



# **The Economic Forecast for Europe**

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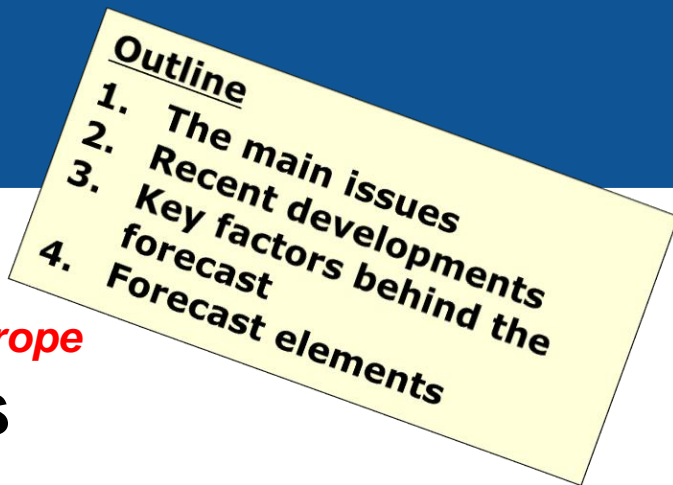
**European Commission, DG ECFIN**

**Economic Situation, Forecasts, Business and Consumer Surveys**

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14-15 November 2019**

**Rue de la Loi 102**

**Disclaimer: The views expressed in this presentation  
are those of the author and do not necessarily  
reflect those of the European Commission.**



## *The economic forecast for Europe*

# Main messages



## *„A challenging road ahead”*

1. Fundamentals of the EU economy are solid
2. Economic growth expected to remain subdued
3. Trade tensions and high uncertainty have hit manufacturing
4. Downside risks remain prominent
5. Inflation is still muted

Source: Commissioner Moscovici's slides at the press conference in Brussels, 7 November 2019.

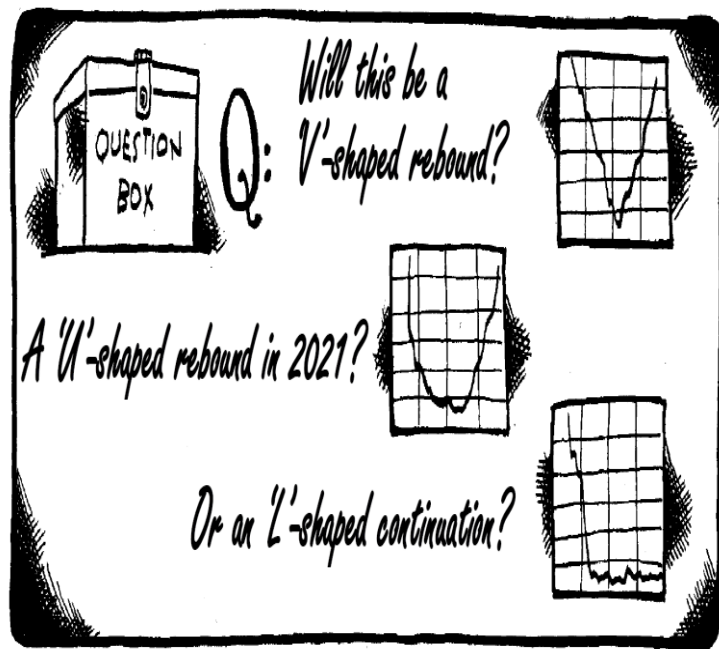
Autumn 2019 forecast document: [https://ec.europa.eu/info/files/european-economic-forecast-autumn-2019\\_en](https://ec.europa.eu/info/files/european-economic-forecast-autumn-2019_en)

Autumn 2019 forecast (VoxEU): <https://voxeu.org/article/challenging-path-ahead-commission-s-autumn-2019-forecast>

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## Main issues

**Which direction for growth rates:** recession, rebound, or low for longer?



**Which issues are crucial for the answer in the autumn 2019 forecast?**

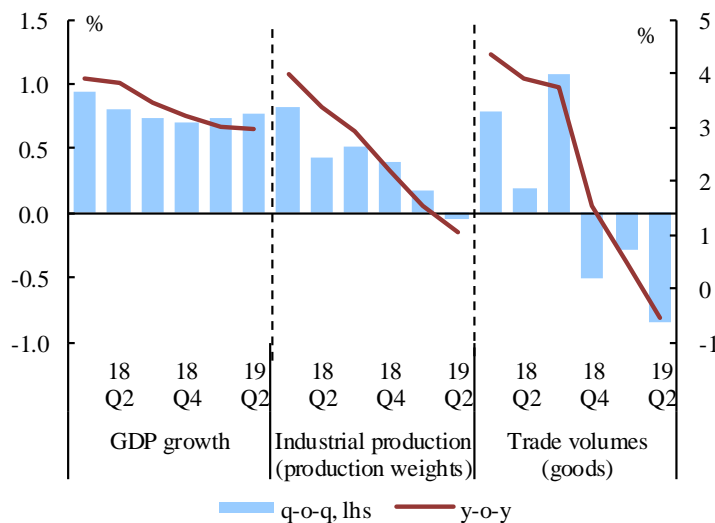
1. **Trade tensions and uncertainty:** can domestic resilience mitigate external headwinds?
2. **Manufacturing weakness vs. services strength:** can it last?
3. **Weakness in Germany vs strength in CEEs:** can the divergence hold up?
4. **Wages and inflation:** will the passthrough remain incomplete?
5. **Labour market improvements:** Can they go on despite low growth?

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## Recent developments: Weak global economy...

Weaker readings of key  
global indicators...

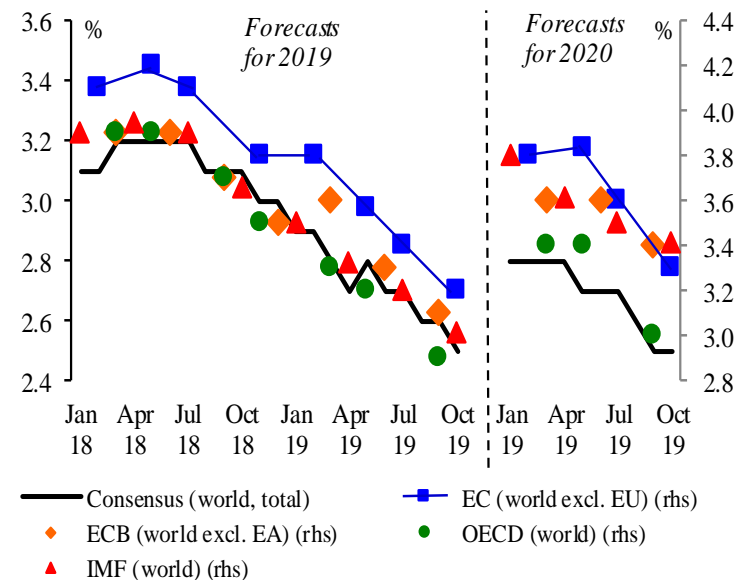
Graph: Indicators of global economic activity, output, industrial production, trade



Sources: OECD, IMF and national sources for GDP growth; CPB for industrial production and trade volumes; own calculations.

...have prompted further  
forecast revisions.

Graph: Global GDP growth 2019-2020, forecasts over time

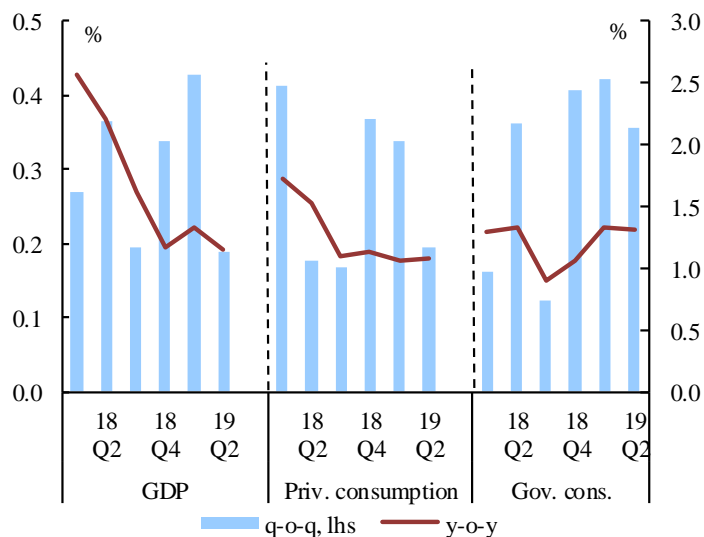


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# ...and slower GDP growth in the euro area...

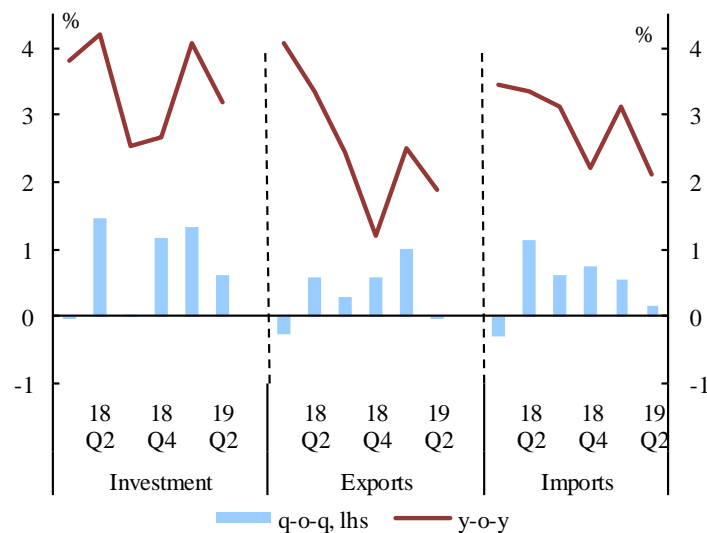
## GDP growth slowed with consumption holding up...

Graph: Real GDP, private and public consumption, euro area



## ...investment expanding, but export growth weakening.

Graph: Investment and foreign trade, euro area (excl. Ireland)

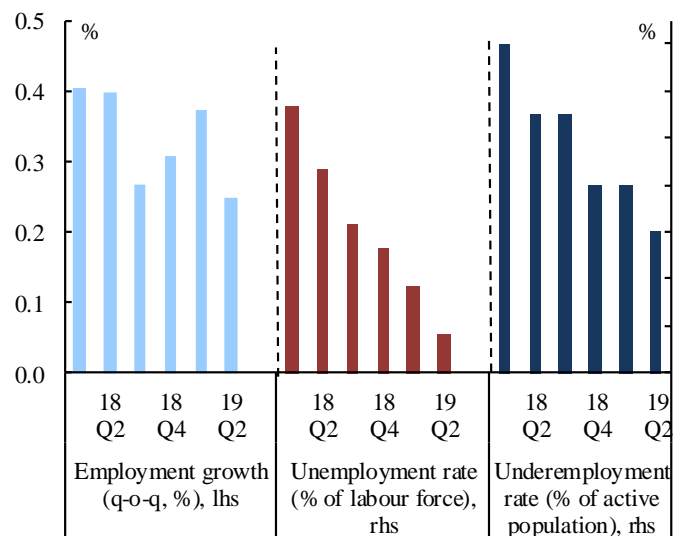


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# ...with employment and wages growing...

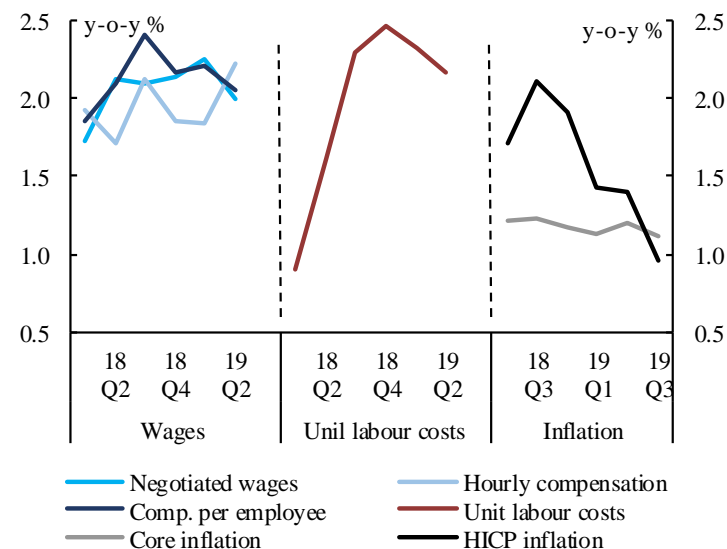
## Further labour market improvements...

Graph: Labour market indicators, euro area



## ...and high wage growth but muted inflation.

Graph: Wages, ULC, and inflation, euro area



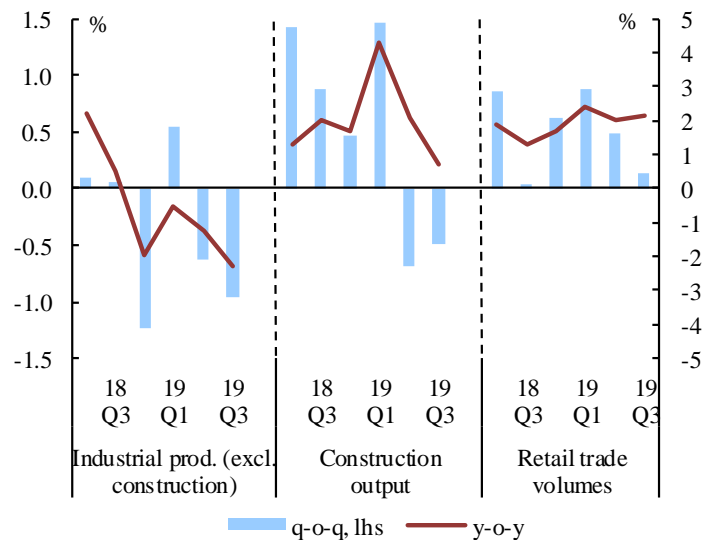


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## ...but differences across sectors,...

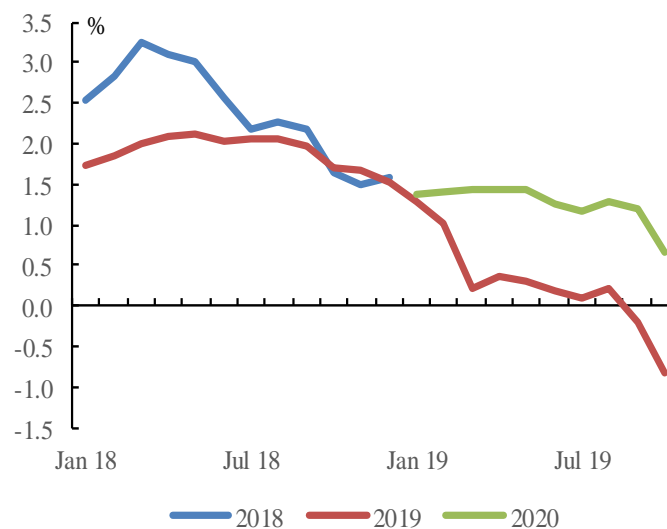
**Among sectors, the manufacturing weakness remains exceptional...**

*Graph: Sectoral indicators (industry, construction, retail trade), euro area*



**...and is reflected in further downward revisions for industrial production.**

*Graph: Industrial production growth forecasts, Consensus means, euro area*

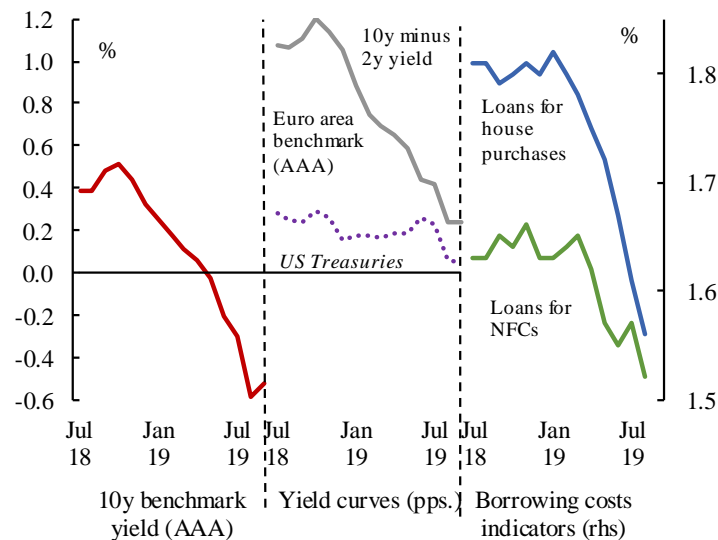


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# ...lower yields and easier monetary policy.

## Yields fell sharply and borrowing costs declined...

*Graph: Sovereign yields, yield curves, and borrowing costs in the euro area*



## ...as central banks eased again due to weaker outlook.

### Rate cuts since July 2019:

**ECB:** Sep. 12: cut of deposit rate, re-start of asset purchases, other measures, confirmed at Oct. meeting.

**Fed:** Oct 30: FOMC cut by 25 bps. to 1.75% (cuts before July&Sep); US Pres. called for negative rates (Nov 12).

**LATAM:** Mexico, Brazil, Chile, Peru

**ASIA:** India, Indonesia, Korea, Hong Kong, Philippines, Thailand

**RoW:** Australia, New Zealand, Russia, Turkey, South Africa



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# Key factors behind the forecast

A complex **matrix of factors** is impacting on growth...

Picture: Selected factors (overview)



...which **can be classified** using several criteria.

Table: A tentative taxonomy of factors

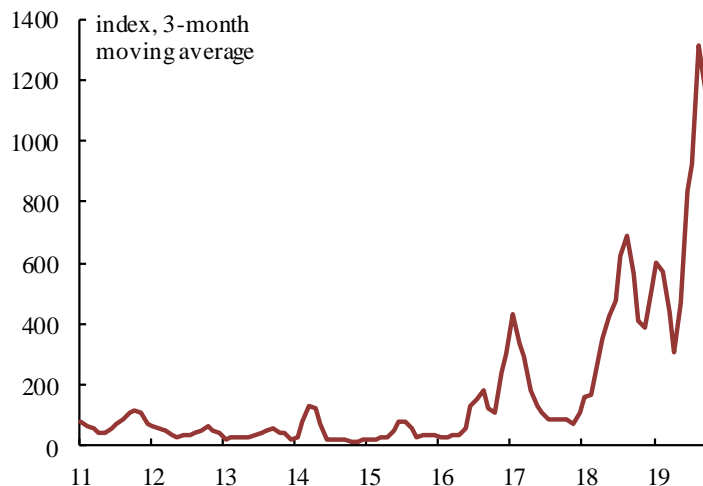
	More short-term	More long term
Mainly demand side	<p>Global slowing</p> <p>US cyclical slowdown</p> <p>Asian tech cycle</p> <p>EME slowdown</p> <p>Trade barriers</p> <p>Disruption of car production (e.g. regulatory changes)</p>	<p>Uncertainty (trade policy, other policies, and technology)</p> <p>Brexit</p> <p>Shift of demand away from cars with Diesel and fuel engines</p> <p>China's structural slowing</p> <p>Disruption of cross-border supply chains</p> <p>Ageing</p> <p>Total factor productivity trend</p>
Mainly supply side		

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## High uncertainty, mainly related to...

**Economic policy**  
**uncertainty** is elevated...

*Graph: Trade policy uncertainty in the US*



Source: Baker, Bloom and Davis at [www.PolicyUncertainty.com](http://www.PolicyUncertainty.com).

...and **Brexit**-related  
uncertainty is persisting.

*Picture: Brexit assumption*

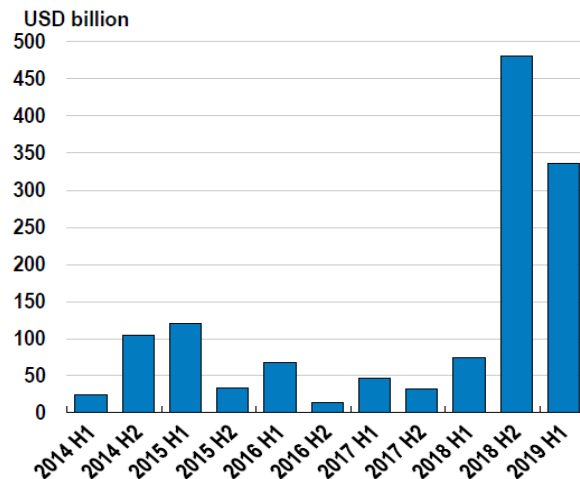


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## ...escalated trade tensions...

### Trade tensions escalated since 2018...

Graph: New trade restrictions in the G20  
(measures introduced in each period)

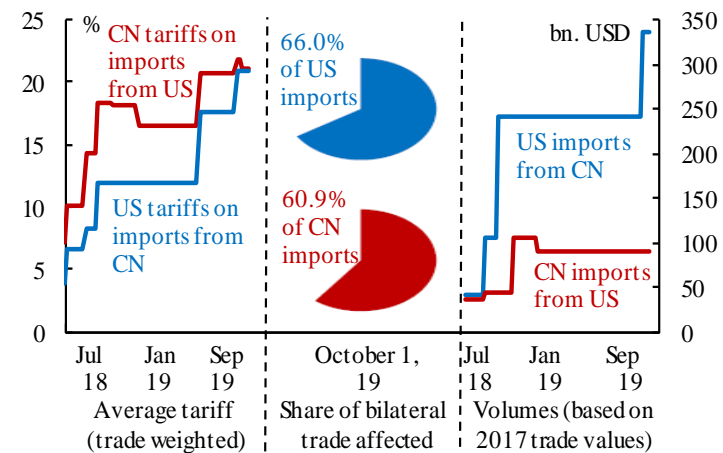


Note: Estimates of annual imports of the products concerned in economies affected by the measures; not cumulative.

Source: OECD Interim Economic Outlook, September 2019.

### as mainly visible in the US-CN trade conflict.

Graph: US-China trade tensions: average  
tariff rates and affected bilateral trade



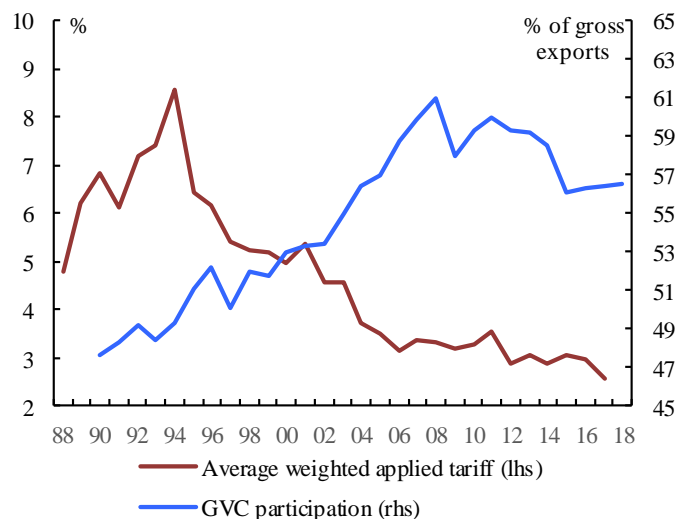
Sources: own calc.; (for tariffs) C. Bown (2019). 'US-China trade war: the guns of August'. PIIE.; (for volumes) B. Williams and H. Hammond (2019). 'U.S.-China tariff actions by the numbers'. Congr. Research Serv.

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## ...impacting on the world economy...

### Global value chains are affected by higher tariffs...

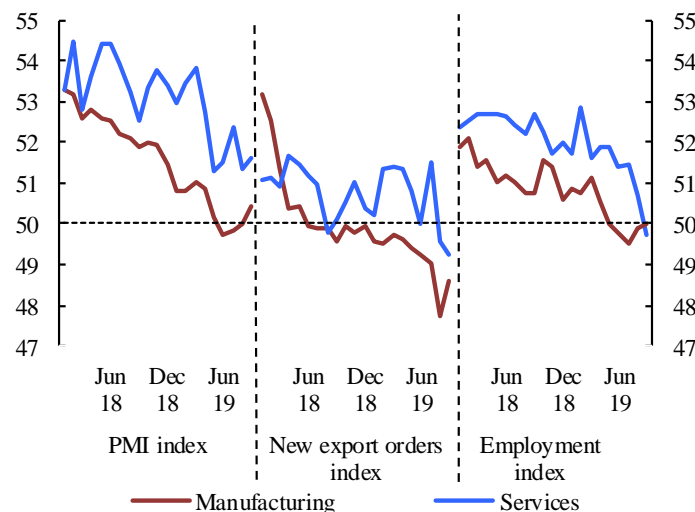
Graph: GVC participation and average applied tariffs (world economy)



Source: UNCTAD-Eora Database, World Bank, own calculations

### ... and global manufacturing has been severely hit.

Graph: Manufacturing and service PMIs, world excluding euro area



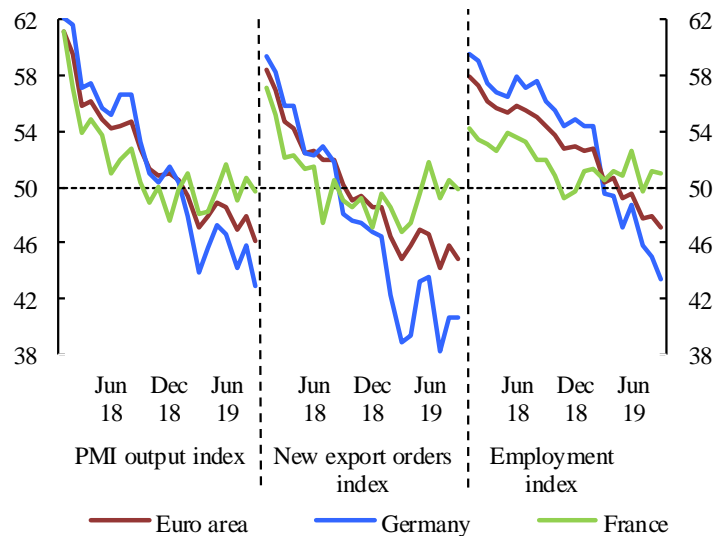
Note: January 2018 to September 2019

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## ...and the euro area and its Member States.

Euro area manufacturing  
also severely hit...

Graph: Manufacturing output, new export orders, and employment (PMI components), euro area, DE and FR



Note: January 2018 to September 2019

...with the trade exposure  
behind country differences.

Table: Exposure to foreign trade and tariffs, selected Member States

	Domestic value added in gross exports of ...	Exports to China	
	... all goods*	... motor vehicles, trailers and semi-trailers*	inter- mediate and final goods*
(% of GDP)			
The Netherlands	33.1	0.4	1.3
Germany	29.7	5.0	3.2
Italy	21.9	1.1	1.4
Spain	23.2	2.2	0.8
France	21.0	1.1	1.7
Slovak Republic	42.5	8.7	3.5
Slovenia	39.6	3.0	0.9
Czechia	42.0	7.7	1.8
Hungary	44.2	8.6	2.9

\* Data for 2015 (latest available TIVA dataset)

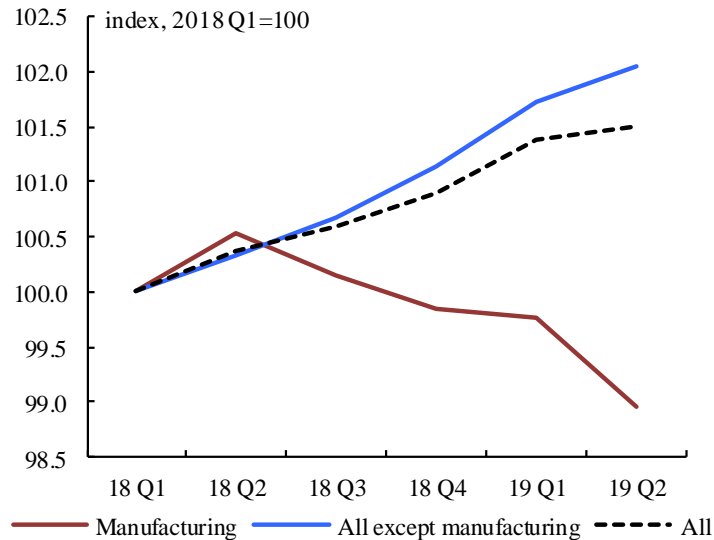
Source: OECD Trade in Value Added (TIVA), OECD Economic Outlook No. 105, own calculations.

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# Weak EA manufacturing vs. strong services...

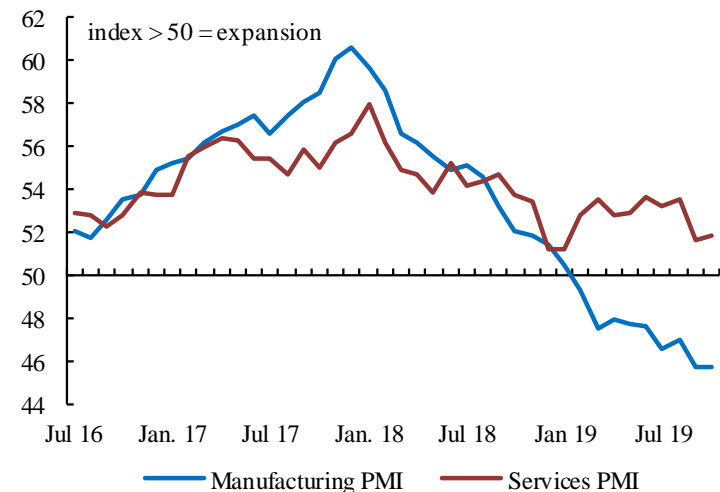
## The past divergence between manufacturing vs services...

*Graph: Manufacturing versus rest of the economy, gross value added, euro area*



## ...seems to hold up in the near term.

*Graph: Manufacturing and services PMIs, euro area*



Source: IHS Markit.

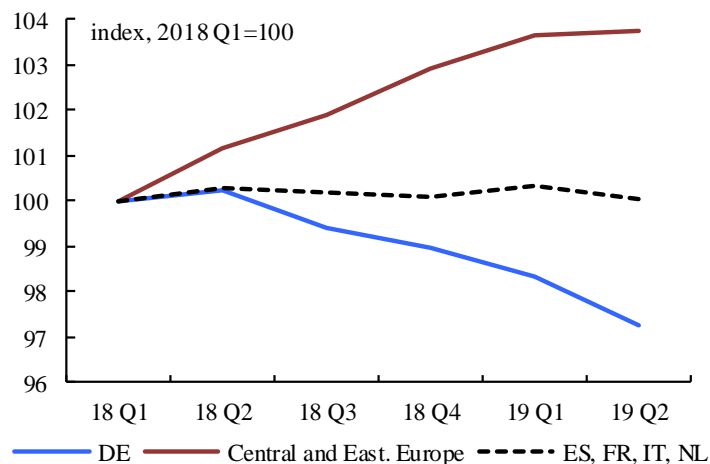
Note: Data in October 2019 are IHS Markit Flash PMIs.

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# ...more manufact. weakness in DE than in CEE...

## The past divergence between manufacturing in DE and CEE...

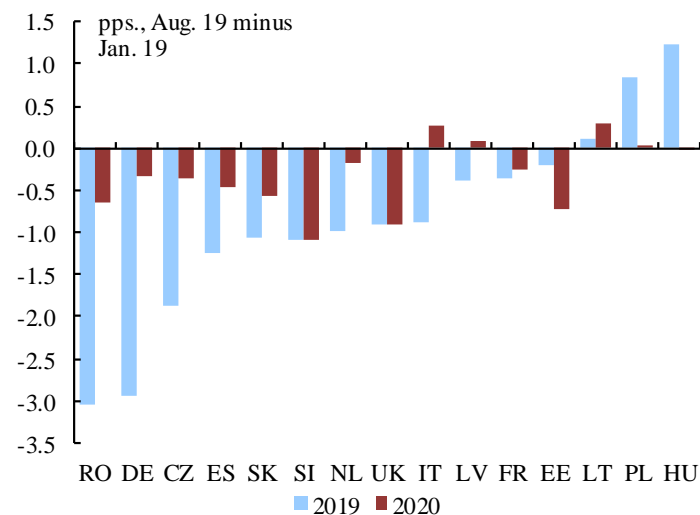
Graph: Manufacturing in Germany and selected groups of Member States, gross value added



Note: The group of Central and Eastern European economies includes BG, CZ, EE, HU, LT, LV, PL, SI, SK and RO.

## ...seems to have weakened and is challenged...

Graph: Industrial production in 2019 and 2020, change in Consensus forecast means



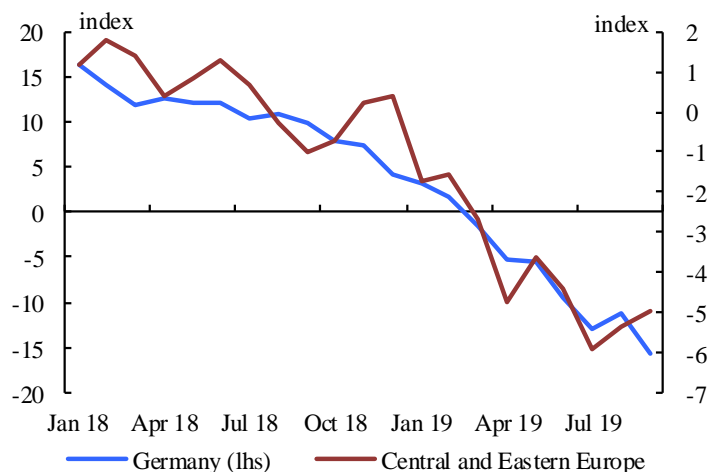


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## ...raising questions about DE-CEE spillovers.

...as **survey indicators** are moving almost in parallel...

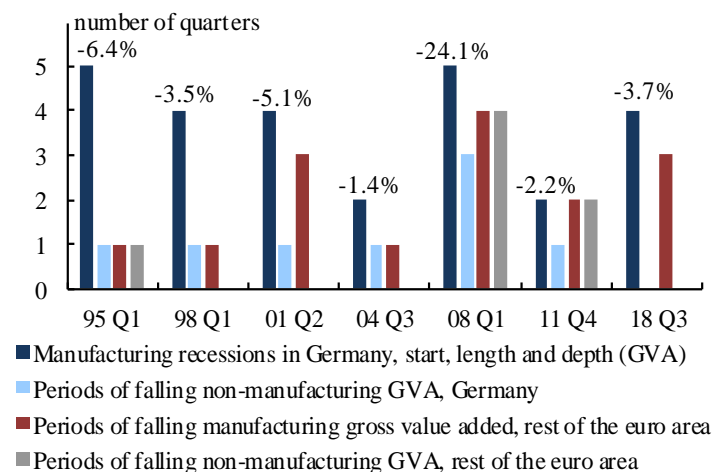
Graph: Industrial confidence in Germany and Member States in Central and Eastern Europe



Note: The group of Central and Eastern European economies includes BG, CZ, EE, HU, LT, LV, PL, SI, SK and RO; weights from the Commission's Business and Consumer surveys.

...but in the **past co-movements** were limited.

Graph: Manufacturing recessions in DE and developments in other sectors and the rest of EA



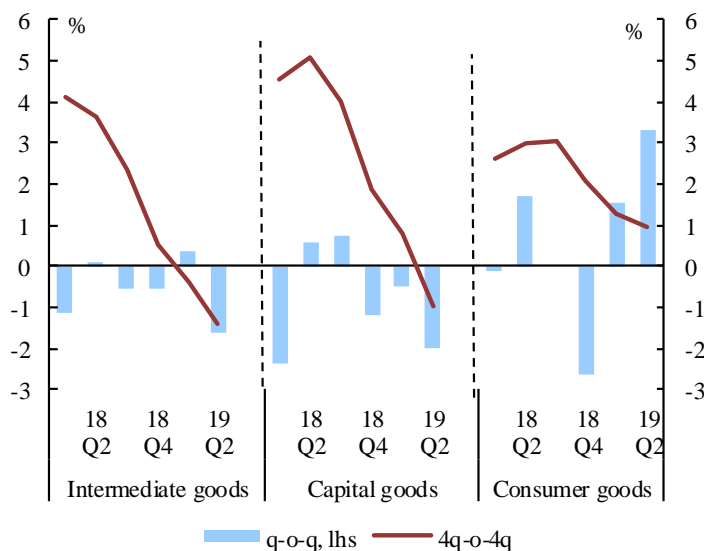
Note: Figures above blue bars indicate the decline of manufacturing gross value added (GVA) in Germany during the recession.

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# Weakness seen for capital goods and cars...

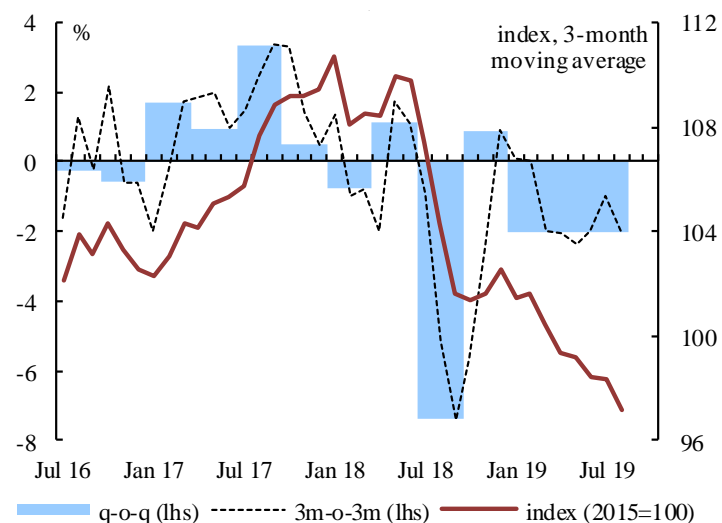
In manufacturing, mainly **capital goods** were affected...

Graph: Manufacturing output, intermediate, capital and consumer goods, euro area



...and **car production** was declining further.

Graph: Manufacture of motor vehicles, trailers, and semi-trailers, euro area

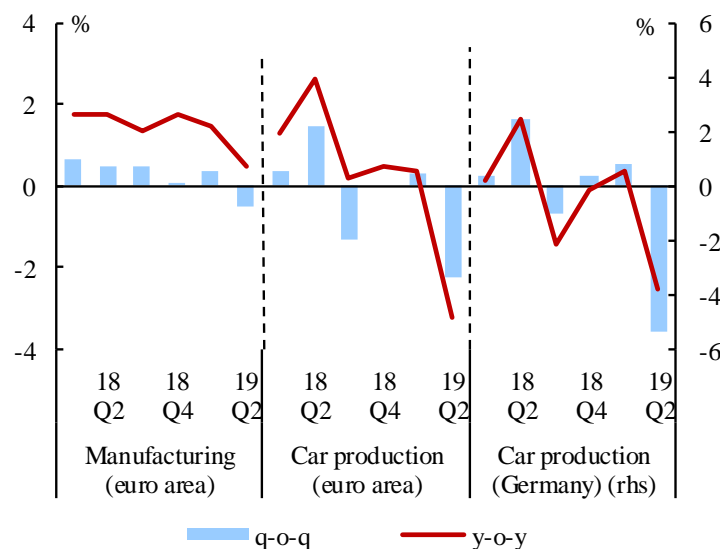


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...already impacted on labour markets.

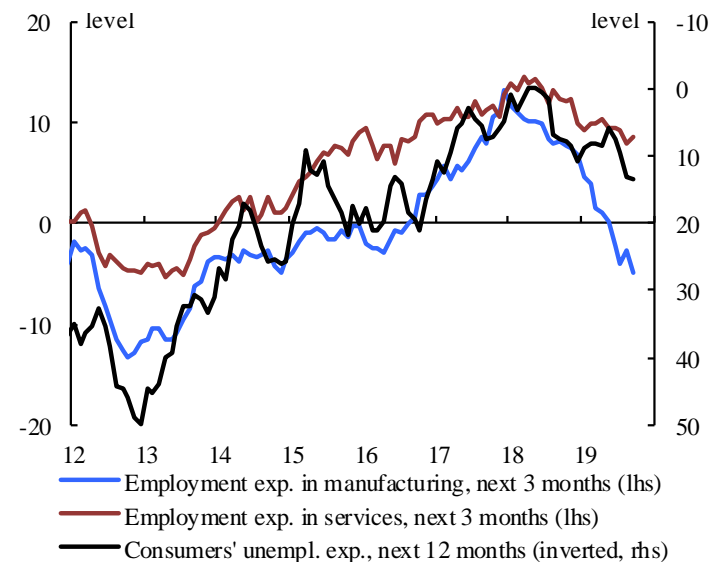
#### Labour market effects visible in car production...

Graph: Manufacturing, labour input (hours),  
euro area and Germany



#### ...and in modified employment expectations.

Graph: Employment expectations,  
Commission surveys, euro area

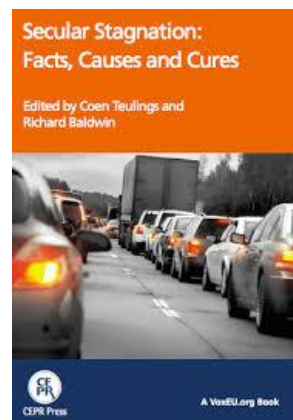
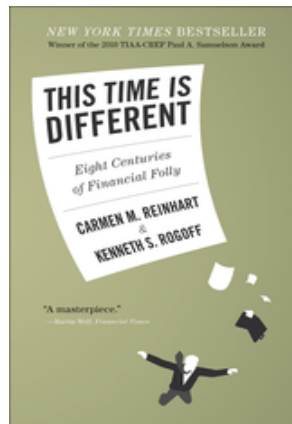


Note: Long-term averages of the displayed series are  
-7.6 (manufacturing), 6.2 (services), 26.5 (consumers).  
The October 2019 readings were -5.6, 9.2, and 15.9.

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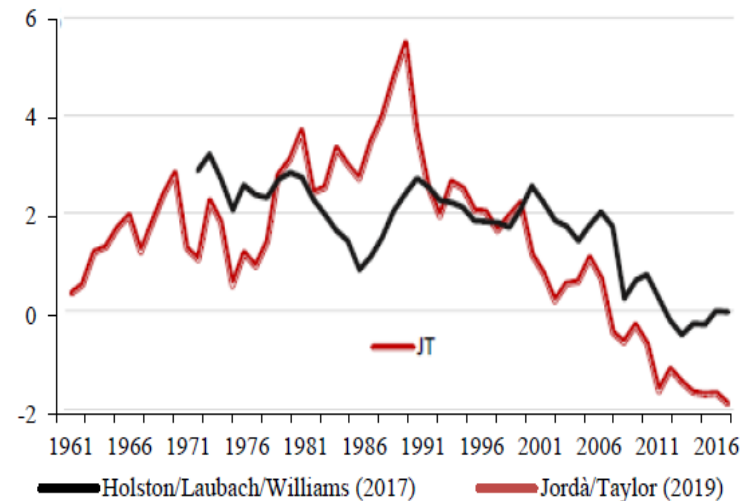
## Underlying trends behind slow growth...

**Ageing, weak TFP growth, and low investment** weigh on potential output; the debate on crisis legacies (**hysteresis**) and long-term trends (**secular stagnation**) continues.



**With a lower natural rate central banks hit the zero-lower bound more often.**

*Graph: Estimates of the natural rate of interest, euro area*



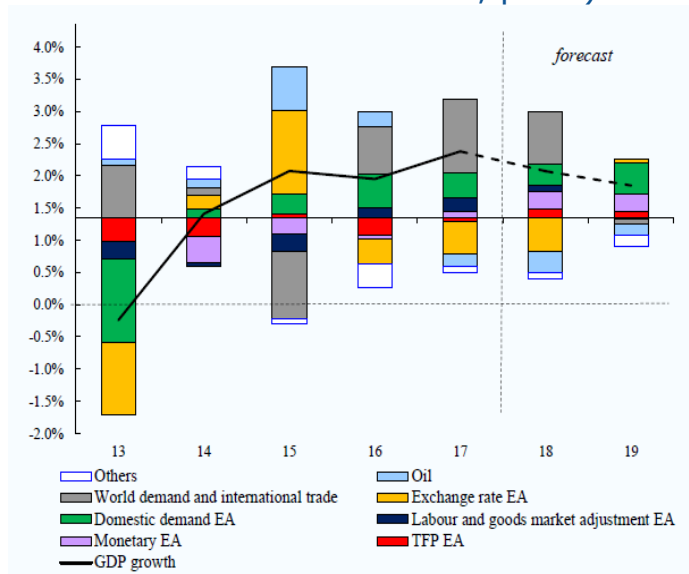
Source: Forbes, K. (2019). Discussion of the Jordà/Taylor (JT) paper at the Economic Policy Symposium, Jackson Hole, WY, August 24 (slides).

### The economic forecast for Europe

# ...and the reliance on monetary policy...

## The Commission's analyses of growth drivers...

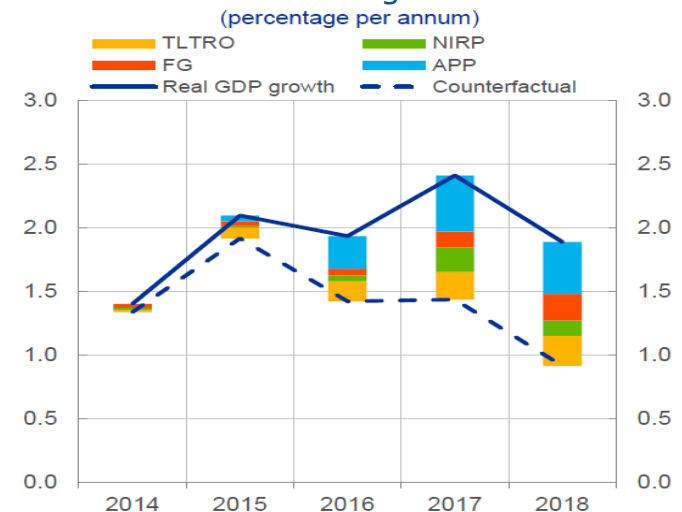
Graph: Euro area real GDP growth (Box 3, Autumn 2018 Forecast, p. 72)



Source: European Commission (DG ECFIN), Autumn 2018 Forecast, Box 3, p. 72 (the analysis in autumn 2019 as presented in the document does not allow to single out the impact of monetary policy).

## ...and ECB analyses find a strong impact on growth.

Graph: Contribution of ECB non-standard measures to real GDP growth 2014-2018 (percentage per annum)



Source: Rostagno, Altavilla, Carboni, Lemke, Motto, Saint-Guilhem, Yiangou (2019), forthcoming.

Notes: The chart shows the impact of ECB non-standard measures on macro variables based on a macroeconomic model with financial variables conditioning on the yield curve impact shown on the previous slide

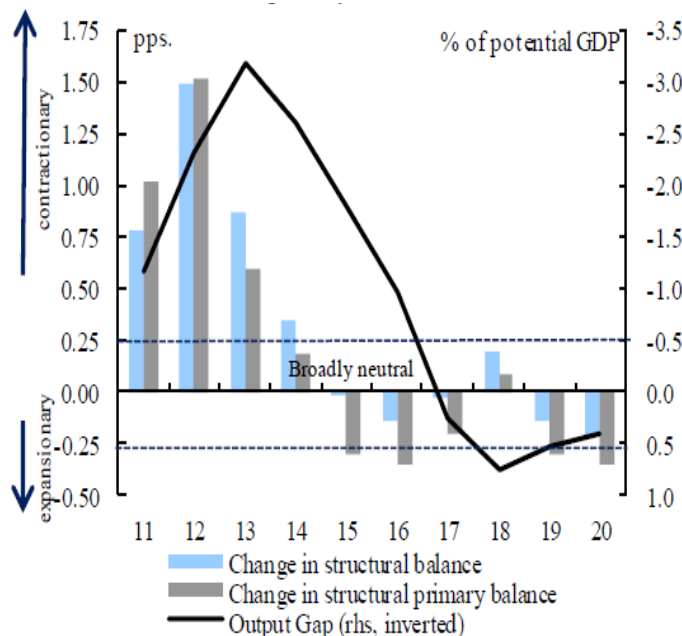
Source: P. Lane (2019). The economic outlook for the euro area. Speech at the Brookings Institution, 16 October 2019.

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# ...have shifted attention to the policy mix.

## Fiscal stance in the euro area...

Graph: Change in the structural balance and in the structural primary balance, euro area



## ...and calls for increased use of fiscal policy.

**ECB President Draghi:** “Almost all the things that you see in Europe, the creation of more than 11 million jobs over a short period of time, the recovery, the sustained growth for several quarters were by and large produced by our monetary policy. ... So now **it's high time I think for the fiscal policy to take charge.**” ECB press conf., Sep. 12, 2019

**Lawrence Summers (Harvard):** “Europe and Japan are engaged in black hole monetary policy. ... Once economies are in the monetary black hole, central banks that focus on inflation targeting will be ineffectual in hitting their immediate goal and unable to stabilise output and employment. **The policy action has to shift elsewhere.**” FT, Oct. 12., 2019

**Laurence Boone (OECD) and Marco Buti (ECFIN):** “...while monetary policy is widely recognised as facing increasing constraints, fiscal policy and structural reforms need to play a stronger role. In particular, **fiscal policy could become more supportive, notably in the euro area.**” OECD ECOSCOPE, Oct. 22., 2019

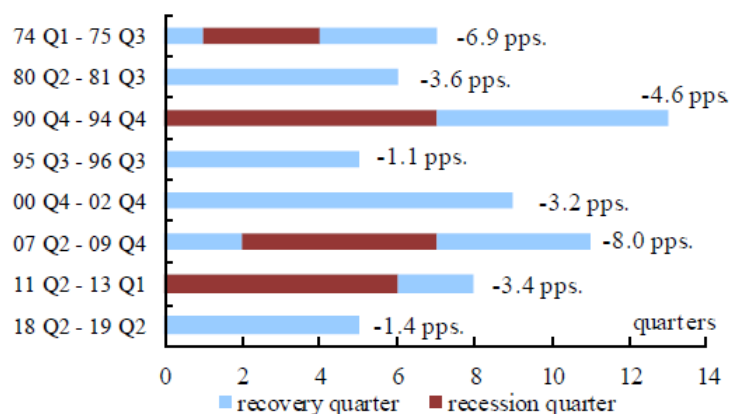
...material for the risk section

## The economic forecast for Europe

# Forecast: Neither a recession is expected, ...

**Not all slowdowns in the EA lead to recessions...**

*Graph: Periods of slowing GDP growth and recessions, euro area*



*Note: Bars display periods of at least 5 consecutive quarters of falling real GDP growth (4q-on-4q); change in the growth rate shown next to the bars; cyclical classification follows decisions by the CEPR Business Cycle Dating Committee.*

*Sources: AWM database, Eurostat, own calculations.*

**...and a recession is not in the cards, the AF19 says.**

1. **Services and other domestically-oriented sectors** are expected to remain strong enough to offset manufacturing weakness.
2. The **strength of the labour market** is set to support domestic demand enough for a continuation of the expansion.
3. The **construction sector is set to remain strong**, supported by an extended period of favourable financing conditions.

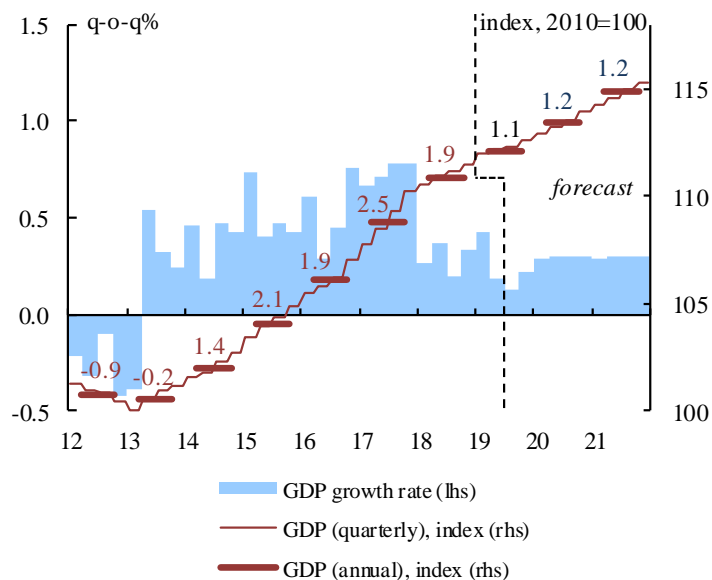


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...nor a rebound, but low and steady growth...

**GDP growth** expected to remain at 1.1-1.2%...

Graph: Real GDP growth, euro area



Figures next to horizontal bars are annual growth rates.

...as also suggested by **pareidolia**.\*

Picture: A new forecast approach

**Pareidolia** (/pærɪˈdɒliə/ parr-i-DOH-lee-ə) is the tendency to interpret a vague stimulus as something known to the observer, such as seeing

shapes in clouds, seeing faces in inanimate objects or abstract patterns, or hearing hidden messages in music.



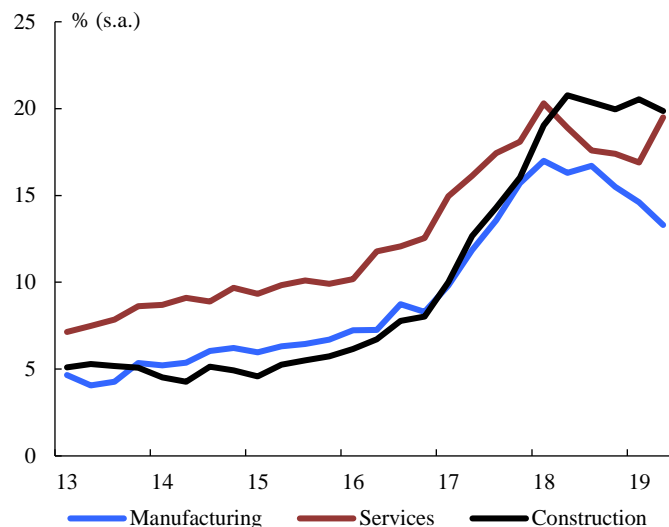
\* This is a joke.

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## ...as further labour market improvements...

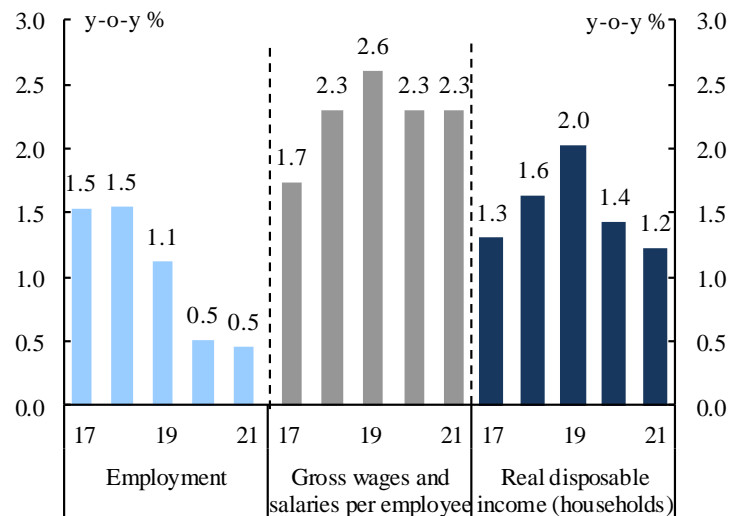
**Despite weakening growth, labour shortages persist in some sector,...**

Graph: Labour seen by firms as limiting factor of activity, euro area



**...employment and wages grow, supporting strong real disposable incomes.**

Graph Employment, wages and real disposable incomes, euro area

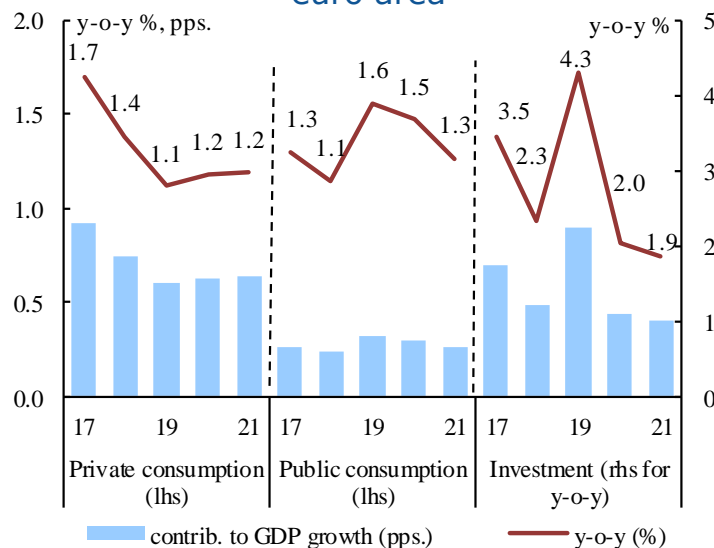


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## ...support domestic demand...

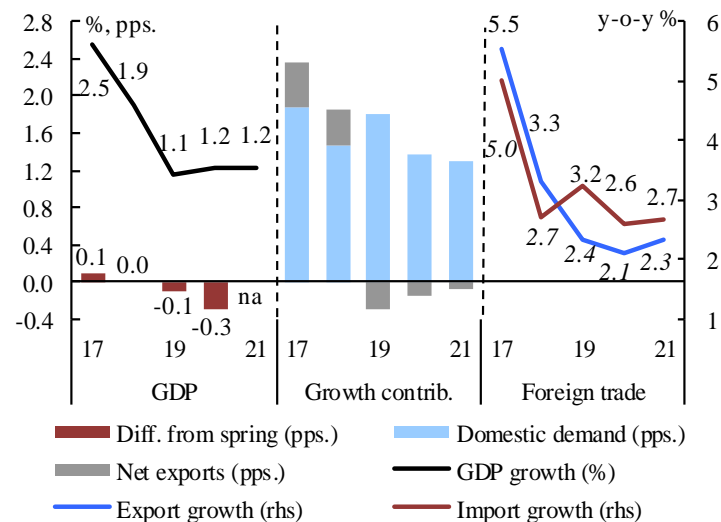
## Expansion of domestic demand components...

Graph: Domestic demand components, euro area



## ...is the key for continued euro area expansion.

Graph: GDP growth and revisions, growth contributions, and foreign trade, euro area

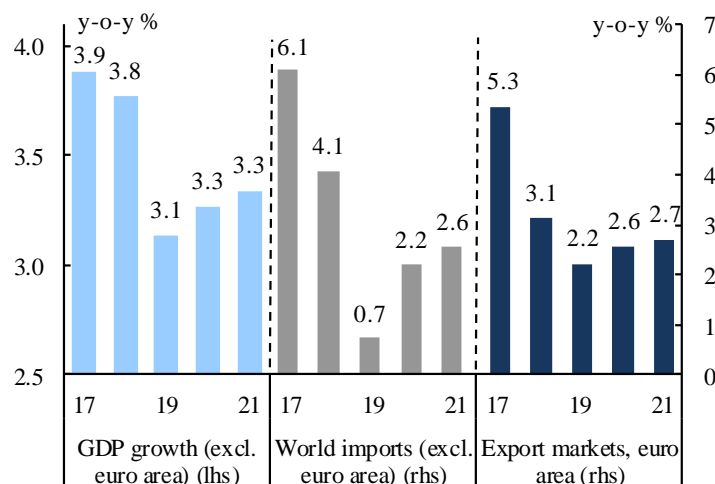


## The economic forecast for Europe

# ...which mitigates a persisting external drag.

## Only moderate growth of global activity and trade.

Graph: Global economic activity, world trade and euro area export markets



## GDP growth in 2020 due to calendar effects.

Table: Statistical decomposition of real GDP growth, euro area

	Autumn 2019 forecast				
(annual rate, %)	2017	2018	2019	2020	2021
Real GDP growth	2.5	1.9	1.1	1.2	1.2
- calendar effect (pps.) *	-0.1	0.0	0.0	0.2	0.0
- calendar adjusted **	2.6	1.9	1.1	1.0	1.2
Carry-over effect ***	0.9	1.2	0.4	0.3	0.5
Growth within the year****	1.7	0.7	0.7	0.7	0.7

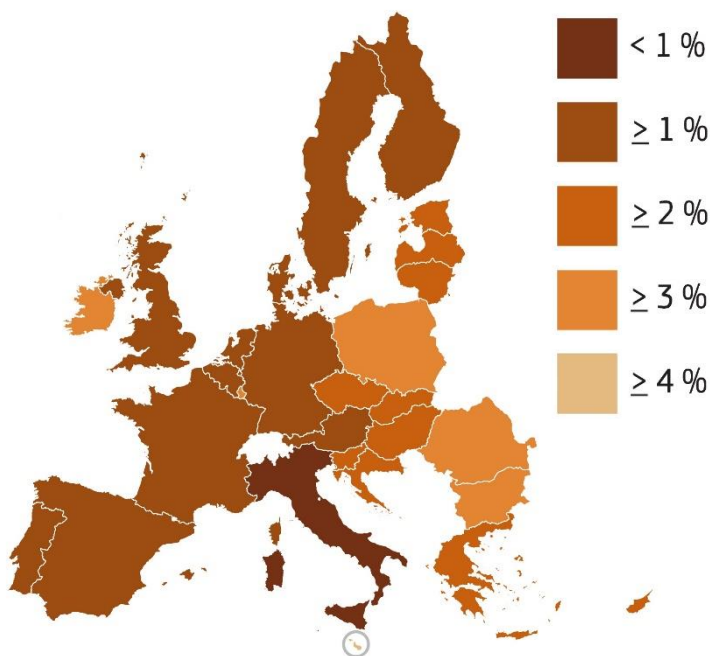
- \* Positive calendar effects result from increases in the number of working days, for example in leap years such as 2020 or when when public holidays move to weekends.
- \*\* Several forecasters present calendar-adjusted annual growth rates (e.g. ECB and OECD).
- \*\*\* The carry-over indicates the annual growth rate that would result if the GDP level of the fourth quarter in the year before would be kept in all four quarters of the year under consideration.
- \*\*\*\* The rate of 'growth within the year' indicates growth that would have resulted in the absence of carryover and calendar effects; see e.g. ECB (2010). 'The carry-over effect of annual average real GDP growth'. ECB Monthly Bulletin, March, pp. 66-7 (Box 6).

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## Growth map

**Expansion set to continue  
in all Member States.**

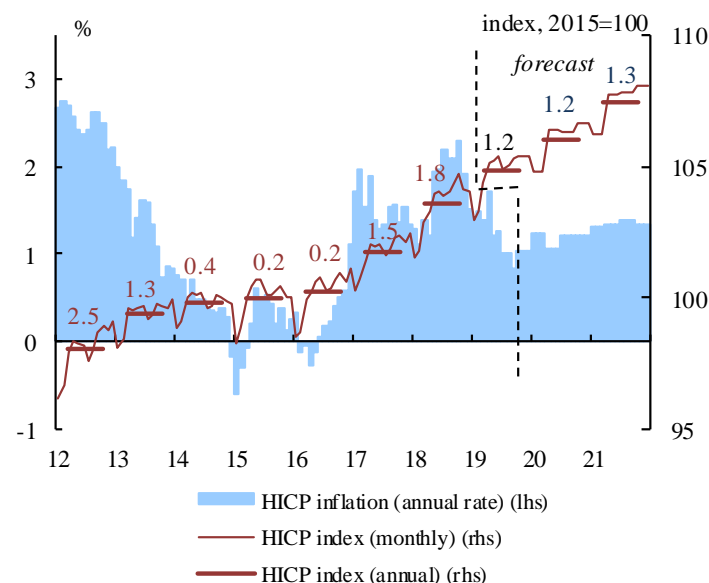
*Graph: GDP growth in 2020*



## Inflation

**HICP inflation set to  
increase only modestly.**

*Graph: HICP inflation, euro area*



*Figures next to horizontal bars are annual inflation rates.*

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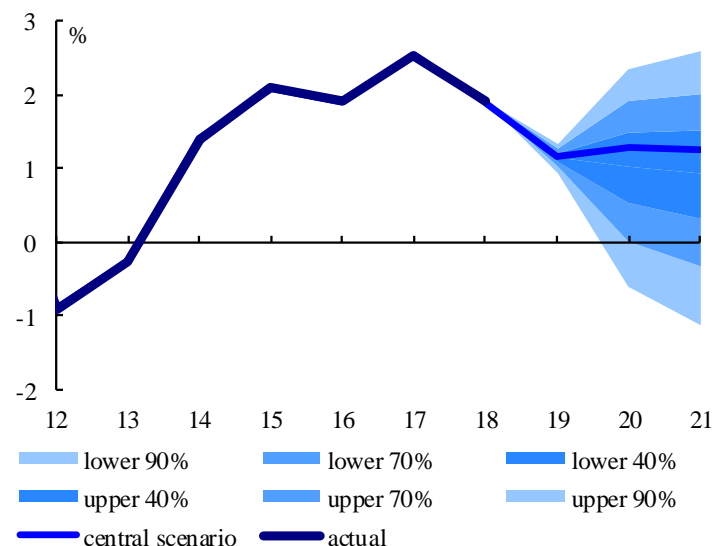
## Risks

### High uncertainty with important **downside risks**...

- Some risks from previous forecasts have **materialised** (slowing global growth, escalation of trade tensions).
- Important interconnected **downside risks** remain in place, e.g. more protectionism, sharper downturn in China, a 'disorderly' Brexit, and financial market turmoil.
- New **tariffs on US imports of cars and car parts** from the EU could be highly disruptive.
- **Upside risks** exist in the external environment (US-CN trade agreement, stronger global rebound) but also on the domestic side (more resilient domestic demand,...).

### ...with the balance tilted to the downside.

Graph: Euro area GDP forecast – uncertainty linked to the balance of risks



Thank you for your attention