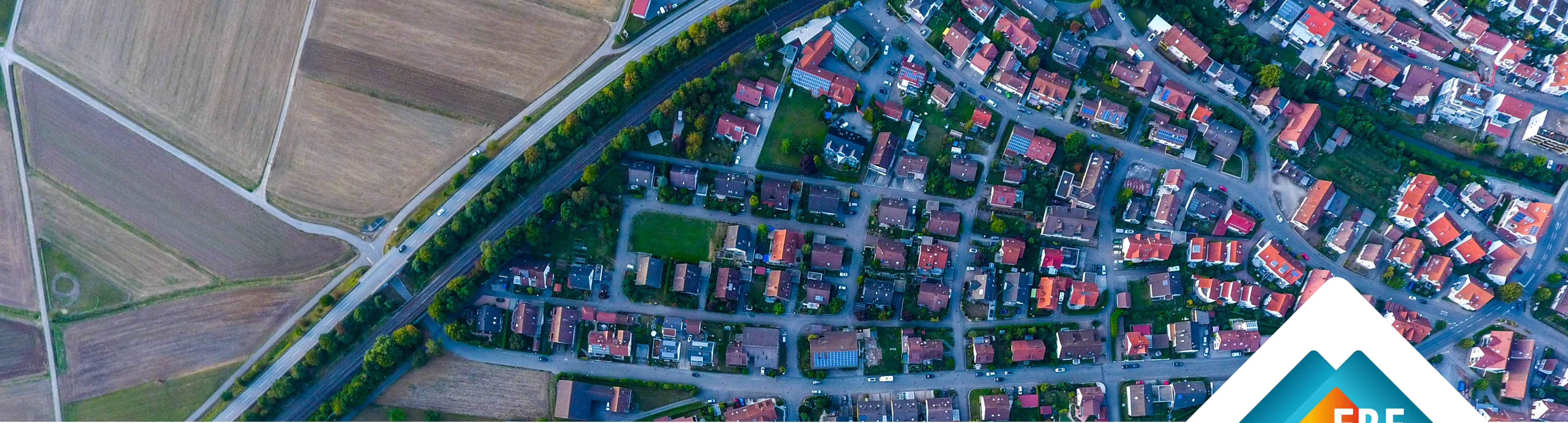
EBF 2019 Spring Outlook in Euro Area Economy 2019 - 2020

Waiting and looking forward to 2020

European Banking Federation



A bi-annual report prepared with contributions from the European Banking Federation’s Chief Economists’ Group. This report reflects a consensus on the outlook for the Euro area economy, which is based on arithmetic averages.

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THE EBF FORECAST FOR THE EURO AREA

- **The Euro area economy will continue to expand, albeit close to potential for the time being.** We foresee the Euro area GDP growing by 1.2 percent in 2019 and with a modest pick up to 1.4 percent in 2020.

- **European banks see inflation subdued.** We forecast an inflation rate of 1.3 percent in 2019 and 1.5 percent in 2020. Core inflation, projected to be 1.2 percent in 2019 and 1.4 percent in 2020, will gradually converge towards headline inflation.

- **Labour markets will continue to improve over the forecast horizon.** The jobless rate is forecast to be 7.7 percent in 2019 with a further improvement to 7.5 percent in 2020.

The CEG consensus forecast for the Euro area in 2019 and 2020

Main indicators of Chief Economists' Group's consensus

year-on-year growth rates unless specified otherwise, in %

	2018	**2019p**	**2020p**
Gross domestic product	1.9	***1.2***	***1.4***
Private consumption	1.3	***1.3***	***1.5***
Public consumption	1.1	***1.4***	***1.3***
Gross fixed investment (GFCF)	3.3	***2.7***	***2.4***
Exports	3.2	***2.5***	***2.6***
Imports	3.2	***3.0***	***3.0***
Unemployment rate	8.2	***7.7***	***7.5***
Prices (HICP)	1.8	***1.3***	***1.5***
General Government balance (% of GDP)	-0.5	***-0.9***	***-0.9***
General Government debt (% of GDP)	87.1	***84.3***	***83.4***

Source: Projections for 2019 and 2020 from EBF. European Commission data for previous year.

Risks to the baseline scenario

- **UPSIDE RISKS**

+ US economy to continue expanding, albeit at a lower pace together with signs of a stabilisation and recovery in China's growth offsetting uncertainties in emerging countries.

+ Global economy gaining moderate momentum in 2020. Also, provided that international trade dispute does not intensify further, global trade will pick up again supporting the export economies in the Euro area.

+ Although a no-deal exit remains probable, Brexit negotiation extension could help bring an outcome that is economically acceptable.

+ A rebound in Germany's performance in the course of 2019 with, in particular, possible recovery of industrial production, mainly in the automobile sector.

+ Fiscal policy in the Euro area is becoming more expansionary.

- **DOWNSIDE RISKS**

– Worsened trade outlook with rising trade tensions between the US and China triggering a trade battle that would harm global economy. The Euro area economy, that is relatively highly exposed to external trade, would be severely hit if EU-US trade frictions materialise and US tariffs are imposed on, for example, EU automotive exports.

– Upward pressure on oil prices coming mainly from an escalation of geopolitical risk, in particular in Iran and Venezuela.

– High debt levels and weak growth in Italy, Euro area's third biggest economy.

– Brexit and the uncertainty around the final outcome remains a major concern.

– Weak manufacturing sentiment spreading to the broader economy.

– Political uncertainty at a broad European level with Eurosceptics gaining attraction in some countries ahead of European elections.

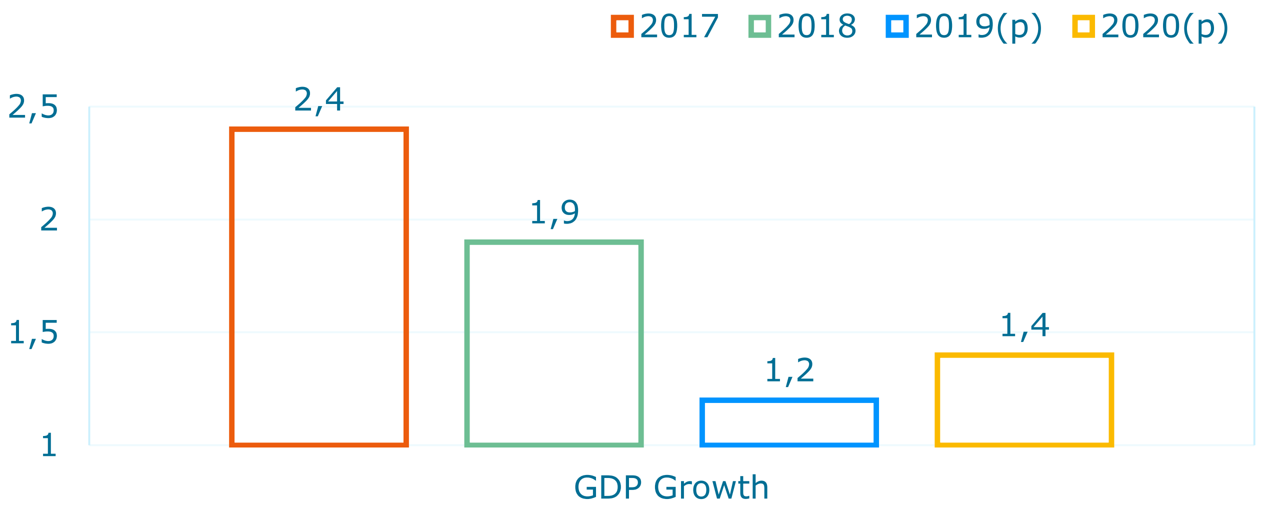
The risks to the growth outlook are tilted to the downside, according to the Chief Economists' Group

The Euro area economy will continue to expand, albeit close to potential for the time being

Further to the slowdown in the pace of the economic growth in the 19-country bloc started in Summer 2018, this will continue in 2019 largely due to weaker global economic conditions arising from multiple global challenges and uncertainties. A soft industrial sector performance in Europe and mixed economic activity by the largest Euro area economies have also influenced the growth pace. The Chief Economists' Group has revised downwards its growth outlook for 2019 to 1.2 percent from the 1.8 percent projected in the Autumn 2018 Economic Outlook.

Stabilising impulses come from the strength of the domestic demand, benefitting from a stable and strong service sector. Private consumption remains the major growth driver benefiting from continued strong labour market performance, higher real wage growth and supportive financing conditions.

Looking forward, a plausible slight gradual recovery in GDP growth is expected to begin in the second half of 2019 and further into 2020 supported mainly by a revitalisation of global trade, economic growth in China following policy stimulation, accommodative financial conditions and a rebound in economic activity in Europe, especially in Germany's manufacturing sector.



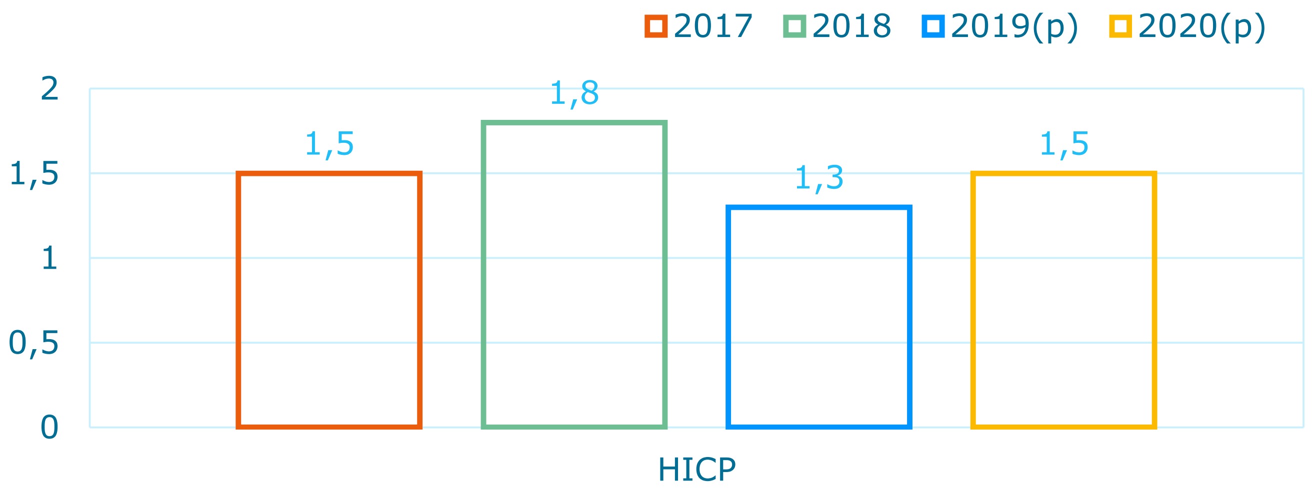
European banks see inflation subdued

Annual headline inflation will be less dynamic in 2019 than in the preceding years mainly due to lower energy prices. Also, the high influence of a volatile oil market will keep inflation expectations low. Meanwhile, the monetary policy transmission mechanism seems to be challenged by structural forces.

Core inflation (excluding volatile items like commodities, energy and non-processed food) has remained moderate over the past years and will gradually increase in 2019 owing to expected strong domestic demand, tightening labour markets and a pick up in wages. We forecast core inflation to stay at 1.2 percent in 2019, before rising to 1.4 percent in 2020.

As a result, core inflation will gradually converge towards headline inflation.

A key factor of the inflation rate is the price of oil, which together with the price of energy, have substantially increased over the last year. Our consensus forecast for the price of Brent oil in 2019 is around USD 70 and USD 69 in 2020.

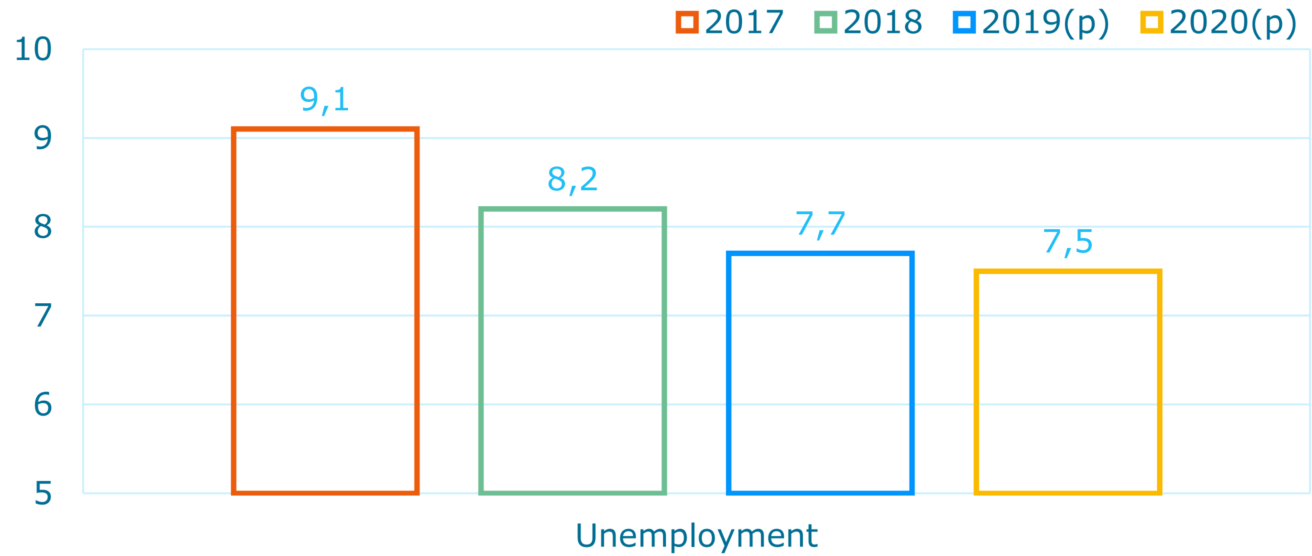


The labour markets will continue to improve over the forecast horizon

Unemployment across Europe will continue dropping, reaching pre-crisis level. While the unemployment rate is expected to drop in almost all Euro area countries over the forecast period, figures will continue, however, to mask uneven rates across the Euro area countries.

Job creation has remained on a more dynamic trend than workforce growth but has slowed in the Eurozone's larger economies slackening the rate of decline in the unemployment rate. The natural slowdown in job creation will however not be an obstacle to further falls in the unemployment rate.

Also, in several countries in the Euro area the job vacancy rate is relatively high. In this context, the lack of adequate labour supply could weight on potential and real growth of the economy.



The Euro will appreciate in the medium to long run

Already under pressure for some time, we foresee the Euro slightly depreciating in the current context of the economic slowdown in the Euro area, together with the high interest rate differential between USD and EUR working in favour of the dollar.

The factors supportive of the USD are, however, to fade now that the Federal Reserve has taken a more cautious stance. This together with expectations of an ECB rate hike, improvement in the Euro area economic performance and the consequences of late cyclical fiscal stimulus (twin deficits) in the US, will lead, in the long run, to EUR appreciation.

The Chief Economists' Group's consensus forecast for the EUR/USD exchange rate at the end of 2019 to be 1.18, with a relatively wide margin between 1.10 and 1.20.

Exports in difficulty for unresolved trade tensions

Trade tensions have started to take a toll on European exports growth, somehow contained until last year. If the US and China do not strike a deal, the situation for European exports may further deteriorate as this will likely lead to a slowdown in China's economic growth which is a key market for EU exports. Europe's export-oriented economy would also be severely hit if EU-US trade frictions materialise and US tariffs are imposed on, for example, EU automotive exports.

We expect exports to grow by 2.5 percent this year to be outpaced by a 3.0 percent growth in imports.

TABLE 1		2018	CEG Consensus 2019			Previous CEG Economic Outlook Autumn 2018	European Commission Forecast Spring 2019
			2019 Mean	2019 Range			
1. Output and aggregate demand:	(Ann.% change)						
Gross domestic product (GDP)		1.9	**1.2**	1.0	1.3	1.8	1.2
Private consumption		1.3	**1.3**	1.1	1.6	1.4	1.3
Public consumption		1.1	**1.4**	1.1	1.7	1.2	1.4
Gross investment (GFCF)		3.3	**2.7**	2.0	3.3	2.6	2.3
Exports		3.2	**2.5**	1.0	3.6	4.0	2.3
Imports		3.2	**3.0**	1.5	3.7	4.0	2.8
2. Labour market and prices:	(Ann.% change)						
Unemployment rate (%)		8.2	**7.7**	7.3	8.0	7.9	7.7
Wages (Unit Labour Cost)		1.9	**1.7**	1.5	2.0	1.4	1.7
Prices (HICP)		1.8	**1.3**	1.2	1.4	1.8	1.4
Core HICP			**1.2**	1.1	1.3	1.4	
3. Public finances:	(% GDP)						
Government Balance		-0.5	**-0.9**	-1.0	-0.6	-0.7	-0.9
Government Debt		87.1	**84.3**	82.0	87.0	83.6	85.8
4. External sector:	(% GDP)						
Trade Balance		2.4	**2.4**	0.8	3.9	2.3	2.1
Current Account Balance		3.6	**2.4**	1.4	2.9	2.9	3.3
(p.m.) US growth	(Ann.% change)	2.9	**2.3**	2.2	2.6	2.5	2.4
(p.m.) Oil price (Brent)	(US$/bl)	71.5	**69.8**	64.6	80.0	74.1	69.2
5. Monetary and financial indicators:							
Interest rate on ECB's main refinancing operations	June	0.00	**0.00**	0.00	0.00	-0.08	
	December	0.00	**0.00**	0.00	0.00	0.01	
3 month interest rate (EURIBOR)	(year-end)	-0.30	**-0.25**	-0.31	-0.10	-0.06	-0.30
10 year government bond yield (Bund)	(year-end)	0.40	**0.34**	0.02	1.00	0.89	0.10
M3 growth	(annual growth)	4.14	**4.55**	4.50	4.60	4.30	
Credit to private sector (M3 definition)	(annual growth)	2.90	**3.90**	3.00	5.50	3.08	
Exchange rate EUR/USD	(year-end)	1.18	**1.15**	1.10	1.20	1.18	1.13

TABLE 2		2018	CEG Consensus 2020			European Commission Forecast Spring 2019
			2020 Mean	2020 Range		
1. Output and aggregate demand:	(Ann.% change)					
	Gross domestic product (GDP)	1.9	**1.4**	1.2	1.6	1.5
	Private consumption	1.3	**1.5**	1.4	1.6	1.5
	Public consumption	1.1	**1.3**	0.9	1.6	1.3
	Gross investment (GFCF)	3.3	**2.4**	2.0	3.2	2.3
	Exports	3.2	**2.6**	1.2	3.7	3.0
	Imports	3.2	**3.0**	1.5	4.0	3.3
2. Labour market and prices:	(Ann.% change)					
	Unemployment rate (%)	8.2	**7.5**	7.0	7.7	7.3
	Wages (Unit Labour Cost)	1.9	**1.6**	1.4	2.1	1.5
	Prices (HICP)	1.8	**1.5**	1.3	1.6	1.4
	Core HICP		**1.4**	1.2	1.5	
3. Public finances:	(% GDP)					
	Government Balance	-0.5	**-0.9**	-1.1	-0.5	-0.9
	Government Debt	87.1	**83.4**	79.8	89.0	84.3
4. External sector:	(% GDP)					
	Trade Balance	2.4	**1.7**	0.8	2.6	2.1
	Current Account Balance	3.6	**2.3**	1.4	2.9	3.2
(p.m.) US growth	(Ann.% change)	2.9	**1.9**	1.5	2.2	1.9
(p.m.) Oil price (Brent)	(US$/bl)	71.5	**69.1**	62.0	75.0	67.8
5. Monetary and financial indicators:						
Interest rate on ECB's main	June	0.00	**0.08**	0.00	0.50	
refinancing operations	December	0.00	**0.14**	0.00	0.80	
3 month interest rate (EURIBOR)	(year-end)	-0.30	**-0.08**	-0.30	0.30	
10 year government bond yield (Bund)	(year-end)	0.40	**0.59**	0.20	1.30	
M3 growth	(annual growth)	4.14	**4.65**	4.50	4.80	
Credit to private sector (M3 definition)	(annual growth)	2.9	**3.77**	3.00	5.00	
Exchange rate EUR/USD	(year-end)	1.18	**1.18**	1.10	1.24	1.13

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