Observatorio de Coyuntura Económica Internacional

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Economic Forecasts

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INDEX

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Review of Forecasts for 2007: Quantities Remarkably Accurate, Prices Much Less So

Table 1 provides a comparison of our forecasts (made in January and revised in July) for the year that has just ended with the final or preliminary data on the real economy for 2007.

Generally speaking, the Table shows that our forecasts have been quite accurate where quantitative variables are concerned (including economic growth and others), but not so in the case of certain prices, particularly exchange rates and, following the downturn at the end of the year, interest rates.

Nevertheless, the overall picture hides the fact that a large number of the most important variables worsened in the last few months of the year. The deterioration of the annual data series will not be noticeable until 2008, a point that we will come back to shortly in this report.

However, the large number of experts who forecast a recession in 2007 were totally wrong.

Table 1

Review of OCEI Forecasts for 2007

VARIABLE	OCEI 2007	REAL FIGURE 2007
▲ **GDP**	2.3%	2.2%
▲ Private Consumption	2.9%	2.9%
▲ Non-residential Investment	5.0%	4.8%
▲ Residential Investment	-12.0%	-16.9%
▲ Federal Govt. Expenditure	2.5%	1.7%
▲ State & Local Government Expenditure	2.5%	2.3%
Inventories (contribution to ▲)	-0.1%	-0.3%
Foreign Trade (contribution to ▲)	0.1%	0.6%
Oil (annual average, barrel of WTI)	66-68$	72.4$
Natural Gas (in millions of BTU; annual average)	7.0$	7.0$
Unemployment Rate (annual average)	4.6%	4.6%
Fed Funds Rate (end of year)	5.25%	4.25%
Inflation Rate (annual average)	2.7%	2.85%
Core Inflation (annual average)	2.4%	2.3%
$/€ Exchange Rate (annual average/end of year)	1.32 / 1.30	1.37 / 1.46
Federal Govt. Budget Balance (% of GDP)	-2.0%	-2.0% *
State & Local Govt. Budget Balance (% of GDP)	-1.0%	-1.0% *
Current Account Balance (% of GDP)	-5. 5%	-5.5% *
▲ **Productivity** (annual average)	1.5%	1.3% *
▲ **Profits After Tax** (annual average)	<5.0%	3.6% *
▲ **Unit Labour Costs** (annual average)	3.0%	3.8% *

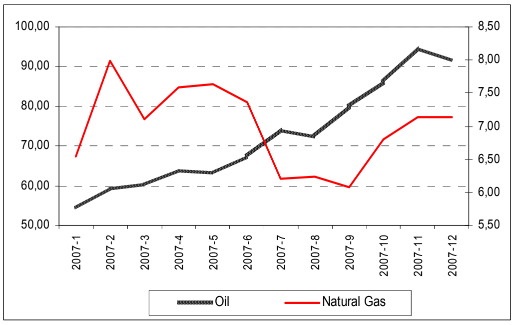
Source: own elaboration

* (Data up to the third quarter)

We will now proceed to review the (in) accuracy of our forecasts:

1) As far as **energy prices** are concerned (Figure 1), while natural gas ended the year exactly as we had expected, despite fluctuations throughout the period, the price of oil once again surpassed our expectations, even after upwardly revising our initial forecast.

Figure 1: Oil Prices ($ per barrel of West Texas Intermediate – left axis) and Natural Gas ($ per million British Termal Units – right axis)

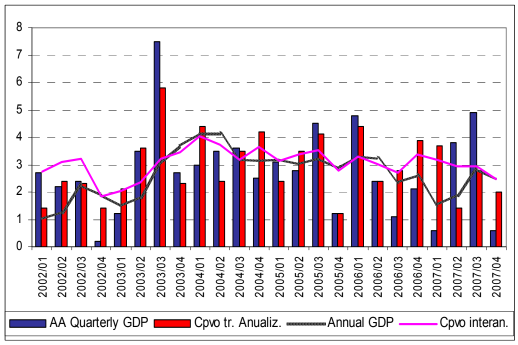


Source: own elaboration with data from FRED II

While the upward trend in oil prices remained steady throughout the year, with the usual suspects (supply problems, strong demand from large emerging nations and geopolitical tension), the real hike occurred following the transfer of funds, as a result of the subprime crisis, from financial markets to certain raw materials[1]. As a result, the price of a barrel of WTI rose by 20 dollars between August and December, despite forecasts for slower growth (and less demand for energy) in 2008.

2) The annual **GDP growth** rate in 2007 was 2.2% (although fourth quarter data are only provisional), one decimal point less than we forecast. This is the lowest growth rate since 2002, but is clearly a part of the slowdown we had anticipated. The most striking aspect, however, is the peculiar quarterly growth trend (Figure 2). In the first and last quarters of the year growth was virtually stagnant, compared to the second and third quarters, which recorded dynamic growth. As private consumption has been more stable, it was the other demand items (investment, inventories and Federal Government expenditure) that displayed a jagged curve full of marked ups and downs.

Figure 2: GDP and Private Consumption (annually adjusted annual and quarterly growth rates)



Source: own elaboration with data from BEA
Note: AA = Annually Adjusted

Private consumption rose by an annual 2.9% in 2007, approaching the figure we forecast in July. Bearing in mind that this forecast was made before the financial crisis, we can conclude that consumption expenditure, at least in 2007, has not yet been affected. In comparison to 2006, growth in private consumption has only decreased by two decimal points.

Our forecast for growth in non residential investment was also accurate (the real figure was 4.8% while our forecast was for 5%), while government expenditure (particularly Federal Government expenditure) and inventories boosted growth less than expected. However, net exports stimulated GDP growth extraordinarily (by six decimal points), much than we initially anticipated and have more than offset the less buoyant items. The reason behind this boost from foreign trade is that economic growth worldwide has been more dynamic than expected, coupled with the fact that the

[1] The annual trend in gold prices is remarkably similar, particularly where the marked rise in the fourth quarter of 2007 is concerned.

US dollar has depreciated severely and imports have remained in check, as a result of a slowdown in demand and that many imported products have recorded increases in price.

Finally, despite our forecast being lower than most (-12%), residential investment recorded an even more pronounced fall (-16.9%). This item alone accounts for 100% of the decrease in GDP growth from 2006 to 2007[2].

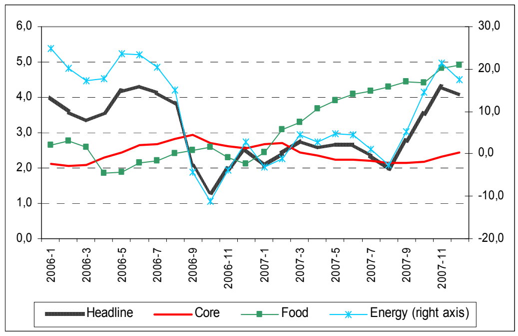
3) As regards the **labour market**, we forecast the creation of 120,000 net jobs a month, which was close to the preliminary figure, but the annual review carried out by the BLS saw the real figure drop to 95,000. Nevertheless, following the two-decimal point decrease in the activity rate, our forecast for an average unemployment rate of 4.6% was accurate.

4) Little more can be said regarding **monetary policy**. Partly due to the need to relax monetary conditions in light of the negative impact of the financial crisis and also to a preference for short term benefits over medium term risks, which we have repeatedly described as inappropriate, the Fed cut interest rates to 4.25% before the end of 2007 (3% when this report was finished), far from the stable rate of between 5% and 5.25% we had anticipated.

5) The average **inflation** rate for 2007 as a whole is particularly deceiving. Indeed, both the headline and core inflation rates were *lower* than in 2006 (and one decimal point higher and lower than our respective forecasts).

[2] Economic growth slowed down from 2.9% to 2.2%; the negative impact of residential investment on growth rose from -0.3% to -1%.

Figure 3: Annual Headline and Core Inflation Rate and Selected Expenditure Items (%)



Source: own elaboration with data from BLS

Figure 3 displays the trend in the headline inflation rate and the main expenditure items. Note how the flat rates (and decreases in some months) recorded by energy prices in the first half of the year (which were already visible at the end of 2006), dragged the headline inflation rate down and even core inflation witnessed a slowdown as a result.

In contrast, towards the end of the year, the depreciation of the dollar and yet another upturn in oil prices pushed up the inflation rate of imported goods and the headline rate (to 4%), together with core inflation, albeit only slightly.

It is also worth highlighting the ongoing rise in food price inflation (to an annual 4.9% in December); in this case, an uninterrupted upward trend is observed that we fear will not revert over the next few quarters.

6) The least accurate forecast made in reference to 2007, as can be observed in Table 1, regarded the **trend of the US dollar**, particularly against the euro. While the first half of the year ended with the dollar losing more or less the ground initially expected, this trend became more pronounced in the second half of the year, flew in the face of our expectations.

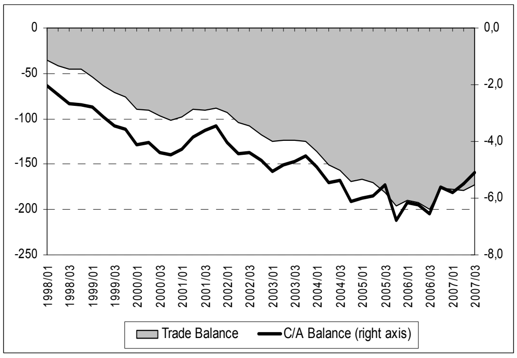
After the situation in the real estate and financial markets worsened, together with accommodating monetary policy the Fed has already employed, the strength of the European economy in 2007 and the ECB's firmness took the bilateral exchange rate to 1.5 dollars to the euro and the dollar has barely recovered since then.

The marked weakness of the dollar saw the yen gain ground in the second half of 2007 after dropping surprisingly against the dollar in the first half of the year. While the figure as of the end of the year was similar to that we had forecast, the year-long trend was exactly the opposite.

Finally, the controlled appreciation of the yuan, which occurred slightly more quickly than in previous years, did fall in line with our analysis, although we must recognise the fact that, bearing in mind how constant Chinese authorities are in this sense, no real merit is involved.

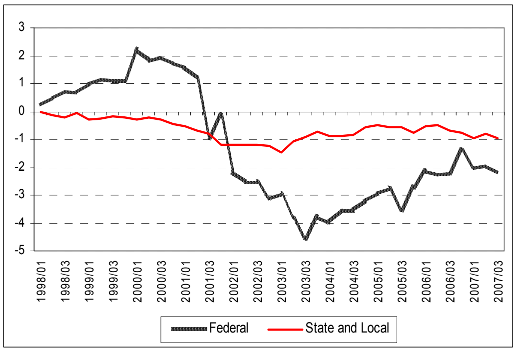
7) In contrast, our forecast was spot on in the case of the **Current Account** (in this case with data up to the third quarter). The deficit only decreased slightly (Figure 4), but did amount to more than half a point in terms of GDP. While exports rose strongly, particularly halfway through 2007, the energy bill prevented further progress being made. Precisely this factor leads us to forecast that, when fourth quarter data are available the US current account deficit will continue to represent the equivalent of 5.5% of GDP in 2007.

Figure 4: Foreign Trade (billions of dollars, quarterly data) and Current Account (% of GDP)



Source: own elaboration with data from BEA

Figure 5: Government Budget Balances (% of GDP)



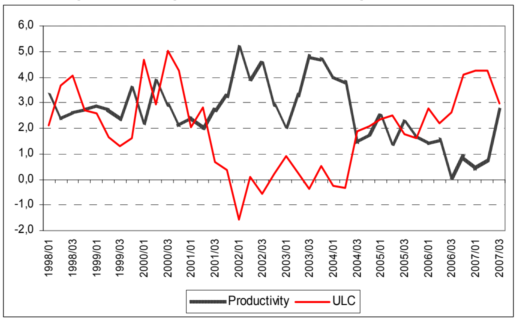
Source: own elaboration with data from BEA

8) Our forecasts regarding the government budget balances in 2007 were also accurate (data also up to the third quarter): a 2% deficit in the case of the Federal Government and 1% in the case of State and Local Governments (Figure 5). This implies the end of the correction, which is always insufficient, of previous years and the beginning of the downward slope of the cycle (or recession if finally applicable), without having managed to balance the budget. This is undoubtedly one of the Bush Government's greatest errors.

9) Productivity growth slowed down for the second year in a row (Figure 6) and by even more than expected (1.3% on average up to the third quarter,

compared to our forecast of 1.5% for the year as a whole). The figure for the last quarter of the year will be mediocre (following GDP growth of 0.6% and a rise, albeit modest, in employment, this is inevitable), but in contrast, the downward review of the job creation figure will force authorities to upward revise productivity growth, which will in the end approach our initial forecast.

Figure 6: Productivity and Unit Labour Costs (annual growth rates, %)

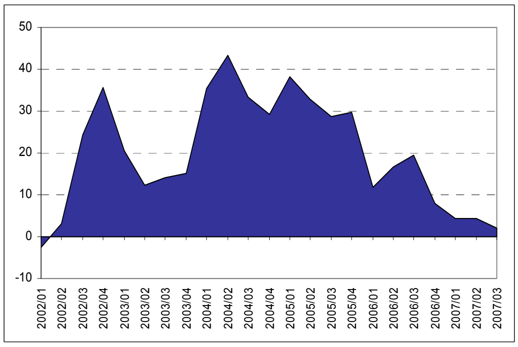


Source: own elaboration with data from FRED II

As regards **unit labour costs**, the slowdown in productivity growth and the fact that the labour market is quite tight and which as permitted a bit of joy in terms of wage rises, resulted in an increase of 3.8% up to the third quarter, well and truly exceeding the 3% we had forecast. From this point onwards, growth in this variable will certainly level out in light of the slowdown the economy is already experiencing.

We end this section with corporate profits, which following several years of record highs, slowed down drastically in 2007 up to the third quarter (+3.6%) and there is a strong possibility that they will fall even closer to zero after fourth quarter data are added. This would therefore easily confirm our expectations of a severe downward correction (growth dropping below 5%).

Figure 7: Corporate Profits After Tax (annual growth rate %)



Source: own elaboration with data from BEA

Forecasts for 2008: No Recession, but Almost Too Close to Call

Will the US economy go into recession in 2008? In the first place, it is perhaps worth recognising the fact that this debate, is terminologically speaking highly entertaining, is not very important in reality, if the idea is to distinguish between a smooth or profound recession, which at the end of the day are the two scenarios generally being considered. In other words, between two quarters in row of 0% growth and two quarters at -0.1% there is a huge difference in nomenclature (recession or not), but no perceptible difference in the evolution of the economy. Moreover, bearing in mind the usual reviews carried out by the BEA, the current conclusion may well be revised three years later, which could result in a recession that was not initially considered as such, or vice-versa.

However, the United States, unlike other countries, certainly has a more complex definition of the expansive and recessive phases of the economic cycle, which is established (with somewhat of a lag) by the National Bureau of Economic Research and which is based on four variables: payroll employment, industrial output, manufacturing sales on a wholesale basis and real disposable income net of transfers. As a result, we will leave it up to the NBER to determine whether or not the expansion that began in 2001 will end in 2008.

However, we will respond to the question at the beginning of this section: **no**, although only just. The first two quarters of the year will border on stagnation, which means economic growth will be close to recording negative figures.

It is however much more interesting, albeit less striking than "the big question", to carry out a detailed analysis of the trends we expect the main economic variables to record in 2008. Our usual top ten forecasts are summarized in Table 2 below.

Table 2:OCEI Forecasts for 2008

VARIABLE	**2007 FORECAST**
▲ **GDP**	1.6%
▲ Private Consumption	1.5%
▲ Non Residential Investment	2.0%
▲ Residential Investment	-10.0%
▲ Federal Government Spending	3.0%
▲ State & Local Govt. Spending	1.0%
Inventories (contribution to ▲)	0.0%
Net exports (contribution to ▲)	0.4%
Oil (barrel of WTI; annual mean)	82$
Natural Gas (millions of BTU; annual mean)	6.3$
Unemployment Rate (annual mean)	5.0%
Fed Funds Rate (end of year)	3.00%
Inflation Rate (annual mean)	2.7%
Core Inflation (annual mean)	2.2%
$/€ Exchange Rate (annual mean/end of year)	1.43 / 1.37
Federal Govt. Budget Balance (% of GDP)	-3.5%
State & Local Govt. Budget Balance (% of GDP)	-1.5%
Current Account Balance (% of GDP)	-4.5%
▲ **Productivity** (annual mean)	1.2%
▲ **Corporate Profits after tax** (annual mean)	0.0%
▲ Unit Labour Costs (annual mean)	2.5%

Source: own elaboration

1) There is widespread agreement that **oil prices** will fall in 2008. The question is by how much. This will undoubtedly depend on the severity of the slowdown in world economic growth and the whether or not the non market operators who took refuge from the turbulence in certain sectors of financial markets by gaining positions in the oil market will revert. As regards supply, we will have to wait and see to what extent the OPEC "hawks" are capable of forcing a decrease in output, based on a risky interpretation of the market: as a global slowdown would

reduce the demand and the price of oil, they wish to restrict supply... which will stop prices from falling, but will also slow down the world economy further still. This stance could have some grounding on the basis of elasticity (even though prices are high and the economy is growing less, it is not easy reduce energy consumption), but this move is more likely to have political connotations than anything else[3].

In our opinion, stable supply, growing demand (China and India), albeit more slowly and the exit of some capital flows from financial markets following the subprime crisis, oil prices will drop to between 70 and 75 dollars a barrel, which would result in an annual average of around 82 dollars a barrel (WTI).

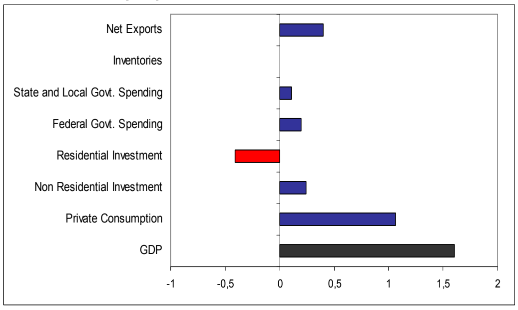
As regards **natural gas**, prices have been much more stable over the past few months and consequently there are no excess to be corrected. Following a decrease in oil prices (to which gas prices are partially correlated), the economic slowdown and another relatively mild winter, we expect natural gas prices to drop by around 10% in regard to the seven dollars per million BTU on average in 2007.

2) Economic growth will repeat the slowdown that occurred between 2006 and 2007, dropping by a further six decimal points to 1.6% for 2008 as a whole. Practically flat quarterly growth is expected in the first half of the year and a recovery in the second half when

[3] If the leaders of Iran and Venezuela, monocultures in terms of foreign income, believe that they will benefit from aggravating the problems in the West, they are mistaken. However, we do coincide with the OPEC in that the current price of a barrel of oil is considerably inflated due to non market operators (or speculators).

the effect of the tax and monetary incentives kicks in and certain forums stop sending out the catastrophist messages that have damaged expectations so much. Figure 8 displays the contributions to economic growth.

Figure 8: Contributions to US Economic Growth in 2008 according to OCEI Forecasts (%)



Source: own elaboration

Private consumption will clearly determine not only overall growth (which is inevitable considering it accounts for 71% of GDP), but also the trend over time. In the first half of the year, growth will be close to zero. The continuous slump in real estate wealth (and the more temporary fall in financial wealth) together with the fact that the labour market is not particularly dynamic in terms of job creation and wage rises explain this situation.

In the second half of 2008, however, growth will rally when tax rebates and the effects of the interest rate cuts (theoretically not only in terms of cost but also in terms of credit accessibility) provide temporary relief. The end of the darkness that the effects of the subprime crisis brought upon expectations will be of particularly help (and more tangible).

Overall, private consumption is forecast to rise by a timid annual 1.5% (half the figure in 2007).

However, we must again insist that until savings return to a sustainable level and borrowing decreases, the foundations to face future problems will be even more worrying than now. In other words, while more frugal behaviour on behalf of households would make a recession almost inevitable in 2008, the end result contemplated beyond the short term would be more beneficial for the economy.

As regards **non residential investment**, we forecast a small (2%) rise for the year as a whole. Although investment is normally more procyclical than consumption, the current expansion has been characterised by moderate rates of investment and productive capacity, with no excesses despite the healthy business situation and high corporate profits. Furthermore, some sectors, particularly the car industry, have seen their stocks drop considerably over the last few quarters. Finally, the tax package includes an incentive for productive investment that companies should take advantage of by bringing forward certain projects. We believe all these factors should be enough to maintain investment growth positive, despite the current slowdown in demand and certain credit restrictions.

The increase in Federal Government spending is now a fact, above all else, because the budget bill involves increases in spending that will more than likely be approved by the Congress and the Senate, along with cuts in other items (Medicare and Medicaid), which under a Democrat party majority will simply be impossible to pass. As a result of this 3% increase in Federal expenditure [4], the decrease in transfers to State and Local governments means they will have little room for joy in terms of spending (+1%) and more than a few cuts will have to be made in public programmes and contracting.

While we expect inventories to make a net neutral contribution to GDP, **net exports** should once again be vital for economic growth in the United States. If domestic demand falls along with the energy bill, sustained growth in exports should enable the external sector to contribute as much as four decimal points to overall growth. However, this boost is smaller than in 2007 as the slowdown will affect the country's main trading partners in 2008 and the dollar will not depreciate any further, both of which are factors that will curb US export growth.

Finally, and once again, the most negative aspect in 2008 will be the real estate sector, which will detract around four decimal points from GDP growth, while **residential investment** is forecast to slump by 10%. While these estimates still forecast the slump to continue, they are more moderate than the disaster that has occurred over the last year and a half.

Not all analysts agree that the slump will slow down, but as more negative data are recorded, the bottom of the pit will obviously be closer. We

[4] It must be pointed out that the package of tax incentives as such will be recorded in GDP through its positive impact on consumption, not as an increase in spending. Otherwise, the increase in Federal expenditure would be greater.

forecast residential investment to return to the same level as those recorded more than a decade ago, before the beginning of the bubble and in a country where the population is still growing (to a great extent due to immigration) which acts as a floor for demand.

3) In 2008, the **labour market** will feel the full brunt of the slowdown in growth that began in the last quarter of 007. We do not expect the US economy to create more than 50,000 net jobs a month, a figure that will only rise towards the end of the year and there will be months in which the figure will fall (apart from whether or not the January figure is confirmed). However, the slowdown in the market itself and in structural terms the foreseeable end to the process of women entering the labour market should maintain the activity rate or even lower it, which will in turn mitigate the increase in unemployment (annual average of 5%).

As far as wages are concerned, the scenario will be less favourable for significant rises and wages can be expected to struggle to keep up with inflation, even though inflation should remain in check, as will be discussed shortly.

4) It is not easy to anticipate **monetary policy** in 2008 (in reality, one of the principles of discretionary policy is indeed that it cannot be premeditated). The Federal Reserve is perfectly aware of the risks that its explosively accommodating policy entails in the medium term and that has been underlined by the OCEI in recent reports, including this one. However, the Fed appears to have made reverting the cyclical trend in the short term a priority, which would be coherent with further interest rate cuts in forthcoming months. Two more decreases of between 25 and 50 basis points can be expected before summer, which would take interest rates to around 2.25%.

From that point onwards, once the red alert has passed, with inflation higher than desired and the added relief from the tax package, we expect interest rates to remain stable for some time before rising quickly (although not as quickly as they have fallen) in order to mitigate the foregoing risks. As a result, we expect interest rates to return to 3% before then end of 2008.

In summary, the Fed, which already has a reputation for being an activist among Central Banks as a whole, would see this fame become more pronounced, forgetting the classical "interest rate smoothing" defended, for example, by Frederic Mishkin, a renowned academic and current Federal Reserve board member, who believes that quick and drastic decisions, which, however, must be reverted in the same way, are the most suitable way of managing monetary policy when times get tough.

We will have to see if we have interpreted the situation correctly... and what the effects of these moves will be if they occur.

5) In reference to **inflation**, according to our outlook for energy prices and poor growth figures, headline inflation should drop. Wages are not expected to exercise upward pressure on inflation this year either.

In contrast, we do not expect any relief from the other volatile item, fresh foods. Structural demand is growing worldwide too much for supply to satisfy (much more if part of this food is used to produce bio fuels) and futures markets are adjusting for further record highs in prices in 2008. Interest rate cuts, a weak dollar throughout most of the year and increasingly less inflows of deflation from imports from Asia are also negative factors.

Summing up, we expect prices to rise by an average of 2.7%, which is excessive in a year of little growth (which is also the case for core inflation which we forecast to reach 2.2%, always in terms of the CPI).

6) We will now attempt to make up for our most inaccurate forecast in 2007, the **pattern of the US dollar**. In order to achieve this, here are our forecasts for the year in course: extreme weakness against the **euro** in the first half of the year, at around 1.44-1.48, followed by marked appreciation towards the end of the year to finish up at around 1.37 dollars to the euro (and an annual average of 1.42). The reasons for this correction include the sum of an economy that overcomes a bad patch, the prospect of rapid interest rate rises on behalf of the Fed and the end of the stream of bad news regarding the financial system (although some problems are still to surface over the next few months.

The US dollar should display a similar pattern with respect to the **yen**, although in this case any sign o fan upturn in the Japanese currency in the next few months would be immediately dealt with by what is still perceived as weak economic growth, low interest rates (which do not look like rising in the short term) and, if necessary, verbal or effective interventions on behalf of Japanese monetary policy makers. Japan, always dependent on its exports, cannot afford the slowdown in the economies of its main trading partners to be joined by a revaluation of its currency.

As regards the **yuan**, the government will continue to strengthen the currency, particularly in the first half of the year, but we doubt this process will be accelerated as the Asian economy is also going to slow down markedly (even though in the case of China this only means growth of less than 10%).

7) We already outlined our forecast for the external sector earlier in this report. Exports will once again outpace imports in terms of growth, although neither of the two variables will increase markedly. Moreover, as foreign energy purchases should be cheaper, the **current account deficit** should decrease substantially, to around 4.5% in terms of GDP, which we consider to be conservative, a priori.

8) The budget bill designed by the Bush government will push the (Federal) budget deficit over 400 billion dollars in the next two years, clearly failing to the he made at the beginning of the legislature of balancing government accounts. This deficit would be the equivalent of around 3.5% of GDP.

As is typical of deficient fiscal management (and this government has been particularly deficient in this aspect), the problem is not a result of lean years such the current period, but rather of not balancing the budget during boom years. In this sense, maintain a deficit of 2% of GDP after six years of expansion is a clear sign of incompetence (or fiscal objectives that are incompatible with macroeconomic stability).

In any case, we also believe the government is overly optimistic. Official forecasts for economic growth (and hence government income) are very high (approaching potential growth in both financial years) and the expenditure side of the balance sheet includes a 200 billion dollar cut in Medicare and Medicaid, which will simply not happen.

As a result, we forecast the Federal budget deficit to rise to 3.5% of GDP in 2008, to which a further 1.5% deficit on behalf of State and Local governments will have to be added, and is no higher mainly because they ill reduce expenditure in light of strict limits (including the fact that presenting annual accounts with deficits is prohibited), which restrict many of these administrations. The collapse of the income linked to the real estate market explains this deterioration.

An overall deficit of 5% of GDP in a year when the baby-boomers are due to retire (although it is true that many of these people are extending their working lives due to the grim outlook in for pensions and health), is a poisoned apple for the next president.

9) **Productivity** will continue to grow in 2008, but less than the long term trend, thus offsetting the cyclical excess prior to 2007 and awaiting another more vigorous boost from investment in equipment and new technologies that will not occur this year.

As a result of the modest growth in productivity (1.2%) and with high inflation bearing down on wages (in those cases where workers can aspire to offset increases in prices), **unit labour costs** will continue to rise considerably (2.5%), albeit more slowly than in 2007. The slowdown in the economy and the increase in the unemployment rate will exercise downward pressure on this indicator.

As regards corporate profits, we expect there to be stagnation due to ULC being on the rise, little room for increases in costs to be passed on to prices and timid demand in most sectors. Any change in this forecast is more likely to be downward rather than upward.

10) **What about 2009?** Growth is highly likely to recover in 2009, but considerable less than most analysts anticipate. The reason for this is the attempt by the Fed to curb the medium term risks of its current policy, the fact that households will not have recovered suitable rates of savings and the payback for the tax incentives that will be applied in 2008.

However, what is undoubtedly the most important issue related to 2009 is that the uncertainty surrounding certain critical aspects of the US economy will begin to clear up. There will be vital structural repercussions depending on what emerges from the current uncertainty.

The first issue is related to how capable monetary policymakers and regulatory organisations are of preventing future speculation bubbles, as when they burst, the impact is destructive as we have seen lately. Likewise, the same policymakers should increase transparency in financial markets and eliminate any trace of "moral risk" (that is, believing that the Fed will come to the rescue of those who incur in losses time and time again due to the cost to the economy as a whole). This "moral risk" exists today and is an incentive for irresponsible behaviour.

The second crucial aspect is related to the fiscal principles of the new government. A Republican victory would almost guarantee disaster in the US public sector in the medium term; more tax cuts and more sunset clauses (applied in 2001 and 2003) eliminated would lead to an unsustainable budget deficit or unacceptable cut backs in spending.

A Democrat government in line with the parameters applied by Bill Clinton during his two terms of office [5], would reduce this risk on severing the tax cuts which are the "leitmotiv" of Republican candidates. However, there would still be challenges linked to the pension and health systems and would endanger any progress in terms of free trade and international investment, in light of the fact that the Democrat Party of late appears to be markedly inclined towards protectionism.

As a result, once the recession (or slowdown) has passed 2009 will be a key year for the economic future of the United States.

Vicente J. Pallardó
OCEI Director

Valencia, 6 February, 2007

[5] Which does not mean that this would only apply if Hillary Clinton wins the Democrat presidential candidacy; part of the previous Democrat president's economic team support Senator Barak Obama.

TABLE 3
MAIN INDICATORS OF THE US ECONOMY (END OF 2007)

VARIABLE	PERIOD	LATEST FIGURE	RECENT TREND
Annually Adjusted Quarterly GDP Growth	Q4:2007	0.6%	Minimal growth levels out surprisingly buoyant third quarter
Annually Adjusted Quarterly Growth in Real Private Consumption	Q4: 2007	2.0%	Steady slowdown in consumption suggests private spending will almost stagnate in 2008
Annual Growth in Retail Sales	Dec-07	-0.4%	Negative figure (after highly favourable results in November) sparks exaggerated fear
Consumer Confidence (University of Michigan)	Dec-07	75.5	15-point decrease since July
Annually Adjusted Quarterly Growth in Non Residential Investment	Q4:2007	7.5%	Reasonable growth despite gloomy economic outlook
Productive Capacity Utilisation	Dec-07	81.4%	Smooth descent in line with the cycle
ISM Manufacturing Output Index (PMI)	Dec-07	48.4	Downward, ending the year below the score that would indicate a recession (50)
Annual Growth in Corporate Profits after Tax	Q3:2007	2.1%	Growth evaporates after several years of excessive rises
Annual Growth in Unit Labour Costs	Q3:2007	3.0%	Rising considerably due to slowdown in productivity
House Construction (housing starts; in millions)	Dec-07	1,006	Ongoing collapse ending the year with the worst figure since May 1991
Annual Growth in Housing Prices	Q3:2007	1.8%	Slump. Quarterly data already reveal a fall in prices
Unemployment Rate (% of labour force)	Dec-07	5.0%	Typical increase in low cycle phase begins
Non Farm Payroll Employment	Dec-07	+ 84,000	Mediocre figure (later upwardly reviewed) becomes the symbol of the supposed recession
Annual Growth in Productivity per Hour Worked (Non farm sector)	Q3:2007	2.7%	Deceptive Q3 figure, occasional in a marked slowdown
Annual Headline Inflation Rate (CPI)	Dec-07	4.1%	Inflation soars at the end of the year boosted by energy and food prices
Annual Core Inflation (CPI)	Dec-07	2.4%	Drifting upwards, but now being ignored due to the fear of recession
Annually Adjusted Quarterly Current Account over GDP	Q3:2007	-5.1%	Lower growth and the depreciation of the dollar reduce deficit
Trade Balance (in millions of dollars)	Nov-07	-63,100	Increases in the last few months of the year due to the oil bill
Foreign Direct Investment (quarterly net balance in millions of dollars)	Q3:2007	24,922	Surplus returns following a striking rise in net inflows
Federal Budget Balance over GDP (annually adjusted quarterly balance over GDP)	Q3:2007	-2.2%	End of the correction without having eliminated the deficit over the entire expansion
Total Gross Debt over GDP (annually adjusted quarterly debt over GDP)	Q3:2007	64.5%	Rising again after slowing down in 2006
State and Local Budget Balance (annually adjusted quarterly balance over GDP)	Q3:2007	-1.0%	Stable but in serious danger of worsening in 2008 due to slump in income
Gross National Savings over GDP	Q3:2007	13.4%	Stable at historical lows
Personal Savings Rate (percentage of disposable income)	Nov-07	-0.5%	Back to the negative figures after data reviews had raised the rate
Household Debt (percentage of disposable income)	Q3:2007	132.98%	More moderate rise, always to record highs
S&P 500	End of 2007	1468.4	Slight decrease (2.3%) in 2nd half of 2007
$/€ Exchange Rate	Dec-07 (mean)	1.456	8.5% depreciation ($) in 2nd half of 2007
Yen/$ Exchange Rate	Dec-07 (mean)	112.45	8.4% depreciation ($) in 2nd half of 2007, concentrated in last few months
Yuan/$ Exchange Rate	Dec-07 (mean)	7.368	Govt. Continues to administer depreciation ($), 3.5%, in 2nd half of 2007
Real Effective Exchange Rate (main currencies)	Dec-07 (mean)	99.27	Remarkable 4.2% depreciation ($) in 2nd half of 2007
Annual Increase in Money Supply (M2)	Dec-07	5.85%	Stable in the 2nd half of 2007
Fed Funds Rate	End of 2007	4.5%	Downward with massive cuts in 2008:1
3-month Treasury Bills	Dec-07 (mean)	3.07%	Spectacular decrease in anticipation of interest rate cuts
10-year Treasury Bonds	Dec-07 (mean)	4.10%	Downward, but smoother than short term rates. Slope becomes more pronounced
Mortgage Interest Rates (fixed 15-year rate)	Dec-07 (mean)	6.10%	Marked decrease in the 2nd half of 2007

Source: own elaboration with data from US Government organisations

2.- Eurozone

Analysis of Deviations Regarding Forecasts for 2007:

The OCEI forecast for GDP growth in the Euro-zone was much more optimistic than the rest of the market's. Our estimate was for between 2.5% and 2.7%, which was later upwardly revised to 2.7%-2.9%.

Although the first estimate of GDP for 2007 is still to be released, most analysts predict a 2.6% growth rate. However, the OCEI forecasts between 2.7 and 2.8%. This implies that GDP would have growth by an annual 2.4% to 2.6% in the fourth quarter (0.5% to 0.7% on a quarterly basis). In any case, this forecast will either coincide or be very close to the real figure that is finally published.

As regards GDP items, private consumption could rise by an annual 1.4% to 1.5% (1.1%-1.3% in the fourth quarter of 2007), well below our initial forecast of between 1.8% and 2%. Government spending could grow by 2%, which is perfectly in line with our forecast (1.7%-2%). As regards fixed investment, in the absence of last minute surprises, an increase of between 5% and 5.2% is expected in 2007 (4%-4.5% in the fourth quarter), which also falls inside our initial forecast range of 5%-6%. Exports are forecast to increase by 6.7% (6.8%-8%), in line with our estimate, while imports will rise less than expected (5.7% vs. 6.4%-8%).

As far as the labour market is concerned, the unemployment rate stood at 7.4% on average throughout the year, which is higher than our initial forecast of 6.9%-7.2%. This deviation is due to a statistical change in the data series. Net job creation could rise by more than expected: 1.8% to 1.9% in 2007, compared to our forecast for between 1.4% and 1.6%. Finally, labour productivity will probably rise by less than initially forecast (0.9% vs. 1.3%-1.5%).

The average inflation rate for the year (2.1%) was also inside the range initially forecast (1.9%-2.1%).

The OCEI was of the opinion that, in light of how strongly GDP was rising and other issues, the ECB would be forced to raise interest rates from 3.5% to 4.75%. However, the financial crisis resulted in the ECB abandoning its plan to raise interest rates in the second half of the year. In any case, money rates have been tightened, as mentioned previously, as if the ECB had raised interest rates to that level, in line with our forecast. Long term interest rates in December (10 year bund) rose to 4.38% from 3.90% in the same month the previous year, but less than expected (4.60-4.85%).

The average euro-dollar exchange rate in 2007 stood at 1.37, while we had forecast 1.30-1.35.

Forecasts for 2008:

Forecasts for 2008 augur a more less significant slowdown in GDP growth in the Euro-zone. While in 2007 growth was generally forecast to reach 2.6%, only 1.8% is expected in 2008, below potential growth. Many experts even forecast GDP to rise by less than 1.6%, with world growth slowing down and the possibility of a recession in the US.

In light of this panorama, institutions believe that the ECB will be forced to cut interest rates by around 50bp in 2008. Long term interest rates are expected to rise or remain stable, therefore making the slope steeper and more in line with the long run trend and the threat of inflation.

Prices are forecast to rise by between 2.4% and 2.5% in 2008, which despite being less than in the last few months, is still higher than the ECB target rate.

Table 1: GDP and CPI Forecasts for the Euro-zone in 2008

	GDP	CPI
Unicredit	1.5%	2.5%
Banesto	1.8%	2.1%
Barclays Bank	1.6%	2.4%
ABN AMRO	2.4%	2.4%
NATIXIS	1.7%	2.5%
Citibank	1.9%	2.0%
CIBC	2.1%	2.0%
BNP PARIBAS	1.3%	2.5%
Societé Générale	1.3%	2.5%
Lehman Brothers	1.5%	2.1%
IMF	1.5%	2.5%
REUTERS CONSENSUS	1.8%	2.1%
JP MORGAN	1.9%	
OECD	1.9%	
EC	2.2%	

Source: own elaboration with data from institutions listed above

Table 2: Interest Rate Forecasts for 2008

	ECB Rate	BUND 10A
Unicredit	3.5%	3.6%
Banesto	3.5%	4.25%
SCH	3.5%	4.55%
Société Générale	4.0%	
Barclays	3.5%	3.77%
Citibank	4.0%	4.6%
Lehman Brothers	3.5%	3.96%
CALYON	4.0%	4.85%
WestLB		4.4%
BayernLB	4.0%	4.6%
ABN AMRO	4.0%	4.1%
NATIXIS	3.5%	3.98%
CICB	4.25%	5.0%
BNP PARIBAS	3.5%	4.55%
BOFA	4.5%	4.8%
BBVA	3.5%	4.23%

Source: own elaboration with data from institutions listed above

Finally, markets expect the euro/dollar exchange rate to drop slightly to 1.42, although some institutions forecast rates of up to 1.56 dollars to the euro.

OCEI Forecasts for 2008

The OCEI's forecasts for 2008 are more optimistic than the overall opinion of the market. While official institutions appear to coincide at 1.8%, the OCEI forecasts a 2.1%-2.3% increase in GDP.

Fixed investment will continue to grow as a result of the increasing level of corporate profits, the high level of self-financing, the still accommodating financial conditions (although things have got tougher recently) and the need to increase productive capacity. For this reason, the OCEI forecasts fixed investment to rise by 3.4%-4% in 2008, slightly less than in 2007.

Despite the fact that net employment is expected to rise by 1.4%-1.5%, growth in private consumption will be considerably weaker in relation to the previous year, due to the decrease in consumer confidence. We forecast private consumption to rise by 1.2%-1.3% and government spending by 1.8%-2%.

Exports will increase by between 6.5% and 7.5%, bearing in mind the 7.4% upturn in international trade and the possibility the real effective exchange rate depreciating, which would have a positive effect. Imports will depend on domestic demand and will rise by between 6% and 7%.

The unemployment rate could range from 7% to 7.1%, taking into account the expected growth in net employment. By the end of the year,the unemployment rate could stand at 6.9%-7%.

The inflation rate is forecast to average between 2.4% and 2.5% for the year as a whole, with the 3.2% figure observed in January tending to decrease. Oil prices are expected to exercise less pressure on prices over the first half of the year. Second round effects are not likely, despite the decrease in the unemployment rate.

As GDP growth remains above potential, private sector loans continue to rise excessively and such a low unemployment rate which must be already causing friction in the labour market, the ECB will maintain interest rates at 4% this year, unless economic growth slumps markedly. While analysts forecast a decrease of 50bp in the minimum bid rate, markets are already adjusting for a theoretical interest rate cut to 3.25%. As regards long term rates, the 10-year bund could stand between 4.10% and 4.30% by the end of the year.

Finally, the euro/dollar exchange rate is forecast to average between 1.35 and 1.40 in 2008, with the euro depreciating sharply in the second half of the year to below 1.3, as the US dollar is undervalued in comparison to its equilibrium exchange rate in regard to the euro and taking into account the confidence that the monetary measures adopted by the Fed, together with the new tax legislation to come into force will have a positive effect in the second half of the year.

Table 3: OCEI Forecasts for 2008

GDP	2.1-2.3
Private Consumption	1.2-1.3
Government Spending	1.8-2
Fixed Investment	3.4-4
Exports	7.5-6.5
Imports	6.-7
Employment	1.4-1.5
Unemployment	7-7.1
Inflation	2.4-2.5
Labour Productivity	0.6-0.9
ECB Minimum Bid Rate	4
10-Year Bund	4.1-4.3

Source: own elaboration

Valencia, 11 February 2008
Nicolás Jannone

3.- Spain

Macroeconomic Forecasts for 2008

Bipolar Trends in 2007

Economic growth was outstanding in the first half of the year and the growth pattern adjusted "tidily" (see July 2007 report). Private consumption and residential investment, the main springboards for growth in recent years, continued to slow down, while services and industry, with an enormous boom in productive investment, took over. Furthermore, growth became more balanced, due to domestic demand contributing less and foreign demand detracting less from overall growth. The labour market remained dynamic, while productivity to continued to crawl.

Everything Changed after Summer

Although the abrupt slowdown in the real estate market and the risk of an overall slump were evident, the economy was still "cruising". However, the financial crisis following the collapse of the sub prime mortgage market in the US in August hurt several sources of world growth, particularly in developed nations, sparking a downturn in economic sentiment. Furthermore, the inflationary tensions that appeared towards the end of the year had a similar effect, further eroding confidence. Consumer confidence in Spain plummeted in light of the new unfavourable scenario, due to the double blow of a less dynamic labour market and a slowdown in the increase in the value of household real estate assets due to housing inflation levelling out and financial assets, due to the effect of uncertainty in financial markets.

Looking at the macroeconomic scenario for 2008 more globally, it is worth bearing in mind that there has been a long and strong period of economic growth worldwide, with some singularities. Interest rates were generally low as a result of the outlook for inflation remaining relatively stable, and there was a great degree of liquidity in the international system. However, the extraordinary financial innovation over the past few years saw part of the global liquidity escape the control of monetary authorities. In addition, certain economic imbalances became more pronounced, especially the US foreign deficit, which was financed with the savings of the Chinese, Japanese and oil producing nations. Finally, emerging nations became a new and important mainstay for world trade and output growth.

It was at this time when in August 2007 the sub prime loan crisis broke out in the United States, triggering a period of financial turbulence that continues today and whose consequences remain unknown, both in terms of how serious they will be and how far they will spread. This logically conditions the overall macroeconomic scenario for 2008 and, as a result, our forecasts.

At this point, it is worth commenting on the international situation in the fourth quarter of 2007, in which financial turbulence continued and became even more pronounced and the US economy grew weaker. Furthermore, tension has escalated in credit markets (despite the main central supply the system with liquidity), after the announcement of enormous losses stemming from the collapse of the sub prime mortgage market on behalf of important financial institutions (most of which were American) and also after these products were downgraded by rating agencies and the US housing market fell progressively. In contrast, emerging economies have performed well, while European economies have seen their growth rates moderate somewhat.

Over the last few months, inflationary tension has risen in response to the upturn in the price of oil prices and some processed foods, which were pushed up by inflationary tension in some agricultural raw material markets due to differences between world supply and demand that could continue in the future. Inflationary tensions result in wage pressure, which also pushes up prices.

General Review of Growth Forecasts

In this current situation of uncertainty (mainly in developed countries) with the economy and world trade slowing down together with inflationary tensions, not only have growth forecasts been downwardly revised by most institutions, but uncertainty has increased (see Table 1 for the forecasts of the main institutions). As a result, the trend of upward reviews observed in recent years has been bucked.

Faced with this scenario of greater uncertainty, risk of recession in some countries and persistent inflation, economic policymakers have a dilemma that has not existed in recent years: should expansive policies be applied to curb the slowdown, or should restrictive (monetary) policy be used to fight inflation? This trade-off, which mainly refers to monetary policy, makes our forecasts even more uncertain. At present the risk of a slowdown appears have prevailed in the US, which has seen the Fed significantly reduce interest rates and even propose tax stimulus. In Europe, the ECB decided to maintain the minimum bid rate to avoid further tension in monetary conditions and to endow the market with enough liquidity at given times.

Global Macroeconomic Scenario...

Our global scenario assumes that the slowdown, not recession, in the United States along with that in the real estate sector will continue, while in the Euro-zone the slowdown will be less severe and passing. The Japanese economy will continue to expand, albeit slightly more weakly in the first part of the year, while emerging nations will maintain high growth rates, although slightly lower than in previous years due to the slowdown in world trade flows.

In the oil market, the slowdown in world economic activity will more than like reduce the pressure stemming from demand. For this reason, we believe oil prices, in the absence of surprises, will remain stable and high at around $75/barrel of Brent (annual average). The average price of oil in 2007 stood at $72.50 (while we had forecast $65 – see Table 2), as a result of the increase from $53.60 in January to $91.20 in December.

Moving on, we expect the euro to remain strong against the dollar due to the fact that the interest rate gap between the two economic regions has widened, together with the fact that the US economy will slow down more markedly than economic activity in Europe in 2008. However, once this period is overcome, the dollar will appreciate towards the end of the year. As a result, we forecast the bilateral exchange rate to be in the vicinity of $1.40-1.42/€ (annual average). The average exchange rate in 2007 was

$1.37/€ (while we had forecast to range from $1.30-$1.35/€).

Table 1: Macroeconomic Forecasts for 2008 (Real % Change, unless indicated otherwise)

	[1]	[2]	[3]	[4]
GDP	3.1	3.0	2.5	2.7
Private Consumption	2.8	2.7	2.7	2.2
Govt. Spending	5.2	5.0	4.1	4.4
Fixed Investment	3.1	3.0	1.2	3.0
Domestic Demand*	3.5	3.4	2.7	3.0
Exports	5.4	4.7	6.5	4.0
Imports	5.5	5.2	5.6	4.0
Foreign Demand*	-0.4	-0.5	-0.2	-0.3
Unemployment Rate (%LF)	8.2	8.5	8.1	8.2
Inflation Rate [HICP]		2.9	3.6	2.8
GDP Deflator	3.4	3.1	3.3	
Budget Deficit (% GDP)	1.2	1.2	1.5	0.8
Current Account Balance (%GDP)**	-8.9	-9.1	-10.0	-10.2

* Contribution to growth

** Borrowing capacity/requirement compared to the rest of the world (% GDP) in [1] and [2].

[1] Spanish Ministry of Economic and Financial Affairs. Updated Stability Plan 2006-2010. December 2007.

[2] European Commission. European Economy. November 2007.

[3] OECD. Economic Outlook, nº 82. December 2007.

[4] IMF. World Economic Outlook. October 2007.

… Main Risks

At present, the main risks for both the world and also Spanish economy could make the current situation worse. In the first place, the slowdown in domestic demand could become more pronounced if the current liquidity crisis becomes a credit crisis and negatively affects both households (consumption and residential investment) and companies (investment), thus increasing their risk of insolvency, which could even spark a mini recession. In the second place, there is risk of inflation rising markedly. In the third place, we could also be faced with a more accentuated slowdown in real estate markets than expected. All the above risks, apart from the impact they have on business, would also further aggravate the current monetary policy dilemma of fighting inflation or the slowdown. If oil prices exercise less upward pressure on inflation, this situation could abate to a certain extent.

Macroeconomic Forecasts for the Spanish Economy

Slowdown in growth that could get worse

The OCEI's forecasts for the Spanish economy in 2008 are as follows:

1) We forecast real **GDP growth** to slow down substantially in 2008 to 2.6%, compared to 3.8% in 2007 (which coincides with our July 2007 forecast).[6]

The slump in the two cornerstones of growth in recent years, residential construction and private consumption, will be responsible for the slowdown in 2008. Our forecast implies a sharp fall in business in the first quarter, to be followed by a slow but steady recovery over the rest of the year, fuelled by services and industry with an upturn in productive investment on the back of the relatively favourable outlook for corporate profits (including private banks), the end of uncertainty related to the financial storm and the recovery of the main Euro-zone economies. Furthermore, the government will more than likely apply tax benefits (that have already been promised by the two main political parties) in order to restrict the scope of the slowdown, in light of the

[6] See Table 2, which includes the recent trends in the main macroeconomic variables and our forecasts for 2007.

healthy situation enjoyed by public finances.

2) **Composition of growth**: the marked slowdown in domestic demand will be mainly responsible for economic activity decelerating in 2008. This variable is expected to contribute around 2.9 percentage points to overall growth, while net foreign demand is forecast to detract less from growth (-0.3pp).

This forecast marks a considerable change with respect to the composition of growth over the last few years (see Table 2). Domestic demand was estimated to have contributed around 4.6pp to overall growth in 2007, while the external sector detracted 0.8pp, exactly in line with our July 2007 forecast.

The slump in domestic expenditure together with the upturn in exports, boosted by strong foreign markets and the increasing number of Spanish companies that have gone international have resulted in GDP growth becoming more balanced. Meanwhile, imports will suffer the consequences of the slow down in domestic demand.

3) **Private consumption** and **Government expenditure** are forecast to display opposite trends. The former is expected to slow down considerably, while the latter is expected to be highly robust.

Growth in private consumption will drop markedly as a result of the weakness displayed by its main drivers. In the first place, the labour market has already received the full brunt of the economic slowdown, as LFS data for Q4 2007 reflect. This is particularly true in the case of construction, which will reduce household disposable income. In the second place, worse credit conditions, along with the increase in interest payments on loans taken out previously under variable interest rates, by people who are highly indebted (88.4% of GDP in Q3 2007). In the third place, the slowdown in the real rate of wealth revaluation – due to housing inflation decreasing and, in the case of financial wealth, due to a similar trend in stock market listings – will further aggravate the effect on consumption. In the fourth place, weak consumer confidence is also related to the situation described above and also affected by the international financial crisis in recent months.

As a result, we forecast private consumption to drop from between 3% and 3.3% in 2007 (which was slightly less than our forecast for 3.4%-3.5%) to 2.5%.

Furthermore, we expect **final government expenditure** to remain robust throughout 2008, at around 5.3%, thus helping to mitigate the impact of the slowdown in private consumption (particularly in the first half of the year) on final consumption expenditure. This variable rose by around 5.5% in 2007, clearly exceeding our July forecast for 4.7%.

Table 2: Recent Trends and OCEI Forecasts (real % growth rates unless indicated otherwise)

			2007*		Forecasts 2007**	
	2005	2006	2007	Period	Jan-07	Jul-07
(Real) GDP	3.6	3.9	3.8	2007	3.4	3.8
Private Consumption	4.2	3.8	3.3	Q1-Q3 2007	3.4	3.5
Govt. Spending	5.5	4.8	5.5	"	4.1	4.7
Fixed Investment	6.9	6.8	6.3	"	5.3	6.1
Domestic Demand*	5.3	5.1	4.8	"	4.3	4.6
Foreign Demand*	-1.6	-1.2	-0.8	"	-0.9	-0.8
** Contribution to growth*						
Employment (QNA)	3.2	3.2	3.2	"	2.6	2.8
Unemployment Rate (%LF)	9.2	8.5	8.3	2007	7.9	8.1
Labour Productivity	0.4	0.7	0.8	Q1-Q3 2007	0.8	1.0
Inflation Rate [CPI]	3.4	3.5	2.8	2007	2.8	2.5
Borrowing Capacity / Requirements (%GDP)	-6.5	-7.8	-9.5	Q1-Q3 2007	-8.5	-8.5
$US/€ Exchange Rate	1.2	1.3	1.37	2007	1.30-1.35	1.30-1.35
Interest Rates	2.3	3.5	4	Dec-07	[4-4.25]	4.5
Oil Prices ($/barrel of Brent)	54.5	65.2	72.5	2007	65.0	65.0

Source: own elaboration with data from Banco de España and INE
*average for period for which data were available
** monthly average
QNA: Quarterly National Accounts

4) **Investment**, like the rest of the components of demand, will see growth moderate in comparison to previous years and will probably record an increase of around 3% for 2008 as a whole (more than 3pp less than in 2007, which falls in line with out July forecast).

Our forecast was based on the slowdown in investment in equipment, particularly in the first quarter of the year, although it is expected to recover in the second half of 2008 on the back of relatively favourable corporate profits and an improvement in economic sentiment, coupled with the slowdown in investment in construction to between 0.5% and 1%.

Investment is particularly sensitive to economic sentiment. As a result, our forecasts to this respect depend a great deal on developments in consumer and business confidence. Nevertheless, we believe productive investment will recover satisfactorily if the current uncertainty blows over quickly and the announcement of favourable corporate profits (on behalf of both financial and non financial institutions) could help this to occur. An upturn in economic activity in the Euro-zone, or at least similar growth, would also help to sustain robust growth in investment, as would economic (and particularly tax) policy in this direction.

In contrast, we expect investment in construction to slump, particularly where residential construction is concerned, as a result of the slowdown in housing investment due to less accommodating credit conditions, the disappearance of the wealth effect caused by increases in housing prices and stock market rallies, together with downturn in job creation and consumer and business confidence.

5) **Labour market**. In 2007, employment (equivalent to full time jobs) increased for the third year in a row at an exceptionally high rate to between 3% and 3.1%, two or three decimal points more than our July forecast.

Economic growth continued to create a large number of jobs, thus offsetting the increase in the labour force through immigration and due to the growing presence of women in the labour market, sparking a significant decrease in the unemployment rate. However, in the absence of data from the fourth quarter National Accounts, LFS data for this quarter (together with the claimant count) clearly suggest the rate of job creation is slowing down, particularly in the construction sector, which is intensive in labour. This trend will continue and even become more pronounced in 2008, especially over the first few months of the year.

As a result, we forecast growth in employment (equivalent to full time jobs) to drop to 1.6% in 2008, a decrease that will only partly be offset by the fact that less people will join the labour force due to immigration flows decreasing along with the number of women entering the labour market for the first time. This will see the unemployment rate rise to 8.6% (three decimal points higher than in 2007). In July 2007, we forecast the unemployment rate to stand at 8.1%.

6) **Interest rates** will depend on inflation and the buoyancy of Euro-zone economies.

In 2007, the European Central Bank continued tighten monetary policy up to June when interest rates reached 4%. From this point onwards, the impact of the financial crisis on Euro-zone economies forced the ECB to stop raising interest rates, despite mounting inflationary pressure over the last few months. As a result, ECB policymakers have, in contrast to the clearly expansive monetary policy put in practice by the Federal Reserve, injected liquidity into markets without altering interest rates. As mentioned at the beginning of this report, monetary policymakers are at a crossroads between inflation and the risk of a recession.

In our opinion, the clear risk of inflation and a marked slowdown in economic activity in the first half of 2008 will result in the ECB leaving interest rates unchanged. In the second half of the year, inflationary tensions are likely to decrease considerably at the same time as the main economies in the Euro-zone recover. As a result, within our base scenario, interest rates can be expected to remain at 4%.

7) The average **inflation** rate in 2007 was 2.8%, seven decimal points less than in 2006 (and the same as our forecast made in January 2007). However, the year ended in an environment of inflation tension (annual inflation rate of 4.2% in December) due to the upturn in oil prices (and the end of the base effect in the first half of 2007 – see Figure 6 in the January 2008 report), as well as to the increase in the price of certain processed foods, due to tension in some raw material markets. Furthermore, the effect of inflation has spread to costs through wage tensions. All the tensions described above will continue in the first half of 2008, despite the slowdown in domestic demand, but will abate towards the end of the year. As a result, we expect the average inflation rate to stand in the vicinity of 3.2% for 2008 as a whole.

8) The **current account deficit** will remain extraordinarily high due to the negative trend in price competitiveness in Spain as a result of productivity growth being outpaced by unit labour costs. Nevertheless, the slowdown in domestic demand and the fact that exports are relatively buoyant will help the trade deficit to decrease, in line with the trend observed in 2007. The rest of current account items will record similar trends to those observed in 2007: moderate increase in the surplus in trade in services, increases in the deficits in both the income account (due to borrowing in the past and worse credit conditions) and in current

transfers, which is to a great extent due to growing immigrant remittances to their countries of origin. However, growth in remittances could moderate due to the impact of slowdown on the labour market, particularly where temporary workers in the construction sector are concerned.

The result is a growing current account deficit of around 10% of GDP and borrowing requirements that exceed 9.8% of GDP, even higher than in 2007 which could amount to slightly over 9% of GDP (and more than our forecast which was for 8.5%).

National savings will continue to fall well short of the level required to finance investment. This deficit, in the context of the Euro-zone, would not be a serious problem if investment were boosting Spain's competitiveness. However, productivity is rising very slowly, mainly due to the fact that in recent years growth in this variable has been largely based on sectors of non marketable goods (construction and consumption services). For this reason the need to reorient growth towards sectors with higher productivity growth is becoming increasingly evident. Apart from helping to improve Spain's competitiveness, this would also reduce the country's enormous foreign deficit.

9) **Productivity:** Economic growth continued to create jobs in 2007, while labour productivity rose by a mere 0.8% (in line with our January 2007 forecast).

The ratio between the contributions of employment and productivity to (less) overall growth is expected to be more balanced in 2008. We expect labour productivity to improve as a result of changes in the structure of production and the fact that construction will lose ground in relation to total output in favour of industry.

As a result, we forecast productivity to rise by 1% in 2008.

10) The **budget deficit** depends on the pattern of government income and expenditure. A budget surplus for 2007 of nearly 2% of GDP is expected (well and truly above our July 2007 forecast of a 1.4% surplus), on the back of government income that was particularly boosted by direct taxation.

In 2008, the government is expected to record another surplus in 2008, although smaller than in 2007, of around 1% of GDP. The slowdown in economic activity, particularly in construction saw government revenue fall, while government spending increased to curb the slowdown in economic growth. The debt/GDP ratio will stand around 35% (36.2% in 2007 according to government estimates, slightly less than our July 2007 forecast of 36.7%).

Main Risks

The primary risks to the expected macroeconomic scenario described above can be classified into two main groups:

- External or global risks
- Domestic risks

In the first place, external risks are mainly associated to the duration and intensity of the current financial crisis. Tougher credit conditions would make the current slump in the real estate sector worse and consumption and investment would also be further restricted. It is worth highlighting how sensitive Spanish households and non financial corporations are to financial turbulence and tougher monetary conditions, due to their high level of borrowing and the fact that a large proportion of loans were taken out with variable interest rates. Furthermore, in a scenario of credit restriction, the foreign deficit may be financed with higher risk premiums, which would negatively affect gross fixed capital formation in Spain.

In the second place, there is also a risk of a downturn in both world growth and trade. More specifically, if economic growth in the Euro-zone slows down more than expected, foreign demand would decrease, thus damaging Spanish exports of goods and services and growth in productive investment. In the third place, there is a risk of inflation rising further on the back of increases in oil prices and raw materials.

As regards domestic risks, the main concern at present is how much and how quickly the real estate will slide, as this could significantly and directly reduce growth, due to the slowdown spilling over into other related sectors, and also private consumption through the negative effect on the labour market, the negative wealth effect in the case of households and shaky consumer confidence. The remaining risks are related to the imbalances that already existed in the Spanish economy and which have been commented on in these reports on previous occasions. These include the inflation gap with respect to the Euro-zone and the lack of progress in terms of productivity, which continues to undermine the competitiveness of the Spanish economy, thus further increasing the foreign trade deficit.

The most positive risk to the base scenario is the possibility of world economic growth being greater than expected, particularly in the Euro-zone, as this could boost exports, productive investment and growth, further balancing the contributions to growth made by foreign and domestic demand. However, there is little chance of this happening at the moment.

Silviano Esteve
Valencia, February 2008

MAIN ECONOMIC INDICATORS FOR SPAIN, January 2008

VARIABLE	2006	PERIOD	LATEST FIGURE	RECENT TREND
Real Annual GDP	3.9%	2007:Q3	3.8%	Change in trend: slowdown in growth
Real Annual Private Consumption	3.8%	2007:Q3	3.0%	Marked slowdown in private consumption
Consumer Confidence (% net positive and negative responses)	-12	2007	-13	Confidence falls in 2007:Q4 to -19 in Dec-07 (from -10 in Dec-06)
Annual Investment in Equipment	10.4%	2007:Q3	11.2%	Growth moderates, but remains the most dynamic component of domestic demand
Equipment Orders (% net positive and negative responses)	3	2007	15	Upward trend that began in 2006:Q2 continues, particularly in 2007:Q3 and Q4
Real Annual Equipment Imports	3.2%	Oct-07	6.8%	Slight recovery in Oct-07 after falling in 2007:Q3
Annual Fixed Investment in Construction	6,0%	2007:Q3	3.8%	Investment in construction slides further, particularly where residential investment is concerned
Construction Orders (% net positive and negative responses)	22	2007	12	Marked decrease, particularly in 2007:Q4 to 2 (from 21 in 2006:Q4)
Annual Industrial Production Index (calendar-adjusted)	3.9%	Nov-07	-0.6%	Slowdown in 2007 dropping into negative figures in November (from 4.1 in Nov-06)
Industrial Climate (without construction)	-2	Dec-07	-2	Stable with respect to 2006. Worse than in the Euro-zone
Domestic Demand Contribution to GDP Growth (percentage points)	5.1	2007:Q3	4.4	Growth pattern readjusts: domestic demand moderates ...
Foreign Trade Contribution to GDP Growth (percentage points)	-1.2	2007:Q3	-0.6	... while foreign demand detracts less from growth
Annual Exports of Goods and Services - Goods (Customs) – Real Terms - Tourism Income (BoP)	5.1% 5.6% 5.6%	2007:Q3	8.0% 6.7% 3.2%	Goods exports pick up in 2007:Q3. Tourism income growth remains moderate
Annual Imports of Goods and Services - Goods (Customs) – Real Terms - Tourism payments (BoP)	8.3% 8.6% 9.4%	2007:Q3	8.3% 7.2% 8.6%	Goods imports also accelerated, although less than exports, reducing the negative contribution to GDP. Marked growth in tourism payments
Trade Balance Tourism Account Income and Current Transfers Current Account Balance (in millions of € - Q3)	-66,603 24,715 -24,704 -71,142	2007:Q3	-71,346 25,027 -34,752 -85,259	Current account deficit continues to grow, although the trade deficit records slower growth, tourism remains stable and net payments for income and current transfers rose remarkably due to the high level of borrowing and immigrant remittances...
Borrowing Capacity/Requirements (C/A and Capital Account Balance / GDP)	-8.1%	2007:Q3	-9.9%	... raising the economy's borrowing requirements with respect tot he rest of the world (8.9% in 2006:Q3)
Unemployment Rate (LFS) –ratio, %- Activity Rate (16-64 years) (LFS) –ratio,%-	8.5% 71.9%	2007:Q4	8.6% 72.8	Unemployment rate rises six decimal points in the last quarter due to less employment growth (2.4%, 0.7 pp less than in 2007:Q3); remarkable increase in the labour force
Annual Employment Equivalent to Full-Time Jobs (Quarterly National Accounts)	3.2%	2007:Q3	3.0%	Strong growth...
Annual Productivity	0.7%	2007:Q3	0.8%	... minimal progress in labour productivity
Annual Unit Labour Costs	2.3%	2007:Q3	3.0%	Labour costs accelerate due to the increase in wages and minimal increase in productivity...
Annual GDP Deflator	4.0%	2007:Q3	2.9%	Slowdown continues and is now outpaced by growth in ULC
Annual Inflation Rate Headline Inflation Core Inflation	 3.5% 2.9%	2007	 2.8% 2.7%	Upward trend since September to 4.2% in December (1.5 pp higher than in Dec-06), due to processed foods and energy products
Spain-EMU Inflation Gap (percentage points)	1.4	2007	0.7	Narrow up to Sept-07, but wide in large in recent months. Persistently positive: deterioration in price competitiveness
Annual Average Price per m2, New Houses	10.4%	2007:Q4	4.8%	Slowdown becomes more pronounced
Central Govt. Budget Balance/GDP	0.5%	Nov-07	2.5%	Growing surplus due to increase in revenue through direct taxation and less interest payments...
Nominal Public Sector Debt/GDP	43.0% (2005)	2006	39.7%	...as a result of less overall debt
Household and NPISH Savings Rate: (% of gross disposable income, annual moving average)	22.4% 10.5%	2007:Q3	22.1% 9.9%	Decrease in household savings, with high overall savings rate. High borrowing requirements (9.9% of GDP) due to strong investment
Household and NPISH Borrowing/GDP	85.2%	2007:Q3	88.4%	Upward trend continues
IBEX-35 (% Change throughout this year)	31.8%	2007	7.3%	Low growth, following exceptional years
$/€ Exchange Rate	1.255	2007	1.371	€ appreciation: decrease in interest rate gap and slowdown in US economy
Real Effective Exchange Rate (compared to developed nations, base index 1999 = 100, consumer prices	104.5	2007	108.3	Euro-zone competitiveness decreases. Spain less competitive with respect to EMU member states and developed nations
Annual M3 (Euro-zone)	9.9%	Nov-07	12.3%	Growth well above target rate of 4.5%
ECB Minimum Bid Rate	3.50%	Jan-08	4.00%	*"Wait and see"*
12-month EURIBOR	3.92%	Jan-08	4.49%	Upward trend inverts
10-year Bond Yields	3.82%	Dec-07	4.35%	Upward trend in 2007
Average Household Mortgage Rates (over the period)	4.2%	Nov-07	5.6%	Upward trend due to increase in interest rates and sub prime loan crisis in the US

Source: own elaboration with data from official institutions

4.- France & Germany

Accuracy of Forecasts for 2007

The accuracy of our forecasts for 2007 in the case of the German economy leaves a bitter sweet after taste. The most accurate forecast was that for GDP growth, which grew by 2.5%, right in the middle of the interval we had forecast. At the same time, the unemployment rate also fell into our forecast ranging from 7.8% to 8.2% on ending the year at 8.1%. However, we were not so accurate in forecasting the growth in GDP components, as the Germany economy behaved quite differently in this sense to what we initially expected, albeit without affecting the overall growth rate as mentioned above. Furthermore, the unexpected rally in the inflation rate in the last few months of the year also clearly surpassed our forecast and that of most analysts.

In the first place, it must be pointed out that domestic demand did not take over from foreign demand in 2007, as we expected at the end of 2006, in the light of the excellent results in the fourth quarter of that year. The reason lies in the 0.3% decrease in private consumption for 2007 as a whole. Fortunately, investment and government spending, with growth rates of 8.4% and 2% respectively have avoided a collapse in domestic demand. As a result, foreign trade was once again the mainstay of German growth, despite export and import growth moderating somewhat in comparison to previous years.

The other error, shared by all analysts, was due to prices soaring at the end of the year, taking the annual inflation rate to 2.8% in December, almost double the upper threshold of our forecast. The use of the verb “soar” is entirely justified considering that the outbreak of inflation began in September, up to which time forecasts had remained accurate. Furthermore, the figure in December was lower than that recorded in November, 3.1%.

One last aspect that was also a surprise, but in this case positive, was the excellent results chalked up by the German government that has wiped away its deficit. As a result, our forecast, which was optimistic in relation to the forecasts made by other institutions, was happily bettered by the final result.

Table 1: Accuracy of Forecasts for 2007-Germany

	Min.	Max.	Figure
GDP	2.3	2.8	2.5
Private Consumption	0.6	0.8	-0.3
Fixed Investment	3.5	5.0	8.4
Government Spending	0.8	1.2	2.0
Exports	10.0	12.0	8.3
Imports	11.0	12.5	5.7
Unemployment Rate	7.8	8.2	8.1
Budget Deficit / GDP	-0.5	-1.0	0.0
Inflation Rate	1.8	2.0	2.8

Source: DESTATIS and own elaboration

As regards the French economy, our forecasts were not as accurate as in the case of Germany. We forecast GDP to grow by between 2% and 2.5%, but the French economy grew less than expected and the growth rate will not differ much from the 1.8% estimate on behalf of INSEE. The fact that overall growth was less than expected results in lower growth rates in private consumption (1.9% compared to our forecast for 2.4%-2.8%) and government spending (1.4% compared to 2.3%-2.5%). However, the final result would have been worse had investment not been as buoyant, with a final growth rate of 3.6%, which coincides with the upper threshold of our forecast. In comparison to overall growth, investment has been strong, a situation that also occurred in Germany, but which was much more pronounced. Foreign trade was, however, much less buoyant, with lower growth rates than expected in the case of both exports and imports, although the overall contribution of the external sector did coincide with our forecast (of less than -0.5%).

The unemployment rate stood at 7.8% in December (Eurostat series), which falls inside our forecast range (7.7% to 8.3%).

As was the case with Germany, our most inaccurate forecast referred to prices, following the end-of-year inflation rate of 2.6%, when we had predicted a rate of between 1.3% and 1.6%, in line with other institutions. Once again like Germany, the price hike occurred towards the end of the year.

Finally, it is worth indicating that our last forecast, for the budget deficit/GDP ratio, was accurate. The final figure was 2.1%, when we had forecast between 2% and 2.5%, on placing less trust in French economic policymakers than in the case of Germany.

Table 2: Accuracy of Forecasts for 2007 in France

	Min.	Max.	Figure
GDP	2.0	2.5	1.8
Private Consumption	2.4	2.8	1.9
Fixed Investment	3.1	3.6	3.6
Government Spending	2.3	2.5	1.4
Exports	4.0	5.5	3.3
Imports	5.0	6.5	4.2
Unemployment Rate	7.7	8.3	7.8
Budget Balance/GDP	-2	-2.5	-2.1
Inflaton Rate	1.3	1.6	2.6

Source: INSEE and own elaboration

Note: Growth rates for GDP and GDP components are the result of annually adjusting third quarter data. The unemployment rate was obtained from the month series compiled by Eurostat.

Forecasts for 2008

Before we begin, it is worth indicating that it is very difficult to make economic forecasts in light of the uncertainty currently surrounding financial markets. Nevertheless, we will present the forecasts made by other institutions for growth, unemployment and inflation in 2008, before presenting our own. It must be said that all the forecasts detailed below were made before the stock market crash on January 21, which could result in some losing their validity to a certain extent. However, they are included herein on considering that the real fundamentals of the European economy are sounder than the ebbs and flows in financial markets would have us believe, on suffering a classical trust crisis and fear which in our opinion is excessive over possible developments on the other side of the Atlantic[7]. Furthermore, it is still too early to know whether financial market instability will spread to the real economy, which explains why forecasts have not been reviewed since they were released at the end of last year[8].

[7] The fact that European stock markets reacted more intensely and before Wall Street allows no other interpretation.

[8] After this report was written, the IMF reviewed the forecasts presented herein. The most striking thing was that the possibility of a recession in 2008 has been discarded, even for the United States, although it is acknowledged that there will be a slowdown. There are two reasons why we have not included these revised forecasts, which are 0.5% lower in the case of Euro-zone growth, in the report: firstly, because forecasts for individual countries are not provided and secondly because the review stems from a change in the procedure used to measure growth (which now includes purchasing power parity), which has seen growth rates in previous years also reduced. It is therefore

As regards the German economy, everyone expects economic growth to slow down in 2007. However we are talking of an average decrease of around 0.5% or slightly more in comparison to 2007. Only one organisation has cut its forecast by one percentage point less than in 2007. Unemployment forecasts are more varied, which is on the other hand, quite normal. As a result, forecasts range from 5.7%, which we believe to be unattainable in light of the current situation, to 9%. Finally, inflation forecasts also vary considerably, albeit not to the same extent as unemployment. In any case, all institutions forecast inflation to moderate in 2008, as was to be expected. It is worth highlighting that most forecast the inflation rate to drop below the ECB target rate of 2%.

Table 3: Forecasts for 2008 in Germany

	GDP	Unemployment	Inflation
IFO	1.8	8.0	2.3
ZEW	2.2	9.0	1.8
IMF	2.0		1.7
OECD	1.8	5.7	2.3
BNP	1.5	8.6	2.0
EC	2.1	7.7	1.6

Source: own elaboration

In the case of the French economy, there is also a wide variety of growth forecasts. While two organisations forecast a GDP growth rate of 2%, which would be higher than in 2007, the other two forecast growth to drop below this figure, one quite substantially. There are different opinions therefore regarding the future of the French economy, which must imply significant differences in their respective diagnoses. Forecasts for unemployment, however, are remarkably similar, with the exception of the OECD. In light of this forecast, the OECD must be considering the monthly unemployment series, which has not been published since July, which means they are forecasting an increase in unemployment almost certain due to the slowdown in growth. Finally, the forecasts for inflation suggest, as was the case for Germany, that prices will moderate with regard to 2007. The average forecast for inflation in 2008 stands at around 2%.

Table 4: Forecasts for 2008 in France

	GDP	Unemployment	Inflation
IMF	2.0		1.8
OECD	1.8	7.5	2.2
BNP	1.3	8.3	2.3
E.C.	2.0	8.2	1.7

Source: own elaboration

Economic Growth

Before announcing our forecasts, we must point out that we have assumed the ECB minimum bid rate will not drop below 3.5% before the end of the year. In addition we expect the euro/dollar exchange rate to range from 1.44 to 1.48 dollars to the euro.

Moving on to our forecasts, we share the diagnosis of other organisations where the German economy is concerned in that 2008 will witness a slowdown in economic growth, as was to be expected in the light of the decrease in world economic activity. However, we believe that at this moment in time a recession is not on the cards. As a result, we forecast German GDP to grow by between 1.7% and 2%, which is at least half a point and at most nearly one full point less than the current growth rate.

In keeping with the rest of organisations, we believe the French

unclear whether the decrease is due to the situation worsening or to the change in methodology.

economy will display a similar trend to that observed in 2007, that is, growth will range from 1.7% to 2%. One might think a forecast for a similar trend in France to that in Germany should result in the French growth forecast being lowered further, but in out opinion, the situation in France would only get worse in 2008 if the world economic climate suffered a much more serious setback than is currently foreseeable. In this sense, the French economy was already weak in 2007, without any foreseeable posterior deterioration, at this moment in time.

GDP Components

In reference to the items that contribute to GDP growth in Germany, despite the unusual trend observed in 2007 mentioned previously, we believe things will get back to normal in 2008, in line with other organisations. As a result, we forecast private consumption to increase by between 1.5% and 2%. That is, we believe private consumption with buck the negative trend that marked 2007, even if only as a result of the low base growth rates this year. Likewise, we forecast investment to grow by between 2.5% and 3.5%, a fair increase, but not as strong as in 2007. The strained economic and business climate makes any further growth unlikely. Government spending is forecast to rise by between 1.2% and 1.7% now that government accounts are out of the red, while exports and imports are forecast to increase by between 6.5% and 7.5% and 6% and 7.5% respectively. The growth rates forecast for foreign trade are more moderate than in 2007 due to the appreciation of the euro and the slowdown world economic growth, but not by much, as the effect of the crisis on the normally strong German external sector is still to seen.

Our forecast for the variables that make up French GDP is similar to that for Germany. In the first place, private consumption is expected to grow at a rate of between 1.5% and 2.0%. Investment will increase by between 2% and 2.5%, while government spending will grow by between 1.5% and 2%. Domestic demand has traditionally been the strong point of the French economy; as regards France's weak point, the external sector, more moderate growth is expected this year: exports will increase at a rate of between 2.5% and 3%, while imports will rise by between 3% and 3.5%.

Unemployment Rate

The German economy has witnessed a significant decrease in unemployment since mid 2005 that saw the unemployment rate drop to 8.1% at the end of 2007. However, the slowdown in growth we forecast for this year will result in this trend being interrupted. The German economy will not create employment at the same rate as it has over the last few years. Therefore, we forecast the unemployment rate to rise to between 8% and 8.5% by the end of 2008. Note that this would not imply a large increase, as the decrease in overall growth is not forecast to be great either.

It is particularly difficult to forecast the unemployment rate in France this year. Apart from the delicate economic situation at present, the change in the data series that INSEE uses as a reference in France makes the task of forecasting even more difficult. We expect the unemployment rate to rise slightly to between 8.1% and 8.6% by the end of 2008.

Public Deficit

In relation to the public deficit, we believe Germany will maintain Budget equilibrium in 2008, although there is a chance of a slight deficit in light of the slowdown in economic growth. As a result, the budget balance/GDP ratio is forecast to stand between 0.0% and -0.2% in 2008.

In the case of France, there is no reason to believe that this variable will change much with regard to 2007. Therefore, we estimate the budget deficit to represent between -2% and -2.5% of GDP.

Inflation

We forecast the inflation rate to return to its long term trend in both Germany and France, following the price boom at the end of 2007. We therefore expect the inflation rate in both countries to stand between 1.8% and 2.2% by the end of 2008.

Table 5: Forecasts for 2008- Germany

	Minimum	Maximum
GDP	1.7	2.0
Private Consumption	1.5	2.0
Fixed Investment	2.5	3.5
Govt. Spending	1.2	1.7
Exports	6.5	7.5
Imports	6.0	7.0
Unemployment Rate	8.0	8.5
Budget Deficit / GDP	0.0	-0.2
Inflation Rate	1.8	2.2

Source: own elaboration

Table 6: Forecasts for 2008 - France

	Minimum	Maximum
GDP	1.7	2.0
Private Consumption	1.5	2.0
Fixed Investment	2.0	2.5
Govt. Spending	1.5	2.0
Exports	2.5	3.0
Imports	3.0	3.5
Unemployment Rate	8.1	8.6
Budget Deficit / GDP	-2.0	-2.5
Inflation Rate	1.8	2.2

Source: own elaboration

In short, we basically forecast growth in the French and German economies to slow down in 2008, with regard to the situation observed in 2007. While we cannot entirely discard the possibility of the situation considered herein becoming worse, particularly in light of financial market jitters, the real economy for the moment does not suggest that this is unavoidable.

Antonio Cutanda
Valencia, 4 February 2008

5.- China

Forecasts for 2008

This is going to be a great year for China, both due to the challenges the country faces to balance certain aspects of its economy and for its role as host of the Olympic Games.

According to Chinese officials, the main tasks to be addressed in 2008 should be:

- Macroeconomic control to prevent the economy from overheating and moderate inflation
- Transformation of "prudent" to "strict" monetary policy
- Control loans to regulate domestic demand and balance international payments
- Optimize fiscal spending on social security, Elath, hygiene, education, etc.
- Consolidate the role of agriculture in the economy to guarantee the supply of food
- Base technical innovation on key technology for economic and social development
- Use price, tax and financial policy to encourage energy conservation
- Foster environmental protection and reduce emissions by curbing the growth of polluting industries
- Channel more financial aid to under developed regions
- Sustainable urbanisation without casting land
- Take economic, financial and tax reform further
- Develop free trade area strategy and strengthen bilateral and multilateral cooperation
- Further effort to improve the standard of living and facilitate social harmony

The government also intends to increase rural aid in order to reduce the ever increasing gap with regard to urban areas and guarantee agricultural development, which will help to stabilize prices. The central government decided to raise its rural budget to 520,000 in 2008 from 392,000 last year.

China is a member of BRIC (Brazil, Russia, India and China). All four are emerging nations, with enormous surface areas and have a growing influence on the world economy. For this reason, Goldman Sach indicates that 2007 was another happy year for BRIC, although 2008 is forecast to be less so due to the possible recession in the US and lower world economic growth. As regards China, Goldman Sach is of the opinion that GDP will increase by 10% in 2008 and that inflation is a real threat that will not allow the central bank to lower interest rates.

Various analysts within the country have forecast different growth rates for China in 2008, but all of them coincide that the economy will grow less than in 2007. The National Development and Reform Commission forecasts GDP to grow by 8%, which in our opinion is overly moderate. The Chinese Academy of Sciences is more realistic in its forecast for 10.2% growth, indicating that the country will enjoy strong development in a favourable economic scenario. The central bank is somewhat more optimistic, forecasting a growth rate of 10.5%, while the State Information Centre forecasts the highest growth rate at 10.8%.

Supranational organisations such as the OECD, the World Bank and the Asian Development Bank estimate that economic growth in China will slow down to 10.7%, 10.8% and 10.5% in 2008 respectively. More specifically, at the beginning of January before official growth data were released, the World Bank made forecasts that we include in Table 1 below. However, these growth forecasts were downwardly corrected in February to 9.6% in the case of GDP. The reasons were a slowdown in exports and an increase in inflation. According to the table below, the slight slowdown in growth is due almost entirely to exports, following the downturn in growth in most economies worldwide.

Table 1: World Bank Forecasts

	2006	2007	2008	2009
Real GDP	11.1	11.3	10.8	10.5
Private Consumtpti on	8.8	9.0	8.5	8.3
Government Spending	9.0	9.5	9.0	9.0
Investment	12.1	11.8	10.1	9.8
Exports	22.3	23.0	18.4	22.0
Imports	19.0	20.0	17.4	24.0

As regards other macroeconomic variables, the PBC forecasts inflation to continue to rise in 2008, but expects it to slow down gradually. The CPI will remain around 4.5%, two decimal points lower than in 2007. Other national forecasts dare to predict a 4.4% rise, but only providing the price control measures implanted by the government work. If they don't, the CPI could rise to 5.8%. The country is not only advised to guarantee a supply of food by creating state reserves of products to avoid prices rising, but also to progress more quickly towards reforming the tax system where energy products such as oil and natural gas are concerned.

As regards foreign trade, imports will outpace exports, which will reduce the trade surplus. The Yuan will continue to appreciate against the dollar, which will make life more difficult for export companies. The government expects the Yuan to appreciate more quickly against the dollar over the first half of the year, which will negatively affect export companies and, indirectly, households.

Bank loans will begin to feel the effect of the recent monetary policy moves, but the problems of excess liquidity at the end of 2007 will persist in 2008.

According to the latest report by the World Bank, China is not expected to suffer greatly from the current situation in international financial markets, due to the country's large currency reserves.

Bearing in mind the economic situation in China, our forecasts for the main macroeconomic indicators in 2008 are as follows:

Table 2: OCEI Forecasts

	2007	2008
GDP (%)	11.4	10.8-11
Inflation (%)	4.8	4.4-4.8
Interest Rates	7.47	7.8-8.0
Exchange Rate (Yuan/$)	7.24	7.0-7.1

Mª Luisa Martí and Rosa Puertas

Valencia, 4 February 2008

6.-México

Previsiones 2008

Entramos a una zona de turbulencia al tratar de pronosticar la evolución de la economía mexicana para el presente año.

Dada la situación económica con fuertes indicios de recesión, resulta muy complicado realizar pronósticos de lo que puede suceder en la economía en este 2008 que inicia. Sin embargo, vamos a intentarlo.

El comportamiento de la economía mexicana en 2008, parecía que iba a ser muy similar a lo observado durante 2007, pero la desaceleración de la economía norteamericana vino a cambiar el panorama.

PIB 2008

Una recesión en la economía norteamericana afectará inevitablemente a la mexicana, como lo hemos venido comentando. Lo que no es fácil predecir es la cuantía del daño.

El principal afectado será sin duda el sector externo al contraerse las exportaciones hacia Estados Unidos, así como el volumen de remesas familiares y la inversión extranjera directa.

Ante el casi seguro debilitamiento del sector externo, se hace necesario tomar medidas para el fortalecimiento del interno.

Parece que en esta ocasión el gobierno mexicano no estará cruzado de brazos esperando a ver qué le sucede a la economía mexicana, como fue en el caso de la recesión de 2001.

Cuando menos ante esta desaceleración o recesión se tiene la intención de actuar, si se toman en cuenta las declaraciones del Presidente mexicano, con mayor gasto público en áreas específicas. Habrá que ver si en la práctica se llevan a cabo.

El crecimiento de la economía mexicana estará como siempre, condicionado al desempeño de la economía de Estados Unidos.

Recién inicia 2008 y ya se tienen revisiones a la baja en materia de crecimiento de la economía.

En sus Perspectivas Económicas Mundiales para 2008, el Banco Mundial estima un crecimiento para la economía mexicana de 3.2%, prácticamente idéntico al observado durante 2007.
La Secretaría de Hacienda, en su última revisión realiza un ajuste a la baja, al ubicar el crecimiento en 2.8%.

El Banco de México lo pronostica entre 2.75% y 3.25%.

En la Encuesta sobre las Expectativas de los Especialistas en Economía del Sector Privado, del Banco de México, en la correspondiente al mes de diciembre de 2007, se estima un crecimiento de la economía mexicana de 3.3% para 2008, y de 3.8% para 2009.

No queremos pecar de pesimistas, pero nuestro pronóstico es de un crecimiento del PIB en alrededor del 2%. De prolongarse la desaceleración o entrar en una recesión más allá del primer semestre, esta cifra deberá ajustarse a la baja.

Inflación bajo control en 2008

Es preocupante la evolución hacia el alza de algunos granos, como el maíz y el trigo, además del acero y cemento, algunos de ellos de origen externo, pero que necesariamente impactan en el nivel de precios interno.

Se esperan en 2008 precios altos en maíz, trigo, cebada y arroz, así como en materiales para construcción.

Es muy probable que las presiones continúen por el lado de los precios en alimentos, con lo cual la inflación subyacente mostrará una tendencia al alza, como se manifestó al término de 2007.

El Banco de México (Informe trimestral julio septiembre) ha estimado el impacto que tendrá la reforma fiscal en materia de precios.

Señala que, dado que el Impuesto Empresarial a Tasa Única (IETU) es un impuesto donde la carga tributaria incide sobre las empresas y las personas físicas con actividad empresarial, no tendrá un efecto directo sobre el Índice Nacional de Precios al Consumidor (INPC). Sin embargo, deja entrever la posibilidad de que las empresas que se vean afectadas trasladen esta carga fiscal adicional al consumidor, vía precios.

Estima el Banco Central que el efecto de la reforma fiscal sobre el INPC será de entre 40 y 50 puntos base en el presente año.

Con relación al impuesto federal a la gasolina y al diesel, señaló que debido a que son productos con precio administrado, en este caso, el impuesto a estos bienes sí se traslada totalmente a su precio, considerando que se incrementen en proporciones no significativas.

También estima que la reducción de las tarifas eléctricas para industrias y comercios, puede llevar a una reducción en este tipo de establecimientos, lo que contrarrestaría el efecto generado por la reforma fiscal, entre 3 y 5 puntos base, en el presente año.

En la encuesta sobre expectativas del Banco de México, se pronostica una inflación de 3.86% para el presente año, y de 3.49% para 2009.

El menor crecimiento esperado para la economía ayudará a contener las presiones inflacionarias, por lo que nuestro pronóstico es una inflación cercana al 4%.

Tasas de interés y tipo de cambio

De materializarse la recesión, seguramente habrá un recorte en las tasas de interés. Es muy probable que el mes de febrero el Banco Central esté anunciando una disminución en las tasas. En la encuesta sobre expectativas del Banco de México, se espera que al cierre de 2008, la tasa del Cete a 28 días, se ubique en 7.36% y al finalizar 2009, en 7.11%.

En cuanto al tipo de cambio del peso mexicano con relación al dólar, para el cierre de 2008 se pronostica un tipo de cambio de 11.13 pesos por dólar, y al terminar 2009, en 11.35 pesos.

Ante una estabilización esperada en 2008 de la brecha inflacionaria entre México y Estados Unidos, es de esperarse poca volatilidad en el tipo de cambio.

Nuestro pronóstico es que la tasa de fondeo estará ubicada durante el año entre 6.25% y 6.5%; y la tasa de CETES a 28 días en 7%.

Estimamos un tipo de cambio estable, por lo que nuestra previsión es un promedio para el año de 11 pesos por dólar.

Empleo 2008

El Banco de México estima una generación de 620 mil puestos de trabajo en el sector formal. Por su parte, en su encuesta sobre expectativas del Banco de México se calcula que se crearán 771 mil nuevos empleos en el presente año; y en 2009 será de 826 mil.

Dado que este sector será uno de los principales afectados al reducirse la producción, nuestro pronóstico es de 400 mil nuevos empleos en 2008.

Petróleo 2008

Llegará buena cantidad de dólares excedentes a lo presupuestado, siempre y cuando no exista una caída considerable en el precio del petróleo.

La diferencia entre el precio fijado con fines de elaboración del presupuesto, a las exportaciones de la mezcla mexicana, de 49 dólares por barril, con el precio pronosticado en los mercados internacionales, es enorme.

En el último trimestre de 2007, el precio de la Mezcla Mexicana de Exportación tuvo un promedio de 77.21 dólares por barril.

Los excedentes petroleros pueden apoyar de manera importante a la economía mexicana. La parte de estos excedentes que se canalizan a las entidades federativas están condicionadas a aplicarse en infraestructura productiva, lo que puede ser un detonante en materia de empleo y de fortalecimiento del consumo interno.

Debe utilizarse este excedente en el fortalecimiento del mercado interno, lo que ayudaría a paliar la previsible crisis recesiva.

Como ya señalábamos, preocupa y seguirá preocupando la baja en los niveles de producción, que por el momento ha sido compensada con un elevado precio, lo que hace que el ingreso total no se vea afectado de manera considerable.

En la encuesta sobre expectativas del Banco de México se pronostica un precio promedio de la mezcla mexicana de exportación de 64.26 dólares por barril como promedio en 2008.

Nuestro pronóstico es de 60 dólares.

Inversión extranjera directa 2008

Este será uno de los principales renglones, afectados con la recesión o desaceleración al igual que las exportaciones manufactureras y remesas.

En 2006 la inversión extranjera directa fue de 19,211 millones de dólares. Durante los primeros nueve meses de 2007, se llevaban contabilizados 18,396 millones, por lo que consideramos que puede cerrar el año con un poco más de 20 mil millones.

En la encuesta sobre expectativas del Banco de México se estima que en 2008 podrían entrar recursos en este renglón por el orden de 20 mil millones de dólares, al igual que en 2009.

Nuestro pronóstico para 2008 es de 17 mil millones de dólares.

Remesas 2008

Si, como parece ser, serán los dos primeros trimestres de 2008 los de mayor dificultad económica, es también muy probable que al disminuirse la actividad de la economía norteamericana el envío de remesas se vea mermado, afectando con ello al consumo interno en México.

Consideramos que en 2008 habrá un decremento en el envío de remesas, por lo que nuestro pronóstico es de 22 mil millones de dólares.

Consideraciones finales

México deberá aplicar una política económica antirecesiva como medida de blindaje económico.

La economía mexicana tiene dos grandes motores. Si uno de ellos (sector externo), tiene problemas, entonces hay que fortalecer el otro (sector interno) con una adecuada política de gasto público que fortalezca la inversión y el consumo interno.

El gasto en infraestructura puede ser el gran detonante para contrarrestar los efectos recesivos. Los recursos están disponibles, solamente falta lo mas importante, el aplicarlos.

La apuesta seguramente deberá ser al consumo interno. En la medida que logre fortalecerse o en el mejor de los casos no deteriorarse, México se encontrará más fortalecido ante el embate de la crisis.

Remesas, mayor gasto público en infraestructura y vivienda, así como más crédito al sector privado, serán los elementos que pueden proteger y apoyar a la economía mexicana, por sus efectos en el consumo interno.

En materia de política monetaria y dado que ya desapareció uno de sus instrumentos "el corto", el otro que seguirá utilizando el Banco de México, la tasa de fondeo, deberá disminuir para facilitar la actividad productiva.

Durante 2007 se aprobaron importantes reformas en materia de pensiones del ISSSTE, la hacendaria y la electoral. Es muy probable que avancen y haya resultados en 2008 en materia de reforma energética y reforma laboral. Esto puede generar un buen clima para la inversión.

Un avance en las reformas pendientes provocará un mayor crecimiento económico, tan necesario en este 2008, dado el contexto internacional.

Por último, resulta interesante la opinión de los consultores encuestados sobre las expectativas que realiza el Banco de México.

Consideran que los cinco factores más importantes que podrían interferir en el crecimiento económico de México son los siguientes, en orden de importancia decreciente:

- La debilidad de los mercados externos y de la economía mundial
- La inestabilidad financiera internacional
- La ausencia de avances en materia de reformas estructurales
- La presencia de presiones inflacionarias en el país
- Problemas de inseguridad pública

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