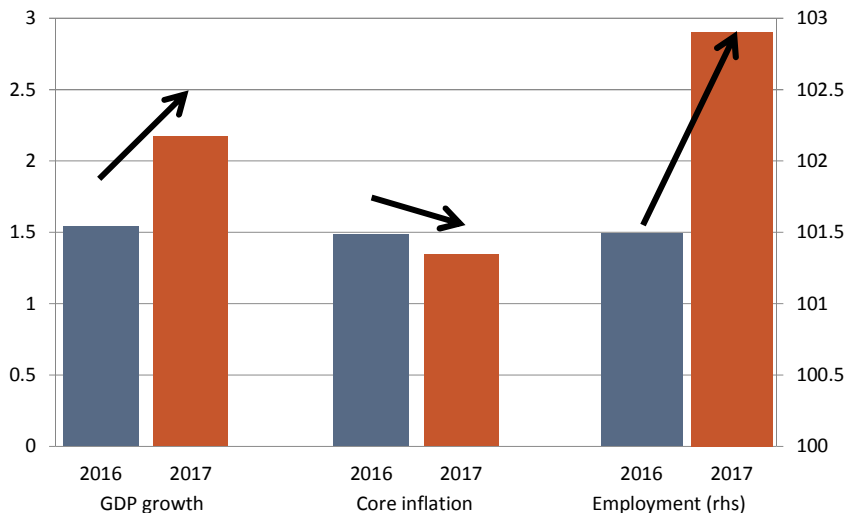


21 December 2017

2017 – what a lovely year it was

A good record: growth, inflation and employment in the developed world



Weighted averages for US, Eurozone, Japan and UK; yoy changes in % for real GDP and core consumer prices, on left-hand scale; index rebased to 2015=100 for employment levels, on right-hand scale. Sources: BEA, BLS, Eurostat, ONS, Cabinet Office of Japan, Bloomberg, Berenberg calculations

- A lovely year:** The Christmas season is the time for some festive cheer. This time, economists may want to adjust the lyrics of John Sebastian's song "Oh what a lovely dream it was" to celebrate the year that is coming to a close. Across almost the entire developed world, economic growth finally accelerated to rates well above trend. Despite a further strong gain in employment roughly in line with the advance of 2016, core inflation receded marginally for the average of the four major economies, the US, the Eurozone, Japan and the UK. While wage inflation remained muted across the board, US core inflation even decelerated further, helped by a welcome plunge in prices for cellphone services.
- The return of the cycle:** After a post-Lehman "age of caution", during which households and companies were more reluctant than usual to borrow, spend and invest, 2017 marked the partial return of normal cyclical dynamics. With the fading of the post-crisis fear factor, the economic upswing gathered more momentum than expected a year ago.
- The year of the ugly ducklings:** The two regions with the worst image in the developed world, the Eurozone and Japan, sprung the major positive surprises. Both proved all those critics wrong who had worried for years that these regions might go down in a deflationary spiral. After years in which markets had not paid enough attention to the underlying progress, such as structural reforms and fiscal repair in the Eurozone and a rising female employment rate in Japan, many observers finally started to appreciate the more positive fundamentals in 2017.
- The British exception:** Of course, nothing in life is perfect. Unfortunately, but not unexpectedly, the UK did show in 2017 that bad policy choices do hurt and that inflation is never dead for good. With its decision to file for divorce from its major market, the EU, the UK has partly decoupled itself from the trends elsewhere. While uncertainty weighs on investment, the country has become less attractive for skilled immigrants. Both factors constrain its supply potential, adding to inflation risks. In the wake of the post-Brexit devaluation of sterling, UK core inflation surged while UK GDP and employment growth softened slightly in 2017.
- More of the same in 2018?** With strong cyclical dynamics and still subdued inflation across the developed world outside the UK, the starting situation for 2018 looks auspicious. The key risk to watch is whether, after unexpectedly strong demand gains in 2017, inflation edges up faster than projected in 2018. The issue will be particularly pertinent in the US where the tax package will raise the supply potential but add even more to demand. Following the subdued rates of US core inflation in 2017, chances are that inflation will not rise to rates that would scare the US Fed into tightening more than needed to keep growth on an even keel. 2018 could well be another good year.

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