

2017 AUTUMN OUTLOOK

ON THE EURO AREA ECONOMIES IN 2017-2018

STRONG GROWTH IN UNCERTAIN TIMES



EDITORIAL TEAM:

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ABOUT THE EBF ECONOMIC OUTLOOK

This bi-annual report is prepared with contributions from the European Banking Federation's Chief Economists' Group, comprising the chief economists of leading European banks and banking associations. This report reflects a consensus on the outlook for the Euro area economy, which is based on arithmetic averages.

ABOUT THE EUROPEAN BANKING FEDERATION

The European Banking Federation serves as the voice of the European banking sector, uniting 32 national banking associations in Europe that collectively represent some 3,500 banks - large and small, wholesale and retail, local and international - employing some two million people. Banks represented through the EBF together make in excess of €20 trillion available in loans to businesses and households across Europe and provide the infrastructure to securely handle some 400 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

Website: www.ebf.eu

THE EBF FORECAST FOR THE EURO AREA

- **The Euro area will continue its recovery, with economic growth gaining momentum, amid continuing political uncertainty.** We foresee the Euro area GDP growing by 2.1 percent in 2017 before slightly moderating to 1.9 percent in 2018.
- **European banks see inflation slightly decelerating in 2018.** We expect consumer price inflation to stand at 1.3 percent in 2018 after a substantial rise to 1.5 percent in 2017 from 0.2 percent in 2016.
- **Public finances will continue to improve slowly.** The Euro area's general government budget deficit will be 1.4 percent of GDP this year, and 1.2 percent of GDP in 2018.
- **Robust economic growth ensures that labour markets will continue to improve over the forecast horizon.** The jobless rate is forecast to be 9.3 percent in 2017 with a further improvement to 8.7 percent in 2018.

Main indicators of CEG consensus			
year-on-year growth rates unless specified otherwise, in %			
	2016	2017p	2018p
<i>Gross domestic product</i>	1.8	2.1	1.9
<i>Private consumption</i>	2.0	1.7	1.7
<i>Public consumption</i>	1.9	1.2	1.3
<i>Gross fixed investment (GFCF)</i>	3.7	3.3	3.7
<i>Exports</i>	2.9	4.2	3.8
<i>Imports</i>	4.0	4.4	4.4
<i>Unemployment rate</i>	10.0	9.3	8.7
<i>Prices (HCPI)</i>	0.2	1.5	1.3
<i>General Government balance (% of GDP)</i>	-1.5	-1.4	-1.2
<i>General Government debt (% of GDP)</i>	91.3	90.9	89.2

Source: Projections for 2017 and 2018 from EBF. European Commission data for previous year.

THE CHIEF ECONOMISTS' GROUP CONSENSUS

The Chief Economists' Group of the European Banking Federation expects strengthened economic growth in the Euro area supported by the ECBs' accommodative monetary policy stance, a strong global economy and a robust domestic demand. Despite political uncertainty and geopolitical

tensions still surrounding the world economy, this is manifested in an upgrade of the EBF Chief Economists Group's forecasts. We now expect the Euro area to expand by 2.1 percent this year (0.5 percent above our spring consensus), before slightly moderating, but still remaining healthy, in 2018 where growth is expected to be 1.9 percent (0.3 percent above our spring consensus).

The momentum of the Euro area's economic recovery not only makes economic growth stronger than potential – as has been the case over the last few years – but also makes the economy of the single currency bloc more resistant to potential risks such as further strengthening of the euro.

DOMESTIC ECONOMY

Private consumption, which has been a growth engine in Europe over the last few years, will continue to grow solidly, benefiting from an improved labour market and easy financing conditions. We expect private consumption to grow by 1.7 percent in both 2017 and 2018. While private consumption growth will slow down slightly, compared to 2.0 percent growth in 2016, it will continue to be a driving force behind the economic recovery.

Fixed business investments will grow by 3.3 percent in 2017 and slightly strengthen throughout 2018 to 3.7 percent growth, benefitting from favorable financing conditions. This long-awaited increase in investments takes place after a period of significant decrease mainly due to a wide range of uncertainties. In several Euro area countries bank lending is strongly recovering with relatively sharp increases in lending to households and corporates, sustaining one of the main roles of banks: responsibly providing finance used for generating economic value and employment. Domestic demand is therefore expected to remain a key driver for the expansion of the Euro area economy.

GLOBAL ECONOMY

On the back of a sustained global recovery, world trade is expected to continue growing, boosting European exports. We now expect exports to grow by 4.2 percent this year and by 3.8 percent in 2018 compared to 2.9 percent growth in 2016. However, European imports will continue to outpace exports as they will increase by 4.4 percent in 2017 and 2018.

The development of the US economy will be crucial to rest of the world, including the Euro zone, as the strengthening of the recovery in the US facilitates the opening up for European and other countries' export sectors, and it is thus likely to be an important source of support for the growth prospects over the forecast horizon. The Chief Economists' Group estimates that the US economy will grow by 2.1 percent this year, accelerating to 2.3 percent in 2018. The economic momentum in the US could be boosted if the proposed US tax reform becomes a reality.

A key factor for the inflation rate is oil prices, which fell by some 75 percent during 2014 and 2015, before recovering sharply in 2016. On the back of the expectation that the OPEC countries will stick to their current production quotas, our consensus forecast for the oil price (Brent) in 2017 is around USD 54 and USD 57 in 2018.

FISCAL POLICY AND PUBLIC DEBT

Since the peak of the financial crisis, Euro area member states have achieved significant progress in reducing public sector deficits. The fiscal policy stance is expected to remain broadly neutral over the forecast horizon. The Chief Economists' Group foresees the Euro area fiscal deficit falling from 1.5 percent in 2016 to 1.4 percent this year and 1.2 percent in 2018. This, in combination with the economic recovery, will translate into a reduction of the debt to GDP ratio. We foresee this rate reaching a level of 90.9 percent by the end of 2017 and inching further downwards to 89.2 percent by the end of 2018. This is a solid development given that the debt to GDP ratio reached an all-time high of 96 percent in 2015. Nonetheless, public debt remains historically high and long-term plans are required to reduce public indebtedness towards more sustainable levels.

PRICE DEVELOPMENTS AND MONETARY POLICY

At the beginning of the year, consumer prices increased at its fastest pace since 2013 driven by a surge in commodity prices. However, since then, the development has softened somewhat, and the overall rate of inflation is expected to come in at 1.5 percent for the full year, up from 0.2 percent in 2016. In 2018 inflation is expected to decline slightly to 1.3 percent as the base effects from increasing oil prices drop out of the price index. This is still significantly below the ECB's target of price stability; close to, but below 2.0 percent.

Core inflation (excluding volatile items like commodities, energy and non-processed food) will increase at an even lower rate of just 1.1 percent in 2017, reflecting continued subdued wage growth and a relatively poor productivity performance of the Euro area. While a robust economy and a still tighter labour market speaks for a more significant rise in core inflation, the stronger euro may delimit the increase to just 1.2 percent in 2018.

Given the still subdued inflationary outlook, the Chief Economists' Group considers the ECB's easy monetary policy stance to be broadly justified. Without such a stance, deflationary risks - the risks of an outright decrease in the general price level of goods and services - may have risen in the Euro area. Such risks are practically negligible at the present time.

After years of extraordinary stimulus, the ECB will now begin a gradual reduction of its expansionary monetary policy in light of the robust economic outlook; this includes winding down its quantitative easing (QE) programme next year. However, due to the weak inflation outlook, the CEG expects, in line with the ECB announcement of 26 October 2017, the ECB to undertake a long and slow tapering of the Asset Purchasing Programme (APP), and it is expected that the ECB will not change rates until after the

end of the APP in accordance with its forward guidance. This means it is highly likely that the first change in ECB interest rates will not take place before the end of 2018.

LABOUR MARKET

Labour market conditions are expected to remain favourable over the forecast horizon stimulated by a combination of robust domestic demand, relatively low increase in productivity growth and structural reforms e.g. labour market reforms overtaken in some Euro area countries. With economic growth above potential, unemployment will continue to decline. We have adjusted our projections accordingly, and now foresee unemployment in the Euro area at 9.3 percent in 2017, with a further improvement to 8.7 percent in 2018, making 8.7 percent the lowest rate to be recorded in the Euro area in a decade. These figures will continue, however, to mask uneven rates across the Euro area countries. The still high unemployment rate will keep wage pressures contained. Our consensus view is that wages are expected to rise by 1.3 percent in 2017 and a slightly higher 1.6 percent in 2018.

THE EURO

The EUR has appreciated against the USD since the beginning of the year on the back of a stronger economic performance in the Euro area than in the US. The Chief Economists' Group's consensus forecast for the euro/dollar exchange rate at the end of 2018 is 1.21 with a relatively wide margin between 1.15 and 1.30.

RISK TO THE SCENARIO

The CEG's consensus remains surrounded by a number of both upside and downside risks.

A) UPSIDE RISK

- + Solid recovery of the world economy with robust gain of global trade growth supported by a pickup in productivity in developed and emerging economies.
- + Stronger than expected recovery of Euro area countries.
- + High level of confidence coming from most leading indicators, business and consumer surveys, and improved economic and labour indicators, all point to a clear solid acceleration in growth.
- + President Juncker's Investment Plan for Europe may start generating effects, albeit moderate in the economy, thus supporting Euro area growth.
- + Ability to uphold a stable trend in structural reforms within EU countries, supporting the momentum of the Euro area's economic recovery.
- + Reduction of political risk in the region will make the Euro area economy more resilient.

B) DOWNSIDE RISKS

- The uncertainty related to the political events in Europe is still alive. Although elections in France and the Netherlands had a positive outcome in 2017, a less stable fourth Angela Merkel's administration in Germany, possibly disruptive results in upcoming elections in Italy, political tension in Spain with Catalonia, together with global geopolitical tensions, may continue to trigger prolonged uncertainty.
- The level of complexity of the Brexit negotiations and the relatively short time (until March 2019) in which to reach a final deal.
- Increasing global protectionism, in particular, by an aggressive US trade policy, could trigger trade conflicts that would harm the recovery of the global economy.
- Lack of due attention to financial markets may be highly costly as any unexpected correction of markets will lead to a large upsurge of uncertainty for companies and private households.
- The slowdown of the Chinese economy might well materialise, which would, inter alia, affect the Euro area's trade exposure and investment in China.
- Persistence of an elevated euro exchange rate would be negative for European competitiveness.

The risks to the growth outlook are fairly balanced, according to the Chief Economists' Group

ANNEX 1:

YEAR-END POLL ON THE EURO AREA ECONOMIC OUTLOOK FOR 2017

TABLE 1		2016	CEG Consensus 2017				
			2017 Mean	2017 Range		Earlier CEG Outlook	Commission's Forecasts
						Spring 2017	Spring 2017
1. Output and aggregate demand:							
(Ann.% change)							
Gross domestic product (GDP)	18	2.1	1.6	2.3	1.6	1.7	
Private consumption	2.0	1.7	1.4	1.9	1.4	1.5	
Public consumption	1.9	1.2	1.1	1.5	1.2	1.5	
Gross investment (GFCF)	3.7	3.3	2.6	3.9	2.7	2.9	
Exports	2.9	4.2	3.0	5.0	3.7	3.8	
Imports	4.0	4.4	3.7	5.2	3.8	4.2	
2. Labour market and prices:							
(Ann.% change)							
Unemployment rate (%)	10.0	9.3	9.1	9.7	9.5	9.4	
Wages (Unit Labour Cost)	0.9	1.3	0.8	1.7	1.6	1.2	
Prices (HCPI)	0.2	1.5	1.2	1.6	1.6	1.6	
Core HCPI	0.8	1.1	0.9	1.3	1.1	1.0	
3. Public finances:							
(% GDP)							
Government Balance	-15	-1.4	-1.8	-1.0	-1.5	-1.4	
Government Debt	913	90.9	88.7	97.3	90.7	90.3	
4. External sector:							
(% GDP)							
Trade Balance	4.2	3.9	2.9	5.0	3.5	3.8	
Current Account Balance	3.4	3.1	2.8	3.5	3.2	3.0	
(p.m.) US growth	(Ann.% change)	1.6	2.1	1.7	2.3	2.2	
(p.m.) Oil price (Brent)	(US\$/bl)	44.8	53.6	49.0	57.0	54.5	55.5
5. Monetary and financial indicators:							
Interest rate on ECB's main refinancing operations	June	0.00	0.01	0.00	0.05	0.00	
	December	0.00	0.00	0.00	0.05	0.00	
3 month interest rate (EURIBOR)	(year-end)	-0.27	-0.31	-0.35	-0.25	-0.20	
10 year government bond yield (Bund)	(year-end)	0.54	0.62	0.44	0.80	0.60	
M3 growth	(annual growth)	5.0	4.82	3.00	5.50	4.00	
Credit to private sector (M3 definition)	(annual growth)	2.5	2.58	1.70	3.20	1.70	
Exchange rate USD/EUR	(year-end)	1.05	1.17	1.13	1.20	1.07	1.06

ANNEX 2:

YEAR-END POLL ON THE EURO AREA ECONOMIC OUTLOOK FOR 2018

TABLE 2		2016	CEG Consensus 2018		Earlier CEG Outlook	Commission's Forecasts
			2018 Mean	2018 Range	Spring 2017	Spring 2017
1. Output and aggregate demand:						
(Ann.% change)						
Gross domestic product (GDP)	1.8	1.9	1.6	2.2	1.6	1.8
Private consumption	2.0	1.7	1.4	2.0	1.4	1.6
Public consumption	1.9	1.3	0.9	1.9	1.2	1.5
Gross investment (GFCF)	3.7	3.7	2.8	5.0	3.1	3.5
Exports	2.9	3.8	2.7	5.8	3.7	4.1
Imports	4.0	4.4	2.6	6.7	4.0	4.6
2. Labour market and prices:						
(Ann.% change)						
Unemployment rate (%)	10.0	8.7	8.2	9.4	9.1	8.9
Wages (Unit Labour Cost)	0.9	1.6	1.2	2.0	1.8	1.4
Prices (HCPI)	0.2	1.3	1.2	1.5	1.5	1.3
Core HCPI	0.8	1.2	0.9	1.6	1.3	1.3
3. Public finances:						
(% GDP)						
Government Balance	-1.5	-1.2	-1.7	-0.9	-1.4	-1.3
Government Debt	91.3	89.2	85.9	93.0	89.7	89.0
4. External sector:						
(% GDP)						
Trade Balance	4.2	3.9	2.8	5.5	3.4	3.7
Current Account Balance	3.4	3.0	2.7	3.6	3.1	2.9
(p.m.) US growth (Ann.% change)	1.6	2.3	1.7	2.5	2.4	2.3
(p.m.) Oil price (Brent) (US\$/bl)	44.8	56.5	51.0	64.0	59.3	55.9
5. Monetary and financial indicators:						
Interest rate on ECB's main refinancing operations	June	0.00	0.01	0.00	0.05	0.07
	December	0.00	0.02	0.00	0.15	0.18
3 month interest rate (EURIBOR)	(year-end)	-0.27	-0.23	-0.35	0.14	-0.01
10 year government bond yield (Bund)	(year-end)	0.54	0.99	0.75	1.30	1.02
M3 growth	(annual growth)	5.0	4.50	3.00	5.40	2.95
Credit to private sector (M3 definition)	(annual growth)	2.5	2.75	2.00	3.00	2.40
Exchange rate USD/EUR	(year-end)	1.05	1.21	1.15	1.30	1.11
					1.11	1.06