only component that made a positive contribution to growth (1.5 percentage points), even though they slowed compared to 2015. For the second consecutive year, household consumption and investment declined, but at a much milder pace than in the previous year.

As to 2017, growth prospects are looking strong. Two factors are expected to fuel a rebound in economic activity: 1) the acceleration in household consumption, lifted by higher real revenues, and 2) an upturn in investment at a time of monetary easing. Given the sharp drop in inflationary pressures (prices rose only 4.5% yoy in March, down from 8% in the year-earlier period), the central bank managed to lower its key rates by 25 basis points (bp) in March, and is expected to continue along this path with a cumulative rate cut of 150 to 200bp over the full year to support growth.

Medium-term growth potential is still weak at 1%, or possibly 1.5%. Powerful structural constraints are still holding back the Russian economy[1]. To counter these headwinds, President Poutine set up a programme co-directed by the finance ministry and Alexeï Kudrin, the former finance minister, to establish a new medium to long-term development strategy to stimulate potential growth. Nonetheless, no large-scale reforms are likely to be launched before the next presidential elections in March 2018.

Public finances are less risky

A year ago, one of the biggest sources of concern was the country's public finances, even though total government debt including public administrations was less than 15% of GDP. It wasn't the size of the deficit that was alarming, but its financing. After international sanctions were set up, the government clearly had to dig into its reserve fund to finance a swelling budget deficit, made worse by the erosion of oil revenues. In two years, the reserve fund was down by nearly USD 72 bn (-82%).

Today, the situation is less alarming for several reasons: 1) oil prices have picked up, 2) the government has launched a fiscal austerity programme that aims to cut spending by 1 point of GDP annually, and to reduce the deficit to only 1% of GDP by 2019 (vs. 3.4% of GDP in 2016), and 3) the finance ministry adopted a "temporary" law to transfer surplus oil revenues above USD 40 a barrel to the reserve fund. Adopted in February, this key measure should help rebuild the reserve fund sufficiently so that the government will not have to dip into the national wealth fund in 2017.

The reserve fund could increase by an estimated USD 18 bn in full-year 2017, assuming that oil prices average USD 52 a barrel. The finance minister also intends to finance more than 30% of the deficit by issuing debt, notably on domestic markets. He hopes to be able to take advantage of the increase in liquidity in the banking sector.

With the reserve fund depleted, in 2018 the government intends to tap into the national wealth fund, using about USD 17 bn (out of a

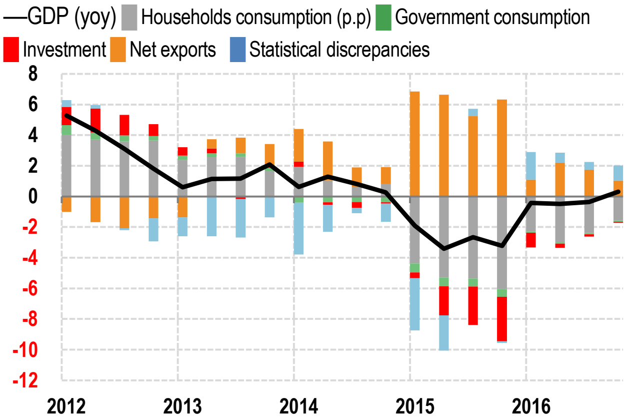
1- Summary of forecasts

	2015	2016	2017e	2018e
Real GDP growth (%)	-2.8	-0.2	1.8	1.4
Inflation (CPI, year average, %)	15.5	7.1	4.9	4.5
General gov. balance / GDP (%)	-2.4	-3.7	-2.7	-2.1
Public debt / GDP (%)	13.6	14.3	15.6	15.2
Current account balance / GDP (%)	5.2	1.9	3.4	3.2
External debt / GDP (%)	38.9	38.1	32.2	30.6
International reserves (USD bn)	368	380	401	438
International reserves, in months of imports	11.9	13.3	12.9	12.9
Exchange rate RUB/USD (year end)	72.5	60.3	67.5	68.3

e: BNP Paribas Group Economic Research estimates and forecasts

2- GDP growth and components (percentage points)

Year-on-year, %



Source: Rosstat

[1] The sub-optimal allocation of production factors, which is straining productivity, can be attributed to declining demographics, a heavy dependency on oil prices and the state's overly strong presence in the economy.

total of USD 73 bn) to finance 57% of the deficit. The remainder will be financed almost exclusively through debt issued in domestic markets. In 2019, nearly 89% of the deficit (estimated at 1.2% of GDP) will be financed in this manner.

The net external position is still solid

In full-year 2016, Russia reported a balance of payments surplus of about 0.7% of GDP, up 0.6 points of GDP compared to 2015.

Although the current account surplus declined, foreign investment picked up and private capital outflows fell sharply (-67%).

In 2016, the current account surplus shrank to 1.9% of GDP, down from 5.1% of GDP in 2015. This decline is notably due to the 2.7 point decline in the trade surplus, reflecting the slowdown in exports in value terms.

At the same time, foreign direct investment (FDI) accelerated to 0.8% of GDP for the year (vs. -1.1% of GDP in 2015), reflecting the partial disposal of Rosneft, while portfolio investments increased significantly, to 0.2% of GDP. Moreover, loan payments by all private sector agents increased to 2% of GDP in 2016, which is 0.4 points more than in 2015.

For full-year 2016, net capital outflows slowed to only USD 13 bn, equivalent to 1% of GDP, compared to USD 70 bn the previous year.

Russia is still a net creditor in foreign currency, even though its position declined sharply in 2016. At year-end 2016, it came to USD 227 bn, equivalent to 17.6% of GDP, nearly 7 points less than the previous year. This 32% decline reflects the increase in the valuation of assets held by non-residents, and the privatisation of Rosneft.

Russia's external debt swelled to USD 513.5 bn at year-end 2016, equivalent to 39.7% of GDP, from 29% of GDP two years earlier. Yet the sharp increase in the debt-to-GDP ratio is not alarming because it reflects the decline in GDP in dollar terms (-37.8%), even though the level of debt contracted by 14.4%. After international sanctions were set up, private sector debt diminished by 15.7%. In 2016, the private sector continued to deleverage. In contrast, government debt increased after two sovereign debt issues to finance the fiscal deficit.

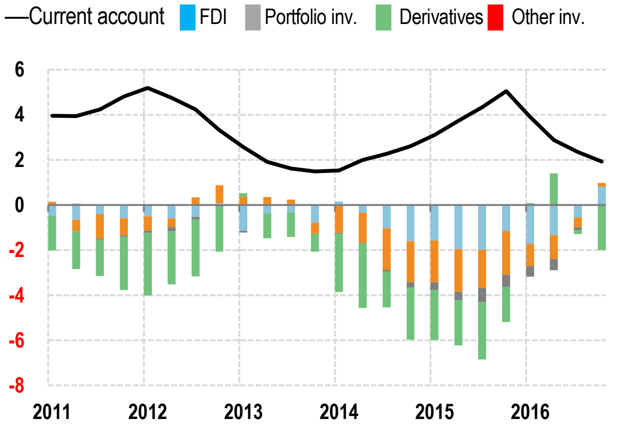
Debt payable within a year amounts to about USD 97.3 bn, of which USD 67.5 bn is for companies and USD 26.5 bn for banks.

The outlook for the balance of payments is favourable. Since the second half of 2016, the terms of trade have improved and the current account surplus rose significantly in first-quarter 2017. Even assuming there is a net slowdown in capital inflows (no large-scale privatisation projects are in the works), private capital outflows should continue to decline in full-year 2017, in line with the decrease in debt repayments. Foreign reserves are expected to increase by more than USD 20 bn.

Banking sector consolidation is underway

The most recently available banking statistics show a slight improvement in the situation of the Russian banking sector in fourth-quarter 2016. The worst seems to be over.

3- Balance of payments (4-quarter moving sum, % of GDP)



Source: Central Bank of Russia (CBR)

According to IMF data, the non-performing loan ratio improved slightly compared to the two previous quarters, down 0.2% to 9.4%. Non-performing loans are still concentrated in sectors turned exclusively towards the domestic market, such as construction and wholesale and retail sales. Loans that are more than 90 days overdue account for 24.7% and 13.4% of sector loans, respectively, which in turn accounted for 5.6% and 12.1% of total loans outstanding. In fourth-quarter 2016, business continued to contract in both sectors.

At the same time, solvency ratios have increased to 13.1% (9.2% for Tier 1 capital at the end of the year) and the financial performance of banks has improved. According to the central bank, ROA was 1.2% and ROE, 10.3%, in January 2017.

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India

Narendra Modi consolidates his power

The withdrawal of 500 and 1000 rupee notes does not seem to have had much of an impact on economic activity or on Narendra Modi's popularity. His BJP party won a major victory in legislative elections in Uttar Pradesh, India's most heavily populated state. Although Mr. Modi still falls short of a majority in the upper house of parliament, this victory nonetheless consolidates his power: he now controls 17 states and two union territories. Despite demonetisation, GDP growth reached 7% year-on-year in the third quarter of fiscal 2016/17, buoyed by robust domestic demand. Nonetheless, the difficulties of public-sector banks still seem to be squeezing financing for corporate investment.

7% growth in Q3 2016/17

In the third quarter of fiscal year 2016/17 (ended 31 March 2017), India reported GDP growth of 7% year-on-year (y-o-y), which is much stronger than expected. Despite the withdrawal of 500 and 1000 rupee notes in November, domestic demand increased 11.4% y-o-y in the third quarter of fiscal 2016/17 (vs. 6.9% the previous quarter).

According to preliminary estimates, growth rates were particularly strong for household consumption, public spending and investment. The only component that made a negative contribution to growth was net exports, due notably to an acceleration in imports (+4.5% y-o-y), a reflection of the strong increase in domestic demand.

The acceleration in investment (+3.5% y-o-y) seems to be due solely to government actions. Although quarterly statistics do not allow us to differentiate between investments by economic agent, the growth in bank lending to companies (+1.5% y-o-y) suggests that private investment did not accelerate.

Although growth prospects are still favourable, January's statistical indicators raise fears of an economic activity in the fourth quarter of 2016/17. Industrial output slowed to 1.3% y-o-y, the production of consumer goods contracted 3.5% y-o-y, and automobile sales declined for the third consecutive month (down 5.1% y-o-y). Triggered by the withdrawal of 500 and 1000 rupee notes, this economic slowdown should nonetheless be short lived. By the end of February, the quantity of money in circulation was estimated at 63% of the amount that prevailed at the end of October 2016.

Fragility of public-sector banks strains lending

The distribution of bank loans has been squeezed by the deterioration of the balance sheets of public-sector banks, which grant more than 71% of loans.

For the past five years, bank lending in India has slowed constantly as businesses have worked to clean up their balance sheets. More recently, however, the public-sector banks have become more reticent to grant loans, given the deterioration of their own balance sheets. At the end of January, bank lending increased only 3.3% y-o-y, and industrial loans contracted. The Indian authorities are aware of the problem created by the deterioration in the public-sector banks' financial situations. Cleaning up their balance sheets is now an essential condition for jump-starting lending. Yet despite numerous measures to restore their health, the amount of assets at risk (non-performing loans and restructured loans) has increased constantly. On the whole, the provisions of public-sector banks are too small to cover expected losses. In February, the Deputy Governor of the Reserve Bank of India (RBI) and the Finance Ministry both suggested the creation of a centralised special purpose vehicle or bad bank. Yet the draft budget for fiscal year 2017/18 does not provide any funding for such a structure. Moreover, despite the deterioration in the balance sheets of public-sector banks, the finance ministry did not raise the amount of bank recapitalisation for the year 2017/18, which now falls far short of the needs of the public-sector banks[1]. The Narendra Modi government

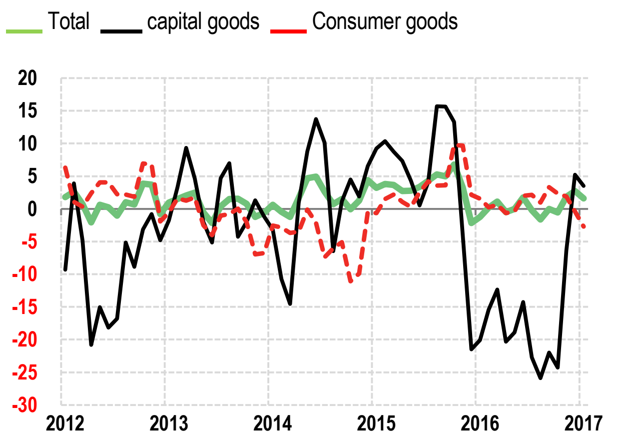
1- Summary of forecasts

	2015	2016	2017e	2018e
Real GDP growth(1) (%)	7.2	7.9	7.0	7.7
Real GDP growth(2) (%)	7.5	7.5	7.3	7.8
Inflation (2) (CPI, year average, %)	4.9	5.0	5.2	5.3
Central Gov. Balance(1) / GDP (%)	-4.1	-3.8	-3.5	-3.2
Central Gov. Debt(1)/ GDP (%)	46.6	47.2	47.0	45.9
Current account balance(1) / GDP (%)	-1.3	-1.1	-0.8	-1.7
External debt(1)/ GDP (%)	23.0	23.2	21.2	20.4
Forex reserves(1) (USD bn)	322	336	337	369
Forex reserves(1), in months of imports	6.7	7.8	7.7	7.9
Exchange rate INR/USD (year end)	66.2	67.9	68.5	69.0

(1): Fiscal year from April 1st of year n-1 to March 31st of year n
(2): Calendar year

e: BNP Paribas Group Economic Research estimates and forecasts

2- Industrial output (year-on-year, %)



Source: CEIC

[1] The government plans to inject INR 100 bn (USD 1.5 bn) in fiscal 2017/18, in keeping with the recapitalisation programme established in March 2015.

seems to have made the consolidation of public finances a top priority.

A cautious 2017/18 budget

The finance ministry aims to reduce the deficit to 3.2% of GDP in 2017/18, i.e. 0.3 points less than the outlook for fiscal 2016/17. Furthermore, the deficit is to be cut to 3% of GDP by fiscal 2018/19. Public finances will be consolidated by cutting back spending as a share of GDP, while the tax base remains weak. For the year 2016/17, government revenues (excluding privatisation proceeds) amounted to only 9.4% of GDP, and the government expects a decline equivalent to 0.4 points of GDP in fiscal 2017/18 following the introduction of the goods and services tax (GST). To contain the deficit, the finance ministry intends to reduce spending to 12.7% of GDP in 2017/18 (vs. 13% of GDP in 2016/17). The two biggest expenditures are still debt servicing charges (3.1% of GDP) and subsidies (1.3% of GDP). In the current year, spending cuts will be derived from the recapitalisation of banks (which will cost only 0.06% of GDP vs. 0.2% of GDP in fiscal 2016/17) and from savings on interest charges (-0.1 point of GDP).

Goods and Services Tax to be applied on 1 July?

Last August, the Modi government managed to get the upper house of parliament to approve the Goods and Services Tax law. But the GST Council, comprised of 16 states and 2 union territories, still had to set the GST tax rate and base, as well as the compensation terms for the different states. This has now been done. The final draft was validated by Parliament during the fiscal session held in March-April. Nothing more now stands in the way of the application of GST, which the government has scheduled for 1 July 2017 (3 months later than initially planned), although the actual date could be postponed again for logistical reasons.

The finalised GST tax has no major divergences from the initial project. Four standardised tax rates – 5%, 12%, 18% and 28% – will be applicable in all states based on the type of goods. All food products (50% of the consumer basket) and alcohol will be tax exempt.

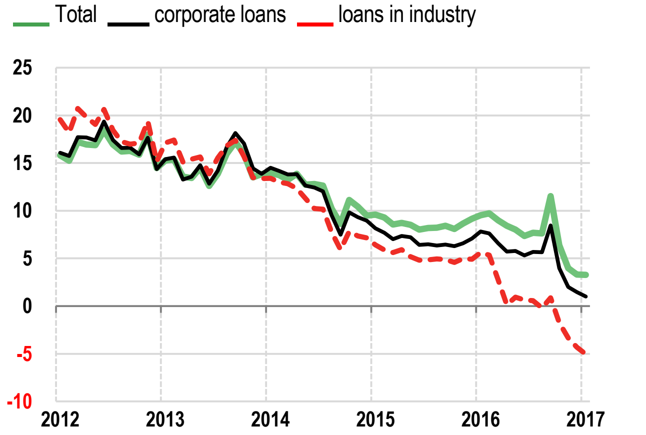
The most heavily taxed products are luxury goods. Certain luxury products will be subject to an additional tax, and the revenues will be used to offset the states' loss of financing. The government will calculate financial compensation based on the assumption that states' fiscal revenues should increase by 14% a year, using the revenues for fiscal 2015/16 as the benchmark.

Some regret that the government did not manage to apply a single tax rate (rather than four different tax rates), but this reform is nonetheless a significant advance.

BJP wins big in legislative elections

During the latest legislative elections in February, Mr. Modi's Bharatiya Janata Party (BJP) won Uttar Pradesh, one of the opposition's fiefs, with 312 out of 403 seats, up from only 47 seats previously. The BJP also won elections in Uttarakhand and maintained control of Goa, thanks to various political alliances. In

3- Loans (year-on-year, %)



Source: RBI

Manipur, the BJP joined the state government for the first time, and it should be able to form a coalition government. In Punjab, in contrast, the opposition Indian National Congress Party won the majority of seats.

The BJP and its allies now head 17 of the 29 states and 2 of the 7 union territories.

The victory of Mr. Modi's party in Uttar Pradesh is crucial because this state, the most heavily populated in India, has 31 seats in the upper house of parliament (Goa and Manipur have only 1 seat each, and Punjab and Uttarakhand have 7 and 3 seats, respectively). In 2018, 10 of the 31 Uttar Pradesh seats and 1 Uttarakhand seat will be up for renewal, which will enable the BJP to reinforce its position in the upper house of parliament. Since Narendra Modi took power, the BJP and its allies have won 18 seats in the upper house. Thanks to their recent victories and the upcoming change of seats in the upper house, they will hold 86 out of 245 seats by the next national elections in May 2019 (an 18-seat gain since 2014), more than the opposition party but still not enough to claim a majority.

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The government has already injected INR 250 bn on two occasions, in 2015/16 and again in 2016/17.

China

Cautious monetary policy tightening

Economic growth has picked up slightly over the past two quarters, supported by the authorities' stimulus policy measures. In Q1 2017, the growth acceleration was fuelled by a rebound in industrial activity, lifted by stronger domestic demand and an upturn in exports. This cyclical strengthening has enabled the central bank to start to tighten monetary policy cautiously, in response to the continued rise in credit risks and liquidity risks in the financial sector. However, downside risks to short-term economic growth prospects remain high, and the authorities' determination to contain financial risks could be tested rapidly in case of another slowdown in economic activity.

Industrial production growth has accelerated

Economic growth accelerated slightly in Q4 2016 and again in Q1 2017. Real GDP rose by 6.9% year-on-year (y-o-y), compared to 6.8% in the previous quarter and 6.7% for full-year 2016. Of the three main sectors of activity, services continued to report the strongest growth (7.7% y-o-y in Q1 2017, vs. 7.8% in 2016), but the industry was the only sector to report an acceleration (6.4% y-o-y in Q1 2017, vs. 6.1% in 2016), buoyed by brighter export prospects and stronger domestic demand.

After two years of contraction, Chinese exports rose by 4% in Q1 2017 compared to Q1 2016 (in US dollars), in a world environment marked by an upturn in demand, prices and trade volumes. This recovery is likely to consolidate in the very short term, and the yuan's recent depreciation (-6% in real effective terms in 2016) is also likely to help. Yet downside risks are still high, notably due to the persisting uncertainty shrouding world trade growth prospects and the possible rise in trade tensions with the United States.

Domestic demand has been the main factor supporting Chinese economic growth over the past year, and again in Q1 2017. Stimulus policy measures have helped turn around three sectors in particular: i) public infrastructure: investment growth rebounded in H1 2016 and again in early 2017, notably in water conservation and environmental projects (see chart 2); ii) real estate: the market has gradually picked up since year-end 2015 (sales and prices have rebounded in a growing number of cities, then triggering an upturn in investment), in response to monetary policy loosening and to the easing of the government's "property policy" (i.e. the prudential rules applied to real estate transactions and loans); and iii) automobile sales, which rose more than 10% in 2016, stimulated by fiscal incentives. Automobile sales have dropped off since early 2017 after the tax rate on small car purchases increased. Retail sales are currently supported by the need for durable goods that is accompanying the rebound in real estate transactions; however, the continued slowdown in household revenue growth remains an important constraint on the expansion of private consumption.

The rebound in activity in the sectors directly targeted by the stimulus policy measures had only very limited spill over effects on the rest of the economy. Yet, investment in the manufacturing sector has also picked up since last fall (see chart 2), buoyed by the upturn in producer price inflation (which swung back into positive territory in September and reached 7.6% y-o-y in March 2017) and the growth rebound in profits of industrial enterprises (+9% in 2016, and +32% y-o-y in the first two months of 2017). The recovery in private investment growth in early 2017 also seems to have been fuelled by the development of infrastructure projects financed through public-private partnerships.

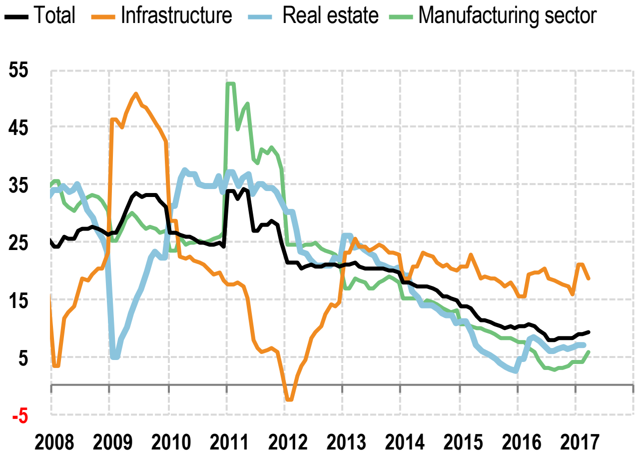
1- Summary of forecasts

	2015	2016e	2017e	2018e
Real GDP growth (%)	6.9	6.7	6.5	6.4
Inflation (CPI, year average, %)	1.4	2.0	2.7	2.5
Official budget balance / GDP (%)	-2.4	-3.0	-3.5	-3.3
Central Gov. debt / GDP (%)	15.6	16.0	18.6	20.8
Current account balance / GDP (%)	3.0	1.9	1.6	1.4
External debt in FC / GDP (%)	5.6	4.5	4.0	3.8
Forex reserves (USD bn)	3 330	3 011	3 100	3 184
Forex reserves, in months of imports	19.5	17.8	17.6	17.2
Exchange rate CNY/USD (year end)	6.5	6.9	7.1	7.0

e: BNP Paribas Group Economic Research estimates and forecasts

2- Investment growth recovery

Nominal Fixed-Asset Investment, year-to-date, year-on-year, %



Source: NBS

Monetary policy is turning less growth-supportive

Infrastructure investment will remain a key growth engine in the quarters ahead. The expansionist fiscal policy could also take the form of new tax measures in favour of companies and households, if private demand were to slump again. In contrast, monetary policy has recently become less accommodative, and is likely to remain very cautious in the short term. The "property policy" has also become more restrictive in recent months (and still differentiated from one city to another), as home purchase restrictions and rules applied to mortgage loans have begun to be tightened in more than 30 cities where house prices have increased excessively fast.

PBOC (People's Bank Of China) has numerous objectives (it must guarantee price stability, support economic growth and the job market, promote financial reforms, etc.). Two main goals were given priority for 2016 and 2017: supporting economic growth and financial stability. The first priority led the monetary authorities to pursue an expansionist policy through Q3 2016, in response to the rapid slowdown in industrial growth. The second priority justifies recent monetary policy tightening actions. As a matter of fact, credit risks, risks of liquidity tensions in the financial sector and risks of asset market bubbles are elevated and have only increased further over the past year. With the recent improvement in real GDP growth rates and industrial performance and the upturn in producer price inflation, the authorities have been able to rank their priorities somewhat differently.

PBOC has announced a "prudent and neutral" monetary policy for 2017, and set a target for growth in total social financing (+12%) that is slightly lower than the 2016 target (+12.8%). In fact, the authorities have already taken actions to tighten monetary conditions.

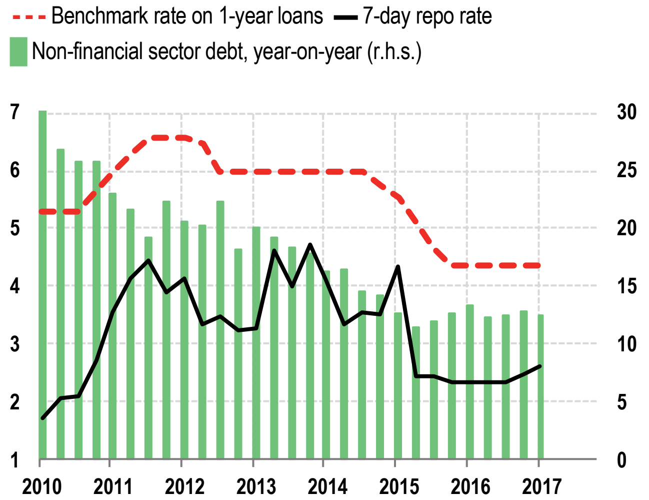
The central bank uses a series of liquidity management instruments, such as reserve requirement ratios but, most importantly, it has also resorted increasingly to open-market operations and to "liquidity facilities", which enable to provide liquidity to certain well-targeted institutions. Interest rates on these liquidity facilities and repo rates have in fact become the main determinants of interbank market rates. Repo rates have been increased gradually since Q4 2016 (see chart 3) and the rates on the liquidity facilities have been increased since early 2017.

PBOC still has recourse to its "benchmark interest rates on loans and deposits". Although there are no longer any interest rate controls since October 2015, commercial banks continue to monitor these benchmark rates to determine the rates they offer customers. These benchmark interest rates, which were cut six consecutive times between year-end 2014 and year-end 2015, have been held steady ever since (see chart 3).

These actions illustrate the cautious approach of the monetary authorities. They want to avoid raising too much the cost of borrowing for households and corporates in order not to weigh on activity or aggravate debt servicing charges, but at the same time, they tighten monetary rates in order to discourage the use of interbank financing. Interbank financing has indeed increased steadily in the recent past and is largely used by small banks and non-bank financial institutions (shadow banking). The problem is that excessive reliance on interbank financing aggravates the risks of financial instability, by increasing the volatility of the creditors' sources of financing, balance-sheet transformation risks and contagion risks in case of a liquidity squeeze on certain institutions. These risks only add to the already high level of credit risks resulting from the debt excess of the Chinese economy (debt of the non-financial sector reached an estimated 213% of GDP at the end of Q1 2017), from the lack of supervision and weak governance of financial institutions.

3- Repo rates trending up

Interest rates and variations in %



Sources: PBOC, BNP Paribas

New macro-prudential measures were introduced in recent months to address this later point, aimed at strengthening risk management by both the authorities and the financial institutions.

Prudent monetary policy tightening, a more restrictive property policy in cities with overheating housing markets, and a tighter regulatory framework for the financial sector are positive steps, which might not enable to reverse, but at least could help stabilize the dynamic of worsening credit risks registered in the last decade. However, to achieve this would mean maintaining a "cautious policy tightening" stance. Yet this policy could be rapidly called into question if economic growth were to slow down excessively, due to the very impact of the recent tightening of monetary conditions, for example. Stable economic growth will indeed remain Beijing's top priority, at least until the 19th Congress of the Communist Party in fall 2017.

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United Kingdom

Britainectomy

Brexit hasn't happened yet, but the countdown has begun. The UK and the EU-27 have two years to unwind relations that are proving to be much closer and more complex than British voters imagined when they voted in the June 2016 referendum. The ball is now in the European's court. Parliament seems to have heard the European Commission's call for unity. A special Council meeting has been called and the talks will begin. As the days go by, the inextricability of UK-EU relations is becoming increasingly clear, and the UK government seems to be reluctantly accepting that it will have to make inevitable sacrifices. Negotiations will be complex against the backdrop of a slowing economy, as Sterling's depreciation erodes household purchasing power and consumer spending…

Brexit still has not occurred yet, and estimating its consequences on the UK economy is almost as complex as the process of leaving the European Union. This process was officially launched on March the 29th, when the UK ambassador to the EU officially delivered notification to the European Council's president signalling the country's intention to leave. The Lisbon Treaty's now famous Article 50 sets a 2-year time limit for completing negotiations. Yet each week brings a new batch of details illustrating the inextricability of the UK-EU relations.

Three phases

Just a few days after the UK officially notified the EU of its intentions to leave, Michel Barnier, the head of Europe's negotiating team with the British, presented the Commission's approach and provisional calendar. The European position is to conduct the negotiations in three phases, and each phase must be resolved before the next one can be started. Ahead of the European Parliament's vote of April the 5th, Michel Barnier warned Members of the European Parliament (MEPs) that the UK would probably seek to lead parallel negotiations, and that it was vital for Europe not to yield this point to the British. He laid down two other conditions for success: maintaining a united front and lifting uncertainties as quickly as possible.

For the Commission, the first step is to untangle the UK's ties and obligations. This raises several questions, notably the UK's financial commitments to the EU (Jean-Claude Juncker estimates them at EUR 60 billion, a figure the UK government finds absurd); the respective rights of European citizens residing in the UK and the British living in Europe (which concerns 4 million individuals); and the border separating Ireland. According to Mr. Barnier's reverse calendar method, this phase of negotiations should take place between June and December 2017.

The next phase, from January to June 2018, would be much the most complex according to the negotiators. It would examine the future relations between the UK and the European Union, notably in terms of trade, including financial services. The Europeans have very high ambitions. Mr. Barnier said that he would seek a very broad comprehensive agreement covering a wide range of issues from "social dumping" to workers' rights, tax regimes, public subsidies and competition. Observers will mainly focus on the UK's degree of access to the common market (and in exchange, any concessions on the free movement of people), and the future of London as a financial hub.

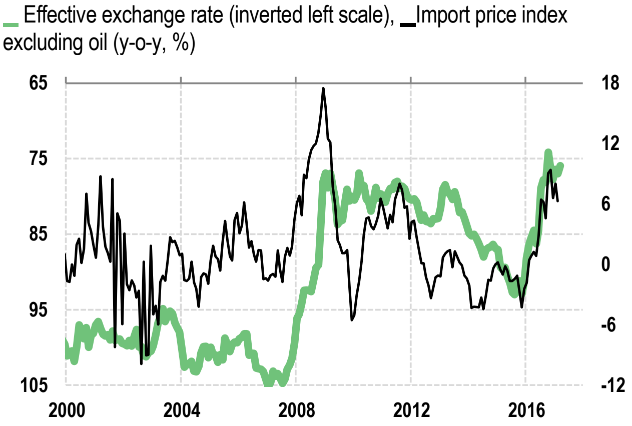
The third and final phase, from July to October 2018, would be the transition phase.

1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.8**	**1.8**	**1.1**
Private consumption	3.0	1.7	1.2
Gross Fixed Capital Formation	0.5	-0.2	-0.1
Exports	1.4	6.5	5.0
Consumer Price Index (CPI)	0.6	2.7	2.6
Unemployment rate	4.9	5.0	5.4
Current account balance	-4.7	-4.1	-3.2
Gen. Govt. Balance (% of GDP)	-3.0	-2.7	-3.1
Public Debt (% GDP)	87.7	87.4	88.2

e: BNP Paribas Group Economic Research estimates and forecasts

2- Imported inflation



Sources : Bank of England, Office for National Statistics

It is only after all this has been settled that negotiations, if any, would begin on a free-trade agreement. The European Parliament adopted this approach by approving a text that clearly states that no trade agreement can be reached before the UK effectively leaves the EU.

Following the Commission's recommendations, Parliament specified that before temporary measures could be envisioned, there first had to be tangible progress on negotiations. Lastly, it would be up to the UK and European parliaments (including UK MEPs) to vote to enact the agreements.

In the very short term, it is up to the European institutions to act. On April the 29th, a special European Council meeting will be held to approve the broad outlines of the UK's exit, which must be approved unanimously by all 27 member countries. The European Commission would then make recommendations concerning the start of negotiations. The Council will not start-up discussions until the text has been approved by a qualified super majority of its 27 members, i.e. at least 20 member states representing 65% of the population of the EU-27.

Two short years

The roadmap has been drawn up. It remains to be seen whether Europe's desire for transparency will be respected, especially given the UK government's propensity for secrecy. The big question is the deadline for completing negotiation. The timeframe is extremely short! Last year's free trade agreement between the EU and Canada, for example, was signed three years after it was approved, and after four years of discussion. Granted, there was no real sense of urgency, whereas for Brexit, it is in everyone's interest for things to advance rapidly. Even so, it will be hard to meet this 2-year deadline, which will soon raise the question of extending negotiations. Either the EU 27 agree to extend talks, or they cannot reach a unanimous decision and the UK will have to leave the EU in spring 2019 without an agreement in hand.

As if this were not difficult enough, there is also the question of Scotland, which voted massively for the UK to remain in the EU in June 2016. Nicola Sturgeon, First Minister of Scotland, is seeking a new referendum on Scottish independence. After receiving approval from Scotland's parliament, she has sent a formal request to the UK government. Theresa May's first response was to say that "now is not the time" and that the focus should be on "working together, not pulling apart". The second referendum could be held in late 2018 or early 2019, once the shape of the UK's Brexit deal becomes clear. Scotland seems to be determined to hold a referendum, whether or not it is legal and binding (which would require the UK government's prior approval). Nicola Sturgeon wanted to base the referendum on a draft agreement, notably concerning trade. The negotiating procedures imposed by Europe will make her task that much harder. This adds more uncertainty, at a time when Ireland, too, is asking questions about its future...

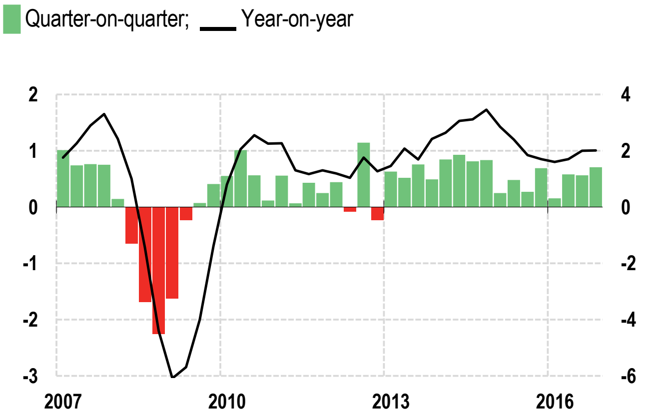
Recently, in a series of statements, the UK government seems to be backing away from the hard Brexit that it advocated at the beginning of the year. It has reluctantly agreed to follow European demands. Boris Johnson, current Foreign Secretary and one of the main champions of the Brexit campaign, recently admitted that the UK might have to accept maintaining the free movement of persons, after the UK exits the EU… Those difficulties as well as a pure game of domestic politics could either be the reasons why Theresa May has called for snap elections on June the 8th. Whatever the reason, the assumed willingness is to broaden the Parliament majority before entering the negotiations and to insure political stability for the years ahead.

First signs of a slowdown

First, the climate of uncertainty did not undermine the UK's economic performance. Quarterly growth even accelerated to 0.6% in the second half of 2016, up from 0.4% in the first half. Contrary to the fears expressed by some in the run-up to the June 2016 referendum, households and companies did not slash spending. As a result, the UK managed to avoid the much feared drop-off in investment.

3- About to slowdown

GDP growth, %



Source : Office for National Statistics.

In the end, it was not confidence but the external value of Sterling that finally cut into demand. Since the referendum, the UK currency has lost about 12% in value in effective terms. This depreciation triggered a surge in import prices: excluding petroleum-based products, the import price index peaked at 9.4% year-on-year in November 2016. Note that this index declined in both 2014 and 2015, after two years of stability. This movement was also accompanied by the upturn in oil prices, which places import prices on an annual slope of 10% since October 2016.

Inflation has accelerated strongly. The consumer price index rose 2.3% year-on-year in February and March. Of course, this is still a far cry from hyperinflation, and even from the most recent peaks: between 2010 and 2013, UK inflation averaged 3.3%. Yet the acceleration has been rapid and driven by core inflation. Excluding food and energy prices, core consumer price inflation rose from 1.2% year-on-year in May 2016 to 2% in February 2017 (before easing back to 1.8% in March).

Higher inflation is beginning to take its toll on demand, as illustrated by the sales statistics published by the British Retail Consortium (BRC). Smoothed over three months, retail sales growth is close to zero on a year-on-year basis, and it managed to remain in positive territory thanks to food products. Excluding food, the indicator contracted 0.8% in February, the worst performance since spring 2011. The national accounts suggest that household spending will contract at a quarterly rate of 0.8%, and that GDP growth will be limited to 0.1%.

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Belgium

Looking inward for growth

Growth is accelerating, fuelled by domestic demand. Supported by job-creation and consumer confidence, private consumption is picking up, and will continue to remain one of the main growth engines. Structural labour market problems - participation of the elderly and of non-EU workers - still exist, however. High operating surpluses, low interest rates and increasing capacity utilisation rates are spurring credit growth. Brexit-related uncertainties are the main downside risks. Public debt is still high. Last year's loosening of the fiscal stance does not bode well for those hoping for a lower indebtedness anytime soon.

In 2017 growth is expected to reach 1.4%, as strong domestic activity is amply outweighing the lower contribution from net exports. Meanwhile, unemployment continues to fall. The high inflation rate and weak government finances remain the main concerns.

GDP and prices

The first quarter of 2016 ended on a low note, with the terror attacks in Brussels and at Zaventem Airport. Thereafter, domestic economic activity slowed somewhat and it was mainly strong export growth that drove the whole economy forward. However, the growth disappointment of 1.2% in 2016 should be only a temporary dip. Over the next few years, the economy could grow by around 1.5%, in line with potential growth.

Inflation has risen strongly, reaching 1.8% in 2016, close to the ECB target ceiling of 2%. Like most neighbouring countries, Belgium is feeling the effects of the recovering oil prices and the further slide in the euro, resulting in generally higher price levels.

However, other factors have also played a role. Over the last few months, various government policy measures, notably a rise in energy taxes and other taxation, have pushed inflation higher. In addition, the producer price index rose sharply: by 10% since last summer, compared with an EU average of 3%. Coupled with the price rises seen in the hotels & restaurants and the telecom sector, inflation could exceed 2% this year.

The structurally higher inflation rate in Belgium than in the neighbouring countries has worried the government since long. The authorities have commissioned a study on the subject, which is due to be completed this year. The report is likely to point to the system of automatic wage indexation and the lack of price competition in certain sectors as the main reasons.

Job market and consumption

Job creation has been dynamic. Employment has for some time been growing by over 1% on an annualised basis. This has driven down the overall unemployment rate, which now stands close to 7%, compared with an average of just over 8% for the European Union as a whole.

Consumer confidence is rising again. Thanks to a sharp rise since last summer, the indicator has been above its long-term average for the last few months. This recovery in combination with the rising employment rate is having a positive impact on household consumption. Private consumption, growing by 1.3% in 2017, will remain a powerful motor for the economy.

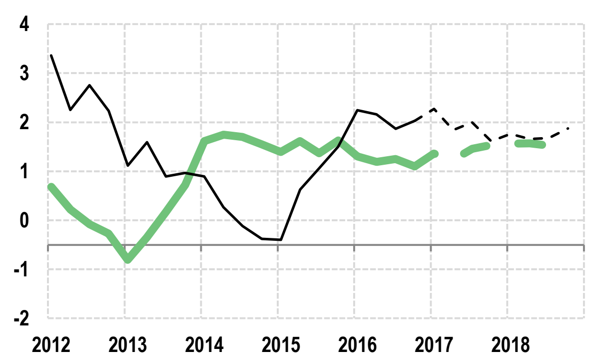
1- Summary of forecasts

Annual growth, %	2016 e	2017 e	2018 e
GDP	**1.2**	**1.4**	**1.5**
Private consumption	0.8	1.3	1.3
Gross Fixed Capital Formation	2.3	3.0	3.2
Exports	5.8	4.5	4.5
Consumer Price Index (CPI)	1.8	2.1	1.9
Unemployment rate	8.0	7.8	7.7
Current account balance	0.7	0.5	0.5
Gen. Govt. Balance (% of GDP)	-3.0	-2.3	-2.2
Public Debt (% GDP)	106.5	106.2	106.4

e: BNP Paribas Group Economic Research estimates and forecasts

2- Growth and inflation

Year-on-year, %



Sources: NBB, BNP Paribas Fortis forecasts

Recent labour market reforms were praised by both the OECD and the IMF. Pension-reforms should help increase the average effective retirement age, which has been one of the lowest of the advanced economies.

However, several issues remain. The employment rate of the elderly and the participation in "lifelong learning schemes" are well below the European average. Also the participation of female and non-EU workers ranks close to the bottom of the European table. To get the employment rate close to the European Commission's 2020 goal of 73%, much more effort will be needed.

Companies and their investment

Business leaders have become gradually more positive about their outlook, although the trading sector is lagging behind somewhat.

Interest rates on new loans to Non-Financial Companies (NFC's) have been declining. The average fixed rate has been below 2% for the last 12 months. Credit is growing by around 5% year-on-year. With credit standards tightening somewhat for NFC's, robust demand has been the main driver of the increased loan-production.

Gross operating surplus, the share of value added that is attributed to the production factor capital, is at its highest level since about 20 years. With companies boasting strong enough margins to raise capital expenditures, still low interest rates and new loans growing at a post-crisis high, the environment favours those with investment needs.

The capacity utilisation rate currently stands at around 80% and investment is beginning to pick up. Business investment could increase by 3% in 2017, which is a considerable acceleration from last year. However, the uncertainties arising from the Brexit negotiations might yet throw a spanner in the works.

As a large portion of Belgian export, 8% of the total in 2015, is destined for the United Kingdom, the stakes are high for the country. Its main trade flows to the UK consist of automobile, pharmaceuticals and fabrics. According to a simulation by the National Bank of Belgium, a future tariff-setup, similar to what is currently in place for non-EU countries, could generate an additional cost of 0.5 % of Belgian GDP.

Efforts are also focussed on bringing UK-based companies and organisations to Brussels, as evidenced by last month's announcement that the insurer Lloyd's of London will open an office in Brussels. Finance Minister Van Overtveldt has already undertaken a mission to promote Belgian Fintech-companies in the City of London.

Public finances

The government budget deficit rose once again in 2016. The extra, unexpected, expenditure on anti-terror measures and on the reception of refugees undoubtedly contributed to this rise. Nevertheless, structural changes have to be made.

As regards 2017, the government showed that it is determined to adopt good habits. With a further drop in interest payments, a smaller budget deficit should be attainable. However, for the moment we do not really expect to see any substantial progress in reducing Belgium's massive national debt.

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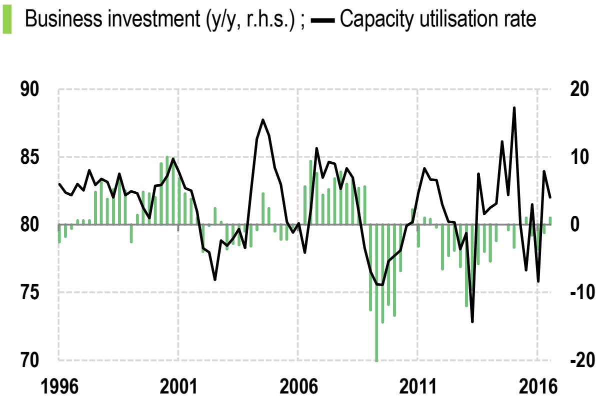
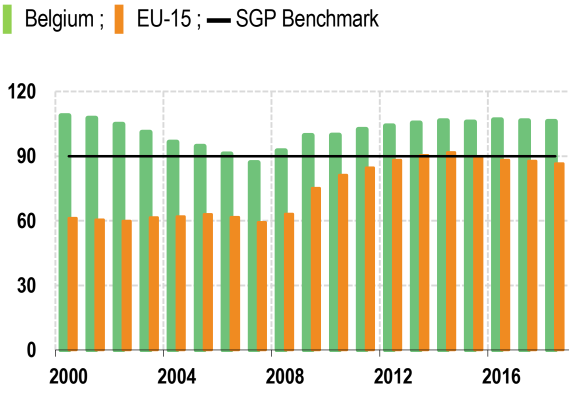
3- Capacity utilisation spurs investment
Percentage



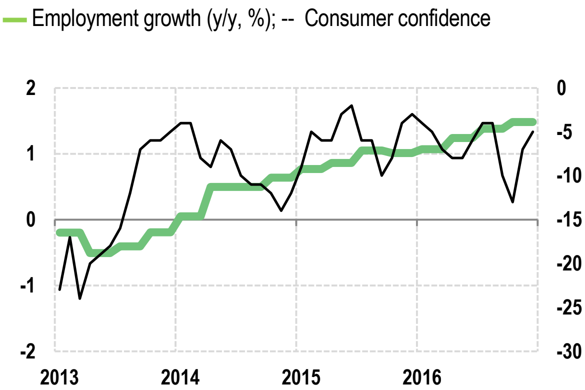
Sources: NBB, BNP Paribas Fortis forecasts

4- Public debt
Percentage of GDP



Source: European Commission

5- Employment and confidence are rising



Sources: NBB, BNP Paribas Fortis forecasts

Economic forecasts

En %	GDP Growth 2016 e	GDP Growth 2017 e	GDP Growth 2018 e	Inflation 2016 e	Inflation 2017 e	Inflation 2018 e	Curr. account / GDP 2016 e	Curr. account / GDP 2017 e	Curr. account / GDP 2018 e	Fiscal balances / GDP 2016 e	Fiscal balances / GDP 2017 e	Fiscal balances / GDP 2018 e
Advanced	**1.6**	**2.0**	**2.1**	**0.8**	**2.0**	**1.9**						
United States	**1.6**	**2.2**	**2.7**	**1.3**	**2.4**	**2.6**	**-2.5**	**-2.4**	**-2.4**	**-3.4**	**-4.2**	**-5.0**
Japan	1.0	1.2	0.9	-0.1	0.7	1.0	3.8	4.2	4.6	-4.7	-4.4	-4.1
United Kingdom	1.8	1.8	1.1	0.6	2.7	2.6	-4.7	-4.1	-3.2	-3.0	-2.7	-3.1
Euro Area	**1.7**	**1.6**	**1.6**	**0.2**	**1.8**	**1.4**	**3.4**	**3.0**	**3.1**	**-1.7**	**-1.4**	**-1.2**
Germany	1.8	1.8	2.0	0.4	1.9	1.6	8.8	8.3	8.5	0.6	0.7	0.6
France	1.1	1.3	1.5	0.3	1.6	1.0	-0.9	-0.9	-1.1	-3.4	-3.0	-2.7
Italy	1.0	0.6	0.6	-0.1	1.6	1.0	2.1	2.2	2.1	-2.4	-2.4	-2.5
Spain	3.3	2.6	2.0	-0.3	2.2	1.5	1.8	2.1	2.1	-4.6	-3.6	-3.0
Netherlands	2.1	2.1	1.6	0.1	1.2	1.4	8.7	8.7	8.3	-0.5	0.0	0.3
Belgium	1.2	1.4	1.5	1.8	2.1	1.9	0.7	0.5	0.5	-3.0	-2.3	-2.2
Emerging	**4.2**	**4.5**	**5.0**	**4.8**	**4.6**	**4.4**						
China	6.7	6.5	6.4	2.0	2.7	2.5	1.9	1.6	1.4	-3.0	-3.5	-3.3
India	7.5	7.3	7.8	5.0	5.2	5.3	-1.1	-0.8	-1.7	-3.8	-3.5	-3.2
Brazil	-3.6	1.0	3.0	8.8	4.1	4.3	-1.2	-1.4	-2.1	-8.9	-9.6	-8.3
Russia	-0.2	1.8	1.4	7.1	4.9	4.5	1.9	3.4	3.2	-3.7	-2.7	-2.1
World	**3.1**	**3.4**	**3.8**	**3.1**	**3.5**	**3.3**						

Source : BNP Paribas Group Economic Research (e: Estimates & forecasts)

Financial forecasts

Interest rates		2016				2017						
End period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e	**2016**	**2017e**	**2018e**
US	Fed Funds	0.25-0.5	0.25-0.5	0.25-0.5	0.5-0.75	1	0.75-1.00	1.00-1.25	1.25-1.50	0.5-0.75	1.25-1.50	2.25-2.50
	3-month Libor $	0.63	0.65	0.85	1.00	1.15	1.25	1.50	1.75	1.00	1.75	2.50
	10-year T-notes	1.79	1.49	1.61	2.45	2.40	3.00	3.25	3.50	2.45	3.50	4.00
EMU	Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
	3-month Euribor	-0.24	-0.29	-0.30	-0.32	-0.33	-0.33	-0.30	-0.30	-0.32	-0.30	-0.05
	10-year Bund	0.16	-0.13	-0.19	0.11	0.33	0.50	0.75	1.00	0.11	1.00	1.60
	10-year OAT	0.41	0.20	0.12	0.69	0.97	0.95	1.15	1.45	0.69	1.45	2.00
	10-year BTP	1.23	1.35	1.19	1.84	2.13	2.20	2.60	3.00	1.84	3.00	3.40
UK	Base rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
	3-month Libor £	0.59	0.56	0.38	0.37	0.34	0.40	0.40	0.40	0.37	0.40	0.40
	10-year Gilt	1.42	1.02	0.76	1.24	1.07	1.55	1.75	1.90	1.24	1.90	2.50
Japan	Overnight call rate	-0.00	-0.06	-0.06	-0.06	-0.06	-0.10	-0.10	-0.10	-0.06	-0.10	-0.10
	3-month JPY Libor	0.10	0.06	0.06	0.06	0.06	0.05	0.05	0.05	0.06	0.05	0.05
	10-year JGB	-0.04	-0.23	-0.08	0.05	0.07	0.10	0.10	0.30	0.05	0.30	0.40

Exchange rates		2016				2017						
End period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e	**2016**	**2017e**	**2018e**
USD	EUR / USD	1.14	1.11	1.12	1.05	1.07	1.02	1.02	1.00	1.05	1.00	1.06
	USD / JPY	112	103	101	117	111	121	124	128	117	128	130
EUR	EUR / GBP	0.79	0.83	0.87	0.85	0.86	0.82	0.82	0.80	0.85	0.80	0.82
	EUR / CHF	1.09	1.08	1.09	1.07	1.07	1.10	1.12	1.12	1.07	1.12	1.15
	EUR/JPY	128	114	114	123	119	123	126	128	123	128	138

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)

BNP PARIBAS

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